RESEARCH BRIEF

Marcus & Millichap

INFLATION JULY 2023

Core Inflation Cooling but Still High, Supporting Likely Fed Rate Hike

Inflation continuing to trend down. The headline consumer price index climbed by 3.0 percent year-over-year in June, the smallest increase since March 2021. A 16.7 percent decline in energy costs helped slow the overall inflation rate to a third of its June 2022 peak. However, prices for other categories of consumer goods and services, such as housing and medical care, continue to ascend. Core CPI inflation, which omits more volatile food and energy costs, rose by 4.8 percent year-over-year in June. While also down from a previous peak of 6.6 percent last September, core inflation is still above both the headline rate and historical norms. Resolving these core pricing pressures will take time, given the structural nature of the underlying challenges, but positive signs are emerging.

Housing dynamics a key part of the inflation story. Despite softening slightly from May, the shelter index that tracks various housing costs continued to climb in June and was the largest overall inflation contributor that month. The index tends to lag market conditions, however, and more recent data points to further softening in pricing. While the median sale price of an existing single-family home jumped 16.5 percent in 2021, the same metric only advanced 1.9 percent in 2022 and was down year-over-year in May. Multifamily rent momentum has also cooled. After rising by a combined 26 percent in 2021 and 2022, the national average effective rent for an apartment has only inched up 1.5 percent through the first six months of this year. While long-term housing demand continues to exceed supply, residential markets are undergoing a recalibration in the short-run. Post-lockdown, household formations surged, but that pace has now retreated. Elevated inflation played a part in that drawback, and the extent to which softening shelter costs facilitate new formation will be an important economic signal.

Cheaper fuel to aid retailers and hoteliers. While not included in the core CPI calculation, energy costs are a very real household budget item. Sustained decreases in the cost of gasoline, oil and gas utilities from 2022 peaks will allow households to allocate funds elsewhere. This may aid household formations, as well as consumer spending, benefiting apartments and retail properties. Travel may also pick up, aiding hotels. Airline fares fell 6.5 percent in June from May, which, when combined with more affordable gas, may encourage more trip taking. Already, airport passenger traffic is back on par with 2019 levels.

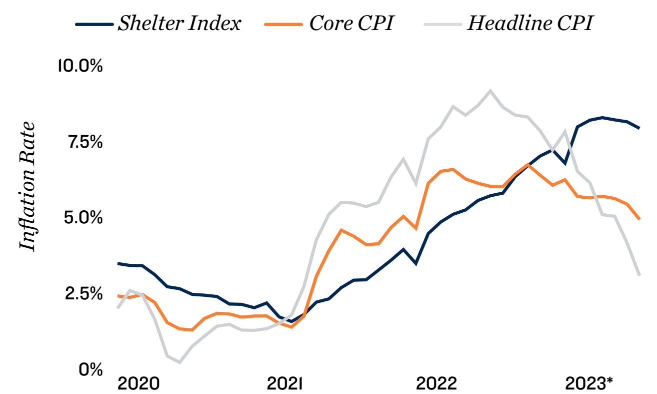
Monetary Policy Implications

Core inflation trend larger consideration for the U.S. central bank. While headline CPI inflation has fallen to just 80 basis points above its 2000-2019 average, for the Federal Reserve, core inflation is the greater focus. The Fed's preferred inflation measure is the core personal consumption expenditures index, which they try to keep near 2 percent over the long run via their monetary policy decisions. The most recent core PCE measure was 4.6 percent in May, well above that target. While the inflation metric is likely to have slowed last month, as its movements are correlated with core CPI — which tapered in June — pricing pressures remain well above desired levels.

Fed rate hike still likely later this month. One factor contributing to inflation persisting above what the Federal Reserve prefers is a historically low unemployment rate of 3.6 percent. The tight labor market is in turn supporting above-average wage growth, last noted at 4.4 percent in June. As such, market participants continue to favor a 25-basis-point increase by the Federal Reserve at its late July meeting. This would bring the overnight lending rate up to a lower bound of 5.25 percent, its highest level since March 2001.

3.0%	*Increase in Headline CPI Year-Over-Year*	4.8%	*Increase in Core CPI Year-Over-Year*

Key Inflation Pressure Plateauing



** Through June*
Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CME Group; Federal Reserve; RealPage, Inc.; TSA