Interest Rate Market Insight

February 4, 2013

• New data and market action flowed freely last week, and the net result was a continuation of the uptrend in equities (S&P 500 at 1513) and interest rates (10-year Treasury yield at 2.02%) that most investors enjoy. The first look at Q4 GDP disappointed and actually fell -0.1% QoQ, compared to the third quarter's 3.1% rise, the first drop since the recession and a move that was driven by the government, both directly (-1.3% of the number was from a drop in government spending) and indirectly (-1.3% of the move due to a decline in inventories, thanks to the fiscal cliff shenanigans). Final demand rose 1.1%. The price index also cooled to 0.6% from 1.7% in Q3 2012. The FOMC meeting policy statement didn't change rate policy or quantitative easing expectations, but the Fed did highlight improvement in fixed business investment and noted the GDP miss was likely "in large part because of weather-related disruptions and other transitory factors." While the sole dissenter Jeffrey Lacker rotated out of his voting position, Esther George replaced him and dissented with the policy statement on the grounds that accommodation increased the risk of long-term inflation. Friday's nonfarm payrolls report did little to stop the general market exuberance, even though the 157,000 new jobs was below consensus and the unemployment rate ticked up to 7.9%. Revisions to the prior two months did net 156k additional payrolls, and hourly earnings rose 0.2% MoM. Government payrolls continue to fall, down 9k on the month. Wednesday's ADP private payrolls report rose 192k, more than consensus, but jobless claims also rose on Thursday to 368k. Earlier in the week, the durable goods orders came in much better than expected (+4.6%, +1.3% ex transportation), thanks to growth in metals, machinery, and electronics. Personal income rose 2.6% in December thanks to dividend payments made ahead of the expected year-end tax changes, and spending rose 0.2%. The ISM Manufacturing survey handily beat expectations on Friday at 53.1 vs. 50.7 consensus and 50.2 in December.

• We might see a downdraft in volume and interest in the coming week since last week was so bustling, and indeed futures are lowering before this morning's opening bell. The biggest reports on the week will be the ISM services survey (consensus of strong growth at 55.1) and the trade deficit report (-$46 billion expected). We will also see data on factory orders (economists looking for +2.4% MoM), productivity and costs, consumer credit (should expand $14.5 billion), and wholesale trade inventories. Both houses of Congress have agreed in principal on raising the debt ceiling as bills become due over the next 90 days, with each party having to prepare budgets for the coming fiscal year. While the focus moves to the sequestration that could hit defense and entitlement spending in March to the tune of $85 billion, the plan could get replaced by alternative austerity.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.20%	0.20%	0.21%	0.26%
3-month LIBOR	0.30%	0.30%	0.31%	0.54%
6-month LIBOR	0.47%	0.48%	0.51%	0.77%
12-month LIBOR	0.78%	0.80%	0.84%	1.09%
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	0.10%	0.10%	0.08%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.26%	0.27%	0.25%	0.22%
3-yr Treasury	0.40%	0.42%	0.35%	0.30%
5-yr Treasury	0.88%	0.85%	0.72%	0.72%
7-yr Treasury	1.41%	1.34%	1.18%	1.27%
10-yr Treasury	2.02%	1.95%	1.76%	1.83%
30-yr Treasury	3.22%	3.13%	2.95%	2.99%
2s-10s Spread	1.75%	1.68%	1.51%	1.60%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	0.41%	0.42%	0.38%	0.49%
3-yr LIBOR Swap	0.55%	0.55%	0.49%	0.57%
5-yr LIBOR Swap	1.01%	0.97%	0.84%	0.95%
7-yr LIBOR Swap	1.49%	1.43%	1.27%	1.41%
10-yr LIBOR Swap	2.04%	1.95%	1.79%	1.87%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	0.31%	0.31%	0.28%	0.34%
3-yr SIFMA Swap	0.41%	0.41%	0.35%	0.42%
5-yr SIFMA Swap	0.79%	0.76%	0.66%	0.78%
7-yr SIFMA Swap	1.22%	1.17%	1.05%	1.21%
10-yr SIFMA Swap	1.71%	1.64%	1.52%	1.64%

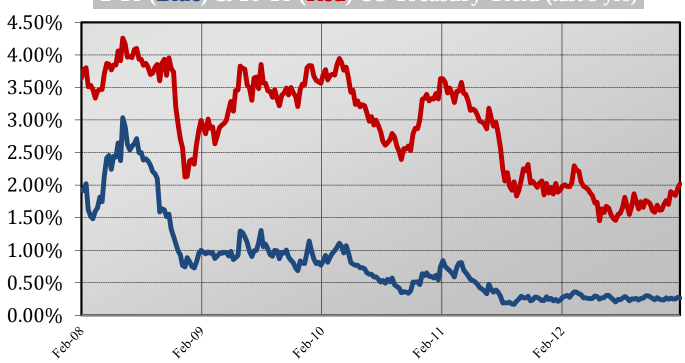
Rate Caps (cost in bps)	Strike = 4.00%	Strike = 5.00%
3-yr LIBOR Cap	15	13
5-yr LIBOR Cap	65	49
7-yr LIBOR Cap	181	135
10-yr LIBOR Cap	433	310

Fwd Implied 3mL Rate	Last
Dec. 13	0.40%
Dec. 14	0.65%
Dec. 15	1.10%
Dec. 16	1.77%

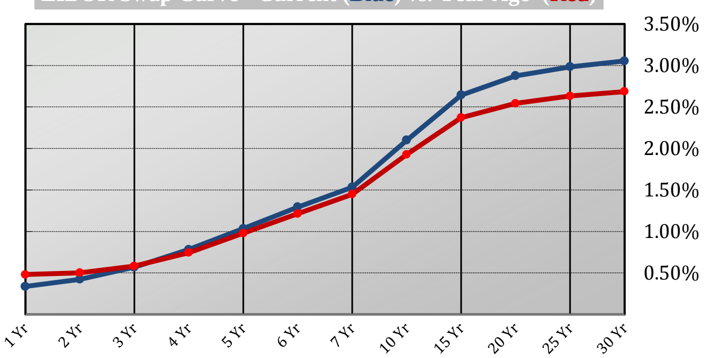
Conventions

LIBOR swaps use 1-month LIBOR, monthly payments, act/360 day count for both legs. SIFMA swaps reset weekly and pay monthly, act/act day count. All else equal, amortizing swaps will have lower rates. 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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