

# US Weekly Flash

## Highlights

### • **Bernanke Highlights Policy Options in Jackson Hole Speech**

- Ben Bernanke's speech at the Jackson Hole Economic Symposium did not meet market expectations in the form of a QE3 announcement. Instead, the Chairman discussed in depth the Fed's actions since the recession and the costs and benefits of additional accommodation. First, Bernanke commented on the effectiveness of balance sheet tools that the Fed has utilized thus far, noting that the two rounds of quantitative easing and Operation Twist have lowered 10-year Treasury yields between 80 and 120 basis points, an effect that is "economically meaningful". He also mentioned that the expansion of securities purchases just shortly after the recession likely influenced the recovery of equity prices in March 2009, influencing both consumption and investment activity and lowering the risk of deflation by increasing inflation expectations. According to the Fed's models of the US economy, the two rounds of quantitative easing have increased output by almost 3% and helped add more than 2 million jobs in the private sector.
- In addition, Bernanke highlighted the Fed's communication tools, referring to the policy guidance as an appropriate "path of policy" rather than "an unconditional promise". Currently, the FOMC expects rates to be exceptionally low through "at least late 2014", but Bernanke provided reasons for possibly extending this guidance. He argued that it might be necessary to "keep rates low for a longer time than implied by policy rules developed during more normal periods", pointing to a cautious interest rate policy.
- Bernanke discussed the costs and benefits of nontraditional monetary policy tools such as LSAPs, with various costs seemingly manageable in order to reach the potential benefit of better economic outcomes. These costs included potential damage to securities markets, reduced confidence regarding the Fed's ability to exit smoothly, risks to financial stability, and the possibility of financial losses by the Fed if interest rates rise more than expected. While he made it clear that the decision to implement non-traditional tools is less clear-cut compared to more traditional options, the Fed is ready to act and use nontraditional monetary tools if economic conditions warrant.
- As in prior statements, Bernanke emphasized the major headwinds facing the economic recovery: weak housing activity, fiscal policy, tight credit conditions, and financial strains related to Europe. He mentioned, as in previous speeches and communications, that the fiscal cliff is a potential risk to growth in the short-term and Congress should "avoid a sharp near-term fiscal contraction" while solving medium- and long-term fiscal issues. Bernanke mentioned again that the Fed "will provide additional policy accommodation as needed", but he hinted at no commitment to taking action in September. Based on his comments today as well as recent macroeconomic news, we expect that the FOMC is more likely to announce an extension of policy guidance rather than additional quantitative easing, unless the employment report is significantly worse than expected for August.

### • **Revisions to Real PCE and Net Exports Boost 2Q12 GDP Growth**

- The second estimate for real GDP growth in 2Q12 came in at 1.7% on a QoQ seasonally-adjusted annualized basis, slightly higher than the initial figure of 1.5% released last month. Improvements in the underlying data mostly reflected upward revisions to personal consumption expenditures (PCE) and net exports. Offsetting these gains were downward revisions to private inventory investment and nonresidential fixed investment. The negative contribution from government spending was slightly less than previously estimated.
- Overall, the revised data are mostly positive and keep us on track to reach our baseline scenario of 2.1% growth for the year, even with the slowing momentum in 2H12. Personal consumption increased 0.4% in July, higher than the monthly average rate in 2Q12, signaling that PCE growth could be slightly stronger in 3Q12. The upward revision to net exports was mostly due to reduced imports, a sign that businesses remain highly uncertain regarding future demand conditions. However, exports continue to grow despite expected slowing in demand from Europe and China. Looking forward, we need to see real GDP growth near 1.4%, on average, for the third and fourth quarters in order to reach 2.1% growth for the year.

## Week Ahead

### ISM Manufacturing Index (August, Tuesday 10:00 ET)

Forecast: 49.9

Consensus: 50.0

Previous: 49.8

According to the ISM Index, manufacturing activity is the weakest in nearly three years, having contracted for two consecutive months. For August, we expect that the index will confirm the slowing trends as highlighted in various Federal Reserve surveys for the month. In fact, most major regional Fed manufacturing reports have shown decelerating rates of activity, with continued weakness in new orders. Surprisingly, manufacturing output has remained positive despite indications of falling demand. Employment has fared relatively well in the manufacturing sector, although increasing demand uncertainties could limit the sector's hiring in the coming months.

### Construction Spending (July, Tuesday 10:00 ET)

Forecast: 0.4%

Consensus: 0.4%

Previous: 0.4%

Construction spending is expected to increase in July at a similar pace as in the previous month. Total spending has grown for three straight months and mostly reflects the gradual improvements we have seen in housing activity, with private construction being the main driver of total outlays. Housing starts actually declined 1.1% in July, which could imply slower growth in private construction spending. However, we often see a one-month lag when comparing the two data series, so July's construction spending may be more reflective of the significant jump in housing starts seen in June. In terms of public spending, outlays are expected to be limited given pending austerity measures.

### ISM Non-Manufacturing Index (August, Thursday 10:00 ET)

Forecast: 53.0

Consensus: 52.5

Previous: 52.6

Unlike its manufacturing counterpart, the ISM Non-Manufacturing Index actually increased in July to suggest a slight acceleration in activity, with new orders and production still holding strong. Still, the index is much lower than it was in early 2012 and is far from the recovery peak reached in February 2011. Although the overall index has remained above 50, the employment index fell below this threshold for the first time in seven months, possibly hinting at fading optimism in the services sector. On the other hand, accelerating new orders points to increasing business activity in the coming months.

### Nonfarm Payrolls and Unemployment rate (August, Friday 8:30 ET)

Forecast: 130K, 8.3%

Consensus: 125K, 8.3%

Previous: 163K, 8.3%

The employment situation has been mixed to start the third quarter. In July, nonfarm payrolls increased significantly compared to growth rates seen in the previous months, but the unemployment rate ticked back up to 8.3%. In August, we expect that payrolls will increase at a slightly slower pace than in July, given that the monthly average for initial jobless claims is slightly higher for this month. Still, we expect that average job growth in 3Q12 should be higher than in 2Q12. However, it is unlikely that nonfarm payroll gains will be strong enough to bring down the unemployment rate, unless we also see another drop in the participation rate and shift in labor force flows.

### Market Impact

There is a lot of important economic news crammed into a holiday-shortened week, most notably the nonfarm payroll report for August. Employment data could be a turning point in regards to the upcoming Federal Reserve meeting, with lower-than-expected payroll growth increasing the probability of additional easing in September. Other important news will come from the ISM manufacturing report, where another month of contracting activity will surely increase market anxiety.

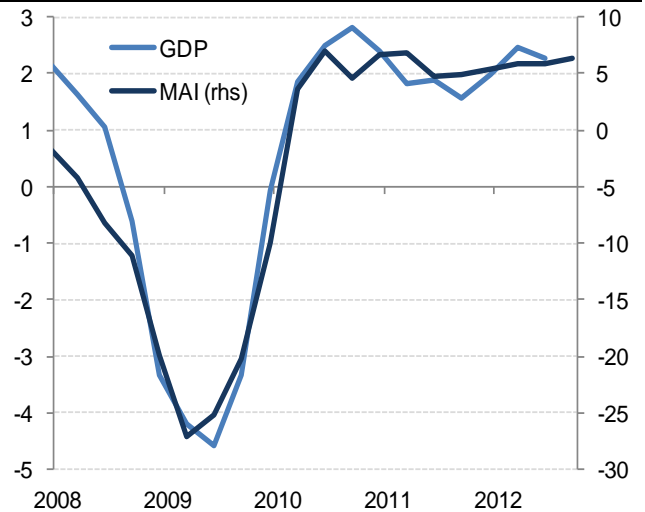
# Economic Trends

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



Source: BBVA Research

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



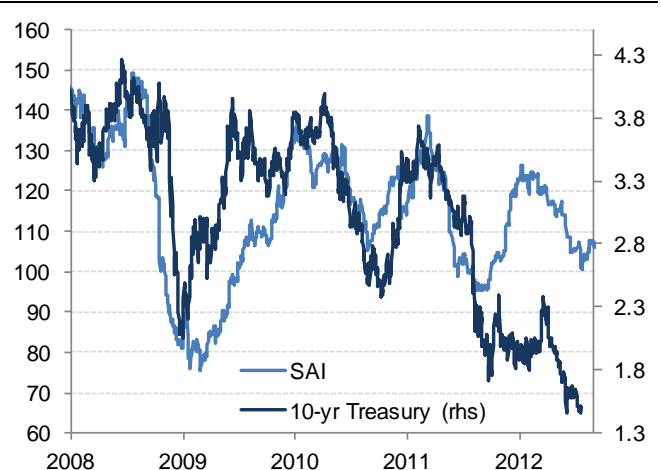
Source: BBVA Research & BEA

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



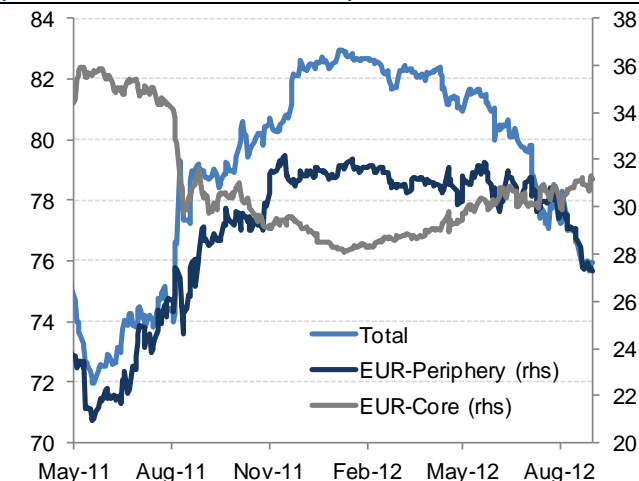
Source: BBVA Research

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



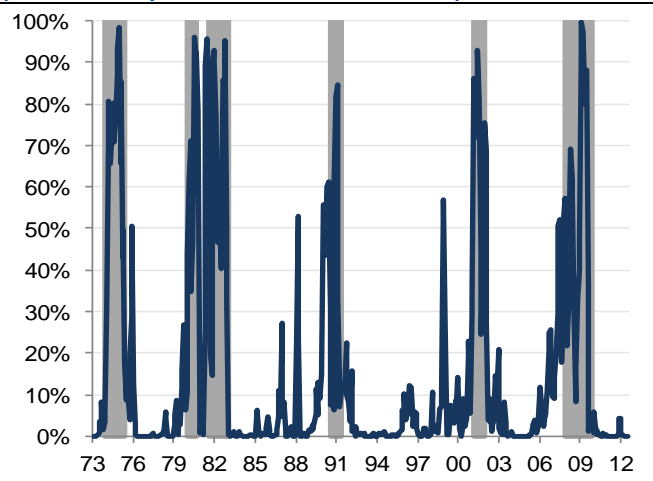
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

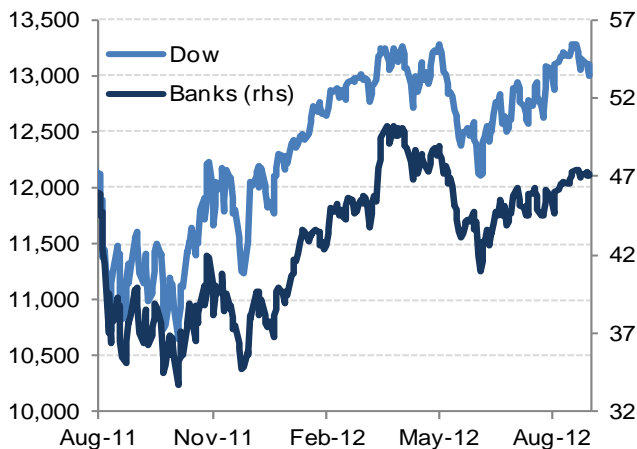
Graph 8  
**BBVA US Recession Probability Model**  
 (Recession episodes in shaded areas, %)



Source: BBVA Research

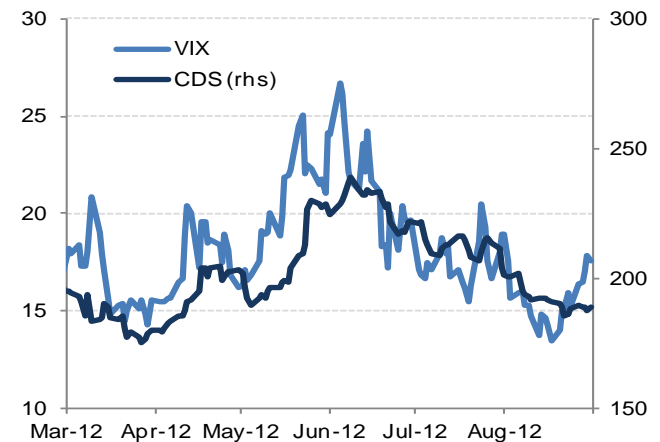
# Financial Markets

Graph 9  
**Stocks**  
**(Index, KBW)**



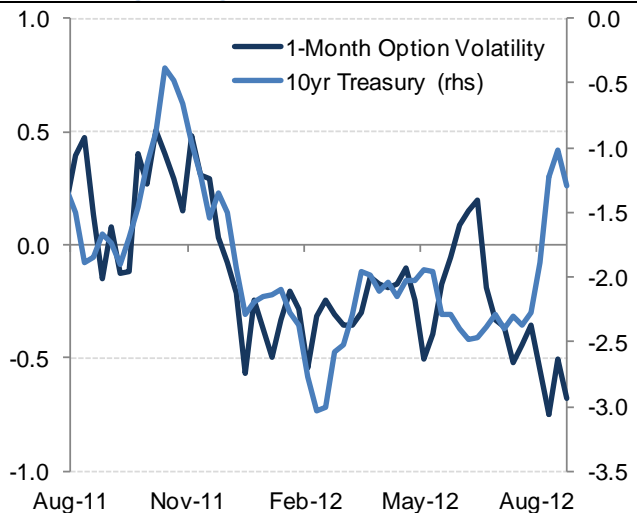
Source: Bloomberg & BBVA Research

Graph 10  
**Volatility & High-Volatility CDS**  
**(Indices)**



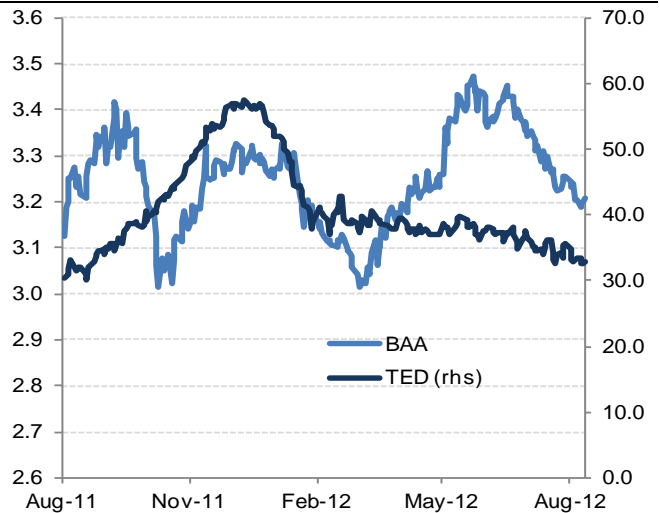
Source: Bloomberg & BBVA Research

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



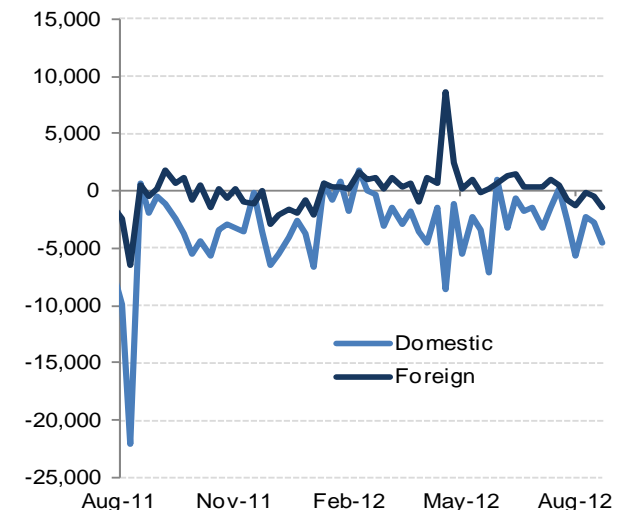
Source: Haver Analytics & BBVA Research

Graph 12  
**TED & BAA Spreads**  
**(%)**



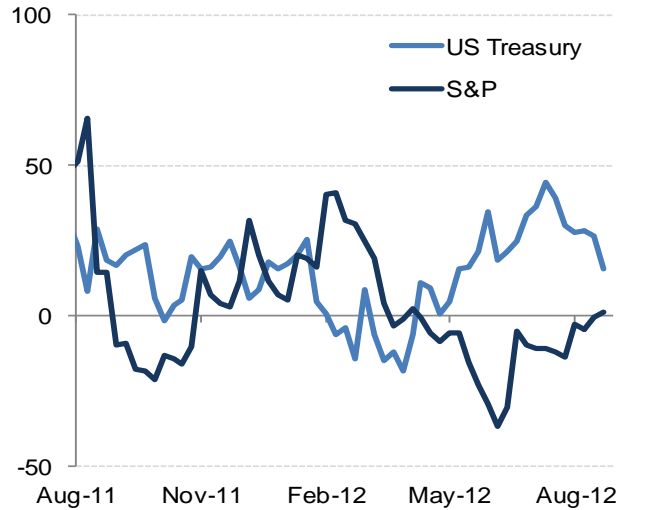
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

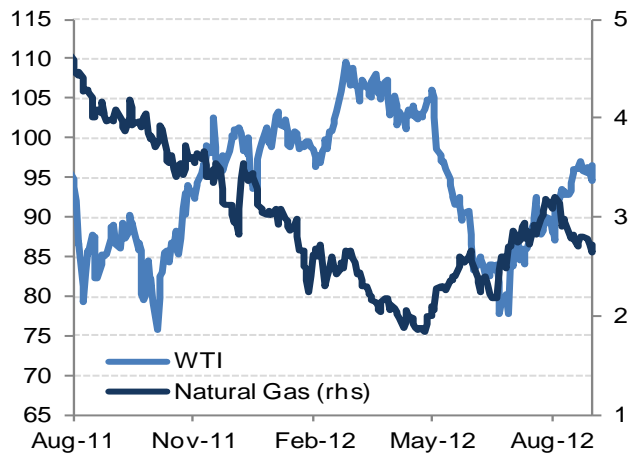
Graph 14  
**Total Reportable Short & Long Positions**  
**(Short-Long, K)**



Source: Haver Analytics & BBVA Research

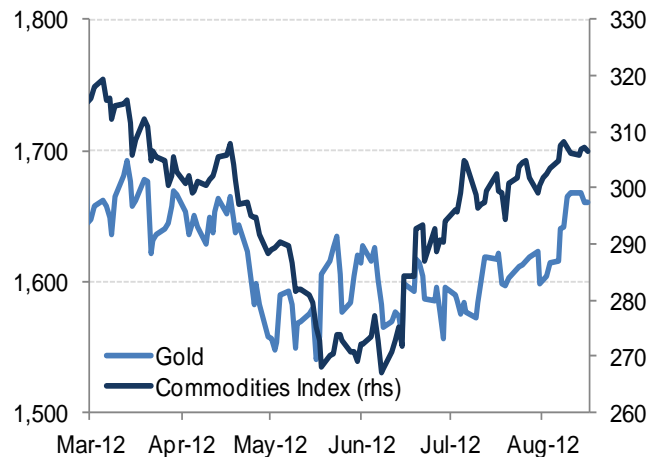
# Financial Markets

Graph 15  
**Commodities**  
(Dpb & DpMMBtu)



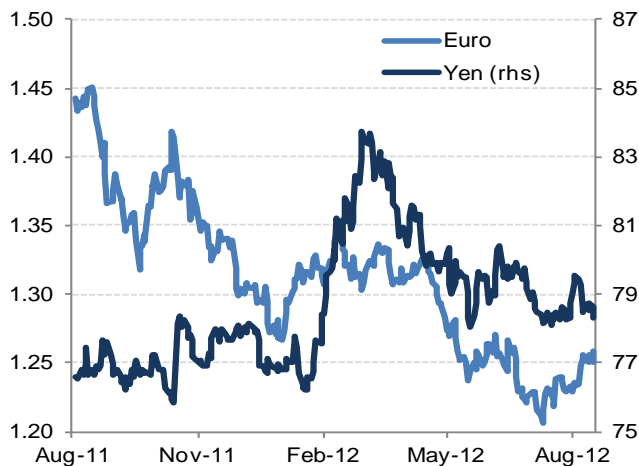
Source: Bloomberg & BBVA Research

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



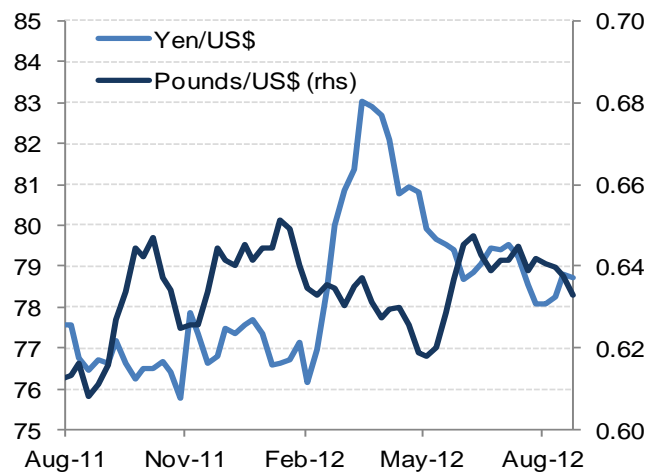
Source: Haver Analytics & BBVA Research

Graph 17  
**Currencies**  
(Dpe & Ypd)



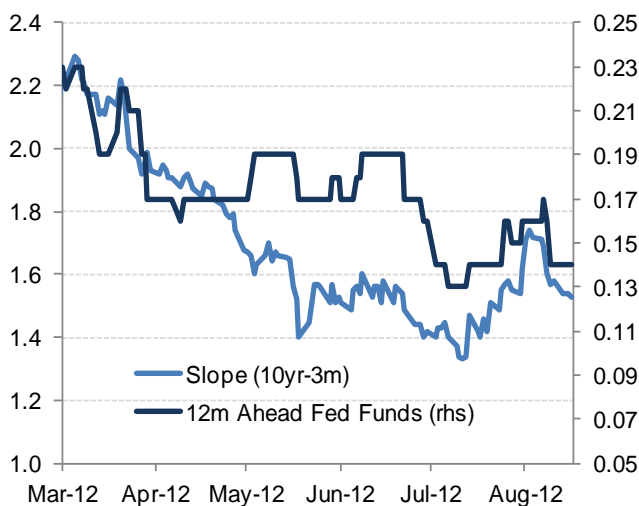
Source: Bloomberg & BBVA Research

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



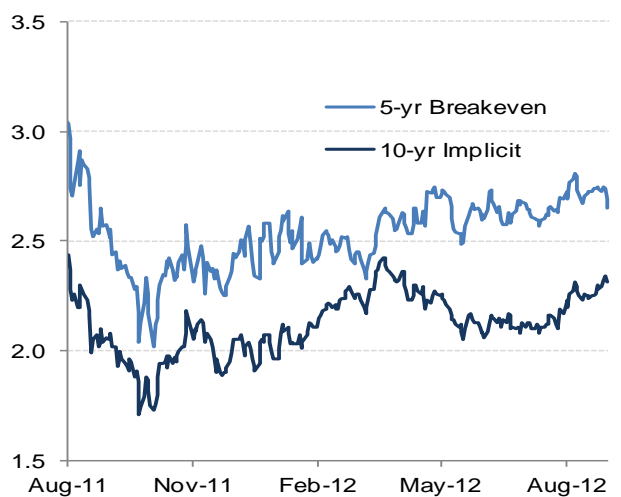
Source: Haver Analytics & BBVA Research

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	13.78
New Auto (36-months)	2.93	2.93	2.95	4.32
Heloc Loan 30K	5.48	5.47	5.44	5.48
5/1 ARM*	2.78	2.80	2.75	2.96
15-year Fixed Mortgage*	2.86	2.89	2.83	3.39
30-year Fixed Mortgage*	3.59	3.66	3.55	4.22
Money Market	0.52	0.52	0.52	0.57
2-year CD	0.85	0.85	0.87	0.99

\*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	0.14	0.13	0.14	0.08
3M Libor	0.42	0.43	0.44	0.33
6M Libor	0.71	0.71	0.73	0.49
12M Libor	1.03	1.04	1.05	0.80
2yr Sw ap	0.40	0.45	0.45	0.50
5yr Sw ap	0.77	0.90	0.88	1.15
10Yr Sw ap	1.66	1.79	1.71	2.19
30yr Sw ap	2.48	2.58	2.45	3.00
7day CP	0.35	0.36	0.33	0.38
30day CP	0.32	0.22	0.34	0.25
60day CP	0.33	0.18	0.36	0.29
90day CP	0.38	0.23	0.38	0.32

Source: Bloomberg & BBVA Research

## Quote of the Week

Ben S. Bernanke, Chairman of the Federal Reserve  
Jackson Hole Economic Symposium  
31 August 2012

*"Monetary policy cannot achieve by itself what a broader and more balanced set of economic policies might achieve; in particular, it cannot neutralize the fiscal and financial risks that the country faces. It certainly cannot fine-tune economic outcomes."*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
4-Sep	ISM Manufacturing Index	AUG	49.9	50.0	49.8
4-Sep	Construction Spending (MoM)	JULY	0.4%	0.4%	0.4%
4-Sep	Total Vehicle Sales	AUG	14.10M	14.20M	14.05M
4-Sep	Domestic Vehicle Sales	AUG	11.10M	11.03M	11.00M
5-Sep	Nonfarm Productivity	2Q12	1.7%	1.8%	1.7%
5-Sep	Unit Labor Costs	2Q12	1.6%	1.5%	1.7%
6-Sep	ADP Employment	AUG	135K	140K	163K
6-Sep	Initial Jobless Claims	1-Sep	370K	370K	374K
6-Sep	Continuing Claims	25-Aug	3310K	3315K	3316K
6-Sep	ISM Non-Manufacturing Index	AUG	53.0	52.5	52.6
7-Sep	Change in Nonfarm Payrolls	AUG	130K	125K	163K
7-Sep	Change in Private Payrolls	AUG	135K	139K	172K
7-Sep	Change in Manufacturing Payrolls	AUG	10K	10K	25K
7-Sep	Unemployment Rate	AUG	8.3%	8.3%	8.3%
7-Sep	Average Hourly Earning (MoM)	AUG	0.2%	0.2%	0.1%



# Forecasts

	2011	2012	2013	2014
Real GDP (% SAAR)	<b>1.8</b>	2.1	1.8	2.3
CPI (YoY %)	<b>3.2</b>	2.0	1.9	2.3
CPI Core (YoY %)	<b>1.7</b>	2.1	1.8	1.9
Unemployment Rate (%)	<b>9.0</b>	8.2	8.1	7.6
Fed Target Rate (eop, %)	<b>0.25</b>	0.25	0.25	0.50
10Yr Treasury (eop, % Yield)	<b>2.0</b>	2.1	2.6	3.0
US Dollar/ Euro (eop)	<b>1.31</b>	1.23	1.31	1.31

Note: Bold numbers reflect actual data

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