FLORIDA PRIME

Weekly Commentary

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Short-term rates were relatively stable during the week, with overnight, one-month, three-month, six-month and 12-month London interbank offered rates (Libor) ending the week at 0.13%, 0.19%, 0.26%, 0.41% and 0.73%, respectively.

On the economic front, inflation news dominated the week. The U.S. Labor Department reported on Friday that the Consumer Price Index increased 0.4 percent in April, which seemed consistent with most expectations. The Index rose 0.5 percent in March and February.

Core CPI–excluding food and energy–was more subdued and in line with expectations, gaining 0.2 percent after edging up 0.1 percent in March. The monthly increase in core CPI has been bouncing around 0.1 percent and 0.2 percent since November. The 0.8% increase in the core CPI for 2010 was the smallest annual full-year gain since record-keeping began in 1958. However, the year-over-year core April CPI is now at 1.3% and rising.

The Personal Consumption Expenditure (PCE) Index--which is the Federal Reserve's preferred measure of inflation because they believe that this basket is most representative of the U.S. economy's consumption patterns--with their target range set at a gain of 1% to 2%. The core year-over-year PCE is still sitting at a deflationary 0.9% through March, which gives the Fed confidence that the spike in commodity costs is indeed transitory. This measure of consumer inflation is far below the CPI's metric, because the calculation for owner's equivalent rent—which has soared lately—is twice the size in CPI compared with PCE.

In general, the trend of very low rates is firmly in place for the near term. The primary culprit for the low rate market conditions is the FDIC assessment change, effective April 1, which effectively increased the amount of bank capital subject to FDIC assessment charges. As a result, interest rates on repurchase agreements—a staple of overnight funding—cratered early in the month as the amount of repo-eligible collateral in the market dropped sharply. In changing its insurance assessment base, the FDIC had sought to shift more of the cost onto larger financial institutions. Though it had been widely assumed that big banks would reduce their participation in the repo market to avoid the expanded fee schedule, similar moves by many smaller institutions had a greater impact than anticipated, sending repo rates plunging from the high-teens at the end of March to the low-single digits barely one week later. In fact, the rate on some government-collateralized repos dropped to a single basis point early in the month. Given that cash managers need an allocation to overnight securities to meet daily liquidity requirements, net yields were adversely affected.

Secondary forces influencing the low rate environment include the ongoing quantitative easing by the Federal Reserve--scheduled to conclude end of June, which should provide some modest relieve in the following weeks--and the uncertainty over the timing of raising the U.S. debt ceiling.

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Views are as of May 16, 2011, and are subject to change based on market conditions and other factors.