

Will Bank Failures Impact the Fed's Rate Path?

At the start of last week financial markets were reasonably stable. There would be a jobs report on Friday, and then this week there would be consumer and producer inflation figures. Plenty of fresh economic data that would help inform the Federal Reserve's next rate decision which is scheduled to be released on the afternoon of March 22, 2023. The only question seemed to be whether rates would move up by the expected 0.25% or perhaps 0.50% if the data warranted.

On Friday, March 10, Silicon Valley Bank (SVB) was closed by California state regulators and placed it into the receivership of the Federal Deposit Insurance Corporation (FDIC). With approximately \$209 billion in total assets on December 31, SVB was the 16th largest U.S. bank and its collapse was the second-biggest bank failure in U.S. history. SVB was the first FDIC-insured institution to fail since October 23, 2020.

SVB's customer base included many leading venture capital firms and tech startups. These companies could deposit large amounts of funds into the bank very quickly and as was witnessed, withdraw these funds at an even faster pace. Unfortunately for SVB, a substantial portion of depositor funds were invested in long-term, fixed-rate bonds that were purchased prior to the Fed's recent tightening cycle. On March 8, as part of an unsuccessful equity offering, SVB reported a \$1.8 billion after-tax loss primarily due to the forced selling of U.S. Treasuries and the bank run was on. Investors with accounts that were not FDIC insured, which was nearly 90% of all the bank's deposits, did not want to take a chance that their unsecured assets would be frozen and a haircut taken.

On Sunday, March 12, Signature Bank was closed by New York state regulators, which appointed the FDIC as receiver. With approximately \$110 billion in total assets on December 31, Signature Bank was the third-biggest bank failure in U.S. history. Signature Bank's recent rapid growth was primarily fueled by serving institutional cryptocurrency customers, which seemed to have spooked depositors after SVB collapsed. Another crypto friendly bank, Silvergate Bank, announced its intentions to liquidate last week after selling assets at steep losses to cover billions of withdrawals.

In order to calm markets before Monday morning, the Federal Reserve and Treasury Department took the extraordinary step of designating SVB and Signature Bank as a systemic risk to the financial system. This gave regulators the flexibility to backstop uninsured deposits. Additionally, the Fed stated that it will make available additional funding to eligible depository institutions.

Labor Market

February's jobs report from the Department of Labor estimated that nonfarm payrolls increased by 311,000, indicating strong hiring. Industries with the most job gains were leisure and hospitality, retail trade, government, and health care. Average hourly earnings for private-sector workers increased by 4.6% over the past 12 months.

Inflation Measures

On Tuesday, March 14, the February consumer-price index (CPI) was released showing a seasonally adjusted monthly increase of 0.5%, and an increase of 6.0% over the past 12 months. This was the smallest annual

increase since the period that ended September 2021. The so-called core CPI, which excludes energy and food prices, rose 0.5% on a month-over-month basis and on an annual basis gained 5.5%. These CPI readings were mostly in line with market expectations, according to Bloomberg's estimates. The one exception was monthly core CPI, which was 0.1% higher than the market expected.

On Wednesday, March 15, the producer-price index (PPI) for March was released and it showed a seasonally adjusted decrease of 0.1% over the previous month and an annual increase of 4.6% for the 12 months ended February 2023. The so-called core PPI, which excludes energy, food, and trade services, rose 0.2% on a month-over-month basis and on an annual basis gained 4.4%.

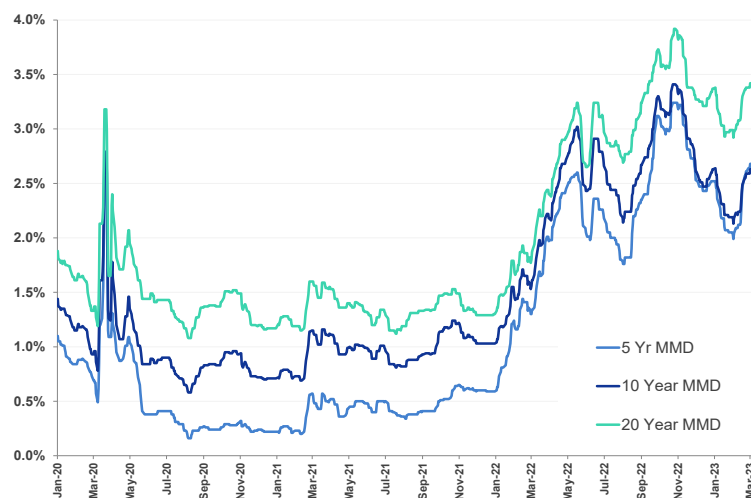
The Fed

The Fed's next regularly scheduled Federal Open Market Committee (FOMC) meeting wraps up on March 22, 2023. It will be interesting to see how the Fed weighs strong employment and sticky inflation versus recent challenges in the banking sector.

Municipal Market Update

The banking crisis, the tamer CPI report and the negative change in the PPI report are all good news for municipal bond rates. What remains to be seen is if the recent rally is sustainable or short lived to be supplanted later on by the next wave of economic reports. 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. Over the past week, yields on the below maturities have decreased by 0.16% to 0.25%, reflective of investor flight to quality.

MMD Bond Index January 2020 - Current



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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