

US Weekly Flash

Highlights

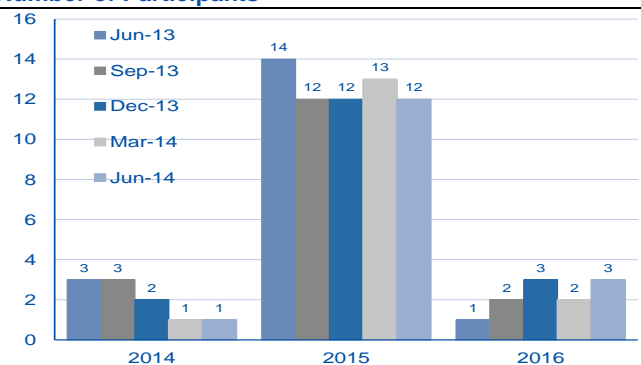
- **June FOMC Statement: Setting the Stage for Pivotal Changes to Monetary Policy**

- The FOMC Statement for the June meeting came as little surprise, with another \$10bn reduction in asset purchases and consistent reports on gradual improvements in economic data. The discussion on the Fed's exit strategy was reserved for Yellen's press conference. Chair Yellen acknowledged the difficulty in determining the appropriate method for moving toward policy normalization. At the same time, Yellen reaffirmed that the broad principles of the June 2011 Exit Strategy (such as normalizing the size and composition of the balance sheet to Treasury security holdings) only remain true for the long-run. She also confirmed Fed's commitment to Bernanke's statement that they would withhold sales of MBS and keep it these assets to maturity. Most importantly, Yellen noted that while discussions continue, the Committee has not yet reached a conclusion regarding the reinvestment and exit strategy details: "Committee is working through many issues related to normalization and will continue discussions with expectations of providing additional details later this year."
- The next twelve months will be significant for the FOMC. First, the end of quantitative easing is in sight, with measured steps of \$10bn reductions expected to continue until the last announcement in 4Q14. Second, the Fed has managed to anchor expectations for the first fed funds rate hike to occur in mid-2015 – consistent with our baseline scenario. Finally, the FOMC will have to overcome internal differences of opinion in order to convey a clear roadmap for balance sheet normalization. This may not be an easy process given the lack of experience with these policy tools and the divergence on opinions regarding the damage on long-term growth caused by the financial crisis. For more details, refer to our [Fed Watch](#).

- **Inflation Surprises to the Upside in May, but Expectations Remain Low and Anchored**

- The consumer price index jumped 0.4% in May, accelerating from April's 0.3% gain and reflecting the fastest monthly pace of price growth since February 2013. Both the food and energy indices were strong contributors for the month, rising 0.5% and 0.9%, respectively. At the core level, prices increased 0.3% for the first time since the end of the recession back in late 2009. The usual drivers were at play here, including medical care commodities (0.5%) and shelter (0.3%), while transportation services added a big 1.0% push.
- Both headline and core CPI accelerated on a YoY basis to 2.1% and 1.9%, respectively. While these rates still remain well-below the Fed's inflation target (2.0% for the core PCE price index but 2.5% for core CPI), the pickup in May was much faster than what we had seen throughout the prior year. When considering monetary policy action, it is important to remember that the FOMC has been careful not to overreact to just one month's worth of data. If this accelerating trend continues, we could see a sooner-than-expected rate hike from the Fed; however, we do not expect that inflation will increase fast enough for the hawks to win out over the doves.

Graph 1
Appropriate Timing of Policy Firming
Number of Participants



Source: Federal Reserve & BBVA Research

Graph 2
Headline and Core CPI
YoY % Change



Source: BLS & BBVA Research

Week Ahead

New Home Sales (May, Tuesday 10:00 ET)

Forecast: 445K

Consensus: 440K

Previous: 433K

New home sales are expected to increase in May for the second consecutive month following a minor setback in the first quarter of 2014. April's gain recovered almost all of the ground lost in March as the spring weather made way for stronger housing activity. However, the current supply of new homes on the market slipped in April and could limit the amount of sales in May. Similarly, new home construction stalled somewhat throughout the first few months of the year, suggesting that supply will remain constrained for the coming months. According to the home builder confidence index, traffic of prospective buyers has improved throughout the past few months, which bodes well for new home sales. Overall, we expect to see a modest gain in sales for May, but levels are not likely to rise above the annual peak seen in January.

Consumer Confidence (June, Tuesday 10:00 ET)

Forecast: 84.1

Consensus: 83.5

Previous: 83.0

Consumer confidence has been a bit volatile in recent months but the general trend is moving upward. May's improvement was driven mostly by a rebound in views on the present situation, although consumer expectations were also stronger for the month. In particular, consumer views on the labor market improved slightly in April and May, with this momentum expected to continue into the summer months. Consumer spending has remained relatively healthy and suggests increased confidence regarding future income growth. For June, we expect that the consumer confidence index will continue edging slowly toward the pre-recession peak, supported by gains in both the present situation and expectations components.

GDP, Final (1Q14, Wednesday 8:30 ET)

Forecast: -0.5%

Consensus: -1.8%

Previous: -1.0%

Data since the second GDP estimate for 1Q14 suggest a minor revision for the final figure, yet we expect that growth for the quarter will remain in negative territory. Construction spending was revised up for March (from 0.2% to 0.6% MoM), though private residential outlays remained weak for the quarter. Personal consumption expenditures were also revised up slightly for March and will at least help offset further downward pressure from other components. The biggest surprise came from the international trade balance, which was revised down significantly for the first few months of the year. On the bright side, import growth was somewhat stronger than previously reported and therefore supports our argument for improvements in domestic demand conditions, with more weakness coming from the global stage. Finally, business inventories were unchanged for March and therefore should have little impact on the final revision.

Personal Income and Outlays (May, Thursday 8:30 ET)

Forecast: 0.4%, 0.4%

Consensus: 0.4%, 0.4%

Previous: 0.3%, -0.1%

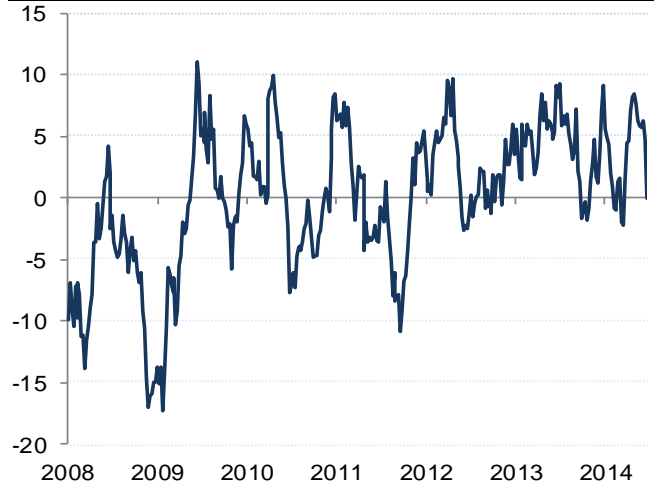
Personal income and outlays are expected to improve in May, supporting our baseline scenario for stronger growth in 2Q14 and beyond. Income growth has been relatively strong throughout 2014 thus far and we expect May's improvement to show some acceleration over April. Although wage pressures have been subdued throughout the recovery period, we are beginning to see more consistent employment growth and therefore more robust personal income is likely to follow suit in the coming year. Personal consumption, on the other hand, took a surprising dip in April after a promising 1.0% monthly gain in March. Consumption data already reported for May suggest an improvement for the month and hint at an upward revision for April's estimate. Thus, we expect a stronger increase in May but not quite enough to match March's impressive gain.

Market Impact

This week's economic calendar could cause some commotion among financial markets. Despite the fact that we are almost done with the second quarter, the final estimate for 1Q14 could be significant if it confirms a major contraction to start the year and furthers concerns of slower-than-expected annual growth for 2014. PCE price inflation will also be heavily watched in relation to ongoing Fed communications, particularly given the surprising jump in CPI for the month.

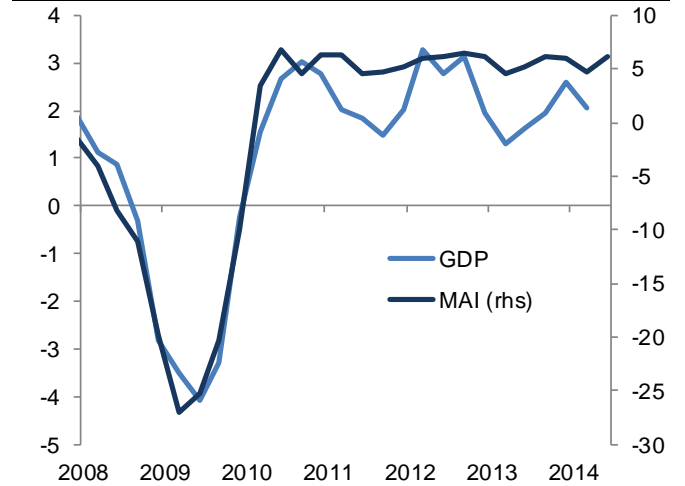
Economic Trends

Graph 3
BBVA US Weekly Activity Index
 (3 month % change)



Source: BBVA Research

Graph 4
BBVA US Monthly Activity Index & Real GDP
 (4Q % change)



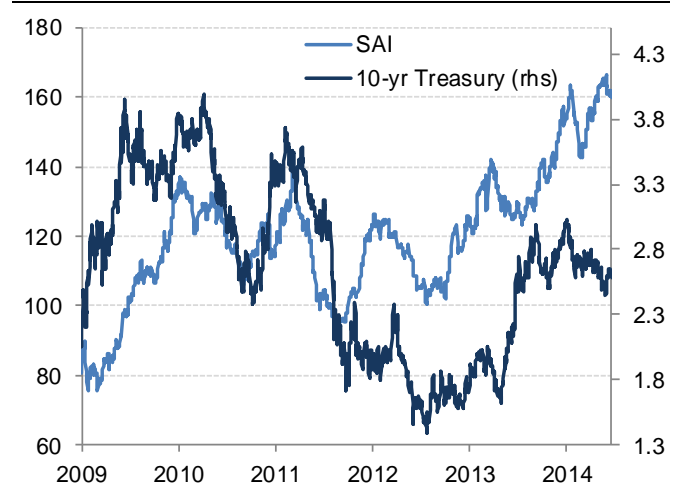
Source: BBVA Research & BEA

Graph 5
BBVA US Surprise Inflation Index
 (Index 2009=100)



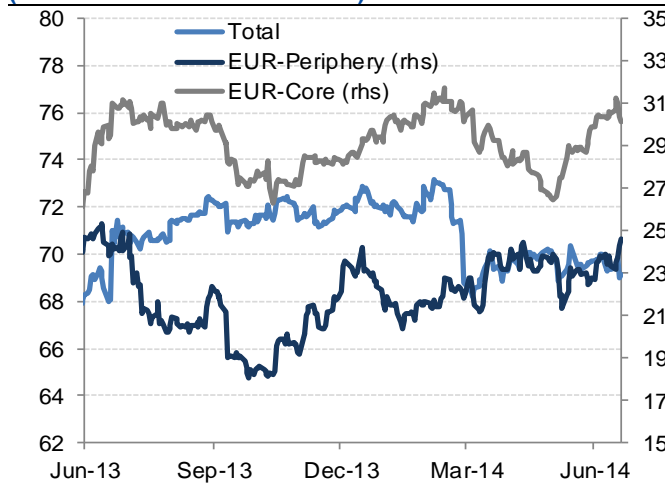
Source: BBVA Research

Graph 6
BBVA US Surprise Activity Index & 10-yr Treasury
 (Index 2009=100 & %)



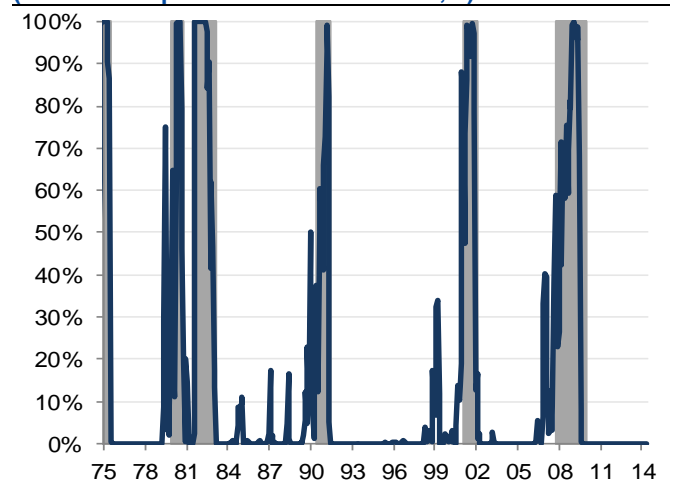
Source: Bloomberg & BBVA Research

Graph 7
Equity Spillover Impact on US
 (% Real Return Co-Movements)



Source: BBVA Research

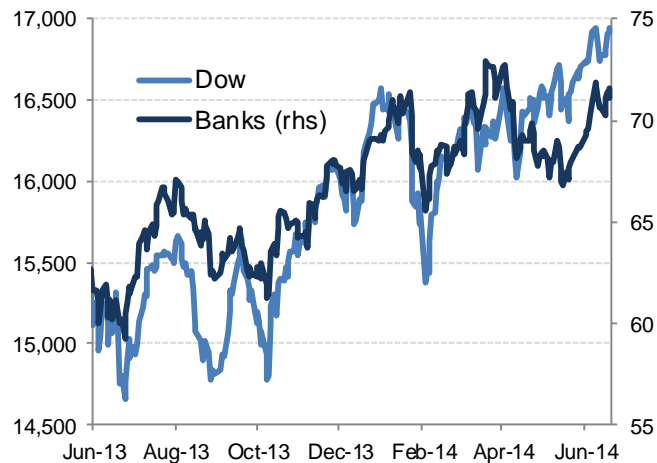
Graph 8
BBVA US Recession Probability Model
 (Recession episodes in shaded areas, %)



Source: BBVA Research

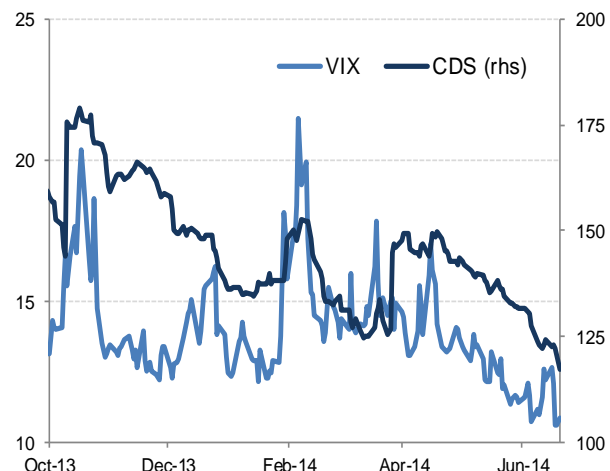
Financial Markets

Graph 9
Stocks
(Index, KBW)



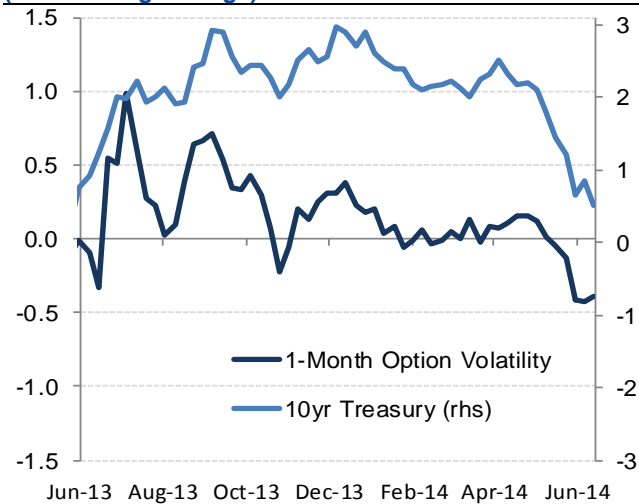
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



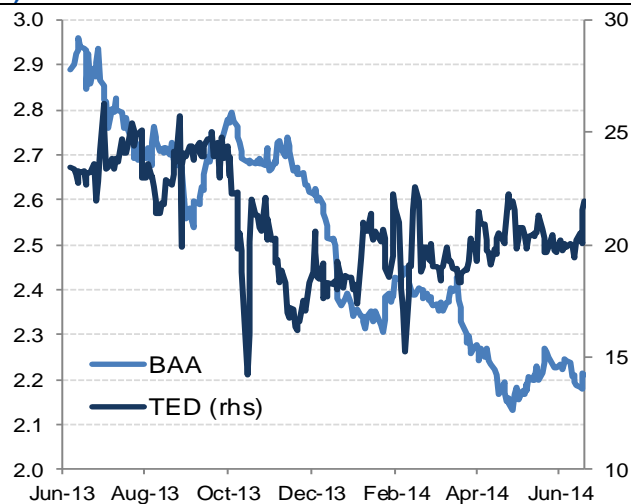
Source: Bloomberg & BBVA Research

Graph 11
Option Volatility & Real Treasury
(52-week avg. change)



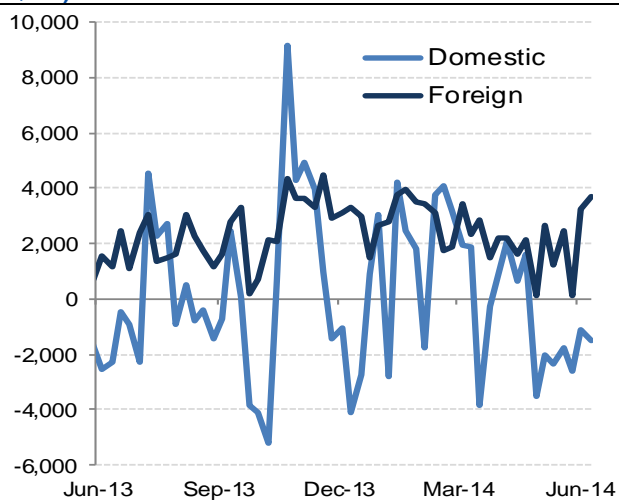
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



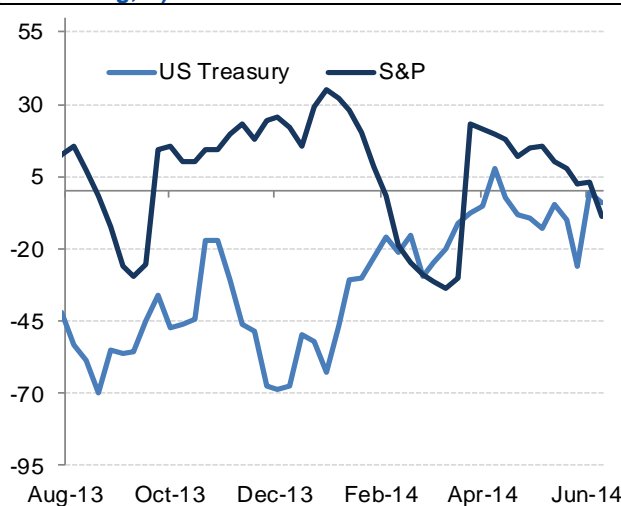
Source: Bloomberg & BBVA Research

Graph 13
Long-Term Mutual Fund Flows
(US\$m)



Source: Haver Analytics & BBVA Research

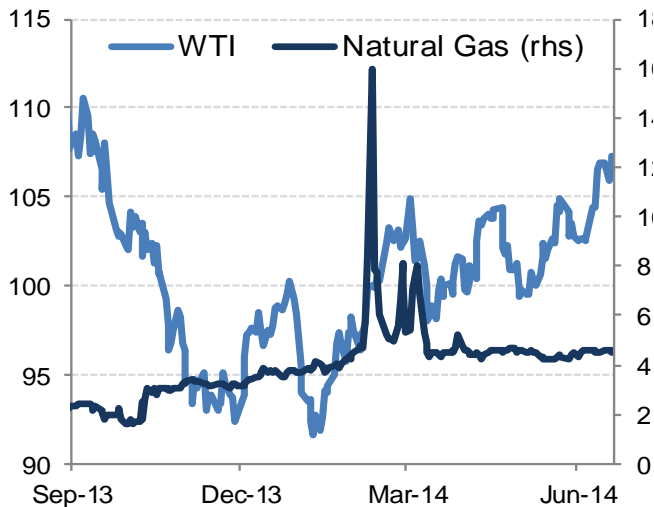
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

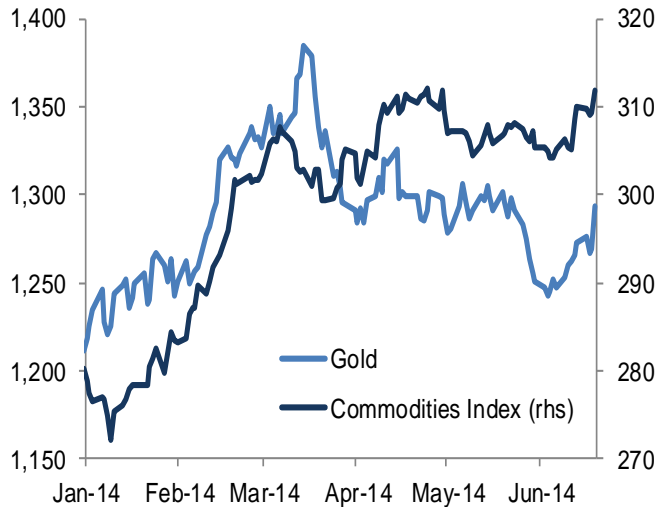
Financial Markets

Graph 15
Commodities
 (Dpb & DpMMBtu)



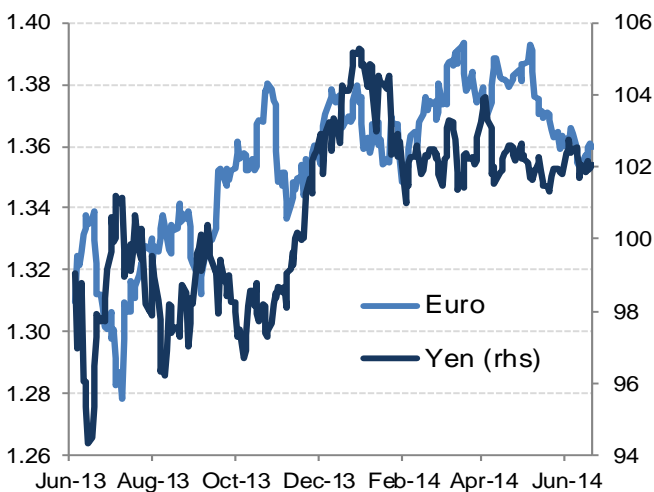
Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
 (US\$ & Index)



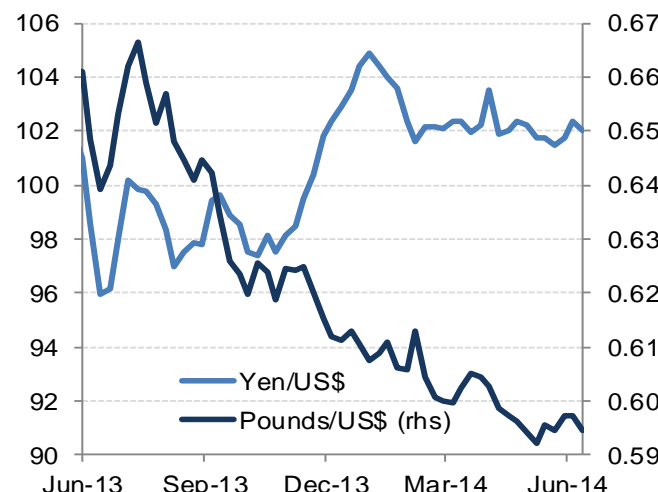
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
 (Dpe & Ypd)



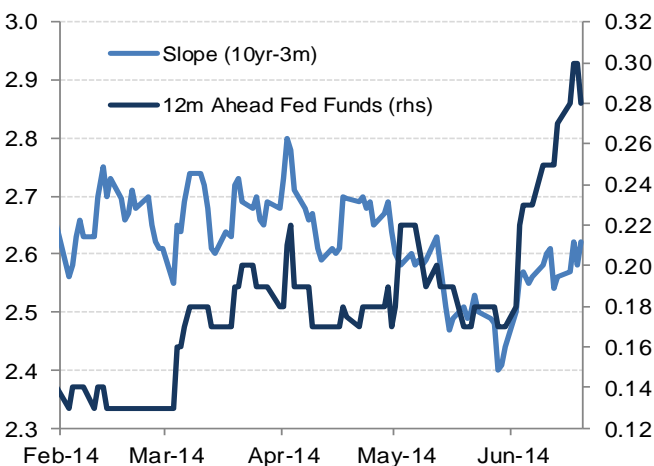
Source: Bloomberg & BBVA Research

Graph 18
6-Month Forward Exchange Rates
 (Yen & Pound / US\$)



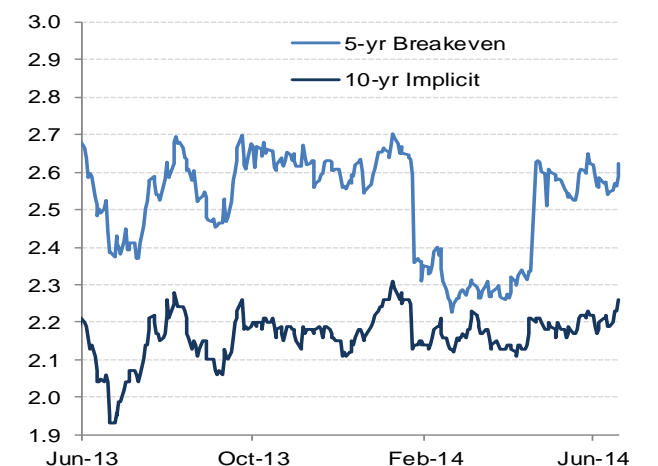
Source: Haver Analytics & BBVA Research

Graph 19
Fed Futures & Yield Curve Slope
 (% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 20
Inflation Expectations
 (%)



Source: Bloomberg & BBVA Research

Interest Rates

Table 1
Key Interest Rates (%)

	Last	4-Weeks		
		Week ago	ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.82	14.82	14.82	14.10
New Auto (36-months)	2.86	2.85	2.79	2.47
Heloc Loan 30K	5.03	5.06	5.25	5.34
5/1 ARM*	3.00	3.05	2.96	2.90
15-year Fixed Mortgage*	3.30	3.31	3.25	3.23
30-year Fixed Mortgage*	4.17	4.20	4.14	3.99
Money Market	0.37	0.37	0.40	0.45
2-year CD	0.81	0.82	0.81	0.72

*Freddie Mac National Mortgage Homeowner Commitment US
Source: Bloomberg & BBVA Research

Table 1
Key Interest Rates (%)

	Last	4-Weeks		
		Week ago	ago	Year ago
1M Fed	0.10	0.10	0.09	0.10
3M Libor	0.23	0.23	0.23	0.28
6M Libor	0.32	0.32	0.32	0.42
12M Libor	0.55	0.54	0.55	0.70
2yr Sw ap	0.61	0.60	0.51	0.58
5yr Sw ap	1.78	1.78	1.62	1.69
10Yr Sw ap	2.70	2.71	2.62	2.83
30yr Sw ap	3.39	3.38	3.36	3.54
30day CP	0.11	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.14	0.13	0.13	0.15

Source: Bloomberg & BBVA Research

Quote of the Week

Janet Yellen, Federal Reserve Chair
Transcript of Chair Yellen's Press Conference
18 June 2014

"The guidance that I want to give you is that there is no mechanical formula whatsoever for what a considerable time means. The answer as to what it means is it depends. It depends on how the economy progresses."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
23-Jun	US Existing Homes Sales SAAR	MAY	4.68	4.74	4.65
23-Jun	US Existing Homes Sales MoM SA	MAY	0.54	1.94	1.31
24-Jun	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	APR	1.70	0.80	1.24
24-Jun	S&P/Case-Shiller Composite-20 City Home Price Index YoY	APR	12.40	11.50	12.37
24-Jun	Conference Board Consumer Confidence SA 1985=100	JUN	84.1	83.5	83.0
25-Jun	US Durable Goods New Orders Industries MoM SA	MAY	1.10	-0.20	0.60
25-Jun	US Durable Goods New Orders Total ex Transportation MoM SA	MAY	0.70	0.30	0.30
25-Jun	GDP US Chained 2009 Dollars QoQ SAAR	1Q T	-0.50	-1.80	-1.00
25-Jun	GDP US Personal Consumption Chained 2009 Dirs % Change from Previous Period SAAR	1Q T	3.10	2.50	3.10
25-Jun	US GDP Price Index QoQ SAAR	1Q T	1.30	1.30	1.30
25-Jun	US GDP Personal Consumption Core Price Index QoQ % SAAR	1Q T	1.20	1.20	1.20
26-Jun	US Initial Jobless Claims SA	JUN 21	305	311	312
26-Jun	US Continuing Jobless Claims SA	JUN 14	2600	2570	2561
26-Jun	US Personal Income MoM SA	MAY	0.40	0.40	0.30
26-Jun	US Personal Consumption Expenditures Nominal Dollars MoM SA	MAY	0.40	0.40	-0.10
27-Jun	University of Michigan Survey of Consumer Confidence Sentiment	JUN F	82.3	82.0	81.2

Forecasts

	2011	2012	2013	2014	2015	2016	2017
Real GDP (% SAAR)	1.8	2.8	1.9	2.5	2.5	2.8	2.8
CPI (YoY %)	3.1	2.1	1.5	1.8	2.2	2.3	2.4
CPI Core (YoY %)	1.7	2.1	1.8	1.9	2.1	2.3	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.6	5.9	5.6	5.2
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	3.41	3.80	4.10	4.34
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.35	1.32	1.37	1.36

Note: Bold numbers reflect actual data



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