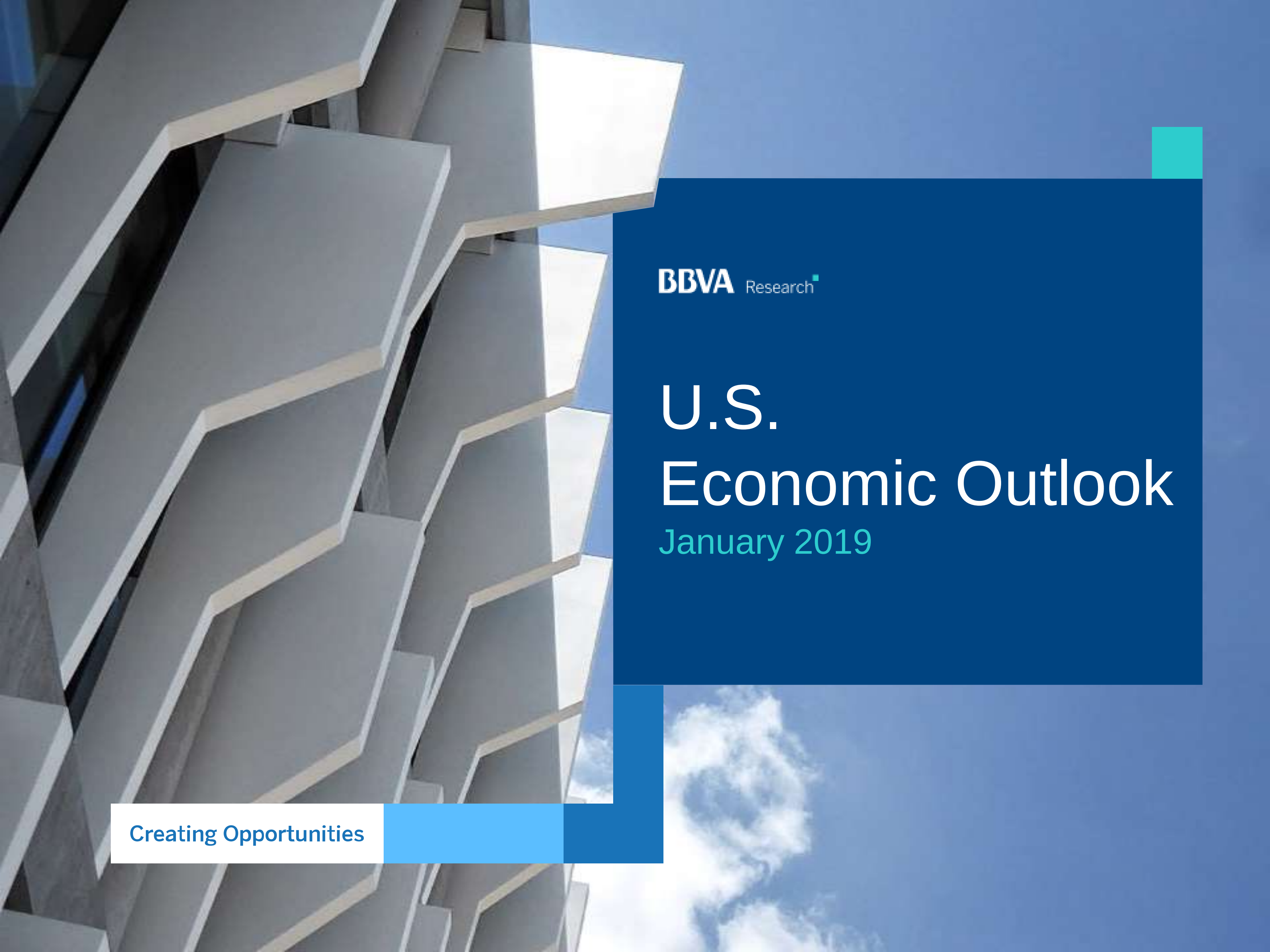


BBVA Research

U.S. Economic Outlook

January 2019

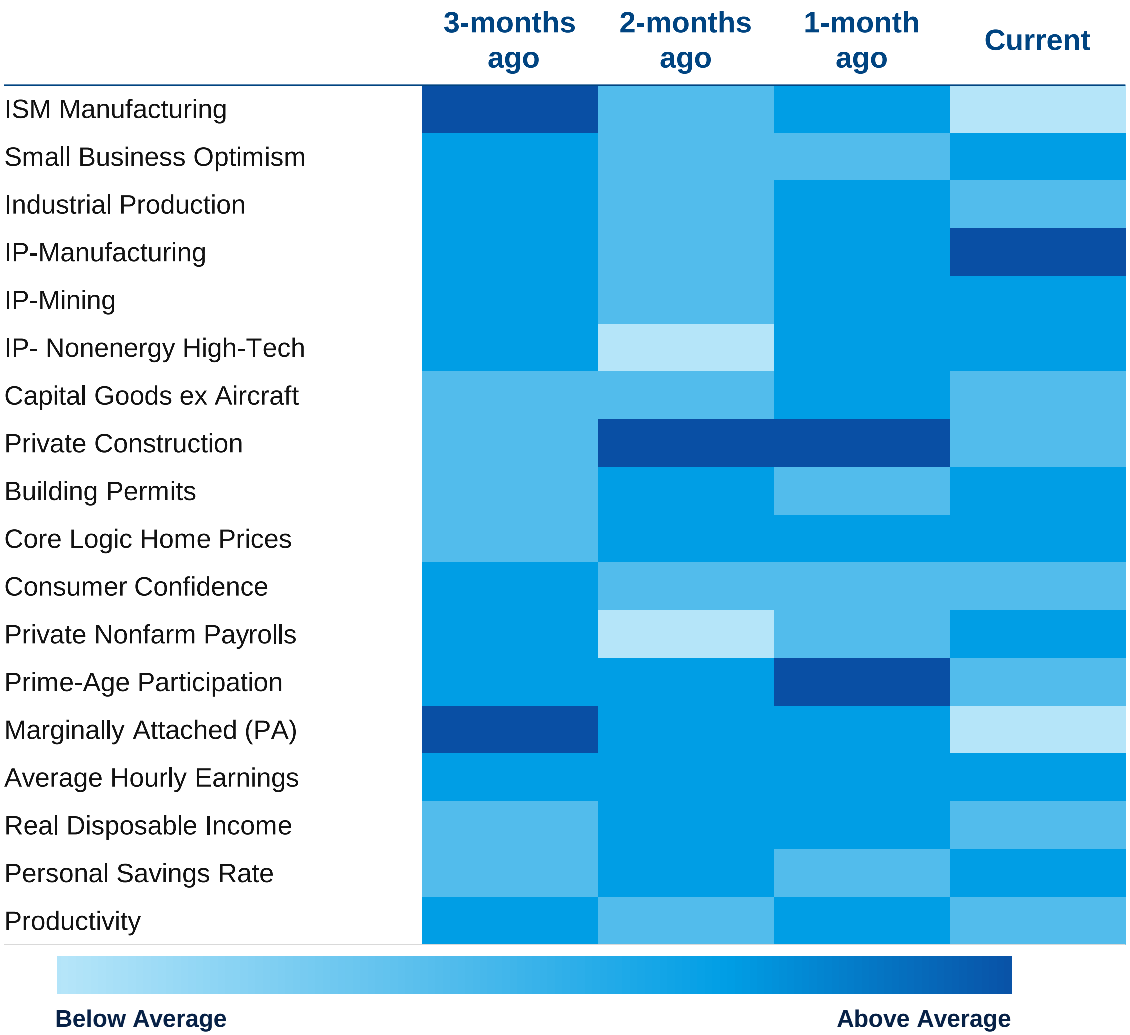
Creating Opportunities

Economic Outlook

- GDP growth to moderate in 2019
- Risk of recession remains elevated over the next 24 months
- Fed to delay raising rates in 1H19 as it continues to engineer a soft-landing
- Labor market slack remains minimal
- Inflation expectations down, as pass-through from rising input costs muted
- 10-year Treasury to follow shallower path
- Oil prices converging with long-term equilibrium around $60/b

Economic activity

Real-Time Economic Momentum Heat Map

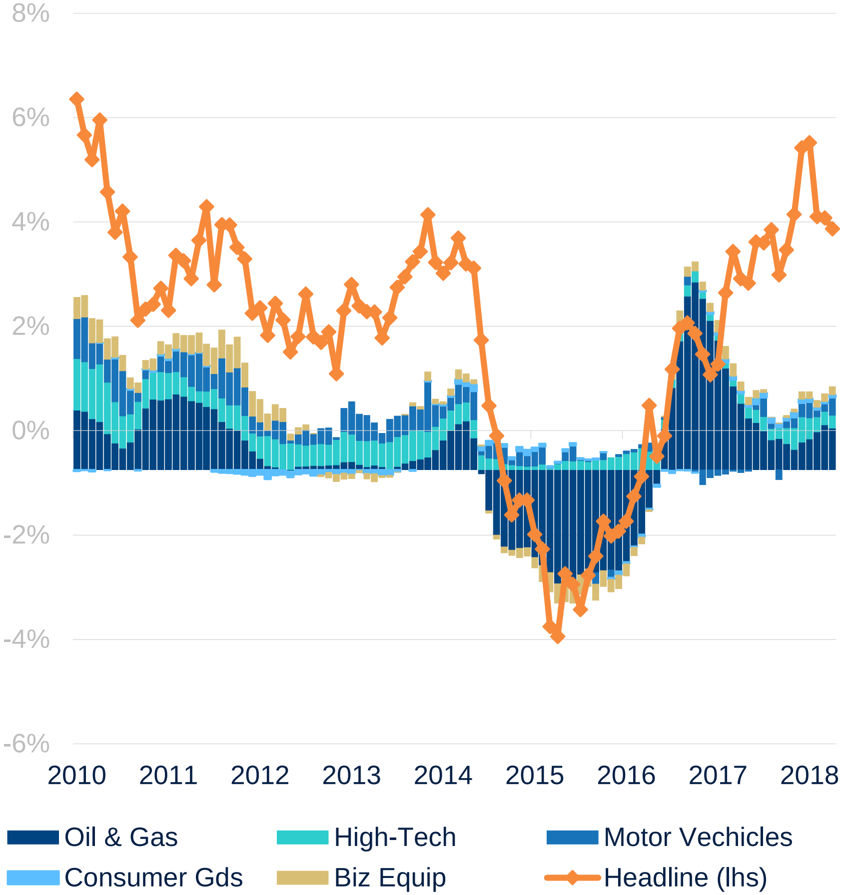


Source BBVA Research

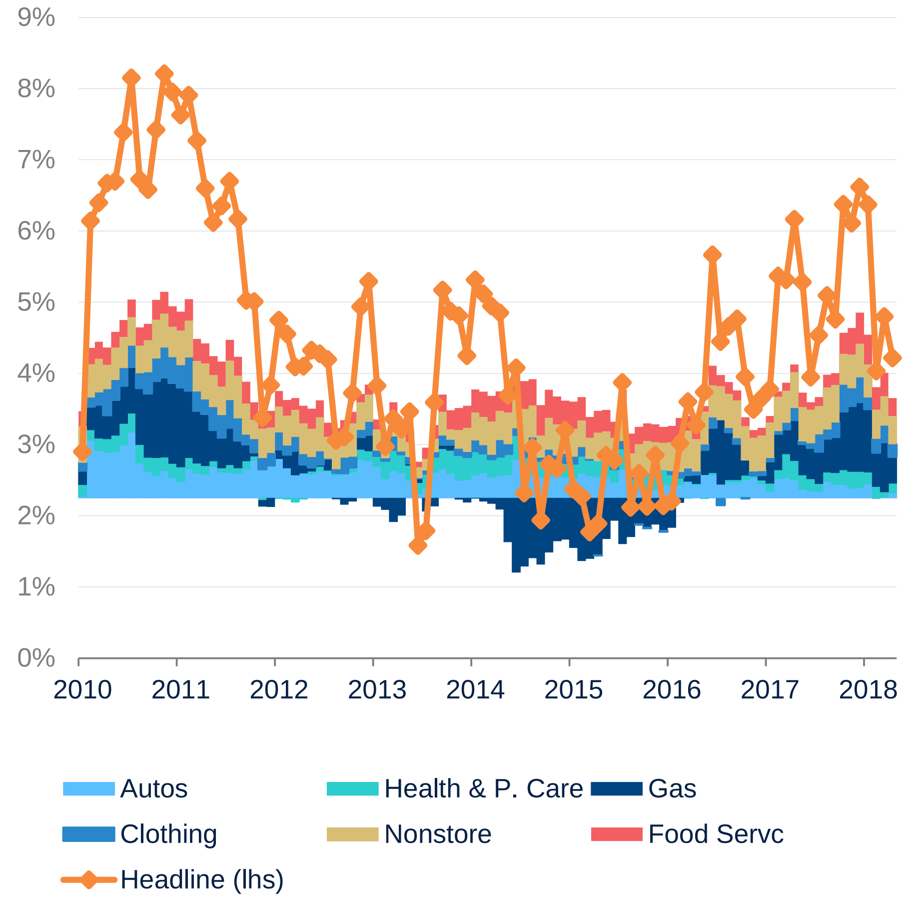
- Some delays and potential volatility in economic releases as a result of the government shutdown
- Small business optimism at lowest since 4Q17
- Survey-based manufacturing indictors suggest slowing activity, industrial production sound
- Home prices appreciation strong despite weaker demand side conditions
- Broad-based improvements in labor market

Economic trends: Industrial production and consumption moderating

Industrial Production
(Year-over-year %)



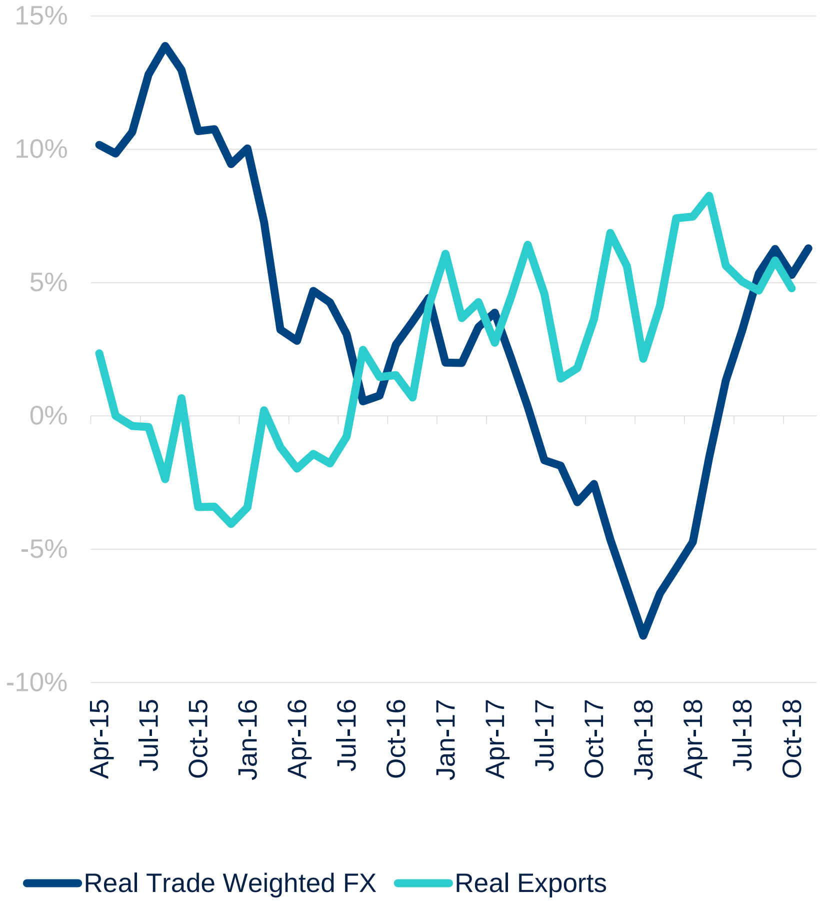
Retail Sales
(Year-over-year %)



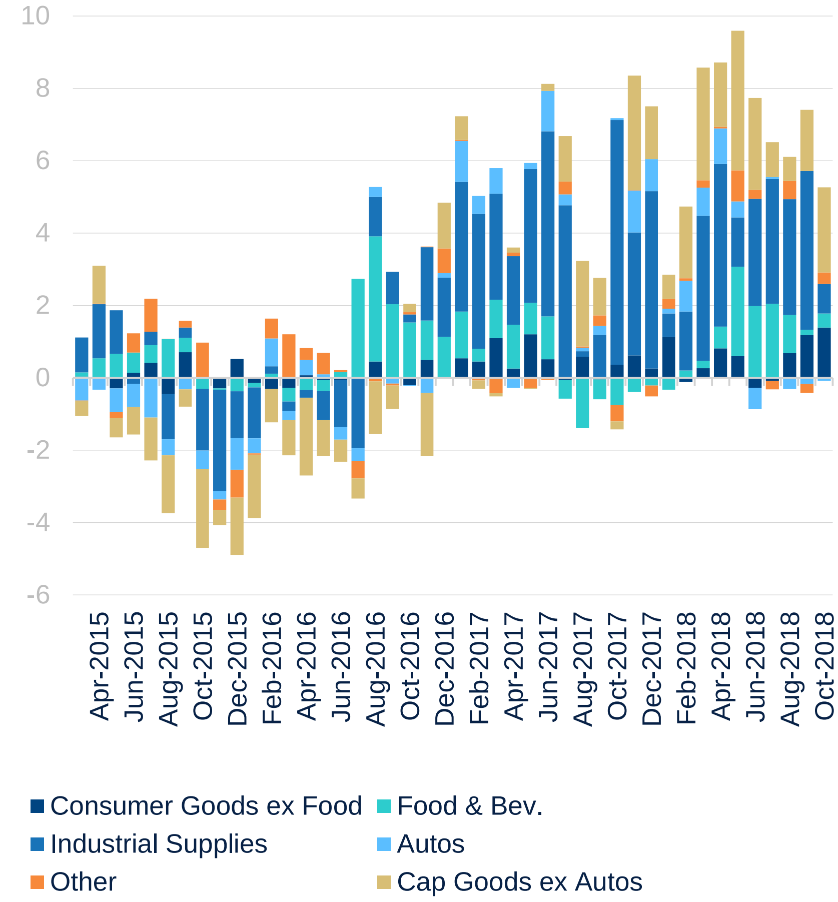
Source: BBVA Research, FRB & BEA

Economic trends: Delay in international trade report leaves uncertainty over impact from trade frictions

Real Exchange Rate and Exports
(Year-over-year %)



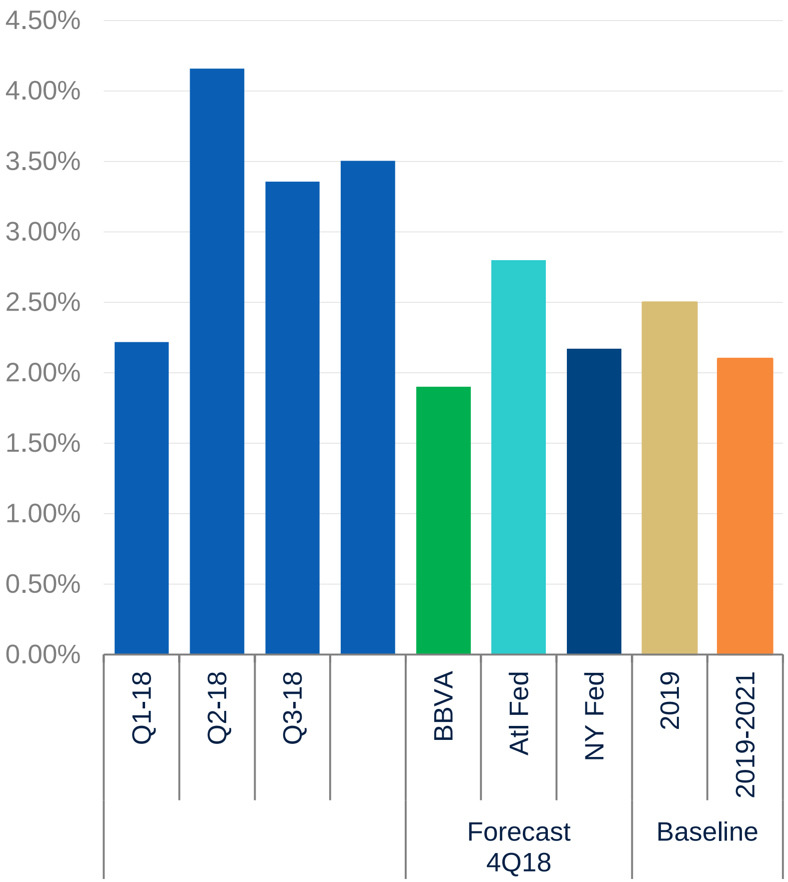
Real Exports
(Contribution to year-over-year %)



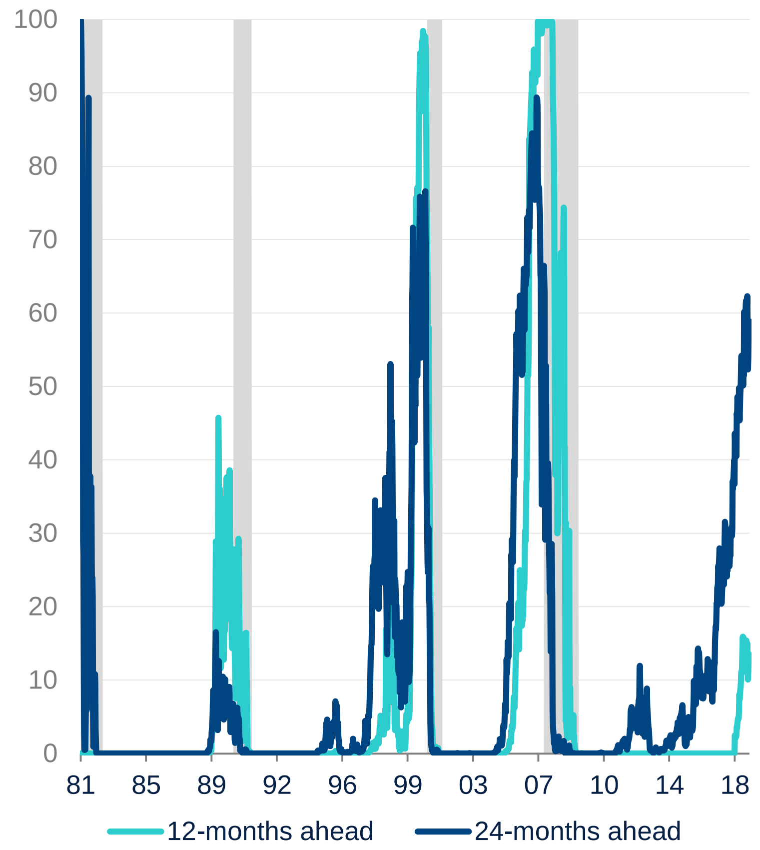
Source: BBVA Research, FRB & Census

Economic trends: Modest impact from government shutdown in 4Q18. Recession probability 13% in next 12-months, 59% in 24 months

Real GDP
(QoQ SAAR, %)



Probability of Recession in 12 Months
(%)

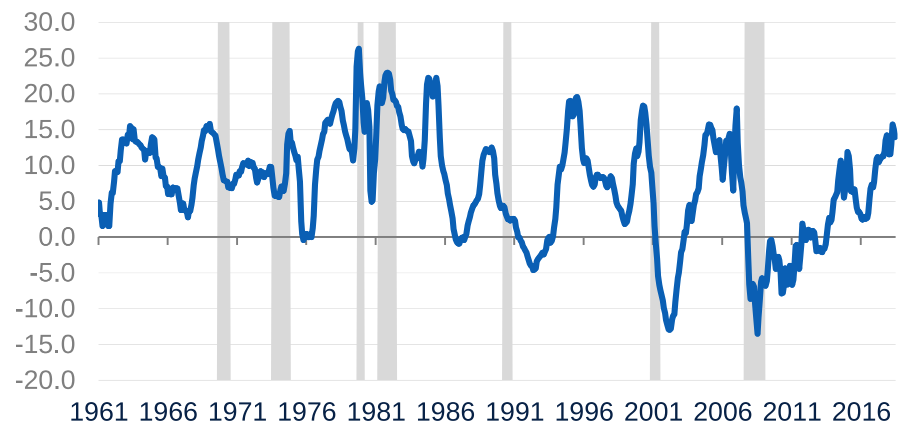


Source: BBVA Research, and ATL & NY Fed

Consumer credit cycle: Consumer fundamentals remain strong, but leverage increasing in rising rate environment

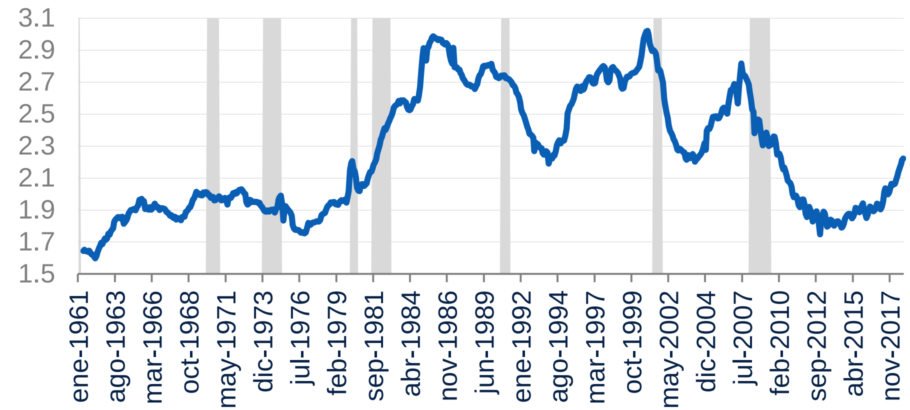
Personal Interest Expense

Year-over-year %



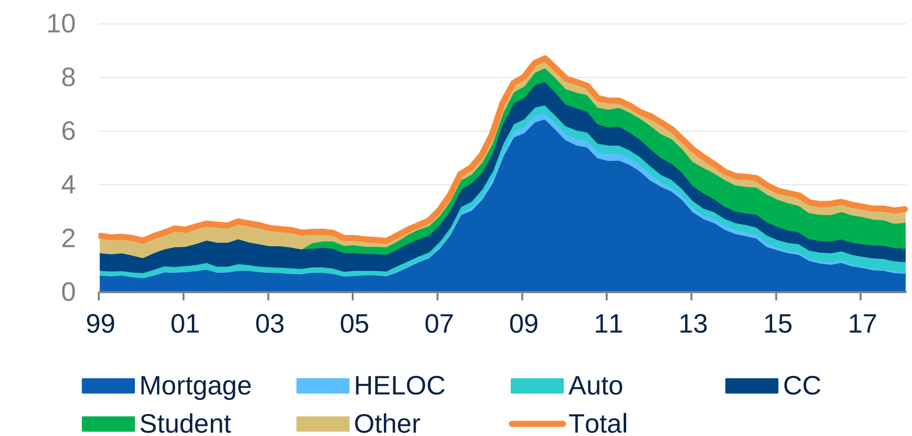
Personal Interest Expense to Disp. Income

Ratio, %



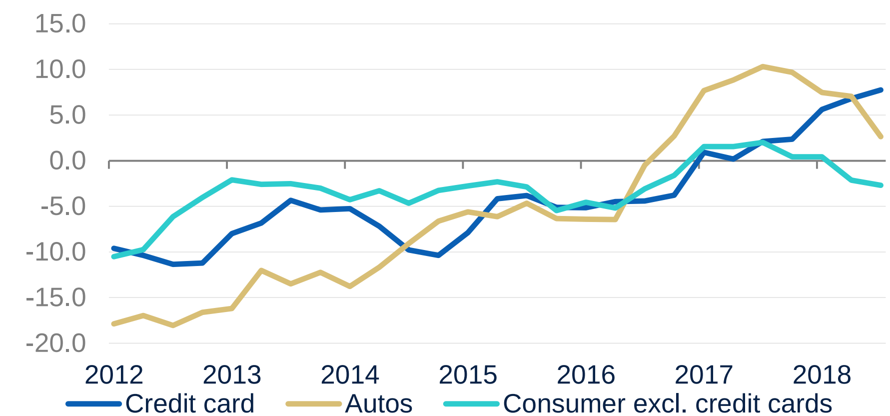
New 90+ Day Consumer Delinquencies Rates

%



Senior Loan Officers Lending Standards

+ tightening / - loosening



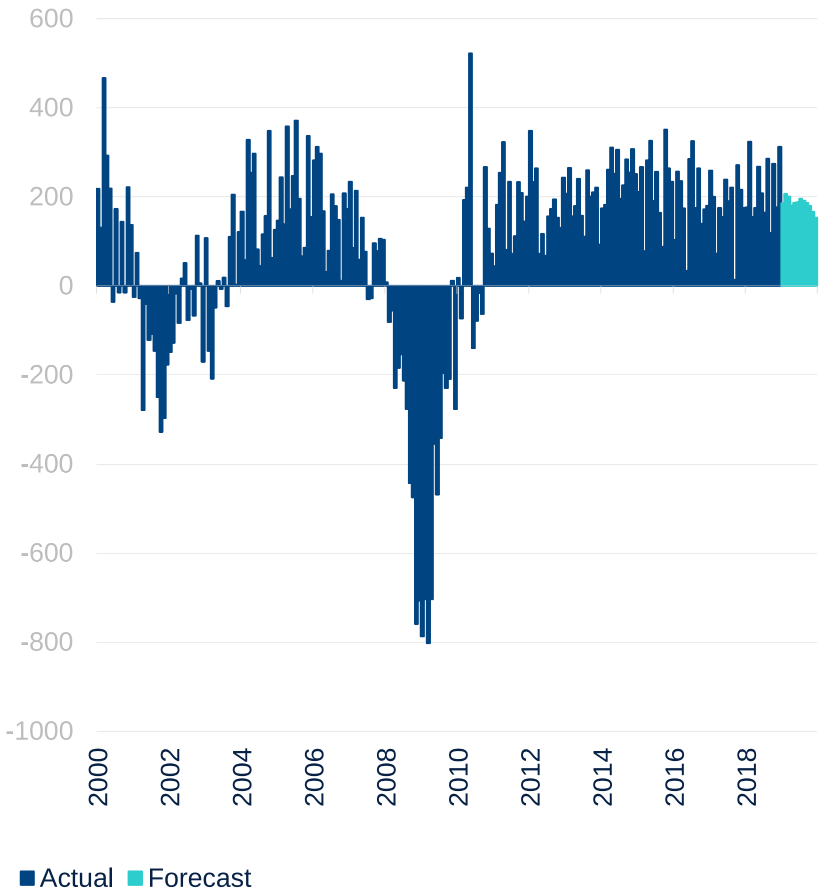
Source: BBVA Research, FRB, NY Fed & BEA

Labor Market

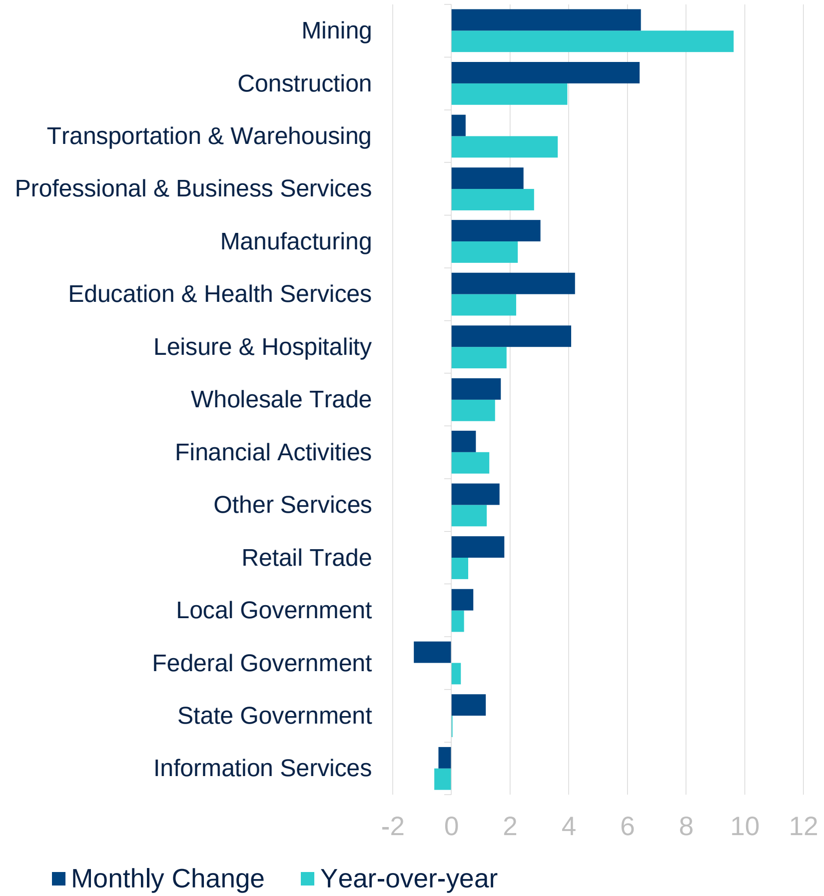
- In December, nonfarm payroll employment grew 312,000, up from 176,000 in November
- The unemployment rate increased 0.2pp to 3.9%, as the number of individuals voluntarily quitting or leaving their current jobs rose significantly
- Major industry gains: health care (50K), food service and drinking places (41K), construction (38K), and manufacturing (32K)
- In 2018, average monthly nonfarm payroll grew at a pace of 199,900 per month while UR dipped below 4.0%. The slightly uptick in the unemployment rate reflects higher number re-entrants and levels of confidence in job leavers
- The labor force participation rate and employment-to-population increased to 0.4pp to 63.1% and 60.6%, respectively
- In 2019, we expect the UR to decline 3.7% despite a deceleration in the pace of job growth

Labor market: Strong job growth to end the year

Nonfarm Payrolls
(Monthly Change, K)



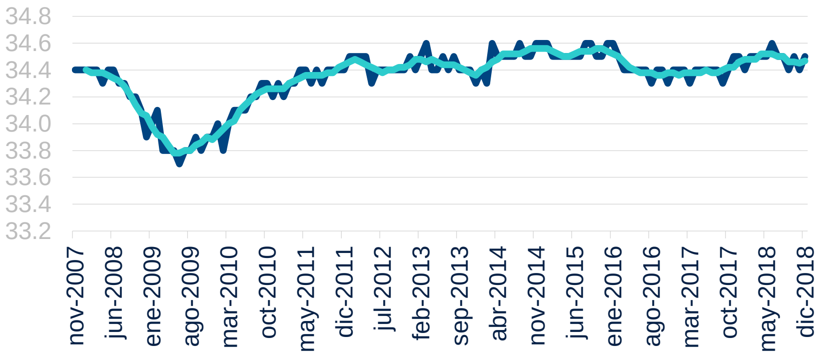
Industry Employment
(Annualized % change)



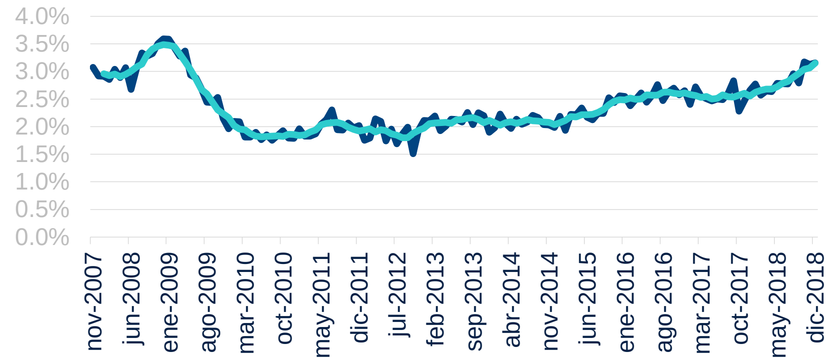
Source: BBVA Research & BLS

Labor market: Wage pressures rising, as prime age slack abates

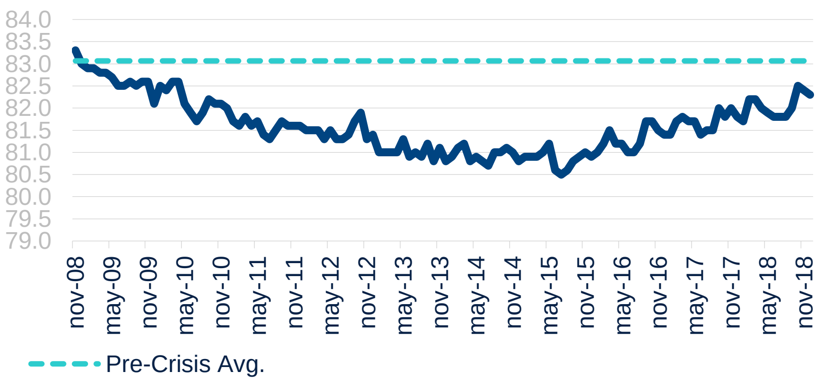
Average Weekly Hours
(number & 5mcma)



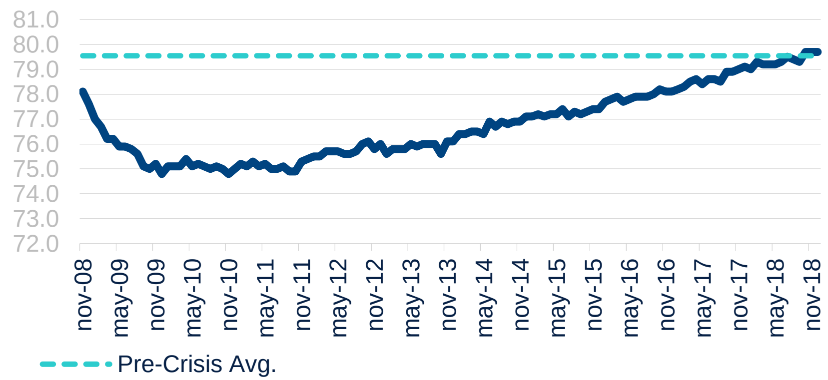
Average Hourly Earnings
(YoY% & 5mcma)



Prime Age Labor Force Participation
(%)



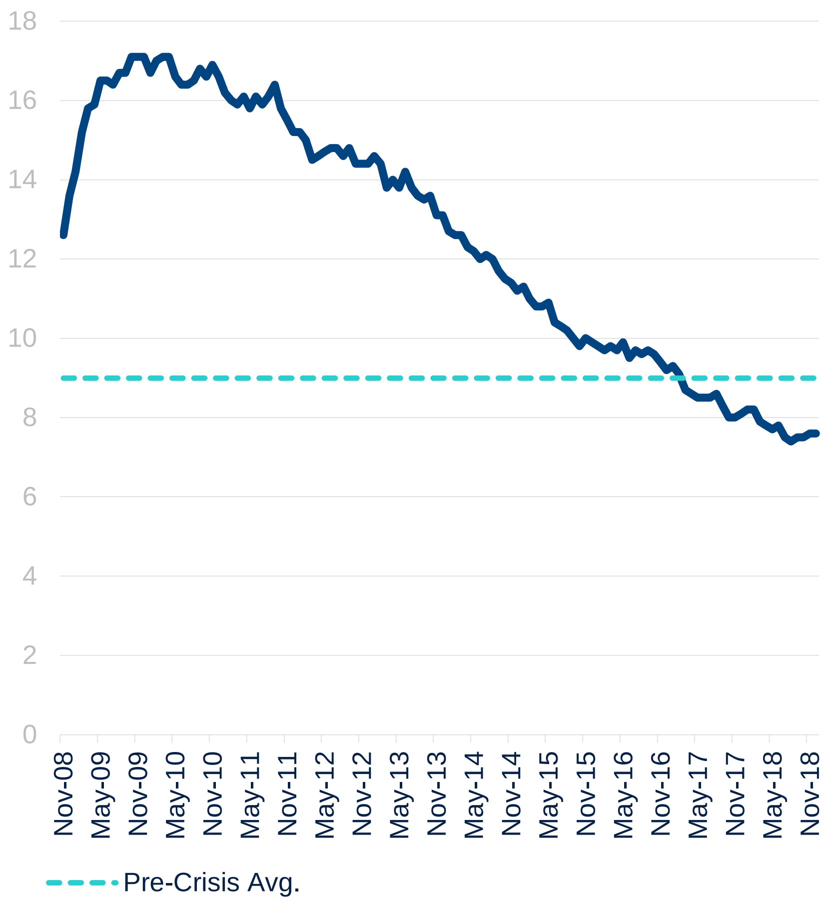
Prime Age Employment-to-Population
(%)



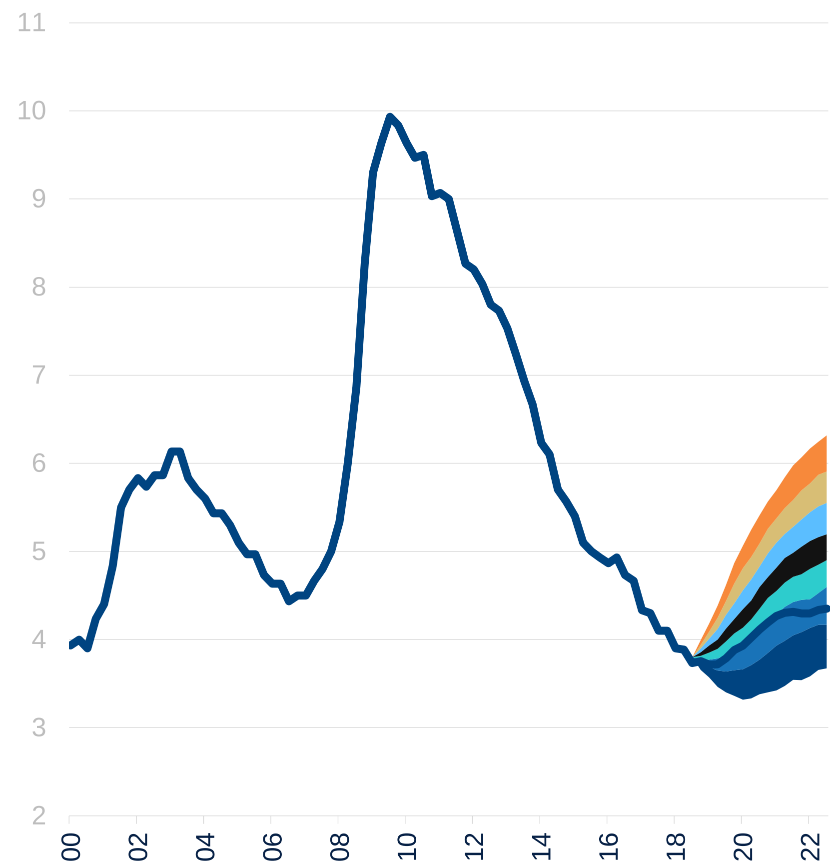
Source: BBVA Research & BLS

Labor market: Modest declines UR amidst high labor market utilization

U-6
(%)



Unemployment Rate
(%)



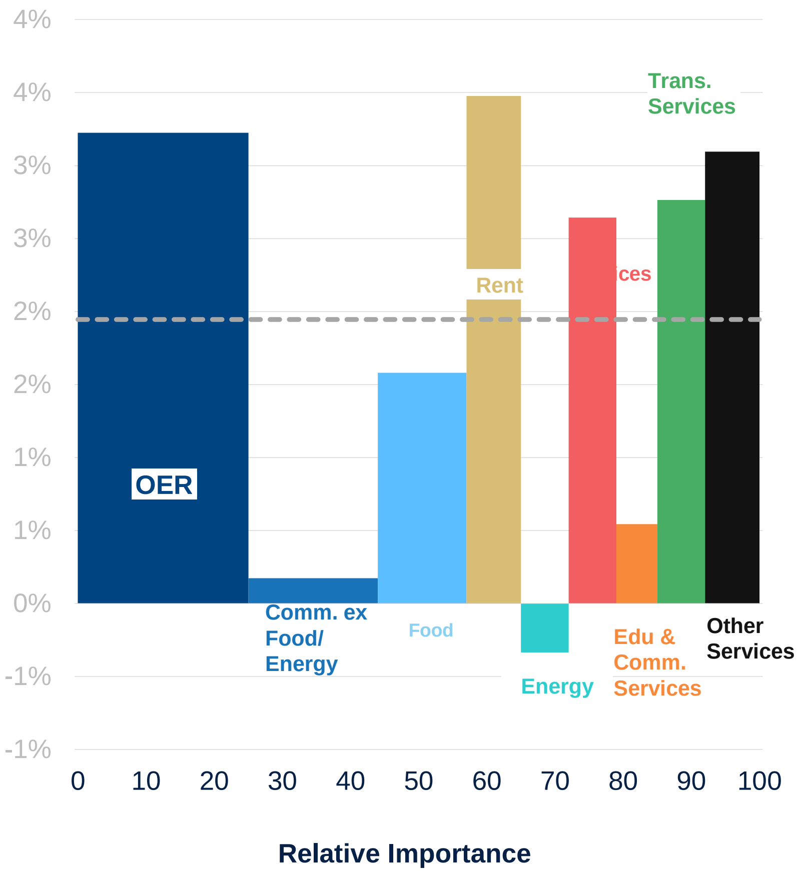
Source: BBVA Research & BLS

Inflation

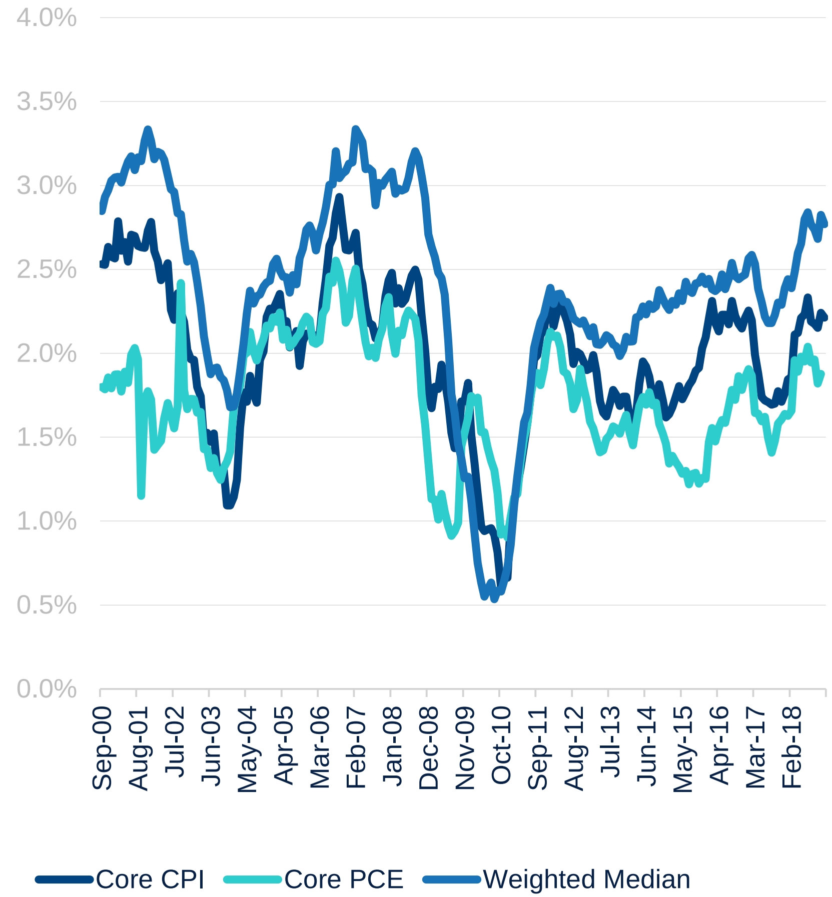
- The headline consumer price index (CPI) fell 0.1% in December driven by 3.5% decrease in energy prices and declines for used cars, drugs, airline fares and tobacco
- Core CPI increased 0.2%, the same gain as in October and November, suggesting modest pass-through from volatile energy costs
- The probability of entering high-inflation regime remains remote
- Over the last 12 months, headline CPI increased 1.9% while core CPI has increased 2.2%
- Implied 5-year and 10-year inflation expectations have declined to 1.6% and 1.9%, respectively
- Despite signs of tighter labor markets, ongoing trade disputes, and pressures on profit margins, inflationary pressures remain well contained

Inflation: Although core prices remains stable, headline dropping due to decline in energy prices

Consumer Price Inflation
(12m change)



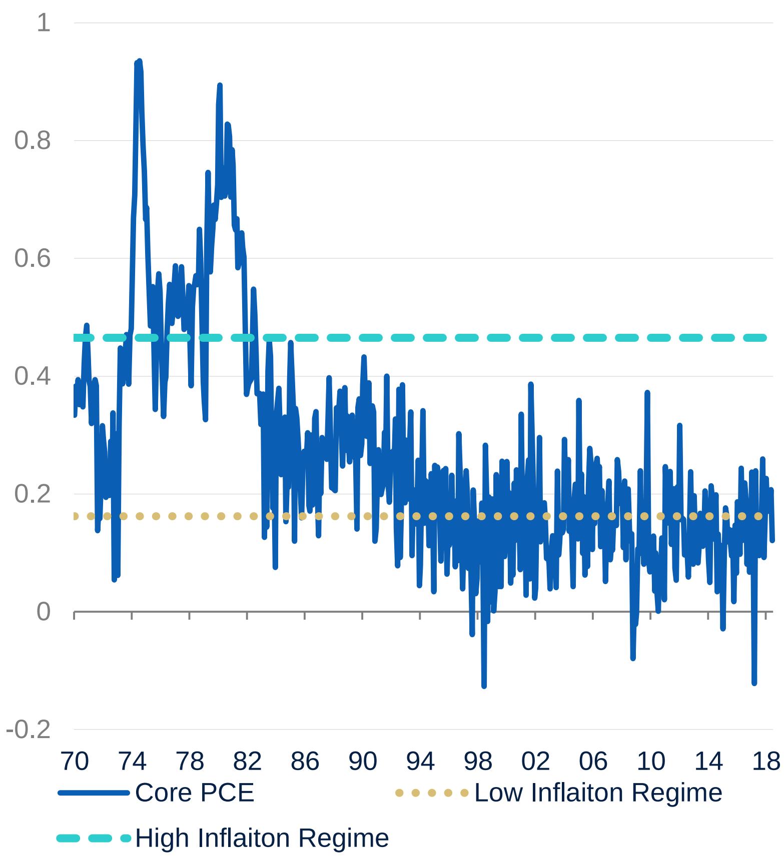
Core Inflation Measures
(12m change)



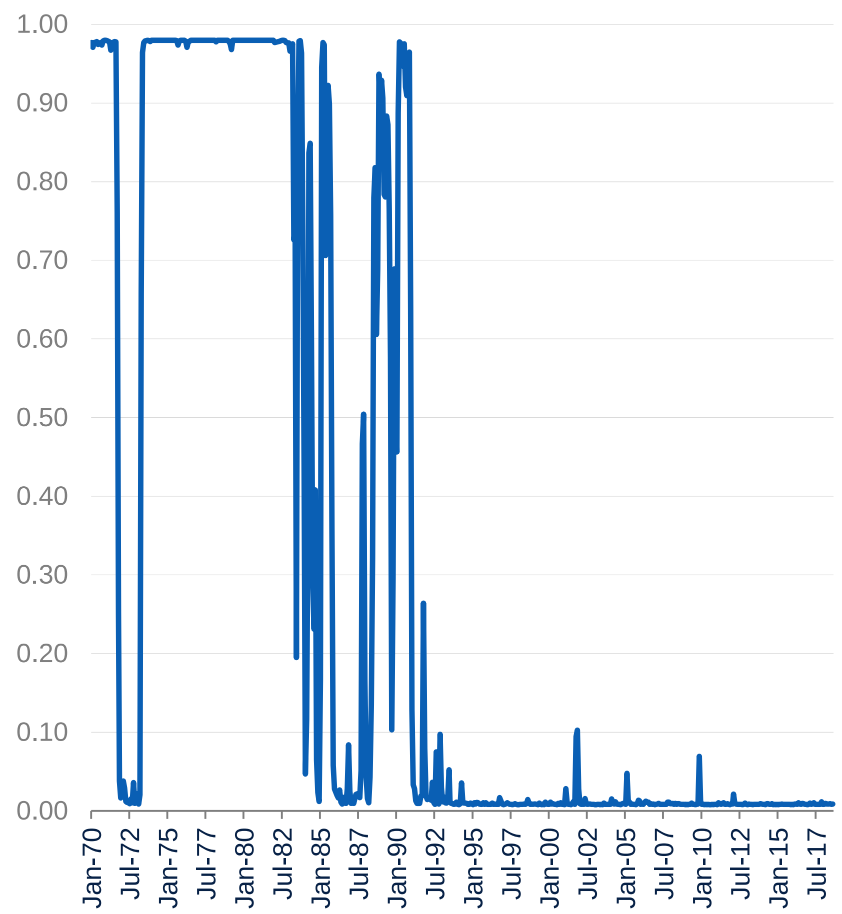
Source: BBVA Research, BLS & BEA

Inflation: Probability of high inflation regime extremely low

Core PCE Price Index & Inflation Regimes
Month-over-month %



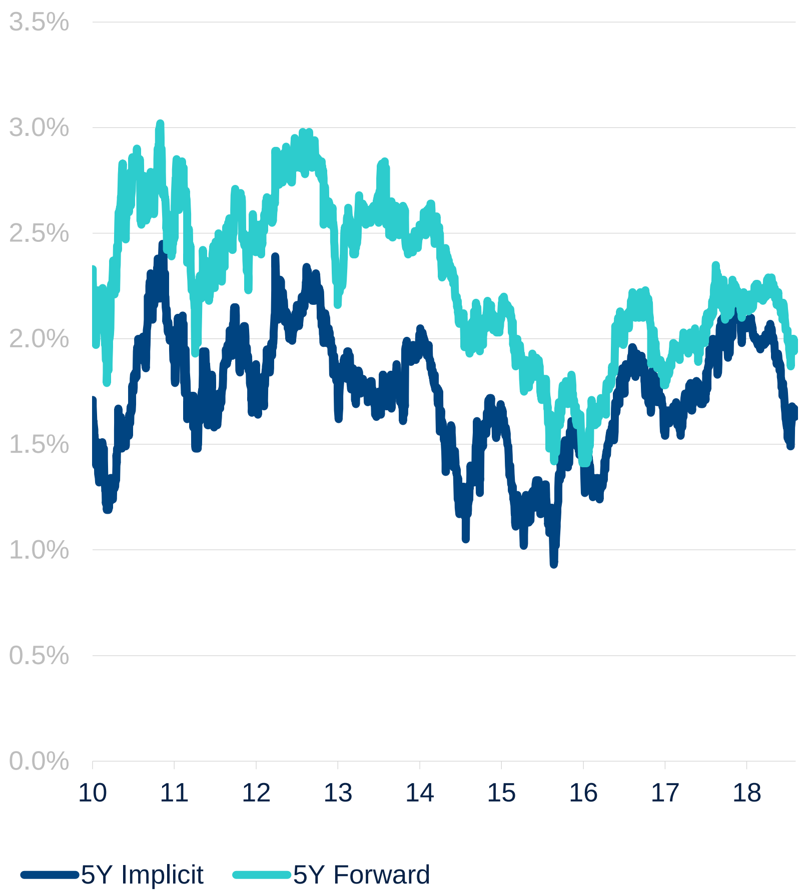
Inflation Regime Change Probability
%



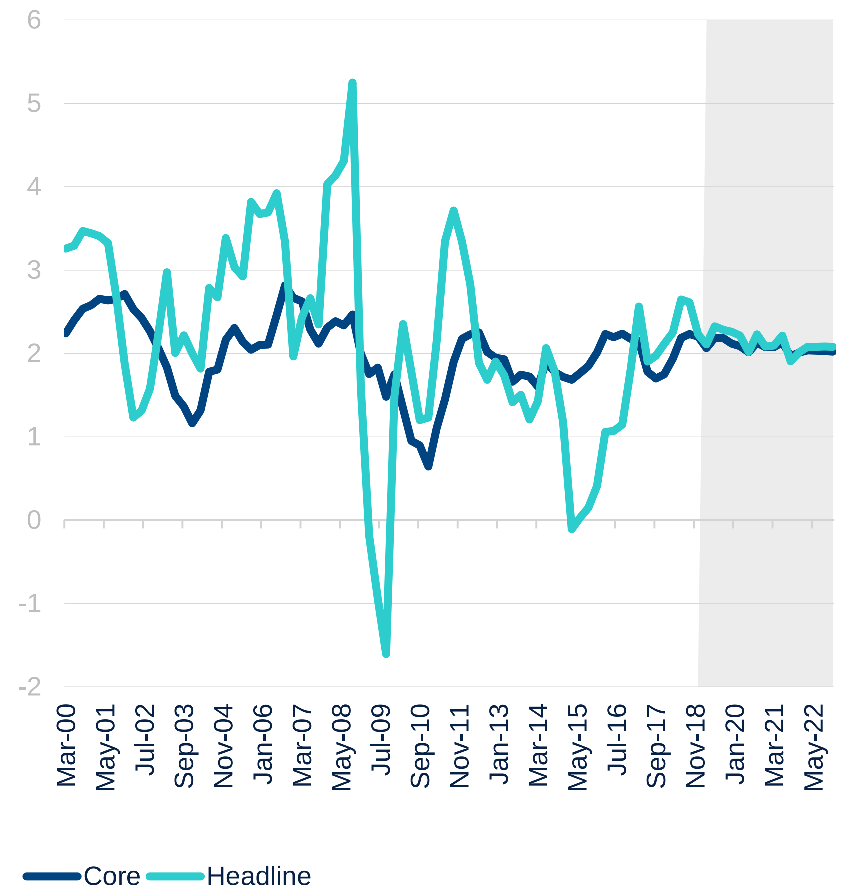
Source: BBVA Research & BLS

Inflation: Baseline for faster convergence to 2% in 2019

Inflation Expectations
(%)



Headline & Core CPI
(Year-over-year %)



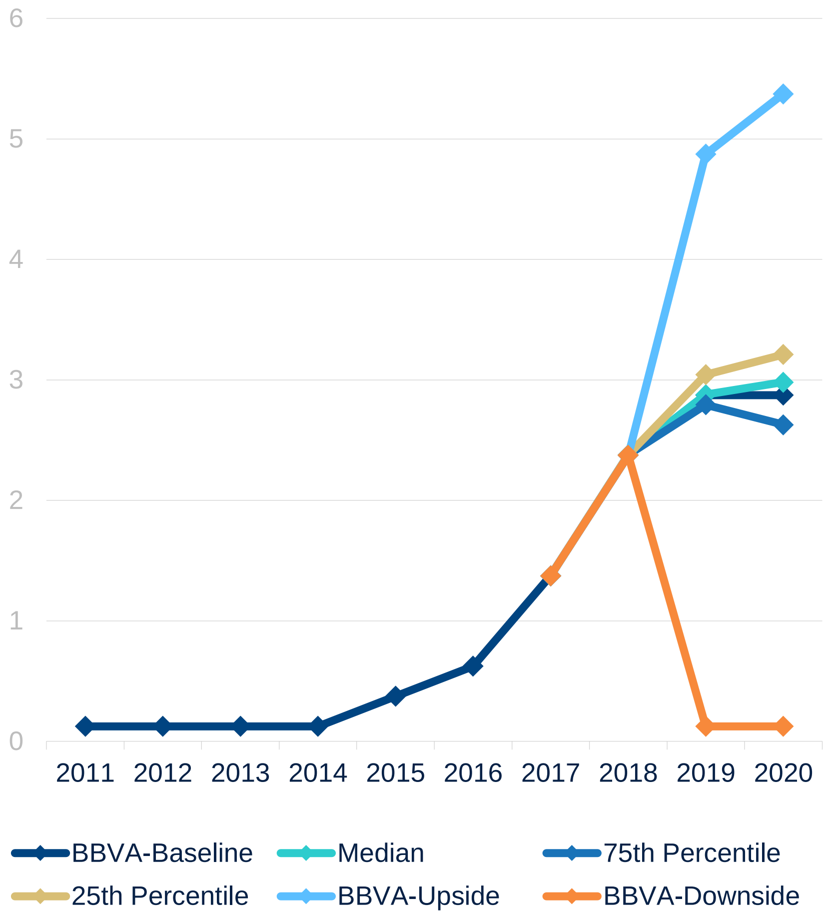
Source: BBVA Research & Haver Analytics

Monetary Policy: Federal Reserve

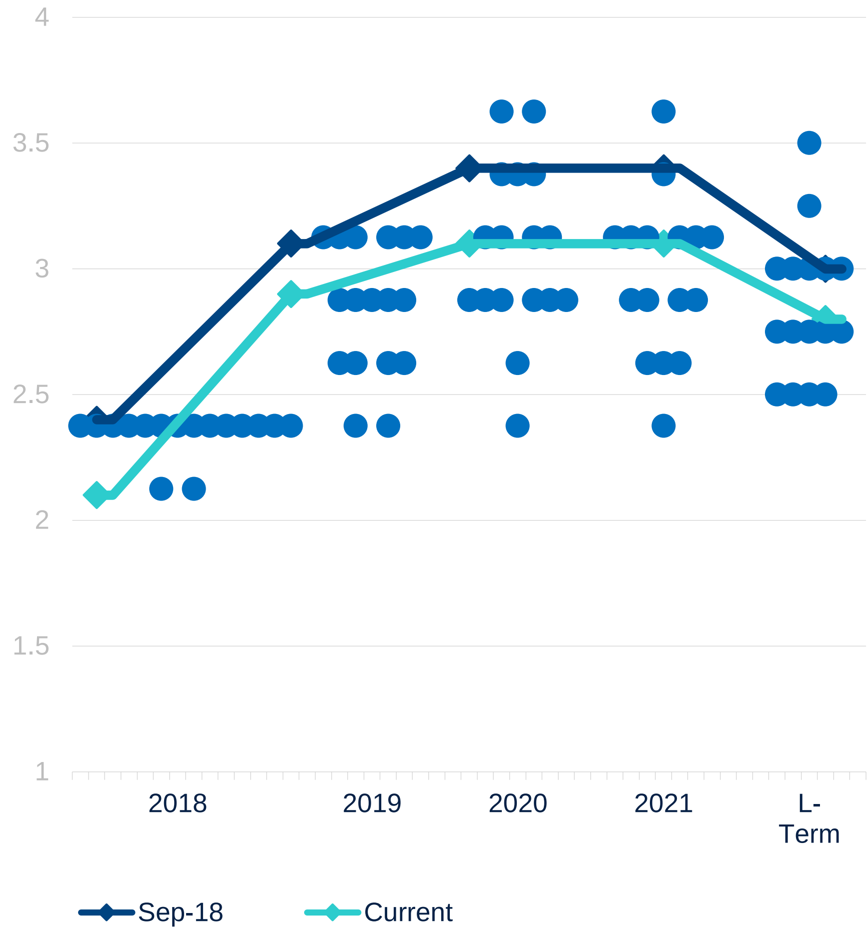
- The Fed to keep rates unchanged at their January meeting
- FOMC will use the January 29th-30th statement and press conference to communicate a slightly dovish shift in policy
- The Fed is trying to calibrate the remaining stretch of its normalization path in order to ensure a soft-landing amidst an uptick in market volatility and growing concerns about financial stability
- In an effort to remain careful and patient, we expect the Fed to pause in 1Q19
- Baseline now assumes 2 rate increases in 2019, terminal level 3.0%
- Markets no longer pricing rate increases in 2019 while likelihood of rate cuts has edged up

Fed: Delayed rate increases in effort to engineer soft-landing

BBVA & Dealers Projections of Fed Funds
(%, Effective)



FOMC Projections of Fed Funds
(Year-over-year %, Mid-point)

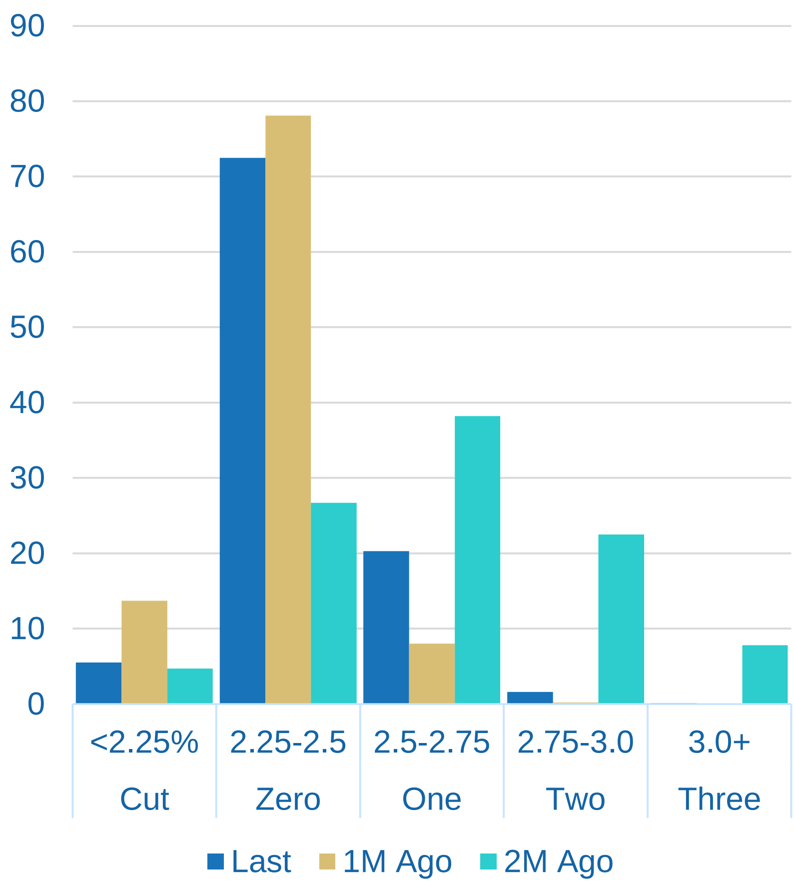


Source: BBVA Research & FRB

Monetary policy: Markets discounting prolonged pause in interest rate normalization

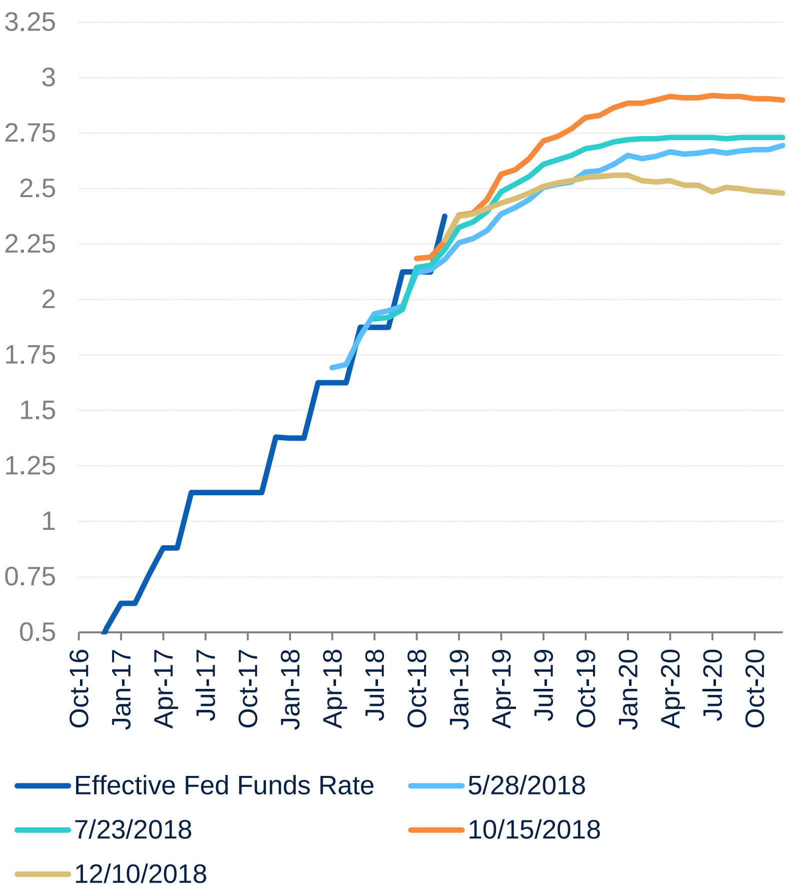
Fed Funds Implied Probability

(Number of rate increases through 2019, %)



Fed Funds Futures & BBVA Baseline

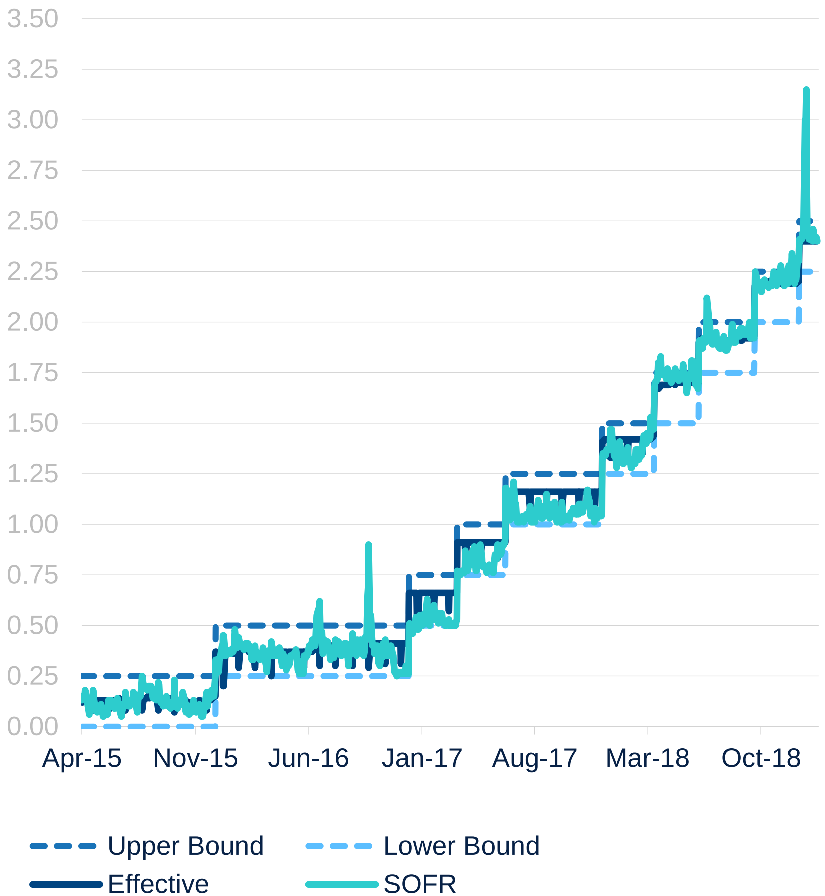
(%)



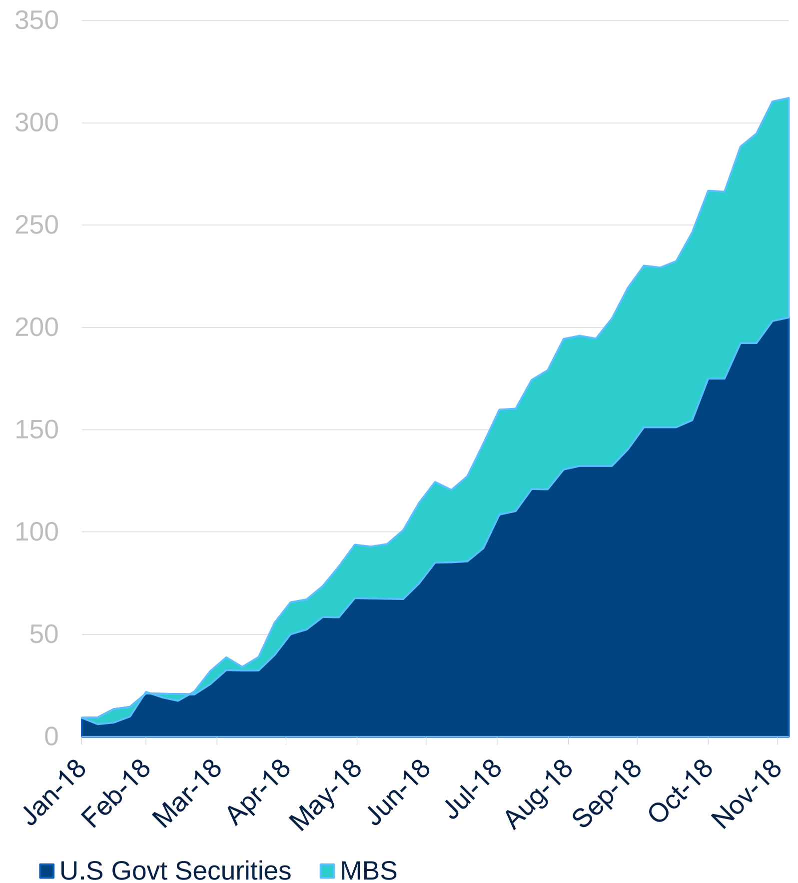
Source: BBVA Research & Bloomberg

Monetary Policy: In short-term, balance sheet strategy unlikely to deviate from current path

Fed Funds & Repo Rates
(%)



Balance Sheet Attrition
(US$bn, Cumulative)



Source: BBVA Research & FRB

Interest Rates

- Lower Fed Funds expectations and weaker inflation outlook slows upward momentum in short end of the yield curve
- 10-yr Treasury at 2.75%, 50bp below 4Q18 peak
- Downward pressure on term premium renewed due to increased global uncertainty, flight-to-safety, and rebalancing of expectations
- Downward revision to 10-year Treasury yields based on more moderate macro outlook, dovish shift in monetary policy and term premium headwinds
- Downward revision in long-term yields matched by shallower short-term rate path
- Yield curve slope remains positive in our baseline scenario

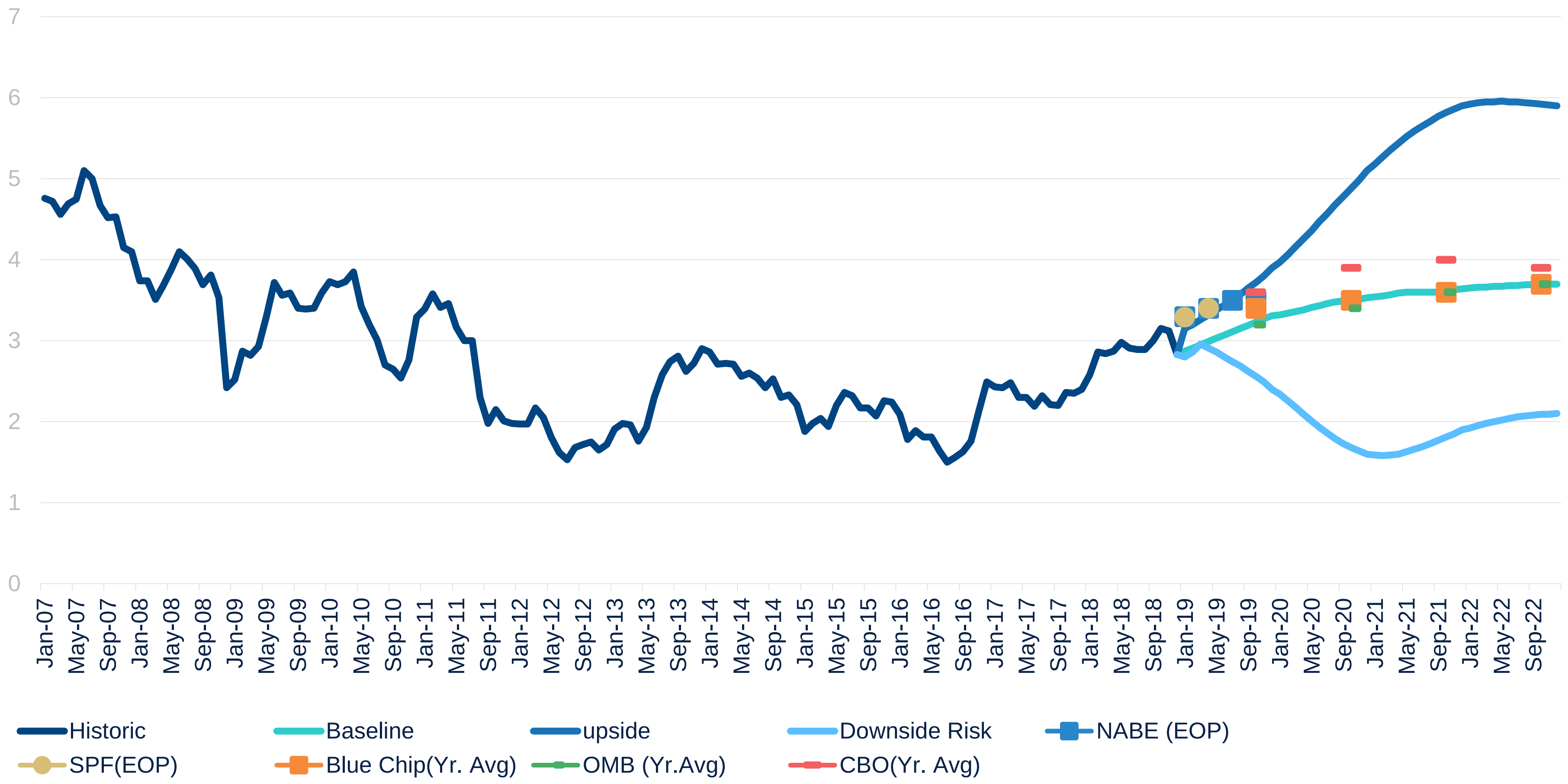
Interest rates: Term premium decompression short-lived, as 10-year Treasury drops to 2.75%

10-Year Treasury Yield Decomposition
(%)

Source: BBVA Research, ACM & Haver Analytics

Interest rates: Nontrivial downward revisions to 10-year

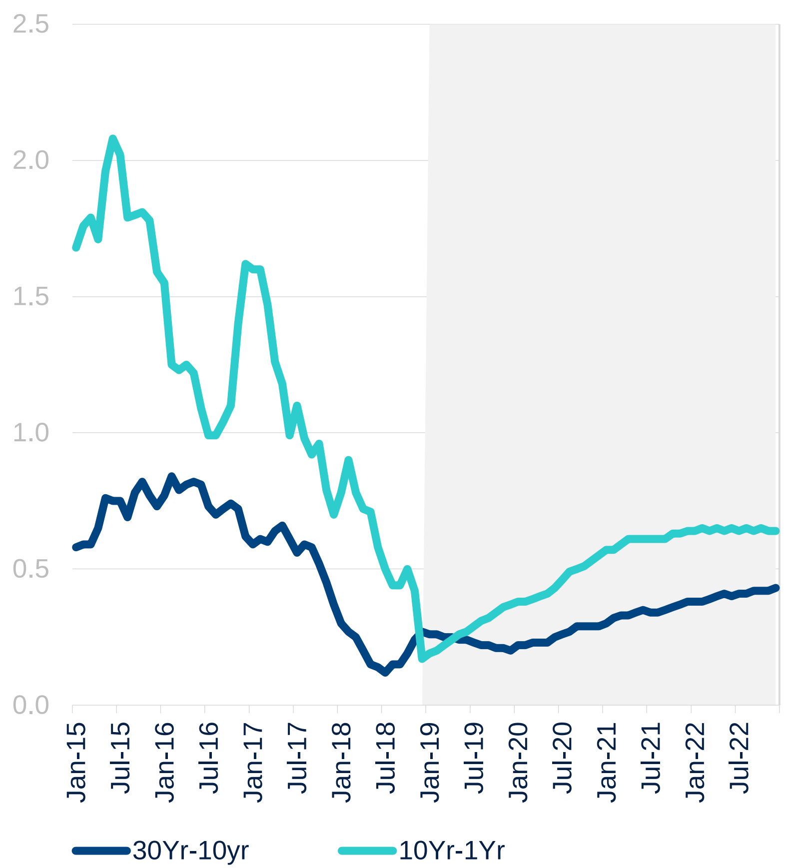
10-Year Treasury Yield
(%)



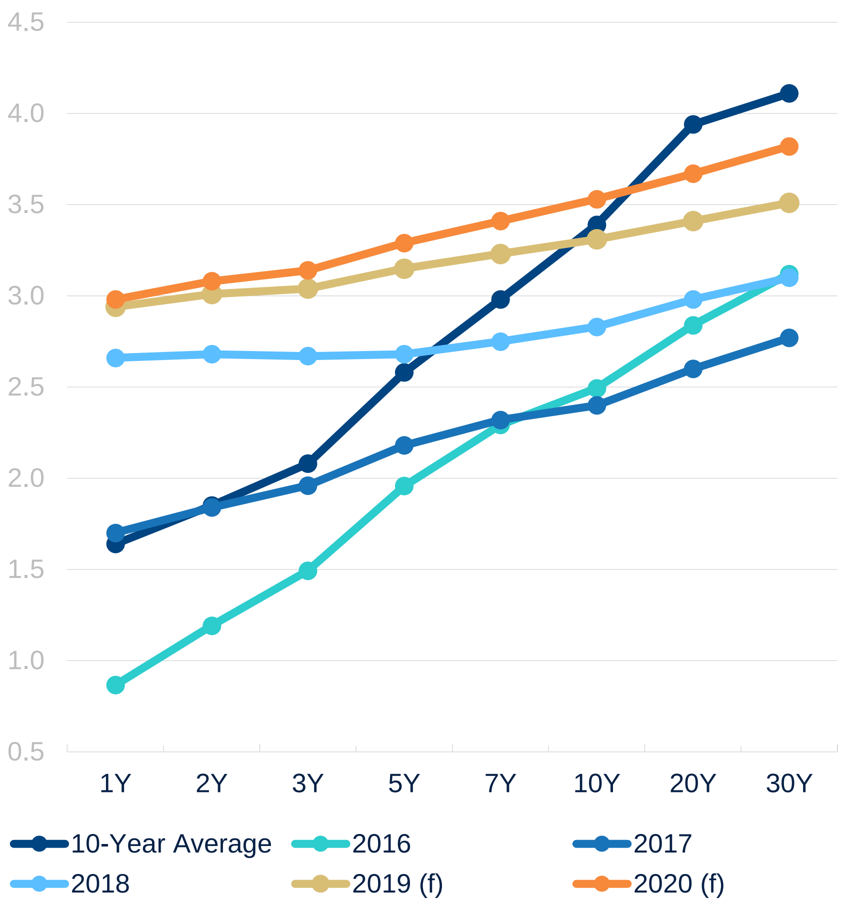
Source: BBVA Research, ACM & Haver Analytics

Interest rates: Slope in yield curve positive with fewer rate hikes and modest decompression in term premium

Yield Curve Slope
(Bp)



Yield Curve
(%, eop)



Source: BBVA Research

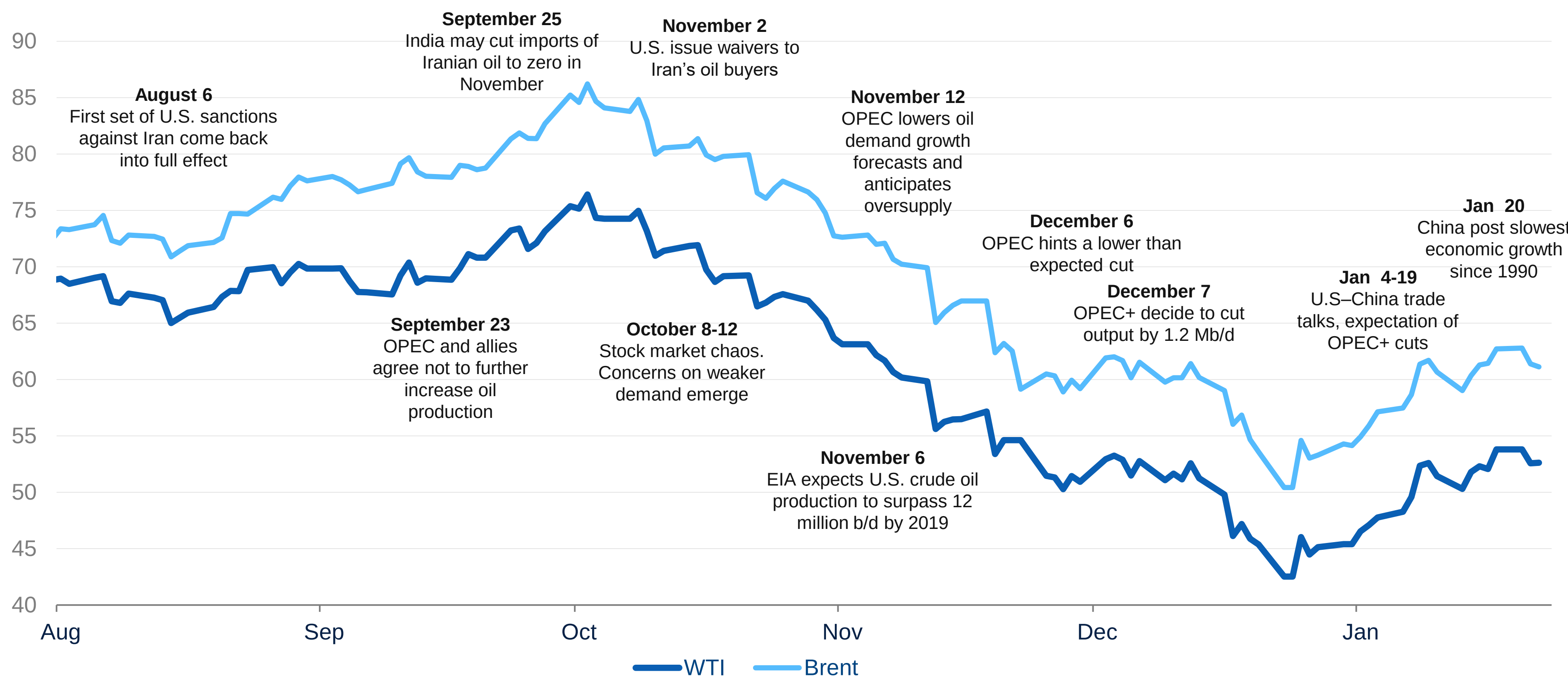
Oil Prices

- OPEC+ decision to reduce output prevented prices from declining further
- The expiration of import waivers of Iranian oil could have a positive effect on prices
- U.S. production is expected to remain robust through the year
- Demand is projected to slow down as global economic growth weakens
- Prices could move between $60 and $70 in 2019, but may decelerate further in 2020
- We maintain our forecasts of convergence to long-term equilibrium around $60/b
- Elevated uncertainty around long-term equilibrium: CAPEX, protectionism, alternative energy sources, EM convergence, EVs, climate change, efficiency and technology

Oil prices increased after OPEC+ committed to curtail production and markets perceived some progress in the U.S.-China trade negotiations

Crude oil prices August 2018 to January 2019

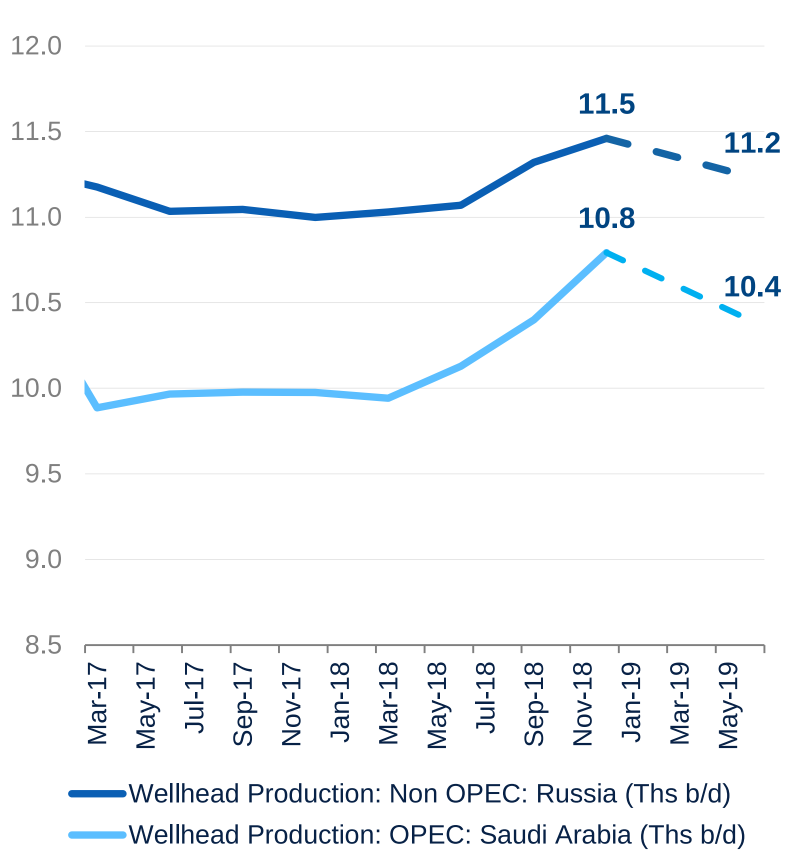
($ per barrel)



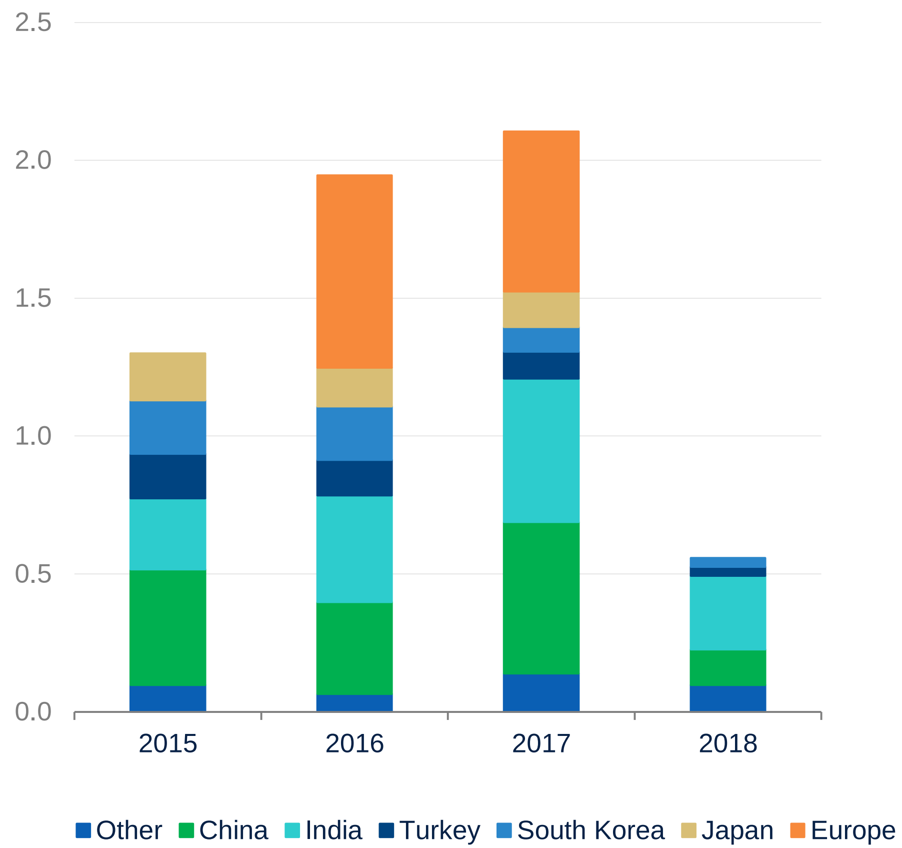
Source: BBVA Research and Haver Analytics

OPEC+ adjustments have yet to fully materialize. The expiration of waivers to importers of Iranian oil would tighten supply even further

Crude oil production
(Million barrels per day)



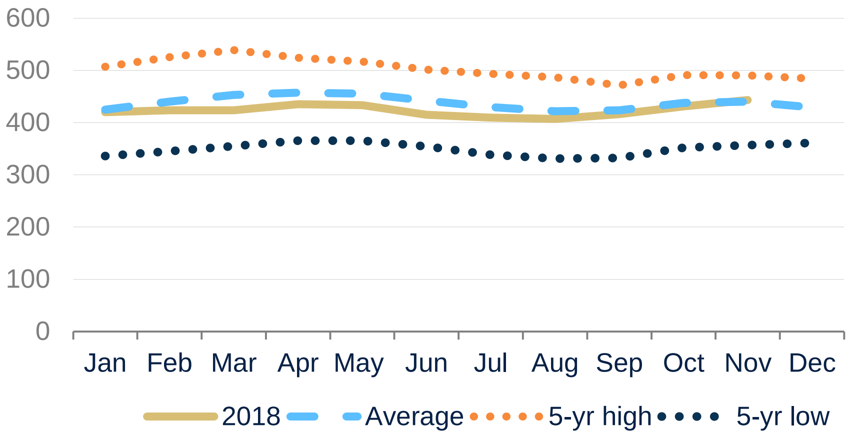
Iran: exports of crude oil
(million barrels per day)



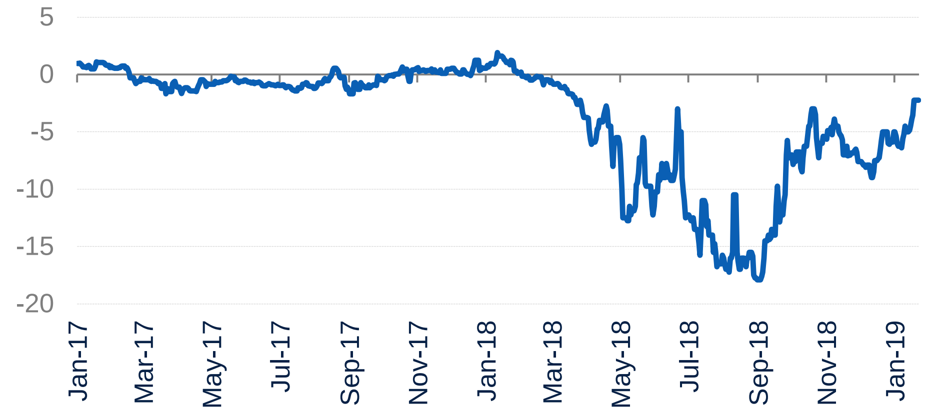
Source: BBVA Research, Haver Analytics, and Bloomberg

In the meantime, U.S. production will remain solid. Transportation bottlenecks may ease in 2019

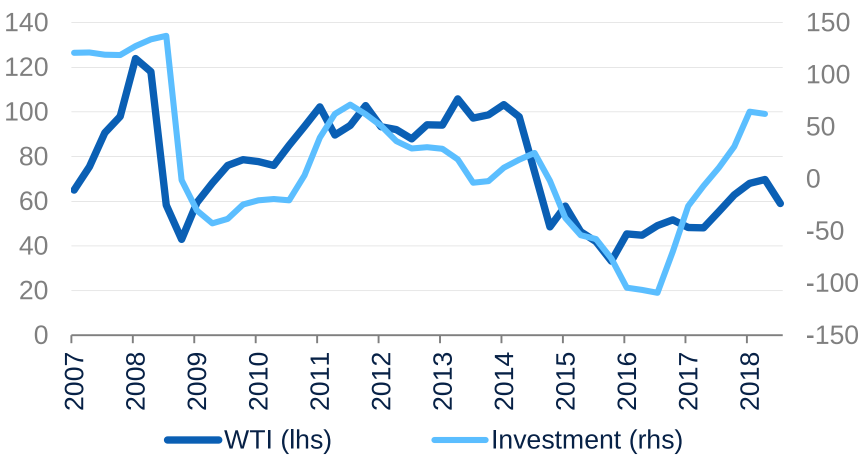
U.S. Crude oil inventories
(Excluding SPR, million barrels)



WTI Midland-Cushing differential
($/b)



U.S. Real private investment in E&P
(yoy $billion)

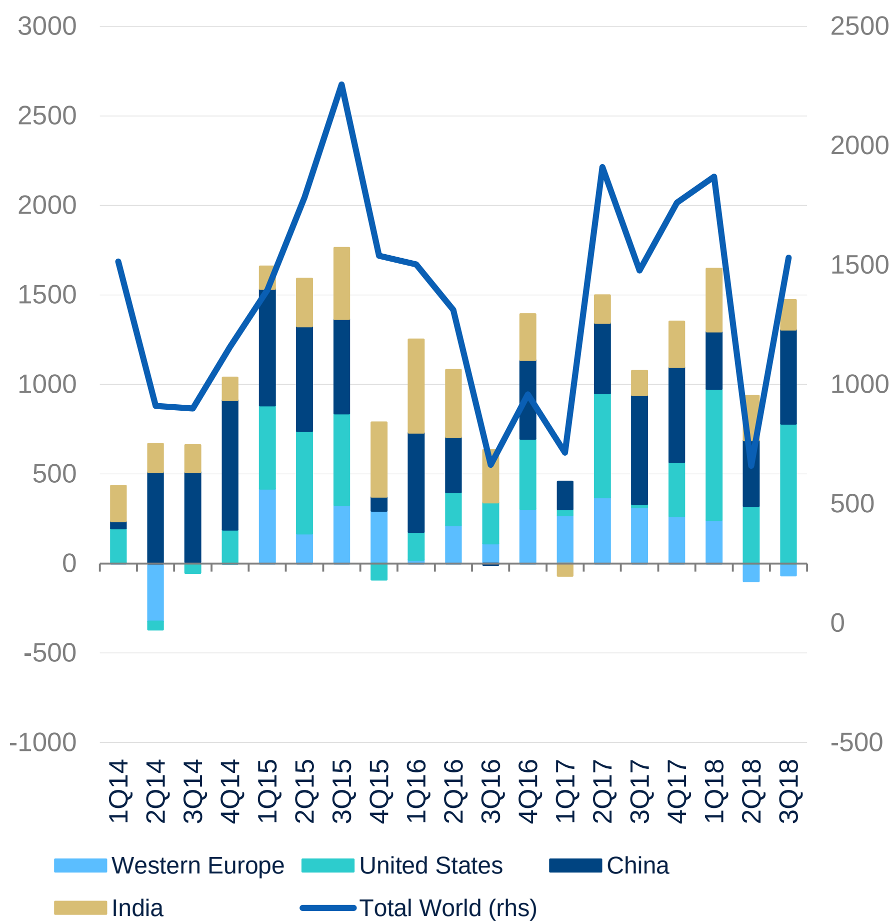


U.S. Estimated crude oil production
(Thousand barrels/day)

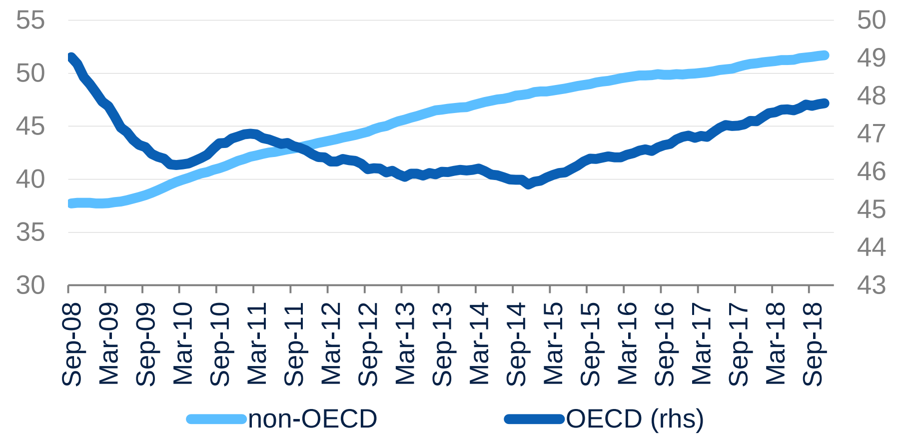
Source: BBVA Research and Haver Analytics

Demand supported by China, India and the U.S.

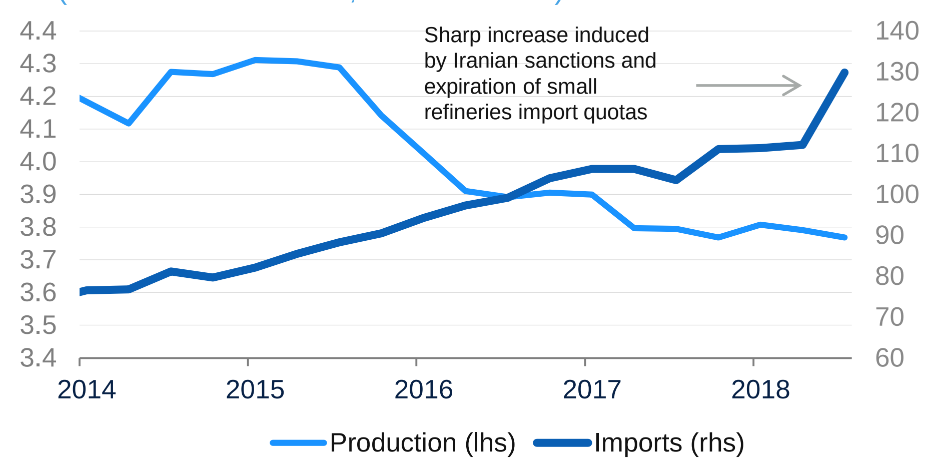
Oil product demand: total world
(Thousand barrels per day, yoy change)



Oil product demand
(Million barrels per day)



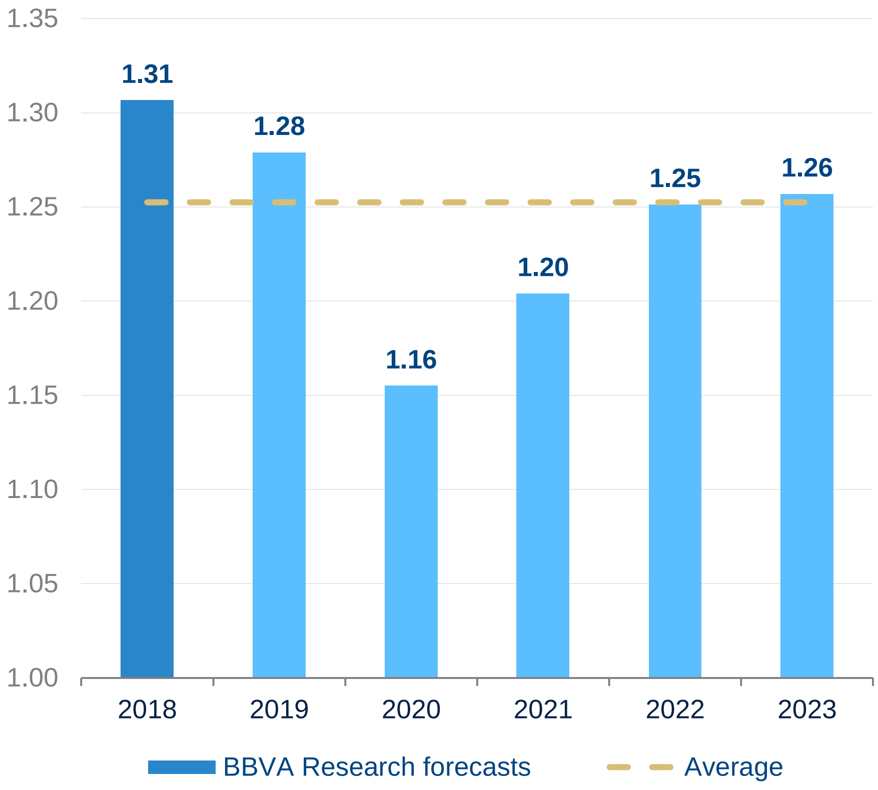
China: imports and production of crude oil
(Million metric tons SA, and million b/d)



Source: BBVA Research and Haver Analytics

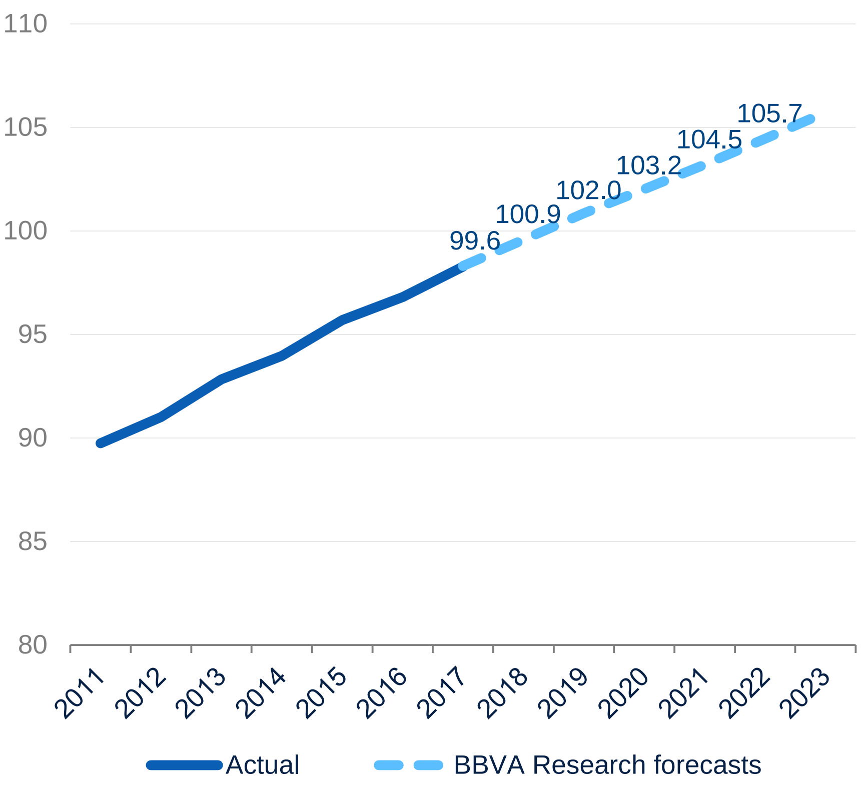
A weaker economic outlook points to slower demand growth

Oil product demand
(YoY change, million b/d)



Source: BBVA Research

Oil product demand
(million b/d)



Source: BBVA Research

Short-term risks are now tilted to the downside

>= $65/b*

- OPEC+ expands output deal to 2H19
- Oil waivers to importers of Iranian oil expire and are not renewed
- Additional negative supply shocks (e.g. Venezuela, Libya, Nigeria)
- Consistent signs of progress in trade negotiations between the U.S. and China
- Milder-than-expected deceleration of global demand
- Takeaway issues preventing U.S. crude to reach global markets

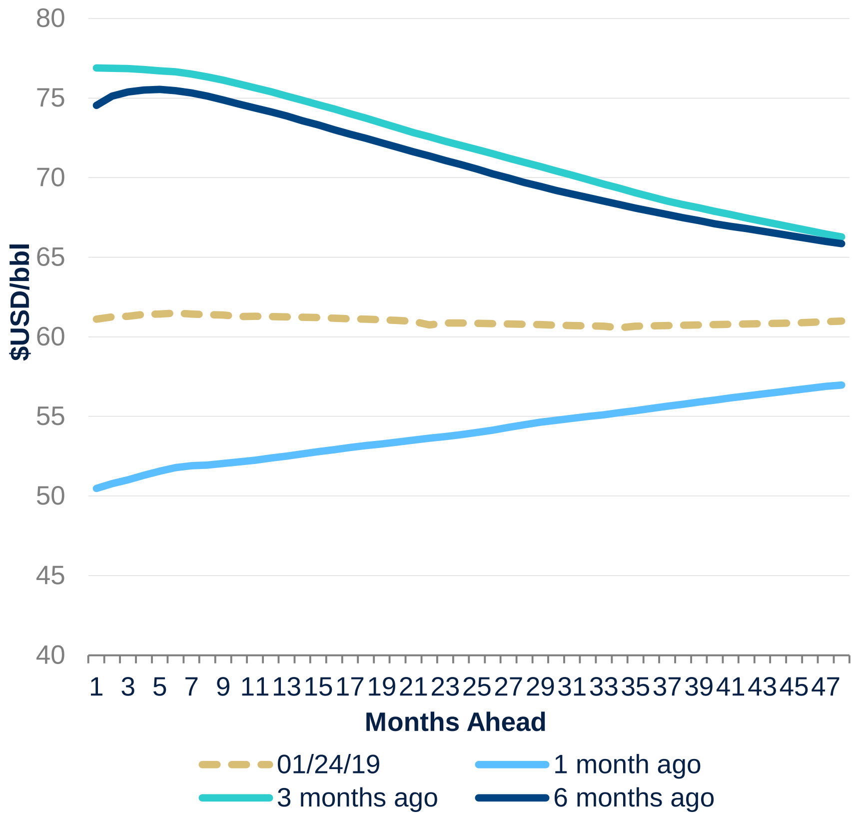
< $65/b*

- Weaker global economic outlook
- Persistent deadlock in trade talks between U.S. and China
- Dollar appreciation
- President Trump's pressure on OPEC
- Limited enforcement of Iranian sanctions
- Higher-than-expected crude oil production in the U.S.

*Brent crude prices. Source: BBVA Research

Prices could move between $60/b and $70/b in 2019, but may decelerate further in 2020. We maintain our forecasts of convergence to long-term equilibrium around $60/b

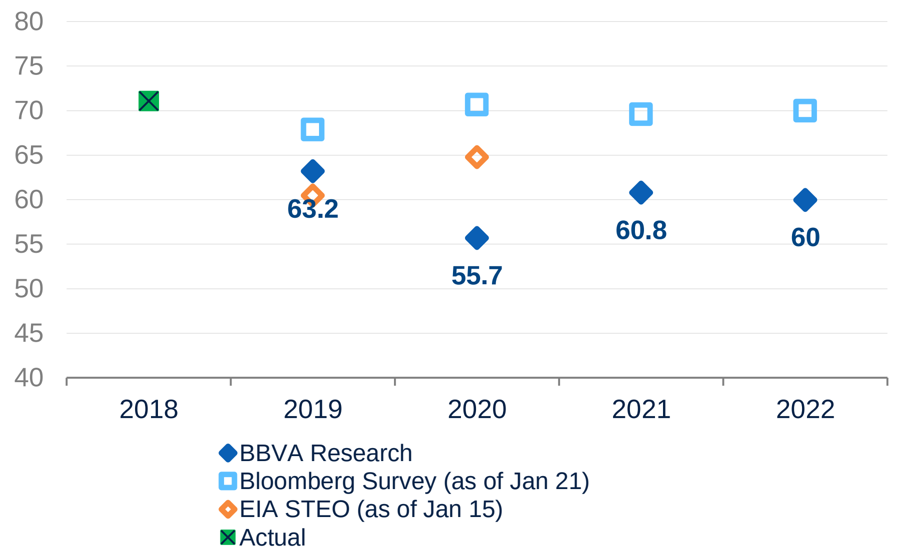
Brent Futures
($ per barrel)



Source: BBVA Research and Bloomberg

Brent prices forecast
($ per barrel)

	BBVA Research (baseline)	Bloomberg Survey (as of Jan 21)	EIA (STEO, Jan 15)
2017	54.2	54.2	54.2
2018	71.1	71.1	71.1
2019	**63.2**	**67.9**	**60.5**
2020	**55.7**	**70.7**	**64.8**
2021	**60.8**	**69.6**	
2022	**60.0**	**70.0**	



Macroeconomic Outlook

	2011	2012	2013	2014	2015	2016	2017	2018	2019 (f)	2020 (f)	2021 (f)	2022 (f)
Real GDP (% SAAR)	1.6	2.2	1.8	2.5	2.9	1.6	2.2	2.9	**2.5**	**2.0**	**1.9**	**1.8**
Real GDP (Contribution, pp)												
PCE	1.3	1.0	1.0	2.0	2.5	1.9	1.8	1.9	**1.9**	**1.3**	**1.3**	**1.3**
Gross Investment	0.9	1.6	1.1	0.9	0.8	-0.2	0.8	1.0	**1.0**	**0.9**	**0.8**	**0.8**
Non Residential	1.0	1.2	0.5	0.9	0.3	0.1	0.7	1.0	**0.8**	**0.8**	**0.7**	**0.8**
Residential	0.0	0.3	0.3	0.1	0.3	0.2	0.1	0.0	**0.0**	**0.0**	**0.0**	**0.0**
Exports	0.9	0.5	0.5	0.6	0.1	0.0	0.4	0.6	**0.5**	**0.6**	**0.7**	**0.7**
Imports	-0.9	-0.5	-0.3	-0.9	-1.0	-0.3	-0.8	-0.9	**-1.0**	**-0.9**	**-0.9**	**-1.0**
Government	-0.7	-0.4	-0.5	-0.2	0.3	0.3	0.0	0.3	**0.3**	**0.1**	**0.0**	**0.0**
Unemployment Rate (%, average)	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	**3.8**	**4.1**	**4.2**	**4.5**
Avg. Monthly Nonfarm Payroll (K)	174	179	192	250	226	195	182	220	**185**	**158**	**124**	**106**
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.1	2.4	**2.2**	**2.1**	**2.1**	**2.1**
Core CPI (YoY %)	1.7	2.1	1.8	1.7	1.8	2.2	1.8	2.1	**2.1**	**2.1**	**2.0**	**2.0**
Fiscal Balance (% GDP, FY)	-8.4	-6.8	-4.1	-2.8	-2.4	-3.2	-3.5	-4.1	**-4.6**	**-4.6**	**-4.9**	**-5.3**
Current Account (bop, % GDP)	-2.9	-2.6	-2.1	-2.1	-2.2	-2.3	-2.3	-2.4	**-2.8**	**-2.9**	**-3.0**	**-3.1**
Fed Target Rate (%, eop)	0.25	0.25	0.25	0.25	0.50	0.75	1.50	2.50	**3.00**	**3.00**	**3.00**	**3.00**
Core Logic National HPI (YoY %)	-2.9	4.0	9.7	6.8	5.3	5.5	5.9	5.9	**4.9**	**4.2**	**3.9**	**3.6**
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	2.49	2.40	2.83	**3.31**	**3.53**	**3.64**	**3.70**
Brent Oil Prices (dpb, average)	111.3	111.7	108.7	99.0	52.4	43.6	54.3	71.1	**63.2**	**55.8**	**60.8**	**60.0**

Source: BBVA Research
*Forecasts subject to change

Economic Scenarios

Probability (%)	Current	Previous
Upside	**5**	10
Baseline	**55**	60
Downside	**40**	30

Macro Scenarios

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
GDP	2.5	2.9	1.6	2.2	2.9	**2.5**	**2.0**	**1.9**	**1.8**	**1.8**
Upside						**3.5**	**3.2**	**3.1**	**2.7**	**2.7**
Downside						**1.2**	**-0.9**	**1.9**	**2.1**	**2.3**
UR	6.2	5.3	4.9	4.4	3.9	**3.8**	**4.1**	**4.2**	**4.5**	**4.5**
Upside						**3.3**	**2.9**	**3.0**	**3.0**	**3.0**
Downside						**4.6**	**6.2**	**6.6**	**5.7**	**5.0**
CPI	1.6	0.1	1.3	2.1	2.4	**2.2**	**2.1**	**2.1**	**2.1**	**2.1**
Upside						**2.5**	**3.3**	**3.7**	**3.7**	**3.8**
Downside						**0.2**	**0.9**	**1.1**	**1.3**	**1.4**
Fed [eop]	0.25	0.50	0.75	1.50	2.50	**3.00**	**3.00**	**3.00**	**3.00**	**3.00**
Upside						**5.00**	**5.50**	**5.50**	**5.50**	**5.50**
Downside						**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
10-Yr [eop]	2.21	2.24	2.49	2.4	2.83	**3.31**	**3.53**	**3.64**	**3.7**	**3.75**
Upside						**3.90**	**5.10**	**5.90**	**5.90**	**5.90**
Downside						**2.40**	**1.60**	**1.90**	**2.10**	**2.10**

Subject to revision without notice

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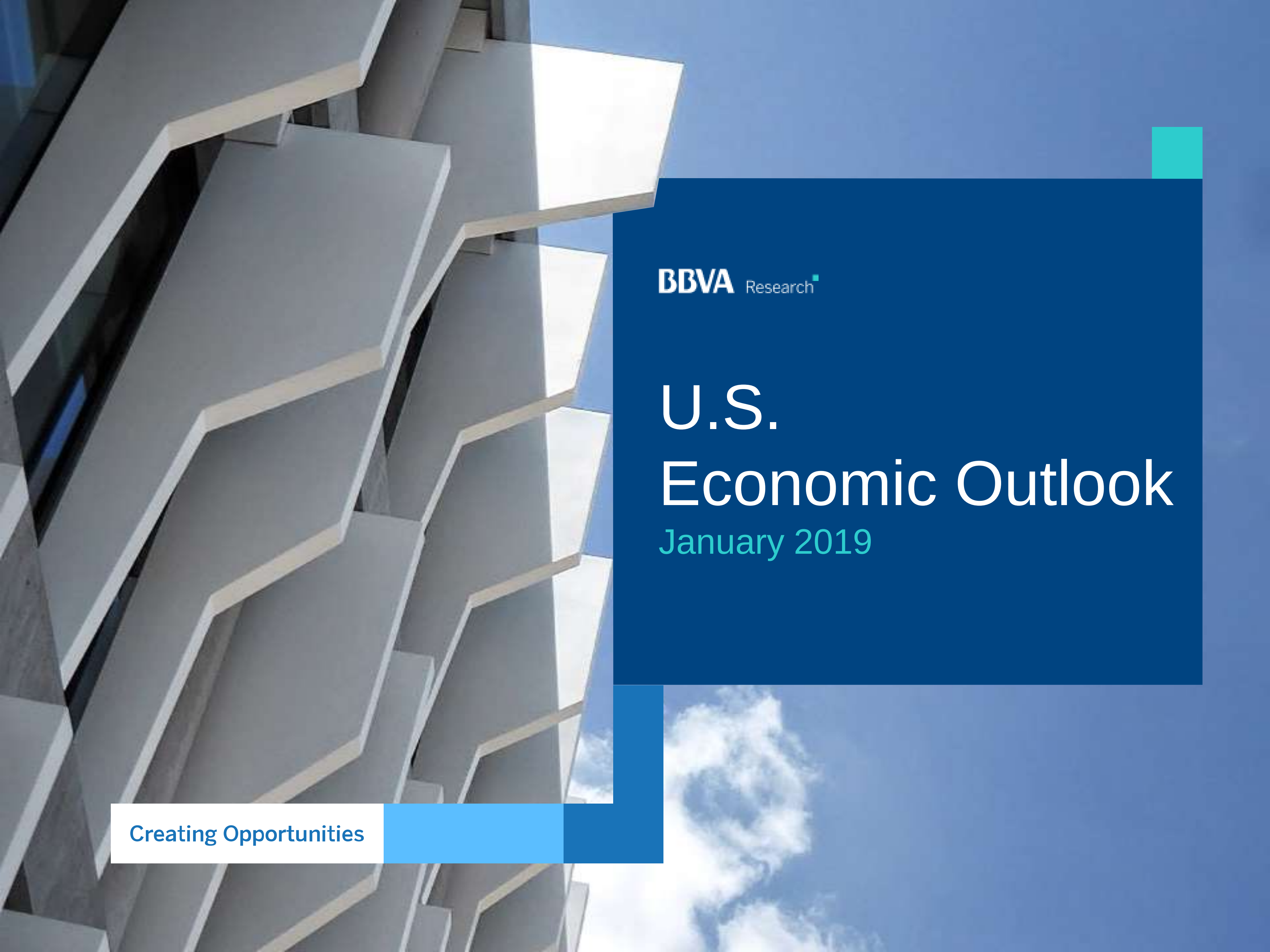

BBVA Research

U.S. Economic Outlook

January 2019

Creating Opportunities