

Economic Analysis

Weekly Focus: FOMC and 2Q15 GDP

Kim Chase

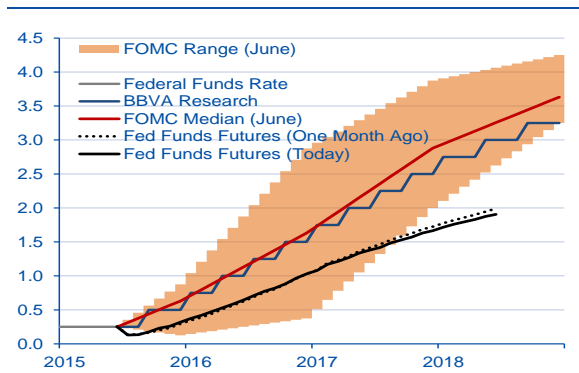
July's FOMC Meeting: Just One More Step Toward a September Rate Hike

July's FOMC meeting (Wednesday) is not expected to bring an unwanted shock to markets but may allude to a potential rate hike in September. So, why September? First of all, September's meeting coincides with a planned press conference and release of updated economic projections, both of which will be helpful in better explaining the reasoning behind the rate hike at that time. Secondly, markets are better prepared to react if the announcement does come in September. Most importantly, it has become clear that the risks to delaying policy normalization are increasing. Yellen noted in her latest semi-annual monetary policy report to Congress that "the economy cannot only tolerate but needs higher rates," favoring a sooner rate hike in order to allow for a more gradual pace of increases thereafter, rather than delaying and potentially being forced into making drastic increases in a shorter period of time. She has been in a similar situation before – back in 1994, when Yellen was a member of the Federal Reserve Board of Governors, the Fed increased rates for the first time in five years, a surprise to the markets resulting in a 150 basis point spike in Treasury yields. This is no time to repeat past mistakes, and the Fed is certainly not out to surprise markets on purpose.

BEA Revisions Likely to Take Center Stage in 2Q15 GDP Release

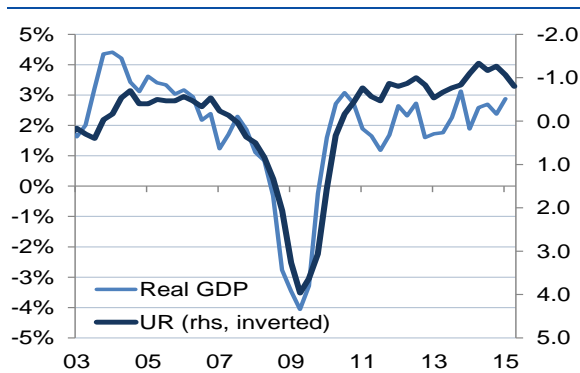
The BEA is set to release the **advance 2Q15 GDP estimate (Thursday)**, and our in-house models suggest that the economy expanded at a 2.0-2.5% pace throughout the quarter. Based on what we have seen so far in 2Q, business inventories and consumption appear to be the strongest drivers of growth. Residential investment also seems to have picked up for the quarter, coming from an extremely weak start to the year. However, the rebound in nonresidential investment is lagging, with nondefense capital goods orders (excluding aircraft) in decline throughout April and May. Ultimately, the biggest factor to watch will be the BEA's annual benchmark revisions, which could change both historical and projected GDP rates. These annual revisions have, on average, adjusted quarterly GDP by approximately 1.5% (in absolute terms). On top of that, the BEA is likely to release other revisions based on seasonal adjustments, so we may see a shift in the notoriously weak first quarter growth rates that could impact annual growth, especially our forecast for 2015.

Graph 1
Fed Funds Rate Futures & Projections (%)



Source: FRB & BBVA Research

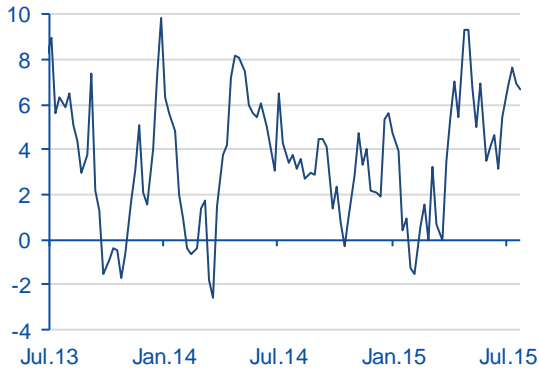
Graph 2
Real GDP Growth & Unemployment Rate (YoY % Change & 4Q Change)



Source: BEA, BLS, & BBVA Research

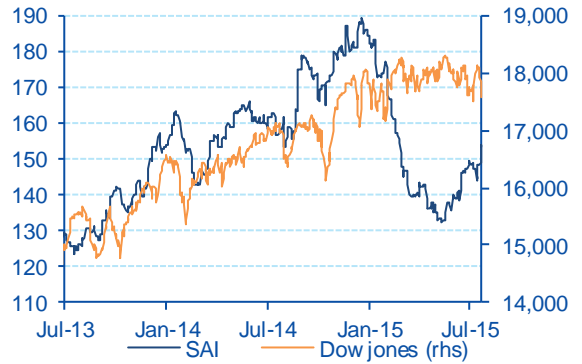
Economic Trends

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



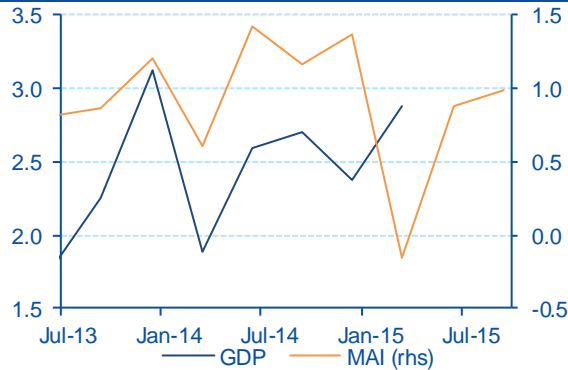
Source: BBVA Research

Graph 4
BBVA USA Surprise Activity Index & Dow Jones (Index 2009=100 & eop)



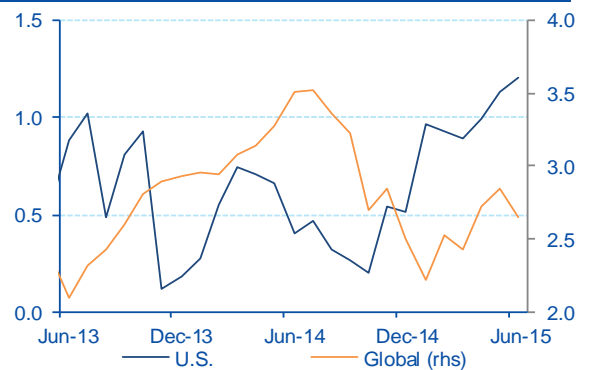
Source: Bloomberg & BBVA Research

Graph 5
BBVA USA Monthly Activity Index & Real GDP (4Q % change)



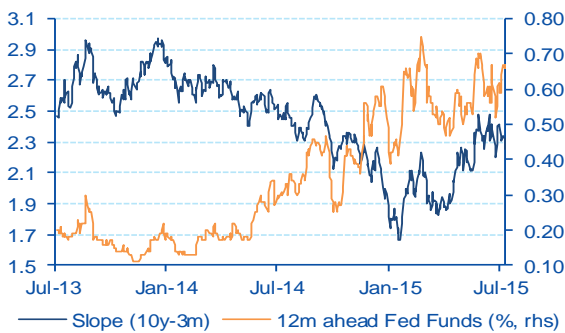
Source: BBVA Research & BEA

Graph 6
BBVA USA Risk Index (> 0 = increasing risk)



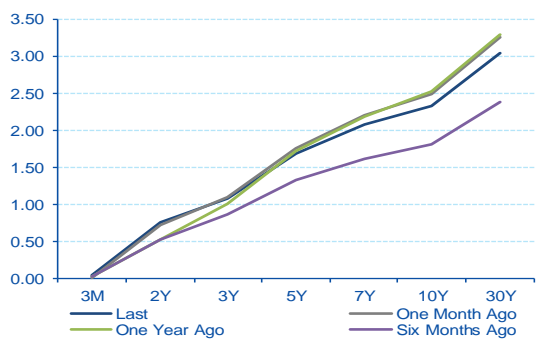
Source: BBVA Research

Graph 7
Fed Futures & Yield Curve Slope (% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 8
U.S. Treasury Yield Curve (% p.a.)



Source: Haver Analytics & BBVA Research

Week Ahead Economic Calendar

Date	Event	Period	BBVA	Consensus	Previous
27-Jul	US Durable Goods New Orders Industries MoMSA	JUN	0.90	3.10	-2.20
27-Jul	US Durable Goods New Orders Total ex Transportation MoMSA	JUN	0.80	0.50	0.00
27-Jul	Dallas Fed Manufacturing Outlook Level Of General Business Activity	JUL	-5.90	-4.00	-7.00
28-Jul	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	MAY	0.40	0.30	0.30
28-Jul	S&P/Case-Shiller Composite-20 City Home Price Index YoY	MAY	5.80	5.50	4.91
28-Jul	Conference Board Consumer Confidence SA 1985=100	JUL	101.90	100.00	101.40
29-Jul	US Pending Home Sales Index MoM SA	JUN	0.50	1.00	0.90
29-Jul	Federal Funds Target Rate - Upper Bound	JUL 29	0.25	0.25	0.25
30-Jul	US Initial Jobless Claims SA	JUL 25	267.00	271.50	255.00
30-Jul	US Continuing Jobless Claims SA	JUL 18	2200.00	2210.00	2207.00
30-Jul	GDP US Chained 2009 Dollars QoQ SAAR	2Q A	2.30	2.55	-0.20
30-Jul	GDP US Personal Consumption Chained 2009 Dlr % Change from Previous Period SAAR	2Q A	2.50	2.70	2.10
30-Jul	US GDP Price Index QoQ SAAR	2Q A	1.60	1.50	0.00
30-Jul	US GDP Personal Consumption Core Price Index QoQ % SAAR	2Q A	0.20	1.60	0.80
31-Jul	Bureau of Labor Statistics Employment Cost Civilian Workers QoQ SA	2Q	0.40	0.60	0.70
31-Jul	MNI Chicago Business Barometer (sa)	JUL	50.50	50.65	49.40
31-Jul	University of Michigan Consumer Sentiment Index	JUL F	94.00	94.00	93.30

Economic Outlook (revisions pending)

	2015				2014	2015	2016	2017
	1Q	2Q	3Q	4Q				
Real GDP (% SAAR)	-0.2	2.5	4.7	3.2	2.4	2.5	2.8	2.8
CPI (YoY %)	-0.1	0.0	0.6	1.4	1.6	0.5	1.8	2.1
CPI Core (YoY %)	1.7	1.8	1.7	1.8	1.7	1.7	1.8	2.0
Unemployment Rate (%)	5.6	5.4	5.2	5.1	6.2	5.3	4.9	4.6
Fed Target Rate (eop, %)	0.25	0.25	0.50	0.50	0.25	0.50	1.50	2.50
10Yr Treasury (eop, % Yield)	2.04	2.36	2.43	2.53	2.21	2.53	2.72	3.64
US Dollar/ Euro (eop)	1.08	1.12	1.02	1.01	1.23	1.01	1.12	1.24
Core Logic Home Prices (YoY %)	5.00	6.14	6.05	5.85	7.48	5.76	4.40	2.45

Fun Fact

According to a new study by TIME labs, the 2013 demographics in Texas reflect what the entire U.S. population will look like in 2060. North Dakota, on the other hand, more closely reflects what the entire country looked like in 1930. (TIME, July 2015)

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