Economic Update

AUGUST 11, 2023

1. CPI INFLATION

- The Consumer Price Index (CPI) rose 3.2% from one year ago, roughly in line with last month's increase and climbing just 0.2% month-over-month.
- Core prices, which exclude food and energy rose 4.7% year-over-year, the lowest annual increase since October 2021. Core prices also rose just 0.2% from the month prior — a signal that inflation pressures continue to ease across the US economy gradually.
- Shelter costs continue to be the primary catalyst behind rising price pressures, increasing 0.4% month-over-month and 7.7% over the past 12 months.
- Food prices aligned with headline inflation during July, rising 0.2% from June.
- Despite a spike in crude oil prices in July, energy prices rose just 0.1% month-over-month.
- Real wages, which adjust wage increases for inflation, rose 0.3% in July and are up 1.1% over the past 12 months. The rise in real wages signals that Americans' incomes are starting to catch up — reversing some of the inflationary erosion in consumer purchasing power.

2. JULY JOBS REPORT

- The US economy added 187k jobs in July, while the unemployment rate remained little changed at 3.5%. July's level registered below the Dow Jones estimate of 200k job adds.
- July's job growth was slightly above June's level of 105k job adds but remained well below its post-pandemic trend. The job growth levels in June and July are the lowest monthly increases since December 2020.
- Average hourly earnings rose 0.4% during the month and have climbed by 4.4% over the past year. The monthly and annual wage increases exceeded consensus estimates, while a slowdown in inflation led to a significant monthly increase in real wages.
- Labor force participation had held steady at 62.6% for the past five months.
- Stocks reacted positively to the jobs report since, despite falling job growth, the gradual nature of the labor market's slowdown alongside steady unemployment and labor force participation levels signal a "soft landing" for the US economy.

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3. HOUSEHOLD DEBT

- Consumer debt rose to a record level during the second quarter of 2023, climbing to $17.06 trillion, according to the New York Fed.
- Credit card balances are up 4.6% quarter-over-quarter, rising by $45 billion to $1.03 trillion in the second quarter. Steady consumer spending levels are being amplified by inflation pressures, partially explaining the sharp increases.
- Meanwhile, mortgage debt remained relatively stable compared to the start of the year, coming in at $12.01 trillion at the end of Q2. These data largely reflect a slowdown in new mortgage originations and refinance applications, which have fallen in 2023 due to rising interest rates. Mortgage debt accounts for roughly 70% of America's total debt load.
- In a worrying sign, the four-quarter average for credit card delinquencies rose to an 11-year high, a potential sign of an upcoming slowdown in consumer spending levels.

4. INTEREST RATE PROJECTIONS

- According to the Chicago Mercantile Exchange's Fed Watch Tool, Fed Funds futures forecast a 90.5% chance of a pause in rate increases when the FOMC meets at its next meeting in September.
- Forecasts were bolstered in recent days after the July CPI report revealed that US inflation pressures continue to soften monthly and annually. One week prior, futures markets were pricing in a less certain 82.0% chance of a pause, which itself was bolstered by a positive July jobs report.
- The Federal Reserve initially paused rate increases in June as it looked to glean signals about the health of the US economy from upcoming data, then enacted a 25 basis points increase in July to help reaffirm inflation expectations. The most recent projections from futures markets reflect a belief that the Fed's data-dependent approach could incentivize a pause as macroeconomic measures point to a softer landing than many had expected.

5. MORTGAGE RATES

- According to Freddie Mac, the average rate on a 30-year fixed-rate mortgage rose to 6.96%, the highest

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rate since November 2022.

- The rise in mortgage rates follows the recent downgrade of the US credit rating alongside a 25 basis points increase in the benchmark federal funds rate by the FOMC in July.
- Housing demand remains relatively strong in the face of higher mortgage rates, with supply remaining tight due to the tepid seller's market, incentivizing many would-be sellers to hold onto their assets until the market environment is more favorable.
- Notably, as mortgage rates reached 7.0% in late 2022, housing market activity slowed, a potential signal for what may be ahead in the coming weeks.

6. CREDIT RATING DOWNGRADE

- On August 1st, rating agency Fitch downgraded the US long-term credit rating to AA+ from AAA, reflecting growing government debt, a perceived fiscal deterioration over the next three years, and the "erosion" of governance stemming from the latest debt ceiling standoff.
- On erosion of governance, Fitch notes a "steady deterioration" of fiscal responsibility over the last 20 years, citing repeated political standoffs and last-minute resolutions. Further, it critiques the US' lack of a medium-term fiscal framework, citing the complexity of the congressional budget process. The agency also notes the impact of debt increases and a failure to address medium-term challenges to entitlement programs.
- More specifically on debt, Fitch notes that while the debt-to-GDP ratio has fallen from a 2020 high of 122.3%, it remained uncomfortably above pre-pandemic levels, which sat at 100.1% in 2019. The agency projects that the US debt-to-GDP ratio will continue to rise in the coming years and may make the US vulnerable to future economic shocks.

7. THE FUTURE OF CITIES

- The debate around the future of cities gained substantial intrigue during the COVID-19 pandemic. Still, experts from universities across the country have recently opined that amenities and "unique attractions" are likely to keep demand for urban living high in the long term.

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- According to Nicholas Bloom of Stanford, who conducts remote work research, the 12 biggest cities collectively lost about two-thirds of a million residents from city centers during the pandemic. About 60% of those who left moved to nearby suburbs, relatively in line with historical trends. However, relatively few people abandoned urban life altogether, according to Bloom, while urban densification returned to similar levels as in 2010.
- Since 2021, population losses in the 12 largest cities have slowed, with many showing signs of gains. While remote work remains prevalent, fewer residents are using it as an opportunity to move to the suburbs than during the early years of the pandemic.
- Other experts expressed their view that downtowns and central business districts must evolve beyond office spaces to survive. Many expect city centers to become more amenity-focused with diverse revenue streams. In contrast, smaller cities could benefit from remote work as people seek more affordable options with good quality of life.

8. INDUSTRIAL SECTOR FUNDAMENTALS

- A new analysis by Colliers suggests that while fundamentals have softened in the Industrial sector, the fall in demand will likely not be enough to reasonably shift the landlord-favorable environment that exists in the space today.
- According to the analysis, with a vacancy rate hovering close to 5%, lease rates should continue to climb at a slower but positive pace, remaining favorable to those holding the asset.
- Further, the revival of US manufacturing is expected to produce logistical advantages for businesses and investors, boosting the Industrial sector’s longer-run fundamentals.
- During the second quarter of 2023, the supply of projects under construction fell by 3.4% as interest-rate increases temporarily halted some projects. The construction slowdown will also help operating incomes on existing properties in the short term.

9. HOTEL TO MULTIFAMILY CONVERSIONS

- As Lodging delinquencies rise in some metros, some areas have considered hotel-to-multifamily

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conversions to reduce property vacancies and prevent a significant decline in values.

- In New York City, where the industry has seen some success with such conversions, the Lodging delinquency rate stands at 15.3%, according to Trepp. Further, New York's insufficient supply of affordable housing units has made the potential for such conversions more favorable compared to less housing-constrained metros.
- Larger metros also continue to experience higher Lodging delinquencies, making them riper for such conversions compared to smaller cities. Houston and Chicago have contributed the most to Lodging delinquencies, with rates of 43.8% and 38.6%, respectively.

10. FORECLOSURES FALL

- According to ATTOM's monthly Foreclosure Activity Report, foreclosure filings are down 9% from June, with a total of 31,877 properties entering foreclosure in July.
- According to the report, the decline in filings reflects a rebounding housing market, with home prices experiencing a similar turnaround during July. Still, with various factors at play, including an uncertain interest rate outlook, the foreclosure activity may continue to be volatile over the next several months.
- The states with the highest monthly increases in foreclosure rates were Maryland, New Jersey, Delaware, Illinois, and South Carolina. Hawaii, New Hampshire, Idaho, Arkansas, and Alabama saw the most significant monthly declines in July.

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SUMMARY OF SOURCES

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