BBVA Research

Navigating a sea of economic uncertainty

March 19, 2019
Sarasota, FL

Creating Opportunities

Key messages

- Global slowdown leads to higher uncertainty
- U.S. GDP expected to slow to 2.5% in 2019, and 2.0% in 2020
- Risk of recession 24 months ahead remains elevated
- Fed to delay raising rates until 4Q19
- Labor market conditions remain favorable
- Core inflation to remain stable, rebound in energy prices to lift headline
- 10-year Treasury to follow shallower path, implying a flat interest rate curve
- Oil prices converging with long-term equilibrium of around $60/b
- High debt levels in a rising rate environment pose credit cycle risks
- Trade deal with China has the potential to support the current expansion
- Florida among the states posed to outperform in growth in 2019
- Sarasota region enjoying excellent economic conditions

Global economy – elevated uncertainty

Global policy uncertainty

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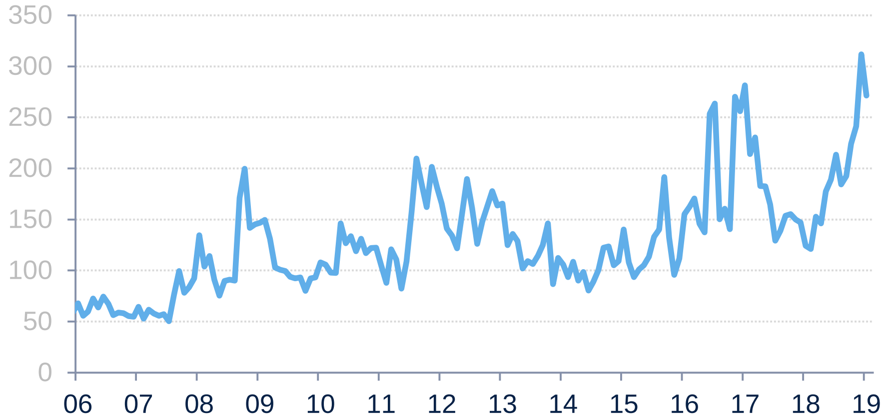
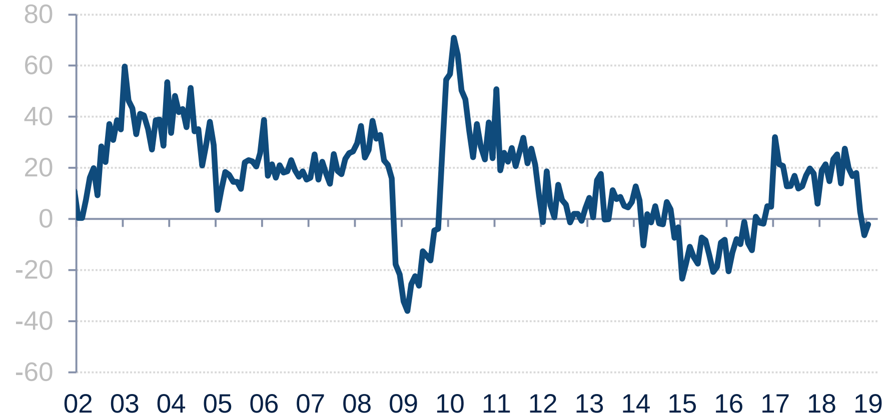


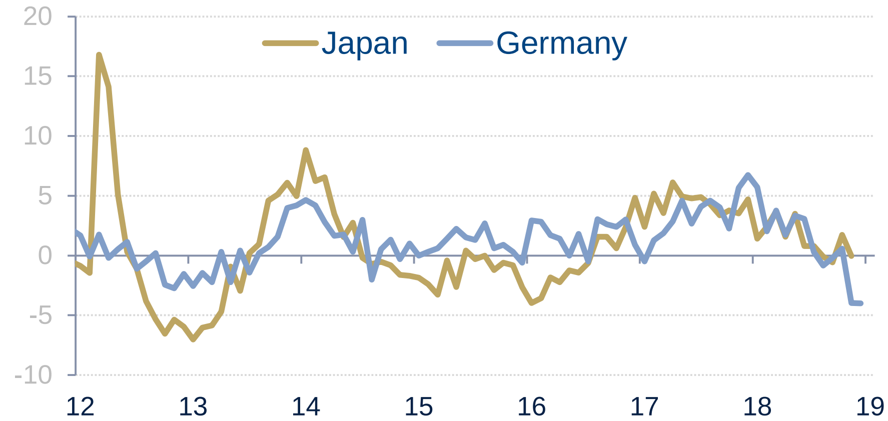
China: Total imports

YoY % Change



Industrial production

YoY % Change



Global sentiment

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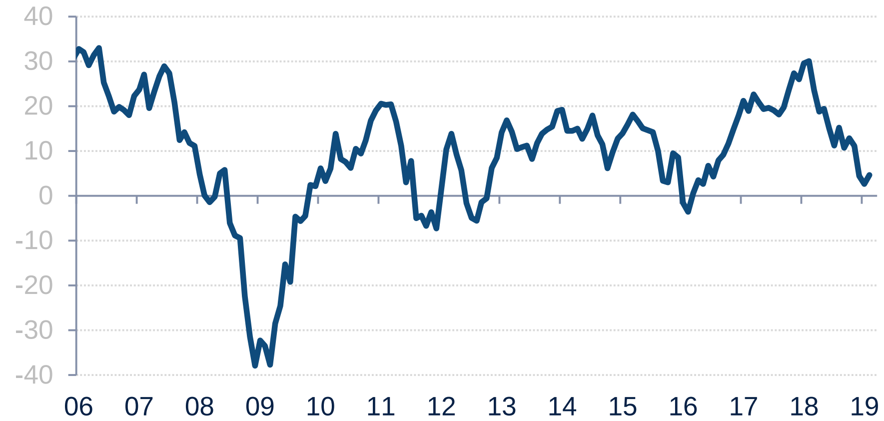
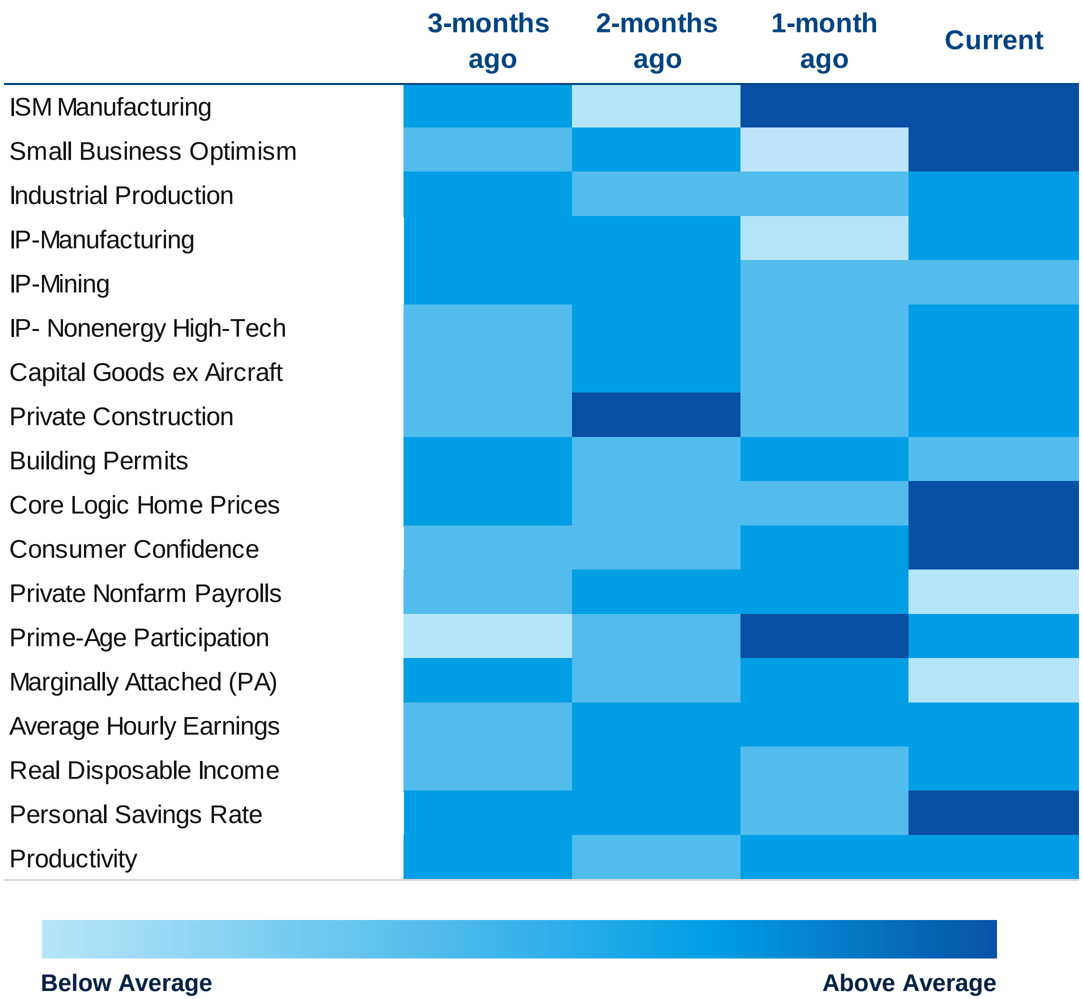


Source: BBVA Research and Haver

Economic activity

Real-time economic momentum heat map



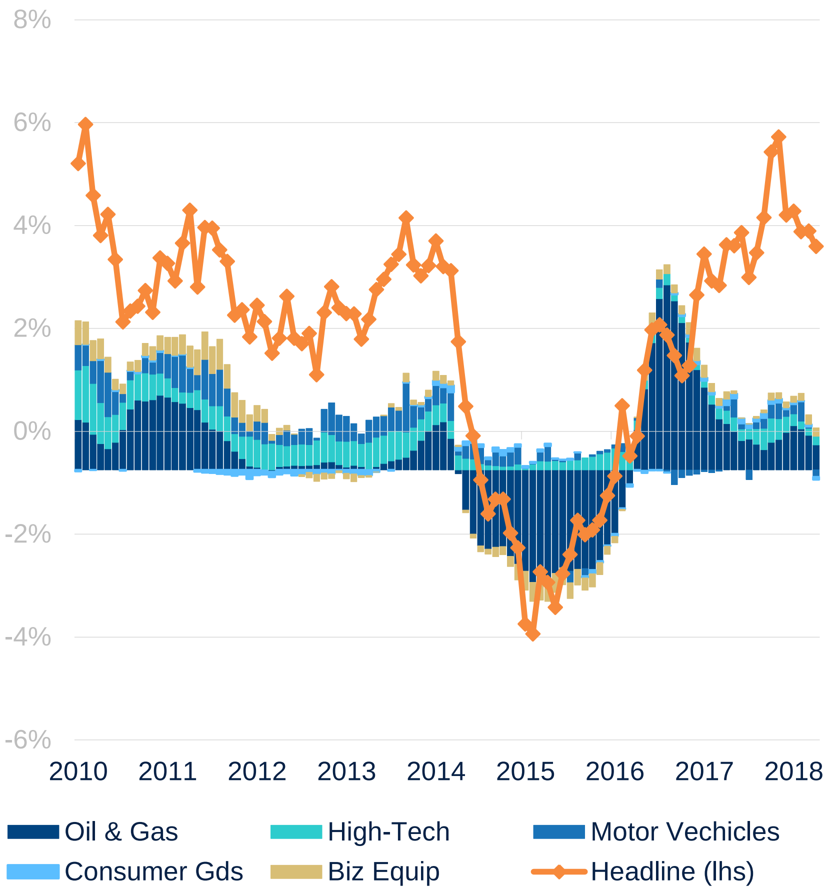
Source BBVA Research

- Improving manufacturing sentiment on less negative views on domestic demand and thawing trade tensions
- Small business optimism has improved after a period od decline Aug-January on concerns about future economic growth
- Home prices appreciation strong despite weaker demand side conditions
- Consumer confidence reversed in February after reaching lowest level since 2017 in January
- Steady productivity growth amidst strong labor force inflows and modest wage increases

Economic trends: Industrial production moderates while retail sales recovered somewhat after plummeting in December

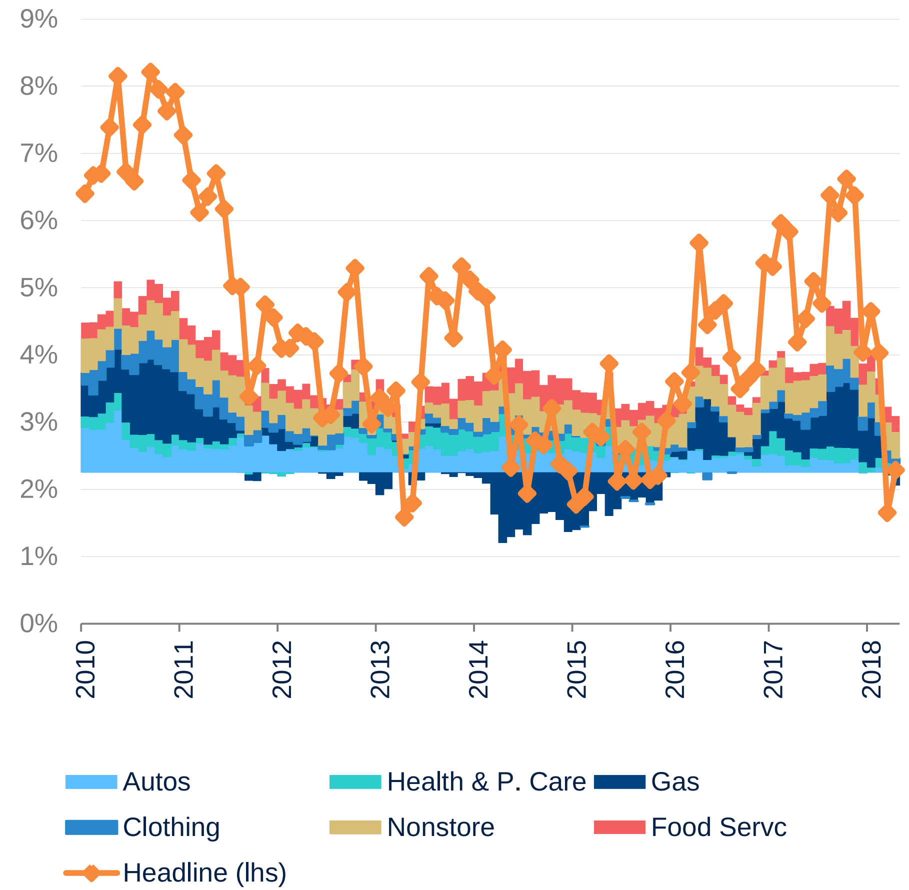
Industrial production

(Year-over-year %)



Retail sales

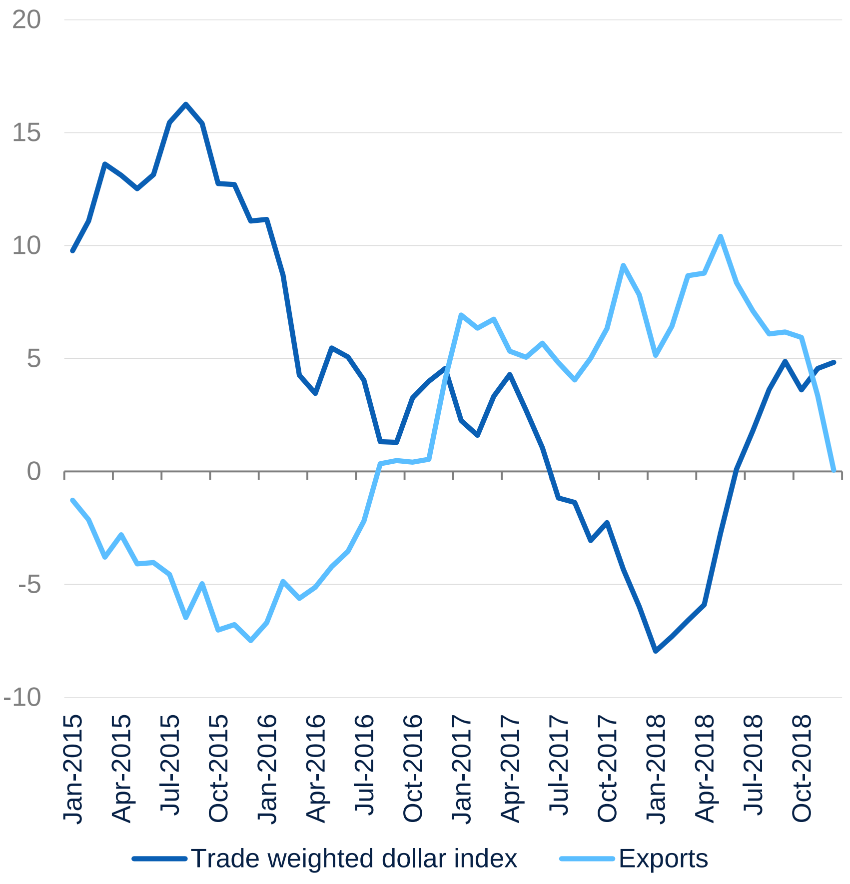
(Year-over-year %)



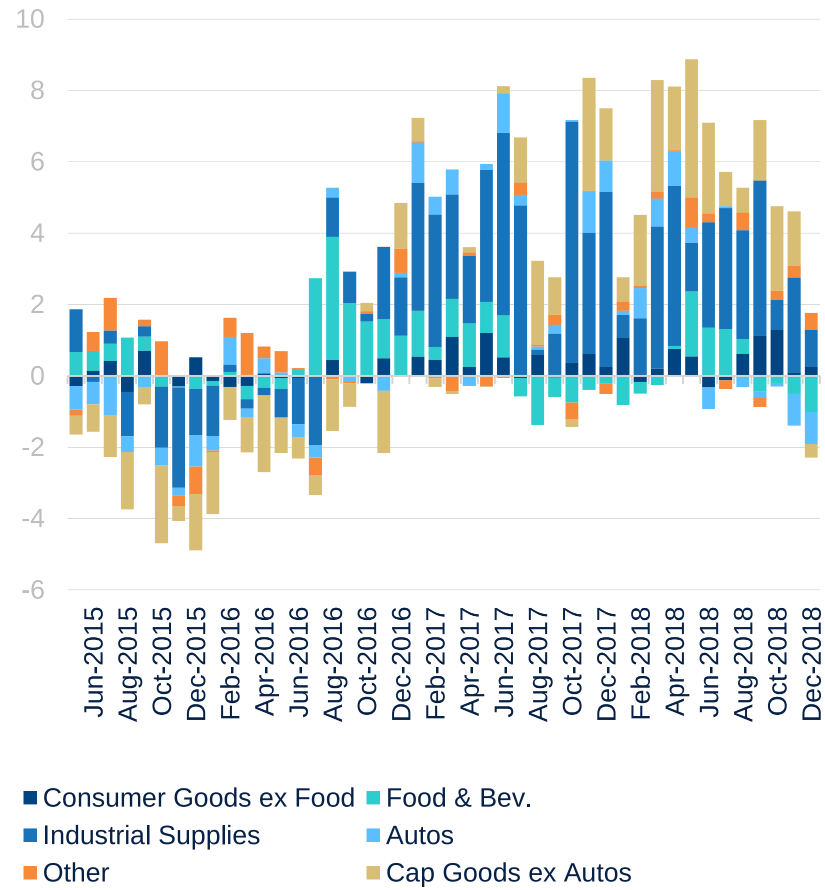
Source: BBVA Research, FRB & BEA

Economic trends: FX and slower global growth weigh on exports

Real exchange rate and exports
(Year-over-year %)



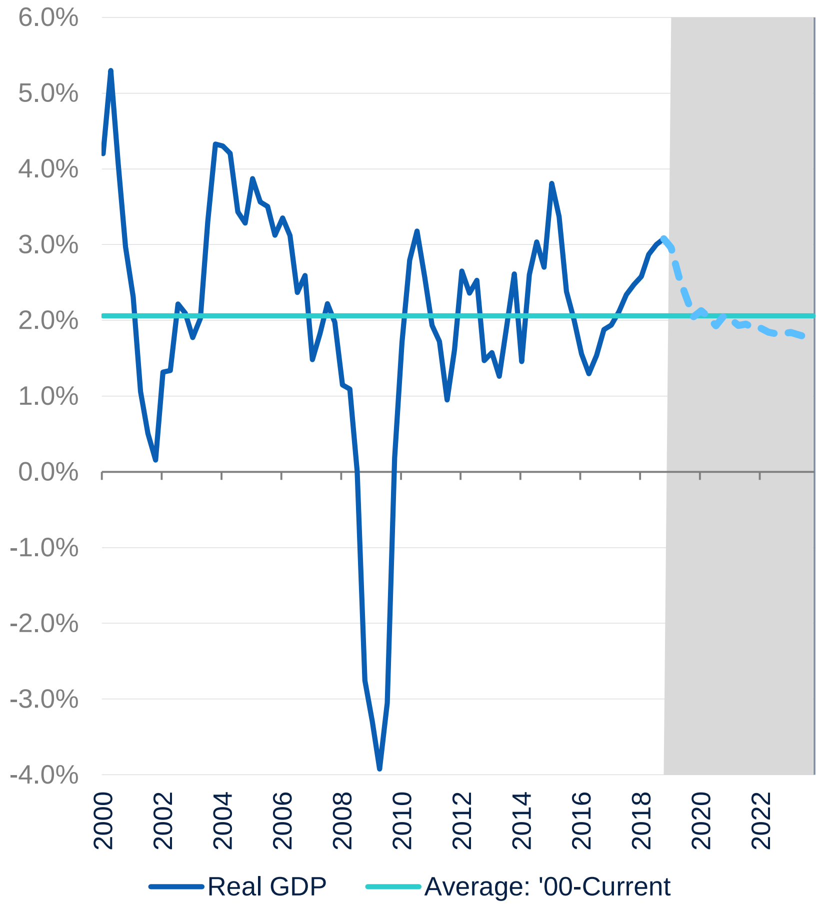
Real exports
(Contribution to year-over-year %)



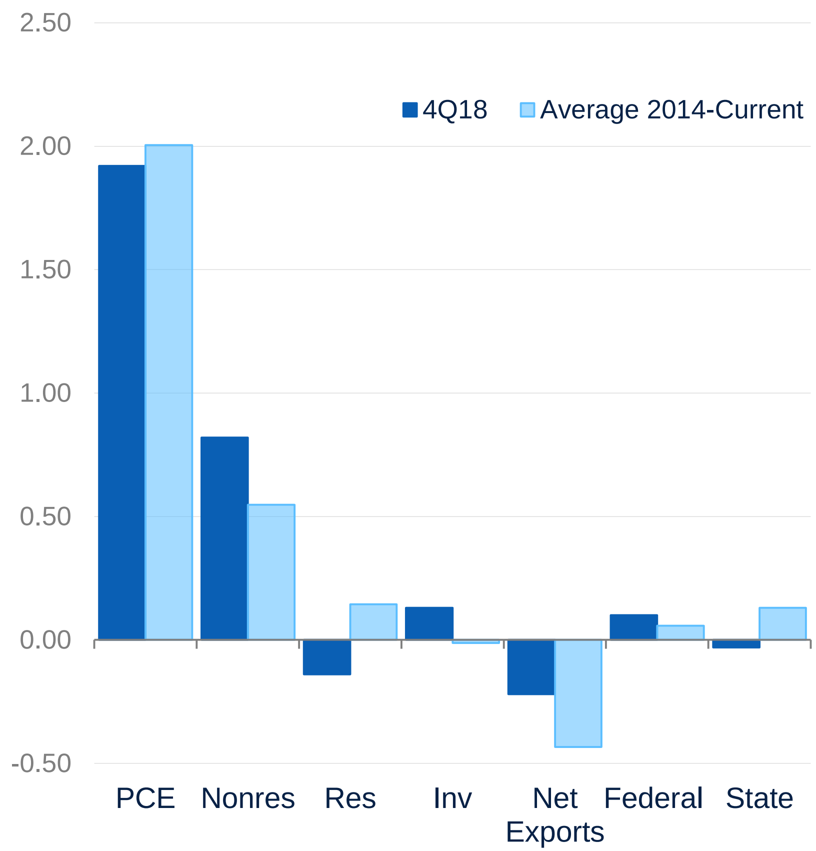
Source: BBVA Research, FRB & Census

GDP

Real GDP
Year-over-year %



GDP- contribution to growth
Annualized %

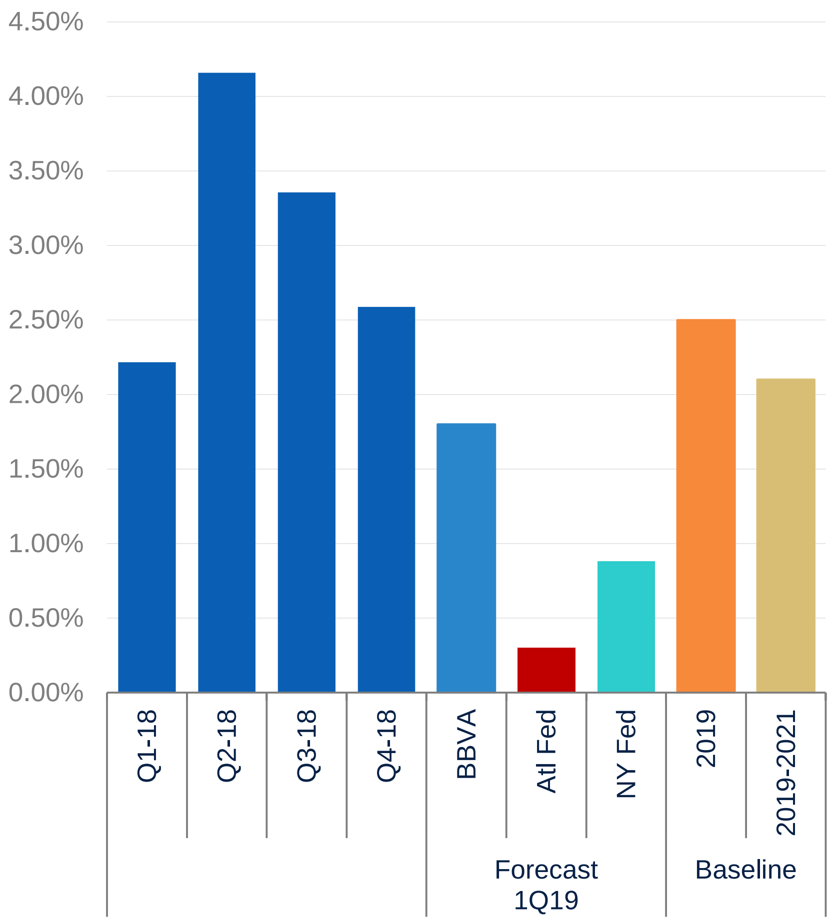


Source: BBVA Research & BEA

GDP and recession probability

Real GDP

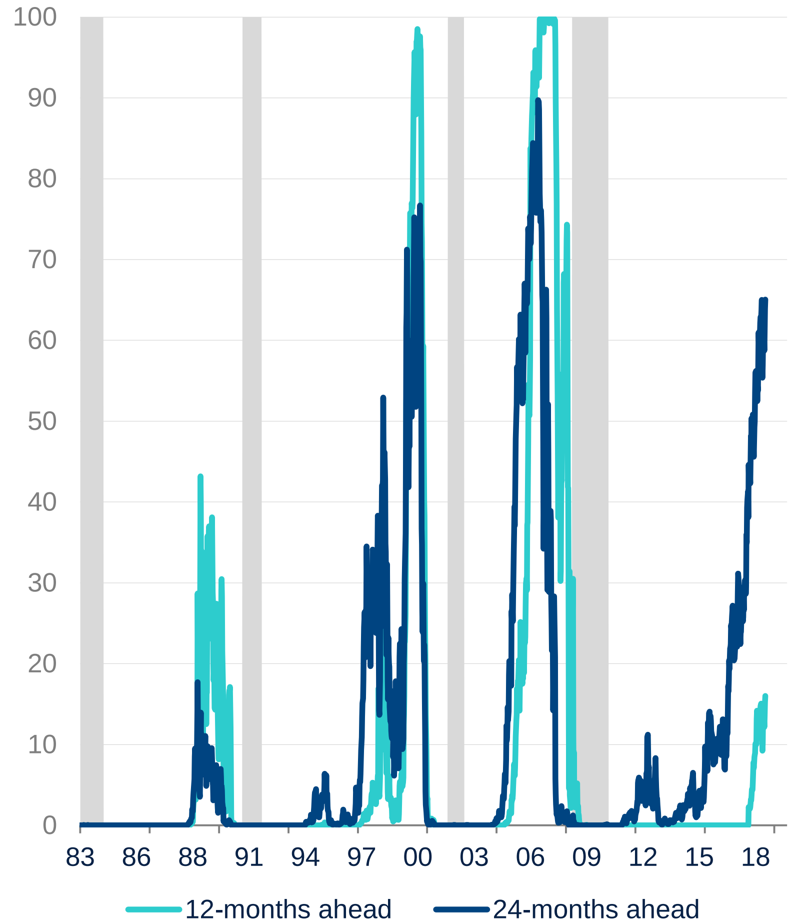
SAAR, %



Source: BBVA Research & BEA

Recession probability

%, 4wkma



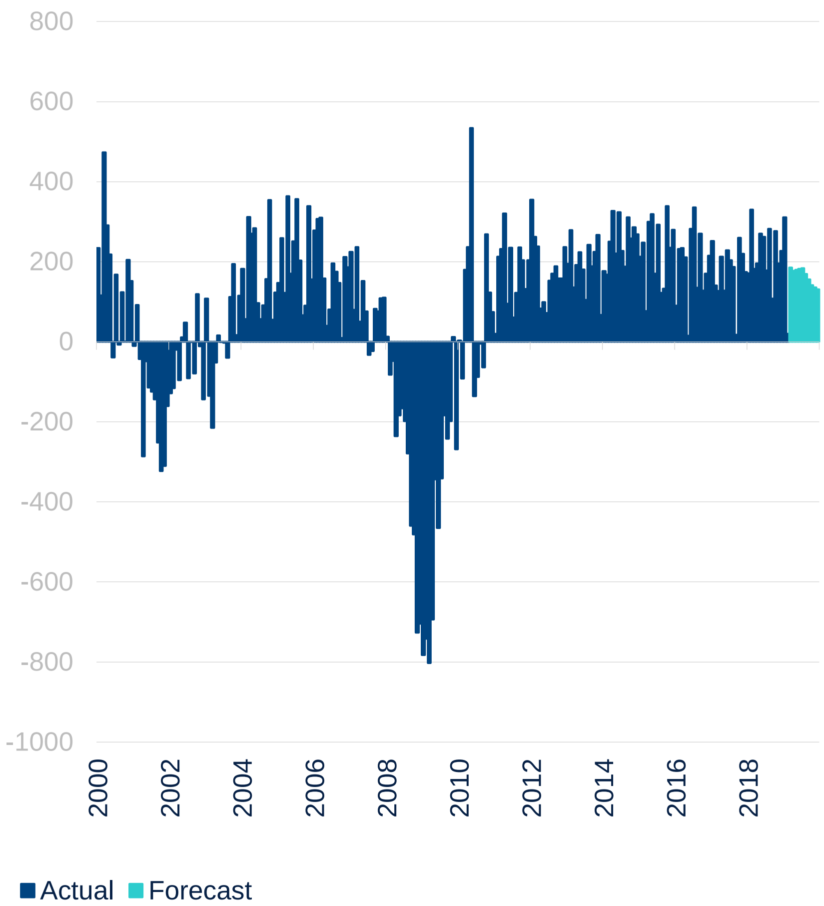
Recession Probability

Labor market

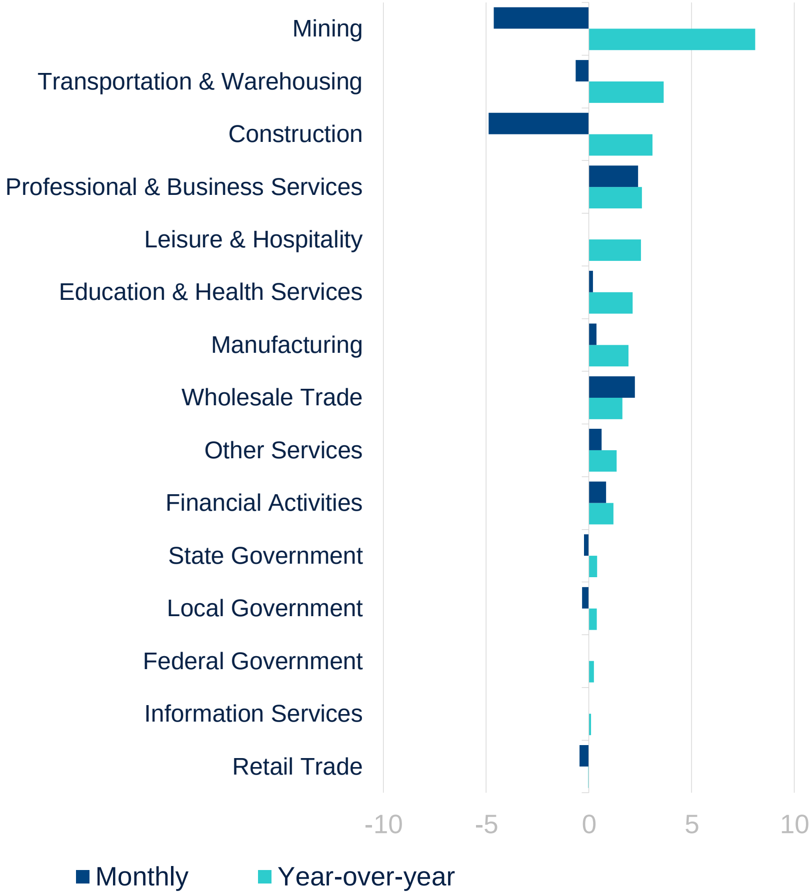
- In February, nonfarm payroll employment grew 20,000, down from 311,000 and 227,000 in December
- The unemployment rate (UR) decreased to 3.8
- Major weaknesses: construction (-31K), education (-18.7K), retail trade (-6.1K), transportation and warehousing (-3.0K), mining (-2.8K), and leisure and hospitality (unchanged).
- Gains: professional business services (42K) and financial related industries (6K).
- Average hourly earnings growth at 3.4% is just shy of the pre-crisis peak of 3.6%.
- Labor force participation has some room to increase further
- We expect the UR to reach its low point in this business cycle in 3Q19 (3.6%), and job growth to continue to decelerate

Labor market: Still solid job growth overall, despite February figures

Nonfarm payrolls
(Monthly Change, K)



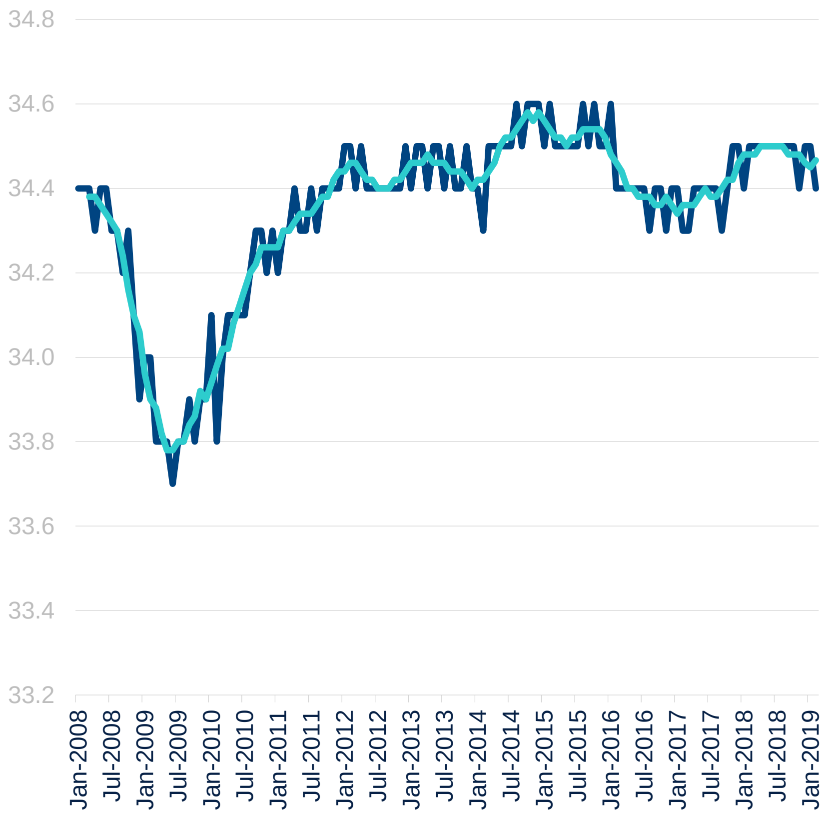
Industry employment
(Annualized % change)



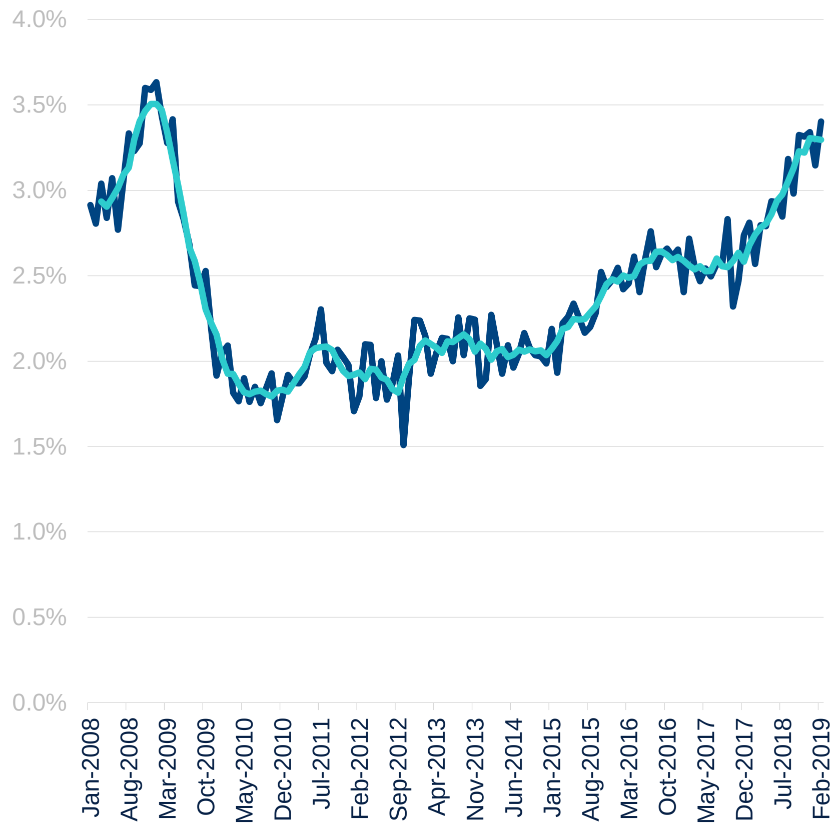
Source: BBVA Research & BLS

Labor market: While hours worked fluctuate somewhat, wage pressures are rising

Average weekly hours
(number & 5mcma)



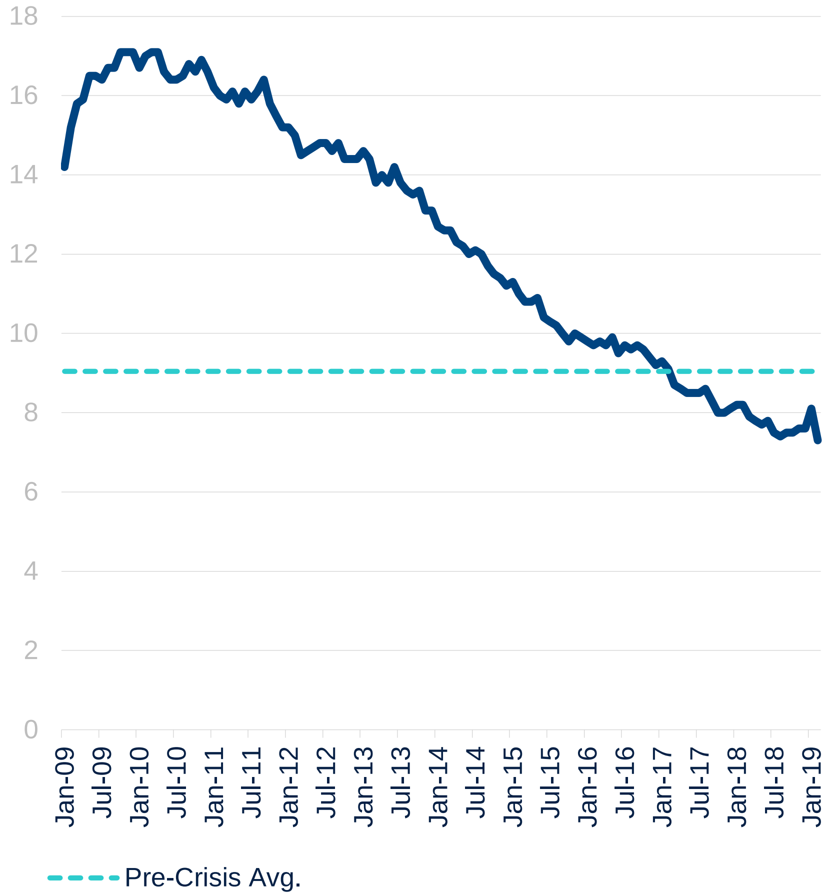
Average hourly earnings
(YoY% & 5mcma)



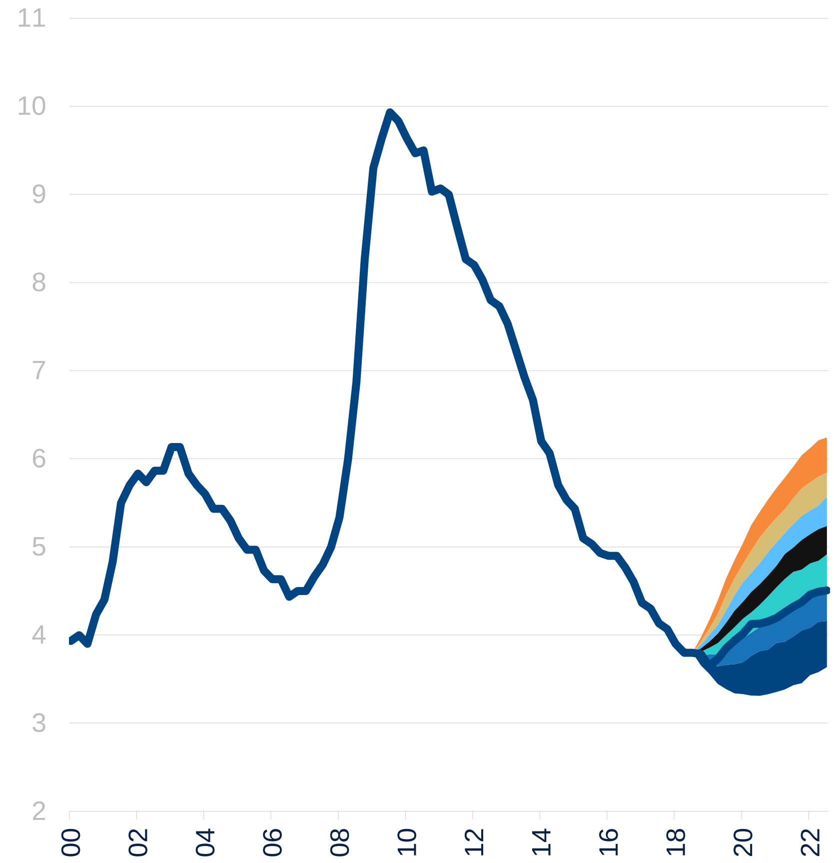
Source: BBVA Research & BLS

Labor market: Solid labor market utilization with some decline in the unemployment rate

U-6
(%)



Unemployment rate
(%)

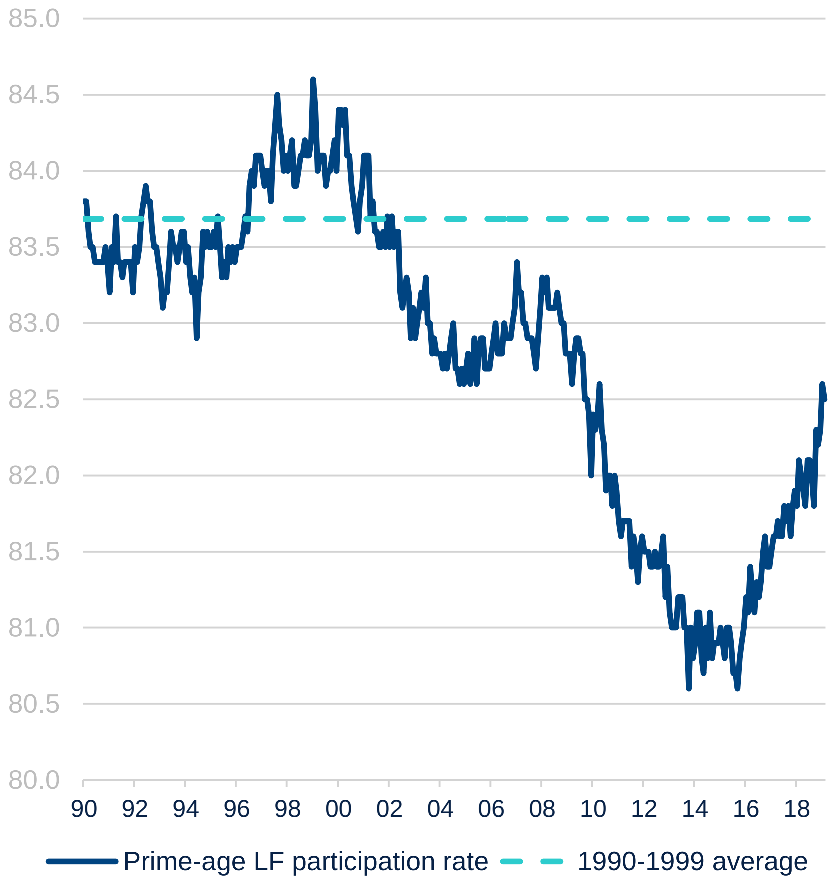


Source: BBVA Research & BLS

Labor market: While more workers can enter the workforce, wage inflation will continue to inch up

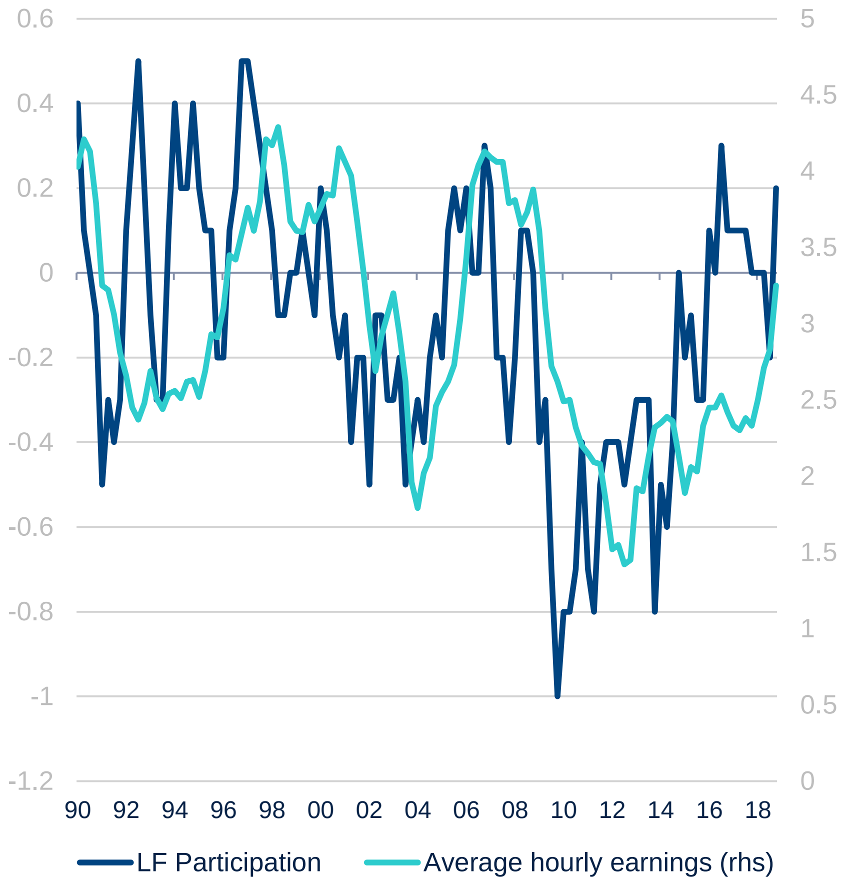
Prime-age labor force participation rate

%



Labor force participation and wages

PP YoY and % YoY



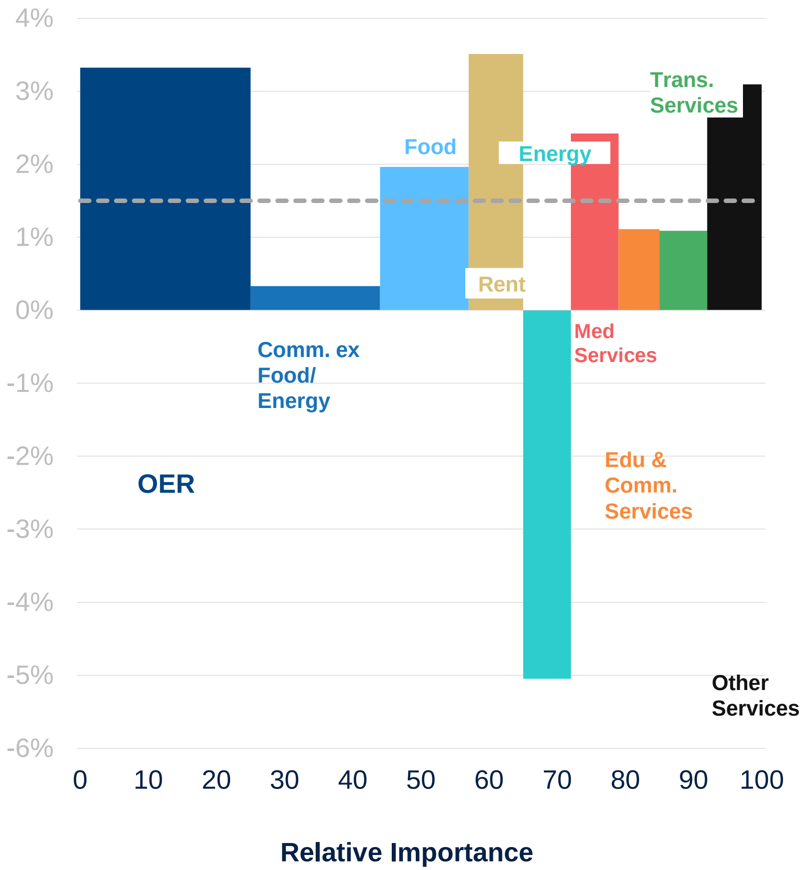
Source: BBV A Research and BLS

Inflation

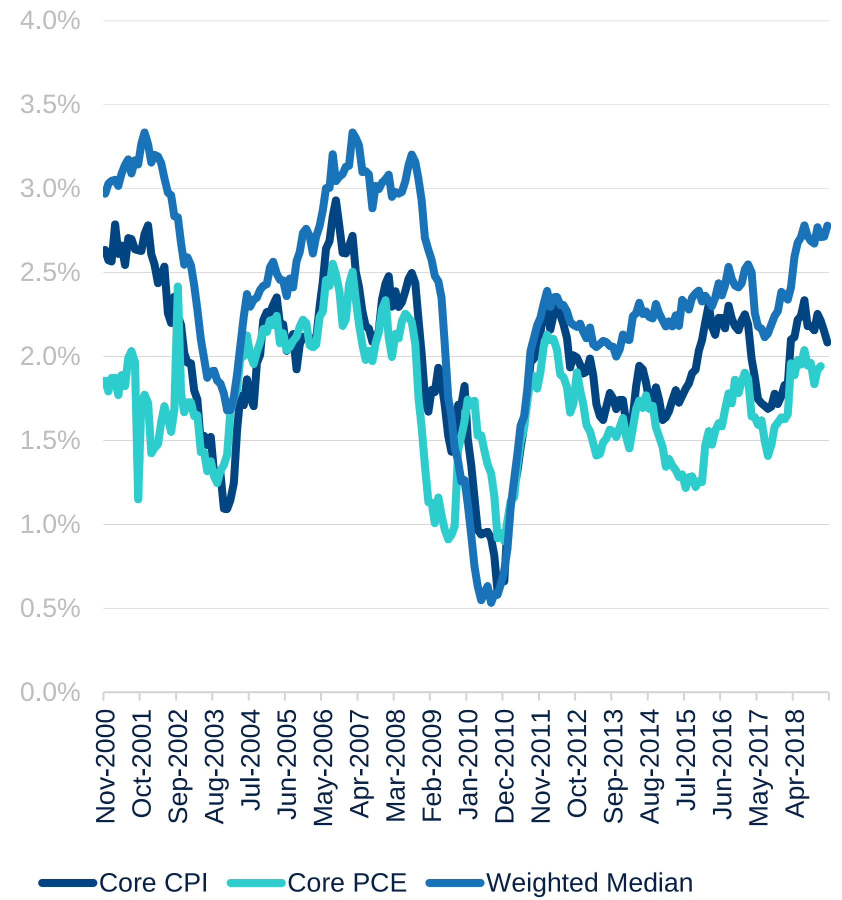
- Headline consumer price index (CPI) was up 0.2% month-over-month in February and core CPI was up 0.1%
- The declines in energy prices ended and the recovery in oil prices should limit pass-through to energy prices going forward
- On a year-over-year basis, headline CPI stood at 1.5% while core remained stable at 2.1%
- The probability of entering high-inflation regime is nonexistent; deflation risks are also low
- Implied 5-year and 10-year inflation expectations have edged up with energy prices rising and demand-side fears fading
- Pass-through from low energy prices to bring headline CPI below 2% for year; core CPI to remain close 2.2%

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

Consumer price inflation
(12m change)



Core inflation measures
(12m change)

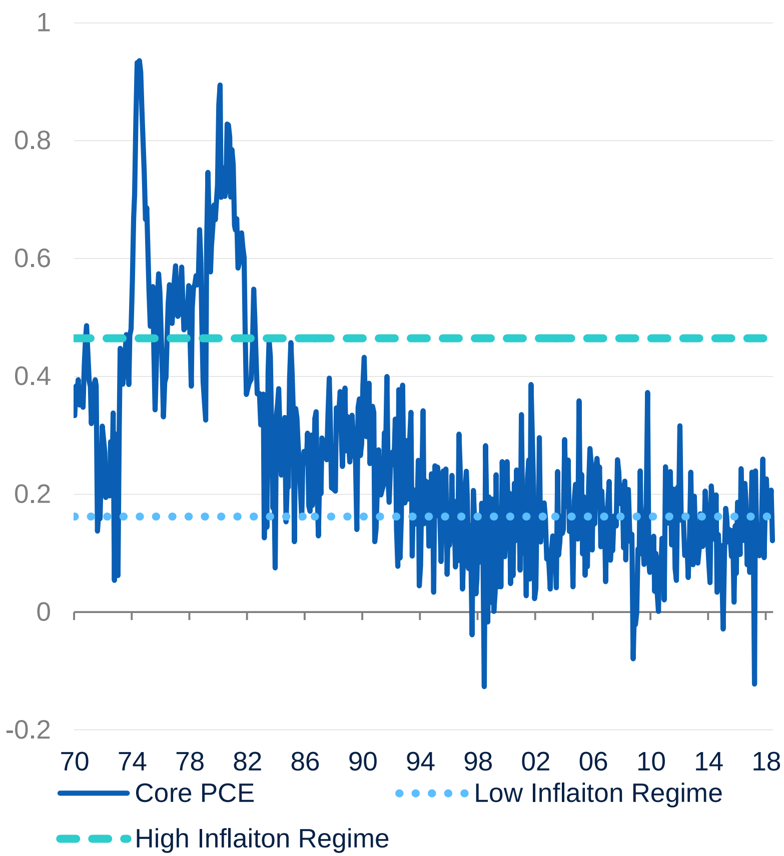


Source: BBVA Research, BLS & BEA

Inflation: Probability of high inflation regime extremely low

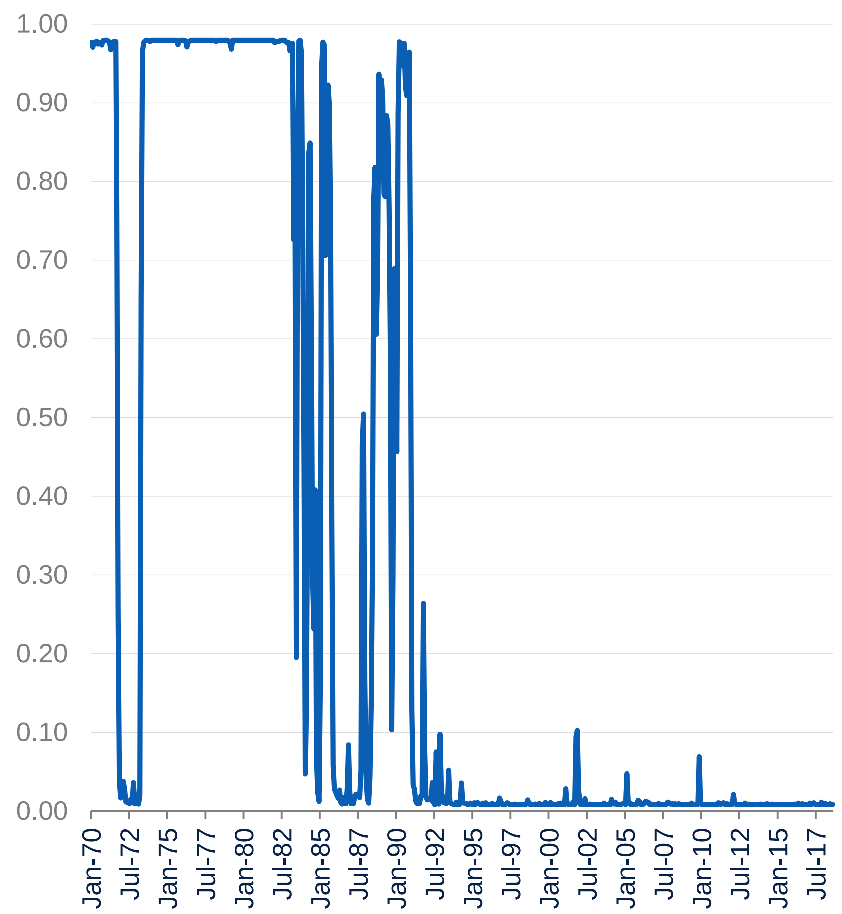
Core PCE price index & inflation regimes

Month-over-month %



Inflation regime change probability

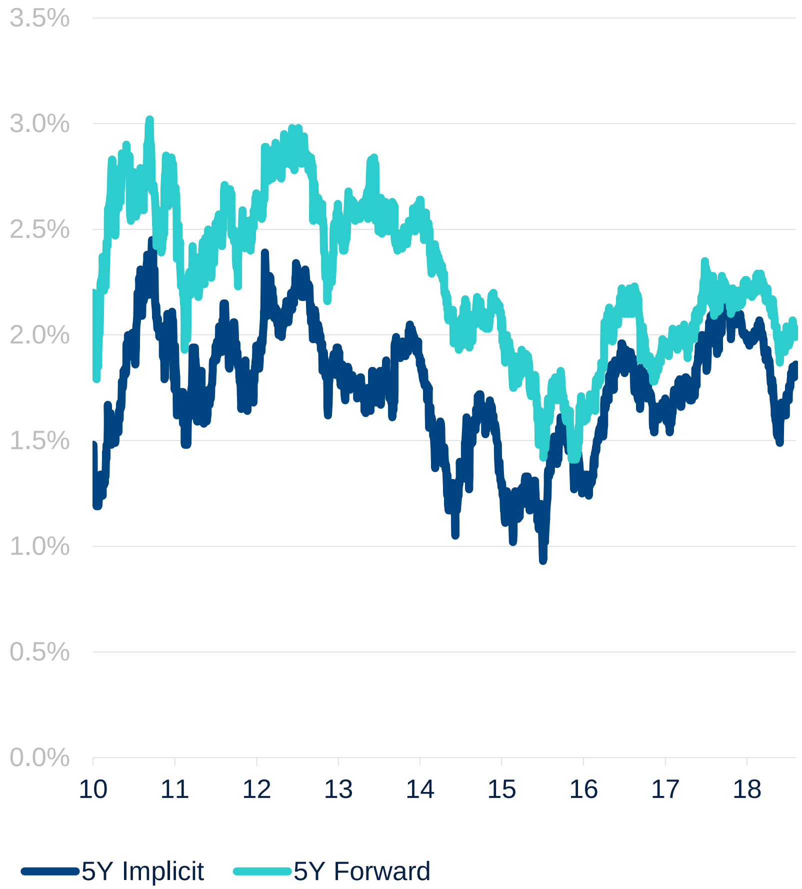
%



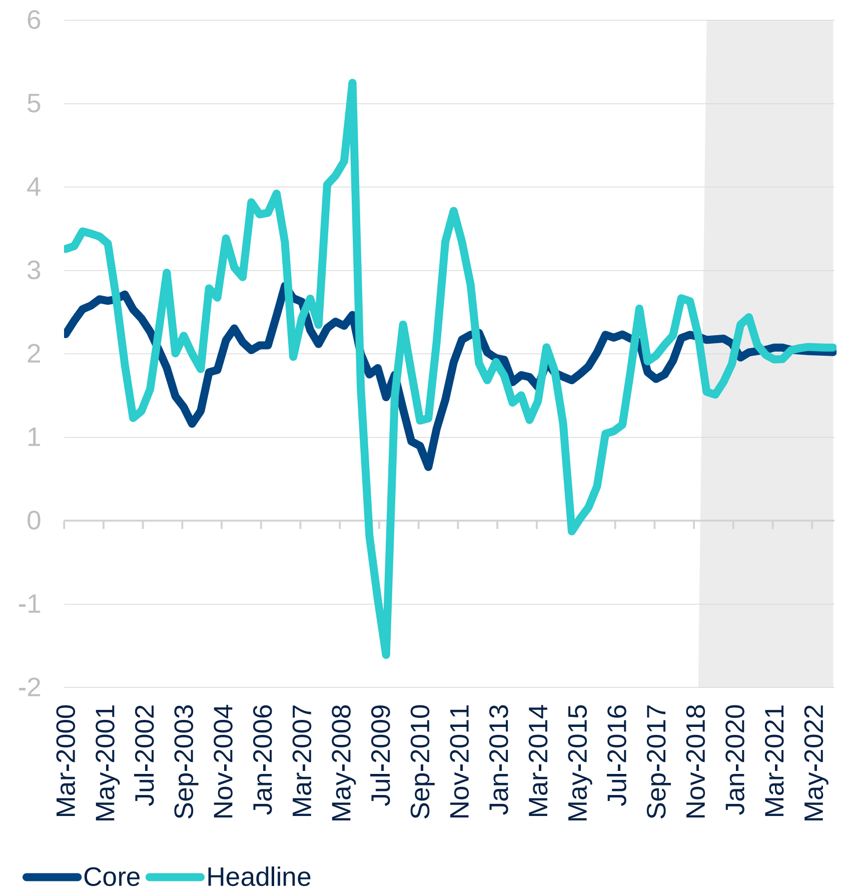
Source: BBVA Research & BLS

Inflation: Baseline for modest undershoot in 2019

Inflation expectations
(%)



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



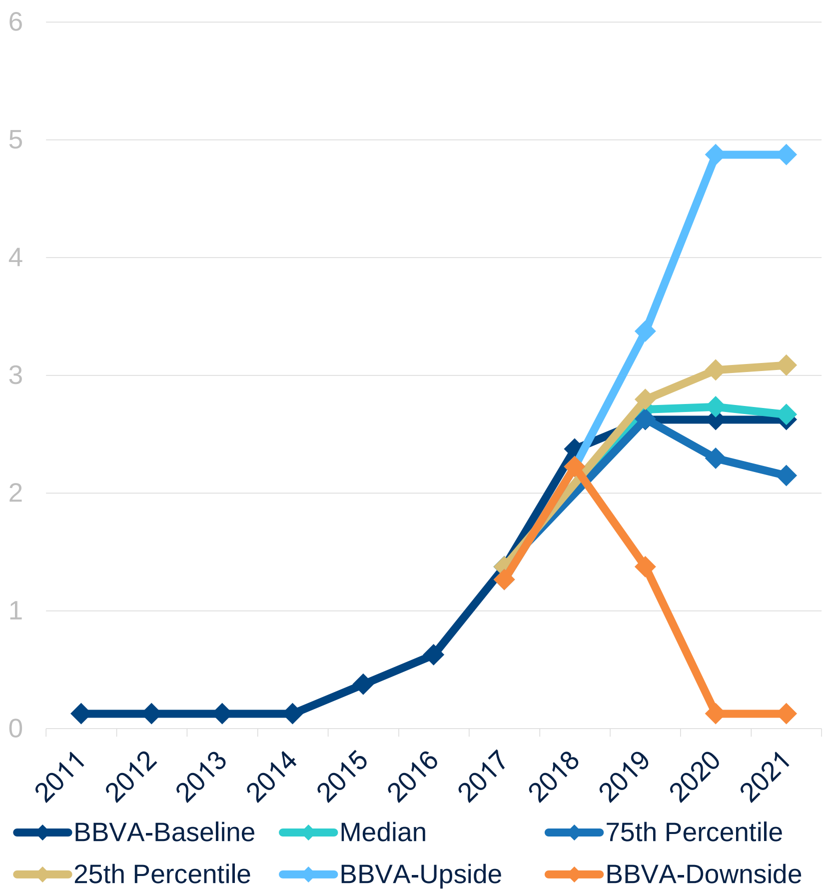
Source: BBVA Research & Haver Analytics

Monetary policy: Federal Reserve

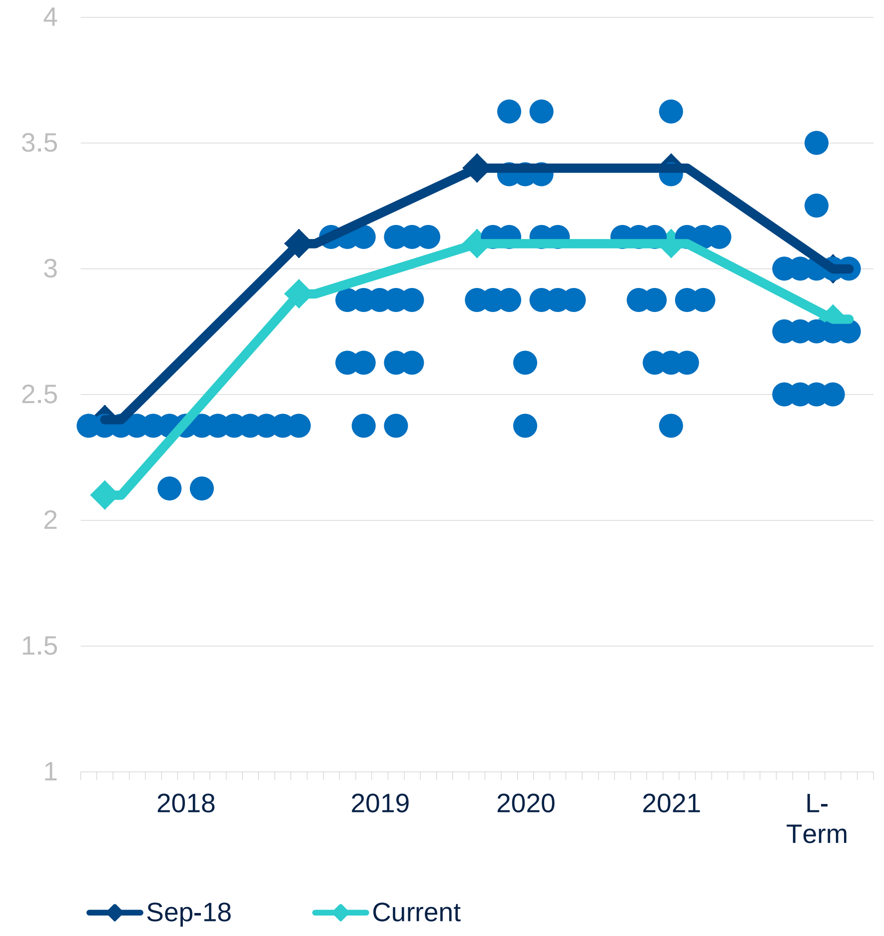
- The FOMC left the target range of the Fed Funds rate unchanged at their January 29-30th meeting
- FOMC shifting tone saying, “[i]n light of global economic and financial developments and muted inflation pressures, the Committee will be ***patient***”
- The FOMC has not reached a consensus on what conditions would be needed to continuing raising rates, but several members felt higher inflation or a more benign risk outlook would be sufficient for the Fed to raise later this year
- Terminal level of the balance sheet will be significantly higher (1-1.5Tr) than previously estimated and the normalization cycle will end sooner (EOY)
- With conditions similar to 2016—elevated uncertainty, financial tensions and weaker growth fundamentals— and with actual and expected inflation likely to undershoot the Fed’s target in the 1H19, we believe that this means the Fed will wait until the 4Q19 before raising rates again.

Fed: Patience is name of the game; rate increases on hold until 4Q19

BBVA & dealers projections of Fed Funds
(%, Effective)



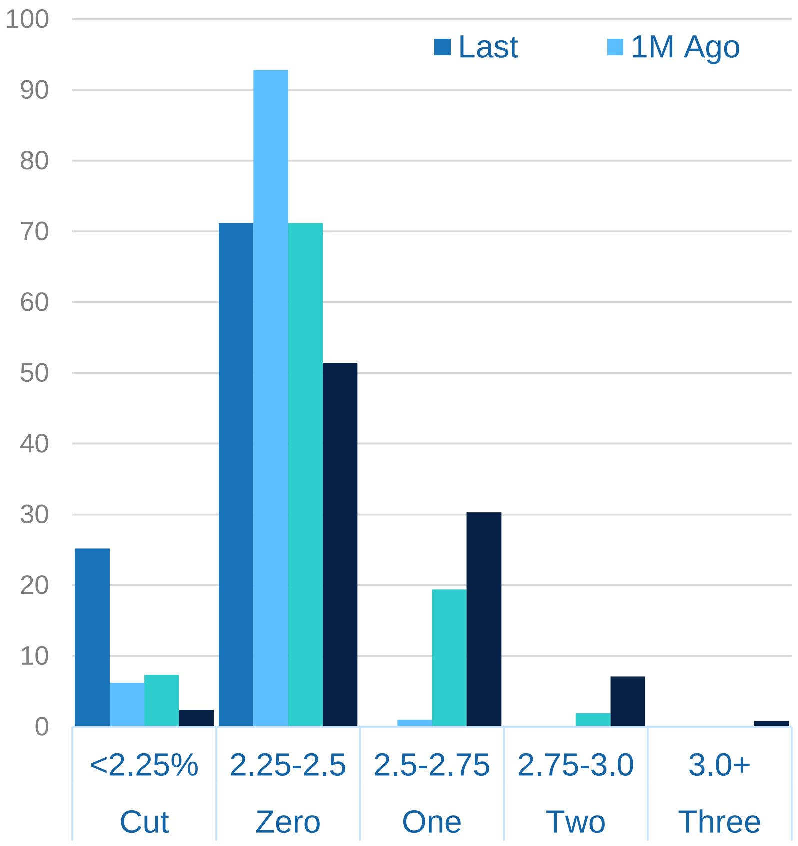
FOMC projections of Fed Funds
(Year-over-year %, Mid-point)



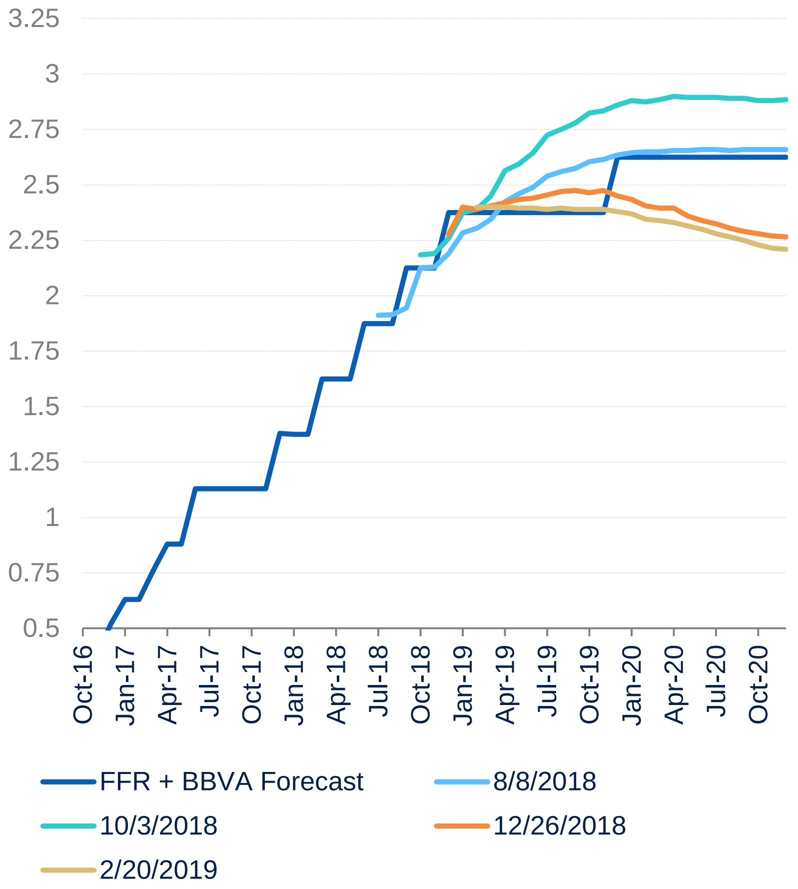
Source: BBVA Research & FRB

Monetary policy: Markets discounting prolonged pause, possible rate cut in 2020

Fed Funds implied probability
(Number of rate increases through 2019, %)



Fed Funds futures & BBVA baseline
(%)



Source: BBVA Research & Bloomberg

Interest rates

- 10-yr Treasury in February at 2.68%, 70bp below 4Q18 peak, 2-yr Treasury at 2.51% 50bp below peak
- Dramatic shift in Fed's balance sheet strategy and the U-turn on their guidance for policy rates suggests further compression in the term premium in medium-term and shift in the level
- Rising global uncertainty and dovish monetary policy abroad could add to the compression on the term premium, meaning a flatter-for-longer scenario for the yield curve
- Ample domestic demand for U.S. government debt from domestic sectors contain upside pressures on yields
- 10-yr Treasury to reach 2.9% by end of 2019 and 3.1% by year end 2020

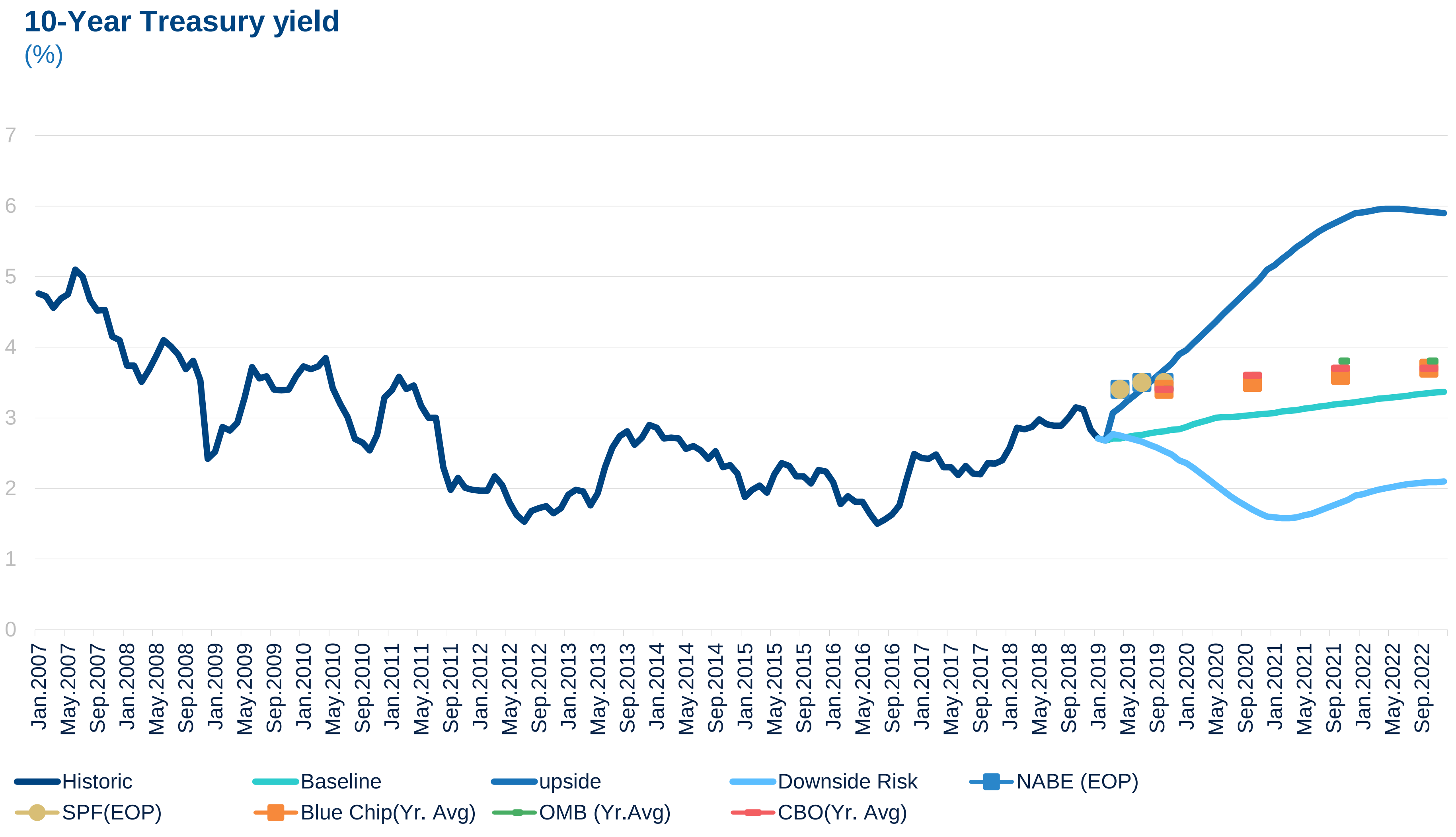
Interest rates: Drop in inflation expectations and negative term premium push 10-year Treasury below 2.7%

10-Year Treasury yield decomposition

(%)

Source: BBVA Research, ACM & Haver Analytics

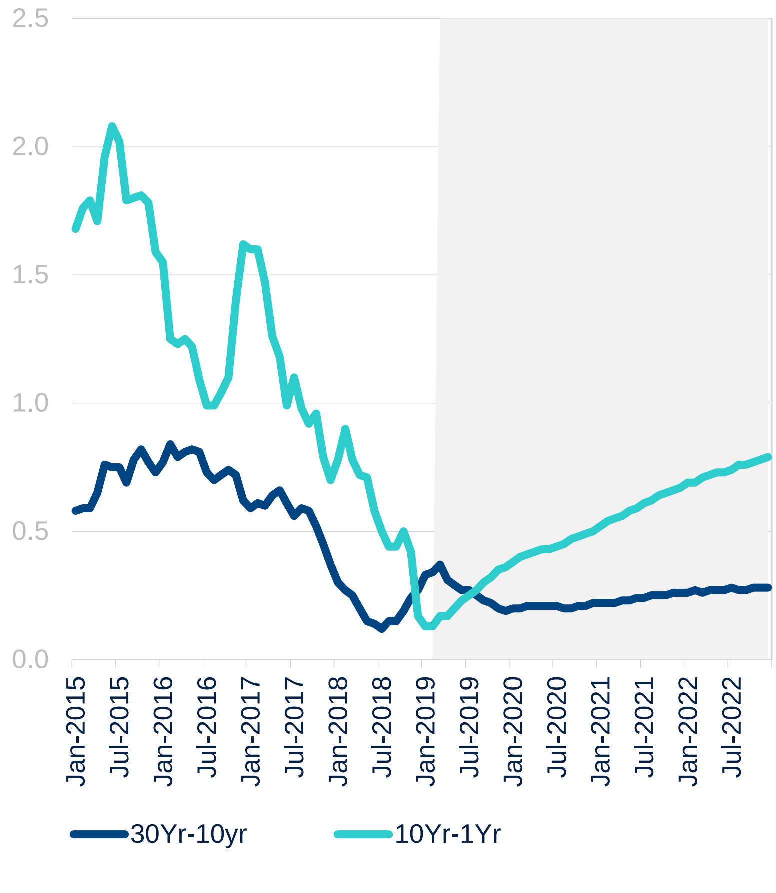
Interest rates: Nontrivial downward revisions to 10-year, risks now more balanced



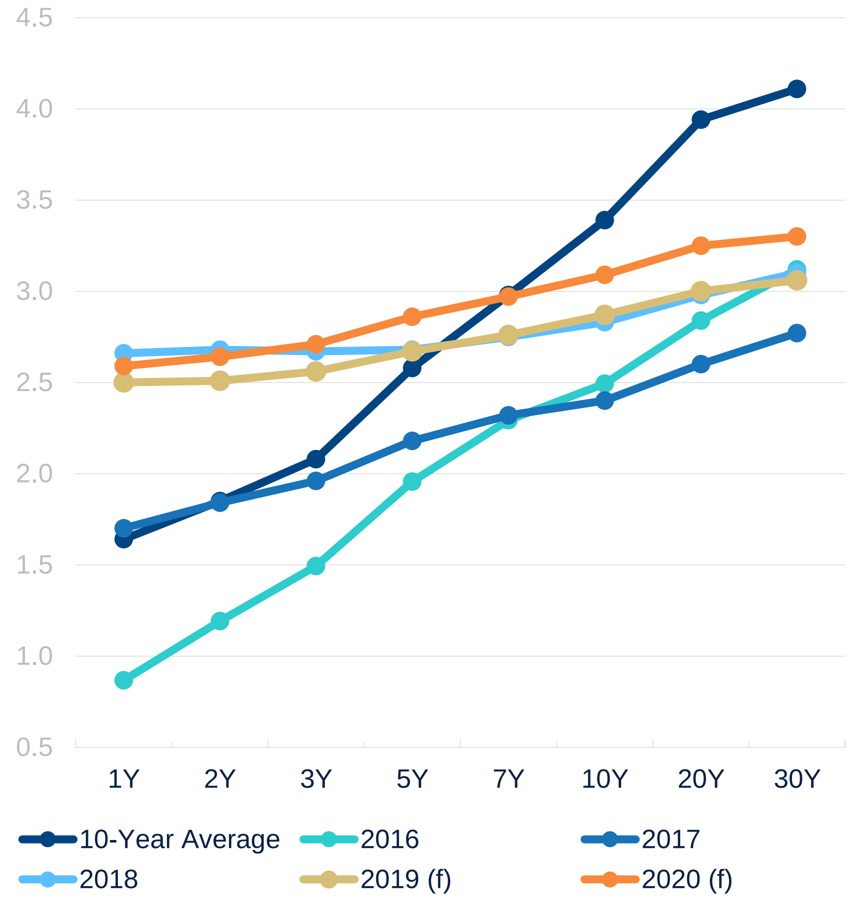
Source: BBVA Research, ACM & Haver Analytics

Interest rates: Yield curve slope to remain low, but positive

Yield curve slope
(Bp)



Yield curve
(%, eop)



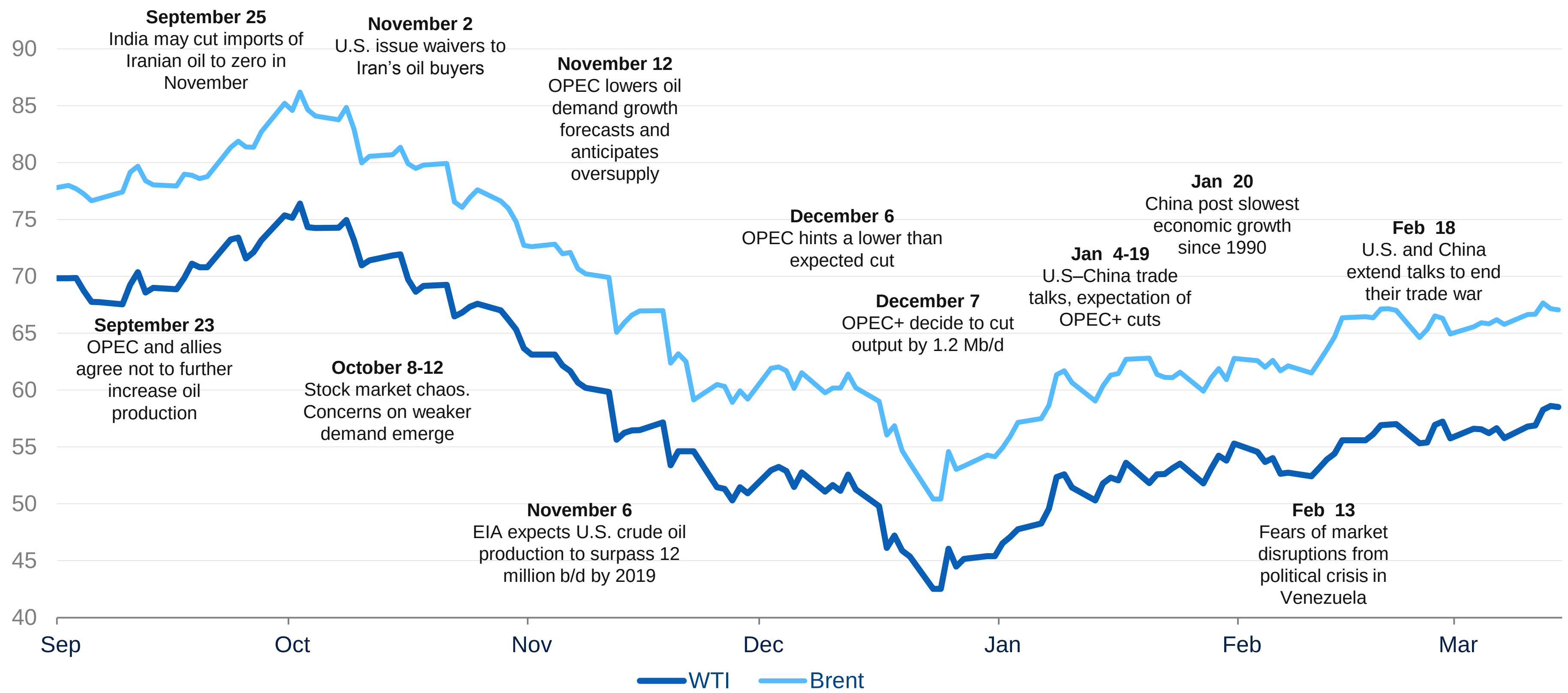
Source: BBVA Research

Oil prices

- OPEC+ cuts, a pause in U.S. interest rate increases, and signals of a trade deal between U.S. and China resulted in higher prices
- Going forward, the expiration of import waivers of Iranian oil could add an extra boost
- U.S. production is expected to remain robust through the year, more transportation infrastructure will facilitate exports
- Demand is projected to slow down as global economic growth weakens
- We maintain our forecasts of convergence to long-term equilibrium around $60/b
- Elevated uncertainty around long-term equilibrium: CAPEX, protectionism, transportation infrastructure, alternative energy sources, EM convergence, EVs, climate change, efficiency and technology

Improving sentiment on the global economy, plus OPEC+ commitment to adjust supply led to higher prices

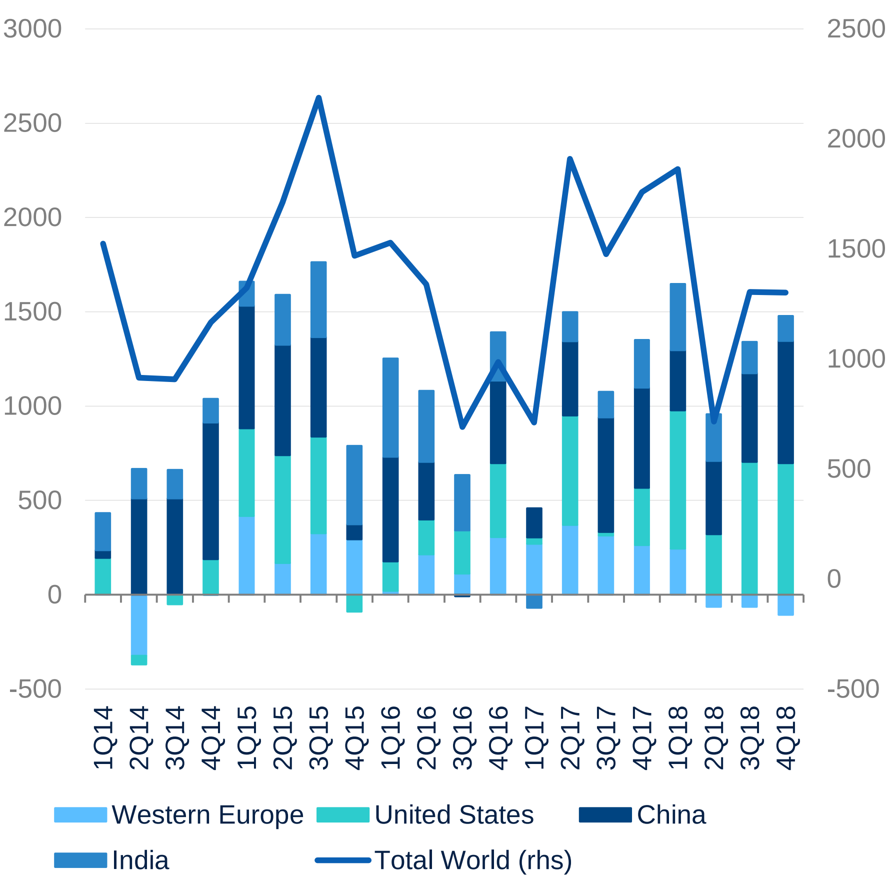
Crude oil prices August 2018 to February 2019
($ per barrel)



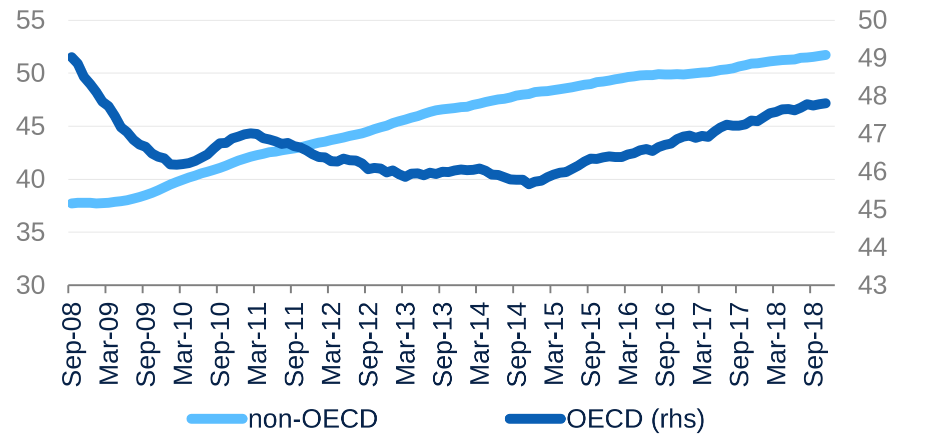
Source: BBVA Research and Haver Analytics

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

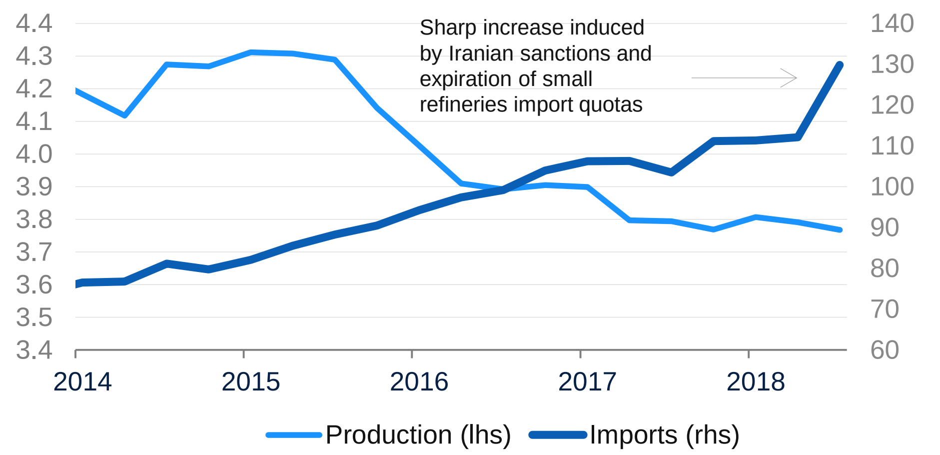
Oil product demand: total world
(Thousand barrels per day, yoy change)



Oil product demand
(Million barrels per day)



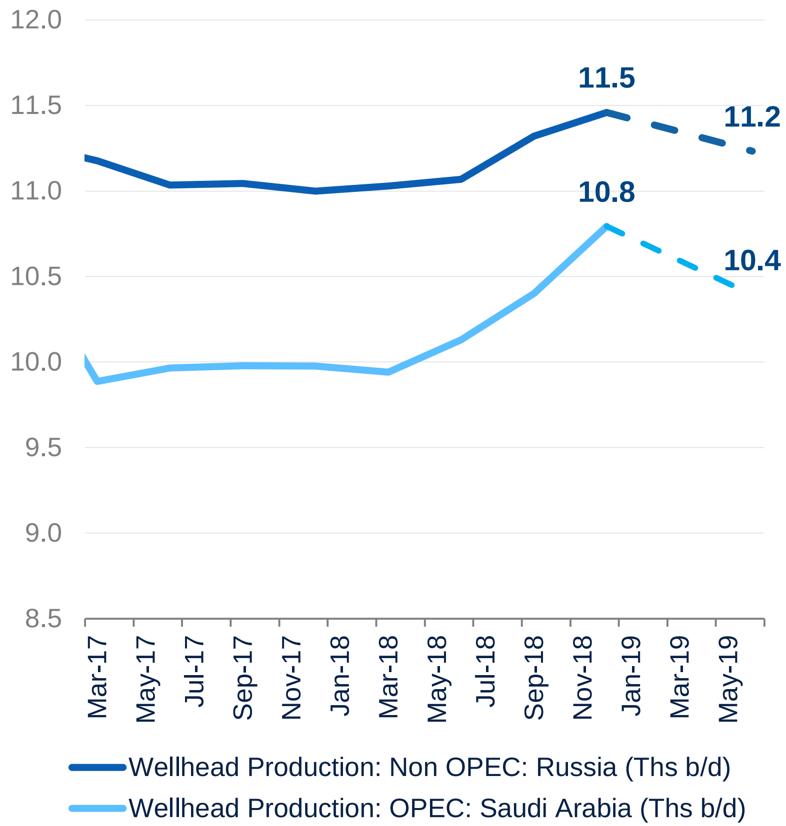
China: imports and production of crude oil
(Million metric tons SA, and million b/d)



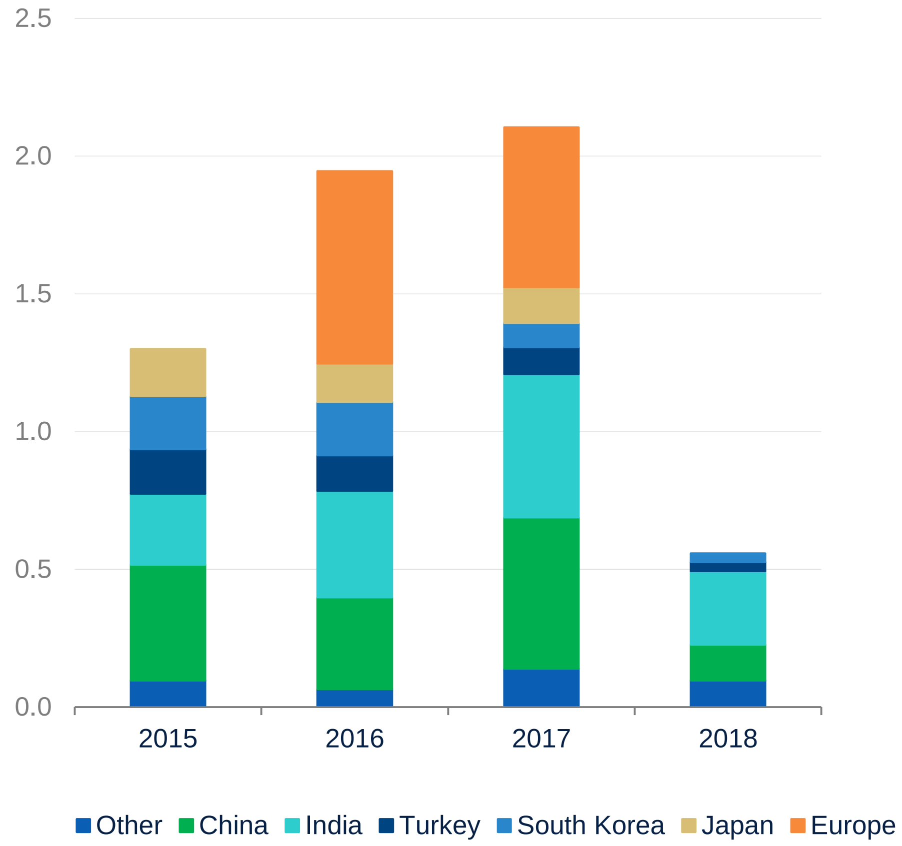
Source: BBVA Research and Haver Analytics

OPEC+ supply adjustments and the expiration of waivers to importers of Iranian oil will tight supply thought 1H19

Crude oil production
(Million barrels per day)



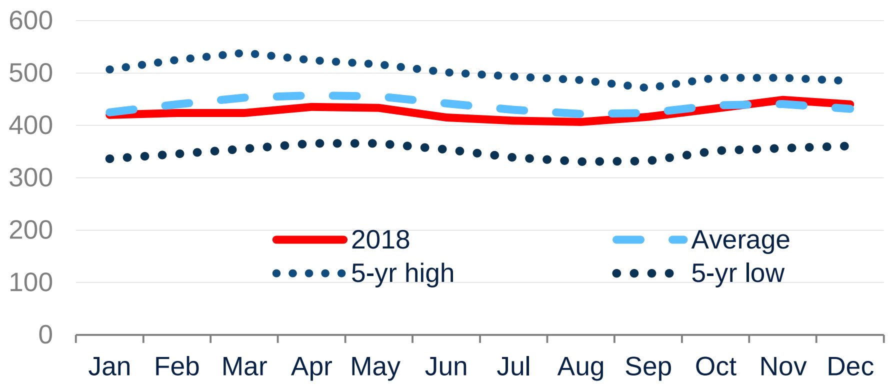
Iran: exports of crude oil
(million barrels per day)



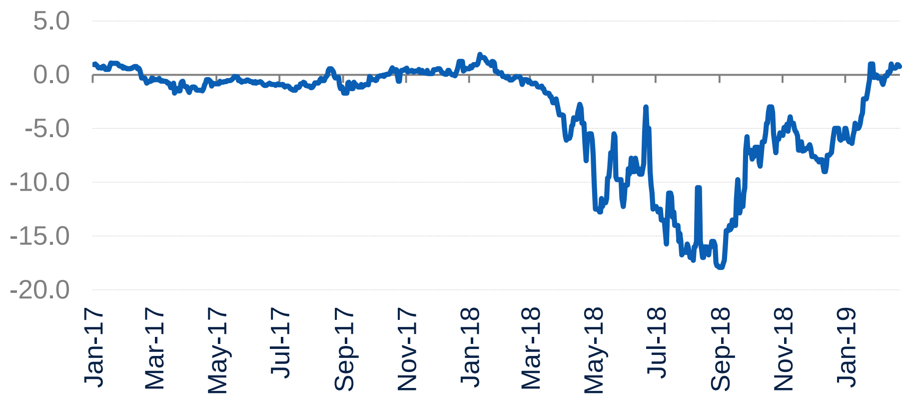
Source: BBVA Research, Haver Analytics, and Bloomberg

U.S. production to remain solid. No signs of domestic oversupply

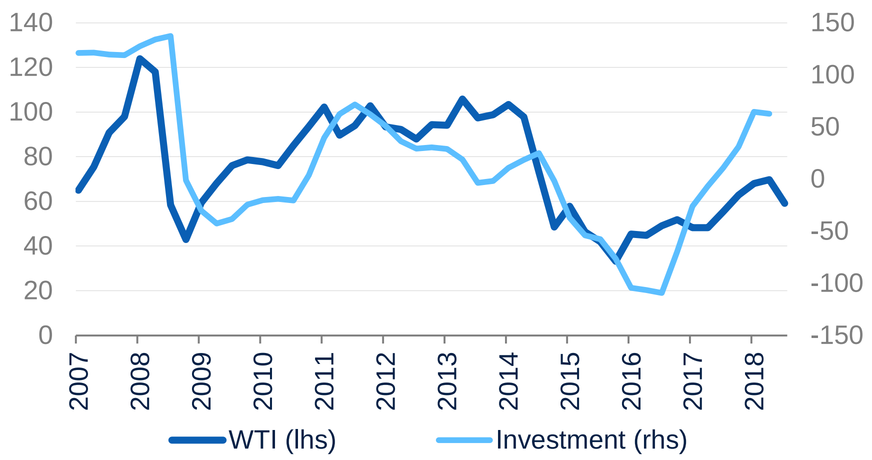
U.S. Crude oil inventories
(Excluding SPR, million barrels)



WTI Midland-Cushing differential
($/b)



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



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

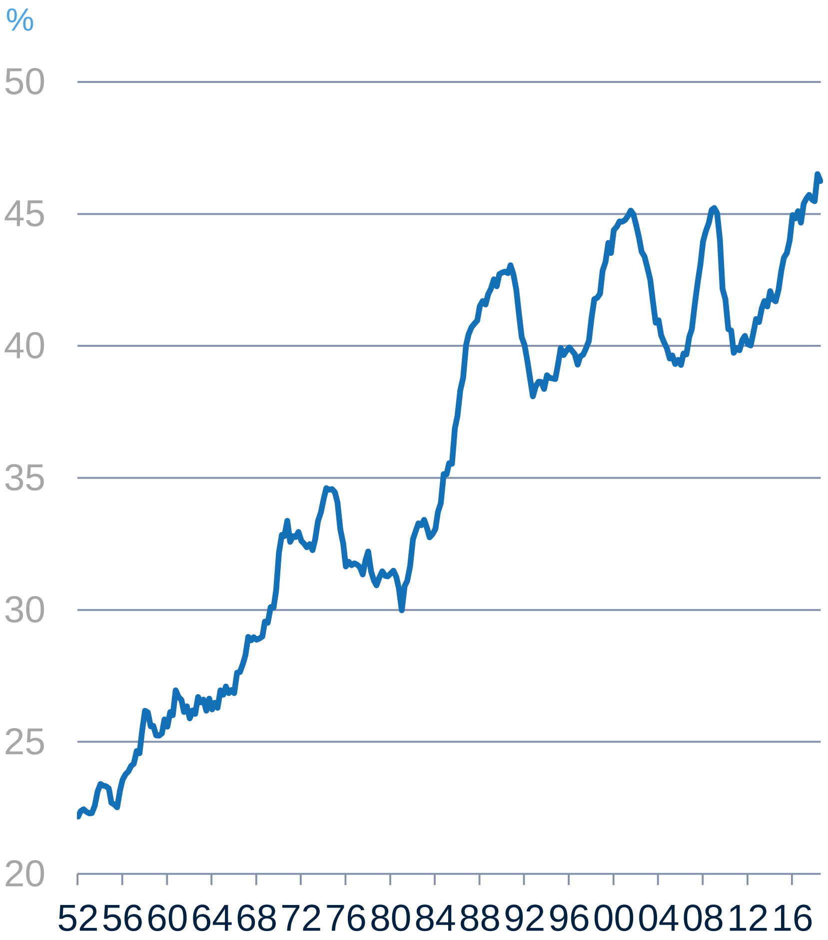
Source: BBVA Research and Haver Analytics

Credit cycle

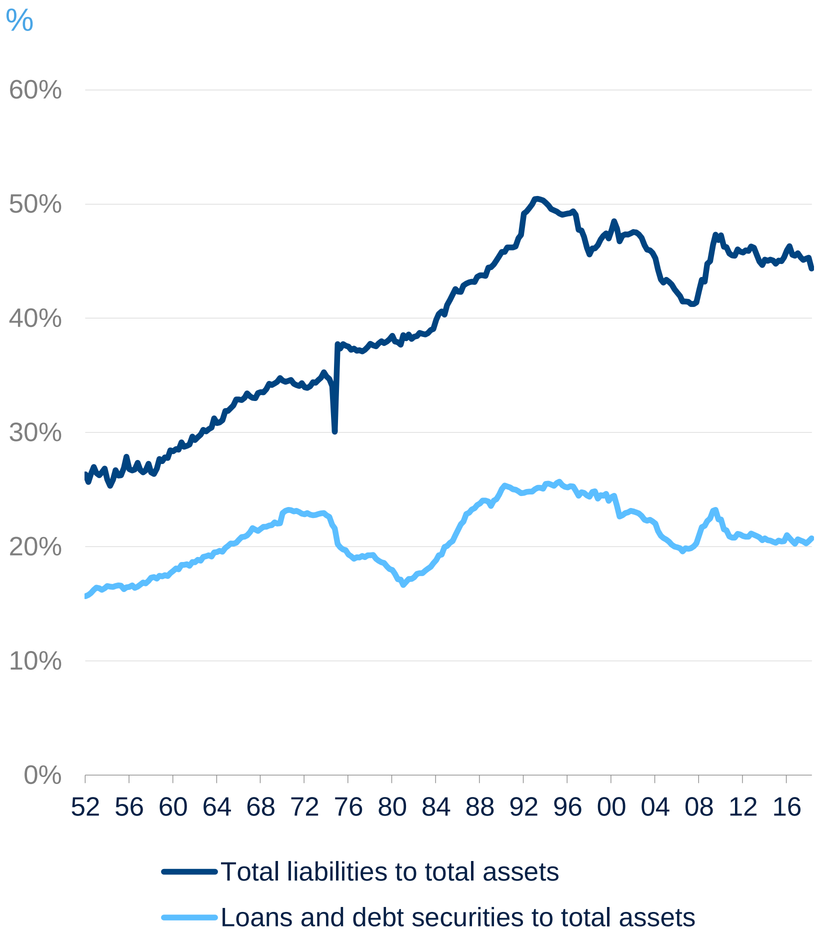
- Risk indicators suggest low risk in the short-term
- Risks are concentrated in the leverage and prices segments
- Debt servicing is becoming more difficult for consumers and will become more difficult for corporations
- An increase in debt distress that would lead to a rise in delinquencies could be a trigger for tighter credit standards, a credit crunch and a recession

Debt to GDP is at historically high level supported by the ability to borrow against assets

Nonfinancial corporate debt to GDP

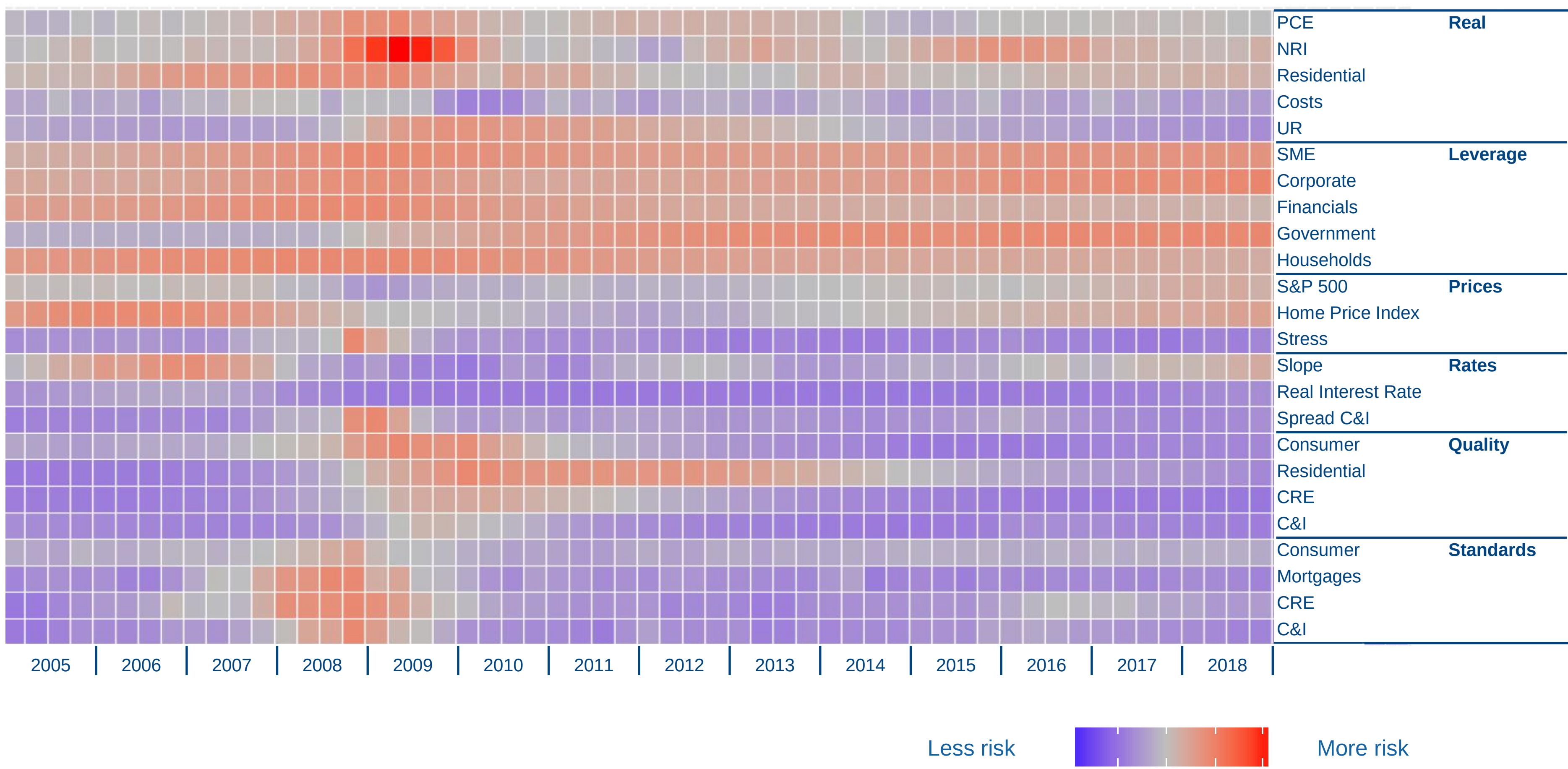


Nonfinancial corporations, leverage



Source: BBVA Research and FRB

The risks are primarily in the leverage and prices segments, making corporate debt one of the primary concerns

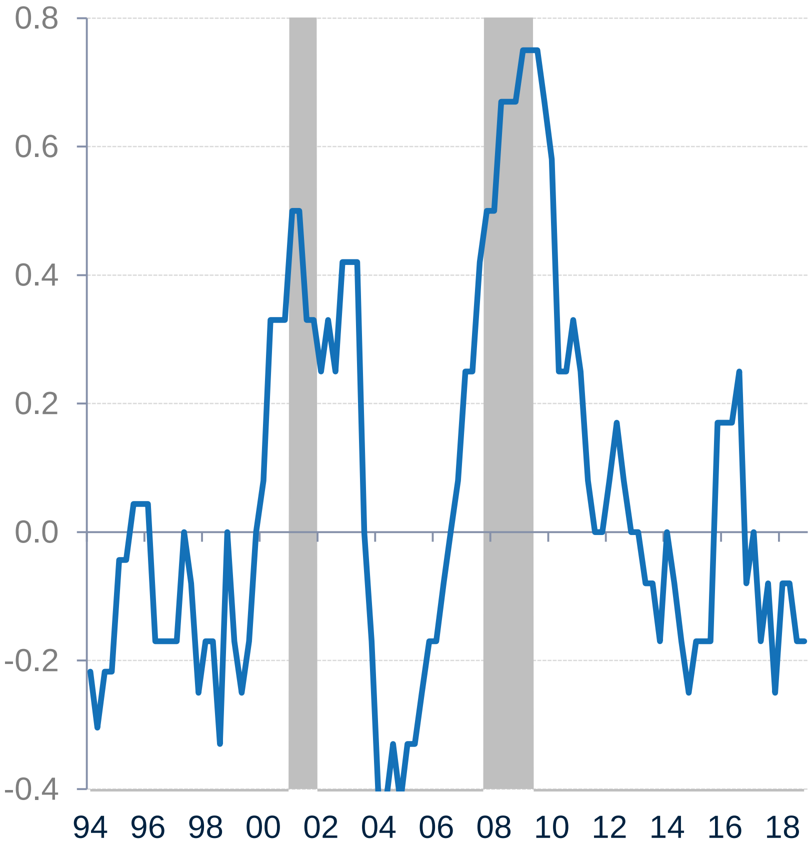


Source: BBVA Research

In the short term, the economy remains in expansion mode

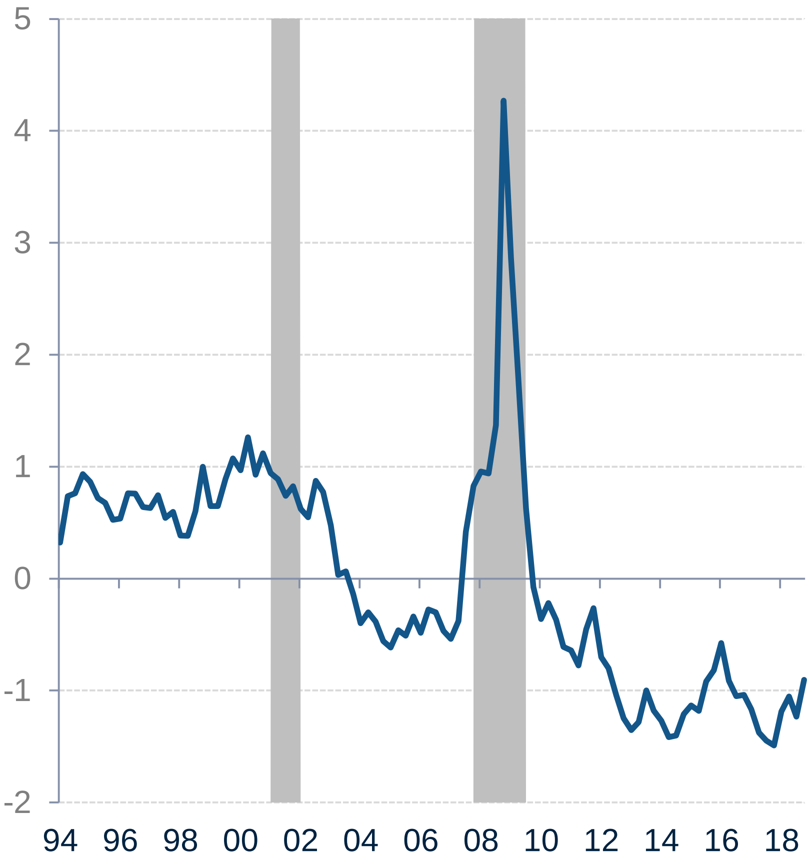
BBVA Research credit cycle risk index

Normalized; >0 above average risk



Financial stress index

Normalized; >0 above average stress

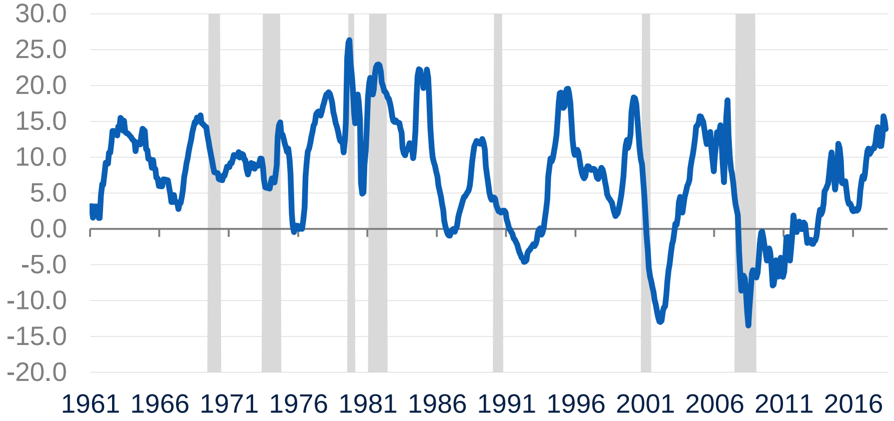


Source: BBVA Research, Haver and FRBSTL

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

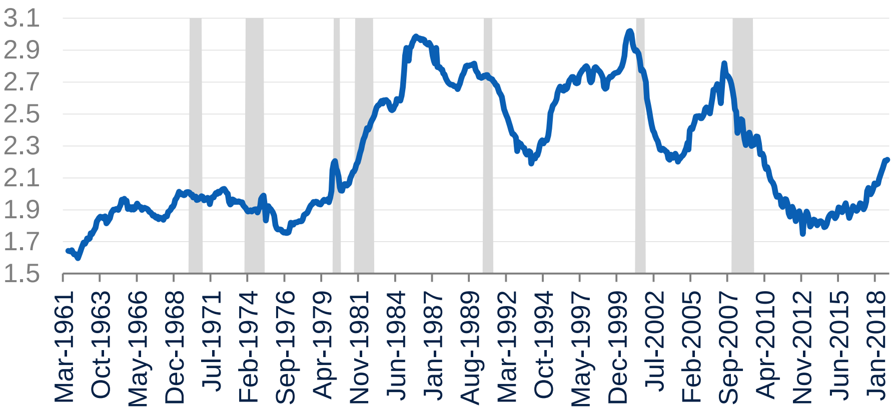
Personal interest expense

Year-over-year %



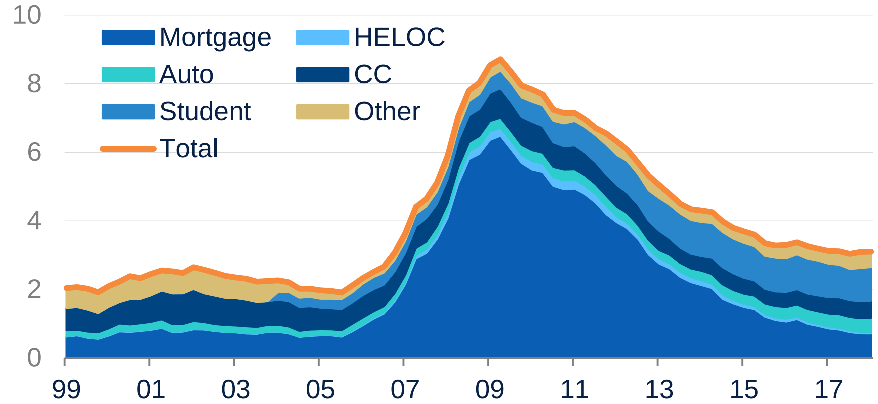
Personal interest expense to disp. income

Ratio, %



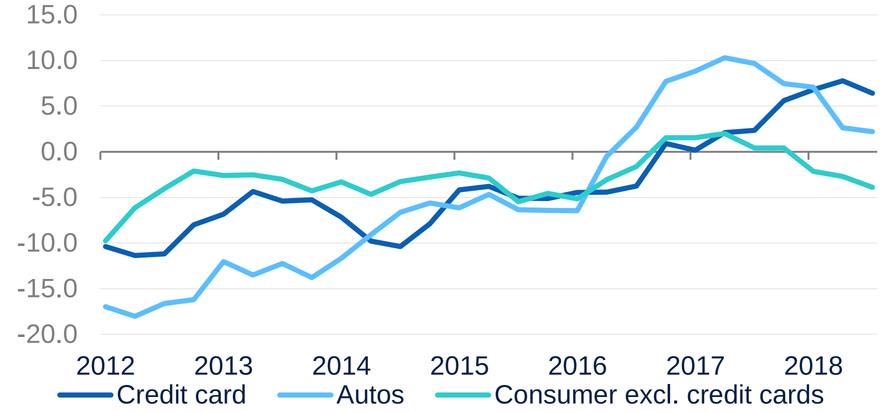
New 90+ day consumer delinquency rates

%



Senior loan officers lending standards

+ tightening / - loosening

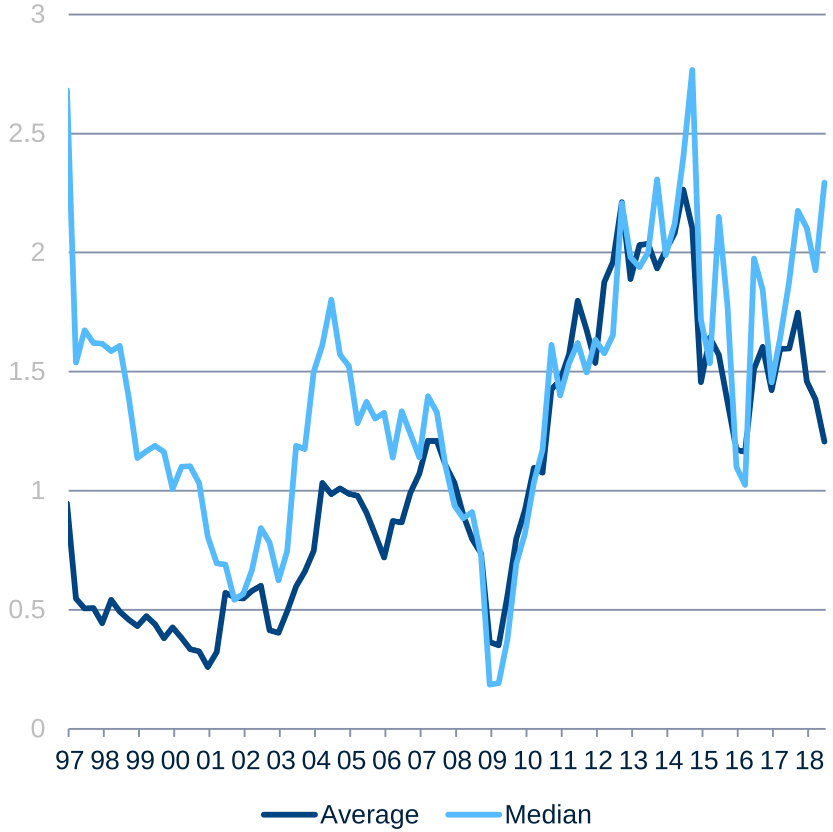


Source: BBVA Research, FRB, NY Fed & BEA

Corporations are able to service their debt, despite some risks in the tails, which are partly related to new corporations that still have negative EBIT

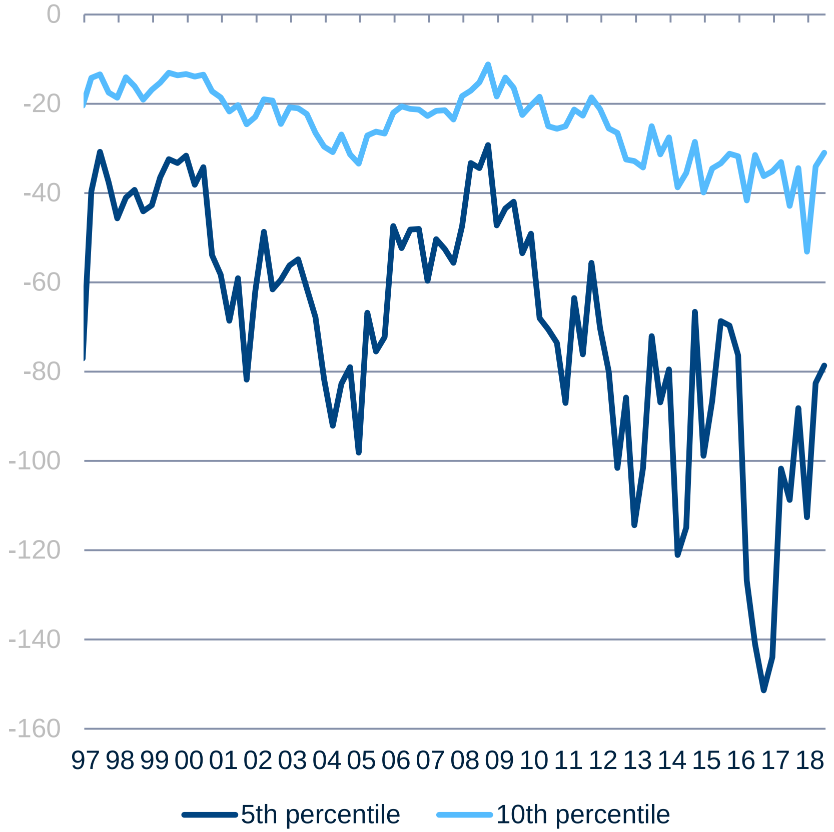
Implied interest coverage ratio

Ratio



Implied interest coverage ratio

Ratio

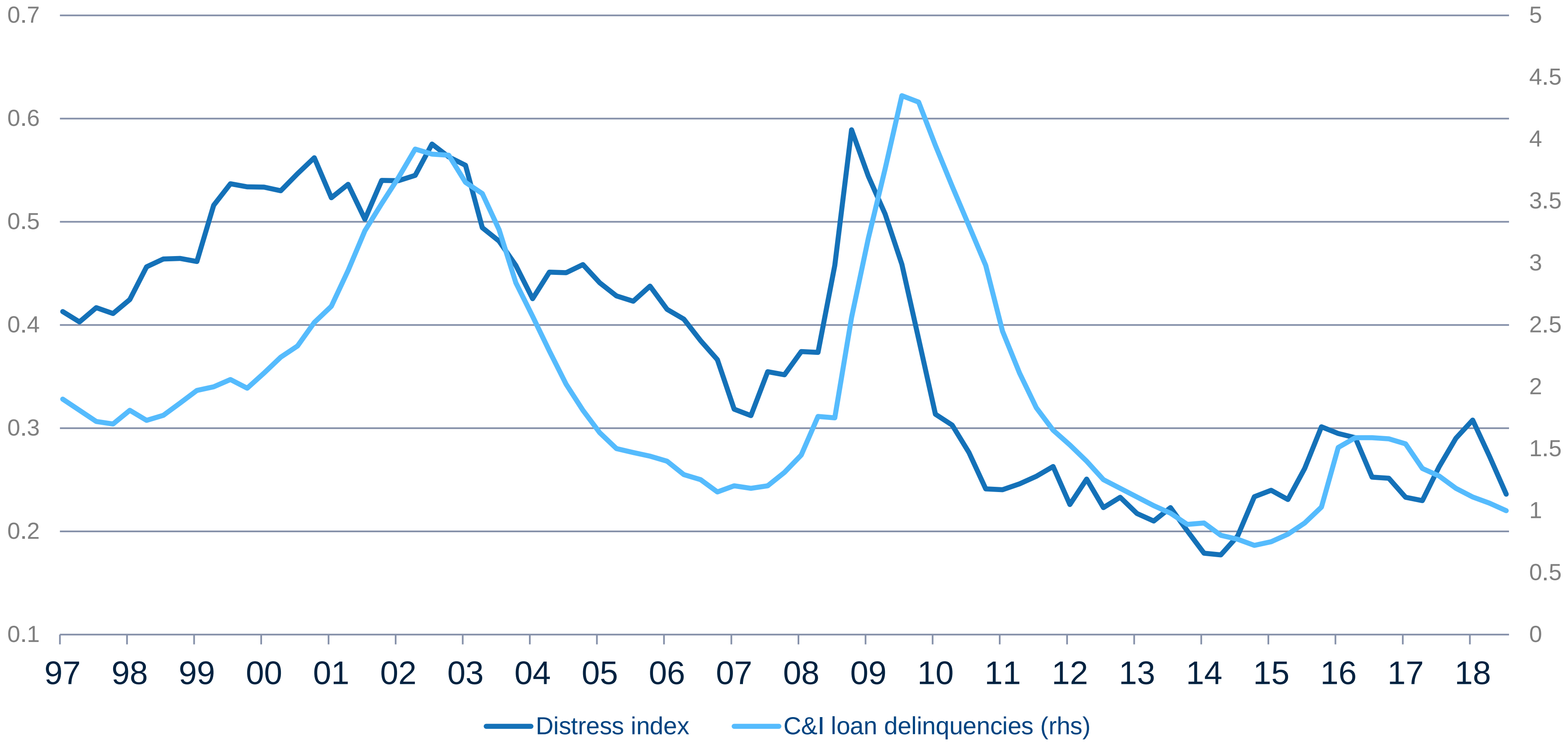


Source: BBVA Research calculations and Bloomberg

Debt distress has been increasing, but is still at favorable levels

BBVA U.S. debt distress leading indicator

Indicator estimated using financial data for a sample of 9448 firms and historical interest rates for corporate debt (AA, BBB, BB, B and CCC)

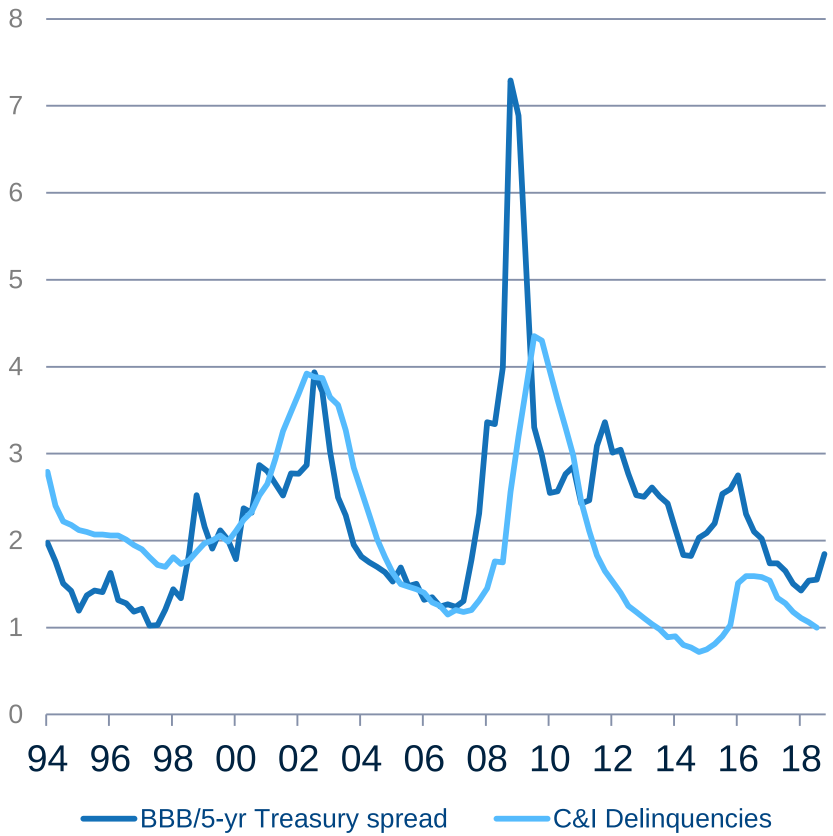


Source: BBVA Research and FRB

Rising interest rates coupled with a sharp correction in asset prices could cause a spike in defaults/delinquencies, weakening expectations

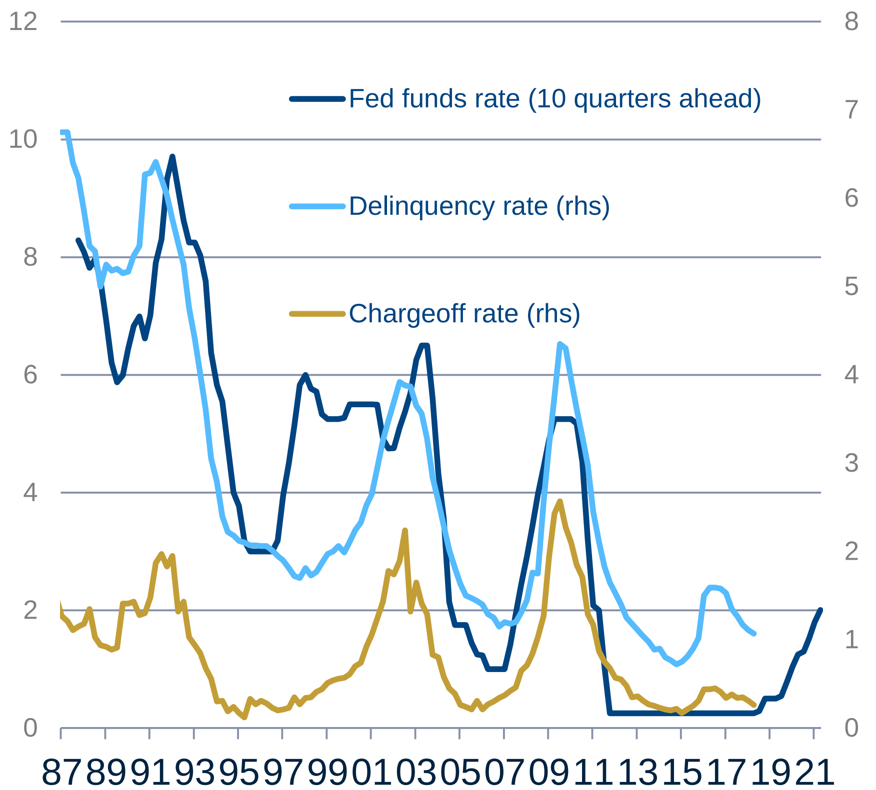
Interest rate spreads and delinquencies

Percentage points



Fed Funds rates and delinquencies

%



Source: BBVA Research, Haver and FRB

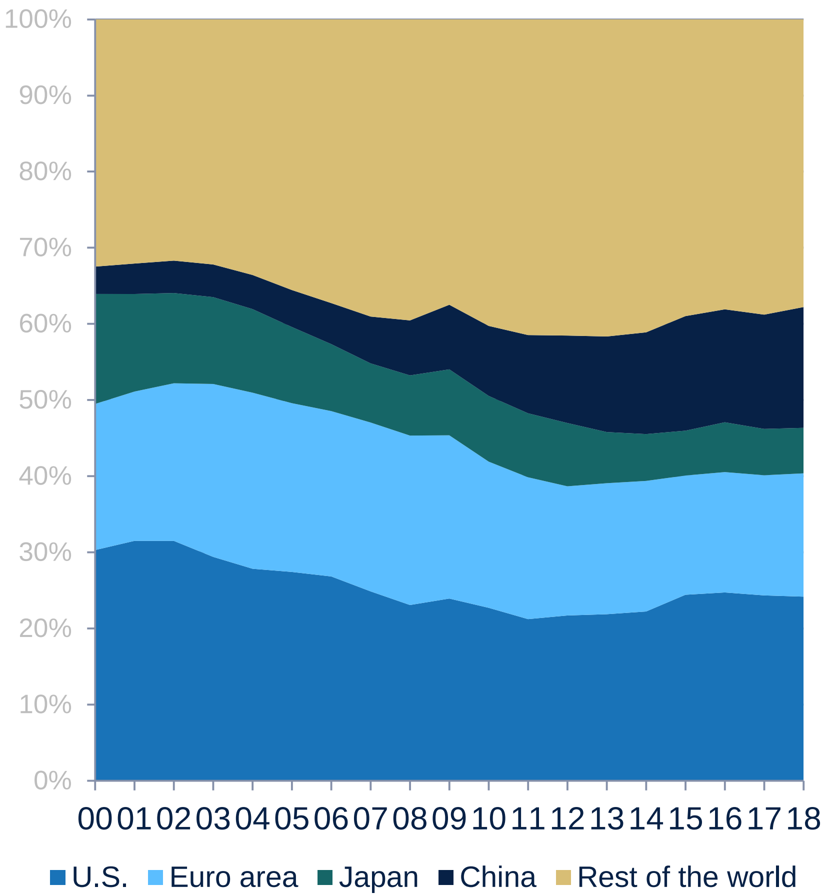
U.S. – China trade war

- China slowdown not necessarily only a result of trade war
- Chinese growth estimate still above 6%
- China and the U.S. working to arrive to a mutually acceptable solution. Agreement expected some time in April, although risk of a no-deal still exists
- Lifting of tariffs should translate to some support for growth both in the U.S. and especially in China
- China has indicated willingness to increase imports from the U.S. which could have a positive impact on U.S. growth. Industries to benefit include aerospace, O&G, agriculture and vehicles and machinery

China concerns are justified, but the challenges seem contained at the moment

World GDP

Distribution



Source: IMF, CEIC and BBVA Research

China activity indicators

3mma, YoY, SA

		2018							2019	
	Mean*	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Industrial Production	9.4	6.6	6.2	5.9	6.0	6.0	5.7	5.7	5.4	5.2
CPI	2.7	1.6	1.6	1.8	2.1	2.3	2.2	2.1	1.8	1.7
Retail sales	14.4	4.2	4.1	3.7	3.9	3.6	4.4	4.5	5.5	7.1
Auto Sales	10.0	9.1	3.4	-1.5	-7.1	-9.5	-12.5	-12.7	-12.8	-12.1
Exports	8.9	11.7	11.7	10.9	12.0	13.4	11.9	4.4	1.8	-3.4
Imports	8.9	20.7	22.5	20.4	21.1	18.7	12.9	4.8	-2.1	-4.6
Manufacturing PMI	-0.4	0.5	0.2	-0.5	-1.4	-2.2	-3.1	-3.5	-3.7	-3.3
Non-manufacturing PMI	-0.5	0.8	0.0	0.2	-0.1	-0.1	-1.4	-1.8	-1.9	-1.2
Caixin PMI	-0.2	1.9	1.2	-0.5	-1.5	-1.9	-1.6	-2.2	-3.6	-4.3
P/E ratio	-0.1	-7.3	-14.6	-20.1	-21.6	-25.3	-26.6	-29.6	-30.8	-27.7
Real estate sales	23.7	12.6	12.9	14.0	14.5	14.5	13.8	13.9	13.9	13.9
Credit	17.0	12.7	12.9	13.0	13.2	13.2	13.1	13.2	13.3	13.4
MICA Forecast		6.70%			6.60%			6.50%		6.30%
GDP YoY		6.70%			6.50%			6.40%		

Contraction | Slow-down | Growth | Boom

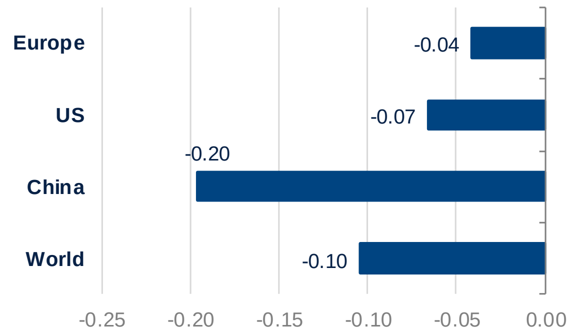
* Mean since 2009

U.S. – China trade

Effect on GDP growth of approved US tariffs and retaliation (pp over two years, trade and financial/confidence channel)

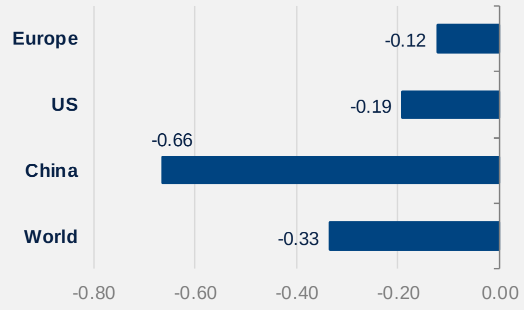
25% Steel
10% Aluminium
All countries

25% $50 billion
10% $200 billion
China

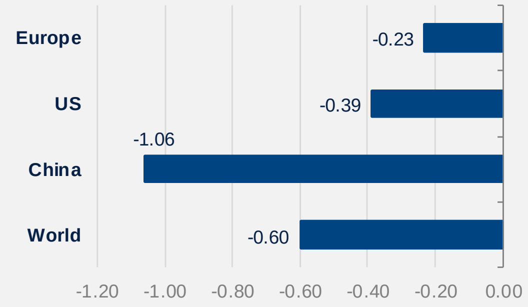


Effect on GDP growth of additional US tariff and retaliation (pp over two years, trade and financial/confidence channel)

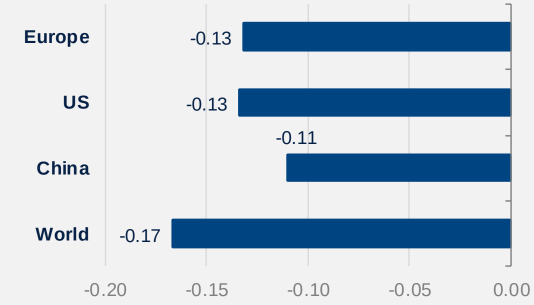
25% $200 billion



25% All Imports from China

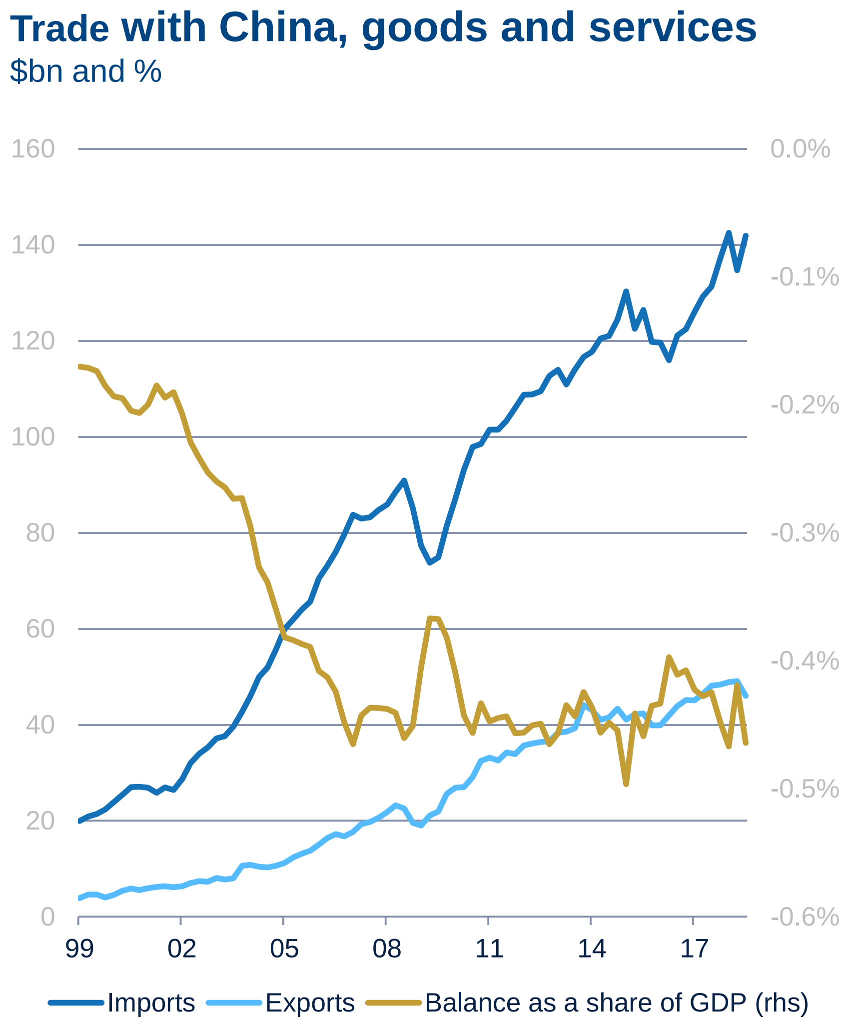


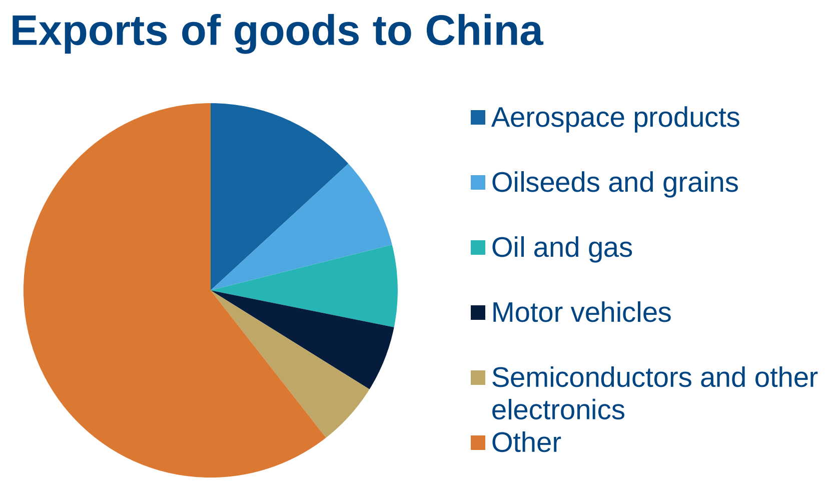
20% All Cars to US

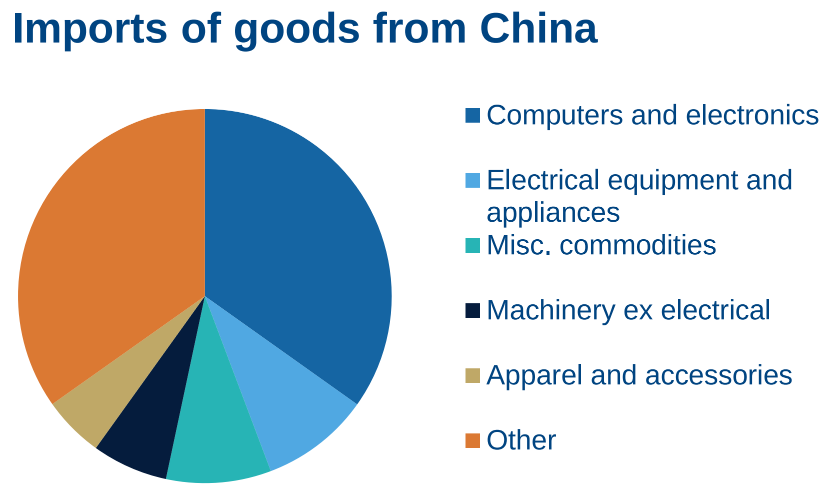


Source: BBVA Research

U.S. – China trade







Source: Census Bureau, BEA and BBVA Research

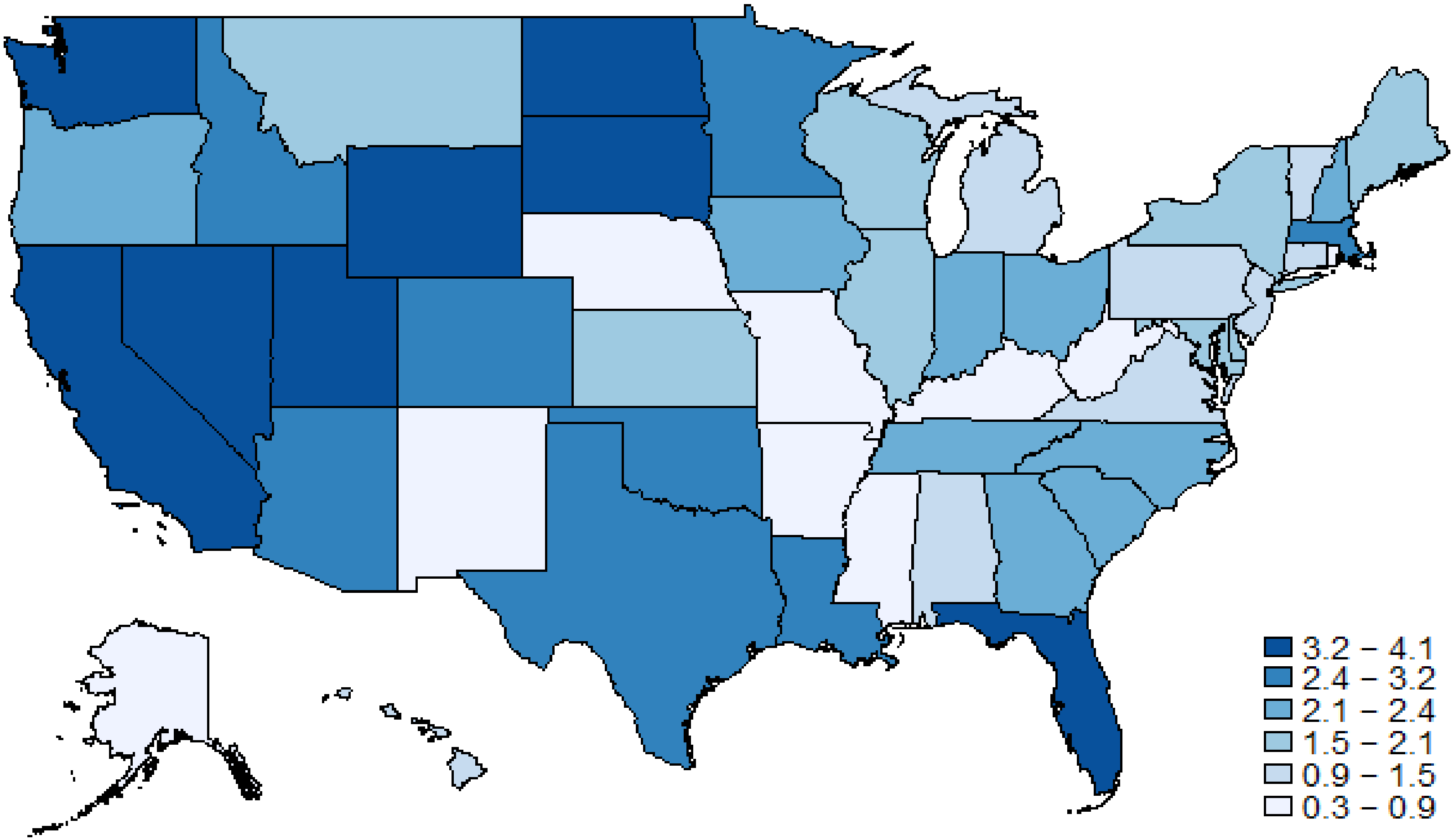
Regional

- Florida expected to outperform in terms of growth in 2019
- The state's low relative exposure to China limits both the upside from the trade deal and the downside from the trade tensions
- The Sarasota region enjoys excellent economic conditions which are expected to continue in the coming period
- The Sarasota-North Port-Bradenton economy is relatively more exposed to cyclical industries, implying greater stress when in recession
- The region could improve its competitiveness with greater investment in facilities that attract young educated people and businesses

Growth forecasts

Real GDP growth 2019, Forecast

%

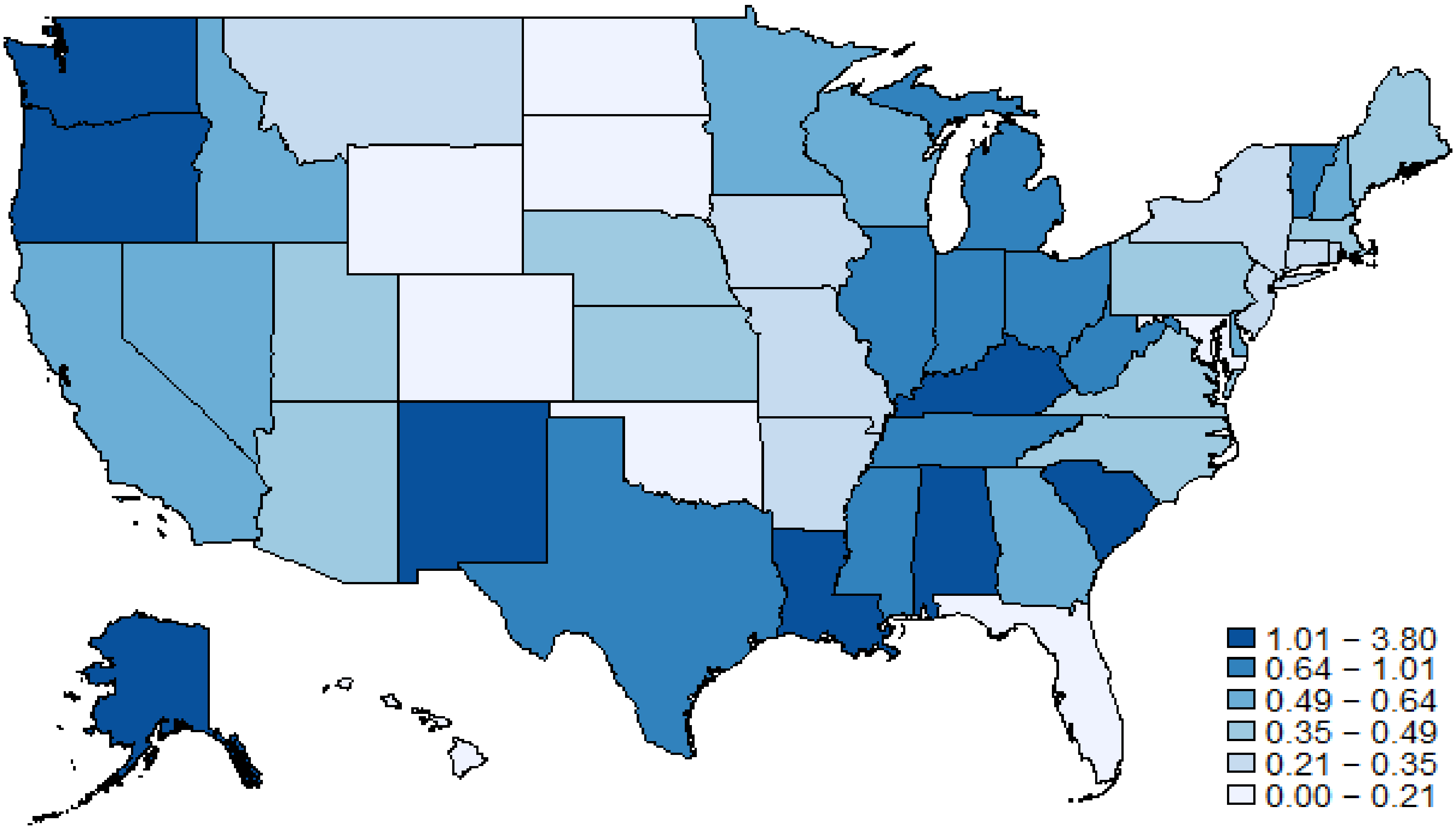


Source: BBVA Research

Regional economy: Trade exposure

Exports to China as a share of GDP

%

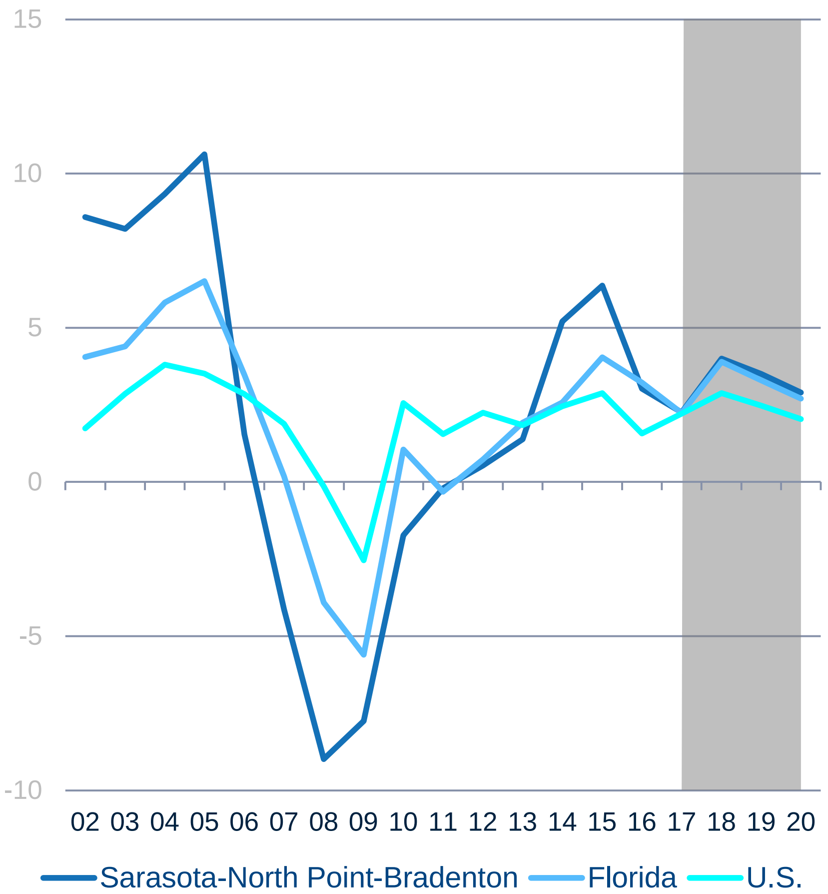


Source: BBVA Research, Census Bureau and BEA

Regional economy: Florida and Sarasota to outperform in 2019

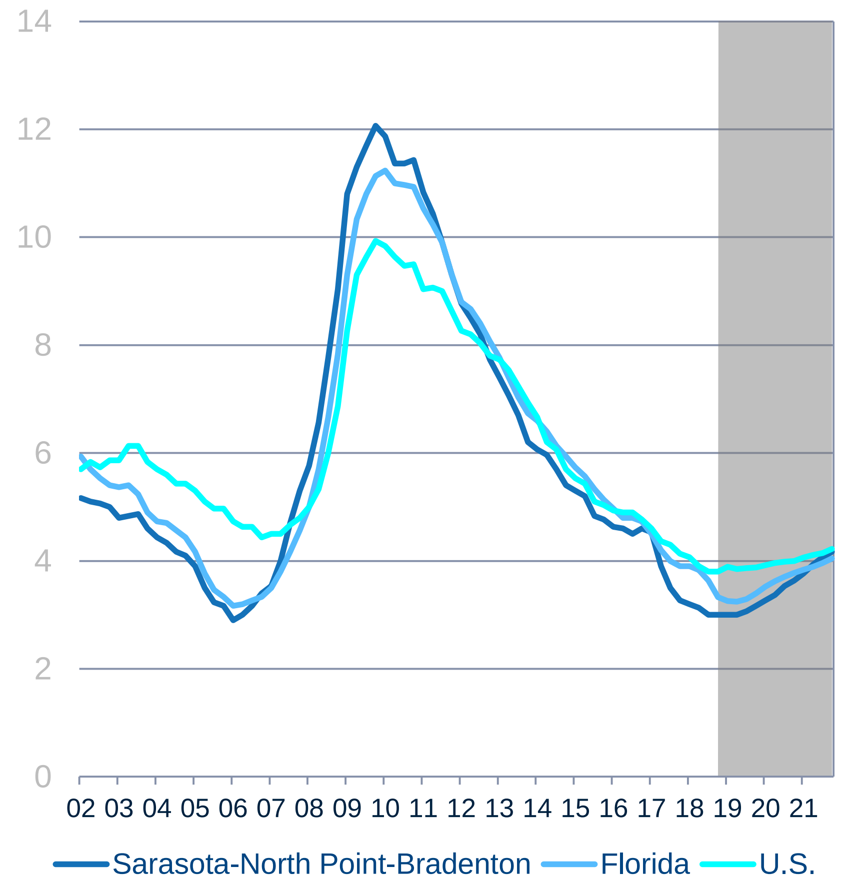
Real GDP

% YoY



Unemployment rate

% YoY

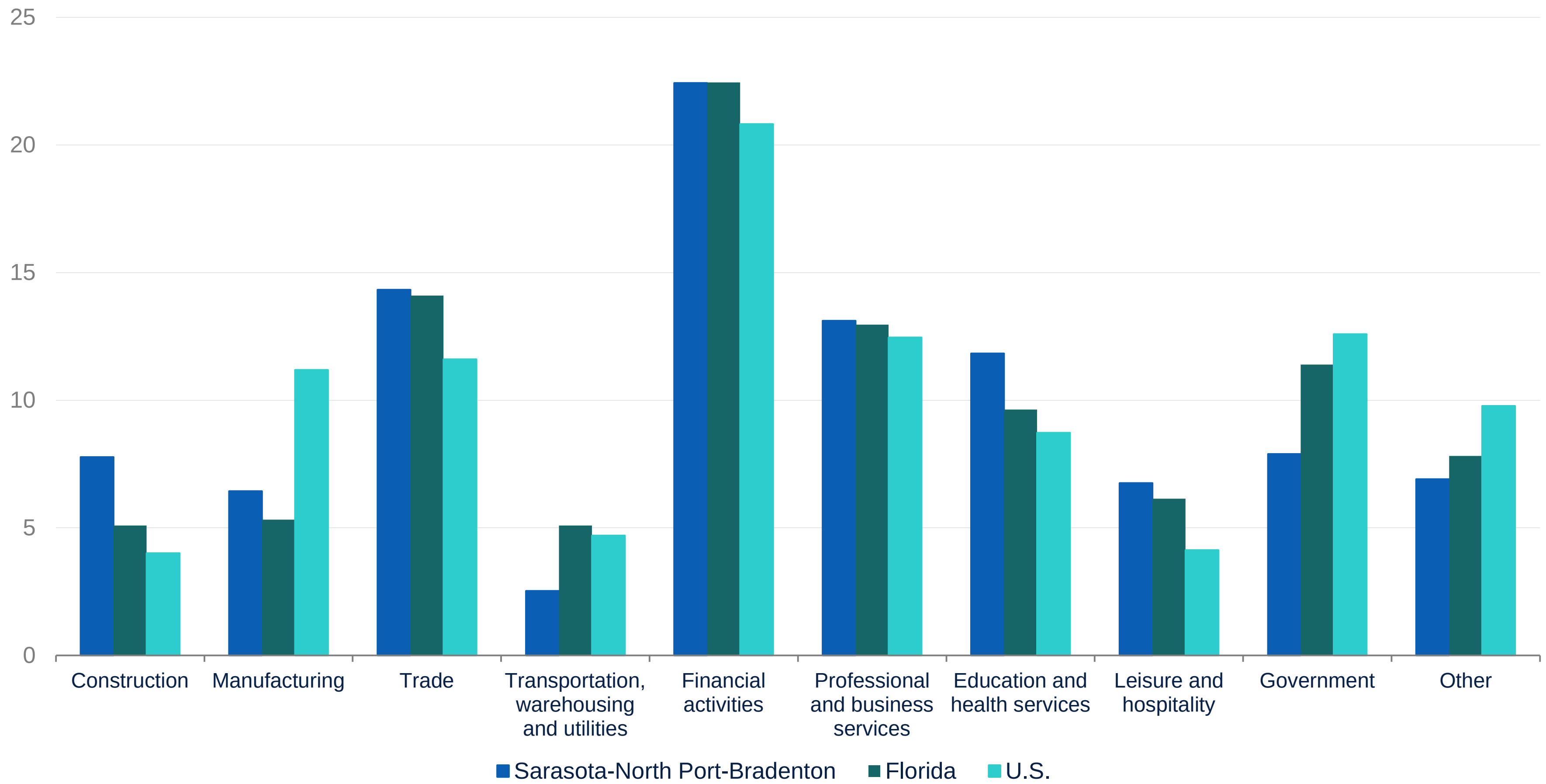


Source: BEA, BLS and BBVA Research

Regional economy: Sarasota more exposed to cyclical industries

Value added by industry group

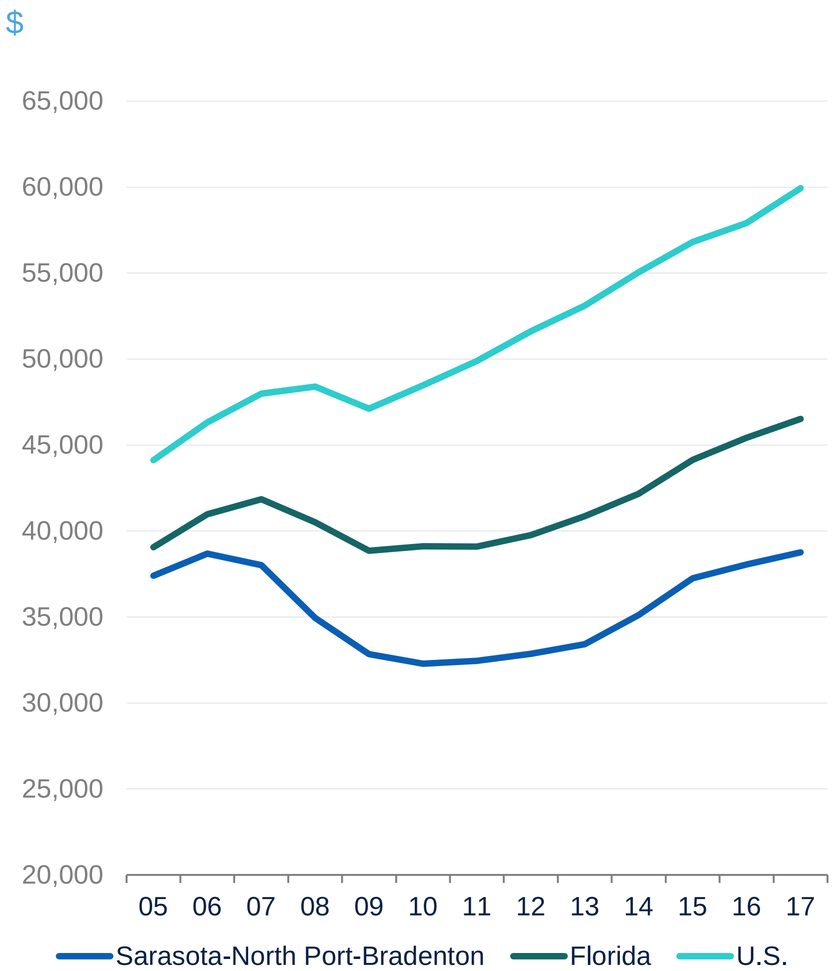
% of GDP



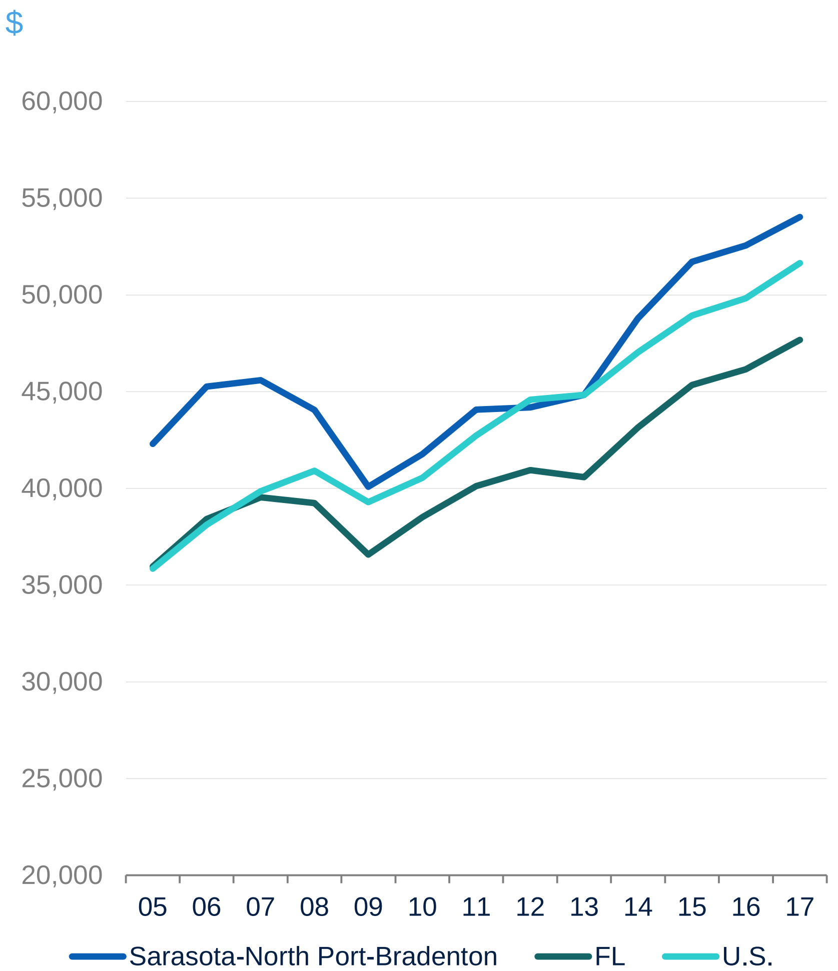
Source: BEA and BBVA Research

Regional economy: Diverging patterns between GDP and personal income per capita

GDP per capita



Personal income per capita



Source: BEA, Census Bureau and BBVA Research

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**
GDP	2.5	2.9	1.6	2.2	2.9	2.5	2.0	1.9	1.8	1.8
Upside					3.0	3.0	3.2	3.1	2.7	2.7
Downside					2.8	0.7	-0.9	1.9	2.1	2.3
UR	6.2	5.3	4.9	4.4	3.9	3.8	4.1	4.2	4.5	4.5
Upside						3.1	2.9	2.9	3.0	3.0
Downside						4.3	6.2	6.6	5.7	5.0
CPI	1.6	0.1	1.3	2.1	2.4	1.7	2.2	2.0	2.1	2.0
Upside						1.6	3.8	3.5	3.8	3.8
Downside						0.7	1.1	1.1	1.3	1.4
Fed [eop]	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
10-Yr [eop]	2.21	2.24	2.49	2.4	2.83	2.87	3.09	3.23	3.37	3.46
Upside						3.90	5.10	5.90	5.90	5.90
Downside						2.40	1.60	1.90	2.10	2.10

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BBVA Research

Navigating a sea of economic uncertainty

March 19, 2019
Sarasota, FL

Creating Opportunities