

Outlook United States

2nd QUARTER 2017



Aluminum
Chrome
Nickel
Bauxite
Cotton
Ferrous
Textiles
Wool
Ferrous
Sulfur
Sulfur
Oil
Gas
Electric power
CHANGE
ASIA
22%
18%
22%
TYU d
54
550
50
320
50
Tyrol
Copper
Steel
Beryllium
Manganese
Aluminum
Chrome
Nickel
Bauxite

Risks remain balanced

Economy



1. Economy at or near full employment
2. GDP growth will remain on a sustainable path
3. Investment gaining traction
4. Upward price pressures from energy and housing expected to moderate going forward

Monetary Policy

- Fed more comfortable as economic indicators align with their views
- Gradual policy normalization will continue Two more 25bp rate increases in 2017
- High probability of taking action on reinvestment policy

Policy

- Tight calendar for Congress: FY2017 spending bill, FY2018 appropriations and budget, debt ceiling/suspension
- Expect modest progress on deregulation, tax reform, healthcare and infrastructure

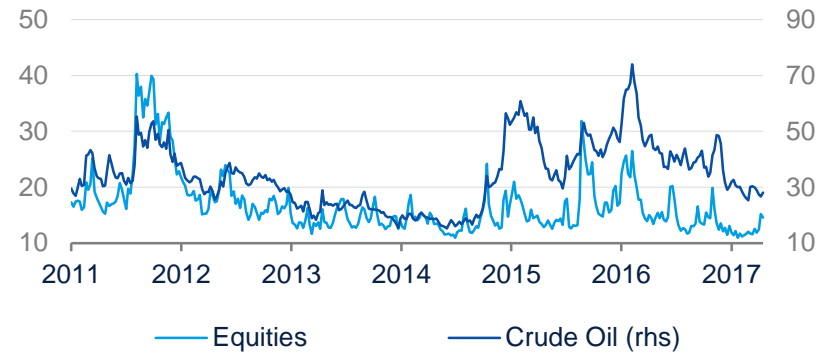
Financial markets: risk appetite fading

Market Risk Indicators

		Current	1-month ago	3-months ago	6-months ago	1-year ago
Equities	S&P 500	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Energy	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Construction	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Consumer	Light Blue	Dark Blue	Light Blue	Light Blue	Light Blue
	Banks	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
Bonds	3-Month Yield	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	10-Year Yield	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Corporate Spreads-AAA	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Corporate Spreads-BBB	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
Volatility	Market Volatility Index	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Crude Oil Volatility Index	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
Credit	C&I Loans	Light Blue	Dark Blue	Light Blue	Light Blue	Light Blue
	Real Estate Loans	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	CRE Loans	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Credit Card Loans	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
Sovereigns (CDS)	Brazil	Light Blue	Light Blue	Light Blue	Light Blue	Dark Blue
	Italy	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Turkey	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Venezuela	Light Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
	Argentina	Light Blue	Light Blue	Dark Blue	Dark Blue	Dark Blue
Misc.	Financial Stress	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Busines Conditions Index	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue
	Exchange Rate	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue

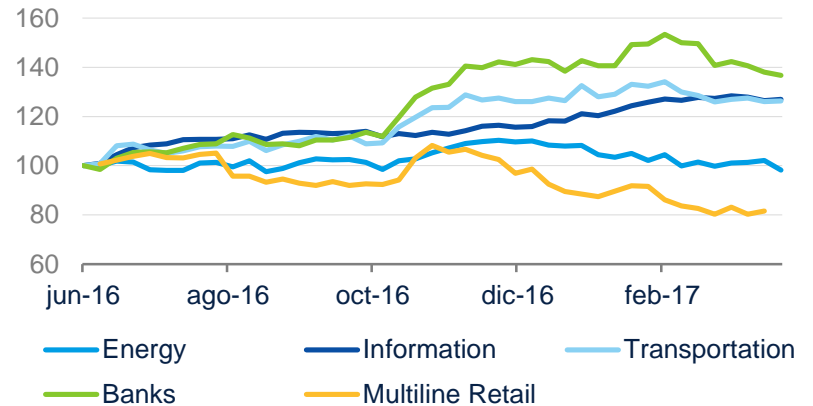
CBOE Market Volatility

(%)



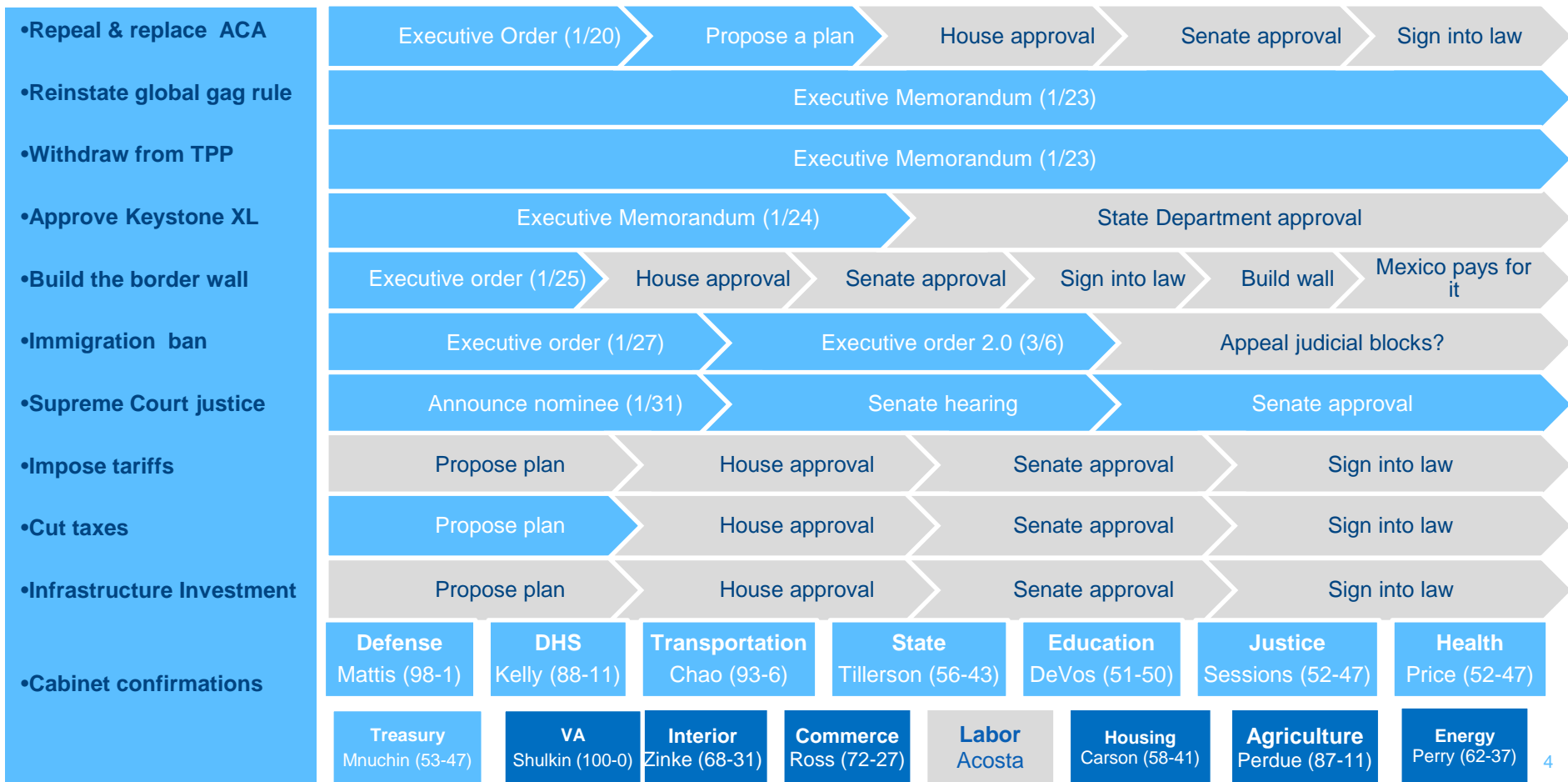
SP Equity Indexes

(July-2016=100)



New administration's agenda

Several obstacles in Congress and in judicial review



U.S. economic dashboard

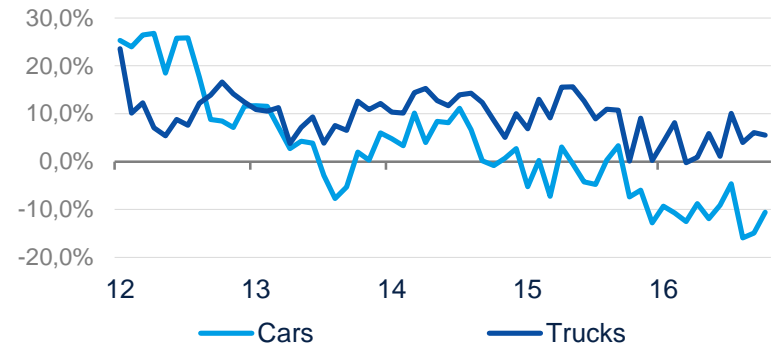
U.S. Economic Heat Map

	Current	1-month ago	3-months ago	6-months ago	1-year ago
ISM Manufacturing	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
ISM Nonmanufacturing	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Small Business Optimism	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Capacity Utilization	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Industrial Production	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Capital Goods New Orders	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Nondurable Goods Orders	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Retail Sales	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Unemployment Rate	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Private Nonfarm Payrolls	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Employment to Population	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Average Hourly Earnings	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Auto Sales	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Real Disposable Income	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Personal Savings Rate	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Retail Sales ex auto & gas	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Consumer Confidence	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Total Private Construction	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Month's Supply	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Housing Starts	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Home Prices	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
New Home Sales	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Exports	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue
Policy Uncertainty	Dark Blue	Dark Blue	Dark Blue	Dark Blue	Dark Blue



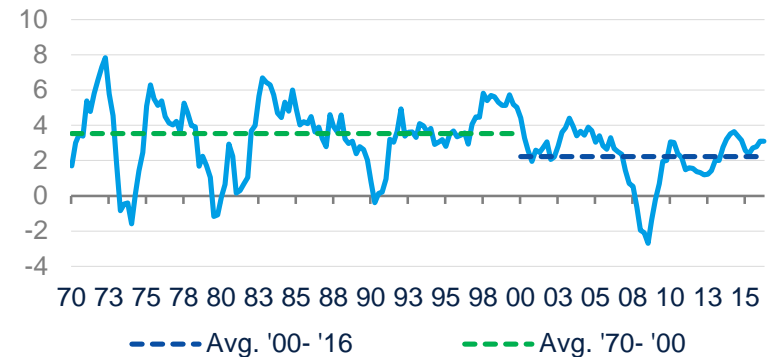
Domestic Auto Sales

(YoY % change)



Real PCE

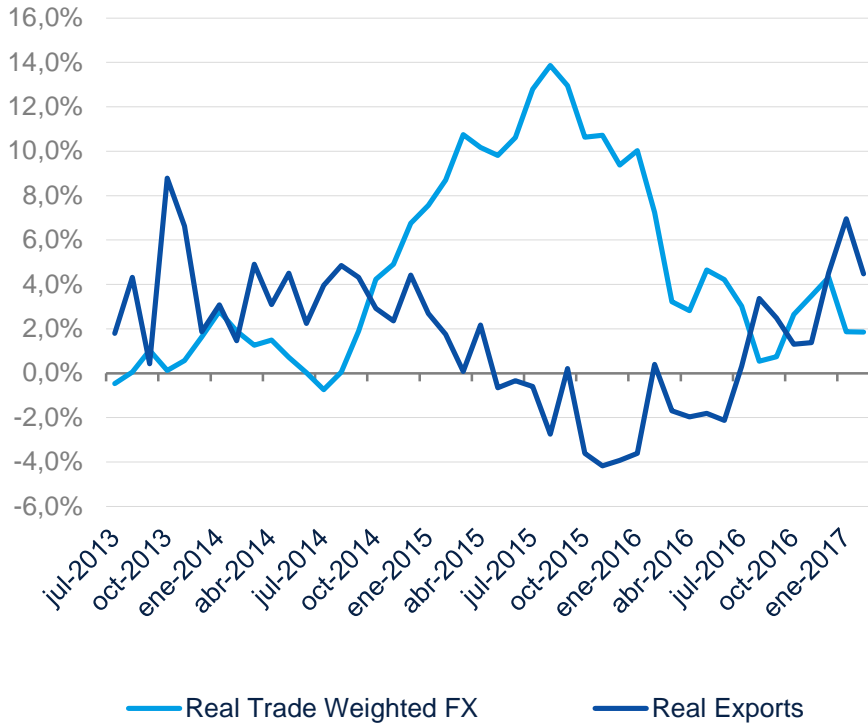
(YoY % change)



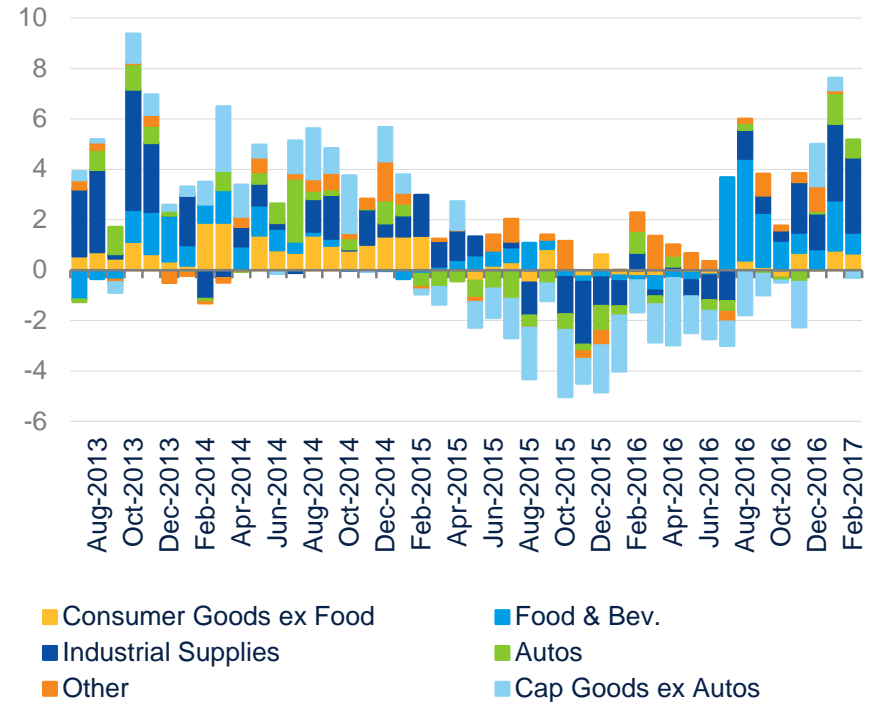
Exchange rate pressures easing

Stronger global trade and growth underlie rebound in exports

Real Exchange Rates & Real Exports
(YoY % change)



Real Exports
(contribution to YoY % change)

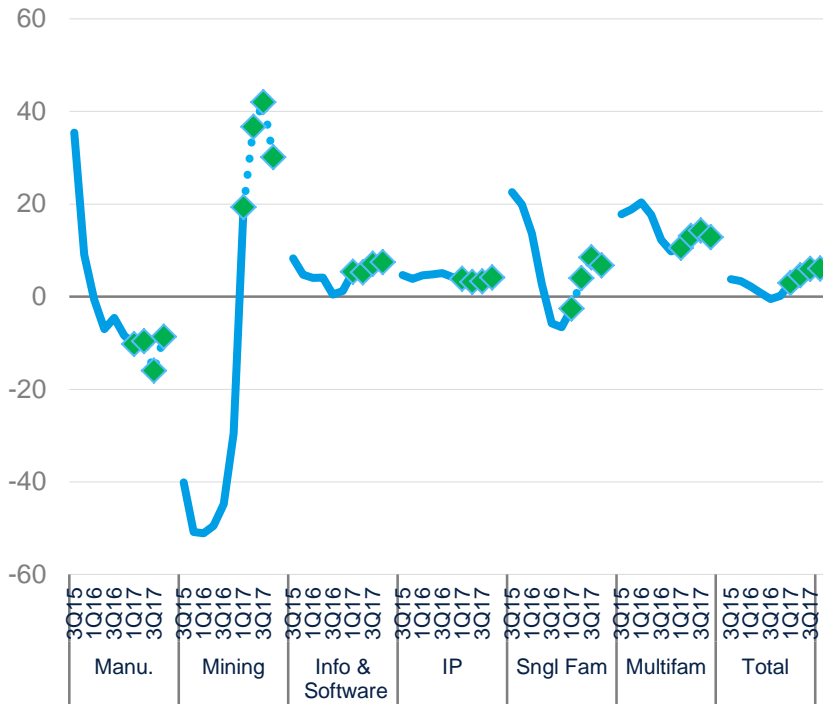


Consumption & investment

Solid business fixed investment to offset slowing consumption growth

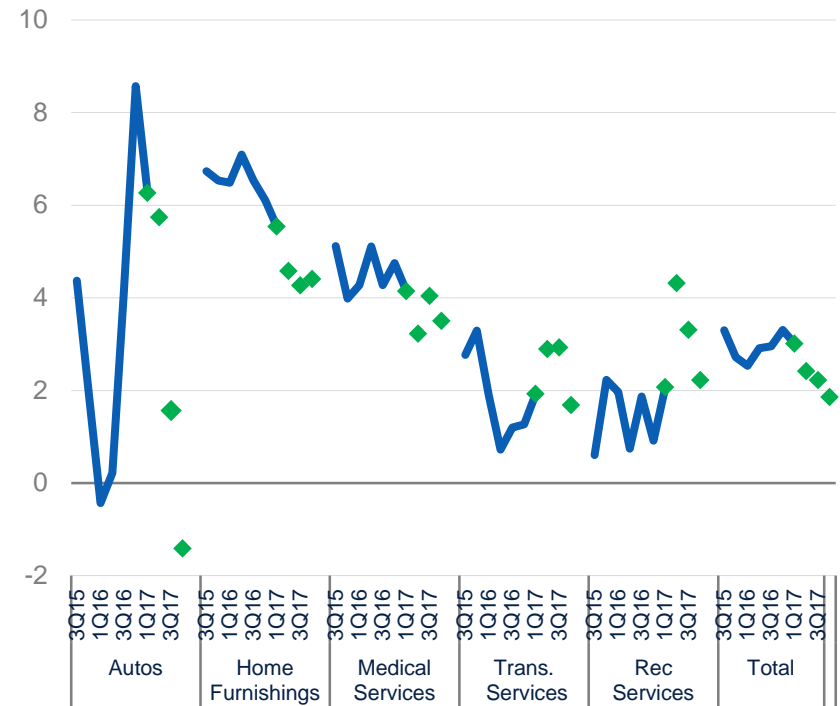
Real Private Fixed Investment*

Year-over-year %



Real Personal Consumption Expenditures*

Year-over-year %



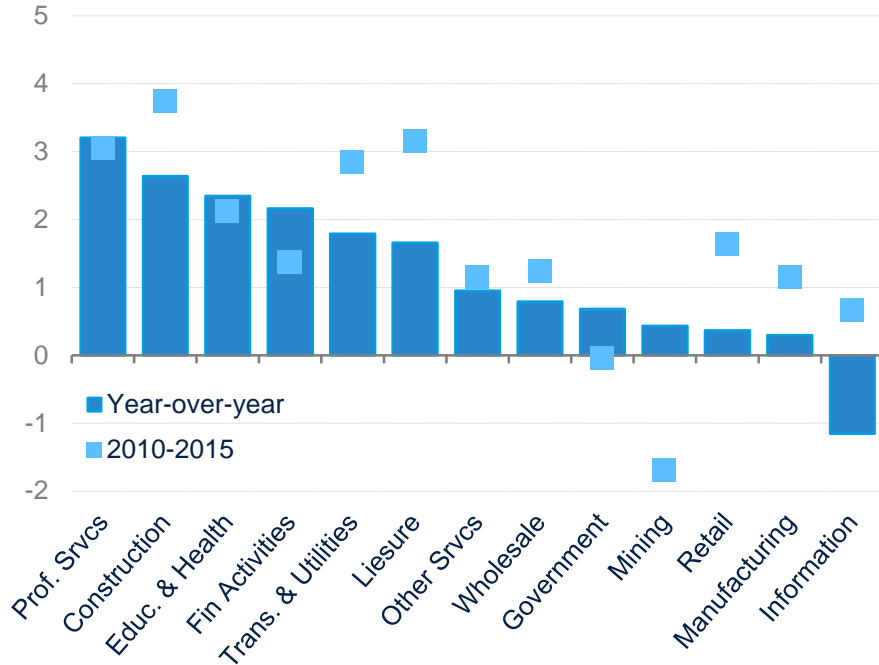
Source: BBVA Research & BEA

*Forecasts from 2Q17-4Q17

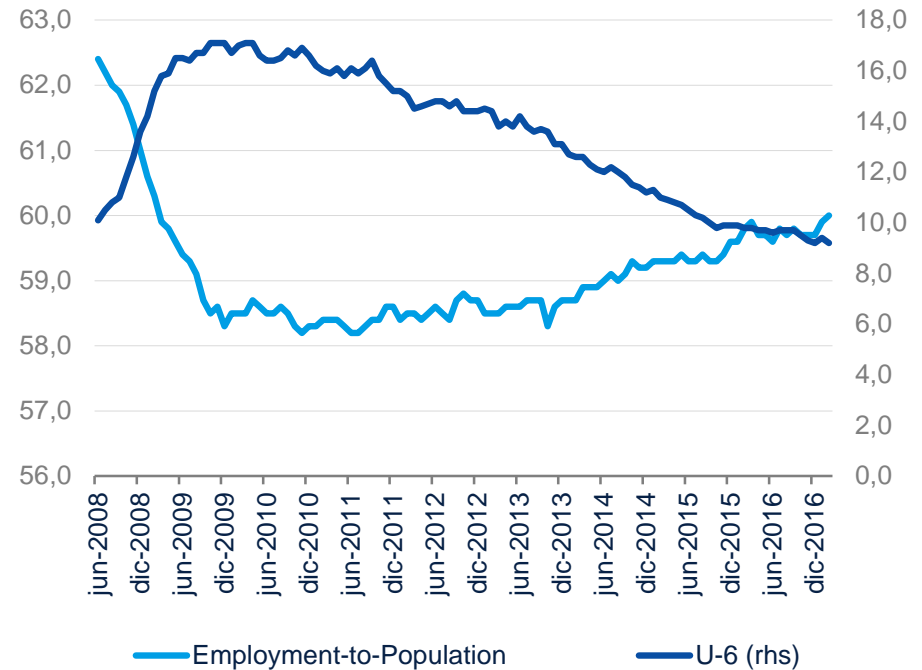
Labor market overview

Manufacturing and mining sectors positive contributors to job gains

Nonfarm Payrolls by Industry (%)



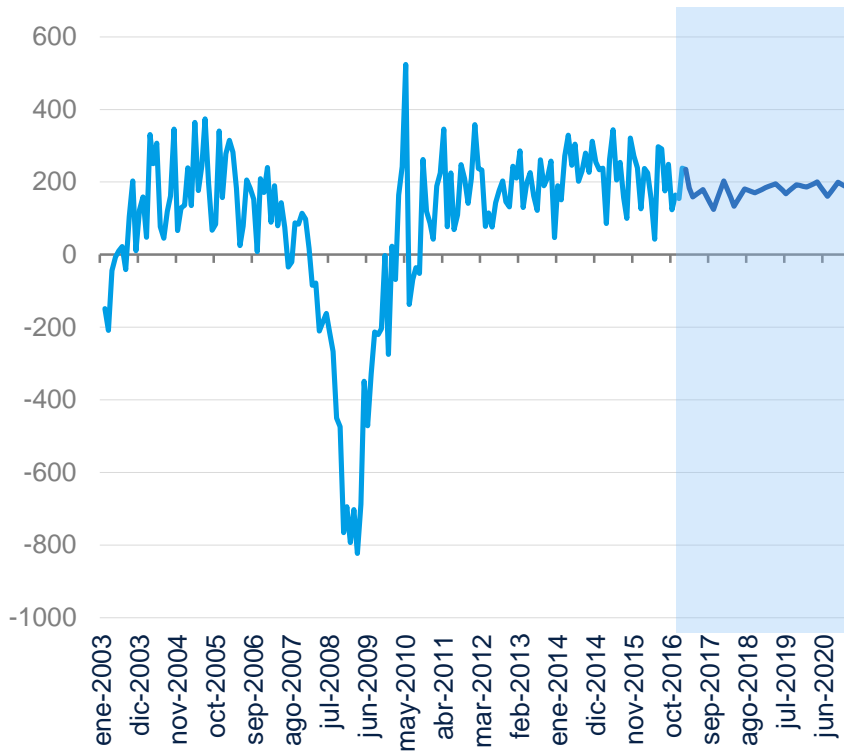
Labor Utilization & Employment-to-population (%)



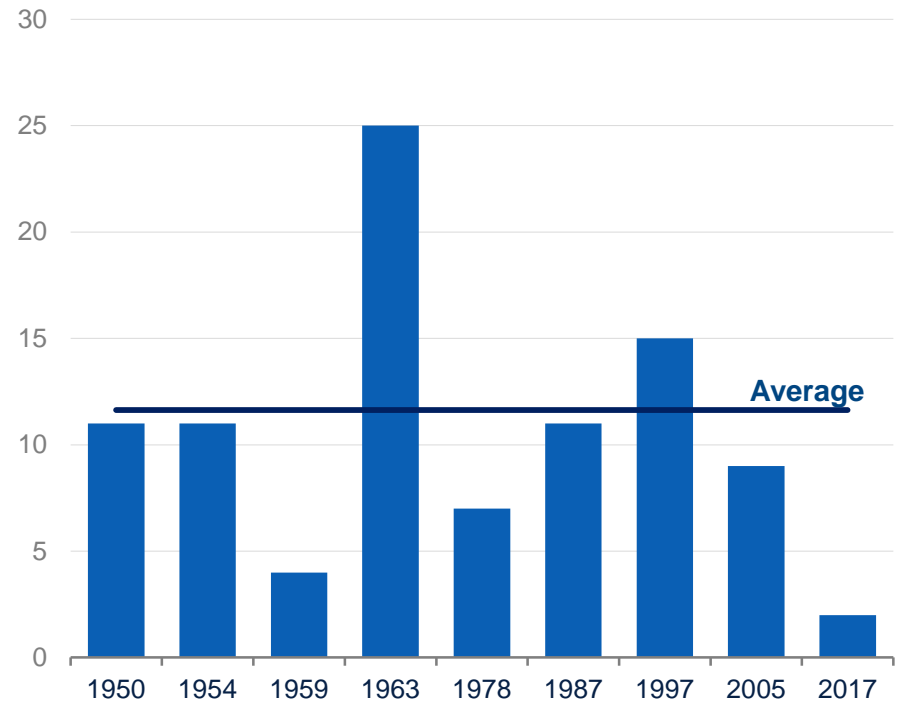
Labor market outlook

Job growth will slow as unemployment rate gap narrows

Nonfarm Payrolls
(K per month)



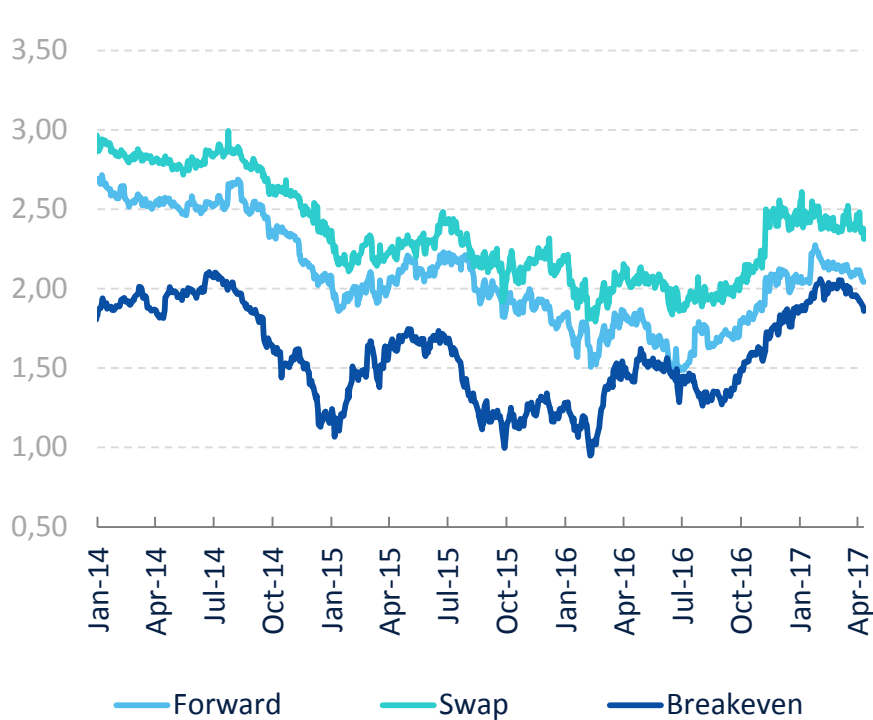
Time until next recession conditional on closing UR gap
Quarters



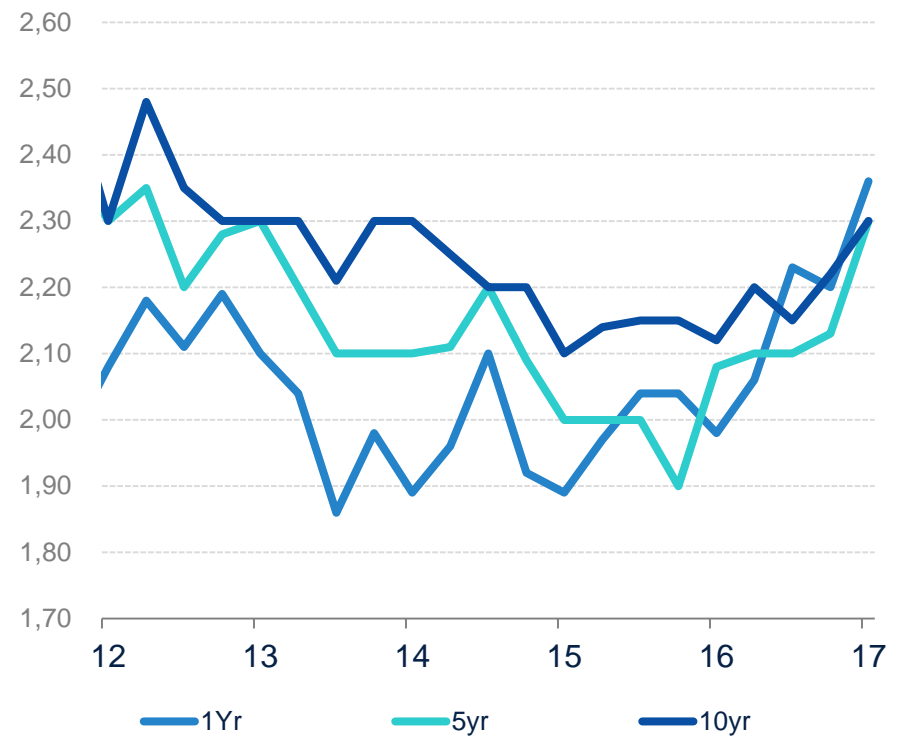
Inflation expectations

Market inflation expectations under more “normal” conditions, survey measures still pricing in reflationary scenario

Market Inflation Expectations
(%)



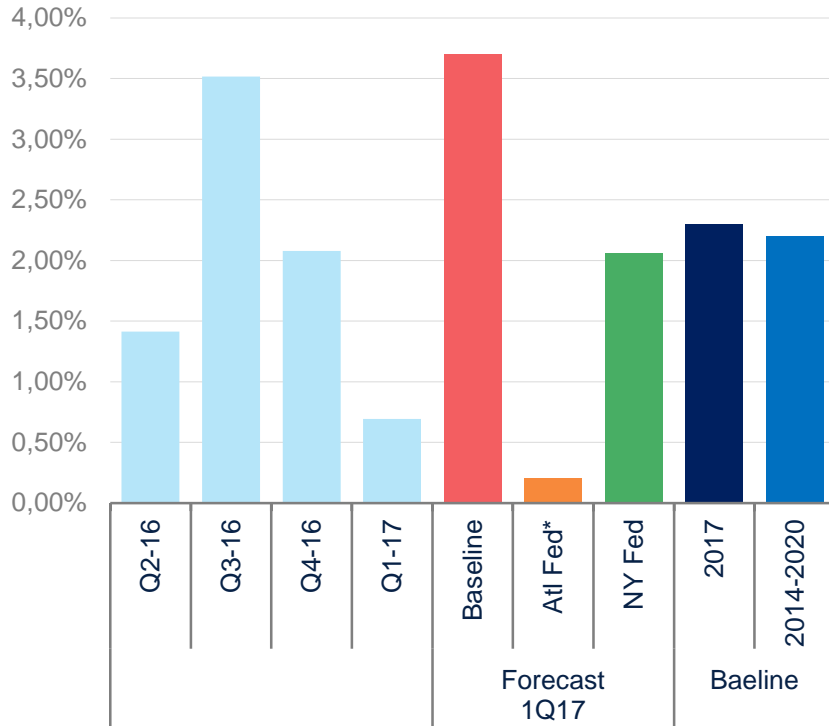
Survey Inflation Expectations
(%)



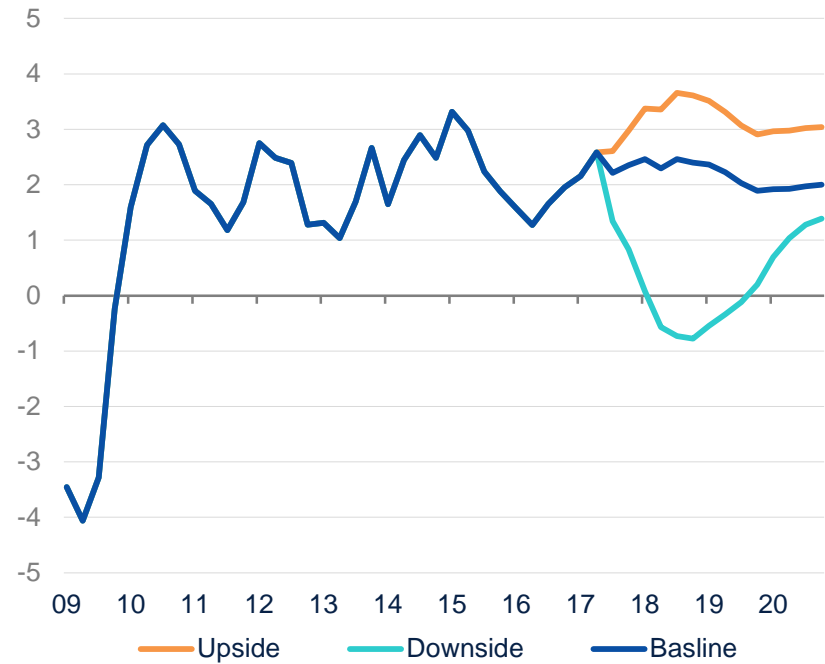
Outlook & forecasts

Seasonal factors and slowing consumption suggest moderate growth in first quarter. Medium-run outlook remains positive

U.S. Short-term Real GDP Forecast
(SAAR %)



U.S. Real GDP Economic Scenarios
(Year-over-year %)



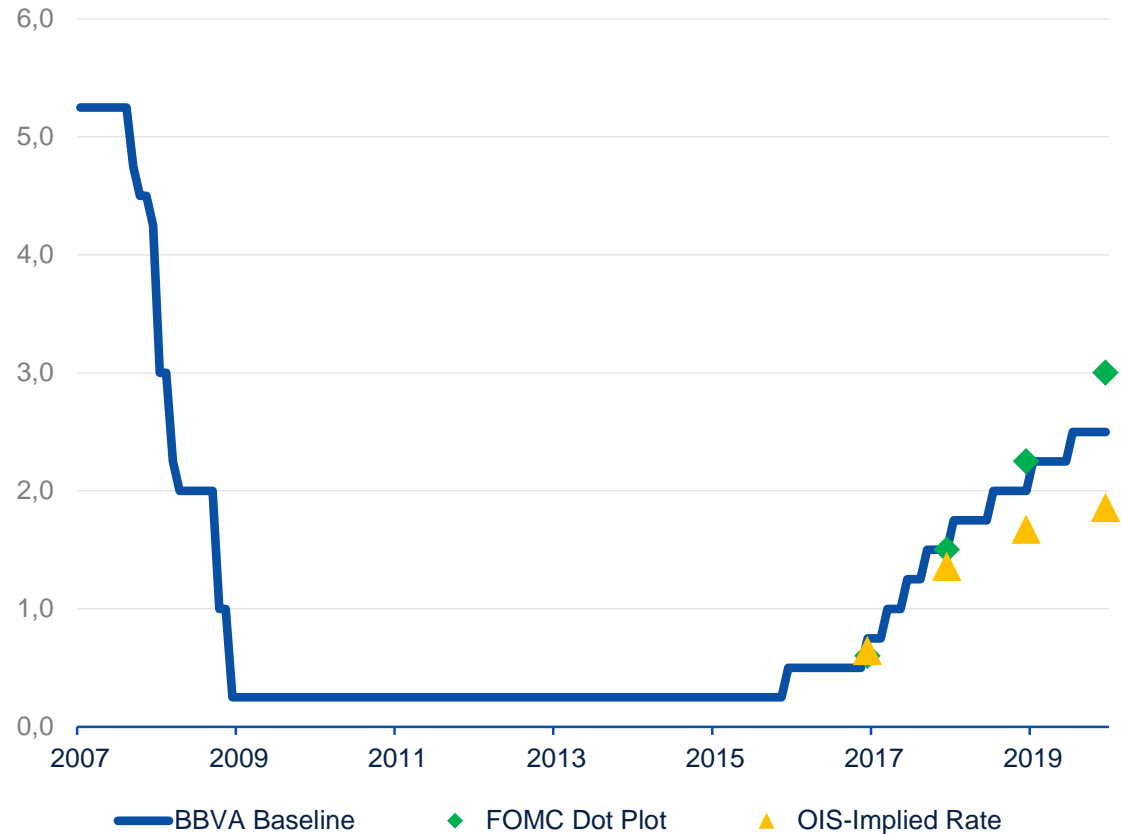
Source: BBVA Research & Haver Analytics

*Current

Monetary policy

- ◆ **Upcoming meetings will likely focus on the evolution of the labor market, balance sheet normalization strategy, and risks from abroad**
- ◆ **FOMC will continue crafting a Balance Sheet(BS) strategy to be set in motion by the end of the year.**
- ◆ **Potential for faster pace of interest rate increases based on committee’s desire to decouple rate increase and BS normalization**
- ◆ **Baseline remains for 2 more rate increase in 2017**
- ◆ **Decoupling preference increases probability of additional hike this year (4 total), lowers probability of brisk pace of rate increases in ‘18**

Fed Funds Rate
%, upper limit



Monetary policy

Fed

Timeline Exit Strategy

March Statement & Minutes

- Minutes confirm that move in March was not a function of a change in participants outlook
- First explicit reference to fiscal policy factoring in to members projections, but bias for some members towards major reform softening
- Balance sheet addendum to minutes opens door for ceasing reinvestment policy, possibly as early as this year
- Fears of taper tantrum 2.0 suggests committee will offer explicit guidance on timing, pace and desired long-run levels of the balance sheet
- **President Dudley (NY) speech March 30, 2017:** "...financial conditions would tighten by more if we were to end reinvestments earlier and more abruptly. This suggests a better course may be to taper reinvestments gradually and predictably"
- **President Williams (SF) speech March 29, 2017:** "With an economy at full employment, inflation nearing the Fed's 2 percent goal, and the expansion now in its eighth year, the data have spoken and the message is clear: We've largely attained the hard-sought recovery we've been after for the past nine years."

What do we expect?

- 25bp increase at June meeting (implied market probability ~70%)
- Timing and magnitude of tightening path could be effected by balance sheet normalization
- Committee to produce plan for ceasing principal reinvestment by yearend in order to promote a predicative and passive wind down of reserve balances.
- Debate likely to shift from sustainability of recovery to how to balance financial market conditions and a multifaceted policy normalization strategy

Projections

Three rate increases in 2017

Two rate increase in 2018

Elevated policy uncertainty

Fed Funds Rate:

Dec 17: 1.5

Dec 18: 2.0

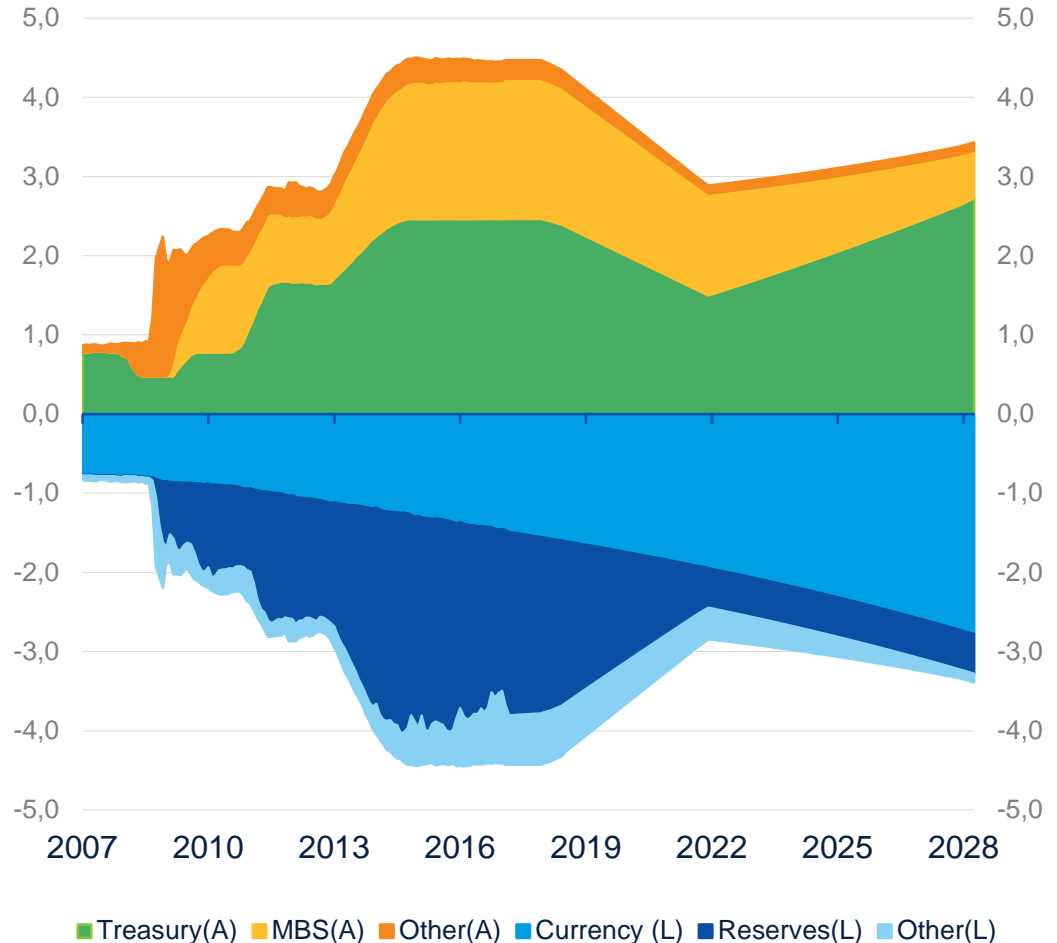


Monetary policy

◆ "It wouldn't surprise me if some time later this year or some time in 2018, should the economy perform in line with our expectations, that we will start to gradually let the securities mature rather than reinvesting them,"
Dudley 3/31/17

◆ "Now that the policy rate has been increased, the FOMC may be in a better position to allow reinvestment to end or to otherwise reduce the size of the balance sheet,"
Bullard 2/28/17

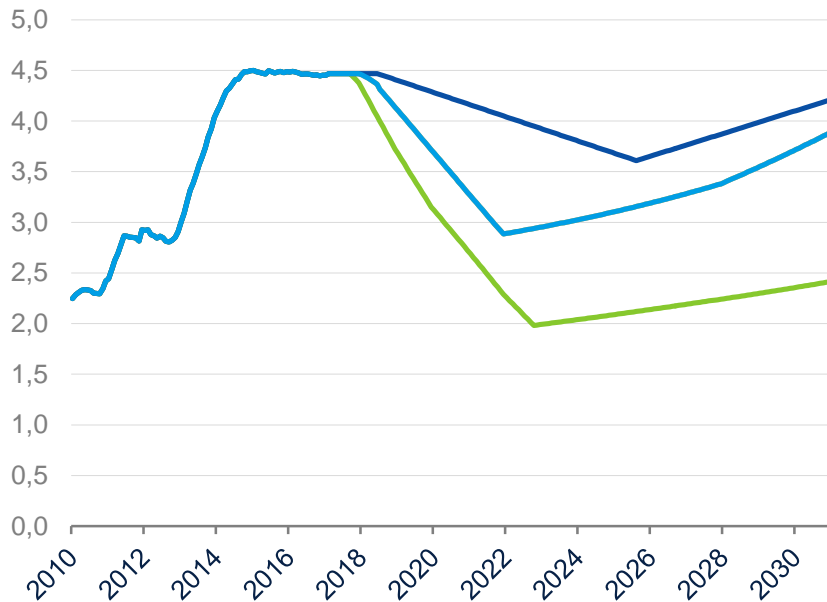
Fed Balance Sheet
\$ Trillion



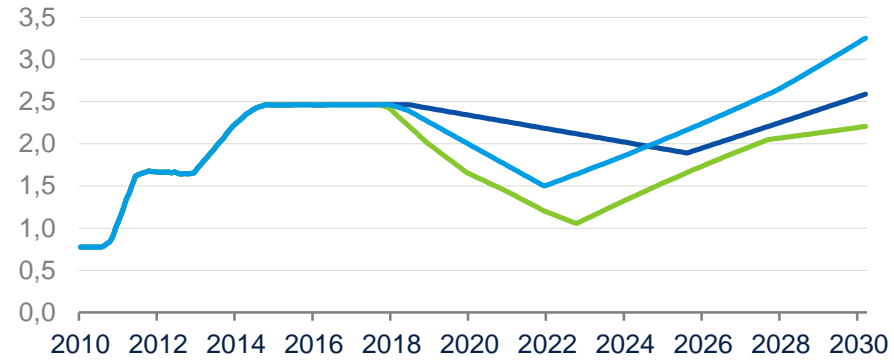
Balance sheet normalization

A more (less) aggressive strategy involves draining reserves quickly (slowly) & greater (lesser) reliance on MBS Money demand, multiplier & velocity will also determine when balances stabilize

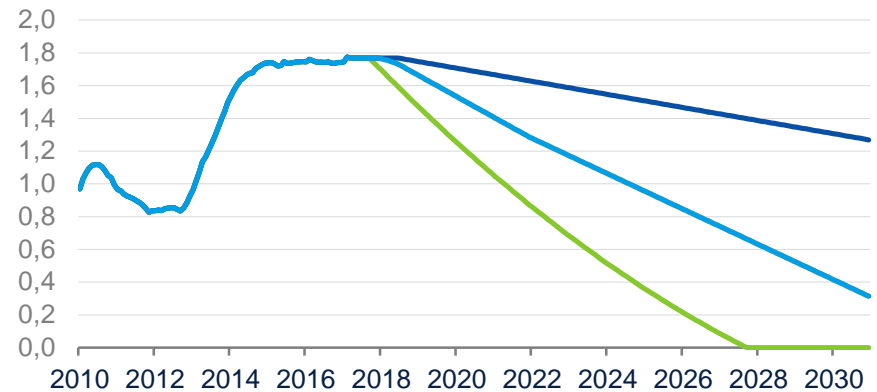
Total Assets
\$ Trillions



Treasuries,
\$ Trillions



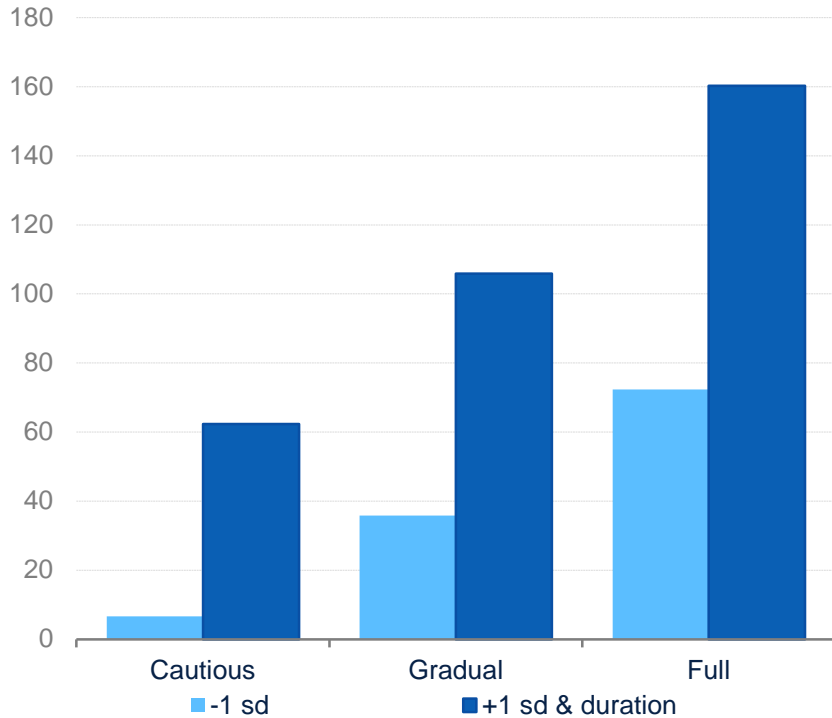
MBS,
\$ Trillions



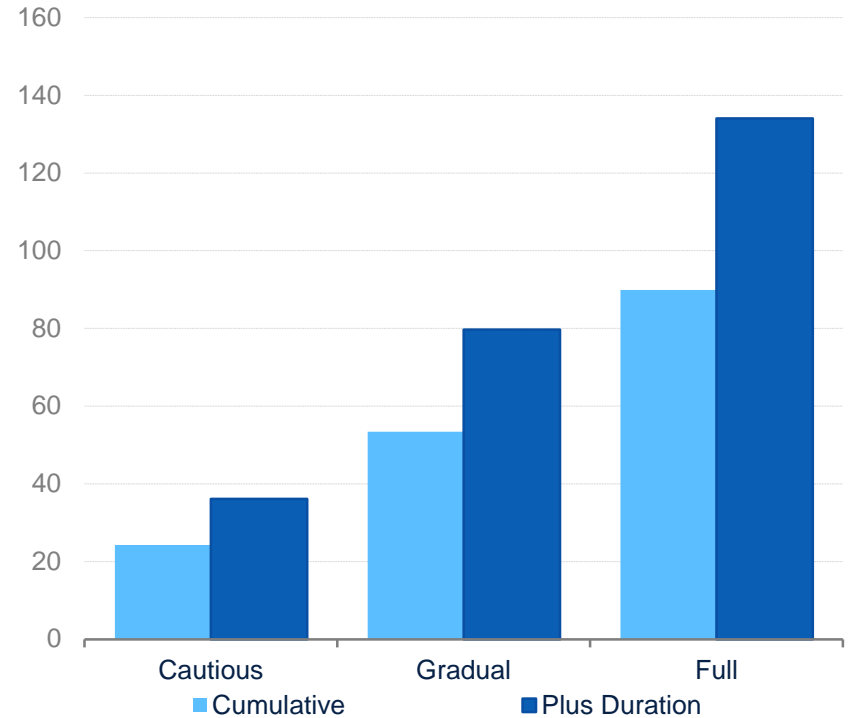
Balance sheet normalization

Market perceptions, eventual balance sheet size and composition to determine impact on 10-year treasury

2018-2022: 10YTN Equivalent Impact
Basis Points



2018-2022: 10YTN Equivalent Impact
Basis Points

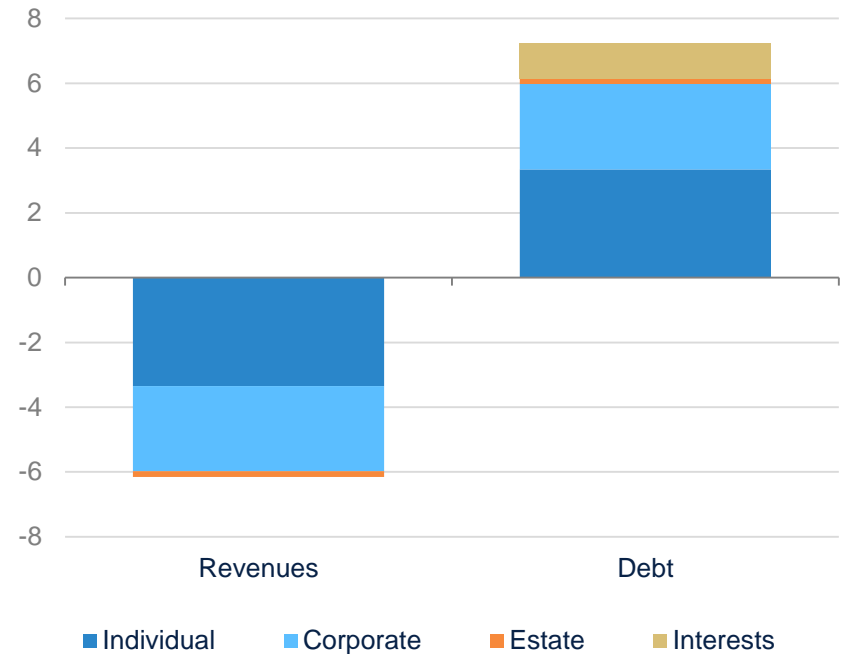


Fiscal policy

Comprehensive tax reform seems unlikely

- ◆ 3 tax brackets of 10%, 25% and 35%
- ◆ Doubling the standard deduction
- ◆ Maintain the Earned Income Tax Credit
- ◆ Maintain mortgage interest and charitable gift tax deductions
- ◆ Repeal the Alternative Minimum Tax
- ◆ Repeal the estate tax
- ◆ Repeal the 3.8% ACA investment tax
- ◆ 15% business tax rate
- ◆ Territorial tax system
- ◆ One-time foreign-earned income repatriation relief
- ◆ Reduce corporate tax breaks

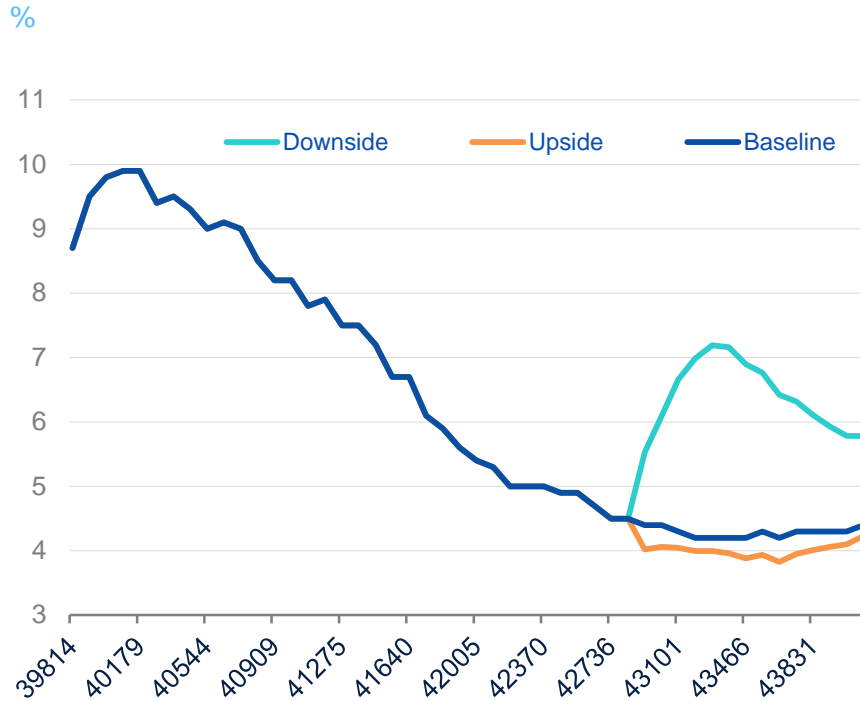
Trump's Tax Plan Impact on Tax Revenues and Debt, (\$ Trillions)



Macro scenarios: too early to deviate from baseline

Lack of progress from administration does suggest probability of reaching upside in 2017 is decreasing

Unemployment Rate



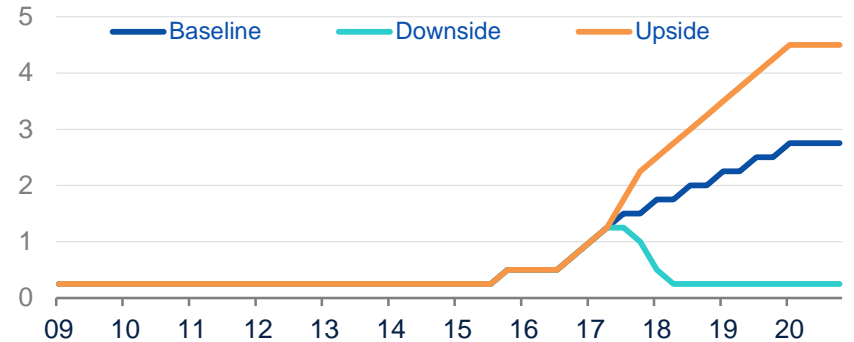
Consumer Price Index

Year-over-year % change



Fed Funds Target Rate

%



Key macroeconomic indicators

Medium-run inflation outlook subdued despite undershooting of long-run UR

U.S. Macroeconomic Indicators

	2016	2017	2018	2019	2020
Real GDP (% SAAR)	1.6	2.3	2.4	2.1	2.0
Real GDP (Contribution, pp)					
PCE	1.9	2.0	1.6	1.5	1.3
Gross Investment	-0.3	0.3	0.5	0.4	0.5
Non Residential	-0.1	0.2	0.4	0.4	0.5
Residential	0.2	0.1	0.1	0.1	0.1
Exports	0.1	0.7	0.6	0.6	0.5
Imports	-0.2	-1.0	-0.5	-0.6	-0.7
Government	0.1	0.1	0.2	0.2	0.2
Unemployment Rate (% average)	4.9	4.5	4.2	4.3	4.3
Avg. Monthly Nonfarm Payroll (K)	208	185	171	167	181
CPI (YoY %)	1.3	2.6	1.9	2.0	2.1
Core CPI (YoY %)	1.3	2.2	1.9	2.0	2.0
Fiscal Balance (% GDP)	-3.1	-2.5	-2.4	-2.9	-3.1
Current Account (bop, % GDP)	-2.8	-3.0	-3.1	-3.1	-3.2
Fed Target Rate (% eop)	0.75	1.50	2.00	2.50	2.75
Core Logic National HPI (YoY %)	5.4	6.6	6.2	6.1	5.2
10-Yr Treasury (% Yield, eop)	2.49	2.70	2.96	3.25	3.35
Brent Oil Prices (dpb, average)	45.2	57.0	58.7	59.6	59.6

Outlook United States

2nd QUARTER 2017



Aluminum
Chrome
Nickel
Bauxite
Cotton
Ferrous
Textiles
Wool
Ferrous
Sulfur
Sulfur
Oil
Gas
Electric power
CHANGE
ASIA
22%
18%
22%
TYU d
54
550
50
320
50
Tin
Copper
Steel
Beryllium
Manganese
Aluminum
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