Interest Rate Risk Management Weekly Update

September 22, 2014

Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.15%	0.15%	0.00%
3-Month LIBOR	0.23%	0.23%	0.00%
Fed Funds	0.25%	0.25%	0.00%
Fed Discount	0.75%	0.75%	0.00%
Prime	3.25%	3.25%	0.00%
US Treasury Yields			
2-year Treasury	0.57%	0.56%	0.01% ↑
5-year Treasury	1.81%	1.82%	(0.01%) ↓
10-year Treasury	2.58%	2.61%	(0.03%) ↓
Swaps vs. 3M LIBOR			
2-year	0.86%	0.85%	0.01% ↑
5-year	2.03%	2.02%	0.01% ↑
10-year	2.76%	2.80%	(0.04%) ↓

Fed Speak & Economic News:

- The Federal Reserve held its ground last week, relatively speaking, despite the labor market gathering momentum. Market participants were looking for the Fed to revise the language related to forward guidance; however, it did not. Rates will remain low until "considerable time" after the end of its large scale asset purchase program, more commonly referred to as quantitative easing. "Considerable time" is not meant to convey a specific timeline but will depend on economic data. In addition, the phrase "there remains significant underutilization of labor resources," remained in the statement, implying that the Fed believes that slack remains in the labor market. But despite keeping forward guidance relatively dovish, the Fed's economic projections implied a different tone.
- Members of the Federal Open Market Committee (FOMC), the body that oversees the direction of open market operations, put a hawkish spin on things, perhaps muddying the water a little. They lowered their projections of unemployment over the next three years, but more interestingly, they lowered their economic growth projections as well. This suggests that if economic output is expected to grow more slowly and the labor market is expected to continue improving, the gap between the two should narrow, putting even greater pressure on the committee to raise rates. This may have been the reason for FOMC members raising their projections for the fed funds rate through 2015 and 2016; the fed funds rate is expected to be at 1.375 and 2.875 percent at the end of 2015 and 2016, respectively. Adding to that, projections for inflation were moved higher, but despite moving higher they remain well within the confines of two percent, the Fed's target for price stability. And that is not just for next year but for the following year as well. Why is the Fed comfortable with forecasting inflation below its two-percent target? It could be that the Fed does not feel comfortable with forecasting inflation above two percent without having communicated a more specific timeline for its first rate hike.
- The Fed has been trying to signal that rates could rise faster than market participants believe, economic data permitting. But the market is not buying it: Fed funds contracts maturing December 2015 and 2016 implied fed funds levels of 0.775 and 1.865 percent, respectively on Friday. Yellen addressed this concern by suggesting that it is important for market participants to understand what the Fed's likely response to the data will be and it is the Fed's job to communicate that as clearly as possible.

Stimulus Back on the Table in China

China's economy is seeing more and more troubling signs. On September 16th, it was rumored that the country's central bank injected $81 billion into the financial system. But it is customary for the central bank to inject money during this time of year due to a spike in demand for money, but the amount injected was far larger than normal. The economy's trouble can be attributed mainly to its property sector, which accounts for 15 percent of China's GDP. But while China wants to reduce its dependency on stimulus and depend more on policy reform, the slowdown in growth prompted a more immediate remedy. This might suggest why the central bank tried to keep the stimulus measure as stealthy as possible.

Source: Bloomberg xxx

U.S. Economic Data

- The Fed reduced its monthly asset purchases from $25 billion per month to $15 billion per month
- Inflation for August ticked lower by 0.2% vs. 0.0% expected
- Housing starts slowed down during August, registering at 956k vs. 1037k expected
- PPI printed at 0.0% vs 0.0% expected during August

Date	Indicator	For	Forecast	Last
22-Sep	Existing Home Sales	Aug	5.20M	5.15M
23-Sep	Richmond Fed Manufact. Index	Sep	10	12
23-Sep	Markit US Manufacturing PMI	Sep F	58.0	57.9
24-Sep	New Home Sales	Aug	430K	412K
25-Sep	Durable Goods Orders	Aug	(18.0%)	22.6%
25-Sep	Markit US Services PMI	Sep P	59.2	59.5
26-Sep	GDP Annualized QoQ	2Q T	4.6%	4.2%
26-Sep	Univ. of Michigan Confidence	Sep F	84.8	84.6

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