

# Economic Watch

US

Houston, July 3, 2012  
Economic Analysis

US

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## Monthly US Outlook

### Will Economic Activity Gain Momentum in 2H12?

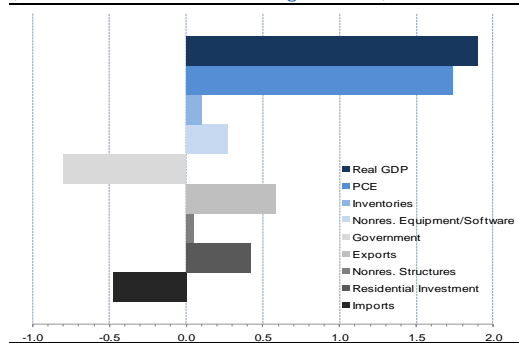
- Slowing manufacturing activity poses a concern for the recovery in 2H12
- We expect that growth in Q2 and Q3 will be slightly stronger than in Q1
- The FOMC has extended OT and remains ready to act again if needed

Throughout the past month, economic news have hinted at a slowing recovery to start 2H12. Despite some positive developments in Europe, data in the U.S. have been less-than-exciting. Real GDP growth for the first quarter remained at 1.9% QoQ annualized on a seasonally-adjusted basis for the final estimate, reflecting the slower-than-expected activity that characterized the earlier months. The final figure reflected downward revisions to personal consumption expenditures and inventory investment which were offset by upward revisions to nonresidential fixed investment, residential investment, and net exports. Nonresidential fixed investment was revised up significantly, from 1.9% to 3.1%, mostly due to a boost in structures to 1.9% from the second estimate of -3.3%. This is particularly encouraging for 2Q12 GDP growth and the possible contribution from construction. However, now we are seeing similar slowing in other economic data, with most concern stemming from mixed manufacturing reports. The latest ISM Manufacturing Index for June suggests contracting activity for the first time since July 2009, falling in line with reports from recent regional Federal Reserve surveys. Although many of the indices continue to show increasing activity in production and employment, contracting new orders imply much slower manufacturing growth in the coming months. Still, industrial production has shown some strength over 1Q12, increasing 0.5% on average compared to only 0.2% in the first quarter. Looking ahead to the coming quarters, we expect that growth will be slightly stronger than in 1Q12, averaging at least 2.0% QoQ SAAR for 2Q12 and 3Q12. Our current baseline scenario assumes 2.3% real GDP growth in 2012; however, downside risks for 2012 and 2013 annual growth projections have increased considerably. As we discussed in our earlier briefs, significant declines in oil prices have created a downward bias for our headline inflation scenario. Our models indicate that the bias could be around 0.4-0.5pp for 2012.

The latest data influenced the FOMC members to downgrade their GDP forecast for the next three years, with the bulk of the revision in the short-term. This downgrade of the forecast is somewhat stronger than expected, but it does bring the FOMC's forecasts closer to reality, as we have often commented that their central tendency forecast was overly optimistic. The usual persistent drags on the economy still exist - a depressed housing sector, household deleveraging, fiscal consolidation in government, and strains from Europe's sovereign debt crisis. Inflation is no longer a concern with oil prices pushing to the lowest levels seen in nearly 18 months. As expected, the pace of reduction in the unemployment rate is progressing insufficiently quickly for the FOMC, and thus they extended Operation Twist until the end of the year by \$267bn to continue a highly accommodative stance of monetary policy. The Fed believes that these purchases will push investors to more risky securities. However, we expect that they will have only limited additional impact on long-term rates, though extending this program will buy some time for the FOMC. Over the next 6 months, we will have a better idea of the outcome of elections, fiscal consolidation negotiations, and also a definitive read on the extent of employment creation. Therefore, the latest action leaves the FOMC ready to implement more stimulus if needed, even before the elections. Given that the U.S. economy has already experienced a number of unorthodox monetary policies and flight to safety has resulted in low long-term lending rates, the FOMC may have to become increasingly more creative, possibly focusing on mortgage rates. Overall, the probability of additional large-scale asset purchases has increased, but the exact trigger or composition of those purchases will depend on the evolution of the data, Europe and political events.

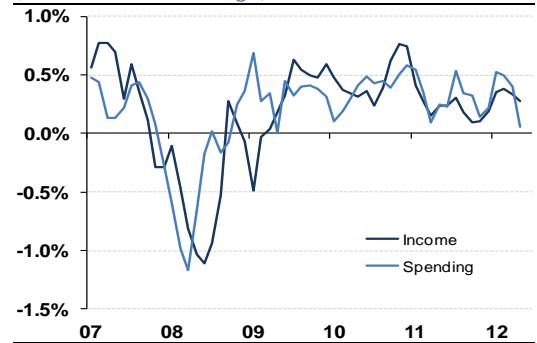
### Economic Indicators

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



Source: BEA and BBVA Research

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



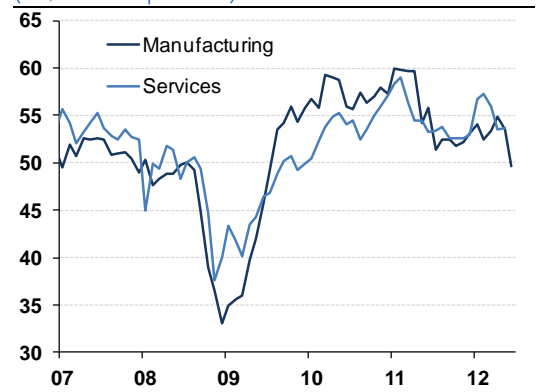
Source: BEA and BBVA Research

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



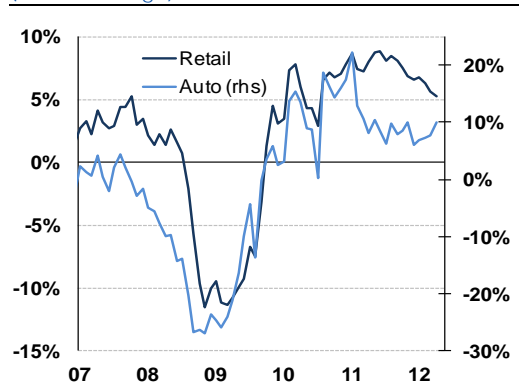
Source: Conference Board and BBVA Research

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



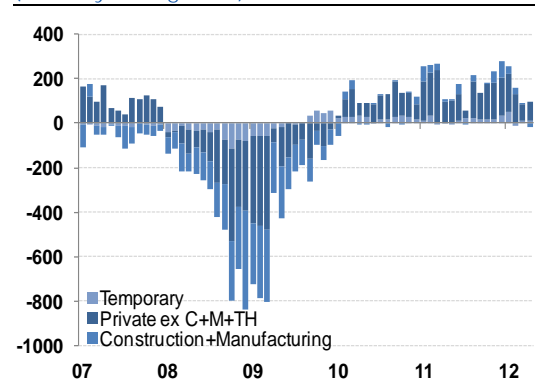
Source: ISM and BBVA Research

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

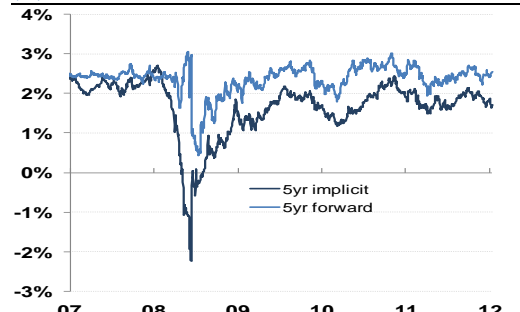
### Economic Indicators

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



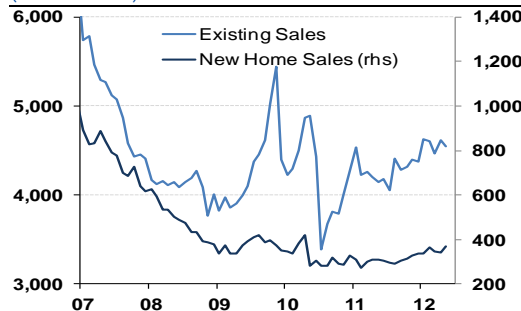
Source: BLS and BBVA Research

Graph 8  
Inflation Expectations  
(%)



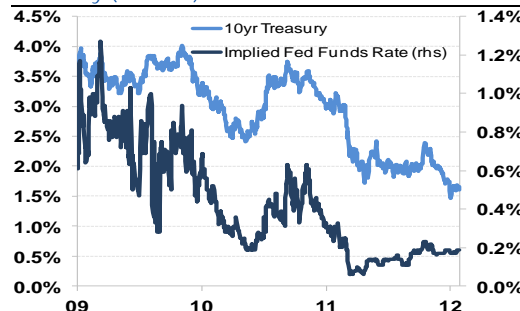
Source: Federal Reserve Board and BBVA Research

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	1.9	1.7	<b>2.3</b>	<b>2.2</b>
Real GDP (Contribution, pp)						
PCE	1.2	1.5	1.7	1.5	<b>1.5</b>	<b>1.5</b>
Gross Investment	0.2	2.6	0.8	0.6	<b>1.2</b>	<b>0.8</b>
Non Residential	1.5	0.5	0.3	0.8	<b>0.8</b>	<b>0.8</b>
Residential	0.0	0.3	0.4	0.0	<b>0.3</b>	<b>0.2</b>
Exports	0.6	0.4	0.6	0.9	<b>0.7</b>	<b>0.9</b>
Imports	-0.2	-0.6	-0.5	-0.8	<b>-0.6</b>	<b>-1.0</b>
Government	0.0	-0.8	-0.8	-0.4	<b>-0.4</b>	<b>0.0</b>
Unemployment Rate (%)	9.1	8.7	8.3	9.0	<b>8.2</b>	<b>7.8</b>
Average Monthly Nonfarm Payroll (K)	128	164	226	153	<b>165</b>	<b>203</b>
CPI (YoY %)	3.8	3.3	2.8	3.2	<b>2.5</b>	<b>2.2</b>
Core CPI (YoY %)	1.9	2.2	2.2	1.7	<b>1.9</b>	<b>1.8</b>
Fiscal Balance (% GDP)	-	-	-	-8.7	<b>-7.6</b>	<b>-5.0</b>
Current Account (bop, % GDP)	-2.9	-3.1	-3.6	-3.2	<b>-3.1</b>	<b>-3.3</b>
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	<b>0.25</b>	<b>0.25</b>
S&P Case-Shiller Index	131.0	125.9	123.3	128.2	<b>124.8</b>	<b>124.2</b>
10-Yr Treasury (% Yield, eop)	2.0	2.0	2.2	2.0	<b>2.2</b>	<b>2.7</b>
U.S. Dollar / Euro (eop)	1.38	1.31	1.32	1.31	<b>1.25</b>	<b>1.31</b>
Oil Prices (dpb, average)	113.3	109.5	118.4	111.3	<b>120.4</b>	<b>106.6</b>

Source: BBVA Research

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