

Economic Analysis

Weekly Focus: FOMC Liftoff and Inflation

Kim Chase

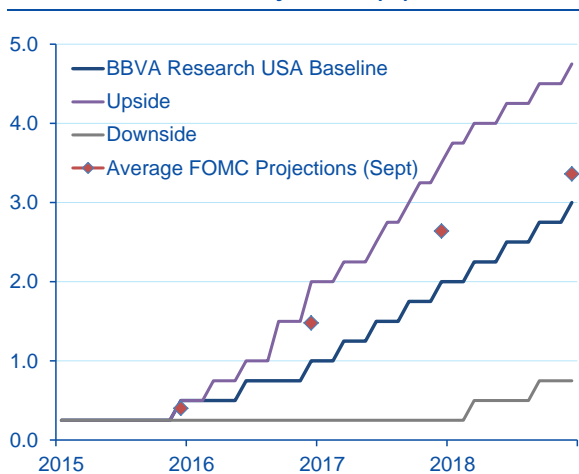
Market Expectations for Liftoff Jump Above 70% as FOMC Heads into Talks

The FOMC is heading into the **December meeting (Wednesday)** with a rate hike announcement in its back pocket. All signs are pointing to a 25 basis point increase in the target range for the federal funds rate, with markets pricing in above 70% probability of liftoff. Labor markets have shown real improvement, with the latest data offsetting the small blip in job growth that caused some concerns of a slowdown back in 3Q15. Inflation remains low, but significant downward pressures seem to have stabilized for the most part. Despite the fact that some economic reports have failed to gain momentum in 4Q15 (especially those related to manufacturing and the strength of the USD), most FOMC members seem comfortable finally raising rates at this time. This holds in line with our expectations for a hike by the end of 2015 yet does not change our view for a very gradual pace of increases in 2016. It is important to remember that the Fed has heavily emphasized the future path of interest rates rather than just the initial jump itself, as this is just one hike of many more to come on the road to normalization. For more details, please read our [FOMC preview](#).

CPI Inflation for November Won't Deter Fed from Rate Increase in December

The Fed has made it clear that they are waiting to review all possible data points before deciding whether to move forward with liftoff, and **November's CPI release (Tuesday)** will be the last piece of the puzzle. We expect that inflation will move modestly upward for the month, giving the hawks all the more support to push for a rate hike on Wednesday. Even a negative report won't likely be enough to sway the FOMC from increasing rates at this time, particularly because of their insistence that these transitory downward pressures are bound to fade away eventually. However, subdued inflationary trends that have become apparent in recent inflation reports will be important to monitor as we move into 2016 and attempt to gauge the speed at which the Fed will move ahead with additional rate hikes.

Graph 1
Federal Funds Rate Projections (%)



Source: FRB & BBVA Research

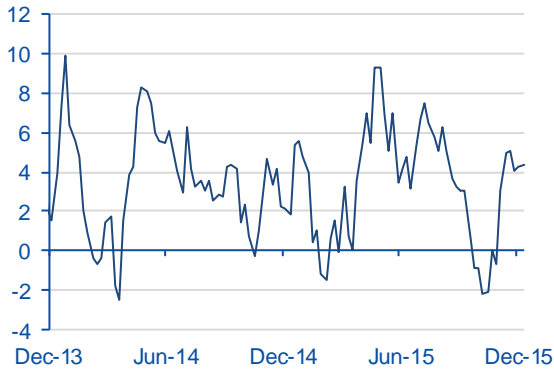
Graph 2
CPI Components (October)

CPI	MoM	YoY	2010-present Average YoY %
Total	0.20%	0.12%	1.71%
Food	0.14%	1.59%	2.16%
Energy	0.29%	-17.28%	1.83%
Core	0.20%	1.91%	1.67%
Core Commodities	-0.14%	-0.68%	0.50%
Apparel	-0.79%	-1.88%	0.87%
Medical Care Commodities	0.22%	2.76%	2.56%
Core Services	0.32%	2.79%	2.07%
Shelter	0.25%	3.19%	1.85%
Medical Care Services	0.85%	3.05%	3.07%
Core Ex Shelter	0.17%	0.99%	1.54%

Source: FRB & BBVA Research

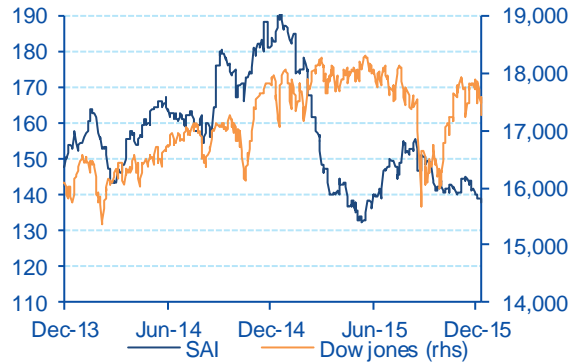
Economic Trends

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



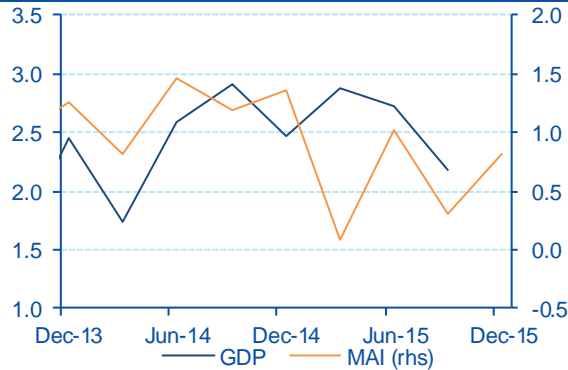
Source: BBVA Research

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



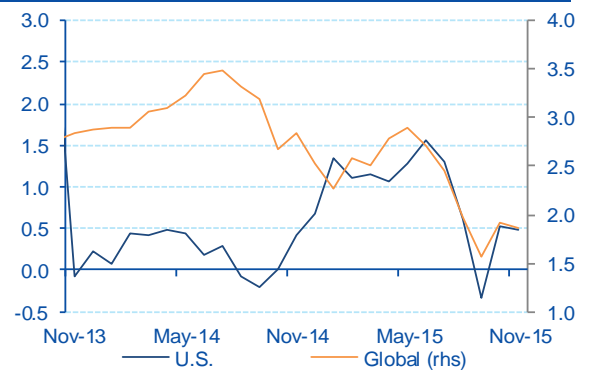
Source: Bloomberg & BBVA Research

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



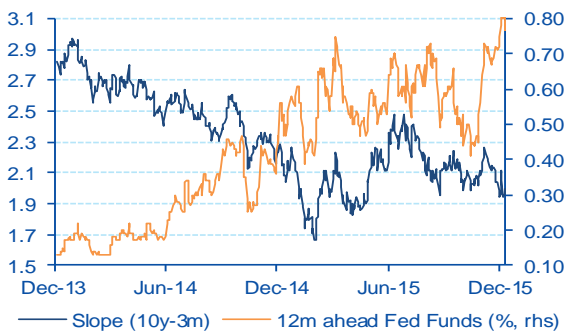
Source: BBVA Research & BEA

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



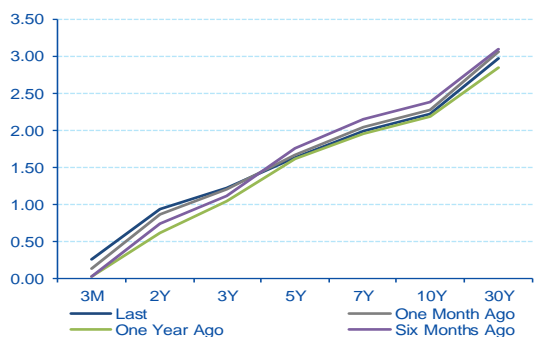
Source: BBVA Research

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
15-Dec	US Empire State Manufacturing Survey General Business Conditions SA	DEC	-5.50	-7.00	-10.74
15-Dec	US CPI Urban Consumers MoM SA	NOV	0.00	0.00	0.20
15-Dec	US CPI Urban Consumers Less Food & Energy MoM SA	NOV	0.10	0.20	0.20
15-Dec	National Association of Home Builders Market Index SA	DEC	63.00	63.00	62.00
16-Dec	US New Privately Owned Housing Units Started by Structure Total SAAR	NOV	1080.00	1135.00	1060.00
16-Dec	Private Housing Units Started by Structure Total Monthly % Change SA	NOV	1.89	7.32	-11.00
16-Dec	Private Housing Authorized by Bldg Permits by Type Total SAAR	NOV	1175.00	1150.00	1161.00
16-Dec	Private Total Housing Authorized by Building Permits MoM SA	NOV	1.21	-0.95	5.10
16-Dec	US Industrial Production MOM SA	NOV	-0.10	-0.10	-0.15
16-Dec	US Capacity Utilization % of Total Capacity SA	NOV	77.40	77.40	77.53
16-Dec	US Industrial Production Industry Groups Manufacturing MoM SA	NOV	0.00	0.00	0.40
16-Dec	Federal Funds Target Rate - Upper Bound	DEC 16	0.50	0.50	0.25
17-Dec	US Initial Jobless Claims SA	DEC 12	277.00	274.00	282.00
17-Dec	US Continuing Jobless Claims SA	DEC 5	2203.00	2220.00	2243.00
17-Dec	Philadelphia Fed Business Outlook Survey Diffusion Index General Conditions	DEC	2.30	1.00	1.90
17-Dec	Conference Board US Leading Index MoM	NOV	0.20	0.10	0.60

Economic Outlook

	2015			2016	2014	2015	2016	2017
	2Q	3Q	4Q	1Q				
Real GDP (% SAAR)	3.9	2.1	2.6	1.9	2.4	2.5	2.5	2.4
CPI (YoY %)	0.0	0.1	0.9	2.2	1.6	0.2	1.8	1.9
CPI Core (YoY %)	1.8	1.8	1.9	1.9	1.7	1.8	1.8	1.9
Unemployment Rate (%)	5.4	5.2	5.0	5.0	6.2	5.3	4.9	4.6
Fed Target Rate (eop, %)	0.25	0.25	0.50	0.50	0.25	0.50	1.00	2.00
10Yr Treasury (eop, % Yield)	2.36	2.17	2.33	2.43	2.21	2.33	2.51	3.21
US Dollar/ Euro (eop)	1.12	1.12	1.07	1.08	1.23	1.07	1.13	1.16
Core Logic Home Prices (YoY %)	4.99	5.24	6.59	5.82	7.66	5.39	4.99	2.45

Fun Fact

Angela Merkel is the fourth standalone woman to be named Time's Person of the Year, following the steps of Corazon Aquino, Queen Elizabeth, and Wallis Simpson. (Time, December 2015)

Recent Publications

[FOMC Preview: December 15-16th Meeting](#) (December 11, 2015)

[November Retail Sales Reflect Holiday Spending](#) (December 11, 2015)

[Highway Bill Reaches the End of the Road](#) (December 4, 2015)

[Texas Economy Parries Oil Price Blow, Looking to Avoid Knockout from Abroad](#) (December 4, 2015)

[Solid Jobs Data Puts December Liftoff in Sight](#) (December 4, 2015)

[FDIC Quarterly Banking Profile 2015 Q3](#) (November 26, 2015)

[Digitization and Productivity: Where is the Growth?](#) (November 25, 2015)

DISCLAIMER

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research U.S. on behalf of itself and its affiliated companies (each BBVA Group Company) for distribution in the United States and the rest of the world and is provided for information purposes only. Within the US, BBVA operates primarily through its subsidiary Compass Bank. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources, believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.