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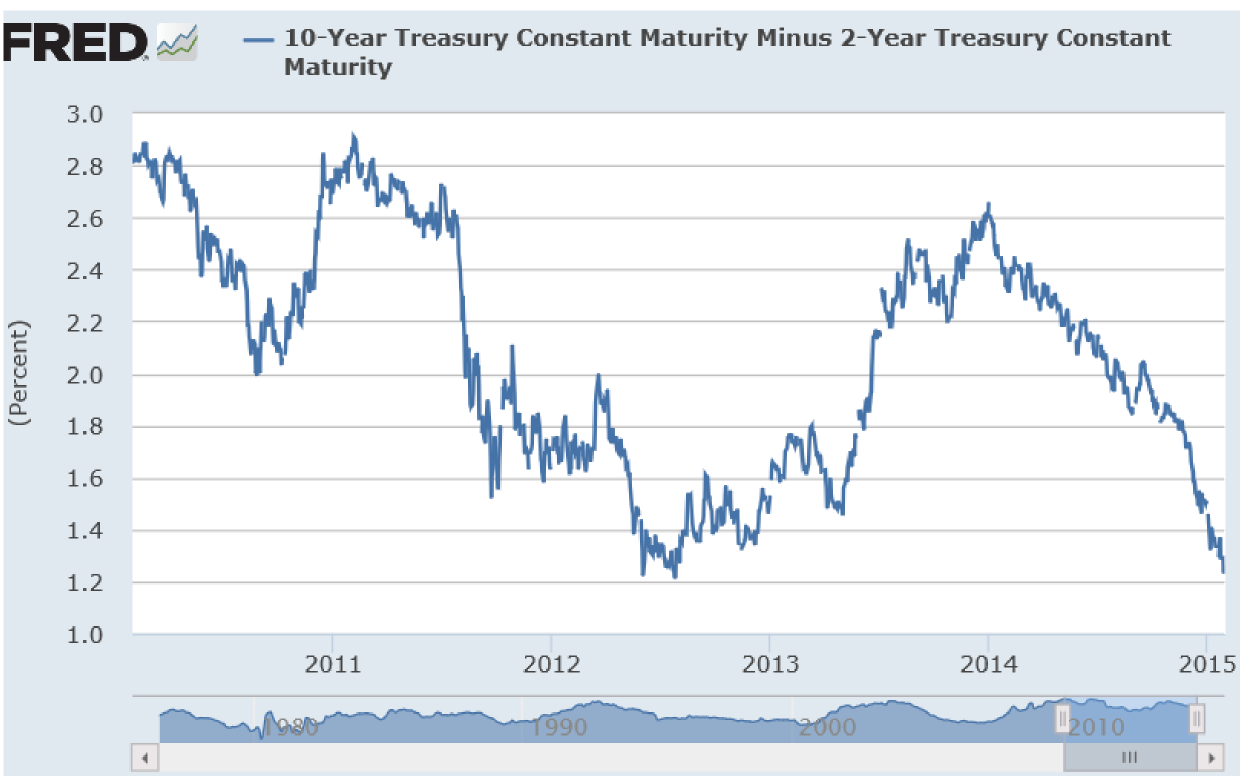
Ready, Set, ??? –the Federal Reserve Bank might not be as ready to raise rates as once thought.

The Background:

From December 2013, when ten-year Treasury yields were 3.0%, to their Friday close at 1.67%, market analysts have expected rates to move higher due to the end of the Fed's bond buying program at the end of last year's third quarter, strengthening domestic GDP (driven by increased consumer spending), and the global economy following along.

What's happening now?

Federal Reserve rate hikes have been forecast to begin this June, but that is starting to look a bit shaky. So, while capital markets interest rates have changed, the benchmarks that determine most adjustable rate loan levels remain unchanged at this time. Federal Funds remain near 0.125%, one-month Libor is 0.25%, and the Prime Rate is still 3.25%, the same as it has been since December 2008.
Besides absolute rate levels, what has also changed is the slope of the Treasury yield curve as short-term rates (the two-year Treasury) inch higher in expectation of the first Fed rate hike since 2004, and longer maturities (like the ten-year note that is the benchmark for our twenty-year debentures) improve in price, dramatically dropping their yield. The current spread is +121 bps, compared to 262 bps thirteen months ago.



Source: Federal Reserve Bank of St. Louis

This chart shows the twelve-month shift in the yield difference of that part of the curve and explains why our twenty-year debenture in January was priced at 2.52% vs. the December 2013 issue priced at 3.38%. In other words, two-year yields have increased 20 bps since December 2013 and ten-year yields have declined 133 bps.

What does that mean for me?

With rates approaching the historic lows that were set in the fourth quarter of 2012, market conditions strongly support the 504 program's ability to provide fixed-rate, term funds to small business borrowers. A major challenge, though, is the extremely low cost of funds for banks now providing fixed-rate term loans as they view commercial real estate to be a superior asset class than low-yielding bonds or stocks that have shown increased volatility. So what does that mean for the industry? Unfortunately, it most likely means more competition from banks who traditionally do not like to lend at fixed rates.

What happens next?

Even with Friday's slightly disappointing GDP rate of 2.6% for the fourth quarter of 2014, the U.S. economy grew at a 2.5% pace for the year, but stubbornly low inflation, weak deflationary euro zone growth, and turmoil in Russia and Greece compel the Federal Reserve to be cautious about raising rates, so this trend can continue until there is a broader based global recovery with increased inflation.
The sharp drop in energy prices has produced a consumer friendly price ≤$2.00 a gallon for gas, but may have more than a temporary effect on inflation, pushing it further down from the Fed's target of 2%. A resulting effect could be an economic slowdown and layoffs in energy dependent states, further dampening the economic recovery, thereby increasing the Fed's dilemma about a rate change.