

Broadening Price Pressures Complicate Borrowing Prospects for CRE Investors

Inflation continues to tick higher. The Consumer Price Index (CPI) rose 3.7 percent year over year in September and 0.6 percent month over month. Core CPI, which excludes food and energy, rose 2.6 percent annually and 0.3 percent monthly. Both readings came in slightly above consensus expectations. They marked a second straight month of accelerating headline and core inflation, in contrast to earlier this summer, when core price growth was more subdued. The latest report suggests inflationary pressures may be broadening beyond a purely energy-driven rebound, as both core commodities and core services prices increased in September. Core commodities rose 0.3 percent month over month, while core services increased 0.4 percent, marking the strongest monthly gains for both categories in five months.

Borrowing costs could stay elevated for longer. The 10-year Treasury yield remains at historically high levels above 5.2 percent, and the latest CPI report suggests interest rates may stay higher for longer as the Federal Reserve faces pressure to curb inflation. After the report's release, expectations for additional Fed rate hikes by the end of this year rose to over 90 percent from 80 percent. This upward pressure on borrowing rates could temper growth in CRE transaction activity over the near to medium term.

High fuel costs could strain consumer spending. Gasoline prices rose 9.3 percent in September, marking the largest monthly increase since March. While consumer spending has remained resilient in recent months, higher fuel costs could weigh on household discretionary spending as a larger share of income is directed toward essential expenditures. Meanwhile, consumer sentiment remained subdued in early October, with the index at an uncommonly low sub-50 level. While retail vacancy has stayed close to the record lows achieved in 2024, some retailers could face headwinds if consumers pull back on spending amid expectations that inflation will remain elevated.

Housing costs remain an inflationary pressure. Shelter costs increased 0.4 percent month over month in September, the fastest pace since April, even as many multifamily markets continue to emerge from the supply-heavy conditions that characterized the last two years. Apartment vacancy remained near mid-4 percent as of September, one of its lowest readings since late 2022, while rent growth is on pace to exceed 2 percent this year, the strongest annual increase in four years. Although shelter inflation does not move in lockstep with apartment rents, the 3.1 percent annual increase in shelter costs remains above current apartment rent growth, suggesting improving multifamily fundamentals are not necessarily adding to inflationary pressure.

KEY TAKEAWAYS

- Inflation exceeded expectations for the second consecutive month, reinforcing concerns that price pressures remain broadly entrenched.
- Financial markets are increasingly pricing in a prolonged period of restrictive monetary policy and elevated financing costs.
- Rising gasoline prices may limit consumers' discretionary spending, creating potential challenges for some retail businesses.
- Housing-related costs also remain a contributor to persistent inflation as apartment market fundamentals continue to improve.

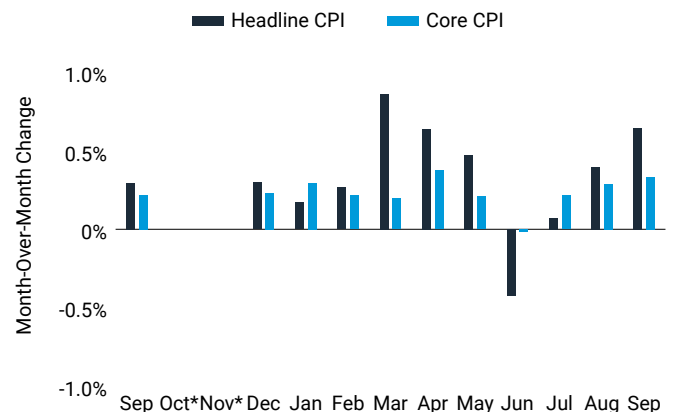
3.7%

Increase in Headline CPI
Year Over Year

2.6%

Increase in Core CPI
Year Over Year

INFLATION ACCELERATES IN RECENT MONTHS



* Data not available due to federal government shutdown.
Sources: IPA Research Services; Bureau of Labor Statistics; Federal Reserve Bank of St. Louis; CME FedWatch; University of Michigan; Consumer Sentiment.