Interest Rate Risk Management Weekly Update

February 23, 2015

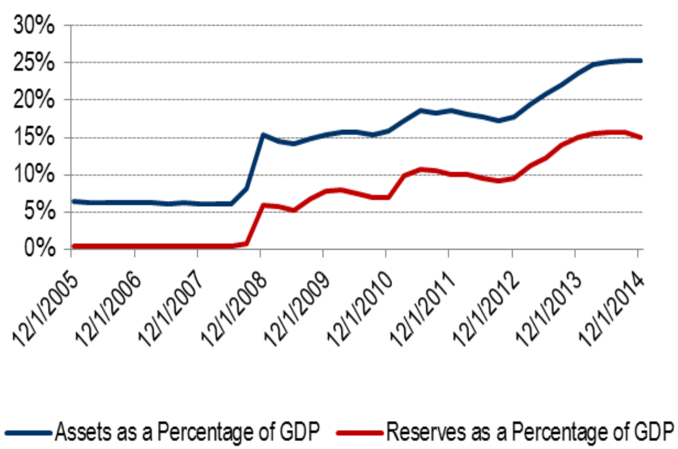
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.17%	0.17%	0.00%
3-Month LIBOR	0.26%	0.26%	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	0.63%	0.64%	(0.01%)
5-year Treasury	1.59%	1.54%	0.05%
10-year Treasury	2.11%	2.05%	0.06%
Swaps vs. 3M LIBOR			
2-year	0.97%	0.95%	0.02%
5-year	1.80%	1.75%	0.05%
10-year	2.29%	2.23%	0.06%

Fed Speak & Economic News:

- The minutes to the Fed's January meeting, released on Wednesday, revealed that officials had detailed discussions surrounding the timing and magnitude of interest-rate increases, as well as conversations related to the strategy for communicating their plans to market participants. During the meeting, they discussed the pros and cons of hiking rates too soon versus waiting. In short, moving too quickly could hinder the recovery while waiting to hike rates could lead to a buildup of inflation risks.
- FOMC members decided that further improvement in the labor market, i.e. wage growth, would be needed to bolster their two percent inflation target before any policy normalization occurs. This comment comes before the release of February's indisputably strong jobs report. Still, other members disagreed, citing that it might be appropriate to begin normalizing policy in the near-term. Members also discussed the issue of removing the assurance of being patient before raising rates. If you remember, Fed Chairwoman Janet Yellen mentioned that as long as being "patient" remains in the statement, the Fed does not anticipate normalizing policy within the next two policy meetings. A big concern of officials is the reaction that market participants will have once things get moving, fearing overreaction would lead to excessive tightening of financial conditions. Officials also discussed the mechanics of how to manage short-term interest rates once they begin moving. If the Fed were to remove the assurance of being patient at its next meeting in March, it would suggest that interest rate normalization could begin in April or June while the market believes it is more likely to occur in the latter half of the year.
- Greece continued to be the focus of market participants. At the beginning of the week, hopes that a deal would be sealed looked grim, but as the week trudged on, Greek officials officially requested an extension and although German officials expressed their displeasure, they eventually jumped onboard with granting Greece a four-month extension. Risk assets performed well because market participants had expected that there would be an eventual resolution. Now, with the concerns surrounding Greece having dissipated for the time being, the market can focus on the launch of the ECB's bond-buying program, which is set to begin in March.
- Going forward, the direction of short-term interest rates will depend on the outcome of the Fed's meeting in March. Has the economy improved enough that the Fed will remove its assurance of being patient? Market participants believe that it will remain for the time being. Later-dated interest rates continue to be driven by lackluster global growth and poor inflationary expectations.

Managing Short-term Interest Rates



Sources: Bloomberg

Since the Fed has implemented quantitative easing, an abundance of liquidity has been provided to banks to alleviate financial stress. But with so much liquidity in the system, it makes it difficult to manage interest rates going forward. The Fed has traditionally relied on the Fed Funds rate to do so, but during the discussion at the January meeting, officials discussed alternatives. One of the topics of discussion involved the reverse repo, which will affect a broader set of participants (fed funds rate directly affects banks). Here's how it works: The Fed would sell its securities to a dealer in return for cash and later on, buy back those securities at a higher price. It allows the Fed to manage interest rates in the money markets. It is a reverse repo from the dealer's perspective.

The Week Ahead

- Fed Chairwoman Janet Yellen will appear before Congress this week, beginning with the US Senate Committee on Banking, Housing, and Urban Affairs on Tuesday, followed by a meeting with the equivalent in the House on Wednesday. Market participants will tune in, looking for any clues surrounding rate normalization.
- We will see plenty of economic releases, including the eurozone aggregate consumer price index, US housing and consumer index figures, and US consumer inflation figures.

Date	Indicator	For	Forecast	Last
23-Feb	Existing Home Sales	Jan	4.82M	5.07M
24-Feb	Consumer Confidence Index	Feb	99.5	102.9
25-Feb	New Home Sales	Jan	470K	481K
26-Feb	CPI MoM	Jan	-0.60%	-0.30%
26-Feb	Durable Goods Orders	Jan	1.6%	(3.3%)
27-Feb	GDP Annualized QoQ	4Q S	2.0%	2.6%
27-Feb	U. of Mich. Sentiment	Feb F	94.0	93.6

Group Head
Matt Milcetich 216-689-3141

Cleveland, OH
David Bowen 216-689-3925
Mary Coe 216-689-4606
Dusko Djukic 216-689-4224
Sam Donzelli 216-689-3635
Anand Gomes 216-689-4932
Frank Kuriakuz 216-689-4071

Seattle, WA
Greg Dawli 206-689-2971
Wil Spink 206-689-2972

Documentation
Ramona Berce 413-567-6758
Linda Maraldo 216-689-0516
Marybeth Simon 216-689-0897

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