

Market Summary: U.S. LIBOR has risen to its highest levels in this rate cycle as concern over more rate hikes intensifies due to changing inflation expectations (Chart 1). Numerous Fed officials have stressed a need to keep raising rates.

• **Fed leadership:** This week's announcement that Ben Bernanke was selected by President Bush to replace Alan Greenspan was greeted with upward pressure on interest rates (Chart 2). Rates rose due to an appreciation that a Bernanke Fed will likely maintain the Fed's current focus.

• **Rate hikes:** Next FOMC decision is scheduled for Nov 1, a 4.00% Fed funds rate is priced in.

• **Yield curve:** The spread between LIBOR and medium-term interest rates remains very near the narrowest seen in over 4 years (Chart 3).

Dominant Themes: In recent weeks, the interest rate environment has shifted its attention to concerns voiced by senior Fed officials.

• **Inflation risk from adjusting the current account deficit:** N.Y. Fed President Geithner said last week that the U.S. Current Account deficit is *unsustainable* and that the *inevitable* process of adjustment will bring with it the risk of large movements of relative prices.

• **Neutral funds rate may be higher:** San Francisco Fed President Yellen said last week she considered it *reasonable to put the current neutral (funds) rate in a range of 3.5% to 5.5%*. The current Fed funds rate is 3.75%.

Opportunity for Borrowers:

• The recent yield curve flattening trend that ended in Oct. is signaling a change in the market's view of medium to long-term interest rates.

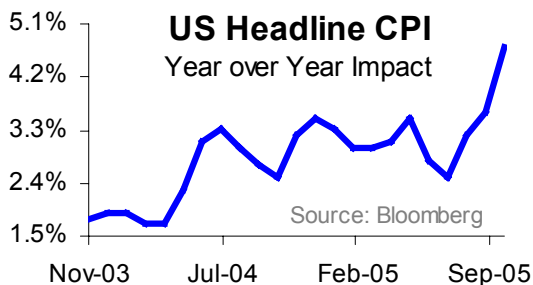
• Given that the market often underestimates LIBOR's outcome (Chart 4), and the relative cost to hedge rate risk today (Chart 3), customers may consider creating rate certainty in this environment.

• **Contact:** Please contact the IRM team for further information at 617-973-4087.

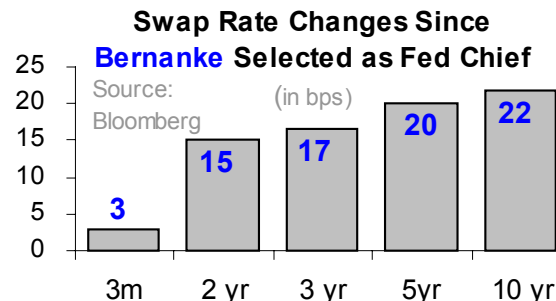
Calendar Ahead:

- 10/27; Sept Durable Goods Orders
- 10/27; Greenspan speaks
- 10/28; 3Q advance report on GDP
- 10/31; Sept PCE Price Index
- 11/01; Oct ISM manufacturing index
- 11/01; FOMC Decision**
- 11/03; Greenspan testifies
- 11/04; Oct Payroll and Unemployment

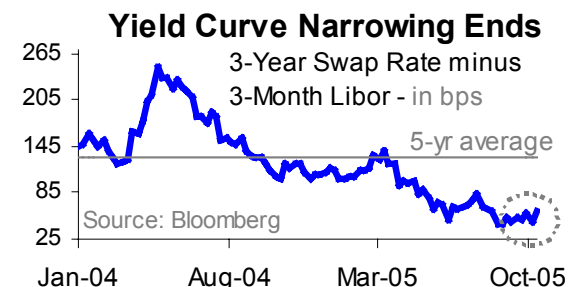
1. Inflation focus intensifies



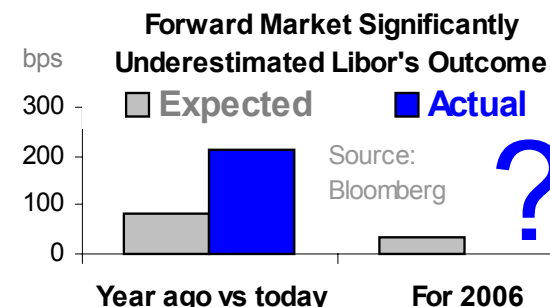
2. Bernanke selection unleashes emotion



3. Relative hedging costs are Low



4. Market often underestimates Libor



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