Interest Rate Risk Management Weekly Update

September 2, 2014

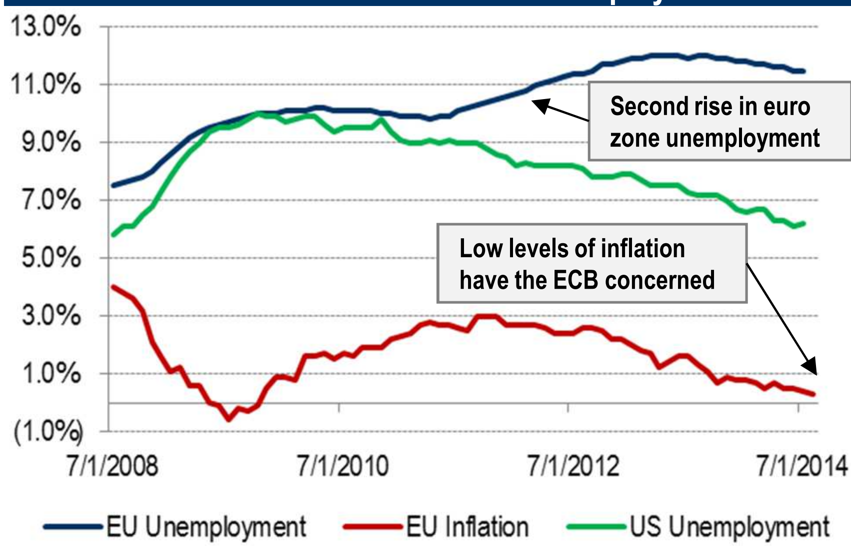
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.16%	0.16%	0.00%
3-Month LIBOR	0.23%	0.24%	(0.01%)
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	0.49%	0.49%	0.00%
5-year Treasury	1.63%	1.66%	(0.03%)
10-year Treasury	2.34%	2.40%	(0.06%)
Swaps vs. 3M LIBOR			
2-year	0.76%	0.76%	0.00%
5-year	1.83%	1.86%	(0.03%)
10-year	2.55%	2.60%	(0.05%)

Fed Speak & Economic News:

- With the holiday-shortened week in the United States, market participants have turned their focus to Europe. High levels of unemployment invariably weigh on all aspects of an economy, but the ramifications can be felt even beyond economic matters, affecting social cohesion to potentially an even higher degree. This is precisely the situation plaguing Europe right now: an environment of high unemployment that is impacting social cohesion. European Central Bank (ECB) President Mario Draghi and the ECB itself are feeling increasing pressure to act. The question is: what policy action will the ECB take when it meets this week?
- We caught a glimpse of Draghi's plan at the symposium in Jackson Hole, Wyoming [1]. It appears his plan to rescue the euro zone is very reminiscent of another already in action: Shinzo Abe's "Abenomics". Abenomics is comprised of three components – or "arrows" – aimed at restoring Japan's economy: quantitative easing, short-term fiscal stimulus, and structural reforms. The three components work together by catalyzing further credit extension to the private sector, reducing and putting public debt levels on a sustainable path, and strengthening the supply side of the economy. But the implementation of quantitative easing in the euro zone is much more complex than, say, here in the United States or in Japan. There are political issues: Whose bonds would the ECB buy? Buying a specific sovereign's bonds would unfairly ease economic conditions in that country. In theory, implementation of such policies should result in lower European bond yields, and spreads in peripheral countries; a weaker euro; and higher equity values, which should create a profound wealth effect. Of course, you have the added benefit of boosting confidence across the region.
- It is unlikely that the ECB will implement quantitative easing this year; the current timeline suggested by economists puts its possible implementation sometime in early 2015, assuming inflationary pressures continue to dwindle. But one thing is for sure, market participants have already priced in their expectations of easing: European asset prices have moved higher. For now, Draghi will likely keep the door open for asset purchases in the future but the unveiling of other forms of easing is possible this week.
- While the ECB considers its course of action, the Fed will have another labor report (August payrolls) to digest so it can fine tune its policy. But the difference is that the Fed will consider when to raise rates, not whether, which is quite contrary to the ECB's position.

Can the ECB Reduce Unemployment in the Euro Zone?



ECB President Mario Draghi's speech at the Kansas City Fed's symposium at Jackson Hole, Wyoming, focused on unemployment in the euro zone [1]. His main concern is whether the ECB's policy can substantially affect unemployment levels. The difference between unemployment in the United States and the euro zone is that the euro zone has seen two rises in unemployment; the second rise was the result of the sovereign debt crisis. In short, he believes the ECB can combat high unemployment but will require fiscal accommodation and structural reform.

Source: Bloomberg *[1] http://www.ecb.europa.eu/press/key/date/2014/html/sp140822.en.html*

U.S. Economic Data

- Personal income for July grew 0.2%
- PCE declined 0.1% nominally and 0.2% after adjusting for inflation
- 2Q GDP surprised to the upside, printing at 4.2% vs. 3.9% expected
- Consumer confidence printed at 92.4 vs 89.0 expected
- Durable goods orders increased by 22.6% in July

Date	Indicator	For	Forecast	Last
2-Sep	ISM Manufacturing	Aug	57.0	57.1
2-Sep	Markit US Manufacturing PMI	Aug F	58.0	58.0
3-Sep	Factory Orders	Jul	11.0%	1.1%
4-Sep	Initial Jobless Claims	30-Aug	300K	298K
4-Sep	Trade Balance	Jul	-$42.2B	-$41.5B
4-Sep	ADP Employment Change	Aug	223K	218K
5-Sep	Change in Nonfarm Payrolls	Aug	225K	209K
5-Sep	Unemployment Rate	Aug	6.1%	6.2%

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