CBRE

Econometric Advisors

Q3 2021 U.S. Macro Outlook

REPORT

Room for improvement

NOVEMBER 5, 2021

End of 2021 outlook

Some high-level thoughts that drive our forecast

– The Q3 2021 slowdown is not emblematic of where the U.S. economy is going. Activity decelerated in late July through September, as a rapidly spreading Delta variant discouraged many consumers from entering restaurants and boarding airplanes. But public health has improved demand for consumer services and other leading indicators began to rally by late September. Indeed, the pick-up in employment during October was a key signal that improvement is underway. As COVID-19 cases ebb-and-flow this oscillation is poised to continue.

– Consumers will have the wind at their backs. Aside from COVID-19 cases fading—at least for the present—other factors supporting consumption include a tight labor market and sturdy income growth. It is likely that consumption will shift from goods to services this autumn. Goods consumption could slow considerably due to supply bottlenecks and rising prices for some goods.

– There are numerous risks facing the U.S. economy with material supply bottlenecks emerging to the forefront. A shortage across the spectrum of commodities and key feedstock is weighing on the capacity to produce and consume. Policy error is another concern as the failure of Congress to pass key spending initiatives would weigh on the growth trajectory.

– Our outlook for inflation has shifted upward as the combination of heightened demand, supply bottlenecks and wage growth have increased prices by greater than 5% year-over-year (Y-o-Y). But many of the factors driving CPI are transitory and inflation should fall back to the low -2% range by the end of 2022. It should be noted that this situation is fluid, and the risks are currently tilted to inflation coming in higher than expected.

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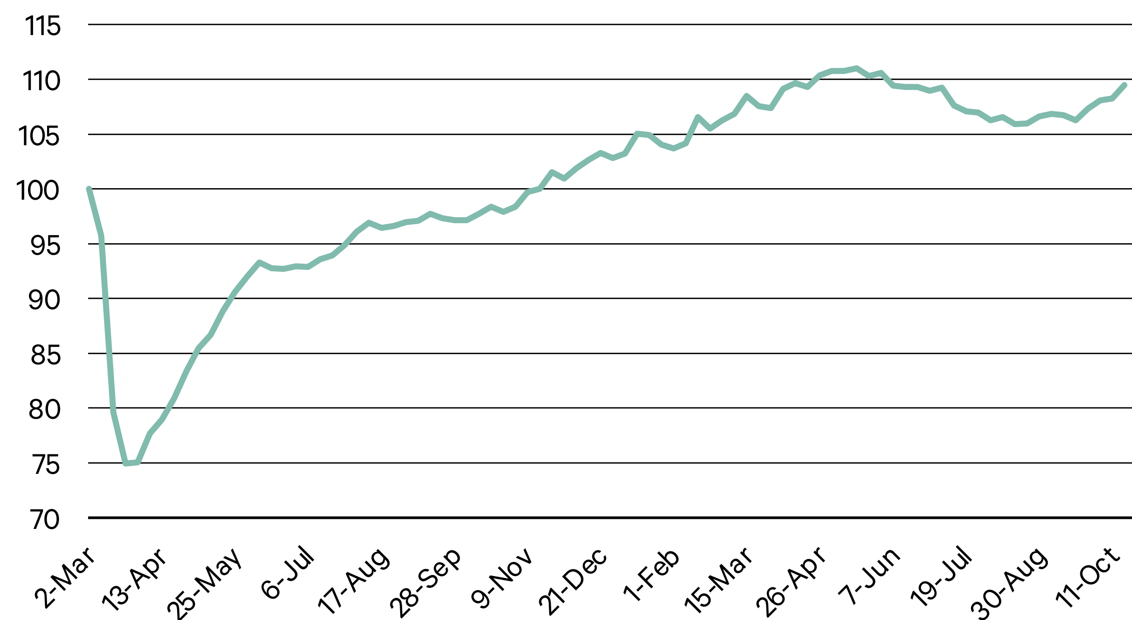
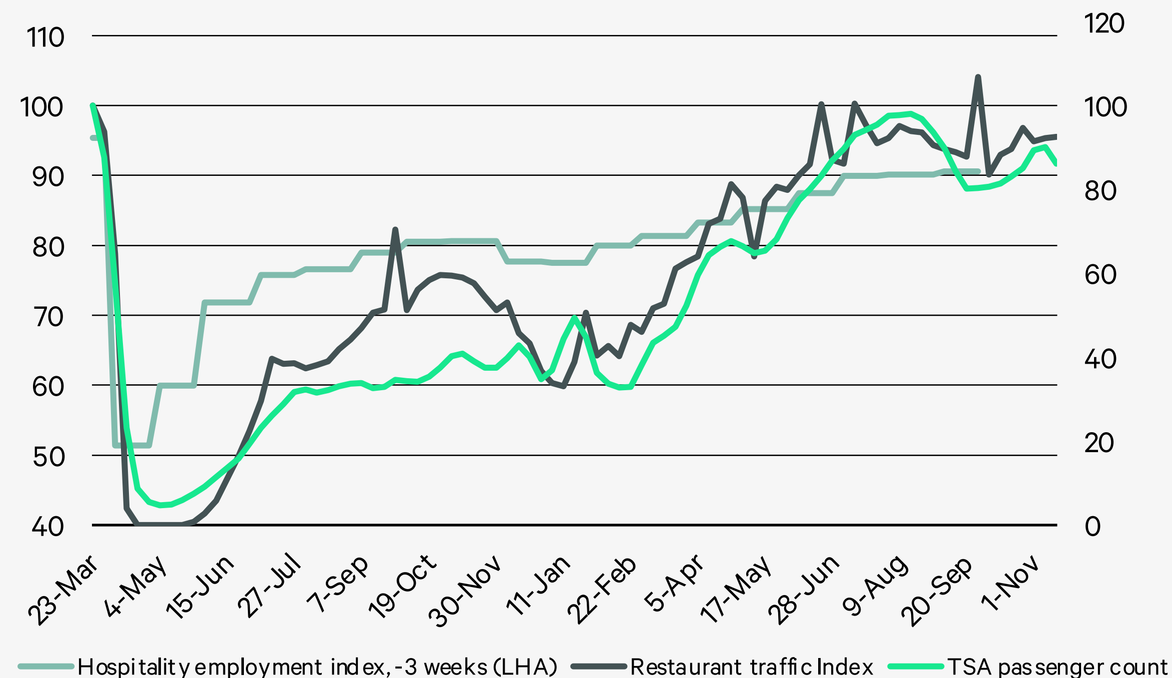
Economic activity began to pick up in late September

Weekly Leading Indicator Index



New York Federal Reserve.

Consumer services indices, March 2020 = 100



U.S. Bureau of Labor Statistics, OpenTable, Transportation Security Administration.

- The Delta variant stalled economic activity in August and September, but leading indicators are now trending upward.
- A lower COVID-19 case count is now encouraging more consumers to venture out to restaurants and board airplanes suggesting the economy will move into the fourth quarter on a stronger footing and put upside pressure on hospitality employment.

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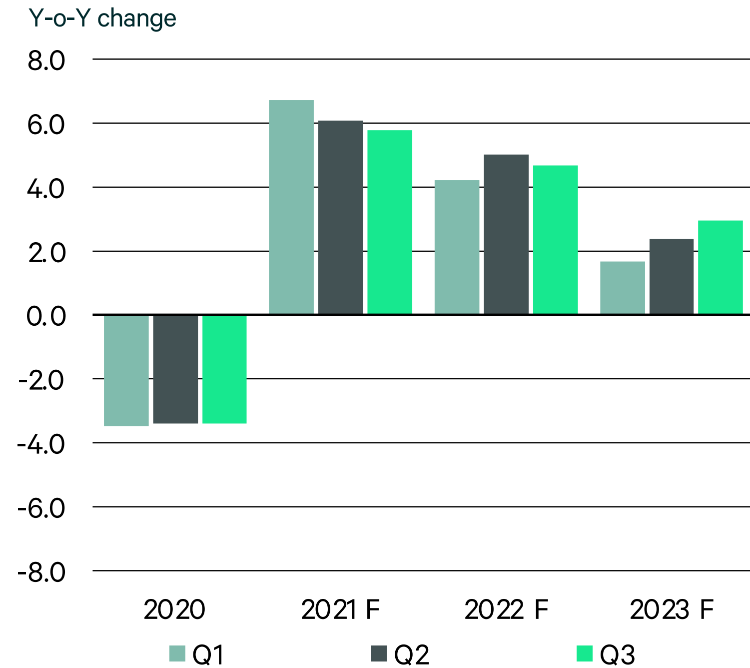
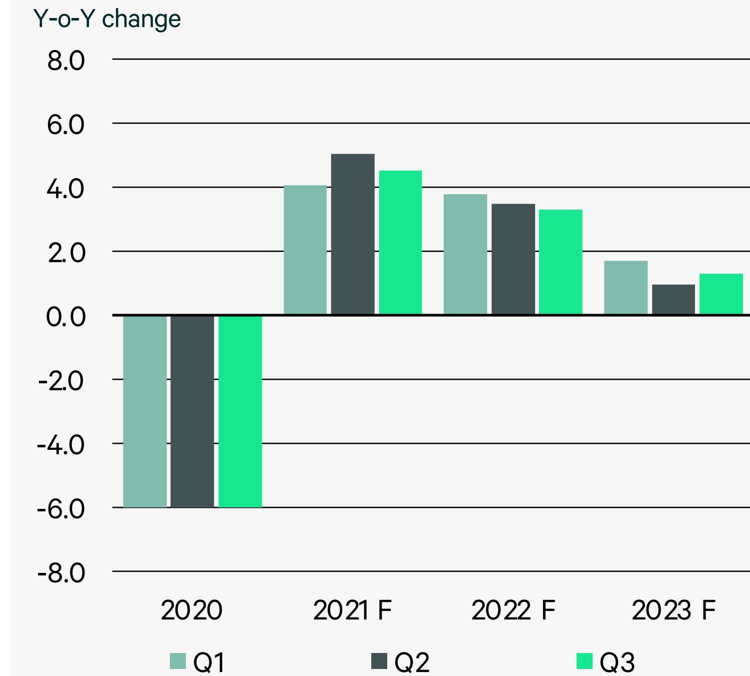
How our forecasts have evolved during 2021



U.S. Bureau of Economic Analysis, CBRE EA.



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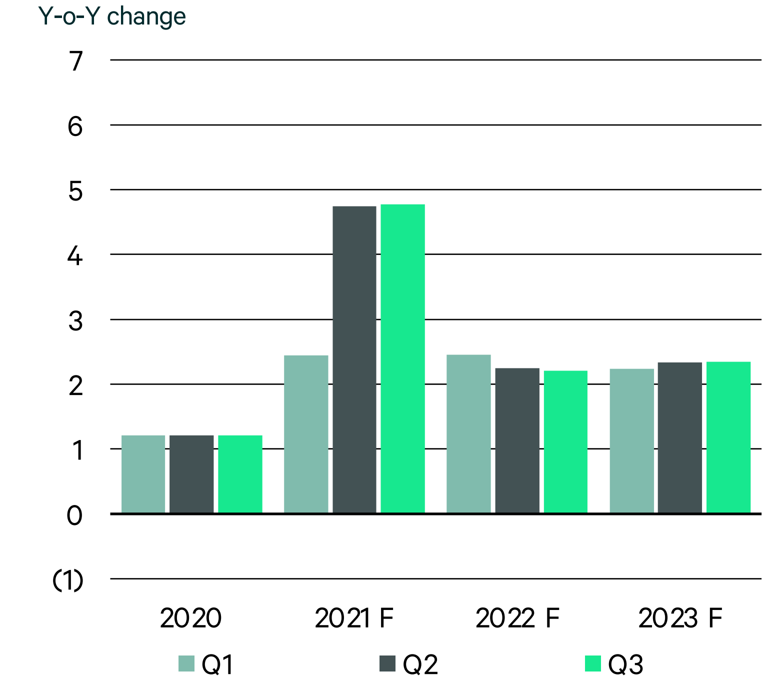

U.S. Bureau of Economic Analysis, CBRE EA.

- Our outlook for 2021 GDP and employment growth has trended down in recent months.
- Our inflation forecast saw the greatest shift during the summer months. We believe many of these factors are transitory and inflation will settle to lower-2% levels by the end of 2022.

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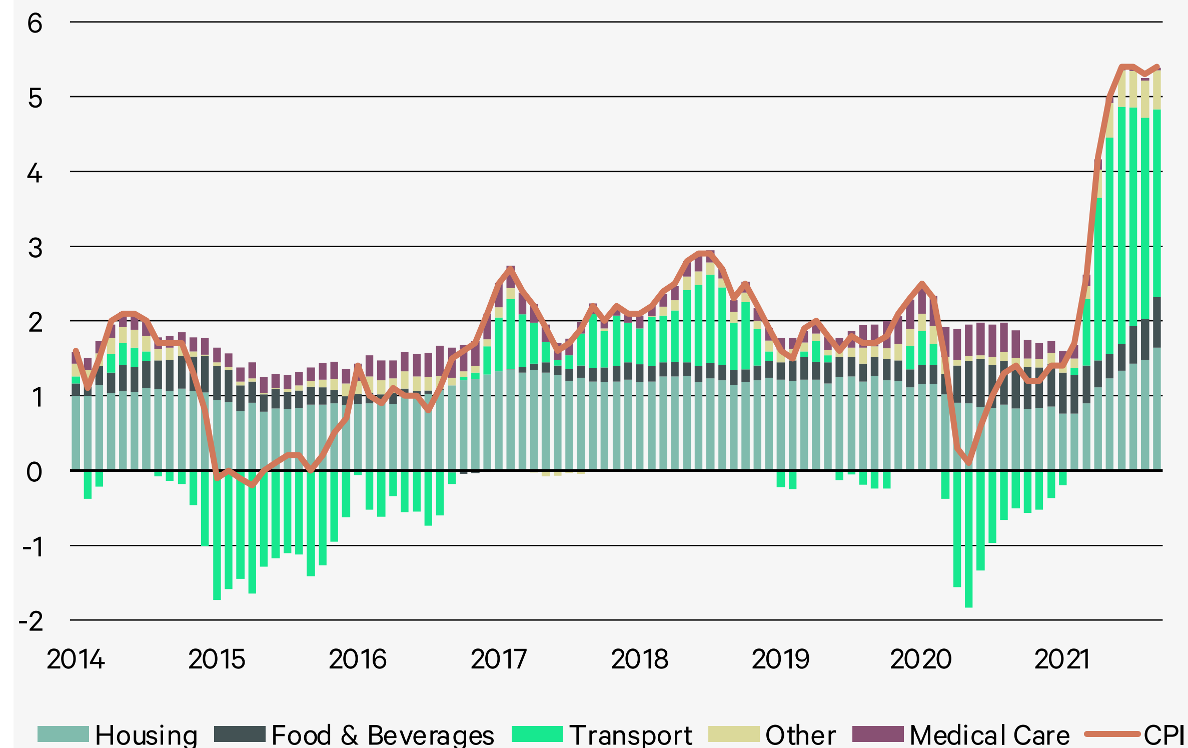
The components of inflation

- Many of the categories that were driving inflation several months ago, especially rental and used autos, are now seeing prices fade but housing costs (e.g., an increase in utilities and apartment rents) and key input prices, mainly energy costs, are picking up the slack.
- The recent surge in commodity prices suggests inflation could accelerate further than expected in the near-term.

CPI, Y-o-Y change (%) and contribution from key components



U.S. Bureau of Labor Statistics, CBRE EA.

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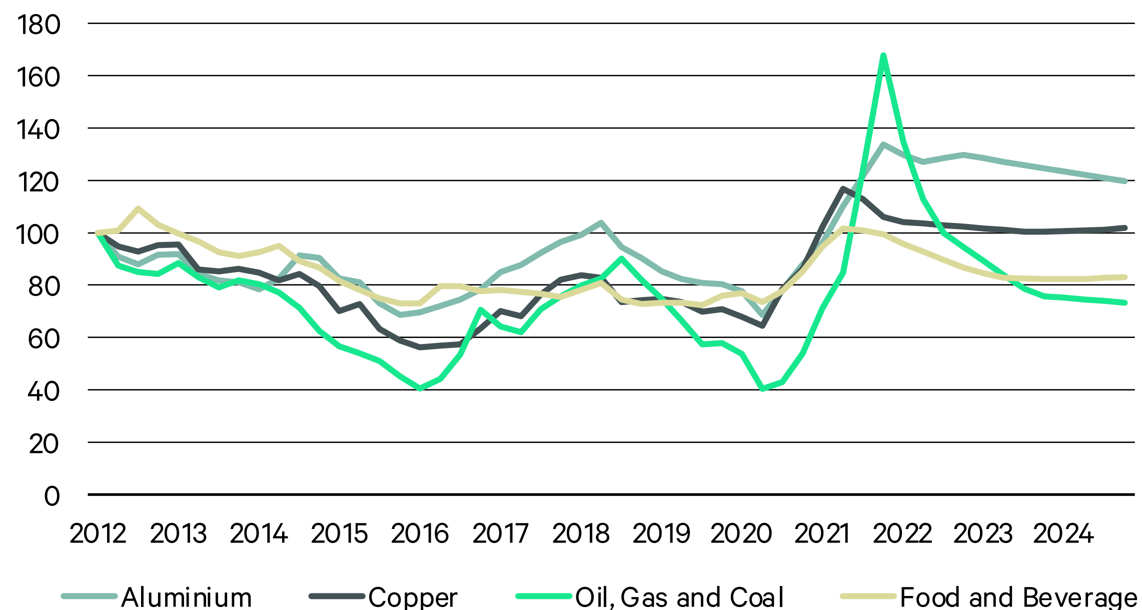
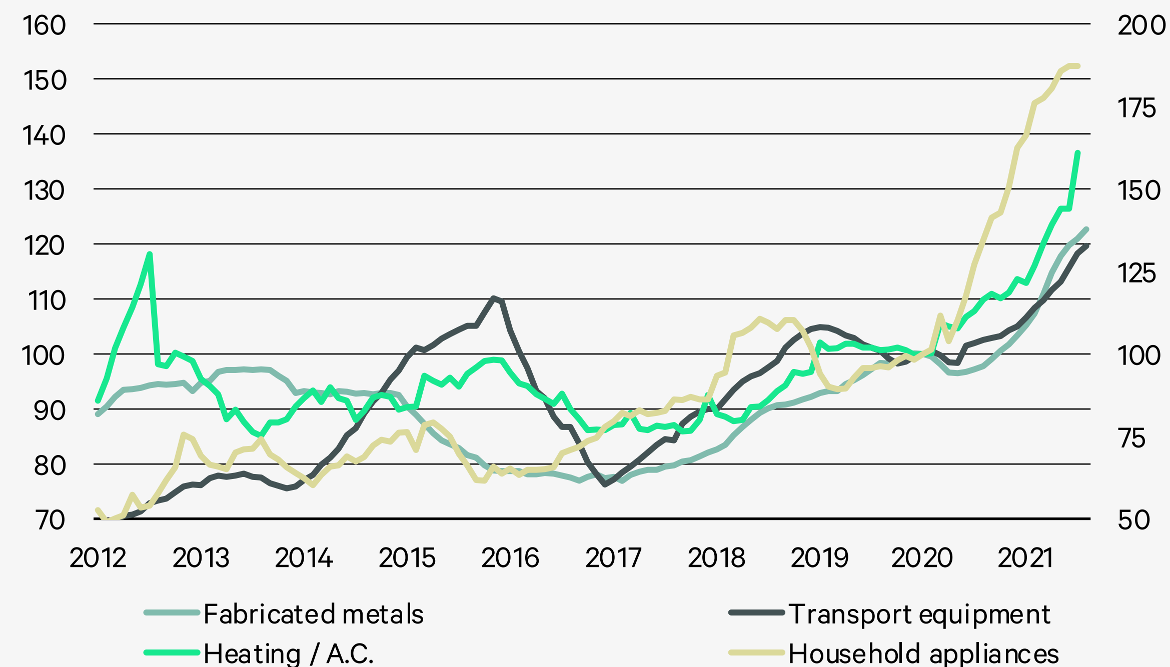
Commodities and durable goods are key 'wild cards'

Commodity price index (2012 = 100)



Energy Information Administration, OPEC, Natural Resources Canada, Intercontinental Exchange.

Unfilled goods orders index (2020=100)



U.S. Census.

- There is a lag between rising energy demand and when oil & gas producers can bring on more production capacity. This is causing prices to spike as the Northern Hemisphere moves into the winter months.
- A shortage of feedstock is causing manufacturing backlogs, especially for durable goods.

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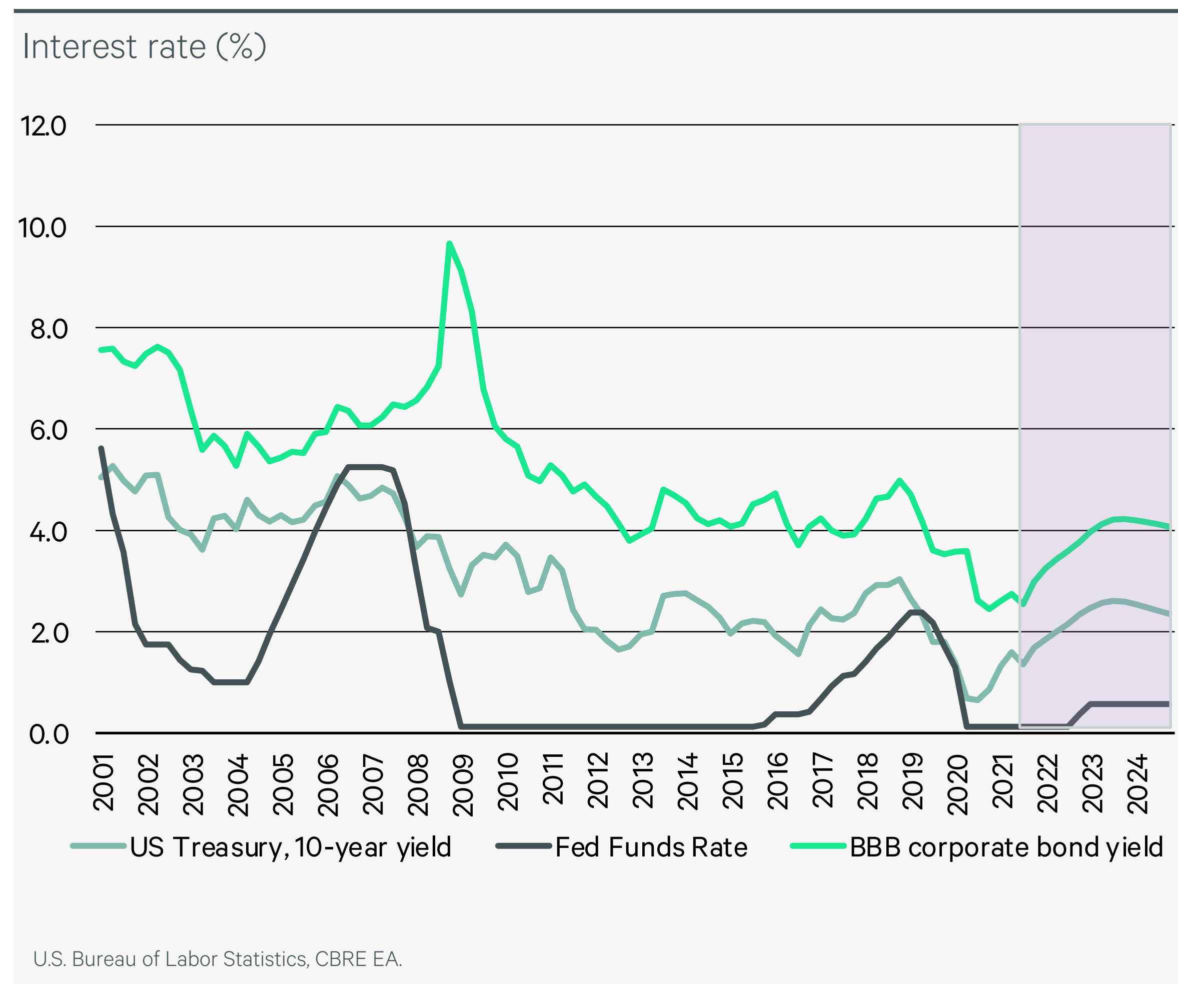
Heightened inflation in the near-term amid 'tapering' will push up interest rates

- Bond yields are trending up as inflation remains persistent and the Fed begins to wind down quantitative easing (QE).
- U.S. Treasury to BBB yield spreads should remain near their current range, which should help drive commercial mortgage and CMBS origination in the near-term.



U.S. Bureau of Labor Statistics, CBRE EA.

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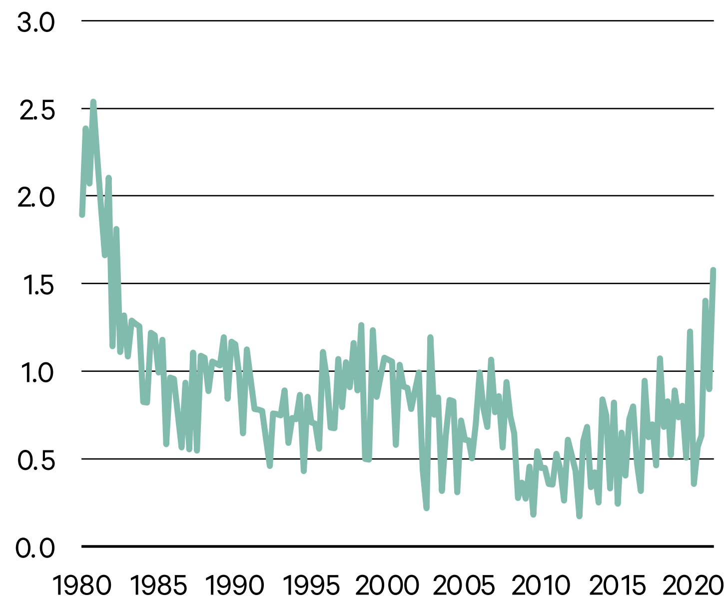
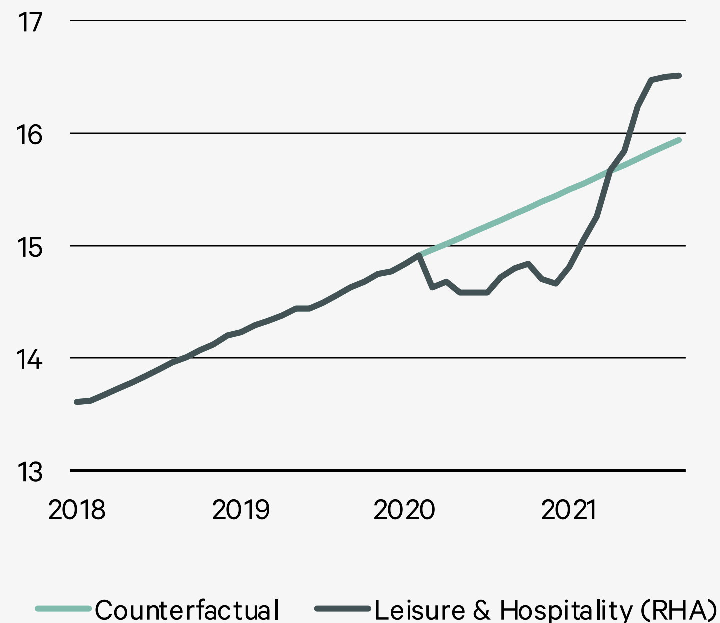
Demand for labor remains upbeat



U.S. Bureau of Labor Statistics.



U.S. Bureau of Labor Statistics.

U.S. Bureau of Labor Statistics.

- Rising labor costs are also exerting upward pressure on CPI. The Employment Cost Index posted the greatest quarterly growth in Q1 since the early 1980s.
- Wage acceleration has been most significant within the leisure & hospitality sector, where average hourly wages have now exceeded their pre-pandemic trend. The cause of this wage spike is a significant mismatch between supply and demand evidenced by the heightened job openings rate in the leisure & hospitality space.

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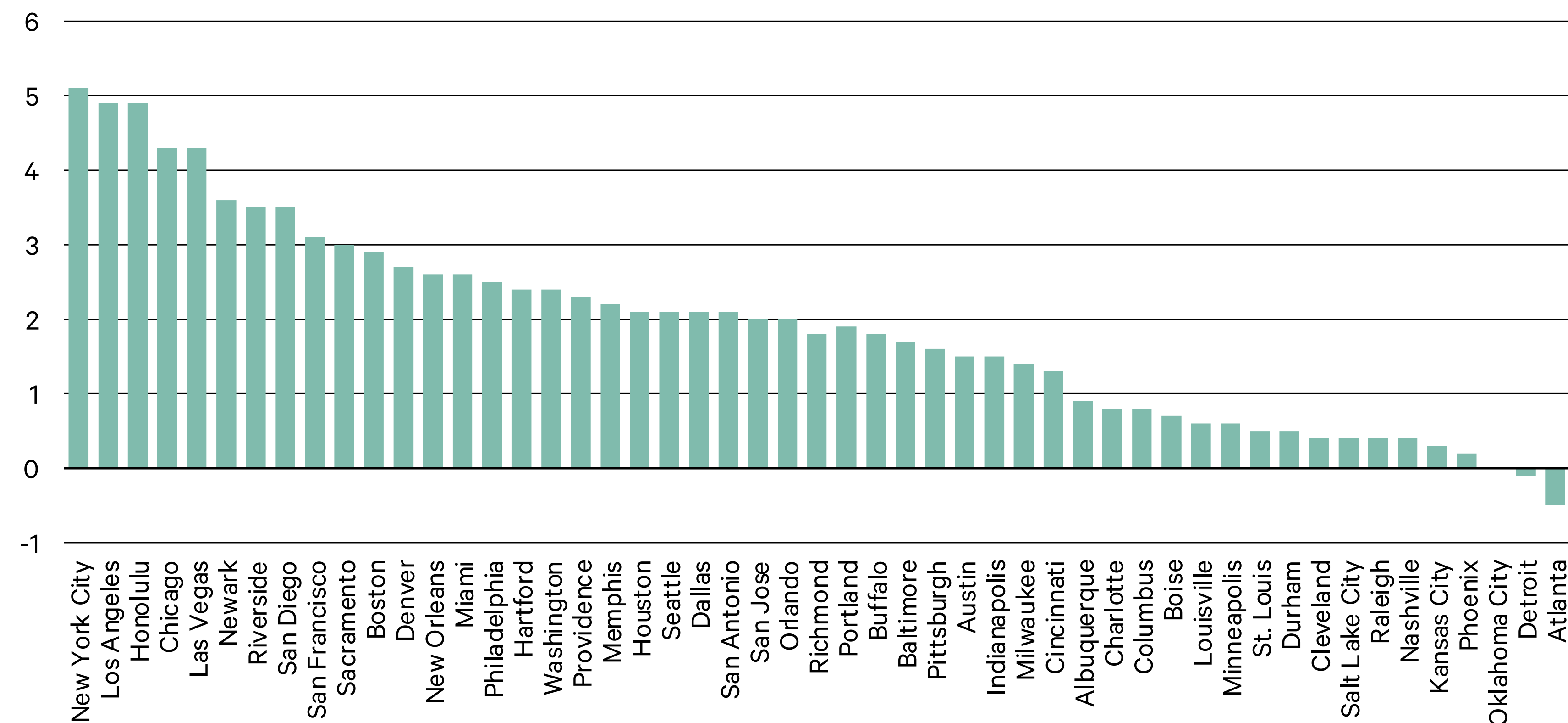
There is a pattern to regional unemployment levels

- Cities with strict social distancing rules (e.g., New York, Los Angeles) saw the greatest labor market disruption. Further, places with a sizable hospitality sector (e.g., Las Vegas, Orlando, New Orleans) continue to suffer heightened unemployment rates.
- Conversely, places with a more laissez-faire approach to social distancing saw less damage to local labor markets.



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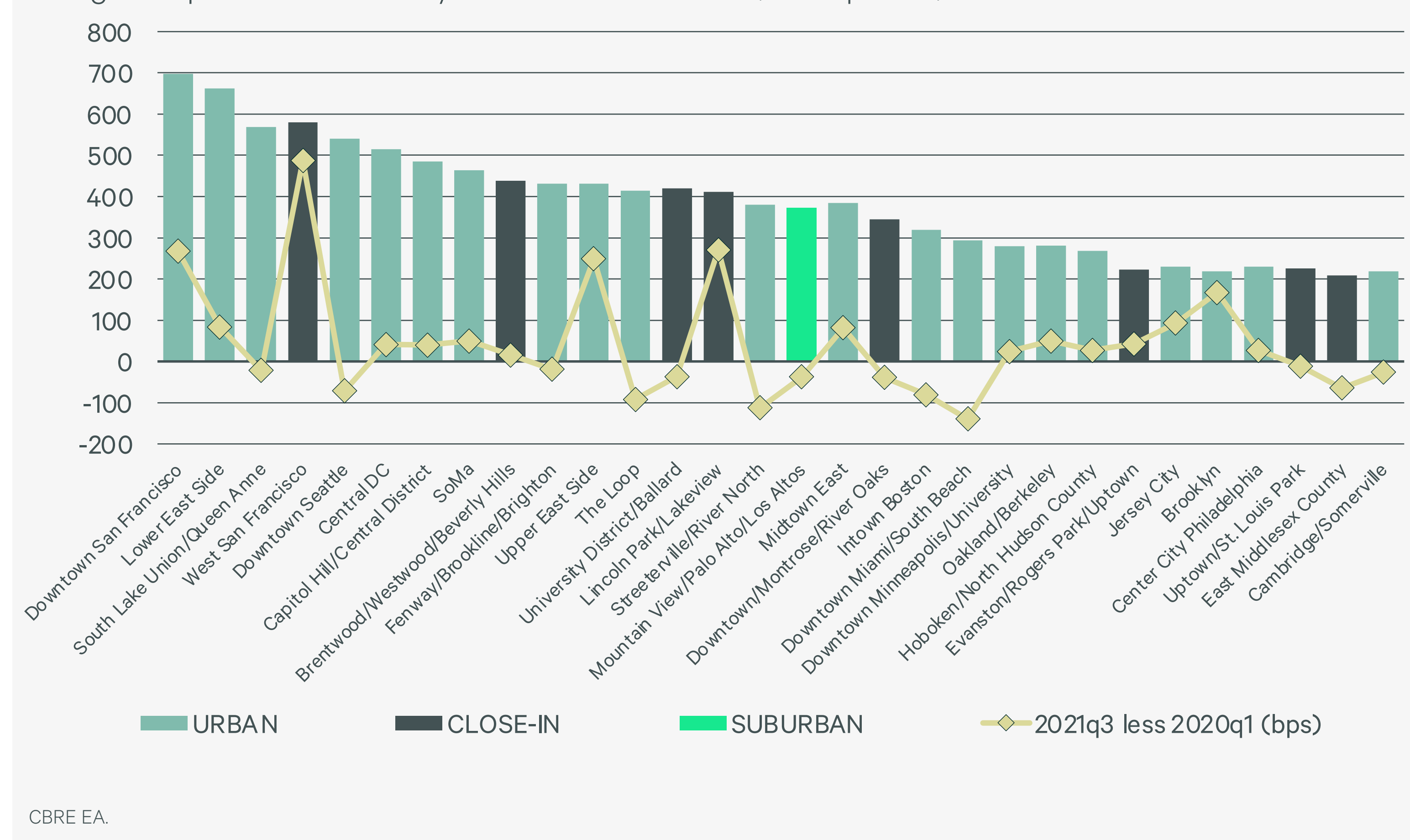
People are quickly moving back to urban neighborhoods

- Most of the hardest-hit submarkets from the pandemic were urban or were adjacent to urban cores.
- As social distancing rules have been relaxed and vaccines deployed, people have been moving back to urban neighborhoods. This is evidenced by vacancy rates generally falling back from their 2020 peaks and even below pre-pandemic levels.



CBRE EA.

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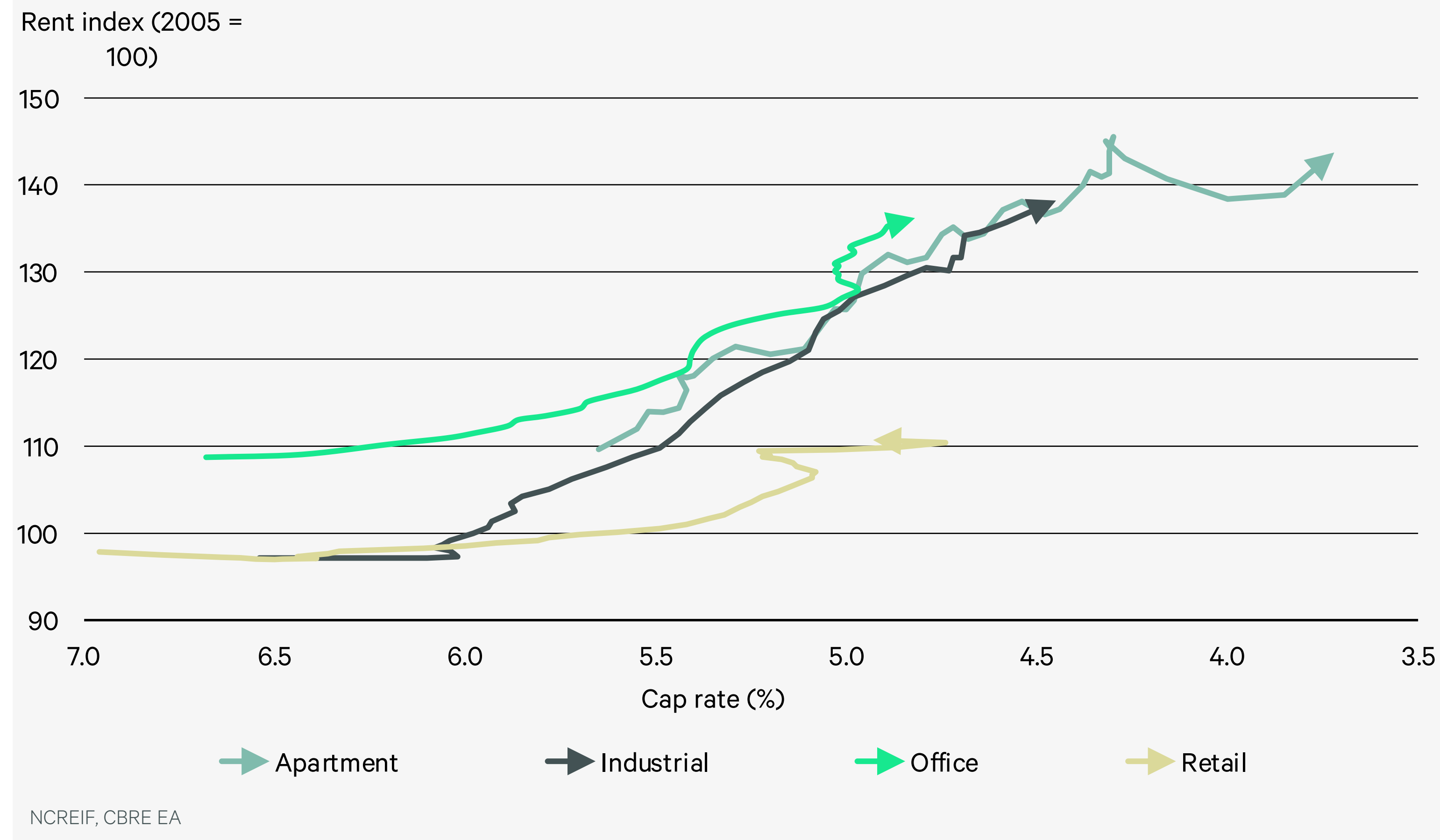
Implications for commercial real estate

- Sturdy e-commerce activity has driven consistent industrial rent growth during the past decade, attracting investors and driving down yields to levels synonymous with offices. Cap rates should fall further soon.
- As urban apartment markets recover expect pricing within this segment to become more aggressive.
- Pricing appears to be stagnant in office and retail spaces as fundamentals are challenged. Some components of retail, such as well-located grocery-anchored centers, could see higher valuations ahead.

The progression of rents and cap rates from 2011 – Q2 2021



NCREIF, CBRE EA

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Detailed macroeconomic assumption that drive our baseline forecast

	Topic	Current Conditions	Key Observations & Forecast Assumptions	Risks
Top line Expectations	US GDP	Recovered	Although Q3 economic growth stumbled, as COVID-19 weighed on activity, many leading indicators show activity is improving. Growth this year should reach the upper-5% range.	Although the demand side of the economy remains upbeat supply-side factors are a threat to U.S. and global economic growth in coming quarters.
	Inflation	Heightened	Supply constraints for a range of goods and commodities will keep inflation heightened during the next few quarters.	Rising prices thwart consumer purchasing power and erode demand.
U.S. Policy	Monetary policy	Aggressive (bust easing)	The Fed has begun to 'taper' its asset purchase program and should complete the process by mid-2022. The first-rate hike is unlikely to occur before late-2022.	Monetary stimulus results in a mispricing of risky assets. The Fed could be overstating the 'transitory' nature of the current inflation dynamics.
	Congressional Stimulus	Uncertain	The scaled-back $1.85T 'human infrastructure' spending plan and bipartisan $1T traditional infrastructure package should be passed into law this year.	The scaled-back $1.85T 'human infrastructure' spending plan and bipartisan $1T traditional infrastructure package should be passed into law this year. It is plausible that political wrangling could derail the passage of both spending bills, which could erode a material share from 2022 GDP growth.
Business Sector	Financial Conditions	Accommodative	Bond yields are trending up, but financial conditions overall are accommodative.	The prospect of higher inflation could cause bond markets to overreact.
	Business Sentiment	High	Struggling supply chains and rising input prices could put margins at risk but ISM business surveys show confidence levels are above pre-COVID-19 highs.	On balance, the risks to business sentiment are on the supply rather than the demand side.
	Business Investment	Recovering	Rebuilding inventories and productive capacity will bolster sturdy business investment.	Unclogging the global supply chain will determine the pace of business investment.
Labor Market & Consumption	Labor Market	Recovering	Increased demand for consumer services will drive job growth of about 4.5% this year.	Labor force participation remains unusually low and stymies the pace of hiring.
	Consumer Sentiment	Weak	Sentiment has weakening due to inflation, the Delta variant, and Federal policies. However, sentiment surveys remain weaker than actual sales.	An array of uncertainties surrounding COVID-19 going into the winter months, inflation, and an anxious national mood suggest there is downside risk to consumer sentiment.
	Retail Sales	Growing	Consumers remain aggressive and have shifted activity from goods to services as the economy has more fully reopened. Consumer spend should grow by about 9% this year.	Rising wages is delivering upside risk for consumption. On the downside, supply bottlenecks limit consumption.
	Housing Market	Easing	Limited inventory and high costs have stalled home sales. The pace of residential investment will slow albeit from very elevated levels. Apartment rents are rising.	The outlook for residential investment hinges on the pace of housing starts.
Public Health	Case Count	Bottoming	New COVID-19 cases are trending down across most regions.	New cases and hospitalization rates increase as the weather turns colder.
	COVID Restrictions	Limited	Activity is approaching pre-COVID norms for many segments of society.	Renewed COVID cases could spark more restrictions in some major cities.

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EA Scenarios

Baseline Scenario

- The Baseline scenario assumes that American economic activity will be able to operate with normalcy even as COVID-19 occurrences fluctuate. Generally widespread vaccination will keep hospitalization rates at manageable levels despite an uptick in cases. The likelihood of the Baseline scenario is HIGH.
- Normalization of American economic life will drive sturdy growth, but supply-side constraints are a barrier to a stronger expansion.
- We upgraded our expectations for inflation during summer 2021 and acknowledge there is upside risk in coming quarters as prices for key economic inputs, such as commodities and labor, have escalated. Our Baseline view is that many of the supply bottlenecks and price hikes will prove transitory as was the case with the transport sector in recent quarters.
- Increased inflation has put upward pressure on government bond yields in recent months and we assume the U.S. 10-year Treasury yield will hit roughly 1.7% by year-end. Yields are poised to trend higher in coming quarters as the Fed winds down QE and inflation remains elevated through H1 2022.

	2018	2019	2020`	2021	2022	2023	2024
CBRE EA BASELINE FORECAST							
GDP, %	2.9	2.3	(3.4)	5.8	4.7	3.0	1.8
EMP, %.	1.6	1.3	(6.0)	4.5	3.3	1.3	0.5
CPI, %	2.2	2.0	1.2	4.8	2.2	2.3	2.1
10-YR TREASURY, %	3.0	1.8	0.9	1.7	2.3	2.6	2.4

Note: Figures are average annual change—except the 10-year, which is Q4% yield.

Source: BEA, BLS, Federal Reserve, CBRE Econometric Advisors, Q3 2021.

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Upside Scenario

- Should global growth exceed expectations in coming quarters, we would likely see GDP growth exceed 7% in 2022. There is a LOW-to-MEDIUM likelihood of this scenario coming to fruition.
- Achieving upper-6% job growth this year would require activity in many sectors to exceed pre-pandemic growth trends. More fundamentally, this scenario requires a material increase in labor force participation and supply-chain bottlenecks to be quickly worked out.
- Because the Upside scenario is predicated upon expanded growth capacity (e.g., supply shortages being worked out), greater economic growth would not produce a significant uptick in inflation relative to the Baseline outlook.

	2018	2019	2020`	2021	2022	2023	2024
CBRE EA UPSIDE FORECAST							
GDP, %	2.9	2.3	-3.4	6.3	7.5	3.6	1.9
EMP, %.	1.6	1.3	-6.0	6.6	4.8	1.8	0.4
CPI, %	2.2	2.0	1.2	4.9	2.5	2.5	2.2
10-YR TREASURY, %	3.0	1.8	0.9	1.7	3.0	3.1	2.7

Note: Figures are average annual change—except the 10-year, which is Q4% yield.

Source: BEA, BLS, Federal Reserve, CBRE Econometric Advisors, Q3 2021.

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Downside Scenario

- In a Downside scenario, the U.S. economy would avoid a double-dip recession but will operate at reduced capacity for a period as COVID-19 concerns weigh on consumption and supply-chain disruptions retard business investment. There is a MEDIUM likelihood of the Downside scenario occurring.
- Specifically, GDP growth will be in the low-5% range in 2021. Job growth will remain restrained but not completely due to weakened demand, as labor force participation remains well below 2019 levels.
- Despite weaker economic activity inflation remains heightened but bond yields remain below 2% as financial markets grow weary of risky assets. The Fed could employ more accommodative language even as it winds down its QE program.

	2018	2019	2020`	2021	2022	2023	2024
CBRE EA DOWNSIDE FORECAST							
GDP, %	2.9	2.3	-3.4	5.2	1.1	2.0	2.0
EMP, %.	1.6	1.3	-6.0	2.4	0.9	0.6	1.1
CPI, %	2.2	2.0	1.2	4.6	1.9	2.1	2.0
10-YR TREASURY, %	3.0	1.8	0.9	1.7	1.4	1.8	2.0

Note: Figures are average annual change—except the 10-year, which is Q4% yield.

Source: BEA, BLS, Federal Reserve, CBRE Econometric Advisors, Q3 2021.

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Severe Downside Scenario

- Within the Severe Downside scenario, the COVID-19 situation deteriorates significantly. Vaccines perform inconsistently against new strains of COVID-19, health systems begin to be overwhelmed and many states are forced to shutter their economies again. Consequently, the economy will face a double-dip recession in 2022.
- Growth after the 'double dip' will remain weak as the economy faces lasting scars. Specifically, firms and households that were hobbled by 2020 will not be able to withstand another contraction, which would stress the financial system.
- The Severe Downside scenario has a VERY LOW probability.

CBRE EA SEVERE DOWNSIDE FORECAST	2018	2019	2020`	2021	2022	2023	2024
GDP, %	2.9	2.3	-3.4	4.7	-2.7	1.0	1.6
EMP, %.	1.6	1.3	-6.0	0.3	-2.1	0.2	0.8
CPI, %	2.2	2.0	1.2	4.5	1.5	1.9	1.8
10-YR TREASURY, %	3.0	1.8	0.9	1.7	0.4	1.0	1.3

Note: Figures are average annual change—except the 10-year, which is Q4% yield.

Source: BEA, BLS, Federal Reserve, CBRE Econometric Advisors, Q3 2021.

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Thank you

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