

Economic Analysis

Energy Prices Continue to Weigh on Inflation

Kim Fraser Chase

The consumer price index increased 0.1% in September following a 0.2% decline in August. As expected, energy prices weighed on headline inflation for the third consecutive month, while prices for energy services have been in steady decline since June. Food inflation ticked up slightly in September at 0.3% versus 0.2% in August. However, producer prices remain subdued and commodity prices have dropped sharply in October, so we do not expect to see a pickup in the headline inflation components for the next report. Excluding food and energy, core inflation rose 0.1% as price pressures increased for medical care commodities (0.5%), motor vehicle maintenance and repair (0.4%), hospital services (0.3%), and rent of primary residence (0.3%). On a YoY basis, both headline and core CPI held at 1.7% for the second consecutive month, settling well below the Fed's inflation target and pushing support away from an early federal funds rate hike in 2015. Looking forward, we expect that inflation will hold at or below 2.0% for the next few months, reaching an annual average of 1.9% in 2014, and then accelerate slowly to 2.2% in 2015. We expect that the Fed will feel comfortable increasing rates by mid-2015 as long as inflationary pressures increase gradually in line with a strengthening economy.

Existing and New Home Sales Continue Volatile Streak in September

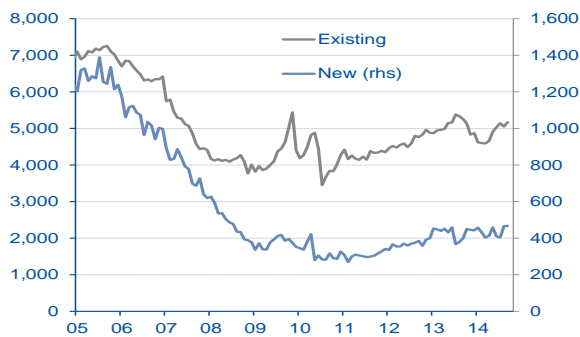
The housing market continues to show signs of month-to-month volatility, with September's data continuing to support the uncertain recovery. Existing home sales more than made up for the monthly decline in August, increasing to 5170K (2.4%) in September. This marks the highest level since September of last year but is not quite near the peak levels we have seen throughout the recovery period thus far. Existing sales have recovered only 34% from the crisis, yet that market has come a lot further than the demand for new homes. For September, new home sales remained mostly unchanged following a significant downward revision in the prior month (from 504K to 466K). At 467K, new home sales have reached the highest level of the recovery but reflect a struggling rebound towards the pre-crisis peak of 1389K. Weak housing demand has brought down home prices at a faster pace than initially expected. The median sales price of existing homes has declined for three consecutive months, while prices for new homes dropped nearly 10% in September. Combined with the latest declines in mortgage rates, housing affordability should bounce back after hitting a recovery low in June.

Graph 1
Consumer Price Index (YoY % Change)



Source: BLS & BBVA Research

Graph 2
New and Existing Home Sales (SAAR, Thousands)



Source: NAR, Census, & BBVA Research

Week Ahead

S&P Case-Shiller Home Price Index (August, Tuesday 9:00 ET)

Forecast: 5.94%

Consensus: 5.70%

Previous: 6.75%

The S&P Case-Shiller HPI has been trending downward throughout the past few months and is expected to make only a minor comeback in August. Various home price indicators have noted modest monthly growth on a seasonally-adjusted basis, yet the median sales prices for both new and existing homes declined for the month. Annual growth rates have fallen faster than we initially expected, mostly due to a prolonged recovery period of weak housing demand. On a YoY basis, we expect to see a continuation of the decelerating trend that has been ongoing since November 2013.

Consumer Confidence (October, Tuesday 10:00 ET)

Forecast: 87.3

Consensus: 87.0

Previous: 86.0

Consumer confidence is expected to rebound slightly in October following September's significant decline in both expectations and views on the present situation. The index jumped to a recovery high in August but then fell back to a four-month low in September, a surprising movement particularly given the ongoing decline in gas prices that have become so favorable for consumers. However, the ebola outbreak and other global threats are likely having a bigger impact on consumer attitudes, and the increased volatility in financial markets is sending a more uncertain outlook regarding household wealth. Still, we expect to see at least a small recovery in the consumer confidence index for October but not quite enough to beat the optimism seen in August.

GDP, Advance (3Q14, Thursday 8:30 ET)

Forecast: 2.5%

Consensus: 3.0%

Previous: 4.6%

Real GDP growth hit nearly a three-year high in 2Q14, with the final estimate coming in stronger than expected. For 3Q14, we are likely to see slightly slower growth but similar trends in the underlying details. Personal consumption has held up relatively well in the third quarter, especially with low inflation encouraging spending, and August's rate for real PCE growth was the strongest since March. Investment remains weak but looks to be mostly on par with what we saw in 2Q, particularly when it comes to residential spending. However, business inventory growth has slowed thus far throughout the quarter and may weigh on the 3Q GDP figure. Finally, we expect to see another negative contribution from net exports despite the modest improvement in the trade gap.

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

Forecast: 0.2%, 0.2%

Consensus: 0.3%, 0.1%

Previous: 0.3%, 0.5%

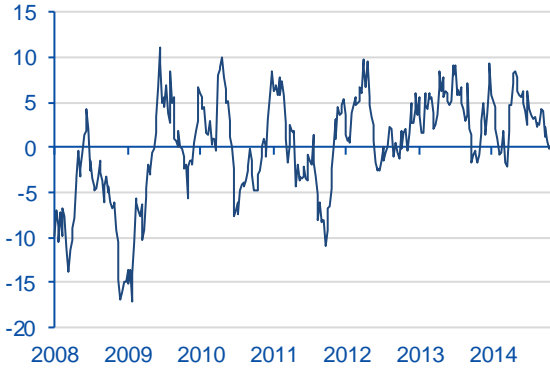
Personal income and outlays are not expected to close out the third quarter on an extremely positive note as recent consumer data have been mixed. Consumption, confidence, and average earnings all weakened in September and hint at a deceleration in monthly growth for both income and spending. Furthermore, the latest declines in consumer prices are likely to weigh on the nominal figures in this report. Even still, we do not expect to see a significant drop off in momentum for the consumer sector, particularly as we transition into the early heavy-shopping season for the holidays.

Market Impact

Markets are heating up again in anticipation of how the Fed will react to increasing global volatility and falling inflation expectations. The FOMC statement on Wednesday will warrant the most market attention, but other economic reports (GDP, consumption, confidence, etc) could shake things up as well.

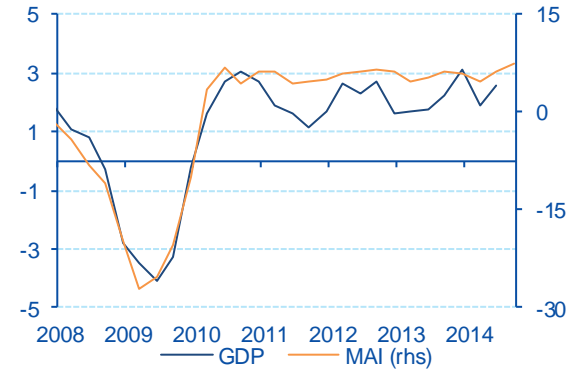
Economic Trends

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



Source: BBVA Research

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



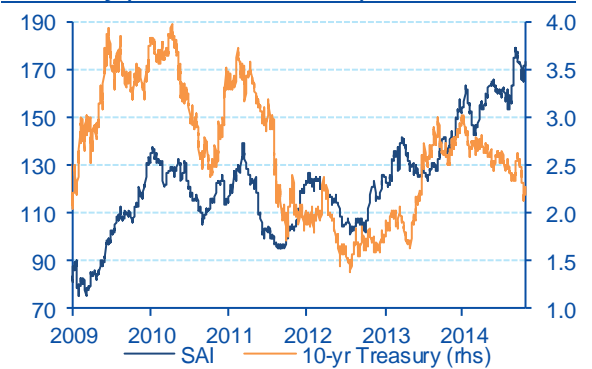
Source: BBVA Research & BEA

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



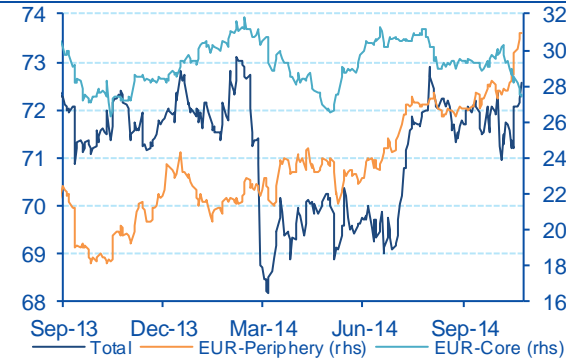
Source: BBVA Research

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



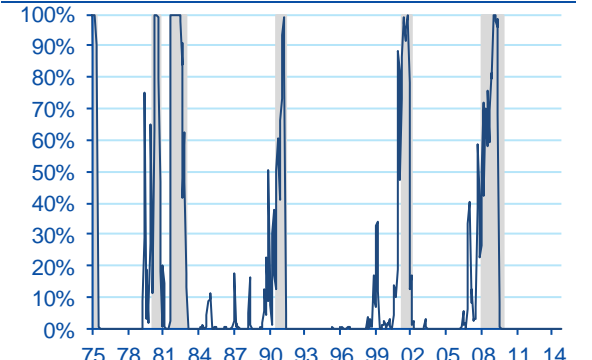
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

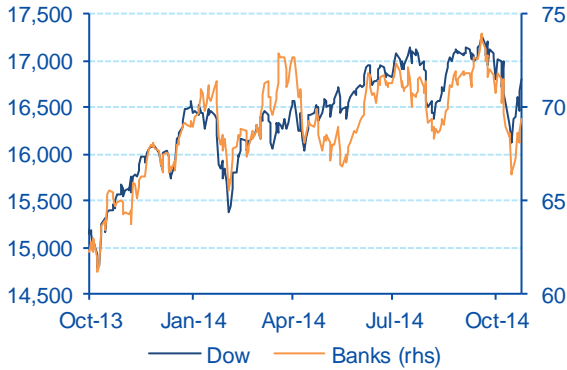
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

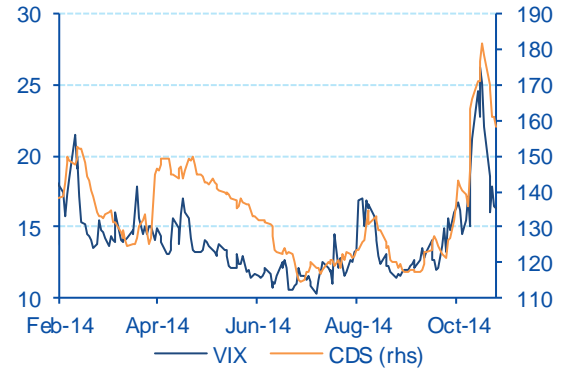
Financial Markets

Graph 9
Stocks
(Index, KBW)



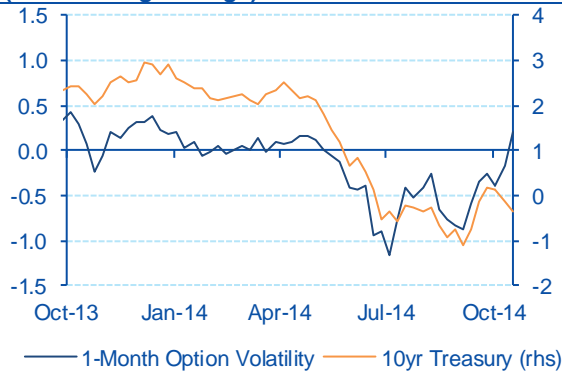
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



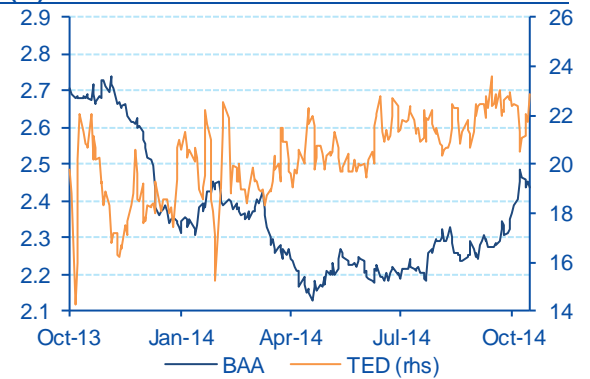
Source: Bloomberg & BBVA Research

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



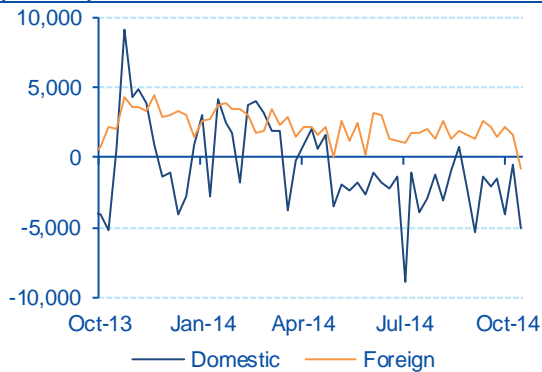
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



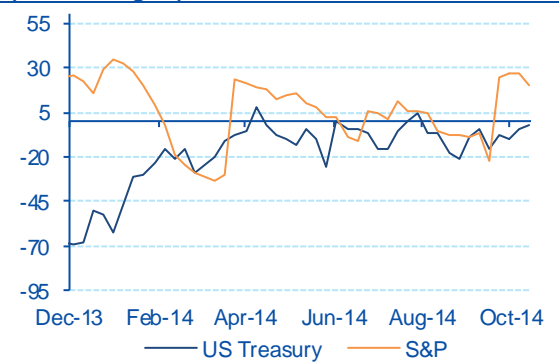
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

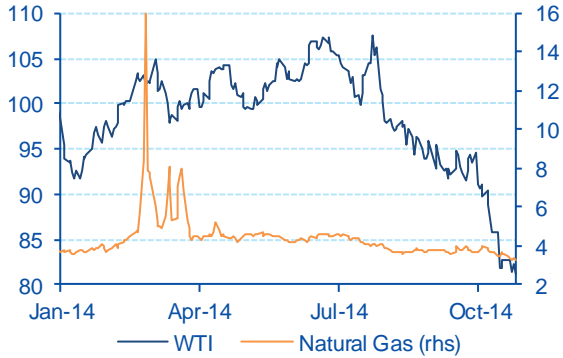
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

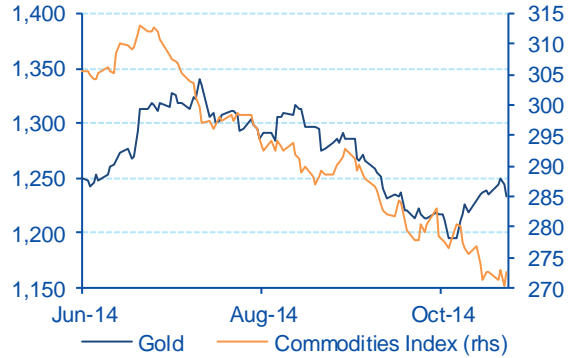
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



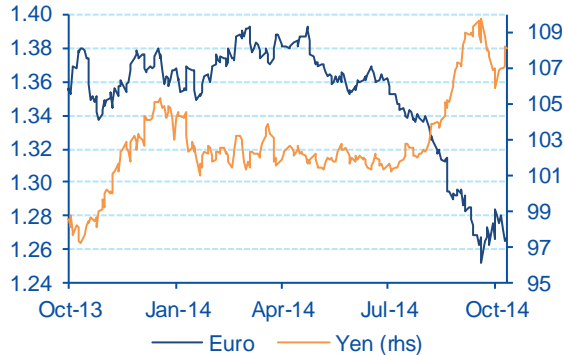
Source: Bloomberg & BBVA Research

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



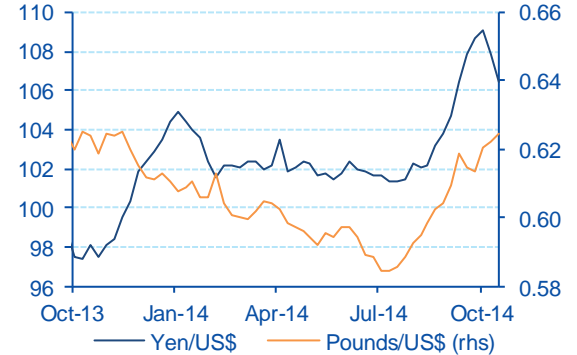
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



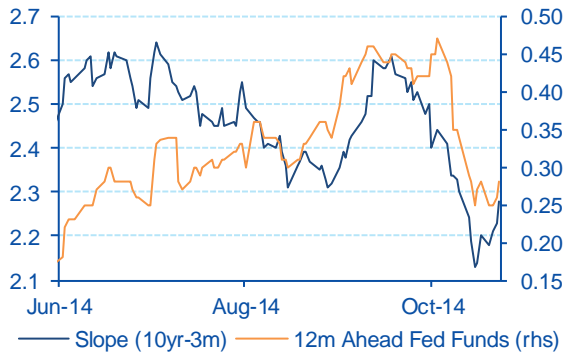
Source: Bloomberg & BBVA Research

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



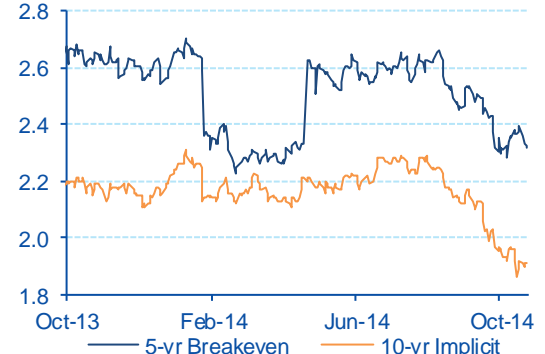
Source: Haver Analytics & BBVA Research

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	4.84	4.83	4.82	5.26
5/1 ARM *	2.91	2.92	3.08	2.90
15-year Fixed Mortgage *	3.08	3.18	3.36	3.23
30-year Fixed Mortgage *	3.92	3.97	4.20	3.99
Money Market	0.42	0.42	0.42	0.42
2-year CD	0.89	0.89	0.89	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	0.08
3M Libor	0.23	0.23	0.23	0.24
6M Libor	0.32	0.32	0.32	0.36
12M Libor	0.54	0.54	0.55	0.61
2yr Sw ap	0.64	0.64	0.81	0.43
5yr Sw ap	1.67	1.61	1.95	1.42
10Yr Sw ap	2.41	2.35	2.66	2.65
30yr Sw ap	3.02	2.96	3.20	3.58
30day CP	0.10	0.12	0.11	0.12
60day CP	0.11	0.11	0.11	0.15
90day CP	0.13	0.13	0.13	0.15

Source: Bloomberg & BBVA Research

Quote of the Week

Eric Rosengren, President of the Federal Reserve Bank of Boston
Fed's Rosengren Sticks to 3% Growth Forecast, Sees End for QE
20 October 2014

"We could stay at the zero lower bound for longer. We could decide to raise rates at a more gradual pace. It's not clear to me that continuing QE would necessarily be the best way to address concern."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
27-Oct	US Pending Home Sales Index MoM SA	SEP	0.50	1.00	-1.04
27-Oct	Dallas Fed Manufacturing Outlook Level Of General Business Activity	OCT	8.50	11.00	10.80
28-Oct	US Durable Goods New Orders Industries MoM SA	SEP	3.00	0.50	-18.40
28-Oct	US Durable Goods New Orders Total ex Transportation MoM SA	SEP	-0.30	0.50	0.40
28-Oct	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	AUG	0.25	0.18	-0.50
28-Oct	S&P/Case-Shiller Composite-20 City Home Price Index YoY	AUG	5.94	5.70	6.75
28-Oct	Conference Board Consumer Confidence SA 1985=100	OCT	87.30	87.00	86.00
29-Oct	Federal Funds Target Rate - Upper Bound	OCT 29	0.25	0.25	0.25
29-Oct	US FOMC Agency Mortgage Backed Security Purchases	OCT	0.00	0.00	5.00
29-Oct	US FOMC Treasury Purchase Program Pace Announced at FOMC Meeting	OCT	0.00	0.00	10.00
30-Oct	US Initial Jobless Claims SA	OCT 25	285.00	284.00	283.00
30-Oct	US Continuing Jobless Claims SA	OCT 18	2375.00	2354.00	2351.00
30-Oct	GDP US Chained 2009 Dollars QoQ SAAR	3Q A	2.50	3.05	4.60
30-Oct	GDP US Personal Consumption Chained 2009 Dlr % Change from Previous Period SAAR	3Q A	2.30	1.90	2.50
30-Oct	US GDP Price Index QoQ SAAR	3Q A	1.70	1.40	2.10
30-Oct	US GDP Personal Consumption Core Price Index QoQ % SAAR	3Q A	1.50	1.40	2.00
31-Oct	US Personal Income MoM SA	SEP	0.20	0.30	0.30
31-Oct	US Personal Consumption Expenditures Nominal Dollars MoM SA	SEP	0.20	0.10	0.50
31-Oct	Bureau of Labor Statistics Employment Cost Civilian Workers QoQ SA	3Q	0.40	0.50	0.70
31-Oct	MNI Chicago Business Barometer (sa)	OCT	61.10	60.00	60.50
31-Oct	University of Michigan Survey of Consumer Confidence Sentiment	OCT F	86.00	86.40	86.40

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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