BBVA | RESEARCH

4th QUARTER
2016

Economic Outlook

United States

Key messages

Despite some signs in the third quarter that the pullback in investment is slowing, the U.S. economy continues to move at two speeds with solid consumption activity and tepid investment

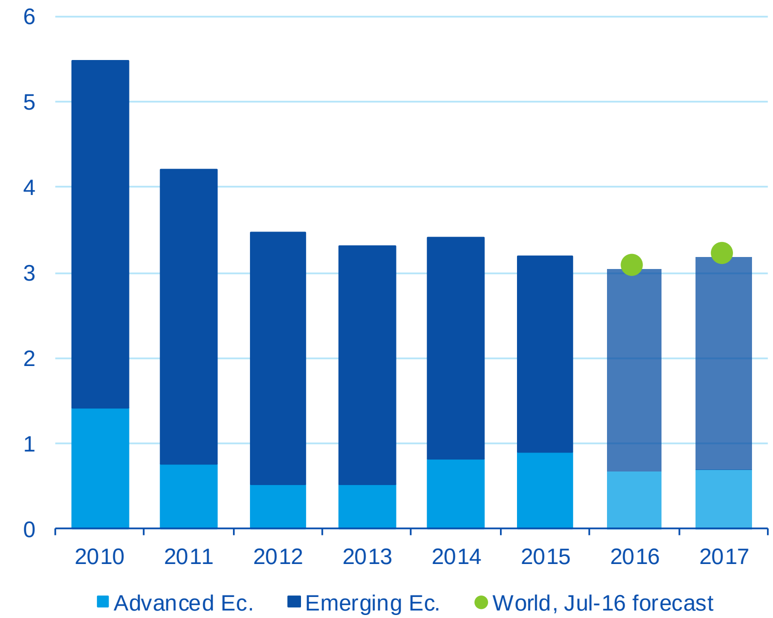
At face value economic fundamentals are nearing levels that are consistent with Fed's equilibrium projections, but committee remains conflicted on how to confront structural headwinds

Despite concerns of the length of the current cycle and a rapid deterioration in conditions following the election our baseline remains for moderate growth through 2020 amidst mounting structural headwinds

Global outlook unchanged, but risks remain

1. Slight downward revision of our projections for 2016
2. Global growth drivers and supportive policies will keep 2017 growth at 3%. There are increasing demands for more fiscal policy
3. Risks biased to the downside; with political concerns reemerging: US political uncertainty; Brexit, European banks, Italy, periphery; China's imbalances and rebalancing

World Growth, pp



Source: BBVA Research

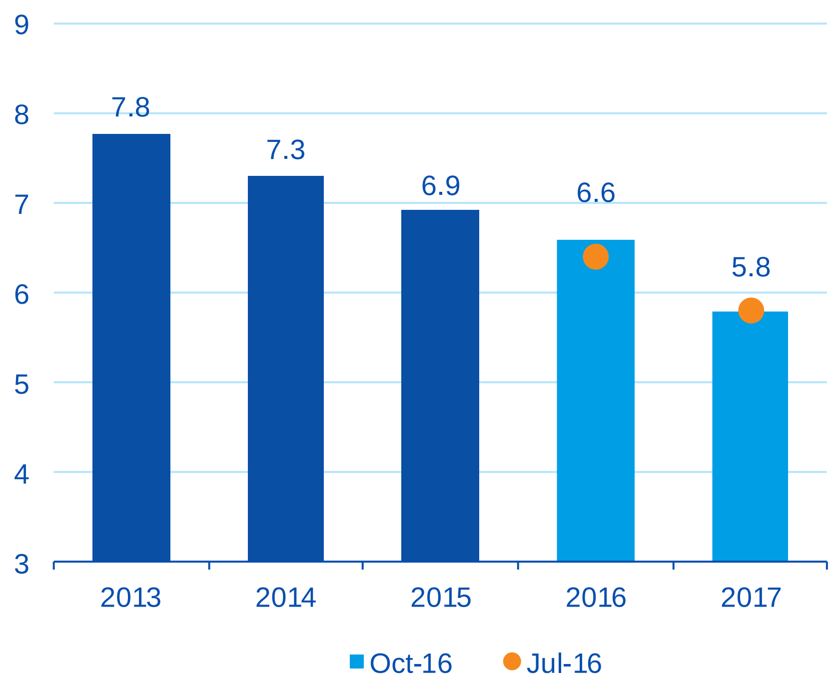
GDP growth, current forecasts and revisions since July-16

	US	EMU	Spain	Mex	LatAm-5 Arg	LatAm-5 Ven	LatAm-5 Andean C.	Turkey	China	Em. Asia
2015	2.6	1.9	3.2	2.5	2.5	-5.9	2.2	4.0	6.9	6.6
2016	1.6	1.6	3.3	1.8	-2.0	-15.5	2.3	2.7	6.6	6.5
2017	2.1	1.5	2.5	2.2	3.2	-5.6	2.2	3.5	5.8	6.0

Unchanged
Upward Review
Downward Review

China: slow adjustment

China: GDP growth, % change



Source: CEIC and BBVA Research

More resilient domestic demand, thanks to extra monetary and fiscal support

Additional monetary measures to be postponed (property bubble), while macro-prudential measures continue

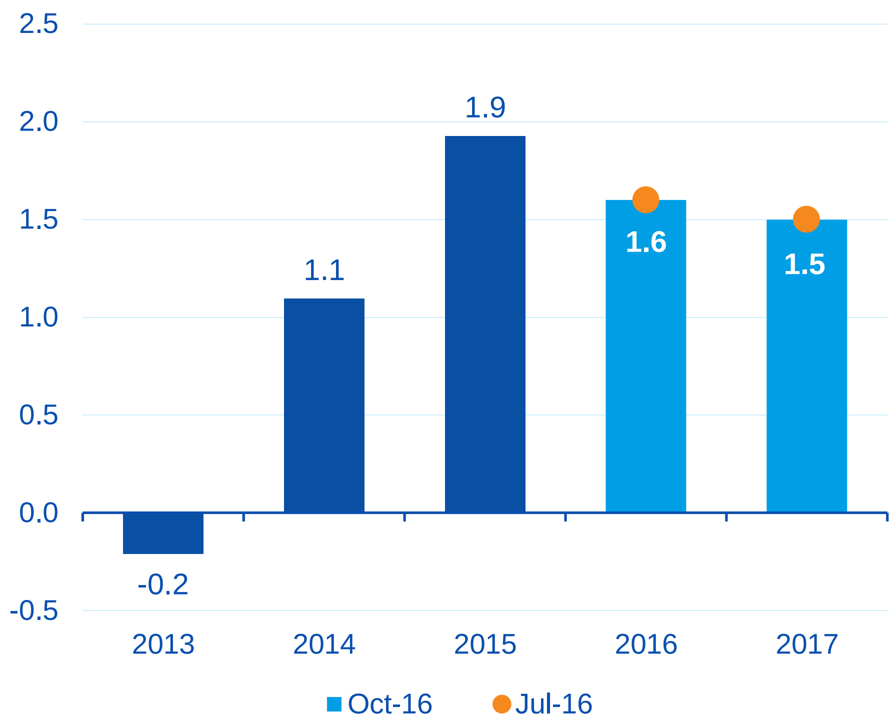
However, tail risks are high:

(i) Property market;
(ii) Capital outflows and exchange rate;
(iii) Shadow banking; and most of all…
(iv) Corporate indebtedness and lack of SOE reform

Geopolitical risk: South China sea.

Eurozone: forecasts unchanged, but doing well

Eurozone: GDP growth, % change



Source: Eurostat and BBVA Research

Supportive domestic drivers remain, despite uncertainty

Downward bias by year-end: political uncertainty, banking system blues and Brexit, despite supportive monetary (and to a lesser extent, fiscal) policy

ECB with little room for further action: the most likely is the extension and fine tuning of QE

Political Risks: Hard Brexit, European institutional crisis, populism, pending issues in Portugal and Greece, and geopolitical risks in the Middle East

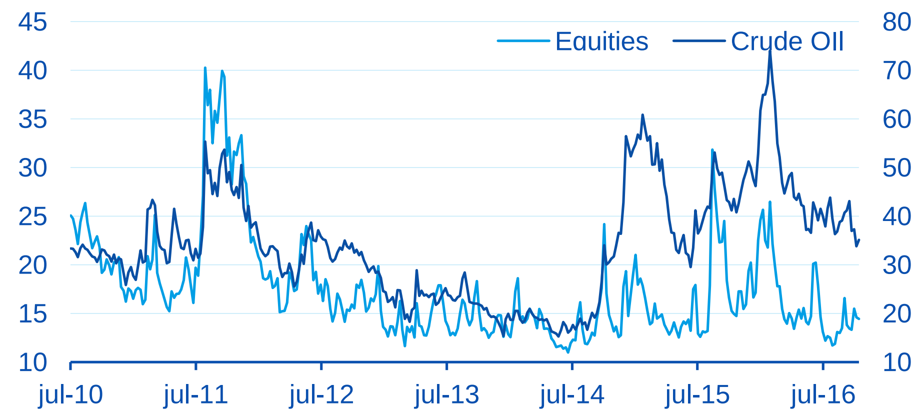
Financial markets

Market Risk Indicators

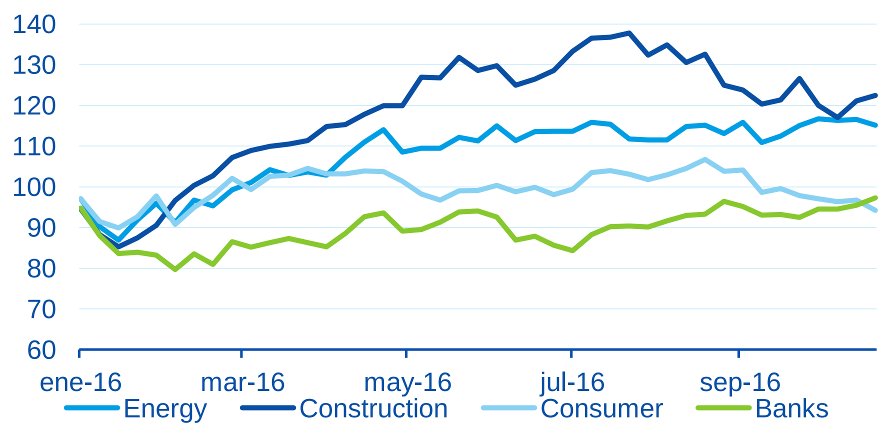
		Current	1-month ago	3-months ago	6-monts ago	1-year ago
Equities	S&P 500					
	Energy					
	Construction					
	Consumer					
	Banks					
Bonds	3-Month Yield					
	10-Year Yield					
	Corporate Spreads-AAA					
	Corporate Spreads-BBB					
Volatility	Market Volatility Index					
	Crude Oil Volatility Index					
Credit	C&I Loans					
	Real Estate Loans					
	CRE Loans					
	Credit Card Loans					
Sovereigns (CDS)	Brazil					
	Italy					
	Turkey					
	Venezuela					
	Argentina					
Misc.	Financial Stress					
	Consumer Comfort					
	Busines Conditions Index					
	Exchange Rate					

Low **High**

CBOE Market Volatility,%



SP Equity Indexes, Jan-2016=100

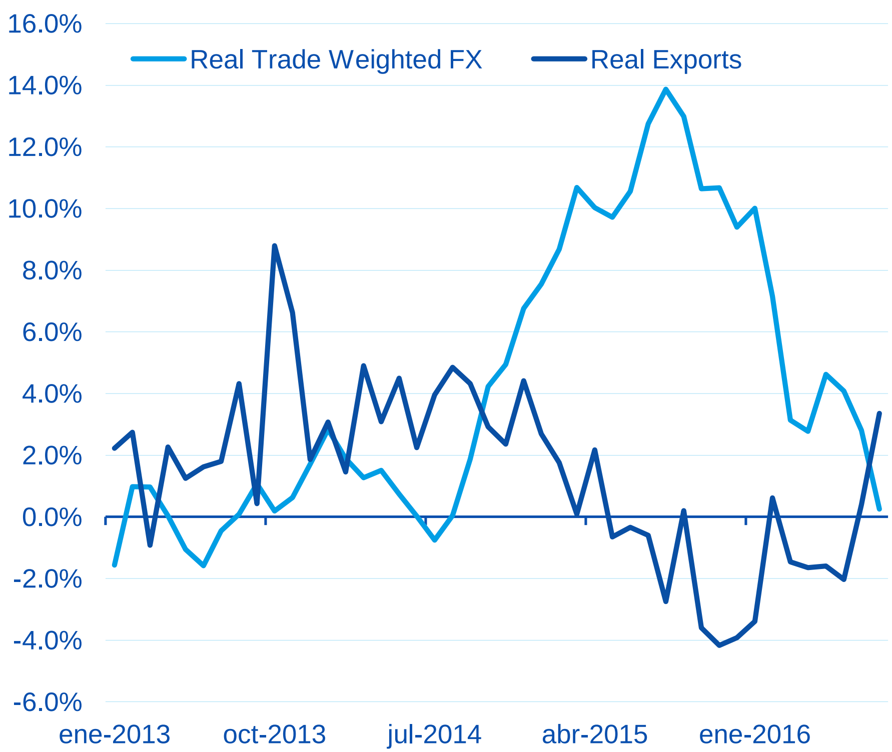


Source: BBVA Research, Bloomberg & Haver Analytics

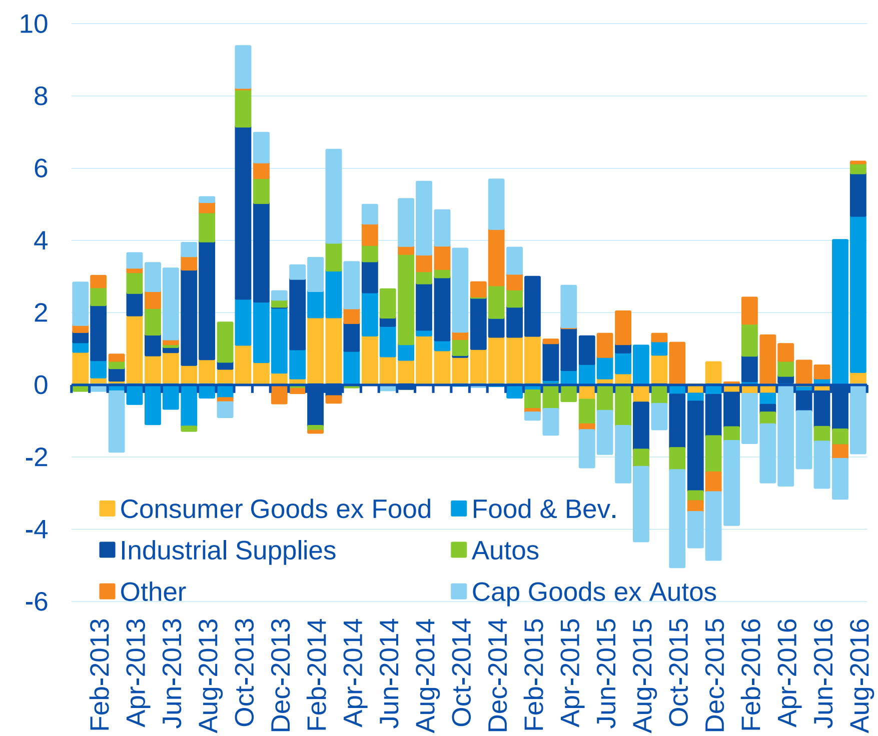
Exchange rate pressures likely to fade

Continued declines in real exchange rates should aid recovery in exports

Real Exchange Rates & Exports, YoY % change



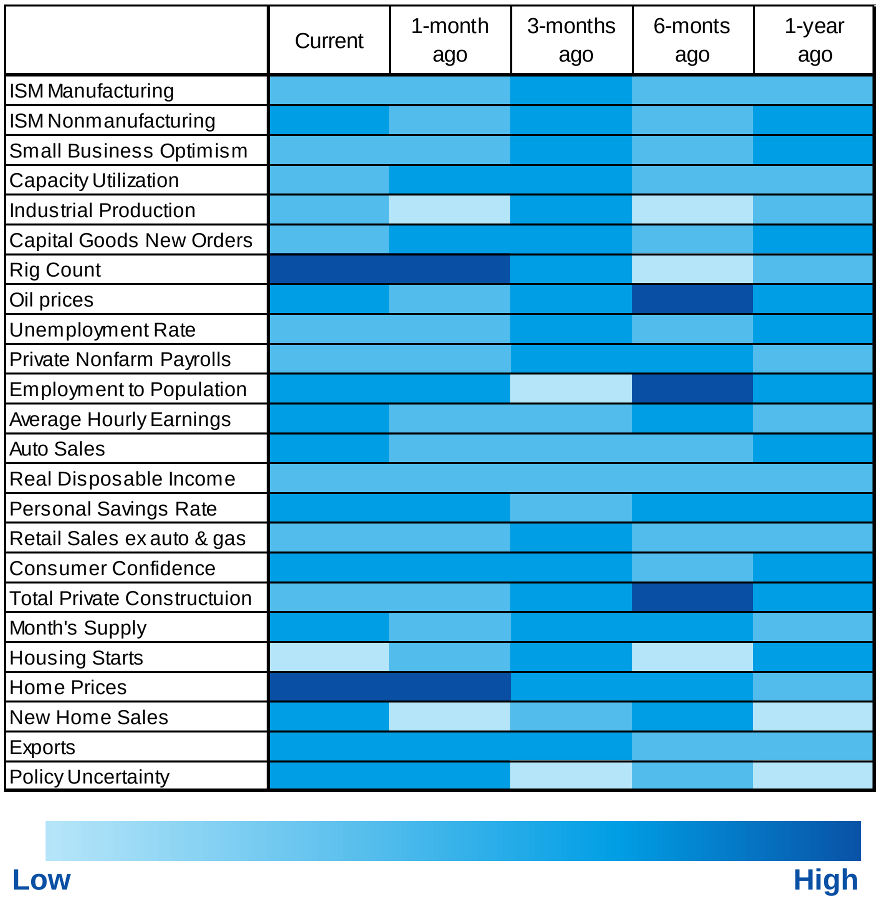
Real Exports, contribution to YoY % change



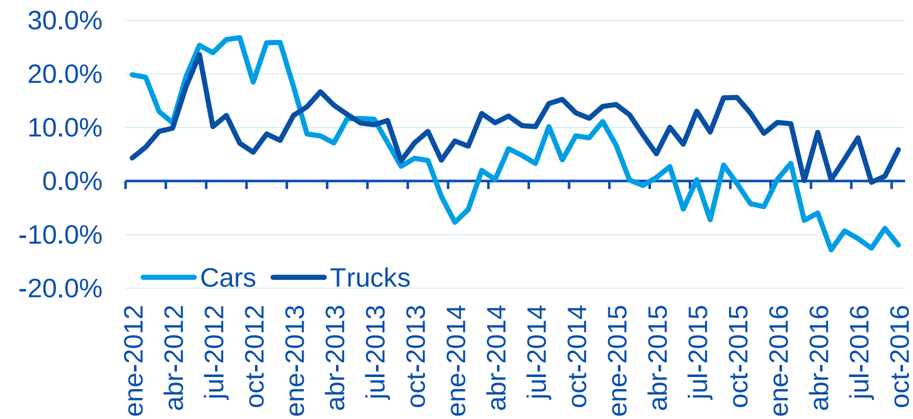
Source: BBVA Research & Haver Analytics

U.S. economic dashboard

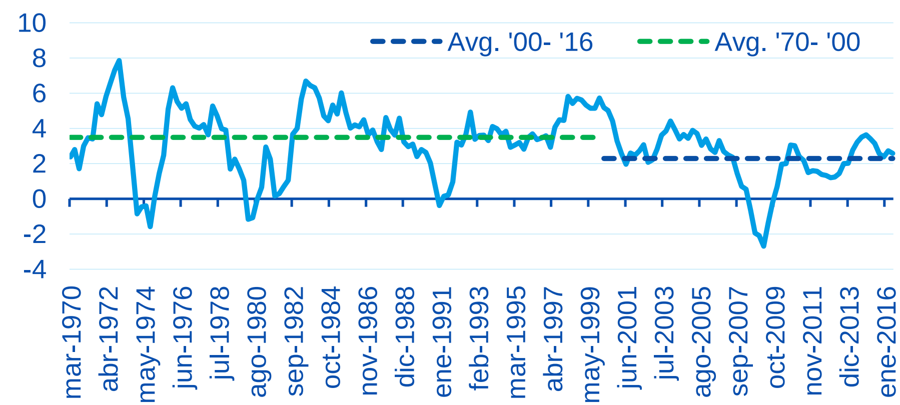
U.S. Economic Heat Map



Domestic Auto Sales, YoY % change



Real PCE, YoY % change



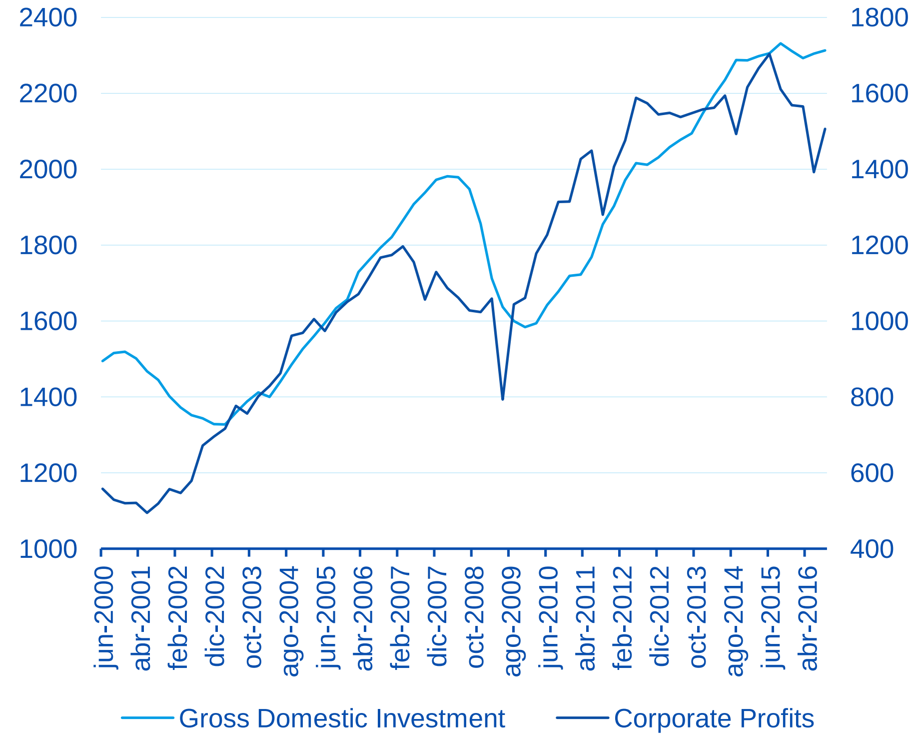
Source: BBVA Research & Haver Analytics

*Includes 6-month ahead forecasts of rigs based on current oil prices

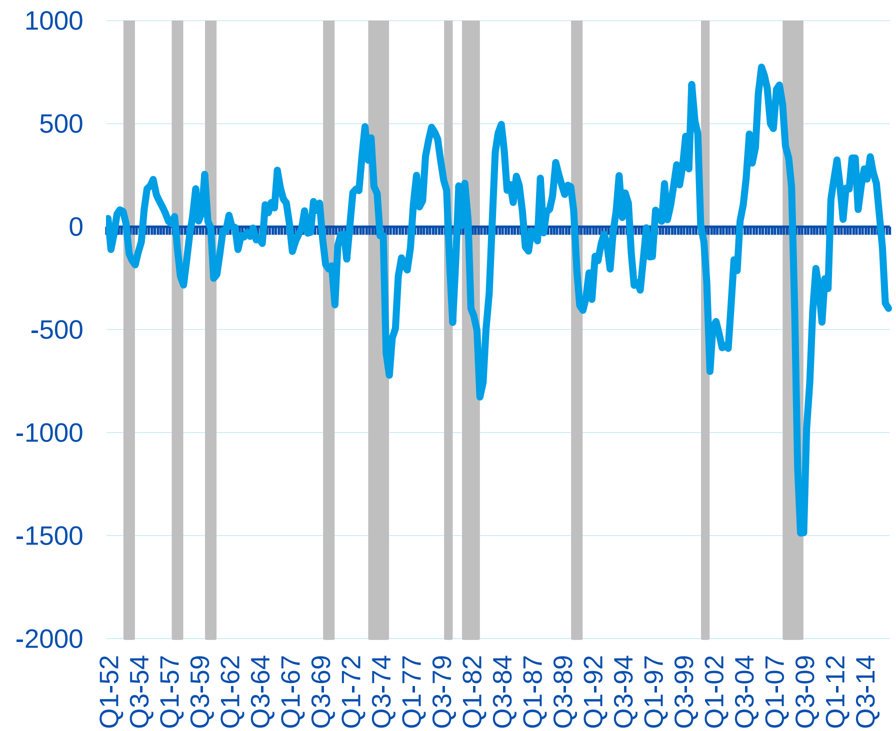
Revenue recession spilling over to investment

Appetite to invest impacted by 6% drop in after-tax profits

Nonfinancial Corporate Profits & Gross Private Domestic Investment*, Billions $



Real Per Capita Private Fixed Investment Cycles & Recessions, Billions 2009$



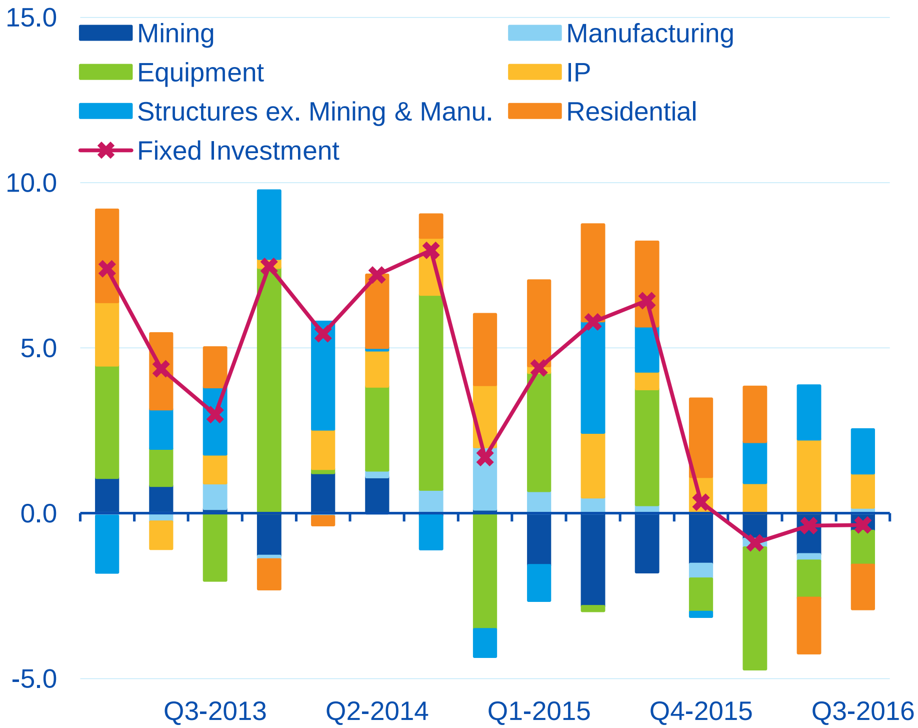
Source: BBVA Research & Haver Analytics

*Nonresidential

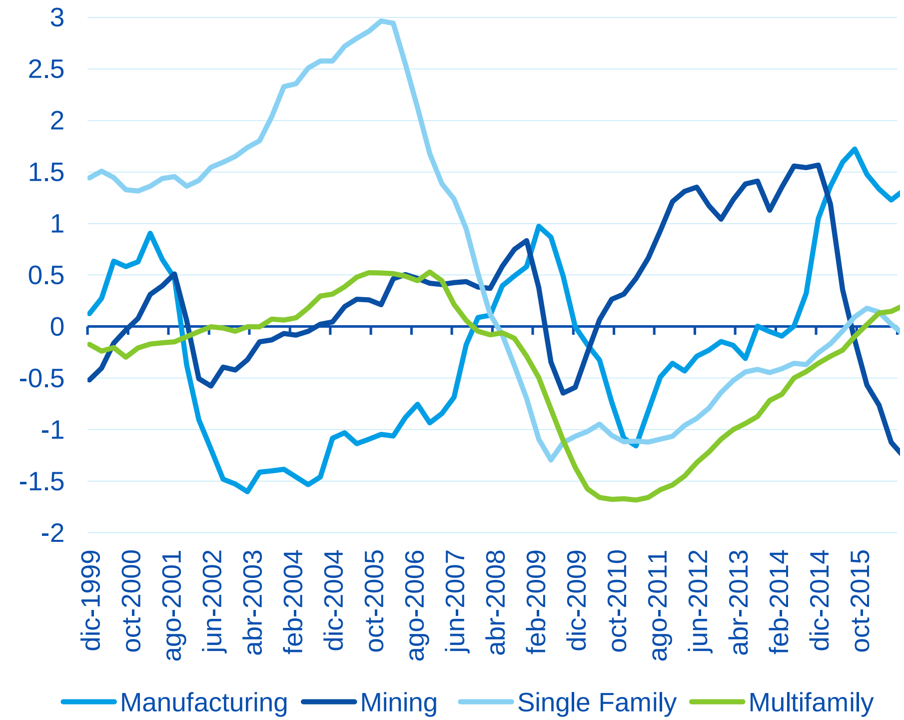
Running room in investment cycles

Single family and multifamily investment cycle in line with historical averages; mining and manufacturing correcting

Real Private Fixed Investment, contribution, pp



Real Private Fixed Investment,+/- s.d.

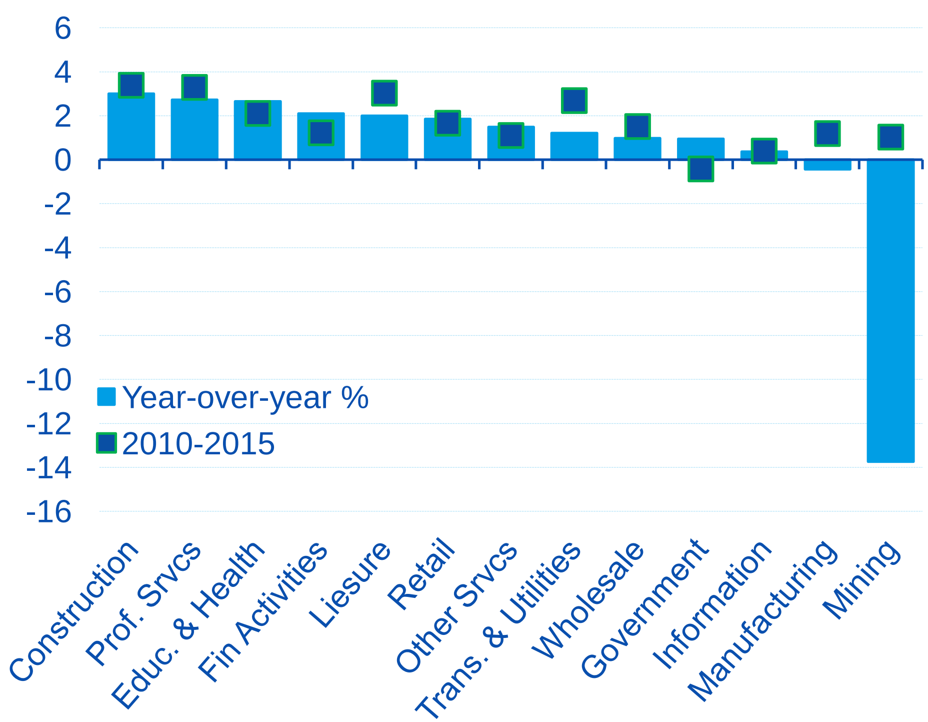


Source: BBVA Research & Haver Analytics

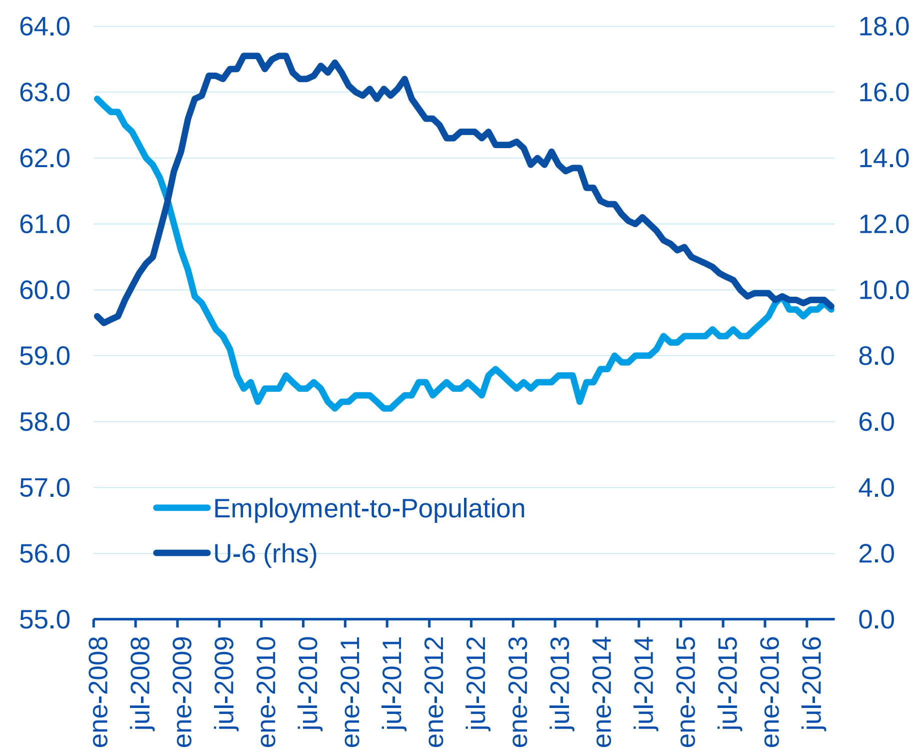
Slack in labor market withdrawing

Excluding mining and manufacturing, labor market edging closer to full-employment in “new normal”

Industry Nonfarm Payrolls, %



Labor Utilization & Employment-to-population, %

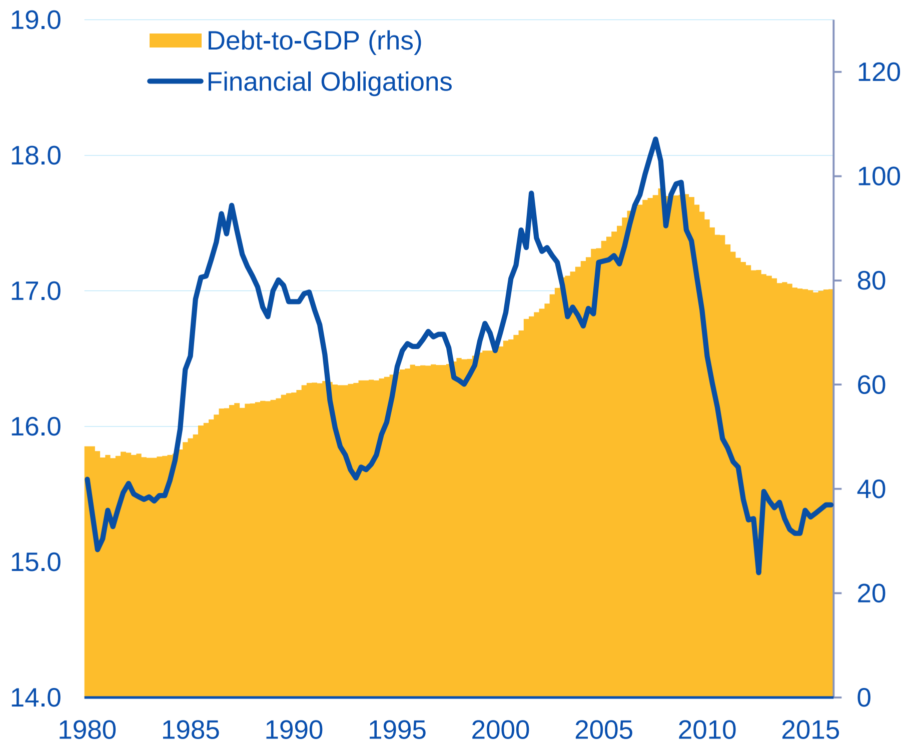


Source: BBVA Research & Haver Analytics

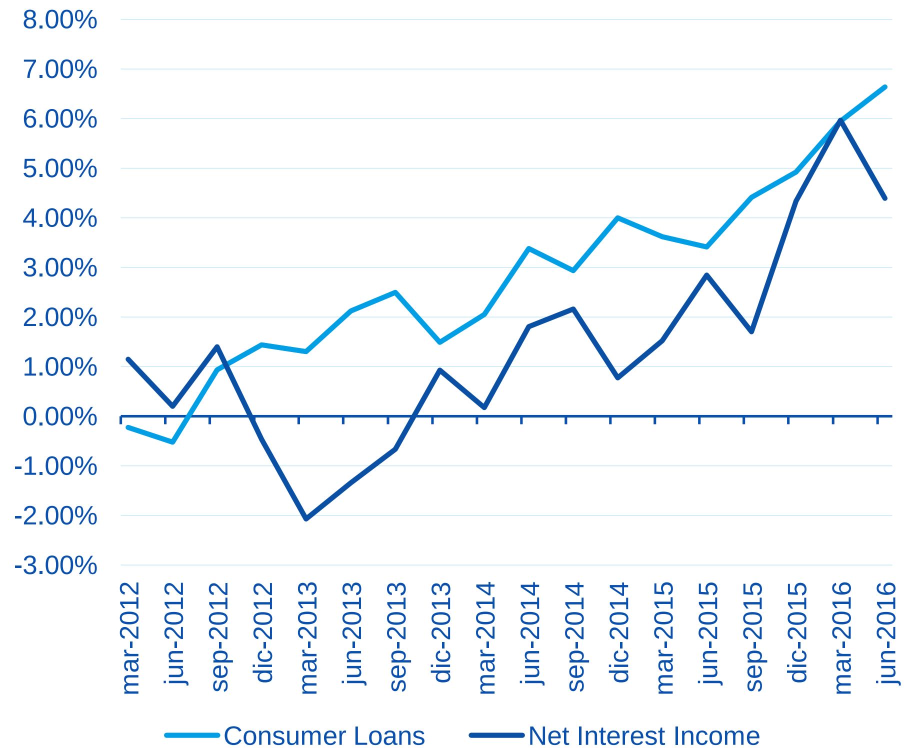
Deleverage still a factor for households

Consumption unlikely to diverge from current trend despite improvement in household balances sheets, which are strongest since 2003

HH Debt-to-GDP & Financial Obligations, %



Banks' Income & Consumer Loans, YoY %

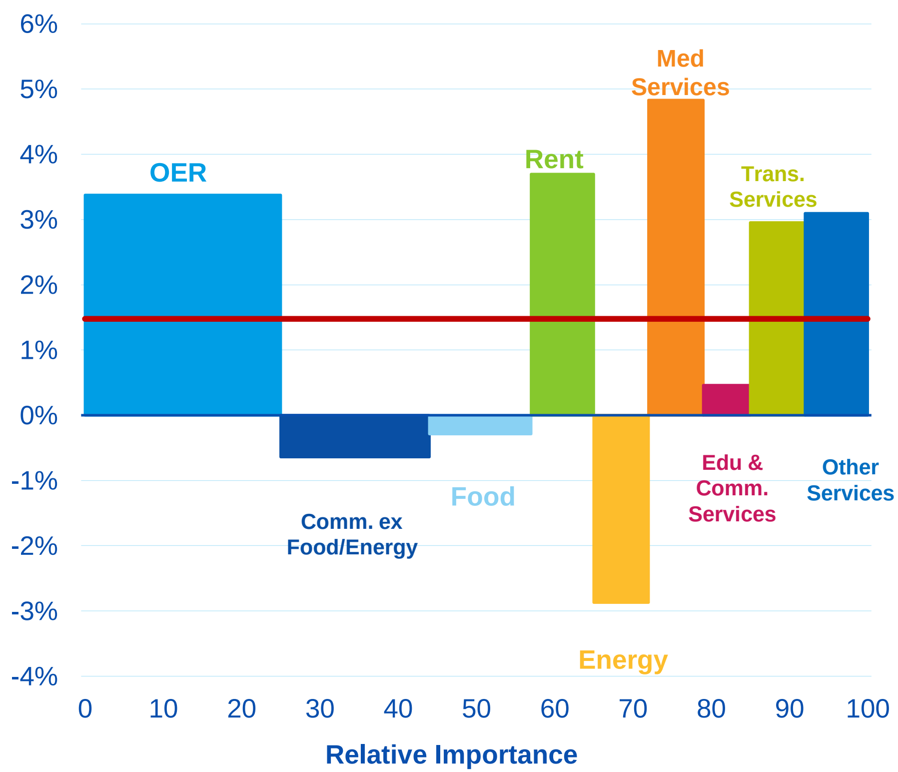


Source: BBVA Research & Haver Analytics

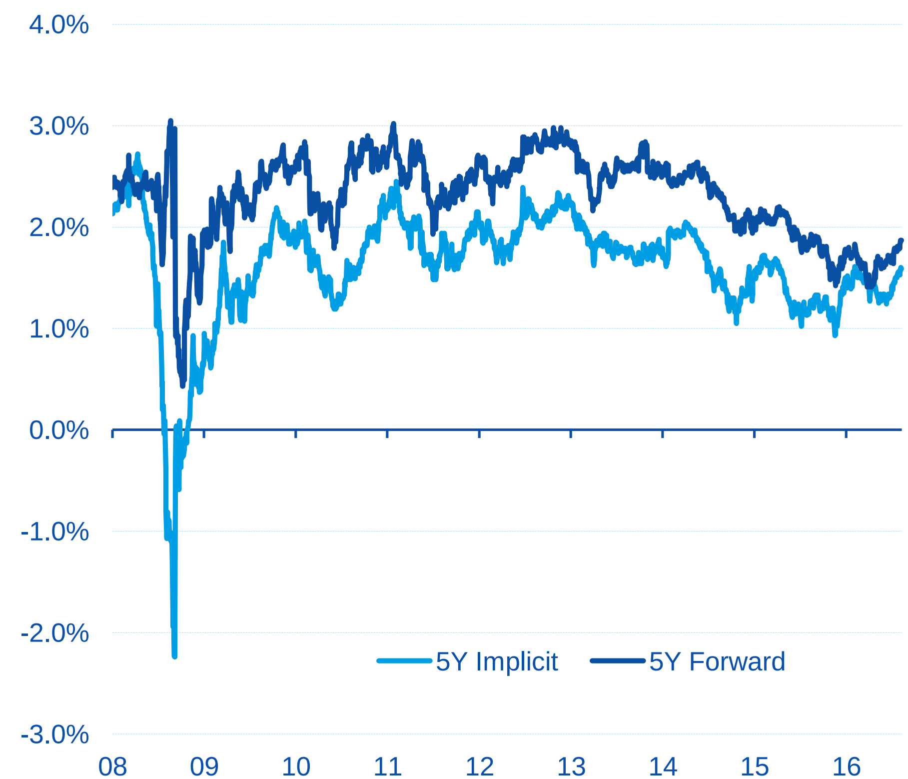
Inflation: least of the Fed's concerns

Inflationary pressures outside medical services and commodities, and housing are muted. Market based measure of inflation expectations running below 2%

Inflation Contributions, YoY%



Inflation Expectations



Source: BBVA Research & Haver Analytics

Fed telegraphing December hike to markets

Fed

November Statement

- FOMC postpones rate hike, moves markets closer to increase in December.
- Case for rate increases "continued to strengthen"
- Change in language with respect to inflation suggests committee members view conditions as at or near potential
- Major undershooting of expectations in 4Q16 or a major geopolitical or financial shock needed to justify further delays
- Forgoing rate increases in December could jeopardize the Fed's communication strategy, limiting committee's ability to use of forward guidance as a tool to respond to adverse shocks in a low interest rate environment
- "The Committee judges that the case for an increase in the federal funds rate has continued to strengthen but decided, for the time being, to wait for some further evidence of continued progress toward its objectives." ***FOMC statement from November 1st-2nd meeting***

What do we expect?

- Most members see "whites of the eyes", so committee likely to pull trigger in 2016
- "Remaining meeting live", probability of Dec. hike ~80%
- Policy uncertainty, global economic and financial developments and the strong USD could delay future rate increases
- Further discussion on normalization tools (ON RRP, IOER), asymmetries in monetary policy with low R*, NAIRU, productivity and inflation targeting
- FOMC opinions diverging on the risks to delaying policy normalization and proximity to steady state (UR, potential GDP, wages, etc.)
- Reinvestments policy to end after the ZLB lift-off "well underway"
- Balance sheet normalization plans not yet finalized

Projections Dec 16/ Dec 17

One rate hike in 2016 (neutral bias)

Two hikes in 2017

Fed funds rate:

Dec 16: 0.75

Dec 17: 1.25

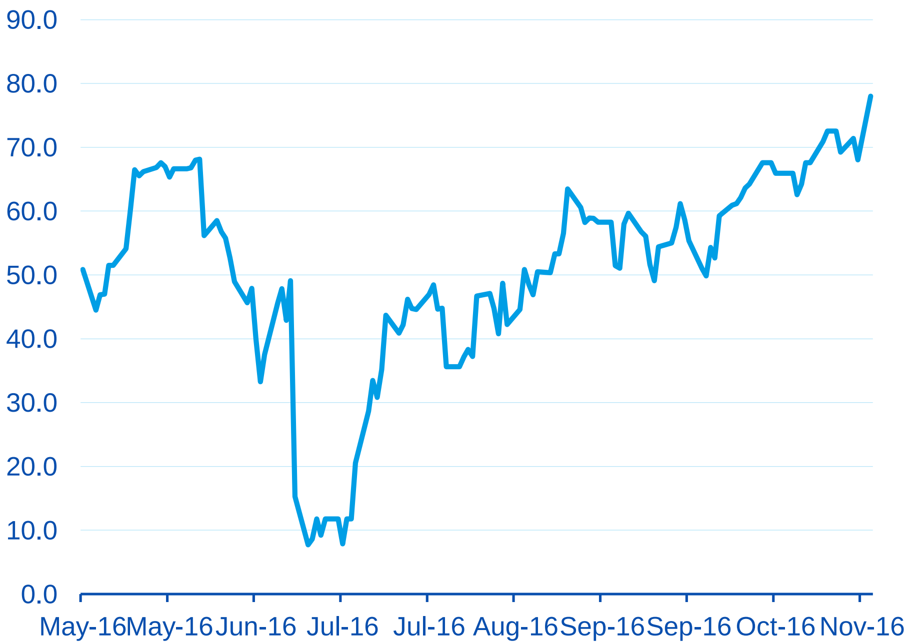
Timeline Exit Strategy

December 2016	**February 2017**	**June 2017**	**2017**
2nd FFR Increase	No FFR Increase	3rd FFR Increase	Maintain reinvestment policy

Fed tasked with realigning long-run expectations

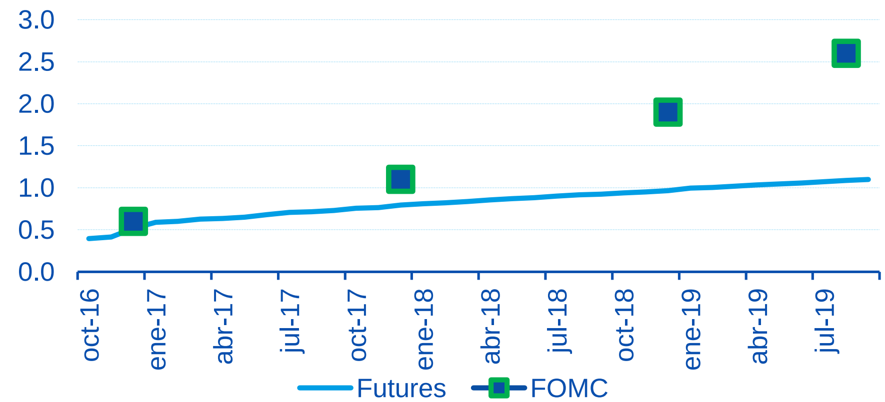
Markets validating a December rate increase; divergence for 2017 and beyond still high

December 2016 Implied Probability of Hike, %

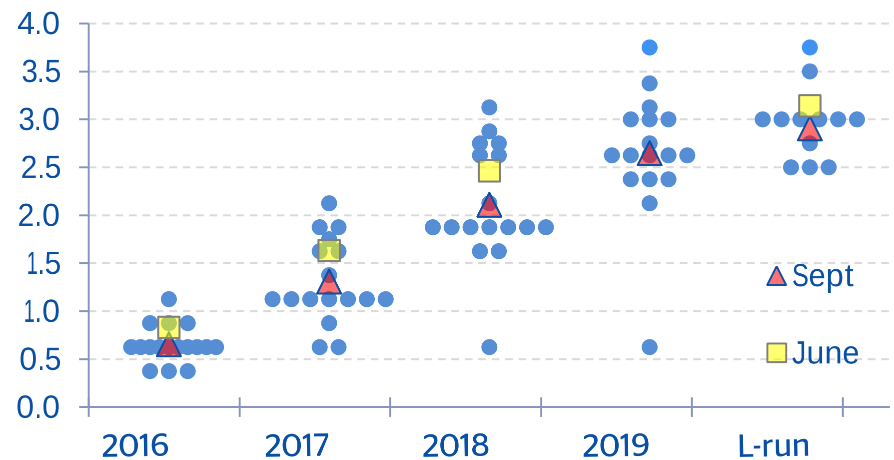


Source: BBVA Research, FRB, Bloomberg & Haver

Fed Funds Rate: FOMC vs. Futures Curve, %



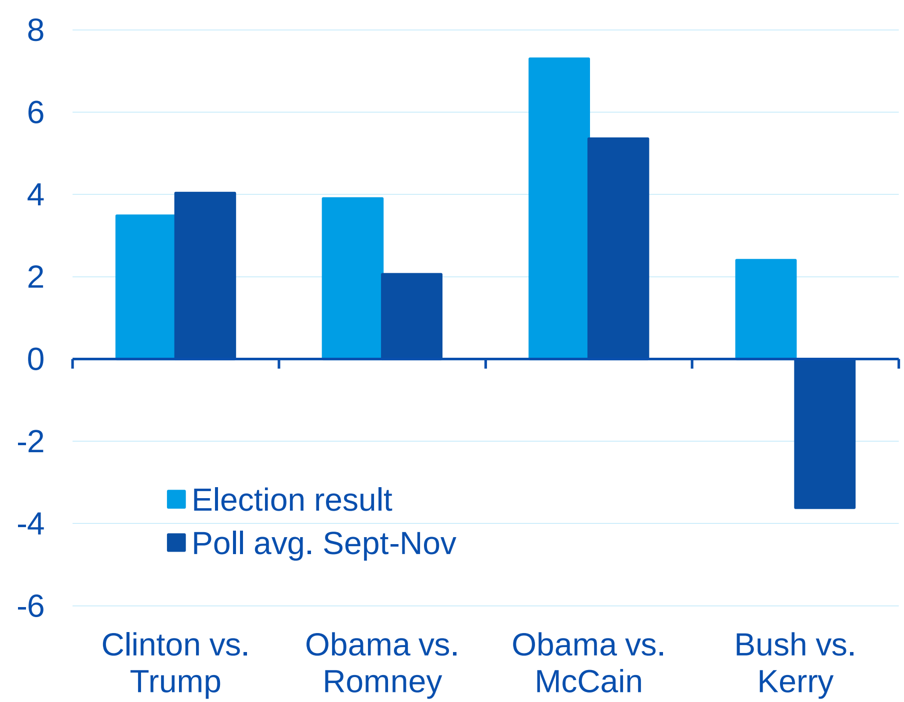
FOMC: Pace of Policy Firming, %



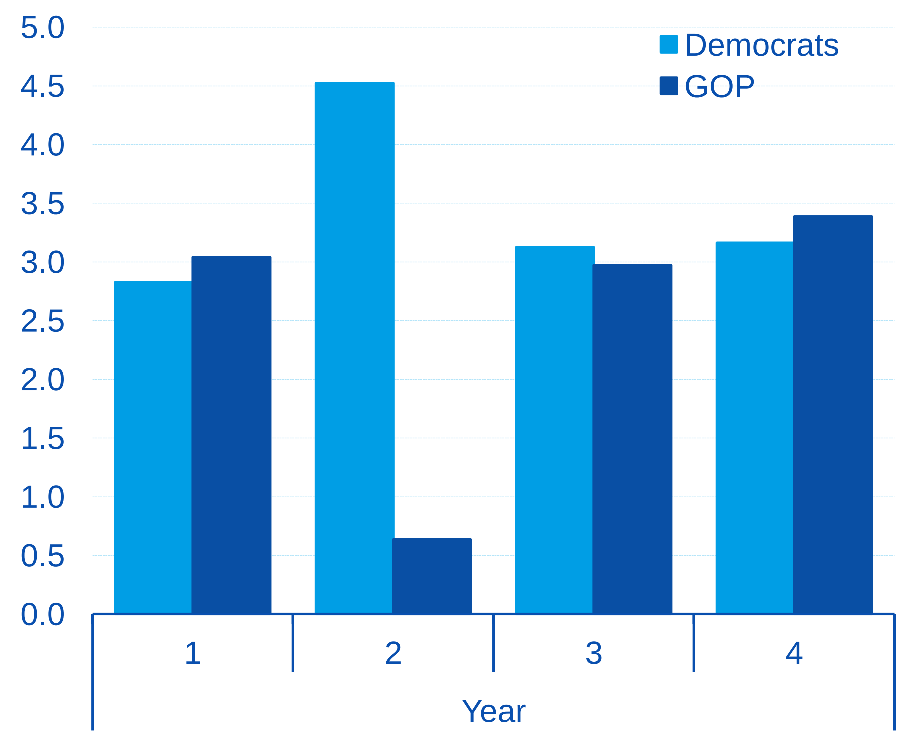
Presidential elections looming

Although polls have tightened, Clinton still has enough of a lead based on recent election precedent. Candidate economic impact most significant in 2nd year

Election Outcomes vs. Polls, spread %



Real GDP Growth in Presidential Term, YoY %

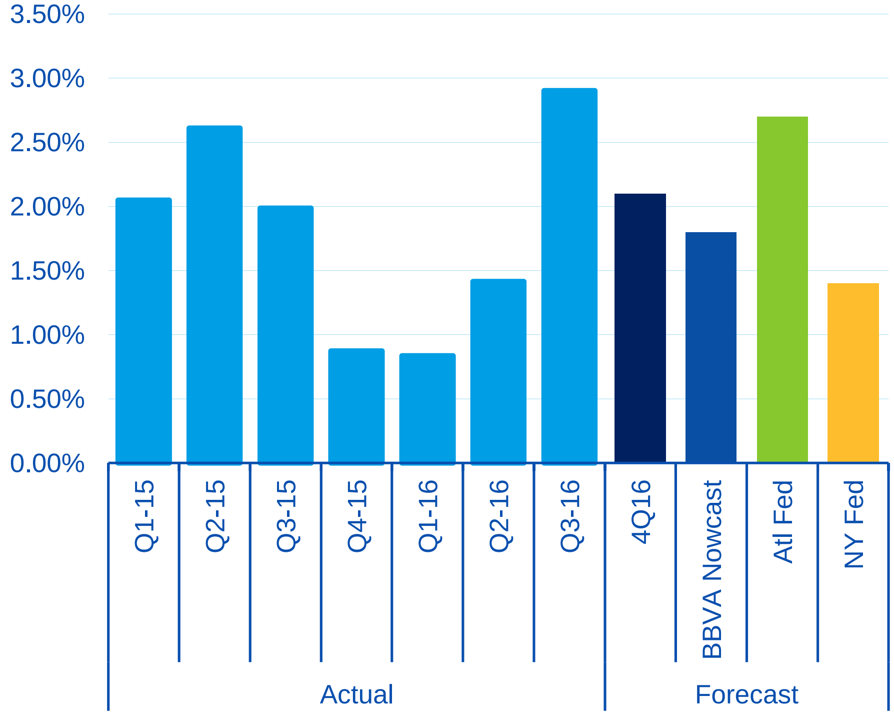


*Implied outcome based on current polling averages
Source: BBVA Research, RCP & New York Times

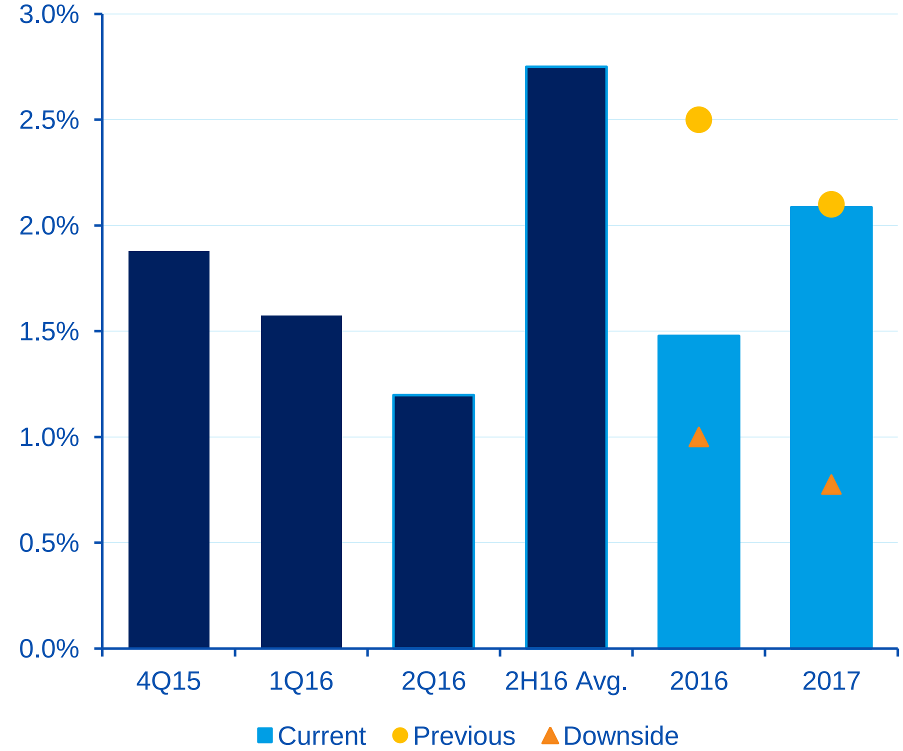
Outlook & forecasts

Outlook for 4th quarter upbeat, but structural headwinds to persist

U.S. Short-term Real GDP Forecast, SAAR %



U.S. Real GDP Growth, % change



Source: BBVA Research

Key macroeconomic indicators

Two-speed economy drags down 2016 projection to 1.6%. Long-run projections unchanged.

U.S. Macroeconomic Indicators

	2011	2012	2013	2014	2015	**2016**	**2017**
Real GDP (% SAAR)	1.6	2.2	1.7	2.4	2.6	**1.6**	**2.1**
Real GDP (Contribution, pp)							
PCE	1.6	1.0	1.0	2.0	2.2	**1.7**	**1.6**
Gross Investment	0.7	1.5	1.0	0.7	0.8	**-0.4**	**0.3**
Non Residential	0.9	1.1	0.4	0.8	0.3	**-0.1**	**0.3**
Residential	0.0	0.3	0.3	0.1	0.4	**0.1**	**0.1**
Exports	0.9	0.5	0.5	0.6	0.0	**0.1**	**0.4**
Imports	-0.9	-0.4	-0.2	-0.7	-0.7	**0.1**	**0.6**
Government	-0.7	-0.4	-0.6	-0.2	0.3	**0.2**	**0.2**
Unemployment Rate (%, average)	8.9	8.1	7.4	6.2	5.3	**4.9**	**4.6**
Average Monthly Nonfarm Payroll (K)	174	179	193	251	229	**206**	**178**
CPI (YoY %)	3.2	2.1	1.5	1.6	0.1	**1.2**	**2.0**
Core CPI (YoY %)	1.7	2.1	1.8	1.7	1.8	**2.2**	**1.9**
Fiscal Balance (% GDP)	-8.7	-6.8	-4.1	-2.8	-2.5	**-3.0**	**-3.0**
Current Account (bop, % GDP)	-3.0	-2.8	-2.2	-2.8	-2.4	**-2.8**	**-3.0**
Fed Target Rate (%, eop)	0.25	0.25	0.25	0.25	0.50	**0.75**	**1.25**
Core Logic National HPI (YoY %)	-2.95	4.01	9.89	7.02	5.32	**5.37**	**5.12**
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	**1.64**	**1.92**
U.S. Dollar / Euro (eop)	1.32	1.31	1.37	1.23	1.09	**1.08**	**1.16**
Brent Oil Prices (dpb, average)	111.3	111.7	108.6	99.0	52.4	**44.1**	**53.3**

BBVA RESEARCH

4th QUARTER
2016

Economic Outlook

United States