

# Hopes of a Meaningful Fed Pivot This Year Diminish

Over the past six months or so, there has been steady declines in both new jobs and aggregate measures of consumer inflation, leading some market participants to believe that the Federal Reserve (the Fed) will only need one or two 0.25% rate increases this year before it pivots towards rate reductions some time prior to the end of 2023. The most recent economic data have reduced those investor hopes, with higher-for-longer now being priced into the interest rate derivatives market.

## Labor Market

The number of new monthly jobs added to the economy had moved lower each month from September 2022 through December 2022. However, January's job report from the Department of Labor estimated that non-farm payrolls increased by 517,000, and December's jobs estimate was revised upwards to 260,000 from the initial 223,000. Over the past 12-month period, average hourly earnings increased by 4.4%, which is lower than last month's 4.6% increase, but is not congruent with the Fed's target of 2% annual inflation.

## Inflation Measures

On Tuesday, February 14, the January consumer-price index (CPI) was released showing a seasonally adjusted monthly increase of 0.5% as compared to last month's reported decrease 0.1%, which was subsequently revised upwards to an increase of 0.1% with this report. This 0.5% increase tied the highest level since July 2022 and implies an annual rate of inflation of approximately 6.0%. Over the last 12 months, the CPI has increased by 6.4%, which is a tick lower than December's 6.5% increase.

The so-called core CPI, which excludes energy and food prices, rose 0.4% on a month-over-month basis and on an annual basis gained 5.6%. The shelter index, which includes rent and owners' equivalent rent, increased 7.9% over the last year and accounted for approximately 60% of the total increase in the core CPI. This large increase in the shelter index for January can be attributed to the way sharp increases in rents and home prices work their way through the index over time. Similarly, decreases in rents and home prices that have been observed have just started to work their way through the index and should have a more material impact as early increases are fully accounted for later this year.

## U.S. Treasury Rates

On February 14, both the benchmark 6-month T-Bill and the 1-year T-Bill moved above 5.00% before closing at 4.98% and 4.99%, respectively. A benchmark U.S. Treasury of any maturity hasn't closed above 5.00% since August 2007.

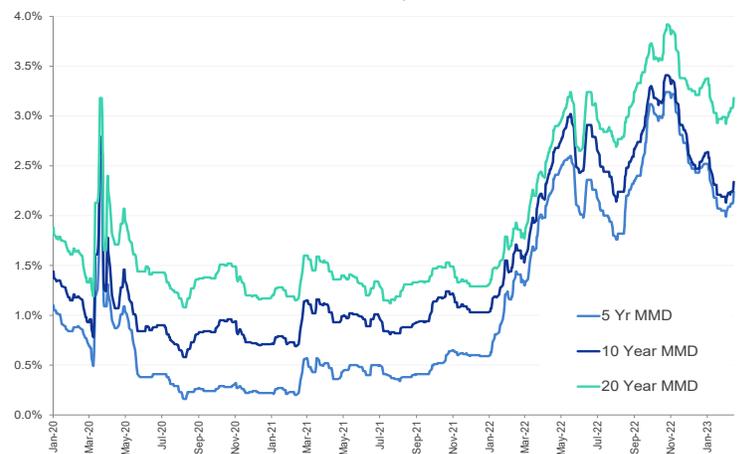
## The Fed

As expected, the Federal Open Market Committee (FOMC) increased its overnight rate by 0.25% on February 1, bringing the federal funds rate range to 4.50%-4.75%. Probabilities for a higher-for-longer federal funds rate have increased substantially since January's jobs report and CPI data were released. As of the date of this update, interest rate traders are now pricing a 0.25% increase on March 22, a 72% probability of an additional 0.25% increase on May 3, and a 47% probability of an additional 0.25% increase on June 14, which would bring the rate range to 5.25%-5.50%. The probability of the rate range still being at least 5.25%-5.50% after the December 13 FOMC meeting is approximately 33%.

## Municipal Market Update

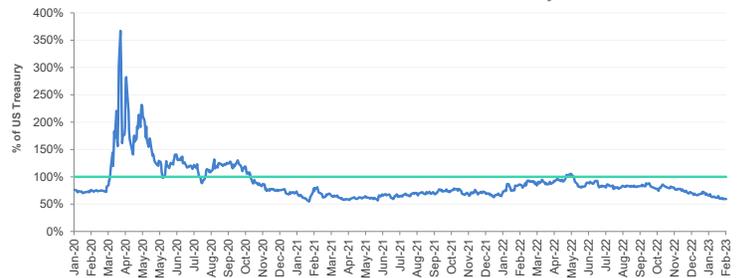
The following chart provides Municipal Market Data (MMD) AAA yields since the start of 2020 for 5-year, 10-year, and 20-year maturities. As illustrated, interest rates on municipal bonds are lower than their 2022 peak that occurred during the last week in October. The decline in municipal yields has largely been fueled by the cooling of inflation. While yields did tick up towards the latter half of December, the market rallied in January primarily driven by a lack of municipal bond supply. Since February 1, yields on the below maturities have increased by 0.15% to 0.21%, reflective of the impact of previously mentioned labor market and CPI data.

MMD Bond Index January 2020 - Current



After a challenging 12-month period of investors pulling money out of long-term municipal bond mutual funds and exchange traded funds, we've seen five straight weeks of inflows that have averaged nearly \$2.0 billion per week. These inflows coupled with January's reduced supply have helped to increase the value of municipal's federal tax exemption. To quantify, the 10-year AAA municipal is currently at approximately 60% of the 10-year U.S. Treasury as compared to being at 80% on November 16, 2022.

10-Year MMD vs. 10-Year US Treasury



PMA is dedicated to staying up to date on market trends and will be ready to guide you through a dynamic and evolving market in the new year. 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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