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All Eyes on the Fed

May 31, 2023

Economic data, and particularly inflation data, continue to describe an economy running hotter than the nation's central bank wants, given its target of 2% inflation. After a slightly improved 4.6% Core PCE inflation rate in March, the data accelerated slightly to a 4.7% rate in April. Consequently, markets are pricing in a solid possibility of an additional rate hike in June or July. Another hike would require changes to previous forecasts (including the NAHB economic outlook) that the May increase to top the federal funds rate of 5.25% was the end of the tightening cycle.

The challenge for the Fed is that the inflation data is lagging. Indeed, shelter inflation is likely to trend lower in the months ahead as real-time data for rent show a slowing pace. Moreover, a significant number of apartments will be placed into service in the next few quarters, as the number of multifamily units under construction is the highest since 1973. Despite these headwinds, the newly revised NAHB Multifamily Production Index held at a neutral reading of 50 during the first quarter of the year.

Moreover, higher short-term interest rates will lower the availability of acquisition, development and construction loans. Indeed, NAHB surveys indicate that the average annualized rate for spec single-family home construction financing was 12.6% in the first quarter of 2023. Higher rates mean reduced supply, which in turn produces the opposite effect on inflation than the Fed intends. And this is in addition to the fact that higher rates will produce additional bond losses for regional banks, which could result in a financial crisis.

The repricing of monetary policy risk, combined with concerns over the last-minute debt ceiling fight, has increased the 10-year Treasury rate from 3.4% in mid-May to above 3.8% at the end of last week. Fortunately, the debt ceiling "deal in principle" has relaxed bond markets and caused some retreat for interest rates. Before that recent rise, mortgages rates averaged below 6.4%.

The lack of resale inventory (a very low 2.9-month supply) coupled with lower rates helped boost new home sales. Sales of newly built, single-family homes in April increased 4.1% to a 683,000 seasonally adjusted annual rate. Despite the gain, sales are down almost 10% on a year-to-date basis. The median new home sale price fell in April to \$420,800, down 8% compared to a year ago. In March, 33% of homes listed for sale were new homes in various stages of construction. That share from 2000-2019 was a 12.7% average.



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Whether the recent improvement for the housing outlook is sustainable is dependent on the interaction of monetary policy and long-term interest rates. It is growing more likely the Fed will increase again at its June meeting. Yet, lowered growth expectations because of tighter policy will reduce long-term rates.

Amidst the uncertainty, it appears the chance of the Fed making a mistake is as high as it has been during this cycle. Now more than ever, more single-family housing would help reduce shelter inflation and could be spurred by more effective fiscal and regulatory policy. In that vein, last week’s 9-0 Supreme Court decision that forces the administration to overhaul its proposed “waters of the U.S.” regulation and enable more permitting is certainly good news for housing.

-NAHB Chief Economist Robert Dietz

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