

U.S. Flash

Baseline Revisions Catapult Romney past President Obama

Mitt Romney will be victorious according to our vote-share model, assuming our revised baseline scenario. Under current conditions, however, opinion polls, options probabilities and our vote-share model suggest Obama has a higher probability of winning. Thus, maintaining the status quo favors Obama whereas deteriorating economic conditions favor Mitt Romney.

- Romney has the upper hand according to our revised baseline**

Romney is favored to win the 2012 according to our vote-share presidential election model. We model presidential election outcomes using seven variables, which represent various aspects of economic activity such as inflation, housing prices, and manufacturing activity. In addition, we include a real time proxy for market volatility and portfolio stability. Of note, our specification does not incorporate individual characteristics or superficial shifts in campaigns, which can be impossible to model. Further, we don't model the share of Electoral College votes, which as in 2000 can produce inconsistent results. Under this specification, Mitt Romney will gain vote share, under our baseline, which anticipates declining ISM, lower volatility, and lower inflation. Moreover given the severe downward correction, the Mitt Romney is projected to win by 4pp (see Table 1).

- Currently Obama is favored in opinion polls, options market probabilities, and our model assuming contemporaneous economic conditions**

The opinion polls and options market probabilities, and our under current conditions models indicate that Obama has a higher probability of being reelected. Currently, manufacturing activity is slightly higher than forecasted and inflation is above our baseline scenario. Intrade probabilities also support president Obama being reelected at a probability of 57.6% (see chart1). Opinion polls offer a similar perspective in that Obama is slightly favored to Romney (+1.5). Thus, current conditions support an Obama reelection.

- Manufacturing, employment key to candidates success or failure**

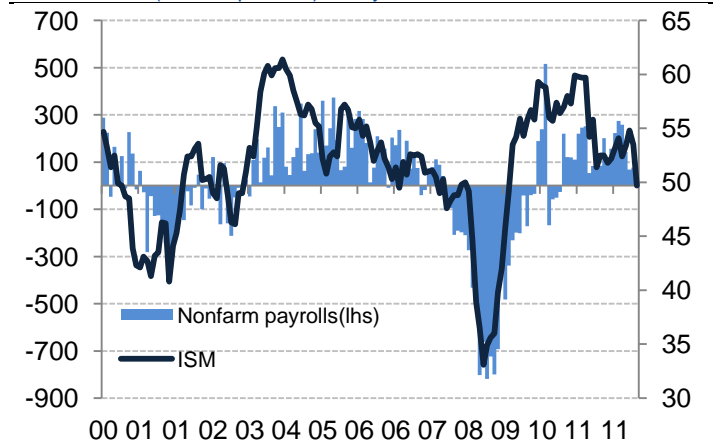
Romney's chances for success will increase insofar as manufacturing activity declines and payrolls continue to slow. Since strong manufacturing activity, which is highly correlated with job growth (chart 2), increases the Democrats' share of the popular vote in our model, deteriorating manufacturing activity will benefit the Republicans. Recently, payroll activity slowed to 75k per month (3mma) and the manufacturing PMI dropped below 50 for the first time in 34 months suggesting economic indicators are pivoting to the downside. In addition, our baseline forecasts now incorporate a more pessimistic view with regard to future activity. The downshift has increased the rhetoric against the President and his unconvincing economic achievements. Ephemeral issues such as gasoline prices and short-term tax policies failed to convince swing voters of the President's ineffectiveness. Now that conditions have and are forecasted to deteriorate, Republicans have additional tools to erode the credibility of the president Obama's economic policies, particularly in key swing-states.

Chart 1
Probability of Obama Winning Election
Implied options probability (%), light blue= volume(k)



Source: BBVA Research & Haver

Chart 2
ISM Manufacturing & Nonfarm Payrolls
Diffusion index(50+= expansion) & Payrolls in K



Source: BBVA Research & Haver

Table 1

Presidential Vote-Share Model(Arrows are relative previous scenario's)

BBVA Compass	Taxes	Portfolio volatility	VIX	Inflation*	House Majority	Home Prices*	ISM	Vote-Share**
<i>Current</i>	↑	↓	↑	↑	↔	↑	↓	49.3%
<i>Baseline (Forecasts)</i>	↓	↔	↔	↓	↔	↑	↓	53.3%

Source: BBVA Research

*Variable is condition to fluctuate with incumbency (0 if no incumbent)

** Represents the predicted Republican share of the popular vote

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