

# U.S. Macroeconomic Pulse

June 2020

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# 01

# Economic Outlook

# Economic Outlook

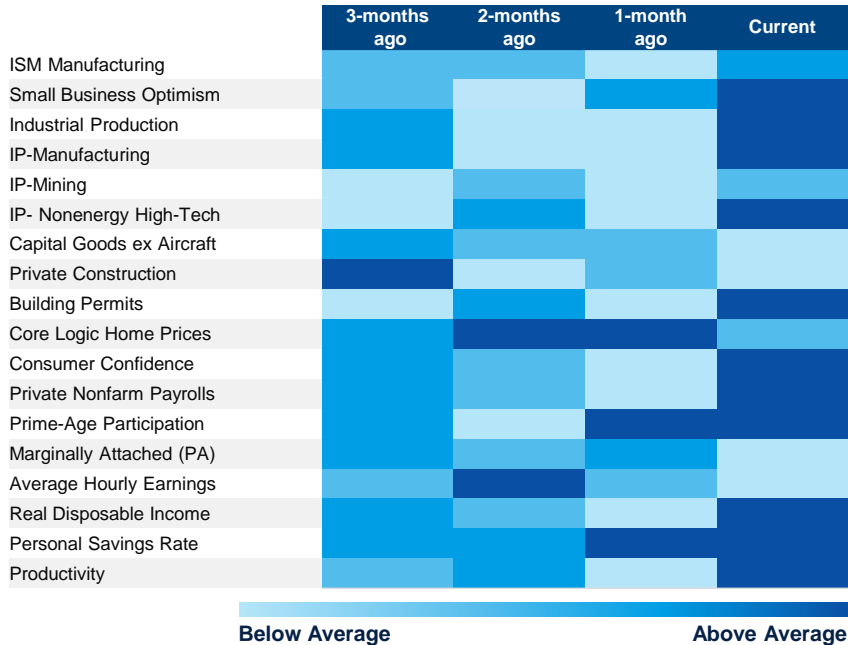
- Baseline assumes real GDP declines by 4.4% in 2020
- Peak unemployment reached, but risks to the labor market remain
- Disinflationary headwinds abate, but inflation to remain low in 2020
- Fed to keep rates at the Zero Lower Bound, balance sheet growth to continue
- Long-term yields to remain low
- Oil prices will stay near current levels for the remainder of the year
- 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

- At -5.0%QoQa, real GDP growth in 1Q20 was the lowest since the financial crisis
- Contributions from healthcare (-2.3pp), transportation (-0.7pp), recreation (-1.0pp) and food service and accommodation (-1.6pp) were the lowest for which data is available
- Conditions to worsen in 2Q20 with GDP growth dropping by 32.3% QoQa
- Real investment to drop 22.6% QoQa in 2Q20 and 9.6% in 2020
- With total trade falling 13.6% in 2020, we expect the trade deficit to shrink
- Without a phase 4 fiscal agreement, government spending to taper off
- Baseline assumes average real GDP growth of -4.4% in 2020 & 3.4% in 2021
- Risks tilted to the downside

# Economic activity

## REAL-TIME ECONOMIC MOMENTUM HEAT MAP



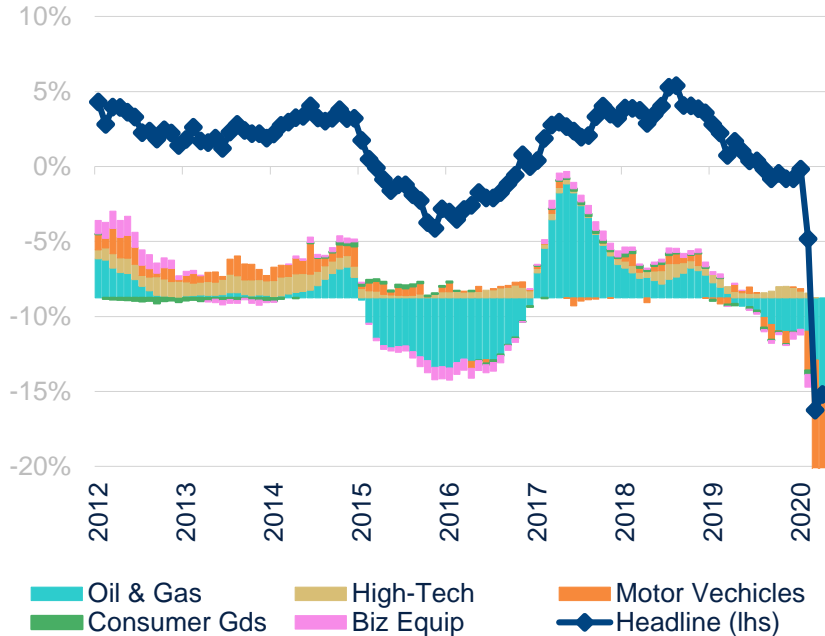
Source: BBVA Research

- Improvement in incoming manufacturing data reflects relaxation of stay-at-home orders and pent-up demand
- Unlike other sectors, mining output remains weak
- Home prices slowing, but supply disruptions and low pre-Covid-19 inventories should help to avoid major contraction in home prices
- Prime-age labor force participation recovering after 3.9M left the labor force
- Small business optimism rebounds, but remains well below levels that prevailed over the past 4 years
- For now, labor productivity buoyant as magnitude of layoffs outweigh drop in production

# Economic trends: Record decline in retail sales nearly offset by prolific gains in goods consumption in May

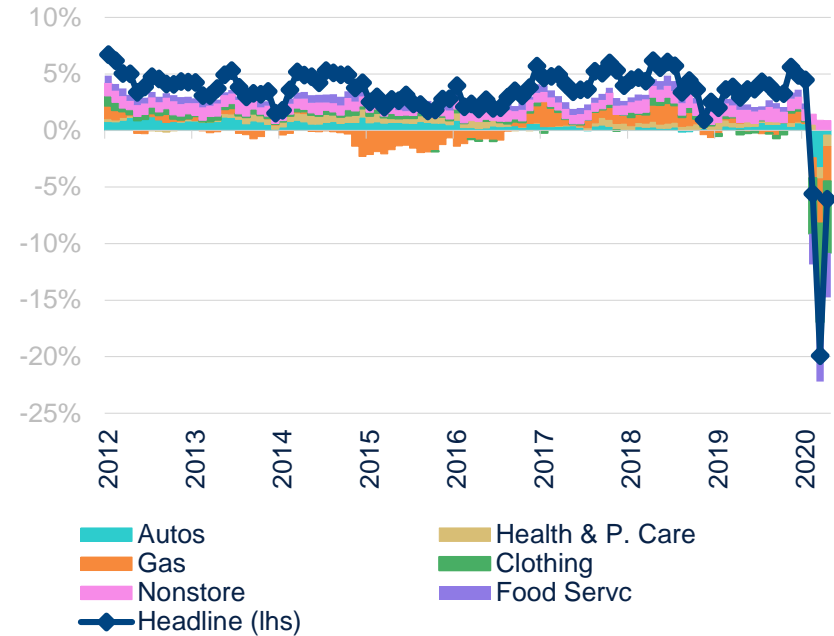
## INDUSTRIAL PRODUCTION

(YEAR-OVER-YEAR % & CONTRIBUTIONS)



## RETAIL SALES

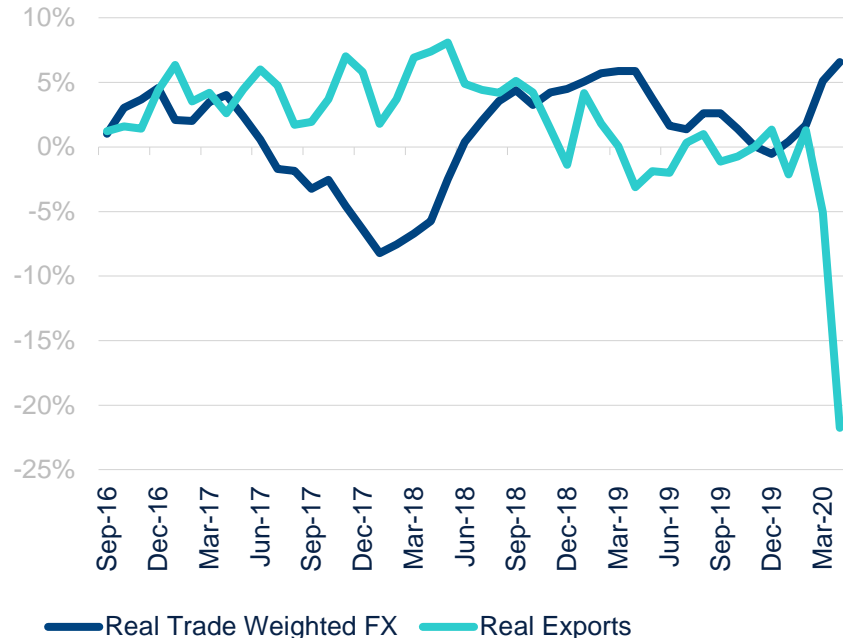
(YEAR-OVER-YEAR % & CONTRIBUTIONS)



# Economic trends: Global lockdowns and stagnation in economic activity lead to major decline in exports

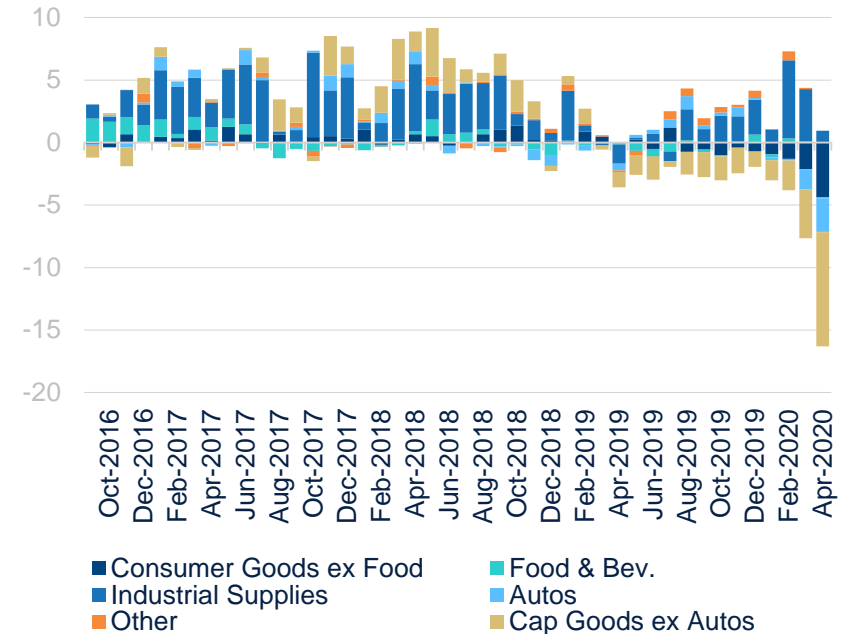
## REAL EXCHANGE RATE AND EXPORTS

(YEAR-OVER-YEAR %)



## REAL EXPORTS

(CONTRIBUTION TO YEAR-OVER-YEAR %)



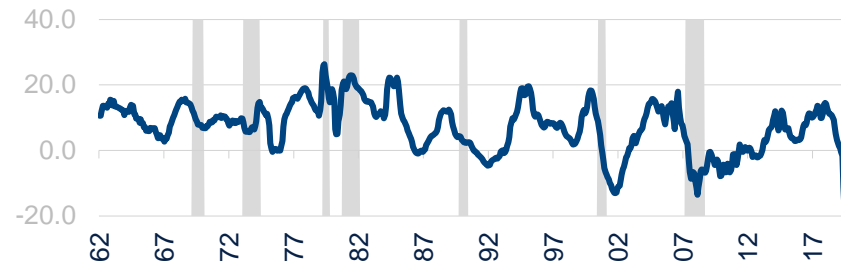
Source: BBVA Research, FRB & Census



# Consumer credit cycle: Despite strong consumer balance sheets, banks pulling back from consumer lending

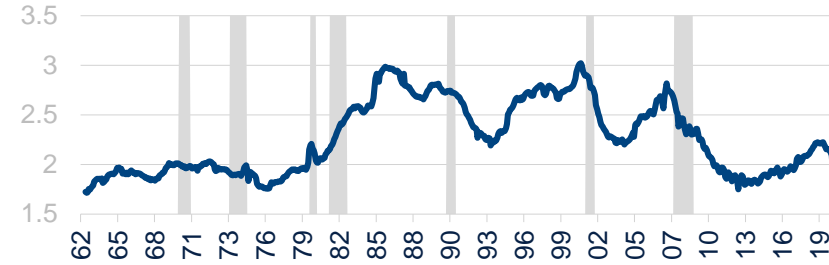
## PERSONAL INTEREST EXPENSE

(YEAR-OVER-YEAR %)



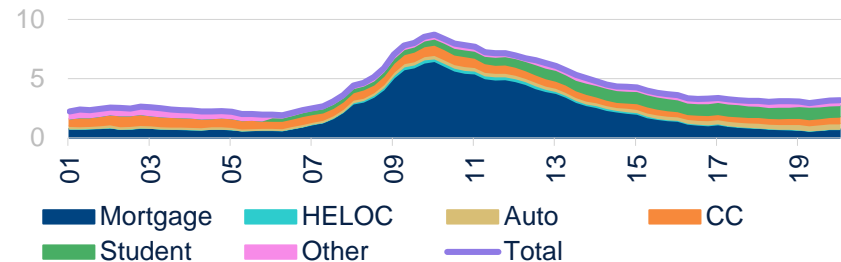
## PERSONAL INTEREST EXPENSE TO DISP. INCOME

(RATIO, %)



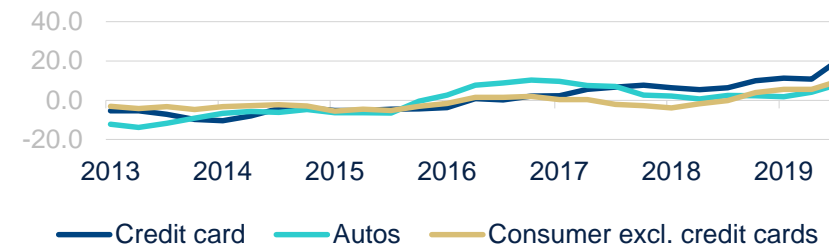
## CONSUMER SERIOUSLY DELINQUENT RATES

(90-DAY, CONTRIBUTION, %)



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

(TIGHTENING / - LOOSENING)



02

**COVID-19**

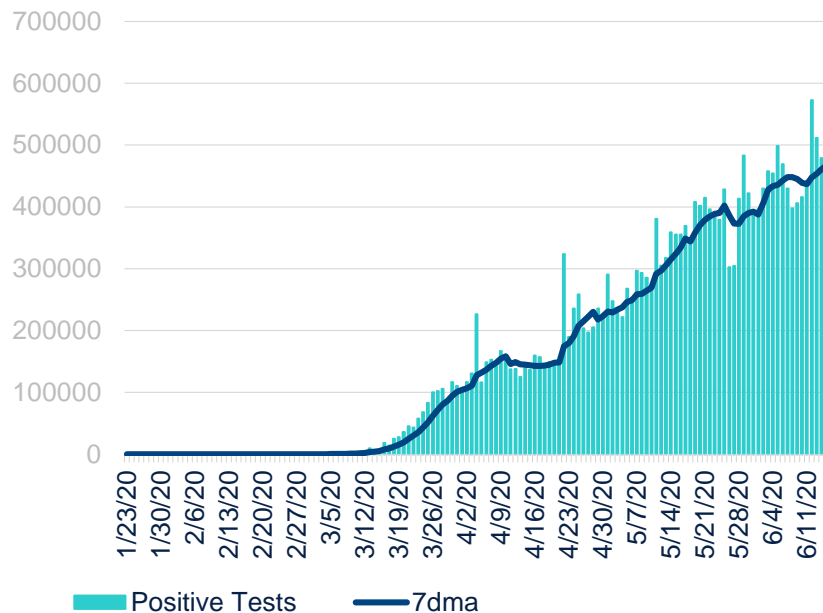
# COVID-19

- Nontrivial suppression of the virus in some major metropolitan areas not enough to slow rising numbers in other parts of the country
- Reduction in hospitalizations per positive Covid-19 test suggests vulnerable populations are remaining socially distant
- As we anticipated, the pace of economic deterioration produced by the pandemic was unprecedented in March and April, but activity seems to be at a turning point
- Risk of a second wave, persistent voluntary social distancing and risk aversion could limit the pace of the recovery
- Pandemic related fiscal initiatives and negative shocks to tax receipts led to a \$1.2Tn increase in the deficit on a seasonally-adjusted basis in April and May

# Covid-19: The reduction in the number of hospitalizations per case is a good sign, but cases in the U.S. continue to rise

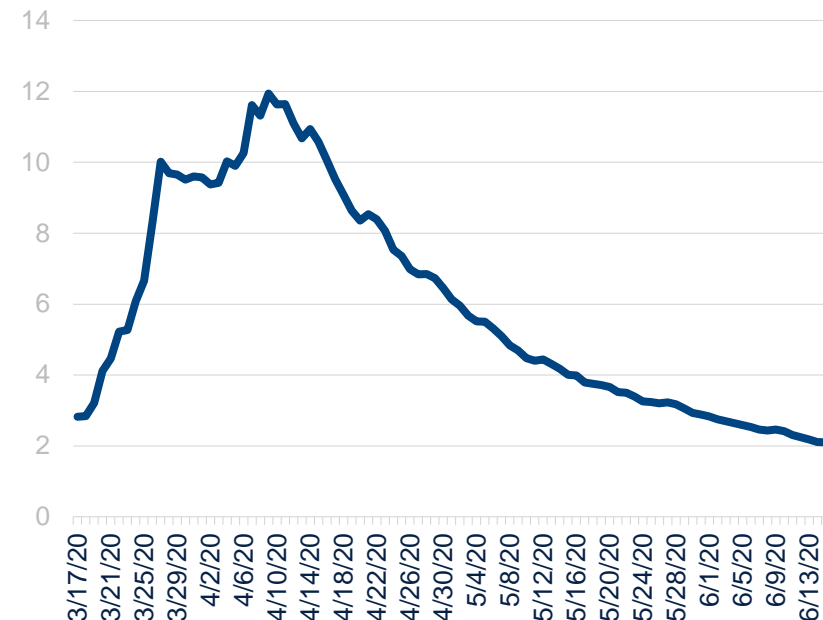
## POSITIVE TEST

(#)



## HOSPITALIZATIONS AS A SHARE OF POSITIVE TEST

(%)



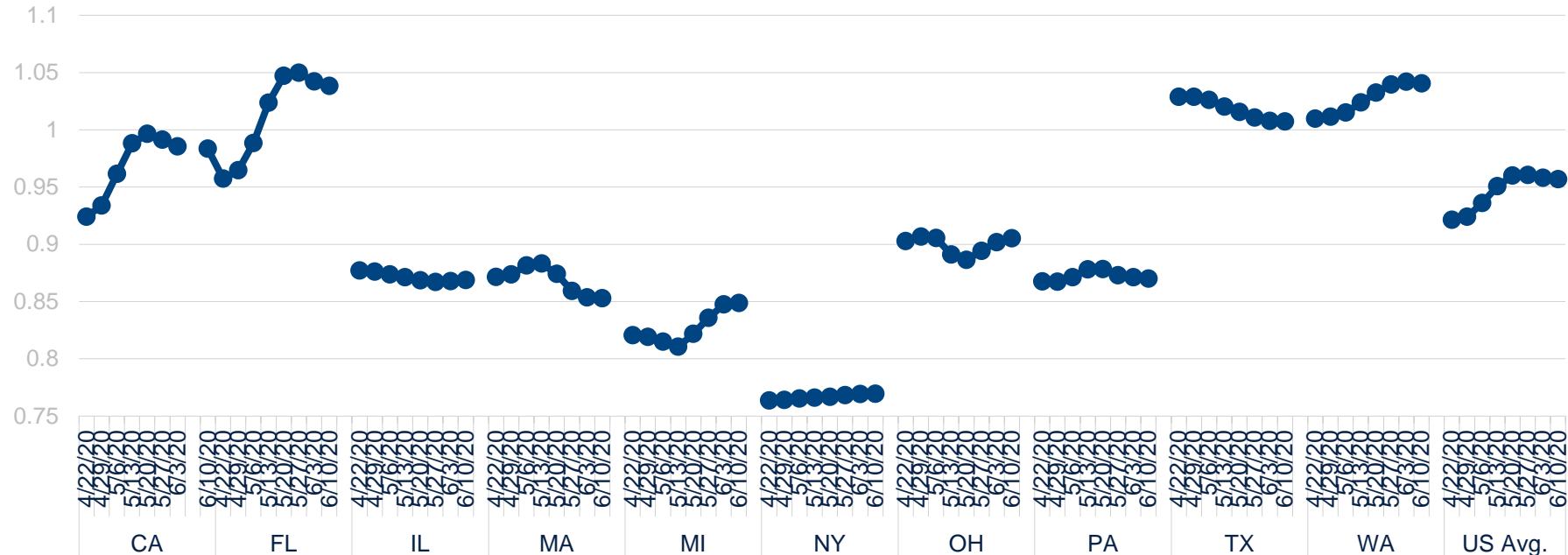
Source: BBVA Research, FRB & Census

\*Shaded area=GNP

# Covid-19: While $R_e$ in some states is consistent with relaxing social distancing measures, cases will rise as interaction increases

## EFFECTIVE REPRODUCTION NUMBER ( $R_e$ )

(#, WEEKLY AVERAGE)

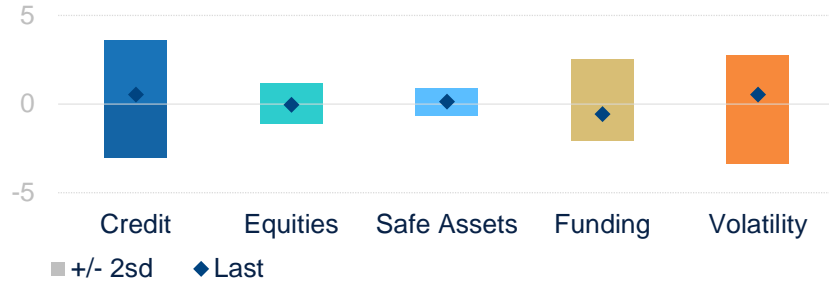


Source: BBVA Research, FRB & Census

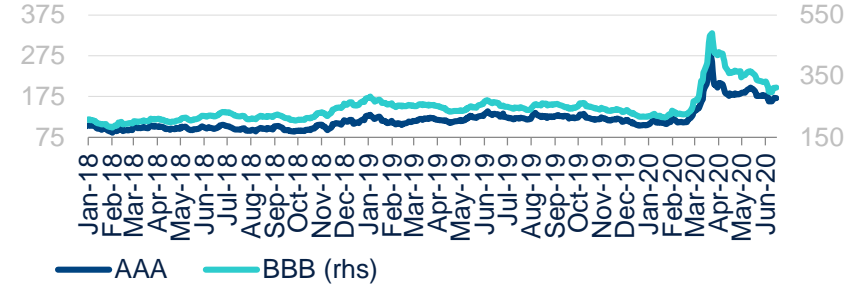
\*Shaded area=GNP

# Financial Markets: tensions decline dramatically across-the-board

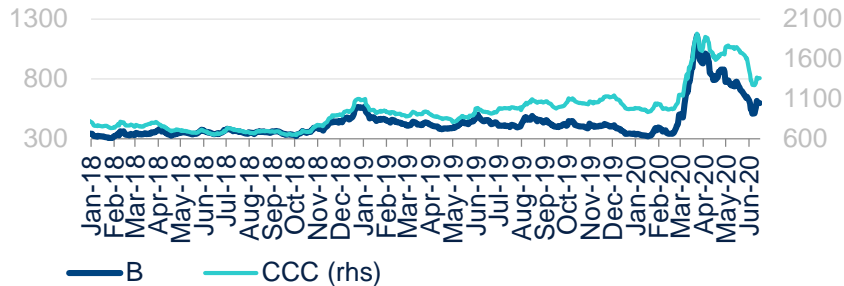
## FINANCIAL STRESS INDEX, >0 STRESS



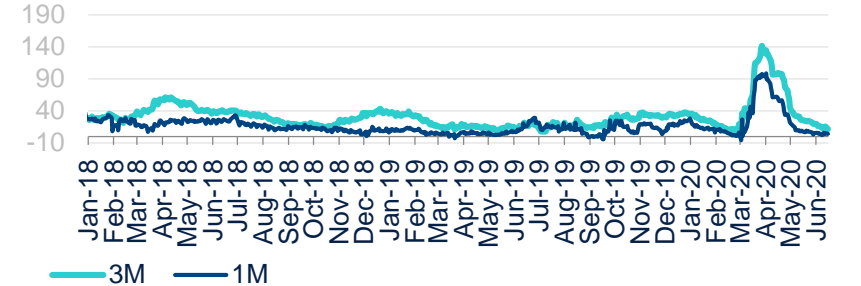
## CORPORATE SPREADS, BP



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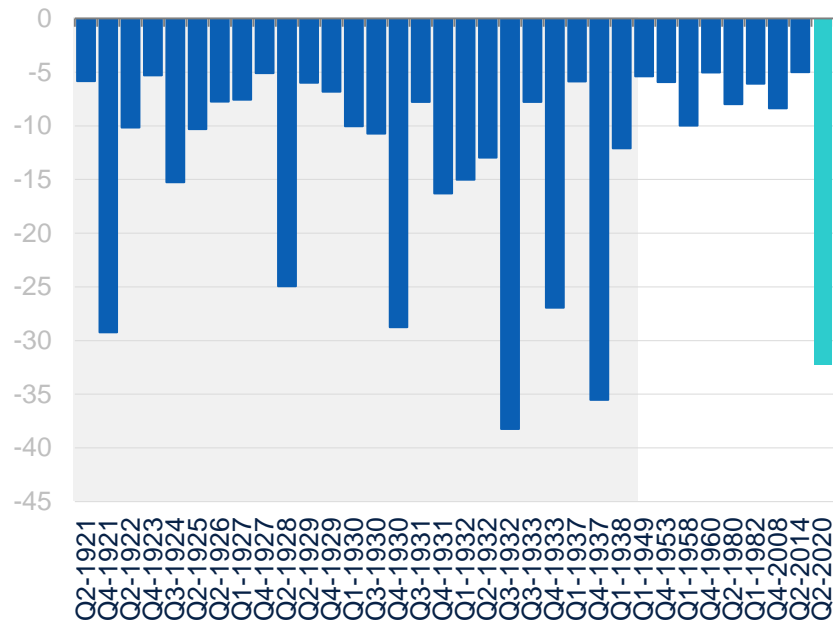


## TED SPREAD, BP

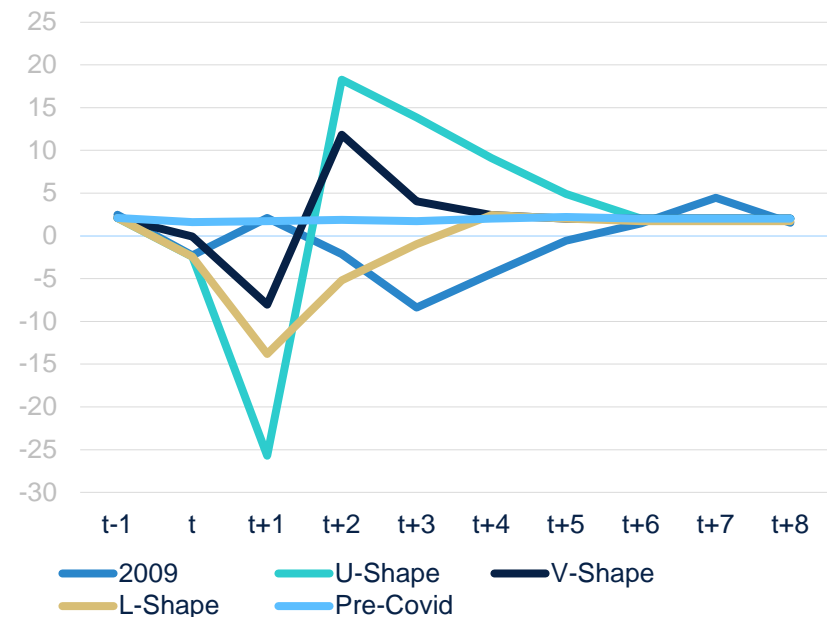


# GDP: our baseline continues to assume growth will drop by 32% in 2Q20. Probability of a U or L-shaped recovery growing

## NEGATIVE ANNUALIZED GROWTH QUARTERS\* (<-5%)



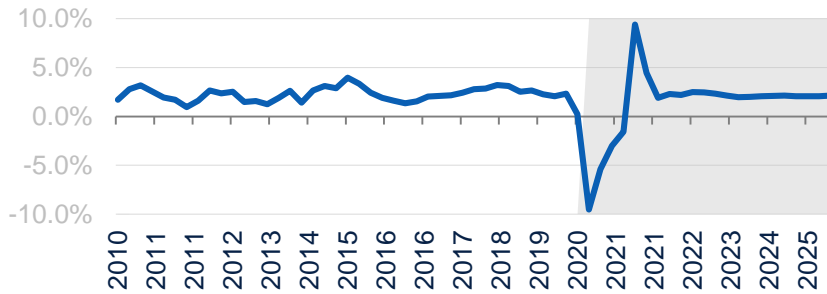
## GDP SIMULATIONS: PRE-COVID VS V, U AND L-SHAPE (QOQ % CHANGE, ANNUALIZED, T=START OF RECESSION)



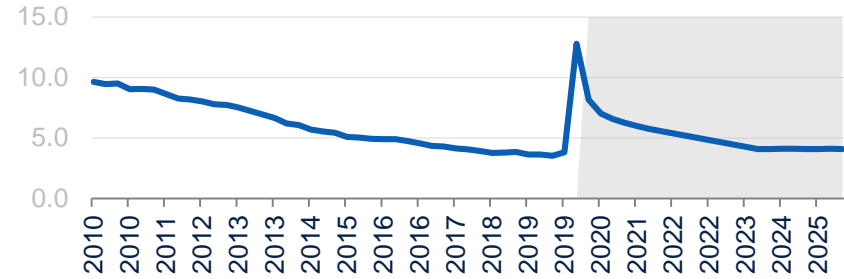
Source: BBVA Research, FRB & Census  
 \*Shaded area=GNP

# COVID-19 Macro Scenario

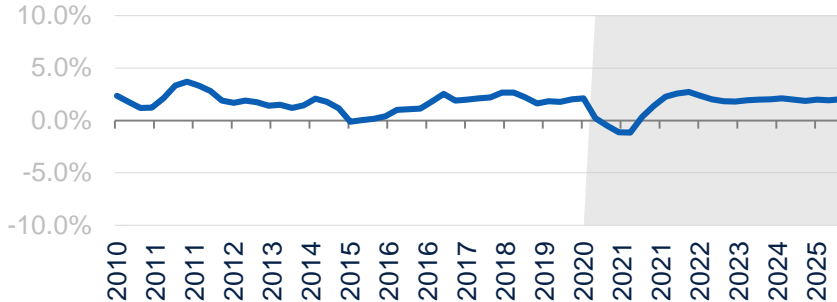
## REAL GDP, YOY%



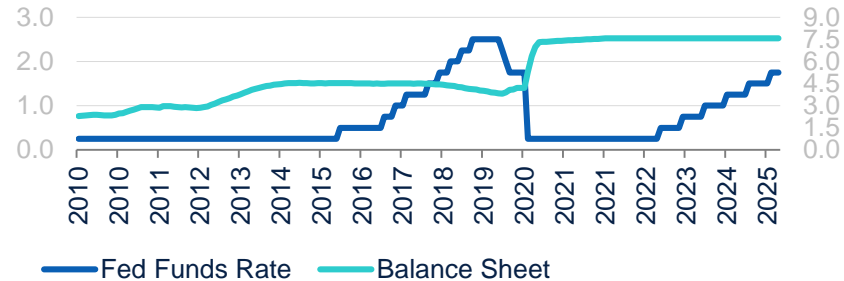
## UNEMPLOYMENT RATE, %



## CONSUMER PRICE INDEX, YOY%

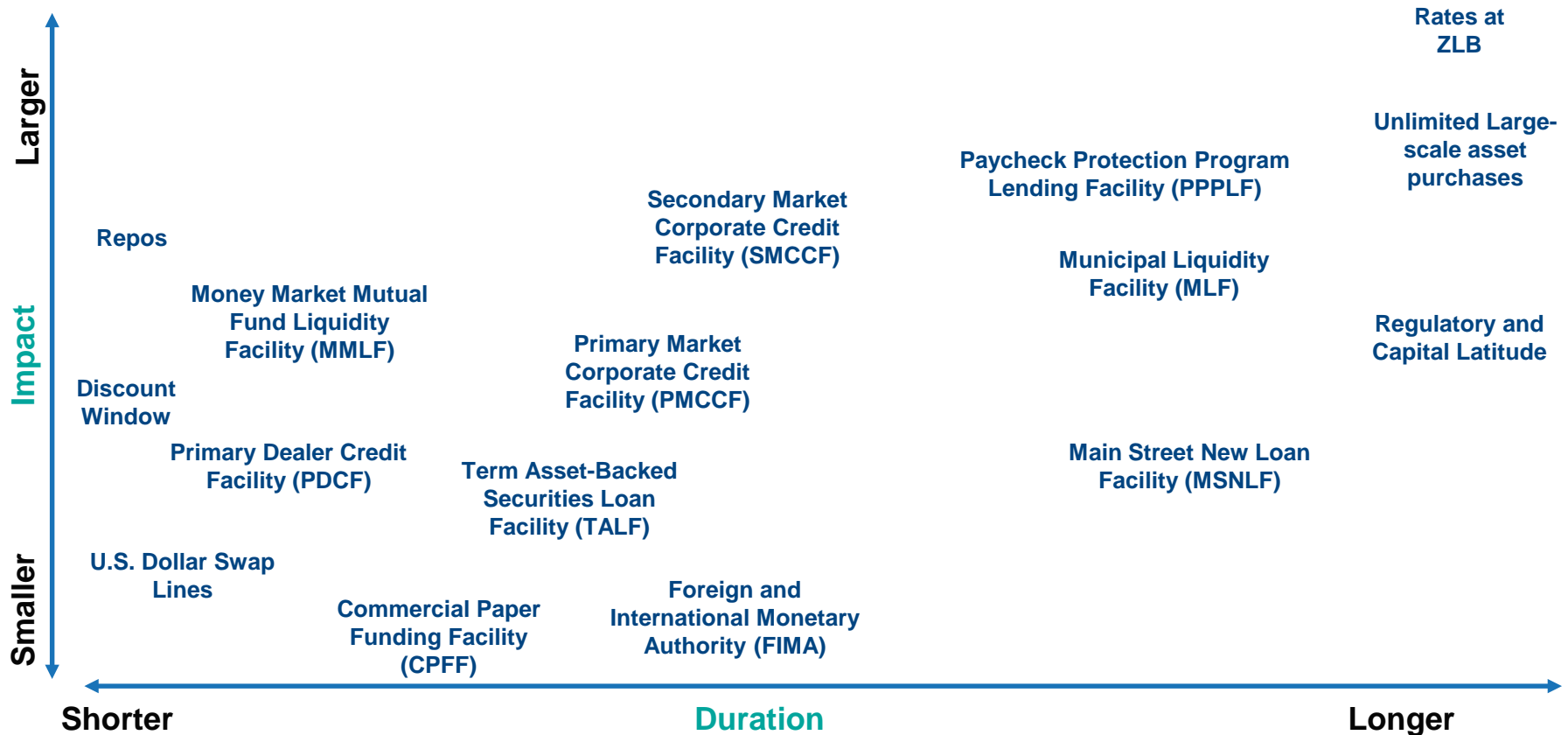


## FED FUNDS RATE AND BALANCE SHEET, % & US\$Tn





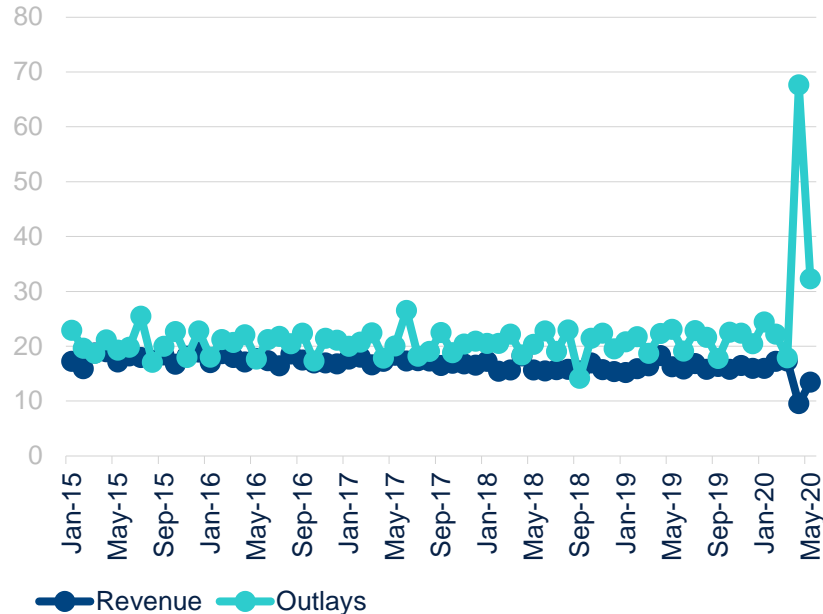
# Fed COVID-19 Policy Action



# Fiscal Policy: Historic rise in federal outlays receding as Congress fails to agree on phase 4 legislation

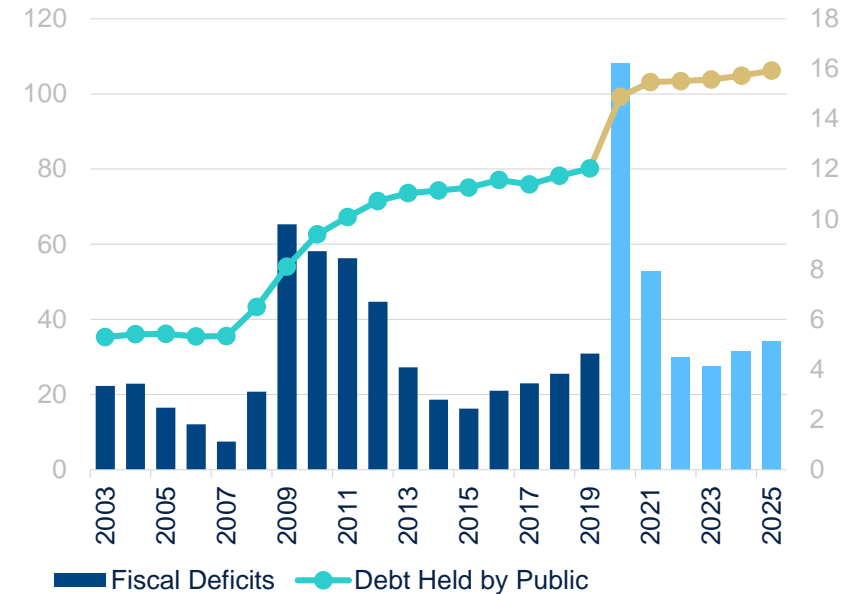
## SAAR FEDERAL BUDGET

(% of GDP)



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

(FY %)



03

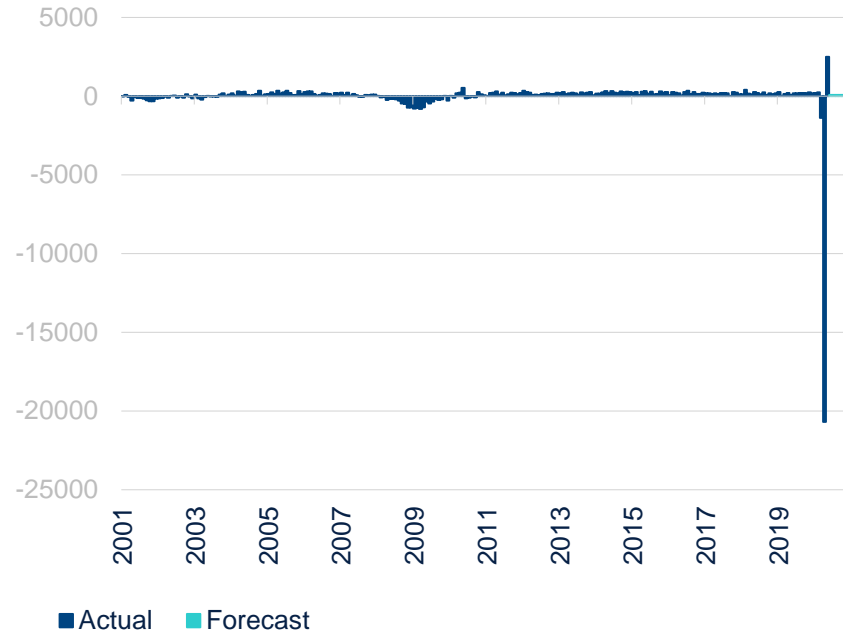
# Labor Market

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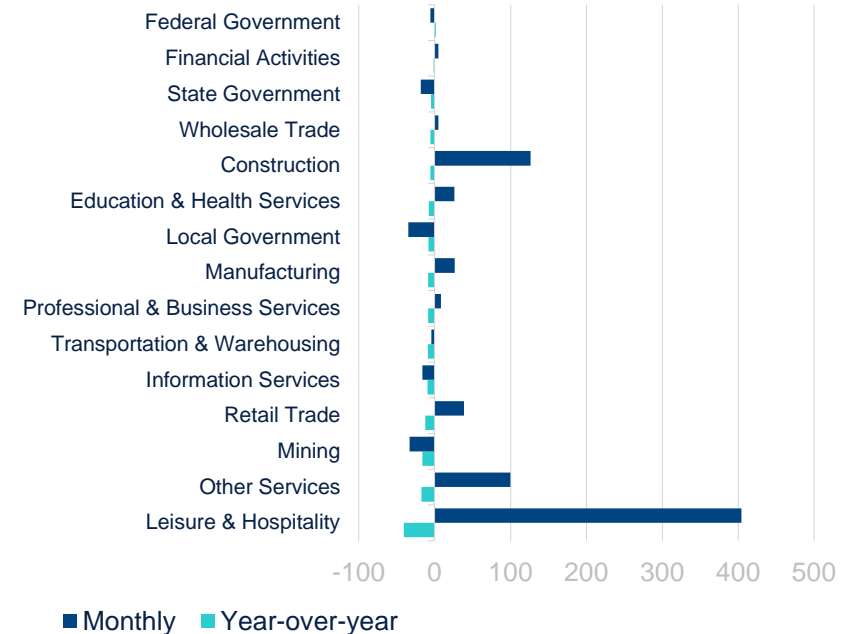
- Economy added 2.5M jobs in May, after losing 22M jobs in March and April
- Nontrivial share of the gains in nonfarm payrolls concentrated in leisure and hospitality(1.2M), retail(368K) and construction(464K)
- After rising 11.2pp to 14.7%, the unemployment rate declined to 13.3%
- Sampling issues and misclassifications of workers suggests that the actual unemployment rate could be as high as 19.8%
- Labor force participation improved by 60bp while the employment-to-population ticked up 1.5pp; nonetheless, both measures remain near historic-lows
- Baseline assumes a modest decline in the unemployment rate by year-end

# Labor market: 2.5M increase in employment concentrated in service-oriented sectors. Unemployment rate declines to 13.3%

## NONFARM PAYROLLS (MONTHLY CHANGE, K)



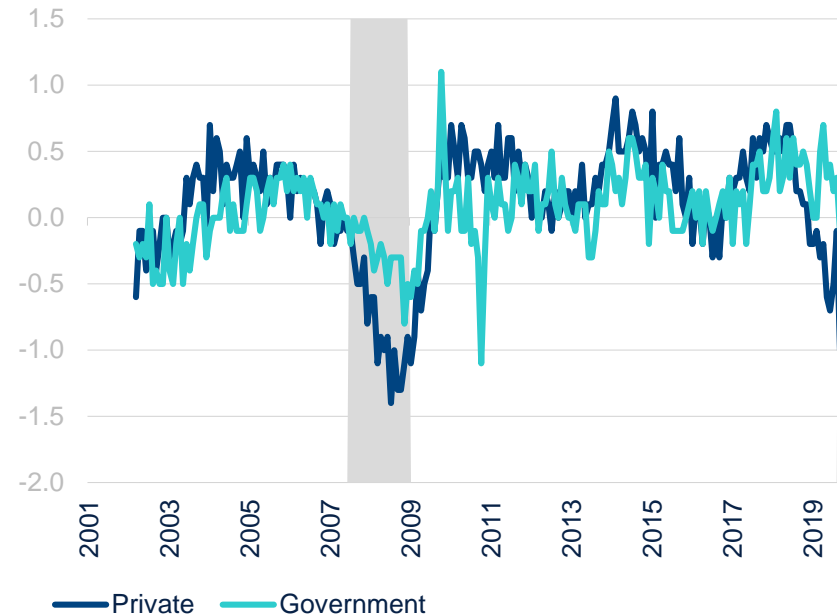
## INDUSTRY EMPLOYMENT (ANNUALIZED % CHANGE)



# Labor market: Churn slows dramatically as openings and quits both fall precipitously

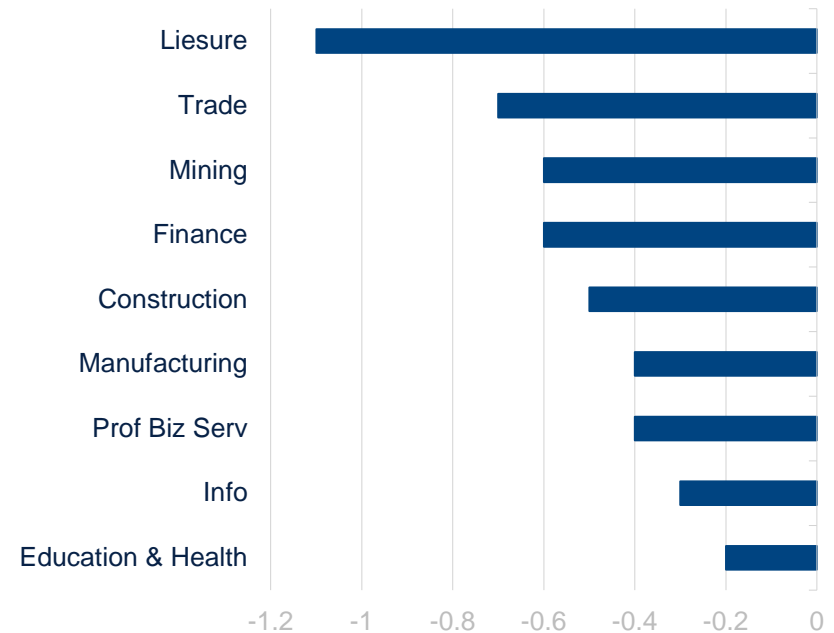
## JOB OPENINGS

(%)



## QUITS

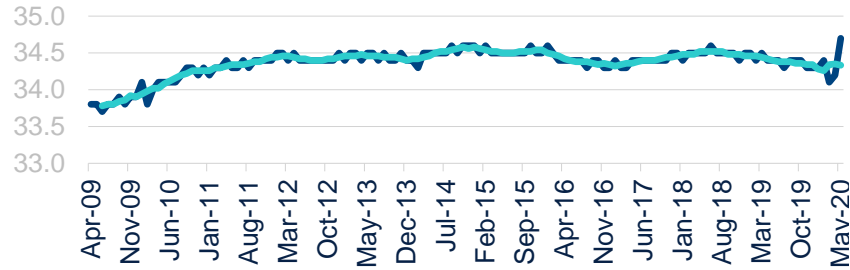
(%)



# Labor market: Upward pressure on wages and hours worked suggests firms leaning on retained workers rather than rehiring

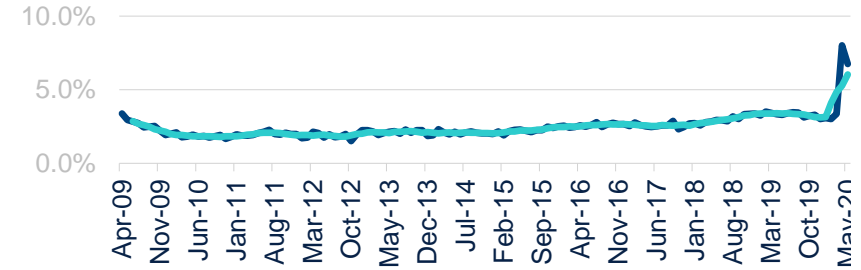
## AVERAGE WEEKLY HOURS

(NUMBER & 5MCMA)



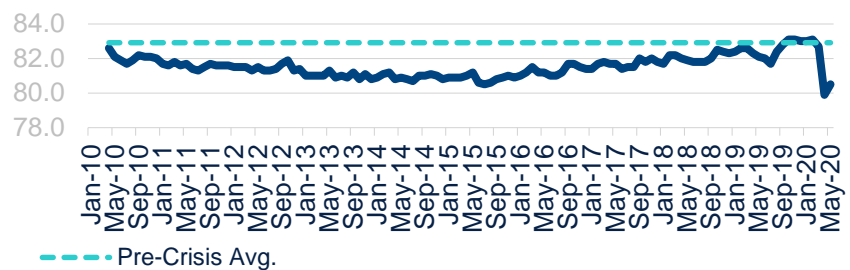
## AVERAGE HOURLY EARNINGS

(YOY% & 5MCMA)



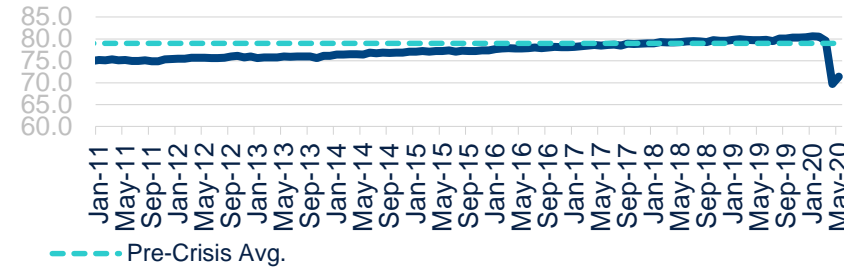
## PRIME AGE LABOR FORCE PARTICIPATION

(%)



## PRIME AGE EMPLOYMENT-TO-POPULATION

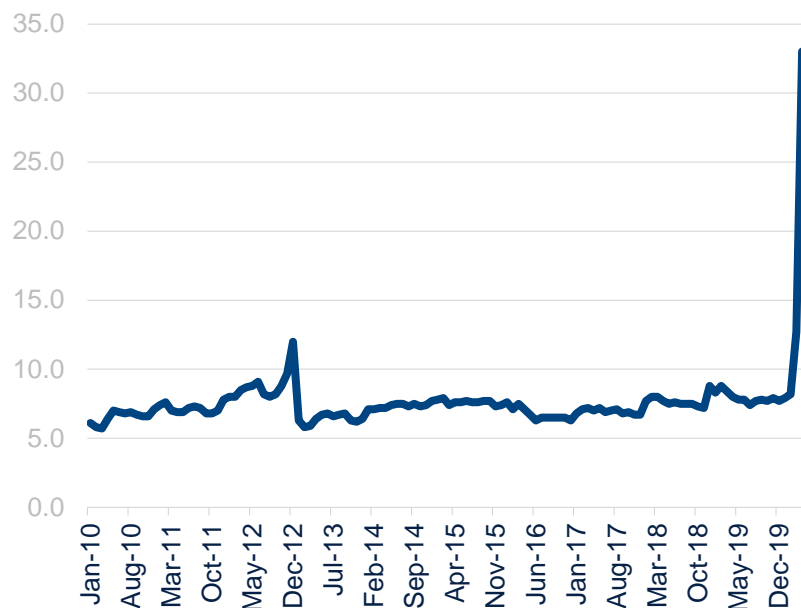
(%)



# Savings glut: impact from massive government transfers and drop in service consumption unlikely to last without fiscal intervention

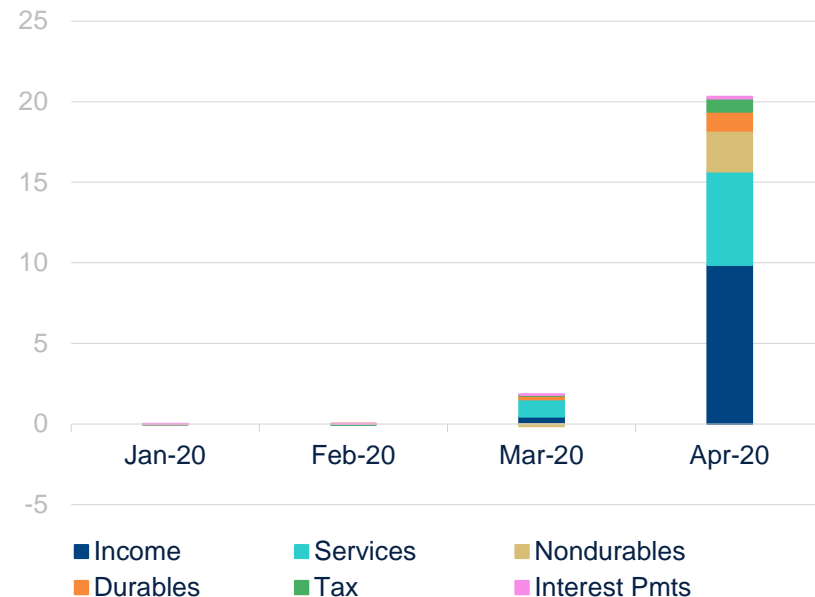
## PERSONAL SAVINGS RATE (%)

(%)



## CONTRIBUTION TO CHANGE IN PERSONAL SAVINGS RATE (PP)

(PP)





04

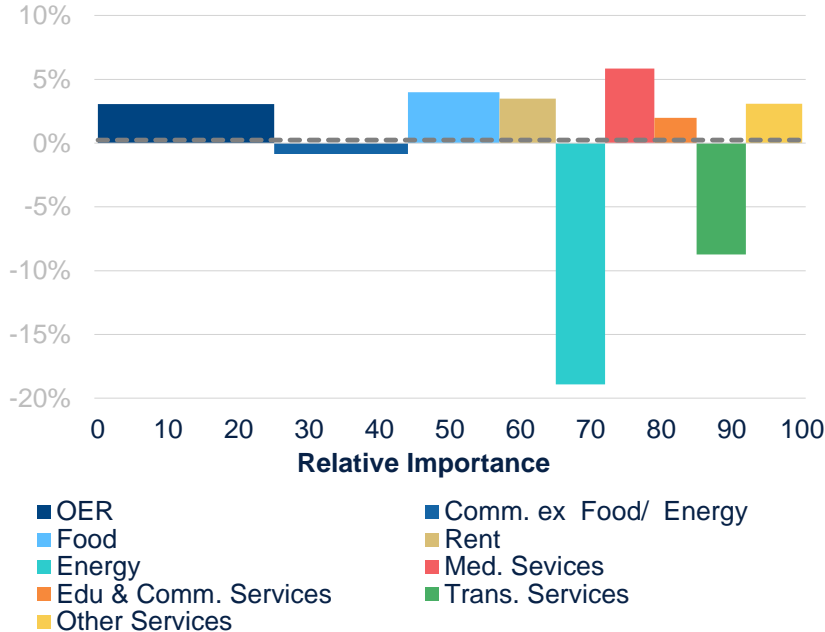
# Inflation

# Inflation

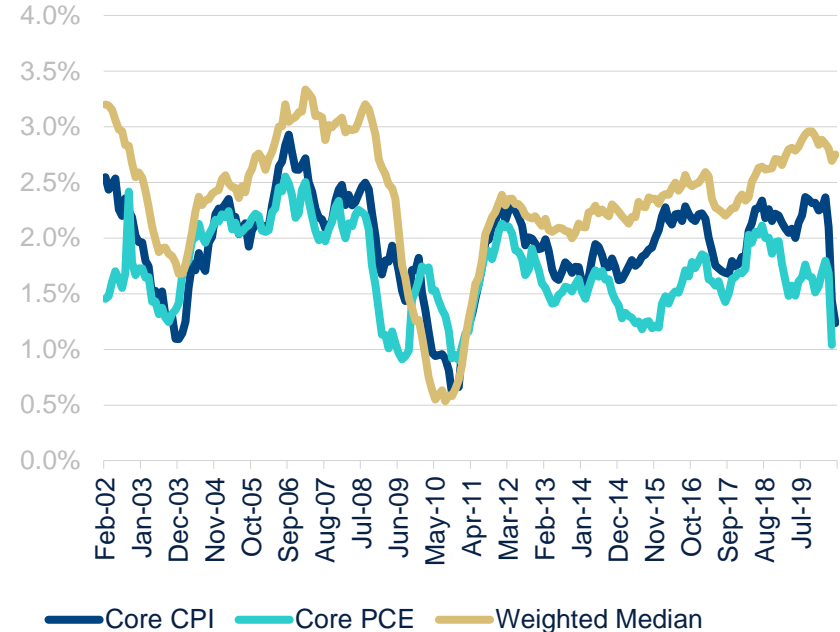
- May's CPI report signaled that, in terms of consumer prices and deflation risk, the worst is behind us, as headline inflation declined by only 0.1% MoM
- On a 12-month basis, headline consumer prices grew by only 0.2%
- For the first time ever, core prices declined for the third consecutive month by 0.1%. The change in core CPI over the past 12 months decelerated to 1.2%
- After plummeting in the early part of the pandemic, inflation expectations have improved albeit at a slow pace
- The pass through from a surge in producer food prices could presage stronger headline inflationary pressures in short-to-medium run
- On balance, we expect consumer prices will be subdued, but it appears the most severe global supply and demand shocks have passed

# Inflation: While disinflationary headwinds remain, incoming data suggests downside risks moderating

## CONSUMER PRICE INFLATION (12M CHANGE)



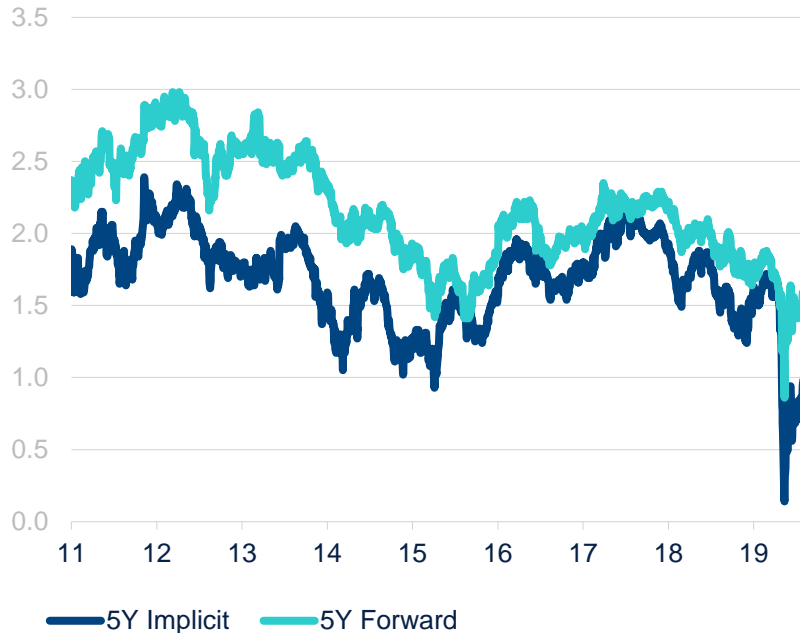
## CORE INFLATION MEASURES (12M CHANGE, %)



# Inflation: With inflation expectations rooted and lockdowns easing, inflation will begin to edge up in coming months

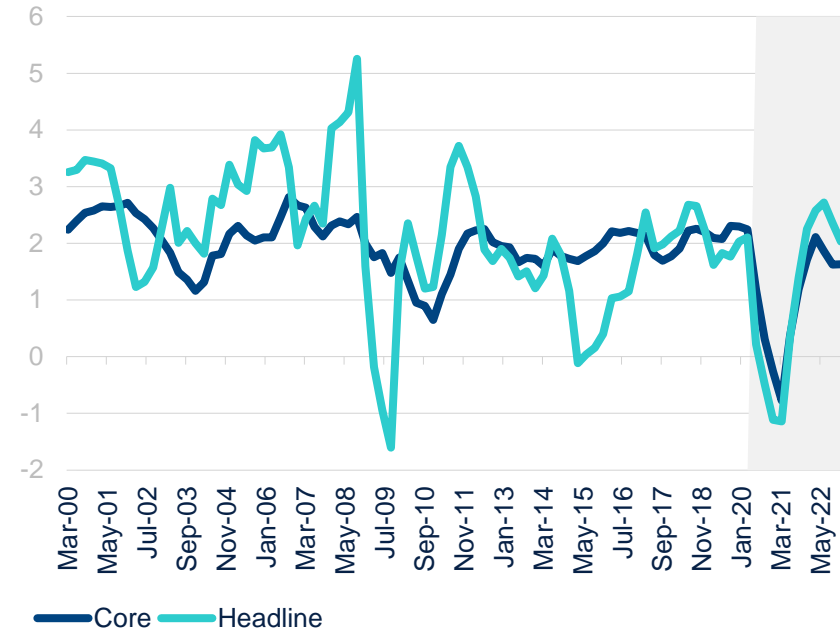
## INFLATION EXPECTATIONS (%)

(%)



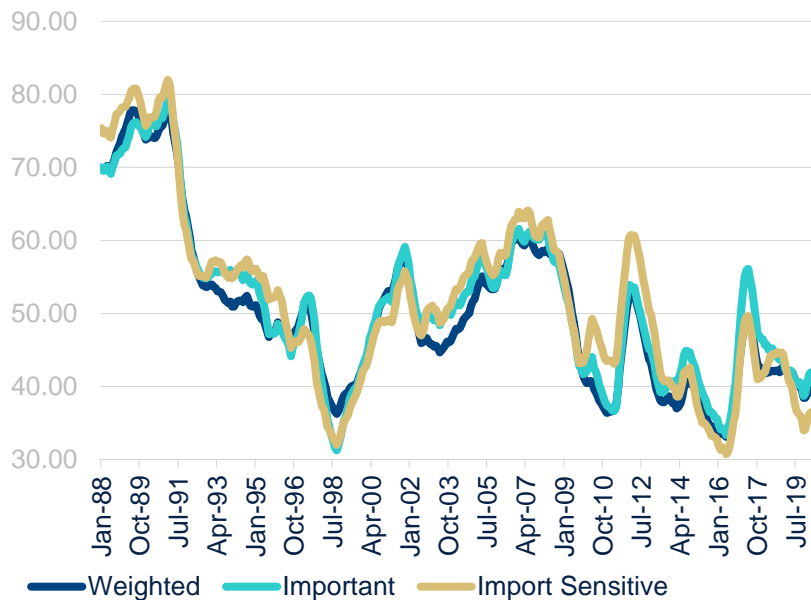
## HEADLINE & CORE CPI (YEAR-OVER-YEAR %)

(YEAR-OVER-YEAR %)

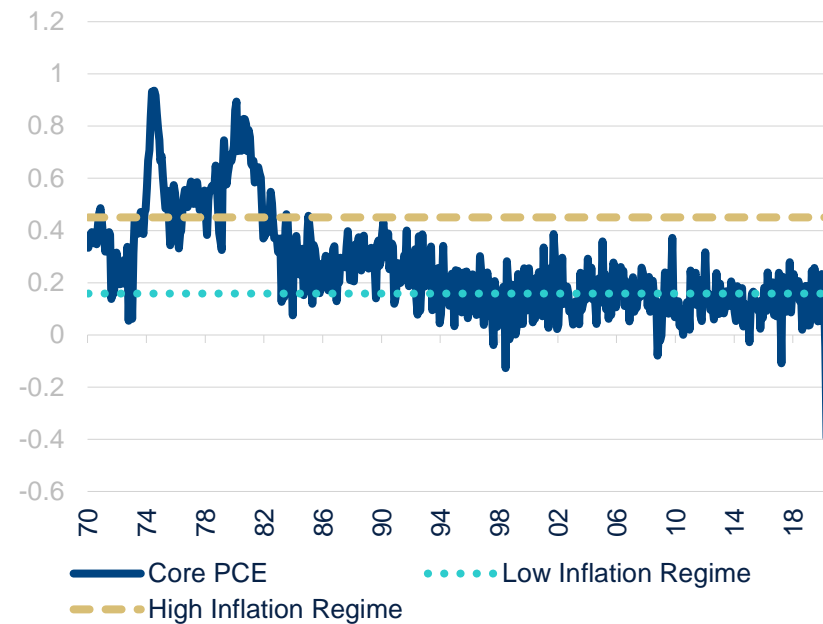


# Inflation: PCE diffusion index suggests that despite the decline in inflationary pressures, risks to the downside remain muted

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



## CORE PCE (MONTH-OVER-MONTH %)



05

# Monetary Policy

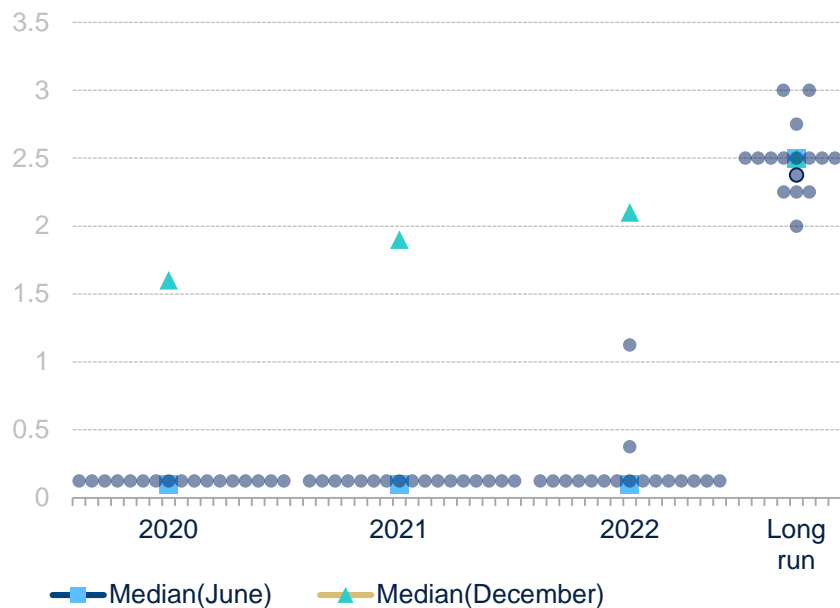
## Monetary Policy: Federal Reserve

- The FOMC statement and post-meeting communication has struck a very dovish tone, and stressed that short- and long-term risks are skewed to the downside
- Commitment to provide whatever is needed reinforced in Powell's trip to Capitol Hill
- Fed to keep pace of net asset purchases at least at the current monthly pace of \$80bn in Treasuries and \$40bn in mortgage-backed securities
- While the uptake in emergency liquidity and primary credit programs is waning, rollout of secondary market corporate credit facility, term asset-backed loan facility and main street lending facility imply second phase of growth in Fed loans
- Baseline unchanged: rates to remain at ZLB until at least 2022, asset purchases to continue indefinitely

# Monetary Policy: Forecasts and communication show Fed remains gravely concerned about the economy despite some positive signs

## FOMC DOT PLOT (%)

(%)



Source: BBVA Research & Haver Analytics

## FOMC JUNE'S SUMMARY OF ECONOMIC PROJECTIONS (%)

	2020	2021	2022	Long-run
<b>Change in real GDP*</b>	-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
<b>Unemployment rate*</b>	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
<b>PCE inflation*</b>	0.8	1.6	1.7	2.0
Range	0.5-1.2	1.1-2.0	1.4-2.2	2.0
<b>Core PCE inflation*</b>	1.0	1.5	1.7	
Range	0.7-1.3	1.2-2.0	1.2-2.2	
<b>Federal funds rate*</b>	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

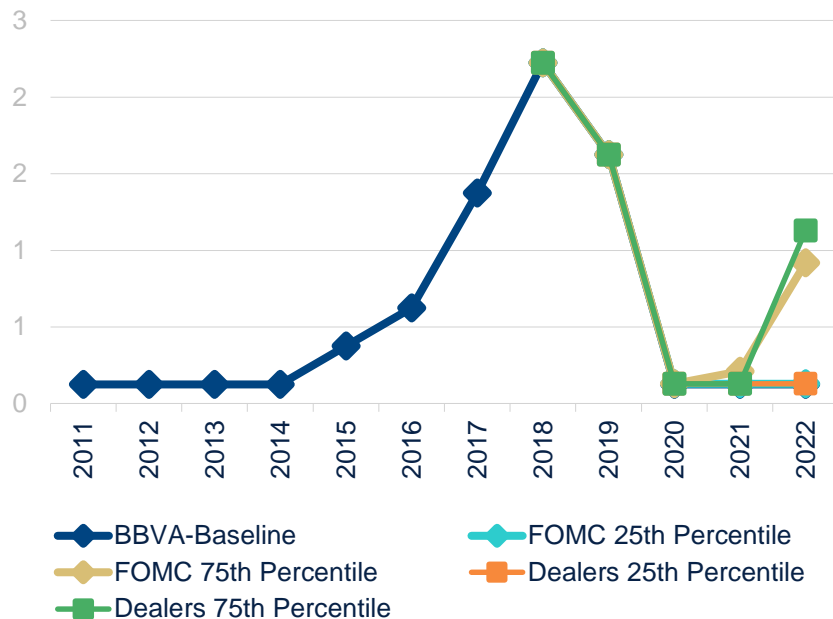
\*Median



# Monetary policy: Consensus and implicit Fed fund futures forecasts imply prolonged period at ZLB

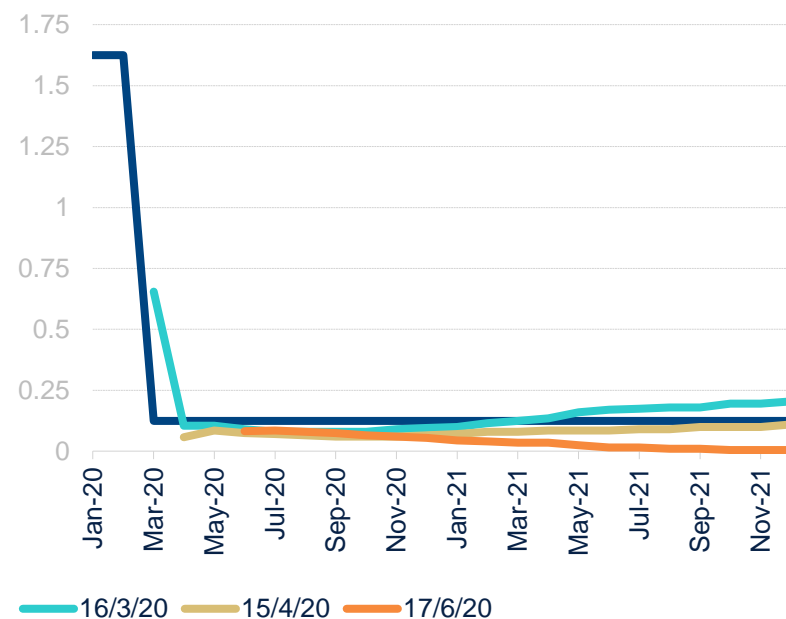
## FED FUNDS RATE PROJECTIONS (%)

(%)



## FED FUNDS FUTURES & BBVA BASELINE (%)

(%)



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

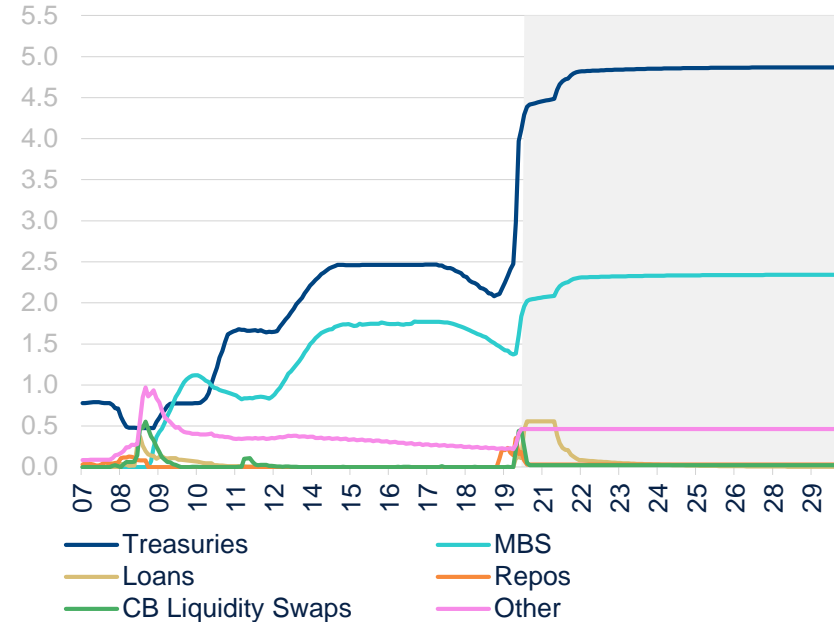
## FACTORS ABSORBING RESERVE FUNDS

(US\$TN)



## FACTORS SUPPLYING RESERVE FUNDS

(US\$TN)



06

# Interest Rates

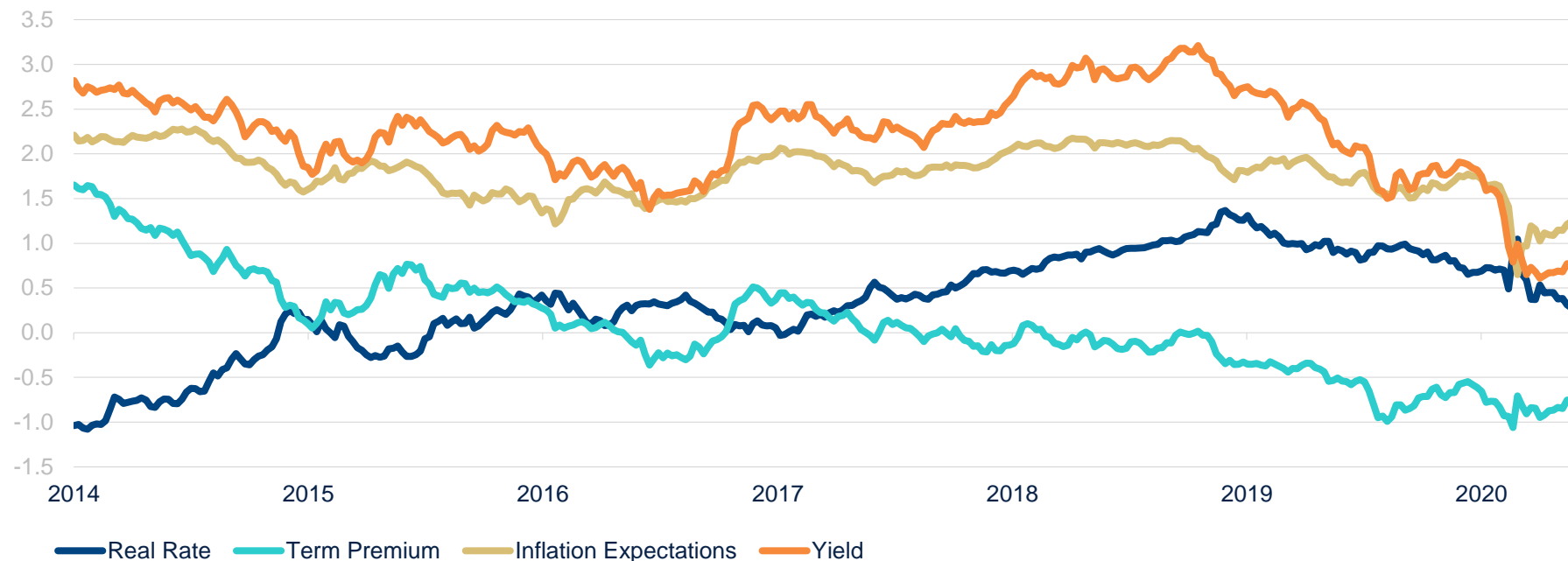
# Interest Rates

- 10-yr and 2-yr Treasury yields steady around 0.7% and 0.2%, respectively
- Fed actions and ongoing commitment to maintaining financial stability have greatly reduced market frictions
- Negative term-premium improving slightly amid strong commitment to maintain LSAP
- 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 0.6% and 1.2% by year-end 2020 and 2021, respectively

# Interest rates: Term premium bounces off lows as inflation expectations rise

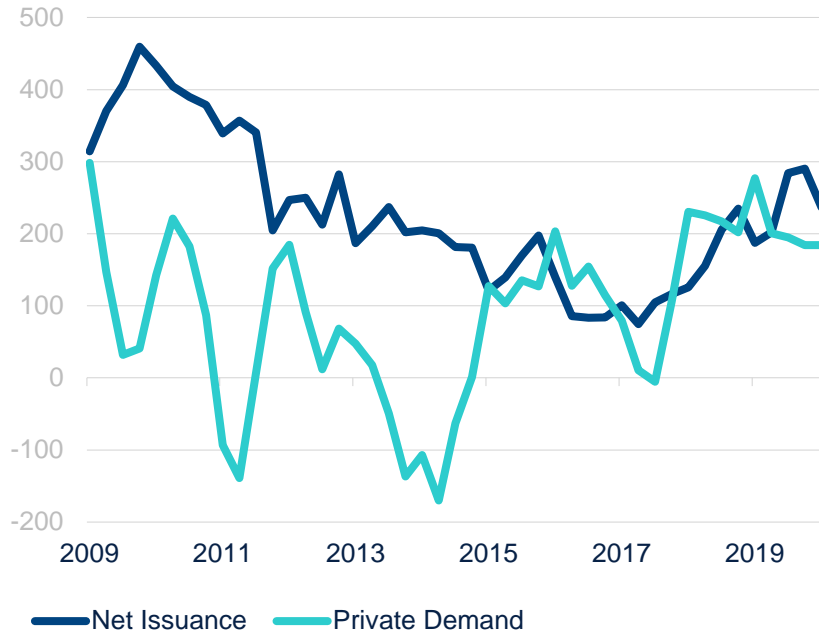
## 10-YEAR TREASURY YIELD DECOMPOSITION

(%)

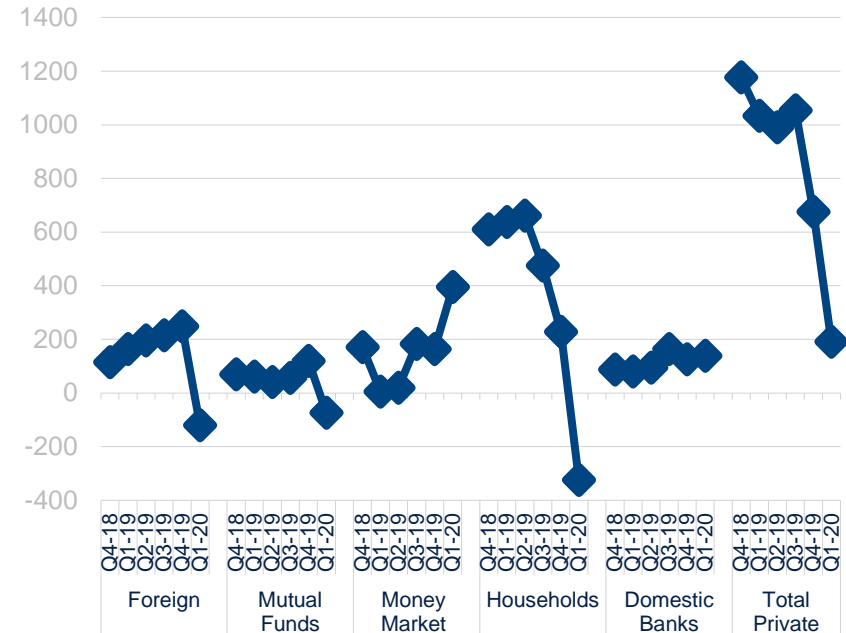


# Interest rates: Private demand for treasuries declining as Fed steps up to the plate with LSAP

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



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

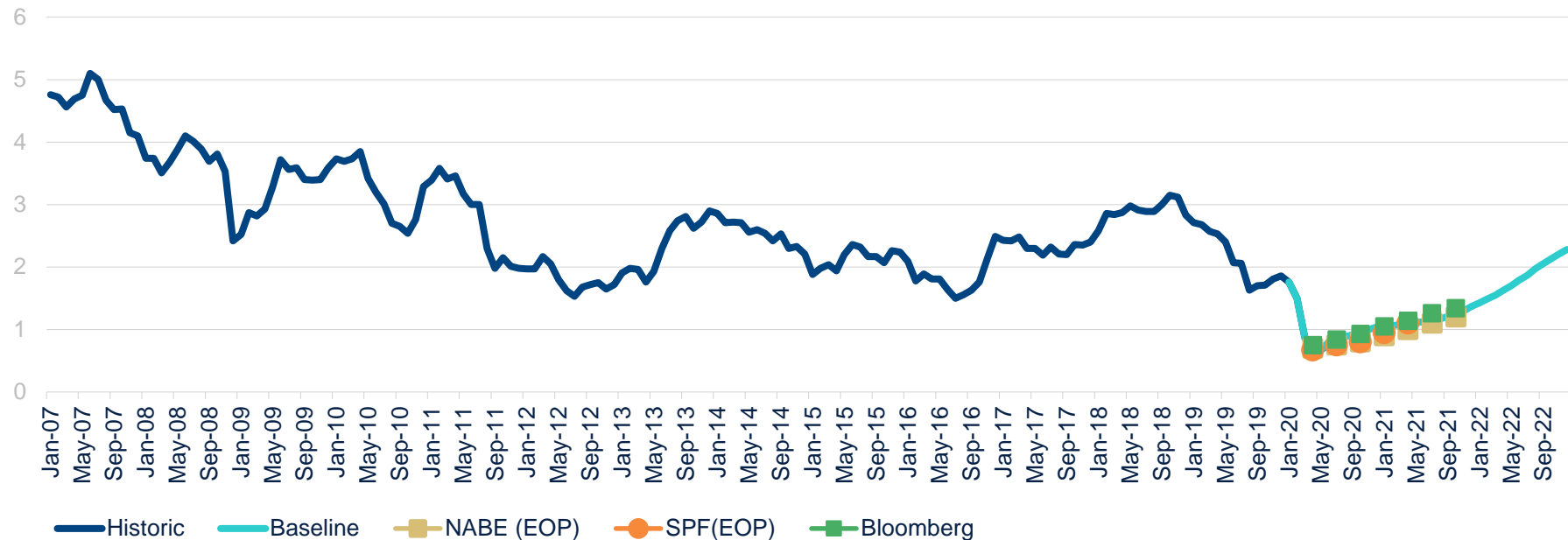


Source: BBVA Research

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

## 10-YEAR TREASURY YIELDS

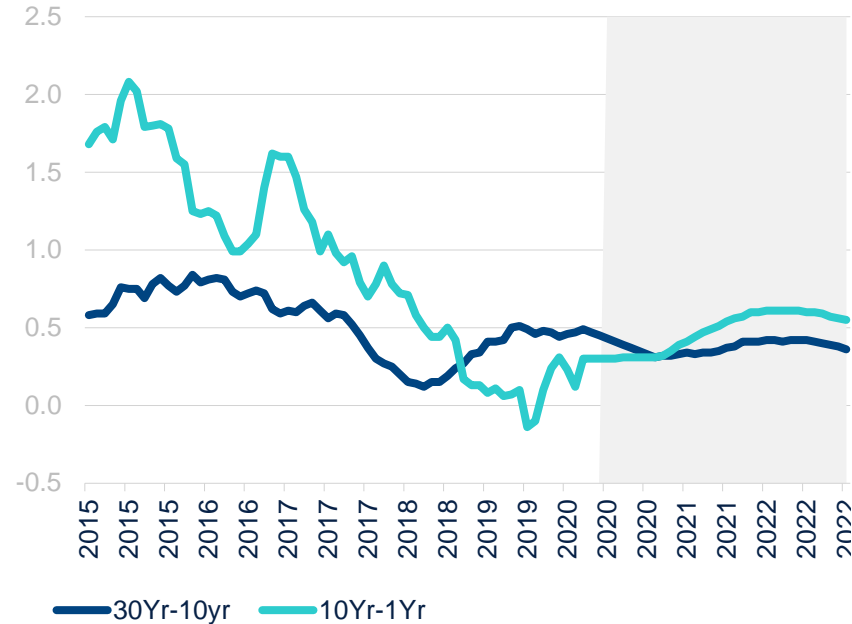
(%)



# Interest rates: Baseline assumes persistent upward sloping yield curve

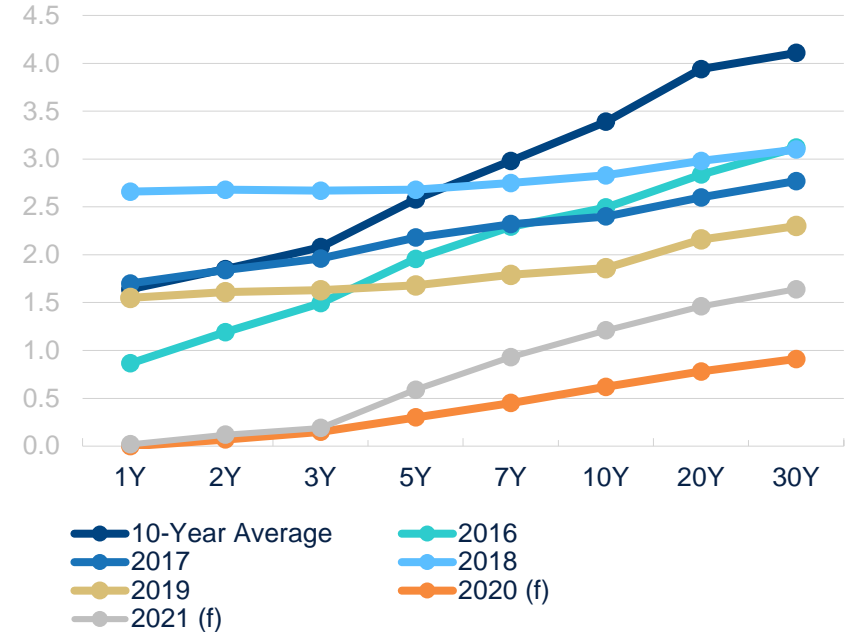
## YIELD CURVE SLOPE (BP)

(BP)



## YIELD CURVE (% EOP)

(%, EOP)





07

# Oil Prices

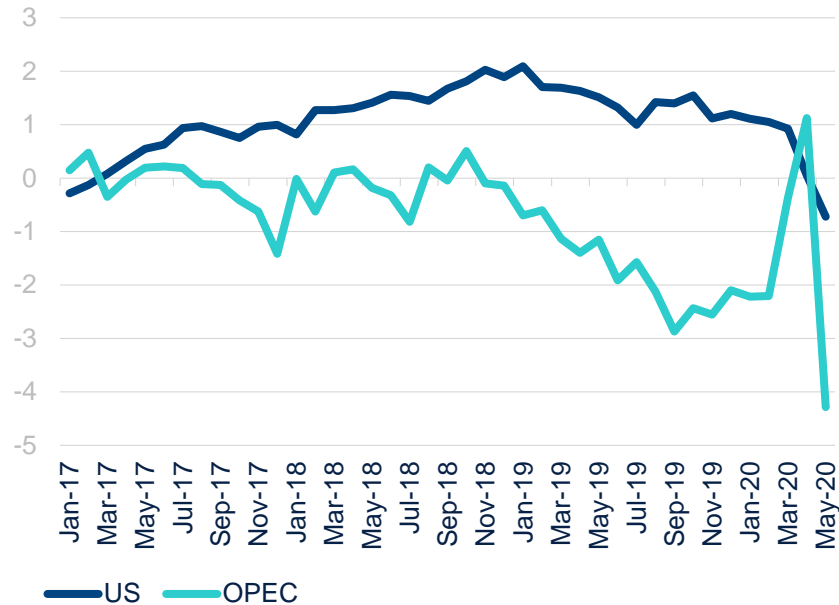
# Oil Prices

- OPEC+ cuts and the gradual reopening of economic activity have boosted oil prices
- This, together with fiscal and monetary stimuli have eased financial stress and lowered the risk of bankruptcy for firms in the O&G sector
- However, current WTI levels remain below the prices needed to profitably drill a well
- Moreover, the rig count is at record low levels, implying sup-par drilling activity going forward
- In our baseline scenario, WTI remains below breakeven levels for the remaining of 2020
- Risks are tilted to the downside, in particular, a second wave of Covid-19 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
- If the second wave of Covid-19 is not too strong and the reopening has a positive effect on the demand of transportation fuels and other petroleum products, prices could surprise to the upside

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

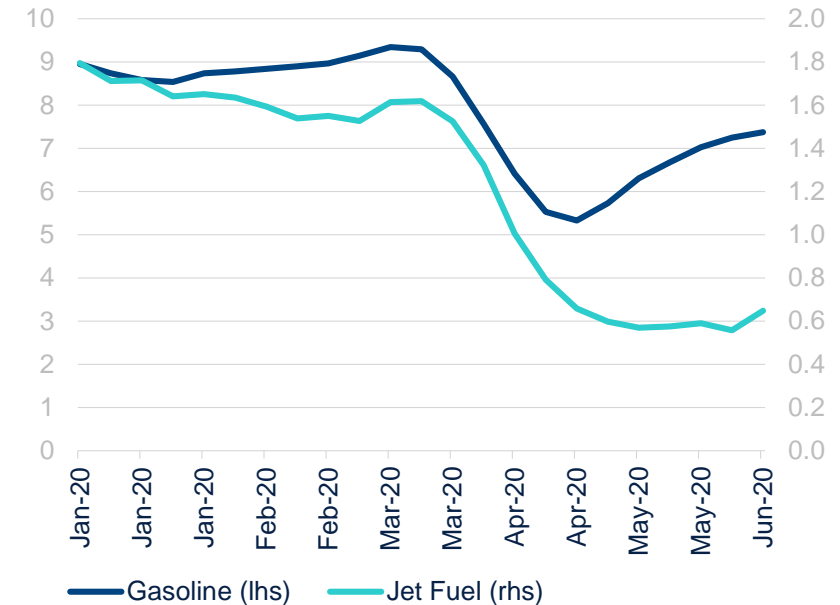
## CRUDE OIL PRODUCTION

(YOY CHANGE, MILLION B/D)



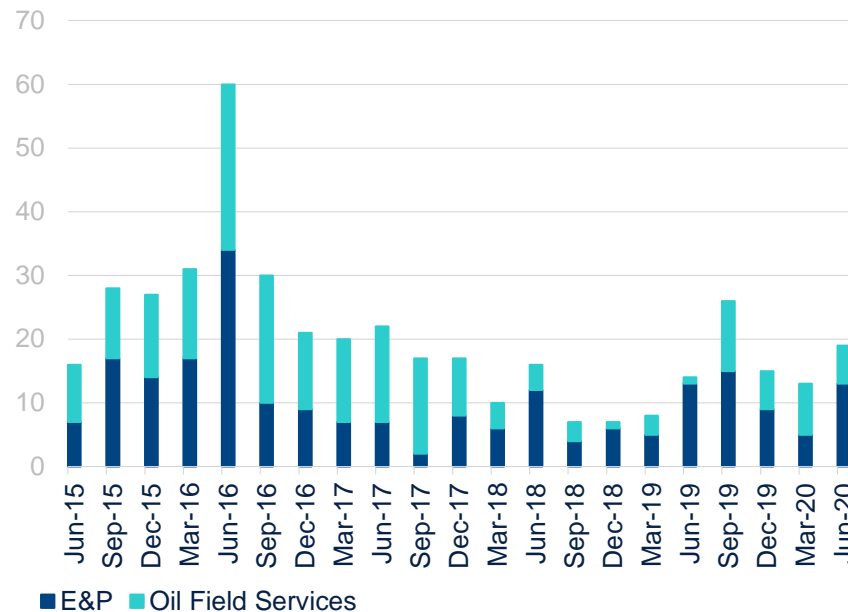
## U.S. DEMAND OF PETROLEUM PRODUCTS

(MILLION B/D)

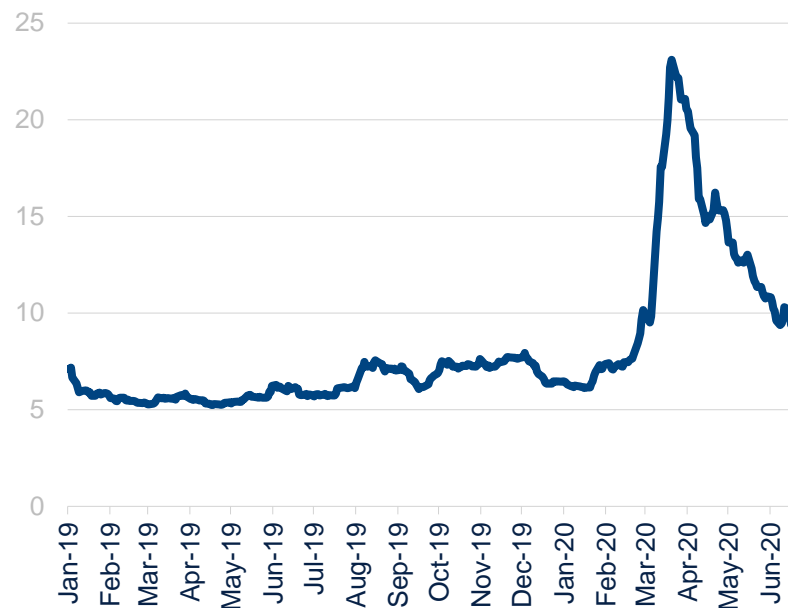


# Higher prices coupled with monetary and fiscal support have lowered the risk of bankruptcy

## U.S. BANKRUPTCY TRACKER (QOQ CHANGE)



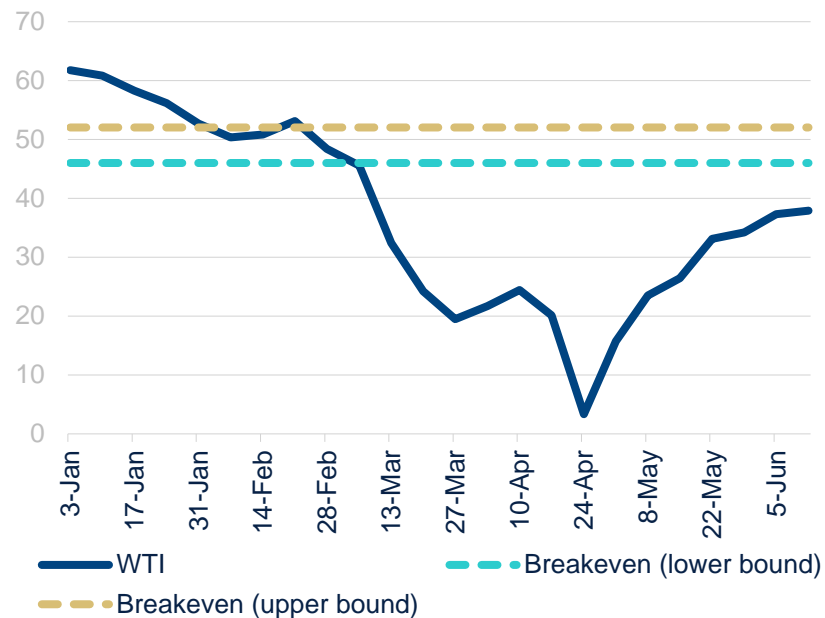
## BLOOMBERG-BARCLAYS HIGH YIELD ENERGY AVERAGE OAS (USD)



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

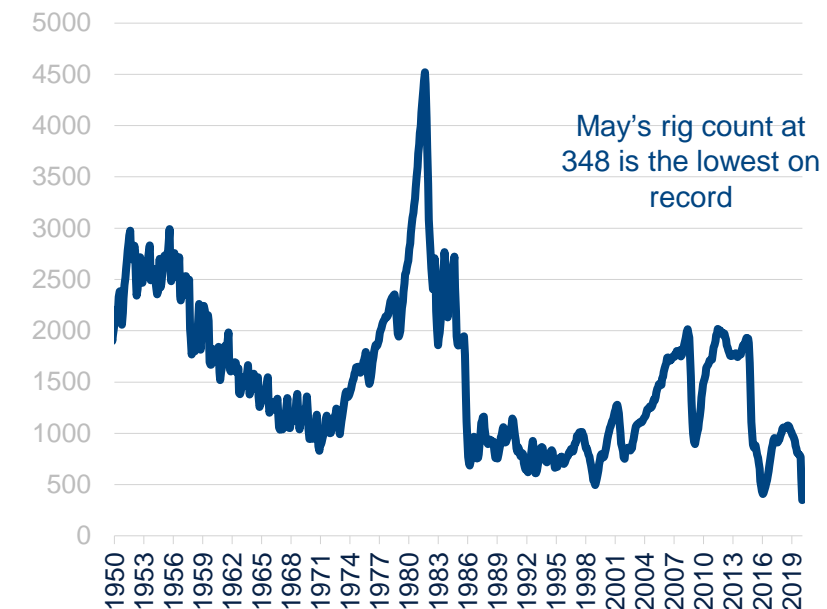
## U.S. WTI & BREAKEVEN PRICES

(\$ PER BARREL)



## U.S. ACTIVE RIG COUNT

(UNITS)



# Macroeconomic Outlook

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 (f)	2021 (f)	2022 (f)	2023 (f)
Real GDP (% SAAR)	1.6	2.2	1.8	2.5	2.9	1.6	2.4	2.9	2.3	-4.4	3.4	2.4	2.1
Real GDP (Contribution, pp)													
PCE	1.3	1.0	1.0	2.0	2.5	1.9	1.8	2.1	1.8	-4.4	2.9	1.7	1.5
Gross Investment	0.9	1.6	1.1	1.0	0.9	-0.2	0.8	0.9	0.3	-1.7	-0.2	0.7	0.7
Non Residential	1.0	1.2	0.5	1.0	0.3	0.1	0.6	0.9	0.3	-1.2	-0.4	0.6	0.6
Residential	0.0	0.3	0.3	0.1	0.3	0.2	0.1	0.0	0.0	0.1	-0.1	0.1	0.1
Exports	0.9	0.5	0.5	0.6	0.1	0.0	0.5	0.4	0.0	-1.5	-0.7	0.3	0.4
Imports	-0.9	-0.5	-0.3	-0.8	-0.9	-0.4	-0.8	-0.8	-0.2	2.9	0.8	-0.5	-0.6
Government	-0.7	-0.4	-0.5	-0.2	0.3	0.3	0.1	0.3	0.4	0.5	0.6	0.2	0.1
Unemployment Rate (% , average)	8.9	8.1	7.4	6.2	5.3	4.9	4.3	3.9	3.7	8.0	6.2	5.3	4.6
Avg. Monthly Nonfarm Payroll (K)	173	181	192	250	227	195	176	193	178	-761	154	138	107
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	2.1	2.4	1.8	0.2	0.7	2.4	1.9
Core CPI (YoY %)	1.7	2.1	1.8	1.8	1.8	2.2	1.8	2.1	2.2	0.9	0.6	1.8	1.8
Fiscal Balance (% GDP, FY)	-8.4	-6.7	-4.1	-2.8	-2.4	-3.2	-3.4	-3.8	-4.6	-16.2	-7.9	-4.5	-4.1
Current Account (bop, % GDP)	-2.9	-2.6	-2.1	-2.1	-2.2	-2.3	-2.3	-2.4	-2.3	-1.9	-2.0	-2.2	-2.4
Fed Target Rate (% , eop)	0.25	0.25	0.25	0.25	0.50	0.75	1.50	2.50	1.75	0.25	0.25	0.25	0.75
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	2.49	2.40	2.83	1.86	0.62	1.21	1.44	1.92
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	35.2	47.0	54.2	57.4

Source: BBVA Research  
\*Forecasts subject to change

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# U.S. Macroeconomic Pulse

June 2020