Weekly Commentary

AUGUST 26, 2013

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In a week in which the biggest market news were minutes from a Federal Reserve policymaker meeting that happened almost a month ago, cash rates remained at very low levels as the supply of direct securities and high-quality collateral remained scarce. Treasury-backed overnight repos averaged a basis point on the week, while mortgage-backed overnight repos averaged 3 basis points. Treasury bill rates also remained in the mid-single digits. The culprits behind the low rates remain the same, led by extremely low new issuance because of diminished Treasury financing needs. It is an environment that we don't see changing much anytime soon.

That being said, the minutes from the July 30-31 policy-setting Federal Open Market Committee (FOMC) meeting did generate some interest. For one, the minutes seemed to support the notion that a tapering of the Fed's $85 billion in monthly Treasury and agency bond purchases could commence this fall, a possibility that clearly impacts longer rates (as we've already seen) but could also eventually help nudge up short rates as more collateral enters the marketplace as the Fed's involvement eases. More interestingly but also much further down the road, the FOMC raised the possibility of establishing an overnight reverse repo facility as a means to help manage its exit strategy from its extraordinary monetary accommodation of the past five years. While details were sketchy and it remains just a possibility, the facility as described would appear to let the Fed set a fixed-rate on overnight transactions with a broad pool of participants—a move that suggests overnight rates could be expected to move up to the 25 basis points range, in line with the interest the Fed currently pays depository institutions on excess reserves. Again, this is just a proposal that isn't likely to get underway until mid-2014 if it does pass.

As for the actual economic news of the week, housing was a bit perplexing. On the one hand, July existing home sales rose 6.5%, nearly five times consensus, to their highest in nearly three years (sales were based on contracts that closed in June precisely as mortgage rates were spiking). Median home prices also continued to rise and were up a record 11% from a year ago. New-home sales, on the other hand, unexpectedly plunged 13% to their lowest level since last October. Sales for the prior months also were revised down, undermining the outlook for future construction as the weaker sales meant the inventory of unsold homes relative to sales actually rose, lessening supply constraints. Still, the broader thesis continues to be that the economy appears ready to gear up for stronger growth in the months ahead, with July's leading indicators rising a broad-based 0.6%, jobless claims falling to a six-year low and reports out of Europe, Japan and China suggesting their economies are strengthening.