

Fed Watch

US

 9 February 2012
 Economic Analysis

 US
 Boyd Nash-Stacey
 boyd.nashstacey@bbvacompass.com

 Jeffrey Owen Herzog
 jeff.herzog@bbvacompass.com

QE Dashboard

Conflicting labor market indicators and slowing headline inflation

- Continued resource slack and cooling commodity prices are registering in headline inflation data, while core inflation has gradually increased. Expectations of subdued inflation leave room for continued QE measures.
- Volatility remains low, but it is unclear whether this is a reflection of decreased volume or continued market uncertainty. Corporate spreads remain unexpectedly high despite a lower volatility index.
- Recent employment gains mark a unique trend in our dashboard: this is the first QE regime to register significant labor market indicator improvement in initial claims, unemployment and private payrolls.
- However, Chairman Bernanke remains unconvinced as unemployment duration remains high and the employment-to-population ratio registers no conclusive movement.

Table 1
 Large Scale Asset Purchases (LSAP) Scorecard

	Latest available	Operation Twist 10/11-present	Post QE2 11/10-10/11	Recovery-preQE2 7/09-10/10	Crisis 12/07-6/09	Pre-Crisis 3/03-11/07
10yr Treasury (%)	2.01	2.03	2.94	3.34	3.49	4.41
3mo Treasury (%)	0.09	0.02	0.10	0.13	1.06	3.02
Slope (bp)	192	201	284	321	243	139
10yr Inflation Indexed (%)	-0.21	0.02	0.80	1.34	1.77	2.06
Implicit 10yr Inflation exp. (%)	2.22	2.02	2.15	2.00	1.72	2.35
5yr Breakeven inflation expectations (%)	2.53	2.32	2.51	2.38	2.15	2.41
VIX (Index)	18.2	29.7	22.3	23.7	33.6	15.8
S&P500 (Index)*	1350	1228	1226	1093	1109	1462
Real effective exchange rate (\$, Index)	98.0	98.7	98.3	102.3	102.9	111.2
Corporate Spreads (BAA bp)	319	323	288	287	409	201
30yr Mortgage sprd (bp)	85	94	39	57	155	115
3M Libor-Treasury (bp)	44	43	22	22	128	36
Monetary aggregate M2 (yoy %)	10.3	9.6	5.8	3.8	7.8	5.5
Mutual Fund Flows Domestic (\$M)	-1801	-3397	-2213	-8171	-	-
Mutual Fund Flows Foreign (\$M)	108	-779	727	3954	-	-
Mutual Fund Flows Taxable (\$M)	5868	3246	2259	27889	-	-
Mutual Fund Flows Muni (\$M)	1626	905	-901	4849	-	-
Commercial Paper issuance (\$bn)	81.8	95.4	86.3	88.3	134.2	173.8
Initial Claims (4wk avg)	366	391	413	494	479	341
Unemployment rate (%)	8.3	8.6	9.1	9.7	6.8	5.2
Private Payrolls (K monthly)	257	199	167	-7	-396	119
Consumer confidence (Index)*	61	56	58	53	53	98
Retail sales ex bldg, autos & gas (yoy %)	5.5	5.9	5.8	1.6	-0.6	5.3
Industrial production (yoy %)	2.9	3.7	4.6	0.2	-7.0	2.3
Capacity Utilization (%)	78	78	77	72	75	79
ISM Survey (Index)	54.1	52.8	55.9	55.9	44.0	54.0
Consumer Prices (12m %)*	3.0	3.4	3.0	1.0	2.2	2.9
Core Consumer Prices (12m %)*	2.2	2.1	1.5	1.2	2.1	2.0
Bank Mortgage loans (\$bn)*	2076	2068	2072	2106	2058	2005
Bank CRE loans (\$bn)*	1409	1415	1463	1610	1673	1571
Bank C&I loans (\$bn)*	1354	1329	1251	1264	1512	1414
Bank Consumer loans (\$bn)*	1084	1092	1088	990	840	789

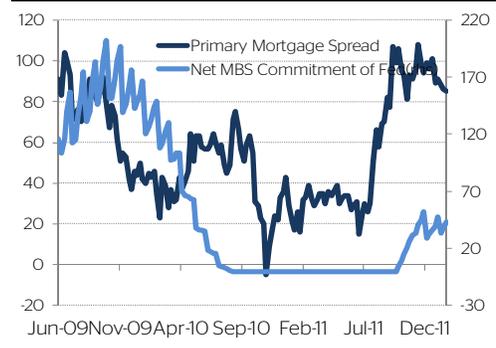
BBVA Research & Haver Analytics. * Pre-Crisis = Nov 2007

Chart 1
Treasury Yield Curve Slope & Secondary Mortgage Market Spread(% , bp)



Source: Bloomberg, Haver Analytics & BBVA Research

Chart 2
30yr Mortgage Spread & Fed MBS Net Purchases (bp & \$bn)



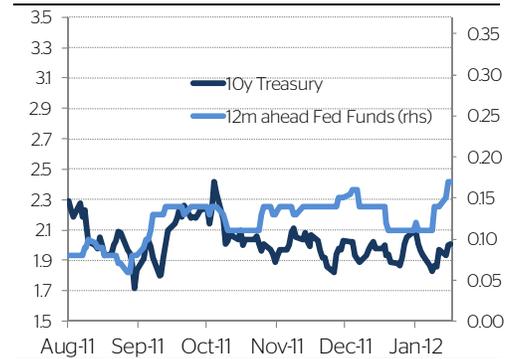
Source: Haver Analytics & BBVA Research

Chart 3
Implied Volatility & Corporate Spreads (index & %)



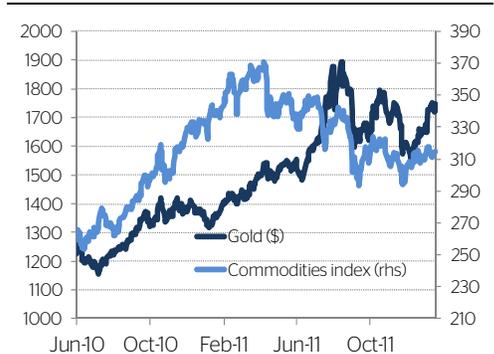
Source: Haver Analytics & BBVA Research

Chart 4
10 year Treasury & Fed Funds futures, %



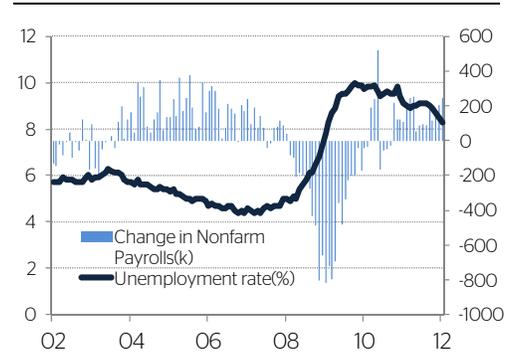
Source: Haver Analytics & BBVA Research

Chart 5
Gold & Commodities



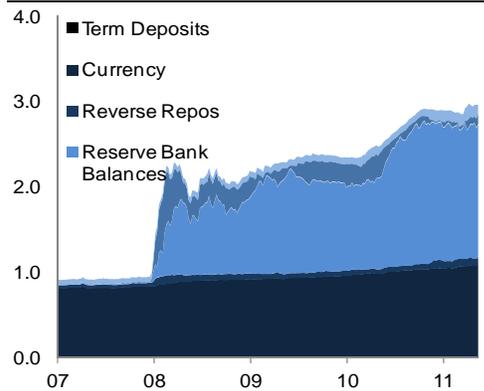
Source: Haver Analytics & BBVA Research

Chart 6
Unemployment Rate & Nonfarm Payroll



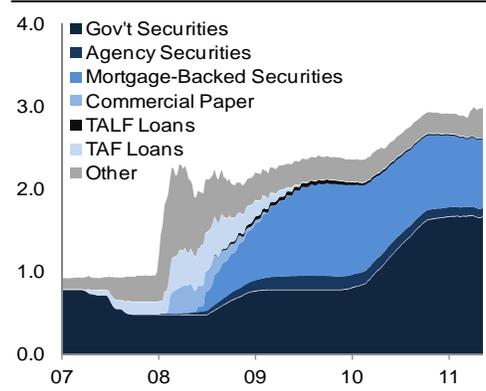
Source: Haver Analytics & BBVA Research

Chart 7
Factors Absorbing Reserve Funds (\$tr)



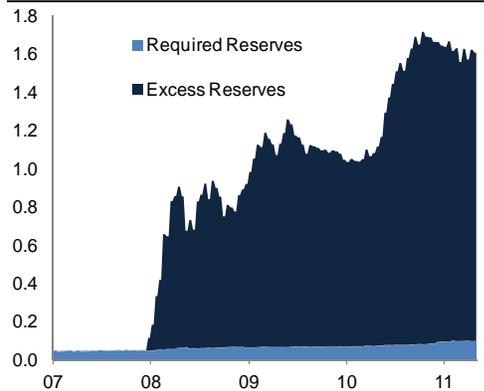
Source: Haver Analytics & BBVA Research

Chart 8
Factors Supplying Reserve Funds (\$tr)



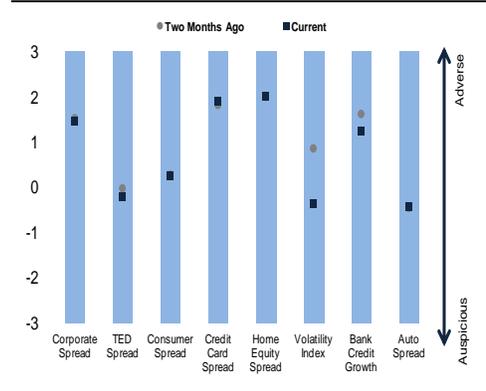
Source: Haver Analytics & BBVA Research

Chart 9
Required and Excess Reserves (\$tr)



Source: Haver Analytics & BBVA Research

Chart 10
Financial Indicators, Deviations from Mean



Source: BBVA Research and Bloomberg

Bottom line: Inflation, Labor but not Housing

The data presented above suggest no clear signal for or against additional quantitative easing. Much like the conditionality of the Federal Reserve's statements ("as conditions warrant") the indicators presented above require further data. With regard to the Fed's dual mandate, inflation appears headed closer to the Fed's long-term target of 2%. While unemployment may be affected by demographic shifts, the raw unemployment number has also moved towards the Fed's long-run expectation of the natural rate. However, housing market indicators remain weak and the balance sheet has not appreciably impacted secondary or primary mortgage spreads, although 30-year mortgage rates are at historic lows. While the Fed's QE measures are verifiably adding to its control of inflation, the link between monetary policy and housing market activity remains attenuated, which is a lasting concern for the Fed.

DISCLAIMER

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research Department on behalf of itself and its affiliated companies (each BBVA Group Company) and is provided for information purposes only. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.