Interest Rate Market Insight

September 23, 2013

• The unassuming Fed Chairman absolutely crushed Treasury bears last week with an FOMC policy statement that indicated the economy isn't yet ready for a tapering of the Federal Reserve's asset purchases. With 90% of the market expecting even a token initiation of tightening, the yield curve fell roughly 20 basis points on the news and equities surged to new all-time highs in the US. These moves mostly held through the week, however equities were sold with the realization Friday that both a government shutdown and a potential technical default could lie on the horizon, thanks to Washington wranglings that have become all too familiar of late. This new uncertainty, and the Fed's failure to get its ball rolling while also indicating that a tapering move could come at any time without an FOMC meeting, leaves an uneasiness to be dealt with, and certainly a downward bias for risk assets and rates in the shorter term. To counterbalance the unknowns, we have news that German PM Angela Merkel was reelected, and the growing consensus that Fed Vice Chair Janet Yellen will get the nod for Bernanke's seat in January. In their quarterly economic forecasts, the Committee lowered expectations for GDP (maybe 3% next year), unemployment (below 6% in 2015), and inflation (core sub-2% through 2016), a corroborating move relative to their tapering decision, and the expectation is that any Washington shenanigans will make the numbers worse. The secondary data last week was mostly positive, with leading indicators up 0.7% MoM, the Philly Fed Survey more than doubling to a resounding 22.3 reading, and jobless claims down to 309k. Existing home sales in August beat handily even as housing starts slipped, with many buyers racing to buy before interest rates moved too far. July was the first month in the last six that foreign interest in long-term US securities rose, up $47 billion with gains in Treasury and agency paper while Americans bought a net $16 billion of foreign assets, according to the Treasury International Capital report. CPI rose on 0.1% MoM for the headline and core.

• As autumn sets in around the country, the data picture should clarify our economic footing in the next two weeks. Before another jobs report in two weeks, we get a plethora of speeches from Fed officials, who will undoubtedly try to assuage market participants after surprising them last week, we get the latest durable goods orders (+1% ex trans consensus), a final revision for Q2 GDP (up 0.2% to 2.7% QoQ growth expected), and personal income and spending (the former actually anticipated to outpace the latter, 0.4% to 0.3% MoM, and a core PCE inflation gauge still floundering below 2%). Both S&P Case-Shiller and the FHFA should report additional 0.7% MoM gains in home prices, and the Treasury department will auction $97 billion in 2-, 5-, and 7-year notes this week. Consumer confidence and sentiment readings should remain strong as well.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.18%	0.18%	0.18%	0.22%
3-month LIBOR	0.25%	0.25%	0.26%	0.37%
6-month LIBOR	0.37%	0.38%	0.39%	0.66%
12-month LIBOR	0.64%	0.66%	0.67%	0.99%
Fed Funds Target	0.25%	0.25%	0.25%	0.25%
Prime Rate	3.25%	3.25%	3.25%	3.25%
SIFMA Muni Swap Index	Call	0.06%	0.06%	0.17%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.33%	0.43%	0.37%	0.26%
3-yr Treasury	0.69%	0.87%	0.77%	0.36%
5-yr Treasury	1.48%	1.69%	1.64%	0.69%
7-yr Treasury	2.11%	2.31%	2.31%	1.15%
10-yr Treasury	2.74%	2.89%	2.89%	1.77%
30-yr Treasury	3.76%	3.84%	3.92%	2.95%
2s-10s Spread	2.40%	2.45%	2.53%	1.51%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.58%	0.54%	0.38%
3-yr LIBOR Swap	Call	0.98%	0.92%	0.46%
5-yr LIBOR Swap	Call	1.81%	1.79%	0.80%
7-yr LIBOR Swap	Call	2.41%	2.43%	1.23%
10-yr LIBOR Swap	Call	2.96%	2.99%	1.74%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.36%	0.35%	0.29%
3-yr SIFMA Swap	Call	0.65%	0.62%	0.36%
5-yr SIFMA Swap	Call	1.34%	1.33%	0.65%
7-yr SIFMA Swap	Call	1.92%	1.93%	1.02%
10-yr SIFMA Swap	Call	2.46%	2.48%	1.49%

All else equal, amortizing swaps and caps will have lower rates and costs, respectively. Please call for specific structure pricing requests.

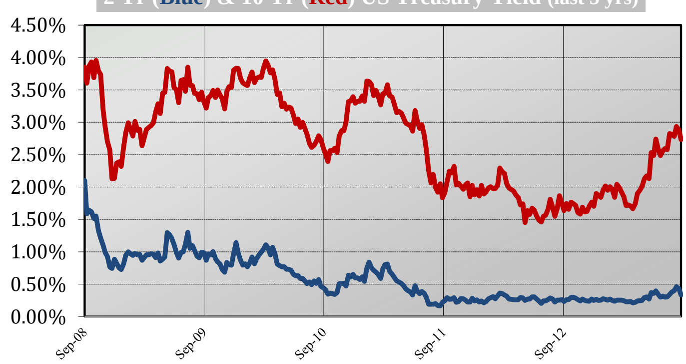
Rate Caps (cost in bps)	Strike = 4.00%	Strike = 5.00%
3-yr LIBOR Cap	24	19
5-yr LIBOR Cap	130	89
7-yr LIBOR Cap	325	221
10-yr LIBOR Cap	674	461

Fwd Implied 3mL Rate	Last
Dec. 13	0.28%
Dec. 14	0.56%
Dec. 15	1.36%
Dec. 16	2.46%

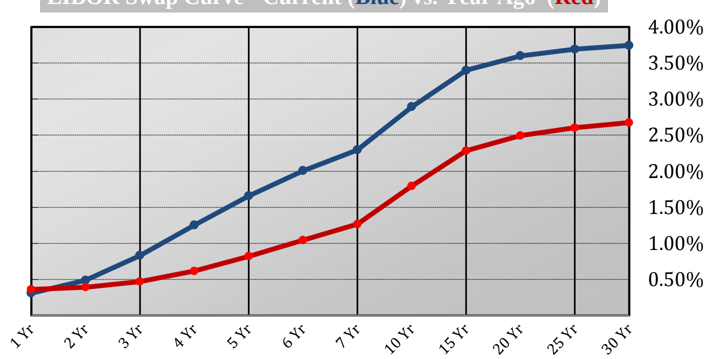
Conventions

Source: Bloomberg. LIBOR swaps use 1-month LIBOR, monthly payments, act/360 for both legs. SIFMA swaps reset weekly and pay monthly, act/act. For % of LIBOR swaps, multiply the % used by the taxable swap rate. No amortization.

2 Yr (Blue) & 10 Yr (Red) US Treasury Yield (last 5 yrs)



LIBOR Swap Curve - Current (Blue) vs. Year Ago (Red)



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