

Economic Analysis

# FOMC Drops “Patient”, Rate Hike Unlikely in April

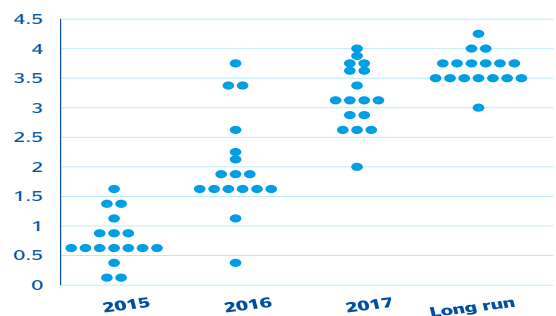
Kim Fraser Chase

The [March FOMC announcement](#) lived up to expectations, with the Committee removing the “patient” language from the statement. To help clarify this change to the forward guidance, the FOMC added to the statement that “an increase in the target range for the federal funds rate remains unlikely at the April FOMC meeting.” Furthermore, the statement noted that despite this change, the Committee is not necessarily closer to an agreement on the timing of the first rate hike. Yellen also emphasized in her press conference that removing the word “doesn’t mean we are going to be impatient.” As expected, the Committee acknowledged that economic activity has “moderated somewhat” in the first quarter, highlighting export growth as another weakness on top of the slow recovery in the housing sector. When it comes to inflation, the statement suggests that the FOMC no longer expects inflation to decline but rather will remain near current low levels in the short term. It’s crunch time for the FOMC, and we are likely to see month-to-month changes in the statement language from this point forward as the first rate hike approaches. April’s meeting will require more specific language to foreshadow whether or not a rate hike is expected to come in June. However, in line with the 1Q15 slowdown in economic activity, March’s FOMC statement supports our baseline expectations for the first hike in September 2015.

## Struggling Manufacturing Sector Weighs on U.S. Industrial Production in 1Q15

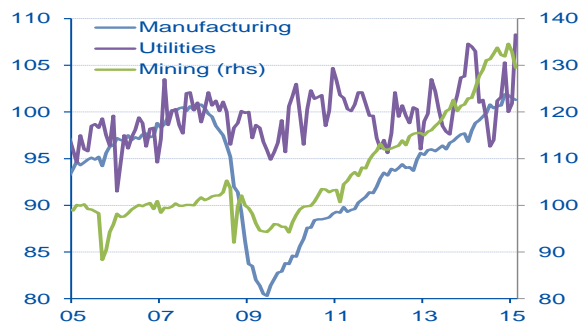
U.S. industrial production inched up 0.1% in February— a disappointing figure considering expectations for a 0.3% increase. This comes after a downward revision to January’s growth (from 0.2% to -0.3%), adding more disappointment to the 1Q15 picture. February’s slight rise in industrial production is owed almost entirely to the surge in utility output, which jumped 7.3% as a result of increased demand for heating due to an unusually harsh winter. Manufacturing, the largest component of industrial output (~80%), dipped 0.2% in February in its third consecutive decline, more likely reflecting a temporary slowdown due to winter weather rather than a more permanent weakening of the economy. Lower manufacturing output is largely attributable to a drop in production of durable goods, which dropped 0.6% for the month. Overall, manufacturing has started off 2015 on a softer note than expected; nevertheless, we do not intend to revise down our GDP forecast for the quarter solely based on this disappointing report. Our forecast had already accounted for a weather-related impact, and we continue to expect a pick-up in output in the coming months.

Graph 1  
Target Federal Funds Rate Forecast (Year-end %)



Source: Federal Reserve & BBVA Research

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



Source: FRB & BBVA Research

## Week Ahead

### Consumer Price Index, Core (February, Tuesday 8:30 ET)

Forecast: 0.2%, 0.1%

Consensus: 0.2%, 0.1%

Previous: -0.7%, 0.2%

The consumer price index is expected to increase in February for the first time since October. WTI and Brent crude oil prices in February increased 6.4% and 20%, respectively, following seven months of declines. However, natural gas prices continued to trend downward for the third straight month. Import prices increased a very modest 0.4% for the first time since June, yet producer prices (both headline and core) dropped again. While we do not expect to see another significant drop in the energy component of the CPI, we are not likely to see as big of a rebound as the crude oil price jump suggests. Other factors, such as severe winter weather, likely had an impact on limiting inflation for February.

### New Home Sales (February, Tuesday 10:00 ET)

Forecast: 475K

Consensus: 467K

Previous: 481K

New home sales have been flat for the past few months and have barely increased from the levels seen during the depths of the recession. Unfortunately, the outlook for February does not look promising, with winter weather conditions likely weighing on homebuyer activity and the homebuilder confidence index hinting at a slowdown in traffic of prospective buyers for the month. The housing sector has not started off on the right foot in 2015, and it is likely to take a few more months before we see signs of spring.

### Durable Goods Orders, Ex Transportation (February, Wednesday 8:30 ET)

Forecast: -0.9%, -0.4%

Consensus: 0.2%, 0.3%

Previous: 2.8%, 0.0%

Durable goods orders are expected to decline in February as the manufacturing sector takes a hit from severe winter weather. Leading indicators for the sector thus far have hinted at weak production for the month, in large part led by the transportation component. January's significant rebound in durable goods orders was led by a 129% jump in nondefense aircraft and parts, a feat that is unlikely to repeat itself in February. On the bright side, core capital goods orders increased in January for the first time since August, providing some momentum for stronger demand in the months ahead.

### Real GDP Growth, Final (4Q14, Friday 8:30 ET)

Forecast: 2.3%

Consensus: 2.4%

Previous: 2.2%

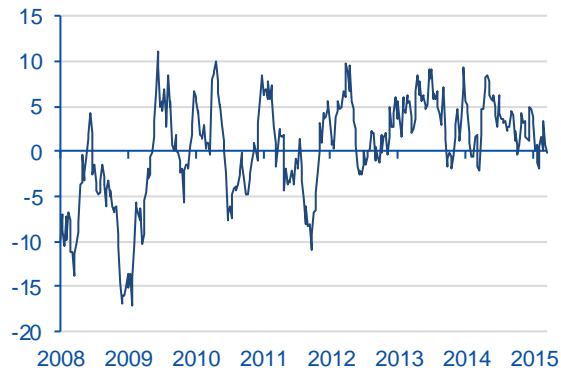
The final estimate for real GDP growth in 4Q14 is expected to show a modest upward revision. Data released since the second report suggest only minor changes to the figure, mostly led by an improvement in December's trade balance. Personal consumption was unchanged for December, though business inventory growth was revised down slightly for the month. Considering the relatively small shifts in GDP-related data, we do not expect to see a market-moving final report. GDP growth for 2014 is expected to hold steady at 2.4%.

### Market Impact

Inflation will be the key indicator to watch this week as markets stay on their toes for data dependent signs of the FOMC's first rate hike. Other economic releases are likely to confirm the weather-related impact on activity throughout 1Q15, though this should not warrant significant market reaction given that expectations are already low. The final estimate for 4Q14 GDP growth is not expected to have any influence over projections for 2015.

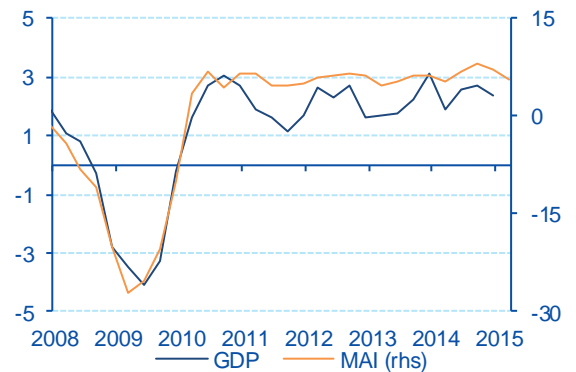
## Economic Trends

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



Source: BBVA Research

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



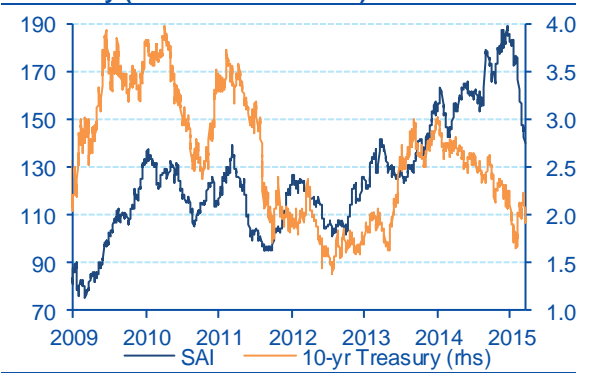
Source: BBVA Research & BEA

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



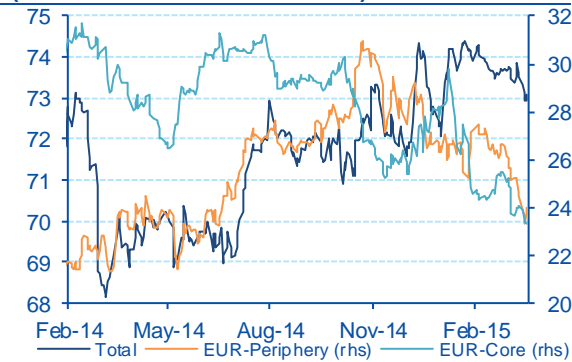
Source: BBVA Research

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



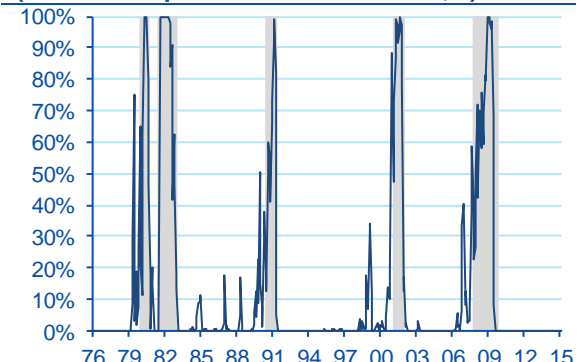
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

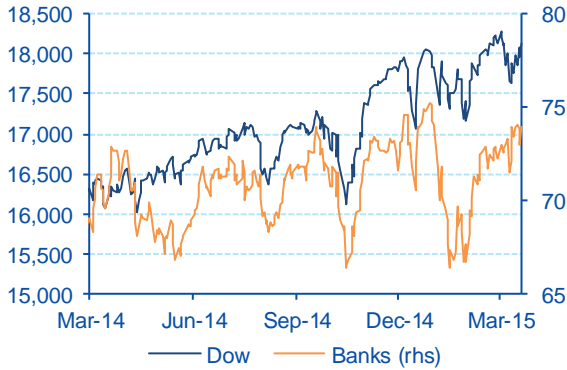
Graph 8  
**BBVA US Recession Probability Model (Recession episodes in shaded areas, %)**



Source: BBVA Research

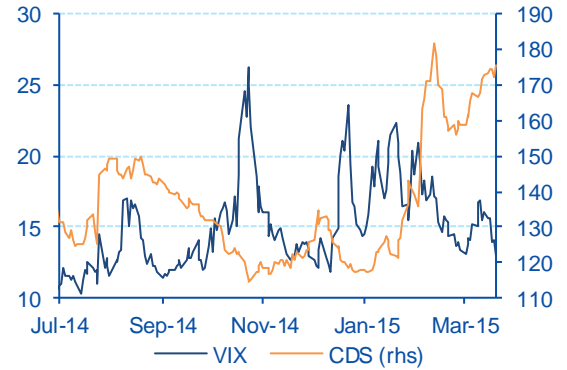
**Financial Markets**

Graph 9  
**Stocks (Index, KBW)**



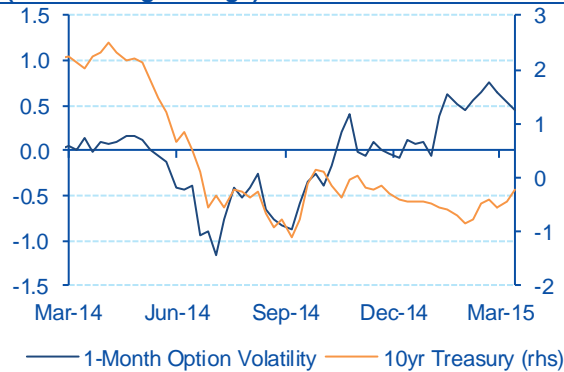
Source: Bloomberg & BBVA Research

Graph 10  
**Volatility & High-Volatility CDS (Indices)**



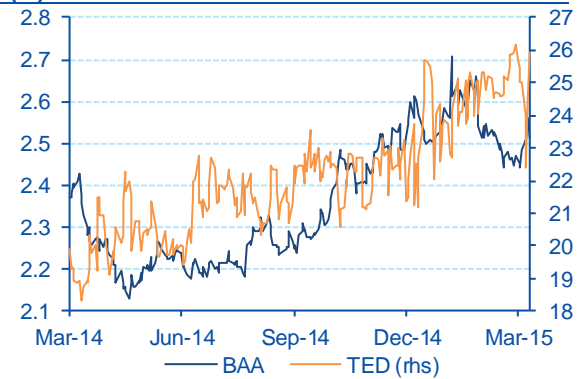
Source: Bloomberg & BBVA Research

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



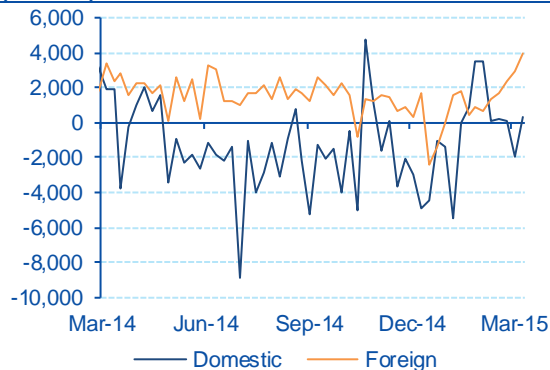
Source: Haver Analytics & BBVA Research

Graph 12  
**TED & BAA Spreads (%)**



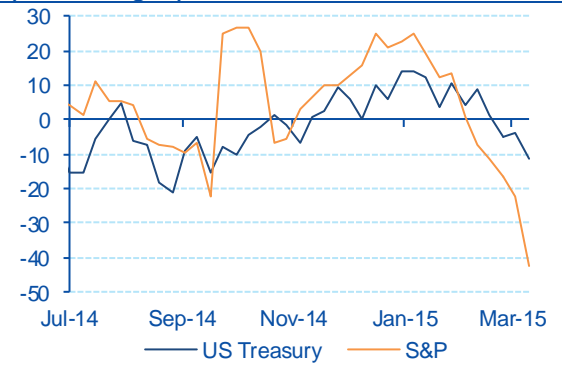
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

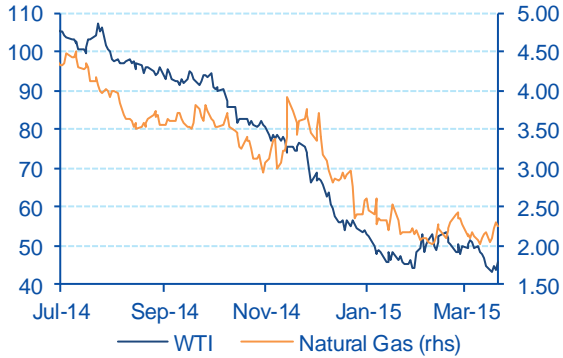
Graph 14  
**Total Reportable Short & Long Positions (Short-Long, K)**



Source: Haver Analytics & BBVA Research

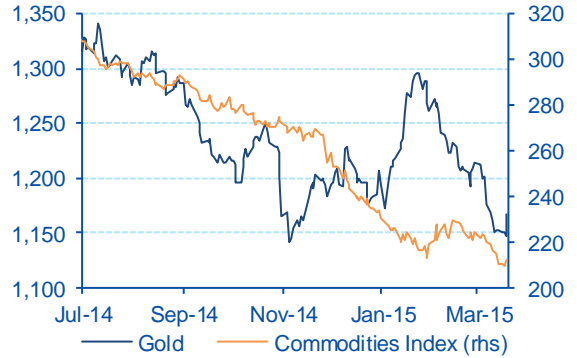
**Financial Markets**

Graph 15  
**Commodities (Dpb & DpMMBtu)**



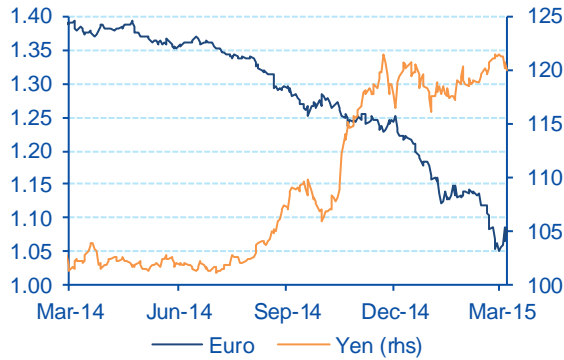
Source: Bloomberg & BBVA Research

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



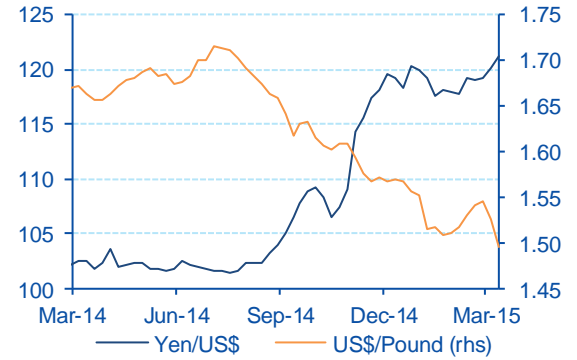
Source: Haver Analytics & BBVA Research

Graph 17  
**Currencies (Dpe & Ypd)**



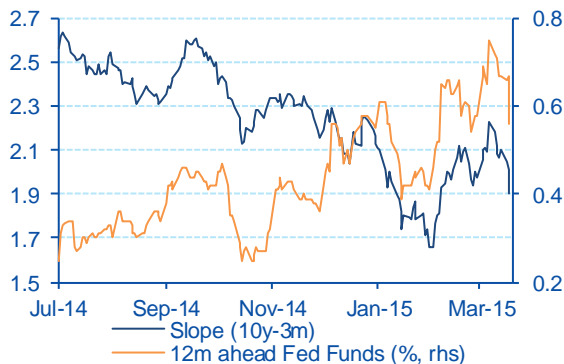
Source: Bloomberg & BBVA Research

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



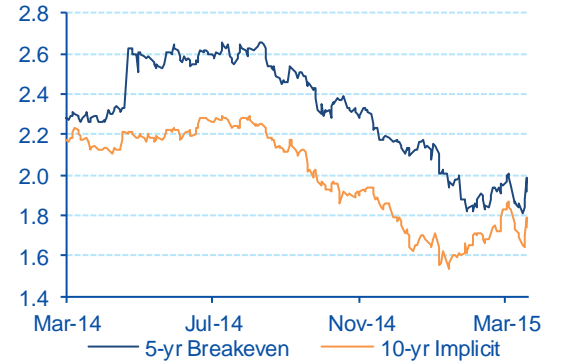
Source: Haver Analytics & BBVA Research

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)	14.96	14.96	14.96	14.10
New Auto (36-months)	2.76	2.77	2.67	2.76
Heloc Loan 30K	4.86	4.85	4.82	5.29
5/1 ARM *	2.97	3.01	2.97	2.90
15-year Fixed Mortgage *	3.06	3.10	3.05	3.23
30-year Fixed Mortgage *	3.78	3.86	3.76	3.99
Money Market	0.42	0.42	0.42	0.41
2-year CD	0.83	0.83	0.86	0.77

\*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	0.12	0.11	0.12	0.08
3M Libor	0.26	0.27	0.23	0.23
6M Libor	0.39	0.40	0.32	0.33
12M Libor	0.69	0.72	0.55	0.56
2yr Sw ap	0.85	0.93	0.92	0.57
5yr Sw ap	1.57	1.75	1.75	1.82
10Yr Sw ap	2.03	2.23	2.24	2.87
30yr Sw ap	2.35	2.57	2.61	3.57
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  
March FOMC Press Conference  
18 March 2015

*“Just because we removed the word ‘patient’ from the statement doesn’t mean we are going to be impatient.”*

## Economic Calendar

Date	Event	Period	BBVA	Consensus	Previous
23-Mar	Chicago Fed National Activity Index	FEB	-0.15	0.10	0.13
23-Mar	US Existing Homes Sales SAAR	FEB	4.91	4.92	4.82
23-Mar	US Existing Homes Sales MoM SA	FEB	1.87	2.02	-4.93
24-Mar	US CPI Urban Consumers MoM SA	FEB	0.20	0.20	-0.68
24-Mar	US CPI Urban Consumers Less Food & Energy MoM SA	FEB	0.10	0.10	0.18
24-Mar	US New One Family Houses Sold Annual Total SAAR	FEB	475.00	467.00	481.00
24-Mar	US New One Family Houses Sold Annual Total MoM SA	FEB	-1.25	-2.91	-0.20
25-Mar	US Durable Goods New Orders Industries MoM SA	FEB	-0.90	0.20	2.80
25-Mar	US Durable Goods New Orders Total ex Transportation MoM SA	FEB	-0.40	0.30	0.00
26-Mar	US Initial Jobless Claims SA	MAR 21	295.00	290.00	291.00
26-Mar	US Continuing Jobless Claims SA	MAR 14	2405.00	2395.00	2417.00
27-Mar	GDP US Chained 2009 Dollars QoQ SAAR	4Q T	2.30	2.40	2.20
27-Mar	GDP US Personal Consumption Chained 2009 Dirs % Change from Previous Period SAAR	4Q T	4.20	4.40	4.20
27-Mar	US GDP Price Index QoQ SAAR	4Q T	0.10	0.10	0.10
27-Mar	US GDP Personal Consumption Core Price Index QoQ % SAAR	4Q T	1.10	1.10	1.10
27-Mar	University of Michigan Consumer Sentiment Index	MAR F	91.70	92.00	91.20

## Forecasts

	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% SAAR)	1.8	2.8	1.9	2.4	<b>2.9</b>	<b>2.8</b>	<b>2.8</b>	<b>2.9</b>
CPI (YoY %)	3.1	2.1	1.5	1.6	<b>1.5</b>	<b>2.1</b>	<b>2.2</b>	<b>2.3</b>
CPI Core (YoY %)	1.7	2.1	1.8	1.8	<b>1.9</b>	<b>2.1</b>	<b>2.2</b>	<b>2.3</b>
Unemployment Rate (%)	8.9	8.1	7.4	6.1	<b>5.3</b>	<b>4.9</b>	<b>4.6</b>	<b>4.5</b>
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	<b>0.50</b>	<b>1.50</b>	<b>2.50</b>	<b>3.25</b>
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	2.21	<b>2.60</b>	<b>3.11</b>	<b>3.54</b>	<b>3.90</b>
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	<b>1.02</b>	<b>1.12</b>	<b>1.24</b>	<b>1.32</b>

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