REVISIONS SUPPORT SEPTEMBER RATE INCREASE

RESEARCH REPORT - WEEKLY ECONOMIC UPDATE

A Cushman & Wakefield Research Publication

AUGUST 17, 2015

- Last week's economic statistics and the revisions to previous months indicate that the economic environment for commercial real estate is healthy and improving. Demand continues to increase, businesses continue to hire, and consumers continue to spend.
- Not only did retail sales in July show a solid 0.6% increase over June, but the volume of sales in both May and June was revised up. Over the most recent three months, retail sales increased at a 7.3% annual rate.
- Job openings remained near historic highs in June, indicating that businesses continue to need more employees.
- Small business optimism improved slightly in July, but they are continuing to have difficulty finding qualified employees.
- This all suggests that the economy is growing at a solid pace, and this is likely to continue through the balance of the year.
- For commercial real estate, this means rising demand for all product types from retail to office, multifamily, industrial, and hotel.
- For investors it means the Fed is likely to raise interest rates in September and probably again in the fourth quarter (possibly December).

In today's world of instant analysis and immediate gratification, it is important to step back once in a while and remember that the statistics produced by the Government are estimates based on surveys. The process of surveying and estimating takes time. The Government is always faced with a choice between timeliness and completeness. As a result, there is a standard process of revision for almost every economic statistic. Most times, the revisions are modest and do not change our views on the state of the economy.

Every once in a while, however, there is a revision that makes us rethink where the economy stands. This was the case last week when the retail sales data for July was released by the Commerce Department. A month ago, the retail sales report for June showed an unexpected 0.3% decline and the growth rate for May

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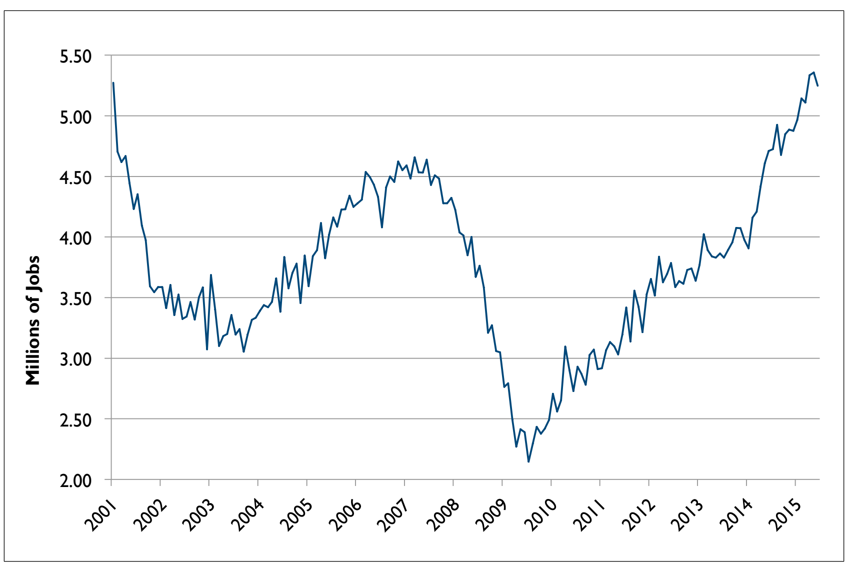
was revised lower. This suggested that consumers cut back on spending, and called into question the strength of the rebound from winter. But that bad news was revised away last week when the July retail sales estimate was released. The June decline became a small (very small) increase and the May increase was made stronger. In addition, sales in July were estimated to increase a solid 0.6%.

The retail sales revisions mean that consumer spending had stronger momentum going into the third quarter than we thought, and it reinforced the conclusion from the July employment data that the domestic economy is on a solid growth track. That is an important conclusion for the Federal Reserve, which is basing its monetary policy decisions on the rate of growth of the domestic economy. It reinforces our expectation that the Fed will start raising interest rates in September.

U.S. JOB OPENINGS



Source: U.S. Bureau of Labor Statistics

The July data also point to faster wage growth in the future. We have not seen strong wage growth yet in the current expansion, although there is a slight upward trend in growth of average hourly earnings. Theoretically, wage growth should be accelerating with the low unemployment rate, and labor shortages should be starting to emerge. That has not happened yet, but we do expect that in the second half of the year the pace of wage growth will accelerate. This is important because faster wage growth will boost income and spending, leading to stronger GDP growth. The signs of labor market tightening included:

- Job openings remain near a record high. In June, the number of openings totaled 5.2 million, just below the record high set a month earlier. Since January 2014, the number of openings has surged by 1.2 million or 34%, indicating a rapid increase in the need for workers. Importantly, some of these jobs are not being filled. The number of people hired in the month was below the number of openings. Normally, the number of people hired exceeds the number of openings by a large margin. From 2001 to 2014, on average, a million more people were hired every month than there were job openings. Over the past four months, however, openings exceeded hiring. This suggests that there is a shortage of workers available for the jobs that are open.

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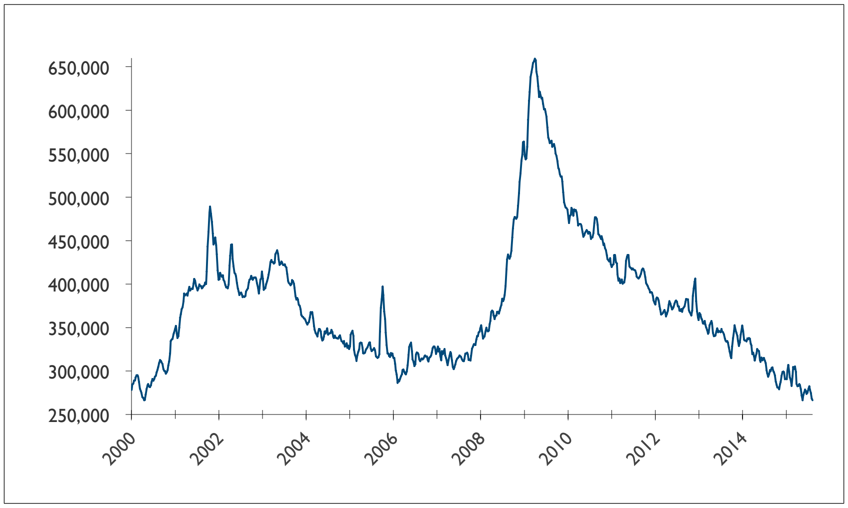
- This lack of qualified workers is also indicated in the National Federation of Independent Business's monthly Small Business Confidence Survey. In July, 25% of respondents indicated that they have at least one position that they are having a hard time filling. That number has been above 24% for 10 consecutive months and 13 of the past 15.
- Layoffs are at multi-decade lows. The number of people filing for unemployment benefits rose slightly in the last week, but the 4-week moving average, a better indicator of the trend, fell to its lowest level since early 2000, at the peak of the dot-com boom. And this is in an economy where there are more people working than ever before. This suggests that businesses are reluctant to let people go because they may have difficulty replacing them, or there is enough work that businesses need all the employees they have.

> Faster wage growth will boost income and spending, leading to stronger GDP growth.

U.S. WEEKLY UNEMPLOYMENT CLAIMS
(4-Week Moving Average)



Source: Department of Labor, Employment and Training Administration

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The implications for commercial real estate are all positive.

- Retail sales are healthy and growing, boosting the need for stores across the nation. Faster wage and income growth will only improve conditions in retail markets.
- As Internet shopping captures a larger share of consumer spending, industrial real estate will also benefit from these trends. In June, 24.5% of all internet and GAFO (general, apparel, furniture and other) store sales was done online. Five years ago that share was 19%. The result is higher demand for industrial real estate. Faster consumer spending growth will only accelerate that demand growth.
- The impact of these trends on office, hotel and multifamily real estate is less direct, but suffice it to say, as the level of economic activity picks up all these sectors will experience rising demand.

The likelihood of the Federal Reserve starting to raise interest rates in September has increased with the data released this week. The reason for the increase in probability is an economy that is performing better than we thought a month ago, and that is good news for the commercial real estate sector.

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