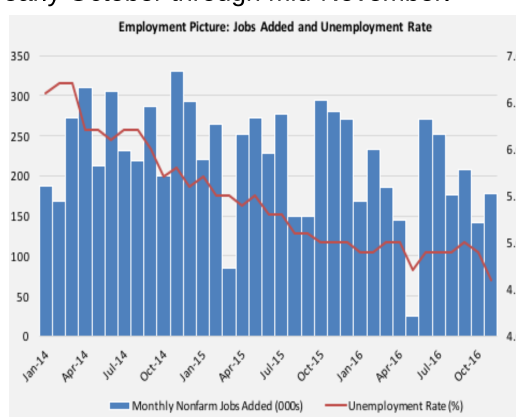
December 7, 2016 | Andrew J. Nelson, Chief U.S. Economist

WHERE WE ARE: Ending the Year on a High Note

Key takeaways: The economy is exhibiting its most robust growth in a year across a broad range of indicators, providing solid momentum into 2017 and strong support for property fundamentals. But interest rates are rising, and January brings the uncertainty of a new administration—both of which may alter the playing field for investors.

After seven and a half years of expansion, the economy is still chugging along. In fact, 2016 is drawing to a close with some of the strongest indicators of the year. Most notably, last week third-quarter GDP was revised upward to an annualized rate of 3.2%, its highest quarterly pace in two years, as corporate earnings and exports surged to join consumers in driving the economy forward.

Growth has continued into the fourth quarter with the Federal Reserve's latest "Beige Book" reporting that "the economy continued to expand across most regions from early October through mid-November." Meanwhile, the Purchasing Managers' Indexes (PMIs) for manufacturing and services continue to improve. The composite manufacturing index grew at its fastest pace since June, with particular strength in the production component, while the services-oriented non-manufacturing index grew at its fastest rate in over a year.



On another positive note for the economy and property markets, the unemployment rate fell to 4.6% in November, its lowest rate in nine years, on the strength of 178,000 new payroll jobs. One downside to the strong jobs report, though: Wage growth fell 0.1% last month—not a material decline, but an unwelcome move in the wrong direction.

Conditions continued to firm in the housing market, too. As measured by the Case-Shiller index, the average price of single-family homes nationally finally reached a new peak in October (latest data available), although the big city indexes still lag their 2006 peaks. These gains came on top of a 25% jump in housing starts in October, the highest pace since August 2007, and a clear sign that homebuilders are ramping up construction to meet rising demand.

Given all this positive economic news, it should not be surprising that consumer confidence has been high, reaching its highest level in nine years—until you realize that this survey was conducted immediately before and after the most divisive election in memory. Perhaps everyone is just happy the campaign is over. Regardless, this exuberance bodes well for consumer spending overall and is well timed for the all-important holiday shopping season—good for both physical and online retailers.

Perhaps the least favorable indicators in recent weeks ironically reflect the strength of both current conditions and market expectations: The trade-weighted value of the dollar is up about 3.5% since the election, to its highest level in over a decade, while the interest rate on the 10-year Treasury note is up about 50 basis points to its highest level in a year and a half. Both likely can be attributed to the "Trump effect" as the markets anticipate that the planned stimulus package will be inflationary and will force the Federal Reserve to raise interest rates more aggressively. Both the rising dollar and interest rates would mute the positive impacts of the stimulus.

IMPLICATIONS FOR PROPERTY MARKETS

Economic and financial markets are almost certainly strong enough for the Fed to finally hike its benchmark federal-funds rate again at its December meeting next week. Indeed, the futures markets are signaling virtually 100% certainty of Fed action. Though property investors typically fear rising interest rates, in fact this fear is misplaced as investment returns frequently rise directly with interest rates. Interest rates generally rise when the economy is growing, which then fuels property fundamentals.

Looking into 2017, the Trump administration will be inheriting a strong economy already poised for continued, if moderate growth. The planned stimulus package should only add to that growth, though the extent of the boost will depend on the many details that remain unknowable at this point. Expect property markets to benefit, as economic and job growth supports continued leasing and investor demand.

ANALYSIS OF RECENT ECONOMIC NEWS

Company Earnings Show Strength as U.S. Growth Picks Up (WSJ) "Corporate profits continued to rebound last quarter alongside solid growth in the broader U.S. economy. A key measure of after-tax earnings across U.S. corporations rose 5.2% in the third quarter from a year earlier, the Commerce Department reported … the strongest year-over-year growth since the fourth quarter of 2012. [The] report also showed that gross domestic product … expanded at an inflation- and seasonally adjusted annual rate of 3.2% in the third quarter, the strongest growth in two years."

Fed Says U.S. Economy Continued to Expand Across Most Regions (Bloomberg) "The U.S. economy continued to expand from early October through mid-November with little inflation as retail sales, real estate markets and business service firms saw rising activity, a Federal Reserve survey showed. The central bank's Beige Book economic report … said 'outlooks were mainly positive' with half of the 12 districts 'expecting moderate growth'."

Manufacturing Production in November Expanded at Fastest Clip since July 2015 (shoptalk.com) "The Institute for Supply Management's Manufacturing Purchasing Managers' Index rebounded once again in November, growing at a five-month high. The composite index rose from 51.9 in October to 53.2 in November, expanding for the third straight month. This is encouraging for a sector that has seen subpar growth over much of the past two years on global headwinds and economic anxieties."

Service Industries in U.S. Grow at Fastest Pace in 13 Months (Bloomberg) "America's service industries expanded in November at the fastest clip since October of last year, putting the economy's biggest sector on a robust growth path. The Institute for Supply Management's non-manufacturing index jumped to 57.2, exceeding all forecasts in a Bloomberg survey."

Job Growth in U.S. Exceeds Forecast, Foreshadowing Rate Increase (Bloomberg) "Employers added more jobs than forecast in November, underscoring Federal Reserve Chair Janet Yellen's confidence that the U.S. economy is strong enough to withstand higher borrowing costs."

U.S. Existing Home Sales Race to More Than 9-1/2-year High (Reuters) "U.S. home resales rose in October to their highest level in more than 9-1/2 years as homebuyers, buoyed by an improving labor market, took advantage of still-low mortgage rates to snatch up properties after many were shut out during the busy summer selling season."

OTHER WORTHWHILE READS

ECONOMIC ANALYSIS AND VIEWS

Small Businesses Lament There Are Too Few Mexicans in U.S., Not Too Many (WSJ) “As the labor market tightens and the population of undocumented immigrants shrinks, employers in low-skill industries such as hospitality, construction and agriculture scramble to fill jobs.”

The Economy’s Hidden Problem: We’re Out of Big Ideas (WSJ) “By all appearances, we’re in a golden age of innovation. Every month sees new advances in artificial intelligence, gene therapy, robotics and software apps. Research and development as a share of gross domestic product is near an all-time high. There are more scientists and engineers in the U.S. than ever before. None of this has translated into meaningful advances in Americans’ standard of living.”

Want to Rev Up the Economy? Don’t Worry About the Trade Deficit (New York Times) “The economic policy of President-elect Donald J. Trump is still a work in progress. But if campaign rhetoric is a reliable guide, reorienting trade policy may become one of the main goals of the new administration … Rather than reflecting the failure of American economic policy, the trade deficit may be better viewed as a sign of success. The relative vibrancy and safety of the American economy is why so many investors around the world want to move their assets here.”

Payrolls in U.S. Rise; Jobless Rate Falls to 4.6% (Bloomberg) “U.S. hiring picked up in November, while the unemployment rate tumbled to a nine-year low on a drop in the number of people in the workforce and wages unexpectedly declined, providing a mixed picture of the labor market … A steady job market signals employers were willing to keep hiring in the days before and after the Nov. 8 presidential election. At the same time, while the Federal Reserve is almost certain to raise borrowing costs this month, sustained weakness in wages or participation would weigh on the economic outlook.

What ‘Expansions Don’t Die of Old Age’ Really Means (WSJ) “Economists expect the U.S. to face another recession in the next four years. After all, the current expansion is already more than seven years old, and since World War II the average period of economic growth has lasted slightly less than six years. Yet a piece of research from the Federal Reserve Bank of San Francisco (highlighted recently by the New York Times) concluded, convincingly, that economic expansions do not die of old age — an old expansion like our current one is not likelier to enter a recession in the next year than a younger expansion.”

COLLIERS VIEWS

Why the Multifamily Market Still Has Room to Run (Globe St.) “Population and demographic trends like reduced homeownership and Millennials delaying marriage and children create long-term structural advantages for multifamily that other sectors lack, Colliers’ Andrew Nelson tells GlobeSt.com.”

Appetizer or Entrée? How Food Continues to Fuel Retail (Colliers) “People are dining out more often at all price points, new restaurant and food concepts are exploding and opportunities are being created for retail centers of all types. In this report, Colliers International brings together the voices of retail real estate professionals and retail center representatives to deliver insight into food-driven trends and opportunities.”

U.S. Office Market Rents Up in Both CBDs, Suburban Markets in Q3 (Bisnow) “US office market fundamentals remained strong in Q3, driven by rebounding GDP and strong employment gains. Asking rents in particular ended the quarter averaging gains in both central business districts and the suburbs.”

OTHER PROPERTY MARKET VIEWS AND NEWS

Rising Rates Threaten Global Property Investments (WSJ) "Commercial property has been a big winner from years of ultralow interest rates around the world. Now markets are signaling that change might be in the air. Investors have been dumping government bonds in Europe, Asia and the U.S., sending prices tumbling. When bond prices fall, real-estate values often follow."

How Will a December Rate Hike Affect REITs? (Urban Land) "It has been a rewarding year for real estate investment trusts (REITs) as their performance has continued to outpace the Standard & Poor's 500 by a substantial margin …However, amid these high returns, investors are reeling back expectations in response to reports that Federal Reserve officials believe the economy's steady growth and low unemployment rate have strengthened the case for raising interest rates."

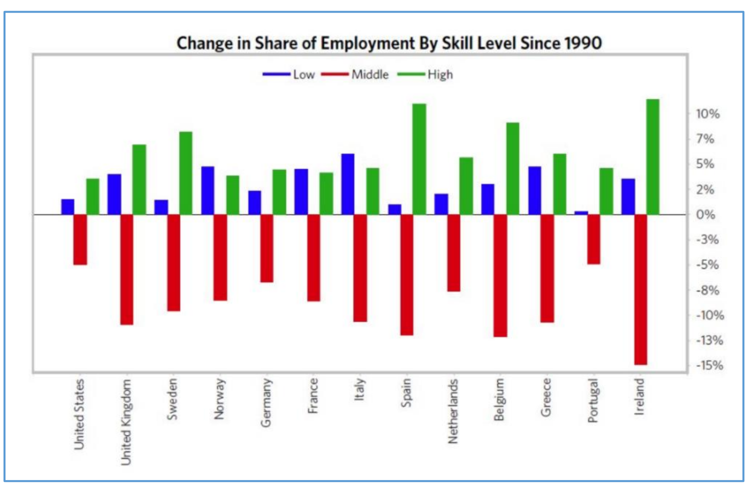
Evolving U.S. Suburbs Continue to Shape Residential Demand and Development (Urban Land) "U.S. suburban housing markets are well positioned to remain preferred places to live and work over the coming decades, even as many urban cores and downtown neighborhoods continue to attract new residents and businesses, says a new report from the ULI Terwilliger Center."

Co-Working Is Changing The Face Of Office Around The World (Bisnow) **"**Co-working space is gaining popularity all over the world. From flex space to high-end amenities, many startups and growing companies are preferring these spaces over traditional and long-term leasing options. Even large companies have taken to co-working spaces to set up satellite offices."

China Issuing 'Strict Controls' on Overseas Investment (WSJ) **"**China plans to clamp tighter controls on Chinese companies seeking to invest overseas, intensifying efforts to slow a surge in capital fleeing offshore amid tepid growth and an uncertain economic outlook. Targeted for particular scrutiny by the pending measure are "extra-large" foreign acquisitions valued at $10 billion or more per deal, property investments by state-owned firms above $1 billion and investments of $1 billion or more by any Chinese company in an overseas entity unrelated to the investor's core business.

CHART OF THE WEEK

"The graph is based on data from MIT economist David Autor and shows how much middle-skill jobs, which generally require some education after high school like community college classes, have declined in the past 26 years." A brutal chart from Bridgewater explains the rise of Trump (Business Insider)



Watch for our forthcoming *State of the U.S. Market and 2017 Outlook* report, with extended analysis of both current conditions and expectations under the Trump Administration.