Economic Update

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MARCH 31, 2023

1. INTEREST RATE IMPACT ON BANK SECURITIES AND CAPITAL

- After recent distress in the banking sector, there is a risk that many of the small and mid-sized banks that hold the bulk of US commercial real estate loans may see a credit crunch, dampening liquidity in the sector.
- According to Goldman Sachs, roughly 80% of all bank loans for CRE come from regional banks, which are most likely to see a tightening of credit and lending standards following the collapse of Silicon Valley Bank.
- CRE fundamentals remain strong relative to the broader US economy. Still, any upcoming refinance activity must factor in higher interest rates and the shifting demand profiles of CRE sectors. This will be of particular concern for low-interest office loans coming due, which will have to contend with higher rates and lower long-term demand.

2. 2023 SCE HOUSING SURVEY

- Households are increasingly expecting home price growth and rents to decline over the near term, according to the New York Fed's latest Survey of Consumer Expectations Housing Survey.
- Households expect home prices to grow by 2.6% over the next 12 months, down from 7.0% one year ago. Current forward-looking sentiment, which relies on survey data taken in February, is the lowest since the regional bank started conducting the survey in 2014.
- On the other hand, five-year forward expectations rose to 2.8% from 2.2% last year.
- Rents are expected to increase by 8.2% over the next 12 months, which is still a robust estimate, but is down from 11.5% last year. Meanwhile, renters place their probability of owning a home in the future at 44.4%, a tick up from the 43.3% registered one year ago.
- Respondents expect mortgage rates to rise to 8.4% one year from now and 8.8% in three years.

3. JOBLESS CLAIMS

- Initial jobless claims rose higher than expected during the week ending on March 25th, totaling 198,000, which is 7,000 claims above the previous week. Economists forecasted claims to grow to 195,000 during the week.
- While the four-week moving average for initial claims have been steadily rising, they remain relatively benign in the face of higher interest rates and slowing economic activity. Specifically, while forward-looking unemployment rate projections continue to rise, employers have been slow to lay off workers, a potentially good sign for the labor market as recession fears grow.
- Continuing claims, which run on a one-week lag, rose by 4,000 during the week to 1.68 million, slightly below estimates.

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4. Q4 GDP FINAL NUMBERS

- The Commerce Department slightly revised down its Q4 2022 GDP numbers in its third estimate, released on March 30th. The final metric was marked down to a 2.6% annualized rate, down from the 2.7% previously reported.
- According to the report's analysis, the downward revision primarily reflects downward revisions to exports and consumer spending. Imports were also revised down, which had an upward effect on GDP.
- Overall, last quarter's growth was driven by increases in private inventory investment, consumer spending, non-residential fixed investment, and government spending.
- Based on the Atlanta Fed's GDPNow tracker, growth is estimated to have accelerated during the first three months of 2023. GDPNow currently projects a 3.2% annualized growth rate for the US economy in Q1.

5. MORTGAGE RATES FALL

- According to Freddie Mac, mortgage rates fell to their lowest levels in six weeks during the week ending on March 30th. The 30-year fixed rate fell to 6.32%, down ten basis points from one week prior.
- After reaching a high of 7% last September, mortgage rates declined to close 2022 and fell as low as 6% in January, prompting an 8% jump in pending home sales that month. Rates began to rise again in mid-February as the market priced some uncertainty around the Fed interest rate policy path. The downtrend follows a cautious 25 basis points rate hike by the Fed, which, combined with recent financial market distress, has many forecasting a pause or reduction in interest rates soon.
- Mortgage rates are also declining right as the spring homebuying season begins, which is likely to entice many who have been on the sidelines in recent months back into the market. However, low inventory will remain a challenge and will likely place some upward pressure on home prices if rates continue to trend lower.

6. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- The on-time payment rate in independently operated rental units improved by 186 bps between February and March, coming in at 84.9% and reaching a new post-pandemic high, according to the latest Independent Landlord Rental Performance Report by Chandan Economics. March's full payment rate is forecasted to land at 94.3% — which would also be a new high.
- National on-time payment rates have now held above 81% for six consecutive months — a first in the life of the Chandan Economics-RentRedi tracking.
- Washington holds the highest on-time payment rate of any state in the country, coming in at 92.8% in

March.

- On-time payment rates picked up across all price points in March, with low-priced rentals seeing substantial month-over-month improvement. Meanwhile, 2–4-unit rental properties held the highest on-time payment rates of all sub-property types in March, coming in at 85.6%.

7. NEW & PENDING HOME SALES

- New single-family home sales rose to an annualized rate of 640,000 in February, up 1.1% from January but down by 19.0% year-over-year. It was the third consecutive month where new home sales rose, partly due to a moderation in mortgage rates that has fueled recent homebuying activity.
- Regionally, the South and West US saw transaction increase in the month while the Northeast underperformed.
- Pending home sales similarly grew for the third consecutive month during February, climbing by 0.8% month-over-month, according to the National Association of Realtors. Year-over-year pending transactions fell by 21.1%.
- NAR Chief Economist Lawrence Yun sees the concurring upticks as evidence that the "housing sector's contraction is coming to an end," as both sales indicators alongside construction activity have trended up in the past quarter.

8. HOME PRICES

- Home prices continued to decline through January 2023, according to the latest update to the S&P CoreLogic Case-Shiller US National Home Price Index. Compared to June 2022's peak, average home prices are down 3.0%. Still, measured year-over-year, home prices remain up 3.8% through January.
- Miami (+13.8%), Tampa (+10.5%), and Atlanta (8.4%) reported the highest year-over-year increases within the 20 cities tracked by the index, with Charlotte (+8.1) following close behind. San Francisco, Seattle, San Diego, and Portland registered negative year-over-year growth.
- Before seasonal adjustment, 19 cities tracked reportedly registered a decline in home prices, while 15 cities tracked registered an increase. However, in both seasonally adjusted and non-seasonally adjusted figures, January's performance was notably better than December's.
- Regionally, the Southeast (+10.2%) remains the strongest region for growth, while the West (-1.5%) remains the weakest.

9. CONSUMER SENTIMENT

- According to preliminary estimates for March by the University of Michigan, consumer sentiment fell for the first time in four months to an index reading of 63.4. The first estimate for March sits roughly 5%

below February's mark but remains 7% above this time last year.

- All index sub-components worsened during the month, mainly due to persistently high prices of goods and services and financial uncertainty.
- Notably, roughly 85% of responses for the current estimate were made before the collapse of Silicon Valley Bank and other financial market stress, which may signal a downward revision in future updates.
- Year-ahead inflation expectations fell to 3.8% in March, the lowest reading since April 2021. Long-run inflation expectations also declined, falling to 2.8%, only the second time in the past 20 months that the metric dipped below 3.1%. Both expectations metrics remain elevated above their pre-pandemic normal ranges.

10. MAY RATE-HIKE PROBABILITIES

- According to the Chicago Mercantile Exchange's Fed Watch Tool, futures markets are relatively split on forecasts for May's policy meeting. The majority of markets (52.9%) are pricing in a pause in the Fed's interest rate hikes, while a weighty minority (47.1%) expect a 25 basis points hike in May. The current federal funds rate sits at 475-500 basis points.
- Recent US bank failures swung what was initially a firmly hawkish forecast in early March into an increasingly dovish one leading up to the Fed's March 22nd policy decision. Many investors are betting that the financial market distress, alongside slowing inflation, will encourage the Fed to pause rate increases to provide liquidity to the market.
- Futures markets now anticipate that the committee will hold rates steady until the September 2023 meeting, when markets expect the Fed to begin loosening again.

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SUMMARY OF SOURCES

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