Five Economic Trends for 2024

Renee Haltom

Vice President and Regional Executive

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Research Department
Federal Reserve Bank of Richmond

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Before we talk about 2024: Where are we today?

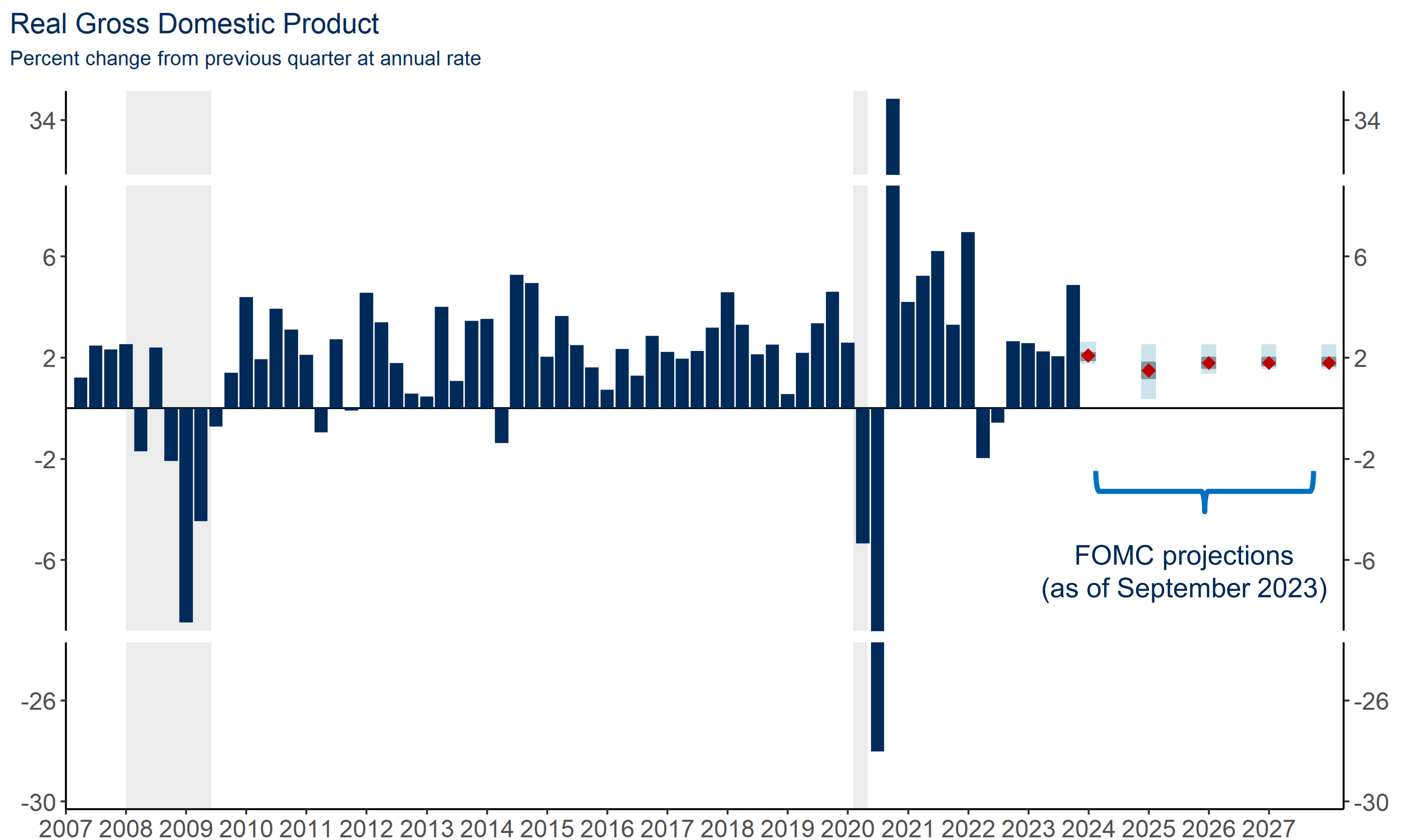
- **A recession has been forecasted for a year… Yet it's still not here. The economy has proven very resilient.**

- **Why?**
  - **Demand surged in Covid, but supply couldn't meet it**
  - **So we got inflation and Fed raised interest rates**
  - **Supply and demand have started to come back into balance, but lots of artificial "stuff" still preventing that**
    - fiscal policy, extra household savings, supply chain disruptions, etc.

- **Things are (weirdly) strong today, but some tailwinds seem to be fading**

Five trends for 2024

1. Expect a slower economy in 2024 (but soft landing is possible)



Source: Bureau of Economic Analysis via Haver Analytics

Notes: FOMC projection is the median, range, and central tendency for Y/Y percent changes, from the September 2023 meeting. Red dots indicate median projections.

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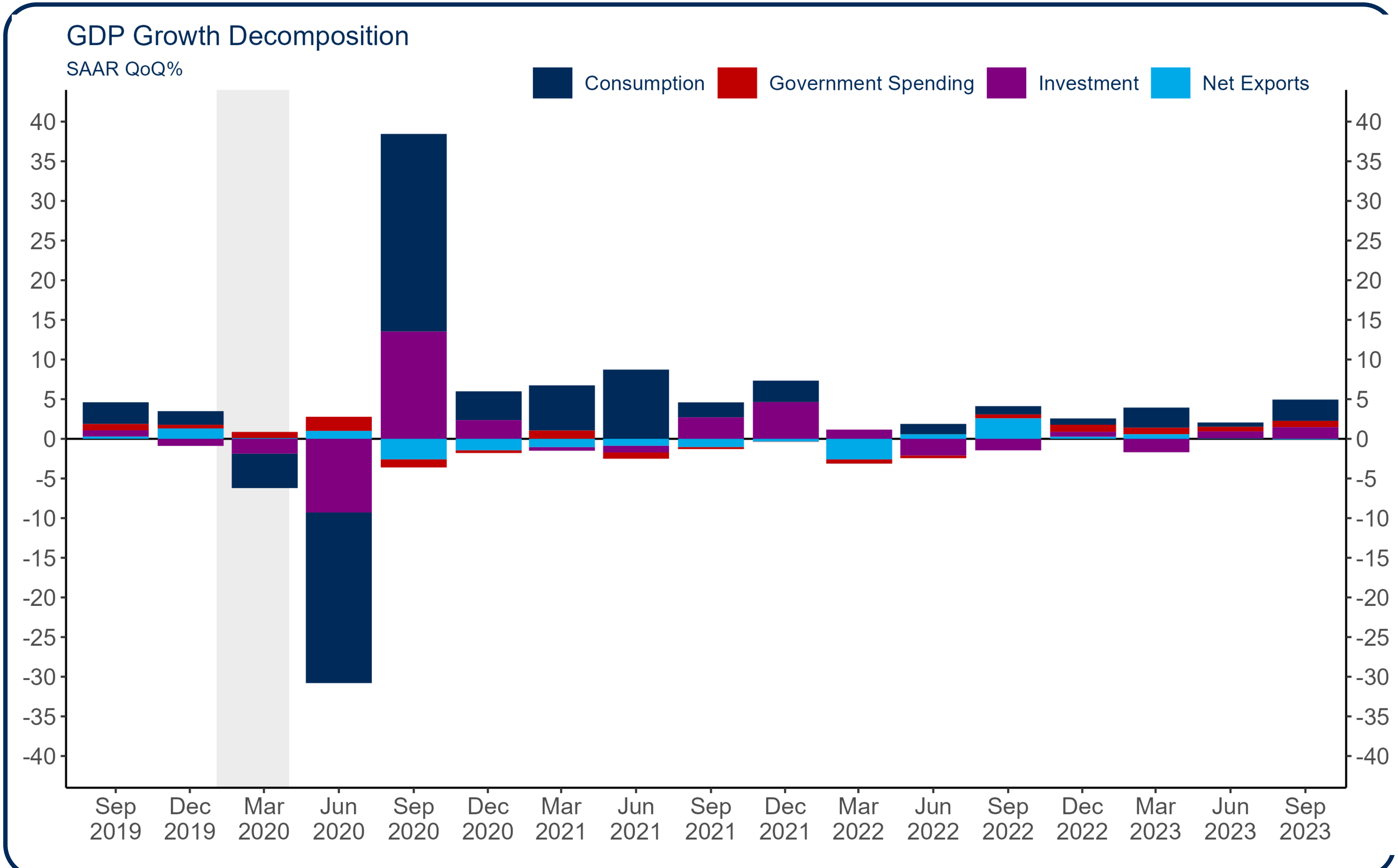
Q3 surge largely about the consumer. Can it last?



Source: Bureau of Economic Analysis/Haver Analytics

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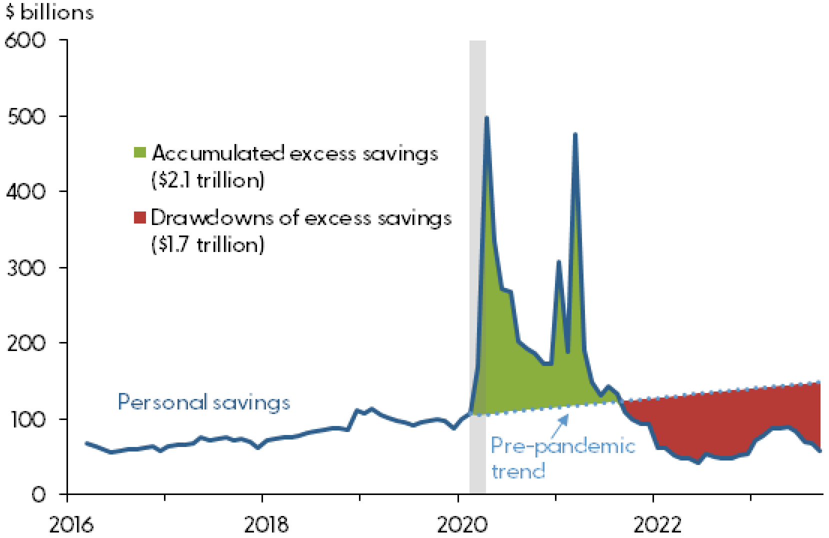
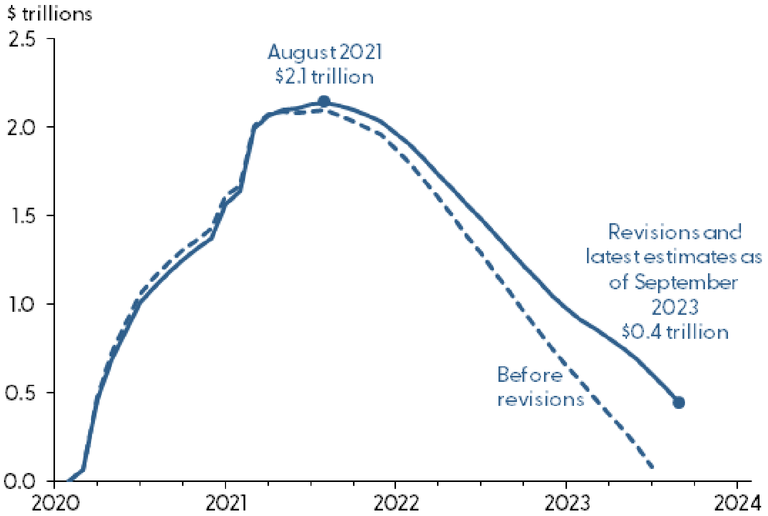
Three reasons to expect the consumer to slow down: (1) Excess savings should run out in first half of 2024

Aggregate personal savings vs. pre-Covid trend



Cumulative excess savings



Source: Bureau of Economic Analysis, San Francisco Fed "Economic Letter", November 8, 2023

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(2) People are spending on experiences and living well, but they're getting tired of inflation

Source: Census Bureau via Haver Analytics

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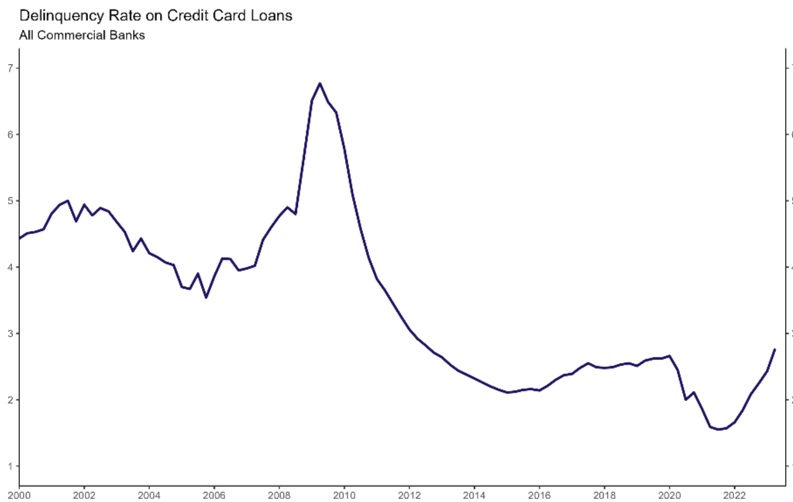
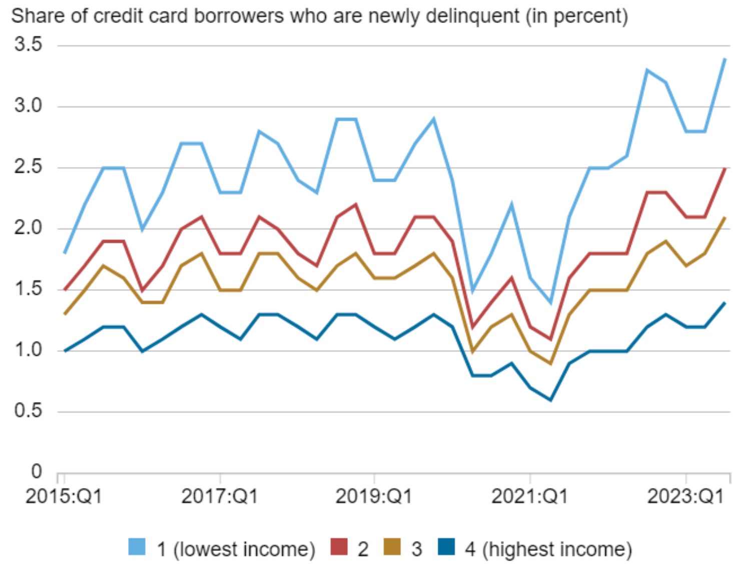
(3) Early signs of rising consumer distress

Credit card delinquency rate



By income level

Delinquency Rates Are Rising Fastest for Lower-Income Areas, but Each Income Quartile Area Has Rates at or above Their 2019 Levels



Sources: New York Fed Consumer Credit Panel/Equifax; American Community Survey.
Notes: Credit card users are categorized into zip income quartiles by ranking zip code median income from lowest to highest and splitting zip codes into four equally sized groups by population.

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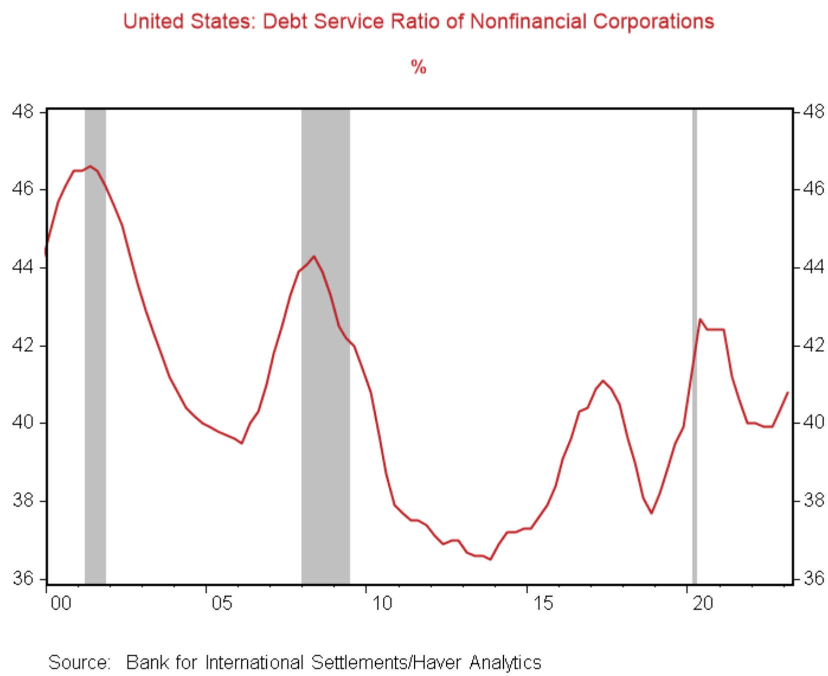
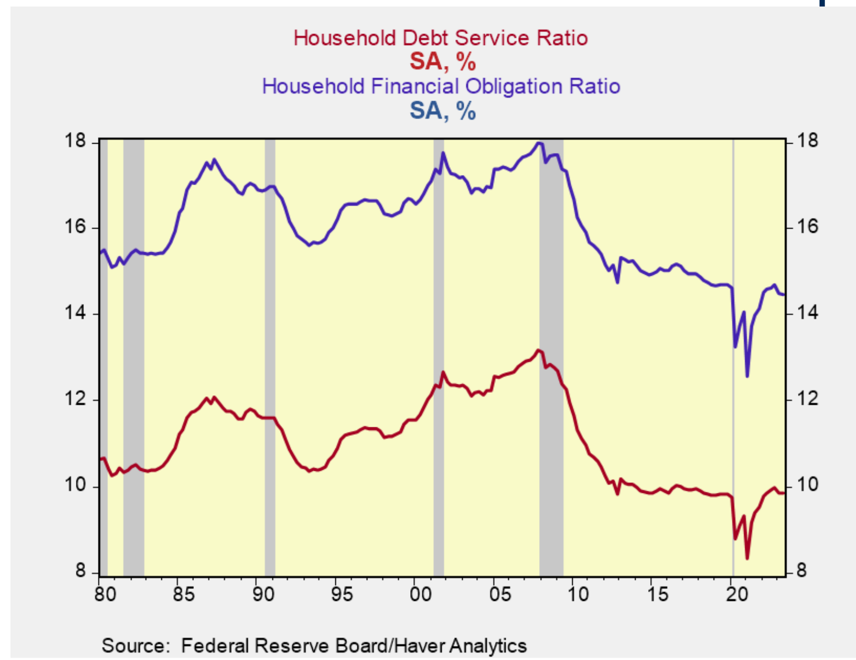
Source: Federal Reserve Board of Governors / New York Fed Liberty Street Blog

Thanks to refinances and debt paydowns, rate hikes haven't hit businesses and consumers super hard… yet

Corporate debt burden



Household debt burden



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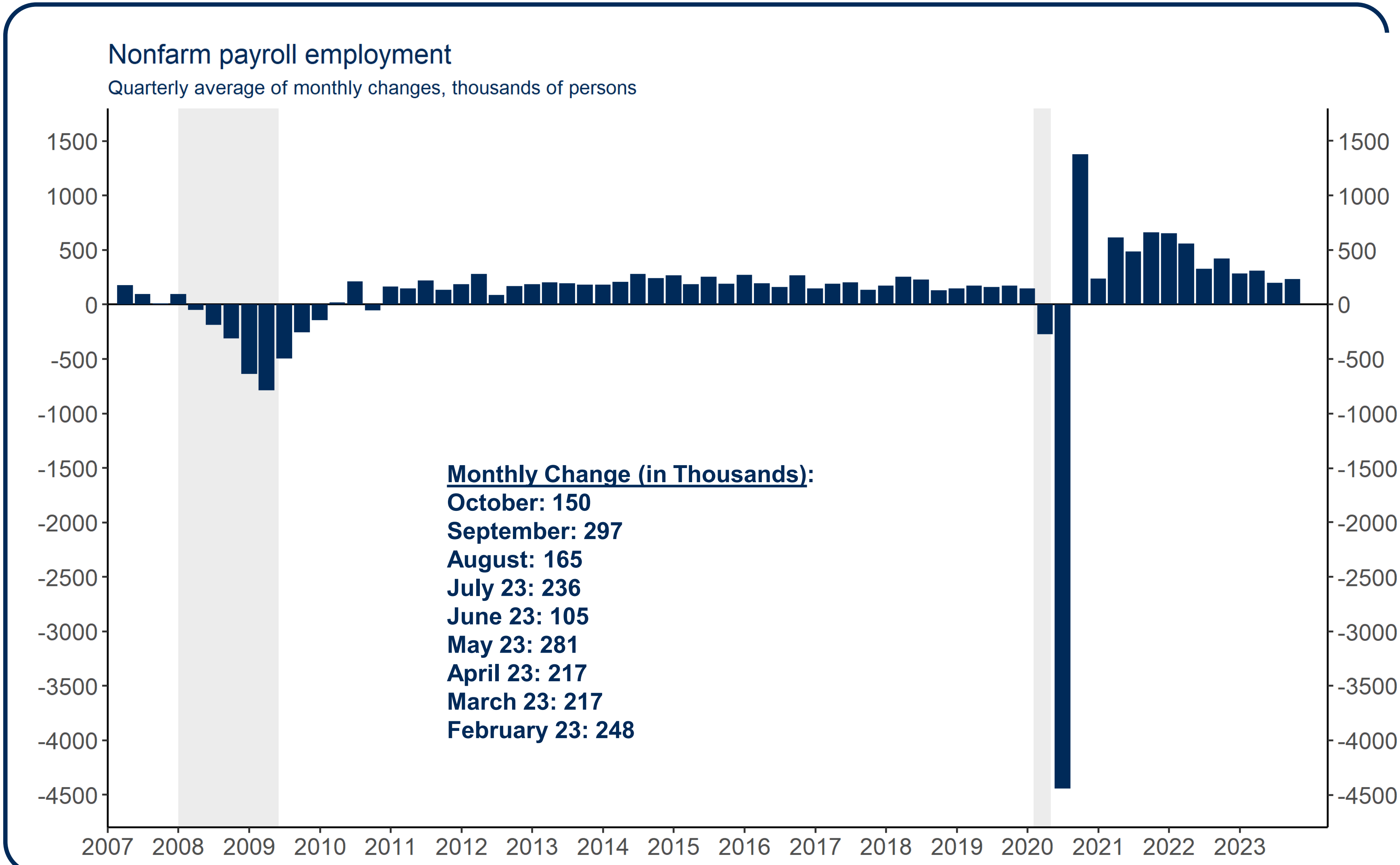
2. The labor market is normalizing from its breakneck pace



Source: Bureau of Labor Statistics/Haver Analytics

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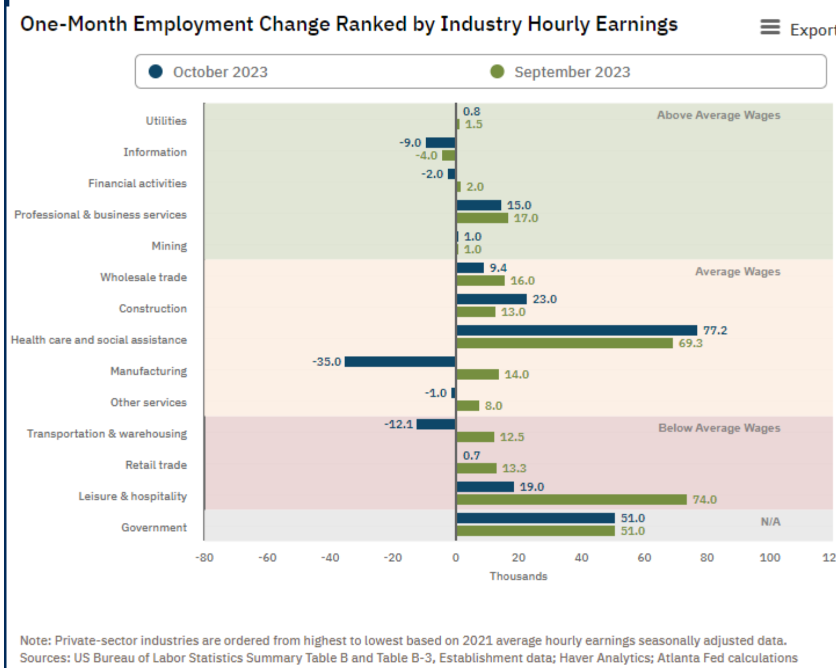
Labor market “churn” has calmed

Source: JOLTS/Haver Analytics

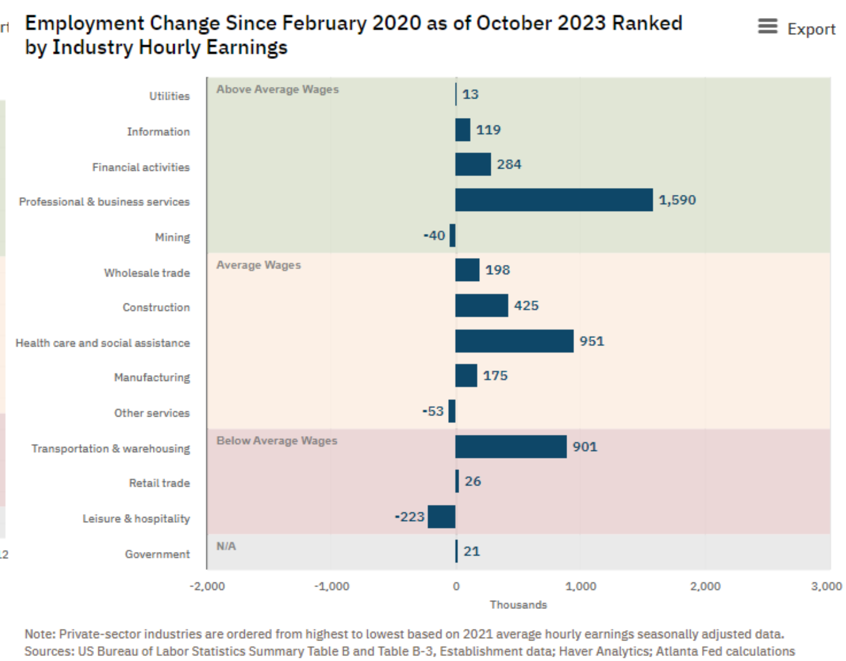
The payoff to job-switching is falling

Where are the jobs getting added fastest? Sectors still down from Covid

Job change in last two months



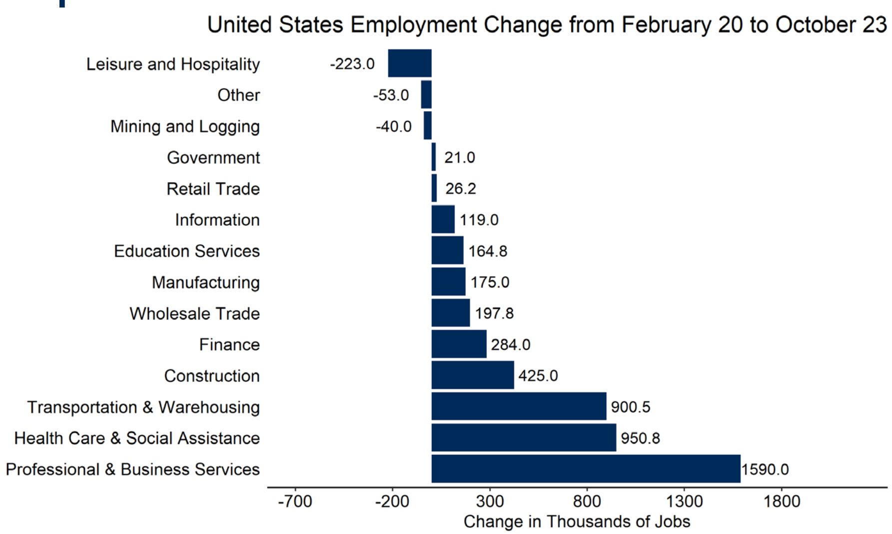
Total job change since Covid



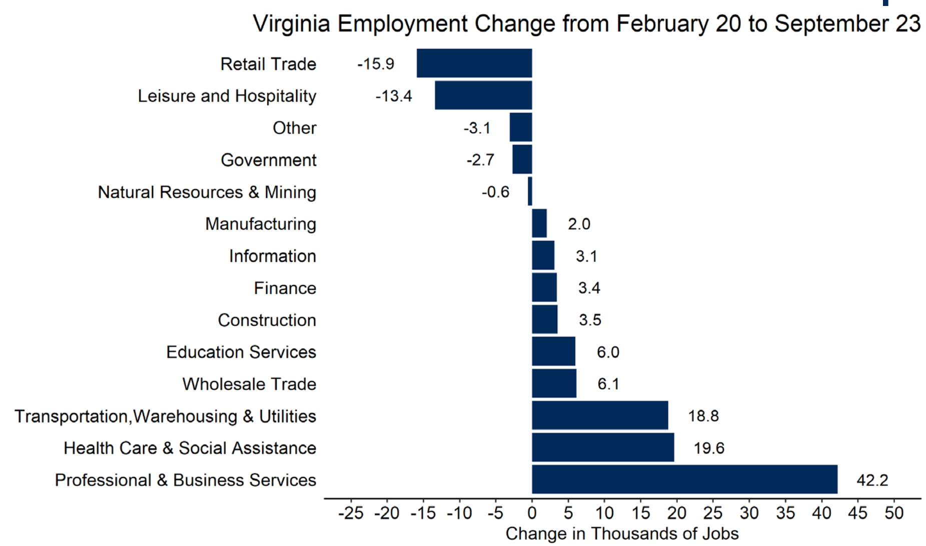
Source: Bureau of Labor Statistics / Atlanta Fed

VA trends mirror the nation, with a few exceptions

U.S. job change

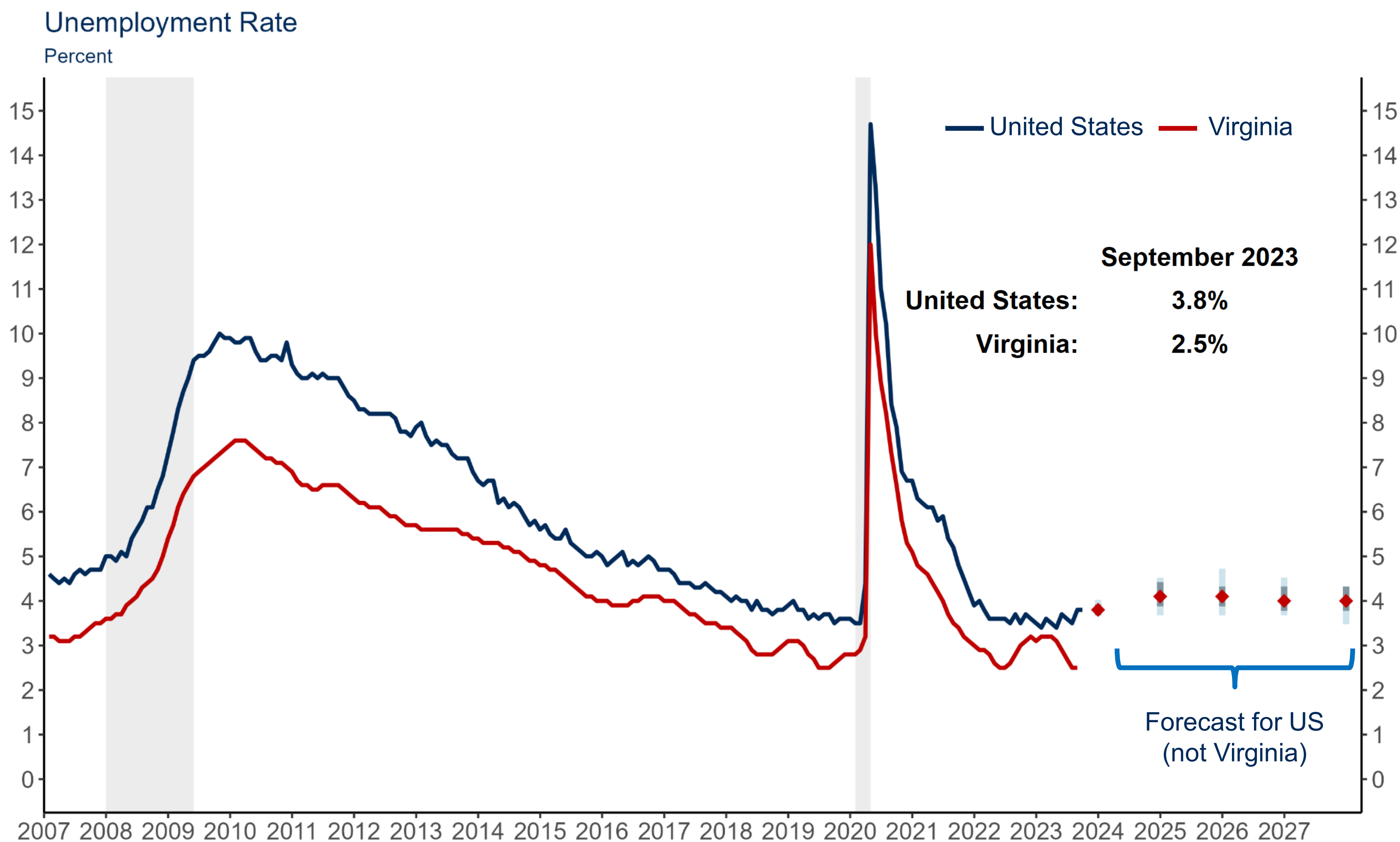


Virginia job change



Source: Bureau of Labor Statistics/Haver Analytics

But… the labor market is still very tight



Source: Bureau of Labor Statistics/Haver Analytics

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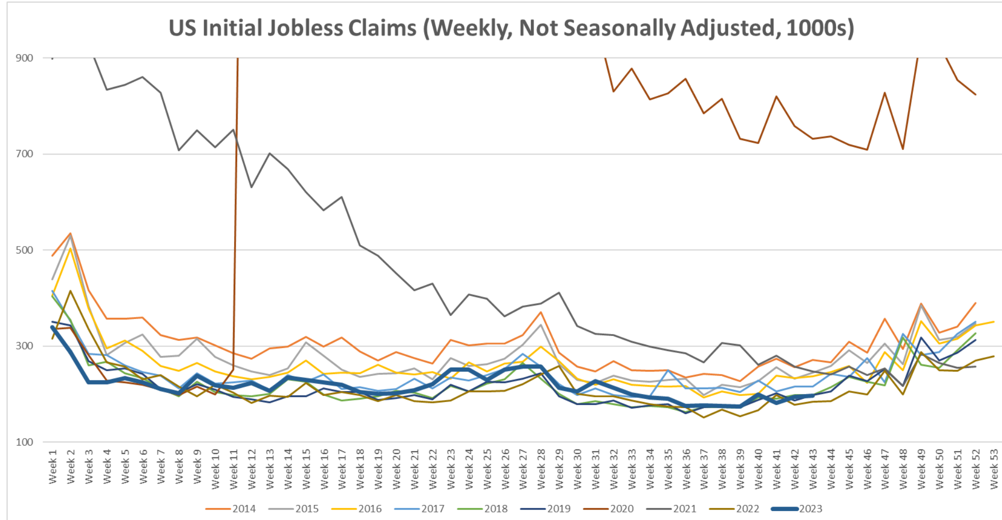
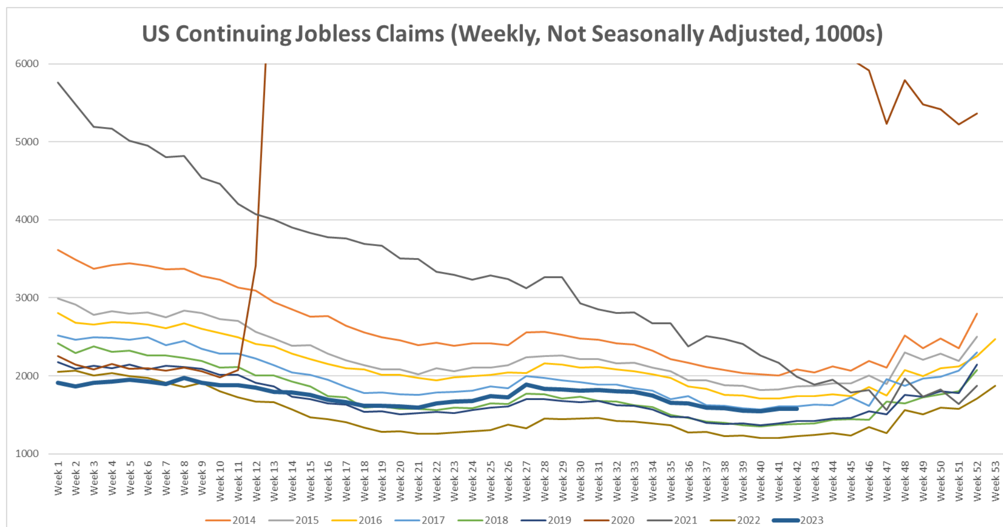
Little sign of mass layoff, either

New claims for unemployment insurance



Existing claims for unemployment insurance



Source: FRED

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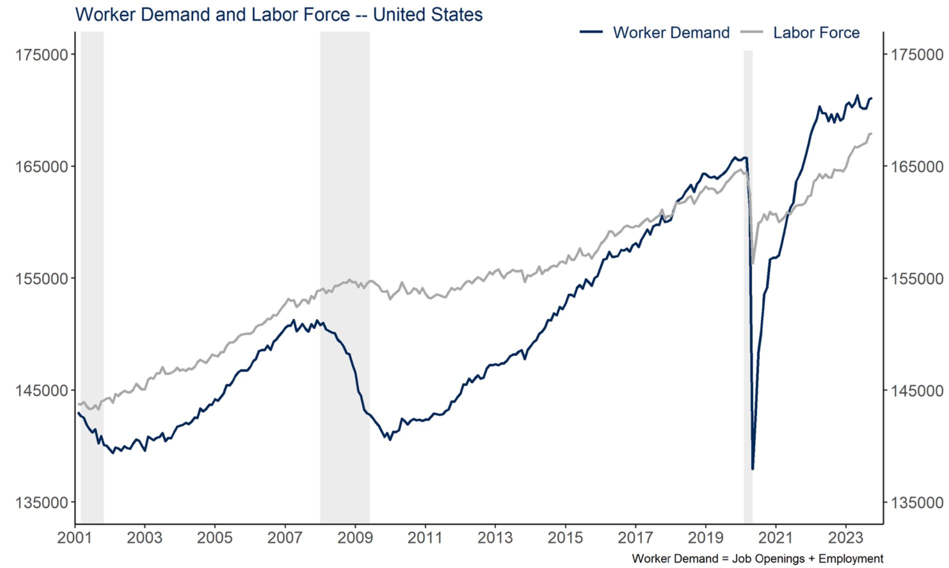
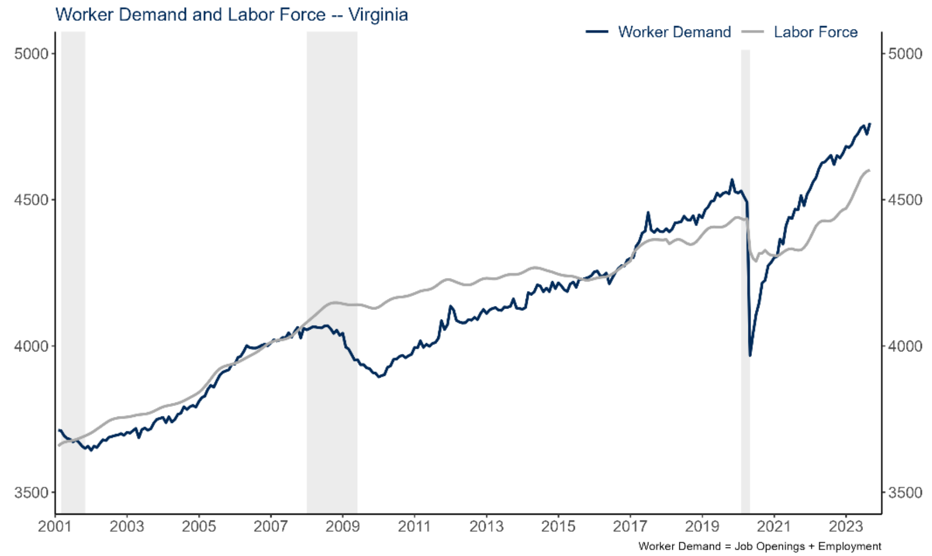
Still a large gap between labor supply and demand

U.S. labor gap
3.1m workers or 1.8% of labor demand

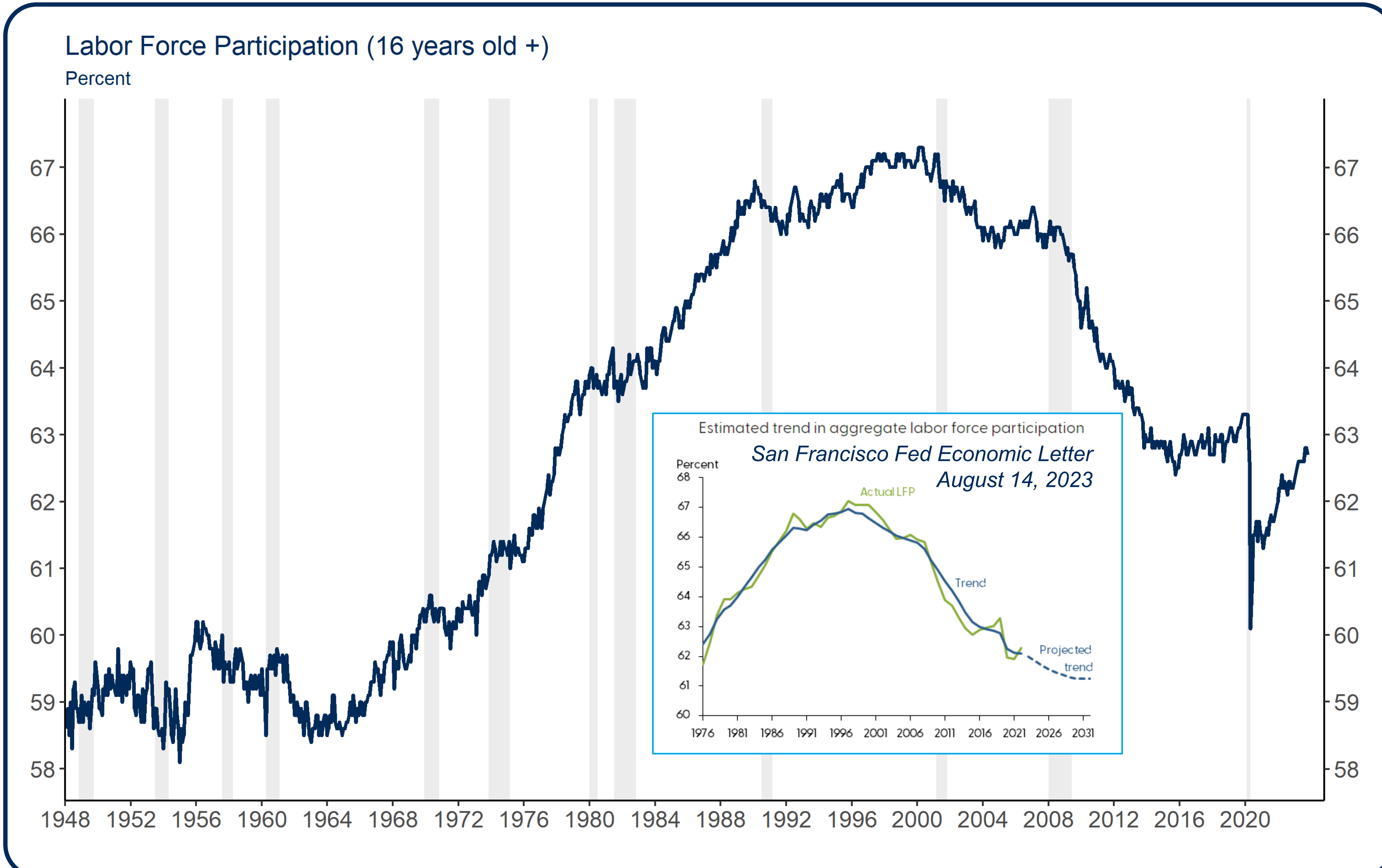


Virginia labor gap
160k workers or 3.3% of labor demand



As of August 2023

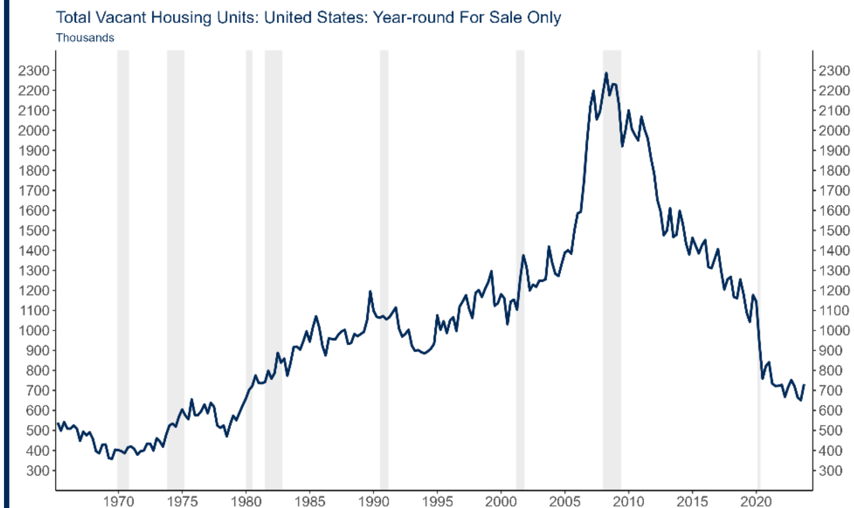
Demographics mean we may be short workers long term



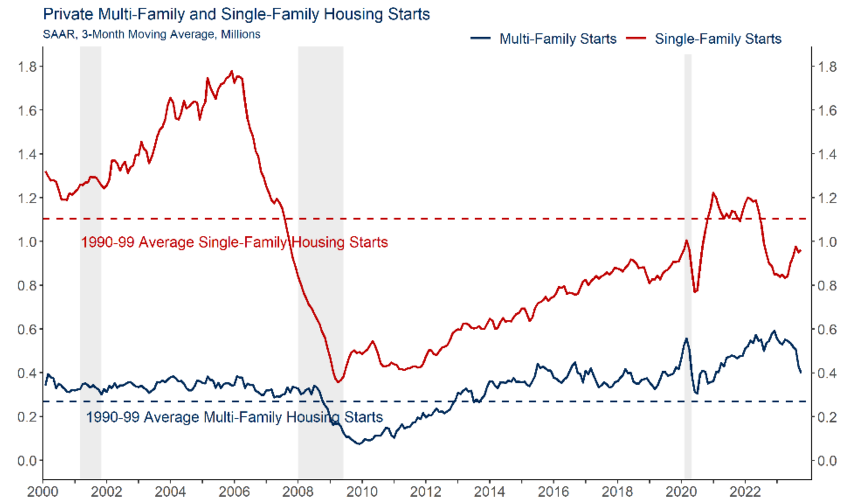
Source: Bureau of Labor Statistics/Haver Analytics

3. I don't see an obvious end to the housing shortage

Total vacant housing units



Housing starts (single and multifamily)



Source: Bureau of Labor Statistics/Haver Analytics

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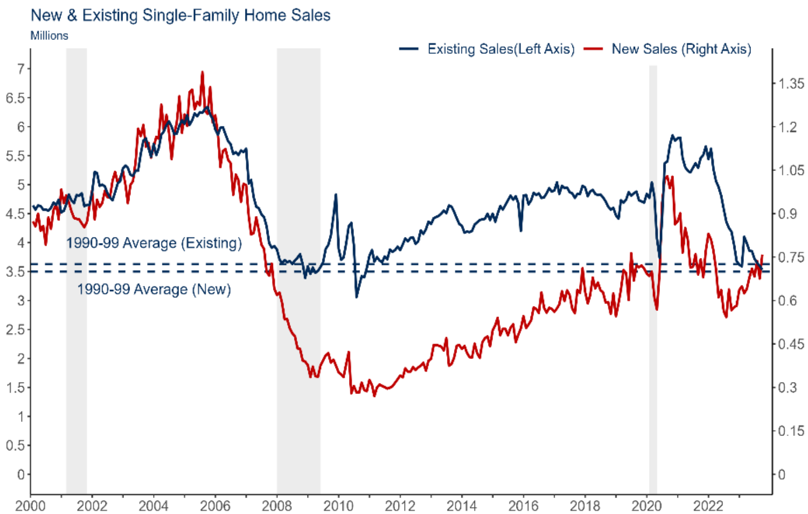
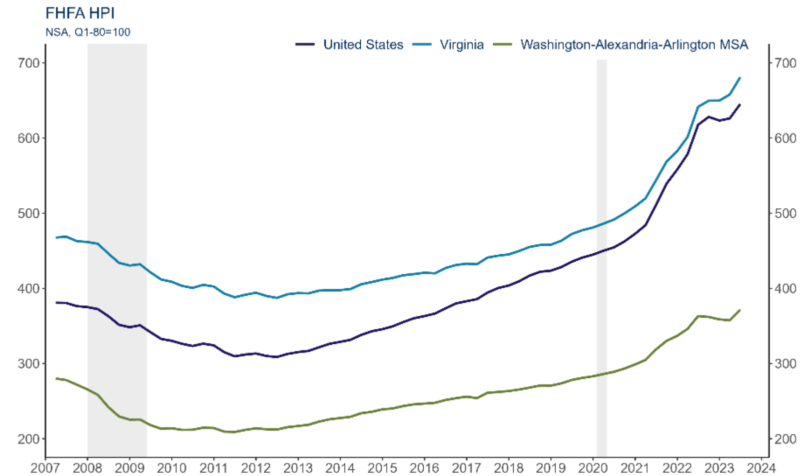
Low inventory is limiting sales and keeping prices high

New and existing single-family home sales



House price growth



Source: Census Bureau via Haver Analytics / Federal Housing Finance Agency/Haver Analytics

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There isn't a region I visit that's not struggling with housing

"When I moved here for a plant manager job, there were 7 homes on the market"

"Workers can't afford living here, and we're getting complaints from the union to give extra money for housing"

"We're competing for economic development deals, but where are people going to live unless they're making $200k?"

Sources: U.S. Census Bureau 2016-2020 American Community Survey (ACS) 5-year estimates; U.S. Department of Agriculture Rural-Urban Continuum Codes

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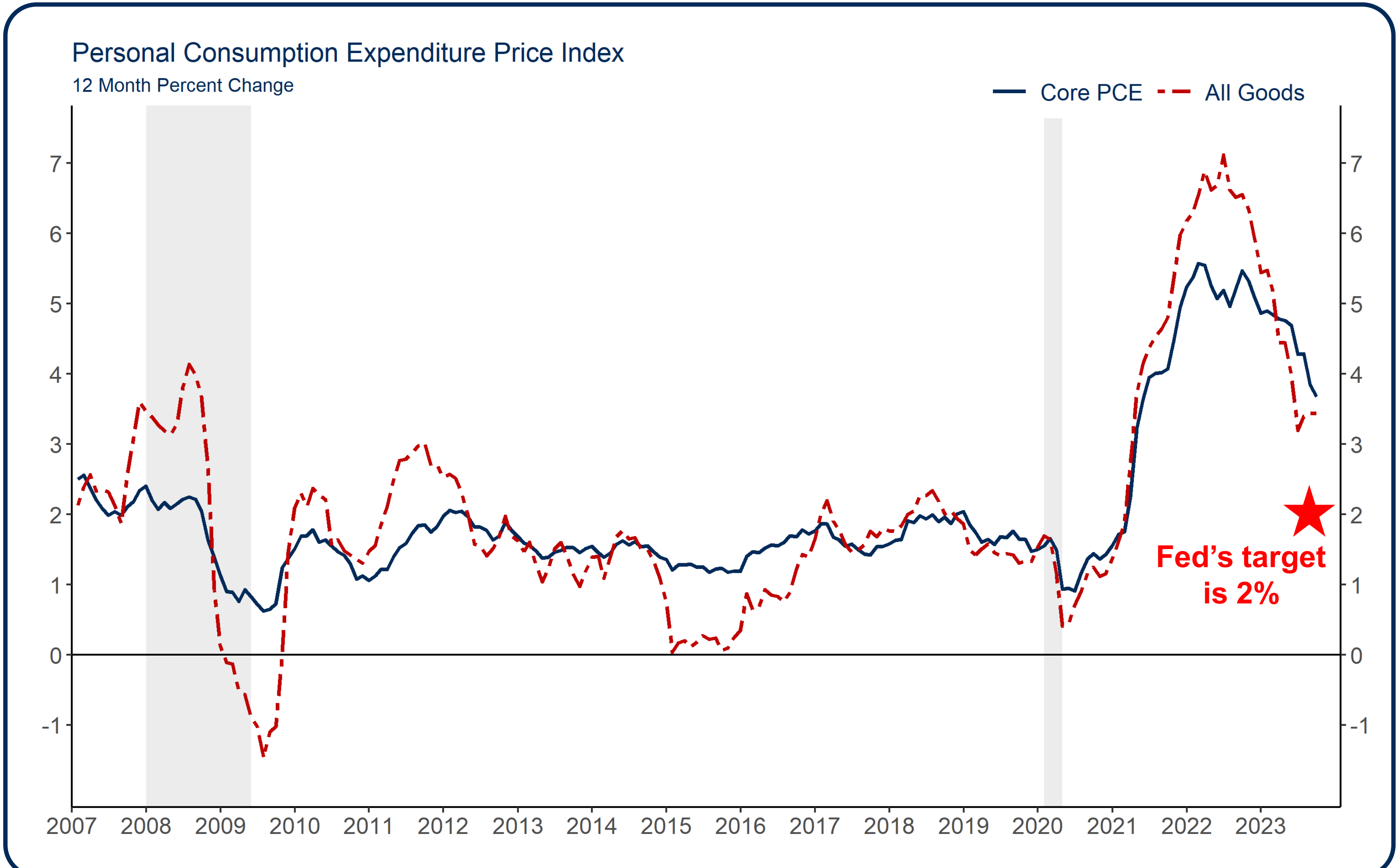
4. Inflation is still elevated, so expect rates to stay high



Source: Bureau of Economic Analysis/ Haver Analytics

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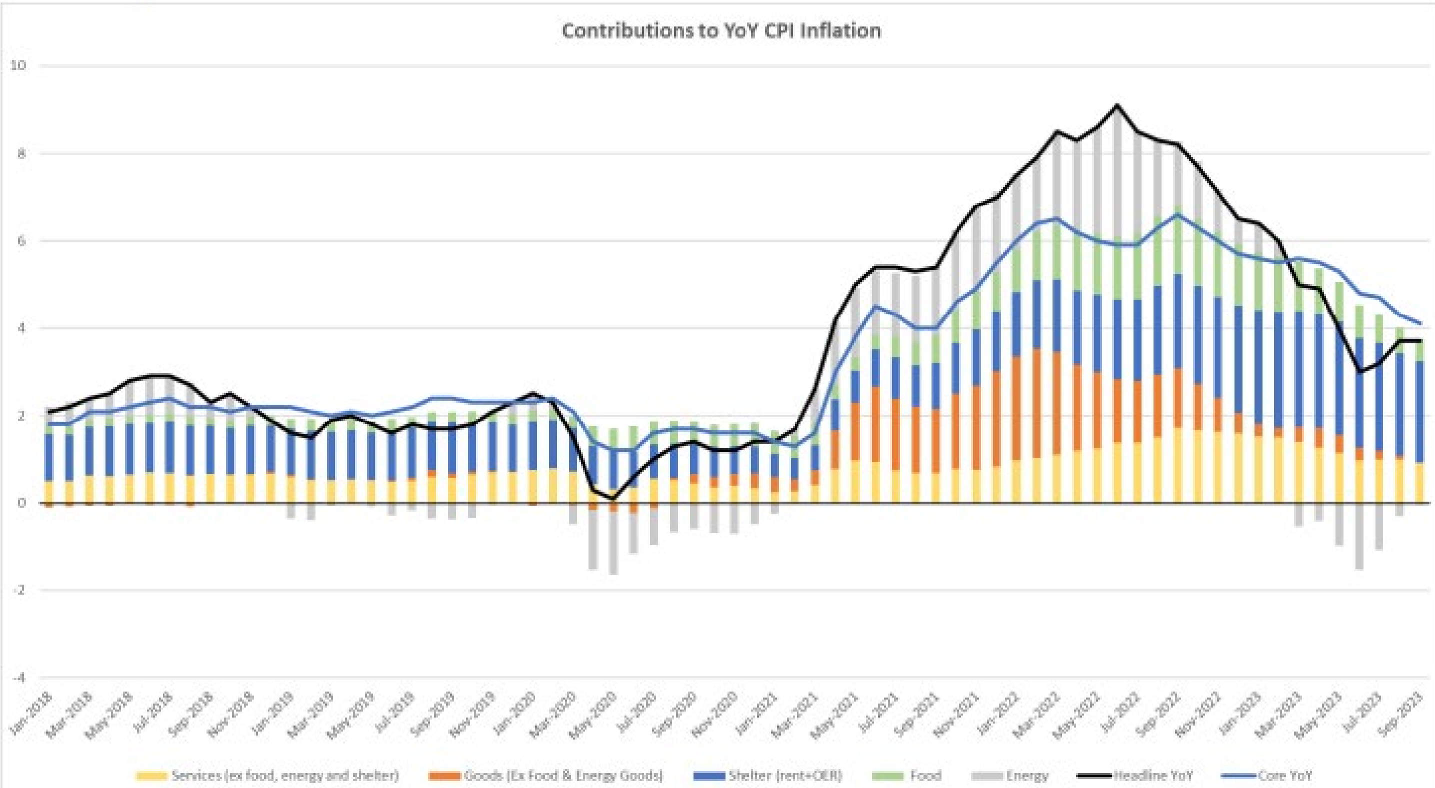
Goods inflation is over; shelter still quite elevated

September CPI Inflation: Core vs. Headline



Source: Bureau of Economic Analysis via Haver Analytics

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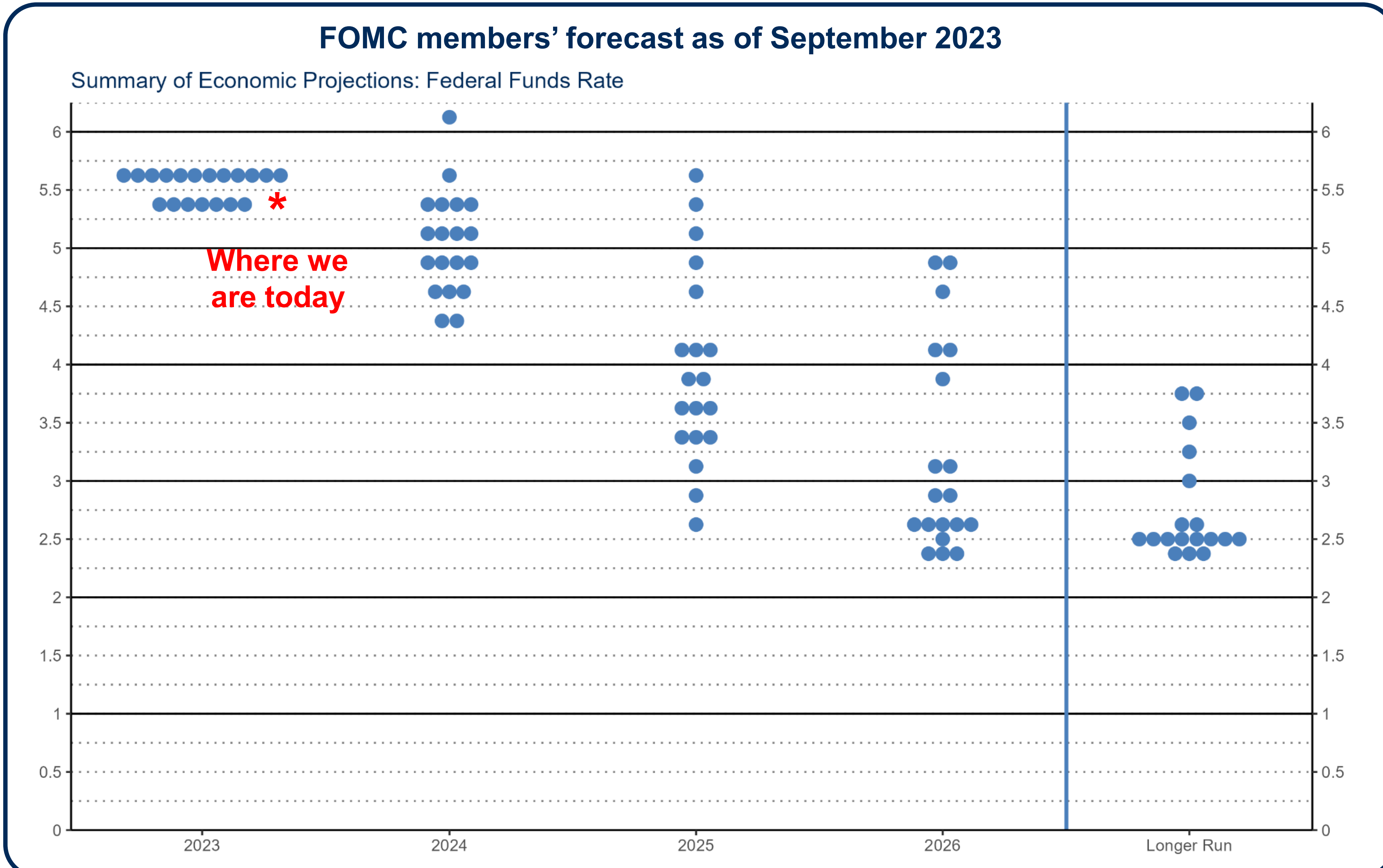
Latest Fed policymaker forecast: Tighter for longer



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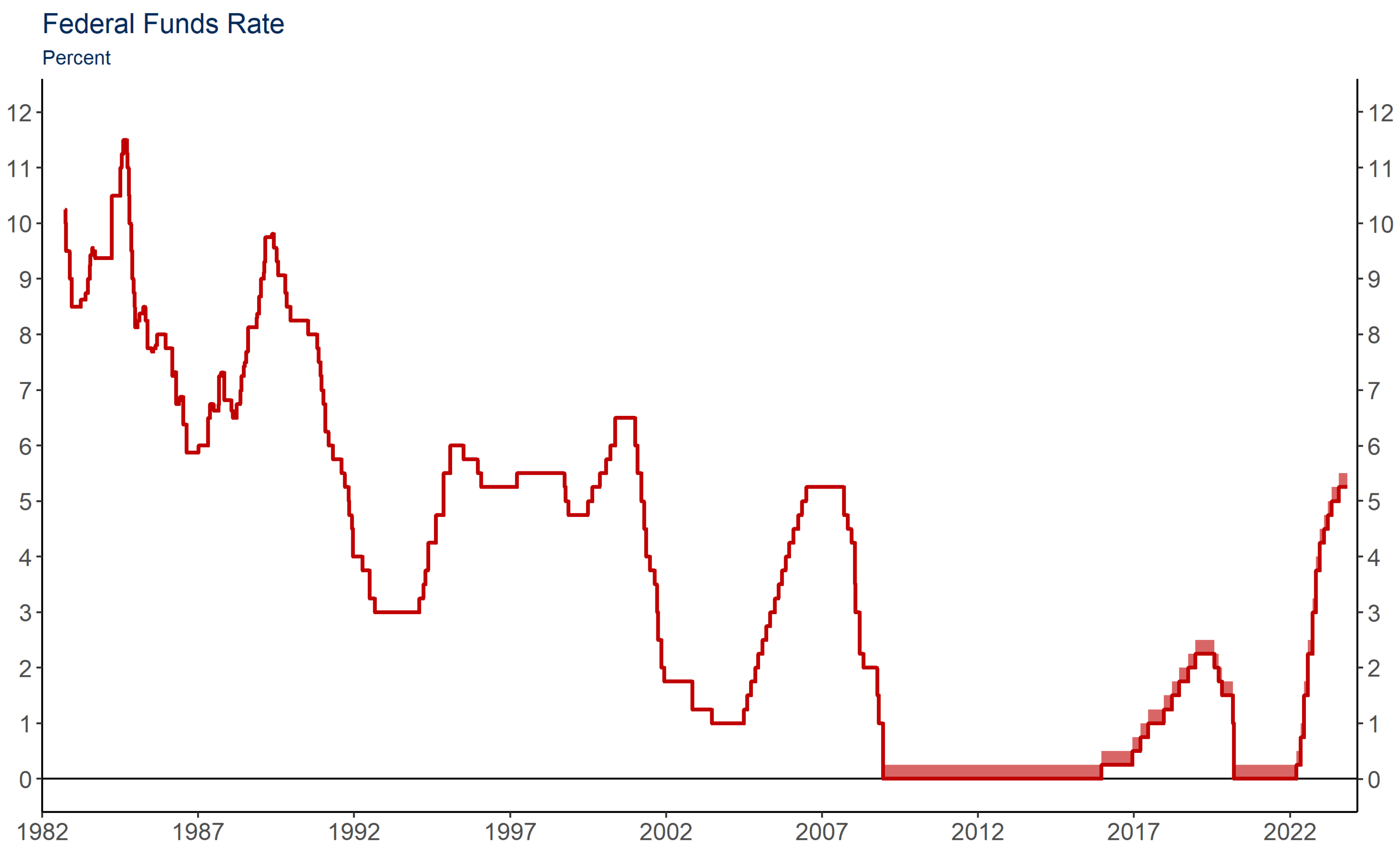
Note: Each dot in the chart represents the value of an FOMC participant's judgment of the midpoint of the appropriate target range (or the appropriate target level) for the federal funds rate at the end of the calendar year.

Source: Federal Reserve Board of Governors Forecast

Rate hikes take 6-24 months to fully hit the economy… that's now



Source: Federal Reserve Board of Governors / Haver Analytics

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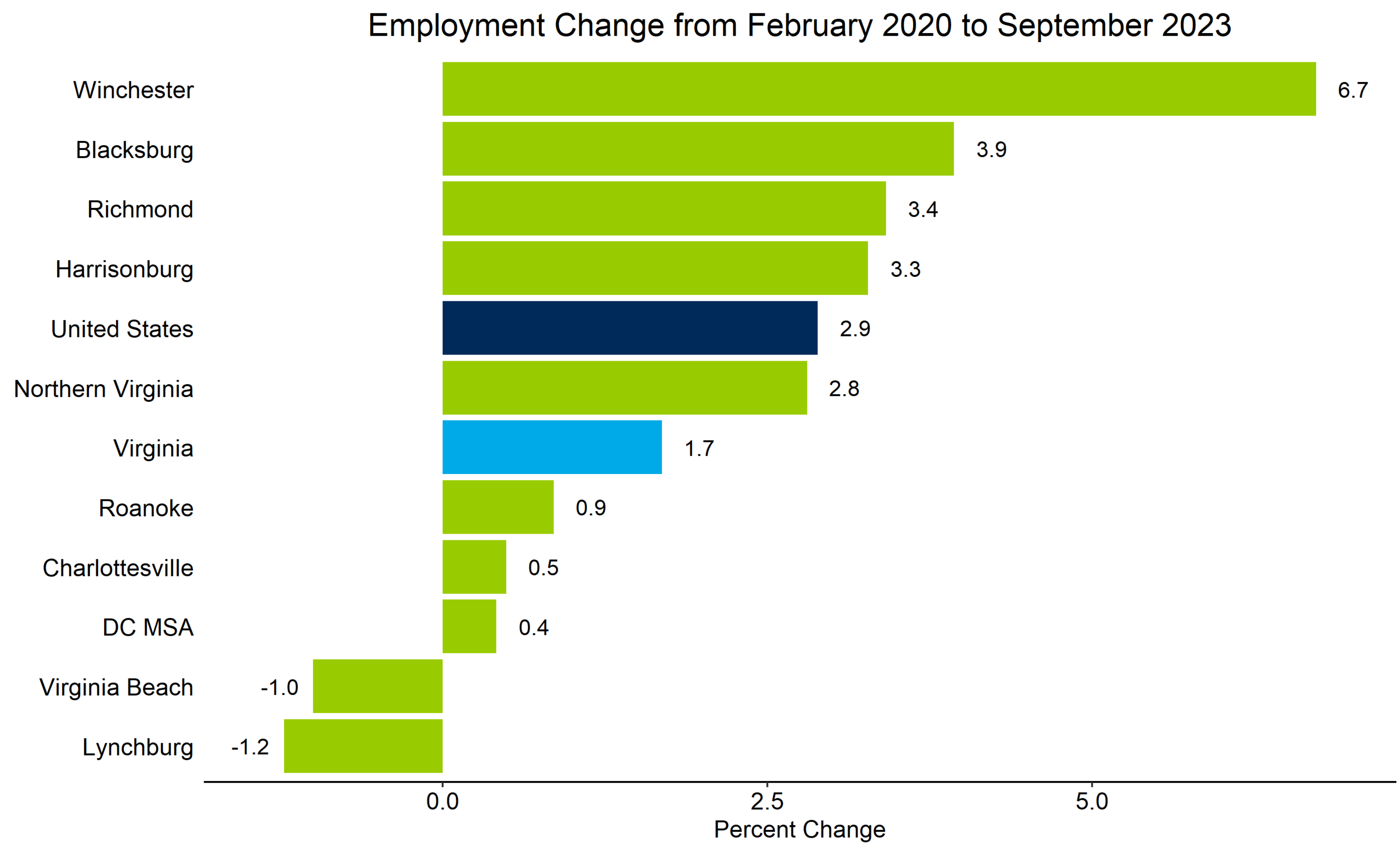
5. It's a key moment for regions to compete



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Source: Bureau of Labor Statistics/Haver Analytics

What do regions need to do to compete?

It's about attracting <u>workers</u> as much as it's about jobs.

Lots of things keep workers away:

- Skill barriers (education, training)
- Non-skill barriers
  - Personal: childcare, health, amenities
  - Infrastructure: housing, transportation, broadband
  - Incentives: benefits cliffs, aspiration

Workers will go to where these problems feel easier!

And increasingly, business will go where workers are.

This is where economic development requires <u>holistic strategy</u> and <u>regional cooperation</u>

What do I want you to leave here knowing?

- **Expect a slower economy**
  - Consumers are running down excess savings
  - Pandemic-era support is ending (and restart of student loan payments)
  - Rate hikes finally hitting in full force

- **But reason to believe a slowdown won’t be dramatic**
  - Slowdown doesn’t necessarily mean recession!
  - And even if recession, businesses have had a long time to prepare. And will they want to cut workers they fought so hard to get?
  - And if labor market stays tight, consumers may not feel the need to pull back
  - Interest-sensitive sectors (like housing and autos) still have pent-up demand

- **There are a lot of risks to the forecast**
  - Key question: Will the anticipated slowdown be enough to bring inflation down, or will the Fed have to slow the economy more?
  - Geopolitical risks… Volatility around government budget… China’s slowdown… CRE repricing...
  - Shocks (where most recessions actually come from!)

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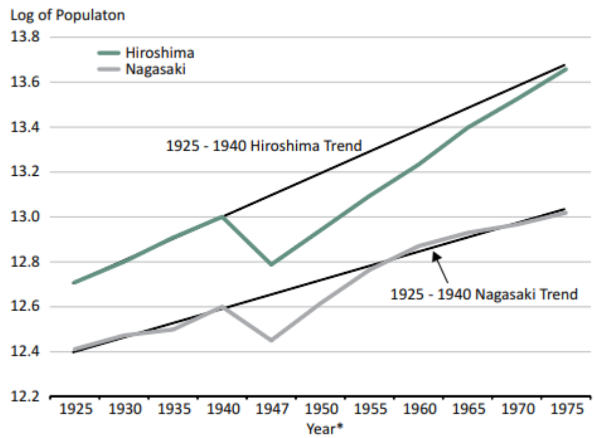
What do we know about CRE risk?

- **Cities exist for a reason – and have survived worse than Covid**
  - **>90% of GDP takes place in urban areas**
  - **Even Hiroshima and Nagasaki recovered**

Populations of Hiroshima and Nagasaki Returned to Trend Growth Quickly



* Data for 1945 were unavailable, so the authors used data for 1947.

Source: Davis and Weinstein (2002), used with permission

Source: https://jlin.org/papers/Lin-GHEDLC.pdf

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- **Cities exist for a reason – and have survived worse than Covid**
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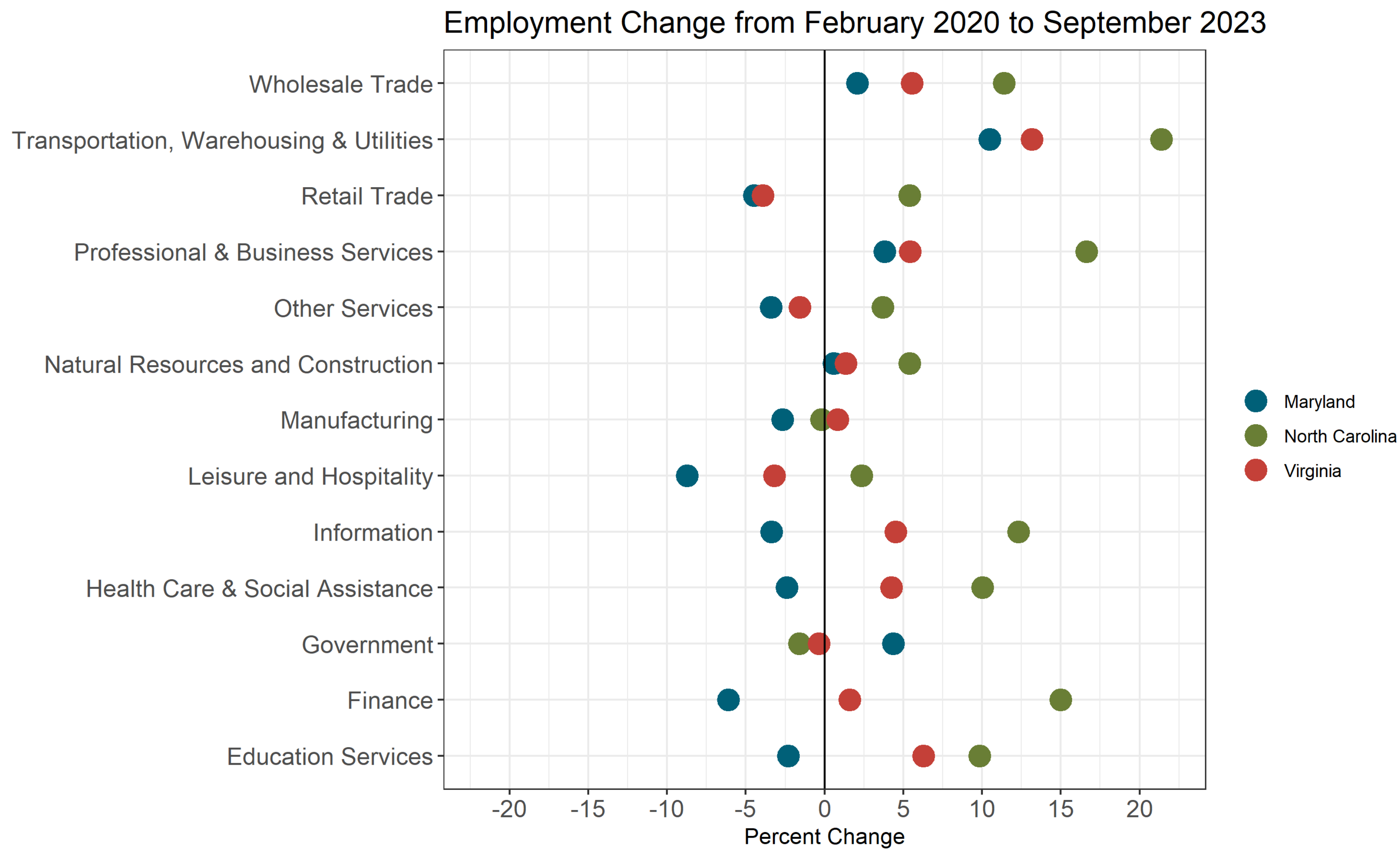
- **Because of the remote work shock, very likely some repricing of CRE values is in order: There will be losses**

- **It's not obvious this will be a disaster for the banking system**
  - CRE lending makes up ~17% ($3t) of bank credit, but office is estimated to be ~11% ($330b) of that – so 2% of total bank credit. By comparison, residential-related debt is ~30% of all bank credit
  - It's a known risk – banks can prepare
  - CRE loan delinquency rates are still <u>very</u> low (~1%, vs. 9% in Great Recession), and banks have been stress tested and can handle bad scenarios
  - Contagion could be something to watch, though

- **Also watch for hidden leverage, which is (by definition) not obvious**
  - Non-bank lenders extend more office credit than banks do (including life insurance companies, mortgage REITs, private debt funds, investors).

Growth has not been uniform by industry or state



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Source: Bureau of Labor Statistics/Haver Analytics

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