

# Economic Watch

## US

Houston, March 4, 2013  
Economic Analysis

US  
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## Monthly US Outlook: March

### Upbeat Economic News Despite Failing Sequester Talks

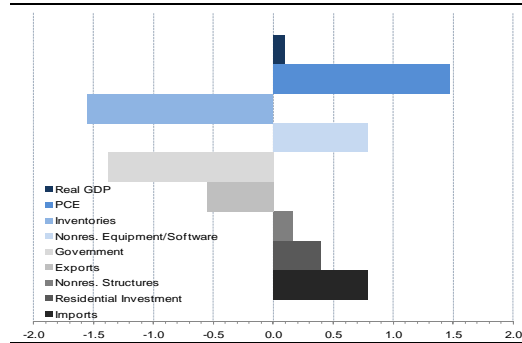
March 1<sup>st</sup> has come and gone without a political compromise on the sequester, and the next few weeks will be filled with questions about how, where, and when the spending cuts will begin to hit the real economy. On the bright side, most of the economic data leading up to the deadline has been mostly upbeat, reflecting continued gains in the manufacturing sector and stable personal consumption expenditures despite a dip in disposable income, ultimately leading to improved consumer sentiment. Furthermore, the housing recovery continues to gain momentum and should help support growth in 2013. In terms of GDP growth, the second estimate for 4Q12 showed a reversal to 0.1% following a slightly worrying negative figure in the advanced report. Government spending and private inventories had pushed down the advance figure and were revised down even further in the second release. This is not surprisingly given the uncertainty in anticipation of the fiscal cliff, and businesses have already started to rebuild inventories in 1Q13. In general, we expect to see only modest growth in 1H13 but then a pickup in activity later in the year once businesses and consumers adjust to new fiscal measures. If Congress does not find some way to reverse the automatic spending cuts, then we could see a reduction in 2013 annual GDP growth by 0.5%-0.8%, with the biggest impact hitting in the second quarter. Considering our current forecast for 1.8% annual growth, the full sequester would not push us into recession.

Even still, it is clear that the Fed remains worried about the sustainability of this improved economic activity. The latest FOMC meeting minutes confirmed the intense debate on how and when to end QE3. Most participants commented that the Committee's asset purchases had been effective in easing financial conditions and helping stimulate economic activity, though many are concerned about rising potential costs and risks. The main concerns expressed by the participants were related to the possible complications during eventual withdrawal of policy accommodation, potential negative effects on financial markets, as well as a chance that a very large portfolio of long-duration assets would, under certain circumstances, expose the Federal Reserve to significant capital losses when these holdings were unwound. Ultimately, the staff was asked to prepare additional analysis ahead of future meetings to support the FOMC's ongoing assessment of the asset purchase program. While the minutes revealed less clarity on the near-term future of monetary policy accommodation, our expectations remain unchanged. We continue to expect that the current pace of purchases will proceed until at least mid-2013, with a slower pace ongoing until the end of the year as the economy slowly improves and the risks from the increasing balance sheet and aggressive asset purchases elevate. FOMC meeting conversation will continue to focus on how to provide highly accommodative monetary policy while at the same time reducing the possibility of an adverse impact when the time comes to decrease the balance sheet. A solid and well-established recovery is needed before the exit strategy can be fully implemented.

The next few months could be a hurdle to jump through as the economy adjusts to new fiscal measures. Aside from the most pressing domestic issues, we are beginning to see some volatility coming from Europe once again, particularly related to political developments in Spain and Italy. In addition, uncertainty regarding exchange rate policies weighs on a still vulnerable global outlook. The risk of a credit ratings downgrade is still on our radar given that the debt ceiling limit will again be reached in May. All in all, if global conditions remain stable and we only have the full sequester on our hands, economic activity should be mostly back on track by the end of 2013, barring further political disruptions of course.

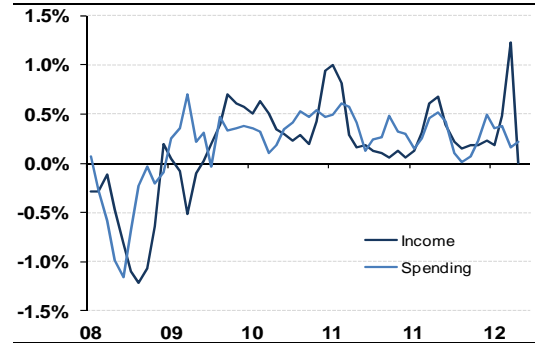
### Economic Indicators

Graph 1  
**Contributions to Real GDP Growth**  
(4Q12 Preliminary, SAAR Percentage Points)



Source: BEA and BBVA Research

Graph 2  
**Personal Income and Expenditures**  
(3MMA, MoM % Change)



Source: BEA and BBVA Research

Graph 3  
**Consumer Confidence**  
(SA, Index 1985=100)



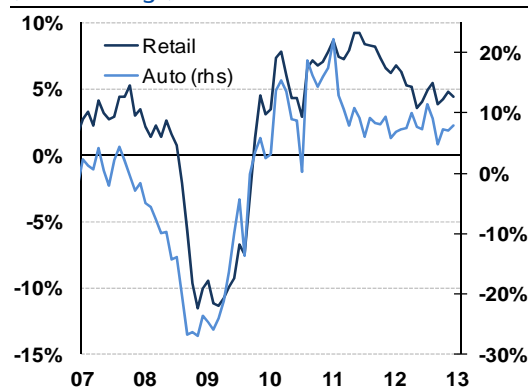
Source: Conference Board and BBVA Research

Graph 4  
**ISM Indices**  
(SA, 50+ = Expansion)



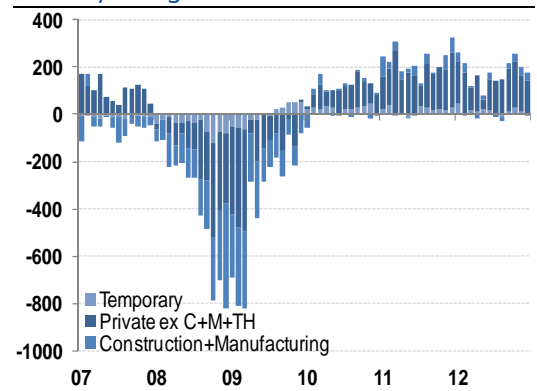
Source: ISM and BBVA Research

Graph 5  
**Retail and Auto Sales**  
(YoY % Change)



Source: US Census Bureau and BBVA Research

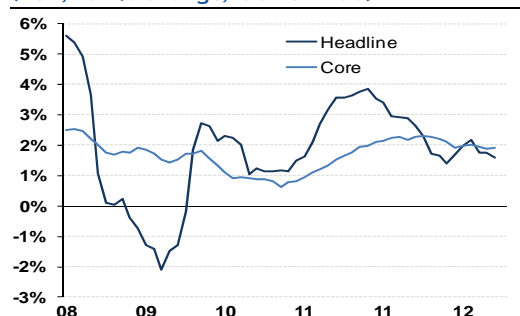
Graph 6  
**Private Nonfarm Payrolls**  
(Monthly Change in K)



Source: BLS and BBVA Research

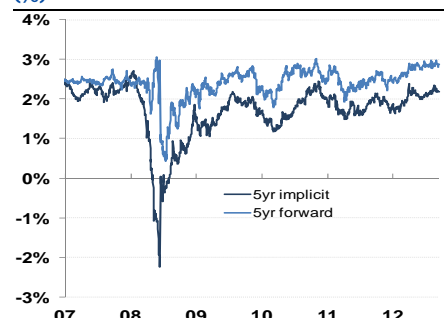
## Economic Indicators

Graph 7  
**Consumer Price Index**  
 (NSA, YoY % Change, 1982-84=100)



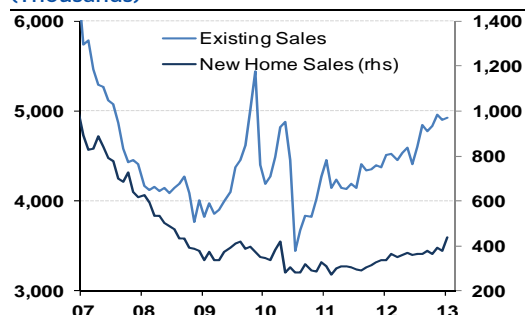
Source: BLS and BBVA Research

Graph 8  
**Inflation Expectations**  
 (%)



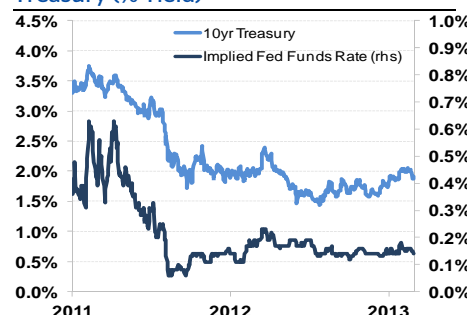
Source: Federal Reserve Board and BBVA Research

Graph 9  
**New and Existing Home Sales**  
 (Thousands)



Source: US Census Bureau, NAR, and BBVA Research

Graph 10  
**12-Month Implied Fed Funds Rate & 10-Yr Treasury**  
 (% Yield)



Source: Federal Reserve Board and BBVA Research

Table 1  
**Forecasts (BOLD=FORECASTS)**

	1Q12	2Q12	3Q12	4Q12	2011	2012	2013	2014	2015
Real GDP (% SAAR)	2.0	1.3	3.1	0.1	1.8	2.2	1.8	2.3	2.5
Real GDP (Contribution, pp)									
PCE	1.7	1.1	1.1	1.5	1.8	1.3	1.2	1.4	1.5
Gross Investment	0.8	0.1	0.9	-0.2	0.6	1.2	0.7	1.0	1.1
Non Residential	0.7	0.4	-0.2	1.0	0.8	0.8	0.6	0.8	0.9
Residential	0.4	0.2	0.3	0.4	0.0	0.3	0.3	0.2	0.2
Exports	0.6	0.7	0.3	-0.6	0.9	0.4	0.5	1.0	1.0
Imports	-0.5	-0.5	0.1	0.8	-0.8	-0.4	-0.5	-1.2	-1.3
Government	-0.6	-0.1	0.8	-1.4	-0.7	-0.3	-0.1	0.1	0.1
Unemployment Rate (%)	8.3	8.2	8.0	7.8	8.9	8.1	7.5	6.8	6.3
Average Monthly Nonfarm Payroll (K)	262	108	152	201	175	181	147	170	192
CPI (YoY %)	2.8	1.9	1.7	1.9	3.1	2.1	2.1	2.2	2.3
Core CPI (YoY %)	2.2	2.3	2.0	1.9	1.7	2.1	1.9	2.0	2.1
Fiscal Balance (% GDP)	-	-	-	-	-8.7	-7.0	-5.4	-3.8	-2.6
Current Account (bop, % GDP)	-3.5	-3.0	-2.7	-	-3.1	-3.1	-3.0	-3.5	-3.8
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
S&P Case-Shiller Index (YoY %)	-1.28	1.55	3.64	7.33	-4.39	2.81	7.30	5.76	3.85
10-Yr Treasury (% Yield, eop)	2.17	1.62	1.72	1.72	1.98	1.72	2.30	2.70	3.39
U.S. Dollar / Euro (eop)	1.32	1.25	1.29	1.31	1.32	1.31	1.32	1.33	1.34
Brent Oil Prices (dpb, average)	118.4	108.5	109.7	110.3	111.3	111.7	109.2	112.9	119.0

Source: BBVA Research

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