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The Monday Morning Quarterback

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

FOR IMMEDIATE RELEASE

Fed Rate Cuts on the Horizon?

Several prominent economists are calling for the Fed to cut its interest rate because it is undermining the process of bringing down inflation. The problem is that the Consumer Price Index (CPI) places more than one-third of its calculation on what is referred to as “shelter” which includes both rent people pay and an implied cost of homeownership. The issue is two-fold:

- As long as interest rates remain high, the cost of shelter will remain high. As we noted in the last MMQ, shelter is heavily weighted at 36.2% of the entire CPI calculation; the implied cost of homeownership represents 26.8% of the CPI estimate. The Bureau of Labor Statistics estimated the shelter inflation factor in April at 5.5%. As long as shelter costs as calculated for the CPI remain high, bringing overall inflation down to the 2.0% Fed preferred range will be difficult.
- The cost of homeownership as measured in the CPI is flawed because many homeowners don't have a mortgage or have a fixed rate mortgage meaning their actual costs don't change much. The CPI estimate of homeownership costs is based on the rents that renters are paying. While rents may be rising, that does not mean the cost of homeownership is also rising as well for most owners. For the 65% of households that own their home in the U.S., housing costs have likely remained fairly stable over the last few years.

Overall, the economists are saying the Fed's stance on the interest rates has tightened the supply of housing by making it harder to build homes and by discouraging homeowners from giving up their low mortgage rates. This ultimately drives up the measure of inflation and does the opposite of the Fed's goal of driving down inflation.

Other countries have started to reduce their interest rates in the last few days. The Bank of Canada reduced its rate from 5.00% to 4.75%, its first cut in four years. The European Central Bank (ECB) also announced its first interest rate cut in five years, slightly lowering it from 4.0% to 3.75%.

It may also be wise for the media and the public in general to focus more on the Personal Consumption Expenditure (PCE) Index rather than the CPI. The PCE is the preferred measure of inflation by the Fed but does not make front-page news. The PCE is constructed differently and readjusts its relative weightings or importance of cost items on a regular basis. For instance, the PCE weights housing at 15% of the total PCE instead of the CPI's 36%. For April, the CPI

clocked in at 3.4%; the PCE estimated inflation for April at 2.7%, close to the Fed's goal of 2.0%.

The Fed is in a difficult position. They want to make sure inflation will not rise again and cause more harm to the economy over the long term. Alternatively, they may need to recognize there are flaws in the most recognized inflation gauge (the CPI) and adjust their thinking on the progress they have made to date.

Please see below some economic highlights since our last update.

U.S. Snapshot

- The U.S. economy surpassed expectations with 272,000 new jobs added in May. The majority of jobs created were in the Private Education & Health Services supersector (86,000) followed by 43,000 in Government and 42,000 in Leisure & Hospitality. Despite negative revisions to April (-10,000) and March (-5,000), the U.S. economy has added an average of 249,000 jobs in the last three months or a 248,000 average year-to-date. While 2024 job growth is below last year's average of 299,000 jobs, the current job market remains stronger than expected.
- The resiliency of the job market has started to reduce the number of job openings according to the latest data available. The number of job openings declined 3.5% for the month to 8.1 million in April. This was down 18.6% from last year and well below the peak of 12.2 million in March 2022.
- ISM's Manufacturing PMI continued to show some weakness in the sector as the index declined again in May and remained below 50 for the second month in a row. The Services PMI bounced back in May to 53.8 after dipping below 50 in April (49.4). Signaling growth of the overall economy driven by consumer spending.
- Despite income growth, American consumers lowered their spending in April. Personal income was up 0.3% in April. This was below the 0.5% increase seen in March. Personal consumption expenditure was up 0.2% after an increase of 0.7% in March.
- The Conference Board Consumer Confidence Index increased to 102 after three months of declines in May. The index was up 4.6% for the month and down 0.5% from a year ago. The confidence boost was based on a strong labor market.
- Consumer credit increased by \$6.4 billion in April. The increase was driven by an increase of \$6.8 billion in nonrevolving credit while the amount of revolving credit decreased by \$0.5 billion.
- The latest figures from the National Association of Realtors continue to show sales at a sluggish pace as buyers continue to deal with low inventory and higher prices and interest rates. The seasonally adjusted annual rate in April dropped 1.9% for the month as prices increased 3.7% in the same period. Single family sales saw a decline of 2.1% and price decline of 3.9%.

Arizona Snapshot

- According to the Cromford Report, the number of listings was nearly unchanged in May as Greater Phoenix saw an increase of 0.2%. The number of resales was up 6.6% to 7,500 while the median sales price remained at \$450,000, up 3.7% from a year earlier.
- The Case-Shiller Home price index for Greater Phoenix continued to show price growth in March, up 4.9% for the year. The composite 20 city index increased 7.4% during that period while the U.S. index grew by 8.2%. San Diego (11.1%) and Los Angeles (8.8%) led the nation in annual gains in March.