BBVA Research

U.S. Macroeconomic Pulse

July 2020

Creating Opportunities

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01

Economic Outlook

Creating Opportunities

Economic Outlook

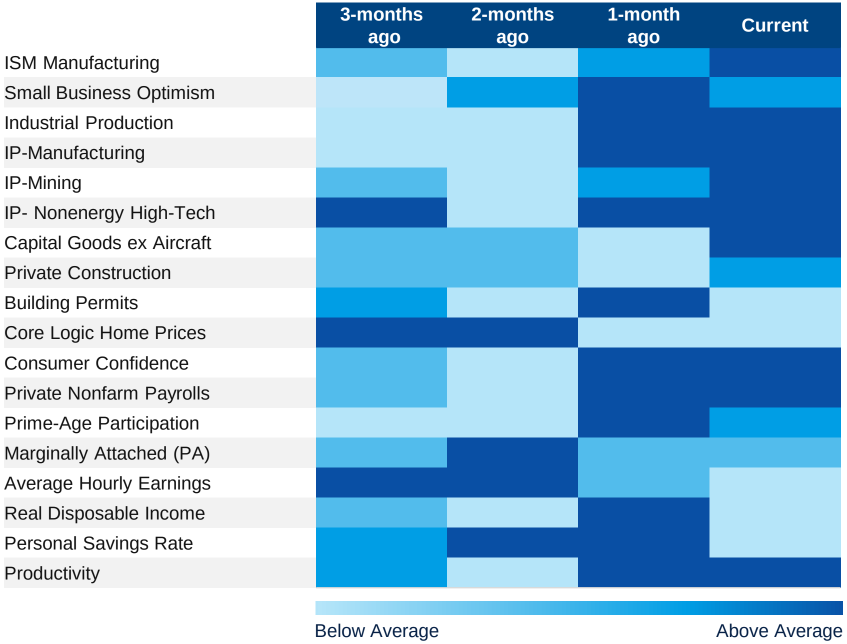
- Baseline assumes real GDP declines by 5.1% in 2020.
- Peak unemployment reached, but risks to the labor market remain.
- Disinflationary headwinds abate, but inflation to remain low in 2020.
- Fed to keep rates at the Zero Lower Bound, balance sheet growth to continue.
- Long-term yields to remain low.
- Uncertainty remains over the depth and duration of the crisis.
- Risks tilted to the downside, although the worst of the crisis likely behind us.

Macro Fundamentals

- Real GDP to contract by 32.6% in 2Q20.
- Range of estimates for the 2Q GDP growth -14% to -34%.
- Service sector to fall by $1.5Tn on an annualized basis in 2Q.
- Real investment to drop 13.7% QoQa in 2Q20 and 8.6% in 2020.
- Trade headwinds to persist into 2H20.
- Without a phase 4 fiscal agreement, government contributions to growth to taper off.
- Baseline assumes average real GDP growth of -5.1% in 2020 & 3.5% in 2021.
- Risks tilted to the downside.

Economic activity

REAL-TIME ECONOMIC MOMENTUM HEAT MAP

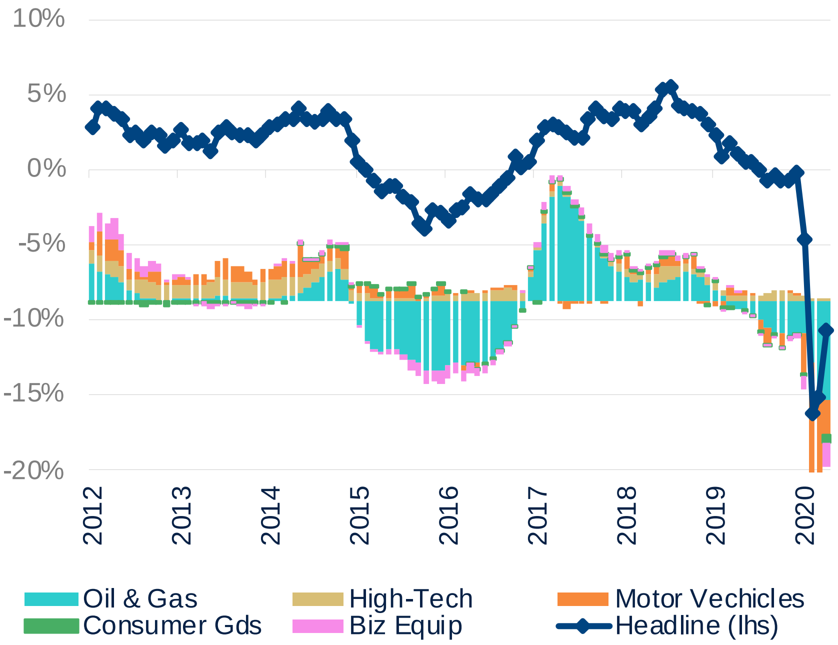


Source: BBVA Research

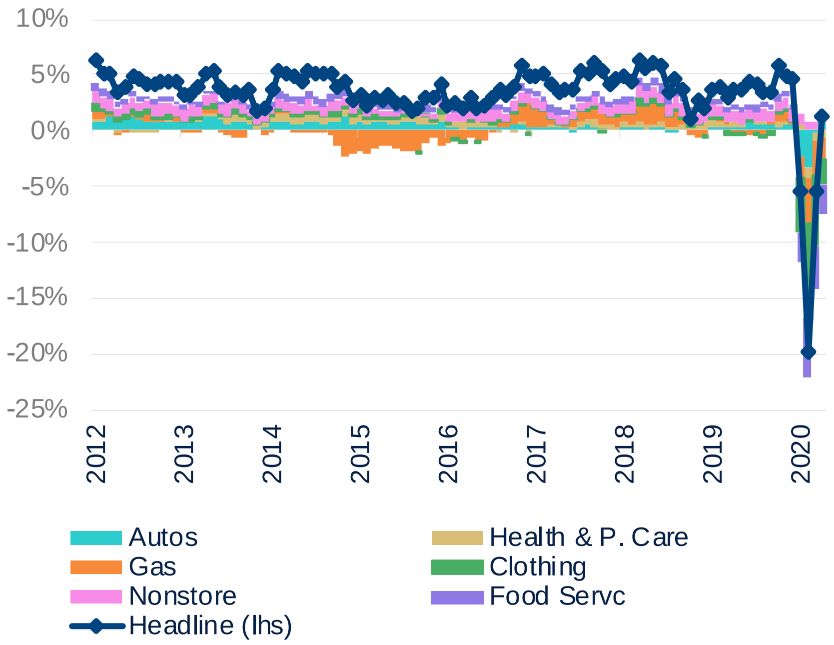
- Positive signals from industrial production with significant increase in June (+5.0% MoM).
- Overall conditions in the mining sector remain weak despite some recent improvement.
- Despite wonky supply and demand side conditions residential construction activity upbeat.
- 3.5M people have re-entered the labor force since April.
- Rebound in output per worker suggests productivity not suffering during recovery from shutdowns.
- Consumer confidence rebounding, but rising case levels in certain parts of the country to jeopardize momentum.

Economic trends: Incoming data suggests retail sales and industrial production have reached bottom

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



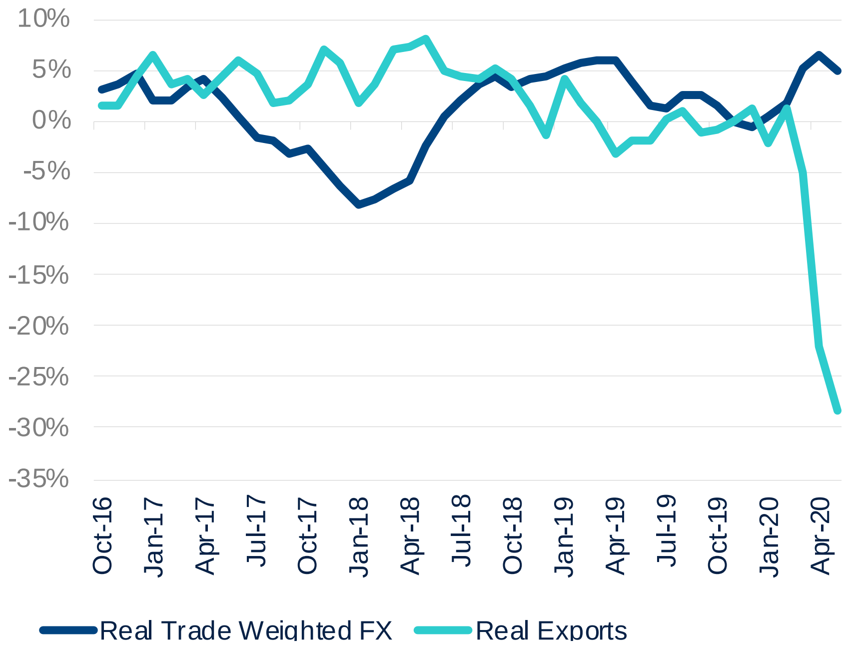
RETAIL SALES
(YEAR-OVER-YEAR % & CONTRIBUTIONS)



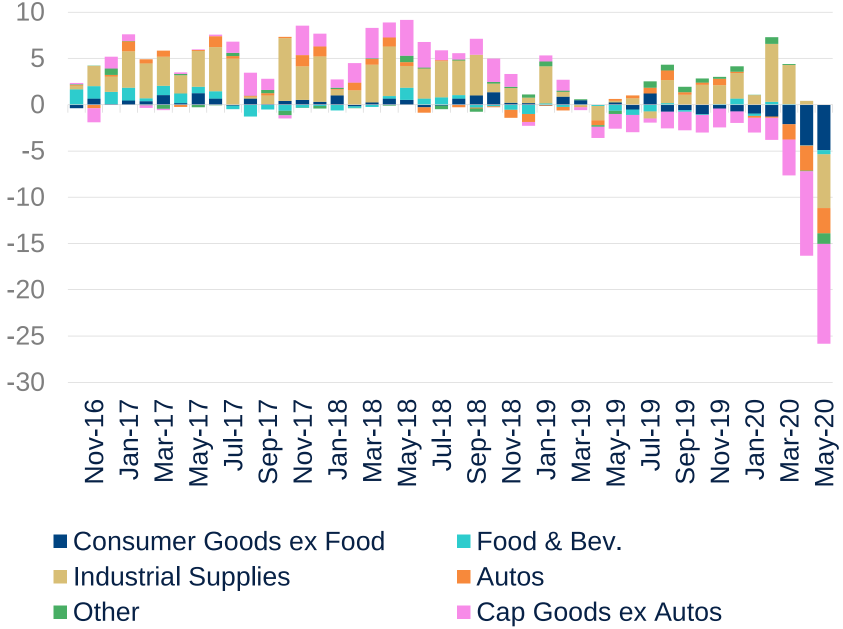
Source: BBVA Research, FRB & BEA

Economic trends: More draconian lockdown measures abroad weigh on U.S. exports

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



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

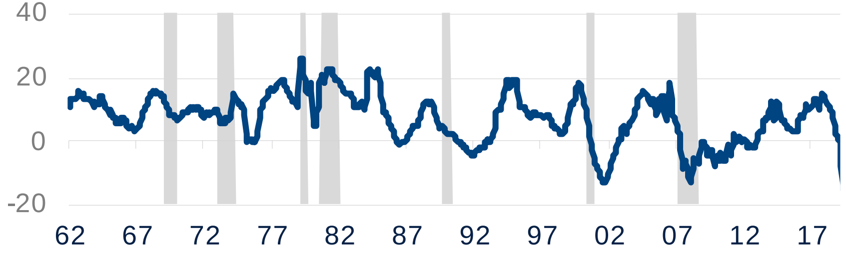


Source: BBVA Research, FRB & Census

Consumer credit cycle: strong pre-pandemic balance sheets, leniency and fiscal support easing pressures on credit quality

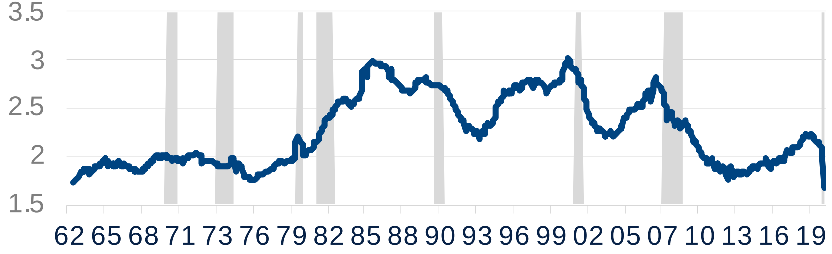
PERSONAL INTEREST EXPENSE

(YEAR-OVER-YEAR %)



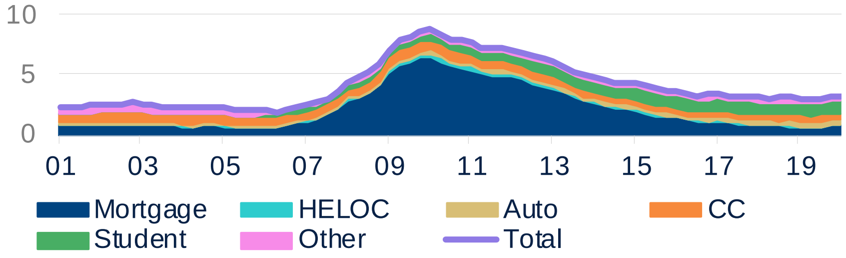
PERSONAL INTEREST EXPENSE TO DISP. INCOME

(RATIO, %)



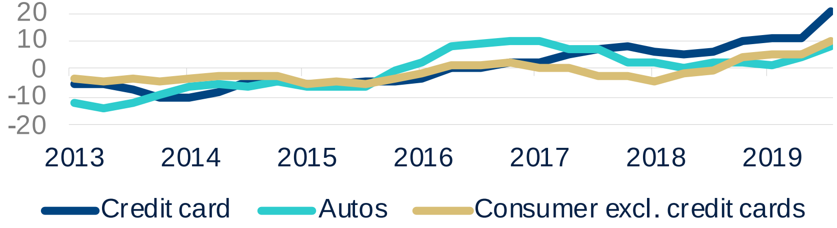
CONSUMER SERIOUSLY DELINQUENT RATES

(90-DAY, CONTRIBUTION, %)



SENIOR LOAN OFFICERS LENDING STANDARDS

(TIGHTENING / - LOOSENING)



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

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02

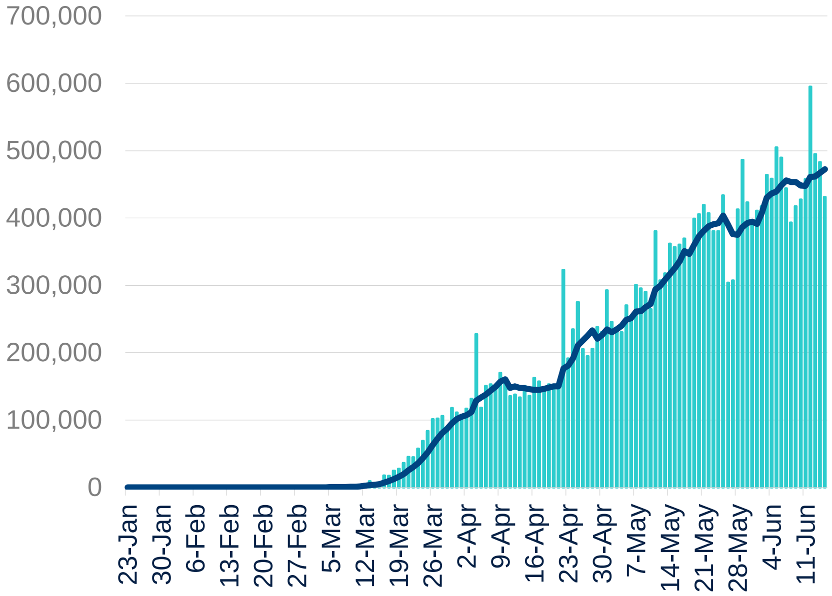
COVID-19

COVID-19

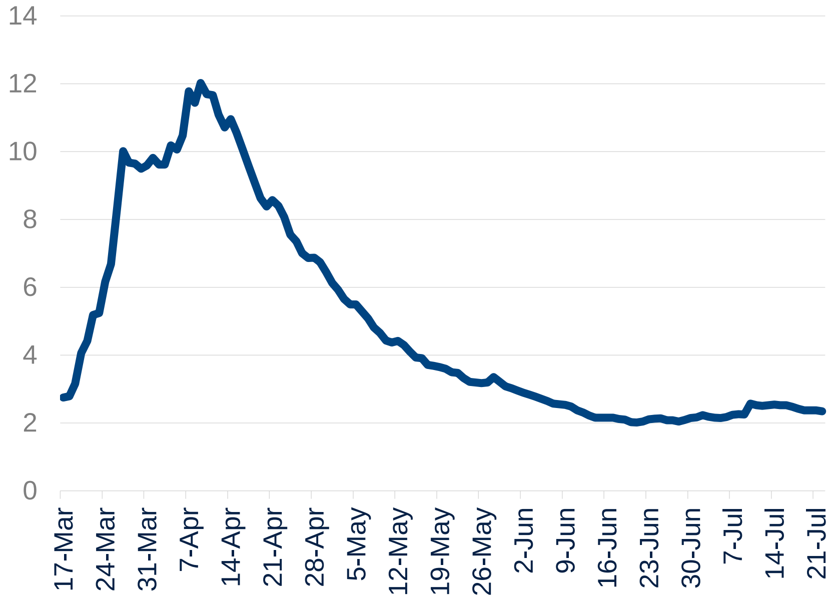
- COVID-19 cases continue to rise with surge in Sunbelt (FL, CA, AZ, AL & TX).
- Despite the rise in cases, the number of hospitalizations as a share of positive cases remains well below peak in April.
- Estimates of the R_e suggests that measures taken in the Sunbelt have been successful at bringing down the infectious rate to those that are consistent with non-accelerating increase in number of cases.
- Changes in individuals behavioral responses, the threat of a more prolonged period of compulsory distancing and risk of persistent dislocations on the supply-side point to jobless recovery rather than quick bounce back.
- While therapeutics, treatment and patient outcomes have improved, the demands of the pandemic may require further fiscal action before there is a vaccine.

COVID-19: U.S. approaching 5M cumulative cases

NEW POSITIVE TEST
(#)



HOSPITALIZATIONS AS A SHARE OF POSITIVE TEST
(%)

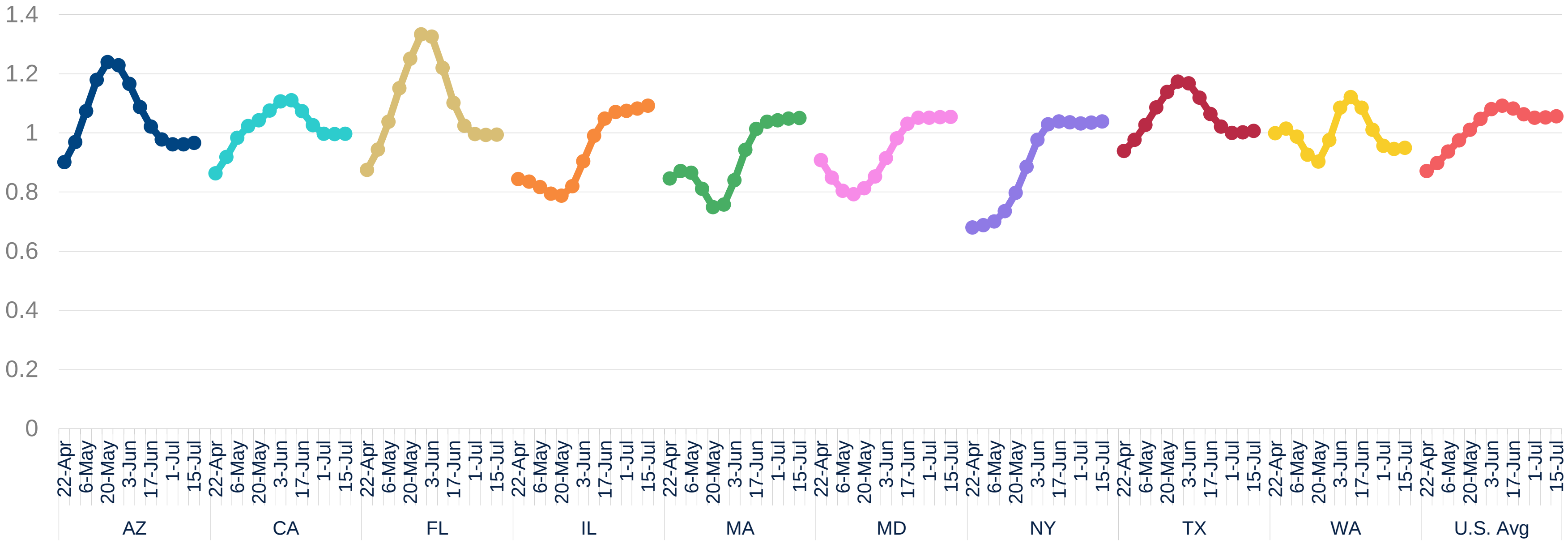


Source: BBVA Research, CDC, ECDC, JHU

COVID-19: Effective reproductive number receding in hotspots after surge in June and early July

EFFECTIVE REPRODUCTION NUMBER (R_e)

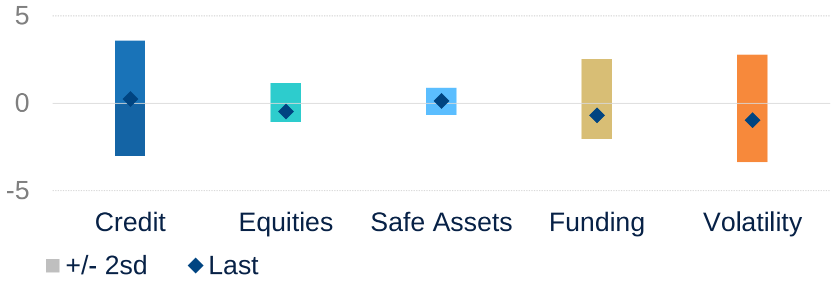
(#, WEEKLY AVERAGE)



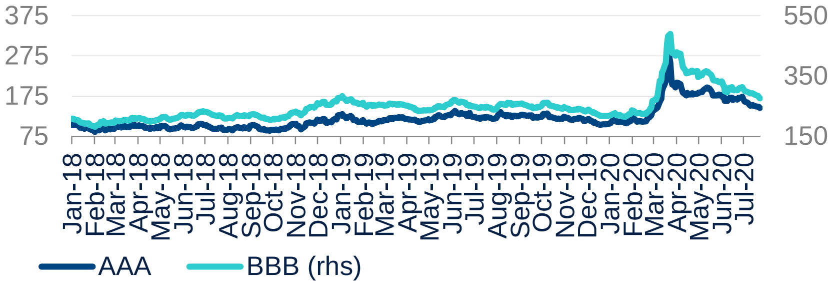
Source: BBVA Research, CDC, ECDC, JHU

Financial Markets: tensions remain subdued despite significant rise in the number of domestic COVID-19 cases

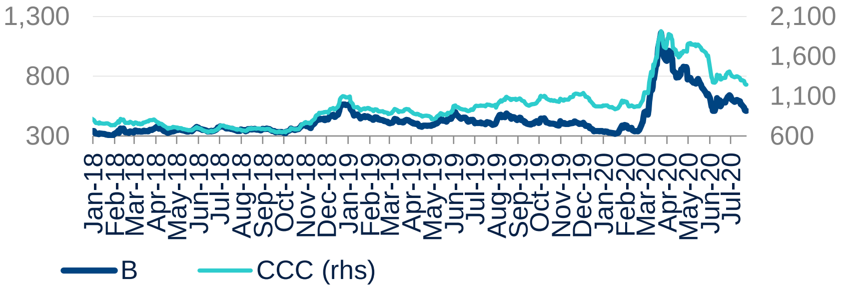
FINANCIAL STRESS INDEX, >0 STRESS



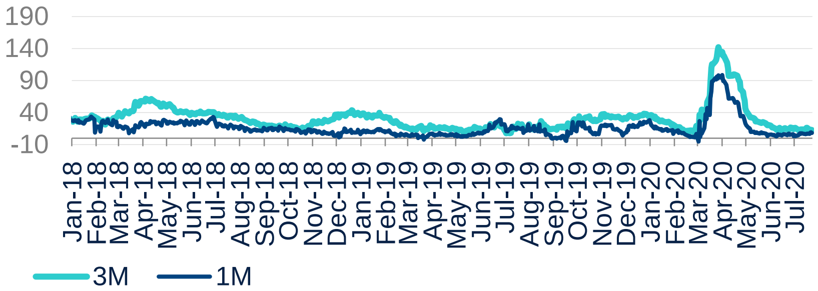
CORPORATE SPREADS, BP



CORPORATE SPREADS, BP



TED SPREAD, BP

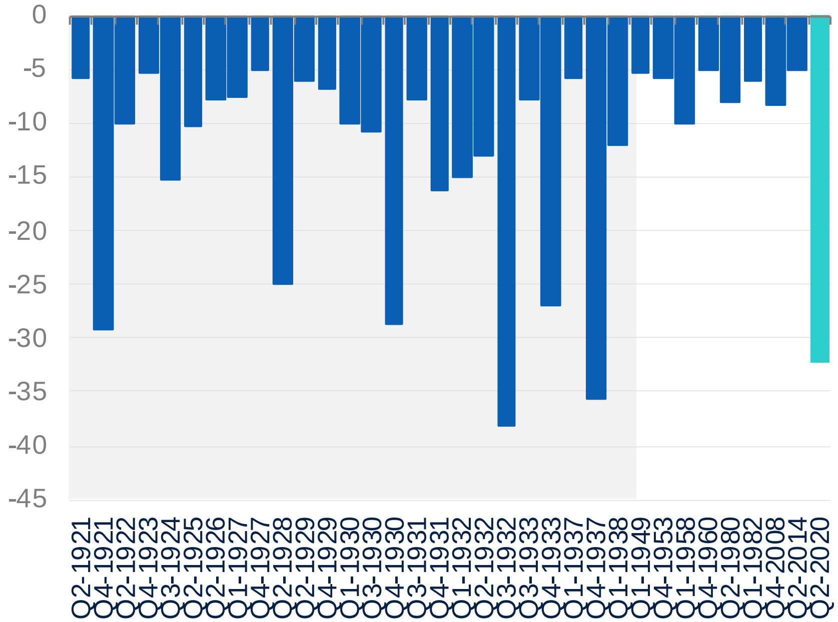


Source: BBVA Research & Haver Analytics

GDP: In line with consensus, we expect GDP will drop by 32% in 2Q20

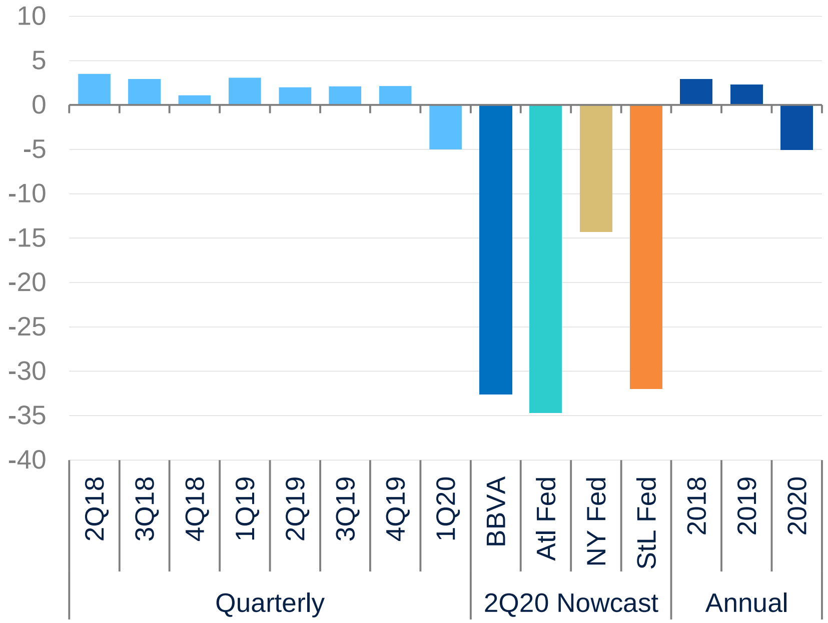
NEGATIVE ANNUALIZED GROWTH QUARTERS*

(<-5%)



REAL GDP GROWTH

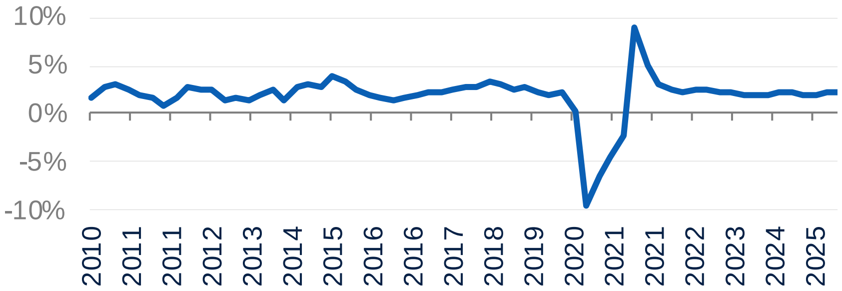
(SAAR % CHANGE)



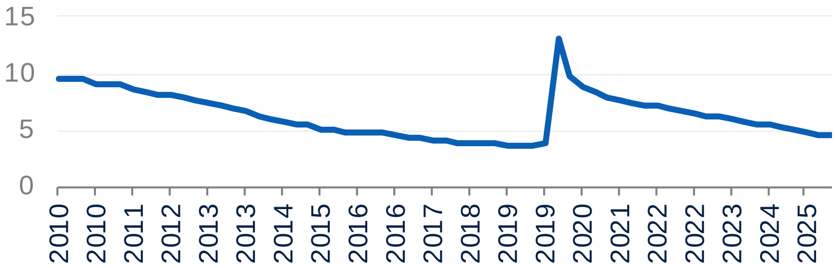
Source: BBVA Research, FRB & Census
*Shaded area=GNP

COVID-19 Macro Scenario

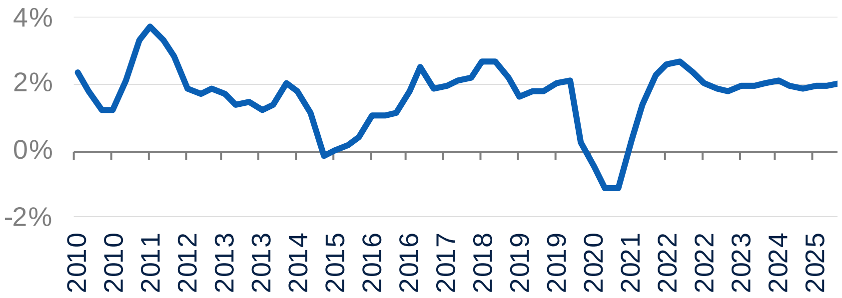
REAL GDP, YOY%



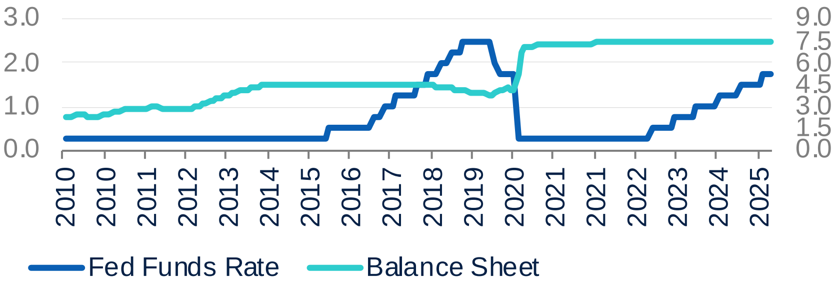
UNEMPLOYMENT RATE, %



CONSUMER PRICE INDEX, YOY%



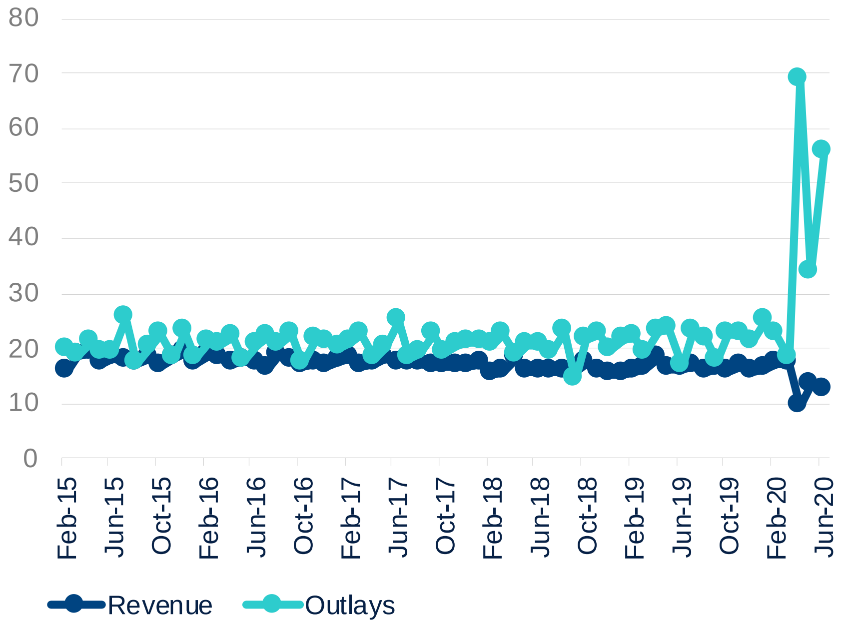
FED FUNDS RATE AND BALANCE SHEET, % & US$Tn



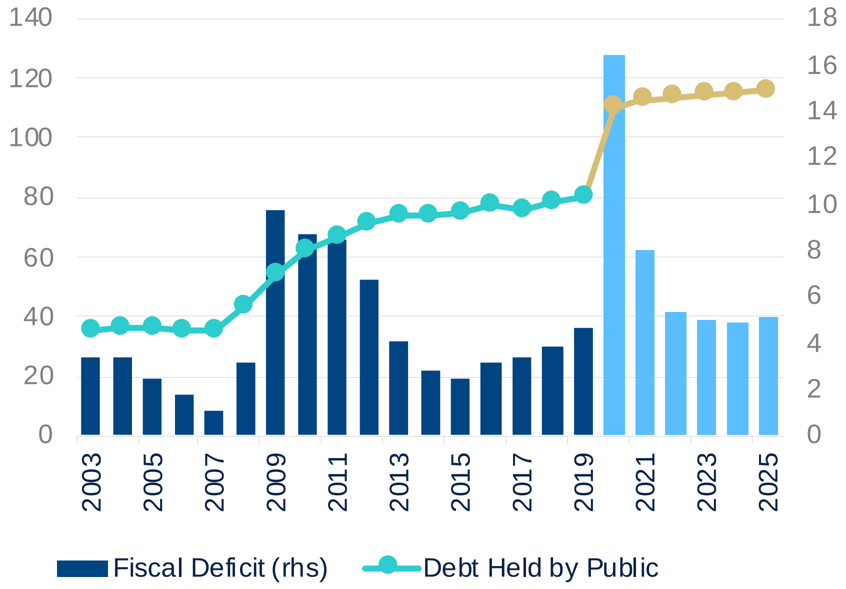
Source: BBVA Research

Fiscal Policy: Deficit reaches $864bn in 2Q20 ($3.4Tn in annualized terms)

SAAR FEDERAL BUDGET
(% OF GDP)



FISCAL DEFICITS & U.S. DEBT HELD BY THE PUBLIC FORECASTS
(FY %)



Source: BBVA Research

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03

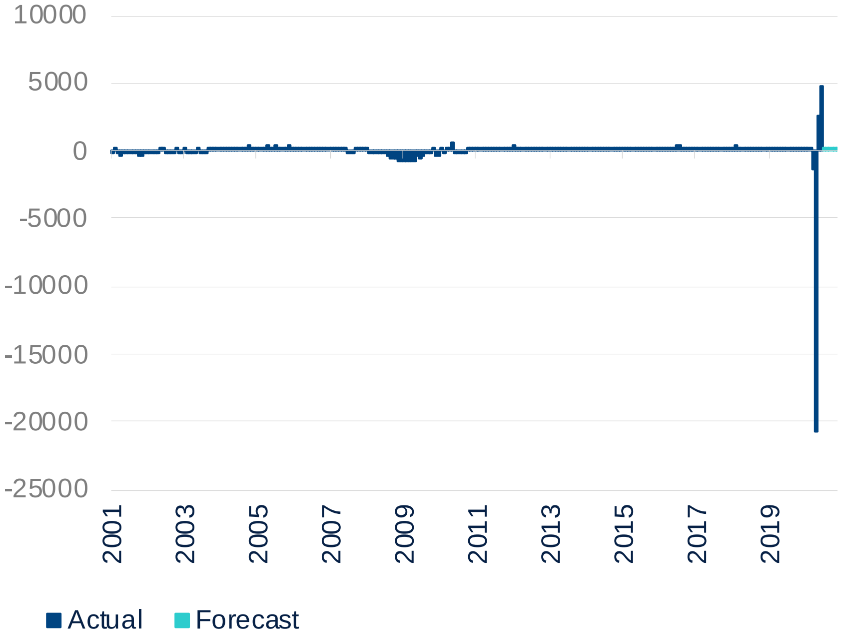
Labor Market

Labor Market

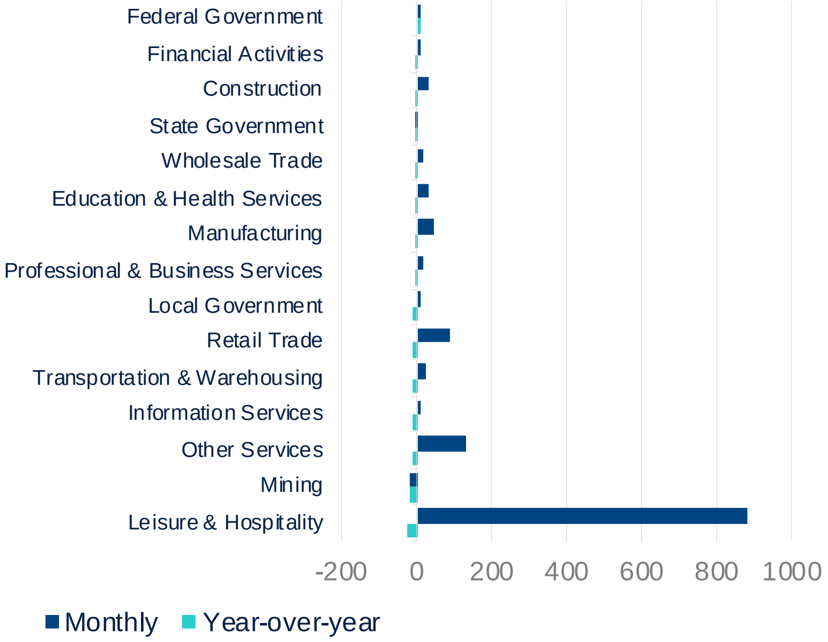
- The economy showed further signs of strengthening with the labor market adding 4.8M jobs.
- Nontrivial share of the gains in nonfarm payrolls concentrated in leisure and hospitality(1.2M), retail (368K) and construction (464K).
- Lifting of stay-at-home orders in a handful of major cities and accelerated relaxation of distancing measures in Sunbelt states drove the gains and led to a 2.2pp reduction in the unemployment rate (UR) to 11.1%.
- Sampling issues and misclassifications of workers suggests the adjusted unemployment rate should be closer to 15.1%.
- Government transfers helping to keep personal savings afloat in a time of wide spread layoffs.
- Baseline assumes a more modest decline in the unemployment rate, which reaches 8.6% by yearend.

Labor market: More uniform growth at the industry level drives strong headline job creation rate of 4.8M

NONFARM PAYROLLS
(MONTHLY CHANGE, K)



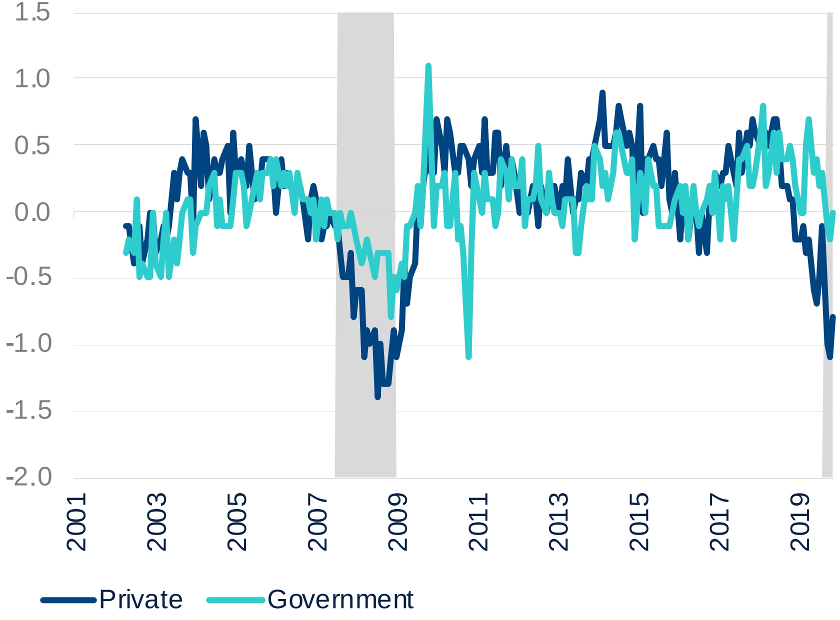
INDUSTRY EMPLOYMENT
(ANNUALIZED % CHANGE)



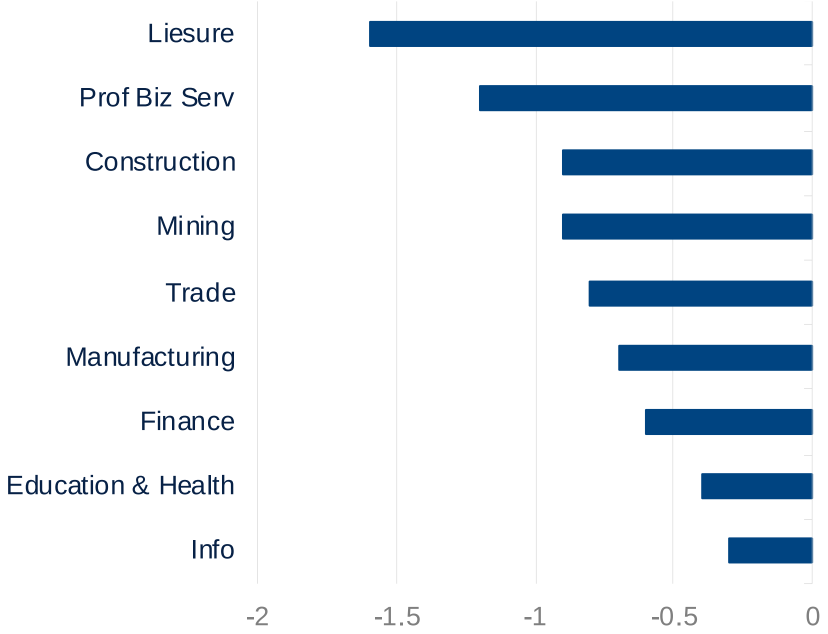
Source: BBVA Research & BLS

Labor market: Private sector labor market churn remains depressed

JOB OPENINGS
(%)



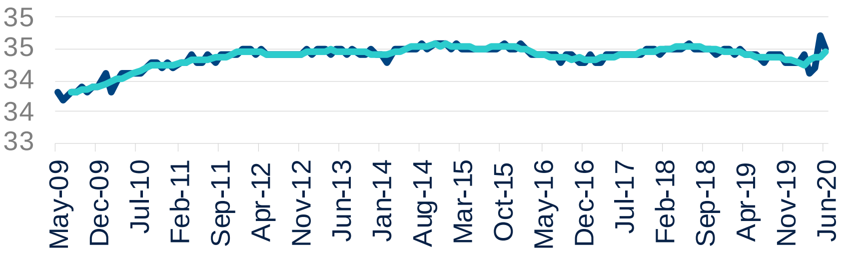
QUITS
(%)



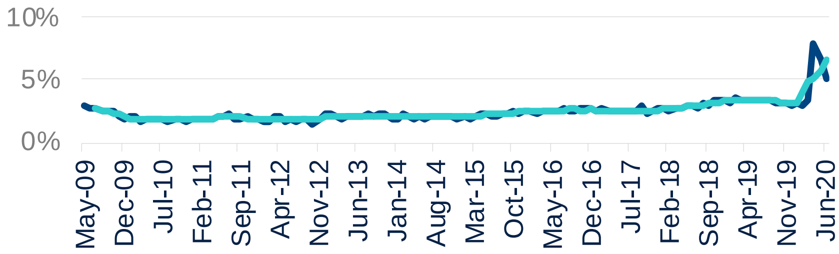
Source: BBVA Research & BLS

Labor market: Participation metrics remain well below pre-pandemic peaks despite steady improvement

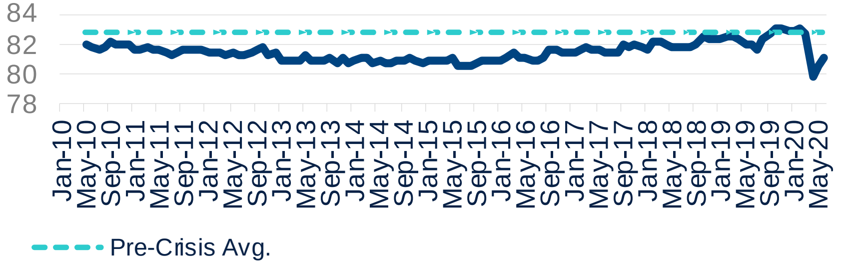
AVERAGE WEEKLY HOURS
(NUMBER & 5MCMA)



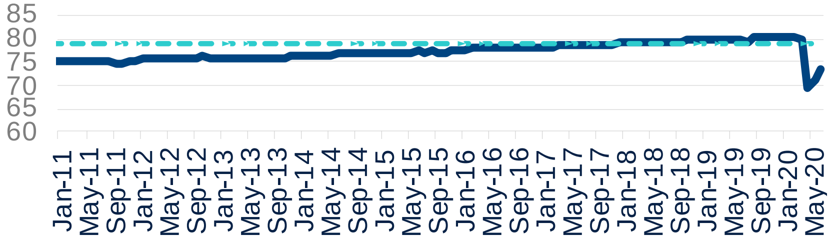
AVERAGE HOURLY EARNINGS
(YOY% & 5MCMA)



PRIME AGE LABOR FORCE PARTICIPATION
(%)



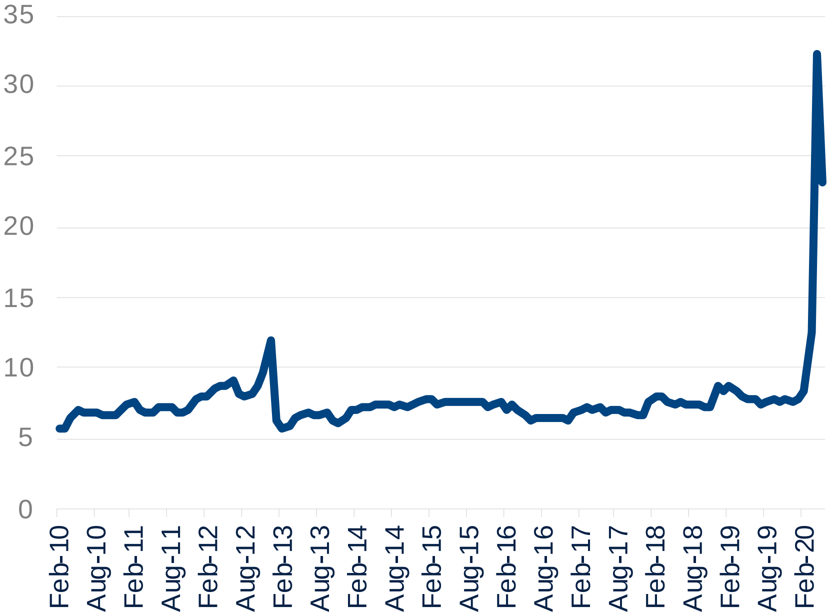
PRIME AGE EMPLOYMENT-TO-POPULATION
(%)



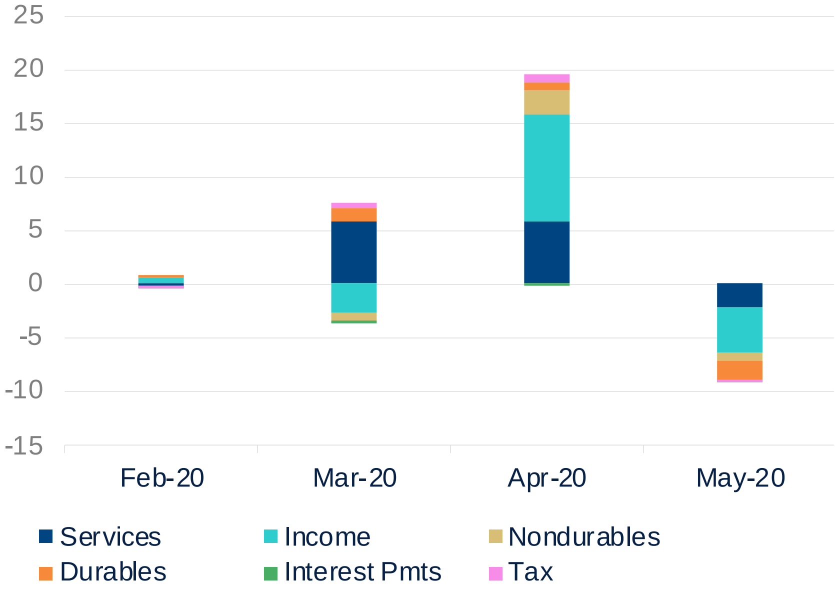
Source: BBVA Research & BLS

Savings rate drops 9pp as incomes fall and personal consumption expenditures rise

PERSONAL SAVINGS RATE
(%)



CONTRIBUTION TO CHANGE IN PERSONAL SAVINGS RATE
(PP)



Source: BBVA Research & BLS

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04

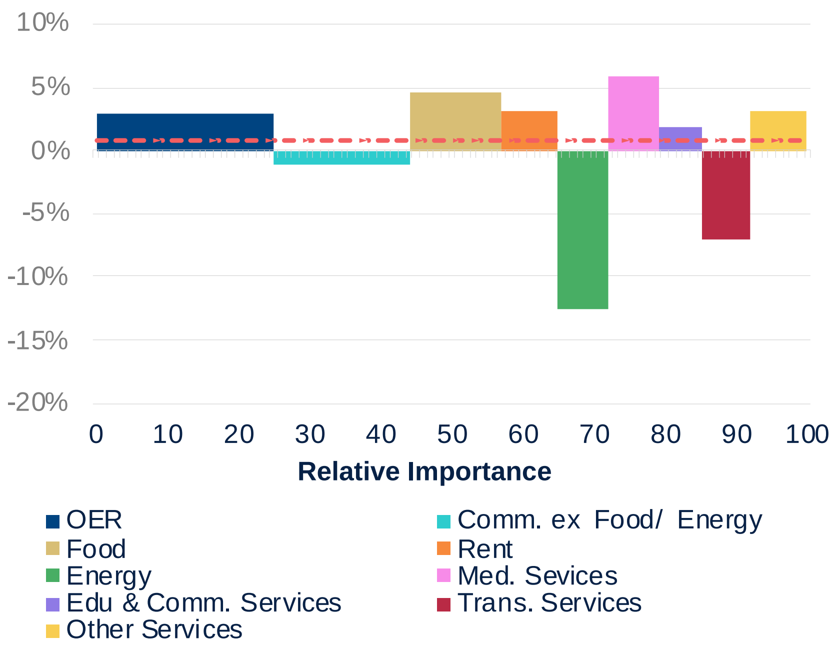
Inflation

Inflation

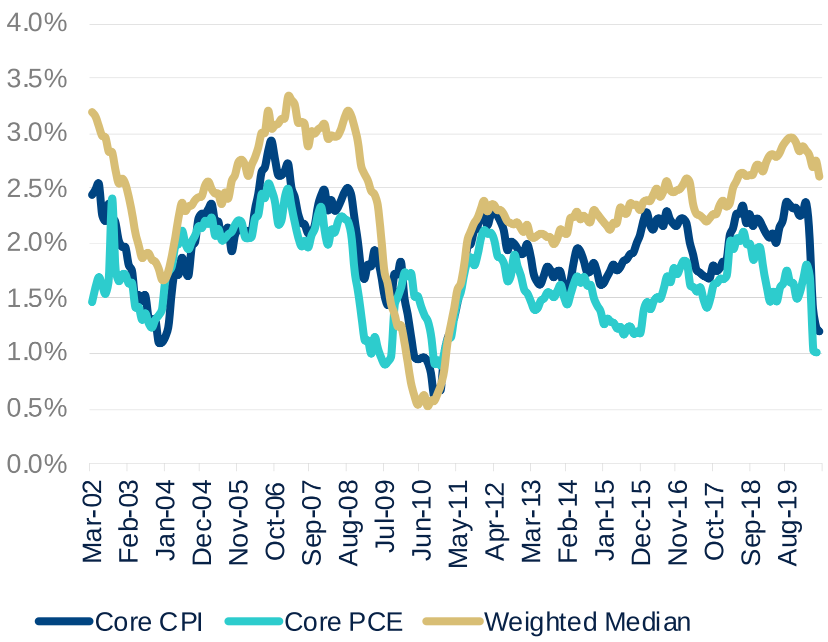
- In June, CPI rose 0.6% over the month and 0.6% over the last twelve months.
- Headline consumer price growth was driven by a 12.3% increase in gasoline prices and a 5.1% increase in the overall energy index; food prices grew 0.6% MoM.
- In terms of core consumer prices, June saw prices snap back 0.2% MoM and hold steady at 1.2% YoY.
- Inflation expectations over the next 5-years have increased 1.3pp since the lows in March.
- Housing market conditions remain buoyant, suggesting that shelter prices will remain supportive while medical care expenses continue to increase.
- Potential for supply-side pressures remains albeit less so than the risk of a major negative demand-side shock.
- Our baseline assume CPI growth of 0.2% in 2020 and 0.7% in 2021.

Inflation: Commodity headwinds fading as structural forces gain traction (shelter, medical and education)

CONSUMER PRICE INFLATION
(12M CHANGE)



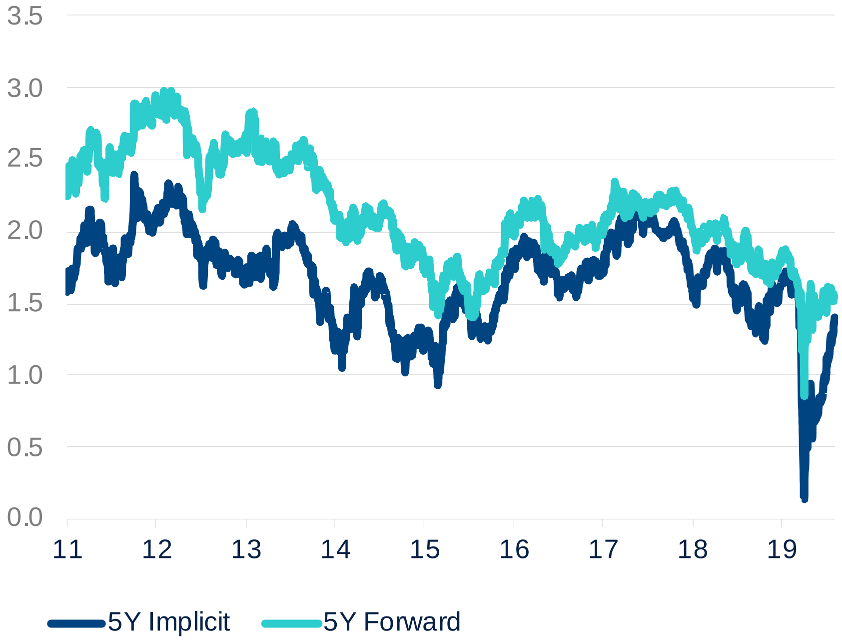
CORE INFLATION MEASURES
(12M CHANGE, %)



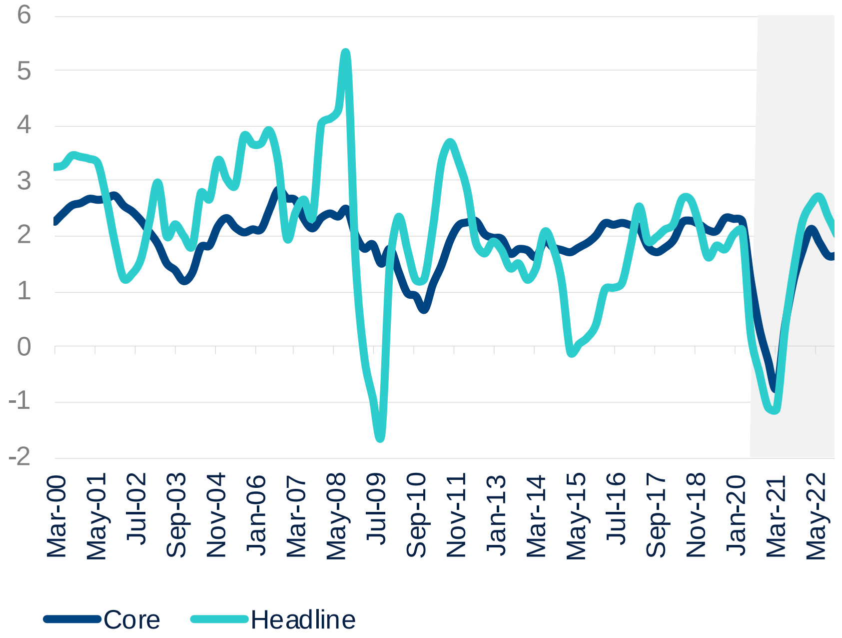
Source: BBVA Research, BLS & BEA

Inflation: Our baseline assumes CPI continues to edge up in 2H20 and in 2021

INFLATION EXPECTATIONS
(%)



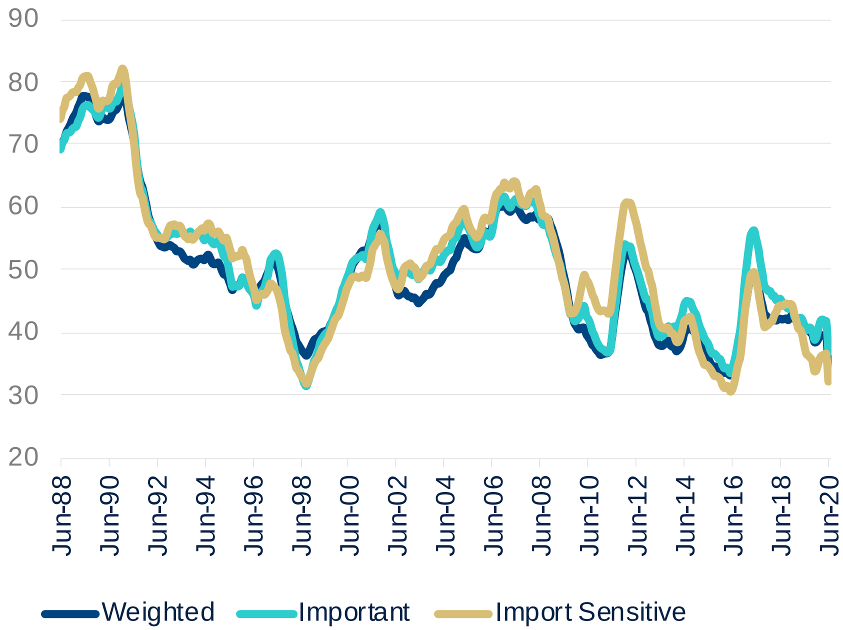
HEADLINE & CORE CPI
(YEAR-OVER-YEAR %)



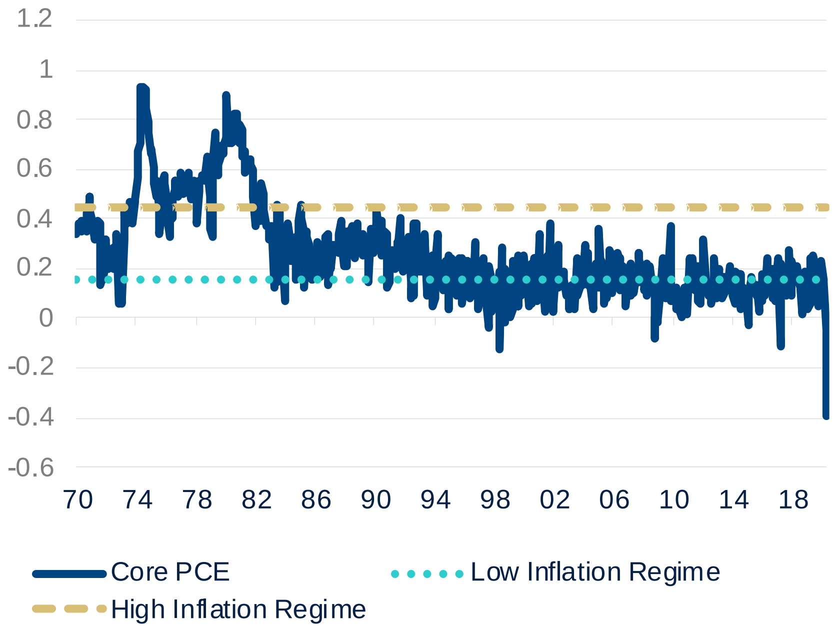
Source: BBVA Research & Haver Analytics

Inflation: Deflationary signals fading out of the data, but risks remain tilted to the downside

HIGH INFLATION REGIME DIFFUSION INDEX
(+/- 50 RISK OF HIGH OR LOW INFLATION REGIME)



CORE PCE
(MONTH-OVER-MONTH %)



Source: BBVA Research & Haver Analytics

05

Monetary Policy

Creating Opportunities

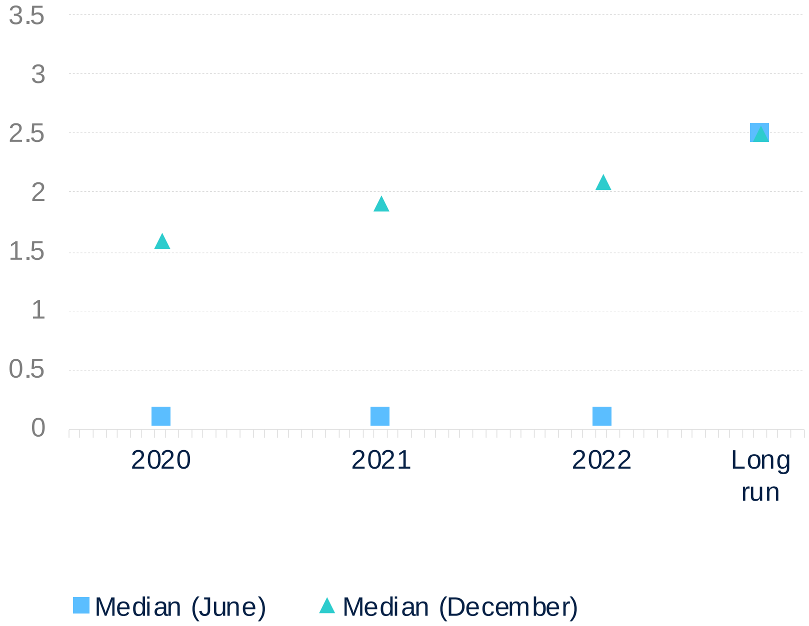
Monetary Policy: Federal Reserve

- Committee communication continues to strike a downbeat tone as risk to the U.S. economy grow.
- Fed beginning next phase of accommodation with focus on loan facilities and balance sheet tools.
- We continue to anticipate more modest LSAPs, but ongoing balance sheet expansion with, as the Fed allows space for expansion in non-treasury and MBS categories.
- Early uptake in emergency liquidity and primary credit programs is waning, but rollout of secondary market corporate credit facility, term asset-backed loan facility, main street lending facility and PPP loan facility leading to nontrivial growth in balance sheet.
- Ongoing discussion on Yield Curve Targeting (YCT), forward guidance, regulatory approach and options still in toolkit, as committee formalizing strategies for a worst case scenario.
- Baseline unchanged: rates to remain at ZLB until at least 2022, asset purchases to continue indefinitely.

Monetary Policy: Recent Fed communication more aligned with bottom end of the range of forecasts

FOMC DOT PLOT

(%)



Source: BBVA Research & Haver Analytics

FOMC JUNE'S SUMMARY OF ECONOMIC PROJECTIONS

(%)

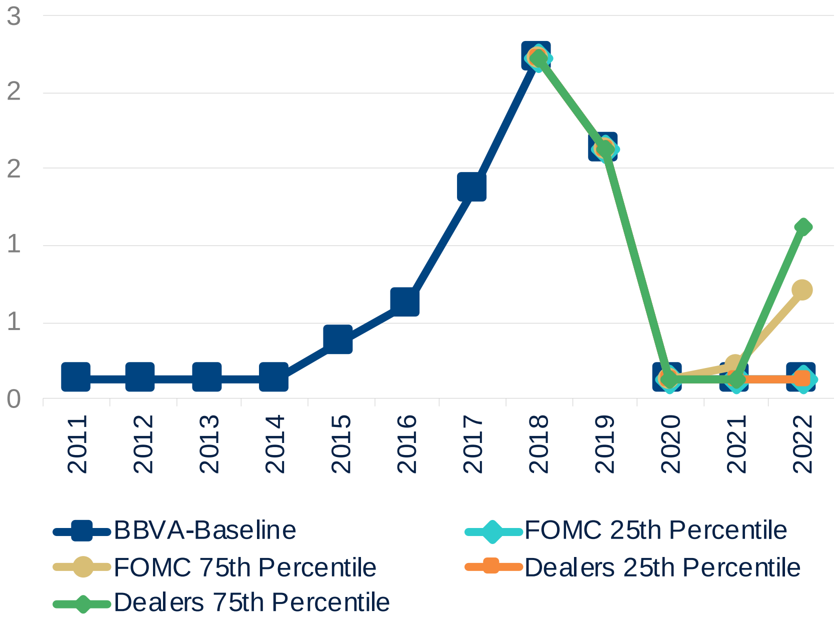
	2020	2021	2022	Long-run
Change in real GDP*	**-6.5**	**5.0**	**3.5**	**1.8**
Range	-10.0--4.2	-1.0-7.0	2.0-6.0	1.6-2.2
Unemployment rate*	**9.3**	**6.5**	**5.5**	**4.1**
Range	7.0-14.0	4.5-12.0	4.0-8.0	3.5-4.7
PCE inflation*	**0.8**	**1.6**	**1.7**	**2.0**
Range	0.5-1.2	1.1-2.0	1.4-2.2	2.0
Core PCE inflation*	**1.0**	**1.5**	**1.7**	
Range	0.7-1.3	1.2-2.0	1.2-2.2	
Federal funds rate*	**0.1**	**0.1**	**0.1**	**2.5**
Range	1.6-1.9	1.6-2.4	1.6-2.9	2.0-3.3

*Median

Monetary Policy: Consensus and implicit Fed fund futures forecasts imply prolonged period at ELB

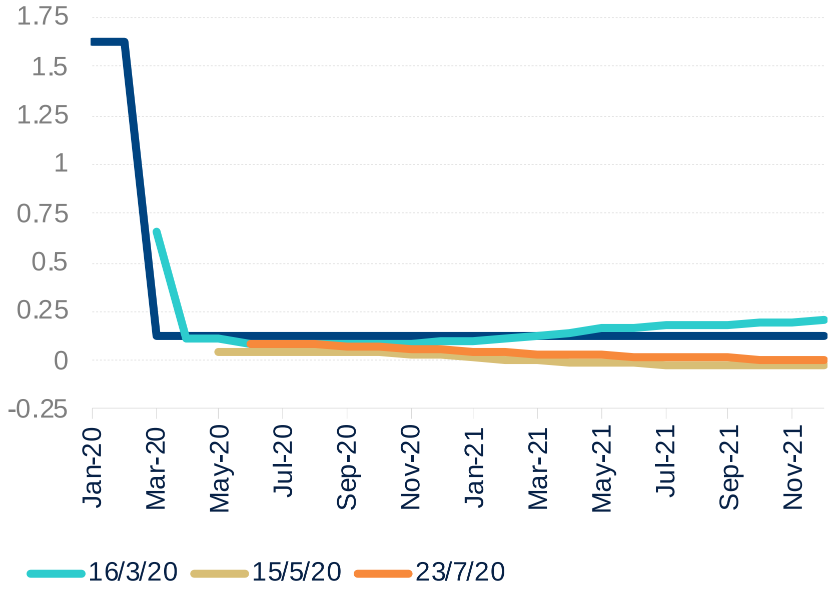
FED FUNDS RATE PROJECTIONS

(%)



FED FUNDS FUTURES & BBVA BASELINE

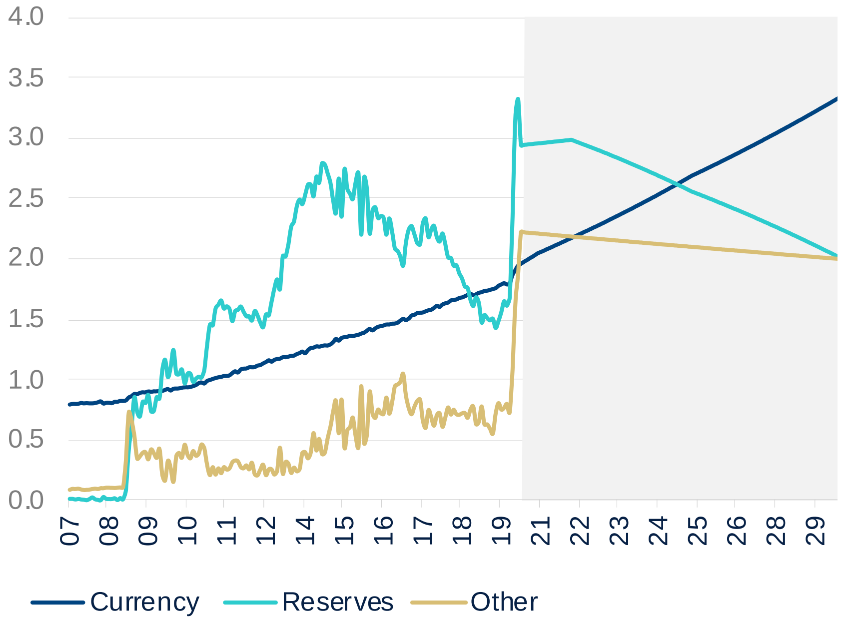
(%)



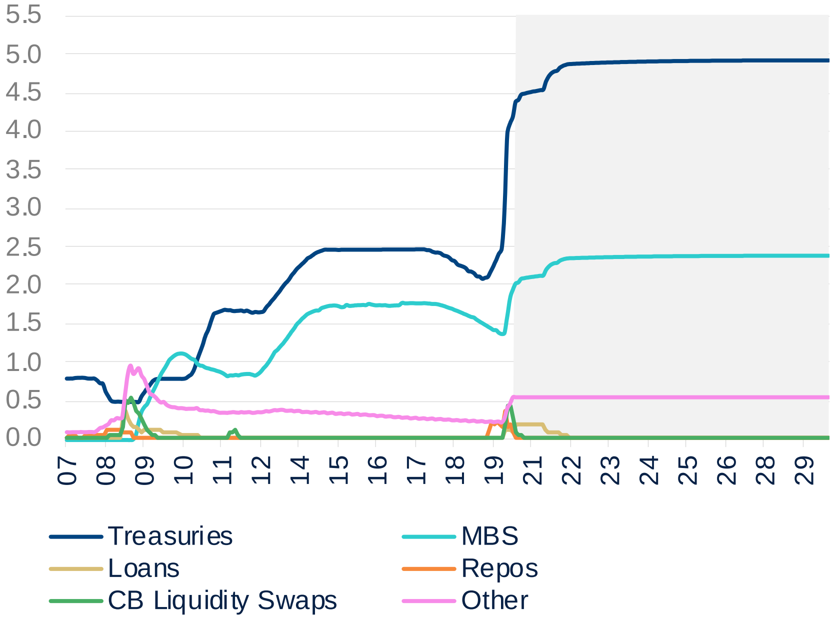
Source: BBVA Research & Haver Analytics

Fed Balance Sheet: Pace of balance sheet growth to slow as Fed shifts from LSAP to its loan facilities

FACTORS ABSORBING RESERVE FUNDS
(US$TN)



FACTORS SUPPLYING RESERVE FUNDS
(US$TN)



Source: BBVA Research, FRB & Haver Analytics

Research

06

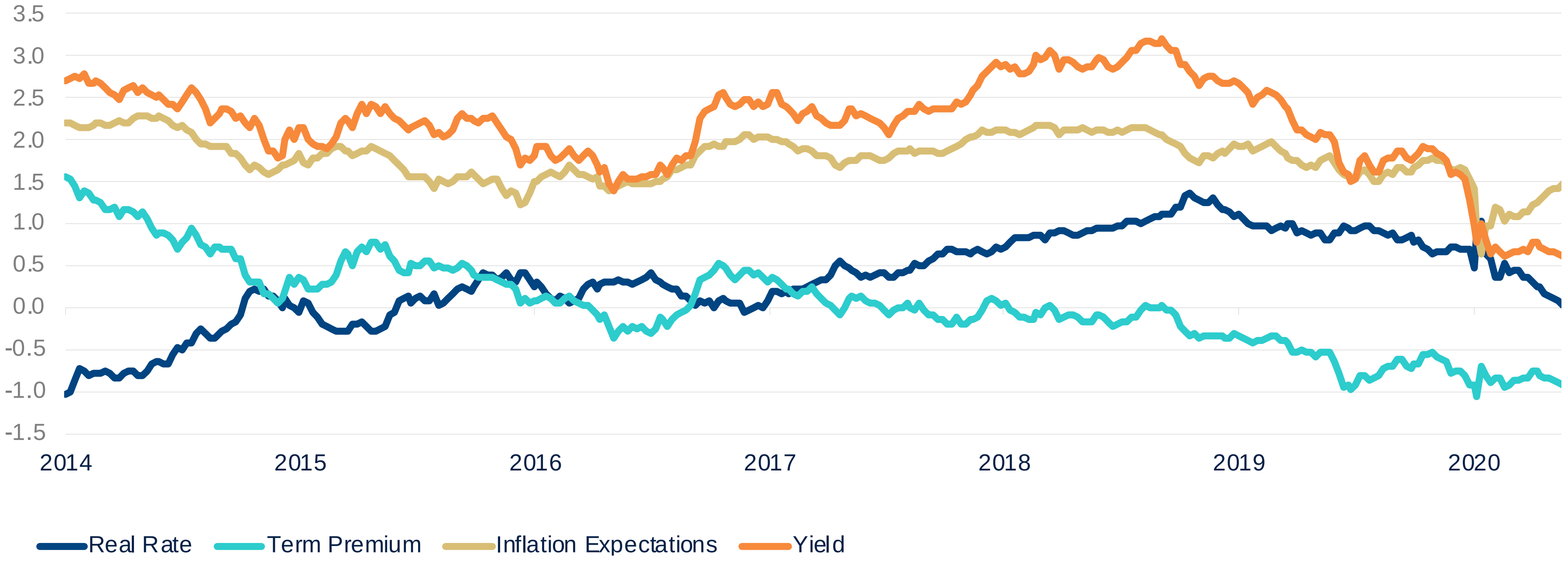
Interest Rates

Interest Rates

- 10-yr and 2-yr Treasury yields steadying around 0.6% and 0.2%, respectively.
- Fed's commitment to financial stability have greatly reduced market frictions.
- Negative term-premium to persist with LSAP and Fed commitment to keeping yield curve stable.
- Inflation expectations improve while nominal yields holding steady, pushing down long-term real treasury yields.
- T-Bill yields remain anchored to administrative rates at ZLB.
- Unprecedented conditions imply positive yield curve slope in spite of the major deterioration in the macroeconomic environment.
- Baseline assumes 10-yr yields at 0.7% and 1.2% by year-end 2020 and 2021, respectively.

Interest rates: Nontrivial rise in inflation expectations and steady term premium pushing down real rate

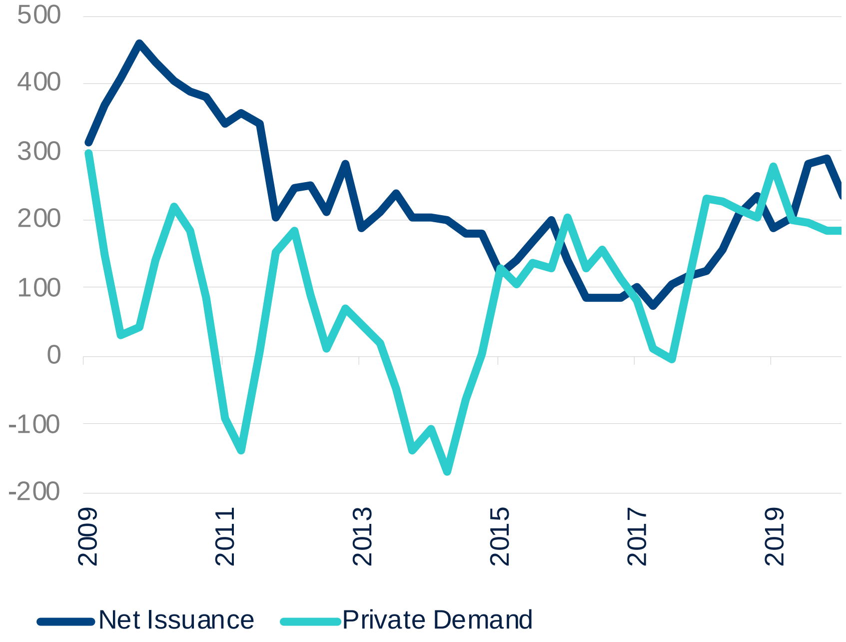
10-YEAR TREASURY YIELD DECOMPOSITION
(%)



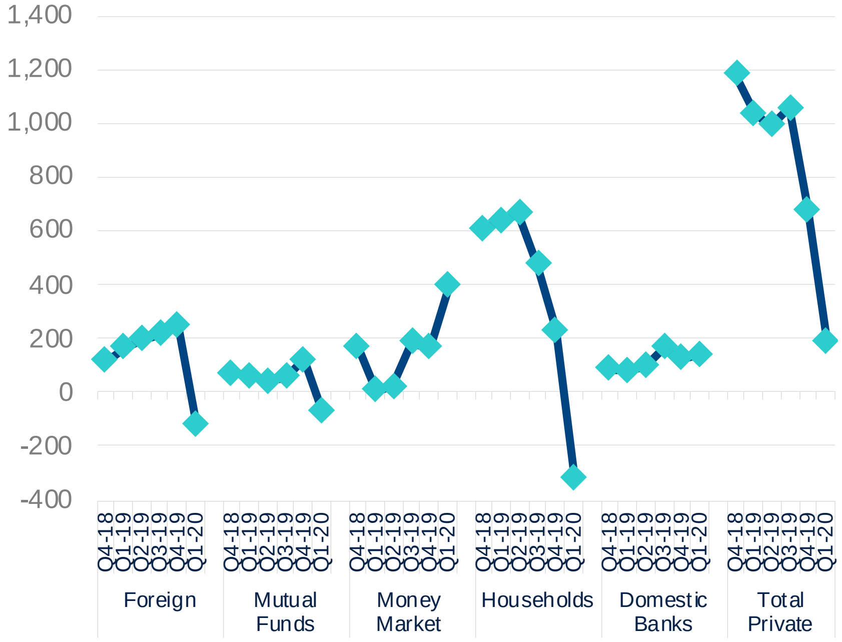
Source: BBVA Research, ACM & Haver Analytics

Interest rates: Weak private demand compensated for by Fed LSAP

CHANGE IN TREASURY SUPPLY & DEMAND
(3-QUARTER MOVING AVERAGE, $BN)



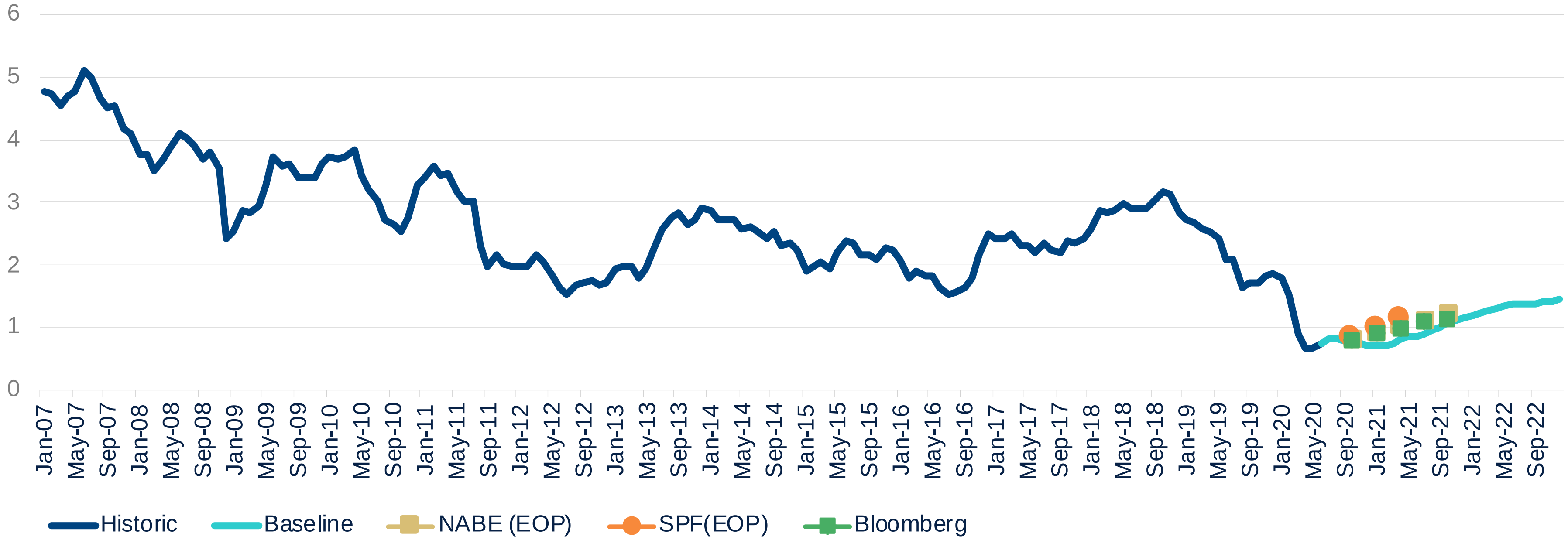
TREASURY DEMAND
(4-QUARTER MOVING AVERAGE, $BN)



Source: BBVA Research

Interest rates: Long-term yields to remain low for longer

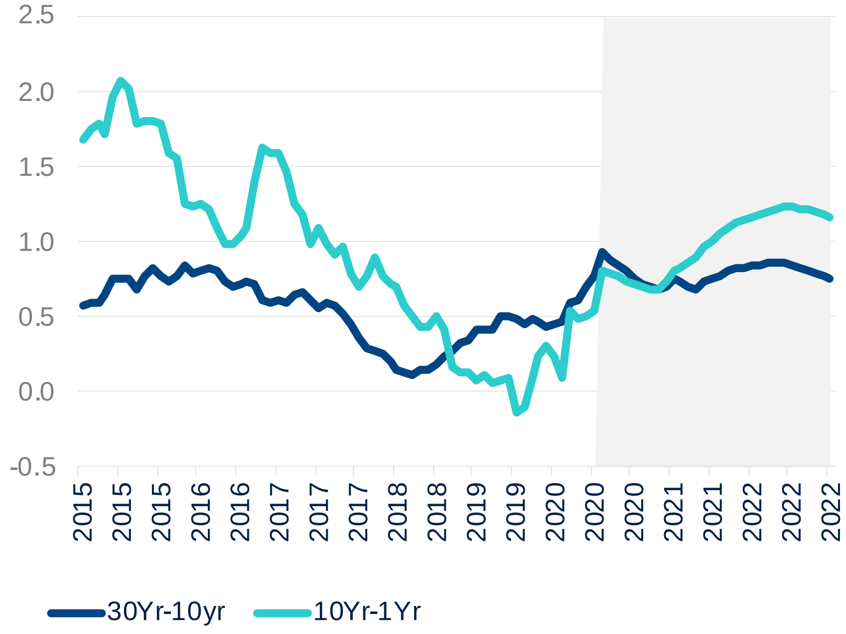
10-YEAR TREASURY YIELDS
(%)



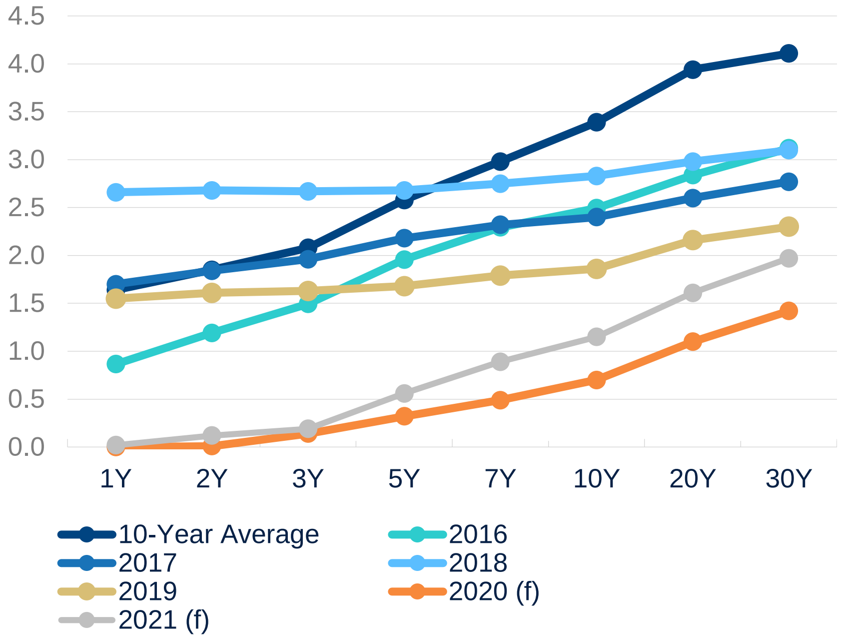
Source: BBVA Research, ACM & Haver Analytics

Interest rates: Baseline assumes persistent upward sloping yield curve

YIELD CURVE SLOPE
(BP)



YIELD CURVE
(%, EOP)



Source: BBVA Research

BBVA Research

07

Oil Prices

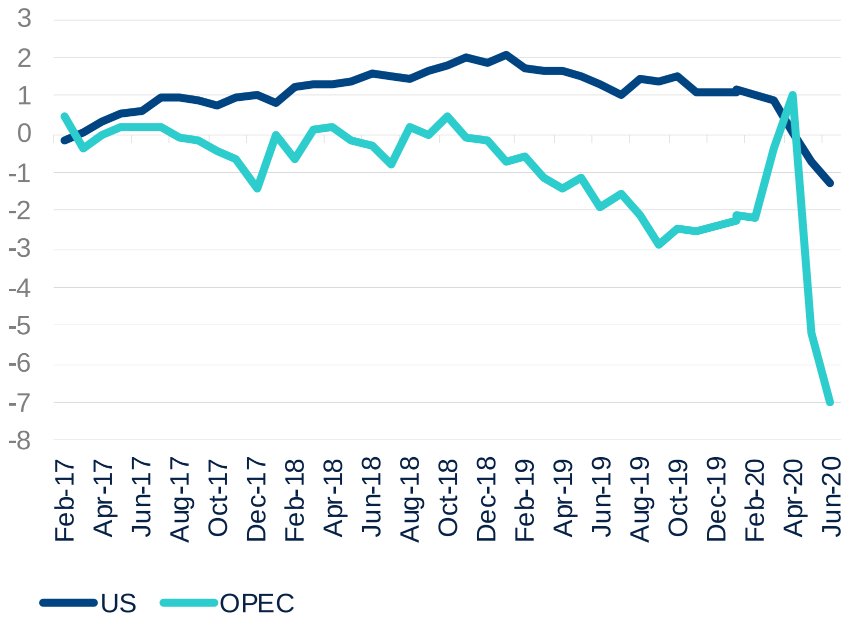
Oil Prices

- WTI prices have stabilized around $40 per barrel.
- Current WTI prices are still below the average levels needed to profitably drill a well
- The rig count remains at record low levels, implying sup-par drilling activity going forward.
- In our baseline scenario, WTI remains below average breakeven in 2020.
- Unless there is a change in the strategy, OPEC+ could scale back production cuts –as planned– in the following weeks, despite weak fundamentals.
- As the world continues to fight the pandemic, OPEC members will feel more pressure to increase production in order to boost much needed fiscal revenues.
- Risks are tilted to the downside, in particular, a resurge of COVID-19 infections could keep crude oil demand subdued for longer than expected.
- Moreover, there is a possibility that crude oil demand does not recover entirely under a new normal if there is a permanent change in the demand for transportation.

Production cuts and economic recovery have boosted oil prices and provide some relief to the O&G industry

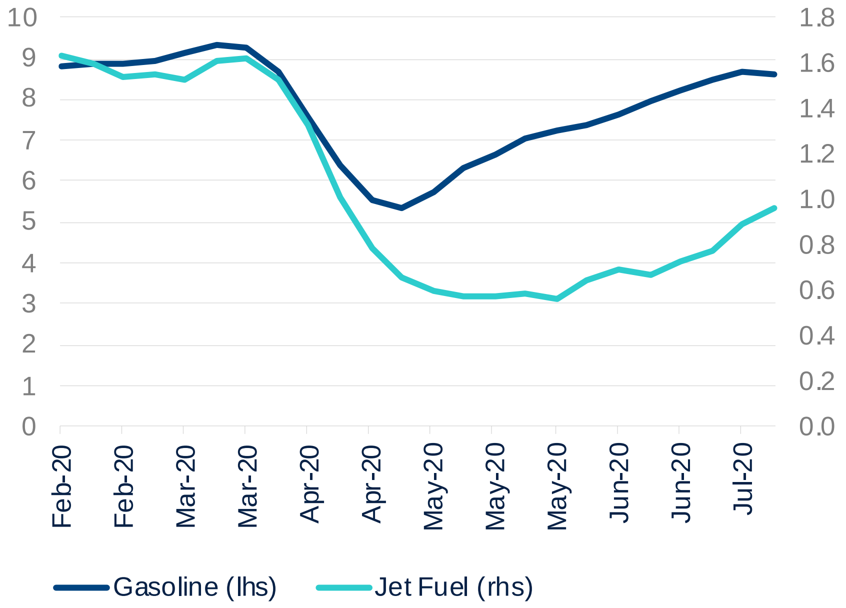
CRUDE OIL PRODUCTION

(YOY CHANGE, MILLION B/D)



U.S. DEMAND OF PETROLEUM PRODUCTS

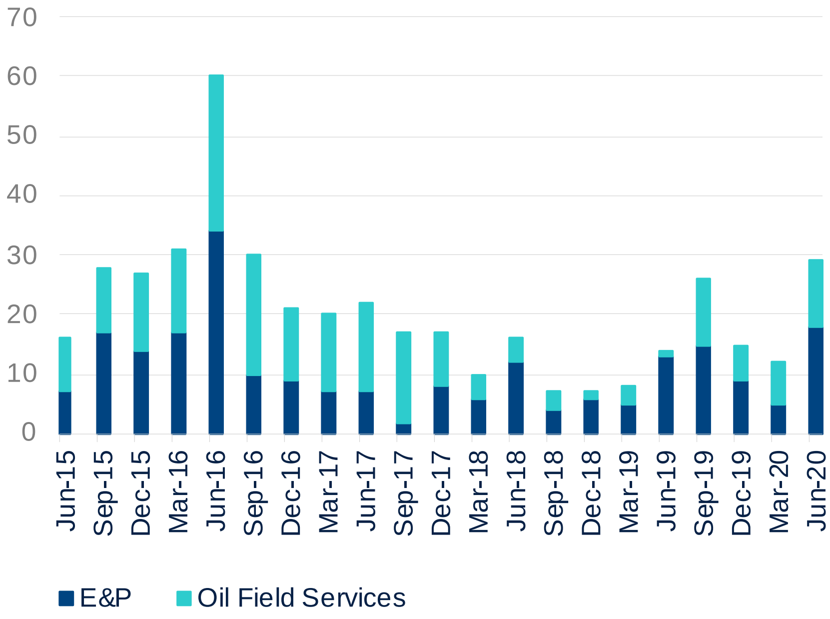
(MILLION B/D)



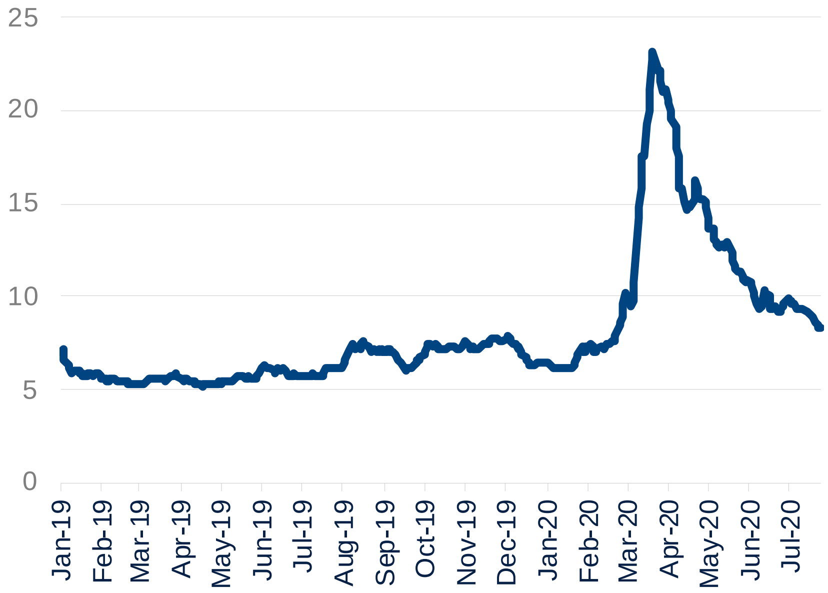
Source: BBVA Research and Haver Analytics

Higher prices coupled with monetary and fiscal support have lowered the risk of bankruptcy

U.S. BANKRUPTCY TRACKER
(QOQ CHANGE)



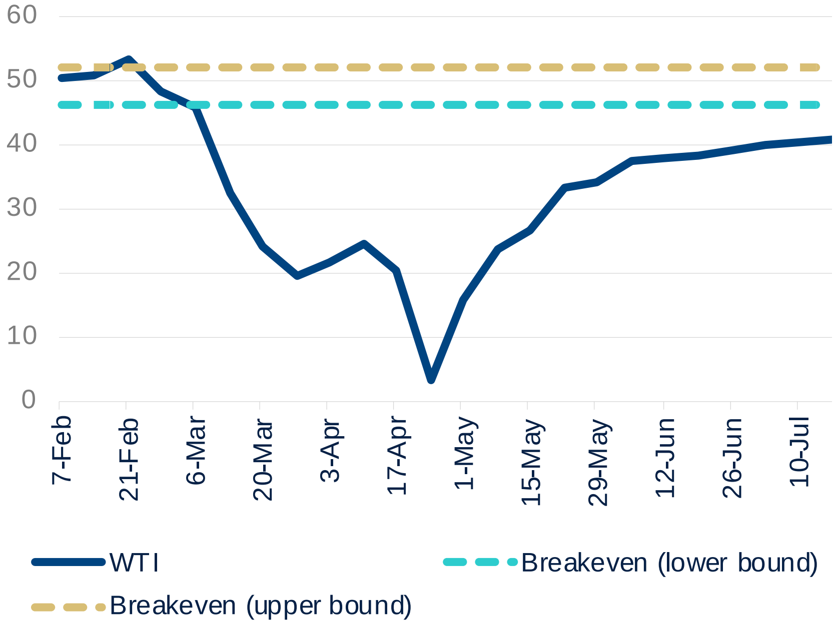
BLOOMBERG-BARCLAYS HIGH YIELD ENERGY AVERAGE OAS
(USD)



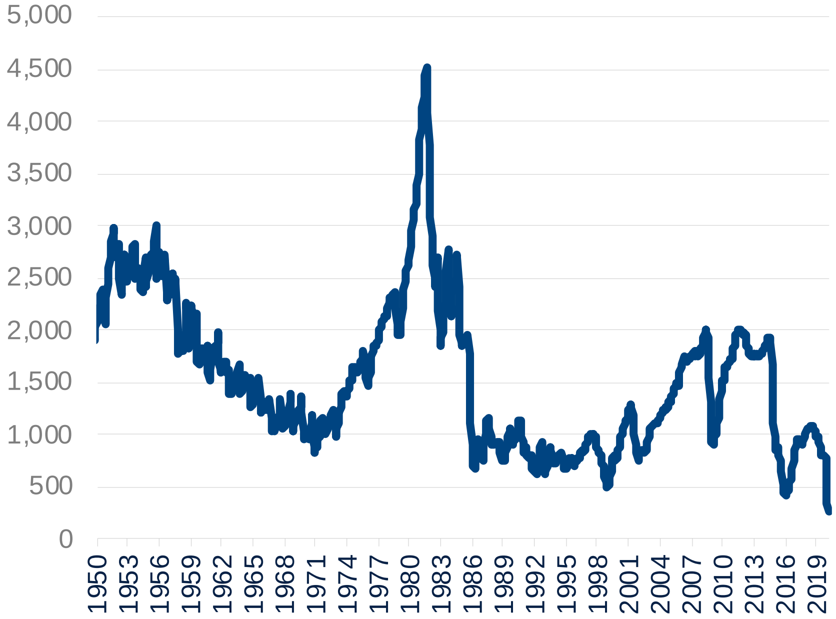
Source: BBVA Research, Bloomberg and Haynes and Boone

WTI prices remain below breakeven levels. This may translate in subpar investment going forward

U.S. WTI & BREAKEVEN PRICES
($ PER BARREL)



U.S. ACTIVE RIG COUNT
(UNITS)



Source: BBVA Research, Dallas Fed Energy Survey, and Haver Analytics

Macroeconomic Outlook

	2015	2016	2017	2018	2019	2020 (f)	2021 (f)	2022 (f)	2023 (f)
Real GDP (% SAAR)	2.9	1.6	2.4	2.9	2.3	-5.1	3.5	2.4	2.1
Real GDP (Contribution, pp)									
PCE	2.5	1.9	1.8	2.1	1.8	-4.1	3.6	1.8	1.6
Gross Investment	0.9	-0.2	0.8	0.9	0.3	-1.5	-0.2	0.7	0.7
Non Residential	0.3	0.1	0.6	0.9	0.3	-1.1	-0.3	0.6	0.6
Residential	0.3	0.2	0.1	0.0	0.0	0.1	-0.1	0.1	0.1
Exports	0.1	0.0	0.5	0.4	0.0	-2.3	-1.0	0.3	0.4
Imports	-0.9	-0.4	-0.8	-0.8	-0.2	2.9	0.9	-0.5	-0.6
Government	0.3	0.3	0.1	0.3	0.4	0.2	0.2	0.2	0.1
Unemployment Rate (%, average)	5.3	4.9	4.3	3.9	3.7	8.8	7.9	7.0	6.3
Avg. Monthly Nonfarm Payroll (K)	227	195	176	193	178	-854	154	138	107
CPI (YoY %)	0.1	1.3	2.1	2.4	1.8	0.2	0.7	2.4	1.9
Core CPI (YoY %)	1.8	2.2	1.8	2.1	2.2	0.9	0.6	1.8	1.8
Fiscal Balance (% GDP, FY)	-2.4	-3.2	-3.4	-3.8	-4.6	-16.4	-8.0	-5.4	-5.0
Current Account (bop, % GDP)	-2.2	-2.1	-1.9	-2.2	-2.2	-2.2	-2.2	-2.2	-2.3
Fed Target Rate (%, eop)	0.50	0.75	1.50	2.50	1.75	0.25	0.25	0.25	0.75
10-Yr Treasury (% Yield, eop)	2.24	2.49	2.40	2.83	1.86	0.70	1.15	1.44	1.91
West Texas Intermediate Oil Prices (dpb, average)	48.7	43.2	50.9	65.0	57.0	36.3	47.0	54.2	57.4

Source: BBVA Research
*Forecasts subject to change

Disclaimer

Research

U.S.

Macroeconomic Pulse

July 2020

Creating Opportunities