

The Economy Could Keep Chugging Along for Quite a While

Last month, I attended the Zell Lurie Real Estate Center at the Wharton School's spring conference, which is always one of my favorite conferences of the year. The panel I found the most interesting pertained to the real estate market and its relationship with the broader economy.

The panelists were all very bullish on the economy and felt that the chances of a recession in the near- to medium-term were very low. This position was supported by many factors and economic metrics. The panel was Thursday, prior to the very positive jobs report for April that came out Friday morning. The overwhelmingly bullish perspective the panelists had on the economy, coupled with the strong report made me think of what a famous economist wrote just after the election in 2016 in response to the election results: "Now comes the mother of all adverse effects—and what it brings with it is a regime that will be ignorant of economic

policy and hostile to any effort to make the economy work. From an economic perspective, a terrible thing has just happened."

This economist is a follower of John Maynard Keynes and, in traditional Keynesian fashion, believes economic output is strongly influenced by aggregate demand which—according to them—does not necessarily equal the productive capacity of the economy. Instead, it's influenced by a variety of factors, sometimes behaving erratically, affecting production, employment and inflation.

Keynesian economists typically argue that as aggregate demand is unstable and volatile, a market economy often experiences inefficient macroeconomic outcomes via recessions (when demand is low) and inflation (when demand is high). These outcomes can be mitigated by economic policy responses such as monetary policy initiatives by the central bank and through fiscal policy initiatives by the

government.

Keynesian economics served as the standard economic model during the latter part of the Great Depression, World War II and the post-war economic expansion. It lost some influence following the oil shortages in the 1970s and resulting stagflation. Today's economy is also suppressing many followers of Keynes, like our aforementioned famous economist (name withheld to protect the guilty—but I guess you can Google the quote easily enough) who couldn't have gotten his predictions more wrong.

One thing that many followers of Keynesianism fail to realize is that his theories were formulated when the economy was cyclically balanced, with periods of deficits balanced by periods of surpluses. Today, we are in a constant state of deficits with no plausible end in sight. What we have seen is that tax cuts and reduced regulation have energized the economy. We should all follow the economy closely as it is so highly correlated to the performance of the underlying fundamentals of commercial real estate.

While this article could be interpreted as a political piece, it is not. I don't side with either major party straight down ideological party lines; I am ideologically a Real-estate-tarian.

The most recent jobs report from April reinforces the positive trends that the Wharton panelists discussed. In April, there were 263,000 jobs created and the unemployment rate dropped to just 3.6 percent, a 50-year low. Importantly, as I have written before, one very profound difference in recent job growth data is the wage growth that is accompanying these jobs. Real wage growth, which adjusts for inflation, was missing from the overwhelming majority of the 103 months that jobs have now grown. And wages for low- and middle-income workers are growing nicely.

The outlook for the economy, and therefore the underlying fundamentals of commercial real estate, appear strong for the short-term, and perhaps beyond that. That would be a good thing for the economy and a great thing for commercial real estate.



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