Fiscal Policy, Inflation, and Interest Rates

What Will The Fed Do Next?

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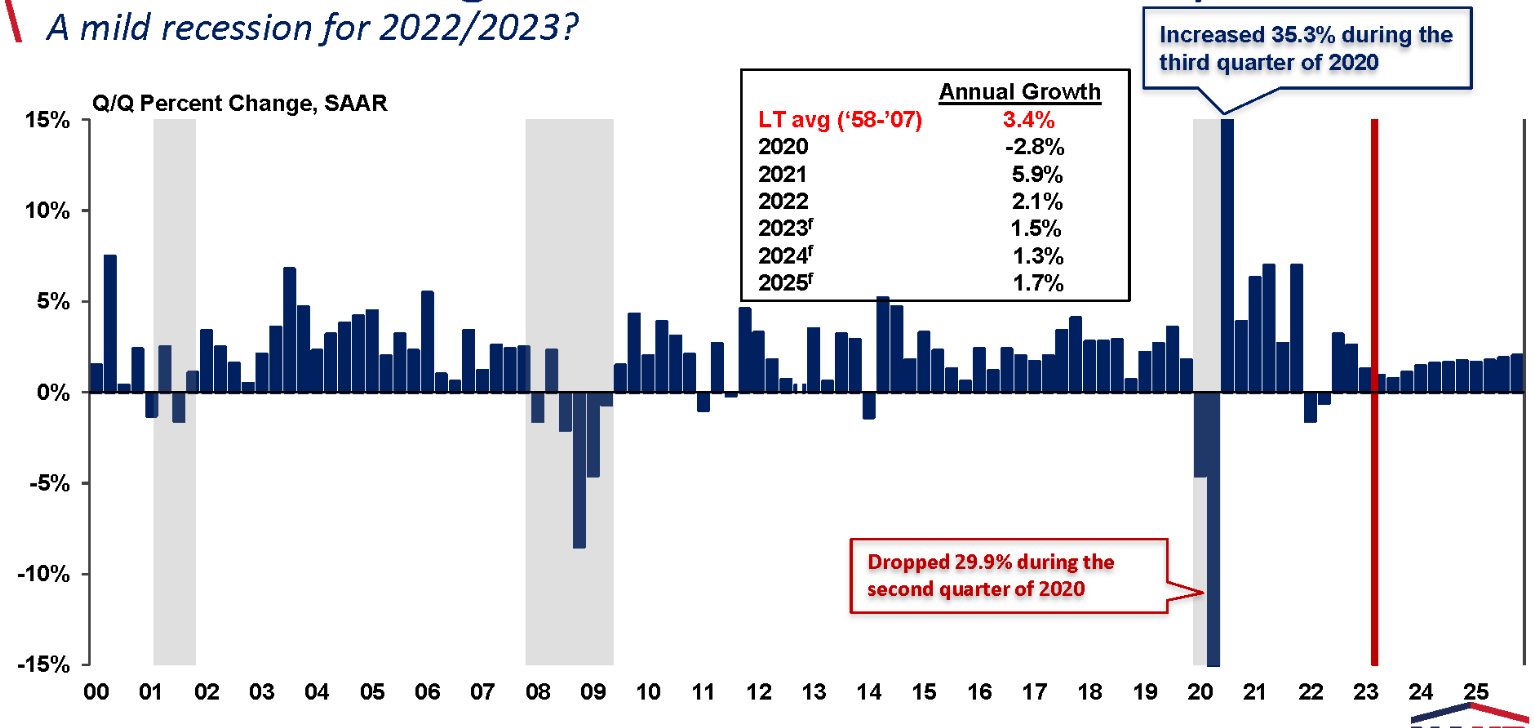
GDP – Weakening Growth after 2022 Quarterly Declines

A mild recession for 2022/2023?



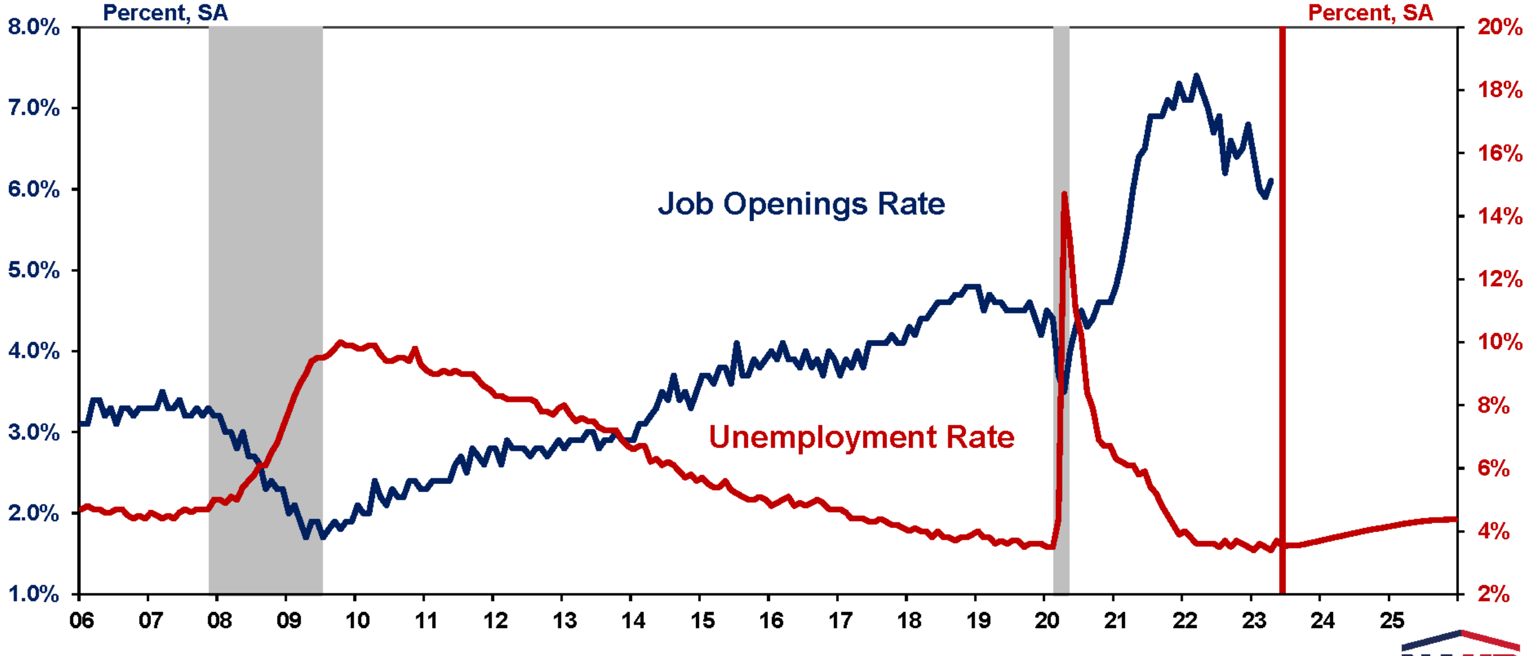
Source: U.S. Bureau of Economic Analysis (BEA) and NAHB forecast.

GDP as a Bellwether

Quarterly GDP growth numbers have varied greatly over the last three years, the result of a pandemic-induced downturn, a dramatic rebound, extraordinary supply chain disruptions, the highest inflation seen in decades and intentional and long-term action by the Fed to stabilize the economy through increased interest rates. 2022 brought GDP declines, and while growth is trending upward in the first two quarters of 2023, it is doing so at a weakened pace. NAHB economists anticipate a retroactive designation of a mild, "rolling" recession in 2022 and the first half of 2023, potentially extending through the rest of the year.

Job Openings

Rising to 10.1 million in April --- Fed wants lower



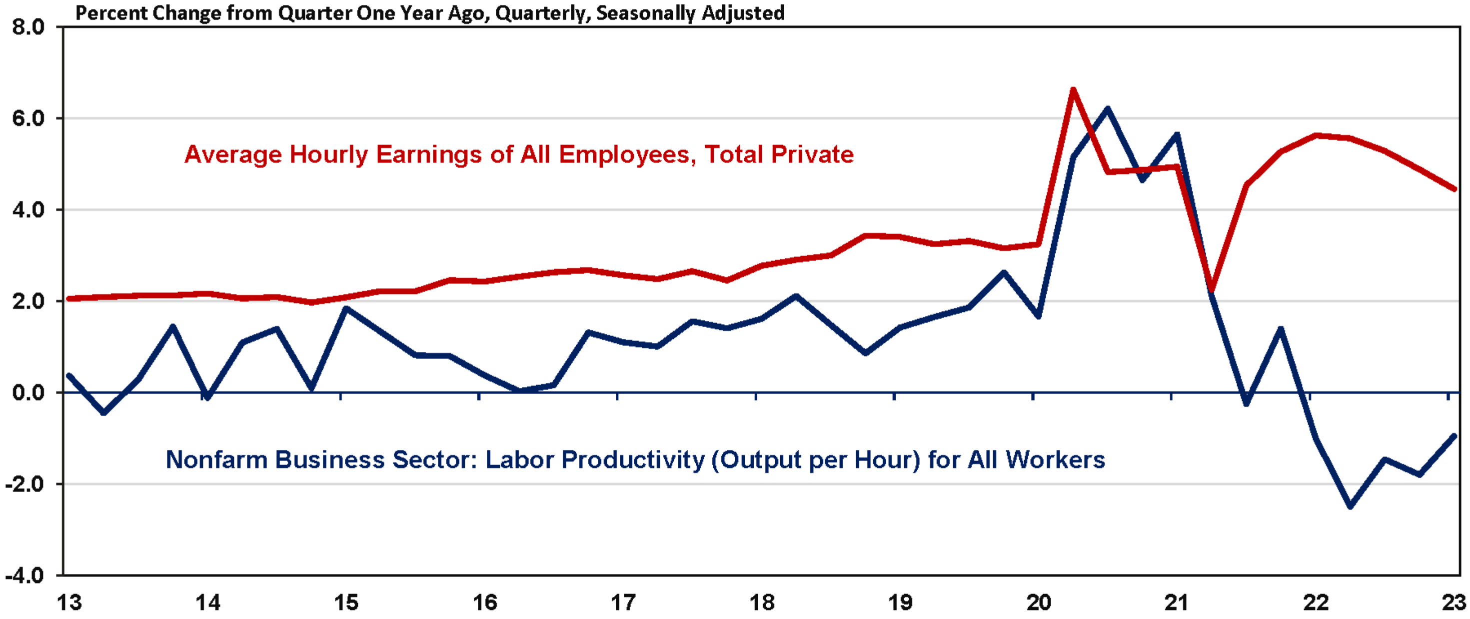
Source: U.S. Bureau of Labor Statistics (BLS) and NAHB forecast.

Fed Wants Lower Job Openings Rate

The number of open jobs increased in April, which complicated the June Federal Reserve decision. The higher the job opening count, the higher the chance of another rate hike by the Fed. While construction job openings increased despite a slowing housing market and reduced backlogs, the ultimate solution for the skilled labor shortage will not be found by slowing worker demand, but by recruiting, training and retaining skilled workers.

Wages Outpacing Productivity

Income can only grow with productivity gains



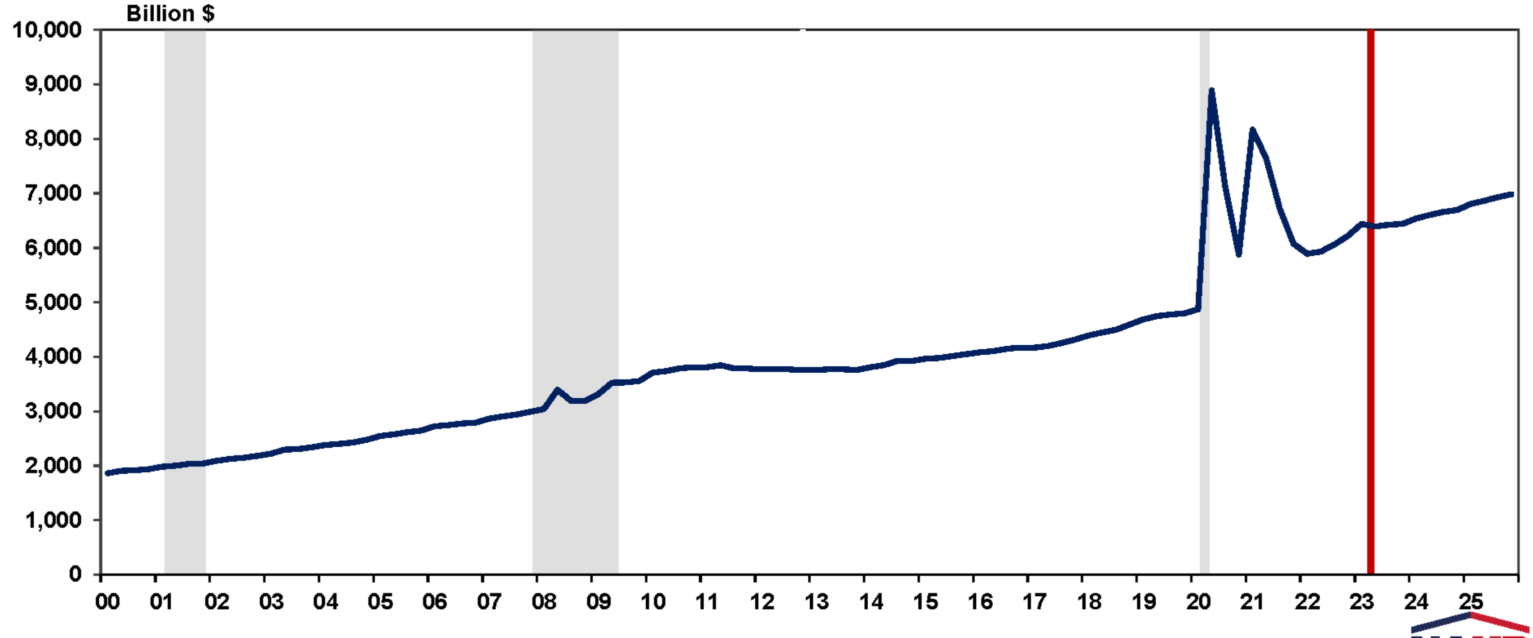
Source: Federal Reserve Bank of St. Louis

Productivity Levels Dictate Wage Growth

After hitting decade-highs at the peak of the COVID-19 pandemic in 2020-21, labor productivity has declined while wage growth remains elevated. The growing gap between productivity growth (now negative) and nominal wage growth is an inflationary warning. Declining productivity growth also shows that work-from-home had some benefits for workers in 2020 and 2021. This is a reminder that housing serves multiple economic roles.

Historic Expansion for Government Spending

Post-covid legislation added to inflation pressure



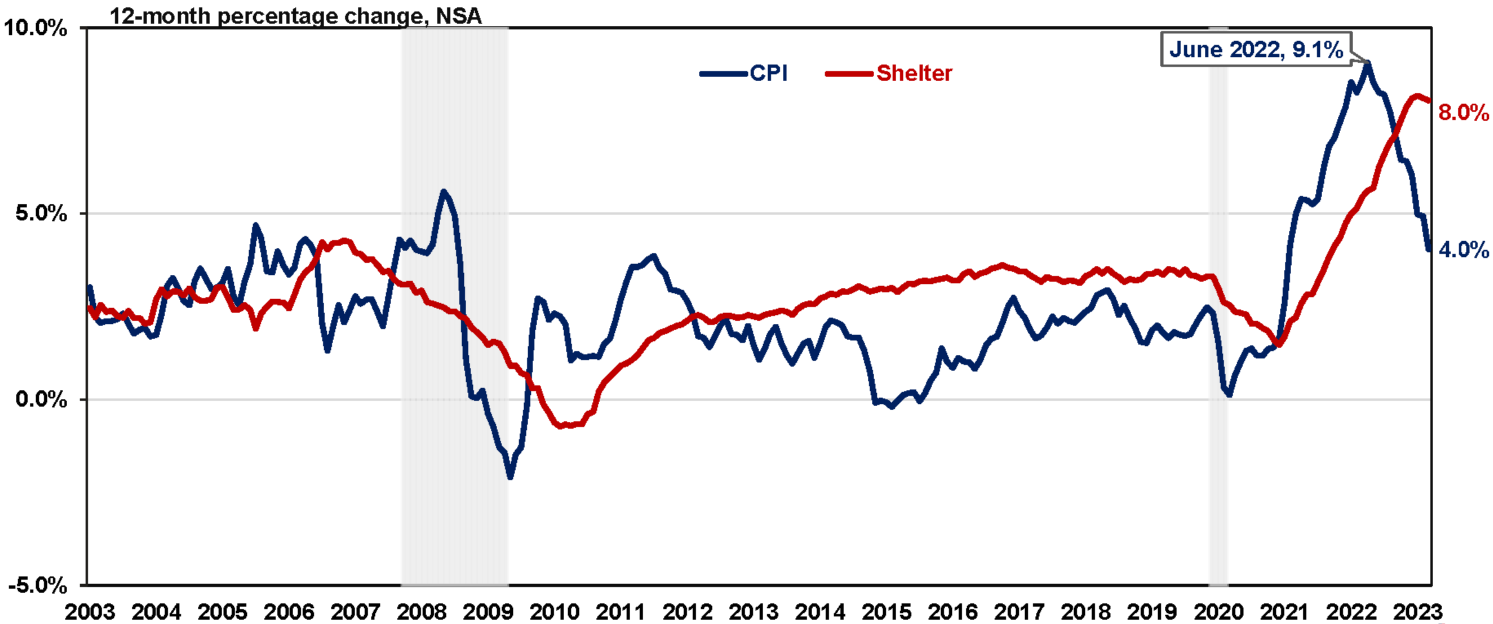
Source: U.S. Bureau of Economic Analysis (BEA) and NAHB forecast.

Government Spending Built Inflation Pressure

Government spending spiked in the past three years in response to the pandemic downturn. A strong argument can be made there was too much stimulus. This elevated spending drove up inflation, as we had more money chasing a finite supply of goods and services. While spending has decreased since highs in 2020 and 2021, the Federal Reserve's tightening monetary policy is attempting to drain the excess liquidity to achieve price stability. This is a reminder that the Fed's actions are in part cleaning up prior policy mistakes.

Consumer Inflation – Headline Rate and Shelter

Shelter costs continue to rise despite Fed policy tightening --- "Gimmie Shelter"

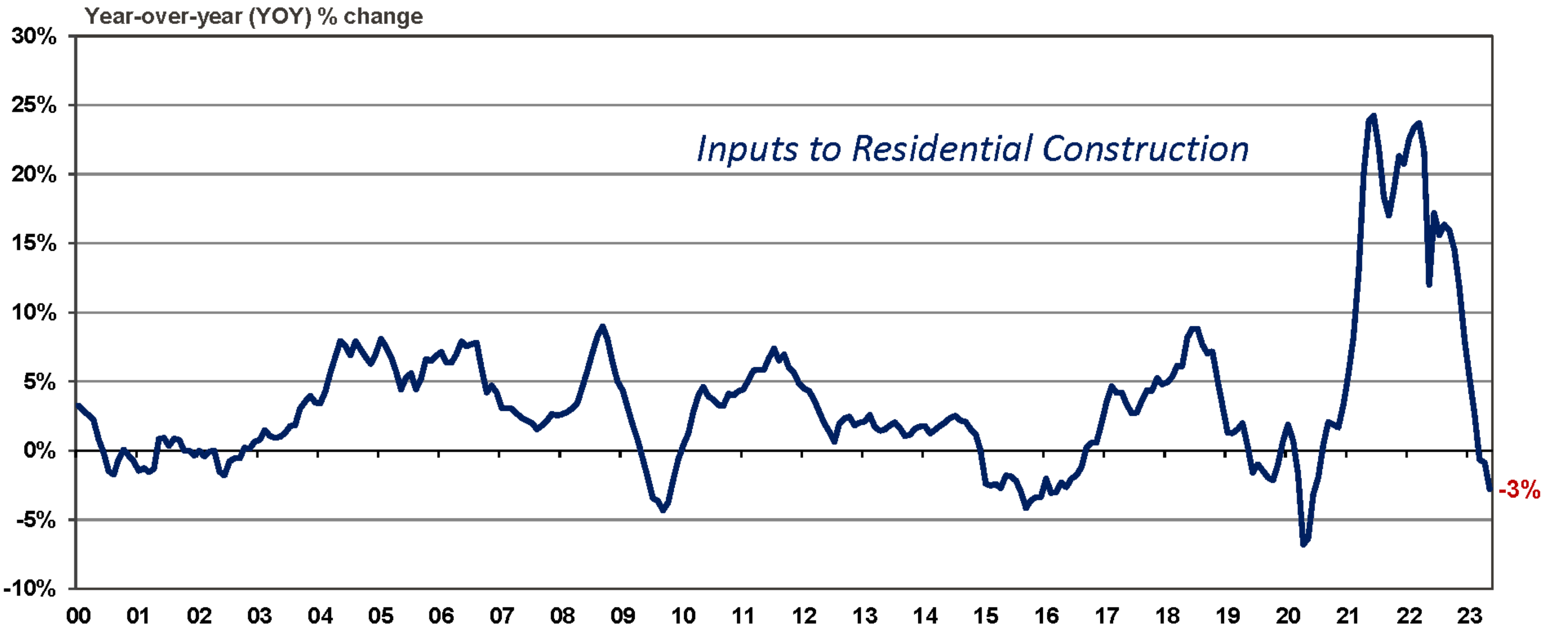


Source: U.S. Bureau of Labor Statistics (BLS)

Shelter Prices a Leading Source of Overall Inflation

The Consumer Price Index (CPI) peaked in June 2022 at 9.1%, as prices of goods and services rose at rates not seen in decades. Recent declines in the CPI led the Fed to pause after a long string of rate increases. But shelter inflation remains stubbornly high, and the Fed's blunt tools are not well suited to address this problem, as demand for housing continues to outstrip supply.

Building Materials - Residential Construction Cost



Source: U.S. Bureau of Labor Statistics (BLS): Producer Price Index (PPI)

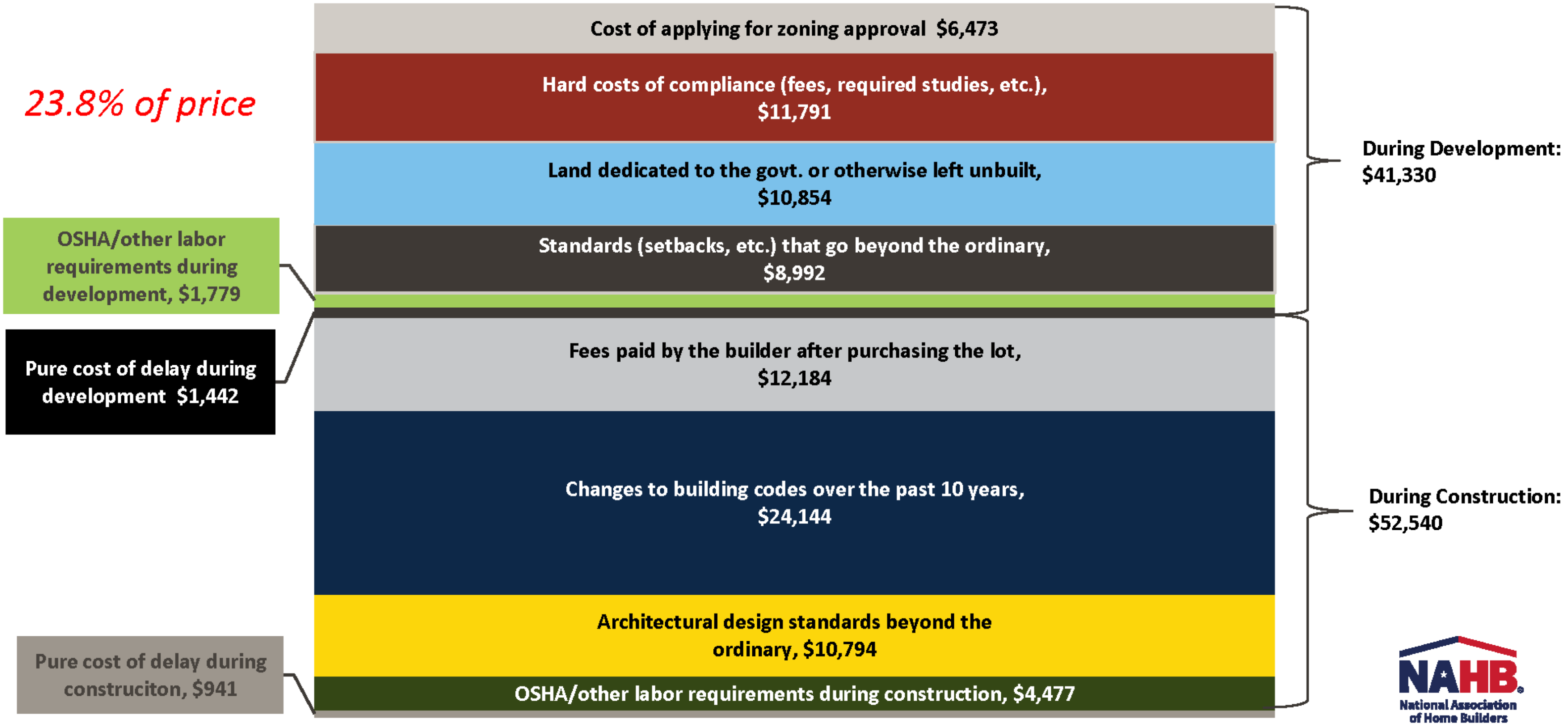
NAHB National Association of Home Builders

Overall Building Material Costs Decline, Some Products Remain High

According to the June Producer Price Index report, the prices of building materials overall decreased 0.1% in May 2023 (not seasonally adjusted), following a 0.2% drop in April. The index has gained 0.3%, year-to-date, a stark contrast from the 10.2% and 4.9% YTD increases seen in 2021 and 2022, respectively. Prices on materials from gypsum to softwood lumber are trending downward, while prices for steel mill products and ready mixed concrete were on the rise. However, lumber prices may increase as the housing market rebounds.

Regulatory Costs $93,870 Per New Home (11% Gain 2016 to 2021)

Total effect of building codes, land use, environmental and other rules



Source: NAHB/Wells Fargo Housing Market Index (HMI)

Overly Burdensome Regulations Push Up Cost of Homes

An NAHB study showed that, on average, regulations imposed by government at all levels account for $93,870 of the final price of a new single-family home. Of the total, $41,330 is due to a higher price for the finished lot, which is attributable to regulations like environmental and land use policy. The remaining $52,540 is the result of regulatory costs imposed on the builder during construction, after the builder purchases the finished lot. While the cost of regulation climbed between 2016-2021, the term of the study, this was not as fast an increase as during the 2011-2016 time period.