

Economic Watch

US

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Economic Analysis

US

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Monthly US Outlook

Recovery Sensitive to Slowing Activity in 2Q12

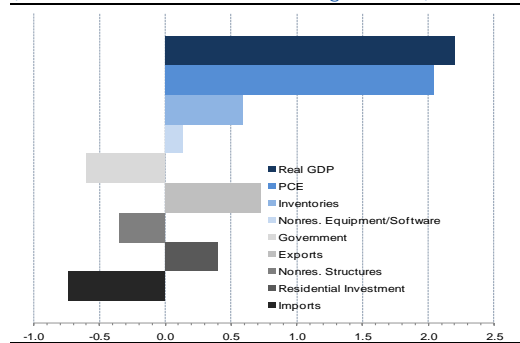
- A strong contribution from real consumption to 1Q12 GDP suggests that consumer activity has held up thus far, but the outlook is mixed
- Manufacturing has experienced modest slowdowns to start 2Q12, yet the **sector's job gains are significant despite weakness in total payrolls**
- **The probability of Fed action has declined, though QE remains "on the table" as a policy option if financial conditions deteriorate**

Recent economic indicators have shown mixed signals on the strength and sustainability of the recovery, however, data through 1Q12 support our outlook for stronger growth in 2012. The first estimate for 1Q12 real GDP growth came in at 2.2% QoQ annualized on a seasonally-adjusted basis. Real personal consumption expenditures (PCE) surprised to the upside at 2.9% growth, helping offset weakness in other components. In fact, average growth of real PCE for the first quarter was the strongest since 4Q06. Excluding inventories, which were a primary driver of the 3.0% growth in 4Q11, first quarter GDP was slightly stronger. The beginning of 2Q12 has shown modest slowing in some areas, including the manufacturing sector which has been a leader of the economic recovery thus far. Despite the slower pace of expansion and a modest decline in demand conditions, the sector continues to add jobs at a healthy rate while overall employment growth weakens. In April, nonfarm payrolls increased only 115K following upward revisions to both March (by 34K) and February (by 19K). While the upward revisions are somewhat encouraging, March and April payrolls remain far from the 200K+ gains seen throughout the winter months. Bernanke has emphasized this weakness in recent speeches, noting that current labor market trends imply around 150K to 200K in job creation per month to reduce the unemployment rate. A job creation pace of 100K, according to Bernanke, would keep the unemployment rate stable. At this point, our monthly activity index suggests that GDP growth in 2Q12 will be near 2.1% QoQ annualized. Upcoming data will provide a clearer picture for the quarter, with great importance placed on consumption given the strong contribution in 1Q12. Average real PCE growth near 0.3% in April, May, and June could push our GDP forecast for 2Q12 up to 2.3%.

In the latest FOMC meeting, members upgraded their economic outlook for 2012, but downgraded their 2013 and 2014 GDP forecasts. Given recent increases in commodity prices, the Fed also increased its outlook for inflation, but over the year the Fed expects it to reside at or below its long-run target. Therefore, given a gradual decline in the unemployment rate and moderate economic activity and inflation, the probability of additional large-scale asset purchases has declined and we expect Operation Twist to end as scheduled in June. Ongoing risks to the outlook (i.e. European sovereign debt issues) and persistent drags on growth (i.e. US fiscal consolidation and a depressed housing sector) still warrant low interest rates for a long period of time. Thus, our expectation remains unchanged for a first Fed Funds rate increase in 4Q14. In addition, the fiscal outlook is warranting more attention as we get closer to the 2013 target. Bernanke continues to stress the need for fiscal reforms and noted a high risk of austerity measures becoming implemented. As such, Bernanke believes that Congress should balance the two goals of fiscal sustainability and economic growth. The Fed has clearly acknowledged that the downside risks to growth remain high. Therefore, if financial conditions deteriorate or growth is derailed by one of many persistent drags on the economy, quantitative easing remains "on the table" as a policy option.

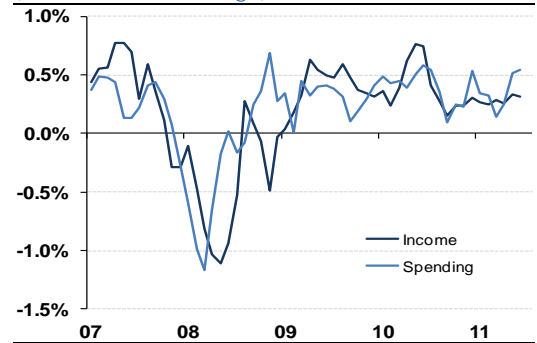
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(1Q12 Advance, SAAR Percentage Points)



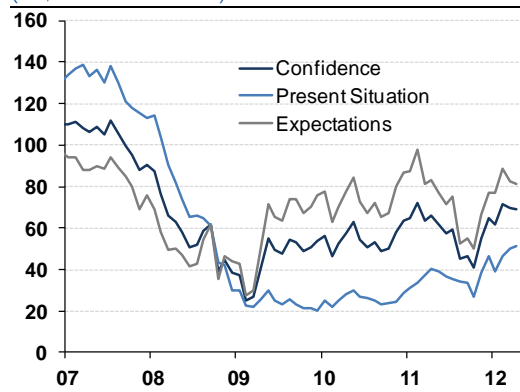
Source: BEA and BBVA Research

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



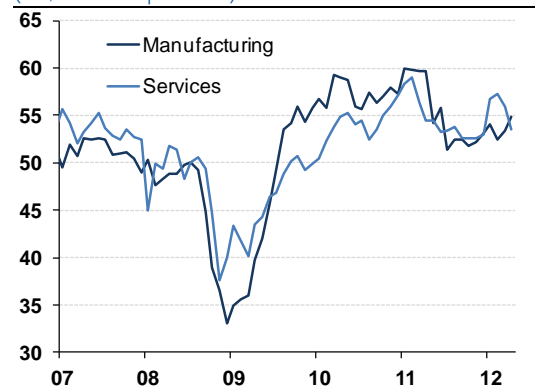
Source: BEA and BBVA Research

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



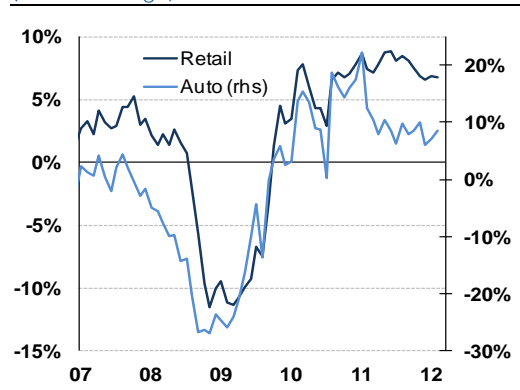
Source: Conference Board and BBVA Research

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



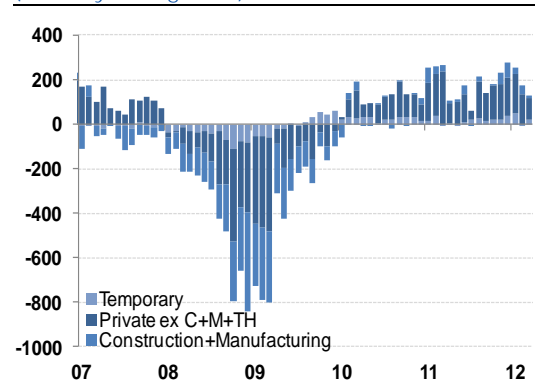
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

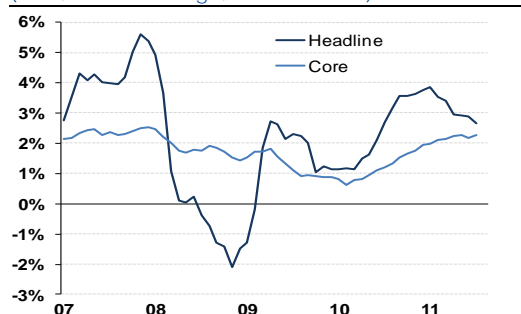
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

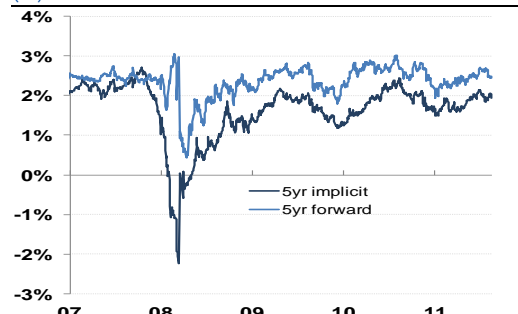
Economic Indicators

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



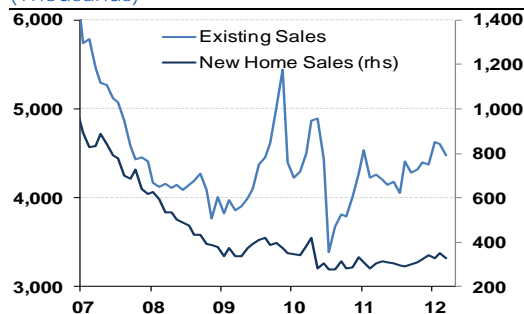
Source: BLS and BBVA Research

Graph 8
 Inflation Expectations
 (%)



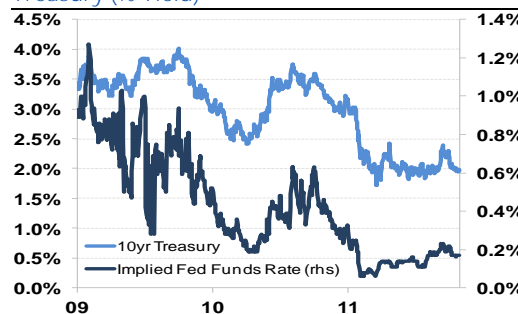
Source: Federal Reserve Board and BBVA Research

Graph 9
 New and Existing Home Sales
 (Thousands)



Source: US Census Bureau, NAR, and BBVA Research

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



Source: Federal Reserve Board and BBVA Research

Table 1
 Forecasts (**BOLD=FORECASTS**)

	3Q11	4Q11	1Q12	2011	2012	2013
Real GDP (% SAAR)	1.8	3.0	2.2	1.7	2.3	2.2
Real GDP (Contribution, pp)						
PCE	1.2	1.5	2.0	1.5	1.5	1.4
Gross Investment	0.2	2.6	0.8	0.6	1.1	0.8
Non Residential	1.5	0.5	-0.2	0.8	0.6	0.7
Residential	0.0	0.3	0.4	0.0	0.2	0.2
Exports	0.6	0.4	0.7	0.9	0.7	0.9
Imports	-0.2	-0.6	-0.7	-0.8	-0.6	-1.0
Government	0.0	-0.8	-0.6	-0.4	-0.3	0.1
Unemployment Rate (%)	9.1	8.7	8.3	9.0	8.2	7.8
Average Monthly Nonfarm Payroll (K)	128	164	229	153	178	203
CPI (YoY %)	3.8	3.3	2.8	3.2	2.5	2.2
Core CPI (YoY %)	1.9	2.2	2.2	1.7	1.9	1.8
Fiscal Balance (% GDP)	-	-	-	-8.7	-7.6	-5.0
Current Account (bop, % GDP)	-2.8	-3.2	-	-3.2	-3.0	-3.3
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25
S&P Case-Shiller Index	130.7	125.7	-	128.5	129.0	130.9
10-Yr Treasury (% Yield, eop)	2.0	2.0	2.2	2.0	2.5	2.7
U.S. Dollar / Euro (eop)	1.37	1.32	1.32	1.31	1.25	1.31
Oil Prices (dcb, average)	113.3	109.5	118.4	113.5	121.2	106.6

Source: BBVA Research

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