FLORIDA PRIME

Weekly Commentary

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This past Wednesday morning, Federal Reserve (Fed) Chairman Ben Bernanke appeared before the Joint Economic Committee (JEC) to update members of Congress on the Fed's economic outlook and its monetary-policy plans, specifically its zero interest-rate fed funds' policy (ZIRP) and "QE-to-Infinity," under which the Fed is buying $85 billion per month in Treasuries and mortgage-backed securities. Bernanke stated that if the Fed saw continued improvement in the economy, and had confidence the improvement would be sustained, the Fed could start scaling back on quantitative easing measures in its "next few meetings." He noted, however, that the Fed was still assessing whether progress in the labor market was "real and sustainable."

Then, on Wednesday afternoon, the minutes from the Fed's April 30-May 1 Federal Open Market Committee (FOMC) meeting were released. According to the minutes, a number of FOMC participants "expressed willingness to adjust the flow of purchases downward as early as the June meeting." Many interpreted this information to mean the Fed is poised to begin to taper its aggressive monetary-policy accommodation as early as the upcoming June 17-18 FOMC meeting.

It is more likely, however, that the data-driven Fed will need more evidence of a sustained recovery before they make their move, and that evidence is not yet clear. The year-over-year core Personal Consumption Expenditure (PCE) index, the Fed's preferred measure of inflation, is running at 1.1% through March, at the low end of the Fed's 1-2% target range and well below its policy trigger of 2.5%. At the same time, while the unemployment rate may be approaching the Fed's target of 6.5%, the labor-force participation rate has also fallen by 2.5% over the past three years to a 34-year cycle low of 63.3% in April. With first-quarter Gross Domestic Product (GDP) flashed at economic growth of 2.5%, and the consensus forecast for second-quarter GDP coming in sequentially slower at only 1.7%, the economy seems to be decelerating this quarter. That is not to say that the Fed won't begin unwinding in the second half of the year, when growth is expected to re-accelerate and signs of recovery should be clearer.

London interbank offered rates (Libor) were unchanged for the week, with three-month steady at 0.27%, six-month steady at 0.42%, and one-year steady at 0.69%. Short-term Treasuries were mixed, with one-month up two basis points to 0.03%, three-month steady at 0.04%, six-month down a basis point to 0.07% and one-year steady at 0.12%. Repo levels remained low in the face of continued downward pressures on market supply. Bill issuance dipped last week as the Treasury prepared for the reinstallation of the debt ceiling, which occurs this week, and although issuance returned to previous levels for this week, it was not enough to improve supply in any material way. Repo rates are expected to remain at depressed levels until there is some relief on the supply front.

Views are as of May 27, 2013, and are subject to change based on market conditions and other factors.