Interest Rate Risk Management Weekly Update

December 7, 2015

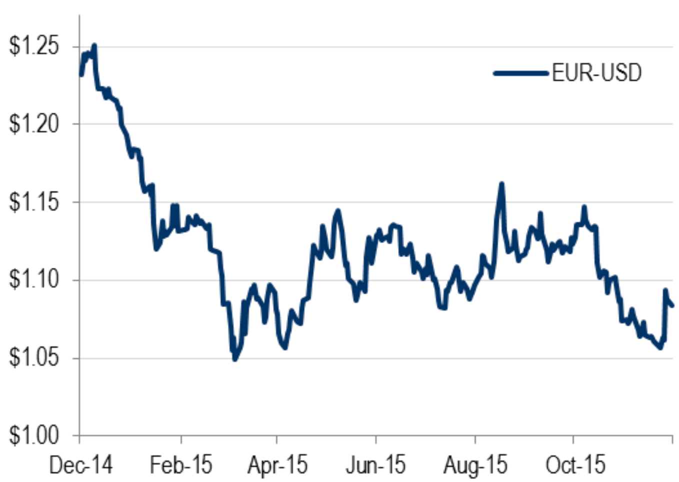
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.24%	0.21%	0.03%
3-Month LIBOR	0.41%	0.38%	0.03%
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	0.92%	0.92%	0.00%
5-year Treasury	1.65%	1.69%	(0.04%)
10-year Treasury	2.22%	2.26%	(0.04%)
Swaps vs. 3M LIBOR			
2-year	1.03%	1.01%	0.02%
5-year	1.62%	1.63%	(0.01%)
10-year	2.13%	2.14%	(0.01%)

Fedspeak & Economic News:

- Last week lived up to its hype: Markets saw a heightened level of volatility amid the US November employment report release and the ECB announcement. The ranges of 5- and 10-year US Treasury yields were 14 and 18 basis points, respectively. In addition, 1- and 3-month LIBORs moved higher by three basis points each as we moved closer to the December 16 FOMC meeting.
- The thousand-mile easing journey that the Fed embarked on in 2008 may finally be evolving into a new segment: The November payrolls report on Friday was seen as the last major hurdle to the Fed's calculus should it decide to hike rates on December 16. The headline figure was stronger than expected at +211k while October's growth was revised higher to +300k. Combing through the details proved to be a merry experience as well: The breadth of job gains seen across industries was the best it had been in months. Wage pressure got a favorable nod as the number of people that quit their jobs hit a four-month high (although this is not necessarily a good thing), and when combined with labor shortages (detailed in the Fed's Beige Book), both suggest that we could start to see further wage pressure. The market's response to the release was more muted than one would have thought; however, we saw a very large movement the day following the ECB's announcement and the prospect of a rate hike had been largely priced into the market already. The December federal funds contract now implies a 74% likelihood that the Fed will hike.
- Last Thursday, ECB President Draghi attempted to appease market participants, but it was far less than they expected: Both US Treasuries and European sovereign bonds sold off sharply following the ECB announcement and the press conference that followed. The central bank cut the deposit rate (its new benchmark rate) to -0.3% from -0.2% (i.e., banks have to pay more to hold cash with the ECB, which encourages lending), but it was less than expected. Heading into the press release, market participants expected Draghi to announce further measures via increasing asset purchases, but it did not happen. He instead opted for a more subtle tweak to the program, extending its targeted maturity. In addition, the widening of the scope of assets allowed to be purchased was relatively conservative. The euro saw its largest rally in nearly seven years while the dollar tanked. However, on the bright side, the weakening of the dollar will make the Fed's decision a little easier as it should ease financial conditions in the US.

The Continental Divide



The ECB's monetary policy package announced last week was underwhelming. Some pointed to signs that suggest the eurozone is making progress, which may have been factored into the amount of additional stimulus that was decided. Market participants reacted by sending the euro considerably higher versus the US dollar as Draghi misjudged his rhetoric in the weeks prior. On the other side of the Atlantic, Fed Chair Yellen has done her part to prepare markets for rate liftoff. Fed funds futures are predicting a 74% chance of a hike as of last Friday, while market surveys suggest approximately a 90% chance. The difference of opinion most likely resides with where the average effective fed funds rate will set, since the Fed is likely to maintain a target range. That being said, a rate hike is arguably largely priced in.

Sources: Bloomberg

The Week Ahead

- Markets should be calmer this week than they were last week
- We will see the release of November US retail sales on Friday. Consensus suggests that sales probably climbed, spurred in part by increased auto sales
- The Monetary Policy Committee of the Bank of England will decide how to move forward with its policy on Wednesday. Expectations call for the committee to leave its key interest rate unchanged
- US Congress must pass a $1.1 trillion federal spending bill by the end of the day Friday, when the current stopgap funding measure expires

Date	Indicator	For	Forecast	Last
9-Dec	Wholesale Inventories MoM	Oct	0.1%	0.5%
10-Dec	Import Price Index MoM	Nov	(0.8%)	(0.5%)
10-Dec	Monthly Budget Statement	Nov	-$67.5b	-
11-Dec	U. of Mich. Sentiment	Dec P	92.0	91.3
11-Dec	Retail Sales Advance MoM	Nov	0.3%	0.1%
11-Dec	PPI Final Demand MoM	Nov	0.0%	(0.4%)

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