



The Economic Outlook for Real Estate Investors

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Beginning our Initial Approach for this Flight



Now

Still at high altitude at rapid speed,
starting a gradual descent



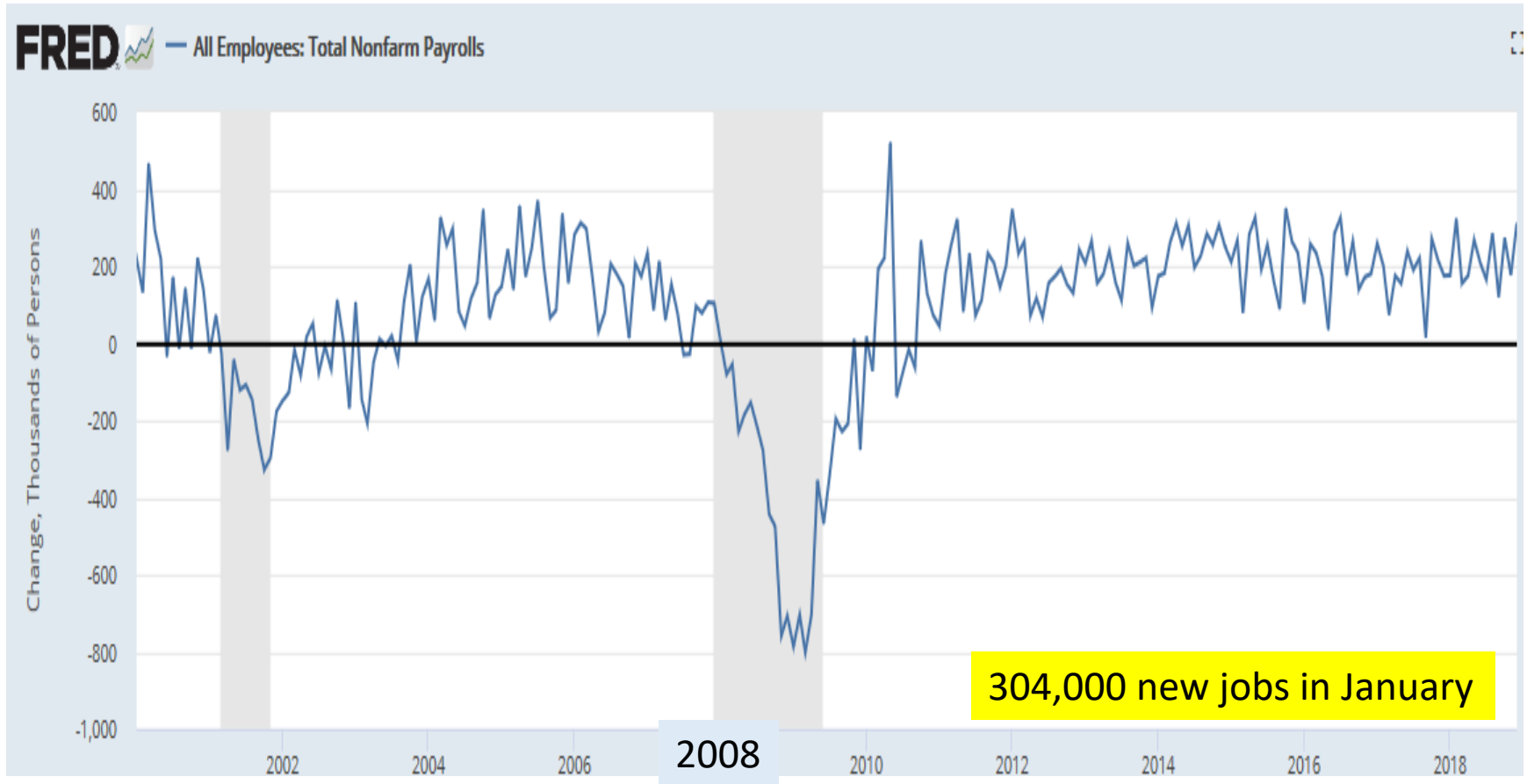
Not touching down

Not a crash



Monthly Increase in Jobs

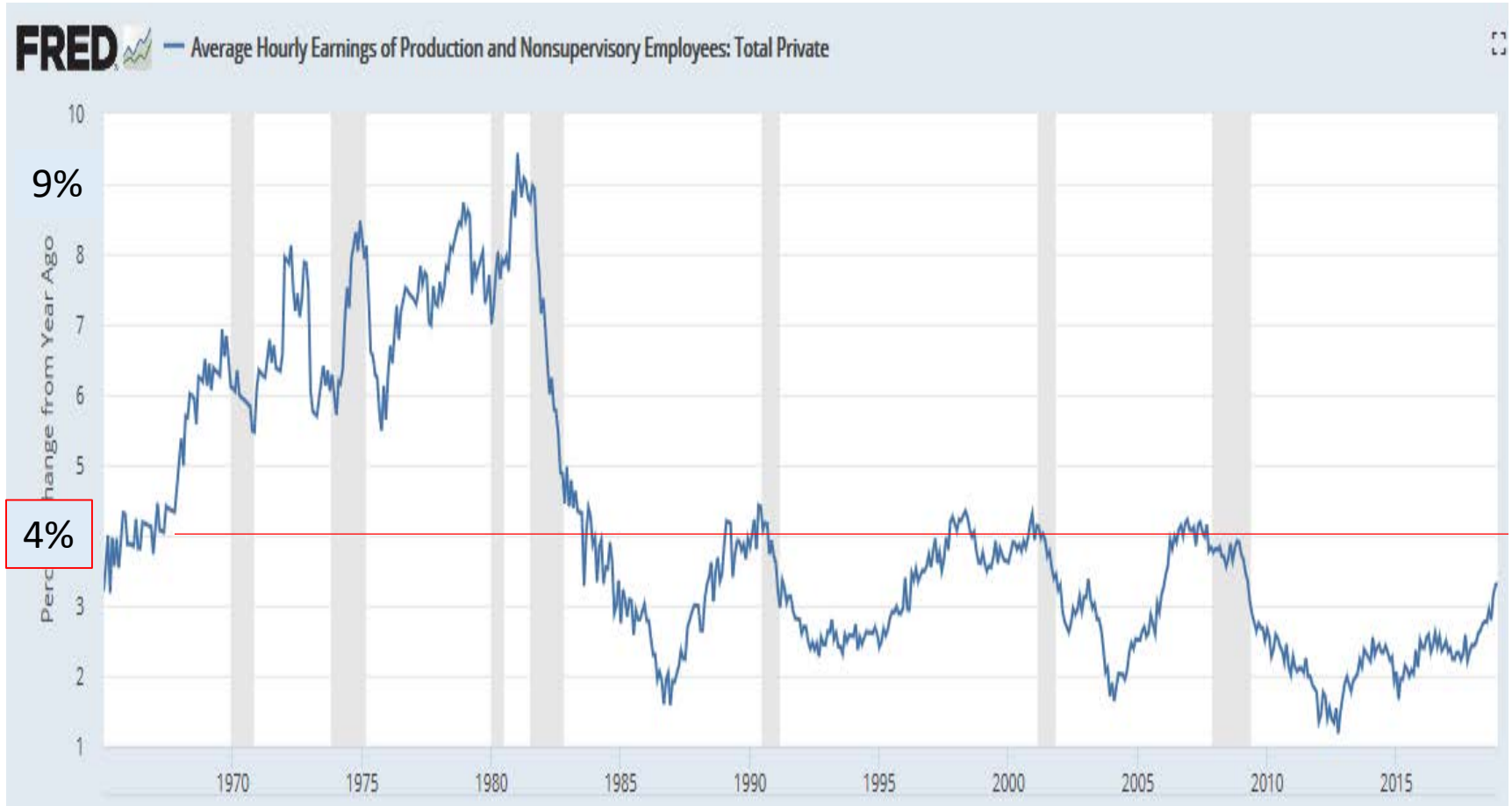
2000 to present



Source: Bureau of Labor Statistics; Federal Reserve Bank of St. Louis

Rate of Wage Growth

1960 to present



Source: Federal Reserve Bank of St. Louis

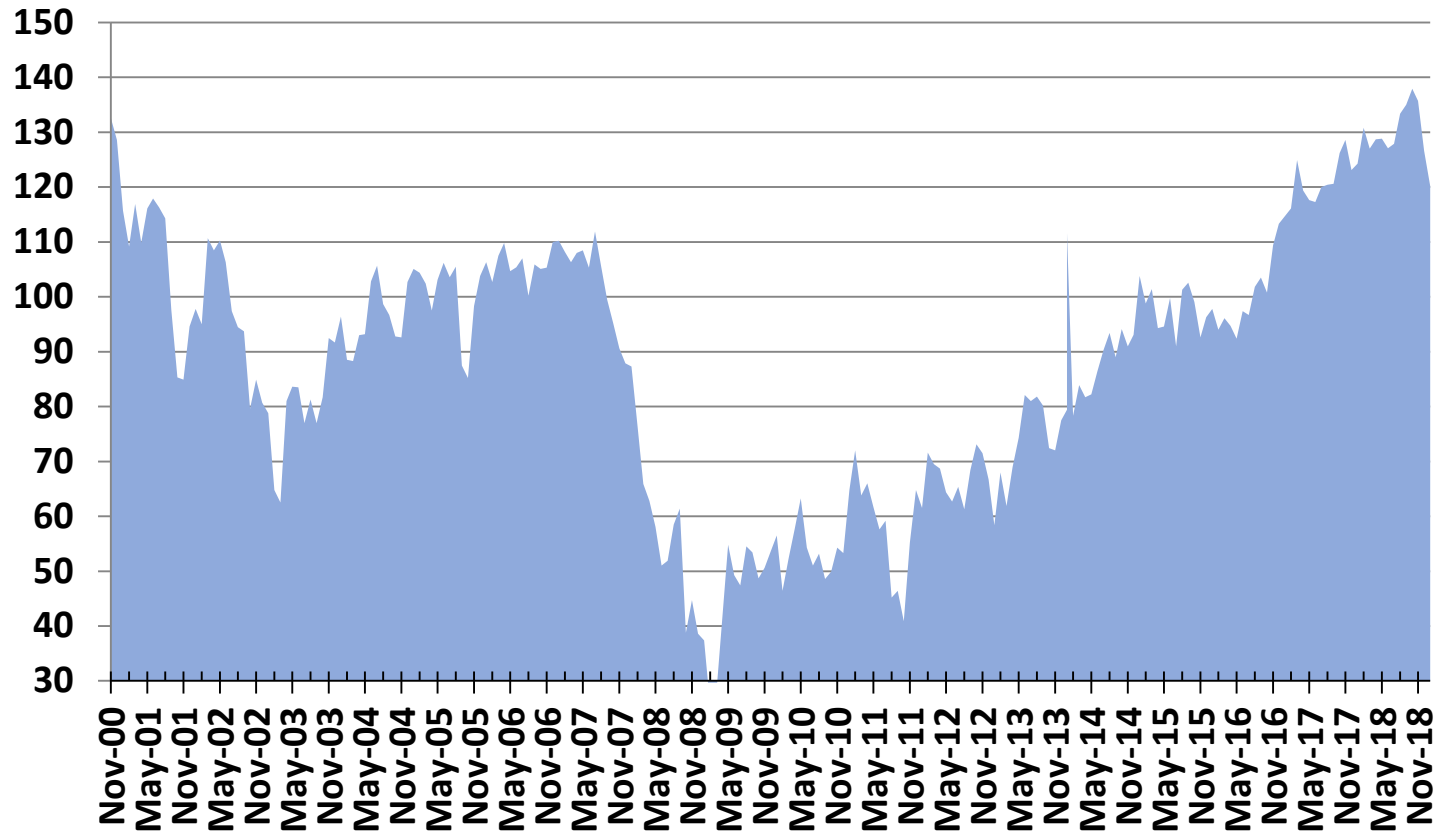
Job Openings in America

Looking for Workers

Total Job Openings in November	6,888,000
Construction	278,000
Manufacturing	493,000
Trade, Transportation, Utilities	1,275,000
Professional & Business Services	1,176,000
Education & Health Care	1,272,000
Leisure & Hospitality	1,003,000
Government	622,000

Source: Bureau of Labor Statistics release on January 8, 2019

Consumer Confidence Index



18-year high in October '18

Why 2019 Will Be Slower

- Housing industry appears to have peaked
- Auto industry appears to have peaked
- Smart phone sales declined in 2017 for first time
- Low oil prices will pressure oil and gas
- Heavy duty trade negotiations with China
- Businesses not using tax benefits to expand
- Congress won't be interested in growth
- Dwindraft in stocks due to lower earnings growth

Why 2019 Will Be Slower

- Corporate earnings growth may have peaked
 - Defense spending may have peaked
 - Federal budget deficits can't get too much higher
 - Companies “buying ahead” inventory in front of tariffs
-
- **3% Interest on the 10-Year Treasury**

Longest U.S. Economic Expansions

Current expansion began in June, 2009

- Mar 1991 to Mar 2001 120 months
- Feb 1961 to Dec 1969 106 months
- Nov 1982 to Jul 1990 92 months
- Jun 1938 to Feb 1945 80 months
- Nov 2001 to Dec 2007 73 months

Current expansion as of February 2019 is 116 months

HOW LONG CAN IT LAST?

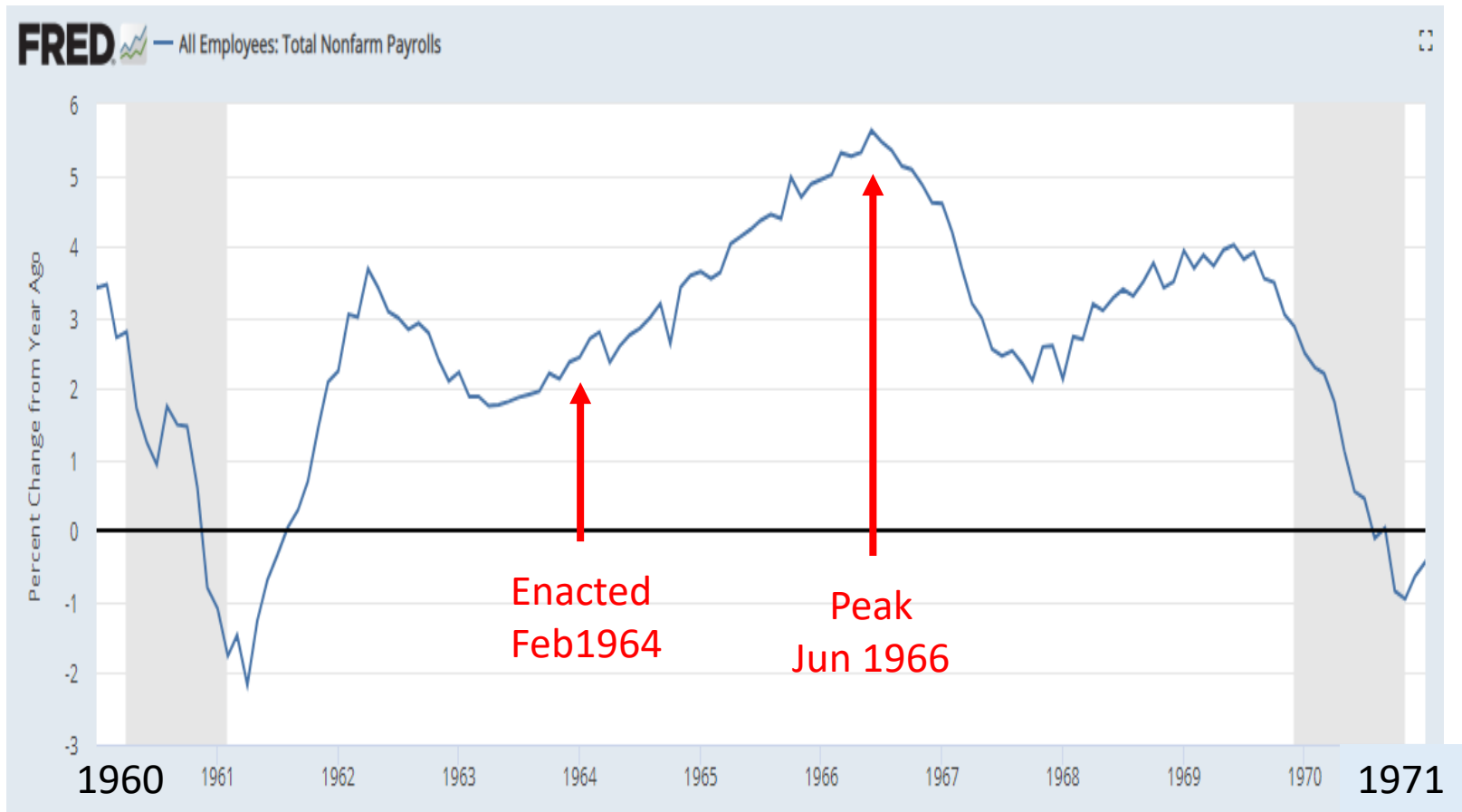


Revenue Act of 1964

Enacted February 26, 1964

- Recovery from recession of 1958 was slow.
- JFK campaigned in 1960 with the slogan of "getting America moving again."
- Proposed cutting individual tax rates from 20-91% to 14-65%
- Proposed cutting the corporate tax rate from 52% to 47%.

Percentage Change in Employment After the Kennedy Tax Cuts



Source: Federal Reserve Bank of St. Louis

Tax Reform Act of 1986

Enacted October 22, 1986

Top rate for individuals cut from 50% to 38.5%.

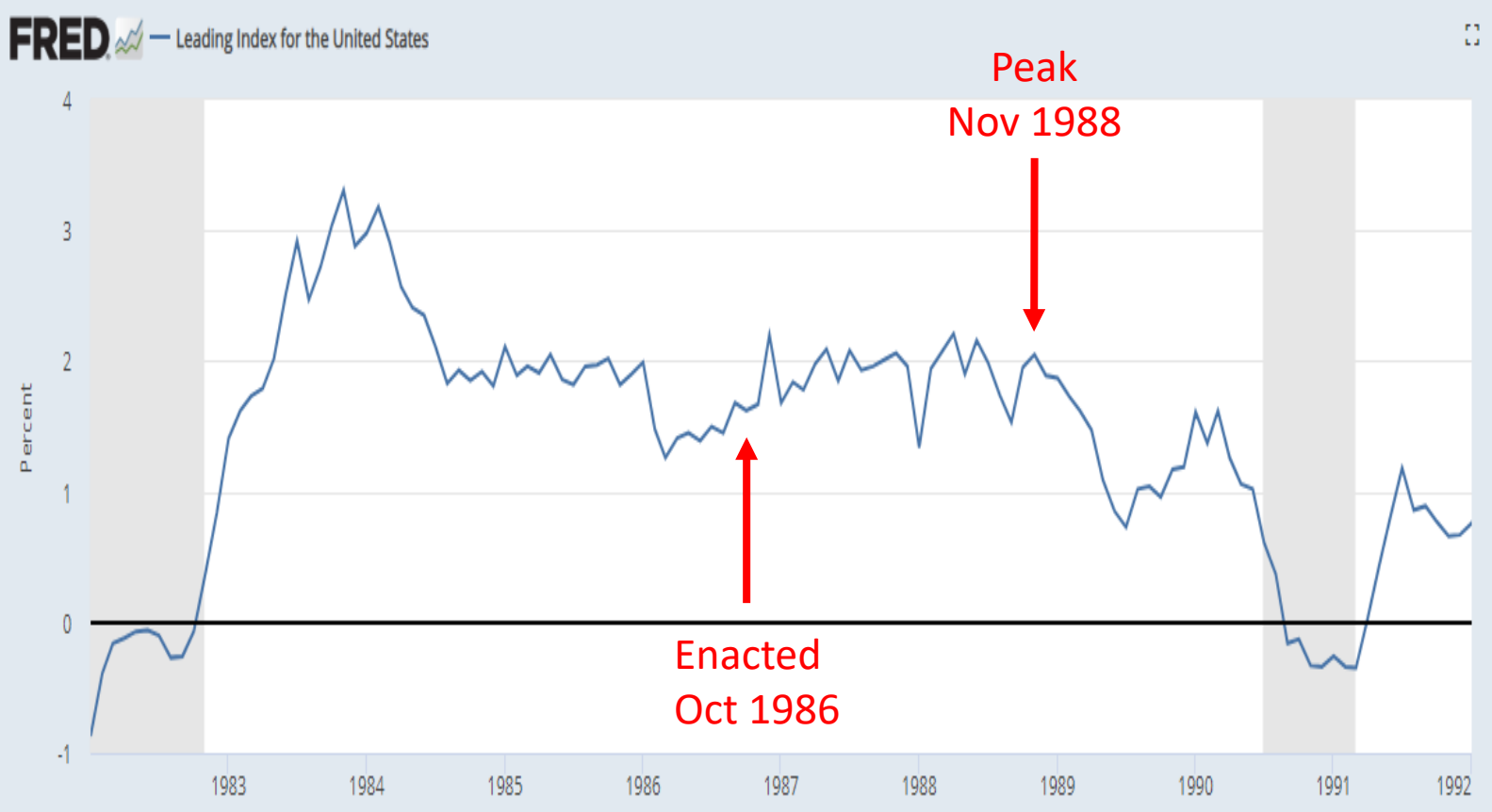
Major reduction of depreciation for real estate

Raised tax rates on capital gains.

Corporate tax rate lowered from 50% to 35%.



Index of Leading Economic Indicators After Reagan Tax Cuts



Source: Federal Reserve Bank of St. Louis

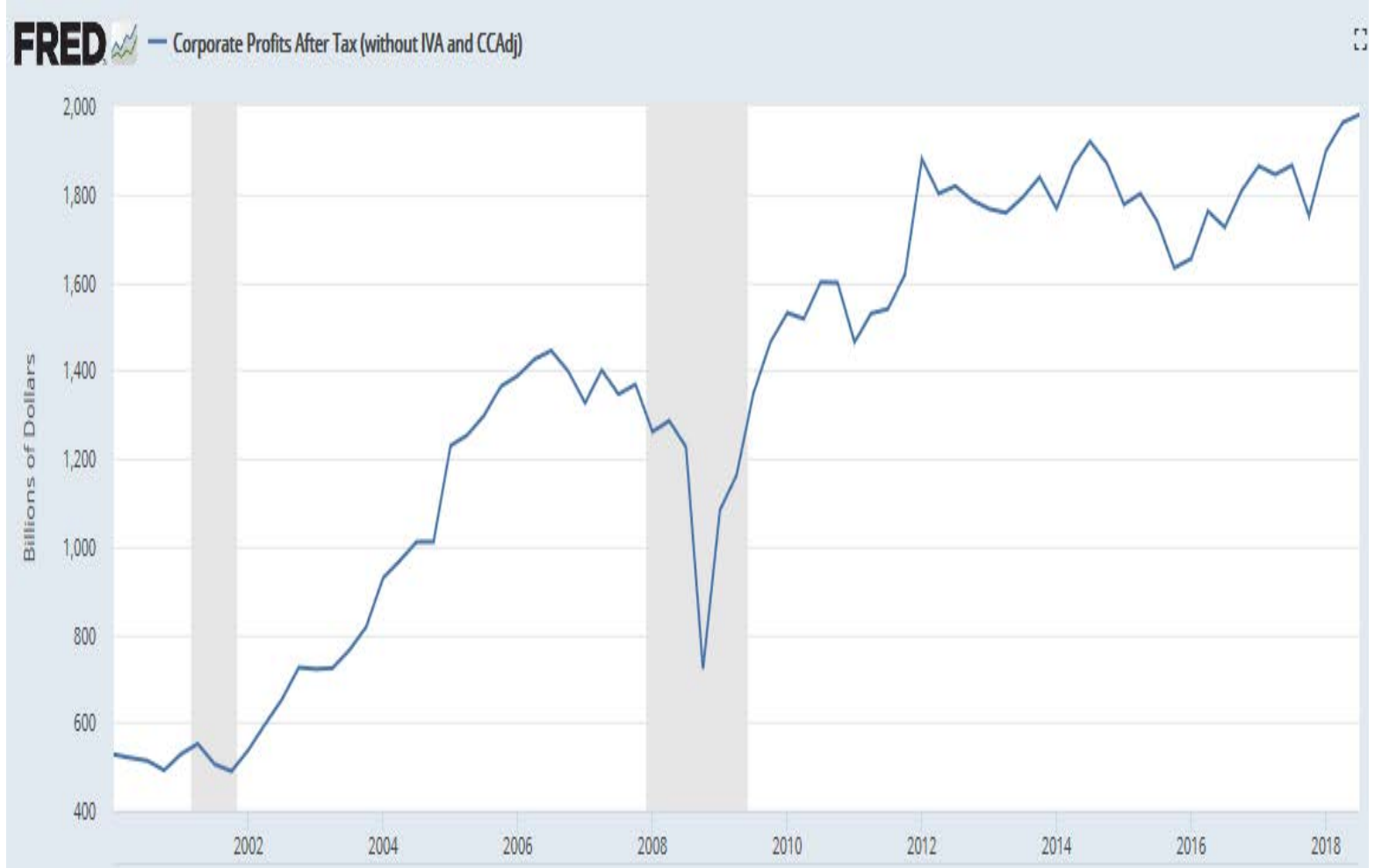


Early Warning Detection System





Corporate Profits

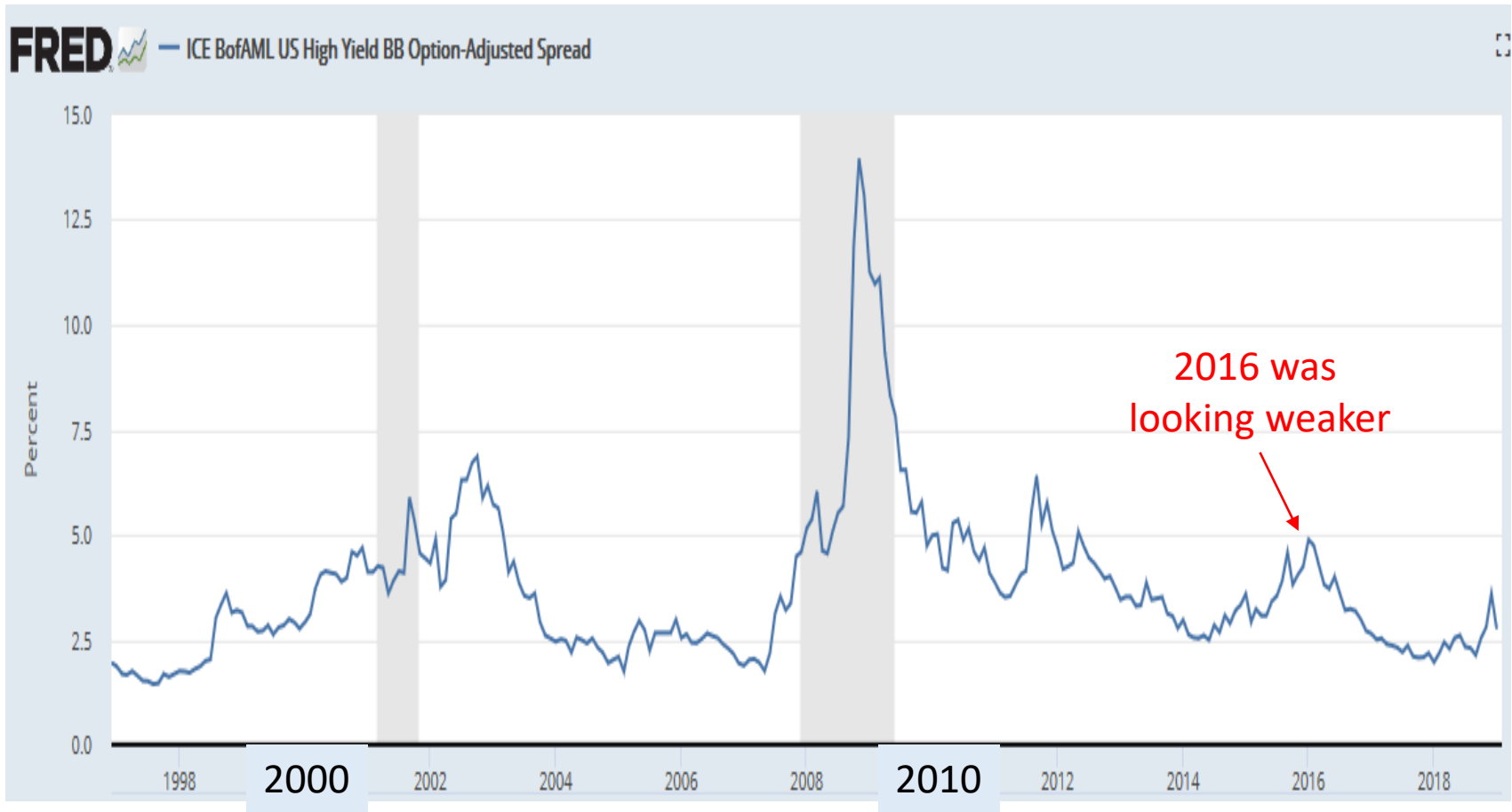


Source: Federal Reserve Bank of St. Louis



Corporate Bond Spread

BB Corporate – 10 Year Treasury

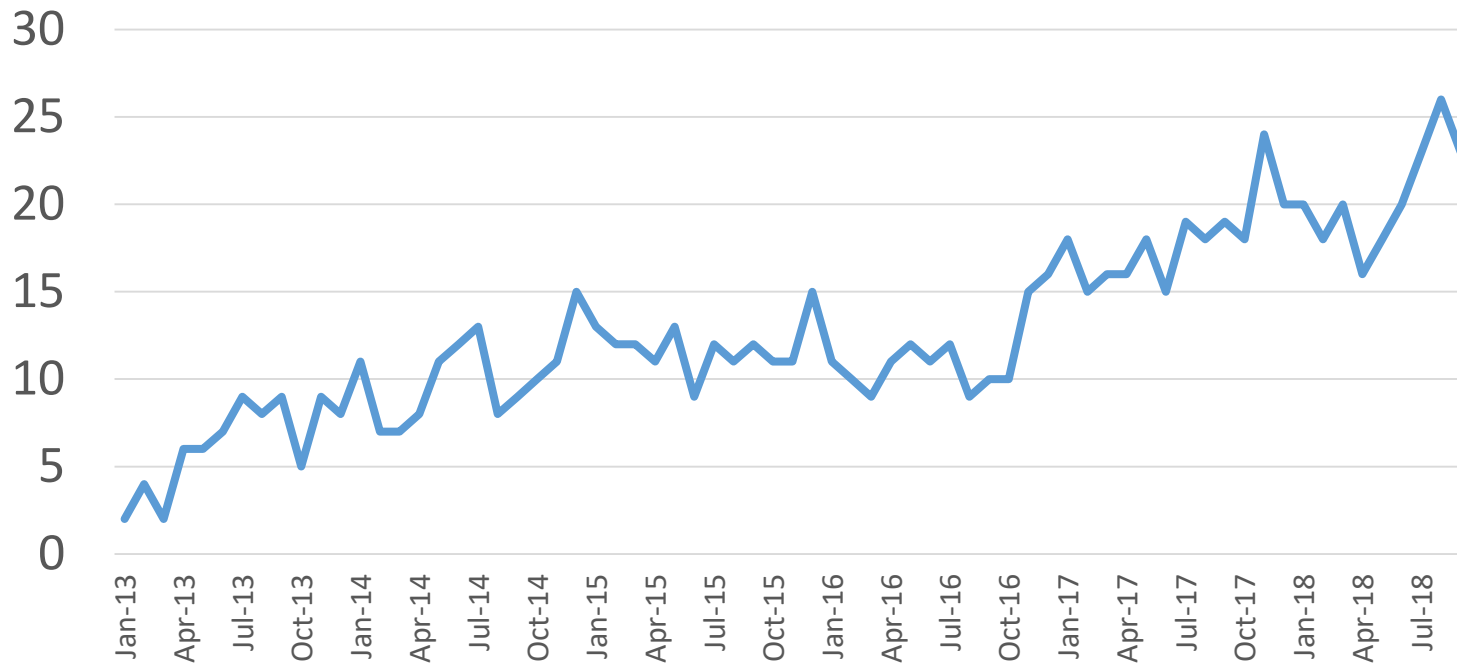


Source: Federal Reserve Bank of St. Louis



Small Business Confidence: “Hiring Plans in the Next Three Months”

Net Percent of Respondents



Source: National Federation of Independent Business



Large Corporate Hiring Plans: Next 6 Months

Q4-18 **Q3-18** **Q2-18** **Q1-18**

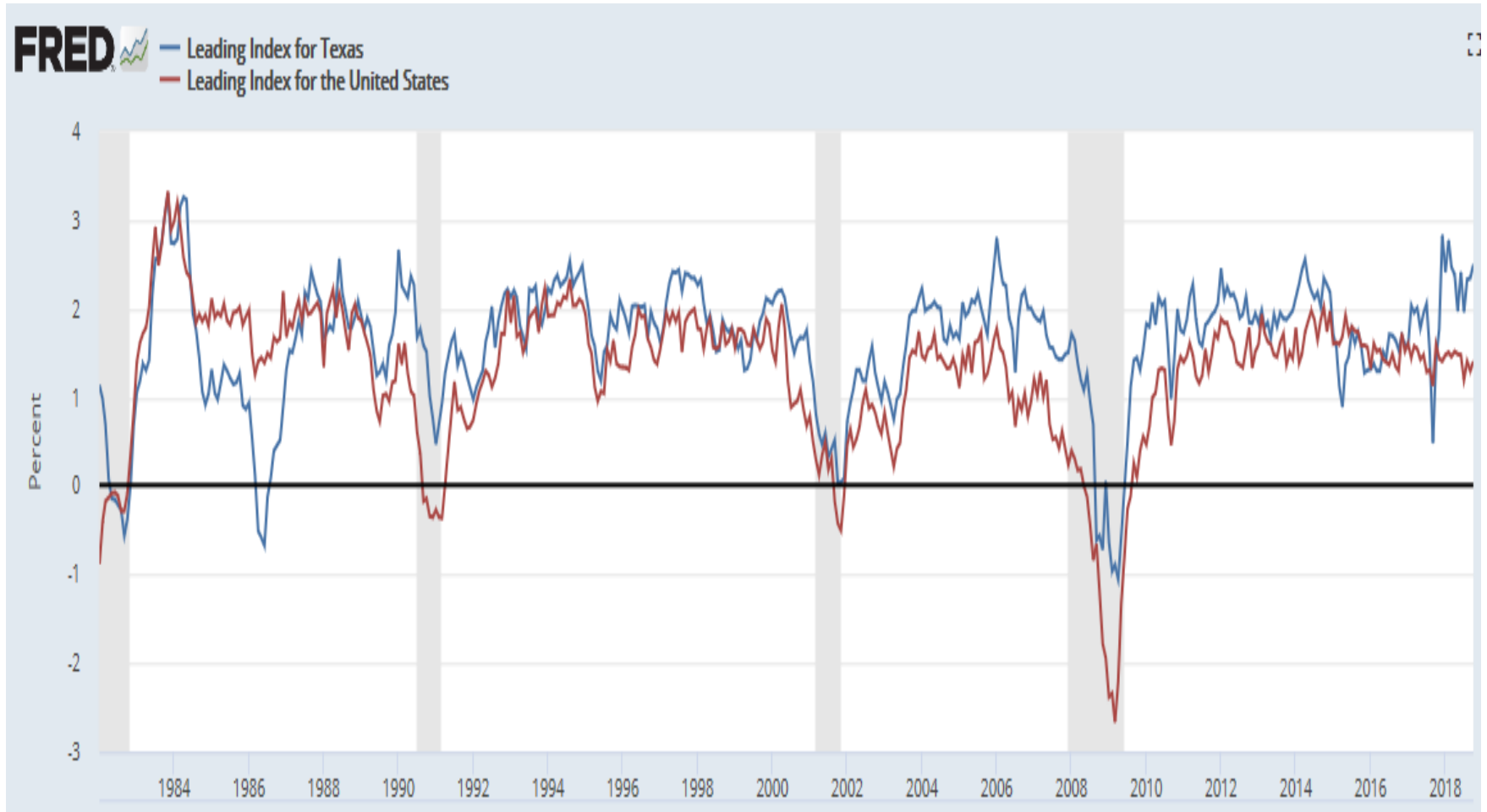
More Jobs 56% 56% 58% 61%

Less Jobs 14% 13% 13% 18%



Leading Index of Economic Indicators

1982 to present



Source: Federal Reserve Bank of St. Louis

Population Projection: Houston Metro Area

Table 2: Metro SA (Feb 2013) Level [\[Top\]](#) Excel PDF CSV

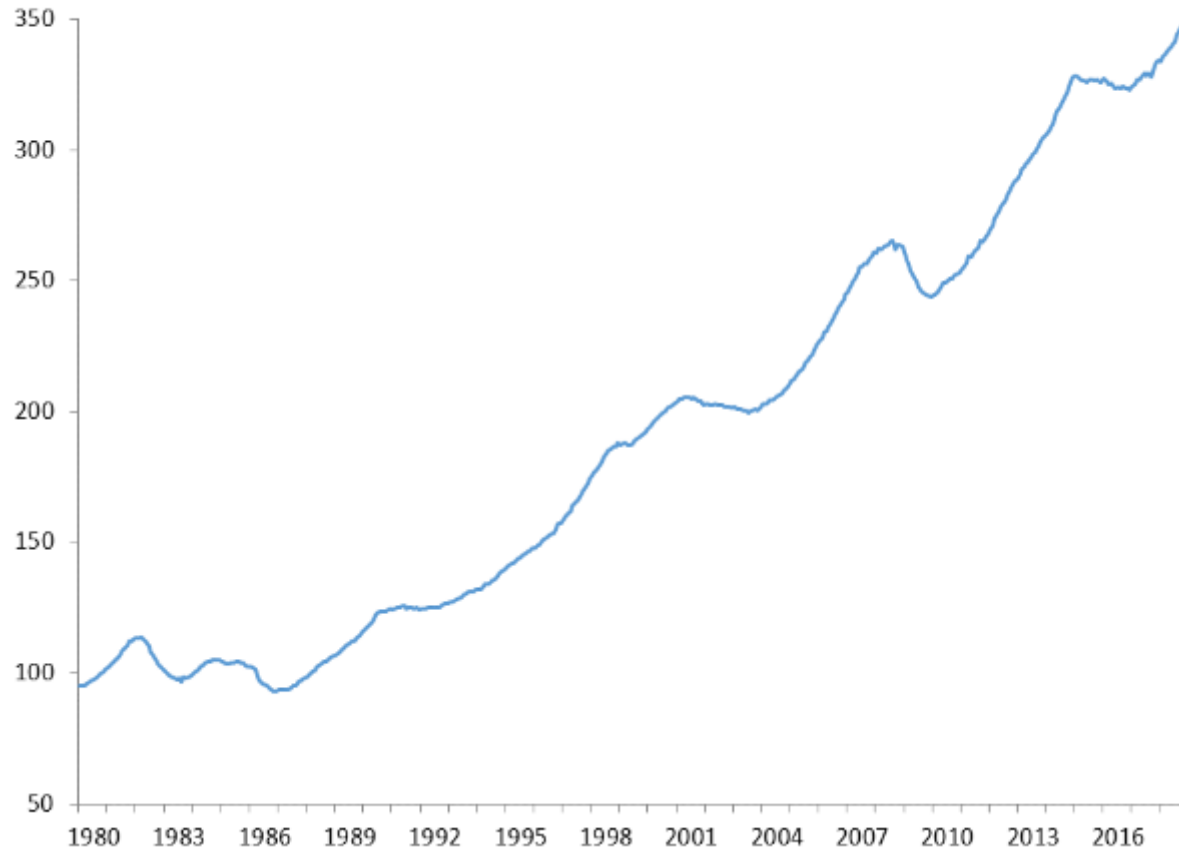
Migration Rate ▲	Year ▼	Area Code ▼	Area Name ▼	Age ▼	Total Pop ▼
2000-2010	2010	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	5,920,416
2000-2010	2015	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	6,622,047
2000-2010	2020	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	7,413,214
2000-2010	2025	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	8,300,084
2000-2010	2030	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	9,278,789
2000-2010	2035	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	10,349,257
2000-2010	2040	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	11,519,566
2000-2010	2045	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	12,802,736
2000-2010	2050	26420	Houston-The Woodlands-Sugar Land	All (0-85+)	14,221,267

Source: Texas State Data Center at UTSA

Houston Business-Cycle Index

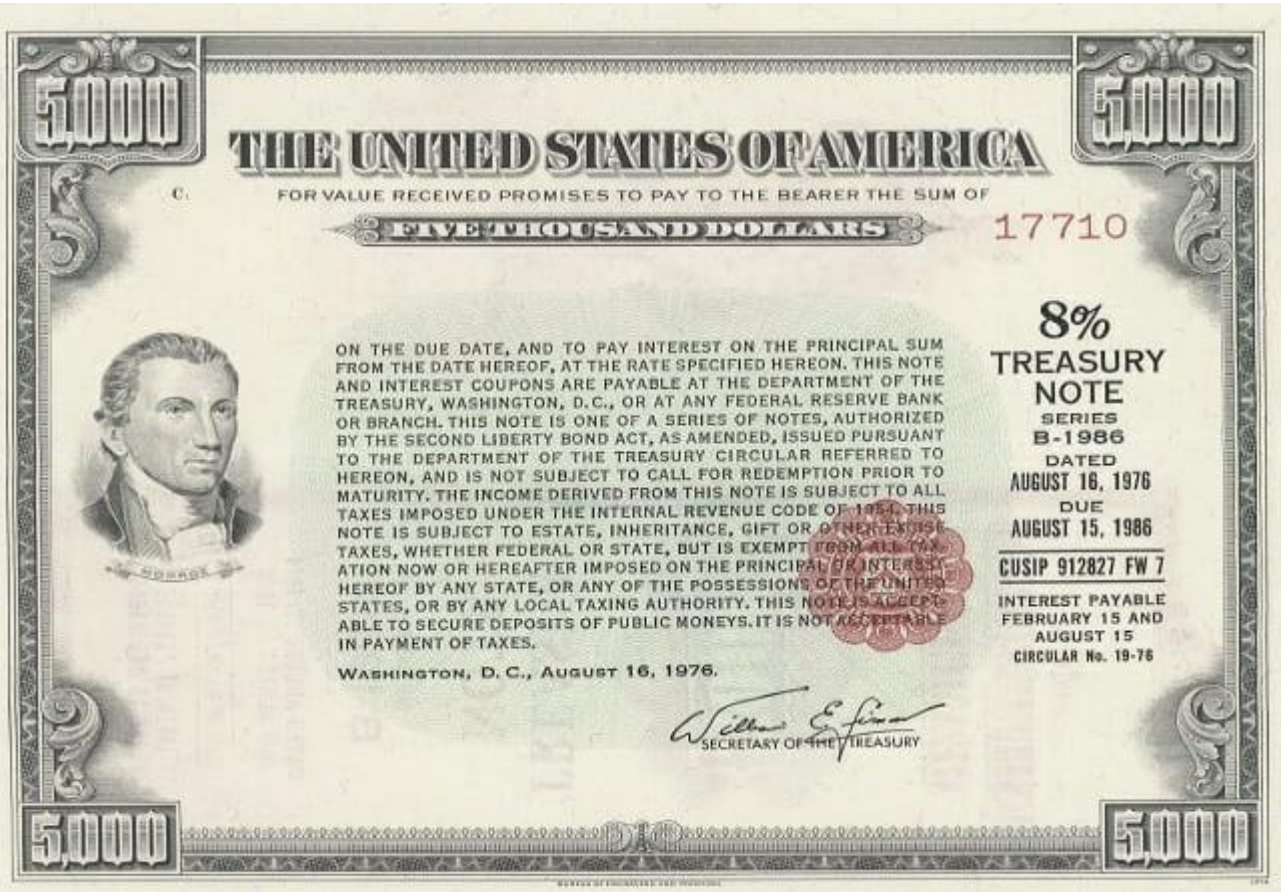
Houston – The Woodlands – Sugar Land Business-Cycle Index

Index, October 1980 = 100*



Source: Federal Reserve Bank of Dallas

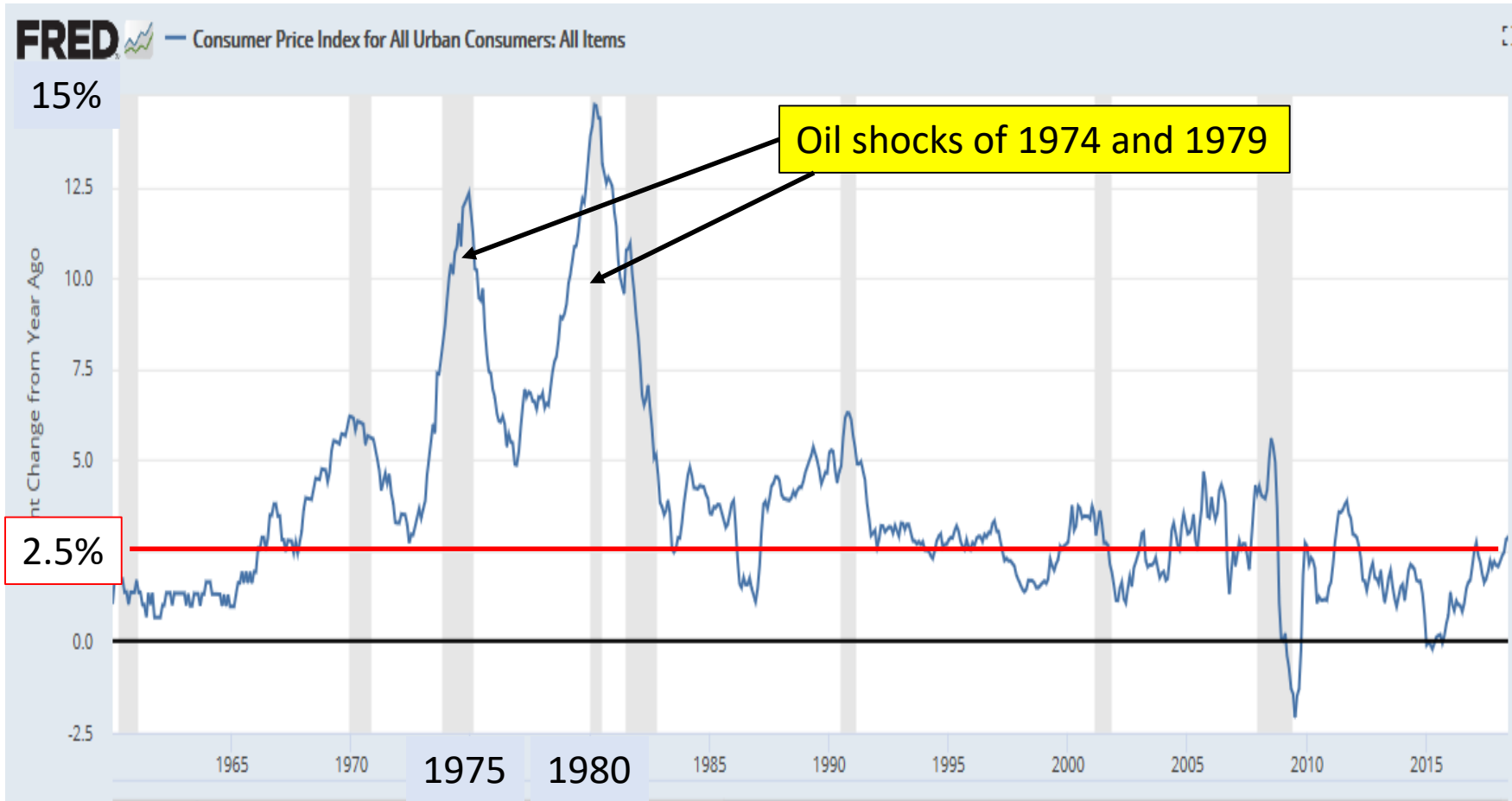
Where Do Interest Rates Go From Here?



Here is the Logic Sequence

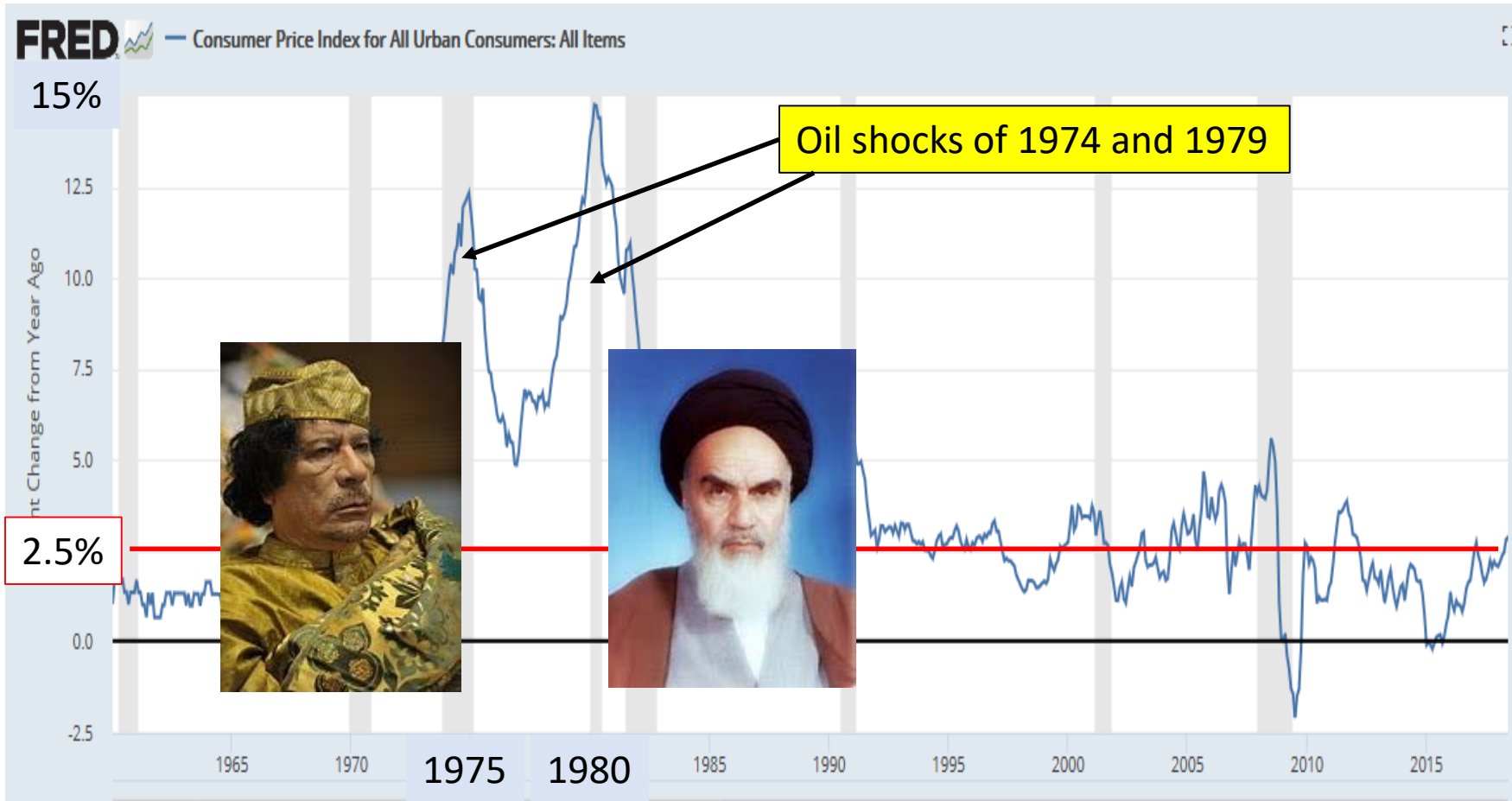
- Cap rates are moderately correlated with the 10-year U.S. Treasury bond rate
- The 10-year bond rate is not controlled by the Fed
- The 10-year bond rate moves up and down with the expected rate of inflation
- Conclusion: Cap rates might increase when inflation expectations increase

Inflation Rate since 1960



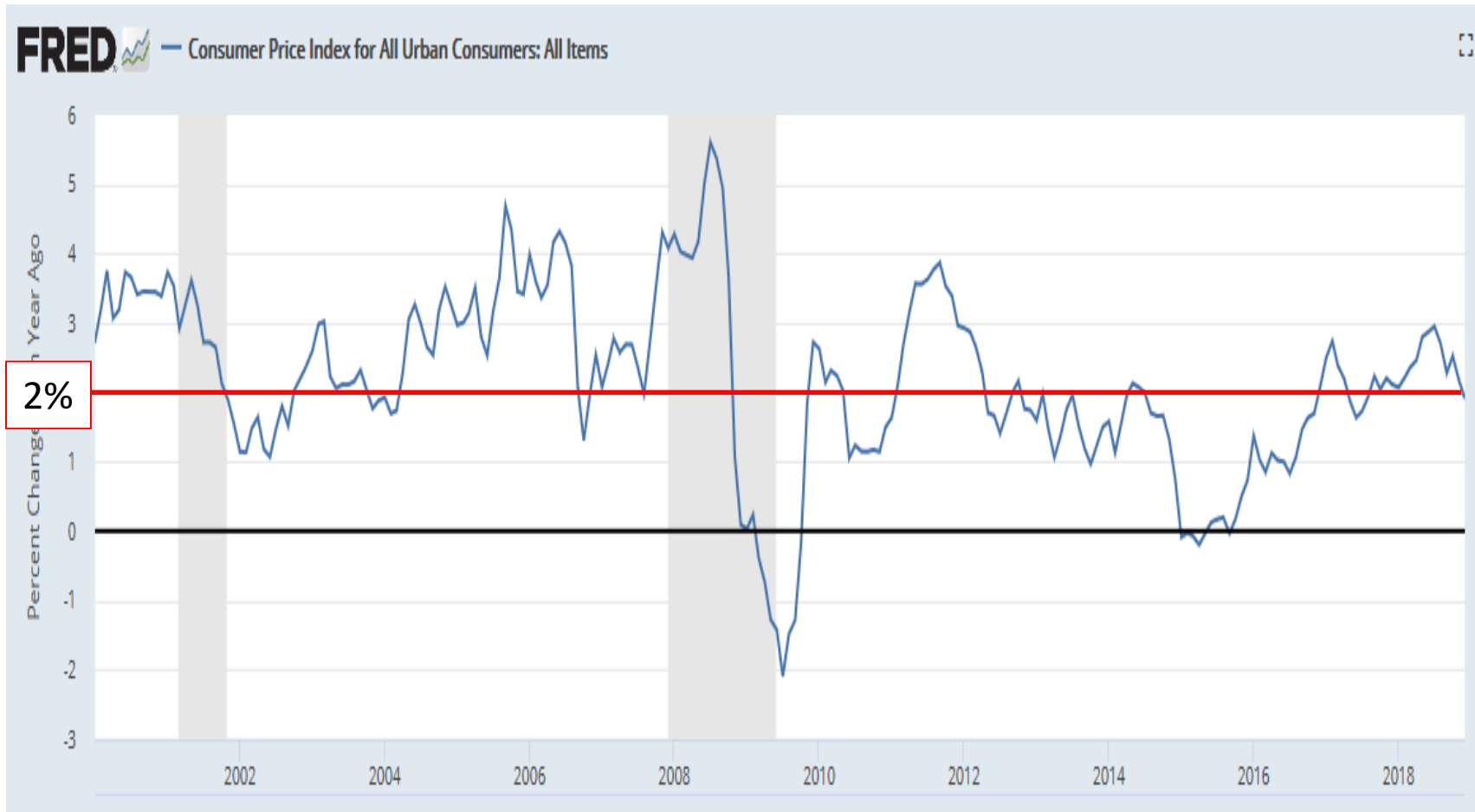
Source: Federal Reserve Bank of St. Louis

Inflation Rate since 1960



Source: Federal Reserve Bank of St. Louis

Inflation Rate since 2000



Source: Federal Reserve Bank of St. Louis

Finding the Elusive “Neutral Rate”

What is the neutral rate?

It's the Fed funds rate that is not too low, but not too high.

Don't want to overheat the economy, but don't want to cause a recession either.

Getting to the Neutral Rate

"We may go past neutral, but we're a long way from neutral at this point, probably."

- Jerome Powell, Federal Reserve Chairman

October 3, 2018

Chairman Jerome H. Powell, said the Fed's benchmark interest rate was "just below" the neutral level.

November 28, 2018

"Where we are right now is the lower end of neutral...."

December 19, 2018



The Neutral Rate of Interest



“It is very difficult to know where that so-called neutral rate is. But we probably will know it when we are there because we will observe a certain degree of balance, which we had not perceived before, which would suggest that we are somewhere very close to where that is.”

Alan Greenspan, Financial Advisor News, June 9, 2005