Why the FED cannot lower rates yet.

The FED will have difficulty lowering rates because when mortgage rates fall, home buying becomes more attractive, forcing prices higher on the largest component of inflation.

For most homebuyers, their monthly payment, or what they can afford monthly, matters much more than the absolute price of a home. Most people do not buy a home with cash. Redfin found that as of December 2023, **66% of people used a mortgage to buy a home**. Two main components determine the size of a monthly mortgage payment: home price and interest rate.

The FED focuses on inflation. Although it leans heavily on PCE, which tends to be better at showing trends than short-term fluctuations, it is still relying on CPI to gauge inflation's temperature.

The table below shows the most recent CPI reading. The fastest growing areas annually are Transportation Services, Shelter, Services less Energy, and Food away from Home. However, the table is not a good way to examine how each category affects CPI since each category is weighted by the BLS, which calculates CPI each month.

Even though Shelter is only the second fastest-growing category, it far outweighs the other categories. The second table below from the Pew Research Center shows that **Shelter accounted for about one-third of the basket** in 2021. So, no matter how the other categories perform, the FED has to pay special attention to Shelter.

Also, although many other categories are peripherally tied to interest rates, housing is particularly sensitive to changes in interest rates.

This is why the Fed is stuck. There is already a shortage of homes. If the Fed cuts rates, it will make homes more affordable on a monthly basis. This will mean more buyers. More demand will drive up prices even higher, compounding inflationary pressures.

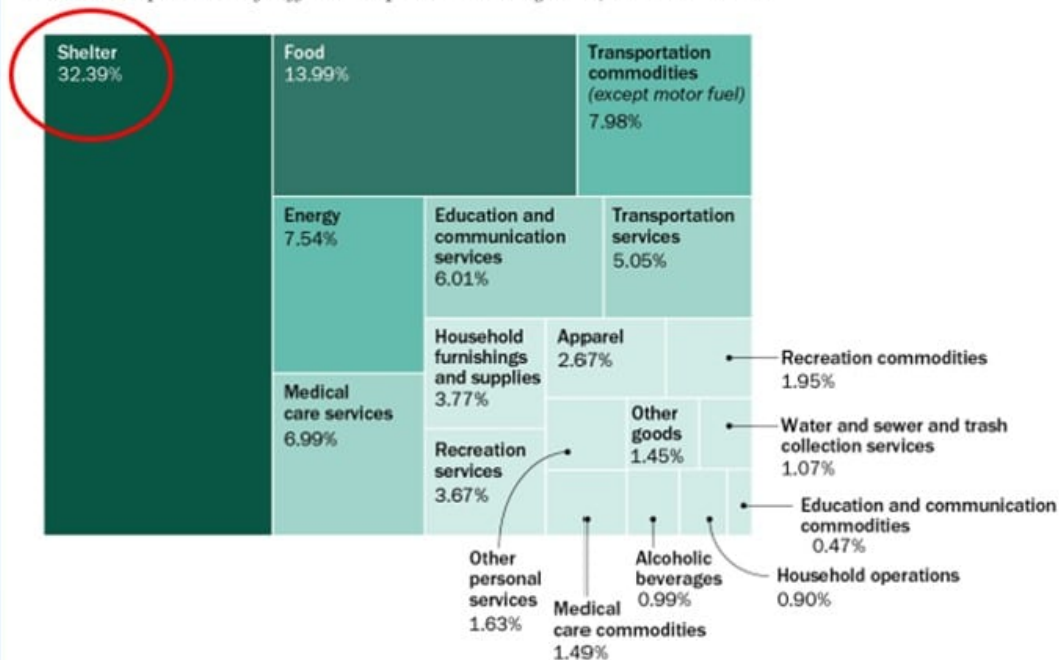# CPI - Seasonally adjusted changes from preceding month (FEB 2024)

	Aug. 2023.0	Sep. 2023.0	Oct. 2023.0	Nov. 2023.0	Dec. 2023.0	Jan. 2024.0	Feb. 2024.0	Un-adjusted 12-mos. ended Feb. 2024	Weighting* 2021
All items	0.5	0.4	0.1	0.2	0.2	0.3	0.4	3.2	
Food	0.2	0.2	0.3	0.2	0.2	0.4	0.0	2.2	13.99%
Food at home	0.2	0.1	0.3	0.0	0.1	0.4	0.0	1.0	
Food away from home(1)	0.3	0.4	0.4	0.4	0.3	0.5	0.1	4.5	
Energy	4.4	1.2	-2.1	-1.6	-0.2	-0.9	2.3	-1.9	7.54%
Energy commodities	8.3	1.8	-4.3	-3.8	-0.7	-3.2	3.6	-4.2	
Gasoline (all types)	8.3	1.6	-4.3	-4.0	-0.6	-3.3	3.8	-3.9	
Fuel oil	11.2	6.4	-6.4	-1.1	-3.3	-4.5	1.1	-5.4	
Energy services	0.1	0.3	0.4	1.0	0.3	1.4	0.8	0.5	
Electricity	0.2	0.8	0.4	1.0	0.6	1.2	0.3	3.6	
Utility (piped) gas service	-0.3	-1.4	0.3	1.2	-0.6	2.0	2.3	-8.8	
All items less food and energy	0.2	0.3	0.2	0.3	0.3	0.4	0.4	3.8	
Commodities less food and energy commodities	-0.2	-0.2	0.0	-0.2	-0.1	-0.3	0.1	-0.3	
New vehicles	0.2	0.2	-0.1	0.0	0.2	0.0	-0.1	0.4	
Used cars and trucks	-1.9	-1.8	-0.4	1.4	0.6	-3.4	0.5	-1.8	
Apparel	0.2	-0.3	0.0	-0.6	0.0	-0.7	0.6	0.0	
Medical care commodities(1)	0.6	-0.3	0.4	0.5	-0.1	-0.6	0.1	2.9	
Services less energy services	0.4	0.5	0.3	0.5	0.4	0.7	0.5	5.2	
Shelter	0.3	0.6	0.3	0.4	0.4	0.6	0.4	5.7	**32.39%**
Transportation services	1.6	0.7	0.9	1.0	0.1	1.0	1.4	9.9	
Medical care services	0.0	0.2	0.2	0.5	0.5	0.7	-0.1	1.1	

What goes into the consumer price index?

Relative importance of different expenditure categories, November 2021

- Shelter 32.39%
- Food 13.99%
- Transportation commodities (except motor fuel) 7.98%
- Energy 7.54%
- Education and communication services 6.01%
- Transportation services 5.05%
- Medical care services 6.99%
- Household furnishings and supplies 3.77%
- Apparel 2.67%
- Recreation commodities 1.95%
- Recreation services 3.67%
- Other goods 1.45%
- Water and sewer and trash collection services 1.07%
- Education and communication commodities 0.47%
- Other personal services 1.63%
- Medical care commodities 1.49%
- Alcoholic beverages 0.99%
- Household operations 0.90%

Source: U.S. Bureau of Labor Statistics

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