Interest Rate Risk Management Weekly Update

January 19, 2016

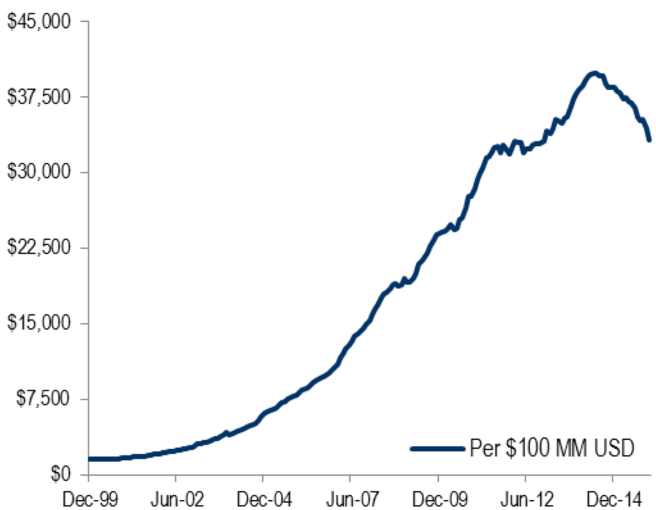
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.43%	0.42%	0.01%	↑
3-Month LIBOR	0.62%	0.62%	0.00%	○
Fed Funds	0.50%	0.50%	0.00%	○
Fed Discount	0.75%	0.75%	0.00%	○
Prime	3.50%	3.50%	0.00%	○
US Treasury Yields				
2-year Treasury	0.85%	0.93%	(0.08%)	↓
5-year Treasury	1.45%	1.56%	(0.11%)	↓
10-year Treasury	2.04%	2.12%	(0.08%)	↓
Swaps vs. 3M LIBOR				
2-year	0.96%	1.07%	(0.11%)	↓
5-year	1.42%	1.55%	(0.13%)	↓
10-year	1.94%	2.03%	(0.09%)	↓

Fedspeak & Economic News:

- The US Treasury market rallied sharply for the second week in a row, with the curve finishing a bit steeper. It is unlikely that the impressive rally has been driven by the Fed rate hike we saw about a month ago. The hike was largely priced into the market at the time. Instead, it is far more likely that the recent market turmoil has been catalyzed by the freefall of China's equity market, which has sparked investor concern about the stability its economy.
- If you recall, Chinese officials stabilized their equity markets last August, but before the year finished, Chinese equities took a dive in anticipation of the end of the sales ban on large investors and new supply via fresh IPOs. On top of that, weak industrial profits, led by state-owned enterprises, also paved the way for further market anxiety. However, recent economic data eased some of the fears of a hard landing as annualized GDP growth from the world's second largest economy was reported at 6.8 percent for the fourth quarter. The not-as-bad-as-expected slowdown also brought a lift in market sentiment as it was deemed just enough by some traders to warrant additional stimulus measures from Beijing. Economists believe China's evolution toward a consumer-driven economy still has some growing pains to work through, suggesting additional volatility in the near term, but remain broadly optimistic.
- Crude oil extended its slide, due largely to two main factors: the first is a reduction in anticipated global demand as China and the rest of the world have a reduced growth outlook. The International Monetary Fund cut its forecast for world economic growth for the third time this year, to 3.4 percent from 3.6 percent. The second factor is on the supply side. The prospect of Iranian crude coming to market as sanctions are lifted has helped push the price of oil below $30/barrel. The International Energy Agency said global oil markets could "drown in oversupply", as an estimated 300K Bbl/day are expected to come into the market at the end of the first quarter. Global inventories have risen by approximately 1 billion barrels in 2014-2015, with an additional build of 285 million barrels expected in 2016. This has strained storage facilities and further exacerbates the oil glut. Yields will have a hard time trending higher with the decline in oil prices via decreased inflation expectations.

Declining Chinese Foreign Exchange Reserves



Sources: Bloomberg

If we take a look at China's monthly foreign exchange reserves, its central bank's war chest for controlling the value of its currency value (in this case, by selling yuan and buying USD), we see that they have declined rather rapidly since late last year. (To be fair, they have been declining since we passed the halfway mark in 2014.) However, going forward, the biggest concern is what we do not know: How long are Chinese officials willing to let the market slide? What is their intention? And even then, Chinese equities remain rich by some measures. A little over two weeks into 2016 and it seems China is the 800-pound gorilla driving markets. While things may have settled down for the time being, it is doubtful that we have seen the light at the end of the tunnel. US Treasuries will likely continue to see heightened volatility, since investors are using Treasuries as a safety channel.

The Week Ahead

- The ECB will conclude its first policy meeting of the year on Thursday. It is expected that it will keep things par for course.
- The Bank of Canada will conclude its policy meeting on Wednesday.
- The major economic data point of the week will be the release of US consumer prices on Wednesday.
- The annual World Economic Forum will begin in Davos, Switzerland, Wednesday and end Friday.

Date	Indicator	For	Forecast	Last
20-Jan	CPI MoM	Dec	0.0%	0.0%
20-Jan	Housing Starts	Dec	1200k	1173k
22-Jan	Markit US Manufacturing PMI	Jan P	51.0	51.2
22-Jan	Existing Home Sales	Dec	5.20m	4.76m
22-Jan	Leading Index	Dec	(0.1%)	0.4%

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