# Economic Update

SVN | Research

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## 1. AI AND COMMERCIAL REAL ESTATE

- A recent article by MSCI Real Capital Analytics suggests that despite the growing concern about AI's potential impact on commercial real estate, a balanced view should be taken that considers both the economic risks of AI and its potential positive impact on productivity.
- The authors argue that AI could advance economic productivity, leading to higher incomes and increased CRE demand over the long run. Data from MSCI RCA shows that, generally, as a country's economic output per worker (a standard measure of productivity) increases, so does the value of a country's commercial real estate assets.
- Like earlier periods of technological advancement, the dawn of AI may increase structural unemployment in the short term but create demand for new knowledge and skills, which effective federal education and training policies can aid.

## 2. RETAIL THEFT HITS MARGINS, FOOT TRAFFIC RISES

- In its Q2 earnings report, Dick's Sporting Goods' cited retail theft as a critical factor compressing profit margins, shaking equities in the sector this week. While not cited as a primary factor, the report highlights a widespread issue facing many retailers as some US cities see a spike in thefts.
- It is yet to be determined how this may affect Retail real estate. Still, falling investor confidence in the consumer sector could trickle down to commercial activity if businesses delay expansion plans as a result.
- So far, however, retail foot traffic continues to increase and serve as a positive force for valuations, helping offset the impact of rising "shrink" rates.

## 3. MULTIFAMILY, A BRIGHT SPOT FOR CRE

- Multifamily has continued to be a bright spot for commercial real estate even in the face of higher interest rates and falling home affordability, as detailed in a recent Mortgage Professional America (MPA) analysis.
- While new supply has hit apartment rents, from a loan perspective, the piece argues, the sector continues to perform well compared to when they were initially financed.
- According to data cited in the analysis, the average 10-year increase in value of a multifamily asset stands at roughly 160% and was underwritten in a lower interest rate environment, amplifying returns.
- Contrarily, more recently purchased assets haven't seen the same levels of appreciation as rates climb. While this is a downside risk for the sector, it represents a smaller share of total assets than those last transacted before the Fed's tightening cycle, tempering the risk.

## 4. WARNING SIGNALS FOR CONSUMER DEMAND

- Demand for manufactured goods and services weakened in August, according to the latest data from S&P Global's US Composite PMI Index. From July to August, business activity saw its most significant drop since November 2022 despite growing for the seventh consecutive month.
- Consumer spending has largely shaken off the effects of inflation and falling sentiment, which has catalyzed the recent quelling of recession fears. However, August's data registered worse than expected and could be a leading indicator of an upcoming fall in consumption. New business and orders fell across all sectors, while new business in the service sector fell for the first time since February.
- Standing out in the survey was a fall in service demand, which has recently propped up consumption and, by extension, economic growth, as goods consumption has fallen from pandemic highs. The fading impact of service-led growth may hamper GDP. Still, it would be a welcomed sign for the Federal Reserve, which has frequently cited services inflation as a persistent barrier to reducing economy-wide price pressures.

## 5. NEW HOME SALES CLIMB

- Sales of new single-family homes in the US increased 4.4% annually to a seasonally adjusted annualized rate of 714,000 in July, according to the US Census Bureau.
- July's increase was the largest year-over-year increase since February of last year and beat consensus market expectations.
- Sales in the US Midwest region saw the highest year-over-year growth rate during the month, climbing by 74.4% to 84,000. Meanwhile, the West region saw the largest overall total transactions over the past 12 months, registering 181,000 sales while climbing 21.5% year-over-year.
- Sales in the South declined by 6.3% year-over-year, while sales in the Northeast dropped by 2.9%.
- The median price of a new single-family home sold was $436,700 in July compared to $478,200 one year ago.

## 6. CRE'S IMPACT ON BIG CITY BUDGETS

- Diverging trends in the commercial real estate industry make it challenging to forecast fiscal consequences for local governments, but a recent analysis by the Tax Policy Center notes that most US cities saw an increase in their property tax base between 2019 and 2022, though this may be a lagging indicator.
- A separate analysis by GreenStreet estimates that, on average, CRE values, while down over the past year, are roughly on par with those registered in early 2018. While falling valuations present a risk to city budgets, pandemic-era value increases provide many cities a fiscal floor for impending falls in tax revenues. However, how this translates into fiscal health largely depends on local policies and priorities.
- According to analysis, Boston maintains the highest reliance on commercial property tax revenue, which

accounts for close to 36% of its total general revenues. Dallas is second, with property taxes accounting for 26% of revenues, and Atlanta is third, with 19%.
- Conversely, Phoenix relies the least of any large metro on property tax revenues, accounting for just 3% of total general revenue, with Chicago second at 7% and Charlotte at 3rd with 8%.

## 7. US ECONOMY LIKELY INSULATED FROM CHINA CRE TROUBLE

- The recent bankruptcy filing by China Evergrande, a property giant in China, has raised concerns about potential economic stagnation in America's third-largest trading partner and how it may affect the economy at home. However, the US economy will likely be insulated from the worst effects of the crisis.
- For starters, one consequence of the US/China trade imbalance is that Chinese purchases of US goods and services account for less than 1% of US GDP. If Chinese commercial real estate markets falter and the nation's growth declines, it will likely have a muted impact on US business activity.
- For further context, consider the potential trouble brewing in US CRE markets. The office sector, which has been the focus of increasing concern in recent months, is currently valued at $2.5 trillion, according to the Bureau of Economic Analysis. In comparison, total US investment in China (including Hong Kong) stands at just $515 billion. Therefore, domestic concerns should weigh heavier for US investors than China-based ones.
- However, if the Chinese economy tips into an extended period of deflation, a weaker yuan may lower the relative costs of Chinese goods abroad, a potential counterweight to US inflation.

## 8. JACKSON HOLE SUMMIT

- As the world's top economists and policymakers descend on Jackson Hole, WY, for its annual summit, Federal Reserve officials are expected to express a more dovish tone compared to 2022 when Fed Chair Powell warned that a recession may be needed to calm post-pandemic inflation.
- In recent days, some officials have signaled that the central bank may be close to finished with its tightening cycle, with Philadelphia Fed President Patrick Harker referring to current rate levels as "restrictive," a more pointed term than typically used in recent statements by officials.
- Still, as put by Jason Furman, an economist at Harvard, Powell is not expected to boast in a "mission accomplished" tone as he speaks to his peers this week and may suggest that there is more work ahead. However, many expect Powell to refrain from the spookier language compared to 2022, when officials aimed to realign Wall Street expectations on the inflation fight.
- A new point of intrigue for Jackson Hole watchers will be economists' reaction to an unexpected rise in US economic growth and a fall in recession fears. Particularly, onlookers will look to gauge whether the latest data signals that policymakers will keep interest rates higher for longer.

## 9. RETAIL SALES CLIMB

- According to the latest data from the Census Bureau, US retail sales were up 0.7% month-over-month in July.
- Retail sales beat the market consensus forecast of a 0.4% increase and followed an upward revision of June's data. This is the fourth consecutive month where sales have increased.
- Amazon Prime Day may have boosted July sales, with nonstore retailers recording the largest monthly increase across all subtypes, up 1.9%. The category of sporting goods, hobby, musical instruments, and books rose by 1.5% in the month, followed by food services and drinking places (1.4%).
- The most significant monthly decreases in sales were seen in furniture stores, falling 0.8%; health and personal care, falling 0.7%; and building materials and garden equipment, falling 0.7%.

## 10. JOBLESS CLAIMS FALL

- Initial unemployment claims fell by 10,000 to a seasonally adjusted 230,000 during the week ending on August 19th, the latest data available from the US Labor Department.
- While jobless claims rose to start the year as the Fed's monetary tightening began to raise costs for businesses, leading to some layoffs, the labor market has so far avoided a major shock.
- The number of continuing unemployment claims, which represent those receiving benefits for more than one week and a valuable barometer for hiring levels, also fell by 9,000 during the week, landing at 1.70 million.
- The simultaneous forces of a strong labor market, falling inflation, and a recent increase in capital spending have prompted many economists to revise upward their GDP expectations for the year, according to comments by Reuters.

## SUMMARY OF SOURCES

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