

US Weekly Flash

Highlights

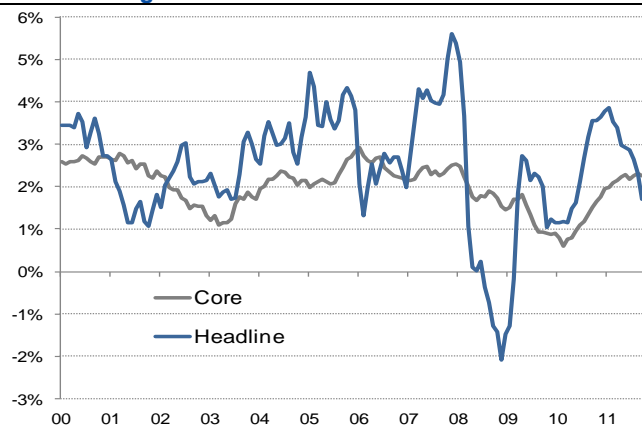
• Falling Gas Prices Drag Down Headline Inflation Again in May

- The consumer price index declined slightly more than expected in May, down 0.3% following no change in April. The energy index declined 4.3% in May after falling 1.7% in April, with the index now at the lowest level since February 2011. Gas prices led the overall decline, dropping 6.8% following a 2.6% decrease in the previous month. Food prices were unchanged in May for the first time in three months. On a YoY basis, headline inflation dropped from 2.3% in April to 1.7% in May, the lowest rate in more than a year.
- Despite the recent swings in headline inflation, core prices held steady at 0.2% MoM for the third consecutive month. Most of the pressure stems from medical care and shelter prices, which increased 0.5% and 0.2%, respectively. Other components are also adding pressure to core inflation, including apparel and used car prices, which increased 0.4% and 1.0%, respectively. On a YoY basis, core inflation holds steady at 2.3%, with medical care services jumping to 3.9% and shelter at 2.3%.
- Our current forecast assumes Brent oil prices above \$120pb in the next five months, which seems high now compared to the latest price of \$113pb in May. This sharp decline in oil prices has created a downward bias for our headline inflation forecast, which stands at 2.5% for 2012. Also, current trends in medical care and shelter prices, as well as other components, continue to present an upward bias for the core figure, which we expect may end the year slightly higher than our current 2012 forecast of 1.9%.

• Retail Sales and Production Data Hint at Slowing Activity in May

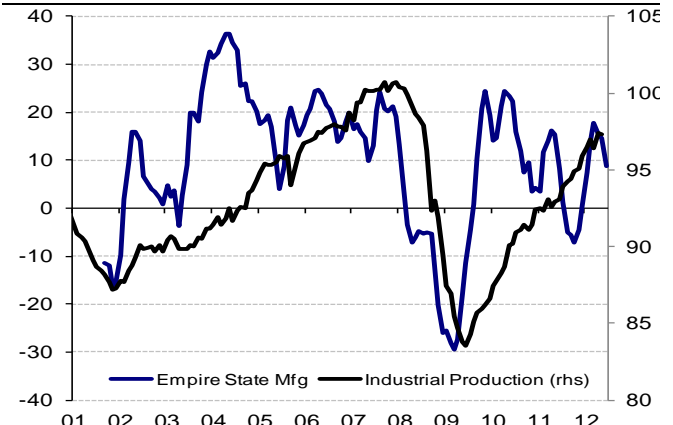
- Retail sales declined 0.2% in May following a downwardly revised 0.2% drop in April. Auto sales increased slightly for the second consecutive month, up 0.8%. However, retail sales excluding autos declined 0.4%, with declines in most of the core components. In particular, gasoline sales weighed on the nominal figure, dropping 2.2% as a result of falling gas prices. On the bright side, the drop in inflation led to a 0.1% increase in real retail sales for May after dropping 0.3% in April. While the nominal figure hints at slowing in consumer activity, the real estimate is more encouraging.
- Industrial production was also weaker than expected in May, falling 0.1% after jumping 1.0% in April. Strength in mining and utilities, which increased 0.9% and 0.8%, respectively, was not quite enough to offset weakness in the manufacturing component (-0.4%). Given April's growth, we continue to expect that production will have a positive impact on GDP growth in 2Q12. In other manufacturing news, the Empire State Survey fell sharply from 17.09 in May to 2.29 in June, with declines in most of the major components. Still, the overall index and the new orders and shipments components remain in expansionary territory.

Graph 1
Consumer Price Inflation
YoY % Change



Source: Bureau of Labor Statistics & BBVA Research

Graph 2
Industrial Production and NY Manufacturing Survey
Index & 3mma



Source: Federal Reserve & BBVA Research

Week Ahead

Housing Starts and Building Permits (May, Tuesday 8:30 ET)

Forecast: 720K, 725K

Consensus: 721K, 729K

Previous: 717K, 715K

Recent trends in housing activity have been positive, and new home starts and permits are both expected to increase slightly in May. The homebuilder confidence index for the month jumped to the highest level of the recovery, suggesting that current conditions improved significantly from April. However, the latest weakness in consumer data and the discouraging labor market conditions may limit housing activity in May. Building permits, which offer a leading look at the housing sector, dropped in April and indicate that gains in new home starts may be minimal.

FOMC Meeting Announcement (June, Wednesday 12:30 ET)

Forecast: 0.25%

Consensus: 0.25%

Previous: 0.25%

The latest FOMC statement and minutes had noted a slightly more centrist committee with lower probability of quantitative easing. However, increasing uncertainties stemming from the situation in Europe and the data released throughout the intermeeting period may influence more immediate action. Recent speeches from Fed presidents highlight mixed responses to the extremely weak labor market data, presenting a more divided committee compared to the meeting minutes. The probability of extending Operation Twist, which expires this month, has increased significantly and quantitative easing remains an option, depending on whether the weak trends continue throughout the next few months. The more likely scenario would be an extension of OT. While this would have only a small impact on rates and economic activity, it could be a tailwind to financial markets since the policy action would indicate that the Fed is ready to act whenever it is needed. With 10-year rates at all-time lows, it will be difficult, if not impossible, to stimulate the economy further with monetary policy unless the Fed gets creative.

Jobless Claims (Week Ending June 16th, Thursday 8:30 ET)

Forecast: 380K

Consensus: 380K

Previous: 386K

Initial jobless claims have trended higher on average in April and May compared to earlier months. So far, the trend appears to be the same for June, with the first half of the month averaging slightly over 380K. The data reflect the discouraging employment conditions which have weakened significantly since the first quarter, though it is not yet clear whether this is due to the seasonal shift in job gains to the warmer-than-usual winter months. Ultimately, in the next month we do not expect a sharp drop in claims back down to the 350K level.

Existing Home Sales (May, Thursday 10:00 ET)

Forecast: 4.65M

Consensus: 4.57M

Previous: 4.62M

Existing home sales are improving only gradually as expected, increasing in April following two consecutive months of declines. In May, we expect that slow improvements in housing activity will continue, with existing sales up 10% on a YoY basis. The latest homebuilder confidence index increased significantly and suggests stronger sales of existing homes despite weakness in other consumer data. On a positive note, median prices of existing sales did increase in April, though this did bring down the affordability index for the month.

Market Impact

The central focus this week will be on Wednesday's FOMC meeting announcement and press conference, with markets looking for the Fed's response to weaker employment data and uncertainty stemming from Europe. An extension of Operation Twist, the more likely scenario, would ease market anxiety and support the Fed's highly accommodative stance. However, weekend developments in Europe could incite more concerns if the Greek elections do not prove to be sustainable.

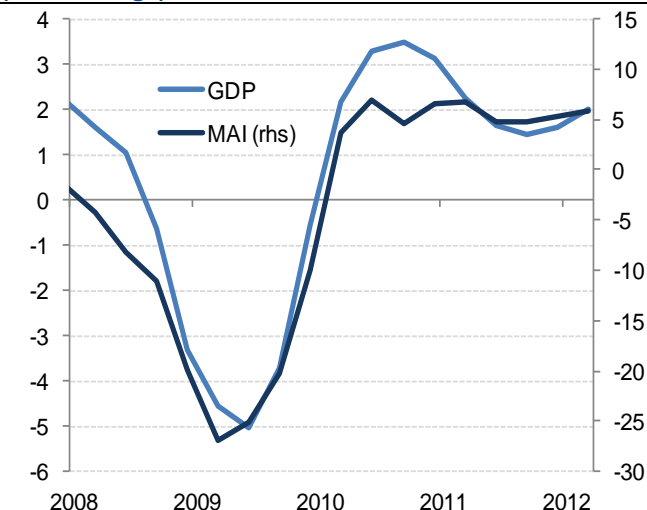
Economic Trends

Graph 3
BBVA US Weekly Activity Index
(3 month % change)



Source: BBVA Research

Graph 4
BBVA US Monthly Activity Index & Real GDP
(4Q % change)



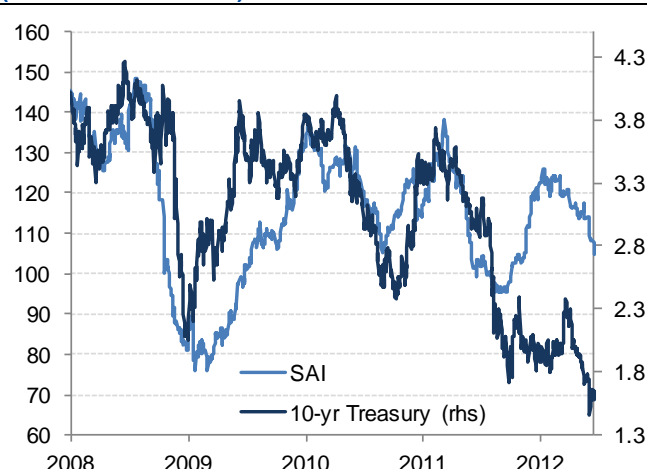
Source: BBVA Research & BEA

Graph 5
BBVA US Surprise Inflation Index
(Index 2009=100)



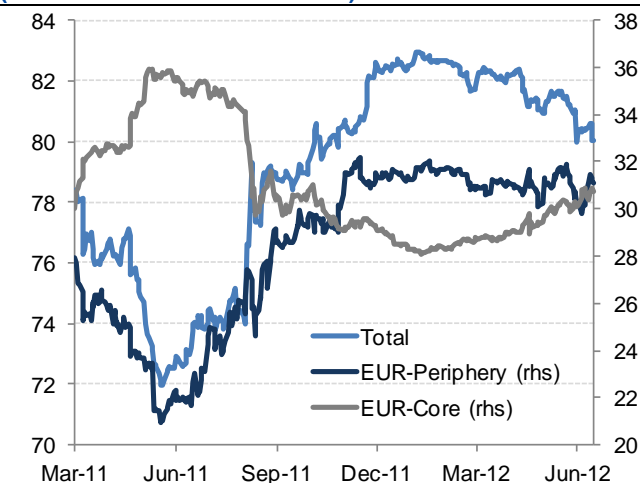
Source: BBVA Research

Graph 6
BBVA US Surprise Activity Index & 10-yr Treasury
(Index 2009=100 & %)



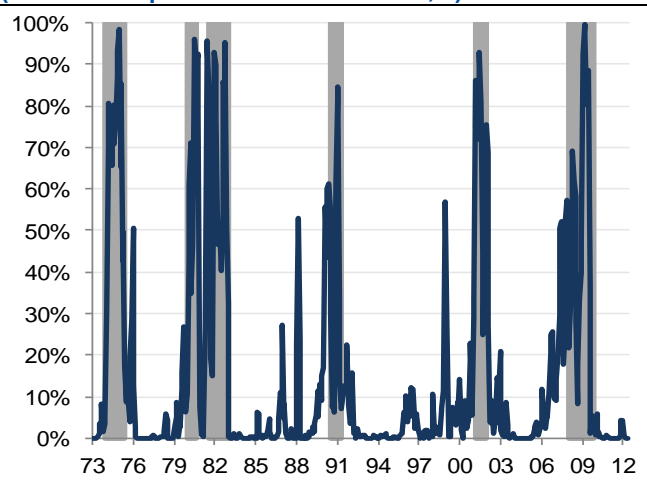
Source: Bloomberg & BBVA Research

Graph 7
Equity Spillover Impact on US
(% Real Return Co-Movements)



Source: BBVA Research

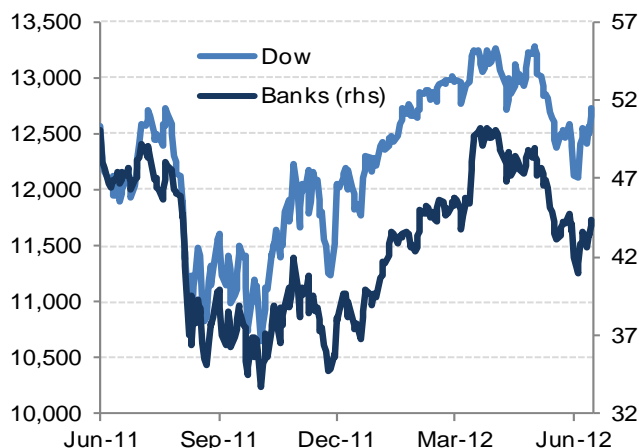
Graph 8
BBVA US Recession Probability Model
(Recession episodes in shaded areas, %)



Source: BBVA Research

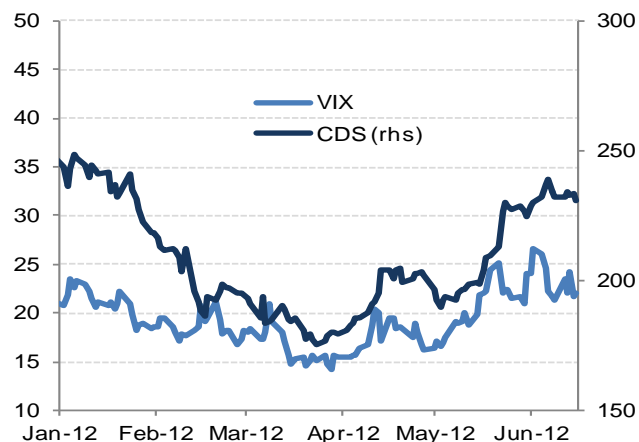
Financial Markets

Graph 9
Stocks
(Index, KBW)



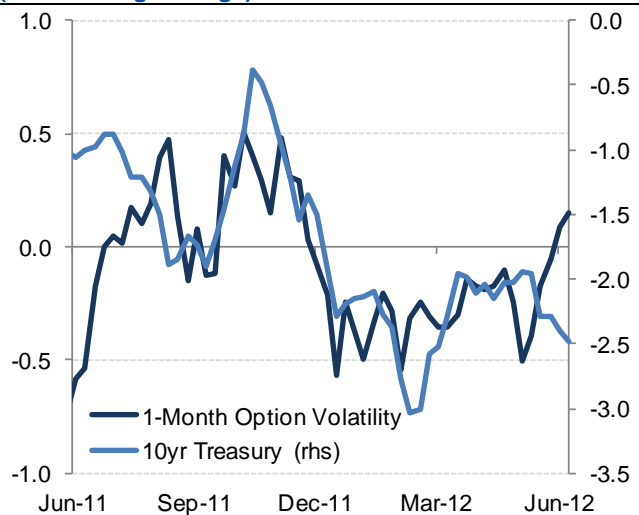
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



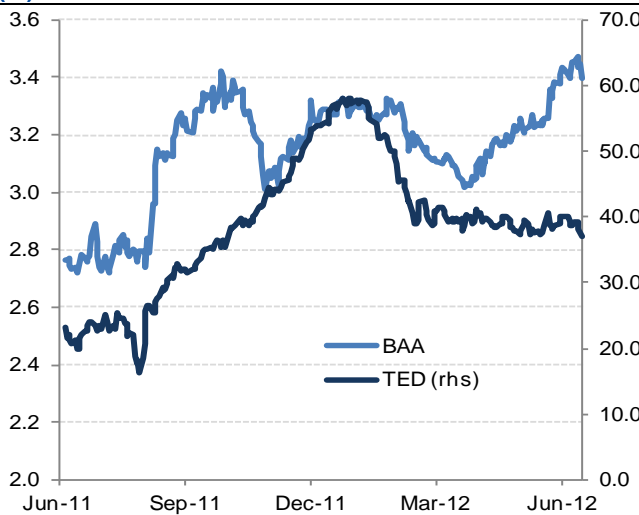
Source: Bloomberg & BBVA Research

Graph 11
Option Volatility & Real Treasury
(52-week avg. change)



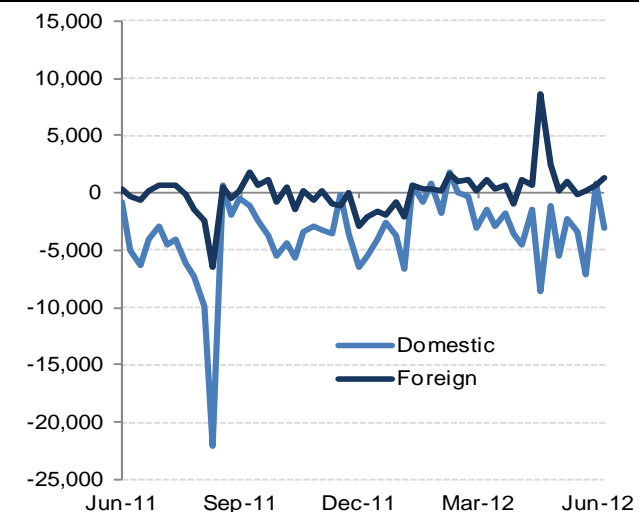
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



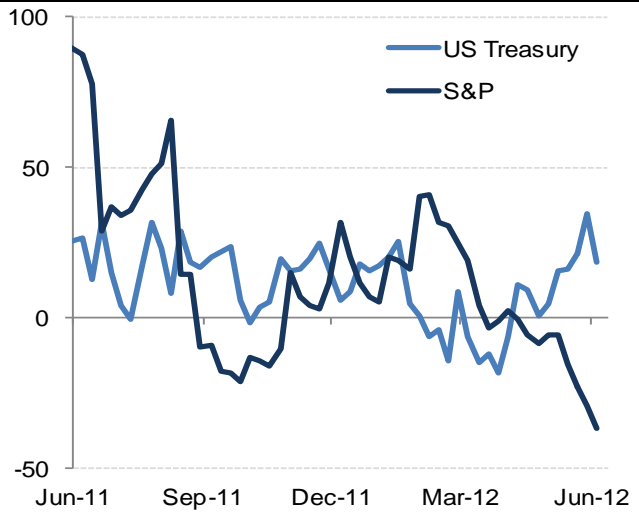
Source: Bloomberg & BBVA Research

Graph 13
Long-Term Mutual Fund Flows
(US\$Mn)



Source: Haver Analytics & BBVA Research

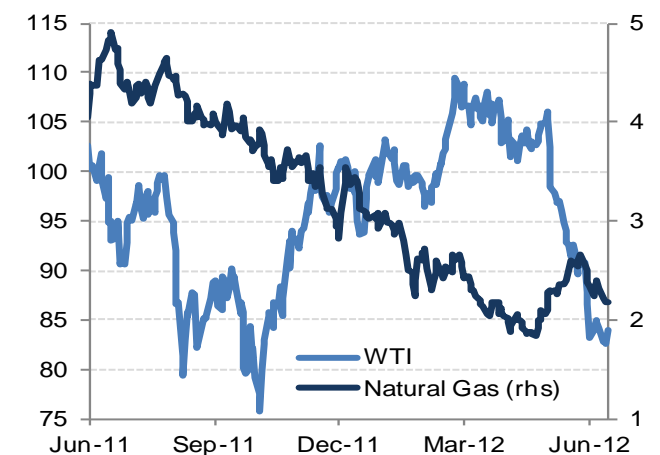
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

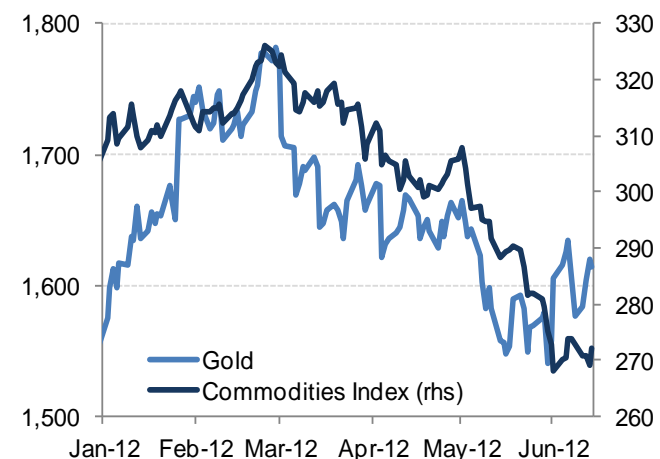
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



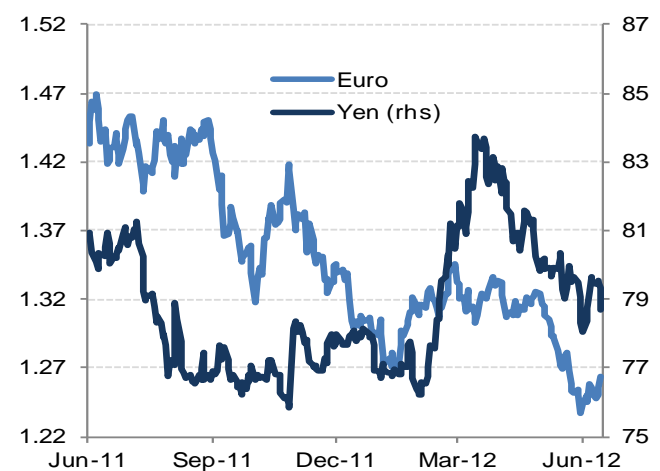
Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
(US\$ & Index)



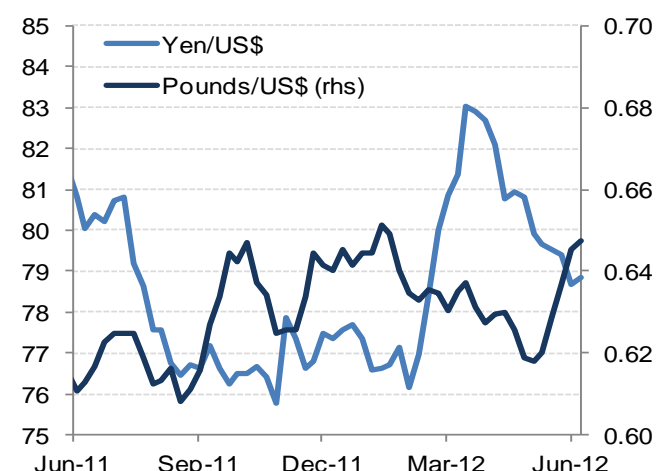
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



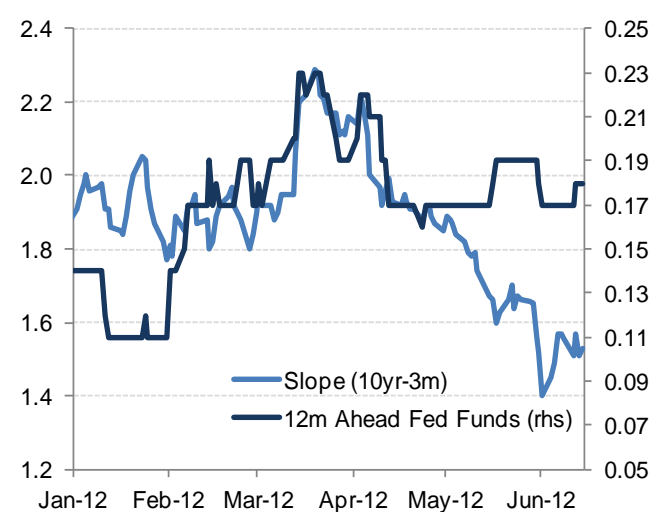
Source: Bloomberg & BBVA Research

Graph 18
6-Month Forward Exchange Rates
(Yen & Pound / US\$)



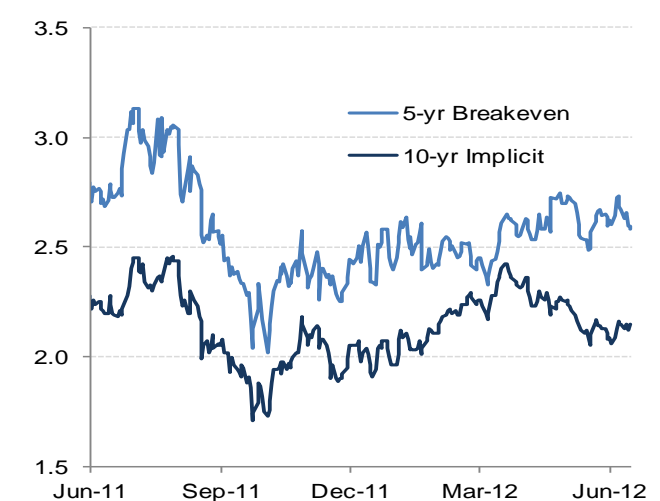
Source: Haver Analytics & BBVA Research

Graph 19
Fed Futures & Yield Curve Slope
(% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 20
Inflation Expectations
(%)



Source: Bloomberg & BBVA Research

Interest Rates

Table 1

Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.10	14.10	14.10	13.73
New Auto (36-months)	3.43	3.07	3.13	3.71
Heloc Loan 30K	5.56	5.56	5.52	5.52
5/1 ARM*	2.80	2.84	2.83	3.27
15-year Fixed Mortgage *	2.98	2.94	3.04	3.67
30-year Fixed Mortgage *	3.71	3.67	3.79	4.50
Money Market	0.72	0.72	0.72	0.62
2-year CD	0.90	0.90	0.90	1.06

*Freddie Mac National Mortgage Homeowner Commitment US
Source: Bloomberg & BBVA Research

Table 1

Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
1M Fed	0.17	0.17	0.16	0.10
3M Libor	0.47	0.47	0.47	0.25
6M Libor	0.74	0.74	0.74	0.40
12M Libor	1.07	1.07	1.07	0.73
2yr Sw ap	0.56	0.58	0.67	0.64
5yr Sw ap	0.96	1.02	1.10	1.84
10Yr Sw ap	1.74	1.82	1.85	3.09
30yr Sw ap	2.42	2.51	2.49	3.94
7day CP	0.30	0.29	0.19	0.14
30day CP	0.40	0.37	0.34	0.17
60day CP	0.44	0.37	0.42	0.23
90day CP	0.44	0.34	0.46	0.26

Source: Bloomberg & BBVA Research

Quote of the Week

President Barack Obama

Remarks by the President on the Economy – Cleveland, Ohio

14 June 2012

"I believe that you can't bring down the debt without a strong and growing economy. And I believe you can't have a strong and growing economy with a strong and growing middle class. This has to be our North Star – an economy that's built not from the top down, but from a growing middle class, that provides ladders of opportunity for folks who aren't yet in the middle class."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
18-Jun	NAHB Housing Market Index	JUN	27.00	28.00	29.00
19-Jun	Housing Starts	MAY	720K	721K	717K
19-Jun	Housing Starts (MoM)	MAY	0.42%	0.60%	2.60%
19-Jun	Building Permits	MAY	725K	729K	715K
19-Jun	Building Permits (MoM)	MAY	1.40%	0.80%	-7.00%
20-Jun	FOMC Meeting Announcement	JUN	0.25%	0.25%	0.25%
21-Jun	Initial Jobless Claims	16-Jun	380K	380K	386K
21-Jun	Continuing Claims	9-Jun	3280K	3275K	3278K
21-Jun	Existing Home Sales	MAY	4.65M	4.57M	4.62M
21-Jun	Existing Home Sales (MoM)	MAY	0.65%	-1.10%	3.40%
21-Jun	Philadelphia Fed Survey	JUN	2.00	0.00	-5.80
21-Jun	Leading Indicators	MAY	0.10%	0.10%	-0.10%

Forecasts

	2011	2012	2013	2014
Real GDP (% SAAR)	1.7	2.3	2.2	2.5
CPI (YoY %)	3.2	2.5	2.2	2.4
CPI Core (YoY %)	1.7	1.9	1.8	1.9
Unemployment Rate (%)	9.0	8.2	7.8	7.4
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.50
10Yr Treasury (eop, % Yield)	2.0	2.2	2.7	3.1
US Dollar/ Euro (eop)	1.31	1.25	1.31	1.31

Note: Bold numbers reflect actual data

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