

US Weekly Flash

Highlights

- **FOMC Minutes Suggest Continued Divide Among Committee Members**

- The minutes of the FOMC meeting from three weeks ago coincided with an expansion of the maturity extension program and a downgrade of the Fed's forecast for US growth. The meeting minutes highlighted four key points: 1) the composition of risks facing the US and the commensurate implications for policy, 2) the degree of brightness in the housing market and prospects for contribution from this sector to GDP, 3) the hawkish wing's rehashing of old arguments in a new light and 4) the question over the exact limit of large-scale asset purchases on the functioning of the Treasury market.
- One new wrinkle in the Fed's story compared to six months ago is a sharp drop in the price of oil which has subsequently caused downward revisions to private sector forecasts for inflation. Most participants view risks to inflation as roughly balanced. This last trend in inflation has now opened the door to potential new policy action given that almost all members saw unemployment as elevated relative to their desired level. Secondly, while some housing indicators are perking up relative to extremely distressed levels, most FOMC participants believed the recovery in this sector would be only gradual and noted the spotty nature of recovery across geographic areas. Third, the text of the minutes show that the hawkish wing still has yet to abandon its theoretical opposition to viewing labor markets as rife with excess resource slack. Even with private forecasters lowering inflation forecasts due to the drop in oil prices, FOMC hawks still adamantly argue that inflation should be dropping more quickly if excess labor resource slack existed. To counter this argument, some participants argue that inflation declines are less responsive to resource slack due to downward nominal wage rigidity. The take-away from this discussion is that more data will be necessary to put this theoretical clash between participants aside.
- Fourth, and most importantly and quite prudently, the FOMC is trying to discover how much large-scale asset purchases (LSAP) may be conducted before the liquidity and price discovery in the Treasury market is negatively affected. According to the minutes, "members generally agreed that such risks seemed low at present," thus showing that LSAP is a usable tool at present if economic conditions warrant more action. A recent speech by Williams noted that consumers were in a "defensive crouch" and a speech by Evans noted the importance of decomposing breakeven inflation rates into real interest rate risk and inflation risk. As such, we will closely be watching the continued evolution of consumption, employment, and risk premia in Treasury markets going forward. Overall, the discussion in the minutes did not change our view of the growing likelihood of additional quantitative easing, but it does show that Bernanke has still a number of participants to convince before providing additional accommodation, though recent data continues to embolden his presumed position towards more action.

- **Consumer Credit and Trade Data Surprise to the Upside**

- Total outstanding consumer credit increased \$17.1bn in May following an upwardly revised \$10bn gain in April. Surprisingly, revolving credit jumped \$8bn to mark the largest monthly increase since November 2007. The data is an encouraging sign for consumer activity though it conflicts with the latest slowing in other related data, such as retail sales and personal consumption expenditures. On the other hand, nonrevolving credit growth decelerated slightly despite continued gains in student loans, increasing only \$9.1bn following a \$13.5bn gain in the previous month. Both components continue to accelerate on a YoY basis.
- The international trade balance also surprised to the upside for May, with the deficit narrowing to -\$48.7bn compared to -\$50.6bn in April, in large part due to an improvement in the petroleum gap. Total exports rebounded 0.2% after declining 0.9% in the previous month, while imports fell 0.7%. While trade conditions remain vulnerable to slowing activity in Europe and China, the latest data hint at a more positive contribution to GDP growth in 2Q12.

Week Ahead

Retail Sales, Ex Auto (June, Monday 8:30 ET)

Forecast: 0.1%, -0.1%

Consensus: 0.3%, 0.1%

Previous: -0.2%, -0.4%

Falling gas prices have dragged down nominal retail sales in recent months, yet trends may be slightly more positive in June. Auto sales rebounded from a decline in the previous month, with gains in both the car and truck components that should lift the headline retail sales figure. Furthermore, real retail sales actually increased 0.1% in May, suggesting that lower gas prices have finally encouraged some increased spending despite weakening consumer confidence reports. On the downside, the chain store sales report for the month suggests a slower pace of YoY growth compared to May, which is discouraging for the ex-auto estimate. Other retail sales reports also note some of the slowest weekly growth rates since January.

Consumer Price Index, Core (June, Tuesday 8:30 ET)

Forecast: -0.1%, 0.2%

Consensus: 0.1%, 0.2%

Previous: -0.3%, 0.2%

Consumer prices are expected to decline for the fourth consecutive month, mostly on account of lower gas prices. Crude oil prices in June declined to the lowest levels in more than a year, falling at the fastest monthly pace since December 2008. Commodity price indices have also declined, while natural gas prices continue to rise but at a slowing pace. Wage growth accelerated in June, which could put upward pressure on core inflation. Furthermore, robust increases in shelter and healthcare prices are still driving the core figure, which is expected to remain steady near 0.2% growth for the fourth straight month.

Industrial Production (June, Tuesday 9:15 ET)

Forecast: 0.2%

Consensus: 0.4%

Previous: -0.1%

Industrial production has declined in two of the last three months, mostly due to slowing in the manufacturing sector. The manufacturing production index dropped 0.4% in May, below February and April's levels. Furthermore, various manufacturing reports have indicated weaker production for the month along with general slowdowns in new orders, suggesting that the sector's contribution to total output will be limited for June. On the other hand, utilities and mining output should remain positive for the month in line with the usual spring and summer trends.

Housing Starts and Building Permits (June, Wednesday 8:30 ET)

Forecast: 720K, 750K

Consensus: 760K, 768K

Previous: 708K, 780K

Housing starts are expected to improve modestly in June while building permits are likely to decline slightly following somewhat of a mixed report in May. Housing starts were relatively weak in the previous month but remained well-above levels seen in 2011. On the other hand, building permits jumped significantly in May and suggest that new home starts will be stronger in the coming months. Furthermore, homebuilder confidence has reached the highest level of the recovery, suggesting that positive momentum in housing activity likely continued in June.

Market Impact

This week markets will gain a better understanding of whether slowing trends in economic activity will continue in the summer months. Continued weakness in industrial production and other manufacturing indicators will surely incite market anxiety over whether the recovery's momentum has stalled. Strong retail sales data could offset some of this pessimism, particularly given the expected impact from persistent declines in gas prices.

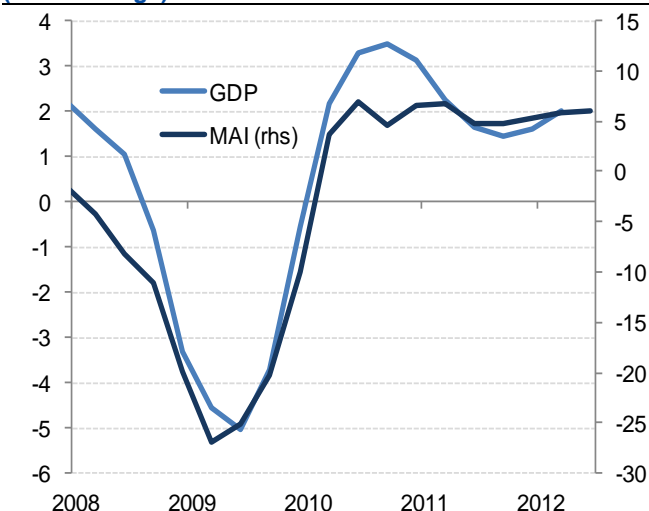
Economic Trends

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



Source: BBVA Research

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



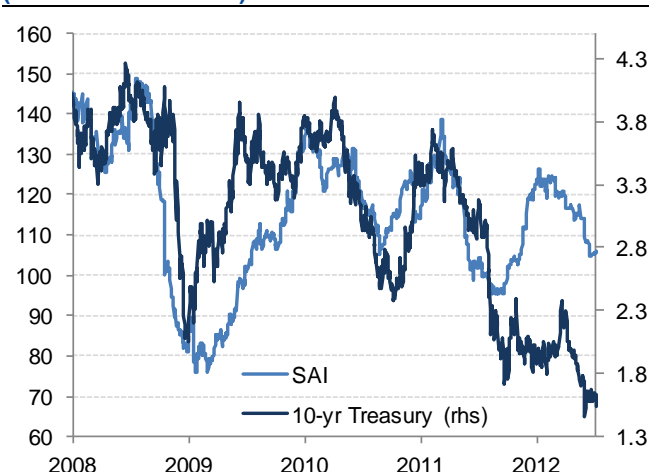
Source: BBVA Research & BEA

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



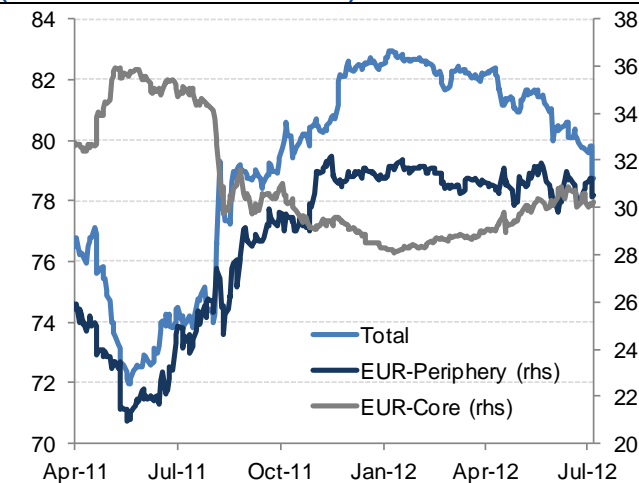
Source: BBVA Research

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



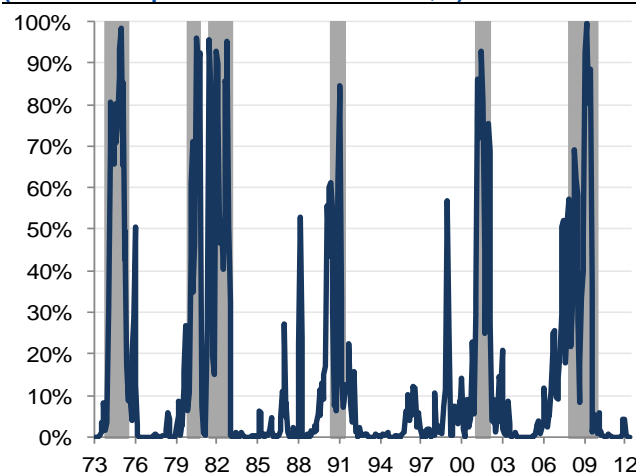
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

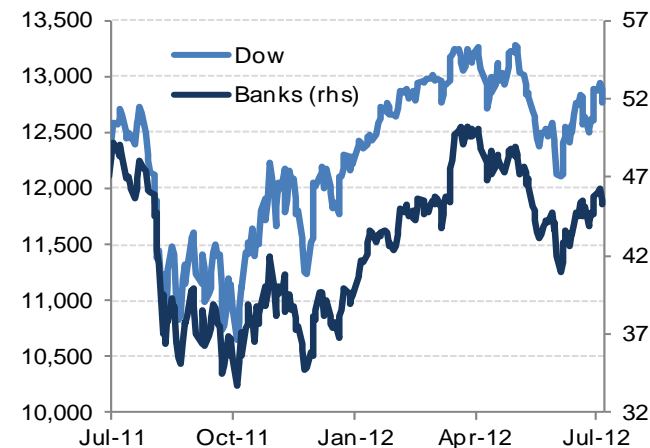
Graph 8
**BBVA US Recession Probability Model
(Recession episodes in shaded areas, %)**



Source: BBVA Research

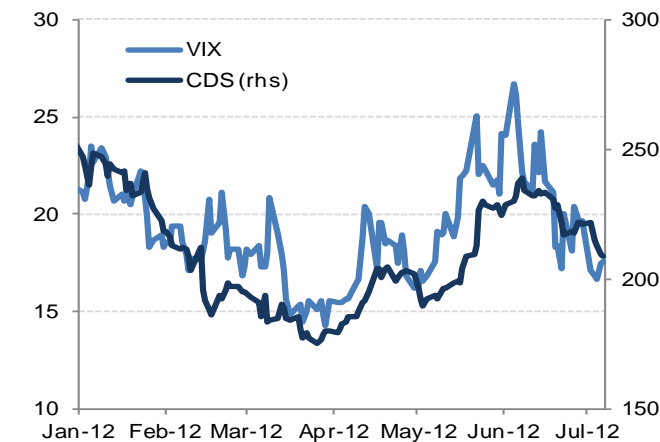
Financial Markets

Graph 9
Stocks
(Index, KBW)



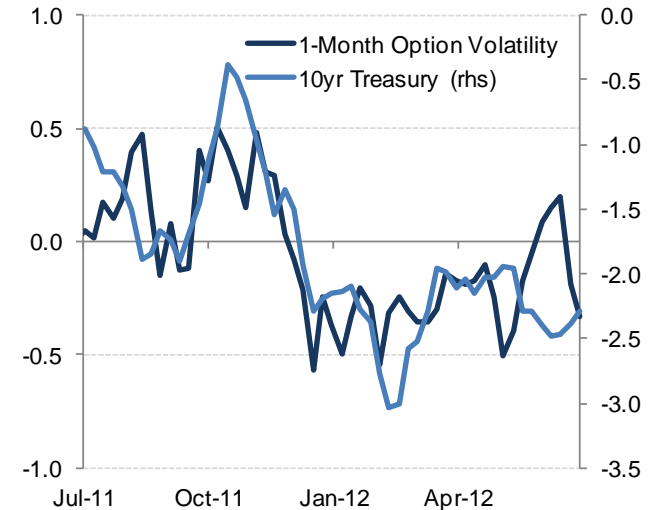
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



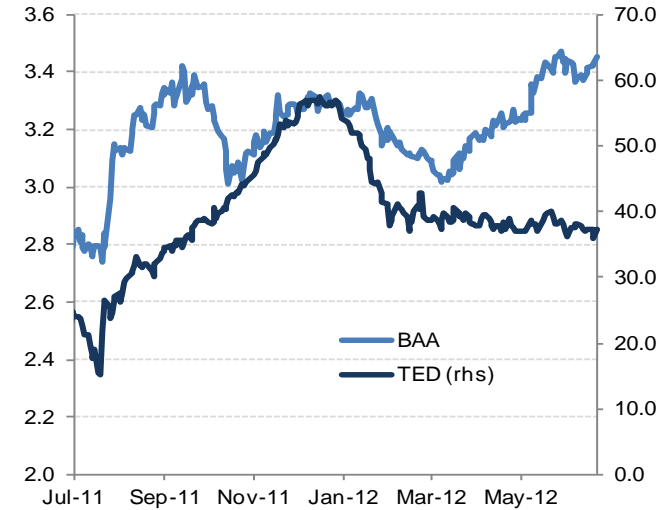
Source: Bloomberg & BBVA Research

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



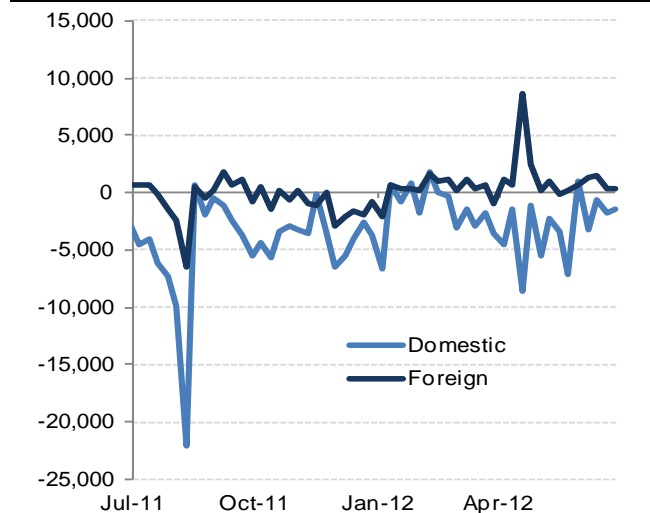
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



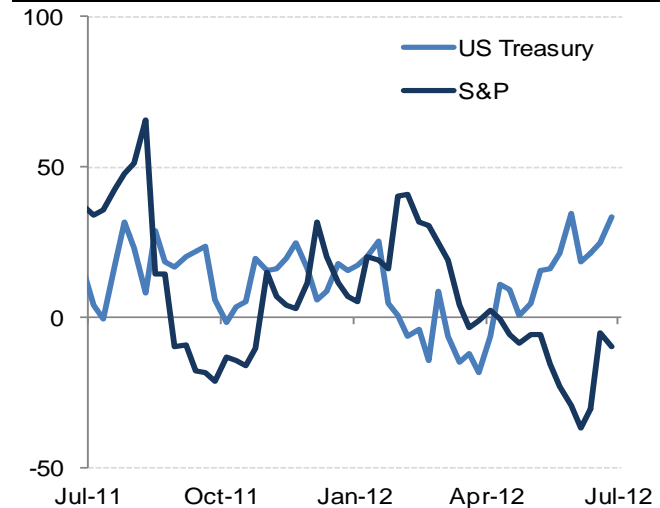
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

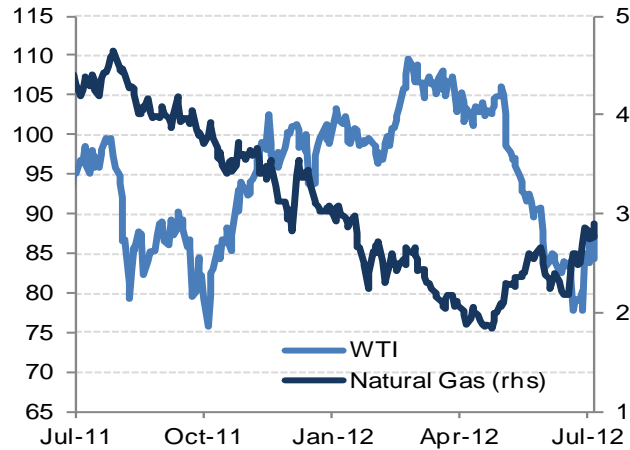
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

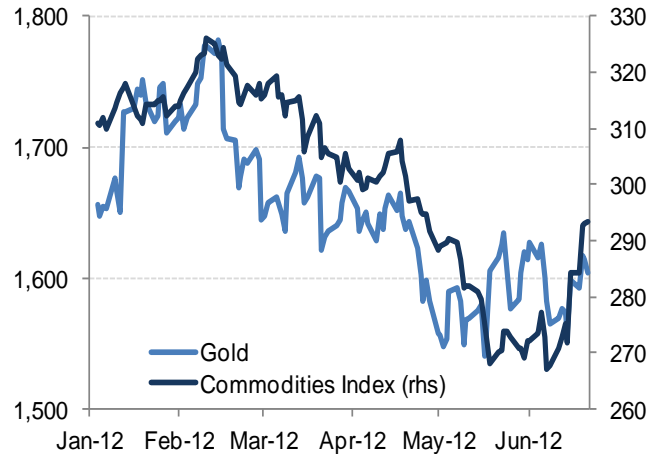
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



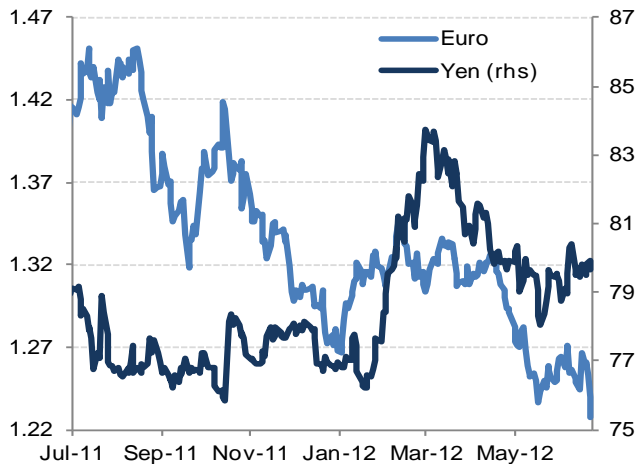
Source: Bloomberg & BBVA Research

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



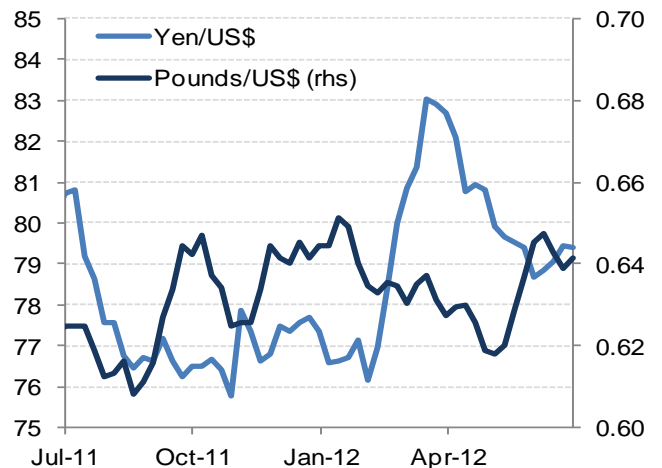
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



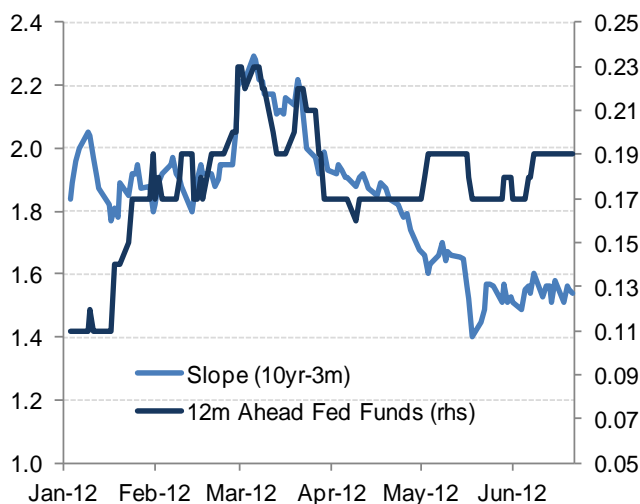
Source: Bloomberg & BBVA Research

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



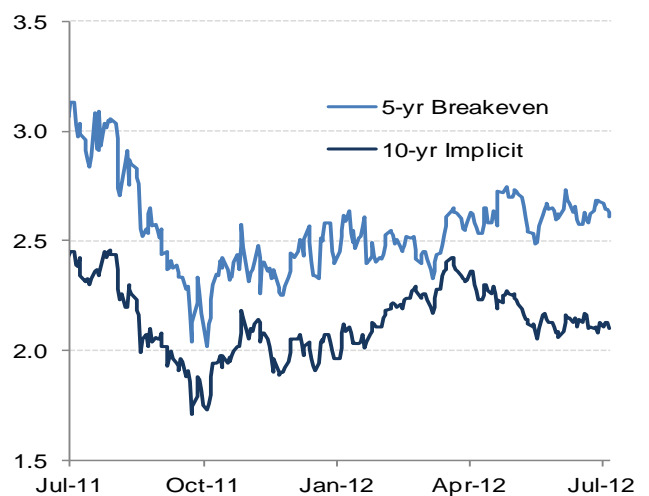
Source: Haver Analytics & BBVA Research

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)	3.11	3.11	3.07	3.68
Heloc Loan 30K	5.51	5.52	5.56	5.55
5/1 ARM*	2.79	2.79	2.84	3.30
15-year Fixed Mortgage *	2.89	2.94	2.94	3.75
30-year Fixed Mortgage *	3.62	3.66	3.67	4.60
Money Market	0.72	0.72	0.72	0.63
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	0.09	0.17	0.07
3M Libor	0.46	0.46	0.47	0.25
6M Libor	0.74	0.73	0.74	0.40
12M Libor	1.07	1.07	1.07	0.74
2yr Sw ap	0.52	0.55	0.58	0.64
5yr Sw ap	0.90	0.97	1.02	1.88
10Yr Sw ap	1.70	1.78	1.82	3.17
30yr Sw ap	2.43	2.50	2.51	3.99
7day CP	0.29	0.31	0.29	0.16
30day CP	0.24	0.25	0.37	0.21
60day CP	0.26	0.29	0.37	0.27
90day CP	0.32	0.40	0.34	0.26

Source: Bloomberg & BBVA Research

Quote of the Week

James Bullard, Federal Reserve Bank of St. Louis President and CEO
The Global Economy and the European Sovereign Debt Crisis
10 July 2012

"The most likely way forward continues to be a long period of debt paydown and sluggish growth, both in Europe and the U.S., and that the most pressing policy issue is to accept this path and prevent any additional problems from developing as we press ahead."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
16-Jul	Advance Retail Sales	JUNE	0.10%	0.30%	-0.20%
16-Jul	Retail Sales Less Autos	JUNE	0.00%	0.10%	-0.40%
16-Jul	Empire State Manufacturing Survey	JULY	1.00	5.00	2.29
16-Jul	Business Inventories	MAY	0.20%	0.30%	0.30%
17-Jul	Consumer Price Index (MoM)	JUNE	-0.10%	0.10%	-0.30%
17-Jul	CPI Ex Food & Energy (MoM)	JUNE	0.20%	0.20%	0.20%
17-Jul	Industrial Production	JUNE	0.20%	0.40%	-0.10%
17-Jul	Capacity Utilization	JUNE	79.10%	79.20%	79.00%
17-Jul	NAHB Housing Market Index	JULY	29.00	--	29.00
18-Jul	Housing Starts	JUNE	720K	760K	708K
18-Jul	Housing Starts (MoM)	JUNE	1.70%	7.30%	-4.80%
18-Jul	Building Permits	JUNE	750K	768K	780K
18-Jul	Building Permits (MoM)	JUNE	-3.85%	-2.10%	7.90%
19-Jul	Initial Jobless Claims	14-Jul	375K	--	350K
19-Jul	Continuing Claims	7-Jul	3300K	--	3304K
19-Jul	Existing Home Sales	JUNE	4.60M	4.65M	4.55M
19-Jul	Existing Home Sales (MoM)	JUNE	1.10%	2.20%	-1.50%
19-Jul	Philadelphia Fed Survey	JULY	-7.00	-12.00	-16.60
19-Jul	Leading Indicators	JUNE	0.10%	-0.10%	0.30%

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. Forecasts pending revisions.

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