



Spring Newsletter | June 10, 2019 | Andrew J. Nelson, Chief U.S. Economist

GOOD WHILE IT LASTS: Solid Growth to Start 2019, but Still Expect the Economy to Slow

- U.S. economic and job growth both exceeded expectations in the first quarter of 2019, rebounding from much weaker growth to end 2018.
- Nonetheless, GDP growth overall is decelerating in the face of fading fiscal stimulus, slowing global growth and mounting trade tensions, while downside risks are rising.
- However, the Fed's new "patient" stance reduces the likelihood of further rate hikes this year, raising the odds for a "soft landing" that avoids an actual downturn.
- In fact, the Fed increasingly looks to be done with rate hikes for this cycle, and the next move might well be to cut rates — though not just yet.
- Escalating trade tensions still present the greatest downside risk to U.S. economic prosperity, potentially compounding slowing global growth, and threatening U.S. exports, manufacturing and business investment.
- Heightened political tensions in Washington are another downside risk if the administration and Congress do not work together on critical spending and funding bills.
- On the other hand, escalating wage gains are a clear positive for consumers and the economy overall, though could refuel inflation and force the Fed to once again hike rates.
- Property market fundamentals have been generally flat year to date but remain at cycle highs. Expect further gains to soften in most sectors as the economy cools.

A Strong Start to the Year

So far, so good! But likely not for much longer. The economy outperformed expectations to start the year. Both [GDP growth](#) and [job gains](#) have surprised to the upside, which benefited the property sector. Nonetheless, the trends were not quite as positive as the headlines suggest, and do not alter our basic view that the economy has again started to cool.

On the positive side, nonfarm payrolls grew by a [robust 224,000 in April \(revised\)](#), its strongest performance since December, and driving unemployment to just 3.6%, its lowest rate in five decades. Still, monthly job figures are notoriously volatile, so we should not read too much into a single month of data. Indeed, the May figure fell back to just 75,000. Average job gains in 2019 have been much less positive than last year, at just 164,000 per month, compared to 223,000 per month in 2018. Moreover, with unemployment so low, the number of job openings continues to exceed the number of unemployed workers, creating labor shortages and driving up wages. All of these factors suggest a hiring slowdown is in the works.

The growth in GDP was perhaps even [more surprising at 3.1% annualized](#) in the first quarter, modestly topping consensus forecasts. This figure is deceptive however, as beneath the surface, trends were not nearly so positive. Most worrying, consumer spending — which accounts for some 70% of GDP — grew

by only 1.3% in the quarter, despite the strong gains in jobs and wages. Stripping out volatile factors like inventory adjustments and trade, the core domestic economy (“final sales to domestic purchasers”) rose by a much more modest 1.5%, its weakest reading since the end of 2015.

Moreover, gross domestic income (“GPI”) — which is the income counterpart to gross domestic product, and should grow at about the same rate — actually has been growing much slower than GDP. First quarter GDI was only 1.4%, less than half of the 3.1% GDP growth; and over the past four quarters, GDP has grown by an average of 3.2% compared to only 1.8% for GDI, suggesting that GDP likely is increasing more slowly than indicated by the official government estimates (and they are only estimates).

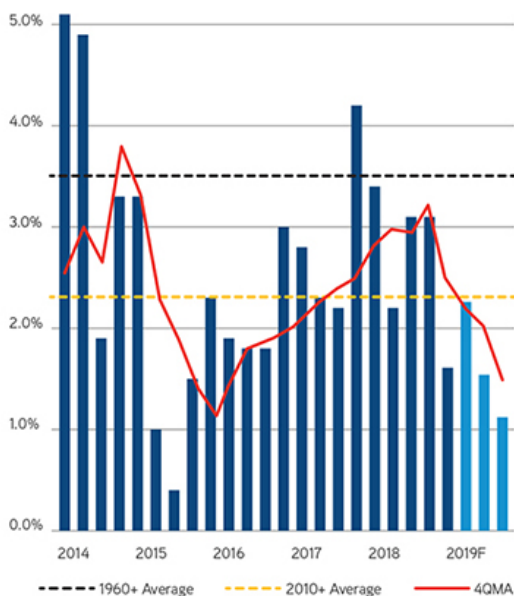
Regardless of the true growth rate, we fully anticipate measured growth to cool throughout the rest of the year, and especially in 2020, as factors that were driving growth in 2018 fade or reverse. [The temporary fiscal stimulus](#) from last year’s federal tax cuts and spending increases is already waning, while [global economic growth is slowing](#) in virtually all of our major trading partners, from China to Germany, reducing demand for our exports. Indeed, [trade is also slowing worldwide](#). The relatively strong dollar represents another headwind for U.S. manufacturing and exports. Moreover, [business confidence surveys](#), while still relatively high, are off the recent highs and trending downward, suggesting further weakness in business investment ahead.

On the other hand, [consumer confidence surged again in May](#) to its highest level in 15 years, reversing downward trends earlier in the year. This is generally a positive sign — as consumer confidence tends to be highly correlated with consumer spending — though the tightness of this relationship has broken down in the last few years.

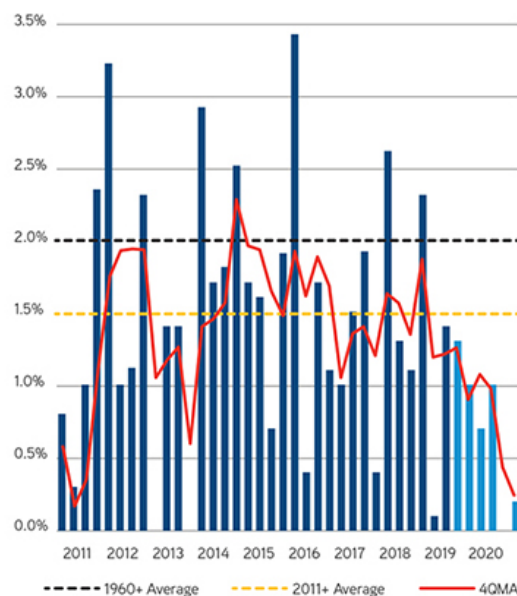
Perhaps the most positive news of all is the Fed’s reaction to this fading economic outlook, with a rather dramatic course reversal to pause further rate hikes indefinitely. Indeed, Wall Street and Fed watchers are increasingly convinced that the next Fed move may well be to cut rates, perhaps as soon as this year, as [insurance against the expected economic slowdown](#).

Putting it all together, expect GDP growth this year in the mid 2% range, down from 2.9% in 2018, while job growth slows to less than 200,000 per month — healthy support for property markets, but not the buoyant growth implied by the recent economic data. Similarly, for employment, we expect growth to average less than 200,000 jobs. However, with the Fed now clearly more concerned with fading growth than with inflation, look for more supportive policies that just may engineer a “soft landing” of slower but sustained growth, and avoid an actual downturn.

Quarterly GDP Growth at SAAR*



Quarterly Nonfarm Jobs Growth at SAAR*



*SAAR = Seasonally Adjusted Annualized Rate.

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics and Colliers International.

CONCLUSIONS AND IMPLICATIONS FOR PROPERTY MARKETS

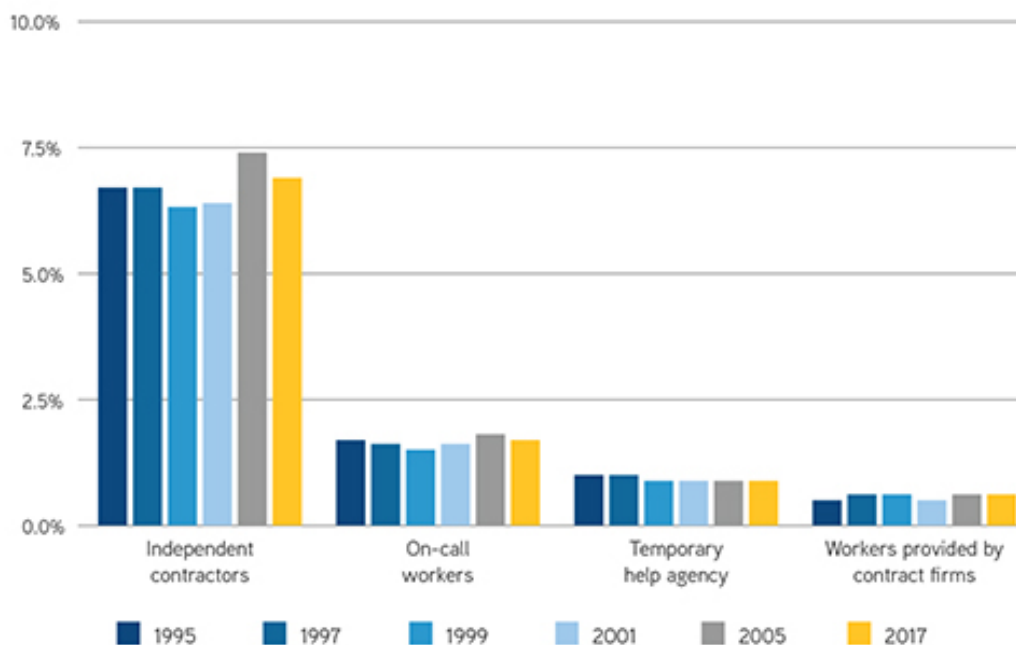
Economic conditions continue to be quite strong in terms of both economic and employment growth, but we believe the best performance of this cycle is now behind us. With no obvious signs of an immediate downturn or correction, we believe the good times for property markets will continue throughout 2019.

Nonetheless, indications are increasingly apparent that the expected slowdown is starting to take hold. With slower trade and economic output, and especially slower job growth, we should expect leasing and sales transactions to also fall this year, along with slower price appreciation. But for now, we do not see any evidence that a price correction is an immediate threat.

CHART OF THE QUARTER: THE GIG ECONOMY

Despite all the attention paid to the “gig” economy, in fact the share of workers in “alternative work arrangements” has been relatively flat in recent years. A [May 2017 survey](#) by the Bureau of Labor Statistics collected information about workers who were in four alternative employment arrangements: people employed as independent contractors, on-call workers, temporary help agency workers and workers provided by contract firms. The big surprise: the share of such workers fell from 2005 (the last time the BLS data was collected) through 2017. So not everyone is working for Uber after all.

**Workers in alternative arrangements as a percent of total employed
February 1995-2005 and May 2017**



Source: Bureau of Labor Statistics.

ANALYSIS OF RECENT ECONOMIC NEWS

[The U.S.-China trade war is the biggest threat to the “fragile” global economy, the OECD says \(Quartz\)](#) “In a report published today, the Paris-based institution said that after a sharp slowdown in

economic growth in the second half of last year, growth has stabilized. It's not much to cheer about: The global economy can expect only "moderate but fragile growth" for the next two years, the OECD added."

[First-quarter economic growth up 3.1%, slightly better than Wall Street expected \(CNBC.com\)](#) "The U.S. economy grew by 3.1% to start the year, slightly better than expected and providing some relief at a time when recession fears are accelerating, the Commerce Department reported Thursday.

First-quarter gross domestic product beat the 3% Dow Jones estimate but was lower than the initial 3.2% projection from the Bureau of Economic Analysis. The decrease came due to downward revisions to nonresidential fixed and private inventory investment, two key drivers to GDP."

[Fed's patience tested as trade spat clouds growth outlook \(WSJ\)](#) "The recent escalation of the U.S. trade dispute with China is putting the Federal Reserve in a bind and complicates its make-no-moves policy posture. Officials see trade tensions as a rising risk to the U.S. expansion that complicates their current make-no-moves policy posture, and bond investors are increasingly betting that economic weakness will lead the central bank to cut interest rates to bolster the economy."

[The impact of U.S.-China trade tensions \(IMF Blog\)](#) "U.S.-China trade tensions have negatively affected consumers as well as many producers in both countries. The tariffs have reduced trade between the U.S. and China, but the bilateral trade deficit remains broadly unchanged. While the impact on global growth is relatively modest at this time, the latest escalation could significantly dent business and financial market sentiment, disrupt global supply chains, and jeopardize the projected recovery in global growth in 2019."



OTHER WORTHWHILE READS

ECONOMIC NEWS AND VIEWS

[Manufacturing gauge hits lowest level since October 2016 \(CNBC\)](#) "Manufacturing in the U.S. slumped to its lowest level in 2½ years amid escalating global trade tensions and a slowdown in global demand. The closely watched ISM manufacturing index fell to 52.1 for May, compared to expectations for 53, according to Refinitiv estimates. That was the lowest reading since October 2016."

[U.S. core capital goods orders tumble; shipments are flat \(CNBC\)](#) "New orders for U.S.-made capital goods fell more than expected in April, further evidence that manufacturing and the broader economy were slowing after a growth spurt in the first quarter that was driven by exports and a buildup of inventories."

[A quarter of Americans have no retirement savings \(Forbes\)](#) "Across the United States, people are struggling to financially prepare themselves for life after work. A recent report from the U.S. Federal Reserve found that nearly a quarter of all American adults have no retirement savings or pension at all. Even though preparedness for retirement increases with age, concern about inadequate savings is also widespread among people approaching the point where they bid farewell to working life."

[Fed's Brainard says middle class squeeze poses risks to economy \(NREI\)](#) "The long-term vigor of the U.S. economy may be at risk as middle-class households are squeezed by slow growth in income and wealth and rising costs for housing, health care and education, Federal Reserve Governor Lael Brainard said."

[The economy that wasn't supposed to happen: booming jobs, low inflation \(NYTimes\)](#) "The labor market the United States is experiencing right now wasn't supposed to be possible. Not that long ago, the overwhelming consensus among economists would have been that you couldn't have a 3.6% unemployment rate without also seeing the rate of job creation slowing (where are new workers going to come from with so few out of work, after all?) and having an inflation surge (a worker shortage should mean employers bidding up wages, right?). And yet that is what has happened, with the April employment numbers putting an exclamation point on the trend."

PROPERTY MARKET VIEWS AND NEWS

[The mall meltdown continues \(WSJ\)](#) “While retailers posted generally strong numbers in 2018, raising hopes of a retail renaissance, this year has seen a reversion to the pre-2018 trend: department stores and mall-based retailers giving up share to discount stores and e-commerce. The perceived renaissance now seems to have been largely a function of lean inventories, not an actual increase in demand. Now inventory is high again, and retailers are resorting to promotions.”

[Forecast sees U.S. warehousing market cooling down \(WSJ\)](#) “The white-hot market for U.S. warehouse space will cool down over the next three years, according to a new forecast that predicts the availability of industrial real estate will grow as new construction outpaces demand growth. In the next three years, the rate of annual demand growth likely will decline to a little below 0.9%, nearly half the level of 2018, according to a forecast released Thursday by the Deloitte Center for Financial Services.”

[Institutions chasing risk at the peak of the cycle \(PERE News\)](#) “According to the firm’s annual *Real Estate Institutional Investor Trends* survey released this week, 62% of investors listed an approaching real estate market peak as their top concern in 2019. The effect of excessive capital chasing real estate assets on lowering returns and increasing risk was a close second, noted by 59% of institutional investors. Too much money chasing too few quality managers and funds was another key concern, cited by 27% of those surveyed.”

[A moderating trend: Global investors are indicating a mild pullback in 2019 allocations to real estate, amidst weakening sentiment \(IREI\)](#) “The 2019 Institutional Investors Real Estate Trends report surveyed 205 investors — its highest total ever — with 134 U.S. investors and 71 non-U.S. investors. Nearly half of surveyed investors said their capital flows to real estate in 2019 will be lower than the previous year, while one-third expect to commit more capital to real estate this year than in 2018. Overall, planned new capital commitments to real estate are forecast to be approximately 15% lower than actual commitments in 2018.”

RECENT ARTICLES FEATURING COLLIERS EXPERTS

[Retail is shaking off its dead skin for a new omnichannel model \(Globe St.\)](#) “The current momentum in **retail** has been built through breaking the rules of its previous models and strikes out on new ground — or less ground, in many cases. To be sure, the sector is undergoing a mind-blowing transformation as it works in tandem with logistics and reinvents itself with bells and whistles for the tech-savvy shopper. With ICSC’s RECon 2019 approaching this week, **Gregory Healy**, SVP of supply chain and logistics consulting with **Colliers International**, shares some exclusive insights into how brick and mortar is reinventing itself, how e-commerce and retail are dovetailing, retailers’ creative approaches and trends in retail/logistics.”

[103 consecutive months of job growth and counting: Gains total 263,000 in April \(REBusinessOnline\)](#) “Beating expectations, the U.S. economy added 263,000 jobs in April, according to the Bureau of Labor Statistics (BLS), marking 103 consecutive months of employment gains. Meanwhile, the unemployment rate ticked down two-tenths of a percentage point to 3.6%, the lowest level since 1969. *REBusinessOnline* reached out to three economic experts to get their takes on the latest data and its impact on commercial real estate including **Andrew Nelson**, U.S. chief economist for **Colliers International** . . .”

[Retail net lease's outlook rises on dovish monetary policy \(Globe St.\)](#) “In contrast to the broader commercial real estate capital markets last year, net lease retail property demand in the U.S. weakened and sales volumes fell sharply. Similarly, according to a recent Colliers International report, while the CRE markets saw stable-to-falling capitalization rates and positive price appreciation, capitalization rates rose modestly in the net lease sector as prices fell.”

[Coworking is coming to shopping centers \(Bisnow\)](#) “The next frontier for coworking space is in shopping centers and other retail properties, according to a new report by **Colliers International**. Coworking is already part of mixed-use developments, but Colliers reports that developers

now have the opportunity to attract coworking companies directly into retail centers, much the same way that clinics and other medical facilities are locating in otherwise retail contexts.”

CRE's end-of-cycle investment strategy looks very different than it did before the recession

(Bisnow) “The global economy is widely predicted to be approaching its first downturn since the Great Recession over the next two years, but the commercial real estate investment environment looks completely different than it did at the end of the last cycle. In a cycle's late stages, real estate investors are targeting industrial and multifamily as the asset classes to have when the music finally stops, multiple industry experts have told *Bisnow*. That stands in stark contrast to the years leading up to the Great Recession, when office and retail were in vogue.”