Economic Update

SVN | Research

JULY 12, 2024

1. CPI INFLATION

- The Consumer Price Index fell by 0.1% month over month in June, its first monthly downtick in over four years, according to the latest data from the Bureau of Labor Statistics.
- Prices continue to climb annually, rising 3.0% year-over-year, but slowed, falling from an annual increase of 3.3% in May.
- Falling gasoline prices helped put downward pressure on overall prices, offsetting much shallower increases in food and shelter prices. Notably, shelter prices have remained a persistent factor behind inflation pressures, and while they were still an upward factor to inflation during this month's report, the recent slowdown in shelter prices is a welcomed sign.
- Core-CPI, which excludes food and energy prices, continued to increase monthly, climbing 0.1% from May. However, core prices climbed by their slowest annual pace of inflation since April 2021, rising 3.3% from one year ago.

2. FOMC MEETING MINUTES

- According to minutes of the Federal Reserve's June policy meeting, officials indicated that while inflation is heading in the right direction, greater confidence is needed before beginning rate cuts.
- There was a greater degree of disagreement among policymakers relative to the previous meeting, with some indicating a willingness to raise rates again to re-anchor inflation expectations. Others emphasized the need for the Fed to stand ready should any unexpected weakness emerge in the US economy.
- Officials continued to emphasize that they would not lower rates before more data emerged that gave them greater confidence that inflation was cooling. This signaled that the most recent mix of macroeconomic data at the time of the meeting had yet to reasonably shift their overall confidence.

3. CRE CONDITIONS & SENTIMENT: Q2 2024

- The latest edition of Altus Group's quarterly survey on commercial real estate conditions and sentiment showed a slight rise in recession concerns among respondents alongside expectations that the financing environment will remain challenging. Still, expectations for income growth improved, and distress is

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
185 Devonshire St, M102
Boston, MA 02110

expected to fall over the next 12 months.

- The survey respondents, who come from a mix of organization types and functions, expect financing costs to continue increasing marginally over the next 12 months, alongside a decrease in net returns to equity. On the one hand, more than a third of respondents expect capital availability to increase in the next year, but a slightly higher share expects the cost of capital to grow over the same period.
- Many expect to remain focused on de-risking in the coming quarters, with capital expenditures expected to stabilize relative to the past 12 months. The continued focus on de-risking comes alongside a slight uptick in recession concerns compared to the previous quarter.
- However, a plurality of respondents (49%) do not anticipate a recession in the short term. More notably, those who identified as having a 'core strategy' remain the least expectant of a recession within the next six months, while respondents deploying more opportunistic strategies tended to view the near term with more pessimism.
- Generally, participants expect revenue and NOI growth to be stable over the next 12 months, while 72% of respondents expect CRE distress to fall over the same period.

4. INVESTORS EYE OFFICE MARKET BARGAINS

- Distress signals have become an increasing focus as close to $1 trillion of commercial real estate debt is set to mature this year under a fundamentally different post-pandemic office sector. However, some well-positioned investors are focused on the opportunity to scoop up bargains amid the frenzy.
- According to Bloomberg's reporting on data compiled by Prequin, private equity firms have set aside an average of 64% of their dry powder to invest in office properties.
- As traditional Office market lenders pull away from CRE amid higher interest rates and falling values, a credit availability gap is widening, presenting opportunities for alternative investors. PGIM estimates that there's a gap of roughly $150 billion between the volume of loans coming due and credit availability from traditional lenders.
- While the structural fundamentals that underlie recent trends in CRE valuations are still salient to investors' outlook, the opportunity to snap up bargains during the current downcycle remains attractive to those

with lower barriers to financing.

5. JUNE JOBS REPORT

- According to the Bureau of Labor Statistics (BLS), the US economy added 206,000 jobs in June, beating the consensus forecast of 200,000 but a downtick from May's 218,000 job adds.
- The unemployment rate rose to 4.1% during the month, its highest rate since October 2021. The previous month's robust jobs report was notably revised downward from the initial 272,000 reported. The data will weigh heavily on the Fed's upcoming policy decisions as officials look for persistent signs of inflation pressures cooling before moving to cut rates.
- The labor force participation rate, which measures all working-age adults who are either employed or looking for work, rose during the month to 62.6%. The concurrent rise in unemployment signals that working-age adults who are out of the labor force are being encouraged to re-enter. The broader unemployment rate, which includes discouraged workers and those who are part-time for economic reasons, held steady from May.
- Annual wage growth rose by 0.3% month over month and 3.9% from one year ago, each in line with the consensus estimate.

6. LOGISTICS MANAGERS' INDEX

- According to the Logistics Managers' Index, US logistics activity expanded for the seventh consecutive month in June but slowed as inventories fell and warehousing utilization dropped.
- Inventory levels fell for the second consecutive month, simultaneously slowing inventory cost inflation and overall warehousing utilization. Meanwhile, warehousing and transportation capacity fell out of expansion for the first time since March 2022, which was notably the final month preceding a prolonged freight downturn.
- The tightening of transportation capacity led to an increase in transportation prices, which now sit at their highest level since September 2022. Considering the trend of transportation prices expanding at a faster rate than transportation capacity in recent months, an expected upcoming seasonal peak could

end a more than two-year freight recession.

7. CONSTRUCTION SPENDING

- US construction spending fell by 0.1% from the previous month in May, the latest month of data availability from the US Census Bureau. The increase in spending charted below consensus estimates and follows a 0.3% increase in April. Construction spending is up 6.4% year-over-year.
- The private spending segment of the market fell by 0.3% month-over-month, led by a decline in non-residential construction, particularly educational (-3.4%), religious (-2.9%), and healthcare (-2.2%). Residential construction also fell, down 0.2% from the previous month, led by a 0.7% drop in single-family projects.
- Public construction spending rose by 0.5%, led by a 2.6% increase in residential construction spending and a 0.4% rise in non-residential spending.

8. NFIB BUSINESS OPTIMISM

- According to the latest report from the National Federation of Independent Businesses, small business optimism in June reached its highest level since December 2023, rising to an index level of 91.5.
- Despite the increase, the index remains below its historical average of 98, while the report's analysts note that, overall, Main Street businesses largely remain pessimistic about the economy this year.
- The share of small business owners reporting job openings that they could not fill fell five points from May. Still, more than eight in ten owners who are actively hiring continue to struggle to find qualified applicants to fill their positions.
- A smaller share of owners reported capital outlays in the last six months than the previous month, while a net negative 12% of owners reported higher nominal sales over the past three months.
- The frequency of reports of positive profit trends stood at a net negative 29% (seasonally adjusted) in the June report, a slight improvement from May but still underwhelming. 34% of small business owners reporting lower profits blamed weaker sales, 17% blamed material cost increases, 12% cited labor costs, and 9% indicated lower selling prices.

Economic Update

SVN | Research

9. BANK CRE LOAN PERFORMANCE

- According to a Trepp analysis using anonymized loan-level repository data, commercial mortgage origination volumes for bank-held CRE loans fell in Q1 2024, decreasing to a total of $3.2 billion from $4.0 billion in Q4 2023.
- Metrics measuring loan performance, such as net charge-offs, delinquency rates, and occupancy rates, largely reflected higher levels of distress in CRE lending.
- The industrial sector is experiencing the lowest quarterly average in origination volume relative to its pre-COVID average compared to all other sectors, down by 82% from 2019. The office sector is experiencing the second-largest decline relative to pre-COVID levels, down by 73%.

10. Q3 2024 GLOBAL ECONOMIC OUTLOOK

- A new report by Capital Economics suggests that while the global economy continues to face headwinds in its recovery, some of the most adverse effects of the post-pandemic inflation surge appear to be subsiding, possibly allowing central banks to begin shifting towards a relatively looser stance in the near future.
- The report notes that GDP picked up in Europe and several emerging markets to begin 2024, which lagged the United States in the initial post-COVID recovery over the past few years while also contending with high inflation.
- Recent falls in inflation have boosted real incomes in most economies. Meanwhile, labor markets remain resilient with relatively low unemployment rates amid supportive fiscal policy regimes.
- The report also notes that there is little sign that higher interest rates will have a lagged recessionary effect on a global stage. It notes that lending standards have tightened across the board over the past two years, with credit conditions, delinquency rates, and consumer confidence levels each moving in relation. However, despite these shifts, growth has remained resilient in most economies.
- Capital economics projects that by the middle of 2025, 20 of the most 30 major central banks will be cutting interest rates, which will have a stimulating effect in most economies throughout next year.

Economic Update

SVN | Research

SUMMARY OF SOURCES

- (1) https://www.bls.gov/news.release/cpi.nr0.htm
- (2) https://www.federalreserve.gov/monetarypolicy/fomcminutes20240612.htm
- (3) https://www.altusgroup.com/insights/cooling-economy-lifts-us-recession-expectations-modestly/
- (4) https://www.benzinga.com/top-stories/24/07/39720428/distressed-investors-see-exceptional-bargains-in-troubled-us-commercial-real-estate-sector
- (5) https://www.bls.gov/news.release/empsit.nr0.htm
- (6) https://www.the-lmi.com/
- (7) census.gov/construction/c30/current/index.html
- (8) https://www.nfib.com/surveys/small-business-economic-trends/
- (9) https://www.trepp.com/instantly-access-q1-2024-tallr-report?submissionGuid=22782548-44a3-4686-8f80-32a78f168470
- (10) https://www.capitaleconomics.com/global-economy-outlook

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
185 Devonshire St, M102
Boston, MA 02110