Interest Rate Risk Management Weekly Update

May 4, 2015

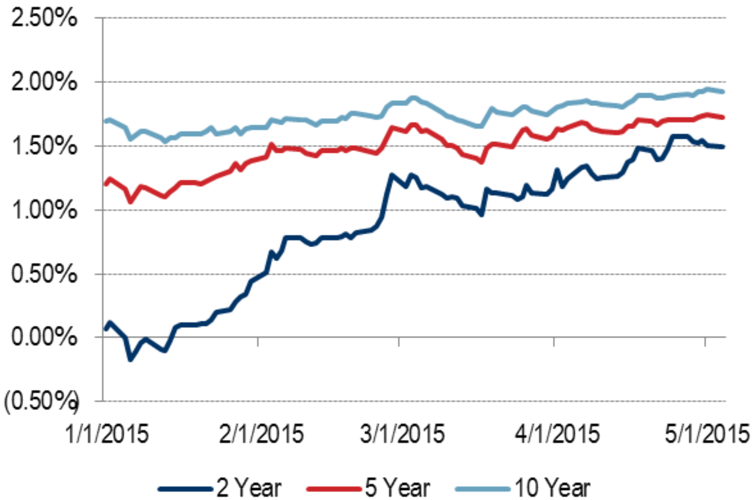
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.18%	0.18%	0.00%	○
3-Month LIBOR	0.28%	0.28%	0.00%	○
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	0.60%	0.51%	0.09%	↑
5-year Treasury	1.50%	1.32%	0.18%	↑
10-year Treasury	2.11%	1.91%	0.20%	↑
Swaps vs. 3M LIBOR				
2-year	0.91%	0.82%	0.09%	↑
5-year	1.70%	1.52%	0.18%	↑
10-year	2.25%	2.04%	0.21%	↑

Fed Speak & Economic News:

- Global bond yields have moved sharply higher during the past two weeks. The 10-year Bund's yield has increased by nearly 30 basis points, while the yields offered on the 10-year Gilt and the 10-year US Treasury have both moved higher by 25 and 24 basis points respectively. As we mentioned in previous distributions, the main drivers underpinning movement in US Treasury yields are monetary policy abroad and the Fed's timeline for interest rate normalization.
- Worldwide economic growth has begun to pick up and energy prices, especially crude oil, have trended higher recently, which have both led market participants to revise their inflation expectations. As such, monetary policy outside the U.S. may become less accommodative down the road. In this case, the US dollar would likely become weaker, improving economic growth and inflation expectations here at home, which would serve to push Treasury yields higher. In addition, if relatively low yields abroad have kept the yields offered on US securities low, an unwind elsewhere would likely lead to an unwind in the U.S..
- Regarding interest rate normalization in the U.S., the FOMC released its April statement on Wednesday. The committee acknowledged that first-quarter economic growth slowed a bit, along with the pace of job gains, though it said that the causes are likely transitory. This was largely in line with market expectations, which means that an increase in short-term interest rates remains on the table for mid- to late-year; however, the market thinks September is the more likely candidate. The Fed had a cautious tone, and for good reason: payroll growth has moderated, economic growth was a bit slow in recent months, and inflation levels remain tepid. However, keep in mind that a few factors have moved in the right direction, namely the stabilization of the US dollar and the bottoming out of energy prices. Now, if the jobs report released on Friday shows robust payroll growth, it should alleviate concerns about slowing economic growth and help pave the way for a rate hike in mid- to late-2015.
- To summarize, improving global growth and higher energy prices have led market participants to believe that monetary policy will become less accommodative, which have both pushed global bond yields higher. At home, the Fed has a cautious tone, but the stabilization of the US dollar and energy prices are both good signs and a solid payroll print on Friday would only add to that.

US Breakeven Yields Have Trended Higher in 2015



The breakeven level is determined by subtracting the real yield of the inflation linked maturity curve from the yield on the respective nominal US Treasury. The difference is called the breakeven inflation rate and helps indicate the inflation expectations priced into the market. Breakevens have managed to trend higher as wage growth and core CPI have moved higher. Core CPI has managed to grow by +0.2% MoM in the past few months while the latest Employment Cost Index release showed an increase in private sector compensation to 2.8% during Q1. In addition, the increase in energy prices has played a role as well.

Sources: Bloomberg

The Week Ahead

- The April employment report will be released on Friday. A weak report would likely rule out a June rate hike and call into question a September hike.
- The United Kingdom will hold its election on May 7. As of now, it is difficult to determine which majority government will be formed.
- The ECB will meet this week, but it will be a non-monetary policy meeting. The central bank will discuss Greek debt.

Date	Indicator	For	Forecast	Last
4-May	Factory Orders	Mar	2.0%	0.2%
5-May	Trade Balance	Mar	-$41.3B	-$35.4B
5-May	ISM Non-Manf. Composite	Apr	56.0	56.5
6-May	ADP Employment Change	Apr	200K	189K
7-May	Initial Jobless Claims	2-May	278K	262K
8-May	Change in Nonfarm Payrolls	Apr	225K	126K
8-May	Unemployment Rate	Apr	5.4%	5.5%
8-May	Wholesale Inventories MoM	Mar	0.3%	0.3%

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