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Municipal Market Update

September 19, 2025

Fed Cuts Rate Amidst Labor Market Concerns

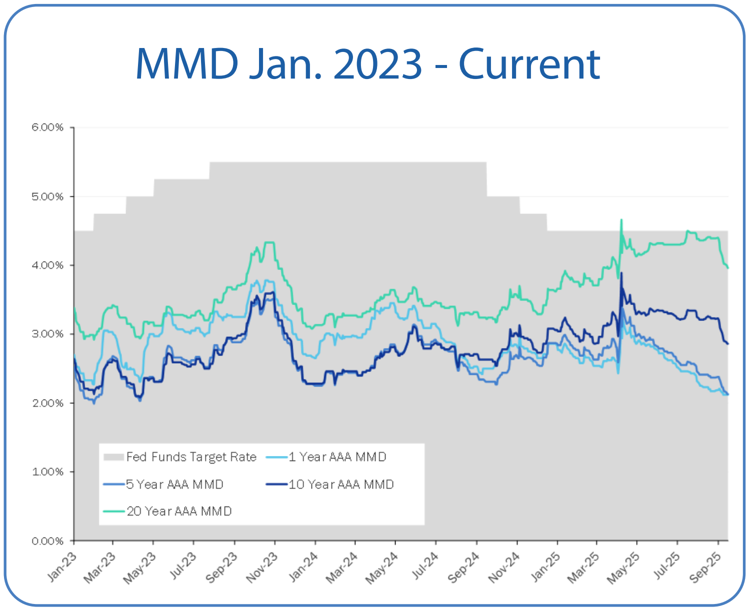
After nine months of holding the benchmark interest rate steady at 4.25%-4.50%, the Federal Reserve ("the Fed") chose to decrease the rate by a quarter of a percentage point to 4.00%-4.25%. Fears of inflationary effects from tariffs and uncertainty surrounding price increases had caused the Fed to refrain from shifting its benchmark until inflation approached the preferred 2.0% level. Despite inflation still being somewhat elevated, cracks in the labor market have forced the Fed to rethink its responsibility of risks and ultimately fueled its decision to begin what markets hope is a steady decline in rates over the next few years.

For most of the last three years, the Fed has focused on reducing inflation from the highs that followed the COVID-19 pandemic. That battle is far from over, with the latest Consumer Price Index (CPI) data showing a 0.4% increase in August and a surge to 2.9% over the last twelve months. Core CPI behaved similarly, rising 0.3% in August and up 3.1% over the year. Core Personal Consumption Expenditures (PCE), the Fed's preferred gauge for inflation, rose 0.3% in July and is up 2.9% over the year. While these metrics would typically warrant the restrictive monetary policy observed since last December, concerning labor market data forced the FOMC to follow through on the rate cuts first signaled in Fed Chair Powell's speech in Jackson Hole last month.

Employment data from the Bureau of Labor Statistics painted a concerning picture once August figures were released, as the economy added just 22,000 jobs in August, well below the expected 75,000. For comparison, the average number of jobs added in 2024 was approximately 168,000 per month. Employers cut 13,000 jobs in June, the first time the economy has lost jobs since 2020 . Additionally, the unemployment rate rose to 4.3%, the highest level observed since 2021. Economists can't pinpoint the exact cause for the number of jobless claims but widely attribute it to economic uncertainty surrounding tariffs and the notion that firms are slow to both hire and fire as they discern the capabilities of Artificial Intelligence.

While markets largely expected a 0.25% rate cut this month and are pricing in two more cuts this year, the path forward is strongly contested, even within the (Federal Open Market Committee (FOMC) itself. The dot plot, updated quarterly, shows that eleven of the nineteen members expected two rate cuts this year, while six expected one more rate cut. Median projections show expectations of one rate cut in 2026 and another in 2027 as the Fed prioritizes the labor market, although those projections vary widely within the committee. The Fed upgraded its forecast for US economic growth, expecting GDP to grow by 1.6% in 2025 instead of the 1.4% forecasted in June, but also expects unemployment to rise to 4.5% this year. The Federal Reserve's independence and its ability to make unbiased decisions have been under scrutiny in the last few months but claims that the Fed is becoming political were quickly dismissed by Powell in his latest press conference.

In the period between August 15th and September 17th, the 10-year Municipal Market Data Index (MMD) has declined 38 basis points (bps) and currently yields 2.86%. Treasury yields have lagged relative to the MMD, with the 10-year Treasury dropping by 27 bps in the same time frame and yielding 4.06%. The MMD curve has significantly flattened relative to where yields were earlier this year, as the longer maturities have experienced greater reductions in yields than those shorter on the curve. Improvement in MMD yields has come with strong demand from investors and increased confidence in the economy, as the four-week period ending September 10th saw the municipal market experience net new inflows of $7.989 billion. The graph below illustrates MMD rates since January 2023.



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If you have any questions regarding the bond market or your specific bond issue,
please do not hesitate to contact an advisor below.

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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