US Weekly Flash

Highlights

- **FOMC Meeting Minutes: Discussions Ignite Over Additional Policy Tools**
  - As mentioned in the meeting statement a few weeks ago, the FOMC revised down their growth outlook in the near-term but remained confident that policy accommodation would prevent a downgrade to activity in the medium-term. The more pessimistic outlook stemmed mostly from a deceleration in consumer spending, deterioration in manufacturing activity, and high uncertainty regarding the fiscal situations in both the U.S. and Europe. In particular, participants blamed slower consumer spending on weak income levels and strained household finances due to continued deleveraging. In terms of the labor market, most FOMC members agree that structural unemployment is not the sole explanation for the current weakness we are seeing. While many argued that excess resource slack should limit inflationary pressures, others noted that they would have expected lower inflation given the estimated size of the output gap. This implies that some participants see potential output as lower than current estimates would suggest. Long-run inflationary concerns are minimal, though the committee did emphasize that food prices could increase temporarily later in the year due to the current drought in the Midwest.
  - The minutes of the latest FOMC meeting underscore the prolonged internal debate among committee members regarding the appropriate response to slow economic activity. Among the various options on the table, FOMC members discussed three policy tools in more detail: additional quantitative easing, extension of the policy guidance, and lowering the interest rate paid on reserves. The internal debate regarding QE3 rages on, with committee members weighing the cost and benefits of such a strategy. Participants in favor of a new large-scale asset purchase program argue that such an action could support a stronger economy via boosted business and consumer confidence as well as downward pressure on interest rates and a general easing in financial conditions. Opponents suggest that such effects would be short-lived. Delving even further into this debate, FOMC members questioned the effectiveness of purchasing Treasury securities compared to Mortgage Backed Securities (MBS). Ultimately, there is little agreement on the matter given that some are worried about the effects on trading conditions in the market.
  - Come September, there may not be enough evidence to sway those opposed to QE3. However, there will be extra time to discuss prior to the meeting at the Jackson Hole Summit toward the end of August. Since last month, economic news has improved slightly and may not be enough to convince the majority of members that immediate action is necessary. Upcoming data on consumer spending for July and employment growth for August could shed additional light on whether economic activity needs a boost from monetary policy or whether it is going to bounce back on its own. In summary, the minutes do not signal for additional quantitative easing but rather a change in policy guidance in September.
- **New Home Sales Continue to Outperform Existing Sales**
  - New home sales increased more than expected in July, reflecting the more optimistic views reported by homebuilders in recent months. Sales increased 3.6%, more than enough to make up for June's decline and drag down supply to the lowest rate of the recovery. Prices declined to the lowest level since January and were likely the primary driver of the boost in sales for the month.
  - On the other hand, sales of existing homes increased 2.3% but remained slightly lower than levels seen earlier in the year. In fact, sales have actually declined more than 3.0% since hitting a 2-year peak in January 2012. Despite constrained supply, median prices of existing homes declined slightly after five consecutive months of gains.
  - Overall, the outlook for housing activity is relatively positive in the sense that we expect these gradual improvements to continue. Limited supply of new homes point to the need for new construction in the near term. In the existing home market, the falling share of distressed sales has contributed to recent gains in prices. As this trend continues, current homeowners will be more likely to sell, ultimately increasing the supply in the market.

Week Ahead

S&P Case-Shiller Home Price Index (June, Tuesday 9:00 ET)

Forecast: -0.05%	Consensus: -0.10%	Previous: -0.66%

Home prices have improved more than expected in recent months, and we expect this trend to continue with the release of the S&P Case-Shiller Index in June. The index jumped significantly in May on a MoM basis but still remains negative in terms of YoY growth. Declining inventory of existing homes has been driving up prices, which is a good sign for homeowners who are waiting for the right time to sell. In June, the median price of existing homes increased more than 5% from the previous month. Looking forward, our baseline scenario assumes positive YoY growth beginning in 3Q12 onward given the encouraging shift in housing activity.

Consumer Confidence (August, Tuesday 10:00 ET)

Forecast: 65.5	Consensus: 65.9	Previous: 65.9

Consumer confidence is expected to remain almost flat in August following several months of less-than-exciting indicators. The overall confidence index was driven mostly by a jump in consumer expectations in July, pointing to a slightly more optimistic outlook on the employment situation. On the other hand, the view on current conditions has remained weak. Jobless claims data signal a slight improvement in labor market conditions in August, which should help lift this component of the index with potentially fewer consumers feeling that jobs are hard to get. Still, uncertainty regarding future income will continue to weigh on home buying and other big-purchase plans in the coming months.

GDP, Second Estimate (2Q12, Wednesday 8:30 ET)

Forecast: 1.6%	Consensus: 1.7%	Previous: 1.5%

The second estimate of GDP growth for 2Q12 is likely to show a slight upward revision due to some better-than-expected data released for the end of the quarter. Most importantly, the trade deficit in June narrowed to the lowest level since December 2010, reflecting an increase in exports for the second consecutive month. Imports declined throughout the entire quarter which should help GDP but point to an uncertain future in terms of domestic demand conditions. Personal consumption expenditures remained weak in June, declining 0.1% in real terms, which may offset some of the positive influence from trade data. Finally, business inventories increased slightly less than expected in June, with no revision to the previous months, but should remain relatively neutral in terms of the contribution to a revision in GDP.

Personal Income and Outlays (July, Thursday 8:30 ET)

Forecast: 0.2%, 0.4%	Consensus: 0.3%, 0.5%	Previous: 0.5%, 0.0%

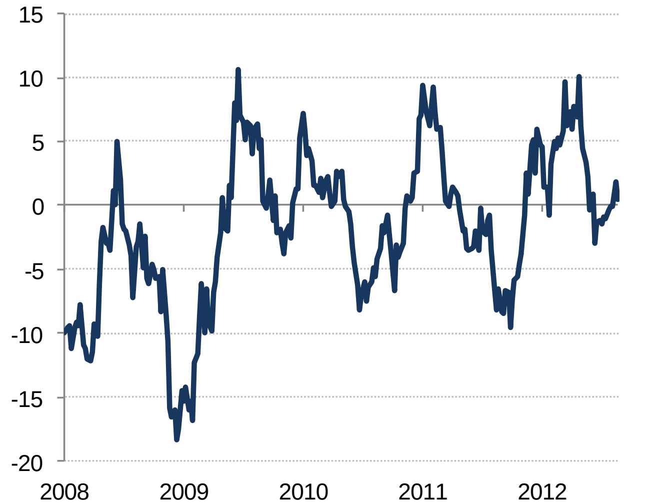
Data on personal income and outlays are expected to show positive monthly growth in July, reflecting a modest rebound in consumer activity. Consumer spirits are slightly brighter, but now gas prices are rising again and the unemployment rate has jumped back up to 8.3%, suggesting that the optimism may be short-lived. Personal income has grown in recent months, up 0.5% in June, but a deceleration in average earnings in July points to a weaker contribution to income from the wages and salaries component. Improvements in household finances have not boosted personal consumption expenditures, which declined in May and were flat in June. However, a jump in retail sales for July suggests that personal outlays will improve at least slightly upon prior weakness. Given that inflation was flat in July, growth should also be positive in real terms.

Market Impact

Markets will focus mostly on the second GDP estimate this week, but even a slight upward revision would do little to improve overall sentiments. Following the FOMC’s latest meeting minutes and slightly better macroeconomic indicators, the possibility of a QE3 announcement in September has declined. Stable trends or even modest improvements in the data throughout the next few weeks should reduce market expectations for this specific policy from the Fed.

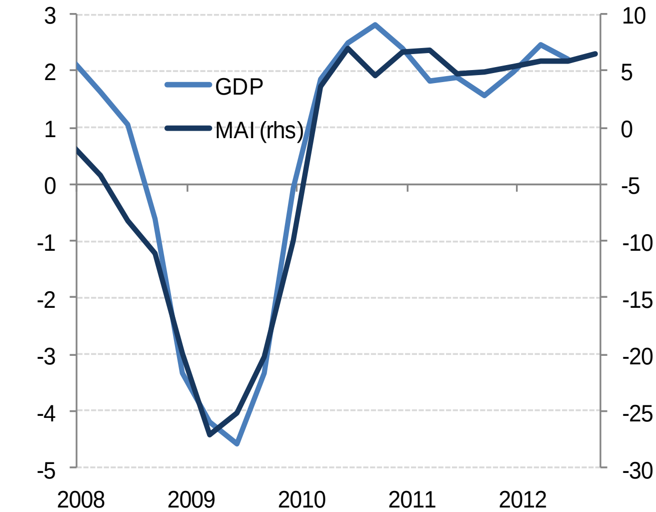
Economic Trends

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



Source: BBVA Research

Graph 4
BBVA US Monthly Activity Index & Real GDP (4Q % change)

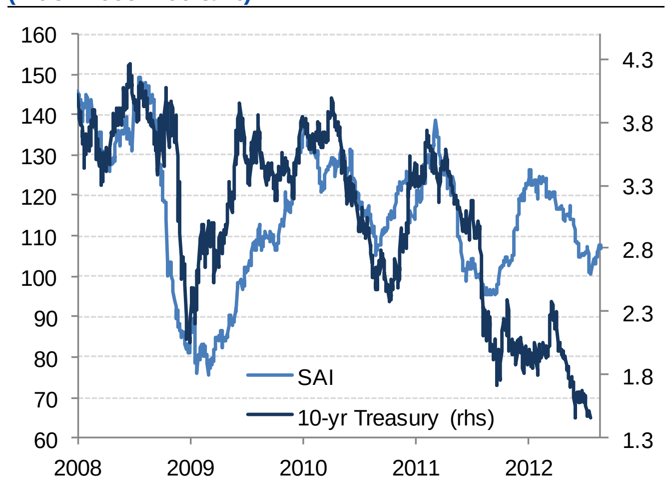


Source: BBVA Research & BEA

Graph 5
BBVA US Surprise Inflation Index (Index 2009=100)

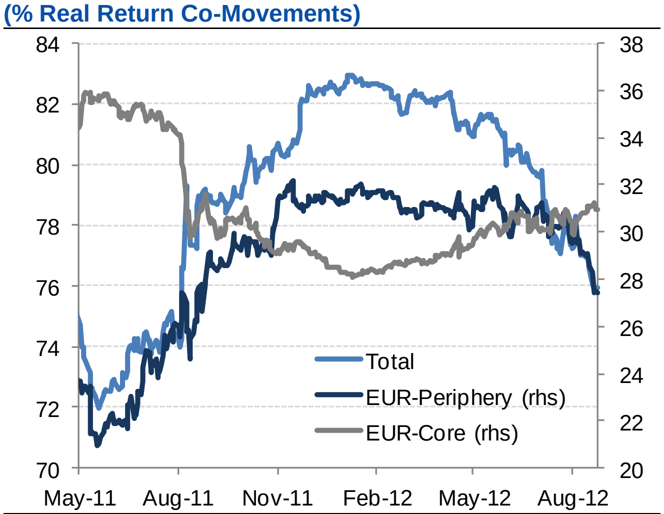
Source: BBVA Research

Graph 6
BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)



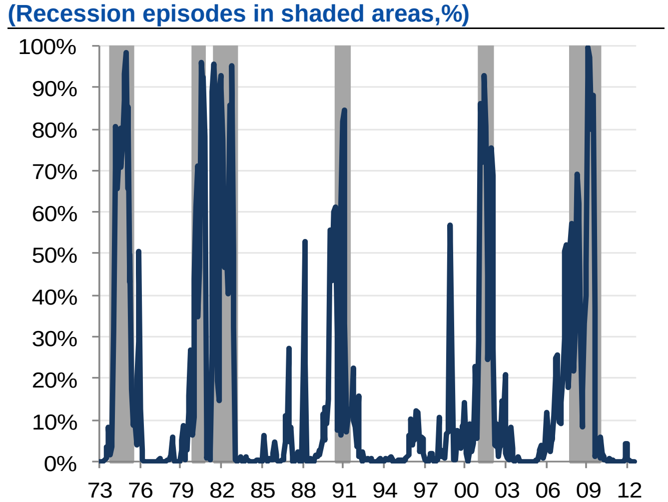
Source: Bloomberg & BBVA Research

Graph 7
Equity Spillover Impact on US (% Real Return Co-Movements)



Source: BBVA Research

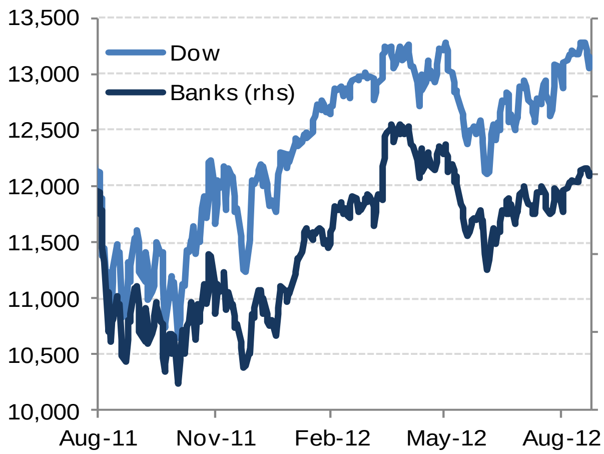
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas,%)



Source: BBVA Research

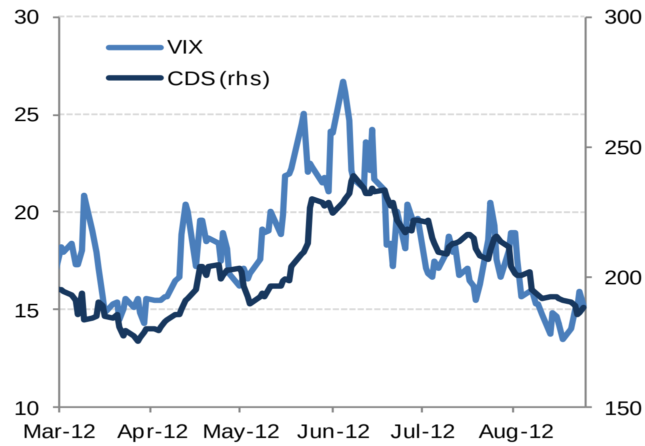
Financial Markets

Graph 9
Stocks
(Index, KBW)



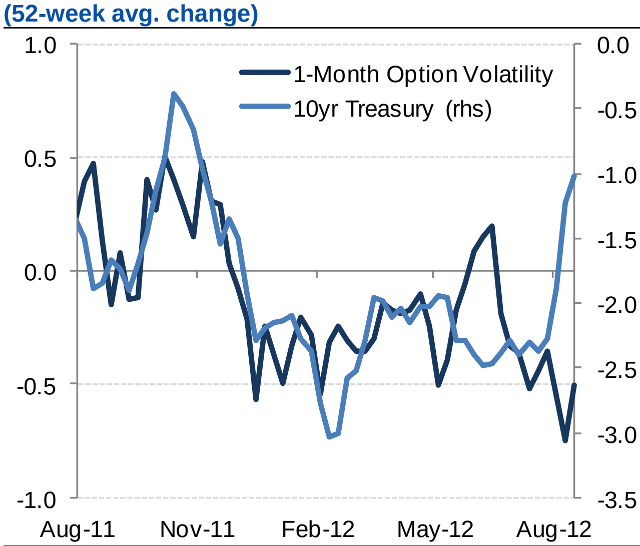
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



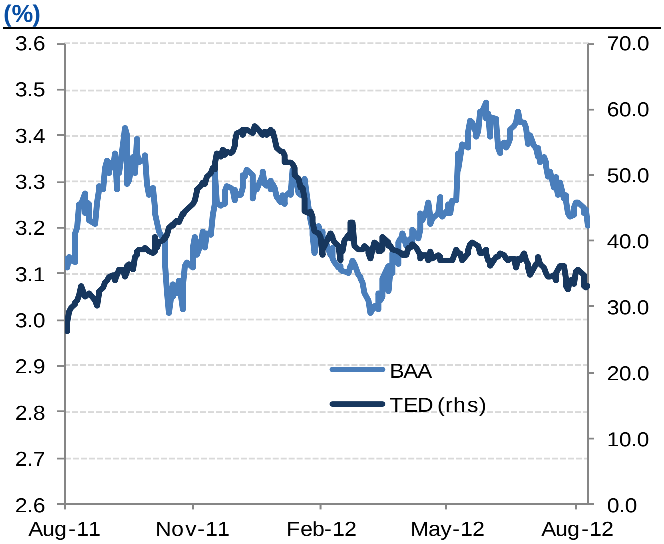
Source: Bloomberg & BBVA Research

Graph 11
Option Volatility & Real Treasury
(52-week avg. change)



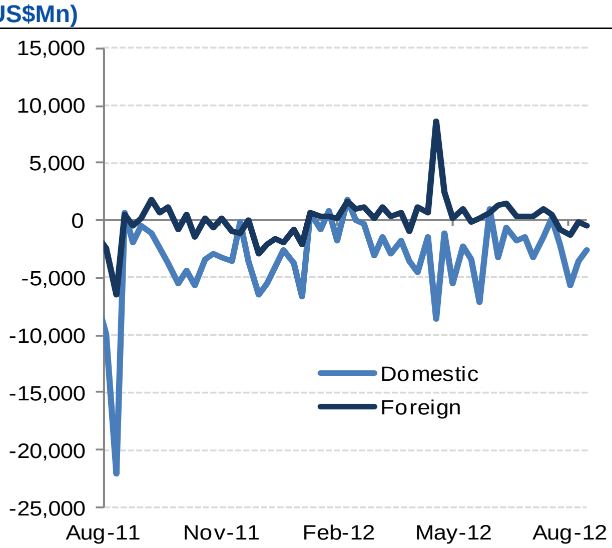
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



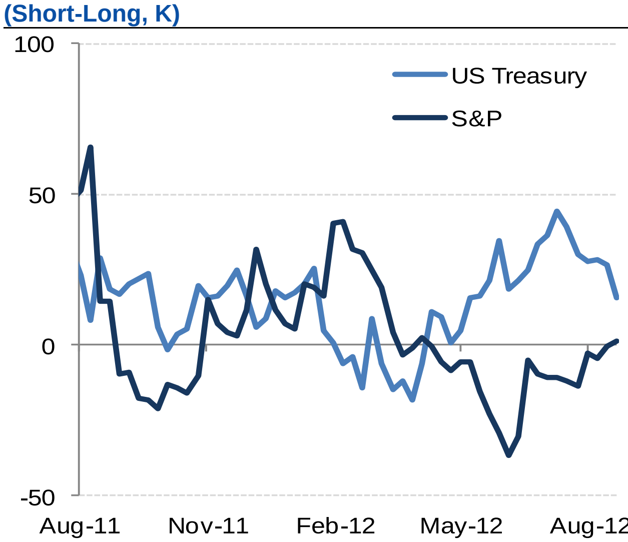
Source: Bloomberg & BBVA Research

Graph 13
Long-Term Mutual Fund Flows
(US$Mn)



Source: Haver Analytics & BBVA Research

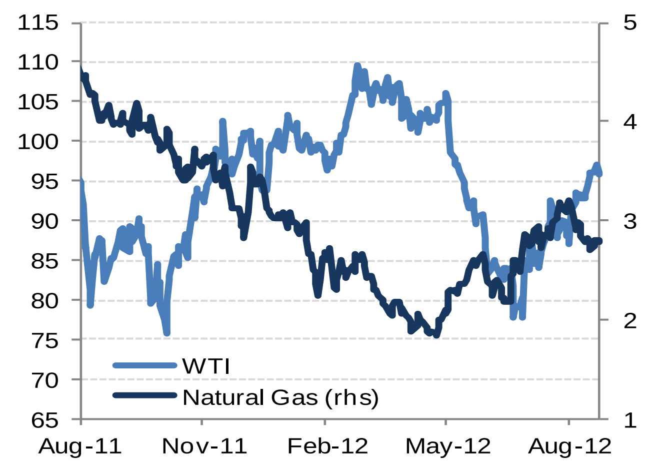
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

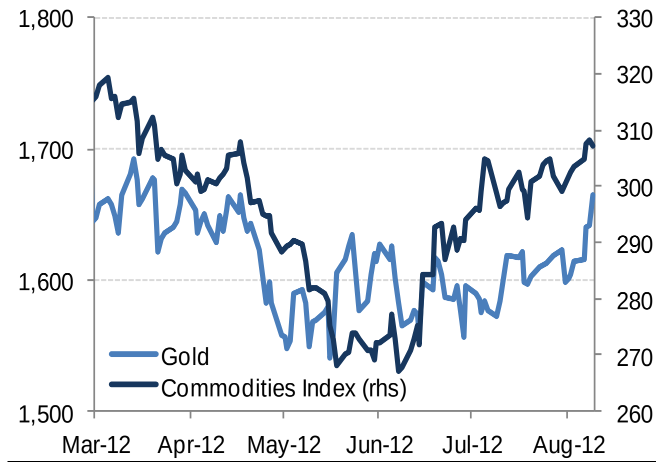
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



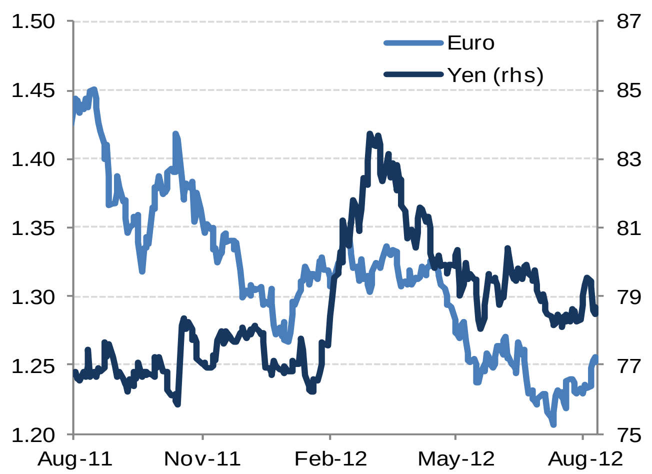
Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
(US$ & Index)



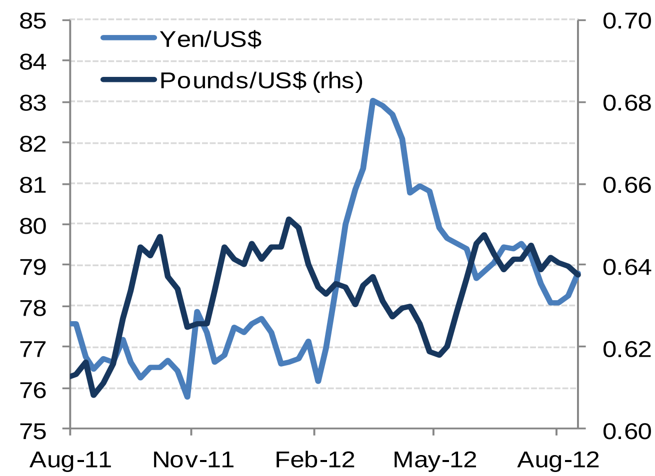
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



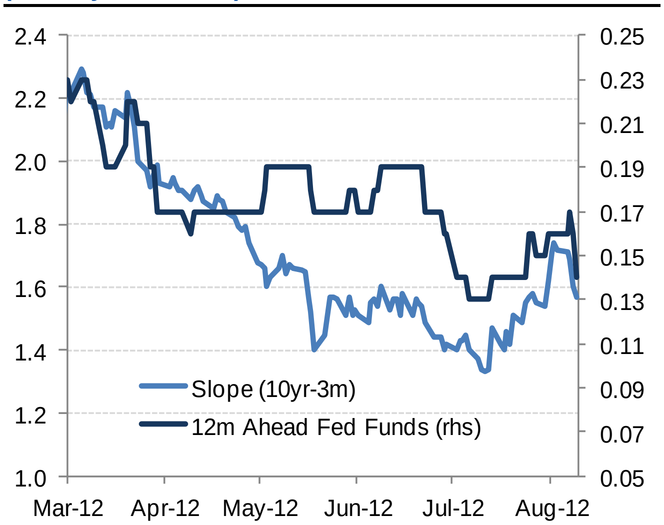
Source: Bloomberg & BBVA Research

Graph 18
6-Month Forward Exchange Rates
(Yen & Pound / US$)



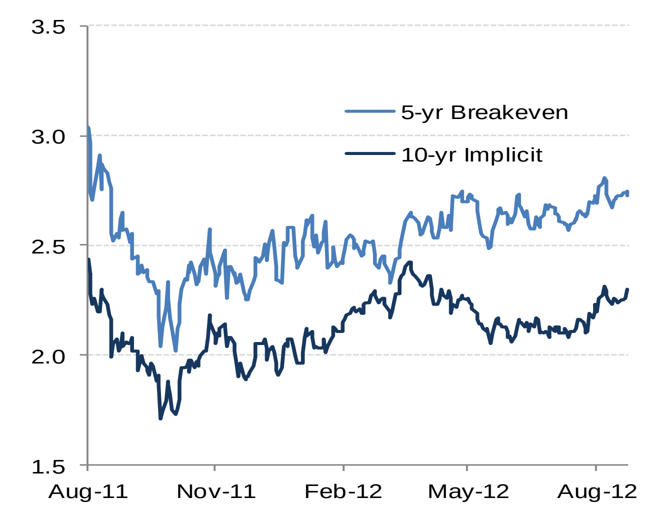
Source: Haver Analytics & BBVA Research

Graph 19
Fed Futures & Yield Curve Slope
(% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 20
Inflation Expectations
(%)



Source: Bloomberg & BBVA Research

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)	14.10	14.10	14.10	13.78
New Auto (36-months)	2.93	2.93	3.01	4.39
Heloc Loan 30K	5.47	5.46	5.42	5.50
5/1 ARM *	2.80	2.76	2.74	3.07
15-year Fixed Mortgage *	2.89	2.88	2.80	3.44
30-year Fixed Mortgage *	3.66	3.62	3.49	4.22
Money Market	0.52	0.52	0.53	0.57
2-year CD	0.86	0.86	0.87	1.00

*Freddie Mac National Mortgage Homeowner Commitment US
Source: Bloomberg & BBVA Research

Table 1
Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
1M Fed	0.13	0.13	0.14	0.09
3M Libor	0.42	0.43	0.45	0.32
6M Libor	0.71	0.72	0.72	0.48
12M Libor	1.04	1.04	1.06	0.80
2yr Sw ap	0.45	0.50	0.44	0.50
5yr Sw ap	0.90	1.00	0.85	1.25
10Yr Sw ap	1.79	1.92	1.67	2.36
30yr Sw ap	2.58	2.71	2.40	3.19
7day CP	0.36	0.20	0.36	0.31
30day CP	0.42	0.20	0.37	0.25
60day CP	0.54	0.24	0.39	0.27
90day CP	0.52	0.29	0.42	0.32

Source: Bloomberg & BBVA Research

Quote of the Week

James Bullard, St. Louis Federal Reserve President
U.S. Fed's Bullard plays down offs of imminent easing
23 August 2012

"I do think that the minutes are a bit stale because we have some data since then that has been somewhat stronger. If we were to resume, which I think we will, 2 percent growth, maybe a bit stronger than that, unemployment ticks down ... that is not a great outcome, but to me that is a good enough outcome to keep us on hold. The tone of the discussions, for me anyway, was 'gosh things are not as good as we thought and it if continues to decelerate here, we're going to have to do something.' Going along at this slow pace is not enough to justify gigantic action. I'd like to see...some deterioration or indication we're going to slide down further."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
27-Aug	Dallas Fed Manufacturing Survey	AUG	-7.00	-7.00	-13.20
28-Aug	S&P Case-Shiller HPI (YoY)	JUNE	-0.05%	-0.10%	-0.66%
28-Aug	Consumer Confidence	AUG	65.50	65.90	65.90
29-Aug	GDP QoQ Annualized	2Q12 P	1.60%	1.70%	1.50%
29-Aug	Personal Consumption	2Q12 P	1.50%	1.50%	1.50%
29-Aug	GDP Price Index	2Q12 P	1.60%	1.60%	1.60%
29-Aug	Core PCE QoQ	2Q12 P	1.80%	1.80%	1.80%
29-Aug	Pending Home Sales (MoM)	JULY	1.00%	1.00%	-1.40%
30-Aug	Initial Jobless Claims	25-Aug	367K	370K	372K
30-Aug	Continuing Claims	18-Aug	3305K	3306K	3317K
30-Aug	Personal Income (MoM)	JULY	0.20%	0.30%	0.50%
30-Aug	Personal Spending (MoM)	JULY	0.40%	0.50%	0.00%
31-Aug	Chicago PMI	AUG	53.50	53.50	53.70
31-Aug	U. of Michigan Consumer Sentiment	AUG	73.80	73.60	73.60
31-Aug	Factory Orders	JULY	0.8%	1.5%	-0.5%

Forecasts

	2011	2012	2013	2014
Real GDP (% SAAR)	**1.8**	2.1	1.8	2.3
CPI (YoY %)	**3.2**	2.0	1.9	2.3
CPI Core (YoY %)	**1.7**	2.1	1.8	1.9
Unemployment Rate (%)	**9.0**	8.2	8.1	7.6
Fed Target Rate (eop, %)	**0.25**	0.25	0.25	0.50
10Yr Treasury (eop, % Yield)	**2.0**	2.1	2.6	3.0
US Dollar/ Euro (eop)	**1.31**	1.23	1.31	1.31

Note: Bold numbers reflect actual data

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