RESEARCH BRIEF

Marcus & Millichap

FINANCIAL MARKETS

JUNE 2023

Fed Takes a Rate Hike Hiatus, Granting Investors Time to Calibrate

Federal Reserve pauses in June to assess data. The Federal Open Market Committee held their policy rate flat at a lower bound of 5 percent at the June meeting. This is the first time the FOMC has not raised the federal funds rate at a meeting since before March 2022. The pause does not, however, imply an end to the current tightening cycle. The Federal Reserve is continuing to reduce its balance sheet, with the June rate pause allowing time for the FOMC to assess the cumulative impact of their policy decisions so far. Chairman Powell reiterated that the Fed will continue to take a data-dependent path going forward, and may lift the lending rate one or more times this year if warranted by labor and financial market conditions.

Investment activity progressing through impediments. While the Fed could hike rates later this year, overall movements in the federal funds rate so far in 2023 have been much less drastic than in 2022. After jumping 425 basis points last year, the rate has only shifted up 75 basis points so far this year. A more consistent rate environment will help commercial real estate buyers and sellers better come to agreement, and lenders to determine valuations. Capital is available for most property types, but the underwriting has tightened measurably over the last several months. Even with these challenges, trades are moving forward. Across the major property types of multifamily, retail and industrial, first quarter sales activity, if extrapolated for a full 12 months, would still outpace most years prior to 2011.

Core inflation holds above wage growth, affecting outlook. While headline CPI inflation fell to less than half the June 2022 peak, at 4.0 percent year-over-year in May 2023, the measure is still hotter than the Federal Reserve would prefer. Core CPI inflation, which omits food and energy prices — the latter of which have been declining — exceeded the headline rate in May by 130 basis points and wage growth by 100 basis points. Curbing core price increases will take time, a factor the FOMC has acknowledged. Many committee members anticipate it could take a year or more to return to target inflation levels. This dynamic will keep the Fed on watch, and could weigh on consumers and businesses, acting as a constraint on retail sales and fixed investment growth.

Commercial Real Estate Implications

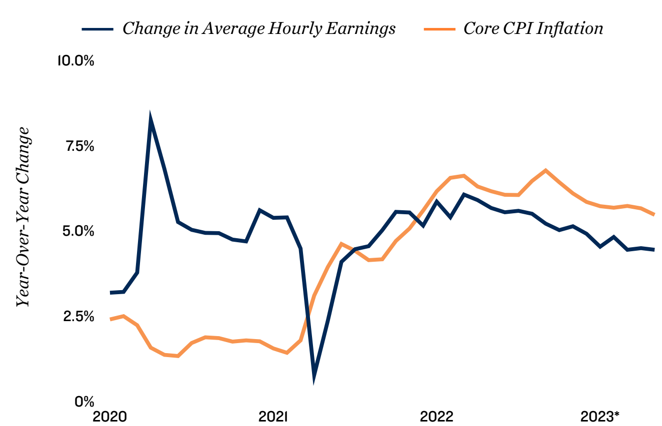
Industrial needs holding amid port disruptions. Since the start of June, West Coast port workers have been involved in work stoppages as part of ongoing contract negotiations, slowing cargo passthrough. Past negotiations have involved similar disruptions, and some carriers have already been diverting cargo to Gulf and East Coast entry points. Government intervention is also possible. As such, a pandemic-level supply chain shock is unlikely, lessening its influence on Fed policy. Long-term shipping demand drivers also remain in place, sustaining the need for related industrial space and bolstering property fundamentals.

Fed and retailers keeping close eye on pay and inflation. Wage growth is an inflation contributor, and its recent slowdown could signal further cooling on price hikes. At the same time, the longer inflation exceeds earnings growth, the more the costs of goods and services to consumers stack in real terms. This could weigh on sales at retailers, which are strong but flattening. A spending pullback, however, could also temper inflation, helping bring overall supply and demand back into alignment.

5.3% *May Core CPI Inflation*

4.3% *May Growth in Avg. Hourly Earnings*

Core Inflation Holding Above Wage Growth



** Through May*

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; Real Capital Analytics