

# U.S. Macroeconomic Pulse

September 2020

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# Economic Outlook

## Economic Outlook

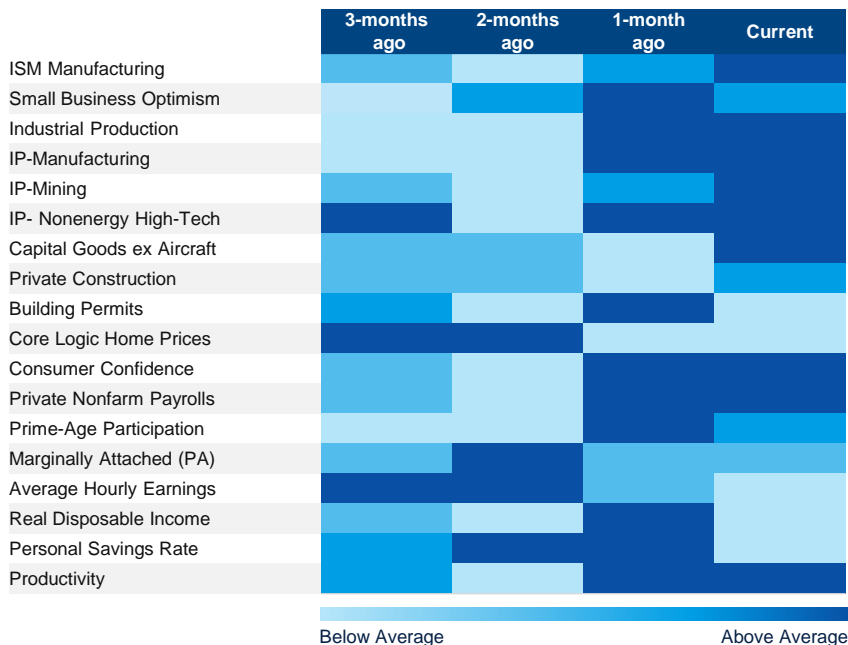
- Baseline assumes real GDP declines by 5.1% in 2020.
- Peak unemployment reached, but risks to the labor market remain.
- Disinflationary headwinds abate, with core services rebounding strongly.
- Fed to keep rates at the Effective Lower Bound, balance sheet growth to continue.
- Long-term yields to remain low.
- Uncertainty remains over the depth and duration of the crisis.

## Macro Fundamentals

- Range of estimates for 3Q GDP growth 15% to 30%.
- Service sector to recover around \$600BN in activity on an SAAR.
- Real private fixed investment to continue to fall in 3Q20.
- Trade headwinds to persist into 2H20, widening trade deficit.
- Without a phase 4 fiscal agreement, government contributions to growth to taper off.
- Risks to 2020 tilted to the upside.

# Economic activity

## REAL-TIME ECONOMIC MOMENTUM HEAT MAP



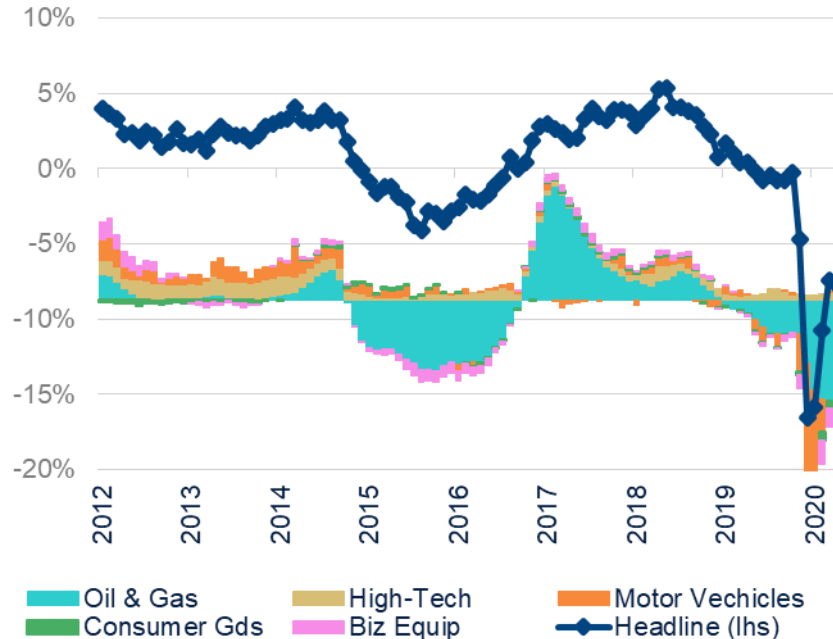
Source: BBVA Research

- ISM index surges past pre-pandemic levels, but readings on industrial production weakening.
- Some early signs improvement in mining sector with active rig counts rising.
- Single-unit residential permits reach highest level since 2007 (+1038K).
- S&P CoreLogic home prices accelerate to 4.8% year-over-year in July.
- Real personal disposable income declining as impact from fiscal stimulus fades.
- Consumer confidence surpasses April lows, but remains well below pre-pandemic average.

# Economic trends: Strong income support from fiscal package driving rebound in retail sales

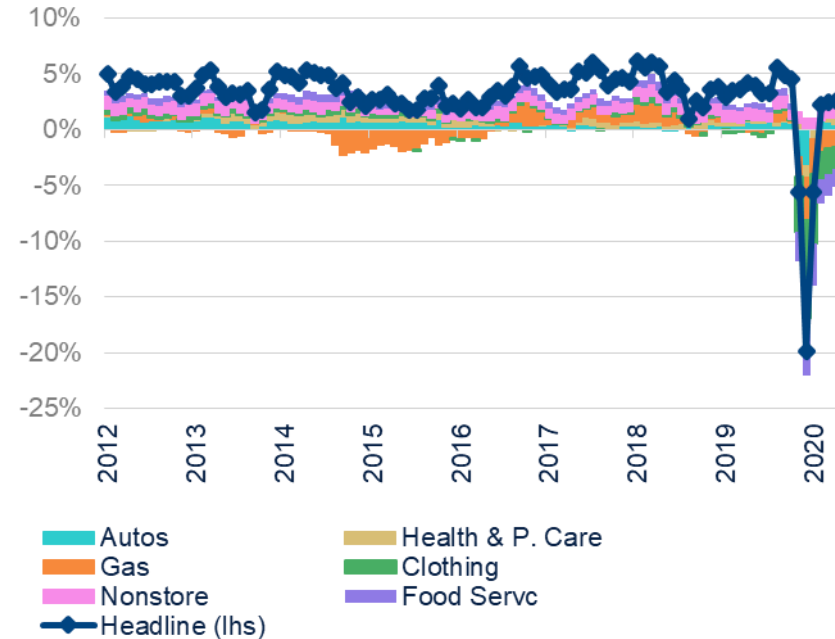
## INDUSTRIAL PRODUCTION

(YEAR-OVER-YEAR % & CONTRIBUTIONS)



## RETAIL SALES

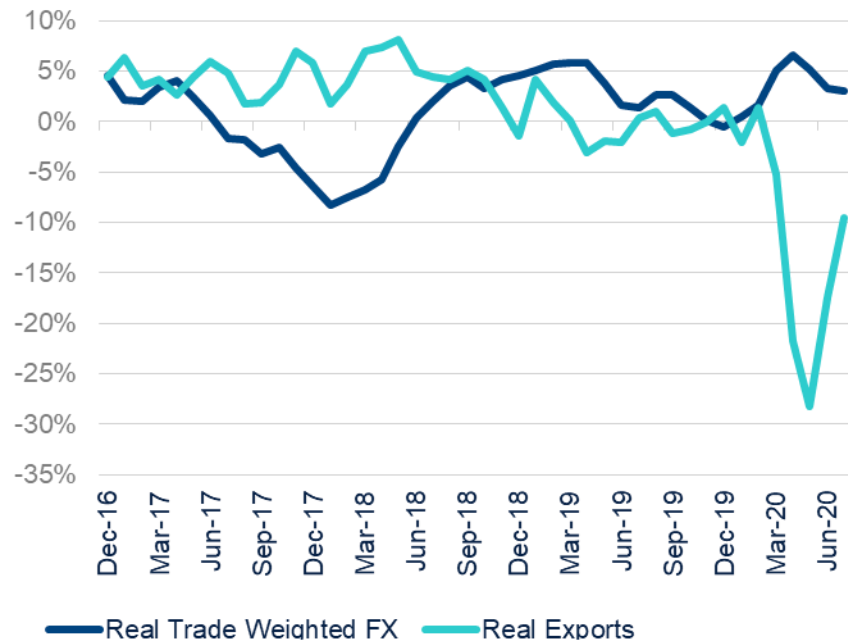
(YEAR-OVER-YEAR % & CONTRIBUTIONS)



# Economic trends: Dollar weakening and resumption of global activity drive recovery in exports

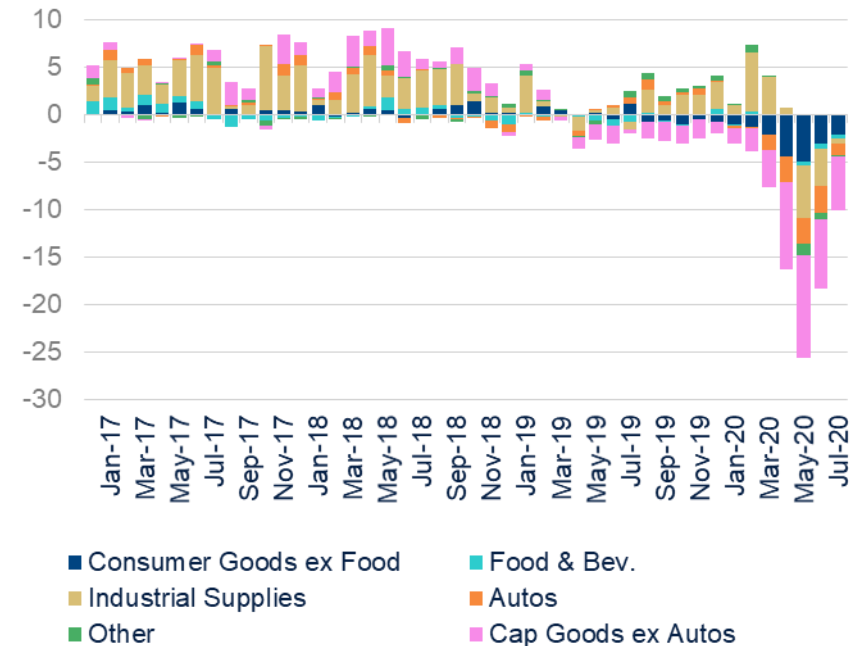
## REAL EXCHANGE RATE AND EXPORTS

(YEAR-OVER-YEAR %)



## REAL EXPORTS

(CONTRIBUTION TO YEAR-OVER-YEAR %)

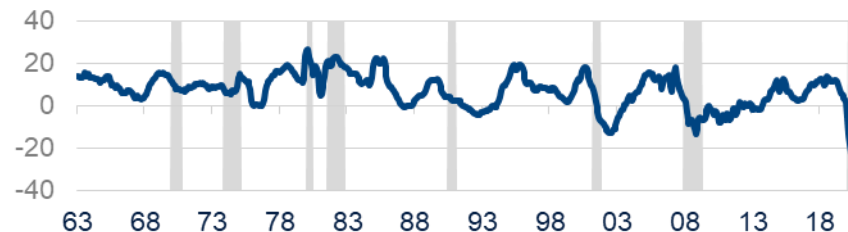




# Consumer credit cycle: credit quality and interest coverage remain favorable for consumers

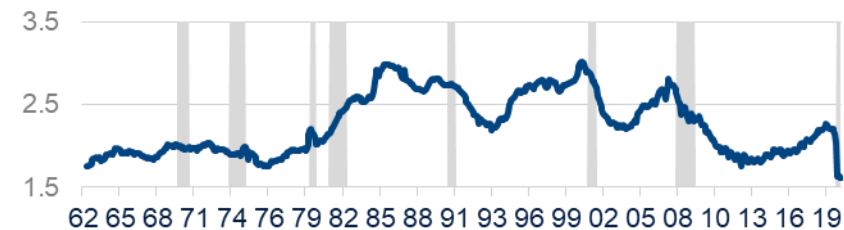
## PERSONAL INTEREST EXPENSE

(YEAR-OVER-YEAR %)



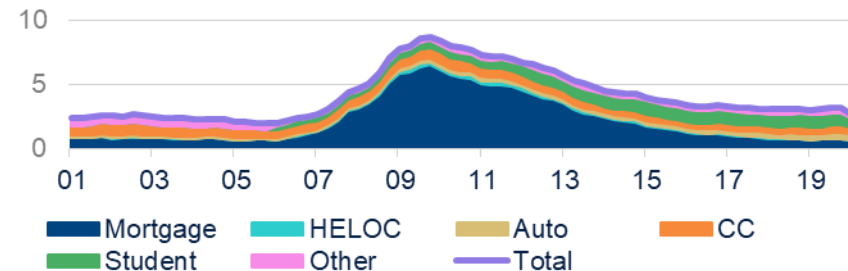
## PERSONAL INTEREST EXPENSE TO DISP. INCOME

(RATIO, %)



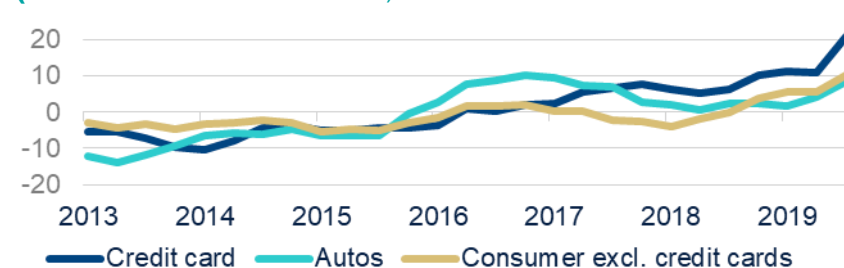
## CONSUMER SERIOUSLY DELINQUENT RATES

(90-DAY, CONTRIBUTION, %)



## SENIOR LOAN OFFICERS LENDING STANDARDS

(TIGHTENING / - LOOSENING)



02

COVID-19

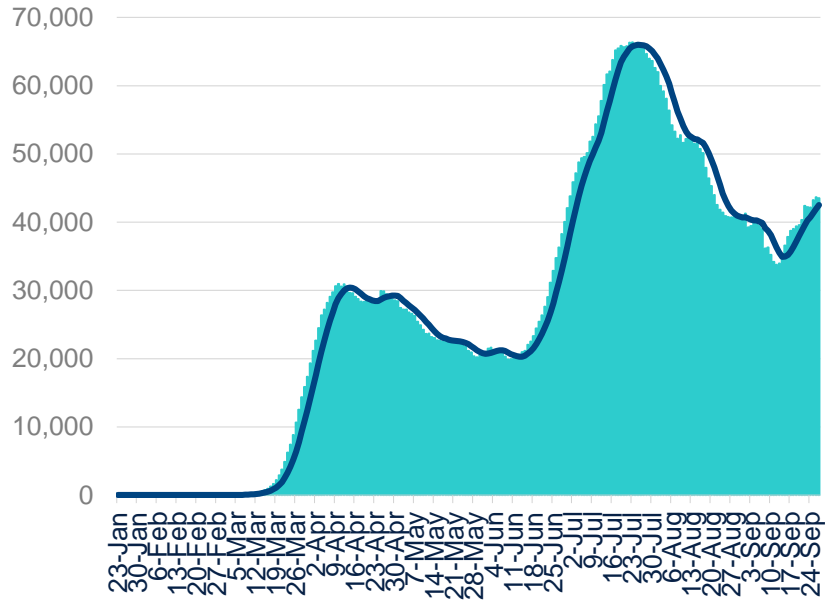
# COVID-19

- COVID-19 cases rising once again as distancing declines with the resumption of school and increased social interaction.
- 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.
- Average  $R_e$  across states rising with new hotspots emerging and 2<sup>nd</sup> waves surfacing in coastal areas.
- 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. surpasses 7M cumulative cases

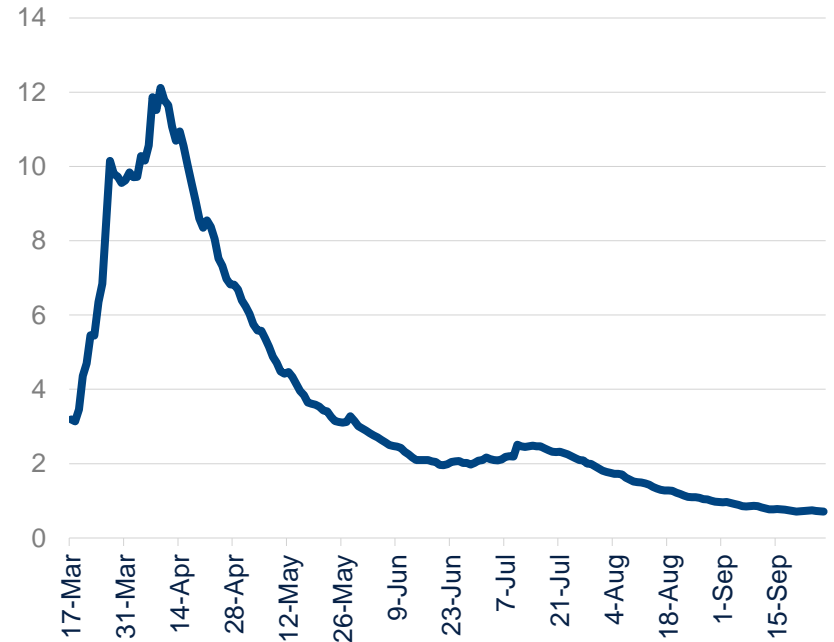
## NEW POSITIVE TEST

(#)



## HOSPITALIZATIONS AS A SHARE OF POSITIVE TEST

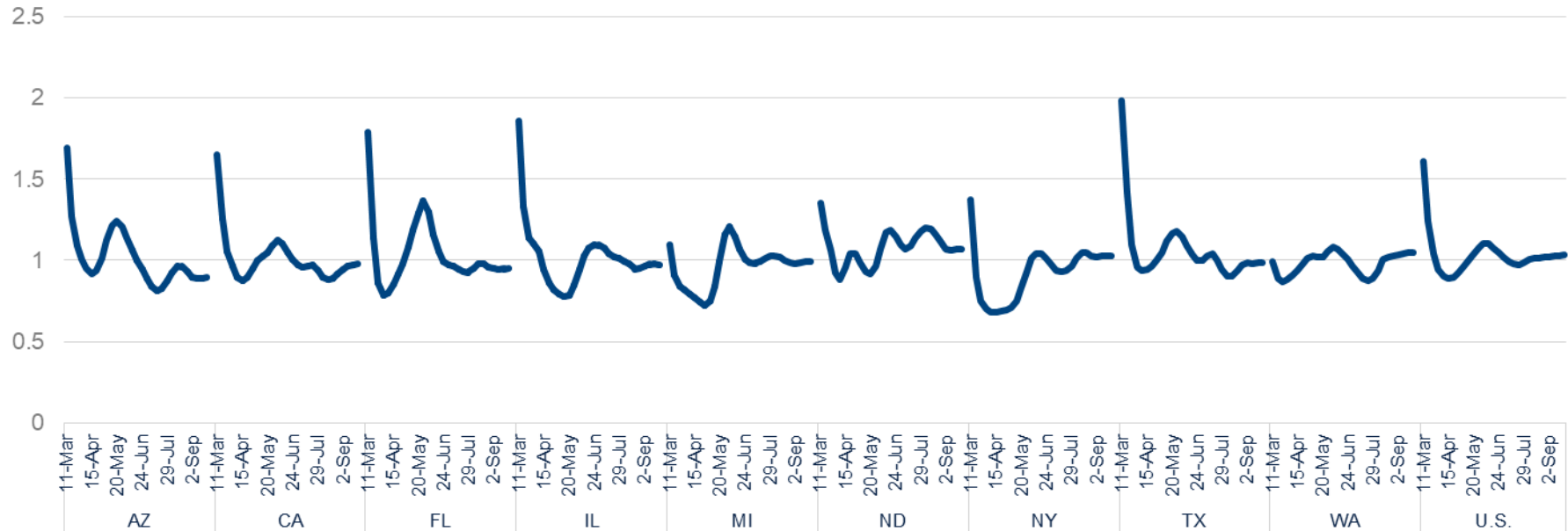
(%)



# COVID-19: Effective reproductive number receding in Sunbelt hotspots but rising in previously contained areas

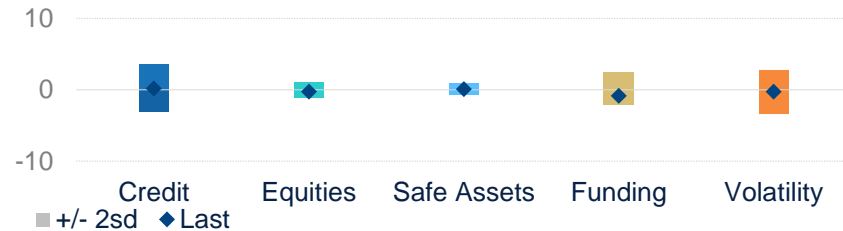
## EFFECTIVE REPRODUCTION NUMBER ( $R_e$ )

(#, WEEKLY AVERAGE)

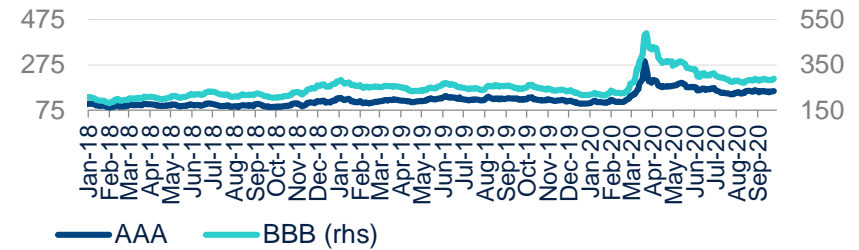


# Financial Markets: tensions remain subdued despite significant number of domestic COVID-19 cases

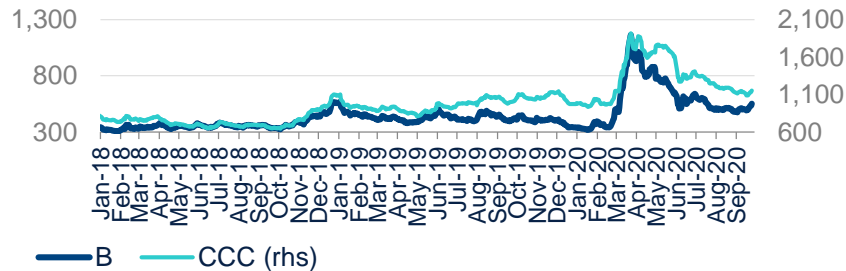
## FINANCIAL STRESS INDEX, >0 STRESS



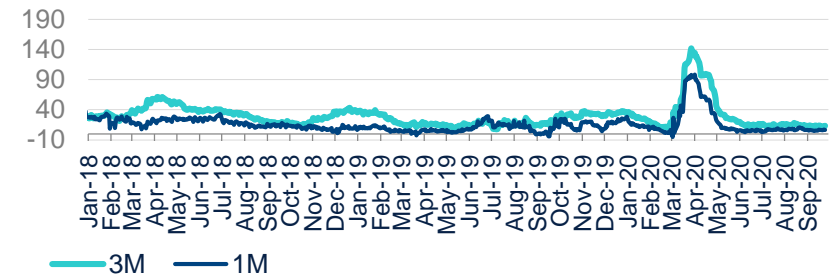
## CORPORATE SPREADS, BP



## CORPORATE SPREADS, BP

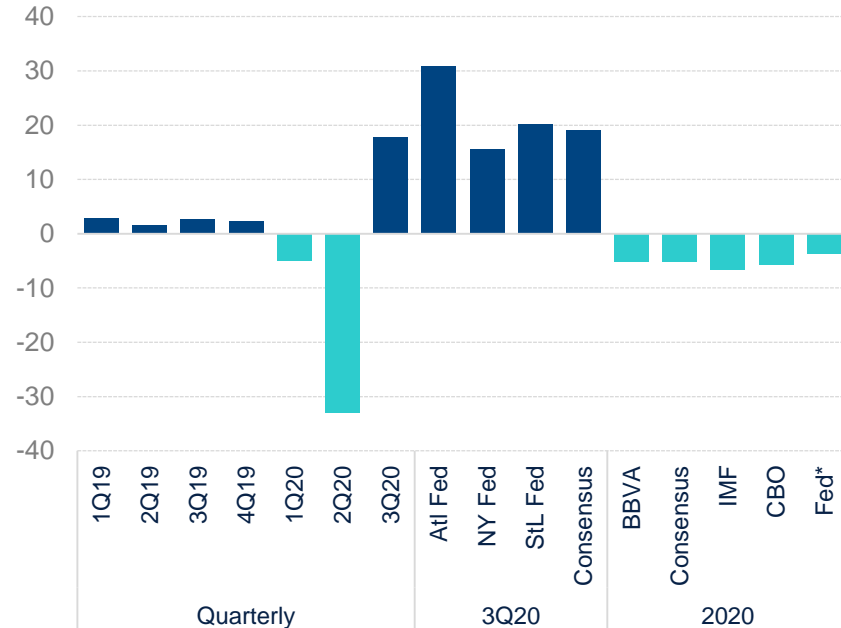


## TED SPREAD, BP



# GDP: We expect strong recovery in 3Q20, following collapse in 2Q20

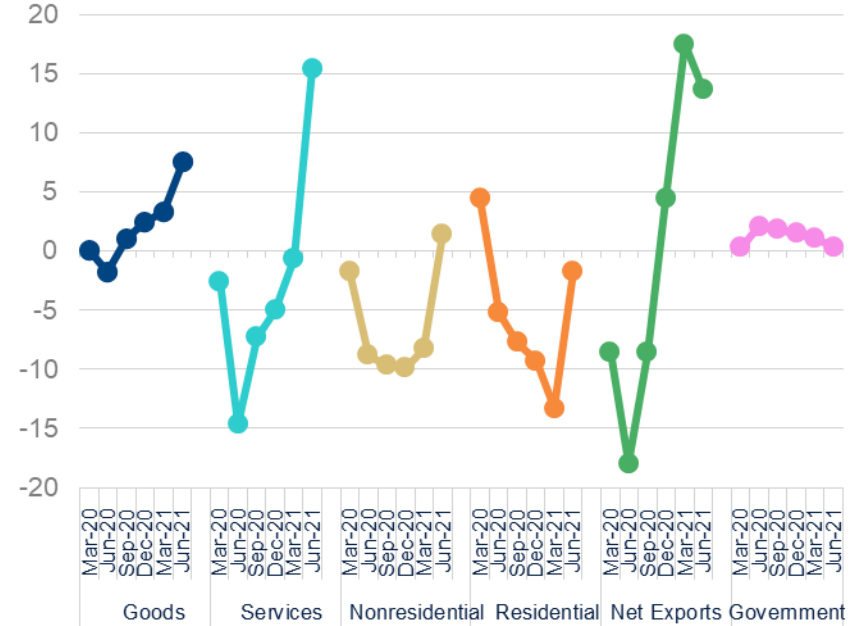
## NEGATIVE ANNUALIZED GROWTH QUARTERS\* (<-5%)



Source: BBVA Research, FRB & Census

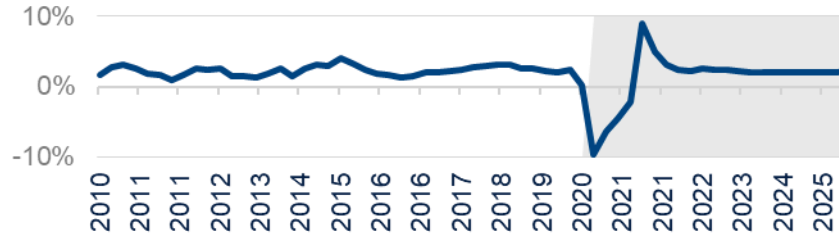
\*Shaded area=GNP

## REAL GDP COMPONENTS (YEAR-OVER-YEAR %)

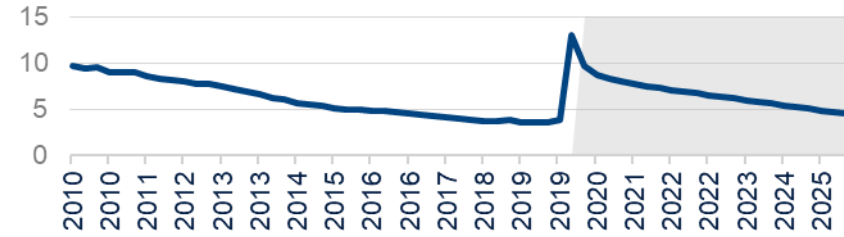


# COVID-19 Macro Scenario

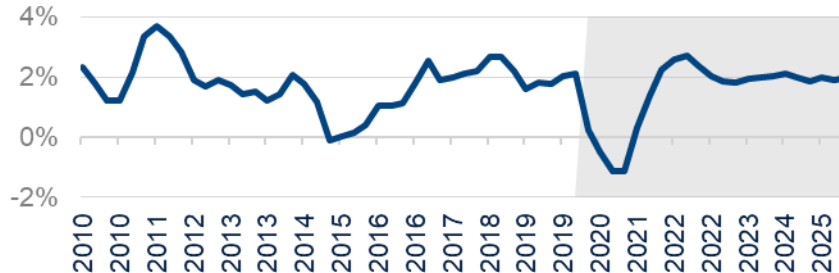
## REAL GDP, YOY%



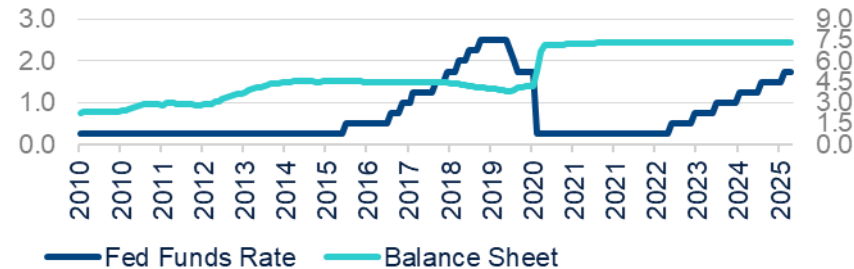
## UNEMPLOYMENT RATE, %



## CONSUMER PRICE INDEX, YOY%



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

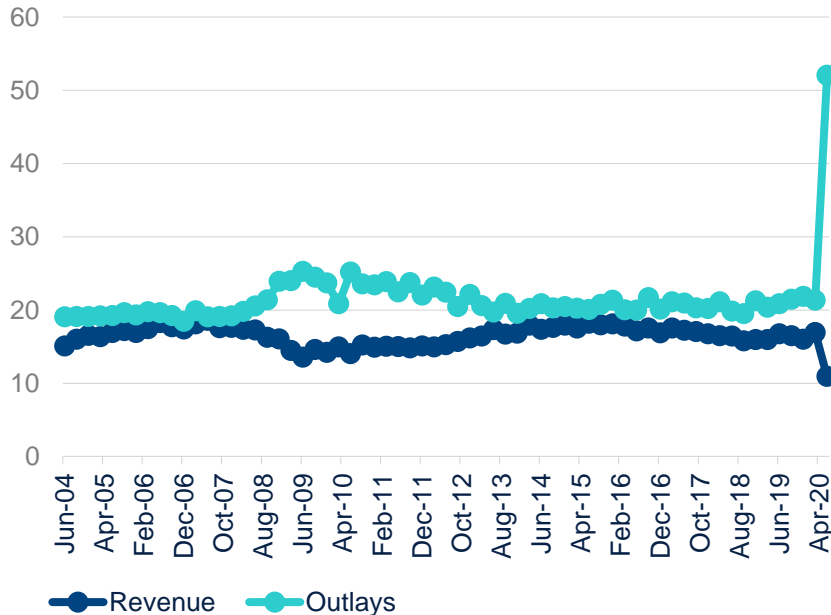




# Fiscal Policy: Fiscal deficits to surpass 16% of GDP in 2Q20

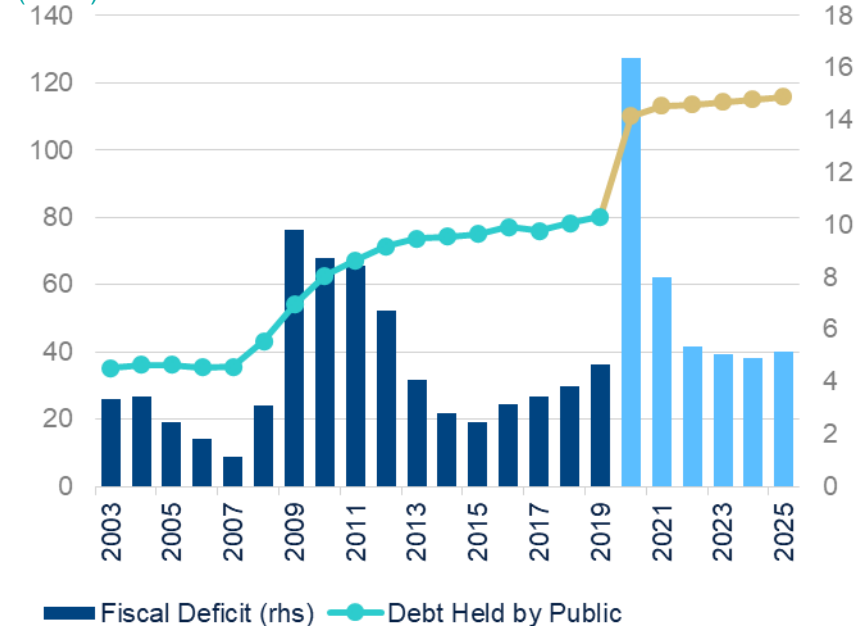
## SAAR FEDERAL BUDGET

(% OF GDP)



## FISCAL DEFICITS & U.S. DEBT HELD BY THE PUBLIC FORECASTS

(FY %)



# 03

## Labor Market

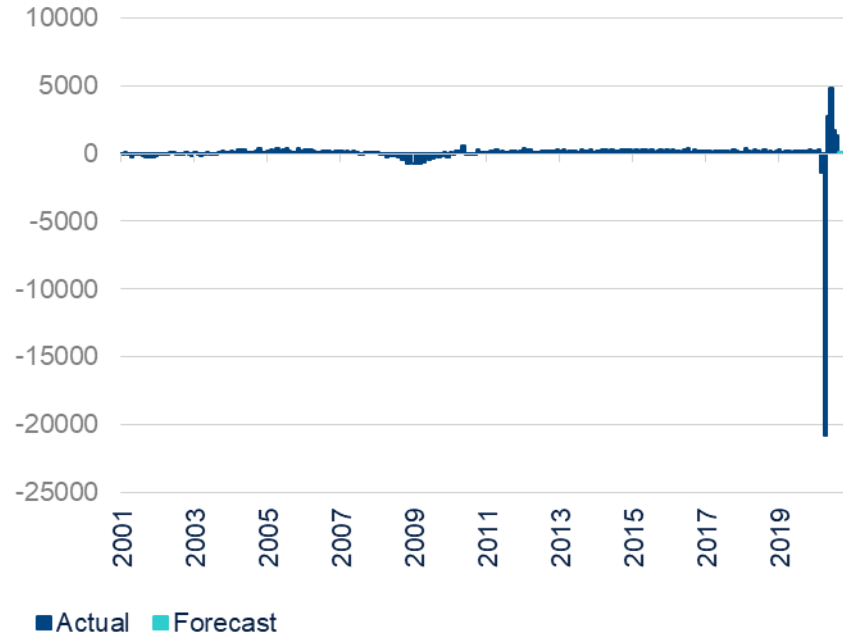
## Labor Market

- Nonfarm payrolls have increased by 10.6M after declining 22.M in March and April, resulting in a net drop of 11.5M since the start of the pandemic in February.
- 24.2M people were out of work due to pandemic-related business closures and 5.2M individuals reported as not in the labor force were unable to look for work due to the pandemic.
- Government transfers helping to keep personal savings afloat in a time of wide spread layoffs.
- August report imprints an upside bias to our short-term forecasts and suggests that labor market conditions could normalize sooner than expected.
- However, given the magnitude of the fallout due to the pandemic, a full recovery to “maximum employment” is still likely to take time.

# Labor market: Continued improvement with strong gains in leisure & hospitality, retail and profession business services

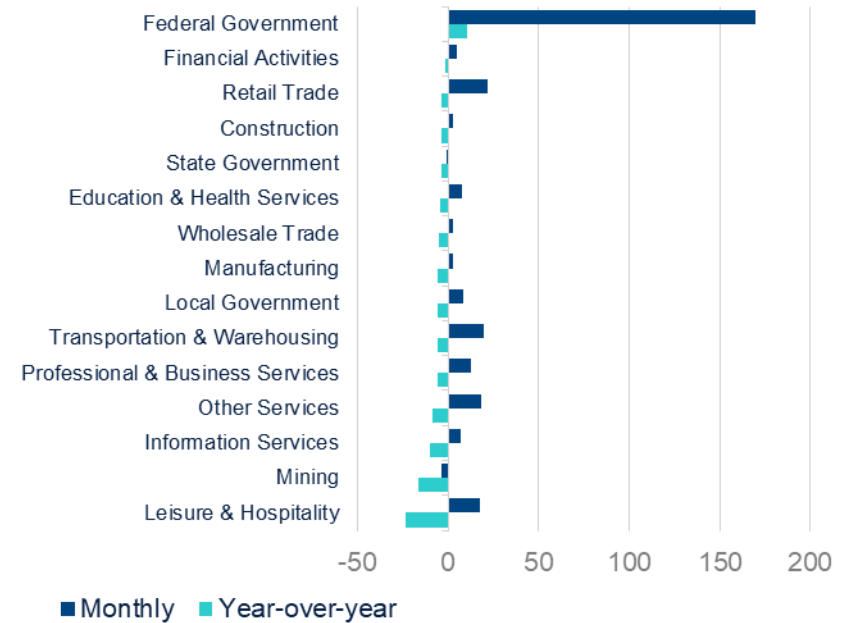
## NONFARM PAYROLLS

(MONTHLY CHANGE, K)



## INDUSTRY EMPLOYMENT

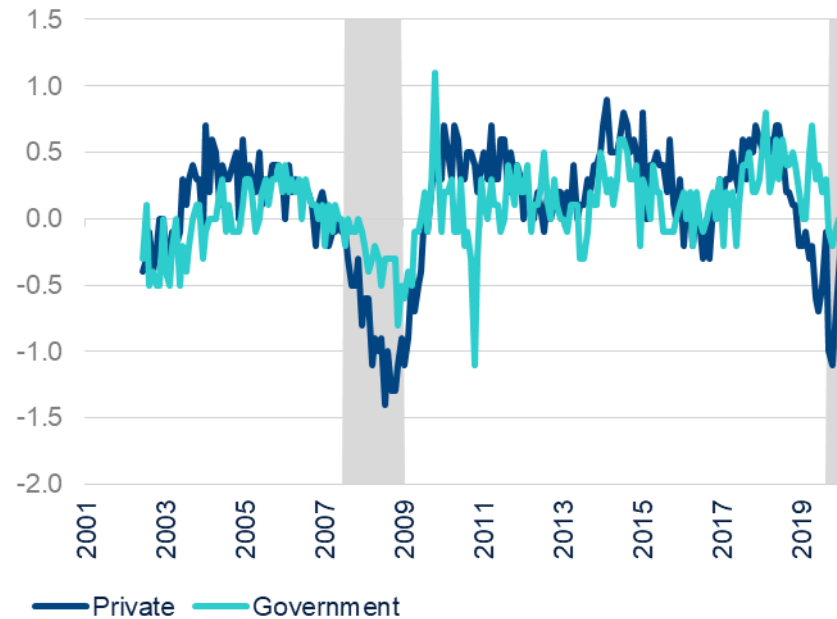
(ANNUALIZED % CHANGE)



# Labor market: Job opening rebound as lock-down measures are relaxed and economic activity normalizes

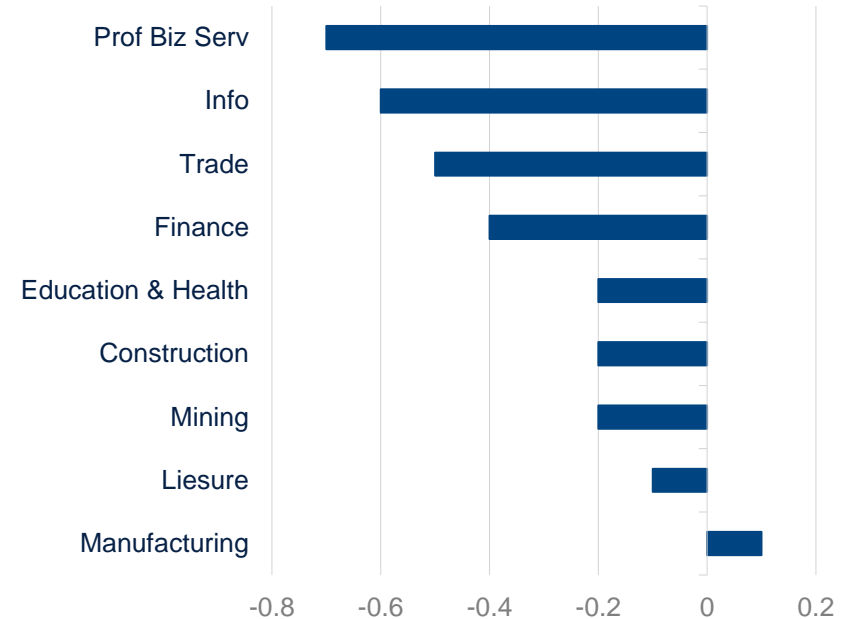
## JOB OPENINGS

(%)



## QUITS

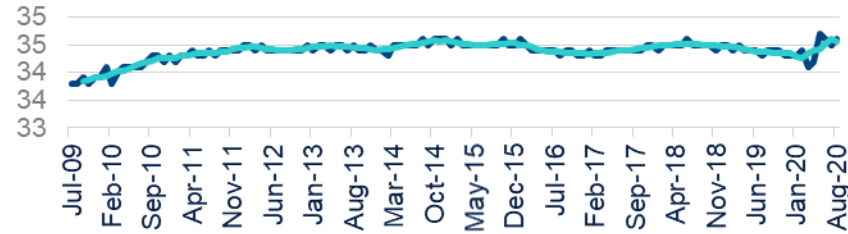
(%)



# Labor market: While gap remains, participation and employment-to-pop ratio converging with pre-pandemic levels

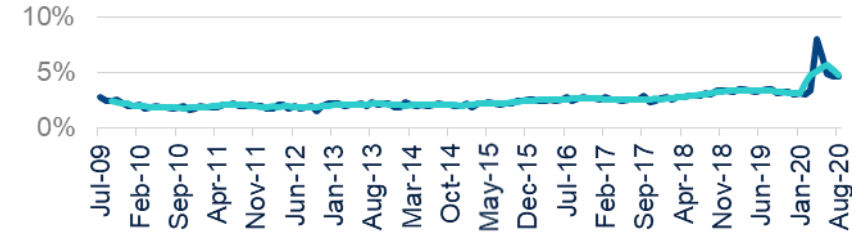
## AVERAGE WEEKLY HOURS

(NUMBER & 5MCMA)



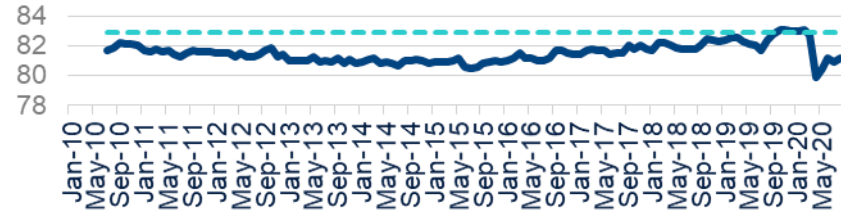
## AVERAGE HOURLY EARNINGS

(YOY% & 5MCMA)



## PRIME AGE LABOR FORCE PARTICIPATION

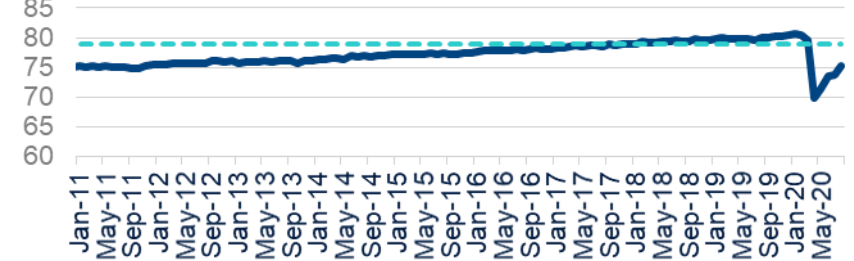
(%)



--- Pre-Crisis Avg.

## PRIME AGE EMPLOYMENT-TO-POPULATION

(%)



# Savings rate falls again, but data continues to point to elevated precautionary savings and service sector dislocations

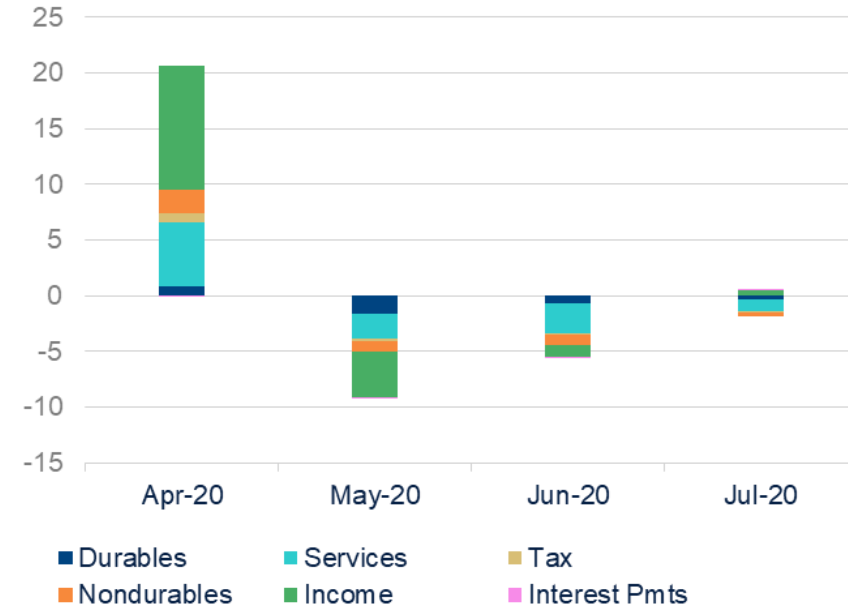
## PERSONAL SAVINGS RATE

(%)



## CONTRIBUTION TO CHANGE IN PERSONAL SAVINGS RATE

(PP)



04

# Inflation



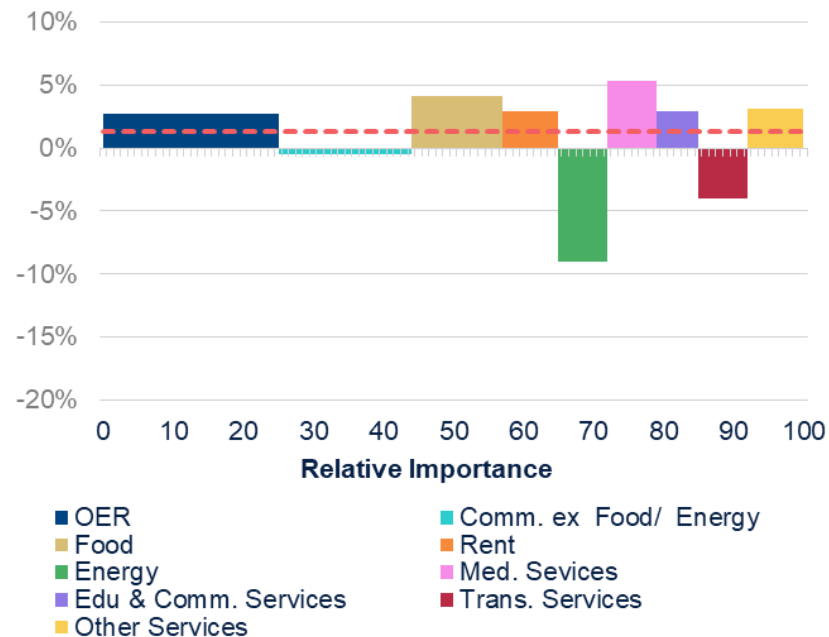
# Inflation

- In August, CPI rose 0.4% over the month and 1.3% over the last twelve months.
- Headline consumer price growth was broad-based, but was largely driven by 5.4% increase in used car and truck prices.
- Prices for gasoline (2.0%), recreation (0.7%), and household furnishings (1.0%) grew strongly in August.
- In terms of core consumer prices, August saw solid growth of 0.4% MoM and 1.7% YoY.
- Inflation expectations over the next 5-years remain anchored around 1.8%.
- Potential for supply-side pressures remains albeit less so than the risk of a major negative demand-side shock or spillovers from a sharp fiscal contraction.
- Our baseline assume CPI growth will grow moderately this year and next.

# Inflation: Energy headwinds fading as food and core prices begin to heat up

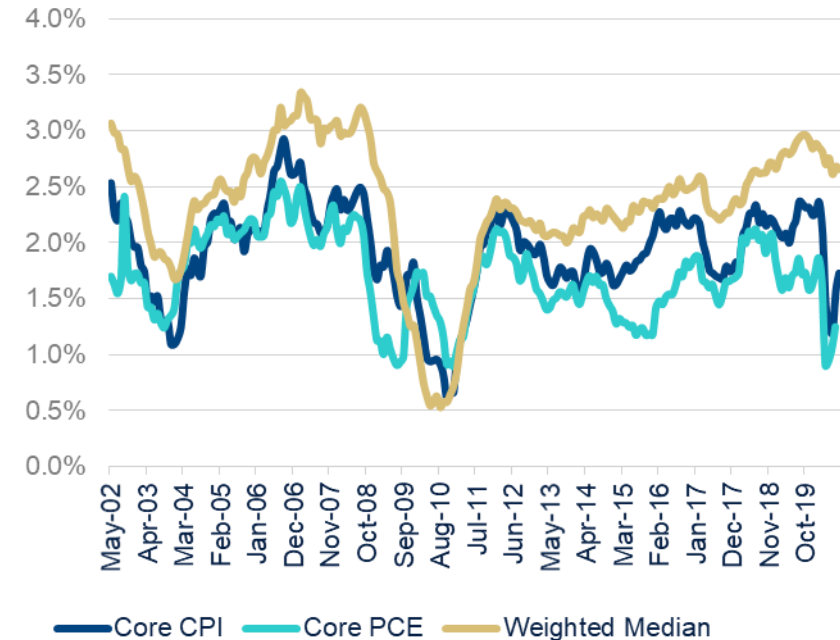
## CONSUMER PRICE INFLATION

(12M CHANGE)



## CORE INFLATION MEASURES

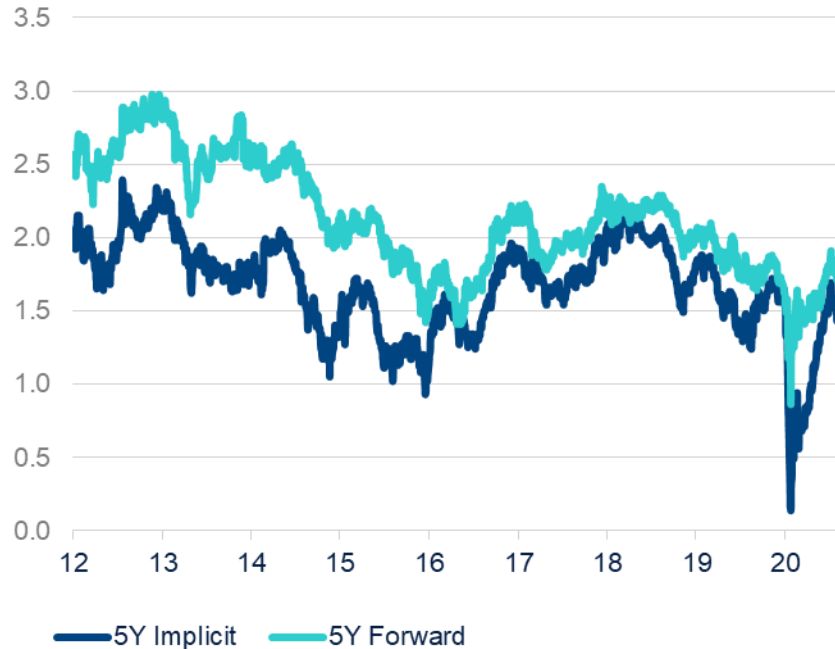
(12M CHANGE, %)



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

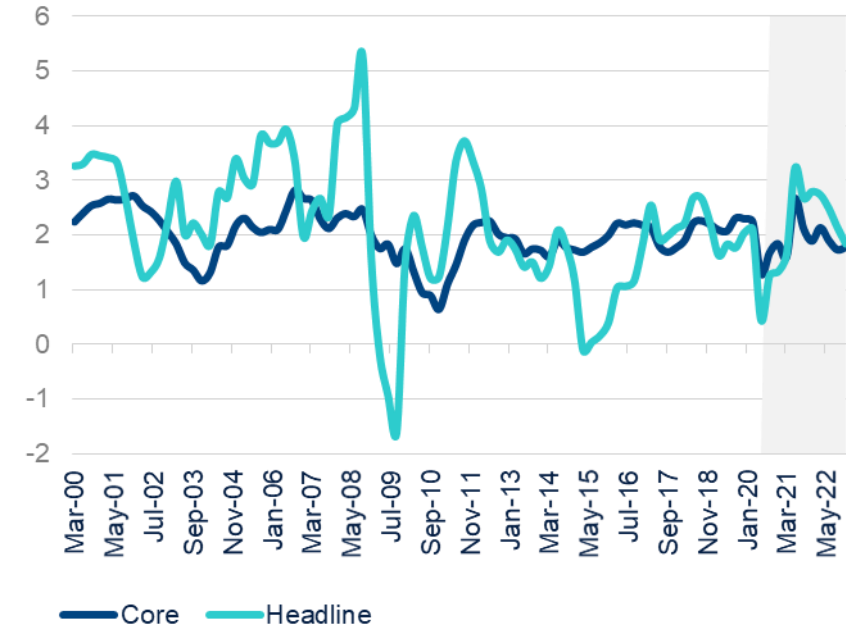
## INFLATION EXPECTATIONS

(%)



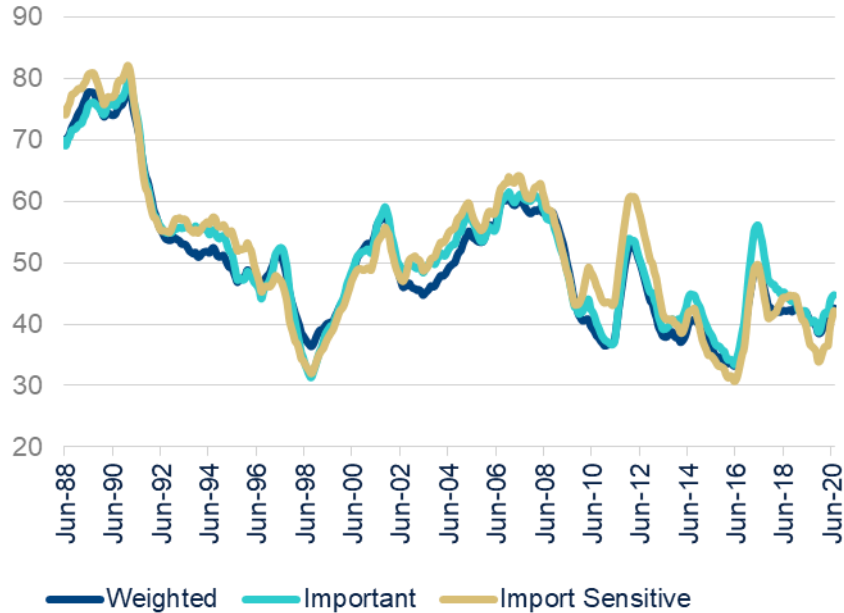
## HEADLINE & CORE CPI

(YEAR-OVER-YEAR %)

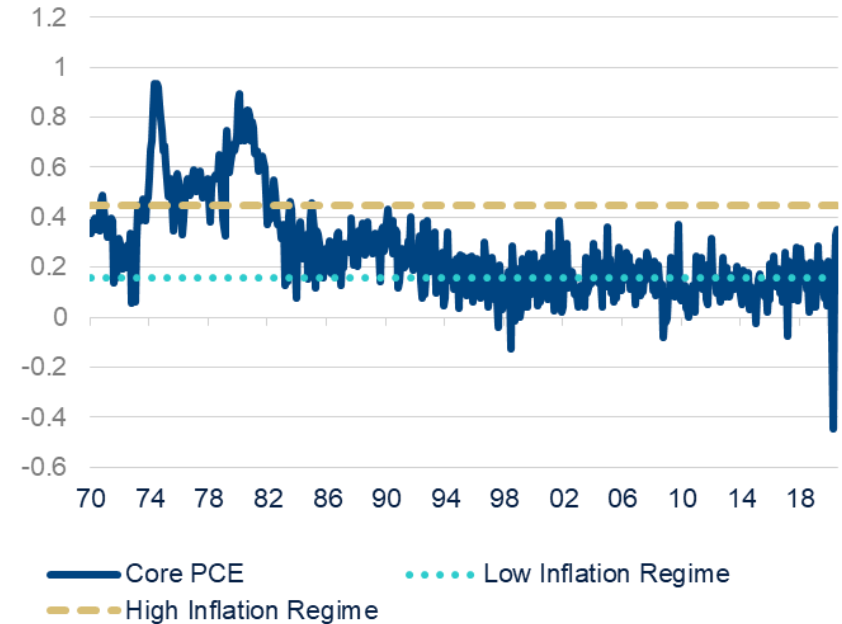


# Inflation: While demand-side risks remain, deflationary headwinds have abated

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



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



05

# Monetary Policy

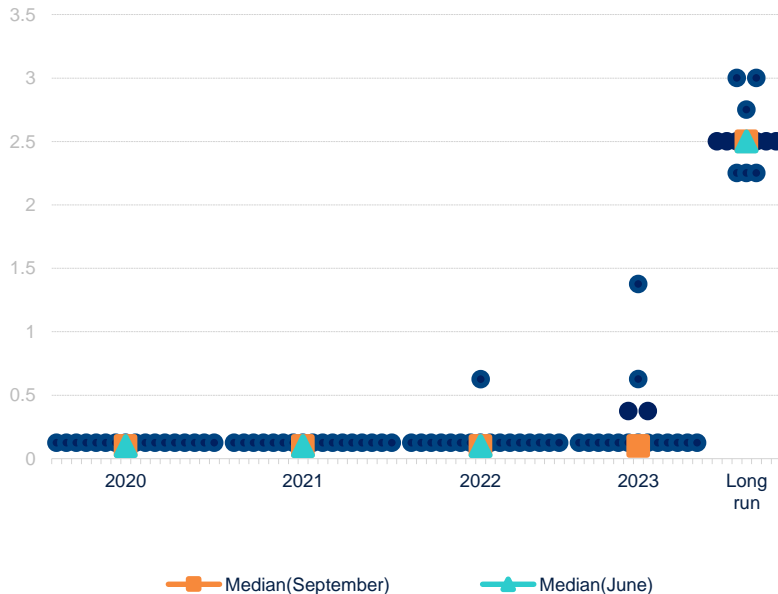
## Monetary Policy: Federal Reserve

- The change in forward guidance signals that interest rates will remain at the zero lower bound indefinitely and they will remain below neutral even after goals are reached.
- The statement did not include meaningful changes to the current strategy on asset purchases.
- While the Fed's economic outlook depends significantly on the course of the virus, the committee's projections improved markedly from June.
- Market expectations coalescing around extended period at the Effective Lower Bound (ELB).
- Based on the latest statement and changes to the committee's Longer-Run Goals and Monetary Policy Strategy, we expect the Fed to raise policy rates in 2025.

# Monetary Policy: Committee's outlook for interest rates edges down despite significant upgrade in forecasts

## FOMC DOT PLOT

(%)



Source: BBVA Research & Haver Analytics

## FOMC SUMMARY OF ECONOMIC PROJECTIONS

(%)

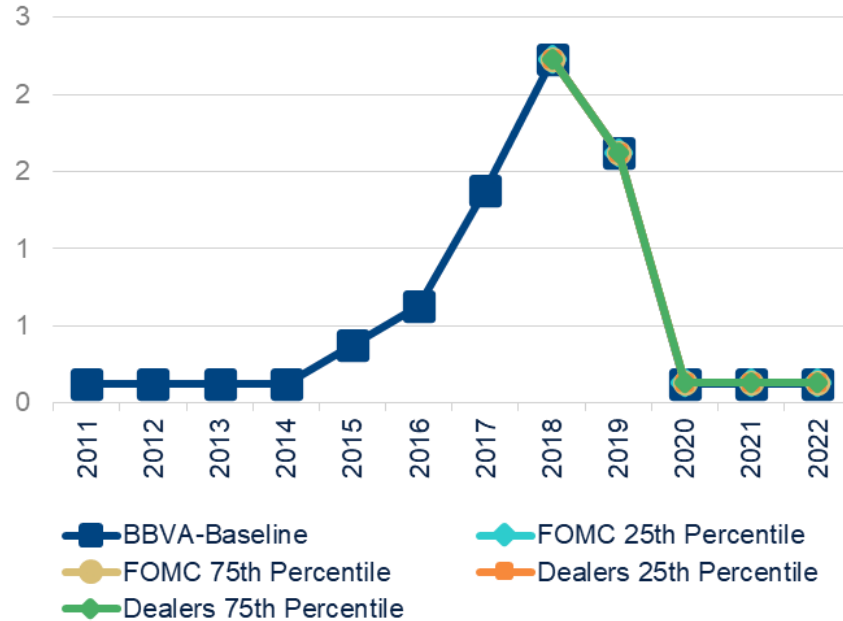
	2020	2021	2022	2023	Long-run
<b>Change in real GDP</b>	-3.7	4.0	3.0	2.5	1.9
June projection	-6.5	5.0	3.5		1.8
<b>Unemployment rate</b>	7.6	5.5	4.6	4.0	4.1
June projection	9.3	6.5	5.5		4.1
<b>PCE inflation</b>	1.2	1.7	1.8	2.0	2.0
June projection	.8	1.6	1.7		2.0
<b>Core PCE inflation</b>	1.5	1.7	1.8	2.0	
June projection	1.0	1.5	1.7		
<b>Federal funds rate</b>	.1	.1	.1	.1	2.5
June projection	.1	.1	.1		2.5

\*Median

# Monetary Policy: Market and consensus expectations consolidating around ELB for extended period of time

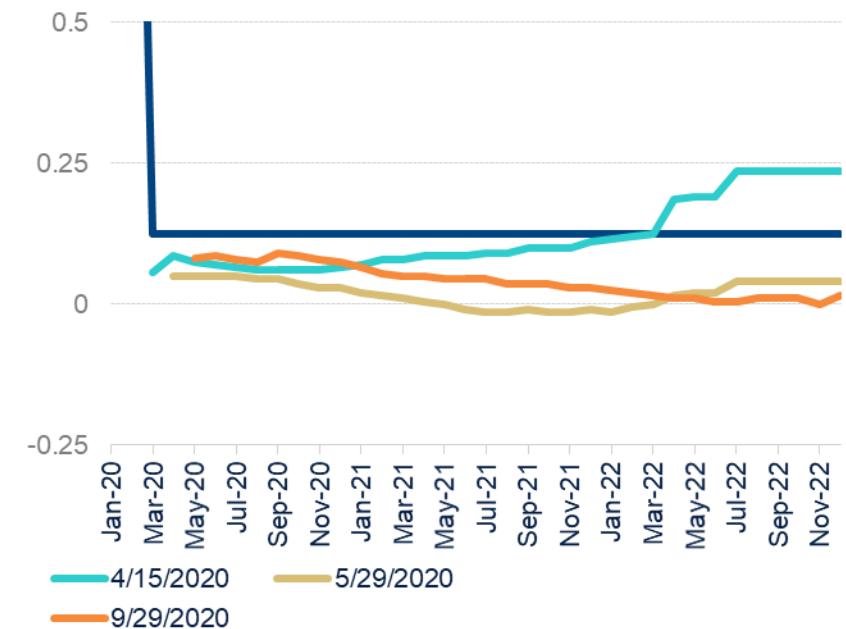
## FED FUNDS RATE PROJECTIONS (%)

(%)



## FED FUNDS FUTURES & BBVA BASELINE (%)

(%)

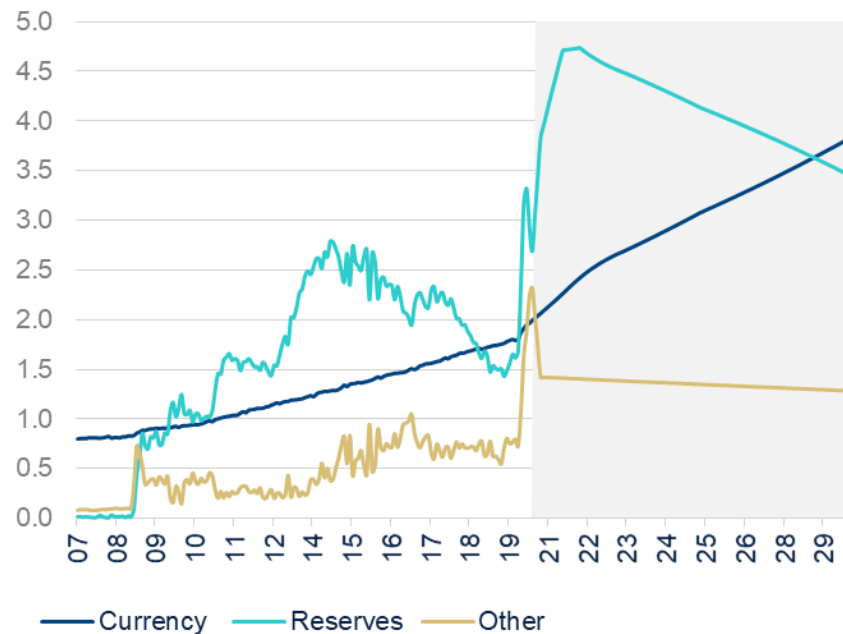




# Fed Balance Sheet: Balance sheet growth slows as uptake in loan and emergency facilities moderates and LSAPs decelerate

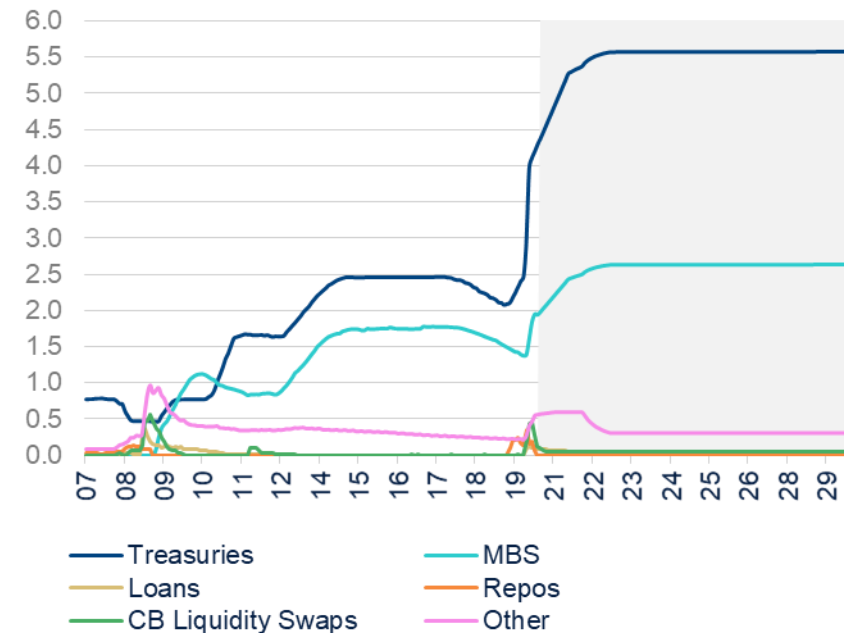
## FACTORS ABSORBING RESERVE FUNDS

(US\$TN)



## FACTORS SUPPLYING RESERVE FUNDS

(US\$TN)



06

# Interest Rates

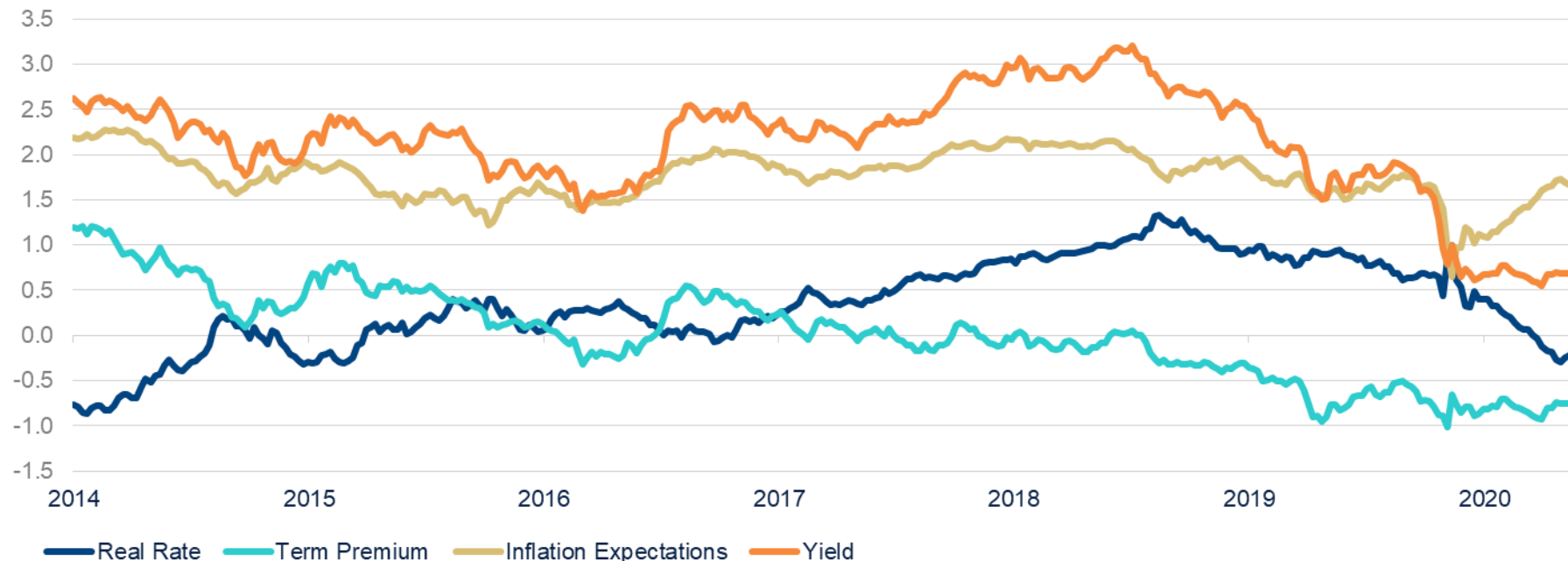
## Interest Rates

- Fed's commitment to financial stability was successful in reducing market frictions.
- 10-yr and 2-yr Treasury yields steady around 0.7% and 0.1%, respectively.
- 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 long-term yields will remain lower for longer.

## Interest rates: Long-term real rates remain negative despite some modest declines in long-term inflation expectations

### 10-YEAR TREASURY YIELD DECOMPOSITION

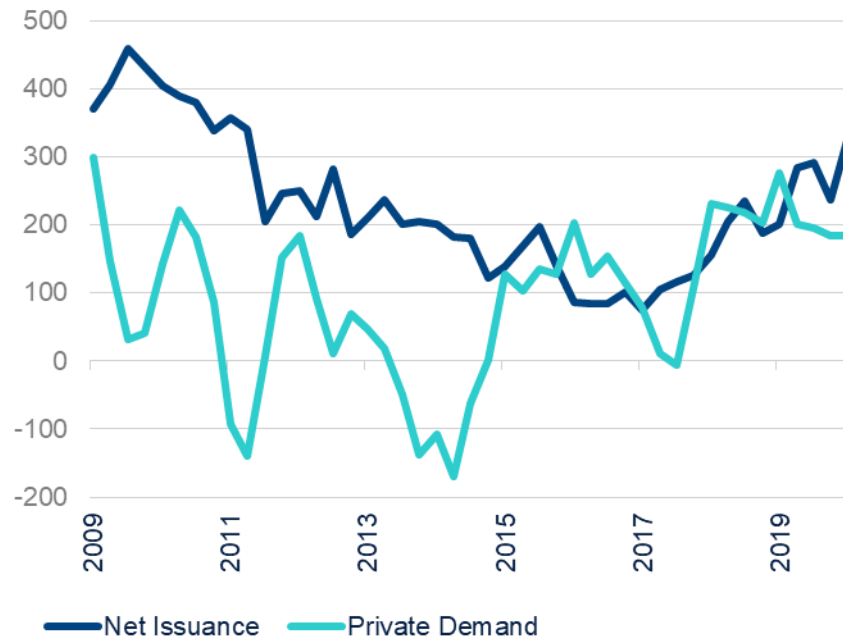
(%)



# Interest rates: Strong intervention by Fed supporting uptick in Treasury supply

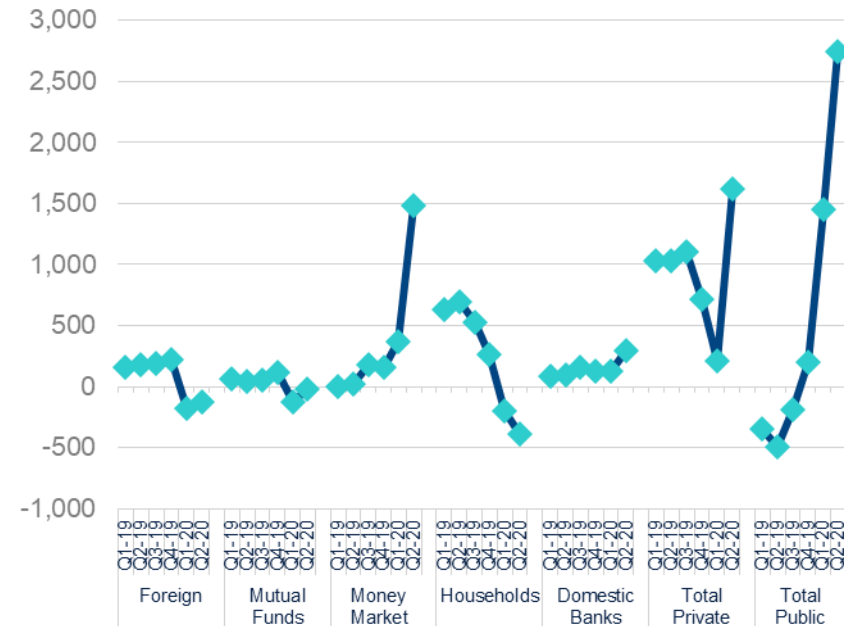
## CHANGE IN TREASURY SUPPLY & DEMAND

(3-QUARTER MOVING AVERAGE, \$BN)



## TREASURY DEMAND

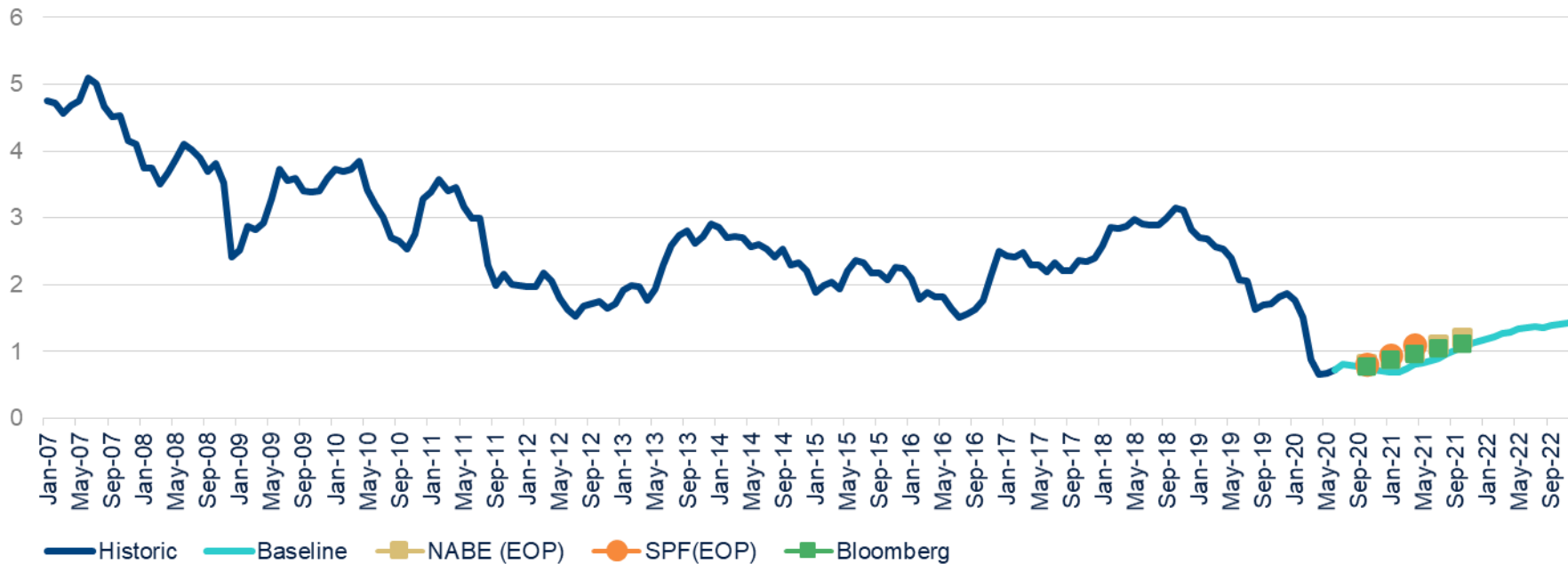
(4-QUARTER MOVING AVERAGE, \$BN)



# Interest rates: Prolonged monetary policy accommodation and structural headwinds will keep nominal yields below equilibrium levels

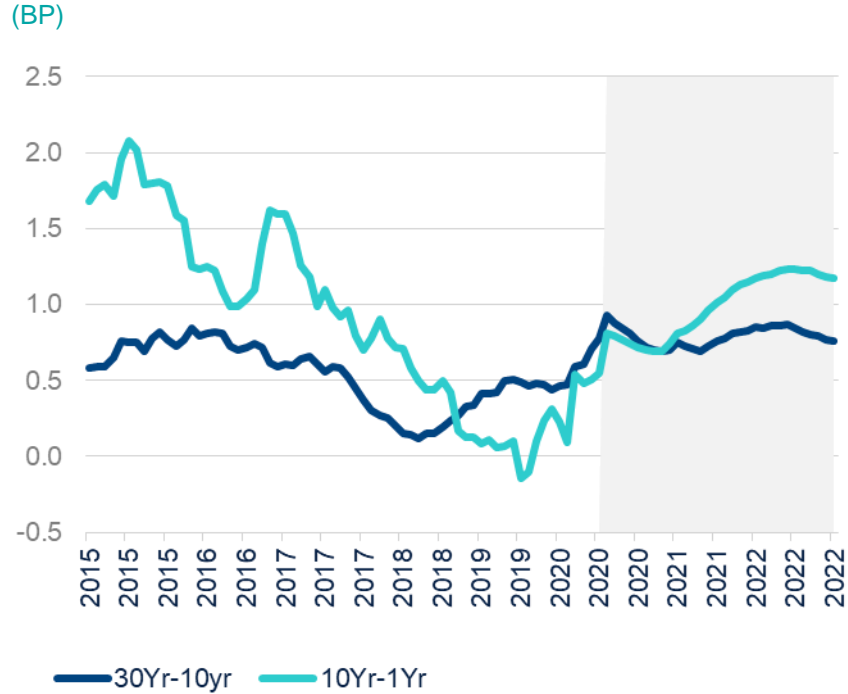
## 10-YEAR TREASURY YIELDS

(%)

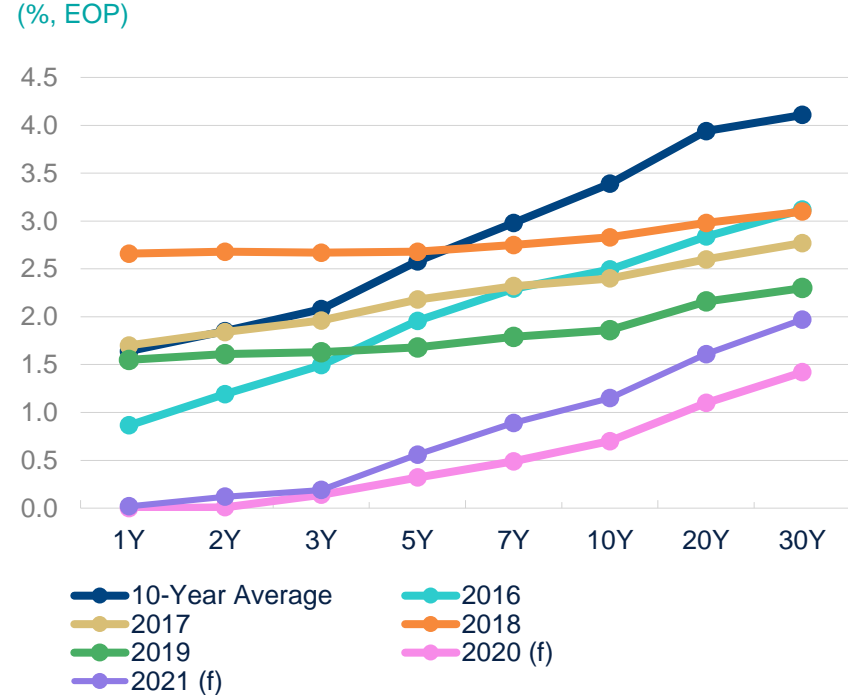


# Interest rates: Baseline assumes persistent upward sloping yield curve

## YIELD CURVE SLOPE (BP)



## YIELD CURVE (% EOP)



07

# Oil Prices

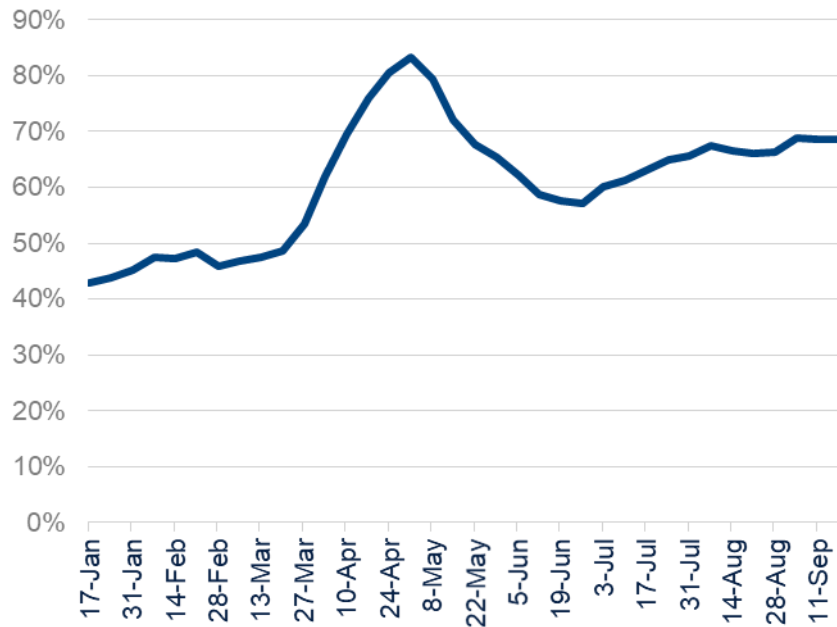


## Oil Prices

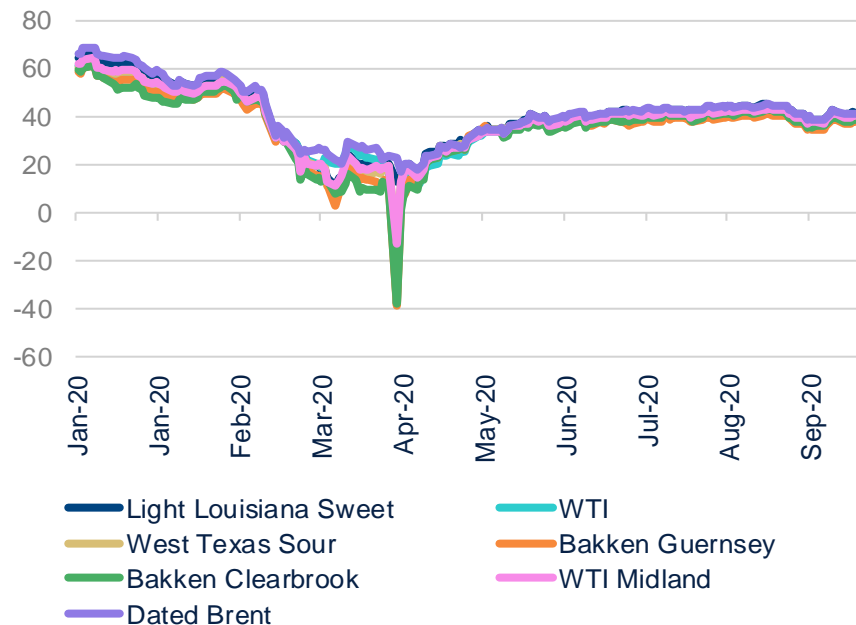
- Fundamentals are consistent with our baseline scenario. In the absence of a vaccine, prices will remain below \$45/b for the rest of the year.
- Demand is recovering, but continues to be capped by the pandemic's effects on economic activity.
- OPEC+ compliance has been supportive of prices, however, output cuts will slow down as planned.
- Although still above trend, inventories have subsided, easing pressures on storage capacity.
- Second waves of contagion around the world could limit the recovery of demand.
- However, prospects could significantly improve if a vaccine is available in 4Q20.

## On average, WTI prices remain stalled. Pressures on storage capacity have eased, but remained elevated

### U.S. CUSHING, OKLAHOMA NET STOCKS PERCENT OF WORKING STORAGE CAPACITY

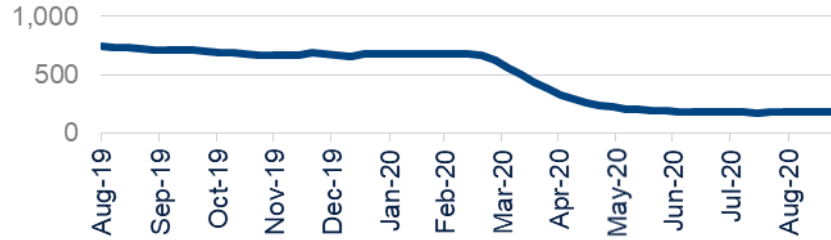


### U.S. REGIONAL BENCHMARKS 2020 (\$ PER BARREL)

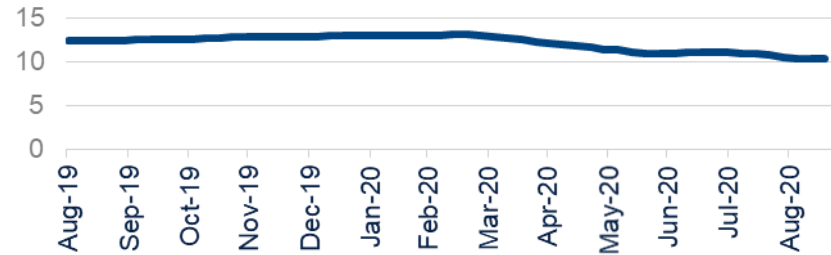


# U.S. shale production may have reached a bottom

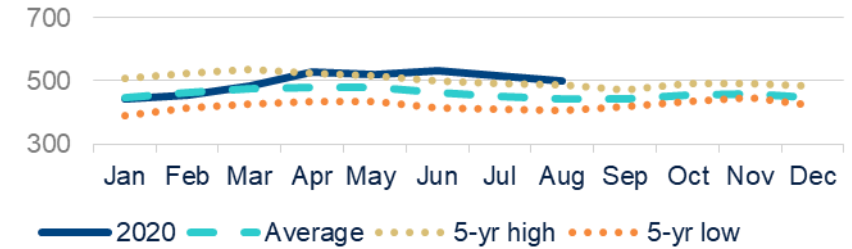
## U.S. ACTIVE RIG COUNT: OIL RIGS (UNITS)



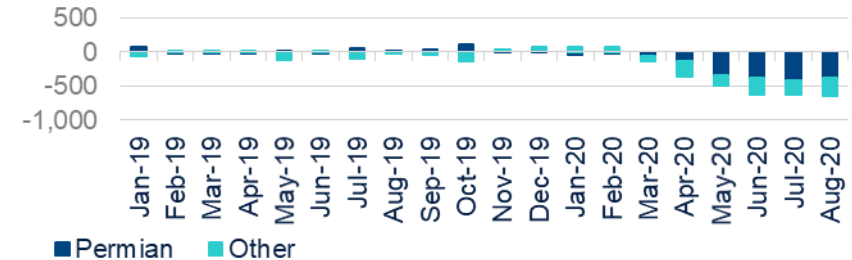
## U.S. CRUDE OIL PRODUCTION (MB/D)



## U.S. STOCKS OF CRUDE OIL EXCL. SPR (MB/D)

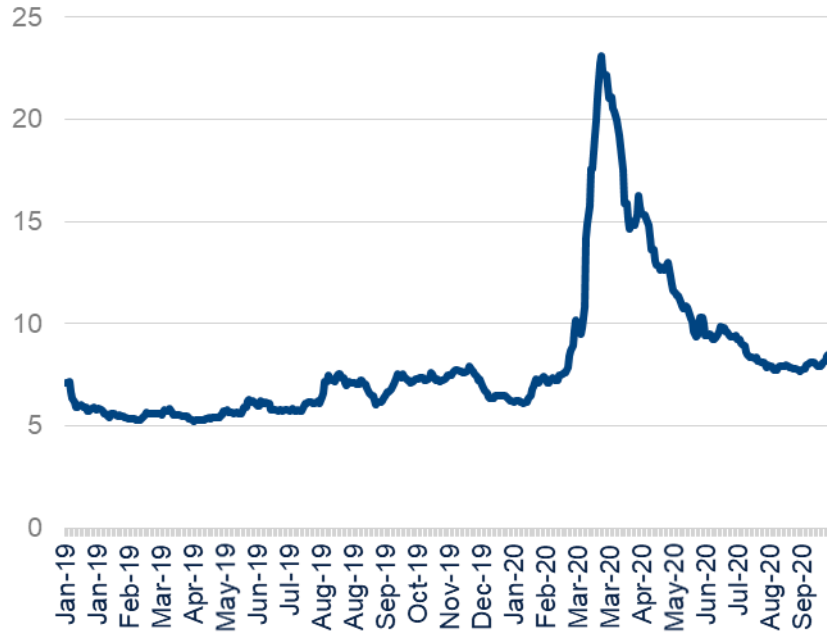


## U.S. SHALE PRODUCTION (THOUSAND B/D, YOY CHANGE)

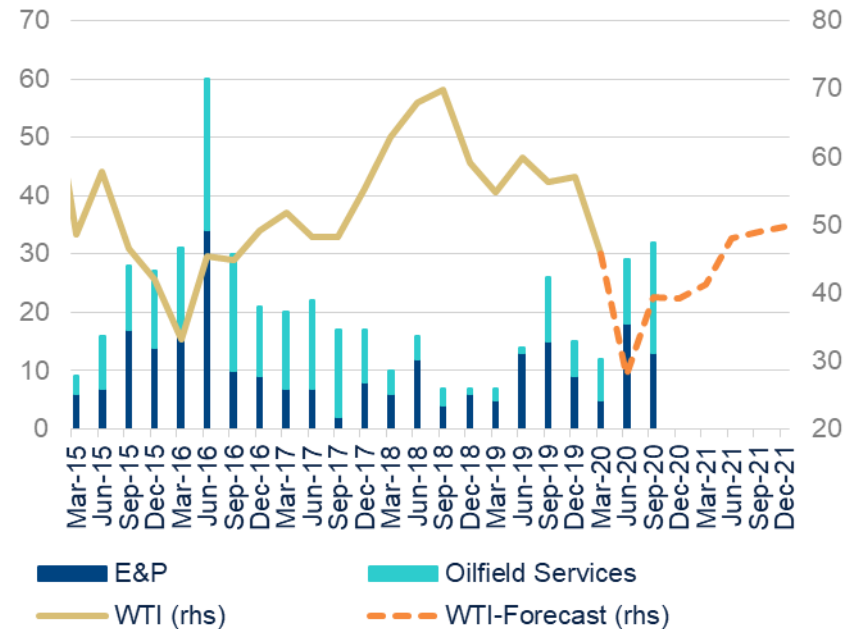


# Government intervention has eased financial pressures and helped avoid mass bankruptcies

## BLOOMBERG-BARCLAYS HIGH YIELD ENERGY AVERAGE OAS (\$)



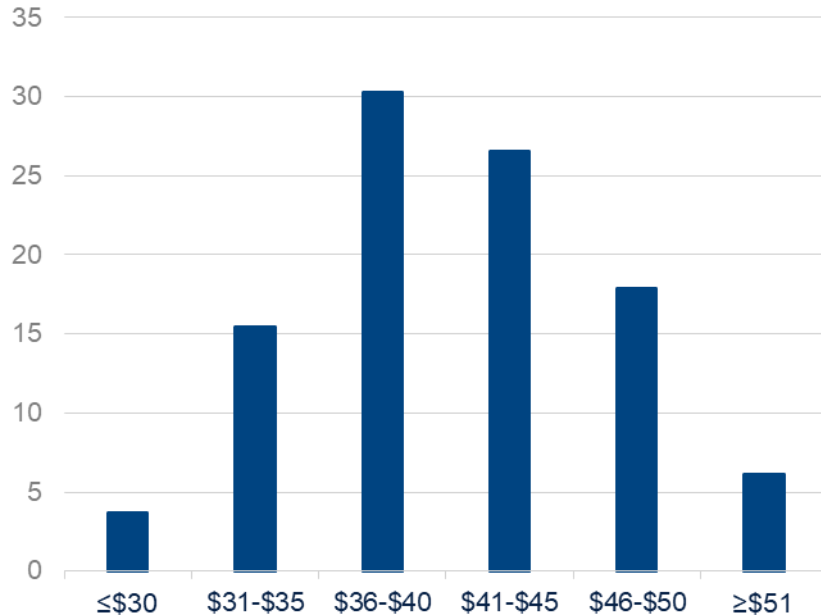
## NORTH AMERICA E&P BANKRUPTCY FILINGS AND WTI (NUMBER AND \$ PER BARREL)



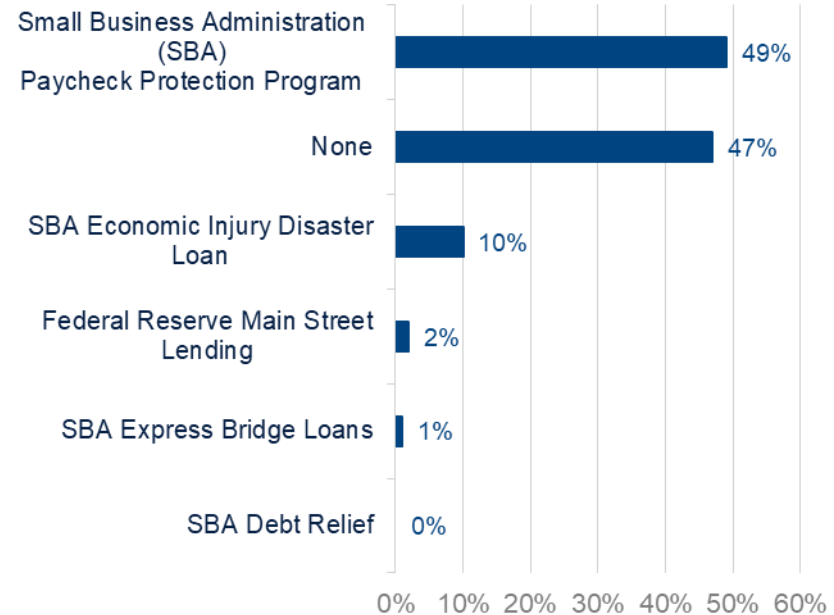
Source: BBVA Research, Haver Analytics, and Haynes and Boone

# Higher prices and government aid set the conditions for a sustained recovery

## AT WHAT PRICE DO YOU EXPECT THE MAJORITY OF PRODUCERS IN THE U.S. TO RESTART HORIZONTAL SHUT-IN WELLS? (\$ PER BARREL)



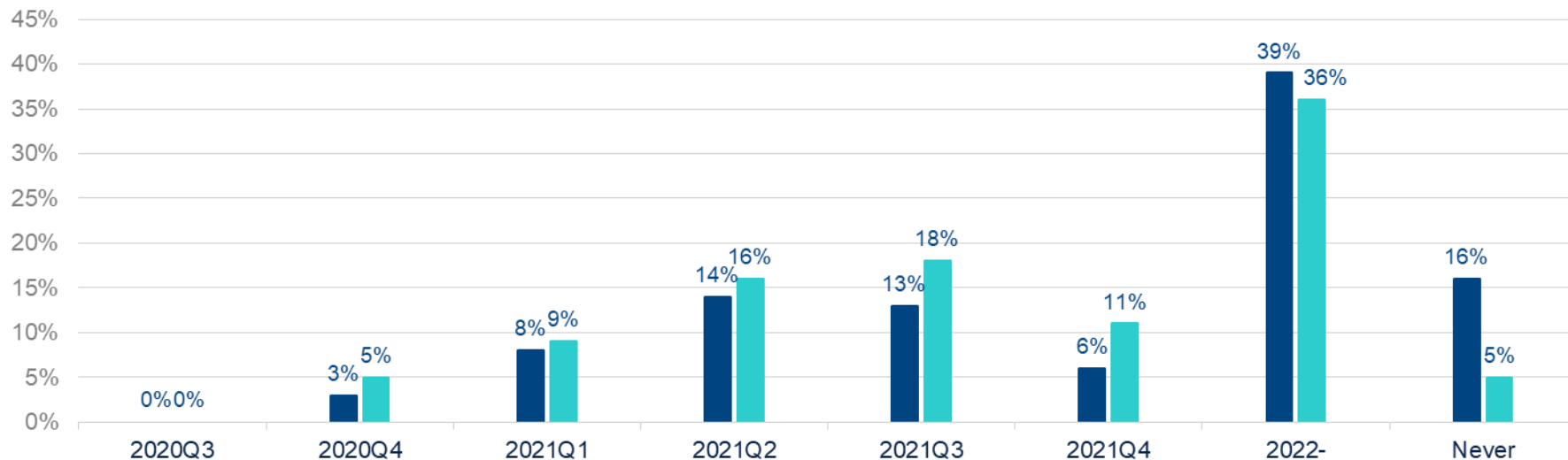
## WHICH OF THE FOLLOWING GOVERNMENT ASSISTANCE PROGRAMS HAS YOUR FIRM APPLIED FOR? (SHARE OF PARTICIPANTS)



# Conditions are expected to improve most likely in 2021 and onwards

## DALLAS FED ENERGY SURVEY

(2Q20)



■ When do you expect U.S. drilling and completions activity to return to pre-COVID-19 levels?\*

■ When do you expect global oil consumption to return to pre-COVID-19 levels?\*

\*Executives from 147 oil and gas firms answered the question between June 10 and June 18, 2020

\*\* Executives from 152 oil and gas firms answered the question between June 10 and June 18, 2020

Source: Federal Reserve Bank of Dallas

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# U.S. Macroeconomic Pulse

September 2020