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Economic Watch

US

Houston, March 7, 2014
Economic Analysis

US
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Monthly US Outlook: March

Economic Data Point to Warmer Months Ahead

- Extreme weather hurting economic activity, but only temporarily
- Fed should be able to hold off on changing thresholds, for now
- Financial risks stemming from emerging markets are limited

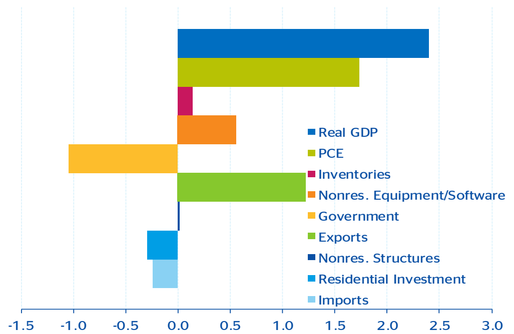
The first quarter of 2014 has not quite been all it was cracked up to be, though the weather forecasters bear more of the burden than economists this time around. Extreme weather conditions have lingered much longer than anticipated throughout most of the U.S., keeping consumers indoors and interrupting the usual flow of business across many sectors. Data through February suggest a moderate slowdown in growth compared to the more robust rates seen in 3Q13 and 4Q13, particularly related to residential investment and manufacturing activity. Still, we expect that the impact will be short-lived, with GDP growth accelerating throughout 2014 to hit our upwardly revised forecast of 2.5% for the year. Reduced fiscal and monetary policy uncertainty during the year should help offset any temporary factors impacting economic momentum.

Weaker-than-expected economic data have not been enough to distract markets from the Fed's ongoing adjustments to their monetary policy strategy. In fact, the latest data have intensified questions about how the Fed will react to persistently low inflation and simultaneous improvements in the unemployment rate. February's employment report noted a jump in the unemployment rate back to 6.7%, a move that should ease the Fed's pressures to make immediate changes to the forward guidance thresholds. However, inflation remains far below the 2.0% threshold, with core CPI and PCE in January hitting only 1.6% and 1.1%, respectively. Considering the vulnerability of the ongoing recovery, fragile business and consumer confidence could be a major factor in holding down prices, with this persistently low inflation reflecting elevated slack in the labor market and downward prices pressures on imported goods. The Fed has summed up their views on inflation in recent FOMC meetings and speeches, committing to the idea that the latest trends are at least due to some transitory factors. Some members within the FOMC have noted that recent declines in inflation might suggest that the economic recovery is not as strong as we like to think, particularly as it has been overshadowed with bouts of monetary stimulus in recent years. In our view, while the drop in inflation appears to be behind us, future pressures will remain limited. However, as spring blooms and both domestic and global activity gain more traction, downward pressures from food, energy, and other services should fade away.

Despite the short-term impact on economic activity in the U.S., risks to growth remain biased to the upside. Global market volatility should subside, though the impact on U.S. activity has been limited particularly as commodity prices suggest contained effects from developments in emerging markets. In the U.S., domestic markets should return to fundamentals as the Fed advances in policy normalization and fiscal policy moves to the back burner. Overall, we can expect to see more consistent improvement in economic reports that will boost confidence and could add a few percentage points to our existing 2014 GDP forecast.

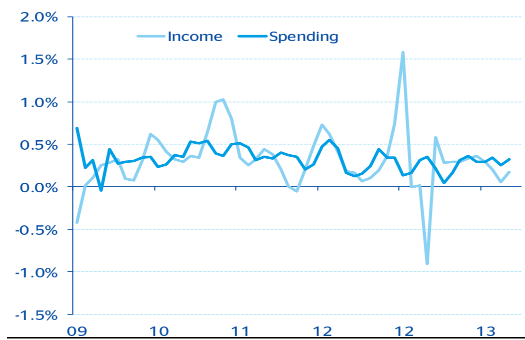
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(4Q13 Preliminary, SAAR Percentage Points)



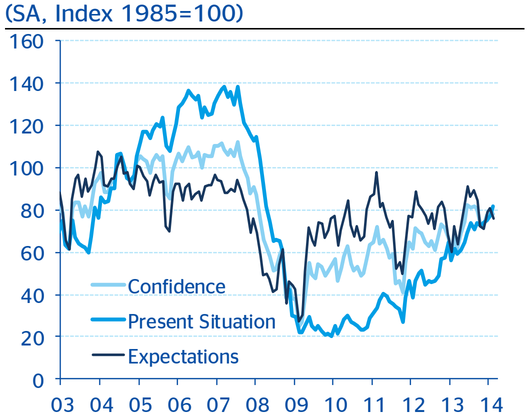
Source: BEA and BBVA Research

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



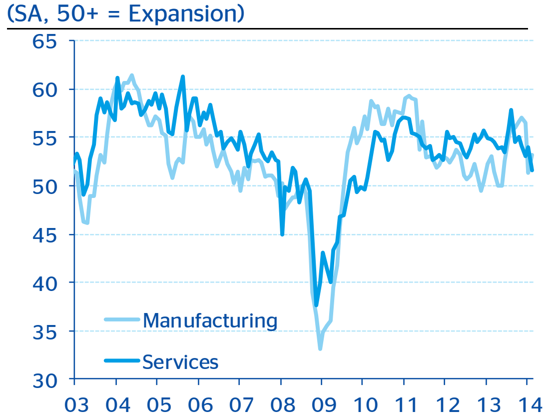
Source: BEA and BBVA Research

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



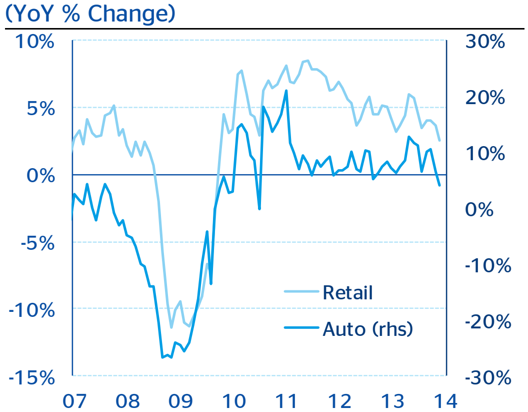
Source: Conference Board and BBVA Research

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



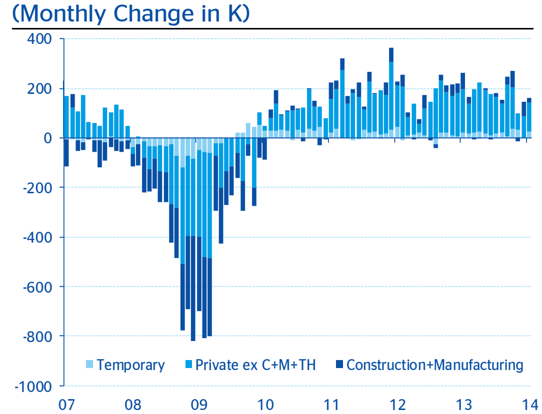
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

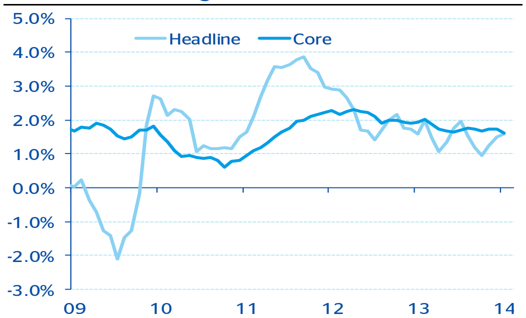
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

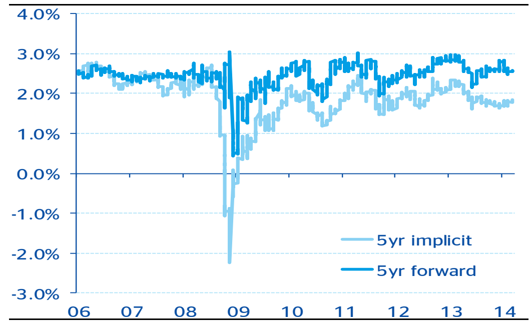
Economic Indicators

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



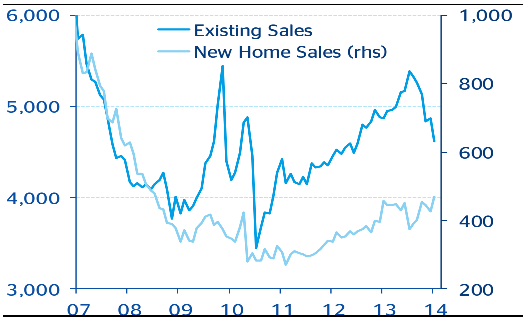
Source: BLS and BBVA Research

Graph 8
Inflation Expectations (%)



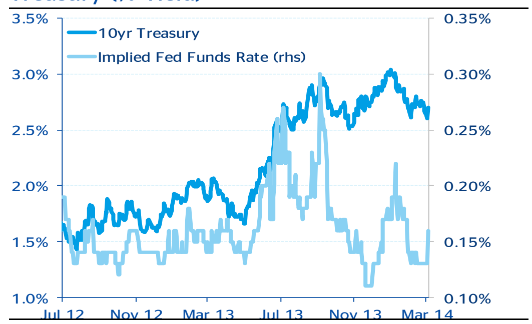
Source: Federal Reserve Board and BBVA Research

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)

	1Q13	2Q13	3Q13	4Q13	**1Q14**	2011	2012	2013	**2014**	**2015**	**2016**	**2017**
Real GDP (% SAAR)	1.1	2.5	4.1	2.4	**1.6**	1.8	2.8	1.9	**2.5**	**2.5**	**2.8**	**2.8**
Real GDP (Contribution, pp)												
PCE	1.5	1.2	1.4	1.7	**0.8**	1.7	1.5	1.3	**1.2**	**1.2**	**1.3**	**1.2**
Gross Investment	0.7	1.4	2.6	0.7	**0.2**	0.7	1.4	0.8	**1.0**	**0.9**	**1.0**	**1.2**
Non Residential	-0.6	0.6	0.6	0.9	**0.6**	0.8	0.9	0.3	**0.7**	**0.9**	**0.9**	**0.9**
Residential	0.3	0.4	0.3	-0.3	**0.2**	0.0	0.3	0.3	**0.2**	**0.3**	**0.2**	**0.3**
Exports	-0.2	1.0	0.5	1.2	**0.7**	0.9	0.5	0.4	**0.8**	**1.0**	**0.8**	**0.8**
Imports	-0.1	-1.1	-0.4	-0.2	**0.6**	-0.8	-0.4	-0.2	**0.5**	**0.5**	**0.3**	**0.4**
Government	-0.8	-0.1	0.1	-1.1	**0.0**	-0.7	-0.2	-0.4	**-0.2**	**0.0**	**0.0**	**0.0**
Unemployment Rate (%, average)	7.7	7.5	7.2	7.0	**6.7**	8.9	8.1	7.4	**6.7**	**6.2**	**5.7**	**5.2**
Average Monthly Nonfarm Payroll (K)	206	201	172	198	**168**	174	186	194	**196**	**226**	**245**	**273**
CPI (YoY %)	1.7	1.4	1.5	1.2	**1.4**	3.1	2.1	1.5	**2.3**	**2.4**	**2.4**	**2.5**
Core CPI (YoY %)	1.9	1.7	1.7	1.7	**1.7**	1.7	2.1	1.8	**2.0**	**2.3**	**2.4**	**2.5**
Fiscal Balance (% GDP)	-	-	-	-	-	-8.7	-6.8	**-4.2**	**-3.1**	**-2.8**	**-2.9**	**-3.0**
Current Account (bop, % GDP)	-2.5	-2.3	-2.3	-	-	-3.0	-3.0	**-2.5**	**-2.6**	**-2.2**	**-2.0**	**-1.4**
Fed Target Rate (%, eop)	0.25	0.25	0.25	0.25	**0.25**	0.25	0.25	0.25	**0.25**	**0.50**	**1.50**	**2.50**
S&P Case-Shiller Index (YoY %)	9.92	9.88	11.17	11.38	**9.68**	-4.34	2.82	**10.60**	**8.78**	**6.20**	**4.62**	**3.78**
10-Yr Treasury (% Yield, eop)	1.96	2.30	2.81	2.90	**2.82**	1.98	1.72	2.90	**3.50**	**3.80**	**4.10**	**4.34**
U.S. Dollar / Euro (eop)	1.30	1.32	1.34	1.37	**1.34**	1.32	1.31	1.37	**1.31**	**1.35**	**1.37**	**1.36**
Brent Oil Prices (dpb, average)	112.6	102.7	110.3	109.3	**109.2**	111.3	111.7	108.7	**112.8**	**117.2**	**120.2**	**124.2**

Source: BBVA Research