

## Economic Analysis

## Real GDP Growth Rebounds 4.0% in 2Q14

Kim Fraser Chase

The advance estimate for 2Q14 GDP growth was slightly higher than expected, coming in at 4.0% on a QoQ seasonally-adjusted annualized basis. Gross private domestic investment was the primary driver, jumping 17% QoQ SAAR in 2Q14. In particular, residential investment rebounded 7.5% following two consecutive quarters of decline. Export growth was also strong at 9.5%, although the contribution from net exports remained negative. As expected, personal consumption growth remained healthy at 2.5%, while government spending increased 1.6%. Annual revisions to the historical GDP series impacted growth estimates from the past few years. Growth in 2011 was revised down from 1.8% to 1.6%. For 2012, the first quarter was revised significantly and pushed annual growth down from 2.8% to 2.3%. On the bright side, 2013 data were revised up for the first, third, and fourth quarters, bringing the annual average up from 1.9% to 2.2%. Finally, the contraction in 1Q14 was slightly less severe, with growth falling only 2.1% compared to the 2.9% drop reported in last month's BEA release. This 1Q revision, along with the 4.0% advance estimate for 2Q14, supports our newly revised baseline scenario of 2.0% for the year. Our expectation for 2015 real GDP growth remains unchanged at 2.5%.

### FOMC Statement: Tapering on Track with \$10bn Reduction in Asset Purchases

The FOMC announced another reduction in asset purchases, reducing the monthly purchases of mortgage-backed securities and longer-term Treasury securities to \$10bn and \$15bn, respectively. Furthermore, the FOMC statement upgraded the economic outlook referencing further decline in the unemployment rate and "advancing" of business fixed investment. At the same time, the Committee remained cautious of painting too bright of an economic picture, stating that "significant underutilization of labor resources" still lingers. Overall, the FOMC will continue with the ongoing "prudent planning" of their exit strategy. The key aspects of the Committee's deliberations on the craftsmanship of forward guidance, on how to convey the trajectory of the federal funds rate, and on the balance sheet normalization roadmap are expected to be communicated in the FOMC minutes. Nonetheless, the Fed is expected to keep in place the discretionary and data dependent policy. As such, and consistent with our prior projections, we expect the gradual tapering process to come to an end in 4Q14 and the first rate hike to occur in mid-2015 ([see our latest Fed Watch](#)).

### Steady Job Growth in July but Unemployment Rate up to 6.2%

Nonfarm payrolls held above the 200K threshold for the sixth consecutive month (a recovery record), rising 209K in July. Private payrolls increased 198K, a significant deceleration from June's 270K but still reflecting notable improvement in important sectors such as manufacturing and construction (28K and 22K, respectively). Employment in the household survey also increased, but so did unemployment, with the rate ticking back up to 6.2% in July. As we have been expecting, the participation rate increased slightly to 62.9% after holding steady for three straight months. According to the CPS labor force status flows, the number of those moving from out of the labor force to unemployed increased 10.6% for the month. We do expect that participation in the older age groups will increase slightly in the near future as discouraged workers feel more confident about starting up their job search again. However, the situation remains vulnerable to shaky business confidence and income prospects. Overall, we expect that the unemployment rate will average around 6.3% in 2014, dropping below 6.0% in early 2015.

## Week Ahead

### ISM Non-Manufacturing (July, Tuesday 10:00 ET)

Forecast: 56.50

Consensus: 56.50

Previous: 56.00

The ISM Non-Manufacturing Index is expected to rebound modestly in July following a minor setback in June. The business activity index, which is comparable to the shipments/production component of the ISM Manufacturing Index, was primarily responsible for the overall decline in June but still remained one of the strongest components in level terms. The new orders index (considered a leading indicator for production) increased in June and suggests that business activity in the services sector will pick up again in the coming months. Employment in the sector has also accelerated in recent months and should continue to reflect positively in the ISM index as the labor market strengthens.

### International Trade (June, Wednesday 8:30 ET)

Forecast: -\$45.00B

Consensus: -\$44.90B

Previous: -\$44.39B

The international trade balance improved significantly in May but is expected to take a minor step back in June as domestic activity overshadows global demand. Business and consumer spending in the U.S. picked up at the end of the second quarter, a trend that will most likely be reflected via a rebound in import growth for June. Furthermore, the ISM manufacturing and services indices both hinted at stronger import demand compared to the new export orders components. Global demand has certainly improved since a weak start to the year, but activity remains vulnerable to geopolitical and other global economic shocks. Therefore, we expect that import growth will slightly offset export growth in June, resulting in only a modest deterioration in the trade balance.

### Consumer Credit (June, Thursday 15:00 ET)

Forecast: \$16.50B

Consensus: \$18.55B

Previous: \$19.60B

Consumer credit growth has been steadily rising throughout the past few years and in May accelerated at the fastest YoY pace since the end of 2011. Outstanding non-revolving credit continues to be a main driver of total credit growth, particularly from the government side as student loans become a larger share of the pile. Revolving credit has been the weaker component but has shown signs of life throughout the past few months, mostly due to rising confidence and an increased willingness to take on additional credit card debt. In June, we expect that total consumer credit growth will decelerate but remain above the lower levels seen in early 2014.

### Wholesale Inventories (June, Friday 10:00 ET)

Forecast: 0.4%

Consensus: 0.7%

Previous: 0.5%

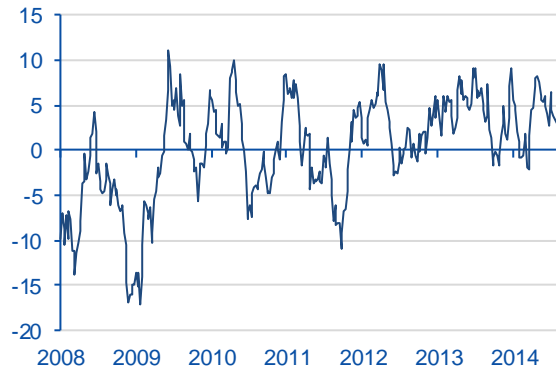
Wholesale inventories are expected to increase in June at a similar pace as in May. Merchant wholesalers have been building up stock at a relatively fast pace throughout 2014 thus far, although growth has been decelerating since a big jump in March. Wholesale inventory growth has certainly been one of the strongest drivers of total business inventories, with retailers and manufacturers often lagging behind. In June, we expect that inventories will continue to increase as wholesalers adjust to growing demand for the summer season.

### Market Impact

This week is a bit slower after the last rush of economic data, and markets should remain relatively quiet as they continue to digest the latest positive reports on 2Q GDP and employment. International trade data could be a market mover if it offers a glimpse of a struggling global environment, but we don't expect that the other indicators on the calendar will cause much of an uproar.

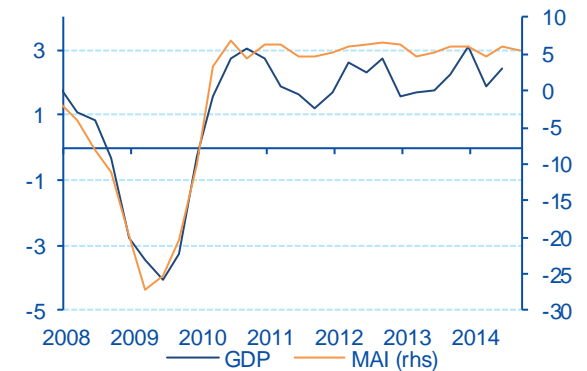
**Economic Trends**

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



Source: BBVA Research

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



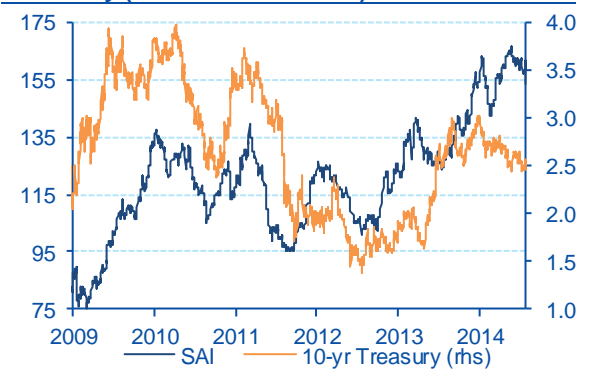
Source: BBVA Research & BEA

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



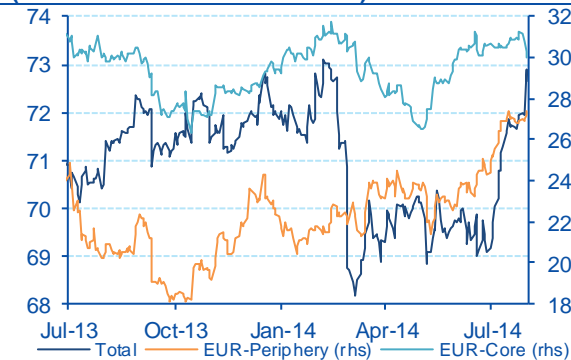
Source: BBVA Research

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



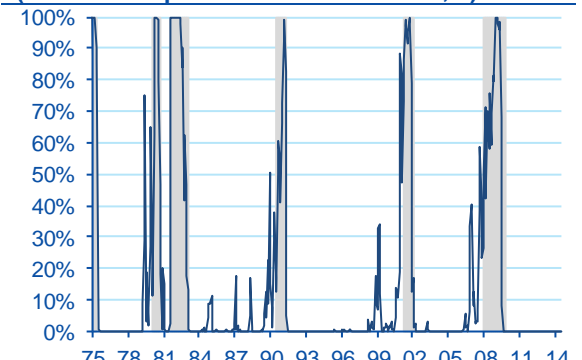
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

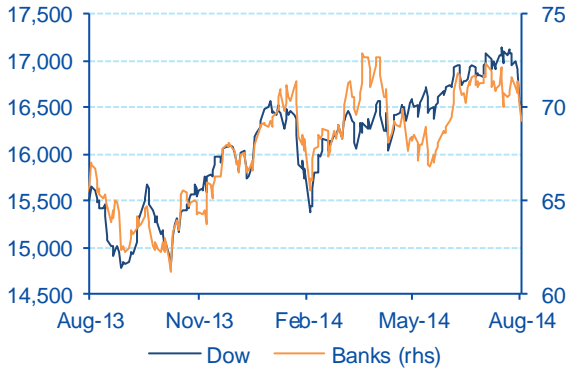
Graph 8  
**BBVA US Recession Probability Model (Recession episodes in shaded areas, %)**



Source: BBVA Research

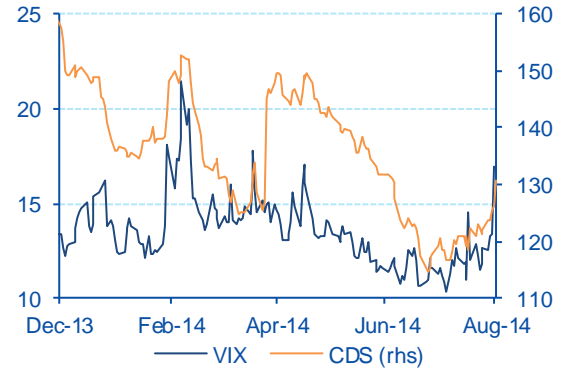
**Financial Markets**

**Graph 9**  
**Stocks**  
**(Index, KBW)**



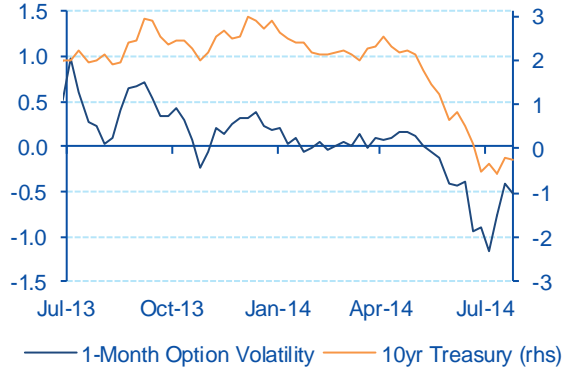
Source: Bloomberg & BBVA Research

**Graph 10**  
**Volatility & High-Volatility CDS**  
**(Indices)**



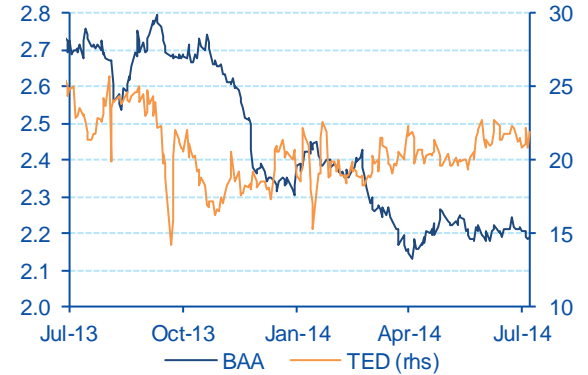
Source: Bloomberg & BBVA Research

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



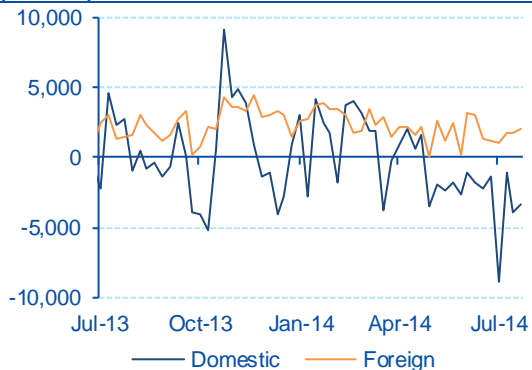
Source: Haver Analytics & BBVA Research

**Graph 12**  
**TED & BAA Spreads**  
**(%)**



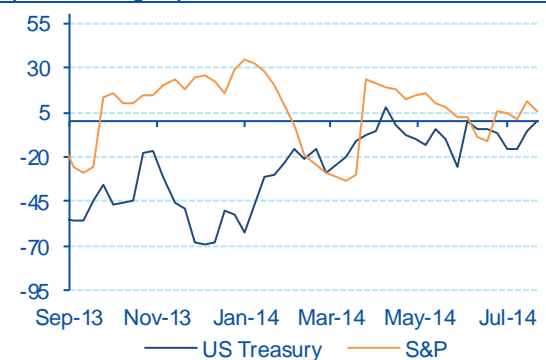
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

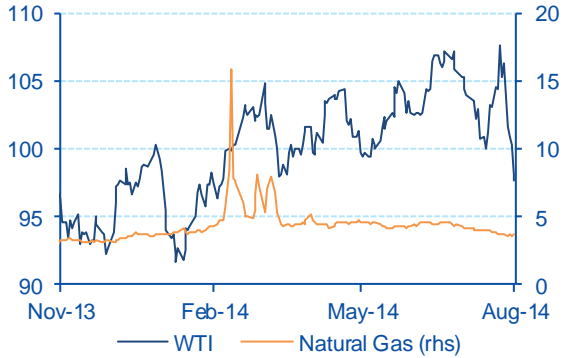
**Graph 14**  
**Total Reportable Short & Long Positions**  
**(Short-Long, K)**



Source: Haver Analytics & BBVA Research

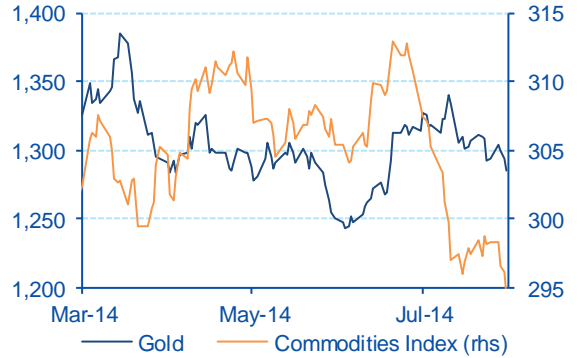
**Financial Markets**

Graph 15  
**Commodities**  
(Dpb & DpMMBtu)



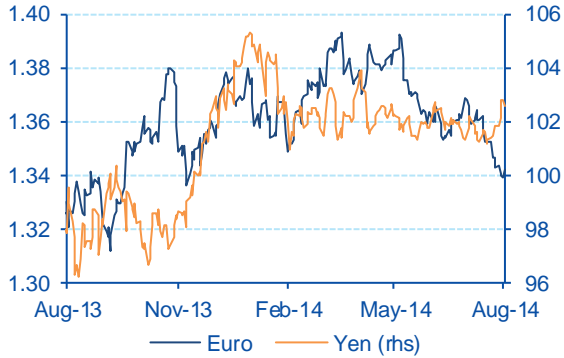
Source: Bloomberg & BBVA Research

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



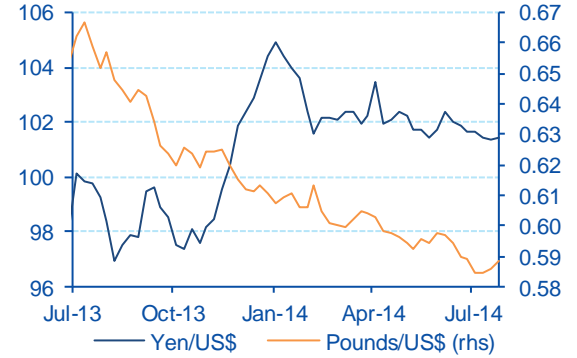
Source: Haver Analytics & BBVA Research

Graph 17  
**Currencies**  
(Dpe & Ypd)



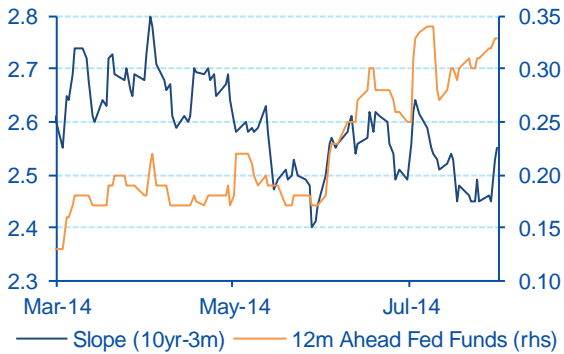
Source: Bloomberg & BBVA Research

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



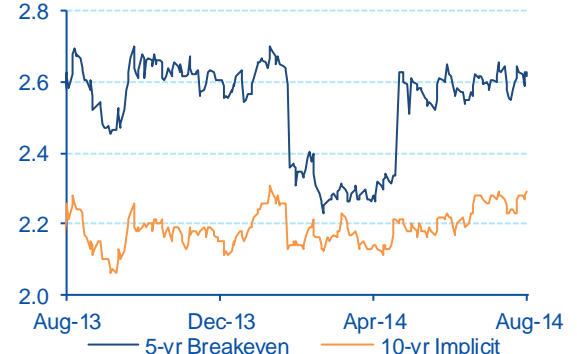
Source: Haver Analytics & BBVA Research

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	2.90	2.90	2.50
Heloc Loan 30K	4.96	4.97	5.01	5.27
5/1 ARM *	3.01	2.99	2.98	2.90
15-year Fixed Mortgage *	3.23	3.26	3.22	3.23
30-year Fixed Mortgage *	4.12	4.13	4.12	3.99
Money Market	0.40	0.40	0.40	0.44
2-year CD	0.82	0.82	0.82	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	0.08	0.09	0.10	0.09
3M Libor	0.24	0.23	0.23	0.27
6M Libor	0.33	0.33	0.32	0.40
12M Libor	0.58	0.56	0.55	0.67
2yr Sw ap	0.68	0.69	0.65	0.48
5yr Sw ap	1.81	1.80	1.82	1.57
10Yr Sw ap	2.64	2.59	2.74	2.83
30yr Sw ap	3.27	3.20	3.43	3.70
30day CP	0.11	0.12	0.11	0.12
60day CP	0.13	0.11	0.11	0.15
90day CP	0.14	0.13	0.13	0.15

Source: Bloomberg & BBVA Research

## Quote of the Week

President Barack Obama

Remarks by the President on the Economy – Kansas City, MO

30 July 2014

*“This is the challenge of our time -- how do we make sure we’ve got an economy that is working for everybody? Now, all of you are doing your part to help bring America back. You’re doing your job. Imagine how much further along we’d be, how much stronger our economy would be, if Congress was doing its job, too.”*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
4-Aug	NEW YORK PURCHASING MANAGER Current Business Conditions SA	JUL	62.00	0.00	60.50
5-Aug	US Manufacturers New Orders Total MoM SA	JUN	0.90	0.60	-0.50
5-Aug	ISM Non-Manufacturing NMI NSA	JUL	56.50	56.50	56.00
6-Aug	US Trade Balance Balance Of Payments SA	JUN	-45.00	-44.90	-44.39
7-Aug	US Initial Jobless Claims SA	AUG 2	300.00	304.50	302.00
7-Aug	US Continuing Jobless Claims SA	JUL 26	2530.00	2500.00	2539.00
7-Aug	Federal Reserve Consumer Credit Total Net Change SA	JUN	16.50	18.55	19.60
8-Aug	US Output Per Hour Nonfarm Business Sector QoQ SA	2Q P	4.00	1.40	-3.20
8-Aug	US Unit Labor Costs Nonfarm Business Sector QoQ % SAAR	2Q P	3.30	1.20	5.70
8-Aug	Merchant Wholesalers Inventories Total Monthly % Change	JUN	0.40	0.70	0.50

## Forecasts

	2011	2012	2013	2014	2015	2016	2017
Real GDP (% SAAR)	1.8	2.8	1.9	<b>2.0</b>	<b>2.5</b>	<b>2.8</b>	<b>2.8</b>
CPI (YoY %)	3.1	2.1	1.5	<b>1.9</b>	<b>2.2</b>	<b>2.3</b>	<b>2.4</b>
CPI Core (YoY %)	1.7	2.1	1.8	<b>2.0</b>	<b>2.1</b>	<b>2.3</b>	<b>2.4</b>
Unemployment Rate (%)	8.9	8.1	7.4	<b>6.3</b>	<b>5.9</b>	<b>5.8</b>	<b>5.5</b>
Fed Target Rate (eop, %)	0.25	0.25	0.25	<b>0.25</b>	<b>0.50</b>	<b>1.50</b>	<b>2.50</b>
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	<b>3.00</b>	<b>3.50</b>	<b>3.75</b>	<b>4.00</b>
US Dollar/ Euro (eop)	1.31	1.31	1.37	<b>1.31</b>	<b>1.29</b>	<b>1.36</b>	<b>1.36</b>

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