

Economic Watch

US

Houston, October 3, 2013
Economic Analysis

US

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Monthly US Outlook: October Government Shutdown Overshadows Economic News

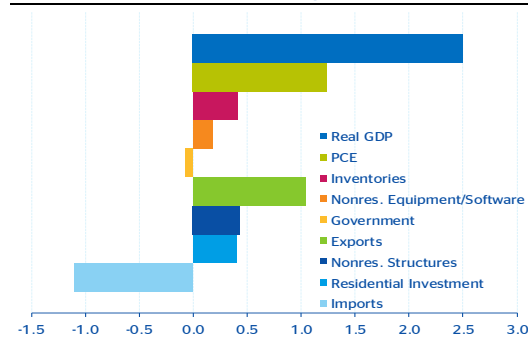
- Shutdown could cut 0.17-0.34% off of 4Q13 real GDP growth
- Various economic reports delayed, financial markets relatively calm
- FOMC likely to delay QE3 tapering to 2014 if conditions do not improve

The moment we've all talked about is finally here: the government shutdown of 2013. Many predicted that Congress would reach an eleventh-hour continuing resolution agreement on budget negotiations, so it was somewhat surprising to see that they allowed for the government shutdown to go into full effect on October 1st. However, with both sides trying to influence public opinion and the divide between parties not getting any smaller, an early exit from this shutdown period seems unlikely. Programs deemed essential by the U.S. government such as air traffic control, border security, food inspections, and the U.S. Postal Service are still operating, and since entitlement programs are not considered during the annual budgeting process, payments to Social Security, Medicare and Medicaid recipients will continue. Currently, it is unclear whether this shutdown will have lasting economic consequences (i.e. compared to the shutdown in 1995) given that furloughed wages are most likely to be paid retroactively. Federal government employment (excluding the Postal Service) makes up approximately 16% of total nonfarm payrolls, about the same as it did in 1995, and less than 50% of these government employees are expected to be furloughed. Still, there is clearly going to be some spillover on certain industries that may not be able to recoup such losses, including tourism, with national parks and museums closed until the shutdown ends. Ultimately, we expect that this shutdown would have a minimal impact on real GDP growth for 4Q13, potentially shaving 0.17-0.34 percentage points off our QoQ SAAR estimate depending on the duration. Our current baseline scenario of 1.8% annual growth in 2013 does not account for this government shutdown, so downward bias to our forecast remains strong.

Other economic news appear to be overshadowed by the government shutdown, which is not surprising given that many closely-watched reports will be delayed for the time being. Data released prior to the shutdown were starting to signal acceleration in activity from the summer months, though not as strong as we had originally predicted. Most importantly, private consumption and investment appear to be lagging throughout 2H13 thus far, and heightened fiscal and monetary policy uncertainty is not likely to encourage stronger growth in the short-term. Financial markets appear to be taking the news relatively well, though mostly as a result of the Fed's decision to hold off on QE3 tapering ([see our Fed Watch](#)). Going forward, there is higher uncertainty for financial markets regarding the expected path of QE3 as well as the Fed's successful exit and policy normalization. The questions on when and how QE3 should be expected to be scaled down remained unanswered. Thus, tapering can likely result in a steeper pace for the wind-down process, a decreased credibility of future QE3 policy announcements, and an increase in financial markets volatility as market expectations of tapering news will grow by December. The Fed's actions clearly remain data-driven and thus contingent upon labor market conditions and inflation. If conditions improve in the next two months, the FOMC could announce its plan to scale down QE3 in December. However, if the recovery stalls, and with this government shutdown in effect, the FOMC could delay tapering until 2014.

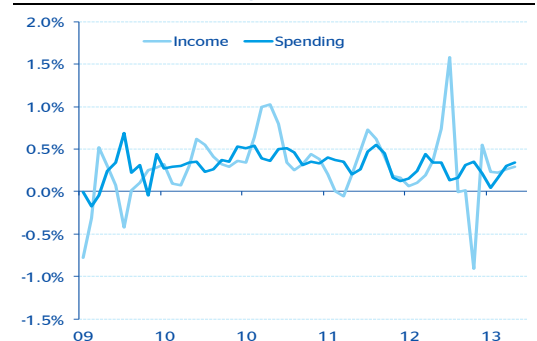
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(2Q13 Final, SAAR Percentage Points)



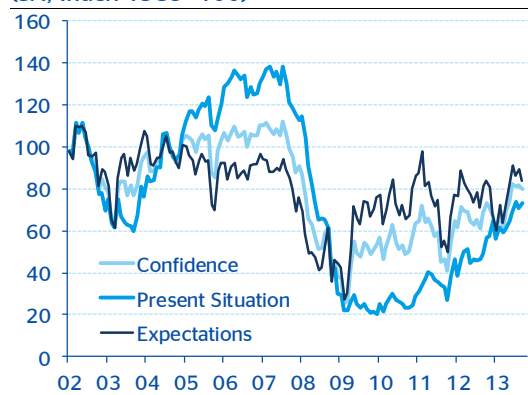
Source: BEA and BBVA Research

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)



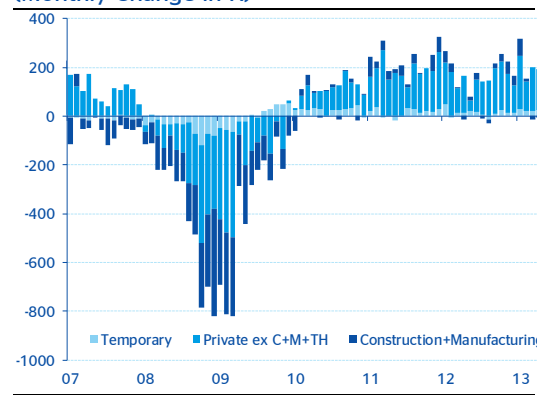
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

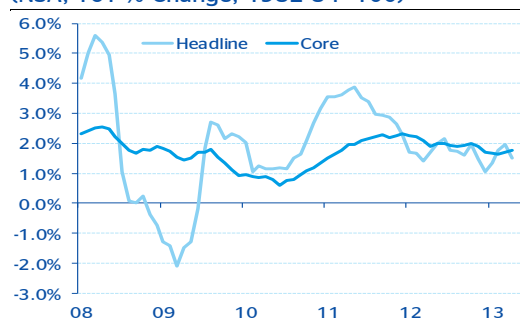
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

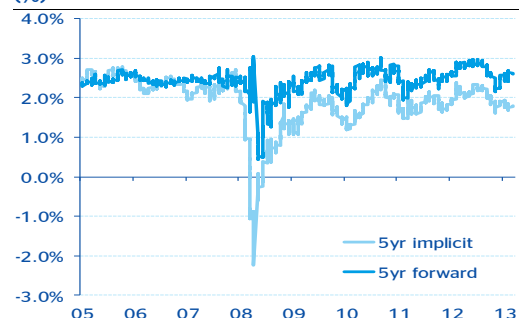
Economic Indicators

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



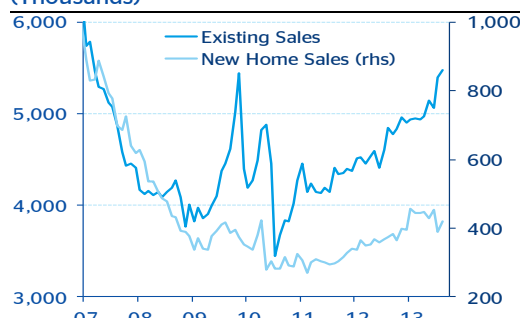
Source: BLS and BBVA Research

Graph 8
Inflation Expectations
 (%)



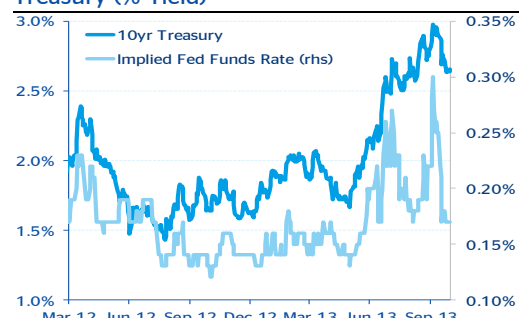
Source: Federal Reserve Board and BBVA Research

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) – Note: Revisions Pending

	3Q12	4Q12	1Q13	2Q13	2011	2012	2013	2014	2015	2016
Real GDP (% SAAR)	2.8	0.1	1.1	2.5	1.8	2.8	1.8	2.3	2.5	2.8
Real GDP (Contribution, pp)										
PCE	1.2	1.1	1.5	1.2	1.7	1.5	1.3	1.0	1.0	1.2
Gross Investment	1.0	-0.4	0.7	1.4	0.7	1.4	0.7	1.0	1.0	1.1
Non Residential	0.0	1.1	-0.6	0.6	0.8	0.9	0.4	0.7	0.8	0.9
Residential	0.4	0.5	0.3	0.4	0.0	0.3	0.4	0.3	0.2	0.3
Exports	0.1	0.2	-0.2	1.0	0.9	0.5	0.4	0.9	0.9	0.8
Imports	-0.1	0.5	-0.1	-1.1	-0.8	-0.4	0.3	0.6	0.5	0.3
Government	0.7	-1.3	-0.8	-0.1	-0.7	-0.2	-0.4	0.0	0.0	0.0
Unemployment Rate (% average)	8.0	7.8	7.7	7.6	8.9	8.1	7.5	7.0	6.4	5.9
Average Monthly Nonfarm Payroll (K)	152	209	207	182	175	183	186	196	211	230
CPI (YoY %)	1.7	1.9	1.7	1.4	3.1	2.1	1.6	2.2	2.4	2.4
Core CPI (YoY %)	2.0	1.9	1.9	1.7	1.7	2.1	1.9	2.0	2.2	2.3
Fiscal Balance (% GDP)	-	-	-	-	-8.0	-6.5	-4.0	-3.4	-2.2	-2.4
Current Account (bop, % GDP)	-2.6	-2.5	-2.5	-	-3.0	-2.7	-2.6	-2.8	-2.7	-2.4
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.50
S&P Case-Shiller Index (YoY %)	3.62	7.30	10.11	-	-4.36	2.76	11.96	9.25	6.86	5.78
10-Yr Treasury (% Yield, eop)	1.72	1.72	1.96	2.30	1.98	1.72	2.90	3.28	3.64	4.03
U.S. Dollar / Euro (eop)	1.29	1.31	1.30	1.32	1.32	1.31	1.30	1.30	1.35	1.36
Brent Oil Prices (dpb, average)	109.7	110.3	112.6	102.7	111.3	111.7	107.6	112.9	119.0	120.1

Source: BBVA Research

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