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Econews

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Puerto Rico The Economy

- The first quarter of the year brought with it a new fiscal plan for the Commonwealth. It detailed over \$77 billion in private and public aid. According to the fiscal plan, CDBG-DR funds won't begin to impact the local economy until fiscal 2020, with the majority of the \$16.3 billion spent in the 2021-2023 period. The plan has not been approved by the Fiscal Oversight & Management Board (FOMB), so changes should be expected.
- The Administration is in the process of getting its new tax incentives code adopted by the legislature. No significant details have been released regarding this new code. It's still not known if the proposal has enough votes to pass as it does reduce the incentives offered to some sectors.
- The Commonwealth has also proposed a new municipal structure, essentially transferring some of the responsibilities of the municipalities to new counties. This new structure would operate in between the State government and the municipalities. This proposal is still being discussed and likely faces an uphill battle in the legislature. This is a complex proposal, as the mixing and matching of municipalities and their finances could create even more problems if fiscal issues aren't resolved.

EMPLOYMENT

Total employment (Household Survey) has declined by almost 17,000 since its peak in August of 2018. This is expected post María to be only temporary, as more federal funds are disbursed after July of 2019 (start of fiscal 2020) employment should increase once again.

Nonfarm private salaried employment, which had remained stagnant since hurricane María, has steadily increased reaching 873,700 in February, the highest level since María. The increase is a very positive sign that economic activity continues to accelerate. It's a signal that more businesses

are optimistic about the economic outlook and thus willing to hire.

The unemployment rate continues to be at its lowest point in the past decades at just 8.5% in February of 2018 (seasonally adjusted).

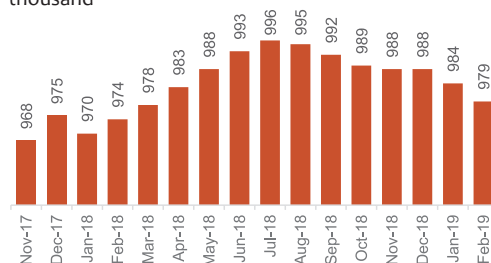
MANUFACTURING

The Purchasing Managers Index (PMI) continued to show an expansion in manufacturing, remaining above its threshold level of 50, in the first months of 2019. Most importantly the New Orders sub-index continues to signal an expansion in manufacturing activity. With the exception of December 2018, the PMI has consistently demonstrated an expansion in manufacturing activity, further evidence that the economy continues to recover.

Employment in the sector has recovered to its pre-María level, yet still below its 2016 annual average of 73,400. At this time, it's difficult to say if manufacturing employment will increase further, it is unlikely that it will reach the 80,000-90,000 level of the 2009-2011 period.

Total Employment

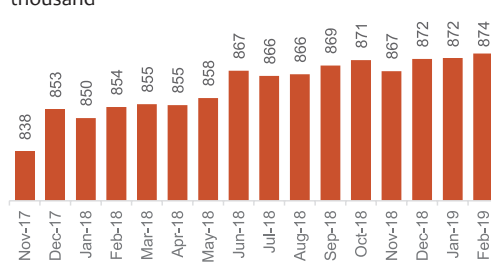
thousand



Source: P.R. Department of Labor, Household Survey.

Private Non Farm Employment

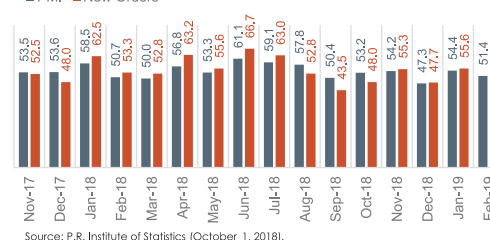
thousand



Source: P.R. Department of Labor, Establishment Survey.

Purchasing Managers Manufacturing Index

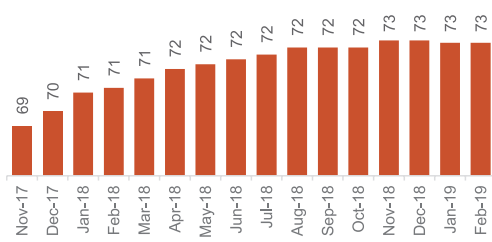
■ PMI ■ New Orders



Source: P.R. Institute of Statistics (October 1, 2018).



Manufacturing Employment



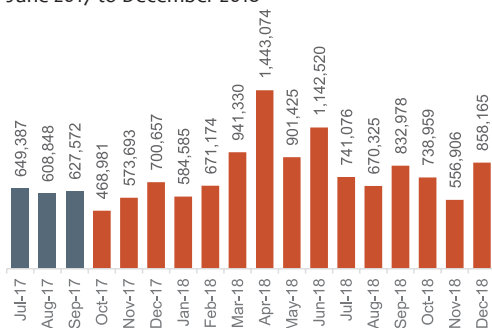
Source: P.R. Department of Labor, Establishment Survey.

FISCAL REVENUES

Fiscal revenue reporting is behind schedule, as the most recent data is up to December 2018. Revenues continue to be very positive, and \$769.3 million above their fiscal 2018 level for the same period. Income taxes and SUT have seen significant increases in the first half of the fiscal year 2019 as compared to fiscal 2018.

Net Revenues to the General Fund

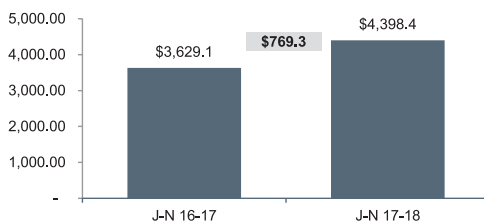
June 2017 to December 2018



Source: Departamento de Hacienda (December 2018).

Net Revenues to the General Fund

December fiscal 2018 & 2019



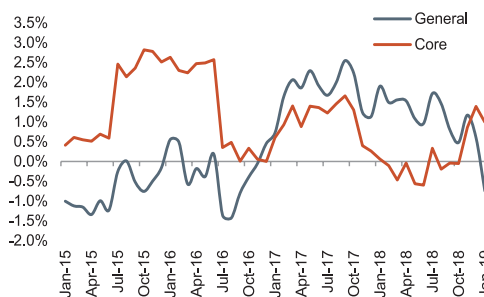
Source: P.R. Treasury Department.

INFLATION

General inflation (CPI) has continued its downward trend since hurricane Maria. Core inflation, however, has ticked upward in December and January. Inflation isn't expected to increase again until more federal funds enter the local economy in fiscal 2020.

Headline and Core Inflation

(December 2006 = 100)



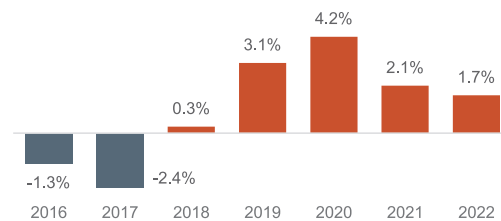
Sources: P.R. Department of Labor; Estudios Técnicos, Inc.

SHORT-TERM OUTLOOK

For the remainder of fiscal 2019, economic trends are expected to continue their current path, with slightly higher employment, low inflation, and higher fiscal revenues. Meanwhile the Administration will continue to pursue its incentives and municipal restructuring proposals. A confrontation is expected between the FOMB and the Administration in summer, as pension cuts are slated to go into effect.

Fiscal 2020 is likely to bring several challenges, including pension reform and the first large disbursements of CDBG-DR funds. The Commonwealth needs to spend these funds in a way that not only promotes long-term economic growth but also mitigates the short-term effects of budget and pension cuts. For these reasons Estudios Técnicos, Inc has reduced its growth forecast for the Puerto Rico economy in 2019 and 2020, with federal funds now likely to be spent over a longer period than originally anticipated.

Real GNP Growth



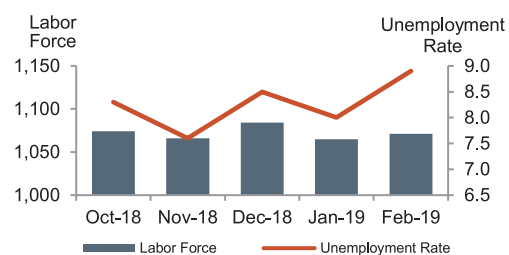
Source: PR Planning Board (2019). 2017 Statistical Appendix [Table 1]. Estimates by Estudios Técnicos, Inc. (January 16, 2019).

Puerto Rico Economic Indicators

Employment

	Dec-18	Jan-19	Feb-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
Labor Force (Household Survey, thousands)	1,084	1,065	1,071	-0.7%	-1.7%
Employment (Establishment Survey)	897	867	872	1.5%	2.8%
Private	691	665	669	3.5%	5.1%
Construction	29	26	27	20.9%	16.0%
Manufacturing	74	73	73	3.0%	3.8%
Public Administration	205	202	202	-4.5%	-4.0%
Unemployment Rate (Household survey, %)	8.5	8.0	8.9	-19.8%	-18.4%

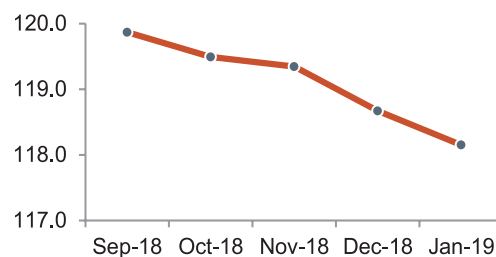
Total Employment
(December 2006 = 100)



Consumer Price Index

	Nov-18	Dec-18	Jan-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
All Items	119.3	118.7	118.2	0.8%	-0.7%
Food & Beverages	130.3	130.5	130.4	0.5%	-1.4%
Housing	113.4	113.6	113.3	0.2%	0.0%
Apparel & Upkeep	86.8	88.2	85.9	-2.5%	-2.1%
Transportation	112.7	109.2	107.2	0.8%	-4.0%
Medical Care	154.1	154.0	154.1	1.7%	1.6%
Education	117.5	117.4	117.6	2.4%	3.0%
Recreation	113.2	113.1	112.8	-0.5%	-0.2%
Other Services	124.6	125.0	126.5	2.9%	3.4%

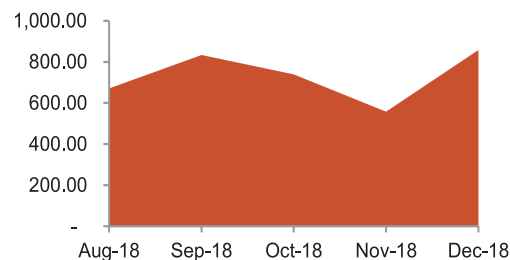
Consumer Price Index



Fiscal Revenues

	Oct-18	Nov-18	Dec-18	Fiscal Year 2017-2018	Percent Change Accumulated year to date
Total Revenues (Mill.\$)	739.0	556.9	858.2	-0.2%	12.1%
Taxes	697.4	531.3	805.4	0.3%	12.2%
Income Taxes	407.7	235.9	525.8	3.5%	17.6%

Net Revenues to the General Fund

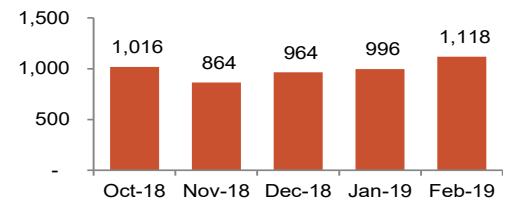


Puerto Rico Economic Indicators

Construction

				Percent Change	
	Dec-18	Jan-19	Feb-19	Fiscal Year 2018-2019	Accumulated year to date
Cement Production (Thousand 94-lb Bags)	964	996	1,118	40.8%	-3.1%
Cement Sales (Thousand 94-lb Bags)	1,002	1,068	1,118	39.3%	-1.0%

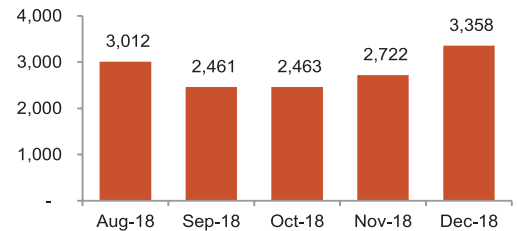
Cement Production



Retail

				Percent Change	
	Oct-18	Nov-18	Dec-18	Fiscal Year 2017-2018	Accumulated year to date
Total (Bill. \$)	2,463	2,722	3,358	15.5%	10.19%
Department Stores (Mill. \$)	837	919	990	22.8%	9.65%
Supermarkets (Mill. \$)	282	283	309	13.5%	4.67%
Used and New Autos (Mill. \$)	424	534	768	5.3%	17.53%
Gasoline Stations (Mill. \$)	154	161	174	68.7%	24.61%
Restaurants (Mill. \$)	158	157	175	13.2%	-5.00%

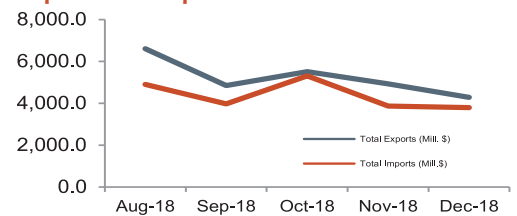
Retail Sales



Exports and Imports

				Percent Change	
	Oct-18	Nov-18	Dec-18	Fiscal Year 2017-2018	Accumulated year to date
Total Exports (Mill. \$)	5,515.7	4,927.4	4,285.5	-14.8%	-2.6%
Foreign Countries	1,194.5	1,118.4	873.2	-23.7%	8.2%
Total Imports (Mill. \$)	5,311.1	3,869.3	3,795.1	-0.8%	27.2%
Foreign Countries	2,701.4	1,950.9	2,035.3	-3.7%	40.7%

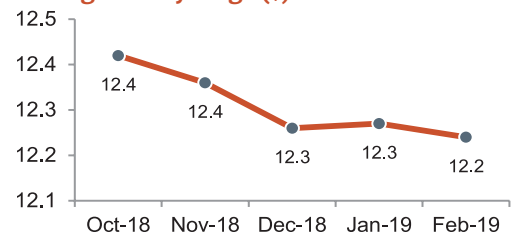
Exports and Imports



Manufacturing

				Percent Change	
	Dec-18	Jan-19	Feb-19	Fiscal Year 2018-2019	Accumulated year to date
Weekly Hours (#)	38.8	38.4	38.9	-0.2%	2.5%
Average Hourly Wage (\$)	12.3	12.3	12.2	-1.4%	-0.3%

Average Hourly Wage (\$)

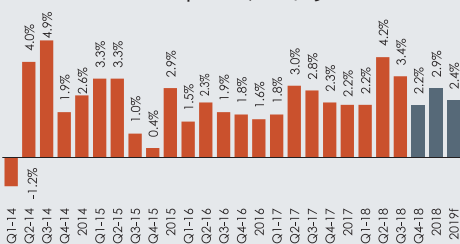


United States The Economy

- The year 2019 opened with the federal government shutdown, which lasted longer than expected and had a negative effect on consumer expectations, and on Wall Street. 2018 ended with the economy growing at 2.9%, from 2.2% in 2017. 2.2% in the fourth quarter. Real GDP growth in the first quarter is expected to be at 1.5%, weighted down by the federal government's partial shutdown.
- Still, the U.S. economy continues in good health, with employment increasing at a good pace, unemployment below 4.0%, and inflation low.
- Consumers' confidence in the first quarter fell, after an upbeat fourth quarter. The decrease in the first quarter is attributed mainly to the federal government partial shutdown. In February it went up, but decreased again in March, as the Expectations Index – based on consumers' short-term outlook – decreased, reflecting a less positive assessment of the labor market.
- Consumers' confidence is also affected by the impact of Trump administration trade policies and tariffs. A recent study by the Federal Reserve Bank of New York, Princeton and Columbia universities respectively, found that these policies are costing U.S. consumers \$1.4 billion per month as these tariffs are passed through to domestic consumers, reducing U.S. income.¹

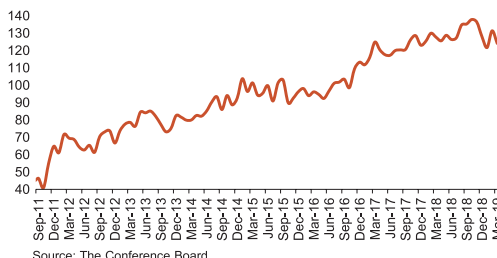
Quarterly U.S. GDP

Real Growth and Expected, 2014-19



Sources: U.S. Bureau of Economic Analysis; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters (March 22, 2019). Seasonally adjusted at annual rates. f = Forecast.

U.S. Consumer Sentiment Index



PRODUCTION

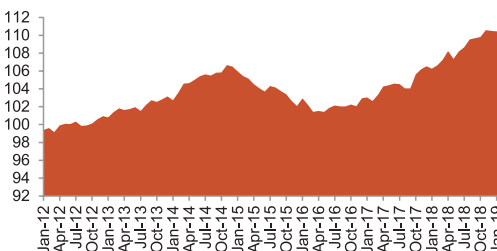
Both, industrial production and manufacturing capacity registered increases during the first two months of Q1-19.

The Fed's industrial production index increased at 3.8% y/y, but remained unchanged m/m. There were mixed results in manufacturing production: the output of durable goods decreased, while computers and miscellaneous transportation equipment saw gains.

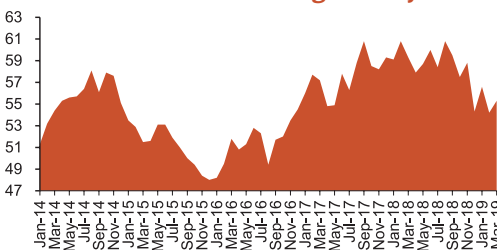
Capacity utilization for manufacturing increased 1.3% y/y, but decreased -0.5% m/m, reflecting losses for durable and nondurable goods.

U.S. Industrial Production Index

(2012=100)



ISM Index of Manufacturing Activity



As to manufacturing activity, it continued to grow, according to the Institute for Supply Management's (ISM) index. Manufacturing expanded in March, as the index registered a reading of 55.3 from 54.2 in February, as

employment increased, and new orders and production improved. Although it has remained above its threshold value of 50 for over 30 months (indicating expansion in the sector), it decreased 7.3% y/y, averaging 55.4. Activity is increasing but at a slower pace, from a high of 60.8 in September 2017. The ISM's survey for March indicates that manufacturing activity should continue to expand, notwithstanding steel tariffs and the trade war with China.²

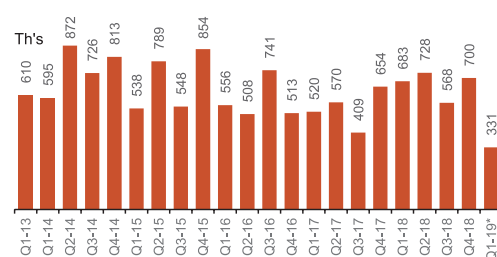
EMPLOYMENT

Employment growth (Nonfarm payroll employment) slowed down during the first two months, to 331,000 from 501,000 in same months last year, and from 700,000 in Q4-18. The decline reflects, in part, the return of federal workers due to the partial government shutdown. Overall, employment in professional and business services, health care, and wholesale trade continued to trend up, with manufacturing registering an increase of 25,000.

The unemployment rate averaged 3.9% during the first two months of the first quarter, from 4.1% in same period in 2018, and is estimated to be 3.7% in 2019, thus, suggesting stronger growth in employment. The employment-population rate (the proportion of those 16-64 years old employed), remained at practically the same level in the first quarter, 60.7% from 60.6% in the previous quarter.

Monthly Changes in Employment

(Seasonally Adjusted - Thousands)



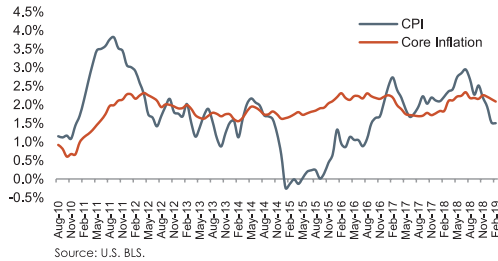
INFLATION

Headline inflation (CPI) eased down during the first two months of the first quarter, to an average of 1.5%, from 2.2% in Q4-18 and 2.4% in 2018. Slower increases in energy prices contributed to the slower growth, although food prices have been on the rise. Headline inflation is expected to rise to 2.0% in 2019, and core inflation (excluding Food and Energy) to 2.4%, from 2.4% and 2.1% respectively in 2018.³

INTEREST RATES

Annual Percent Change in CPI

(Y/y, seasonally adjusted)

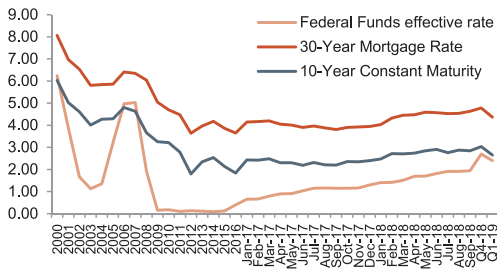


Source: U.S. BLS.

On December 18th, the Federal Open Market Committee raised the fed funds rate to 2.5%. At that time, and at their last meeting in March, the FOMC indicated that they do not expect to increase this interest rate in the future, contrary to what was expected last year. The Fed is now more concerned about the slower growth expectations. On the other hand, since the Fed is no longer replacing the securities it owns, it will create more supply in the Treasury's bonds, which should raise the yield on the 10-year note, driving up long-term interest rates, such as those on fixed-rate mortgages.

Selected Interest Rates

(Annual and monthly averages)



Source: U.S. Federal Reserve Bank of St. Louis (FRED).

U.S./GLOBAL OUTLOOK

In its most recent world economic outlook, as reported previously, the World Bank lowered its previous economic growth forecasts, from a downwardly revised 3.0% in 2018 to 2.9% in 2019, amid rising downside risks to the outlook.⁴ Growth is weakening

particularly in Europe, with China's economy slowing down, and the wider impact of a trade war between the U.S. and China, which figures among the top ten global risks. The OECD (Organization for Economic Cooperation and Development) cut its economic forecast in March, warning of downside risks.⁵

For the U.S., economic growth is expected to slow down this year, to 2.4%, from 2.9% in 2018, according to the Survey of Professional Forecasters, as effects from fiscal stimulus measures wane, and with weaker global growth and tariffs as the key constraints.⁶ For this first quarter real GDP growth forecasts point to a lower 1.5%, with the government shutdown and winter storms affecting growth, but higher growth in the second quarter of 2.4%.⁷ A US/China trade deal is expected this year, which could help to improve the outlook. Nevertheless, the WTO (World Trade Organization) expects world trade to continue downward in 2019 and 2020.⁸

World Economic Growth: Historic and Outlook

2016 - 2021

	2016	2017	2018e
World GDP	2.4%	3.1%	3.0%
Advanced Economies	1.7%	2.3%	2.2%
Euro Zone	1.9%	2.4%	1.9%
U.S.	1.6%	2.2%	2.9%
Emerging Economies	3.7%	4.3%	4.2%
China	6.7%	6.9%	6.5%
Latin America & Caribbean	-1.5%	0.8%	0.6%

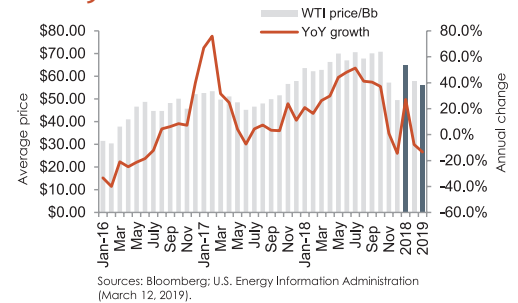
	Forecasts		
	2019f	2020f	2021f
World GDP	2.9%	2.8%	2.8%
Advanced Economies	2.0%	1.6%	1.5%
Euro Zone	1.6%	1.5%	1.3%
U.S.	2.5%	1.7%	1.6%
Emerging Economies	4.2%	4.5%	4.6%
China	6.2%	6.2%	6.0%
Latin America & Caribbean	1.7%	2.4%	2.5%

Source: World Bank (2019). Global Economic Prospects January 8, 2019.

Table 1.1, e = Estimate f = Forecast

The price of oil (West Texas Intermediate, WTI) continued its downward trend in the first quarter, averaging \$58.08/Bb, from an average of \$64.82/Bb in 2018 as the oil market is still responding to the impact of U.S. shale production. For this year, the U.S. Energy Information Administration estimated that the average price will be lower, \$56.13/Bb, which will be good news in the inflation front.⁹

Recent Evolution of WTI Prices and Expected for 2019



Sources: Bloomberg; U.S. Energy Information Administration (March 12, 2019).

Notes:

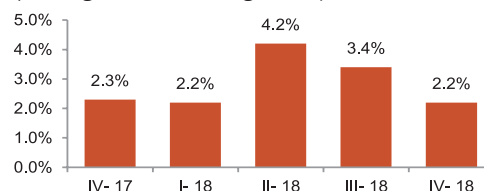
1. Thomas Franck (2019). Trump tariffs costing US consumers \$1.4 billion per month, study shows, CNBC – Trade (March 26, 2019). At: <https://www.cnbc.com/2019/03/26/ny-fed-trump-tariffs-costing-us-consumers-1point4-billion-per-month.html>.
2. Institute for Supply Management (2019) March 2019 Manufacturing ISM (April 1, 2019). At: <https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm?navitemNumber=31128>.
3. Federal Reserve Bank of Philadelphia (2019). Survey of Professional Forecasters, First Quarter 2019 (March 22, 2019). At: <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters/2019/survq119>.
4. The World Bank (2019). Darkening Prospects: Global Economy to Slow to 2.9 percent in 2019 as Trade, Investment Weaken (January 8). At: <http://www.worldbank.org/en/news/press-release/2019/01/08/darkening-prospects-global-economy-to-slow-to-29-percent-in-2019-as-trade-investment-weaken>.
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6. Federal Reserve Bank of Philadelphia (2019). Survey of Professional Forecasters, First Quarter 2019 (March 22, 2019). At: <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters/2019/survq119>.
7. Federal Reserve Bank of Philadelphia (2019). Survey of Professional Forecasters, First Quarter 2019 (March 22, 2019). At: <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters/2019/survq119>.
8. Bryce Baschuck (2019). Tariff War Will Harm Global Trade Growth This Year, WTO Says, Bloomberg News – Economics (April 2, 2019). At: <https://www.bloomberg.com/news/articles/2019-04-02/wto-says-tariff-war-will-harm-global-trade-growth-this-year?srnd=premium>.
9. U.S. Energy Information Administration (2019). Short-Term Energy Outlook (March 12, 2019). At: <https://www.eia.gov/outlooks/steo/>.

United States Economic Indicators

GDP

	I- 18	II- 18	III- 18	IV- 18
GDP (% Change From Preceding Period)	2.2	4.2	3.4	2.2
Private Consumption	0.5	3.8	3.5	2.5
Fixed Investment	8.0	6.4	1.1	3.1
Residential	-3.4	-1.3	-3.6	-4.7
Non-Residential	11.5	8.7	2.5	5.4
Government Spending	1.5	2.5	2.6	-0.4
Exports	3.6	9.3	-4.9	1.8
Imports	3.0	-0.6	9.3	2.0

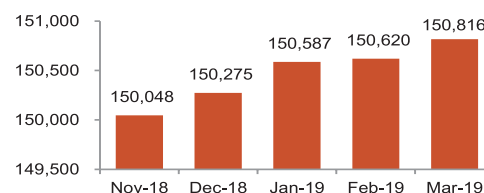
Gross Domestic Product (% Change From Preceding Period)



Employment

	Dec-18	Jan-19	Feb-19	Mar-19
Employees on Non-Farm Payrolls (SA) (Thousands)	150,275	150,587	150,620	150,816
Change (%)	0.2%	0.2%	0.0%	0.1%
Goods Producing	20,961	21,041	21,013	21,025
Change (%)	0.2%	0.4%	-0.1%	0.1%
Service Industries	129,314	129,546	129,607	129,791
Change (%)	0.1%	0.2%	0.0%	0.1%

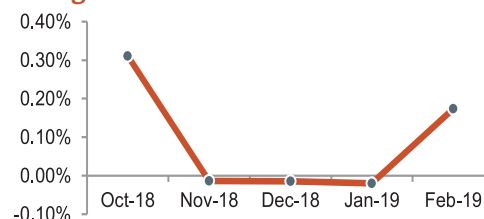
Employees on Non-Farm Payrolls (In thousands)



Consumer Price Index

	Nov-18	Dec-18	Jan-19	Feb-19
CPI - All Urban Consumers (1984=100)				
Change from preceeding month	0.0%	0.0%	0.0%	0.2%
Change from preceeding year	2.2%	1.9%	1.5%	1.5%
CPI - Less Food and Energy				
Change from preceeding month	0.2%	0.2%	0.2%	0.1%
Change from preceeding year	2.3%	2.2%	2.1%	2.1%

Change in CPI



Interest Rates

	Dec-18	Jan-19	Feb-19	Mar-19
Effective Federal Funds	2.27	2.40	2.40	2.41
Three Month Treasury Bill (Constant Maturity Rate)	2.37	2.37	2.39	2.40
Prime Rate	5.35	5.50	5.50	5.50
Ten Year Treasury Bond	2.83	2.71	2.68	2.57
Moody's Seasoned Aaa Rate	4.02	3.93	3.79	3.77
30-Year Conventional Mortgage Rate	4.64	4.46	4.37	4.27

Selected Interest Rates (3month T Bills)

