

The logo for BBVA Research, featuring the text "BBVA" in a bold, white, sans-serif font, followed by "Research" in a smaller, lighter weight sans-serif font. A small teal square is positioned to the right of the word "Research".

BBVA Research

# U.S. Economic Outlook

May 2019

Creating Opportunities

## Economic Outlook



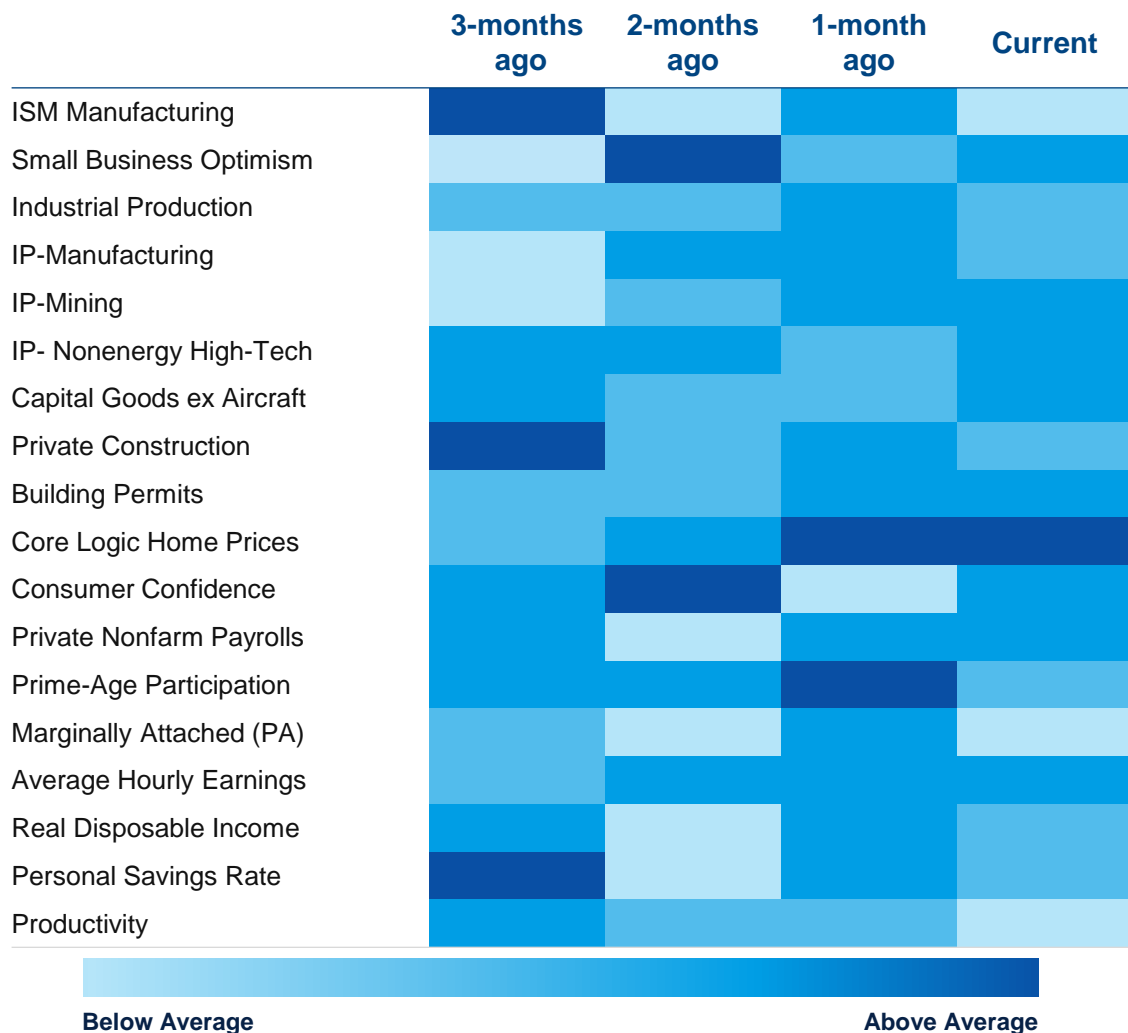
- GDP growth 2.5% in 2019, and 2.0% in 2020
- Model-based recessions projections suggest probability around 60%
- Low likelihood of Fed rate hike in 2019
- Labor market improving in spite growing risks to the outlook
- Core inflation stable, headline trending upwards
- Current yield curve dynamics mainly driven by flight to safety
- Geopolitics pressuring oil prices; short-term risks tilted to the upside

## Macro Fundamentals

- Upside surprise to growth in 1Q19 underpinned by weak fundamentals, suggesting growth will trend closer to potential for the remainder of the year
- State & Local government, inventories and net exports accounted for 65 percent of growth; consumption and investment tepid
- Hard and soft indicators suggests moderate growth in investment despite tepid outlook for residential and nonresidential structures
- Export balance unlikely to worsen dramatically from year-end 2018, but substantial narrowing in 1Q19 likely to be offset by widening in second and third quarter
- Boost from fiscal stimulus should remain in place in 1H19; impetus to fade in 2H19 if no additional measures taken

# Economic activity

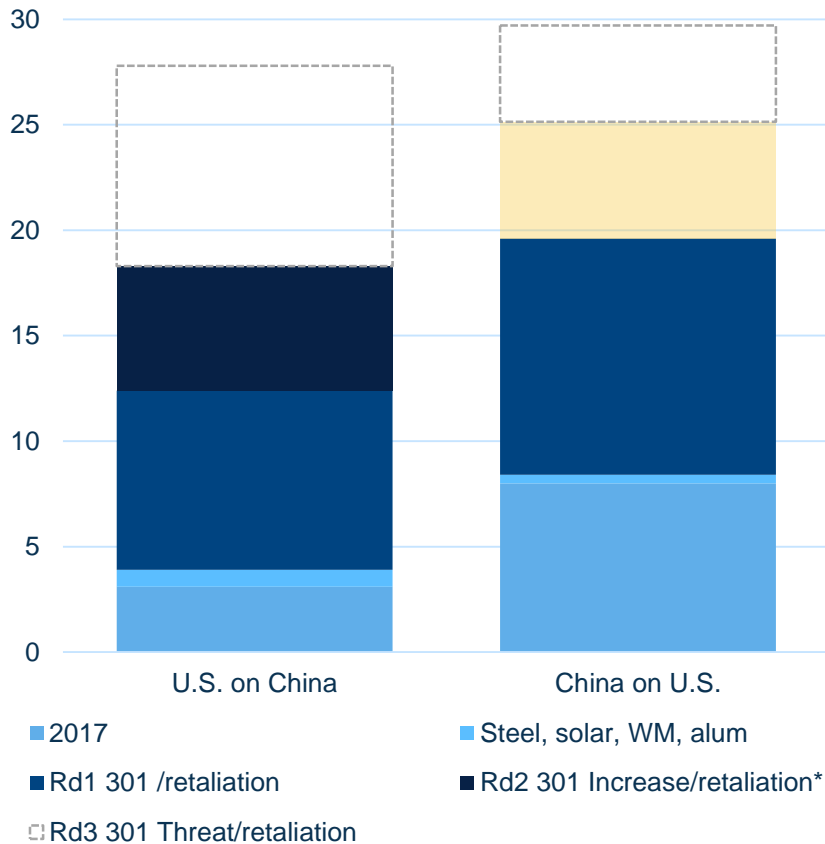
## Real-Time Economic Momentum Heat Map



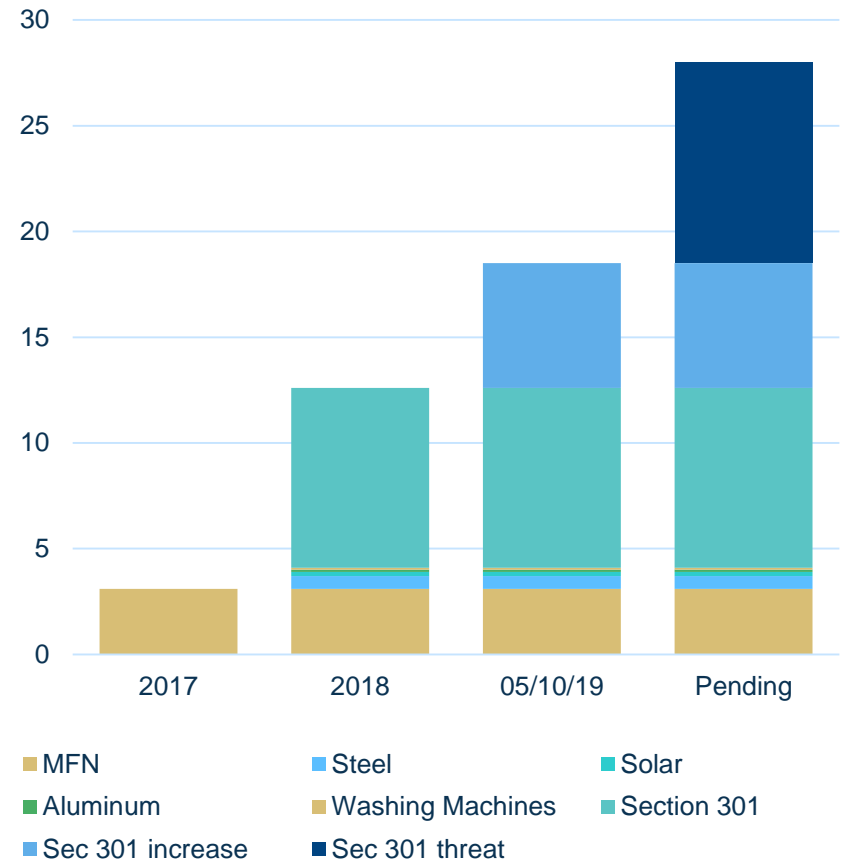
- Hard and soft industrial indicators tilting to the downside
- Manufacturing industrial production down year-over-year
- Supply-side housing conditions improving; demand-side remains tepid
- Confidence indicators improved, but could face headwinds from escalating trade and financial tensions
- Moderate growth in average hourly earnings and real disposable income

# Economic trends: Major escalation in U.S.-China trade war

## Average bilateral tariffs before and after 2018 (%)



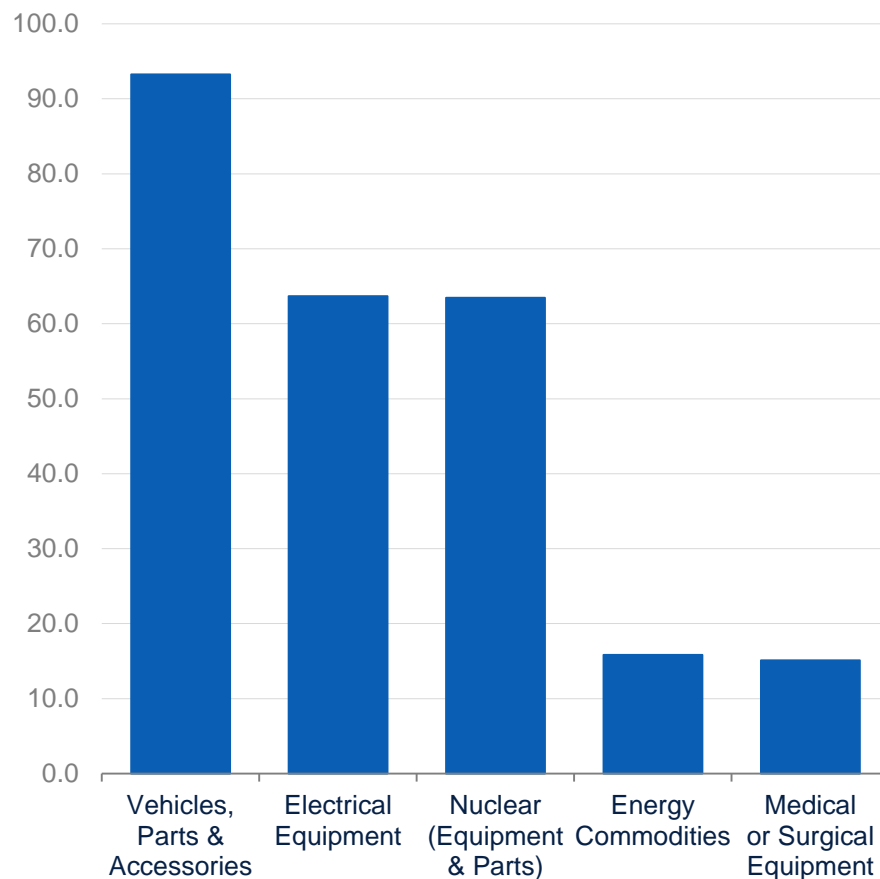
## Average U.S. tariff rates on imports from China (%)



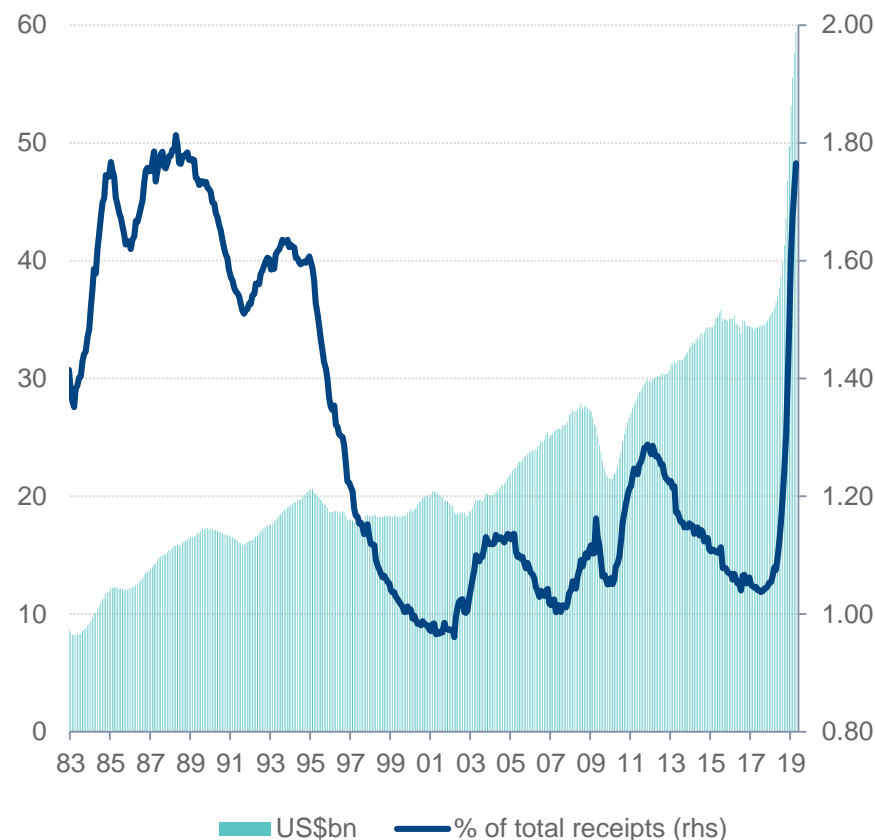
Details of China's retaliation set for June 1 are not known yet  
 Source: BBVA Research, Haver Analytics & PIIE

# Economic trends: U.S. reopens front in trade war with threat of across-the-board tariffs on Mexico

## U.S. Largest Imports from Mexico (US\$bn)

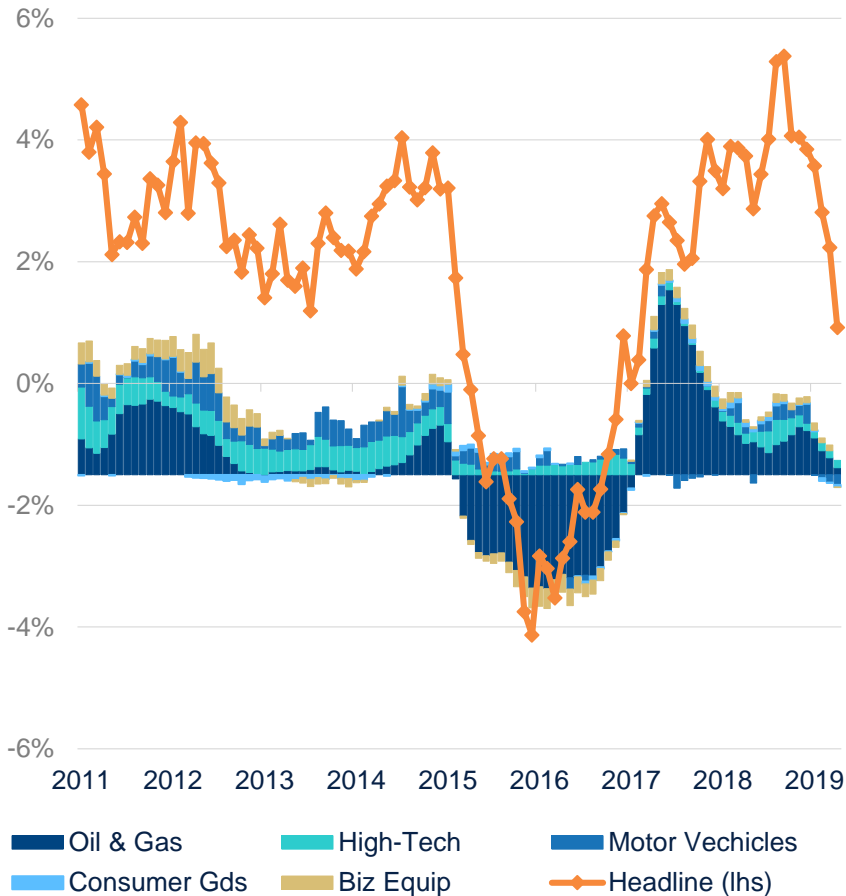


## Customs Receipts (US\$bn and %)

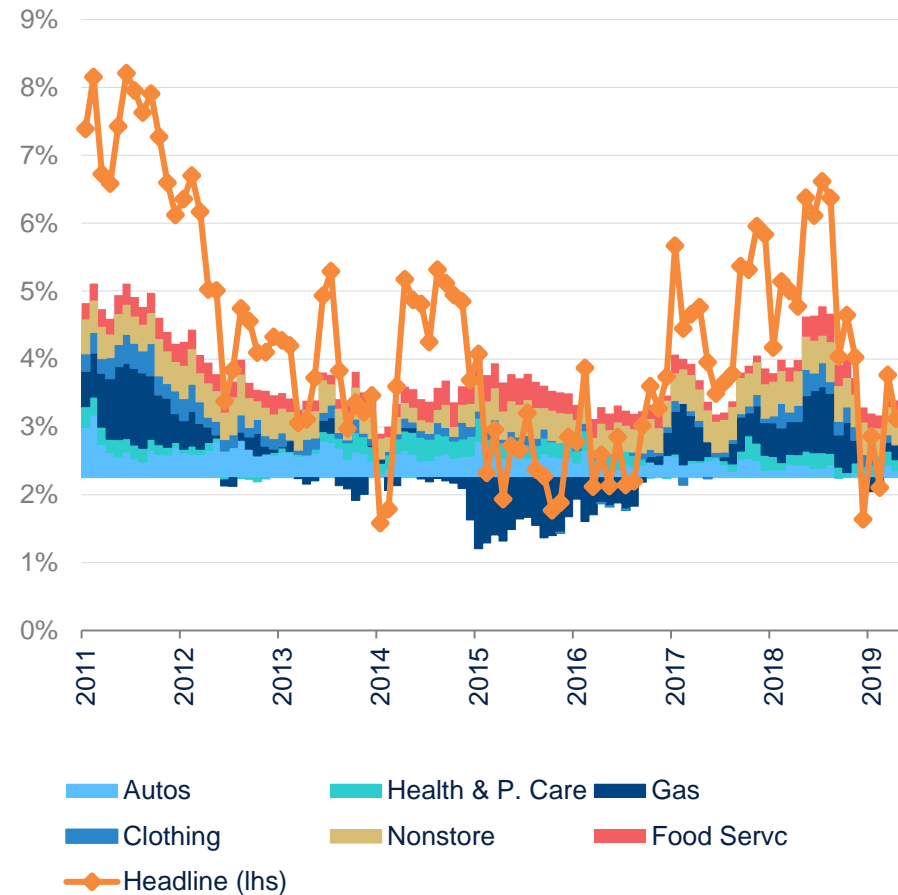


# Economic trends: Modest rebound in retail sales while industrial production continues to weaken

## Industrial Production (Year-over-year %)

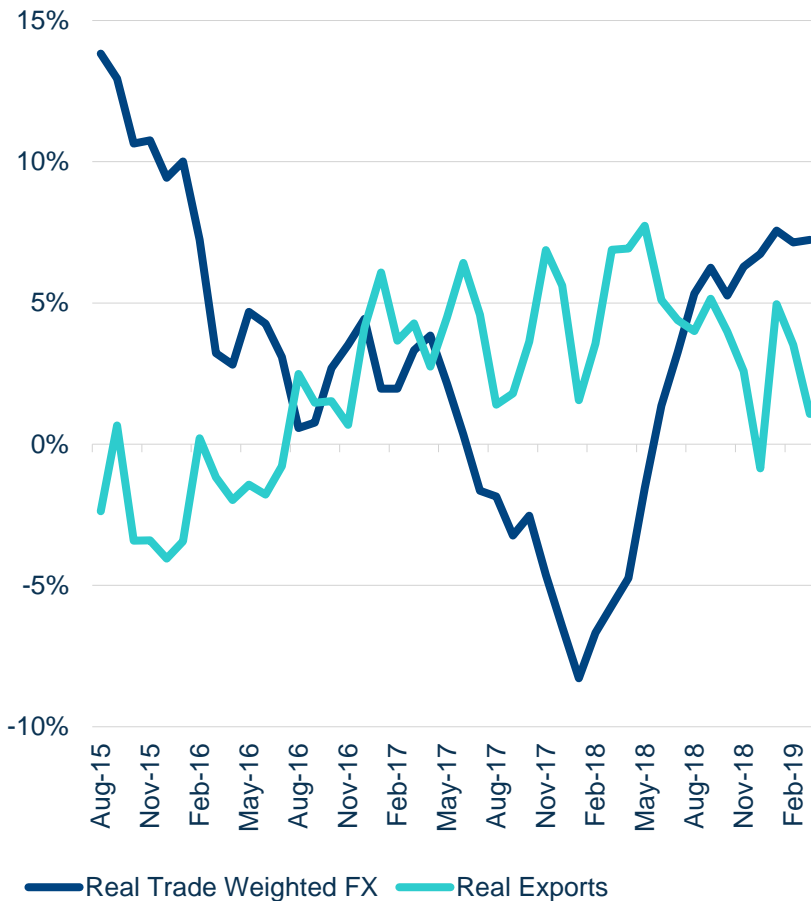


## Retail Sales (Year-over-year %)

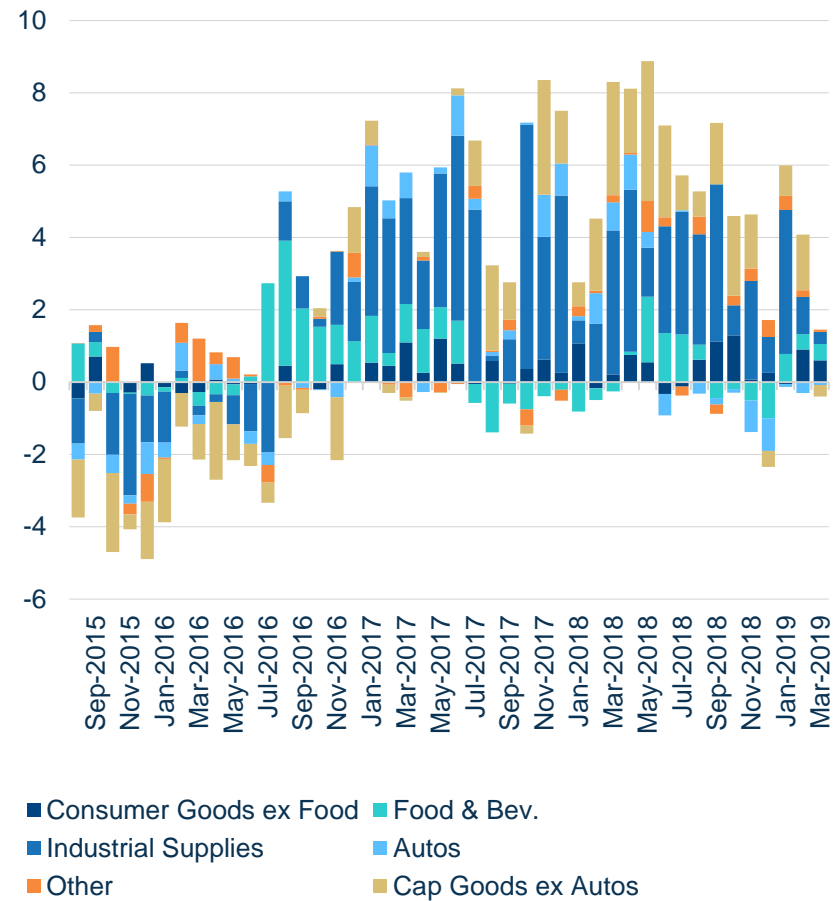


# Economic trends: Weak external growth and dollar strength continues to dampen outlook for trade

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



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

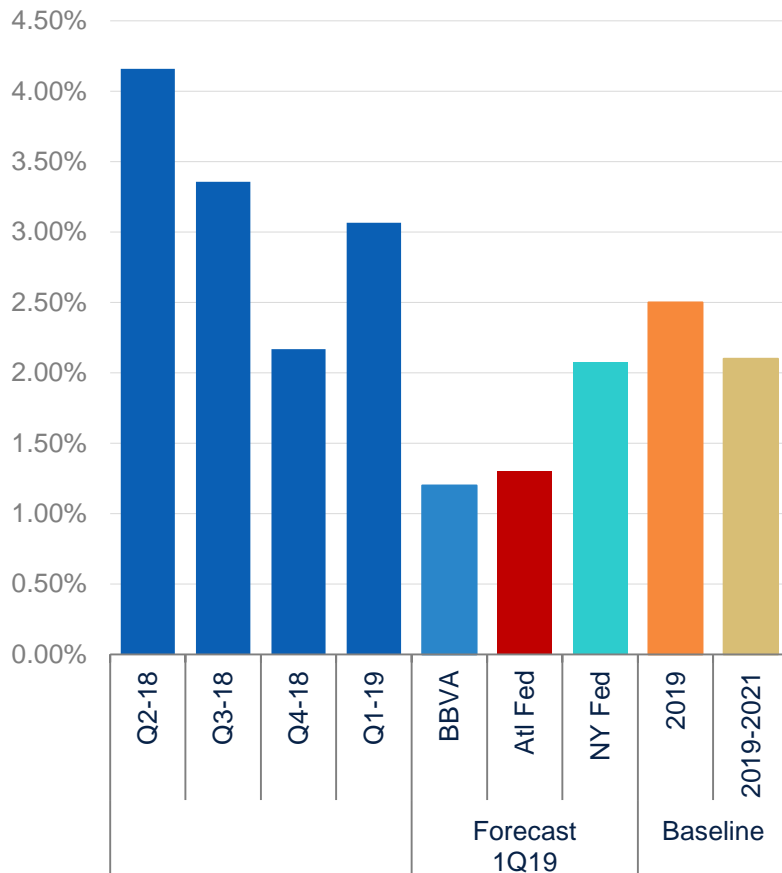


Source: BBVA Research, FRB & Census

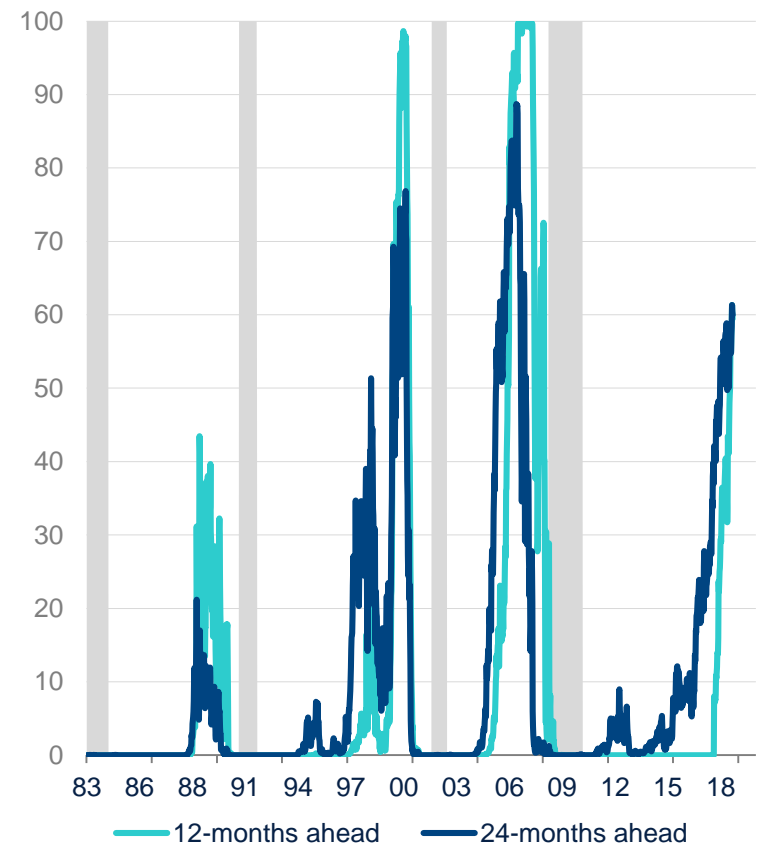


# Economic trends: Notwithstanding the potential for growth to be pulled forward with trade tensions, 2Q19 growth to dip below 2%

**Real GDP**  
(QoQ SAAR, %)



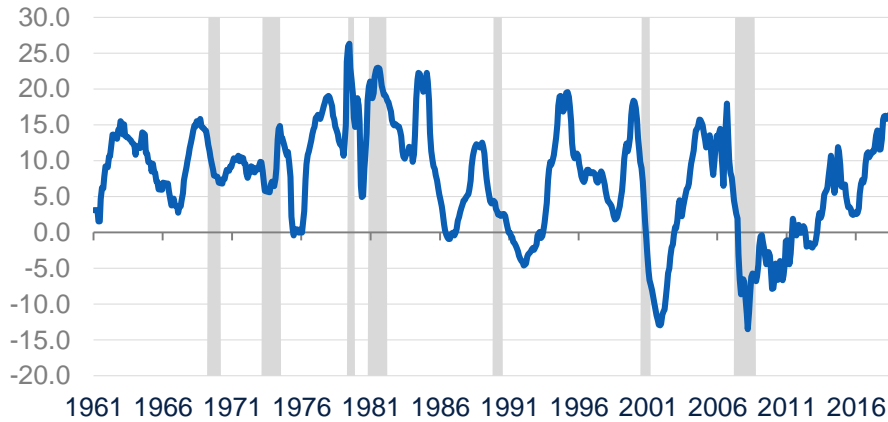
**Probability of Recession in 12 Months**  
(%)



# Consumer credit cycle: risks contained, but balance sheet stress rising

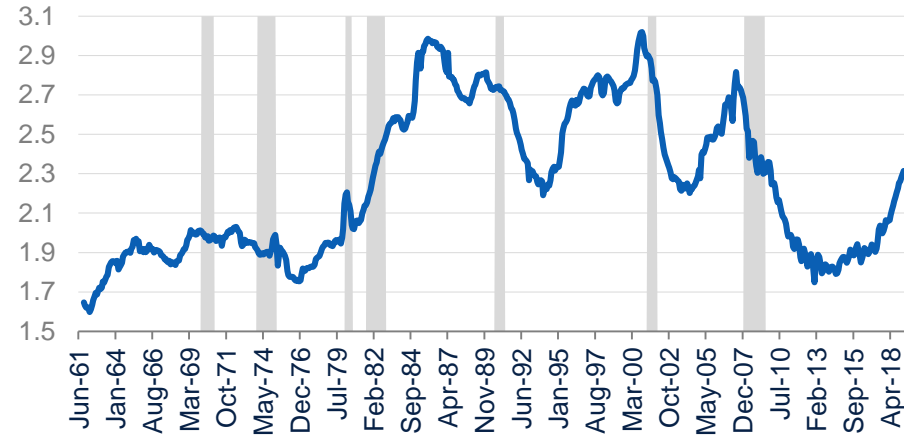
## Personal Interest Expense

Year-over-year %



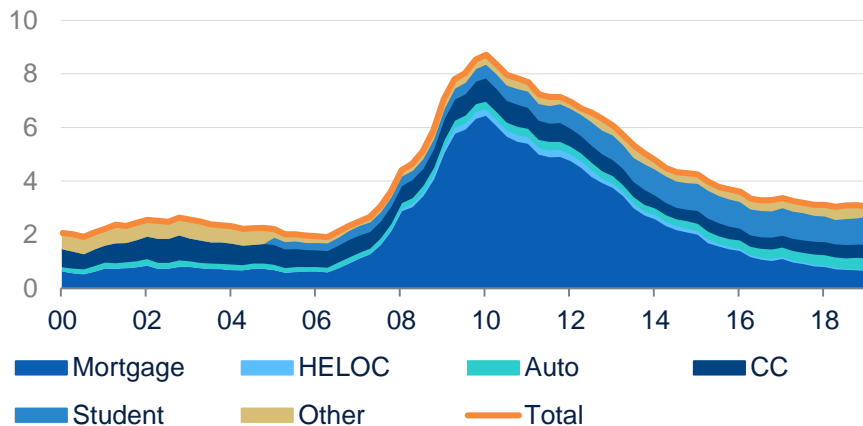
## Personal Interest Expense to Disp. Income

Ratio, %



## New 90+ Day Consumer Delinquencies Rates

Contribution, %

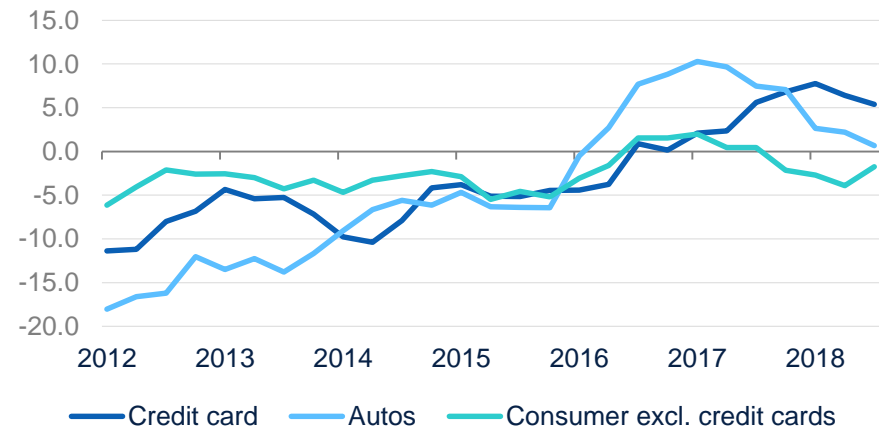


■ Mortgage    ■ HELOC    ■ Auto    ■ CC  
■ Student    ■ Other    ■ Total

Source: BBVA Research, FRB, NY Fed & BEA

## Senior Loan Officers Lending Standards

+ tightening / - loosening



— Credit card    — Autos    — Consumer excl. credit cards

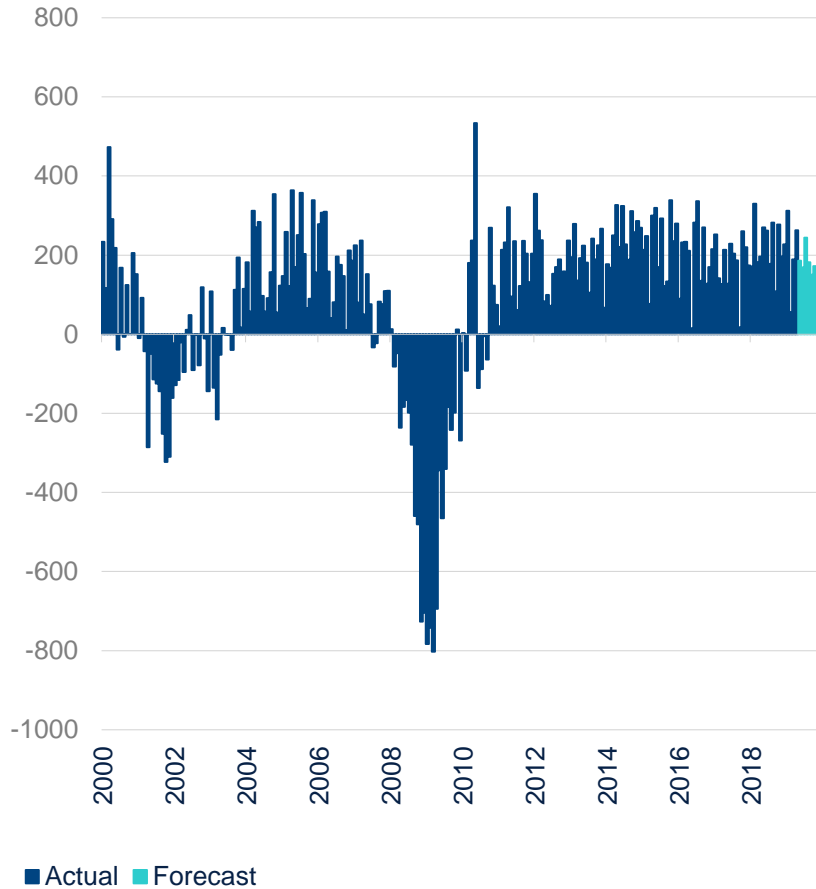
## Labor Market



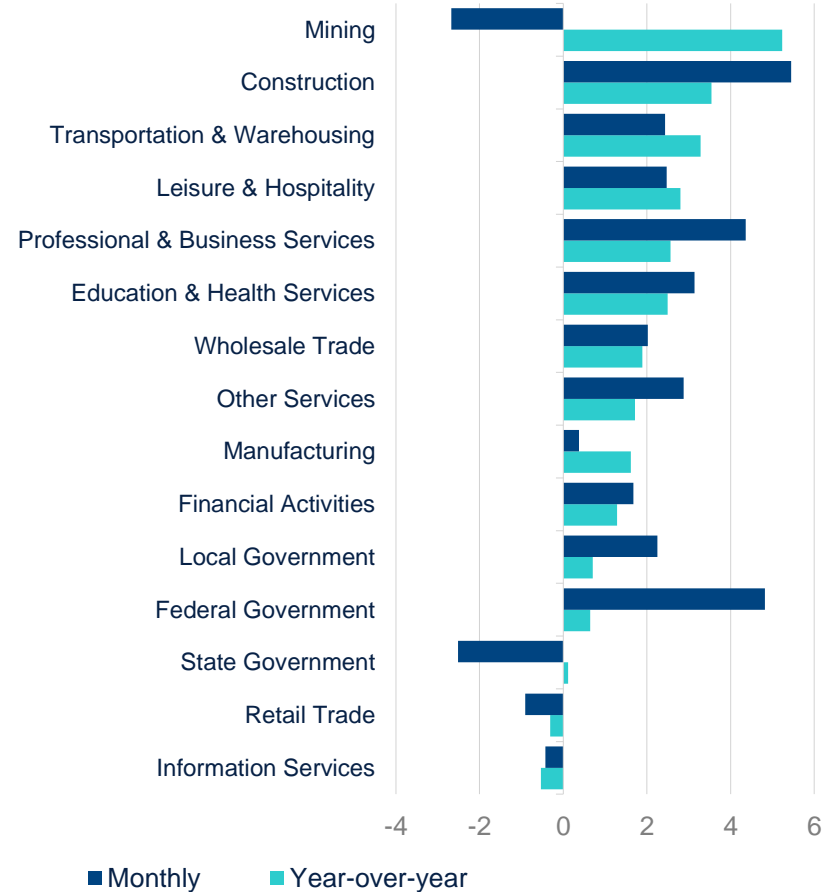
- In March, nonfarm payroll employment grew 263,000; an improvement from February (189,000)
- Major industry strengths included professional and business services (76K), construction (33K), and health care and social assistance (53K)
- The unemployment rate declined to 3.6% in April, reaching the lowest level since December 1969
- The labor force participation rate dropped to 62.8% while the employment-to-population held steady at 60.6%
- We expect the UR to reach its low point in this business cycle soon (3.6%). Average monthly job growth to slow to 186K this year, from 223K in 2018

# Labor market: Nonfarm payrolls improve again in April with job creation continuing to outpace growth in labor force

## Nonfarm Payrolls (Monthly Change, K)

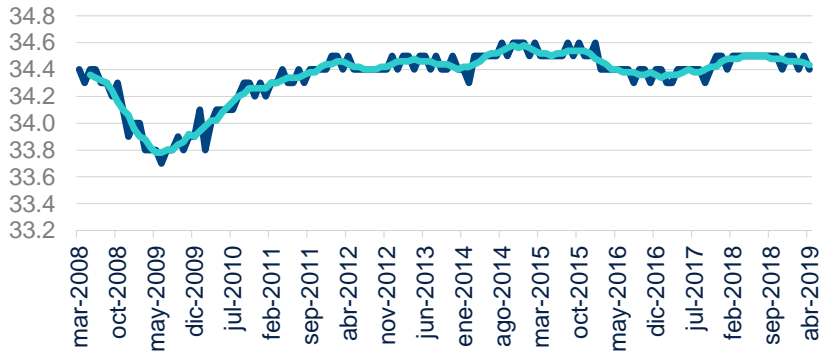


## Industry Employment (Annualized % change)

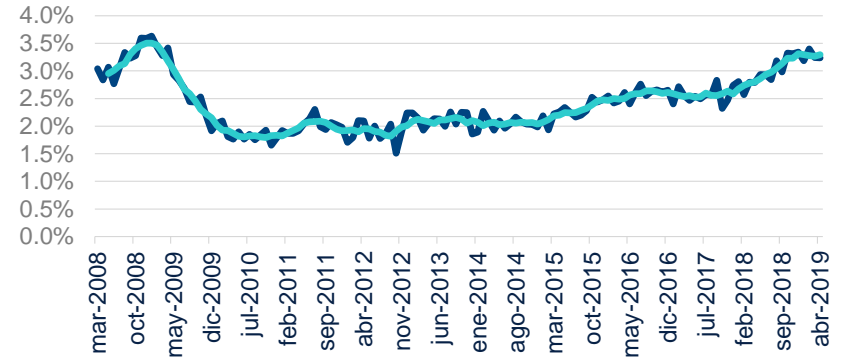


# Labor market: Improvement in broader labor market conditions slowing

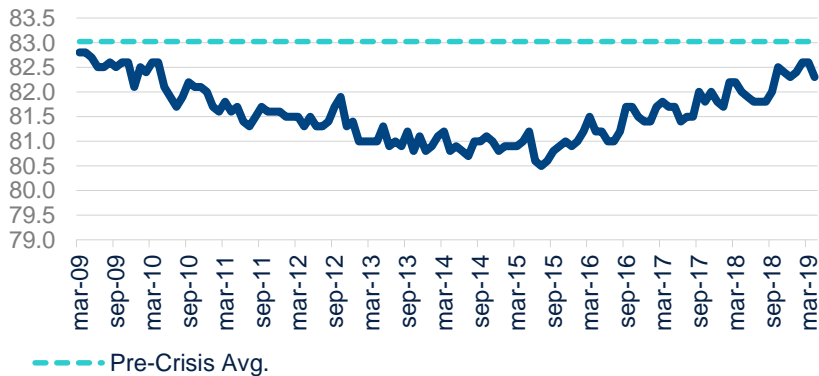
## Average Weekly Hours (number & 5mcm)



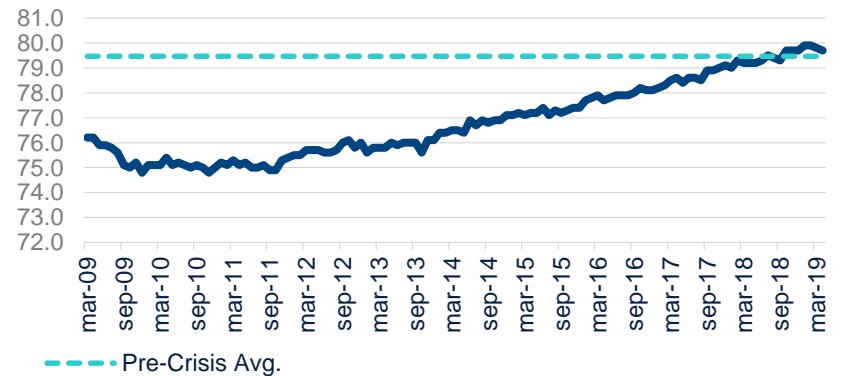
## Average Hourly Earnings (YoY% & 5mcm)



## Prime Age Labor Force Participation (%)

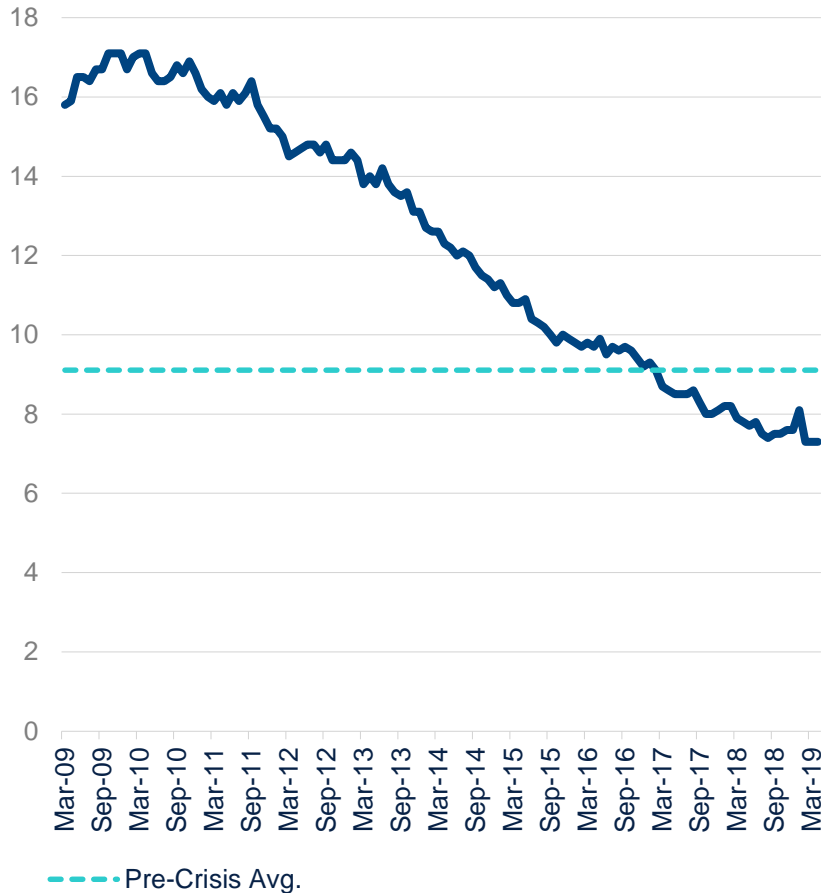


## Prime Age Employment-to-Population (%)

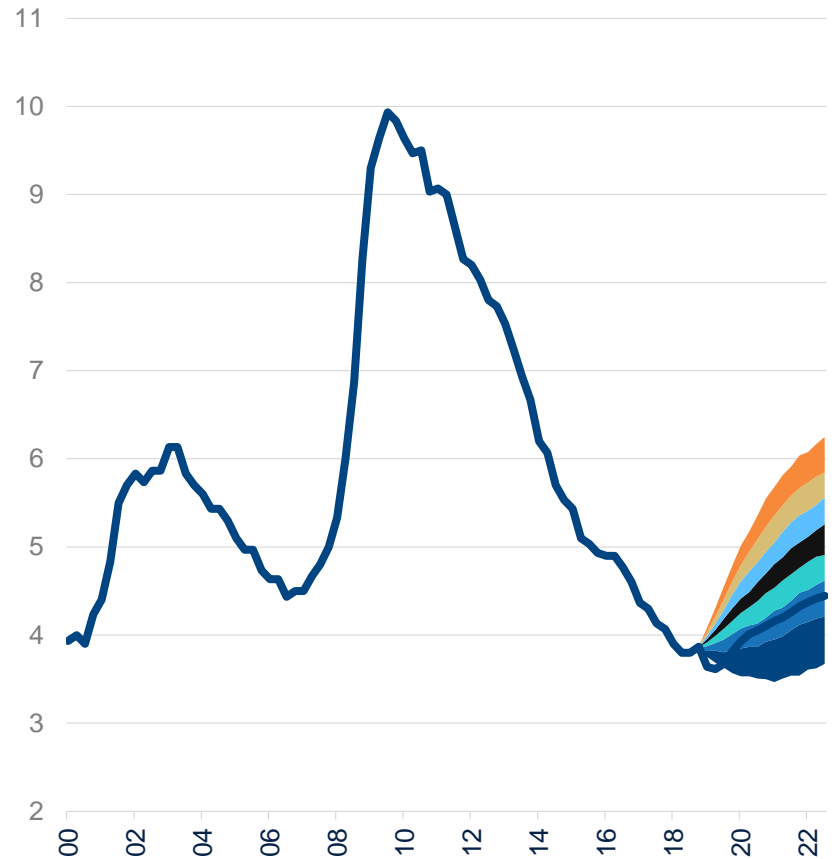


# Labor market: Unemployment rate unlikely to drop much more, as labor force tightens

**U-6**  
(%)



**Unemployment Rate**  
(%)

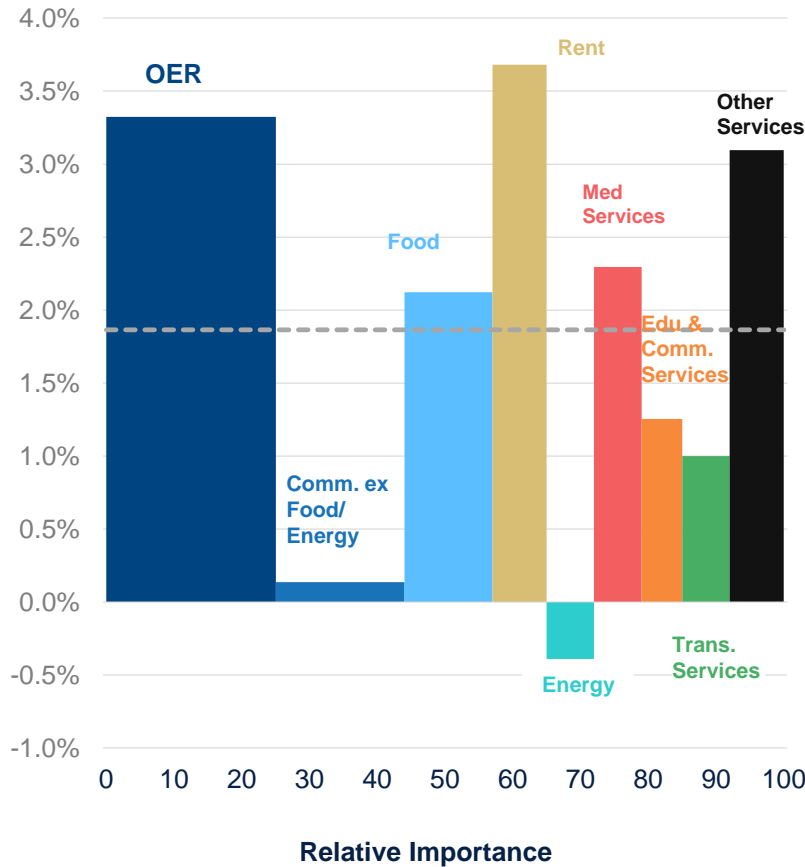


# Inflation

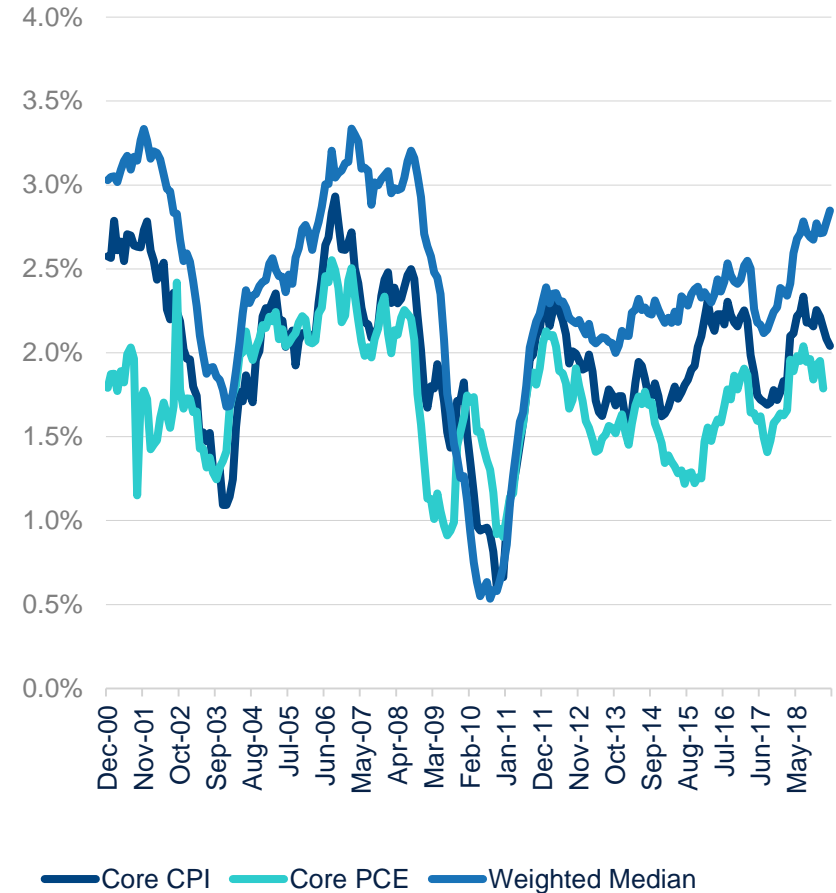
- Headline consumer prices increased 0.3% month-over-month in April. Around two thirds of the increase was due to a 5.7% rise in gasoline prices
- On a year-over-year basis, headline CPI increased 2.0% while core accelerated slightly to 2.1%
- The probability of entering high-inflation regime is currently modest; deflation risk is also low
- Idiosyncratic supply-side shocks from tariffs could push prices up in short-run
- Implied 5-year spot and forward inflation expectations have weakened
- Baseline assumes average headline inflation to decelerate to 1.8% in 2019, before rebounding in 2020; core inflation to average 2.0% in 2019

# Inflation: Housing supporting slower growth in other services

## Consumer Price Inflation (12m change)



## Core Inflation Measures (12m change)



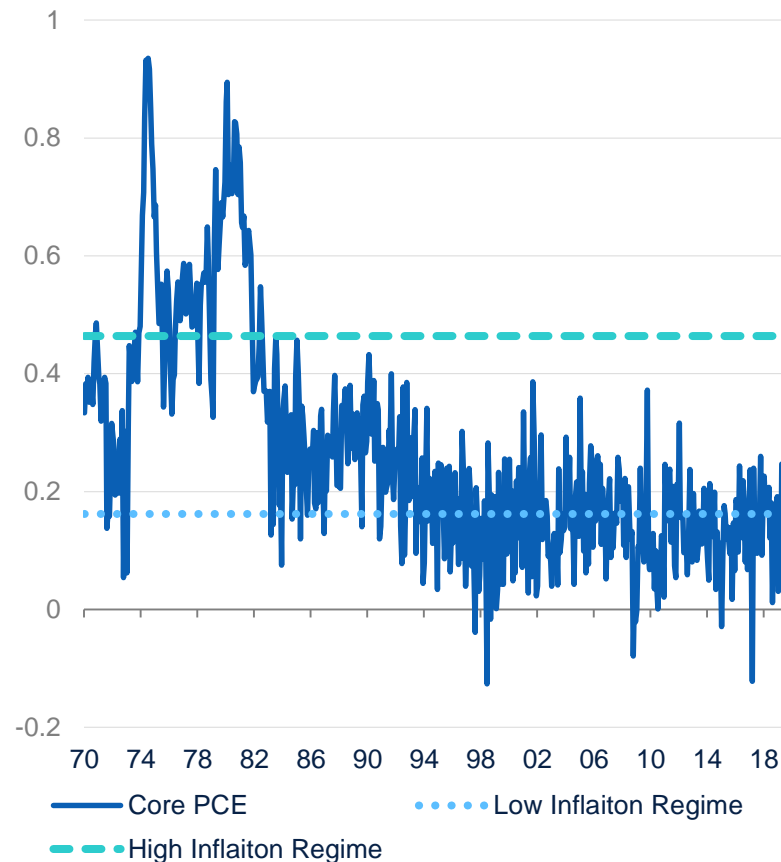
Source: BBVA Research, BLS & BEA



# Inflation: Lack of inflationary pressures a concern, but deflation risk minimal

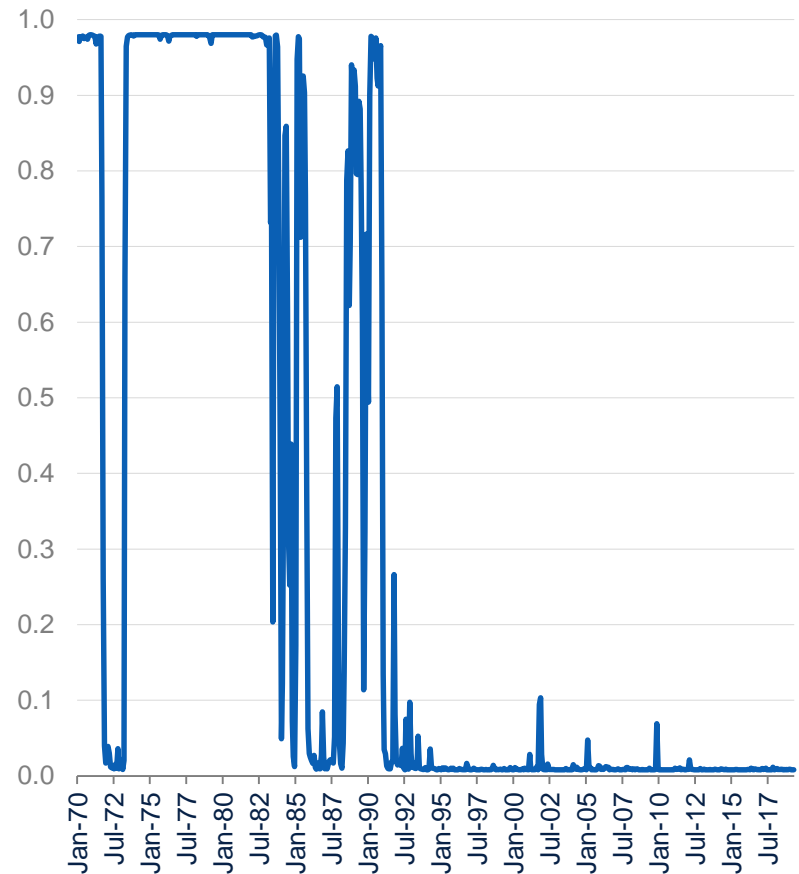
## Core PCE Price Index & Inflation Regimes

Month-over-month %



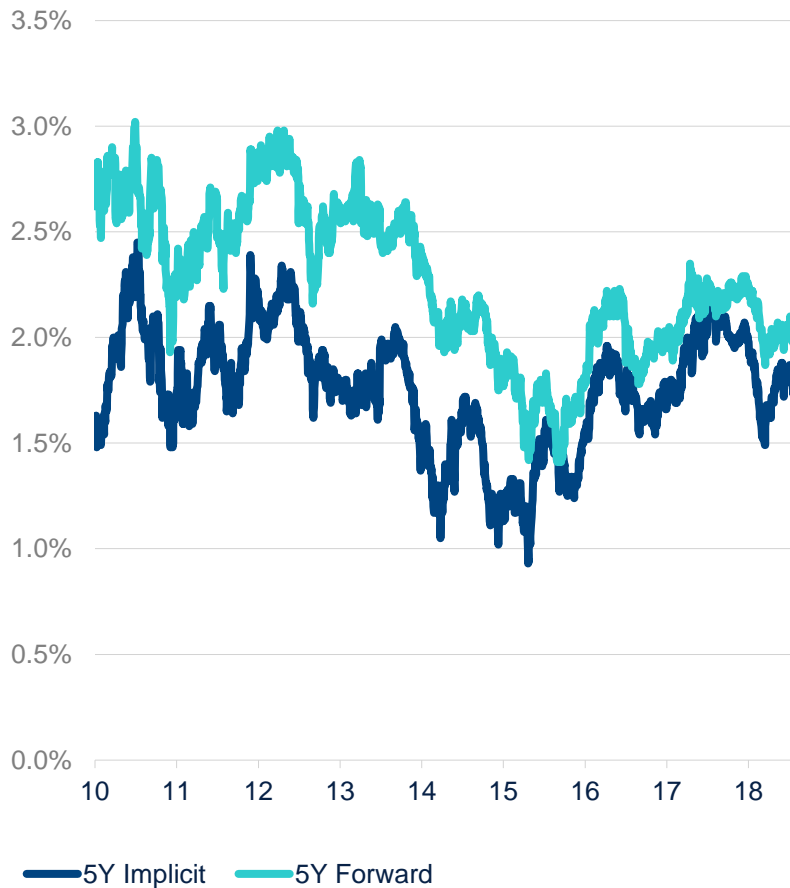
## Inflation Regime Change Probability

%

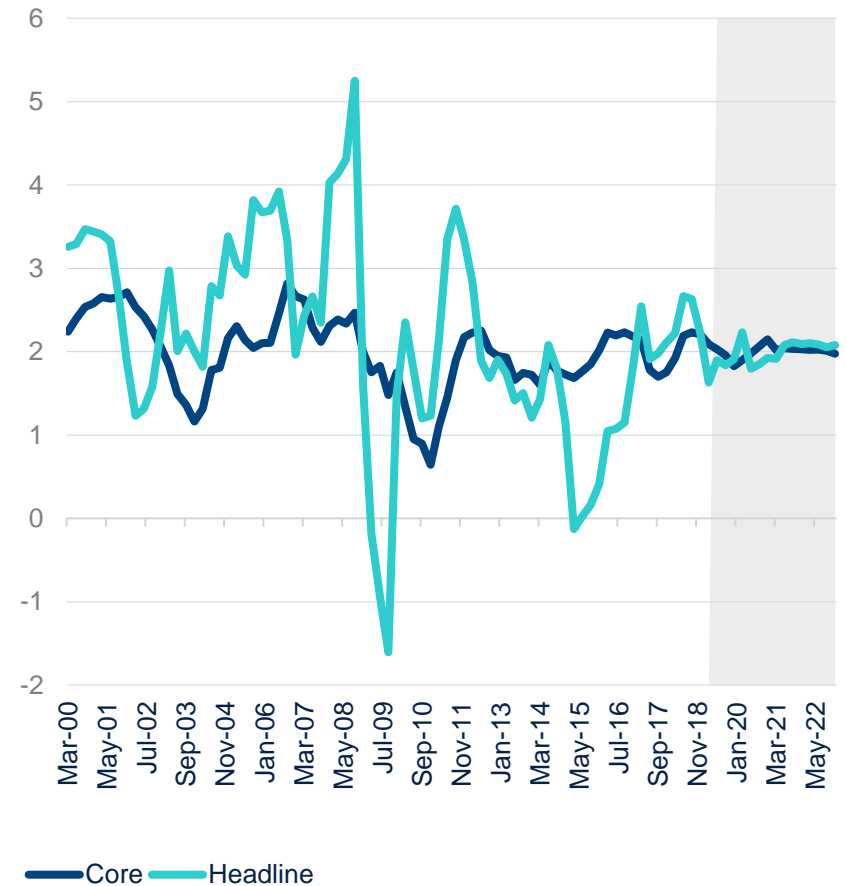


# Inflation: Modest undershoot for headline in 2019, core prices to remain low and stable

## Inflation Expectations (%)



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

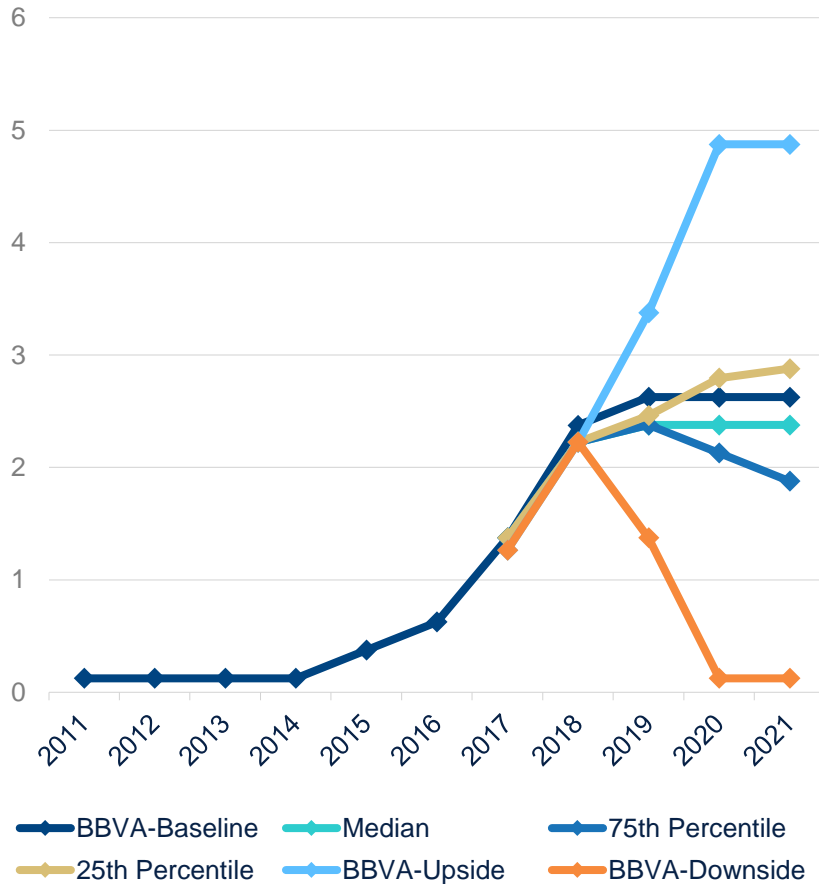


## Monetary Policy: Federal Reserve

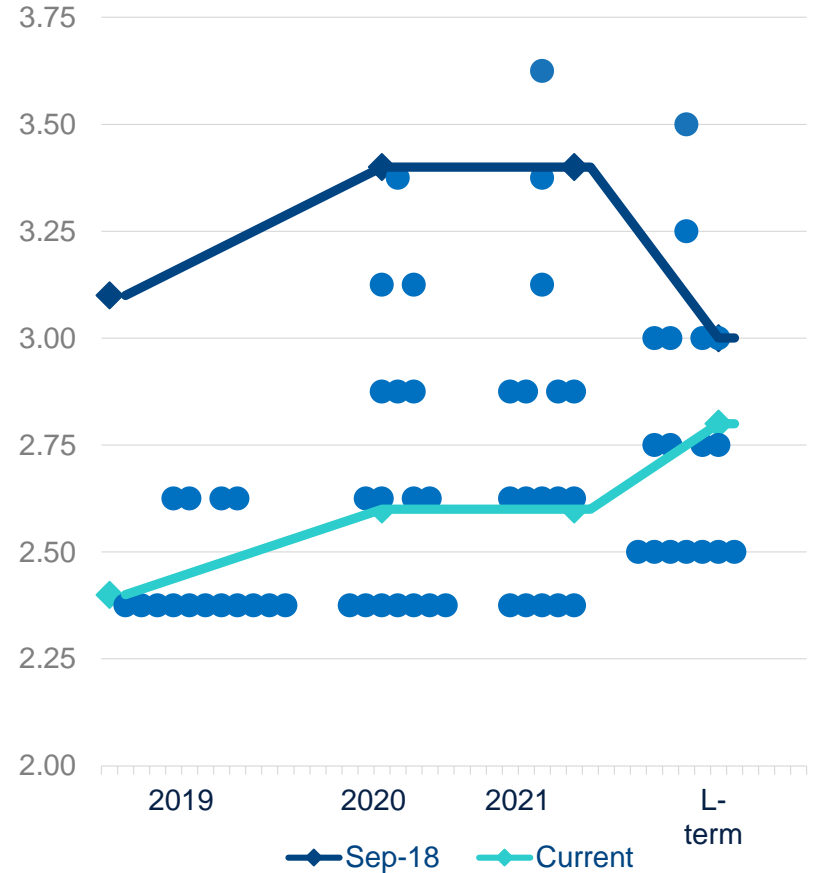
- Fed kept interest rates unchanged at their April 30<sup>th</sup>-May 1<sup>st</sup>, as crosscurrents, global uncertainty, muted inflation and concerns on prolonging the expansion cycle remain
- FOMC minutes reaffirmed the slightly more optimistic tone of the committee, but factors underlying improved outlook have deteriorated since then
- Discussion on Balance Sheet Normalization (BSN) impact on term premium intensifying, as committee strives to keep its policy neutral
- The drawdown on cash assets at domestic financial institutions has slowed following the announcement of changes to the BSN plans
- Markets now fully discounting rate cuts in 2019, Fed funds futures curve implies multiple rate cuts
- Possibility of rate increase in 2019 extremely low when considering significant uncertainty surrounding remainder of the year

# Fed: Patience likely to prevail in 2019, but committee fracturing on choice of pausing vs. cutting

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



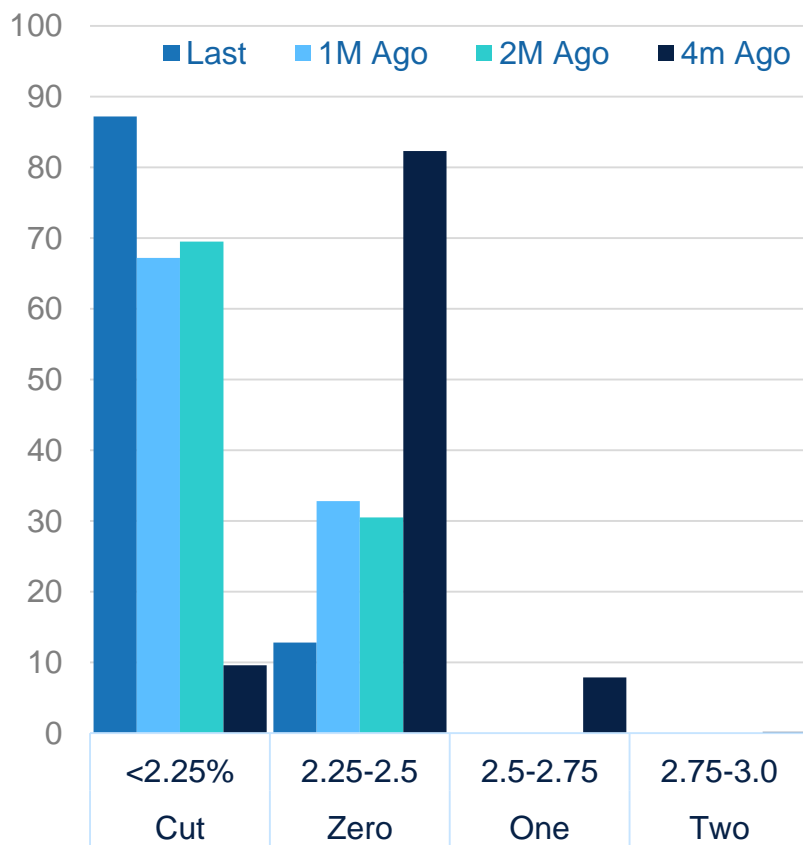
## FOMC Projections of Fed Funds (Year-over-year %, Mid-point)



# Monetary policy: Fed funds futures further tilt to the downside

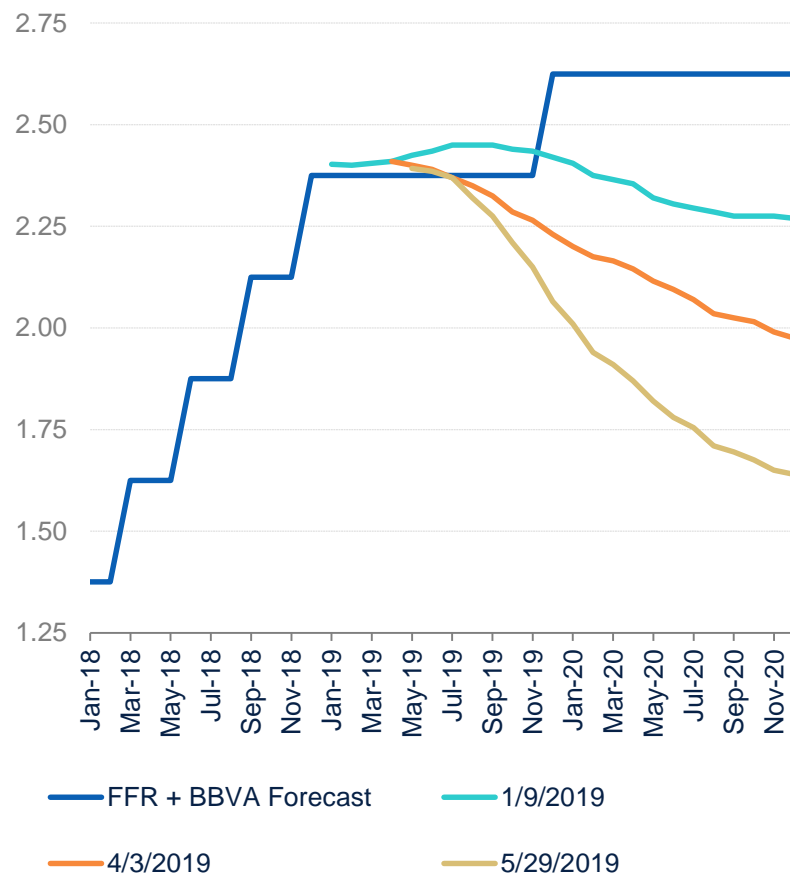
## Fed Funds Implied Probability

(Number of rate increases through 2019, %)



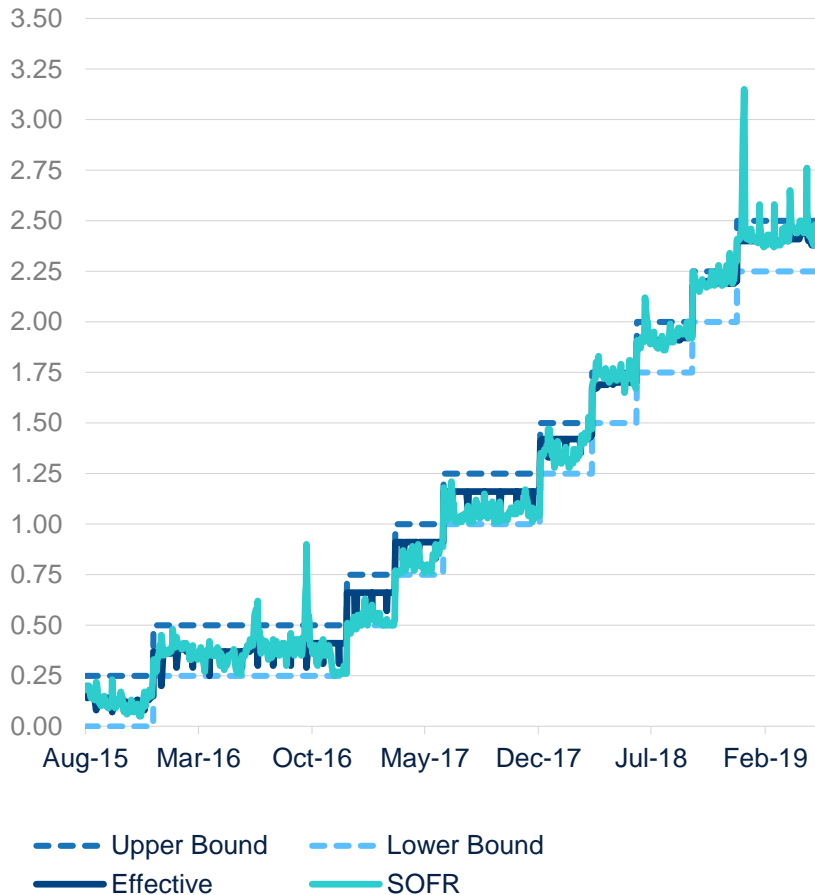
## Fed Funds Futures & BBVA Baseline

(%)

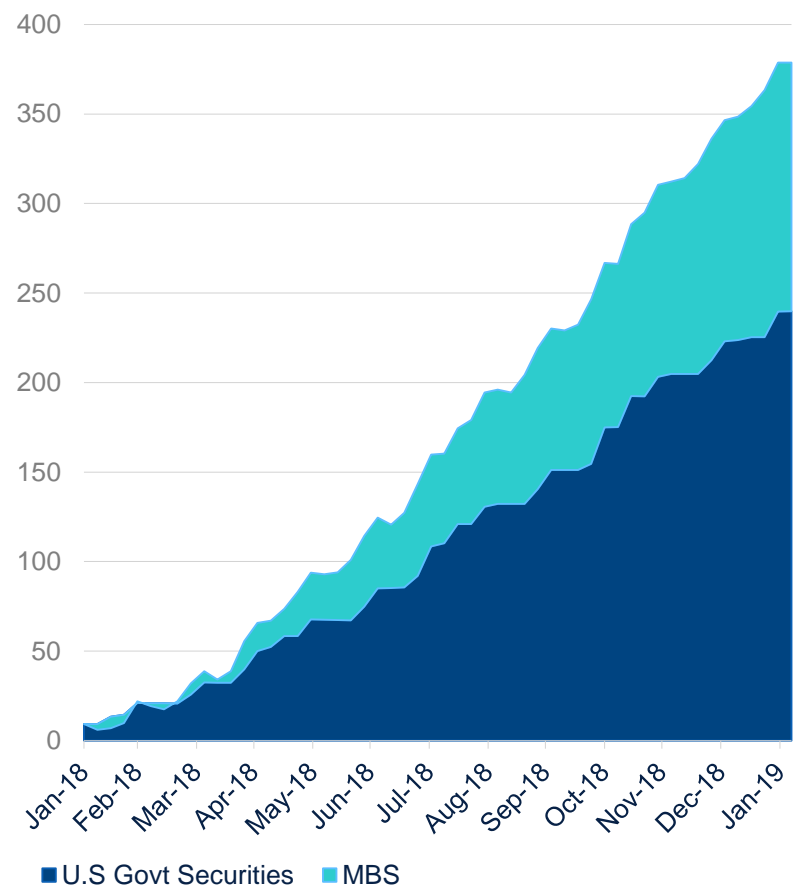


# Monetary policy: IOER fine-tuning helping anchor money market rates within target range

## Fed Funds & Repo Rates (%)



## Balance Sheet Attrition (US\$bn, Cumulative)



## Interest Rates

- 10-yr Treasury down to 2.1%, 2-yr Treasury down to 1.9%
- Dramatic shift in Fed's balance sheet strategy, U-turn in rates guidance, global weakness and elevated uncertainty push term premium to lowest level ever
- Short-term rates converging with IOER; deviation from these levels unlikely with shift in monetary policy strategy ("floor system")
- Yield curve slope narrows across most durations (6-month, 3-month and 1-year). Weakening rates outlook impacting belly (2-year to 5-year) of yield curve
- Nontrivial downside risk to 10-yr Treasury yields; short-term rates will likely remain close to current levels by yearend

# Interest rates: Term premium testing historic lows

## 10-Year Treasury Yield Decomposition

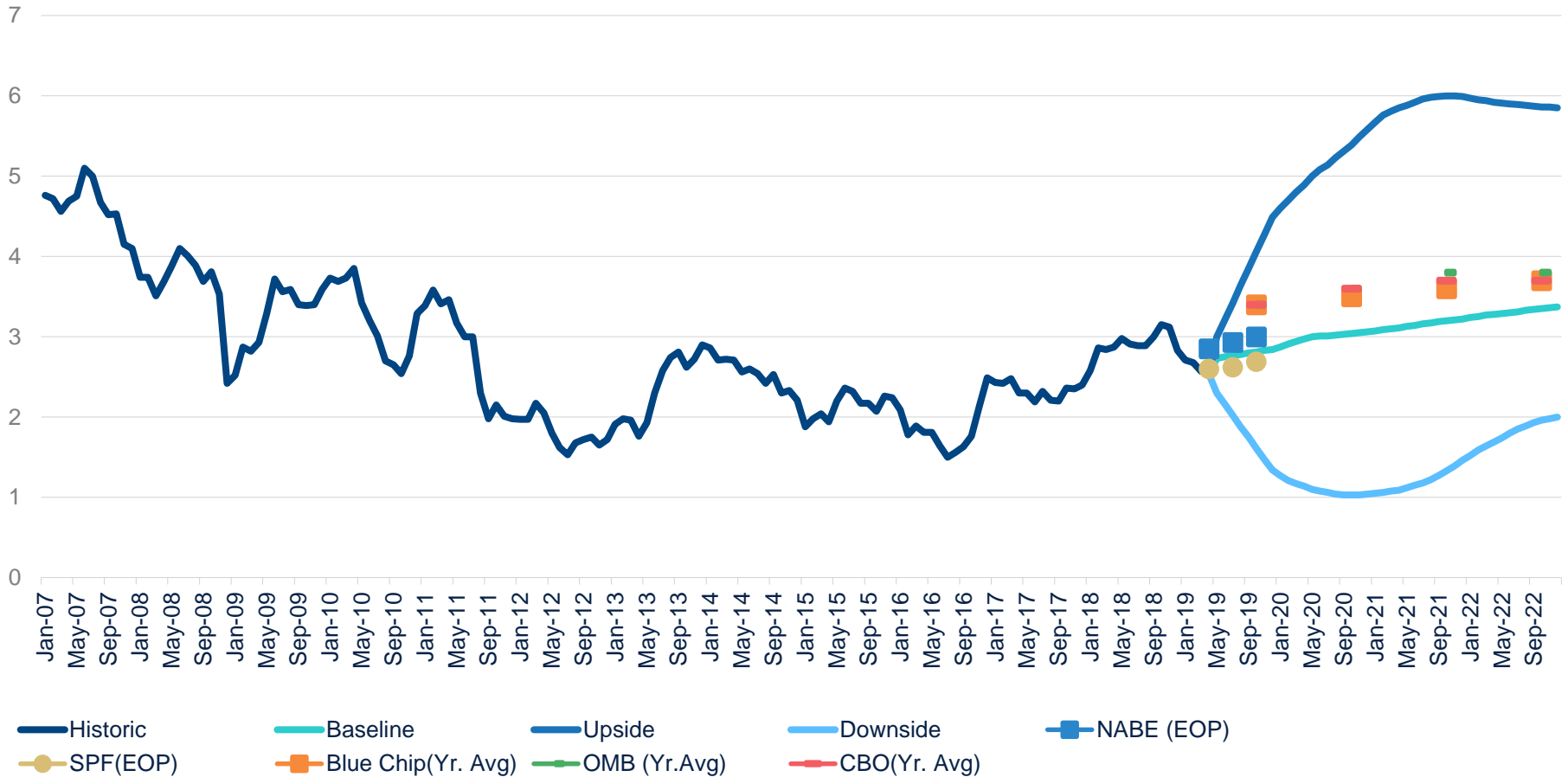
(%)





# Interest rates: 10-year Treasury yields over 100bp below 2018 highs

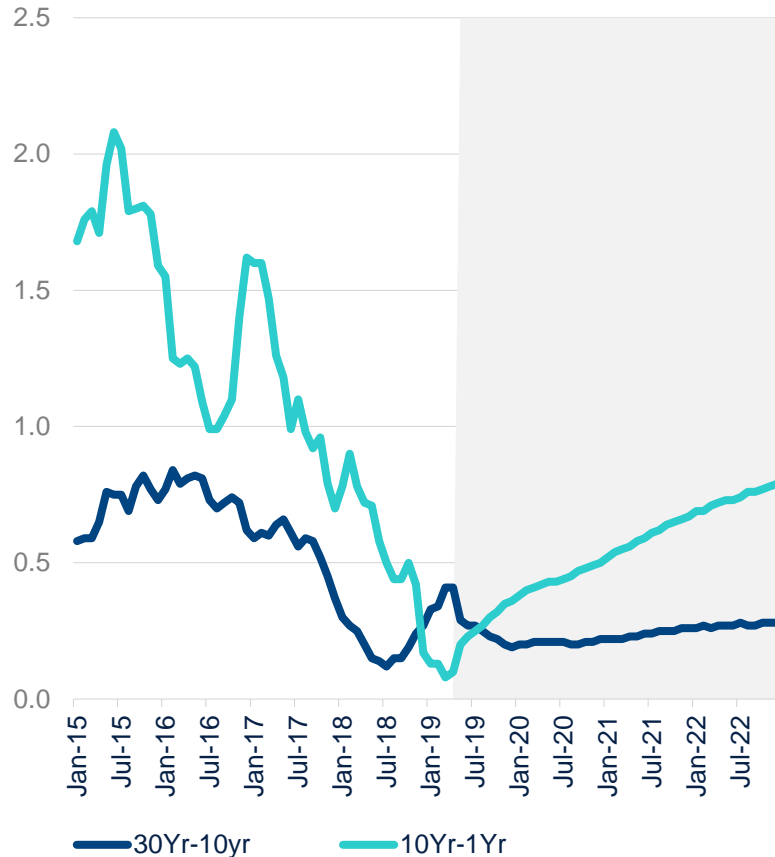
## 10-Year Treasury Yield (%)



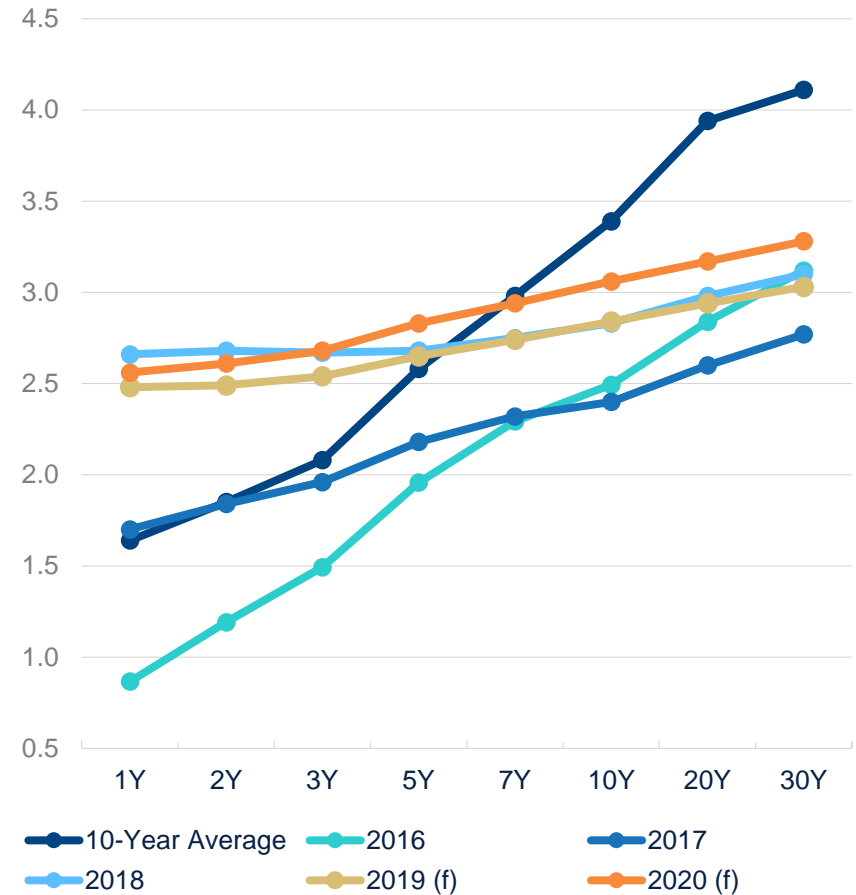
Source: BBVA Research, ACM & Haver Analytics

# Interest rates: Yield curve slope edging closer to full inversion

## Yield Curve Slope (Bp)



## Yield Curve (% eop)



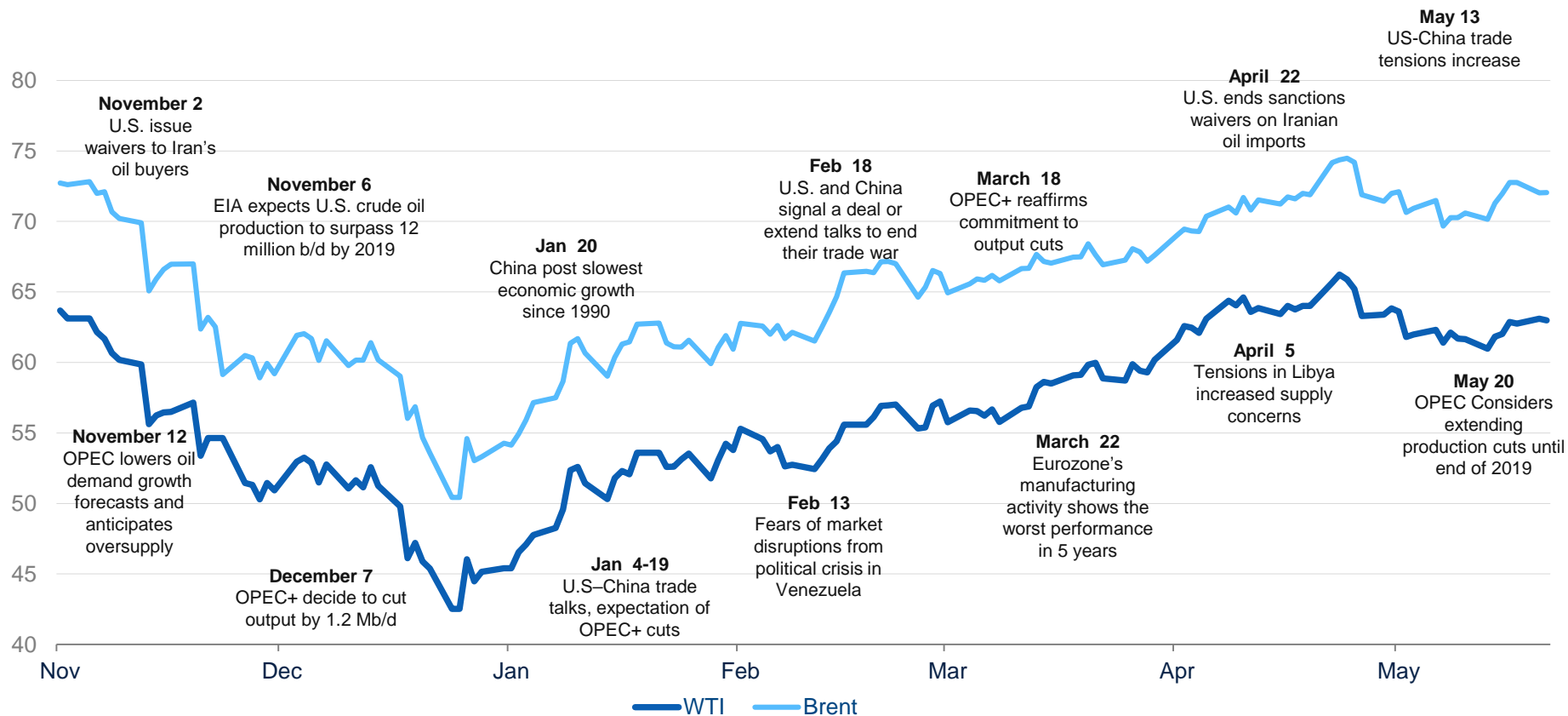
## Oil Prices

- OPEC+ cuts are tightening the market and driving up prices. The deal could remain in place for the rest of the year
- Sanctions to Venezuela and Iran could tighten supply further. However, OPEC has significant spare capacity to offset upward price pressures
- Escalation of tensions between U.S. and Iran, as well as trade negotiations between China and the U.S., are the main sources of uncertainty in the short-run
- In 2019, U.S oil production will expand further reaching new record highs, while substantial transportation capacity will be added
- Our prospects for lower prices in 2H19 and 2020 assume slower global growth. Crude oil demand is contracting in Europe, but remains supportive in U.S. & Asia
- We maintain our view of convergence to long-term equilibrium of around \$60/b
- Elevated uncertainty around long-term equilibrium: CAPEX, protectionism, transportation infrastructure, alternative energy sources, EM convergence, EVs, climate change, efficiency and technology

# Upward trend supported by OPEC+ cuts, but contained by expectations of rising U.S. production and concerns on global economic growth

## Crude oil prices November 2018 to May 2019

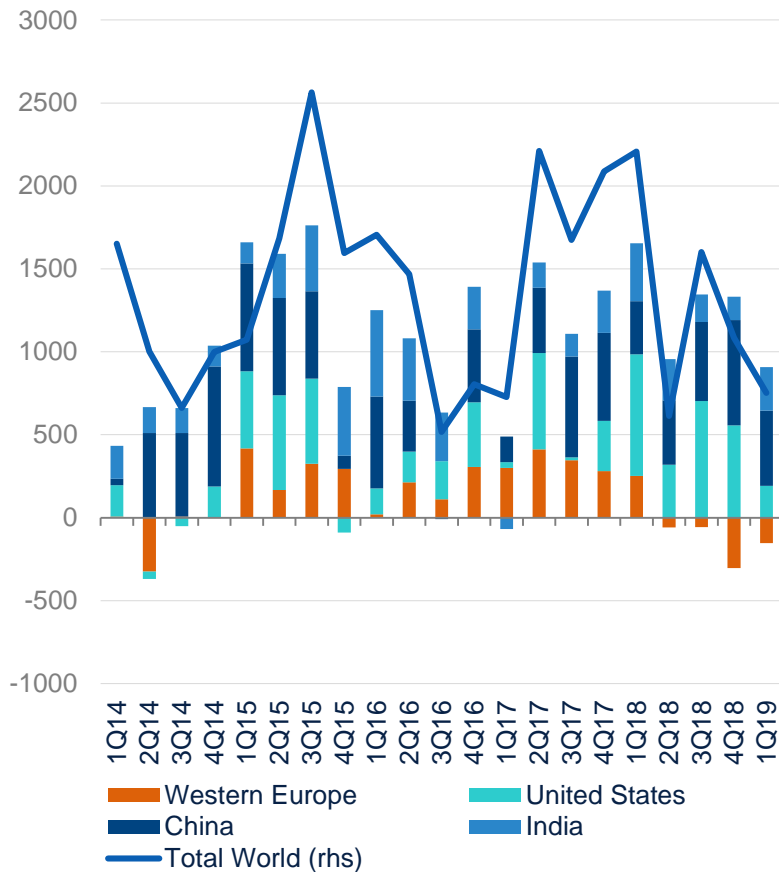
(\$ per barrel)



# Demand has declined in Europe, but remains supportive in China, India and the U.S.

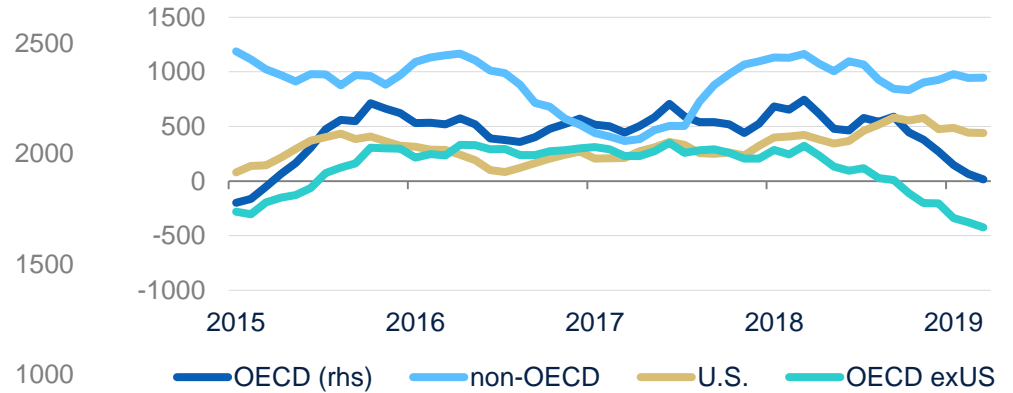
## Oil product demand: total world

(Thousand barrels per day, yoy change)



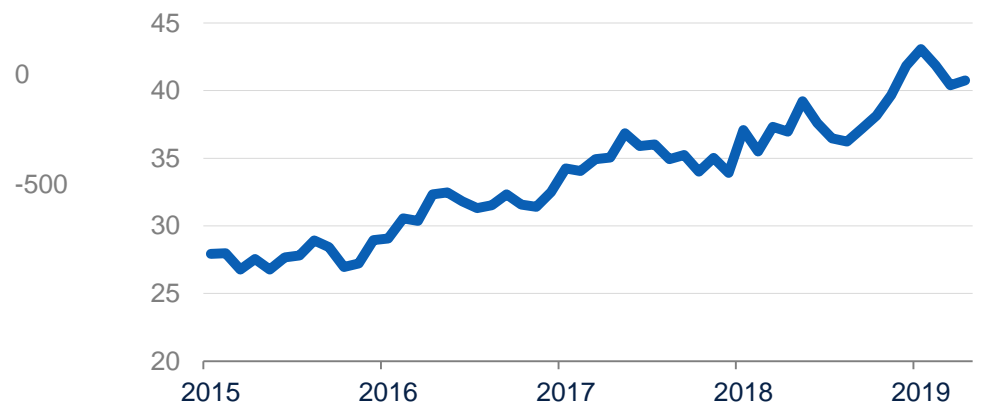
## Oil product demand

(Million barrels per day)



## China customs crude oil total imports

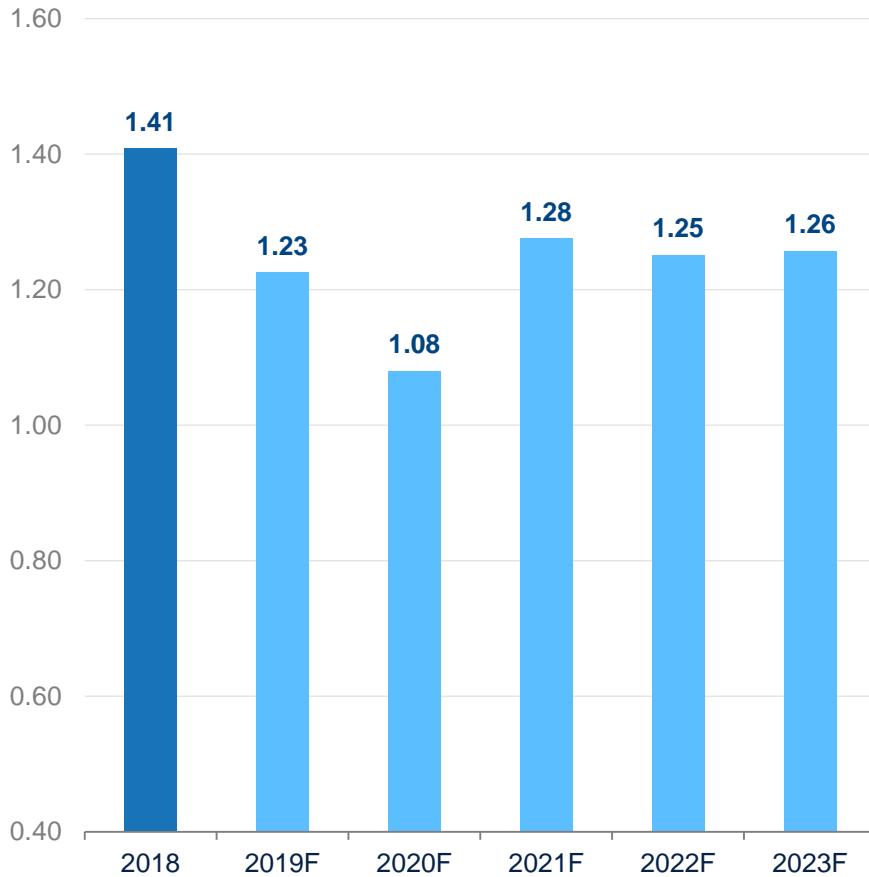
(3-month MA, metric tonne)



# A weaker economic outlook points to slower demand growth

## Oil product demand

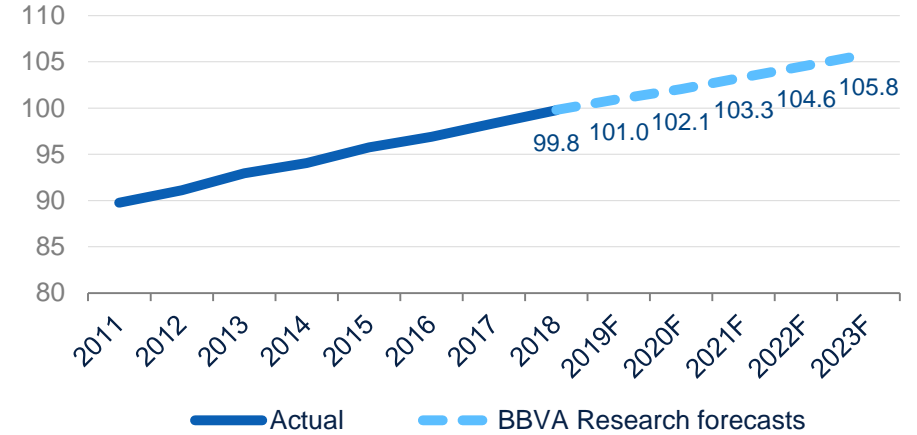
(YoY change, million b/d)



Source: BBVA Research, F = forecasts

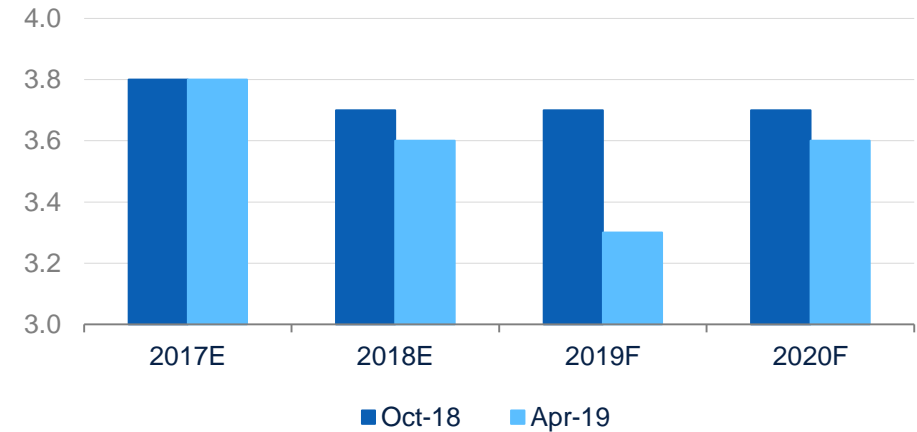
## Oil product demand

(million b/d)



## IMF World GDP growth

(YoY percent change)

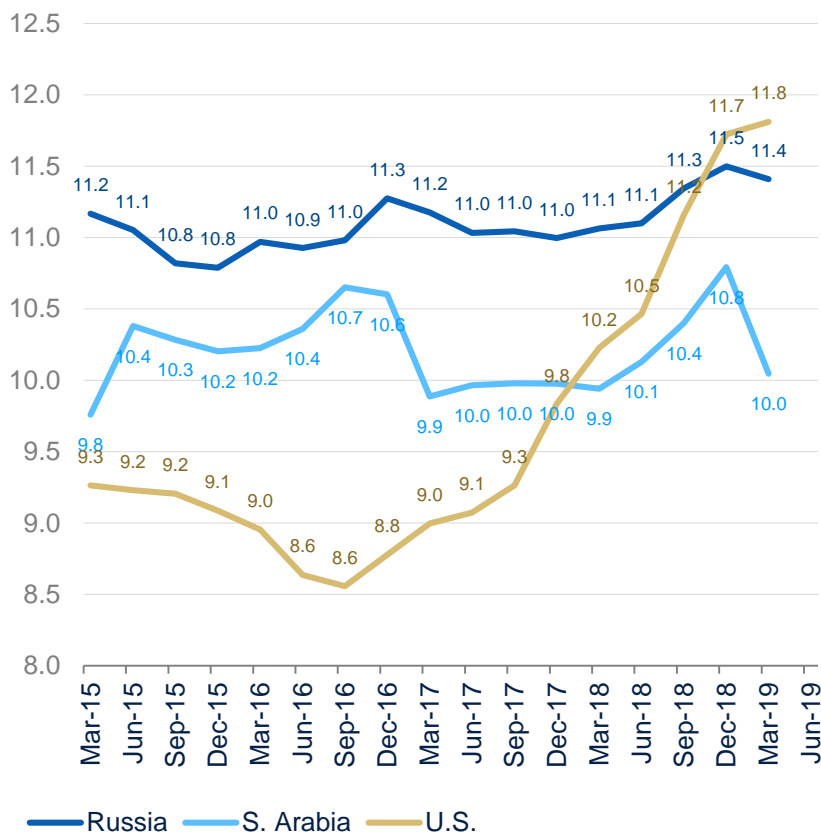


Source: IMF WEO Jan, 2019 update, E = estimates, F = forecast

# OPEC+ supply adjustments and U.S. sanctions on Iran and Venezuela may tighten supply throughout 2H19

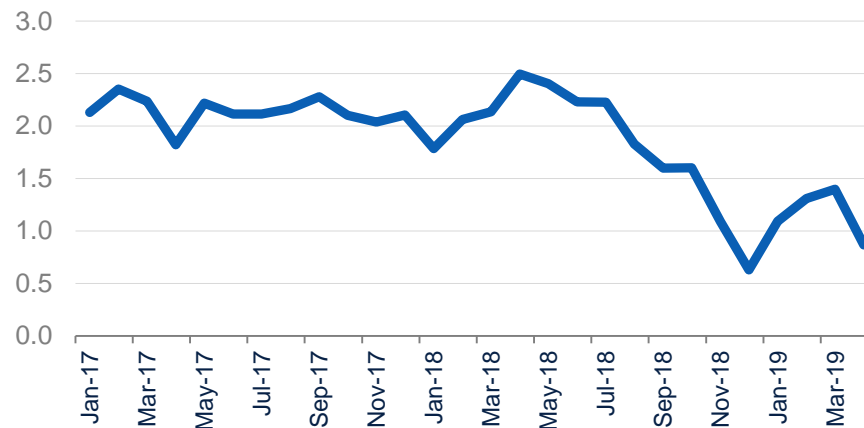
## Crude oil production

(Million barrels per day)



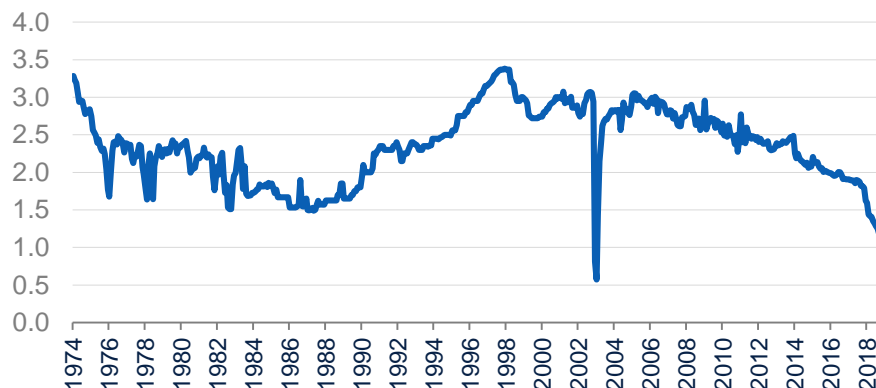
## Iran: exports of crude oil

(Million barrels per day)



## Venezuela: crude oil production

(Million barrels per day)

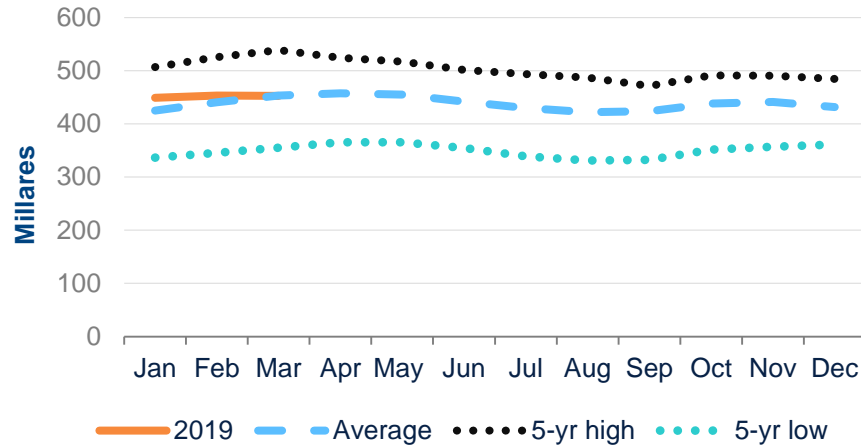


Source: BBVA Research, Haver Analytics, and Bloomberg

# U.S. production remains solid but investment has slowed down

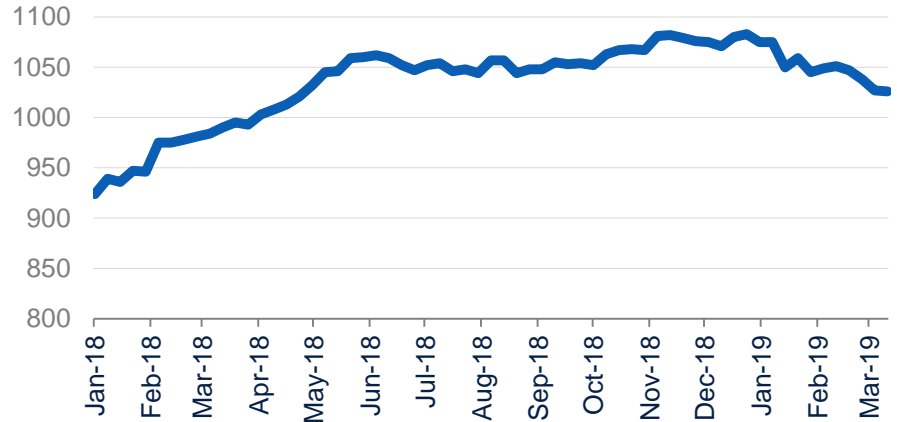
## U.S. Crude oil inventories

(Excluding SPR, million barrels)



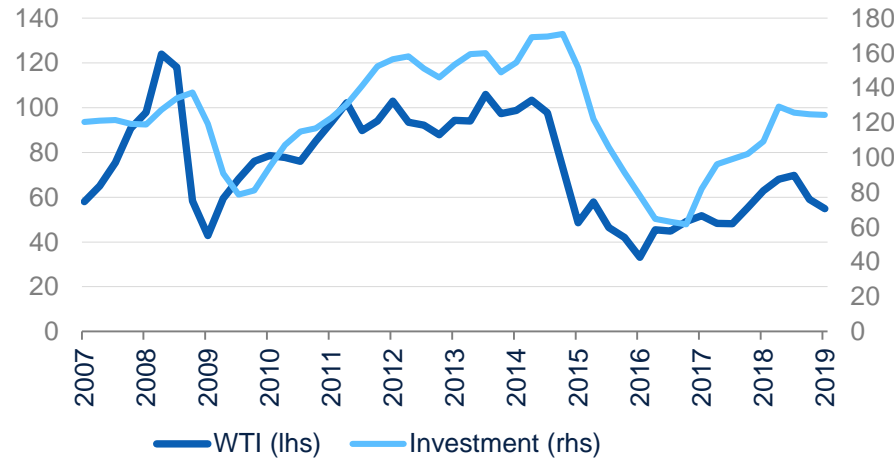
## U.S. Active rig count

(units)



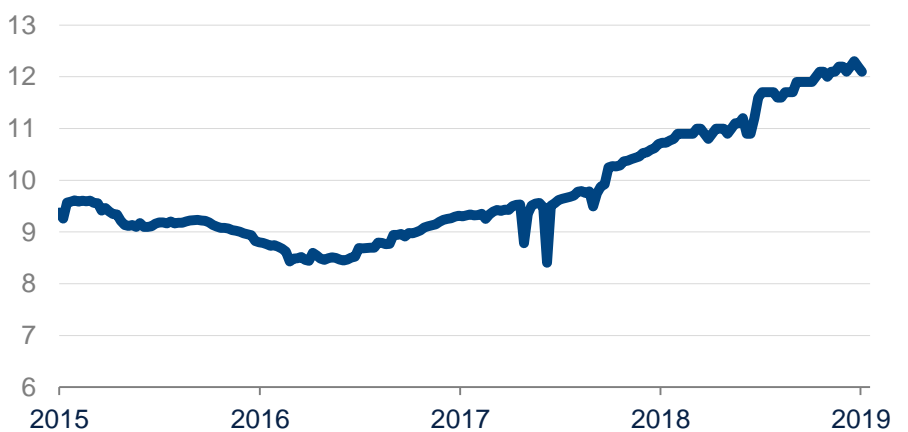
## U.S. Real private investment in E&P

(Yoy \$billion )



## U.S. Estimated crude oil production

(Thousand barrels/day)





# Supply adjustments will support prices in 2019, but demand will be the main driver going forward

## Brent prices forecast

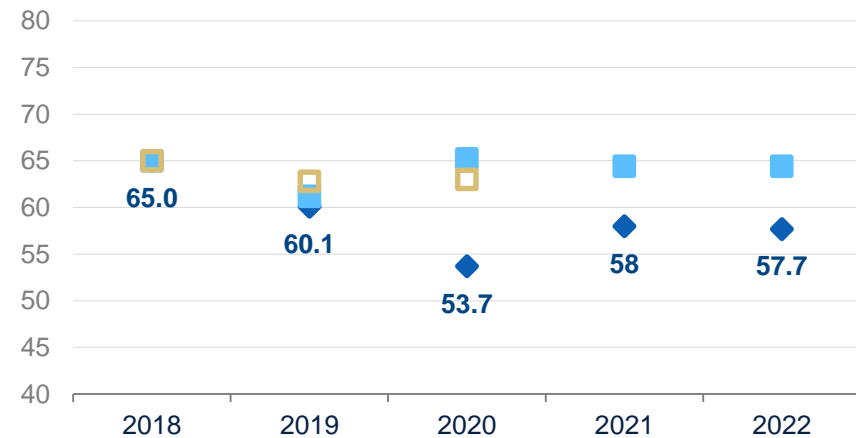
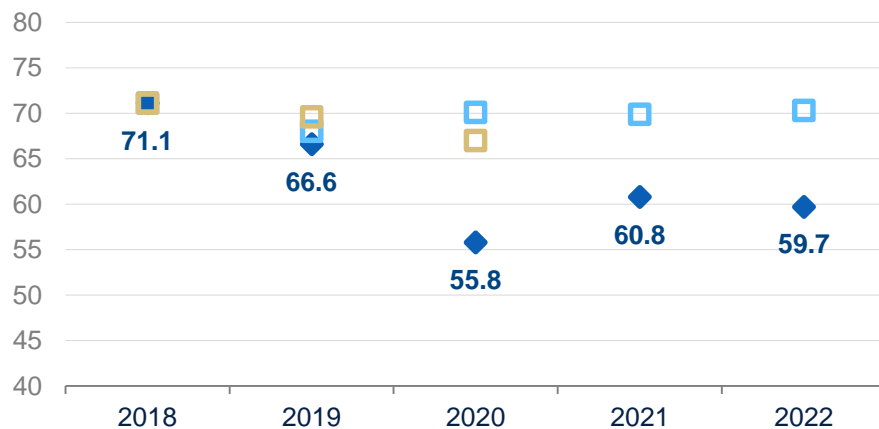
(\$ per barrel)

	BBVA Research (baseline)	Bloomberg Survey (May 28)	EIA STEO (May 7)
2017	54.2	54.2	54.2
2018	71.1	71.1	71.1
2019	66.6	68.0	69.6
2020	55.8	70.1	67.0
2021	60.8	69.9	
2022	59.7	70.3	

## WTI prices forecast

(\$ per barrel)

	BBVA Research (baseline)	Bloomberg Survey (May 28)	EIA STEO (May 7)
2017	50.9	50.9	50.9
2018	65.0	65.0	65.0
2019	60.1	61.2	62.8
2020	53.7	65.2	63.0
2021	58.0	64.4	
2022	57.7	64.4	



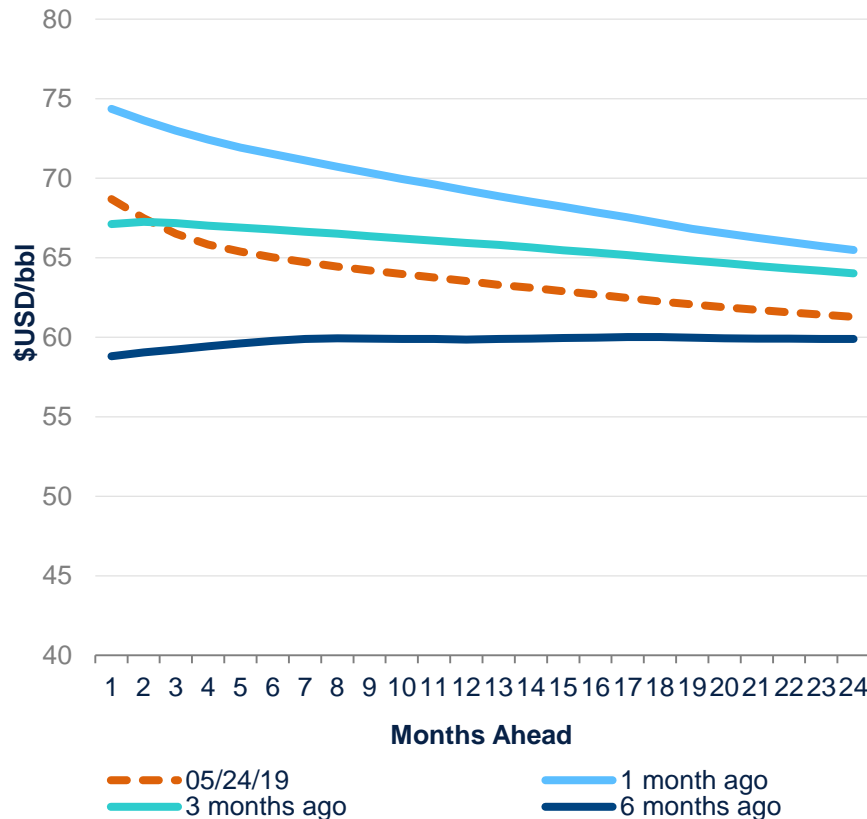
◆ BBVA Research    □ Bloomberg Survey (May 28)    ■ EIA STEO (May 7)

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# A backwardated futures curve points to tighter supply in the short-term, but lower prices in the mid- to long- term

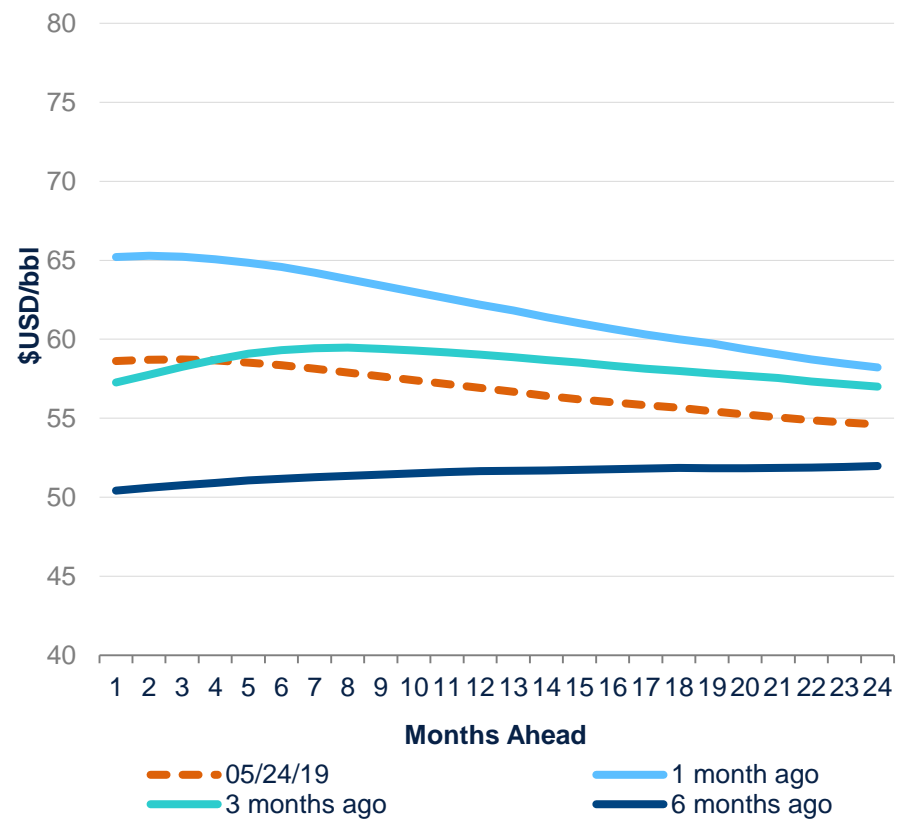
## Brent Futures

(\$ per barrel)

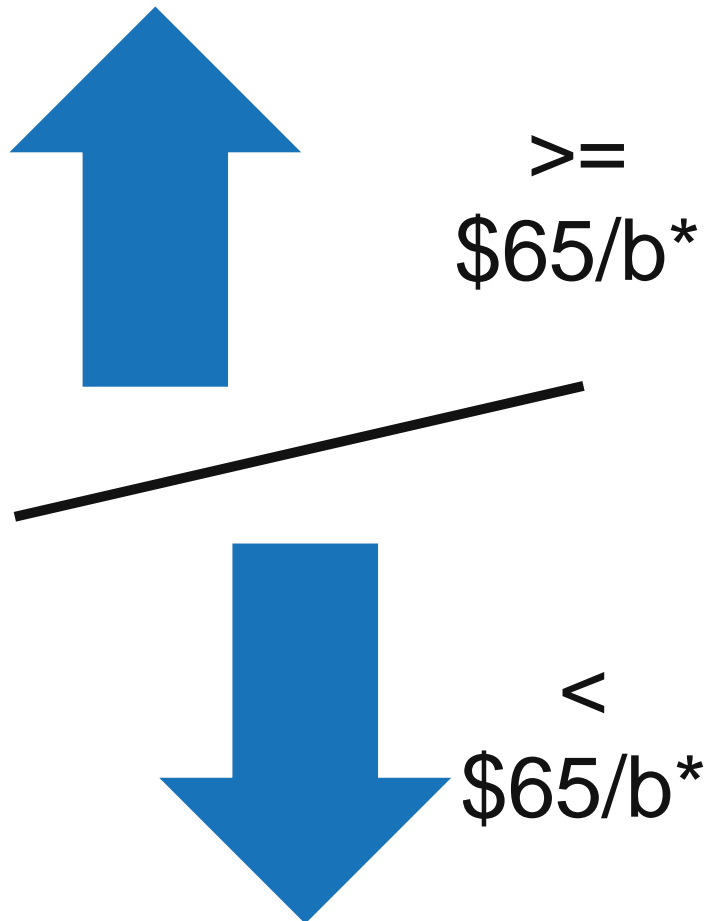


## WTI Futures

(\$ per barrel)



## Short-term risks are tilted to the upside



- OPEC spare capacity is insufficient to deal with unexpected supply shocks
  - Tensions in the Middle East escalate
  - Stronger –than-expected impact from additional negative supply shocks (e.g. Venezuela and Libya)
  - 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
- 
- 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.

# 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	1.8	1.6	1.5	1.2	1.2
Gross Investment	0.9	1.6	1.1	0.9	0.8	-0.2	0.8	1.0	0.8	0.7	0.8	0.8
Non Residential	1.0	1.2	0.5	0.9	0.3	0.1	0.7	1.0	0.7	0.7	0.7	0.7
Residential	0.0	0.3	0.3	0.1	0.3	0.2	0.1	0.0	-0.1	0.0	0.0	0.1
Exports	0.9	0.5	0.5	0.6	0.1	0.0	0.4	0.5	0.4	0.6	0.7	0.7
Imports	-0.9	-0.5	-0.3	-0.9	-1.0	-0.3	-0.8	-0.8	-0.3	-0.9	-0.9	-1.0
Government	-0.7	-0.4	-0.5	-0.2	0.3	0.3	0.0	0.3	0.2	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	3.7	4.0	4.2	4.4
Avg. Monthly Nonfarm Payroll (K)	173	181	192	251	227	193	179	223	187	160	135	113
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.1	2.4	1.8	2.0	2.1	2.1
Core CPI (YoY %)	1.7	2.1	1.8	1.8	1.8	2.2	1.8	2.1	2.0	2.0	2.0	2.0
Fiscal Balance (% GDP, FY)	-8.4	-6.8	-4.1	-2.8	-2.4	-3.2	-3.5	-4.0	-4.2	-4.2	-4.3	-4.8
Current Account (bop, % GDP)	-2.9	-2.6	-2.1	-2.1	-2.2	-2.3	-2.3	-2.4	-2.3	-2.4	-2.5	-2.6
Fed Target Rate (% , eop)	0.25	0.25	0.25	0.25	0.50	0.75	1.50	2.50	2.75	2.75	2.75	2.75
Core Logic National HPI (YoY %)	-2.9	4.0	9.7	6.8	5.3	5.5	5.9	5.7	3.7	3.0	3.2	3.5
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	2.49	2.40	2.83	2.84	3.06	3.22	3.37
West Texas Intermediate Oil Prices (dcb, average)	94.9	94.1	97.9	93.3	48.7	43.2	50.9	65.0	60.1	53.7	58.0	57.7

# Economic Scenarios

Probability (%)	Current	Previous
Upside	5	5
Baseline	55	55
Downside	40	40

Macro Scenarios										
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>GDP</b>	2.5	2.9	1.6	2.2	2.9	2.5	2.0	1.9	1.8	1.8
Upside						3.4	3.2	3.1	2.7	2.7
Downside						1.1	-0.9	1.9	2.1	2.3
<b>UR</b>	6.2	5.3	4.9	4.4	3.9	3.7	4.0	4.2	4.4	4.5
Upside						3.5	2.9	2.9	3.0	3.0
Downside						4.4	6.2	6.6	5.7	5.0
<b>CPI</b>	1.6	0.1	1.3	2.1	2.4	1.8	1.9	2.1	2.1	2.1
Upside						2.0	3.3	3.6	3.8	3.8
Downside						1.1	0.6	1.1	1.3	1.4
<b>Fed [eop]</b>	0.25	0.50	0.75	1.50	2.50	2.75	2.75	2.75	2.75	2.75
Upside						3.50	5.00	5.00	5.00	5.00
Downside						1.50	0.25	0.25	0.25	0.25
<b>10-Yr [eop]</b>	2.21	2.24	2.49	2.4	2.83	2.84	3.06	3.22	3.37	3.48
Upside						4.49	5.58	5.99	5.85	5.96
Downside						1.34	1.04	1.46	2.00	2.11

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# U.S. Economic Outlook

May 2019

Creating Opportunities