The Economic Outlook:
Can The Fed Still Engineer a 'Softish' Landing?

2023 ECONOMIC OUTLOOK

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Higher Inflation Snuffs Out Economic Growth

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After Peaking, Inflation is Proving 'Sticky'

Inflation appears to have peaked around the middle of last year. Most of the improvement has come from lower energy prices and lower prices for used cars, which have now largely been played out. Inflation is proving sticky in most other areas, with services prices presenting the greatest long-term challenge. We expect inflation to improve only modestly through the rest of this year and remain well above the Fed's 2% target.

Policy Rates Are Still Headed Higher

Businesses are replacing supply chains with supply webs, which add costs and complexity to the production and distribution process. Trading efficiency for resiliency will add to long-term inflation challenges. Persistently higher inflation will force discipline upon the Fed, which would like to permanently move rates away from the zero bound. Banking system challenges may keep them on hold this summer.

Recession, Soft Landing or Something Else

Economic growth has proven more resilient in the US, most notably with labor market conditions. A recession still seems more likely than not in the second half of 2023. If the US skirts a recession, the most likely alternative would be a continuation of the rolling recessions of the past 18 months. The downturn that started in the tech sector, has spread to housing and commercial real estate and more recently to financial services and small business.

Real Estate & Credit Availability

Home prices fell on a year-to-year basis in February, marking the first such drop since 2012. We are unlikely to see a repeat of the issues that led to the Global Financial Crisis. Unusually low inventories of existing homes are helping support prices and are also driving demand for new homes. The commercial real estate market is coming under increased scrutiny in the wake of the banking crisis. So far, credit conditions have tightened only modestly.

Inventory Drawdowns Help Back Q1 Growth

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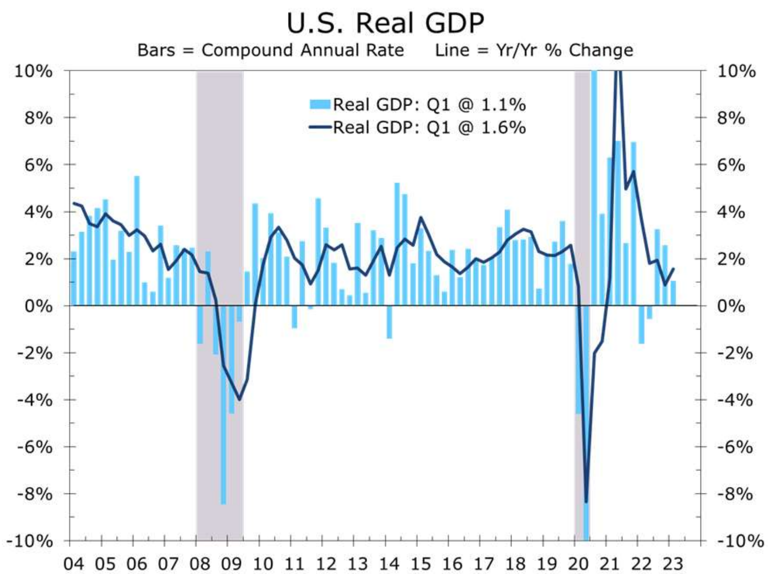
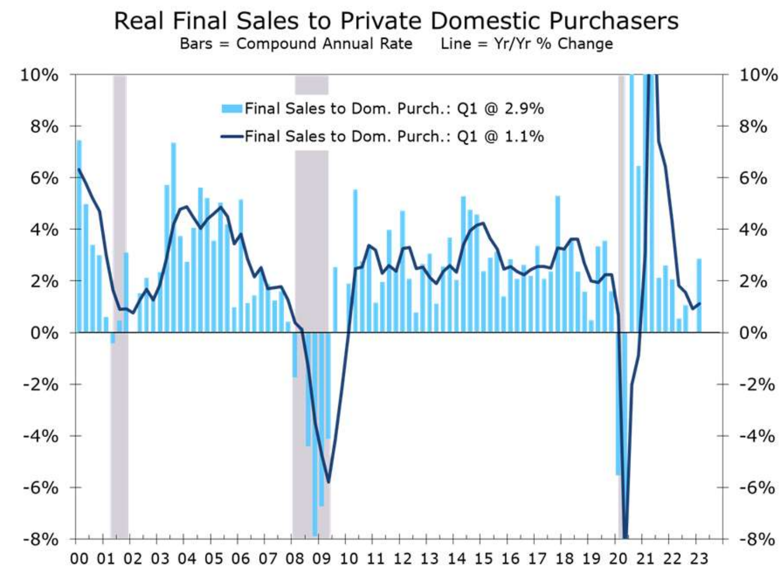
CONSUMER SPENDING HELPED DRIVE ECONOMIC GROWTH DURING Q1



FINAL DEMAND DOMESTIC DEMAND CONTINUES TO BENEFIT FROM EXPANSION FISCAL POLICY



The Labor Market is Proving Remarkably Resilient

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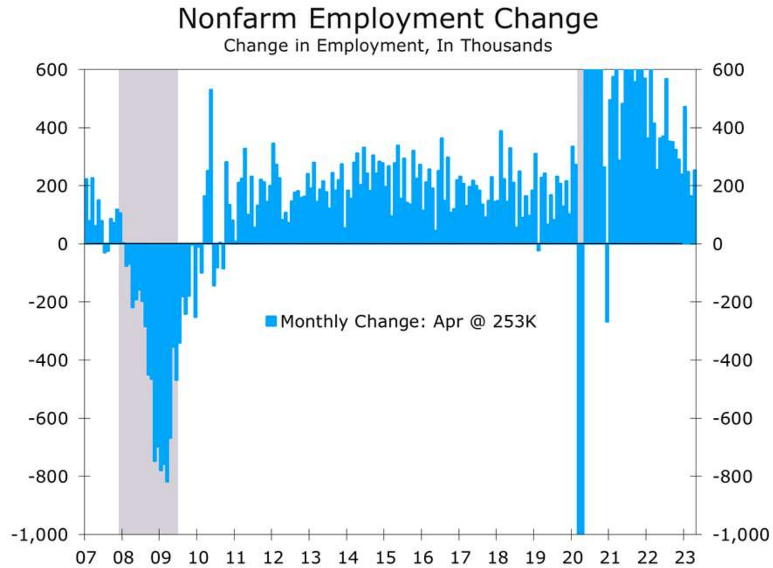
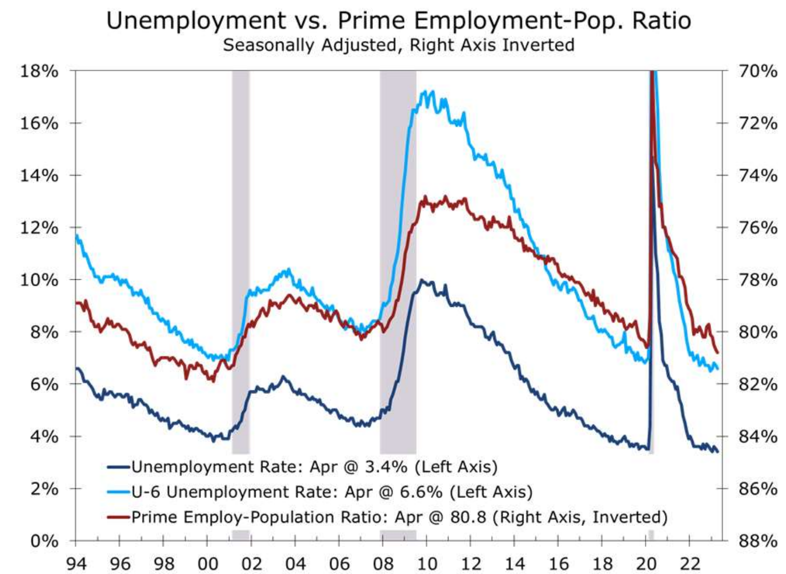
JOB GROWTH IS BEING BOLSTERED BY A REBOUND IN HIRING IN INDUSTRIES HARDEST BY THE PANDEMIC LOCKDOWNS, MOST NOTABLY RESTAURANTS & BARS



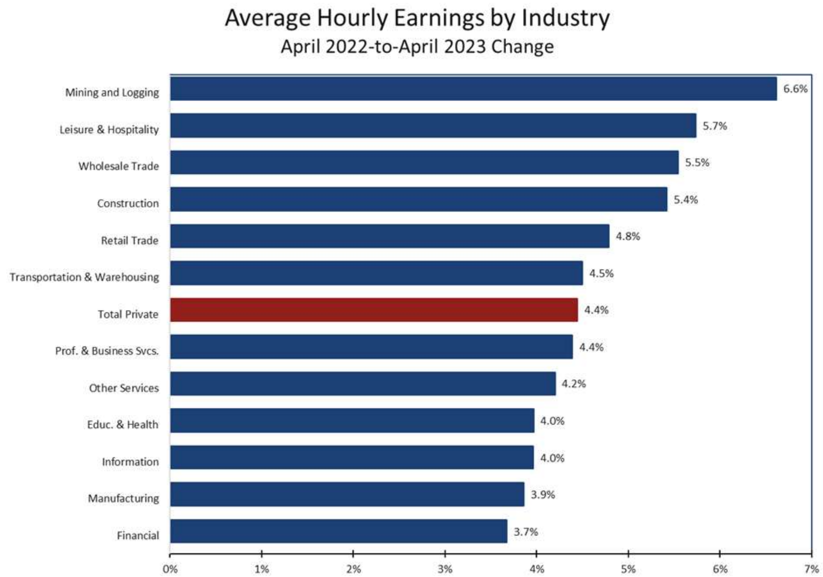
THE LABOR MARKET IS EXCEPTIONALLY TIGHT, WHICH IS KEEPING PRESSURE ON WAGES

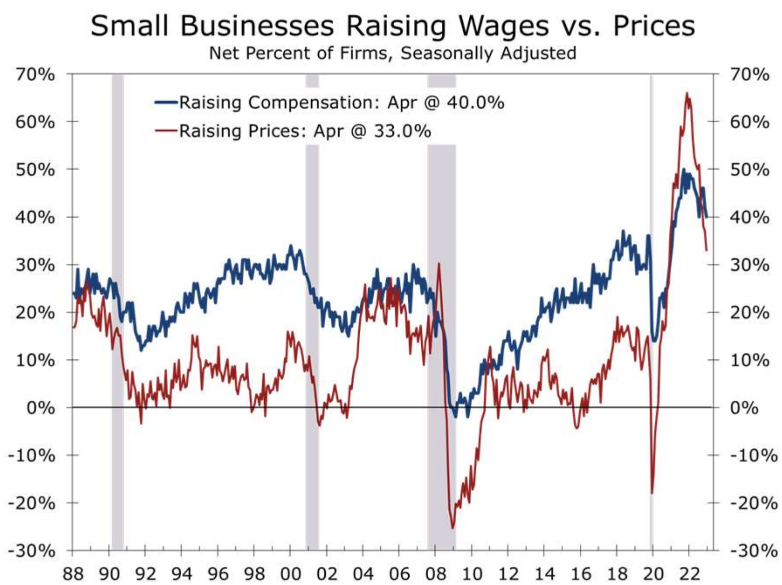


Source: Bureau of Labor Statistics

Rising Wages Will Continue to Drive Inflation

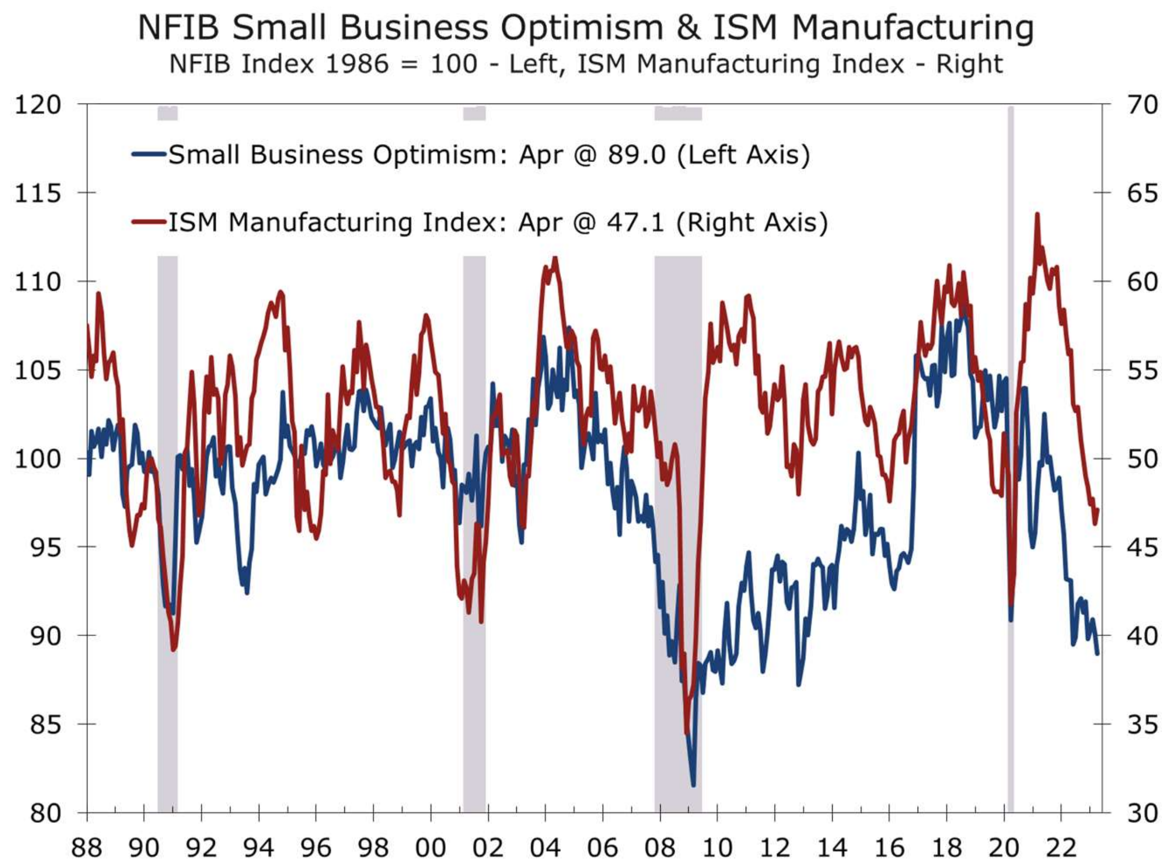
Wages are rising faster than they did in the prior cycle in all industries. Firms are raising prices to offset the hit to margins, which raises the prospect of a self-reinforcing wage-price spiral. Wage pressures have eased somewhat in recent months, as many firms are now trimming staff. Leisure and hospitality continues to see particularly large gains, as restaurants and bars remain short staffed.





Slower Growth is Squeezing Profit Margins

- Small business optimism has fallen further than the ISM index, reflecting the more limited opportunities smaller firms have to offset higher costs.
- The ISM Manufacturing Index has remained below the key 50 break-even level for the past six months.
- Prices paid for raw materials ticked higher in April.



Source: National Federation of Independent Business and Institute for Supply Management

What Would A Recession Look Like

This year has gotten off to a solid start, which pushes the prospect of a recession a little further out.

We still expect a recession to begin by the middle of this year, and expect the downturn to be average in terms of depth and length.

Recessions: The Recent Record

Business Cycle Peak	Business Cycle Trough	Duration in Months	Real GDP	Industrial Production	Nonfarm Employment	Manufacturing Employment	Real After-tax Income	Civilian Unemployment Rate Cycle Low	Cycle Peak	Change
Nov-48	Oct-49	11	-1.7%	-10.1%	-5.2%	-10.8%	N/A	3.4	7.9	4.5
Jul-53	May-54	10	-2.5%	-9.5%	-3.4%	-9.7%	N/A	2.5	6.1	3.6
Aug-57	Apr-58	8	-3.6%	-13.6%	-4.4%	-9.9%	N/A	3.7	7.5	3.8
Apr-60	Feb-61	10	-1.3%	-8.6%	-2.3%	-6.1%	-0.9%	4.8	7.1	2.3
Dec-69	Nov-70	11	-0.7%	-7.0%	-1.5%	-8.7%	-0.9%	3.4	6.1	2.7
Nov-73	Mar-75	16	-3.1%	-13.1%	-2.7%	-11.4%	-5.1%	4.6	9	4.4
Jan-80	Jul-80	6	-2.2%	-6.7%	-1.3%	-6.5%	-1.6%	5.6	7.8	2.2
Jul-81	Nov-82	16	-2.2%	-8.6%	-3.1%	-11.2%	-0.8%	7.2	10.8	3.6
Jul-90	Mar-91	8	-1.4%	-4.1%	-1.5%	-7.2%	-2.5%	5.2	7.8	2.6
Mar-01	Nov-01	8	-0.4%	-5.0%	-2.0%	-17.6%	-1.9%	3.8	6.3	2.5
Dec-07	Jun-09	18	-4.0%	-17.2%	-6.3%	-19.5%	-7.3%	4.4	10	5.6
Feb-20	Apr-20	2	-9.6%	-18.4%	-14.4%	-10.7%	-8.2%	3.5	14.7	11.2
Overall Average		10.3	-2.7%	-10.2%	-4.0%	-10.8%	-3.2%	4.3	8.4	4.1
Average Ex Pandemic		11.1	-2.1%	-9.4%	-3.0%	-10.8%	-2.6%	4.4	7.9	3.4

Source: NBER, BEA, Federal Reserve, BLS & Piedmont Crescent Capital

Source: Piedmont Crescent Capital

Inflation Has Rolled Over But Remains Persistent and High

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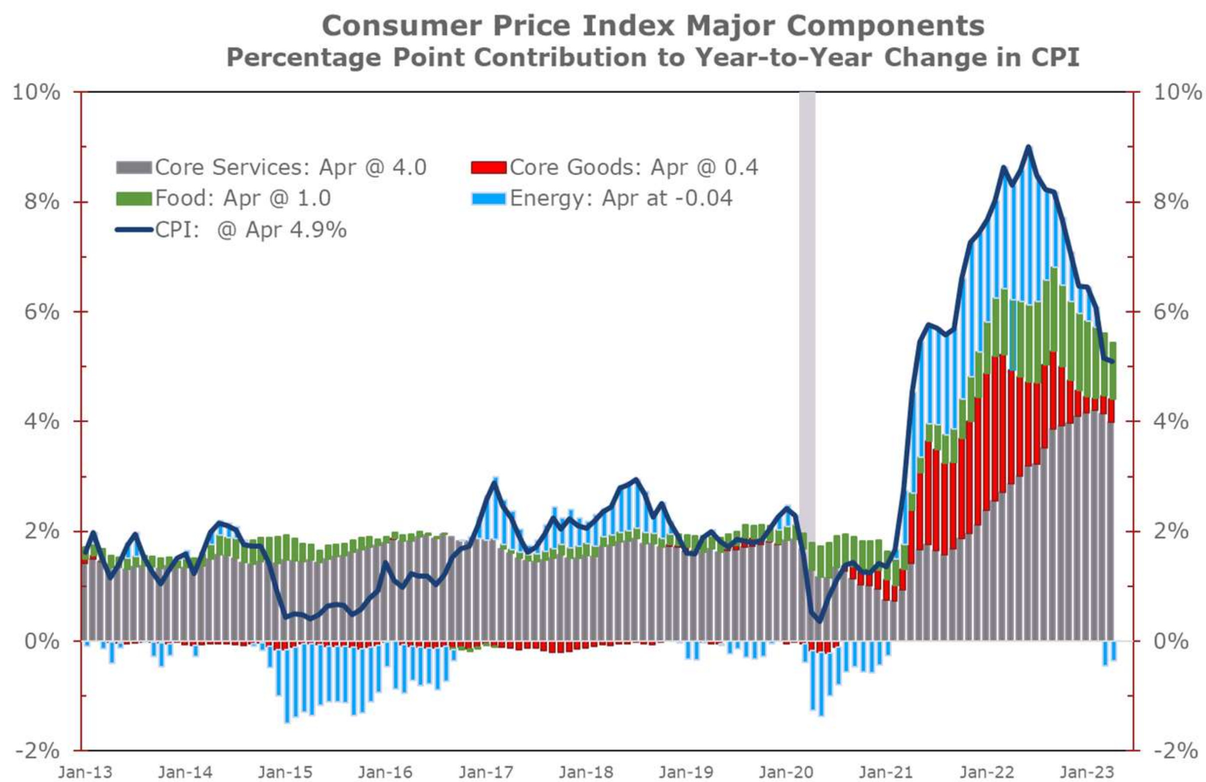
- The headline inflation numbers have moderated slightly since the middle of last year, as gasoline prices and used car prices plummeted.
- Core inflation remains problematic, however, particularly in the service sector. The BLS measure of rents is still catching up with larger earlier increases in market rents.



Source: Bureau of Labor Statistics

Higher Inflation Continues to Weigh on Consumer Sentiment

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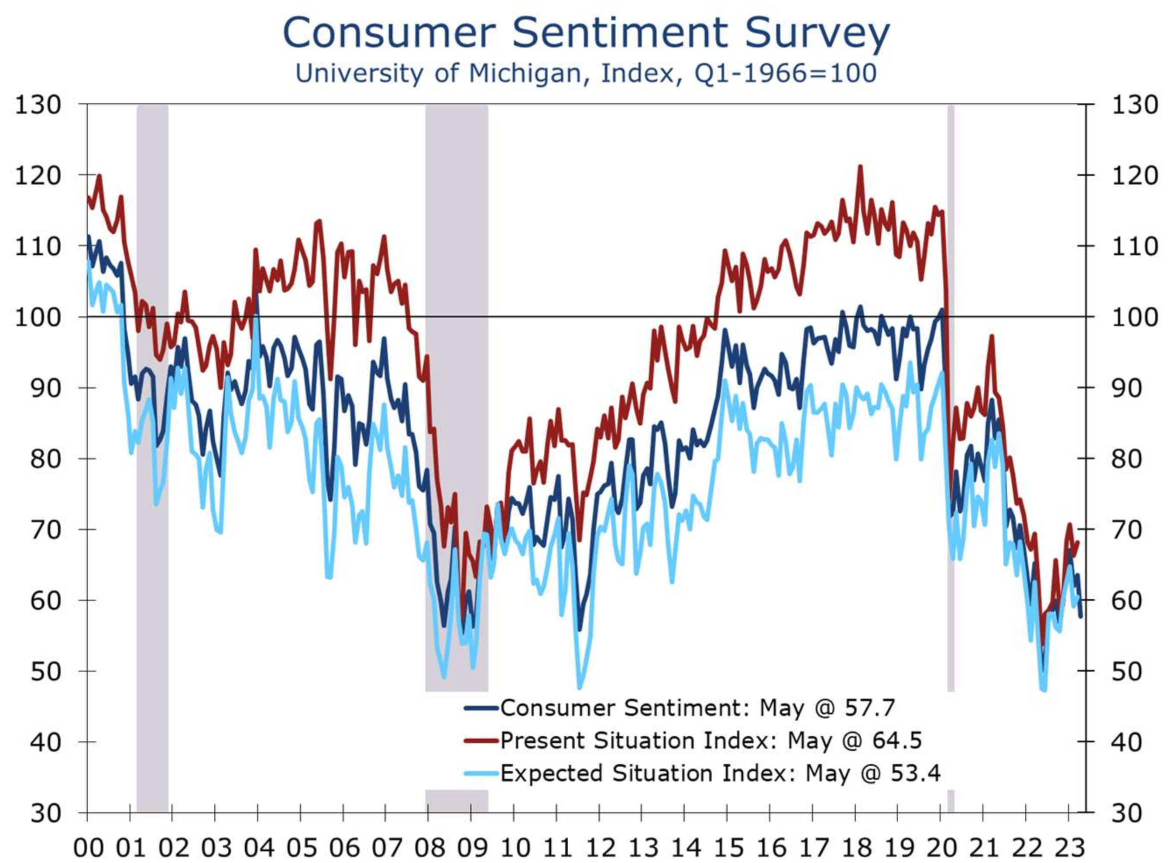
- Consumer sentiment has rebounded during the first quarter, likely reflecting larger transfer payments.
- Consumers remain concerned about inflation, with 1-year ahead inflation expectations closely tracking the core PCE deflator.
- Housing costs remain the primary driver of core inflation, with renewal rents taking a larger bite out of household budgets.



Source: University of Michigan

Services Outlays Continue to Outpace Goods Spending

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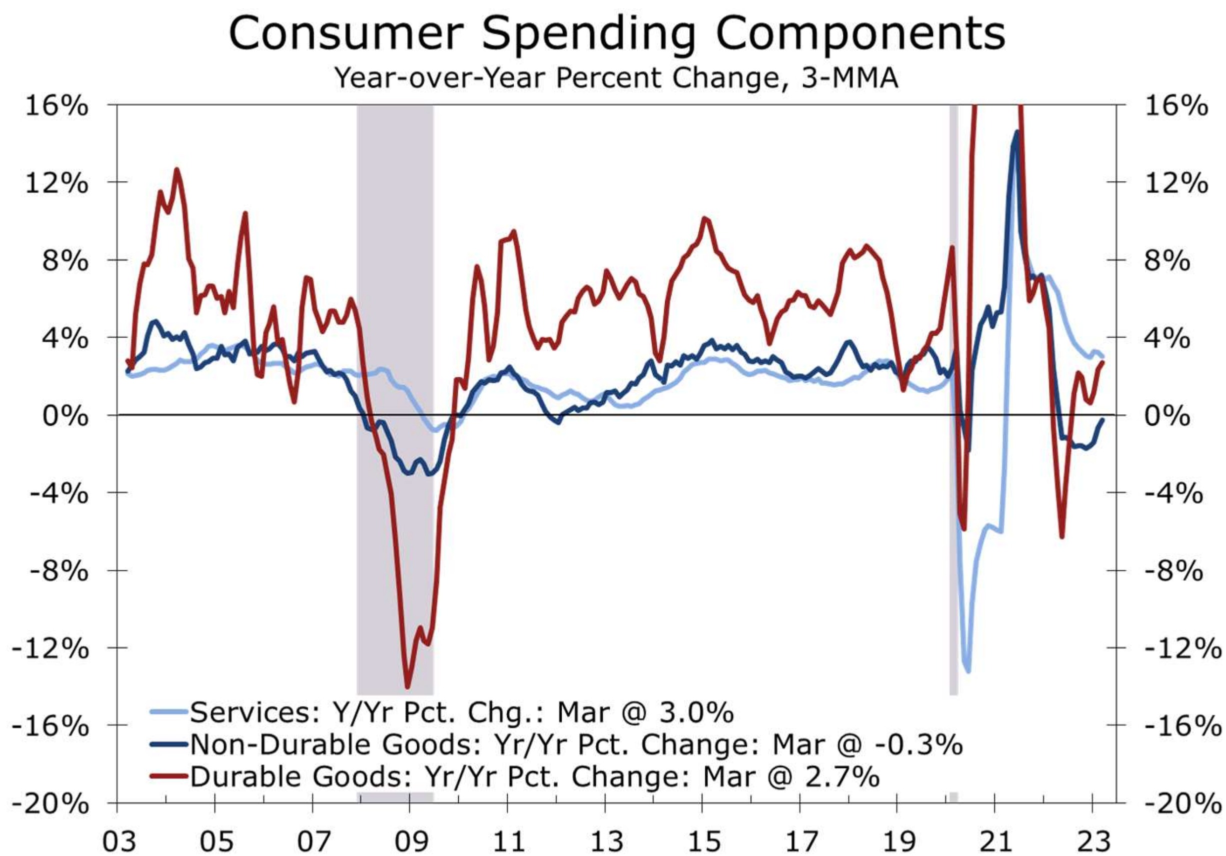
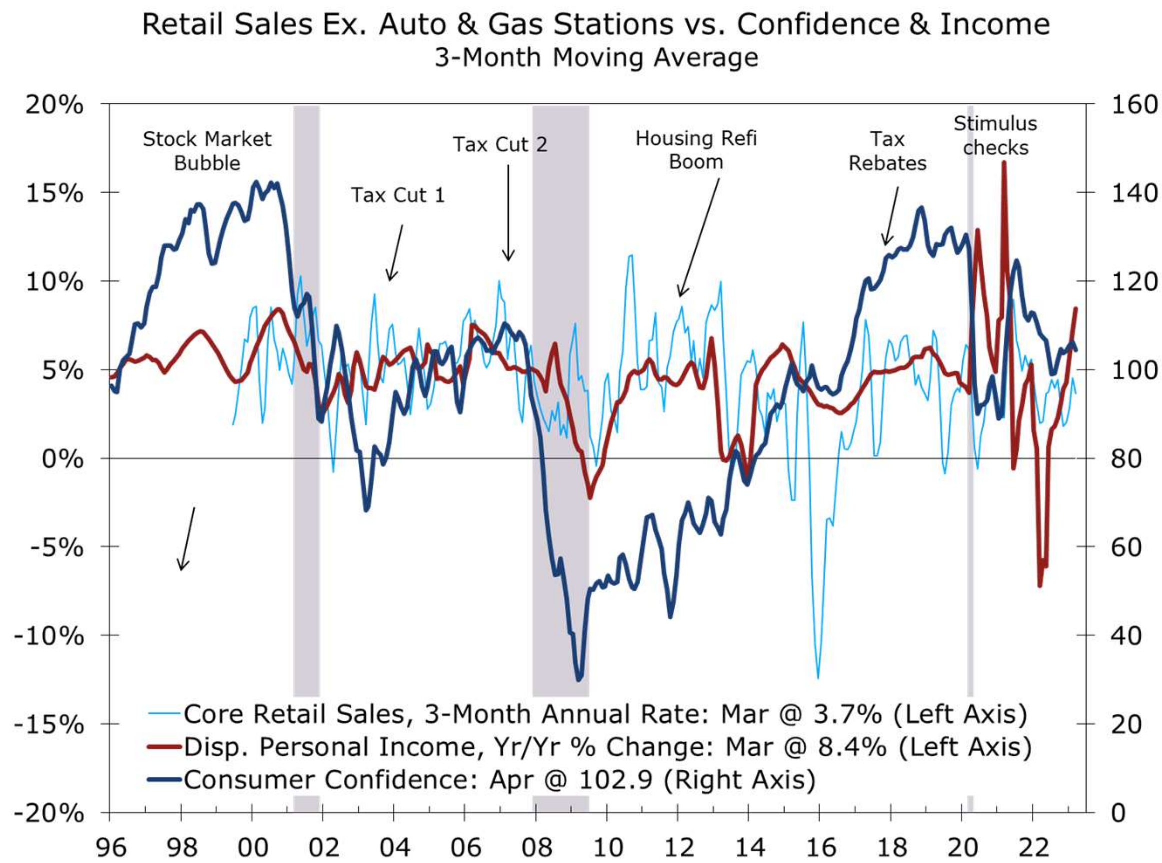
- Disposable income surged at the start of 2023, helped along by large increases in Social Security COLAs and wage gains.
- The boost in income has helped sustain spending on services, with dining out, entertainment and travel seeing the largest gains.
- Spending for goods continues to normalize following the post-pandemic surge.



Source: Bureau of Economic Analysis

Retail Sales Showed Surprising Strength in January

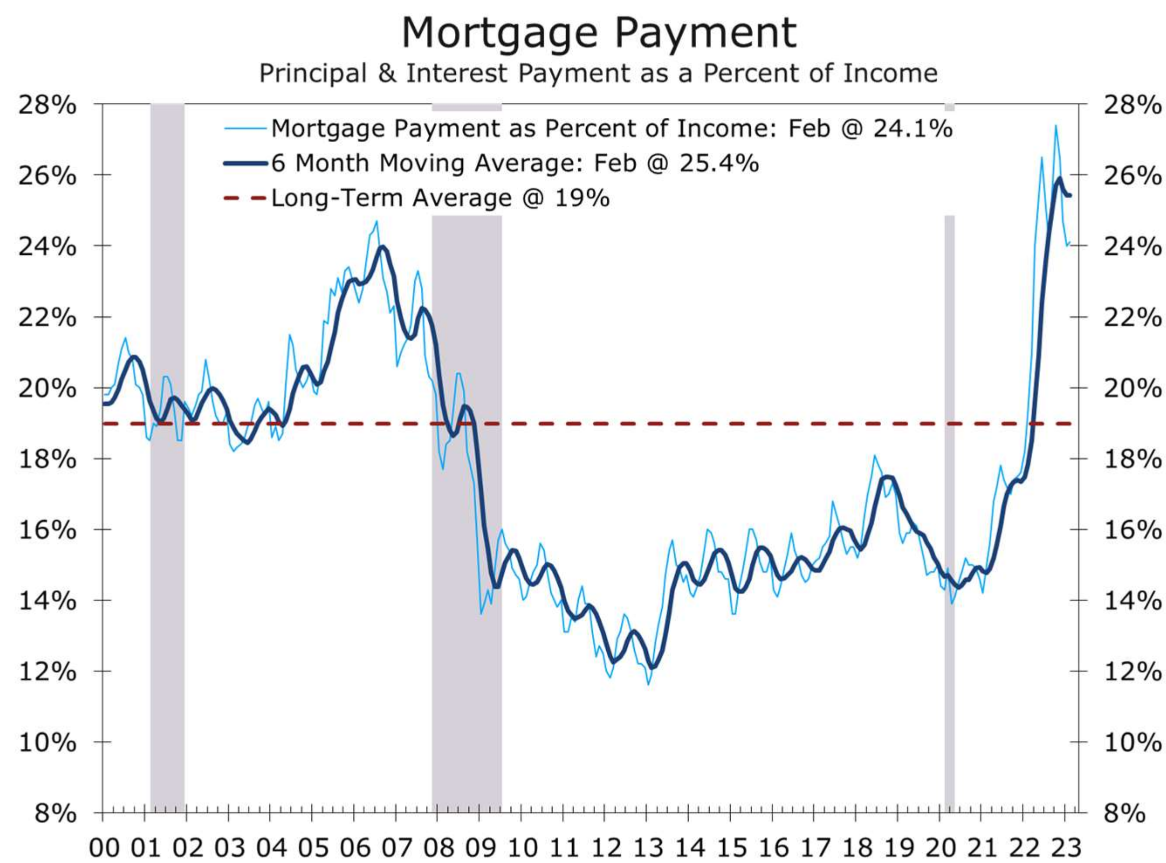
- Retail sales began the year incredibly strong, with retail sales surging 3% in January and remained strong the following month.
- Sales benefitted from stronger job and income growth, as well as unseasonably mild weather.
- Much of the strength in disposable income is accruing to older and wealthier households, however, which is bolstering travel and leisure outlays more than outlays on goods.
- Spending ended the quarter on a weak note



Source: Census Bureau, Bureau of Economic Analysis and Conference Board

Affordability Deteriorated Quickly Following the Pandemic

- Housing affordability has begun to recover. Principal and interest payments have fallen back to 24.1% of median family income. The norm is around 19%.
- At $1,827/Month, principal and interest payments now account for about the same share of family income that they did at the peak of the housing bubble.



Source: National Association of Realtors

Home Sales Have Tumbled As Interest Rates Spiked

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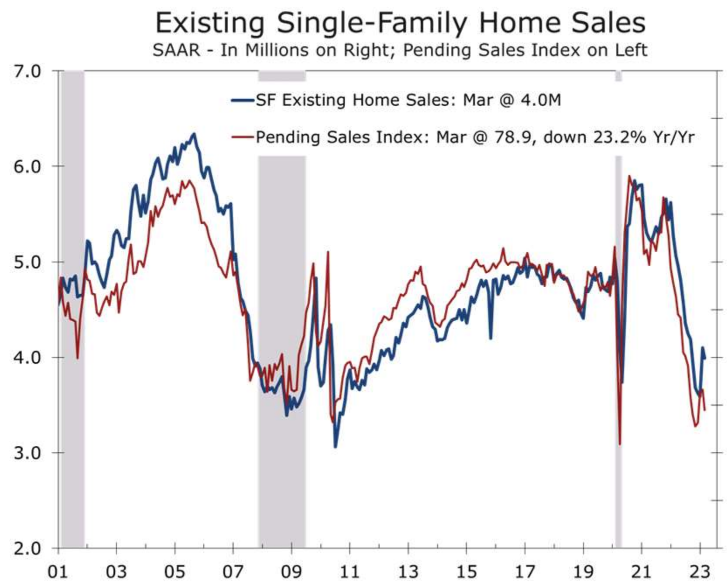
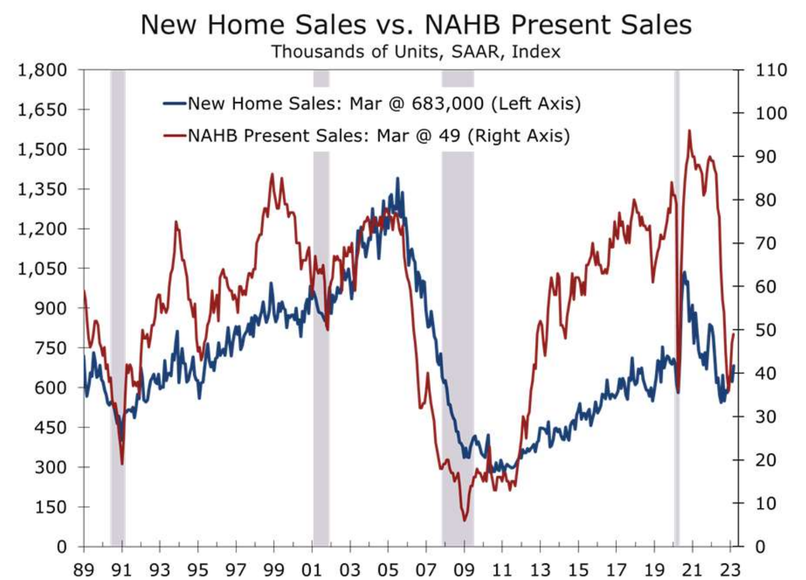
Sales of existing homes fell for 12 consecutive months, falling a cumulative 36.1%, before turning up in February. The drop was the longest consecutive decline on record. Higher mortgage rates led to a spike in contract cancelations last fall and some buyers returned when rates fell in January. Following the collapse of SVB, mortgage rates have likely seen the peak for the cycle but will remain volatile.





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

New Home Sales Have Fallen Below Their Pandemic Lows

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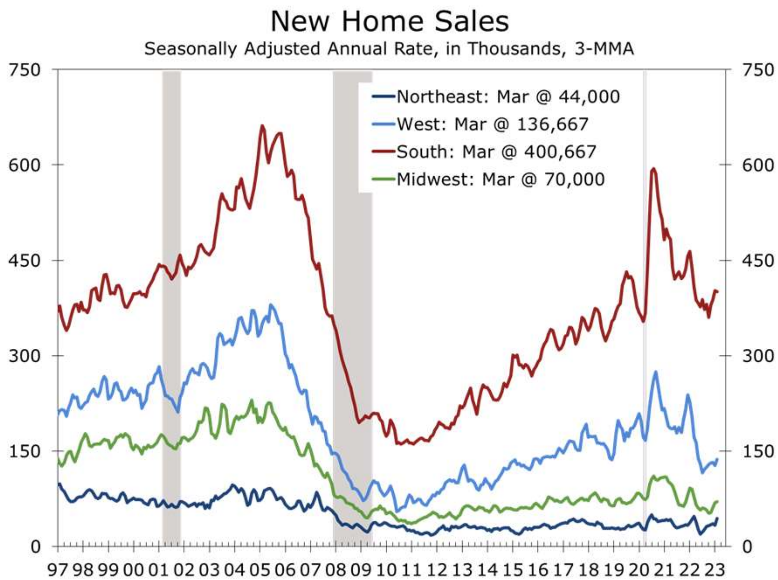
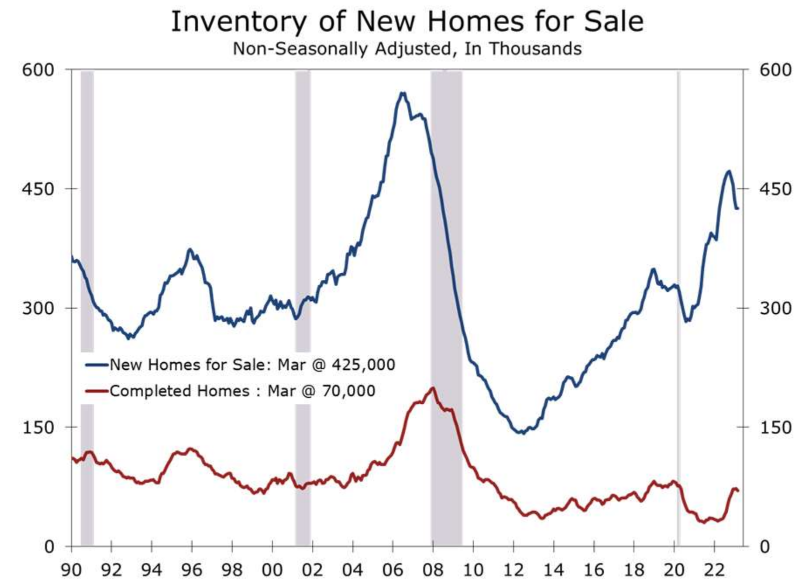
New home sales have fallen back below their pandemic lows in every region except the South. The greater availability and relative affordability of lots has made the South a destination for younger workers and families seeking more affordable housing. Builders are making progress reducing inventory.

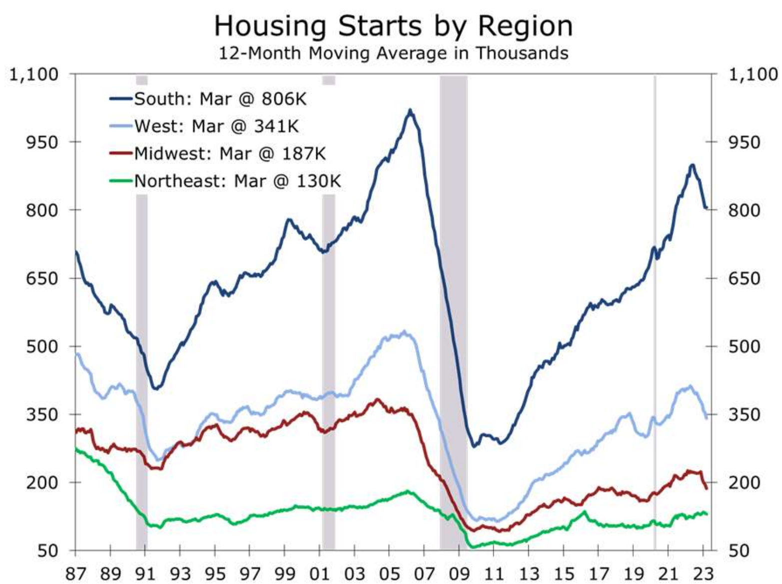


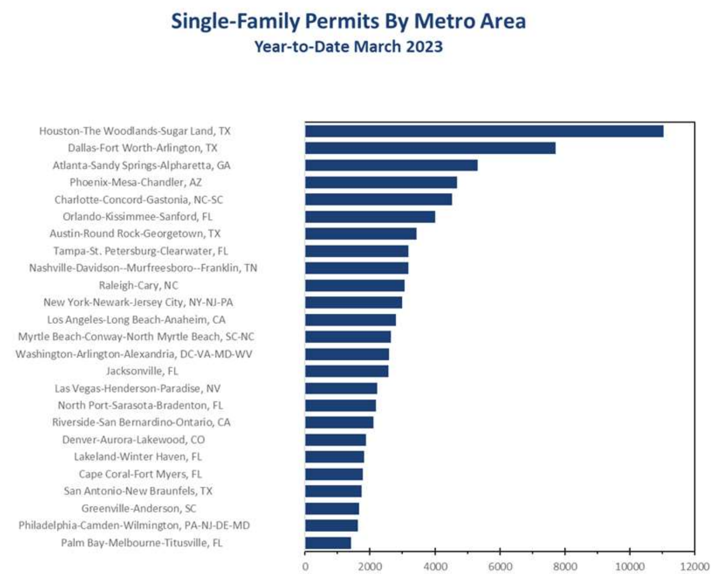


Source: Census Bureau

The South Is Home to More than Half the Nation's Housing Starts

The South continues to see a large influx of new residents from higher-cost parts of the country. The affordability migration is most evident in Texas, Florida, Georgia and the Carolinas. The region's large MSAs account for the bulk of gains but many smaller metro areas are also seeing significant gains.

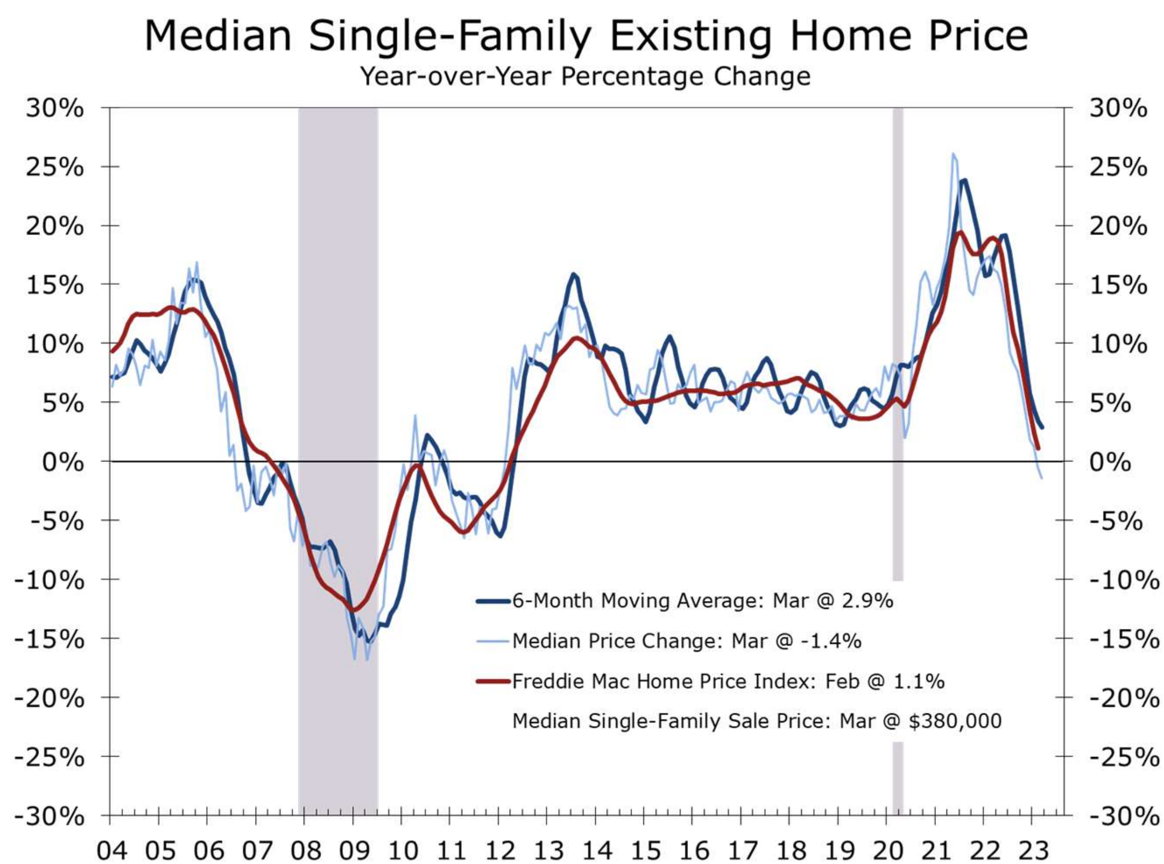




Source: Census Bureau

Home Prices Will Likely Fall 15% From Their Recent Peak

- Home prices have been declining since the middle of last year but have shown some resiliency more recently.
- A repeat of the Housing Bust is unlikely, as credit underwriting has been tight throughout the cycle and most loans are fixed-rate and locked in at low interest rates.
- Home prices will need to fall back in line with household income.



Source: National Association of Realtors, Federal Housing Finance Agency

Home Prices Appear to Have Peaked Around Mid-2022

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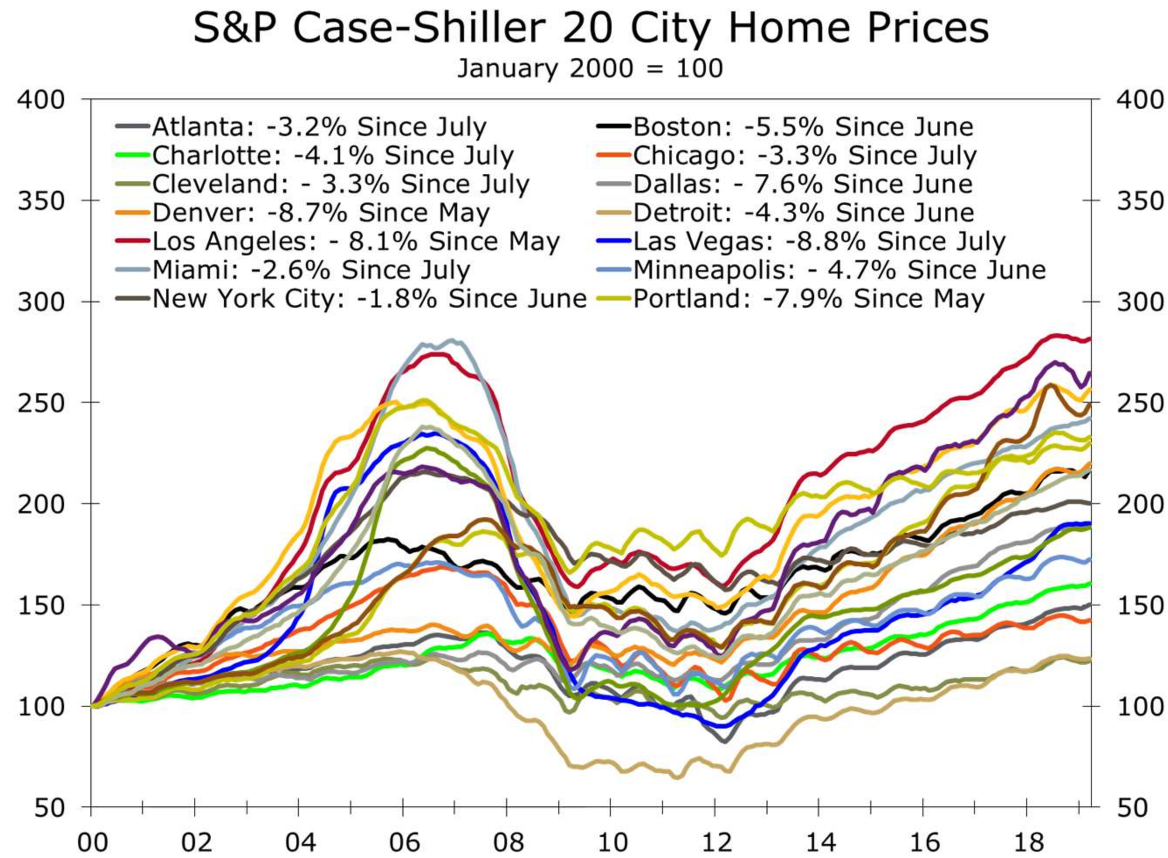
- The Case-Shiller 20 City index has fallen 6.2% since June, while the 10 City index is down 5.9%. The National index has fallen just 4.4%.
- Home prices have been falling most major markets, with the largest declines occurring along the West Coast.
- San Francisco and Seattle have seen the largest drops, with prices falling 16% and 15%, respectively.



Source: S&P Global and Refinitiv

Long-Term Interest Rates May Have Hit a Cycle Peak

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- Large bank failures and other financial crises have typically marked the peak of interest rate cycles.
- The failure of Silicon Valley Bank was somewhat unique in that it appears to have been triggered poor A/L management
- The cure may be worse than the disease, as regulation of regional banks is likely to tighten, and all banks are likely to build capital ahead of the next stress tests.

Source: Federal Reserve Board & Piedmont Crescent Capital

Commercial Real Estate Values Likely Peaked About a Year Ago

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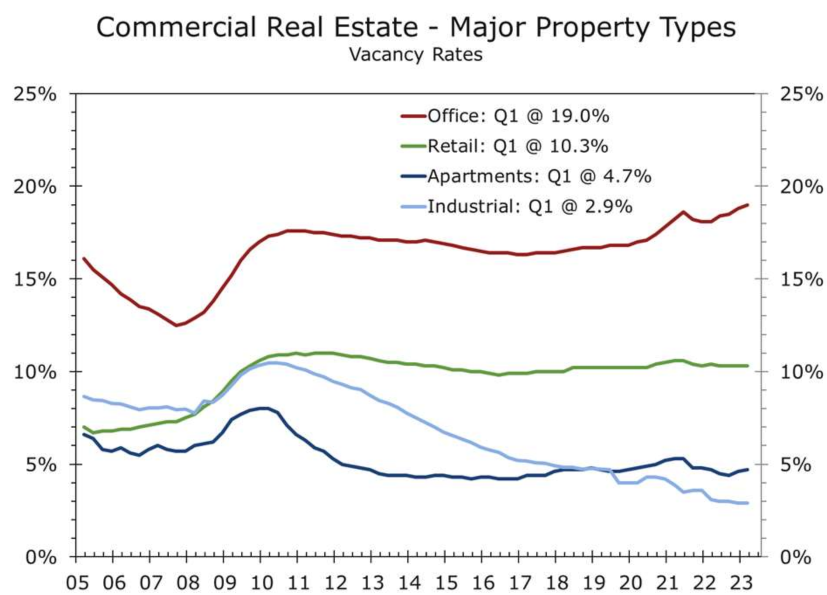
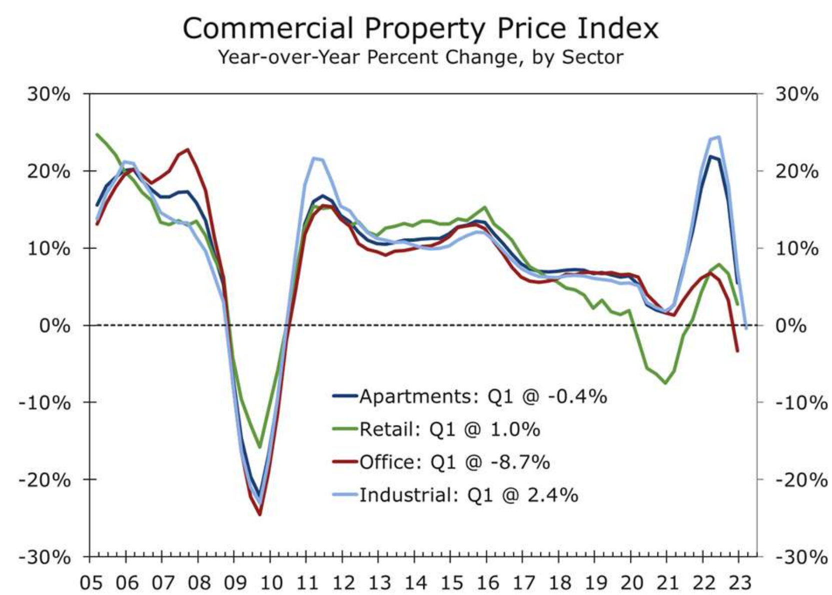
The commercial real estate market likely peaked about a year ago, but most product categories appear to be holding up relatively well. The office market is the notable exception. Vacancy rates have risen sharply in large urban markets, particularly in older class B and C buildings. Retail space has benefitted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

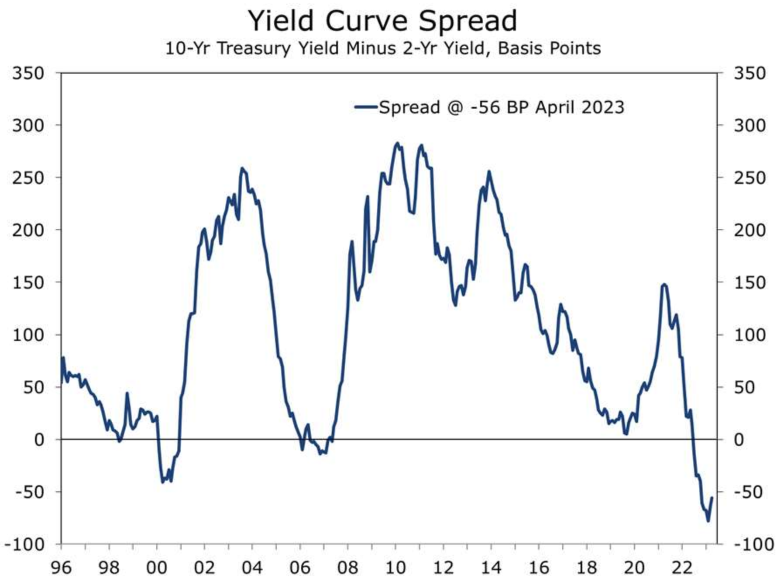


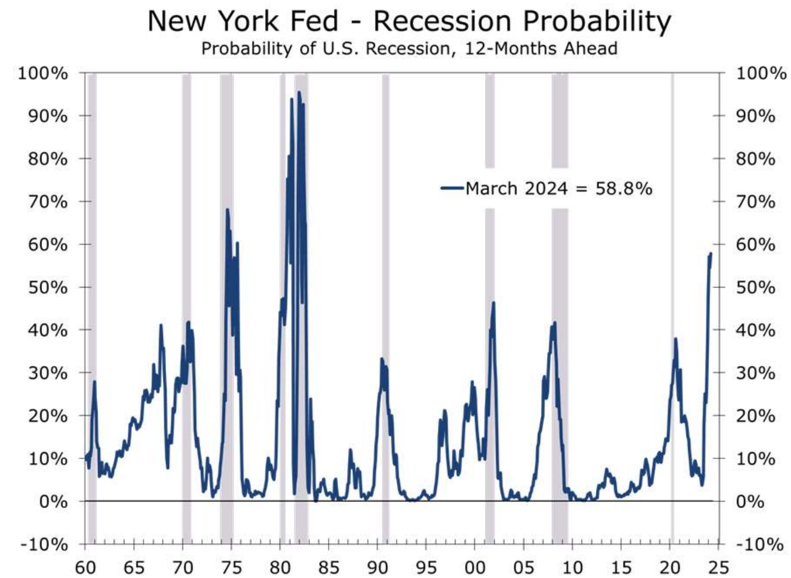


Source: Refinitiv, Moody's REIS, NCREIF, Piedmont Crescent Capital

Skepticism About A Soft Landing

The yield curve has inverted, signaling a recession is likely within a year to 18 month 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.

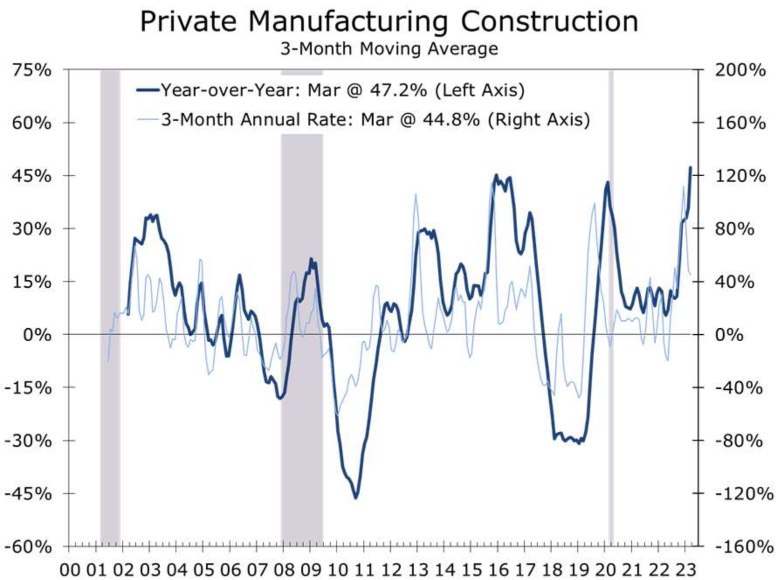


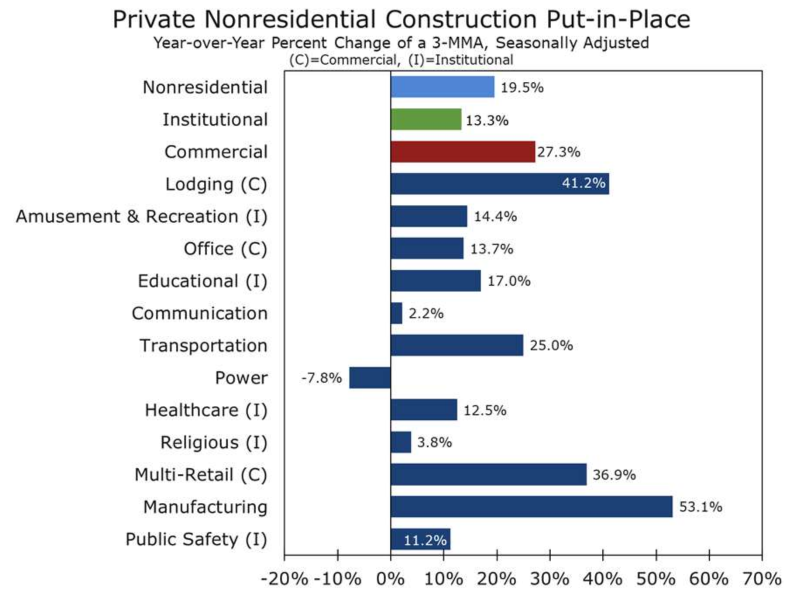


Source: Refinitiv, Federal Reserve Bank of New York

Reshoring & the Shift to EVs is Driving Manufacturing Construction

Manufacturing construction is surging across the country, driven by the tremendous investment in semiconductor plants and the shift toward EV production. The South has been a major recipient of this investment, with Texas landing several semiconductor plants and the Carolinas, Georgia and Tennessee landing numerous EV assembly plants and suppliers.





Source: Census Bureau

The South Dominates The List of Fastest Growing States

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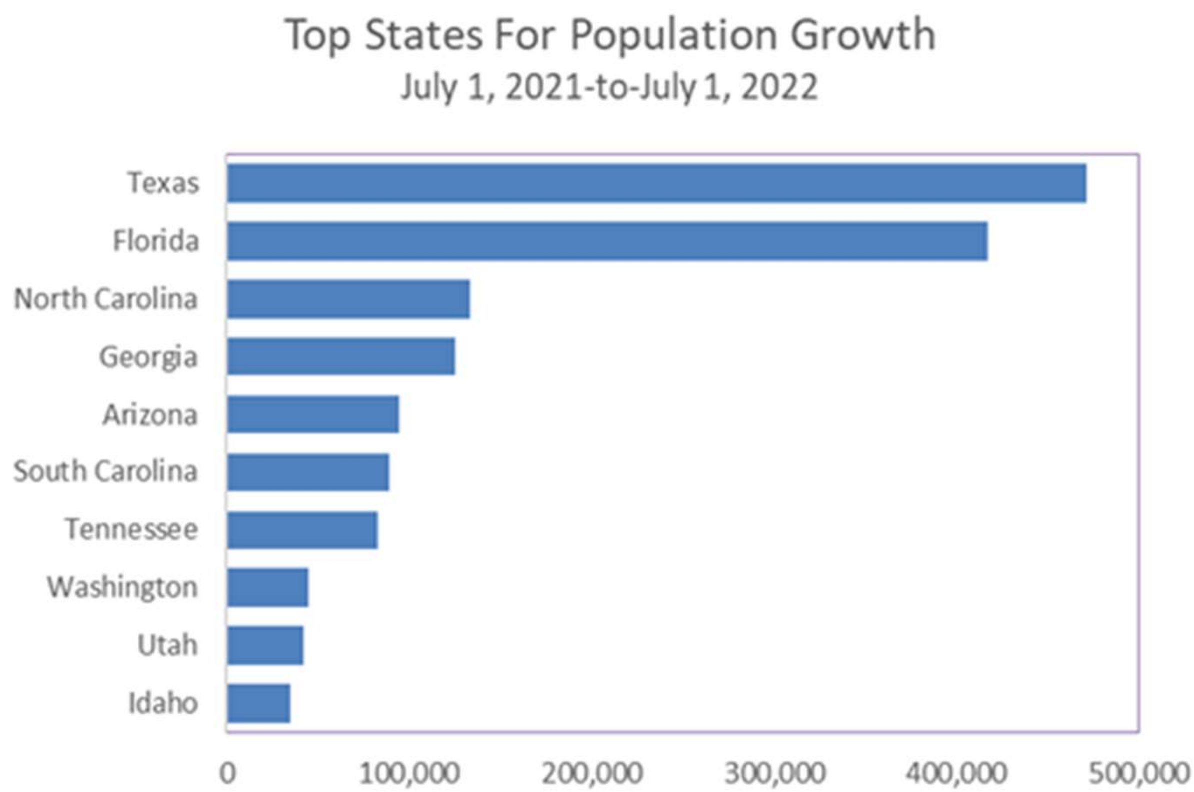
- Texas has become the nation's primary growth engine over the past decade. The Lone Star State has attracted scores of corporate headquarters and expansions in recent years, with most setting up shop in Dallas-Fort Worth, Houston, Austin and San Antonio.
- Florida led the nation in net domestic migration,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



Source: Census Bureau

The South is Home to Half the Nation's Top Job Markets

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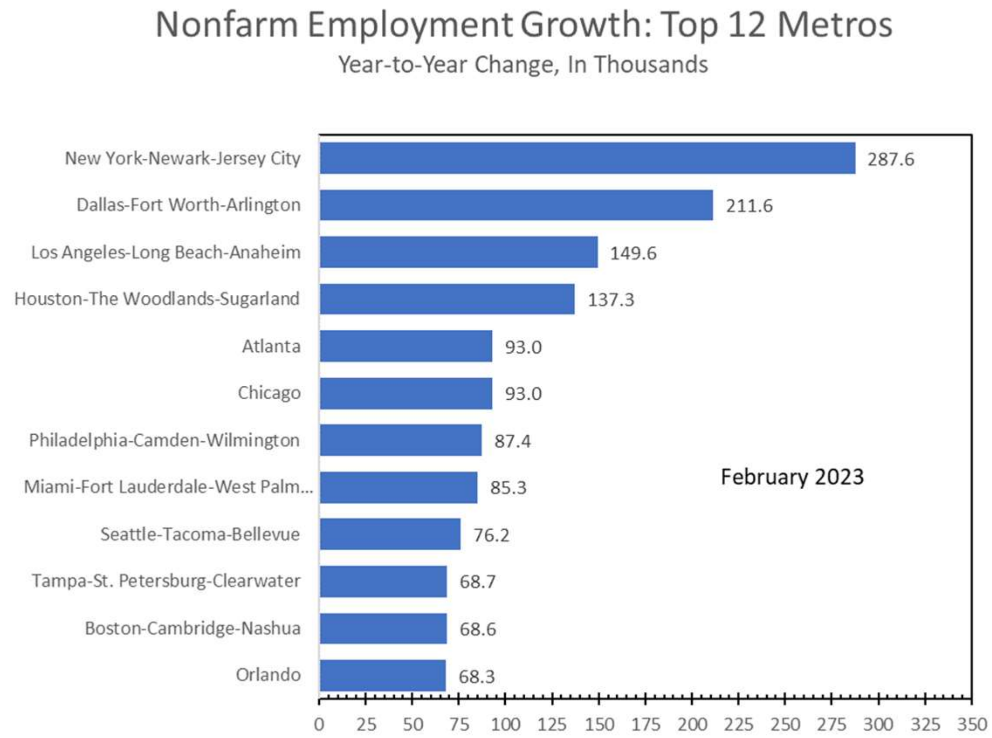
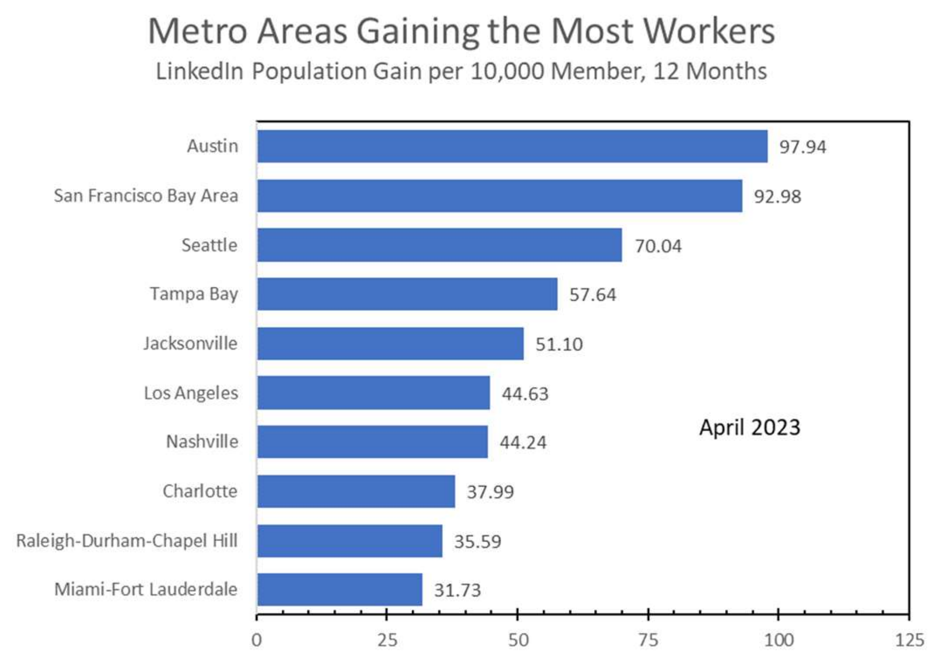
- New York, Los Angeles and Chicago have seen hiring bounce back this past year, reflecting the return to the office and an uptick in spending at restaurants and bars.
- Dallas, Houston, Atlanta and South Florida have consistently ranked among the largest job gainers.
- Tampa and Orlando are seeing broad based job gains, reflecting strong economic development.



Source: Bureau of Labor Statistics

Workers Are Now Returning to Gateway Markets

- While secondary markets continue to dominate the list of metro areas attracting the most workers, the San Francisco Bay area, Seattle and Los Angeles have all moved back into the top ten markets during each of the past four months.
- The Greater New York City area is also likely seeing stronger inflows.
- Recession concerns may be bringing workers back to the office and workplace.



Source: LinkedIn

The South Is A Leader in Industrial Development

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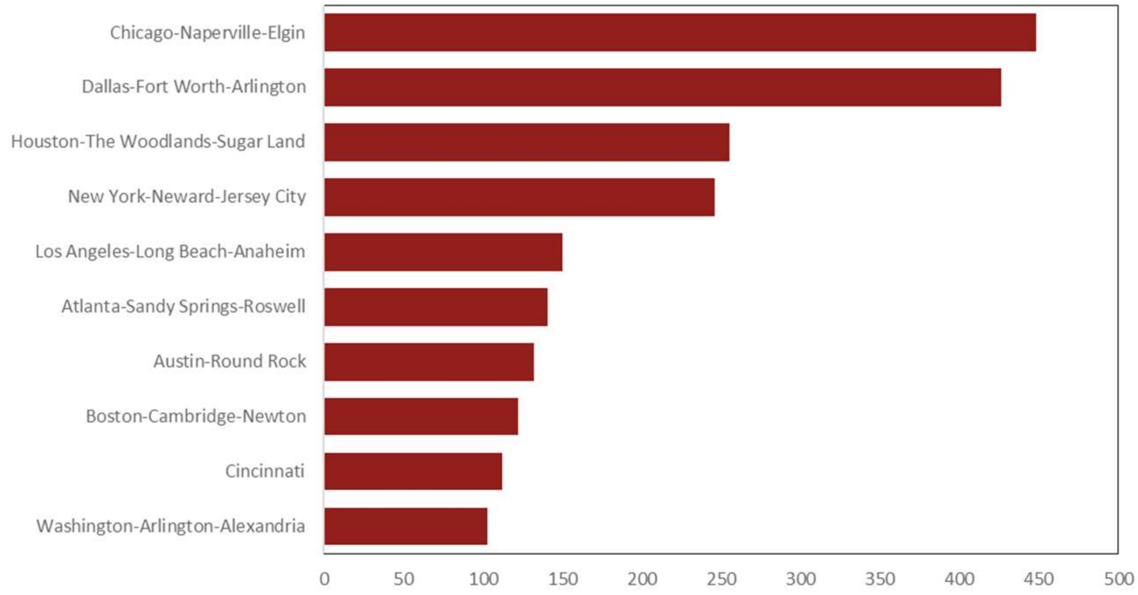
- The South accounted for 44% of the nation's manufacturing construction over the past year.
- Texas is the top state for manufacturing activity, benefitting from an influx of large chip plants.
- Georgia, the Carolinas, Tennessee and Alabama have seen a deluge of EV plants over the past couple of year, while Virginia continues to land scores of data centers.

Top Metro Areas for Major Industrial Developments

Site Selection Magazine, 2022



Source: Conway Projects Database

Economic Outlook

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US Economic and Financial Outlook

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

	2022				2023				2021	2022	2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Actual	Prelim.	Forecast	Forecast	Forecast
Output													
Real GDP	(1.6)	(0.6)	3.2	2.6	1.1	0.6	(1.9)	(1.7)	5.7	2.1	1.3	(0.8)	2.1
Consumer Spending	1.3	2.0	2.3	1.0	3.7	0.3	(0.9)	(0.5)	7.9	2.8	0.9	1.0	2.4
Nonresidential Fixed Investment	7.9	0.1	6.2	4.0	0.7	(0.5)	(2.7)	(3.0)	7.4	3.8	(0.5)	0.7	3.7
Light Vehicle Sales	14.1	13.3	13.4	14.3	15.3	14.7	14.3	14.2	15.0	13.9	14.6	14.7	15.8
Industrial Production, Manufacturing	3.1	3.0	0.4	-3.4	0.5	0.6	-1.2	-1.0	5.0	4.3	(1.9)	1.2	2.9
Unemployment Rate (Qtrly Avg)	3.8	3.6	3.6	3.6	3.5	3.7	3.9	4.1	3.9	3.7	3.8	4.5	4.3
Housing Market													
Housing Starts (Units, thous)	1,720	1,647	1,450	1,398	1,395	1,340	1,280	1,250	1,601	1,554	1,390	1,300	1,460
New Home Sales	776	609	580	598	651	585	570	570	771	641	595	620	700
Existing Home Sales	6,057	5,373	4,770	4,197	4,330	3,950	3,900	3,900	6,120	5,030	4,040	4,200	4,500
S&P/Case-Shiller Natl Home Prices (Yr/Yr % Change)	20.1	19.6	8.6	6.0	2.9	(2.7)	(2.2)	(1.6)	18.5	14.7	(1.1)	1.7	3.8
Inflation (Year-to-Year % Change)													
Consumer Price Index (CPI)	8.0	8.6	8.3	7.1	5.8	4.5	3.9	3.6	7.1	6.7	4.4	3.5	3.0
Core CPI	6.3	6.0	6.3	6.0	5.6	5.3	4.6	3.9	5.5	6.1	4.8	3.5	2.8
Personal Consumption Deflator	6.4	6.6	6.3	5.7	4.9	4.6	4.3	4.0	5.8	5.8	4.4	3.1	3.0
Core PCE Deflator	5.3	5.0	4.9	4.8	4.7	4.5	4.1	3.9	4.9	4.7	4.3	3.0	2.8
Employment Cost Index	4.5	5.1	5.1	5.1	4.9	4.8	4.7	4.6	3.3	4.9	4.7	4.2	3.9
Interest Rates (Quarter End)													
Fed Funds Target Range	0.25-0.5	1.5-1.75	3-3.25	4.25-4.5	4.75-5	5-5.25	5-5.25	5-5.25	0-0.25	2.75	5-5.25	4-4.25	3.25-3.5
10-Year Treasury Note	2.32	2.98	3.83	3.88	3.48	4.10	4.00	3.90	1.45	2.95	3.90	3.80	3.80
Conventional Mortgage Rate (Freddie Mac)	4.42	5.81	6.70	6.42	6.32	6.60	6.40	6.20	2.95	5.34	6.38	6.00	5.90

Piedmont Crescent Capital - Updated May 1, 2023

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