

Economic Analysis

Inflation Posts another Healthy Gain in June

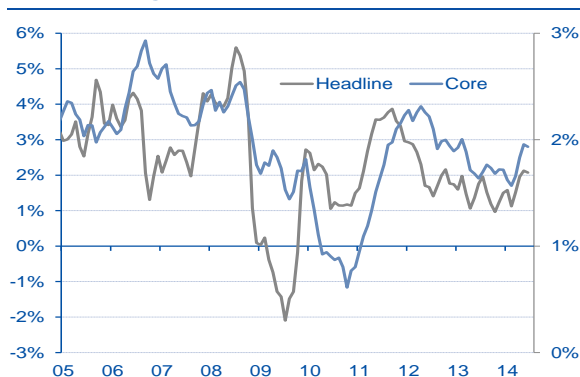
Kim Fraser Chase

Consumer prices continue to move away from discouragingly low growth rates as economic activity recovers from an extremely weak start to the year. In June, the headline consumer price index increased 0.3%, driven mostly by a significant 1.6% monthly increase in the energy component. Energy commodities were the largest contributor, with gasoline prices up 3.3% for the month, the fastest monthly increase since June of last year. Food prices were less drastic, rising a modest 0.1% following four consecutive months of near 0.4% growth. Excluding food and energy, prices increased 0.1% as a result of upward pressures from medical care commodities and apparel. Shelter prices, which have been a growing concern given the setback in housing demand, softened slightly in June to the slowest pace since October. On an annual basis, headline and core inflation reached 2.1% and 1.9%, respectively, as prices continue to move away from the lows seen earlier this year. We don't expect that June's data will have any impact on the Fed's current action plan for ending tapering in 4Q14 as the latest increase in prices fits in nicely with fading transitory factors and their projections for stronger economic activity in the months to come.

Existing Home Sales Rebound in June as New Home Demand Struggles

Housing activity has been a sore spot in the recovery, particularly in the past few quarters as we have seen a negative contribution from residential investment to GDP growth. Unfortunately, we haven't seen as strong of a rebound in 2Q14 as we had hoped as rising home prices continue to push potential homebuyers out of the market. In June, existing home sales increased 2.7% (the third consecutive monthly gain) but levels remain below the recovery peak reached back in July of 2013. At the same time, new home sales in June declined 8.1%, continuing the volatile trend we have seen throughout the recovery period thus far. The new home market has been struggling to regain traction and unfortunately has remained mostly flat throughout the past few years. While the rebound in existing home sales is more apparent, the demand for new homes seems almost non-existent on a national level. With the Fed's stimulus coming to an end this year, we could see the housing market continue to struggle as affordability suffers from an increase in both home prices and mortgage rates.

Graph 1
Consumer Price Inflation
YoY % Change



Source: BLS & BBVA Research

Graph 2
New and Existing Home Sales
SAAR, Thousands



Source: U.S. Census Bureau, NAR, & BBVA Research

Week Ahead

GDP, Advance (2Q14, Wednesday 8:30 ET)

Forecast: 3.5%

Consensus: 3.1%

Previous: -2.9%

Real GDP growth in 2Q14 is expected to show significant improvement over the first quarter's contraction as most components post a natural rebound. On a seasonally-adjusted annualized basis, the major contributors to GDP have shown a solid recovery throughout 2Q thus far, including personal consumption expenditures, industrial production, and net exports. However, residential investment remains weak and is unlikely to show enough momentum to recoup the losses from the past few quarters. Ultimately, we expect to see stronger activity throughout the rest of 2014 despite the fact that the first quarter contraction weighs on our average forecast for the year.

Nonfarm Payrolls and Unemployment Rate (July, Friday 8:30 ET)

Forecast: 205K, 6.1%

Consensus: 231K, 6.1%

Previous: 288K, 6.1%

Nonfarm payroll growth in 2014 has exceeded expectations thus far, hovering above 200K since February and actually breaking the 300K barrier in April. Leading indicators for July point to another healthy month for job growth, though likely at a slower pace than in the previous few months. Initial jobless claims for the first few weeks in July have fallen from June's 315K average. Furthermore, regional manufacturing surveys have reported steady hiring in the sector for the month. When it comes to the unemployment rate, we expect to see gradual declines moving forward as long as the participation rate remains relatively constant.

Personal Income and Outlays (June, Friday 8:30 ET)

Forecast: 0.3%, 0.3%

Consensus: 0.4%, 0.4%

Previous: 0.4%, 0.2%

Personal income and outlays are expected to increase in June, closing out the second quarter on a positive note. Surprisingly, personal income growth has overshadowed consumption throughout the past few months, despite the fact that significant resource slack in the labor market implies subdued wage pressures at least for the short term. This improvement in household income will certainly boost consumer confidence and willingness to spend. Other data for June suggest another steady gain in income as well as a boost in personal spending as consumers transition to the summertime.

ISM Manufacturing Index (July, Friday 10:00 ET)

Forecast: 55.9

Consensus: 56.0

Previous: 55.3

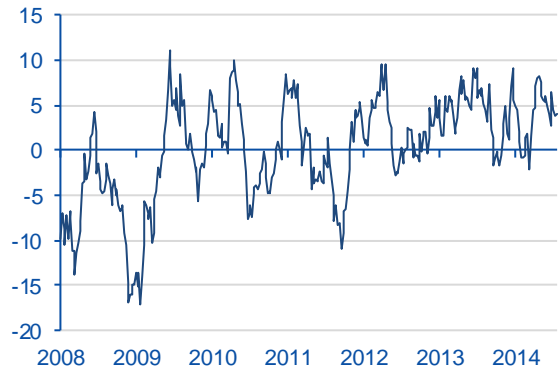
The ISM Manufacturing Index is expected to rebound in July from June's minor decline. Various leading indicators for the month have noted a significant acceleration in manufacturing activity for most components of the index, including new orders, production, and employment. Consumer and business demand have been trending upward since the weak start to 2014 and should help put upward pressure on economic activity. In general, we expect that the ISM Manufacturing Index in July will make up for June's loss and accelerate to the highest level since December 2013.

Market Impact

This week is flooded with economic data that could sway markets one way or another. Most importantly, the advance estimate for 2Q GDP will set the tone for growth expectations in 2014 to (hopefully) offset the 1Q contraction. As always, the FOMC meeting and the employment report could warrant significant market reaction.

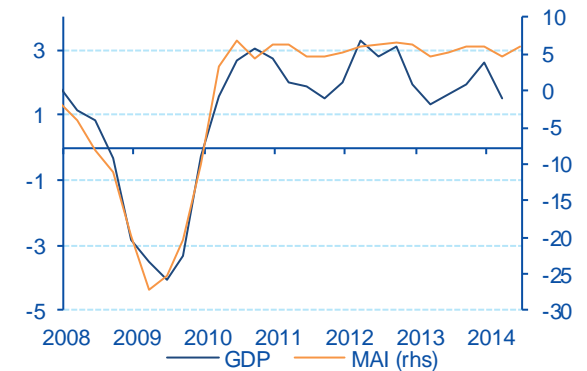
Economic Trends

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



Source: BBVA Research

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



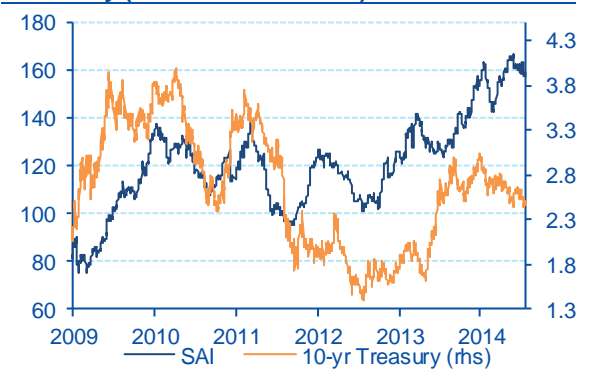
Source: BBVA Research & BEA

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



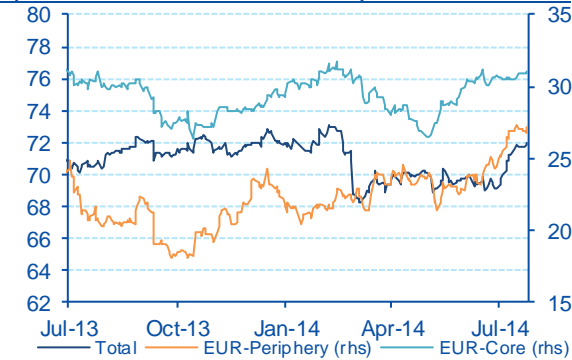
Source: BBVA Research

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



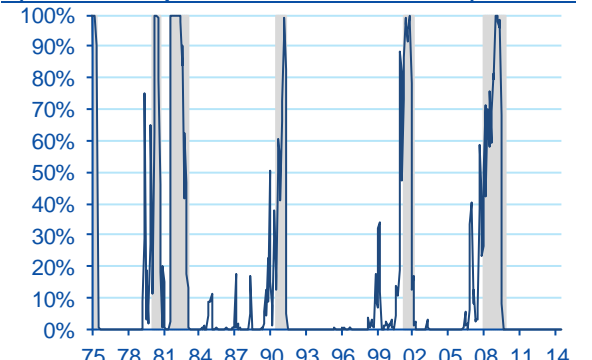
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

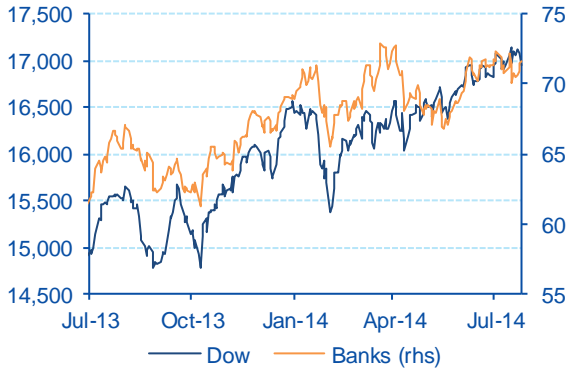
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

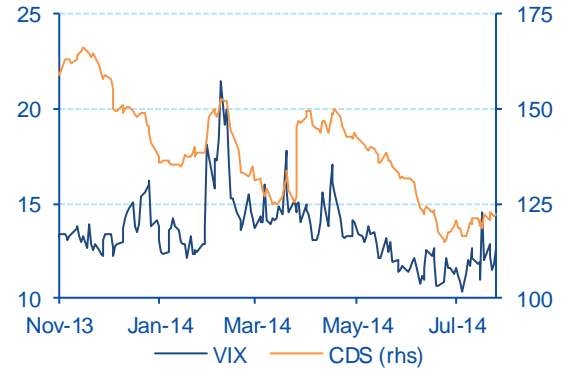
Financial Markets

Graph 9
Stocks
(Index, KBW)



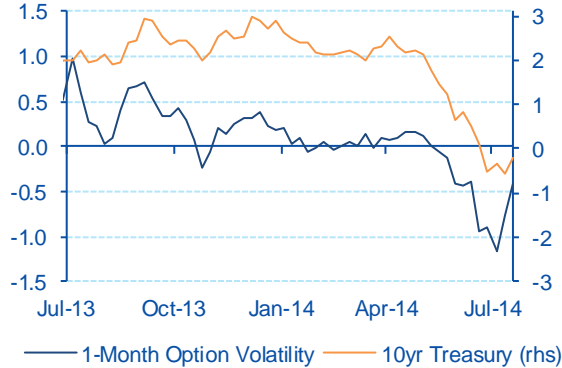
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



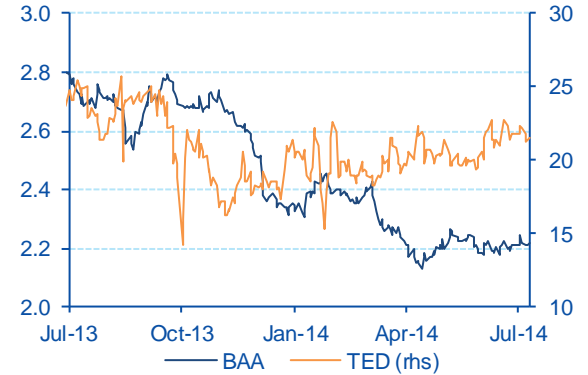
Source: Bloomberg & BBVA Research

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



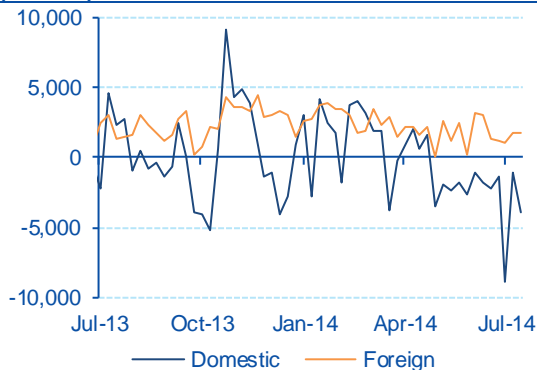
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



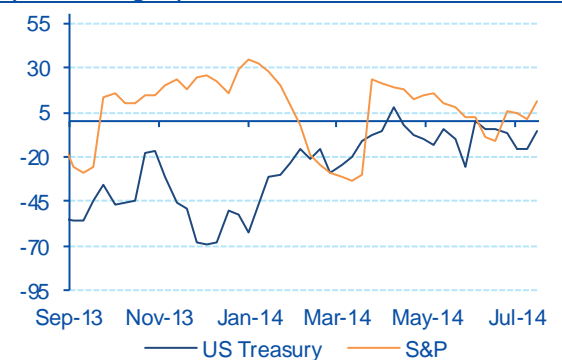
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

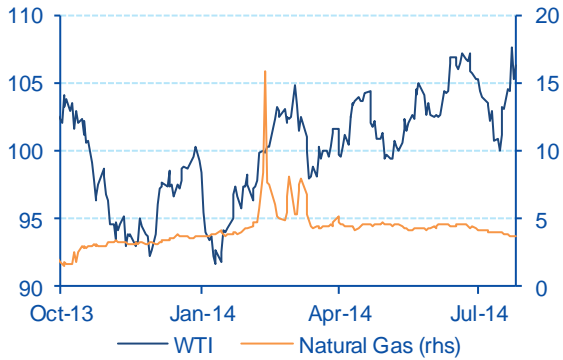
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

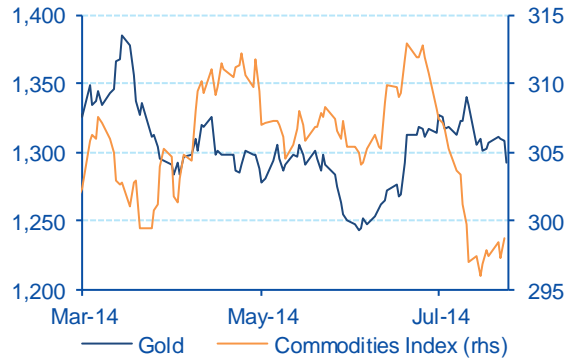
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



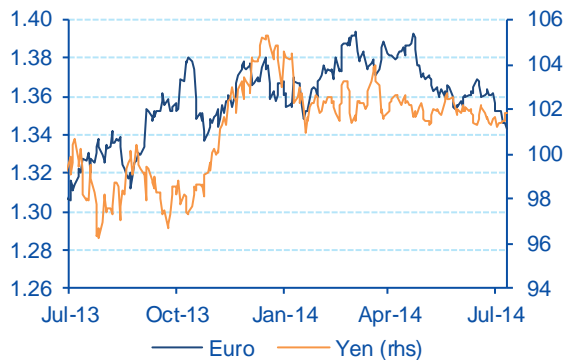
Source: Bloomberg & BBVA Research

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



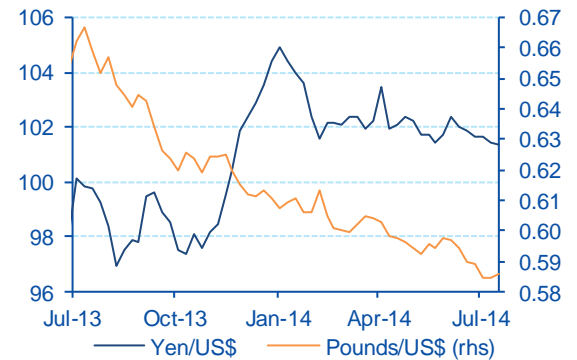
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



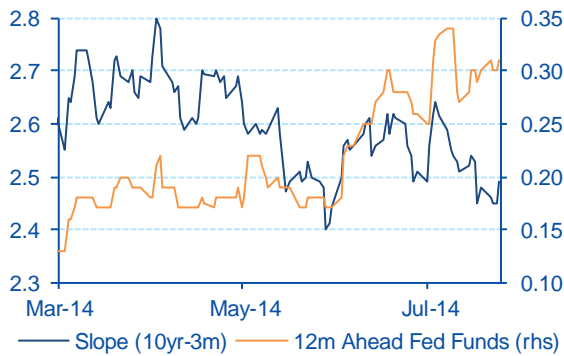
Source: Bloomberg & BBVA Research

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	14.86	14.86	14.10
New Auto (36-months)	2.90	2.91	2.89	2.50
Heloc Loan 30K	4.97	4.98	5.00	5.29
5/1 ARM *	2.99	2.97	2.98	2.90
15-year Fixed Mortgage *	3.26	3.23	3.22	3.23
30-year Fixed Mortgage *	4.13	4.13	4.14	3.99
Money Market	0.40	0.40	0.43	0.44
2-year CD	0.82	0.82	0.81	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	0.09	0.09	0.10	0.09
3M Libor	0.23	0.23	0.23	0.27
6M Libor	0.33	0.33	0.32	0.40
12M Libor	0.56	0.55	0.55	0.67
2yr Sw ap	0.69	0.67	0.59	0.48
5yr Sw ap	1.80	1.79	1.71	1.56
10Yr Sw ap	2.59	2.60	2.64	2.80
30yr Sw ap	3.21	3.26	3.34	3.67
30day CP	0.11	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.13	0.13	0.13	0.15

Source: Bloomberg & BBVA Research

Quote of the Week

Alan Greenspan, Former Federal Reserve Board Chairman
Greenspan says bubbles can't be stopped without 'crunch'
24 July 2014

"I do believe that central banks that believe they can quell bubbles are living in a state of unrealism."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
28-Jul	US Pending Home Sales Index MoM SA	JUN	0.30	0.50	6.13
28-Jul	Dallas Fed Manufacturing Outlook Level Of General Business Activity	JUL	15.30	12.00	11.40
29-Jul	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	MAY	0.17	0.30	0.19
29-Jul	S&P/Case-Shiller Composite-20 City Home Price Index YoY	MAY	9.90	10.00	10.82
29-Jul	Conference Board Consumer Confidence SA 1985=100	JUL	85.50	85.45	85.18
30-Jul	ADP National Employment Report SA Private Nonfarm Level Change	JUL	210.00	230.00	280.80
30-Jul	GDP US Chained 2009 Dollars QoQ SAAR	2Q A	3.50	3.10	-2.90
30-Jul	GDP US Personal Consumption Chained 2009 Dlr % Change from Previous Period SAAR	2Q A	2.10	1.90	1.00
30-Jul	US GDP Price Index QoQ SAAR	2Q A	1.90	1.80	1.30
30-Jul	US GDP Personal Consumption Core Price Index QoQ % SAAR	2Q A	1.70	1.90	1.20
30-Jul	Federal Funds Target Rate US	JUL 30	0.25	0.25	0.25
30-Jul	US FOMC Agency Mortgage Backed Security Purchases	JUL	10.00	10.00	15.00
30-Jul	US FOMC Treasury Purchase Program Pace Announced at FOMC Meeting	JUL	15.00	15.00	20.00
31-Jul	Bureau of Labor Statistics Employment Cost Civilian Workers QoQ SA	2Q	0.40	0.50	0.30
31-Jul	US Initial Jobless Claims SA	JUL 26	295.00	302.00	284.00
31-Jul	US Continuing Jobless Claims SA	JUL 19	2525.00	2492.00	2500.00
31-Jul	MNI Chicago Business Barometer (sa)	JUL	63.70	63.00	62.60
1-Aug	US Auto Sales Total Annualized SA	JUL	16.95	16.80	16.92
1-Aug	US Unemployment Rate (%)	JUL	6.10	6.10	6.10
1-Aug	US Employees on Nonfarm Payrolls Total MoM Net Change SA	JUL	205.00	231.00	288.00
1-Aug	US Employees on Nonfarm Payrolls Total Private MoM Net Change SA	JUL	210.00	230.00	262.00
1-Aug	US Employees on Nonfarm Payrolls Manufacturing Industry Monthly Net Change SA	JUL	10.00	14.50	16.00
1-Aug	US Average Hourly Earnings All Employees Total Private Monthly Percentage Change	JUL	0.20	0.20	0.20
1-Aug	US Average Weekly Hours All Employees Total Private SA	JUL	34.50	34.50	34.50
1-Aug	US Labor Force Participation Rate Total SA	JUL	62.80	-	62.80
1-Aug	US Personal Income MoM SA	JUN	0.30	0.40	0.40
1-Aug	US Personal Consumption Expenditures Nominal Dollars MoM SA	JUN	0.30	0.40	0.20
1-Aug	University of Michigan Survey of Consumer Confidence Sentiment	JUL F	82.00	81.50	81.30
1-Aug	ISM Manufacturing PMI SA	JUL	55.90	56.00	55.30
1-Aug	Census Bureau US Construction Spending MoM SA	JUN	0.20	0.50	0.10

Forecasts (NOTE: revisions pending)

	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	3.00	3.50	3.75	4.00
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.31	1.29	1.36	1.36

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