FLORIDA PRIME

Weekly Commentary

FEBRUARY 18, 2013

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London interbank offered rates (Libor) were down very slightly for the week, with three-month steady at 0.30%, six-month down less than a basis point to 0.46%, and one-year down less than a basis point to 0.76%. Short-term Treasuries were up across the board, with one-month up six basis points to 0.09%, three-month up three basis points to 0.10%, six-month up two basis points to 0.13%, and one-year up three basis points to 0.17%. Overnight repo rates firmed up over the week and ended in the mid teens. Overall, given that Federal Reserve's (the Fed) Quantitative Easing policies are still in place, the short-term yield curve may be anchored in this low territory for the foreseeable future. With the slow growth in the recovery, getting to that 6.5% unemployment target rate set by the Fed for an end to QE is likely to take some time.

Last week we saw more of the same pattern of economic gains, balanced by signs of caution, we've been in for some time. Nominal and core retail sales slowed in January, the first relatively comprehensive read on consumer spending since the 2013 tax hikes took effect. The core reading, however, was stronger than expected and general merchandise sales—a bellwether of consumer habits that includes department stores—were particularly strong. The Institute of Supply Management's non-manufacturing business activity index—a proxy for economic activity in the service portion of the economy, which accounts for about 80% of all U.S. economic activity—peaked at a very healthy 60.9 in November 2012, but has since fallen to 56.4 in January. While the current reading still implies economic growth because it remains comfortably above the 50 mark, this sharp contraction over the past two months bears careful watching.

There were several tax-law changes implemented at the beginning of the year that have the potential to negatively impact business and consumer spending, including tax increases for higher earners, Medicare tax increases, reductions in itemized deductions for some, and increased rates on long-term capital gains and dividends. While these tax changes will largely affect the top 5% of American taxpayers, going forward the steeper progressivity in tax rates is likely to hurt consumer spending and GDP growth. And Washington still has yet to show signs of compromise on the upcoming sequester deadline, another in a series of unfortunate events that could put a bite into GDP.

G40461-19 (02/13)

Views are as of February 18, 2013, and are subject to change based on market conditions and other factors.