



Item Number: 2



CITY OF GRAND RAPIDS AGENDA ACTION REQUEST

DATE: July 16, 2024

TO: Mark Washington, City Manager

COMMITTEE: Fiscal Committee

LIAISON: Molly Clarin, Chief Financial Officer

FROM: John M. Globensky, City Treasurer
City Treasurer's Office

SUBJECT: **Treasurer's Report for Period of May 22, 2024 through June 30, 2024**

Minutes of the April 30 – May 1 Federal Reserve's Open Market Committee (FOMC) meeting were released. One passage in particular is notable:

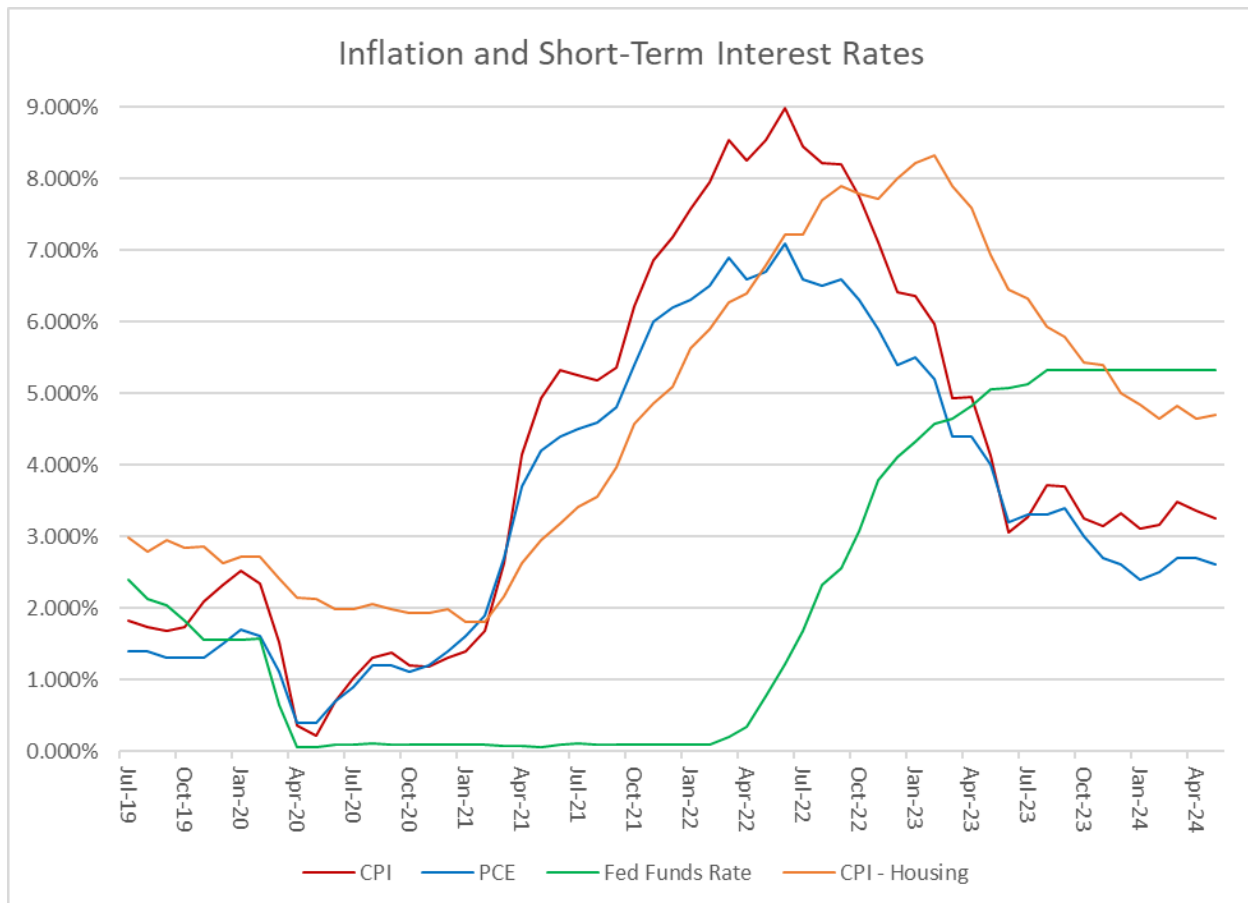
"Although monetary policy was seen as restrictive, many participants commented on their uncertainty about the degree of restrictiveness. These participants saw this uncertainty as coming from the possibility that high interest rates may be having smaller effects than in the past, that longer-run equilibrium interest rates may be higher than previously thought, or that the level of potential output may be lower than estimated."

There are technical reasons that high interest rates may be less effective than in the past. Some economists have pointed to interest on excess reserves as a potential cause. Starting in 2007, FOMC began paying member banks interest on monies held on deposit at the Fed above and beyond those necessary to meet bank reserve requirements. While the price of money (interest) has increased, the total supply of money available to the economy has not returned to pre-pandemic trend.

In a May 28 CNBC interview, Minneapolis Federal Reserve President Neel Kashkari commented on economic developments.

"We were pleasantly surprised, in the second half of last year in the US, how quickly inflation fell. It gave us a lot of optimism that maybe it would go back down to our 2% target. But then in this beginning of this year, just as chairman Powell said, it has moved sideways."

The below chart shows a sharp fall in inflation by last summer. FOMC stopped raising short-term interest rates in July 2023. Since then, both inflation and short-term interest rates have been relatively unchanged.



Source: Federal Reserve Bank of St Louis

Note that there are two different inflation indices displayed on the above chart, the Consumer Price Index for Urban Consumers (CPI) and the Personal Consumption Expenditures (PCE) deflator. The Federal Reserve Open Market Committee (FOMC) targets inflation at 2.0% annual PCE growth.

In most economic circumstances, the difference between the CPI and PCE growth is relatively negligible. However, the two indices use different weightings and methodologies that occasionally result in divergent results. That divergence is particularly instructive.

Housing composes roughly 37% of CPI, but only 17% of PCE. Because housing includes both consumption and investment aspects, inflation gauges use the owner's

equivalent rent. Most residences in the US are priced via annual lease agreements. Once signed, rents do not change, even if other newly signed leases go up or down in price. This produces a significant lag effect where housing costs tend to follow broader trends by several months. This lag is the biggest reason why inflation remains well above the FOMC's 2.0% target.

Markets have priced in a 91.2% likelihood that FOMC will maintain short-term interest rates at their current range of 5.25% – 5.50% at its next meeting July 30-31. Market pricing also indicates a 72.8% likelihood that FOMC will reduce rates 0.25% at its September 17-18 meeting. There is an FOMC meeting scheduled for November 6-7. Note that election day is November 5; FOMC tries to avoid significant or unexpected interest rate changes near elections when possible.

As interest rates rise, the market price of outstanding fixed-yield bonds and other debt obligations declines. The opposite also holds true; market prices rise when interest rates drop. The magnitude of the market price change is roughly proportional to time to maturity. Gains or losses in market value are only realized when portfolio securities are sold prior to maturity. Unrealized gains or losses have no impact on portfolio cash flow or interest earnings.

Governmental accounting standards require the Treasurer's Office to mark the portfolio to current market prices on the City's financial statements. It is important to understand that unrealized gains and losses exist "on paper" only. Sufficient liquidity is available to fund expected current expenditures without selling portfolio holdings prior to maturity.

The Treasurer's Office manages the City's investment portfolio with the goals of safety of principal, sufficient liquidity to meet expected liabilities, and obtaining a competitive yield on invested monies. By selecting portfolio holdings with positive cash flows during periods of expected drawdown, the Treasurer's Office maximizes invested capital while minimizing the likelihood that of a liquidity demand in excess of readily available resources, which could result in a loss of principal. This also allows some flexibility to take advantage of market themes and opportunities as they present themselves. Communication among City staff, especially as to the timing of major expenditures, is critical to the success of this approach.

The FY2025 fiscal plan calls for the drawdown of fund balances and/or retained earnings to pay for a portion of large capital projects. This has resulted in investment purchases of mostly short-term assets. Due to an inverted yield curve (when short-term interest rates are higher than long-term rates), these purchases have temporarily boosted portfolio yield. However, we are mindful of the need to sustain yields even as

overall rates decline. Our focus on short-term investments comes at the expense of sustained yields over longer periods of time.

Portfolio segments and investment returns are listed in the following table.

Portfolio Segment	Market Value	Purchase Yield
Pooled Funds	\$567,120,936	3.26%
Cemetery Perpetual Care	\$5,146,726	4.46%
Bond Proceeds:		
CIB 2021 – Street Lighting	\$248,719	0.40%
CIB 2023 – Lyon Square	\$5,497,297	5.48%
CIB 2024 – Amphitheater	\$20,413,689	5.31%
CIB 2024 – Scribner	\$59,762,108	5.46%
Total:	<u>\$658,189,475</u>	3.55%

The attached appendices detail portfolio holdings and recent trading activity. Please contact me at ext. 3285 with any questions on this report. Thank you.

CORRECT IN FORM

DEPARTMENT OF LAW