

U.S.

Weekly Watch

September 20, 2010

Highlights

Economic Analysis

US
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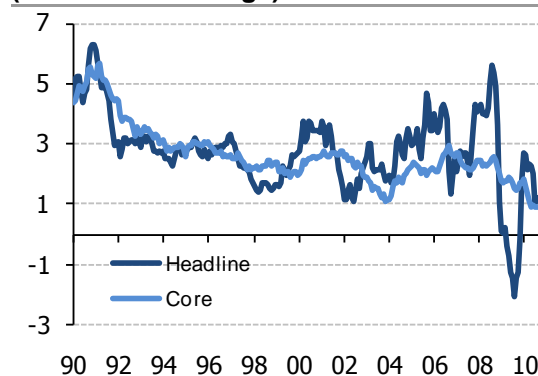
Consumer Price Index

In August, CPI and PPI data showed a similar trend; a large increase in energy prices and a negligible jump in core inflation. Core consumer prices, which exclude volatile energy and food prices, increased 0.05% slightly lower than our expectations (0.1%). This is the seventh straight month that core prices have risen, causing 12-month core inflation to remain stable at 0.9% for the past five months. One of the main reasons why core CPI remains low is the trend of shelter prices, which declined in August. Although the index decreased only 0.02%, the rent component edged down 0.07%, which was the first drop in the last six months. In contrast, owners' equivalent rent jumped 0.02% which helped offset the decline in rent prices and lodging (-1.3%). These trends indicate that core inflation is likely to remain low but positive, which is consistent with our baseline scenario. In addition, the report shows that deflationary risks are limited although they increased a bit. This will probably intensify the debate within FOMC members in their next meeting on September 21, 2010.

FOMC Meeting (Sept. 21)

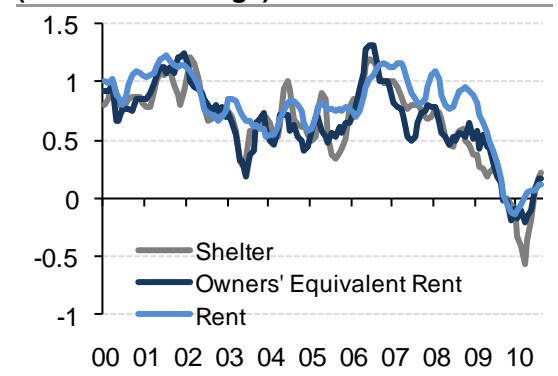
The FOMC members will meet tomorrow for their scheduled meeting. Although there are speculations about whether the Fed will announce a second round of quantitative easing or change its policy on interest paid on excess reserves, we expect no change in the Fed's monetary policy. As it was stressed couple of times by Bernanke, the Fed's main concerns are the financial stability, inflation and economic recovery. The Fed makes cost and benefit analysis before taking new actions and recent statements of FOMC members indicate that there is no need for a policy change at this moment. Although the economic recovery is slower than the Fed's expectation, financial stability seems prudent and inflation is under control. We expect that unless there is significant threat to financial stability which might negatively affect economic recovery and unless there are significant and clear signs of deflation, the Fed will continue to implement its current monetary policies.

Graph 1
CPI
(12-month % change)



Source: BLS

Graph 2
CPI
(3-month % change)



Source: BLS

Week Ahead

Housing Starts (August, Tuesday 08:30 ET)

Forecast: 550K	Consensus: 550K	Previous: 546K
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Despite the fiscal stimulus, new home sales have slightly decreased in the first seven months of 2010. As a result of declining demand, home builders' confidence is cooling down, as shown by the National Association of Home Builders Index. However, inventories of new homes are at historical low levels, which provide a short term incentive for builders to increase supply. In August, housing starts will be around 550 thousand, implying a 1% monthly gain.

FOMC Meeting (Sept-21, Tuesday 14:15 ET)

Forecast: 0.25%	Consensus: 0.25%	Previous: 0.25%
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We are expecting that the Fed will continue its low interest rate policy in the medium term. The federal funds rate is expected to remain at 0.25% and we continue to anticipate that the Fed would start increasing interest rates no sooner than 3Q11. As it was made clear by the current Fed's chairman Bernanke in his speech in Jackson Hole last month, the Fed is ready to do whatever it takes to support the economy if economic outlook worsens significantly. However, he also noted that there is no significant risk worth acting on, at this moment. Since his speech, the economic indicators have come out stronger than expected and therefore, although there are some discussions in the market on the possibility and need of a second round quantitative easing, we expect no change in the Fed's current monetary policy at this week's FOMC meeting.

Existing Home Sales (August, Thursday 10:00 ET)

Forecast: 4.58M	Consensus: 4.10M	Previous: 3.83M
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The end of the tax credit had a strong negative impact on July's existing home sales, which posted the lowest level since 2000. In addition, tight mortgage credit conditions and weak employment conditions are also limiting the pace of recovery. In contrast, improved affordability ratios, record-low mortgage rates and low prices, bring back buyers to the market, providing some support to existing home prices.

Durable Goods Order (August, Friday 08:30 ET)

Forecast: -1.5%	Consensus: -0.9%	Previous: 0.4%
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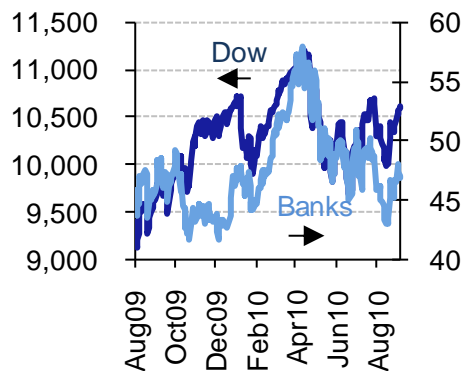
Durable goods orders are expected to decline in August following a 0.4% increase in July, which was due to increase in nondefense aircrafts and parts component which is basically demand for commercial aircrafts. Market will be closely watching the release since it could give insights for the pace of the recovery. Durable goods orders increased 9.3% in the last 12 months although the pace of its growth seems to be fading away.

Market Impact

The market will be focused on the FOMC statement after its regular meeting. If the Fed announces a second round of quantitative easing, the market would be caught unguarded and it would decrease long term rates further if, for example, the Fed decides to increase its large-scale purchases of treasury securities significantly.

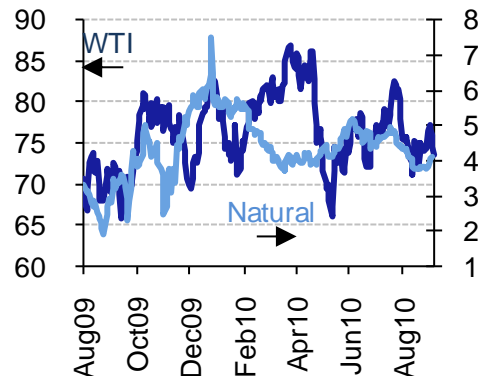
Financial Markets

Graph 3
Stocks (Index, KBW)



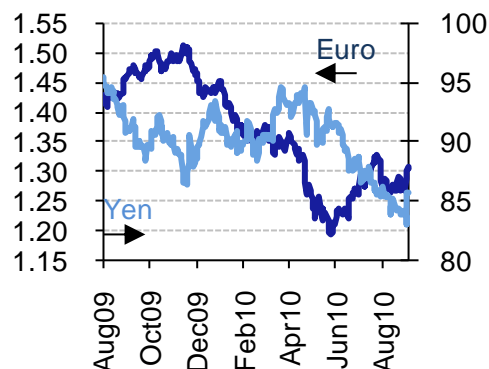
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



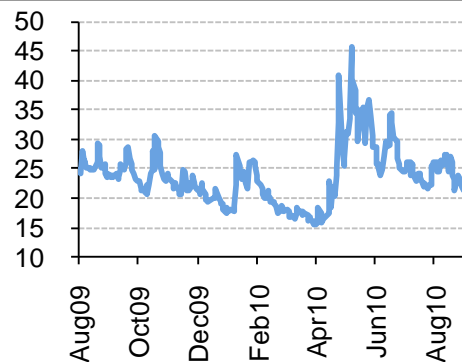
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



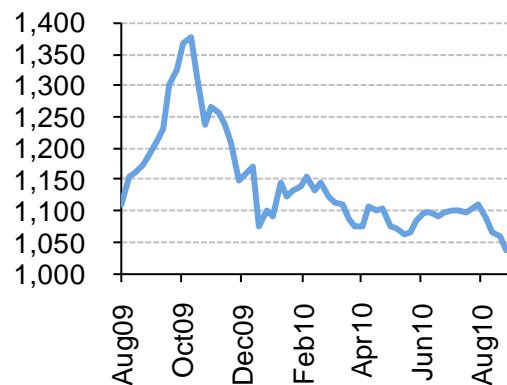
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



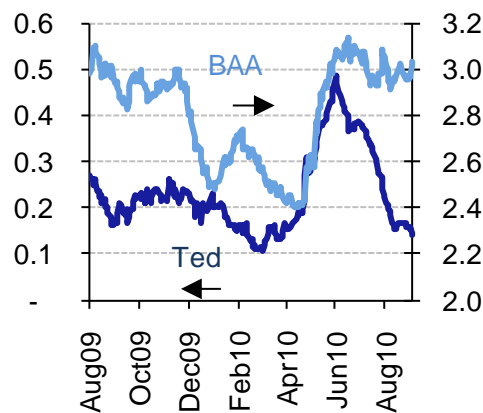
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

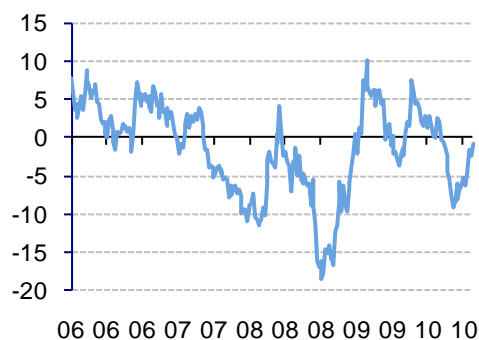
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

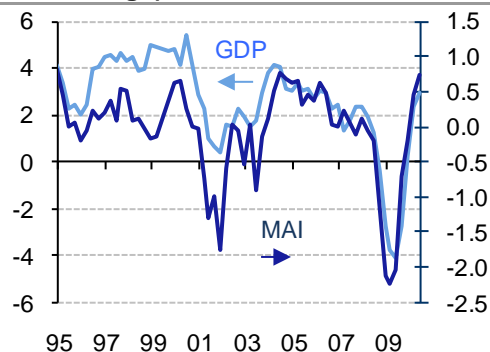
Economic Trends

Graph 9
BBVA US Weekly Activity Index (3 month % change)



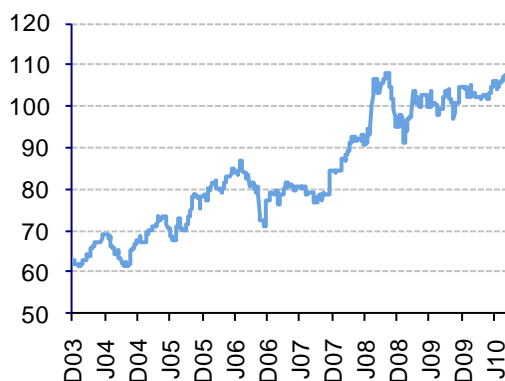
Source: BBVA Research

Graph 10
BBVA US Monthly Activity Index & Real Gross Domestic Product (4Q % change)



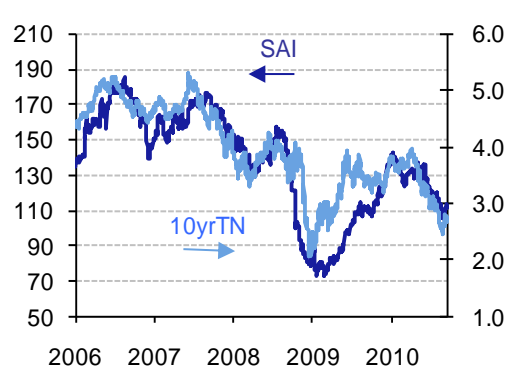
Source: BBVA Research & BEA

Graph 11
BBVA US Surprise Inflation Index (Index 2009=100)



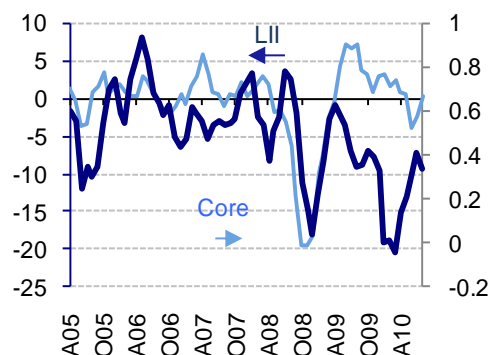
Source: BBVA Research

Graph 12
BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)



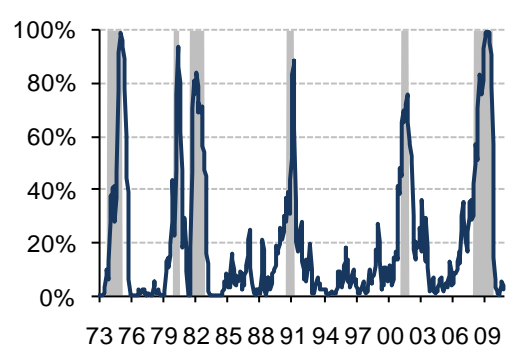
Source: Bloomberg & BBVA Research

Graph 13
BBVA US Leading Inflation Index & Core Inflation (Qoq % change)



Source: BLS & BBVA Research

Graph 14
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

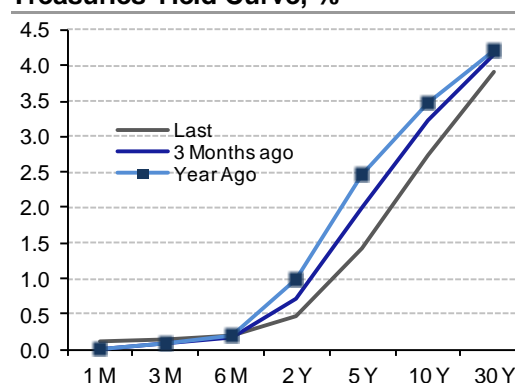
Yield Curve and Interest Rates

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)	13.58	13.58	13.44	11.41
New Auto (36-months)	5.90	5.95	6.10	7.24
Heloc Loan 30K	5.52	5.52	5.52	5.85
30-year Fixed Mortgage *	4.37	4.35	4.42	5.04
Money Market	0.98	0.70	0.71	1.15
2-year CD	1.40	1.42	1.45	1.95
5-year CD	2.33	2.32	2.37	2.70

* Freddie Mac National Mortgage Homeowner Commitment 30 Year US
Source: Bloomberg and BBVA Research

Graph 15
Treasuries Yield Curve, %



Source: Bloomberg

Quote of the Week

Treasury Secretary Timothy F. Geithner
September 16, 2010

Before the Senate Banking, Housing, and Urban Affairs and House Ways and Means Committees

“It is critical for sustainable growth in China, the United States, and the rest of the world that China and the United States both do our part to prevent a return to pre-crisis global imbalances.”

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous	Revised
20-Sep	NAHB Housing Market Index	SEP	13.0	14.0	13.0	--
21-Sep	Housing Starts	AUG	550K	550K	546K	--
21-Sep	Housing Starts MOM%	AUG	0.7%	0.7%	1.7%	--
21-Sep	Building Permits	AUG	570K	560K	565K	559K
21-Sep	Building Permits MOM%	AUG	0.9%	0.2%	-3.1%	-4.1%
21-Sep	FOMC Rate Decision	21-Sep	0.25%	0.25%	0.25%	--
22-Sep	House Price Index MoM	JUL		-0.1%	-0.3%	--
23-Sep	Initial Jobless Claims	18-Sep	455K	450K	450K	--
23-Sep	Continuing Claims	11-Sep	4.480M	4.492M	4.485M	--
23-Sep	Existing Home Sales	AUG	4.58M	4.10M	3.83M	--
23-Sep	Leading Indicators	AUG	0.1%	0.1%	0.1%	--
23-Sep	Existing Home Sales MoM	AUG	19.6%	7.1%	-27.2%	--
24-Sep	Durable Goods Orders	AUG	-1.5%	-1.0%	0.3%	0.4%
24-Sep	Durables Ex Transportation	AUG	-0.3%	0.8%	-3.8%	-3.7%
24-Sep	Cap Goods Orders Nondef Ex Air	AUG	2.8%	4.0%	-8.0%	--
24-Sep	Cap Goods Ship Nondef Ex Air	AUG		--	-1.5%	--
24-Sep	New Home Sales	AUG	320K	295K	276K	--
24-Sep	New Home Sales MoM	AUG	15.9%	6.9%	-12.4%	--

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