

Economic Analysis

Personal Consumption Disappoints in July

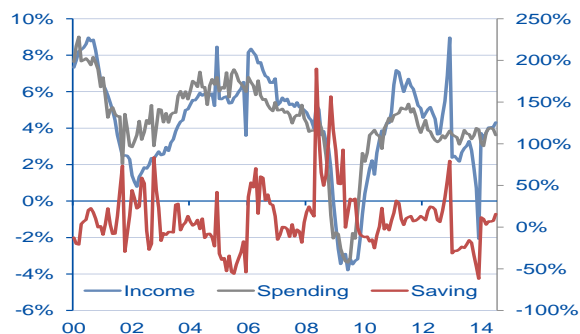
Kim Fraser Chase

July's report on personal income and spending did not meet expectations, with income up a modest 0.2% for the month while consumption declined 0.1%. The biggest drag in spending came from the durable goods component, which dropped 0.7% following two months of growth. Personal income growth was surprisingly strong throughout the first half of 2014, but these gains were not enough to drive a significant boost in spending. In fact, personal savings have increased throughout the past four months, suggesting that consumers are still hesitant to loosen their purse strings. In real terms, the 0.2% drop in personal consumption does not bode well for the 3Q14 GDP estimate. However, we do expect that this is just a minor hiccup and that personal spending will pick up again throughout the rest of the year.

2Q14 Real GDP Growth Revised up to 4.2%

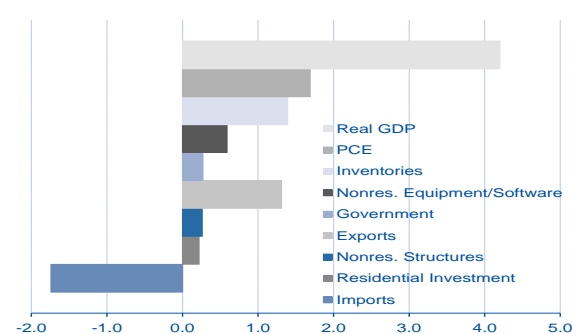
Real GDP growth was revised slightly for 2Q14, with the preliminary data reporting 4.2% QoQ SAAR compared to the advance estimate of 4.0%. Most of the revision stemmed from nonresidential investment, with slightly higher contributions coming from equipment and structures. Export growth was also revised up, from 9.5% to 10.1%, marking the strongest pace since 4Q10. Personal consumption was unchanged at 2.5%, holding slightly above the post-recession average. Residential investment and government spending were revised down slightly to 7.2%, and 1.4%, respectively. Overall, investment is not expanding as robustly as we had previously expected. This is somewhat surprising given reduced policy uncertainty, but it may be the case that businesses are diversifying and investing abroad rather than in the U.S. Personal consumption remains healthy but average growth remains low compared to the pre-crisis 2000s. While we do expect consumption to remain one of the strongest contributors to growth, we could very well see another component taking the spotlight over the coming years. In particular, exports are poised to become a larger share of total GDP growth in the mid- to long-term, especially given the increasingly optimistic energy-producing outlook for the U.S. (i.e. improvements in the petroleum trade balance). For the short-term, we expect that economic activity in 3Q and 4Q will expand at a modest pace (2.0-3.0%), bringing us to an annual average of 2.0% for 2014. Our expectation for real GDP growth in 2015 remains unchanged at 2.5%.

Graph 1
Personal Income, Outlays, and Saving
YoY % Change



Source: Bureau of Economic Analysis & BBVA Research

Graph 2
Contributions to Real GDP Growth
2Q14 Preliminary, SAAR Percentage Points



Source: Bureau of Economic Analysis & BBVA Research

Week Ahead

ISM Manufacturing Index (August, Tuesday 10:00 ET)

Forecast: 57.5

Consensus: 57.0

Previous: 57.1

The ISM Manufacturing Index is expected to continue its upward trend in August as new orders and production surge. July's data pointed to a significant jump in demand for manufactured goods, marking the largest increase seen in more than a year. This will certainly help to boost production in the coming months, building on July's 2014 high for the sub-index. Employment has also been an important driver of the composite index, with hiring in the manufacturing sector expected to continue as businesses bring on more work.

Construction Spending (July, Tuesday 10:00 ET)

Forecast: 0.9%

Consensus: 1.0%

Previous: -1.8%

Construction spending took a turn for the worse in June, falling at the fastest pace since January 2011. Most of this decline was due to the nonresidential sector, particularly from the public side, although the private sector also showed weakness for the month. In July, we expect that total construction spending will recover at least some of what was lost in June. Recent good news coming from the housing sector should boost the residential component, and the usual volatility of the nonresidential component suggests a rebound in July. This should ultimately lift the contribution to GDP growth for 3Q14.

International Trade (July, Thursday 8:30 ET)

Forecast: -\$42.00B

Consensus: -\$42.40B

Previous: -\$41.54B

The international trade balance is expected to widen slightly in July as increasing internal demand helps boost import growth. Imports have declined throughout the past two months but should rebound in July as domestic conditions continue to improve. However, weak global demand continues to hurt exports, and we could see export growth drop into negative territory after two consecutive months of gains. The petroleum balance has improved significantly throughout 2014 thus far and is expected to continue on a similar path as the U.S. becomes less energy dependent and petroleum-related imports decline.

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

Forecast: 205K, 6.2%

Consensus: 225K, 6.1%

Previous: 209K, 6.2%

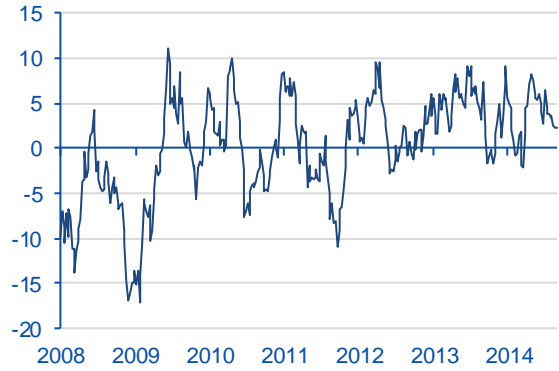
Employment growth has certainly been a highlight of 2014 thus far, with nonfarm payrolls holding above 200K for six straight months. We expect that this trend will continue in August as the labor market outlook continues to improve. The unemployment rate dropped briefly to 6.1% in June before ticking back up to 6.2% in July, where we expect it to remain in August. Labor force participation remains low but may start to increase gradually as individuals feel more comfortable with job availability and get back on the job search. Recent talk of employment underutilization suggests that there are still concerns about the overall health of the labor market, yet we can certainly see at least some movement in the right direction.

Market Impact

Markets face a relatively calm economic calendar for the short holiday week. With markets closed on Monday, focus will shift to data releases later in the week. The employment report on Friday will likely be a market mover one way or another, but we don't expect the other economic indicators to warrant significant reaction.

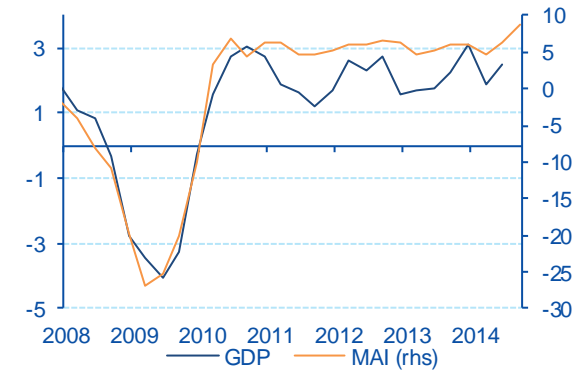
Economic Trends

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



Source: BBVA Research

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



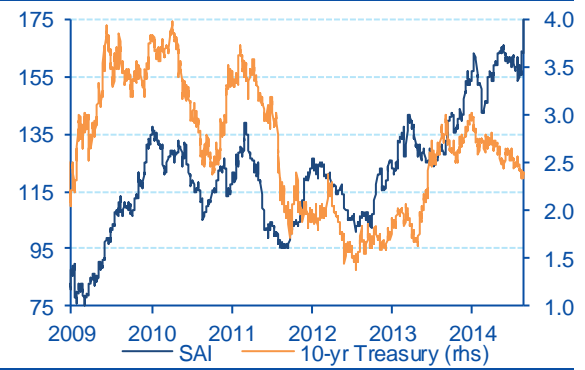
Source: BBVA Research & BEA

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



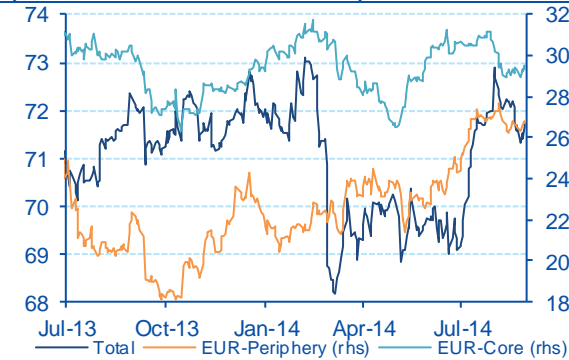
Source: BBVA Research

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



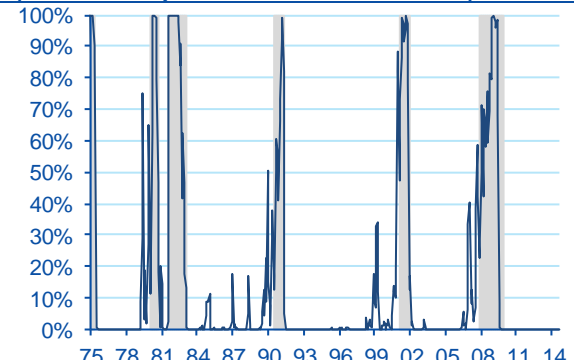
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

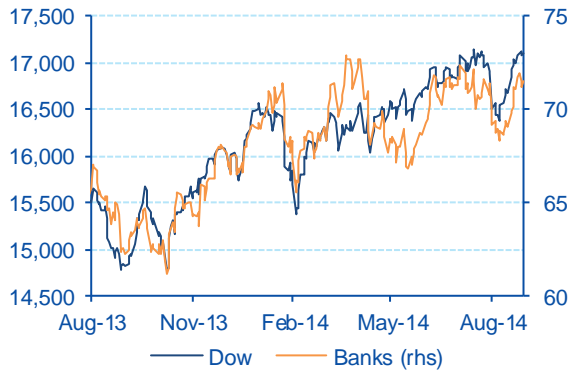
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

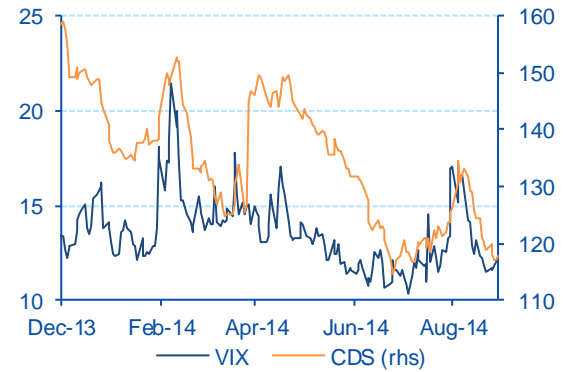
Financial Markets

Graph 9
Stocks
(Index, KBW)



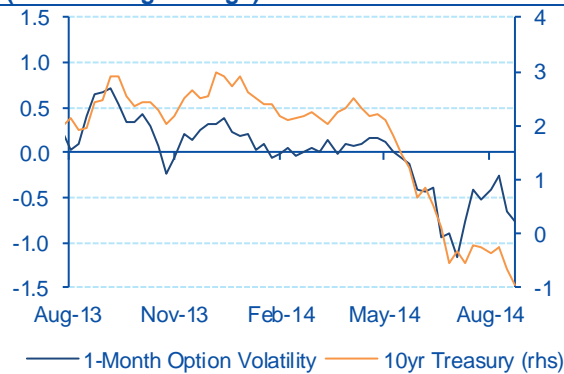
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



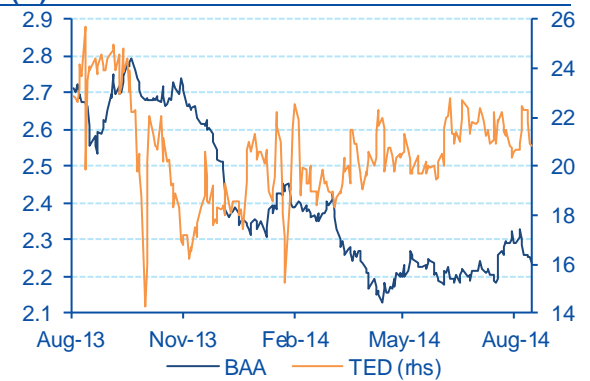
Source: Bloomberg & BBVA Research

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



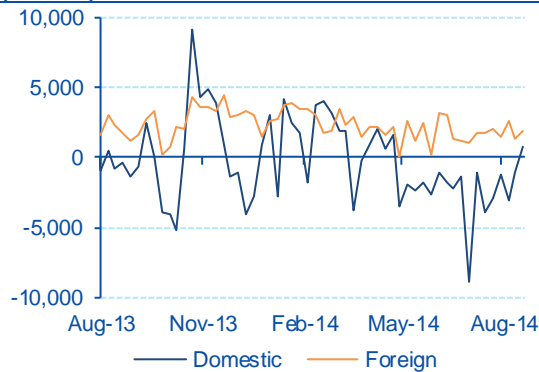
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



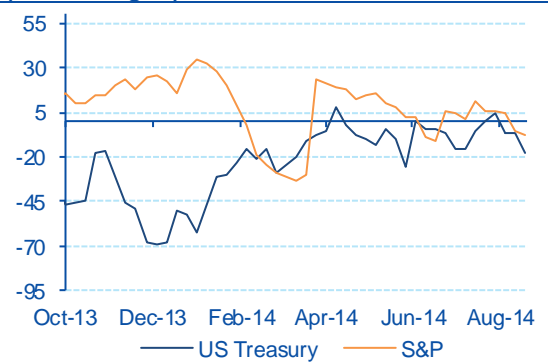
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

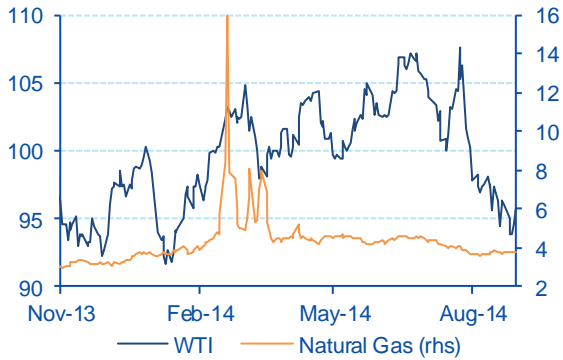
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

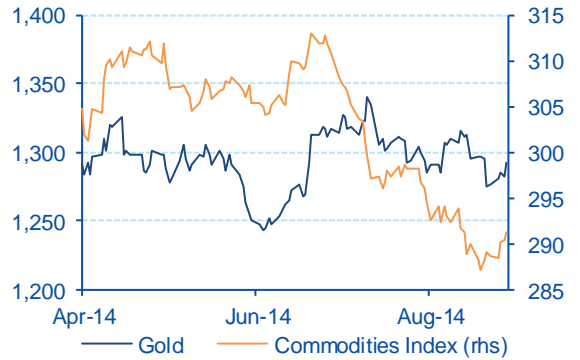
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



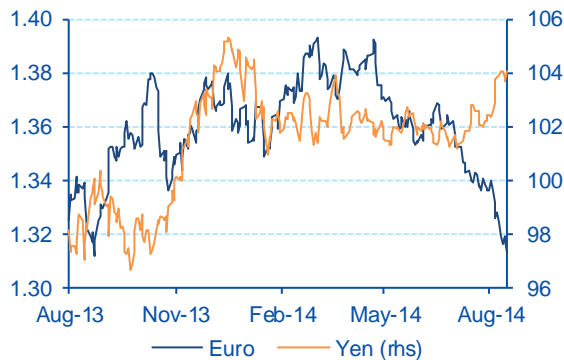
Source: Bloomberg & BBVA Research

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



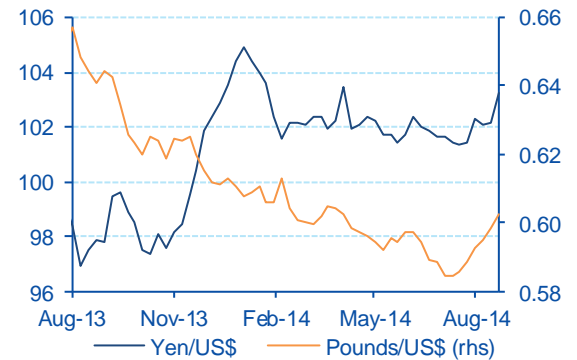
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



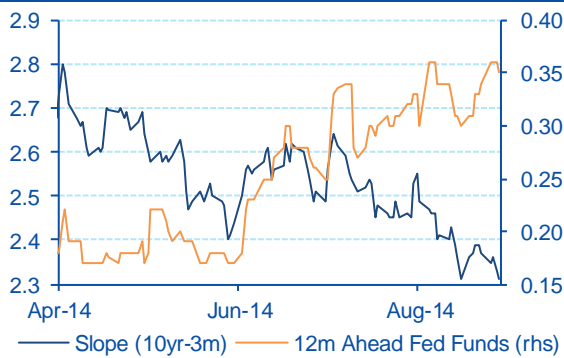
Source: Bloomberg & BBVA Research

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



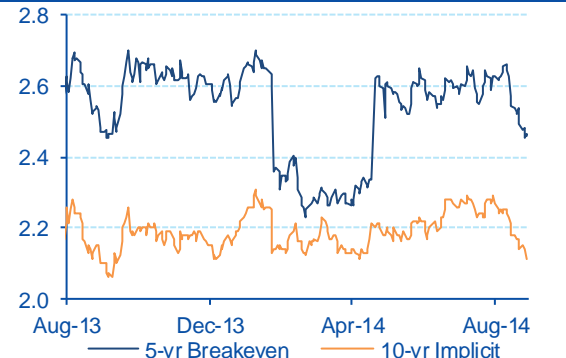
Source: Haver Analytics & BBVA Research

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)	2.93	2.92	2.90	2.39
Heloc Loan 30K	4.97	4.97	4.96	5.34
5/1 ARM *	2.97	2.95	3.01	2.90
15-year Fixed Mortgage *	3.25	3.23	3.23	3.23
30-year Fixed Mortgage *	4.10	4.10	4.12	3.99
Money Market	0.39	0.39	0.40	0.44
2-year CD	0.85	0.85	0.82	0.76

*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	0.09	0.07
3M Libor	0.23	0.23	0.23	0.26
6M Libor	0.33	0.33	0.32	0.39
12M Libor	0.56	0.55	0.55	0.67
2yr Sw ap	0.71	0.71	0.68	0.59
5yr Sw ap	1.78	1.81	1.81	1.83
10Yr Sw ap	2.50	2.55	2.63	3.03
30yr Sw ap	3.07	3.14	3.26	3.80
30day CP	0.12	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.13	0.13	0.13	0.17

Source: Bloomberg & BBVA Research

Quote of the Week

President Barack Obama

President Obama Delivers an Update on the Economy, Iraq, and Ukraine

28 August 2014

“Over the past four and a half years, our businesses have created now nearly 10 million new jobs. So there are reasons to feel good about the direction we’re headed. But as everybody knows, there’s a lot more we should be doing to make sure more Americans benefit from the progress that we’ve made and I am going to be pushing Congress hard on this when they return next week.”

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
2-Sep	ISM Manufacturing PMI SA	AUG	57.50	57.00	57.10
2-Sep	Census Bureau US Construction Spending MoM SA	JUL	0.90	1.00	-1.80
3-Sep	NEW YORK PURCHASING MANAGER Current Business Conditions SA	AUG	69.00	-	68.10
3-Sep	US Manufacturers New Orders Total MoM SA	JUL	18.50	11.00	1.10
9/3/2014	US Auto Sales Total Annualized SA	AUG	16.70	16.60	16.40
4-Sep	ADP National Employment Report SA Private Nonfarm Level Change	AUG	200.00	225.00	218.10
4-Sep	US Initial Jobless Claims SA	30-Aug	297.00	300.00	298.00
4-Sep	US Continuing Jobless Claims SA	23-Aug	2510.00	2510.00	2527.00
4-Sep	US Output Per Hour Nonfarm Business Sector QoQ SA	2Q F	2.60	2.50	2.50
4-Sep	US Unit Labor Costs Nonfarm Business Sector QoQ % SAAR	2Q F	0.50	0.60	0.60
4-Sep	US Trade Balance Balance Of Payments SA	JUL	-42.00	-42.40	-41.54
4-Sep	ISM Non-Manufacturing NMI NSA	AUG	59.30	57.55	58.70
5-Sep	US Employees on Nonfarm Payrolls Total MoM Net Change SA	AUG	205.00	225.00	209.00
5-Sep	US Employees on Nonfarm Payrolls Total Private MoM Net Change SA	AUG	200.00	210.00	198.00
5-Sep	US Employees on Nonfarm Payrolls Manufacturing Industry Monthly Net Change SA	AUG	17.00	18.00	28.00
5-Sep	US Average Hourly Earnings All Employees Total Private Monthly Percentage Change	AUG	0.10	0.20	0.00
5-Sep	US Average Weekly Hours All Employees Total Private SA	AUG	34.50	34.50	34.50
5-Sep	US Unemployment Rate (%)	AUG	6.20	6.10	6.20

Forecasts

	2011	2012	2013	2014	2015	2016	2017
Real GDP (% SAAR)	1.8	2.8	1.9	2.0	2.5	2.8	2.8
CPI (YoY %)	3.1	2.1	1.5	1.9	2.2	2.3	2.4
CPI Core (YoY %)	1.7	2.1	1.8	2.0	2.1	2.3	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.3	5.9	5.8	5.5
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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