Interest Rate Risk Management Weekly Update

March 14, 2016

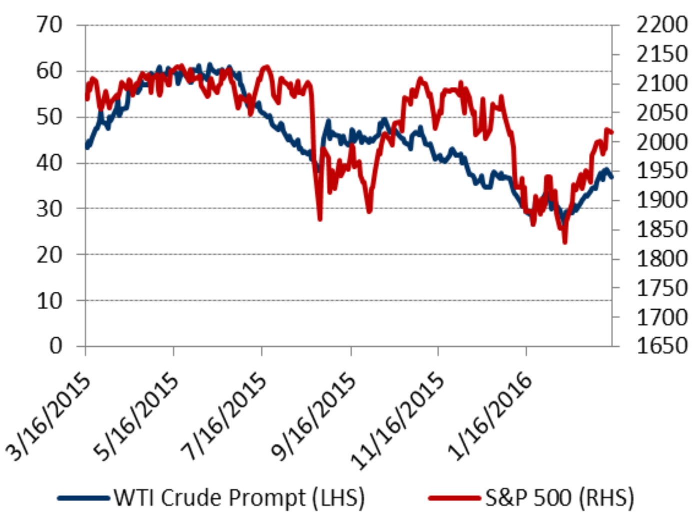
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.44%	0.44%	0.00%	○
3-Month LIBOR	0.63%	0.63%	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	0.96%	0.86%	0.10%	↑
5-year Treasury	1.49%	1.38%	0.11%	↑
10-year Treasury	1.99%	1.88%	0.11%	↑
Swaps vs. 3M LIBOR				
2-year	1.06%	0.97%	0.09%	↑
5-year	1.46%	1.34%	0.12%	↑
10-year	1.88%	1.78%	0.10%	↑

Fedspeak & Economic News:

- US Treasury yields continued their march higher, with the curve flattening a bit as shorter-dated yields rose more than their later-dated counterparts. Global safe haven yields have increased approximately 20bps since the beginning of the month, with Japanese and European bond markets seeing heightened levels of volatility especially (15-25bp intra-day movements). The comprehensive easing package the European Central Bank (ECB) released catalyzed a pick-up in risk appetite leading to the selloff in riskless bonds.
- ECB President Draghi proved that he still has the ability to make markets docile: At its latest meeting, the central bank delivered a comprehensive stimulus package well above market expectations, unlike its last meeting in December. Surprisingly, the focus shifted away from short-term rates towards more unconventional policy tools. Mr. Draghi managed to get approval for everything but the kitchen sink: rate cuts, acceleration of asset purchases (including corporate bonds), and new long-term repos. The deposit rate was cut 10bps to minus 40bps while asset purchases were increased by 20 billion euros per month to 80 billion, with purchases including investment grade non-financial corporate bonds to address concerns of a shortage of assets. The ECB will introduce new long-term repo operations beginning in June (known as TLTROs).
- Markets responded very favorably to the announcement: bond yields fell, equity prices rose, and the euro weakened; however, price action reversed after the press conference finished. While the ECB cut the deposit rate by 10bps, during the press conference, Draghi implied that the ECB would no longer rely on lowering deposit rate cuts. Instead, he indicated that the central bank's policy will rely more on quantitative and credit easing. Although market participants welcomed increased asset purchases, they were slightly disappointed due to the grim prospect of further deposit rate cuts. The market's response also highlights its skepticism about what effect increased asset purchases will have. In other words, market participants are beginning to doubt "more of the same" policies.
- Monetary policy will be placed front and center this week; five major central banks are set to meet including the Federal Reserve, Bank of Japan, Bank of England, Norges Bank, and the Swiss National Bank. The Fed will conclude its meeting Wednesday, followed by a press conference. Market participants do not expect a rate hike, with the Fed to instead err on the side of caution.

Recovering Global Aggregate Demand



Sources: Bloomberg; The Brookings Institution: "The relationship between stocks and oil prices"

Why have stock prices fallen with crude oil prices? Falling crude prices are good for the consumer and net importers of crude (e.g., China). So one would think that falling oil prices would have an inverse association with stock prices. People save at the pump and spend more, generating more corporate profit. As you can see the chart to the left, that's not the case over the past year. What gives? One plausible explanation given by former US Fed Chairman Ben Bernanke is that both are reacting to a common factor: global aggregate demand. A decrease in global aggregate demand would mean less corporate profit and demand for oil, both of which highlight fears about global economic growth. However, according to Bernanke, demand only acccounts for most of the positive relationship, not all of it.

The Week Ahead

- This week's schedule will be jam-packed, including major economic data (US CPI and retail sales) and central bank meetings.
- The **Fed** will conclude its two-day meeting Wednesday, followed with a press release and updated projections.
- The **BoJ** will conclude its two-day meeting tomorrow. No major action is expected.

Date	Indicator	For	Forecast	Last
15-Mar	Retail Sales Advance MoM	Feb	(0.1%)	0.2%
15-Mar	PPI Final Demand MoM	Feb	(0.2%)	0.1%
15-Mar	Empire Manufacturing	Mar P	-11.5	-16.64
16-Mar	FOMC Rate Decision	Mar 16	0.50%	0.50%
16-Mar	CPI MoM	Feb	(0.20%)	0.00%
16-Mar	Housing Starts	Feb	1150k	1099k
16-Mar	Industrial Production MoM	Feb	(0.3%)	0.9%
17-Mar	Leading Index	Feb	0.2%	(0.2%)
18-Mar	U. of Mich. Sentiment	Mar P	92.2	91.7

KeyBank

Cleveland, OH
David Bowen 216-689-3925
Mary Coe 216-689-4606
Srdjan Demonjic 216-689-3922
Dusko Djukic 216-689-4224
Sam Donzelli 216-689-3635
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

Disclaimer

This communication is generated by the derivatives sales & trading unit of KeyBank and conveyed as commentary on economic, political and/or market conditions or, in some cases, may be considered to be a general solicitation for entering into derivatives transactions, as contemplated under Commodity Futures Trading Commission ("CFTC") Regulation 23.605, and is not a "research report" as defined therein. This communication is not to be construed as a recommendation or opinion with respect to any derivative or trading strategy involving a derivative for purposes of CFTC Part 23 Regulations. This communication does not take into account the investment objectives, financial conditions, or needs of individual parties and is not intended to serve as a basis for entering into a derivatives transaction or to suggest, in any manner, that a party should enter into a particular derivatives transaction or trading strategy involving a derivative. Parties should consult their own advisors for opinions and advice on whether to enter into any derivatives transaction or trading strategy involving a derivative. The information contained herein has been obtained from sources deemed to be reliable but it is not represented to be accurate, complete or objective. In providing this information, neither KeyBank nor any affiliate of KeyBank is acting as your agent, broker, advisor, or fiduciary, or is offering any tax, accounting, or legal advice regarding these instruments or transactions. KeyBank may have current positions or strategies that may be inconsistent with any views expressed herein.