

# IMF sounds a warning on commercial real estate

Nick Beams  
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The International Monetary Fund has added its voice to those expressing concern about the state of the global commercial property market in the face of elevated interest rates, particularly in the US, the largest such market in the world.

In a blog post issued last week, it noted that commercial property prices there had “tumbled by 11 percent since the Federal Reserve started raising interest rates in March 2022, erasing the gains of the preceding two years.”

It described the fall in commercial property prices as “striking” and reported they “have plummeted more in the present monetary policy tightening cycle than in previous episodes.”

One of the factors involved, it said, may be the steep pace of the monetary tightening – a rise in the Fed rate from near zero to around 5 percent in little more than a year – which contributed to a sharp increase in mortgage rates and the interest on mortgage-backed securities. There was also a slowing in private equity funding which had been an important source of funding for the sector.

The effect of the rapid increase in interest rates, as well as the tightening of conditions by banks for commercial property lending, had been “catalyzed” by the effects of the pandemic which had resulted in increased “teleworking,” as well as e-commerce, leading to a “drastically lower demand for office and retail buildings and pushed vacancy rates higher.”

It said these challenges were “particularly daunting as high volumes of refinancing are coming due” with the Mortgage Bankers Association estimating that \$1.2 trillion of commercial real estate debt in the US is maturing in the next two years.

Notwithstanding the prospect that the Fed may reduce interest rates this year as investors become more

optimistic about a “soft landing” for the US economy, the situation for the commercial property would remain “challenging.”

“Financial intermediaries and investors with significant exposure to commercial real estate face heightened asset quality risks. Smaller and regional US banks are particularly vulnerable as they are almost five times more exposed than larger banks.”

That warning recalls the events of last March when three major banks went under because their holdings of Treasury debt fell due to the interest rate rises and they experienced a run by depositors, leading government authorities to intervene because of “systemic risk” to the entire financial system.

The IMF pointed out that the risks were not confined to the US but were present in Europe as well. The recent collapse of the property firm Signa has already signified the dangers.

The blog concluded by warning that rising delinquencies and defaults in the commercial property sector “could restrict lending and trigger a vicious cycle of tighter funding conditions, falling commercial property prices, and losses for financial intermediaries with adverse spillovers to the rest of the economy.”

The roots of the crisis are not simply in the rise in interest rates by the Fed – as the blog itself pointed out commercial property has withstood rate rises in the past – but in the historical context in which the present increases have taken place.

Ever since the global stock market crash of 1987, when the incoming Fed chair Alan Greenspan pledged full support for Wall Street, the US financial system has become ever more dependent on the inflow of ultra-cheap money.

That dependence underwent a qualitative leap after the global financial crash of 2008 and again in the crisis

of March 2020 when the Fed intervened to the tune of more than \$4 trillion to prop the key market for US Treasury bonds and virtually every other area of the financial system.

This inflow of money enabled the accumulation of wealth by the most powerful oligarchs with the five richest men more than doubling their wealth after 2020 from \$405 billion to \$869 billion at the rate of \$14 million per hour.

Low interest rates have even been significant from the standpoint of the operation of the financial system. It has become so dependent on low interest rates that the maintenance of a Fed rate of more than 5 percent – once considered well within the bounds of normality – now poses great dangers. The situation in commercial property is the expression of a much broader process.

This can be seen in the gyrations of Wall Street in which one of the key determinants is what the Fed will or will not do. Thus, after reaching a record high in January 2022, the market began a decline as a result of first, the expectation of interest rate rises, and then their actuality in March 2022 and subsequently.

Apart from what has been described as a “sizzle” between March and July, when tech stocks soared on the basis of profit prospects flowing from artificial intelligence (AI), the general trend was down until October last year.

Then the market began an upswing on the basis that with the headline inflation rate starting to fall the Fed would not only halt the tightening cycle but would start cutting rates in 2024. It was given a further boost in December when Fed chair Jerome Powell indicated, contrary to all his previous remarks, that it was looking to cut rates.

Last Friday, the key Wall Street index, the S&P 500, reached a new record high, eclipsing the previous record set in January 2022. The rise continued this week with the Dow passing 38,000 for the first time on Monday.

Since the middle of last October, the S&P 500 has risen by 17.5 percent with the tech-heavy NASDAQ index up 21 percent, though still short of its record high.

The stock prices of the so-called “Magnificent Seven” – the google parent, Alphabet, Facebook parent Meta, Amazon, Apple, Microsoft, Tesla and Nvidia – have jumped by more than 25 percent in the space of

three months.

The rise and rise of Nvidia, which dominates the production of graphics units for AI, is the clearest expression of the speculative character of the market boom.

In March last year Nvidia’s market value was \$565 billion. It has now risen to \$1.5 trillion. The narrow base in the Wall Street surge is indicated by the fact that if Nvidia were removed from the S&P index it would not have reached a new record.

No one, least of all the participants, can predict where the market will turn, but one thing can be said with certainty: there will be sharp twists and turns.

For example, just months ago nickel and lithium were booming because of their role in electric vehicles. Today mines in Australia are announcing job cuts and closures because of a falloff in expected demand for electric vehicles and a price war in the production of these metals.

The US presidential elections scheduled for November are set to be held in conditions of extreme social and political volatility that could well be intensified by major financial turbulence, if not a crisis as in 2008.



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