

A Fed Pause or a Skip?

As expected, for the first time in 15 months the Federal Reserve (the Fed) did not change its overnight rate at a regularly scheduled Federal Open Market Committee (FOMC) meeting. Less expected was that the latest Summary of Economic Projections had a majority of FOMC participants indicating that appropriate monetary policy would include two more rate increases this year. While most market participants were hoping for a Fed pause, meaning that the Fed is done raising rates for this cycle, the Fed is projecting that June's meeting was a skip, meaning the Fed will need to raise rates yet again in 2023 to fight sticky inflation.

Labor Market

The May jobs report from the Department of Labor was released on Friday, June 2 and it estimated that non-farm payrolls increased by 339,000, which was another upside surprise and marked the third straight monthly increase. The report also included upward revisions to the March and April estimated job gains. Hourly wages for May grew by 4.3% over the past 12 months, which was down a tick versus last month.

Inflation Measures

On Tuesday, June 13, the May consumer-price index (CPI) was released with the data showing a continued divergence in the all-items (headline) CPI versus the core CPI. The all-items CPI showed a seasonally adjusted monthly increase of 0.1%, and an increase of only 4.0% over the past 12 months. This was the smallest annual increase since the period that ended March 2021, and a far cry from the 9.1% annual increase measured in June 2022.

The so-called core CPI, which excludes volatile energy and food prices, rose 0.4% on a month-over-month basis for the third straight month and on an annual basis gained 5.3%. A monthly increase of 0.4% is roughly consistent with an annual increase of 4.8%. To give a sense of just how sticky core-CPI has been the measure in June 2022 was 5.9%.

The Fed

The next FOMC meeting will conclude on July 26. Between now and then the Fed will have plenty of inflation data to mull over including personal consumption expenditures (PCE) on June 30, consumer prices (CPI) on July 12, and the producer prices (PPI) on July 13, which are all well before the next FOMC meeting date and could impact the Fed's next rate decision.

For those of a certain age, you might remember the Hans & Franz sketch from Saturday Night Live played by Dana Carvey and Kevin Nealon. One of their catch phrases was "Hear me now and believe this later." It appears that interest rate traders have finally decided to heed this timeless advice and believe Fed Chair Jerome Powell, who by most accounts has been consistently communicating to markets that the Fed will err on the side of over tightening in order to make sure

inflation is truly tamed. Last month we noted that interest rate traders still had a 40% probability of a Fed rate cut at the July 26 FOMC meeting. Probabilities after this week's FOMC press conference and the release of the Fed's quarterly economic projections effectively have a zero percent chance of a cut and more than a 70% likelihood of a rate increase in July. It looks like interest rate traders now believe the Fed is willing and able to pump up those puny rates in order to slow down still too hot wage growth and core inflation measures.

Municipal Market Update

Municipal bond rates have been generally range bound since the beginning of December last year. 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 December 1, 2022, yields on the 5-year have decreased by 0.13%, with the 10-year and 20-year essentially unchanged.

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).

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