Interest Rate Market Insight

February 9, 2015

• The first week of February brought with it a massive reversal, with equity markets moving broadly in anticipation of the January jobs nonfarm payrolls, and interest rates jumping higher both before and after the release of the data on Friday. All told, the S&P 500 climbed 3% WoW, and the yield curve rose 20 bps at the front end and 32 bps from the 5-year point and beyond. While the headline jobs print was stronger than expected at +257,000 MoM, the report impressed because the revisions for the prior two months jumped 147k and average earnings rose 0.5% MoM. The wage gains more than offset the disappointing December, and in total, the data definitely supports a less accommodative Federal Reserve. The unemployment rate rose slightly to 5.7% because the labor force participation rate rose 0.2% to 62.9%, which may also be construed as a positive divergence from trend. WTI crude oil rose 7% to $54/barrel. With much of the Q4 reporting complete, roughly half of large public companies have bested revenue estimates and three quarters have beaten on earnings. In Europe, Germany and France are negotiating on two fronts--one with Russia to end Ukrainian violence and the other with Greece to clarify terms for continued assistance.

• Traders had much to digest even before payrolls were released Friday morning. On Wednesday, ADP private payrolls came in lighter than consensus at 213k, and Challenger job cuts rose more than the month prior. Factory orders and construction spending both lagged estimates, but the latter showed growth of 0.4% MoM in December. Personal income and spending showed 0.3% MoM gains and -0.3% contraction, respectively, in January, as saving and debt reduction seem to be the first order for gasoline savings. The ISM manufacturing index fell to 53.5, still expansionary but below consensus of 54.5, while the services index rose slightly to a stronger 56.7 reading. The trade deficit widened to -$46.6 billion MoM and could cut into GDP estimates, but demand for imports remained solid. While higher than the week prior, initial jobless claims of 278k stayed not far from the structural lows of a strong job market. Consumer credit rose $14.8 billion in December, split between a larger than expected $5 billion of revolving credit and $9 billion of non-revolving credit like auto loans. Q4 nonfarm productivity declined nearly 2% QoQ annualized after a strong Q3, while unit labor costs rose 2.7% QoQ but still fail to show much wage pressure.

• The data isn't quite as remarkable this week, but retail sales for January will get a lot of attention--consensus expects -0.5% on the headline and excluding autos, but the number should be positive when gasoline gets stripped out as well. Import and export prices are expected to decline once again, but these figures are nearly flat lining when oil and agricultural commodities are factored out. Business and wholesale inventories should rise only modestly again in December. Treasury will auction $64 billion of 3-, 10-, and 30-year paper midweek at significantly higher rates, and Fed speakers will be out in force with new data to model and account for when they speak to market participants.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.17%	0.17%	0.17%	0.16%
3-month LIBOR	0.26%	0.25%	0.25%	0.24%
6-month LIBOR	0.36%	0.36%	0.36%	0.33%
12-month LIBOR	0.63%	0.62%	0.63%	0.56%
Fed Funds Target	0.25%	0.25%	0.25%	0.25%
Prime Rate	3.25%	3.25%	3.25%	3.25%
SIFMA Muni Swap Index	Call	0.02%	0.02%	0.03%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.65%	0.45%	0.63%	0.32%
3-yr Treasury	1.01%	0.74%	0.99%	0.66%
5-yr Treasury	1.48%	1.16%	1.48%	1.52%
7-yr Treasury	1.78%	1.46%	1.76%	2.17%
10-yr Treasury	1.96%	1.64%	1.94%	2.70%
30-yr Treasury	2.53%	2.22%	2.50%	3.67%
2s-10s Spread	1.31%	1.19%	1.31%	2.38%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.67%	0.83%	0.44%
3-yr LIBOR Swap	Call	0.94%	1.16%	0.79%
5-yr LIBOR Swap	Call	1.30%	1.56%	1.59%
7-yr LIBOR Swap	Call	1.52%	1.79%	2.19%
10-yr LIBOR Swap	Call	1.74%	1.99%	2.76%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.36%	0.46%	0.27%
3-yr SIFMA Swap	Call	0.57%	0.73%	0.52%
5-yr SIFMA Swap	Call	0.95%	1.14%	1.22%
7-yr SIFMA Swap	Call	1.21%	1.40%	1.81%
10-yr SIFMA Swap	Call	1.46%	1.65%	2.38%

All else equal, amortizing swaps and caps will have lower rates and costs, respectively. Please call for specific structure pricing requests.

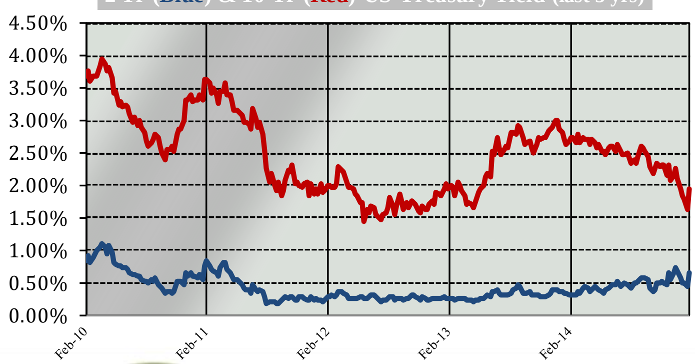
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	34	15	10	11
4-yr LIBOR Cap	80	43	25	17
5-yr LIBOR Cap	138	75	44	28
7-yr LIBOR Cap	277	163	100	65

Fwd Implied 3mL Rate	Last
Dec. 15	0.86%
Dec. 16	1.66%
Dec. 17	2.13%
Dec. 18	2.36%

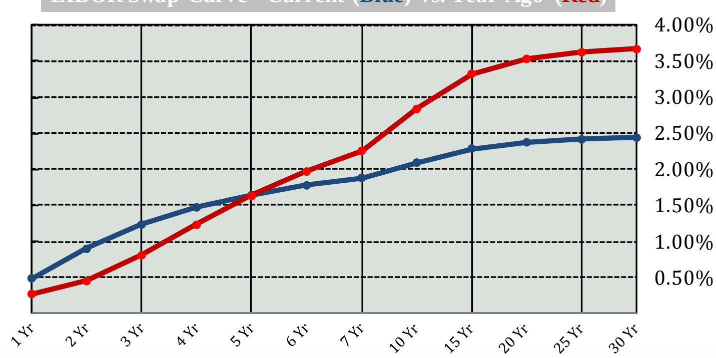
Conventions

Source: Bloomberg. LIBOR swaps use 1-month LIBOR, monthly payments, act/360 for both legs. SIFMA swaps reset weekly and pay monthly, act/act. For %of LIBOR swaps, multiply the %used by the taxable swap rate. No amortization.

2 Yr (Blue) & 10 Yr (Red) US Treasury Yield (last 5 yrs)



LIBOR Swap Curve - Current (Blue) vs. Year Ago (Red)



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