FLORIDA PRIME

Weekly Commentary

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Already low short-term interest rates dipped a bit more last week after Federal Reserve policymakers dropped a bombshell by choosing to do nothing after their two-day meeting that ended Wednesday. With the market overwhelmingly expecting at least some tapering of the central bank's monthly bond purchases to get underway, the news sent rates plunging across the yield curve. On the short end, six-month and one-year London interbank offered rates (Libor) slipped a basis point and two basis points, respectively, to 0.37% and 0.64%, while 4-week and 13-week Treasury bills slipped a point each to yield 0.0% and 0.01%, respectively. Rates on overnight Treasury and agency mortgage-backed securities also pulled in two basis points each to end the week at a respective 5 and 6 basis points.

What may have surprised the market the most is that Fed policymakers did little if anything to dissuade investors from thinking there would be tapering of some sort. Given that there wasn't, and that the policy-setting Federal Open Market Committee's views on the economy didn't appear to deteriorate significantly, the market was left feeling a little confused. Fed Chairman Ben Bernanke attempted to clear up the confusion in his post-meeting press conference, citing concerns about the quality of job gains, the impact rising longer-term rates are having on housing and the potential for fiscal policy mess in coming weeks as justifications for holding off. And while that may be the case and tapering could potentially still get underway before year-end, the reality is any near-term rate relief for the cash market has likely been delayed. For now, it seems the markets are dealing with a very dovish Fed, perhaps made all the more so by the decision of potential Bernanke successor Lawrence Summers, considered by markets to be a little more hawkish and persnickety, to drop his name from consideration.

As for the economy, the week's news suggested potential acceleration going into the fourth quarter. August industrial production rose the most in six months, and bellwether Philadelphia and New York regional gauges showed future expectations jumping to their highest levels in 17 months and a decade, respectively. August existing home sales rose more than expected, pushing the three-month average sales pace to its fastest pace since 2007, and single-family housing starts hit a six-month high in August while permits rose to a post-recession high. All of this came as the inflation backdrop remained benign, with August headline and core CPI rising 1.5% and 1.8% over the past 12 months.