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U.S. Interest Rates

Chartbook

March 2017

Takeaways

- The FOMC has raised the Fed funds rate for the third time since the start of the policy rate normalization cycle in 2015. The Committee has also reinforced its commitment to the gradual Fed funds rate increase in line with their projections of an additional two rate increases planned for 2017

  "Today's decision also reflects our view that waiting too long to scale back some accommodation could potentially require us to raise rates rapidly sometime down the road, which, in turn, could risk disrupting financial markets and pushing the economy into recession."

  March 15, 2017, Chair Yellen's March FOMC meeting Press Conference

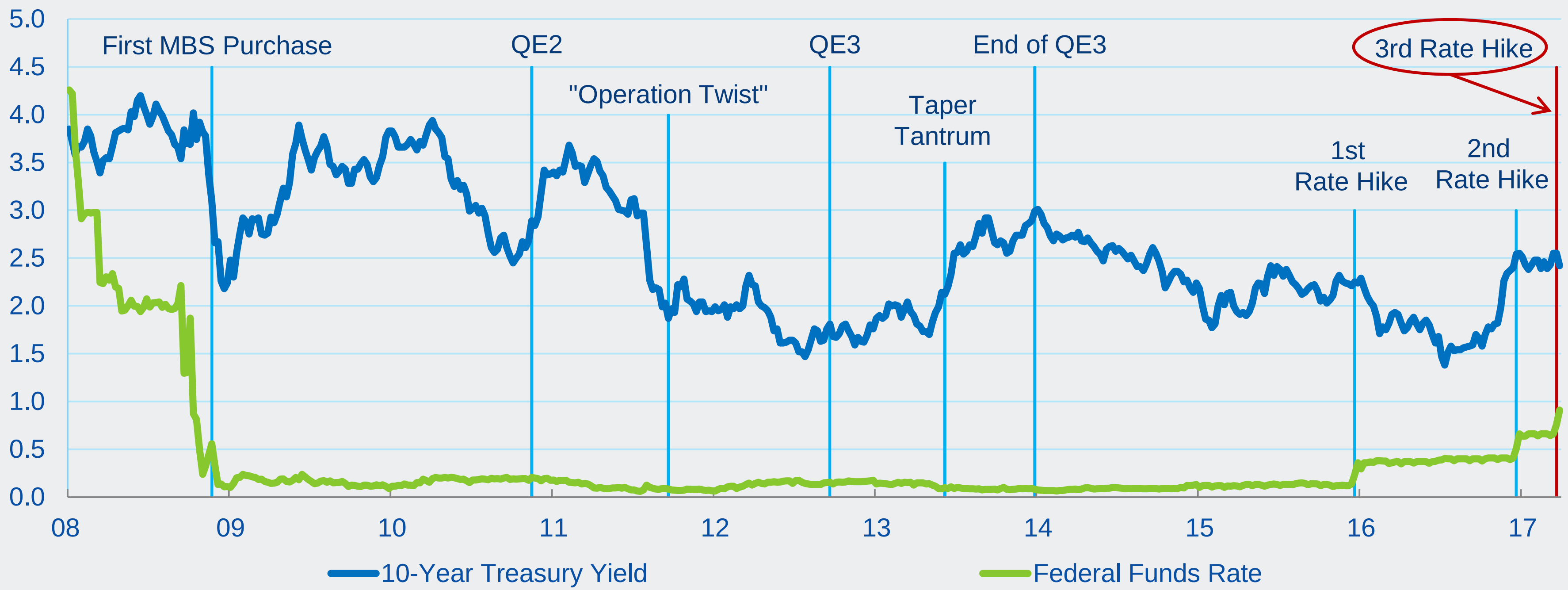
  "A couple more hikes this year seem reasonable. If the economy is a little bit stronger than we expect, we can do a little bit more. If it is a little bit weaker than we expect, we can do a little bit less."

  March 31, 2017, Bloomberg Interview with FRBNY President Dudley

- The Fed funds futures market is aligned with the Fed pricing in two more rate hikes in 2017 with an implied probability of 66% for the next rate increase in June, followed by a rate increase in 4Q17
- The volatility in long-term yields has remained contained, coupled with an edged down term premium and lack of further upward pressure on inflation expectations
- Long-term treasury fluctuations have been holding steady against the backdrop of elevated policy uncertainties domestically and abroad
- We continue to expect a moderate increase in long-term yields, supported by higher expectations for growth and inflation

Unconventional Monetary Policy

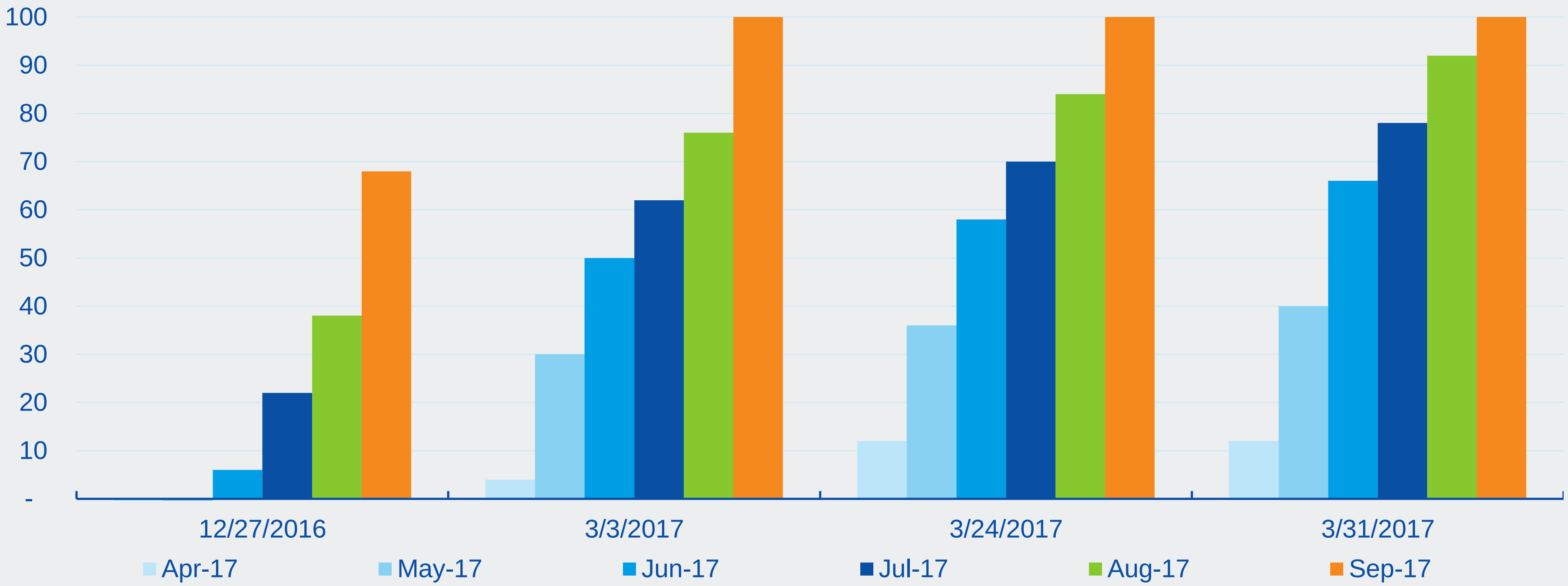
FEDERAL FUNDS RATE AND 10-YEAR TREASUREY NOTE
(%)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

June Rate Hike Probability is at 66%

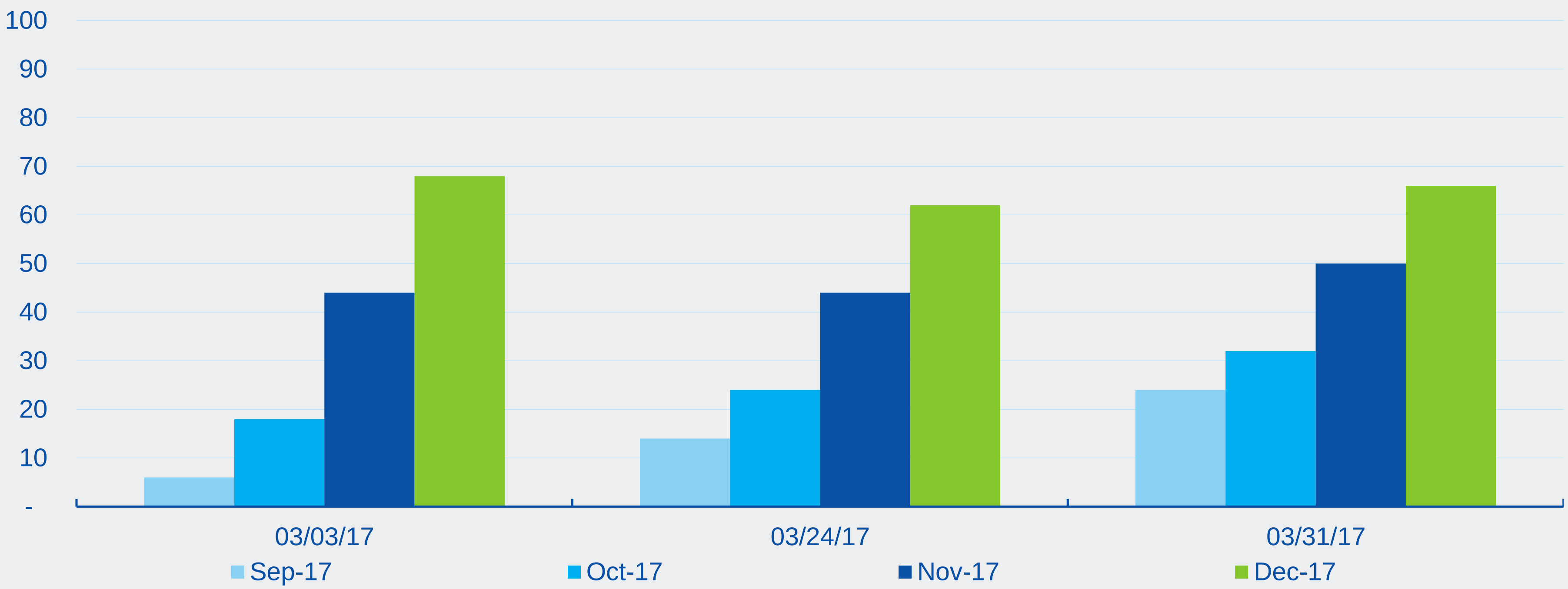
FED FUNDS FUTURES IMPLIED PROBABILITIES, FOURTH 25BP HIKE
(%)



Source: BBVA Research and Bloomberg

Fifth Rate Hike is Priced in for 4Q17

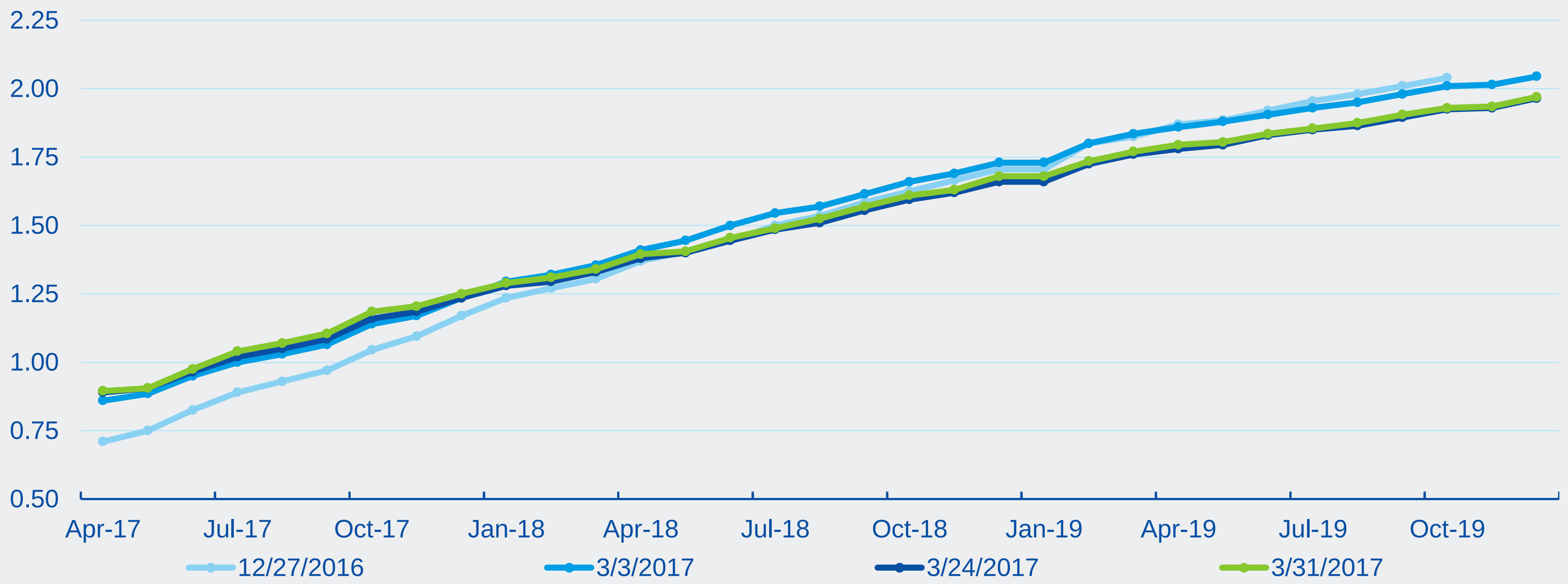
FED FUNDS FUTURES IMPLIED PROBABILITIES, FIFTH 25BP HIKE
(%)



Source: BBVA Research and Bloomberg

Fed Funds Futures Curve

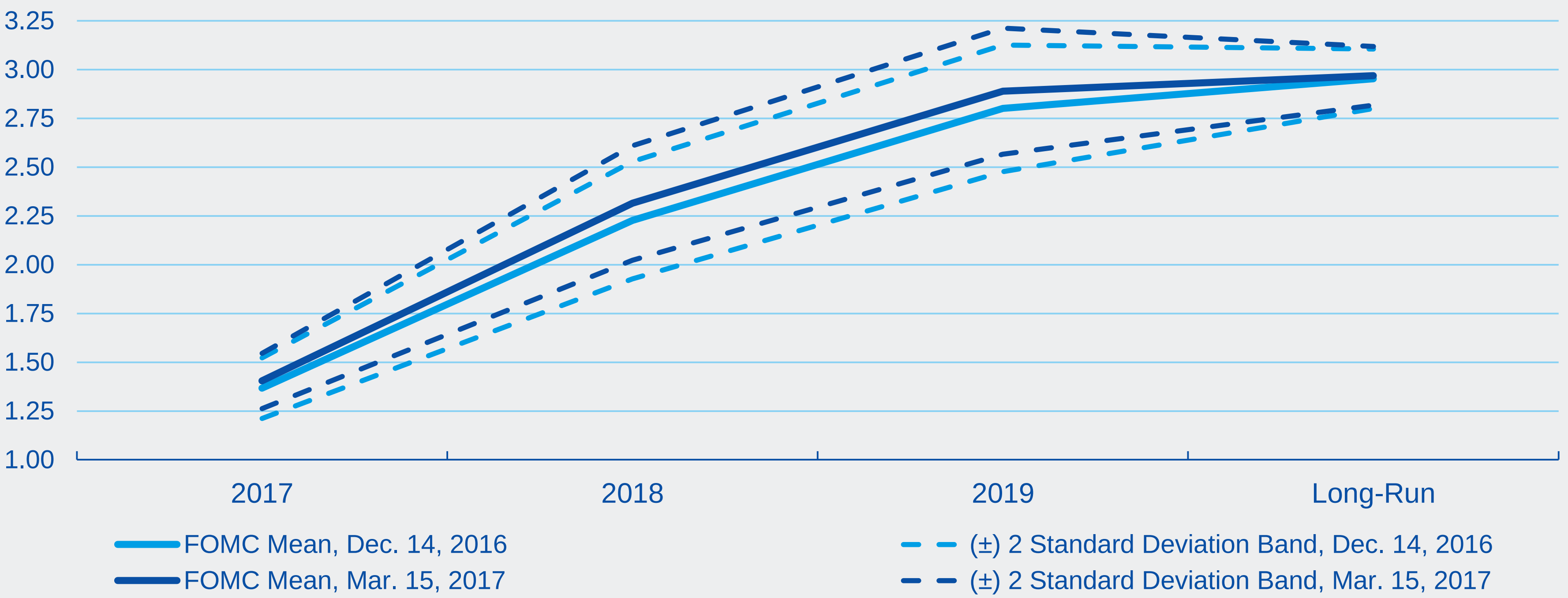
FED FUNDS FUTURES – MOST RECENT, 1 WEEK PRIOR, 1 MONTH PRIOR, 3 MONTHS PRIOR
(%)



Source: BBVA Research and Bloomberg

FOMC 2017 and 2018 Policy Firming Trajectory Medians Remain Unchanged

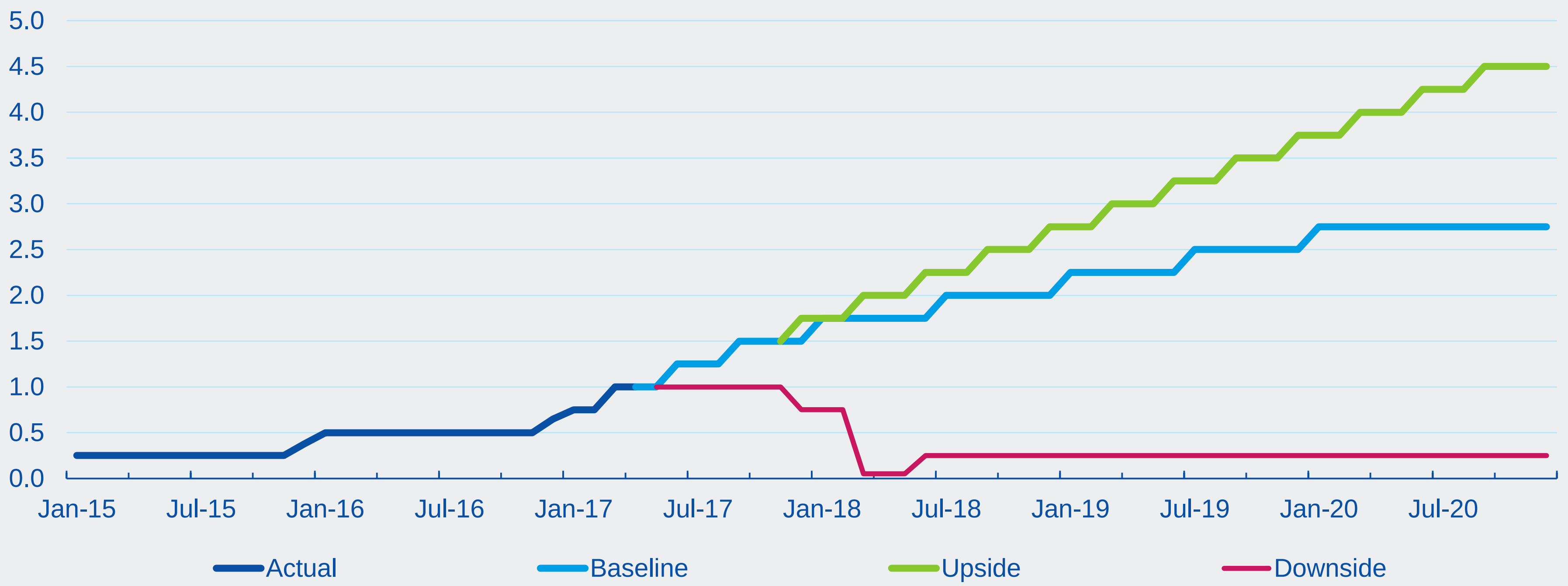
PROJECTED PACE OF POLICY FIRMING
(%)



Source: BBVA Research and Federal Reserve Board

BBVA Fed Funds Firming Pace Forecast

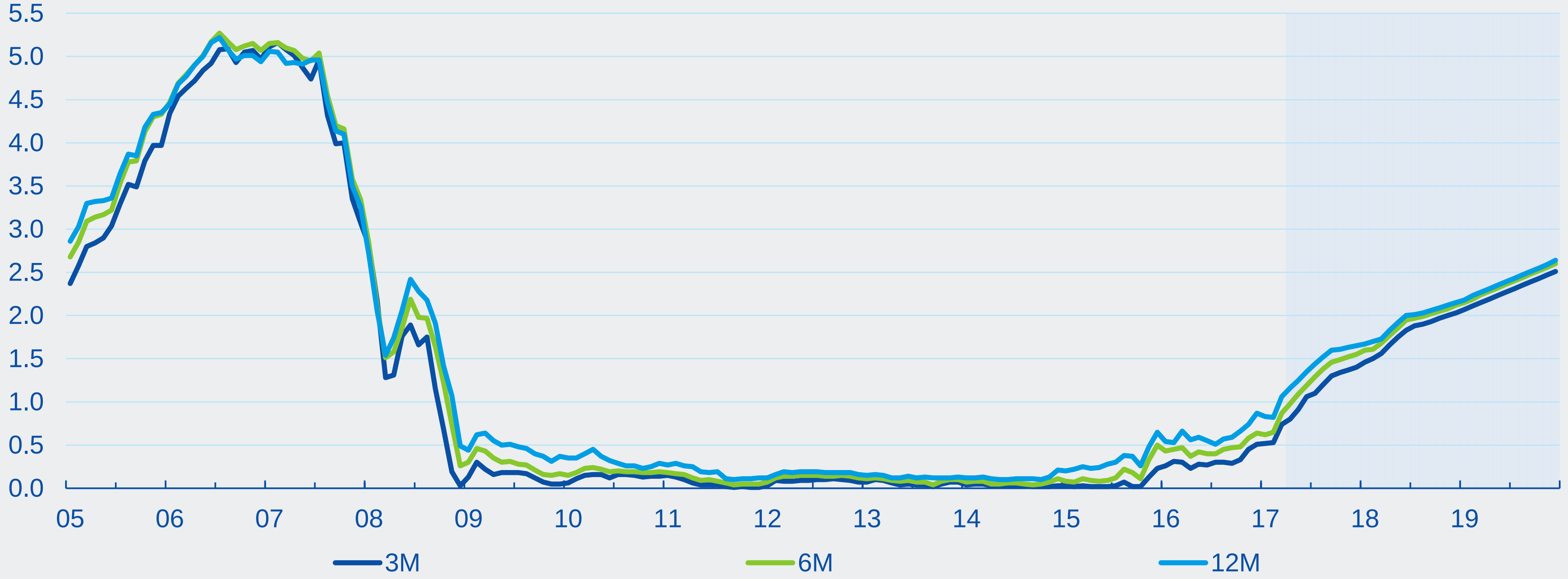
FEDERAL FUNDS RATE
(Upper Bound, %, End of Period)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

BBVA Baseline Forecasts of Treasury Bill Yield

3-MONTH TO 12-MONTH RATES
(%)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

Long-Term Yield Volatility Has Normalized Below Historic Mean

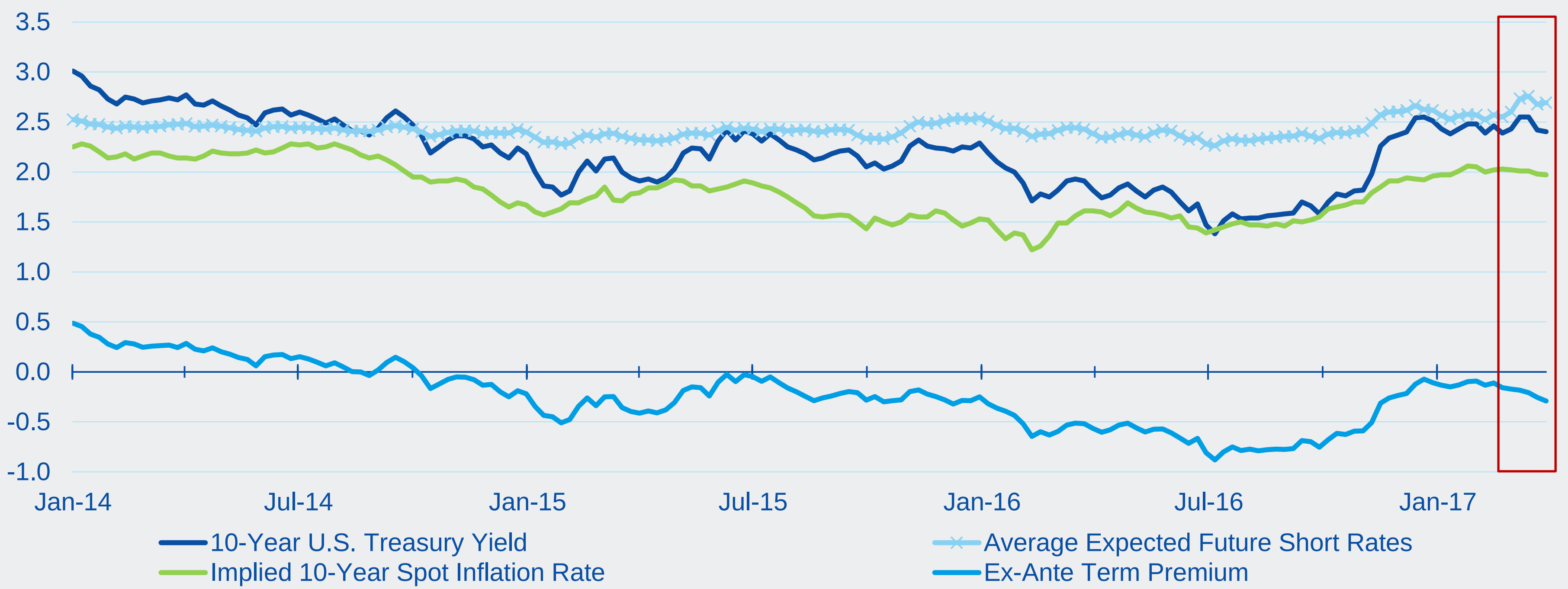
10-YEAR U.S. TREASURY NOTE VOLATILITY
(Daily index)

Index measures a constant 30-day expected volatility of 10-Year Treasury Note futures prices, and is calculated based on transparent pricing from Chicago Board of Trade's actively traded options on the Treasury Note futures

Source: BBVA Research, Chicago Board Options Exchange and Bloomberg

Downward Pressure on Term Premium Resumed

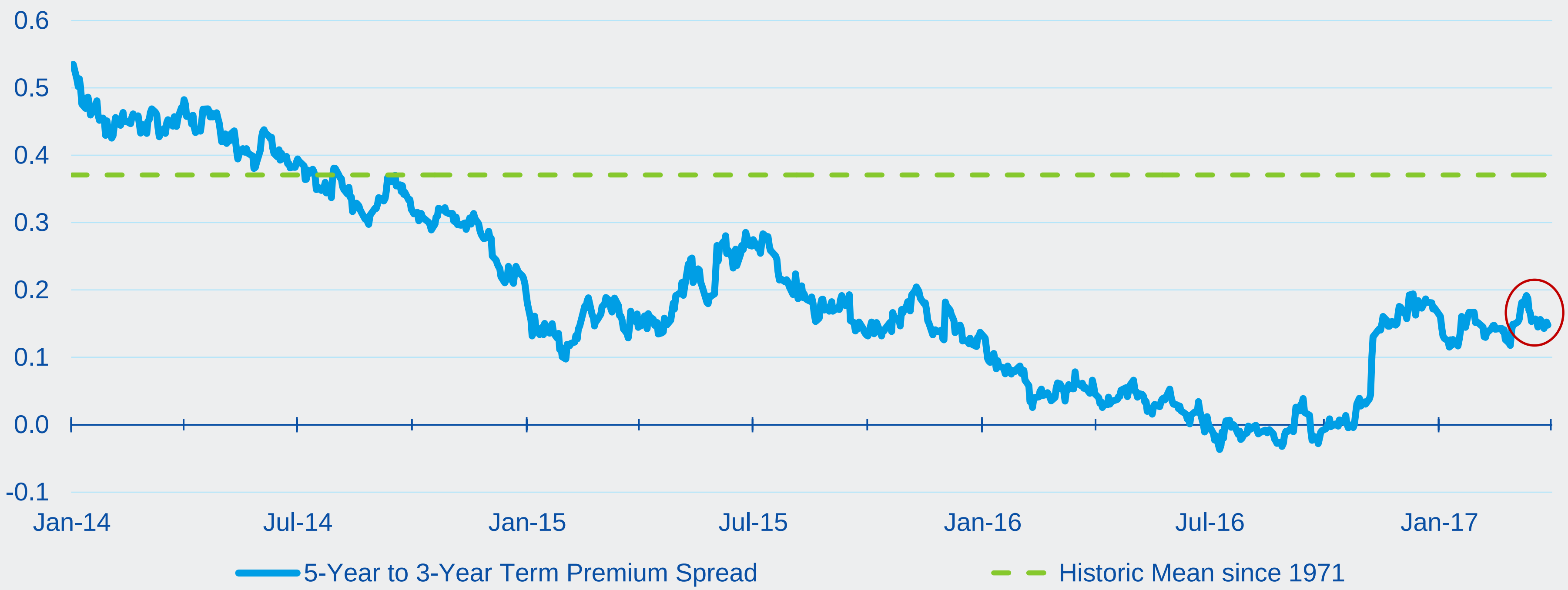
10-YEAR U.S. TREASURY TERM PREMIUM & MARKET INFLATION EXPECTATIONS
(Weekly, %)



Source: BBVA Research and Federal Reserve Board

Mid-Term Duration-Risk Compression Has Normalized in the Vicinity of 15 Basis Points

DURATION-RISK COMPRESSION
(Daily, %)

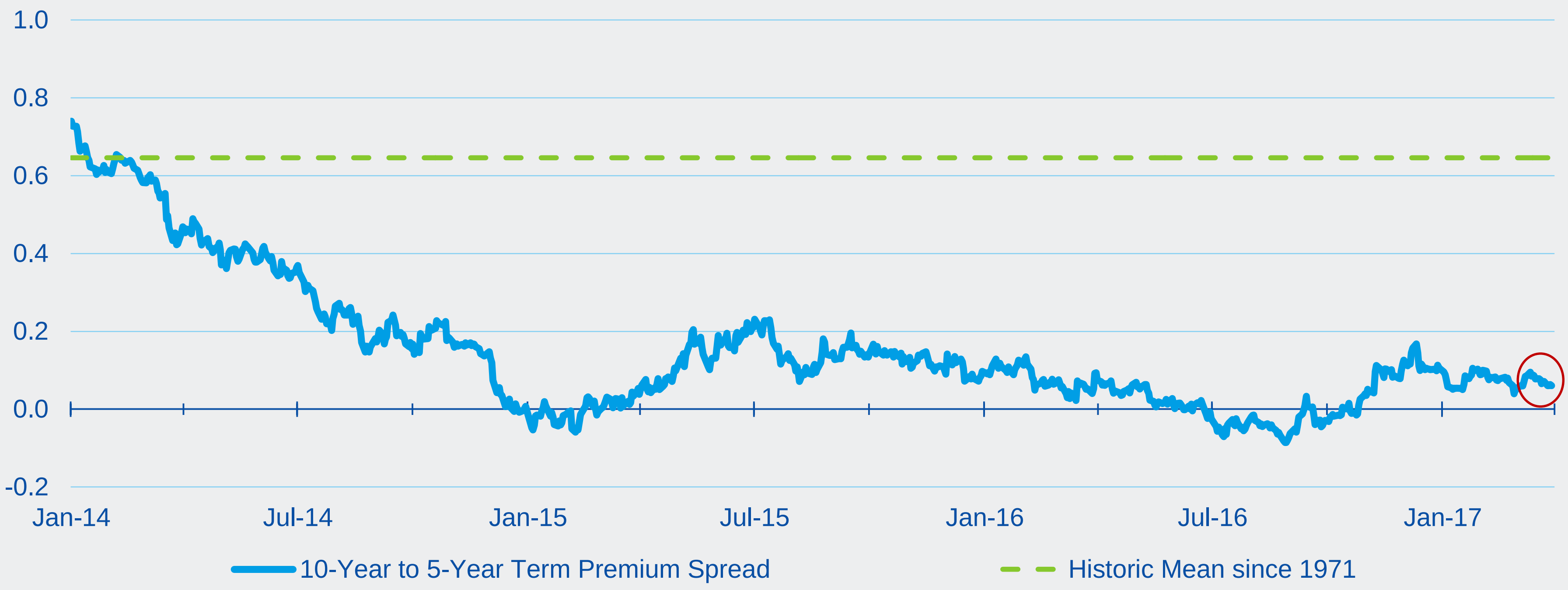


Calculated as the difference between 5-Year and 3-Year term premium reported by the New York Fed ACM (Adrian, Crump, and Moench) five-factor, no-arbitrage term structure model incorporating pricing factors.

Source: BBVA Research, Federal Reserve Bank of New York and Haver Analytics

Long-Term Duration-Risk Compression Has Edged Down

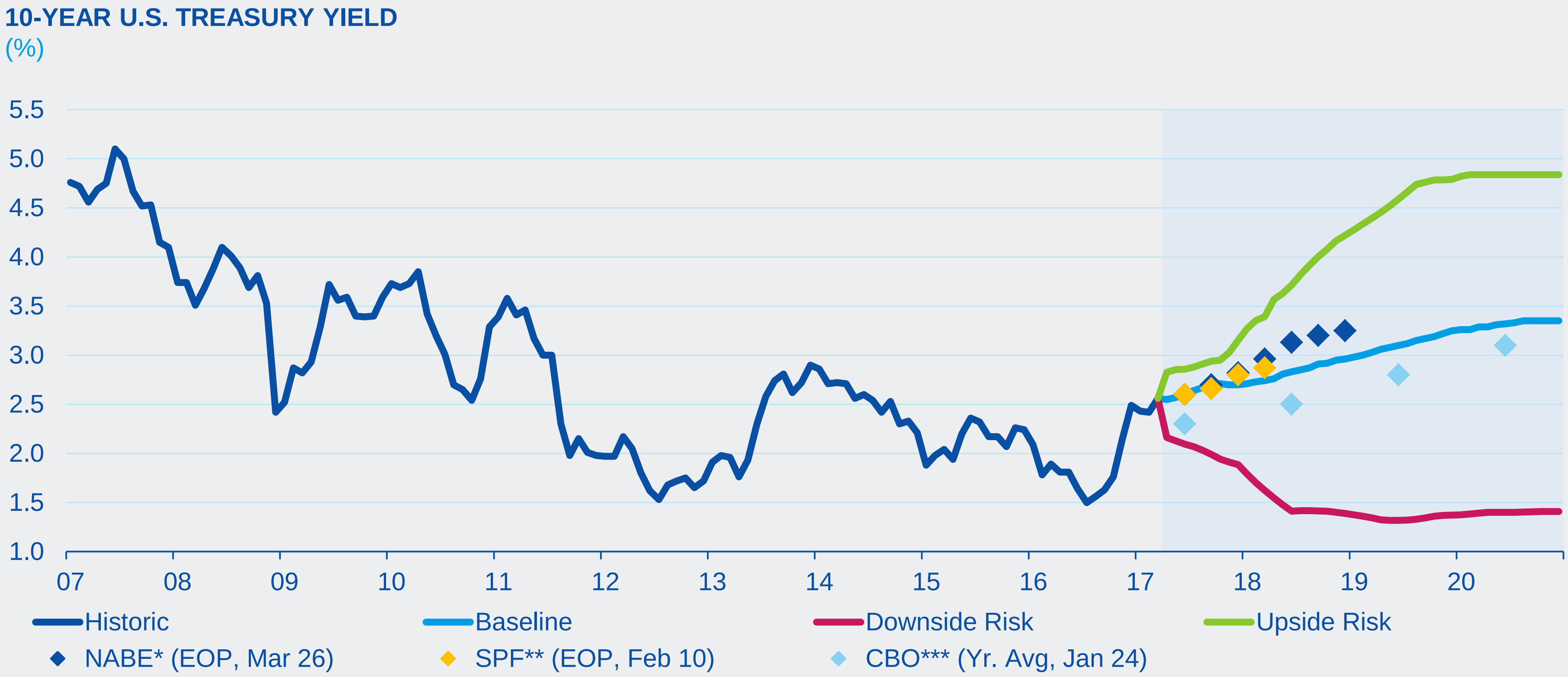
DURATION-RISK COMPRESSION
(Daily, %)



Calculated as the difference between 10-Year and 5-Year term premium reported by the New York Fed ACM (Adrian, Crump, and Moench) five-factor, no-arbitrage term structure model incorporating pricing factors.

Source: BBVA Research, Federal Reserve Bank of New York and Haver Analytics

10-Year Treasury Yield Forecasts



* National Association for Business Economics (NABE) Outlook median forecast compiled from a panel of NABE members. Last release date March 26, 2017
** Survey of Professional Forecasters (SPF) conducted by Federal Reserve Bank of Philadelphia. Last release date February 10, 2017
*** Congressional Budget Office (CBO). Last release date January 24, 2017

Source: BBVA Research, NABE, FRB Philadelphia, CBO and Haver Analytics

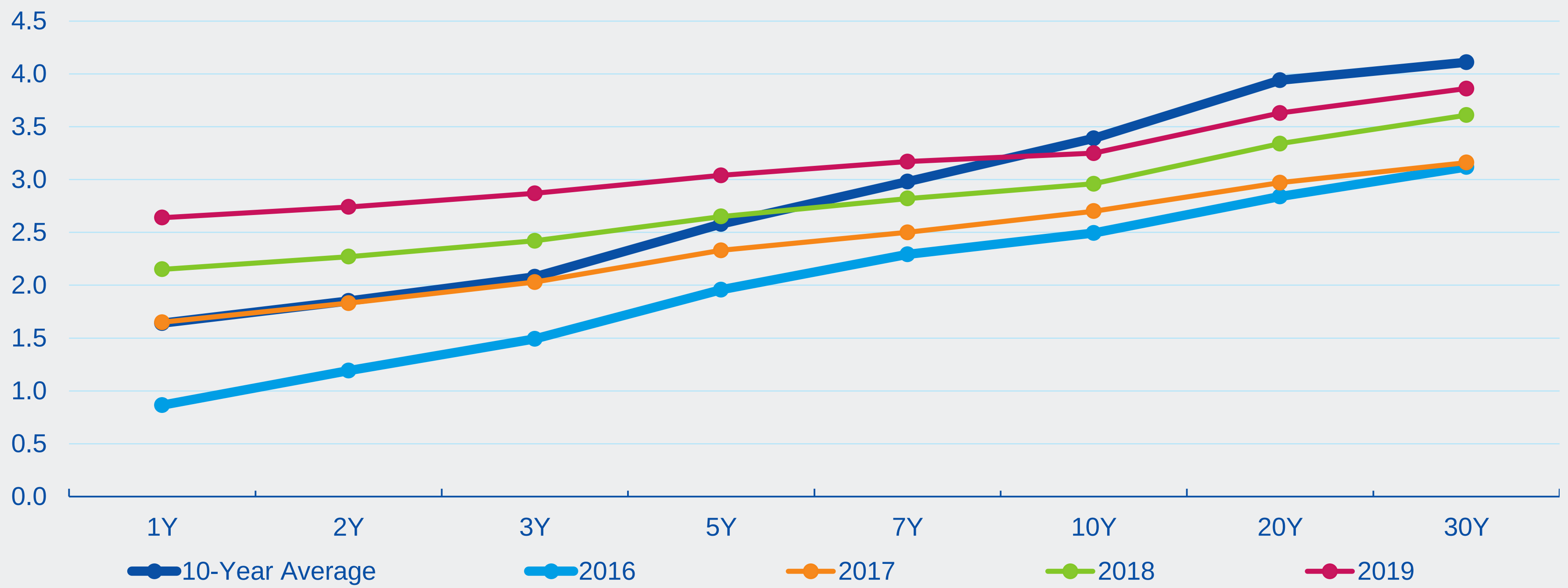
Yield Curve Slope Forecasts

TREASURY YIELD CURVE SLOPE
(%, 10Y-2Y)

Source: BBVA Research, Federal Reserve Board and Haver Analytics

Yield Curve Forecasts

TREASURY YIELD CURVE BASELINE FORECAST
(%, End of Period)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

Treasury Yield Curve Baseline Forecasts

U.S. TREASURY YIELD CURVE
(%)

Treasury yield curve is estimated with a three-factor no-arbitrage model linked to macroeconomic factors measuring growth, inflation and monetary policy. Estimates are based on BBVA Research baseline forecast for GDP growth, inflation and Fed funds rate.

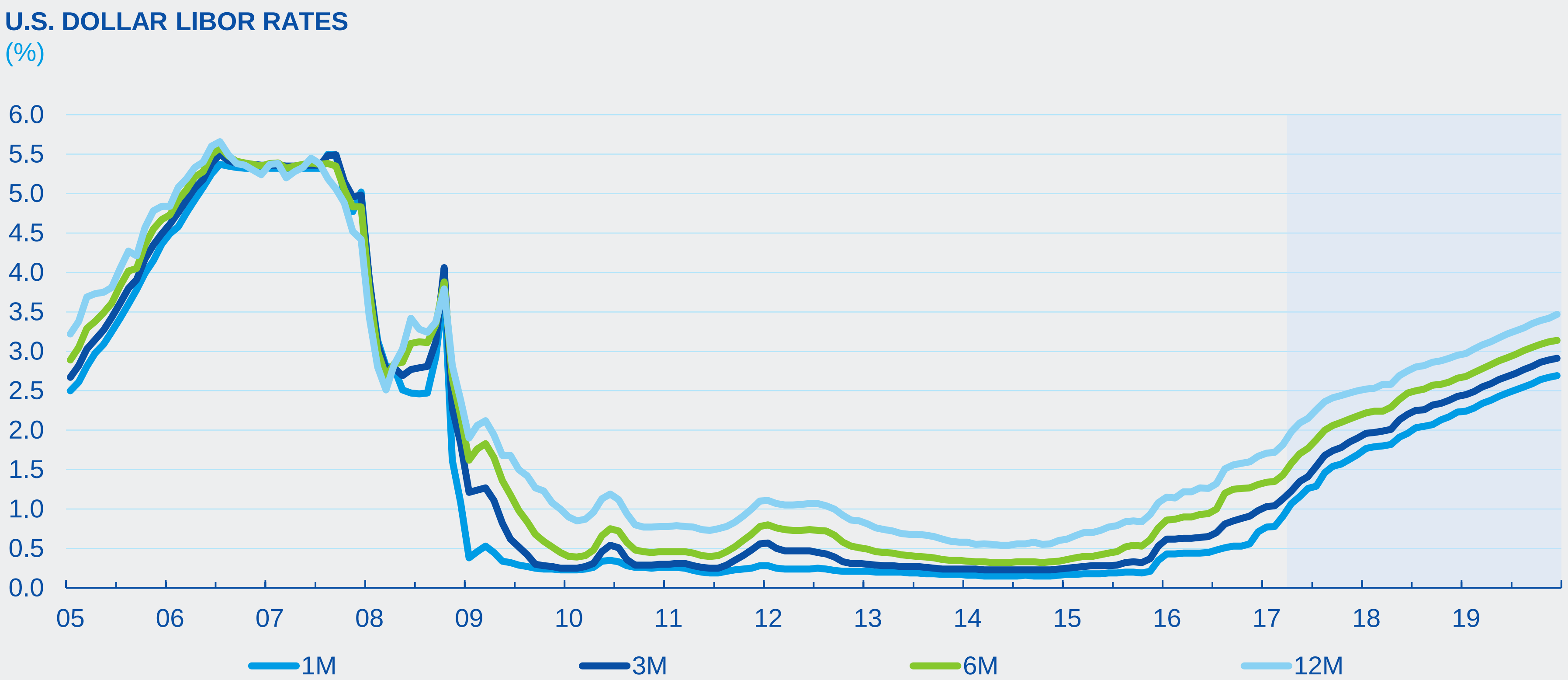
Source: BBVA Research, Federal Reserve Board and Haver Analytics

Swap Curve Baseline Forecasts

U.S. SWAP RATES
(%)

Source: BBVA Research and Bloomberg

LIBOR Curve Baseline Forecasts



Source: BBVA Research, Federal Reserve Board and Haver Analytics

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