Interest Rate Risk Management Weekly Update

December 22, 2014

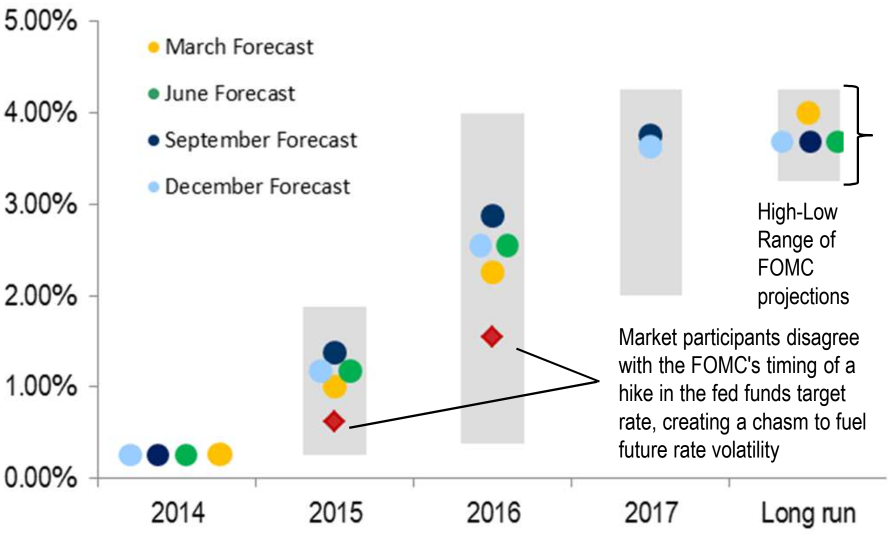
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.16%	0.16%	0.00%
3-Month LIBOR	0.25%	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	0.64%	0.54%	0.10% ↑
5-year Treasury	1.65%	1.51%	0.14% ↑
10-year Treasury	2.16%	2.08%	0.08% ↑
Swaps vs. 3M LIBOR			
2-year	0.92%	0.83%	0.09% ↑
5-year	1.83%	1.71%	0.12% ↑
10-year	2.34%	2.26%	0.08% ↑

Fed Speak & Economic News:

- The Fed's FOMC concluded its last meeting of the year on Thursday. The statement released after the meeting had market participants somewhat confused because it contained a medley of vocabulary, comprising a little bit of everything, and because it received its fair share of dissents from both hawks and doves. The statement added the language "can be patient," referring to interest rate normalization, but kept the "considerable time" language. Despite the fact that the central bank's message was about as clear as muddy water to some, what was very apparent was the fact that there was a lack of agreement among voters and that the Fed has decided to more carefully articulate its communications going forward. However, during the subsequent press conference, Fed Chair Janet Yellen's commentary was much clearer: she took a very balanced tone, with a slightly hawkish note, and she emphasized that the rate hiking timeline remains data dependent.
- The vast majority of FOMC participants (15 of 17) expect that we will see the first rate hike next year. However, it is highly unlikely that the Fed will hike rates at one of the first two meetings (Jan and Mar), although it is not unreasonable. The most common expectation is that the Fed will raise rates in the middle of 2015, at the June meeting, which is also consistent with the views expressed by committee members via Fedspeak. The central bank wants to stay away from a rate normalization process that does not introduce some degree of financial stress (like the hiking process we saw during the 2004 cycle). This means that the pace of hiking will not be a constant string of 25 basis points per meeting, but will instead probably vary.
- Not surprisingly, the Fed significantly revised its forecasts for unemployment lower: by the end of 2015, the unemployment rate is forecasted to be 5.25 percent, which is below the 5.35 percent rate considered to be the natural rate by many (below this level, wages and prices should start to accelerate). In fact, one official dissented from the Fed's decision to hold rates steady on precisely that reason (another dissented because he did not like the guidance). One of the main reasons for dissent, between committee members and market participants, revolves around lower global crude oil prices and the current trajectory of global output. For now, the drop in oil prices, and hence inflation expectations, has given the Fed a little wiggle room to leave rates at historic lows.

The Fed's Revised Dot Plot



Source: The Federal Reserve

The FOMC projections of interest rates put the median official's forecast of the federal funds rate at 1.125 percent by the end of 2015 and 2.5 percent by the end of 2016, which is a drop from the 2.875 percent median forecast released in September. This is more than what market participants had priced in, but Janet Yellen downplayed the difference in opinions, citing technical factors. The decline in the Fed's forecasts is the result of the decline in oil prices and inflation expectations.

U.S. Economic Data

- Consumer prices slid in November, falling 0.3 percent, with energy prices pulling the index lower. Core prices moved higher by 0.1 percent
- Industrial production data showed an impressive pace of output for the month, and the previous month's data were revised higher
- Housing starts fell 1.6 percent in November and posted a 1.7 increase in October

Date	Indicator	For	Forecast	Last
22-Dec	Existing Home Sales	Nov	5.20M	5.26M
23-Dec	GDP Annualized QoQ	3Q T	4.3%	3.9%
23-Dec	Univ. of Michigan Confidence	Dec F	93.5	93.8
23-Dec	Durable Goods Orders	Nov	3.00%	0.30%
23-Dec	New Home Sales	Nov	460K	458K
23-Dec	Personal Income	Nov	0.4%	0.2%
23-Dec	Personal Spending	Nov	0.5%	0.2%

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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