

Interest Rates Trend Lower As Fed Responds to Trade War Uncertainty

Fed has increasingly accommodative stance as trade battles weigh on economy. At its latest meeting, the Federal Reserve showed a greater willingness to ease policy rates in the near term. Chairman Powell pointed to weaker inflation and economic data, together with uncertainty amid trade tensions between the United States and China. The Fed reinforced its willingness to let inflation rise above the 2 percent level going forward, a notable shift in its historical policy framework designed to increase future flexibility. Wall Street has begun to price in rate cuts as early as the July meeting, reflecting a rapid shift toward more dovish policy. Rate cuts during an ongoing expansion would echo similar steps taken during the mid-1990s, when Fed officials responded to softening data by trimming rates three times. The recent trade detente reached between Presidents Trump and Xi at the G20 meetings in Tokyo has eased market concerns in the near term, yet ongoing uncertainty and the potential for re-escalation of tensions remain key considerations of Fed officials moving forward.

Yield spread widening as global interest rates plummet.

As the 10-Year Treasury yield hovers in the 2 percent range, borrowing costs have followed suit. This has widened the yield spread between cap rates and lending rates for investments, allowing buyers more aggressive underwriting. Primary markets are likely to be the key beneficiary of this trend due to the razor-thin yield spreads in many property types, particularly highly desired multifamily assets. Lower interest rates could potentially boost market liquidity, as many economic metrics including low unemployment and stable wage growth still favor additional acquisitions. However, risks to the economic outlook remain, particularly in manufacturing industries where tariffs have already caused notable weakness. The impact of previously announced tariffs on consumer goods in the coming months should be closely monitored for risks of slowing consumption and economic growth.

Developing Trends

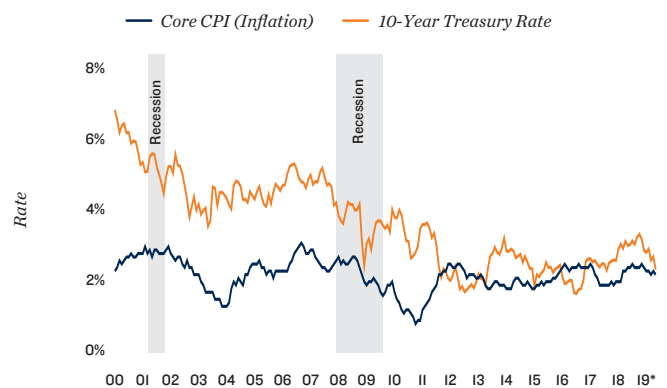
Subdued inflation aiding relaxed Fed stance. While job growth and wage trends are positive, inflationary pressures remain muted. Core CPI recently printed 2 percent, yet the Fed's preferred metric, Core PCE, trended down to 1.6 percent. Both metrics allow the Fed ample latitude to execute policy as necessary without significant concern of sparking a bout of increased inflationary pressure.

International central banks place downward pressure on interest rates. Within the last month, both the Federal Reserve and the European Central Bank reiterated their willingness to act amid risks of a broader economic slowdown. This has placed significant downward pressure on interest rates, pushing more than \$12.5 trillion in sovereign bonds into negative yields. Extremely low and negative rates reinforce the competitive benefits of commercial real estate, where cap rates range from the 4 to 8 percent range.

2.25% Current Fed Funds overnight rate

1.6% Core PCE in May 2019

Tame Inflation Enabling Fed Caution



* Through June
Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; Federal Reserve Bank