
WEEK IN REVIEW | REINHART FIXED INCOME BY MADISON INVESTMENTS

September 30, 2022

INCOME & SPENDING

August Personal Income rose 0.3% from July, which just kept up with inflation. The Personal Consumption Expenditures (PCE) Deflator rose 0.3% from July and 6.2% from August of 2021, while the Core PCE Deflator rose 0.6% from July and 4.9% from a year ago. Inflation adjusted spending on goods and services rose 0.1% from July with a continuing shift from goods to services.

Our Take: This report further indicates that consumer spending is slowing to just keep up with still persistent and broad-based inflation. The U.S. will likely see continued low or negative growth in the second half of 2022, but the Fed will need to continue its aggressive tightening to bring inflation back down to target levels.

UK BUDGET

UK Prime Minister Liz Truss and Chancellor of the Exchequer Kwasi Kwarteng released an interim budget that includes significant tax cuts and deregulation measures. While Truss and Kwarteng insisted that their plans would not lead to intermediate-term debt increases, they did not give details and did not include an analysis from the Office for Fiscal Responsibility. The pound fell significantly and rates on gilts spiked in response. The BOE had to intervene to ensure market functioning in longer dated gilts due to forced margin selling by pension plans.

Our Take: Truss and Kwarteng are seeking to make the UK more competitive and more attractive for investment by moving towards a regime of less taxes and regulation. While the medium and long-term merits of this strategy can be debated, the short-term impact of fiscal loosening through unfunded tax cuts during a period of high inflation is immediate and clear as capital markets respond by expecting more inflation and more monetary tightening to fight it.

EU INFLATION

Inflation in the Eurozone rose 10% from a year ago with core inflation rising 4.8%. Both readings were record highs and above consensus estimates. Lagarde told lawmakers that she expects the European Central Bank (ECB) to continue to raise rates at the next few meetings.

Our Take: The ECB will need to act decisively to bring Eurozone inflation down. Even if inflation there is more driven by a reduction in energy supplies than in the U.S., the ECB will still need to push demand down in response and will likely have to cause a more severe recession in order to avoid a prolonged period of high and entrenched inflation.

ITALY ELECTION

Following Sunday's elections, Italy looks set to be governed by a right-wing populist coalition led by Giorgia Meloni of the Brothers of Italy party. Meloni is a source of concern for many EU leaders due to some of her past statements and positions on a variety of social and economic issues.



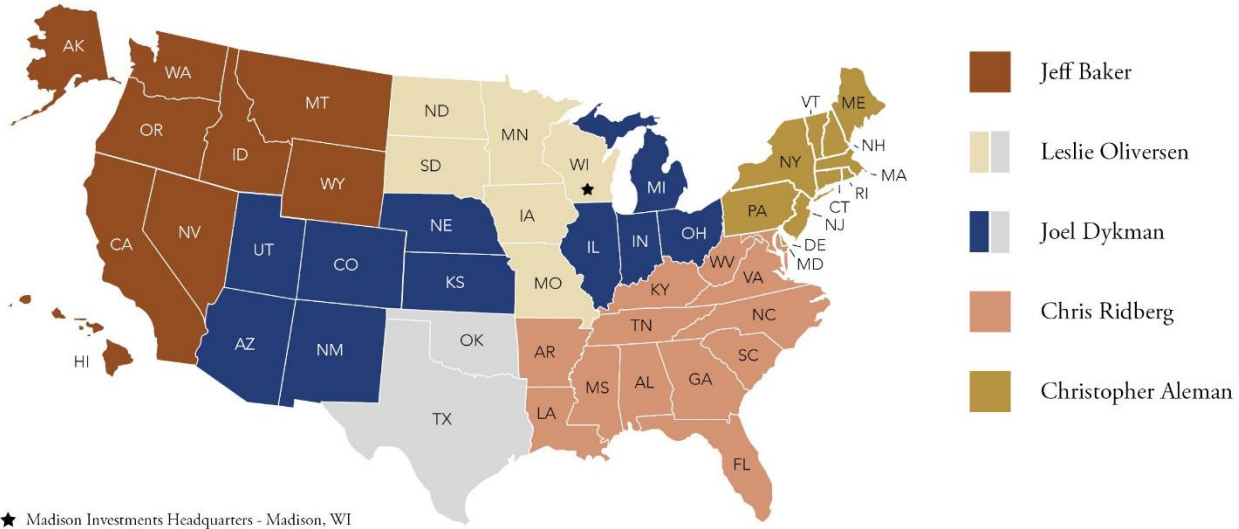
Our Take: Other EU politicians and investors will both be watching carefully to see what policies Meloni actually implements in Italy. There will be particular concern about Italy maintaining eligibility for ECB bond buying to prevent yields on Italian government bonds from spiking relative to yields on other Eurozone government debt.

MUNICIPALS

States are beginning to experience sales tax revenue declines according to a recently released report from the Urban Institute. There were 16 states that reported year-over-year declines in May and 25 states reported year-over-year declines in June. Many states experienced record sales tax and income tax collections in 2021.

Our Take: Federal stimulus funds along with strong spending led to increased sales tax receipts in 2021. Inflation and changing consumer trends have contributed to a decrease in 2022. Some states have already adjusted their current fiscal year tax collection estimates to reflect the recent declines.

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