
WEEK IN REVIEW | REINHART FIXED INCOME BY MADISON INVESTMENTS

August 26, 2022

POWELL SPEECH

In a speech delivered at the Jackson Hole summit, Fed Chairman Jerome Powell made it very clear that the Fed's "overarching focus" is bringing inflation down to its 2% target rate. He noted that returning to price stability will likely require maintaining a restrictive policy stance for some time and that the historical record strongly cautions against prematurely loosening policy. Chairman Powell stated that while recent economic data are mixed, the economy continues to show strong underlying demand. He maintains his view that, depending on the incoming and evolving outlook, another unusually large rate increase could be appropriate at the next meeting. The Chairman concluded by noting the Fed is taking "forceful and rapid steps" to keep inflation expectations anchored and that it will keep at it "until the job is done."

Our Take: Price stability is the Fed's top priority, and it remains committed to raising rates as high as necessary and maintaining a more restrictive policy stance until it sees real progress against inflation. Powell's speech left little room for anyone trying to find a dovish pivot, a lower terminal rate, or a rapid shift to rate cuts next year.

INCOME & SPENDING

U.S. consumer spending rose 0.2% from June to July, a slower pace than expected. The Personal Consumption Expenditure (PCE) deflator fell 0.1% in July and was up 6.3% from a year earlier with the core measure up 4.6%.

Our Take: While spending and inflation may have decelerated in July, neither one moved enough to alter the Fed's tightening trajectory or to suggest a major shift in the U.S. economic picture.

CHINA

China announced 1 trillion yuan (\$146 billion) in additional stimulus that will mostly go towards infrastructure spending. This fiscal stimulus is in addition to last week's 10bps rate cut and increased loan growth goals for banks. Markets were largely unchanged on the news.

Our Take: The Chinese leadership is attempting to shore up growth that is suffering from Covid Zero lockdowns and a collapsing property market with fiscal and monetary stimulus. However, the leadership seems to recognize that continued credit growth is posing a risk to the Chinese economy and financial system. China is unlikely to sustainably return to the high growth levels of the past few decades and may face an economic downturn in the near term.

MUNICIPALS

The Texas Permanent School Fund's (PSF) Guarantee program, which guarantees bonds issued by public school districts and charter schools, is nearing capacity. As of the end of June, only \$3.9 billion was available, as \$110.15 billion of bonds were outstanding. The program is capped at \$117.32 billion under IRS rule. Currently, there are \$20.5 billion of voter-approved but unissued school district bonds in the state.

Our Take: Texas PSF officials have notified the U.S. Treasury and IRS that the program is almost at capacity. In 2009, the program was close to capacity and the IRS increased the program's limit. Many are hopeful that the IRS will increase the limit again, as issuers depend on the PSF guarantee to boost their credit quality. Without the PSF guarantee and its AAA rating, Texas school districts and charter schools with lower stand-alone credit quality could experience increased borrowing costs.



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