

Economic Analysis

September's Retail Sales Confirm Weaker Conclusion to 3Q14 Consumer Data

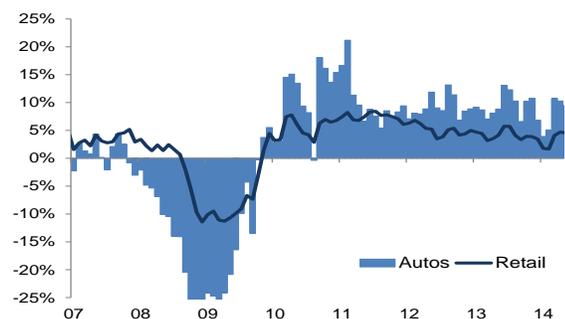
Kim Fraser Chase

Retail sales in September declined a surprising 0.3% following a 0.6% gain in the previous month. Auto sales were a big driver of the negative report, down 0.8% for the first time since January. Similarly, falling gas prices have weighed on nominal sales at gasoline stations, with the figure down 0.8% and marking the fourth consecutive monthly decline. Core retail sales dropped 0.2% excluding only autos and fell 0.1% excluding both autos and gas. Most other components of the retail sales report showed little encouragement from the consumer side in September, except maybe electronic sales which increased 3.4%, likely influenced by the release of the iPhone6 during the month. Overall, retail sales growth for the third quarter is somewhat of a disappointment, with monthly rates barely averaging 0.2% (the slowest pace since 2Q12). This is not so encouraging when we consider that personal consumption has thus far been the strongest and most consistent driver of GDP growth throughout the recovery. Compared to 2Q14, we expect to see a slightly slower pace of growth for 3Q14, somewhere closer to 2-2.5% QoQ SAAR. This is in line with our baseline scenario to reach 2.0% growth in 2014.

Industrial Production Surprises to the Upside as Manufacturing Bounces Back

Economic news throughout 3Q14 has been mixed, yet September's industrial production report helps ease concerns of a slowing manufacturing sector. Total industrial output increased 1.0%, the largest monthly jump since November 2012 and more than offsetting August's 0.2% decline. The manufacturing index completely recovered from the drop in August, up 0.5% in September, with a mostly even split between durable and nondurable goods. Motor vehicle production slipped 2.7% for the second consecutive month, though this decline stemmed mostly from light trucks rather than autos. We also saw strength in other components of the industrial production index, with utilities leading the way (3.9%) and mining following closely behind (1.8%). On a YoY basis, industrial production growth has held above 4% for five consecutive months and we expect it to do so throughout the rest of this year. Looking ahead to 2015 and beyond, we expect that industrial production growth will stabilize around 3.0%, in line with the pre-recession average. This bodes well for steady and consistent GDP growth throughout the coming years, which we expect to reach 2.5% in 2015 and accelerate thereafter.

Graph 1
Retail and Auto Sales (YoY % Change)



Source: Census & BBVA Research

Graph 2
Industrial Production Index (SA, 2007=100)



Source: FRB & BBVA Research

Week Ahead

Existing Home Sales (September, Tuesday 10:00 ET)

Forecast: 5100K

Consensus: 5100K

Previous: 5050K

Existing home sales are expected to increase in September but remain below July's 11-month high. The housing market has been bleaker than expected throughout the past year, with annual growth holding in negative territory since November 2013. In September, we expect to see another YoY decline but at a softer pace compared to the previous two months. Pending home sales jumped 3.2% in July but then retreated 1.0% in August, so it is unclear how much of an impact this will have on the existing home sales figure. However, existing home sales dropped in August for the first time in five months, so it is likely that some of July's pending contracts were delayed to close until September.

Consumer Price Index, Core (September, Wednesday 8:30 ET)

Forecast: -0.1%, 0.0%

Consensus: 0.0%, 0.2%

Previous: -0.2%, 0.0%

The CPI is expected to show another modest decline in September, keeping in trend with subdued consumer price pressures seen throughout the past few months. Energy prices have certainly contributed to the latest downward pressure on headline inflation, and food inflation has been softening. Crude oil prices dropped again in September for the third straight month, while natural gas prices increased only slightly following major monthly declines in July and August. Prices received by farmers for agricultural goods also declined, particularly for meat, food commodities, and commercial vegetables. Import prices for September also indicated a continuation of low inflation, down 0.5% for the fifth consecutive month.

Jobless Claims (Week of October 18th, Thursday 8:30 ET)

Forecast: 280K

Consensus: 284K

Previous: 264K

Jobless claims have been in steady decline for the past few weeks, supporting the faster-than-expected drop in the unemployment rate as of late. Initial claims held below 300K throughout most of September and the first part of October, without any special factors at play. Mid-month figures noted a significant drop in claims to a 14-year low of 264K, although we don't expect this sharp downward trend to continue. For the third week in October, we expect to see another signal that jobless claims are on the decline – although this report may be unusually low due to the holiday-shortened workweek.

New Home Sales (September, Friday 10:00 ET)

Forecast: 475K

Consensus: 470K

Previous: 504K

New home sales jumped unexpectedly in August, up a massive 18.0% for the month, yet we expect that September's report will show some sort of correction for this significant change in trend. Homebuilder confidence has been on the rise after a brief downturn throughout the first half of this year, and September's views on both present and future sales are near the highest of the recovery period thus far. We expect that activity in the new home market will continue to gradually gain momentum throughout the next year, although we still have a long way to go to recover the losses from the crisis.

Market Impact

Markets have been in a frenzy throughout the past week as global threats continue to worry investors. This week, we could see another volatile stretch even though the economic calendar is relatively light. Our focus is on upcoming weeks, where the FOMC announcement could shift markets one way or another.

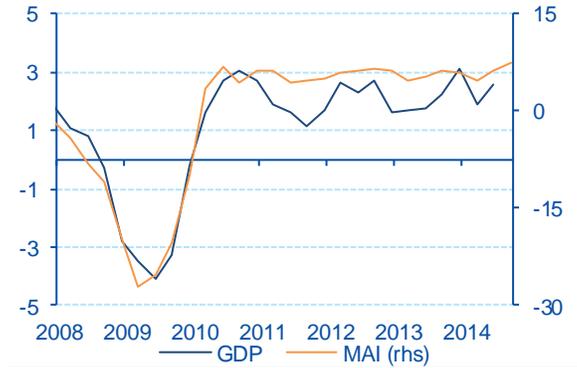
Economic Trends

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 & %)



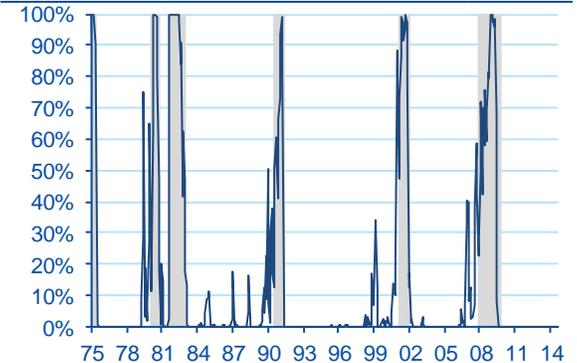
Source: Bloomberg & BBVA Research

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

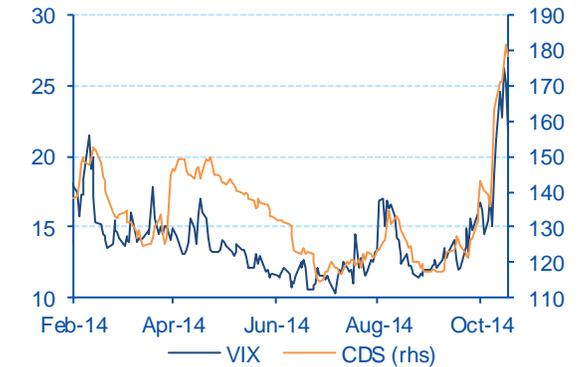
Financial Markets

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)



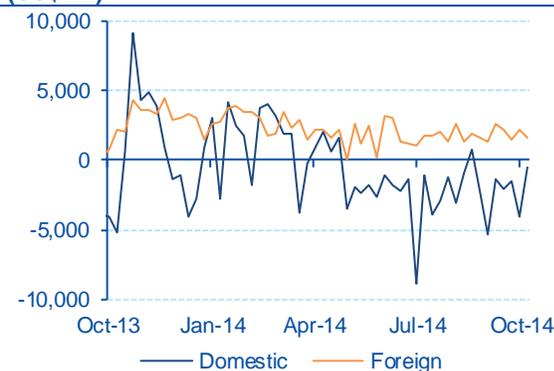
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



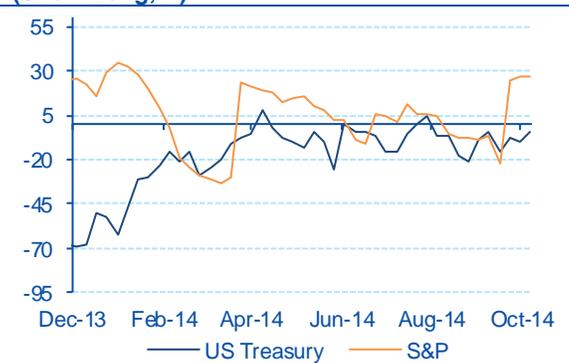
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

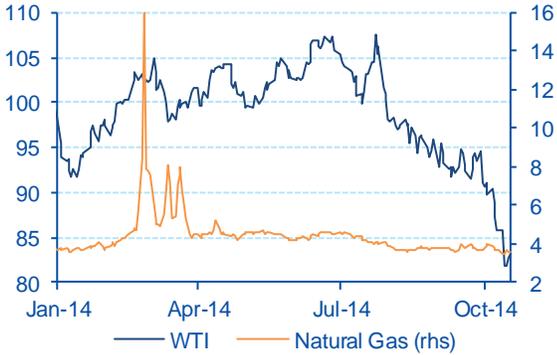
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



Source: Bloomberg & BBVA Research

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



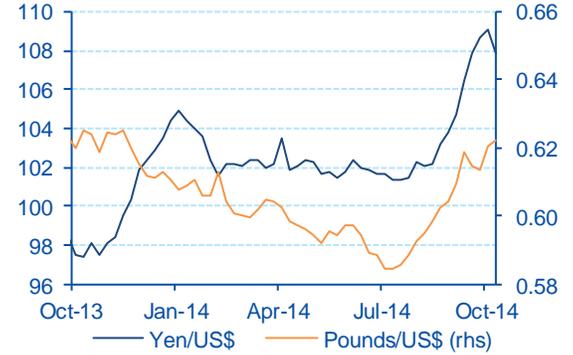
Source: Haver Analytics & BBVA Research

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)	2.94	2.94	2.93	2.63
Heloc Loan 30K	4.83	4.81	4.81	5.28
5/1 ARM *	2.92	3.05	3.06	2.90
15-year Fixed Mortgage *	3.18	3.30	3.37	3.23
30-year Fixed Mortgage *	3.97	4.12	4.23	3.99
Money Market	0.42	0.42	0.42	0.41
2-year CD	0.89	0.90	0.87	0.81

*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	0.10
3M Libor	0.23	0.23	0.23	0.24
6M Libor	0.32	0.33	0.32	0.36
12M Libor	0.54	0.57	0.55	0.61
2yr Sw ap	0.64	0.69	0.81	0.43
5yr Sw ap	1.61	1.71	1.98	1.44
10Yr Sw ap	2.35	2.42	2.71	2.66
30yr Sw ap	2.96	3.00	3.28	3.58
30day CP	0.13	0.12	0.11	0.12
60day CP	0.15	0.11	0.11	0.15
90day CP	0.16	0.13	0.13	0.15

Source: Bloomberg & BBVA Research

Quote of the Week

Charles Evans, President and CEO of the Federal Reserve Bank of Chicago
Monetary Policy Normalization: If Not Now, When?

13 October 2014

"I am very uncomfortable with calls to raise our policy rate sooner than later. I favor delaying liftoff until I am more certain that we have sufficient momentum in place toward our policy goals. And I think we should plan for our path of policy rate increases to be shallow in order to be sure that the economy's momentum is sustainable in the presence of less accommodative financial conditions. I look forward to the day when we can return to business-as-usual monetary policy, but that time has not yet arrived."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
21-Oct	US Existing Homes Sales SAAR	SEP	5.10	5.10	5.05
21-Oct	US Existing Homes Sales MoM SA	SEP	1.00	0.99	-1.75
22-Oct	US CPI Urban Consumers MoM SA	SEP	-0.10	0.00	-0.20
22-Oct	US CPI Urban Consumers Less Food & Energy MoM SA	SEP	0.00	0.20	0.01
23-Oct	US Initial Jobless Claims SA	OCT 18	280.00	284.00	264.00
23-Oct	US Continuing Jobless Claims SA	OCT 11	2380.00	2380.00	2389.00
23-Oct	Chicago Fed National Activity Index	SEP	-0.05	0.00	-0.21
23-Oct	Conference Board US Leading Index MoM	SEP	0.30	0.70	0.20
24-Oct	US New One Family Houses Sold Annual Total SAAR	SEP	475.00	470.00	504.00
24-Oct	US New One Family Houses Sold Annual Total MoM SA	SEP	-5.75	-6.75	18.00

Forecasts (Note: Revisions Pending)

	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	2.65	3.36	3.75	3.98
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.20	1.24	1.26

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