PIEDMONT CRESCENT CAPITAL

The 2024 Economic Outlook: *Can the Fed Pull Off a Soft Landing?*

2023 ECONOMIC OUTLOOK

NOVEMBER 3, 2023

Mark P. Vitner
Chief Economist
mark.vitner@piedmontcrescentcapital.com
(704) 458-4000

Mark Vitner, Chief Economist

PIEDMONT CRESCENT CAPITAL

After spending the past 30 years as managing director and senior economist at Wells Fargo's Corporate and Investment Bank, Mark Vitner founded Piedmont Crescent Capital this past year. At his new firm, Mark provides analysis of the macro economy to clients located throughout the country and writes a series of reports on the US economy, local economies, small business, and residential and commercial real estate. He also provides economic content for CAVU Securities, writing their monthly newsletter, The CAVU Compass.

Originally from Atlanta, Mark earned a BBA in economics from the University of Georgia, an MBA from the University of North Florida and completed further graduate work in economics at the University of Florida. Mark is a member of the National Association of Business Economics and completed the NABE Advanced Training in Economics Program at Carnegie Mellon University. He is also a member of NABE's inaugural Certified Business Economist (CBE) class.

Mark is active in the community, co-founding the Charlotte NABE chapter and serving as board chair for the Foundation for the Charlotte Jewish Community. Mark also chaired the Economic Advisory Council for the California Chamber of Commerce and currently serves on the Joint Advisory Board of Economists for the Commonwealth of Virginia. His commentary has been featured in The New York Times, The Wall Street Journal, Bloomberg, and many other publications. Mark also makes frequent guest appearances on CNBC and other major networks.

Higher Inflation Snuffs Out Economic Growth

PIEDMONT CRESCENT CAPITAL

Recession, Soft Landing or Something Else

A recession still seems slightly more likely either late this year or in early 2024 but looks less certain given continued strong job growth. The economic data are harder to read due to the extreme swings brought about by the pandemic. While many traditional business cycles measures, such as the inverted yield curve, are giving off distinct warning signals, the lags between rising interest rates and slower economic growth appear to have lengthened.

After Peaking, Inflation is Proving "Sticky"

Inflation peaked around the middle of 2022. Most of the improvement has come from lower energy prices and lower prices for used cars. Inflation is proving sticky in most other areas, particularly labor-intensive services. We expect to see higher inflation readings later this year and expect inflation to remain above the Fed's 2% target through 2024. As a result, the Fed will be reluctant to cut rates when growth falters.

Higher Rates Have Kept Home Sellers On the Sidelines

Over 80% of outstanding first lien mortgages have fixed rates of 5% or less, with more than 60% are below 4%. With mortgage rates well over 7%, news listings have plummeted. The lack of existing homes has slightly boosted new home sales. Existing sales have fallen less than inventories, resulting in sharply higher home prices. Affordability has hit an all-time low, as has the share of consumers that fell now is a good time to buy a home.

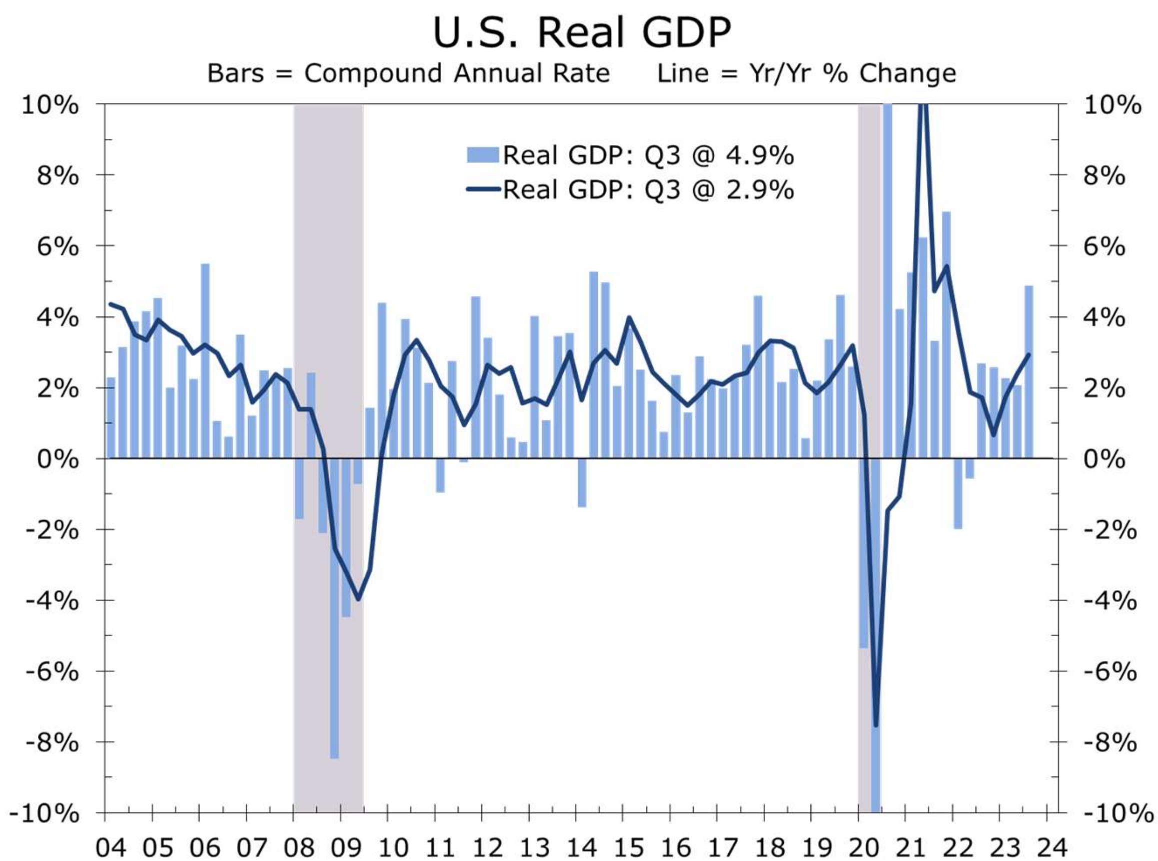
Furniture Industry

After surging during the pandemic and its immediate aftermath, consumer spending on goods slowed from mid-2022 to mid-2023. Spending for experiences surged this summer but now appears to be normalizing. Household finances for middle income and below are now under a great of stress. Upper income households still have significant residual savings.

Economic Growth Has Shown Surprising Resiliency

PIEDMONT CRESCENT CAPITAL

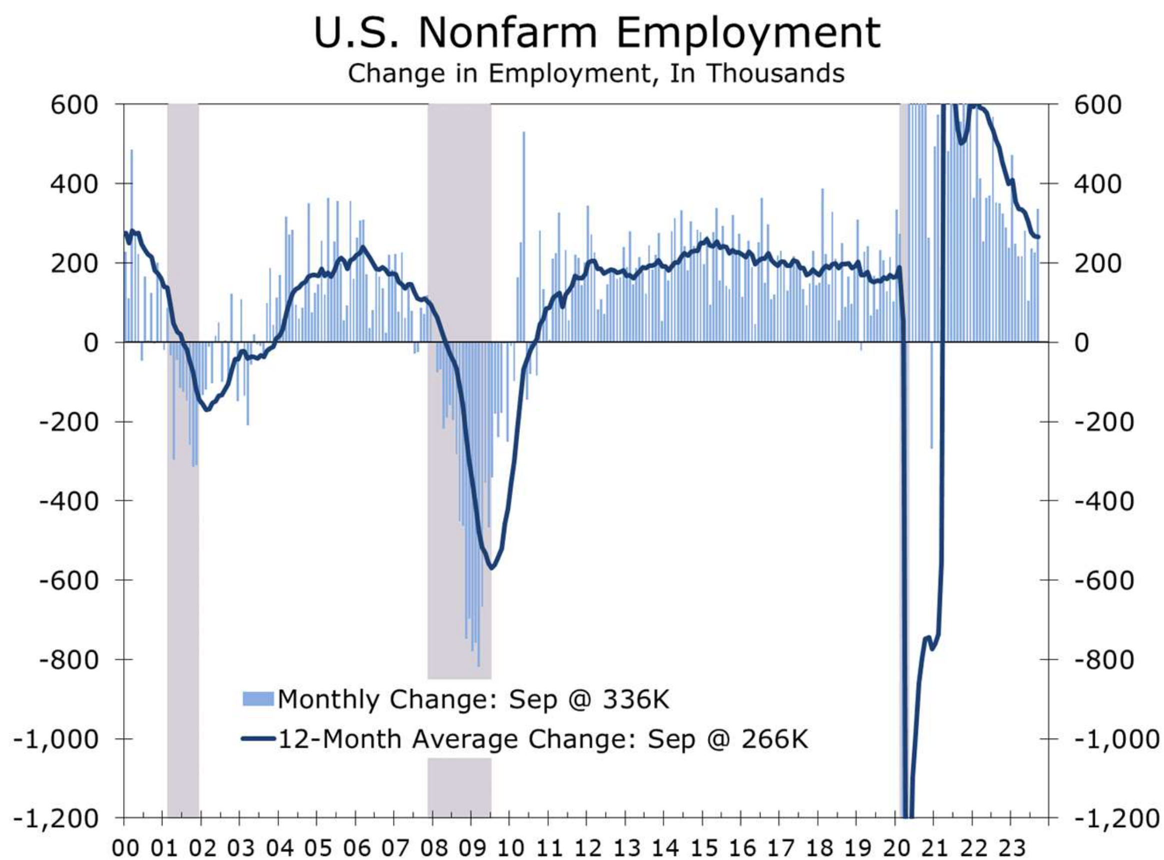
- Real GDP grew at a 4.9% annual rate in the third quarter..
- Growth was driven by strength in consumer spending, government outlays and inventory building.
- Early indications suggest that momentum has carried over into Q4.



Source: Bureau of Economic Analysis

Job Growth Is Showing Signs of Moderating

- While headline job growth continues to top expectations, hiring is clearly moderating.
- The bulk of job growth is coming from industries still struggling to replace workers lost during the lockdowns.
- Construction payrolls are benefitting from the large backlog of residential and industrial projects.

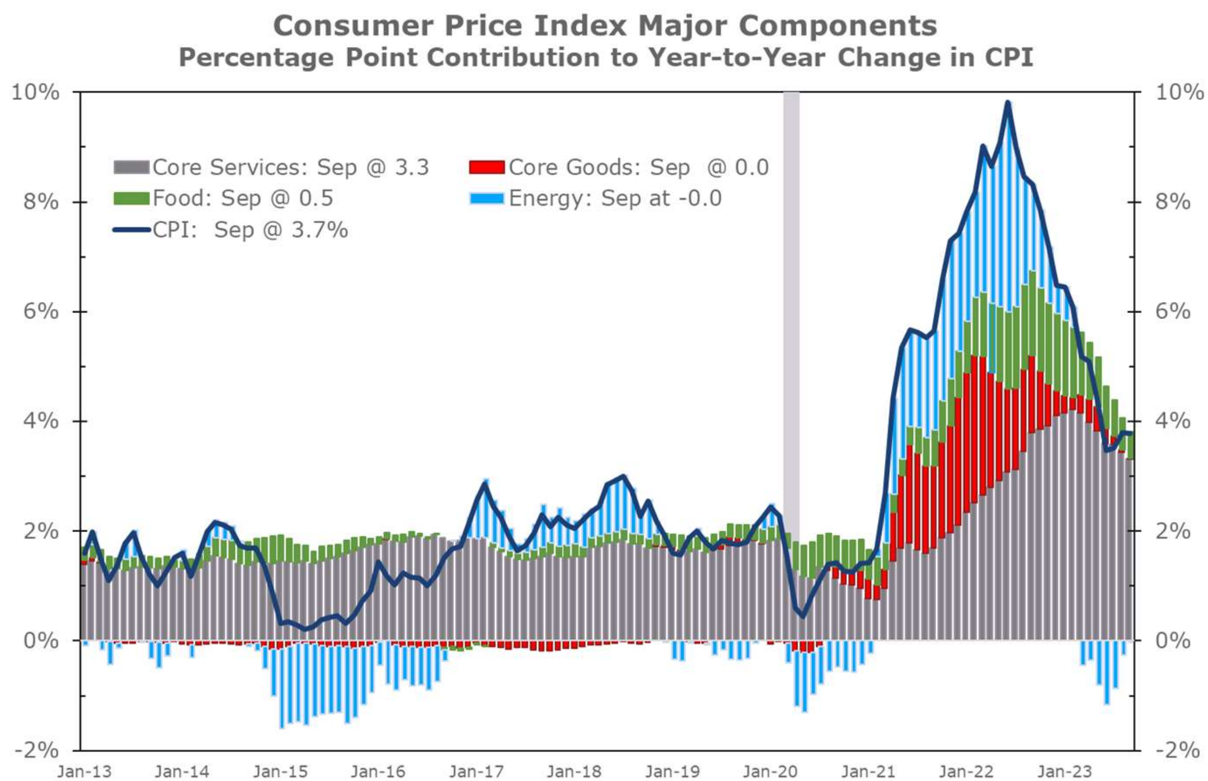


Source: Bureau of Labor Statistics

Inflation Has Rolled Over But Remains Persistent and High

PIEDMONT CRESCENT CAPITAL

- Headline inflation moderated after the middle of last year, as gasoline prices declined and used car prices moderated.
- Core inflation remains persistent, particularly in labor-intensive parts of the service sector.
- Healthcare cost were understated during the summer and are now rebounding.

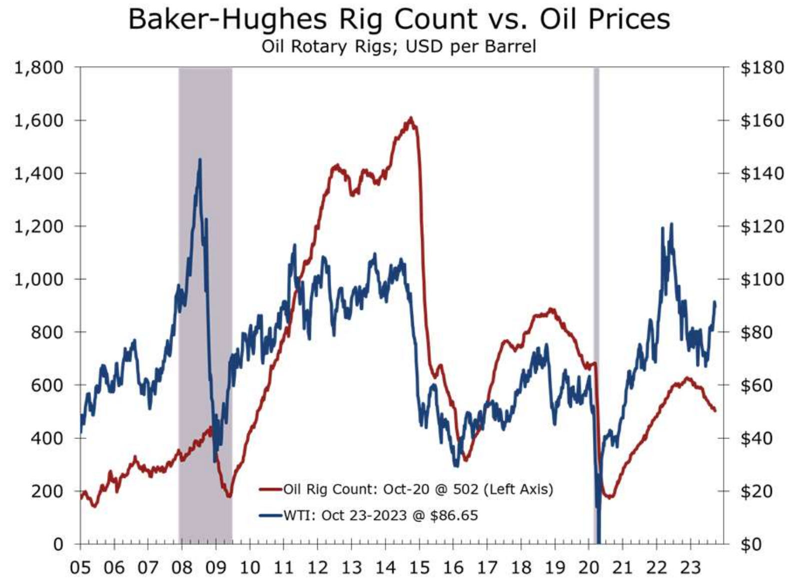


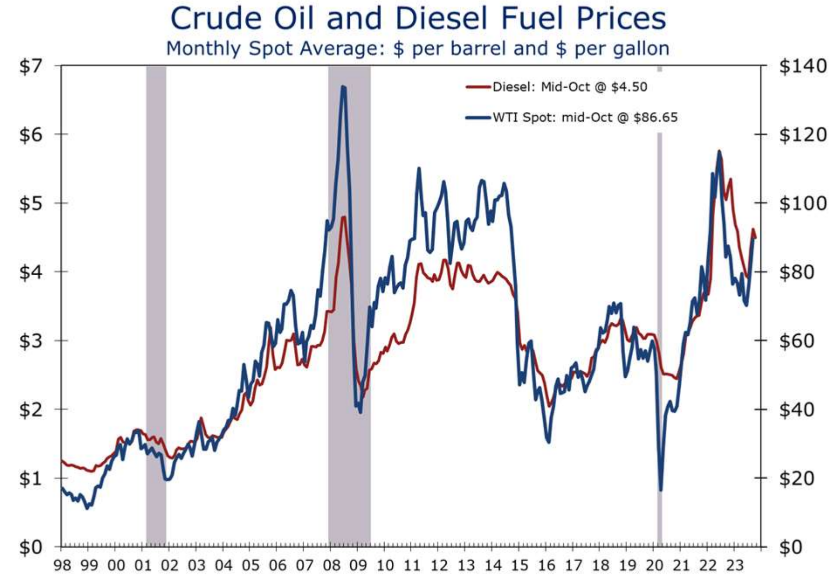
Source: Bureau of Labor Statistics

Oil Prices Have Firmed Recently On Supply Cuts & Reviving Demand

PIEDMONT CRESCENT CAPITAL

Crude oil prices have fallen back in recent weeks, following reports of rising inventories and slowing global demand. The horrific attacks in Israel and the resulting war will cause oil prices to hold near current levels and will rise if the war spreads broadens to include Iran.

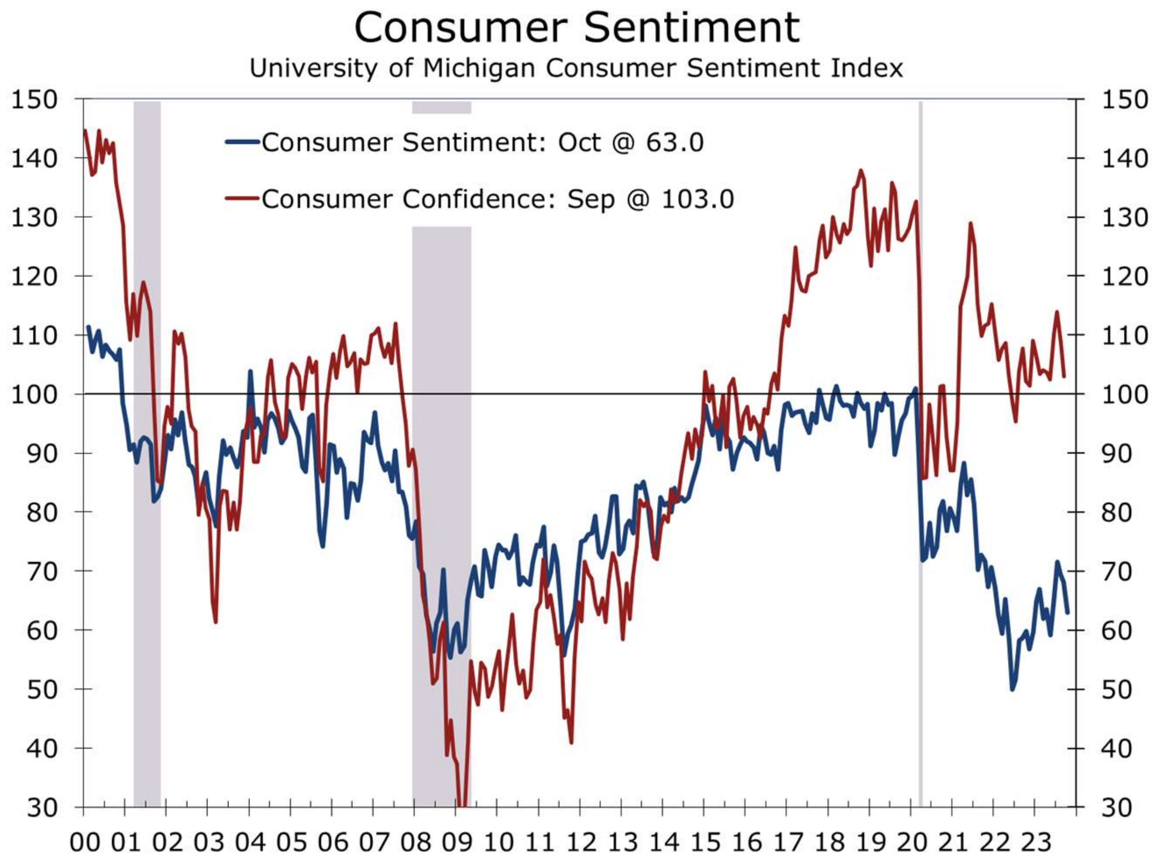




Source: Energy Information Agency

Higher Inflation Continues to Weigh on Consumer Sentiment

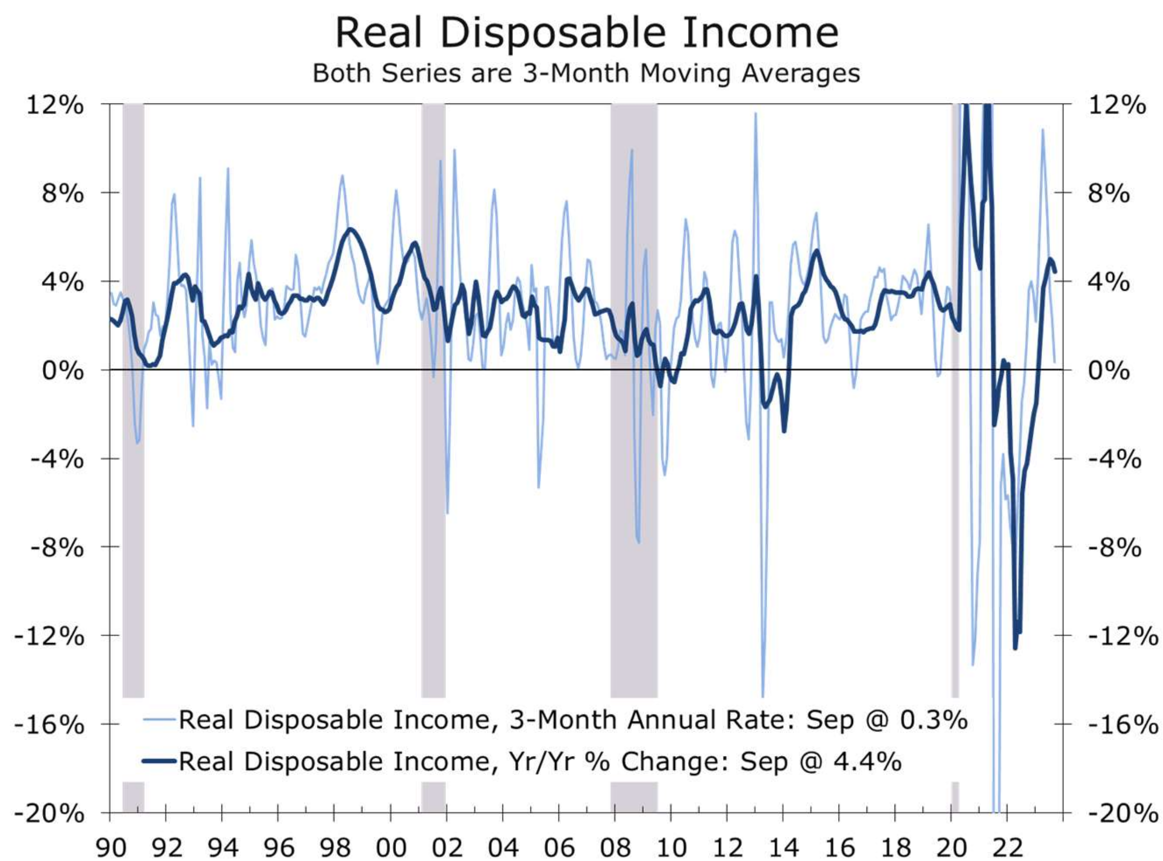
- An unusually wide gap between Consumer Confidence and Sentiment has persisted since the pandemic.
- Consumer Confidence more closely tracks the labor market, which remains strong. Consumer Sentiment follows finances which have struggled with higher inflation, rising interest rates and a volatile stock market.
- Both Confidence and Sentiment have been sensitive to swings in inflation.



Source: Conference Board and University of Michigan

Real Income Slowed in Q3 As Tax Payments Increased

- Real after-tax income declined slightly during the third quarter, as inflation edged higher and tax payments rose.
- Real Income has risen solidly over the past year but is expected to grow more slowly in 2024.
- Wage and salary growth is moderating as the mix of jobs is shifting toward lower paying jobs.

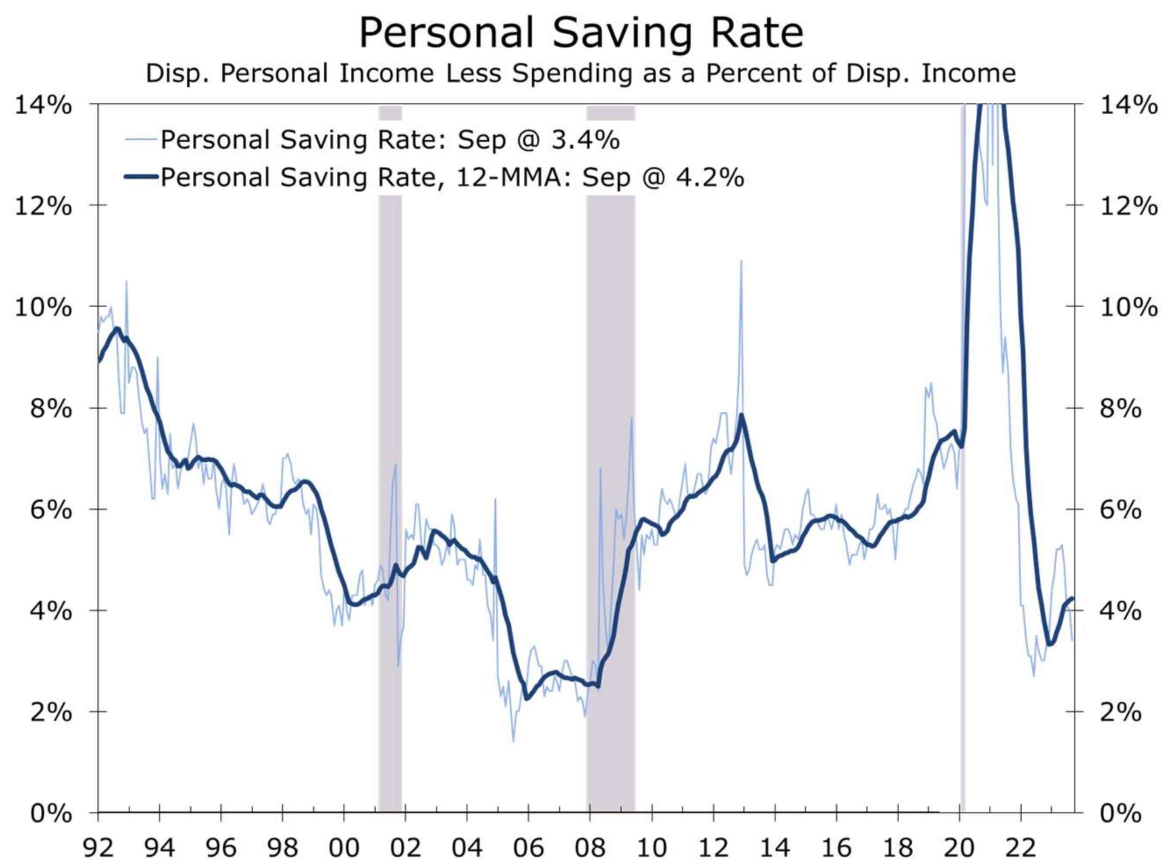


- Source: Bureau of Economic Analysis

The Personal Saving Rate Has Fallen To Low Levels

PIEDMONT CRESCENT CAPITAL

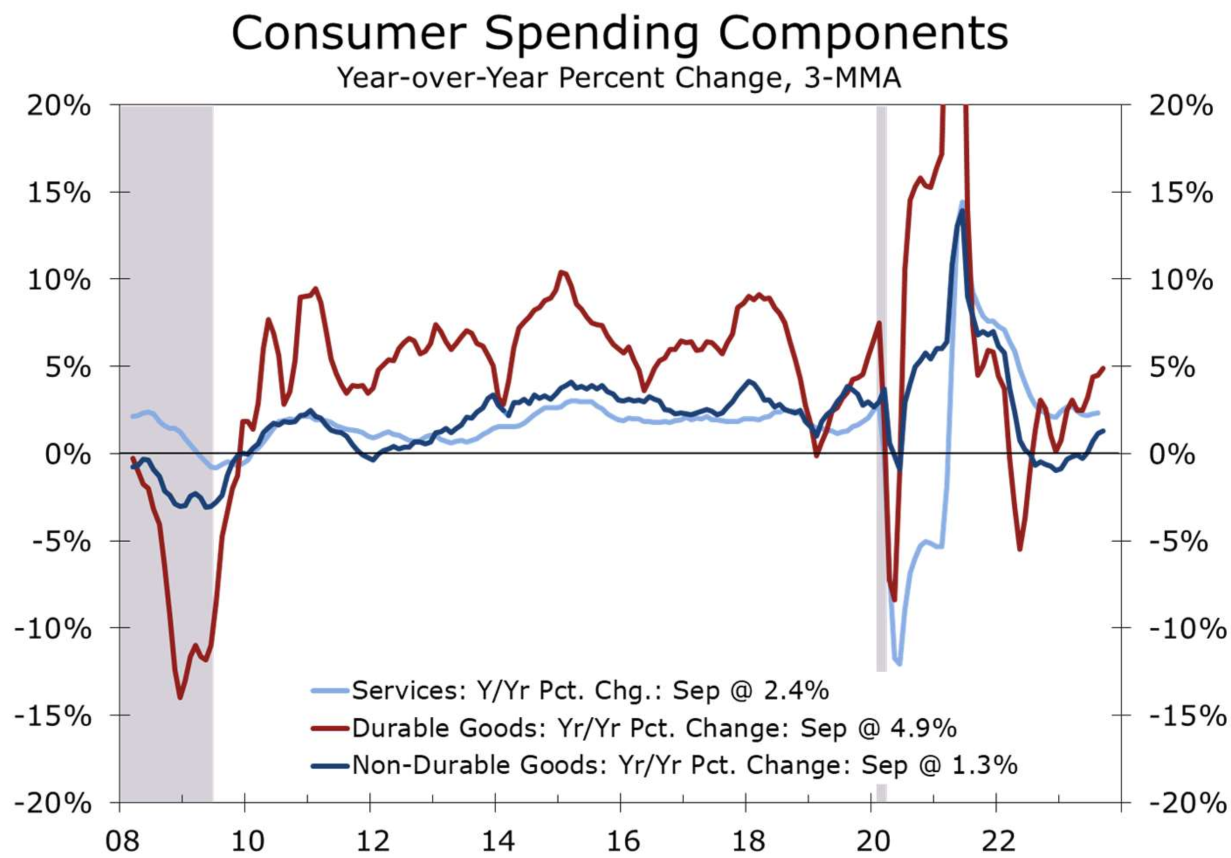
- In an overall sense, consumers have largely exhausted the savings built up during the pandemic.
- Upper-income households still hold significant savings and have accumulated considerable wealth during the pandemic and aftermath.



Source: Bureau of Economic Analysis

Consumer Spending Remains Resilient

- Consumer spending on durable goods surged as the economy reopened.
- Spending on nondurable rose more modestly, reflecting the slow return to the office.
- Services outlays have been strong the past few years, led travel and leisure spending.

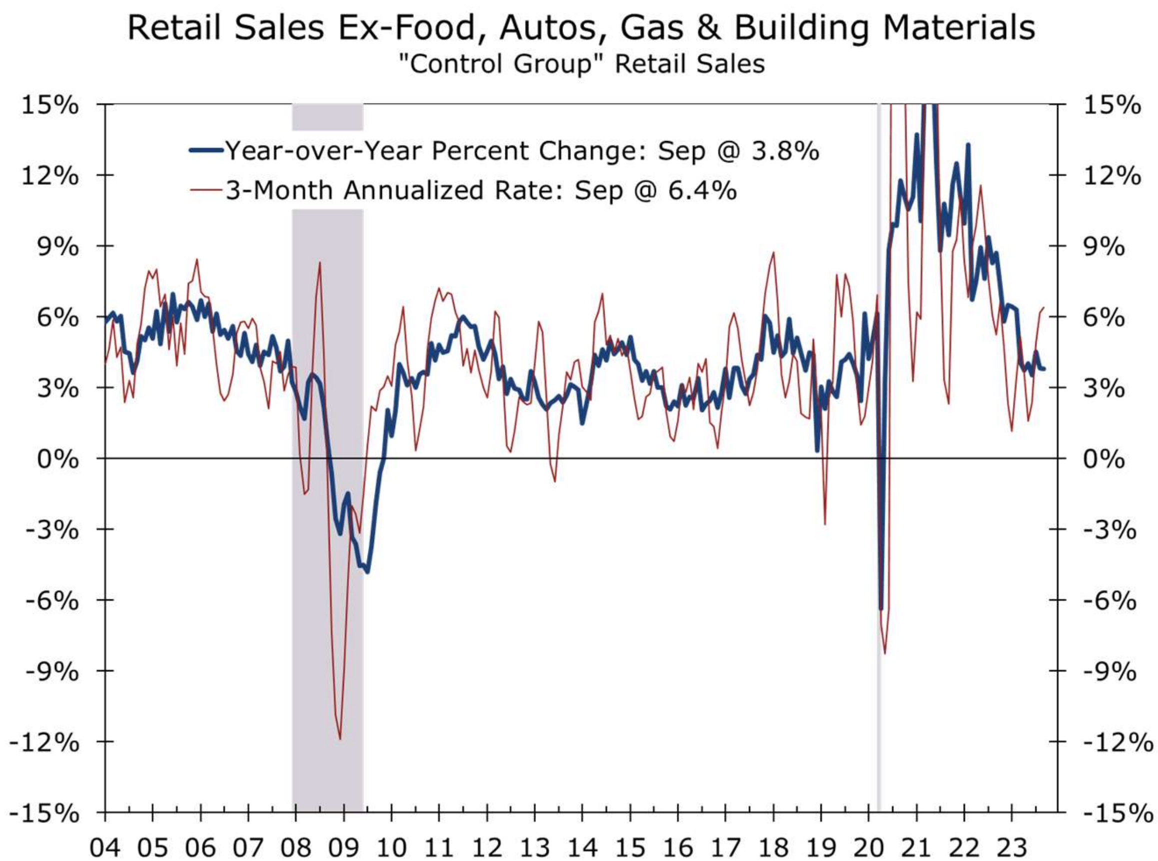


Source: Bureau of Labor Statistics

Retail Sales Were Surprising Strong This Summer

PIEDMONT CRESCENT CAPITAL

- Retail sales rose solidly this summer, with spending on core goods rising at a 6.4% annual rate.
- The strength in consumer spending has pulled Q3 GDP forecasts higher.
- Spending ended on a strong note, boosting the Q4 outlook.
- Spending patterns are returning to pre-pandemic norms.

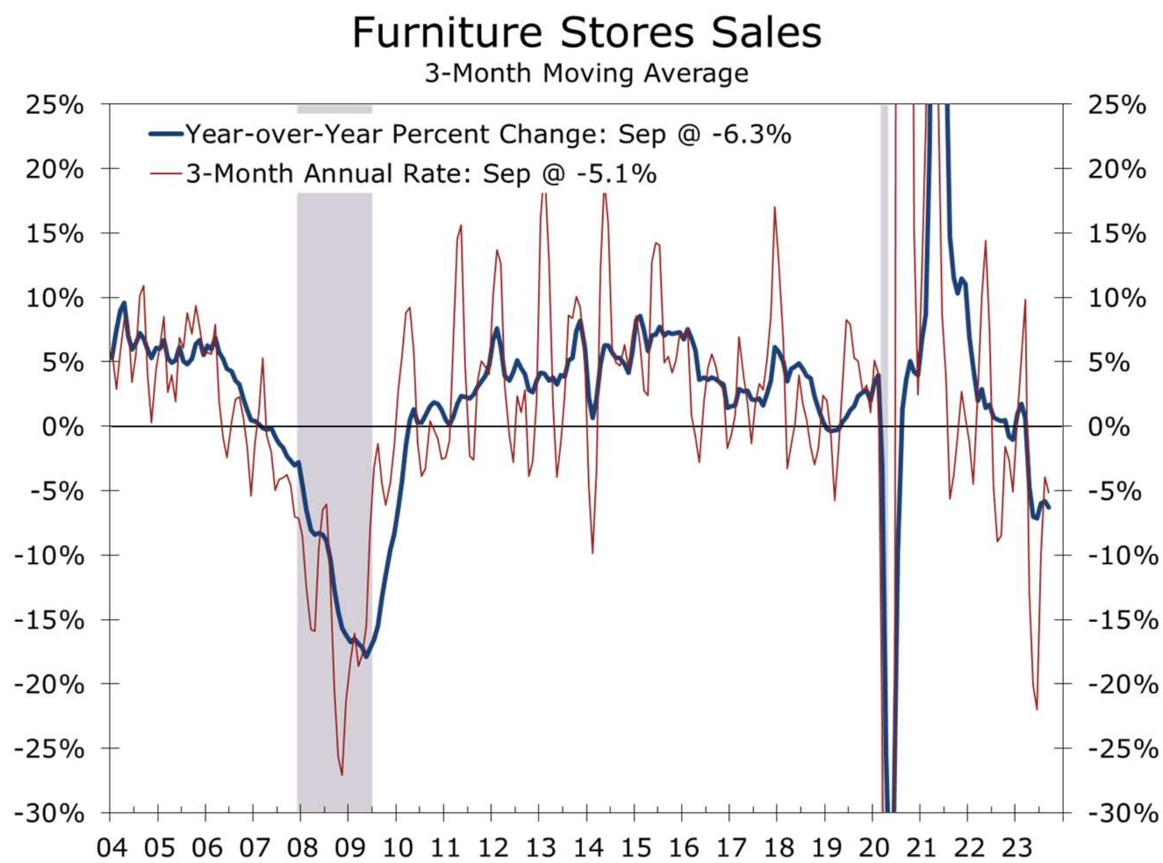


Source: Census Bureau

Furniture Store Sales Have Suffered Through a Rough Patch

PIEDMONT CRESCENT CAPITAL

- Overall home sales have continued to decline, with sales of existing homes falling in 15 of the past 18 months.
- Part of this decline has been offset by a modest rise in new home sales.
- On net consumers are purchasing less furniture and also shopping less at brick and mortar stores.

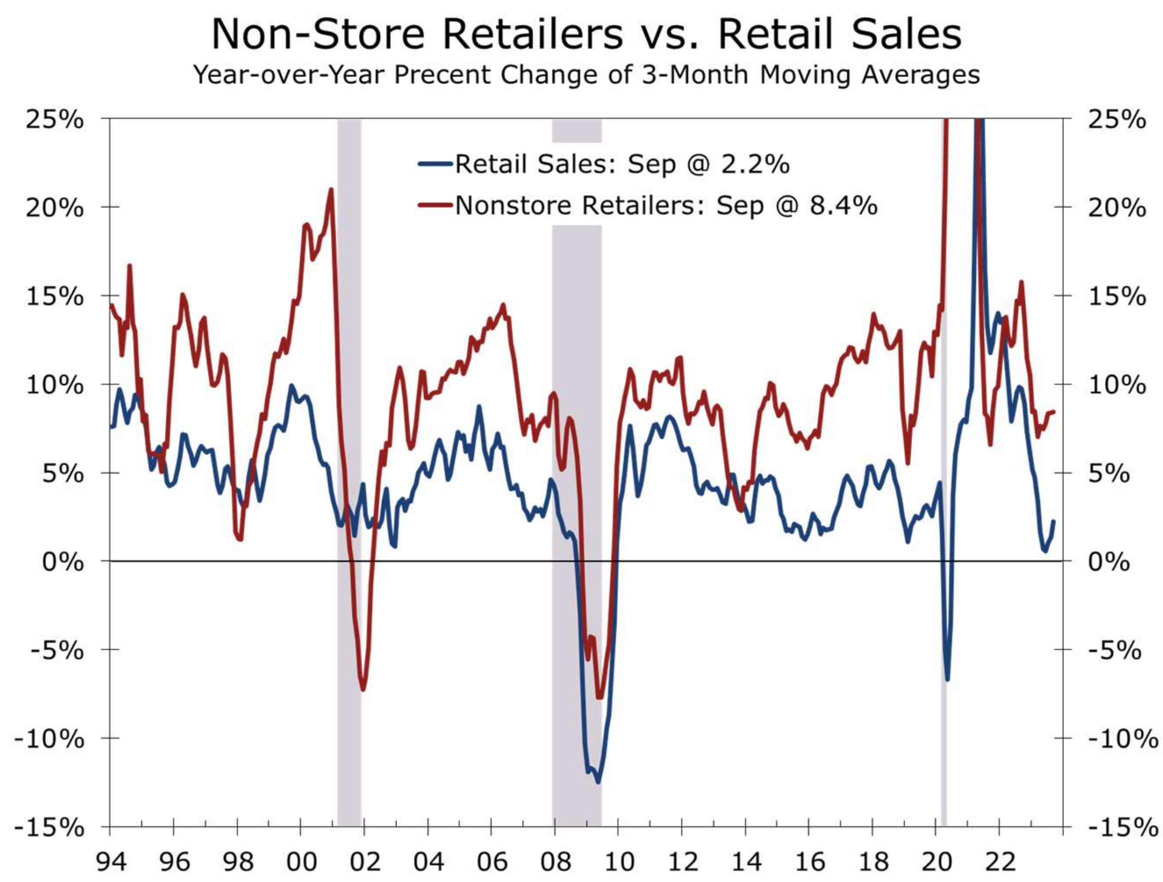


Source: Census Bureau

Online Retailing Continues to Gain Share

PIEDMONT CRESCENT CAPITAL

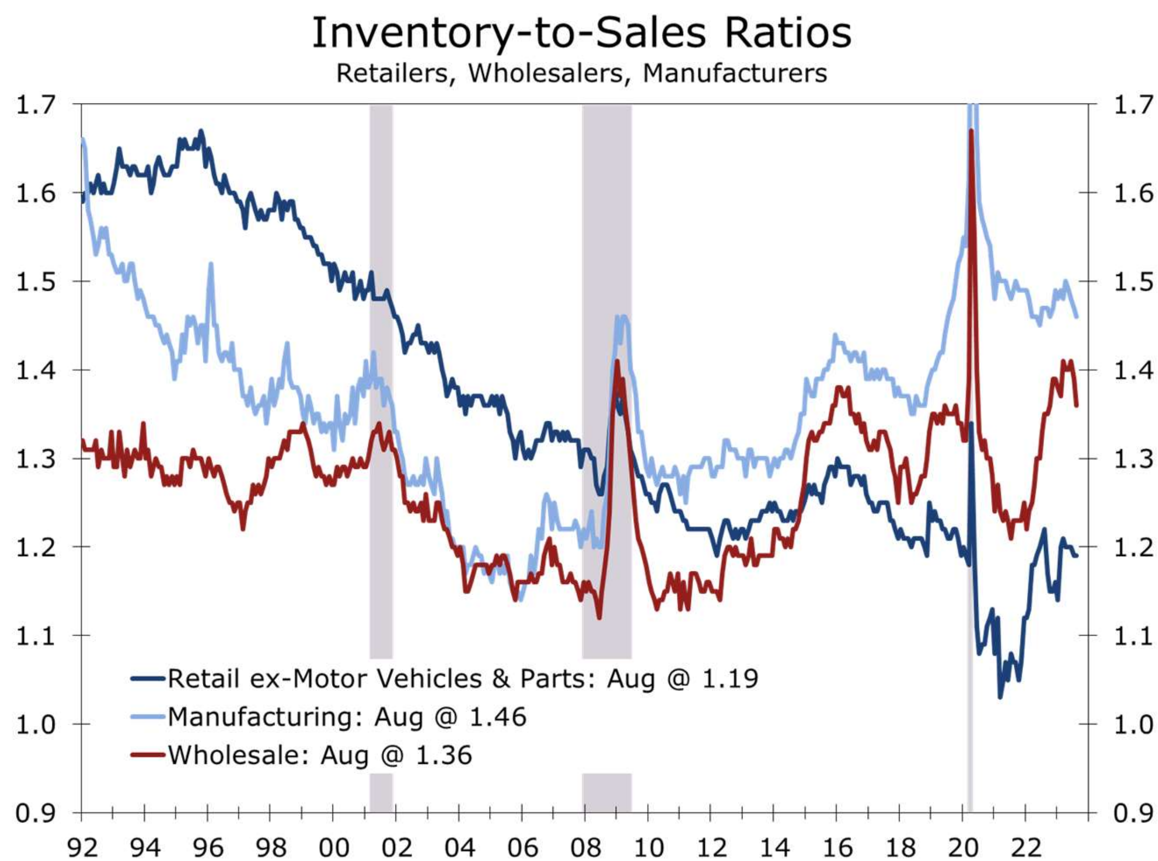
- Brick & mortar retailers benefitted from work-from-home, as consumers had more time to shop. With workers returning to the workplace, this tailwind has lessened.
- Online shopping decelerated from its pandemic-era pace but continues to gain market share.
- Townhalls/lifestyle centers remain one of the strongest retail formats.



Source: Census Bureau

Business Inventories Remain Somewhat High

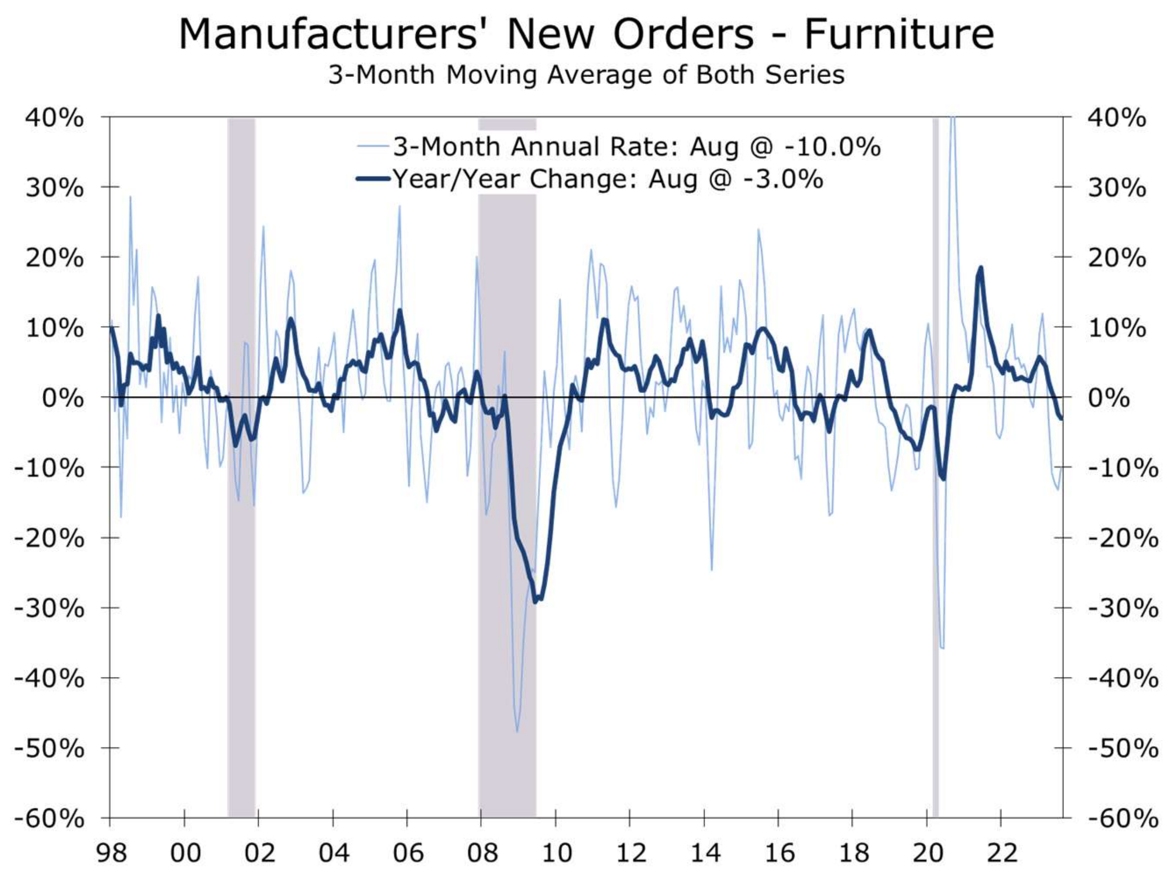
- The abrupt switch in consumer preferences for experiences left retailers and wholesales with too much inventory.
- Overall inventories remains slightly above their pre-pandemic level.
- Retail inventories are lean, as chains focus on expense control.



Source: Census Bureau

Manufacturers Orders for Furniture have Fallen this Past Year

- Manufacturers orders have fallen sharply over the past six months
- The declines have been in response reduced consumer spending on goods and a build up of inventories.
- Spending picked up modestly this summer and has helped begin to curb inventories.

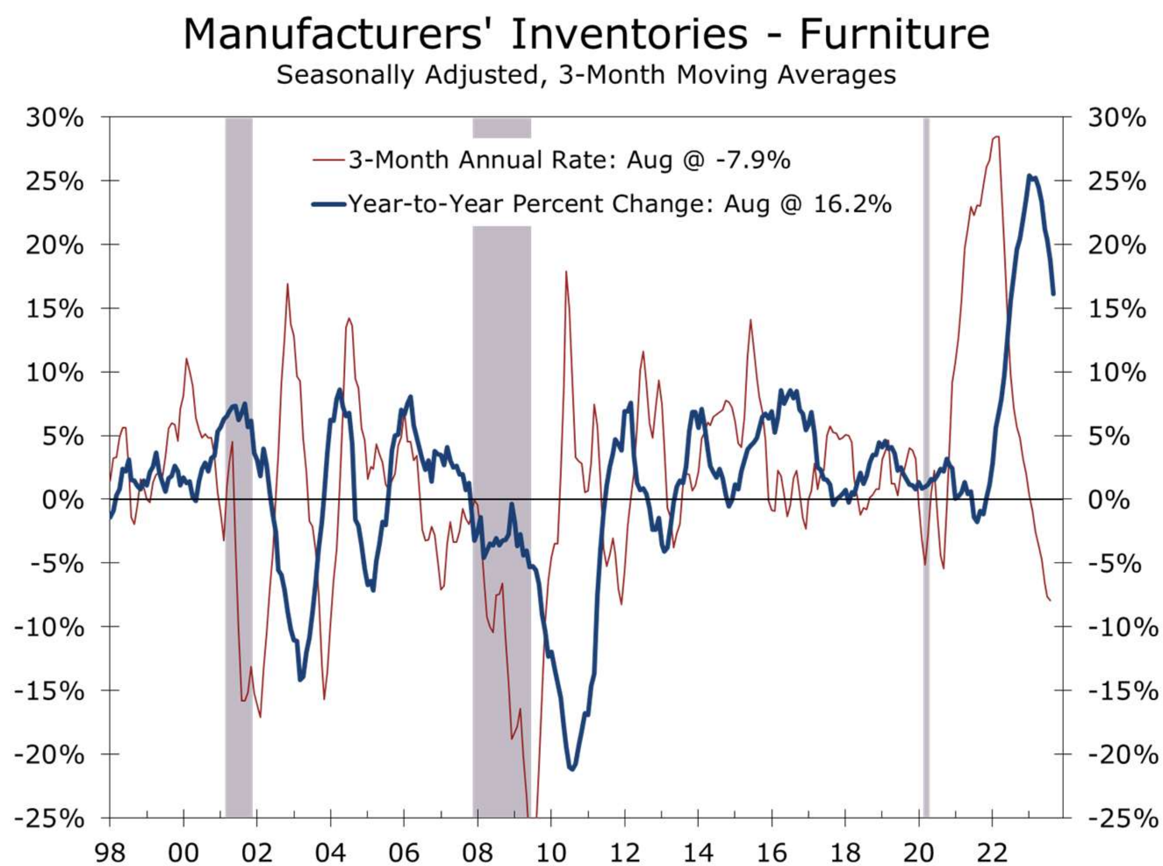


Source: Census Bureau

• Furniture Inventories Have Begun to Come Back Down

PIEDMONT CRESCENT CAPITAL

- Manufacturers inventories of furniture spiked this past year.
- Inventories have come back down this summer, as prices have fallen.
- Inventories clearly remain too high, however, despite the sharp decline over the past three months.

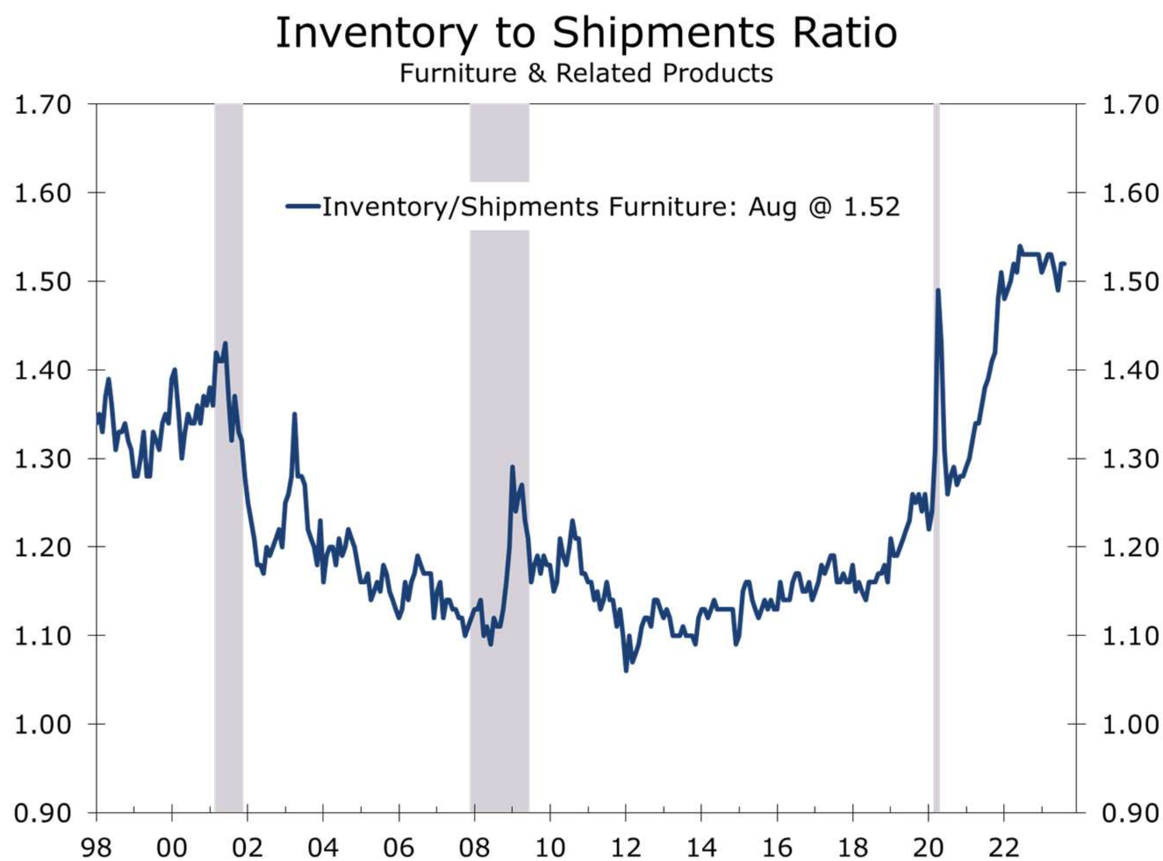


Source: Census Bureau

The Inventory/Shipments Ratio Has Improved Only Slightly

PIEDMONT CRESCENT CAPITAL

- Inventory/Shipments is less impacted by price swings, although price declines will generally cause improvement to lag.
- Demand for furniture is being held back by sluggish real after-tax income growth and weakening home sales.
- The coming year will see only modest consumer spending growth.

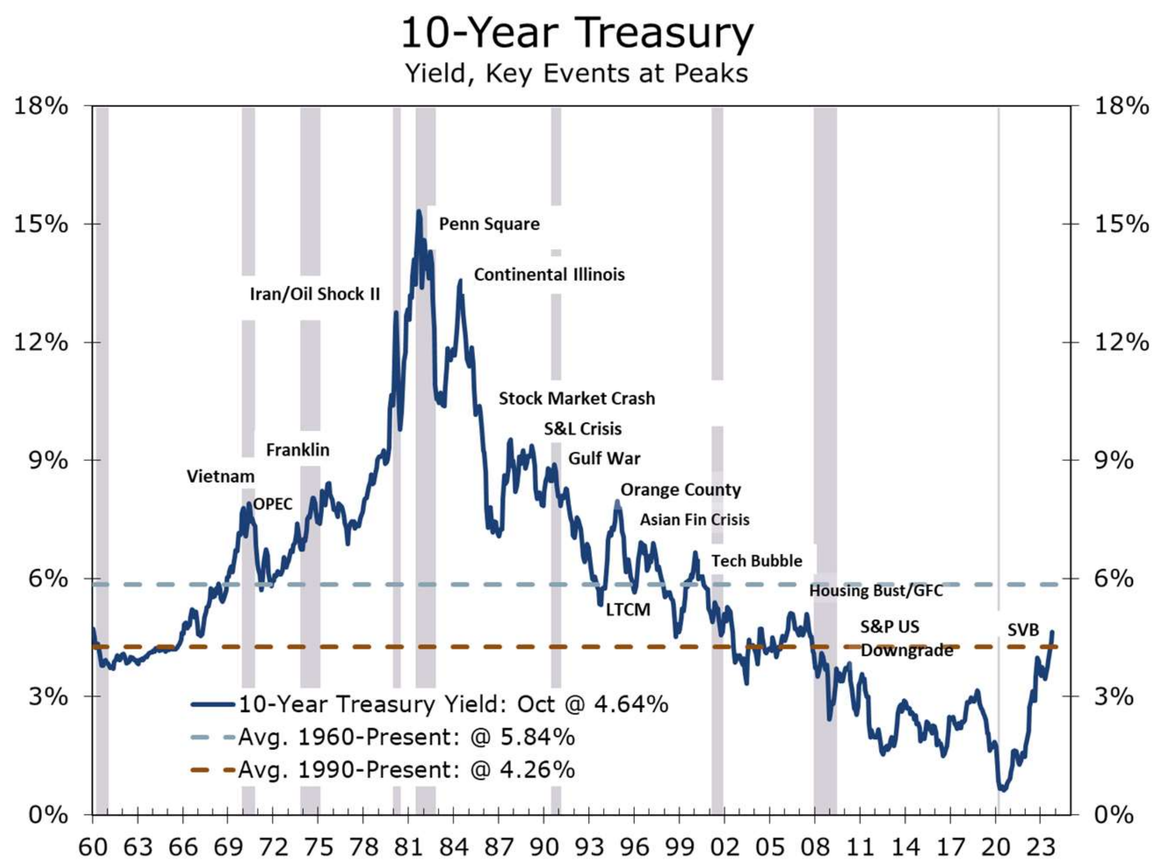


Source: Census Bureau

Concerns About Higher Inflation Are Pulling Interest Rates Higher

PIEDMONT CRESCENT CAPITAL

- Long-term Interest rates recently hit their highest level since 2007.
- Rates have risen on the drive by the Treasury to rebuild their coffers and persistent large budget deficits.
- The 10-Year Treasury is now close to its average for the past 25 years.
- Mortgage Rates are usually 170 bp above the 10-Yr Treasury Yield.

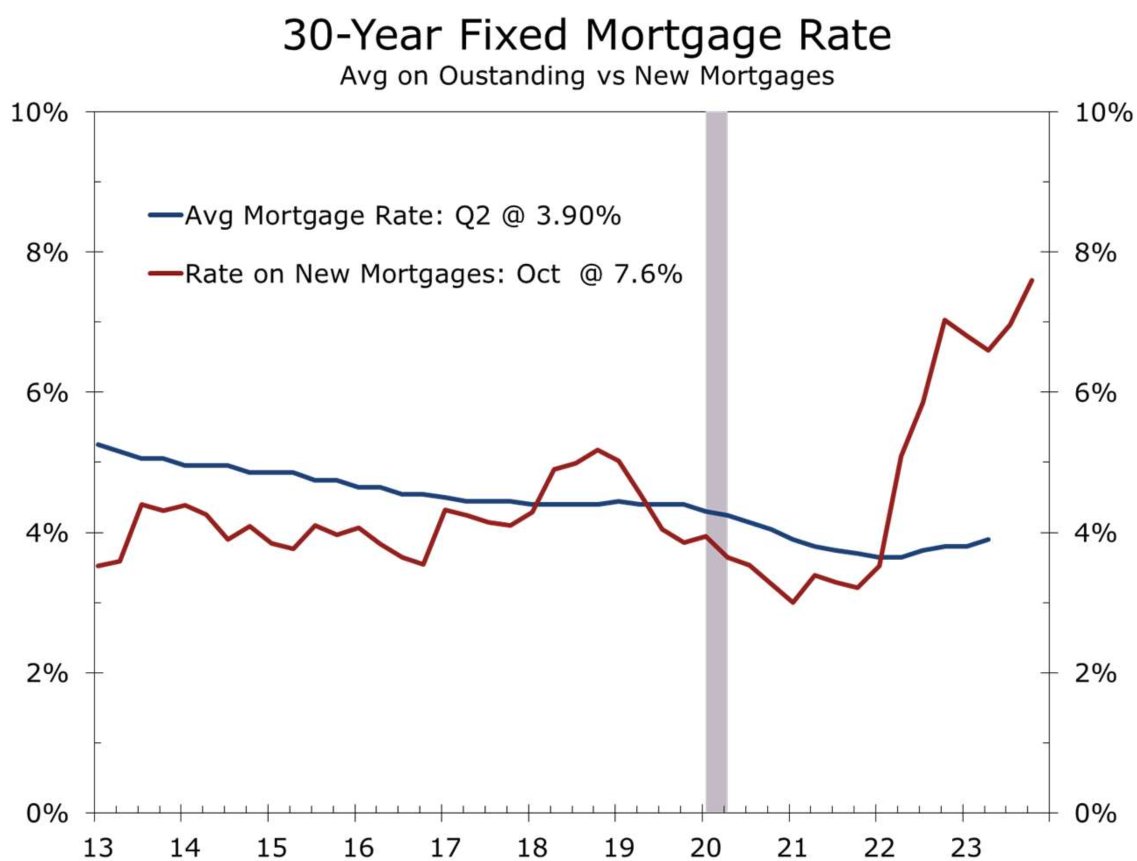


South: Federal Reserve Board

Slightly More Than 80% of Outstanding Mortgages Are Below 5%

PIEDMONT CRESCENT CAPITAL

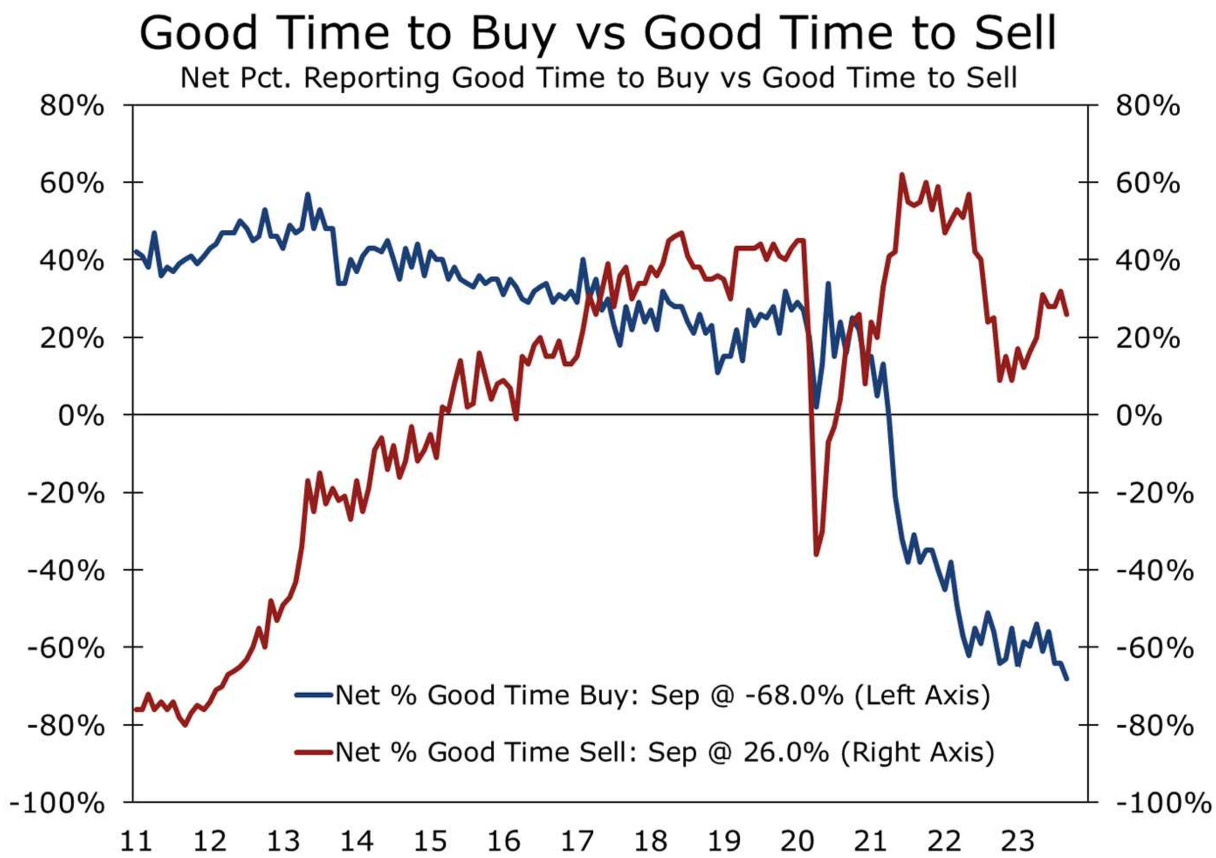
- The gap between prevailing mortgage rates and the effective rate on outstanding mortgages is wider than any time since the early 1980s.
- With low fixed-rate mortgages, fewer existing homeowners are looking to sell their homes.
- The preponderance of low-rate mortgages is a big reason why consumer spending has held up so well.



Source: Federal Housing Finance Agency

Affordability Remains A Formidable Hurdle to Home Buyers

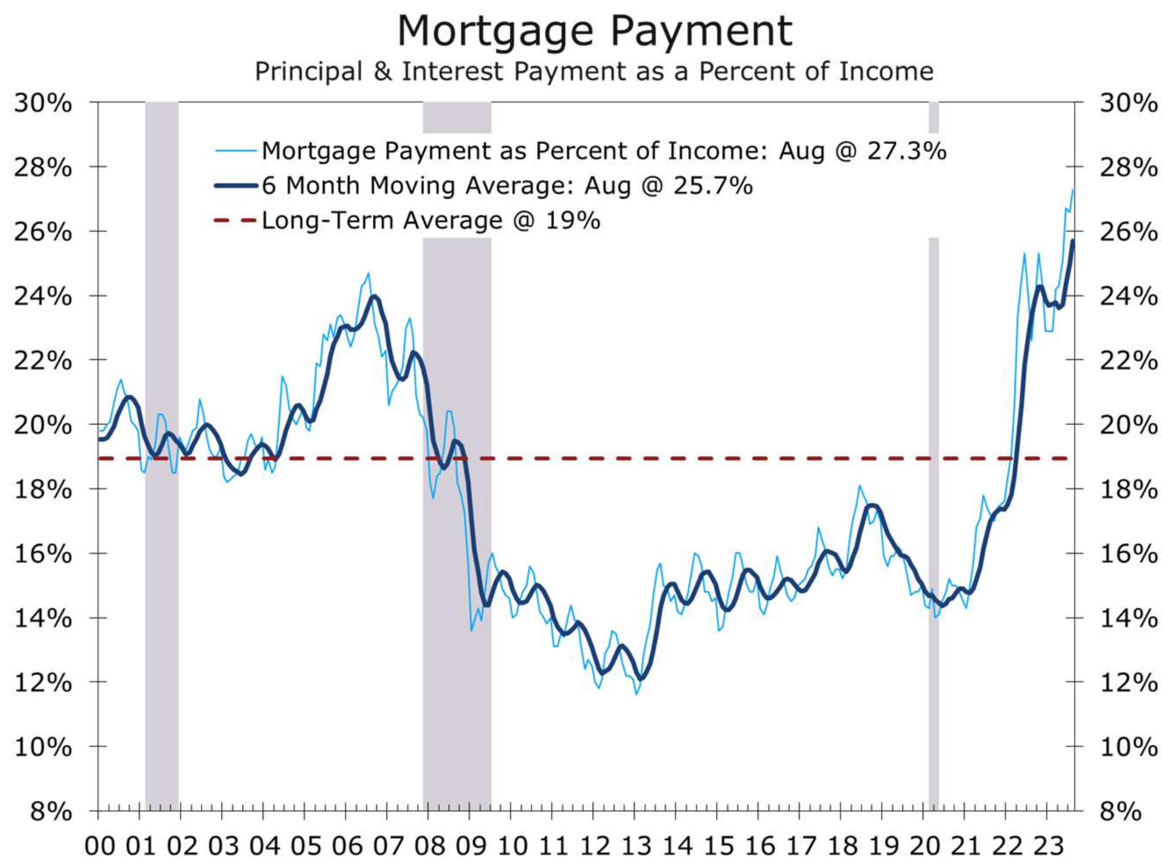
- The net proportion of consumers that feel now is a good time to buy a home remains near a record low, reflecting the general lack of affordable homes.
- There has been a slight uptick in the proportion of consumers that feel now is a good time to sell, likely reflecting the resurgence in home prices.



Source: Fannie Mae

Affordability Deteriorated Quickly Following the Pandemic

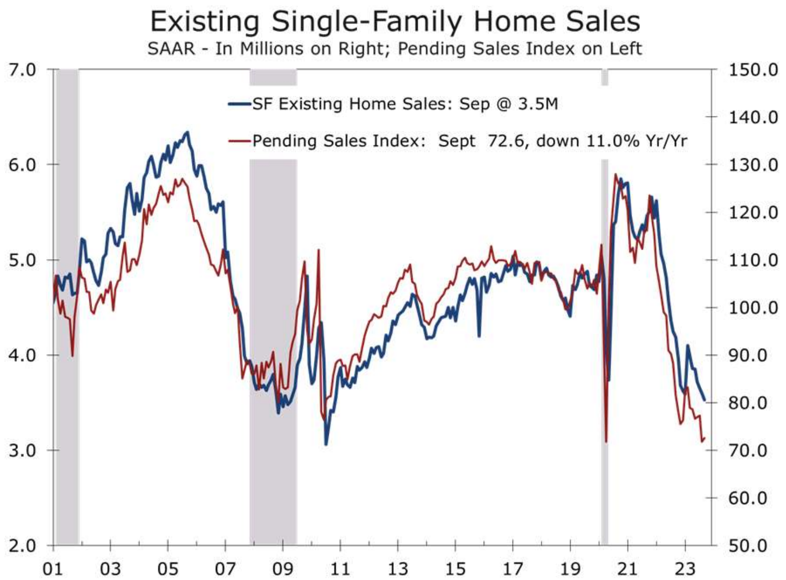
- Housing affordability remains stretched. Principal and interest payments have risen to 27.3% of median family income and will likely rise further in June, the rise in interest rates and home prices. The norm is around 19%.
- At $2,234/Month, principal and interest payments now account for a larger share of median family income than they did at the peak of the housing bubble.

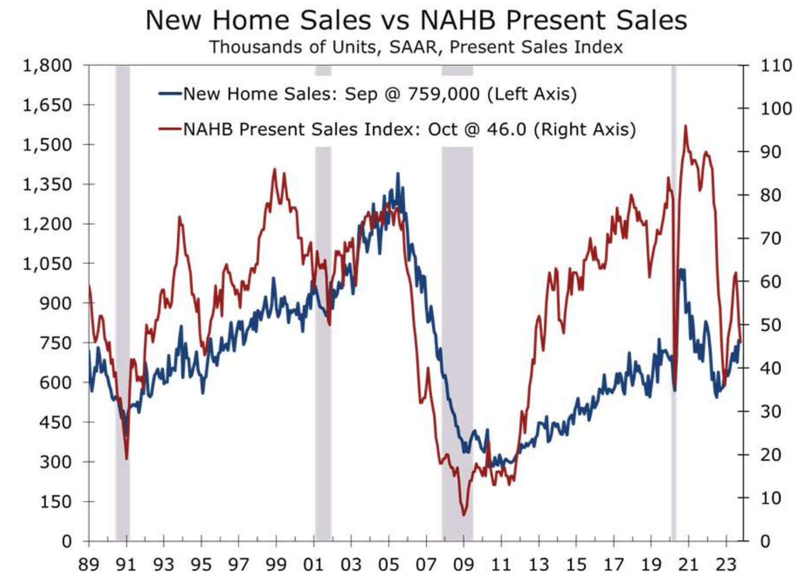


Source: National Association of Realtors

Home Sales Have Tumbled As Interest Rates Have Spiked

Existing home sales are essentially back to where they were at the start of the year. Sales fell for 12 consecutive months, falling a cumulative 36.1%, before rising in February. The drop was the longest consecutive decline on record. Higher mortgage rates led to a spike in contract cancelations last fall and some buyers returned when rates fell in January. Amidst record low inventories and a dearth of new listing, that rebound proved brief and existing home sales resumed their slide.



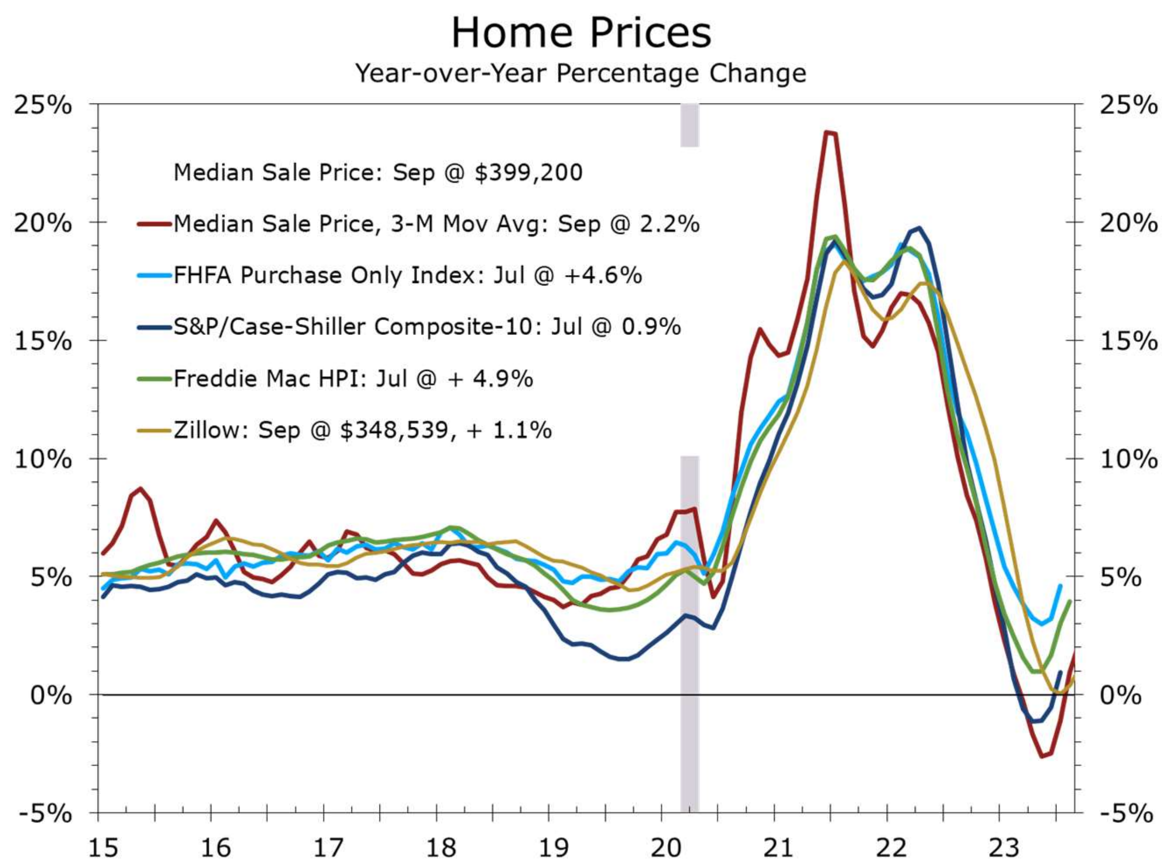


Source: National Association of Realtors, Census Bureau and National Association of Home Builders

Lean Inventories Have Reversed The Correction in Home Prices

PIEDMONT CRESCENT CAPITAL

- After falling from the middle of 2022 through early this year, home prices have rebounded and are now close to their previous highs.
- Prices for existing homes have risen, as the number of homes for sale has fallen more than home sales.
- Price increases are expected to moderate as new listings increase. There has also been a rise in cancelations in the past few months, due to the recent spike in mortgage rates.

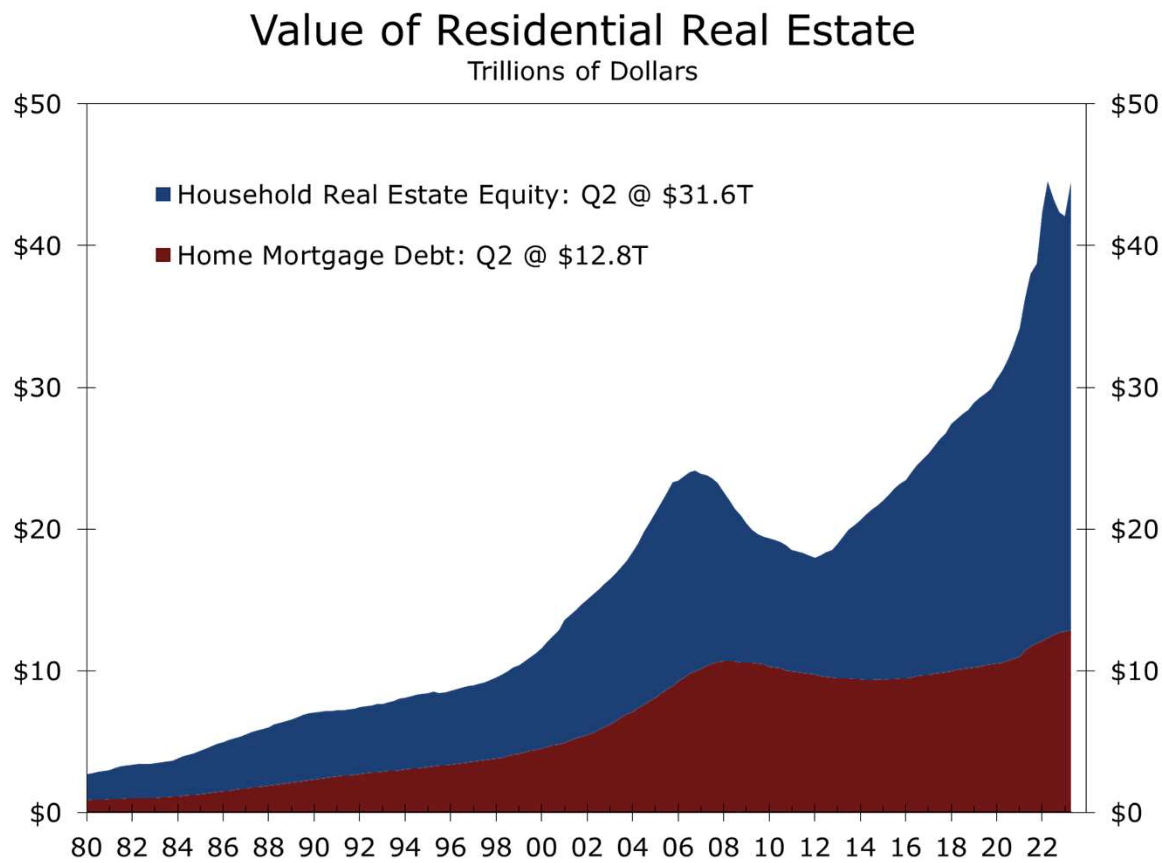


Source: National Association of Realtors, Federal Housing Finance Agency

Rising Home Values Are Boosting Home Equity

PIEDMONT CRESCENT CAPITAL

- The combination of rising home value and low mortgage rates on the existing stock of homes has boosted home equity.
- Equity fell slightly from the middle of 2022 to early 2023, as home prices fell slightly.
- Home equity is a key driver for home improvement spending.

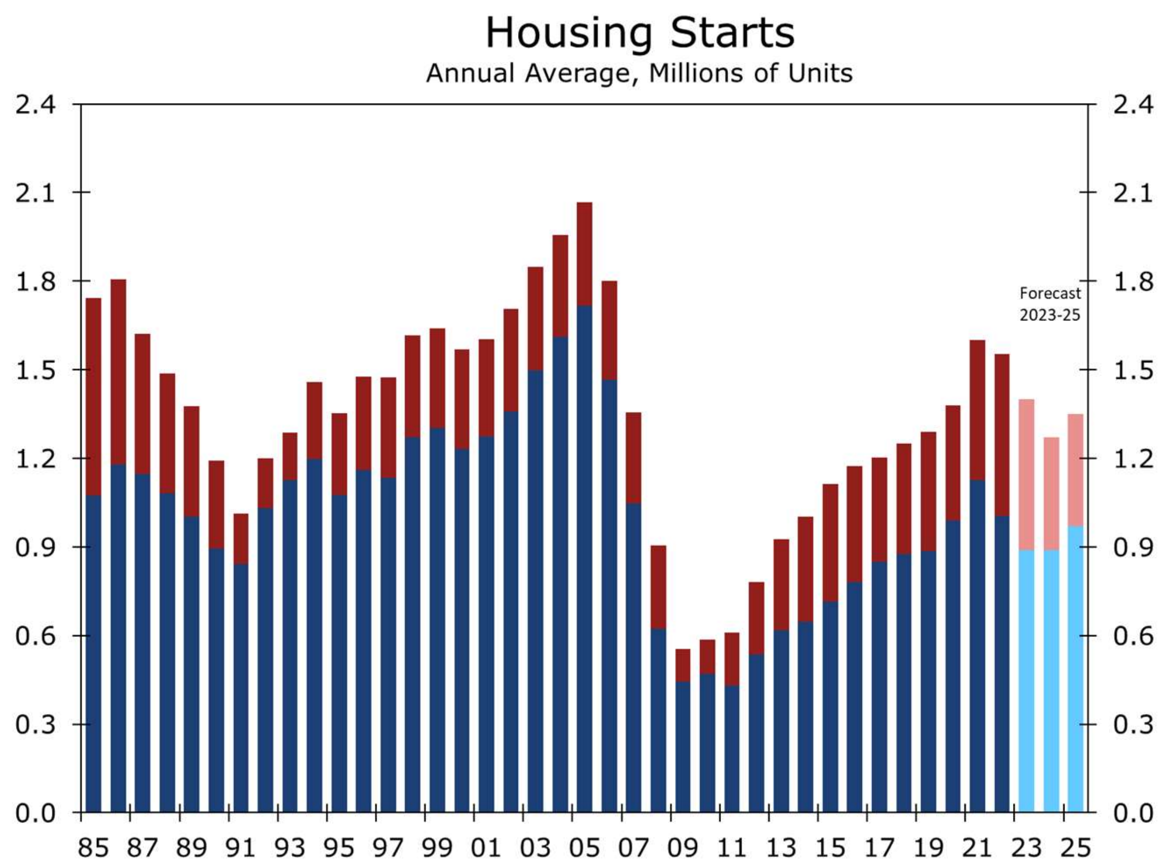


Source: The Federal Reserve Board

Housing Starts Appear Set For a Moderate Pullback

PIEDMONT CRESCENT CAPITAL

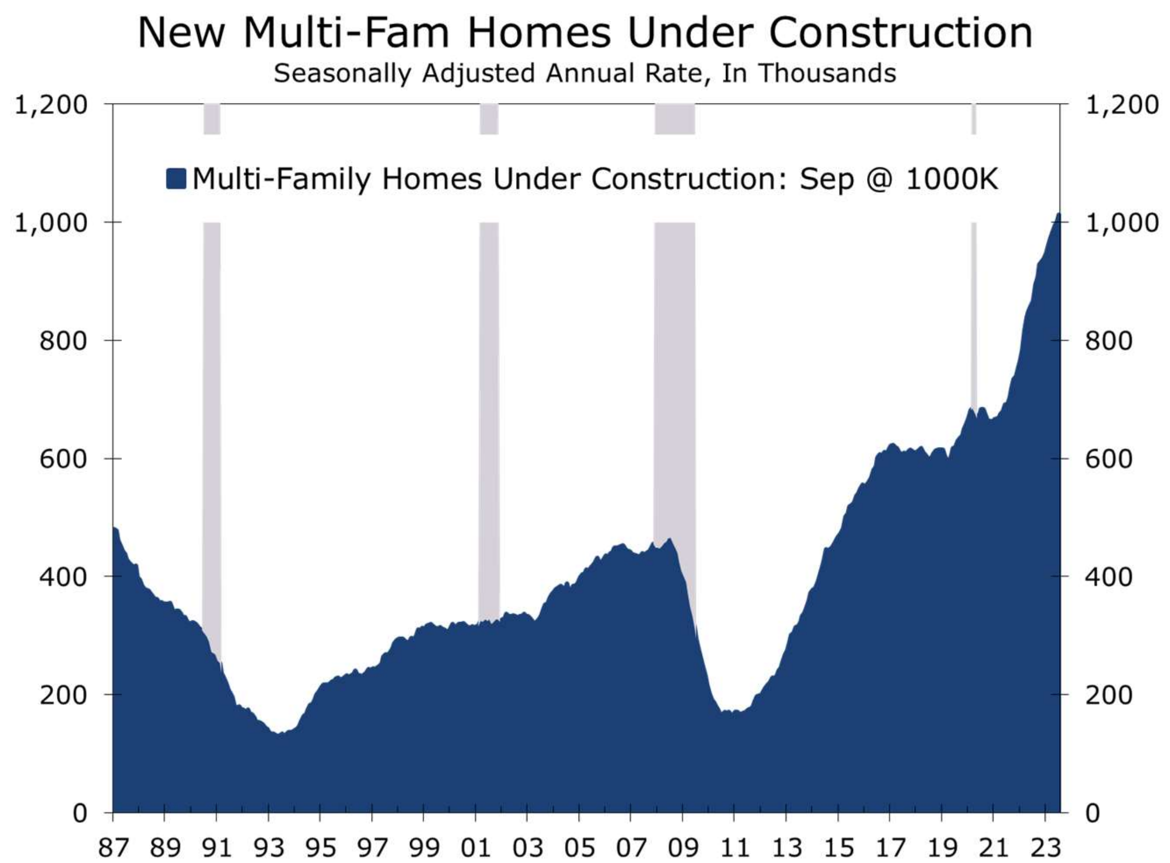
- The recent revival in new home sales appears to be driven by more affordable product being delivered in distant suburbs.
- Higher short-term rates are discouraging spec single-family development.
- Rising vacancy rates, an impending wave of completions and slower real income growth will slow multi-family starts.



Source: Census Bureau

The Are Close to 1 Million Apartments Under Construction

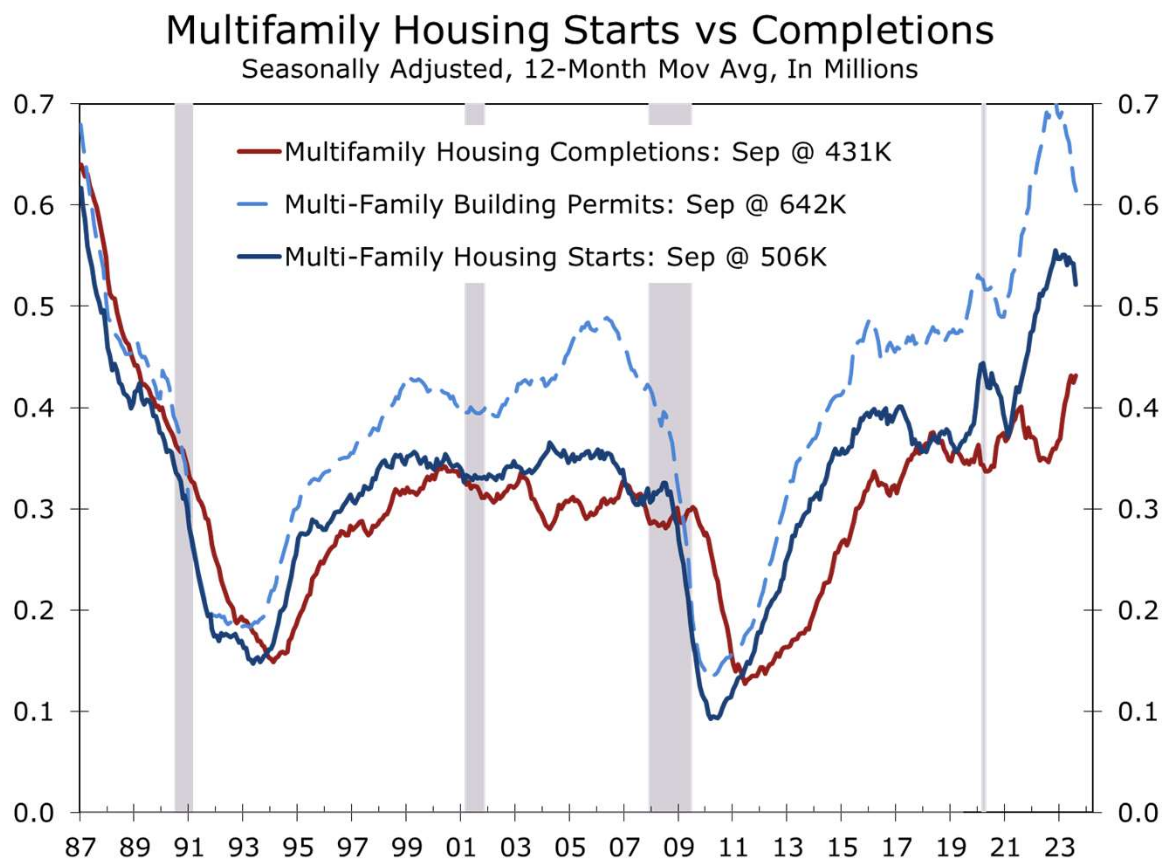
- The number of apartments under construction has continued to rise, as cycle-times remain unusually long.
- There has also been a rush to start new projects ahead of tightening credit.
- Despite the surge in construction, the overall housing supply remains relatively tight.



Source: Census Bureau

The Pipeline of New Apartments Has Begun to Turn

- Permits for new multi-family units have finally rolled over, as credit has tightened and concerns about overbuilding have increased.
- Starts have rolled over, but construction will remain strong for quite some time.
- Completions have trailed starts by an unusually large margin.

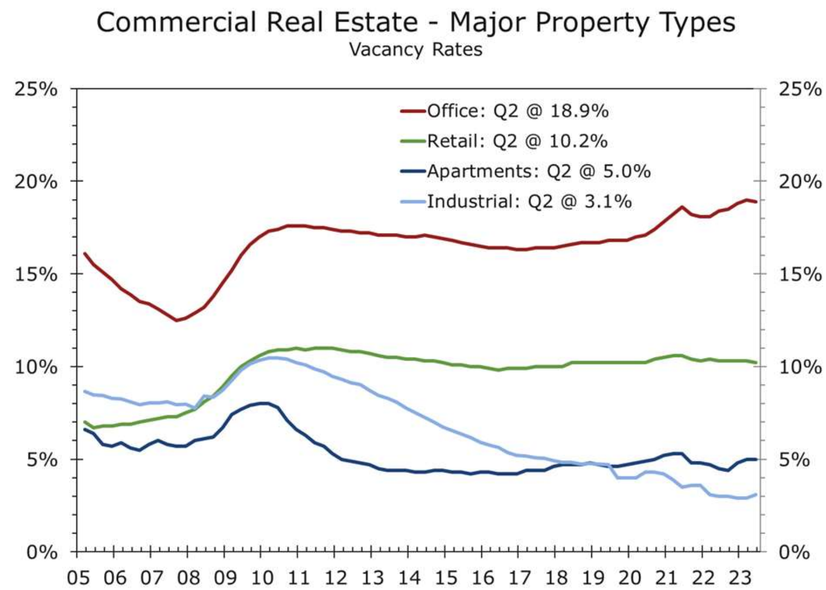


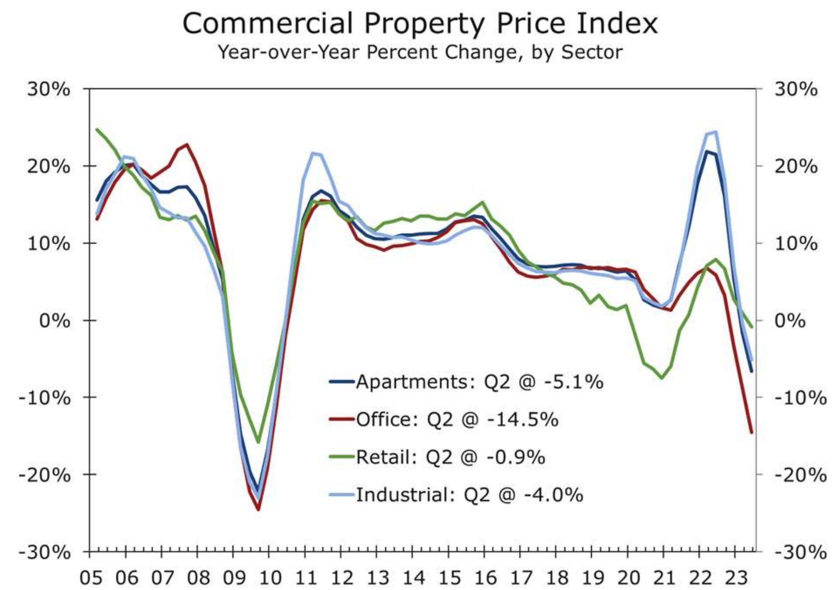
Source: Census Bureau

Commercial Real Estate Values Likely Peaked About a Year Ago

PIEDMONT CRESCENT CAPITAL

The commercial real estate market likely peaked about a year ago, but most product categories appear to be holding up relatively well. The office market is the notable exception. Vacancy rates have risen sharply in large urban markets, particularly in older class B and C buildings. Retail space has benefitted from the shift toward remote work and apartment and industrial vacancy rates remain historically low.

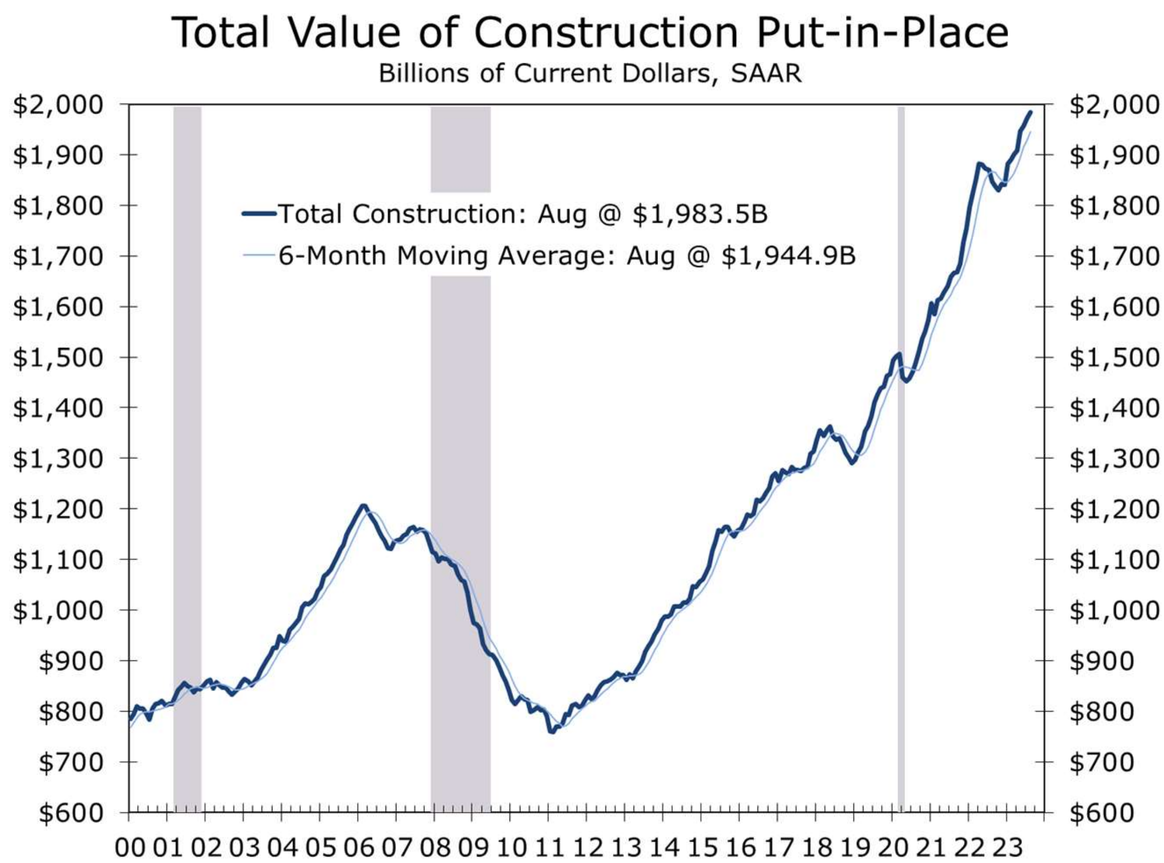




Source: Refinitiv, Moody's REIS, NCREIF, Piedmont Crescent Capital

Fiscal Stimulus Has Helped Drive Construction Higher This Past Year

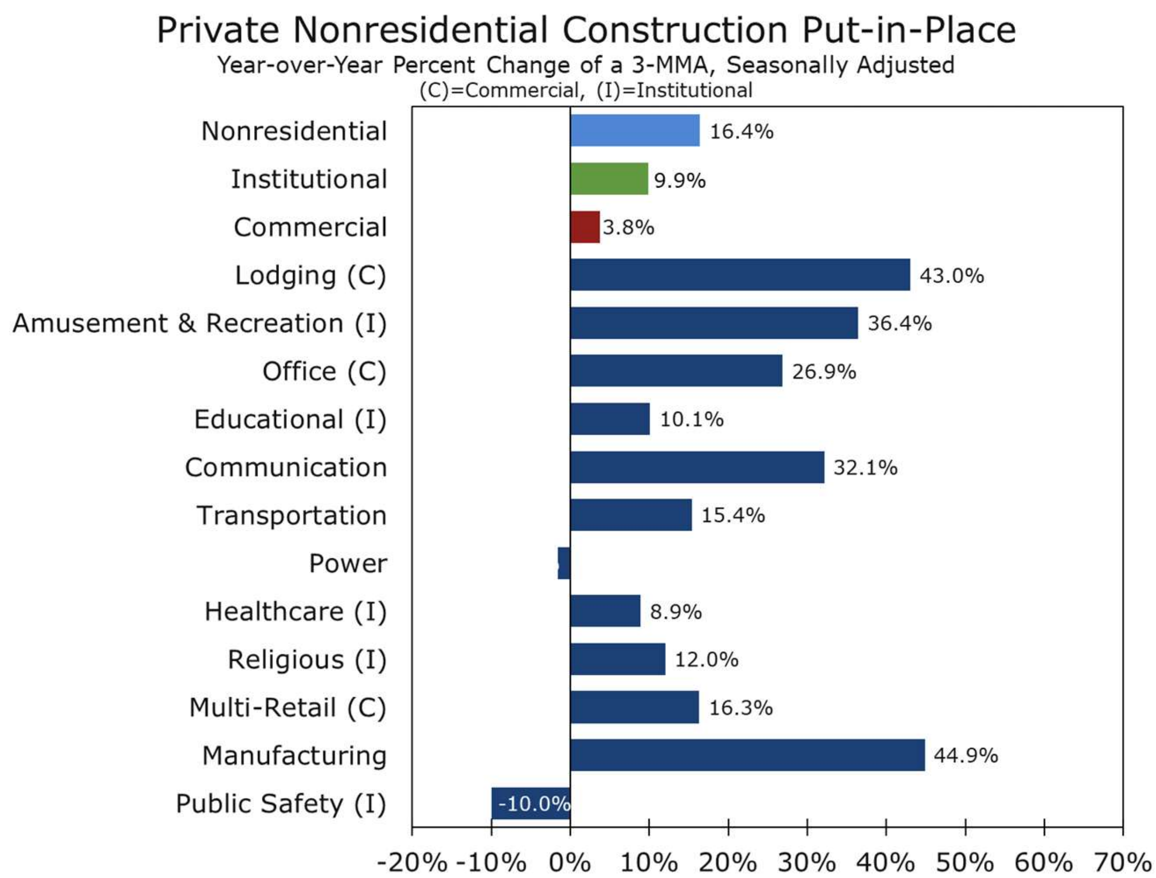
- Overall construction spending through August is up 4.2% from the prior year.
- Construction spending has been led by continued strength in private and public nonresidential.
- The Infrastructure, CHIPS and IRA programs have generated more activity than the GAO & CBO expected.



Source: Census Bureau

Manufacturing Projects Are Leading Private Construction

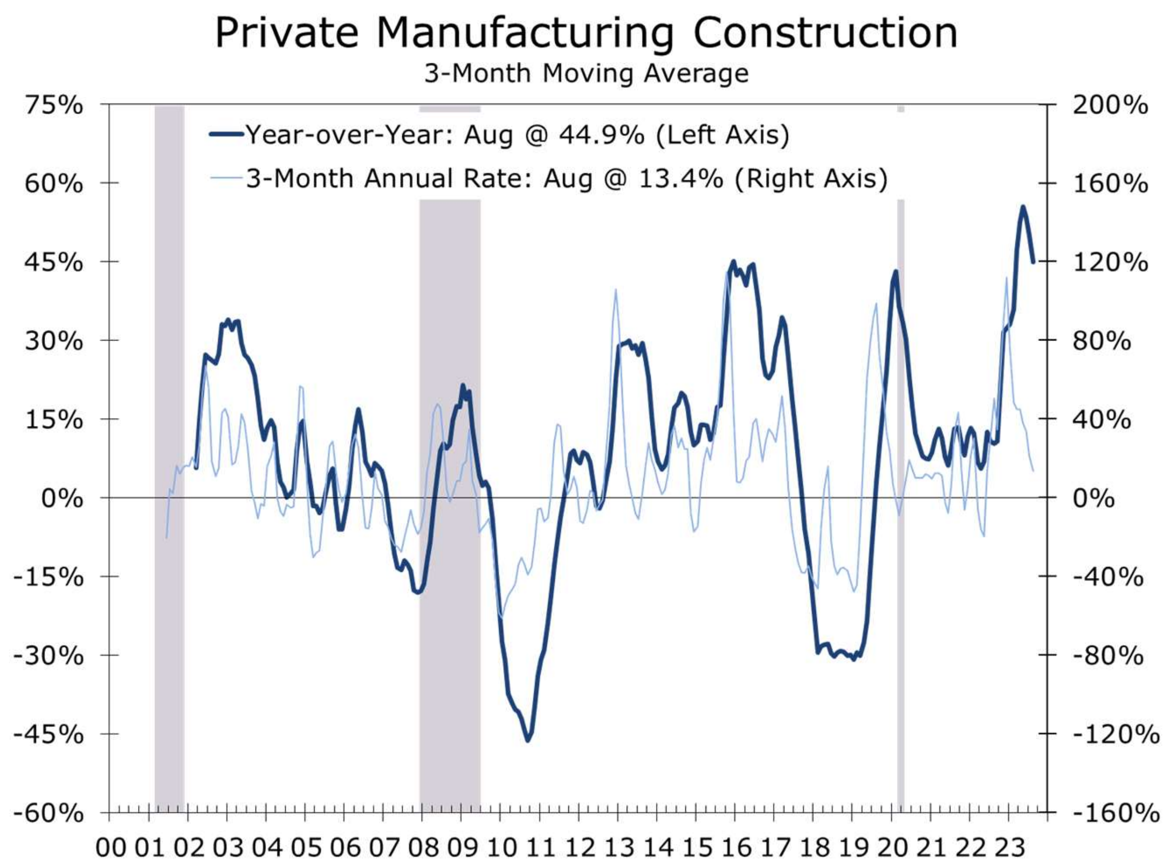
- The Inflation Reduction Act and CHIPS Act have set off a surge in manufacturing projects.
- Battery plants and EV projects have a strong incentive to get plants up and running as quickly as possible.
- Most of this investment is going to the South and Midwest.



Source: Census Bureau

Fiscal Initiatives and Reshoring Are Driving Manufacturing Projects

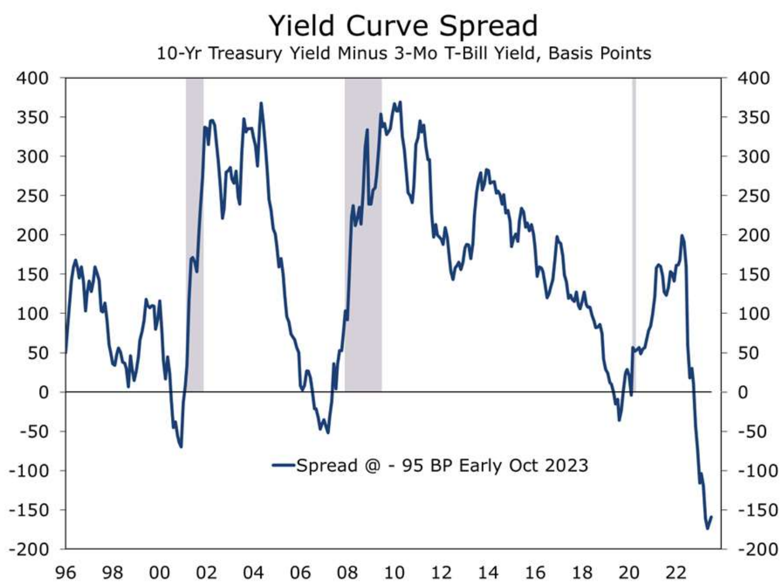
- The IRA and CHIPS Acts have proved much more popular with manufacturers, which has raised the cost of these programs and led to a surge in new construction.
- Spending for new manufacturing plants are up 71.5% YTD over the past year.
- Reshoring is also a factor in manufacturing across the country.

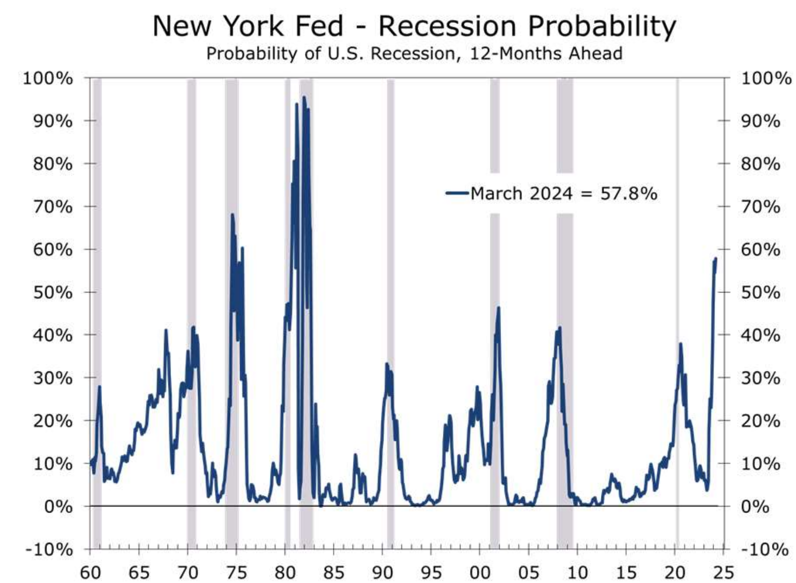


Source: Census Bureau

Skepticism About A Soft Landing

The yield curve has been inverted for the past year. The Fed has never achieved a soft landing when it has had to bring inflation down from its current height or push unemployment marginally higher from its current lows. The New York Fed Recession Probability Model has recently soared to its highest level since the early 1990s, reflecting the deeply inverted yield curve.



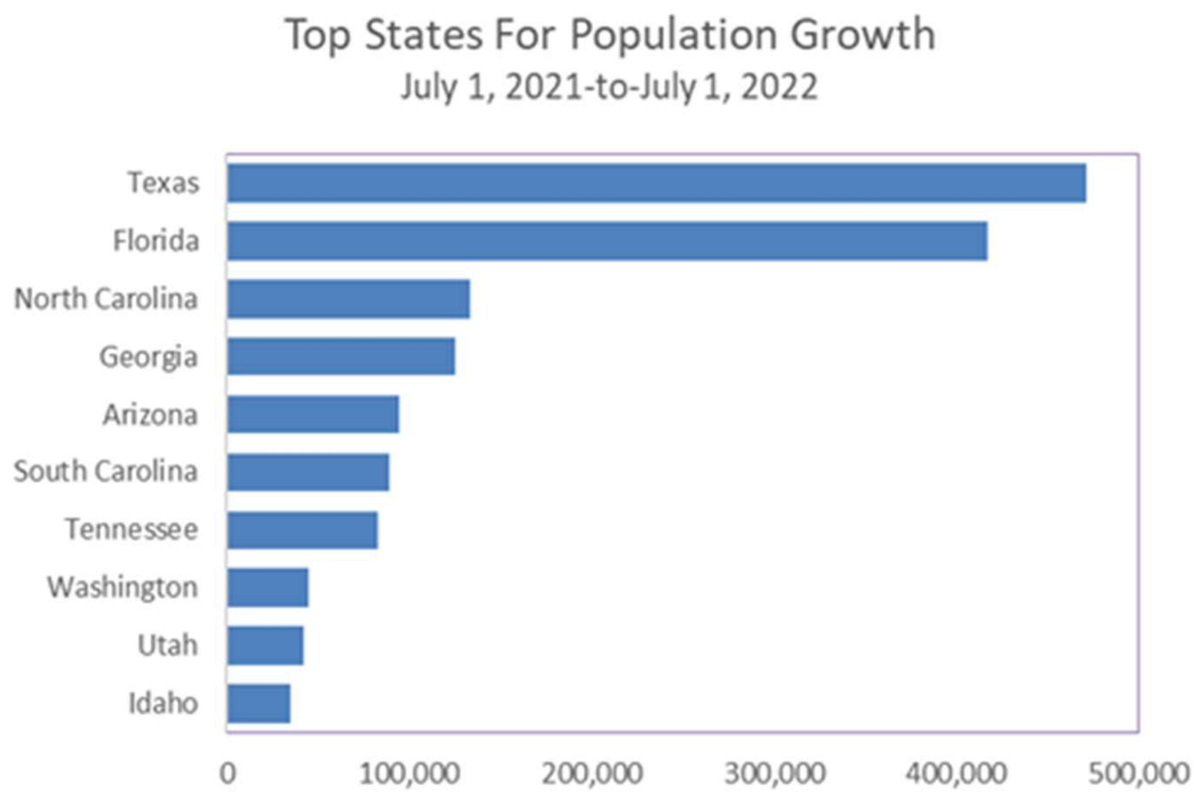


Source: Refinitiv, Federal Reserve Bank of New York

The South Dominates The List of Fastest Growing States

PIEDMONT CRESCENT CAPITAL

- Texas has become the nation's primary growth engine over the past decade. The Lone Star State has attracted scores of corporate headquarters and expansions in recent years, with most setting up shop in Dallas-Fort Worth, Houston, Austin and San Antonio.
- Florida led the nation in net domestic migration, followed by Texas, the Carolinas, and Tennessee

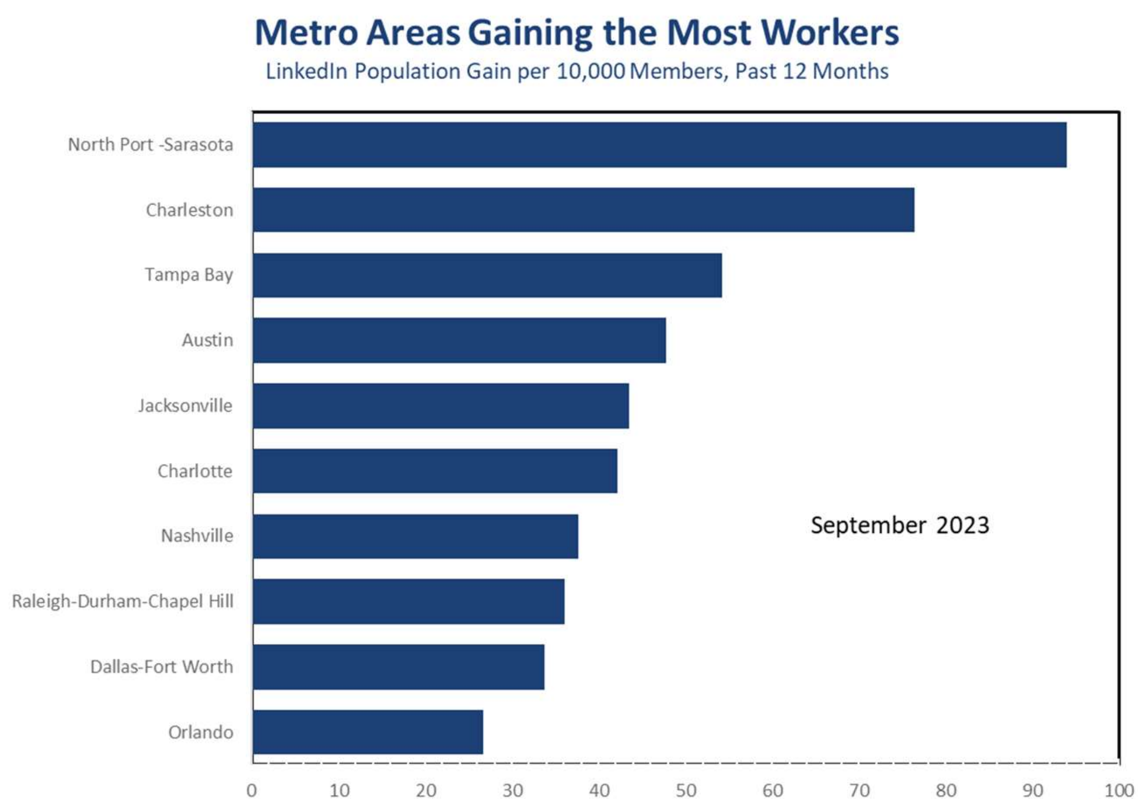


Source: Census Bureau

Workers Are Continuing to Migrate to the South

PIEDMONT CRESCENT CAPITAL

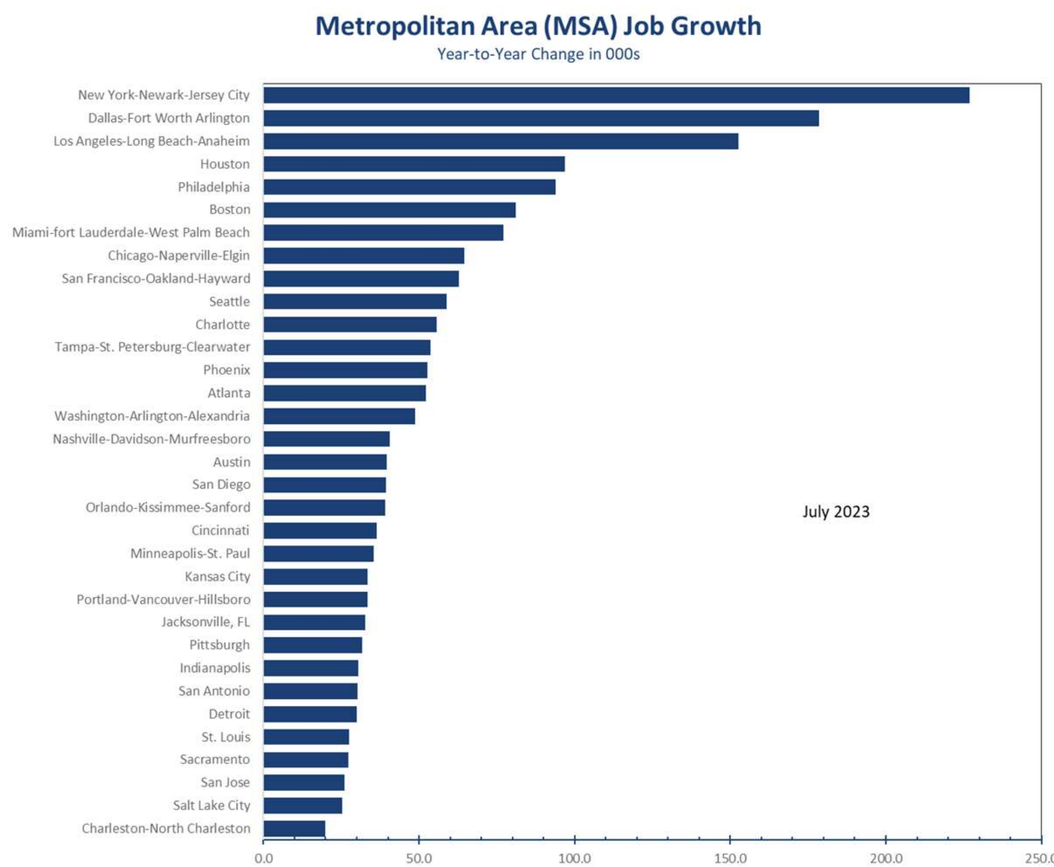
- Florida is home to 4 of the top 10 markets gaining the most workers, according to the latest LinkedIn Workforce Report.
- Three of the top four cities are in Southwest Florida.
- Workers are moving less than they have in recent years.
- Charlotte and Raleigh have maintained the 6th and 8th spots for quite some time.
- Austin and Nashville have fallen back from their long-held spots at the top of the list.



Source: LinkedIn

Large Markets Are Adding the Most Jobs

- Large markets are adding the most jobs, as workers are returning to the office and workplace.
- We continue to believe that work arrangements will be only slightly more flexible than they were pre-pandemic.
- California markets are adding jobs, with AI boosting job growth in the Bay Area.



Source: Census Bureau

Economic Outlook

PIEDMONT CRESCENT CAPITAL

US Economic and Financial Outlook

(% change on previous period, annualized, except where noted)

	2022		2023				2024				2021	2022	2023	2024	2025
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Actual	Actual	Forecast	Forecast	Forecast
Output															
Real GDP	2.7	2.6	2.2	2.1	4.9	1.8	(1.8)	(0.6)	1.3	2.1	5.7	2.1	2.4	1.1	2.2
Consumer Spending	1.6	1.2	3.8	0.8	4.0	1.7	1.0	0.8	1.0	1.1	7.9	2.8	1.8	1.7	2.0
Nonresidential Fixed Investment	4.7	1.7	5.7	7.4	(0.1)	(1.5)	(3.0)	(1.2)	1.3	2.4	7.4	3.8	4.9	(0.3)	2.7
Light Vehicle Sales	13.6	14.2	15.0	15.7	15.7	14.9	14.8	14.6	14.7	15.1	15.0	13.9	15.3	15.0	15.3
Industrial Production, Manufacturing	0.4	-3.6	-0.4	1.0	(0.1)	1.5	-1.8	-0.4	2.3	2.6	5.0	4.3	(0.6)	0.2	2.6
Unemployment Rate (Qtrly Avg)	3.6	3.6	3.5	3.6	3.7	3.8	4.0	4.1	4.3	4.3	3.9	3.7	3.7	4.2	4.3
Housing Market															
Housing Starts (Units, thous)	1,446	1,405	1,385	1,450	1,359	1,310	1,250	1,200	1,210	1,250	1,601	1,554	1,390	1,270	1,460
New Home Sales	583	598	638	691	724	670	650	640	650	660	771	637	681	650	690
Existing Home Sales	4,770	4,197	4,327	4,250	4,023	3,840	3,710	3,740	3,810	3,950	6,120	5,030	4,150	3,803	4,200
S&P/Case-Shiller Natl Home Prices (Yr/Yr % Change)	13.1	7.5	2.2	(0.1)	0.5	2.4	2.6	2.0	1.2	0.5	18.5	14.8	1.2	1.9	3.2
Inflation (Year-to-Year % Change)															
Consumer Price Index (CPI)	8.3	7.1	5.8	4.1	3.6	3.4	3.2	3.2	3.0	3.0	7.1	6.7	4.2	3.1	2.7
Core CPI	6.3	6.0	5.6	5.2	4.4	3.9	3.7	3.4	3.3	3.2	5.5	6.1	4.8	3.4	2.9
Personal Consumption Deflator	6.6	5.9	5.0	3.9	3.4	3.2	3.0	3.0	3.0	3.0	5.8	5.8	3.9	3.0	2.6
Core PCE Deflator	5.2	5.1	4.8	4.6	3.9	3.5	3.2	3.1	3.0	2.9	4.9	4.7	4.2	3.1	2.7
Employment Cost Index	5.1	5.1	4.9	4.5	4.8	4.7	4.7	4.5	4.4	4.3	3.3	4.9	4.7	4.5	4.1
Interest Rates (Quarter End and Ann Avg)															
Fed Funds Target Range	3-3.25	4.25-4.50	4.75-5.00	5-5.25	5.25-5.50	5.25-5.50	5.25-5.50	5-5.25	4.75-5	4.5-4.75	0-0.25	2.75	5.19	5.03	3.88
10-Year Treasury Note	3.83	3.88	3.48	3.84	4.59	4.85	5.20	5.10	5.00	4.90	1.45	2.95	4.19	5.05	4.80
Conventional Mortgage Rate (Freddie Mac)	6.70	6.42	6.32	6.71	7.31	8.00	8.15	8.00	7.70	7.50	2.95	5.34	7.09	7.84	7.20

Piedmont Crescent Capital - Updated October 27, 2023

Disclaimer

PIEDMONT CRESCENT CAPITAL

This publication has been prepared for informational purposes only and is not intended as a recommendation offer or solicitation with respect to the purchase or sale of any security or other financial product nor does it constitute investment advice.