Municipal Market Update
July 14, 2023

Inflation Progress Inches Along

The latest round of core inflation data, measurements that exclude volatile food and energy prices, continues its slow and steady march lower. However, with core inflation still substantially higher than the Federal Reserve's (the Fed), 2.0% target, and a labor market that continues to exhibit low unemployment and meaningful wage growth, there is still much work to do.

Inflation Measures

On June 30, the Fed's preferred inflation measure, the personal-consumption expenditures price index (PCE), was released for May. Over the past 12 months, headline PCE increased by 3.0%, while core PCE was up 4.6%, a tick lower than the 4.7% measured in April.

On July 12, the June consumer-price index (CPI) was released and the data came in a little better (lower) than expected giving some market participants' hope that July might be the last Fed rate hike of the year. The all-items CPI showed a seasonally adjusted monthly increase of 0.2%, and an increase of 3.0% over the past 12 months. Shelter was the largest contributor to the monthly all-items increase, accounting for over 70% of it. The core CPI rose 0.2% on a month-over-month basis and on an annual basis gained 4.8%.

Both the PCE and CPI data show a continued divergence between the all-items measures of inflation and core inflation, which is proving to be very sticky.

Labor Market

The June jobs report from the Department of Labor was released on July 7 and it estimated that nonfarm payrolls increased by 209,000. This was the first time in 15 months that nonfarm payrolls have come in lower than expected, and the April and May numbers were revised downward by 77,000 and 33,000, respectively. Hourly wages for June grew by 4.4% over the past 12 months, which was up 0.1% from May.

Financial Conditions

One worry certain economists have about this tightening cycle in particular is the efficacy of Fed rate increases to create sufficiently tighter aggregate fiscal conditions, which would slow down economic activity and price increases (monetary transmission mechanism). While the plural of anecdotes is not data, consider the following:

Pushing the 30-year fixed rate mortgage to near 7.0% has not yet dampened the housing market. With so many existing mortgages under 4.0% there is a reluctance by homeowners to sell and give up their low mortgage rate, which has helped to create a lack of supply of existing homes for sale. New housing units started has resumed its annual growth trajectory, which puts it at 1.4 to 1.8 million new units annually. Purchasers are likely either not materially affected by higher prices as evidenced by the substantial percentage of homes purchased with cash, or they are looking past this rate cycle and anticipate refinancing at a lower rate.

Both the 7-year and 10-year US Treasury have spent most of the year rangebound between 3.5% and 4.0%, one of several measures indicating subdued long-term inflation expectations. Corporate bonds are often issued in this maturity range and issuance year-to-date through June totaled $845.6 billion, which is up year-over-year by 0.5% (per SIFMA). Corporate bond spreads to US Treasuries have continued to tighten since March of this year and are consistent with longer-term levels (per ICE BofA US Corporate Index via FRED). This data indicates that on a national level US companies have not experienced new challenges accessing the bond market and are getting deals done at reasonable rates. This is not yet reflective of sufficiently tight financial conditions.

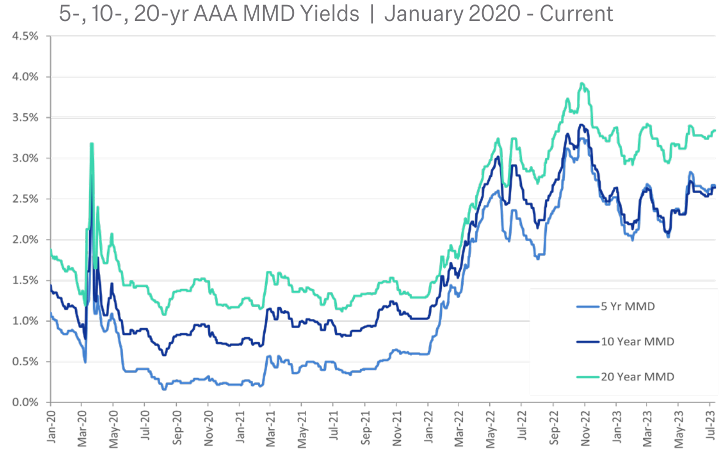
The Fed

The next Federal Open Market Committee (FOMC) meeting will conclude on July 26, and there is still wide consensus that the Fed will increase its overnight rate by 0.25%, bringing the range to 5.25%-5.50%. The latest round of inflation and labor data has lowered expectations for additional rate hikes this year.

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. Current rates for the below three maturities are very similar to those on December 1, 2022, down just 0.03% to 0.12%.

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).

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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