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The Monday Morning Quarterback

A quick analysis of important economic data released over the last week

FOR IMMEDIATE RELEASE

Inflation and the Fed

The April Consumer Price Index (CPI) decline to 3.4% from 3.5% in March set off a stock market rally that pushed the Dow Jones Industrial Average to a record high for the market index of 40,000. Clearly the market is hoping and wishing for a reduction in the Fed rate. But is a slight one month decline a reason to believe the Fed will drop rates? We think not.

To be certain, we are seeing a slow decline in inflation. In 2023, inflation started at 6.4%; by December the rate declined to 3.4%. Inflation then declined further to 3.1% in January and February of this year suggesting that a Fed rate decrease may be possible. However, an increase to 3.5% in March dashed those hopes and the 3.4% rate in April did not help the situation substantially. So, we are just starting to see how difficult it might be to tame inflation down to the Fed's 2% target. As a result, the Fed is taking a wait and see approach to interest rate reductions, adopting the mantra of "higher for longer". A hike in interest rates is unlikely. Staying at the current rate of 5.25% to 5.50% until there is a firm and sustained downward trend in inflation is the direction the Fed is taking for now.

What exactly is causing the fluctuation in inflation? It might not be what most think. Looking at individual expenditure categories, the normally volatile food and energy categories are not causing the problem. For instance, inflation for food (which includes groceries and restaurant spending) increased by 2.2% in April. Groceries only increased by 1.1% in April (year over year) while inflation at restaurants increased by 4.1%. Between March and April of 2024, groceries actually declined by -0.2%. When the inflation rate declines below zero, it is known as deflation, something we have not seen in recent years (other than in gas prices). The energy category also increased at a low rate of 2.6%.

The problem with controlling inflation is in the categories known as "Core Inflation" - everything else excluding food and energy. Core inflation makes up 80% of the weighting of the CPI. Core inflation grew by 3.6% in April 2024. While some categories such as used cars and trucks were down -6.9%, housing (known as "Shelter" in the CPI) increased by 5.5%.

Shelter makes up 36% of the CPI weighting and is the primary reason we are seeing rates remaining above 3.0%. Across the nation, we are seeing a shortage of housing relative to household creations. The Arizona Department of Housing estimates that 270,000 housing units are needed to help alleviate cost burdened households in the state. Unfortunately, as long as housing demand outpaces supply, we may continue to see inflation remain above the Fed's target inflation rate of 2.0%.

Remarkably, the current inflation rate in Greater Phoenix is lower than the national average. The CPI for Phoenix is produced every two months starting in February of each year. In February 2024, the Phoenix CPI was 2.2% (compared to the national average of 3.1%) as the housing market cooled to some extent. While this is good news, it does not offset the 13% inflation rate experienced in mid-2022 in Phoenix while the national CPI rate topped out at 9.1%.

The Fed anticipates as of their March forecast that they will make three 0.25% rate reductions in 2024. We will see. Some observers anticipate a reduction in July. However, this is a monthly process for the Fed of reviewing data and anticipating where the economy and inflation is going. They do not want to make the mistake of decreasing rates and then seeing inflation raise its ugly head. While we hope to see reduced interest rates this year, until we see a sustained decrease in inflation the Fed may continue to hold rates at the current level.

U.S. Snapshot

- The Conference Board Leading Economic Index saw a decline of 0.6% in April following 0.3% in March. The LEI indicates softer economic conditions pushing real GDP growth below 1% for the next two quarters.
- Retail sales were flat in April after a strong 0.6% growth in March. This continues the trend of softer second-quarter growth.
- Industrial production was unchanged in April but was down 0.4% from a year earlier. Capacity utilization was down for the month and 1.7% from a year ago.
- Total permitting activity in the U.S. declined 3.0% in April while single family permits were down 0.8% for the same period. The number of total starts jumped by 5.7% in April. The increase was entirely driven by multi-family housing as single family saw a 0.4% drop for the month.
- Mortgage rates averaged above 7% and pushed builder confidence down by 6 to 45 in May. Higher rates have added pressure on potential buyers and forcing them to delay or stop purchasing a home altogether.

Arizona Snapshot

- Not seasonally adjusted employment was released last week, with positive movement for the state by adding 12,900 jobs. Greater Phoenix contributed 10,100 jobs to the total while Greater Tucson added 300 in the month of April.
- The majority of employment gains were in Private Education & Health Services with 4,800 jobs followed by Professional & Business Services at 2,000 jobs. Only the manufacturing sector lost jobs (400) in April.
- Seasonally adjusted employment data shows Arizona employment grew by 9,800 jobs in April bringing the 2024 total to 31,900 jobs added. Year-to-date, Greater Phoenix has added 20,100 jobs while Greater Tucson has gained 900 jobs.

- The seasonally unadjusted unemployment data shows Arizona with a 2.6% unemployment rate (3.6% S/A) Greater Tucson and Greater Phoenix have lower unemployment rates at 2.5% and 2.3%, respectively.
- RLBrownReports.com released April data for Greater Phoenix and Greater Tucson and permitting activity has improved significantly from the beginning of 2023.
 - Greater Phoenix saw more than 2,400 permits in April, up by 55% from a year ago. April's total brought the year-to-date increase to 76%. Similarly, Greater Tucson saw nearly a 50% increase in April while the number of permits issued are up by 90% in the first four months of the year.
 - New home closings continue to fare better than resales. Greater Phoenix has seen an increase of more than 6% in new home closings in 2024 while the number of resales has declined by 3% for the year. Similarly, in Greater Tucson new home closings are up nearly 9% while the number of resales is down by nearly 6% in 2024.