Weekly Commentary

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It was a repeat performance for credit markets last week, as short credit rates in the United States continued to inch up, while their euro-denominated counterparts again pulled in a tad. The three-month London interbank offered rate (Libor) rose two basis points to 0.56%, while six-month and one-year Libor rose three basis points each to 0.79% and 1.11%, respectively. Overseas, one-month and three-month euro Libor (Libor denominated in euros) last week fell a respective three basis points and two basis points to 1.14% and 1.42%, but were beginning to inch up again at the start of this week on concerns about the euro and the euro-zone economy.

The disparate movement in the credit markets reflects the continuing dichotomy between the ongoing sovereign-debt crisis in Europe—and fears that the euro-zone may suffer a recession—and the improving outlook for the U.S. economy. The markets aren't convinced European Union leaders have done enough to stem the crisis and the potential impact on major European banks that have significant exposure to the most troubled EU countries. Until there is a clear resolution, we would expect the European cash markets to remain unsettled. Federated continues to monitor the situation daily and, as we've noted previously, we have taken a series of steps to assure that our money funds have minimal exposure to European bank debt.

The situation back at home is much more settled, with all signs pointing to a U.S. economy that continues to gradually improve. The latest weekly jobless claims unexpectedly fell to a 3½-year low, suggesting the pace of job growth is picking up as we move into the New Year. November's retail sales rose a below-consensus 0.2%, but that was offset by upward revisions to the previous two months, bringing the overall numbers in line with expectations and prompting the National Retail Federation to bump up its holiday season's forecast to an increase of 3.8% from a previous 2.8%.

Reports on November producer and consumer prices also reflected a pullback in inflationary pressures, a sentiment shared by Federal Reserve policymakers. Following their last meeting of the year, policymakers acknowledged that the domestic economy continues to improve but also noted unemployment is likely to remain elevated and inflation is likely to settle below its long-term target over the next several quarters—indicating their bias remains toward more easing, even though they did not act to further loosen in this go-round.

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