Interest Rate Market Insight

September 2, 2014

• After a week led by European deflationary implications shifting the global rate complex lower, a more robust trading cohort is likely back from vacation this week, and the selling of bonds has already begun in early trading, with 10-year benchmark yields up some 4 bps in Germany and the US. While Ukraine and Russia seem poised for continued skirmishes in the months to come, that threat is not scaring markets ahead of a jobs report this Friday, especially after another week of decent data domestically. The second print of Q2 GDP improved to a 4.2% QoQ annualized growth rate coming out of the winter decline, still led by nonresidential investment. Residential investment, and the consumer as well, did seem to soften in the month of August, however, as new home sales fell to 412k annualized and home prices from FHFA rose only 5% YoY and S&P Case-Shiller only 8% YoY, the latter falling 0.2% MoM. Personal income rose 0.2%, but spending fell 0.1%. Durable goods orders surged nearly 23% MoM thanks to massive aircraft orders, but ex transportation fell slightly for the month. After-tax corporate profits for the second quarter rose 4.5% to another all-time high of $1.84 trillion, and Chicago PMI surged to above 64 in its August print.

• Initial jobless claims of 298k bode well for Friday. The wisdom of the economist collective projects a net new 230,000 payrolls added for August, steady with the trend and likely to push the unemployment rate down a tenth to 6.1%, and hourly earnings should rise 0.2% MoM. These will once again be mostly private payrolls, and ADP is projected to show a gain of 223,000 for that subset on Wednesday. It seems that ECB President Mario Draghi could begin some form of quantitative easing this week at its policy meeting this week. The overnight Euro borrowing rate between banks went negative today at -0.013%, and this is not a function of credit quality. As when we see the German 10-year bund below 1%, it is important to factor in the currency effect when comparing yields across borders, particularly with the dollar strengthening to seven month highs against a global basket. While the GDP rose to 4.2%, the price index rose to 2.1%, but other metrics like the core PCE deflator shows inflation fully checked, and the pricing pressure in the oil and agriculture spaces has eased as well in recent weeks, so the Federal Reserve has great cover to take its time dovishly for several months more, it would seem to most market prognosticators.

• The Beige book of district business anecdotes will be released on Wednesday, where more of the same 'slow and steady' is expected. ISM releases its manufacturing and service indices, with both expected to show decent growth around 57 (above 50 is expansionary) when released. The international trade report should show the trade deficit widening to -$42.3 billion MoM. Along with a fair bit of Fed speak this week, forecasts show that factory orders and construction spending for July will have advanced MoM. Nonfarm productivity will slip slightly to 2.4% annualized. The President is in Europe this week for a NATO summit and will formally warn Russian President Putin in a speech today.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.16%	0.16%	0.16%	0.18%
3-month LIBOR	0.23%	0.24%	0.24%	0.26%
6-month LIBOR	0.33%	0.33%	0.33%	0.39%
12-month LIBOR	0.57%	0.57%	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%	0.49%	0.54%	0.40%
3-yr Treasury	0.93%	0.97%	0.98%	0.77%
5-yr Treasury	1.63%	1.66%	1.69%	1.61%
7-yr Treasury	2.04%	2.09%	2.13%	2.19%
10-yr Treasury	2.34%	2.40%	2.46%	2.76%
30-yr Treasury	3.08%	3.16%	3.23%	3.72%
2s-10s Spread	1.85%	1.91%	1.92%	2.37%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.70%	0.69%	0.55%
3-yr LIBOR Swap	Call	1.13%	1.13%	0.93%
5-yr LIBOR Swap	Call	1.76%	1.77%	1.72%
7-yr LIBOR Swap	Call	2.13%	2.15%	2.32%
10-yr LIBOR Swap	Call	2.48%	2.51%	2.87%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.40%	0.40%	0.35%
3-yr SIFMA Swap	Call	0.72%	0.72%	0.63%
5-yr SIFMA Swap	Call	1.29%	1.31%	1.29%
7-yr SIFMA Swap	Call	1.67%	1.70%	1.85%
10-yr SIFMA Swap	Call	2.04%	2.09%	2.38%

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

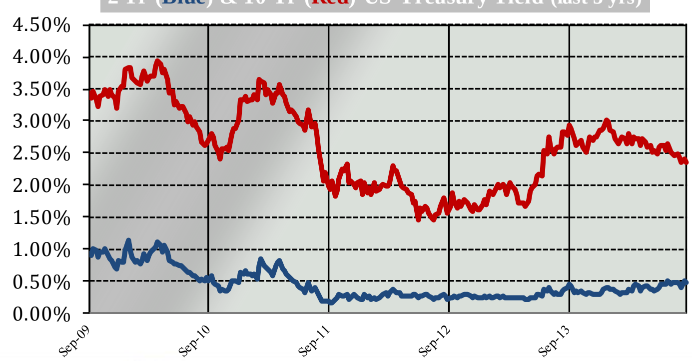
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	35	18	12	8
4-yr LIBOR Cap	96	52	30	20
5-yr LIBOR Cap	170	95	55	34
7-yr LIBOR Cap	357	222	128	80

Fwd Implied 3mL Rate	Last
Dec. 14	0.25%
Dec. 15	1.00%
Dec. 16	2.03%
Dec. 17	2.70%

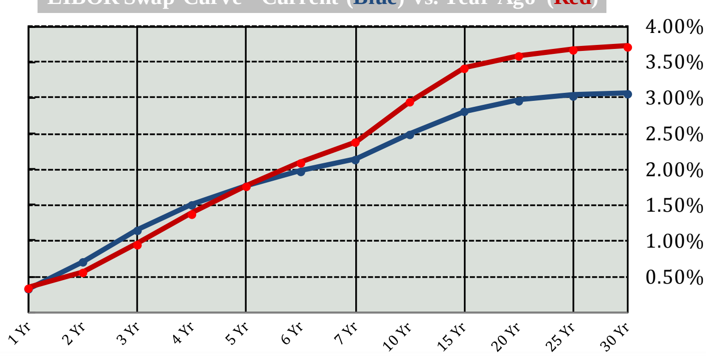
Conventions

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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