

February
2017

US Interest Rates
Chartbook



Takeaways

The FOMC minutes have reinforced the commitment to gradual rate normalization, however the pace of tightening could change if the risk of overheating the economy is perceived

“it might be appropriate to raise the federal funds rate *again fairly soon if* incoming information on the labor market and inflation was in line with or stronger than their current expectations or if the risks of overshooting the Committee's maximum-employment and inflation objectives increased” (FOMC minutes, February 22, 2017)

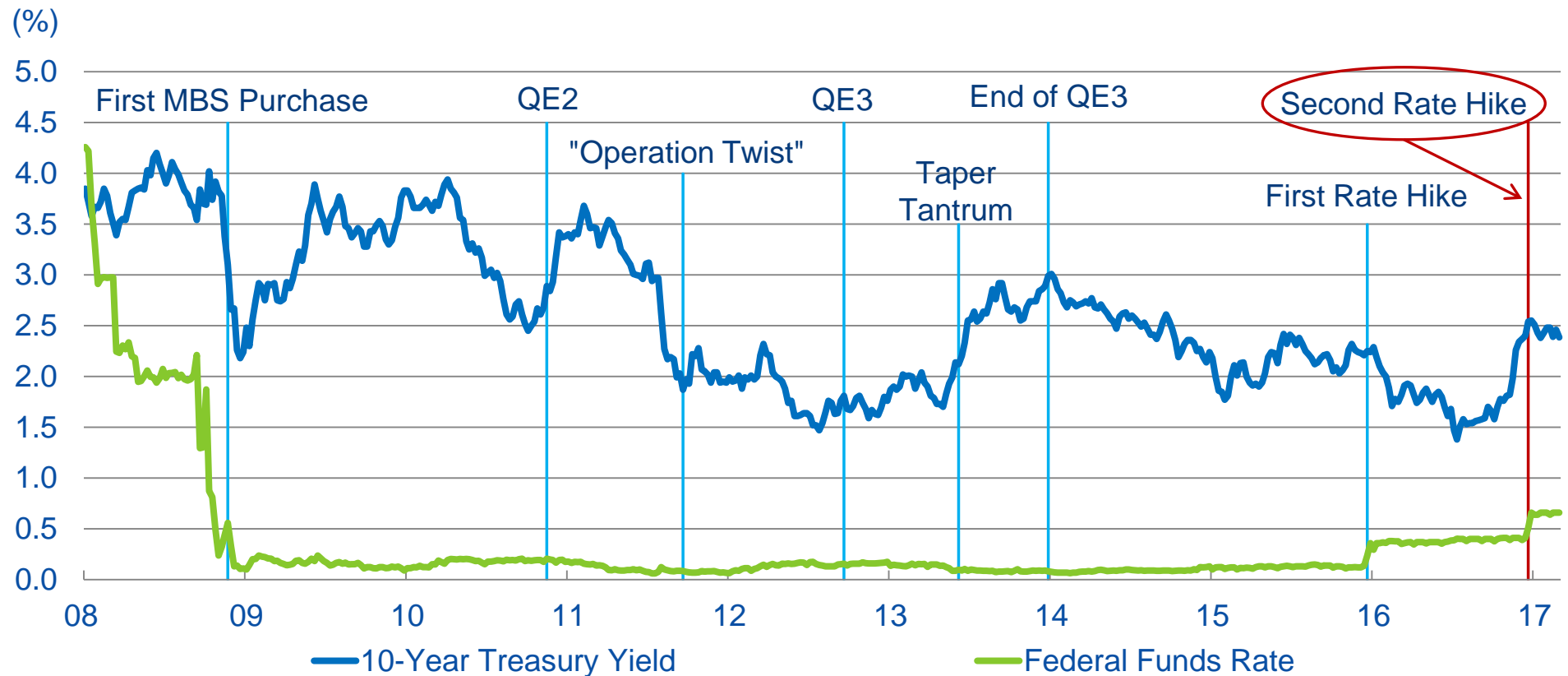
The Primary Dealer's expectations remained unchanged. Fed funds futures continue to price in two rate hikes in 2017 but imply 50-50 odds for the FOMC's action in March

The volatility in long-term yields has remained contained, due in part to a lack of further upward pressure on inflation expectations, and edged down to a near-zero term premium

We continue to expect a moderate increase in long-term yields, supported by a soft risk-on sentiment and higher expectations for growth and inflation. The baseline is for higher long-term rates and for a relatively flatter yield curve, while risks to the baseline projections for overall long-term yields are biased towards the upside

Unconventional monetary policy

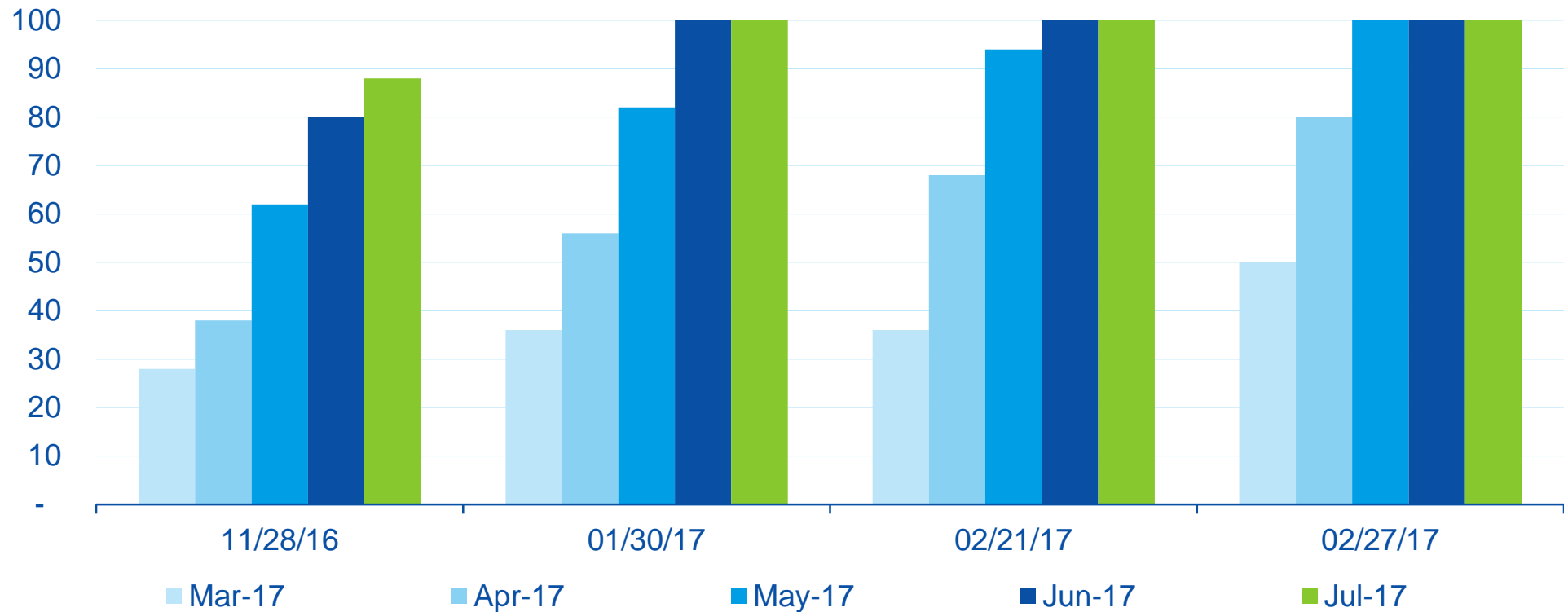
Federal Funds Rate and 10-Year Treasury Note



March rate hike probability has reached 50%

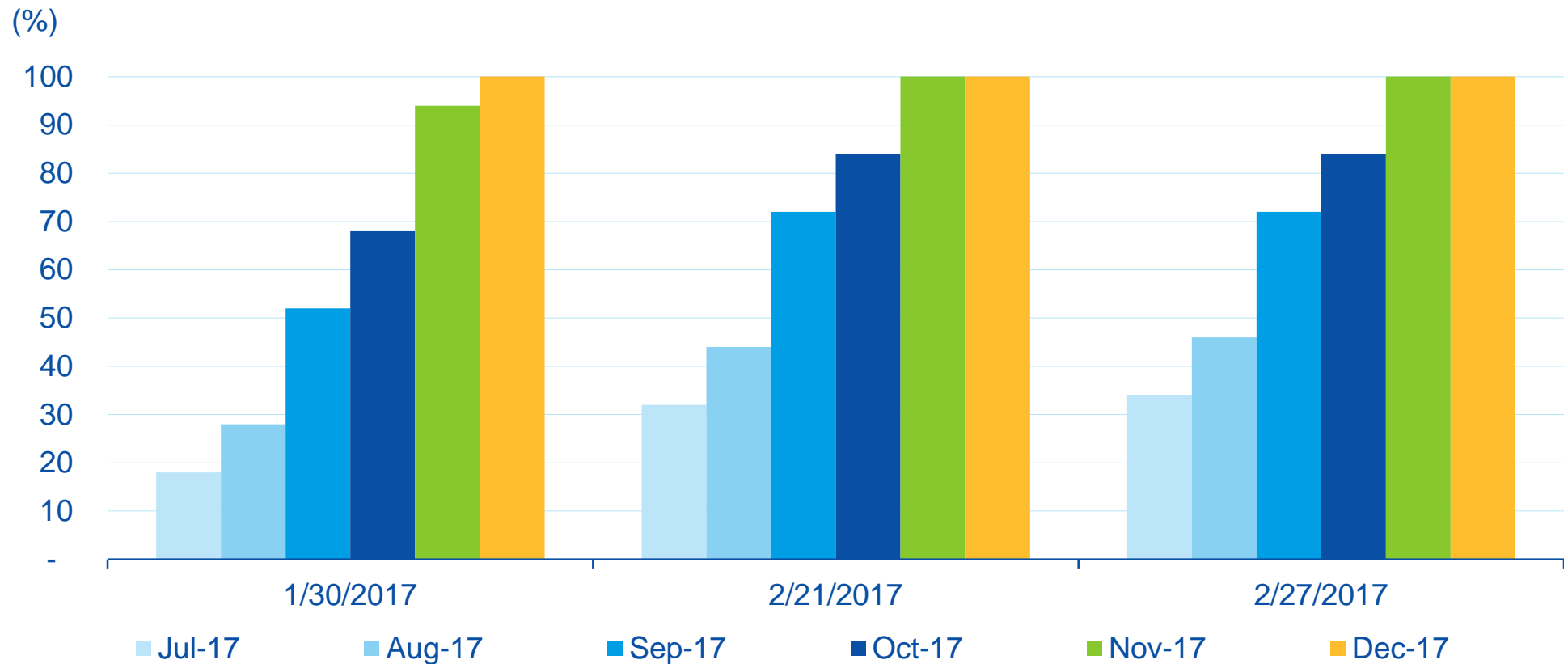
Fed Funds Futures Implied Probabilities, Third 25bp Hike

(%)



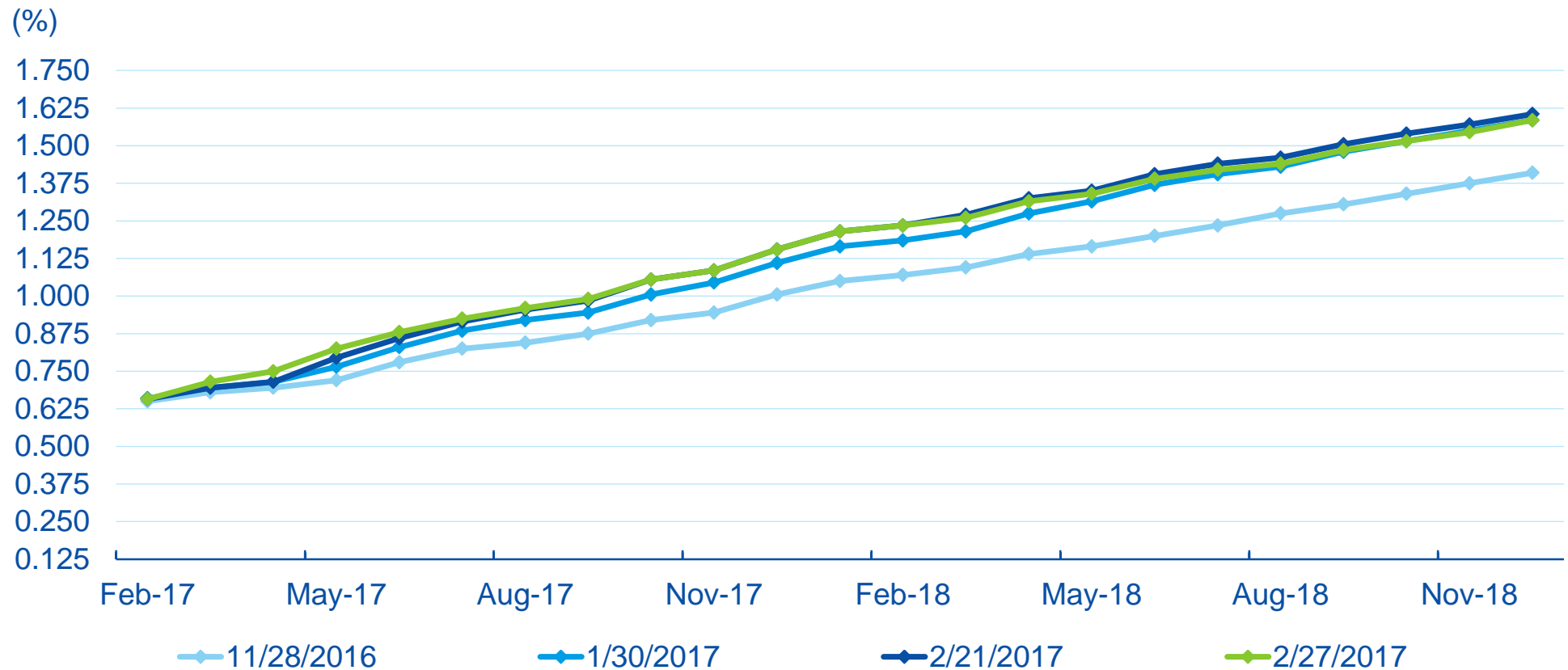
Fourth rate hike is priced in for 3Q17

Fed Funds Futures Implied Probabilities, Fourth 25bp Hike



Fed funds futures curve

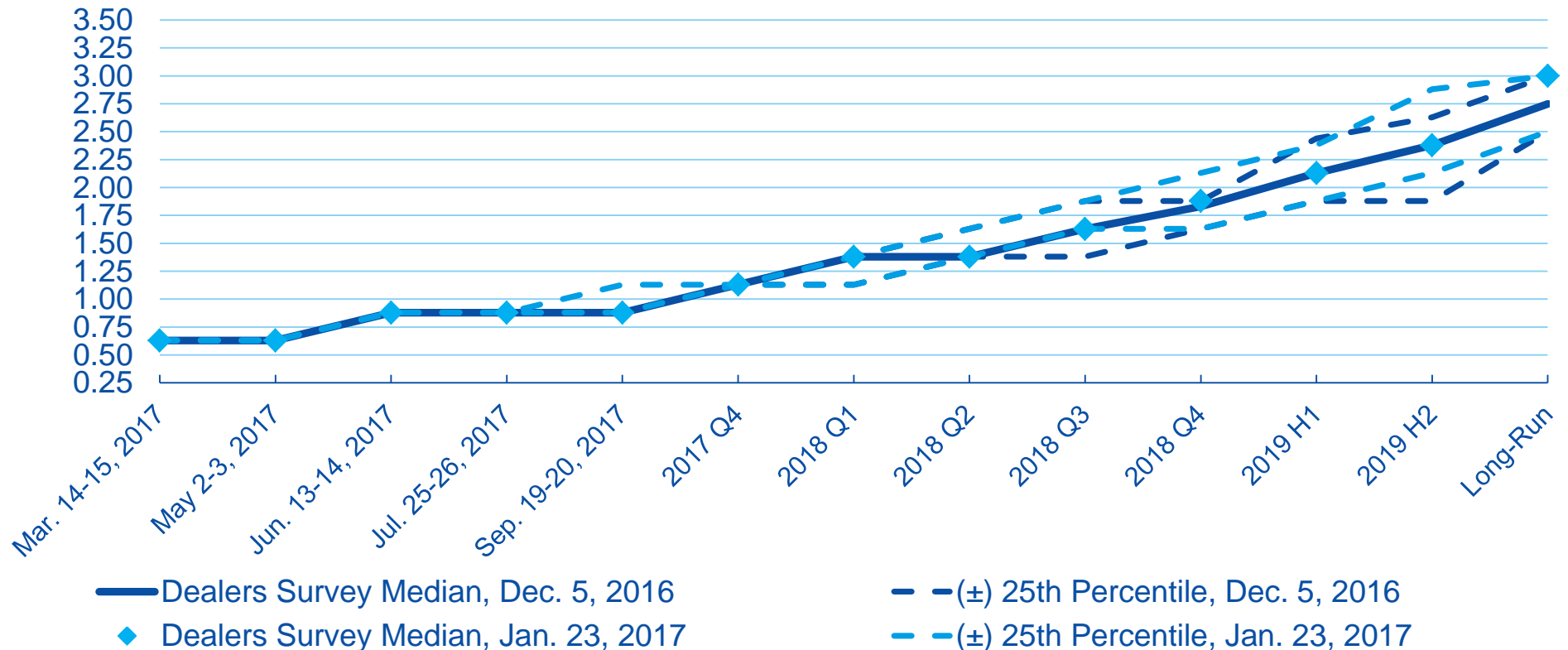
Fed Funds Futures – Most Recent, 1 Week Prior, 1 Month Prior, 3 Months Prior



Dealers' expectations for 2017-2019 remain unchanged

Projected Pace of Policy Firming

(%)

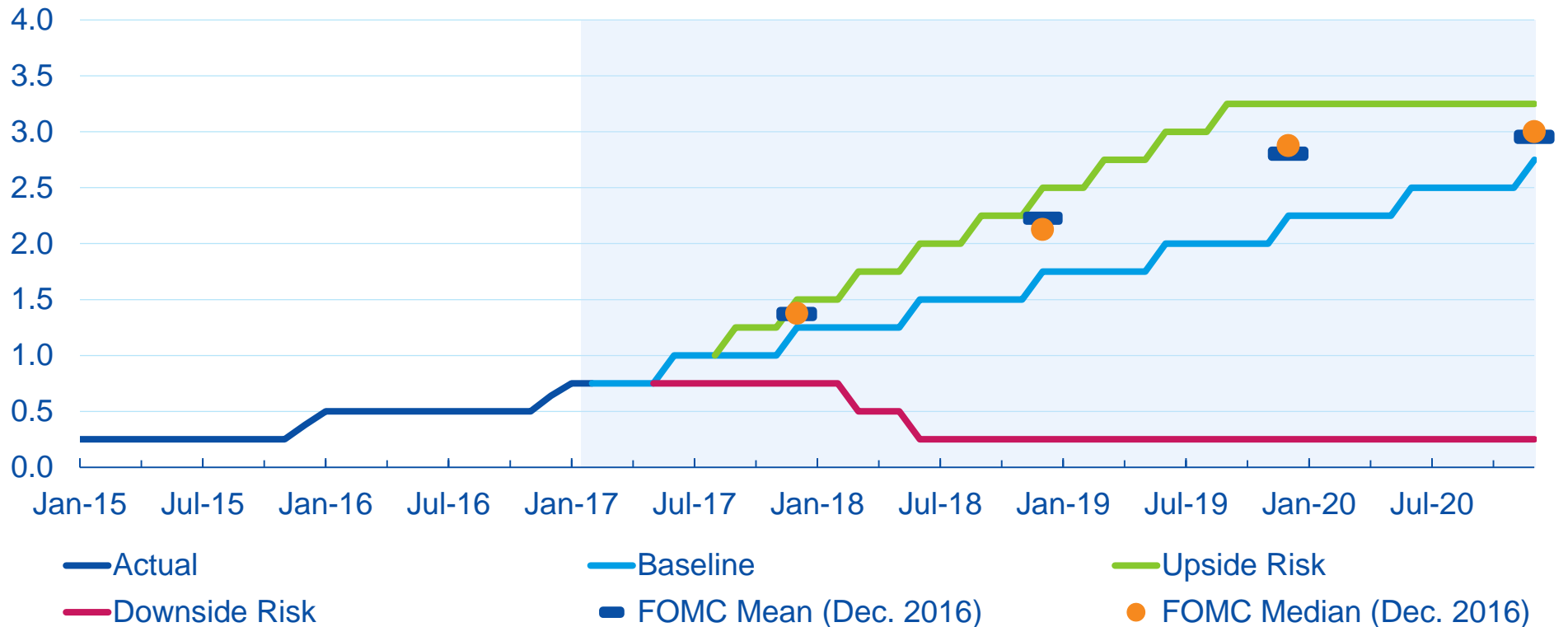


Source: BBVA Research, Federal Reserve Bank of New York and Federal Reserve Board

BBVA forecast of the Fed funds firming pace

Federal Funds Rate

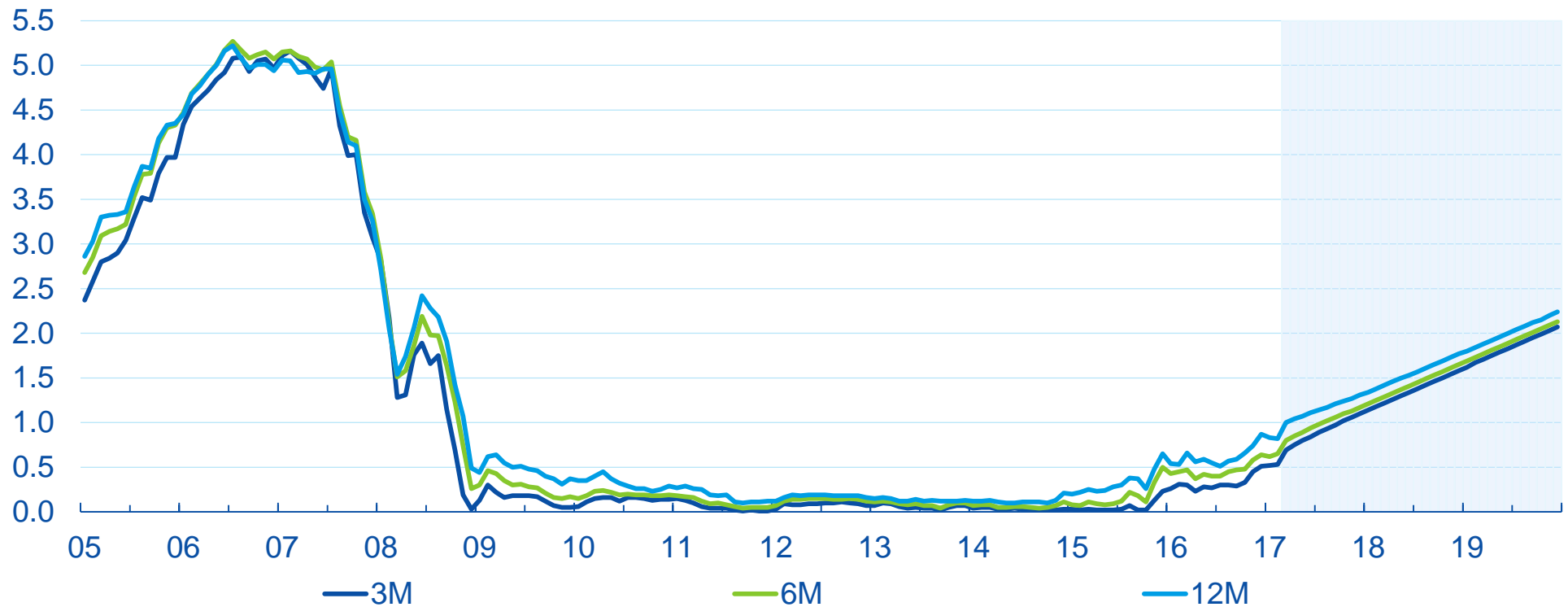
(Upper Bound, %, EOP)



Baseline forecasts of Treasury Bill yield

3-Month to 12-Month Rates

(%)



Long-term yield volatility has normalized below historic mean

10-Year U.S. Treasury Note Volatility

(Daily Index)



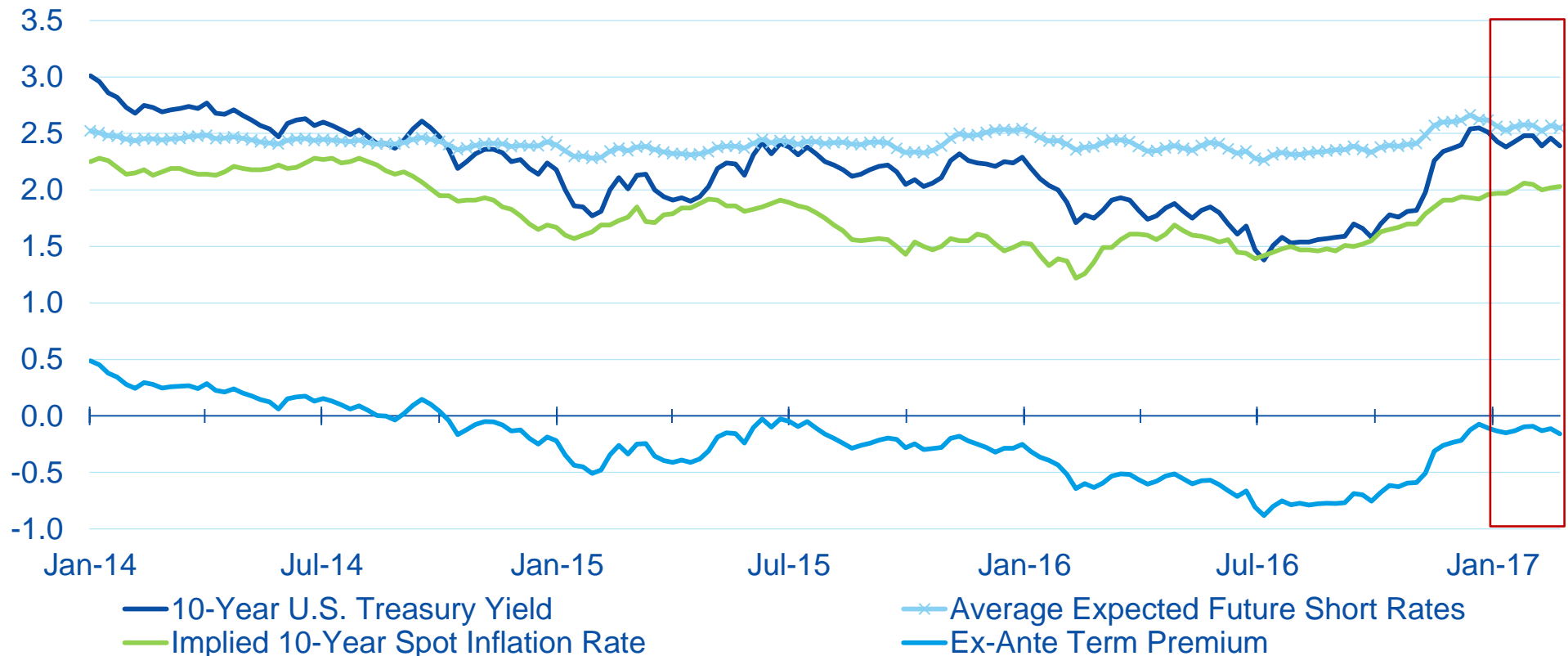
Index measures a constant 30-day expected volatility of 10-Year Treasury Note futures prices, and is calculated based on transparent pricing from Chicago Board of Trade's actively traded options on the Treasury Note futures

Source: BBVA Research, Chicago Board Options Exchange and Bloomberg

Soft upward pressure on term premium maintained

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

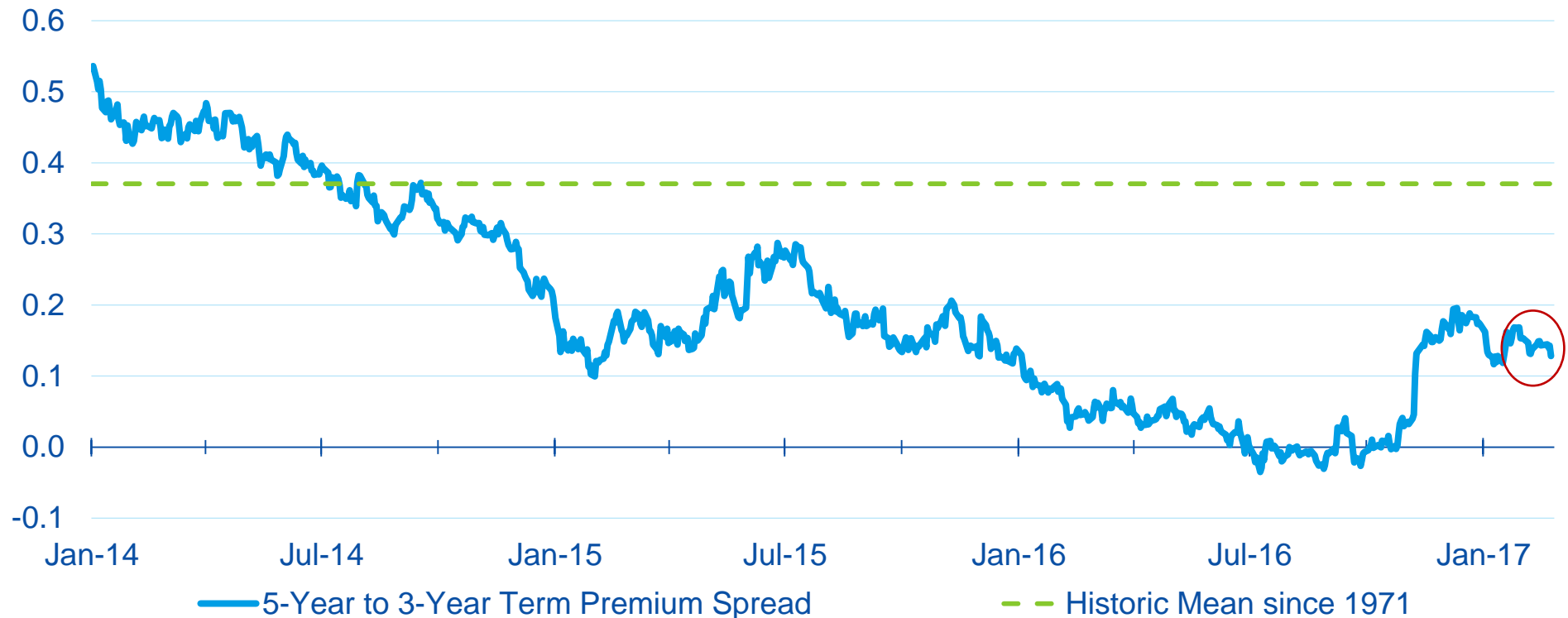
(Weekly, %)



Mid-term duration-risk compression has normalized in the vicinity of 14 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 normalized in the vicinity of 8 basis points

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

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 Dec 4, 2016

** 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

****The Blue Chip Consensus is the average of about 50 private forecasts. Last release date July 19, 2016

Yield curve slope forecasts

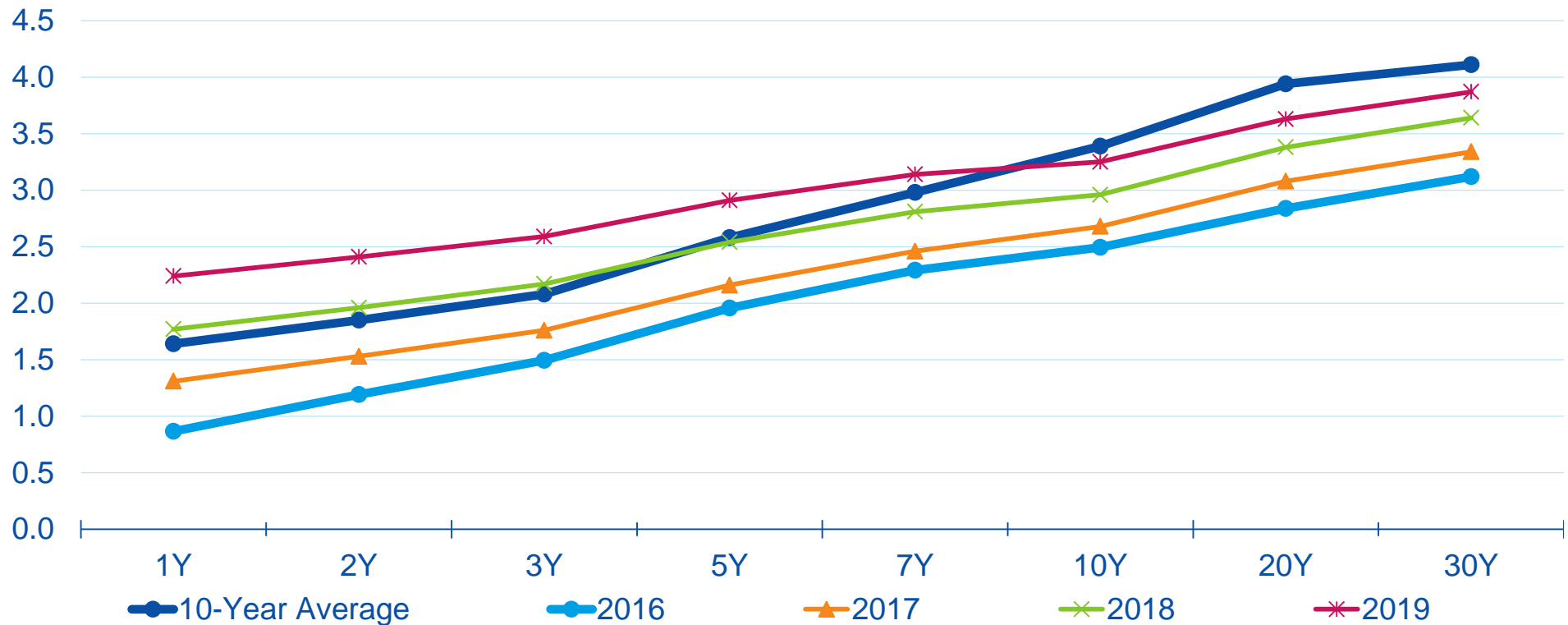
Treasury Yield Curve Slope

(%, 10Y-2Y)



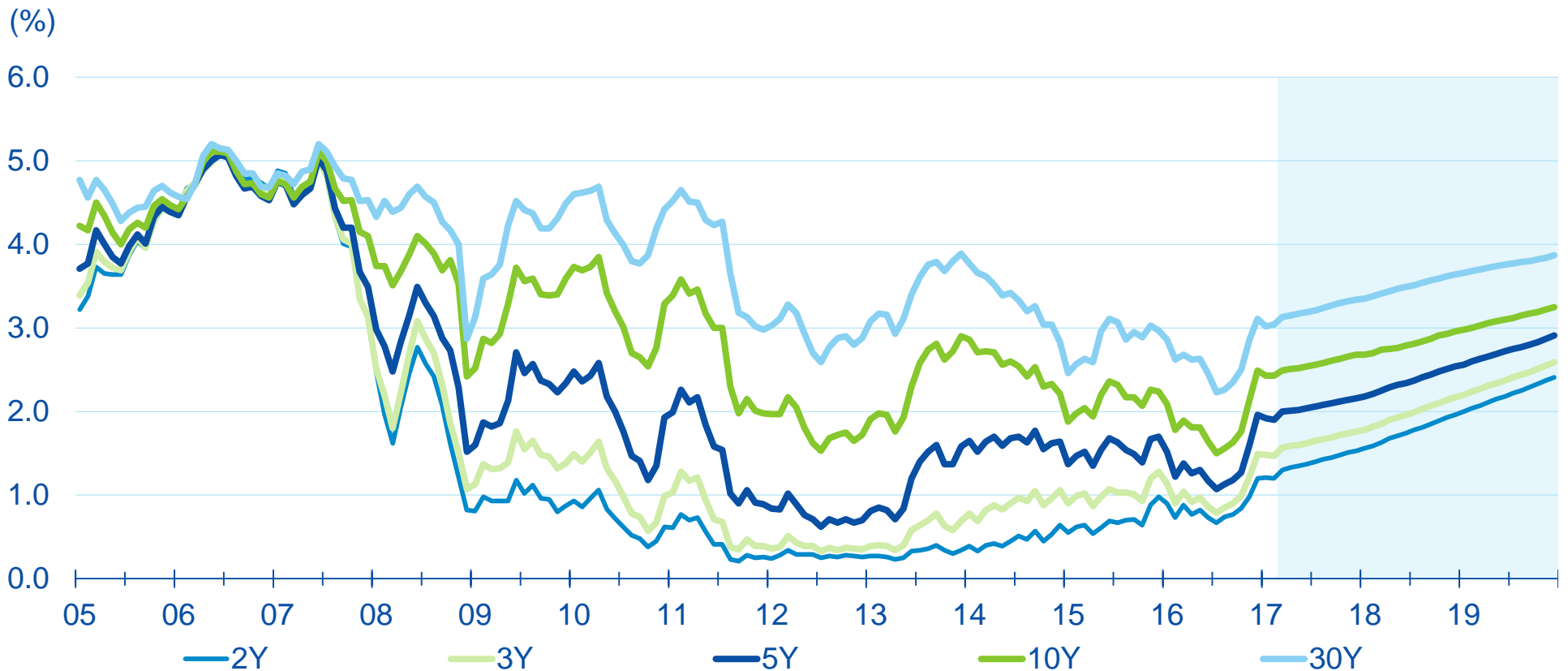
Yield curve forecasts

Treasury Yield Curve Baseline Forecast
(%, end of period)



Treasury yield curve baseline forecasts

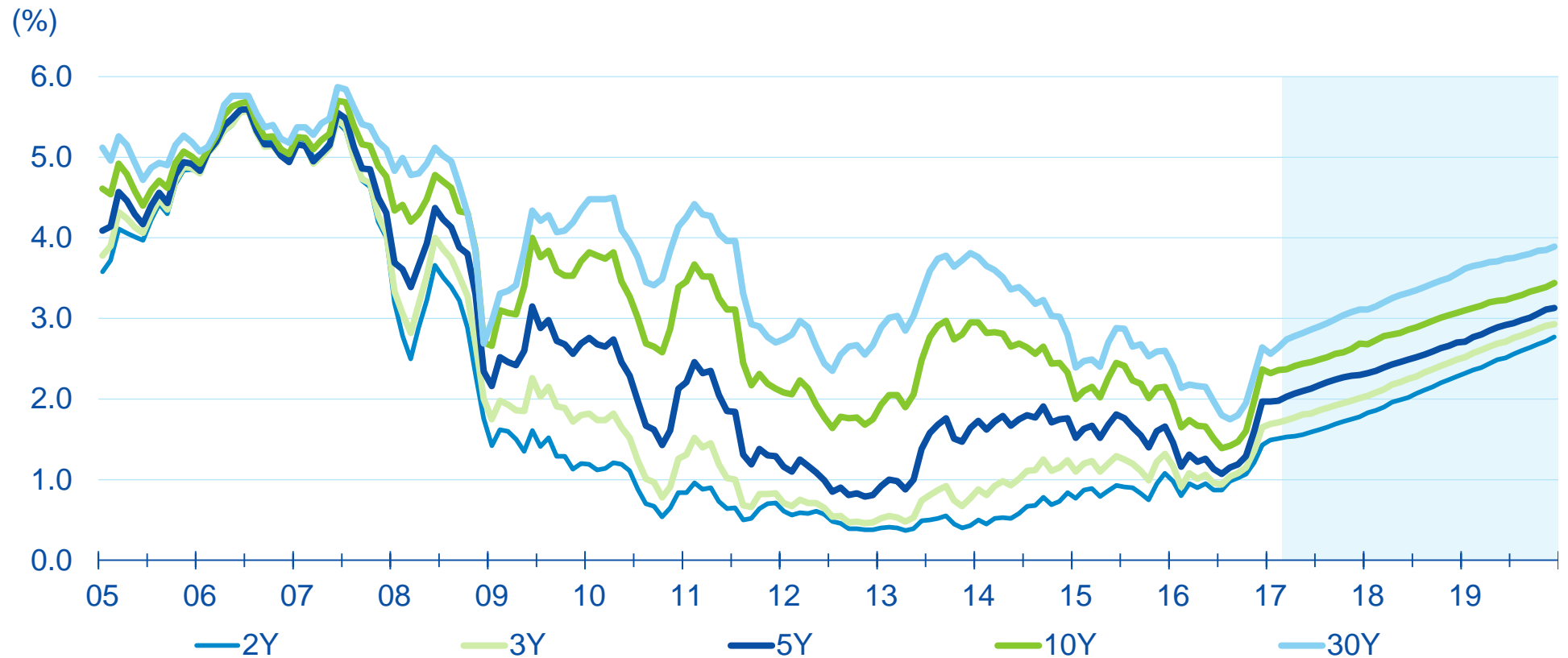
U.S. Treasury Yield Curve



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.

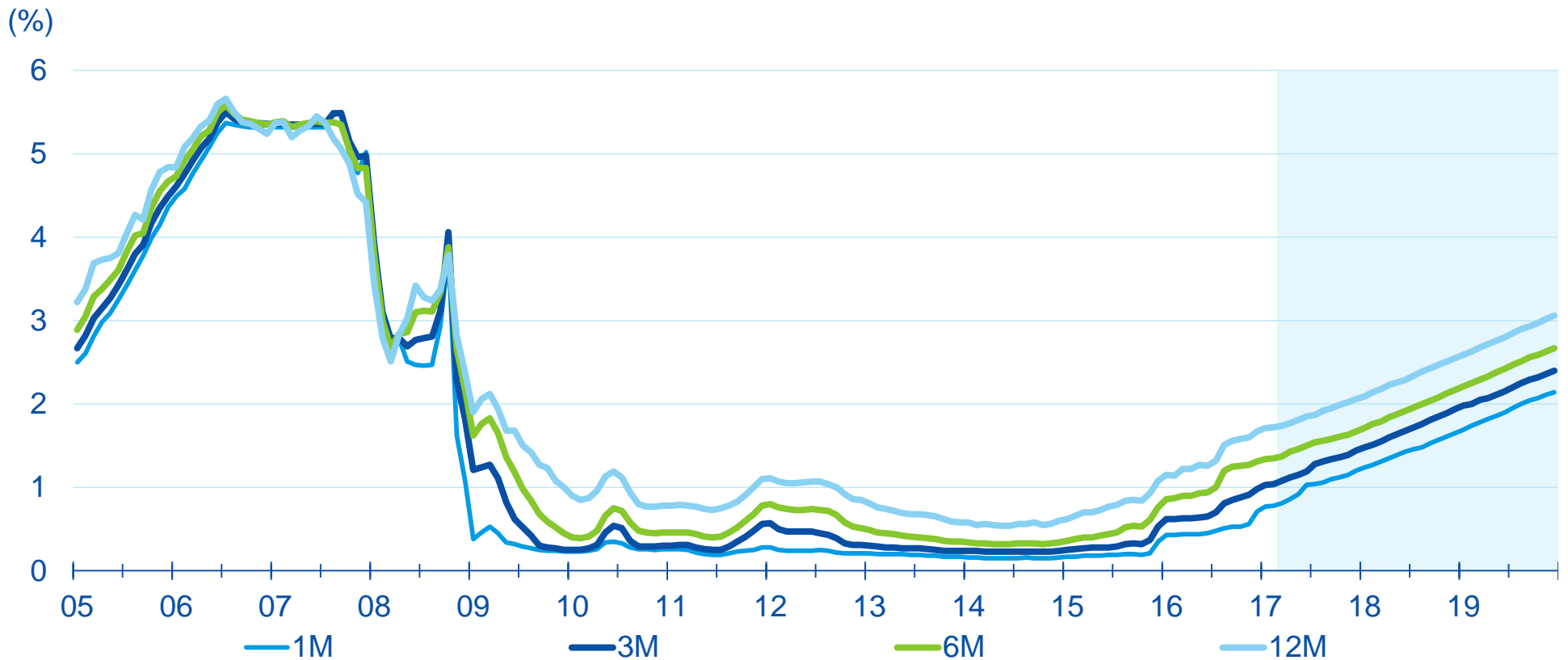
Swap curve baseline forecasts

U.S. Swap Rates



LIBOR curve baseline forecasts

U.S. LIBOR Rates



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