FLORIDA PRIME

Weekly Commentary

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London interbank offered rates (Libor) were down for the week, with three-month down a basis point to 0.27%, six-month steady at 0.41%, and one-year down two basis points to 0.67%. Short-term Treasuries were up slightly, with one-month steady at 0.04%, three-month up a basis point to 0.05%, six-month up a basis point to 0.08% and one-year steady at 0.14%. Repos traded much of the past week at very low levels—just two basis points for Treasury-backed repos and four basis points for mortgage-backed repos—and they were likely to go even lower, as the next two weeks bring about a pay-down of roughly $46 billion in Treasury bills, and another $26 billion to come in the two weeks to follow, for a total reduction in Treasury bill supply of approximately $72 billion over the next month. With the Fed's ongoing influence on repo collateral supply, no significant Treasury bill issuance on the horizon, and the end of second quarter 2013 on its way, it would not be surprising to see repos trading at a single basis point throughout the end of June and beginning of July. Absent some event that might loosen the current chokehold on supply, rates on very short-term Treasuries and possibly agency securities could be flattened, as well.

Last month Federal Reserve (Fed) Chairman Ben Bernanke, during the question-and-answer session that followed his regular statement before Congress, dropped a comment that the Fed could taper its quantitative easing purchases before long, and perhaps as early its "next few meetings." That statement sent markets into a frenzy of guessing about the manner and timing of the withdrawal. As speculation grew, talk moved beyond QE, however, and some observers began to speculate the Fed might also look at adjusting the federal funds target rate, which had been expected to remain in the 0% to 0.25% rate range for some time. This might be too much for the Fed. While it's generally understood the debate within the Federal Open Market Committee (FOMC) on when and how to taper QE is likely to get more animated in its next few meetings, there are indications in the press that the Fed is getting likely to push back against market expectations it will move the federal funds rate. The response may come as early as Bernanke's press conference this week. As the recovery begins to move closer toward the "sustained" development seen as the benchmark for an end to easing, and markets scrutinize every single word out of the Fed looking for clues to the end game, the Fed is going to have to be more clear in the messages it sends to markets.

Tapering of QE purchases could be good news for money markets, as it would allow for more collateral, easing some of the supply pressures. That being said, it's likely the Fed will keep its bond-buying program in place until at least September or December of this year—or perhaps even early 2014—before beginning to taper. Ultimately, this will be a data-dependent decision, and the Fed will only begin to pull back if the economy is demonstrating sustainable strength.

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Views are as of June 17, 2013, and are subject to change based on market conditions and other factors.