

Weekly Watch

U.S.

Highlights

18 July 2011
Economic Analysis

U.S.

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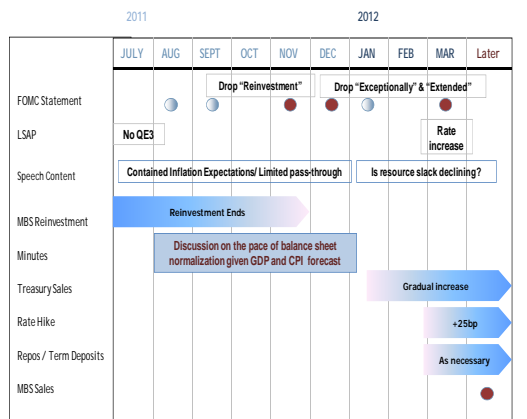
FOMC minutes give first indications of exit strategy sequencing and risk scenario policies

Tuesday's release of the FOMC minutes and Bernanke's speech before the House Financial Services Committee revealed a more formalized sequencing of the exit strategy. The minutes underlined that this discussion of normalization is for "prudential planning" purposes only and should not be construed as an imminent sign of exit. Also, the staff review of the economic situation unveiled a focus on two major issues: first, ongoing changes in both survey and market-based inflation expectations, and second, structural unemployment and wage pressures in a "softened" labor market. During his semiannual speech in regards to monetary policy, Bernanke touched on both the exit strategy and also options for the Fed if economic growth slows considerably. According to Bernanke, if deflationary risks reemerge, the Fed may offer more explicit guidance on the target rate and balance sheet, conduct more securities purchases, and increase the average maturity of the Fed's holdings, but he alluded to the untested nature of these policy choices. The minutes and Bernanke's semiannual monetary policy speech are consistent with our expected sequencing of policy, excluding the cessation of principal reinvestment, which we expect to be pushed back into Nov-Dec, in expectation of moderate growth in 2H11 and low and stable core inflation, consistent with the Fed's mandate.

Core CPI remains high, Headline CPI continues to ease

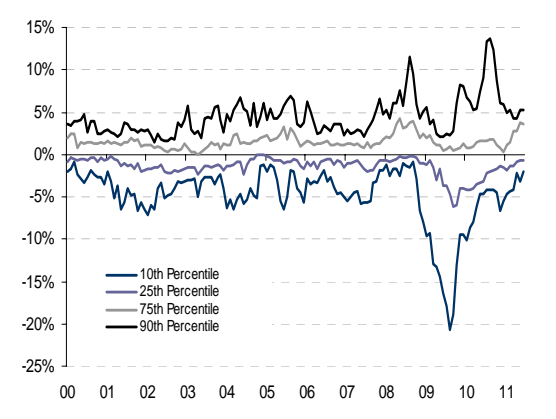
Consumer price inflation (CPI) eased in June, falling 0.2% MoM after a 0.2% increase in May. Energy prices fell 4.4% due in large part to a 6.8% decrease in gas prices. Food prices increased 0.2% MoM, the smallest increase this year. Core CPI, however, increased 0.3% for the second straight month. Leading factors were new vehicles, used cars and trucks, and apparel, which increased 0.6%, 1.6%, and 1.4%, respectively. Twelve-month headline inflation matched last month's figure of 3.4% on a seasonally-adjusted basis, while YoY core prices increased from 1.5% to 1.6% in June. Lower energy costs deflated headline consumer prices while vehicles and apparel contributed to a rise in core consumer inflation. However, it is likely that the increases in vehicle prices are temporary, thus we expect core inflation rates to fall in the coming months

Chart 1
Expected Sequencing of Fed Monetary Policy



Source: BBVA Research

Chart 2
Consumer Price Distribution (Change in YoY rates)



Source: BEA & BBVA Research

Week Ahead

Housing Start (June, Tuesday 8:30 ET)

Forecast: 567k	Consensus: 575k	Previous: 560k
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Oversupply and tight credit are likely to suppress housing starts again in June, however, strong housing permit issuance in May could be an indication that housing starts will increase. Even though multi-unit constructions are on an upward trajectory, single unit constructions are declining and will partially offset the impact of multi-unit gains. Overall construction of new homes has been discouraged by weak residential mortgage demand, tight credit conditions, and growing supply, thus we expect the current low growth trajectory to persist.

Existing Home Sales (June, Wednesday 10:00 ET)

Forecast: 5.15M	Consensus: 4.9M	Previous: 4.8M
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The negative indications from the June employment report, pessimistic price expectations, and low credit availability will weigh on residential housing demand in June. However, pending home sales, which is a leading indicator for existing home sales, increased in May. In addition, it appears price normalization for non-distressed homes continues, suggesting that existing home sales could increase in June. The modest MoM increase, while positive, does not deviate from our baseline low growth scenario in 2H11.

Jobless Claims (July 15th, Thursday 8:30 ET)

Forecast: 425K	Consensus: 405	Previous: 405K
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Initial jobless claims for the week ending July 15 are expected to remain relatively unchanged. Last week's figure of 405K may be an underestimate, given that the shortened holiday week likely contributed to fewer claims. The 4-week moving average also dropped slightly last week from 427K to 423K, but we expect that this will adjust accordingly. Looking forward, it is unclear whether the decrease in initial jobless claims is an indication of improvements in the job market. Thus, we expect jobless claims to stay in line with the average at 425K.

Philadelphia Fed Manufacturing Survey (July, Friday 10:00 ET)

Forecast: -3.3	Consensus: 4.5	Previous: -7.7
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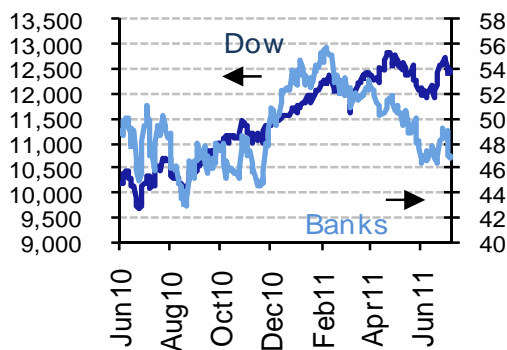
Despite improved market conditions in June, the negative pressures from weak economic data will continue to weigh on July's index, though less so than last month. Demand for manufactured goods decreased in June but should rebound this month as input price pressures continue to moderate. This should help to reduce inventories and boost production. However, we expect that July's index will remain negative due to weak employment data and uncertain demand expectations. The outlook for manufacturing conditions will remain weak until there is a consistent period of economic improvement.

Market Impact

Employment became the central focus after last week's employment situation report was well below expectations. However, markets this week will shift their attention to the housing situation. Strong housing demand and declining inventories will help to strengthen market expectations following last week's troublesome report.

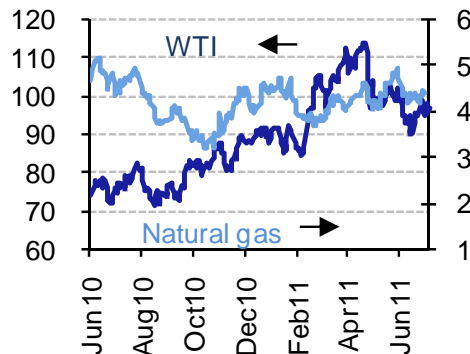
Financial Markets

Graph 3
Stocks (Index, KBW)



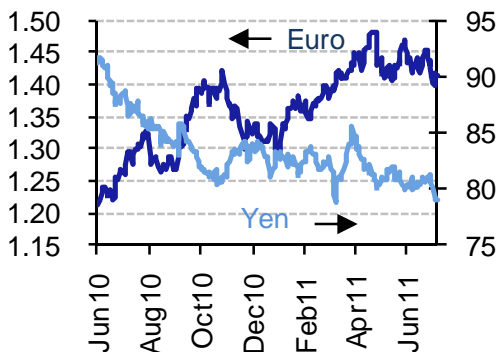
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



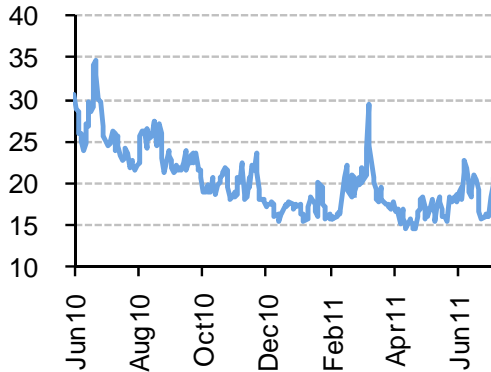
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



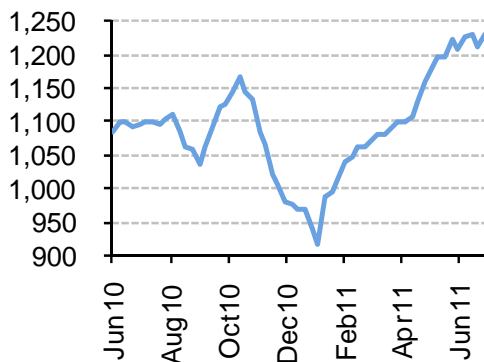
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



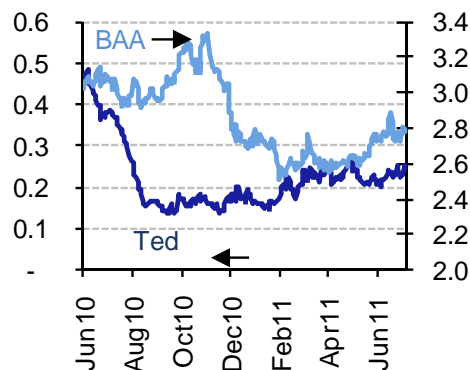
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

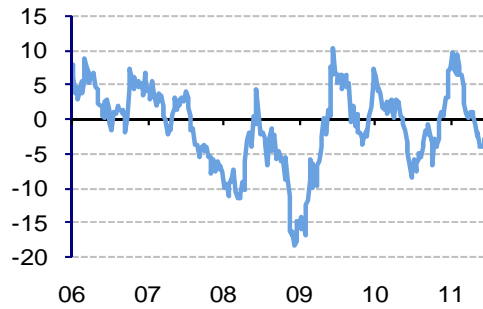
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

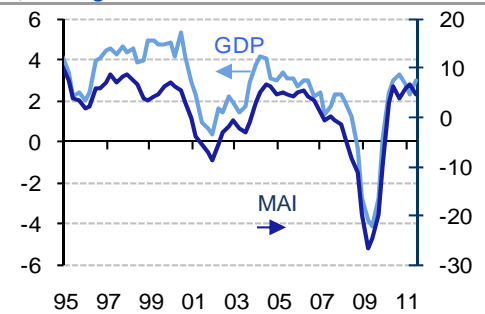
Economic Trends

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



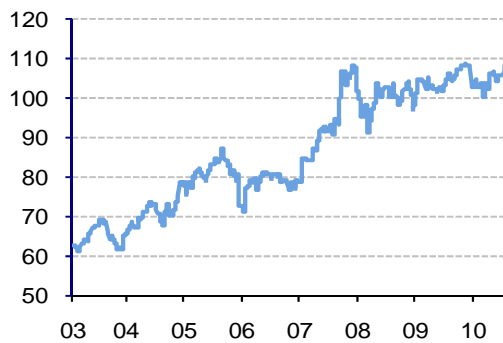
Source: BBVA Research

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



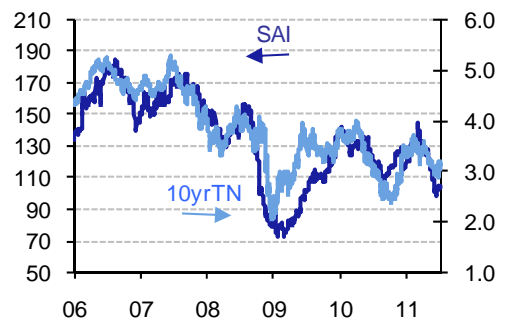
Source: BBVA Research & BEA

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



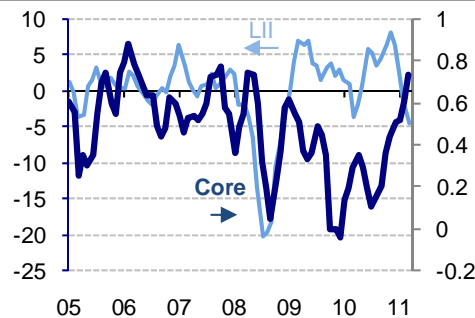
Source: BBVA Research

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



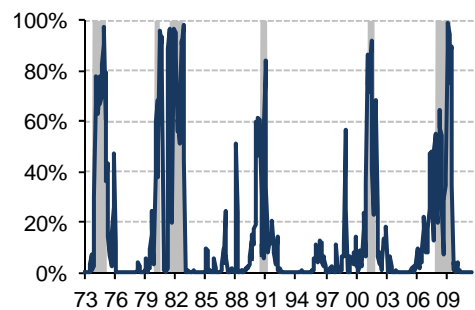
Source: Bloomberg & BBVA Research

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

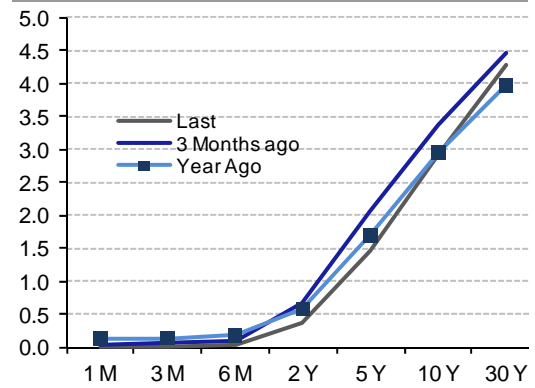
Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

Key Interest Rates	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)	3.96	3.68	3.71	6.19
Heloc Loan 30K	5.61	5.55	5.52	5.59
30-year Fixed Mortgage *	4.51	4.60	4.50	4.57
Money Market	0.58	0.63	0.62	0.75
2-year CD	1.05	1.06	1.08	1.52
5-year CD	2.04	2.04	2.05	2.48

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

Graph 15
Treasury Yield Curve, %



Source: Bloomberg

Quote of the Week

Chairman Bernanke
Semiannual Monetary Policy Report to Financial Services Committee
13 July 2011

"...Given the range of uncertainties about the strength of the recovery and prospects for inflation over the medium term, the Federal Reserve remains prepared to respond should economic developments indicate that an adjustment in the stance of monetary policy would be appropriate"

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
19-Jul	Housing Starts	JUN	567k	575K	560K
19-Jul	Housing Starts MOM%	JUN	1.0%	2.7%	3.5%
19-Jul	Building Permits	JUN	614k	600K	612K
19-Jul	Building Permits MOM%	JUN	0.3%	-1.5%	8.1%
20-Jul	Existing Home Sales	JUN	5.15M	4.92M	4.81M
20-Jul	Existing Home Sales MoM	JUN	7.0%	2.3%	-3.8%
21-Jul	Initial Jobless Claims	15-Jul	425k	405K	405K
21-Jul	Continuing Claims	9-Jul	3721K	3705k	3727K
21-Jul	FHFA House Price Index MoM	MAY	0.8%	0%	0.8%
21-Jul	Leading Indicators	JUN	0.0%	0.2%	0.8%
21-Jul	Philadelphia Fed.	JUL	-3.3	4.5	-7.7

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