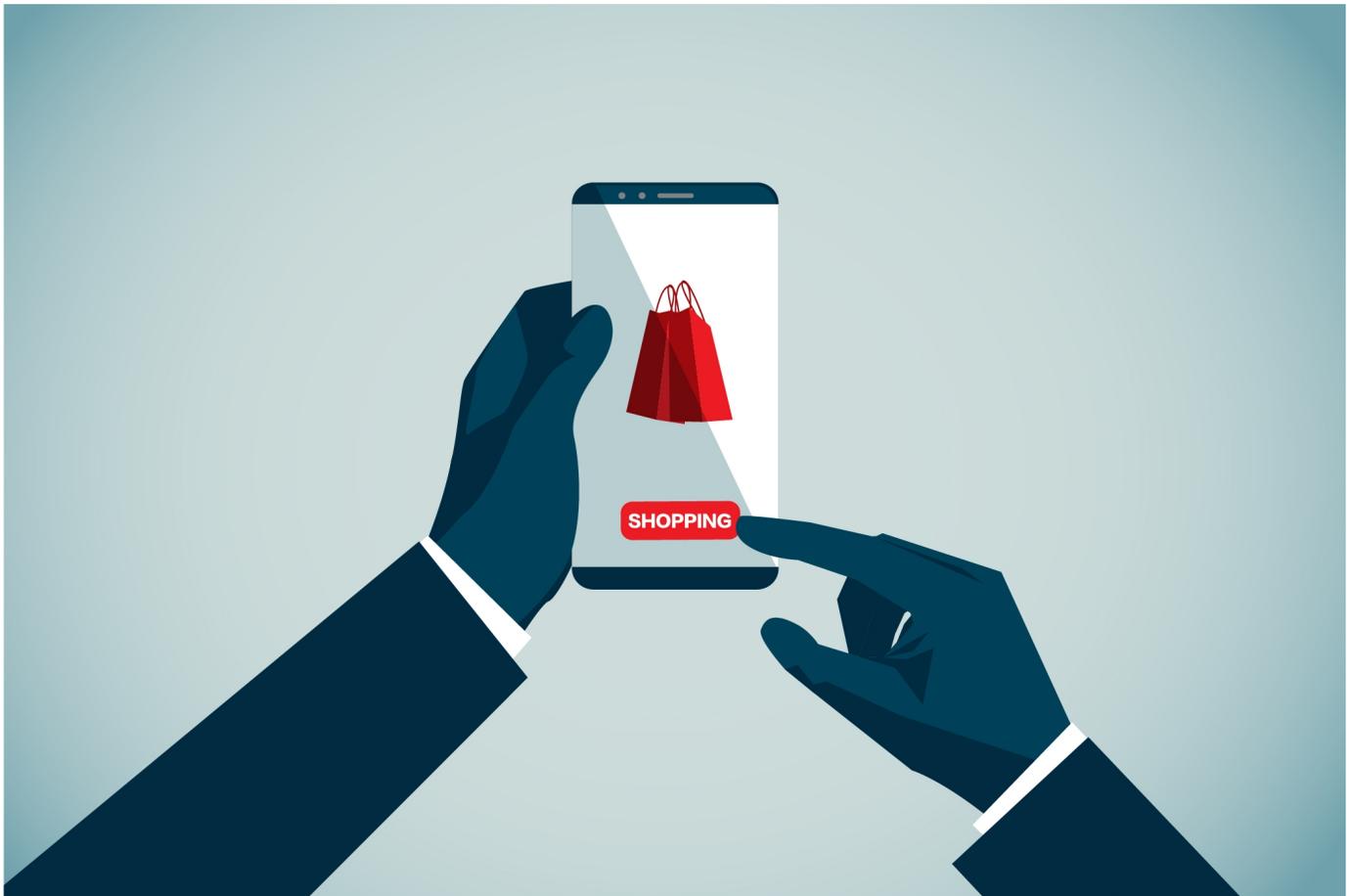




COSTAR ECONOMY

Optimism Abounds As the Economy Powers Forward

Spending, Investment, Economic Growth Show Positive Gains



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After many months of predicting a recession, Wall Street is celebrating recent economic news suggesting that the economy is powering through the Federal Reserve's interest rate hikes and seems ready to emerge in pretty good shape.

The term *soft landing* is being bandied about as economic growth accelerates and economy watchers cast off recession calls. According to the [Bureau of Economic Analysis](#), real gross domestic product (GDP) grew by 2.4% annualized in the second

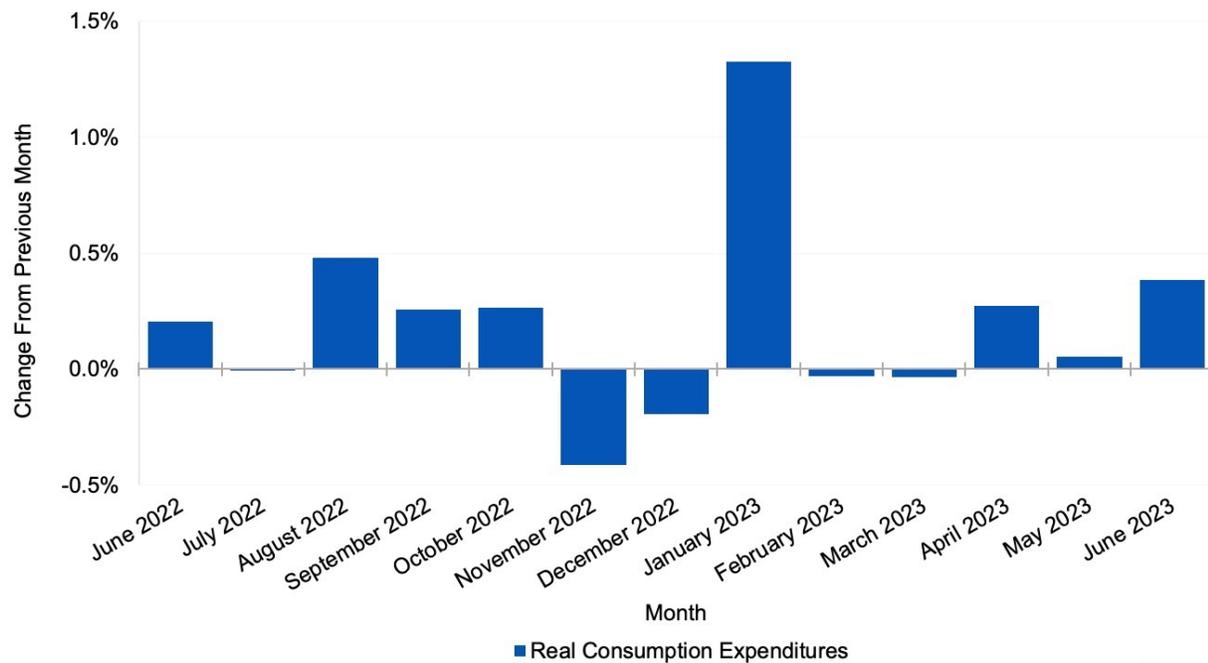
quarter of 2023, faster than the first quarter's 2% annualized rate, and faster than the economy's overall long-term expected sustainable growth rate..

Since the pandemic, unexpected swings in GDP data have often been due to changes in private inventories, as they are the most difficult to predict within the components of the measure and supply constraints and consumer shopping behavior wreaked havoc with inventory management. But this latest report was unambiguous. Both consumers and businesses moved forward, with each accounting for about one percentage point of overall growth, and government investment coming in at almost ½ percentage point.

We've been cheering on consumers for some time, as spending has propped up the economy while business activity slowed. [Surveys from the Institute for Supply Management](#) have shown the manufacturing sector in recession for the last nine consecutive months.

Meanwhile, the labor market continues to hum along, wage growth is solid and pandemic-era relief payments have given households the means to engage in some retail therapy despite rising prices. In a separate report, the Commerce Department reported that real consumption expenditures grew by 0.4% in June, the most since January, when holiday season spending pushed spending higher by 1.3% over the month. That consumers are happy with their spending habits confirmed by the strong results in [retail sales and consumer sentiment](#).

Spending Growth Accelerated in June

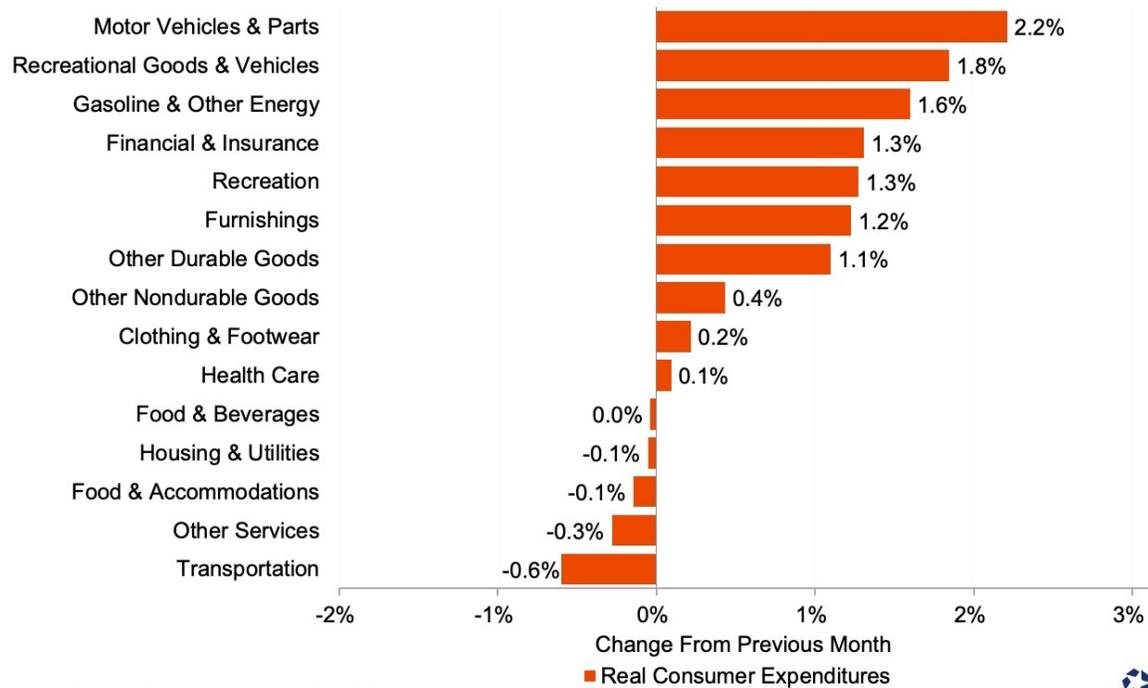


Source: Bureau of Economic Analysis, June 2023



Consumers decisively turned up inflation-adjusted spending on cars and trucks, even though car loans come at the expense of much higher rates than in the past. It's been quite a while since inventories were flush enough for people to even find cars to replace their aging automobiles, yet auto sales are still below their pre-pandemic average. Spending surprising continues to be healthy on recreational vehicles like electric bicycles and Pelotons, and on financial services, recreation like sporting and musical events, and furniture — as if we haven't all bought enough new couches already.

Transport Goods Are Driving Real Spending Growth

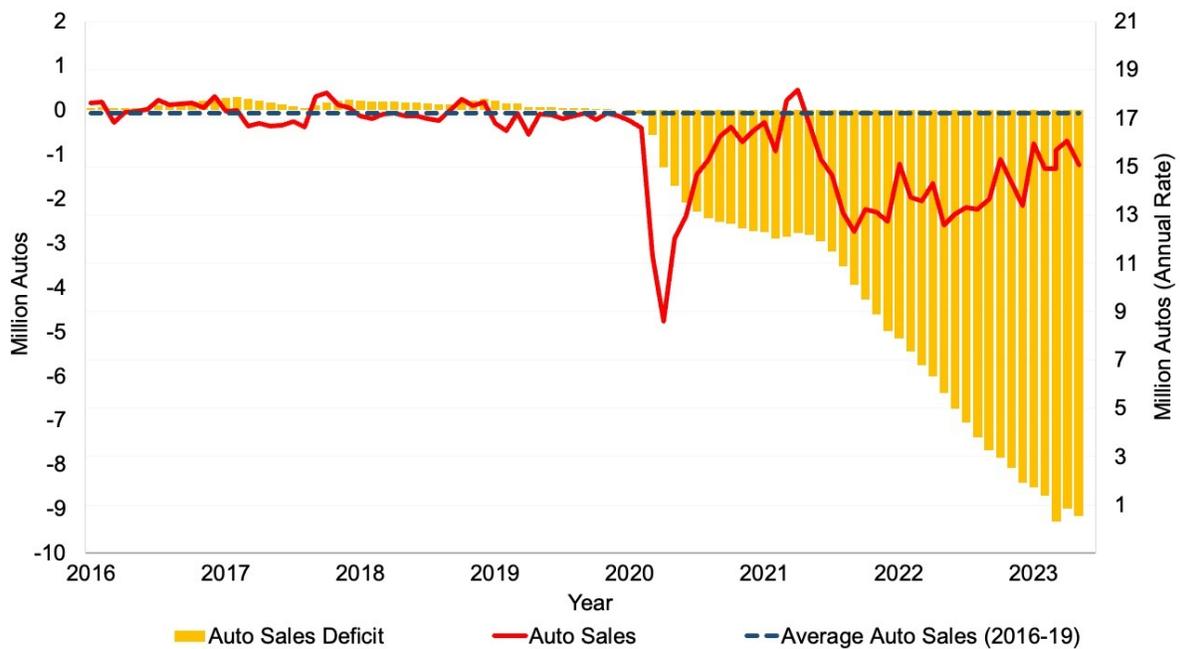


Source: Bureau of Economic Analysis, March 2023



June auto sales reached an annual rate of 15.1 million units, compared to the 2016 to 2019 average of 17 million. Since the start of the pandemic, the cumulative deficit in autos purchased is about 9.2 million units. Cars don't last forever and the need to replace aging automobiles could keep spending in this category afloat for months provided higher interest rates are tolerated.

Fewer Automobiles Sold



The big surprise in the GDP report was the surge in business fixed investment. Since the second quarter of last year, we've seen businesses pull back in spending, usually a precursor to a recession. However, that turned around in the third quarter. Business spending on equipment rose by 10.8% in the second quarter (annualized) after two quarters of double-digit contraction. Investment on structures rose for the third consecutive quarter, by 9.7%, while investment on intellectual property continued its long-running growth trend rising by 3.9% in the second quarter.

Much of this investment has been spurred by the Inflation Reduction Act and the Chips and Science Act, both signed into law in August of last year, which together provided for about \$650 billion or so over 10 years to incentivize domestic manufacturing of semiconductors and clean energy facilities.

This type of investment should boost the economy's potential output and labor productivity, suggesting growth to continue in the future and promising disinflation.

What We're Watching ...

Let's not get overly ebullient here. While recent news about spending, investment and economic growth are all positive, we're still facing significant pressure on credit conditions that are likely to weigh on all of those components in the months to come.

The [latest survey of loan officers](#) shows almost half of all banks tightening lending standards and many are preparing to tighten further over the rest of the year. This is bound to work against the ability of business and consumers to keep spending (and investing). Although broader financial conditions are still easing given the frothy equity markets, something's likely to give at some point.

CoStar Economy is produced weekly by [Christine Cooper](#), managing director and chief U.S. economist, and [Rafael De Anda](#), associate director of CoStar Market Analytics in Los Angeles.

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