

COSTAR ECONOMY

The Federal Reserve Moves One Step Closer to Declaring Victory

Moderating Inflation Approaches Government Target



By Christine Cooper and Rafael De Anda
CoStar Analytics

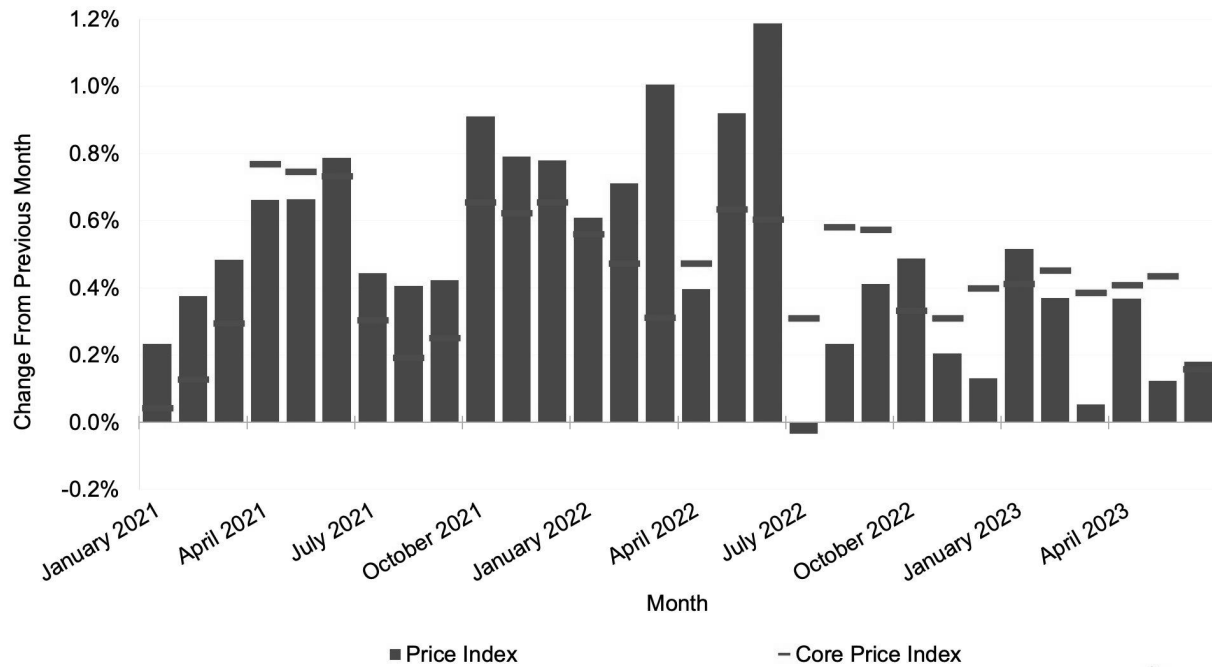
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Inflation continued to moderate in June as consumer prices grew by 0.2%, according to the Bureau of Labor Statistics.

The core price index, which excludes the volatile food and energy categories and had remained stubbornly above 0.4% for much of the last two years, also decelerated to just 0.2%, a significant dropoff from the prior month.

Compared to a year ago, the consumer price index is 3% higher and the core price index is 4.8% higher— both continuing to approach the Federal Reserve’s 2% target rate.

Core Inflation Is Finally Returning to Norm

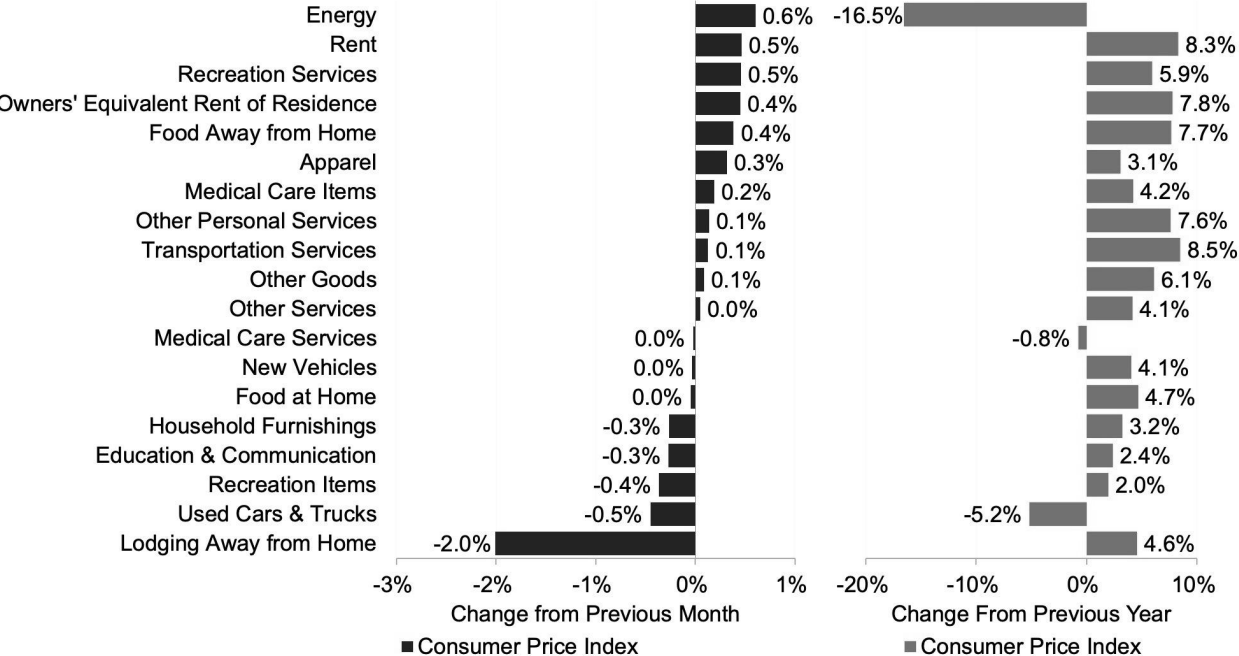


Source: Bureau of Labor Statistics, June 2023



The slowdown in inflation in June was broad-based across sectors, including some such as travel costs that had seen stronger growth recently as pandemic effects faded. Prices for lodging away from home fell by 2% June from the prior month, while airfares and car rental costs, grew by just 0.1%.

Housing Inflation Remains Elevated



Source: Bureau of Labor Statistics, June 2023



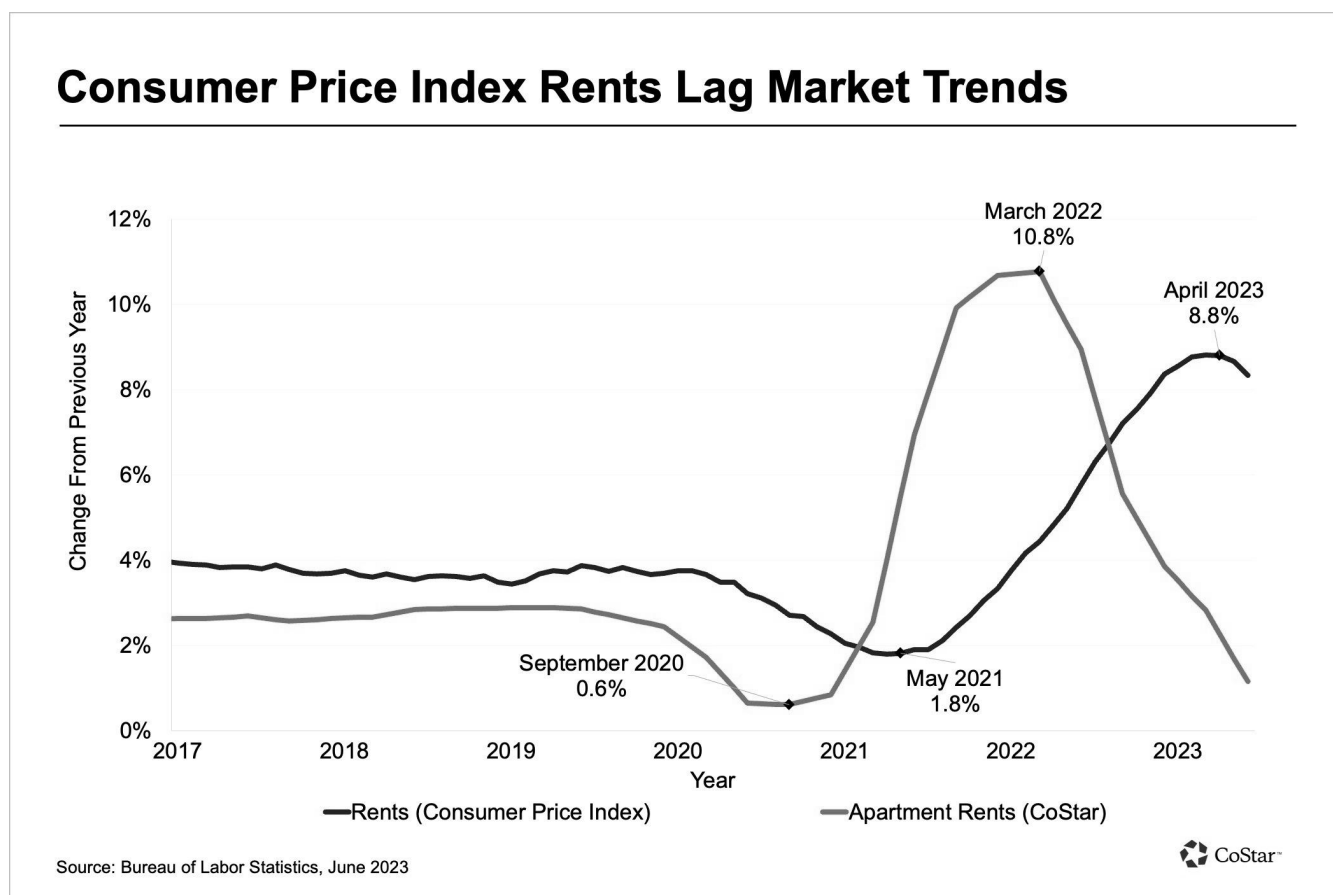
Prices at grocery stores were flat over the month, but 4.7% higher than a year ago. Restaurant prices, however, which are more responsive to labor costs, rose by 0.4% and were still a strong 7.7% higher than last year. These prices don't include tipping, which has become more common in casual-restaurant environments and food delivery.

Prices of cars and trucks have been a large driver of inflation over the past two years as inventory shortages plagued production. Demand has yet to return to pre-pandemic levels because of that pricing, but that seems to now be normalizing. New vehicle prices were flat in June, while prices of used cars and trucks prices fell by 0.5% and were 5.2% lower than a year ago.

Other signs point toward inflation continuing to cool. Shelter costs account for more than a third of overall inflation and rose by 0.4% in June, accounting for more than 70% of the rise in the all-items index this month. Owners' equivalent rent, which is a measure of how much a property owner would have to pay in rent for their home, accounts for almost a quarter of inflation and rose 0.4% over the month, while actual rents, accounting for 7% of the index, stepped 0.5% higher.

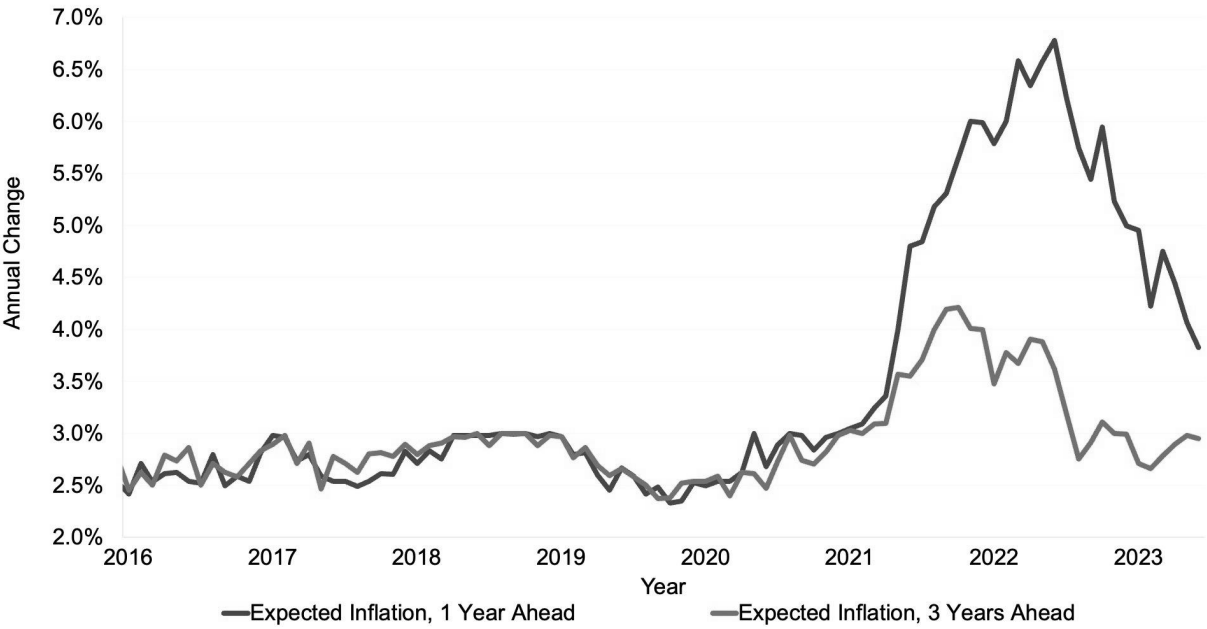
The disconnect between shelter costs as reflected in the consumer price index and what is occurring in the broader housing market suggests that more deflation is coming.

Asking rents for apartments peaked earlier in the year, according to CoStar data, but these appear to lag in the consumer price index by eight to 12 months. This discrepancy is largely due to differences in methodology, as the consumer price index collects current rents in a sample of rental units every six months, while CoStar captures real-time rent observations, including those on newly signed leases. We expect CPI rent growth to continue to decelerate through mid-2024.



Consumers seem to agree that inflation is on its way down. The median consumer expectation for inflation a year from now has fallen from 6.8% a year ago to 3.8% in June, according to the Federal Reserve Bank of New York. Households also feel better about the longer-term picture of inflation, with their median expectation for inflation three years in the future down to 2.9%, in pre-pandemic range (below 3%) since last August.

Inflation Expectations Fall Sharply

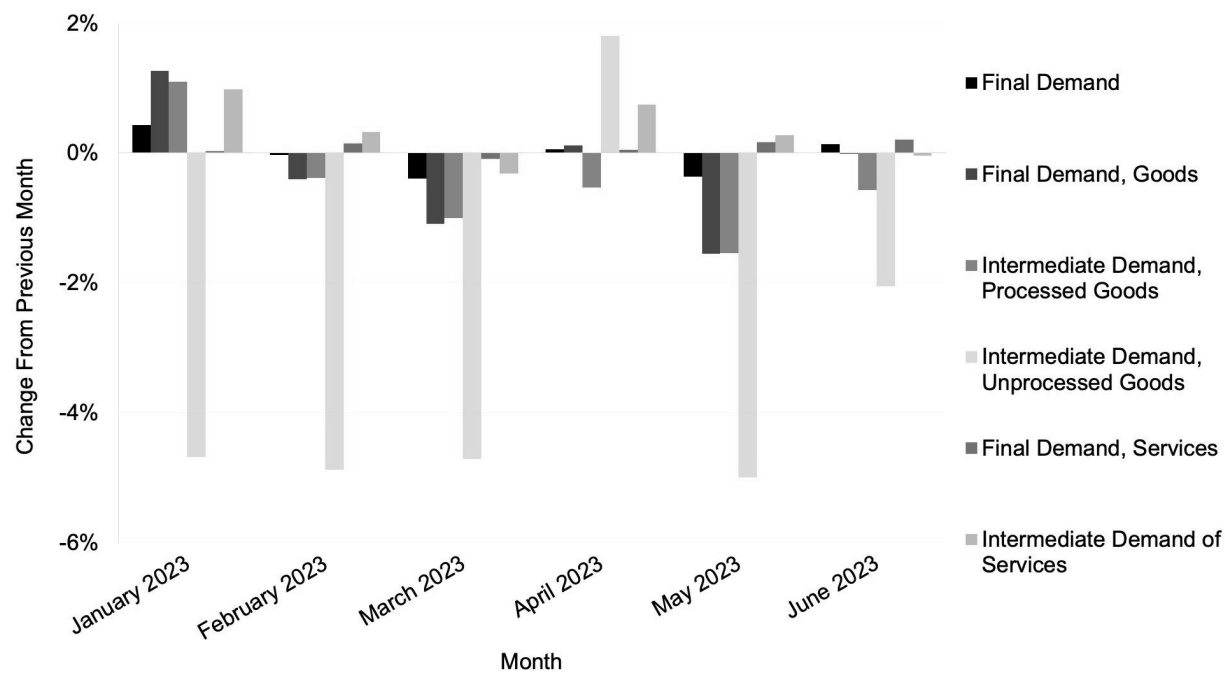


Source: Federal Reserve Bank of New York, June 2023



The supply-side also suggests that inflation will continue to cool. Wholesale prices grew by 0.1% as measured by the producer price index for final demand. While final demand draws the headlines, wholesale prices further up the production line, particularly for goods, is exhibiting even more softening due to energy costs, which have declined over the year, and to easing of supply chain backlogs. The price of final demand for goods was flat in June, and prices for processed intermediary goods, which tend to lead prices of final goods, fell by 0.6% in June. Even further up the production line, prices of unprocessed intermediate goods fell by 2.1% in June after dropping by 5% in May.

Wholesale Prices Are Flat



Source: Bureau of Labor Statistics, June 2023



On the services side, prices for final demand grew by 0.2%, while prices of intermediate demand of services were flat in June. These prices are more closely tied to labor costs, which have started to outpace inflation.

What We're Watching ...

The big story of the past two years has been the resilience of the consumer. Despite our desire to be past it, we're still recovering from the effects of the pandemic, including the impacts of the shutdowns and of restrictions on many activities and of the massive fiscal stimulus meant to stave off a potential pandemic-related depression.

Consumers have been stalwart in the face of these headwinds, continuing to support the economy. And that continues. Retail sales rose for the third consecutive month in June, suggesting consumers are tolerating inflation and still have the capacity to spend. Not only that, but they seem to be feeling pretty cheerful, with consumer sentiment still on the rise, according to the University of Michigan's latest survey findings.

We're closely watching for a loss of confidence among either consumers or businesses, as once those turn sour economic conditions tend to deteriorate. So far, so good.

CoStar Economy is produced weekly by Christine Cooper, managing director and chief U.S. economist, and Rafael De Anda, associate director of CoStar Market Analytics in Los Angeles.
