Economic Update

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SEPTEMBER 30, 2022

1. INTEREST RATE HIKE

- On September 21st, the FOMC voted to increase the Federal Funds Rate by 75 bps for third consecutive time to fight persistent US inflation. The current Federal Funds Target Rate sits at 3.00%-3.25%—its highest level since January 2008.
- Stocks reacted negatively to the news, with the Dow closing 1.7% lower than it started on Thursday, while the Nasdaq Composite fell 1.79%.
- In its summary of economic projections, the committee forecasted a half-percentage point rise in unemployment and an effective federal funds rate of 4.6% by the end of 2023.
- Notably, central banks across Asia and Europe followed suit on September 22nd with their own string of rate hikes, a signal that global monetary policy is coalescing to tackle what is a global phenomenon.

2. SUMMARY OF ECONOMIC PROJECTIONS

- The Federal Reserve's latest summary of economic projections, released alongside the September policy meetings, reflected a consensus forecast of slowing growth, higher inflation, and a limited increase in unemployment by the end of 2022.
- The average forecast for the annual change in GDP through Q4 2022 fell to a dismal 0.2% in their September projection, a drop from the 1.7% growth forecast in June.
- The Fed also projects that, as a result of higher rates and slowing growth, the unemployment rate will rise to 3.8% by year's end, but this is just ten bps above their June forecast.
- Both headline and core inflation are expected to remain above the FOMC's 2.0% target as we turn the page to 2023. The median forecast for headline PCE was 5.4% in the September projections, up from a forecasted 4.2% in June, signaling that the Fed believes that more aggressive action is needed to fight inflation compared to what they thought was required just a few months ago. The median core-PCE projection, which removes food and energy costs, rose to 4.5% from 4.3% in June.

3. LIFE SCIENCES DRIVE OFFICE DEMAND

- CommercialEdge's latest National Office Report, released in September 2022, shows that Life Sciences is increasingly driving office demand even as office vacancies continue to climb.
- 21.6 million square feet of lab space is currently in development nationally, with the largest projects in Boston, San Diego, and San Francisco. Moreover, the average Life Science facility sits at $645 per square foot, significantly above the average of $258 per square foot for general office buildings.
- Large projects planned in Boulder County, Colorado, and Phoenix also signal that the trend has stretched beyond the typical hubs for the sector and into more tertiary markets.
- According to BLS data, as of 2021, employment in life science related positions is highest in Boston

(23,900), New York (18,100), and San Francisco (14,200), as defined by CommercialEdge's scope of the industry.

4. MEDIAN APARTMENT RENTS DECLINE

- Property tracking by Zumper shows that the median apartment rent has decreased for the first time in almost two years, with more than half of the markets tracked by the firm showing month-over-month declines in the average one-bedroom rent.
- Zumper's findings are supported by recent data from CoStar and RealPage, which show a ten bps decline in apartment asking rents nationally between July and August (CoStar) and a 0.4% increase in same-store asking rents for new leases between July and August (RealPage).
- Some large metros are bucking this trend; however, low supply in some markets amid high demand has limited the flexibility of rent prices. In Seattle, the median one-bedroom is $2,040, up 20.7% year-over-year and 2.0% month-over-month, according to RealPage. Rents in New York City also continue to reach new highs.
- Minneapolis, Nashville, Tampa, Orlando, Jacksonville, and El Paso saw declines in asking rents in August.

5. RETURN-TO-OFFICE

- Market watchers have long signaled that September would be a telling month for the health of the US office sector. With children returning to schools without the overhanging threat of possible shutdowns and prolonged periods of remote learning, employers are making bigger pushes to get workers back at their desks.
- According to Kastle System's "Back to Work Barometer," physical office occupancy across the 10 US cities averaged 47.5% of its pre-pandemic benchmark in the week of September 14th. While these data indicate that physical office occupancy remains less than hallway towards a full recovery, they nonetheless represent the highest occupancy rates since March 2020.
- Average office physical occupancy rates jumped by a sizable 4.1% across the top 10 markets, reflecting the impact of children starting their school year. New York saw the largest one-week increase, with occupancy rates rising by an encouraging 8.7%. Meanwhile, Austin holds the title as the most recovered office market to-date, with physical occupancy rates rising to 60.5% of their pre-pandemic benchmark.

6. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- The on-time collection rate for independently operated residential properties fell by 55 bps between August and September, landing at 81.1%, according to the latest Independent Landlord Rental Performance Report by Chandan Economics.

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- Gateway markets have maintained higher on-time payment rates than units located elsewhere for nine consecutive months through July 2022, though the gap has been narrowing over the previous three months. The September on-time rate for Gateway markets stands at 82.3%, while non-gateway markets registered an on-time rate of 81.2%.
- Analyzing performance trends at different rental price points, units with monthly rents below $1,000 continue to register the lowest average on-time payment rate through September 2022, coming in at 79.6%. Mid-priced rental units perform the strongest, with a September on-time payment rate of 85.4%. High-priced rentals, defined as those charging more than $2,500 sit in the middle, with an on-time payment rate of 84.4% in September.
- 2-4 Family rentals maintained the highest on-time payment rate of all sub-property types for the sixth consecutive month, arriving at 83.2%.

7. REMOTE WORK AND HOUSING DEMAND

- A new paper by the San Francisco Fed analyzes the relationship between the uptick in remote work and housing demand and found that the shift to remote work may account for more than half of overall home-price increases between November 2019 and November 2021.
- The share of work done from home, either full or hybrid, has stabilized around 30% as of August 2022, up from 5% in 2019 and 60% in Spring 2020. Still, levels differ significantly across metros, and data shows that cities with more remote work before the pandemic saw larger increases in remote work during the pandemic.
- Breaking cities down into tiers, based on their level of remote work, price growth was essentially uniform across all tiers before the pandemic. However, by late 2020, cities with a higher share of remote work saw significantly higher home price increases than those with less, with the divergence expanding in 2021.

8. LABOR MARKET DISENGAGEMENTS

- Despite rising economic headwinds and growing recessionary concerns, the US labor market remains exceptionally tight, with nearly two job openings available for every one person looking for work. A significant reason why demand for labor is outpacing supply is that less Americans are participating in the labor force. While the labor force participation rate has risen by 0.7 percentage points in the past year, it remains down by another 1.0 percentage points from where it entered the pandemic.
- A recent Chandan Economics analysis of the Census Bureau's August 2022 Current Population Survey explored the reasons why out-of-work Americans are choosing not to look for jobs. According to the findings, two factors are keeping a growing number of people out of the job market: family responsibilities and schooling/training.

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- Family responsibilities was the primary reason why 18.8% of out-of-work Americans had not looked for new employment in recent weeks— up from just 12.1% in 2020. The uptick is likely due to a surge in family formations following the initial stages of the pandemic.
- Similarly, 15.1% gave the reason of attending school or enrolling in a training— up from 8.8% two years ago.

9. MSCI RCA COMMERCIAL PROPERTY PRICE INDEX

- Commercial real estate prices climbed by 14.0% year-over-year through August, according to the latest national all-property index released by MSCI RCA. This month's increase was the slowest annual pace of 2022, while the index rose just 40 basis points month-over-month.
- Each of the four major sectors saw modest price growth deceleration in August. Industrial retains its top spot, with prices growing 24.7% year-over-year. Industrial also charted the most significant monthly increase, climbing by 1.5%.
- The Apartment index rose 17.1% year-over-year but experienced its sixth consecutive month of slowing growth. Apartment prices climbed by ten bps between July and August.
- The Retail index rose 16.0% year-over-year but, like Apartments, saw its sixth consecutive month of slowing growth. Retail prices are up 80 bps from July.
- Suburban Office posted a 6.6% year-over-year increase and saw its fourth consecutive month of slowing price growth. The CBD Office index rose 7.7% year-over-year and ten bps between July and August.
- Price growth in Gateway markets climbed 7.6% year-over-year while price growth in non-major metros rose by 16.3% year-over-year.

10. GLOBAL SUPPLY CHAINS

- According to the New York Federal Reserve's Global Supply Chain Pressure Index, supply chain conditions have made significant progress towards normalization in recent months, though they are still far from pre-pandemic normality.
- Supply chain disruptions have proven a significant contributor to inflation both in the US and around the world over the past year, as consumer demand has exceeded the capacity of supply lines to keep up.
- The index has a historical average value of zero, with each monthly observation represented as standard deviation from the mean. August 2022's index value was a 1.47. Before the pandemic, the index had never fallen below -1.57 or risen above 1.56, indicating that today's conditions still reflect abnormally stressed supply chain conditions.
- Nonetheless, the index has improved considerably in 2022. After reaching an all-time high is December 2021 (4.31), the Supply Chain Pressure Index has fallen in six of the past eight months.

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SUMMARY OF SOURCES

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