

# U.S. Economic Outlook

## Monthly Update

April 15, 2015

# Meeting Details

**Topic: U.S. Economic Outlook**

**Date: Wednesday, April 15, 2015**

**Time: 10:00 am, Central Standard Time (Chicago, GMT-06:00)**

**Meeting Number / Access Code: 716 890 870**

**Meeting Password: bbva1234**

**To join the online meeting:**

<https://bbvacompass.webex.com/bbvacompass/j.php?MTID=me51336d1ba0e043a2b41f555c8f5b9ce>

**To join the audio conference only:**

**Call-in toll-free number (US/Canada): 1-877-768-4036**

**Call-in toll number (US/Canada): 1-972-932-2100**

**Global call-in numbers:**

<https://bbvacompass.webex.com/bbvacompass/globalcallin.php?serviceType=MC&ED=187370482&tollFree=1>

# Discussion

## GDP

Offsetting weak growth in 1Q15

- Slow start to 2015 reveals weaknesses other than weather
- 2Q-4Q growth at ~3.5% in order to reach 2.9% annual
- Domestic consumption offsetting slow global demand, pending further rapid USD appreciation

## Inflation

Prolonged period of low inflation

- Oil prices have stabilized somewhat, holding at low levels
- Headline CPI inflation in negative YoY territory to start 2015
- Core inflation not likely to reach 2.0% target until 2017 or later

## Fed

So close and yet so far

- Downside risks pushing down probability for June hike
- Lift off date remains unchanged at September
- FOMC has brought down expectations for pace of normalization closer to BBVA projections

## Interest Rates

Low yields for a prolonged period

- Flatter yield curve slope - flight to safety, falling inflation expectations, carry trade, etc.
- Yield curve could flatten significantly after first rate hike
- More moderate future increases in long-term rates

## Risks

Tilted toward global threats

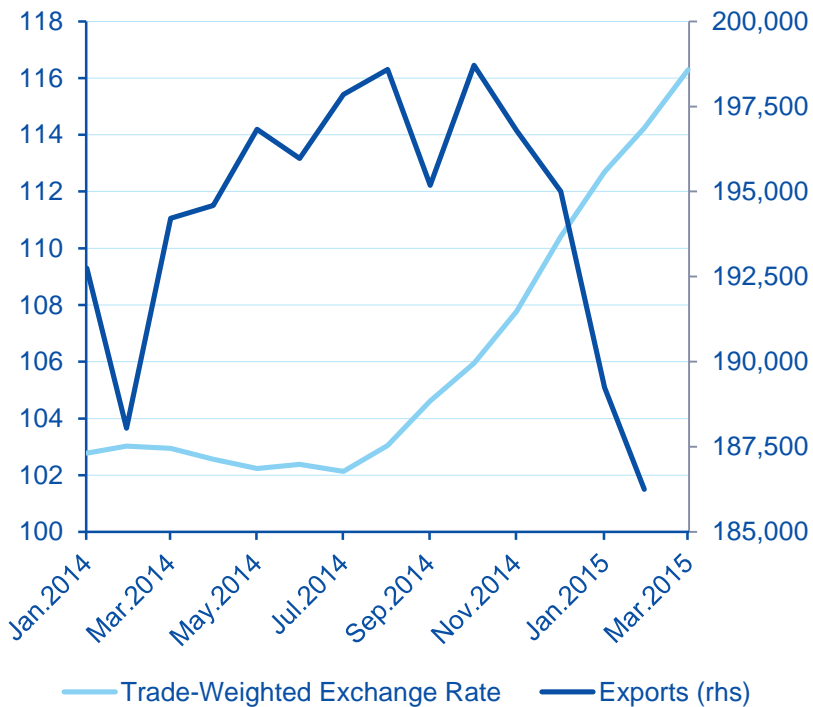
- Domestic: steep disinflation, financial overheating, Fed exit strategy, political brinkmanship, regional shocks (Texas)
- Global: Slowdown in EM, deflation/recession Europe, financial volatility, geopolitical threats, etc.

# Economic Surprises

## Accounting for the faster-than-expected appreciation/depreciation of USD/oil prices

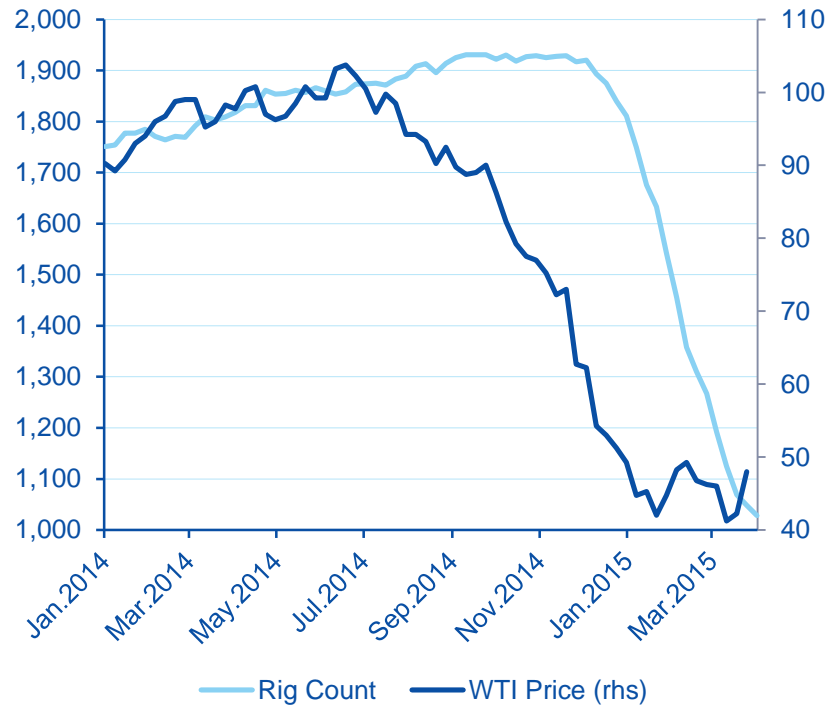
USD Exchange Rate and Exports

Index Jan-97=100, SA Mil.\$



Rig Count and WTI Price

Units, \$/Barrel

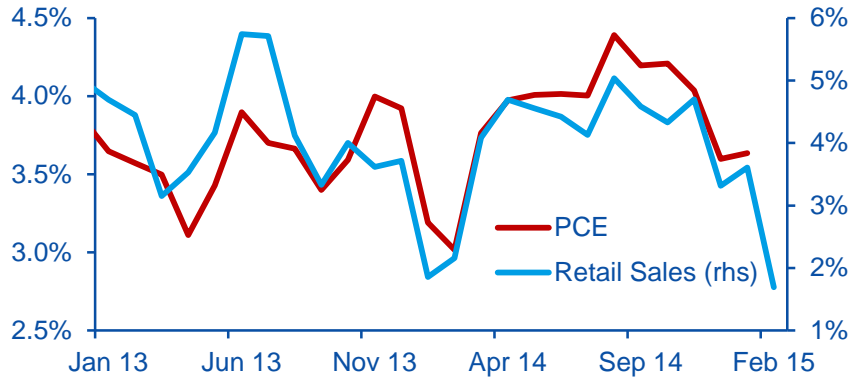


# Economic Activity

## Recent data confirm brief weather-related slowdown in 1Q15

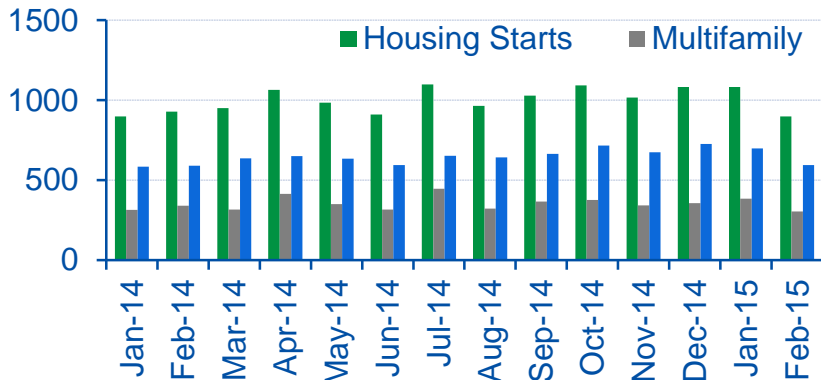
### Personal Consumption Expenditures & Retail Sales

YoY% Change



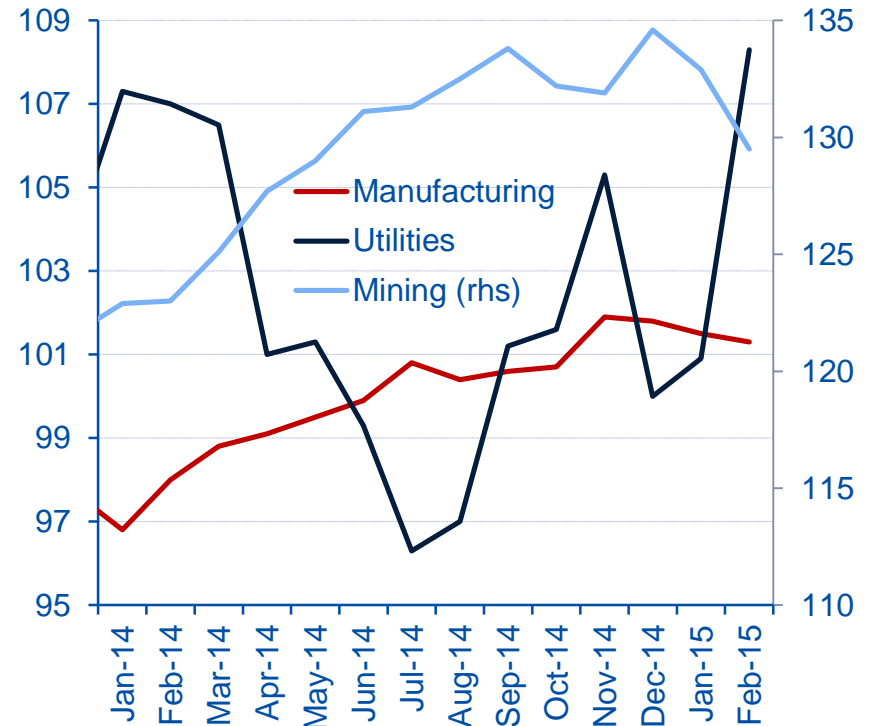
### Housing Starts

SAAR, Thousands



### Industrial Production Components

SA, 2007=100

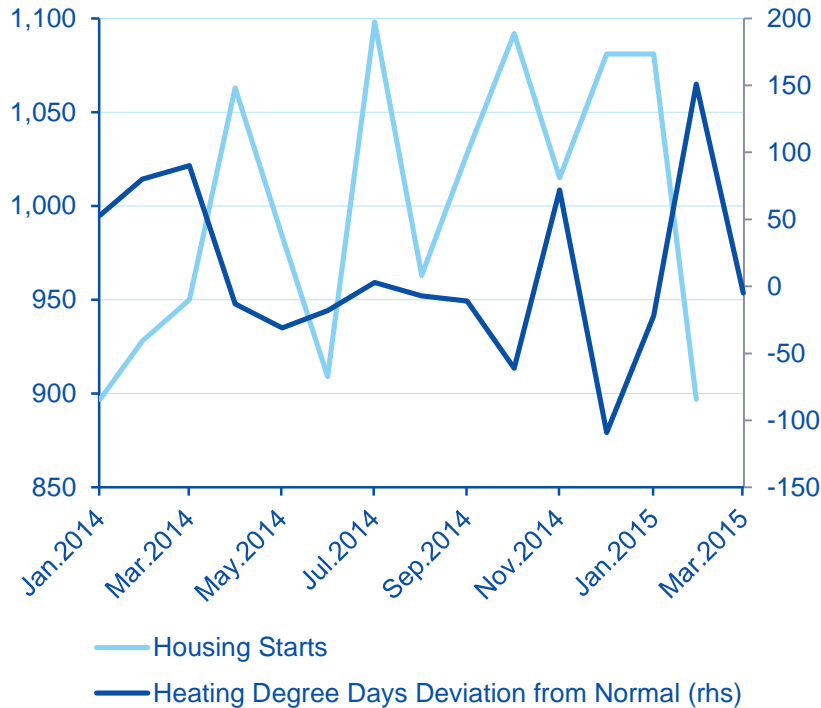


# Economic Activity

Bad weather is only one piece of the puzzle holding back growth in 1Q15

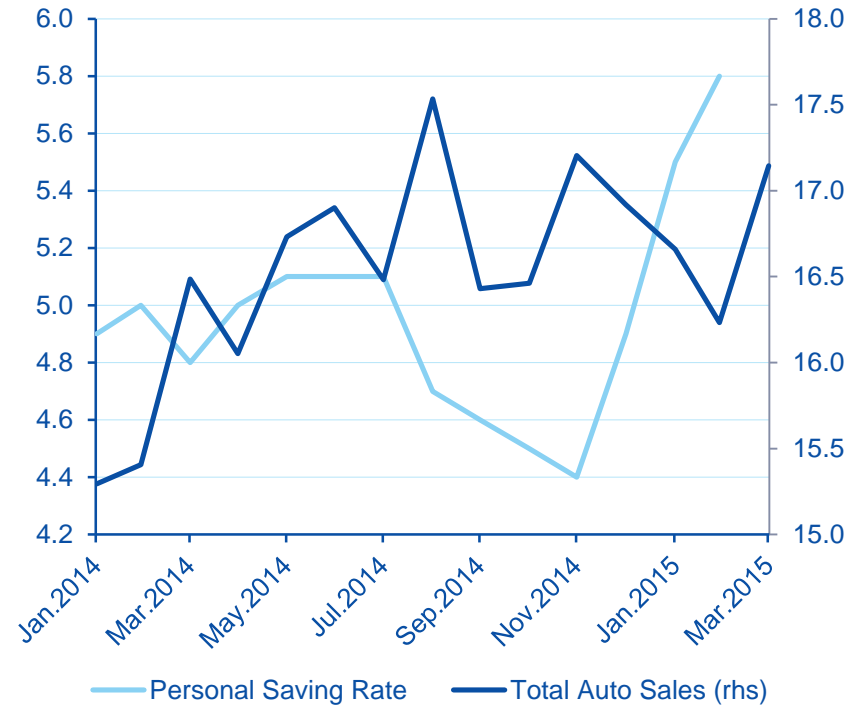
Weather and Housing Starts

Days, SAAR Thousand Units



Personal Saving Rate and Auto Sales

%, SAAR Million Units

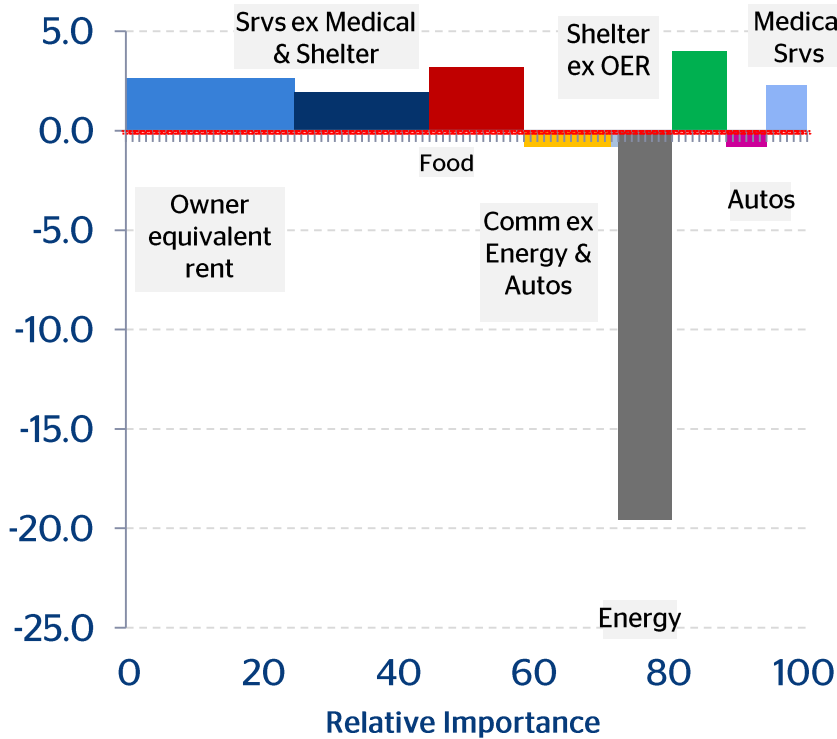


# Inflation

## Further declines in energy prices and tradables

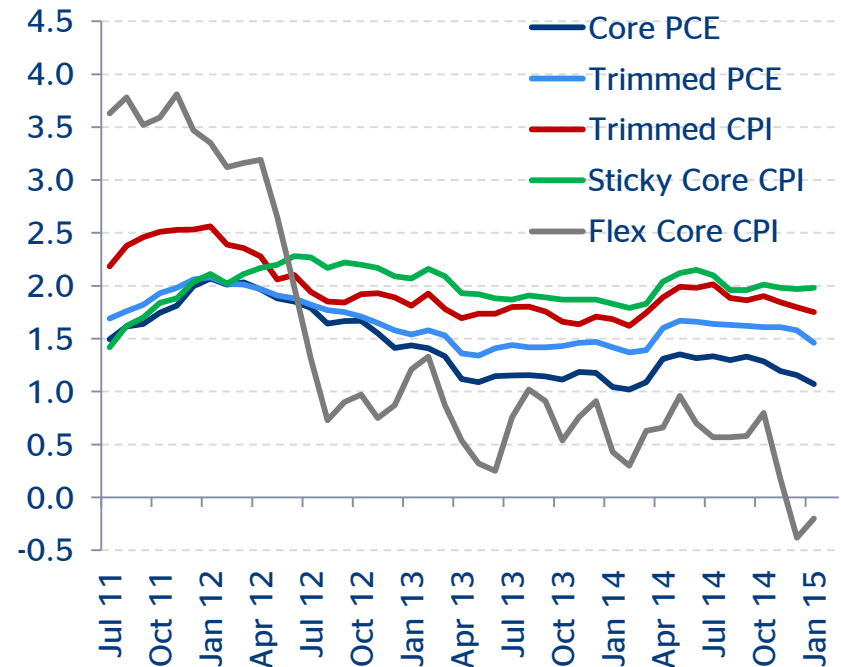
### Contributions to CPI

Relative Importance & 12m% change



### Inflation

12m % change



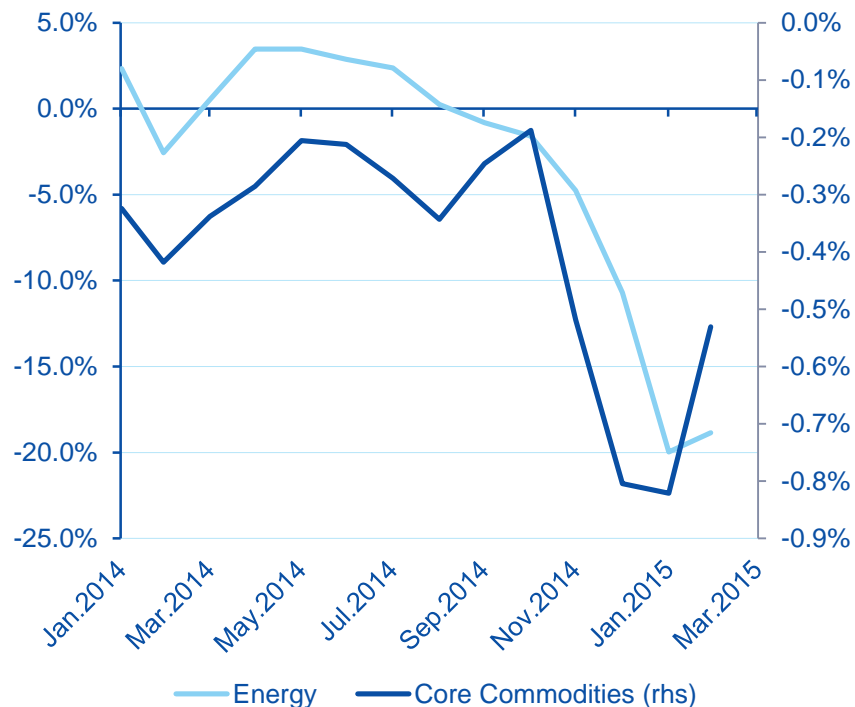
Source: BBVA Research / Haver Analytics

# Signs of Pass-Through to Core?

No immediate influence on core inflation, but the impacts could be lagged

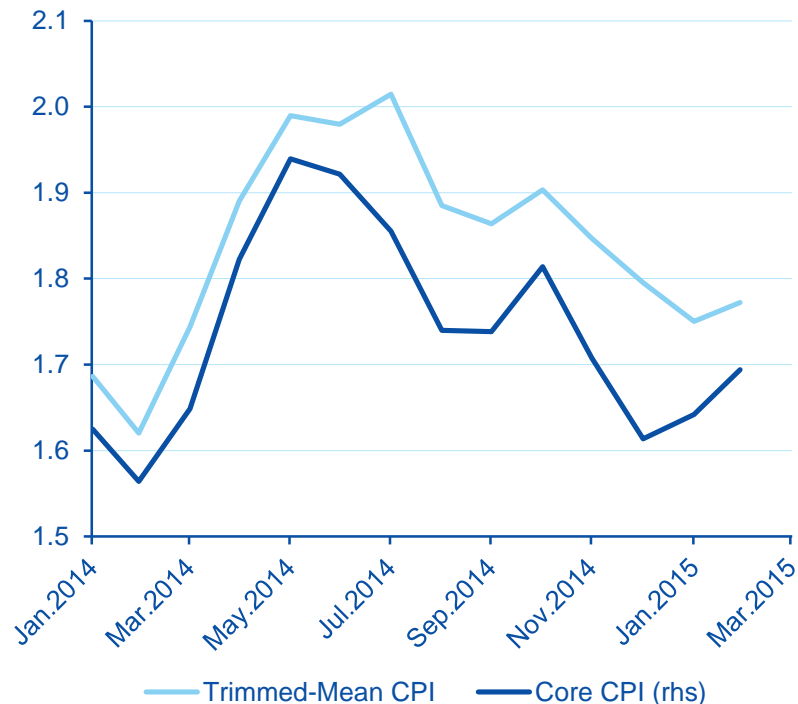
Energy and Core Commodity Prices

YoY % Change



Trimmed-Mean and Core CPI

YoY % Change





# FOMC

## Meeting-by-meeting approach to normalization

### FOMC Minutes: March 18<sup>th</sup> 2015

- Fed drops “patient” from forward guidance, but this **“doesn’t mean we are going to be impatient”**
- FOMC signals “meeting-by-meeting” approach, implying that the first rate hike is “unlikely” at the April meeting
- Yellen: “If conditions do evolve in the manner that most of my FOMC colleagues and I anticipate, I would expect the level of the federal funds rate to be normalised only gradually, reflecting the gradual diminution of headwinds from the financial crisis and the balance of risks I have enumerated of moving either too slowly or too quickly.”

### What do we expect?

- Monetary policy actions remain data-dependent
- The probability of an early rate hike in June has declined significantly given slow activity in 1Q15
- Downward pressures on prices, lack of broad-based acceleration in wages, and “deterioration in the foreign economic situation” may heighten concerns
- Reinvestments policy to end after the ZLB lift-off “looks sustainable”
- Further discussion on normalization tools (ON RRP, IOER) and timing

### 1<sup>st</sup> Rate increase

**Sept – 2015**

**Maintaining the 3Q15 baseline**

**Fed**

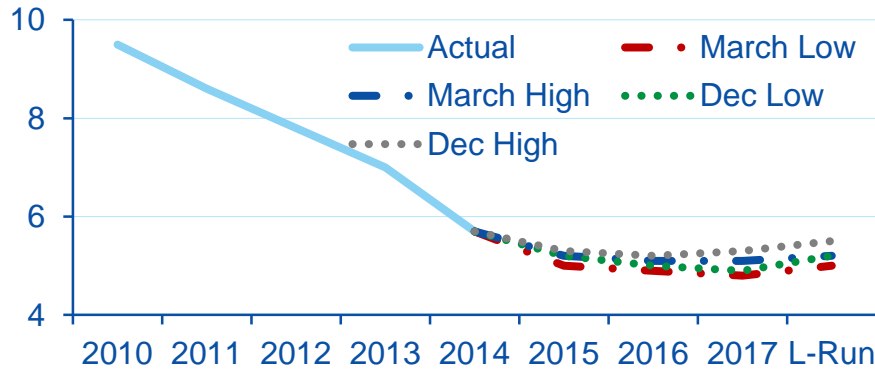
**Timeline Exit Strategy**



# Monetary Policy

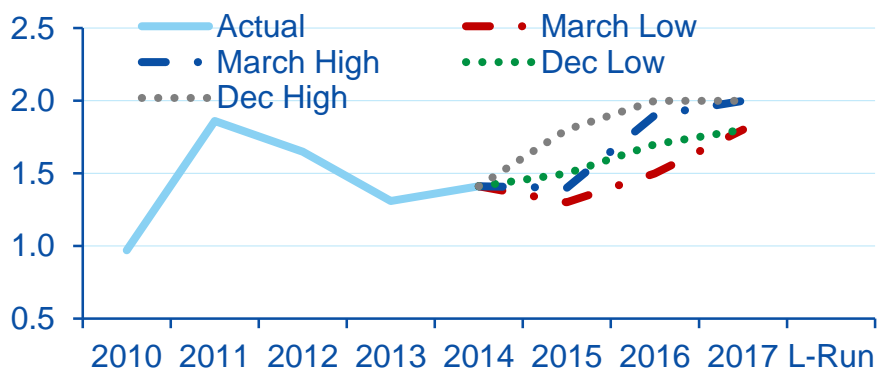
## Unemployment Rate, 4Q %

Central Tendency



## Core PCE Inflation, 4Q % Change

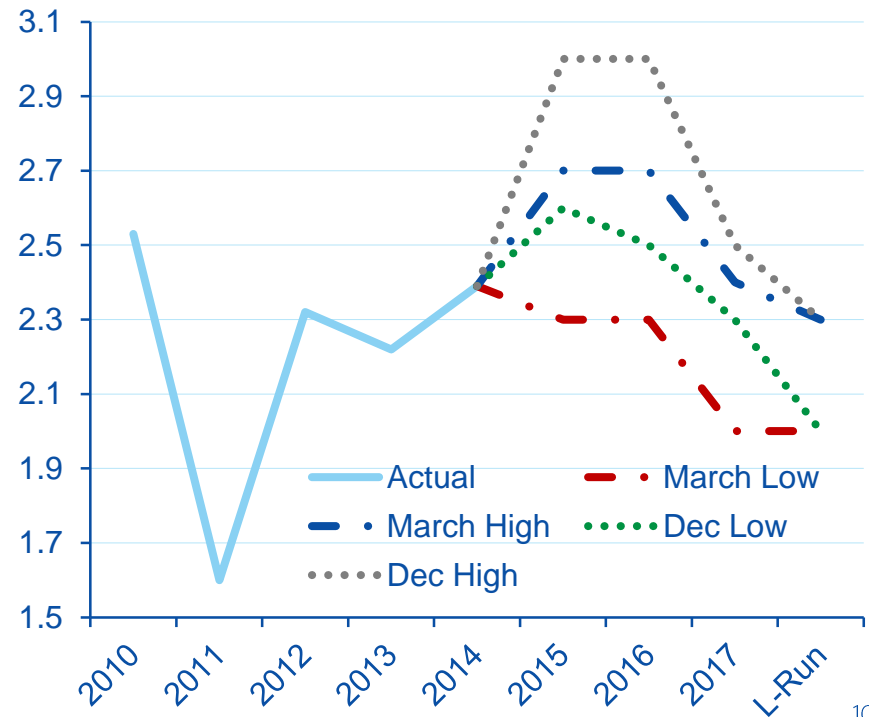
Central Tendency



## Downward revision to FOMC growth outlook

### Change in Real GDP, 4Q % Change

Central Tendency

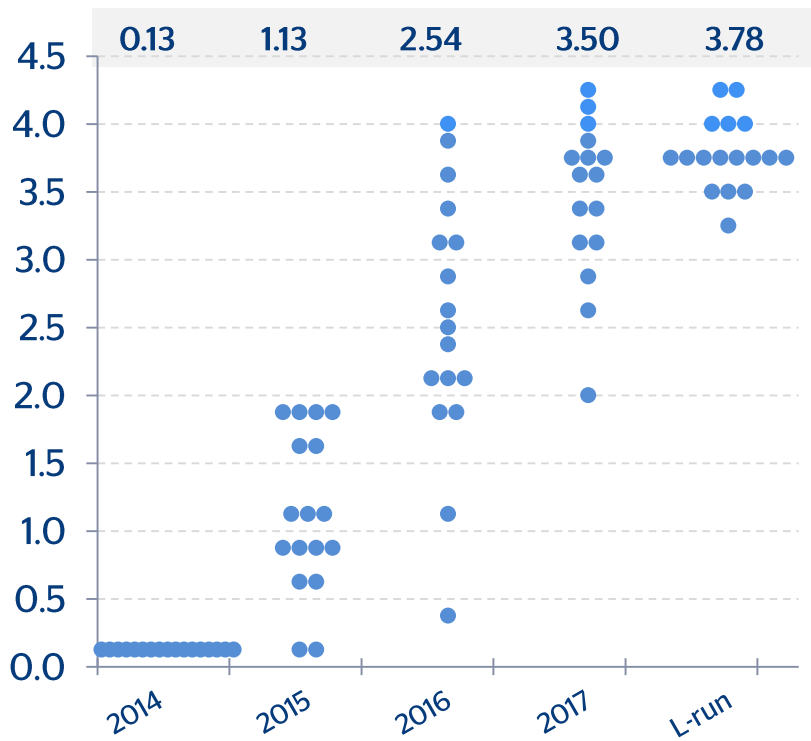


# Monetary Policy

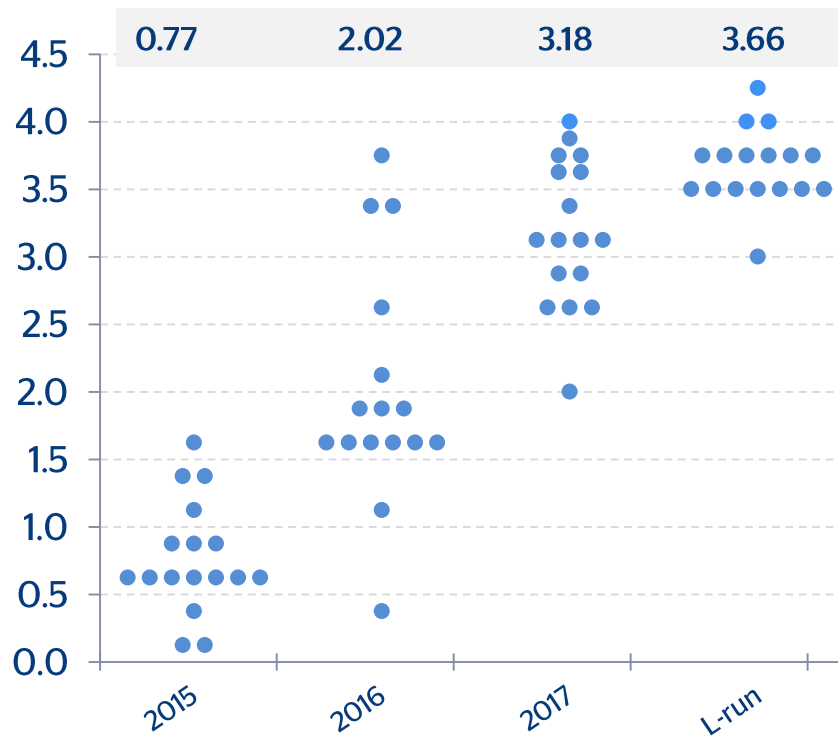
## A more dovish Fed than three months ago

FOMC Appropriate pace of policy firming: Target fed funds rate year-end

%, December 2014 release



%, March 2015 release

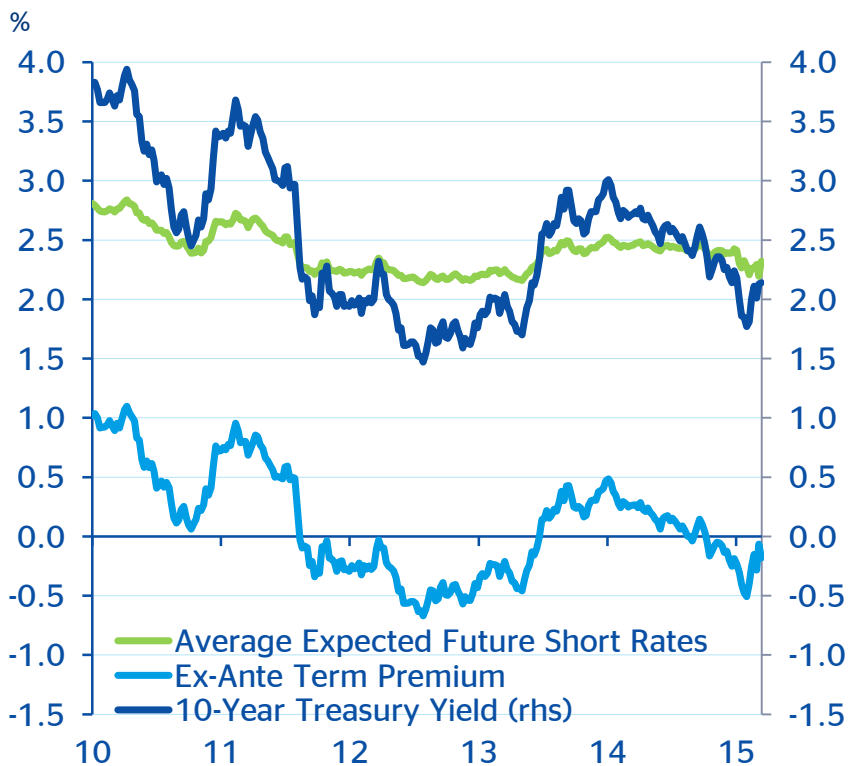


Numbers in shaded area=average  
Source: BBVA Research, Bloomberg & Fed

# Interest Rates

Term premium and inflation expectations have consistently declined since 2014

10-year U.S. Treasury Yield & Term Premium



Source: BBVA Research & FRB

10-year U.S. Treasury Term Premium & Market Inflation Expectations

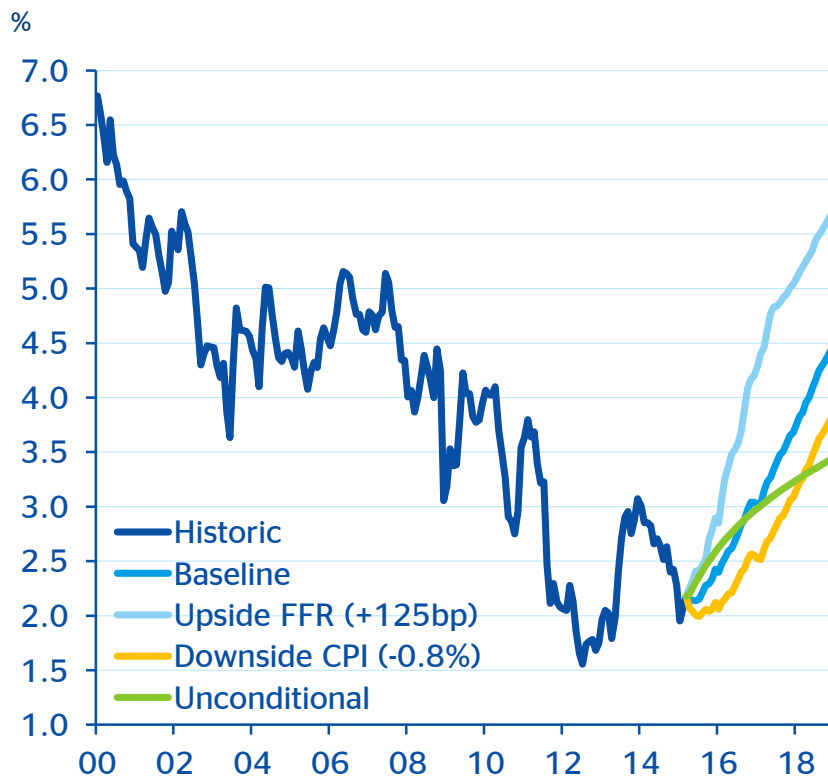


Source: BBVA Research & FRB

# Interest Rates

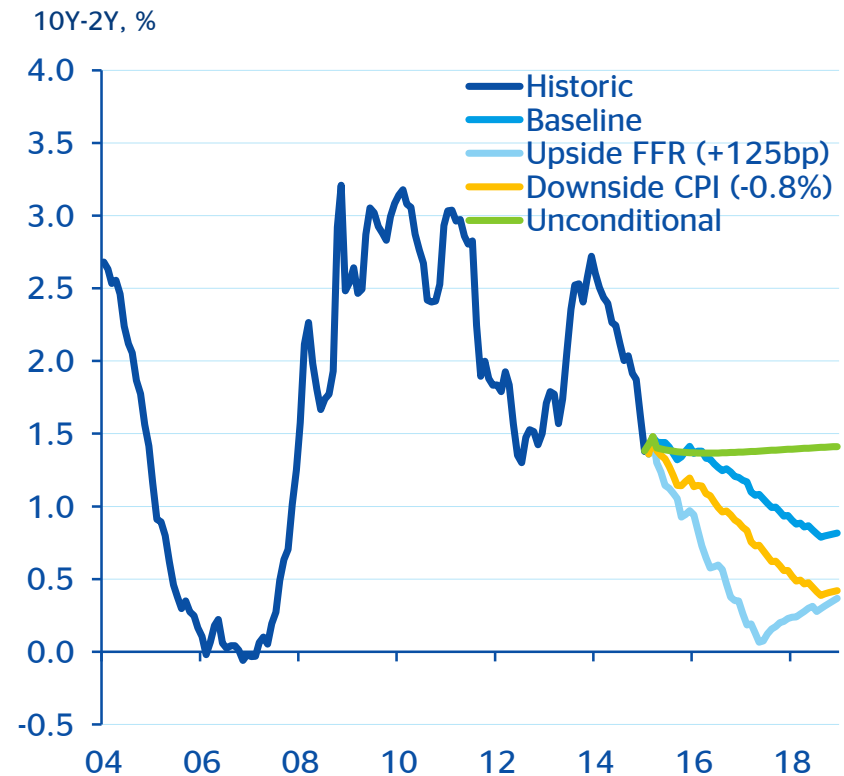
Future increases in long-term yields could be moderate and the yield curve could flatten significantly after the first rate hike

Zero-Coupon 10-year U.S. Treasury Yield



Source: BBVA Research & FRB

Zero-Coupon Yield Curve Slope



Source: BBVA Research & FRB

# Baseline Scenario

## Ongoing downward pressures on inflation force a revision to our CPI forecasts

	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% SAAR)	1.8	4.5	3.5	-2.1	4.6	5.0	2.2	1.6	2.3	2.2	2.4	<b>2.9</b>	<b>2.8</b>	<b>2.8</b>	<b>2.9</b>
Real GDP (Contribution, pp)															
PCE	1.2	1.4	2.5	0.8	1.8	2.2	3.0	1.6	1.3	1.6	1.7	<b>1.9</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>
Gross Investment	1.0	2.5	0.6	-1.1	2.9	1.2	0.6	0.7	1.3	0.8	0.9	<b>0.7</b>	<b>1.0</b>	<b>1.0</b>	<b>1.0</b>
Non Residential	0.2	0.7	1.2	0.2	1.2	1.1	0.6	0.9	0.8	0.4	0.8	<b>0.8</b>	<b>0.8</b>	<b>0.7</b>	<b>0.8</b>
Residential	0.5	0.3	-0.3	-0.2	0.3	0.1	0.1	0.0	0.3	0.3	0.1	<b>0.1</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>
Exports	0.8	0.7	1.3	-1.3	1.4	0.6	0.6	0.9	0.4	0.4	0.4	<b>0.6</b>	<b>0.5</b>	<b>0.6</b>	<b>0.6</b>
Imports	-1.4	-0.1	-0.2	-0.4	-1.8	0.2	-1.6	-0.9	-0.4	-0.2	-0.7	<b>0.3</b>	<b>-0.1</b>	<b>-0.2</b>	<b>-0.3</b>
Government	0.0	0.0	-0.7	-0.2	0.3	0.8	-0.4	-0.7	-0.3	-0.4	0.0	<b>0.1</b>	<b>0.0</b>	<b>-0.1</b>	<b>0.0</b>
Unemployment Rate (% average)	7.5	7.2	7.0	6.6	6.2	6.1	5.7	8.9	8.1	7.4	6.2	<b>5.3</b>	<b>4.9</b>	<b>4.6</b>	<b>4.5</b>
Average Monthly Nonfarm Payroll (K)	178	190	217	193	284	237	324	173	188	199	260	<b>224</b>	<b>233</b>	<b>252</b>	<b>256</b>
CPI (YoY %)	1.4	1.5	1.2	1.4	2.1	1.8	1.2	3.1	2.1	1.5	1.6	<b>0.6</b>	<b>1.9</b>	<b>2.2</b>	<b>2.2</b>
Core CPI (YoY %)	1.7	1.7	1.7	1.6	1.9	1.8	1.7	1.7	2.1	1.8	1.7	<b>1.6</b>	<b>1.8</b>	<b>1.9</b>	<b>2.1</b>
Fiscal Balance (% GDP)	-	-	-	-	-	-	-	-8.7	-6.8	-4.1	-2.9	<b>-2.8</b>	<b>-2.5</b>	<b>-2.4</b>	<b>-2.5</b>
Current Account (bop, % GDP)	-2.6	-2.4	-2.1	-2.4	-2.3	-2.3	-2.6	-3.0	-2.8	-2.4	-2.5	<b>-2.9</b>	<b>-2.9</b>	<b>-2.6</b>	<b>-2.3</b>
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	<b>0.50</b>	<b>1.50</b>	<b>2.50</b>	<b>3.25</b>
Core Logic National HPI (YoY %)	11.06	11.66	11.83	11.05	7.94	5.92	5.06	-3.82	3.88	11.09	7.40	<b>6.10</b>	<b>5.70</b>	<b>4.38</b>	<b>3.25</b>
10-Yr Treasury (% Yield, eop)	2.30	2.81	2.90	2.72	2.60	2.53	2.21	1.98	1.72	2.90	2.21	<b>2.60</b>	<b>3.11</b>	<b>3.54</b>	<b>3.90</b>
U.S. Dollar / Euro (eop)	1.32	1.34	1.37	1.38	1.36	1.29	1.23	1.32	1.31	1.37	1.23	<b>1.02</b>	<b>1.12</b>	<b>1.24</b>	<b>1.32</b>
Brent Oil Prices (dpb, average)	102.7	110.3	109.3	108.2	109.7	102.0	76.3	111.3	111.7	108.7	99.0	<b>61.0</b>	<b>87.8</b>	<b>99.5</b>	<b>100.5</b>

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