



## Weekly Review—December 6, 2019

Last week Federal Governor Brainard painted a fairly optimistic picture of the near-term outlook for the U.S. economy while advocating longer-term changes in the conduct of monetary policy in an era of low interest rates and subdued inflation. According to Brainard, “There are good reasons to expect the economy to grow at a pace modestly above potential over the next year or so, supported by strong consumers and a healthy job market, despite persistent uncertainty about trade conflict and disappointing foreign growth,” While downside risks remain, Brainard said the Fed has taken “significant action” in response by lowering interest rates three times this year, noting that it will take some time for the cuts to take their full effect.

While Brainard signaled that policy is likely on hold for the near term, she laid out a roadmap beyond zero bound policy to potentially achieve the Fed’s dual mandate of maximum employment and stable prices. According to Brainard’s plan, if the U.S. enters a deep enough economic downturn to merit cutting interest rates to zero, and the Fed determines even more stimulus is needed, the central bank could start capping yields on short-to-intermediate term Treasury securities by conducting asset purchases to set rate levels it deems appropriate. This policy action would be in lieu of negative rates as the minutes from the last Fed meeting showed that policy makers viewed the option of negative rates as mostly unattractive. “The yield curve ceilings would transmit additional accommodation through the longer rates that are relevant for households and businesses in a manner that is more continuous than quantitative asset purchases,” she said. In the case of the Great Recession, “such an approach could be augmented with purchases of 10-year Treasury securities to provide further accommodation,” she added.

By controlling the yield curve, the idea is that the Fed can manipulate the \$16 trillion U.S. Treasury market with whatever asset purchases necessary to achieve their dual mandate. Although Brainard’s suggested policy isn’t official policy, it undermines free market theory whereas bond yields are currently determined by the law of supply & demand.

Just the idea of government intervention via yield curve control warrants taking action now. If you haven’t already, quantify the impact to earnings and capital assuming the curve approaches zero. Not sure of all the moving parts, seek guidance from your asset/liability team whereas their simulation model is designed for such a task! As for investment portfolio managers, this is another reminder to potentially limit optionality to protect earnings from materially lower rates. Depending on how your portfolio is currently positioned, it likely makes sense to give up some yield on new purchases for improved structure.

Looking into next week, the Fed is not expected to change policy at their last FOMC meeting of 2019. Although November’s stronger-than-expected jobs data - which was released earlier today - showed that wage inflation picked up slightly, those pressures have yet to spill into a faster pace of overall inflation. For now, the world’s largest economy continues to hold up amid constant headwinds. As such, the Fed can remain patient as it sits on the sideline.

Your comments/questions are encouraged.

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### NEW ISSUE MUNICIPAL CALENDAR

Date	Amount (\$)	Description	Maturity
12/9/2019	\$4,290,000.00	ABILENE KS 2019 UT GO BQ AA-	2020-2028
12/9/2019	\$5,295,000	MOUNDRIDGE KS 2019 PBC BQ A	2021-2049
12/9/2019	\$3,270,000	ELLSWORTH KS TEMP NOTE BQ	2021
12/9/2019	\$785,000	HAYSVILLE KS TEMP NOTE BQ	2020
12/10/2019	\$7,200,000	OSAGE MO SCH DST GO BQ AA+	2020-2034
12/11/2019	\$6,000,000	MIAMI COUNTY KS GO BQ AA3	2021-2032

## ECONOMIC CALENDAR

Monday 12/9	Tuesday 12/10	Wednesday 12/11	Thursday 12/12	Friday 12/13
		MBA Mortgage Applications CPI MoM FOMC Rate Decision (Upper Bound)	PPI Final Demand MoM Initial Jobless Claims	Retail Sales Advance MoM

KEY INDICES				MUNI AA-BQ	
	Current	Last Month	One Year Ago		
Prime Rate	4.75	4.75	5.25	3 Mo.	1.03
Discount Rate	2.25	2.25	2.75	6 Mo.	1.06
Fed Funds Rate	1.55	1.56	2.20	1-Year	1.08
IOER	1.55	1.55	2.20	2-Year	1.11
1-Month Libor	1.71	1.77	2.38	3-Year	1.13
11th Dist COFI	1.10	1.13	1.06	5-Year	1.22
1-Yr. CMT	1.57	1.62	2.71	7-Year	1.37
Dow	28,015.06	27,492.56	24,947.67	10-Year	1.60
NASDAQ	8,656.53	8,410.63	7,188.26	30-Year	2.25
S&P 500	3,145.91	3,076.78	2,695.95		
Bond Buyer	2.77	2.79	4.12		

Treasuries & New Issue Agencies ( <i>Spread to Treasuries</i> )						CMO Spreads to Treasuries		
	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year		PAC	Vanilla
3 Mo. Bill	1.51					1-Year	N/A	+45
6 Mo. Bill	1.53					2-Year	50	63
1-Year Bill	1.55					3-Year	62	75
2-Year Note	1.61	4	10	0		5-Year	75	85
3-Year Note	1.63	4	20	10		<b>MBS Current Coupon Yields</b>		
5-Year Note	1.66	6	40	30	14	GNMA 30 Yr.	2.39%	
7-Year Note	1.77	14	45	36	21	FNMA 30 Yr.	2.74%	
10-Year Note	1.83	26	63	52	40	GNMA 15 Yr.	2.06%	
30-Year Bond	2.28					FNMA 15 Yr.	2.31%	

### 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.

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