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Econews

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Puerto Rico The Economy

- As of Q4-19, the economy, on balance, had recovered from Hurricane María. The performance of key indicators, such as private employment, unemployment rate, construction employment, retail sales, commercial banks assets, net income and deposits, new residential mortgage originations, net revenues to the General Fund, inflation, point in that direction, albeit at a slower pace in some cases, like private employment and manufacturing activity.
- The key issue, though, continued to be federal recovery funds and the pace of disbursements. Since the first semester of 2019 it became obvious that the expected inflows of funds were not proceeding as expected, tempering optimistic estimates, such as those of the Financial Oversight and Management Board in their Certified Fiscal Plan of May 2019.
- As of December 5th, a total of \$15.0 billion were outlayed/dispensed, that is, only 34% of the total \$44.3 funds allocated for Puerto Rico, of which 86% came from FEMA. Those under the CDBG-DR funding, which account for 46% of the total funds allocated, have had the slowest pace in disbursement. A \$5.7 billion allocation in additional Medicaid funds was approved in the U.S. House of Representatives in December.

Disaster Funds Allocated, Obligated, and Outlayed for Puerto Rico (As of December 5, 2019)*

Funds	Announced / Allocated	Obligated	Outlayed/Disbursed
FEMA	\$16,235.7	\$16,172.9	\$12,870.4
Public Assistance & Mitigation	\$6,060.7	\$6,010.5	\$3,993.6
Individual Assistance	\$2,450.3	\$2,450.3	\$2,274.0
Community Disaster Loans, Operations, and Administration	\$7,724.8	\$7,712.2	\$6,602.8
Corps of Engineers—Civil Works	\$2,533.4	\$58.1	\$24.4
Small Business Administration	\$1,987.3	\$1,987.3	\$1,258.1
Community Planning and Development (CDBG-DR)	\$20,222.6	\$1,507.2	\$5.7
A- Emergency PL 115-56	\$1,507.2	\$1,507.2	\$5.7
C- Emergency PL 115-123	\$18,438.4	\$0.0	\$0.0
CDBG-DR (December 2019)	\$277.0	\$0.0	\$0.0
Subtotal:	\$40,979.0	\$19,725.5	\$14,158.6
Other funds/programs	\$3,302.2	\$2,271.2	\$854.4
Total:	\$44,281.2	\$21,996.7	\$15,013.0

Sources: FEMA (2020), RSFLG-PMO-November 2019 - Financial Data (January 2020); Other sources/reports. * Includes Hurricane Irma.

EMPLOYMENT

After reaching a high of 1.0 million in August, total employment (Household Survey) trended down, averaging 987,000 in November. Still, it was up 0.4% y/y from the same period in 2018.

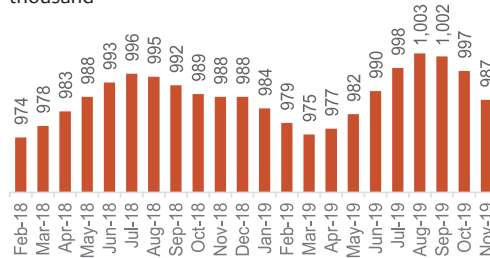
Private salaried employment (Seasonally adjusted) was up by 0.8% in the quarter (October-November), with major gains in educational and health services,

leisure and hospitality, and construction. On the other hand, employment in professional and business services, and retail trade, registered decreases. The level, though, has remained almost stagnant, and growth has slowed down, from the high of 4.5% y/y in the first quarter of 2019.

The unemployment rate fell to 7.8%, from 8.4% in Q4-18, as the number of those in the labor force decreased, with

Total Employment

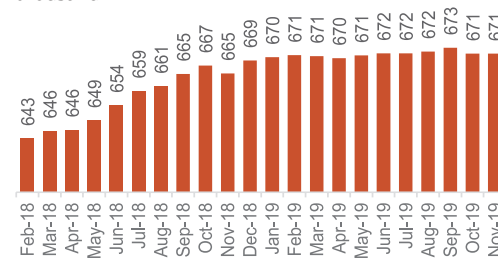
thousand



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

Private Salaried Non-Farm Employment

thousand



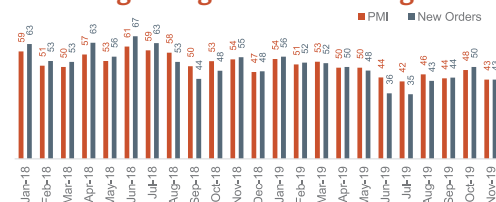
Source: P.R. Department of Labor, Establishment Survey.



the participation rate averaging 40.2%, almost unchanged since January 2019. The employment rate (the proportion of the population 16-64 years old employed) was 36.7%, the same as in Q4-19.

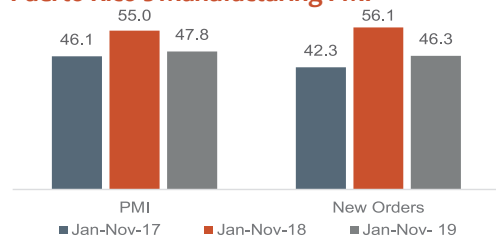
MANUFACTURING

Purchasing Managers Manufacturing Index



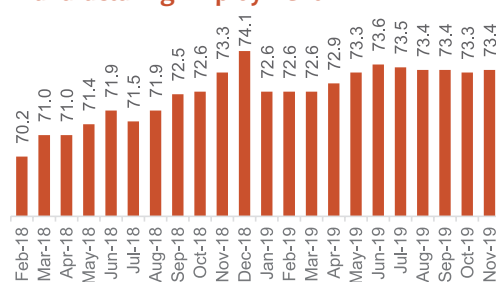
Source: Puerto Rico Institute of Statistics.

Puerto Rico's Manufacturing PMI



Source: Puerto Rico Institute of Statistics.

Manufacturing Employment



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

Manufacturing activity, according to its PMI, remained on the downside, with the index averaging 45.8, from 53.7 during the first two months of Q4-19, a 15.0% decrease y/y, and below its threshold level of 50. A high of 54.4 was reached in January 2019. Its New Orders Sub Index, which points to activity in the coming months, fell to 46.6 from 52.0 in Q4-18. With the exception of October, the New Orders Sub Index has also been below the expansion level of 50 since March 2019. On an accumulated basis (up to November), the PMI index was 13.1% and its New Orders Sub Index 17.5% below their levels in 2018. What the above suggests is a contraction on manufacturing activity.

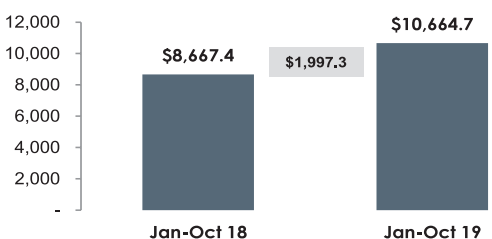
Salaried employment in the sector increased 0.5% during the first two months

of Q4-19, to 73,400, a level that has remained almost unchanged since May of 2019. On an accumulated basis (up to November), employment rose 2.2% y/y. Jobs increased in non-durable goods but decreased in durable goods.

FISCAL REVENUES

In October (as of the date of this note there is no complete information for the quarter), net revenues to the General Fund increased 19.3% y/y, led by an increase in receipts from corporate income taxes. Since January, receipts increased 23.0% by almost \$2.0 billion. Again, receipts from corporate income taxes were mainly responsible for the increase, as receipts from Law 154 decreased 2.5% y/y, and from the Sales and Use Tax also fell by 2.5% y/y.

Net Revenues to the General Fund

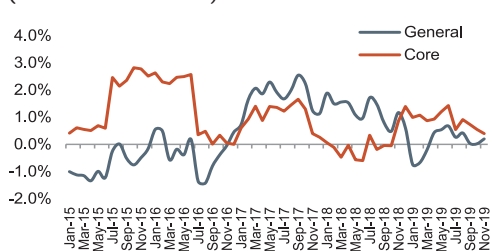


Source: P.R. Treasury Department.

INFLATION

Headline and Core Inflation

(December 2006 = 100)



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

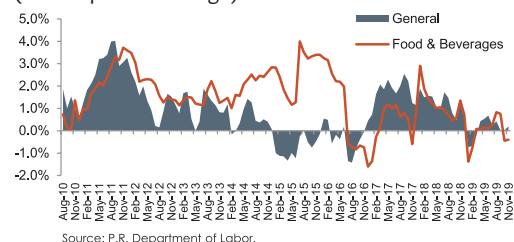
General inflation (CPI) continued to remain on the low side, with the CPI increasing at an annual average rate of 0.1% during the first two months of Q4-19. On an accumulated basis (up to November) general inflation was up at a moderate rate of 0.1%, lower than the rate of 1.2% in 2018.

Core inflation (excludes food and energy prices) rose at an annual rate of 0.5% in the two months of Q4-19, led by an increase of 1.7% in private transportation costs. So far this year (up to November), core inflation has been trending higher than general inflation at 0.9%, which

indicates that inflation is creeping into other sectors of the economy.

Food Price and Economy-Wide Inflation

(Annual percent change)



Source: P.R. Department of Labor.

SHORT-TERM OUTLOOK

The year 2019 ended with some positive notes with respect to general economic indicators, but also left unsolved key economic and policy challenges.

The issues facing the economy include: an incoming new governor, an electoral year 2020, uncertainty as to the pace of disbursements of the federal funds for reconstruction two years after Hurricane María, the policy alternative to replace Law 154, and the pace of economic growth in the Mainland slowing down (see the section on the U.S. in this report).

Year 2020 could be a continuation of the same condition prevailing in 2019 and a period of uncertainty.

Reviewing a seminal report done by Estudios Técnicos in 2016 (Puerto Rico: 2016 – 2030), we observe that several of the key challenges then identified still remain relevant looking forward, all of which are still relevant: 1. Policy reforms will be indispensable to achieve economic growth; 2. The recovery path will likely extend beyond 2030; 3. Population will continue to decrease and will be older; 4. Government spending will be less, and; 5. Restructuring of the high level of public indebtedness is a must, all these in the context of an expected slowing in global economic growth in 2020.¹

The slowing in the pace of growth of private salaried employment, and the PMI remaining below its expansion level, as mentioned before, are red flags to be watched at the beginning of 2020.

Notes:

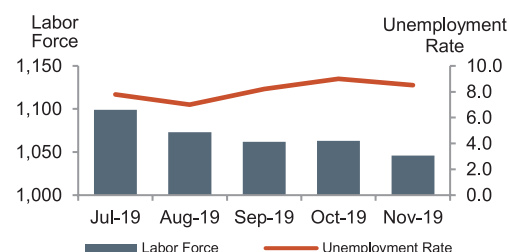
1. The World Bank (2020). Global Growth: Modest Pickup to 2.5% in 2020 Amid Mounting Debt and Slowing Productivity (January 8, 2020). At: <https://www.worldbank.org/en/news/press-release/2020/01/08/modest-pickup-in-2020-amid-mounting-debt-and-slowness-productivity-growth>.

Puerto Rico Economic Indicators

Employment

	Sep-19	Oct-19	Nov-19	Percent Change Fiscal Year 2018-2019	Percent Change Accumulated year to date
Labor Force (Household Survey, thousands)	1,062	1,063	1,046	-0.6%	-0.9%
Employment (Establishment Survey)	872	875	883	1.6%	1.6%
Private	669	671	679	3.5%	2.9%
Construction	27	27	27	16.8%	7.7%
Manufacturing	73	74	74	2.7%	2.1%
Public Administration	203	203	204	-4.2%	-2.4%
Unemployment Rate (Household survey, %)	8.2	9.0	8.5	-17.8%	-11.4%

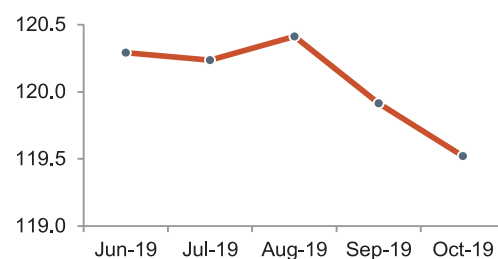
Total Employment
(December 2006 = 100)



Consumer Price Index

	Aug-19	Sep-19	Oct-19	Percent Change Fiscal Year 2018-2019	Percent Change Accumulated year to date
All Items	120.4	119.9	119.5	0.5%	0.1%
Food & Beverages	131.7	131.6	130.2	0.2%	0.0%
Housing	114.6	114.8	114.9	0.3%	0.6%
Apparel & Upkeep	86.6	86.2	86.6	-1.8%	-1.1%
Transportation	113.6	111.2	111.4	-0.5%	-2.1%
Medical Care	155.2	155.2	155.1	1.6%	1.3%
Education	118.3	118.3	118.5	2.6%	2.1%
Recreation	114.0	113.8	113.9	-0.2%	0.3%
Other Services	125.9	126.5	124.9	3.2%	2.6%

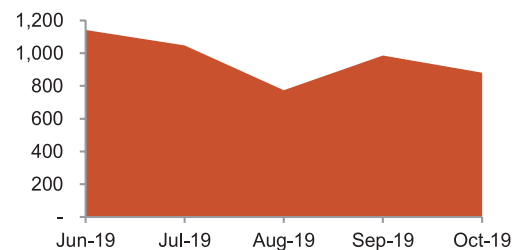
Consumer Price Index



Fiscal Revenues

	Aug-19	Sep-19	Oct-19	Percent Change Fiscal Year 2018-2019	Percent Change Accumulated year to date
Total Revenues (Mill.\$)	773.64	985.49	881.58	22.1%	23.0%
Taxes	715.7	935.4	837.0	21.8%	23.0%
Income Taxes	391.5	654.2	557.5	22.1%	30.2%

Net Revenues to the General Fund

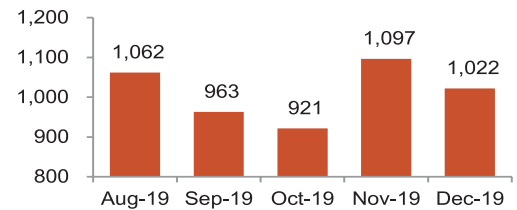


Puerto Rico Economic Indicators

Construction

	Oct-19	Nov-19	Dec-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
Cement Production (Thousand 94-lb Bags)	921	1,097	1,022	13.9%	-6.7%
Cement Sales (Thousand 94-lb Bags)	1,256	1,084	1,035	16.9%	-5.6%

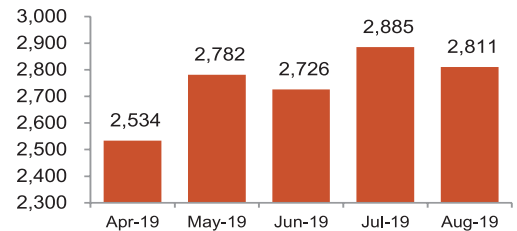
Cement Production



Retail

	Jun-19	Jul-19	Aug-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
Total (Bill. \$)	2,726	2,885	2,811	1.5%	-3.8%
Department Stores (Mill. \$)	1,000	1,139	1,027	2.2%	3.0%
Supermarkets (Mill. \$)	265	282	303	-10.8%	-15.7%
Used and New Autos (Mill. \$)	515	518	507	15.4%	-5.0%
Gasoline Stations (Mill. \$)	112	115	162	2.0%	-3.3%
Restaurants (Mill. \$)	169	167	161	-9.4%	-4.0%

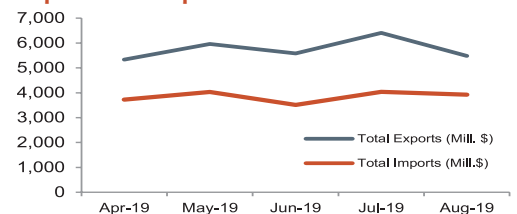
Retail Sales



Exports and Imports

	Jun-19	Jul-19	Aug-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
Total Exports (Mill. \$)	5,580	6,407	5,483	5.2%	3.0%
Foreign Countries	1,295	2,115	1,199	27.8%	20.9%
Total Imports (Mill. \$)	3,511	4,037	3,926	7.8%	-14.2%
Foreign Countries	1,772	2,141	2,102	19.8%	-10.7%

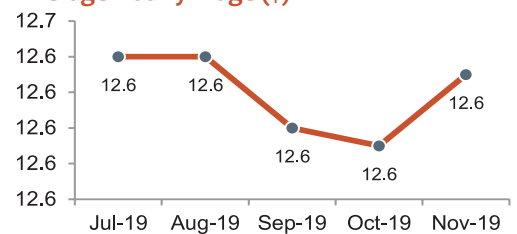
Exports and Imports



Manufacturing

	Sep-19	Oct-19	Nov-19	Fiscal Year 2018-2019	Percent Change Accumulated year to date
Weekly Hours (#)	39.4	39.7	40.2	1.2%	3.8%
Average Hourly Wage (\$)	12.6	12.6	12.6	-0.6%	1.0%

Average Hourly Wage (\$)

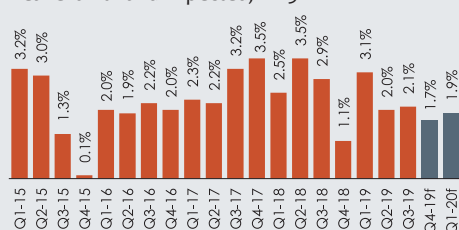


United States The Economy

- With growth of 2.1% in the third quarter, the fourth quarter of 2019 was expected to close with a slower pace of 1.7%, with still continuing business uncertainty from U.S.-China trade tensions and Brexit. On the other hand, the U.S. consumer continued to support growth, thanks to lower interest rates and strength in job markets.

Quarterly U.S. GDP

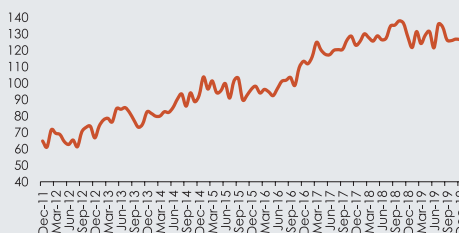
Real Growth and Expected, 2015-2020



Sources: U.S. Bureau of Economic Analysis; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters, Fourth Quarter 2019 (November 15, 2019). Seasonally adjusted at annual rates. f = Forecast.

- This contributed to elevated consumer confidence. While their assessment of current conditions improved, according to The Conference Board's Consumer Confidence Index, by the end of the year their short-term expectations were less favorable, pointing to "less momentum in early 2020".¹

U.S. Consumer Sentiment Index



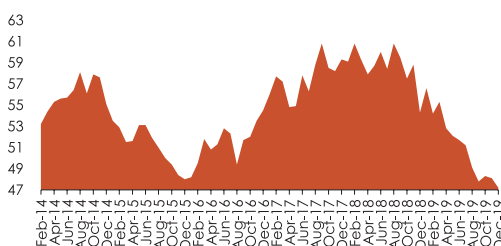
Source: The Conference Board.

- Key policy changes by the end of the quarter and in 2019 were: Continuing imposition of additional tariffs, to which China has retaliated; continuation of the tightening cycle by the Federal Reserve by lowering interest rates, and; the manufacturing sector in recession. These are indeed challenges and worrisome trends that will extend into 2020.

PRODUCTION

While the overall economy is growing, manufacturing activity in the U.S. continued to contract during the fourth quarter, with the PMI remaining in December below its level of 50 for a fifth consecutive month. Since March of 2019, the index has been decreasing consistently, from 55.3 to 47.2 (which might help to explain why Puerto Rico's PMI has also been falling). During the fourth quarter the index decreased by 16.0 y/y, the largest decrease since 2008, as the New Orders Index contracted at a faster pace.

ISM Index of Manufacturing Activity

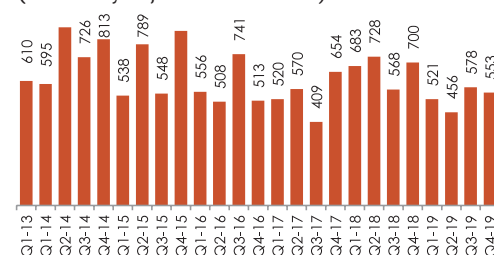


Source: Institute for Supply Management. **Note:** A reading above 50 points indicates that the manufacturing economy is generally expanding, and declining when the reading falls below 50 points.

EMPLOYMENT

Quarterly Changes in Employment

(Seasonally Adjusted - Thousands)



Source: U.S. BLS, Establishment Survey.

Job creation during the fourth quarter slowed its pace to 553,000 new jobs (Non-farm employment), from a high of 700,000 in Q4-18, a decrease of 21.0% y/y. In all 2019, a total of 2.1 million new jobs were added, from 2.7 million in 2018.

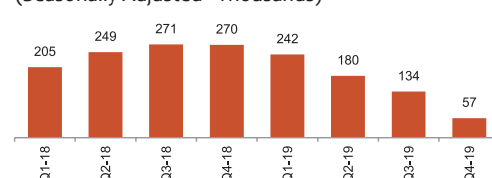
Employment increased in retail trade, health care, leisure activities and hospitality. On the other hand, employment in manufacturing (All employees, seasonally adjusted) registered a net increase of 57,000 jobs in the fourth quarter, compared to a gain of 270,000 in same quarter of 2018, with

a net increase of 153,000 jobs in 2019, from the 249,000 added in 2018.

The unemployment rate averaged 3.5% from 3.9% in 2018. The participation rate has remained unchanged throughout the year at 63.2%. The employment-population ratio (the proportion of those 16 – 64 years old with a job) edged up a bit to 61.0% from 60.6% the year before.

Quarterly Changes in Manufacturing Employment

(Seasonally Adjusted - Thousands)



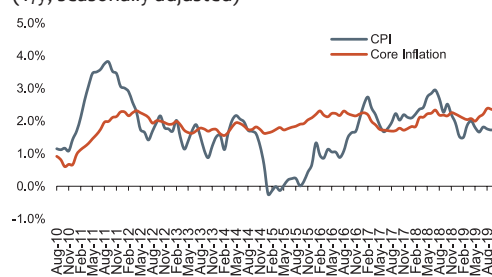
Source: U.S. BLS, Establishment Survey.

INFLATION

Inflation has remained stable, with both, Headline (CPI) and Core Inflation indexes rising an average of 1.8% and 2.2% respectively since Q1-19, slightly below the rates of 2018. During Q4-19 Headline inflation was slightly up to 1.8%, lead by increases in energy prices. For 2020, Headline CPI is projected at 2.1% and Core at 2.3%.⁴

Annual Percent Change in CPI

(Y/y, seasonally adjusted)

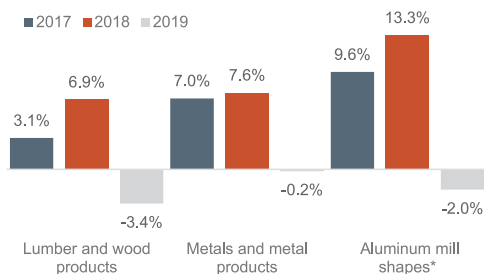


Source: U.S. BLS.

After the significant increases in 2018, reflecting the higher tariffs imposed by the U.S. on imports, prices of construction materials trended down considerably in 2019 (up to October). The Producer Price Index (PPI) for lumber and wood products was -3.4% from an increase of 7.0% in 2018; prices for metal and metal products, which includes aluminum were -0.2% from an increase of 7.6% in 2018, and the PPI for aluminum mill shapes were -2.0% from a high of 13.3% last year.

US Producer Price Index (PPI) Annual Growth - Lumber and Wood Products, Metals and Metal Products, and Aluminium Mill Shapes

Jan-Oct 2017 - Jan-Oct 2019



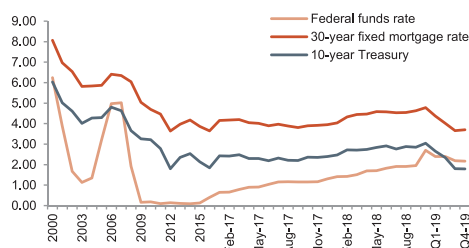
Source: U.S. BLS (2019). PPI Commodity Data (November 25, 2019). *Part of the group of Metals and Metal products.

INTEREST RATES

After lowering interest rates in September by a quarter percentage point, the second cut since July, the expectation was of one more cut before the end of the year. By the end of October, the Fed had cut rates three times (to a target range of 1.50 – 1.75%). The rates of the 10-year Treasury and of mortgages (30-year fixed) remained at practically the same levels of the previous quarter but were below the high of Q4-18. The Fed has indicated that it would follow an accommodative position, insofar the economy evolves under current risks and trend.

Selected Interest Rates

(Annual and monthly averages)



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

U.S./GLOBAL OUTLOOK

The fourth quarter was defined, and 2019 closed, by the threat of a U.S.-Iran conflict, which would have disrupted oil supplies, the next turn in the U.S.-China

trade war, the assurance of the U.K.-E.U. divorce as a result of Great Britain's general elections in December, and a revised third quarter real GDP growth of the U.S. at 2.1% from 1.9%.

Still, the latter seems to point to a soft landing for U.S. growth, from the 3.1% rate in the first quarter, signaling probably a similar trend in 2020, particularly as foreign risks are increasing.⁵ U.S. growth is expected to edge down to 1.8% in 2020 from a preliminary 2.3% in 2019. The outlook for the next four quarters for the U.S. economy, according to the Survey of Professional Forecasters, "looks weaker than it did three months ago."⁶

Global trade is stagnating, dragging down world economic activity. According to the World Bank's most recent forecasts, global growth is expected to increase to 2.5% in 2020, from 2.4% in 2019, "as investment and trade gradually recover", but with downwards risks in the horizon, namely, "a re-escalation of trade tensions, and financial turmoil in emerging markets."⁷

World Merchandise Trade Volume and Real GDP Growth

2016 - 2022

	2016	2017	2018e
World GDP	2.6%	3.2%	3.0%
Advanced Economies	1.7%	2.4%	2.2%
Euro Zone	1.9%	2.5%	1.9%
U.S.	1.6%	2.4%	2.9%
Emerging Economies	4.2%	4.5%	4.3%
China	6.7%	6.8%	6.6%
Latin America & Caribbean	-0.3%	1.9%	1.7%

	Forecasts			
	2019e	2020f	2021f	2022f
World GDP	2.4%	2.5%	2.6%	2.7%
Advanced Economies	1.6%	1.4%	1.5%	1.5%
Euro Zone	1.1%	1.0%	1.3%	1.3%
U.S.	2.3%	1.8%	1.7%	1.7%
Emerging Economies	3.5%	4.1%	4.3%	4.4%
China	6.1%	5.9%	5.8%	5.7%
Latin America & Caribbean	0.8%	1.8%	2.4%	2.6%

Source: World Bank (2020). Global Economic Prospects, Table 1.1. e = Estimate f = Forecast

There is a great deal of uncertainty concerning the prospects for the global and U.S. economies. Risks, both downside and upside, exist that could alter the projections. In the U.S. a major concern recently mentioned by two former FED chairs, Bernanke and Yellen, is that with

interest rates being as low as they are, the FED has lost one of its key instruments for mitigating an economic slowdown. In other words, the U.S. is in a Keynesian "liquidity trap" situation where lowering interest rates below a certain point will not stimulate additional investment. The concern is that the U.S. interest rates have reached that point.

The announced trade agreement between the U.S. and China could put to an end the trade war issue, but at this point it's not clear what the agreement is all about. Likewise, Middle East political volatility could impact the announced prospects, although it appears that the Iran/U.S. confrontation will be relaxed, at least in the very short term. BREXIT, now certain, will probably have some immediate consequences on European growth but will not impact U.S. growth materially. Nevertheless, major structural changes in the global economy will certainly impact U.S. prospects. The performance of the manufacturing sector is perhaps a harbinger of things to come in the rest of the economy.

Notes:

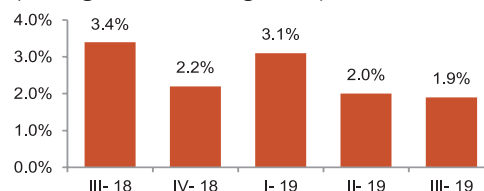
1. The Conference Board. The Conference Board Consumer Confidence Index Dipped in December (December 31, 2019). At: <https://www.conference-board.org/data/consumerconfidence.cfm>.
2. Daniel Bachman (2019). United States Economic Forecast Fourth Quarter 2019, Deloitte Insights (December 19, 2019). P. 2. At: <https://www2.deloitte.com/us/en/insights/economy/us-economic-forecast/united-states-outlook-analysis.html>.
3. Institute for Supply Management (2020). December 2019 Manufacturing ISM (January 3, 2020). At: <https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm?SSO=1>.
4. Research Department, Federal Reserve Bank of Philadelphia. Survey of Professional Forecasters, Fourth Quarter 2019 (November 15, 2019). P. 4. At: <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters>.
5. Daniel Bachman (2019). United States Economic Forecast Fourth Quarter 2019, Deloitte Insights (December 19, 2019). P. 2. At: <https://www2.deloitte.com/us/en/insights/economy/us-economic-forecast/united-states-outlook-analysis.html>.
6. Research Department, Federal Reserve Bank of Philadelphia. Survey of Professional Forecasters, Fourth Quarter 2019 (November 15, 2019). At: <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters>.
7. The World Bank (2020). Global Growth: Modest Pickup to 2.5% in 2020 Amid Mounting Debt and Slowing Productivity (January 8, 2020). At: <https://www.worldbank.org/en/news/press-release/2020/01/08/modest-pickup-in-2020-amid-mounting-debt-and-slowing-productivity-growth>.

United States Economic Indicators

GDP

	IV- 18	I- 19	II- 19	III- 19
GDP (% Change From Preceding Period)	2.2	3.1	2	1.9
Private Consumption	2.5	1.1	4.6	2.9
Fixed Investment	3.1	3.2	-1.4	-1.3
Residential	-4.7	-1	-3	5.1
Non-Residential	5.4	4.4	-1	-3
Government Spending	-0.4	2.9	4.8	2
Exports	1.8	4.1	-5.7	0.7
Imports	2	-1.5	0	1.2

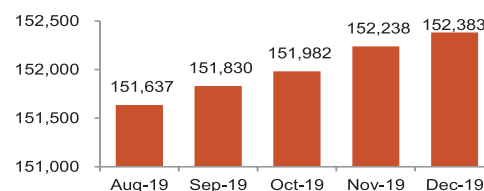
Gross Domestic Product (% Change From Preceding Period)



Employment

	Sep-19	Oct-19	Nov-19	Dec-19
Employees on Non-Farm Payrolls (SA) (Thousands)	151,830	151,982	152,238	152,383
Change (%)	0.1%	0.1%	0.2%	0.1%
Goods Producing	21,115	21,086	21,138	21,137
Change (%)	0.1%	-0.1%	0.2%	0.0%
Service Industries	130,715	130,896	131,100	131,246
Change (%)	0.1%	0.1%	0.2%	0.1%

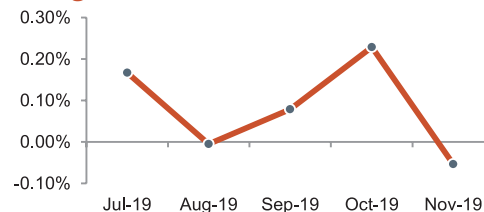
Employees on Non-Farm Payrolls (In thousands)



Consumer Price Index

	Aug-19	Sep-19	Oct-19	Nov-19
CPI - All Urban Consumers (1984=100)				
Change from preceeding month	0.0%	0.1%	0.2%	-0.1%
Change from preceeding year	1.7%	1.7%	1.8%	2.1%
CPI - Less Food and Energy				
Change from preceeding month	0.2%	0.1%	0.2%	0.0%
Change from preceeding year	2.4%	2.4%	2.3%	2.3%

Change in CPI



Interest Rates

	Sep-19	Oct-19	Nov-19	Dec-19
Effective Federal Funds	2.05	1.83	1.55	1.55
Three Month Treasury Bill (Constant Maturity Rate)	1.93	1.68	1.57	1.57
Prime Rate	5.15	4.99	4.75	4.75
Ten Year Treasury Bond	1.70	1.71	1.81	1.86
Moody's Seasoned Aaa Rate	3.03	3.01	3.06	3.01
30-Year Conventional Mortgage Rate	3.61	3.69	3.70	3.72

Selected Interest Rates (3month T Bills)

