FLORIDA PRIME

Weekly Commentary

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Paige Wilhelm
Senior Vice President
Senior Portfolio Manager
Federated Investment Counseling

London interbank offered rates (Libor) were down slightly for the week, with three-month down a basis point to 0.27%, six-month down a basis point to 0.42%, and one-year down a basis point to 0.69%. Short-term Treasuries were largely unchanged, with one-month steady at 0.01%, three-month steady at 0.04%, six-month steady at 0.08% and one-year up a basis point to 0.12%.

Short-term Treasuries and repo rates have been going through a bit of a soft patch in recent weeks due primarily to a lack of supply. Much of this was expected, as seasonal Treasury bill issuance is always cut back in the second quarter—as the Treasury brings in taxes it has smaller short-term financing needs as a result. But some of the softness is not cyclical—the Treasury, in fact, has a good deal of extra cash on hand due to greater-than-expected tax receipts in April. Although this would not automatically lead to cutbacks in bill issuance to the magnitude we've seen lately, the impending reinstatement of the debt ceiling on May 19 has complicated matters. When Congress suspended the debt ceiling earlier this year, it did so with the understanding that during the suspension the Treasury would issue debt only to the extent needed to pay bills. As a result, the Treasury has been attempting to get rid of approximately $100 billion in excess cash, and has been doing so in the form of reduced short-term bill issuance with a goal of returning the Treasury's cash balance to what it was before the suspension went into effect. As a result, the yield on short-term Treasuries has declined noticeably.

This leads to the question of whether yields could go into negative territory as bill supply is expected to remain scarce for the rest of the month. Aside from very short-term maturities trading in negative territory on the secondary market, we would not expect pervasively negative rates as long as the Treasury resists the temptation to allow bill auctions to take place at something less than zero. Repo rates remained soft as well, trading in the single digits, in part because of the dearth of supply in the bill market, but also reflecting the ongoing quantitative easing by the Federal Reserve (the Fed). So far this year, the Fed has purchased, on an unsterilized basis, approximately $400 billion of Treasury and agency mortgage-backed securities, which takes a toll on repo collateral supply.

When will the soft patch end? Typically, bill issuance tends to increase after the end of May and into June, when we could see some issuance of short-term cash management bills. The sizable payments Fannie Mae is expected to pay into the Treasury in June, and Freddie Mac is likely to pay at the end of the third quarter, complicate matters somewhat, as the Treasury will be expecting a large influx of cash as the two housing agencies find themselves on the rebound.

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Views are as of May 20, 2013, and are subject to change based on market conditions and other factors.