

Core Inflation Continues to Cool: Implications for Housing, Industrial and Retail Space

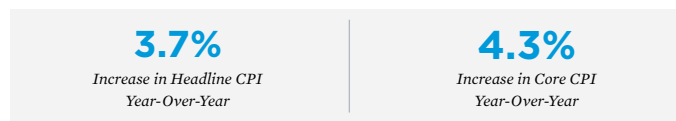
Core pricing pressures subside further. The headline consumer price index rose 3.7 percent year-over-year in August, the second month in a row that the metric ticked up. While this could suggest a re-acceleration of price hikes, the cyclical nature of the increase suggests that inflation is still broadly slowing. Over one-half of the rise was due to a 10.6 percent annual jump in gasoline costs, an index that is subject to volatile external forces like natural disasters and global conflict. Core CPI, which omits volatile energy and food costs, decelerated to a two-year low of 4.3 percent in August. A smaller rise in the cost of shelter is reducing core inflationary pressures, and should help place headline inflation on a downward path again once energy prices re-stabilize.

Near-term apartment rent data points to abating pricing pressures. The shelter index, which tracks prices for various forms of housing, rose 7.2 percent year-over-year in August. This marked the fifth month in a row that the figure decelerated, as both rent and owner's equivalent rent tapered to their lowest metrics since November 2022. Still, these indices tend to lag market conditions due to the annual basis of most leases, and are likely only reflecting market conditions from earlier this year. More recent data indicates that the mean effective multifamily rent bumped up by just 0.3 percent year-over-year in August, which was nearly a two-year low. The completion of more than 200,000 units through 2023's latter half will put up an additional roadblock for rent growth. While these easing pricing pressures may take some time to appear in the core CPI calculation, they should eventually aid the Fed in reining in overall inflation.

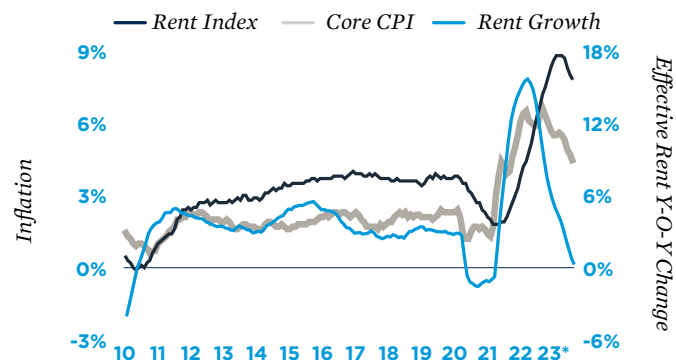
Industrial properties benefit from manufacturing needs. Climbing costs for diesel fuel are challenging transportation and warehousing firms. The sector shed 44,200 jobs in July and August, accompanying rises in the fuel oil index. Conversely, prices for energy used by manufacturers have eased. The cost of natural gas — which accounts for 42 percent of the industrial sector's energy consumption — fell in the two months, coinciding with the creation of 12,000 manufacturing roles despite some industry-specific labor disputes. Recent sizable move-ins from GlobiTech, Tesla and LKQ reflect new space demand from manufacturing tenants, a trend that will help keep overall industrial vacancy far-below the long-term mean of 7.1 percent in 2023.

Rising gas prices may limit non-essential spending. Retail properties showed remarkable stability over the first half of 2023, with the U.S. vacancy rate holding flat at 4.7 percent in that span. Nevertheless, August's higher gas prices could threaten retailer performance. Many households will have to allocate a greater portion of their monthly incomes to transportation, which could curb discretionary spending on other goods and services, and potentially reduce near-term motivation for retailers to grow footprints. Net absorption in 2023 is projected to stay below the long-term average of 87 million square feet, but a mild slate of deliveries will limit upward momentum on the national vacancy rate and keep asking rent growth historically elevated.

Experts signal a pause in September from the Fed. Despite the CPI rise, markets are pricing a 97 percent probability that the Fed will hold rates flat in September. High gasoline costs may have disinflationary spillovers, and the Fed will likely place an emphasis on core CPI's sustained cool. Still, chances for one more hike in 2023 remain relevant. If the Fed sees shelter costs pick back up, or if hiring re-accelerates, a rate hike could be on the table for the final two months.



Rent Changes Materialize Later in Core CPI



* Through August
Sources: IPA Research Services; Bureau of Labor Statistics; U.S. Energy Information Administration; CME Group; Federal Reserve; RealPage, Inc.; Moody's Analytics; Census Bureau