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Month in Cash: Euro woes benefit savers

As of 12-01-2011

Short-term interest rates rose over the month in response to a tightening of liquidity and credit conditions in Europe, as the region's long sovereign debt crisis entered a new and more worrisome phase. Though we would welcome a comprehensive solution, the euro-zone crisis nonetheless can work to the advantage of savers by boosting short-term yields. During November, the one-month London interbank offered rate (Libor) rose 2.6 basis points to 0.27%, three-month Libor jumped 9.9 basis points to 0.53%, six-month Libor soared 12.9 basis points to 0.75%, and one-year Libor moved up by 13.5 basis points to 1.07%.

Cash investors are tracking more than just developments in Europe. But in stark contrast to the global financial crisis in 2008 and the near technical default on Treasury securities last summer, the failure of America's so-called Super Committee to reach agreement on at least $1.2 trillion in spending cuts and/or revenue increases to the federal budget had minimal impact on short-term funding markets, probably because the outcome already had been discounted. Longer-term, the continued inability of lawmakers to put fiscal policy on a sustainable path could further undermine the U.S. credit rating, which was put on negative watch by Fitch this month after being lowered one notch by Standard & Poor's last summer.

Meanwhile, the Federal Reserve continued to sell a portion of its massive short-term Treasury position as part of "Operation Twist," which the central bank launched in September to bring down intermediate- and longer-dated yields. Subsequent Fed auctions have been vastly oversubscribed, however, and thus have exerted little or no upward pressure on cash rates. With U.S. monetary policy on hold for the foreseeable future—and with year-end technical factors set to exert downward pressure on yields at the extreme short end of the cash curve—we sought to opportunistically lengthen maturities by moving into sectors where we found value.

Coordinated actions provide backstop

We continue to closely monitor developments in Europe and, at this time, remain comfortable with our credit exposures. The coordinated actions taken by six large central banks on November 30 to provide the global financial system with dollar liquidity at a cheaper price is strongly positive since it indicates that policymakers recognize the severity of the euro-zone situation and are prepared to take whatever steps are necessary to avoid a repeat of the credit freeze that accompanied the September 2008 bankruptcy of Lehman Brothers. Though the liquidity injection does not bridge the deep political chasm that continues to separate creditor and debtor countries in the euro zone, we are encouraged that in addition to the strong policy response overseas, the U.S. economy appears to have regained a meaningful degree of traction in recent weeks, with housing, manufacturing and employment all showing at least modest improvement. Economic healing in the United States is a prerequisite for the normalization of domestic interest rates, which now have been within the unprecedented low range of zero to 0.25% for three consecutive years.

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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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