FLORIDA PRIME

Weekly Commentary

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Last week's press conference by Federal Reserve (Fed) Chairman Ben Bernanke at the end of the two-day Federal Open Market Committee (FOMC) meeting certainly provoked a reaction from markets. What Bernanke said wasn't all that surprising—while the Fed isn't ready to act yet, it may start pulling back on its quantitative easing program consisting of $85 billion in monthly purchases of Treasury and agency mortgage-backed securities (MBS) by fall and end them by the middle of next year. Bernanke took pains to signal a hesitancy to act too quickly, noting the economy remains weak enough to justify continuing with QE through mid-2014, when the Fed projects the unemployment rate will have fallen to 7%. He also made clear that tapering is data dependent: if growth falters, the Fed's timetable to begin scaling back asset purchases could be delayed.

Bernanke also emphasized there could be considerable time between tapering and a tightening. The former represents a slowing in Treasury and agency MBS purchases, while the latter represents actual increases in the target federal funds rate. Bernanke likened tapering to easing off the accelerator, which he said will begin if the economy achieves sufficient cruising speed to grow without additional monetary accommodation. Increases in the benchmark funds rate, on the other hand, are akin to applying the brakes, and that won't likely start until "far into the future." He noted 14 of the 19 Fed policymakers don't expect fed fund rate increases to begin until 2015; one doesn't expect any until 2016 at the earliest. When they do start to come, Bernanke said, the increases are likely to be gradual and small, more like a gentle tapping on than a slamming of the brakes. Despite Bernanke's cautious tone and reminders that any pullback from QE would be directly proportional to improvements in the economy, markets reacted negatively, an indication that there is widespread concern about whether this recovery can survive without continued life support from the Fed.

Despite the huge swings in the bond and equity markets due to Bernanke's comments, money market yields were largely unaffected by the news. London interbank offered rates (Libor) were basically unchanged for the week, with three-month steady at 0.27%, six-month steady at 0.41%, and one-year up a basis point to 0.68%. Short-term Treasuries were mixed, with one-month down two basis points to 0.02%, three-month down a basis point to 0.04%, six-month up a basis point to 0.09% and one-year down a basis point to 0.13%. Repo rates remained at very low levels.

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Views are as of June 24, 2013, and are subject to change based on market conditions and other factors.