FLORIDA PRIME

Weekly Commentary

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Ongoing euro debt concerns are continuing to push short credit rates up and Treasury yields down. Three-month and one-year London interbank offered rates (Libor) rose a basis point last week to 0.35% and 0.83%, respectively, while six-month Libor rose 2 basis points to 0.52%—all 52-week highs. Meanwhile, Treasury yields across the yield curve moved down on the haven trade, off 2 basis points to 0.01% and 0.05%, respectively, for 13-week and 26-week T-bills; 4-week T-bills held steady at 0.00%.

The divergent move between credit and U.S. government rates comes as European finance leaders put off a decision on another package of aid for Greece until next month, raising fears Greece may default and highlighting ongoing disagreements among EU officials about how best to deal with the euro's seemingly unending—if not worsening—sovereign-debt crisis. Since the extent of the sovereign-debt crisis was first uncovered in 2010, Federated's conservative stance on managing and monitoring every security within its money market portfolios has resulted in extensive and continuous review of exposures to European senior bank debt. This has led portfolio management to shorten maturities, downgrade certain names and to eliminate others from its list of investable securities—and, because all of these securities roll over at short intervals, to quickly address its portfolios' exposures to any security.

In the United States, the economic data continues to be mixed but, in general, to reflect an economy that has slowed dramatically but does not appear headed into recession. Despite soft regional survey readings—both the Philly Fed and Empire readings for September contracted again, though not as much as in August—industrial output rose more than expected in August and manufacturing output growth has been accelerating at a 4.5% annual rate the past three months, vs. a 3.8% year-to-date pace. Moreover both the Philly and Empire surveys posted sizable gains in six-months-ahead expectations, led by new orders, shipments and hiring.

At the same time, inflation pressures appear to be easing but have not skipped off the radar completely—the August PPI was unchanged in August, held back by declining energy prices, and the core rate also pulled back, but both headline CPI came in double expectations, and core CPI on the year is running at the upper range of the Fed's implicit target. On the consumer front, retail sales were flat in August, and healthy gains for both June and July were pared back. But it appears the floods and weather may have played a role in August as stores this month have been reporting relatively robust traffic.

Views are as of September 19, 2011, and are subject to change based on market conditions and other factors.

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Much of this week will focus on what Fed policymakers may, or may not, do when they meet Tuesday and Wednesday. Analysts are somewhat split on whether the policy-setting Federal Open Market Committee may attempt to go forward with a new round of quantitative easing, with a more likely outcome being an attempt to “twist’’ the yield curve by shifting purchases of Treasury securities from the shorter end to the longer end of the maturity spectrum as existing securities mature in an effort to drive longer yields down.

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