

U.S. Economic Outlook

June 2019

Economic Outlook

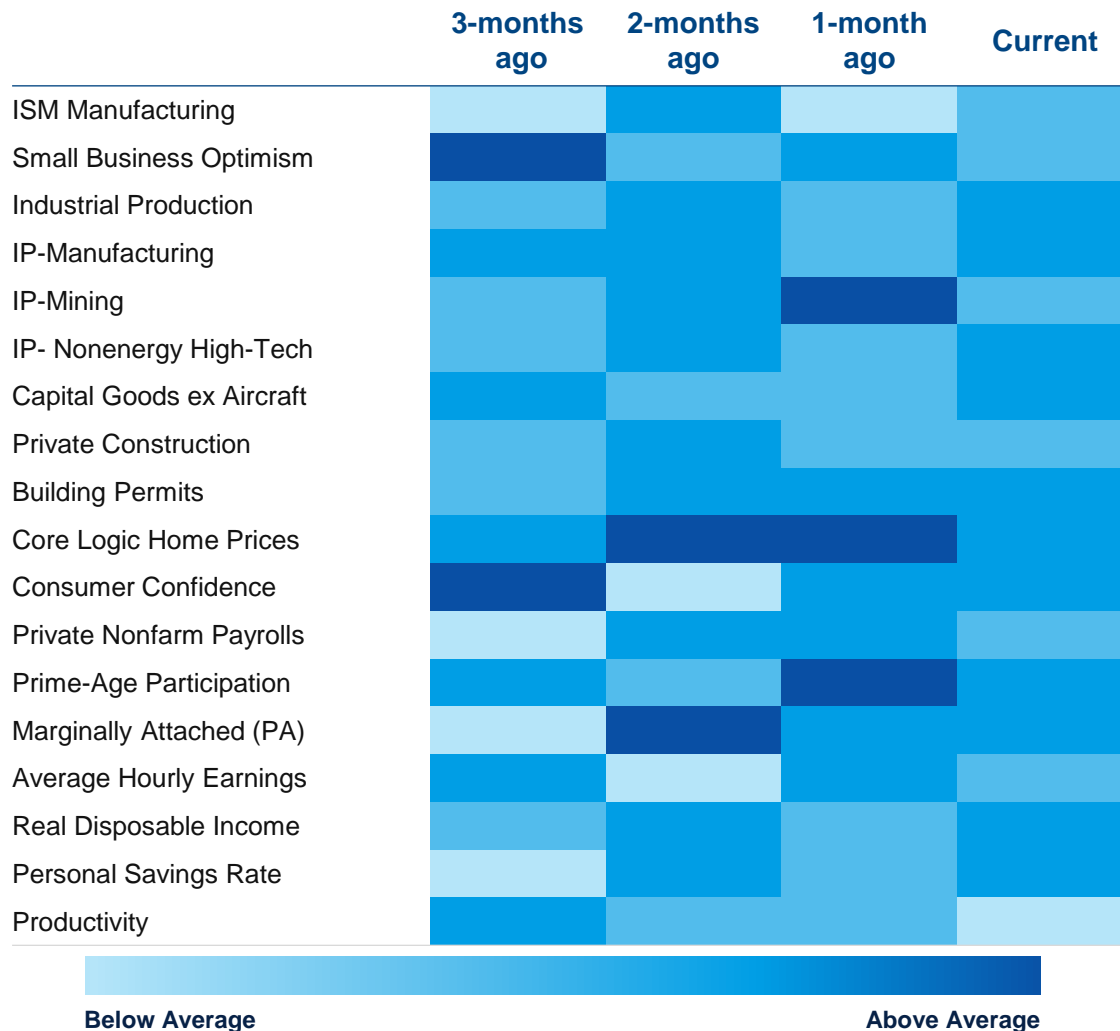
- Baseline growth forecast unchanged, but risks to downside growing
- Model-based recession projections suggest probability around 60% over the next 24-months
- Mixed signals from labor market indicators
- Inflation outlook in question with core PCE persistently below target
- Fed preparing markets for rate cuts in 3Q19
- Yield curve dynamics mainly driven by flight to safety and dovish monetary policy expectations
- Weaker demand pressuring oil prices, but geopolitical risks remain

Macro Fundamentals

- GDP growth decelerated in 2Q19
- Rebound in consumption should support moderate growth rates in 2H19
- Survey-based investment indicators declining amidst deteriorating business expectations
- Countervailing trade dynamics(weaker global growth vs. reduced trade tensions) imply no material change in net export balance
- Boost from fiscal stimulus will fade in 2H19 if no additional measures taken
- Growth to remain above potential despite growing risks to downside

Economic activity

REAL-TIME ECONOMIC MOMENTUM HEAT MAP

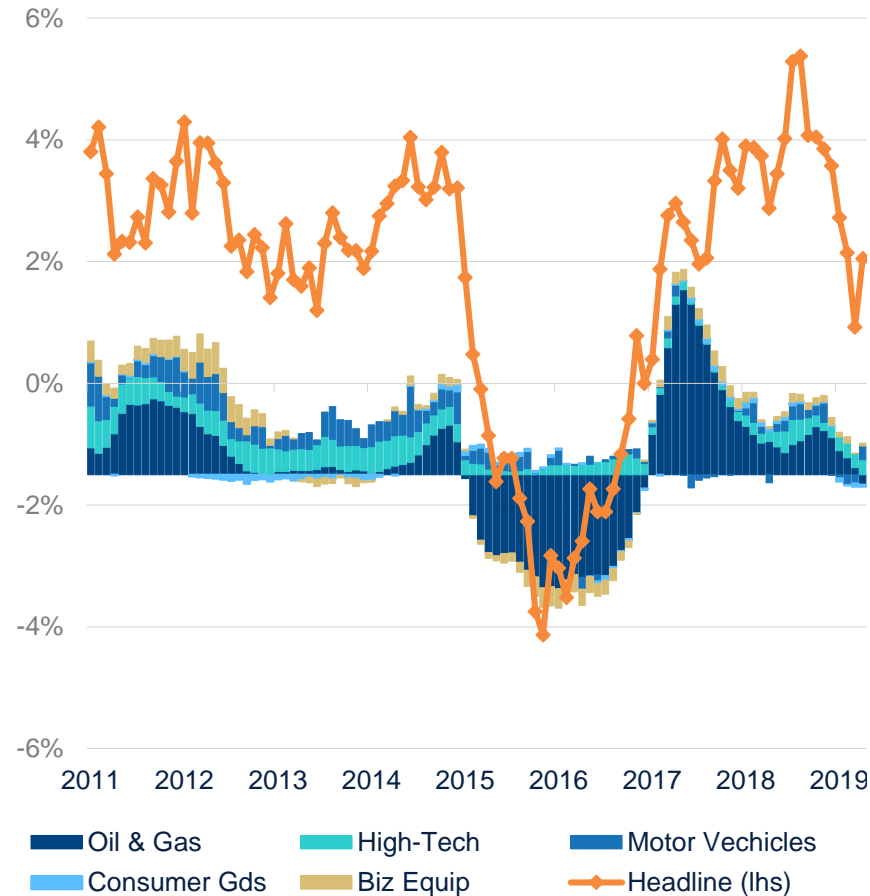


Source BBVA Research

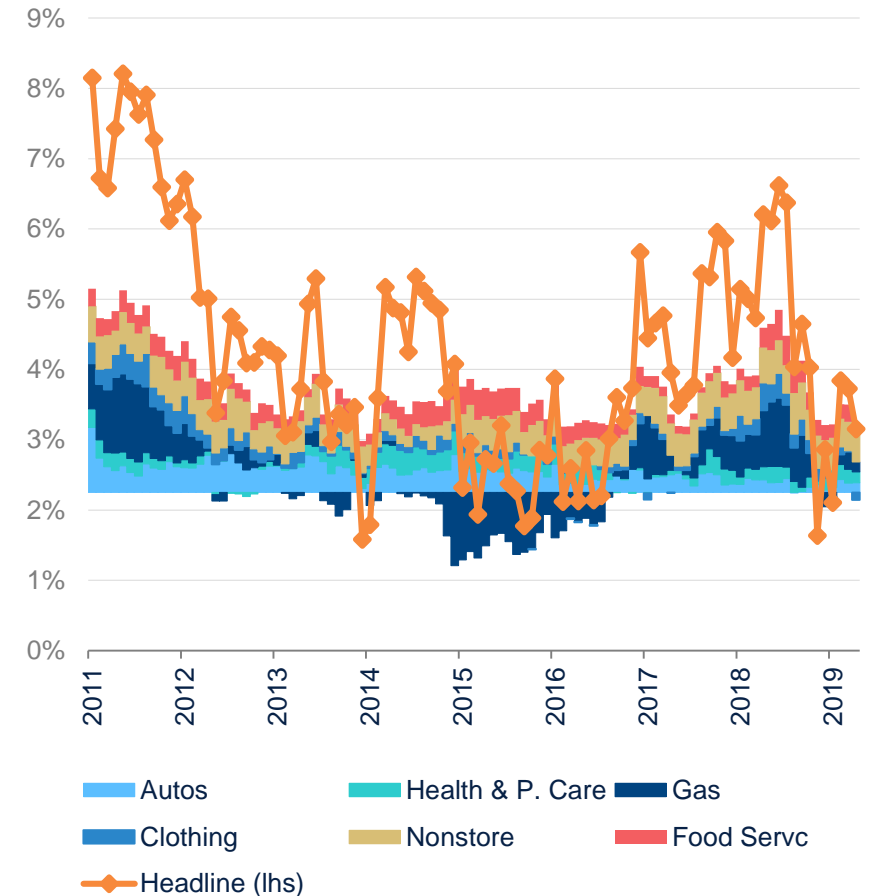
- Overall balance of risks tilted to the downside amid weaker indicators
- Slight improvement in industrial production from April, but surveys deteriorating
- Growth in private residential construction the weakest since crisis
- Confidence indicators whipsaw with market correction and geopolitical tensions
- Nontrivial deceleration in labor productivity

Economic trends: Slowdown in mining and manufacturing underlie weakness in industrial production

INDUSTRIAL PRODUCTION (YEAR-OVER-YEAR %)

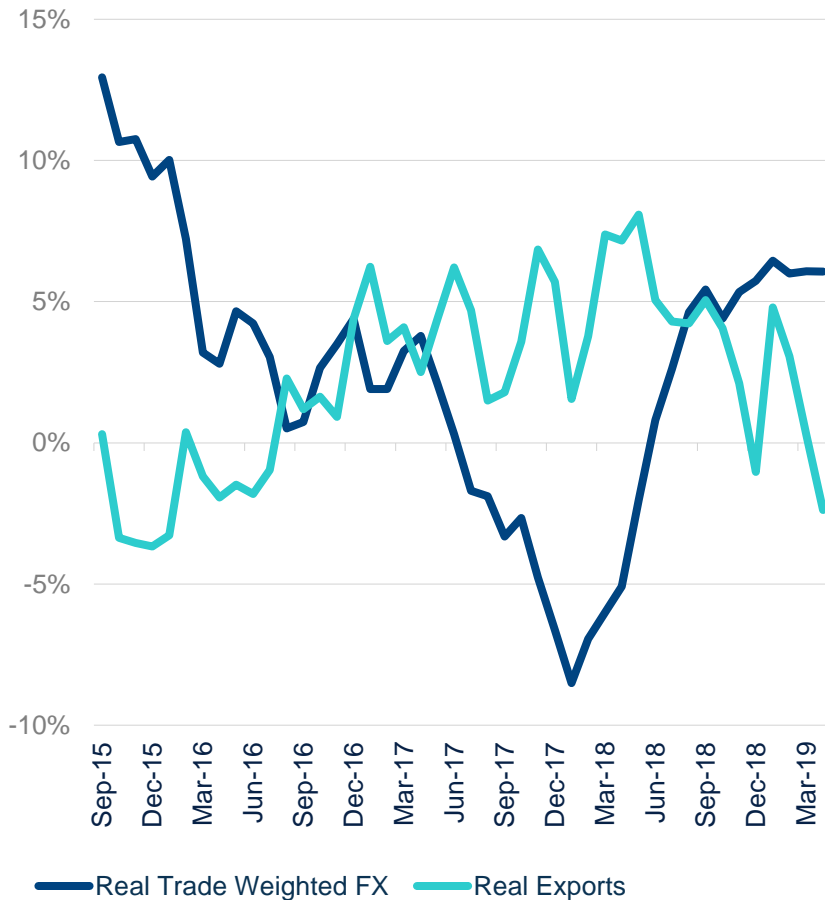


RETAIL SALES (YEAR-OVER-YEAR %)

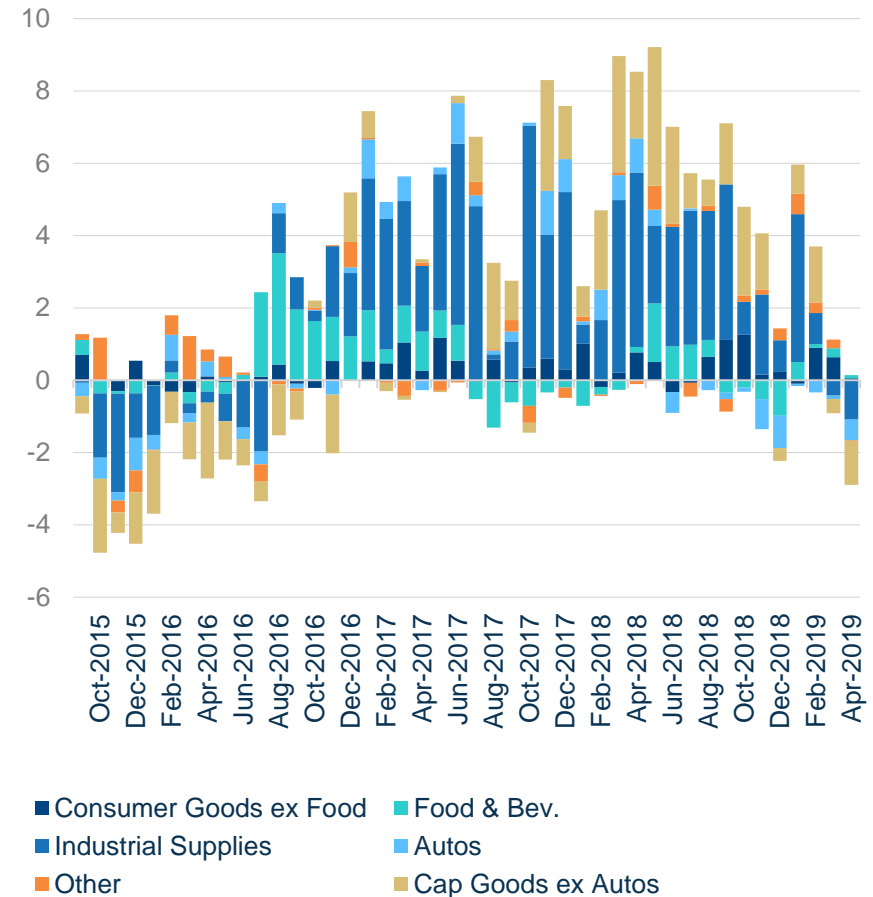


Economic trends: Real exports decline despite stable dollar, suggesting further deterioration in global demand

REAL EXCHANGE RATE AND EXPORTS (YEAR-OVER-YEAR %)



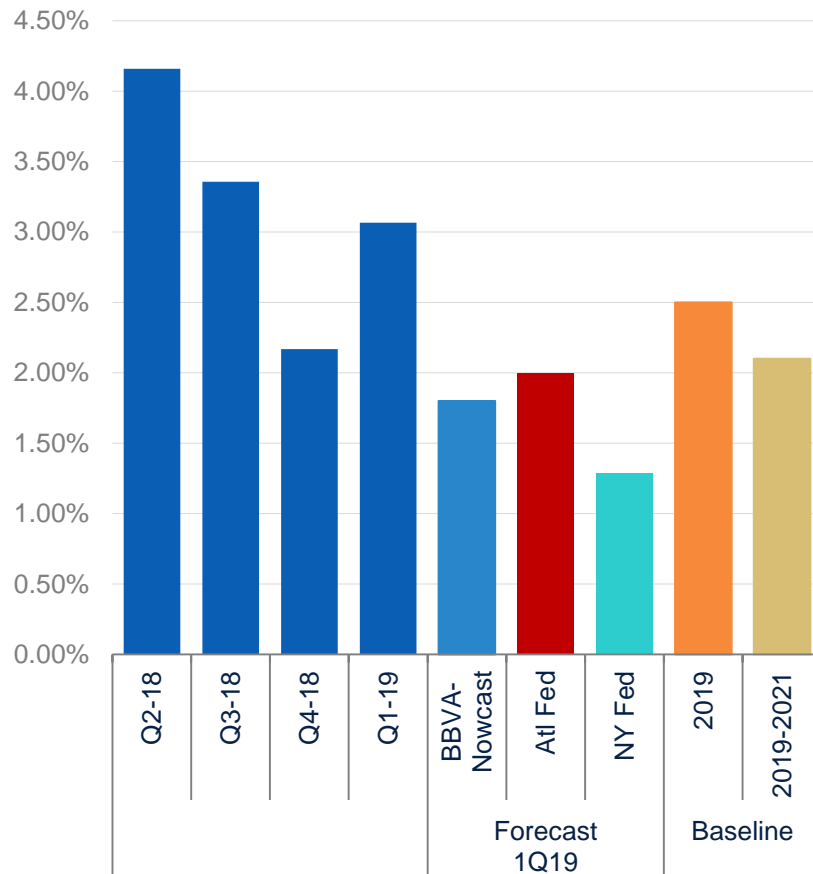
REAL EXPORTS (CONTRIBUTION TO YEAR-OVER-YEAR %)



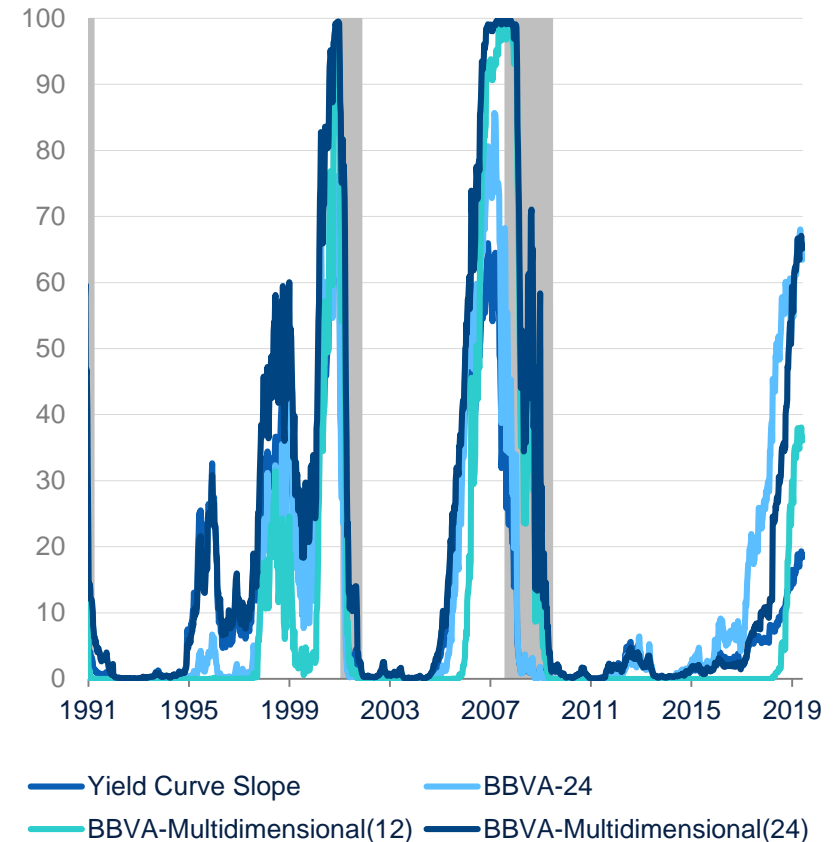
Source: BBVA Research, FRB & Census

Economic trends: 2Q19 growth to dip below 2%, recession risk around 40% in next 12 months

REAL GDP (QOQ SAAR, %)

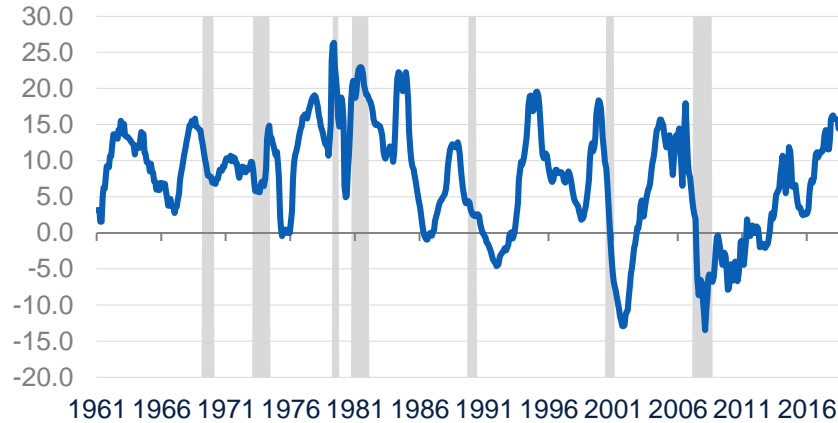


PROBABILITY OF RECESSION IN 12 MONTHS (%)

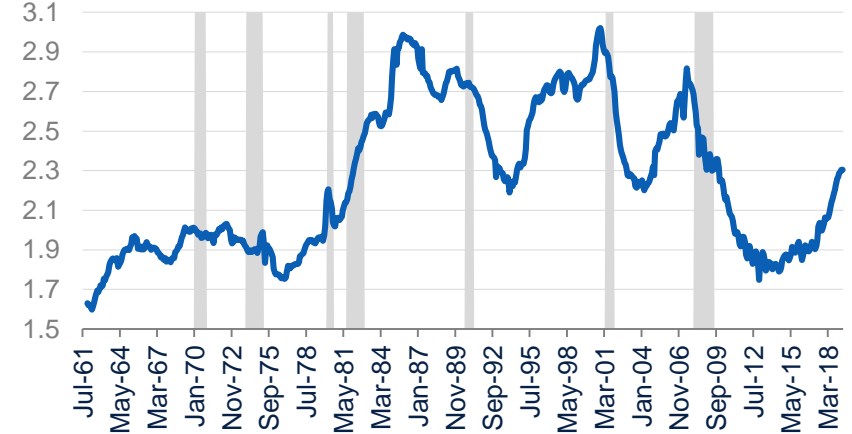


Consumer credit cycle: No major signs of deterioration in consumer credit conditions

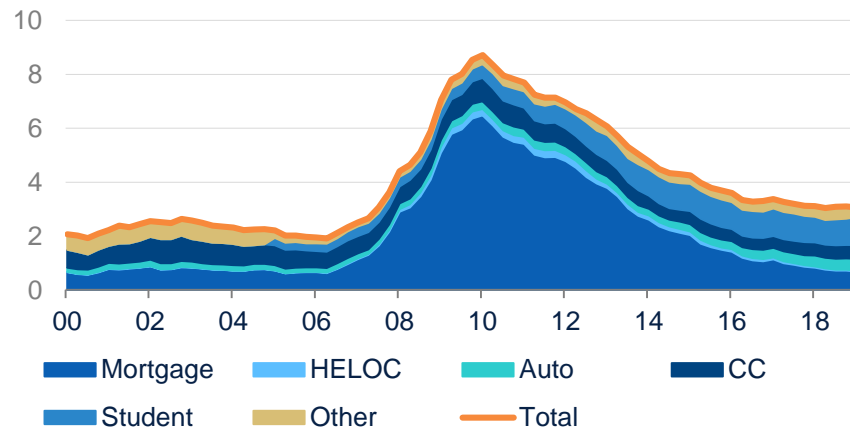
PERSONAL INTEREST EXPENSE (YEAR-OVER-YEAR %)



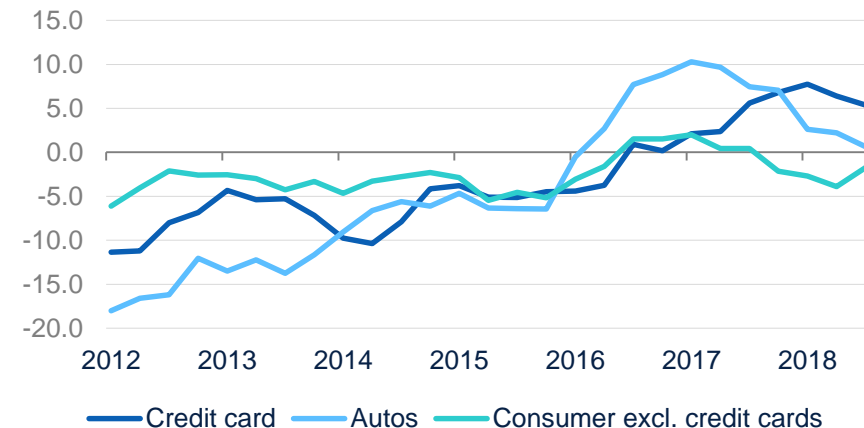
PERSONAL INTEREST EXPENSE TO DISP. INCOME (RATIO, %)



NEW 90+ DAY CONSUMER DELINQUENCIES RATES (CONTRIBUTION, %)



SENIOR LOAN OFFICERS LENDING STANDARDS (+ TIGHTENING / - LOOSENING)

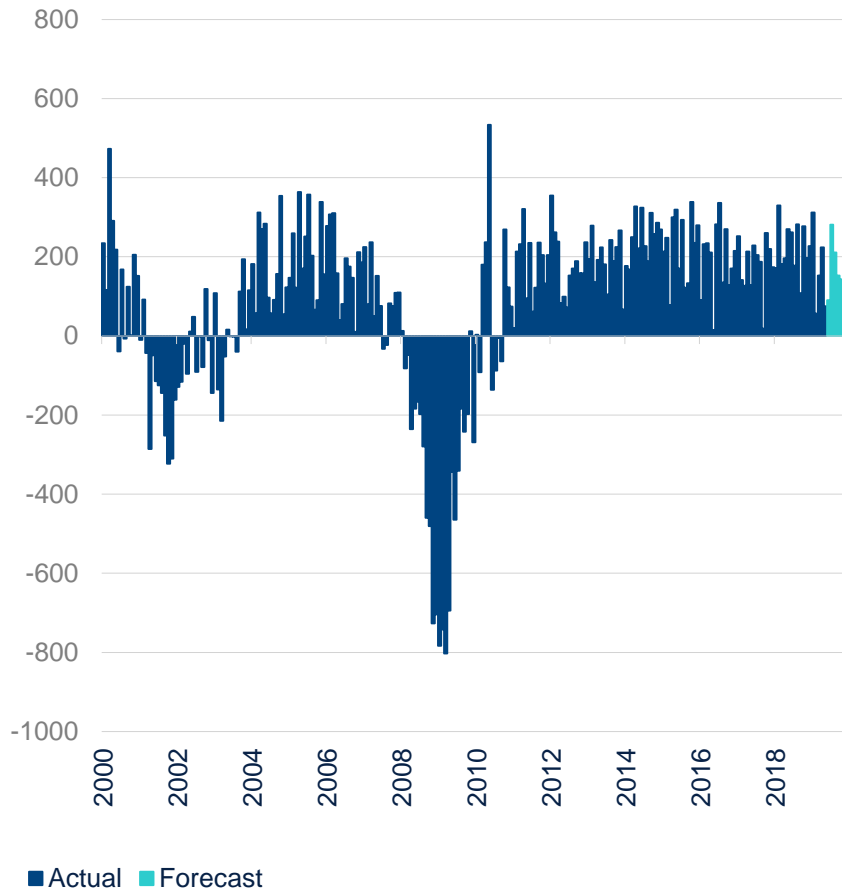


Labor Market

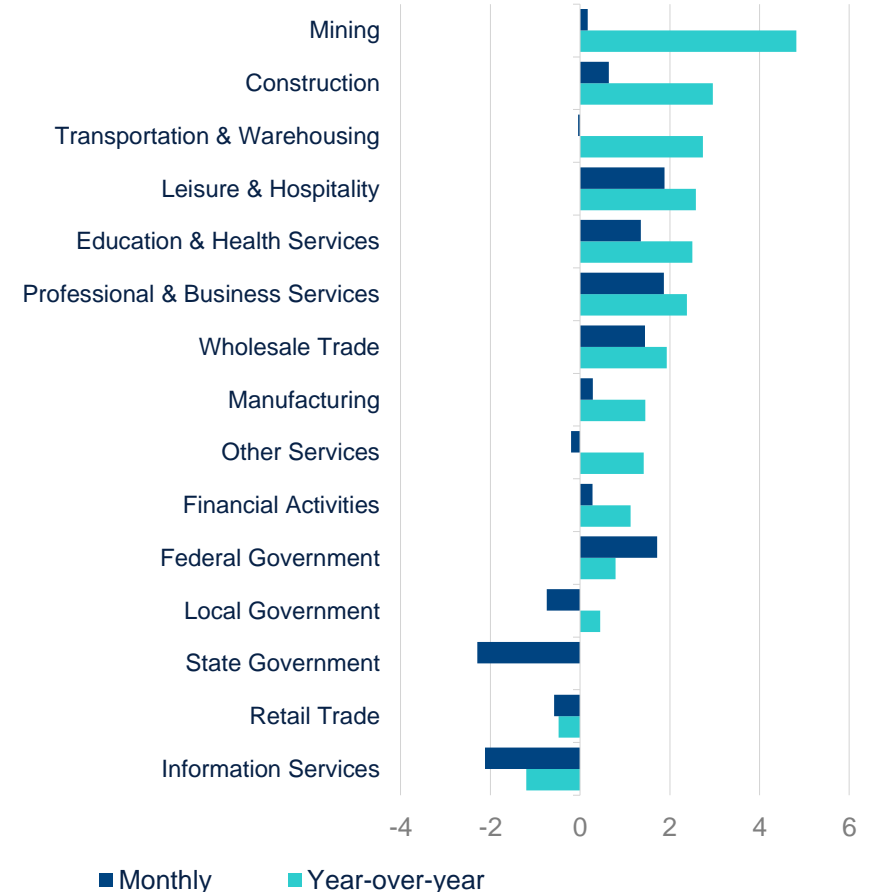
- In May, nonfarm payroll employment grew 75,000; an nontrivial deceleration since April (224,000)
- Weakness in the retail trade sector (-7K), transportation and warehousing (-0.2), information (-5K) and government (-15K) offset strength in professional and business services (33K), health care (16K) and construction (4K)
- The unemployment rate (UR) held steady at 3.6% in May
- The labor force participation rate and the employment-population ratio were unchanged at 62.8% and 60.6%
- Baseline assumes only modest declines in UR in 2019. Average monthly job growth to slow to 166K this year, from 223K in 2018

Labor market: 104 consecutive months of positive payroll growth, but headwinds building

NONFARM PAYROLLS (MONTHLY CHANGE, K)

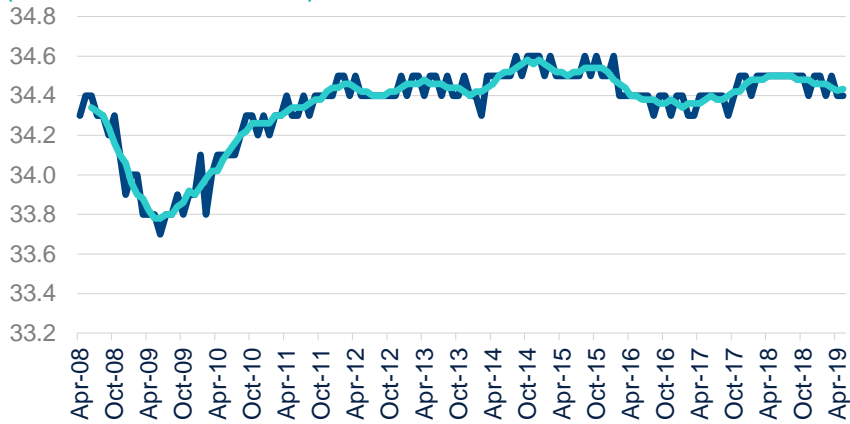


INDUSTRY EMPLOYMENT (ANNUALIZED % CHANGE)

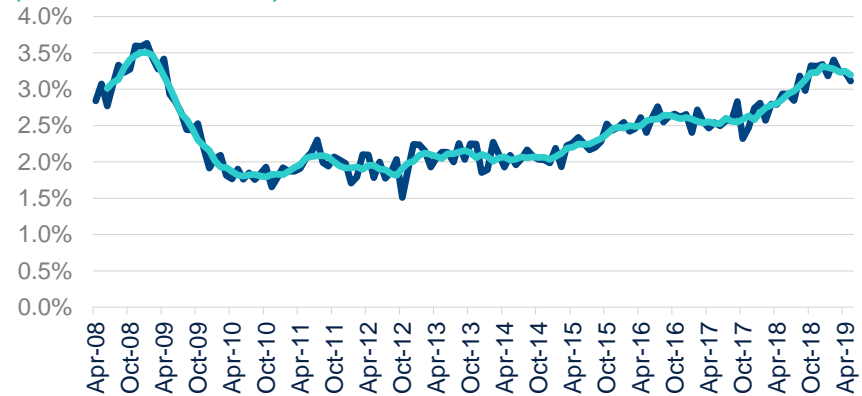


Labor market: Slowdown in average weekly hours and earnings

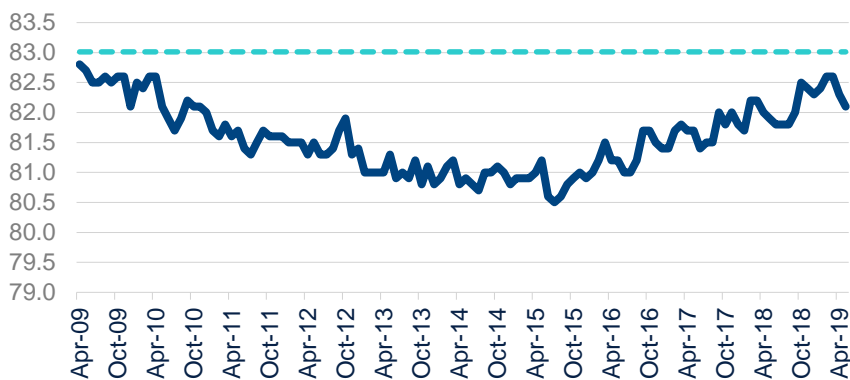
AVERAGE WEEKLY HOURS (NUMBER & 5MCMA)



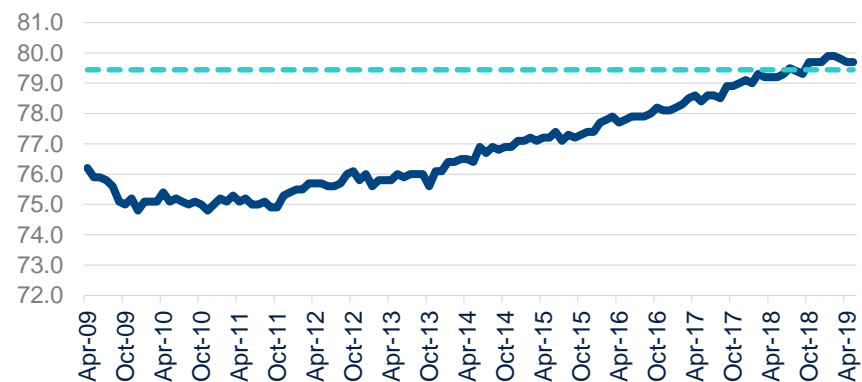
AVERAGE HOURLY EARNINGS (YOY% & 5MCMA)



PRIME AGE LABOR FORCE PARTICIPATION (%)



PRIME AGE EMPLOYMENT-TO-POPULATION (%)

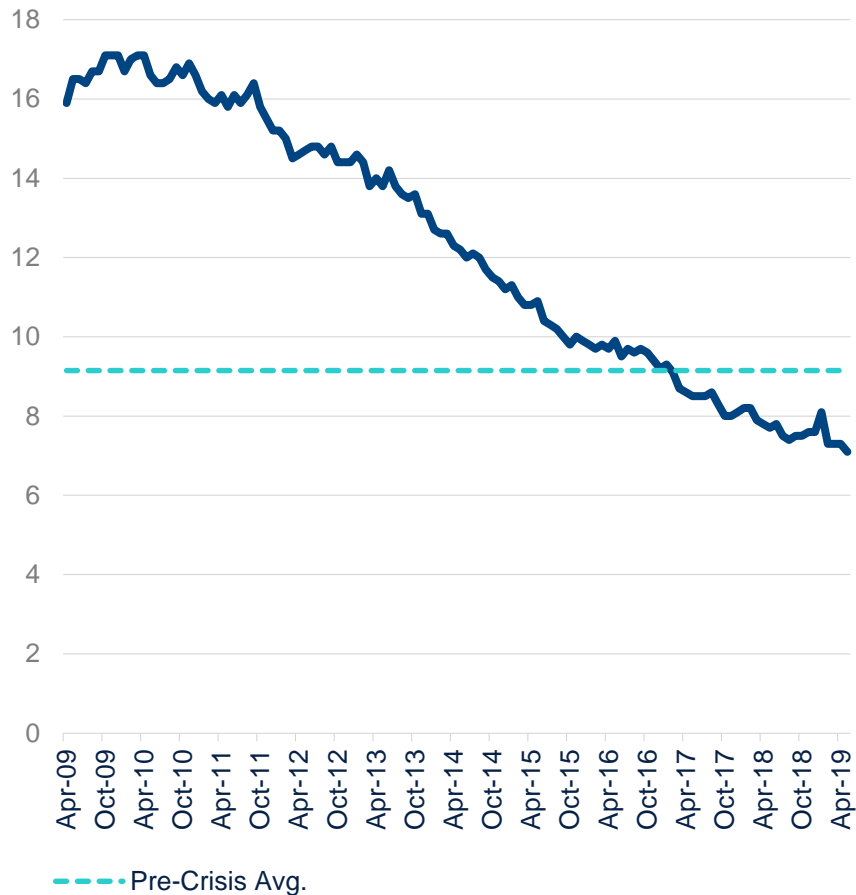


--- Pre-Crisis Avg.

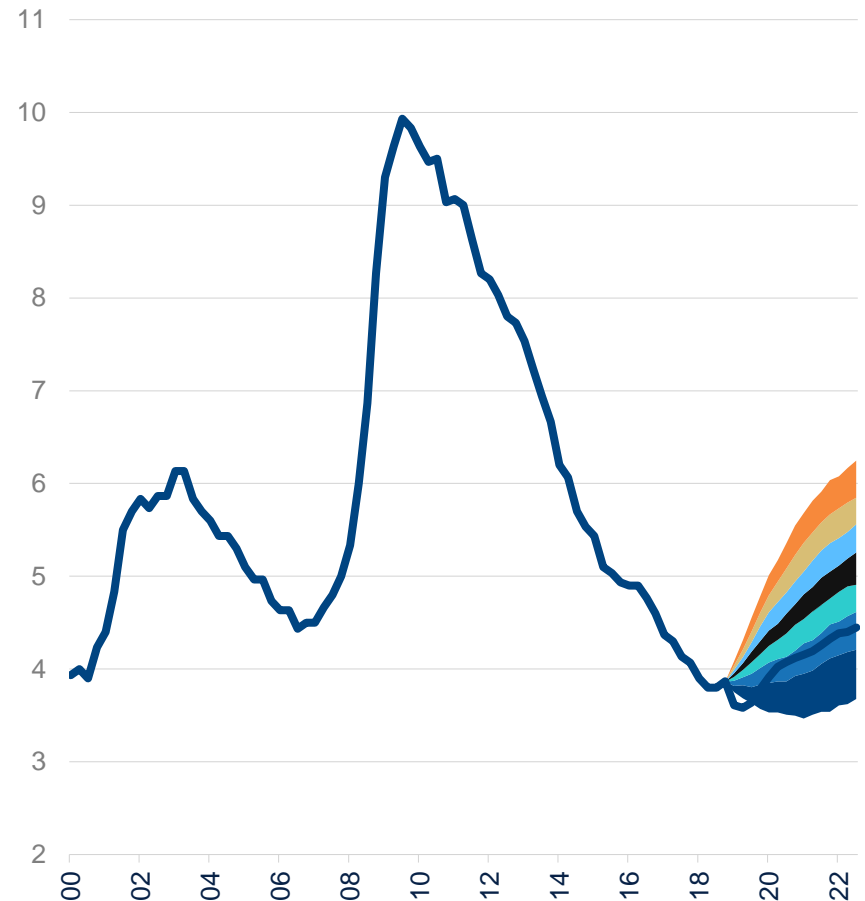
--- Pre-Crisis Avg.

Labor market: Unemployment rate unlikely to decline further, as signs of late-cycle fears growing

U-6
(%)



UNEMPLOYMENT RATE
(%)

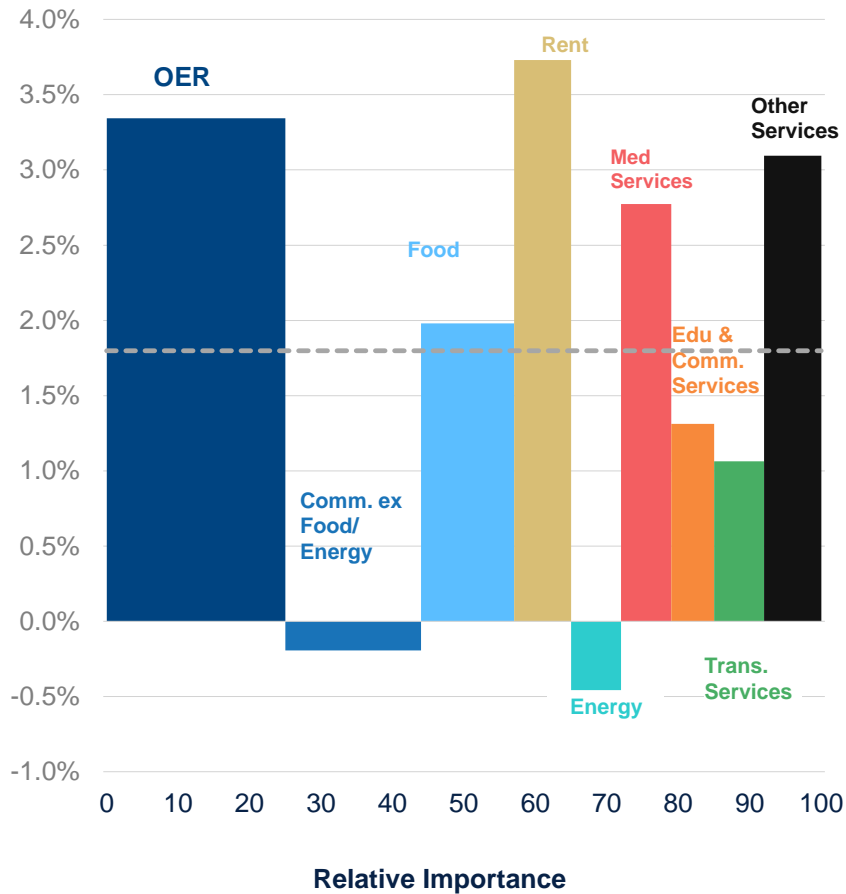


Inflation

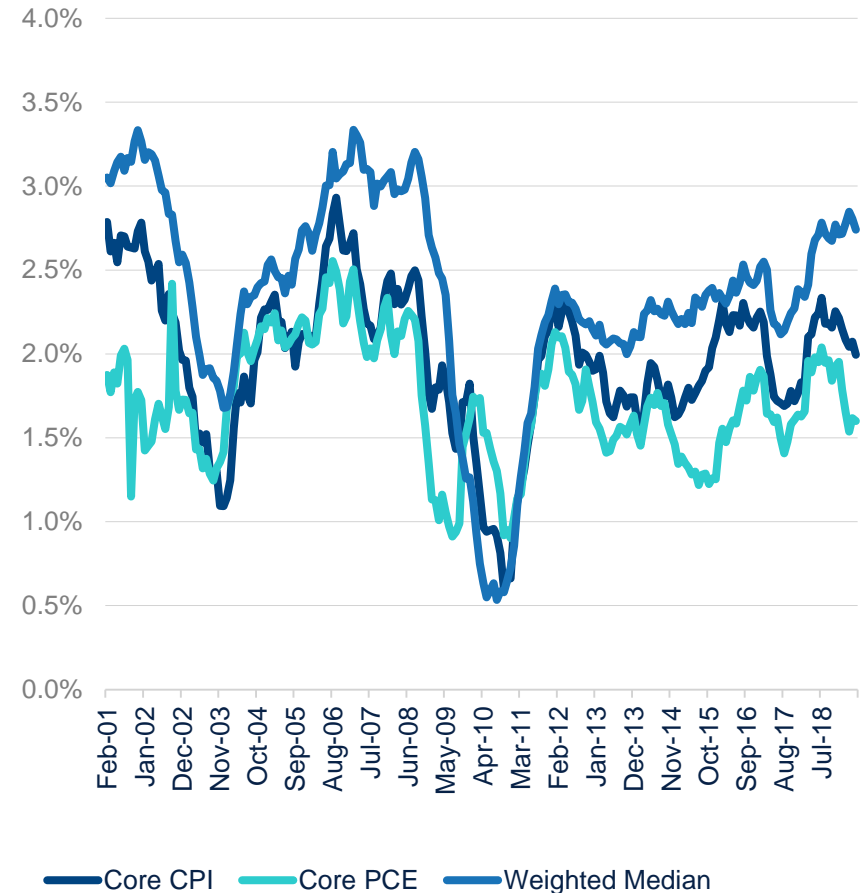
- Headline consumer prices increased 0.1% month-over-month in May, after rising 0.3% in April
- The 12-month change in headline CPI slumped below 2% again to 1.8%, while core CPI continued to decelerate, reaching 2.0% in May
- In addition to the slowdown in energy prices, used car and trucks, and motor vehicle insurance prices decelerated dragging down headline CPI
- Idiosyncratic supply-side shocks from tariffs could push prices up in short-run, but majority of risks are tilted to downside
- Inflation expectations trending near lowest levels in 3 years
- Baseline assumes average headline CPI to decelerate to 1.8% in 2019, before rebounding in 2020

Inflation: Core inflation continues to trend below Fed target

CONSUMER PRICE INFLATION (12M CHANGE)



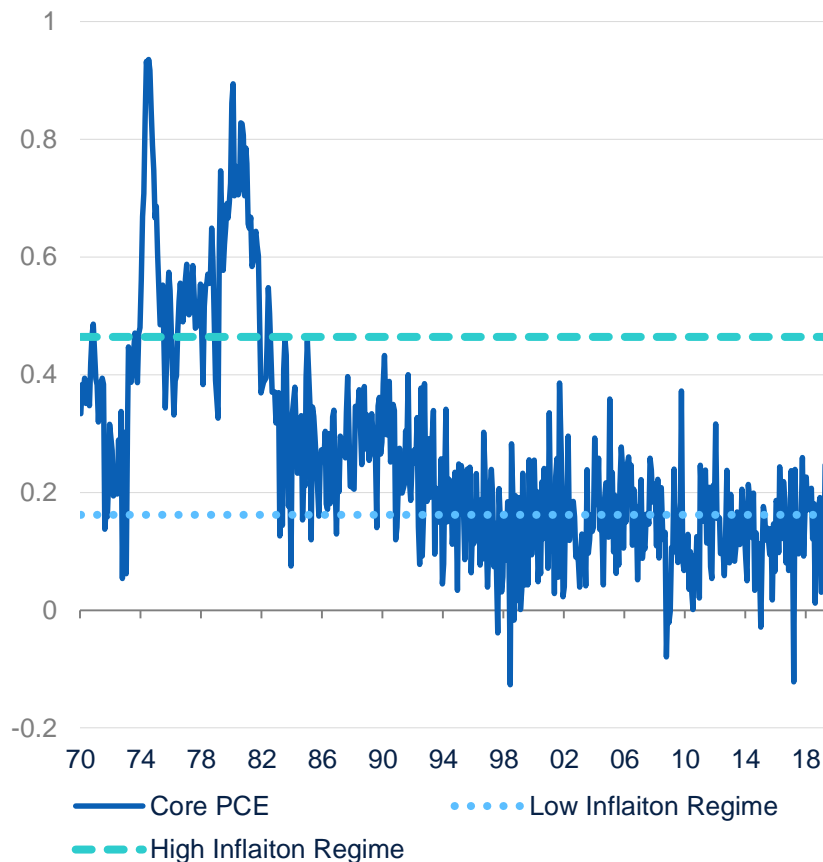
CORE INFLATION MEASURES (12M CHANGE)



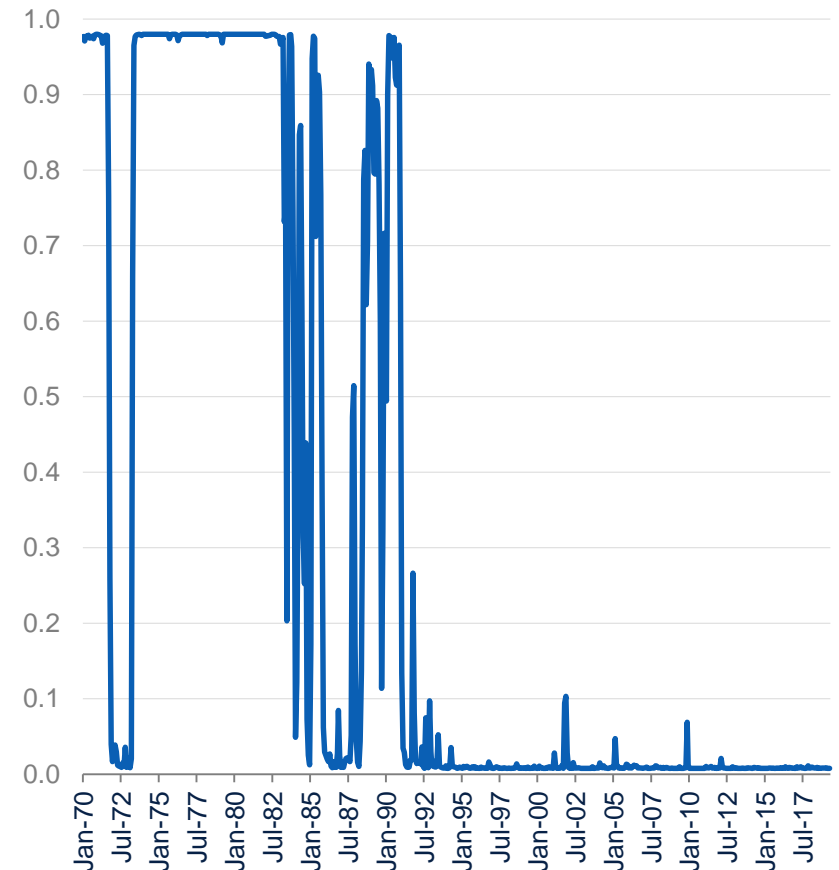
Source: BBVA Research, BLS & BEA

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

CORE PCE PRICE INDEX & INFLATION REGIMES (MONTH-OVER-MONTH %)

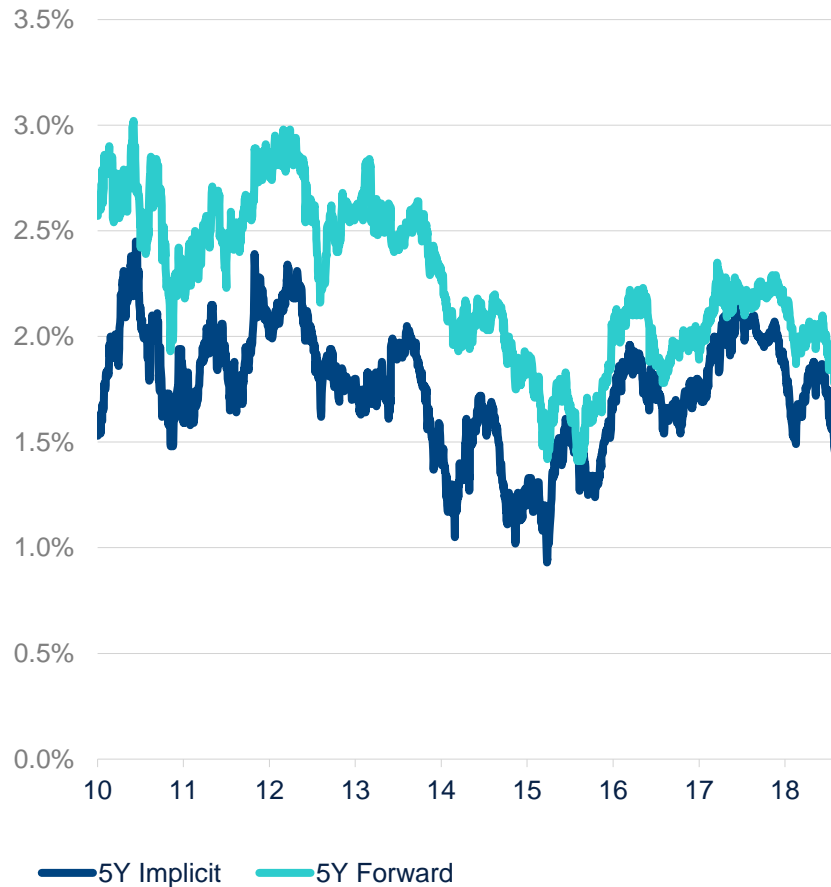


INFLATION REGIME CHANGE PROBABILITY (%)

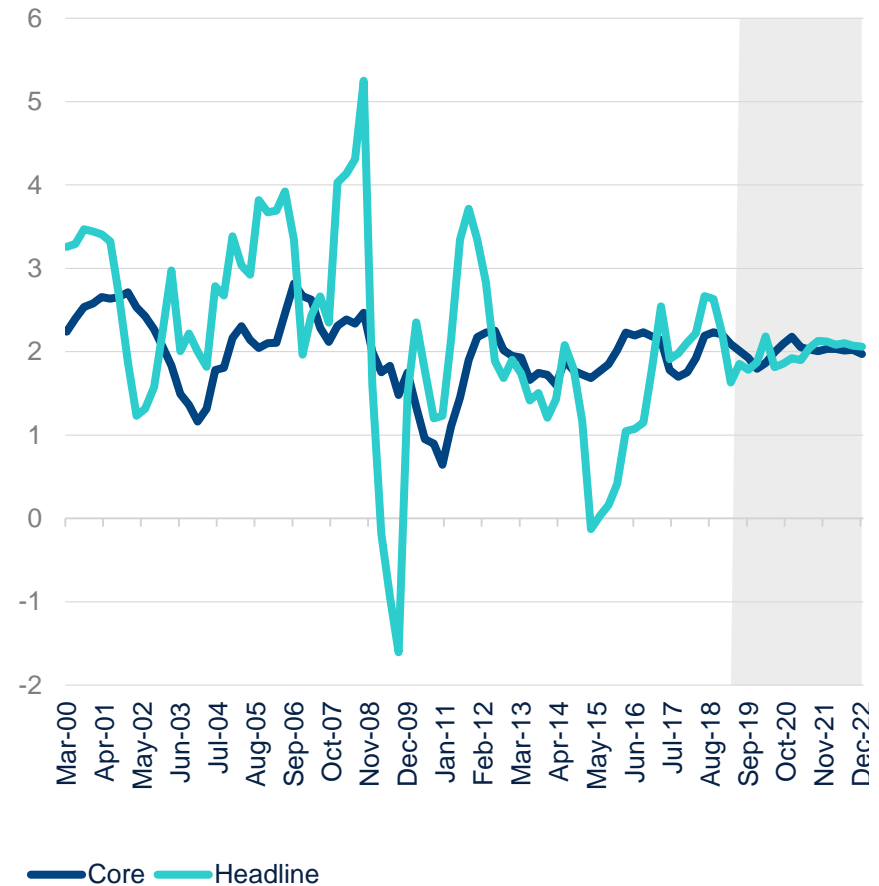


Inflation: Baseline continues to assume modest undershooting in short-run, but recovery in 2H19

INFLATION EXPECTATIONS (%)



HEADLINE & CORE CPI (YEAR-OVER-YEAR %)

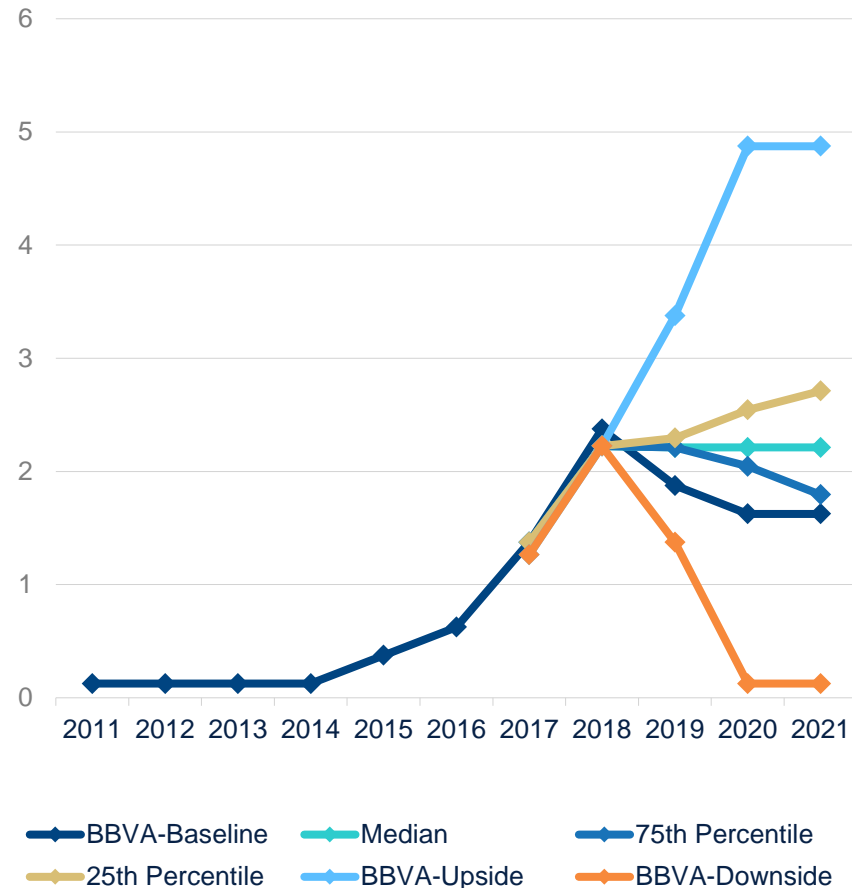


Monetary Policy: Federal Reserve

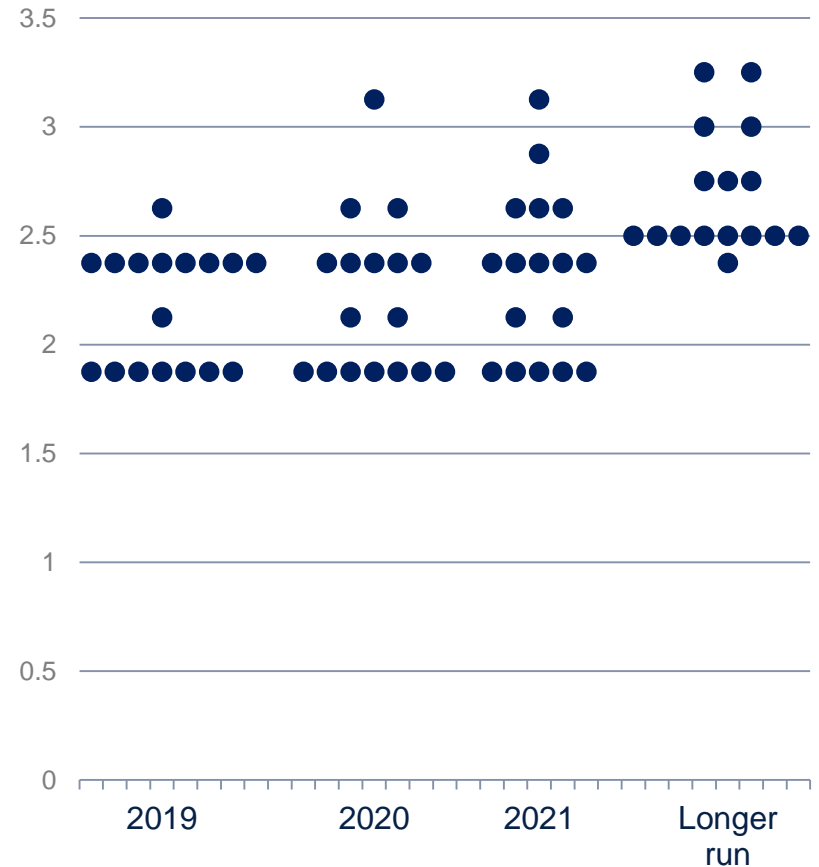
- Fed kept interest rates unchanged at their June 18-19th meeting, but altered their forward guidance from “patient” to “closely monitor”
- Elevated policy uncertainty, renewed “crosscurrents” and the threat of inflation and inflation expectations further drifting below the Fed’s two percent target suggest the Fed will lower rates this year
- The summary of economic projections recognized that risks to inflation have shifted to the downside and that FOMC will cut interest rates. However, Dot Plot hinted at a more polarized committee, with eight members viewing no rate increases as the most likely path while seven members projected two rate cuts in 2019 as the most likely outcome.
- Baseline assumes two 25bp rates cuts this year plus one additional “fine-tuning” cut in 2020

Fed: Projections fail to reflect change in committee members communication and shift in guidance

BBVA & DEALERS PROJECTIONS OF FED FUNDS (% , EFFECTIVE)



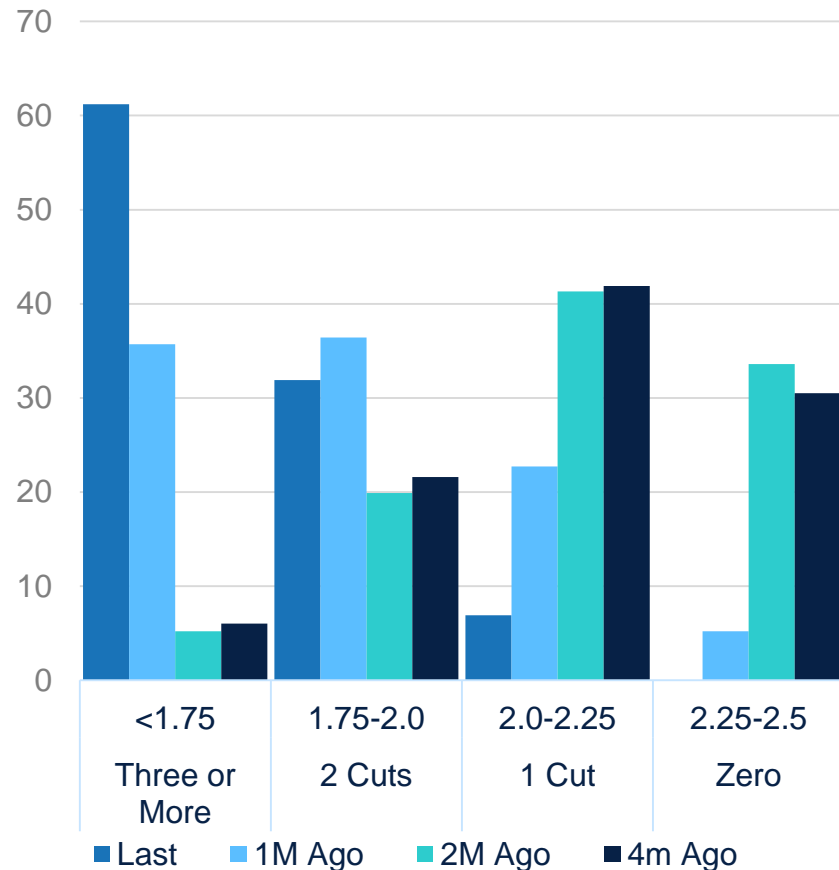
FOMC PROJECTIONS OF FED FUNDS (YEAR-OVER-YEAR % , MID-POINT)



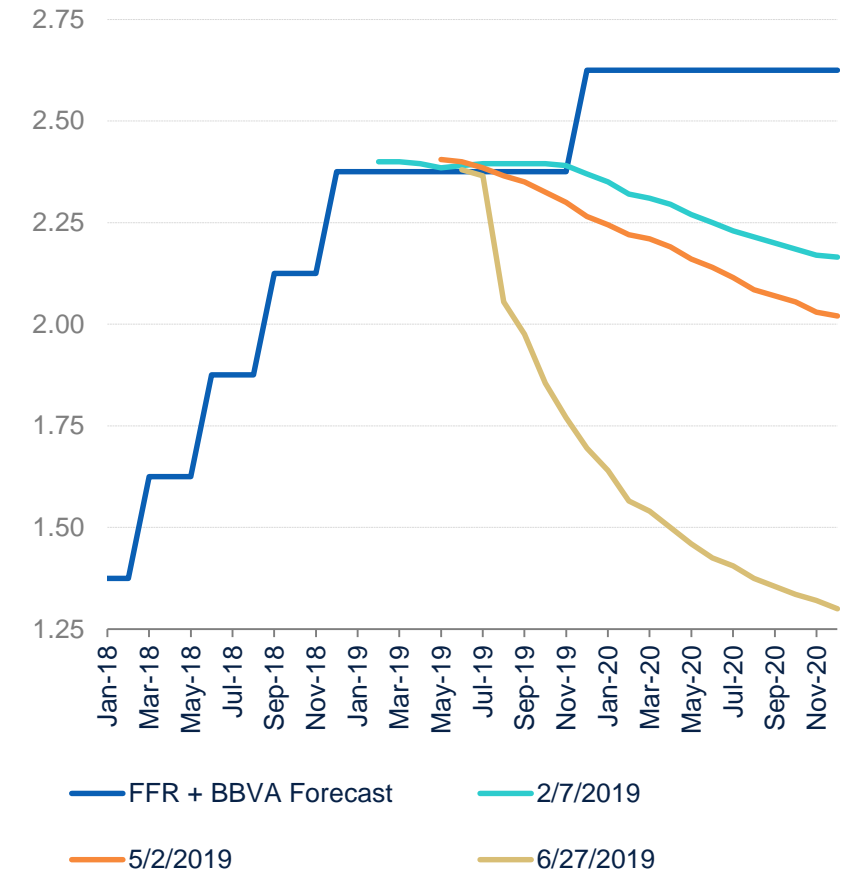
Source: BBVA Research & FRB

Monetary policy: Market expectations coalesce around three or more rate cuts

FED FUNDS IMPLIED PROBABILITY (NUMBER OF RATE CUTS THROUGH 2019, %)

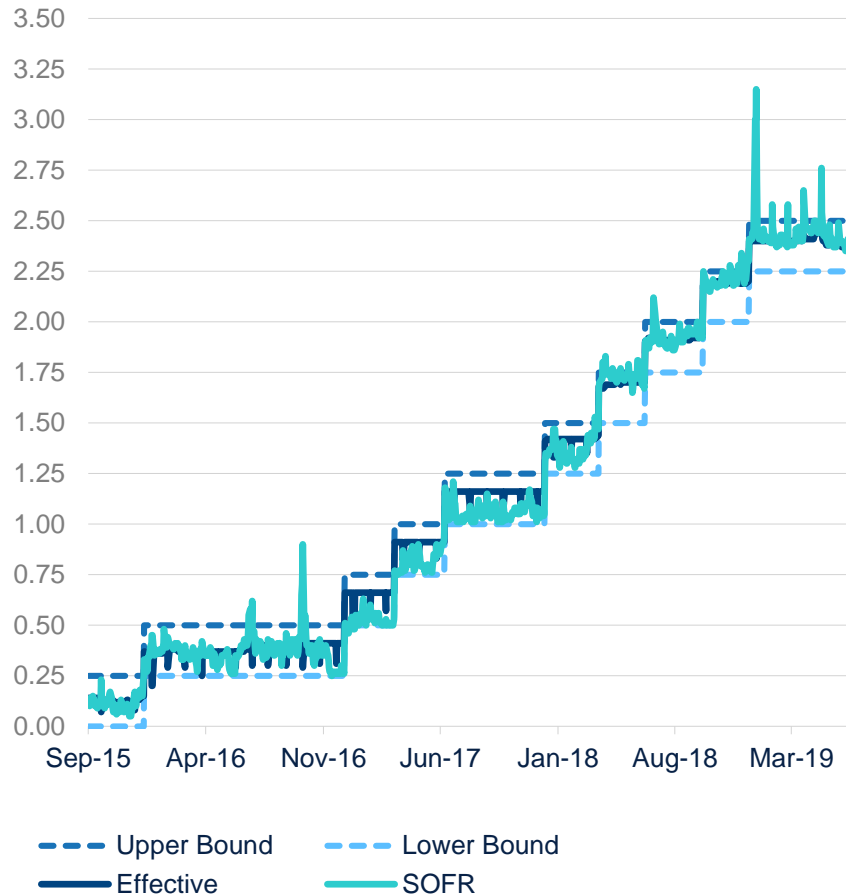


FED FUNDS FUTURES & BBVA BASELINE (%)

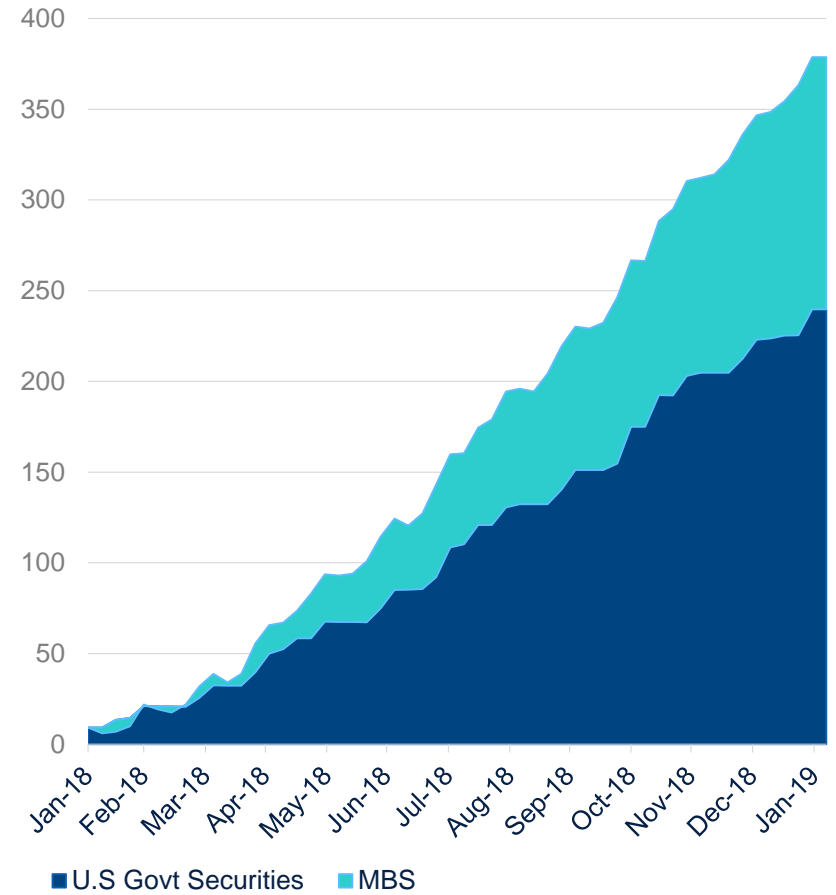


Monetary policy: Balance sheet attrition plateaued as increase in Treasury holdings offsetting wind down in MBS portfolio

FED FUNDS & REPO RATES (%)



BALANCE SHEET ATTRITION (US\$BN, CUMULATIVE)

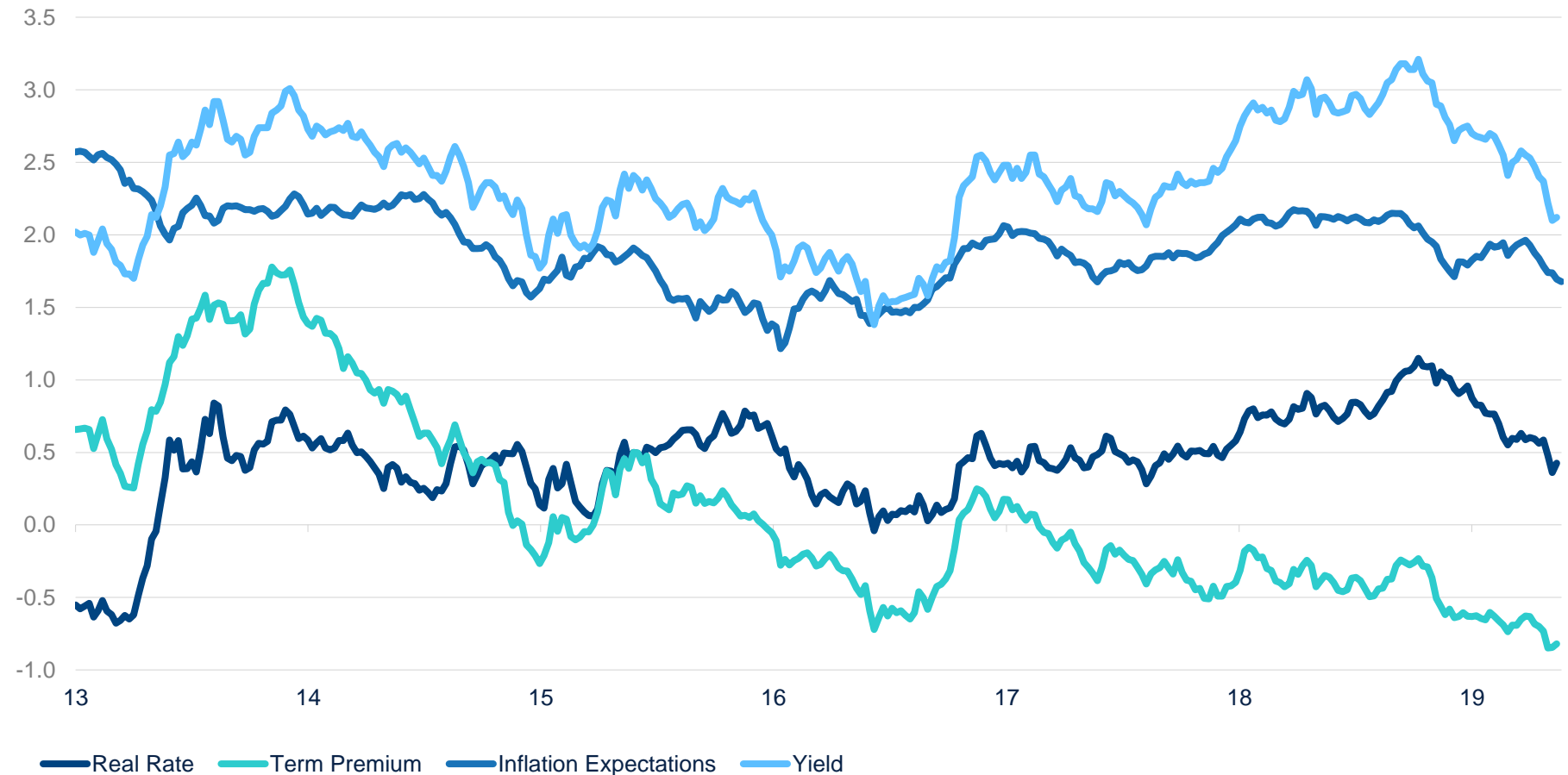


Interest Rates

- 10-yr Treasury down to 2.0%, 2-yr Treasury down to 1.75%
- Term premium remains at historic lows due to dramatic shift in Fed's balance sheet strategy, U-turn in rates guidance, global weakness and elevated uncertainty
- 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
- New baseline assumes lower year end target for the 10-yr Treasury yields; short-terms rates to align with Fed rate cut scenario

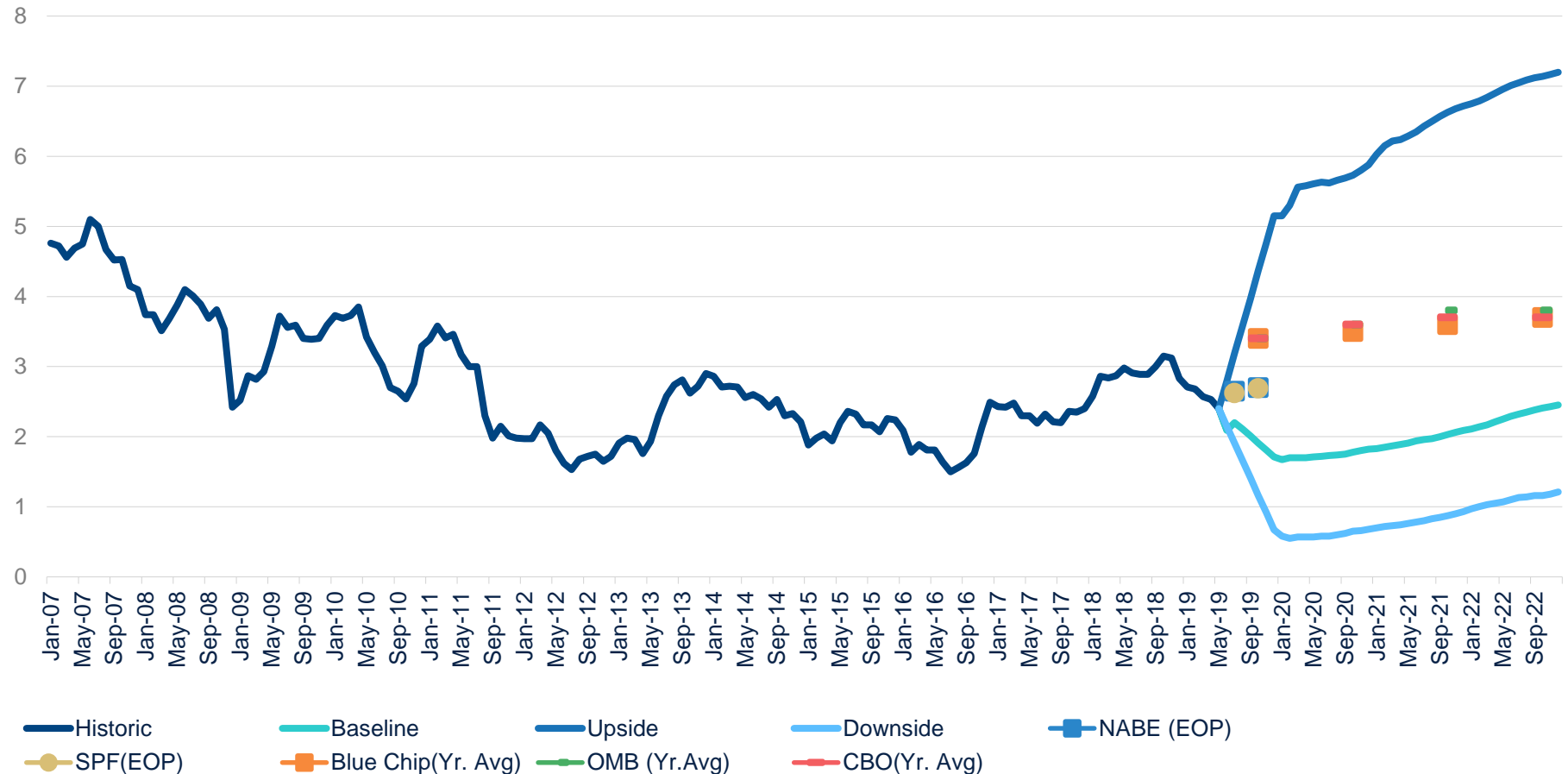
Interest rates: Drop in inflation expectations and increased risk aversion fueling decline in long-term rates

10-YEAR TREASURY YIELD DECOMPOSITION (%)



Interest rates: Baseline assumes 10-year below 2% by end of year

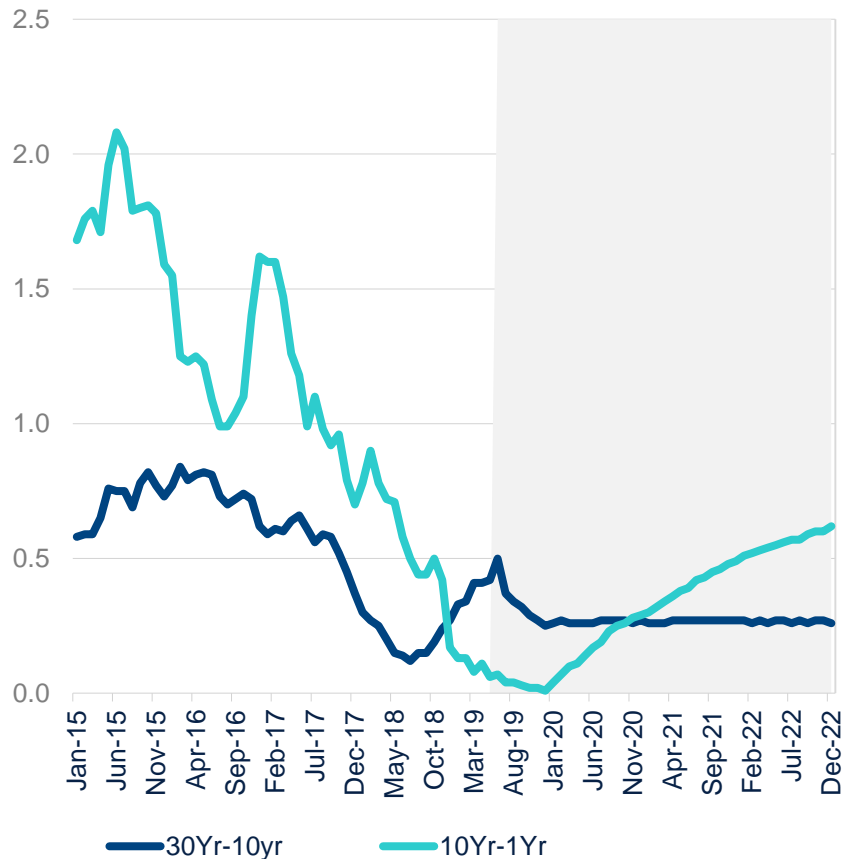
10-YEAR TREASURY YIELD (%)



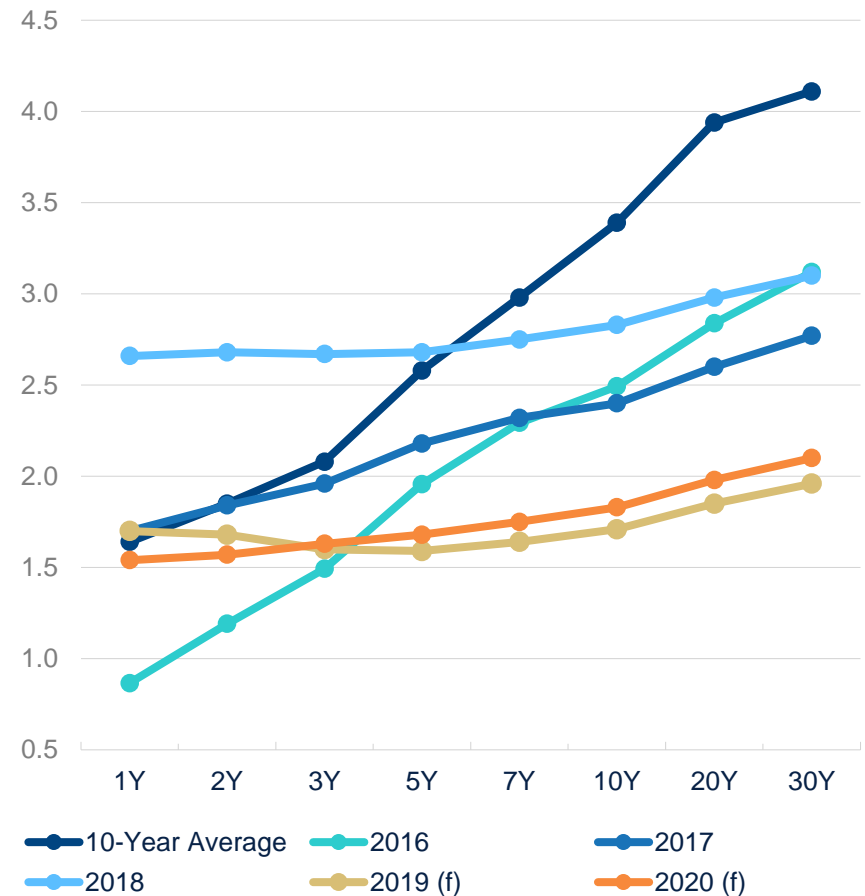
Source: BBVA Research, ACM & Haver Analytics

Interest rates: Inverted yield curve (10y-6m) through remainder of 2019

YIELD CURVE SLOPE (BP)



YIELD CURVE (% EOP)

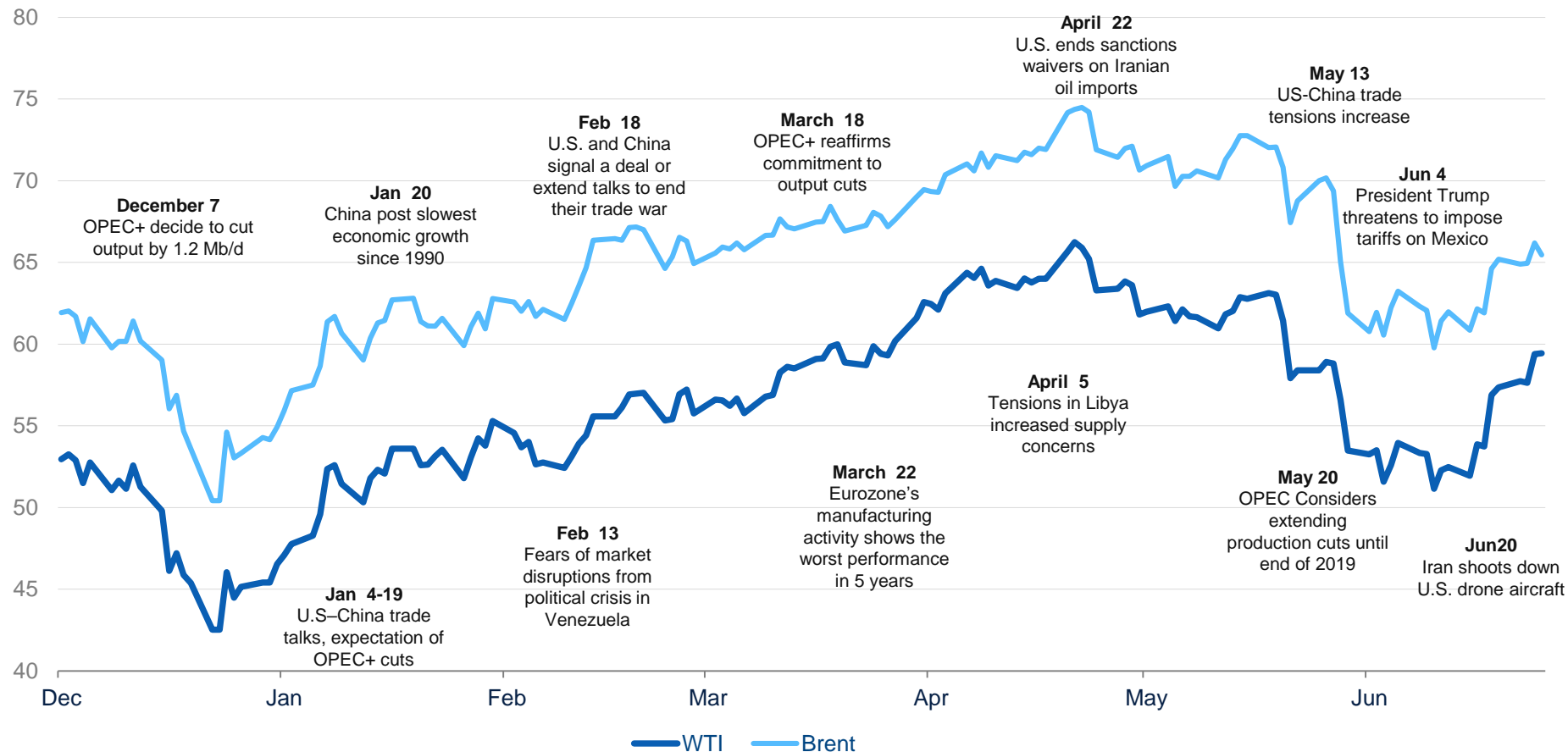


Oil Prices Outlook

- OPEC+ extended the output deal through the rest of the year
- Weaker economic growth to lead to slower demand for oil
- 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
- U.S oil production will expand further while substantial transportation capacity is being added
- Our prospects for lower prices in 2H19 and 2020 assume slower economic growth amid sufficient supply
- 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

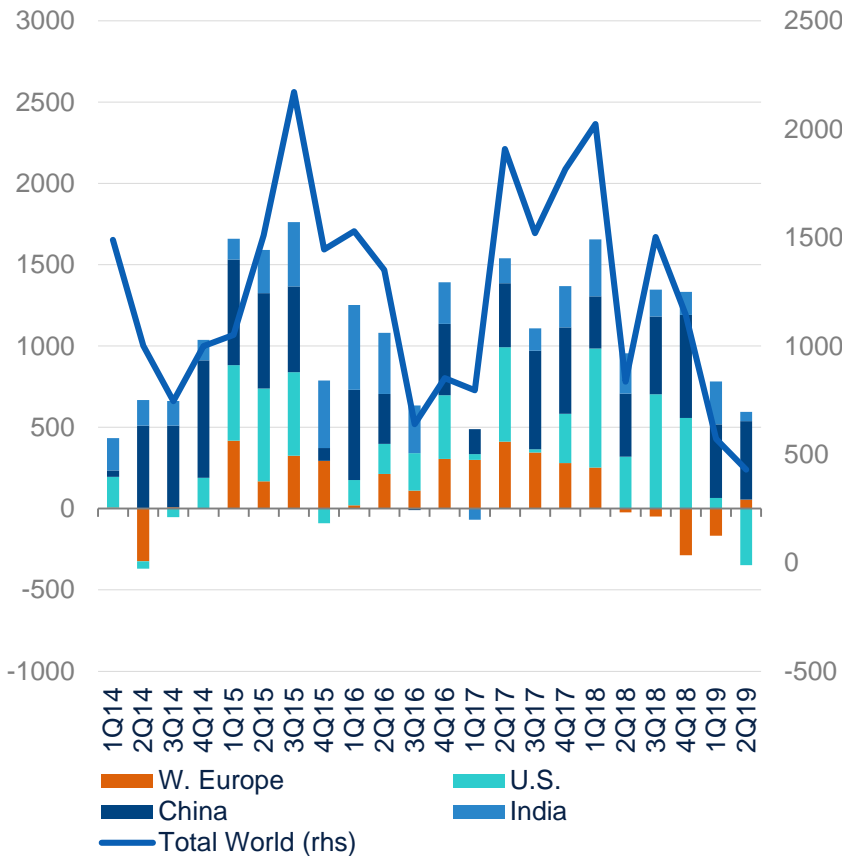
Downward pressures from weaker economic growth were partially offset by growing tensions between the U.S. and Iran

CRUDE OIL PRICES DECEMBER 2018 TO JUNE 2019 (\$ PER BARREL)

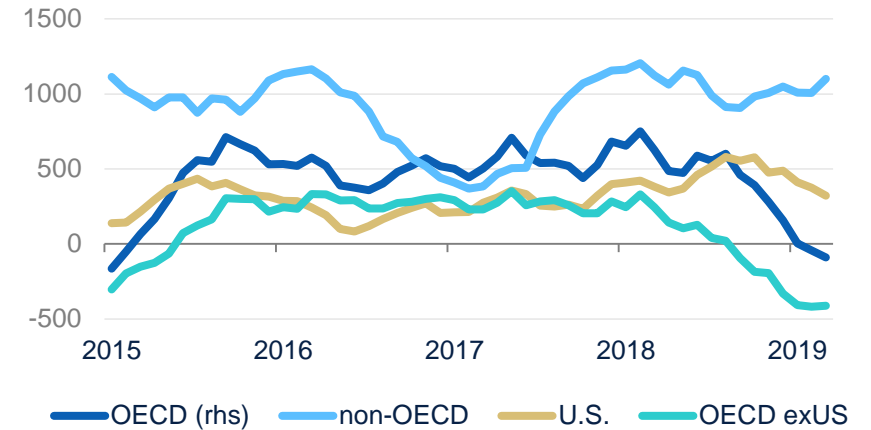


Demand in developing countries remains supportive

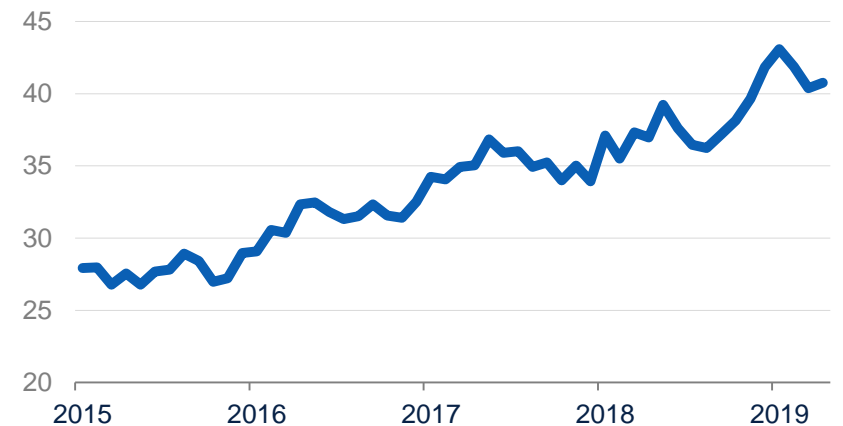
OIL PRODUCT DEMAND: TOTAL WORLD (THOUSAND BARRELS PER DAY, YOY CHANGE)



OIL PRODUCT DEMAND (THOUSAND BARRELS PER DAY, YOY CHANGE)



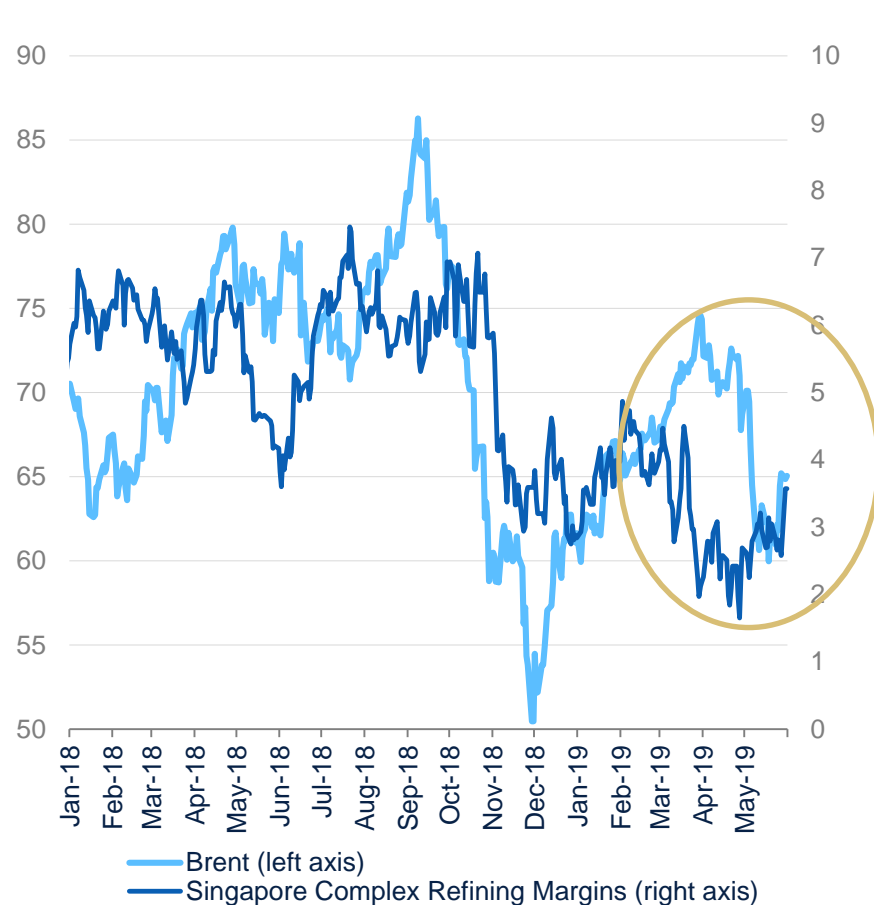
CHINA CUSTOMS CRUDE OIL TOTAL IMPORTS (MILLION METRIC TONES)



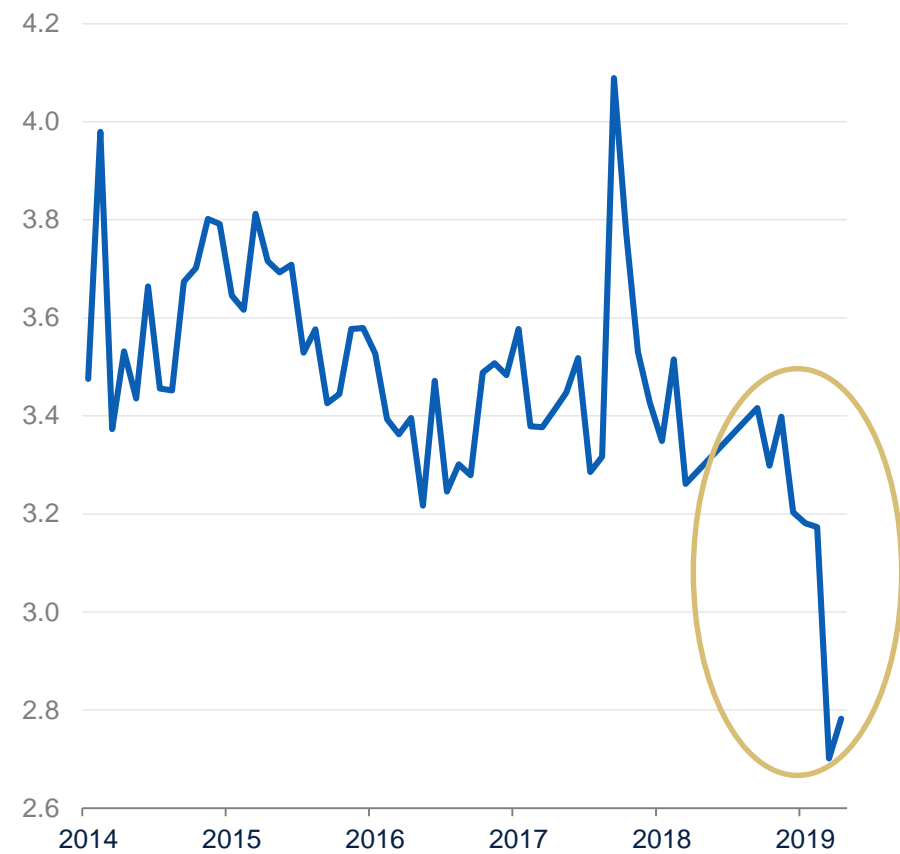
Source BBVA Research with data from Haver Analytics and Bloomberg

However, there are signs that demand is also slowing down in Asia

ASIA REFINING MARGINS
(\$ PER BARREL)



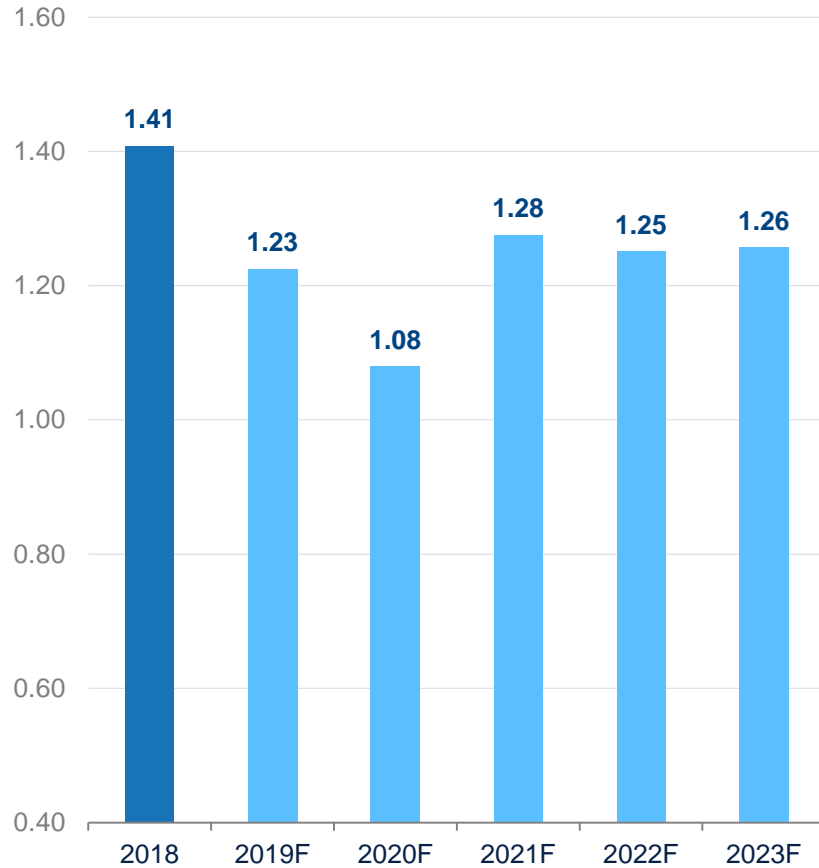
CHINA DIESEL CONSUMPTION
(MILLION BARRELS PER DAY)



Source BBVA Research with data from Bloomberg

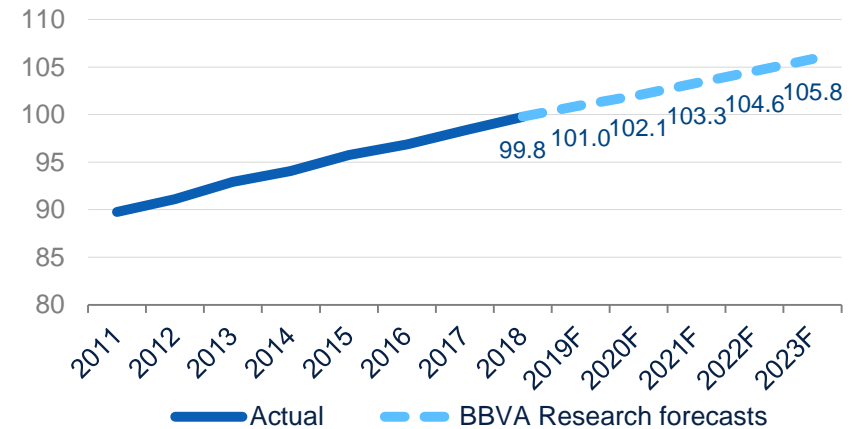
A weaker economic outlook points to slower demand growth

OIL PRODUCT DEMAND
(YOY CHANGE, MILLION BARRELS PER DAY)

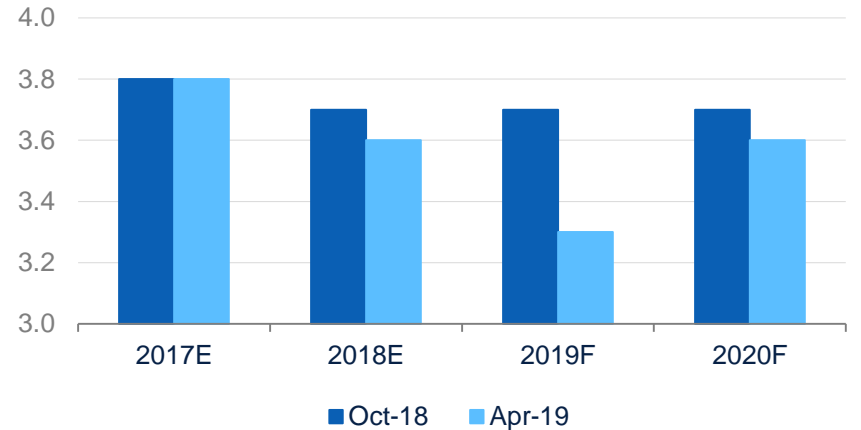


Source BBVA Research with data from Bloomberg

OIL PRODUCT DEMAND
(MILLION BARRELS PER DAY)



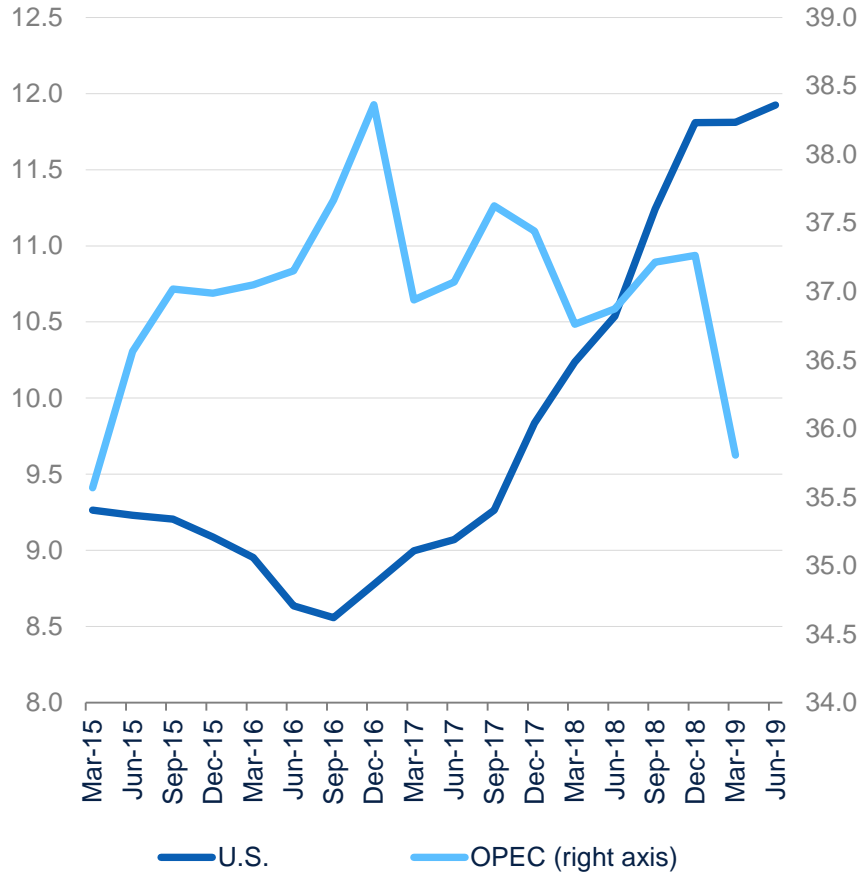
IMF WORLD GDP GROWTH
(YOY PERCENT CHANGE)



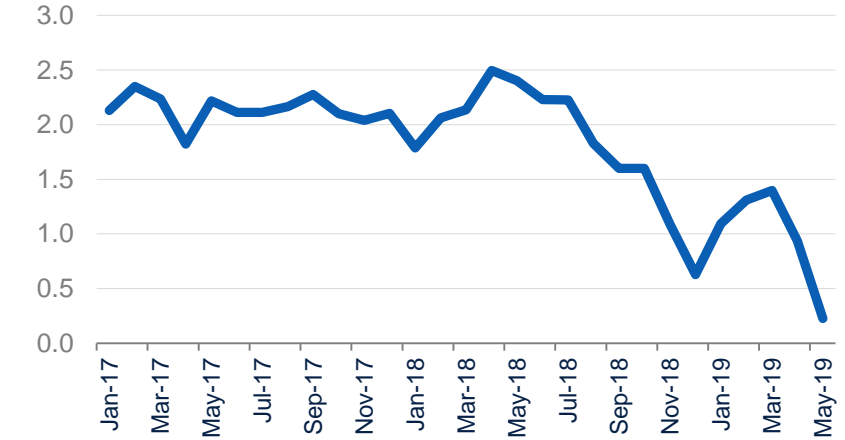
Source : IMF WEO , E = estimates, F = forecast

OPEC production is the lowest since 2015

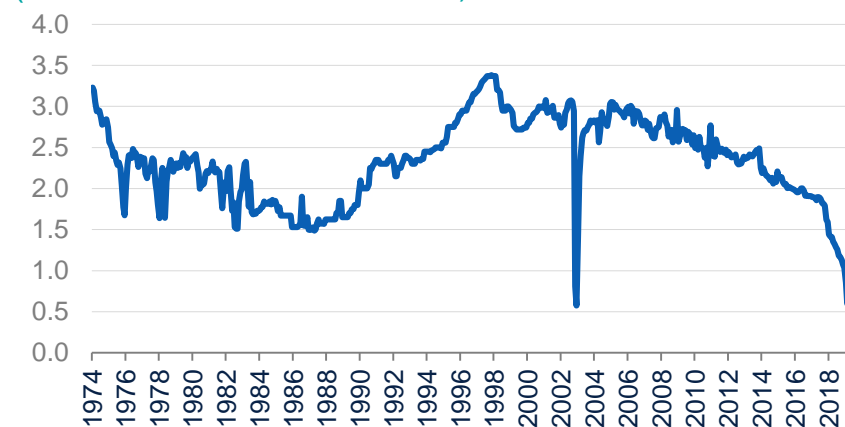
CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



IRAN: EXPORTS OF CRUDE OIL (MILLION BARRELS PER DAY)



VENEZUELA: CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



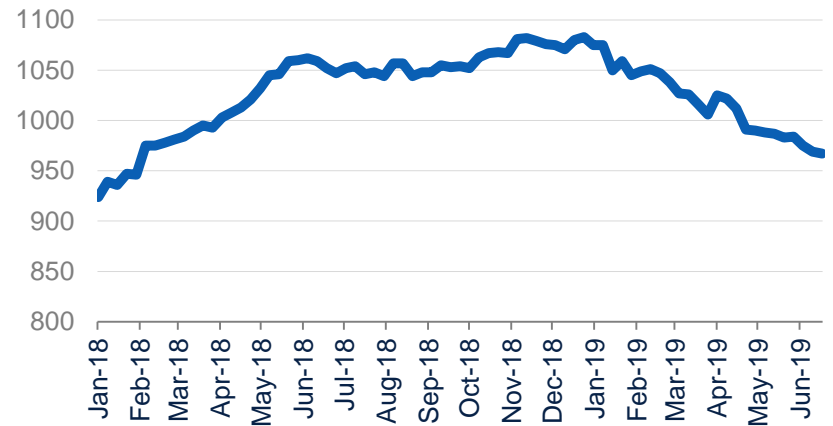
Source: BBVA Research, Haver Analytics, and Bloomberg

U.S. shale production on track to reach 9 million b/d

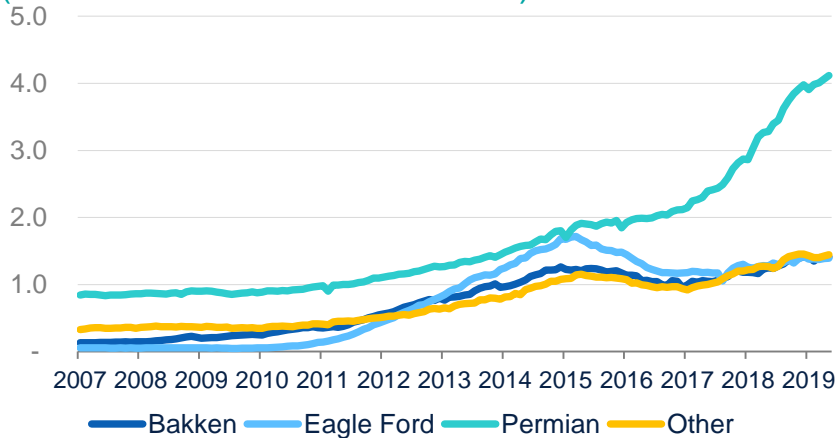
U.S. STOCKS OF CRUDE OIL (EXCLUDING SPR, MILLION BARRELS)



U.S. ACTIVE RIG COUNT (UNITS)



U.S. OIL PRODUCTION BY REGION (MILLION BARRELS PER DAY)

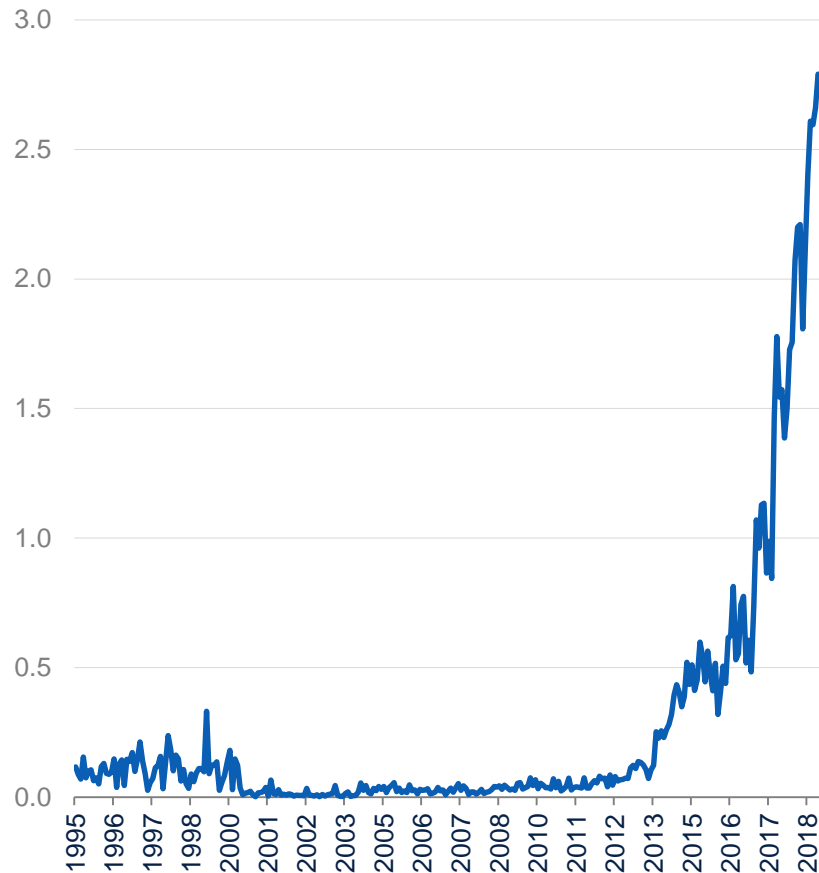


U.S. TOTAL ESTIMATED CRUDE OIL PRODUCTION (THOUSAND BARRELS PER DAY)

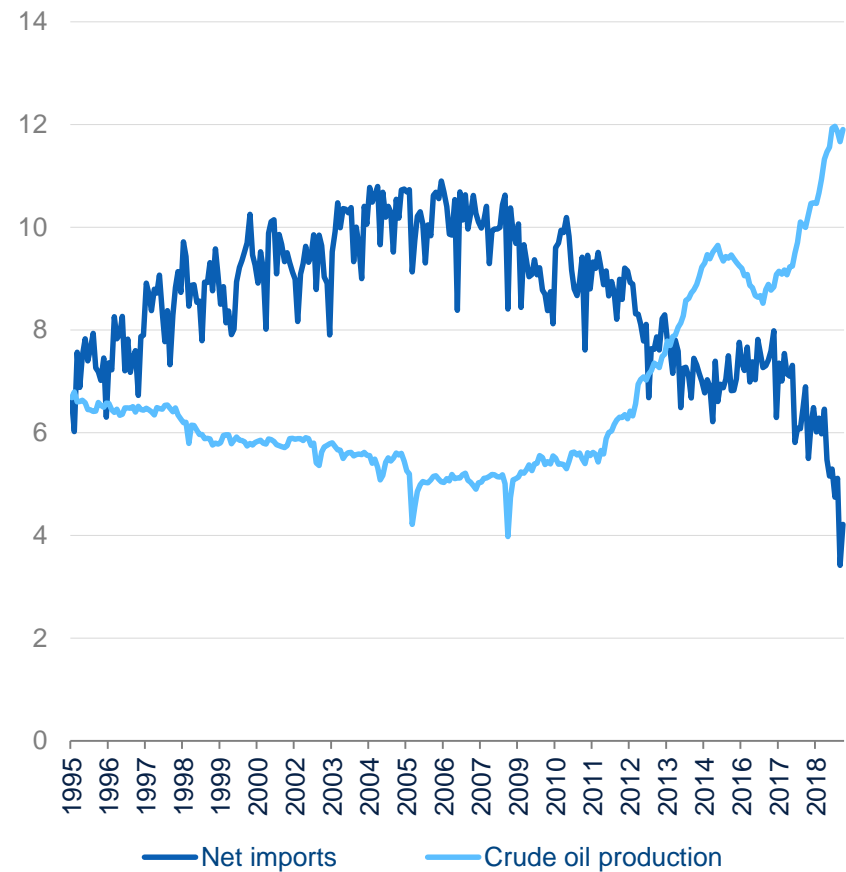


U.S. Imports substitution has accelerated

U.S. EXPORTS OF CRUDE OIL (MILLION BARRELS PER DAY)

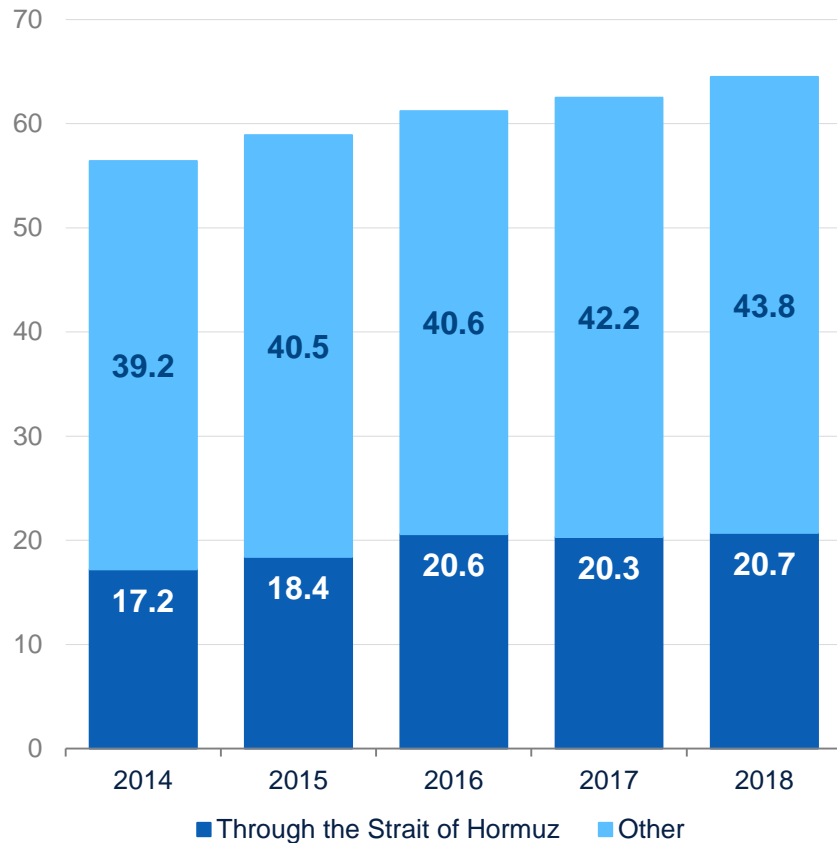


U.S. PRODUCTION AND NET IMPORTS OF CRUDE OIL (MILLION BARRELS PER DAY)



Escalation of tensions between the U.S. and Iran could cause significant disruption

WORLD MARITIME OIL TRADE (MILLION BARRELS PER DAY)



Note: Other maritime trade flows in 2018 are BBVA Research estimate.
Source: Energy Information Administration

STRAIT OF HORMUZ

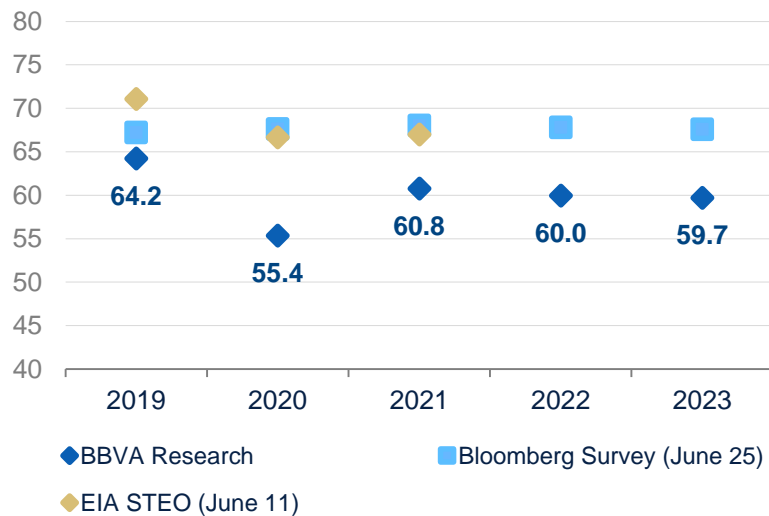


Source: Australian BC

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

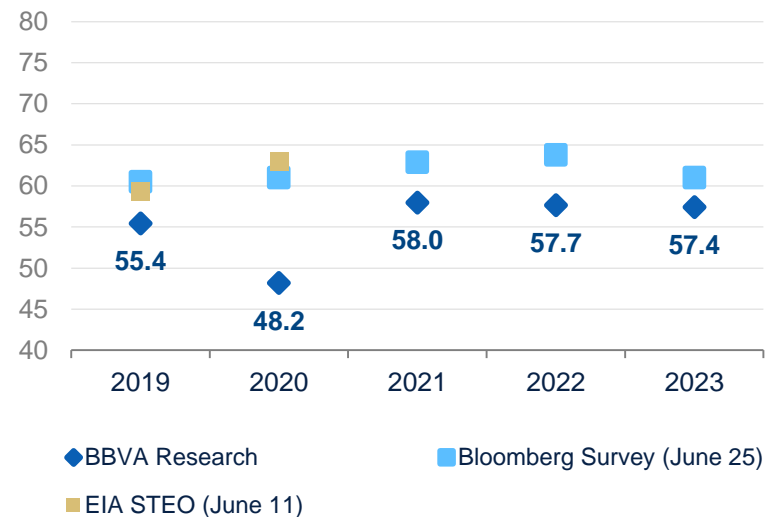
Brent prices forecast (\$ per barrel)

	BBVA Research (baseline)	Bloomberg Survey (June 25)	EIA STEO (June 11)
2017	54.2	54.2	54.2
2018	71.1	71.1	71.1
2019	64.2	67.2	66.7
2020	55.4	67.7	67.0
2021	60.8	68.0	
2022	60.0	67.8	
2023	59.7	67.6	



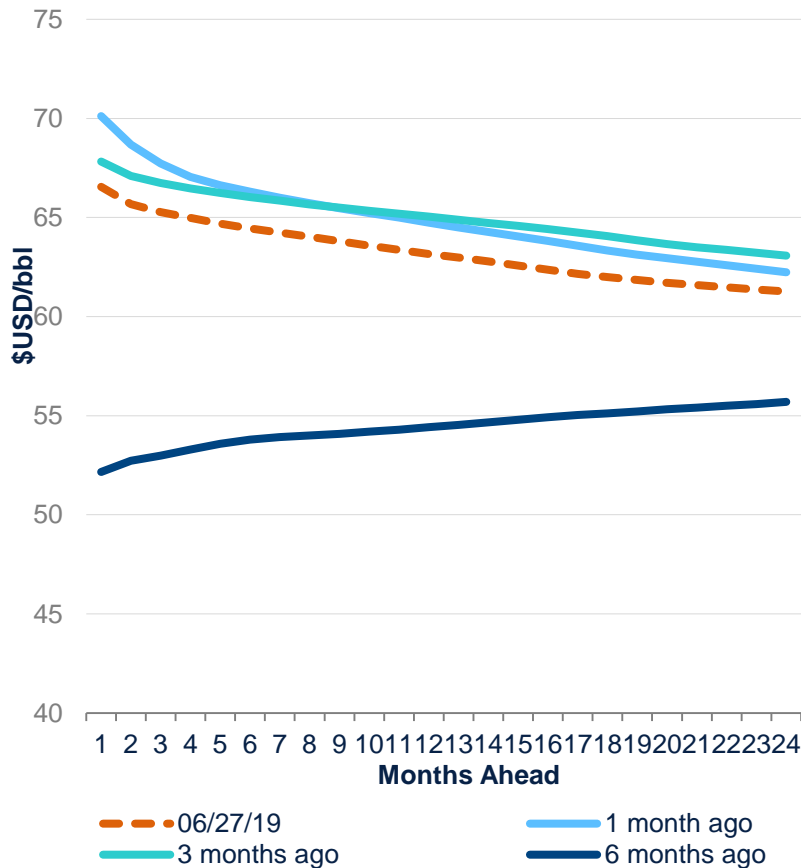
WTI prices forecast (\$ per barrel)

	BBVA Research	Bloomberg Survey (June 25)	EIA STEO (June 11)
2017	50.9	50.9	50.9
2018	65.0	65.0	65.0
2019	55.4	60.5	59.3
2020	48.2	61.0	63.0
2021	58.0	62.9	
2022	57.7	63.8	
2023	57.4	61.0	

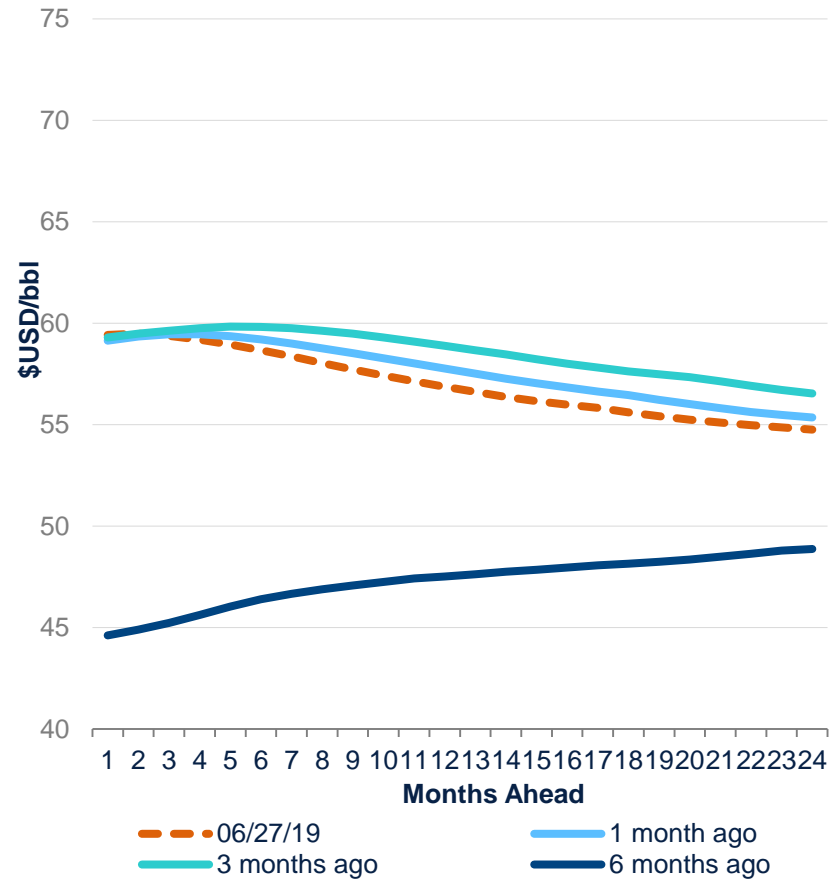


Futures curve remains in backwardation

Brent Futures (\$ per barrel)

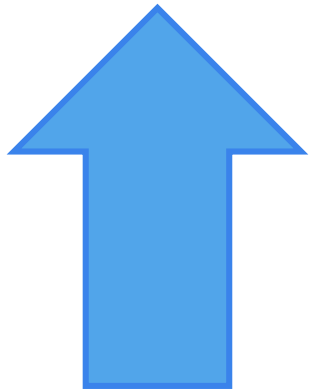


WTI Futures (\$ per barrel)

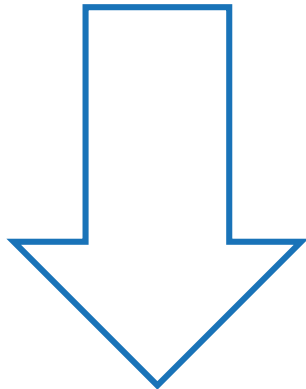


Source: BBVA Research and Bloomberg

The balance of short-term risks is tilted to the upside



\geq
\$60/b*



$<$
\$60/b*

- OPEC spare capacity insufficient to deal with unexpected shocks
 - Tensions between the U.S. and Iran escalate
 - Stronger-than-expected impact from additional negative supply shocks (e.g., Eastern Europe, Venezuela and Libya)
 - Signs of progress in trade negotiations between the U.S. and China after G-20
 - Milder-than-expected deceleration of global demand
 - Takeaway issues preventing U.S. crude to reach global markets
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- Weaker global economic outlook
 - Persistent deadlock in trade talks between U.S. and China
 - OPEC+ output deal is broken
 - Dollar appreciation
 - President Trump's pressure on OPEC
 - Limited enforcement of Iranian sanctions
 - Iran sues for peace and quickly revamps exports
 - 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	1.5	1.3	1.3	1.2
Gross Investment	0.9	1.6	1.1	0.9	0.8	-0.2	0.8	1.0	0.7	0.7	0.8	0.9
Non Residential	1.0	1.2	0.5	0.9	0.3	0.1	0.7	1.0	0.6	0.7	0.7	0.8
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	-0.2	-0.8	-0.9	-0.9
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	166	151	135	113
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.1	2.4	1.8	1.9	2.0	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	-3.8	-4.6	-4.1	-4.2	-4.7
Current Account (bop, % GDP)	-2.9	-2.6	-2.1	-2.1	-2.2	-2.3	-2.3	-2.4	-2.2	-2.3	-2.3	-2.4
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.50	0.75	1.50	2.50	2.00	1.75	1.75	2.25
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	1.71	1.82	2.09	2.45
West Texas Intermediate Oil Prices (dpb, average)	94.9	94.1	97.9	93.3	48.7	43.2	50.9	65.0	55.4	48.2	58.0	57.7

Source: BBVA Research

*Forecasts subject to change

Economic Scenarios

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

Macro Scenarios

	2015	2016	2017	2018	2019	2020	2021	2022	2023
GDP	2.9	1.6	2.2	2.9	2.5	2.0	1.9	1.8	1.7
Upside					3.1	3.5	3.1	2.7	2.7
Downside					1.5	-0.7	1.2	1.4	1.6
UR	5.3	4.9	4.4	3.9	3.7	4.0	4.2	4.4	4.4
Upside					3.5	2.9	2.9	3.0	3.0
Downside					4.2	6.2	6.6	5.7	5.0
CPI	0.1	1.3	2.1	2.4	1.8	1.9	2.0	2.1	2.0
Upside					2.0	3.3	3.7	3.8	3.8
Downside					1.3	0.4	1.1	1.3	1.4
Fed [eop]	0.50	0.75	1.50	2.50	2.00	1.75	1.75	2.25	2.25
Upside					3.50	5.00	5.50	6.00	6.50
Downside					1.50	0.25	0.25	0.25	0.25
10-Yr [eop]	2.24	2.49	2.4	2.83	1.71	1.82	2.09	2.45	2.6
Upside					5.15	5.88	6.72	7.20	7.35
Downside					0.67	0.68	0.93	1.21	1.55

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U.S. Economic Outlook

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