RESEARCH BRIEF
INFLATION

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MAY 2023

Tighter Credit Tempers Consumer Price Pressures, but Also Curtails Lending

Inflation descending at a more subdued pace. Annual growth in the headline consumer price index (CPI) slowed to 4.9 percent in April, marking the 10th month in a row that this metric has decelerated since the Federal Reserve began tightening policy in the current cycle. Increases in the cost of borrowing have chipped away at household demand for major purchases, including for homes and new vehicles, which are often financed. The price index for shelter increased by 0.4 percent in April, the smallest rise since January 2022, while the cost of new motor vehicles fell by 0.2 percent. Nevertheless, OPEC's recent oil production cuts pushed the cost of gasoline up by 3.0 percent during that month. This abrupt rise, paired with sticky, higher prices for a number of services, minimized the cooling of headline inflation, signaling that ongoing efforts to reduce the inflation rate to the Fed's 2 percent target may be hitting a snag.

Higher wages prop up inflation. Prices for non-energy services rose by 6.8 percent annually in April, down from recent months but higher than any metric prior to November 2022. Rising service costs are still being kept elevated by labor demand exceeding the number of people looking for work. In April, employers added 253,000 new positions, helping reduce unemployment back to the 53-year low of 3.4 percent. This contributed to average hourly earnings rising by an accelerated 4.4 percent annually, keeping many consumer price points elevated. The ongoing dynamic is a crux for the Fed in determining future actions — softening the labor market enough to ease higher service costs without tipping the economy into a layoff-induced recession.

Tightening credit to cool consumption. Despite inflation remaining elevated, the current market consensus is for the Fed to pause rate hikes in June. Chairman Powell suggested that tightening credit conditions, resulting from heightened banking sector risks, may emerge as a weight on economic activity. For this reason — and with objectives of keeping full employment and a healthy banking sector — the Fed postured it would only continue to firm policy if the economic data provides a clear indication to do so.

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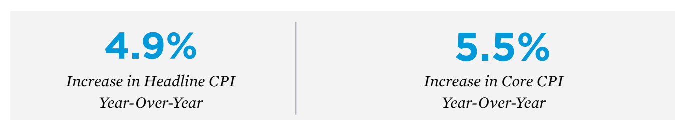
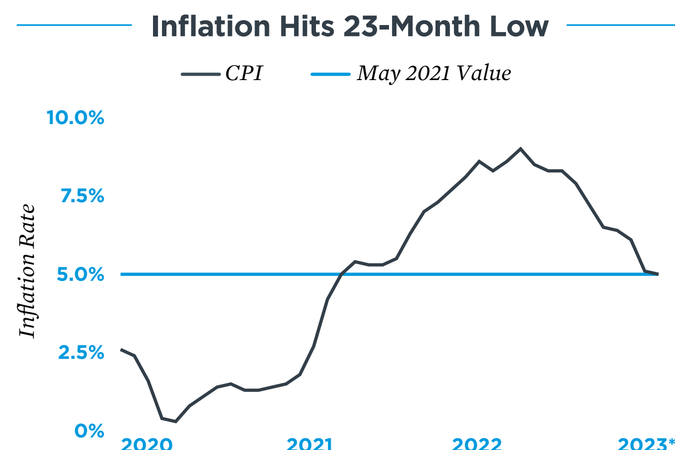
Commercial Real Estate Implications

CRE lending standards constricting. Higher interest rates are hampering pricing across the property spectrum, while recent banking failures convinced many institutions to tighten underwriting. The Fed's quarterly Senior Loan Officer Opinion Survey noted a net of 46 percent of banks narrowing lending requirements over the first quarter. Meanwhile, CRE loan-to-value ratios tempered to levels similar to the Global Financial Crisis. Trading may remain inhibited near-term as a result. On a more positive note, this tightening could help restore long-term interest rate stability following a dynamic year.

Lending cobwebs may begin to clear. Inflation's continued cooling, as well as the Fed's more measured stance in April, suggest that upward pressure on interest rates could abate this year. This would ease hurdles in financing development and investment sales for most property types as lenders have been challenged in locking down terms recently. Investment sales and new proposals declined sharply in the past year, but may begin to revive as interest rates stabilize.



Inflation Hits 23-Month Low



** Through April*

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; CME Group; Federal Reserve; Trepp