Interest Rate Risk Management Weekly Update

February 9, 2015

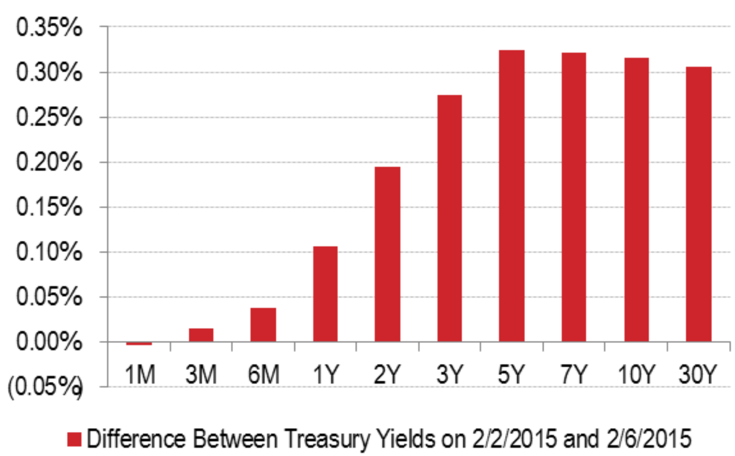
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.17%	0.17%	0.00%	○
3-Month LIBOR	0.26%	0.25%	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	0.65%	0.45%	0.20%	↑
5-year Treasury	1.48%	1.16%	0.32%	↑
10-year Treasury	1.96%	1.64%	0.32%	↑
Swaps vs. 3M LIBOR				
2-year	0.95%	0.74%	0.21%	↑
5-year	1.70%	1.38%	0.32%	↑
10-year	2.15%	1.84%	0.31%	↑

Fed Speak & Economic News:

- The labor report for January, released on Friday, showed that the US economy is in full swing. Nonfarm payrolls rose by 257,000 jobs, beating consensus that called for a 230,000 gain. Even more exciting was that revisions to both December's and November's figures accounted for a net gain of 147,000. With that, the US economy has created more than 1,000,000 additional jobs in the last three months, which is the strongest pace of growth since 1997. The unemployment rate ticked slightly higher, but not because the amount of available jobs decreased, but because the size of the labor force increased. There was also inspiring news on wage gains: Hourly pay in the private sector climbed higher by $0.12 to $24.75 in January and has edged higher by 2.2 percent over the past year. In light of the news, Treasury yields spiked by as many as 17 basis points, with the largest movement occurring in the belly of the curve, as market participants adjusted their timelines for interest rate normalization.
- The fact that consumer prices have increased a little less than one percent over the last 12 months – partially due to the unexpected fall in energy prices – suggests that workers' real hourly earnings are likely to accelerate, which is an encouraging sign for the Fed; however, missing signs of inflation are discouraging (e.g., consumer price inflation, as measured by the core PCE deflator, slowed to a 1.4 percent rate.) But even still, the hearty jobs report will further twist the Fed's arm to consider hiking short-term interest rates sooner rather than later. The question is: how long can Federal Reserve officials let the job market heat up before raising short-term interest rates? History tells us that inflation slowly creeps higher, so the chance that the Fed will overshoot its target is small; however, if the central bank were to tighten policy too soon, and possibly slow inflation even further, the result could be disastrous. The current growth climate, involving a stronger dollar and weaker energy prices, makes the appropriate policy even more difficult to determine. If officials raise rates now, the US dollar will only get stronger, hampering economic growth. This is alarming given that US assets are considered to be safe-havens, and given the current situation in the euro zone, a flight to quality would make the US dollar even stronger. In short, it is likely that the Fed remains on its path to raise short-term interest rates soon, but we are still missing inflation, the necessary ingredient, and also, the central bank has to worry about the global economic environment as well.

Treasury Yields Move Higher on Positive Jobs Data



Last week, we saw Treasury yields in the belly and long-end increase as market participants felt much more comfortable with risk on more positive economic fundamentals, especially in Asia and Europe. However, concerns regarding Greece continued to grab headlines and weighed on investor sentiment. The very strong US labor market report led to most of the uptick in yields. Market participants expect that the Fed will hike short-term interest rates this year, with mid-year being the soonest. In light of the labor report, the Fed may alter the language in its statement at its next meeting in March.

Sources: Bloomberg

The Week Ahead

- This week will likely be a little quieter than the past couple of weeks. There will be a handful of economic releases out of the United States, Japan, China, the euro zone, and the UK.
- China will release January trade data on Monday, consumer and produce inflation figures on Tuesday, and loan data on Wednesday. Investors will try to determine the impact that lower energy prices have had on inflation.
- German consumer prices for January and aggregate euro zone industrial production will be released on Thursday and then on Friday, fourth-quarter GDP revisions for Germany and France will be released.

Date	Indicator	For	Forecast	Last
10-Feb	Wholesale Inventories MoM	Dec	0.2%	0.8%
11-Feb	MBA Mortgage Applications	6-Feb	-	1.3%
12-Feb	Retail Sales Advance MoM	Jan	(0.5%)	(0.9%)
13-Feb	U. of Mich. Sentiment	Feb P	98.1	98.1

Group Head
Matt Milcetich 216-689-3141

Cleveland, OH
David Bowen 216-689-3925
Mary Coe 216-689-4606
Dusko Djukic 216-689-4224
Sam Donzelli 216-689-3635
Anand Gomes 216-689-4932
Frank Kuriakuz 216-689-4071

Seattle, WA
Greg Dawli 206-689-2971
Wil Spink 206-689-2972

Documentation
Ramona Berce 413-567-6758
Linda Maraldo 216-689-0516
Marybeth Simon 216-689-0897

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