nerej
19 63 CELEBRATING 55 YEARS

# Rob Nahigian - Are we headed for inflation or deflation?

June 09, 2011 - Appraisal & Consulting

As we focus on the second quarter of 2011, we are faced each day with investment decisions based on projections. Where is the economy headed in 2011 or for the next 5 years? Are we headed into inflation or deflation? Will real estate investments be a better investment option than equities or bonds? Are interest rates going to rise or fall? Is the housing market foreclosure chaos finally over?

Investors will take more risk in the coming months to buy real estate because of supply and demand. The core properties have now been purchased so investors face "value-added" properties and that product is almost absorbed from the market. The next tier is more " at risk" properties. Investors remain with a great deal of capital. Investors may sell their core assets and perhaps move down the risk-line.

I am in the midst of reading "The Age of Deleveraging" by Dr. Gary Shilling. Shilling's outlook on inflation is quite bearish. He feels that the US consumer, after 30 years of spending, is now ready to pay off its bills and "stash the cash". With some research, it is evident that the U.S. consumer is saving more than in the last 10 years with a 5.8% personal savings rate. The Velocity Rate of the M1 Money Stock is also an indicator that the consumer is not spending as the rate as been decreasing since Jan. 2009 by over 20%. Additionally the M1 Money Multiplier has been dismal: it is currently at 0.74 (1.0 represents no turnover). People are concerned with unemployment as it increased during April 2011 to 9%. Shilling believes interest rates and pricing of goods will be deflationary. So his recommendations on investment choices differ from an inflationary proponent.

I believe that in the very near future it is becomes more evident that we will see immediate inflation. With the end of QE2 on June 30, many believe that it will be the start of inflation that may hurt the stock market. During May, the U.S. CPI has continued to increase from Oct. 2010 at 0.1% to April 2011 of 3.1%. The M2 Money Stock, after months of being on the increase has suddenly reversed itself as the stock is decreasing during May. The core inflation rate is also over 3%. The 10 Yr. Treasury Note is still on the decrease. Unfortunately, for the U.S., our greatest global investors of T-Notes (the Chinese) cannot be pleased with such low returns. We take the chance that they become disgusted with the interest rate and pull out altogether thereby collapsing the system (therefore it would harm the Chinese economy as well). Gold continues to increase as does most hard assets in anticipation of inflation (gold, silver, oil and oh, yes, real estate). The inflation wave can only be good for investment real estate: remember, real estate is an inflation hedge.

As an industry, we are in the beginning of a different economy that experts propose are headed for one of two different futures; high inflation/high interest rates and deflation/low interest rates and low returns. It is difficult to combine a room of experts for a consensus. It is problematic for our CRE clients. They have problems and problems are the crux of how Counselors thrive. Be prepared for an intriguing second half.

Robert Nahigian, FRICS, CRE, is the 2011 CRE chairman of CRE/NE and president of Auburndale Realty, Co., Newton, Mass.