Marcus & Millichap

Research Brief

FEDERAL RESERVE

June 2018

Booming Economy Prompting Hawkish Fed Policy; Global Financial Markets May Complicate Future Action

Developing Trends

Recession indicator close to tipping point. Following the increase in the Fed funds rate, the spread between the two-year Treasury and 10-year Treasury has fallen to 34 basis points, the lowest level since prior to the Great Recession.

Small business optimism on pricing, earnings signals percolating inflation pressure. A recent survey of small business owners by the NFIB showcased widespread optimism among small businesses, with compensation and expansion optimism at the highest levels in the history of the survey. Price hikes and plans to raise prices are at the highest point since 2008.

PPI and CPI gaining steam, reinforcing robust economy. The Producer Price Index reached a new cycle high of 3.1 percent, while the Consumer Price Index hit 2.8 percent, the highest level in 78 months, reinforcing a pickup in inflationary pressure. Inflation measures are now above the Fed's target, reinforcing their hawkish policy stance.

Recent Research Briefs

Employment
06/2018
>>

Retail Sales
06/2018
>>

Follow Us on Twitter @
https://twitter.com/MMResearch

Fed raises benchmark interest rate; additional increases anticipated. The Federal Reserve increased the federal funds rate by 25 basis points, lifting the overnight lending rate to a range of 1.75 percent to 2 percent. Citing stronger consumer spending, and a highly optimistic business community, the Fed laid out the potential for two additional rate hikes in 2018. The Fed noted strong job growth, accommodative fiscal policy and above-target inflation as reasons for continuing to normalize monetary policy over the coming months.

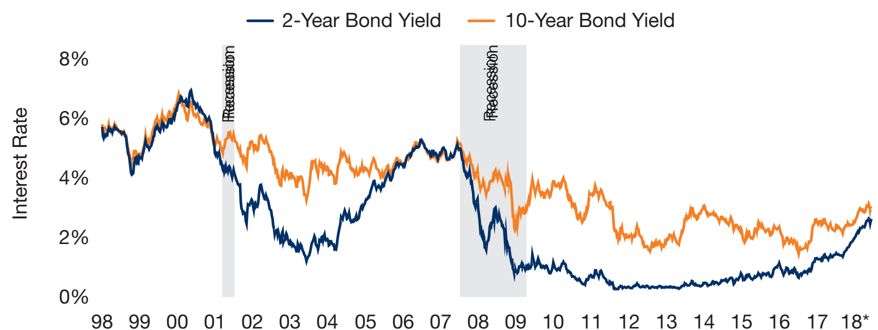
Federal Reserve faces balancing act as yield curve flattens. While the Fed suggested two additional rate hikes before year's end, stimulative international monetary policies could restrain long-term Treasury yields. Very low long-term interest rates, particularly in Western Europe and Japan, could drive more international capital into U.S. Treasuries, restraining the 10-year yield to the 3 percent range. This would restrict the Fed's ability to push short-term rates higher without causing the two-year yield to rise above the 10-year yield, a commonly known signal of an impending recession. The Fed will remain highly cautious about sending such a signal, and could curtail rate increases if long-term rates do not rise.

Lending costs increase in rising interest rate climate. As the Fed has lifted interest rates, benchmark loan rates have followed. While some lenders are absorbing a portion of the increase, borrowers will increasingly face higher interest rates, which may motivate buyers to seek price reductions. However, economic growth continues to lift NOIs, prompting sellers to remain committed to higher asking prices, creating an expectation gap. Net-leased properties face the greatest rebalancing risk due to their bondlike lower yields, but they have yet to experience wholesale repricing.

1.90% Fed Funds Rate*

2.92% 10-Year Treasury Rate*

Yield Curve Inversion Risk Rising



* As of June 18

Sources: Marcus & Millichap Research Services; BLS; Federal Reserve Economic Data