

U.S. Economic Outlook

Monthly Update

February 22, 2016

Conference Call Details

U.S. Economic Outlook: Powering Through Despite Dreary Start to 2016

BBVA Research USA would like to invite you to our U.S. Economic Outlook conference call on Monday, February 22nd, at 10am CT. During the call, we will present our monthly update to the economic scenario followed by a brief Q&A period. Presentation materials will be distributed prior to the call.

The U.S. economy is expected to maintain a moderate pace of expansion throughout the coming year, but recent data has caused fears of another recession on the horizon. Market volatility has intensified, but we can't let this blur our vision of what's still to come later this year. Another Fed funds rate increase, perhaps?

Please join us for an informative discussion with Kim Chase



Kim Chase
Senior Economist, BBVA Research USA
kim.fraser@bbva.com
[@BBVAResearchUSA](https://twitter.com/BBVAResearchUSA)
www.bbva.com/research

Monday, February 22, 2016

10:00 am | CDT (GMT -06:00) | 30 min

[Join WebEx Meeting](#)

Meeting Number: 714 877 792

Meeting Password: bbva1234

Join by phone

+1-877-768-4036 US Toll Free

+1-972-932-2100 US Toll

Access code: 711 804 024

WebEx Link

<https://bbvacompass.webex.com/bbvacompass/j.php?MTID=mf1d55fec55a29b0321b81f48c40dfa4b>

Global Call-in Numbers

<https://bbvacompass.webex.com/bbvacompass>



Discussion

GDP

Relying on robust consumption

- Healthy consumption is the key to moderate growth of 2.5%
- Boost from low oil prices offsetting USD impact on exports
- Fiscal budget relieves some downward pressures on growth

Inflation

No signs of a fire

- Falling oil/commodity and import prices extending into 2016
- Core services inflation outweighing commodities
- Unlikely to reach Fed's target until 2017 or later

Fed

Finding a comfortable policy path

- Fed announces first rate hike in December to 0.25-0.50%
- Shallow path as Fed waits to assess impact of higher rates
- Meeting-by-meeting approach continues, with two increases likely in 2016 under our baseline scenario

Interest Rates

Low yields for a prolonged period

- Yield curve continues to flatten
- Downward pressure on long-end (financial volatility, risk-off sentiment, regulation, HFT)
- Limited increases in future long-term yields

Risks

Global spillover more pronounced

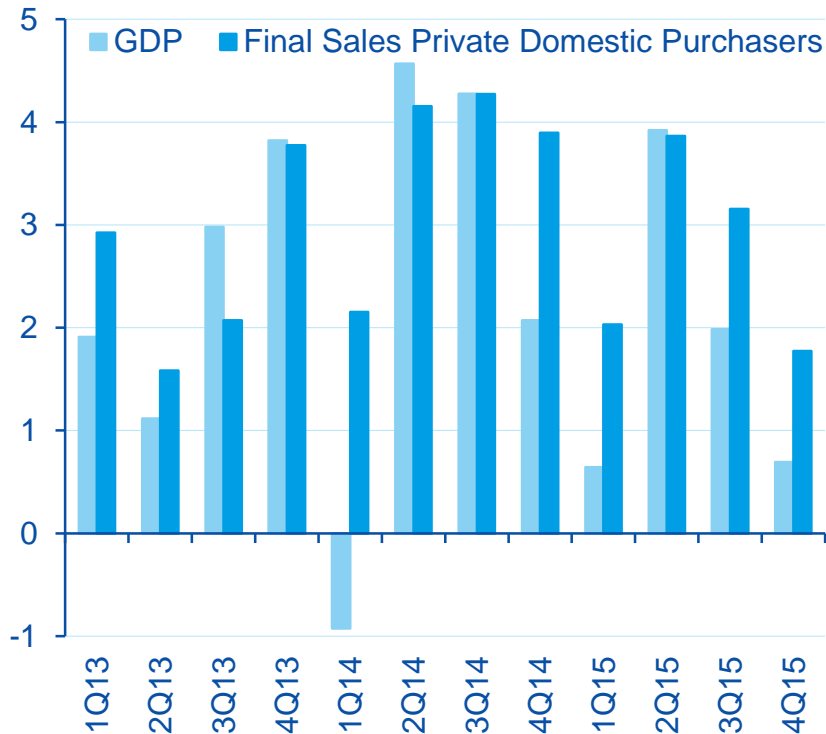
- Domestic: Fed exit strategy, steep disinflation, financial overheating, regional shocks (Texas)
- Global: Further slowdown in China/EMs, deflation/recession Europe, financial volatility, geopolitical threats, etc.

U.S. Economic Activity

Current conditions pointing to signs of a slowdown in growth, at least for 1Q16

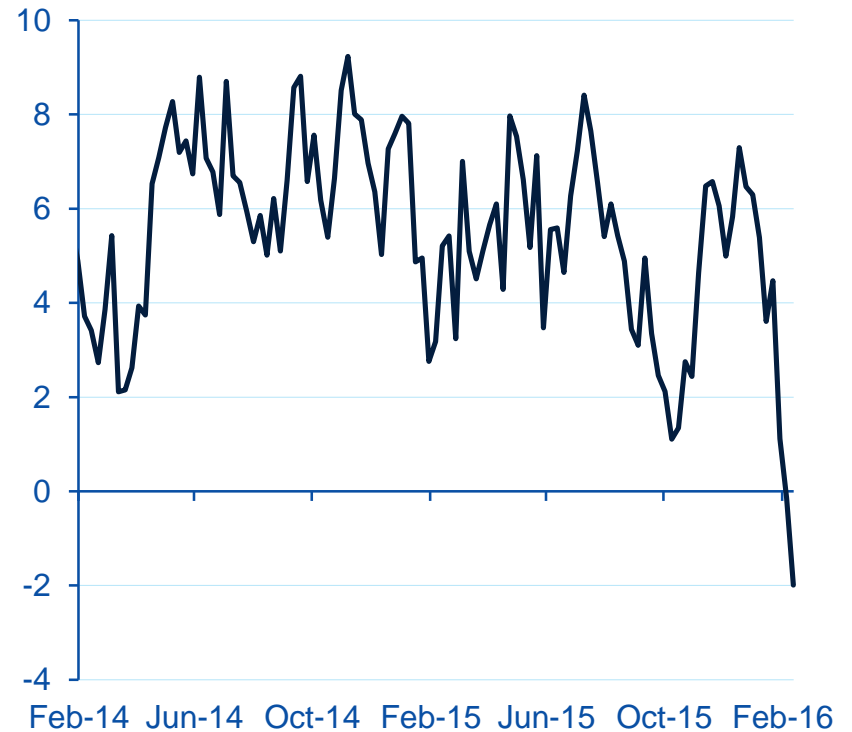
Real GDP Growth and Final Sales

QoQ SAAR % Change



BBVA USA Weekly Activity Index

3 Month % Change

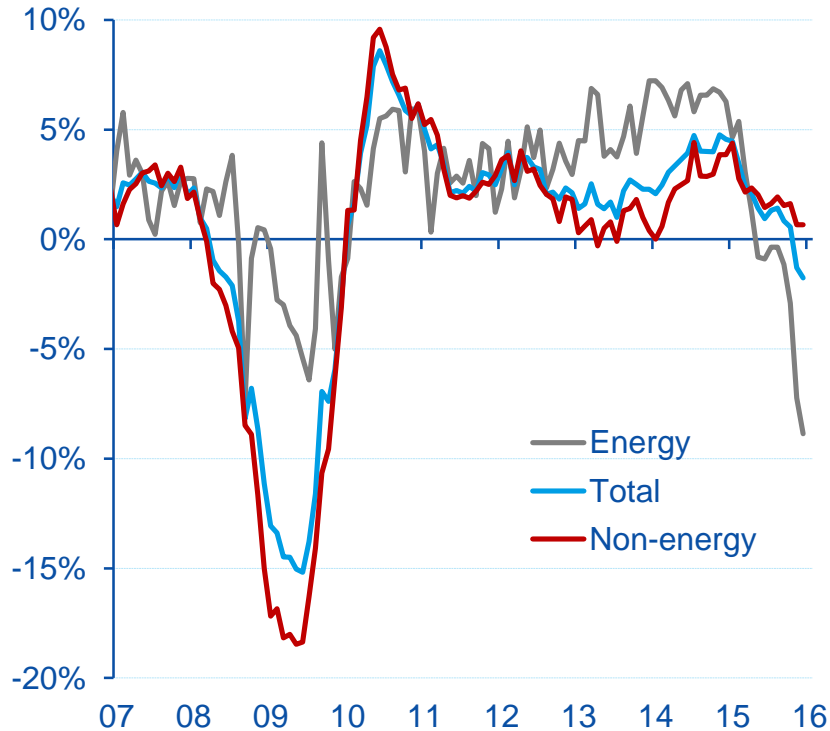


U.S. Economic Activity

Declines in industrial production led primarily by the energy sector

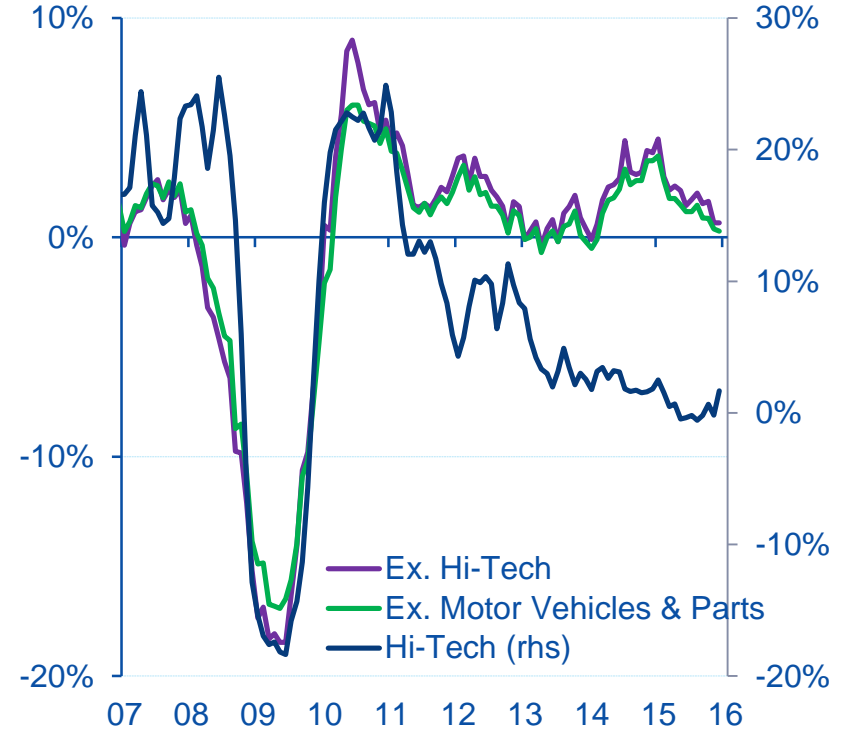
Industrial Production: Energy vs Non-Energy

YoY % Change



Non-Energy Industrial Production

YoY % Change

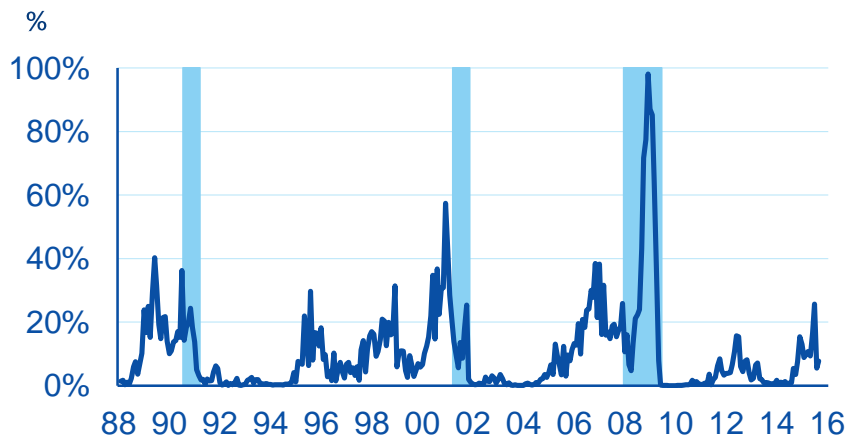


U.S. Economic Activity

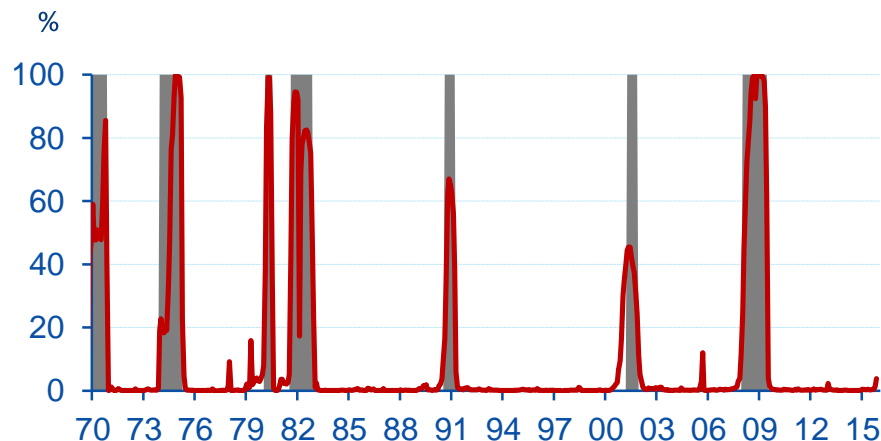
Are we on the verge of another recession?

- Broad-based models point to low probability
- Modelling at-risk sectors, spreads, and P/E ratios increases recession concerns, albeit still relatively low

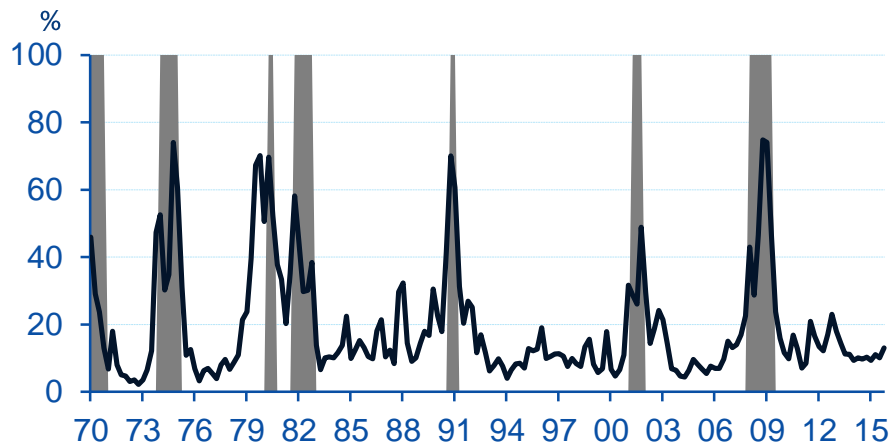
BBVA USA Probability of Recession in 12M



Fed's Probability of Recession



Philly Fed's Anxious Survey



Labor Markets

Improvements in job availability suggests that the participation rate should tick up slowly in the coming years

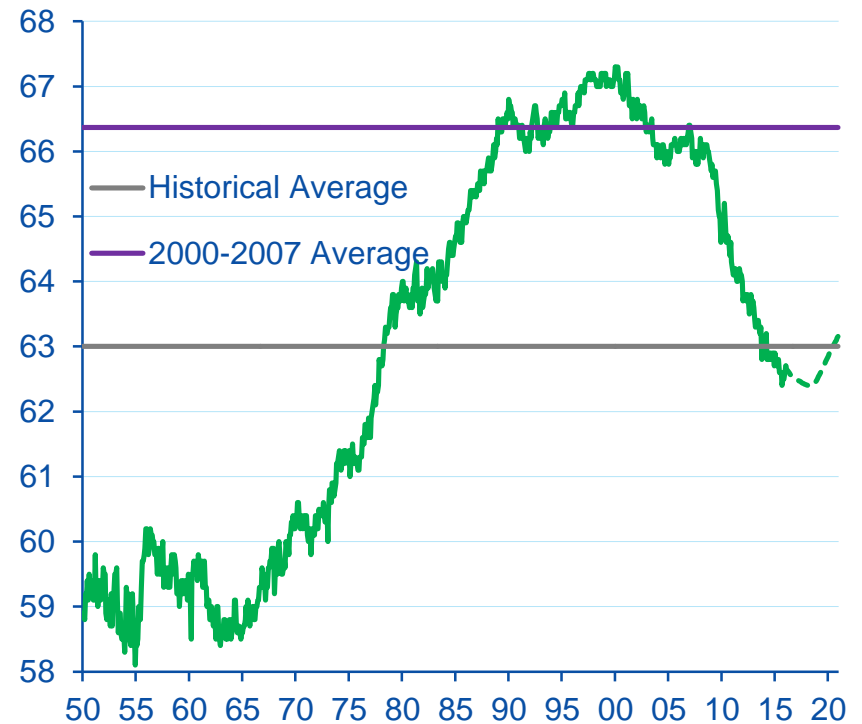
National Beveridge Curve

%



Labor Force Participation Rate

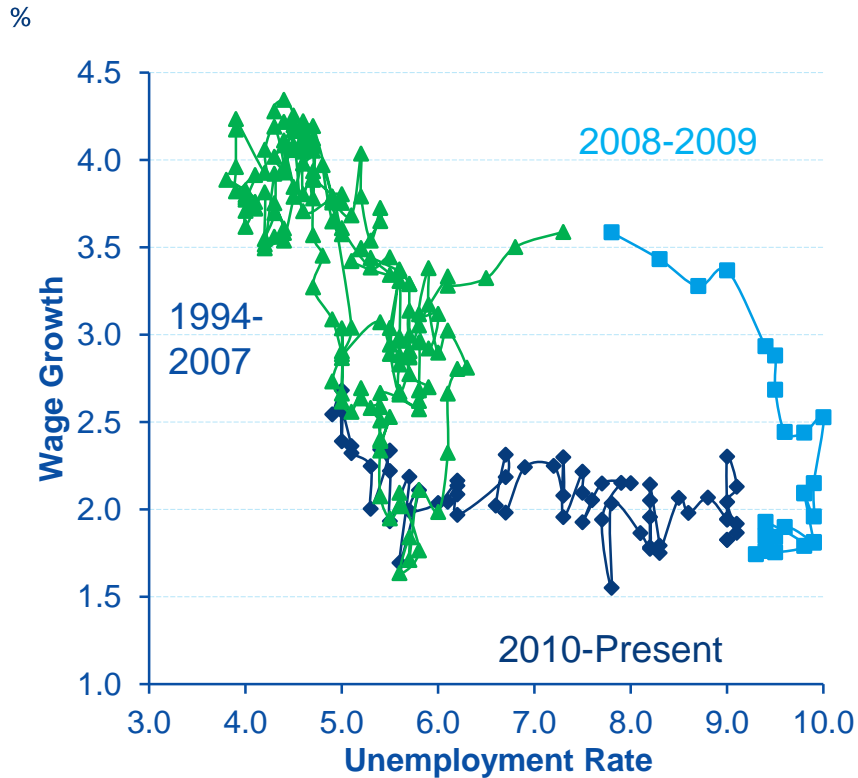
%



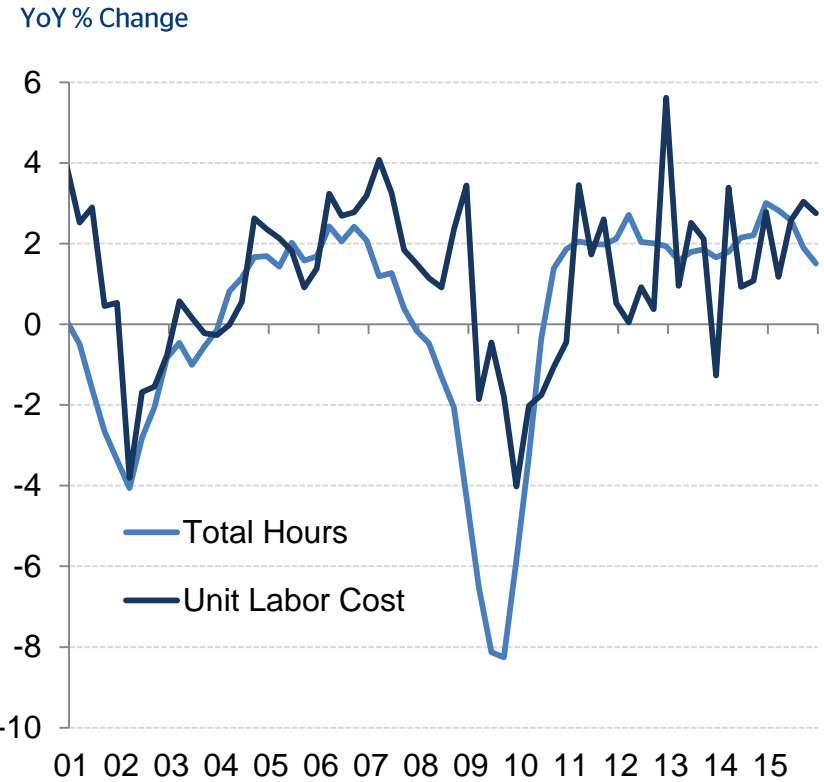
Labor Markets

Wage growth is building but remaining slack suggests slow pace in 2016

Philips Curve



Total Hours and Unit Labor Costs

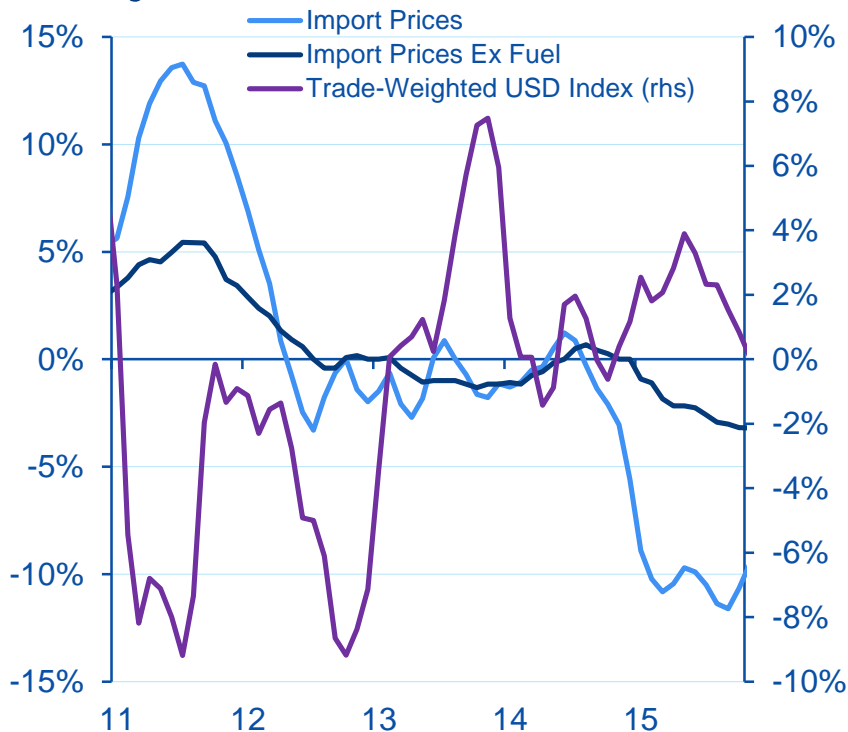


Inflation

Encouraging data to start 2016 despite ongoing downward pressures from oil and USD

Import Price and USD Strength

YoY % Change



CPI Components

January 2016

CPI	MoM	YoY
Total	0.03%	1.34%
Food	0.01%	0.83%
Energy	-2.76%	-6.53%
Core	0.29%	2.22%
Core Commodities	0.23%	-0.08%
Apparel	0.58%	-0.63%
Medical Care Commodities	0.38%	2.12%
Core Services	0.31%	2.98%
Shelter	0.30%	3.25%
Medical Care Services	0.52%	3.25%
Core Ex Shelter	0.28%	1.46%

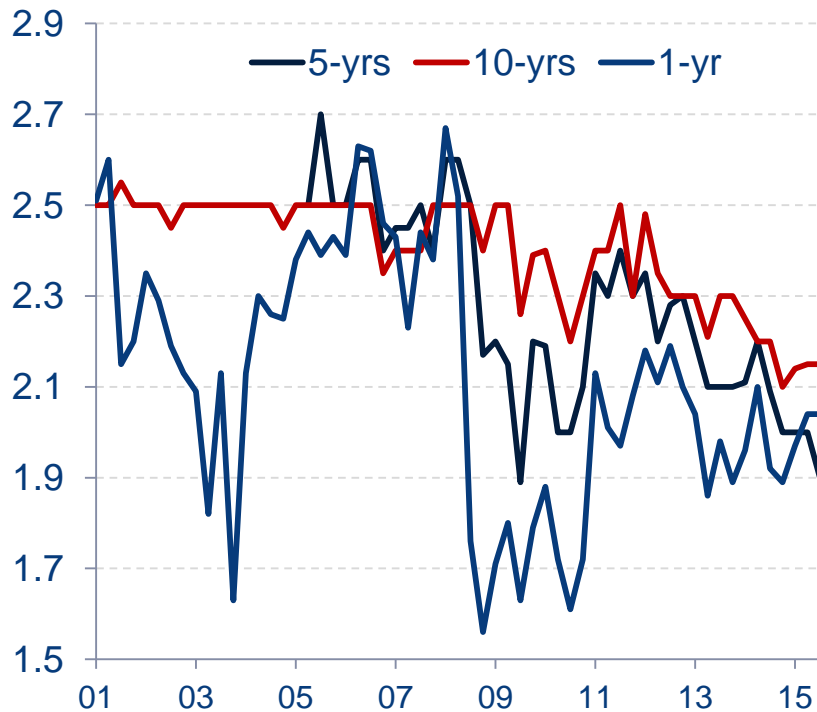
Source: BBVA Research, BLS, FRB & Haver

Inflation

Still, inflation expectations have fallen to 7-year lows

Survey-Based Inflation Expectations

%, Survey



12M Implied FFR & Inflation Expectations

%

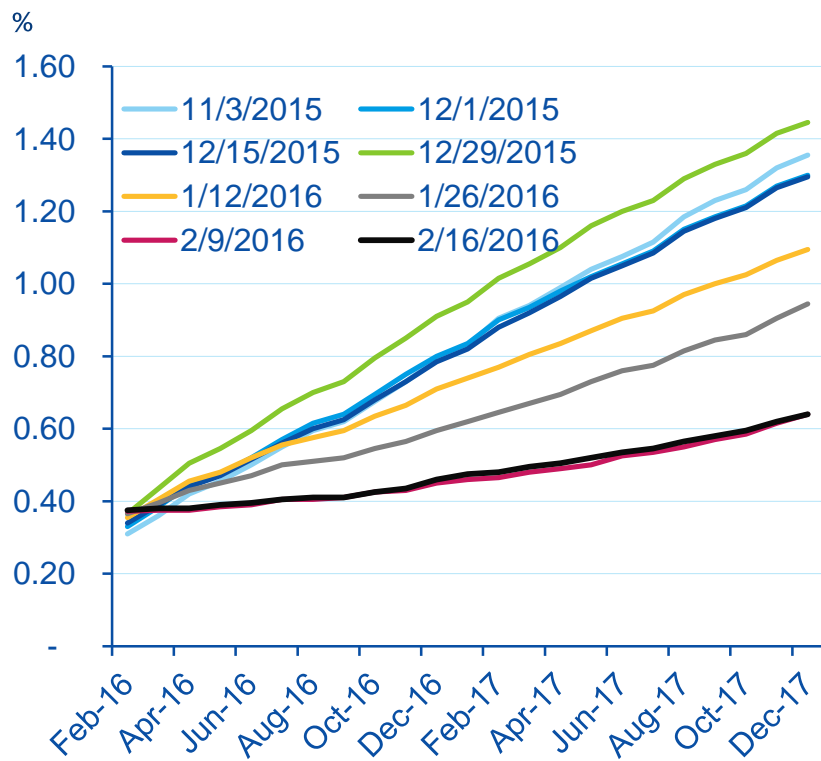


Source: BBVA Research & Haver

Monetary Policy

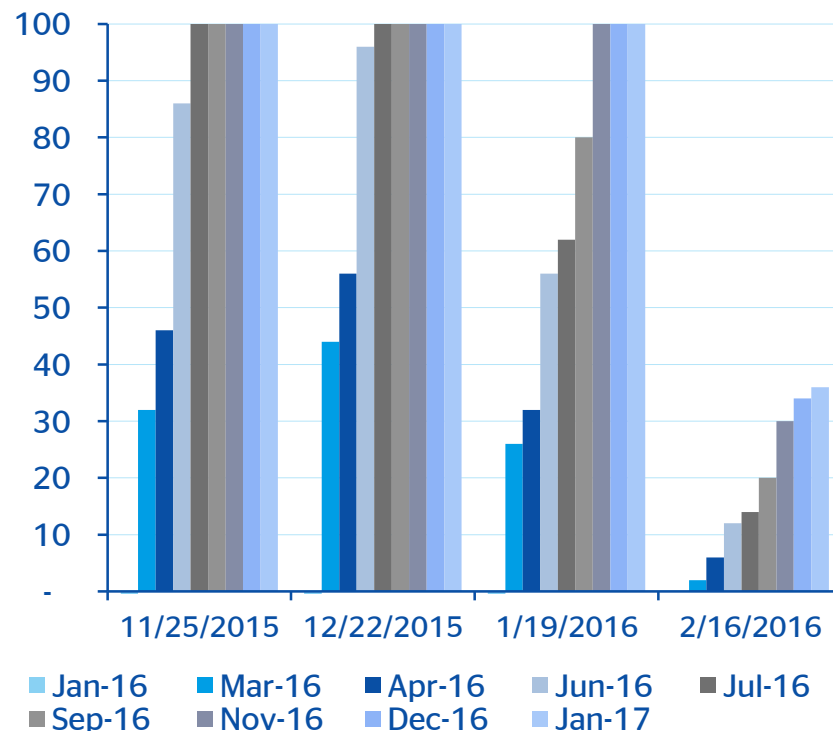
Markets no longer expecting any rate increases in 2016

Federal Funds Rate Futures



Fed Funds Futures Implied Probabilities

2nd 25bp increase, %



Source: BBVA Research & Haver

Monetary Policy

Yellen's testimony hinted at Fed's growing concerns

Economic Outlook

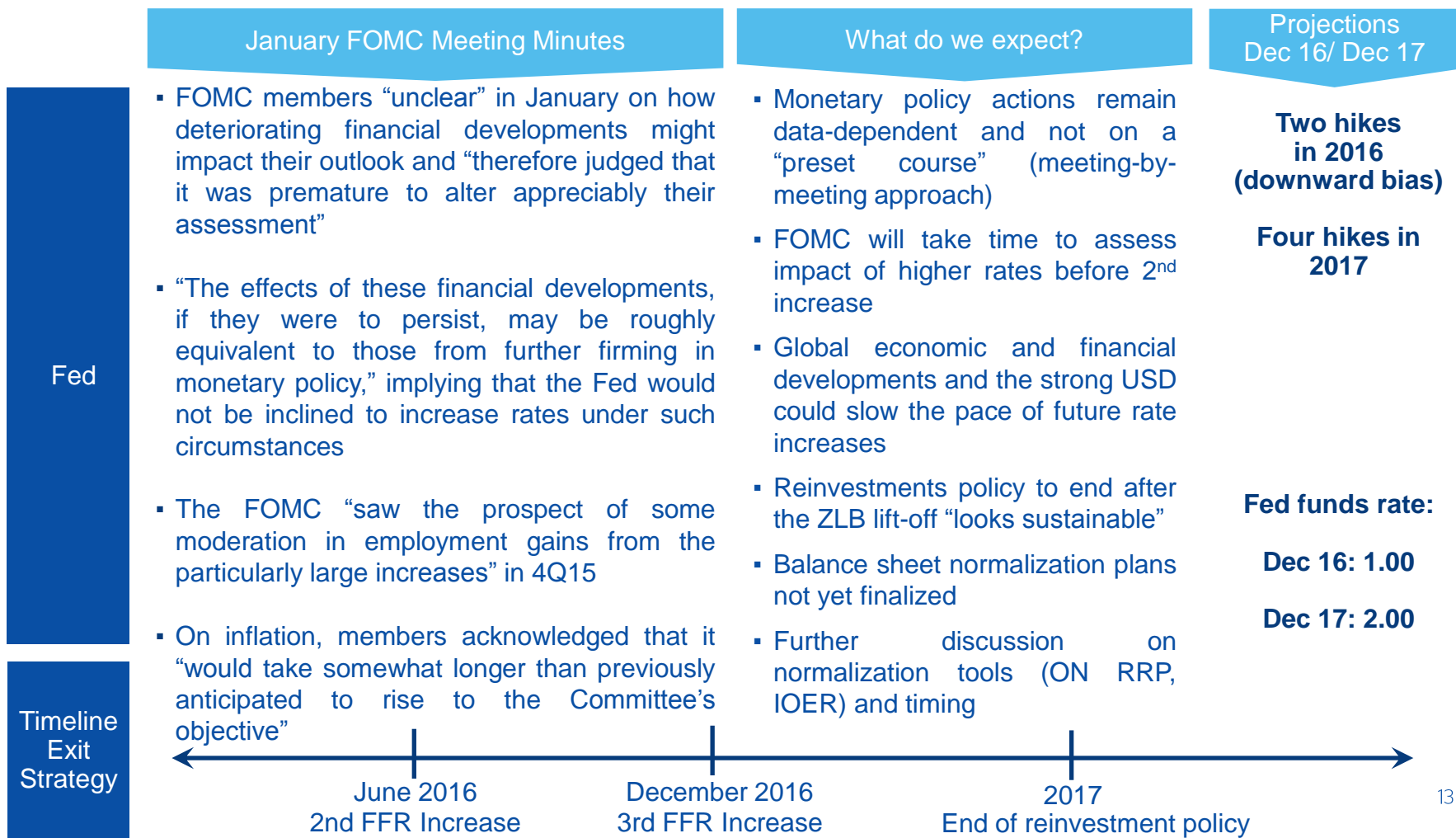
- Lower equity prices, the stronger USD, and increased interest rates for risky borrowers “if they prove persistent, could weigh on the outlook for economic activity and the labor market”
- “I would say there is always some chance of a recession in any year but the evidence suggests that expansions don't die of old age.”
- The Fed must be “careful not to jump to a premature conclusion about what is in store for the U.S. economy”

Monetary Policy & Negative Rates

- “Monetary policy is by no means on a preset course”
- When it comes to negative rates, “We're taking a look at them ... I wouldn't take those off the table.”
- However, “I don't think it's going to be necessary to cut rates.”

Monetary Policy

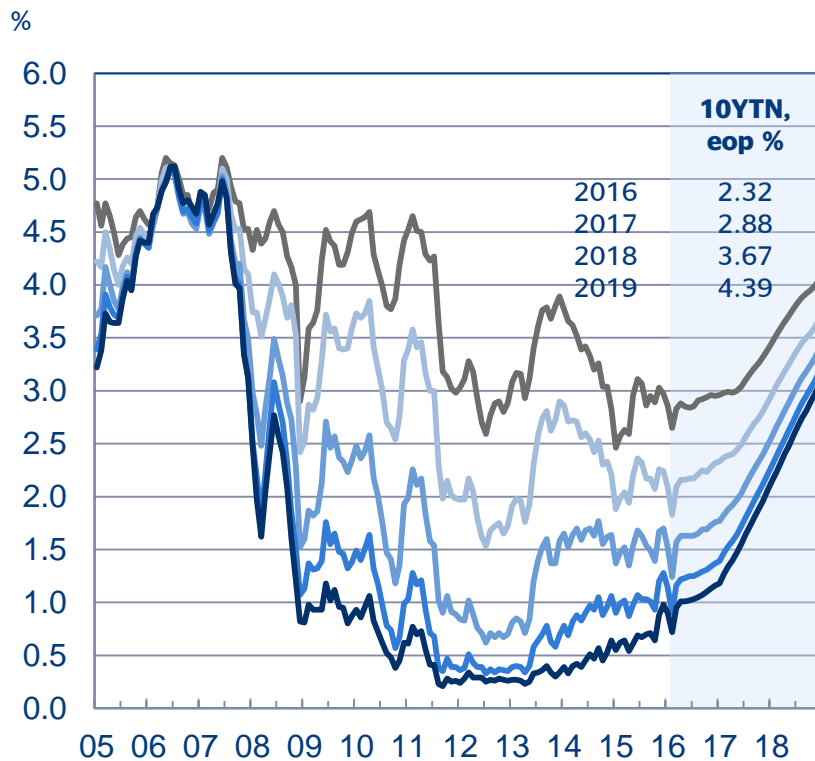
The Fed is more worried than they are willing to admit...



Treasury Yields

Short-term volatility is not unusual, and we expect yields to return to our projected path of gradual increases

Treasury Yield Curve Baseline Forecast



Source: BBVA Research

Treasury Yield Curve Baseline Slope



Source: BBVA Research

Baseline Scenario

No changes, but slight downward bias given current conditions

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP (% SAAR)	1.6	2.2	1.5	2.4	2.4	2.5	2.4	2.3	2.3	2.3
Unemployment Rate (% , average)	8.9	8.1	7.4	6.2	5.3	4.8	4.6	4.5	4.5	4.6
Average Monthly Nonfarm Payroll (K)	174	179	193	251	228	205	245	265	283	281
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.0	2.0	2.1	2.2
Core CPI (YoY %)	1.7	2.1	1.8	1.7	1.8	2.0	2.0	2.1	2.1	2.2
Fed Target Rate (% , eop)	0.25	0.25	0.25	0.25	0.50	1.00	2.00	3.00	3.50	3.50
Core Logic National HPI (YoY %)	-3.64	3.84	10.91	7.69	4.99	5.37	2.45	2.43	1.10	1.18
Housing Starts (SAAR Thousands)	612	784	928	1,001	1,107	1,227	1,370	1,506	1,620	1,640
Industrial Production (YoY %)	3.03	2.86	1.93	3.72	1.31	-0.45	1.94	1.82	1.63	1.67
Auto Sales (annualized, average)	12.73	14.44	15.53	16.43	17.33	18.18	18.68	19.08	19.39	19.47
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	2.32	2.88	3.67	4.39	4.56
U.S. Dollar / Euro (eop)	1.32	1.31	1.37	1.23	1.09	1.11	1.16	1.20	1.20	1.20
Brent Oil Prices (dps, average)	111.26	111.65	108.64	99.02	52.35	30.01	45.73	55.73	59.60	59.60

Thank You!

Join our distribution list and send us your feedback:



researchusa@bbva.com



www.bbvacompass.com/compass/research/



@BBVAResearchUSA <https://twitter.com/BBVAResearchUSA>



BBVA ResearchUSA



<http://vimeo.com/bbvaresearchusa>



<http://bbvaresearchusa.podbean.com/>

U.S. Economic Outlook

Monthly Update

February 22, 2016