FED TIME IS COMING

RESEARCH REPORT - WEEKLY ECONOMIC UPDATE

A Cushman & Wakefield Research Publication

AUGUST 3, 2015

- Commercial real estate is facing the first interest increase in nearly a decade. We do not expect higher interest rates to negatively impact real estate values because the increase will be a result of improving economic fundamentals, particularly strong labor markets. Strong job growth means rising demand for all kinds of commercial real estate, supporting higher values even in a rising interest rate environment.
- The Federal Reserve's Open Market Committee (FOMC) met last week. The statement released at the end of the two day meeting indicates that the Central Bank is likely to raise short term interest rates at least once before the end of the year.
- We believe the shift to higher interest rates will begin in September.
- Even though some recently released economic indicators have been a bit soft, the FOMC's statement made clear that the key driver of the decision will be conditions in labor markets.
- The employment data scheduled to be released over the next six weeks will be critical for the Fed in deciding whether to start raising rates in September, or wait a little longer.

AT THE END OF 2Q 2015

IN THE FIRST HALF OF 2015

THE FEDERAL RESERVE'S OPEN MARKET COMMITTEE MET LAST WEEK

The Federal Reserve has always been a secretive organization. It comes with the territory. The Fed's job is to guide financial markets in such a way that interest rates are roughly where policy makers believe they should be, without giving anyone information that could provide an advantage in the marketplace. In the 1980s and earlier, the Fed never told anyone the level of interest rates it believed were needed to encourage both full employment and price stability. Analysts tried to ascertain the Fed's thinking (dubbed "Fed Watchers") based on how the Fed intervened in fixed income markets by buying and selling bonds. Every day at about 11:30 a.m. the Fed would announce its purchases or sales for that day, and traders in the fixed income markets would look at the numbers and the actions, and adjust their trading strategies accordingly.

CUSHMAN & WAKEFIELD®

Cushman & Wakefield, Inc.
1290 Avenue of the Americas
New York, NY 10104
www.cushmanwakefield.com

FOR MORE INFORMATION, CONTACT:
Ken McCarthy
Senior Managing Director, Regional Research Director – Tri-State New York, Economic Analysis and Forecasting
(212) 698 2502
ken.mccarthy@cushwake.com

FED TIME
IS COMING

RESEARCH REPORT
WEEKLY ECONOMIC UPDATE

AUGUST 3, 2015

So 11:30 in the morning became known as "Fed Time" at every fixed income trading desk on Wall Street.

Over the past two decades the Central Bank has become a lot more open about its views on the current state, and future expectations for the economy, and the appropriate level of interest rates. The FOMC meets every six weeks, releases a statement of its views and expectations, and holds a press conference to follow up. But even in this more open environment, there remains a shroud of secrecy over the FOMC's deliberations and policy conclusions. It still takes a Fed Watcher to read through the FOMC statement and draw a conclusion about the future direction and level of interest rates.

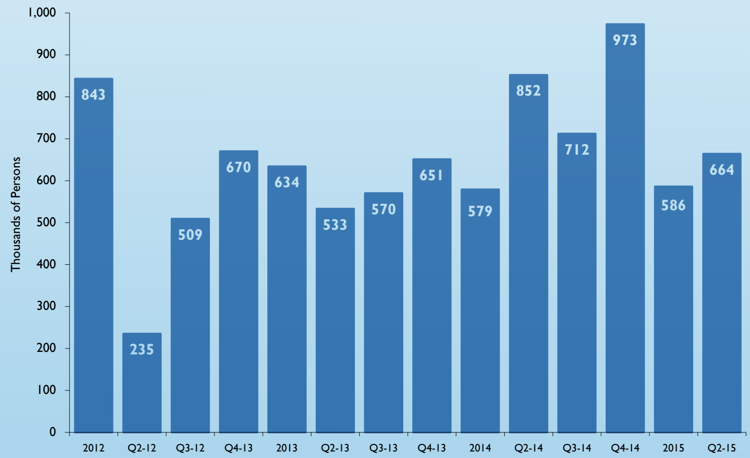
What we know today is that, to paraphrase the popular HBO series *Game of Thrones*, "Fed Time is coming." The Fed is about to change interest rate policy for the first time since 2009. The six years that the Fed has kept short term interest rates unchanged is, by far, the longest period of unchanged policy in the Fed's history. When the Fed makes this shift to raising rates, it will mark the first time in almost a decade that it has increased interest rates.

The shift to higher interest rates has been anticipated for a long time and has been signaled by the FOMC in its press releases over the past year or so. In last week's release, the FOMC was pretty clear in its intention to raise interest rates and what will influence the timing of that move.

THE LONGEST PERIOD OF INTEREST RATE STABILITY IN THE POST-WAR U.S. FEDERAL FUND RATE

Source: U.S. Federal Reserve Board

JOB GROWTH REMAINS ROBUST
Quarterly Change in Payroll Employment



Source: U.S. Bureau of Labor Statistics

CUSHMAN & WAKEFIELD®

Cushman & Wakefield, Inc.
1290 Avenue of the Americas
New York, NY 10104
www.cushmanwakefield.com

FOR MORE INFORMATION, CONTACT:
Ken McCarthy
Senior Managing Director, Regional Research Director – Tri-State New York, Economic Analysis and Forecasting
(212) 698 2502
ken.mccarthy@cushwake.com

FED TIME
IS COMING

RESEARCH REPORT
WEEKLY ECONOMIC UPDATE

AUGUST 3, 2015

The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen some further improvement in the labor market…

"The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen some further improvement in the labor market..."

This statement indicates a clear intention to raise interest rates and shows the importance of labor markets in the FOMC's decision making process. This is important because over the past few weeks some of the economic data released by the U.S. Government has been softer than expected, suggesting that the initial bounce-back from the severe winter may have dissipated.

- U.S. retail sales unexpectedly declined 0.3% in June and the gains recorded in April and May were revised down slightly, indicating that consumer spending growth may be slowing.
- In another sign of a softer consumer environment, the Thomson Reuters University of Michigan's Index of Consumer Sentiment declined in July after surging in June.
- U.S. manufacturing production was flat in June and barely budged in the second quarter. The output of U.S. factories in June was below the level at the end of 2014.
- U.S. housing starts increased in June, but only because of a surge in apartment construction, which may have been caused by a change in tax policy in New York City.
- U.S. gross domestic product (GDP) increased at a 2.3% annual rate in the second quarter which, while stronger than the first quarter's 0.6% increase, is far from stellar and indicates that the economy remains stuck in slow-growth mode.

CUSHMAN & WAKEFIELD®

Cushman & Wakefield, Inc.
1290 Avenue of the Americas
New York, NY 10104
www.cushmanwakefield.com

FOR MORE INFORMATION, CONTACT:
Ken McCarthy
Senior Managing Director, Regional Research Director – Tri-State New York, Economic Analysis and Forecasting
(212) 698 2502
ken.mccarthy@cushwake.com

FED TIME IS COMING

RESEARCH REPORT
WEEKLY ECONOMIC UPDATE

AUGUST 3, 2015

Despite these signs of softness in the overall economy, labor markets remain healthy.

- The U.S. economy continues to add jobs at a strong pace. In the first half of 2015 payroll employment increased by 1.25 million jobs, a pace which, if sustained, would be second only to 2014 in the recovery so far. It would mark only the third time since 1999 that employment growth is 2.5 million or higher.
- There are a record number of job openings. The Labor Department started its survey of job openings in 2000, and the 5.4 million jobs currently open is the highest ever recorded.
- According to the Labor Department's employment cost index, private sector wages in the second quarter were up 2.1% from a year ago. That is a disappointing slowdown from the 2.7% annual gain recorded in the first quarter, but still marks the fourth consecutive quarter that gains exceeded 2.0%, something not seen since 2008.

U.S. economic statistics have been sending mixed signals over the past few weeks, with softness in production and spending, but strength in job growth and signs that it will continue. The Fed is clearly signaling that the job numbers take precedence in its deliberations, so those will be the key data to watch over the next several weeks, starting with the July employment data to be announced on August 7. If job growth is sustained at over 200,000 per month, we would expect that will be enough evidence for the FOMC to raise interest rates at their next meeting on September 16-17. This is what we anticipate. Fed Time is coming.

For the commercial real estate sector, the move to higher interest rates will mark a sea change in the environment, as more than six years of easy money comes to an end. Financing costs will increase for buyers, and although interest rates will still be low by historical standards, they will be moving higher. However, it is important to keep in mind that the reason for the increase is a strong labor market. More jobs mean more demand for space, particularly office space. This environment should also lead to healthy wage and income growth, which will boost consumer spending. Stronger spending growth will boost retail, industrial and hotel demand. A healthy job market should also lead to more household formations, and more demand for multifamily real estate.

The financial environment is expected to shift in September. The Fed has been telling us all for some time that this change is coming. When it comes, it will be for all the right reasons: rising employment and faster wage growth. Those healthy fundamentals will be critical in boosting the commercial real estate sector in the coming year.

CUSHMAN & WAKEFIELD®

Cushman & Wakefield, Inc.
1290 Avenue of the Americas
New York, NY 10104
www.cushmanwakefield.com

FOR MORE INFORMATION, CONTACT:
Ken McCarthy
Senior Managing Director, Regional Research Director – Tri-State New York, Economic Analysis and Forecasting
(212) 698 2502
ken.mccarthy@cushwake.com