

Market Insights

# FOMC Keeps Rates Unchanged, While Brexit Concerns Result In The BOE To Do The Same

LIQUIDITY | GLOBAL LIQUIDITY TEAM | JANUARY 2019

## Overview<sup>1</sup>

In January, Federal Reserve (Fed) Chairman Jerome Powell, to improve communications, started a new practice of holding a press conference after every central bank meeting. The Fed's statement showed that the Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 2.25% to 2.50%. While this was expected, investors looked to the FOMC's projections for updated guidance on possible upcoming rate hikes.

The statement showed that the FOMC downgraded its classification of economic growth from "rising at a strong rate" as was the case in December to "solid" in January. The overall tone of the conference was dovish. This called into question the expectations for future monetary policy, especially since there was no explicit mention of a rate hike.

One notable change in the FOMC statement was the lack of forward guidance. There was no mention of "some further gradual increases" in rates as was the case in December. This begs the question of whether the market should expect any rate increases.

The December employment rate was quite strong with nonfarm payrolls increasing by 304,000, which was more than expected. Additionally, the upsurge in the labor force participation rate helped boost the employment-to-population ratio to a new cycle-high of 60.7%.

In the Eurozone, the European Central Bank (ECB) promised to keep interest rates at record lows at least through the summer. President Mario Draghi, who is completing his term in October of this year, indicated that the persistence of geopolitical factors and threat of protectionism is weighing on the Eurozone's economic development.

The U.K economy is facing its own set of difficulties with Brexit. Political uncertainty in January reduced consumer confidence, and amid Brexit indecisions, households are facing tighter credit conditions. Furthermore, the U.K. economy's growth is lagging after the service sector neared stagnation, with firms growing more anxious of Brexit and its impact on their businesses. The Monetary Policy Committee is expected to keep borrowing cost on hold at 0.75% as uncertainty surrounding Brexit continues.

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<sup>1</sup>Source: Bloomberg L.P.

**DISPLAY 1****Monthly Interest Rate Summary**

As of 01/31/2019

<b>US TREASURY RATES</b>	<b>YIELD (%)</b>	<b>MOM CHANGE (%)</b>
<b>1M UST</b>	2.39	(0.04)
<b>3M UST</b>	2.38	0.03
<b>6M UST</b>	2.45	(0.02)
<b>12M UST</b>	2.54	(0.05)
<b>2Y UST</b>	2.46	(0.03)
<b>5Y UST</b>	2.44	(0.07)
<b>10Y UST</b>	2.63	(0.05)
<b>30Y UST</b>	3.00	(0.02)
<b>USD LIBOR CURVE</b>		
<b>O/N LIBOR</b>	2.38	0.01
<b>1M LIBOR</b>	2.51	0.01
<b>3M LIBOR</b>	2.74	(0.07)

Source: Bloomberg

**PRIME STRATEGY<sup>2</sup>**

As widely expected, the Fed voted unanimously to leave its benchmark policy rate unchanged at the conclusion of the January 29-30 FOMC meeting, while altering key language in its statement, indicating that policy makers “will be patient” as they determine future adjustments to the target range for the federal funds rate, a dovish shift from prior meetings. With the market pricing out further gradual interest rate hikes in the near term, 3-month LIBOR ended the reporting period at 2.74%, a decrease of 7 basis points from prior month-end. Throughout the month we opportunistically extended the weighted average maturity of our portfolios, purchasing fixed rate paper in the 6- and 9-month tenors. We continue to manage our portfolios from a conservative

positioning standpoint, focusing on high levels of weekly liquidity and structuring our portfolios to help minimize interest rate risk that could arise from future interest rate hikes.

**GOVERNMENT/TREASURY STRATEGY<sup>3</sup>**

In January, the Treasury curve flattened as the market repriced expectations of FOMC policy actions in the 2019. By month end, overall market expectations moved to no anticipated interest rate hikes this year as the FOMC delivered its dovish message and “wait and see” approach to incoming economic data. While this is quite a change from the prior month, we feel well-positioned in our portfolios, having extended duration in December and early January when interest rates were higher. We invested in fixed-rate Treasuries and agencies,

primarily in 5- and 6-month tenors. We also bought agency floating-rate notes, favoring longer tenor notes. We continue to manage the portfolios to be responsive to changing market conditions and to invest a significant portion of most portfolios in overnight repurchase agreements.

**TAX-EXEMPT STRATEGY<sup>4</sup>**

At the short end of the curve, yields for variable rate demand obligations (VRDOs) fell during the month of January after rising during December. The SIFMA Index,<sup>4</sup> which measures yields for weekly VRDOs, fell from 1.63% at the beginning of the month to finish the month at 1.43% percent. Yields at the longer end of the municipal money market maturity range trended lower

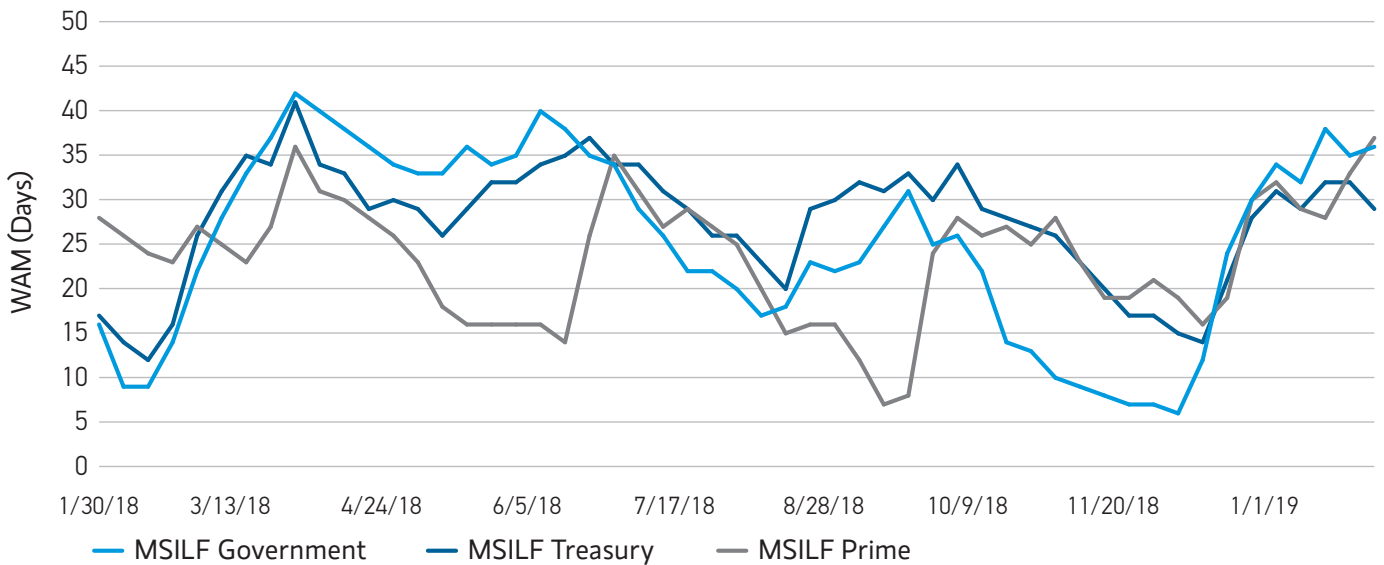
<sup>2</sup> The Portfolio will be required to price and transact in their shares at a floating net asset value (“NAV”) and will be permitted to impose a liquidity fee on redemptions or temporarily restrict redemptions in the event that the Portfolio’s weekly liquid assets fall below certain thresholds.

<sup>3</sup> Government and Treasury Funds are Stable NAV funds.

<sup>4</sup> The **SIFMA Index** is issued weekly and is compiled from the weekly interest rate resets of tax-exempt variable rate issues included in a database maintained by Municipal Market Data which meet specific criteria established from time to time by The Bond Market Association. The index is unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

**DISPLAY 2****Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)<sup>5</sup>**

1/31/18-1/31/19



Source: iMoneyNet

during the month as supply remained constrained. The Municipal Market Data One-Year Note Index<sup>6</sup> finished the month at 1.74%, down 0.16% from the prior month end. We maintained our emphasis on high levels of liquidity and relatively short duration and closely monitored monetary policy and its potential impacts on municipal yields.

<sup>5</sup> **Weighted Average Maturity (WAM):** Measures the weighted average of the maturities of the portfolio's individual holdings, taking into account reset dates for floating rate securities.

<sup>6</sup> Thomson Reuters Municipal Market Data (MMD) AAA Curve is a proprietary yield curve that provides the offer-side of "AAA" rated state general obligation bonds, as determined by the MMD analyst team. The "AAA" scale (MMD Scale), is published by Municipal Market Data every day at 3:00 p.m. eastern standard time with earlier indications of market movement provided throughout the trading day. The MMD AAA curve represents the MMD analyst team's opinion of AAA valuation, based on institutional block size (\$2 million+) market activity in both the primary and secondary municipal bond market. In the interest of transparency, MMD publishes extensive yield curve assumptions relating to various structural criteria which are used in filtering market information for the purpose of benchmark yield curve creation. MMD yield curves are available on a subscription basis from Thomson Reuters TM3.

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