RESEARCH BRIEF

Marcus & Millichap

GROSS DOMESTIC PRODUCT

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Latest GDP Release Offers Insights for Retail, Industrial and Office Properties

Economy grows in the first quarter, but at slowing pace. Real gross domestic product increased at an annual rate of 1.1 percent in the first quarter of this year. Factors contributing to this growth include gains in consumer spending, exports, and government spending. Last quarter's improvement to GDP was nevertheless a deceleration from the 2.6 percent annual rate reported for the final three months of 2022. An uptick in imports, along with a slowdown in private inventory investment, contributed to this downshift. Despite this economic moderation, last quarter's GDP figure underscores some positive areas of resilience.

Consumer service spending shines light on retail. Personal consumption expenditures improved by 3.7 percent on an annual basis in the first quarter, with consumers spending more on both major discretionary items — such as motor vehicles, as well as on services. Sales at restaurants and on travel reflect a return of some pre-pandemic shopping habits, supporting retail property performance. The national retail vacancy rate has held at 4.7 percent, just under the 2019 measure, for three consecutive quarters. This places the retail sector in a relatively sturdy position to weather near-term headwinds. Retail sales declined in February and March. Certain beleaguered brands, such as Bed Bath & Beyond, are also closing, although this process frees locations for more optimal uses.

Cost-cutting factoring into 2023 industrial and office outlooks. Topline GDP was weighed down by a drawback in private inventory investment. Companies are streamlining balance sheets, reducing expenditures on equipment, fuel and other supplies. Some organizations are also reducing staff counts. These trends may interrupt demand for industrial and office space. Vacancies in both sectors increased in the first quarter. A slowdown of industrial space absorption, while ill-timed with this year's near-record delivery slate, is likely to be short-lived, given returning North American manufacturing and a growing population using direct delivery services. Meanwhile, the office sector will likely contend with companies' changing space needs for many quarters to come.

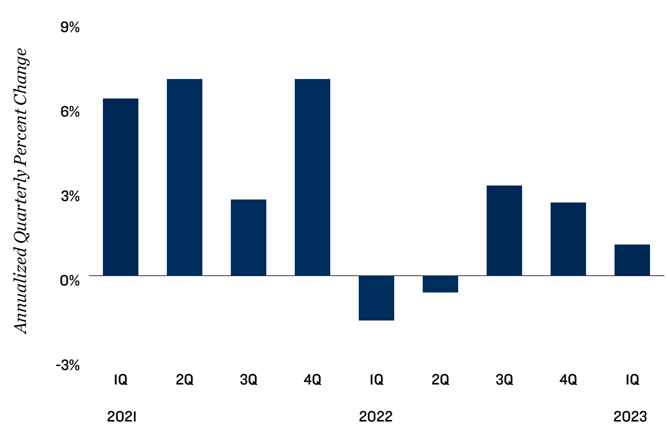
Monetary Policy Implications

Higher prices point to another small rate hike. Inflation pressures remained in the first quarter, as the core PCE index increased by an annual rate of 4.9 percent in the first quarter, up from the fourth quarter of last year. While economic growth is slowing, these ongoing price climbs will likely prompt the Federal Open Market Committee to raise the overnight lending rate again on May 3. Market participants currently favor a 25-basis-point hike, the third of such magnitude this year, followed by several months of flat rates.

A rate increase break first step to mending investor confidence. A pause in rate hikes after the May Fed meeting would help lenders and investors better come to terms on commercial real estate financing and trading. A limiting factor will be lingering concern from the recent bank closures, which has prompted tighter due diligence. If no further closures arise and bank spreads narrow, even by a minor degree, it would go a long way toward facilitating a more active investment climate.

1.1%	*Annual Rate of Change in real GDP in 1Q 2023*	2.3%	*Annual Rate of Change in Personal Consumption Expenditures - Services in 1Q 2023*

GDP Growth Moderating Through First Quarter



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Sources: Marcus & Millichap Research Services; Bureau of Economic Analysis; CoStar Group, Inc.; CME Group