Mid-Quarter Economic Pulse: Q1 2024

ARA Research

Halfway through the first quarter of 2025, the haze that had been clearing on inflation, policy, and the economy through the end of 2024 has threatened to roll back in.

At the end of last year, the Federal Reserve's carefully managed glidepath appeared effective with inflation below 3.0% and the labor market healthy. Yet 45 days later, inflation is back above 3.0%, with planned tariffs on steel and aluminum imports and the potential for reciprocal duties from trade partners threatening even further pricing pressures.

The Fed is now signaling a cautious approach to rate cuts in the near term. With an eye on the danger of renewed, persistent labor shortages and uncertainty in policy shifts, there's little reason for the Fed to cut rates aggressively, especially with the economy proving more resilient than many expected.

While we still expect rate cuts to occur in 2025, the Fed's recent pause suggests these will be slower to come than expected. Instead, 'higher for longer' remains the likely scenario with neutral interest rates settling into a new elevated level, reflecting a fundamentally different economic landscape than the pre-pandemic era.

Implications for Real Estate

The 'soft landing' had begun thawing the commercial real estate market in the fourth quarter of 2024, as receding recession concerns allowed confidence in the lending market to improve. While the latest inflation print is likely to reinforce the Fed pause on further rate cuts, it doesn't necessarily derail the recovery, as capital markets can operate successfully at higher levels of interest rates.

As financing conditions continue to improve, transaction volumes should follow suit, bringing much-needed transparency to a market that has been navigating murky waters. Capital access, of course, is the grease that keeps deal-making in motion and as lenders gradually loosen the reins, more liquidity should flow, giving valuations and investment activity even more of a lift. In our view, the market has accepted 'higher for longer' and will continue to improve absent an unexpected shock to growth. However, with fewer rate cuts likely, real estate investors should focus on strength and stability of cash flow over the potential for cap rate compression as the primary driver of returns in the near term.

A Deeper Look at Labor

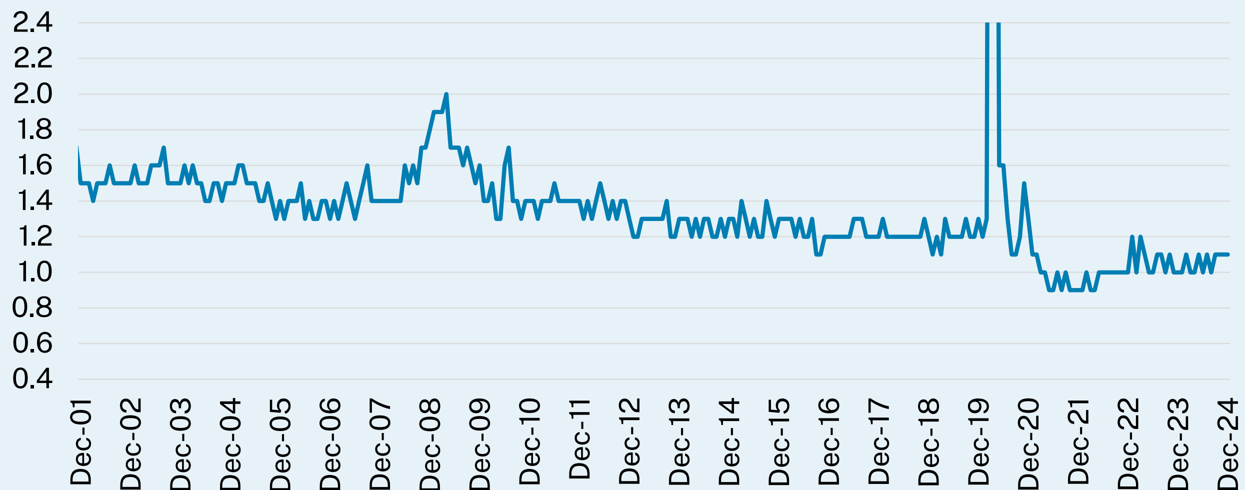
To date, demand for workers has remained generally healthy, allowing wages to continue to outpace inflation and give consumers the spending power required to keep the economy humming along. Job opportunities in certain segments, however, are becoming scarcer and this could temper wage growth going forward if moderation becomes more widespread. The latest BLS JOLTS data shows that hiring rates in many industries have dropped versus their pre-pandemic level with the most material declines in construction, accommodation and food services, and professional and business services – the latter indicating softer potential earnings growth in a typically high-paying industry.

Other indicators have recently started to flash a bit more cautionary. Weaker relative hiring is beginning to affect new entrants into the labor force – the unemployment rate for 20–24-year-olds with a bachelor's degree started increasing earlier than for the same age cohort with lesser education and is comparable to where it was back in 2015. The share of Glassdoor reviews mentioning "layoffs" or "recession" have ticked up in recent months, with the former up 4.6% month over month and the latter up 28.8% for the same period, insinuating a more anxious general state for employees[1].

Yet at the same time, actual layoffs remain very low (Figure 1). Companies are denoting a growing expectation to increase their capex spending, as measured by various Federal Reserve Bank indices, a clear indication that firms are feeling more optimistic about their earnings potential. Staffing firm stock prices have rebounded, insinuating a rebound in job openings. So despite a growing wariness on behalf of employees, indicators from the employer side suggest a solid footing.

FIGURE 1

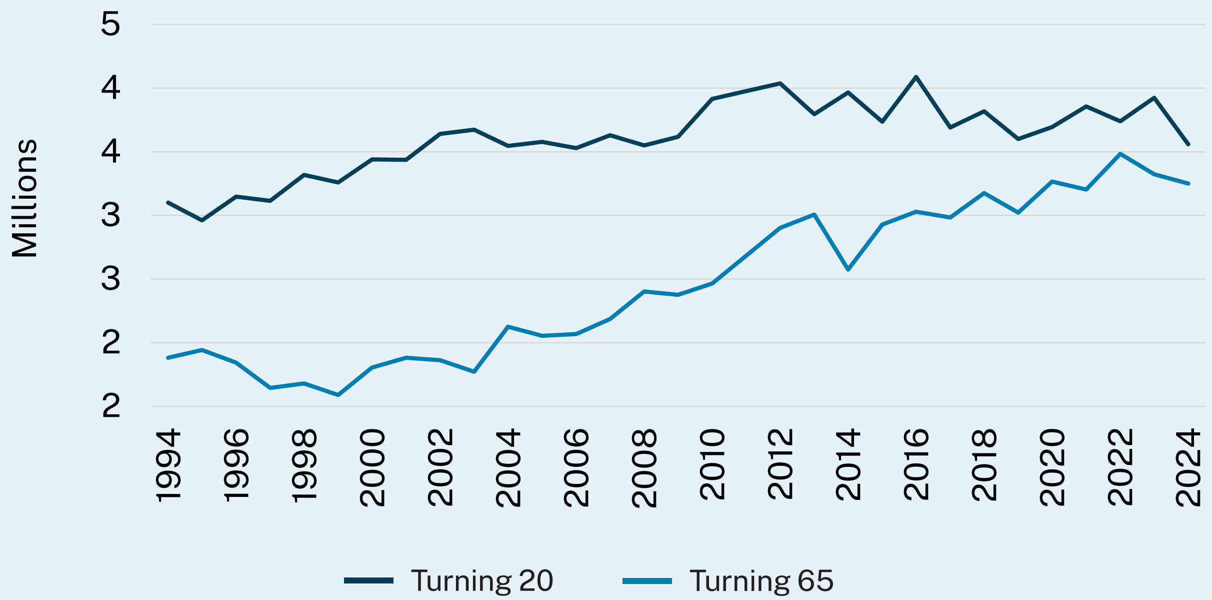
Layoffs and Discharge Rate



Source: American Realty Advisors based on data the Bureau of Labor Statistics and Macrobond as of February 2025. Note: Layoffs and discharges spiked to 9% of total employment at the peak of the pandemic in 2020, shown off chart.

FIGURE 2

Native-Born U.S. Population Turning 20 and 65 Annually



Source: American Realty Advisors based on data from the Conference Board Employment Trends Index, the Bureau of Labor Statistics, and John Burns Real Estate Consulting tabulations of U.S. Census Bureau data as of December 2024.

Long-term trends in the labor market are likely to keep consumers in that solid position. A shrinking supply of new working-age entrants – driven by declining birth rates and tighter immigration policies under the new administration – may continue to make it gradually harder to replace the growing wave of retirees (Figure 2). With fewer young workers coming in to offset an aging workforce, the labor pool appears to be structurally tightening, creating prolonged challenges that employers will have to navigate.

The ripple effect of this shift is likely to be two-pronged: on the one hand, competition for talent would likely push wages higher and keep consumer spending steady – a clear win for the economy. On the other hand, employers will have to manage hiring against a more constrained workforce, likely limiting corporate expansion and slowing the pace of job growth.

1 Glassdoor Economic Research, Glassdoor Employee Confidence Index January 2025. Data reflects reviews from U.S. full-time and part-time employees through January 31, 2025.

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Authored by:

Stanley L. Iezman
Chairman & CEO
siezman@aracapital.com

Sabrina Unger
Managing Director,
Research & Strategy
sunger@aracapital.com

Britteni Lupe
Assistant Vice President,
Research & Strategy
blupe@aracapital.com

AMERICAN
REALTY ADVISORS
INSTITUTIONAL CAPITAL MANAGEMENT

www.aracapital.com