WHY? WE EXPECT CONSUMER SPENDING TO REBOUND

RESEARCH REPORT - WEEKLY ECONOMIC UPDATE

A Cushman & Wakefield Research Publication

April 20, 2015

CONSUMER SPENDING IS REBOUNDING!

- Although the economy hit a soft spot in the first quarter, we expect stronger growth for the balance of the year to boost full year gross domestic product (GDP) growth to about 3.0% to 3.5%.
- How fast the economy bounces back will be determined by consumers and their ability and willingness to increase spending. We expect a healthy rebound in consumer outlays in the second quarter.
- As the economy resumes its strong growth trend, it will have a positive impact on commercial real estate markets across the U.S.

Much of the economic data for the U.S. in the first quarter of 2015 has now been released. The data suggest that the economy remained sluggish in the first quarter of the year and the U.S. gross domestic product (GDP) probably grew at about a 1.0% to 1.5% annual rate. This would be a slowdown from the already sluggish 2.2% rate of growth recorded in the fourth quarter.

The biggest reason for the slowdown was weaker consumer spending. After growing at a 4.4% annual rate in the fourth quarter, consumer spending is estimated to have increased at approximately a 2.0% pace in the first quarter. This would be the slowest rate of growth since the first quarter of 2014 when severe winter weather caused consumer spending growth to slow to a 1.2% annual rate.

The slowdown in consumer spending this year was clearly caused by the second consecutive year of severe winter weather.

The fundamental drivers of spending would suggest that the rate of growth should have been much stronger:

• INCOME GROWTH HAS BEEN STRONG.
A combination of rapid employment growth, rising wages (albeit slowly) and low inflation has boosted the growth rate of personal income adjusted for inflation and taxes. In the three months from December 2014 to February 2015, real after-tax income increased at a 6.9% annual rate. When income growth is this strong, it is usually accompanied by solid growth in consumer spending. But in the same three months, consumer spending, adjusted for inflation, increased at a 0.8% annual rate, the slowest three months since last year.

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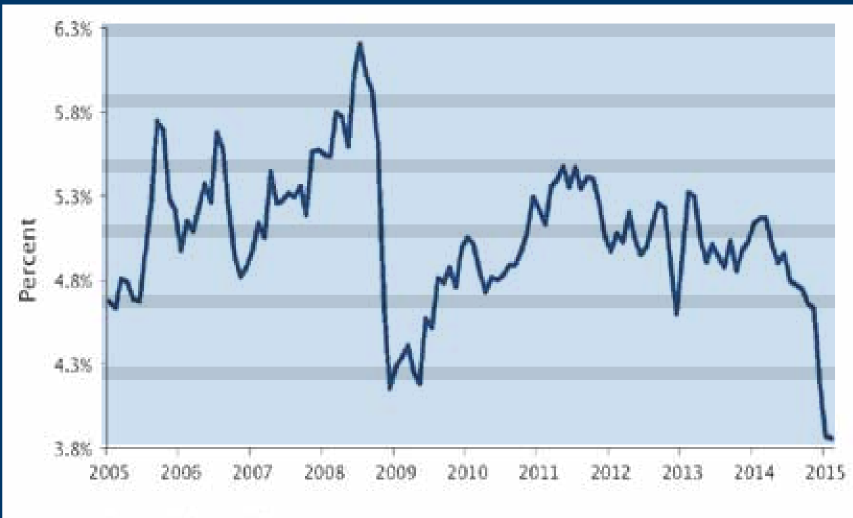
THE PLUNGING ENERGY BITE

SPENDING ON ENERGY GOODS AND SERVICES AS A PERCENT OF AFTER-TAX INCOME



Source: U.S. Bureau of Economic Analysis

CONFIDENCE IS AT THE HIGHEST LEVEL IN A DECADE

(THREE MONTH MOVING AVERAGE)

Source: University of Michigan Survey Research Center, Thomson Reuters

• ENERGY PRICES ARE DOWN.

The price of a barrel of oil remained between $40 and $50 for most of the quarter, and averaged $48.72. That is less than half the $98.57 per barrel price recorded in the first quarter of 2014. This decline means that households are spending much less to heat their homes and drive their cars than they were in the first quarter of 2014. The Bureau of Economic Analysis estimates that the proportion of their after-tax income that consumers spent on energy in the first two months of 2015 was the lowest since 2002. In terms of total dollars, consumers spent approximately 22% (almost $150 billion) less for energy in the first quarter of 2015 than they did a year earlier. That is $150 billion that can be spent on other goods and services.

• RISING CONFIDENCE.

Consumers entered 2015 in the most optimistic mood in a decade. The University of Michigan's Index of Consumer Sentiment rose above 90 (February 1966=100) in December 2014 and has since remained above that level. In general, when this measure of confidence is above a reading of 90, there is healthy growth in consumer spending. Although the index did dip a bit in February and March, it has been consistently high throughout the year.

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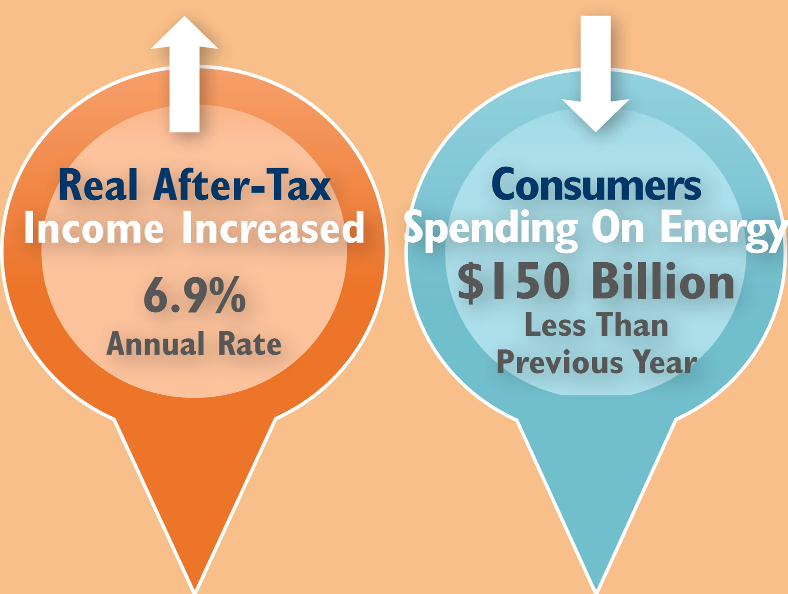

DECEMBER 2014 TO FEBRUARY 2015	IN THE FIRST QUARTER OF 2015

FOR THE REAL ESTATE SECTOR, STRONG CONSUMER SPENDING WILL HAVE NUMEROUS POSITIVE EFFECTS.

These fundamentals would suggest strong consumer spending growth in the first quarter, yet in the first two months of the year, inflation-adjusted spending barely rose, up less than 0.1% (an annual rate of 0.8%). Clearly, the severe weather had an impact on spending in January and especially February. This was verified by the March retail sales report which showed an increase on 0.9% in retail sales in the month. Retail sales represent about half of total consumer spending (the other half is on services) and the big jump in March suggests that overall consumer spending also rose during the month, but the growth for the quarter was likely weak because of the decline in February.

We expect that these healthy spending drivers - high confidence, rapid income growth and less need to spend on energy - will enable consumers to increase spending at a much faster pace in the second and third quarters. In other words, it really was the weather and now that spring has come, consumers will be back at the stores and spending will rebound.

For the real estate sector, strong consumer spending will have numerous positive effects from boosting the retail sector to increasing travel and tourism to pushing up demand for industrial space. As the consumer goes, so goes the economy in the U.S., and we expect the consumer to raise spending at a much faster pace in the second and third quarters. A stronger economy is expected to boost demand for all sectors of commercial real estate over the balance of 2015.

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