FLORIDA PRIME

Weekly Commentary

NOVEMBER 21, 2011

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Attention turned last week from Europe to Washington, where a congressional Super Committee charged with coming up with at least $1.2 trillion of budget savings over the next decade went into the 11th hour with few signs of a breakthrough. By week's end, it became fairly apparent that no deal would be reached, an outcome that wasn't unexpected by the markets but nonetheless spawned a flight-to-safety trade that kept short Treasury rates near record lows and drove longer yields down as well. One question is how the ratings agencies may respond to the committee's failure. On one hand, this served to only highlight the sort of dysfunctional stalemate cited by Standard & Poor's this past summer when it downgraded the U.S.'s long-term AAA rating. On the other, without further action from Congress, the Super Committee's inability to reach an agreement is suppose to result in across-the-board cuts totaling $1.2 trillion in 2013, addressing fiscal concerns raised by S&P and others.

Despite the committee's failure, and the euro-zone's ongoing sovereign-debt struggles, signs continue to point to an accelerating domestic economy as we head into the heart of the fourth quarter and the holiday season. October's leading indicators jumped a much better-than-expected 0.9%, the biggest increase since February. October retail sales also surprised, rising 0.5%, nearly double forecasts. And October industrial production also topped consensus expectations, led by a surge in business equipment output. The numbers suggest that fourth-quarter GDP will come in above the consensus thinking of just a few weeks ago, abetted by an improving labor market that has seen initial jobless claims fall below the bellwether 400,000 level four straight weeks. Even housing is showing signs of life—October housing starts and building permits surprised, and November's builder confidence rose to its highest level since May 2010.

We continue to keep an eye on potential inflation. October's core CPI was up 2.1% year-over-year, the fastest pace of increase since October 2008. But core producer prices were flat, dropping the year-over-year core PPI reading to 2.8% and potentially easing pressure on the consumer end. We're also keeping an eye on the savings rate. It fell in September to 3.6%, half its 15-year high of 7.2% in June 2009, indicating consumers are dipping into savings to fuel surprisingly robust spending—an unsustainable formula that makes the recovery vulnerable if job and income growth don't accelerate.

On the week, credit rates continued to inch up, with the one-month London interbank offered rate (Libor) up a basis point to 0.26%, three-month Libor up three basis points to 0.49%, and both six-month and one-year Libor up four

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basis points, to 0.70% and 1.02%, respectively. The latest three-month, six-month and one-year Libor rates represent new 52-week highs.

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