Capital Markets Group

Weekly Review—December 16, 2022

I'm starting to feel a sense of déjà vu! At the last six Fed meetings, policy makers increased benchmark interest rates in response to historically high inflation. At this week's meeting, their action was no different. As expected, the Fed raised its overnight rate to 4.25-4.50%, marking a 15-year high. Prior to this week's 50bps increase, the last four rate increases were 75bps each. While the pace of rate hikes has now slowed, the Fed's work isn't done as their updated projections suggest they could increase the fed funds rate another 75bps (in total) to approximately 5.125% by the end of next year. This 5.125% forecast was an increase from last quarter's 4.625% median projection.

Why does the Fed keep tightening? Obviously, inflation is still too high. And, despite an economy that is showing signs of weakness, the labor market remains tight with the unemployment rate hovering near a 50-year low. The continued strength in the jobs market has been feeding wage inflation. To slow wage growth, the Fed plans to keep raising rates to discourage companies from borrowing, expanding, and creating jobs. Additionally, higher rates will weigh on consumer spending which will eventually drive down prices. (Breaking News: November's retail sales data which was released yesterday showed signs that consumer demand is losing momentum as last month's 0.06% decline was the largest in nearly a year.) Monetary policy remains focused on reducing demand to slow inflation. Too bad the Fed doesn't have the tools to address the supply side causes of inflation…that's fiscal policy and I'll save that discussion for another day.

The Fed understands that their battle with inflation will likely come at the cost of economic stability. Fed Chairman Powell has mentioned several times that slowing economic growth which will increase unemployment will cause "pain" on many fronts. Forward guidance via the Fed's updated Survey of Economic Projections (SEP) confirms that policy makers believe that unemployment could increase to 4.8% in 2024 from today's 3.70% headline. In response, policy will eventually shift from restrictive to accommodative to revive a weakened economy. As such, benchmark rates could fall from next year's terminal rate of roughly 5% to 2.50% based on their longer-term forecast.

It's always fun to discuss the Fed's forward guidance as it is seldom accurate. Last year, the Fed projected a fed fund rate of just under 1% by this time – not today's 4% plus! As a heads up, next week's Weekly Commentary will be published on Thursday, not Friday.

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NEW ISSUE MUNICIPAL CALENDAR			
Date	Amount ($)	Description	Maturity
		NO NEW ISSUES – HAPPY HOLIDAYS	

ECONOMIC CALENDAR

Monday 12/19	Tuesday 12/20	Wednesday 12/21	Thursday 12/22	Friday 12/23
NAHB Housing Market Index	Housing Starts	MBA Mortgage Applications	GDP Annualized QoQ (Final 3Q)	Personal Income
	Building Permits	Existing Home Sales	Initial Jobless Claims	Personal Spending
		Conf. Board Consumer Confid.	Leading Index	Durable Goods Orders

KEY INDICES

	Current	Last Month	One Year Ago
Prime Rate	7.50	7.00	3.25
Discount Rate	4.50	4.00	0.25
Fed Funds Rate	4.32	3.83	0.08
IORB	4.40	3.90	0.15
1-Month Libor	4.34	3.89	0.11
11th Dist COFI (ECOFC)	1.59	1.35	0.22
1-Yr. CMT	4.61	4.60	0.29
Dow	32,920.46	33,553.83	35,897.64
NASDAQ	10,705.41	11,183.66	15,180.43
S&P 500	3,852.36	3,958.79	4,668.67
Bond Buyer	3.59	4.02	2.05

MUNI AA—BQ

3 Mo.	2.08
6 Mo.	2.23
1-Year	2.71
2-Year	2.55
3-Year	2.49
5-Year	2.53
7-Year	2.59
10-Year	2.65
30-Year	3.79

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

	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year
3 Mo. Bill	4.53				
6 Mo. Bill	4.67				
1-Year Bill	4.62				
2-Year Note	4.24	16	81	81	
3-Year Note	3.96	10	85	82	80
5-Year Note	3.66	14	98	94	86
7-Year Note	3.61	31	106	98	88
10-Year Note	3.51	67	120	111	99
20-Year Bond	3.75				
30-Year Bond	3.55				

CMO Spreads to Treasuries

	PAC	Vanilla
1-Year	N/A	+40
2-Year	45	55
3-Year	70	85
5-Year	85	102

MBS Current Coupon Yields

GNMA 30 Yr.	4.82%
FNMA 30 Yr.	4.88%
FNMA 15 Yr.	4.33%

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.

The Weekly Review is a publication of the Capital Markets Group of Commerce Bank.