

Economic Watch

U.S.

Monthly US Outlook

Positive Economic Data Lifting Spirits, But is it Sustainable?

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Economic Analysis

U.S.

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- **Economic activity slows down while labor market conditions continue to improve gradually**
- **While the threat of a European spillover has faded slightly, downside risks have shifted toward geopolitical tensions and a possible oil shock**
- **The Federal Reserve is worried about the sustainability of the US recovery and is prepared to intervene if conditions deteriorate**

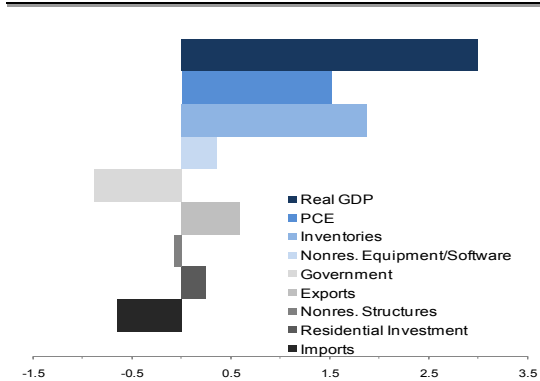
The most recent economic data have arrived in line with our expectations for slowing growth throughout 1Q12, though we expect activity to rebound in 2Q12. Volatility swings that highlighted the economic uncertainties in 4Q11 have become less cumbersome, and the threat of a spillover from the European sovereign debt crisis has diminished somewhat given the latest developments in February. Private investment and exports remain solid, labor market conditions continue to improve, and our economic indices point to robust activity in the coming months. The Bureau of Economic Analysis also revised its 4Q11 real GDP growth estimate from 2.8% to 3.0% SAAR, mainly due to upward revisions to nonresidential fixed investment and personal consumption expenditures (PCE), as well as a downward revision to imports. Consumer confidence appears to have rebounded from a brief deterioration in early 1Q12, but real PCE has been mostly flat in the last three months. Moreover, rising oil and gas prices remain a concern and could affect consumer sentiments negatively. Still, recent inflation data support our baseline scenario for moderating price pressures in 2012. Our baseline assumes that commodity price pressures will decline throughout 1Q12, particularly with the slowdown and uncertainty in global economies. However, we remain cautious of an oil shock related to tensions in the Middle East, as high gas prices could linger and put upward pressure on headline inflation for longer than expected. In general, inflation trends are still unfolding as expected by the FOMC, and well-anchored inflation expectations limit potential upward pressure to core prices.

The Federal Reserve remains unconvinced of a stronger recovery, focusing particularly on weakness in the housing market. Although the correction in housing inventories is beginning to encourage construction of new single-family homes, we expect that increasing foreclosures will continue to put downward pressure on home prices throughout 2012. Other FOMC concerns include weak household spending, ongoing deleveraging, and high levels of fiscal and regulatory uncertainty. As Chairman Bernanke stressed in the Semiannual Monetary Policy Report to the Congress last week, the Fed set a numerical target of 2.0% PCE inflation over the long run in its last meeting and is unlikely to set a target for the unemployment rate. He also made it clear that the recent change in the communication policy is not an alteration in how the FOMC conducts monetary policy. Furthermore, improvements in the employment situation are not so clear given that long-term unemployment remains elevated, ultimately furthering concerns of structural problems. The fall in the unemployment rate could also be somewhat misleading given the simultaneous decline in the participation rate. The QE3 debate continues, but most FOMC members agree that conditions need to deteriorate to spark further action on their part.

Overall, we maintain our conservative outlook regarding the acceleration in economic activity as we approach 2Q12. We expect labor market conditions to remain weak in 2012, yet it will improve upon 2010-11 and will coincide with moderate economic growth. Political brinkmanship continues to incite fiscal uncertainty, and we do not expect significant reforms until after the elections.

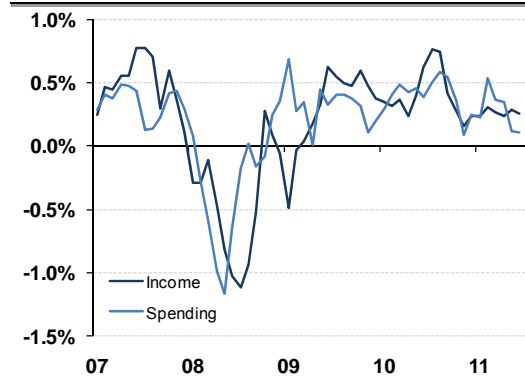
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(4Q11 Second Estimate, SAAR % Points)



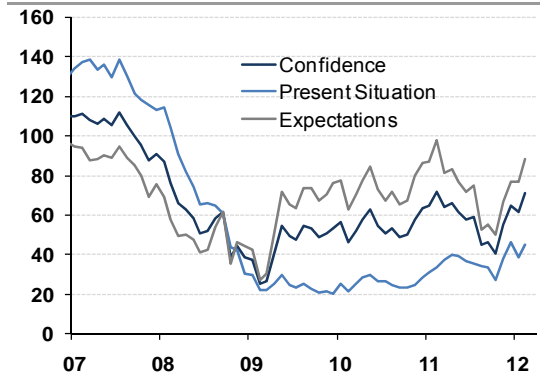
Source: Bureau of Economic Analysis

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



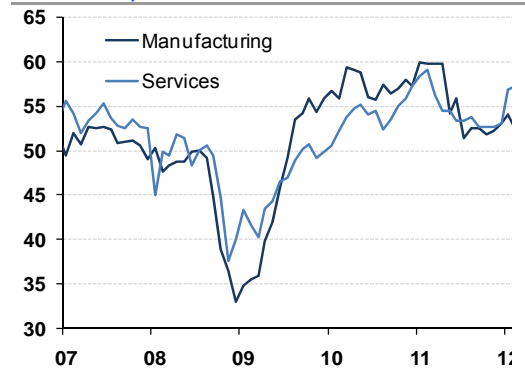
Source: Bureau of Economic Analysis

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



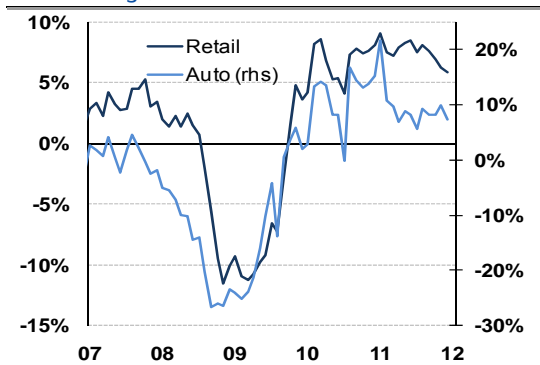
Source: Conference Board

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



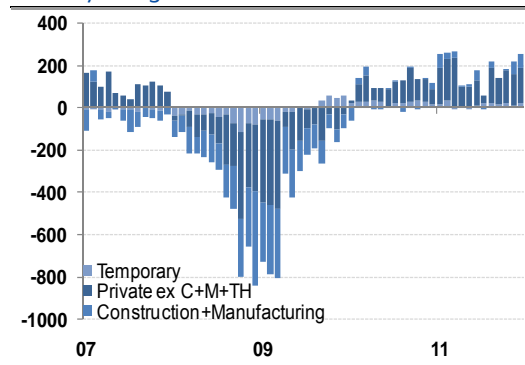
Source: ISM

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau

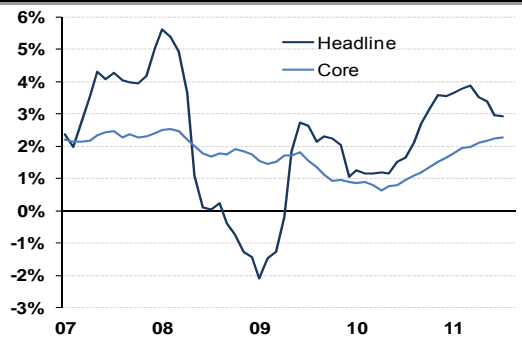
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: Haver Analytics & BBVA Research

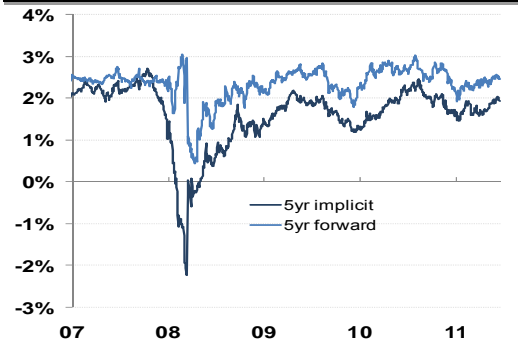
Economic Indicators

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



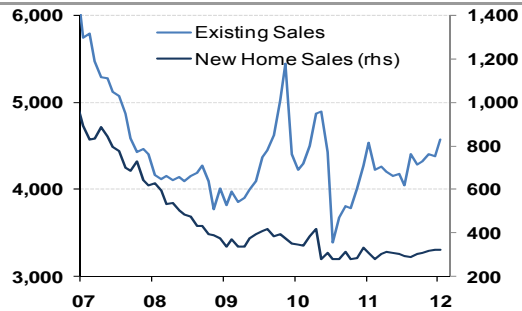
Source: Bureau of Labor Statistics

Graph 8
Inflation Expectations
(%)



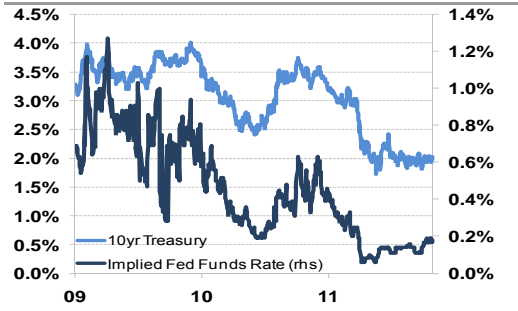
Source: Federal Reserve Board & BBVA Research

Graph 9
New and Existing Home Sales
(Thousands)



Source: Haver Analytics & BBVA Research

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



Source: Haver Analytics

Table 1
Forecasts (BOLD=FORECASTS)

	2Q2011	3Q2011	4Q2011	2011	2012	2013
Real GDP (% SAAR)						
GDP	1.3	1.8	3.0	1.7	2.3	2.2
Real GDP (Contribution, pp)						
PCE	0.7	1.7	2.1	1.5	1.6	1.5
Gross Investment	6.4	1.3	20.6	0.6	0.9	0.8
Non Residential	10.3	15.7	2.8	0.8	0.8	0.7
Residential	4.2	1.3	11.5	0.0	0.1	0.1
Exports	3.6	4.7	4.3	0.9	0.8	0.9
Imports	1.4	1.2	3.8	-0.8	-0.8	-1.1
Government	-0.9	-0.1	-4.4	-0.4	-0.1	0.1
Unemployment rate (%)	9.0	9.1	8.7	9.0	8.5	8.1
Average Monthly Nonfarm Payroll(k)	130	128	157	152	158	176
CPI						
CPI (YoY%)	3.4%	3.8%	3.3%	3.2	2.3	2.3
Core CPI (YoY%)	1.5%	1.9%	2.2%	1.7	1.9	1.8
Fiscal balance (% GDP)	-	-	-	-8.7	-7.1	-4.6
Current Account (bop, % GDP)	-3.3	-2.9	-	-3.2	-3.1	-3.2
Fed target rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25
S&P Case & Shiller Index	129.8	127.9	125.7	128.2	126.2	125.6
10Yr Treasury (% Yield, average)	3.2	2.4	2.0	2.8	2.3	2.7
US Dollar/ Euro	1.44	1.41	1.35	1.31	1.27	1.30
Oil Prices (dpb)	117.6	113.3	109.5	113.5	99.3	102.8

Source: BBVA Research

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