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Weekly Watch

U.S.

13 June 2011
Economic Analysis

U.S.

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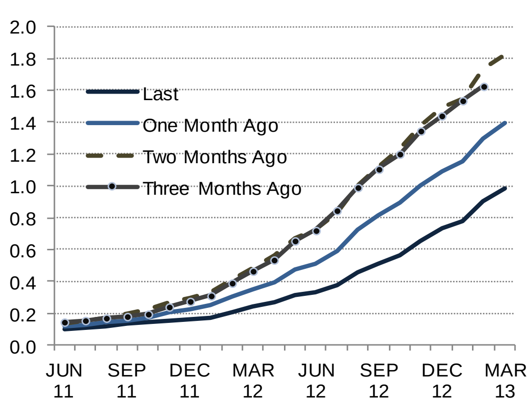
Highlights

Accommodative Monetary Policies are Likely to Continue Through 2011

Federal Reserve Chairman Bernanke said on Tuesday that accommodative monetary policies are still needed "until we see a sustained period of job creation" and the recent increase in inflation rates are likely to prove temporary. Recent economic indicators have proved weaker-than-expected, suggesting a sharper and more widespread deceleration. The Beige Book, released last Wednesday also supports slowdown in economic activity in 2Q11. The report detailed an uneven economic recovery across districts, with only Dallas reporting economic acceleration. A weak job recovery and uneven wage growth continue to negatively impact consumer spending, residential housing sales, and credit markets. Structural unemployment remains a concern in the Minneapolis, Kansas City, Dallas, and San Francisco districts which reported mismatched labor markets. Furthermore, tight regional credit markets continue to drag down residential mortgage applications, with Cleveland being the only district reporting growth. Unfavorable weather, supply chain disruptions stemming from the earthquakes in Japan, and pass-through from input price increases added to the slowdown and reduced consumer spending in most regions. Slow wage growth and general deceleration of economic activity are counteracting commodity inflation, netting small to moderate core price increases in most districts.

In sum, the latest slowdown in economic activity has sparked speculation on additional quantitative easing (QE3) once QE2 finishes at the end of June. However, the Fed is unlikely to make such a move if the net benefit of QE3 is perceived as negative. First, although data has been weak, the economy continues expanding. Second, the duration of the current slowdown is highly uncertain. Third, deflationary risks are nowhere on the horizon. Finally, financial markets are functioning more normally. Thus, the Fed will wait until new data provides a clearer view on the downside risks confronting the economy. As we move into a hot summer the Fed will end QE2 as planned, continue reinvestment of principal payments on holdings of securities, keep the discussion on the exit strategy on hold, and evaluate additional monetary tools in case they become necessary.

Graph 1
Fed Funds Expectation
(Fed Funds Futures, end of contract, %)



Source: Bloomberg and BBVA Research

Graph 2
Initial Jobless Claims
(Weekly. thousands)

Source: BLS and BBVA Research

Week Ahead

Retail Sales (May, Tuesday 8:30 ET)

Forecast: -0.4%	Consensus: -0.3%	Previous: 0.5%

Retail sales remained robust, increasing by 0.5% MoM in April. The increase continued ten consecutive months of growth. Unnerving nonfarm payroll data and declining consumer confidence present significant downside risk to retail sales for the month of May. Moreover, disappointing auto sales, a slight decline in gas prices and a relatively small increase in consumer prices could also drag down retail sales in May.

Consumer Price Index, Core (May, Wednesday 8:30 ET)

Forecast: 0.0%, 0.2%	Consensus: 0.1%, 0.2%	Previous: 0.4% , 0.2%

Inflationary concerns persist as the CPI rose in April by 0.4% MoM. Energy and food prices continue to drive up the consumer prices, increasing 19.0% and 3.2% over the last 12 months, respectively. Core CPI remains subdued growing at 0.2% MoM in April consistent with slow employment growth and large economic slack. Due to a slight decline in oil and gas prices we expect no change in headline consumer prices in May.

Industrial Production (May, Wednesday 9:15 ET)

Forecast: 0.2%	Consensus: 0.2%	Previous: 0.0%

There was no change in the industrial production index and the capacity utilization rate declined slightly to 76.9% in April. Latest economic indicators such as ISM manufacturing index and regional activity indices point to slow expansion in industrial production, suggesting slowdown in economic activity in 2Q11. We expect the industrial production to increase by 0.2% in May.

Housing Starts (May, Thursday 8:30 ET)

Forecast: 532K	Consensus: 545K	Previous: 523K

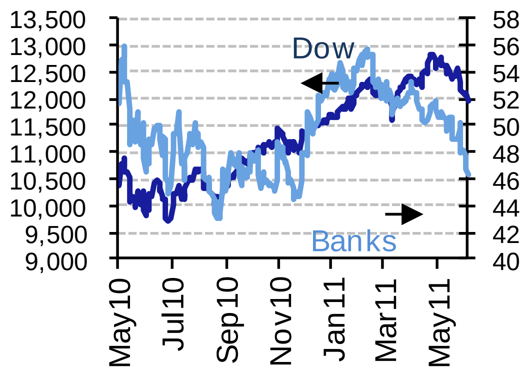
Housing starts are above the 3-month moving-average but remain well below historical and seasonal averages. Any significant increase in housing starts is unlikely to happen in 2Q11 or 3Q11. Although inventories have declined significantly, historically low builders' confidence, weak labor market conditions, restrictive lending standards, and substantial supply of foreclosed properties will limit any significant increase in housing starts. Therefore, we expect moderate increase in housing starts in May.

Market Impact

Recent weak macroeconomic indicators have sparked discussion on the need for additional monetary policy intervention. We believe that it is still early to call for additional quantitative easing and that the Fed needs additional data to shape its monetary policy. Therefore, this week's economic indicators are increasingly important. Significant increases in retail sales, industrial production and housing starts would eliminate some of the recent pessimism in the economy and boost stock prices. On the other hand, if consumer prices decline significantly it would show not only the impact of declining energy prices but also the slowdown in economic activity. This would affect equity prices negatively and ignite deflation scenarios once again.

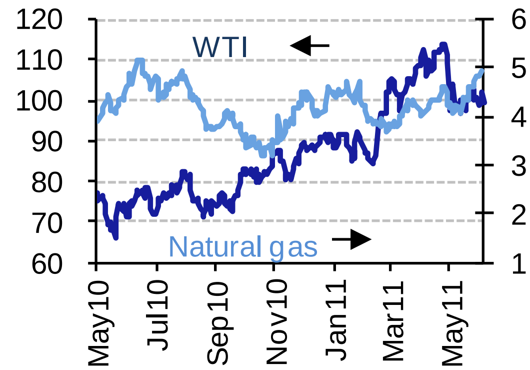
Financial Markets

Graph 3
Stocks (Index, KBW)



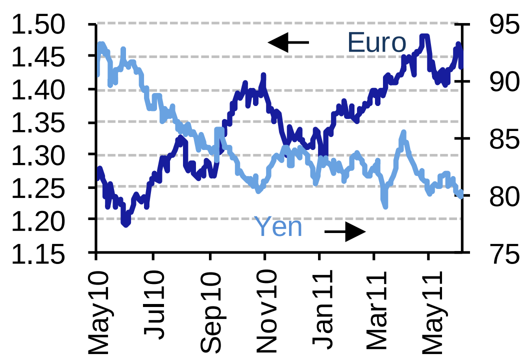
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



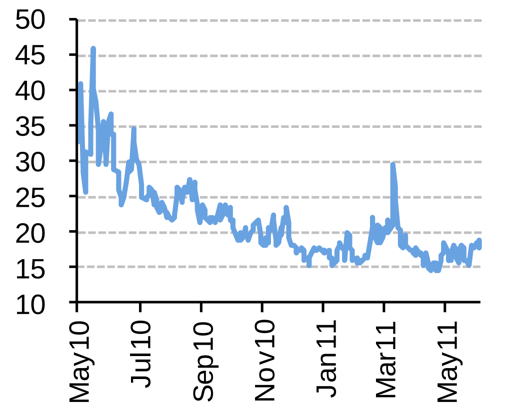
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



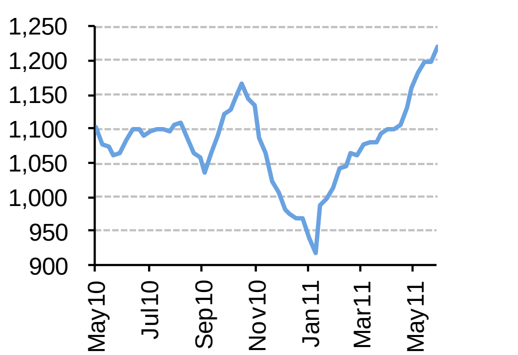
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



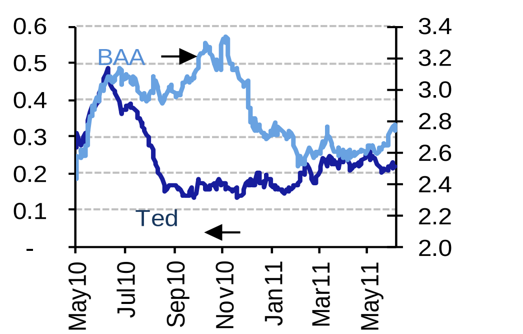
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US$Bn)



Source: Bloomberg & BBVA Research

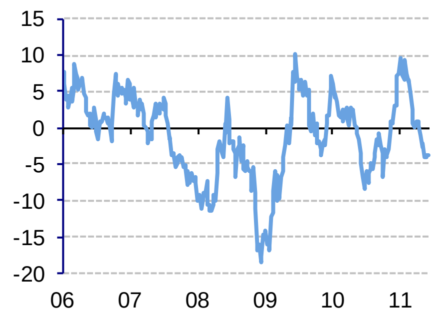
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

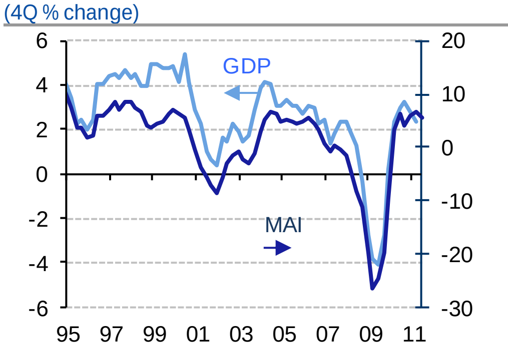
Economic Trends

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)

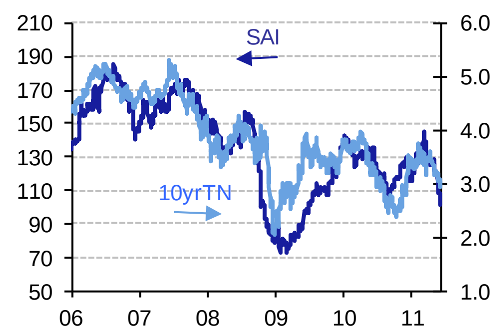


Source: BBVA Research & BEA

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

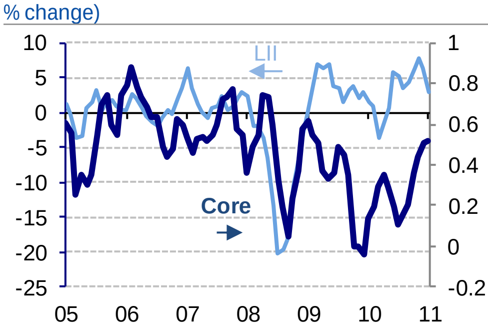
Source: BBVA Research

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



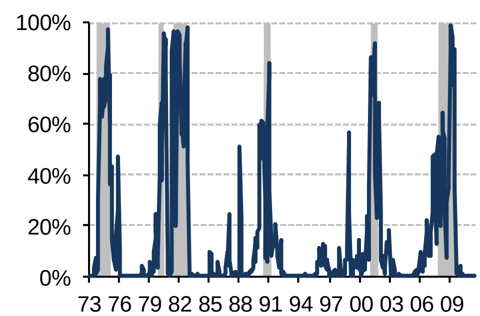
Source: Bloomberg & BBVA Research

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

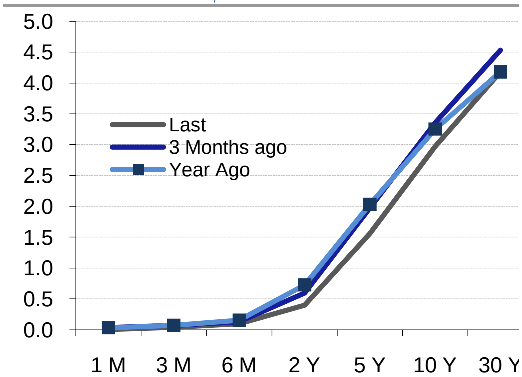
Yield Curve and Interest Rates

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)	13.73	13.73	13.73	13.44
New Auto (36-months)	3.70	3.80	3.79	6.33
Heloc Loan 30K	5.50	5.49	5.48	5.56
30-year Fixed Mortgage *	4.49	4.55	4.63	4.72
Money Market	0.63	0.62	0.62	0.78
2-year CD	1.11	1.12	1.23	1.59
5-year CD	2.05	2.12	2.07	2.58

* 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

Federal Reserve Chairman Ben Bernanke
"The U.S. Economic Outlook"
June 7, 2011, Atlanta, Georgia

"If the nation is to have a healthy economic future, policymakers urgently need to put the federal government's finances on a sustainable trajectory. But, on the other hand, a sharp fiscal consolidation focused on the very near term could be self-defeating if it were to undercut the still-fragile recovery"

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
14-Jun	Producer Price Index (MoM)	MAY	0.10%	0.10%	0.80%
14-Jun	PPI Ex Food & Energy (MoM)	MAY	0.20%	0.20%	0.30%
14-Jun	Advance Retail Sales	MAY	-0.40%	-0.50%	0.50%
14-Jun	Retail Sales Less Autos	MAY	0.40%	0.30%	0.60%
14-Jun	Business Inventories	APR	1.00%	0.90%	1.00%
15-Jun	Consumer Price Index (MoM)	MAY	0.00%	0.10%	0.40%
15-Jun	CPI Ex Food & Energy (MoM)	MAY	0.20%	0.20%	0.20%
15-Jun	Empire Manufacturing	JUN	11	13	11.88
15-Jun	Industrial Production	MAY	0.20%	0.20%	0.00%
15-Jun	Capacity Utilization	MAY	77.00%	77.00%	76.90%
16-Jun	Initial Jobless Claims	11-Jun	422K	420K	427K
16-Jun	Continuing Claims	4-Jun	3640K	3650K	3676K
16-Jun	Building Permits	MAY	545K	552K	551K
16-Jun	Housing Starts	MAY	532K	545K	523K
16-Jun	Current Account Balance	1Q	-$130.0B	-$130.0B	-$113.3B
17-Jun	Philadelphia Fed.	JUN	6	7	3.9
17-Jun	U. of Michigan Confidence	JUN	73.5	74	74.3
17-Jun	Leading Indicators	MAY	0.10%	0.30%	-0.30%

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