

Economic Update

 **SVN** | Research

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1. GDP

- Real US GDP expanded at a 3.3% annualized rate during Q4 of 2023, according to the advanced estimate from the US Bureau of Economic Analysis. The estimate surpasses the consensus projection of 2% and follows a 4.9% growth rate in Q3, bringing total 2023 US GDP to 2.5% compared to 1.9% in 2022.
- Non-residential investment increased by 1.9% in Q4 compared to 1.4% the quarter prior, led by rebounds in equipment and intellectual property products. Investment in structures eased while residential investment grew but at a slower pace.
- Consumer spending slowed during the quarter, dropping to 2.8% from 3.1%. The slowdown was led by slowing goods consumption, while services consumption rose from 2.2% to 2.4%. Food services, accommodations, and health care were the leading growth sectors for services.
- Private inventory growth dropped from 1.27% in Q3 to just 0.07% in Q4, while government services rose at a 3.3% rate compared to 5.8% the quarter prior. Export growth accelerated from 5.4% to 6.3% while imports slowed.

2. COMMERCIAL PROPERTY PRICE INDEX

- According to the MSCI RCA commercial property price index, the pace of decline in US commercial sector prices decelerated in December, led by stronger performance in the industrial sector.
- Commercial property prices were unchanged month-over-month but fell 5.9% year-over-year through December. For context, at the end of Q3 2023, prices fell at nearly double the rate.
- The industrial sector was the only property type with an annual or monthly decline in December. Prices rose 0.3% month-over-month and 0.5% year-over-year.
- Apartment sector prices declined 8.4% year-over-year and changed little month-over-month. Sector price declines have been decelerating in recent months, signaling that apartment prices may be approaching a nadir in the ongoing cycle.
- Retail prices were down -0.1% from November and -5.5% year over year. Meanwhile, the office sector continued to post the largest decline on both a monthly and annual basis, dropping -1.3% and -16.1%, respectively.

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- Total US deal volume finished 2023 down 51% compared to the previous year, its sharpest annual decline since 2009.

3. INDUSTRIAL REAL ESTATE TRENDS

- The Industrial real estate sector has been the best-performing segment of CRE during both the pandemic-era boom and the current market downturn, and while the sector is likely to remain bright, growth is expected to slow compared to previous years, according to a recent analysis by Commercial Property Executive
- 505 million sqft of industrial space was under construction as of November 2023, accounting for 2.7 of existing inventory. However, the increased cost of financing over the past two years has begun to settle into construction activity, with buyers and sellers slowing their activity.
- Prologist head of Global Research Melinda McLaughlin suggests that the logistics market is in the middle of a supply-driven “mini-cycle,” characterized by a recent influx of new supply that is likely to be followed by a pullback in project deliveries in the second half of 2024.

4. REIT PERFORMANCE IMPROVES

- Public-market real estate performance strengthened to end 2023 and could signal upcoming improvement in the private sector. According to the MSCI USA IMI Liquid Real Estate Index, public market REITs saw performance strengthen during Q4, resulting in an annual return of 8.5% during 2023 despite posting prices with negative returns throughout much of the year.
- While public markets notably utilize significantly higher rates of leverage compared to private markets, the MSCI’s Liquid Real Estate Index controls for leverage and provides readers with a more apples-to-apples comparison. Public market performance is often a leading indicator for upcoming private market activity.
- Interest rate increases in 2022 and 2023 dampened private markets, sending the MSCI Global Quarterly Property Index down 7.3% between their peak in June 2022 and September 2023.

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5. RED SEA CRISIS & CRE

- Global supply chain concerns have again come into focus as a crisis unfolds in the Red Sea, creating bottlenecks for goods and sparking fears that disruptions could trigger similar supply-side price pressures compared to during the pandemic.
- A BisNow analysis shows that shipping costs skyrocketed during the first two weeks of January in response to the recent Houthi rebel attacks on Red Sea shipping. Ships passing through the Red Sea accounts for 30% of global shipping traffic, and reroutes around Africa can add an average of 10 days and \$1M in fuel costs per trip.
- Real estate and construction may face the most immediate risks as architects, designers, and contractors must factor potential disruptions into their plans, projections, and project analyses.

6. INTEREST RATE FORECASTS

- With market consensus pointing towards several Fed rate cuts in 2024, some warn that robust US economic data and recent signals from central bank officials should cause investors to moderate their bets.
- According to the Chicago Mercantile Exchange's Fed Watch Tool, futures markets, on average, project that there will be six quarter-percentage point cuts in 2024, bringing the end-of-year federal funds rate to 375-400.
- However, in recent weeks, several officials have pushed back against the idea that cuts are imminent, with most comments suggesting that policymakers will need more evidence that inflation is continuing to cool and approaching its 2% target. As a result, futures markets have recently pushed back their forecast for the first rate cut in 2024 from March to May.
- While inflation has continued to cool year-over-year, monthly price pressures continue to fluctuate. The consumer price index increased slightly faster in December than in November, registering 0.3% and 0.1% month-over-month, respectively. However, updates to the PCE price index—the Fed's preferred inflation measure— will provide better insight into the FOMC's considerations later this month.
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7. CPI

- According to the Bureau of Labor Statistics, the Consumer Price Index rose 0.3% month over month and 3.4% annually. The monthly pace of CPI is an improvement over the previous month's mark, which saw prices increase by 0.1% monthly, but annual prices accelerated from 3.1% in November.
- The shelter index continued to climb in December, contributing more than half of the increase during the month.
- US energy prices rose by 0.4% on the month, led by increases in electricity and gasoline rates. While there was a decrease in the natural gas index, this was mostly offset by the previously mentioned increases. Food prices increased by 0.1% month-over-month.
- Core-cpi prices, which excludes food and energy, rose 0.3% in December, in line with November's rate of increase.

8. WHO IS MOVING INTO SFR?

- According to a Chandan Economics analysis, the average SFR household entering their unit materially differs from renters already in their homes.
- The average age of a head of household moving into an SFR in 2022 was just 38.8 years old. Conversely, the average age of preexisting householders in SFR was nearly a decade older at 47.1. Further, almost half of all new SFR renters were below the age of 35 — compared to just a quarter of preexisting SFR renters.
- Considering new SFR households are, on average, younger than their preexisting SFR neighbors, it would be reasonable to expect them to have lower incomes due to less career experience. Yet, the data indicate otherwise. Instead, new SFR households out-earn preexisting SFR households by an average of more than \$11k. New SFR households have an average annual household income of \$83,635, while preexisting SFRs earned \$72,246.

9. OFFICE TO APARTMENT CONVERSIONS

- According to a recent Rent Cafe analysis, Office-to-Apartment conversions in major cities during 2024 are set to quadruple compared to four years ago. Over 55,000 conversions are in the pipeline for this

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year, soaring above the 12,100 converted in 2021.

- Conversions have steadily increased over the past four years, reaching 23,100 units in 2022 and 45,200 in 2023. More than 147,000 conversions are planned to take place over the next few years.
- Washington, DC, has the largest number of units planned for conversion from offices this year, at 5,820. New York is second, with 5,215 apartments under conversion from offices, followed by Dallas (3,163), Chicago (2,822), and Los Angeles (2,442).

10. CONSUMER SENTIMENT

- The University of Michigan's consumer sentiment soared to 78.8 in January, its highest mark since July 2021, according to the preliminary estimate. December's mark was 69.7, while consensus forecasts for January sat at an index value of 70 leading up to the report.
- Consumer confidence was boosted by views that inflation has turned a corner and income expectations are beginning to strengthen. One year ahead, inflation fell to 2.9%, the lowest level since December 2020. Meanwhile, the five-year outlook edged lower to 2.8% from 2.9% in December.
- Consumer expectations climbed to 75.9 from 67.4 the previous month, while the measure assessing current economic conditions rose to 83.3 from 73.3.
- Taking January and December together, consumer sentiment has climbed a cumulative 29%, the largest two-month increase since 1991, with all five index components rising for the second straight month.

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SUMMARY OF SOURCES

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