INTEREST RATE MARKET INSIGHT

AUGUST 3, 2015

• The Federal Reserve's Open Market Committee minimally revised their policy statement last week to reflect the stabilizing labor market and persistent downdraft in costs for households, effectively setting the table for a September hike in the fed funds target rate. They want to hike soon to get policy closer to equilibrium, and a Committee lacking dissention despite some mixed data and the Greek fiasco shows how eager they are to get started. Futures imply a 70% hike probability for 2015 at this stage, but it feels like we could see two, almost certainly by January, assuming the economy continues to plow through. The yield curve compressed a few basis points WoW, mostly in the belly--the 5-year is down to 1.53% and the 10-year fell to 2.18%, while only the 2-year at 66 bps is up YoY. The July jobs report release this Friday will have a big role to play in the timing, and consensus projects 212,000 net new payrolls, a 5.3% unemployment rate (flat), and a +0.2% MoM gain for average hourly earnings. The Greek stock market reopened today for international accounts, and while it appears to be avoiding a 'one-day bear market' drop of 20%+, the major banks' shares have lost a third of their value. Domestic owners remain locked out from trading.

• In more local debt crisis news, Puerto Rico missed a scheduled $58 million bond payment, pushing them towards bankruptcy or a renegotiation of their $72 billion debt burden. While PR did pay on some other obligations this week, the island territory may be out of cash by November. After the durable goods orders beat consensus, the rest of the data held up tolerably, particularly the first estimate for Q2 GDP (+2.3% QoQ annualized) and a surprising revision for Q1 that went from -0.2% to +0.6% QoQ. Inside the numbers, the consumer that is fixing up her house and buying a car is battling the lack of fixed investment from business and governments. The price index rose to +1.5% QoQ. The annual revisions showed a slippage in 2013 to 1.5% that took the 2011-2014 average down to 2% annual growth. The employment cost index (ECI) fell to +0.2% QoQ, which is actually the worst reading the indicator has ever had in its 33 years, and the +2% YoY is right near those weakest of levels--wages, salaries, and benefits all slowed their advance in the quarter. Chicago PMI surprised to the upside with a 54.7 print after contracting in four of the last five months. The PMI services flash was strong at 55.2 and jobless claims were good at 267k.

• ADP private payrolls are expected to rise by 210,000 when released on Wednesday. Personal income and spending are both expected to rise at a slower pace this month (+0.3% and 0.2% MoM, respectively), and the core PCE price index is only seen rising one tenth. Construction spending is projected at +0.6% MoM in June, while both Markit and ISM have manufacturing surveys that economists forecast in the 53 range (modest growth) later today. The services gauges should be closer to 56. The trade deficit should expand to -$43 billion in June, and jobless claims and consumer credit should both rise too. Aircraft demand in the durable goods orders should drive factory orders up 1.7% MoM.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.19%	0.19%	0.19%	0.16%
3-month LIBOR	0.31%	0.29%	0.28%	0.24%
6-month LIBOR	0.49%	0.47%	0.44%	0.33%
12-month LIBOR	0.83%	0.81%	0.77%	0.58%
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	0.03%	0.05%	0.06%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.66%	0.68%	0.65%	0.53%
3-yr Treasury	0.97%	1.04%	1.01%	0.99%
5-yr Treasury	1.53%	1.62%	1.65%	1.75%
7-yr Treasury	1.92%	2.01%	2.08%	2.23%
10-yr Treasury	2.18%	2.26%	2.35%	2.56%
30-yr Treasury	2.91%	2.96%	3.12%	3.32%
2s-10s Spread	1.52%	1.58%	1.71%	2.03%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.91%	0.88%	0.71%
3-yr LIBOR Swap	Call	1.23%	1.22%	1.17%
5-yr LIBOR Swap	Call	1.70%	1.74%	1.83%
7-yr LIBOR Swap	Call	2.00%	2.08%	2.24%
10-yr LIBOR Swap	Call	2.28%	2.39%	2.62%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.42%	0.42%	0.40%
3-yr SIFMA Swap	Call	0.68%	0.68%	0.73%
5-yr SIFMA Swap	Call	1.14%	1.17%	1.35%
7-yr SIFMA Swap	Call	1.45%	1.51%	1.76%
10-yr SIFMA Swap	Call	1.75%	1.85%	2.16%

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

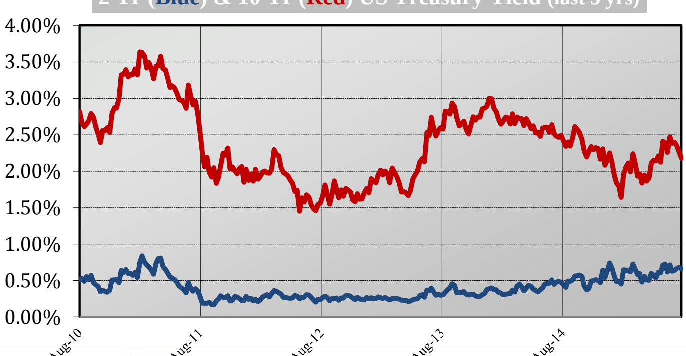
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	28	15	13	7
4-yr LIBOR Cap	76	47	34	27
5-yr LIBOR Cap	136	65	36	46
7-yr LIBOR Cap	296	188	131	99

Fwd Implied 3mL Rate	Last
Dec. 15	0.53%
Dec. 16	1.29%
Dec. 17	1.90%
Dec. 18	2.33%

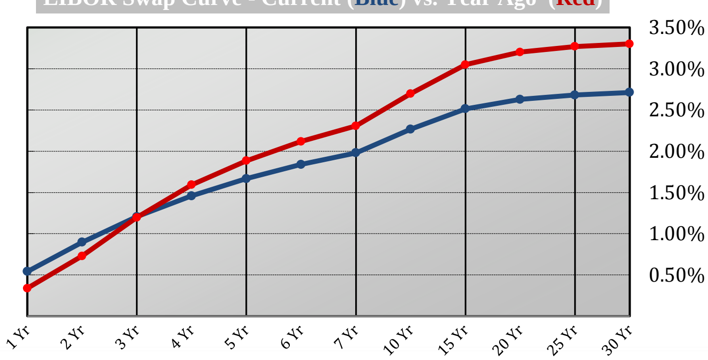
Conventions

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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