

US Weekly Flash

Highlights

- **Fed Announces QE3 and Extends Policy Guidance**

- Despite the fact that recent macroeconomic data were not a dead giveaway for QE3, the Fed decided to move forward with additional easing in order to stimulate the economy. As expected, this round of quantitative easing will be slightly different than the previous two rounds, with plans to purchase \$40bn per month of mortgage-backed securities (MBS) on an open-ended basis (i.e. until we see substantial improvement in labor market conditions given that inflation is under control). The FOMC also decided to continue Operation Twist as scheduled through the end of the year. Ultimately, both policy accommodations will increase long-term securities holdings by about \$85bn per month until the end of 2012. In addition, the FOMC announced an extension of their policy guidance. The committee expects that "exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015" rather than late-2014 as announced in the previous meeting.
- The FOMC also released its Summary of Economic Projections. In general, committee members downgraded growth forecasts for 2012 but upgraded the outlook for 2013. Compared to our own baseline scenario, we continue to see a more optimistic outlook from the Fed.
- In the Chairman's press conference, Bernanke made it clear that the Fed's highly accommodative stance will be appropriate even as economic growth picks up. The FOMC is committed to promoting a stronger recovery and will be careful not to prematurely tighten monetary policy in order to give some time to the economy to show steady growth. Prior rounds of quantitative easing have been effective in helping economic growth, yet monetary policy cannot solve the problem on its own. As in previous communications, Bernanke highlighted the need to address the fiscal cliff while simultaneously focusing on long-term fiscal sustainability. For more details, see our latest [Fed Watch](#).

- **CPI Jumps 0.6% in August and Overshadows Gain in Retail Sales**

- The consumer price index increased 0.6% in August following 4 months of flat and negative readings. As expected, rising gas prices were a primary driver of headline inflation, jumping 9.0%, the strongest increase in more than 3 years. Total energy prices increased 5.6% for the first time since March. Food inflation also accelerated to 0.2% growth for the month, and we expect that this trend will continue as we see the more prolonged impact from the Midwest drought. Core inflation was much more modest, increasing only 0.1% for the second consecutive month and was driven mostly by shelter and medical care services.
- Unfortunately, this rise in inflation overshadows the retail sales gain for August. Total retail sales increased 0.9% for the month following a revised 0.6% increase in July, while the ex-auto figure rose 0.8%. However, most of the nominal gains were due to the rise in gas prices, with sales at gasoline stations up 5.5%. Thus, real retail sales grew at a more modest pace, up only 0.3% in August. On the bright side, we have seen positive spending data so far for 3Q12, which points to a slightly stronger PCE contribution to real GDP growth for the quarter.

Week Ahead

Empire State Manufacturing Survey (September, Monday 8:30 ET)

Forecast: -4.00

Consensus: -2.00

Previous: -5.85

Manufacturing data has been anything but encouraging lately, with most indicators suggesting contracting activity. In August, the Empire State Index dropped below zero for the first time since October, reflecting persistent declines in the new orders component. Surprisingly, weak orders have yet to influence a drop in shipments, but we expect that this trend will not last if demand does not rebound soon. Similarly, employment gains in the sector will continue to decelerate if production remains subdued. Ultimately, we do not expect to see a significant rebound in the data throughout the next few months.

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

Forecast: 760K, 800K

Consensus: 765K, 795K

Previous: 746K, 812K

Housing starts and building permits are both volatile data series and permits usually lead starts by a few months or so. In general, both series are moving in a positive direction. In July, housing starts declined slightly after a big gain in the previous month, while building permits jumped to the highest level of the recovery by far. We expect that both figures will change only slightly in August, with July's gain in permits pointing to an increase in new home starts for the month. Despite recent deterioration in consumer confidence and future income prospects, the rising homebuilder confidence index points to continued improvements in housing activity for the months ahead.

Existing Home Sales (August, Wednesday 10:00 ET)

Forecast: 4.57M

Consensus: 4.55M

Previous: 4.47M

Existing home sales are expected to increase in August to slightly higher levels than seen in the previous two months. Rising home prices have been discouraging homebuyers, however the brief relief in prices in July helped to reverse this trend. July's increase in pending home sales, which is a leading indicator of existing sales, will likely be reflected in final housing activity for August. However, existing sales will remain limited by falling supply, with the share of distressed properties dwindling. We expect that housing demand will continue to improve gradually while growing on a YoY basis.

Initial Jobless Claims (September, Thursday 8:30 ET)

Forecast: 375K

Consensus: 373K

Previous: 382K

Initial jobless claims have not shown much improvement in the past few weeks, with the 4-week moving average hovering above 370K. For the second week in September, claims jumped to 382K, the highest level since mid-July. The latest consumer confidence report noted a decline in the number of respondents stating that jobs are plentiful, but also reflected a drop in those who feel that jobs are hard to get. On the downside, the 6-month outlook for the labor market was worse than in previous months. Given the uncertain outlook for future activity, it is unlikely that we will see a significant decline in initial claims through the rest of the year.

Market Impact

Markets should be less volatile this week given the latest announcement from the Fed. However, it may take a while before we begin to see an impact on economic data. In particular, manufacturing data remains weak and another month of negative indicators could increase market anxiety. On a brighter note, housing activity has been gradually improving and thus should warrant little reaction from markets.

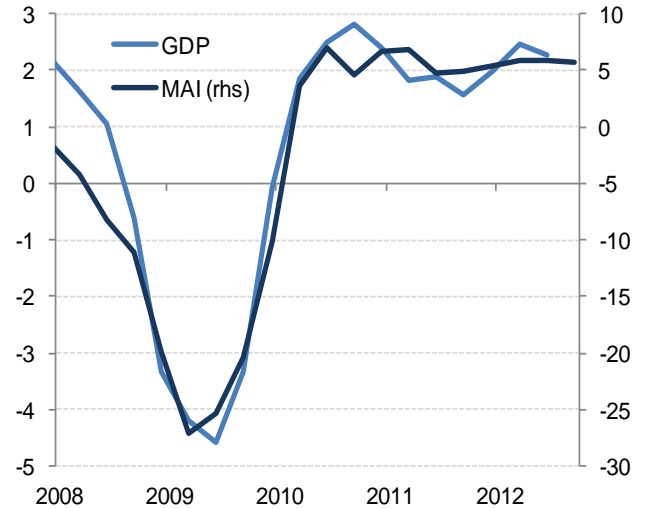
Economic Trends

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



Source: BBVA Research

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



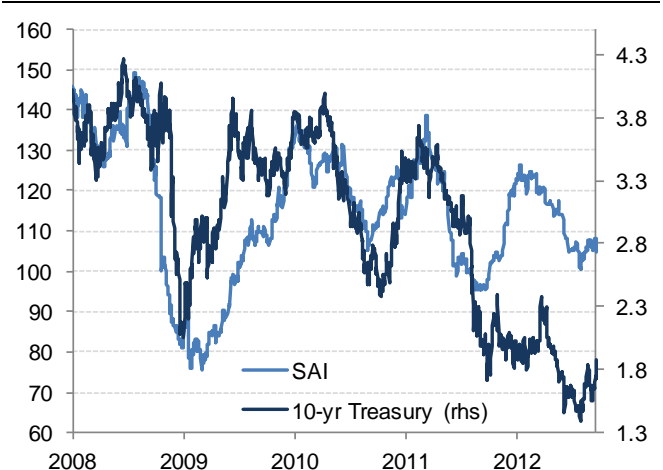
Source: BBVA Research & BEA

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



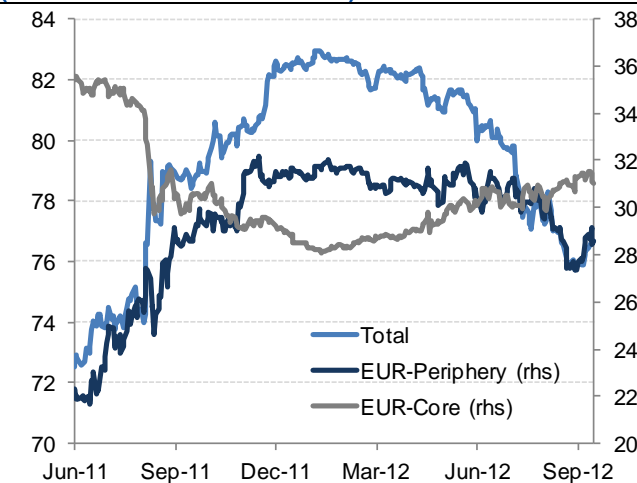
Source: BBVA Research

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



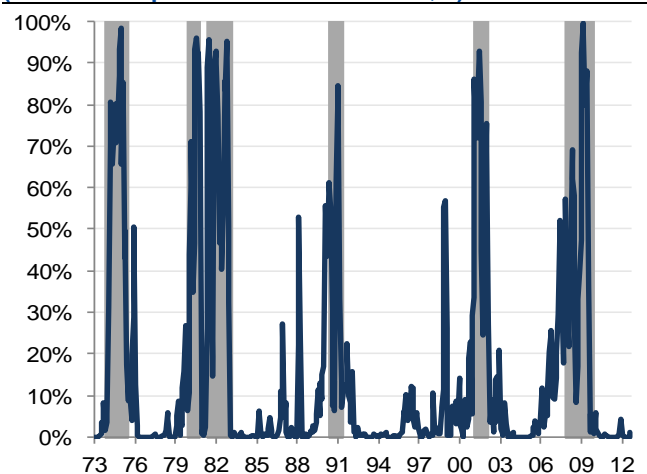
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

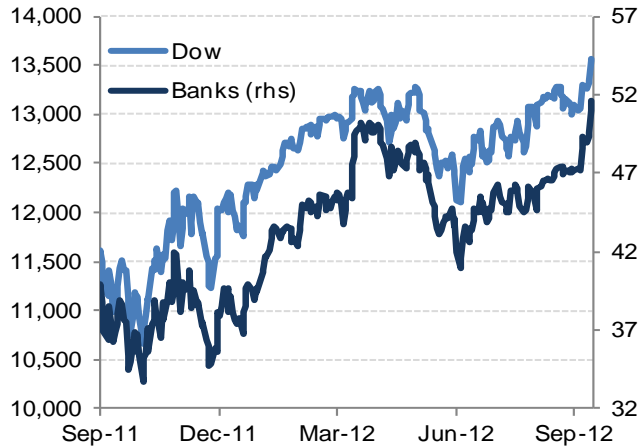
Graph 8
**BBVA US Recession Probability Model
(Recession episodes in shaded areas, %)**



Source: BBVA Research

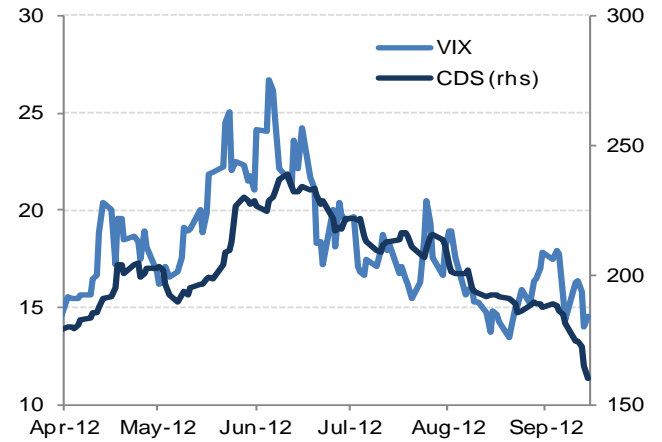
Financial Markets

Graph 9
Stocks
(Index, KBW)



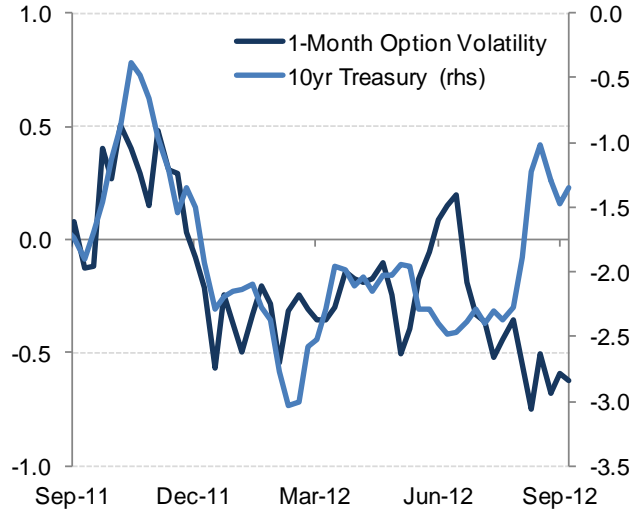
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



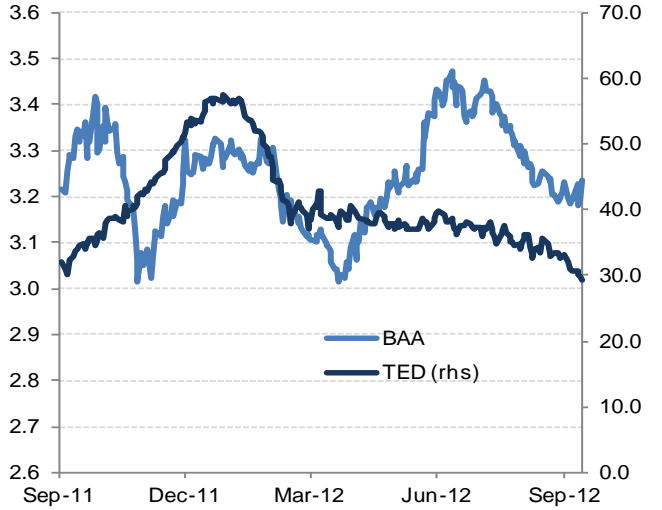
Source: Bloomberg & BBVA Research

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



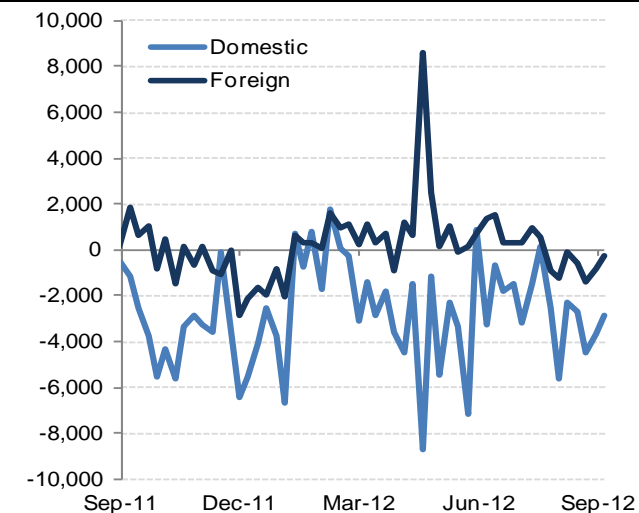
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



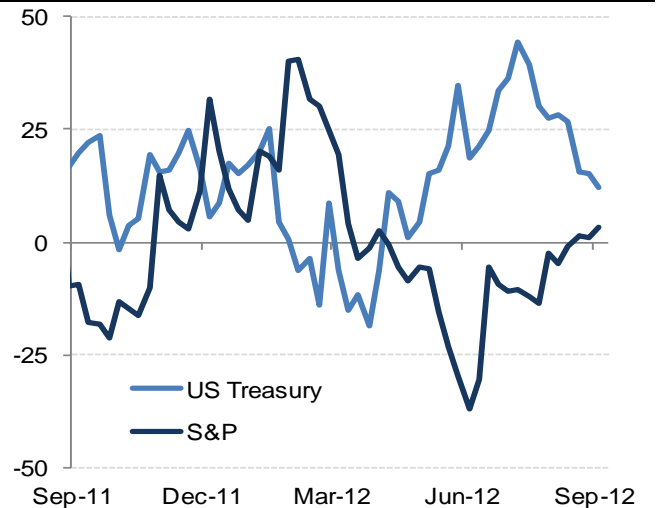
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

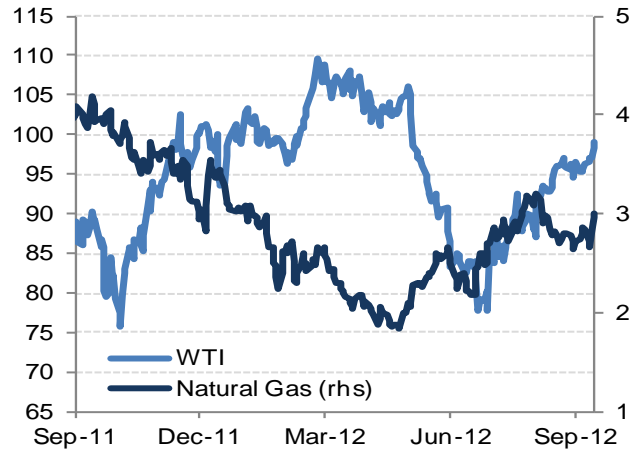
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

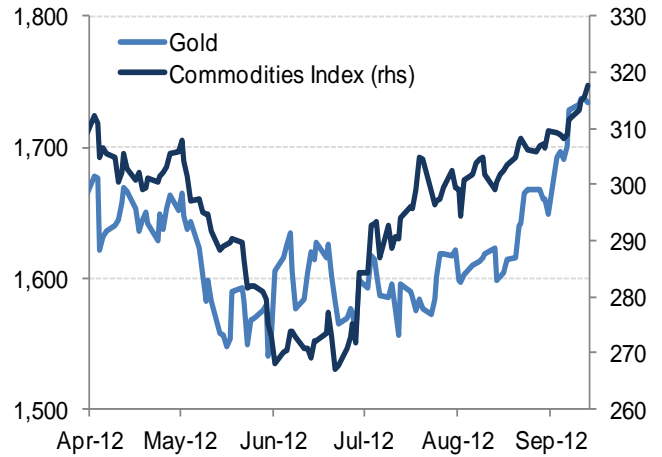
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



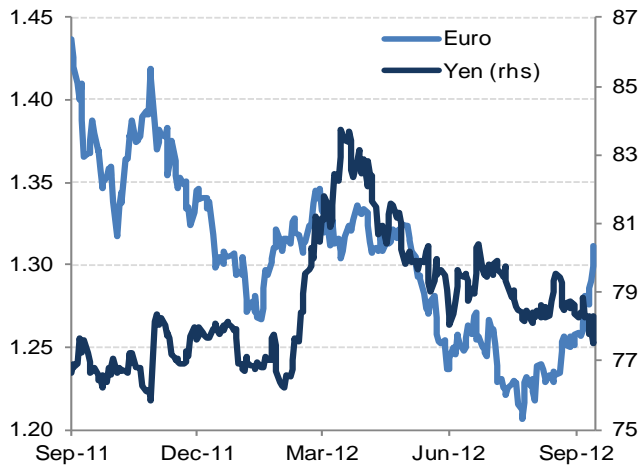
Source: Bloomberg & BBVA Research

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



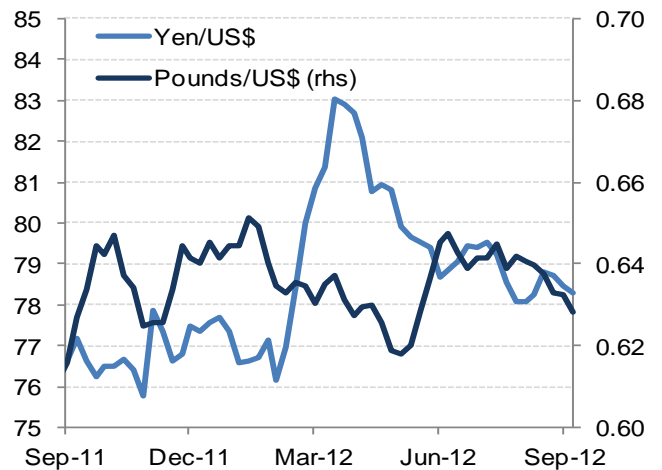
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



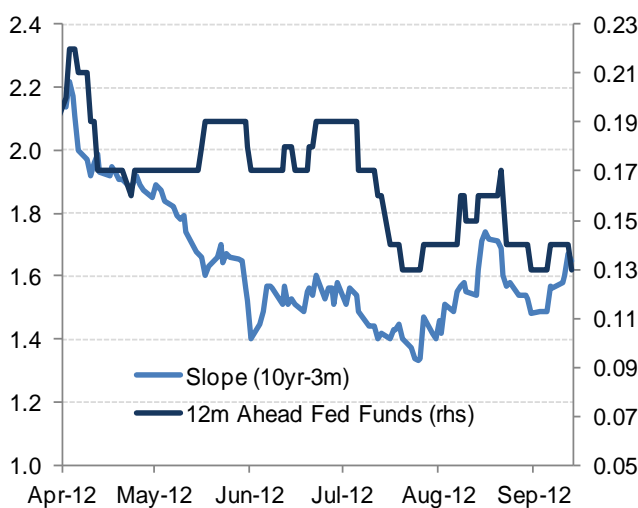
Source: Bloomberg & BBVA Research

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



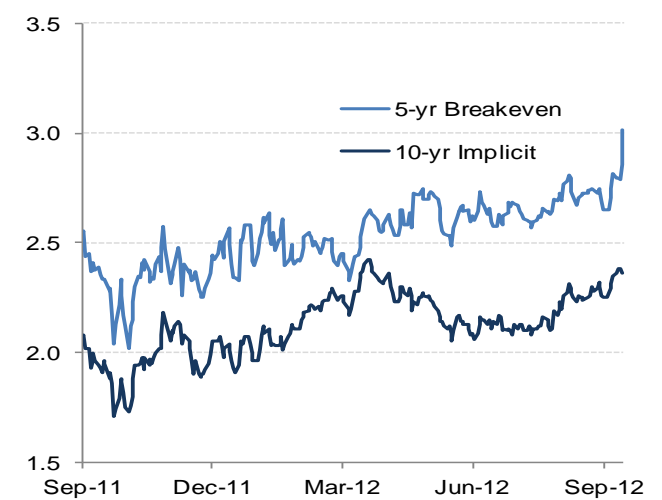
Source: Haver Analytics & BBVA Research

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	13.95
New Auto (36-months)	3.15	3.14	2.93	4.22
Heloc Loan 30K	5.46	5.48	5.46	5.47
5/1 ARM*	2.72	2.75	2.76	2.99
15-year Fixed Mortgage *	2.85	2.86	2.88	3.30
30-year Fixed Mortgage *	3.55	3.55	3.62	4.09
Money Market	0.51	0.52	0.52	0.56
2-year CD	0.87	0.86	0.86	0.98

*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	0.15	0.15	0.13	0.09
3M Libor	0.39	0.41	0.43	0.35
6M Libor	0.67	0.70	0.72	0.52
12M Libor	1.00	1.02	1.04	0.84
2yr Sw ap	0.38	0.40	0.50	0.50
5yr Sw ap	0.86	0.82	1.00	1.22
10Yr Sw ap	1.90	1.78	1.92	2.24
30yr Sw ap	2.84	2.63	2.71	3.03
7day CP	0.23	0.32	0.20	0.31
30day CP	0.40	0.57	0.20	0.32
60day CP	0.57	0.69	0.24	0.35
90day CP	0.50	0.67	0.29	0.36

Source: Bloomberg & BBVA Research

Quote of the Week

Ben S. Bernanke, Chairman of the Federal Reserve
Press Conference Following FOMC Announcement
13 September 2012

"The committee is concerned that, without further policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions. We're looking for ongoing, sustained improvement in the labor market. There's not a specific number we have in mind. What we've seen in the last six months isn't it."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
17-Sep	Empire State Manufacturing Survey	SEPT	-4.00	-2.00	-5.85
18-Sep	NAHB Housing Market Index	SEPT	37.00	38.00	37.00
19-Sep	Housing Starts	AUG	760K	765K	746K
19-Sep	Housing Starts (MoM)	AUG	1.88%	2.60%	-1.10%
19-Sep	Building Permits	AUG	800K	795K	812K
19-Sep	Building Permits (MoM)	AUG	-1.48%	-2.00%	6.80%
19-Sep	Existing Home Sales	AUG	4.57M	4.55M	4.47M
19-Sep	Existing Home Sales (MoM)	AUG	2.98%	1.80%	2.30%
20-Sep	Initial Jobless Claims	15-Sep	375K	373K	382K
20-Sep	Continuing Claims	8-Sep	3300K	3275K	3283K
20-Sep	Philadelphia Fed Survey	SEPT	-6.00	-3.80	-7.10
20-Sep	Leading Indicators	AUG	0.10%	-0.10%	0.40%

Forecasts

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

Note: Bold numbers reflect actual data

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