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The Public Finance Outlook for 2023: Prepare to Slog

Disinflation and economic deceleration will dominate state and local budgets and investments. Cash is king, at least for a while. Payroll costs will outrace revenues. It's going to be a year for muddling through.

Last year's New Year's column capsulized the outlook for public finance for 2022 in one word: inflation. For 2023, it's almost the reverse, as disinflation — a slowing in the rise of prices — will be the backstory. But it will be a sticky and murky disinflation. With 12-month CPI measures still running hot, workers are not going to sit still for 2 percent pay increases, as much as the Federal Reserve might aspire to that number as its long-term inflation target.

Meanwhile, state and local government budget squeezes are coming, as softer revenues are expected from income, sales and property taxes. A soft landing for the economy is possible, but there is still a credible risk of worse. By spring, the global economy and business environment will feel like a muddy, mucky Ukrainian battlefield: prepare to slog.

Although it's now highly probable that the Federal Reserve will soon be able to escalate its overnight Fed funds interest rate to levels higher than the latest core inflation rates, that is just the first salvo in the central bank's battle to tame the multi-headed inflation hydra. As long as workers expect to see 5 percent pay raises this year, the overnight interest rate needs to hover at that level or above. Whether that pinches pocketbooks enough to auger a soft landing or pushes the U.S. economy into a recession, nobody truly knows. The two most important and encouraging mile markers that I'm now watching are the M2 money supply, which has gone flatline for six months now, and the private sector's unit labor cost increases, which declined to 2.4 percent in the third quarter. Now, that's genuine disinflation, which tells me we're on the right and cautious path.

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Jan. 3, 2023 • Girard Miller