FLORIDA PRIME

Weekly Commentary

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Minutes from the Federal Reserve's (the Fed) late January's Federal Open Market Committee (FOMC) meeting released last week showed members are becoming less supportive of quantitative easing. A significant amount of space was devoted to discussion of the potential costs of QE, including inflation risks, financial imbalances, capital losses during exit, and impairing financial market functioning. It's likely, however, that the Fed will keep its zero interest-rate policy and its indefinite monthly $85 billion purchases of Treasuries and mortgages in place into at least 2014, unless economic growth suddenly begins to re-accelerate. The Fed has not revised its stated targets—an unemployment rate below 6.5% and core inflation exceeding 2.5%—and trends don't show the economy hitting those targets anytime soon. Unemployment ticked up to 7.9% in January 2013, well above the Fed's target. The year-over-year core producer price index (PPI) slipped to 1.8% in January, reflecting disinflation, while the headline consumer price index (CPI) was unchanged for a second straight month.

London interbank offered rates (Libor) were largely unchanged for the week, with three-month down a basis point to 0.29%, six-month steady at 0.46%, and one-year steady at 0.76%. Short-term Treasuries were up overall, with one-month up two basis points to 0.11%, three-month up three basis points to 0.13%, six-month up one basis point to 0.14% and one-year down one basis point to 0.16%. Overnight repo rates were firmer this week, ending the week in the 0.15-0.19% range.

Looming over any recovery talk, however, is the possibility of sequester out of Washington. Unless Congress votes to change or postpone the action, $85 billion in automatic spending cuts will take effect on March 1, with an additional $1.1 trillion coming over the next decade. Half of these cuts will be focused on defense spending (which accounts for 18% of total federal spending), with the other half centered on non-defense discretionary spending (which accounts for about 16% of total federal spending).

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