

Economic Analysis

Fed Statement Reveals Trivial Change in Strategy

Kim Fraser Chase

The December FOMC statement did not stray far from our expectations, presenting a slight change to the forward guidance language and hinting at modest adjustments to the economic outlook. As expected, the FOMC replaced the “considerable time” language related to the timing of the federal funds rate and instead specified that “the Committee judges that it can be patient in beginning to normalize the stance of monetary policy.” However, the statement did point out that this new language is “consistent with its previous statement”, giving the Committee the opportunity to ease into this adjustment in an attempt to curb any market misinterpretations or overreactions. The FOMC also readdressed the reinvestment strategy and the fact that the balance sheet will not decline even when interest rates start to increase, helping to maintain accommodative financial conditions.

In line with previous statements, the FOMC made sure to keep data-dependency in the center of the policy normalization decision-wheel, and the press conference offered specifics on the economic conditions that “would make liftoff appropriate.” The Committee specified that a pickup in headline inflation is not expected as part of the data-dependent environment, as long as FOMC members project that the gap between inflation and the 2.0% target will gradually close, with inflation expectations to move back to the 2.0% objective and core inflation to run near current levels. As expected, the changes in the forward guidance language reflected the ongoing difficulty in reconciling the views of the dovish members with those of the hawks, resulting in the most number of dissents since August 2011 (with the exact same dissenters of Plosser, Fisher, and Kocherlakota). Our expectations remain unchanged, with the first rate hike projected for mid-2015 and the start of balance sheet normalization sometime in 2016. For more details, see our latest [Fed Watch](#).

Oil Prices Drag Down Headline CPI, but Core Inflation Stable

The ongoing decline in oil prices has been dominating economic news throughout the past few months, presenting an uncertain picture of how such deflationary movements will impact the global recovery. November's data mark the fifth consecutive month for oil price declines, with levels down nearly 30% since June. Data for December suggest an even bigger drop, with WTI prices approaching \$55/barrel and marking a 47% decline since July 1st. In November, headline CPI declined 0.3% following a flat reading in October, with the energy index down 3.8% to mark the largest monthly drop since the midst of the crisis in 2008. However, food inflation remained stable around the 0.2% monthly pace. Excluding food and energy, core inflation increased a modest 0.1% in November after increasing 0.2% in the previous month. The usual drivers are still at play, with shelter prices up nearly 0.3% and medical care services up 0.4% for the month. While prices for services have held steady, commodity prices (other than energy) are falling. Most notably, apparel prices have declined throughout the past four months, while transportation commodities have been down since September. Compared to 12 months ago, the inflation message is clear: headline CPI has decelerated sharply to 1.3% YoY, while core CPI has remained more stable, dropping to only 1.7% in November. Expectations for the ongoing downward pressure on headline inflation prompted a slight revision to both our 2014 and 2015 inflation projections, although our qualitative assessment regarding the path of the inflation rate for the next few years has not changed. Headline CPI will average 1.7% in 2014, rising slightly to 2.0% in 2015. Core CPI will remain slightly higher at 1.8% in 2014 and 2.1% in 2015 (see our [inflation outlook](#)).

Week Ahead

GDP, Final (3Q14, Tuesday 8:30 ET)

Forecast: 3.8%

Consensus: 4.3%

Previous: 3.9%

The final release for 3Q14 real GDP growth is not expected to show any significant adjustment from the previous estimate. Most of the relevant data has already been accounted for, and the few minor revisions for September's data are not expected to have a major impact on the figure. Personal consumption expenditures and construction spending were both revised up slightly but still did not break into positive monthly growth to close out 3Q14. The trade balance has been a bigger focus lately given the downward pressure on oil prices and the dollar appreciation influencing a slowdown in U.S. exports. September's trade data was slightly worse than originally reported and may have a minor impact on the final GDP estimate.

Personal Income and Outlays (November, Tuesday 8:30 ET)

Forecast: 0.3%, 0.5%

Consensus: 0.5%, 0.5%

Previous: 0.2%, 0.2%

Personal income and outlays are both expected to accelerate in November following a decent pickup in the previous month. Income growth has been very steady throughout the past year, and November's increase in average hourly earnings suggests another positive movement for the wages and salaries component. On the consumption side, falling gas prices have been extremely favorable for consumers during the busy holiday shopping season. Looking ahead, we expect that personal spending will remain strong well into 2015 as consumers continue to take advantage of low prices.

Consumer Sentiment (December, Tuesday 9:55 ET)

Forecast: 94.0

Consensus: 93.5

Previous: 93.8

Consumer sentiment has been on the rise since late summer, when gas prices starting edging down noticeably. This boost to consumers' purchasing power has lifted confidence near recovery highs when it comes to views on current conditions as well as expectations for the next six months. Despite the fact that the global recovery remains on shaky ground, domestic consumers are feeling much better about the economy. Therefore, we expect that the consumer sentiment index will finish strong for 2014, with much of this momentum expected to carry over into the early part of 2015 as well.

New Home Sales (November, Tuesday 10:00 ET)

Forecast: 460K

Consensus: 460K

Previous: 458K

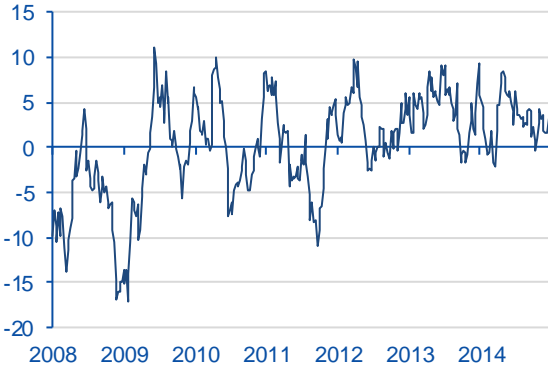
New home sales are expected to increase gradually in November for the fourth consecutive month, holding near a recovery high but still far off from the pre-crisis peak. While the latest trends have been positive, it is clear that there are still a lot of factors preventing a more robust rebound in the new home market, particularly tight credit and constrained supply. November's data mostly benefitted from falling oil prices, although this is likely to have more of a lagged impact on housing demand. Still, we did see a big jump in the homebuilder confidence index for the month, hinting at increased traffic of prospective buyers and stronger sales expectations. Therefore, we expect to see continued forward progress in the new home market throughout the coming months.

Market Impact

The short holiday week should make for a relatively quiet end to 2014. With the FOMC announcement out of the way, markets will have little to worry about until after the New Year. GDP and consumption may warrant some reaction, but in general we expect markets to remain mostly calm throughout the next two weeks.

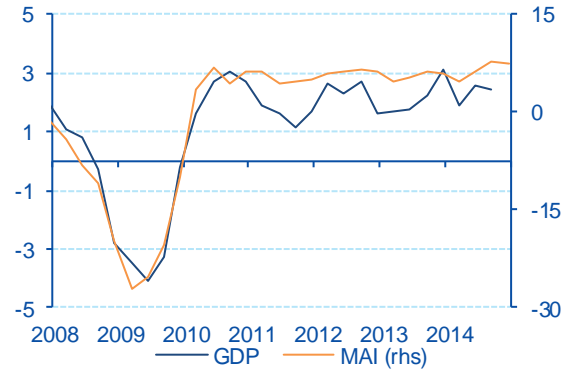
Economic Trends

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



Source: BBVA Research

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



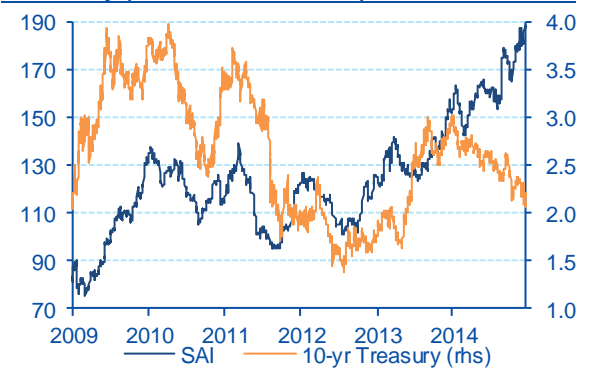
Source: BBVA Research & BEA

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



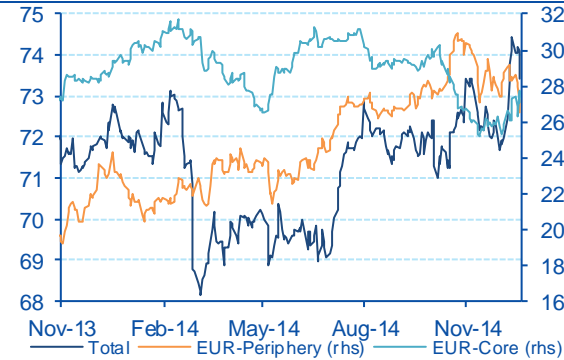
Source: BBVA Research

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



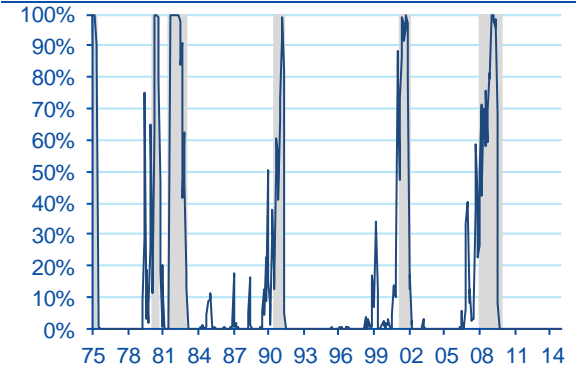
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

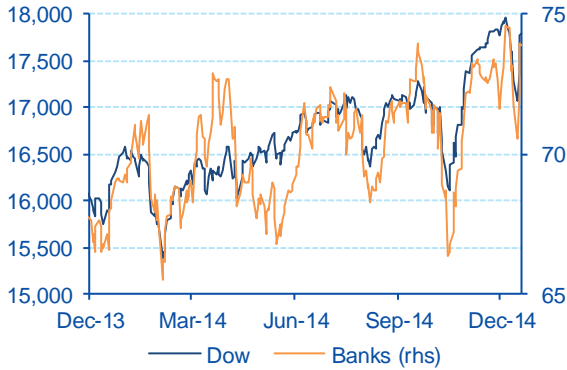
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

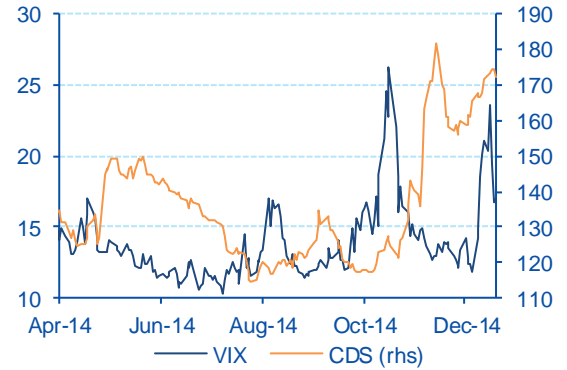
Financial Markets

Graph 9
Stocks
(Index, KBW)



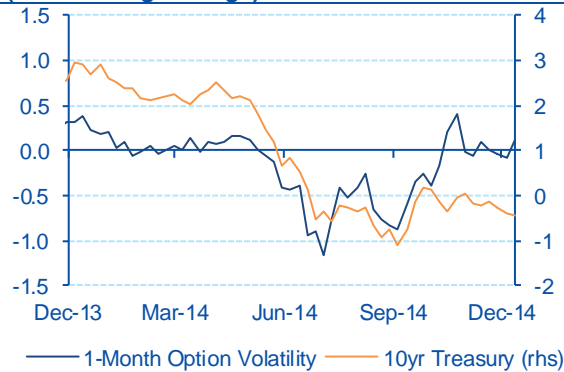
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



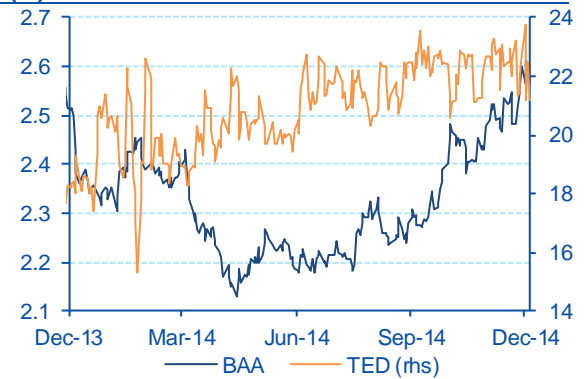
Source: Bloomberg & BBVA Research

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



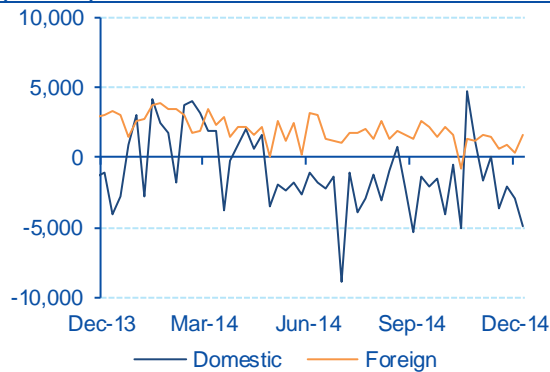
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



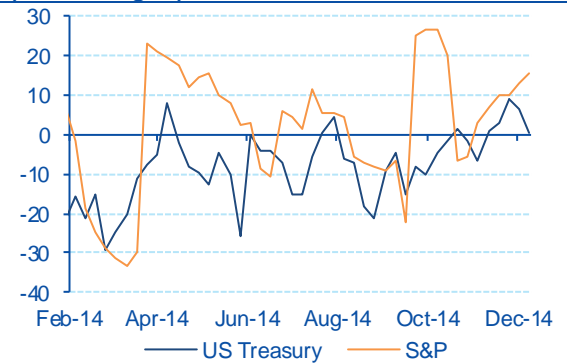
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

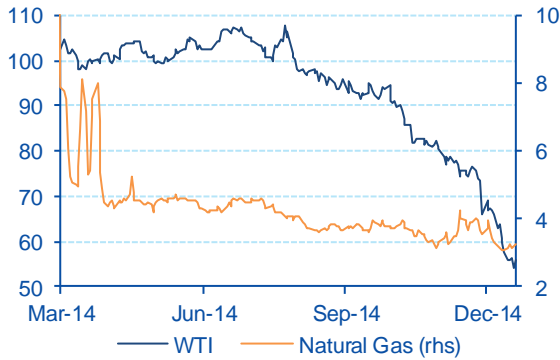
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

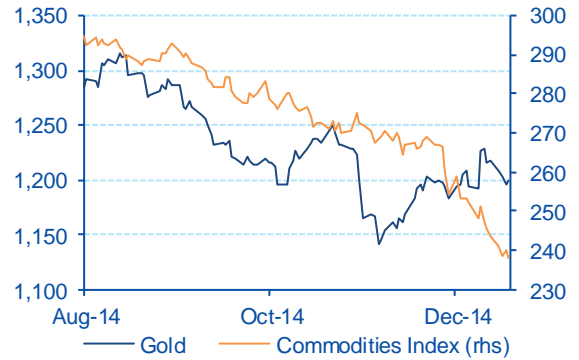
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



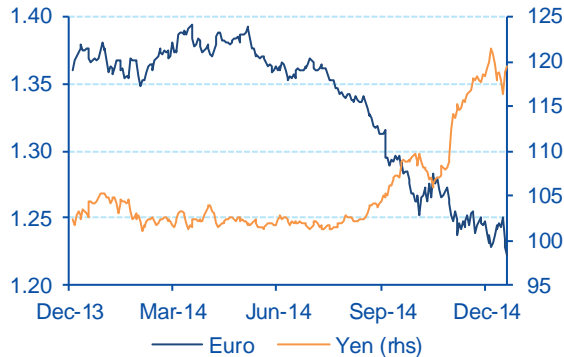
Source: Bloomberg & BBVA Research

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



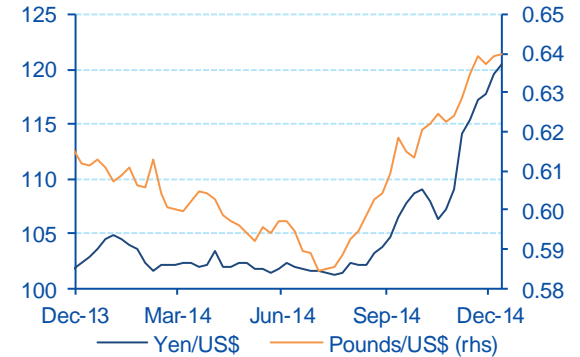
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



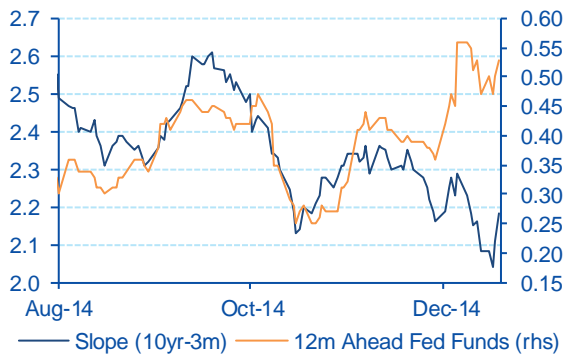
Source: Bloomberg & BBVA Research

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



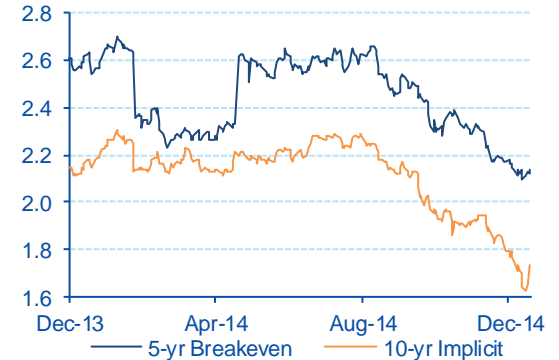
Source: Haver Analytics & BBVA Research

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)	2.70	2.84	2.94	2.67
Heloc Loan 30K	4.93	4.91	4.82	5.32
5/1 ARM *	2.95	2.98	3.01	2.90
15-year Fixed Mortgage *	3.09	3.20	3.17	3.23
30-year Fixed Mortgage *	3.80	3.93	3.99	3.99
Money Market	0.43	0.43	0.43	0.42
2-year CD	0.87	0.87	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	0.13	0.12	0.10	0.09
3M Libor	0.25	0.24	0.23	0.25
6M Libor	0.34	0.34	0.32	0.35
12M Libor	0.61	0.60	0.55	0.58
2yr Sw ap	0.87	0.78	0.72	0.49
5yr Sw ap	1.79	1.66	1.74	1.74
10Yr Sw ap	2.31	2.21	2.43	3.05
30yr Sw ap	2.74	2.70	2.99	3.86
30day CP	0.12	0.12	0.11	0.12
60day CP	0.13	0.11	0.11	0.15
90day CP	0.15	0.13	0.13	0.14

Source: Bloomberg & BBVA Research

Quote of the Week

Janet Yellen, Federal Reserve Board Chair
Chair Yellen's FOMC Press Conference
17 December 2014

"The Committee considers it unlikely to begin the normalization process for at least the next couple of meetings. This assessment, of course, is completely data dependent."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
22-Dec	Chicago Fed National Activity Index	NOV	0.25	0.25	0.14
22-Dec	US Existing Homes Sales SAAR	NOV	5.23	5.20	5.26
22-Dec	US Existing Homes Sales MoM SA	NOV	-0.67	-1.14	1.54
23-Dec	GDP US Chained 2009 Dollars QoQ SAAR	3Q T	3.80	4.30	3.90
23-Dec	GDP US Personal Consumption Chained 2009 Dls % Change from Previous Period SAAR	3Q T	2.20	2.60	2.20
23-Dec	US GDP Price Index QoQ SAAR	3Q T	1.40	1.40	1.40
23-Dec	US GDP Personal Consumption Core Price Index QoQ % SAAR	3Q T	1.40	1.40	1.40
23-Dec	US Durable Goods New Orders Industries MoM SA	NOV	0.70	3.00	0.30
23-Dec	US Durable Goods New Orders Total ex Transportation MoM SA	NOV	0.50	1.00	-1.10
23-Dec	University of Michigan Consumer Sentiment Index	DEC F	94.00	93.50	93.80
23-Dec	US Personal Income MoM SA	NOV	0.30	0.50	0.20
23-Dec	US Personal Consumption Expenditures Nominal Dollars MoM SA	NOV	0.50	0.50	0.20
23-Dec	US New One Family Houses Sold Annual Total SAAR	NOV	460.00	460.00	458.00
23-Dec	US New One Family Houses Sold Annual Total MoM SA	NOV	0.44	0.44	0.70
24-Dec	US Initial Jobless Claims SA	DEC 20	293.00	290.00	289.00
24-Dec	US Continuing Jobless Claims SA	DEC 13	2385.00	2377.50	2373.00

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	1.7	2.0	2.1	2.4
CPI Core (YoY %)	1.7	2.1	1.8	1.8	2.1	2.2	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.2	5.8	5.5	5.0
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	2.30	3.12	3.67	3.90
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.20	1.24	1.28

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