

MARKET COMMENTARY

Fig. 1: 30-Year Fixed Rate Mortgage Average in the US



Source: St. Louis Federal Reserve, Mill Creek.

Earlier this month, economists at the US Bureau of Labor Statistics and Federal Reserve Bank of Cleveland released [a commentary exploring methodologies used to calculate rent inflation](#) which accounts for 32% of the Consumer Price Index (CPI). This component of CPI has drawn fresh scrutiny as investors debate whether underlying inflation is much lower than official numbers suggest. The authors found that using rent growth based on new tenants only (CPI data uses all tenants, new and existing) *leads* CPI data by a full year. For example, if new tenant data replaced the official CPI rent measure, annualized CPI would be negative.

New home sales, housing starts, and construction activity are all heavily influenced by Fed policy. We'd be concerned if a 4.1 percentage point year-over-year increase in mortgage rates—the most on record—had negligible impact on one of the most interest rate-sensitive areas of the economy. It would indicate that even after seventeen 25 basis point rate hikes, monetary conditions remain overly accommodative, and the Fed has more wood to chop. The fact that rent growth has declined from a high of 17.1% (YoY) in February 2022 to 8.4% means rate hikes are having the desired result and flowing through to this corner of the market.

Powell has repeatedly acknowledged the lag in the effect of monetary policy and his willingness to consider alternative data points to construct a more fulsome picture of economic conditions. We assume the softening 'real-time' rent metrics play into his analysis. However, our (and likely Powell's) primary focus remains on aggregate nominal income growth. It is a key leading indicator and one that needs to come down for inflation to cool. Recent economic data suggests that both GDP growth and labor markets remain resilient heading into

2023. The weakness in housing needs to spread throughout the economy before the Fed can signal the all-clear.

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