

US Weekly Flash

Highlights

- **Unemployment rate falls to 7.8% aided by payroll revisions**

- Employment figures released for September show surprisingly positive movements from the economy in both the private and public sector. Total nonfarm payrolls increased 114K in September following upward revisions in July (from 141K to 181K) and August (from 96K to 142K). Private payrolls increased 104K, lead mostly by gains in the healthcare sector. Manufacturing payrolls actually declined for the second consecutive month, down 16K in September. However, recent manufacturing indicators have suggested a slight turnaround in the sector's activity, so we expect that hiring should rebound in the coming months. Surprisingly, government payrolls rose by 10K following upward revisions to the previous two months.
- Surprisingly, these revisions to payroll growth were enough to push down the unemployment rate in September, from 8.1% in August to a post-recession low of 7.8%. Understandably, we would be apt to consider how the participation rate also fared as a fall in the labor force has been an explanatory factor for the lower unemployment data in recent months. However, the participation rate actually increased slightly to 63.6%: more people entering or re-entering the work force, coupled with the lower unemployment rate, highlights some positive signs for the US employment outlook.
- September's report was a surprise to the upside, but conditions appear almost too good to be true. There is the possibility that these numbers will be revised in the coming months given the significant revisions we have seen in this report. Looking forward, we expect that payroll growth will continue at a similar pace throughout the next few quarters. In regards to the unemployment rate, our forecast for 8.2% on average in 2012 is slightly high and will likely be revised down. This release will also give the Fed something to consider over the coming weeks before their October FOMC meeting and the question in mind would be whether or not we will see tightening sooner than anticipated if these levels are indicative of better months to come.

- **FOMC meeting minutes reveal QE3 and policy guidance, now its congress's turn**

- The September FOMC meeting was a decisive moment in regards to monetary policy accommodation, resulting in the announcement of QE3 and an extension of the interest rate policy guidance. Meeting minutes released provide more details related to the strongly debated topic of QE3, which ultimately became a majority agreement by the end of the session. Committee members concluded that the economy was unlikely to strengthen enough to generate "sustained improvement in labor markets conditions" without additional monetary policy accommodation. The open-ended strategy for MBS purchases was presented as a way to increase the policy's success in reducing unemployment and boosting economic confidence. Members in support of additional easing noted that QE3 would "emphasize the Committee's commitment to continued progress toward its dual mandate," thus increasing both business and consumer confidence. See our latest [Fedwatch](#) for more details.
- Now that the FOMC has maximized its policy accommodation for the time being, we do not expect much to come out of the October session. Members will likely continue discussing the effectiveness of QE3 and will closely monitor the impact on economic activity. In addition, the minutes from the September meeting noted that the Committee plans to discuss developments related to an FOMC consensus forecast and enhanced communication policies. Most importantly, with the upcoming meeting occurring only two weeks before the election, the Fed will sit back and wait for the political leaders to do their part. Bernanke and his colleagues have made it very clear that without some sort of compromise in Congress, monetary policy will be unable to prevent the economy from sliding into recession in 2013.

Week Ahead

Wholesale Inventories (August, Wednesday 10:00 ET)

Forecast: 0.5

Consensus: 0.4%

Previous: 0.7%

Wholesale inventories are expected to increase in August by 0.5%, reflecting a lag in unloading the stock of inventory that has been building outside of the slight drop in May and June. July's inventory rose by 0.7%, the largest increase since February, but given the most recent data, stock is unlikely to turnover quickly. Various business surveys reported mixed data for August that hint at a decreased need for inventory build. Despite the fact that the month was particularly weak for the manufacturing sector, wholesalers likely continued on the path of lean inventory management.

International Trade Balance (August, Thursday 8:30 ET)

Forecast: -\$43.0B

Consensus: -\$44.4B

Previous: -\$42.0B

The US trade deficit is expected to grow slightly in August for the second straight month given continued slowing in the global economy. Figures for July exports show a 1.0% decline from June, and various manufacturing indicators for new export orders tell the same story, still in decline. Export prices in August increased and may inflate the value of total exports, even though we expect a monthly decline in volume. While the decline in the balance may be cushioned by weaker import growth, we expect that rising import prices will offset gains from the export side.

Jobless Claims (October, Thursday 8:30 ET)

Forecast: 370K

Consensus: 365K

Previous: 367K

Initial jobless claims have fallen from their mid-September highs down to 367K at month's end, yet the data do not point to significant improvement for payroll growth. On average, claims in September reached the highest level since May and June, when nonfarm payrolls increased only 87K and 45K, respectively. Although levels are still 13K away from the 385K we saw twice in September, there is little data to support a significant decline in claims for the beginning of October. In general, we do not expect that levels will drop closer to the 350K mark in the coming weeks.

Consumer Sentiment (October, Friday 9:55 ET)

Forecast: 77.9

Consensus: 77.9

Previous: 78.3

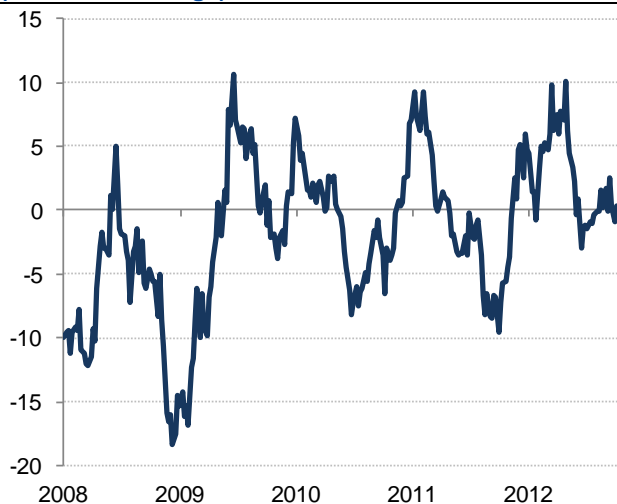
As food prices and rising price per barrel loom, University of Michigan's Consumer Sentiment Index stands to worsen as consumers' uncertainties grow about their income and expenses. The Midwest drought has moved food prices higher, and consumers fear paying more not only for their grains and meats, but for their fuel as well. Oil prices in September were higher than levels seen earlier in the summer but remain lower than the significant price gains in the beginning of the year. Both scenarios translate to higher gas prices at the pump and then a higher bill once consumers reach the grocery store.

Market Impact

Despite the light economic calendar, markets are likely to remain more optimistic after the better-than-expected employment report for September. The international trade balance will warrant most market attention but stands poised to disappoint as employment levels show a consistent but gradual pace and last week's ISM figures, although improved, are not enough to boost the outlook just yet. Prices are also being watched as the PPI is released and forecasted to remain around its normal levels – anything far off might warn of a rise in prices to the consumers further on down the road.

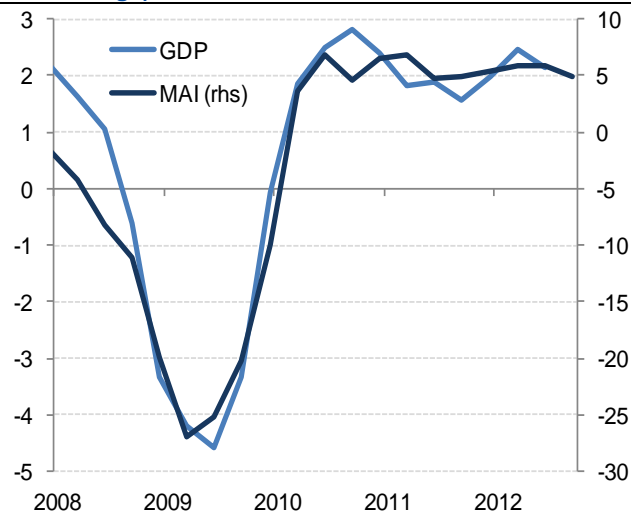
Economic Trends

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



Source: BBVA Research

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



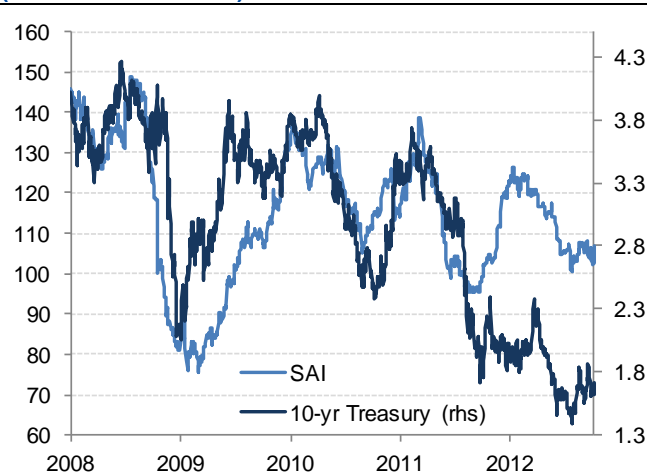
Source: BBVA Research & BEA

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



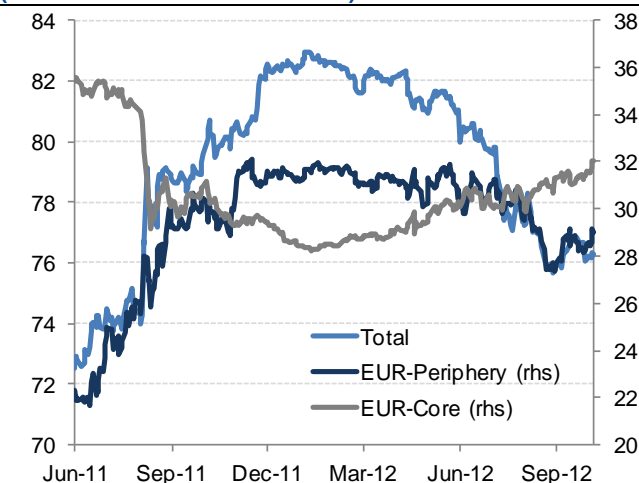
Source: BBVA Research

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



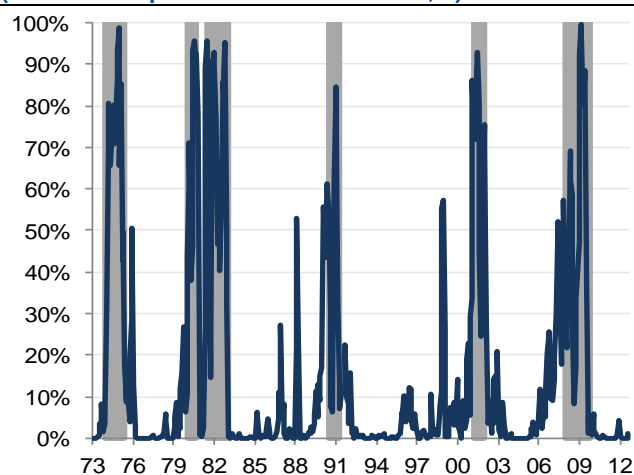
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

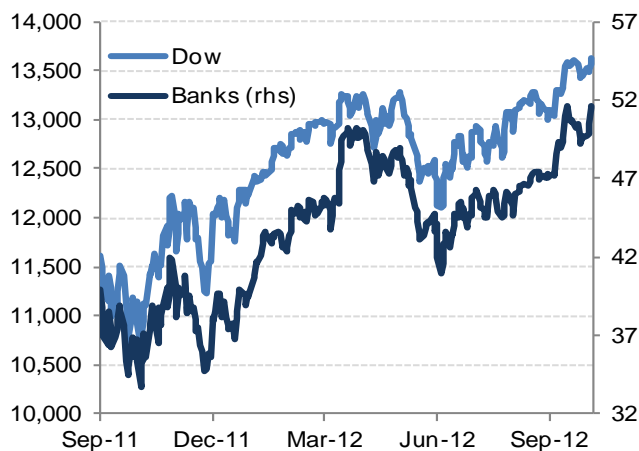
Graph 8
BBVA US Recession Probability Model
(Recession episodes in shaded areas, %)



Source: BBVA Research

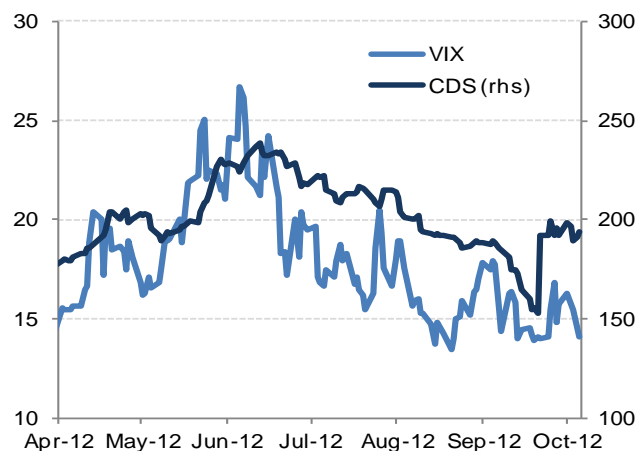
Financial Markets

Graph 9
Stocks
(Index, KBW)



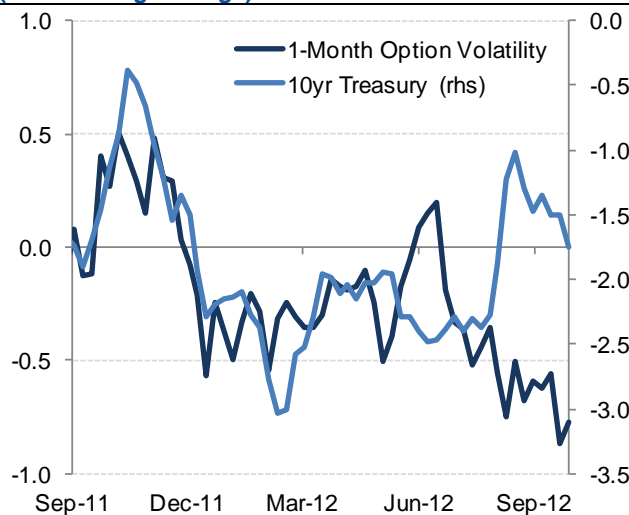
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



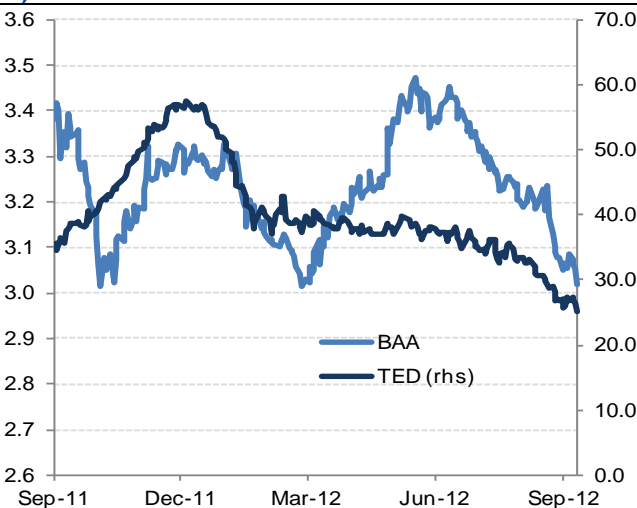
Source: Bloomberg & BBVA Research

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



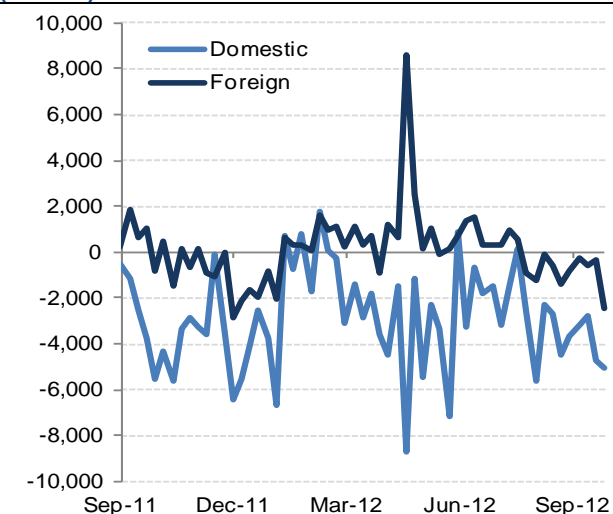
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



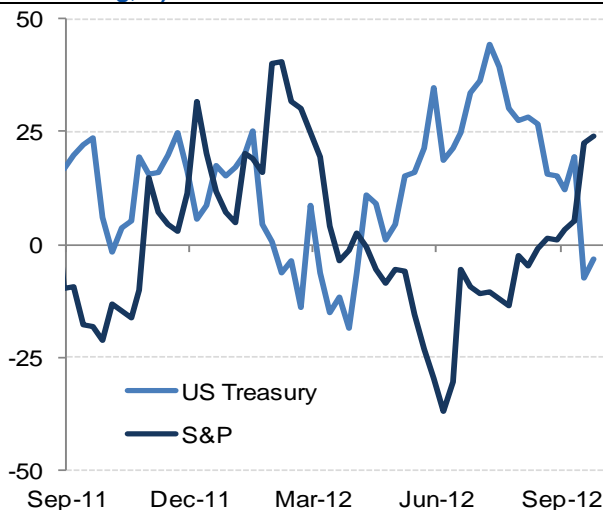
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

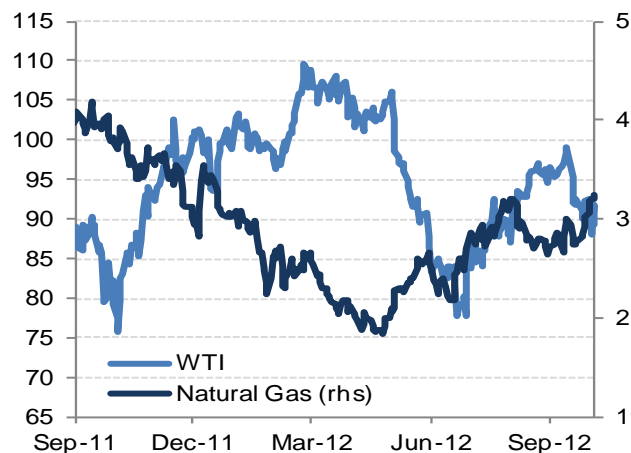
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

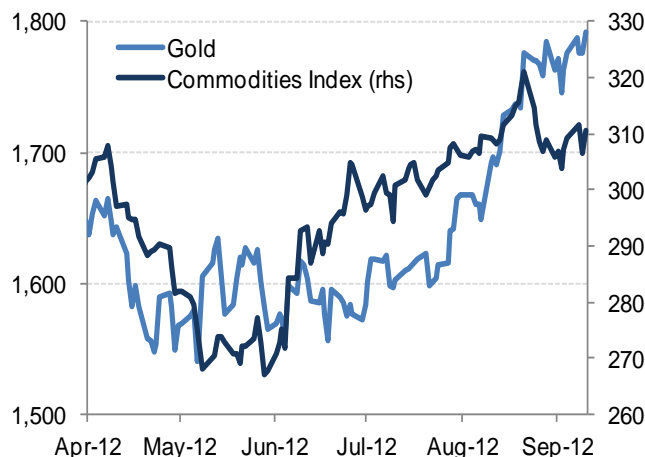
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



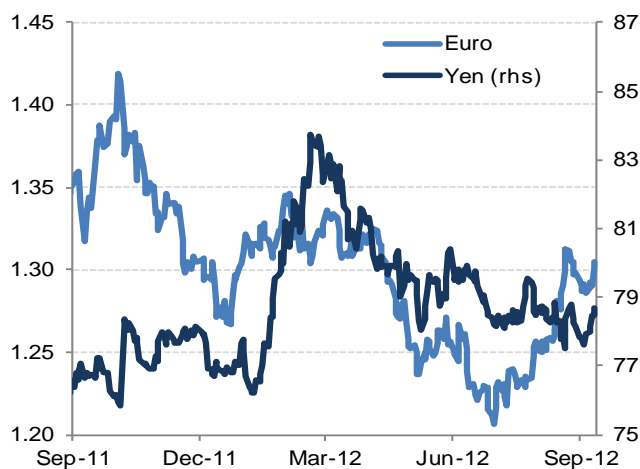
Source: Bloomberg & BBVA Research

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



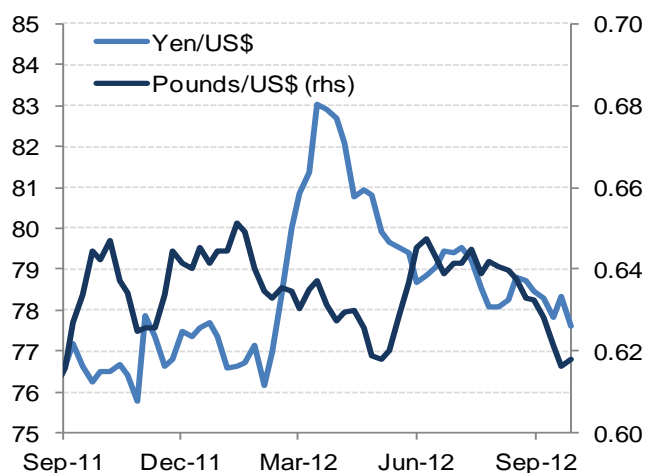
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



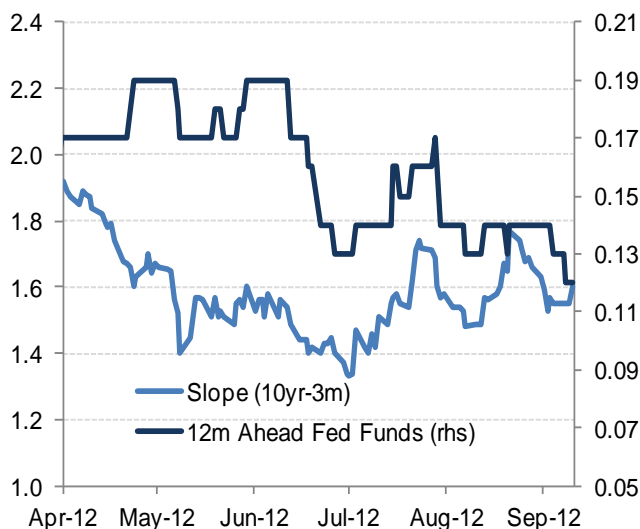
Source: Bloomberg & BBVA Research

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



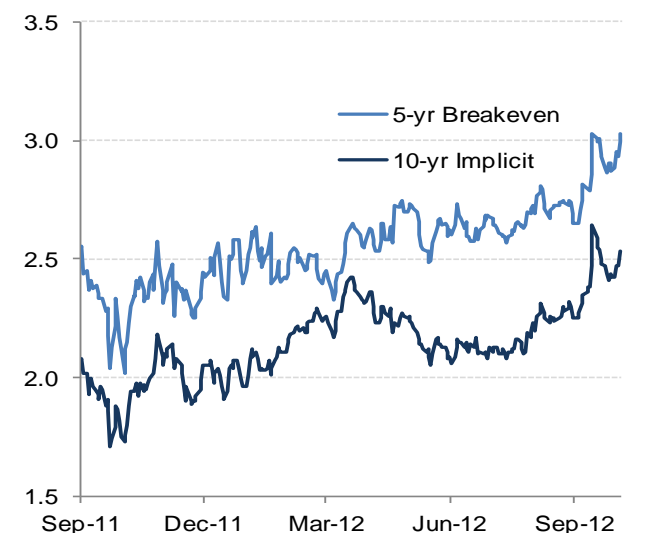
Source: Haver Analytics & BBVA Research

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)	14.12	14.10	14.10	13.95
New Auto (36-months)	3.12	3.14	3.14	4.12
Heloc Loan 30K	5.49	5.46	5.48	5.50
5/1 ARM *	2.72	2.71	2.75	2.96
15-year Fixed Mortgage *	2.69	2.73	2.86	3.26
30-year Fixed Mortgage *	3.36	3.40	3.55	3.94
Money Market	0.51	0.51	0.52	0.55
2-year CD	0.86	0.87	0.86	0.93

*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	0.09	0.15	0.07
3M Libor	0.35	0.36	0.41	0.39
6M Libor	0.62	0.64	0.70	0.58
12M Libor	0.95	0.98	1.02	0.89
2yr Sw ap	0.40	0.37	0.40	0.68
5yr Sw ap	0.80	0.76	0.82	1.43
10Yr Sw ap	1.79	1.70	1.78	2.28
30yr Sw ap	2.75	2.61	2.63	2.79
7day CP	0.28	0.32	0.30	0.55
30day CP	0.31	0.34	0.57	0.44
60day CP	0.34	0.46	0.69	0.31
90day CP	0.38	0.53	0.67	0.38

Source: Bloomberg & BBVA Research

Quote of the Week

Ben Bernanke, Chairman of the Federal Reserve
Five Questions about the Federal Reserve and Monetary Policy
1 October 2012

"Monetizing the debt means using money creation as a permanent source of financing for government spending. In contrast, we are acquiring Treasury securities on the open market and only on a temporary basis, with the goal of supporting the economic recovery through lower interest rates. At the appropriate time, the Federal Reserve will gradually sell these securities or let them mature, as needed, to return its balance sheet to a more normal size."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
10-Oct	Wholesale inventories	AUG	0.5%	0.4%	0.7%
11-Oct	Import Prices (MoM)	SEPT	0.6%	0.7%	0.7%
11-Oct	International Trade Balance	AUG	-\$43.0B	-\$44.0B	-\$42.0B
11-Oct	Initial Jobless Claims	6-Oct	370K	365K	367K
11-Oct	Continuing Claims	29-Sep	3270K	3279K	3281K
12-Oct	Producer Price Index (MoM)	SEPT	0.90%	0.70%	1.70%
12-Oct	PPI Ex Food & Energy (MoM)	SEPT	0.20%	0.20%	0.20%
12-Oct	U. Michigan Consumer Sentiment	OCT	77.90	77.90	78.30

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	0.25
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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