

Economic Data Points to Another Fed Increase in May

Recent economic data indicates a still strong albeit cooling labor market, and inflation that continues to move lower, but remains at elevated levels. This data coupled with the stabilizing of the U.S. banking sector clears the way for the Federal Reserve (the Fed) to increase the overnight rate by 0.25% at its next meeting, which will conclude on May 3.

Labor Market

The March jobs report from the Department of Labor was released on Friday, April 7 and it estimated that nonfarm payrolls increased by 236,000. This increase was largely consistent with economist surveys, and effectively ended a streak of upside surprises to the monthly jobs numbers. While 236,000 new jobs are above the pre-pandemic average, it is only the fourth time since January 2021 that monthly new jobs were below 300,000. The unemployment rate ticked lower to 3.5% and the labor force participation rate moved up in March to 62.6%, yet remains below the 63.3% reported in February 2020.

Inflation Measures

On Wednesday, April 12, the March consumer-price index (CPI) was released showing a seasonally adjusted monthly increase of 0.1%, and an increase of 5.0% over the past 12 months. This was the smallest annual increase since the period that ended May 2021, and was slightly lower (better) than market expectations, which, according to Bloomberg, were 0.2% for the monthly increase and 5.1% for the 12-month 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%, which were in-line with economist expectations, according to Bloomberg. This was the first time that the 12-month core CPI was higher than the 12-month all items CPI since January 2021.

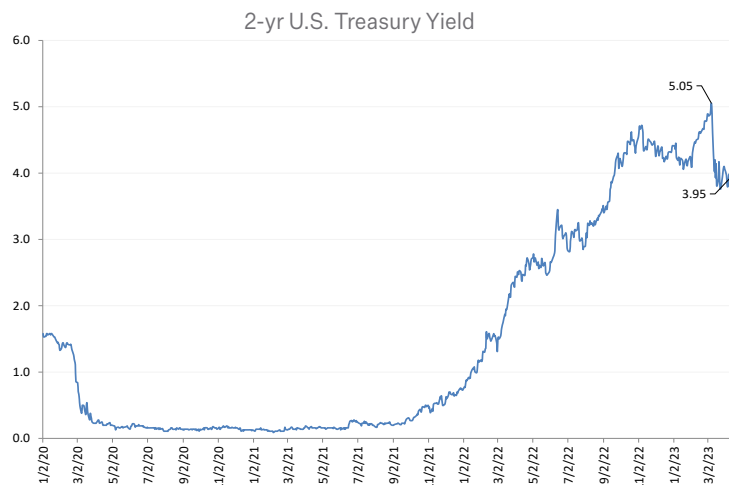
On Thursday, April 13, the producer-price index (PPI) for March was released and it showed a seasonally adjusted decrease of 0.5% over the previous month and an annual increase of just 2.7% for the 12 months ended March 2023. The so-called core PPI, which excludes energy, food, and trade services, rose 0.1% on a month-over-month basis and on an annual basis gained 3.6%.

U.S. Regional Banks

Last month all eyes were on the banking sector as three banks failed within a few days of each other, and fear of additional regional bank failures was top of mind. Since then, there have been no additional failures or forced mergers, but the financial health of the nation's regional banks has come into question. Questions center on the value of banks' assets due to rising interest rates (rates up, price down regardless of credit quality), as well as the credit quality of certain loans, particularly in commercial real estate. If depositors decide to pull money and banks are forced to sell their assets at losses, at a minimum the ability for banks to make new loans will be diminished. Any tightening of credit would slow down economic activity and assist the Fed in its efforts to tame inflation.

U.S. Treasury Rates

A chart of the daily yield on a 2-year U.S. Treasury shows how dramatically fixed income markets have altered expectations for the path of Fed rate increases. During the first full week of March, and prior to the mentioned banking challenges, the 2-year UST crossed 5.00% for the first time since June 2007. On April 12, the 2-year closed at 3.95%.



U.S. Department of the Treasury

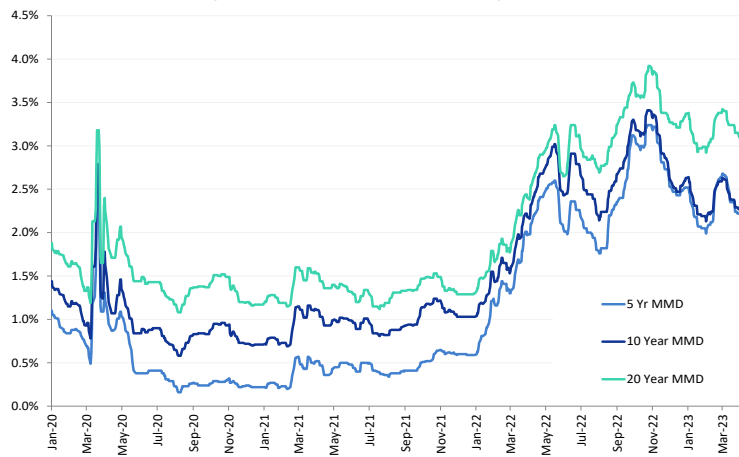
The Fed

As expected, the Federal Open Market Committee (FOMC) increased its overnight rate by 0.25% on March 22, bringing the federal funds rate range to 4.75%-5.00%. The next FOMC meeting will conclude on May 3 and barring something very unexpected, all indications are that the Fed will increase the rate by another 0.25% at that time. There is very little consensus for future Fed rate moves as the Fed has indicated that its actions will be data dependent and that its preferred measure of inflation is still running more than twice the target rate.

Municipal Market Update

Municipal bond rates have continued to trend lower since the beginning of March, responding favorably to several variables, including an investor flight to quality and safety after last month's bank failures. 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. Since March 1, yields on the below maturities have decreased by 0.61%, 0.51%, and 0.44%, respectively.

5-, 10-, 20-yr AAA MMD Yields | January 2020 - Current



REFINITIV MMD yields for 5-, 10-, 20-yr maturities, AAA-rated, General Obligation (5.00% coupon).

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.



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