

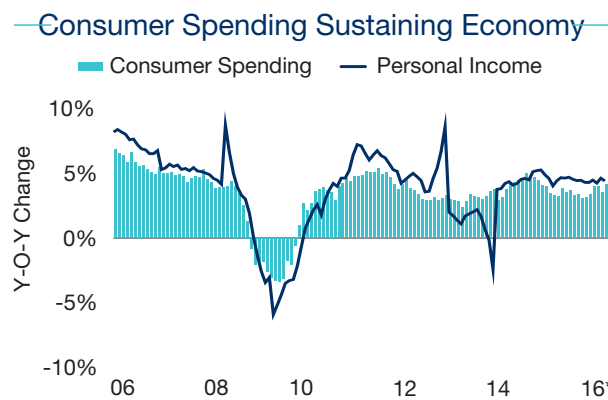
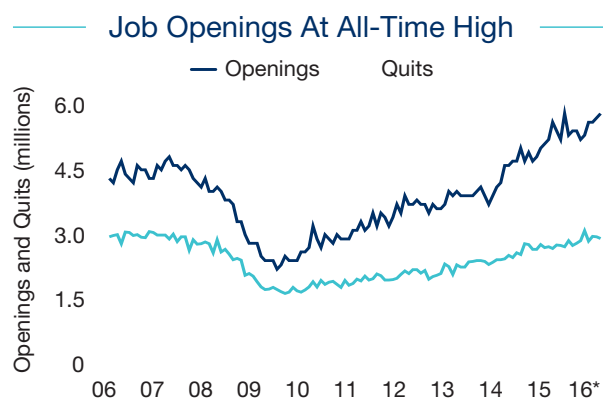
Extended Expansion Cycle Remains on Track, But Questions of Sustainability Mounting

The current economic expansion has run for 84 months through June, prompting discussions on how much fuel remains in the tank. A calendar, however, and the age of the cycle in itself will not induce a downturn. Key segments of the economy, including the labor market, consumer spending and the availability of credit for businesses, remain positive forces capable of driving additional expansion despite volatility in other areas. A choppy pattern of growth that has prevailed throughout the cycle has had an unintended but positive tempering effect. The modest pace of expansion, combined with a healthy level of risk aversion, has greatly minimized the threat of bubbles developing and largely eliminated the need for policy prescriptions to avert potential overheating. A range of headwinds continue to weigh on the pace of economic growth and nurture uncertainty, but the economy continues to reiterate moderate growth capable of driving commercial real estate performance.

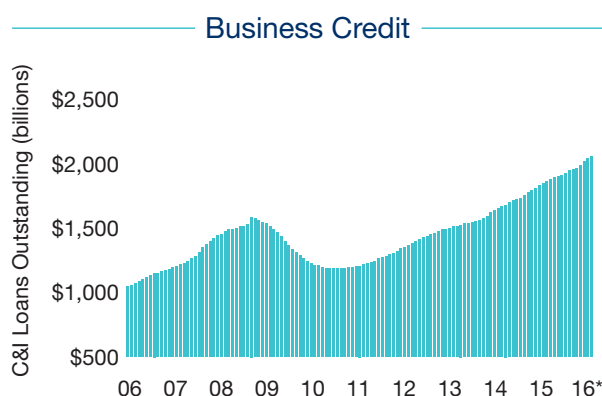
The U.S. labor market provides the clearest indication that the economy remains healthy despite an easing pace of growth, although the pace of growth has eased. Job gains have averaged nearly 200,000 per month over the past five years as openings hover near an all-time high. Still, a worrisome weakening in job additions, possibly due to labor force limitations and skills misalignment, has begun to surface. Unlocking the dynamics of converting openings to hires could be a hurdle for the economy, especially with unemployment below 5.0 percent.

Considerable attention has been placed on the low labor force participation rate during the current cycle, but the fall in the rate actually started 16 years ago. The economic downturn contributed to the drop, factors including the aging of the population and greater college enrollment of working-age adults are also suppressing participation. The departure from the workforce of retiring baby boomers has the positive effect of lowering the minimum number of new jobs needed to maintain a stable labor market and upward pressure on incomes. That threshold has declined from the long-accepted level of 150,000 new positions per month to around 100,000 new hires monthly.

Other measures of labor market slack are consistently tightening, indicating greater opportunities for employment and raising consumer confidence. After peaking at 17.1 percent during the recession, the underemployment rate has settled to less than 10 percent in 2016. Also, the unemployment rate of individuals age 20 to 34, comprising the prime renter cohort, has fallen from double digits during the recession to 6.0 percent most recently. Although these unemployment measurements have tightened considerably, they still offer some room for additional compression.



* Through April



* Through May

Prepared and edited by

Art Gering

Senior Analyst | Research Services

For information on national economic trends, contact:

John Chang

First Vice President | Research Services

Tel: (602) 687-6700

john.chang@marcusmillichap.com

Price: \$250

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Confidence in economic conditions and the improving wage outlook have lifted spending on a wide array of goods and services. Purchases of long-lasting and generally big-ticket items, including autos, illustrate a heightened sense of economic security among consumers, while a low rate of inflation continues to augment purchasing power. On an inflation-adjusted basis, disposable income per capita has risen by more than 2 percent. Positive demographic trends and technological innovation are also taking hold and providing a stiff tailwind for near-term growth in consumer spending. E-commerce and now mobile commerce have reiterated strengthening gains, lifting retail sales dramatically. Omnichannel distribution through digital devices continues to provide new opportunities for retailers to engage customers and grow sales.

Discerning the health of U.S. businesses remains challenging due to the ongoing decline in oil-and-gas exploration and extraction that is obscuring trends in other industries. The manufacturing sector has lost business in energy-related economic segments, but a prominent gauge of manufacturing activity has returned to expansion territory. Fields that serve domestic demand are growing, offsetting softness related to oil-and-gas activity and foreign markets. Service-sector businesses are also expanding, according to a widely cited survey, and a subsidiary index of new business on the books also remains positive, highlighting potential growth opportunities in the coming months and further hiring.

Unlike the circumstances at the end of the last business cycle that triggered the recession, the credit markets are in sound condition. Healthier bank balance sheets and favorable terms are enabling additional borrowing by U.S. businesses for the purposes of funding expansions and other capital requirements. Commercial and industrial loan balances on the books of U.S. banks have climbed to all-time highs. Top-rated corporate borrowers tapping the bond market for financing are also finding favorable long-term interest rates near cycle lows to fill their capital needs or refinance existing obligations. Greater stress among borrowers in the energy sector, and higher return requirements of bond investors, have contributed to higher borrowing costs for lower-rated bond issuers.

Outlook: GDP will generate growth in the 2 percent range this year, and U.S. employers will create roughly 2.1 million jobs. The integration of millennials in the workforce and greater leisure spending by retiring baby boomers will continue to support growth in consumer spending.