

US Weekly Flash

Highlights

Fed Watch: Converging Committee Views on Tapering and Forward Guidance

- Details in the Fed meeting reveal the participants' broad agreement and confidence regarding the appropriateness of the timing of the tapering announcement. At the same time, the minutes also reflected the cautiousness of the Committee to craft a message that would avoid causing further financial market tightening. Consequently, the minutes were communicated in a neutral language with a light dovish spin of an optimistic economic outlook. Two major factors behind the decision to taper were the decline in the marginal efficacy of LSAP and the lowered risks of "disruptive political impasse" by Congress. Across the board among meeting participants, there were no substantial changes in "broad contours" of the economic outlook, such as real growth, labor market and inflation, but members did see improved confidence in the outlook as the negative risks of the first half of 2013 subsided. The overall optimistic views of the Committee were driven by diminished fiscal restraints, a pickup in global economic growth and the subsequent boost to U.S. exports, further easing credit conditions and improvements in household balance sheets.
- The learning process between markets and the Fed has been rocky but will improve over time as both sides understand the implications of forward guidance and the evolution of Fed communication. Nevertheless, the risk of a disorderly exit process remains. The path of asset purchases remain data driven while the Fed's communication emphasizes that there would be no "preset course" for tapering and further reductions should be expected in "measured steps." We continue to expect a gradual tapering process throughout 2014. Assuming that the Fed maintains the \$10bn per month incremental reductions, asset purchases will likely continue until 4Q14.

U.S. Adds Only 74k Jobs in December, Yet Unemployment Drops to 6.7%

- The U.S. added only 74k nonfarm payroll jobs in December, marking the lowest MoM increase in nearly three years as the job market finished the year on an unexpectedly weak note. The unemployment rate fell from 7.0% in November to 6.7%, but this figure appears to be misleading. The decline is largely explained by people leaving the workforce, a discouraging sign in the job market amidst a wave of mostly positive economic news for the month. The number of workers currently looking for work or working fell to 62.8% in December, a jump back to the 35-year-low October figure. Furthermore, the number of discouraged workers increased by an unexpected 155k after experiencing declines for five consecutive months.
- The December employment report sends mixed signals, as the job growth was surprisingly low yet the unemployment rate significantly fell to its lowest level since November 2008. Amid a growing sense of optimism due to strong reports in housing, manufacturing, and trade, the loss of jobs in construction further questions the sustainability of the labor market improvement. Ahead of the FOMC January meeting, the blurry picture of the employment report increases pressure on the Fed to strengthen their stance on forward guidance as December unemployment is only 0.2% away from their policy rate threshold of 6.5%. Although certainly disappointing, it is important to remember that the monthly payroll can be subject to significant revisions and has been considerably volatile over recent months. Even though job growth was lower than expected in December, we remain optimistic about the economic situation heading into 2014.

Week Ahead

Retail Sales, Ex Autos (December, Tuesday 8:30 ET)

Forecast: 0.2%, 0.4%

Consensus: 0.1%, 0.4%

Previous: 0.7%, 0.4%

The retail sales figures were stronger than expected in November, jumping 0.7%, an encouraging sign that the U.S. economy is gaining momentum as consumer spending is on the rise. After decelerating in 3Q13, retail sales rallied once again and posted healthy growth in both October and November. Consumer spending has been upbeat recently in the wake of several encouraging economic reports. The December retail sales will be crucial in gauging consumer spending and reflect consumer confidence in the recovery. Furthermore, many retailers depend on the holiday season for a bulk of their revenue, so healthy spending for the month could foreshadow an optimistic beginning to the new year. While we do not expect the pace for December to match the pace of the recent months, we still expect a positive retail sales number that will be dragged down slightly by a decline in auto sales to finish out the quarter.

Empire State Manufacturing Survey (December, Wednesday 8:30 ET)

Forecast: 2.80

Consensus: 3.00

Previous: 0.98

The Empire State Manufacturing Survey was considerably below expectations in October and November. The survey will give us critical insight on the health of New York's manufacturing state and give us a clue on what we should expect to start the new year. After posting a negative reading in October and a slightly positive figure in November, we expect the manufacturing index to strengthen in December, boosted by an increase in consumer spending in the last month of the holiday season. As one of the leading manufacturing indicators for the month, this report could continue the run of stronger data heading into the New Year.

Consumer Price Index, Core (December, Thursday 8:30 ET)

Forecast: 0.3%, 0.2%

Consensus: 0.3%, 0.1%

Previous: 0.1%, 0.2%

The Consumer Price Index posted a flat reading for November due to a combination of lower energy prices and increases in transportation and shelter. For December, we expect to see a minor pickup in inflation as both crude oil and natural gas prices jumped back up for the month. As consumer confidence and spending have picked up in recent months, low inflation has been lifting consumers' purchasing power and therefore boosting personal consumption in the latter half of 2013. Furthermore, headline prices have remained below the Fed's inflation target of 2.0%, so it will be interesting to see how the gradual tapering to begin in January will affect inflation as we transition into 2014. Overall, we expect to see a modest increase in inflation to close out 2013, partially driven by a bump in overall core prices accompanied by a small jump in auto and energy prices.

Industrial Production (December, Friday 9:15 ET)

Forecast: 0.2%

Consensus: 0.3%

Previous: 1.1%

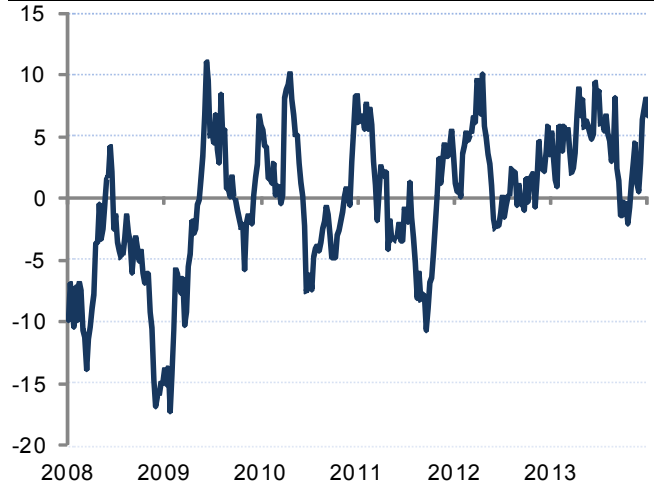
Industrial production in November exceeded expectations and rose a surprising 1.1% driven by a gain of 3.9% in utilities output and steady gains in mining and manufacturing. The encouraging manufacturing data through 2H13 has substantially increased optimism about the U.S. recovery moving forward, and a strong finish in December would provide confidence that the current growth in economic output is in fact robust. The latest manufacturing reports will most likely be reflected in the industrial production data, as an expected increase in demand for manufactured goods will lead to more production. We do not expect the industrial production increase to be as large as last month; nonetheless, we are still expecting a positive December for industrial production, particularly led by utilities output in the midst of a cold winter.

Market Impact

Following the FOMC meeting and employment report, the markets will have a lot of information to digest entering next week. The discouraging employment report for December will likely cause some confusion in the markets, as most did not expect job growth to decelerate after the influx of positive economic news. After the FOMC was widely in agreement regarding when to begin tapering, the employment number may at least force the FOMC to assess their forward guidance. Moving forward, markets will be looking at the manufacturing and industrial production data released next week to gauge the state of the economy.

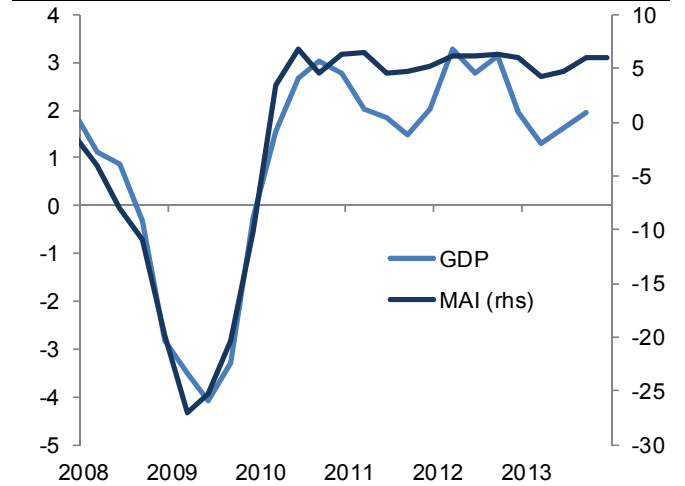
Economic Trends

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



Source: BBVA Research

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



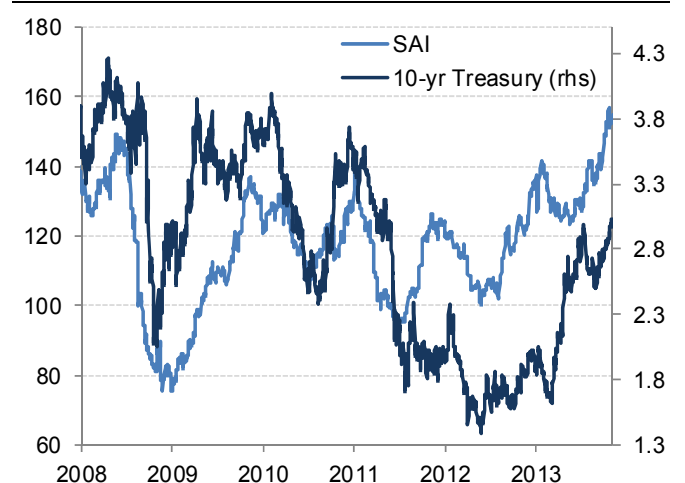
Source: BBVA Research & BEA

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



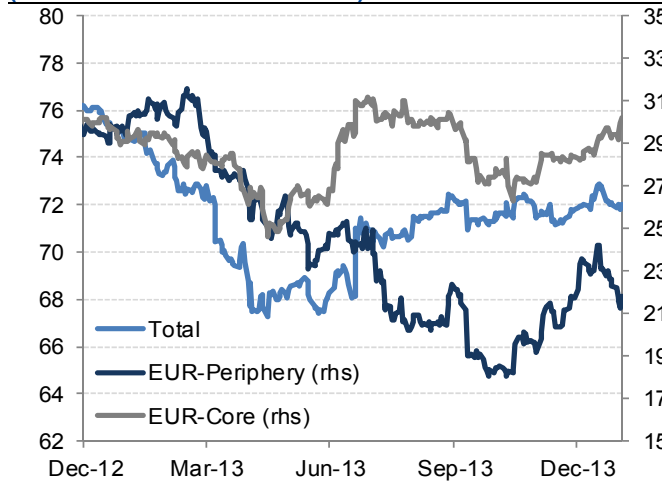
Source: BBVA Research

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



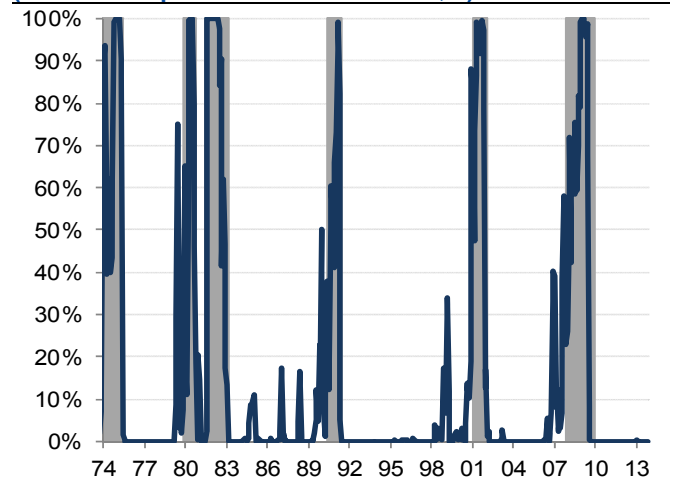
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

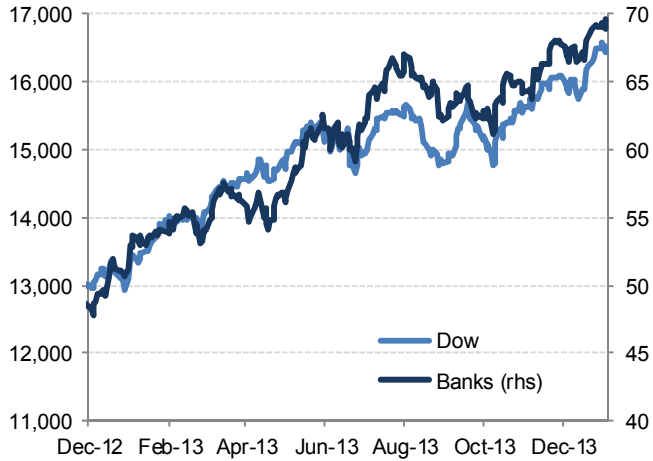
Graph 8
**BBVA US Recession Probability Model
 (Recession episodes in shaded areas, %)**



Source: BBVA Research

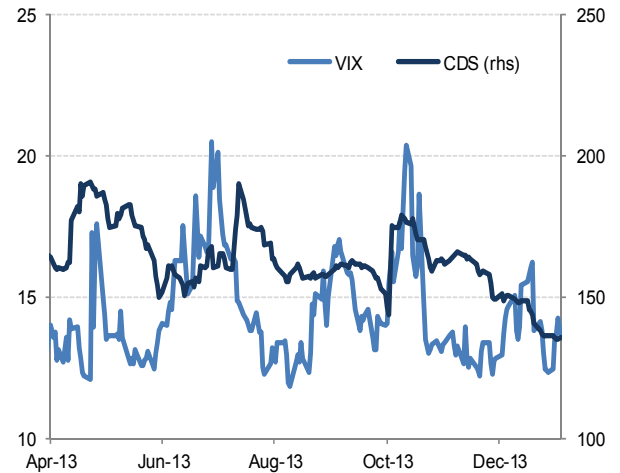
Financial Markets

Graph 9
Stocks
(Index, KBW)



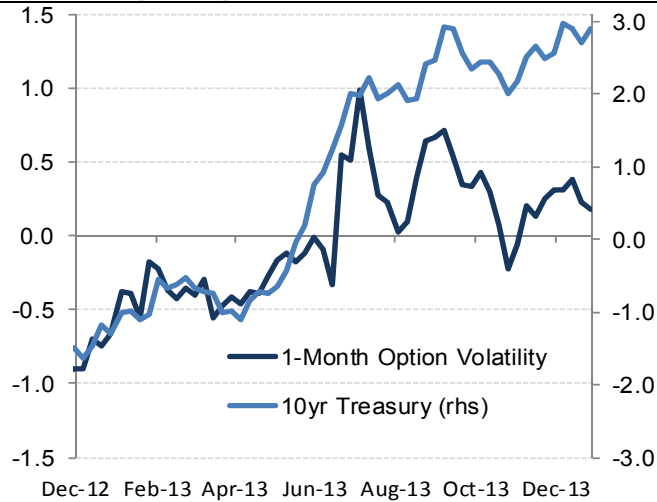
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



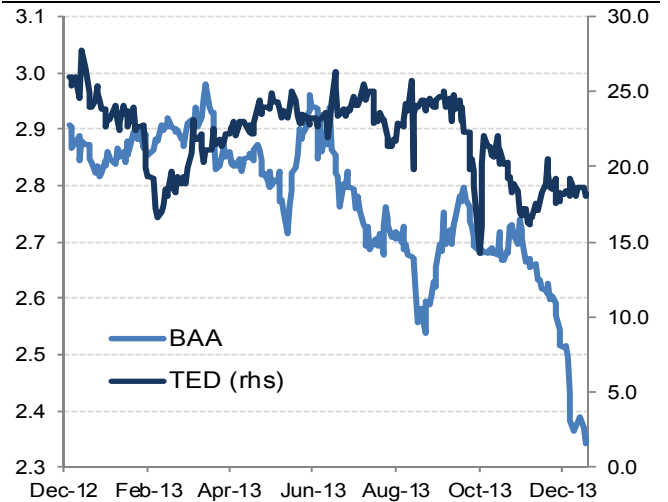
Source: Bloomberg & BBVA Research

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



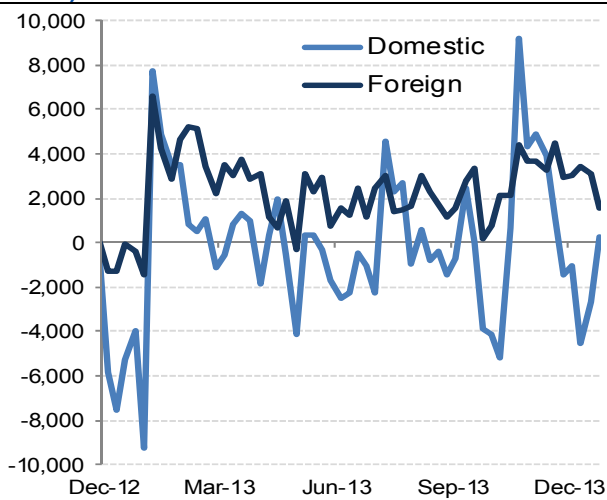
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



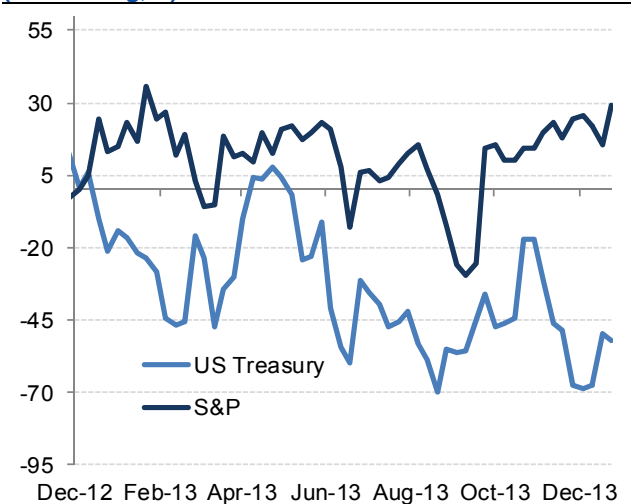
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

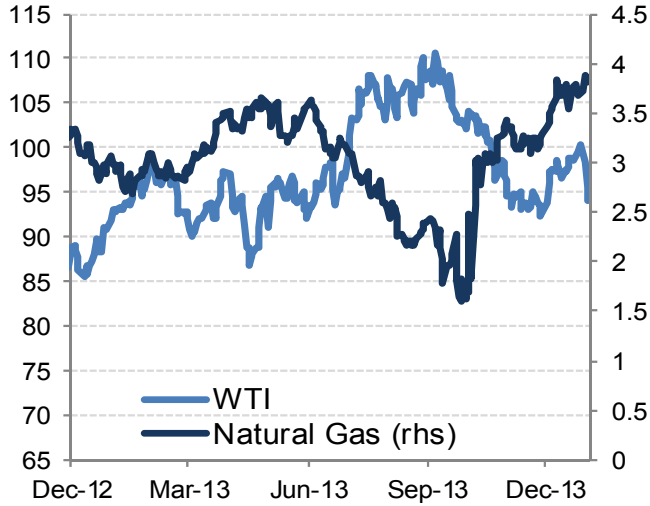
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

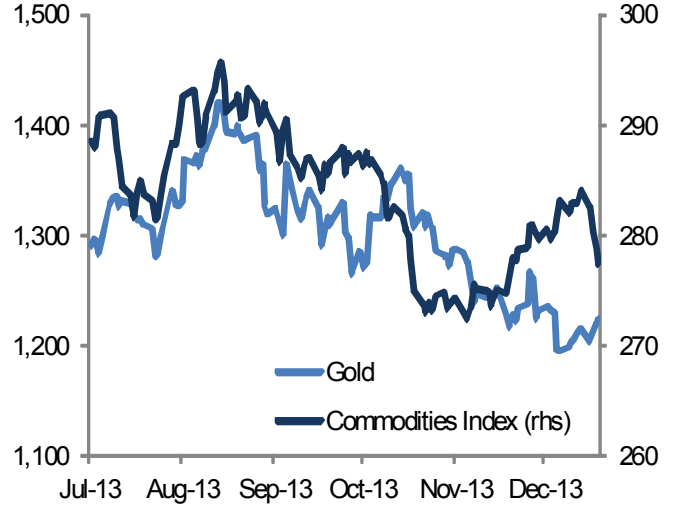
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



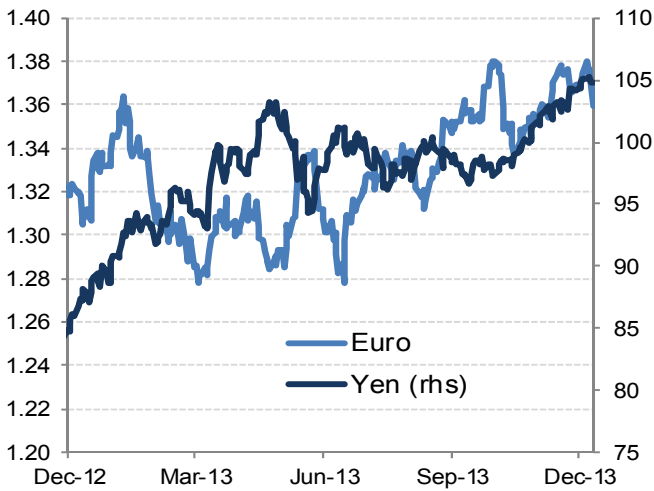
Source: Bloomberg & BBVA Research

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



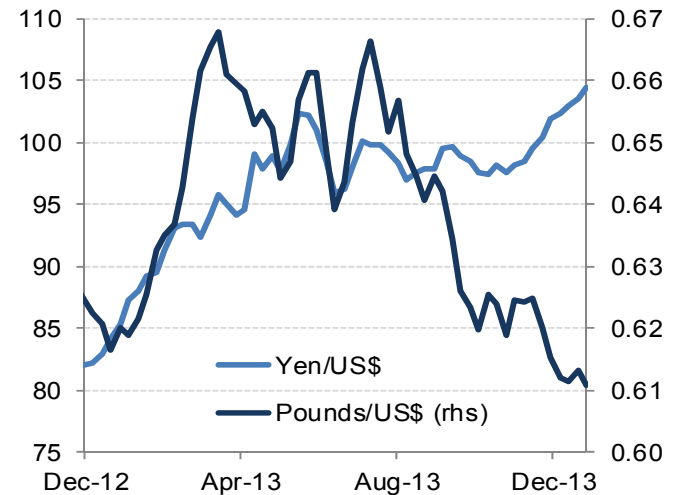
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



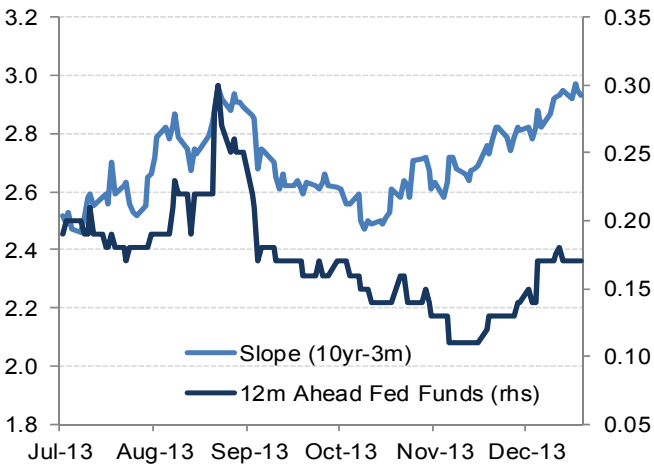
Source: Bloomberg & BBVA Research

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



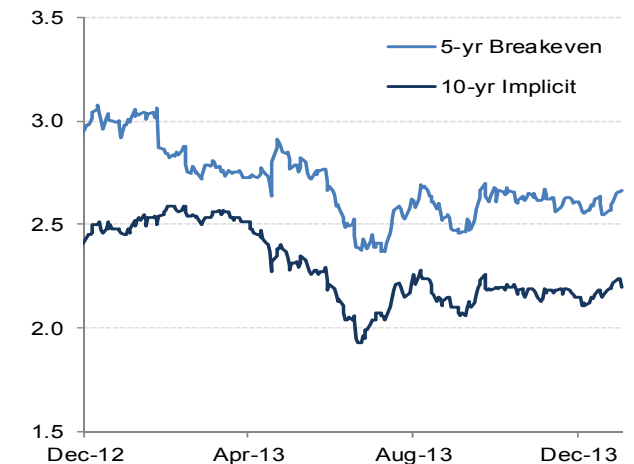
Source: Haver Analytics & BBVA Research

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	4-Weeks		
		Week ago	ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.23	14.23	14.23	14.10
New Auto (36-months)	2.44	2.44	2.66	2.74
Heloc Loan 30K	5.30	5.32	5.31	5.41
5/1 ARM*	3.15	3.05	2.94	2.90
15-year Fixed Mortgage *	3.56	3.55	3.43	3.23
30-year Fixed Mortgage *	4.51	4.53	4.42	3.99
Money Market	0.42	0.43	0.42	0.53
2-year CD	0.84	0.82	0.81	0.82

*Freddie Mac National Mortgage Homeowner Commitment US
Source: Bloomberg & BBVA Research

Table 2

Key Interest Rates (%)

	Last	4-Weeks		
		Week ago	ago	Year ago
1M Fed	0.07	0.08	0.08	0.14
3M Libor	0.24	0.25	0.24	0.30
6M Libor	0.34	0.35	0.35	0.49
12M Libor	0.58	0.58	0.58	0.81
2yr Sw ap	0.49	0.51	0.43	0.38
5yr Sw ap	1.72	1.79	1.62	0.87
10Yr Sw ap	2.95	3.07	2.93	1.87
30yr Sw ap	3.78	3.90	3.78	2.84
30day CP	0.11	0.12	0.11	0.15
60day CP	0.13	0.13	0.12	0.17
90day CP	0.32	0.13	0.13	0.19

Source: Bloomberg & BBVA Research

Quote of the Week

President Barack Obama
Speech at the White House
7 January 2014

"You know, a few weeks ago I said that 2014 could be a breakthrough year for America. Think about it. Five years ago this month, our economy was shedding 800,000 jobs, just in one month. But as Americans buckled down and worked hard and sacrificed, we began to come back. And our businesses have created more than 8 million new jobs since we hit the bottom".

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
14-Jan	Retail Sales (MoM)	DEC	0.2%	0.1%	0.7%
14-Jan	Retail Sales , Ex Auto and Gas (MoM)	DEC	0.4%	0.4%	0.4%
14-Jan	Import Prices (MoM)	DEC	0.2	0.3	-0.6
14-Jan	Business Inventories (MoM)	NOV	0.1%	0.3%	0.7%
15-Jan	Empire State Manufacturing Index	JAN	2.80	3.00	0.98
15-Jan	Producer Price Index (MoM)	DEC	0.3%	0.4%	-0.1%
15-Jan	Producer Price Index Core (MoM)	DEC	0.1%	0.1%	0.1%
16-Jan	Consumer Price Index (MoM)	DEC	0.3%	0.3%	0.0%
16-Jan	Consumer Price Index, Ex Food and Gas (MoM)	DEC	0.2%	0.1%	0.2%
16-Jan	Philly Fed Business Index	JAN	8.8	8.7	7.0
16-Jan	NAHB Housing Market Index	JAN	58.0	58	58.0
17-Jan	Housing Starts	DEC	0.970M	0.990M	1.091M
17-Jan	Building Permits	DEC	0.980M	1.010M	1.017M
17-Jan	Industrial Output (MoM)	DEC	0.2%	0.3%	1.1%
17-Jan	Capacity Utilization	DEC	79.0%	79.1%	79.0%
17-Jan	Manufacturing Output (MoM)	DEC	0.4%	0.3%	0.6%
17-Jan	Consumer Sentiment	JAN	83.5	83.2	82.5

Forecasts

	2011	2012	2013	2014	2015	2016
Real GDP (% SAAR)	1.8	2.8	1.6	2.3	2.5	2.8
CPI (YoY %)	3.1	2.1	1.7	2.2	2.4	2.4
CPI Core (YoY %)	1.7	2.1	1.8	2.0	2.1	2.3
Unemployment Rate (%)	8.9	8.1	7.4	7.0	6.4	5.9
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50
10Yr Treasury (eop, % Yield)	1.98	1.72	3.03	3.37	3.64	4.05
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.30	1.38	1.36

Note: Bold numbers reflect actual data. Forecast revisions pending.

Michael Soni
Michael.Soni@bbvacompass.com



| 2200 Post Oak Blvd, 21st Floor, Houston, Texas 77056 | Tel.: +1 713 831 7345 | www.bbva.com

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