

Economic Watch

U.S.

Monthly US Outlook

A Quiet End to 2011, But How Long Will it Last?

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Economic Analysis

U.S.

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- **Despite a downward revision to 3Q11 GDP, economic data point to stronger growth in 4Q11 but increased uncertainties for 2012**
- **The Fed has plans to improve their communication strategy, but unlikely to announce QE3 as they await outcomes from Congress and Europe**

The economic recovery in the US continues to gain momentum in 4Q11 despite the slowing European economy and a lower-than-expected final GDP estimate for 3Q11. Growth was revised down to 1.8% QoQ annualized on a seasonally-adjusted basis from the second estimate of 2.0%. The downward revision was in large part due to surprising decline in personal consumption expenditures, mostly related to health care spending. Spending on durable goods was stronger than previously estimated, suggesting that underlying demand conditions have not deteriorated. While Europe appears to be heading into recession, current macroeconomic indicators in the US continue to indicate stronger growth in 4Q11, and we expect GDP growth more than 3.0% annualized for the quarter. Given the acceleration in economic activity in the latter half of 2011, annual growth is likely to be greater than our baseline forecast for 1.6%. In regards to fiscal policy, the Obama Administration was able to extend the payroll tax cut and unemployment benefits for two months. We expect that these measures will be extended until the end of the year and will have positive but yet minimal effect on the pace and sustainability of economic growth.

Recent increases in consumer confidence suggest that personal consumption expenditures in December will be similar to the previous two months and provide additional evidence of stronger growth in 4Q11. Consumer attitudes toward current conditions have increased slightly, and expectations for the next six months have improved significantly. Much of this can be attributed to positive labor market data, mostly centered on declines in initial jobless claims and the lower unemployment rate. Although total nonfarm payrolls have increased only modestly in recent months, the unemployment rate declined faster than expected in 4Q11 mainly due to a decline in the participation rate. Looking forward, we expect labor market conditions to improve only gradually throughout 2012, while the unemployment rate remains much higher than pre-recession levels.

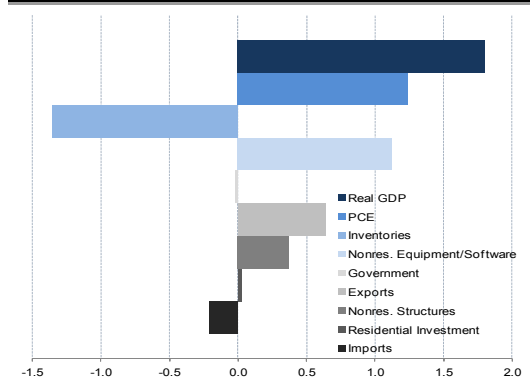
Inflation expectations have been relatively stable and pressures should remain limited in the coming months. Inflationary pressures on core prices should ease due to excess resource slack. For 2011, we expect that headline inflation will be near 3.2%, slightly higher than our baseline forecast of 2.9%, but will slow down in 2012.

The Fed continues to monitor economic data and is prepared to act if conditions worsen. Given that the economy is growing at a moderate pace and further action relies on pending outcomes in Congress and in Europe, the Fed has turned its focus to the communication strategy. In the next meeting, we expect the FOMC to follow through on its commitment to release the future path of the Federal Funds Target Rate, a long-run level of the rate, and a timing of the first rate increase as part of the Summary of Economic Projections. Our baseline scenario assumes that there will be no implementation of QE3, since a modest economic recovery will mean significant pressure over the Fed not to implement. The needed consensus around QE3 will be difficult to build in the face of moderate growth.

In summary, while 4Q11 growth is likely to lift 2011 GDP above our baseline forecast, downside risks to 2012 growth have increased. The crisis in Europe, slower global growth, and fiscal debates in the US have furthered uncertainties for 2012.

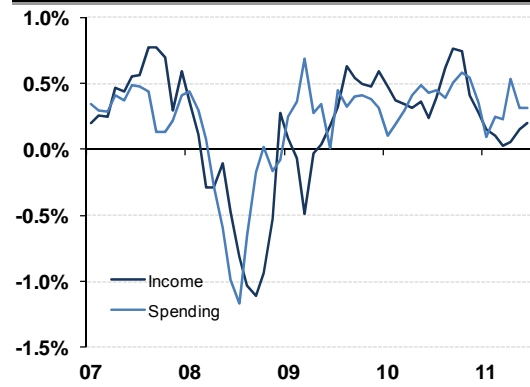
Economic Indicators

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



Source: Bureau of Economic Analysis

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



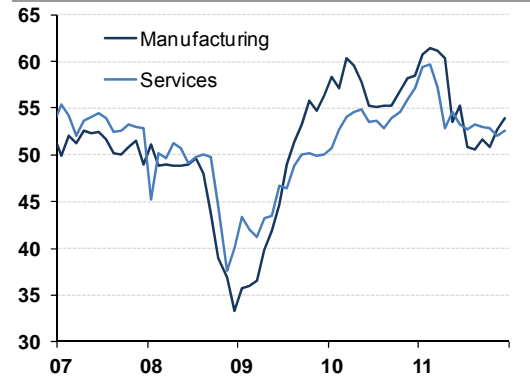
Source: Bureau of Economic Analysis

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



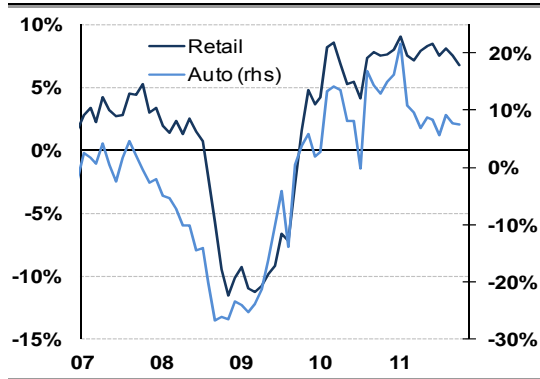
Source: Conference Board

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



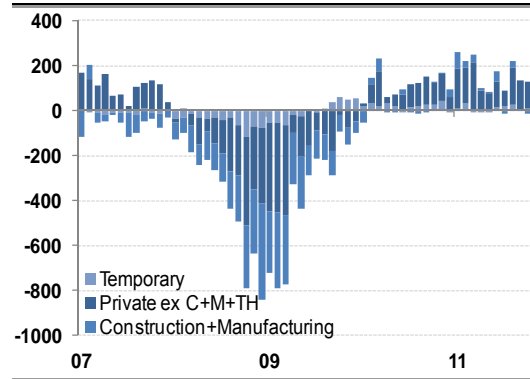
Source: ISM

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau

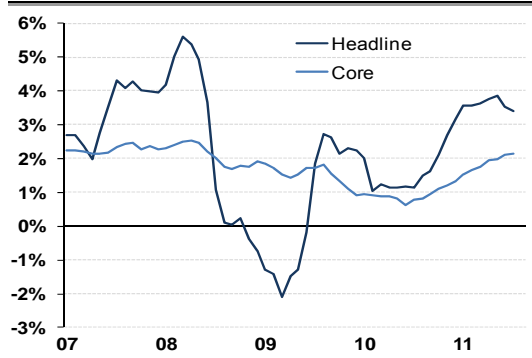
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: Haver Analytics & BBVA Research

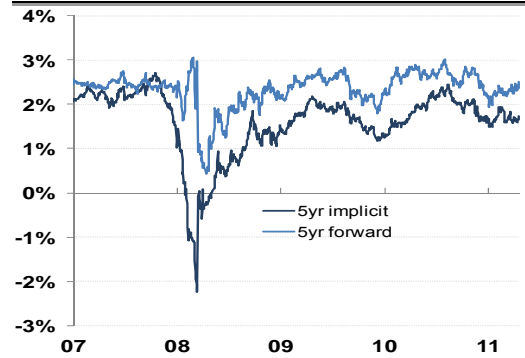
Economic Indicators

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



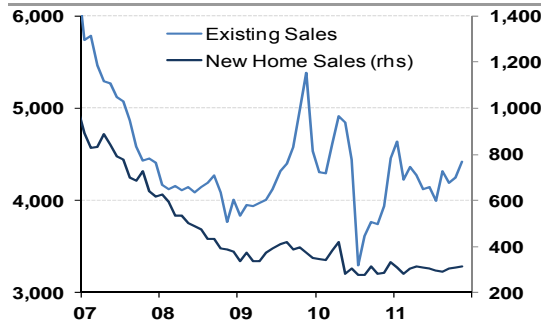
Source: Bureau of Labor Statistics

Graph 8
Inflation Expectations
(%)



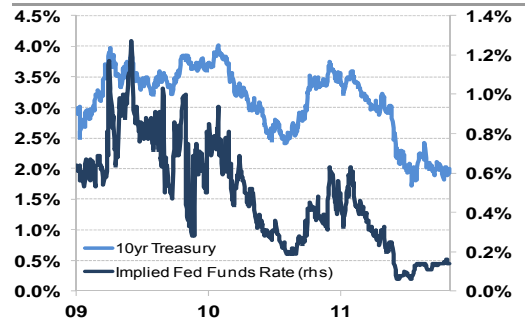
Source: Federal Reserve Board & BBVA Research

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	1.8	1.6	2.3	2.2
Real GDP (Contribution, pp)							
PCE	3.6	2.1	0.7	1.7	2.2	2.0	2.0
Gross Investment	-7.1	3.8	6.4	1.3	3.7	8.6	6.5
Non Residential	8.7	2.1	10.3	15.7	8.9	9.5	7.1
Residential	2.5	-2.4	4.2	1.3	-1.9	3.0	4.3
Exports	7.8	7.9	3.6	4.7	6.7	6.1	6.8
Imports	-2.3	8.3	1.4	1.2	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	9.0	9.0	9.1	9.0	8.9	8.4
Average Monthly Nonfarm Payroll(k)	139	166	97	147	137	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	-3.3	-2.9	-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	2.0	2.6	3.2
US Dollar/ Euro	1.36	1.37	1.44	1.41	1.35	1.33	1.36
Oil Prices (dpb)	86.6	104.8	117.6	113.3	109.5	94.0	102.5

Note: Revisions pending

Source: BBVA Research

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