

Economic Watch

US

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Economic Analysis

US

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BBVA Research Monthly Activity Index

Assessing underlying volatility in economic data

- Ten individual activity indices and an overall composite index were created in order to provide a general assessment of economic data
- Index trends suggest slightly slower economic activity compared to three and six months ago
- The MAI, which we use to forecast short-term GDP, points to 2.1% QoQ annualized growth for 2Q12

Recent economic data has been mixed, with much of the underlying data telling a different story than what is on the surface. In order to assess overall economic activity and the underlying volatility stemming from various aspects of the economy, we developed a monthly activity index (MAI) that encompasses nearly 100 macroeconomic variables. The overall MAI is a composite of ten individual indices representing housing, commercial real estate (CRE), employment, economic confidence, financial markets, spending, production, prices, international trade, and banking (Chart 1). All components are mutually exclusive in the sense that variables are not included in more than one individual index. The data are collected on a monthly basis, with historical series dating back to 1993. Each of the indices were developed using principal component and dynamic factor analysis to reveal the internal structure of the variables in a single index. Unfortunately, our index is limited to only the most available and up-to-date monthly data – some sector-related variables in which the data are lagged more than two months are not included in our analysis. For those variables that are lagged only slightly, we forecast ahead one or two periods in order to ensure that that data are current and balanced.

Chart 1

Monthly Activity Index Components

Housing	CRE	Employment	Economic Confidence	Financial
Housing Starts Building Permits New Home Sales Existing Home Sales S&P Case-Shiller Home Prices Mortgages Rates (15 and 30-year) Housing Affordability National Homebuilder Index	Commercial Property Prices Office Construction Spending Commercial Construction Spending Multifamily Construction Spending	Nonfarm Payrolls Average Hourly Earnings Civilian Labor Force Total employment Total unemployment Employment to Population Ratio Participation Rate Unemployment Rate Long-term Unemployed Initial Jobless Claims Average Workweek Hours Number of Hires Number of Job Openings Manufacturing ISM Employment Services ISM Employment	ISM Manufacturing New Orders Consumer Confidence Capital Expenditure Expectations Small Business Optimism	Dow Jones S&P 500 Russell 3000 TED Spread AAA Spread BAA Spread Financial CP Spread Swap Spread Gold Price \$/Euro Yen/\$ Yield Curve Slope
Spending	Production	Prices	International Trade	Banking
Real PCE Retail Sales Real Personal Income Real Disposable Personal Income Personal Savings Rate	Manufacturing Output Mining Output Utilities Output Capacity Utilization Nondefense Capital Goods Orders Durable Goods Orders and Shipments Business Inventories Sales/Inventory Ratio	CPI PPI PCE Prices Import Prices Commodity Prices	Real Goods and Services Exports Real Goods and Services Imports Nominal Trade-Weighted Exchange	C&I Lending Real Estate Lending Consumer Lending Cash Assets Large Time Deposits

Source: BBVA Research

Using the most up-to-date economic data through April, our MAI suggests slightly slower economic activity compared to three and six months ago (Chart 2). Current levels of the individual indices are lower than in previous months, except for housing which has seen growing momentum in building permits and sales. Economic confidence slipped into negative territory for the first time in three months, mostly due to slowing new orders and growing uncertainties in the business outlook. The employment index is still positive but reflects the latest weakness in nonfarm payroll growth as well as the declining participation rate. As expected, the trade index has deteriorated on account of the ongoing crisis in Europe and slowdowns in emerging markets. Throughout the past year, the index points to volatility in various sectors of the economy, including CRE, economic confidence, consumer spending, and international trade.

Chart 2
Monthly Activity Index Trends

BBVA Index	Current	3 Months Ago	6 Months Ago	12 Months Ago	Long Run SD
Monthly Activity Index	0.65	1.68	0.98	0.59	1.57
Housing	1.31	0.19	0.25	-0.28	1.73
CRE	-0.14	0.90	-0.56	0.56	0.83
Employment	1.20	3.68	2.17	1.74	2.14
Economic Confidence	-0.18	0.04	-0.12	-0.14	2.15
Financial	0.39	0.93	1.34	0.94	1.62
Spending	-0.35	0.79	0.25	-0.08	0.76
Production	0.88	1.89	1.11	0.82	1.49
Prices	0.92	1.21	0.71	-0.41	1.68
Trade	-0.97	0.13	0.04	-0.97	0.80
Banking	-0.43	-1.20	-2.52	-2.13	3.10

Source: BBVA Research

In order to assess the ten individual activity indices and the composite MAI, we applied a risk level to the resulting trends based on the number of standard deviations away from the mean (zero). For example, index levels one standard deviation above or below zero are less risky, whereas the indices more than two standard deviations away from zero represent a greater risk. While indices below zero may be more suggestive of slowing economic activity, data significantly above zero may be indicative of a potential bubble and are thus important to monitor concurrently.

While we did not develop our index based on any other existing activity indices, the MAI does compare nicely to more commonly used indicators, including the Chicago Fed National Activity Index (Chart 3) and the Conference Board Leading Index (Chart 4). The trends are very similar and suggest that our estimates will be a reliable resource moving forward in our assessment of current data. We are comfortable that our index is adequate and will prove successful in capturing any changes in economic variables that may impact our outlook.

Chart 3
Monthly Activity Index and Chicago Fed NAI
(3MMA)

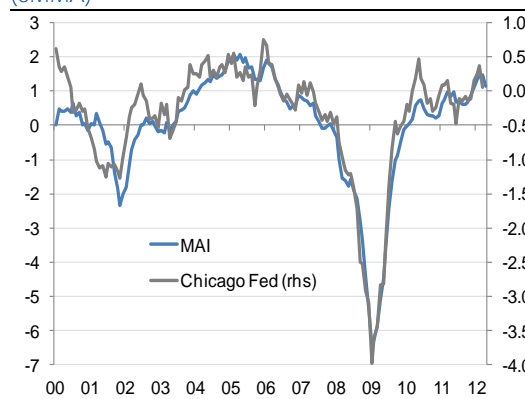
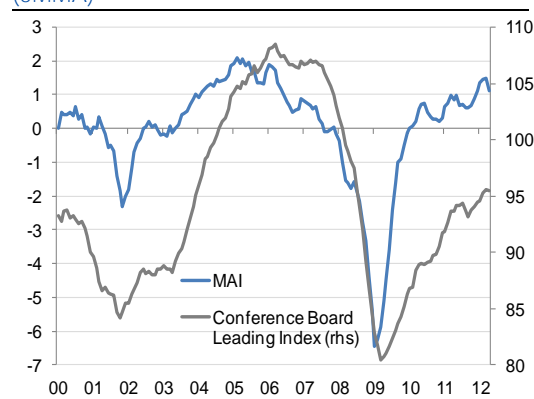


Chart 4
Monthly Activity Index and Leading Indicators
(3MMA)



Not only does our MAI provide a unique outlook on current economic trends, but it also serves as a tool to forecast real GDP growth on a short-term basis (Chart 5). In general, the idea is that the index will be more telling of future growth trends as the data become more current, and our forecast for GDP will change on a monthly basis according to the underlying changes in the macroeconomic variables. For instance, throughout the past few months, our forecast for 2Q12 GDP has shifted down slightly in conjunction with modest deceleration for many short-term indicators, from 2.3% two months ago to our current projection of 2.1% QoQ annualized (Chart 6). Upcoming data will provide a clearer picture for the quarter, with great importance placed on consumption given the strong contribution in 1Q12. In particular, average real PCE growth near 0.3% in April, May, and June could push our GDP forecast for 2Q12 back up to 2.3%.

Chart 5
Monthly Activity Index and Real GDP
(4Q % Change)

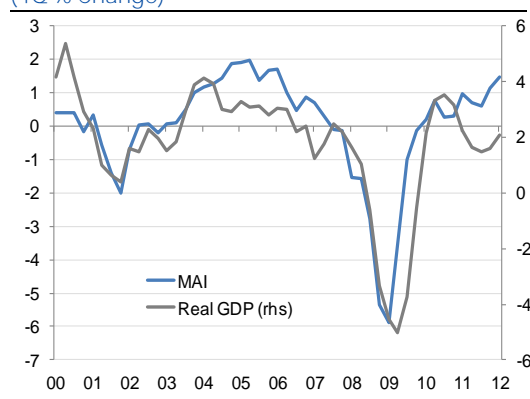
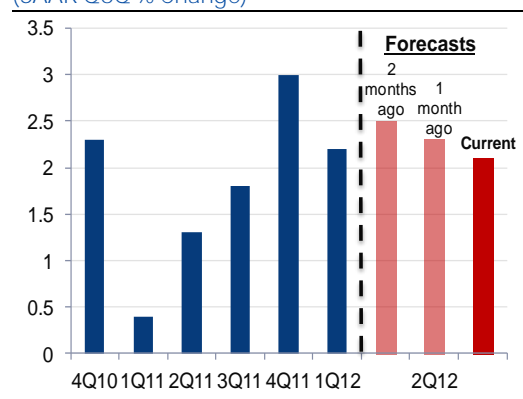


Chart 6
Real GDP Growth
(SAAR QoQ % Change)



Bottom line: Monthly Activity Index Helps Pinpoint Vulnerability in Economic Data

The monthly activity index was developed in order to gain a better understanding of underlying trends in macroeconomic variables, with specific focus on ten different aspects of the economy. Overall, our MAI acts as a useful tool to assess current trends in economic variables. Furthermore, the index provides an opportunity to monitor real GDP growth on a monthly basis in order to more closely support our baseline scenario for the upcoming quarters. Future analyses will present additional opportunities to use the composite MAI as well as the individual indices as an economic forecasting tool.

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