Feels Like Mile 20

A marathon is 26.2 miles, but runners have an old saying that a marathon begins at mile 20, meaning this is where the hard part starts. Some might say the Federal Reserve (the Fed) is at mile 20 on its inflation taming mission. Core inflation, measurements that exclude volatile food and energy prices, are slowly improving but are still in near 4.5% on an annual basis. For those who believe increases in wages is a conduit to inflation, employment costs continue to hover near 4.5%. To date, this tightening cycle has been easy for the Fed: raise rates, see inflation subside, all while unemployment is low and workers are seeing meaningful wage gains. Guiding the economy towards its 2.0% inflation target without a materially negative impact to the labor market could be the hard part.

Inflation Measures

On July 28, the Fed's preferred inflation measure, the personal-consumption expenditures price index (PCE), was released for June. From the same month one year ago, headline PCE increased by 3.0%, while core PCE was up 4.1%, which is substantially lower than the previous month's 4.6% annual increase.

On August 10, the July consumer-price index (CPI) was released and the data came as expected. The all-items CPI showed a seasonally adjusted monthly increase of 0.2%, and an increase of 3.2% over the past 12 months. The core CPI rose 0.2% on a month-over-month basis and on an annual basis gained 4.7%, down slightly from last month's 4.8%.

Labor Market

On July 28, the employment cost index was released for June. Compensation costs, which include wages, salaries, bonuses and benefits, increased a seasonally adjusted 1.0% in the second quarter versus the first quarter, and 4.5% over the 12-month period ending in June. These values are lower than first quarter results, which were 1.2% and 4.8%, respectively.

The July jobs report from the Department of Labor was released on August 4 and it estimated that nonfarm payrolls increased by 187,000, which is similar to June's revised 185,000 job gain. By most metrics these are steady job gains, but they continue to trend lower and for the second month in a row actuals were lower than consensus estimates. The unemployment rate ticked down to 3.5% from 3.6% the previous month. Hourly wages for July grew by 4.4% over the past 12 months, which is the same as June and higher than May's 4.3% annual increase.

The Fed

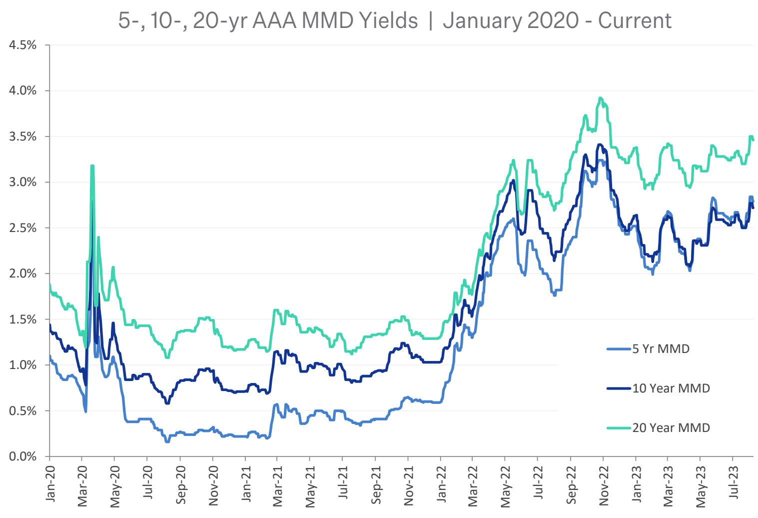
As expected, the July 26 Federal Open Market Committee (FOMC) meeting saw an increase to the overnight rate by 0.25%, bringing the range to 5.25%-5.50%. The next FOMC meeting will conclude on September 20, which allows the Fed to consider additional data including personal consumption expenditures (PCE) on August 31, a jobs report on September 1, consumer prices (CPI) on September 13, and producer prices (PPI) on September 14.

There is a growing perception that the Fed might be able to achieve its inflation goals by holding rates at current levels. Interest rate traders currently have 25% probability of one more rate hike in 2023, and 60% probability that there will be 0.25% to 0.50% of rate cuts from current level by the March 20, 2024, FOMC meeting.

Many economists believe that a key factor affecting inflation is the strength of the labor market, particularly the rate of increases in the cost of labor. As such, there is a line of thinking that the Fed will need to keep tight fiscal conditions until annual labor costs increases are closer to a 3.5% annual rate in order to have inflation near the 2.0% target. The concept being that increases in worker productivity, the output per hour worked, would offset a portion of the increase in work compensation. Most recently, nonfarm productivity was an annualized 3.7% in the second quarter.

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, up just 0.11% to 0.26%.



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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