



About Bill Sullivan

*William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a report on credit market trends and maintaining a regular schedule of economic broadcasts that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.*

*Mr. Sullivan is the familiar voice that JVB features on our weekly Economic Broadcast, where he discusses the economy and the events that affect the marketplace.*

*He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.*

*Prior to joining Morgan Stanley, he was affiliated with The Bank of New York, where he was a Senior Vice President in the Treasurer's Division.*

*Mr. Sullivan holds a Bachelor of Arts Degree in Economics from Fairfield University and an MBA in Investments from New York University.*

# JVB FINANCIAL

## Economic Commentary by Bill Sullivan, JVB Chief Economist

May 3, 2010

### LIBOR higher, savings lower

A development that has not received a lot of attribution of late is the gradual up tick in the London Inter-Bank Offering Rate (LIBOR) at several key maturities. The trend has been in place for nearly two months, adding to the cost of borrowing for many business firms and even consumers. Whether the upturn reflects some renewed credit stresses in this arena is certainly open to debate, but there is no doubt the upward bias to these postings has transpired against the backdrop of the sovereign debt crisis in Europe.

Of particular note are the recent changes in the one and three month LIBOR rates which serve as a frame of reference for numerous borrowing arrangements around the globe. Both the one and three month postings reached their recent cycle lows in mid-December with the thirty day rate pegged at 23 basis points while the ninety day maturity tallied 25 basis points. Rates on these maturities held steady until the second week of March when the three month posting rose one basis point to 26 basis points. Since then a persistent upward climb has been observed and, by the end of April, the one month maturity had risen to 28 basis points while the three month rate posted 35 basis points, or ten basis points above the March low watermark. During this same time frame, the daily effective Federal funds rate in the United States moved up by just three basis points to roughly 20 basis points. Clearly, the upward climb in LIBOR postings is only remotely related to domestic monetary policy as the cost of overnight has held fairly steady since late winter.

While LIBOR postings are still historically low, interest expense for many short term borrowers are starting to move higher, even as the central banking fraternity pledges their resolve to maintain an

accommodative posture well into the future. Conceivably, the higher LIBOR rates could be driven by a heightened competition for lendable funds as the world economy recovers. However, the bias could also be a credit driven phenomenon where some banks that have considerable asset exposure to Greece and other heavily indebted nations in Europe are being required to pay a premium for their short term funding. Whatever the cause, the upturn in LIBOR will have a ripple effect as many credit agreements are linked to these postings. Admittedly, the increases are modest so far and shouldn't be viewed as a major headwind for overall business activity. Nonetheless, if a borrower has a loan linked to three month LIBOR, the ten basis point increase since March raises net interest expense by 40% in dollar terms.

Eventually, the upward adjustments in LIBOR postings will add to the cost of credit for many U.S. households. Any upturn in borrowing rates would be predicated upon a consumer balance sheet that has weakened in the last few quarters. Indeed, a great deal of focus has been directed towards the ongoing revival in personal spending over the last few quarters. Unfortunately, households have significantly depleted their liquidity positions to provide the cash for consumption, a pattern that can't go on indefinitely. To provide perspective, since September, 2009, when personal outlays registered an interim low, nominal consumption has risen by \$292.2 billion or at a 5.8% annualized rate. Within this six month interval, personal savings have been drawn down by \$152.5 billion. Effectively, 52% of the rise in household outlays was funded by a draw down in savings, with the overall savings rate falling from 4.2% of disposable income to

*(Continued on page 2)*

*(Continued from page 1)*

just 2.7% in March, the latest month for which data are available. Any upturn in interest payments that may result from the recent movement in LIBOR rates would of course be another claim on household savings and could create an environment of increased caution among consumers, especially if wage growth remains sluggish.

Another attribute to the higher LIBOR rates is that the trend is transpiring in the context of a diminution in core inflationary pressures. Specifically, the personal consumption deflator excluding food and energy registered a 1.3% gain on a year-over-year basis in March, off from 1.6% as recently as December. When utilizing market-based prices, core inflation was down to a 1.1% annualized rate in March as compared to 1.7% last November. The implication is that the expense of LIBOR based borrowing in real terms is actually moving up quite rapidly and from that perspective could have a larger impact than commonly perceived on spending decisions that are linked to credit usage.■

*William V. Sullivan, Jr.  
Chief Economist  
JVB Financial Group  
May 3, 2010*

---

**JVB Financial Group, LLC, member FINRA, SIPC**  
2700 N. Military Trail, Suite 200 / Boca Raton, FL 33431  
(561) 416-5876 • [www.jvbfinancial.com](http://www.jvbfinancial.com)

***For Broker Dealer, Institutional, and Advisor Use Only***  
***Not to be distributed to individual investors***

This document has been furnished to you solely for your information and may not be reproduced in any manner or provided to any other person. The information contained herein is based on sources that we believe to be reliable, but we do not represent that it is accurate or complete. Nothing contained herein should be considered as an offer to sell or a solicitation of an offer to buy any financial instruments discussed herein. All references to prices and yields are subject to change without notice. Any opinions expressed herein are solely those of the author. As such, they may differ in material respects from those of, or expressed or published by or on behalf of JVB Financial Group, LLC or its officers, directors, employees or affiliates.