

Economic Update

 **SVN | Research**

JULY 29, 2022

1. GDP

- Real GDP declined by an annualized 0.9% in Q2 2022, according to the advanced estimate released by the Bureau of Economic Analysis (BEA). The decline follows a 1.6% annualized contraction in Q1, placing the US economy in a technical recession, though one has not yet been officially declared by the National Bureau of Economic Research (NBER).
- Private inventory investment, residential fixed investment, federal government spending, state and local government spending, and nonresidential fixed investment declined during the quarter, while exports and consumption increased. Imports also increased, contributing negatively to growth.
- Retail trade registered the most significant decrease within private inventory investment, which mainly reflected a contraction among general merchandising stores and vehicle dealerships. A decline in brokers' commissions led to a reduction in residential fixed investment. Meanwhile, a drop in non-defense spending was partially offset by a rise in defense spending, but not enough to avoid a decline in total federal government expenditures.
- Decreased investment in structures led to declines in both nonresidential fixed investment and state and local government expenditures. A rise in service expenditures led imports. Meanwhile, the increase in exports reflected an increase in industrial supplies, materials, and travel. Consumption was powered by a rise in food services and health care expenditures.

2. INTEREST RATE HIKE

- On July 27th, the FOMC voted to increase the Federal Funds Rate by 75 bps to help tame inflationary pressures. The increase follows initial increases of 25 and 50 bps in March and May, respectively, and another 75 bps hike in June. The current Federal Funds Rate sits at 2.25%-2.5%—its highest level since December 2018.
- Since tightening began in March, the committee has consistently signaled its intent to follow through with rate increases until inflation and inflation expectations were confidently under control. In a statement after their Wednesday meeting, Fed Chair Jerome Powell stated that the committee believes we may need a “period of growth below potential in order to create some slack” and that they may, at some point, slow their pace of rate increases in order to observe the impact of their initial policy moves.
- Stocks initially climbed on the news, as futures markets had already accurately priced in an anticipated 75 bps hike. Following the announcement of the increase, a plurality of traders still forecast another 75 bps increase at the FOMC's next policy meeting in September.

3. INDEPENDENT LANDLORD RENTAL PERFORMANCE

Economic Update



- The on-time collection rate for independently operated residential properties fell by 114 bps between June and July, landing at 80.1%, according to the latest Independent Landlord Rental Performance Report by Chandan Economics.
- Gateway markets have maintained higher on-time payment rates than units located elsewhere for seven consecutive months through July 2022; however, they also registered a significant 240 bps decline between June and July. The July on-time rate for Gateway markets stands at 80.4%, while non-gateway markets registered an on-time rate of 80.0%.
- Sun Belt rentals have underperformed the rest of the US for four consecutive months, though the spread has begun to narrow. Between June and July, on-time payments in non-Sun Belt regions fell by 160 bps while the rate inside of the Sun Belt only declined by ten bps, shrinking the gap between the two to just six bps. The Sun Belt's growing success has seen some affordability issues arise, as markets re-price more quickly than some existing residents can handle.
- 2-4 Family rentals maintained the highest on-time payment rate of all sub-property types in June, though they also saw a slight decline, coming in at 81.3% for the month.

4. RESIDENTIAL MORTGAGE DEMAND

- During the week ending on July 22nd, mortgage demand in the US, including both purchases and refinancing activity, declined to its lowest level since February of 2000, according to the Mortgage Bankers Association of America.
- Mortgage applications fell by 1.8% week-over-week despite an eight bp decline in the average rate on a 30-year fixed rate mortgage. Economic uncertainty and broad affordability challenges appear to have left some potential buyers on the sideline as purchase activity declines.
- The refinancing rate fell by 3.7% week-over-week while loan purchases fell by 80 bps.

5. MSCI RCA COMMERCIAL PROPERTY PRICE INDEX

- Commercial real estate prices climbed by 18.5% year-over-year through June, according to the latest data from MSCI RCA's All-Property index. The index rose by 1.3% month-over-month.
- June's pace is on par with growth rates seen in recent months and is a tad under the record 19.5% growth registered earlier this year.
- Industrial outpaced all other property types in quarterly and annual growth rates, climbing by 4.8% and 26.9%, respectively. June marked the ninth consecutive month of above-20% year-over-year growth for the sector.
- Apartment followed close behind, with a 23.7% year-over-year rise in the index. Prices in the Apartment sector rose 1.6% from May to June—the highest monthly increase among the sub-indices.

Economic Update



- Annual growth in the Retail sector was little changed, with an 18.8% climb— just 110 bps below its record high, which was reached earlier this year.
- Suburban office slowed to 9.7% year-over-year, while CBD office rose by 7.6%.

6. LUMBER PRICES

- A recent analysis by the National Association of Home Builders shows that, on average, lumber price increases during the pandemic added \$14,000 to the price of a home and \$51 to monthly rents.
- The study looked at the basket of goods that feed into lumber and wood pricing, such as framing lumber, plywood, oriented OSB, particleboard, fiberboard, shakes, and shingles. It is also based on Home Innovation Research Labs's estimate that new single-family homes use roughly 2,200 square feet of softwood plywood, 6,800 feet of OSB, and 15,000 feet of framing lumber.
- In addition to lumber prices, home price appreciation has climbed due to factors such as interest on construction loans, broker's feeds, and other margins, plus market demand factors. Rising wages for construction workers have also contributed.

7. PCE INFLATION

- The PCE Price Index increased by 7.1% in Q2 2022. The Q2 increase matches that of Q1, which is the fastest rise since 1981.
- Core PCE prices, which exclude the cost of food and energy and are the Fed's preferred inflation gauge when considering monetary policy decisions, increased by 4.4% in Q2 compared to 5.2% in Q1.
- The price index has accelerated or remained the same in five of the previous six quarters. On July 27th, The FOMC initiated its second consecutive 75 bps rate hike to tame inflationary pressures.

8. OFFICE DEMAND

- VTS reported a 6% decline in demand for new office space in June as remote work remains a factor in many tracked markets, according to the latest office demand index (VODI).
- Demand on the local level has seen increased volatility, reflecting growing uncertainty among potential tenants as companies consider upcoming recessionary risks. According to the June report, more than half of the markets tracked saw a demand swing greater than 10%. New York City registered a -15% decline month-over-month while San Francisco saw demand climb by 16%.
- In part, the decline in June is in-line with pre-pandemic seasonal norms. For comparison, the VODI fell by 7.1% in June 2019 and 5.9% in June 2018.
- Office demand in tracked markets is a massive 25.9% lower than in June 2021, though this partly reflects

Economic Update



base effects from a wave of pent-up demand stemming from last year's vaccine rollout.

9. REGIONAL DIFFERENCES IN CONSUMER SENTIMENT, RETAIL SALES

- A new Morning Consult study shows that regional inflation and unemployment variations contribute to significant differences in consumer sentiment and, therefore, spending activity.
- According to the analysis, while inflation remains a nationwide concern, in May, there was a 2.6% gap between price growth in the highest region, the West South-Central US (9.9%), and the lowest, the Middle Atlantic US (7.3%). Their findings suggest that if the regional inflation gap persists for the remainder of 2022, it will amount to a more considerable drag on consumer sentiment in the Mountain region of the US than in the Middle Atlantic.
- Employment outcomes exhibit a similar gap looking between different regions. The study's findings suggest that continued variation in the labor market recovery would continue to drive differences observed in consumer sentiment and likely spending.
- On a state-by-state level, sizable differences in consumer sentiment and retail sales persist. According to US Census Data for March (the latest available data at the time this study was conducted), Vermont led year-over-year changes in retail sales with a 12.5% increase, while Pennsylvania registered a modest 1.7% increase. Hawaii led changes in consumer sentiment, with a 1.4% year-over-year increase through March, while South Dakota led all declines with a decrease of -25.0% year-over-year.

10. TREASURY DEPARTMENT AFFORDABLE HOUSING GUIDELINES

- On July 27th, the Treasury Department released new guidelines meant to increase access of American Rescue Plan disbursed funds by state and local governments. The updated guidance is designed to boost the supply of affordable housing.
- The update guidance widens the use of State and Local Fiscal Recovery Funds (SLFRF). Most notably, they are now permitted to be used to finance long-term affordable housing loans.
- The Treasury's updated guidance also allows SLFRF funds to be used for the development, repair, or operation of affordable housing units, so long as it helps to maintain long-term affordability of the housing units.

Economic Update



SUMMARY OF SOURCES

- (1) <https://www.bea.gov/news/2022/gross-domestic-product-second-quarter-2022-advance-estimate>
- (2) <https://www.federalreserve.gov/newsevents/pressreleases/monetary20220727a.htm>
- (3) https://www.chandan.com/_files/ugd/df56fe_8cccce5ce9ac4b67851830309d9d1838.pdf
- (4) <https://www.mba.org/news-and-research/newsroom/news/2022/07/27/mortgage-applications-decrease-in-latest-mba-weekly-survey>
- (5) <https://www5.rcanalytics.com/webmail/71612/1320089930/d196fa9edcdbc28870f742246c5dcb4284d1bc9d62a4b45c2f8d05f65f5dc44>
- (6) https://eyeonhousing.org/2022/07/since-pandemic-onset-lumber-products-have-added-14k-to-house-price-51-to-rent/?_ga=2.244320773.1488509329.1658951870-1774177786.1658951870
- (7) <https://www.bea.gov/data/personal-consumption-expenditures-price-index#:~:text=A%20measure%20of%20the%20prices,reflecting%20changes%20in%20consumer%20behavior>
- (8) <https://stagingwww.vts.com/vts-office-demand-index-july-2022>
- (9) <https://morningconsult.com/2022/07/13/weak-consumer-sentiment-impacting-regional-retail-sales/>
- (10) <https://home.treasury.gov/news/press-releases/jy0889>