Month in Cash: Savers get a little—very little—relief

As of 10-03-2011
Continuing a mild uptrend begun a few weeks earlier, short-term interest rates crept higher in September, with the largest moves occurring at the intermediate- and longer-term portions of the London interbank offered rate (Libor) cash curve. Overall, one-year Libor was up 6 basis points to close at 0.87%, six-month Libor jumped 7 basis points to 0.56%, three-month Libor increased by 5 basis points to 0.37%, and one-month Libor rose 2 basis points to finish at 0.24%. Though the increase in Libor rates was relatively modest—and while all cash yields remain extraordinarily low by historical standards—any boost is welcome news for savers. Yields on U.S. Treasury paper remained virtually nonexistent, with four-week Treasury bills finishing at minus 0.01% and one-year Treasurys yielding a mere 0.1%, unchanged from a month earlier.

Though the Fed has committed to holding benchmark interest rates within the current zero to 0.25% range until at least mid-2013, cash yields nonetheless were impacted by two developments. First, concerns that the latest financial aid package for Greece will unravel over demands by some creditors that private investors take “haircuts” and that the Greek government provide collateral created mild stresses in some European interbank funding operations, thus pushing Libor yields higher. Notably, coordinated action by global central banks, including the Fed, pumped massive amounts of dollar liquidity into the European financial system, thus keeping spreads well under the extraordinary levels reached during the financial crisis of 2008.

‘Twist’ may add upward pressure on cash rates

Also in September, the Fed announced “Operation Twist,” in which it will use proceeds from the sale or maturing of short-term Treasury securities to buy longer-dated government and mortgage-backed debt. The new strategy does not involve expanding the Fed’s balance sheet and was launched in lieu of a third round of a quantitative easing, a policy that has come under heavy political fire as well as growing opposition within the central bank’s rate-setting committee itself. Over time, “twisting” the Fed’s holdings to include fewer short maturities and more longer ones could exert meaningful upward pressure on some cash yields (especially repos) by expanding the supply of near-term paper, which had been severely constricted after the expiration of the Treasury Supplementary Finance Program (SFP) in the first quarter and the conclusion of QE2 purchases in June. Given increased collateral in the market, we are focusing new purchases in callable securities and in those maturing in about six months and under. We also are moving opportunistically to add to our holdings in fixed-rate securities at about the 12-month area of the cash curve.

Looking ahead, we do not believe the U.S. economy is sliding into another recession. Though there has been a pronounced deterioration of consumer and investor sentiment since last spring, the preponderance of “hard” economic data argues for a mild reacceleration of economic growth next year. Still, we take the Fed at its word that benchmark interest rates will not rise until mid-2013 at the earliest, with the timing and speed of future rate hikes dependent upon progress in restoring economic growth and lowering the unemployment rate, as well as keeping inflation under wraps. Though the macroeconomic picture is muddy and tenuous as of this writing, the outlook should become much clearer over the next few months.

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Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. The Libor is fixed on a daily basis by the British Bankers' Association and acts as a benchmark for other short-term interest rates.

The cash-yield curve is a graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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