

First Fed Rate Cut Pushed Back Again

The latest inflation report eclipsed consensus expectations for the third month in a row and markets responded accordingly. Bond yields increased, stock prices decreased, and interest rate traders now have only an approximately 50/50 probability of a 0.25% rate cut at the July Federal Reserve meeting.

Inflation Measures:

On Wednesday of this week the March consumer-price index (CPI) was released and again, the data came in a little higher than markets were expecting. The all-items CPI showed a seasonally adjusted monthly increase of 0.4% (0.6% unadjusted), and an increase of 3.5% over the past 12 months. More importantly from the Fed's perspective, the all items less food and energy index (core CPI) rose 0.4% on a month-over-month basis, matching the previous two months. A 0.4% seasonally adjusted monthly increase roughly equates to an annual increase of 4.8%. On an annual basis, core CPI gained 3.8%, which matched last month's reading. While annual core CPI measures have been falling since September 2022, the rate of change has slowed dramatically since the 4.1% increase posted for September 2023.

Labor Market:

The March jobs report was released on April 5, and the number of jobs created substantially exceeded economist expectations again and there was no downward revision to previous monthly data, which somewhat undercut the strong February payroll numbers. The Labor Department's establishment survey estimated nonfarm payrolls increased by 303,000 in March, while economist surveys had estimates near 200,000.

For those worried about inflation, there were silver linings to the jobs report. Average hourly earnings rose 4.1% from a year ago, which was the smallest gain since June 2021. The unemployment rate has been in a narrow range of 3.7% to 3.9% since August 2023, but this range is actually a little higher than the range over the previous 18 months. A U.S. economy that is generating strong monthly increases in the number of jobs at the same time wage increases continue to moderate, and unemployment has ticked a little higher, is not consistent with most economic models.

Commodities:

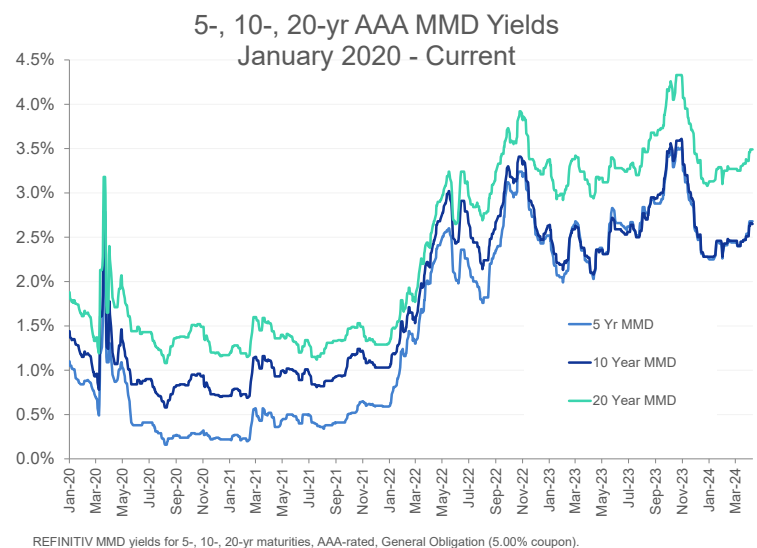
Investors are worried that this year's increases in commodity prices will be inflationary, further complicating the Federal Reserve's ability to cut its overnight rate. An index of global commodities prices, the S&P GSCI, has advanced 11.2% this year. Copper and oil have gained more than 10% and 16%, respectively.

The Fed:

The next two Federal Open Market Committee (FOMC) meetings conclude on May 1 and June 24, and in response to this week's CPI release, interest rate traders see little chance of a change in the Fed's overnight rate from its current range of 5.25-5.50%. Investors in interest rate futures currently have a 57% probability of a 0.50% in cuts by the December meeting. The Fed's most recent Summary of Economic Projections has the median voting member penciling in three rate cuts for 2024.

Municipal Market Update:

Tax-exempt municipal yields moved higher by about 0.25% over the past month, but are substantially lower than their recent peak on October 31 of 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.



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