Interest Rate Market Insight

August 25, 2014

• Not surprisingly, the Federal Reserve members collectively emerged from Jackson Hole looking as dovish as their European guests, leaving few onlookers overly stressed about the inflation outlook and market makers happy to continue on 'long and strong' in risk assets. The move pushed the S&P 500 to an all-time closing high yet again at 1988.40, and the data was just rosy enough to complement the rhetoric. The Treasury yield curve did a belly-fattener as the 5-year maturity rose 12 bps WoW to 1.66% and the 10-year yield crept up but stands at 2.38% this morning in early trade. Ahead of the holiday weekend, it seems the bullish trend will continue, particularly as European markets take ECB President Draghi's concerns over medium-term inflation to imply that quantitative easing is likely. The current euro area inflation reading is only 0.3% annualized and the 5-yr forward 5-year inflation swap yield dropped below 2%, the general target level used in both Europe and the US. Despite the sluggishness of the domestic recovery, it is nice that the US seems to be several years ahead of Europe in the recovery cycle, even though our policymakers often seem as disparate in ideology as the EU nations. A fresh GDP print this week will be closely monitored at home.

• The consensus remains with the initial 4% QoQ annualized growth and 2% for the price index in the second quarter. Some of the market action must be attributed to housing last week as well, with housing starts jumping over 15% in July to nearly 1.1MM annualized and existing home sales up 2.4% to 5.15MM, with a boost in the homebuilder sentiment index to 55 from 53 MoM as well, led by the Midwest. Consumer prices came in at consensus (+0.1% MoM for both headline and core ex food and energy) and leading indicators blew away consensus at +0.9% MoM thanks to falling unemployment claims and the yield spread. The Philly Fed index rose to 28, but its components softened somewhat. Initial jobless claims dropped below 300k again on the week. Fed Chair Yellen made certain to include nearly every economic and labor indicator as relevant in the Fed's assessment of when to tighten, highlighting that there will be no 'preset path' in the process. The FOMC minutes released included greater discussion of the eventual balance sheet unwind, which will be driven by a flexible rate collar between reverse repo rates and interest paid on excess reserves. If any mantra should be taken from the Fed communications at this time, it would be 'predictable.'

• Treasury auctions $93 billion in paper in the belly of the curve (2-, 5-, and 7-year maturities) and run a 2-yr FRN auction as well. The calendar ahead of the long weekend will include durable goods orders, which should be strong on the headline as transportation orders pop. Personal income and spending are both expected to rise more slowly this month over last (+0.3% and 0.2%, respectively), core PCE prices should rise only 0.1% MoM, and Chicago PMI is expected above 56. On the resurgent housing front, we will see new home sales and price gauges from FHFA and S&P Case-Shiller, both of which should increase at less than 1% MoM as the YoY growth in prices falls below 10% nationwide.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.16%	0.16%	0.16%	0.18%
3-month LIBOR	0.24%	0.23%	0.23%	0.26%
6-month LIBOR	0.33%	0.33%	0.33%	0.40%
12-month LIBOR	0.57%	0.55%	0.56%	0.67%
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	0.05%	0.06%	0.06%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.49%	0.41%	0.47%	0.39%
3-yr Treasury	0.97%	0.86%	0.96%	0.81%
5-yr Treasury	1.66%	1.54%	1.65%	1.68%
7-yr Treasury	2.09%	1.99%	2.11%	2.32%
10-yr Treasury	2.40%	2.34%	2.46%	2.89%
30-yr Treasury	3.16%	3.13%	3.25%	3.87%
2s-10s Spread	1.91%	1.93%	1.99%	2.50%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.62%	0.66%	0.57%
3-yr LIBOR Swap	Call	1.03%	1.09%	0.97%
5-yr LIBOR Swap	Call	1.66%	1.73%	1.82%
7-yr LIBOR Swap	Call	2.05%	2.13%	2.44%
10-yr LIBOR Swap	Call	2.42%	2.51%	3.00%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.36%	0.38%	0.36%
3-yr SIFMA Swap	Call	0.65%	0.69%	0.64%
5-yr SIFMA Swap	Call	1.22%	1.28%	1.36%
7-yr SIFMA Swap	Call	1.62%	1.69%	1.94%
10-yr SIFMA Swap	Call	2.01%	2.10%	2.48%

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

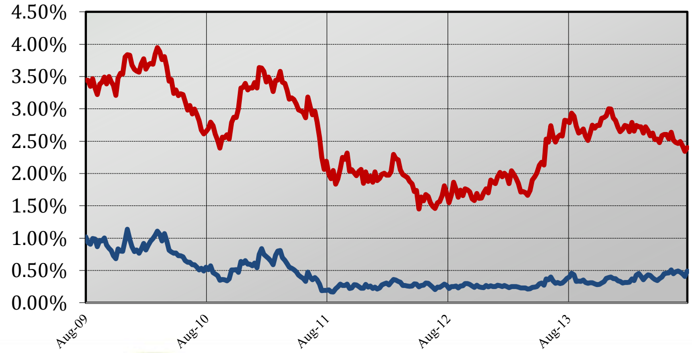
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	36	19	13	9
4-yr LIBOR Cap	100	55	33	21
5-yr LIBOR Cap	177	102	59	37
7-yr LIBOR Cap	371	238	136	86

Fwd Implied 3mL Rate	Last
Dec. 14	0.26%
Dec. 15	1.01%
Dec. 16	2.05%
Dec. 17	2.76%

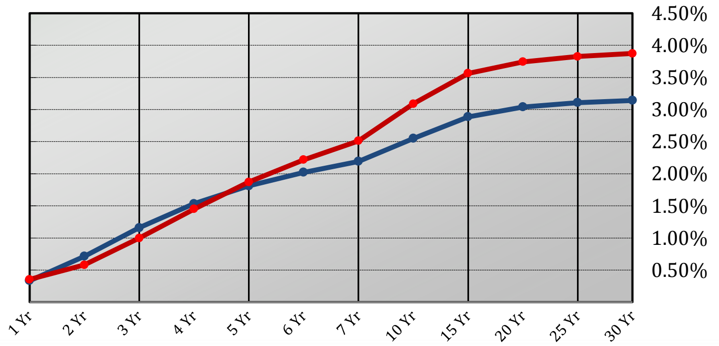
Conventions

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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