Capital Markets Group

Weekly Review—October 22, 2021

Short-term interest rates continue to be little changed as the front end of the treasury curve remains hitched to current Fed policy. Intermediate-term treasury yields have increased to levels not seen since early 2020 while longer-term yields remain just below their March 2021 highs. Specifically, the five-year treasury yield at 1.21% has returned to pre-pandemic levels while the ten-year yield remains only 10bps off its 1.75% YTD high set in March.

This steepening of the yield curve is reflective of the market's continued response to a hawkish shift in monetary policy. During his speech at Stanford Institute for Economic Policy Research earlier this week, Fed Governor Waller believed that "substantial further progress" towards improved economic conditions had been met allowing the Fed to begin scaling back asset purchases while cautioning that rate hikes were "some time off." As for taper timing, he stated "we have made enough progress such that tapering of our asset purchases should commence following our next (Federal Open Market Committee/FOMC) meeting," which is set for early next month. That said, FOMC-voting member Waller did acknowledge that if inflation remains persistently elevated that the central bank will be forced to take more aggressive tightening action. "If monthly prints of inflation continue to run high…a more aggressive policy response than just tapering may well be warranted in 2022," he said.

Hawkish comments such as Waller's support the market's growing concern that the Fed may need to taper its pandemic-era purchases at a faster pace as a prelude to increasing benchmark interest rates to slow inflation. Previously provided forward guidance via Fed Chair Powell has made it clear that asset purchases must be tapered to zero before liftoff can occur. The current plan is that the taper won't be complete until middle of next year making lift off no earlier than 3rd quarter of 2022.

The FOMC redefined its new long-term monetary policy framework in 2020 by establishing the following conditions that have to be met before raising its federal funds rate target from the current zero lower bound: 1) employment which is now defined as broad-based and inclusive - affecting all parts of the labor market and not just certain segments - is at maximum sustainable levels and 2) inflation has reached 2% on average over time. To achieve their "average over time" condition, the FOMC will aim for inflation to run moderately higher than the 2% target for some time to make up for past misses of inflation to the low side of the target. According to the Fed, this new inflation strategy is referred to as flexible average inflation targeting and is expected to center longer-term inflation expectations at 2% while reinforcing their inflation target.

Obviously, inflation is running well above the Fed's 2% objective and is beginning to look more persistent than transitory while current employment levels remain well below pre-pandemic levels. By committing not to raise its benchmark overnight rate until the economy has reached full employment, the Fed has ensured that their policy response to combat higher inflation will be delayed. If Fed policymakers are slow to tighten, they will have to play catch up and raise interest rates higher and faster increasing the possibility of an economic hard landing rather than a prolonged and healthy economic expansion.

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NEW ISSUE MUNICIPAL CALENDAR			
Date	Amount ($)	Description	Maturity
10/25/2021	$52,170,000	SHAWNEE KS -A-REF UT GO RATING APPLIED	2022-2051
10/27/2021	$41,495,000	JOHNSON CO KS -A UT GO Aaa	2022-2041
10/27/2021	$7,105,000	JOHNSON CO KS PUB BLDG-A REVS Aaa	2022-2031

ECONOMIC CALENDAR				
Monday 10/25	Tuesday 10/26	Wednesday 10/27	Thursday 10/28	Friday 10/29
Chicago Fed Nat. Activity Index	New Home Sales	MBA Mortgage Applications	GDP (3Q A) Annualized QoQ	Personal Income
Dallas Fed Manf. Activity	Conf. Board Consumer Confid.	Wholesale Inventories MoM	Initial Jobless Claims	Personal Spending
	Richmond Fed Manufact. Index	Durable Goods Orders	Core PCE QoQ	U. of Mich. Sentiment

KEY INDICES	Current	Last Month	One Year Ago
Prime Rate	3.25	3.25	3.25
Discount Rate	0.25	0.25	0.25
Fed Funds Rate	0.08	0.08	0.09
IOER	0.15	0.15	0.10
1-Month Libor	0.09	0.08	0.15
11th Dist COFI	0.24	0.26	0.53
1-Yr. CMT	0.13	0.07	0.13
Dow	35,677.08	34,258.32	28,363.66
NASDAQ	15,090.20	14,896.85	11,506.01
S&P 500	4,544.90	4,395.64	3,453.49
Bond Buyer	2.28	2.14	2.35

MUNI AA—BQ	
3 Mo.	0.10
6 Mo.	0.13
1-Year	0.15
2-Year	0.23
3-Year	0.33
5-Year	0.65
7-Year	1.04
10-Year	1.36
30-Year	1.92

Treasuries & New Issue Agencies *(Spread to Treasuries)*

	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year
3 Mo. Bill	0.05				
6 Mo. Bill	0.05				
1-Year Bill	0.12				
2-Year Note	0.48	0	-12	-13	
3-Year Note	0.80	1	-8	-11	-11
5-Year Note	1.23	0	5	1	-7
7-Year Note	1.51	5	12	5	-5
10-Year Note	1.66	13	27	18	6
20-Year Bond	2.07				
30-Year Bond	2.09				

CMO Spreads to Treasuries

	PAC	Vanilla
1-Year	N/A	+35
2-Year	40	45
3-Year	45	55
5-Year	55	65

MBS Current Coupon Yields

GNMA 30 Yr.	2.17%
FNMA 30 Yr.	2.13%
GNMA 15 Yr.	0.44%
FNMA 15 Yr.	1.44%

About the Author, Dennis Zimmerman

In 2015, Dennis joined Commerce Bank's Capital Markets Group as Manager of Asset/Liability Services. With his leadership, the Capital Market's ALM team provides asset/liability management consulting services to community banks.

Prior to joining Commerce, he was employed for nearly 26 years at one of the largest privately-held banks in Kansas. In addition to managing a $775 million bond portfolio, his Asset/Liability Chairman responsibilities included managing margin, interest rate risk, liquidity and capital. Prior to becoming the bank's Finance Treasury Officer, he was a Registered Investment Representative and Supervising Principal in the bank's Capital Markets division.

As a seasoned professional, Mr. Zimmerman offers a comprehensive understanding of bank finance treasury, fixed income, complex financial analysis as well as regulatory and operational awareness. As a banker, he understands the challenge of balancing shareholder expectations within appropriate levels of risk.