BBVA | RESEARCH

June

2016

US Interest Rates

Chartbook

Takeaways

The FOMC's unanimous vote to leave the policy rate unchanged followed by the post-"Brexit"-vote environment of dovish Fedspeak undertone indicates high uncertainty around the projected Fed funds rate path

> "We are quite uncertain about where rates are heading in the longer term." FRB Chair Yellen, FOMC Press Conference, June 15, 2016
>
> "…at least for the time being, the appropriate level of rates is simply lower than it was before the crisis. As a result, policy is not as stimulative as it might appear to be." FRB Governor Powell, June 28, 2016

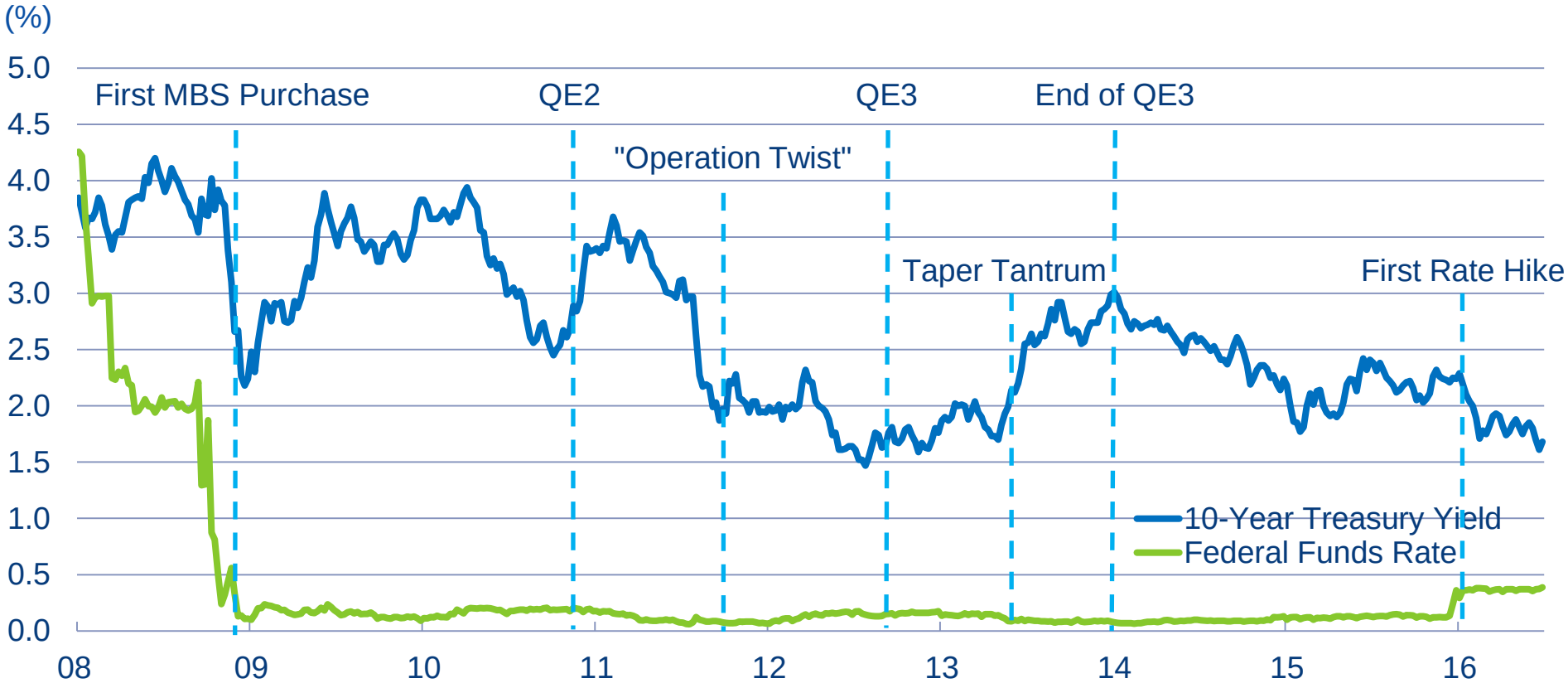
The Fed funds futures market has adjusted to the dovish Fed stance, erasing the odds for a 2016 rate increase and pricing in a 54% likelihood for one rate hike by the end of 2017

The yield curve has flattened under downward pressure on the long end due to the post-"Brexit"-vote flight to safety rush, coupled with a prolonged period of negative term premium and further duration risk compression

We continue to expect limited increase in long-term yields in the long run due to global risk-off sentiment, low inflation risk, moderate growth expectations, and the condensed duration risk environment

Unconventional monetary policy

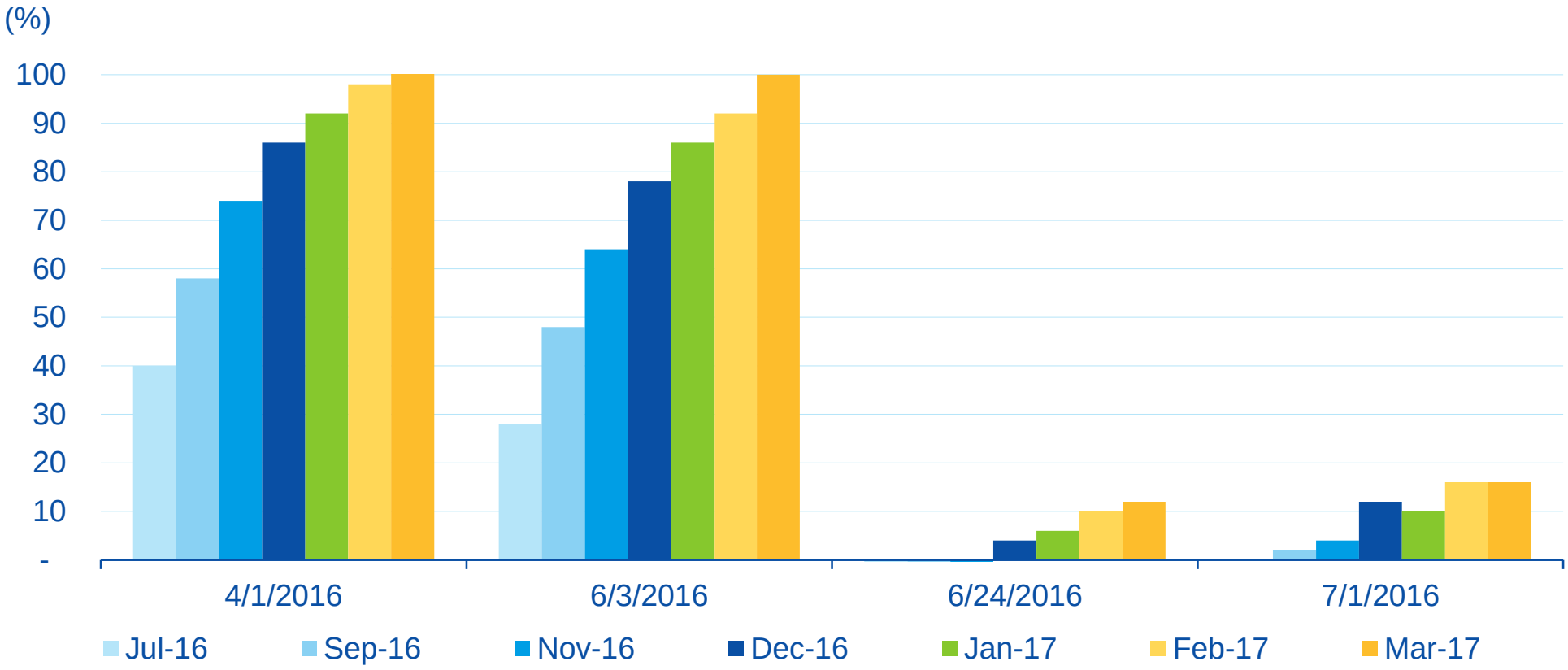
Federal Funds Rate and 10-Year Treasury Note



Source: BBVA Research, Federal Reserve Board and Haver Analytics

Futures trades erase summer rate hike probability

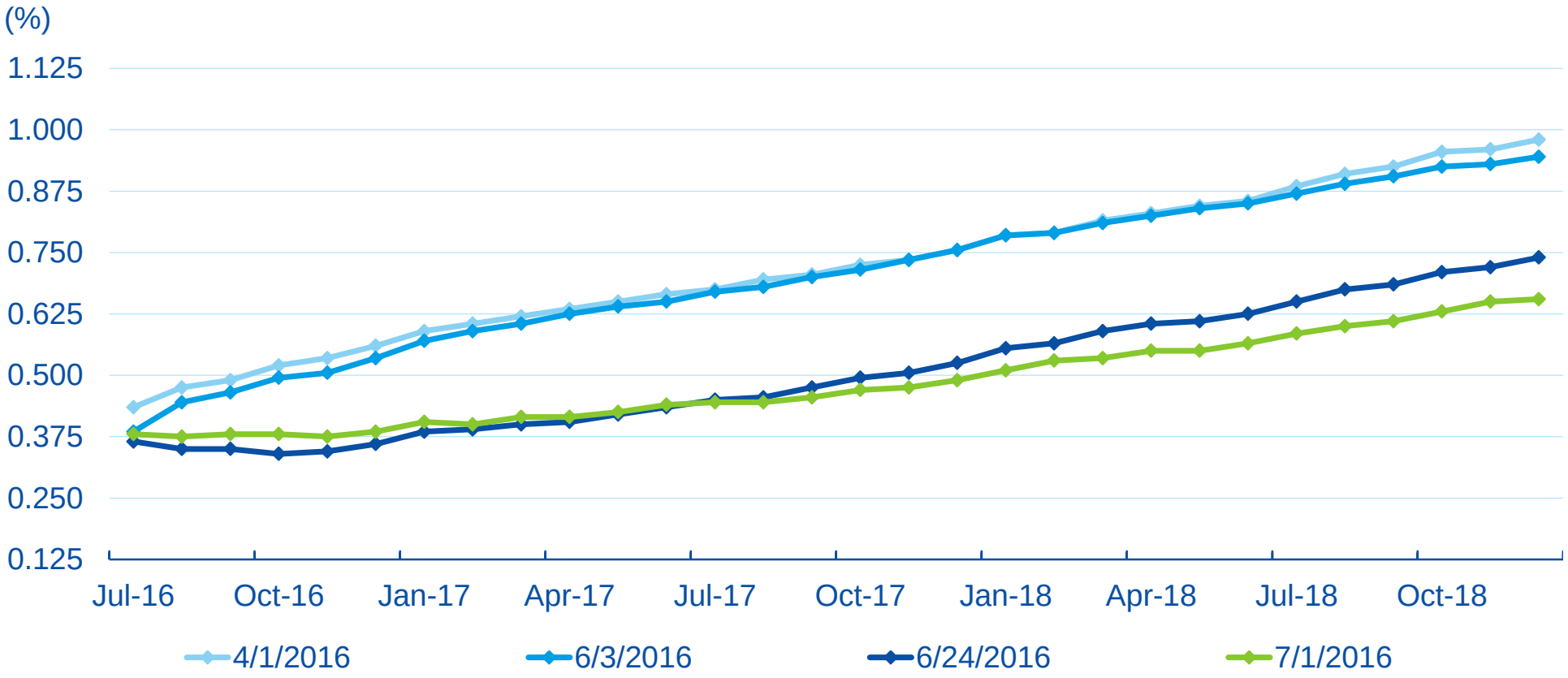
Fed Funds Futures Implied Probabilities, Second 25bp



Source: BBVA Research and Bloomberg

Historic flattening in Fed funds futures curve

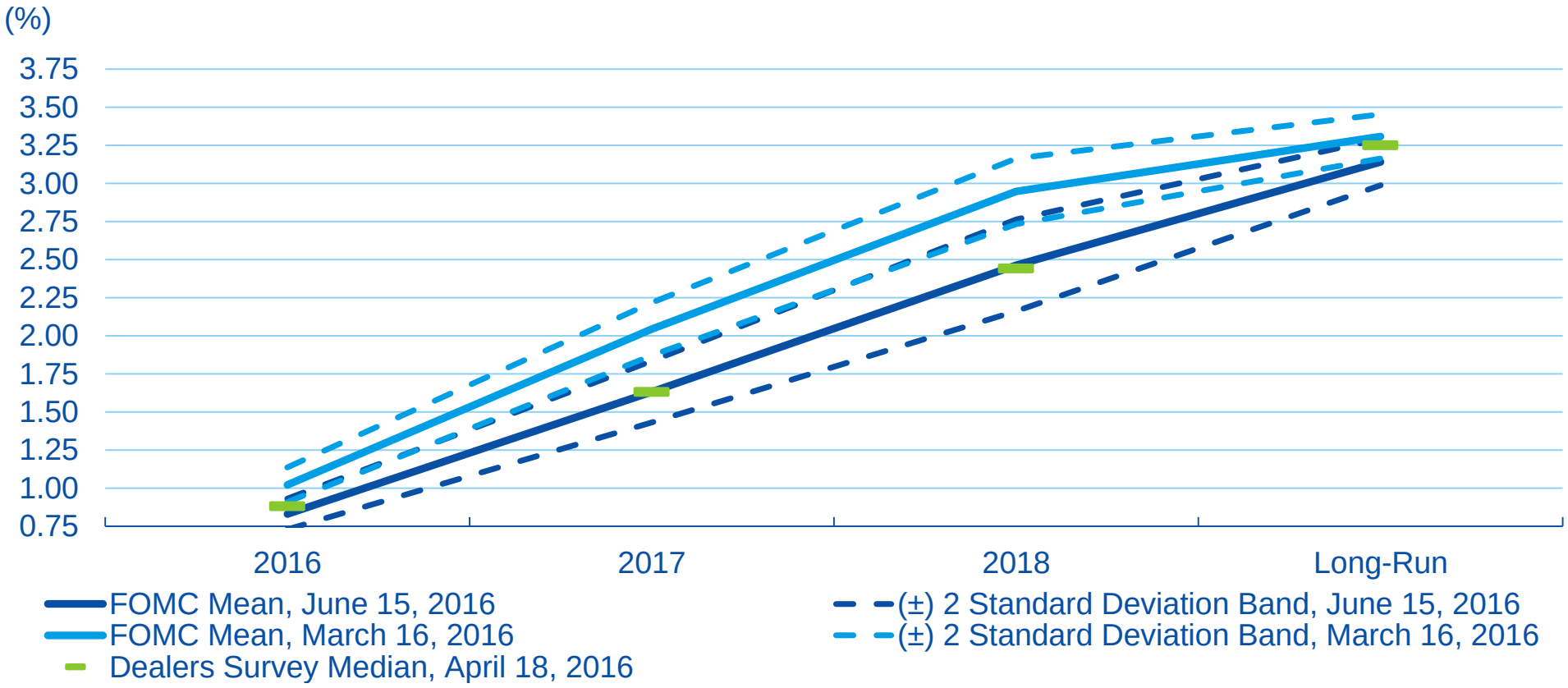
Fed Funds Futures – Most Recent, 1 Week Prior, 1 Month Prior, 3 Months Prior



Source: BBVA Research and Bloomberg

FOMC revised downwards the policy firming path by 20 basis points in 2016 and 40 basis points in 2017

Projected Pace of Policy Firming

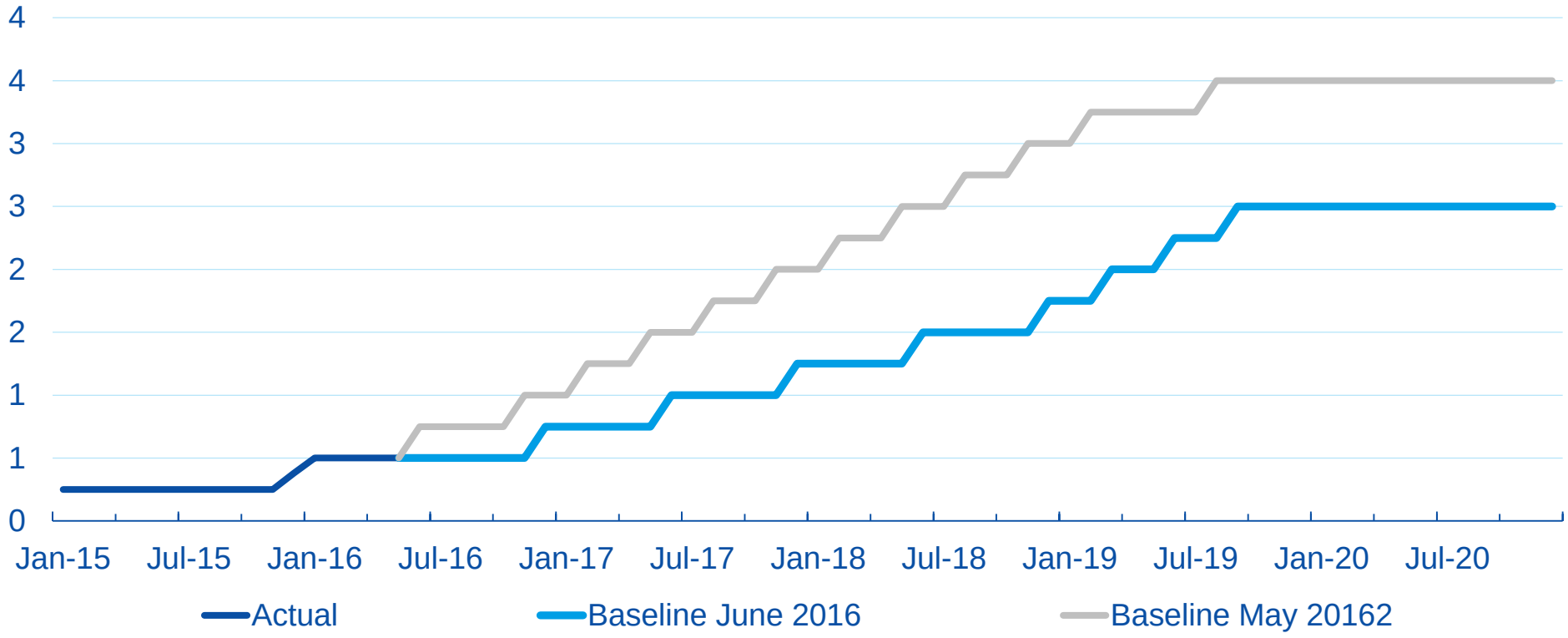


Source: BBVA Research and Federal Reserve Board

BBVA forecast of the pace of Fed funds firming revised to a lower rate path

Federal Funds Rate

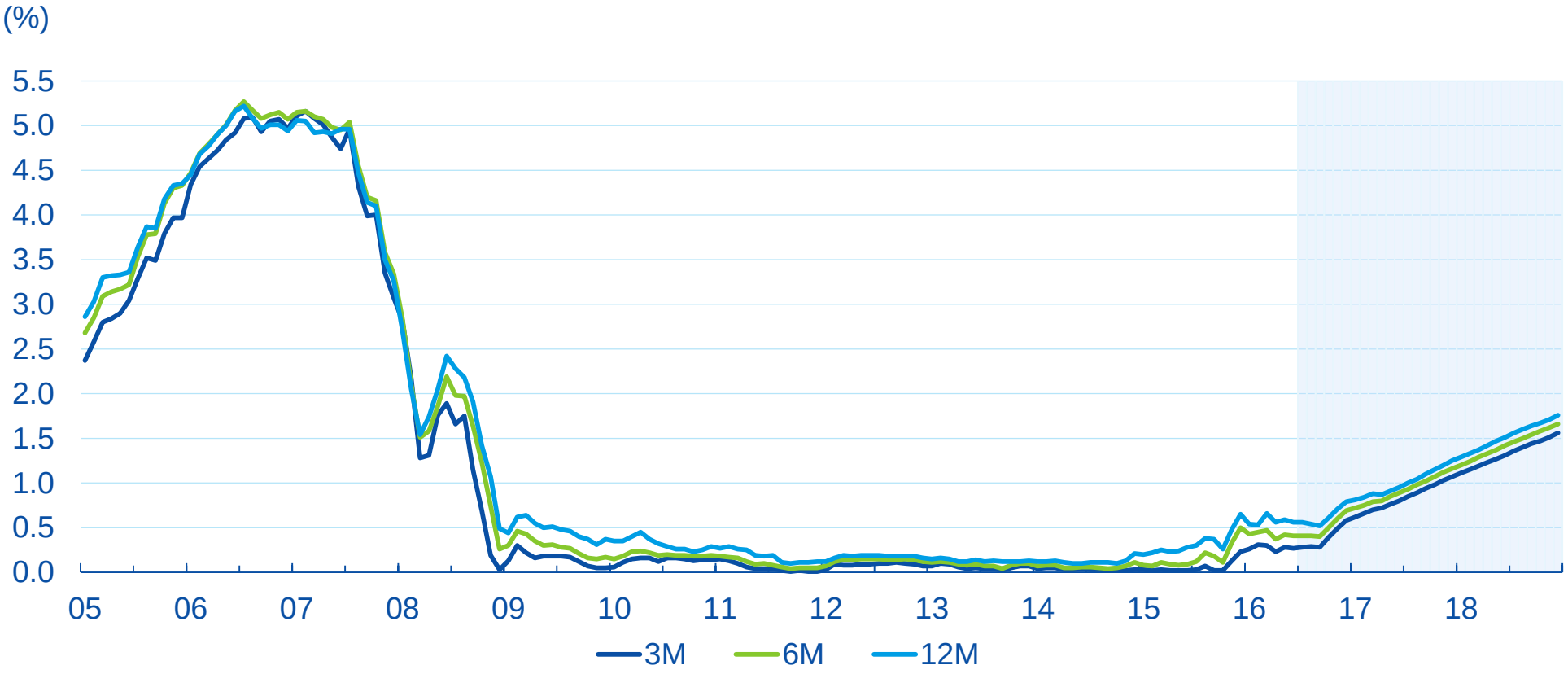
(Upper Bound, %)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

Treasury bill yield baseline forecasts

3-Month to 12-Month Rates

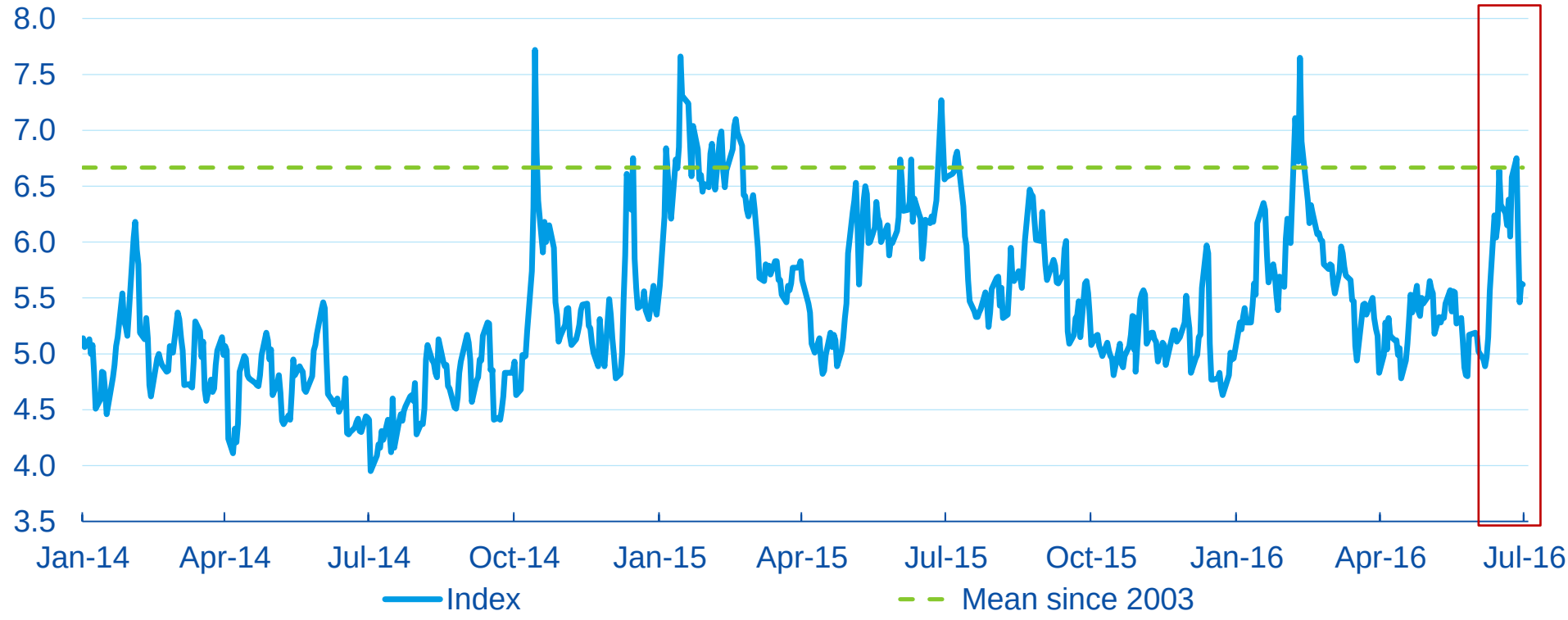


Source: BBVA Research, Federal Reserve Board and Haver Analytics

June long-term rate futures volatility reaches but does not surpass the historic mean

10-Year U.S. Treasury Note Volatility

(Daily Index)



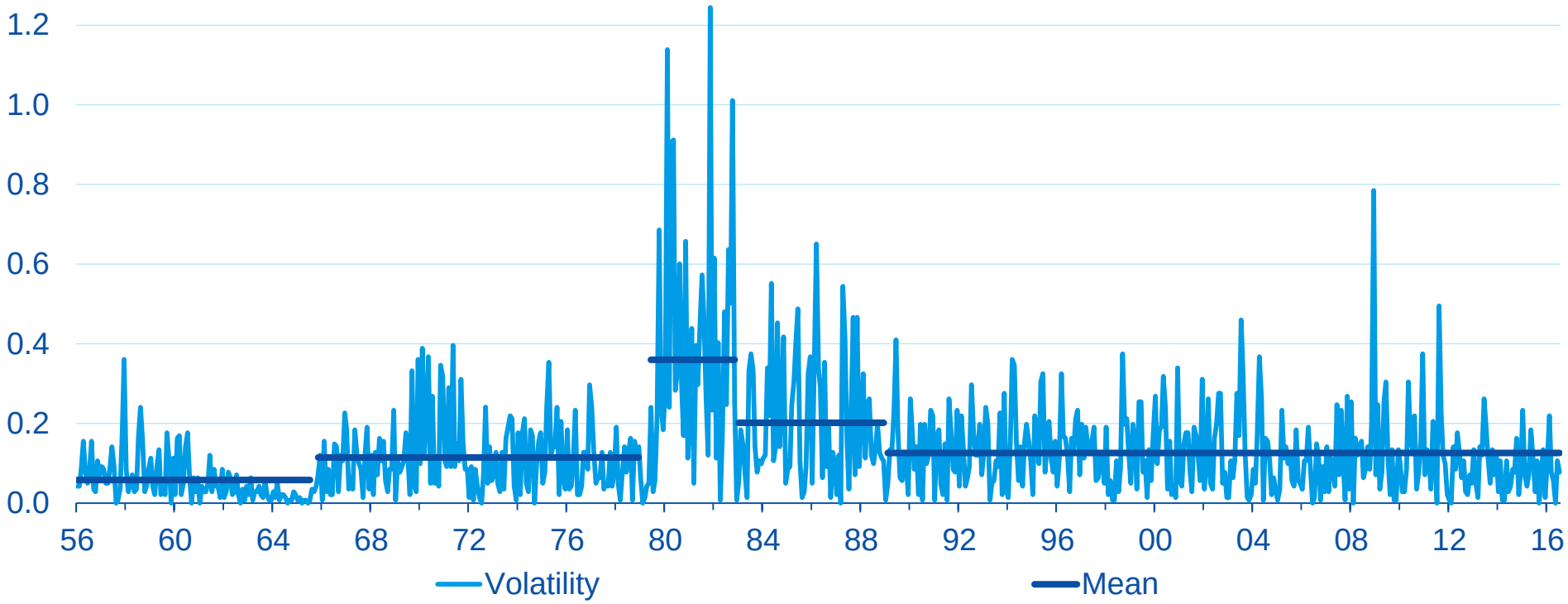
Index measures a constant 30-day expected volatility of 10-Year Treasury Note futures prices, and is calculated based on transparent pricing from Chicago Board of Trade's actively traded options on the Treasury Note futures.

Source: BBVA Research, Chicago Board Options Exchange and Bloomberg

Long-term rate yield volatility is near historic mean

10-Year U.S. Treasury Yield Volatility

(MoM, %)

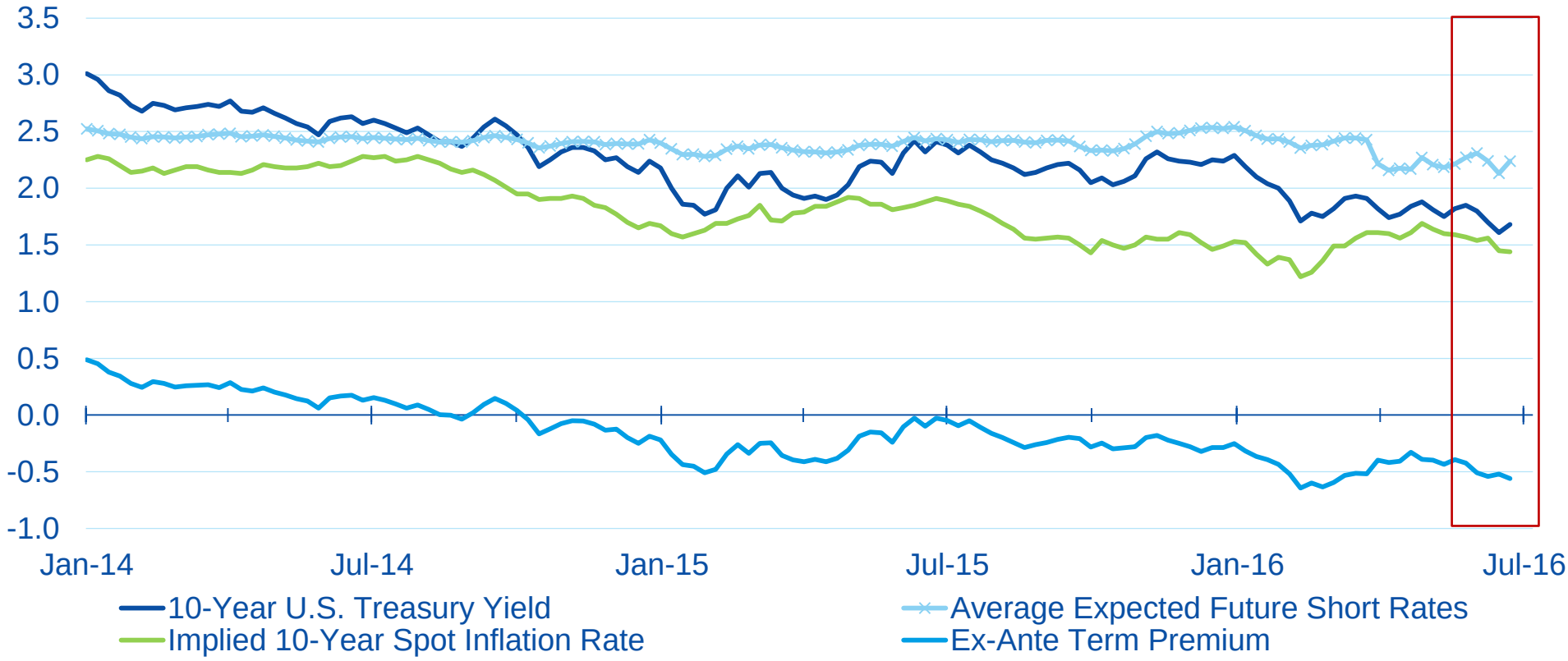


Source: BBVA Research, Federal Reserve Board and Haver Analytics

Downward pressure on term premium unchanged

10-Year U.S. Treasury Term Premium & Market Inflation Expectations

(Weekly, %)

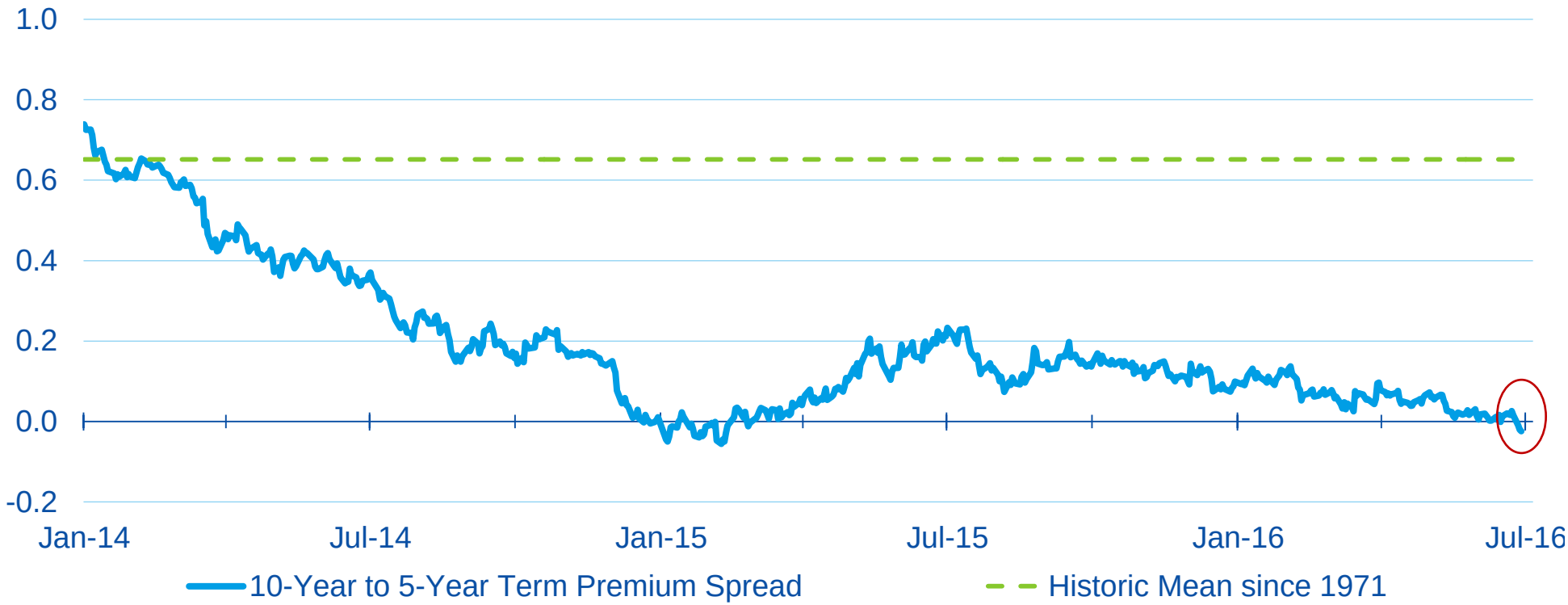


Fuente: BBVA Research and Federal Reserve Board

Long-term duration-risk compression crosses over from near zero into negative territory

Duration-Risk Compression

(Daily, %)



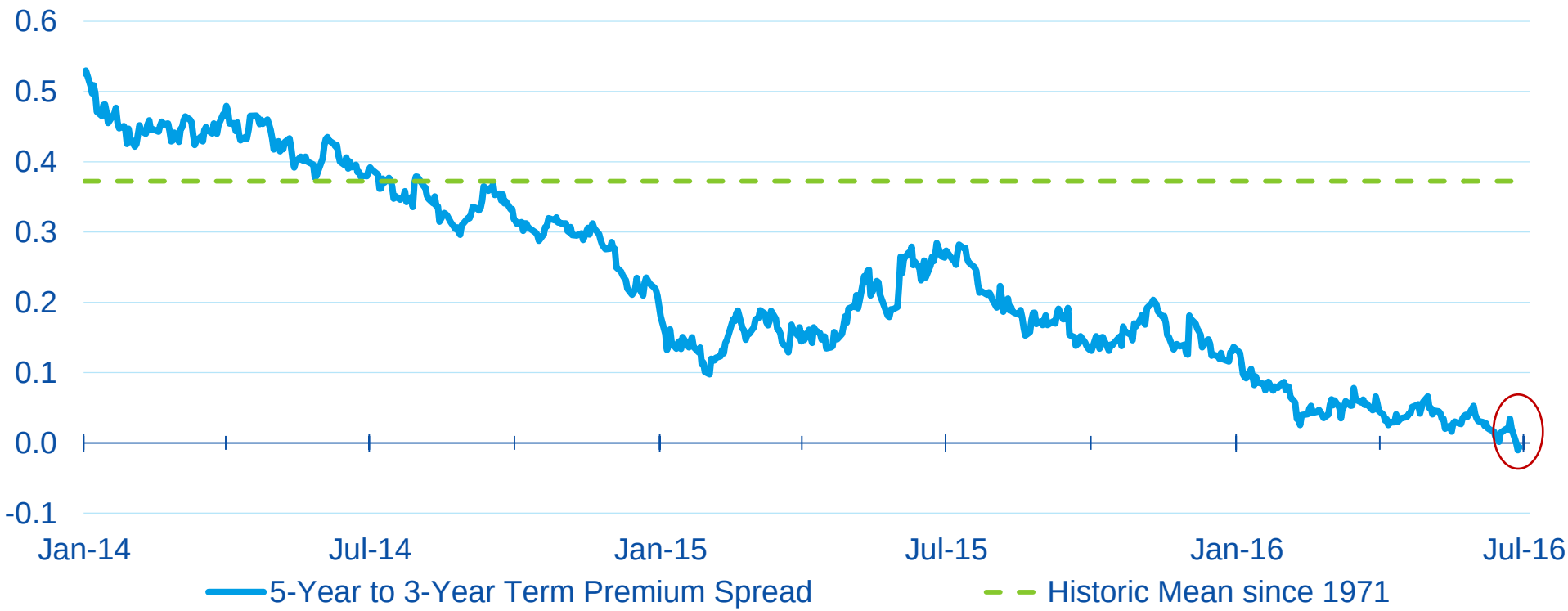
Calculated as the difference between 5-Year and 3-Year term premium reported by the New York Fed ACM (Adrian, Crump, and Moench) five-factor, no-arbitrage term structure model incorporating pricing factors.

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

Mid-term duration-risk compression crosses over from near zero into negative territory

Duration-Risk Compression

(Daily, %)



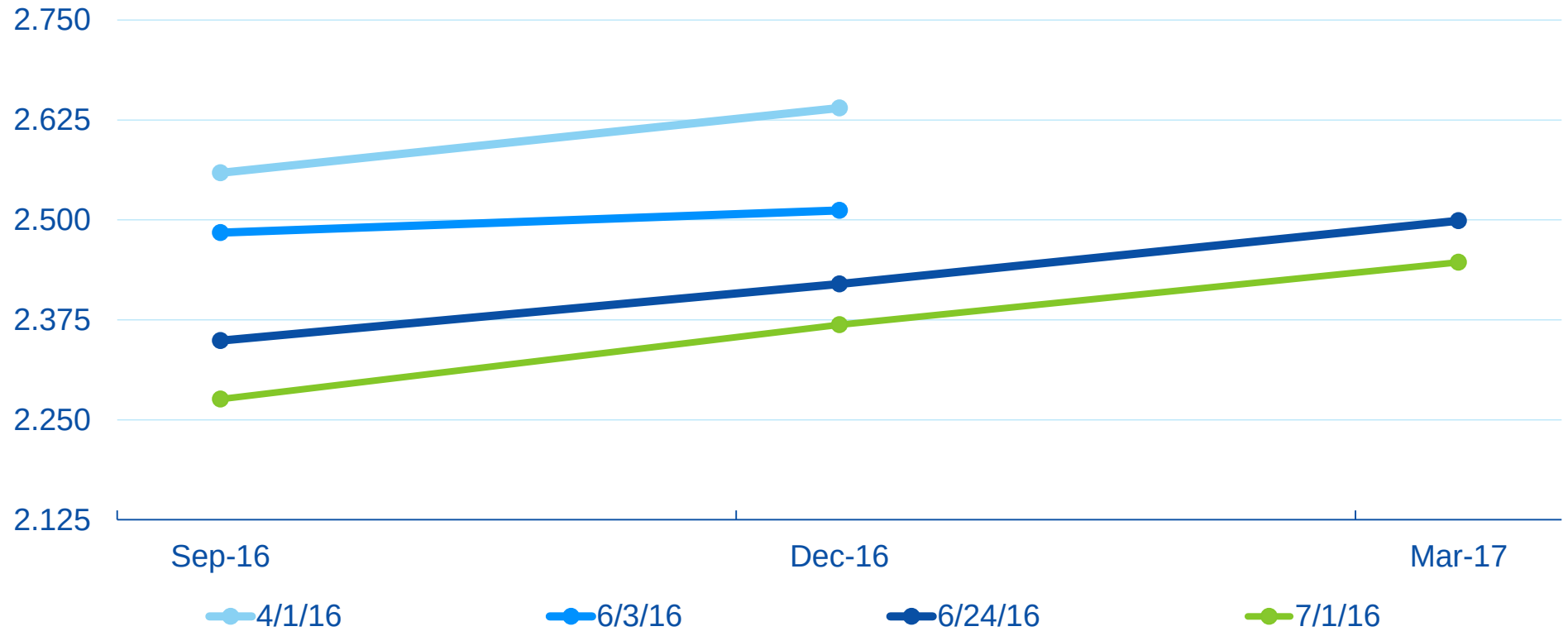
Calculated as the difference between 5-Year and 3-Year term premium reported by the New York Fed ACM (Adrian, Crump, and Moench) five-factor, no-arbitrage term structure model incorporating pricing factors.

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

Futures discount at 17bp raise in 10YTN yields over the next 3 quarters

10-Year U.S. Treasury Yield Futures – Most Recent, 1 Week Prior, 1 Month Prior, 3 Months Prior

(%)



Source: BBVA Research and Bloomberg

10-year treasury yield forecasts

10-Year U.S. Treasury Yield

* National Association for Business Economics (NABE) Outlook median forecast compiled from a panel of NABE members. Last release date June 5, 2016
** Survey of Professional Forecasters (SPF) conducted by Federal Reserve Bank of Philadelphia. Last release date May 13, 2016

Source: BBVA Research, NABE, FRB Philadelphia, Office of Management and Budget, and Haver Analytics

Yield curve slope forecasts

Treasury Yield Curve Slope

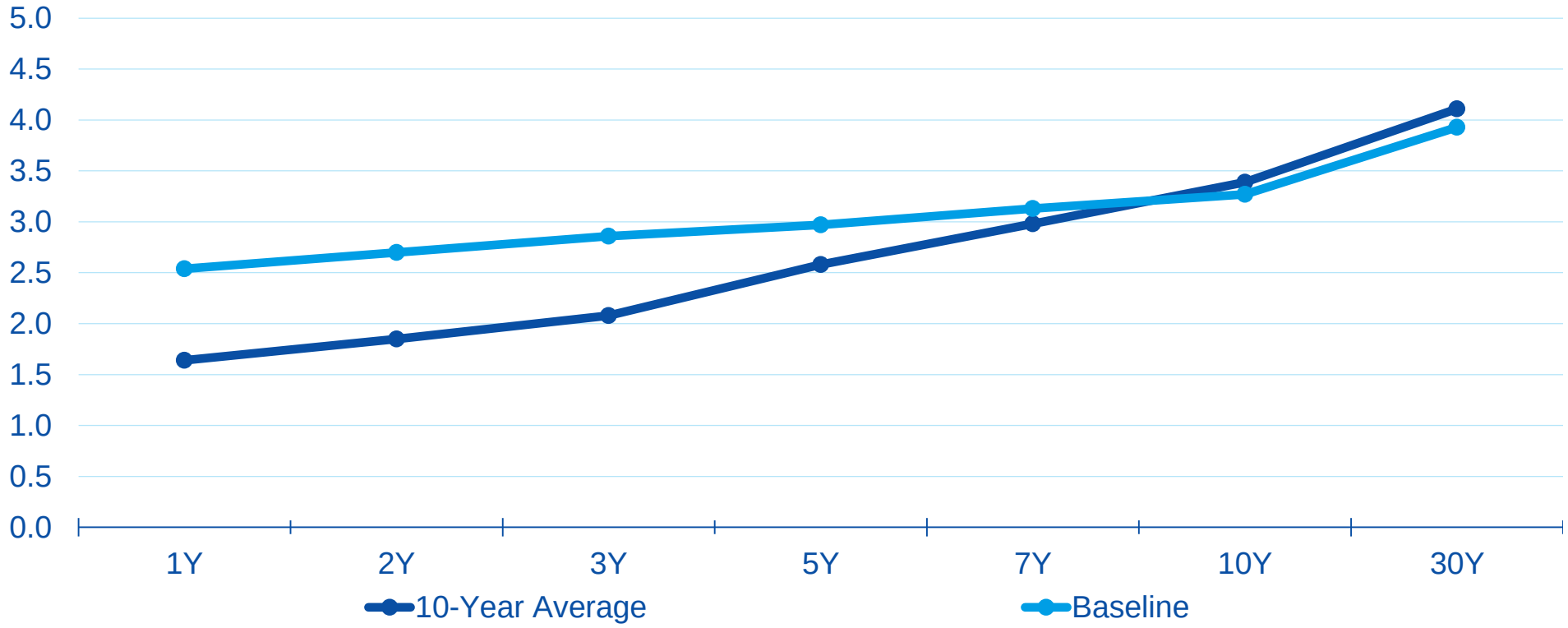
(10Y-2Y, %)

Source: BBVA Research, Federal Reserve Board and Haver Analytics

2019 yield curve forecasts

2019 Treasury Yield Curve

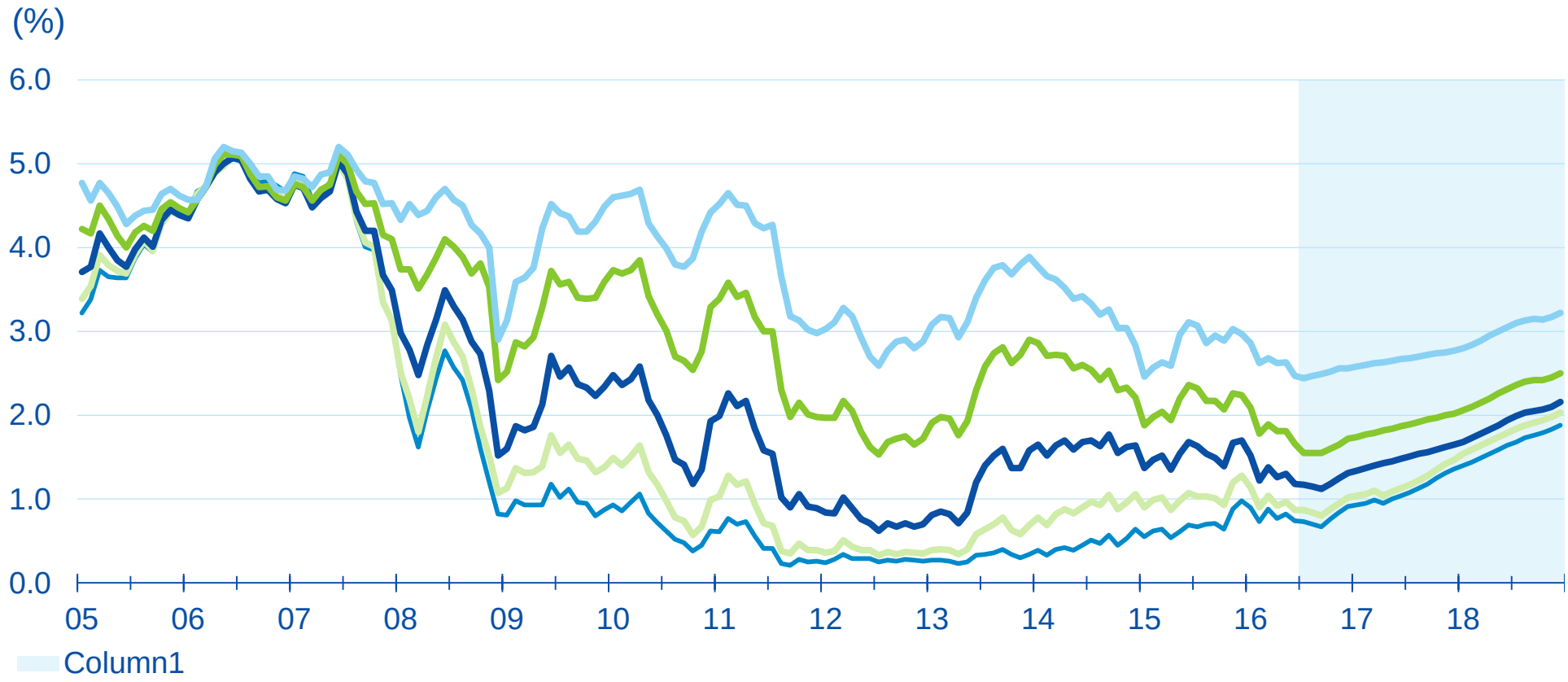
(EOP, %)



Source: BBVA Research, Federal Reserve Board and Haver Analytics

Treasury yield curve baseline forecasts

U.S. Treasury Yield Curve

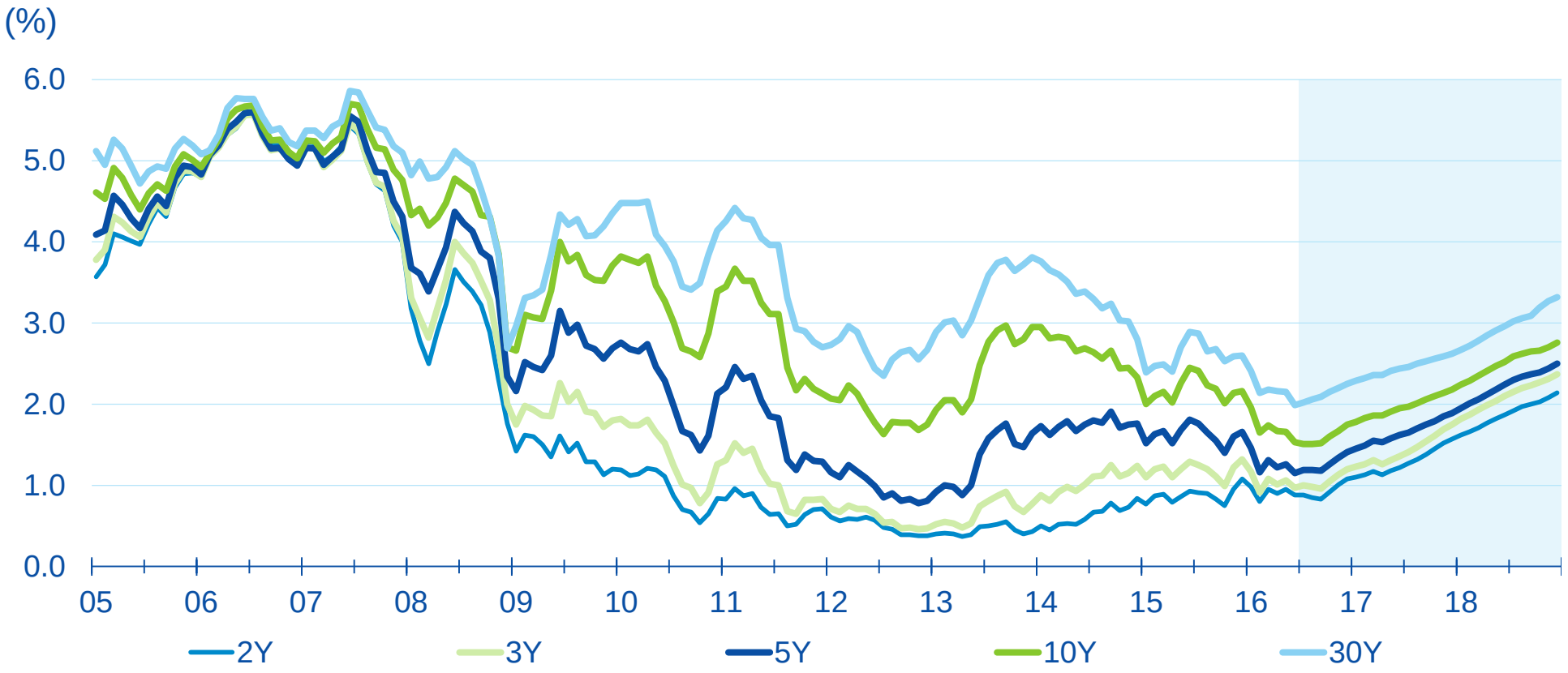


Source: BBVA Research, Federal Reserve Board and Haver Analytics

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.

Swap curve baseline forecasts

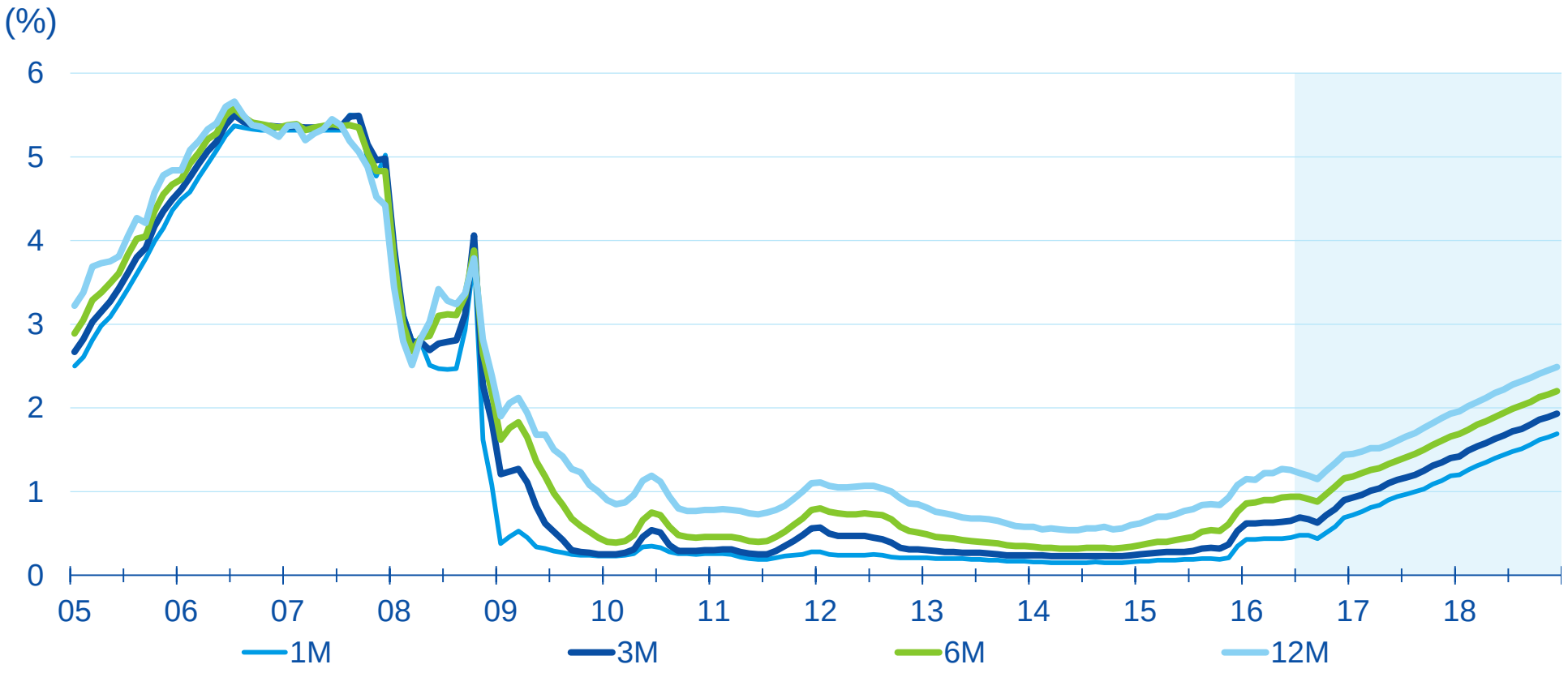
U.S. Swap Rates



Source: BBVA Research, Federal Reserve Board and Haver Analytics

LIBOR curve baseline forecasts

U.S. LIBOR Rates



Source: BBVA Research, Federal Reserve Board and Haver Analytics

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