Interest Rate Market Insight

July 21, 2014

• Longer-dated Treasury yields dipped last week towards the lower end of their range most recently seen in May on concern that the downed Malaysian airliner over Ukraine was the work of Russian-backed separatists, which seems to be the case. This may be the last straw needed to unite the western European community to apply pressure to the Putin-regime, but the global equities markets effectively shrugged off the news as the week closed, with the Dow and S&P 500 back within a handful of points from all-time closing highs. The 2-year yield is a shade below 0.50% as the 10-year maturity ducked under 2.50%, now below the December 2017 consensus for 3-month LIBOR of 2.77%. Economically speaking, Chair Yellen met committees in both houses of Congress and testified to the fact that while the economy has picked up of late, labor market slack remains, and the likely scenario for the Fed funds target rate is near-zero until summer of next year (and 1% at yearend) in the best case. Wage inflation is not visible, perhaps repressed by higher earning baby-boomer retirees downsizing their employment instead of leaving the workforce. The retail sales report missed the mark in June (+0.2% vs. 0.6%) but was revised equally higher in May to offset.

• Producer price inflation was hotter than expected at +0.4% MoM, but both the YoY headline and core readings are still below 2%. Leading indicators slowed to +0.3% MoM thanks to persistent housing weakness also evidenced by the deplorable housing starts (sub-900k annualized) and permits figures, although the homebuilder sentiment index popped (53 vs. 49 last month) in a sign that the new home market could be freshening. First-time home buyers are lacking, which is not surprising given the market shock of the decade prior. Both Empire State and Philly Fed surveys rose MoM in a sign that the leading edge of manufacturing should be strong in the summer, with strength noted particularly in the new order and employment components of the former. Treasury International Capital (TIC) data showed a net inflow of $20 billion into long term US securities in May, with foreign demand for our bonds and equities offsetting US demand for the same in foreign accounts, and both China and Japan modestly increased their Treasury holdings in the period. Export prices fell 0.4% in June (+0.2% YoY) as the agricultural complex slipped, and import prices rose only 0.1% MoM and 1.2% YoY, so the report was viewed as relatively mild.

• Apart from monitoring fighting in Ukraine and Gaza, the fact that nearly 10% of the S&P 500 report second quarter earnings this week will drive the otherwise slow summer week for trading and data. Consumer prices are expected to rise in June (+0.3% MoM headline, +0.2% ex food and energy), and Friday we will get the durable goods orders report for June that should show a rebound of +0.5% MoM, modestly stronger with transportation excluded. Jobless claims are expected to rise fractionally to 310k net new this week, but the four week average of 309k is the best level of the recovery period. New home sales are expected to fall, existing home sales should rise, and FHFA home prices are

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.15%	0.15%	0.15%	0.19%
3-month LIBOR	0.23%	0.23%	0.23%	0.27%
6-month LIBOR	0.33%	0.33%	0.33%	0.40%
12-month LIBOR	0.55%	0.55%	0.55%	0.68%
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	0.04%	0.07%	0.05%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.48%	0.45%	0.45%	0.31%
3-yr Treasury	0.97%	0.93%	0.94%	0.60%
5-yr Treasury	1.67%	1.64%	1.67%	1.33%
7-yr Treasury	2.13%	2.13%	2.19%	1.92%
10-yr Treasury	2.48%	2.52%	2.59%	2.53%
30-yr Treasury	3.29%	3.34%	3.40%	3.63%
2s-10s Spread	2.00%	2.07%	2.14%	2.22%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.60%	0.59%	0.47%
3-yr LIBOR Swap	Call	1.02%	1.02%	0.74%
5-yr LIBOR Swap	Call	1.70%	1.71%	1.47%
7-yr LIBOR Swap	Call	2.14%	2.18%	2.07%
10-yr LIBOR Swap	Call	2.55%	2.60%	2.65%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.35%	0.34%	0.31%
3-yr SIFMA Swap	Call	0.65%	0.64%	0.50%
5-yr SIFMA Swap	Call	1.27%	1.27%	1.10%
7-yr SIFMA Swap	Call	1.72%	1.72%	1.66%
10-yr SIFMA Swap	Call	2.16%	2.17%	2.21%

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

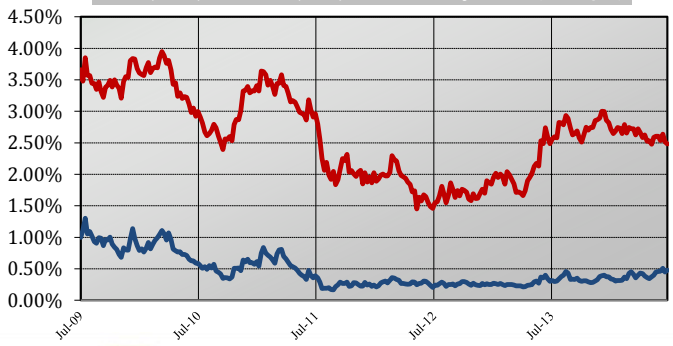
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	40	24	12	13
4-yr LIBOR Cap	101	62	32	21
5-yr LIBOR Cap	181	112	59	37
7-yr LIBOR Cap	382	243	163	87

Fwd Implied 3mL Rate	Last
Dec. 14	0.28%
Dec. 15	1.05%
Dec. 16	2.09%
Dec. 17	2.77%

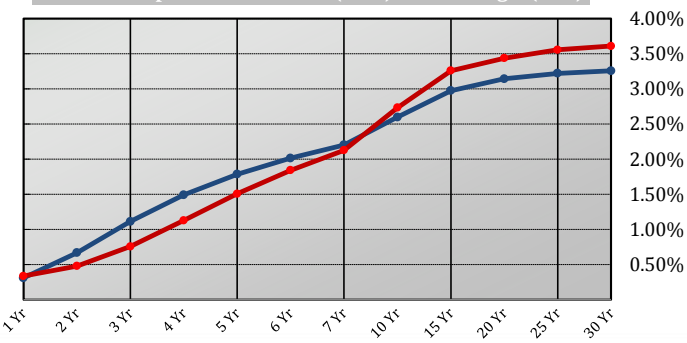
Conventions

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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