

Economic Watch

U.S.

Monthly US Outlook

Recovery Gaining Momentum, but Uncertainties Loom

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Economic Analysis

U.S.

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- **Economic data in the US has been positive moving into 4Q11 as consumers become more optimistic about current conditions**
- **Markets are mainly focused on events in Europe, where slowdowns stemming from the ongoing crisis could threaten the recovery**

Economic activity continues to improve gradually as we move into 4Q11. Although the second estimate for 3Q11 GDP growth was revised down to 2.0% annualized, the adjustment reflects very little change in personal consumption. Much of the revision was due to declining business inventories which we expect to revert as the outlook for future sales improves. This appears to be the case already, with the busy holiday shopping season boosting retail sales and other consumer activity. Consumer confidence has rebounded from a two-year low, and attitudes toward job availability and future income have improved in line with upward employment trends. The unemployment rate dropped surprisingly to 8.6% in November, the lowest since March 2009, but largely reflects a decline of 315K in the labor force. The participation rate has been declining since the recession and is near a decade-low at 64.0%, which is a discouraging sign for potential employment growth. While we continue to expect modest growth in payrolls, structural employment is still very much a concern.

The housing market has been a weak spot in the recovery but is beginning to show some signs of improvement. New home starts and building permits in October were stronger than average for the year and showed strength compared to 12 months ago. Both existing and new home sales also grew, and moderating price declines suggest that distressed properties are becoming less of a threat to the market. The latest increase in the homebuilder outlook points to future gains, and we expect to see similar trends continue in the coming months.

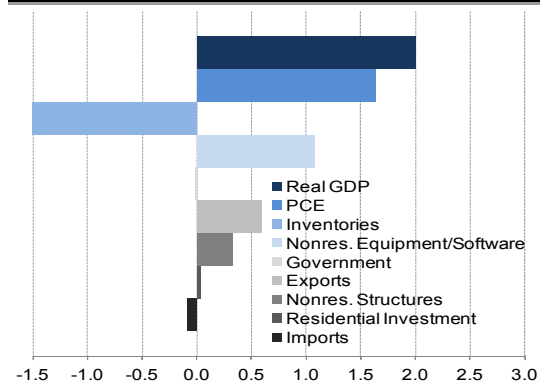
Despite improvements in domestic data, the US recovery remains vulnerable to slowdowns stemming from the ongoing debt crisis in Europe, which has prompted some European banks to halt lending and start selling assets in USD. In an attempt to curb the contagion impact, the Federal Reserve and other leading central banks announced an expansion to the liquidity Swap Program to provide support to the global financial system as needed. These central banks will be able to use the funds to extend dollar-denominated loans to their national banks, easing some of the pressure on global financial markets. However, the action does not intend to solve the structural problems in Europe but instead allows more time for European leaders to fix the issues.

On the domestic front, Fed interventions have flattened the yield curve by increasing short-term rates and lowering long-term rates. Concerns are focused more on economic activity given that core PCE inflation has remained within the target range. Improvements in economic data suggest that the Fed is likely to delay any further action at least for the near term. However, they are prepared to act and are likely to target mortgage-backed securities "if conditions warrant". Further monetary easing may be justified if the financial sector deteriorates.

Similar to last month, household deleveraging, global financial uncertainty, sluggish residential investment, and tight credit conditions continue to limit economic growth. Fiscal uncertainty puts additional stress on the economy, particularly after last month's failure of the Supercommittee to agree on a deficit reduction plan. Looking forward to 2012, we continue to expect increasing downside risks to economic growth as fiscal reform and European debt issues develop further.

Economic Indicators

Graph 1
Contributions to Real GDP Growth
(3Q11 Preliminary, 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)



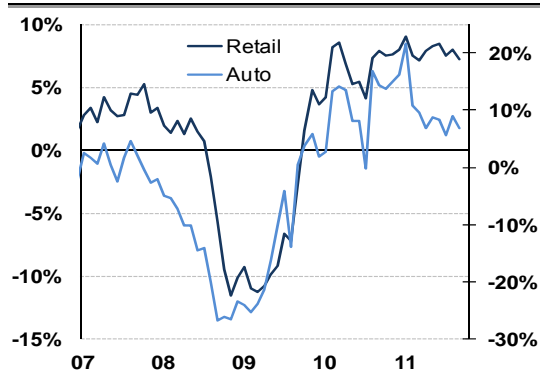
Source: Conference Board

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



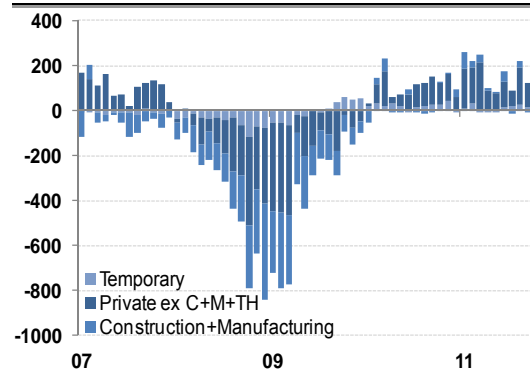
Source: ISM

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau

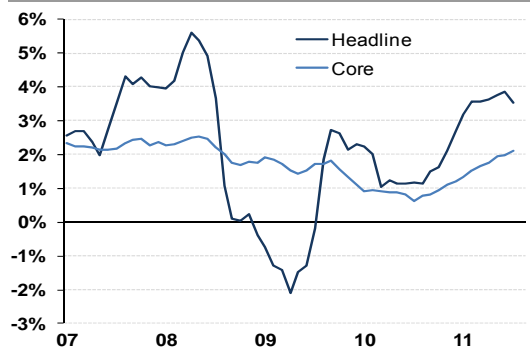
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: Haver Analytics & BBVA Research

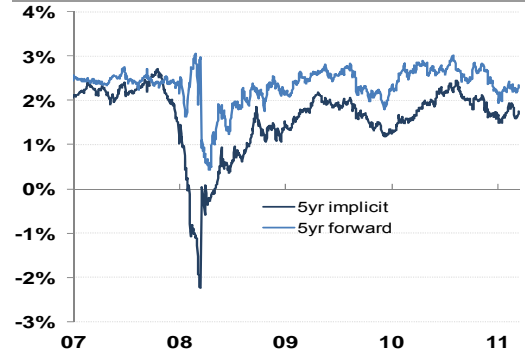
Economic Indicators

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



Source: Bureau of Labor Statistics

Graph 8
Inflation Expectations
(%)



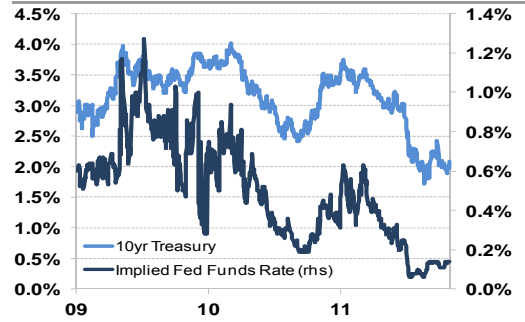
Source: Federal Reserve Board & BBVA Research

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	2.0	1.6	2.3	2.2
Real GDP (Contribution, pp)							
PCE	3.6	2.1	0.7	2.3	2.2	2.0	2.0
Gross Investment	-7.1	3.8	6.4	-0.9	3.7	8.6	6.5
Non Residential	8.7	2.1	10.3	14.8	8.9	9.5	7.1
Residential	2.5	-2.4	4.2	1.6	-1.9	3.0	4.3
Exports	7.8	7.9	3.6	4.3	6.7	6.1	6.8
Imports	-2.3	8.3	1.4	0.5	5.1	6.5	6.8
Government	-2.8	-5.9	-0.9	-0.1	-1.9	0.2	0.9
Unemployment rate (%)	9.6	8.9	9.1	9.1	9.0	8.9	8.4
Average Monthly Nonfarm Payroll(k)	139	166	97	147	122	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)	-	-	-	-	-8.5	-7.1	-4.6
Current Account (bop, % GDP)	-3.0	-3.2	-3.2	-	-3.0	-2.9	-3.0
Fed target rate (%)	0.25	0.25	0.25	0.25	0.25	0.25	1.00
S&P Case & Shiller Index	130.9	125.5	130.2	130.4	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	111.6	94.0	102.5

Source: BBVA Research

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