

Fed Watch

US

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 Economic Analysis

US

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QE Dashboard

New policy guidance reaffirms Fed's commitment

- Unemployment rates and yield curve declines of 0.6pp and 36bp, since the initial announcement of the maturity extension program, were not enough to foster “sustained improvements in labor conditions” according to the FOMC
- Low inflation, stable exchange rates and declining commodity prices support high levels of accommodation in the short-to-medium run
- Although credit remains tight, underlying housing market strengths could create medium-to-long run impetus for tightening if reserve outflows are mismanaged
- The reaffirmed commitment to markets comes with 5-yr forward inflation expectations edging above the newly minted tolerance of no more than 50bp higher than the 2% target, suggesting that the Fed remains willing to tolerate slightly higher long-run inflation risks

Table 1
 Large Scale Asset Purchases (LSAP) Scorecard

| | QE3 (Hybrid) Latest available | Sterilized Purchases 10/11-12/12 | Post QE2 11/10-10/11 | Recovery 7/09-10/10 | Crisis 12/07-6/09 | Pre-Crisis 3/03-11/07 |
|---|--|--|-------------------------|------------------------|----------------------|--------------------------|
| Inflation Indicators | | | | | | |
| Slope (bp) | 168 | 204 | 284 | 321 | 243 | 139 |
| 10yr Treasury (%) | 1.7 | 2.1 | 2.9 | 3.3 | 3.5 | 4.4 |
| 10yr Inflation Indexed (%) | -0.7 | -0.1 | 0.8 | 1.3 | 1.8 | 2.1 |
| 5yr breakeven Inflation expectations (%) | 2.1 | 1.9 | 1.8 | 1.6 | 1.3 | 2.3 |
| 5yr forward Inflation expectations (%) | 2.8 | 2.5 | 2.5 | 2.4 | 2.1 | 2.4 |
| CRB Spot Commodity Prices(Index,1967=100) | 486 | 506 | 519 | 421 | 392 | 316 |
| West Texas Intermediate Spot Price(\$) | 86.8 | 94.7 | 89.2 | 75.8 | 82.9 | 53.2 |
| Consumer Prices (12m %) | 1.7 | 2.4 | 3.0 | 1.4 | 2.0 | 3.6 |
| Core Consumer Prices (12m %) | 1.6 | 2.2 | 1.5 | 1.5 | 2.0 | 2.4 |
| Risk Indicators | | | | | | |
| VIX (Index) | 16.0 | 22.5 | 22.3 | 23.7 | 33.6 | 15.8 |
| S&P500 (Index) | 1419 | 1310 | 1226 | 1093 | 1109 | 1219 |
| FTSE Emerging Markets | 730 | 706 | 773 | 682 | 599 | 868 |
| US Dollar (Effective, broad Index) | 99.2 | 98.8 | 98.2 | 102.3 | 102.8 | 111.2 |
| US Dollar (Effective, emerging markets) | 127.0 | 127.5 | 126.6 | 131.8 | 130.7 | 138.4 |
| Corporate Spreads (BAA bp) | 294 | 313 | 288 | 287 | 106 | 302 |
| 3M Llibor-Treasury (bp) | 24 | 36 | 22 | 22 | 243 | 139 |
| Growth Indicators | | | | | | |
| Initial Claims (4wk avg) | 382 | 378 | 418 | 493 | 479 | 332 |
| Unemployment rate (%) | 7.7 | 8.3 | 9.1 | 9.7 | 6.8 | 4.7 |
| Private Payrolls (K monthly) | 147 | 155 | 167 | -7 | -396 | 75 |
| Consumer confidence (Index) | 74 | 63 | 58 | 53 | 53 | 88 |
| Housing Starts | 894 | 710 | 572 | 588 | 781 | 1818 |
| Core Logic Home Prices (yoy%) | 6.3 | 0.1 | -4.4 | -2.4 | -14.1 | 9.0 |
| Retail sales ex bldg, autos & gas (yoy %) | 3.6 | 5.2 | 5.8 | 0.9 | -0.6 | 5.3 |
| Industrial production (yoy %) | 1.8 | 4.1 | 4.4 | 0.2 | -7.0 | 2.3 |
| ISM Survey (Index) | 49.5 | 52.2 | 55.9 | 55.9 | 43.9 | 54.1 |
| Credit Markets | | | | | | |
| Monetary aggregate M1 (yoy %) | 13.3 | 9.0 | 6.0 | 3.9 | 7.6 | 5.5 |
| Bank Credit (\$bn) | 6141 | 6018 | 5870 | 5967 | 6081 | 4520 |
| Bank Mortgage loans (\$bn) | 2124 | 2104 | 2073 | 2107 | 2057 | 2011 |
| Commercial Paper Issuance (\$bn) | 64 | 80 | 86 | 88 | 134 | 174 |
| 3Oyr Mortgage sprd (bp) | 55 | 84 | 39 | 57 | 155 | 115 |
| CP 3m spread (bp) | 11 | 14 | 14 | 15 | 95 | 24 |

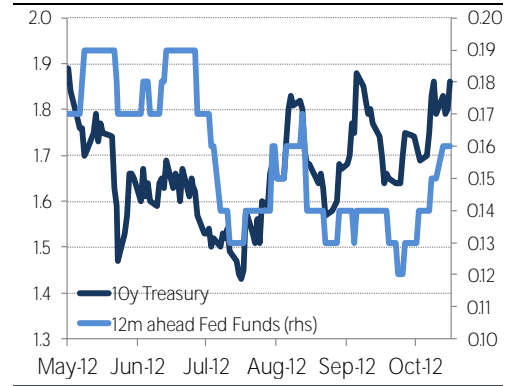
BBVA Research & Haver Analytics. * Pre-Crisis = Nov 2007

Chart 1
S & P 500 & Slope (Index, bp)



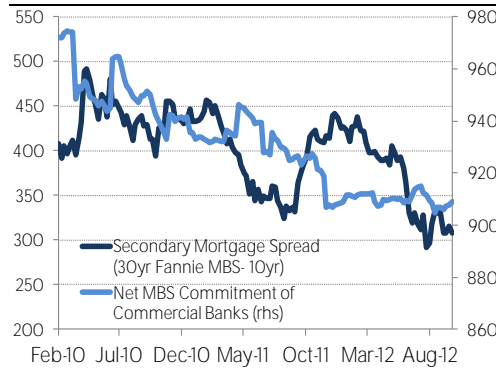
Source: Bloomberg, Haver Analytics & BBVA Research

Chart 2
10year Treasury & Fed Funds futures, (yields & %)



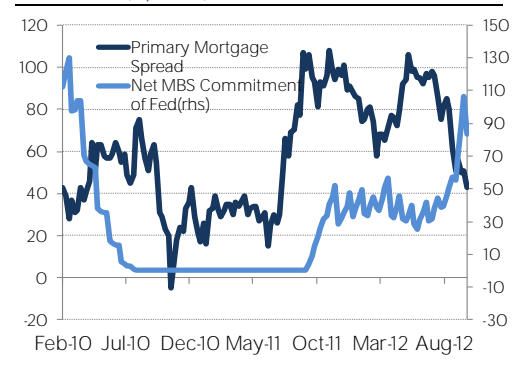
Source: Haver Analytics & BBVA Research

Chart 3
Secondary MBS Spread & Net Commercial Bank MBS Commitment



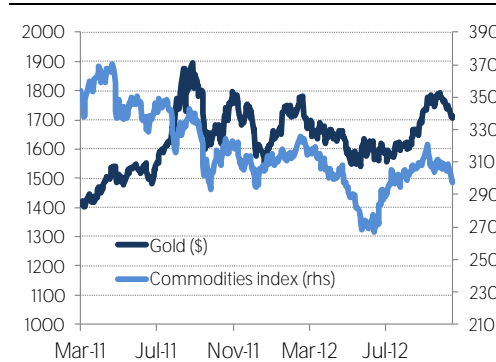
Source: Haver Analytics & BBVA Research

Chart 4
30yr Mortgage Spread & Net Fed MBS Purchases



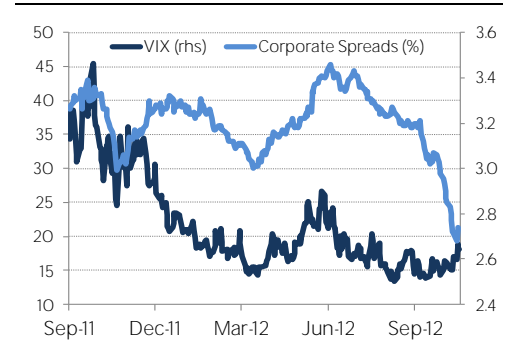
Source: Haver Analytics & BBVA Research

Chart 5
Gold & Commodities (\$ & Index, 1967=100)



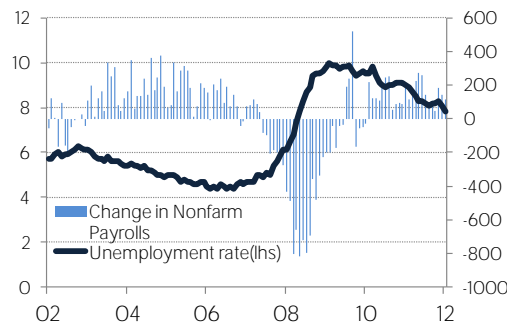
Source: Haver Analytics & BBVA Research

Chart 6
Implied Volatility & Corporate Spreads (Index & %)



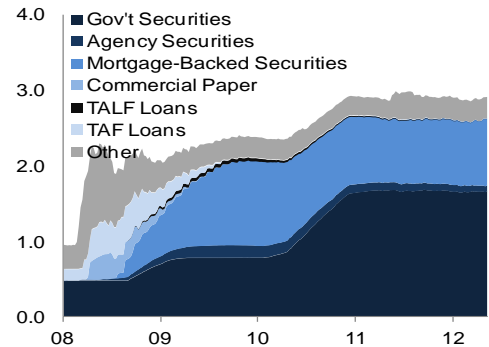
Source: Haver Analytics & BBVA Research

Chart 7
Unemployment & Nonfarm Payrolls (%&K)



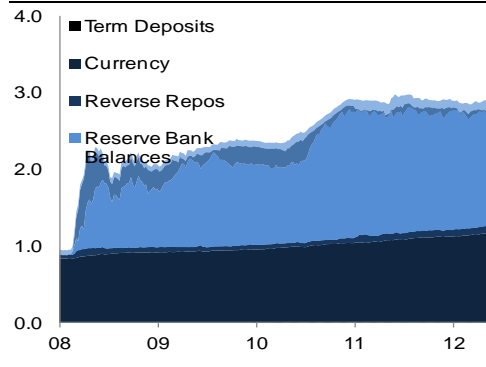
Source: Haver Analytics & BBVA Research

Chart 8
Factors Supplying Reserve Funds (\$tr)



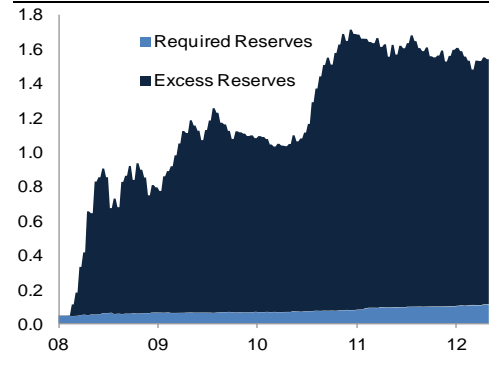
Source: Haver Analytics & BBVA Research

Chart 9
Factors Absorbing Reserve Funds (\$tr)



Source: Haver Analytics & BBVA Research

Chart 10
Required and Excess Reserves (\$tr)



Source: Haver Analytics & BBVA Research

Bottom line: Slight improvements not enough to reduce Fed accommodation

The announcement of additional Quantitative Easing this past week coincided with broader improvements in many key indicators such as unemployment and a reduction yield curve slope, which decreased 0.6pp and 36bp, respectively. These fundamental improvements and the underlying housing market rebound were not enough to reduce the amount of stimulus or timing of Fed withdrawal. Rather, the Fed enhanced its commitment to high levels of accommodation, tying the commitment to substantial reduction (1.2pp) of unemployment rate. In addition, in the short-run, risks appear balanced between high levels of liquidity and slow growth and limited inflationary pressures, which are below the explicit long-run inflation target of 2.0% plus a 50bp buffer.

However, continued accommodation is not costless. For example, forward-greater than 5yr-inflation expectations suggest upside risk to long-run inflation. Moreover, extremely high levels of bank reserves could increase inflationary pressures if the outflow of reserves was not carefully controlled or directed at unstable market such as residential mortgages. Given that risks appear tilted to the long-run and the Fed has now firmly committed to labor market improvements, we do not anticipate any change from the current levels of accommodation in the foreseeable future.

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