THOUGHTS OF THE WEEK
Eugenio J. Alemán, PhD, *Chief Economist*
Giampiero Fuentes, CFP®, *Economist*

We Can't Import Cheap Homes; But We Could Import Cheap EV Cars

We are free trade enthusiasts, in economic terms, even at a time when free trade has been losing some of its aura within the US political system. Why? Because the existence of trade allows countries, in general, to achieve higher consumption levels than what they otherwise could achieve with what is called 'autarky,' which is a scenario in which a country doesn't import or export from/to the rest of the world. This is not a fantasy or a fallacy, it is indisputable. Thus, we take the view 'free trade is better than no trade' and everyone wins with 'free' or 'freer' trade.

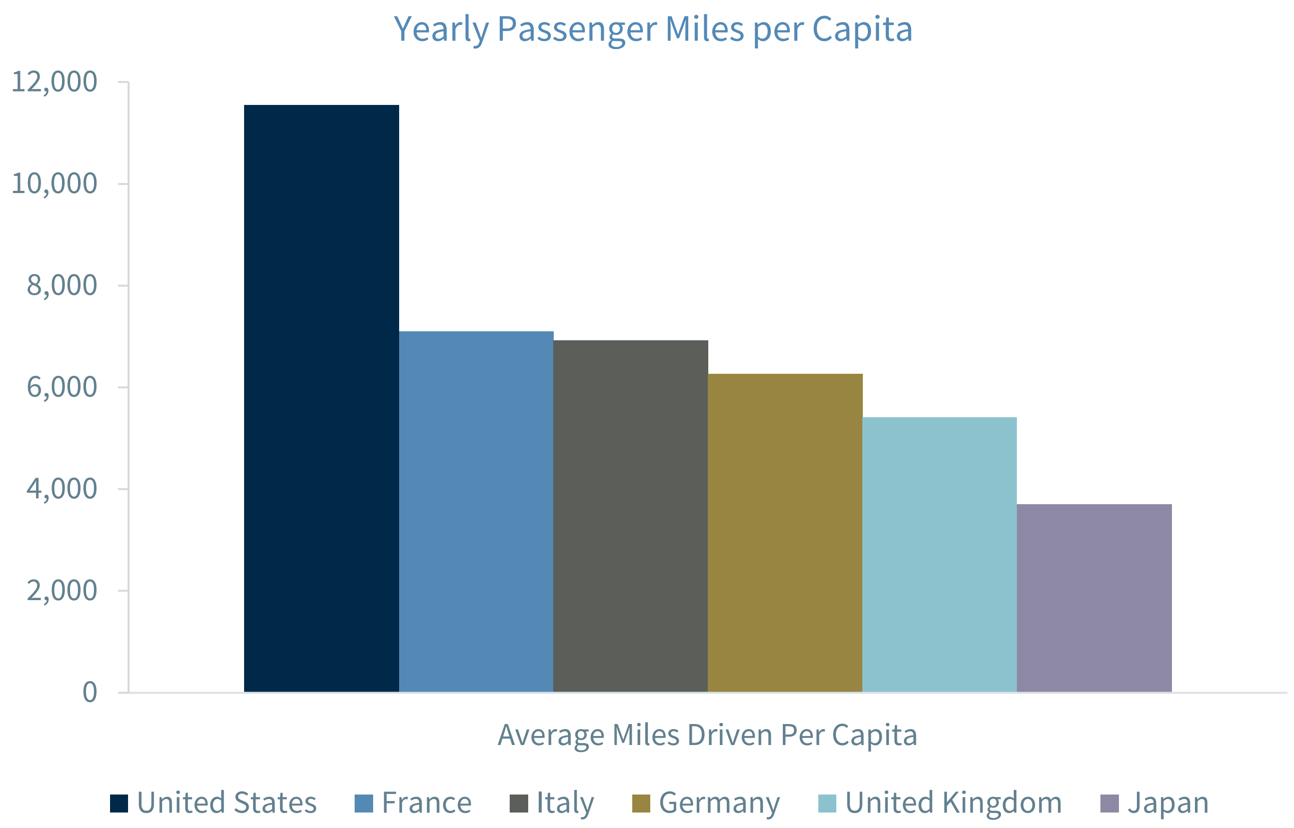
Having said this, there are instances where trade protection 'may' make sense, such as national security and, sometimes, temporary protection measures. Nevertheless, we always remain reluctant to make a case for some of the protection measures we see over the years. Our reluctance to accept protecting some industries with trade barriers is because often it means protecting industries that have become uncompetitive and inefficient and, typically, protecting them provides little incentives for these industries to make changes and attempt to become competitive again.

It is true that it is very difficult to keep domestic companies competitive if we consider domestic wages compared to wages in less developed countries. Sometimes there is an argument that some countries may be 'dumping,' which means that they may be selling some goods to foreign markets at a price that is lower than their production costs. However, sometimes the lack of competitiveness has to do more with failure to adapt and become more efficient than with anything else even though companies/industry lobby groups try to sell protection on anti-dumping arguments even if the evidence is lacking.

The auto industry is one of those industries that has failed to remain competitive in the past. Back in the 1970s and 1980s, the US auto industry was caught off-guard by the increase in oil and gasoline prices, producing large, gas-gauging cars and trucks—sound familiar? At the same time, Japanese automakers were producing smaller, more efficient, and cheaper cars and started to flood the US with cheaper cars that helped Americans deal with higher gasoline prices.

After complaints by US auto manufacturers, Japanese auto producers started to use Voluntary Export Restraints (VER), to limit their automobile exports to the US market. In 1982, and to bypass these limits, they started assembling automobiles in the US. Still, many tariffs and non-tariff barriers have continued to protect some segments of the US automobile market over time. Today, the imposition of tariffs on EVs from China is not only to protect US auto manufacturers, but also Japanese, Korean, and German, etc., auto manufacturers that assemble automobiles in the US.

You may ask, what is the issue here? The issue is that automobiles are an essential working tool for American workers compared to what happens in other countries. Public transportation in the rest of the world helps workers commute every day so automobile ownership is, typically, used more for leisure and vacations than a necessary tool for work as is the case in the US, where public transportation is, for all intents and purposes, basically non-existent.



Source: OECD, RJ Economics, data as of 2022

But there is an even more worrisome issue. Many US auto manufacturers are no longer building cars for the mass market. They have continued to specialize in high-end models rather than cars for the masses, which makes accessing these expensive cars even more difficult for the average consumer. We recall a meeting several decades ago in which the chief economist of a large US auto manufacturer argued that they were no longer targeting the production of cars for the masses but rather the production of specialized cars. They viewed their future car offerings as one car for the weekends, one for working, one for speed, one for retirement, one for grocery shopping, one for the grandkids, one for long trips, another for short trips, etc. That is, they seemed to have been targeting their efforts to producing different cars for different facets of an individual's life, like sneakers, where people no longer had just one pair of sneakers for all sporting activities but one sneaker for each individual 'sporting' activity, i.e., basketball, running, walking, jumping, sitting, standing, playing tennis, stretching, etc., or something similar.

As a confirmation of such strategy, one US auto manufacturer has already abandoned the production of sedans and is only producing high-end SUVs and trucks because those are the only profitable segments of the automobile market for them in the US. Furthermore, even the most important EV producer in the US has scrapped plans to build an EV for the masses because it cannot compete with cheap foreign EVs.

Thus, if US auto manufacturers are not going to compete in EVs for the mass market, why don't we allow cheap foreign EVs to serve the mass automobile market while limiting, if we prefer, the importation of high-end EVs so we can temporarily protect the high-end EV industry in the US?

This is nothing new or even innovative and we are not thrilled for even suggesting it because, as we said earlier, we are ‘free trade enthusiasts.’ However, the US does it in the meat industry to protect and support the incomes of cattle farmers across the country, where we typically use quotas to complement US meat production during periods of high demand and allow ‘lower’ quality meat to come in during some periods of the year. We also remember Asian countries’ strategies to protect their ‘high-end’ rice market, supporting the incomes of domestic rice producers while importing similar high-quality rice from other countries but then putting the imported rice in silos until it got close to a pre-rotted state and became ‘low-quality rice.’ After that, the low-quality rice was allowed to be sold to the masses at a lower price, which helped the less well-off in those countries.

Of course, we are not advocating that the US follow the rice import strategy of Asian countries—buying high-end EVs, allowing them to deteriorate, and then selling them to the less well-off—but we could open only the low-end, cheap EV market to foreign companies EV imports, and thus allow the masses to reduce the cost of gasoline and the cost of buying ‘high-end’ EV luxury cars supplied by US and foreign producers with plants in the US. This will help the less well-off and help reduce some of the inflationary pressures created by higher oil prices and higher luxury car prices.

The largest expenditure for any US household budget includes the purchase of a home and the purchase of a car. We cannot import cheaper homes from overseas (homes are non-tradable goods) but we can make it easier, and cheaper, for American households to own a cheap EV.

Economic Forecast:

	Actual					Forecast							Actual	Forecast	
	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	2023	2024	2025
Real Gross Domestic Product [1]	**2.2**	**2.1**	**4.9**	**3.4**	**1.6**	**0.9**	**1.0**	**1.6**	**2.4**	**2.6**	**2.1**	**2.5**	**2.5**	**2.1**	**2.0**
Real Gross Domestic Product [2]	1.7	2.4	2.9	3.1	2.9	2.6	1.7	1.3	1.5	1.9	2.2	2.4	2.5	2.1	2.0
Consumer Price Index [2]	**5.7**	**4.0**	**3.6**	**3.2**	**3.2**	**3.5**	**3.3**	**3.2**	**2.8**	**2.5**	**2.4**	**2.4**	**4.1**	**3.3**	**3.0**
Ex-food & energy [2]	5.5	5.2	4.4	4.0	3.8	3.6	3.6	3.5	3.1	2.7	2.5	2.4	4.8	3.7	2.7
PCE Price Index [2]	**5.0**	**3.9**	**3.3**	**2.8**	**2.6**	**2.8**	**2.8**	**2.9**	**2.6**	**2.3**	**2.2**	**2.2**	**3.7**	**2.8**	**2.3**
Ex-food & energy [2]	4.8	4.6	3.8	3.2	2.9	2.7	2.7	2.7	2.3	2.0	2.0	1.9	4.1	2.8	2.0
Unemployment Rate	**3.5**	**3.5**	**3.7**	**3.7**	**3.8**	**3.9**	**4.1**	**4.1**	**4.0**	**3.9**	**3.9**	**3.9**	**3.6**	**4.0**	**3.9**
Fed Funds Rate [3]	5.00	5.25	5.50	5.50	5.50	5.25	5.00	4.75	4.75	4.50	4.00	4.00	5.1	5.1	4.3

[1] Annualized Quarter-Over-Quarter Growth
[2] Year-Over-Year Percentage Change
[3] Upper Bound of the Federal Funds Target Range

Economic Releases:

Existing Home Sales: Existing home sales were lower than expected in April, declining by 1.9% on a month-over-month basis as well as on a year-earlier basis. However, even though the inventory of homes increased, home prices also continued to increase. According to the release, much of the activity in the existing home sales market is occurring at the top or high-end market, which is not strange as high mortgage rates are pricing many Americans out of the housing market. Existing home sales declined by 1.9% in April of this year compared to the previous month while also declining by 1.9% compared to April of last year, according to the National Association of Realtors (NAR). Existing home sales for the month of March were revised up from 4.190 million to 4.220 million. Every region of the country saw a decline in existing home sales in April, according to the report, with the Northeast region reporting sales 4.0% lower in April than in March and also down 4.0% compared to April of last year. In the Midwest, sales declined 1.0% compared to March of this year as well as compared to April of last year. The South reported a month-over-month decline of 1.6% but a year-over-year decline of 3.1%. Finally, the West saw existing home sales decline by 2.6% compared to March of this year but an increase of 1.3% compared to April of last year. The median price of homes increased to $407,600 in April of this year compared to a price of $385,800 a year earlier, or an increase of 5.7%. By region, the median price of existing homes increased in every region. In the Northeast, prices jumped by 8.5% compared to April of last year while prices in the Midwest increased by 6.0%. In the South, prices increased by 3.7% on a year- earlier basis while the West region experienced the largest year-over-year increase, up 9.3%. The supply of homes at the end of April at current sales levels increased from 3.2 months in March to 3.5 months in April, this was up by 9.4% compared to March and by 16.7% compared to April of last year. According to the Chief Economist of the NAR, Lawrence Yun, "home sales changed little overall, but the upper-end market is experiencing a sizable gain due to more supply coming onto the market."

New Home Sales: New home sales were weaker than expected while the months' supply of new homes for sale increased in April. However, the median price of new homes continued to increase. This was very similar to the data we got from existing home sales earlier this week where existing home sales continued to weaken but existing home sales prices continued to move higher. Still, new home sales have not collapsed, but have continued to move slightly lower during the first four months of the year. We should expect lower home prices going forward if this trend continues. New single-family houses sold declined by 4.7% in April compared to the previous month to a seasonally adjusted rate of 634,000 compared to the revised March estimate of 665,000. The April number of new single-family houses sold was down 7.7% compared to April of last year, according to the US Census Bureau and the US Department of Housing and Urban Development. By region, the Northeast showed sales of new homes collapsing by 20.9% compared to March of this year while remaining flat on a year-over-year basis. In the Midwest, new home sales increased 10.0% versus March of this year while being up 27.5% compared to April of last year. In the South, which is the largest market, new home sales declined by 4.8% versus March of this year while declining 15.1% compared to April of last year. Finally, the West saw new home sales increasing by 2.1% versus March of this year while also increasing by 12.1% compared to April of last year. The median price for new houses sold in April of 2024 was $433,000 compared to a median price of $417,200 in April of last year or an increase of 3.9% on a year-earlier basis while the average sale price for April was $505,700. Inventory of new home at the end of April at current sales rate was up to 9.1 months' supply compared to 8.5 months' supply at the end of March of this year. New home sales were weaker than expected in April and the US Census Bureau indicated in its release that data was revised back to 2019.

Economic Forecast:

Durable Goods: This was a strong preliminary print by durable goods orders and will probably help investment spending during the start of the second quarter of the year. Furthermore, this was the third consecutive increase in durable goods orders. There was a marked decline in new orders for non-defense capital goods but a strong increase in defense capital goods. The strong increase in transportation equipment, with a 1.5% increase in new orders of motor vehicles and parts, could indicate some restocking in the auto industry. However, we have to caution that this preliminary release on durable goods is prone to sharp revisions. The advance report on durable goods orders for April came in better than expected, up 0.7% compared to expectations for a 0.6% decline, according to FactSet consensus. However, durable goods orders for March were revised slightly down, from an increase of 0.9% to an increase of 0.8%, according to the US Census Bureau. If we exclude new orders of transportation equipment, durable goods orders increased by 0.4%. If we exclude new orders of defense durable goods, the index was virtually unchanged. This was the third consecutive increase in new orders, according to the report. One of the strongest growth sectors within new orders of durable goods was new orders of computer and related products, increasing 3.9% during the month. Transportation equipment new orders increased by 1.2% while new orders of motor vehicles and parts increased by 1.5%. Within transportation equipment, new orders of nondefense aircraft and parts was the weakest sector, reporting a decline of 8.0% during the month. Capital goods new orders increased by 0.5%. Nondefense capital goods new orders declined by 1.5%, while defense capital goods new orders surged by 15.2%. Capital goods new orders for defense helped the capital goods sector remain positive in April, while new orders of computers and motor vehicles drove the overall index higher.

Consumer Sentiment: Although the revised Consumer Sentiment index came in better for May than the preliminary number, the decline in sentiment compared to April remains large. The better news with the final release was the better readings on inflation expectations, both at the year-ahead level as well as at the five-years ahead level. The final Consumer Sentiment Index published by the University of Michigan Survey of Consumers came in a bit better than the preliminary number published in mid-May. The overall index came in at 69.1 in May compared to 77.2 in April, but it was an improvement from the preliminary number of 67.4. Both components of the index were better than the preliminary numbers, but both remained below the April numbers. The inflation expectations numbers were also better in the final release than what the preliminary numbers reflected. Preliminary one-year ahead inflation expectations were reported at 3.5% but were revised down to 3.3% in the final release, while 5-year ahead inflation expectations were originally reported at 3.1% but were revised down slightly to 3.0%—unchanged from April. We were expecting some downward revisions to inflation expectations as gasoline prices moved lower in May.

DISCLOSURES

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

The U.S. Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA House Price Index (FHFA HPI®) is a comprehensive collection of public, freely available house price indexes that measure changes in single-family home values based on data from all 50 states and over 400 American cities that extend back to the mid-1970s.

The Pending Home Sales Index (PHSI) tracks home sales in which a contract has been signed but the sale has not yet closed.

Supplier Deliveries Index: The suppliers' delivery times index from IHS Markit's PMI business surveys captures the extent of supply chain delays in an economy, which in turn acts as a useful barometer of capacity constraints.

Backlog of Orders Index: The Backlog of Orders Index represents the share of orders that businesses have received but have yet to start or finish. An increasing index value usually indicates growth in business but shows that output is below its maximum potential.

DISCLOSURES

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI new export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Durable Goods: Durable goods orders reflect new orders placed with domestic manufacturers for delivery of long-lasting manufactured goods (durable goods) in the near term or future.

Source: FactSet, data as of 5/24/2024

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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER

880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863

RAYMONDJAMES.COM

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