

# 2019 Economic Outlook

**BBVA**

Creating Opportunities



## Economic Outlook

- Global growth slowing as headwinds strengthen in both developed and emerging markets
- In U.S., growth moderation to continue in 2019-2020
- Probability of recession increasing, as handful of indicators suggests growing risks
- FOMC tasked with engineering a soft-landing, as financial and macroeconomic conditions diverge
- Downward pressure on Oil prices should ease in 1Q19, but prices to remain below long-term levels in medium term
- Texas and Houston poised for another strong year

# Slowing global growth, while risks intensify

01



More moderate and less synchronized global growth

Moderation in performance in the **US, EZ** (policies on hold) and **CHN** (policies stimulating)

02



Ongoing monetary policy normalization

Fed and ECB at very different stages: Fed at the end of tightening cycle while the ECB just ended QE with rates on hold until Sept19

03



Global financial tensions on the rise

Risk-off mood prevails in financial markets: while pressure in EMs recedes, tensions arise in equity, credit and European debt.

04



US-CHN trade war ongoing

US ready for more action, pending a 3 months truce, while tensions with other countries have eased for now.

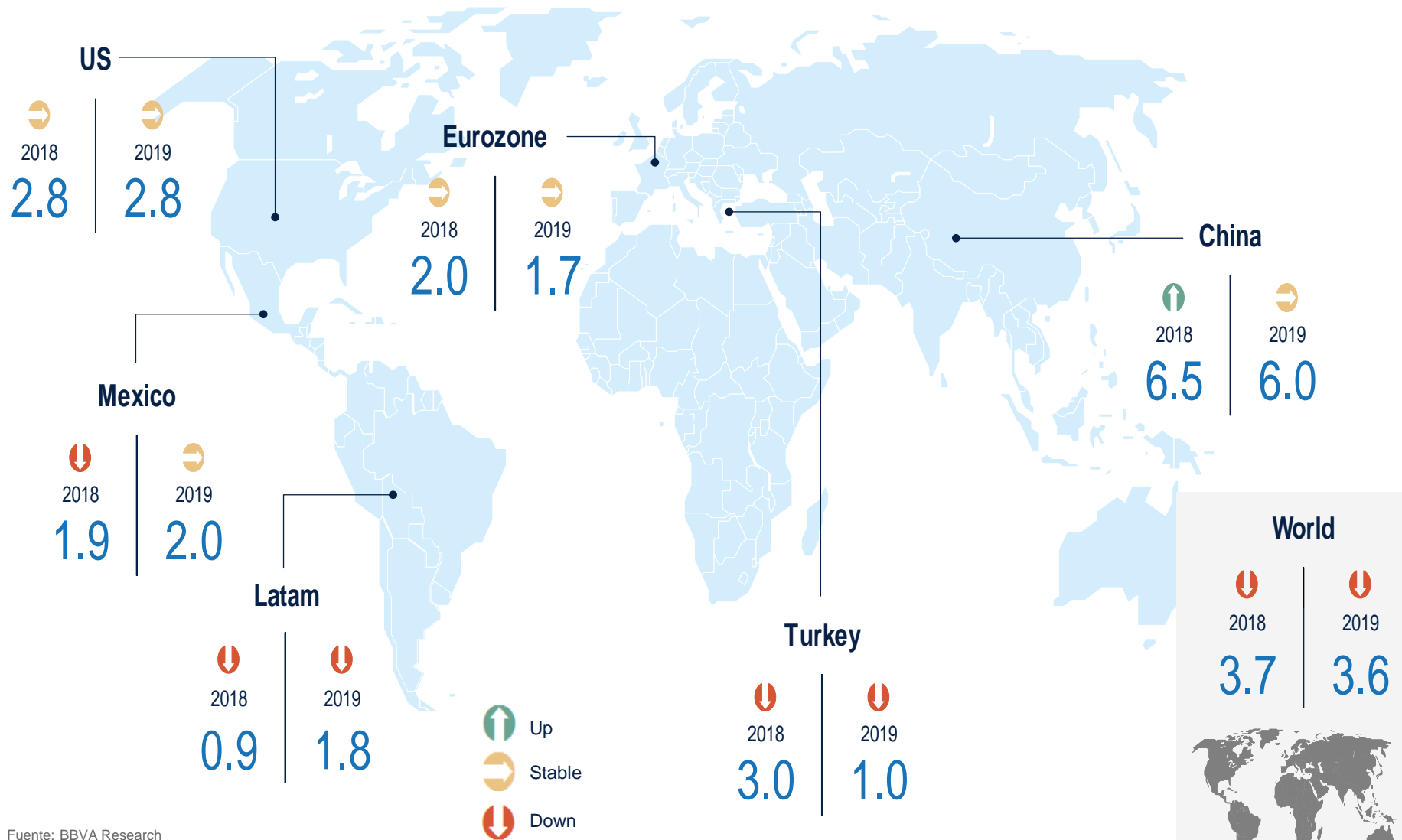
05



Global risks intensify

Protectionism and Fed policy mistakes, EM sell-off acting as potential amplifier; greater political uncertainty in Europe

# Global economic growth tilting to the downside

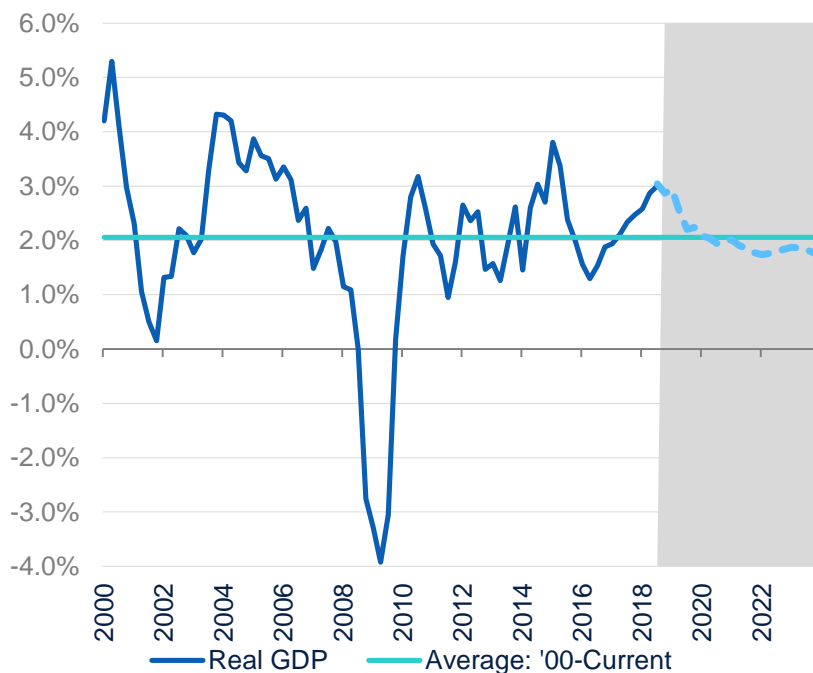


# U.S. Economy: Growth to moderate in 2019

Government and consumption offsetting weak private investment. Growth to moderate, but remain above potential

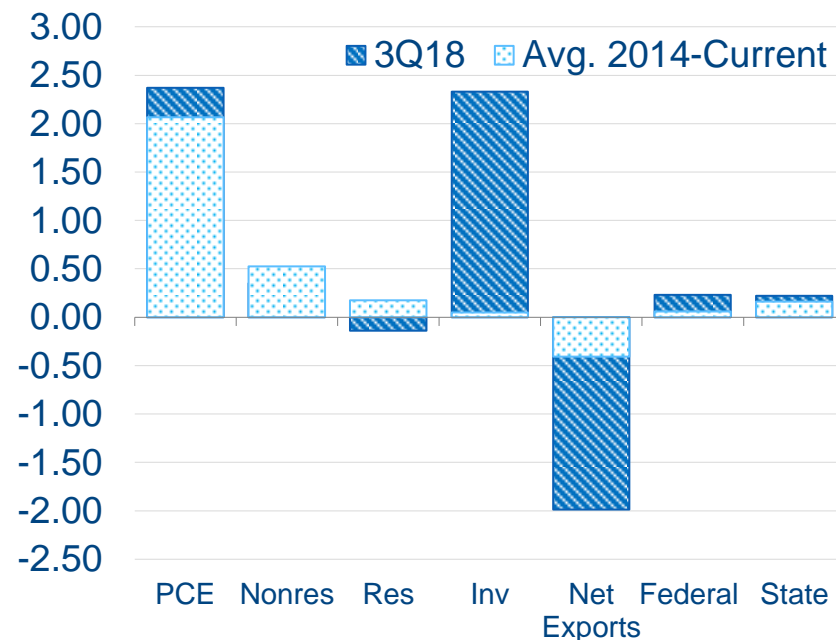
## Real GDP

Year-over-year %



## GDP- Contribution to 3Q Growth

Annualized %



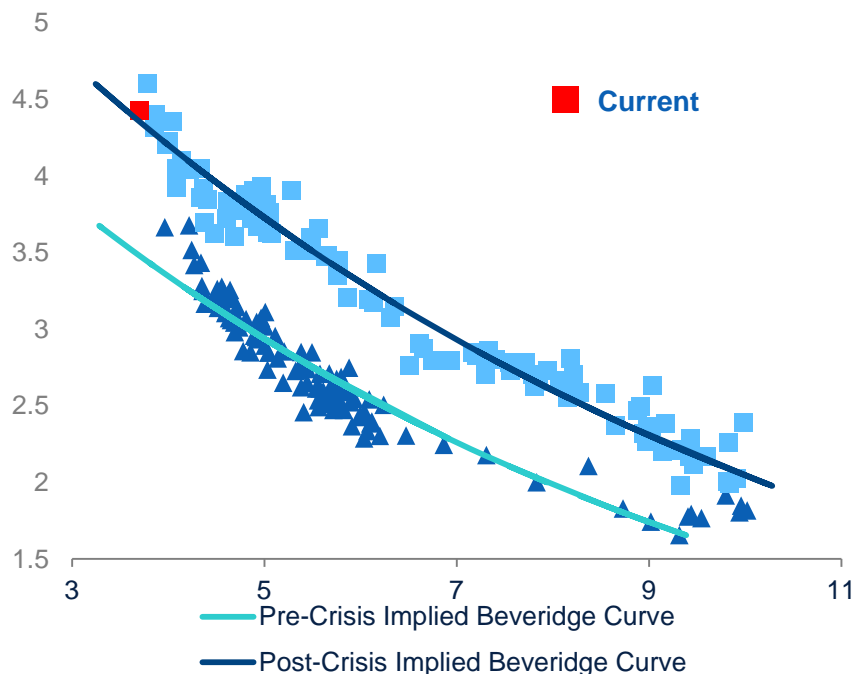
Source: BBVA Research & BEA

# Labor Market: Unemployment rate at 50 year lows

As labor market continues to tighten, potential for further declines in the UR becoming more difficult

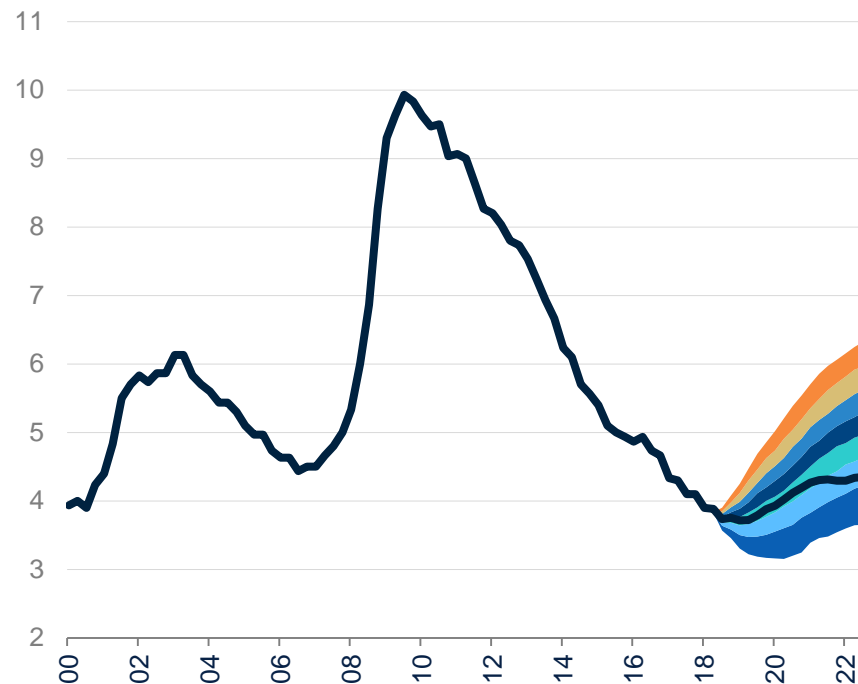
## Beveridge Curve

UR & Job Openings %



## Unemployment Rate

%

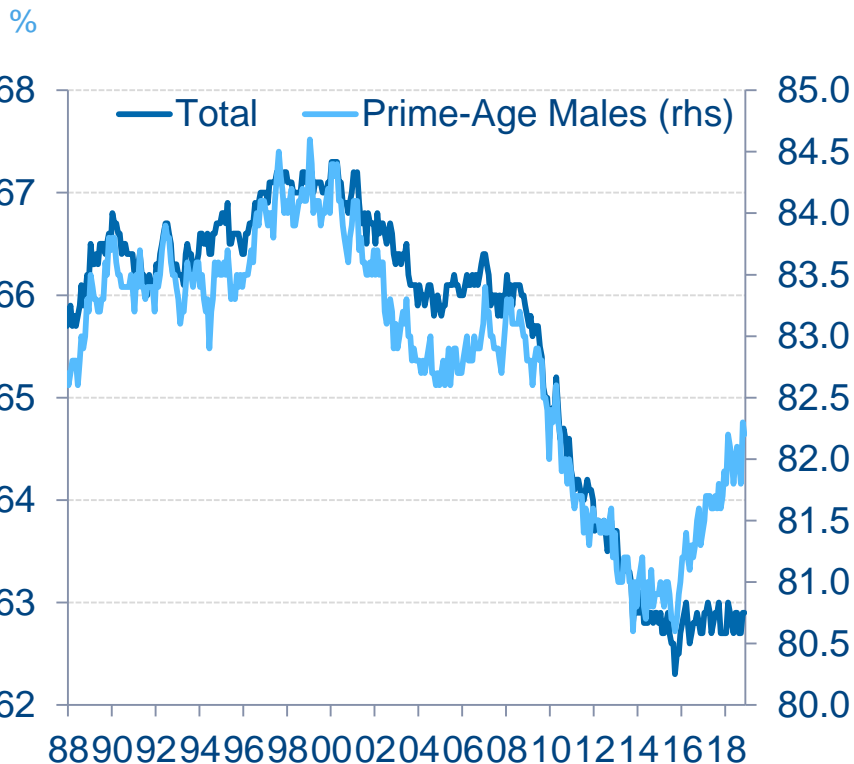


Source: BBVA Research & BLS

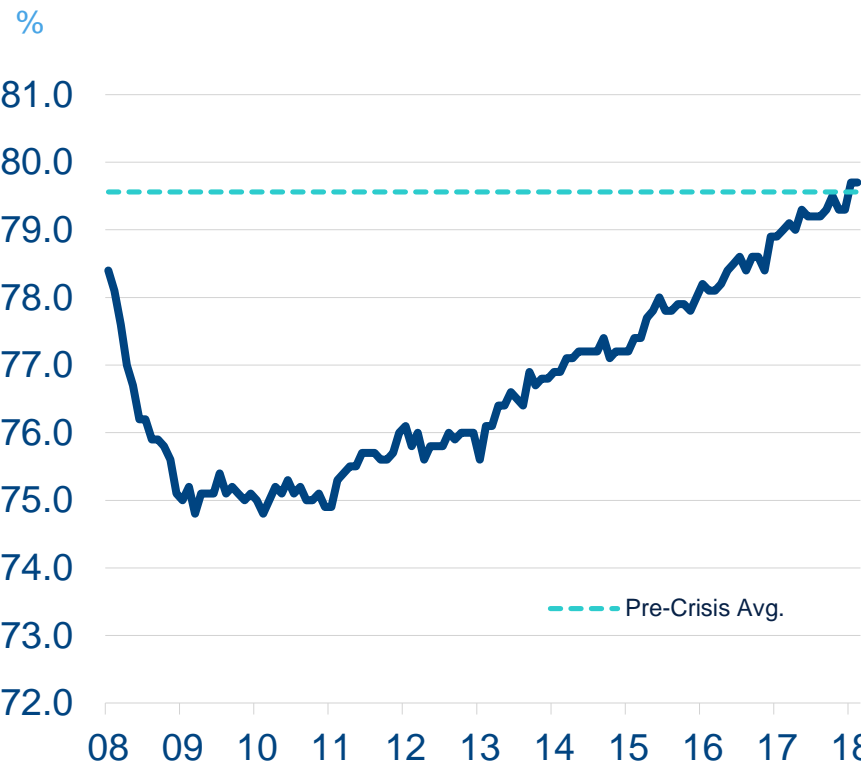
# Labor Market: Improvement in broader indicators

Improved economic outlook drawing more prime-age participants back into the labor force

**Participation Rate**



**Prime-Age Employment-to-Population**



Source: BBVA Research and Haver

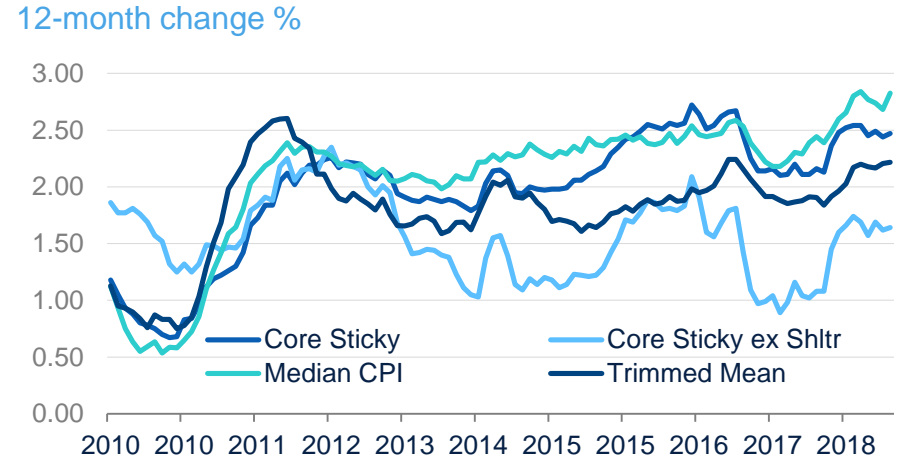
# Inflation: Upward momentum fading

Inflation momentum slowing, pushing inflation expectations below 2%

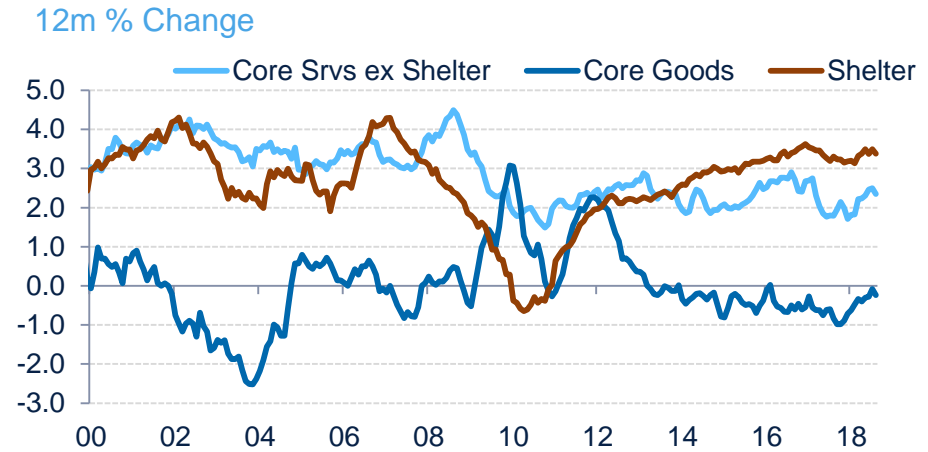
## Market-Based Inflation Expectations



## Consumer Price Index



## Core Inflation

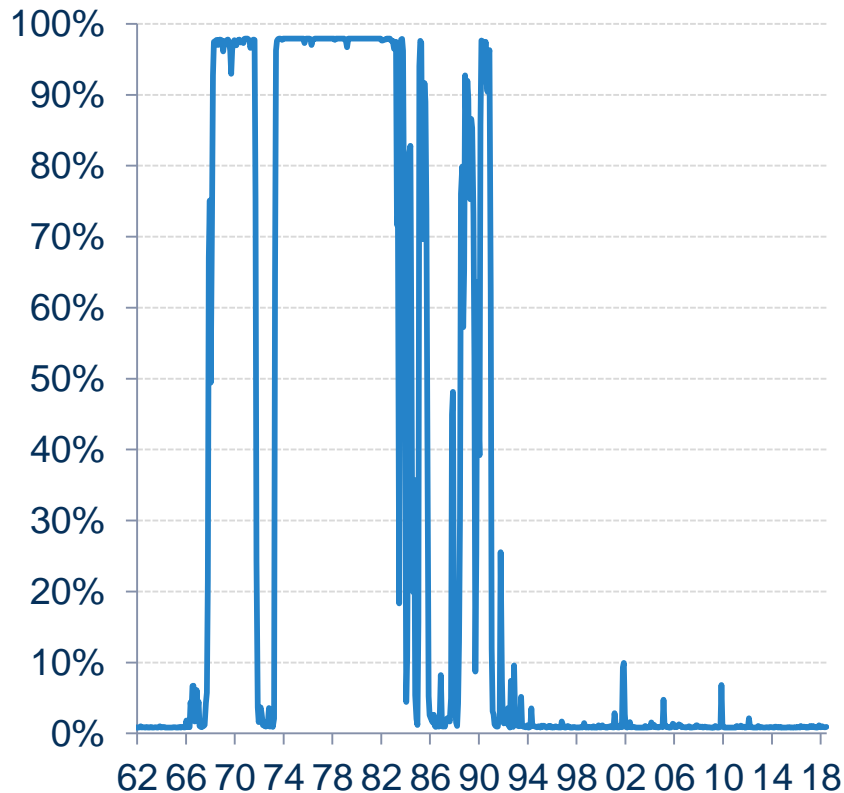




# Inflation: Probability of high inflation scenario declining

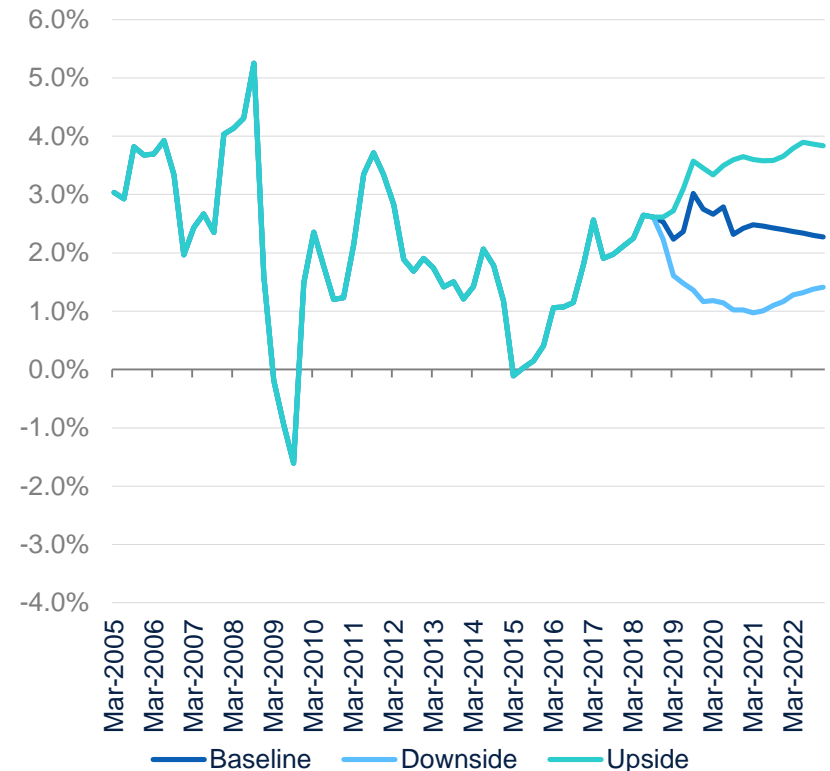
## Inflation Regime Probability

Regime change high / low



## Consumer Price Index

Year-over-year change



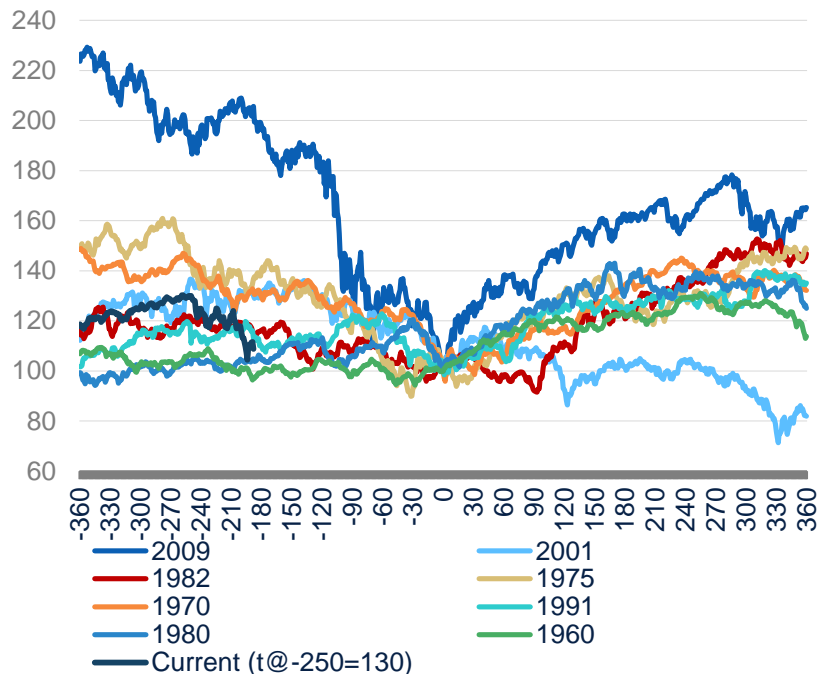
Source: BBVA Research

# Recession: Equity prices & business cycles

Since 1960 there have been 7 major equity price corrections with no corresponding recession

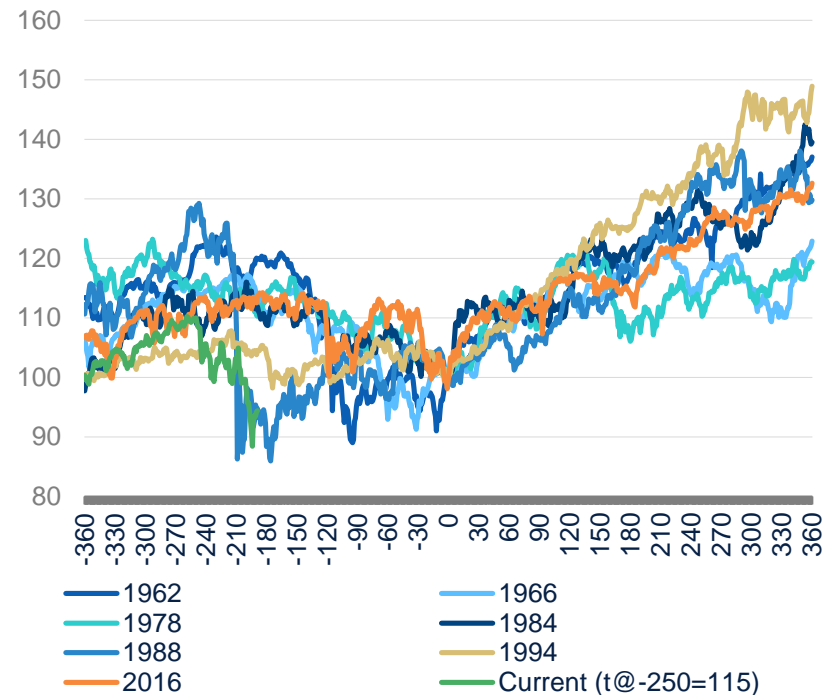
## Equity Price Correction w/ Recession

Trough=100, t=days



## Equity Price Correction w/ No Recession

Trough=100, t=days

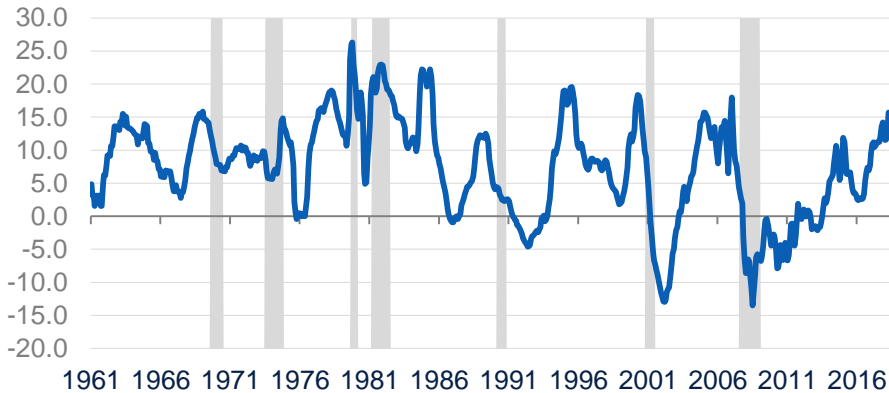


Source: BBVA Research & Haver Analytics

# Recession: Consumer indicators suggests risks contained

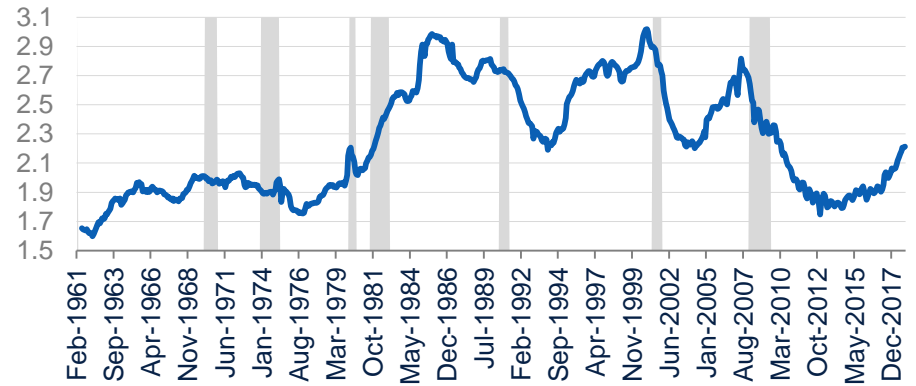
## Personal Interest Expense

Year-over-year %



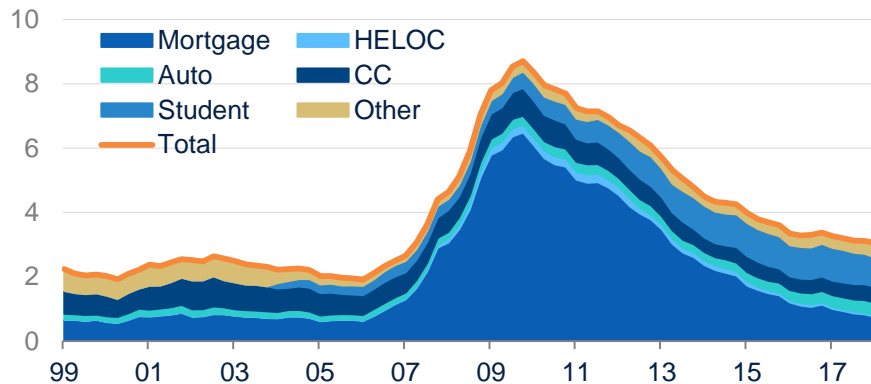
## Personal Interest Expense to Disp. Income

Ratio, %



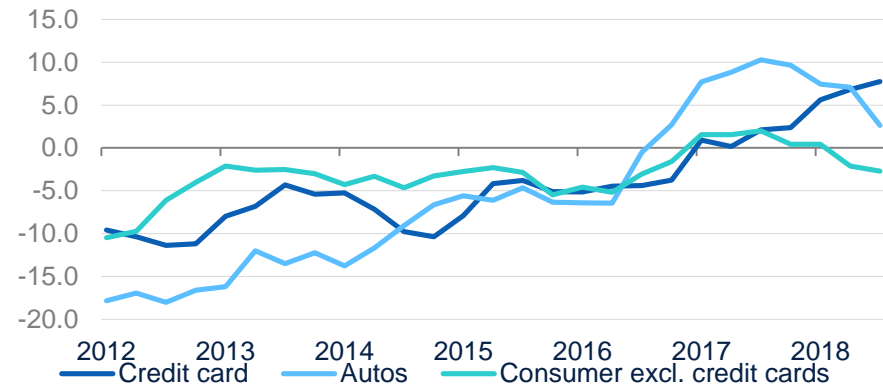
## New 30+ Day Consumer Delinquency Rates

%



## Senior Loan Officers Lending Standards

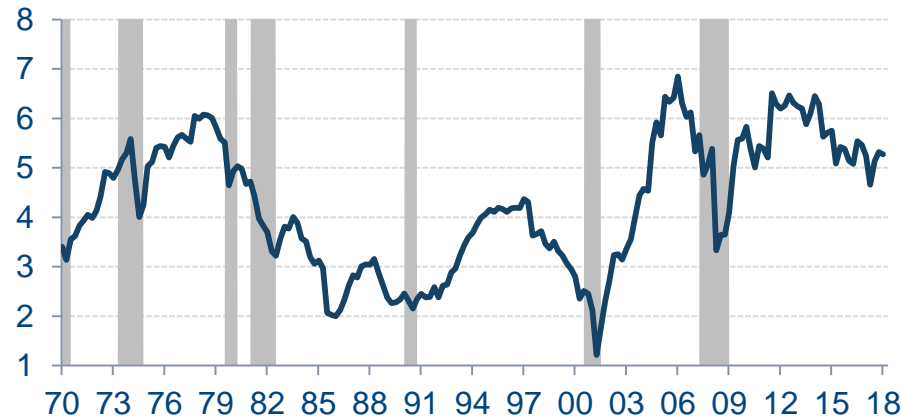
+ tightening / - loosening



# Recession: Corporate indicators imply elevated risk

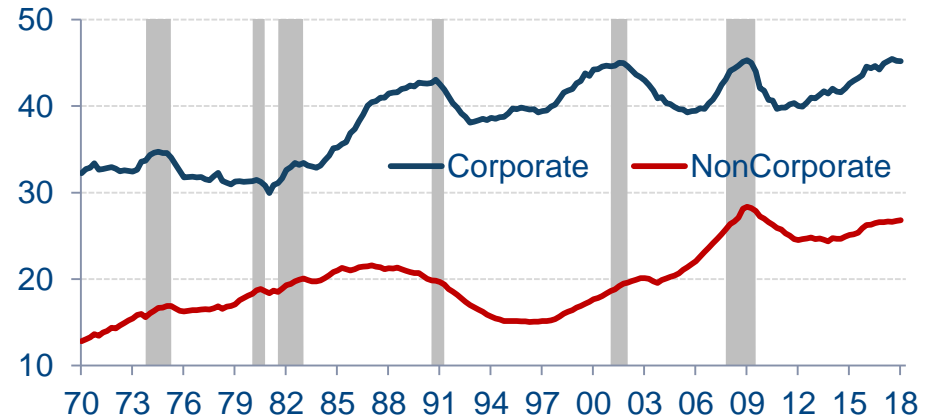
## Nonfinancial Corporate Profits

% of GDP



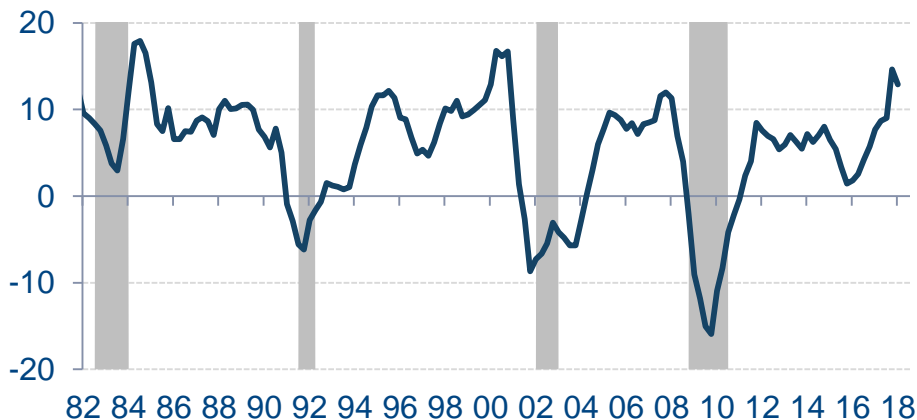
## Nonfinancial Business Debt

% of GDP



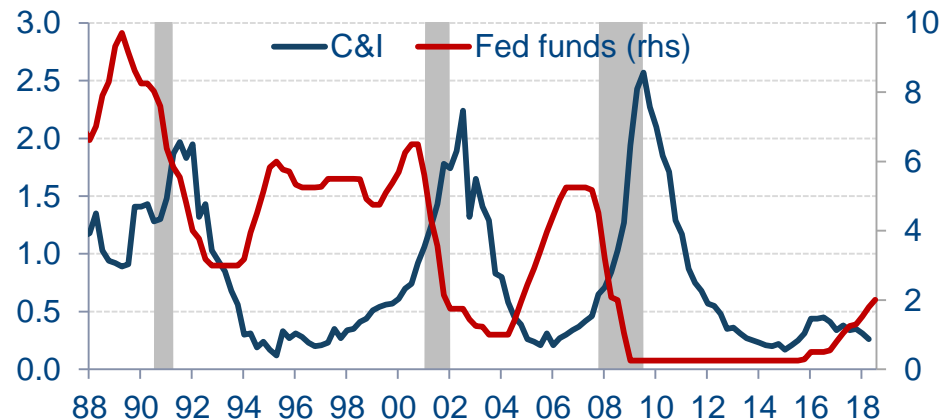
## Nonfinancial Corporate Short-term Liabilities

YoY % Change



## C&I Loan Charge-Off Rate & Fed Funds

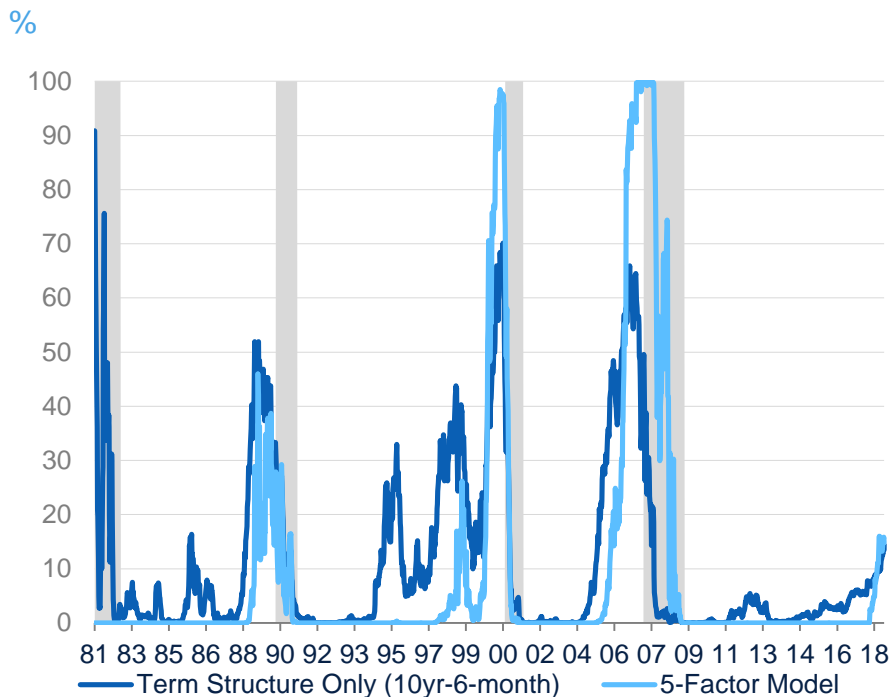
%



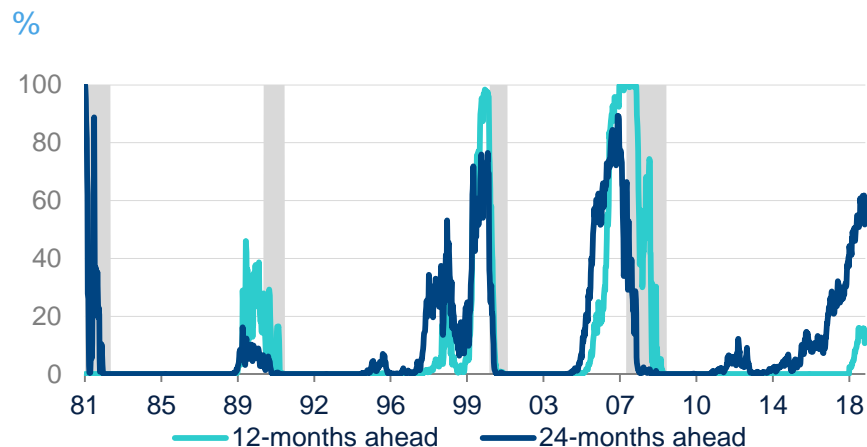
# Recession: Probability of downturn rising

Near term risks modest, but probability of recession within 2 years above 50%

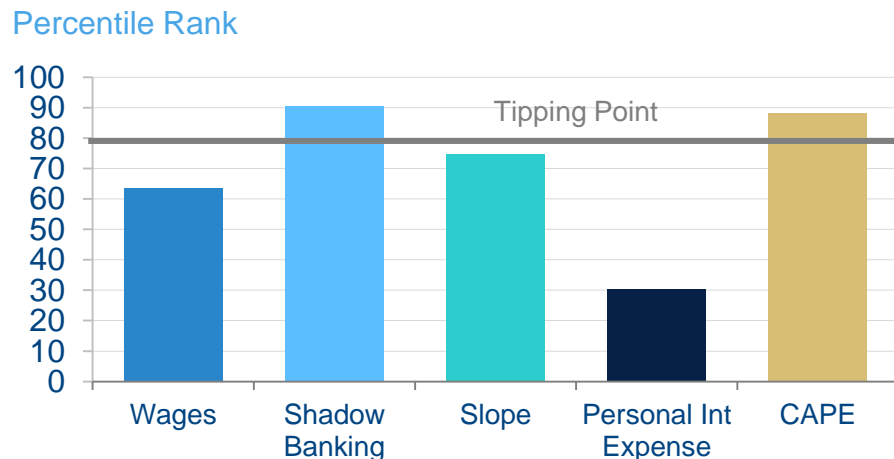
## 12-Month Ahead Recession Probability



## Future Recession Probability



## Risk Factors

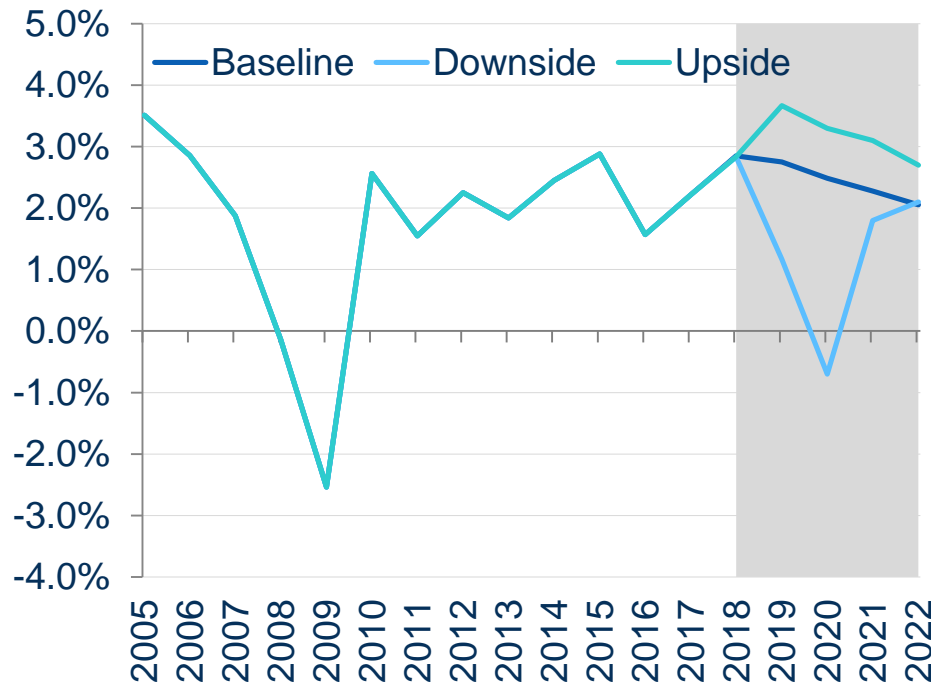


# Recession: A case for a soft landing

Increased capital buffers and importance of intangibles implies more moderate business cycles. Lack of fiscal and monetary capacity a risk.

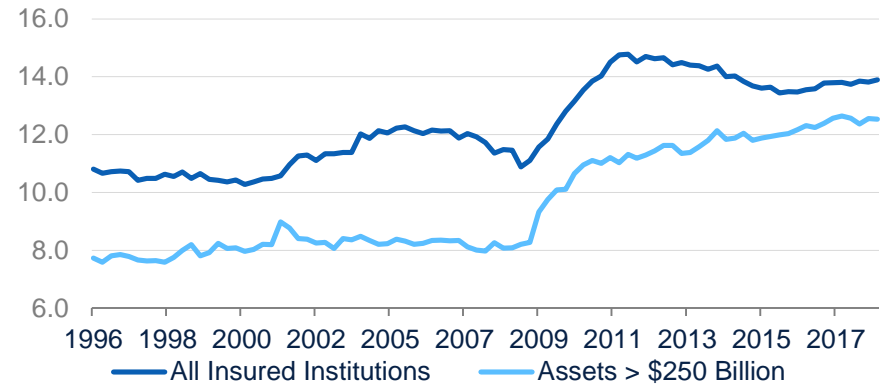
## Real GDP

YoY % Change



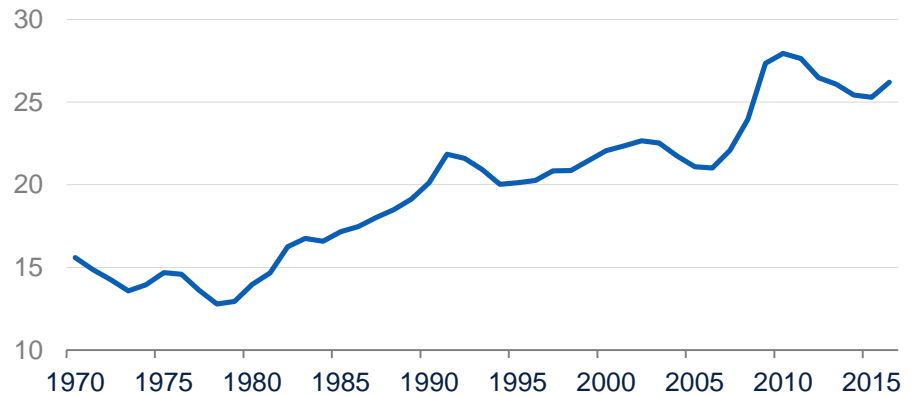
## Tier 1 Risk-Based Capital Ratio

Tier 1 Core Capital/risk-weighted assets, %



## Intangibles Investment

share of total investment, %

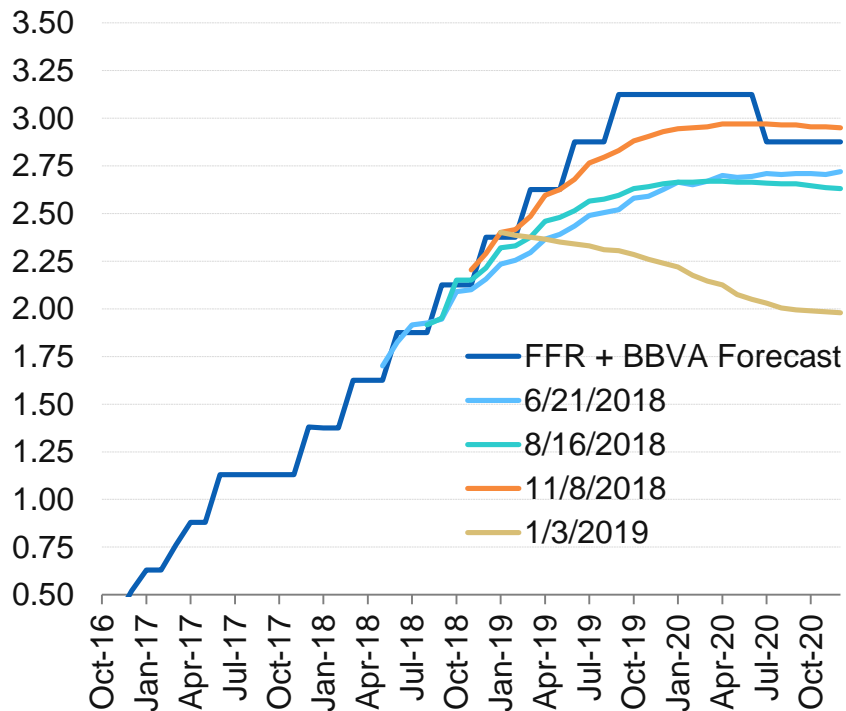


# Monetary Policy

## A sharp adjustment in market expectations

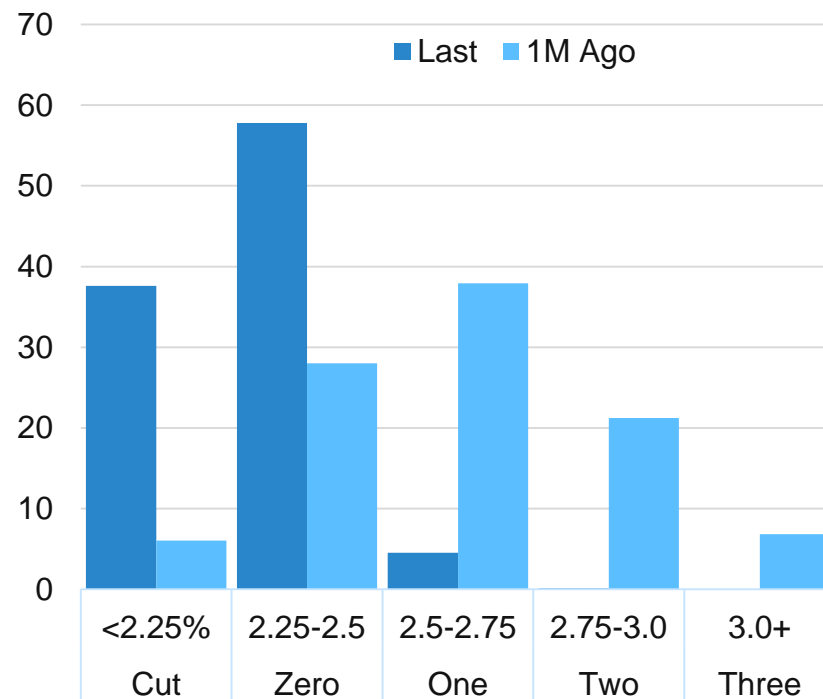
### Fed Funds Expectations

EOY, %



### Fed Funds Implied Probability

Number of rate increases through 2019, %



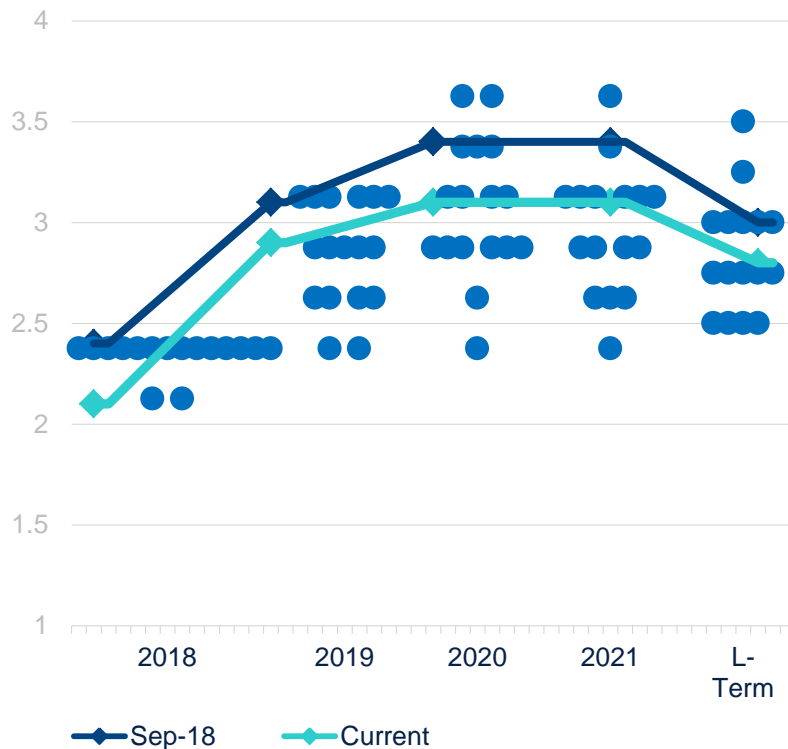
Source: BBVA Research, Bloomberg, FRB & Haver

# Monetary Policy

## FOMC tasked with engineering the soft landing

### FOMC Projections of Fed Funds

Year-over-year %, median



Source: BBVA Research, FRB

### Change in FOMC Tone

#### Post-meeting Press Conference December

If you look at 2018, as I mentioned, is the best year since the financial crisis... And we also have a positive forecast, as I mentioned, and, in that context, we think this move was appropriate for what is a very healthy economy.

Runoff of the balance sheet has been smooth and has served its purpose. And I don't see us changing that

#### Powell Remarks at 2019 AEA

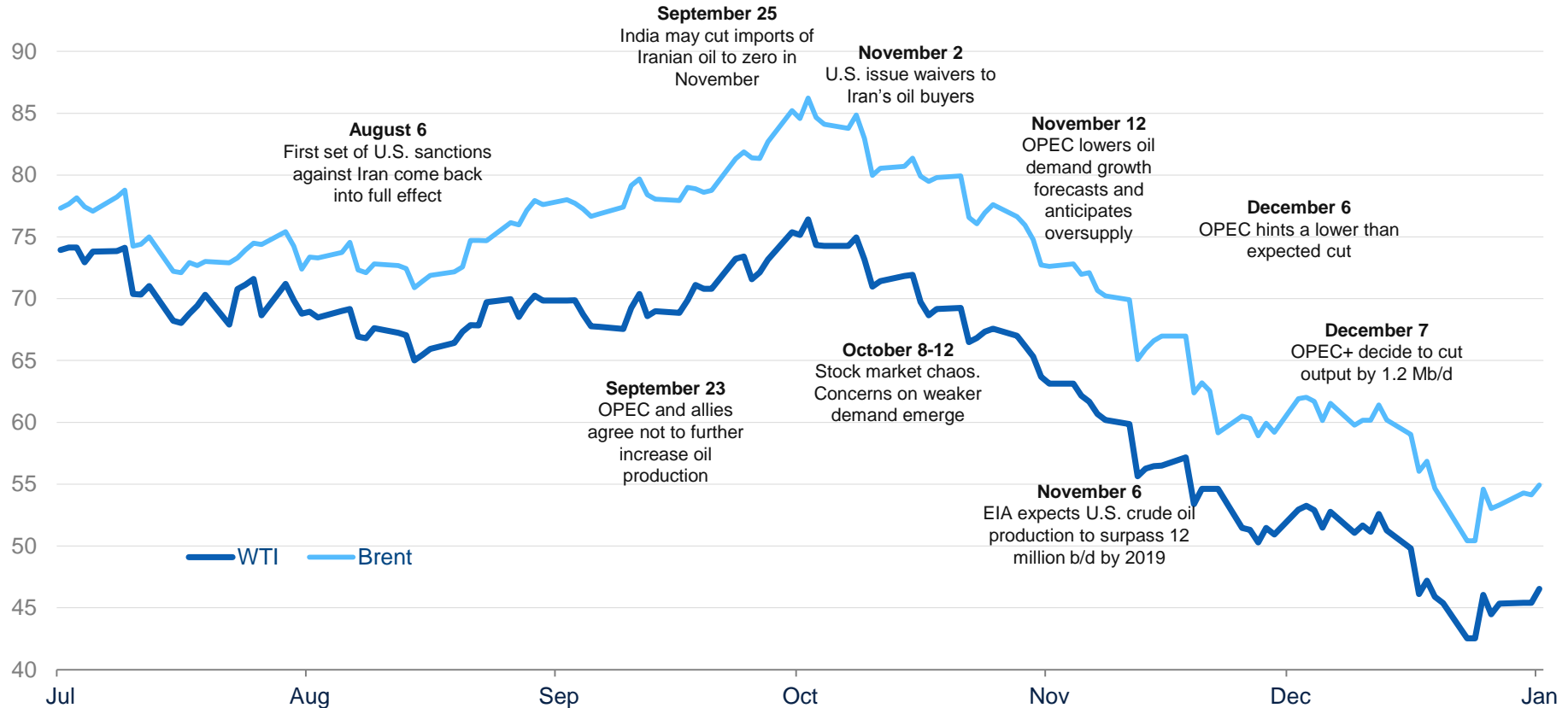
With the muted inflation readings that have been coming in, we will be patient and see how the economy evolves

If we came to the view that the balance sheet normalization plan — or any other aspect of normalization — was part of the problem, we wouldn't hesitate to make a change



# Oil Price Outlook: 30% below their previous peak

## Crude oil prices July to December 2018 (\$ per barrel, 2018)

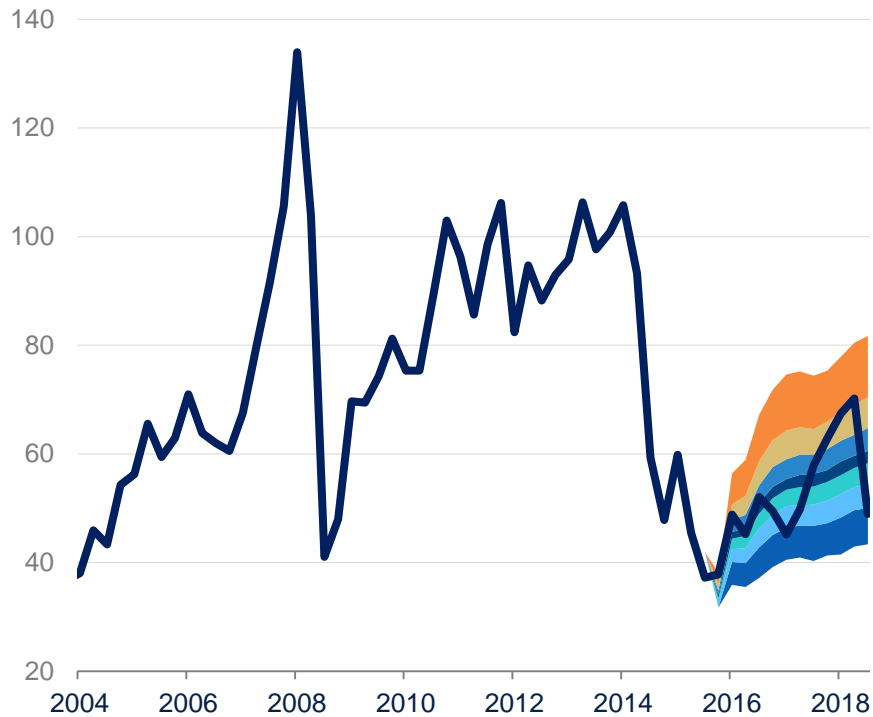


# Oil Price Outlook: Market dynamics

Current dynamics driven by market uncertainty, weaker demand expectations and supply considerations

## Ex-Post Forecasts and Actual West Texas Intermediate Prices

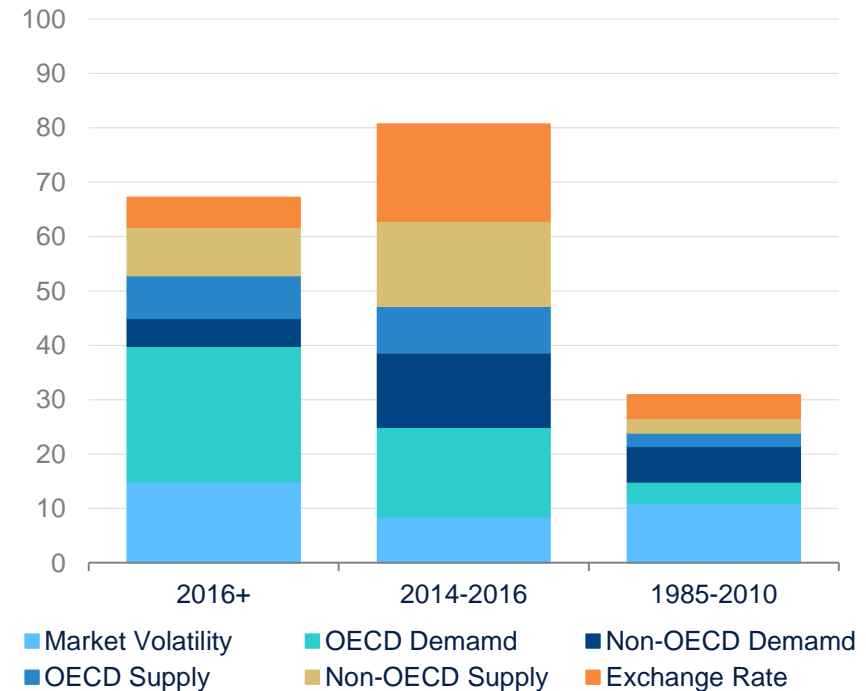
Spot Price \$/barrel



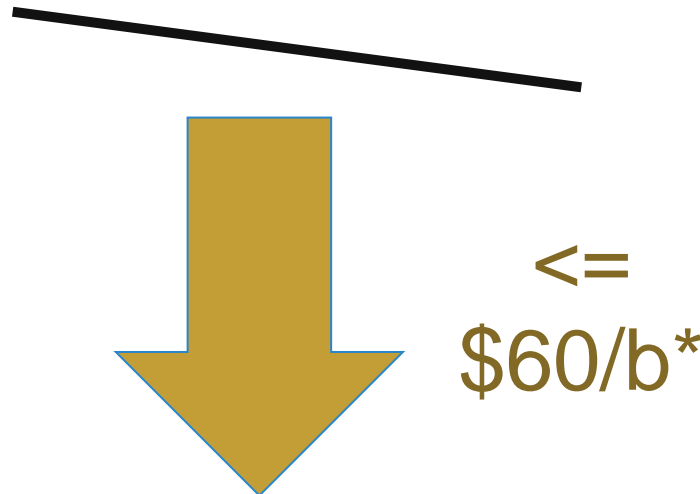
Source: BBVA Research & Haver Analytics

## Oil Price Error Variance Decomposition

% explained



# Oil Price Outlook: Short-term risks are now tilted to the downside



- OPEC+ implements further cuts to production
- U.S. waivers expired and are not renewed
- OPEC+ is perceived incapable of offsetting the gap left by Iran and Venezuela
- Additional negative supply shocks (e.g. Libya, Nigeria)
- Stronger-than-expected global demand
- Takeaway issues prevent U.S. crude to reach global markets

- Weaker global outlook after turbulence in emerging markets (e.g. Turkey, Argentina)
- Escalation of protectionism
- Dollar appreciation
- President Trump's pressure on OPEC
- Limited enforcement of Iranian sanctions
- Higher-than-expected crude oil production in the U.S.

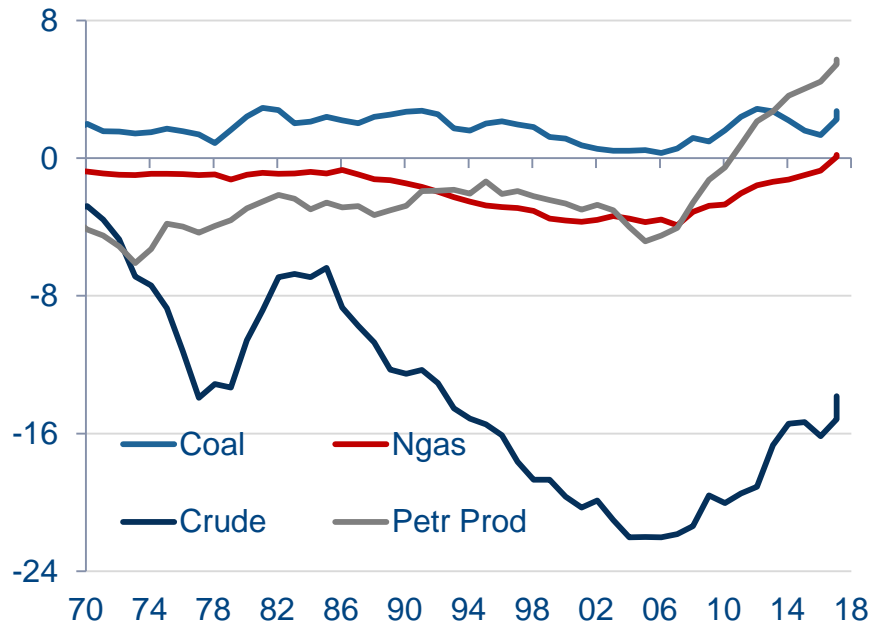
\*Brent crude prices. Source: BBVA Research

# United States of Energy

Impact from changes in energy prices obfuscated by growth in domestic production and the spillovers to other sectors

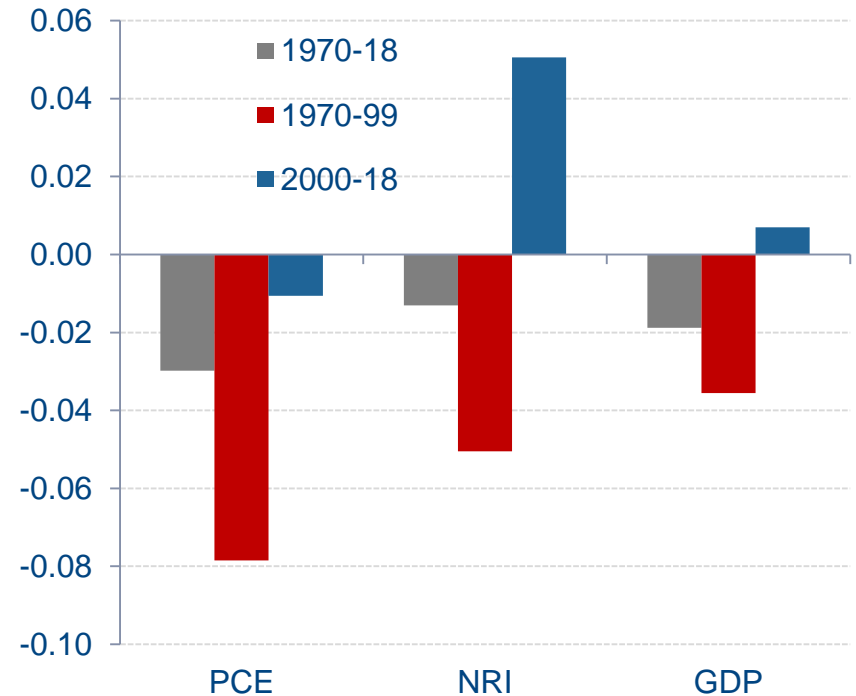
## Primary Energy Trade Balance

Quadrillion Btu



## Impact of Energy Prices on Real Growth

Response to price increase in gasoline (PCE) & Oil (NRI/GDP)



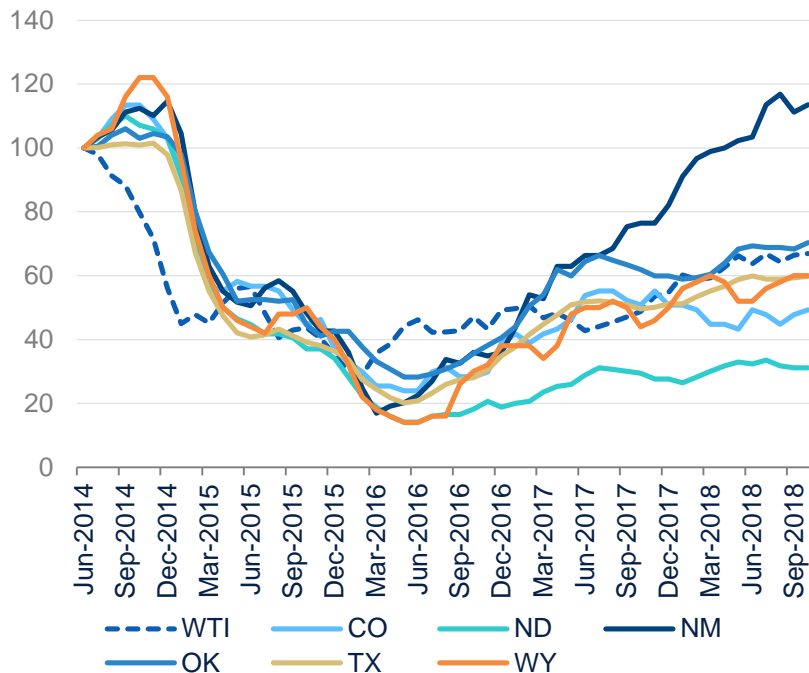
Source: BBVA Research, Haver, Census; 2018 Capex YTD annualized, WTI baseline forecast

# Texas Economic Outlook: O&G impact on economy evolving

Mining sector's sensitivity to oil price changes has declined, as industry shifts to productivity driven model

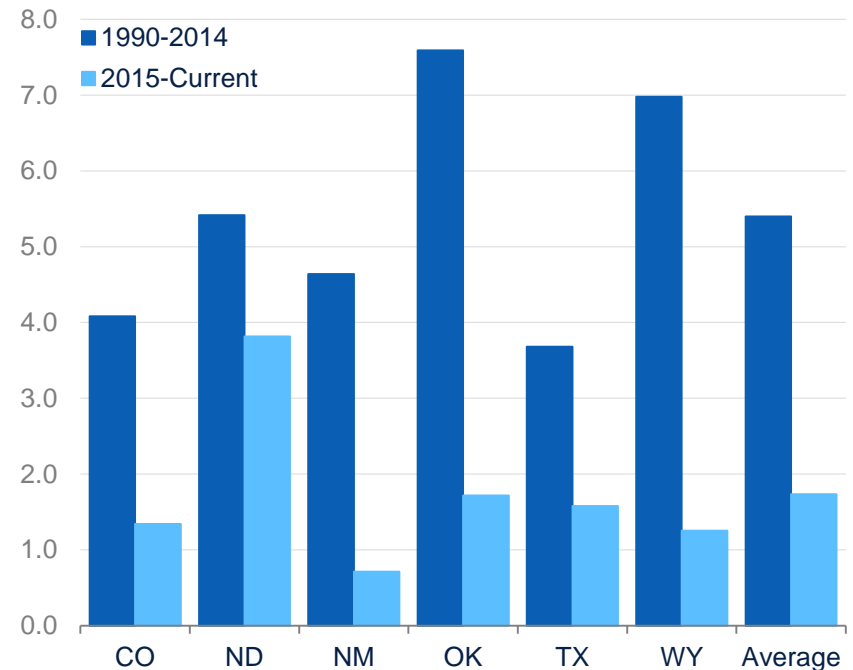
## Oil Prices & State-Level Rig Activity

Index=June-2014, rig activity= 3-month lag



## Mining Employment & Rig Activity Elasticity

%response to 10% increase in Rig Activity

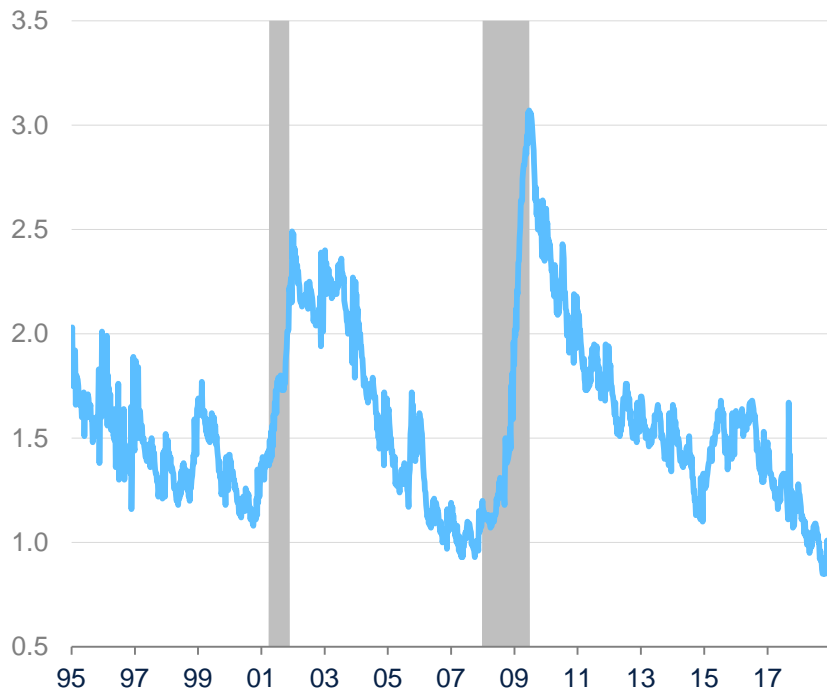


# Texas Economic Outlook: State recession risks

Recession risks in next 12-months remain low despite correction in oil prices and deceleration in U.S. growth

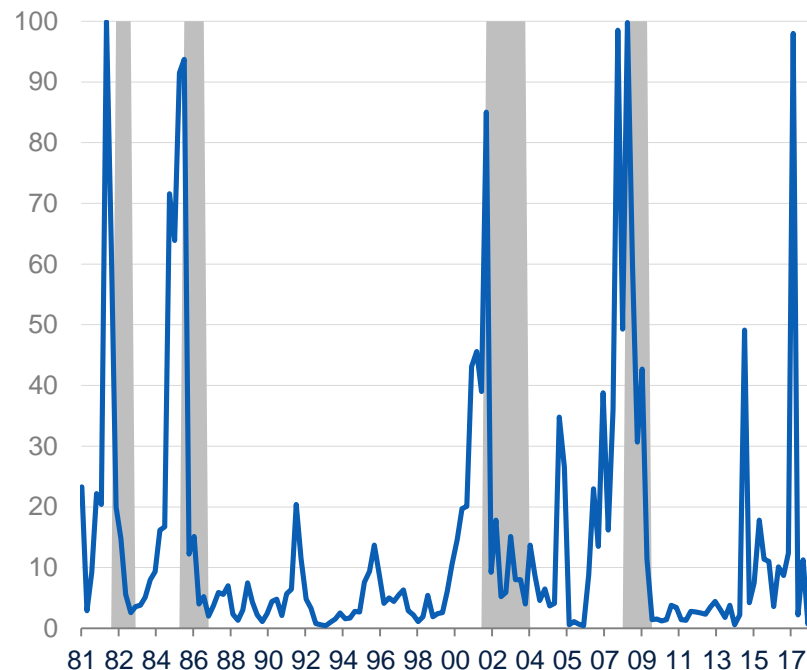
## Insured Unemployment Rate

%, SA



## Texas Recession Risk

Probability of recession within 12-months, %

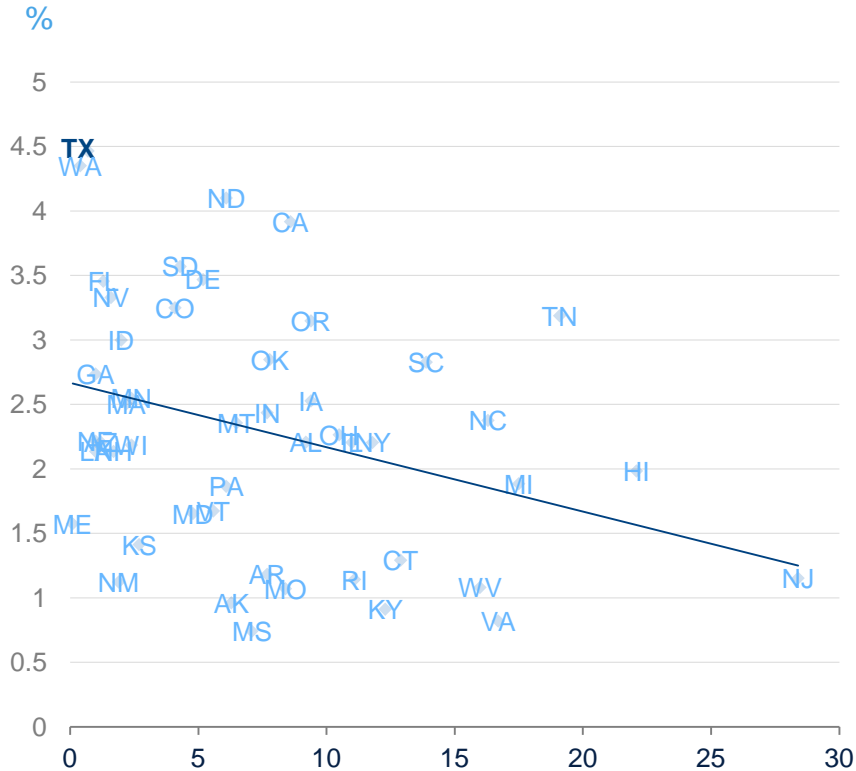


Source: BBVA Research & BLS

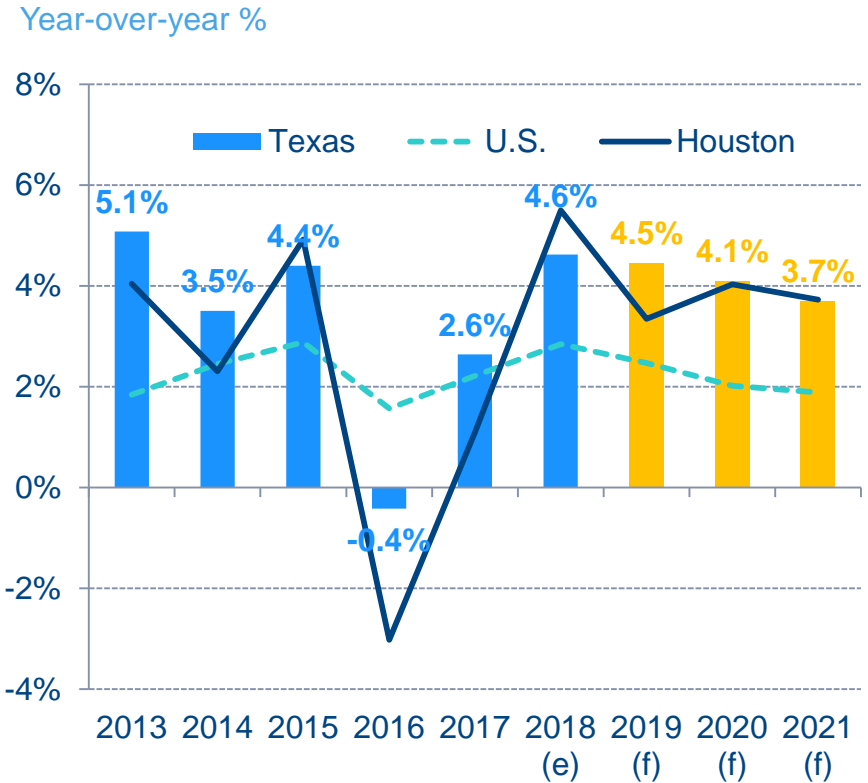
# Texas Economic Outlook: Low risk, high reward

In 2019, Texas and Houston present optimal risk-reward balance

## Growth and Recession Risk



## GDP Growth



Source: BBVA Research

# 2019 Economic Outlook

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