

Economic Analysis

Advance Estimate Shows GDP up 2.6% in 4Q14

Kim Fraser Chase

The first estimate for real GDP growth in 4Q14 showed a 2.6% QoQ SAAR gain, a notable slowdown from 3Q's astonishing 5.0% but in line with expectations for a relatively healthy quarter. Imports led the way in 4Q14, up 8.9% following a slight decline in 3Q and hinting at increasing strength for domestic demand. Gross private investment jumped 7.4%, mostly reflecting a stronger push from residential to close out the year. Personal consumption expenditures accelerated to a 4.3% pace from 3.2% in the third quarter, although we may see a downward revision in future estimates given some discouraging data on retail sales and other consumer activity in December. Export growth managed to remain positive despite growing concerns over slowing global demand and an appreciating U.S. dollar. Not surprisingly, government consumption declined 2.2% after a massive push from national defense spending in the previous quarter. Growth hit 2.4% for the year, the strongest since 2010 and up from 2.2% in 2013. For 2015, annual growth should come close to 3.0% for the first time since 2005 as we see more evidence of a solid and sustainable expansion. The upside is strong when we consider the potential for a significant boost to consumption from lower energy prices. However, the healing process is not complete as cyclical and structural weaknesses remain.

Employment Cost Index Posts Another Strong Gain to Close out 2014

The employment cost index (ECI) is coming under close watch as policymakers await signs of higher inflation, and more notably, higher wages. In the fourth quarter, the ECI increased 0.6% on a QoQ seasonally-adjusted basis following a 0.7% pace in both 2Q and 3Q, marking 2014 as the strongest year of the recovery thus far. By component, wages and salaries increased 0.5% while benefits rose 0.6% for the quarter. On a YoY basis, the ECI accelerated throughout all of 2014, finishing the year off at 2.3% growth. In real terms, the ECI increased 1.5% YoY, the fastest pace since 3Q09. Taken at face value, strength in the ECI is welcomed with open arms. However, there seem to be some inconsistencies with other measures of wage inflation. Most notably, average hourly earnings reported in the establishment survey were flat and/or decelerated throughout 2014, with YoY growth in 4Q14 hitting the slowest pace since 2Q13. The relationship between the two measures, particularly when considering the wages and salaries component of the ECI, appears to have fallen apart compared to pre-recession trends. This brings up the question of which indicator is more relevant and reflective of the true underlying movement in the labor market. Furthermore, it remains unclear whether one can be a leading indicator of the other as we move forward in monitoring wage inflation. As other labor market indicators have shown significant improvement throughout the past year, wage growth is still lagging behind. Even with the latest strength in the ECI and the diminishing slack in the labor market, we are not convinced that wage growth will pick up significantly in 2015. Hiring tends to be skewed toward the low-skilled lower-wage positions, and with such a large pool of workers to fill those spots, it is unlikely that business will feel the pressure to increase wages. Still, we will continue to monitor the ECI particularly as it relates to the Fed's policy accommodation as it is one of the indicators that Yellen has brought up on multiple occasions.

Week Ahead

Personal Income and Outlays (December, Monday 8:30 ET)

Forecast: 0.1%, -0.1%

Consensus: 0.2%, -0.2%

Previous: 0.4%, 0.6%

Personal income and spending have accelerated throughout the past few months but we expect to see somewhat of a reversal to close out 2014. December's data have been much less encouraging compared to strong reports for earlier in the fourth quarter, with average hourly earnings and retail sales declining for the month. Much of this has been due to the price effect of falling gas prices, particularly for consumption, where we expect to see added downward pressure on the nominal figure in December. In real terms, we expect that both income and consumption will continue to strengthen gradually as we move into 2015.

ISM Manufacturing Index (January, Monday 10:00 ET)

Forecast: 55.0

Consensus: 54.5

Previous: 55.1

The ISM Manufacturing Index is expected to decline in January for the third consecutive month, though still remain in expansionary territory. Manufacturing activity has certainly seen an impact from the drop in global demand as well as the ongoing fall in oil prices. New orders and production have seen a serious deceleration since late 3Q14 and early 4Q14, and we expect that this has continued into the first part of 2015. The regional manufacturing reports for January have not been overly impressive despite the expected boost to consumption that comes along with lower oil prices. While we do not expect to see significant acceleration in manufacturing activity to start 2015, the index remains near relatively healthy levels that do not warrant much concern for now.

International Trade (December, Thursday 8:30 ET)

Forecast: -\$38.9B

Consensus: -\$38.0B

Previous: -\$39.0B

International trade has been limited by falling global demand, yet the downward trend in world oil prices is helping to offset pressure on the U.S. trade balance. For December, we expect that the trade deficit will shrink for the third consecutive month as cheaper petroleum imports drag down the total value of imports for the U.S. at a similar pace as in November. We expect that exports will remain weak as well, so the improvement in the trade balance will not necessarily reflect positive underlying trends. This movement in the international trade balance is expected to carry over into 2015 as oil prices remain low and activity abroad remains weak.

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

Forecast: 215K, 5.6%

Consensus: 235K, 5.5%

Previous: 252K, 5.6%

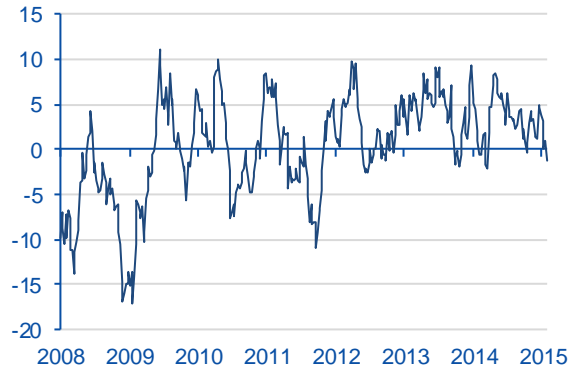
Nonfarm payrolls are expected to increase at a healthy rate in January, maintaining the +200K pace seen throughout most of 2014. Employment growth between September and December was extremely strong, averaging nearly 285K per month, yet it is unlikely that this pace is sustainable over the longer term. Already for January we have seen a jump in initial jobless claims, though much of the increase was likely due to holiday disruptions. When it comes to the unemployment rate, the latest strength in job growth suggests continued declines in unemployment despite the fact that participation remains near 35-year lows.

Market Impact

The first week of February brings a busy economic calendar, and many of the reports have the potential to sway markets one way or the other. Global issues will likely dominate this week as markets continue to closely monitor oil prices, politics in Europe, and ongoing flight-to-safety attitudes.

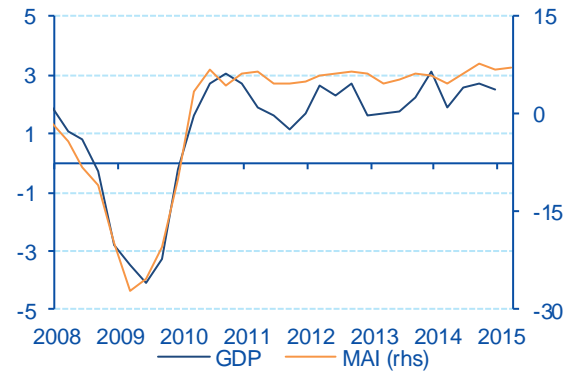
Economic Trends

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



Source: BBVA Research

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



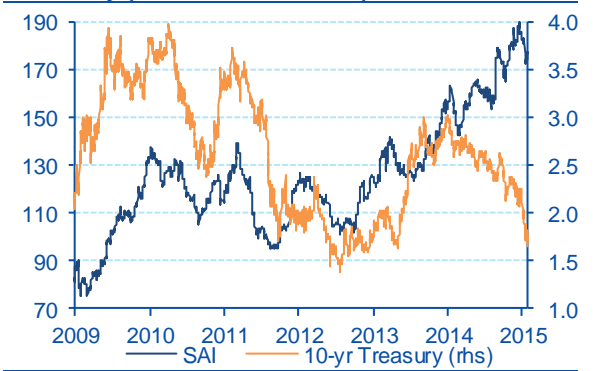
Source: BBVA Research & BEA

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



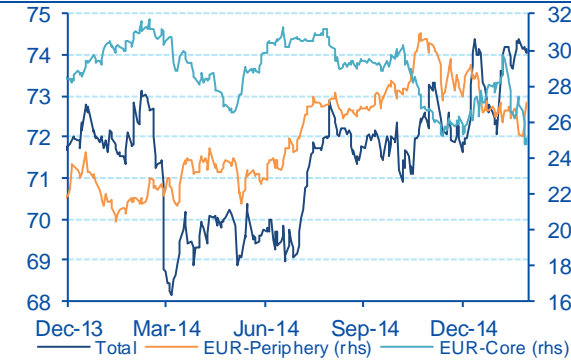
Source: BBVA Research

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



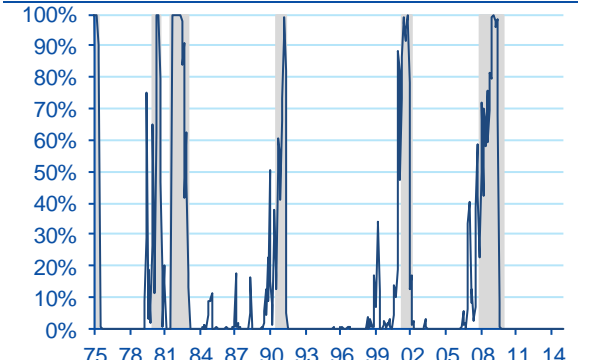
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

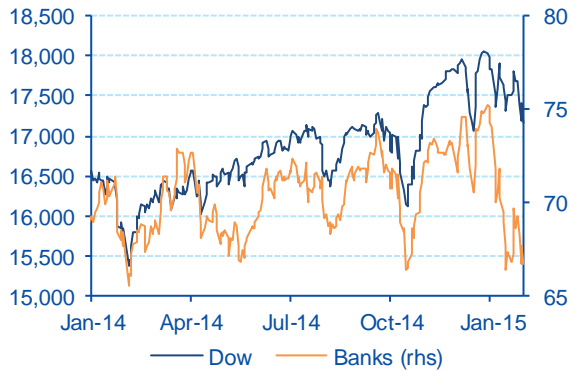
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

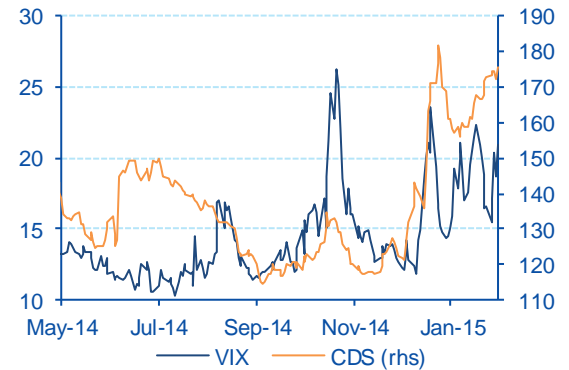
Financial Markets

Graph 9
Stocks
(Index, KBW)



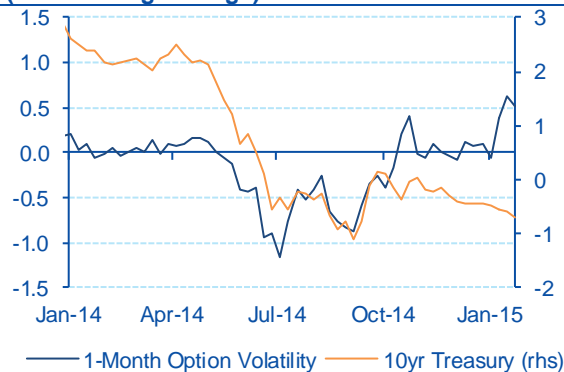
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



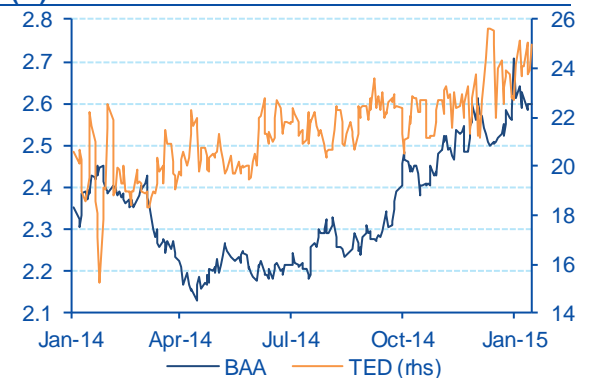
Source: Bloomberg & BBVA Research

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



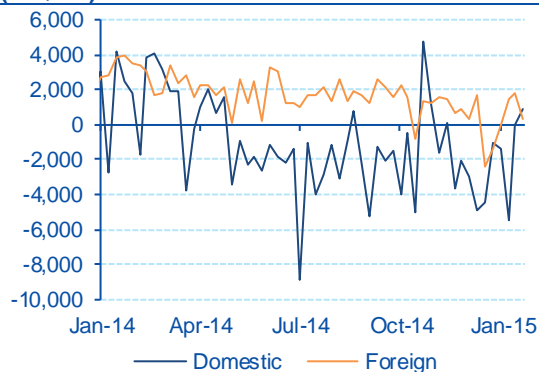
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



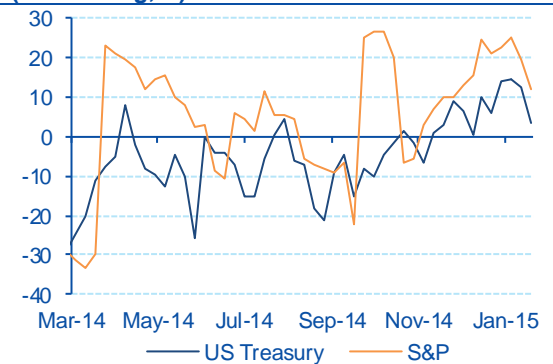
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

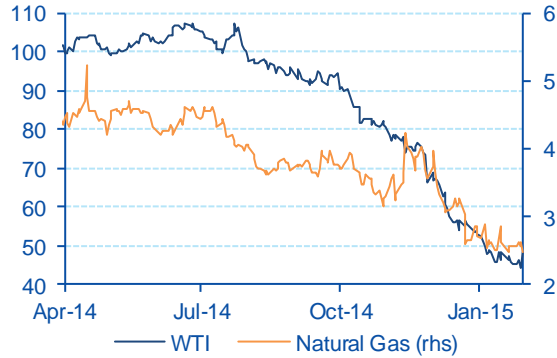
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

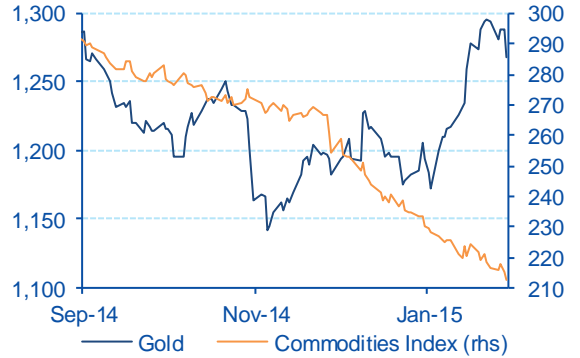
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



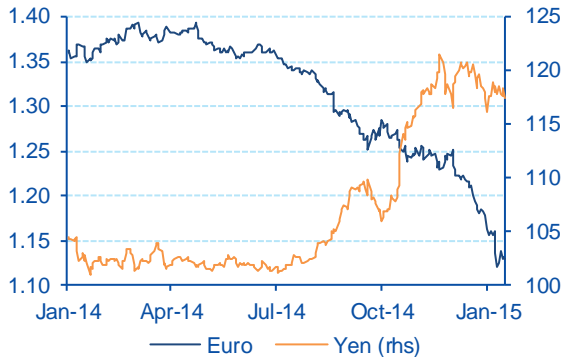
Source: Bloomberg & BBVA Research

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



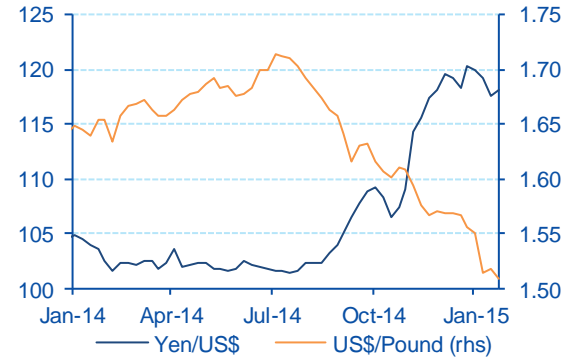
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



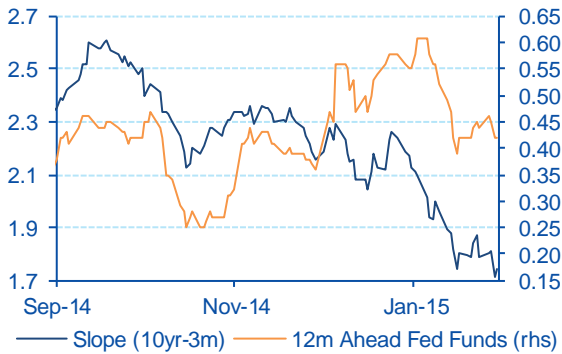
Source: Bloomberg & BBVA Research

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



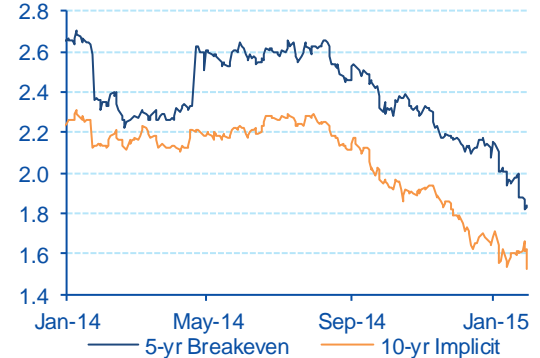
Source: Haver Analytics & BBVA Research

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)	14.96	14.86	14.86	14.10
New Auto (36-months)	2.67	2.64	2.66	2.36
Heloc Loan 30K	4.94	4.99	4.93	5.40
5/1 ARM *	2.86	2.83	3.01	2.90
15-year Fixed Mortgage *	2.98	2.93	3.15	3.23
30-year Fixed Mortgage *	3.66	3.63	3.87	3.99
Money Market	0.42	0.42	0.44	0.41
2-year CD	0.84	0.83	0.88	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	0.11	0.12	0.12	0.07
3M Libor	0.25	0.26	0.23	0.24
6M Libor	0.36	0.36	0.32	0.33
12M Libor	0.62	0.62	0.55	0.56
2yr Sw ap	0.69	0.75	0.89	0.44
5yr Sw ap	1.33	1.47	1.73	1.58
10Yr Sw ap	1.78	1.94	2.22	2.77
30yr Sw ap	2.15	2.30	2.64	3.60
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	0.13

Source: Bloomberg & BBVA Research

Quote of the Week

President Barack Obama

Remarks by the President to the House Democratic Issues Conference

29 January 2015

"And one good piece of news is I noticed that even though their policies haven't quite caught up yet, their rhetoric is starting to sound pretty Democratic...I consider imitation the highest form of flattery. Come on board. Let's go help out that middle-class family. Let's get something done."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
2-Feb	US Personal Income MoM SA	DEC	0.10	0.20	0.40
2-Feb	US Personal Consumption Expenditures Nominal Dollars MoM SA	DEC	-0.10	-0.20	0.60
2-Feb	ISM Manufacturing PMI SA	JAN	55.10	54.50	55.10
2-Feb	Census Bureau US Construction Spending MoM SA	DEC	0.50	0.70	-0.30
3-Feb	US Auto Sales Total Annualized SA	JAN	17.10	16.60	16.80
3-Feb	NEW YORK PURCHASING MANAGER Current Business Conditions SA	JAN	68.90	0.00	70.80
3-Feb	US Manufacturers New Orders Total MoM SA	DEC	-1.00	-2.20	-0.70
4-Feb	ADP National Employment Report SA Private Nonfarm Level Change	JAN	210.00	225.00	241.00
4-Feb	ISM Non-Manufacturing NMI NSA	JAN	55.70	56.50	56.50
5-Feb	US Initial Jobless Claims SA	JAN 31	298.00	290.00	265.00
5-Feb	US Continuing Jobless Claims SA	JAN 24	2410.00	2400.00	2385.00
5-Feb	US Trade Balance of Goods and Services SA	DEC	-38.90	-38.00	-39.00
5-Feb	US Output Per Hour Nonfarm Business Sector QoQ SA	4Q P	1.00	0.35	2.30
5-Feb	US Unit Labor Costs Nonfarm Business Sector QoQ % SAAR	4Q P	1.50	1.10	-1.00
6-Feb	US Employees on Nonfarm Payrolls Total MoM Net Change SA	JAN	215.00	235.00	252.00
6-Feb	US Employees on Nonfarm Payrolls Total Private MoM Net Change SA	JAN	210.00	227.50	240.00
6-Feb	US Employees on Nonfarm Payrolls Manufacturing Industry Monthly Net Change SA	JAN	5.00	12.00	17.00
6-Feb	US Unemployment Rate (%)	JAN	5.60	5.50	5.60
6-Feb	US Average Hourly Earnings All Employees Total Private Monthly Percentage Change	JAN	0.10	0.30	-0.20
6-Feb	US Average Weekly Hours All Employees Total Private SA	JAN	34.60	34.60	34.60
6-Feb	Federal Reserve Consumer Credit Total Net Change SA	DEC	15.10	15.00	14.08

Forecasts *(Revisions Pending)*

	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% SAAR)	1.8	2.8	1.9	2.4	2.5	2.8	2.8	2.9
CPI (YoY %)	3.1	2.1	1.5	1.6	2.0	2.3	2.4	2.4
CPI Core (YoY %)	1.7	2.1	1.8	1.8	2.1	2.3	2.4	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.2	5.8	5.5	5.0	5.0
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50	3.25
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	2.21	2.60	3.11	3.54	3.90
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.15	1.20	1.28	1.32

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