Taxable Money Market Commentary

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- At the December's Federal Open Market Committee (FOMC) meeting, the Federal Reserve (Fed) increased interest rates by 50 basis points (bps). This increase brings the federal funds target range to 4.25% to 4.50%. Markets currently expect the Fed to raise rates by at least an additional 25 bps hike in February and potentially an additional 25 bps in March 2023, bringing the projected terminal fed funds rate to a range of 4.75% to 5.00%. The FOMC statement pointed to three factors the committee is now considering when determining the pace and magnitude of future rate increases: cumulative tightening of monetary supply, the lags with which monetary policy effects activity and inflation, and economic and financial developments. The inclusion of financial developments suggests that all else equal, there is now more sensitivity to potential financial market spillovers.

- December's headline Consumer Price Index (CPI) rate of 7.1% was down 0.6% from the prior month and down from last quarter's 8.5%. While energy and vehicle prices continued to decline, some sectors have remained stubbornly elevated such as rents and service sector wages. Owners' equivalent rent is likely to remain high as cooling home prices will take time to pass through to the rent component. Core CPI, which excludes the more volatile components such as food and energy, decreased to 6.0% year-over-year from 6.3% last month.

- December's employment report continued the recent trend of strong results; however, slowing wages and a softer ISM report drove yields lower across the curve. December's nonfarm payrolls increased by 223,000 versus expectations of 203,000, but lower than November's 256,000 (revised down from 263,000). Private payrolls increased by 220,000, stronger than the expected 183,000. The unemployment rate dropped to 3.5% compared to expectations of 3.7% and again revisiting a 53-year low. The payroll gains were broad based, strongest again in education and healthcare services, leisure and hospitality, and manufacturing. The real surprise for markets was December's average hourly earnings, which dropped to 0.3% from November's 0.4% (revised down from 0.6%). Compounding the market's enthusiasm on softer wage data was December's ISM services print at 49.6, materially lower than expectations of 55.0. Additionally, new orders dropped to 45.2 from 56.0, the lowest reading since the pandemic and a sign that service demand materially faded at year-end.

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- Third quarter real GDP rose 3.2% quarter over quarter, up from -0.6% in the prior quarter. Consumer spending, the largest component of GDP, decelerated to a 1.4% annualized pace, from 2.0% the prior quarter. This was driven by a decline in goods spending, food and energy. Imports dropped while exports rose 2.8% as businesses liquidated inventories to better align expectations for slower demand with existing stock of unsold goods. Residential investment declined by 26.4% as interest rates on 30-year fixed mortgages rose to more than 7%, making homes less affordable. Regarding recessionary indicators, most of the key statistics that the National Bureau of Economic Research (NBER) analyzes have shown positive quarter-over-quarter increases: Real personal income (+0.9% over last six months), nonfarm payroll employment (+1.3% over the last six months), household survey employment (+0.0% over last six months), real consumer spending (+1.4% over last six months) and industrial production (+0.3% over last six months).

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