Interest Rate Risk Management Weekly Update

August 18, 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	0.41%	0.45%	(0.04%)
5-year Treasury	1.54%	1.62%	(0.08%)
10-year Treasury	2.34%	2.42%	(0.08%)
Swaps vs. 3M LIBOR			
2-year	0.68%	0.73%	(0.05%)
5-year	1.75%	1.84%	(0.09%)
10-year	2.54%	2.63%	(0.09%)

Fed Speak & Economic News:

- From *The Wall Street Journal*: "30 private economists said they feared the Federal Reserve would wait too long before raising short-term interest rates, while only three said they feared the Fed would move too early." This has been dubbed in the media as "falling behind the curve". What does it mean exactly? Put simply: It can take some time before monetary policy affects the economy and inflation. There tends to be a lag, which can vary to different degrees, between the two variables. If the Fed waits too long to raise interest rates, inflation could move higher sharply, and then the Fed has fallen behind the curve and is playing a game of catch-up; as you can imagine, this is not an ideal scenario. Current events around the globe make this timing even more difficult.
- There was an amalgam of events that influenced the curve last week: disappointing global economic data releases and contentions among foreign affairs. The euro zone posted its weakest quarter of economic growth since it emerged from a recession last year. Most of the weakness stemmed from the "core" economies: Germany, France, and Italy. But while inflationary pressures are apparent in the United States, hovering around two percent year-over-year, inflation in the euro zone is not, with the recent reading showing 0.4 percent growth. Weak economic growth coupled with anemic inflationary levels puts pressure on the ECB to act further. Contrary to the Fed falling behind the curve, if the ECB waits too long to act, via easing, deflation could set in. Asia was not immune to soft economic data either: China saw weak growth in retail sales, loans, and imports while Japan's economy felt the pain from its double-edged sword, the VAT hike, with economic growth contracting by 6.8 percent. In addition to disappointing economic data, foreign affairs became heated, with Ukrainian forces destroying a Russian convoy. The aforementioned factors catalyzed a rally in Treasuries; yields across the term structure fell by five to 10 basis points.
- The world's most prominent economists will meet this week in Jackson Hole, Wyoming, at the annual summit hosted by the Federal Reserve Bank of Kansas City. The title of the event seems fitting for the times: "Re-evaluating Labor Market Dynamics". The health of the labor market has been the key driver of justifying current monetary policy. The discussions will probably shed light on the appropriate timing to raise interest rates, as well as attempt to answer the question, has the Fed fallen behind the curve?

Conditions Continue to Decelerate in China's Property Market

Source: Bloomberg

[1] Bloomberg

In China, fixed asset investment registered its weakest reading since 2001. This was driven in part by soft real estate investment. As a result, some economists are predicting that the People's Bank of China will eventually provide further easing. While June saw some of the largest outflows of long-term US bonds on record, driven by China and Japan offloading their holdings [1], the recent rally suggests that this trend may have reversed in July and August, evident by the rally in Treasuries. If China increases the pace of its Treasury purchases to further weaken its currency, in an attempt to stoke economic growth, we could see later-dated Treasury yields decline as a consequence.

U.S. Economic Data

- Retail sales in July were unchanged (0.0% vs 0.2% expected), putting the figure below expectations. There were declines in general merchandise as a result of weak department store sales and weak vehicle sales.
- Empire Manufacturing registered below consensus at 14.69 versus 20.00 expected.
- Consumer confidence, per Univ. of Michigan, dipped to 79.2, below the 82.5 consensus figure.

Date	Indicator	For	Forecast	Last
19-Aug	CPI MoM	Jul	0.1%	0.3%
19-Aug	Housing Starts	Jul	968K	893K
20-Aug	MBA Mortgage Applications	15-Aug	-	-
21-Aug	Markit US Manufacturing PMI	Aug P	55.6	55.8
21-Aug	Existing Home Sales	Jul	5.00M	5.04M
21-Aug	Leading Index	Jul	0.6%	0.3%
21-Aug	Philadelphoa Fed Business Outlook	Aug	19.4	23.9

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