Economic Update

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JULY 28, 2023

1. FED INTEREST RATE DECISION

- On July 26th, The Federal Reserve raised their benchmark interest-rate by 25 bps, reversing a pause in rate-hikes that occurred in June.
- While the June pause was intended to start a "wait and see" approach by officials, their meeting minutes and commentary in recent weeks suggested to the market that they were prepared to move forward with additional rate hikes this year. It was the 11th rate-hike since the central bank's inflation fight began in March 2022.
- Following the failure of three regional banks earlier this year, some officials wanted to pause and assess the economy's state before moving forward with additional hikes. According to its most recent projections, on average, Fed officials estimate one more rate hike in 2023.
- Recently, Fed Chair Jerome Powell stated that stronger economic growth may lead to higher inflation, keeping the option of further rate hikes open. In recent weeks and months, economists have, on average, reduced their forecast for a US recession in the near term.

2. Q2 GDP OUTPERFORMS EXPECTATIONS

- US economic output beat expectations in the second quarter, with GDP growing at a 2.4% annualized rate, up from 2.0% in the previous quarter, according to the latest data from the Bureau of Economic Analysis (BEA).
- Resilient post-pandemic consumer spending and increased business investment were the key contributors to the growth, with consumers leading the way as they spent on services like travel and dining.
- The strength of the economy has surprised many economists who reached consensus of an upcoming slowdown due to high inflation and the Federal Reserve's rate increases. In recent months, inflation has slowed, easing pressures on policymakers and re-anchoring consumer expectations, likely fueling additional economic activity on the margins.
- Still, some economists warn that consumer spending may slow in the second half of the year as the job market slows and excess savings diminish. Further, the Fed remains on hawkish footing, moving forward with an interest rate hike of 25 bps in July, increasing the potential for an economic "hard landing."

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3. REDUCED US RECESSION PROBABILITIES

- Amid signs that inflation is cooling, there is growing optimism that the US economy may avoid a severe recession, according to recent survey data from the National Association of Business Economists (NABE)
- Nearly three-quarters of forecasters surveyed by the NABE believe there is a 50% or less chance of a recession in the next 12 months. Economists' median estimate within the next 12 months fell to 58% from a staggering 70% in December 2022.
- After increasing interest rates for an 11th time since March 2022 in July and stronger than expected GDP numbers that arrived the following day, these projections may shift further in the coming weeks. However, it may be too soon to suggest that strong GDP numbers are a positive, as it may encourage Fed officials to remain aggressive in their rate-hikes, increasing the probability of a recession.

4. CONSUMER CONFIDENCE RISES

- Consumer Confidence rose to 117.0 in July according to data from the Conference Board, indicating an uptick in consumer optimism about the economy as recession risks fall and policymakers signal confidence in a soft landing.
- Both the Present Situation Index and the Expectations Index of the overall measure improved in July, reflecting positive views on current business and labor market conditions and a more favorable short-term outlook for income, business, and labor market conditions.
- Despite rising interest rates, consumers remain upbeat, as inflation slows the labor market remains robust. Consumers' view of current family financial situations and short-term financial prospects have also improved.
- The share of consumers expecting a recession rose this month, but fears of a recession appear have eased relative to earlier this year.

5. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- On-time rental payments in independently operated rental units remained steady in July 2023, with 81.8% of tenants completing their payments on time, a marginal decrease of 5 bps from the previous month, according to the latest data from Chandan Economics.

- Although the current rate is 294 bps lower than the peak in March, it still shows a year-over-year improvement of 105 bps. The overall collection trends are positive, with the forecast full-payment rate for July at 91.9%, a 42-bps increase from the previous month.
- Despite the impact of higher interest rates, the rental housing sector has managed to avoid widespread distress, and owners can wait for pricing to recover while fewer distressed sales are occurring. As long as the cash flow ecosystem remains intact, rental property owners can weather the current interest rate climate.

6. Q2 HOME SALES

- Median home prices rose on a quarterly basis in over 90% of the country, according to the Q2 2023 US Home Sales Report by ATTOM—signaling some remaining strength in a dynamic housing market. Further, profit margins increased in about two-thirds of US metro areas but were still down annually in most of them.
- The average profit margin on median-priced single-family homes and condos rose to 47.7% in the second quarter, marking the first gain in a year. While seller fortunes notably improved during the second quarter, the typical investment return remains below the previous year's high point of 53.2%.
- According to the report, the median nationwide home price is up 10% in the second quarter compared to last year, rising to $350,000.
- The homebuying season in the US is just heating up, increasing the potential for further gains in profit margins for sellers entering the market in the coming months. Still, factors such as mortgage rates, overall housing supply, and inflation will remain a key determinant of performance.

7. RETAIL SPACE DEMAND DROPS

- The pandemic-era rise in consumer spending continues to push on, but some investors are inching into industrial and retail investments cautiously as excess savings levels by US consumers diminish, according findings by Globe St.

- As higher interest rates dampen savings rates that had initially risen to a decade-high during the pandemic, investors worry that a spending slowdown may be on the horizon.
- Absorption rates for both industrial and retail properties in 2023 are estimated to be just 1/3rd of 2022 levels, while the hotel industry also appears to be bracing for a slowdown in travel spending following the summer of 2023.
- Still, reduced savings may favor apartment demand, with absorption in the sector expected to remain positive for the foreseeable future.

8. SINGLE-FAMILY RENTAL INDEX

- According to recent data by CoreLogic, annual US rent growth for single-family rentals (SFR) eased in May to 3.4%, converging towards pre-pandemic levels recorded from 2010 to 2019.
- Recently, rental housing demand has buckled as the remote work growth slows and renters struggle to absorb inflation, contributing to lower year-over-year rent increases compared to recent years.
- Still, SFR rents returned to a “typical” seasonal pattern in February, according to the report, indicating that rent growth should continue through this year.
- By metro, Chicago ranked highest for rent growth in may (+6.6%), followed by Charlotte (5.9%), and Boston and New York (5.7%).

9. MULTIFAMILY SYNDICATIONS

- Some are raising the alarm on a potential risk in the multifamily syndication space, according to a recent review by Trepp.
- During the pandemic boom in commercial real estate, syndicators acquired properties using a value-add strategy, which used floating-rate loans to achieve quick stabilization and increased rents.
- However, weakening demand in the sector alongside an increase in construction are impacting rent growth, increasing vacancies, and reducing cash flows.
- Further, as the Federal Rserve continues its rate-hike cycle, debt service burden has increased, leaving entities who are exposed to floating-rate loans at lower coverage ratios.

- According to Trepp, many of these loans have maturity extension options subject to performance conditions, suggesting an uncertain outlook on refinancing activity in the near-to-medium term.

10. DATA CENTER OUTLOOK

- Data center demand saw a notable rise in the CRE boom that took place between 2020 and 2022 and remains robust globally. However, according to a recent review by GlobeSt, the global data center market is facing a power shortage that could threaten its growth.
- Since data centers require significant energy to operate, operators worldwide are prioritizing sourcing enough power, with certain secondary markets having robust power supplies and therefore, attracting more operators.
- Despite these concerns, vacancy rates continue to fall in many areas, contributing to rising prices for the sector.
- Demand in the sector remains strong due to the growth of artificial intelligence, streaming, gaming, and self-driving cars. Leasing activity in the data center market has shown resilience, driven by industries such as technology, financial services, healthcare, and telecommunications.

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SUMMARY OF SOURCES

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