Lies And The Lying LIBOR At New Lows

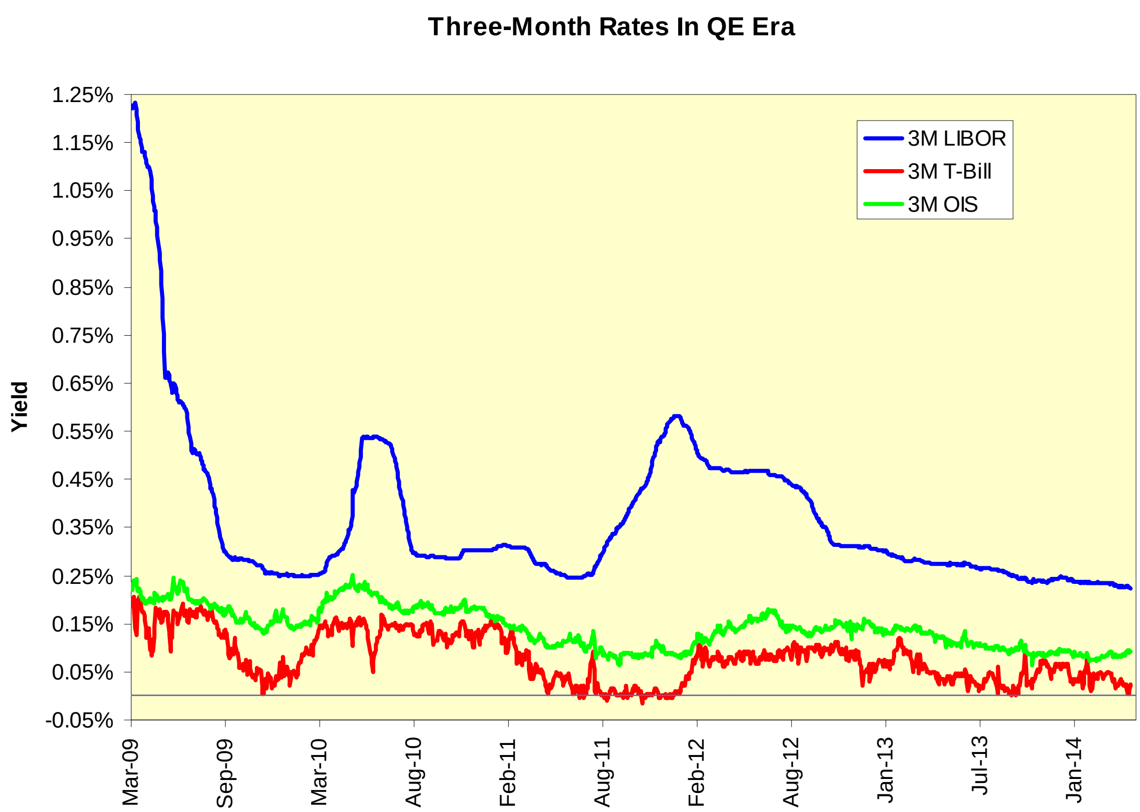
Senator Al Franken (D., MN) penned a great title while still making his living as a comedian, *Lies and the Lying Liars Who Tell Them*. Whether this earns him a coveted Renaissance Man award or not remains to be seen.

We do not have to wait for history to pass judgment on the veracity of LIBOR. The British Bankers' Association's trimmed-mean survey of a range of short-term interest rates across a set of currencies, now managed by the Intercontinental Exchange (ICE) always had incentives for self-serving reporting, but the whole edifice collapsed during the financial crisis when banks stopped trusting one another and – and too many people gloss over the 'and' portion – central banks, government officials and banks decided collectively we could not handle the truth about the banks' actual conditions.

News From The Only Game In Town

This little nod to reality is required to note what I am about to note and that is three-month USD LIBOR hit all-time lows last week. This must come as a rude shock to those who thought the Federal Reserve's three rounds of tapering were the opening salvos in a multi-year campaign of credit tightening.

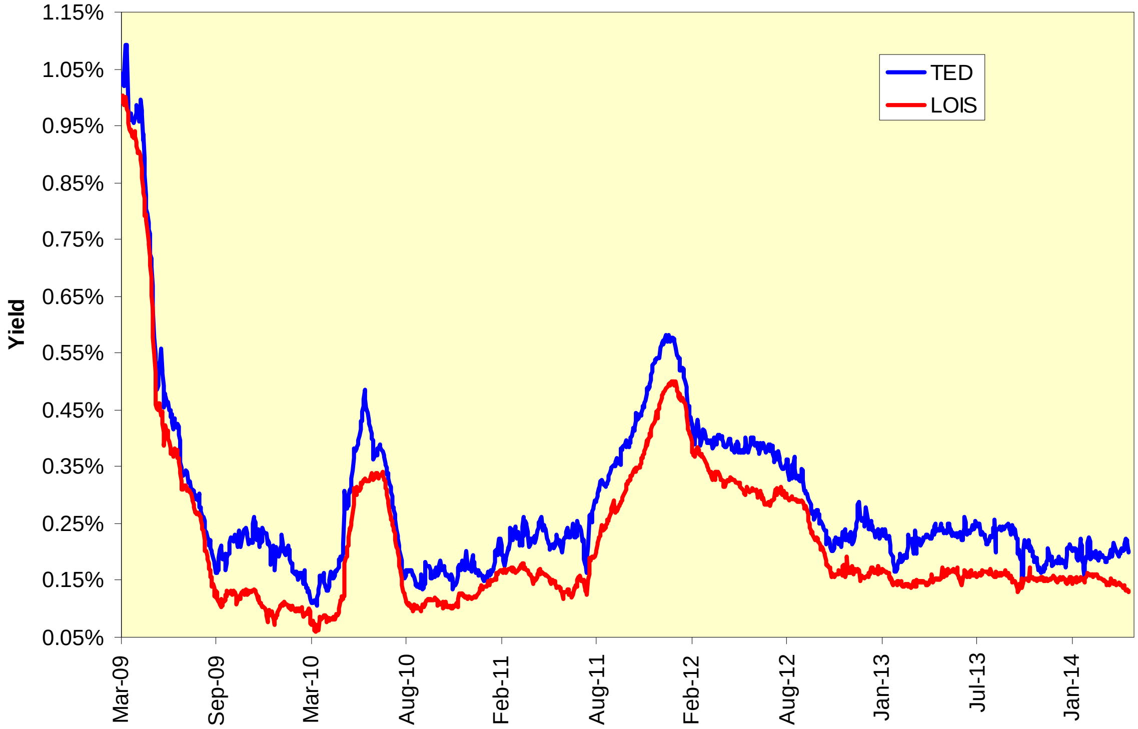
I might dismiss this as more book-cooking by people with already-low culinary reputations, but the spreads between LIBOR and both Treasury bills and overnight index swaps have been quite normal. Let's take a look at these three rates and both the TED and LOIS (Treasury-Eurodollar and LIBOR-OIS) spreads since QE began more than five years ago.



Please note how three-month T-bill rates were negative on numerous occasions in 2011. This will make their effect additive in the TED spread. As an aside, Uncle Sam had a pretty sweet deal going: Get paid to borrow, have the Federal Reserve buy Treasury debt and then have the Federal Reserve rebate its portfolio income to the Treasury at the end of the year while taxable investors had to cough up their measly interest income. Charles Ponzi must be slapping his forehead somewhere.

Now let's track the TED and LOIS spreads. The TED spread has been drifting higher since late 2013. This means T-bill rates have been falling even faster than LIBOR. The LOIS spread has been narrowing as OIS rates have been inching higher as fixed-rate payors on these swaps have been pricing in the risk of any change in monetary policy. Nothing in either spread indicates LIBOR’s move to a new low is suspect.

Key LIBOR Spreads In QE Era



I have noted several times in various contexts that tapering has not produced material changes in asset return patterns. We now know why: Despite reduced rates of security purchases, the Federal Reserve still is pumping money into the banking system at a rate in excess of demand for short-term funds. If tapering is tightening, they are doing it all wrong.

Finally, the slight upward move in OIS gives us a taste of the volatility to come in short-term funding markets if and when a strong signal for an real credit tightening emerges.