

U.S. Economic Outlook

August 2019

Economic Outlook

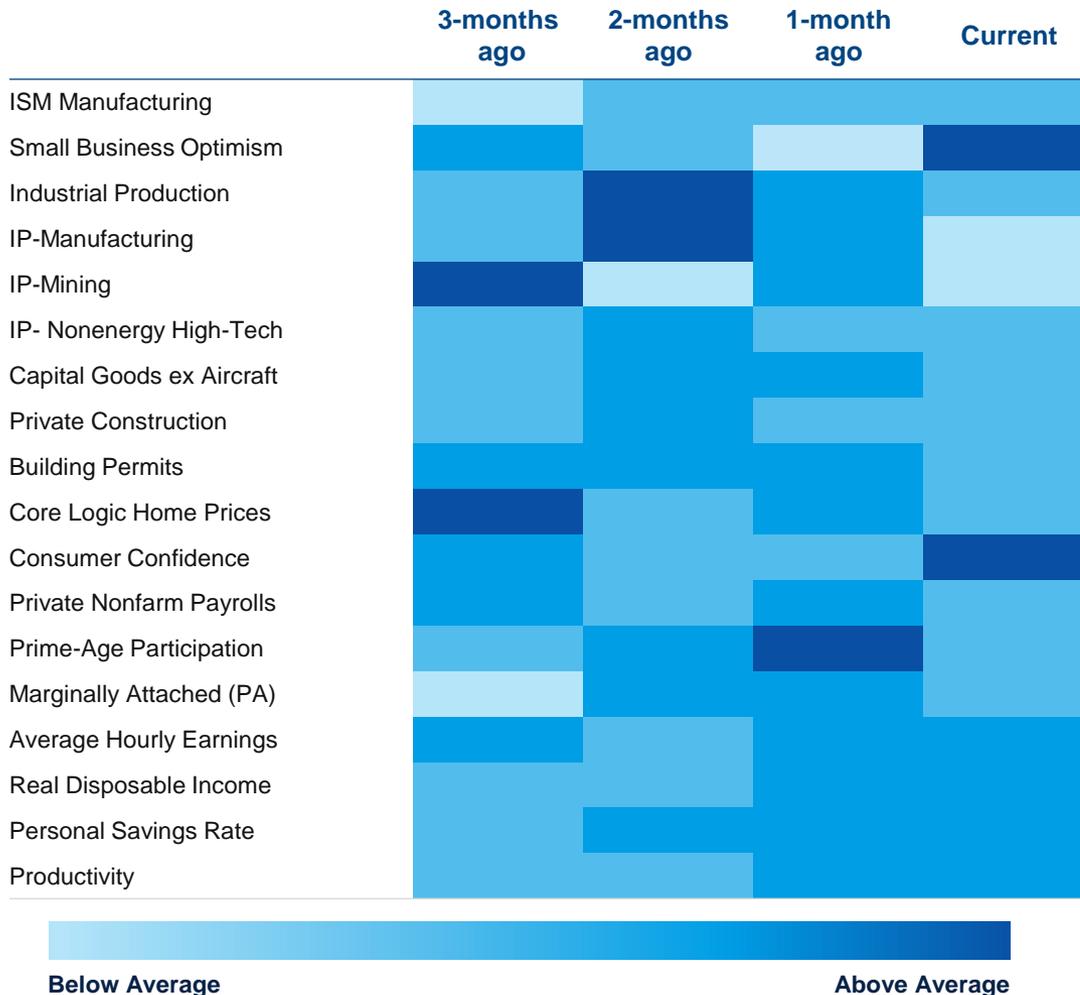
- Baseline growth forecast unchanged, but risks tilted to downside
- Model-based recession projections suggest probability around 75% over the next 24-months
- Mixed signals from labor market indicators
- Downside risks to inflation moderating
- Fed debating if further rate cuts are needed
- Global weakness and policy uncertainty push term premium to record lows
- Weaker demand pressuring oil prices, but geopolitical risks remain

Macro Fundamentals

- In 2Q19, GDP growth decelerated to 2.1% QoQa from 3.1% in the previous period
- Consumption growth was the strongest since the 4Q17 while federal, state and local expenditures were the highest since the recession
- Net exports and inventories whipsawed after strong first quarter while nonresidential and residential investment contracted
- Notwithstanding any major change in consumer and business expectations we expect growth to continue decelerating in 2H19
- Preliminary budget deal reached between the White House and Congress should alleviate potential domestic headwind to growth
- While risks to the downside have grown, we are maintaining our GDP growth baseline of 2.5% for 2019

Economic activity

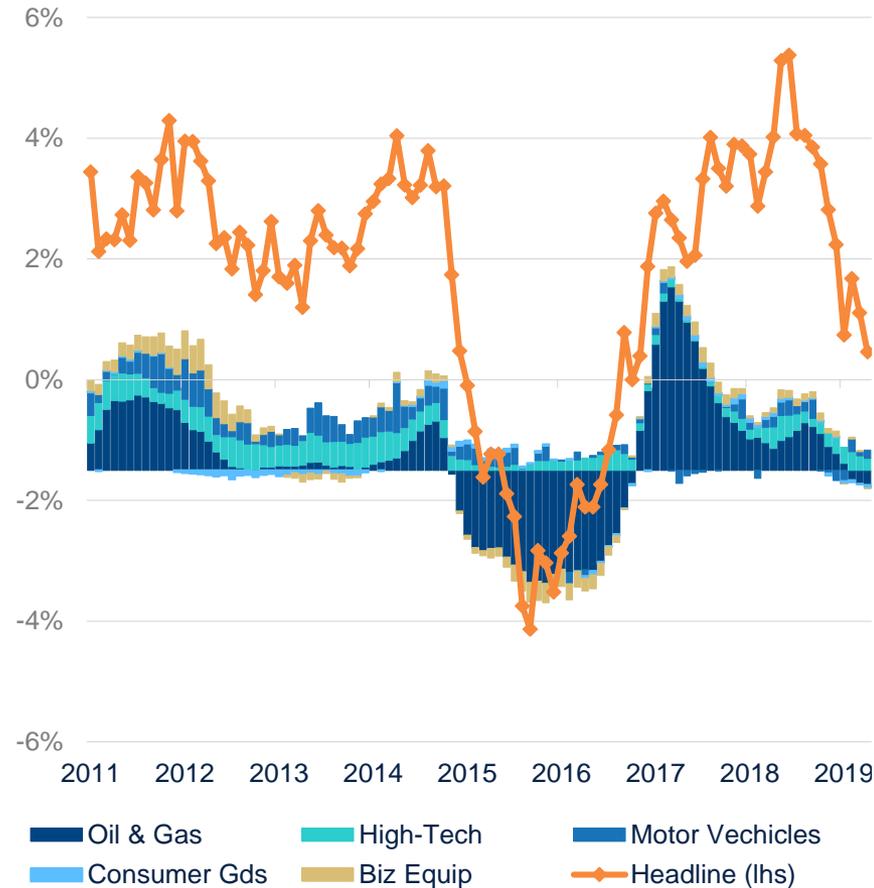
REAL-TIME ECONOMIC MOMENTUM HEAT MAP



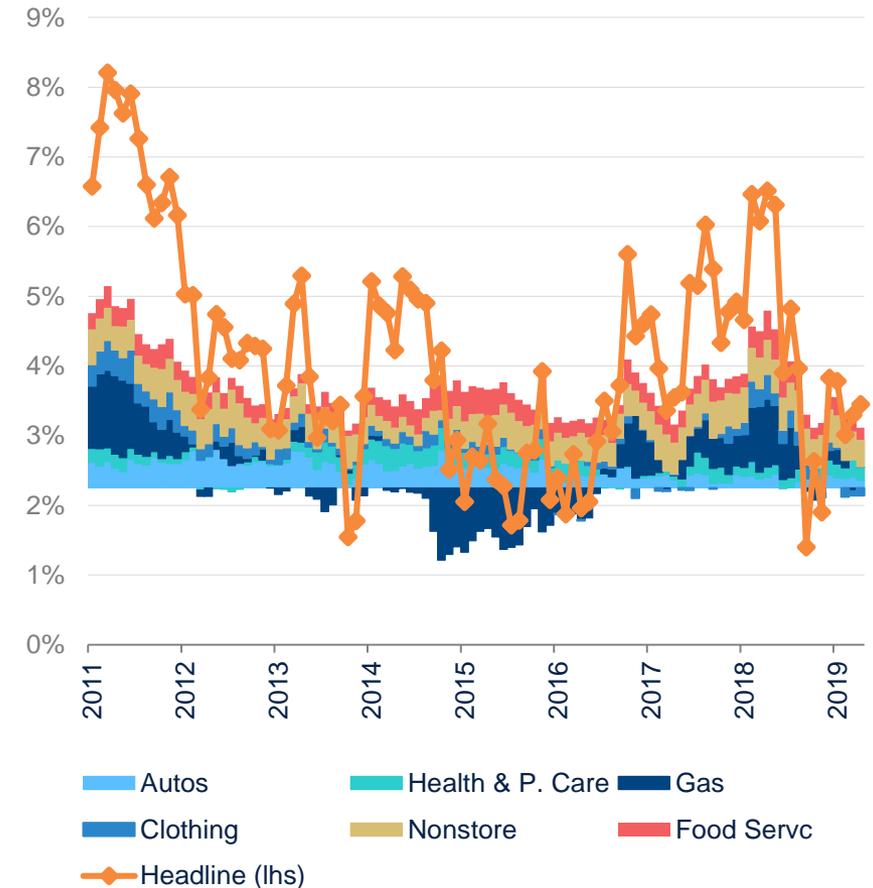
- Divergent trends between consumer (small businesses) and corporate sentiment
- IP: weak investment in business equipment, business supplies and mixed consumer demand
- Strongest increase in retail sales since 1Q19
- Housing starts dropped in July, but permits are rising on prospects of lower rates, presaging stronger growth in 2H19
- Real wage growth decelerating despite rise in labor productivity

Economic trends: Industrial production contracting despite improvement in business survey data

INDUSTRIAL PRODUCTION (YEAR-OVER-YEAR %)

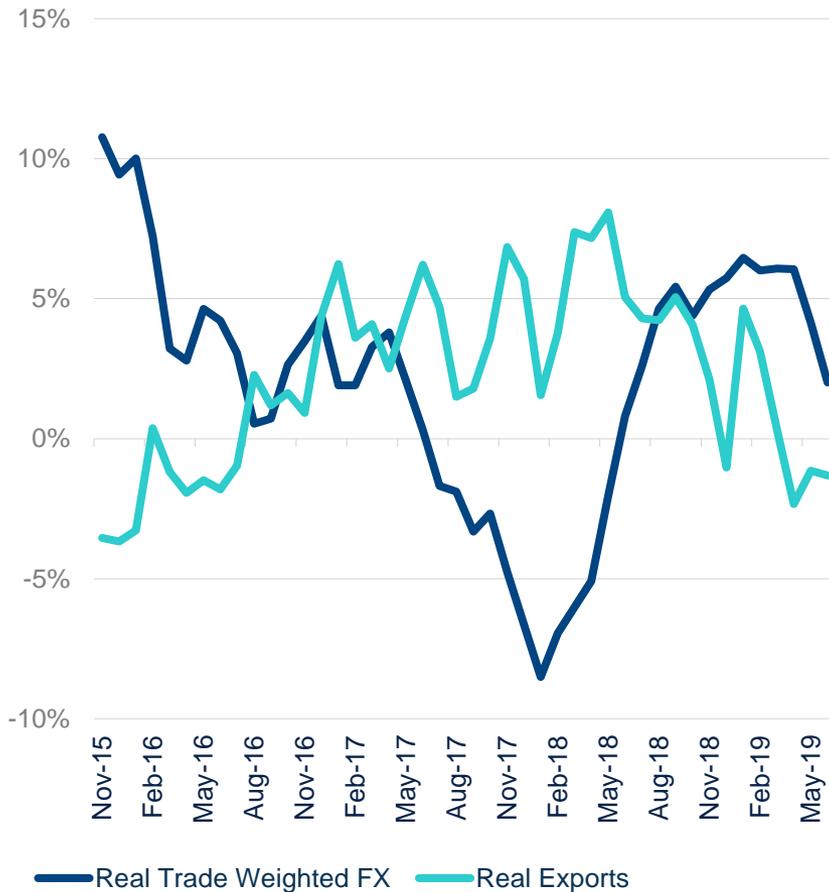


RETAIL SALES (YEAR-OVER-YEAR %)

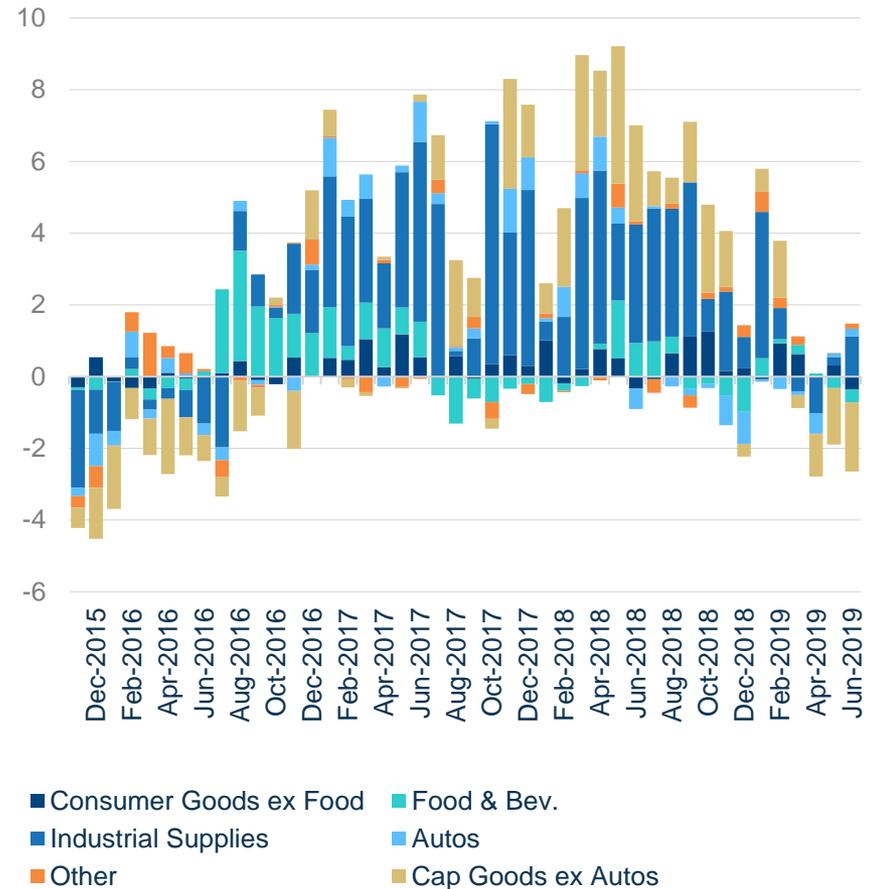


Economic trends: Dollar decline in real trade-weighted terms not enough to offset global growth headwinds

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



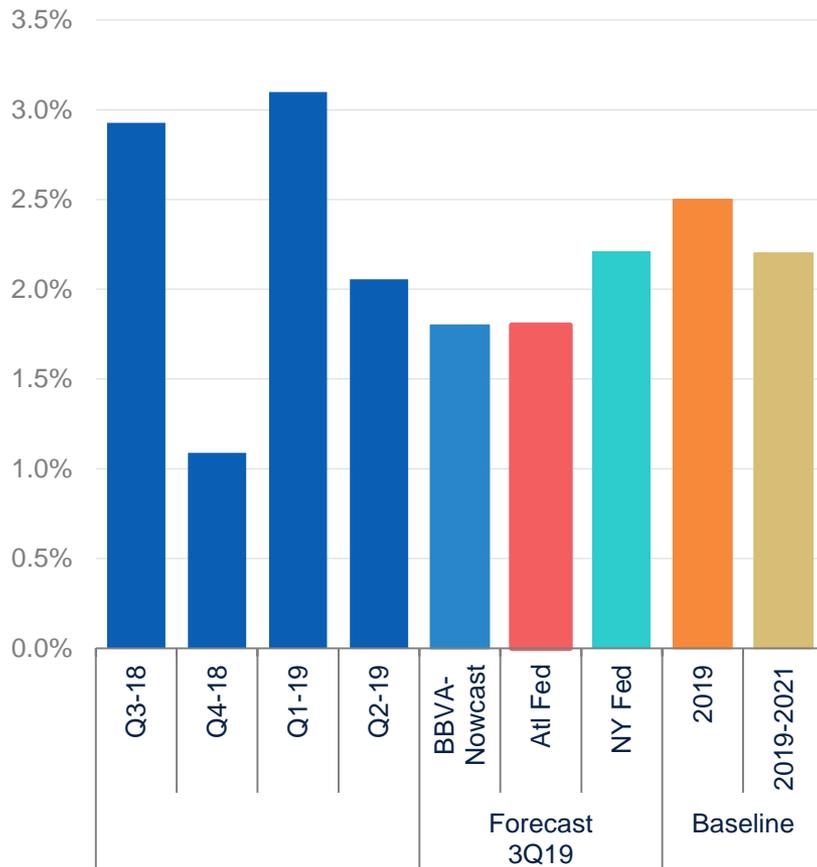
REAL EXPORTS (CONTRIBUTION TO YEAR-OVER-YEAR %)



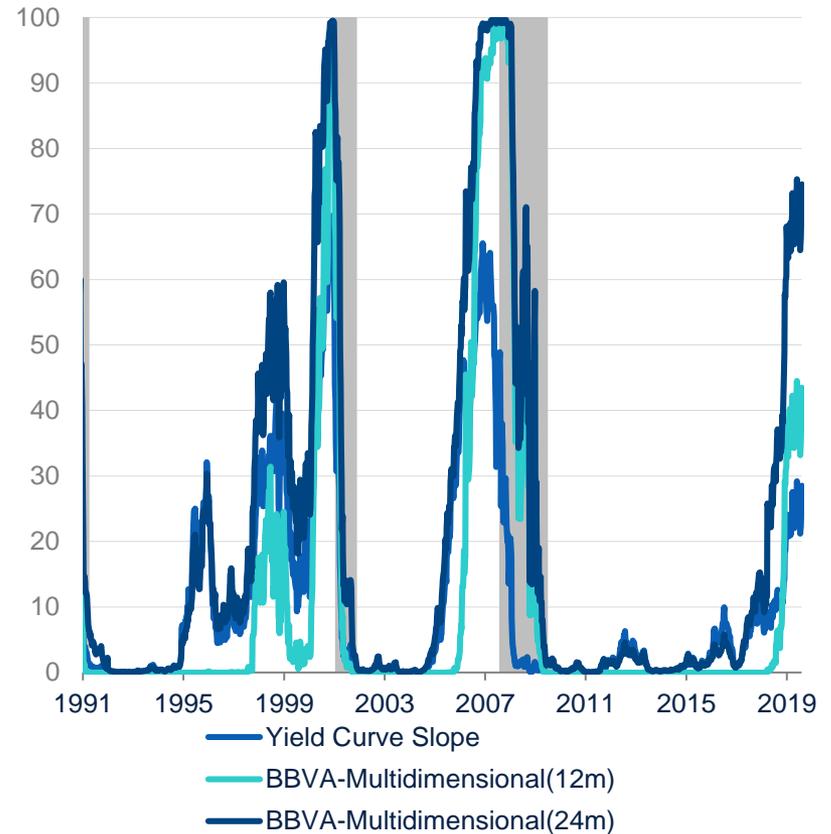
Source: BBVA Research, FRB & Census

Economic trends: Growth to continue to moderate in 3Q19, as recession risk rises above 40% in next 12 months

REAL GDP
(QOQ SAAR, %)

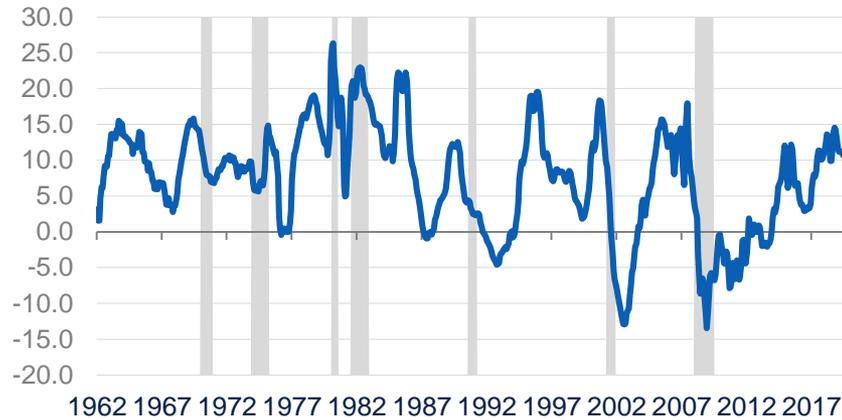


PROBABILITY OF RECESSION
(%)



Consumer credit cycle: Consumer balance sheets and credit conditions resilient

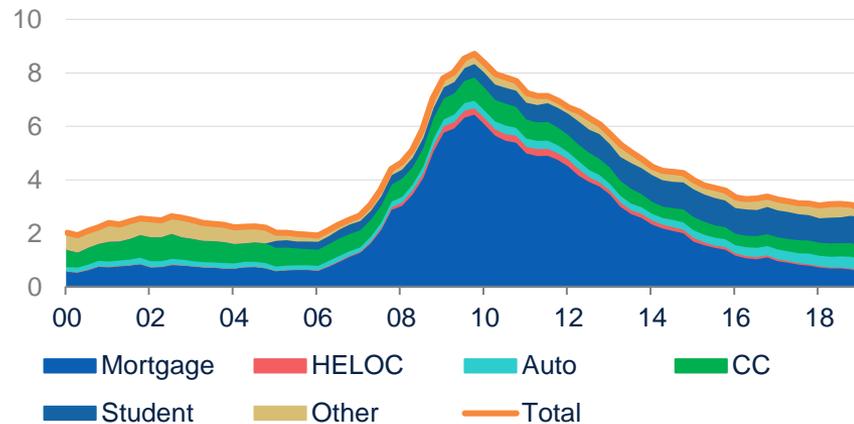
PERSONAL INTEREST EXPENSE (YEAR-OVER-YEAR %)



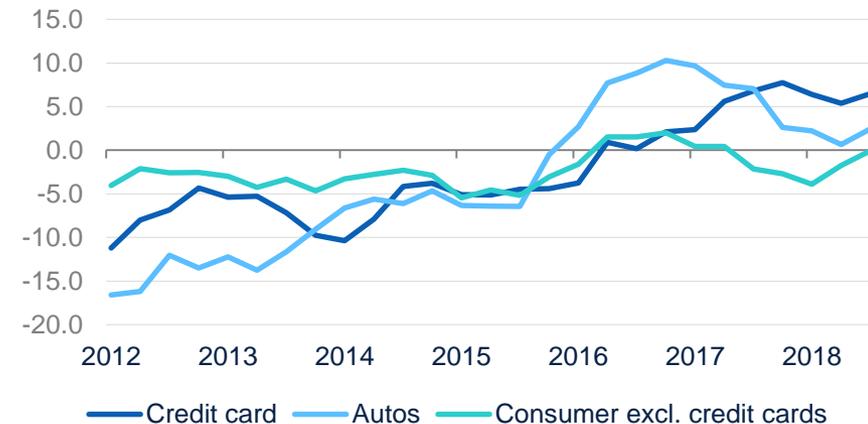
PERSONAL INTEREST EXPENSE TO DISP. INCOME (RATIO, %)



CONSUMER SERIOUSLY DELINQUENT RATES (90-DAY, CONTRIBUTION, %)



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

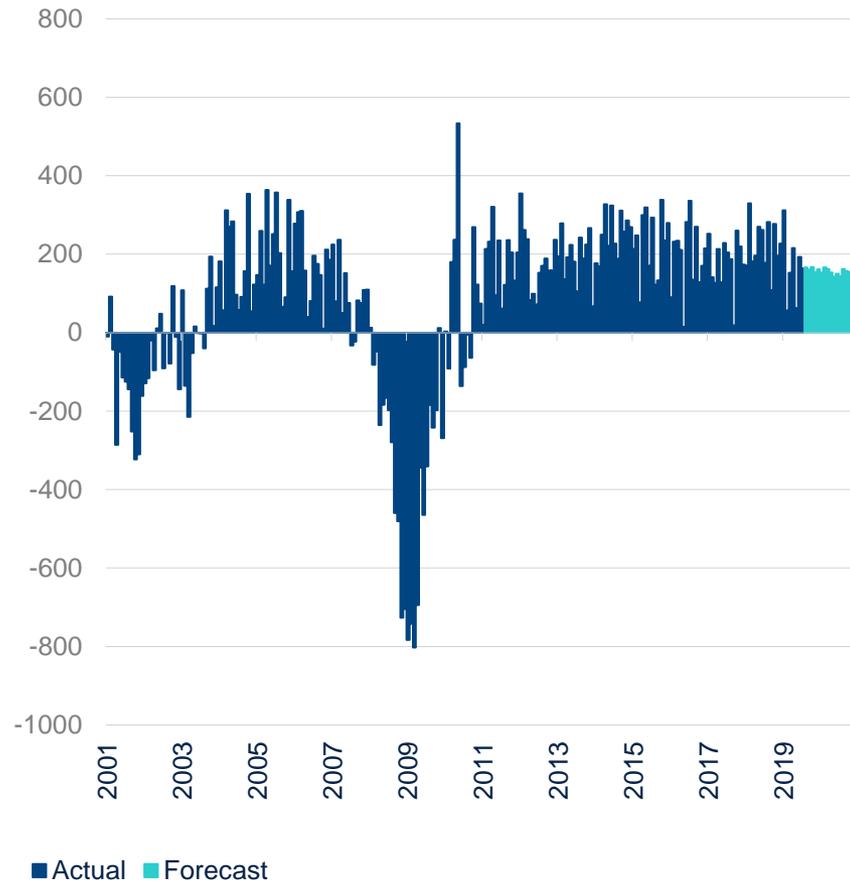


Labor Market

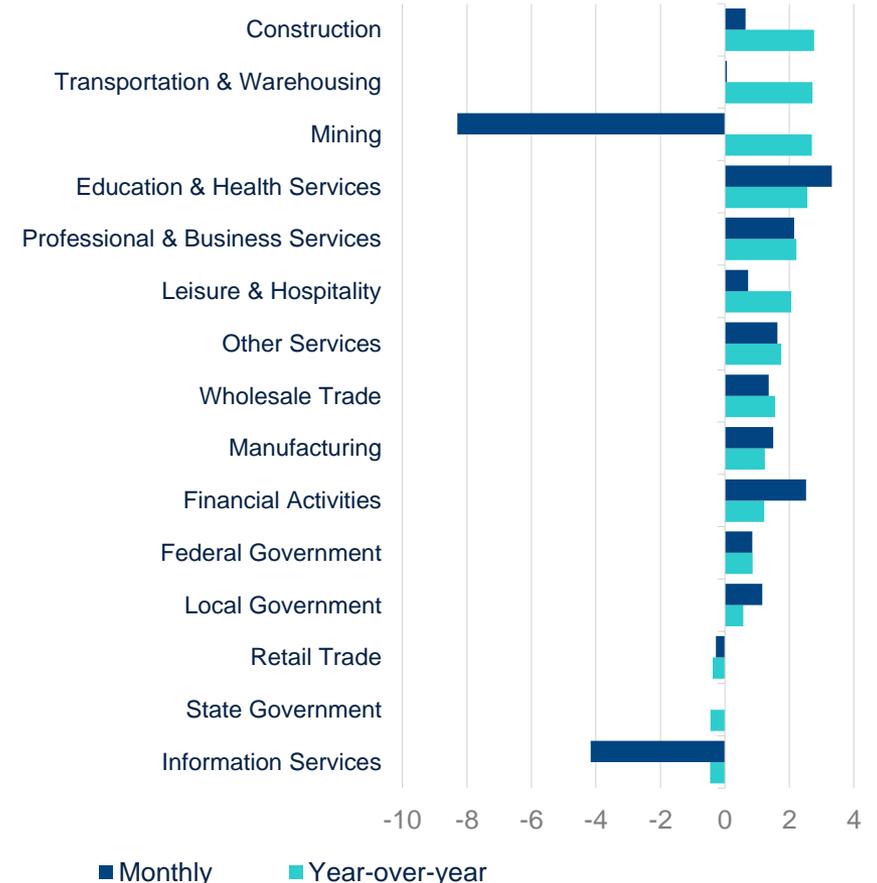
- In July, the labor market added 164,000 jobs after strong growth in June (193,000)
- Sectors such as professional and technical services (31K), health care (30K), social assistance (20K), and financial activities (18K) experienced strong monthly job gains
- The unemployment rate (UR) was unchanged at 3.7%
- The labor force participation rate and the employment-population ratio were little changed at 63.0% and 60.7%
- Baseline assumes modest declines in UR in remainder of 2019. Average monthly job growth to slow to 163K this year, from 223K in 2018

Labor market: Steady job gains in 2H19

NONFARM PAYROLLS (MONTHLY CHANGE, K)

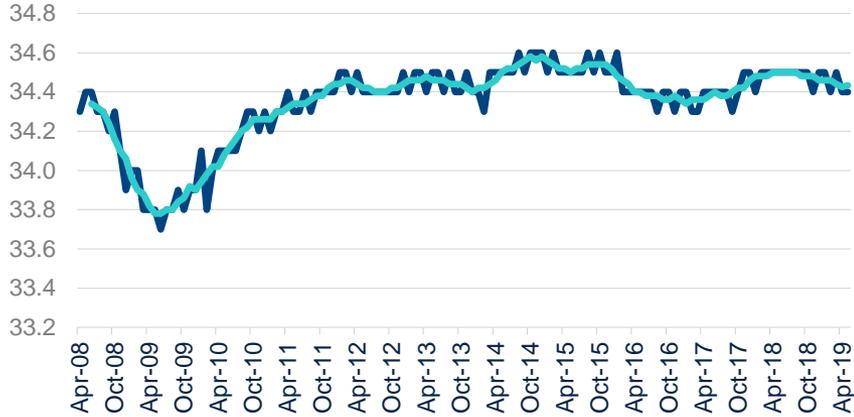


INDUSTRY EMPLOYMENT (ANNUALIZED % CHANGE)

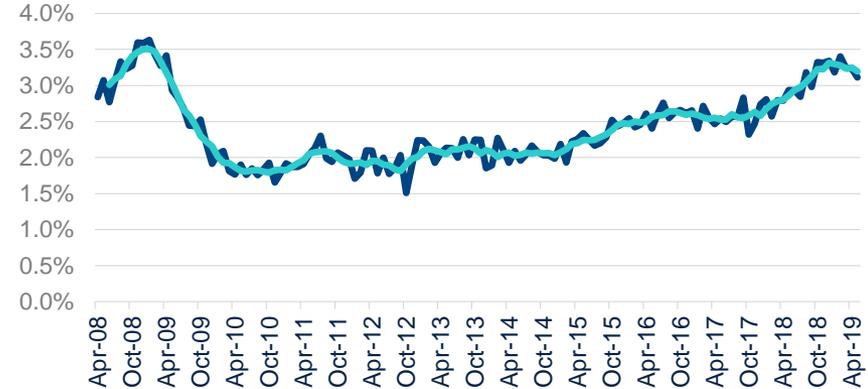


Labor market: Weaker investment conditions putting pressures on broader labor market indicators

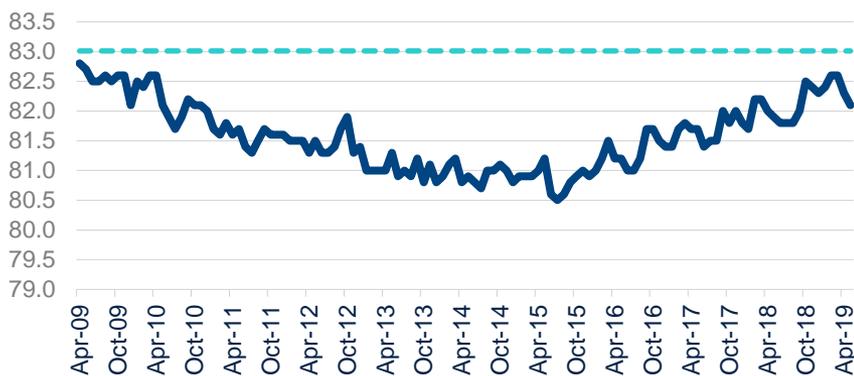
AVERAGE WEEKLY HOURS (NUMBER & 5MCMA)



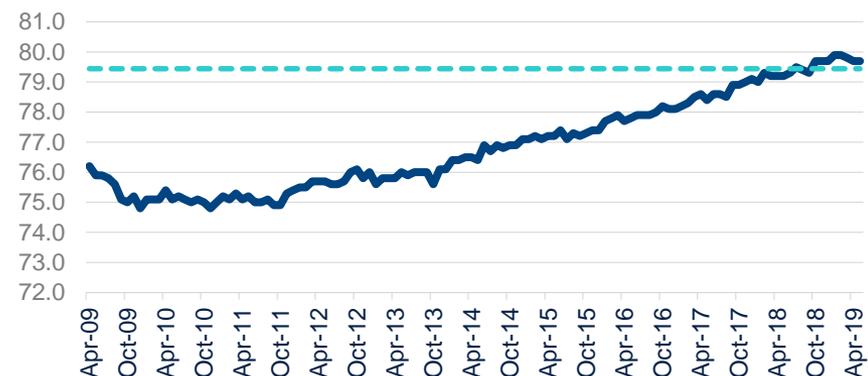
AVERAGE HOURLY EARNINGS (YOY% & 5MCMA)



PRIME AGE LABOR FORCE PARTICIPATION (%)



PRIME AGE EMPLOYMENT-TO-POPULATION (%)

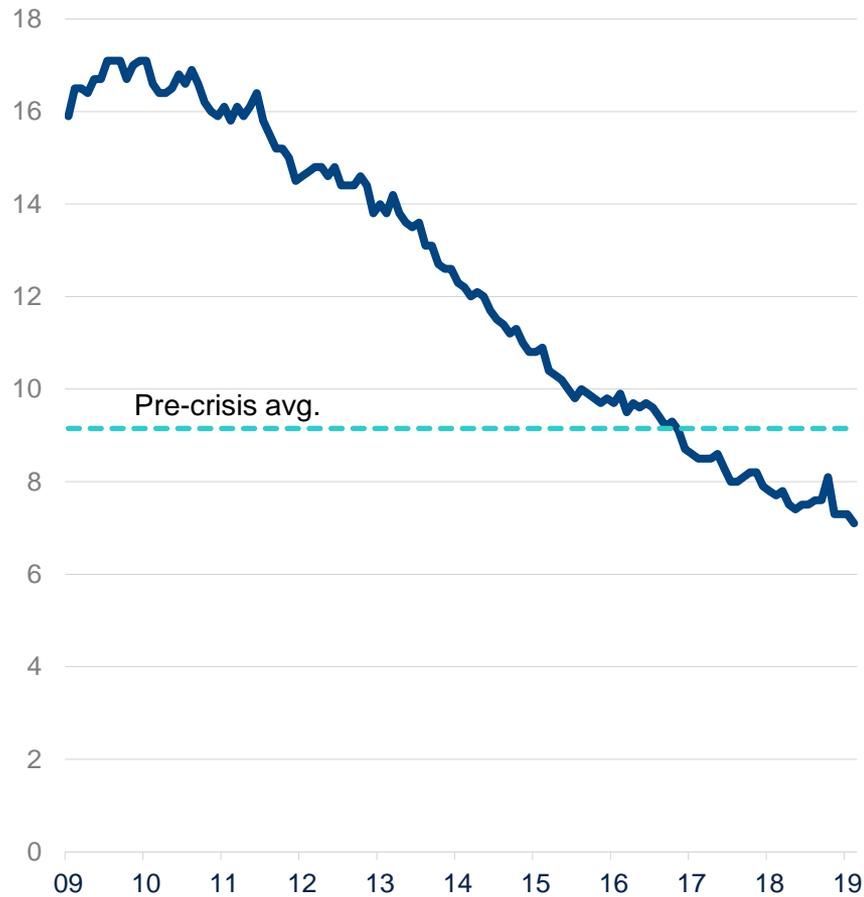


--- Pre-Crisis Avg.

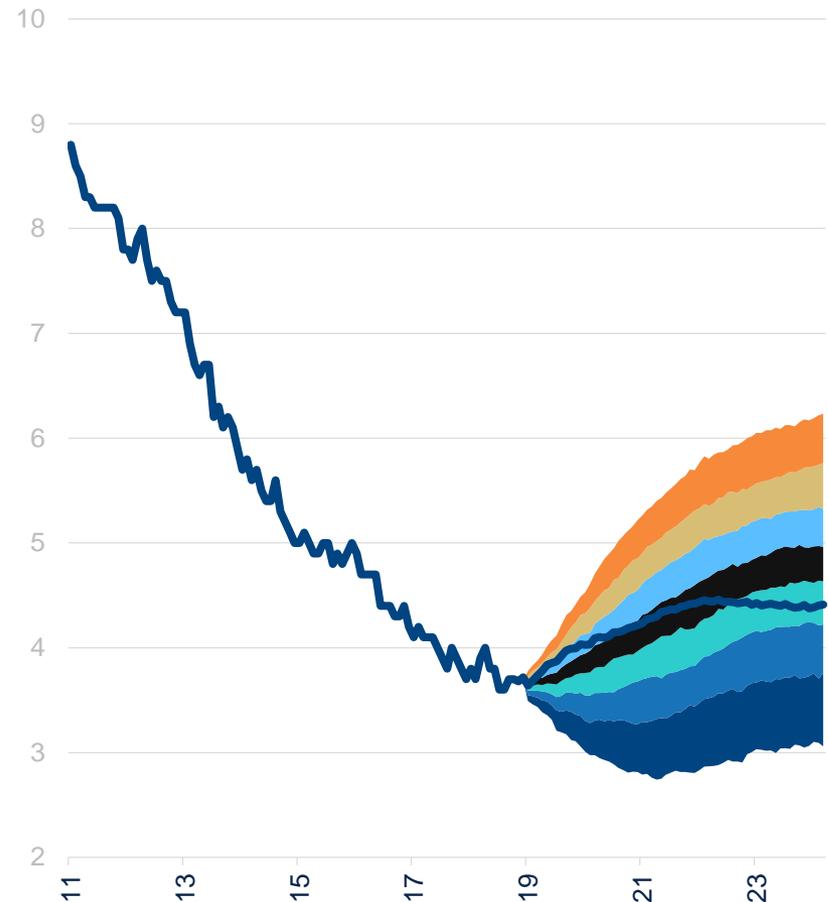
--- Pre-Crisis Avg.

Labor market: Lack of upside risks suggests improvements in UR are going to be harder to come by

U-6 (%)



UNEMPLOYMENT RATE (%)

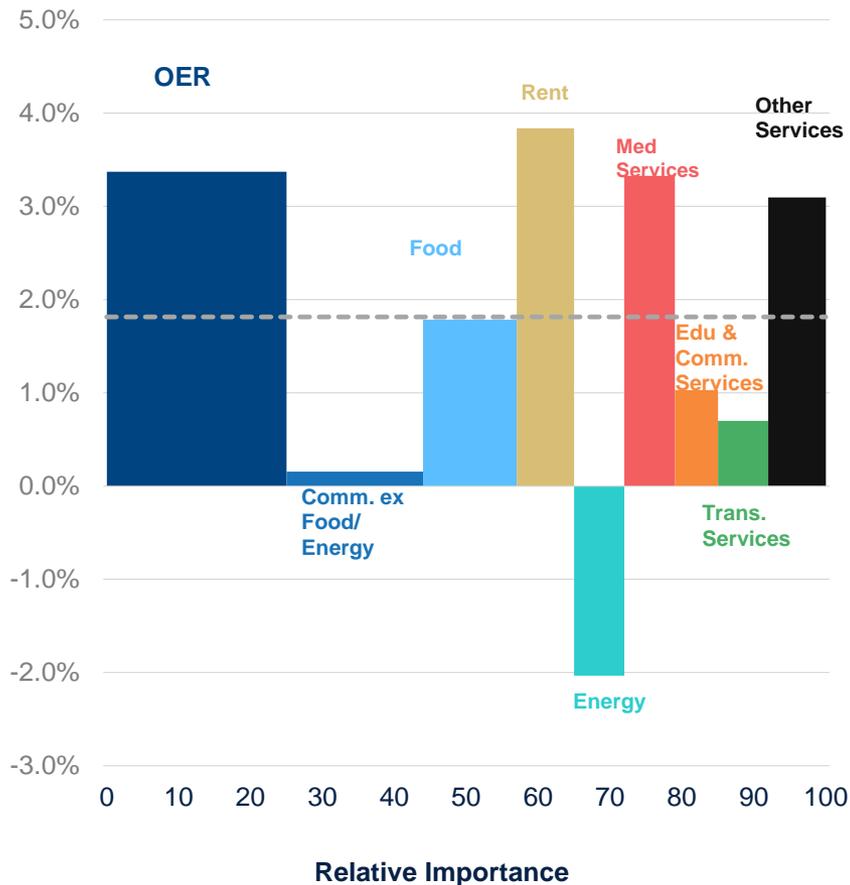


Inflation

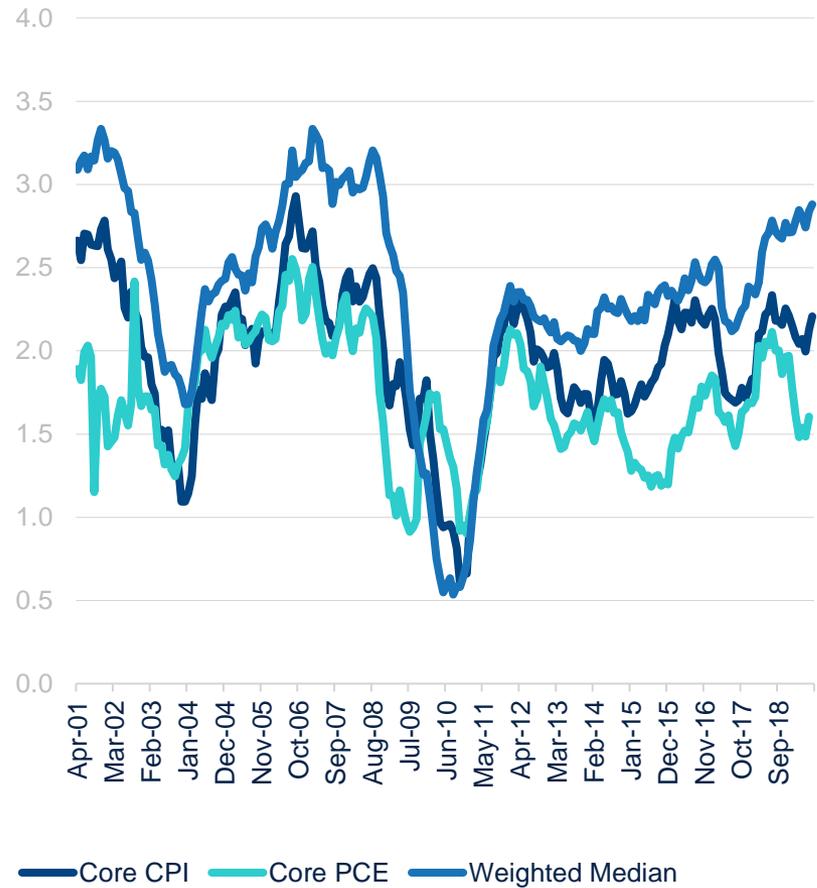
- Headline CPI advanced 0.3% in July, following a 0.1% increase in June
- On a year-over-year basis, headline CPI increased 1.8% while Core CPI went up 2.2%, which was the highest since January
- Gasoline and electricity prices were up by 2.5% and 0.6% in July
- Shelter costs rose 0.3%, medical care services increased 0.5% while apparel was up 0.4%. Used cars and trucks also advanced 0.9%. Supply-side issues pushed airline fares up 2.3%
- Despite lower downside risks to inflation, expectations stand at their lowest level since 2016
- Baseline assumes average headline CPI will be 1.8% in 2019, before rebounding in 2020

Inflation: Rebound in core price pressures points to turnaround in 2H19

CONSUMER PRICE INFLATION (12M CHANGE)



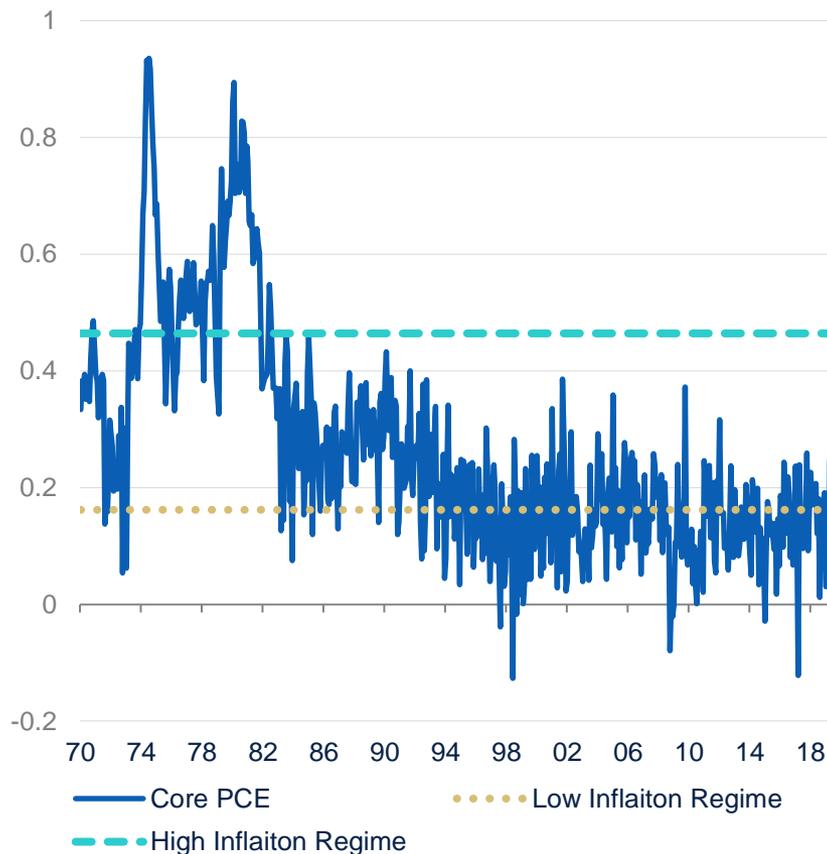
CORE INFLATION MEASURES (12M CHANGE, %)



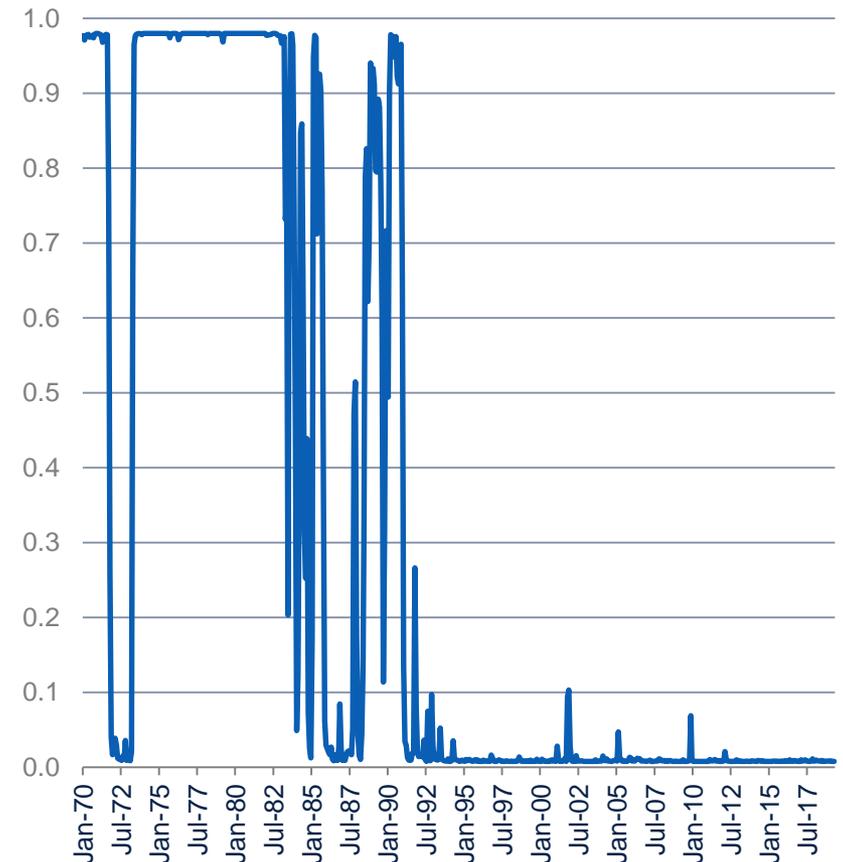
Source: BBVA Research, BLS & BEA

Inflation: Core prices firmly rooted in low-stable inflationary regime

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



INFLATION REGIME CHANGE PROBABILITY (%)

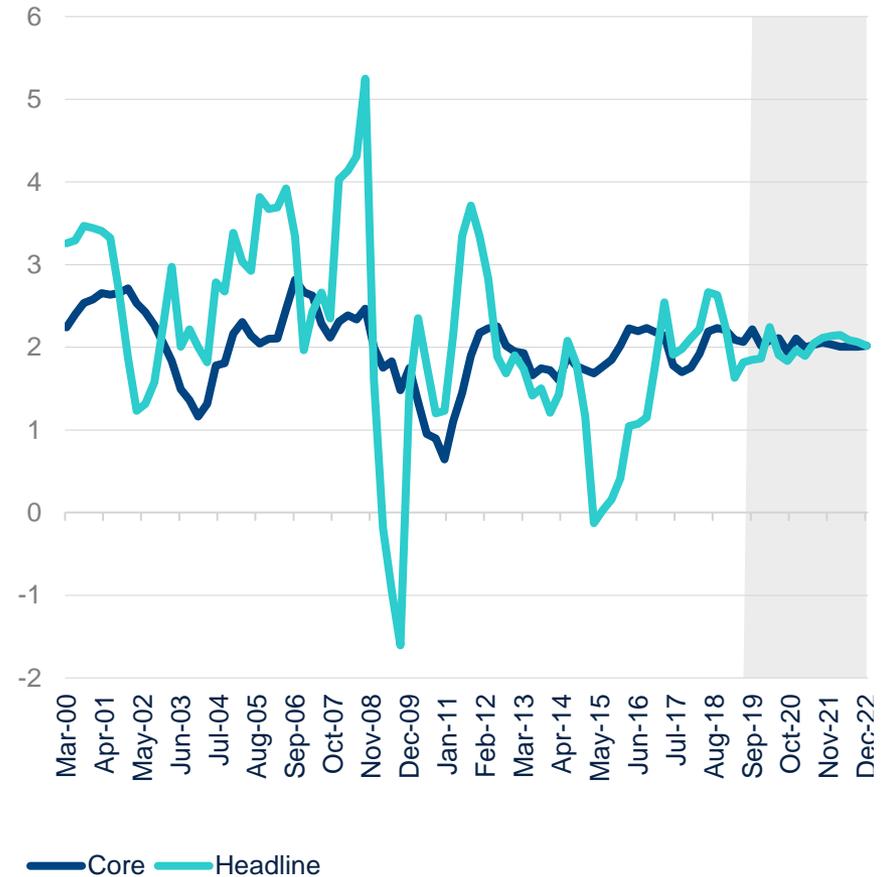


Inflation: Modest upside risk to baseline given recent recovery in prices

INFLATION EXPECTATIONS (%)



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

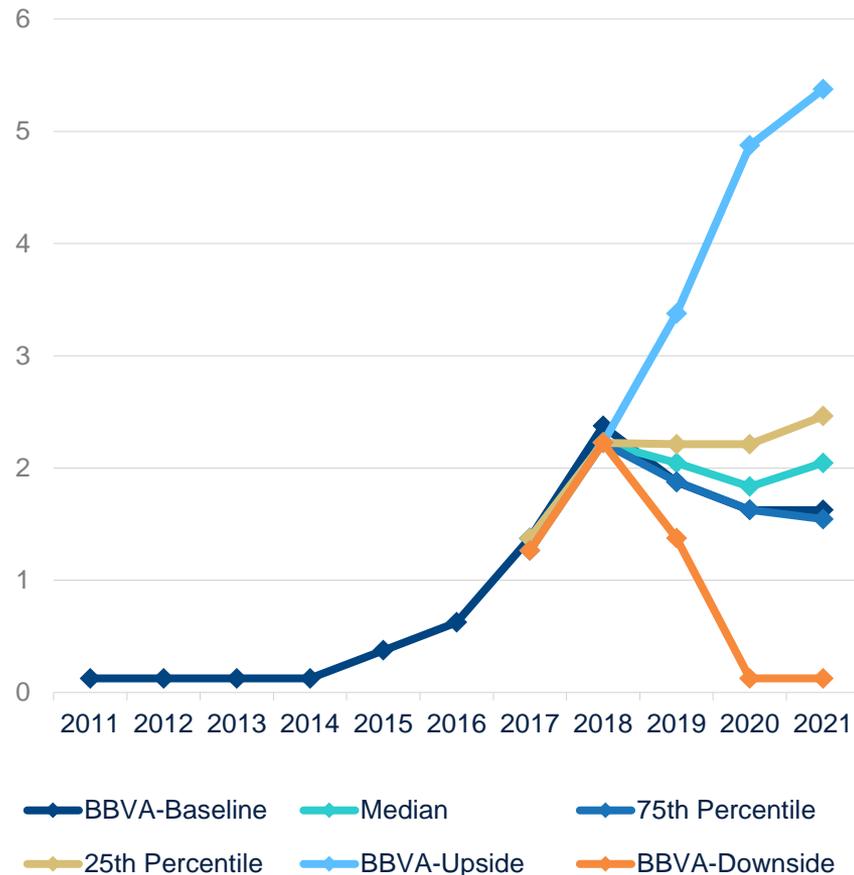


Monetary Policy: Federal Reserve

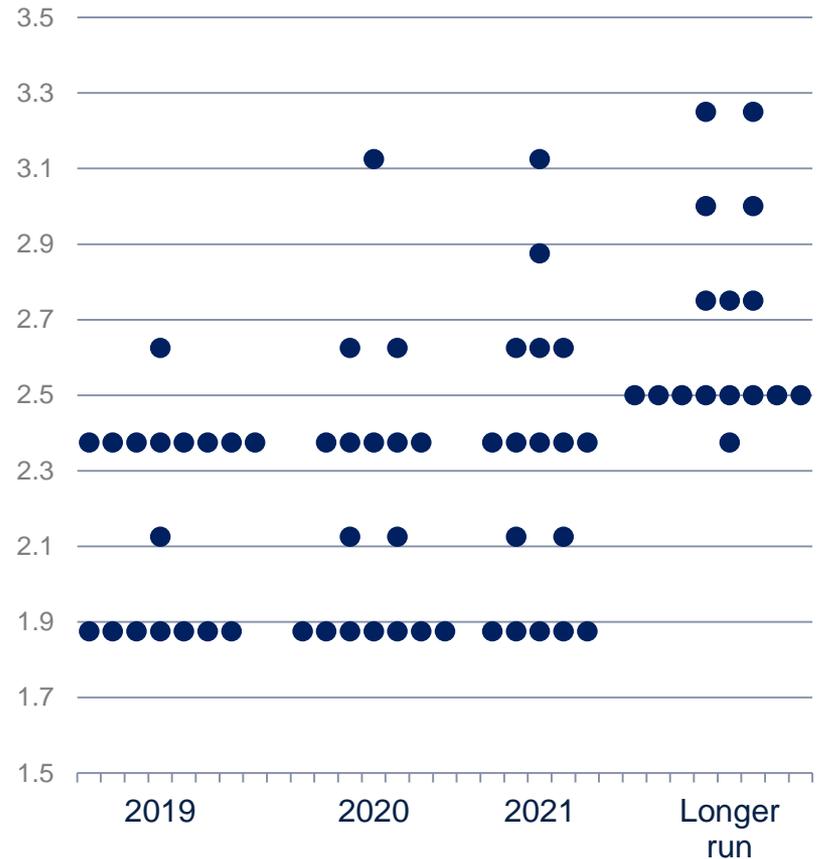
- As expected, the Fed lowered its benchmark rate (25bp) for the first time since 2008, citing global risks and muted inflation pressures
- Chairman announced end to balance sheet normalization, two months earlier than previously communicated
- Fed's attempt to reconcile risks and positive data surprises results in only modest change in tone of statement
- Fed's justification for "mid-cycle" insurance cut versus extended tightening cycle, adds uncertainty to future path of monetary policy
- Strong emphasis on "trade" and "trade uncertainty" in press conference risks entangling White House trade policy and U.S. monetary policy
- Baseline assumes one more 25bp rate cut this year plus one additional "fine-tuning" cut in 2020

Fed: Surveys aligned with one additional rate cut this year

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



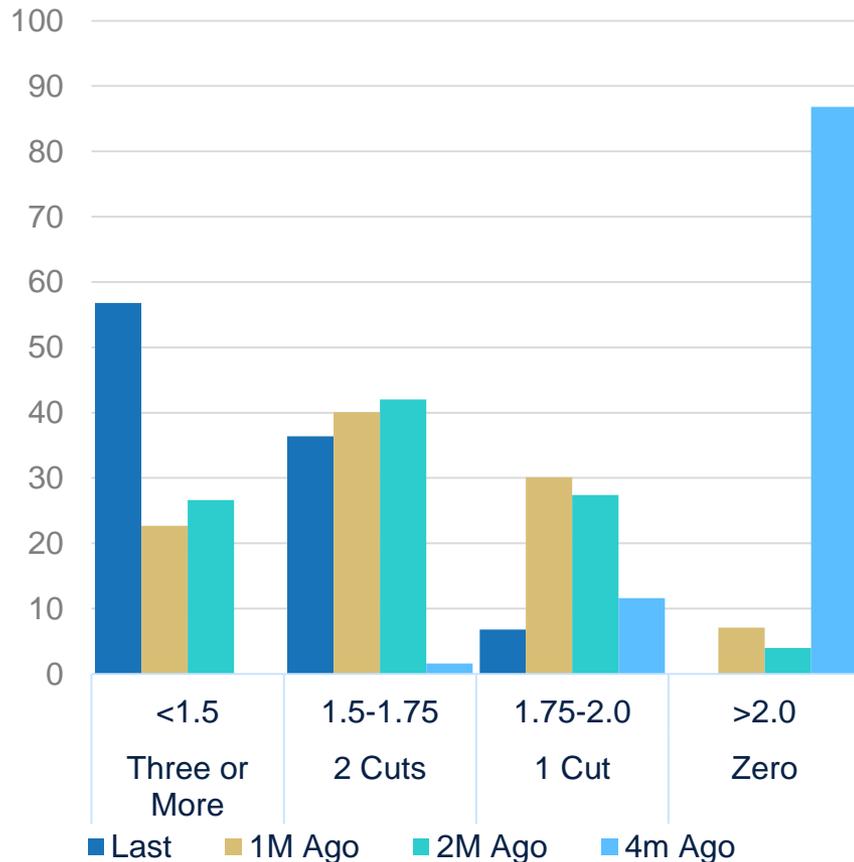
FOMC PROJECTIONS OF FED FUNDS (YEAR-END %, MID-POINT)



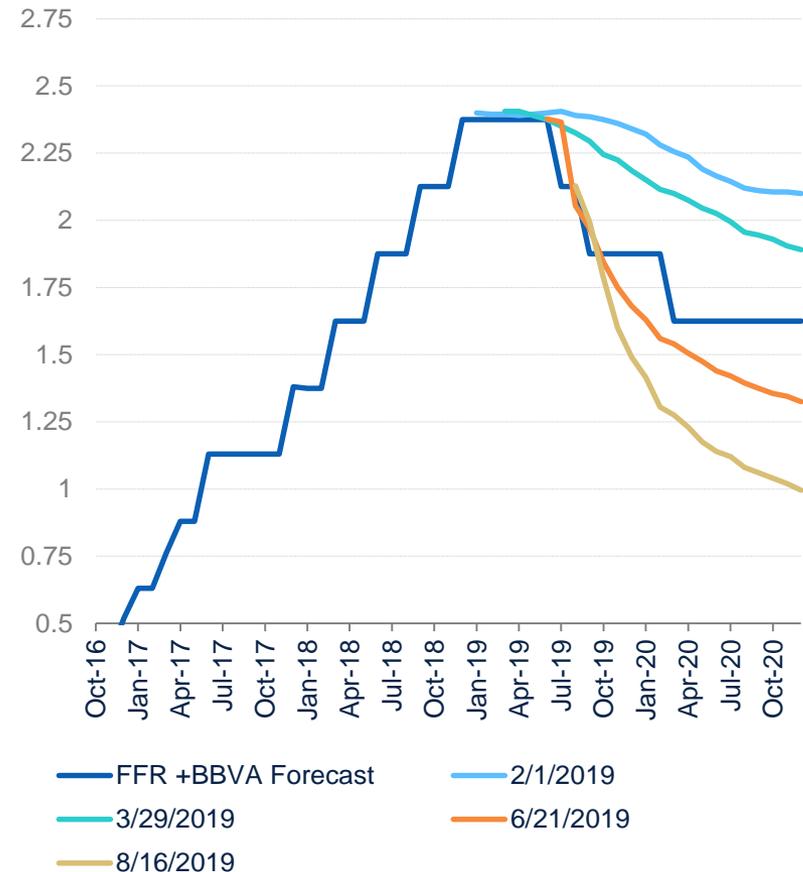
Source: BBVA Research & FRB

Monetary policy: Geopolitical uncertainty and late cycle fears increase expectations of more aggressive Fed tightening cycle

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

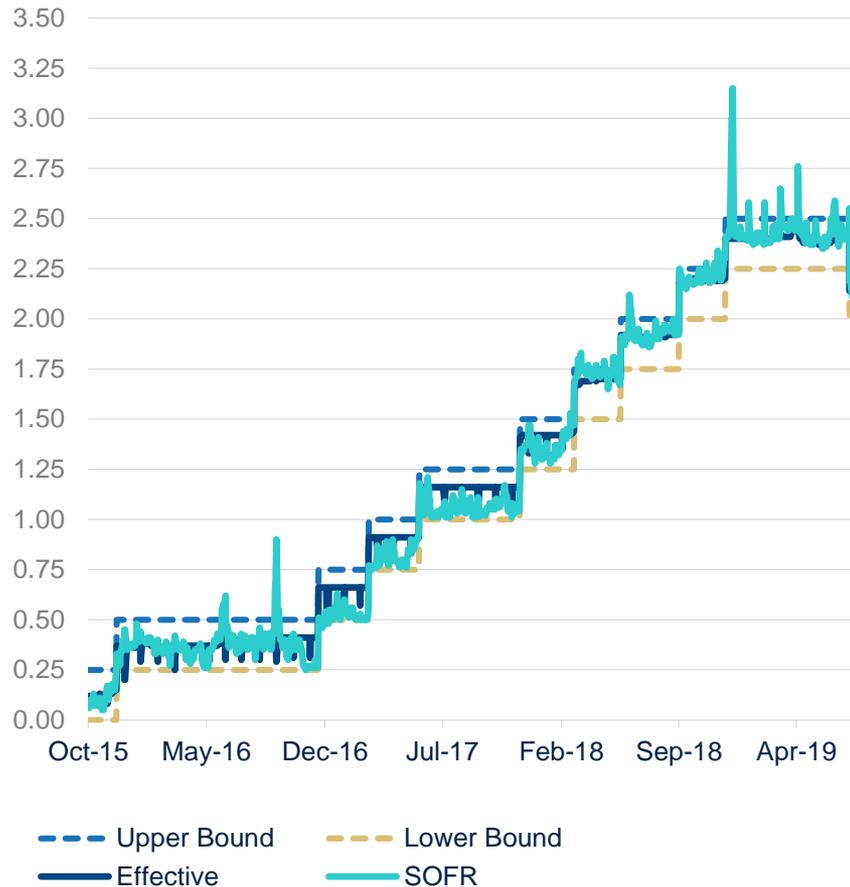


FED FUNDS FUTURES & BBVA BASELINE (%)

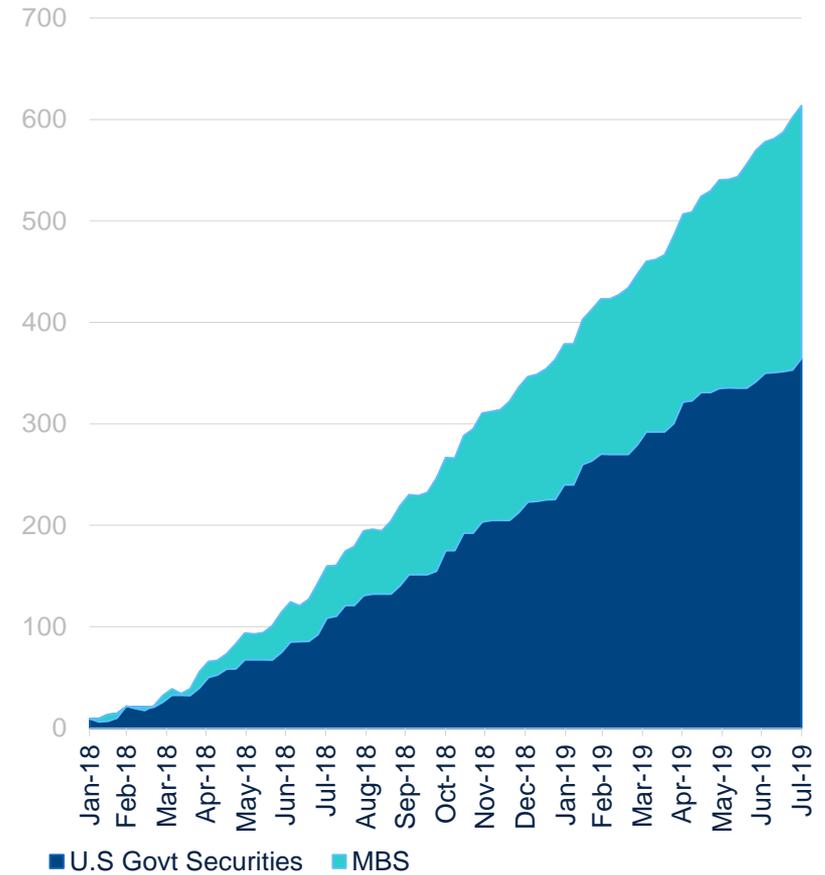


Monetary policy: Quantitative tightening ends with shift in Fed interest rate policy

FED FUNDS & REPO RATES (%)



BALANCE SHEET ATTRITION (US\$BN, CUMULATIVE)



Interest Rates

- 10-yr Treasury down to 1.6%, 2-yr Treasury down to 1.5%
- Risk aversion and weaker growth prospects increased demand for long-term Treasuries, pushing term premium beyond historic lows
- Short-term rates anchored benchmark IOER; more dovish rates outlook impacting belly (2-year to 5-year) of yield curve
- Yield curve continues to invert with 10-YR trending below most short-term Treasuries (6-month, 3-month, 1-year and 2-year).
- Baseline assumes 10-yr Treasury yields reach 1.6% by year end; short-terms rates to align with Fed's "mid-cycle" scenario

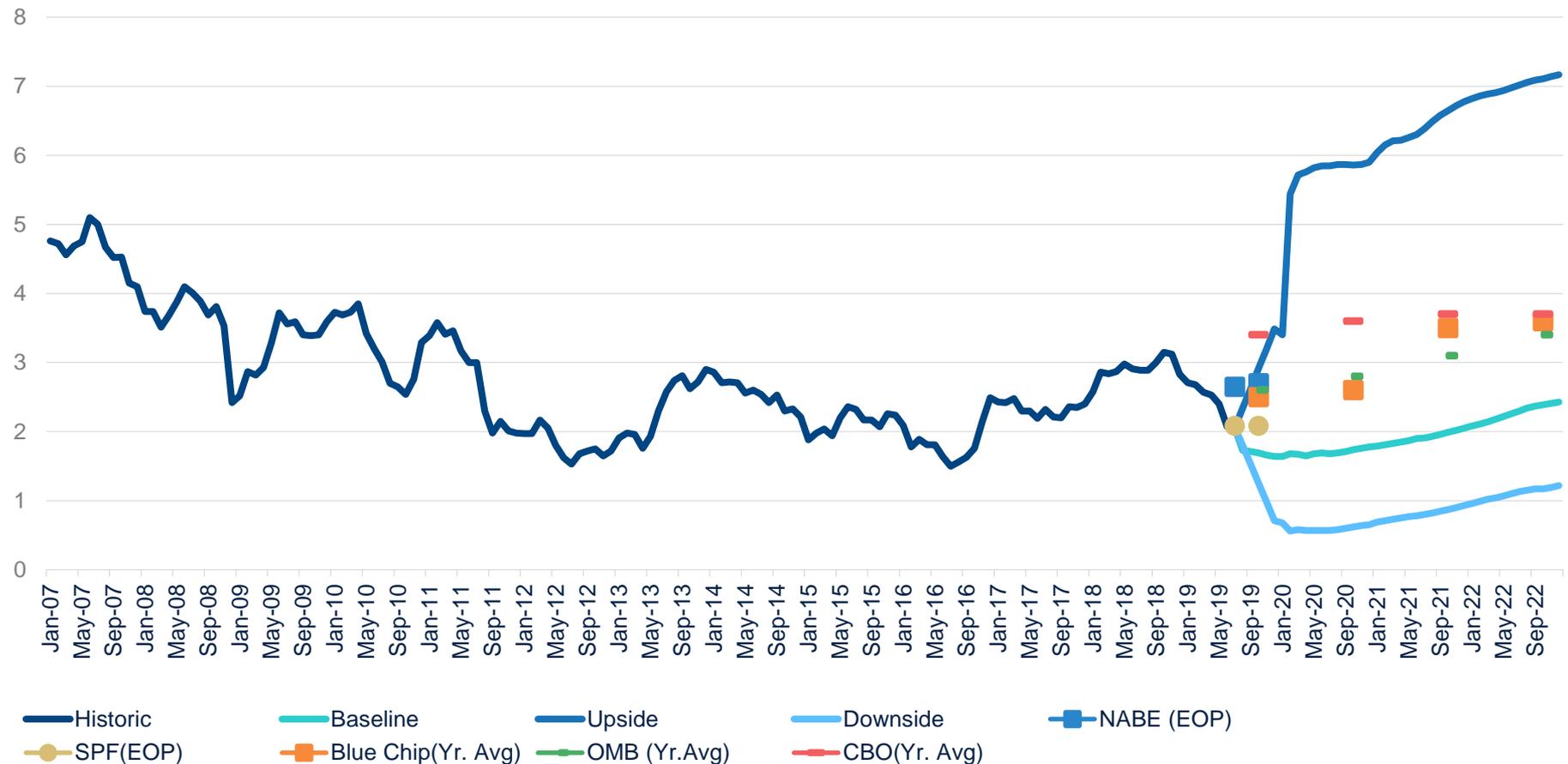
Interest rates: Unprecedented negative term premium nearly two times lower than previous low-point

10-YEAR TREASURY YIELD DECOMPOSITION (%)



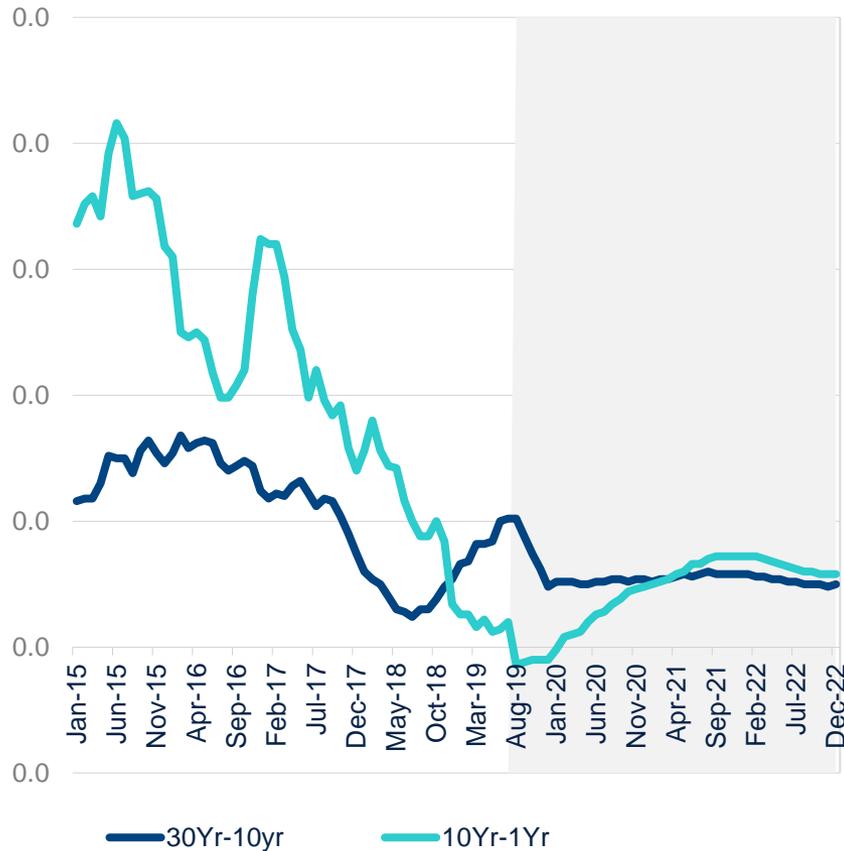
Interest rates: Downside risks to 10-year elevated

10-YEAR TREASURY YIELD (%)

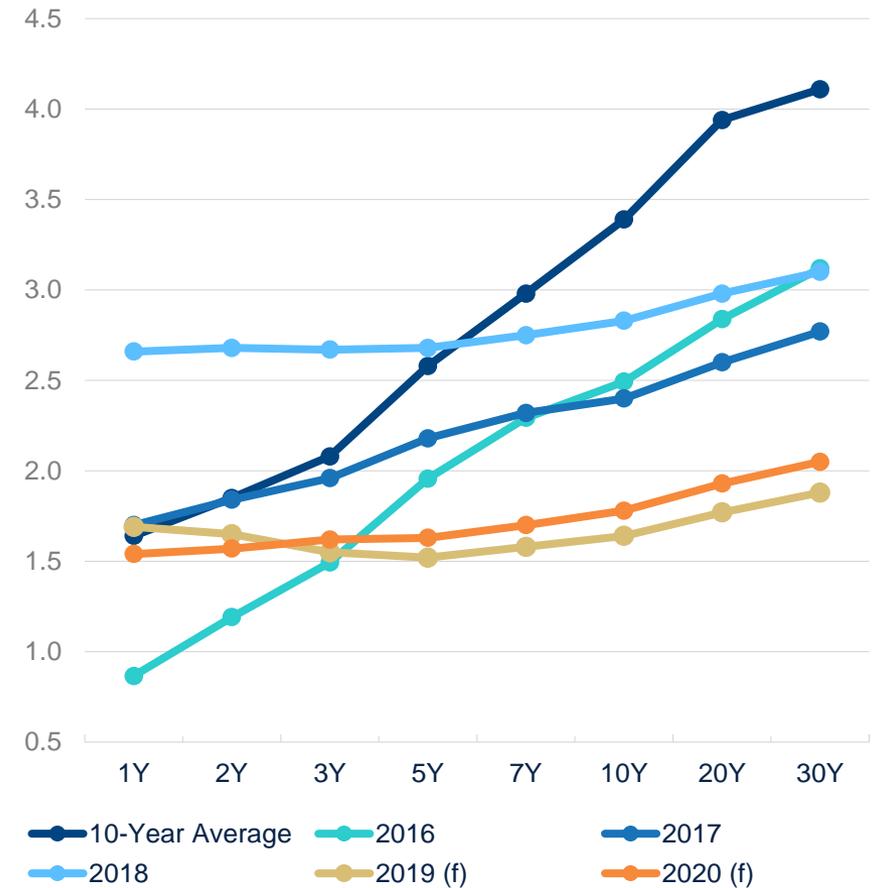


Interest rates: Inverted yield curve (10y-1y) through remainder of 2019

YIELD CURVE SLOPE
(BP)



YIELD CURVE
(%, EOP)

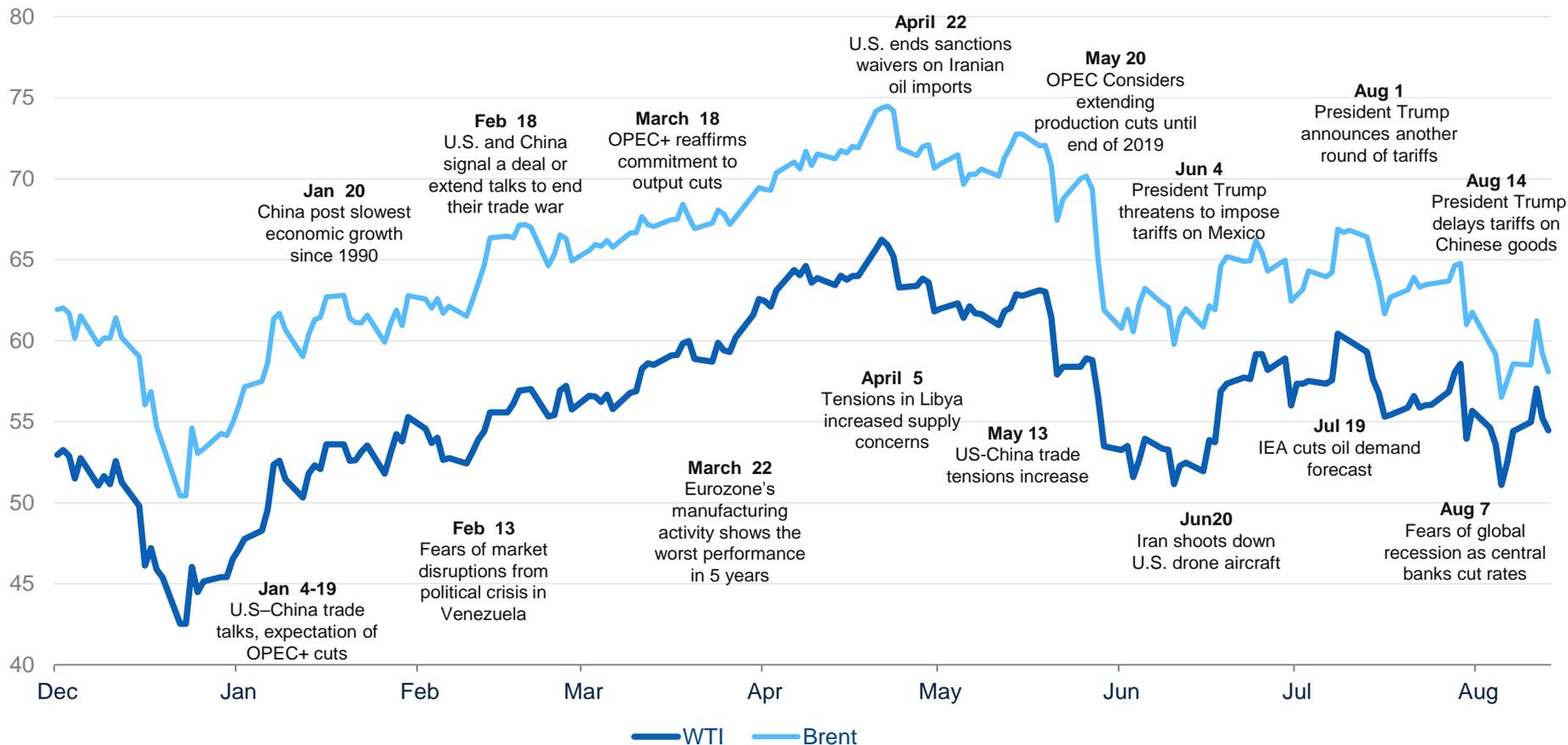


Oil Prices Outlook

- Weaker economic growth to slow oil demand
- U.S oil production will expand further while substantial transportation capacity is being added
- Escalation of tensions between U.S. and Iran, and trade negotiations between China and the U.S. are the main sources of uncertainty
- 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

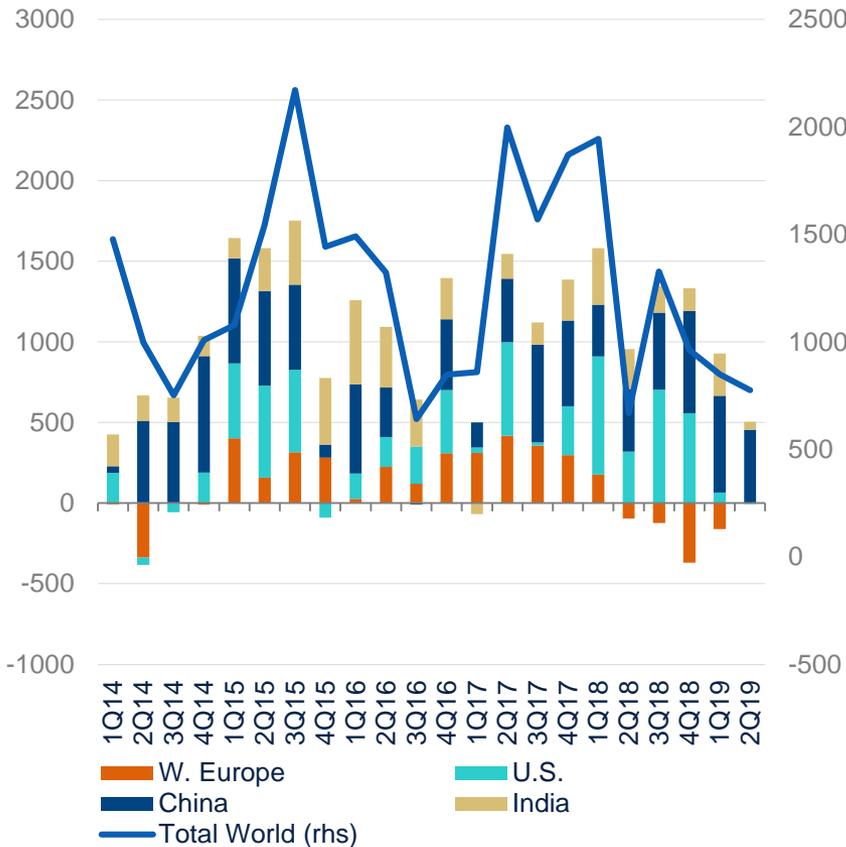
CRUDE OIL PRICES DECEMBER 2018 TO AUGUST 2019 (\$ PER BARREL)



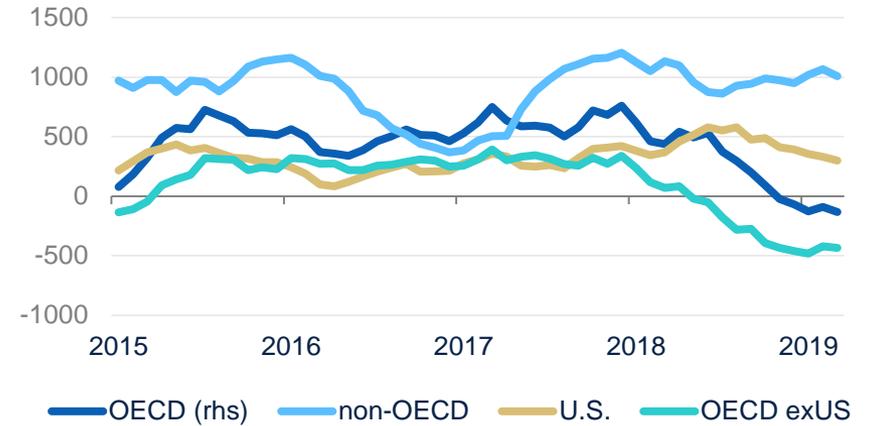
Source BBVA Research with data from Haver Analytics

Demand in developing countries remains supportive

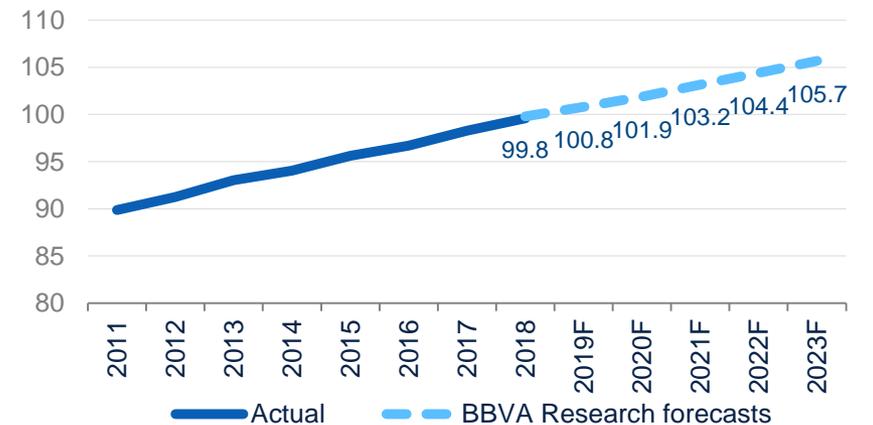
OIL PRODUCT DEMAND: TOTAL WORLD (THOUSAND BARRELS PER DAY, YOY CHANGE)



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



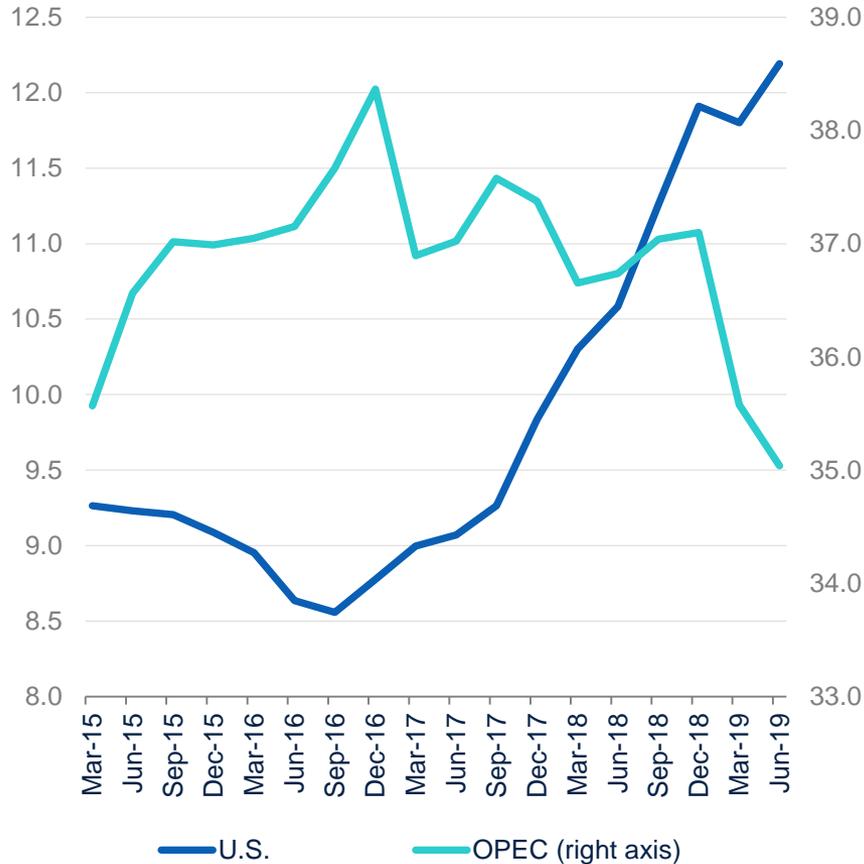
OIL PRODUCT DEMAND (MILLION BARRELS PER DAY)



Source BBVA Research with data from Haver Analytics and Bloomberg

OPEC production decline consistent with weaker demand outlook

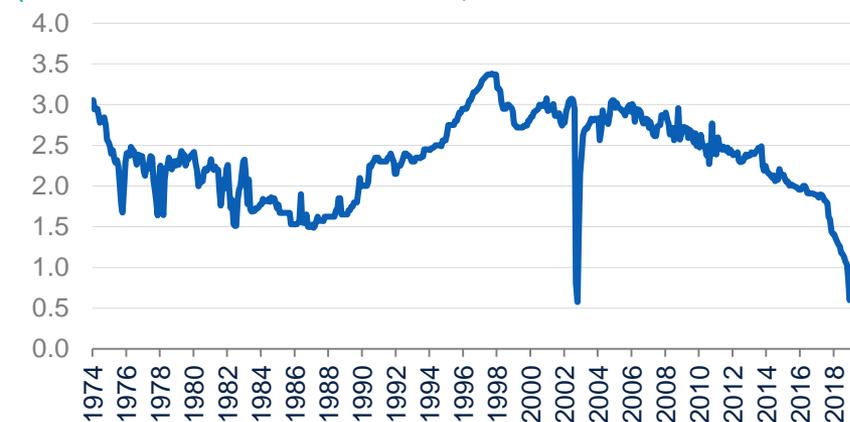
CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



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



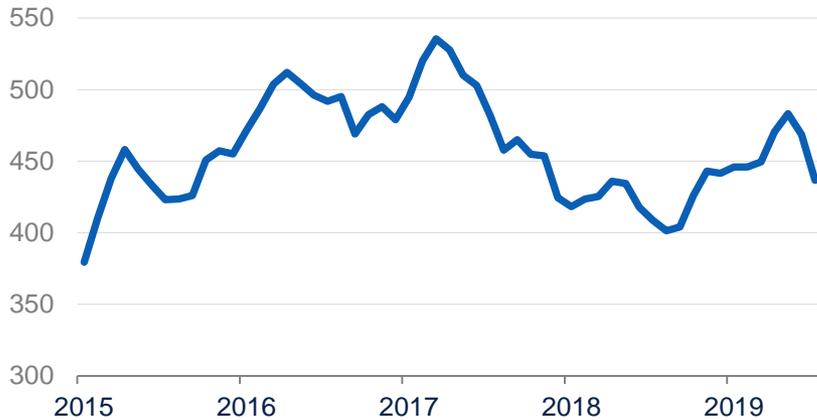
VENEZUELA: CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



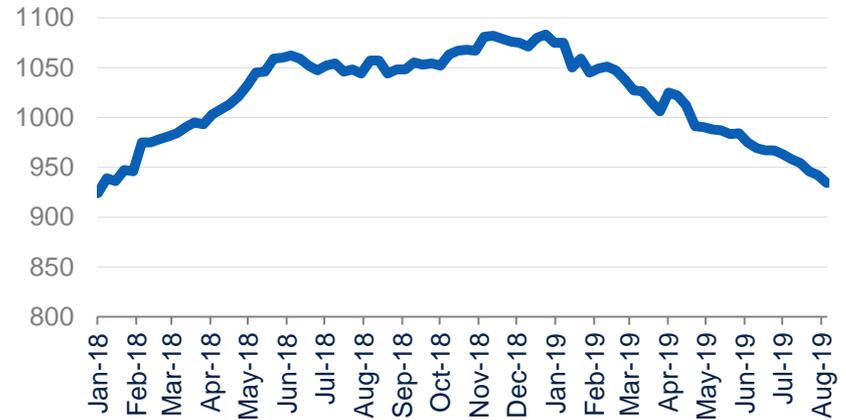
Source: BBVA Research, Haver Analytics, and Bloomberg

Permian basin production surpassed 4.3 million b/d in July

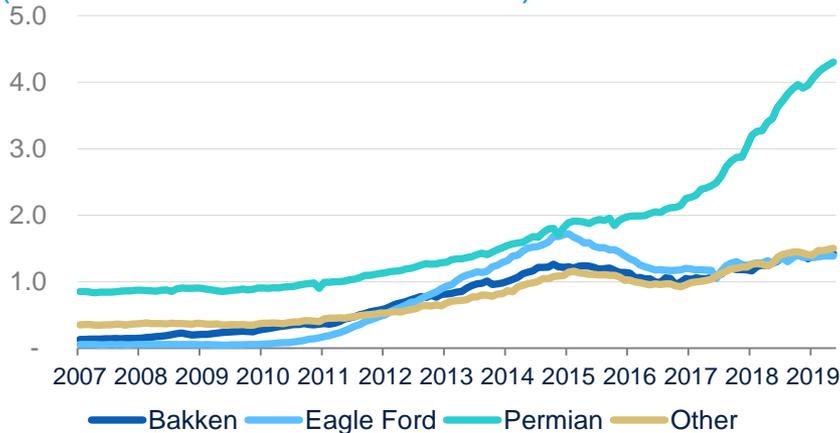
U.S. STOCKS OF CRUDE OIL (EXCLUDING SPR, MILLION BARRELS)



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)



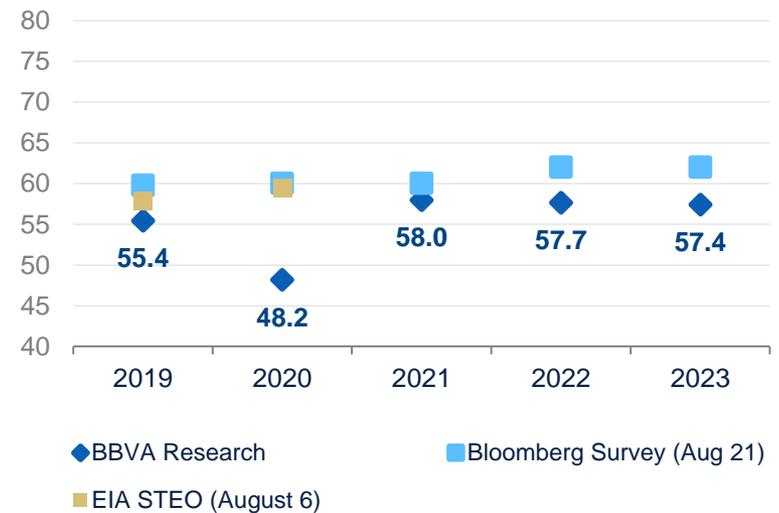
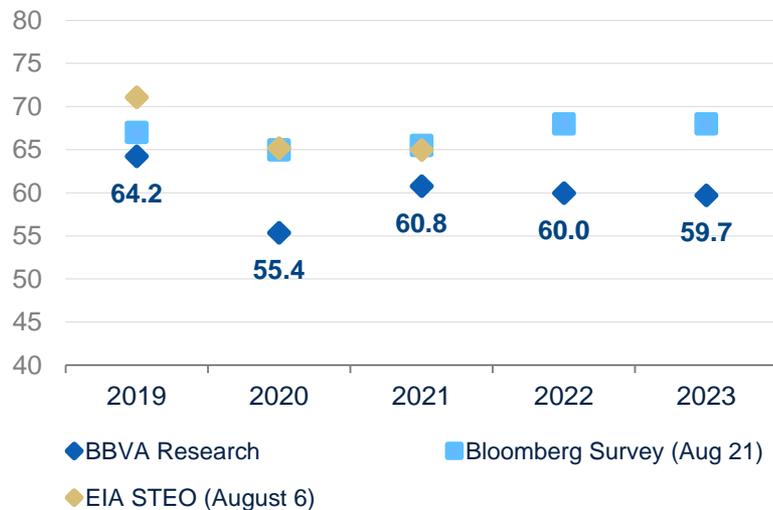
Demand conditions will be the main driver going forward

Brent prices forecast (\$ per barrel)

	Actual	BBVA Research (Baseline)	Bloomberg Survey (Aug 21)	EIA STEO (Aug 6)
2017	54.2	54.2	54.2	54.2
2018	71.1	71.1	71.1	71.1
2019		64.2	67.0	65.2
2020		55.4	65.0	65.0
2021		60.8	65.5	
2022		60.0	68.0	
2023		59.7	68.0	

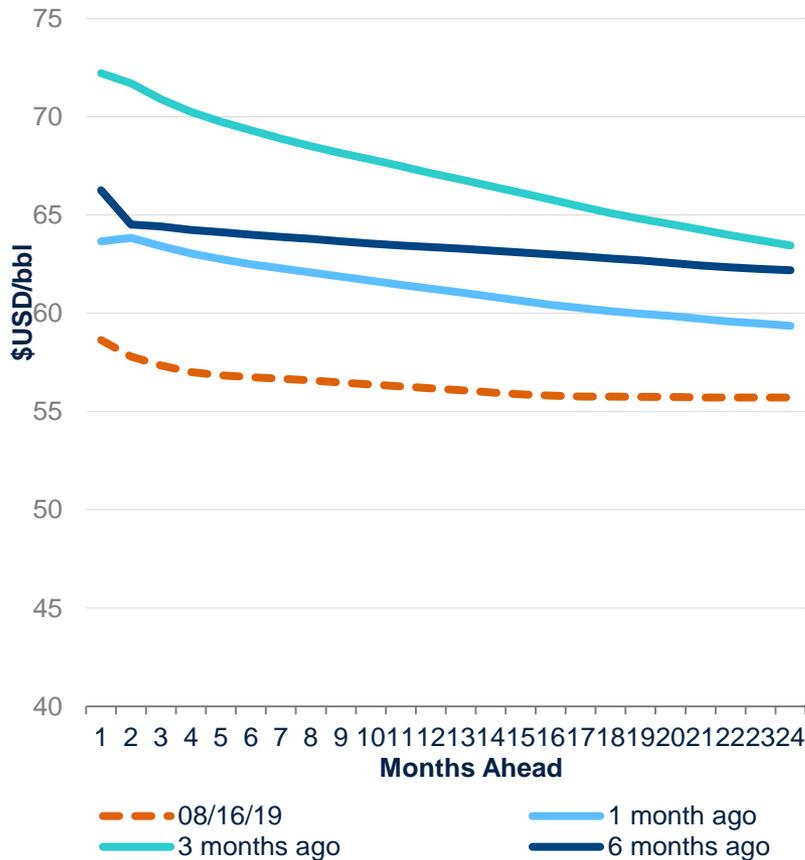
WTI prices forecast (\$ per barrel)

	BBVA Research (Baseline)	Bloomberg Survey (Aug 21)	EIA STEO (Aug 6)
2017	50.8	50.9	50.8
2018	65.0	65.0	65.0
2019	55.4	59.8	57.9
2020	48.2	60.0	59.5
2021	58.0	60.0	
2022	57.7	62.0	
2023	57.4	62.0	



Futures curve remains in backwardation

Brent Futures (\$ per barrel)

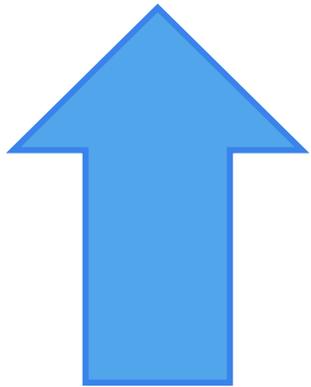


WTI Futures (\$ per barrel)

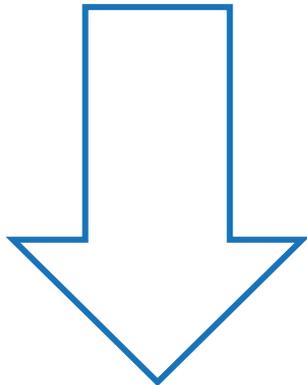


Source: BBVA Research and Bloomberg

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



\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
 - 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
 - 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	2.4	2.9	2.5	2.0	2.0	1.9
Real GDP (Contribution, pp)												
PCE	1.3	1.0	1.0	2.0	2.5	1.9	1.8	2.1	1.8	1.6	1.4	1.3
Gross Investment	0.9	1.6	1.1	1.0	0.9	-0.2	0.8	0.9	0.6	0.4	0.8	0.9
Non Residential	1.0	1.2	0.5	1.0	0.3	0.1	0.6	0.9	0.5	0.5	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	0.0
Exports	0.9	0.5	0.5	0.6	0.1	0.0	0.5	0.4	0.1	0.5	0.7	0.6
Imports	-0.9	-0.5	-0.3	-0.8	-0.9	-0.4	-0.8	-0.8	-0.3	-0.7	-0.9	-0.9
Government	-0.7	-0.4	-0.5	-0.2	0.3	0.3	0.1	0.3	0.5	0.3	0.0	0.1
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	164	151	135	113
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.1	2.4	1.8	2.0	2.0	2.1
Core CPI (YoY %)	1.7	2.1	1.8	1.8	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	-3.4	-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	-2.5	-2.5	-2.6	-2.7
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	5.4	5.9	5.8	3.5	3.2	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	1.64	1.78	2.05	2.43
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

Macro Scenarios										
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
GDP	2.9	1.6	2.4	2.9	2.5	2.0	2.0	1.9	1.8	2.0
Upside					3.3	3.7	3.1	2.7	2.7	2.7
Downside					1.6	-0.4	1.2	1.4	1.6	1.6
UR	5.3	4.9	4.4	3.9	3.7	4.0	4.2	4.4	4.4	4.4
Upside					3.6	2.9	2.9	3.0	3.0	3.0
Downside					4.1	6.2	6.6	5.7	5.0	4.8
CPI	0.1	1.3	2.1	2.4	1.8	2.0	2.1	2.1	2.0	1.9
Upside					2.0	3.4	3.7	3.8	3.8	3.8
Downside					1.3	0.4	1.1	1.3	1.4	1.4
Fed [eop]	0.50	0.75	1.50	2.50	2.00	1.75	1.75	2.25	2.25	2.25
Upside					3.50	5.00	5.50	6.00	6.50	6.50
Downside					1.50	0.25	0.25	0.25	0.25	0.25
10-Yr [eop]	2.24	2.49	2.4	2.83	1.64	1.78	2.05	2.43	2.58	2.68
Upside					3.49	5.90	6.78	7.17	7.26	7.42
Downside					0.71	0.65	0.93	1.22	1.55	1.60

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U.S. Economic Outlook

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