



Annual Consumer Price Index in line with Expectations

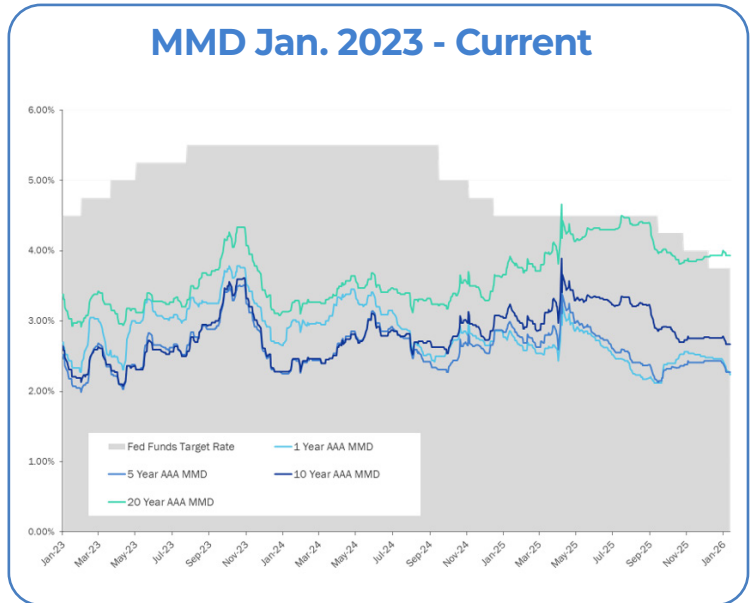
After year-long concerns of inflationary pressures and fears of an unstable economy, the December Consumer Price Index (CPI) was in line with expectations at 2.7%, setting the annual rate at the lowest since 2020. Despite progress in the battle relative to years past, inflation is still above the Federal Reserve's ("the Fed") target of 2.0%, with consumer headlines often discussing the affordability crisis across the nation. Core inflation, the Fed's preferred gauge, came in slightly better, ending the year at 2.6% annually. Moderate but persistent inflation, combined with a weaker job market, has made the Fed's rate decisions more difficult and has already led to dissent among members of the FOMC. Current predictions suggest a 95% chance that the Fed will not cut rates at its meeting on January 27th and 28th, while two rate cuts later in the year are on the table with no level of certainty.

The recent jobs and unemployment data reports have provided conflicting accounts of a labor market that is causing increasing concern for both the Federal Reserve and the Federal Government. The US economy added just 50,000 jobs in December, trickling down from the downwardly revised figure of 56,000 jobs added in November. The unemployment rate dropped to 4.4% in December after spiking up to 4.6% in November. Possible explanations for the November increase include a spike in government job cuts following the budget crisis, lower quality data during the government shutdown, and the emergence of a "low-fire, low-hire" economy.

Despite conflicting data and moderate readings for both sides of the Fed's dual mandate, Treasury yields have been relatively stable in the month since the Fed's last meeting. In the period between December 15th and January 14th, the 1-Year Treasury has fallen by 2 bps (basis points) and currently sits at 3.50%. Similarly, the 10-Year Treasury has fallen by 3 bps and currently sits at 4.15%. Yields spiked sharply on January 11th before adjusting for economic data after the Justice Department issued subpoenas to members of the Fed relating to mismanagement of funds used to update the Fed Office Buildings. Those subpoenaed include Federal Reserve chair Jerome Powell, who publicly stated his belief that the administration was trying to pressure him into lowering rates. Market forces strongly support an independent Federal Reserve, and any hints of movement to the contrary could cause Treasury yields to drastically shift upward.

Yields in the municipal market tell a completely different story as the MMD curve continues its pattern of steepening. From December 15th to January 14th, the 1-Year AAA MMD

has fallen 24 bps to 2.24%, while the 10-Year AAA MMD has fallen 9 bps to 2.67%. The graph below illustrates MMD rates since January 2023.



Municipal yields gaining strength relative to Treasuries early in the year is known as the "January effect". Investors in the municipal market often have unusually high cash balances after receiving principal and interest payments from their existing investments towards the end of the year prior. As these funds are reinvested back into the municipal market, high demand pushes yields down, creating a temporary mismatch between municipal bonds and Treasuries. The "January effect" can be observed in municipal mutual fund flows, with fund inflows for the 4-week period ending January 7th totaling \$7.714 billion, over \$3 billion more than the prior 4-week period. Historically, this phenomenon begins to taper off as the year progresses, and investors buy new bonds.



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