Economic Update

SVN | Research

MAY 12, 2023

1. CPI INFLATION

- US annual inflation continues to decelerate through April. As reported by the BLS, the Consumer Price Index grew 4.9% year-over-year as of the most recent reading. The current pace of growth indicates a slowdown compared to the 5% year-over-year growth witnessed in March, signaling a gradual easing of inflationary pressures.
- Despite overall signs of cooling inflation, shelter costs, up 8.1% year-over-year, remain a sore spot.
- Conversely, prices for airline fares, new cars, and communication declined throughout the month, providing some relief to consumers. Food prices have remained relatively stable, with grocery store prices generally decreasing while the cost of eating out has continued to rise.

2. RENTER VS. HOMEOWNER INFLATION

- Personal inflation rates can differ widely depending on whether someone rents or owns their home. According to Chandan Economics' latest calculations, the adjusted CPI for renters was 4.9% year-over-year in April, its slowest annual pace since April 2021.
- Meanwhile, the adjusted CPI for homeowners held steady at 2.4% year-over-year in April, remaining virtually unchanged from March.
- Inflation rates are adjusted for each group, stripping rental costs for homeowners and homeownership costs for renters. Further, the calculation assumes that fixed-rate homeowners would not feel the impact of higher shelter costs, given that they have already locked in monthly housing expenses that do not change.
- The inflation spread between these two groups fell for the first time in nine months in April. However, the difference between renter and fixed-rate homeowner personal inflation rates remains near their all-time high, currently sitting at 2.6 percentage points.

3. FOMC INTEREST RATE DECISION

- On May 3rd, the Federal Reserve's policy-setting committee raised their target Federal Funds Rate (FFR) range by 25 basis points to 5.00%-5.25%, electing to continue tightening the economy's financial valves as it tries to bring inflation down.

- The FOMC's policy decision arrives amid heightened concern and volatility in the banking sector, which saw three high-profile bank failures over the past six weeks. Despite the most recent collapse—that of First Republic Bank—occurring just 48 hours before the FOMC's decision, the committee decided to proceed with a rate hike based on the belief that liquidity backstops continue to function for the banking sector despite the recent panic.
- In their accompanying meeting statement, the committee acknowledged that tightening credit conditions will likely weigh on households and businesses in the weeks and months ahead, placing downward pressure on hiring and inflation. Fed Chair Jerome Powell suggests that the committee will take a "data dependent" approach to their upcoming rate decisions, making May's employment, inflation, and expectations data paramount to the future path of monetary policy.

4. SENIOR LOAN OFFICER OPINION SURVEY

- Results from the Federal Reserve's quarterly Senior Loan Officer Opinion Survey (SLOOS) released on May 8th indicate that lenders are increasingly worried about near-term financial conditions as recession fears rise amid banking sector distress.
- During Q1 2023, the percentage of lenders indicating tightening standards increased across several key loan types. A net 46.0% of large and medium banks and 46.7% of small banks signaled tighter standards for Commercial and Industrial loans in Q1 compared to Q4 2022, up slightly from 44.8% and 43.8%, respectively.
- The net percentage of lenders indicating tightening standards for Commercial Real Estate loans similarly increased across all sub-types. A net 73.8% of banks showed tighter lending standards for construction and land development loans in Q1 2023 compared to a net 69.2% in Q4 2022. 66.7% of banks indicated tighter standards for nonfarm residential loans compared to 57.6% in Q4 2022. Meanwhile, 64.5% of lenders indicated tighter standards for Multifamily loans in Q1 compared to 56.7% in Q4.
- According to the survey's findings, the most frequently cited reasons for tightening standards were a deterioration in credit quality within their loan portfolios, reduced risk tolerance, and concerns about

bank liquidity and deposit outflows.

5. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- The on-time payment rate in independently operated rental units declined by 98 bps between March and April, coming in at 83.6%, according to the latest Independent Landlord Rental Performance Report by Chandan Economics.
- Encouragingly, while the monthly on-time payment rate fell slightly, the forecast full-payment rate rose again in April to a new record high of 93.8% — improving 40 bps from March.
- The pressures of higher interest rates have led to higher cap rates and fewer transactions, while banking sector turmoil has caused lenders to tighten underwriting standards. Despite such supply-side distress, tenant resiliency has been strong, keeping the apartment market afloat.
- Of the states with at least 500 tracked units in the RentRedi-Chandan Economics sample, Washington holds the highest on-time payment rate of any state in the country, coming in at 92.8% in April. Massachusetts (92.0%) and Virginia (88.5) are close behind. All three top performers are coastal, high incomes states.
- On-time payment rates dropped across all price points in April, with low-priced rentals seeing the largest month-over-month declines. By property type, 2–4-unit rental properties continue to see the highest on-time payment rates of all sub-property types as they have throughout the life of Chandan Economics' tracking, coming in at 84.7% in April.

6. APRIL JOBS REPORT

- According to the Bureau of Labor Statistics, the US economy added 253,000 jobs in April while the unemployment rate dropped slightly to 3.4%.
- Job growth exceeded most market expectations in April, remaining robust despite rising concerns about banking sector distress and rising recession risks. Meanwhile, average hourly wages rose by 4.4% year-over-year.
- The most significant job gains by industry occurred in professional and business services (+43,000), health care (+40,000), and leisure and hospitality (+31,000). Sectors that saw little change in payroll totals include construction, manufacturing, wholesale trade, retail trade, transportation and warehousing,

information, and other services.

- The strength of both job and wage growth should calm some short-term recession fears but also risks further complicating the Federal Reserve's policy goals. On May 3rd, the FOMC raised their target fed funds rate by 25 basis points, signaling that inflation remains a broader risk despite recent bank failures and, therefore, is a higher priority.

7. NFIB SMALL BUSINESS OPTIMISM

- The NFIB Small Business Optimism Index, which indicates the strength of small businesses in the US, experienced a decline of 1.1 points in April. According to the survey, the two most significant challenges small businesses face are labor quality and inflation.
- Many owners have found themselves with excessive inventory due to overestimating demand. Owners are adjusting accordingly and beginning to decrease prices by an average of four points. Overall, there is an increased pessimism, with many owners expecting lower sales figures compared to March.
- Regarding employment, 17% of owners anticipate creating new jobs in the next three months, while 40% expect to be raising compensation for employees. Half of those planning to raise wages intend to do so within the next three months. However, it is worth noting that 33% of owners consider labor costs or labor quality to be their primary business challenge.

8. MORTGAGE APPLICATIONS

- Mortgage applications climbed by 6.3% during the week ending on May 5th, 2023, its most significant increase in close to two months, according to the Mortgage Bankers Association. During the last week of April, applications contracted by 1.2%.
- Refinance applications surged by 10.0% during the first week of May, while purchase applications rose 4.8%.
- The average rate on a 30-year fixed-rate mortgage dropped two basis points to 6.48% during the week — its lowest in three weeks.
- Application demand fell significantly during the second half of 2022 as mortgage rates rose steeply. After falling for much of December, mortgage applications increased to begin 2023 as market rates began to

fall from their peak. Recent signals by the Fed suggesting a potential pause in interest rate hikes in the near future also appear to be contributing to a rise in demand.

9. ISM PURCHASING MANAGERS INDEX

- The Manufacturing PMI, a composite index where a reading above 50 generally indicates expansion in the sector while a reading below 50 indicates a contraction, measured at 46.3% in March, 1.4 percentage points below the February total.
- March represents the fourth consecutive month of contraction following 30 months of consecutive expansion, with the PMI reaching its lowest level since May 2020, when it fell to 43.5%.
- A sub-index measuring new orders fell to 44.3% — 2.7 percentage points below its February figure. The production sub-index rose slightly to 47.8%, half of a percentage point above February's total but still in contraction.
- The prices sub-index fell 2.1 percentage points to 49.2% in March. The backlog of orders sub-index fell 1.2 percentage points to 43.9%.
- All remaining sub-indices, including the employment index, the supplier deliveries index, the inventory index, and the export and import indices, all moved lower in March compared to the month before and remain in contraction.

10. INFLATION AND INTEREST RATE EXPECTATIONS

- Inflation expectations for the year ahead dropped to 4.4% in April. Still, they increased at the three- and five-year forecasts, registering at 2.9% and 2.6%, respectively, according to the New York Fed's Survey of Consumer Expectations. The median one-year ahead expected inflation rate peaked in June 2022 and has been receding ever since.
- Sentiment regarding current credit access and expectations of future credit access were mostly unchanged during the month. Credit sentiment began to shift in late 2021/early 2022 and has remained relatively stable since.
- As inferred by the Chicago Mercantile Exchange's Fed Watch Tool, market forecasts firmly expect no

interest rate hike by the Fed at its June 2023 meeting, anchored by falling inflation data and recent liquidity issues in the banking sector.

- Additionally, futures markets predict at least three rate cuts by the Fed by year's end based on the prediction that policymakers will be forced to pivot if economic growth slows and unemployment rises due to tighter financial conditions.

SUMMARY OF SOURCES

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