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## Month in Cash: Unfortunately for savers, just the shortest of short rates are moving up

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The bottoming process in the cash market continued at a glacial pace in January as overnight yields moved marginally higher and longer-dated rates declined by about an equal amount. For example, yields on the overnight London interbank offered rate (Libor) rose from zero to 18 basis points, while six-month Libor dropped by five basis points to 0.38% and 12-month Libor fell by 13 basis points to 0.85%. The uptick in yields at the extreme short-term end of the cash curve was caused by the unwinding of seasonal liquidity-related factors; the rate declines among six- to 12-month maturities reflected better credit metrics and a firming of the consensus view that higher rates are not imminent.



**Deborah A. Cunningham**

Against the backdrop of a flattening yield curve—and amid unexpectedly contentious Senate deliberations on the reconfirmation of Federal Reserve Chairman Ben Bernanke—the Fed's monetary policy committee met late in the month and left the target range for official interest rates unchanged at between zero and 0.25%. While noting that inflationary expectations remained anchored and that economic conditions (including the labor market) had strengthened since its last meeting in mid-December, the Federal Open Market Committee (FOMC) nonetheless gave no hint that it intended to stray from its oft-repeated promise of virtually open-ended monetary accommodation. One member of the committee, Kansas City Fed President Thomas M. Hoenig, dissented from the wording of the FOMC decision. Though Hoenig did not argue for a rate increase, he believed that economic and financial conditions had improved enough that "the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted."

Of course, an earlier-than-expected rise in benchmark rates would be good news for long-suffering savers. Yet barring an acceleration in consumer inflation or a tightening in resource markets, we believe that the first rate hike is not likely to occur until the Fed's August or September meetings, at the earliest. As we have noted previously, however, there are steps that the Fed probably will soon take to nudge rates higher without formally raising the funds target range. Specifically, we expect the central bank to soon implement its reverse repo program, a move that will effectively shrink the Fed's balance sheet while draining reserves from the banking system. The Fed successfully undertook several small procedural tests of the reverse repo process in December. Assuming the plan goes forward, overnight yields should move closer to the upper end of the zero to 0.25 basis point target range.

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Views are as of February 3, 2010, and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security.

London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. 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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