Economic Update

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1. JANUARY JOBS REPORT

- According to the Bureau of Labor Statistics, the US economy added 517,000 jobs in January while the unemployment rate was little changed at 3.4%. The number of unemployed persons was also little changed at 5.7 million.
- On the surface, the January report registered way above most industry expectations, with some observers concerned that the Federal Reserve may need to continue rate increases for longer than markets are anticipating. However, January's total is likely to be significantly revised downward following adjustments, as is historically common during January.
- Notably, January's significant payroll increase followed the announcement of massive layoffs by several tech giants, including Google and Microsoft — while corporate America also frets about the risk of a looming US debt ceiling limit.

2. FOMC INTEREST RATE DECISION

- On February 1st, the Federal Reserve's policy-setting committee raised their target Federal Funds Rate (FFR) range by 25 basis points to 4.50%-4.75%, slowing their speed of rate increases after four consecutive 75 basis point hikes and one 50 basis point hike in December.
- The FOMC's policy decision arrives after weeks of falling leading inflation indicators. However, several macroeconomic indicators remain far from recession territory, convincing many officials to stay committed to additional increases and holding rates higher for longer if needed.
- Based on data from the Chicago Mercantile Exchange's Fed Watch tool, most market watchers anticipate another 25 basis point hike at the FOMC's next meeting in March.

3. JEROME POWELL STATEMENTS

- In his first public press conference since January's 25 basis-point hike, Federal Reserve Chair Jerome Powell claimed that the Fed still has a "significant road ahead" to bring down inflation, despite the FOMC recently slowing their pace of rate hikes.
- Powell's comments came just a few days after the release of the January jobs report, which showed higher-than-expected payroll growth and an unemployment rate pushed to its lowest level since 1969.
- Powell suggested that several more rate increases are likely on the horizon, though he did not indicate what the pace of the increases may be. He also states that the longer-run Fed Funds rate will likely end up higher than where markets are currently pricing.

4. HOUSING AFFORDABILITY INDEX

- According to the latest Housing Affordability Index by the National Association of Realtors, housing affordability rose in December for the second consecutive month, following consecutive declines in September and October.
- The index reflects how much a "typical" family can afford a "typical" home, defined as a family earning the median family income and an existing single-family home at the national median price, respectively. The median-priced existing single-family home has declined for seven consecutive months, while the median family income has risen for 12 straight months.
- Regionally, housing affordability is highest in the Midwest, followed by the Northeast, while the South and West were less affordable. All regions have seen affordability rates fall precipitously over the last year.

5. FREDDIE MAC MORTGAGE MARKET INDEX

- According to Freddie Mac, mortgage rates rose slightly during the week ending on February 9th.
- The 30-year fixed-rate mortgage ticked up to an average of 6.12% as of February 9th, up three basis points from last week. The 15-year fixed rate mortgage averaged 5.25%, up from 5.14% the week before.
- Mortgage rates remain well above their levels from a year ago as the Federal Reserve continues its monetary tightening actions in an effort to calm US inflation. In recent weeks, mortgage applications have risen significantly as rates began to dampen slightly in January. The recent uptick may be a boon to homebuying markets as consumer interest grows right in time for the busy spring season.

6. LOGISTICS MANAGERS INDEX

- The Logistics Managers' Index (LMI), a diffusion index where above 50 signals expansion in transportation and warehousing activity and below 50 is a contraction, increased to 57.6 in January, up from 54.6 the month before and is the index's second consecutive monthly increase.
- The consecutive increases follow seven declines in the LMI over the past eight months. According to the report, the uptick was primarily driven by the transfer of overstocked inventories away from upstream wholesalers toward downstream retailers.
- Notably, a temporary increase in the LMI in September 2022 came amid supply chains that were newly flushed with high inventory. Such fundamentals at the time signaled that goods were merely moving from place to place, and during the previous two LMI increases, inventories were much lower. The consistency may be showing the beginning of a trend toward sector growth.
- According to the report, another critical development for global warehousing and transporting activity is the reopening of China's economy. Over the past several years, supply chains had to account for the "start-stop" nature of Chinese manufacturers. However, an economic surge in January after an end to the nation's "zero-COVID" policies is sparking new life and certainty in logistics markets.

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7. CMBS DELINQUENCIES FALL IN JANUARY

- According to data from Trepp, the CMBS delinquency rate declined in January 2023, following several months of only tepid increases despite anticipated trouble arising from rapidly rising interest rates.
- The Trepp CMBS delinquency rate fell ten basis points in January to 2.94, the second-lowest reading since the pandemic began. Annually, delinquencies are down by 124 basis points.
- Tracking delinquencies by sector, Industrial maintains the lowest rate of 0.40%, falling slightly month-over-month. Multifamily follows with a delinquency rate of 1.56% in January, down from 2.17% in December. Office registered a 1.83% delinquency rate in January, a 30 basis points increase and the only sector outside of lodging that saw a month-over-month increase. Lodging delinquencies stand at 4.44%, up from 4.40% in December. Meanwhile, Retail maintains the highest delinquency rate by sector at 6.58% but is down nearly 40 basis points from the month before.

8. VTS OFFICE DEMAND INDEX

- Office demand finished 2022 down 20.7% year-over-year, according to the latest Office Demand Index by VTS (VODI).
- Notable upticks in office demand occurred during the Spring and Fall of 2022; however, it was not enough to offset other seasonal declines.
- According to VTS, office demand has strongly correlated with average job postings over the past year. Washington DC exemplified this, with the local VODI increasing 21.4% year-over-year through December 2022 as the metro's concentration of government, nonprofit, and professional services employment helped keep demand high.
- Remote work remains the most significant challenge to office sector growth, though its prevalence has declined. Work-from-home prevalence has reduced from roughly 5% to 30% during the early days of the pandemic to a current range of 40 to 60%. The variation in the frequency of occupations using remote work has narrowed while remote work rates have stabilized at current levels.

9. MSCI 2023 TRENDS TO WATCH

- A new report by MSCI summarizes several key trends in Real Estate that the authors believe will be pertinent in 2023, including the importance of price expectations for market liquidity and a more critical role for market fundamentals.
- Higher interest rates are creating repricing opportunities for many commercial real estate assets sold during the previous decade's low-yield environment. As a result, there is a growing gap in price expectations between buyers and sellers, accelerating the slowdown in transaction volume. How this gap

shifts will be vital in evaluating likely 2023 outcomes.
- Similarly, as the Fed tightens interest rates, yield performance is no longer accelerating market returns, forcing managers to focus on retaining tenants and operating efficiently.

10. ECONOMIC OPTIMISM

- Economic optimism in the US increased to a ten-month high in February, according to an Index developed by Investor's Business Daily and Technometrica Market Intelligence.
- The index is based on a nationwide survey of 900 adults and measures the six-month forward-looking economic outlook, where a reading above 50 indicated optimism and one below 50 indicated pessimism.
- February's Economic Optimism Index ticked up to 45.1 from 42.3 in January. Though the index remains in "pessimistic" territory, the percentage of consumers who believe that the US is currently in recession or that their personal finances are at risk saw month-over-month declines.
- Other key items included climate risk, which has proven difficult for investors to price, but rising evidence shows that buildings that meet specific sustainability standards sell at high premiums. Down-market resilience and due diligence in using data were also important developments to keep an eye on.

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SUMMARY OF SOURCES

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