

Economic Watch

US

Houston, September 11, 2013
Economic Analysis

US

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Monthly US Outlook: September Fiscal and Monetary Policy Take Center Stage

- September/October deadline for sequestration and debt ceiling debates
- Despite uncertainty in economic data, Fed is likely to announce tapering
- Growth forecast for 2013 unchanged at 1.8%, but with downward bias

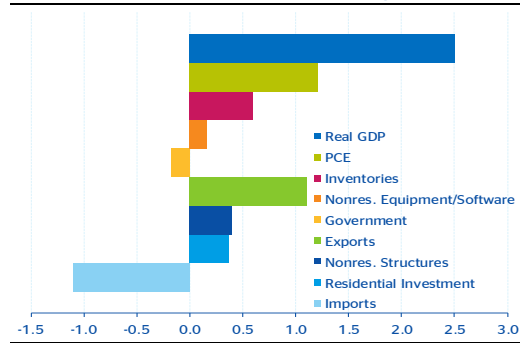
Since the beginning of the year, September has been built up as a critical month for both fiscal and monetary policy. The sequestration and debt ceiling debates ([see our latest brief](#)) are reemerging as the FY'13 deadline approaches, though expectations are low for discussions to go through without a hitch. While the impact from the sequestration has been lower than originally predicted, long-run fiscal sustainability remains vulnerable. In a separate but related dispute, failure to authorize an increase in the debt ceiling will likely roil treasury and equity markets, with high levels of policy uncertainty creating economic headwinds in an already slow-growth environment. Estimates suggest that the U.S. Treasury will officially be unable to pay its debts sometime between October 18th and November 5th. Given the serious threat of a credit rating downgrade and a government shutdown, we expect that policymakers will eventually agree to raise the debt ceiling yet again, though a last-second agreement is by no means out of the question.

At the same time, we expect that the Fed will announce QE3 tapering mid-month. Monetary policy expectations have been heightened since the market "overreaction" back in June, and it seems that uncertainty is still high as to how the Fed will proceed. Recent economic data have rendered mixed sentiments, in particular related to this eventual tapering of QE3. Employment and inflation, the two most heavily watched indicators for monetary policy accommodation, do not show significant improvement from earlier this year. Nonfarm payroll growth has averaged only 137K per month so far in 3Q13, much lower than the 207K in 1Q and 182K in 2Q. The unemployment rate has moved much closer to the FOMC's suggested threshold, reaching 7.3% in August, but the continued declines in labor force participation and other underlying dynamics suggest a much less positive employment situation. Wage growth remains subdued and is not expected to put significant pressure on inflation for the next few years. Overall deflationary concerns are subsiding, though core PCE inflation still remains well below the Fed's 2% threshold and is supportive of continued monetary policy accommodation. In general, delaying any tapering announcement would ultimately increase the cost of QE3, decrease the Fed's credibility, and certainly increase financial market volatility ([see our latest Fed Watch](#)).

Considering that economic data has not shifted significantly in either direction, we maintain our baseline projection for 1.8% annual growth in 2013, with further acceleration above 2.0% in 2014. However, given the potential headwinds from a disruption in fiscal and/or monetary policy, there is downward bias to our short-term forecast. Furthermore, initial readings for real personal consumption expenditures were flat to start 3Q13, which suggests a slower quarterly pace of growth than originally predicted. Still, consumption tends to be stronger as the second half of the year gets underway, with a big push from back-to-school and then holiday shopping. Unfortunately, though, if current consumption and investment trends continue to tilt to the downside, a downward revision to our forecast is not unlikely.

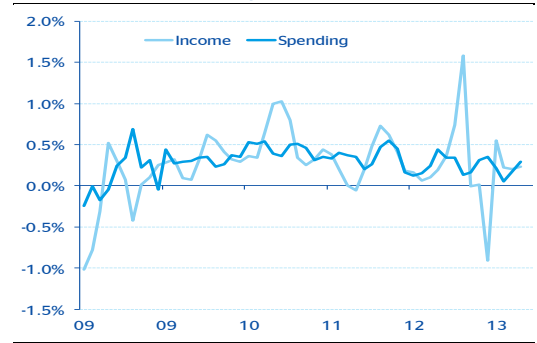
Economic Indicators

Graph 1
Contributions to Real GDP Growth
(2Q13 Preliminary, SAAR Percentage Points)



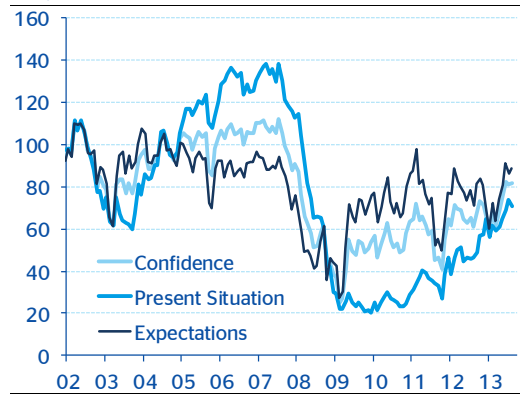
Source: BEA and BBVA Research

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



Source: BEA and BBVA Research

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



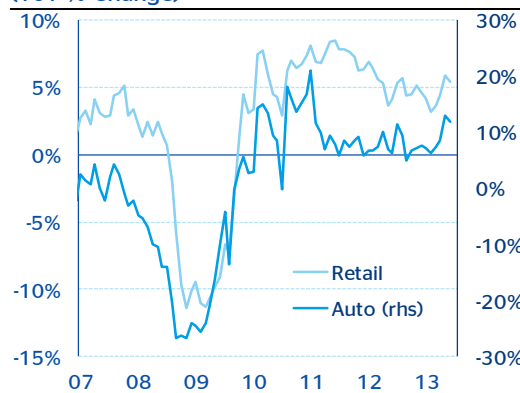
Source: Conference Board and BBVA Research

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



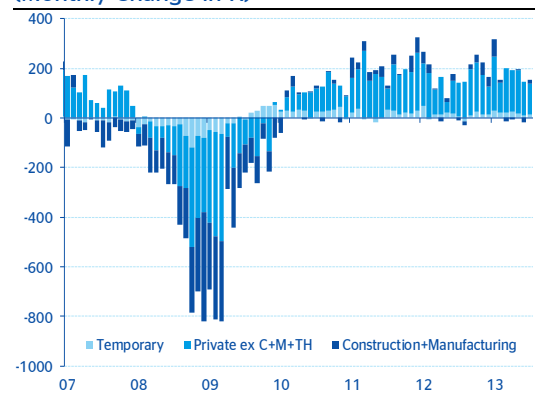
Source: ISM and BBVA Research

Graph 5
Retail and Auto Sales
(YoY % Change)



Source: US Census Bureau and BBVA Research

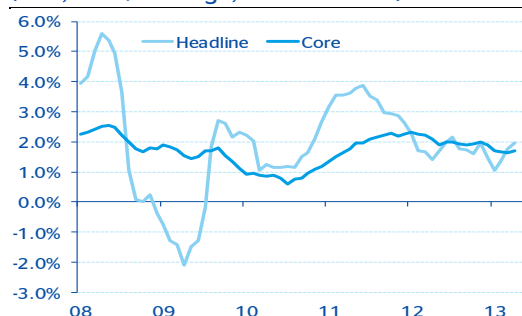
Graph 6
Private Nonfarm Payrolls
(Monthly Change in K)



Source: BLS and BBVA Research

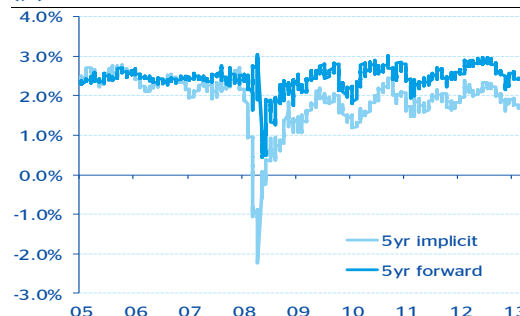
Economic Indicators

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



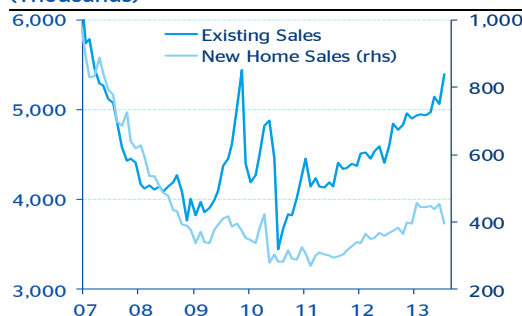
Source: BLS and BBVA Research

Graph 8
Inflation Expectations
(%)



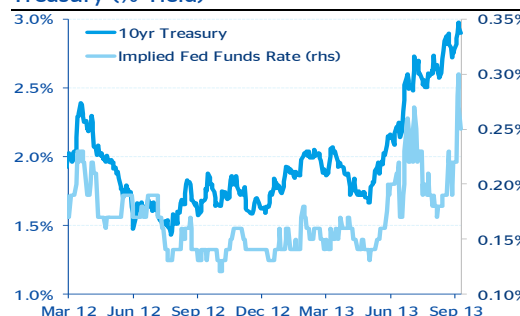
Source: Federal Reserve Board and BBVA Research

Graph 9
New and Existing Home Sales
(Thousands)



Source: US Census Bureau, NAR, and BBVA Research

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



Source: Federal Reserve Board and BBVA Research

Table 1
Forecasts (BOLD=FORECASTS)

	3Q12	4Q12	1Q13	2Q13	2011	2012	2013	2014	2015	2016
Real GDP (% SAAR)	2.8	0.1	1.1	2.5	1.8	2.8	1.8	2.3	2.5	2.8
Real GDP (Contribution, pp)										
PCE	1.2	1.1	1.5	1.2	1.7	1.5	1.3	1.0	1.0	1.2
Gross Investment	1.0	-0.4	0.7	1.5	0.7	1.4	0.7	1.0	1.0	1.1
Non Residential	0.0	1.1	-0.6	0.5	0.8	0.9	0.4	0.7	0.8	0.9
Residential	0.4	0.5	0.3	0.4	0.0	0.3	0.4	0.3	0.2	0.3
Exports	0.1	0.2	-0.2	1.1	0.9	0.5	0.4	0.9	0.9	0.8
Imports	-0.1	0.5	-0.1	-1.1	-0.8	-0.4	0.3	0.6	0.5	0.3
Government	0.7	-1.3	-0.8	-0.2	-0.7	-0.2	-0.4	0.0	0.0	0.0
Unemployment Rate (% average)	8.0	7.8	7.7	7.6	8.9	8.1	7.5	7.0	6.4	5.9
Average Monthly Nonfarm Payroll (K)	152	209	207	182	175	183	186	196	211	230
CPI (YoY %)	1.7	1.9	1.7	1.4	3.1	2.1	1.6	2.2	2.4	2.4
Core CPI (YoY %)	2.0	1.9	1.9	1.7	1.7	2.1	1.9	2.0	2.2	2.3
Fiscal Balance (% GDP)	-	-	-	-	-8.3	-6.8	-4.0	-3.4	-2.2	-2.4
Current Account (bop, % GDP)	-2.7	-2.6	-2.7	-	-3.0	-2.8	-2.6	-2.8	-2.7	-2.4
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.50
S&P Case-Shiller Index (YoY %)	3.62	7.30	10.11	-	-4.36	2.76	11.96	9.25	6.86	5.78
10-Yr Treasury (% Yield, eop)	1.72	1.72	1.96	2.30	1.98	1.72	2.90	3.28	3.64	4.03
U.S. Dollar / Euro (eop)	1.29	1.31	1.30	1.32	1.32	1.31	1.30	1.30	1.35	1.36
Brent Oil Prices (dpp, average)	109.7	110.3	112.6	102.7	111.3	111.7	107.6	112.9	119.0	120.1

Source: BBVA Research

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