Interest Rate Market Insight

August 4, 2014

• Was the tidal wave of data and policy implication last week enough to force a shift in the thinking of investors and borrowers? The likely, known direction of the Federal Reserve's actions still seems plausible, but the certainty may be gone as Treasury and equity markets sold off last week, sending term rates up overall and sapping about half of the annual gains for the major indices. The shift seems to have been driven by the strong GDP report (+4% Q2 QoQ vs. 3% proj.) and some wage inflation, and how that news might lead the Fed to move up its policy schedule from summer 2015 into the first quarter. The policy statement did little but reiterate labor slack and keep up the tapering of $10 billion, leaving the remaining purchase pace at $25 billion a month, likely to hit zero in October. However, a bond default from Argentina (maybe curable?) and the Friday nonfarm payrolls report (indifferent +209k MoM gain, +15k revisions, unemployment ticked up to 6.2%) muddied the waters and pushed selling for a fourth straight day to end the week. The rate move up from Wednesday was partially pared Friday after the soft jobs report gave investors an excuse to limit exposures to seemingly ever-present rocket launches overseas these days over weekends.

• The hawks think the fed funds target rate could move up from 0.25% as early as January, finishing 2015 near 2%, and the policy statement had a dissenter this month in Plosser, who thought that keeping a low target rate for a 'considerable time after the asset purchase program ends' was excessively dovish given the economic progress shown to date and the admission from the Fed that 'inflation has moved somewhat closer to the Committee's longer-run objective.' Breaking down the employment situation for the week, the ADP private payrolls report missed consensus with 218k net new private jobs, while jobless claims rose slightly to 302k WoW, but the 4-week average remains at post-recession lows. Hourly earnings were flat MoM (+2% YoY), labor force participation crept up to 62.9%, and underemployment rose to 12.2%. Personal income and spending both rose 0.4% MoM, in line with expectations, and the core PCE inflation gauge stayed at 1.5% YoY. The ISM Manufacturing index bested consensus at 57.1 thanks to surging new orders, but the positivity of the report was seeming lost with all the other news, or perhaps coupled with the Chicago PMI that fell off the cliff from 62.6 to 52.6, maybe manufacturing in general was a wash in July.

• Thankfully the calendar lets up this week and we can just continue to analyze the data and implications from last week with relatively little else to worry about, however traders will keep an eye on the ISM services index tomorrow (a stronger 56.5 reading is expected), and a similar flash indicator from Markit. Factory orders should rise 0.6% MoM for June after slipping 0.5% in May. Reports on the trade balance (-$45 billion), jobless claims (300k), and consumer credit ($19 billion) are expected to show little change MoM. Nonfarm productivity (+1.5% vs. -3.2% QoQ) and unit labor costs (+1% vs. 5.7% QoQ) are expected to completely shift for Q2, much like the GDP report from last week.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.16%	0.16%	0.16%	0.19%
3-month LIBOR	0.24%	0.23%	0.23%	0.27%
6-month LIBOR	0.33%	0.33%	0.33%	0.40%
12-month LIBOR	0.58%	0.56%	0.55%	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	0.06%	0.04%	0.05%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.47%	0.49%	0.47%	0.33%
3-yr Treasury	0.92%	0.97%	0.88%	0.64%
5-yr Treasury	1.66%	1.67%	1.66%	1.49%
7-yr Treasury	2.15%	2.13%	2.17%	2.14%
10-yr Treasury	2.49%	2.47%	2.57%	2.71%
30-yr Treasury	3.28%	3.24%	3.40%	3.76%
2s-10s Spread	2.02%	1.98%	2.10%	2.38%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.67%	0.58%	0.49%
3-yr LIBOR Swap	Call	1.11%	0.99%	0.80%
5-yr LIBOR Swap	Call	1.75%	1.69%	1.62%
7-yr LIBOR Swap	Call	2.14%	2.15%	2.24%
10-yr LIBOR Swap	Call	2.51%	2.59%	2.81%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.39%	0.34%	0.32%
3-yr SIFMA Swap	Call	0.70%	0.63%	0.55%
5-yr SIFMA Swap	Call	1.30%	1.27%	1.21%
7-yr SIFMA Swap	Call	1.70%	1.72%	1.79%
10-yr SIFMA Swap	Call	2.09%	2.17%	2.33%

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

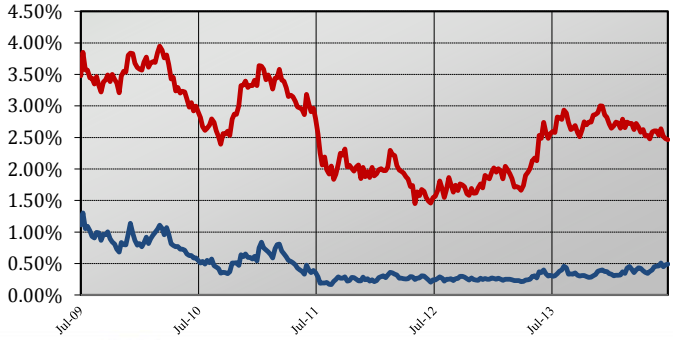
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	36	21	12	10
4-yr LIBOR Cap	99	55	32	21
5-yr LIBOR Cap	180	103	60	38
7-yr LIBOR Cap	397	238	145	91

Fwd Implied 3mL Rate	Last
Dec. 14	0.28%
Dec. 15	1.03%
Dec. 16	2.11%
Dec. 17	2.84%

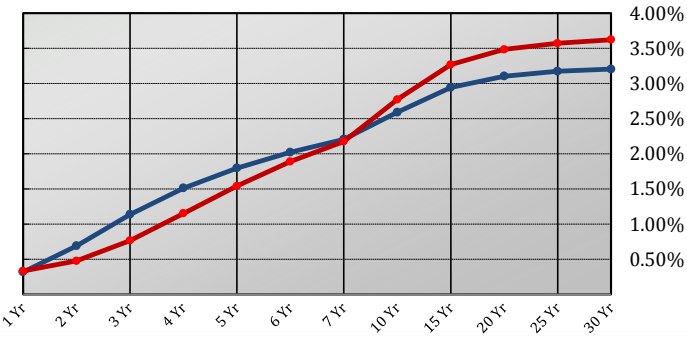
Conventions

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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Cleveland, OH (440-892-8000)

San Francisco, CA (925-988-0703)

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