FLORIDA PRIME

Weekly Commentary

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Despite a data-light week on the economic front, the money markets were jostled by the FDIC's new insurance assessment fee that kicked in April 1. Even though the increase wasn't unexpected, it jolted the repo market, pushing Treasury and mortgage repo rates down as low as 1 and 3 basis points, respectively, early last week before they recovered to end the week at a respective 5 and 8 basis points.

While we believe the market overreacted to the FDIC assessment, in part because it effectively eliminated arbitrage opportunities for banks, we don't expect repo rates to recover to their mid-teen levels of mid-March anytime soon. Instead, we would expect them to hover in the low double-digits, around 10 to 11 basis points, at least until June when it becomes clear what the Fed will do in a post-QE2 world and what Congress will do about the pending debt ceiling limit. We've seen substantial supply pulled from the money markets with the Fed's purchases of Treasury securities under quantitative easing and the Treasury's paring of supplemental financing for fear of exceeding the federal debt ceiling. Until we see some relief on the supply front, it's difficult to envision repo rates returning to their previous levels.

Last week's activity pulled down rates throughout the money markets. London interbank offered rates (Libor), which had been relatively sticky the past six months, fell a basis point each on one-month, three-month, six-month and one-year Libor, to 0.23%, 0.29%, 0.45% and 0.78%, respectively. The effective federal funds rate dipped below 10 basis points during the week before closing unchanged at 0.11%, still low relatively to where it stood earlier in the year, when it was close to the upper end of the 0% to 0.25% target range. Thirteen-week and 26-week Treasury bills also fell 5 and 4 basis points, respectively, to 0.05% and 0.13%.

While we still believe economic fundamentals and signs of budding inflationary pressures will lead the Federal Reserve to take its foot off the monetary pedal late this year, for now, it appears rates will bounce around these very low levels until the dust settles on the post-QE2 and government funding fronts.

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Views are as of April 11, 2011, and are subject to change based on market conditions and other factors.