Interest Rate Risk Management Weekly Update

January 26, 2015

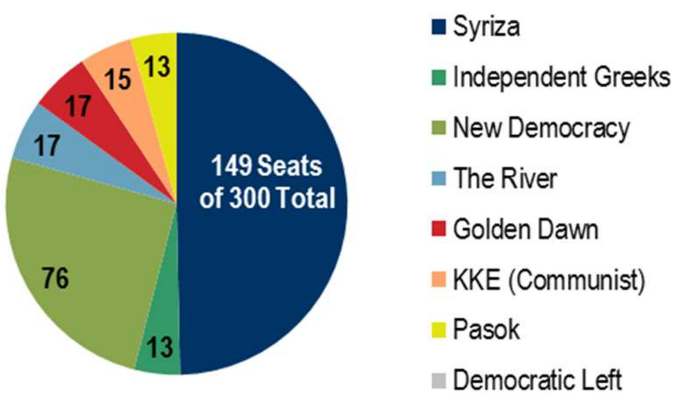
Current Rate Environment

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	0.49%	0.49%	0.00%
5-year Treasury	1.31%	1.30%	0.01%
10-year Treasury	1.80%	1.84%	(0.04%)
Swaps vs. 3M LIBOR			
2-year	0.80%	0.77%	0.03%
5-year	1.52%	1.51%	0.01%
10-year	1.99%	2.01%	(0.02%)

Fed Speak & Economic News:

- On Thursday, the European Central Bank ("ECB") delivered a little more than market participants had expected: 60 billion euros of asset purchases per month comprising investment grade government debt and agency debt. The program came stamped with an expiration date of September 2016, which, if the program were carried out until then, would expand the ECB's balance sheet by around one trillion euros. However, there is an important caveat to the maturity date: bond buying will continue until the central bank sees an adjustment to the path of expected inflation levels. The message Draghi sent to the market reminds us of his promise in 2012: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."
- By the end of the day, the euro weakened, after strengthening in the days preceding, and European bond yields declined, leading to a compression between peripheral and core bond spreads. Perhaps more importantly, inflation expectations via inflation-linked bonds and the ECB's five-year forward measure of inflation (similar to the Fed's very own measure) had increased. Initially market participants were a little disappointed but after Draghi's Q&A session, they felt more satisfied.
- There are a couple of very important takeaways from the press conference. First, Draghi mentioned that asset purchases would extend out to bonds with a tenor of 30 years, putting any initial interpretation by the market to rest (the spread between Germany's two-year note's yield and 30-year bond's yield narrowed significantly after he provided clarification.) Second, investors are concerned about the impact that such a program could have, if any, given that interest rates are already so low. ECB President Draghi reassured participants that the program will work but that it is only one component required for success. The other components required for success include structural and fiscal reforms. Many are worried that with the ECB providing a lift to economic growth, via a weaker euro, and lowering borrowing costs that eurozone governments have less incentive to enact reforms. Reform will be crucial but requires political will and hard choices, which will prove difficult, especially in the context of an increasingly polarized electorate. For now, the announcement has provided a much-needed shot in the arm. US bond yields will likely feel some spillover effects as inflation premiums adjust, but very low bond yields in Europe will likely keep the spigot open for global capital flow into US assets.

Anti-Austerity Party Wins in Greece's Snap Election



Sources: BBC, Greek Interior Ministry

Over the weekend, Greece's Syriza leftist party proved victorious. Party leader Alexis Tsipras promised to end five years of austerity, which made him the first prime minister to openly oppose the austerity policies that the European Union and IMF imposed on Greece as a condition of receiving a bailout. However, since his party fell short of an absolute majority, he formed a coalition with a minority party known as Independent Greeks. The coalition is expected to make debt negotiations even more difficult. Within an hour of Mr. Tsipras being sworn in, rating agency S&P suggested that it could downgrade Greece. Needless to say, the election result has European leaders concerned, but the market's reaction to the news was relatively mute.

The Week Ahead

- The Fed's FOMC will conclude its two-day meeting on Wednesday, January 28. It is widely expected that the Fed will continue with its current timeline of interest rate normalization despite global economic developments. Remember, at the last meeting, the Fed shifted its forward guidance from a "considerable period" to being "patient" before hiking short-term interest rates. Any material change is likely to come at the following meeting in March.
- Eight central banks in emerging markets will meet in the week ahead.

Date	Indicator	For	Forecast	Last
27-Jan	Consumer Confidence Index	Jan	95.5	92.6
27-Jan	Durable Goods Orders	Dec	0.40%	0.90%
27-Jan	New Home Sales	Dec	450K	438K
28-Jan	FOMC Rate Decision (Upper Bound)	28-Jan	0.25%	0.25%
30-Jan	GDP Annualized QoQ	4Q A	3.10%	5.00%
30-Jan	U. of Mich. Sentiment	Jan F	98.2	98.2
30-Jan	Chicago Purchasing Manager	Jan	57.8	58.8

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