

Weekly Watch

U.S.

26 September 2011
Economic Analysis

U.S.

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Highlights

Fed unveils new program for stimulus, Operation Drop-Kick (Twist) begins

The recent FOMC statement acknowledged slow economic growth and significant downside risks to the outlook. At the same time, inflation is expected to be at or below the Fed's implicit inflation target. While equipment and software continues to expand, the housing sector remains depressed. Given these trends, the Federal Reserve decided to lengthen the average maturity of its balance sheet by selling \$400bn of shorter-term Treasury holdings and purchasing same amount of longer-term maturity holdings by June 2012, as expected. In addition, the Fed plans to reinvest principal from maturing securities into agency mortgages instead of its previous policy of reinvestment into Treasuries. As such, the size of the balance sheet will not change, but the duration will be higher and the level of mortgage securities will no longer shrink. The Fed appears to be applying a drop-kick to the housing market by lowering mortgage and other long-term interest rates to encourage activity in residential investment and support personal consumption and business investment by lowering long-term interest rates. The next move for the Fed will be to follow the economic indicators in housing, employment, and inflation expectations to determine if this drop-kick to the housing sector is working. If growth prospects start to really fall apart the Fed would consider more action, most likely involving an expansion of the balance sheet. At the very least, they will need to wait 6 months before additional action considering that the new program is slated to last 9 months. However, if a significant external shock occurs (for example, renewed European debt issues) then earlier action might be necessary.

Housing market recovery remains uncertain

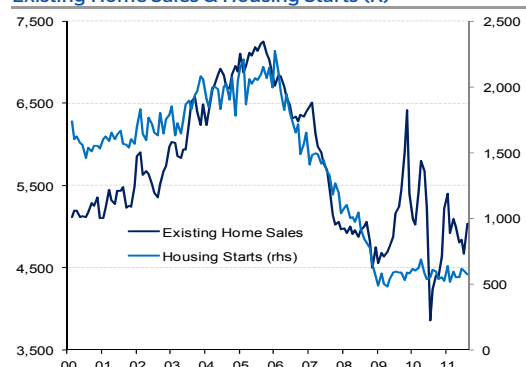
Housing indicators came in mixed for August, with new starts down 5.0% and building permits up 3.2%. The conflicting reports suggest that construction may have been hurt by weather-related factors (mostly Hurricane Irene), given that the increase in permit issuance indicates stronger demand. Existing home sales also surprised to the upside, jumping 7.7%, while housing supply fell to 8.5 months. Much of the sales increase was likely due to the abundance of distressed homes that has made prices very attractive for buyers. Despite some positive breakthroughs in August, a decline in the NAHB housing market index for September signals a less optimistic outlook as both the current and future sales components fell. Upcoming data on new home sales for August could indicate whether competition from foreclosed homes continues to impact builder activity.

Graph 1
Maturity Extension Program Composition

| Nominal Coupon Securities by Maturity Range | |
|---|-----|
| 6 - 8 Years | 32% |
| 8 - 10 Years | 32% |
| 10 - 20 Years | 4% |
| 20 - 30 Years | 29% |
| TIPS 6 - 30 Years | 3% |

Source: Federal Reserve Bank of New York

Graph 2
Existing Home Sales & Housing Starts (K)



Source: NAR & US Census Bureau

Week Ahead

S&P Case-Shiller HPI (July, Tuesday 9:00 ET)

| | | |
|-----------------|-------------------|-----------------|
| Forecast: -4.3% | Consensus: -4.55% | Previous: -4.5% |
|-----------------|-------------------|-----------------|

Weak housing market conditions have dragged on the economic recovery, yet prices are expected to improve slightly in July. The FHFA and CoreLogic home price indices both increased for the month. Growing supply of foreclosed homes has caused prices to decline in prior months, however it is likely that investors will take advantage of low mortgages rates and affordable prices in order to see positive returns in the rental market. Thus, we expect investor demand to contribute to an increase in the S&P Case-Shiller Index.

Durable Goods Orders (August, Wednesday 8:30 ET)

| | | |
|-----------------|------------------|----------------|
| Forecast: -1.0% | Consensus: -0.4% | Previous: 4.0% |
|-----------------|------------------|----------------|

Durable goods orders have rebounded since the end of the recession to about half of the historical peak, however we expect the figure to decline in August. Retail sales were flat for the month and motor vehicle sales fell slightly. Furthermore, aircraft orders are likely to decrease after a significant jump in July. Regional manufacturing reports have suggested that the sector continues to face significant headwinds in addition to historically high inventories. Although we expect new orders to decline in August, it is likely that the upward long-term trend will continue through 2011.

Gross Domestic Product, Final (2Q11, Thursday 8:30 ET)

| | | |
|----------------|-----------------|----------------|
| Forecast: 1.2% | Consensus: 1.2% | Previous: 1.0% |
|----------------|-----------------|----------------|

The final estimate for 2Q11 GDP is expected to be slightly higher than the preliminary figure. Although not much new data for Q2 were released since the last report, business inventories and durable goods orders were revised upward for June. Furthermore, the international trade balance was revised up, from -\$53.1bn to -\$51.6bn, mostly due to a reduction in imports. As economic activity has remained sluggish, we expect GDP to remain in line with our baseline scenario for modest growth in 2011.

Personal Income and Outlays (August, Friday 8:30 ET)

| | | |
|----------------------|-----------------------|----------------------|
| Forecast: 0.1%, 0.1% | Consensus: 0.1%, 0.2% | Previous: 0.3%, 0.8% |
|----------------------|-----------------------|----------------------|

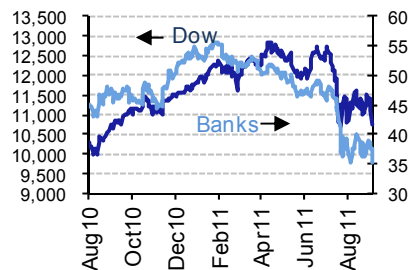
Personal income and outlays are expected to grow in August but at a slower MoM pace. Weak employment conditions continue to weigh on personal income, with the August report indicating no job growth and a reduction in average earnings. Continued declines in consumer confidence and flat retail sales for the month suggest conservative spending, particularly after July's surprising jump. Although higher food and energy prices may have contributed to growth in nominal terms, we expect real growth to be minimal.

Market Impact

Increasing uncertainties regarding the future growth outlook have caused markets to become very sensitive to worse-than-expected economic reports, and this week's indicators are no exception. Continued weakness in the manufacturing and housing sectors could cause some anxiety. However, surprises to the upside could signal a much-needed boost in consumer demand and activity. The final GDP estimate should have little impact on markets given that much of the relevant data has already been released.

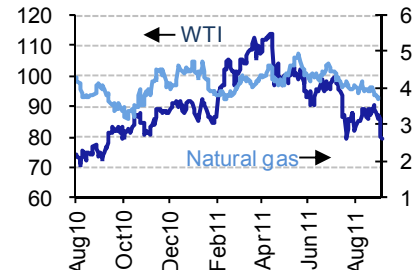
Financial Markets

Graph 3
Stocks (Index, KBW)



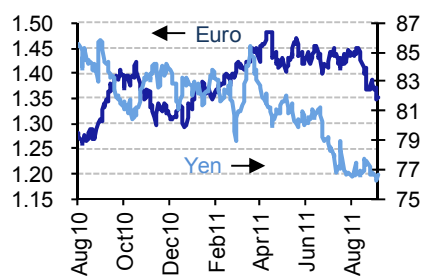
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



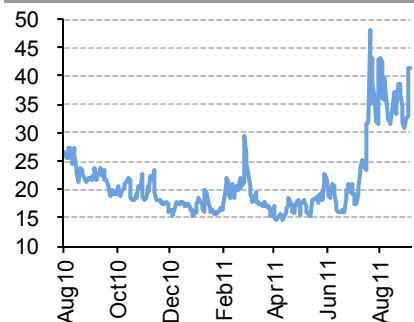
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



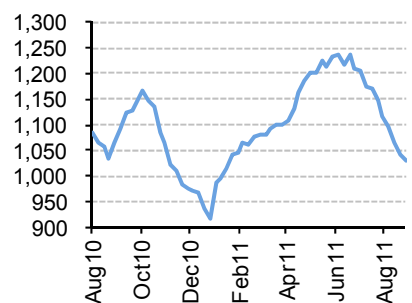
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



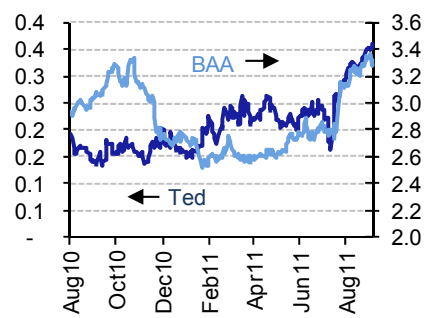
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

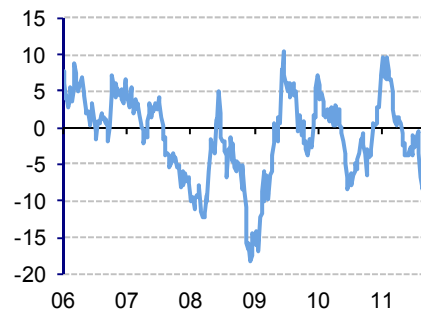
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

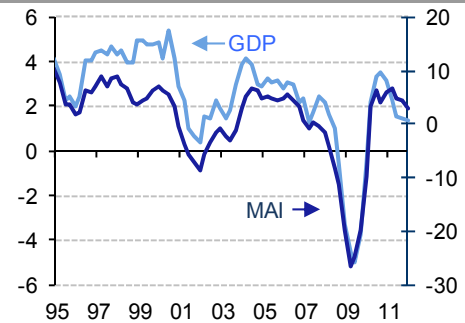
Economic Trends

Graph 9
BBVA US Weekly Activity Index
(3 month % change)



Source: BBVA Research

Graph 10
BBVA US Monthly Activity Index & Real Gross Domestic Product
(4Q % change)



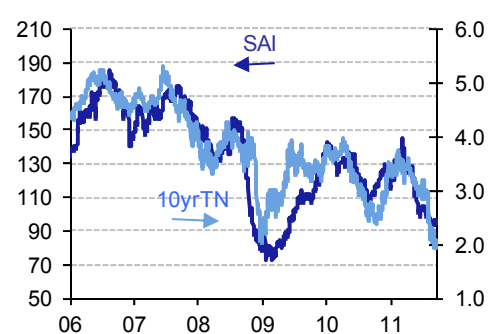
Source: BBVA Research & BEA

Graph 11
BBVA US Surprise Inflation Index
(Index 2009=100)



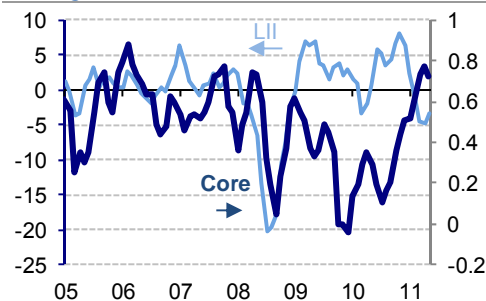
Source: BBVA Research

Graph 12
BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)



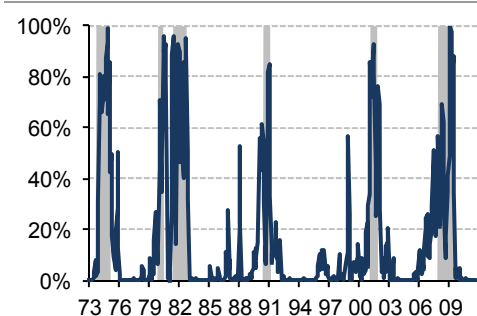
Source: Bloomberg & BBVA Research

Graph 13
BBVA US Leading Inflation Index & Core Inflation (QoQ % change)



Source: BLS & BBVA Research

Graph 14
BBVA US Recession Probability Model
(Recession episodes in shaded areas, %)



Source: BBVA Research

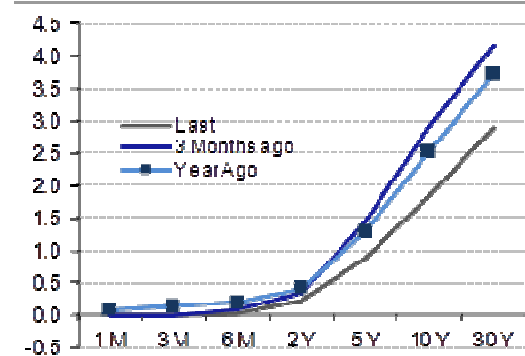
Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

| | Last | Week ago | 4-Weeks ago | Year ago |
|--------------------------|-------|----------|-------------|----------|
| Prime Rate | 3.25 | 3.25 | 3.25 | 3.25 |
| Credit Card (variable) | 13.95 | 13.95 | 13.78 | 13.58 |
| New Auto (36-months) | 4.10 | 4.22 | 4.39 | 5.91 |
| Heloc Loan 30K | 5.49 | 5.47 | 5.50 | 5.52 |
| 30-year Fixed Mortgage * | 4.09 | 4.09 | 4.22 | 4.37 |
| Money Market | 0.80 | 0.56 | 0.57 | 0.69 |
| 2-year CD | 0.96 | 0.98 | 1.00 | 1.40 |
| 5-year CD | 1.75 | 1.78 | 1.84 | 2.29 |

* Freddie Mac National Mortgage Homeowner Commitment 30 Year US
Source: Bloomberg and BBVA Research

Graph 15
Treasury Yield Curve, %



Source: Bloomberg

Quote of the Week

Christine Lagarde, IMF Managing Director
US Pressures Europe to Act with Force on Debt Crisis
23 September 2011

"The set of solutions and methods to address the situation is quite well known. The challenge is pushing leaders into the direction where they have to take much-needed, more action than what has already been done."

Economic Calendar

| Date | Event | Period | Forecast | Survey | Previous |
|--------|--|--------|----------|--------|----------|
| 26-Sep | Chicago Fed National Activity Index | AUG | -0.10 | -0.40 | -0.06 |
| 26-Sep | New Home Sales | AUG | 305K | 295K | 298K |
| 26-Sep | New Home Sales (MoM) | AUG | 2.35% | -1.00% | -0.70% |
| 27-Sep | S&P Case-Shiller HPI (YoY) | JUL | -4.30% | -4.55% | -4.52% |
| 27-Sep | Consumer Confidence | SEPT | 48.00 | 46.20 | 44.50 |
| 28-Sep | Durable Goods Orders | AUG | -1.00% | -0.40% | 4.10% |
| 28-Sep | Durable Goods Orders Ex Transportation | AUG | 0.10% | 0.00% | 0.80% |
| 29-Sep | GDP QoQ Annualized | 2Q F | 1.20% | 1.20% | 1.00% |
| 29-Sep | Personal Consumption | 2Q F | 0.40% | 0.40% | 0.40% |
| 29-Sep | GDP Price Index | 2Q F | 2.40% | 2.40% | 2.40% |
| 29-Sep | Core PCE QoQ | 2Q F | 2.20% | 2.20% | 2.20% |
| 29-Sep | Initial Jobless Claims | 24-Sep | 420K | 420K | 423K |
| 29-Sep | Continuing Claims | 17-Sep | 3725K | 3728K | 3727K |
| 29-Sep | Corporate Profits (YoY) | 2Q | 7.20% | -- | 7.80% |
| 29-Sep | Pending Home Sales (MoM) | AUG | 0.10% | -1.70% | -1.30% |
| 30-Sep | Personal Income | AUG | 0.10% | 0.10% | 0.30% |
| 30-Sep | Personal Spending | AUG | 0.10% | 0.20% | 0.80% |
| 30-Sep | PCE Core (MoM) | AUG | 0.20% | 0.20% | 0.20% |
| 30-Sep | PCE Core (YoY) | AUG | 1.70% | 1.70% | 1.60% |
| 30-Sep | Chicago Purchasing Manager Index | SEPT | 56.00 | 55.50 | 56.50 |
| 30-Sep | U. of Michigan Consumer Sentiment | SEPT | 58.00 | 57.80 | 57.80 |

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