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Economic Outlook
Economic Outlook

- Baseline assumes GDP declines by 4.4% in 2020
- GDP returns to pre-crisis levels by 2Q22
- Peak unemployment rate could surpass 15%
- With inflation headwinds building we expect CPI to drop by 0.1% in 2020
- Fed to keep rates at the Zero Lower Bound, balance sheet to grow to $7.5tn
- Long-term yields to remain close to current levels by year-end
- Oil prices to remain low in 2020
- Uncertainty remains over the depth and duration of the crisis
- Risks tilted to the downside
Macro Fundamentals

- Our estimates suggest GDP growth will drop by 4.7% in 1Q20 and 32.3% in 2Q20
- Our scenario assumes a major deterioration in consumption which drops by more than 40% on an annualized basis in the second quarter, but a strong rebound in 3Q20
- Real private fixed investment to drop 13.4% QoQa in 2Q20; decline 11.6% in 2020
- Total trade to fall 13.1% in 2020, while the trade deficit shrinks
- Strong federal government contributions as a result of the CARES Act
- Baseline assumes average growth of -4.4% in 2020 and 3.4% in 2021
Economic activity

Historic pressures build on supply-side, but high-tech sectors remain one bright spot

Positive momentum in the housing sector wiped out with lockdowns and tepid demand-side outlook

Labor force participation plummets with layoffs and furloughs, but inflows could increase if social safety net encourages attachment

Relative to last year the worst drop in participation rates are among the 20-24 year olds, which are down 1.8pp YoY

Small business confidence returns to pre-2016 election levels on COVID-19 uncertainty

Precautionary personal savings to climb amid COVID-19 fears
Economic trends: Industrial production and retail sales record historic monthly declines of 8.7% and 5.4%, respectively

**INDUSTRIAL PRODUCTION**
(YEAR-OVER-YEAR % & CONTRIBUTIONS)

**RETAIL SALES**
(YEAR-OVER-YEAR % & CONTRIBUTIONS)

Source: BBVA Research, FRB & BEA
Economic trends: Positive residual effects from trade détente to give way to dramatic weakening in trade flows

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

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

Source: BBVA Research, FRB & Census
Consumer credit cycle: Pre-COVID-19 balance sheet deleveraging should ease delinquency pressures in short-run

**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)

Source: BBVA Research, FRB, NY Fed & BEA
02

COVID-19
COVID-19

- After initial shock to expectations from the scale and scope of the lockdowns, financial tensions have eased somewhat.

- Incoming data suggests that the pace of deterioration in the macroeconomic environment will be unprecedented, but should fade faster than past downturns.

- Elevated uncertainty over the duration and magnitude of the crisis: GDP ranges between -3% and -7%. As well as on the pace of the recovery: V-shape, U-shape or L-shape.

- Monetary policy actions enacted to respond to the pandemic vary in impact and duration.

- Fiscal measures implemented during the crisis will surpass those enacted during the 2008-2009 Global Financial Crisis.

- Federal deficits will likely grow to more than 16% of GDP in 2020, U.S. debt held by the public to surpass 100% of GDP.
Respite in financial markets pressures

**FINANCIAL STRESS INDEX, >0 STRESS**

- Credit
- Equities
- Safe Assets
- Funding
- Volatility

**CORPORATE SPREADS, BP**

- AAA
- BBB (rhs)

**TED SPREAD, BP**

- 3M
- 1M

Source: BBVA Research & Haver Analytics
U.S. economy to experience its largest contraction in GDP growth since the Depression (-32.3% QoQa)

QUARTERLY NEGATIVE GDP*
(% CHANGE ANNUALIZED)

GDP SIMULATIONS: PRE-COVID VS V, U AND L-SHAPE
(QOQ % CHANGE, ANNUALIZED, T=START OF RECESSION)

Source: BBVA Research, FRB & Census
*Shaded area=GNP
COVID-19 Macro Scenario

REAL GDP, YOY%

CONSUMER PRICE INDEX, YOY%

UR, %

FED FUNDS RATE AND FED BALANCE SHEET, % & US$Tn

Source: BBVA Research
Fed COVID-19 Policy Action

- **Shorter**
  - Primary Dealer Credit Facility (PDCF)
  - Money Market Mutual Fund Liquidity Facility (MMLF)
  - U.S. Dollar Swap Lines
- **Duration**
  - Primary Market Corporate Credit Facility (PMCCF)
  - Secondary Market Corporate Credit Facility (SMCCF)
  - Term Asset-Backed Securities Loan Facility (TALF)
  - Foreign and International Monetary Authority (FIMA)
  - Commercial Paper Funding Facility (CPFF)
- **Longer**
  - Paycheck Protection Program Lending Facility (PPPLF)
  - Main Street New Loan Facility (MSNLF)
  - Main Street Expanded Loan Facility (MSELF)
  - Municipal Liquidity Facility (MLF)
- **Rates at ZLB**
  - Unlimited Large-scale asset purchases
- **Regulatory and Capital Latitude**
  - Repos
  - Discount Window
  - Primary Dealer Credit Facility (PDCF)
  - Commercial Paper Funding Facility (CPFF)
  - Foreign and International Monetary Authority (FIMA)
### A massive fiscal response to mitigate economic and social damages

#### FISCAL STIMULUS (% of GDP)

<table>
<thead>
<tr>
<th>Provision</th>
<th>Amount $bn</th>
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<tbody>
<tr>
<td>Expand &amp; Extend Unemployment Benefits</td>
<td>260</td>
</tr>
<tr>
<td>Issue One-Time Checks</td>
<td>290</td>
</tr>
<tr>
<td>Provide Small Business Loans &amp; Grants</td>
<td>377</td>
</tr>
<tr>
<td>Support Loans &amp; Loan Guarantees for LB &amp; G</td>
<td>510</td>
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<tr>
<td>Support Fed Facilities</td>
<td>$454</td>
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<tr>
<td>Support State &amp; Local Governments</td>
<td>150</td>
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<tr>
<td>Increase Health-Related Spending</td>
<td>180</td>
</tr>
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<td>Support the Safety Net</td>
<td>42</td>
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<tr>
<td>Increase Disaster Assistance</td>
<td>45</td>
</tr>
<tr>
<td>Increase Education Spending</td>
<td>32</td>
</tr>
<tr>
<td>Support Transportation Providers &amp; Industries</td>
<td>72</td>
</tr>
<tr>
<td>Reduce Individual Taxes</td>
<td>20</td>
</tr>
<tr>
<td>Cut Business Taxes</td>
<td>280</td>
</tr>
<tr>
<td>Other spending</td>
<td>25</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td><strong>2,283</strong></td>
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</table>

Source: BBVA Research, CBO, BEA, JCT, CRFB and Haver Analytics
Massive fiscal stimulus implies more than 10pp increase in U.S. public debt

**FISCAL DEFICITS & U.S. DEBT HELD BY THE PUBLIC**
(% of GDP)

**ESTIMATED ARRA ECONOMIC IMPACT ON GDP**
(FY %)

Source: BBVA Research
Labor Market
Labor Market

- Over the past four weeks 22M people have filed for unemployment insurance

- In March, the unemployment rate increased to 4.4%, which was the largest month-over-month percentage point increase since January 1975

- Nonfarm payrolls decreased by 701K in March

- Weaknesses in leisure and hospitality (-459K) of which 90% occurred in food service and drinking places

- Industries such as health care and social assistance (-61K), professional and business services (-52K), retail trade (-46K), manufacturing (-18K) and construction (-29K) were not immune to the pandemic

- Our baseline assumes the unemployment rate peaks at 15.3% in June, returning to 4.6% by the end of 2021
Labor market: wage growth remains solid despite nontrivial weakening in the labor market

AVERAGE WEEKLY HOURS (NUMBER & 5MCMA)

AVERAGE HOURLY EARNINGS (Y0Y% & 5MCMA)

PRIME AGE LABOR FORCE PARTICIPATION (%)

PRIME AGE EMPLOYMENT-TO-POPULATION (%)

Source: BBVA Research & BLS
Labor market: Nonfarm payrolls could shrink by more than 18M before recovering in the 3Q20

NONFARM PAYROLLS (MONTHLY CHANGE, K)

Source: BBVA Research & BLS
Labor market: Bulk of the 22M unemployment insurance claims concentrated in a handful of sectors

Unemployment Insurance Claims (K)

INDUSTRY UNEMPLOYMENT
(BARS=PP CHANGE SINCE JANUARY, LABELS= SA UR(%)}

- Leisure & Hosp.
- Mining
- Trans. & Utl.
- Construction
- Trans. & Utl.
- Mining
- Leisure & Hosp.
- Financial
- Gov
- Info
- Man-Durables
- W. & Retail Trd
- Other Srvcs.
- Edu & Health
- Prof Biz Srvcs
- Man-Nondurables
- Financial
- Gov
- Info
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- W. & Retail Trd
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Inflation
Inflation

- Due to the containment efforts from COVID-19, the behavioral impact of the pandemic and elevated uncertainty, consumer prices experienced a nontrivial drop in March.

- On a 12-month basis, headline consumer prices decelerated to 1.5%.

- The impact on core prices was more muted with prices dropping 0.1% over-the-month; overall core CPI increased 2.1% over the past 12-months.

- At 0.6%, 5-year implicit inflation expectations are the weakest they have been since the 2008 financial crisis.

- Going forward, we expect the historic weakening in the labor market, global supply and demand shocks and major drop in energy prices will contribute to a nontrivial drop in prices in 2020.
Inflation: Disinflationary headwinds building during lockdown

CONSUMER PRICE INFLATION
(12M CHANGE)

Source: BBVA Research, BLS & BEA

CORE INFLATION MEASURES
(12M CHANGE, %)

Source: BBVA Research, BLS & BEA
Inflation: Our baseline assumes a significant drop in inflation in 2020

**INFLATION EXPECTATIONS**

(\%)

-3
-2
-1
0
1
2
3
4
5
6
11 12 13 14 15 16 17 18 19

**HEADLINE & CORE CPI**

(YEAR-OVER-YEAR %)

Source: BBVA Research & Haver Analytics
Monetary Policy
Monetary Policy: Federal Reserve

- In terms of its traditional monetary policy tools, to combat the coronavirus, the Fed has cut the fed funds rate to zero, lowered the interest rate on discount window loans and announced unlimited large-scale asset purchases.

- Additional emergency liquidity and credit programs, USD swap lines, regulatory adjustments aimed to free up capital and liquidity for financial institutions and lowering the reserve requirement to zero have also been enacted to supplement traditional tools.

- The emergency lending facilities provide up to $2.3 trillion, but have additional capacity via the CARES Act.

- Fed balance sheet to grow to $7.5BN by the end of 2020.

- Our baseline assumes rates remain at the ZLB until 2023.
Monetary policy: Unprecedented measures taken to compensate for lack of capacity to lower rates further

**IMPLIED FED FUNDS RATE BASED ON “TAYLOR RULES” (%)**

- Taylor Rule (93)
- Inertial
- Alternative r*
- Forward-looking
- Core Inflation (99)
- Low weight on output gap

**FED SUPPORT THROUGH FACILITIES (US$BN)**

- MSLP
- PMCCF
- MLF
- SMCCF
- PPPLF
- CPFF
- MMLF
- TALF

**FED BALANCE SHEET ASSETS (US$TN)**
Announced measures and market response suggests Fed balance sheet could reach close to $7.5TN by end of 2020

RESERVE BALANCES & MZM
(US$TN, YEAR-OVER-YEAR %)

FACTORS SUPPLYING & ABSORBING FUNDS ON FED BALANCE SHEET (US$TN)

Source: BBVA Research, FRB & Haver Analytics
Interest Rates
Interest Rates

- 10-yr and 2-yr Treasury yields steadying around 0.6% and 0.2%, respectively
- Fed actions and commitment to maintaining financial stability have eased frictions in fixed income markets
- Negative term-premium holding steady amid “unlimited” QE and global uncertainty
- Inflation expectations plummet on fears of disinflationary pressures
- T-Bills yields remain positive despite proximity to ZLB
- Unprecedented conditions imply positive yield curve slope in spite of the major deterioration in the macroeconomic environment
- Baseline assumes 10-yr yields at 0.6% and 1.2% by year-end 2020 and 2021, respectively
Interest rates: Plunge in inflation expectations explains significant portion of drop in long-term yields

**10-YEAR TREASURY YIELD DECOMPOSITION**

Source: BBVA Research, ACM & Haver Analytics
Interest rates: Yield curve slope to remain positive amidst major economic weakening

YIELD CURVE SLOPE
(BP)

Source: BBVA Research
07

Oil Prices
Oil Prices

- Excess net supply of crude oil between 1Q20 and 2Q21, exerting downward pressures on prices
- Oil prices are expected to remain very low in 2Q20, but to recover in 2H20 as the worst of the pandemic is left behind
- Despite massive fiscal and monetary responses globally, prices will most likely remain subdued
- Price pressures could lead OPEC+ to accelerate committed output cuts and consider new ones
- Although demand will most likely recover in 2H20, it will remain weak as key economic sectors take time to return to pre-COVID19 levels
- U.S. crude oil markets severely dislocated: plunge in demand and storage near capacity
- Government intervention could help alleviate some of the pressures
- A new wave of bankruptcies and consolidation in the shale industry seems likely
- Risks are tilted to the downside: inventory accumulation, uneven control of the pandemic across regions, uncertainty on the implementation of output cuts, etc.
WTI went into negative territory for the first time ever. Its collapse reverberated across regional benchmarks.

**CRUDE OIL PRICES 2019 ($ PER BARREL)**

**U.S. REGIONAL BENCHMARKS ($ PER BARREL)**
OPEC+ and G20 output deal is not enough to compensate for the sharp decline in global demand

- Oil demand is likely to remain subdued through the rest of the year as the economy won’t return to pre-crisis levels before 2021.
- The implementation of OPEC+ cuts is subject to a high degree of uncertainty.
  - Only a few countries can comply with their quotas in a short-period of time.
  - Most countries will let their production decline organically, which could take several months.

Source: BBVA Research and Haver Analytics
Extreme “contango” in the futures market incentivizes stock accumulation. Inventories fill at unprecedented speed.

Source: BBVA Research, Haver Analytics, and Bloomberg
**U.S. Government intervention could take various forms**

**Policies**

1. Buy untapped crude reserves and incorporate them to the country’s emergency stockpile

2. Release oil and gas produced on federal lands and waters from royalties

3. Deem some companies “critical to national security”, with access to additional resources

4. Expand Fed lending facilities for distressed sectors and companies with low credit ratings

5. Create a specific program for O&G companies (similar to airline industry under CARES Act)

6. Pressure G-20 countries to buy U.S. oil

**Limitations**

1. Requires authorization from Congress, which already refused to spend $3bn for SPR

2. White House shows willingness but only on a case by case basis

3. Will benefit large producers but small companies may be excluded

4. Higher risk to the taxpayer and political backlash

5. Could provide biggest relief depending on resources, but constrained by political divide

6. Not enough to significantly reduce the glut
A decline in production and consolidation in the industry is imminent.

Source: BBVA Research, Haver Analytics, and Haynes and Boone
Prices will recover but will remain subdued due to excess supply and a gradual economic rebound

### BRENT PRICES FORECAST
($ PER BARREL)

<table>
<thead>
<tr>
<th></th>
<th>BBVA Research (baseline)</th>
<th>Bloomberg Survey (Apr 21)</th>
<th>EIA STEO (Apr 7)</th>
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<tbody>
<tr>
<td>2018</td>
<td>71.1</td>
<td>71.1</td>
<td>71.1</td>
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<tr>
<td>2019</td>
<td>64.1</td>
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<tr>
<td>2020</td>
<td>39.3</td>
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<tr>
<td>2021</td>
<td>49.8</td>
<td>52.2</td>
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<td>2022</td>
<td>56.5</td>
<td>54.8</td>
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<tr>
<td>2023</td>
<td>59.7</td>
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<tr>
<td>2024</td>
<td>59.7</td>
<td>62.9</td>
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### WTI PRICES FORECAST
($ PER BARREL)

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<td>2024</td>
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### Macroeconomic Outlook

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<tr>
<td>Forecasts subject to change</td>
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**2015 | 2016 | 2017 | 2018 | 2019 (e) | 2020 (f) | 2021 (f) | 2022 (f) |

<table>
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<th>Real GDP (% SAAR)</th>
<th>2.9</th>
<th>1.6</th>
<th>2.4</th>
<th>2.9</th>
<th>2.3</th>
<th>-4.4</th>
<th>3.4</th>
<th>2.4</th>
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<tr>
<td>Real GDP (Contribution, pp)</td>
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<td></td>
<td></td>
<td></td>
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<td>PCE</td>
<td>2.5</td>
<td>1.9</td>
<td>1.8</td>
<td>2.1</td>
<td>1.8</td>
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<td>1.7</td>
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<td>Gross Investment</td>
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<td>-0.2</td>
<td>0.8</td>
<td>0.9</td>
<td>0.3</td>
<td>-2.2</td>
<td>0.1</td>
<td>0.7</td>
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<td>Non Residential</td>
<td>0.3</td>
<td>0.1</td>
<td>0.6</td>
<td>0.9</td>
<td>0.3</td>
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<td>Residential</td>
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<td>Imports</td>
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<td>Government</td>
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<td>0.1</td>
<td>0.3</td>
<td>0.4</td>
<td>0.6</td>
<td>0.8</td>
<td>0.4</td>
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<td>Unemployment Rate (% average)</td>
<td>5.3</td>
<td>4.9</td>
<td>4.3</td>
<td>3.9</td>
<td>3.7</td>
<td>7.8</td>
<td>5.0</td>
<td>4.2</td>
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<tr>
<td>Avg. Monthly Nonfarm Payroll (K)</td>
<td>227</td>
<td>195</td>
<td>176</td>
<td>193</td>
<td>178</td>
<td>-211</td>
<td>181</td>
<td>108</td>
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<tr>
<td>CPI (YoY %)</td>
<td>0.1</td>
<td>1.3</td>
<td>2.1</td>
<td>2.4</td>
<td>1.8</td>
<td>-0.1</td>
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<td>2.1</td>
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<tr>
<td>Core CPI (YoY %)</td>
<td>1.8</td>
<td>2.2</td>
<td>1.8</td>
<td>2.1</td>
<td>2.2</td>
<td>1.4</td>
<td>0.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Fiscal Balance (% GDP, FY)</td>
<td>-2.4</td>
<td>-3.2</td>
<td>-3.4</td>
<td>-3.8</td>
<td>-4.6</td>
<td>-12.8</td>
<td>-9.3</td>
<td>-5.0</td>
</tr>
<tr>
<td>Current Account (bop, % GDP)</td>
<td>-2.2</td>
<td>-2.3</td>
<td>-2.3</td>
<td>-2.4</td>
<td>-2.3</td>
<td>-1.9</td>
<td>-2.0</td>
<td>-2.2</td>
</tr>
<tr>
<td>Fed Target Rate (% eop)</td>
<td>0.50</td>
<td>0.75</td>
<td>1.50</td>
<td>2.50</td>
<td>1.75</td>
<td>0.25</td>
<td>0.25</td>
<td>0.25</td>
</tr>
<tr>
<td>10-Yr Treasury (% Yield, eop)</td>
<td>2.24</td>
<td>2.49</td>
<td>2.40</td>
<td>2.83</td>
<td>1.86</td>
<td>0.56</td>
<td>1.16</td>
<td>1.39</td>
</tr>
<tr>
<td>WTI (dpb, average)</td>
<td>48.7</td>
<td>43.2</td>
<td>50.9</td>
<td>65.0</td>
<td>57.0</td>
<td>35.2</td>
<td>47.0</td>
<td>54.2</td>
</tr>
</tbody>
</table>

*Forecasts subject to change*
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U.S. Macroeconomic Pulse

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