

Economic Analysis

Final 1Q14 GDP Estimate Revised Down to -2.9%

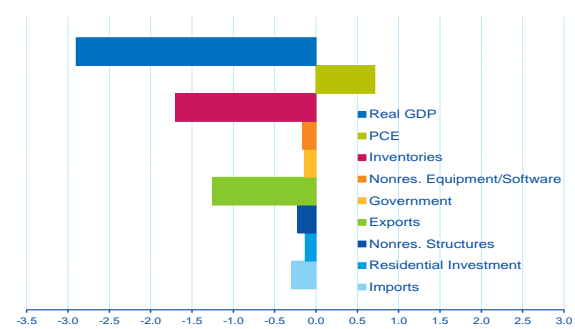
Kim Fraser Chase

The final estimate for 1Q14 GDP growth came in at a surprising -2.9% QoQ SAAR, the biggest economic contraction seen since the recession. This figure is certainly frightening at face value, but when considering some of the underlying details and the subsequent rebound in 2Q14 data thus far, it is easier to accept that this is likely a one-off contraction. The negative contribution from the change in private inventories was larger than previously reported at -1.7 SAAR percentage points. Exports were also revised down again, this time to -8.9% and almost completely offsetting the growth seen in 4Q13. Residential investment remained weak but was revised up slightly to -4.2% QoQ SAAR. Personal consumption expenditures were the only positive contribution to real GDP growth in 1Q14, although the figure was revised down from 3.1% to 1.0% for the quarter in large part due to lower spending on healthcare services. The biggest issue this data presents is that it puts downward pressure on our annual GDP forecast for 2014. After the preliminary estimate, consensus expectations shifted down to around 2.2% growth for the year, but today's report makes this an optimistic bet. At the end of July, the BEA will release their annual revisions along with the initial 2Q14 GDP estimate, both of which could significantly influence our forecast for the year. Regardless, we continue to see gradual improvements in the economy as activity recovers from a severe winter, so growth in the second quarter should be stronger by comparison. Furthermore, we maintain our expectations for increased momentum and a better second half of 2014.

Personal Income and Outlays on the Rise in May, but Weaknesses Remain

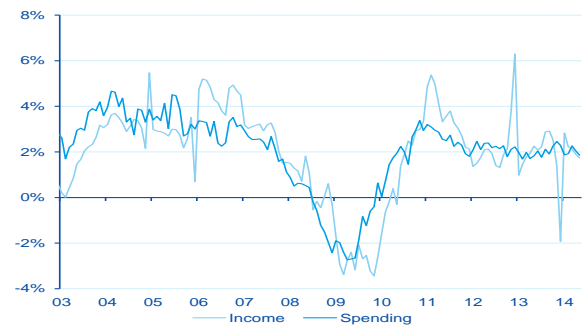
Personal income and spending for May increased 0.4% and 0.2%, respectively, following slightly slower monthly growth in April. The continued gains in income are certainly welcome given that wage growth has been incredibly subdued throughout the past few years. However, in real terms, income growth on a YoY basis has decelerated throughout all of 2014 thus far. When it comes to personal consumption, May's gain was slower than expected, though April's data was revised up slightly. On the down side, real spending (which factors into real GDP estimates) has declined throughout the past two months. Overall, the outlook for personal consumption in 2Q14 does not look much better than what we saw in 1Q14.

Graph 1
Contributions to Real GDP Growth
1Q14 Final Estimate, SAAR Percentage Points



Source: BEA & BBVA Research

Graph 2
Real Personal Income and Spending
YoY % Change



Source: BEA & BBVA Research

Week Ahead

Construction Spending (May, Tuesday 10:00 ET)

Forecast: 0.3%

Consensus: 0.5%

Previous: 0.2%

Construction spending is expected to accelerate slightly in May, marking the fourth consecutive positive month. Private residential spending had been a key driver of total outlays up until April, when spending in the category fell flat. Given the recent weakness in residential demand, we do not expect to see a huge push in the coming months. Public construction spending has been the primary driver throughout the past few months, although this trend is likely to shift back in favor of the private side as the summer construction season gets underway.

Nonfarm Payrolls and Unemployment Rate (June, Thursday 8:30 ET)

Forecast: 195K, 6.4%

Consensus: 215K, 6.3%

Previous: 217K, 6.3%

Nonfarm payroll growth has held above 200K throughout the past four months, a feat that had yet to occur during the recovery period thus far. For June, we expect that monthly payroll gains will continue to hover around that pivotal mark as business and consumer confidence edge up gradually. Also, jobless claims remain at recovery lows but the data do not necessarily hint at significant improvement in job growth for the month. Unemployment has been a trickier issue in 2014 so far, with the rate dropping to 6.3% as labor force participation continues to fall. We expect that individuals will come back into the workforce as more jobs become available, putting upward pressure on the unemployment rate temporarily until job growth truly gains speed.

International Trade (May, Thursday 8:30 ET)

Forecast: -\$46.9B

Consensus: -\$45.0B

Previous: -\$47.2B

The international trade balance took a big step backward in April, with downward revisions pushing the deficit to the worst level in two years. Unfortunately, we don't expect to see much improvement in May given that slow global demand continues to weigh on U.S. exports. Export growth has been particularly weak throughout 2014 thus far, with monthly declines in January, February, and April. March's modest gain was just enough to offset losses to start the year, but export levels still remain well-below the recovery peak reached in November 2013. On a positive note, import growth has reached a new recovery high, with recent monthly gains suggesting stronger domestic demand to support the ongoing rebound in economic activity.

ISM Non-Manufacturing Index (June, Thursday 10:00 ET)

Forecast: 57.1

Consensus: 56.3

Previous: 56.3

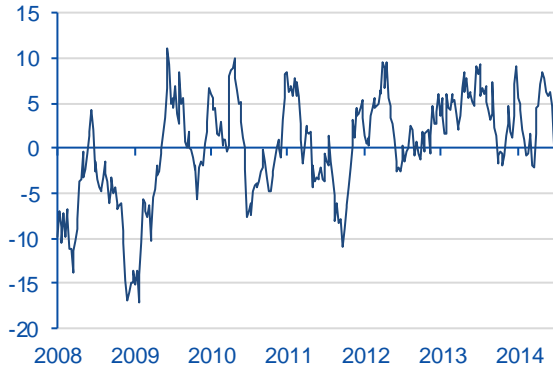
The ISM Non-Manufacturing Index is expected to continue its upward trend in June, increasing for the fourth consecutive month. May's gain in the services sector was driven by a big boost in new orders, which hints at another rise in the business activity index for the coming months. Overall, the index has remained above 50 throughout most of the economic recovery (February 2010 onwards), yet the average pace remains slightly below that seen prior to the recession. Still, we expect that the sector will continue to outpace manufacturing throughout the coming year, with the ISM Non-Manufacturing Index stabilizing just slightly above current levels.

Market Impact

Markets may be sensitive to incoming data this week after a disappointing final report for 1Q14 GDP growth. Employment growth will be heavily watched with the hopes that the momentum of the past few months will continue, but a sub-200K payroll report could warrant a negative reaction. Furthermore, another disappointing estimate for export growth could intensify worries about a slow-moving global economy.

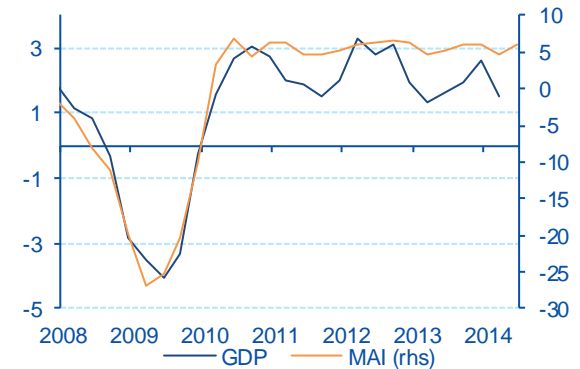
Economic Trends

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



Source: BBVA Research

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



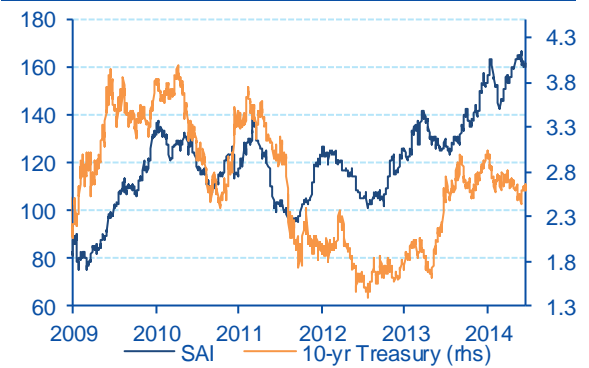
Source: BBVA Research & BEA

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



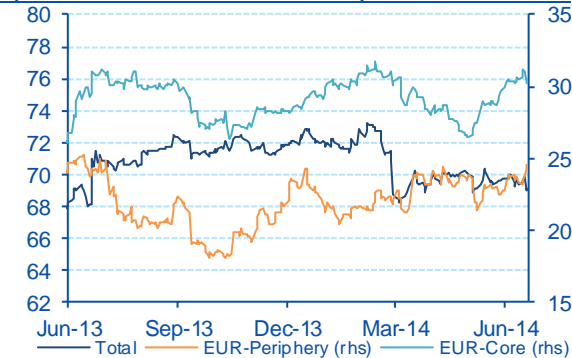
Source: BBVA Research

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



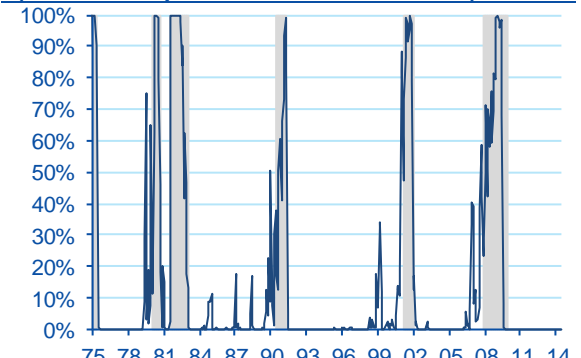
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

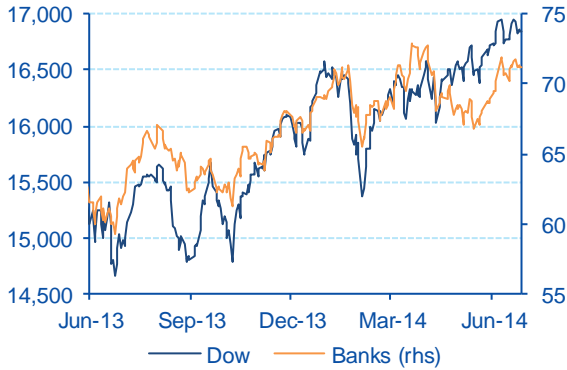
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

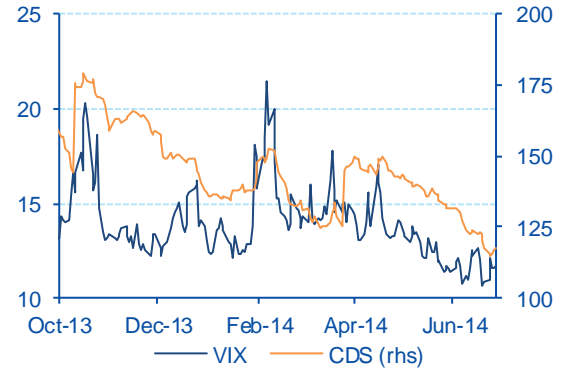
Financial Markets

Graph 9
Stocks
(Index, KBW)



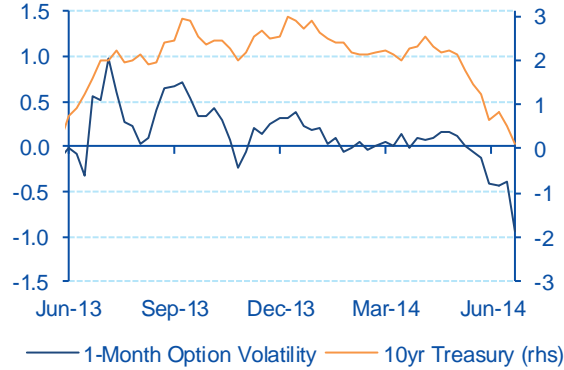
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



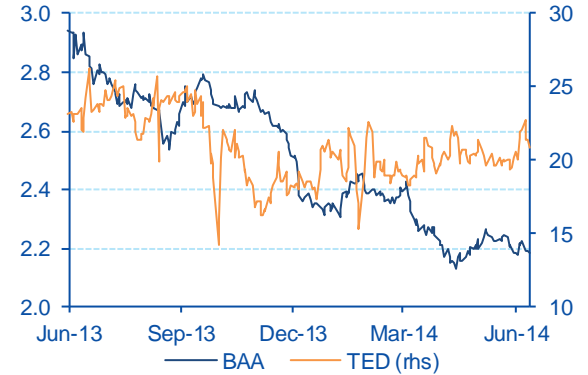
Source: Bloomberg & BBVA Research

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



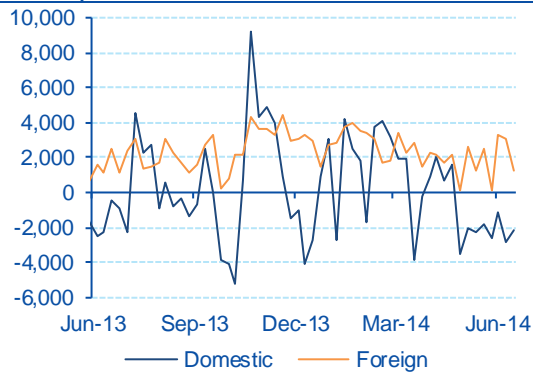
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



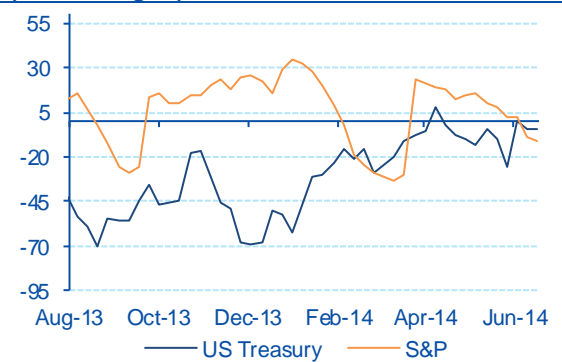
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

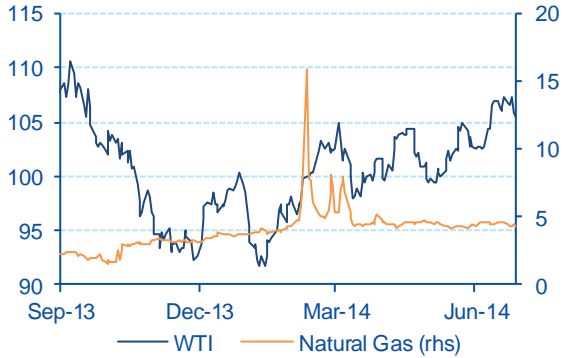
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

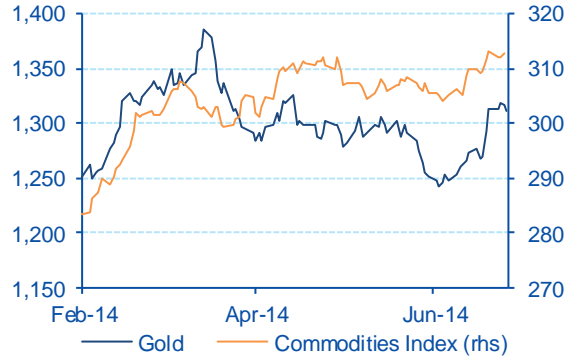
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



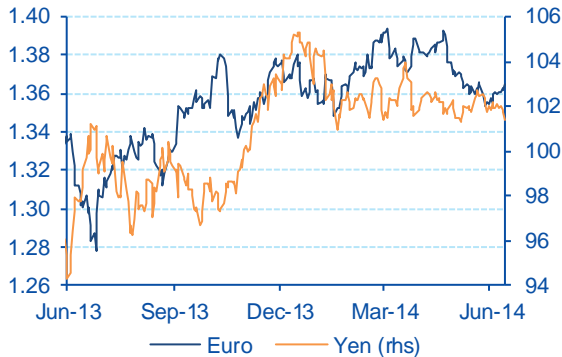
Source: Bloomberg & BBVA Research

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



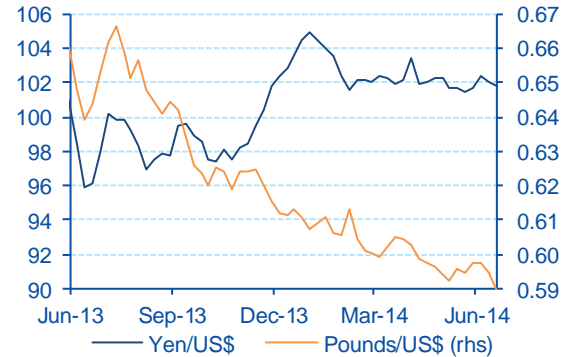
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



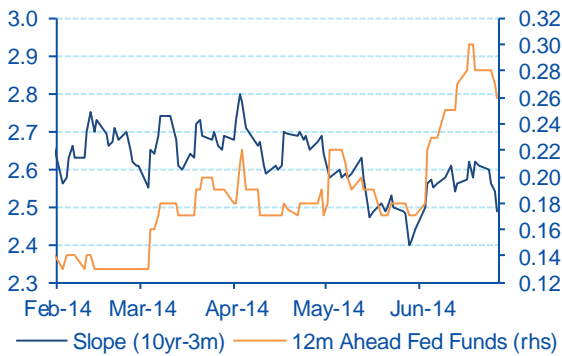
Source: Bloomberg & BBVA Research

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



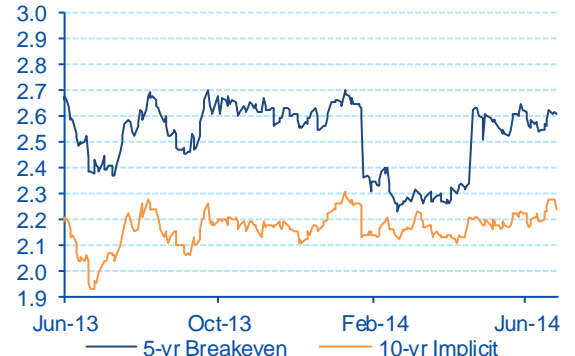
Source: Haver Analytics & BBVA Research

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	Week ago	4-Weeks ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.86	14.82	14.82	14.10
New Auto (36-months)	2.89	2.86	2.80	2.46
Heloc Loan 30K	5.00	5.03	5.14	5.34
5/1 ARM *	2.98	3.00	2.96	2.90
15-year Fixed Mortgage *	3.22	3.30	3.21	3.23
30-year Fixed Mortgage *	4.14	4.17	4.12	3.99
Money Market	0.43	0.37	0.40	0.45
2-year CD	0.81	0.81	0.80	0.73

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

Table 2
Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
1M Fed	0.10	0.10	0.08	0.07
3M Libor	0.23	0.23	0.23	0.27
6M Libor	0.33	0.32	0.32	0.41
12M Libor	0.55	0.55	0.55	0.69
2yr Sw ap	0.59	0.61	0.51	0.52
5yr Sw ap	1.71	1.77	1.62	1.56
10Yr Sw ap	2.64	2.70	2.59	2.69
30yr Sw ap	3.34	3.39	3.31	3.44
30day CP	0.10	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.13	0.13	0.13	0.16

Source: Bloomberg & BBVA Research

Quote of the Week

Jeffrey Lacker, Federal Reserve Bank of Richmond President

Rates Could Rise Even If Economic Growth Remains Subdued, 26 June 2014

“Even if growth remains relatively subdued as it has been over the past five years, in the 2% to 2.5% range, even if that’s true, you can reach a situation in which real rates need to rise just to equilibrate the balance between pressure on current resources and pressure on future resources. That can happen even without an increase in the rate of growth in the economy.”

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
30-Jun	MNI Chicago Business Barometer (sa)	JUN	66.00	63.00	65.50
30-Jun	US Pending Home Sales Index MoM SA	MAY	0.20	1.20	0.41
30-Jun	Dallas Fed Manufacturing Outlook Level Of General Business Activity	JUN	5.10	10.00	8.00
1-Jul	US Auto Sales Total Annualized SA	JUN	16.81	16.30	16.70
1-Jul	ISM Manufacturing PMI SA	JUN	56.30	55.80	55.40
1-Jul	Census Bureau US Construction Spending MoM SA	MAY	0.30	0.50	0.20
2-Jul	ADP National Employment Report SA Private Nonfarm Level Change	JUN	190.00	205.00	179.50
2-Jul	NEW YORK PURCHASING MANAGER Current Business Conditions SA	JUN	56.00	-	55.30
2-Jul	US Manufacturers New Orders Total MoM SA	MAY	-0.50	-0.30	0.70
3-Jul	US Initial Jobless Claims SA	JUN 28	305.00	313.00	312.00
3-Jul	US Continuing Jobless Claims SA	JUN 21	2550.00	2570.00	2571.00
3-Jul	US Employees on Nonfarm Payrolls Total MoM Net Change SA	JUN	195.00	215.00	217.00
3-Jul	US Employees on Nonfarm Payrolls Total Private MoM Net Change SA	JUN	197.00	210.00	216.00
3-Jul	US Employees on Nonfarm Payrolls Manufacturing Industry Monthly Net Change SA	JUN	5.00	10.00	10.00
3-Jul	US Average Hourly Earnings All Employees Total Private Monthly Percentage Change	JUN	0.20	0.20	0.20
3-Jul	US Average Weekly Hours All Employees Total Private SA	JUN	34.50	34.50	34.50
3-Jul	US Trade Balance Balance Of Payments SA	MAY	-46.90	-45.00	-47.24
3-Jul	ISM Non-Manufacturing NMI NSA	JUN	57.10	56.30	56.30

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

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