

Economic Watch

US

Houston, July 3, 2013
Economic Analysis

US

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Monthly US Outlook: July

Pending Fed Action Dominates the Outlook for 2H13

- Economic pickup expected in 2H13 after slower growth in 1H13
- Fed attempts to clarify policy timeline and correct market “overreaction”
- Domestic risks to growth overshadowed by slower external activity

Economic headlines throughout the past few weeks have highlighted an interesting shift into 3Q13. Recent activity has certainly been in-line with expectations for a slower second quarter, though the surprising downward revision to 1Q13 GDP growth suggests a sluggish pace throughout the entire first half of the year. Although personal consumption seemed to hold up stronger than expected throughout the past few months, much of this was related to deflationary pressures and some temporary relief at the gas pump. Housing activity has mostly maintained its positive momentum but limited supply and reduced affordability could limit sales in the short-term. Manufacturing indicators confirmed that domestic production was relatively weak, with exports taking a hit as global growth continues to struggle. Employment growth has sputtered along at a steady pace, but changing dynamics and flows into and out of the labor force are putting unique pressure on the unemployment rate.

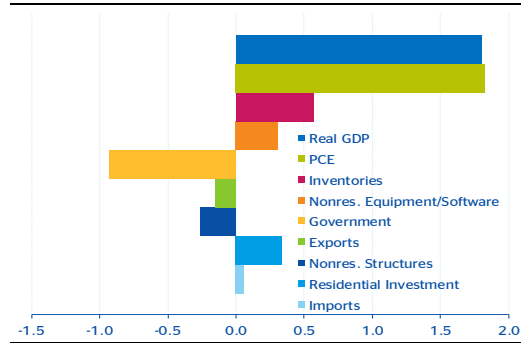
Garnering the most attention lately was June's FOMC statement and subsequent market “overreaction”, with Ben Bernanke's press conference at the center of all the hustle and bustle. While the Chairman simply affirmed the Fed's plans for maintaining a highly accommodative stance of monetary policy, the ensuing jump in the 10-year Treasury yield and simultaneous drop in equities seemed to be out-of-line with what the Fed intended. Markets went haywire when Bernanke outlined a suggested timeline for tapering and ending QE3, but our outlook remains unchanged. We continue to expect that the FOMC will begin to dial down asset purchases in late 3Q13, ultimately concluding the program in 1H14, as long as economic activity continues to improve at a steady pace. Furthermore, we expect that the Fed will first increase the Fed Funds rate in 3Q15, prior to continuing its exit strategy with asset sales in 2Q16. However, the plan is not quite set in stone and there is plenty of room for the Fed to stray from this suggested timeline. For more details see our latest [Fedwatch](#).

The unexpected jump in interest rates has invoked new concerns of a potential asset bubble and the fact that this rebound may be happening too soon ahead of underlying strength in the economic recovery. However, we still see a low probability of risks to growth for the foreseeable future. Fiscal policy is still on the radar, and we are likely to see some noise related to the debt ceiling and 2014 budget by the end of FY2013. Newer concerns related to QE3 are rampant but we expect that the Fed will be even more careful moving forward so as not to allow for a repeat response from markets. Ultimately, the major source of downward risk comes from the external environment, with global slowdowns potentially limiting production of U.S. exports. Slowdowns in emerging markets are also becoming a bit more realistic, particularly with the latest slow-growth data coming from China. There is also the risk that this slow-growth environment allows for the latest deflationary pressures to persist throughout the global economy.

Still, the U.S. seems poised to endure the current headwinds as long as the situation does not deteriorate significantly. In fact, there is some potential upside to growth, especially with our expectations for a stronger 2H13 as both business and consumer confidence rise. Overall, we maintain our baseline scenario for 1.8% growth in 2013 with acceleration above 2.0% thereafter.

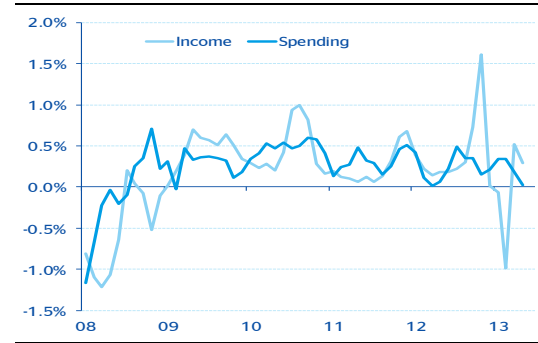
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(1Q13 Final, SAAR Percentage Points)



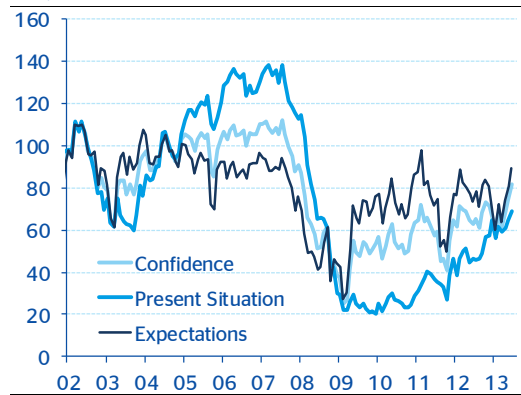
Source: BEA and BBVA Research

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



Source: BEA and BBVA Research

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



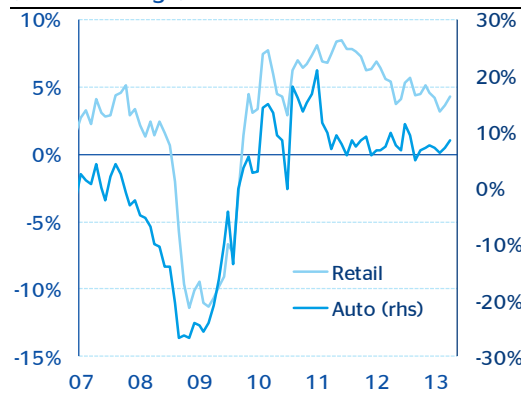
Source: Conference Board and BBVA Research

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



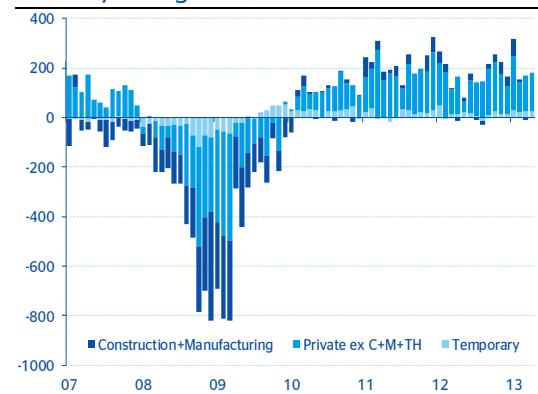
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

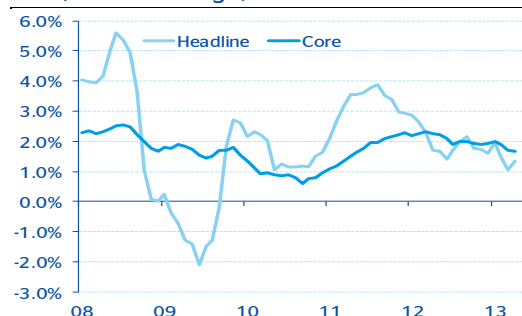
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

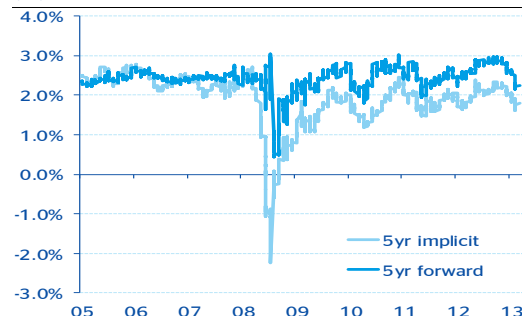
Economic Indicators

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



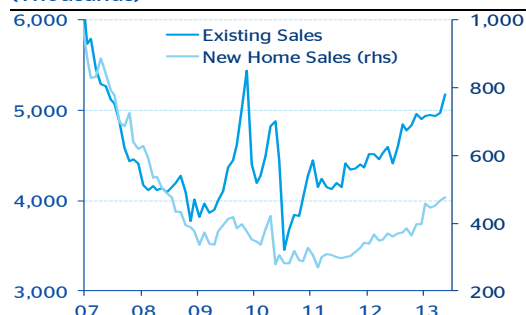
Source: BLS and BBVA Research

Graph 8
Inflation Expectations
(%)



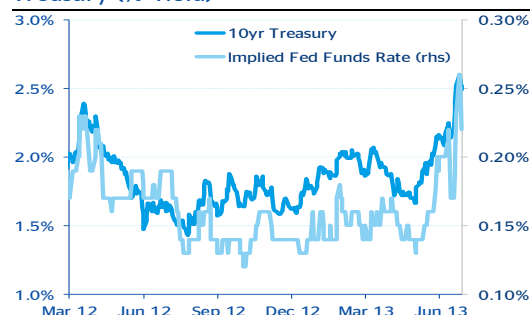
Source: Federal Reserve Board and BBVA Research

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)

	2Q12	3Q12	4Q12	1Q13	2Q13	2011	2012	2013	2014	2015
Real GDP (% SAAR)	1.3	3.1	0.4	1.8	1.8	1.8	2.2	1.8	2.3	2.5
Real GDP (Contribution, pp)										
PCE	1.1	1.1	1.3	1.8	1.2	1.8	1.3	1.4	1.4	1.6
Gross Investment	0.1	0.9	0.2	1.0	0.9	0.6	1.2	0.8	0.9	0.9
Non Residential	0.4	-0.2	1.3	0.0	1.0	0.8	0.8	0.6	0.8	0.8
Residential	0.2	0.3	0.4	0.3	0.2	0.0	0.3	0.3	0.2	0.2
Exports	0.7	0.3	-0.4	-0.2	0.7	0.9	0.5	0.2	0.9	0.9
Imports	-0.5	0.1	0.7	0.1	0.9	-0.8	-0.4	-0.2	-0.9	-0.9
Government	-0.1	0.8	-1.4	-0.9	-0.4	-0.7	-0.3	-0.5	-0.1	0.0
Unemployment Rate (% average)	8.2	8.0	7.8	7.7	7.6	8.9	8.1	7.6	7.0	6.4
Average Monthly Nonfarm Payroll (K)	108	152	209	207	160	175	183	182	193	219
CPI (YoY %)	1.9	1.7	1.9	1.7	1.3	3.1	2.1	1.6	2.2	2.3
Core CPI (YoY %)	2.3	2.0	1.9	1.9	1.7	1.7	2.1	1.9	2.0	2.2
Fiscal Balance (% GDP)	-	-	-	-	-	-8.7	-7.0	-4.1	-3.5	-2.3
Current Account (bop, % GDP)	-2.8	-2.7	-2.6	-2.7	-	-3.0	-2.8	-2.8	-3.4	-3.7
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
S&P Case-Shiller Index (YoY %)	1.64	3.62	7.25	10.17	10.61	-4.38	2.78	9.88	6.73	4.77
10-Yr Treasury (% Yield, eop)	1.62	1.72	1.72	1.96	2.30	1.98	1.72	2.30	2.73	3.39
U.S. Dollar / Euro (eop)	1.25	1.29	1.31	1.30	1.32	1.31	1.31	1.31	1.30	1.35
Brent Oil Prices (dpb, average)	108.5	109.7	110.3	112.6	102.7	111.3	111.7	108.0	112.9	119.0

Source: BBVA Research

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