First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Senior Economist*
Bryce Gill – *Economist*
Nate Gerze – *Economic Analyst*

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Disinflation, Not Deflation

New home prices are much lower than a year ago. The average price of a new home sold in October was 10.4% lower, while the median price was down 17.6%.

Records on new home prices go back all the way to the Kennedy Administration and never before has the median new home price dropped so much in twelve months, even during the bursting of the housing bubble in 2007-11. Is this a signal that monetary policy has become excruciatingly tight, that deflation – an outright and generalized drop in consumer prices – is about to grip the US economy?

Hardly.

In fact, deflation doesn't even have a grip on the housing market. New home prices only include the prices for the new homes sold each month, which in the past year has averaged about 55,000 per month. That's out of a total housing stock of about 145 million homes. In other words, new home prices reflect what's going on each month with only about 0.04% of all homes.

Another big problem with just looking at prices for new homes sold is that those sold in October 2023 might be very different in size and quality than the new homes sold a year ago. Mortgage rates are higher, so many new home buyers are cropping their appetites, buying smaller homes to reduce their projected future mortgage payments. And builders are reacting to this, building smaller, less expensive homes. As a result, the average and median prices are falling, but not the price per square foot.

Better gauges of national home prices include the Case-Shiller index and the FHFA index, which are designed to adjust for the quality of homes. They also attempt to track the sales price of the same homes over time. These two indexes show home prices up 3.9% and 6.0% in the past year, respectively. In other words, no deflation. Home prices are not really falling.

And, when politics gets involved with economic data, confusion is often the result. When you hear that "inflation is falling" what that means is that prices are still rising, just not as fast as they were a year ago. The PCE price index, the Fed's favorite measure for inflation, is up 3.0% in the past year versus a gain of 6.3% in the year ending in October 2022. Core PCE prices, which exclude food and energy, are up 3.5% in the past year versus a gain of 5.3% in the year ending in October 2022.

We expect this process to continue, with consumer prices climbing, but at a slower pace. Yes, they might fall in a particular month when energy prices drop, but even in those months core prices will continue to rise.

It's important to remember that although the M2 measure of the money supply is down 4.5% from the peak in July 2022, that follows the surge of 40% that preceded it. That huge increase is still wending its way into the economy, and it would be crazy to try to take all that money back out. That would cause a massive deflationary problem. As a result, the general price level is permanently higher than the path it was on pre-COVID.

The bottom line is that the stance of monetary policy is tight enough to keep bringing inflation down in 2024. But don't expect it to stay there so long that general prices start consistently falling. At present, the futures market is pricing in a drop in short-term interest rates of about 1.25 percentage points. We think the rate cuts will be steeper, the front edge of a shift in policy that will eventually cause an echo of the 2021-23 inflation problem in the years ahead. Unfortunately, like the 1970s.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-4 / 9:00 am	Factory Orders – Oct	-3.0%	**-2.9%**	-3.6%	+2.5%
12-5 / 9:00 am	ISM Non Mfg Index – Nov	52.2	**52.3**		51.8
12-6 / 7:30 am	Int'l Trade Balance – Oct	-$64.2 Bil	**-$65.6 Bil**		-$61.5 Bil
7:30 am	Q3 Non-Farm Productivity	+4.9%	**+4.8%**		+4.7%
7:30 am	Q3 Unit Labor Costs	-0.9%	**-0.4%**		-0.8%
12-7 / 7:30 am	Initial Claims – Dec 2	221K	**219K**		218K
2:00 pm	Consumer Credit – Oct	$8.5 Bil	**$5.1 Bil**		$9.1 Bil
12-8 / 7:30 am	Non-Farm Payrolls – Nov	180K	**190K**		150K
7:30 am	Private Payrolls – Nov	159K	**150K**		99K
7:30 am	Manufacturing Payrolls – Nov	31K	**40K**		-35K
7:30 am	Unemployment Rate – Nov	3.9%	**3.9%**		3.9%
7:30 am	Average Hourly Earnings – Nov	+0.3%	**+0.3%**		+0.2%
7:30 am	Average Weekly Hours – Nov	34.3	**34.3**		34.3
9:00 am	U. Mich Consumer Sentiment- Dec	62.0	**62.0**		61.3