

Economic Watch

US

Houston, May 6, 2013
Economic Analysis

US
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Monthly US Outlook: May Momentum Stabilizing as 2Q13 Gets Underway

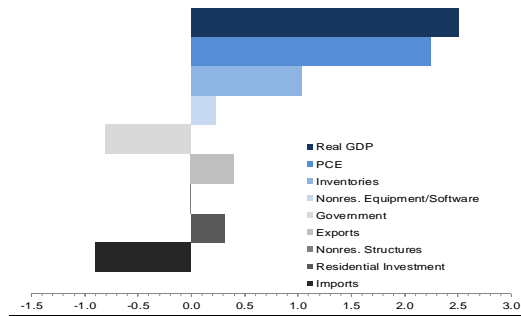
After a strong start to the first quarter of 2013, economic indicators are beginning to suggest a modest stabilization as we move into 2Q13. Real GDP growth for 1Q13 came in slightly stronger than we expected on account of resilient consumption in January and February and robust production data mid-quarter. However, the underlying details are not so encouraging; manufacturing indicators suggest a slowdown in March that may carry over into 2Q13 as new orders waver, particularly for business capital goods. Despite March's improvement in the international trade balance that could positively impact the upcoming revised GDP estimates, the drop in exports does not bode well for external demand and falling imports suggest that both businesses and consumers may have lost some steam moving into the second quarter. Last year, imports declined for five consecutive months between April and August as domestic growth slowed and fiscal worries were high, and we could see a similar trend emerge for the coming months. Fortunately, we expect that even with a slower second quarter, economic growth should accelerate again later in the year as it did in 2012, barring any unexpected negative consequences from upcoming fiscal negotiations. Supporting this argument is the latest employment report, which showed a 165K jump in nonfarm payrolls for April following a significant upward revision to March's figures (from a depressing 88K to 138K). The unemployment rate also dropped for the second consecutive month, down to 7.5%, while the participation rate remained unchanged at 63.3% (still the lowest in more than three decades). We maintain our expectations for steady employment gains over the second half of 2013, though we don't foresee payrolls jumping significantly over the 200K threshold throughout the next few quarters. The unemployment rate is expected to remain above 7.0% throughout the rest of the year, with potential for labor force participation to increase again as the job outlook continues to improve.

This better-than-expected employment report for April is still not enough to persuade the Federal Reserve to change gears immediately. The latest FOMC meeting minutes suggest that the committee will continue to assess the costs and benefits of QE3 while monitoring current economic conditions to determine the appropriateness of continuing asset purchases. Our baseline scenario remains unchanged: we expect that the Fed will begin to taper QE3 in 3Q13 before ending the program completely in 1Q14. The Fed Funds rate will remain near-zero until after the unemployment rate hits 6.5%, assuming that inflation is also under control. Market expectations assume a similar timing for the first rate hike but increasing at a slightly faster pace compared to our baseline.

Despite some negative sentiment stemming from recent data, we have not changed our overall baseline expectations from last quarter. We continue to expect slower growth in 2013 but accelerating thereafter, with inflationary pressures contained throughout the next few years. On the other hand, our risk scenario has moderated significantly, assuming a milder European crisis, reduced policy uncertainty, and a lower probability of tail-risk events. Domestic risks are still at play, and we are not out of the woods yet when it comes to fiscal policy. A government shutdown was avoided but budget negotiations will resume again as the fiscal year-end approaches, and the debt ceiling debate is still on the back burner. In addition, we could potentially see damage as the Fed pushes the limit with this highly accommodative stance of monetary policy. Global risks are a bit more subdued as well, with geopolitical threats and the situation in Europe still on the radar. Taking these risks into account, we could see real GDP growth closer to 1.0% in 2013 compared to our baseline for 1.8% growth. Our risk scenario also assumes only minimal declines in inflation and near-zero interest rates past the current 2015 target in our baseline projections.

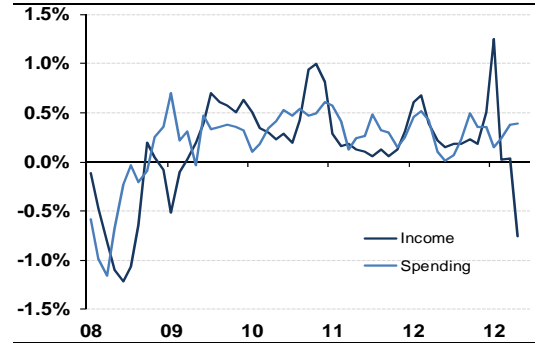
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(1Q13 Advance, SAAR Percentage Points)



Source: BEA and BBVA Research

Graph 2
Personal Income and Expenditures
(3MMA, MoM % Change)



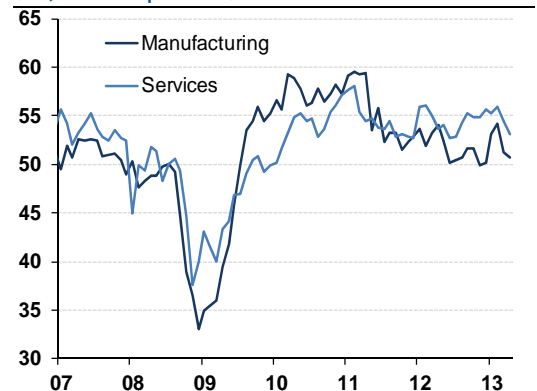
Source: BEA and BBVA Research

Graph 3
Consumer Confidence
(SA, Index 1985=100)



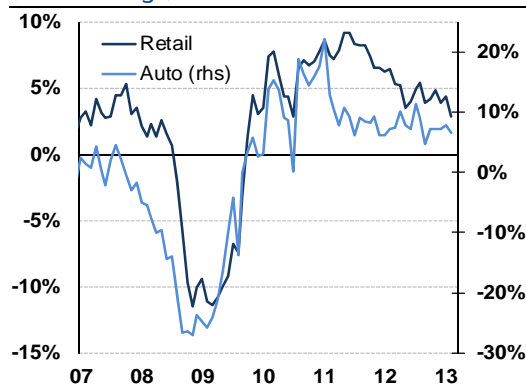
Source: Conference Board and BBVA Research

Graph 4
ISM Indices
(SA, 50+ = Expansion)



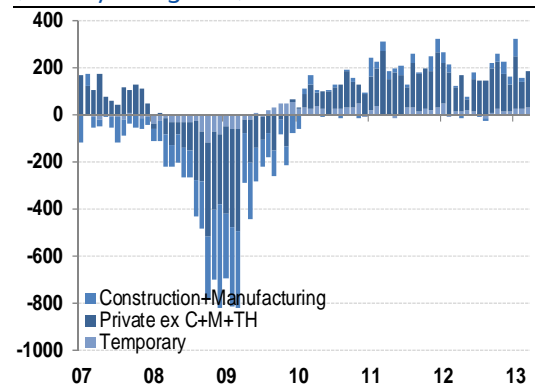
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

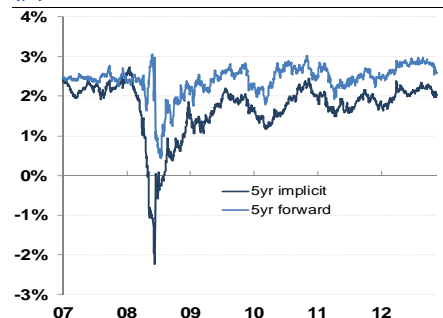
Economic Indicators

Graph 7
Consumer Price Index
(NSA, YoY % Change, 1982-84=100)



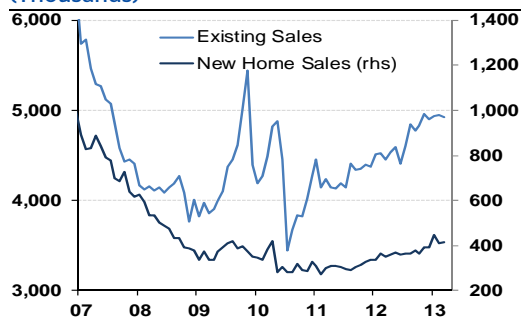
Source: BLS and BBVA Research

Graph 8
Inflation Expectations
(%)



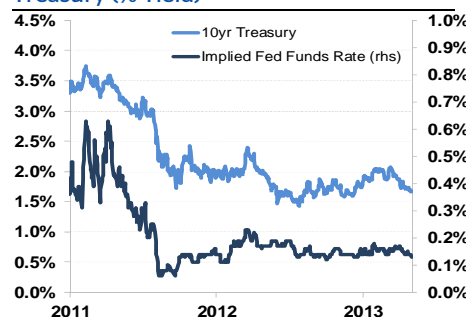
Source: Federal Reserve Board and BBVA Research

Graph 9
New and Existing Home Sales
(Thousands)



Source: US Census Bureau, NAR, and BBVA Research

Graph 10
12-Month Implied Fed Funds Rate & 10-Yr Treasury
(% Yield)



Source: Federal Reserve Board and BBVA Research

Table 1
Forecasts (BOLD=FORECASTS)

	2Q12	3Q12	4Q12	1Q13	2011	2012	2013	2014	2015
Real GDP (% SAAR)	1.3	3.1	0.4	2.5	1.8	2.2	1.8	2.3	2.5
Real GDP (Contribution, pp)									
PCE	1.1	1.1	1.3	2.2	1.8	1.3	1.3	1.2	1.2
Gross Investment	0.1	0.9	0.2	1.6	0.6	1.2	0.9	1.0	1.1
Non Residential	0.4	-0.2	1.3	0.2	0.8	0.8	0.6	0.8	0.9
Residential	0.2	0.3	0.4	0.3	0.0	0.3	0.3	0.2	0.2
Exports	0.7	0.3	-0.4	0.4	0.9	0.5	0.4	0.9	0.9
Imports	-0.5	0.1	0.7	-0.9	-0.8	-0.4	-0.4	-0.9	-0.8
Government	-0.1	0.8	-1.4	-0.8	-0.7	-0.3	-0.4	0.1	0.1
Unemployment Rate (%)	8.2	8.0	7.8	7.7	8.9	8.1	7.5	7.0	6.5
Average Monthly Nonfarm Payroll (K)	108	152	209	206	175	183	175	166	245
CPI (YoY %)	1.9	1.7	1.9	1.7	3.1	2.1	2.1	2.2	2.3
Core CPI (YoY %)	2.3	2.0	1.9	1.9	1.7	2.1	1.9	2.0	2.1
Fiscal Balance (% GDP)	-	-	-	-	-8.7	-7.0	-5.4	-3.8	-2.6
Current Account (bop, % GDP)	-3.0	-2.8	-2.8	-	-3.1	-3.1	-3.0	-3.4	-3.6
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
S&P Case-Shiller Index (YoY %)	1.47	3.60	7.35	-	-4.38	2.78	9.36	8.34	5.53
10-Yr Treasury (% Yield, eop)	1.62	1.72	1.72	1.96	1.98	1.72	2.39	2.73	3.39
U.S. Dollar / Euro (eop)	1.25	1.29	1.31	1.30	1.31	1.31	1.32	1.30	1.35
Brent Oil Prices (dps, average)	108.5	109.7	110.3	112.6	111.3	111.7	109.0	112.9	119.0

Source: BBVA Research

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