Core Inflation Exceeds Consensus Estimates

Economic data released over the past week indicate continued widespread inflationary pressures throughout the U.S. economy, although the impact of monetary tightening is becoming evident in some corners.

Last Friday, the Labor Department reported for September that the U.S. economy added 263,000 jobs, which was lower than the 315,000 added in August and the lowest monthly total since April 2021. The unemployment rate ticked lower to 3.5%, and hourly earnings grew by 5.0% over the past year as compared to 5.1% in August.

On Wednesday, October 12, the producer-price index (PPI) for September was released and it showed a seasonally adjusted increase of 0.4% over the previous month and an increase of 8.5% for the 12-month period ended in September. The month-over-month increase for final demand services and final demand goods were both 0.4%.

The following day the September consumer-price index (CPI) was released showing a seasonally adjusted increase of 0.4% after rising 0.1% in August, and an increase of 8.2% over the past year as compared to 8.3% in August. While price increases were broad-based, shelter, food, and medical care indexes were the largest contributors. Some relief in the headline CPI was due to the energy index declining 2.1% in September after falling 5.0% in August. The so-called core CPI, which excludes energy and food prices, rose 0.6% on a month-over-month basis and on an annual basis gained 6.6% versus last month's 6.3% increase. The 6.6% annual increase in core CPI is the highest measurement since the summer of 1982. The increases in PPI, CPI and core CPI all exceeded consensus expectations for September.

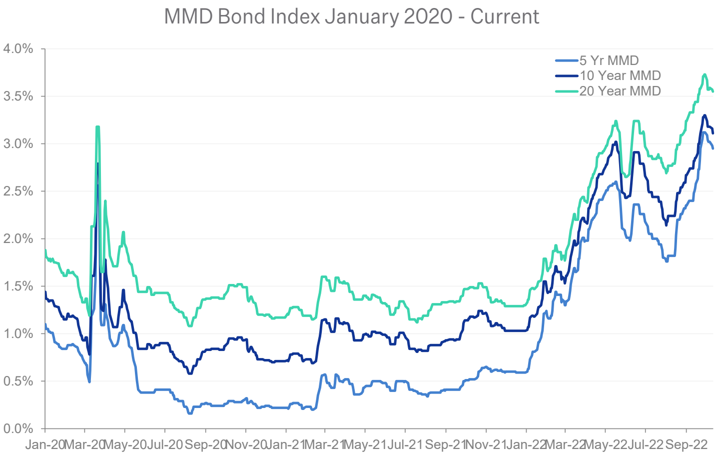
A still robust but cooling labor market and persistent inflation is causing financial markets to continue to reprice most assets lower based on the Federal Reserve (the Fed) keeping rates higher for longer than was generally anticipated.

The Fed has its next regularly scheduled Federal Open Market Committee (FOMC) meeting on November 1-2, 2022. Markets widely expect the Fed to increase its overnight rate by another 0.75%, the fourth such rate increase in a row, bringing the fed-funds rate range to 3.75%-4.00%. The Fed's most recent Summary of Economic Projections was released at September's FMOC meeting and indicates that the median official expects the overnight rate to climb to 4.4% by year-end, and to 4.6% in 2023. A 4.4% rate by the end of 2022 implies another 0.50% increase at the December FMOC meeting; however, after the September inflation numbers were made public the market now expects a 0.75% increase at the December meeting.

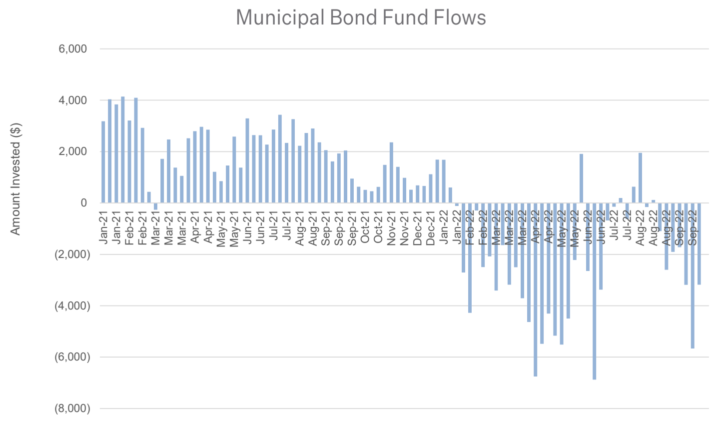
There are concerns that the Fed will tighten beyond what is necessary to cool inflation as the impact of its rate increases on the economy will lag in the data. Additionally, as it tightens the Fed's actions could cause unforeseen issues with the financial stability of U.S. markets, or more likely overseas markets, which could elevate contagion risks. The contrary argument would be along the lines that entrenched inflation and a wage-price spiral would be even more destructive outcomes and it is prudent to err on the side of overtightening.

Municipal Market Update

Interest rates on municipal bonds continue to exhibit volatility after steadily moving higher during the first five months of the year as illustrated by the following chart which provides Municipal Market Data (MMD) AAA yields since the start of 2020 for 5-year, 10-year, and 20-year maturities. Rates have generally increased since the first week in August, largely in sympathy with U.S. Treasuries.



Despite the occasional week of net purchases that tend to coincide with a falling rate environment, investors continue to sell municipal bonds with net municipal bond outflows occurring in 33 of the past 38 weeks.



PMA is dedicated to staying up to date on market trends and will be ready to guide you through a dynamic and evolving market. If you have any questions about the municipal bond market in general or your specific bond issue, please feel free to contact a PMA advisor below.

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