

Fed Watch

US

QE Dashboard

Indicators support a wait-and-see approach

- Initial claims for unemployment insurance are approaching pre-crisis lows which support the recent favorable hiring data. Nevertheless, unemployment rates remain well above the Fed's long-run natural level target and thus a wait-and-see approach appears most likely.
- From the perspective of business activity, Operation Twist has coincided with an uptick in the ISM and capacity utilization. Although residential investment remains lackluster, the cost of residential investment is very low.
- The slightly improved optimism may not overcome serious structural problems in the housing market (high foreclosures, insufficient demand) that is weakening the link between monetary policy and the economy
- Equity markets, however, have responded favorably to highly accommodative Fed communications. Volatility has declined and recently the S&P 500 broke through the auspicious 1300 pt threshold

23 February 2012
Economic Analysis

US
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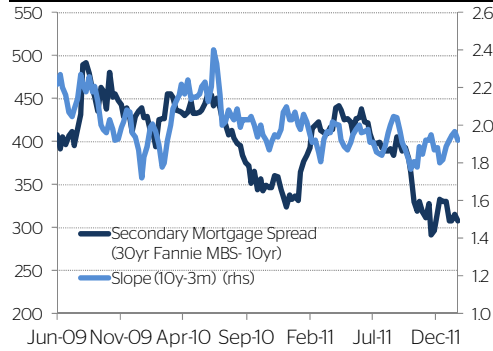
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Table 1
Large Scale Asset Purchases (LSAP) Scorecard

	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	2.04	2.94	3.34	3.49	4.41
3mo Treasury (%)	0.09	0.03	0.10	0.13	1.06	3.02
Slope (bp)	192	202	284	321	243	139
10yr Inflation Indexed (%)	-0.27	0.01	0.80	1.34	1.77	2.06
Implicit 10yr Inflation exp. (%)	2.28	2.04	2.15	2.00	1.72	2.35
5yr Breakeven inflation expectations (%)	2.57	2.34	2.51	2.38	2.15	2.41
VIX (Index)	18.2	29.1	22.3	23.7	33.6	15.8
S & P 500 (Index)*	1358	1235	1226	1093	1109	1462
Real effective exchange rate (\$, Index)	98.4	98.6	98.3	102.3	102.9	111.2
Corporate Spreads (BAA bp)	315	321	288	287	409	201
30yr Mortgage sprd (bp)	75	92	39	57	155	115
3M Libor-Treasury (bp)	41	42	22	22	128	36
Monetary aggregate M2 (yoy %)	10.0	9.7	5.8	3.8	7.8	5.5
Mutual Fund Flows Domestic (\$M)	35	-2980	-2213	-8171	-	-
Mutual Fund Flows Foreign (\$M)	1008	-576	727	3954	-	-
Mutual Fund Flows Taxable (\$M)	6463	3492	2259	27889	-	-
Mutual Fund Flows Muni (\$M)	1733	984	-901	4849	-	-
Commercial Paper issuance (\$bn)	80.8	94.0	86.3	88.3	134.2	173.8
Initial Claims (4wk avg)	359	388	413	494	479	341
Unemployment rate (%)	8.3	8.7	9.1	9.7	6.8	5.2
Private Payrolls (K monthly)	257	202	167	-7	-396	119
Consumer confidence (Index)*	61	54	58	53	53	98
Retail sales ex bldg, autos & gas (yoy %)	5.2	5.6	5.8	1.6	-0.6	5.3
Industrial production (yoy %)	3.3	3.7	4.5	0.2	-7.0	2.3
Capacity Utilization (%)	79	78	77	72	75	79
ISM Survey (Index)	54.1	52.7	55.9	55.9	44.0	54.0
Consumer Prices (12m %)*	2.9	3.3	3.0	1.0	2.2	2.9
Core Consumer Prices (12m %)*	2.3	2.1	1.5	1.2	2.1	2.0
Bank Mortgage loans (\$bn)*	2102	2071	2072	2106	2058	2005
Bank CRE loans (\$bn)*	1427	1417	1463	1610	1673	1571
Bank C&I loans (\$bn)*	1367	1333	1251	1264	1512	1414
Bank Consumer loans (\$bn)*	1088	1091	1088	990	840	789

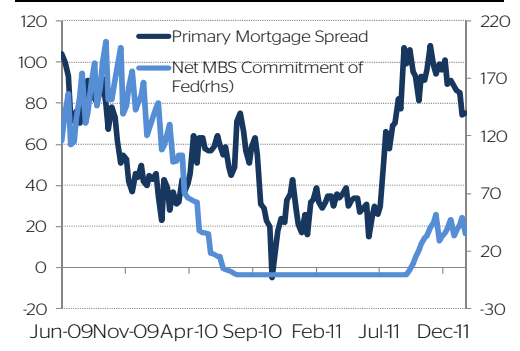
BBVA Research & Haver Analytics. * Pre-Crisis = Nov 2007

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



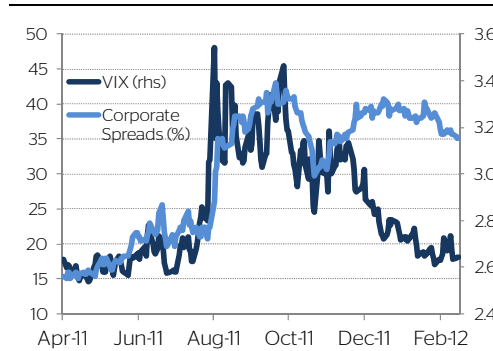
Source: Bloomberg, Haver Analytics & BBVA Research

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



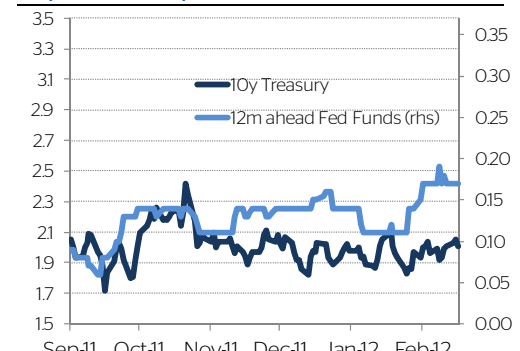
Source: Haver Analytics & BBVA Research

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



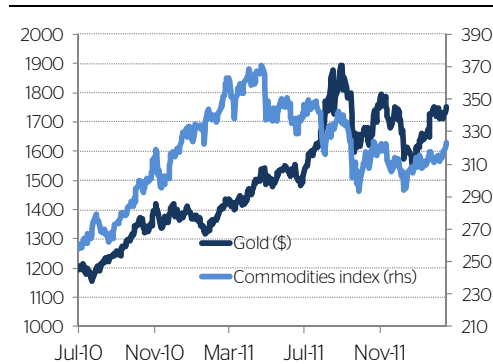
Source: Haver Analytics & BBVA Research

Chart 4
10 year Treasury & Fed Funds futures, %



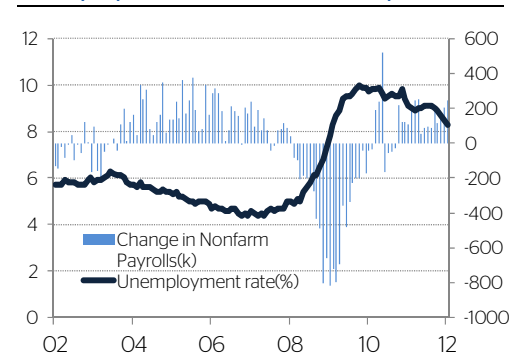
Source: Haver Analytics & BBVA Research

Chart 5
Gold & Commodities



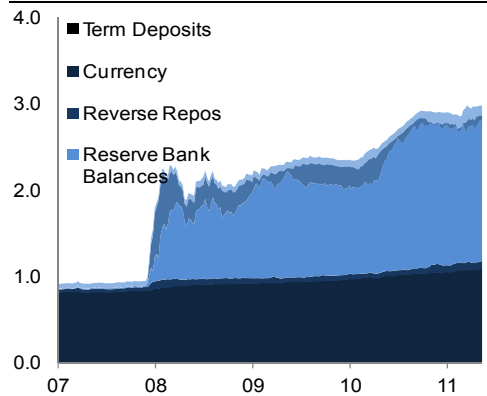
Source: Haver Analytics & BBVA Research

Chart 6
Unemployment Rate & Nonfarm Payroll



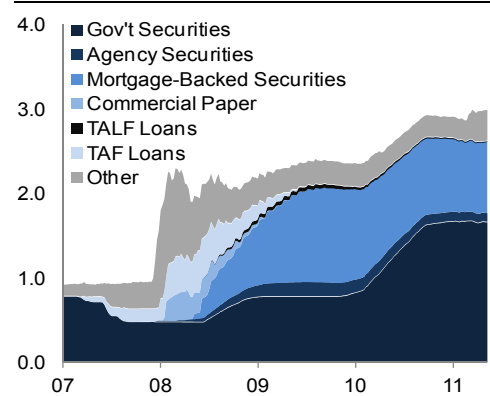
Source: Haver Analytics & BBVA Research

Chart 7
Factors Absorbing Reserve Funds (\$tr)



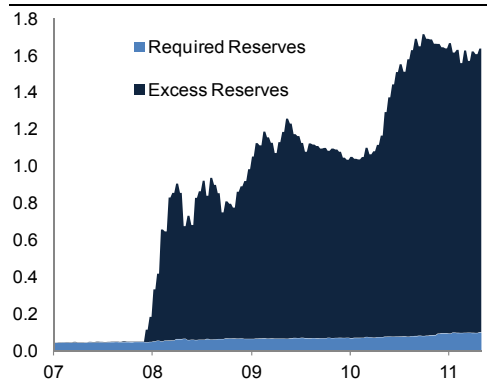
Source: Haver Analytics & BBVA Research

Chart 8
Factors Supplying Reserve Funds (\$tr)



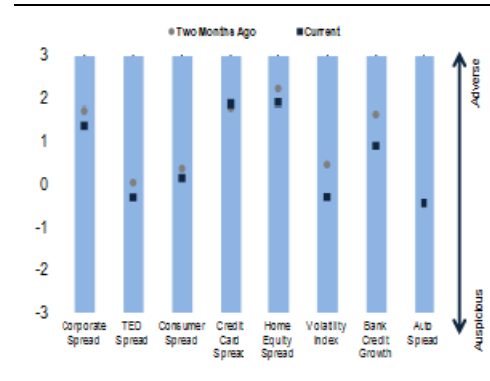
Source: Haver Analytics & BBVA Research

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: Optimism grows, but vulnerability still exists

Current indicators suggest the Fed's maturity lengthening program has been associated with improvements in manufacturing, expanding private employment, low long-term interest rates and subsiding inflation. Given these auspicious signs, financial markets have responded with lower volatility and small equity market gains. Furthermore, mortgage spreads have declined during the Maturity Extension Program and 30yr mortgage rates remain at historic lows. Nevertheless, given the improving conditions and stable inflation, the Fed appears to have adopted a wait-and-see approach in the near-term. The short-term glow of optimism may fade as a result of the overhang from the European debt crisis and increased geopolitical risks. The economy remains susceptible to external shocks - similar to the oil shock of last year - and the Fed may have reached diminishing returns with asset purchases. These conditions may limit the economy's resilience over the year.

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