OREGON STATE TREASURY

Local Government News Report

OCTOBER 2018

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INSIDE THIS ISSUE

HOLIDAY

Veterans Day November 12

Pool Closed

See article for more information

CREDIT MARKET REVIEW

Monetary Policy Update

Finding neutral in your car is easy to do but finding neutral for monetary policy is nearly impossible to do. The futility of the task does not mean it is a wasted effort as neutral is akin to nirvana for central bankers. What is neutral and why are we discussing it? In central bank parlance, neutral refers to the policy interest rate that is neither stimulative nor restrictive for economic growth. Neutral is important for investors as it is the desired end-point for interest rates. This leads us to a recent quote from Federal Reserve Chairman Jerome Powell, where he had the following to say, "Interest rates are still accommodative, but we're gradually moving to a place where they will be neutral. We may go past neutral, but we're a long way from neutral at this point, probably." This comment is important for two reasons. First is the reference to "gradually moving" and second is the reference that Chair Powell believes we are probably a "long way" from neutral. Given the economic backdrop, this suggests the Federal Reserve is comfortable continuing gradual rate increases until it gets the sense the increases are stifling economic activity.

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LGIP PARTICIPANT SURVEY

One year ago, we transformed the Local Government Investment Pool by partnering with PFM Asset Management LLC to provide administrative and operational support for the pool. Thanks to that partnership, participants today enjoy strengthened security, increased functionality, and around-the-clock access through the web-based EON system. To gauge how our customers view the services provided by PFM's Client Services Group, we will soon launch a participant survey. This feedback will allow us to objectively evaluate our current level of service and enhance future services to meet our customers' evolving needs. Look for more information in the coming weeks about this opportunity to share your thoughts.

UPCOMING HOLIDAY

The pool will be closed on Monday, November 12, for Veterans Day. EON will be available but the system will not allow transactions to settle on the holiday.

INTEREST RATE

Average Annualized Yield

September
2.25 percent

Interest Rate

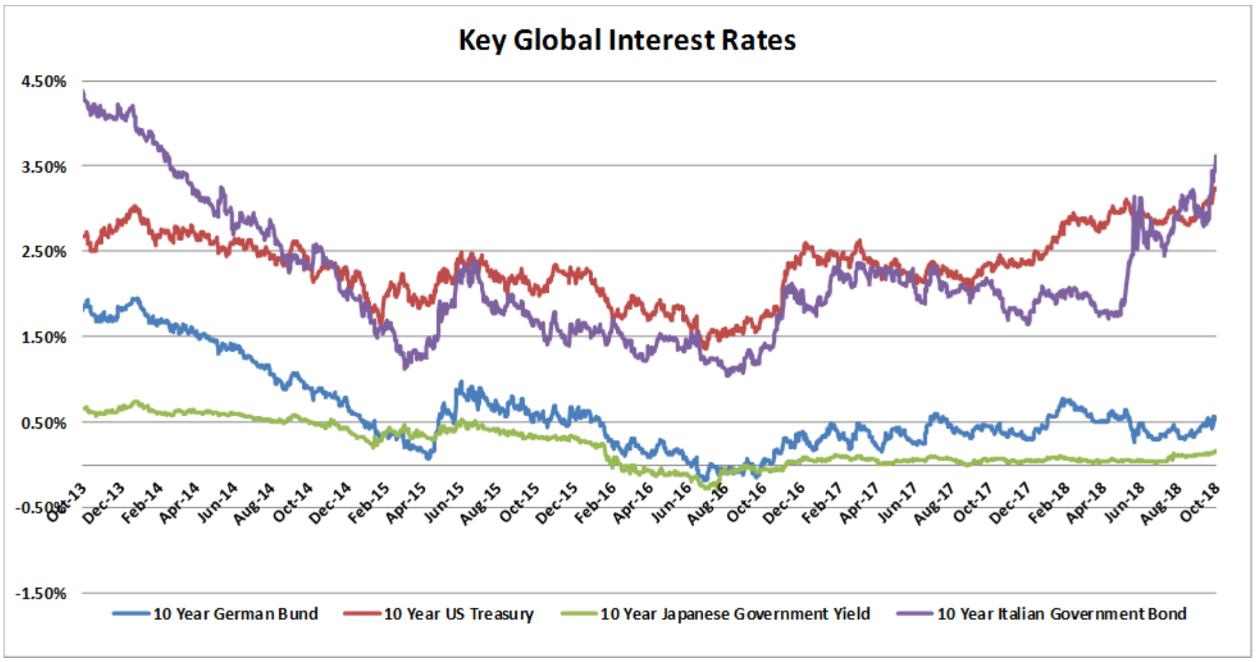
September 1–30
2.25 percent

CREDIT MARKET REVIEW

(Continued from page 1)

U.S. Interest Rates

Interest rates in the United States reached multi-year highs on the back of strong economic data and a Federal Reserve content with slowly moving the policy rate higher. With growth maintaining momentum and more U.S. Treasury issuance coming to fund the deficit, rates are likely to remain elevated as we head into the end of the year.



European Update

Italy recently offered up sobering and refreshing proof that budget deficits still matter to some. We pointed out the potential for political disruptions in Italy in the January 2018 issue. In particular we note that, unlike smaller economies, Italy is a large economy with a lot of debt outstanding. The risk we discussed in January has become a reality as a coalition government has formed in Italy between the anti-establishment Five Star Movement and the far-right populist League. The common element these otherwise disparate political parties share is their unwillingness to continue austerity in the face of declining economic outcomes, especially when compared to the economic outcomes seen in France and Germany. This element showed through in the government's proposed budget, which called for increased spending and a deficit that was beyond the limits policy makers in Brussels would allow. Markets reacted negatively to the development, sending Italian bond yields soaring higher and Italian stocks tumbling which are now down 18 percent from their May 2018 high.

Federal Reserve Rate Hikes

The Federal Reserve hiked rates again at the conclusion of its two-day meeting on September 26. This marks the eighth rate increase since December 2015. The federal funds rate is now pegged in a range between 2.00 percent to 2.25 percent. Given the ongoing economic strength and forecasts from Federal Reserve members, markets are pricing in a 75-percent chance that we will see another rate hike at the conclusion of their December 2018 meeting.

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CREDIT MARKET REVIEW

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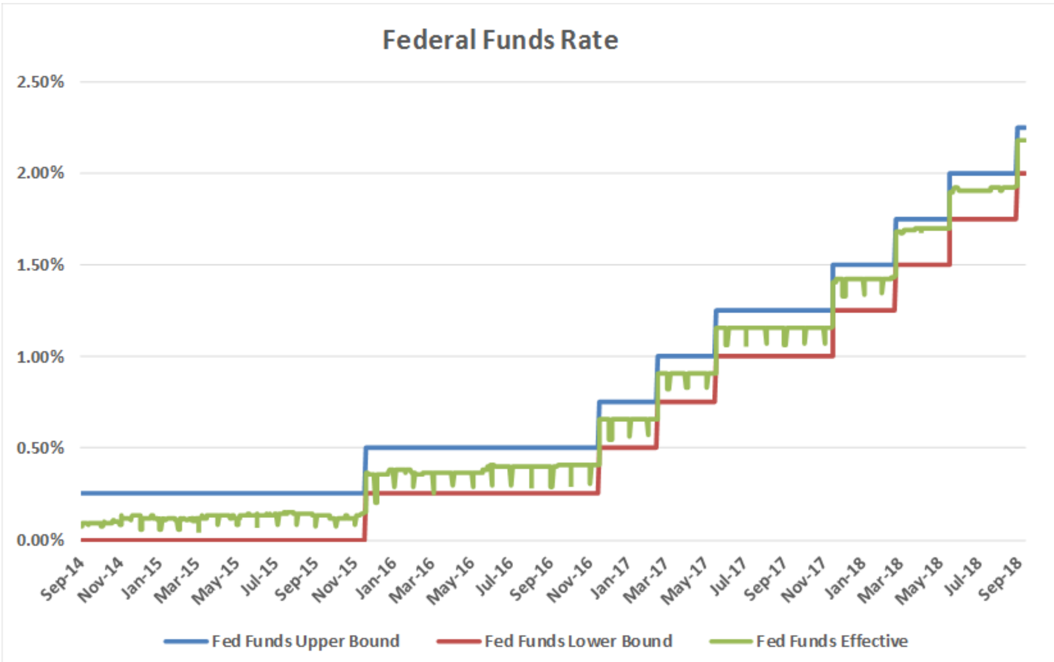

Monterey Policy Tightening

While a rising policy rate is the headline, it is ever-more important to pay attention to other types of policy tightening going on in the background. For example, the Federal Reserve continues its effort to reduce its balance sheet which, since the financial crisis, grew to more than $4 trillion as the central bank purchased securities in order to inject liquidity into the market and reduce interest rates in the hopes of stimulating the economy. October 2018 is important for two reasons. First, the Federal Reserve will now be reducing its balance sheet by $50 billion per month—an increase from previous months. Second, the European Central Bank (ECB) will its their bond-buying efforts from €30 billion to €15 billion per month. Currently, the ECB plans to end bond-buying at the end of the calendar year. This is a big transition, particularly as the U.S. increases debt issuance to fund the expanded deficit. With less demand from central banks and more supply we often need to adjust the price lower, or yield higher, in order to find a balanced market.

U.S. Employment

The employment picture continues to be a strength for the U.S. economy. Over the past three months, the U.S. economy added 569,000 non-farm jobs, an average of 190,000 per month. Wage growth, or the lack thereof, continues to be a big focus in the labor market. As of the September reading, wages were growing at an annualized pace of 2.8 percent which is roughly in-line with consumer price inflation (CPI) of 2.7 percent. Low wage growth continues to defy economic models and history, particularly with an unemployment rate at 3.7 percent.

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CREDIT MARKET REVIEW

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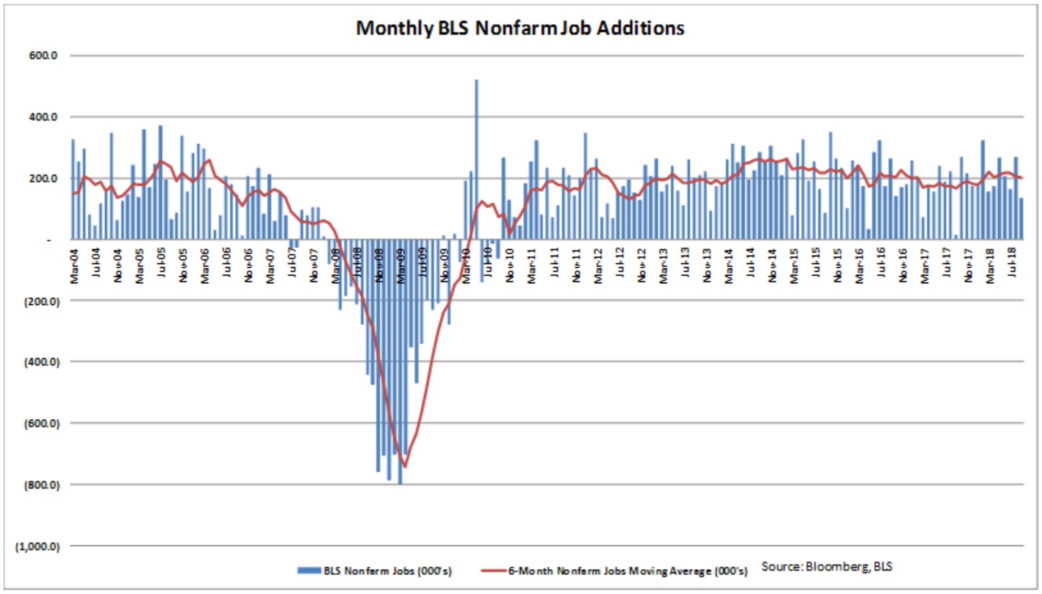


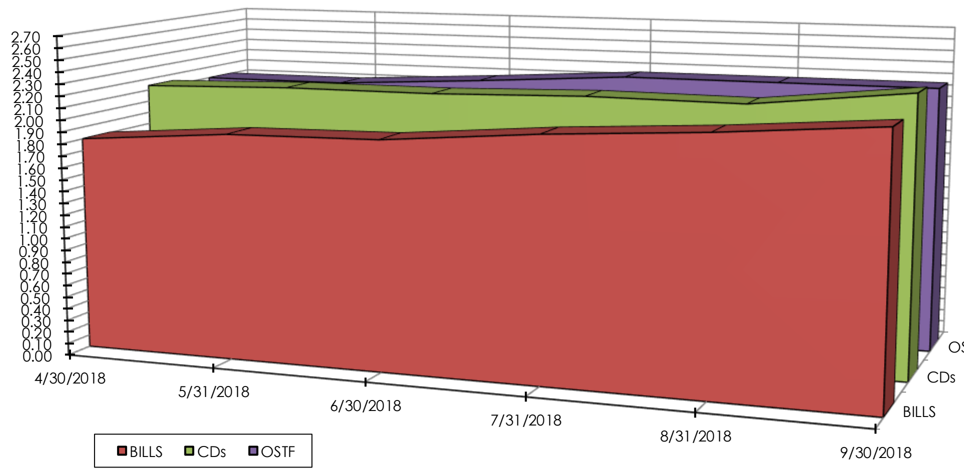
Health of the U.S. Consumer

Heading into the ever-important holiday shopping season, we would like to revisit the health of the U.S. consumer. In the April 2018 issue we discussed the U.S. consumer's financial health as consumer debt was reaching all-time highs while savings rates were nearing all-time lows. All this as wages are merely growing in-line with consumer inflation. Data revisions have come to the rescue as the Bureau of Economic Analysis dramatically revised the savings rate upward as noted in the chart below.

Front-end Rate Snapshot

Front-end interest rates moved noticeably higher during September and early October. After 10 years of ultra-low rates, it is a relief to be able to obtain yield on short-duration cash products. Short-duration corporate credit spreads continue to be well-behaved as investors now can earn more than 3.25 percent in high-quality credit product.

OREGON SHORT TERM FUND ANALYSIS AS OF 9-30-18



	4/30/2018	5/31/2018	6/30/2018	7/31/2018	8/31/2018	9/30/2018
LGIP AV DOLLARS INVESTED (MM)	8,051	8,001	7,167	6,778	6,959	6,886
STATE AGENCY AV DOLLARS INVESTED (MM)	10,720	11,312	11,747	11,826	11,425	11,163
TOTAL OSTF AV DOLLARS INVESTED (MM)	18,771	19,313	18,914	18,604	18,384	18,049
OST ANNUAL YIELD (ACT/ACT)	2.10	2.10	2.17	2.25	2.25	2.25
3-MO UST BILLS (BOND EQ YLD)	1.80	1.90	1.92	2.02	2.10	2.20
3-MO US CD (ACT/360)*	2.14	2.17	2.17	2.20	2.19	2.33

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to account holders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectivley) bank certificates of deposit and are quoted on a CD equivalent yield basis.

This material is available in alternative format and media upon request.

MARKET DATA TABLE

	10/8/2018	1 Month	3 Months	12 Months
7-Day Agency Discount Note**	2.15	1.86	1.77	0.96
30-Day Agy Nt Disc**	2.17	1.96	1.80	0.98
90-Day Agy Nt Disc**	2.19	2.09	1.90	1.04
180-Day Agy Nt Disc**	2.34	2.18	1.99	1.14
360-Day Agy Nt Disc**	2.45	2.40	2.22	1.26
30-Day Treasury Bill**	2.09	1.97	1.78	0.94
60-Day Treasury Bill**	2.13	2.04	1.85	0.98
90-Day Treasury Bill**	2.18	2.11	1.91	1.03
6-Month Treasury Yield**	2.41	2.30	2.11	1.22
1-Year Treasury Yield**	2.61	2.51	2.31	1.34
2-Year Treasury Yield**	2.89	2.71	2.54	1.51
3-Year Treasury Yield**	2.98	2.77	2.63	1.64
1-Month LIBOR**	2.28	2.13	2.09	1.24
3-Month LIBOR**	2.41	2.33	2.33	1.35
6-Month LIBOR**	2.63	2.54	2.51	1.52
12-Month LIBOR**	2.96	2.85	2.77	1.80
Sources: *Bloomberg Index Services, **Bloomberg				

	10/8/2018	1 Month	3 Months	12 Months
Bloomberg Barclays 1-3 Year Corporate YTW*	3.32	3.18	3.11	1.96
Bloomberg Barclays 1-3 Year Corporate OAS*	0.50	0.55	0.65	0.49
Bloomberg Barclays 1-3 Year Corporate Modified Duration*	1.96	1.95	1.97	1.95
7-Day Muni VRDN Yield**	1.53	1.49	1.19	0.92
O/N GGC Repo Yield**	2.23	1.94	1.98	1.12
US 1 Year Inflation Break-Even**	1.30	1.00	1.42	1.23
US 2 Year Inflation Break-Even**	1.81	1.70	1.83	1.57
US 3 Year Inflation Break-Even**	1.93	1.86	1.97	1.66
1-Day CP (A1/P1)**	2.18	1.89	1.91	1.16
7-Day CP (A1/P1)**	2.23	1.93	1.94	1.17
30-Day CP (A1/P1)**	2.24	2.06	2.05	1.19
30-Day CD (A1/P1)**	2.24	2.03	2.03	1.23
90-Day CD (A1/P1)**	2.44	2.28	2.21	1.34
6-Month CD (A1/P1)**	2.68	2.50	2.40	1.47
1-Year CD (A1/P1)**	2.89	2.77	2.63	1.70

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