Interest Rate Risk Management Weekly Update

October 6, 2014

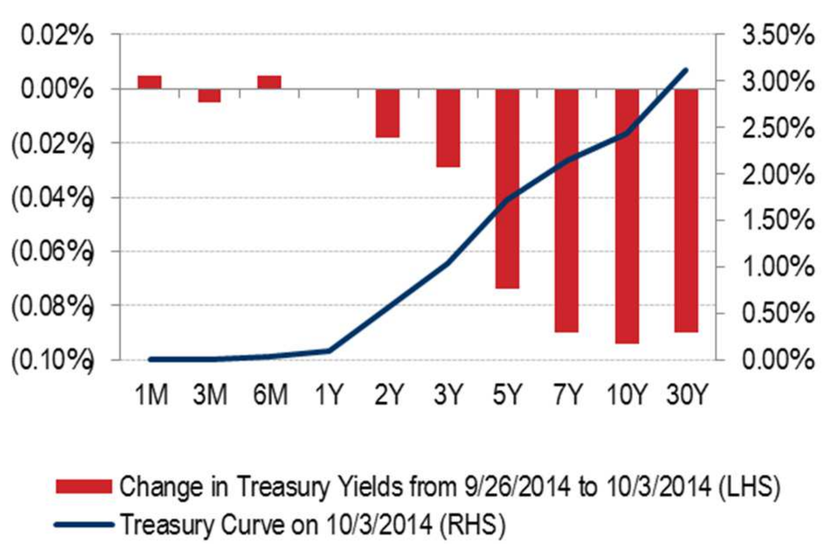
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.15%	0.15%	0.00%
3-Month LIBOR	0.23%	0.23%	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	0.56%	0.58%	(0.02%)
5-year Treasury	1.72%	1.80%	(0.08%)
10-year Treasury	2.44%	2.53%	(0.09%)
Swaps vs. 3M LIBOR			
2-year	0.87%	0.86%	0.01%
5-year	1.96%	2.00%	(0.04%)
10-year	2.64%	2.71%	(0.07%)

Fed Speak & Economic News:

- Last Friday we saw something that we have not seen since 2008: the unemployment rate fall below six percent. The September jobs report was very satisfactory, but as usual, it was not without its quips. First, the drop in the unemployment was not only due to a rise in the labor force but a decline in the participation rate. Of course, we can attribute part of the decline to retiring baby boomers, but the truth is, there are discouraged workers who want to work but have stopped looking for a job. But, for the time being, the more important question to ask is: does this change the Fed's timeline for rate normalization?
- It is hard to deny that the American economy is making steady progress. Just about every economic measure suggests this. Labor-market measures have been no different. The gain in nonfarm payrolls in September was driven by big jumps in professional services, retail, and healthcare. In addition, during the previous two months, jobs growth was not anemic as we once thought: net revisions for July and August amounted to an increase of 69,000 jobs. But while the aforementioned gives the hawks justification for their stance to raise rates sooner rather than later, the report also gives credence to doves' views.
- As mentioned earlier, the decline in unemployment is due partly to a decline in the labor force. It would be preferable to see jobs growth play a bigger role in driving unemployment lower than participants leaving the work force. On top of that, wage gains for the report printed flat, which puts income levels as a whole about two percent higher than last year. Here is the question we have heard all year: is the unemployment rate a reliable measure of labor-market slack? The answer is that it is not reliable as it once was.
- The association between the unemployment rate and wage gains is not as clear as it used to be. This makes the Fed's job incredibly difficult, especially in the midst of so many other variables. This is part of the reason why the Fed has focused on wage gains, because they are a simpler indicator and represent a marriage of unemployment and price stability. In other words, focus less on the unemployment rate and more on the development of wage gains to determine when the Fed will raise rates. But for now, the Fed remains on track for rate normalization, which, if current trends continue, puts liftoff sometime in the first half of next year.
- This week's economic calendar will be light, and the Treasury will auction new 3-year notes, and reopened 10- and 30-year bonds.

Treasury Yields Remain Stubbornly Low



Despite the bullish jobs report for September, Treasury yields finished the week lower, although they reversed direction after the payrolls release. It was likely in response to risk assets underperforming. The majority of the move has been driven by global factors, most notably disappointing economic news out of the eurozone. Some domestic economic data were disappointing as well (see right). Inflation expectations have declined, with TIPS breakevens trading close to lows seen over the past few years, which helps explain why the curve has flattened as of late.

Source: Bloomberg

U.S. Economic Data

- The third print for second-quarter GDP showed a 4.6% annualized gain, compared to the initially-reported 4.0% increase
- Durable goods plunged by 18.2% in August; however, the manufacturing sector expanded at a healthy level
- ADP employment beat expectations, printing at 213k vs 205k expected
- ISM manufacturing registered below consensus at 56.6 vs. 58.5 expected
- New home sales increased modestly in August while existing home sales declined
- Personal income printed on the screws at 0.3%
- Personal spending beat expectations, printing at 0.5% vs 0.4% expected

Date	Indicator	For	Forecast	Last
7-Oct	Consumer Credit	Aug	$20.0B	$26.0B
7-Oct	JOLTS Job Openings	Aug	4700	4673
9-Oct	Wholesale Inventories MoM	Aug	0.3%	0.1%
10-Oct	Import Price Index MoM	Sep	(0.7%)	(0.9%)
10-Oct	Monthly Budget Statement	Sep	$72.0B	$75.1B

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