Madison INVESTMENTS

WEEK IN REVIEW | REINHART FIXED INCOME BY MADISON INVESTMENTS

July 29, 2022

U.S. ECONOMY

U.S. GDP fell at a 0.9% annual rate in the second quarter. Slower inventory builds and reduced residential investment were the largest drivers of the decrease. Slowing consumption was less of an offset, and a reduction in the trade deficit from record levels in the first quarter kept the decline from being even larger. Final sales to domestic purchasers declined for the first time since the pandemic. The GDP deflator increased, and the core personal consumption expenditures (PCE) deflator was at 4.4%, well above the Fed's 2% target. June consumer spending rose only 0.1% after a revised 0.3% drop in May, while real incomes fell 0.3% as the 0.5% nominal increase was less than inflation. The June core deflator was up 0.6% from May and 4.8% from a year ago. The Employment Cost Index rose 1.3% from the first quarter.

Our Take: The U.S. economy is slowing in response to reduced purchasing power from inflation and monetary tightening by the Federal Reserve (Fed). Even with the slowdown, inflation does not appear to be moving back into the Fed's target range. Given the persistence of inflation and the tight labor market, the Fed is unlikely to alter its monetary tightening trajectory. The U.S. economy is unlikely to rebound until inflation comes under control, and this is unlikely to happen without a further contraction and a loosening of the labor market.

FED

The FOMC (Federal Open Market Committee) by unanimous vote increased its benchmark rate this week by 75 basis points to a range of 2.25% - 2.50%. This is the second time the Fed has raised rates by an "unusually large" 75 basis points and is in line with its more aggressive stance on fighting inflation taken in the past few meetings. During his post-meeting statement, Chairman Powell noted that the Fed remains "strongly committed" to bringing inflation down and to "expeditiously" getting rates to a more neutral range. Further, the chairman commented that a "soft landing" has become more challenging in recent months, and that slower economic activity is likely necessary to temper inflation risks. Chairman Powell added that June's Summary of Economic Projections target fed funds range of 3.25% - 3.50% for year-end 2022 remains a good guide as to where the committee thinks rates need to be, implying additional rate hikes totaling 100 basis points are needed before the end of the year.

Our Take: Reining in inflation is the Fed's top priority and the committee's unanimous vote may signal there is still a lot of work to be done on that front. The Fed will likely continue to raise rates until it sees real progress against inflation, even as the economy moves towards recession.

MUNICIPALS

Moody's Investors Service upgraded Minnesota's issuer rating and general obligation ratings from Aa1 to Aaa. In addition, Moody's upgraded the state's annual appropriation and lease revenue bond ratings from Aa2 to Aa1. Moody's cited Minnesota's "track record of prudent governance that has driven growth in financial reserves and strong management of long-term liabilities" as reasons for the upgrade.

Our Take: Minnesota has taken steps to improve its fiscal health including growing its reserves and increasing pension contributions. This week's upgrade may lead to decreased borrowing costs in the future, which is good news for bondholders.

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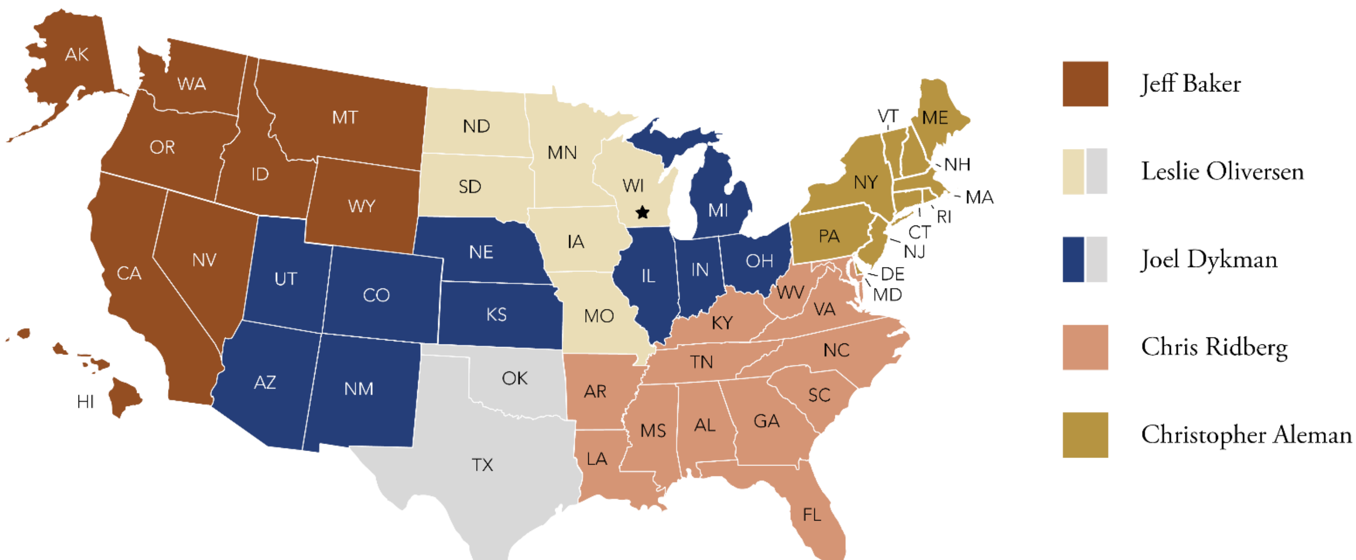

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