

Economic Update

 **SVN** | Research

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1. CPI INFLATION

- Consumer prices rose 0.5% from December and 3.0% year-over-year, according to the latest data from the Bureau of Labor Statistics.
- The typically more volatile food and energy prices were key contributors to the increase, but core prices, which remove the items, were also up 0.4% on the month and 3.3% over the past year.
- Food price increases mostly reflected an uptick in grocery prices, which rose 0.5% in January, primarily driven by a nationwide egg shortage following an outbreak of avian flu. Egg prices are up 15.2% over the past four weeks.
- Gasoline prices also climbed, up 1.8% in January, but are down 0.2% from one year ago. Fuel oil rose 6.2% month-over-month.
- The shelter index continues to add upward pressure to CPI, accounting for roughly 30% of the monthly increase in the headline index. The shelter price increase in January is accelerated relative to its November and December levels.

2. CONSUMER SENTIMENT

- Consumer sentiment declined for a second consecutive month and dropped to a seven-month low, according to preliminary data from the University of Michigan. The index is down by 4.8% from January and 11.8% year-over-year.
- Sentiment fell across all key cohorts measured, including among consumers of different age groups and wealth levels and voters of both parties.
- The index also deteriorated among all of its sub-components but was led by falling sentiment surrounding buying conditions for durable goods. This was partly due to a perception that it may be too late to avoid the negative impacts of tariff policy.
- Expectations around personal finances also fell, while consumers increasingly worry that higher inflation could return within the next year, though alternate measures of inflation expectations dispute the latter.

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3. INFLATION EXPECTATIONS

- According to the New York Federal Reserve's Survey of Consumer Expectations, consumer inflation expectations appear stable, conflicting with signals from the University of Michigan's assessment over a similar period.
- Both the one- and three-year-ahead expectation indices remained unchanged at 3.0% year-over-year. Households also expect to spend less relative to their sentiment one month ago, amounting to an expectation of 4.4% spending growth over the next year— the lowest reading since January 2021.
- The NY Fed index historically tracks better with inflation metrics compared to the University of Michigan measure. While the NY Fed index currently shows that inflation expectations are stable, its index of inflation uncertainty remains significantly elevated relative to pre-pandemic levels.

4. INTEREST RATE FORECASTS

- Forecasts for the median year-end federal funds rate shifted significantly in the past week as consumer prices accelerated more quickly than expected in January, causing markets to adopt a more hawkish outlook for rates.
- By the end of the trading day on February 12th, the same day that the January CPI data was released, futures markets placed a majority 40.1% probability on just one rate cut by the end of the year. Just one week ago, markets placed a majority 32.4% probability of two rate cuts.
- While January's inflation report follows several months of encouraging data, the acceleration will certainly test an FOMC already keeping its eyes peeled for a dislocation of forward-looking inflation expectations.
- Assuming the Fed's preferred gauge, the PCE price index, mirrors the rise in core consumer prices; it will at least keep policymakers on hold through their next rate decision.
- Inflation expectations appear stable now, but January's price acceleration risks filtering into those expectations.

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5. POWELL TESTIFIES TO CONGRESS

- On February 12th, Fed Chair Jerome Powell testified in front of the new Congress for the first time, offering clues to the central banker's outlook on the US economy and policy expectations.
- Powell reiterated the consensus FOMC view that the economy remains on a firm footing, supported by a less restrictive policy stance that he expects will hold for some time.
- Echoing comments made during his post-meeting press conference in January, Powell said that the combined potential for changes to trade, immigration, fiscal, and regulatory policies make it nearly impossible for the central bank to make clear policy judgments at this time.
- In the Fed's upcoming framework review researchers will examine pandemic-era rate strategies where policymakers contended with trying to accommodate the economy while rates remained at historically low levels.
- Officials took a flexible approach to inflation targeting during the 2020 rebound, with some viewing that a brief period of above-target inflation could offset the long-term effects of historically low inflation during the last decade. Following a sustained period of above-average inflation, the approach was challenged, but Powell signals it's a key part of a once-every-five-year review.

6. OFFICE VACANCY FORECASTS

- According to recent reporting from Hines, a leading global property manager, researchers expect the Office sector to continue to see rising vacancies through at least 2028 in most scenarios, though second-tier assets will continue to experience increased absorption over the next year.
- Illustrating the sector's progress in finding its bottom, Hines points out that its own tenants returned an average of about 10% of leased space following lease expirations during 2024 compared to roughly 33% returned 12-18 months prior.
- Looking more medium-term, Hines forecasts that in a medium-case scenario where office usage gets halfway back to its pre-pandemic trend, vacancy rates will fall by about 1000 basis points by 2028. The national vacancy rate stands at 19.8% year-over-year.

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7. LOGISTICS ACTIVITY

- In January, US logistics activity, a key indicator of Industrial Real Estate demand, rose at its fastest pace since June 2022, according to the Logistics Managers' Index report.
- Reflecting activity seen toward the end of 2024, January's increase comes amid a spike in imports driven by North American firms ramping up purchases ahead of anticipated tariffs. It also reflects further expansion in the US economy, with consumer spending helping propel fourth-quarter growth.
- The sub-index measuring inventory levels surged during the month, driven by increases at downstream firms, which was the opposite of activity in December that found upstream firms with inventory upticks.
- The shift led to cost increases for downstream firms, including inventory, warehousing, and transportation prices, collectively rising to their highest levels since April 2022.
- Capacity expansion slowed, signaling that strong consumer demand is providing a floor to inventory levels and that price pressures aren't simply a reflection of supply chain considerations.

8. JANUARY JOBS REPORT

- According to the Bureau of Labor Statistics (BLS), US employers added 143,000 jobs in January while the unemployment rate ticked down to 4.0%.
- The report fell short of expectations, with the market consensus coming into the release projecting an increase of 175,000 payrolls. Nonetheless, the BLS upwardly revised the job additions from November and December by a total of 100,000 payrolls.
- Real wages continued to climb, with the average hourly wage up 0.5% during the month and 4.1% year-over-year.
- Healthcare and related jobs saw employment increases during the month, adding 44,000 payrolls. Retail trade employment was up 34,000, while social assistance and government jobs also rose.
- More cyclical sectors, such as construction and manufacturing, remain tepid. However, the Institute for Supply Management reported in its January Manufacturing PMI report that sector activity expanded for the first time in 26 months, potentially foreshadowing a rebound in manufacturing employment.

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9. CONSTRUCTION SPENDING

- According to the latest data from the Census Bureau, US construction spending rose 0.5% month-over-month to a seasonally adjusted annual rate of \$2,192 billion in December, surpassing the consensus estimate of 0.2%. Construction spending is up 4.3% year-over-year.
- Following an upwardly revised 0.2% monthly increase in November, this is now the third consecutive monthly increase in construction spending. Spending contracted twice in 2024, once in June and once in September.
- Private spending rose by 0.9% from November, led by the residential segment, which rose 1.5% mainly due to an increase in spending on single-family projects. The non-residential segment increased by just 0.1%.
- Public spending declined by 0.5%, driven by decreases in both residential and non-residential spending, which both contracted by 0.5%.

10. THE DIGITAL RETAIL TRANSFORMATION

- A recent look at the Retail landscape by Deloitte describes the industry as shifting from macro focuses to micro focuses in recent years, which references retailers moving away from a supply-driven approach that matches goods to the masses to a more data-driven approach that is personalized to the individual consumer.
- This Retail transition has come with high costs, and some of those headwinds are expected to continue in 2025. Meanwhile, retailers employing increased automation are experiencing a boost above the stagnant growth that the industry has experienced on average in recent years. Those offering gen AI tools during the Black Friday weekend noted a 15% conversion rate compared to those that didn't.
- Increased digital efficiency will be critical to industry growth in 2025. According to the firm's research, 7-in-10 retail executives expect to have AI capabilities in place within the next year.

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SUMMARY OF SOURCES

- (1) <https://www.bls.gov/news.release/cpi.nr0.htm>
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