

Economic Watch

U.S.

Monthly US Outlook

Better Growth in 2H11, Economic Reports Remain Mixed

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Economic Analysis

U.S.

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- **Growth has picked up in 2H11 but lasting uncertainties should limit acceleration in 4Q11**
- **We maintain our baseline scenario for declining price pressures and low employment growth, with downside risks for 2012 GDP**

The second half of 2011 has started out stronger than expected, with Q3 GDP growth hitting 2.5% (annualized) following a modest 0.4% and 1.3% in Q1 and Q2, respectively. Despite reports of sluggish consumer activity throughout the summer months, personal consumption expenditures contributed most to the acceleration in GDP, helping diminish fears of a double-dip recession. However, improvement in economic activity was not enough to boost consumers and businesses expectations. Consequently, we expect that Q4 GDP will be slightly weaker than in Q3.

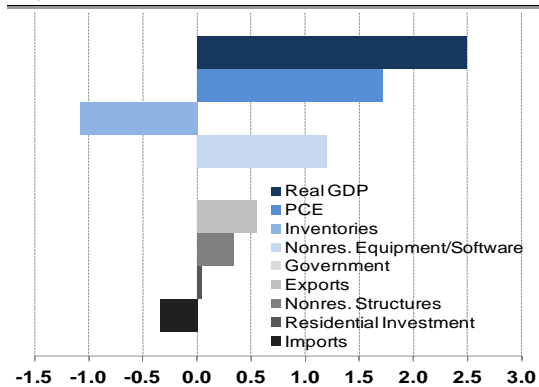
While stronger GDP and PCE point to a rebound in economic activity, the latest reports have been mixed. Retail sales jumped in September, indicating better-than-expected consumer activity, however, consumer confidence remains near historical lows. Despite upward revisions to employment data for Q3, job growth remains slower than in early 2011 and job availability has not been enough to decrease the unemployment rate. Manufacturing reports have been conflicting, with the ISM suggesting improvements but some regional Federal Reserve surveys noting continued slowdowns in the sector. While some housing data has been better-than-expected, an increase in distressed properties continues to threaten the market. Recent changes to the HARP and Federal Student Loan Program will have a minimal effect on the economy and will not appreciably help the labor market. Looking forward, we expect that PCE will continue to expand at a moderate pace as gradual improvements in the employment situation help reduce uncertainties regarding future earnings. However, we expect that employment growth will remain low and the unemployment rate will be stubbornly high, ultimately limiting real PCE growth.

On the inflation front, high food and energy prices continue to exert pressure on headline inflation, while shelter and medical care have pushed core inflation higher. Accelerating employment costs reversed last quarter, and global slowdown and large resource slack will help keep inflation under control. Core inflation might exceed the Fed's maximum rate in the implicit inflation target range of 1.5-2.0% but will remain within the comfort zone at least in the medium term. Although short-term inflation expectations have increased, long-term expectations remain anchored. We expect that headline inflation in 2011 will slightly surpass our baseline scenario.

Weak growth and downside risks favor a more dovish Fed, and the pressure is on for them to act if economic data do not consistently improve. Concerns remain focused on lowering the unemployment rate while keeping inflation expectations in check. The Fed is worried about the housing market and is likely to announce another round of mortgage bond purchases if growth prospects do not improve. However, given that Operation Twist has just begun, we do not expect the Fed to announce additional stimulus at today's meeting. The Fed is likely to rely more on public communications as a policy tool, and the meeting could be an opportunity for them to communicate strategy and options. Although mixed economic data have furthered uncertainties regarding the future outlook, we see more upside risk to our baseline scenario for 2011 given the higher-than-expected Q3 GDP growth. However, downside risks increase for 2012 as more long-term factors come into play, including fiscal reform, global slowdown, and the European sovereign debt crisis.

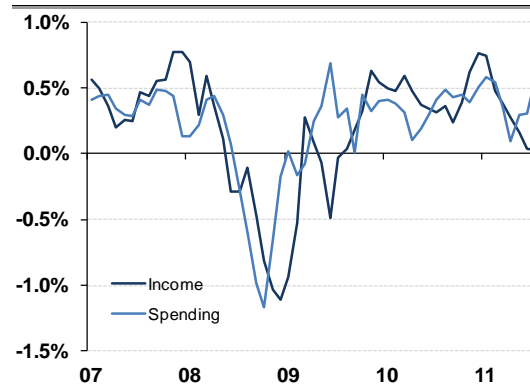
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(3Q11 Advance, SAAR % Points)



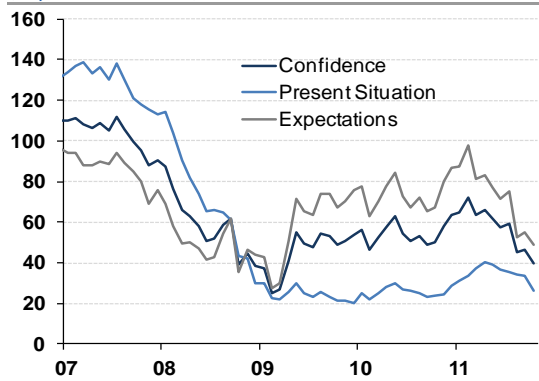
Source: Bureau of Economic Analysis

Graph 2
Personal Income and Expenditures
(3MMA, MoM%)



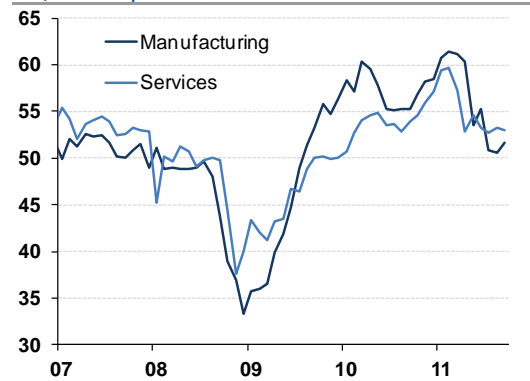
Source: Bureau of Economic Analysis

Graph 3
Consumer Confidence
(SA, Index 1985=100)



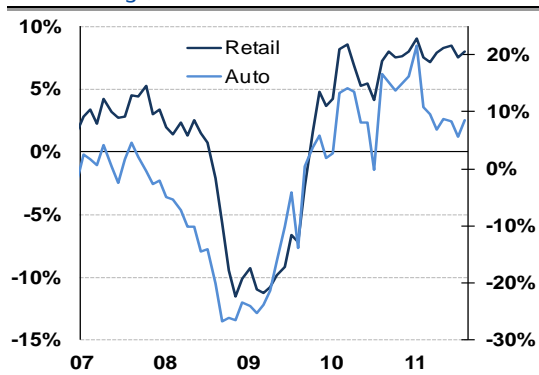
Source: Conference Board

Graph 4
ISM Indices
(SA, 50+ = Expansion)



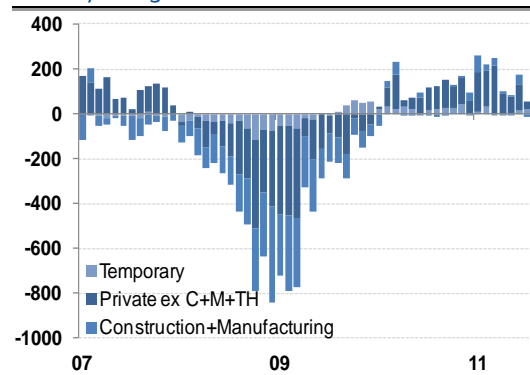
Source: ISM

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau

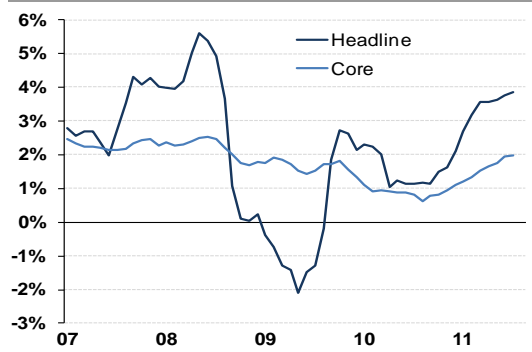
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: Haver Analytics & BBVA Research

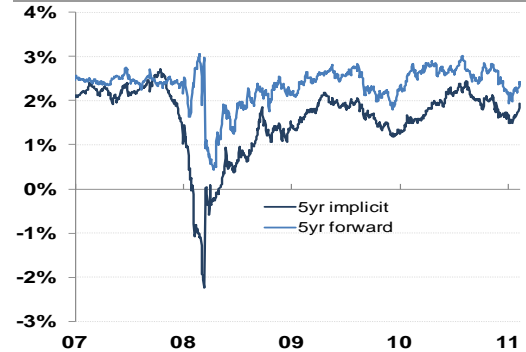
Economic Indicators

Graph 7
Consumer Price Index
(YOY% NSA, 1982-84=100)



Source: Bureau of Labor Statistics

Graph 8
Inflation Expectations
(%)



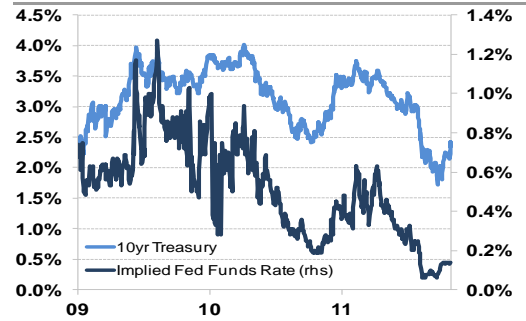
Source: Federal Reserve Board & BBVA Research

Graph 9
New and Existing Home Sales
(Thousands)



Source: Haver Analytics & BBVA Research

Graph 10
12 Month Implied Fed Funds Rate & 10 Yr Treasury
(%Yield)



Source: Haver Analytics

Table 1
Forecasts (BOLD=FORECASTS)

	4Q2010	1Q2011	2Q2011	3Q2011	2011	2012	2013
Real GDP (% SAAR)							
GDP	2.3	0.4	1.3	2.5	1.6	2.3	2.2
Real GDP (Contribution, pp)							
PCE	3.6	2.1	0.7	2.4	2.2	2.0	2.0
Gross Investment	-7.1	3.8	6.4	4.1	4.1	8.6	6.5
Non Residential	8.7	2.1	10.3	16.3	9.1	9.7	7.1
Residential	2.5	-2.4	4.2	2.4	-1.8	3.1	4.3
Exports	7.8	7.9	3.6	4.0	6.7	6.0	6.8
Imports	-2.3	8.3	1.4	1.9	5.3	6.7	6.8
Government	-2.8	-5.9	-0.9	0.0	-1.8	0.3	0.9
Unemployment rate (%)	9.6	8.9	9.1	9.1	9.1	8.9	8.4
Average Monthly Nonfarm Payroll(k)	139	166	97	96	115	128	168
CPI							
CPI (YoY%)	1.3%	2.1%	3.4%	3.8%	2.9	2.2	2.3
Core CPI (YoY%)	0.7%	1.1%	1.5%	1.9%	1.6	1.7	1.8
Fiscal balance (% GDP)	-	-	-	-	-9.5	-6.9	-4.6
Current Account (bop, % GDP)	-3.0	-3.2	-3.2	-	-3.4	-3.5	-3.5
Fed target rate (%)	0.25	0.25	0.25	0.25	0.25	0.25	1.00
S&P Case & Shiller Index	130.9	125.6	130.1	-	128.5	128.5	130.2
10Yr Treasury (% Yield)	2.9	3.5	3.2	2.4	2.2	2.6	3.2
US Dollar/ Euro	1.36	1.37	1.44	1.41	1.37	1.33	1.36
Oil Prices(dpb)	86.6	104.8	117.6	113.3	111.4	94.0	102.5

Source: BBVA Research

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