

June Inflation Gives More Runway to Fed for Rate Cuts

Falling commodity prices reflect cooling economy. While pricing pressures remain above target 27 months into the Federal Reserve's current monetary tightening cycle, meaningful relief is beginning to show. Annual growth in the commodities less food and energy index — which captures pricing changes for non-necessity items such as recreation, vehicles and apparel — has been in negative territory for six consecutive months and reached a near 20-year-low at -1.8 percent in June. Elevated costs for essentials such as housing services, medical care and vehicle insurance are constraining household budgets and limiting spending on discretionary items. These changes in consumers' spending habits helped lower headline CPI inflation down to 3.0 percent year over year in June, with a normalizing job market likely to help sustain a downward trend in the near term.

Pricing pressures for several services are poised to ease. The U.S. unemployment rate rose for the fourth straight month in June to hit a near three year high of 4.1 percent, signaling that labor supply is rising relative to demand. Fewer personnel shortages — especially in the health care, construction and vehicle maintenance industries — could begin to cool overall services inflation, as these constraints have contributed to lifting consumer prices for insurance and shelter. Reduced pressures on labor-related operational costs may also bolster the ability for service providers in all three industries to invest additional capital into leasing physical spaces, potentially a tailwind for medical office, industrial and retail property demand in 2024.

Retail sector remains stable amid spending pullback. Retail real estate is well positioned to navigate any near-term headwinds arising from a normalizing job market and changes in consumers' spending habits. The U.S. vacancy rate was the lowest among the four major property types at 4.5 percent in March, and was the only one to register a drop over the last year. New supply will also stay under 45 million square feet for the fourth year in a row, despite multi-decade high occupancy, motivating retailers to lease spaces when slots do open. Ollie's Bargain Outlet and Dollar Tree, for example, acquired most of the 300-plus 99 Cents Only Stores properties after the company filed for bankruptcy. Limited vacancy at power centers further emphasizes this dynamic, with recent big-box closures from Bed Bath & Beyond and JCPenney not significantly impacting property metrics.

Trio of measures confirm broad-based inflation ease. Headline CPI fell 0.1 percent from May to June, the first month-to-month decline since May 2020. Annual core CPI inflation — which omits food and energy — also descended to half of the September 2022 peak, reaching 3.3 percent. Moderation in both CPI readings reflects a broad-based cooling of the economy that could be further accentuated by a slowing Core PCE figure at the end of this month. Core PCE inflation, which is less impacted by housing costs, also reached a 38-month low in May.

Inflation readings heighten probability of rate cut. Wall Street projections for a September rate cut from the Fed jumped to over 90 percent after the June CPI release. A normalizing labor market is adding fuel to expectations, with Chairman Jerome Powell intimating that personnel shortages are no longer a major source of inflation for the economy. While near-term rate cuts may help reignite real estate dealmaking activity, capital costs are likely to remain high. The persistence of elevated interest rates will continue to shape transaction activity by placing an emphasis on smaller capex deals and motivating owners to re-balance their portfolios to manage debt.

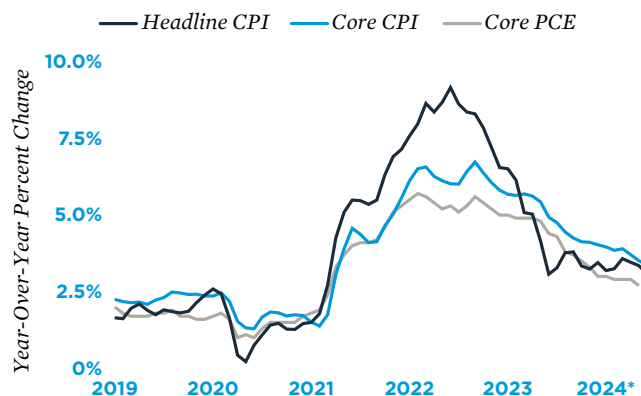
3.0%

Increase in Headline CPI
Year-Over-Year

3.3%

Increase in Core CPI
Year-Over-Year

- Trio of Inflation Measures Sustain Cooling -



* Headline and Core CPI through June; Core PCE through May

Sources: IPA Research Services; Bureau of Labor Statistics; CME Group; Federal Reserve; Census Bureau; Bureau of Economic Analysis; CoStar Group, Inc.

