

Seventh Rate Hike of 2022 is the Smallest Since May, Fed Not Yet Satisfied

Federal Reserve caps off 2022 with a slimmer rate bump. In December, the Federal Open Market Committee administered a 50-basis-point hike to the federal funds rate, following four straight 75-basis-point upward adjustments. The final rate lift of 2022 brought the lower bound target range to 4.25 percent, the highest mark since the global financial crisis in 2008. At the most recent meeting, the FOMC advised that additional increases are warranted to sustain downward pressure on prices. A terminal rate above 5 percent was intimated, representing another 75 basis points of elevation that could occur over the span of 2023. Despite headway slowing the pace of inflation, the Fed remains vigilant and wants more evidence of persistent price softening before holding the rate firm.

Reduced pricing pressure supports Fed moderation. Inflation has shown signs of settling down. The headline Consumer Price Index rose 7.1 percent year-over-year in November, the smallest 12-month increase since December 2021. Positive momentum toward cooling upward price pressure is helping guide the Federal Reserve's moderately less aggressive stance. Nonetheless, inflation remains well above the 2 percent target, and more progress is needed before the Fed feels comfortable ending their monetary policy tightening. One factor that still eludes the central bank is a softening employment market. The FOMC expects a rise in unemployment will be necessary to ultimately curb inflation, a trend that has yet to meaningfully occur.

Trend toward stability should assist real estate trading next year. The fourth quarter has been a difficult period for commercial real estate transactions, as the Fed's aggressive rate increases destabilized the lending environment. While these headwinds are unlikely to completely abate in early 2023, December's smaller rate hike is a positive sign. Investment conditions should improve over the course of next year as the Fed applies smaller rate refinements, allowing the bid-ask spread among investors to narrow and enabling lenders to tighten their spreads. However, investors will need to adapt to the higher interest rate climate, as downward movement should not be expected in 2023, unless the economy rapidly contracts.

Inflation Insights

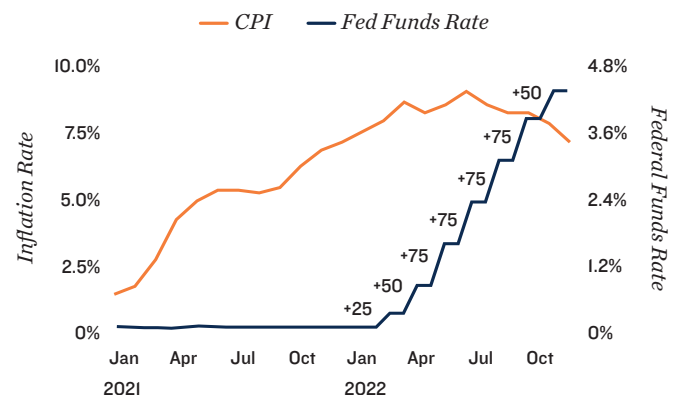
Softer energy costs aid consumer sentiment. Many Americans have noticed lower prices at the gas pump, which has helped some feel slightly more secure in their financial situation. The preliminary December consumer sentiment index rose above expectations, with the inflation component of the survey falling to a 15-month low. This coincides with the November CPI figures, in which gasoline and utility gas services had some of the largest monthly declines, while airline fares also fell. The war in Ukraine, OPEC production cutbacks and the shrinking Strategic Oil Reserve have the potential to reverse this trend, but stronger sentiment could aid holiday shopping and travel in early 2023.

Food and shelter remain stubborn contributors to inflation. While energy costs descended in November, other components of the CPI continued to rise. Most notably, the cost of shelter and food remained on the ascent. While consumers can shift to lower-cost options, ultimately these are essential goods, and higher prices in these categories will continue to heavily impact consumer behavior.

4.25% Lower Bound of Federal Funds Target

6.0% Core CPI Inflation in November 2022

— Inflation Downshift Permits Smaller Rate Hike —



Note: CPI through November; Federal Funds Rate through December

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Real Capital Analytics; Yardi Matrix; U.S. Census Bureau



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