

# U.S. Macroeconomic Pulse

October 2019

# Economic Outlook

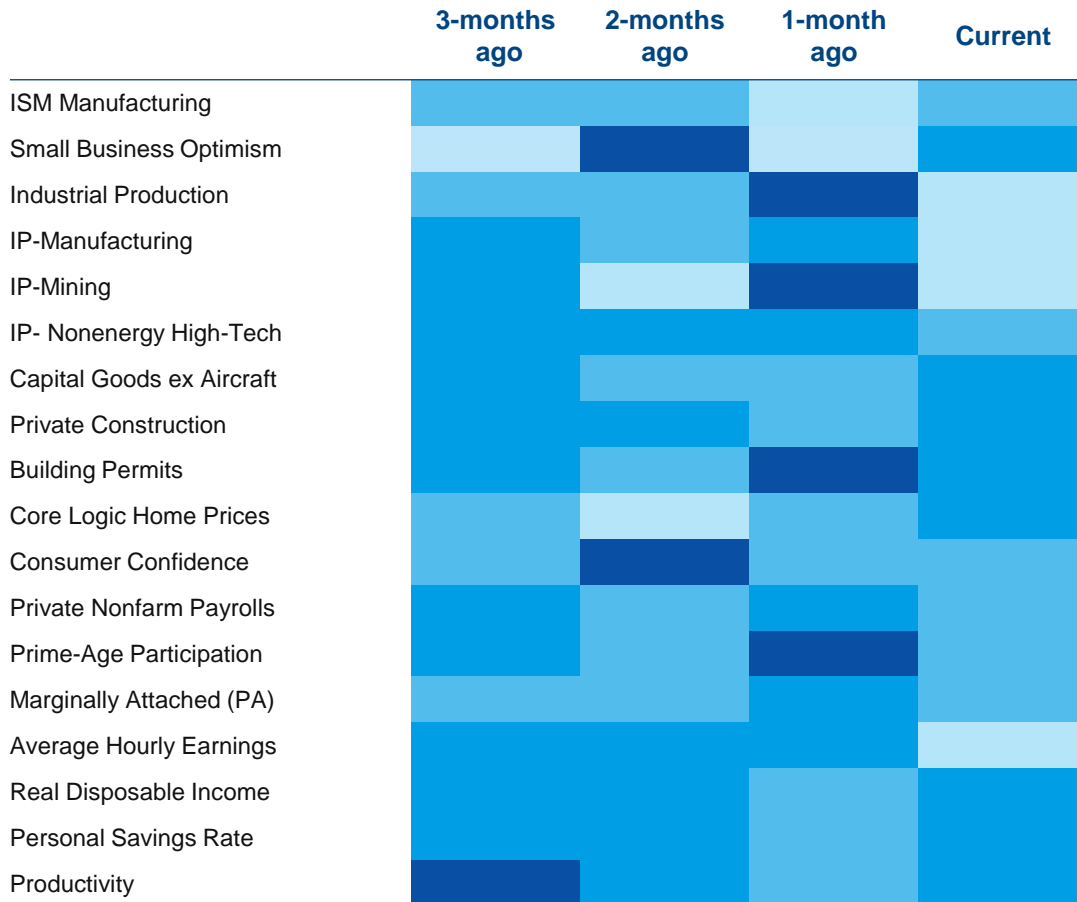
- Baseline revised down on weaker incoming data and rising global pessimism
- Model-based recession projections suggest probability around 65% over the next 24-months
- Mixed signals from labor market, as momentum continues to wane
- Inflation returning to target, if downside risks moderate
- Fed likely to take a step back from its “mid-cycle” path to allow for time to evaluate the impact of increased accommodation
- Yield curve inversion easing with slight improvement in term premium
- Weaker demand pressuring oil prices, but geopolitical risks remain

## Macro Fundamentals

- In 2Q19, GDP growth decelerated to 2.0% QoQa from 3.1% in the previous period.
- Investment remains weak as global headwinds and high-levels of policy uncertainty weigh on firm-level optimism
- Net exports and inventories whipsawed after strong 1Q19 readings; weakness likely to persist
- Higher federal expenditures to partially offset growing private sector headwinds
- We expect growth to continue decelerating in 2H19, prompting a modest downward revision of 20bp to 2.3% in 2019 and 1.8% in 2020.

# Economic activity

## REAL-TIME ECONOMIC MOMENTUM HEAT MAP



Below Average

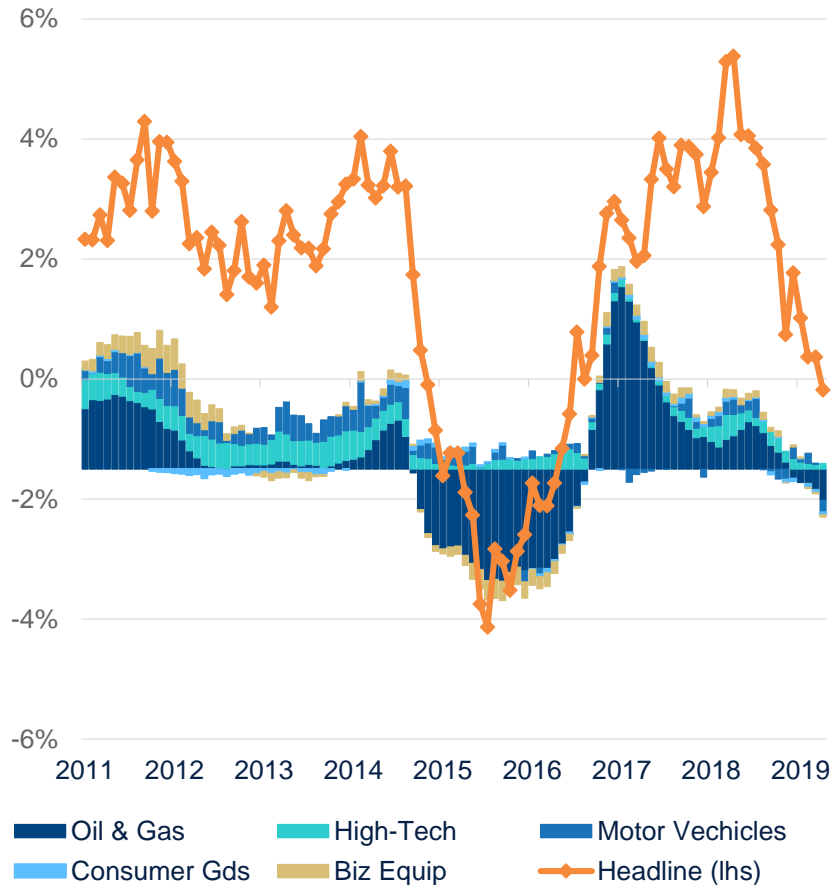
Above Average

Source BBVA Research

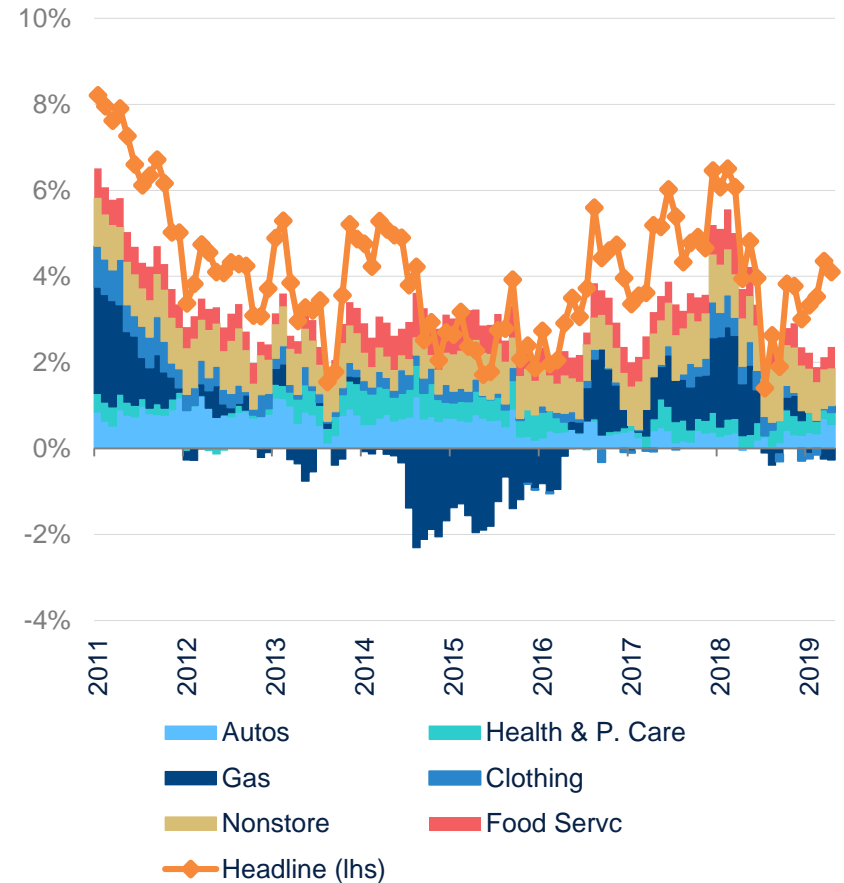
- Slowing global trade flows and idiosyncratic manufacturing headwinds drag down IP
- CEO and small business confidence decline on unprecedented trade uncertainty
- Retail sales dragged down by weak auto demand and lower gas prices
- Single family housing starts trending upward on lower rates and stable labor market outlook
- Rising uncertainty driving precautionary personal savings

# Economic trends: Signs of a consumer slowdown, as industrial outlook continues to dampen

## INDUSTRIAL PRODUCTION (YEAR-OVER-YEAR %)

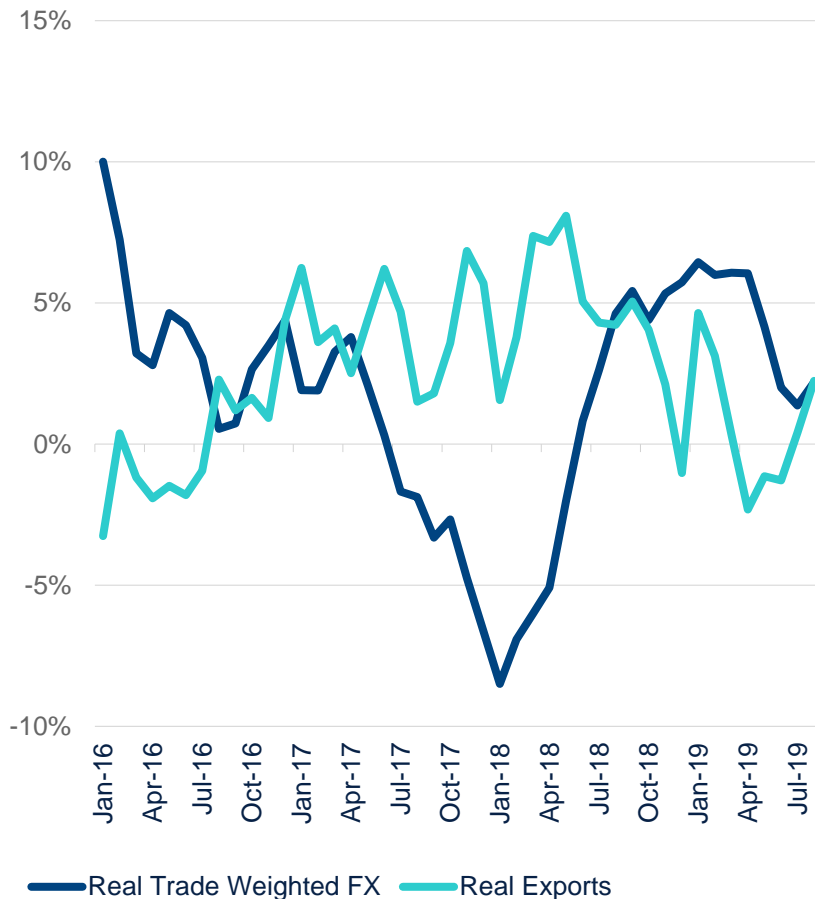


## RETAIL SALES (YEAR-OVER-YEAR %)

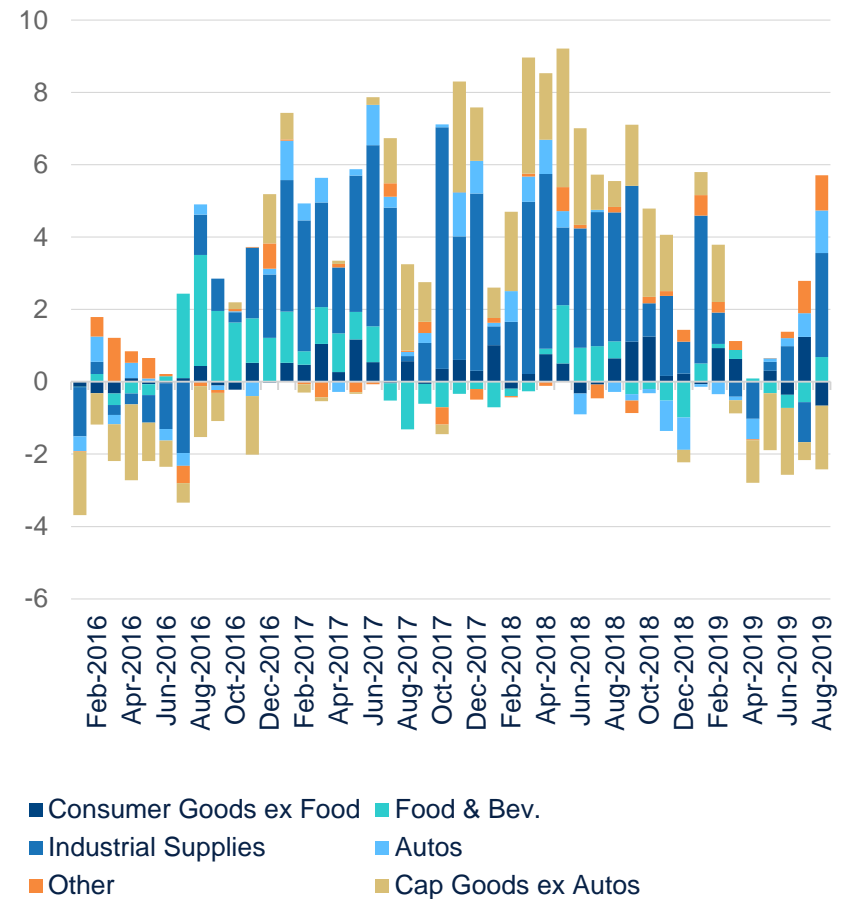


# Economic trends: Modest improvement in exports despite drag from weak capital goods demand

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



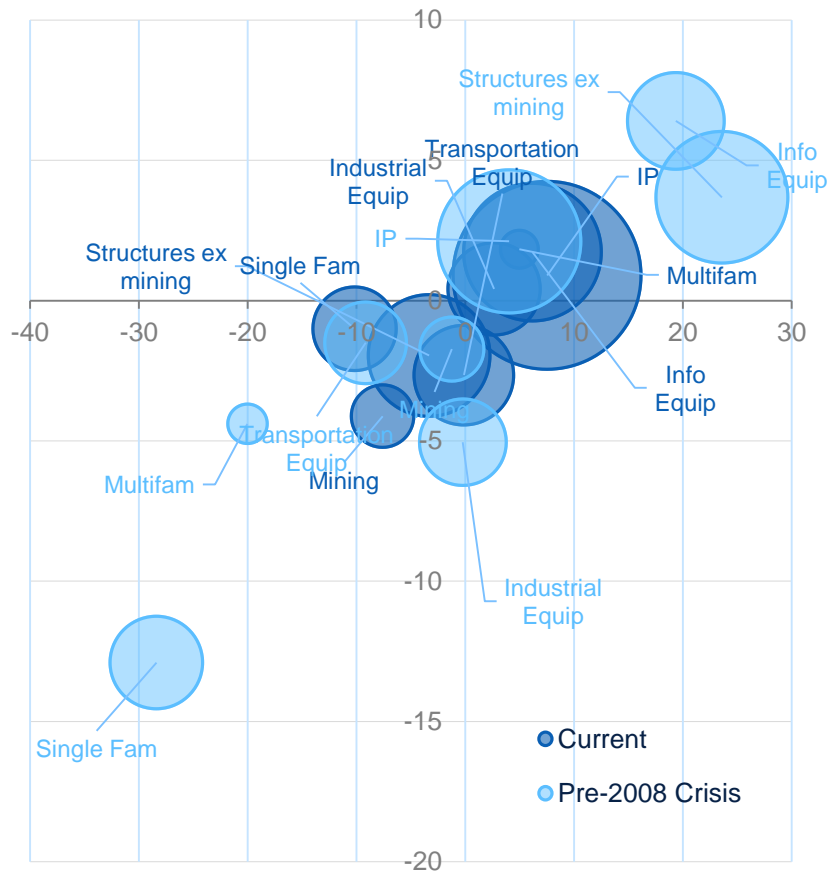
## REAL EXPORTS (CONTRIBUTION TO YEAR-OVER-YEAR %)



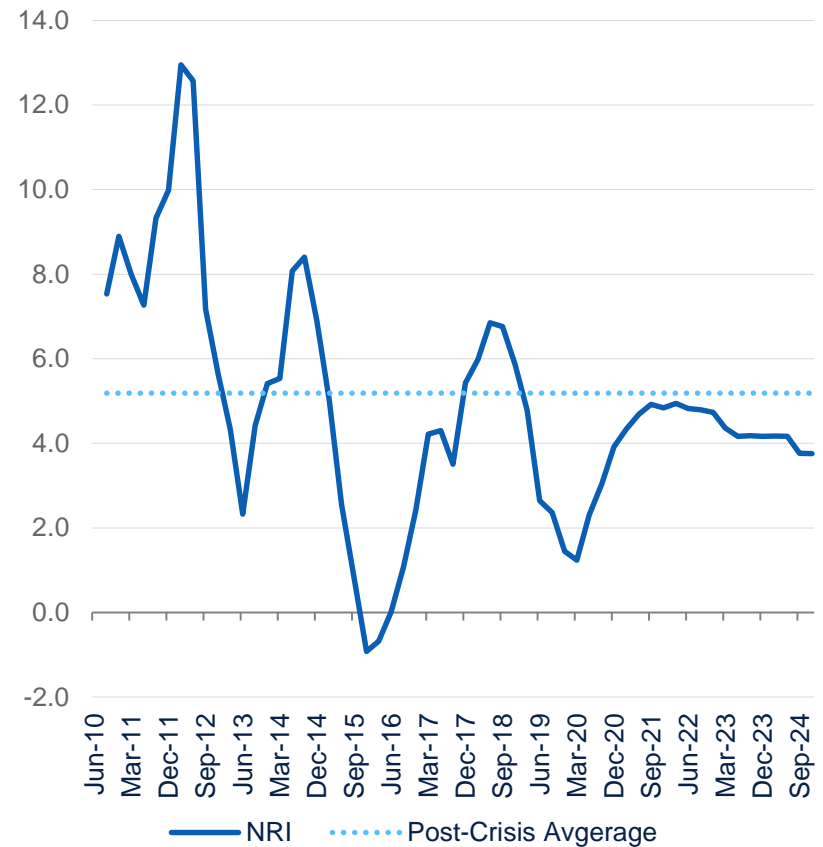
Source: BBVA Research, FRB & Census

# Economic trends: Despite some slowing of investment, systemic risks appear muted

## REAL PRIVATE FIXED INVESTMENT (YOY & QOQ %)



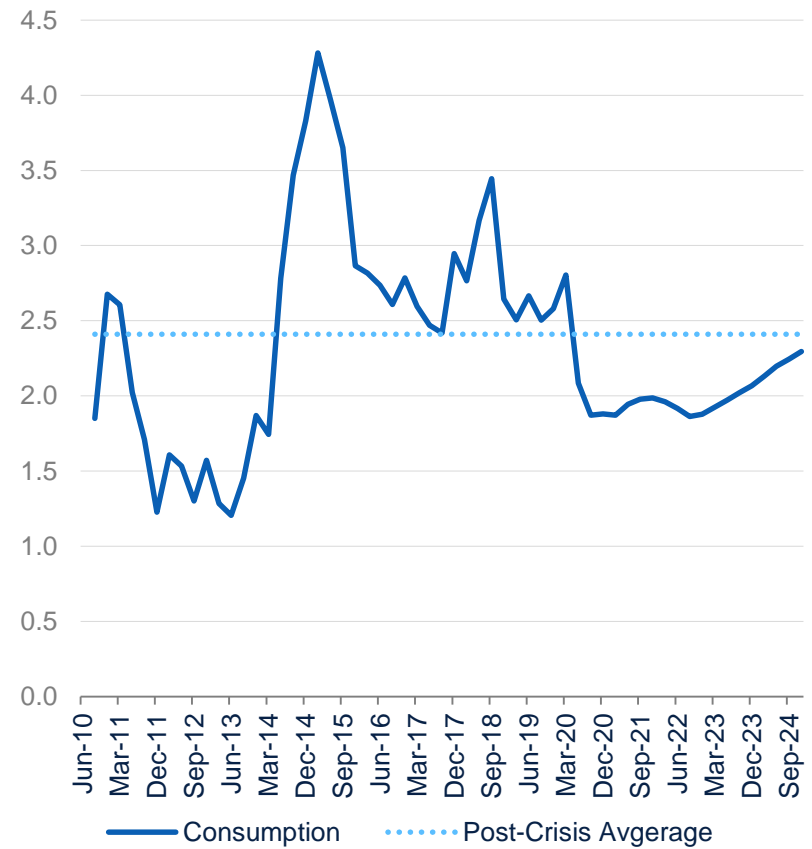
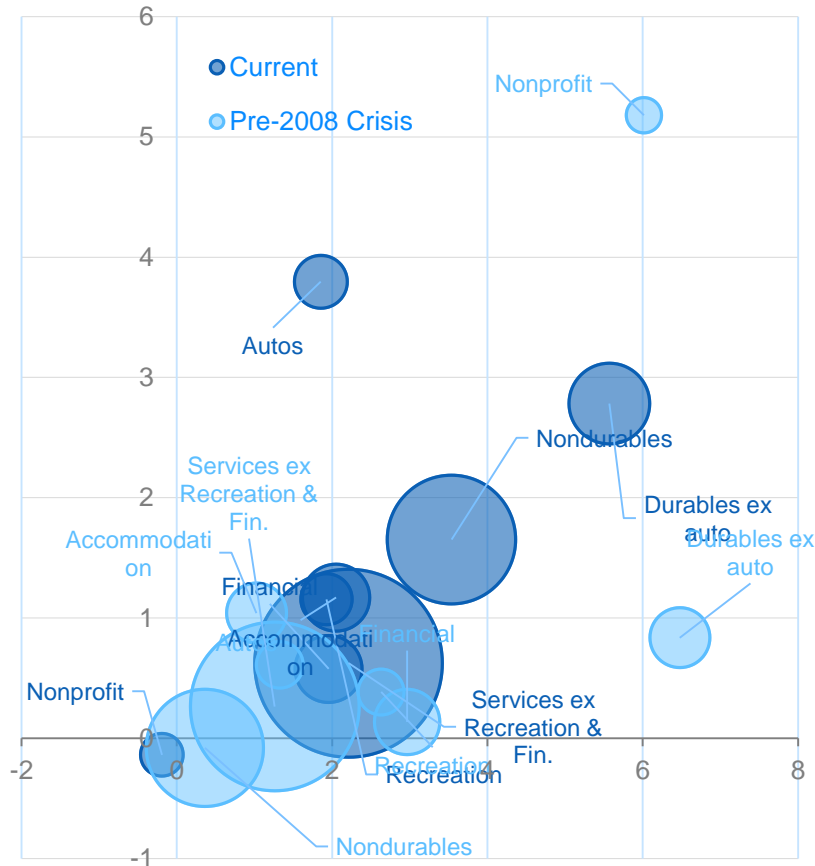
## REAL NONRESIDENTIAL PRIVATE INVESTMENT (BN 2012\$, YOY %)



Source: BBVA Research, FRB & Census

# Economic trends: Consumption outlook still upbeat

## REAL PERSONAL CONSUMPTION EXPENDITURES (YOY & QOQ %)      REAL PERSONAL CONSUMPTION EXPENDITURES (BN 2012\$, YOY %)

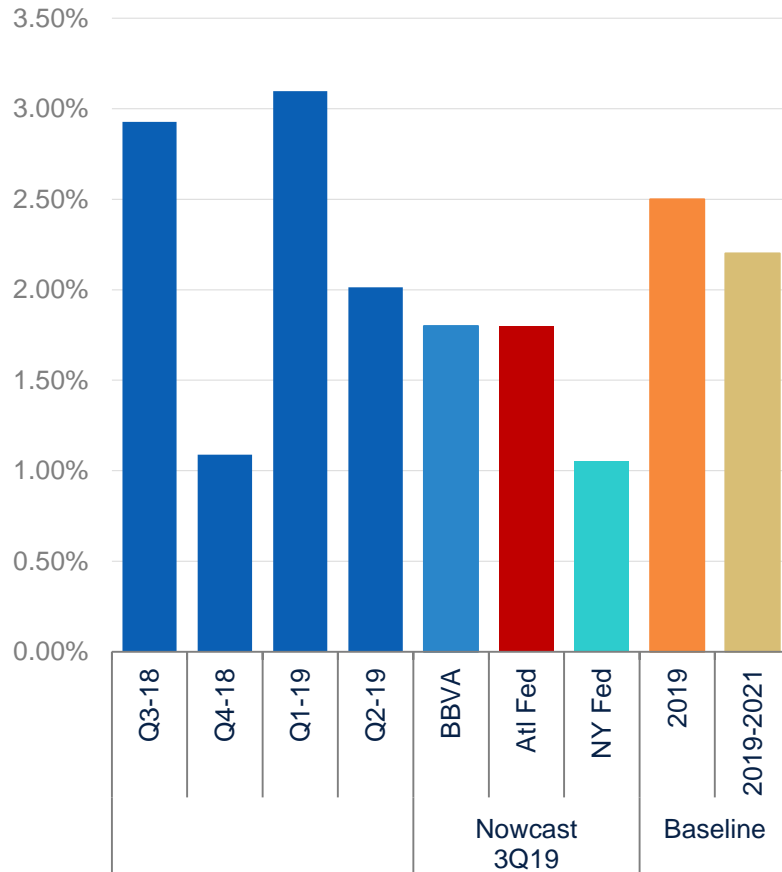


Source: BBVA Research, FRB & Census

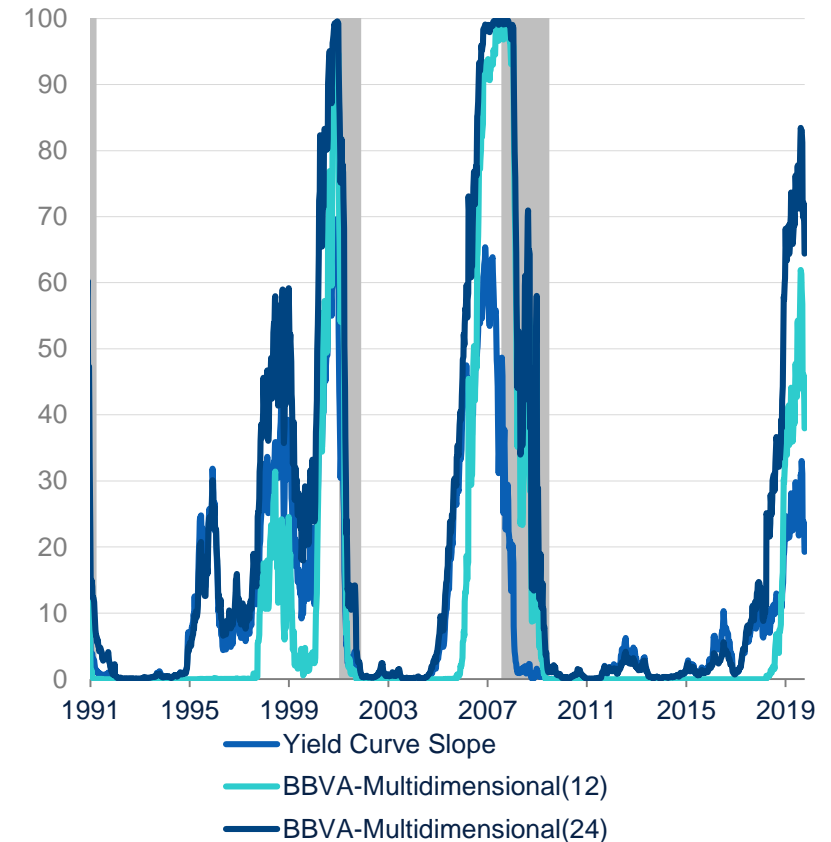


# Economic trends: Weaker growth expected in 3Q19, as recession risk hovers close 40% over next 12 months

## REAL GDP (QOQ SAAR, %)

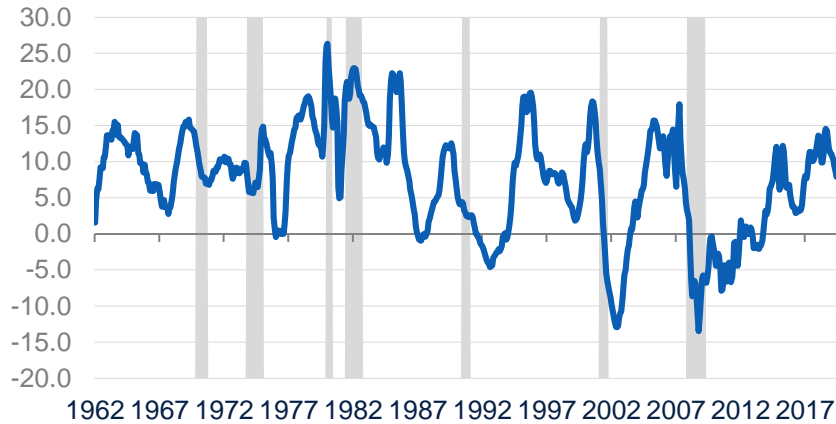


## PROBABILITY OF RECESSION (%)

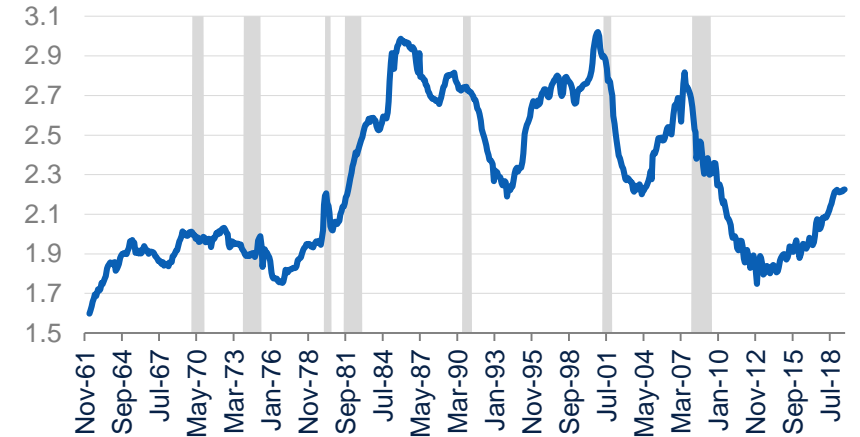


# Consumer credit cycle: Consumer financial burden easing on account of lower rates while bank standards tighten

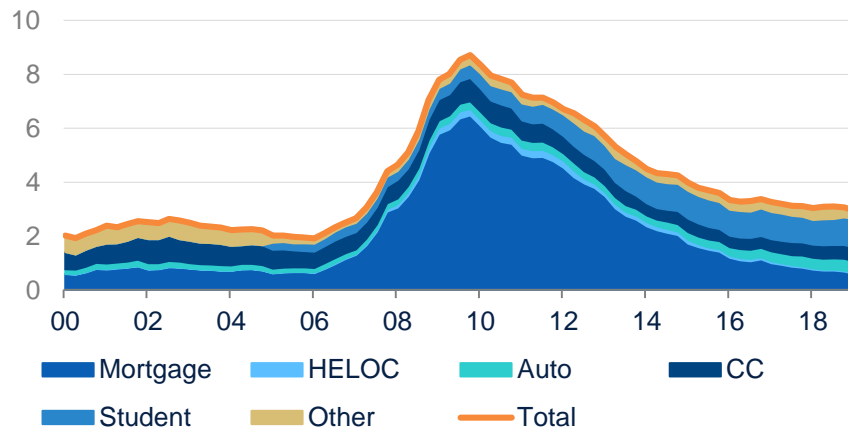
**PERSONAL INTEREST EXPENSE**  
(YEAR-OVER-YEAR %)



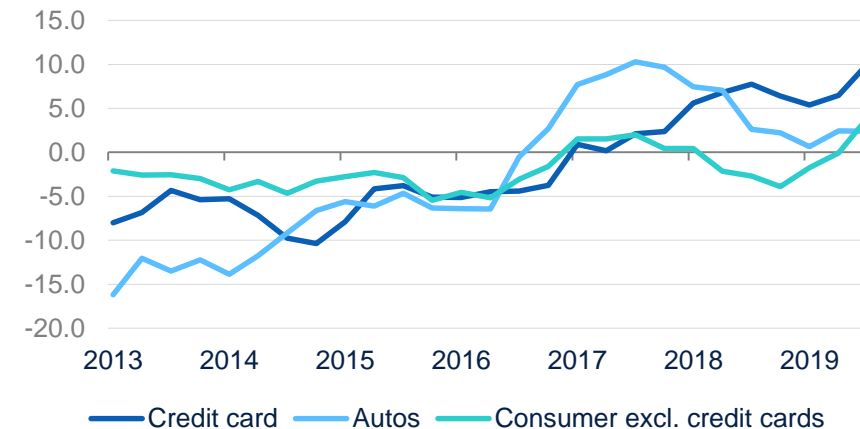
**PERSONAL INTEREST EXPENSE TO DISP. INCOME (RATIO, %)**



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



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

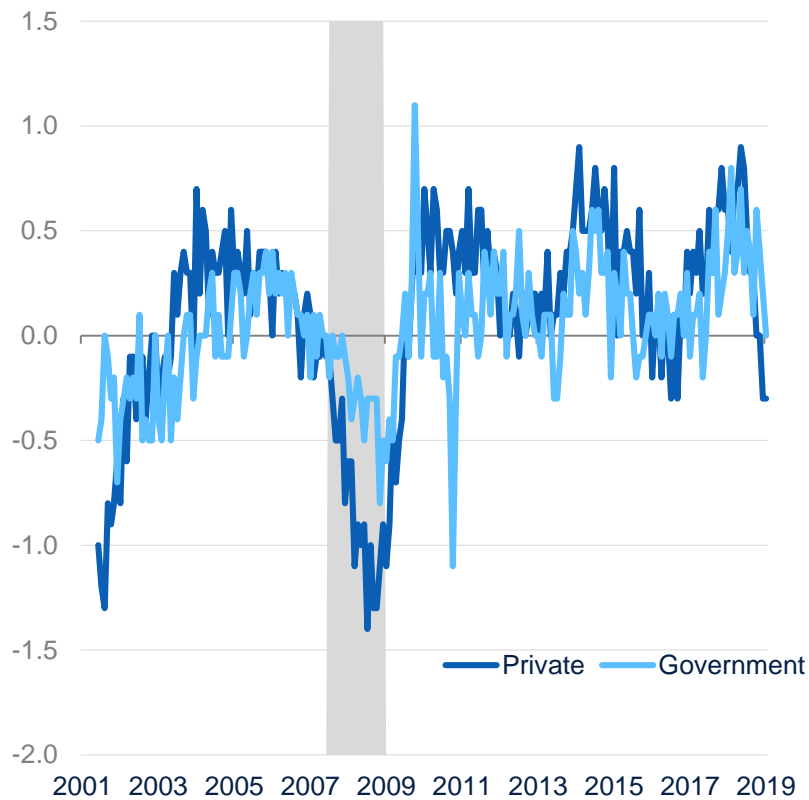


## Labor Market

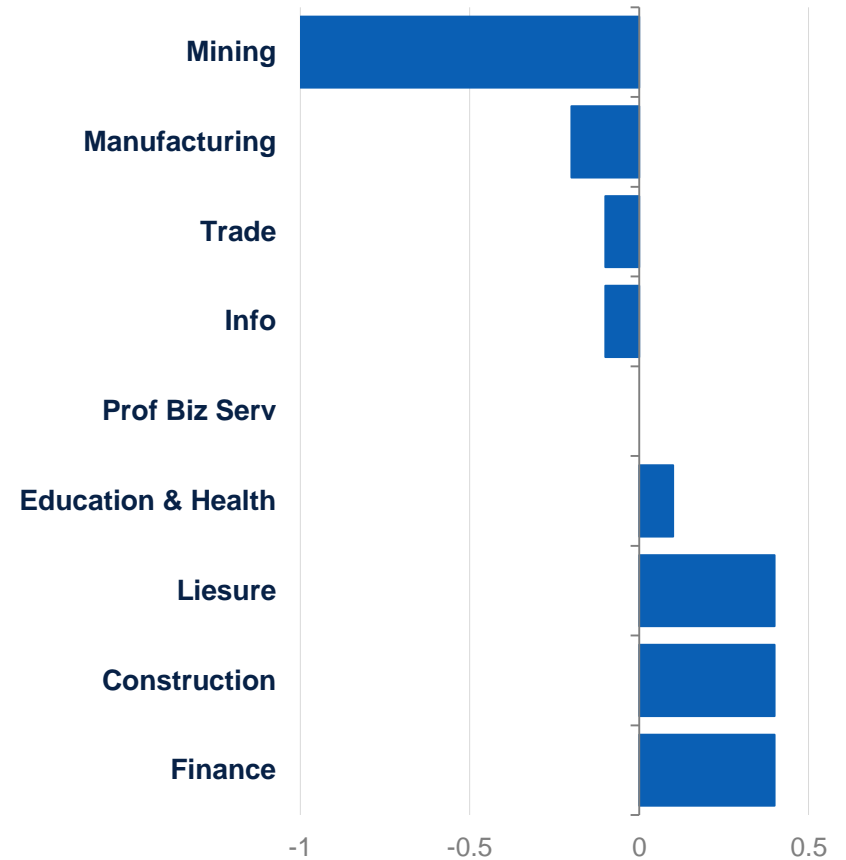
- In September, the labor market added 136,000 jobs after moderate growth in August (168,000)
- Solid job gains in healthcare (39K), professional and business services (34K), government (22K), and transportation and warehousing (16K). In contrast, retail trade shed 11K jobs, continuing the downward trend in employment that began in February
- The unemployment rate (UR) dropped to 3.5%
- Labor force participation rate and the employment-population ratio were unchanged at 63.2% and 61%, respectively
- Baseline assumes modest declines in UR going forward. Average monthly job growth to slow to 157K this year, from 223K in 2018

# Labor market: Growing signs of sectoral frictions in the labor market

**JOB OPENINGS RATE**  
(YEAR-OVER-YEAR, PP)

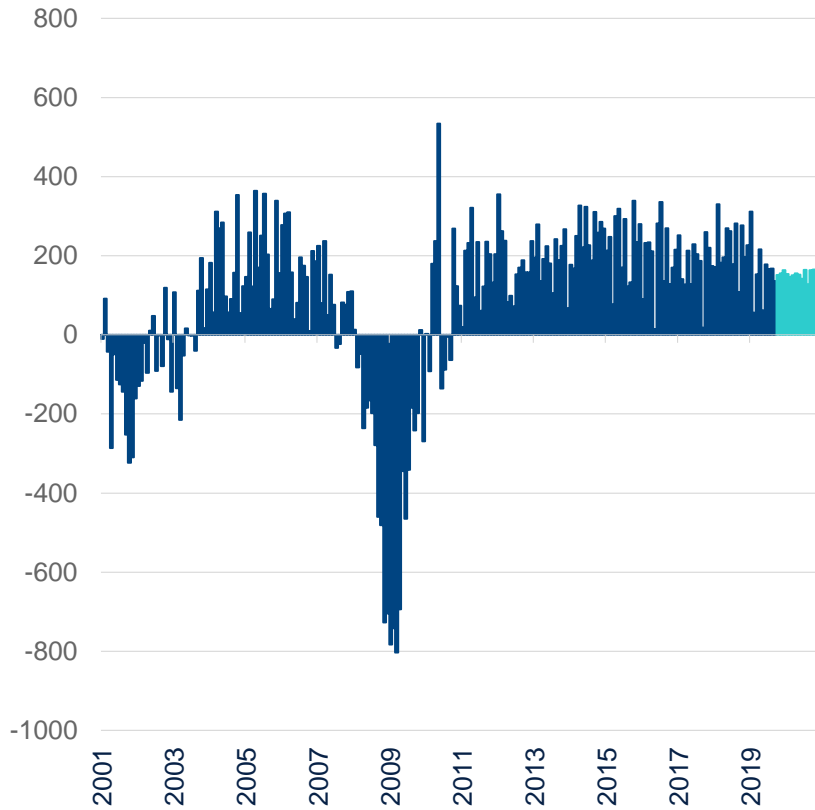


**QUITS RATE**  
(CHANGE SINCE MARCH 2019, PP)



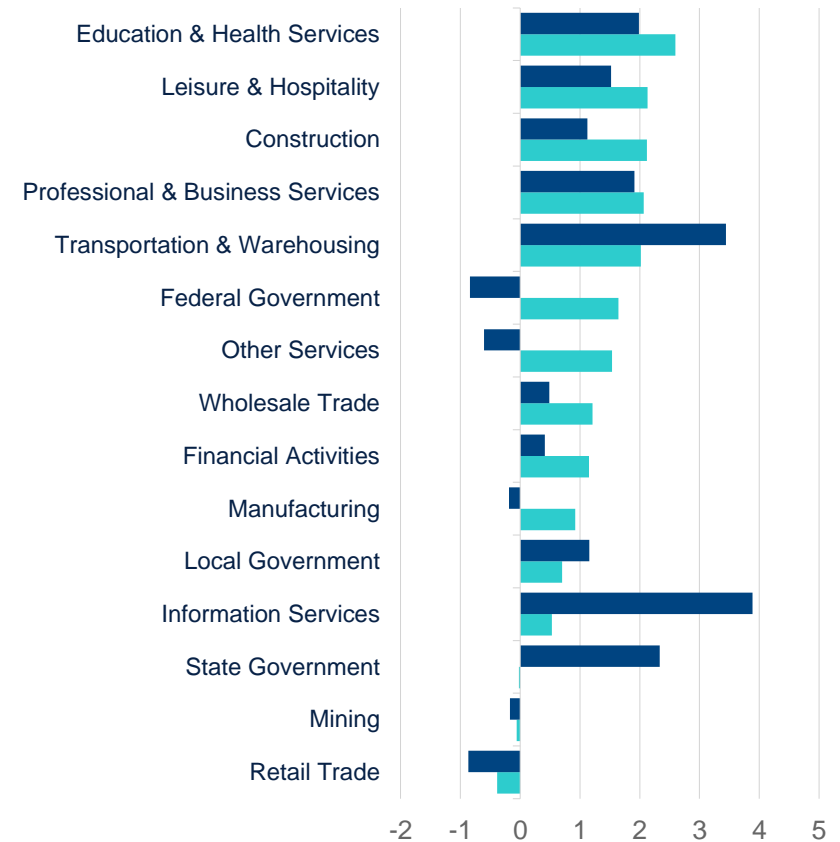
# Labor market: Moderate job growth to continue in 4Q19

## NONFARM PAYROLLS (MONTHLY CHANGE, K)



■ Actual ■ Forecast

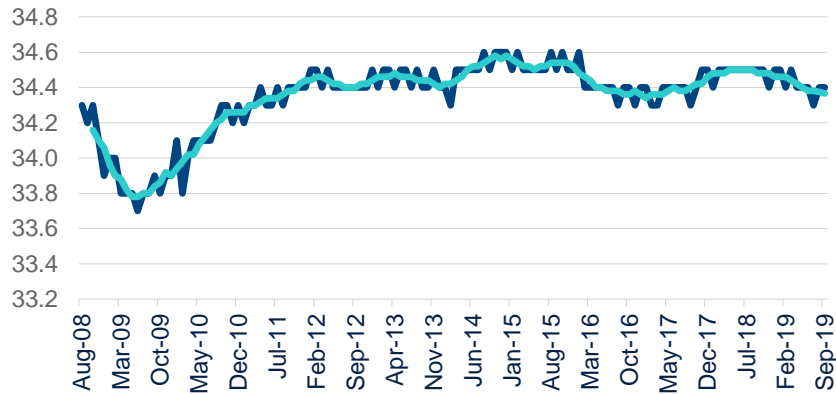
## INDUSTRY EMPLOYMENT (ANNUALIZED % CHANGE)



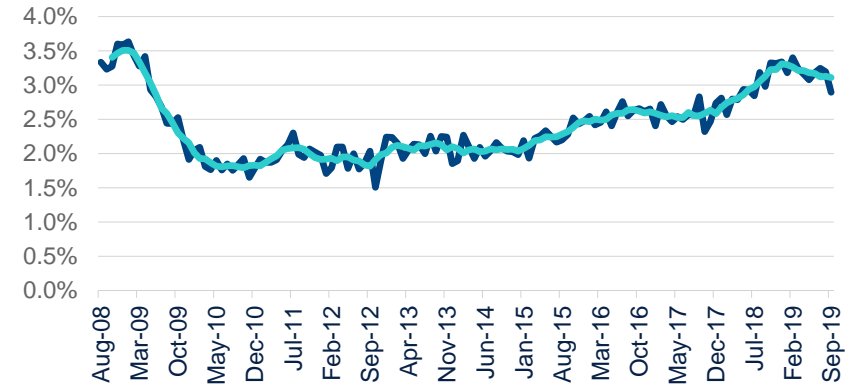
■ Monthly ■ Year-over-year

# Labor market: Measures of prime age engagement continue to improve

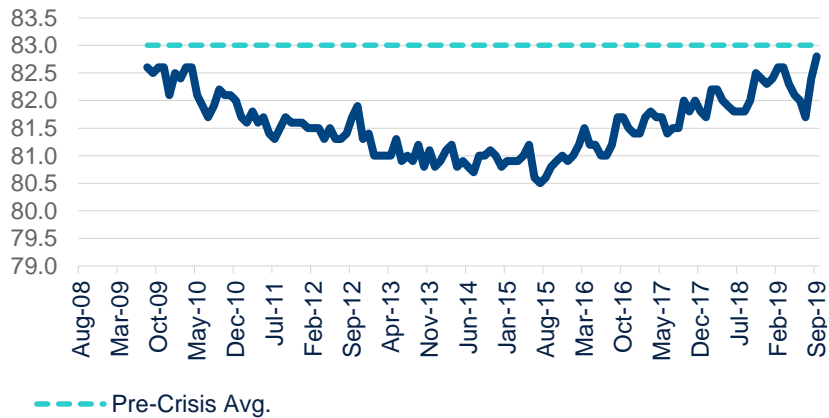
## AVERAGE WEEKLY HOURS (NUMBER & 5MCMA)



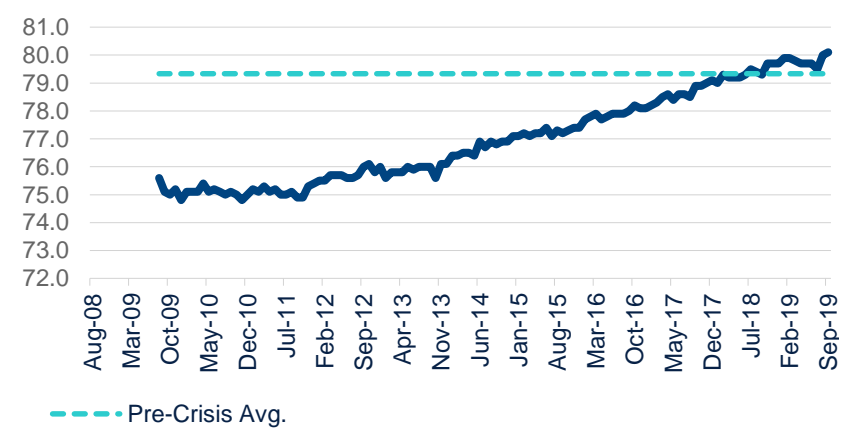
## AVERAGE HOURLY EARNINGS (YOY% & 5MCMA)



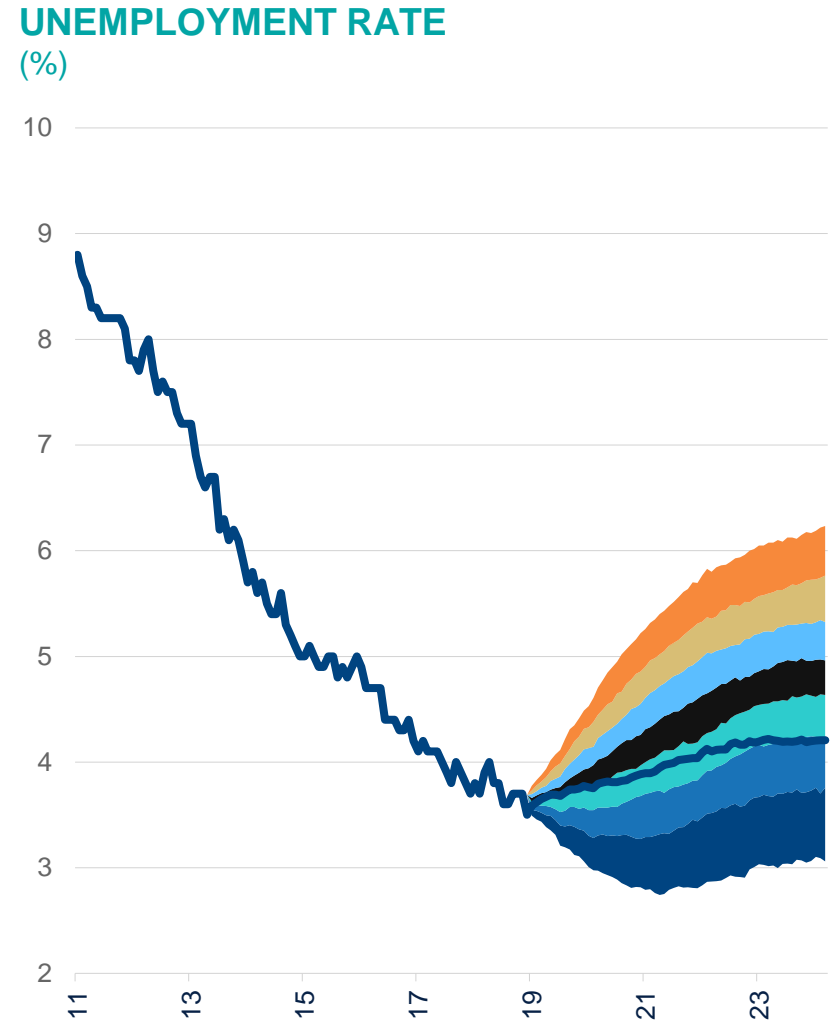
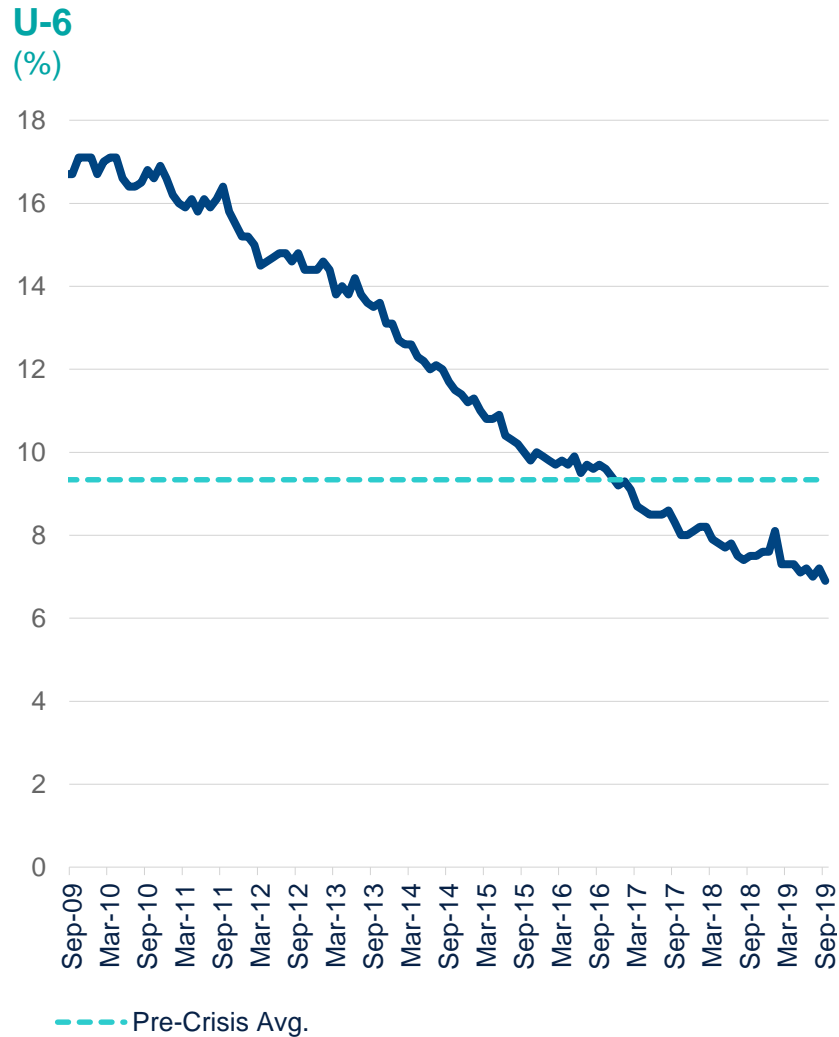
## PRIME AGE LABOR FORCE PARTICIPATION (%)



## PRIME AGE EMPLOYMENT-TO-POPULATION (%)



# Labor market: UR remains at 50-year lows at 3.5%



Source: BBVA Research & BLS

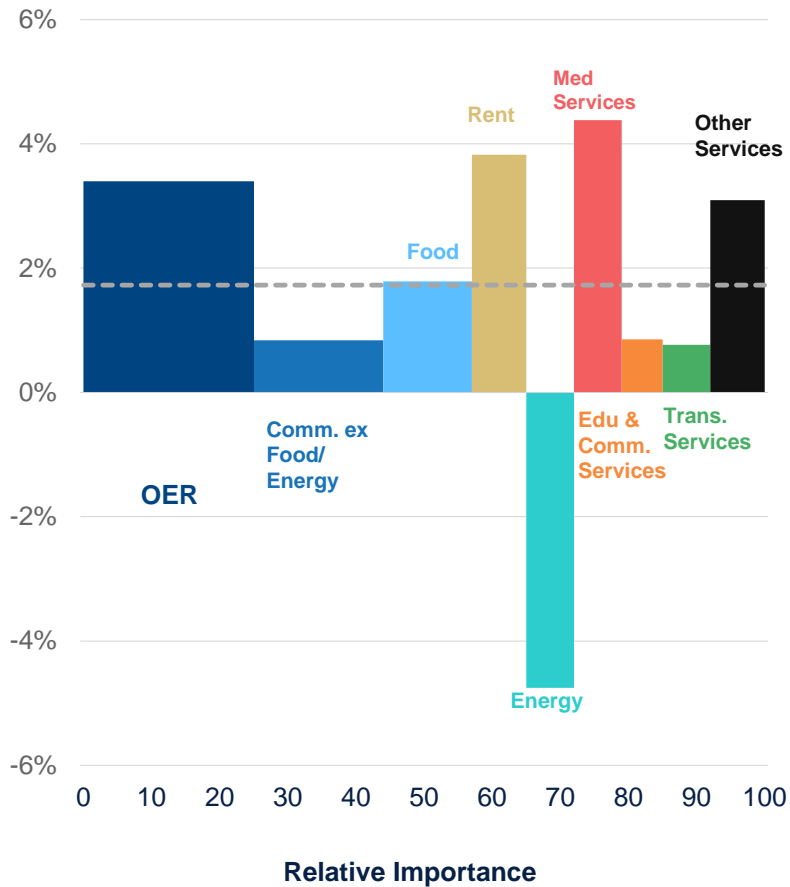
# Inflation

- Headline CPI was unchanged in September, following a 0.1% increase in August
- On a year-over-year basis, headline CPI increased 1.7% while core CPI rose 2.4%
- Gasoline prices fell 2.4% in September
- Core services remained solid; shelter, medical care and transportation service increased 0.3%, 0.4% and 0.3%, respectively
- Downside risks to inflation continue to abate, but market-based inflation expectations remain subdued
- Baseline assumes average headline CPI will be 1.8% in 2019, before rebounding to 2.0% in 2020

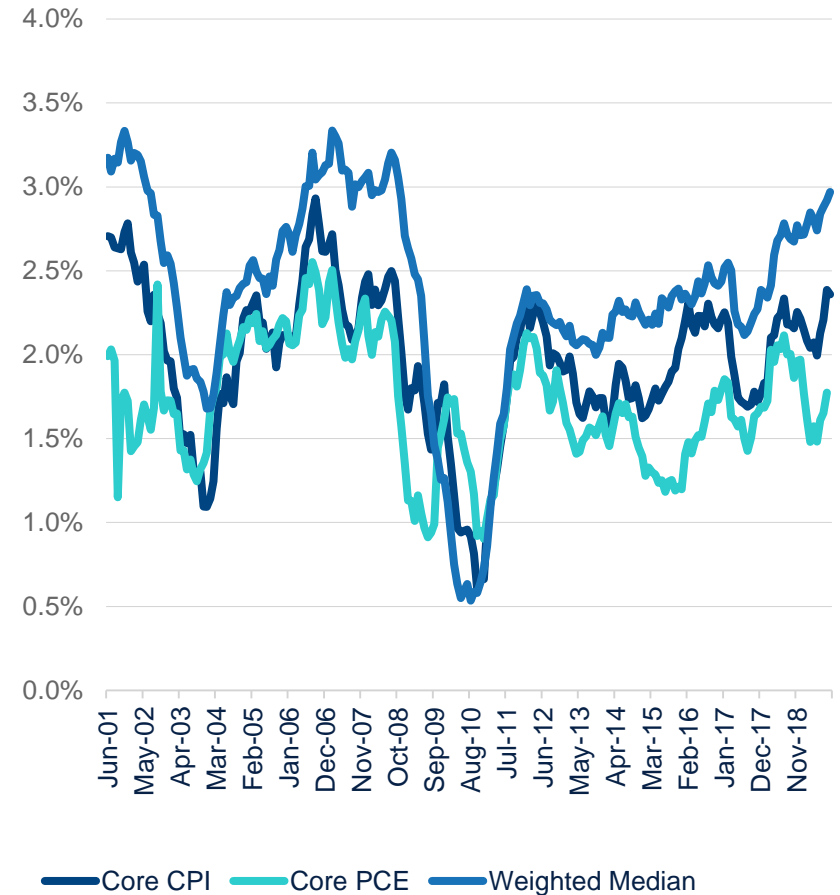


# Inflation: Core services support rebound in inflation

## CONSUMER PRICE INFLATION (12M CHANGE)



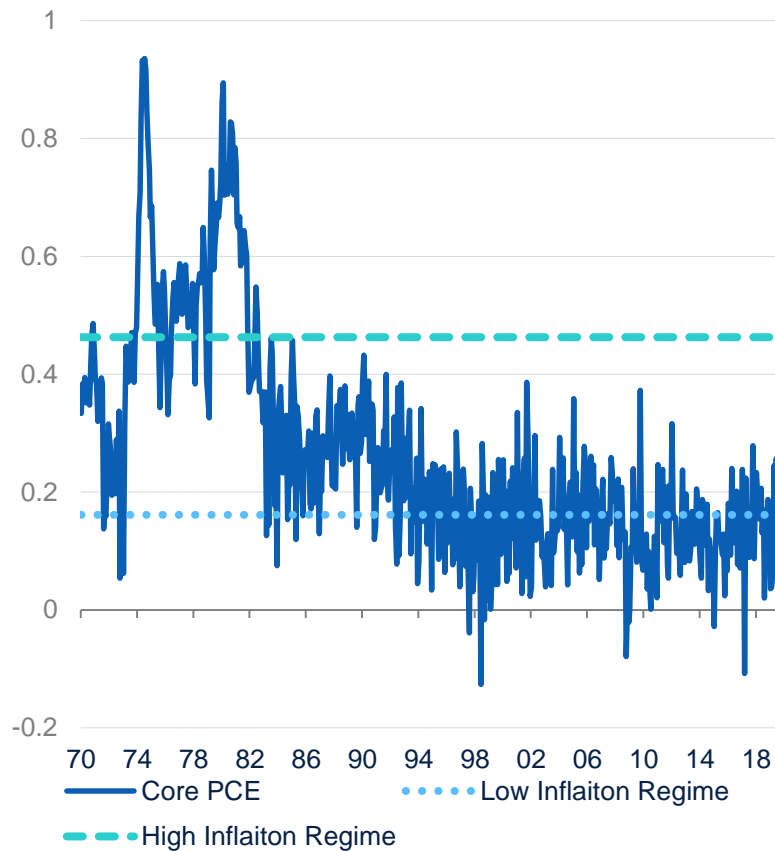
## CORE INFLATION MEASURES (12M CHANGE, %)



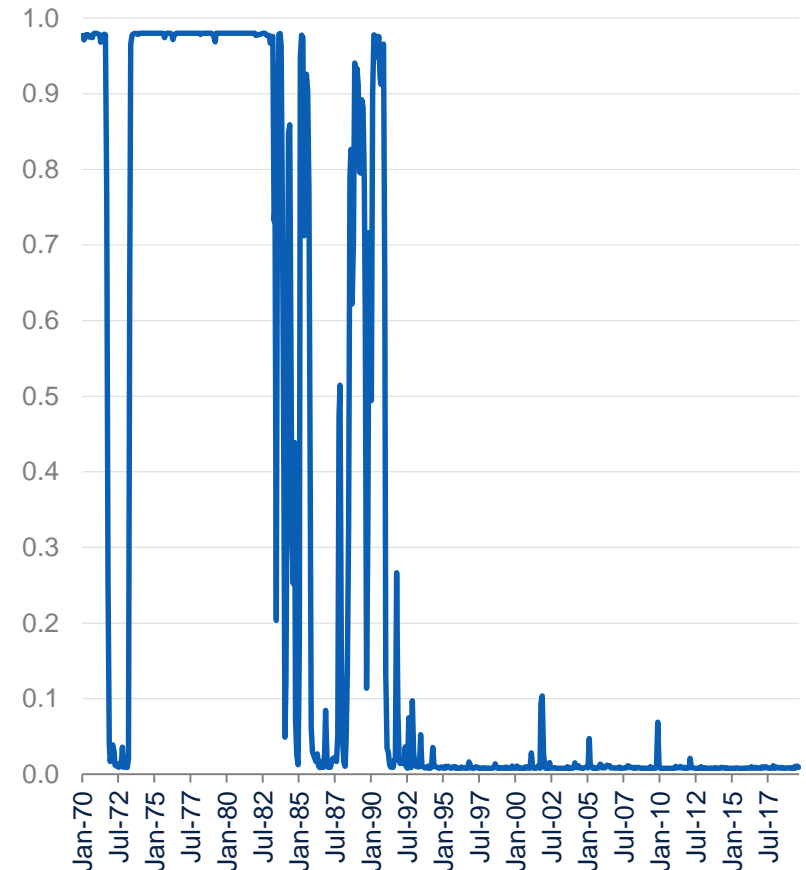
Source: BBVA Research, BLS & BEA

# Inflation: Risks to inflation outlook balanced

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

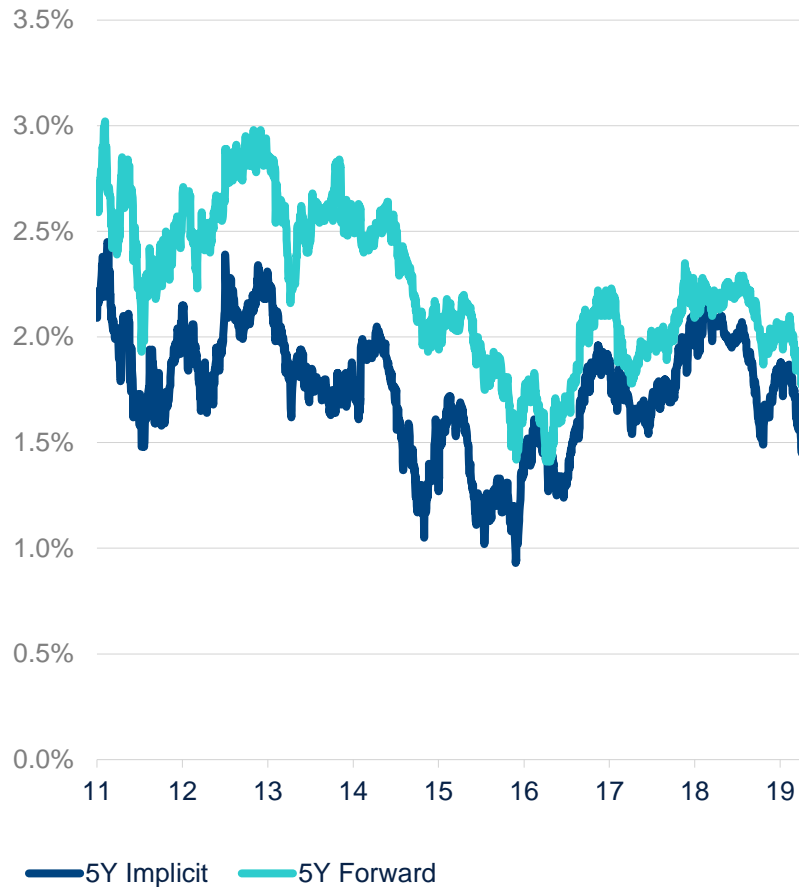


## INFLATION REGIME CHANGE PROBABILITY (%)

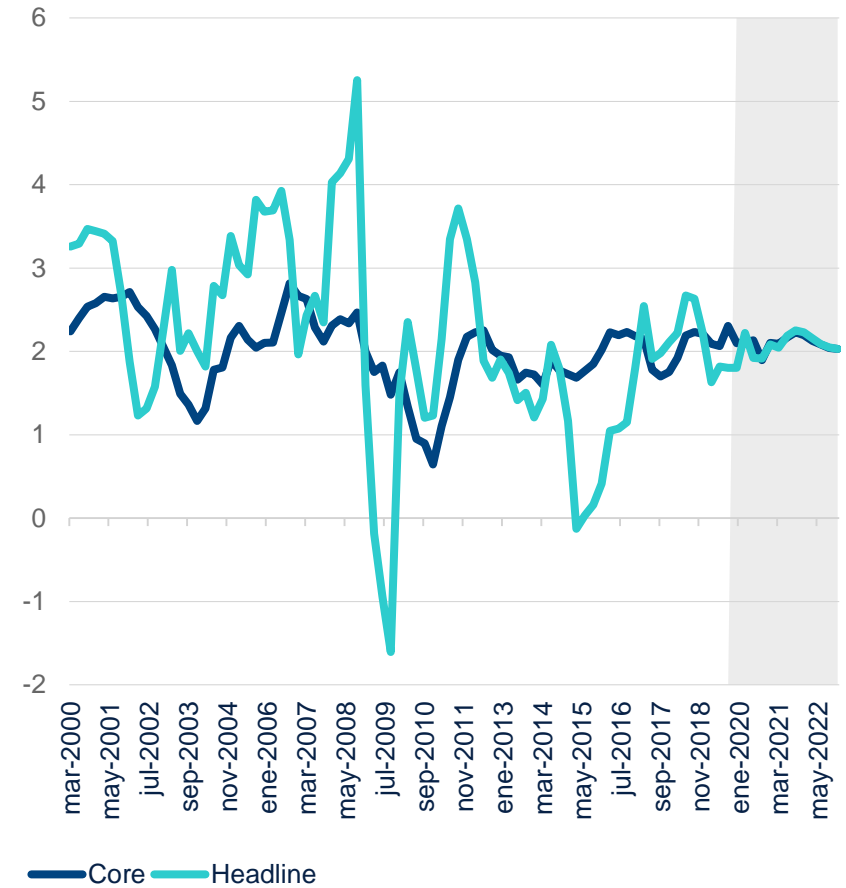


# Inflation: Convergence to 2% in 2020

## INFLATION EXPECTATIONS (%)



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



## Monetary Policy: Federal Reserve

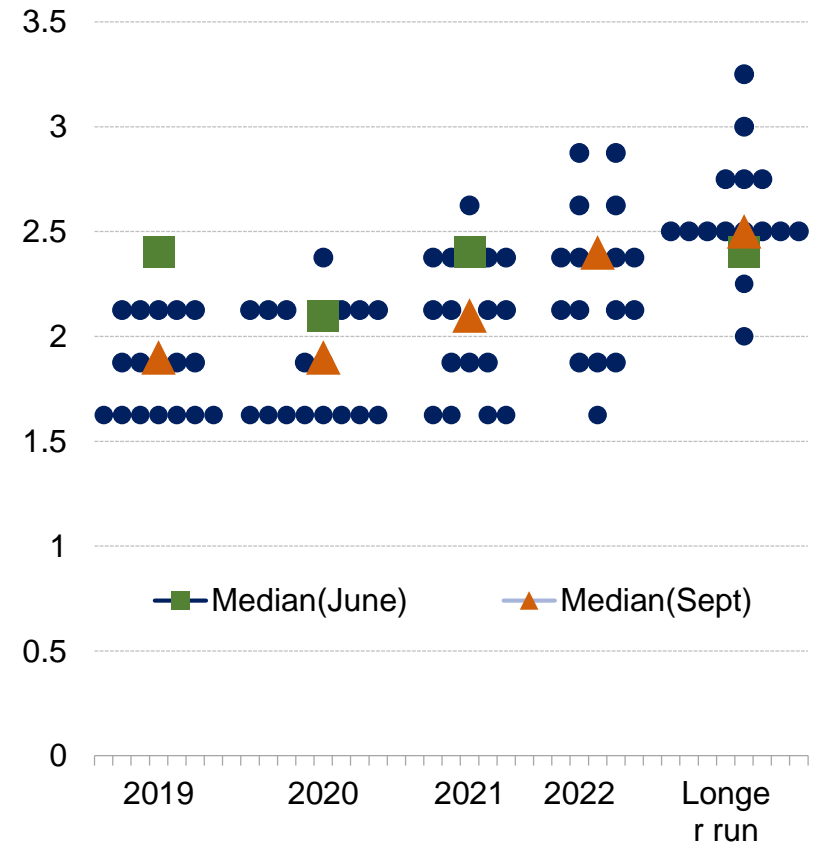
- At the September's meeting, the FOMC lowered interest rates by 25bp for the second time since 2007
- Trade policy uncertainty, global weakness and muted inflationary pressures motivate Fed officials for continuing with the “mid-cycle” cuts
- Markets and largest FOMC faction supporting additional cut in 2019
- Our baseline assumes that after cutting rates in October by 25bp, and completing a “mid-cycle” adjustment in line with past experiences, the doves will be satisfied with the “fine-tuning” thus far, implying no additional rate cuts this year
- In an effort to disentangle the current efforts to replenish bank reserves with the stance of monetary policy, the committee will maintain its current balance sheet policy announced over the intermeeting period (\$60bn T-bill purchases and “organic growth in assets)

# Fed: Divergent opinions on future path of monetary policy

## FOMC SUMMARY OF ECONOMIC PROJECTIONS (%)

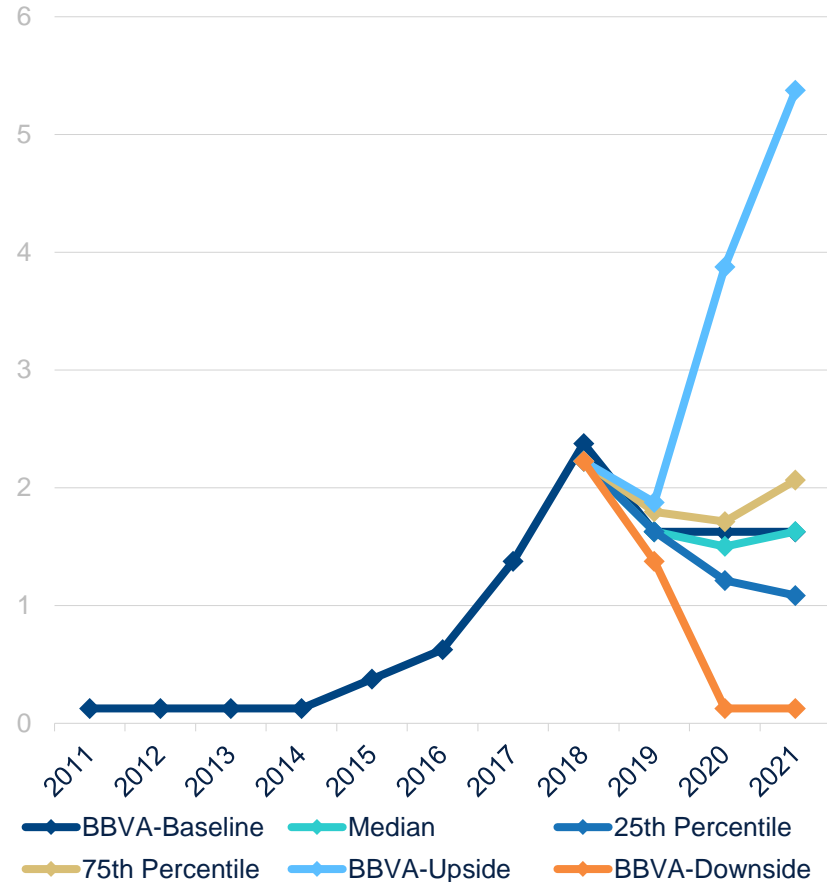
| FOMC Median Estimates     | 2019 | 2020 | 2021 | 2022 | Long-run |
|---------------------------|------|------|------|------|----------|
| <b>Change in real GDP</b> | 2.2  | 2.0  | 1.9  | 1.8  | 1.9      |
| June projection           | 2.1  | 2.0  | 1.8  |      | 1.9      |
| <b>Unemployment rate</b>  | 3.7  | 3.7  | 3.8  | 3.9  | 4.2      |
| June projection           | 3.6  | 3.7  | 3.8  |      | 4.2      |
| <b>PCE inflation</b>      | 1.5  | 1.9  | 2.0  | 2.0  | 2.0      |
| June projection           | 1.5  | 1.9  | 2.0  |      | 2.0      |
| <b>Core PCE inflation</b> | 1.8  | 1.9  | 2.0  | 2.0  |          |
| June projection           | 1.8  | 1.9  | 2.0  |      |          |
| <b>Federal funds rate</b> | 1.9  | 1.9  | 2.1  | 2.4  | 2.5      |
| June projection           | 2.4  | 2.1  | 2.4  |      | 2.5      |

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

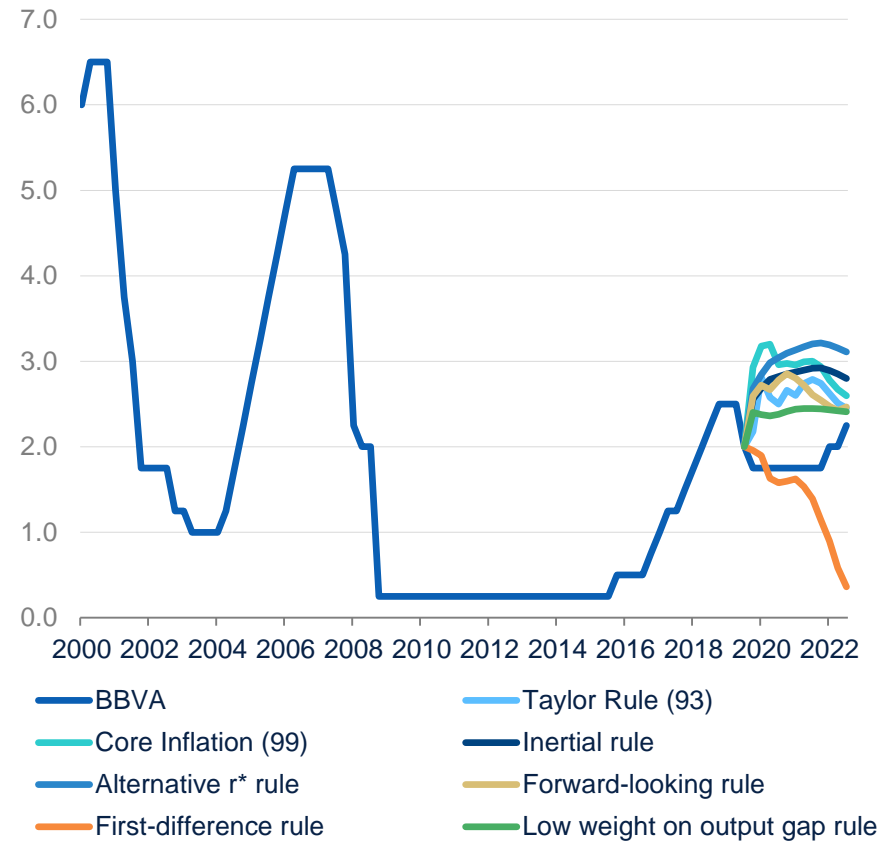


# Fed: Current path diverging from “rules-based” approach

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

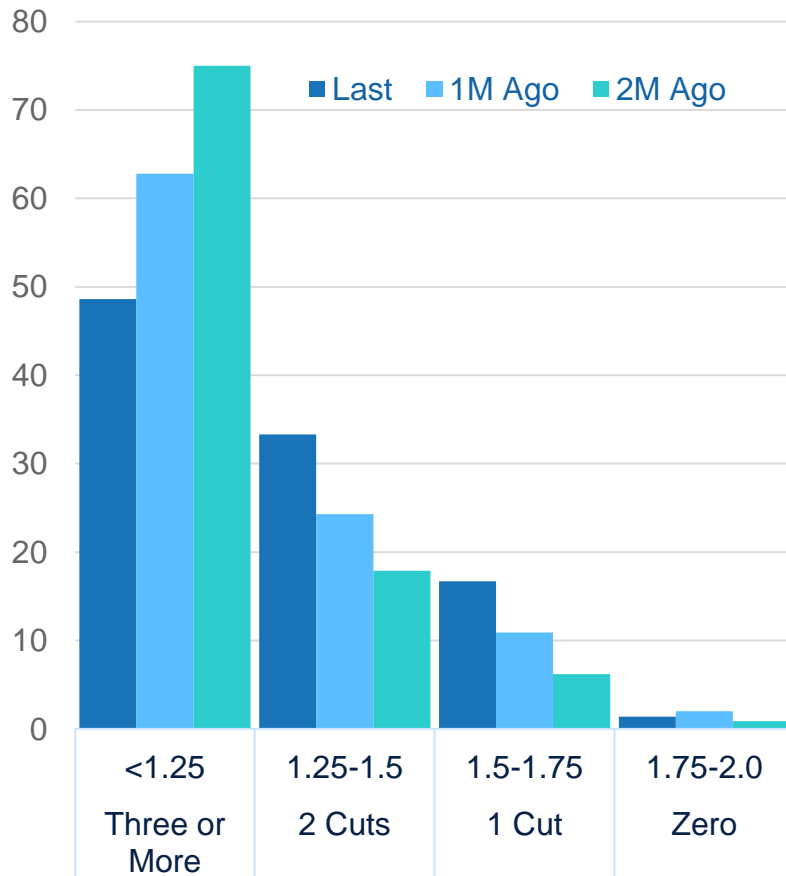


## MONETARY POLICY RULES OF FED FUNDS (% EOP, UPPER BOUND)

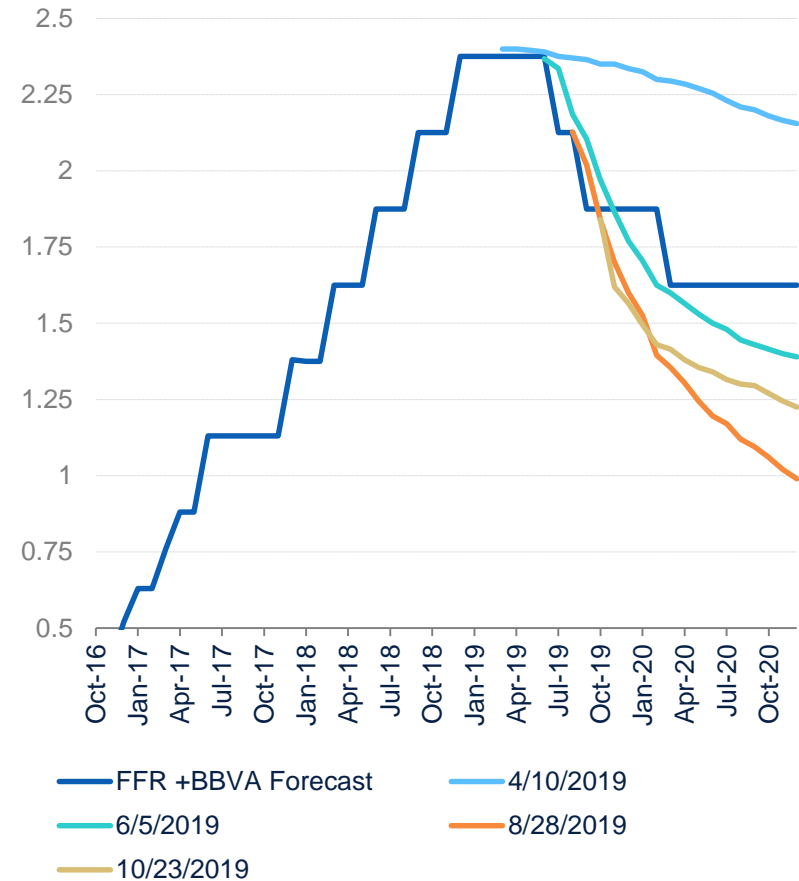


# Monetary policy: Markets discounting fewer rate cuts after October

**FED FUNDS IMPLIED PROBABILITY**  
(NUMBER OF RATE CUTS THROUGH 2020, %)

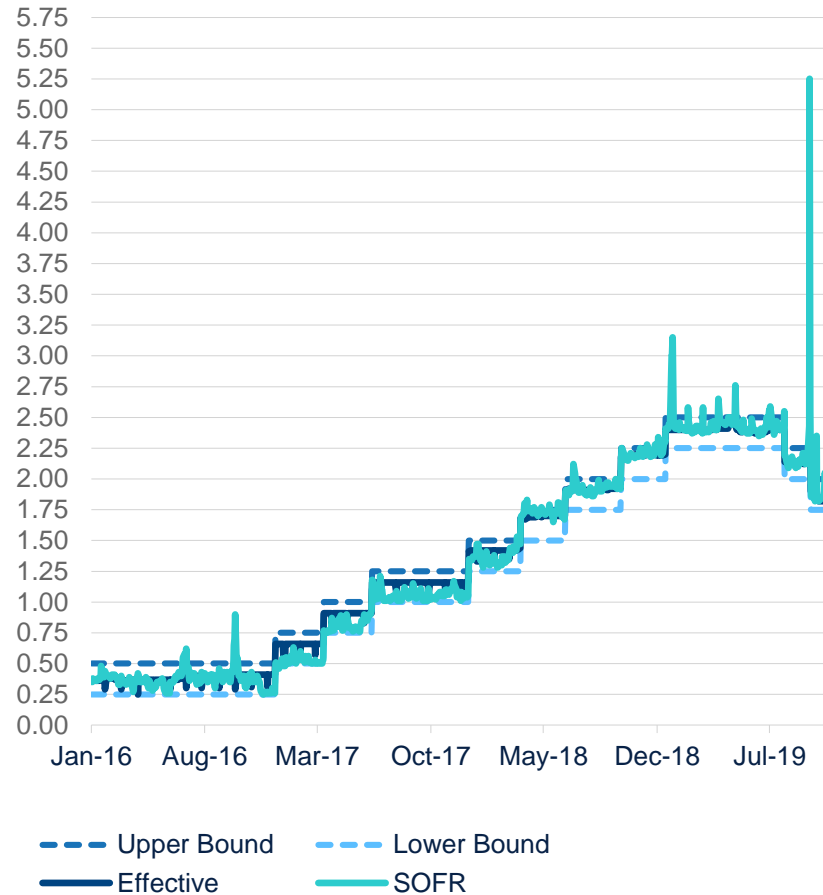


**FED FUNDS FUTURES & BBVA BASELINE**  
(%)

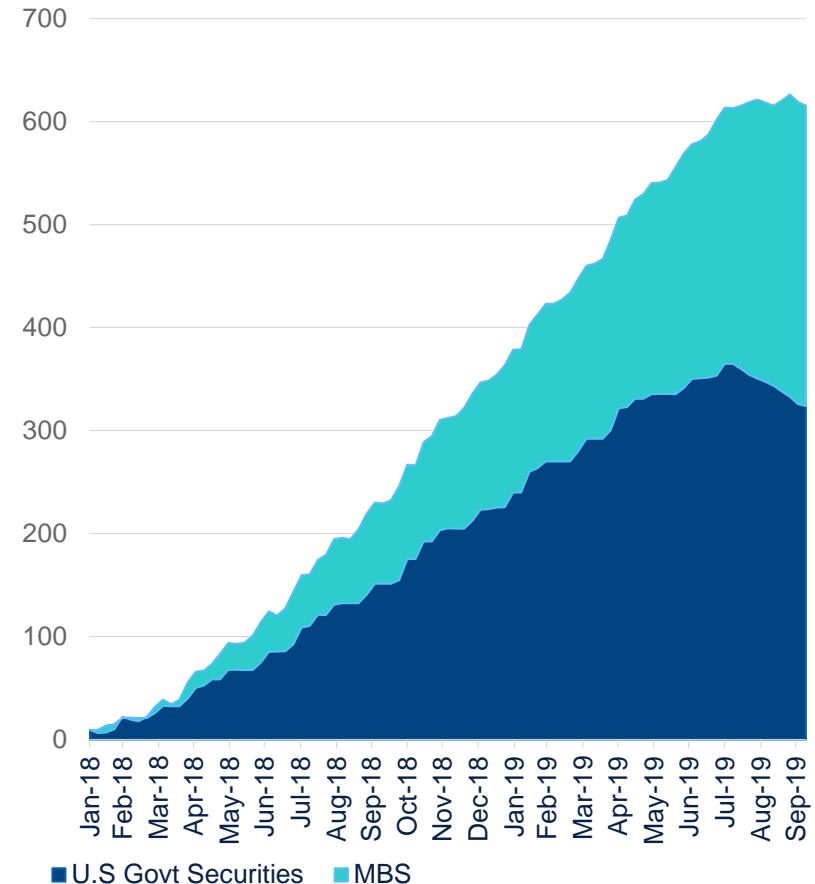


# Monetary policy: Fed trying to replenish bank reserves after scarcity pushed repo rates above target range

## FED FUNDS & REPO RATES (%)



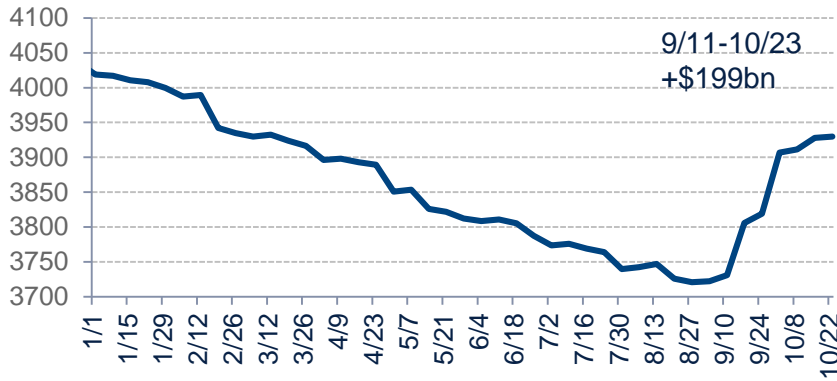
## BALANCE SHEET ATTRITION (US\$BN, CUMULATIVE)



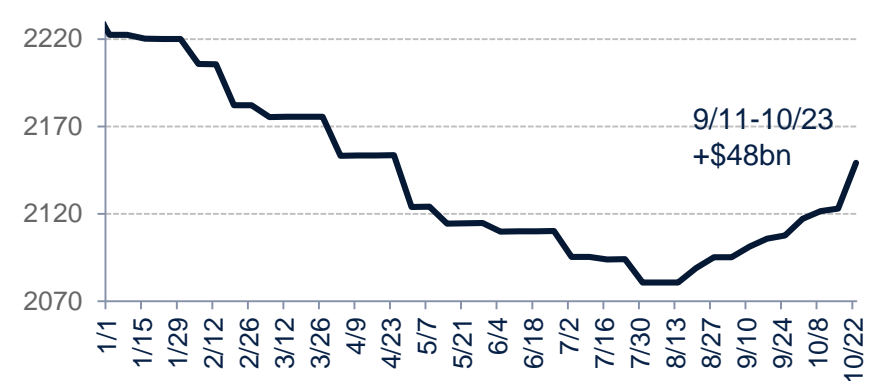


# Monetary policy: “Organic” growth implies \$30-\$50bn monthly gross Treasury purchases

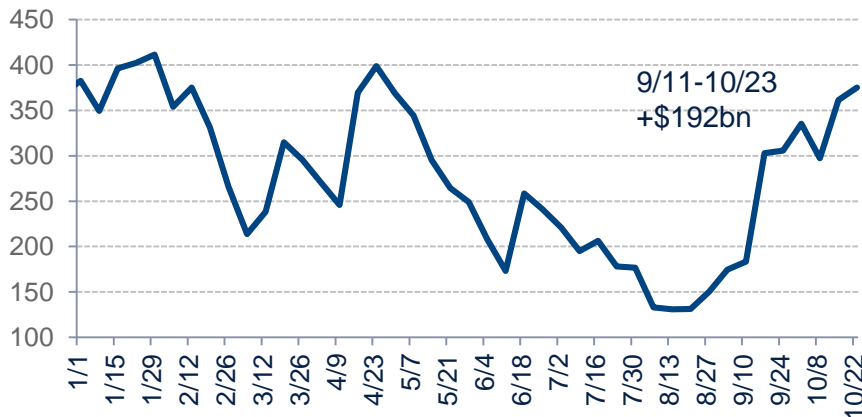
**TOTAL ASSETS**  
(US\$BN)



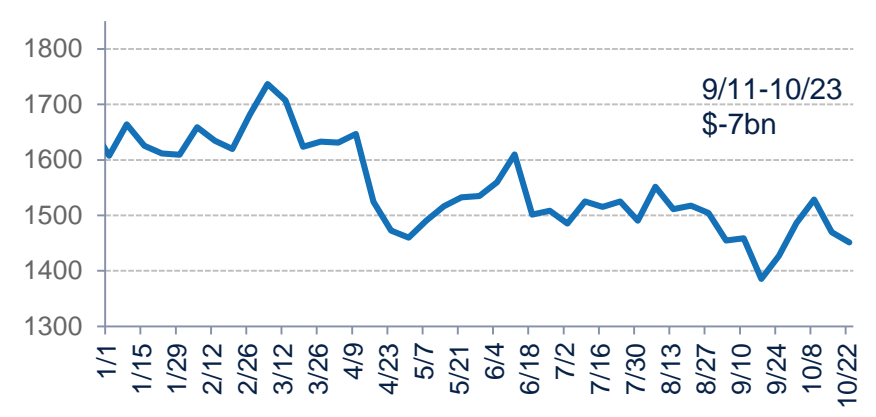
**TREASURIES HELD OUTRIGHT**  
(US\$BN)



**U.S. TREASURY GENERAL ACCOUNT**  
(US\$BN)



**RESERVE BALANCES**  
(US\$BN)



## Interest Rates

- 10-yr Treasury rebounds to 1.7%, 2-yr Treasury largely unchanged over the month at 1.5%
- Risks remain skewed to the downside given weaker global growth prospects and elevated uncertainty
- Term premium off historic lows, but remains depressed given increased targeted asset purchases (Fed & ECB), global risk aversion and downtrodden near-term growth prospects
- Short-term rates realign with benchmarks after liquidity event squeezed reserves
- Yield curve inversion eases somewhat, but should persist throughout the year
- Baseline assumes 10-yr Treasury yields reach 1.6% by year-end

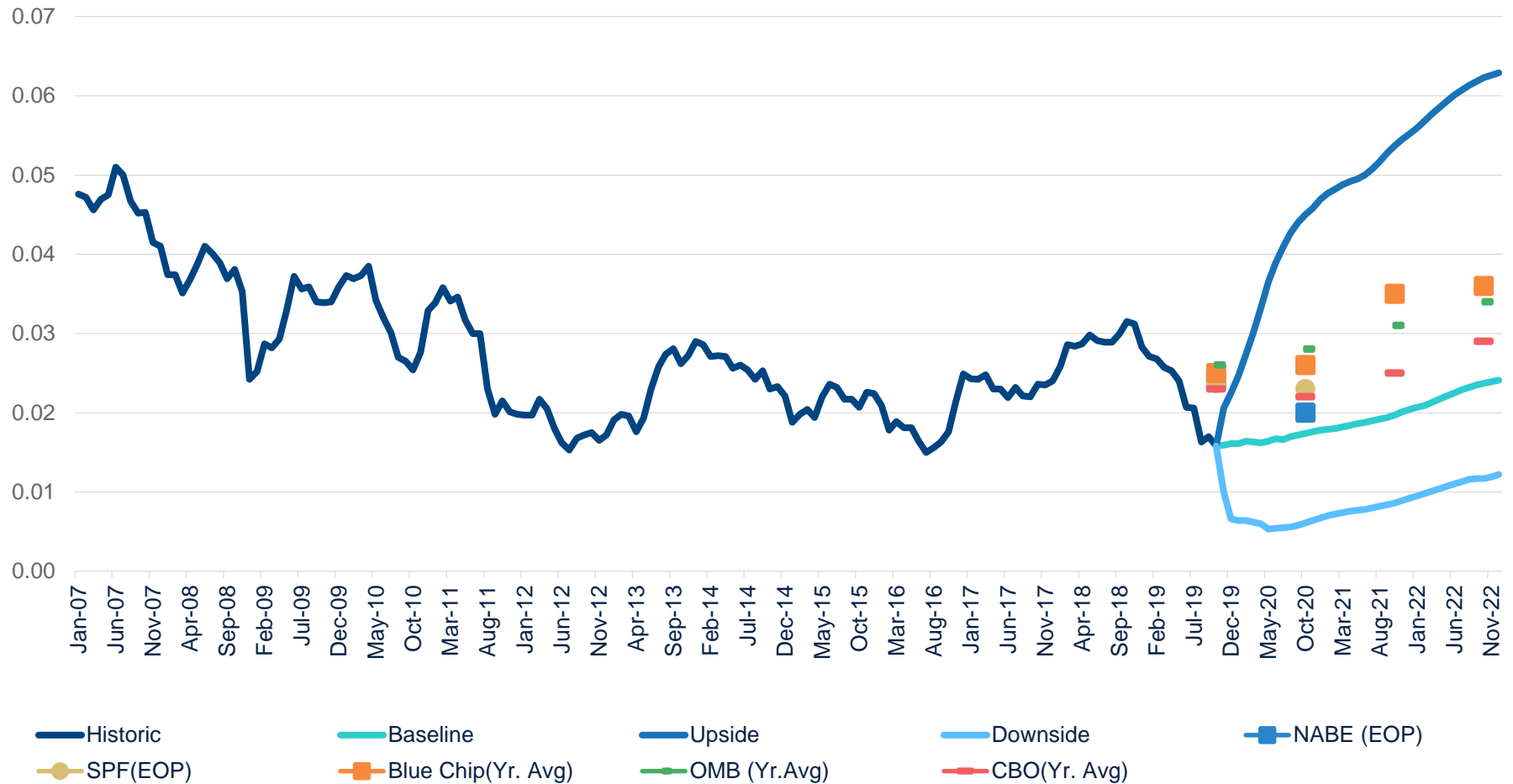
# Interest rates: Stable inflation expectations and less negative term premium push 10-year yields up

## 10-YEAR TREASURY YIELD DECOMPOSITION (%)



# Interest rates: Risks to 10-year skewed to the downside

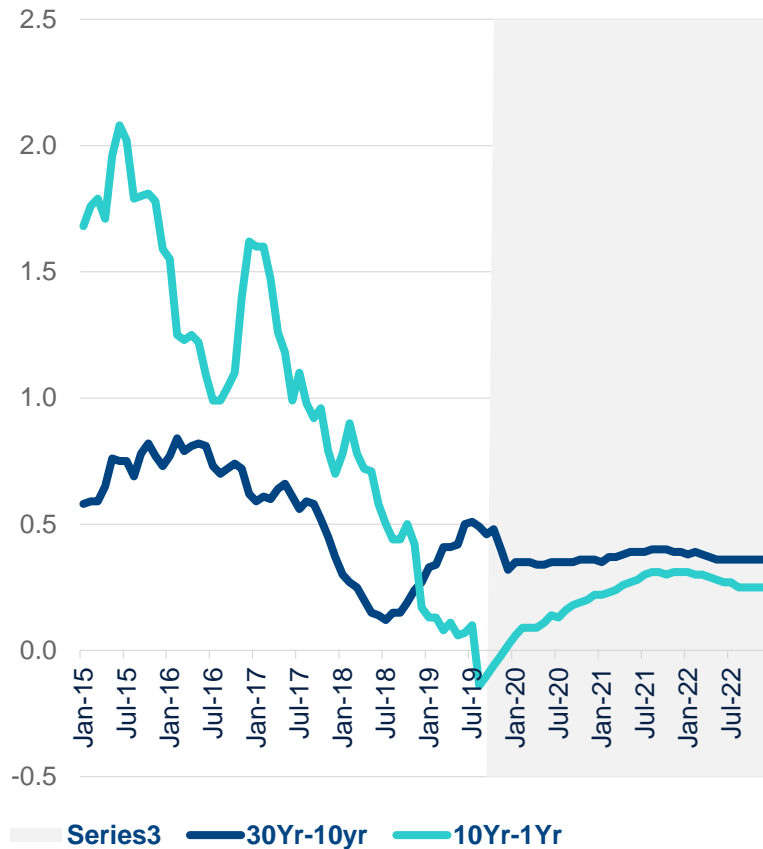
## 10-YEAR TREASURY YIELD (%)



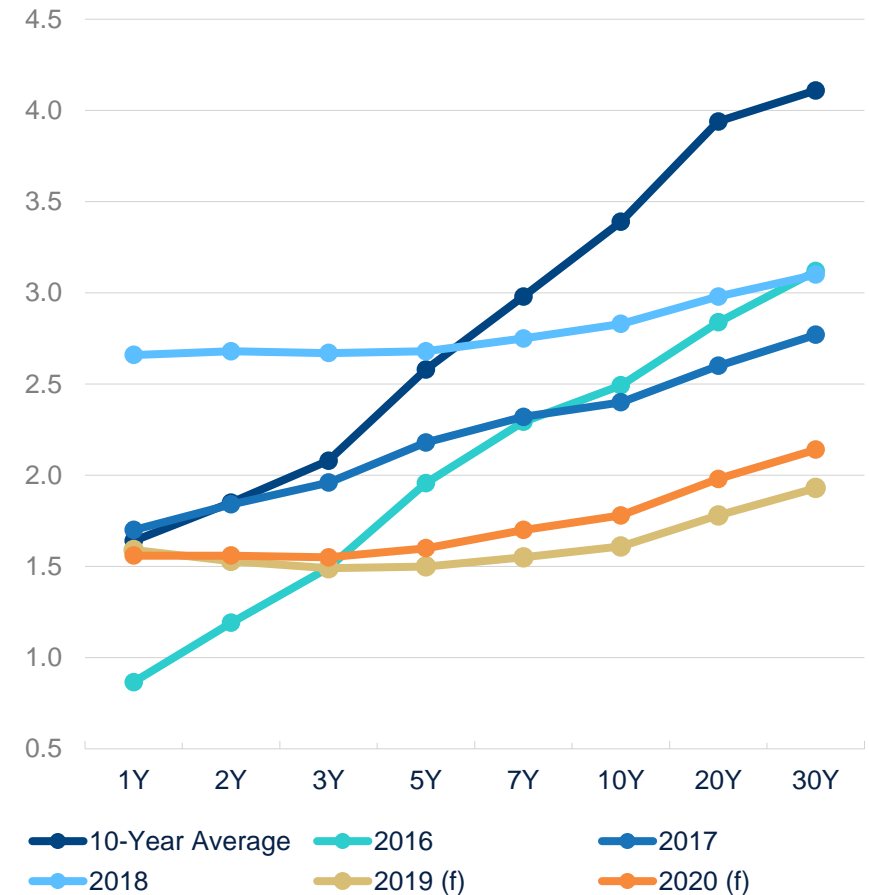
Source: BBVA Research, ACM & Haver Analytics

# Interest rates: Inverted or extremely flat yield curve through remainder of 4Q19 and 1H20

## YIELD CURVE SLOPE (BP)



## YIELD CURVE (% EOP)

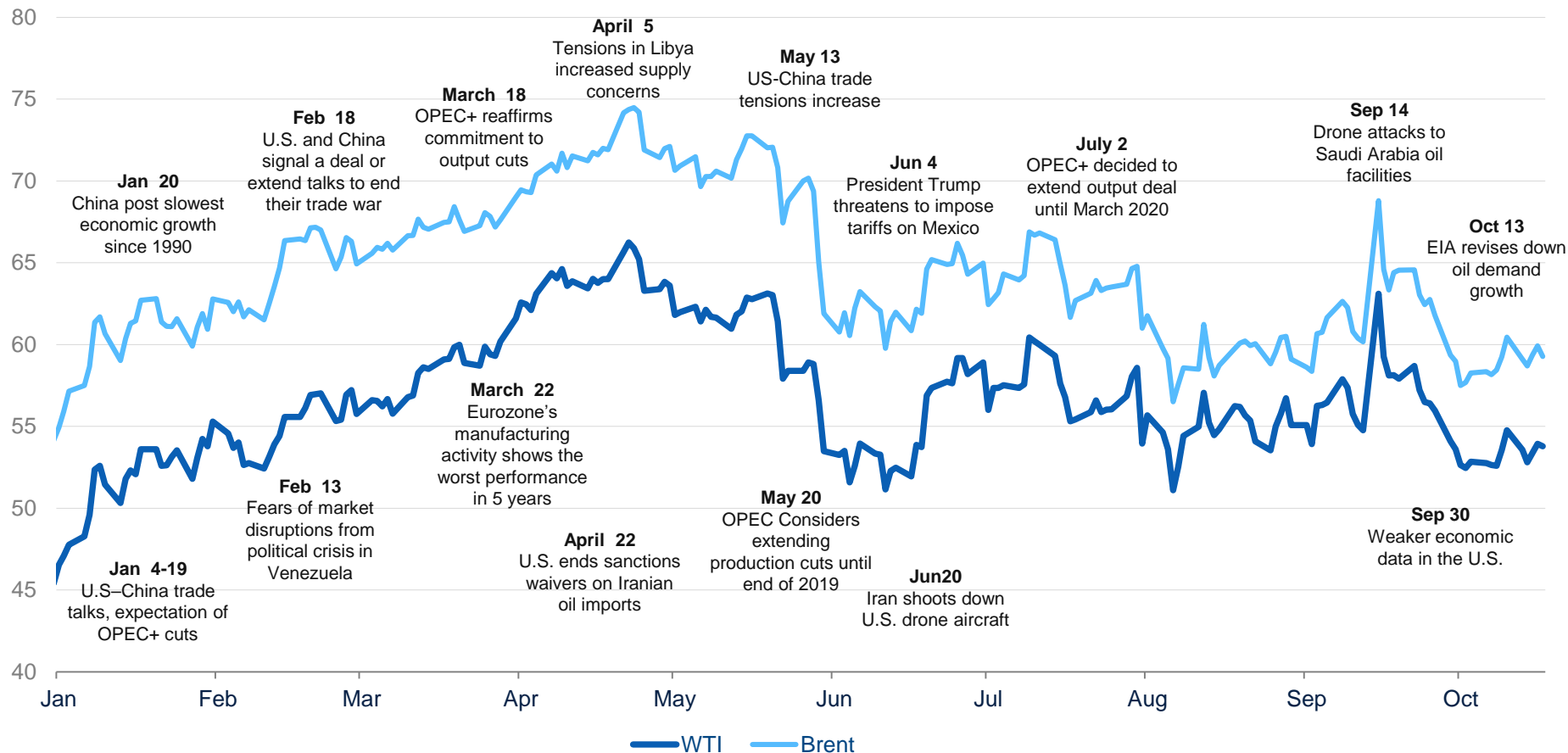


# Oil Prices Outlook

- OPEC+ extended the output deal until March 2020
- Global economic indicators continue deteriorating, implying slower oil demand
- Tensions in the Middle East, as well as trade negotiations between China and the U.S. are the main sources of uncertainty
- U.S oil production will expand further, albeit at a slower pace
- Our prospects for lower prices in 4Q19 and 2020 assume slower demand growth in a well-supplied market
- Long-term equilibrium prices around \$60/b
- Elevated uncertainty around long-term equilibrium: CAPEX, protectionism, transportation infrastructure, alternative energy sources, EM convergence, EVs, climate change, efficiency and technology

# Oil prices: Prospects of slower economic growth outweighed geopolitical tensions

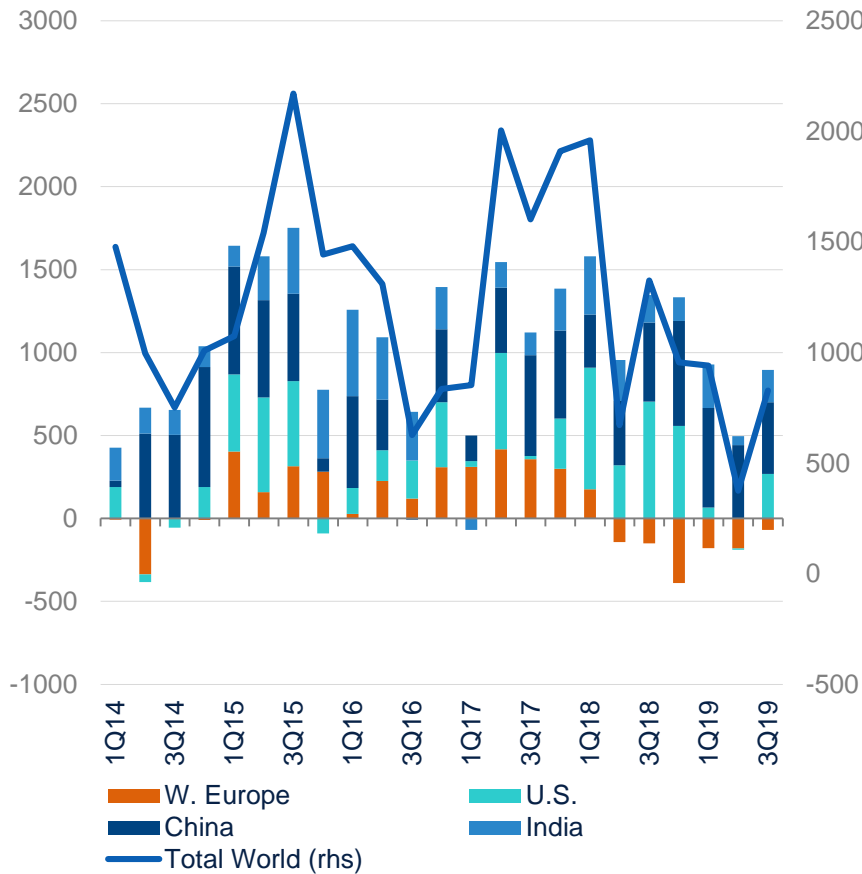
## CRUDE OIL PRICES 2019 (\$ PER BARREL)



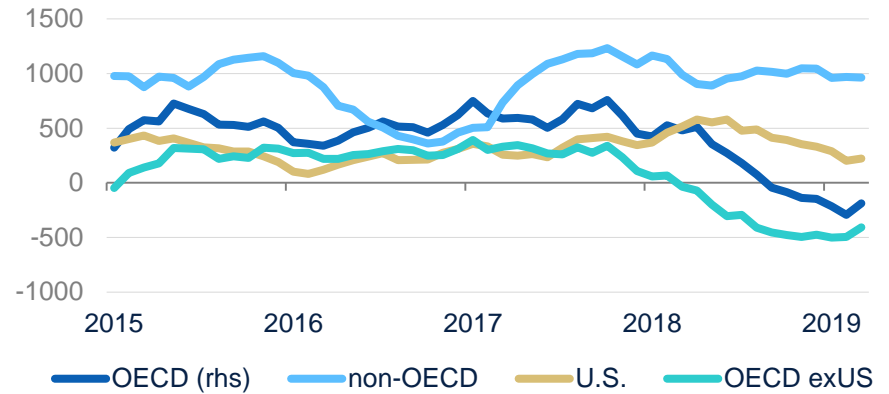
Source BBVA Research with data from Haver Analytics

# Oil prices: Demand has weakened following global economic trends

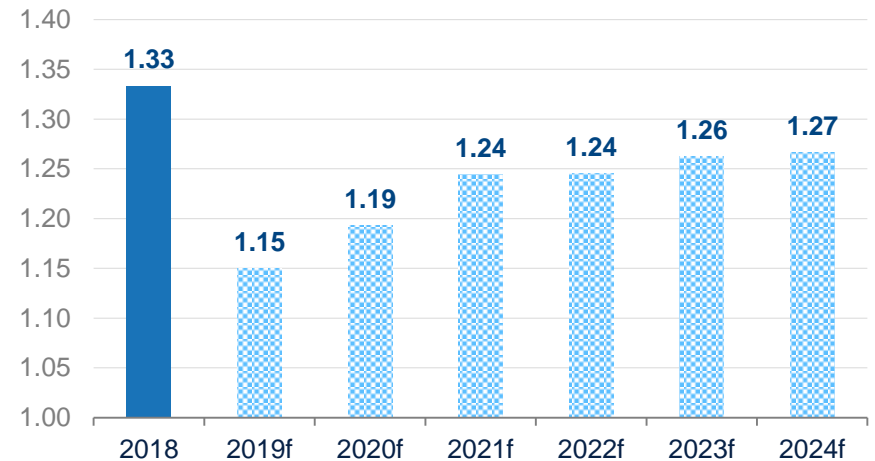
### OIL PRODUCT DEMAND: TOTAL WORLD (THOUSAND BARRELS PER DAY, YOY CHANGE)



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



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

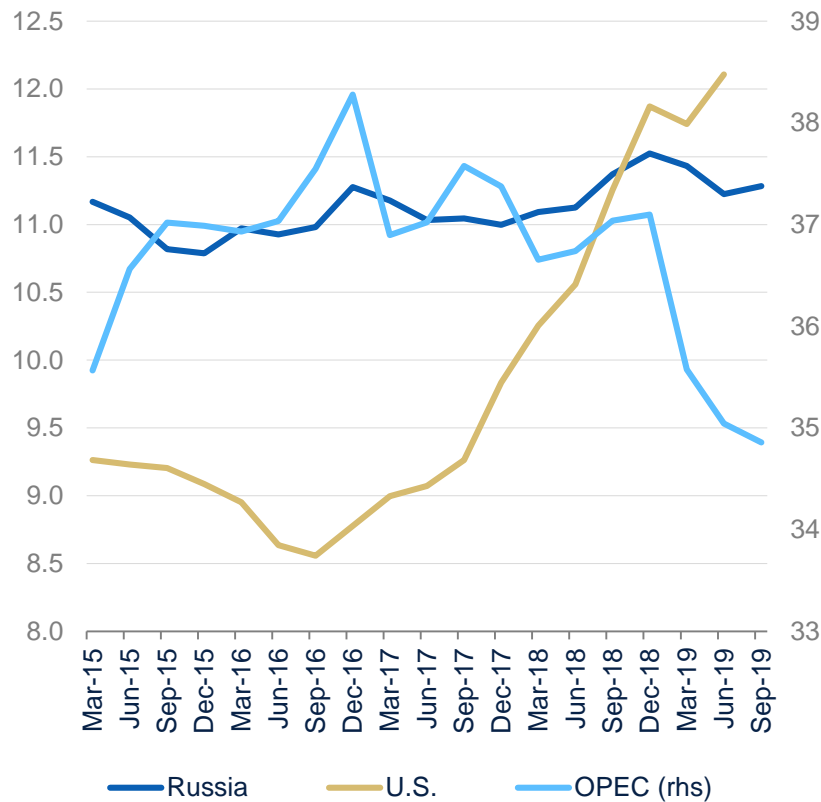


Source BBVA Research with data from Haver Analytics, Bloomberg and WEO

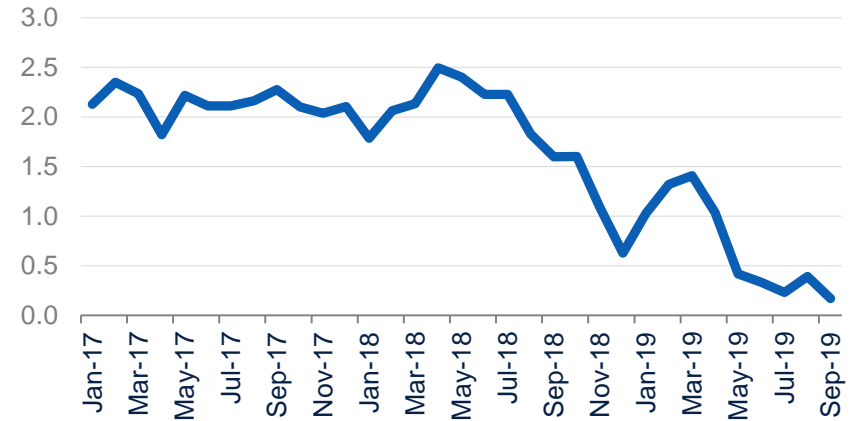


# Oil prices: Despite OPEC+ voluntary and non-voluntary adjustments, lower prices suggest there is no shortage of oil

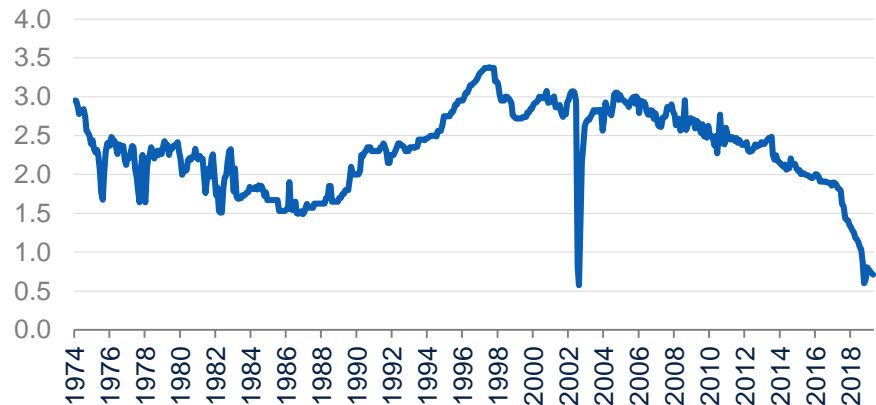
## CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



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



## VENEZUELA: CRUDE OIL PRODUCTION (MILLION BARRELS PER DAY)



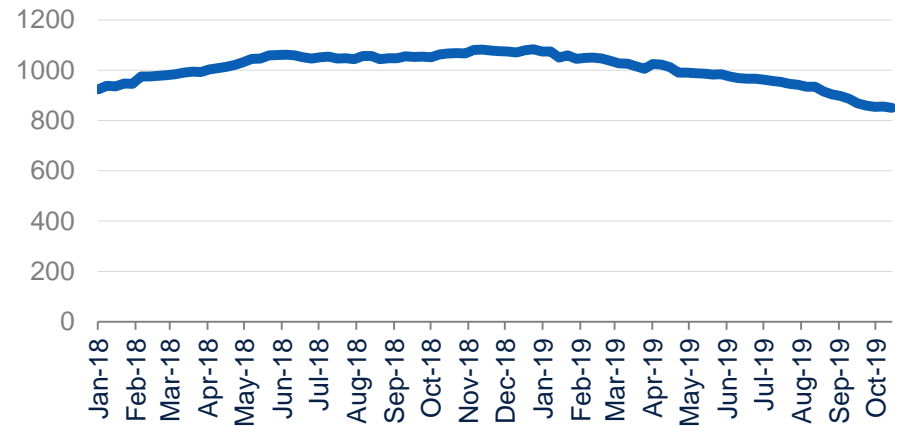
Source: BBVA Research, Haver Analytics, and Bloomberg

# U.S. shale production keeps growing, albeit at a slower pace

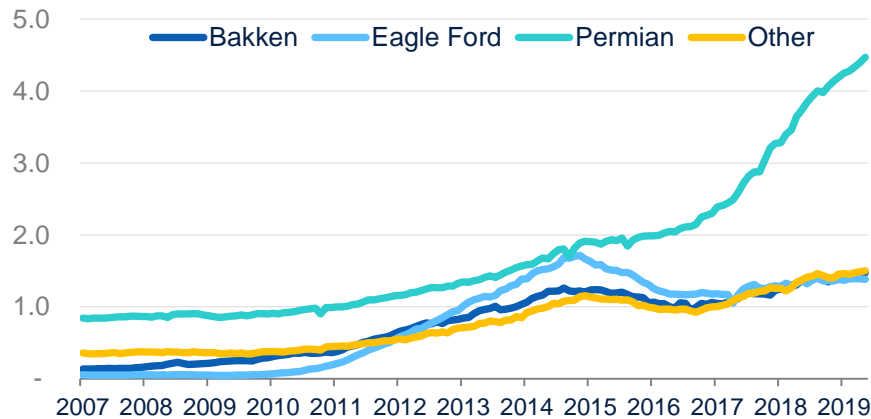
## U.S. STOCKS OF CRUDE OIL (EXCLUDING SPR, MILLION BARRELS)



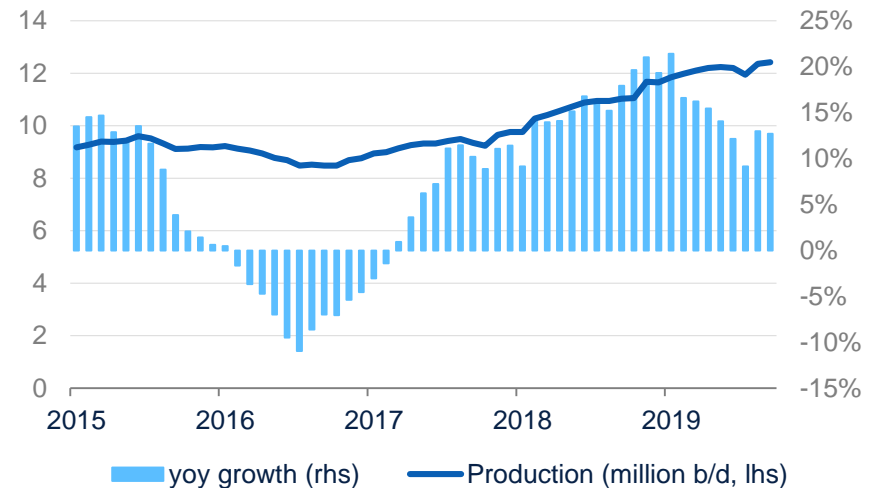
## U.S. ACTIVE RIG COUNT (UNITS)



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



## U.S. TOTAL ESTIMATED CRUDE OIL PRODUCTION

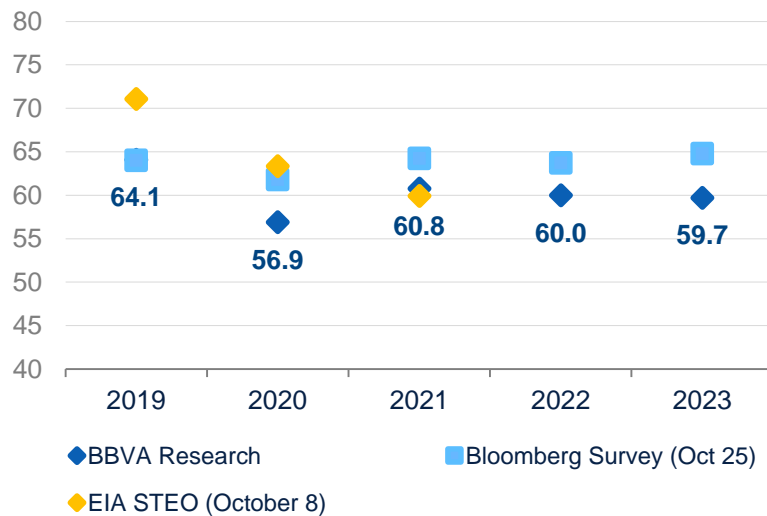


# Slower demand growth remains the main driver of our baseline scenario

## Brent prices forecast

(\$ per barrel)

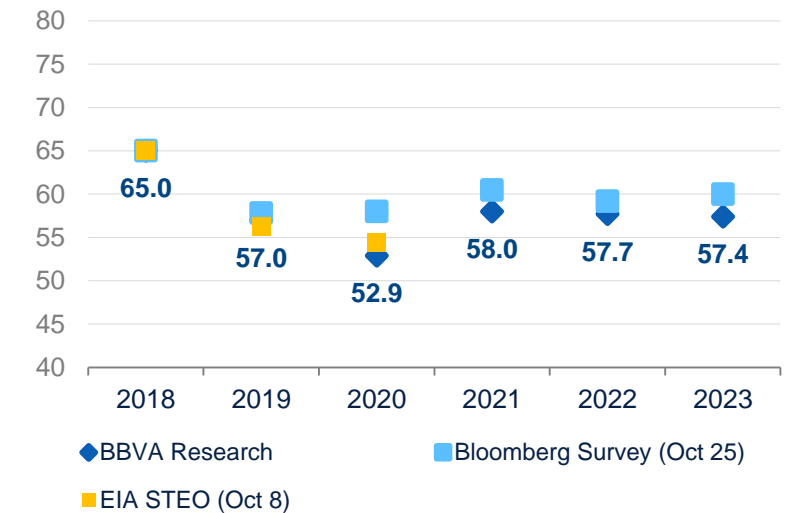
|      | BBVA Research<br>(baseline) | Bloomberg<br>Survey<br>(Oct 25) | EIA<br>STEO (Oct 8) |
|------|-----------------------------|---------------------------------|---------------------|
| 2017 | 54.2                        | 54.2                            | 54.2                |
| 2018 | 71.1                        | 71.1                            | 71.1                |
| 2019 | 64.1                        | 64.0                            | 63.4                |
| 2020 | 56.9                        | 61.8                            | 59.9                |
| 2021 | 60.8                        | 64.3                            |                     |
| 2022 | 60.0                        | 63.7                            |                     |
| 2023 | 59.7                        | 64.8                            |                     |



## WTI prices forecast

(\$ per barrel)

|      | BBVA<br>Research<br>(baseline) | Bloomberg<br>Survey<br>(Oct 25) | EIA<br>STEO (Oct 8) |
|------|--------------------------------|---------------------------------|---------------------|
| 2017 | 50.9                           | 50.9                            | 50.9                |
| 2018 | 65.0                           | 65.0                            | 65.0                |
| 2019 | 57.0                           | 57.8                            | 56.3                |
| 2020 | 52.9                           | 58.0                            | 54.4                |
| 2021 | 58.0                           | 60.5                            |                     |
| 2022 | 57.7                           | 59.2                            |                     |
| 2023 | 57.4                           | 60.0                            |                     |



# 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  | 2.4  | 2.9  | 2.3      | 1.8      | 1.9      | 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      | 1.5      | 1.4      | 1.3      |
| Gross Investment                                  | 0.9  | 1.6  | 1.1  | 1.0  | 0.9  | -0.2 | 0.8  | 0.9  | 0.5      | 0.4      | 0.8      | 0.8      |
| Non Residential                                   | 1.0  | 1.2  | 0.5  | 1.0  | 0.3  | 0.1  | 0.6  | 0.9  | 0.4      | 0.4      | 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      | 0.0      |
| Exports   | 0.9  | 0.5  | 0.5  | 0.6  | 0.1  | 0.0  | 0.5  | 0.4  | 0.0      | 0.3      | 0.5      | 0.5      |
| Imports   | -0.9 | -0.5 | -0.3 | -0.8 | -0.9 | -0.4 | -0.8 | -0.8 | -0.3     | -0.6     | -0.8     | -0.8     |
| Government  | -0.7 | -0.4 | -0.5 | -0.2 | 0.3  | 0.3  | 0.1  | 0.3  | 0.4      | 0.3      | 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      | 3.7      | 3.8      | 4.0      |
| Avg. Monthly Nonfarm Payroll (K)                  | 173  | 181  | 192  | 251  | 227  | 193  | 179  | 223  | 157      | 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      | 2.2      | 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      | 2.2      | 2.1      |
| Fiscal Balance (% GDP, FY)                        | -8.4 | -6.8 | -4.1 | -2.8 | -2.4 | -3.2 | -3.4 | -3.8 | -4.6     | -4.6     | -4.5     | -4.9     |
| Current Account (bop, % GDP)                      | -2.9 | -2.6 | -2.1 | -2.1 | -2.2 | -2.3 | -2.3 | -2.4 | -2.5     | -2.6     | -2.7     | -2.8     |
| Fed Target Rate (% eop)                           | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.75 | 1.50 | 2.50 | 1.75     | 1.75     | 1.75     | 2.25     |
| Core Logic National HPI (YoY %)                   | -2.9 | 4.0  | 9.7  | 6.7  | 5.3  | 5.4  | 5.9  | 5.7  | 3.5      | 3.1      | 3.1      | 3.2      |
| 10-Yr Treasury (% Yield, eop)                     | 1.98 | 1.72 | 2.90 | 2.21 | 2.24 | 2.49 | 2.40 | 2.83 | 1.61     | 1.78     | 2.04     | 2.41     |
| West Texas Intermediate Oil Prices (dpb, average) | 94.9 | 94.1 | 97.9 | 93.3 | 48.7 | 43.2 | 50.9 | 65.0 | 57.0     | 52.9     | 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 |
| <b>GDP</b>         | 2.9  | 1.6  | 2.4  | 2.9  | 2.3  | 1.8  | 1.9  | 1.9  | 1.9  | 2.0  |
| Upside             |      |      |      |      | 3.1  | 3.4  | 2.9  | 2.7  | 2.7  | 2.7  |
| Downside           |      |      |      |      | 1.9  | -0.7 | 1.1  | 1.5  | 1.7  | 1.8  |
| <b>UR</b>          | 5.3  | 4.9  | 4.4  | 3.9  | 3.7  | 3.7  | 3.8  | 4.0  | 4.2  | 4.2  |
| Upside             |      |      |      |      | 3.6  | 3.1  | 2.9  | 3.0  | 3.0  | 3.0  |
| Downside           |      |      |      |      | 3.8  | 5.4  | 6.6  | 5.7  | 5.0  | 4.4  |
| <b>CPI</b>         | 0.1  | 1.3  | 2.1  | 2.4  | 1.8  | 2.0  | 2.2  | 2.1  | 2.1  | 2.1  |
| Upside             |      |      |      |      | 1.9  | 3.4  | 3.7  | 3.8  | 3.8  | 3.8  |
| Downside           |      |      |      |      | 1.6  | 0.3  | 1.1  | 1.3  | 1.5  | 1.6  |
| <b>Fed [eop]</b>   | 0.50 | 0.75 | 1.50 | 2.50 | 1.75 | 1.75 | 1.75 | 2.25 | 2.25 | 2.25 |
| Upside             |      |      |      |      | 2.00 | 4.00 | 5.50 | 6.00 | 6.50 | 6.50 |
| Downside           |      |      |      |      | 1.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| <b>10-Yr [eop]</b> | 2.24 | 2.49 | 2.4  | 2.83 | 1.61 | 1.78 | 2.04 | 2.41 | 2.57 | 2.68 |
| Upside             |      |      |      |      | 2.73 | 5.14 | 5.36 | 6.34 | 6.14 | 6.11 |
| Downside           |      |      |      |      | 1.17 | 0.88 | 1.38 | 1.41 | 1.55 | 1.45 |

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# U.S. Macroeconomic Pulse

October 2019