US Weekly Flash

Highlights

- **Surge in energy prices keeps pressure on CPI**
  - The Consumer Price Index looked quite similar to the prior month's figures as headline inflation rose 0.6% on intensifying energy prices. A 7.0% jump in gasoline prices led the energy components and the overall 4.5% gain, marking the second consecutive monthly increase for the energy index after a 4-month swing of declines. Although energy prices did climb considerably, the increase was slightly less sharp compared to the 5.6% gain in August. On the other hand, the heavily watched food sector showed very little movement on a month-over-month basis, growing by only 0.1% following a 0.2% increase in August. Concerns are rising that the Midwest drought will soon have its impact on food prices. On a YoY basis, food inflation has decelerated since December of last year, from 4.6% to 1.6%, but we expect that this trend will soon return to an upward trend
  - Excluding food and energy, core inflation held steady at a 0.1% for the third straight month, with a small uptick to 2.0% in the YoY figure. This small movement is likely the result of a fall in prices for vehicles, new and used, balanced by an increase in transportation services (0.6%) and medical care (0.4%) prices since August. Shelter prices have accelerated slightly throughout the past few months, mostly on account of rising rental costs. While core prices remain relatively unresponsive for the time being, it is likely that shelter prices will make more of an impact as its consecutive growth has hastened and will be more influential as vehicle price volatility becomes less of a driver. However, the headline level stands to increase some, if not more, as food prices exert additional upward pressures.
- **Industrial production recovers only slightly from prior decline**
  - Industrial production data were only slightly more positive for September after posting declines in August. Total output rose 0.4% in September but not enough to offset the 1.4% drop in the previous month. All three major components rebounded from declines in August, though the indices still remain below levels seen in July. Utilities output led the gains at 1.5% while mining increased 0.9%. Manufacturing production increased a very modest 0.2% after falling 0.9% in the prior month. Recent data on the sector have indicated a particularly weak third quarter, with the industrial production component showing a similar story. On average, manufacturing output declined 0.1% per month in 3Q12, the lowest rate in more than a year.
  - The month-over-month comparison is hard to gauge at this point, as it seems that some of the increase can be chalked up to Hurricane Issac. The Gulf of Mexico's production and manufacturing industries were offline for part of August due to the looming hurricane. By September, the facilities were back online and therefore we might be seeing an augmented spike due to the restart. It is possible that close to 0.3% of the decline in production for August can be attributed to the hurricane, but the overall movement is questionable. Ultimately, we will wait to see the next report to monitor whether revisions change the story.
- **Housing starts & permits rise to highest levels since the end of the recession**
  - September figures released for housing starts and building permits convey strong optimism and implied growth for the housing market as levels reach the highest point since the end of the recession. Housing starts increased 15.0% while building permits rose 11.6%, the fastest month-over-month pace since December 2010 and illustrating a hopeful demand by contractors and home constructors for consumer interest in eventual properties. The third quarter has been a large force behind housing market sanguinity: new and existing home sales have grown, the number of vacant homes has decreased, and the average length of time to complete construction on new homes has also fallen. All of the data point to a more fertile housing sector with gradual long-term growth expected as newly constructed houses fill with homebuyers, with rising prices helping to boost homeowner confidence and stimulate additional activity. On the whole, housing seems to be a driver for economic optimism, and there is reason to hope that consumers, requiring appliances and household products, might reach further outside of their recent comfort zones and continue to spend.

Week Ahead

New Home Sales (September, Wednesday 10:00 ET)

Forecast: 385K	Consensus: 385K	Previous: 373K

The housing industry is gaining pace and new home sales have been trending upward throughout the past year. Constrained supply has encouraged new home construction, with housing starts and building permits jumping significantly in September. Furthermore, the assurance of low mortgage rates for an extended period of time will help to bring new consumers into the housing market. The rise in consumer confidence and the gradual improvements in the labor market suggest that consumers may be more apt to buy a new home in the coming months. On the downside, the latest rebound in the price of new homes may deter potential homebuyers

Durable Goods Orders, Ex Transportation (September, Thursday 8:30 ET)

Forecast: 5.5%, 1.2%	Consensus: 6.8%, 0.9%	Previous: -13.2%, -1.6%

Durable goods orders are expected to rebound in September after falling dramatically in August, the largest drop since the midst of the recession. The transportation component was a leader of the massive decline, down 35% to mark the largest recorded decline since the data have been reported. However, we expect that transportation orders will recover in September given the usual monthly volatility in the data, particularly for aircraft orders, as well as the significant increase in auto demand we have seen in recent months. ISM and production figures suggest businesses are not all too keen on producing more than they can unload with certainty, so the growth from durable goods orders isn't estimated to be a polar opposite of August with an increase in the double digit range.

GDP, Advance Estimate (3Q12, Friday 8:30 ET)

Forecast: 1.5%	Consensus: 1.8%	Previous: 1.3%

The advanced estimate for real GDP growth in 3Q12 is expected to reflect the slowing pace of activity framed by key economic indicators, particularly on the production side. Trade did little to bolster figures, with the deficit widening consistently since the second quarter on account of falling exports. Production and inventories were a disappointment as well, with average industrial output in the negative compared to the previous quarter. Inventories appear to be a bit stronger in 3Q12, with consumer demand on the uptick again in August and September. A positive sign from personal consumption expenditures might be the catalyst for the quarter, with growth averaging only slightly less than the strong rates seen in 1Q12. Although September's data has not been released for many of these important indicators, we expect that the month will be similar, if not stronger, than what was seen in August. Ultimately, our expectation is that third quarter growth may be on pace or a little better than 2Q12, but not enough to offset looming uncertainties impacting the second half of 2012.

Consumer Sentiment (October, Friday 9:55 ET)

Forecast: 82.6	Consensus: 83.0	Previous: 83.1

Consumer sentiment is expected to fall slightly for the second half of October as the looming elections, fiscal cliff, and unresolved issues in Europe continue to unnerve consumers. Increasing uncertainties have shifted consumer sentiment to the future, with the expectations component increasing at a faster pace compared to the views on current conditions. However, recent data do embody some optimism in regards to housing starts and moderately tame inflationary pressures. The hope is that the latter half of the month will be the driver as revisions to the employment figures from September will shed some light on the economy's recovery. Households, while poised to begin a faster paced recovery, may be waiting for a sign from the economy before releasing the flood gates and spending again.

Market Impact

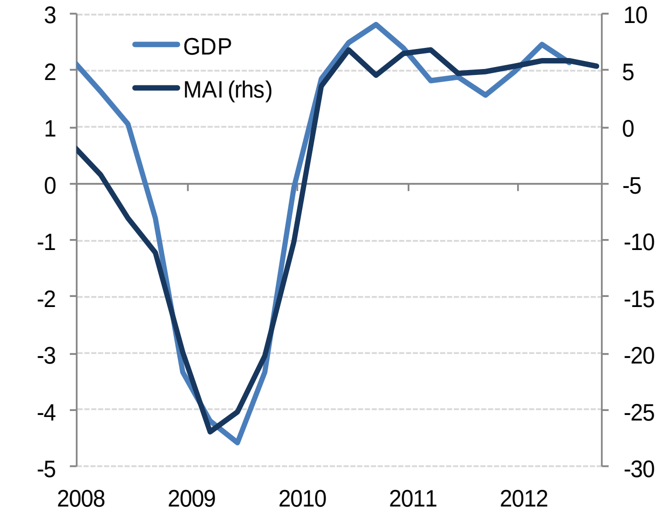
This week all eyes will be fixed on GDP figures and the the first look at official 2H12 growth estimates. A reading significantly lower than 2Q12 growth will surely warrant a negative reaction. On the other hand, the FOMC meeting announcement should have little impact given that markets have no need to fret at this point over when the Fed will adjust its monetary policy. Ultimately, markets will be awaiting the larger indicators at the end of the month in order to assess the validity of September's employment report and whether we can expect something to the same effect in other leading indicators in the coming weeks.

Economic Trends

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

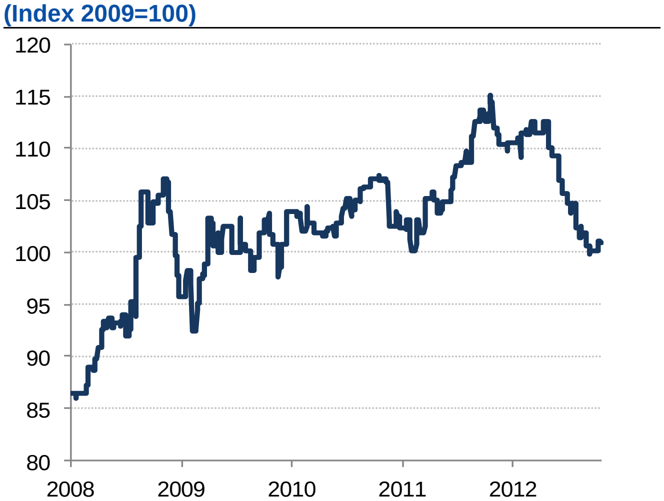
Source: BBVA Research

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



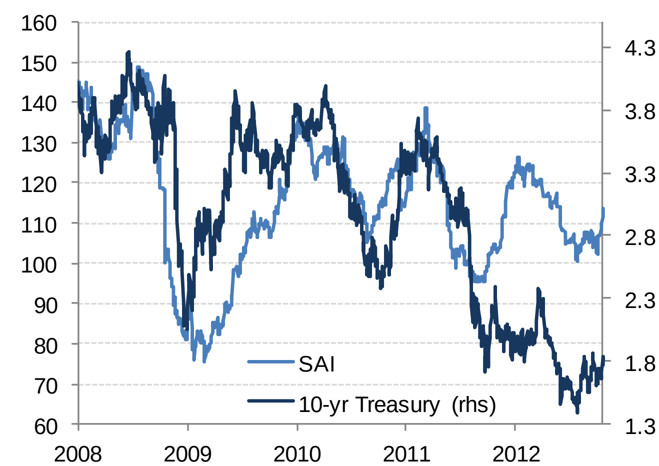
Source: BBVA Research & BEA

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



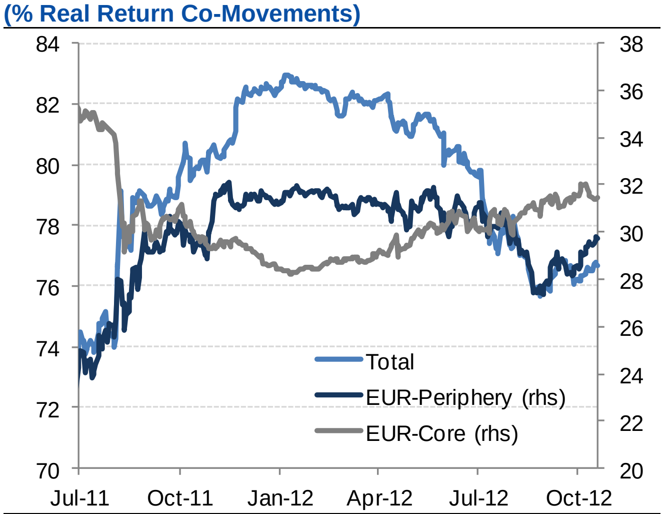
Source: BBVA Research

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



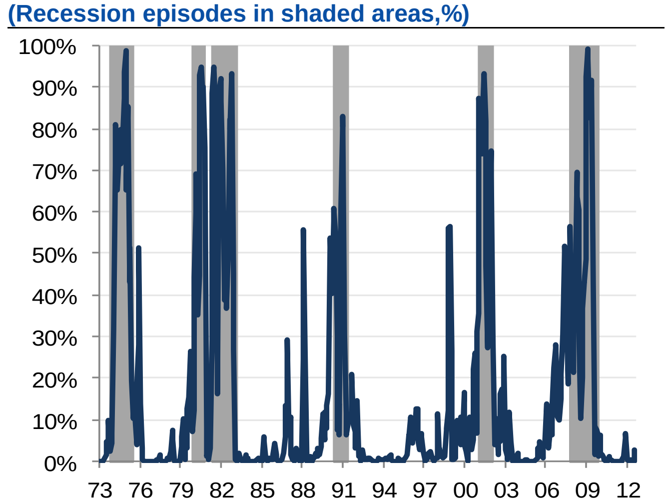
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

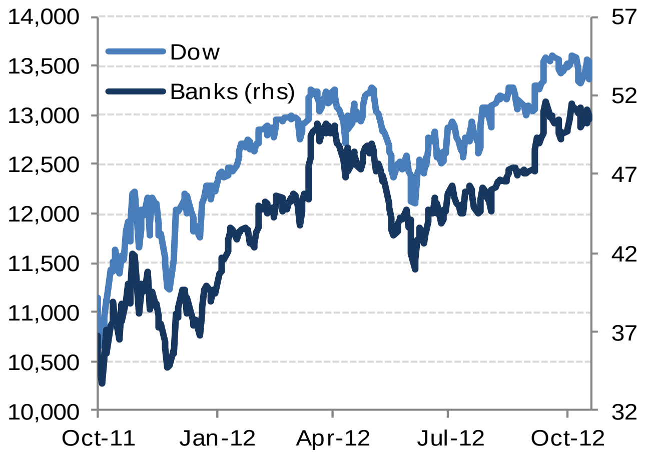
Graph 8
BBVA US Recession Probability Model
(Recession episodes in shaded areas,%)



Source: BBVA Research

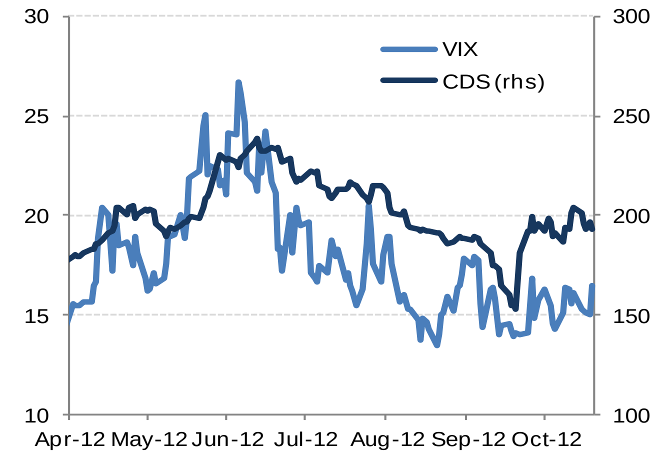
Financial Markets

Graph 9
Stocks
(Index, KBW)



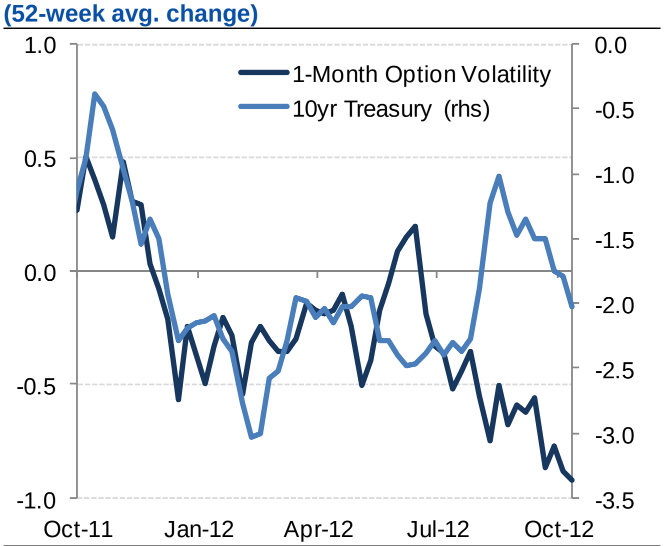
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



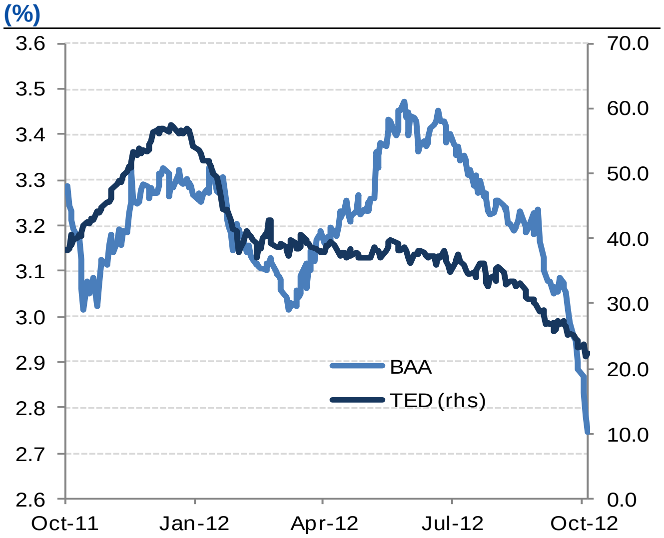
Source: Bloomberg & BBVA Research

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



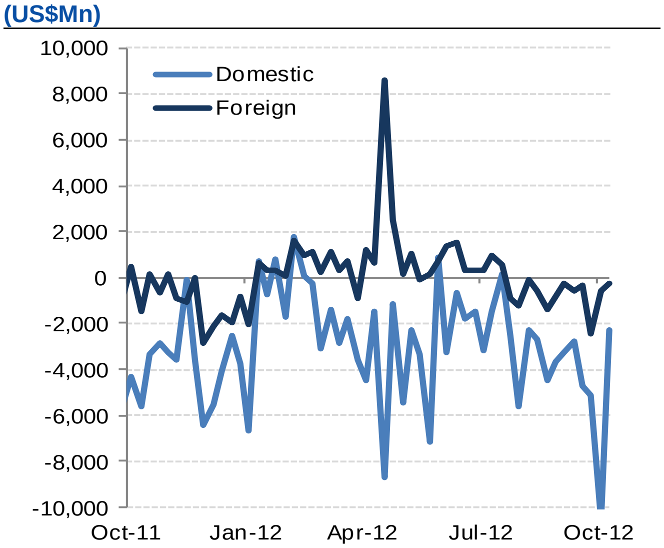
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



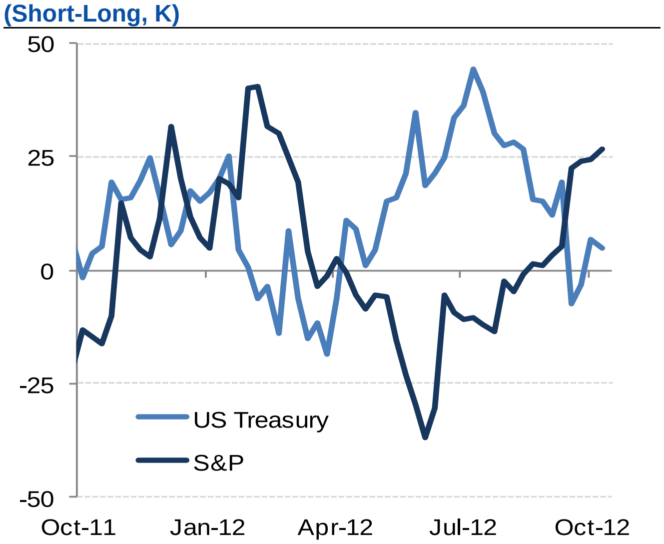
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

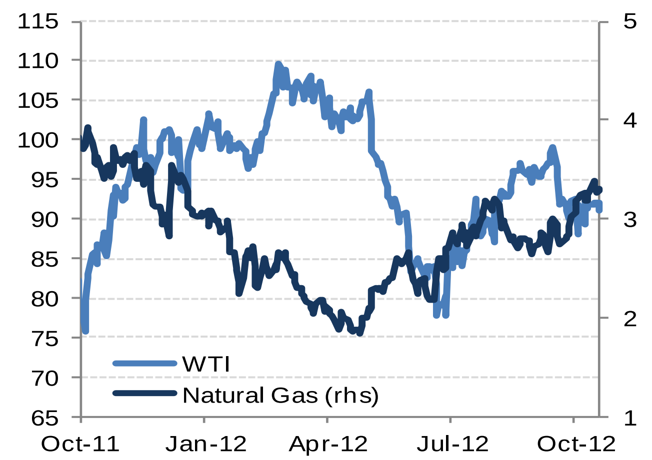
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

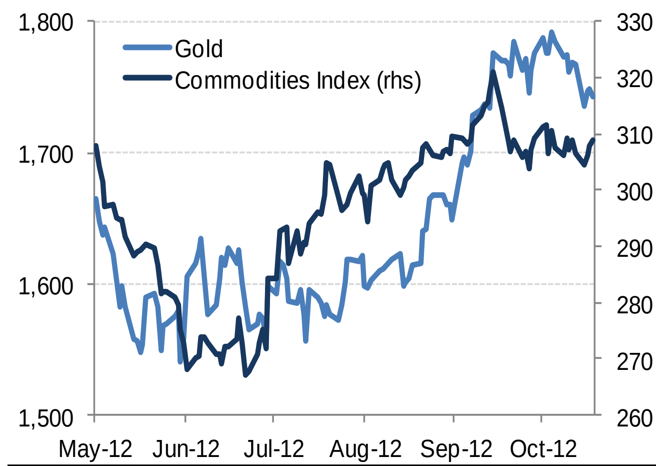
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



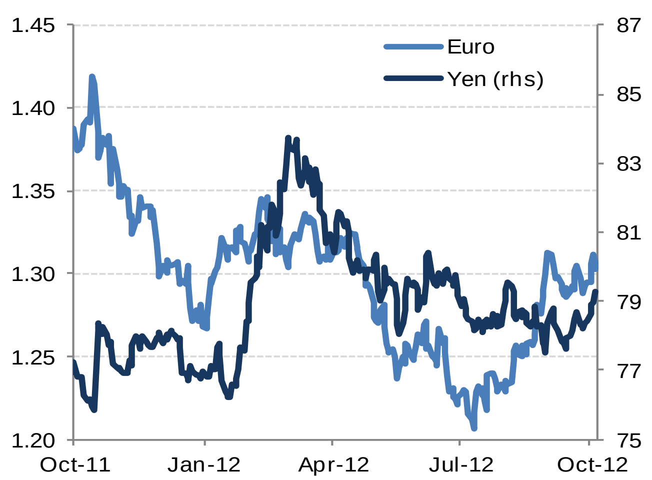
Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
(US$ & Index)



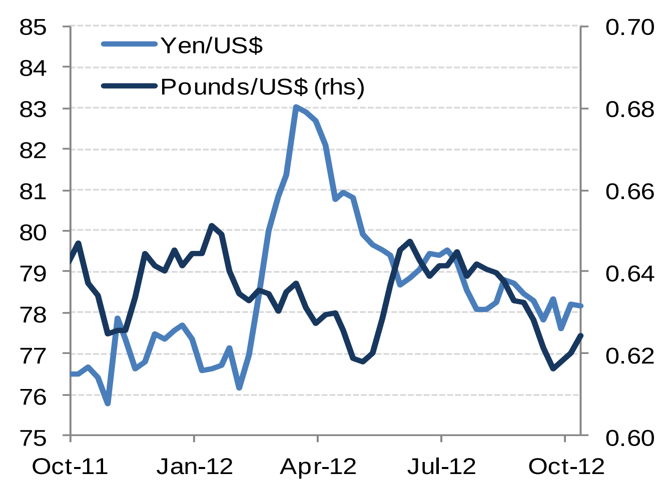
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



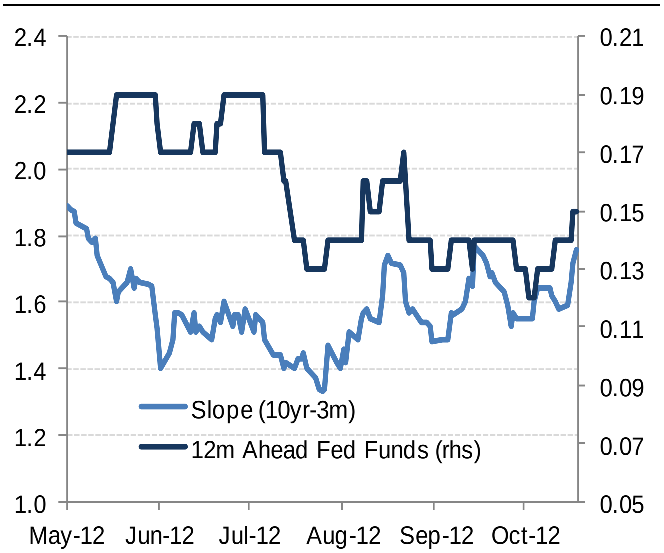
Source: Bloomberg & BBVA Research

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



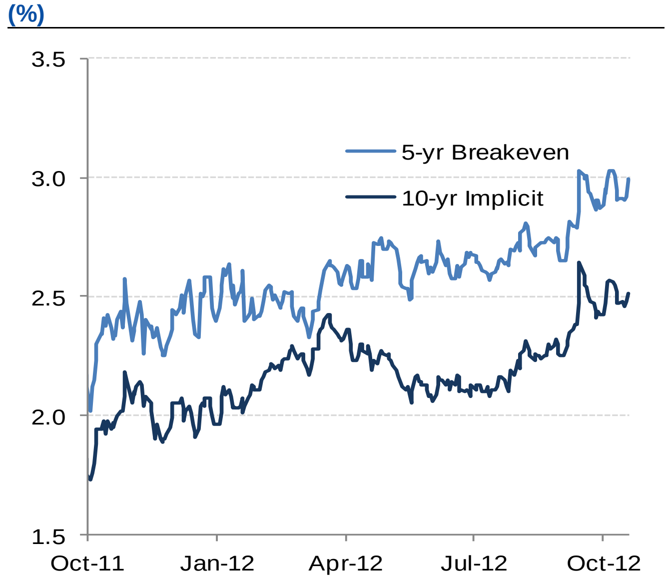
Source: Haver Analytics & BBVA Research

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	14.12	14.10	13.96
New Auto (36-months)	3.14	3.65	3.15	4.07
Heloc Loan 30K	5.46	5.47	5.50	5.50
5/1 ARM*	2.75	2.73	2.76	3.01
15-year Fixed Mortgage *	2.66	2.70	2.77	3.38
30-year Fixed Mortgage *	3.37	3.39	3.49	4.11
Money Market	0.51	0.52	0.51	0.54
2-year CD	0.86	0.86	0.86	0.87

*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	0.16	0.15	0.07
3M Libor	0.32	0.34	0.37	0.42
6M Libor	0.56	0.60	0.66	0.60
12M Libor	0.90	0.94	0.99	0.92
2yr Sw ap	0.40	0.38	0.39	0.65
5yr Sw ap	0.86	0.79	0.80	1.42
10Yr Sw ap	1.80	1.71	1.77	2.42
30yr Sw ap	2.70	2.61	2.70	3.05
7day CP	0.19	0.32	0.27	0.51
30day CP	0.27	0.25	0.24	0.44
60day CP	0.34	0.25	0.35	0.34
90day CP	0.38	0.23	0.51	0.38

Source: Bloomberg & BBVA Research

Quote of the Week

Former President Bill Clinton
Clinton: Obama knows economy not ‘fixed’
18 October 2012

“Governor Romney’s argument is 'we're not fixed, so fire him and put me in.' It is true, we're not fixed. When President Obama looked into the eyes of that man who said in the debate, 'I had so much hope four years ago and I don't now,' I thought he was going to cry because he knows that it's not fixed.”

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
24-Oct	New Home Sales	SEPT	385K	385K	373K
24-Oct	New Home Sales (MoM)	SEPT	3.20%	3.20%	-0.30%
24-Oct	FOMC Meeting Announcement	OCT	0.25%	0.25%	0.25%
25-Oct	Durable Goods Orders	SEPT	5.5%	6.8%	-13.2%
25-Oct	Durable Goods Orders Ex Transportation	SEPT	1.2%	0.9%	-1.6%
25-Oct	Initial Jobless Claims	20-Oct	372K	371K	388K
25-Oct	Continuing Claims	13-Oct	3250K	3260K	3252K
26-Oct	GDP QoQ Annualized	3Q12 A	1.5%	1.8%	1.3%
26-Oct	Personal Consumption	3Q12 A	1.9%	2.0%	1.5%
26-Oct	GDP Price Index	3Q12 A	2.0%	2.0%	1.6%
26-Oct	Core PCE QoQ	3Q12 A	1.3%	1.3%	1.7%
26-Oct	U. of Michigan Consumer Sentiment	OCT	82.6	83.0	83.1

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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