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Markets Remain Volatile as Observers Assess if Recent Action by the Fed Can Curb Inflation

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by Greg Johnson

The Federal Open Market Committee ("FOMC") last week approved a rare half percentage point rate increase to the target range for the federal funds rate and a plan to shrink its $9 trillion asset portfolio as part of a plan to combat inflation, which has been running at a 40-year high. This marks the largest single rate increase since 2000, increasing the target range for the federal funds rate to 0.75% – 1.00%.

Federal Reserve Chair Jerome Powell said at a news conference that officials broadly agreed additional half-point increases could be warranted in June and July given current economic conditions. Such actions would increase the rate range to levels last seen in 2019. Chair Powell also stated officials are not considering an even larger increase of three-fourths of a percentage point, or 75 basis points, at the FOMC's June meeting. In recent weeks financial markets seemed to have seriously considered the potential for this higher move, creating volatility in stock and bond markets.

The Labor Department released its jobs report late last week that revealed:

- The U.S. labor market added 428,000 jobs in April, matching March's increase. This marks the 12th straight month of gains above 400,000. Employers have added an average 552,000 jobs a month for the past six months.
- The unemployment rate remained at 3.6%, just above the pre-pandemic level of 3.5%.
- One reason the unemployment rate is low is that in order to be counted as unemployed, one must be actively seeking work. The labor-force participation rate—the share of workers with a job or actively looking for one—was 62.2% last month versus 63.4% in February 2020. It seems factors many thought would draw people back into the labor force, such as the availability of vaccines, the easing of Covid-19 concerns and the ending of enhanced benefits for the unemployed, didn't have as much of an effect as economists expected.

- Wage growth continues with average hourly earnings up 5.5% over the past year In April. These gains are well below the 8.5% increase in consumer prices. This year annual wage growth has remained in a range of 5.2% to 5.6%, but broader inflation has accelerated from a 7% annual gain in December.

The Fed has an ambitious task ahead to lower inflation without causing a recession. The Fed had expected supply chain problems from the pandemic would alleviate inflation concerns, but the war In Ukraine, Russian sanctions, and COVID lockdowns in China have all worsened the situation.

Cleveland Fed President Loretta Mester stated in an interview with Bloomberg this week a 75-basis point increase cannot be ruled out forever. "I don't want to rule anything out. When we get to that point in the second half of the year, if we don't have inflation moving down, we may have to speed up."

Financial markets have remained volatile as investors take stock of the Federal Reserve's ability to reduce inflation. Fed officials have commented they want to raise rates to the so-called "neutral" level that neither speeds up nor slows down the economy, which they estimate lies between 2% and 3%, and then assess if they need to go further.

The Federal Reserve Bank of New York on Monday released a poll that stated respondents believe inflation one year from now will rise by 6.3%, down from March's 6.6% level. The expected increase in gasoline prices one year from now is projected to hit 5.2%, compared to the 9.6% increase seen in March. Food and medical care costs twelve months from now were projected to increase by a smaller degree relative to the prior month; however, a 10.3% increase in rent was anticipated.

Trends in Municipal Bond Yields

Once again, week-over-week changes in AAA, tax-exempt yields were fairly uniform across the maturity spectrum.

The 10-year U.S. Treasury yield fell on Tuesday morning, dipping below the 3.00% mark, as fears of rising inflation and a potential economic slowdown lingered. It has since returned to just over 3.00%. The 10-year rate hit 3.17% in early trading on Monday, its highest level since November 2018. While municipal bond yields have lagged behind some of the larger moves in treasury yields, municipal bond yields have generally been following a similar trajectory.

Trends in Municipal Bond Yields April 8, 2022 to May 6, 2022					
AAA Yields*	**April 8, 2022**	**April 22, 2022**	**May 6, 2022**	**Change Since 4/8**	**Change Since 4/22**
5 Years	2.19%	2.48%	2.60%	0.41%	0.12%
10 Years	2.40%	2.69%	2.83%	0.43%	0.14%
20 Years	2.64%	2.91%	3.05%	0.41%	0.14%
30 Years	2.76%	3.04%	3.19%	0.43%	0.15%
Bond Buyer 20 Bond Index**	2.73%	3.19%	3.27%	0.54%	0.08%

Source:
** Bloomberg Valuation*
*** The Bond Buyer, average yield on a portfolio of municipal bonds maturing in 20 years, AA/Aa2 average rating*

Issuers still need to be mindful of long-term capital needs and investment. Please contact your Ehlers Municipal Advisor to discuss the current interest rate environment and evaluation of your capital and operational needs.

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