Interest Rate Risk Management Weekly Update

August 25, 2014

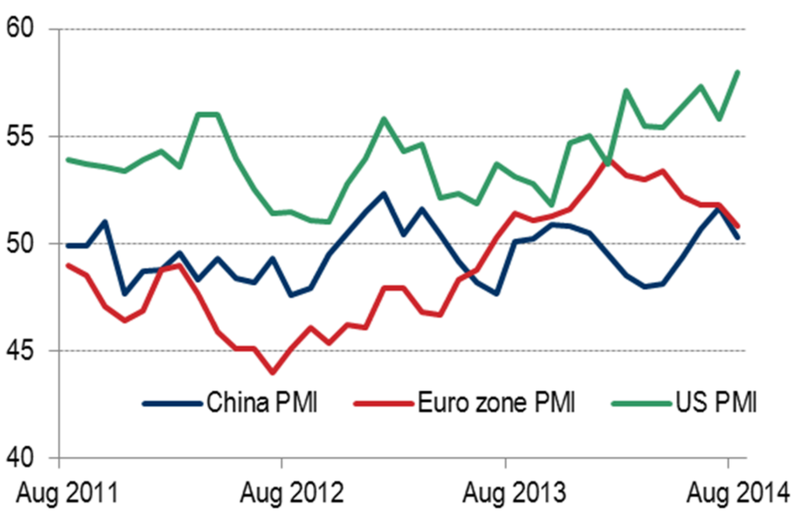
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.16%	0.16%	0.00%	○
3-Month LIBOR	0.24%	0.23%	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%	0.41%	0.08%	↑
5-year Treasury	1.66%	1.54%	0.12%	↑
10-year Treasury	2.40%	2.34%	0.06%	↑
Swaps vs. 3M LIBOR				
2-year	0.76%	0.68%	0.08%	↑
5-year	1.86%	1.75%	0.11%	↑
10-year	2.60%	2.54%	0.06%	↑

Fed Speak & Economic News:

- Fed Chairwoman Janet Yellen's prepared remarks echoed at the Kansas City Fed's Economic Symposium in Jackson Hole, Wyoming, on Friday: "These developments are encouraging, but it speaks to the depth of the damage that, five years after the end of the recession, the labor market has yet to fully recover." While market participants usually view her as rather omnipotent, she had little effect on interest rates markets on Friday. But that is not surprising; many of her comments were very much customary. She mentioned the usual concerns hampering development in the labor market, including the low level of labor force participation and high level of part-time employment. And there we have it, the brewing pot of contention at the Fed: Is there still enough slack in the labor market to justify keeping rates low, especially, some would argue, with inflation knocking on the door? Well, it depends on which data you are constructing your argument with and your interpretation of the data.
- A handful of Fed officials (e.g., Plosser, Bullard, and George) have sounded their alarm bells, arguing that a decline in the unemployment rate is enough evidence that slack in the labor market is dissipating. On the other side of the aisle, the tepid growth rate in wages underpins the argument of doves to keep rates low. During her remarks, Yellen used a term that is likely to garner interest: pent-up wage deflation. The gist of the term, which stems from a paper by the San Francisco Fed, suggests that as companies have been reluctant to cut employees' wages after the economic downturn, due to lawful bargaining agreements or otherwise, they are now reluctant to pass out raises as the economy improves. However, at some point, employers will raise wages, and it could happen rather quickly. If this is the case, we would see an abrupt tightening of policy. That being said, Dr. Yellen made dovish remarks as well. For now, it seems that the Fed's policy decisions will remain on course. At the end of the day, it is likely that Yellen believes the benefits of keeping rates low to reduce labor market slack outweigh the risks of run-away inflation.
- At the same economic symposium, and on the same day Yellen gave her prepared remarks, ECB President Draghi seemed dismissive of the recent string of poor economic data out of Europe and assured investors that the ECB is willing and ready to do all that is necessary. The ECB will conclude its next meeting on September 4; it will be interesting to see if the ECB takes action.

Diverging Manufacturing PMIs Across Markets



Source: Bloomberg

The euro zone's economy has had a weak performance so far this year. But so has China's economy, given the level of growth it has seen in recent years. This should not be surprising as the euro zone is the biggest market for Chinese exports. Remember, for PMI readings, 50 marks the expansion/contraction line: Anything above the line signals expansion while anything below signals contraction. And while most mandates of central banks are domestically focused, it is hard to ignore the influence of global growth factors. It does not seem surprising that Treasury yields have had a remarkable fall since the end of 2013. Treasuries are a safe haven and an easy way to devalue currency given their liquidity.

U.S. Economic Data

- During July, consumer price inflation registered at consensus at 0.1% versus 0.1% expected. CPI was rather tame because energy prices moderated in July.
- Housing starts increased by 15.7% during July, from 965k to 1093k. In addition, the previous month's figure was revised higher from 893k to 945k. Most of the gains were in multiple units, but surprisingly, joined by single-family homes. However, new home sales remain weak.

Date	Indicator	For	Forecast	Last
25-Aug	New Home Sales	Jul	428K	406K
26-Aug	Consumer Confidence Index	Aug	88.5	90.9
26-Aug	Durable Goods Orders	Jul	7.6%	1.7%
28-Aug	GDP Annualized QoQ	2Q S	3.9%	4.0%
29-Aug	Univ. of Michigan Confidence	Aug F	80.2	79.2
29-Aug	Personal Income	Jul	0.3%	0.4%
29-Aug	Personal Spending	Jul	0.1%	0.4%

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