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The Economic Outlook:
Recession, Soft Landing or Something Else?

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. Inflation is proving sticky in most other areas. Food prices have been particularly troublesome, but services prices present the greatest long-term challenge. We expect inflation to improve further this year but 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 process. Trading efficiency for resiliency will add to long-term inflation challenges. The Fed would like to move rates away from the zero bound. The sudden collapse of Silicon Valley Bank and policy response will likely cause the Fed to reduce their terminal rate from 6% back to around 5.50%.

Recession, Soft Landing or Something Else

Economic growth has proven more resilient in the US, most notably with persistently strong job growth. 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 soft landing or a series of rolling recessions. The latter is already underway in the tech sector, housing and commercial real estate and will likely spread to financial services this year.

Real Estate

Home prices fell on a year-to-year basis in February, marking the first such drop since 2012. Home prices are likely to ultimately decline 15% to 20% peak-to-trough, but we are unlikely to see a repeat of the issues that led to the Global Financial Crisis. The commercial real estate market is coming under increased scrutiny in the wake of the abrupt collapse of Silicon Valley Bank and Signature Bank.

The Lost Considerable Momentum This Past Year

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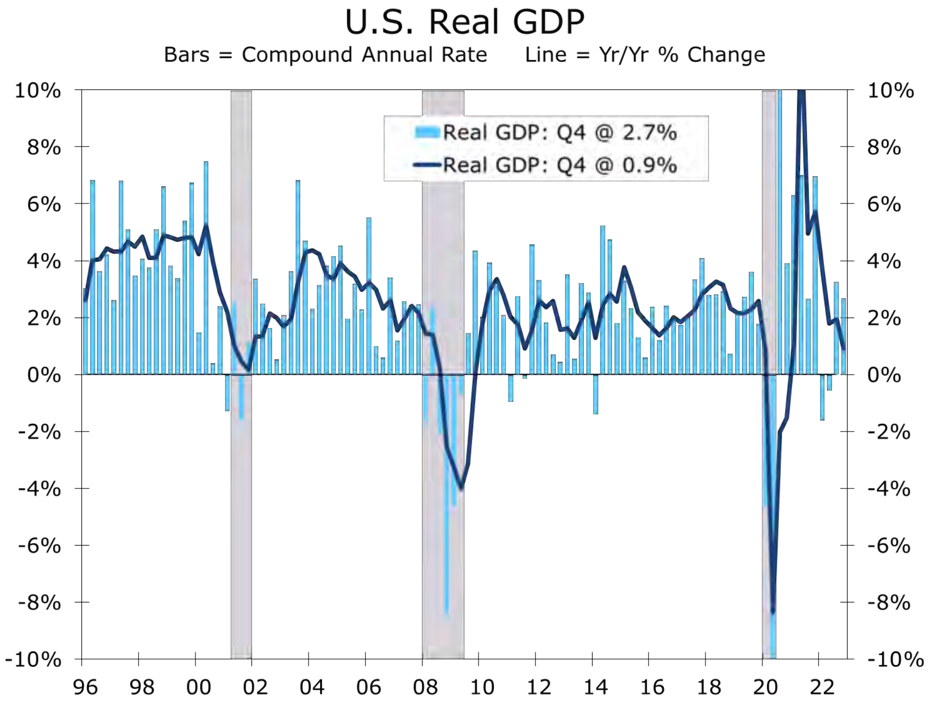
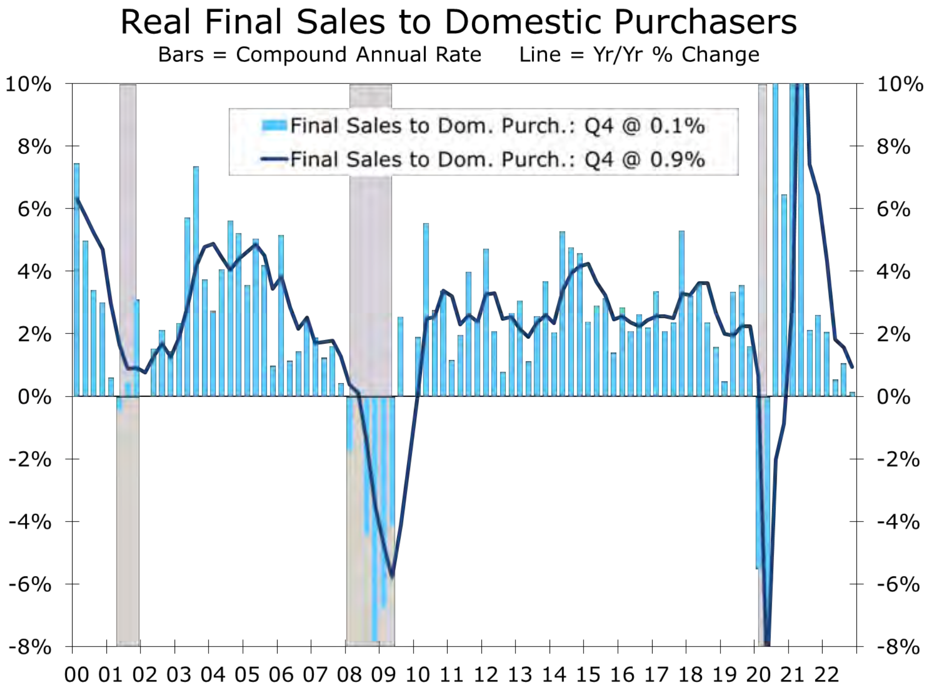
LARGE SWINGS IN INTERNATIONAL TRADE & INVENTORIES CAUSED GDP TO STUMBLE LAST YEAR



WHEN YOU STRIP OUT TRADE & INVENTORIES, THE MODERATION IN ECONOMIC GROWTH IS CLEARER



The Labor Market is Proving Remarkably Resilient

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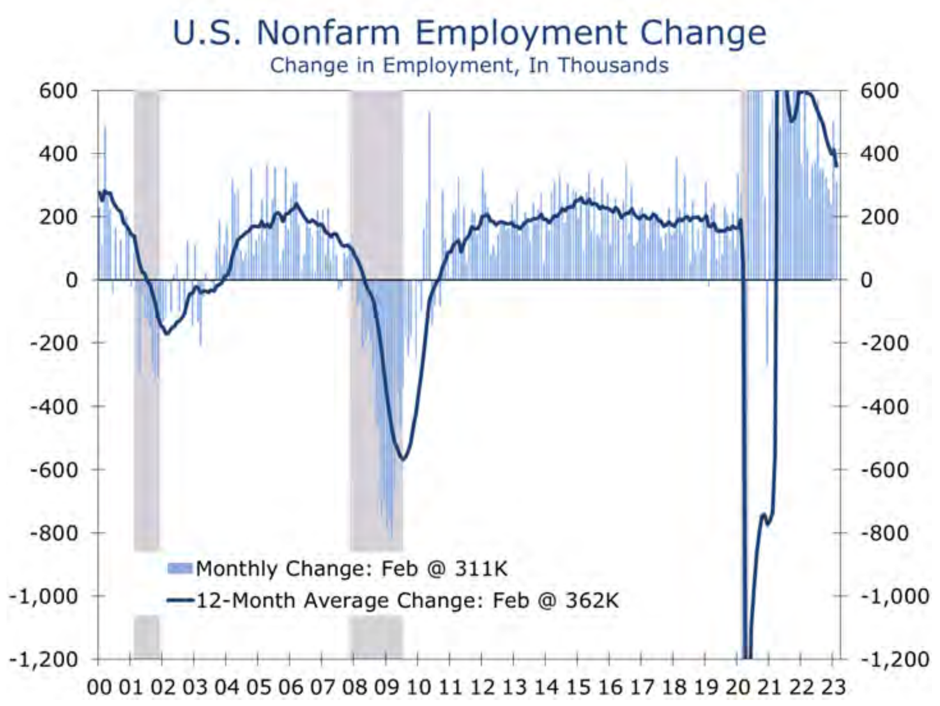
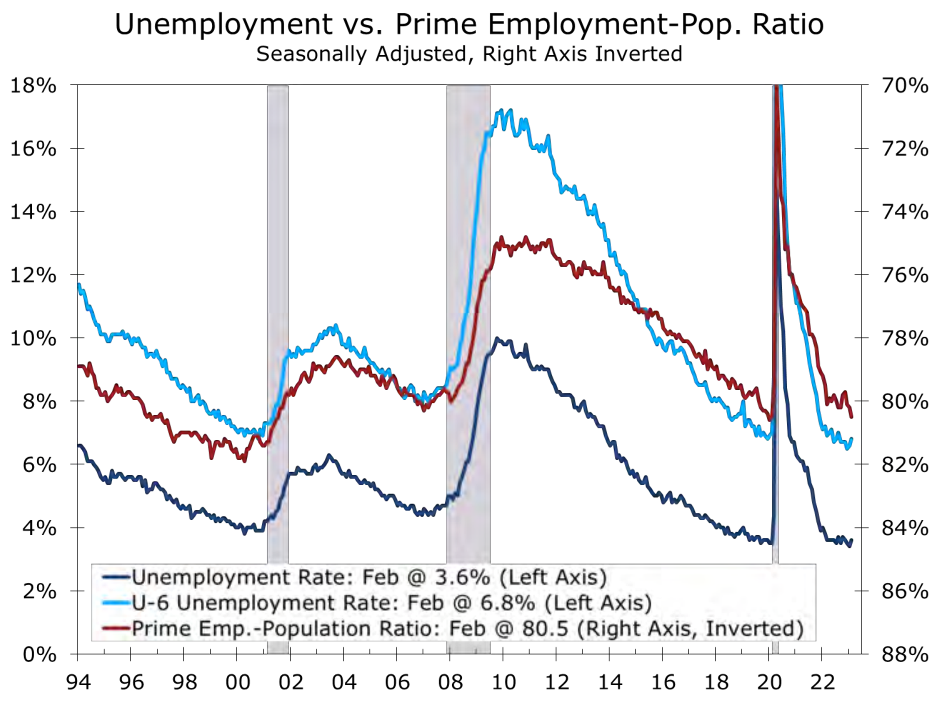
JOB GROWTH IS BEING BOLSTERED BY A REBOUND IN LEISURE & HOSPITALITY JOBS AND MILD WEATHER



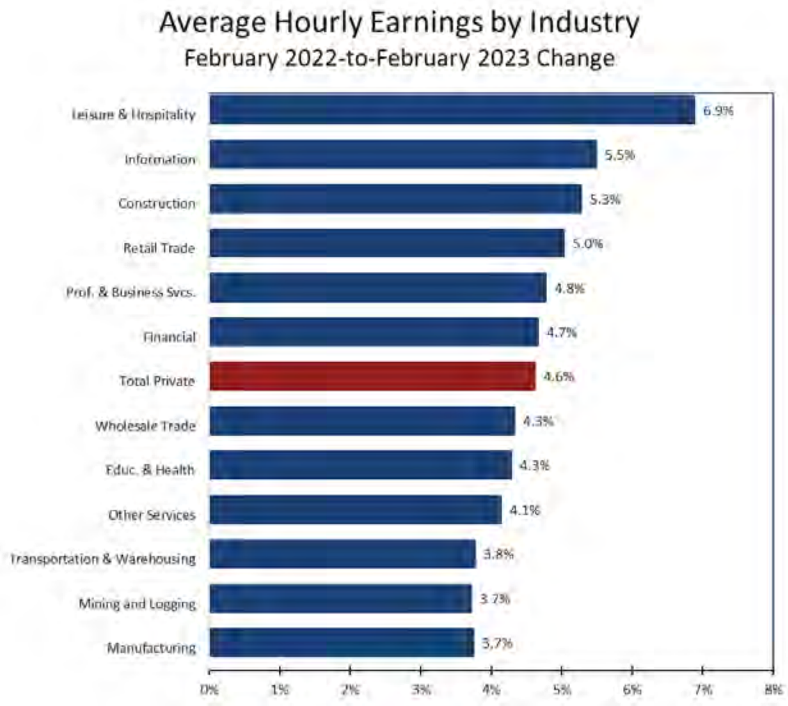
THE LABOR MARKET IS EXCEPTIONALLY TIGHT, WHICH IS KEEPING PRESSURE ON WAGES

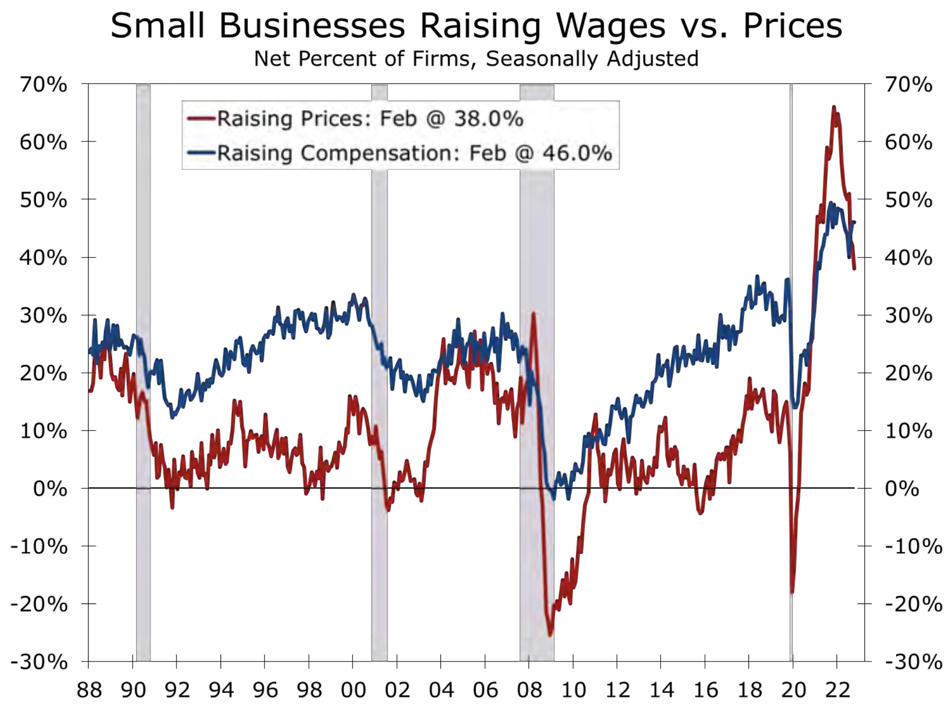


Source: Bureau of Labor Statistics

Rising Wages Will Continue to Drive Inflation

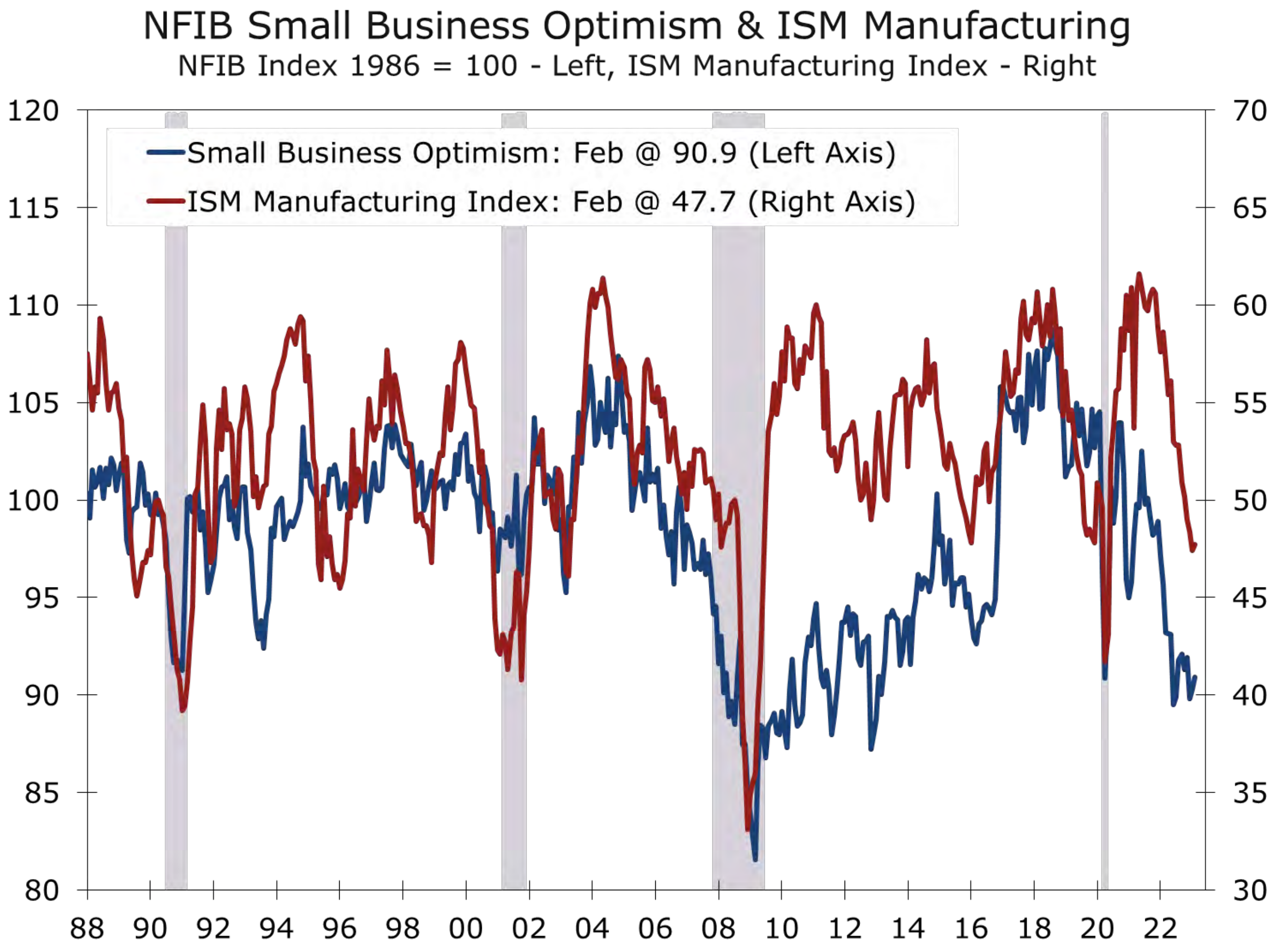
Wages are rising faster than they did in the prior cycle in all industries. Firms are raising prices to offset the hit to margins, which raises the prospect of a self-reinforcing wage-price spiral. Wage pressures have eased somewhat in recent months, as many firms are now trimming staff. Leisure and hospitality continues to see the largest wage 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 fallen below the key 50 break-even level. This index would need to drop below 43, however, before it would be consistent with a recession.



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

Job Openings Have Begun to Correct

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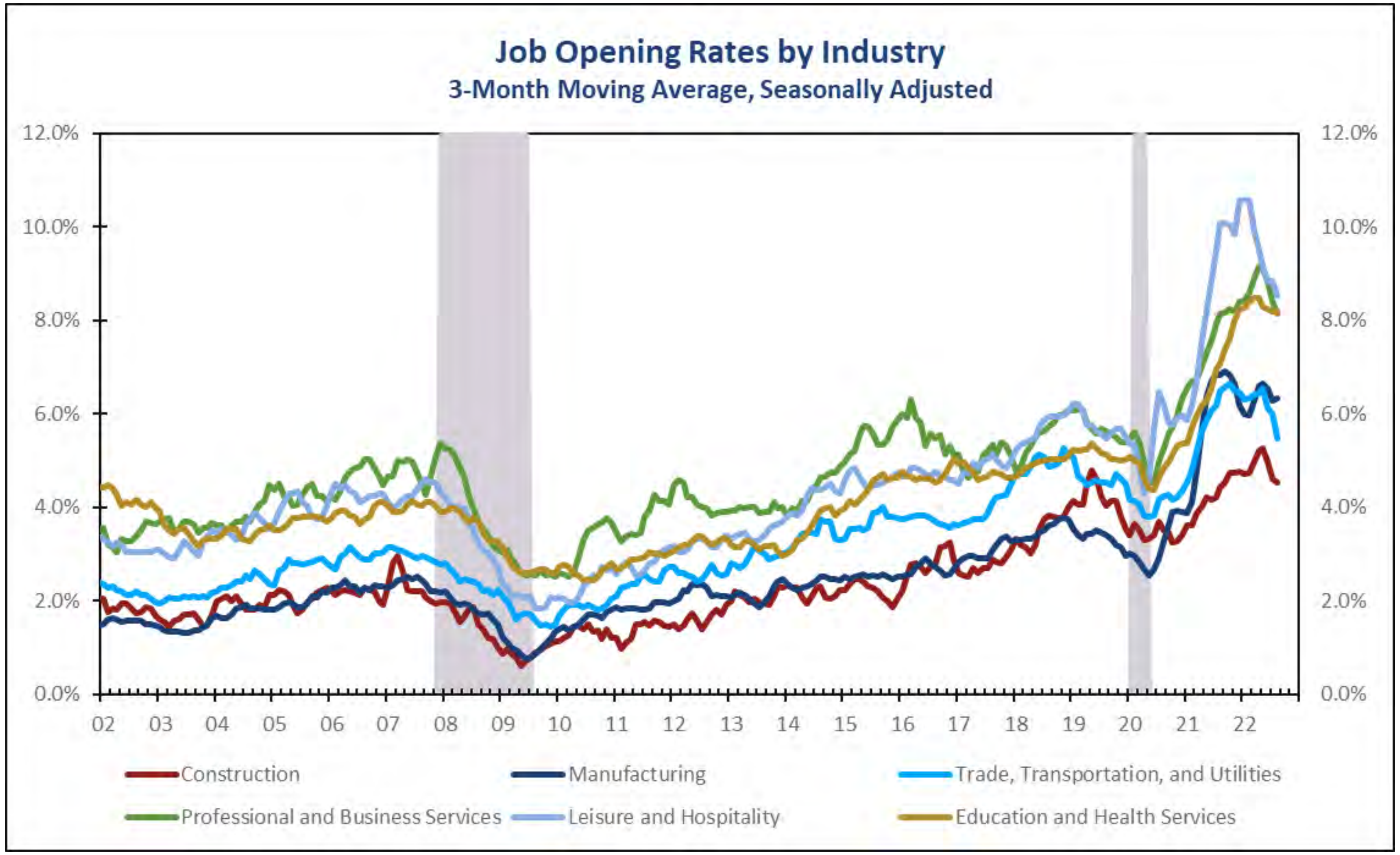
- While restaurants still appear to be packed, job openings in the hospitality sector have clearly rolled over.
- Job posting in transportation & warehousing have also rolled over, although overall job openings remain historically high.
- The persistence of job openings reduces the odds of a hard landing but will make it harder to bring inflation to the Fed's 2% target/



Source: Bureau of Labor Statistics

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, which would likely 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

Inflation Has Rolled Over But Remains Persistent and High

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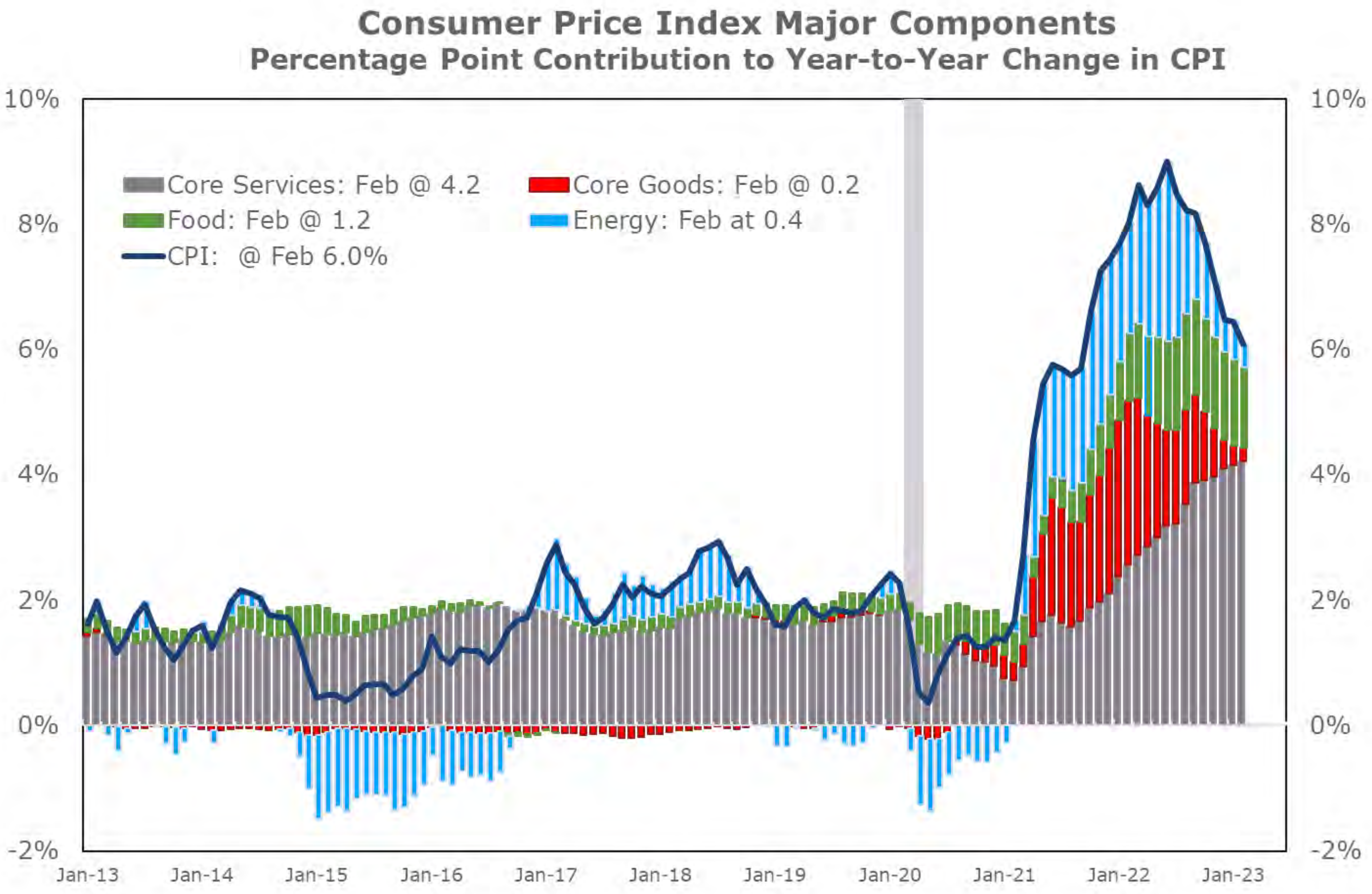
- The headline inflation numbers have moderated slightly since the middle of last year, as gasoline prices and used car prices plummeted.

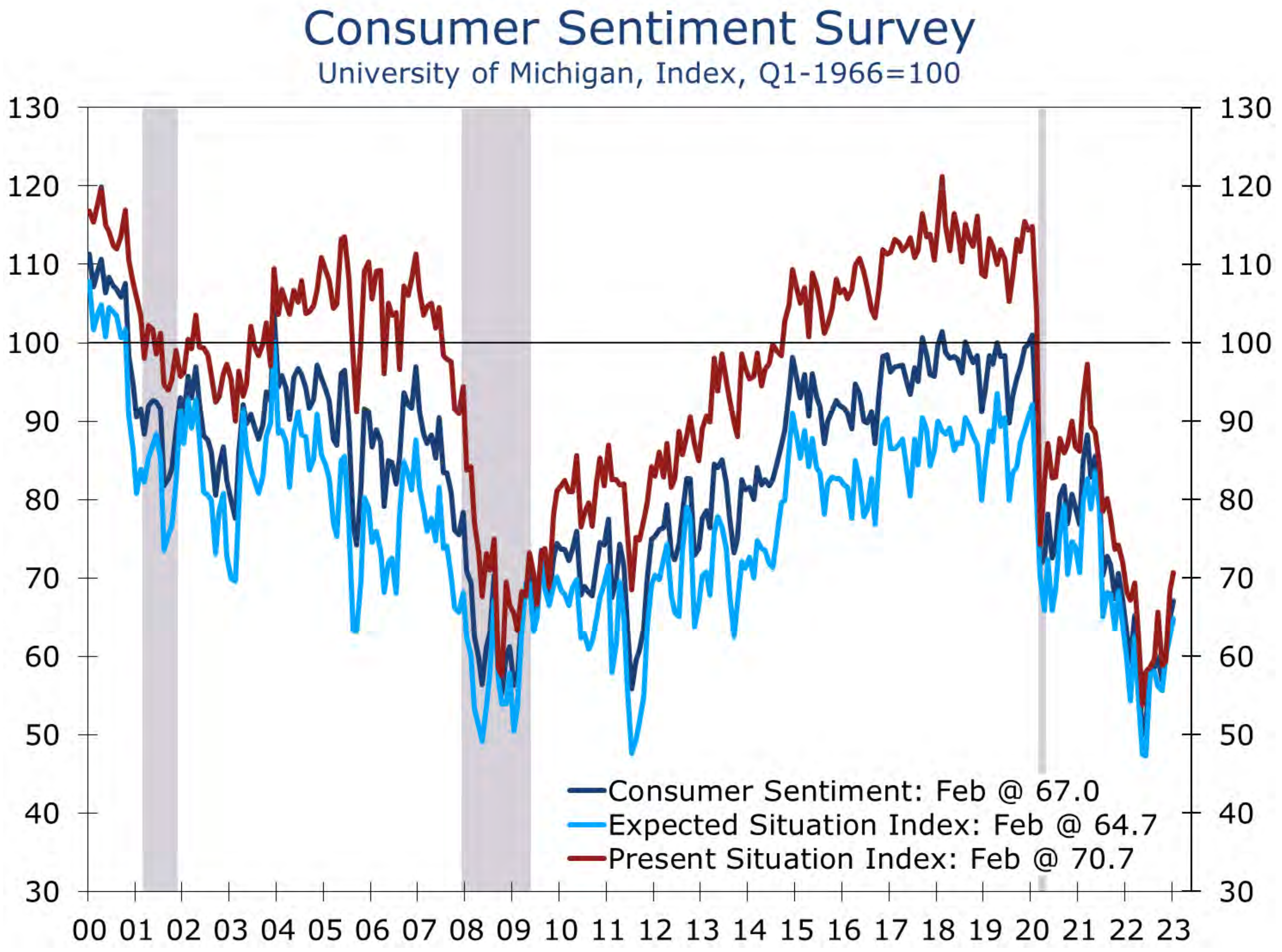
- Core inflation remains problematic, however, particularly in the service sector. The BLS measure of rents is still catching up with larger increases in market rents.



Source: Bureau of Labor Statistics

Higher Inflation Continues to Weigh on Consumer Sentiment

- Consumer sentiment has rebounded slightly in recent months, likely reflecting stronger near-term economic growth.
- 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: S&P CoreLogic Case Shiller

Services Outlays Continue to Outpace Goods Spending

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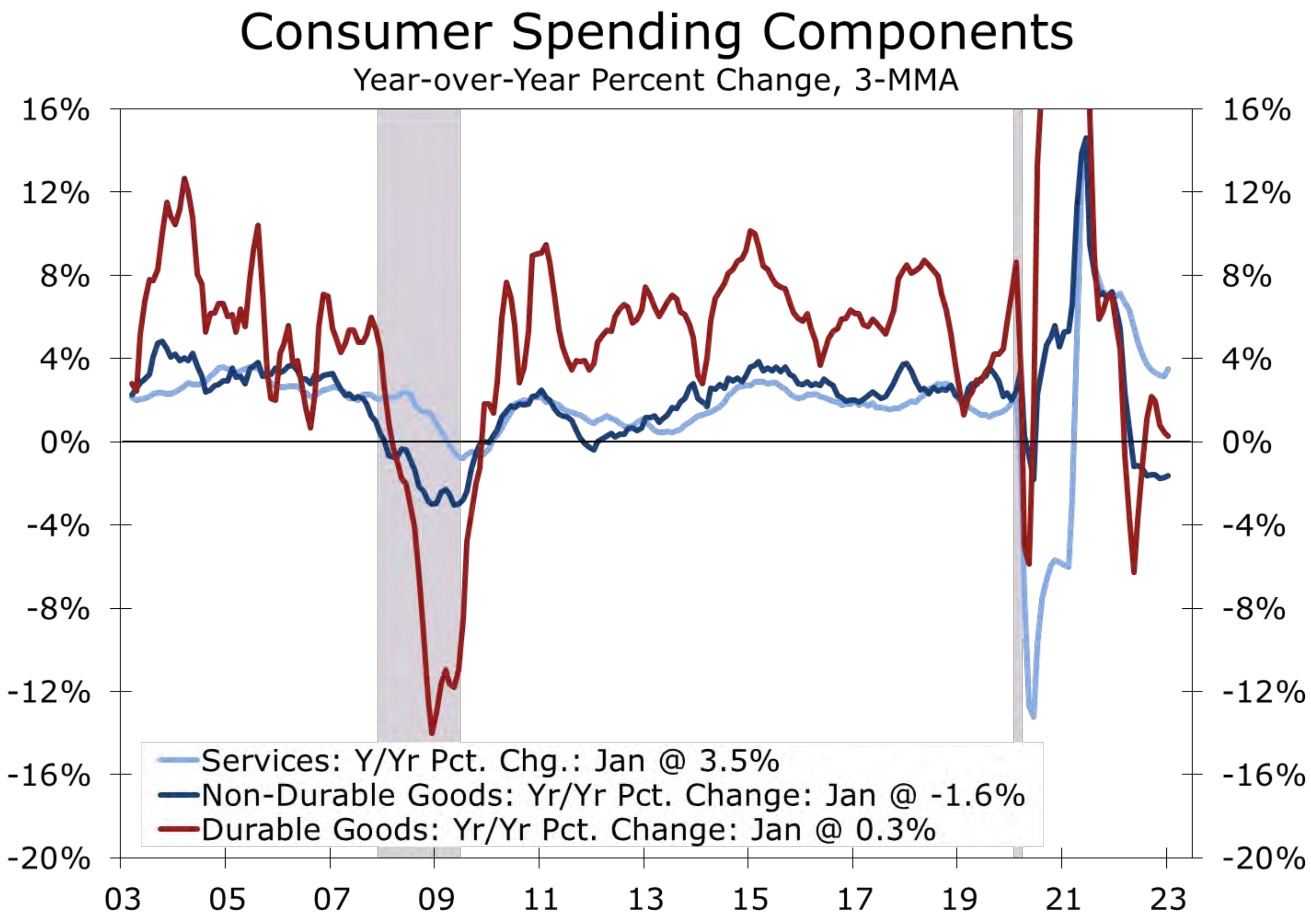
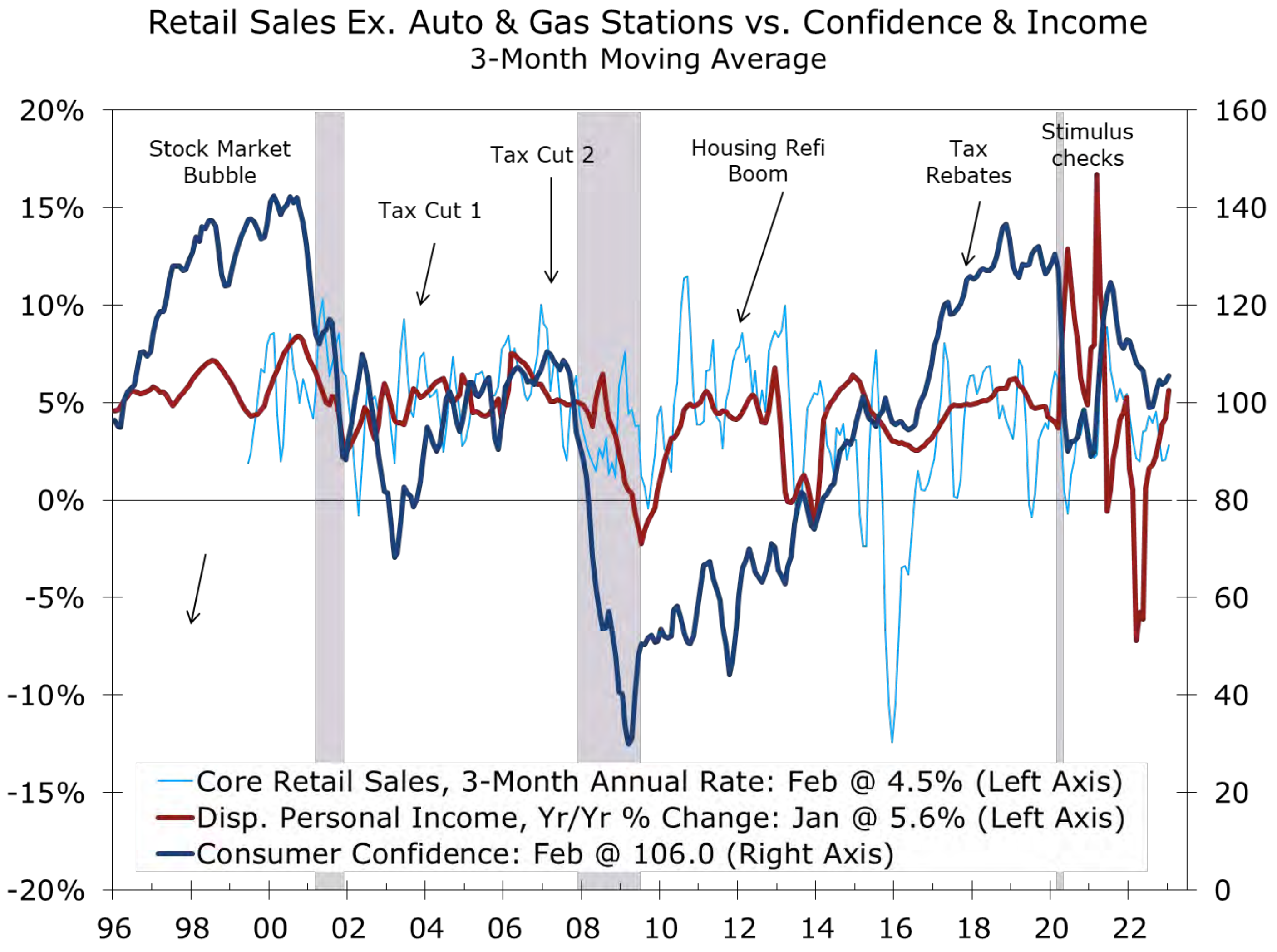
- Disposable income surged at the start of 2023, helped along by large increases in Social Security COLAs and wage gains.
- The boost in income has helped sustain spending on services, with dining out, entertainment and travel seeing the largest gains.
- Spending for goods continues to normalize following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



Source: S&P CoreLogic Case Shiller

Retail Sales Showed Surprising Strength in January

- The incredible 3.0% surge in January retail sales was greatly exaggerated by seasonal factors. Sales were unusually weak in December, which meant they fell less than usual in January.
- Sales did benefit from stronger job and income growth, as well as unseasonably mild weather – a condition that carried over into February.
- Much of the strength in disposable income is accruing to older and wealthier households.



Source: S&P CoreLogic Case Shiller

Higher Mortgage Rates Clobber Affordability

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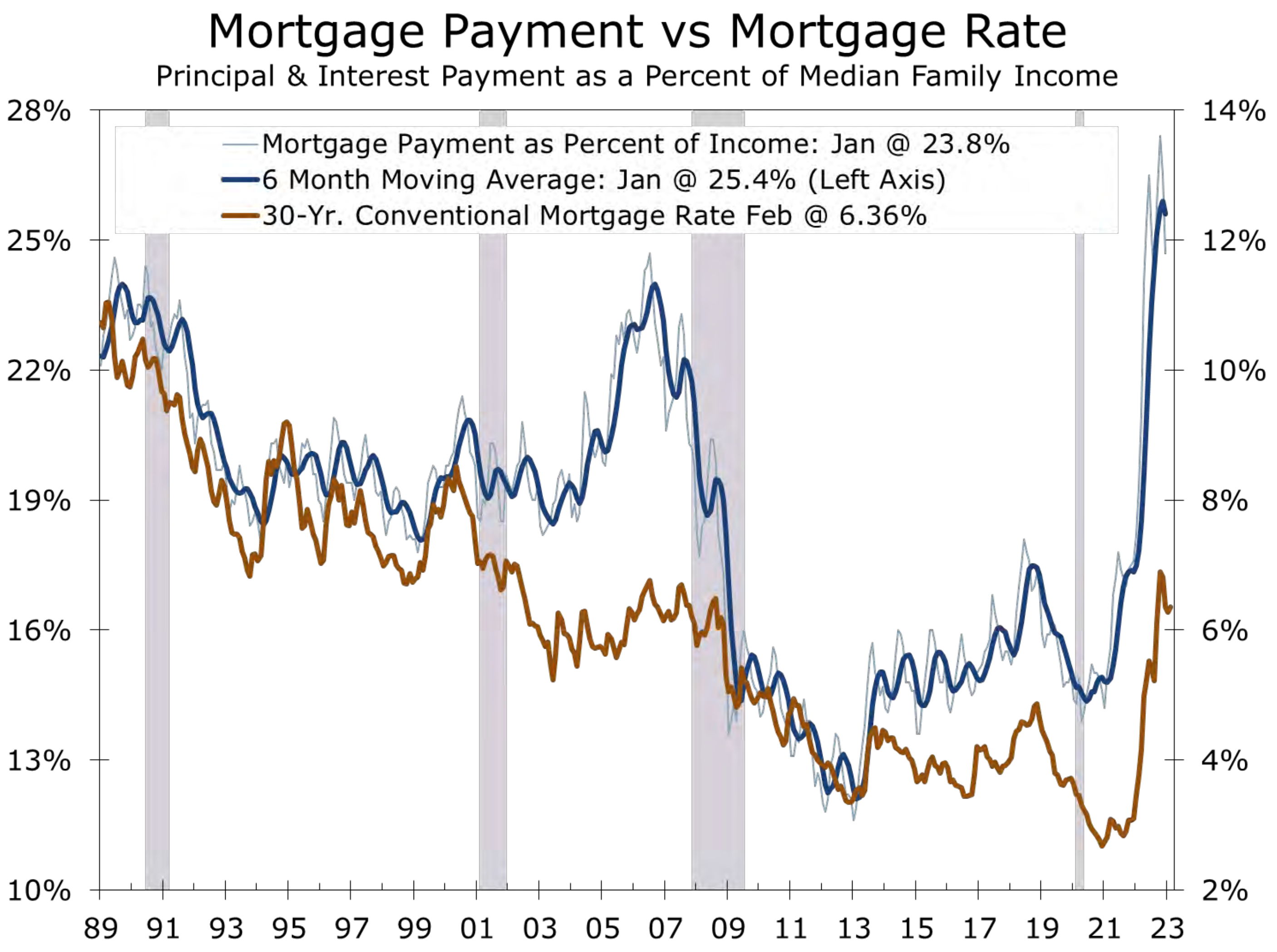
- Housing affordability has begun to recover. Principal and interest payments have fallen back to 23.8% of median family income. The norm is around 19%.

- At $1,807/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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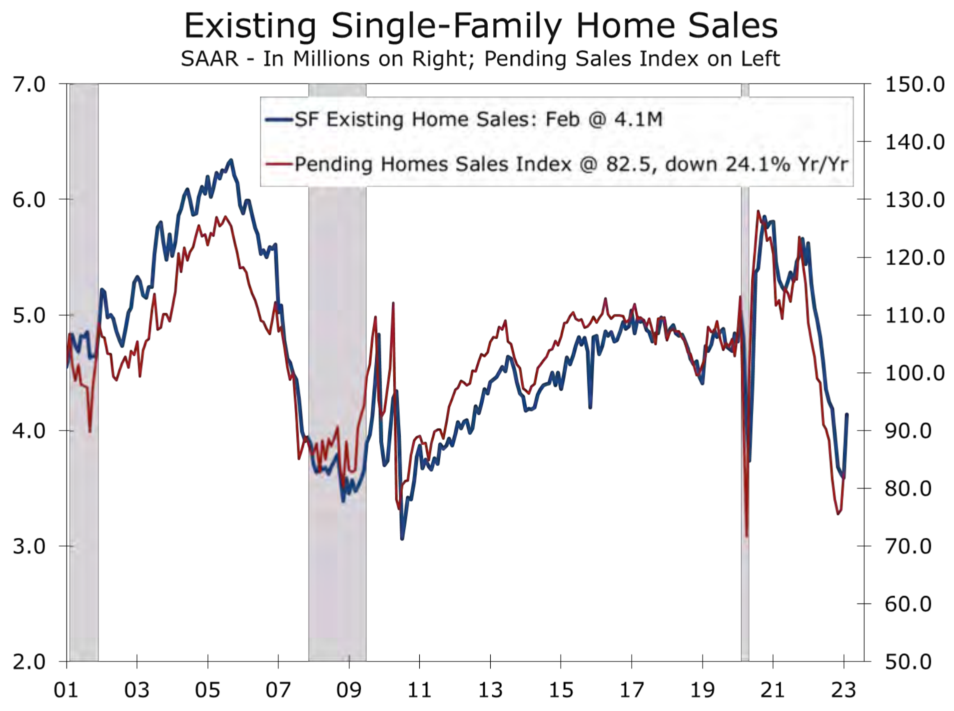
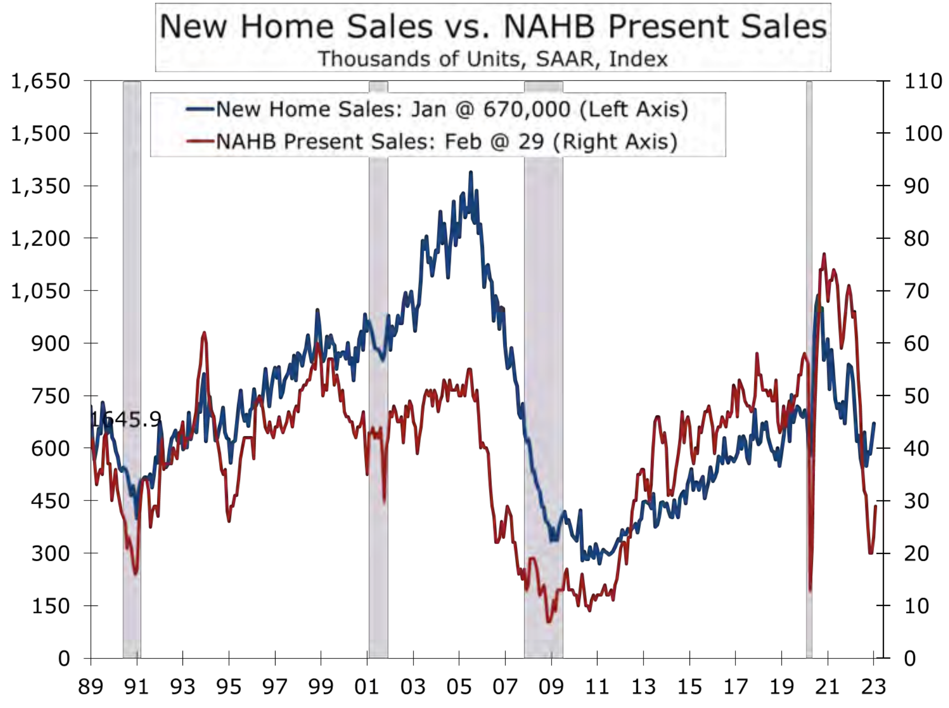
Sales of existing homes have fallen in each of the past 12 months, falling a cumulative 36.1%. The drop is the longest consecutive decline on record. Higher mortgage rates led to a spike in contract cancelations last fall and some buyers returned when rates fell in January. Rates rose this month, following the release of stronger economic reports for the month of January.





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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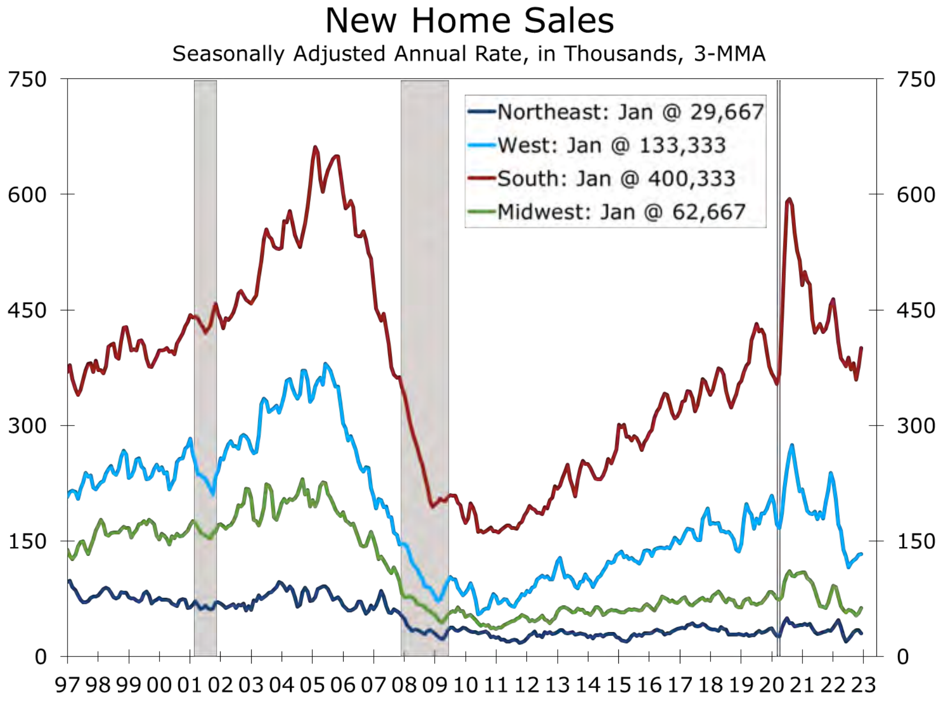
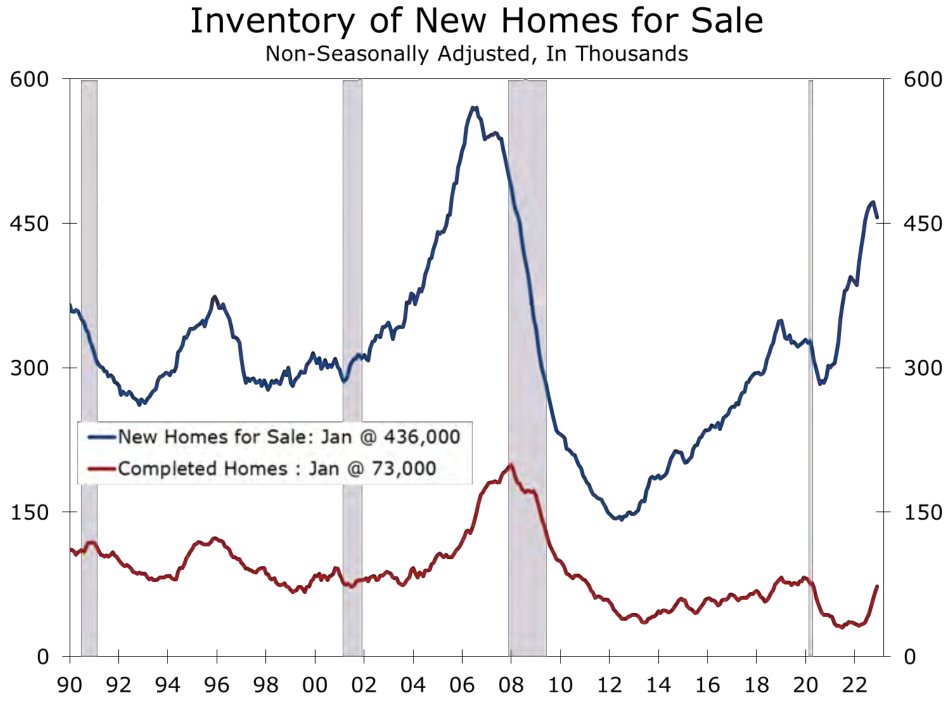
New home sales have fallen back below their pandemic lows in every region except the South.





Source: Census Bureau

New Home Prices Are Selling At Premium to Existing Homes

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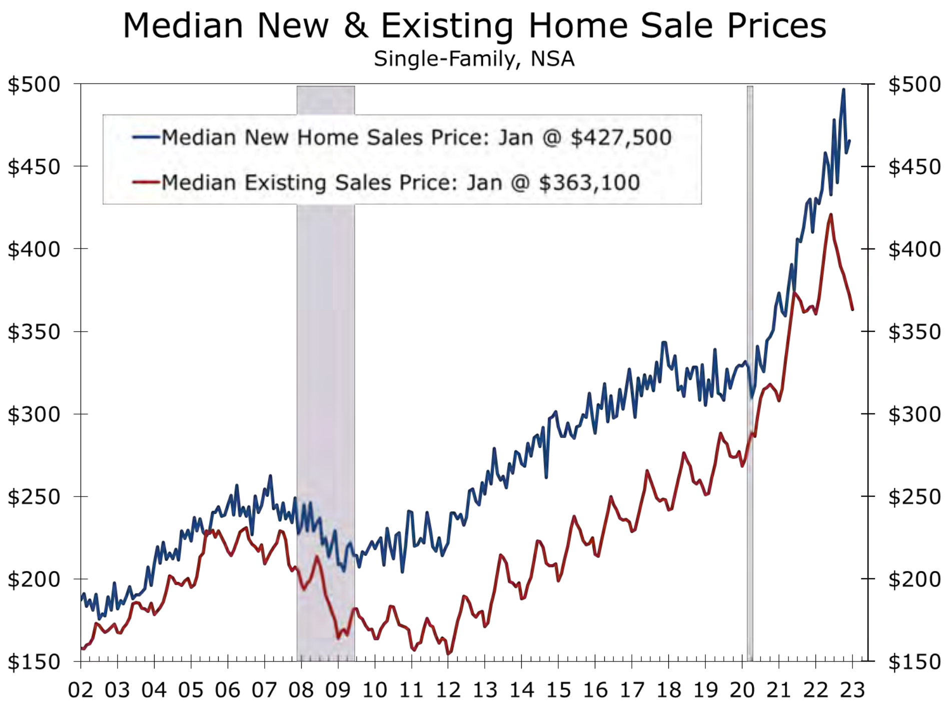
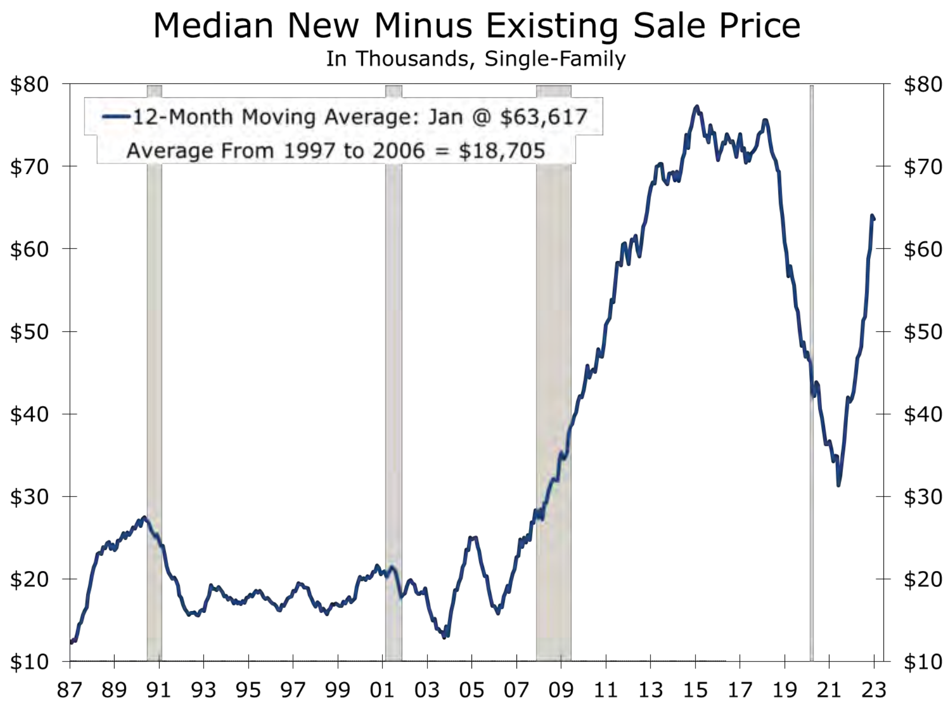
New home prices are selling at a substantial premium to existing homes, reflecting higher construction and development costs. The premium had been shrinking before construction cost spiked following the pandemic and more recently as existing home prices have retreated more rapidly in higher priced MSAs.





Home Prices Will Likely Fall 15% From Their Recent Peak

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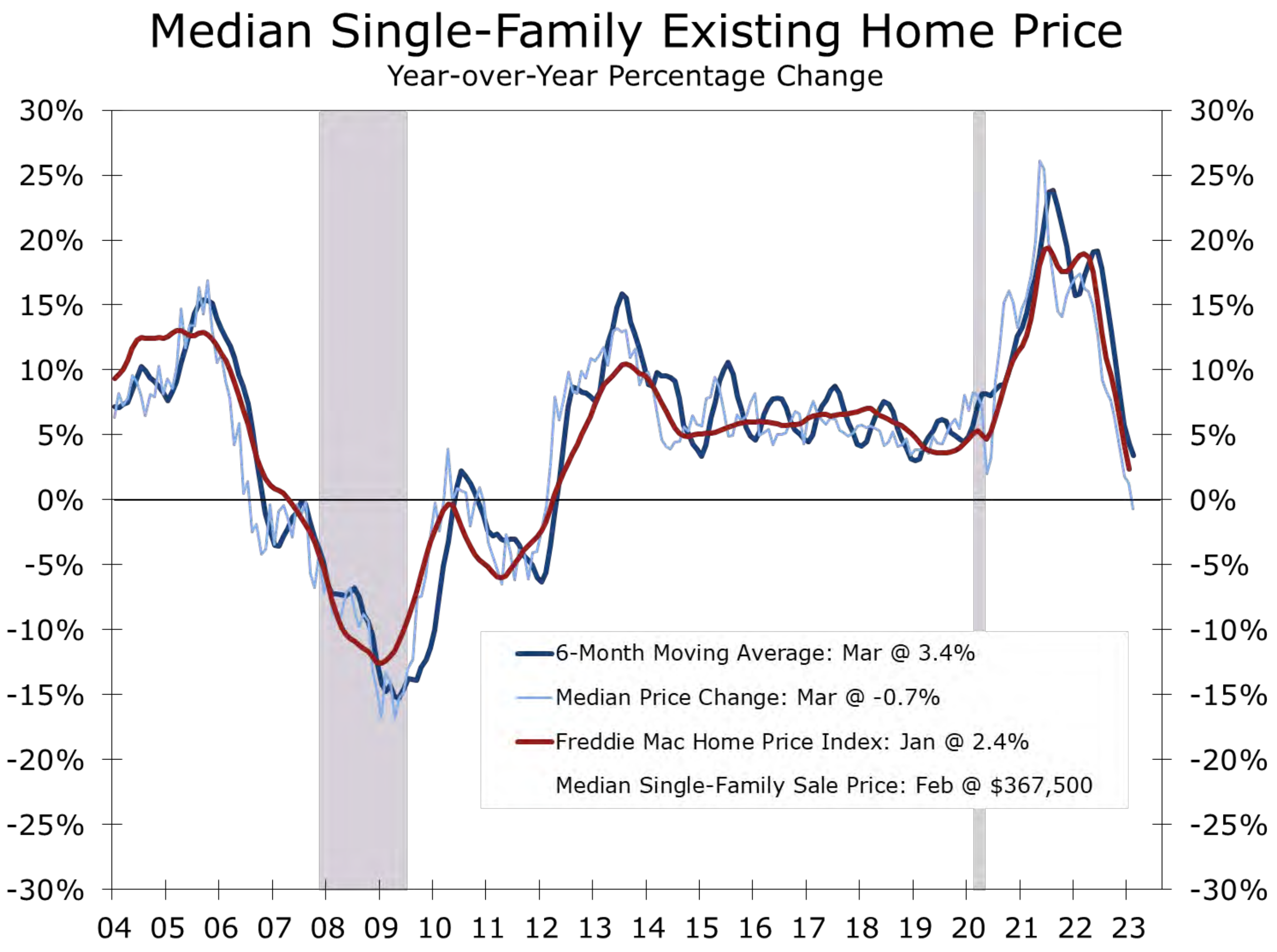
- Home prices have been declining since the middle of last year and appear set to decline at least 15% over the next year to 18 months.
- A repeat of the Housing Bust is unlikely, as credit underwriting has been tight throughout the cycle and most loans are fixed-rate and locked in at low interest rates.
- 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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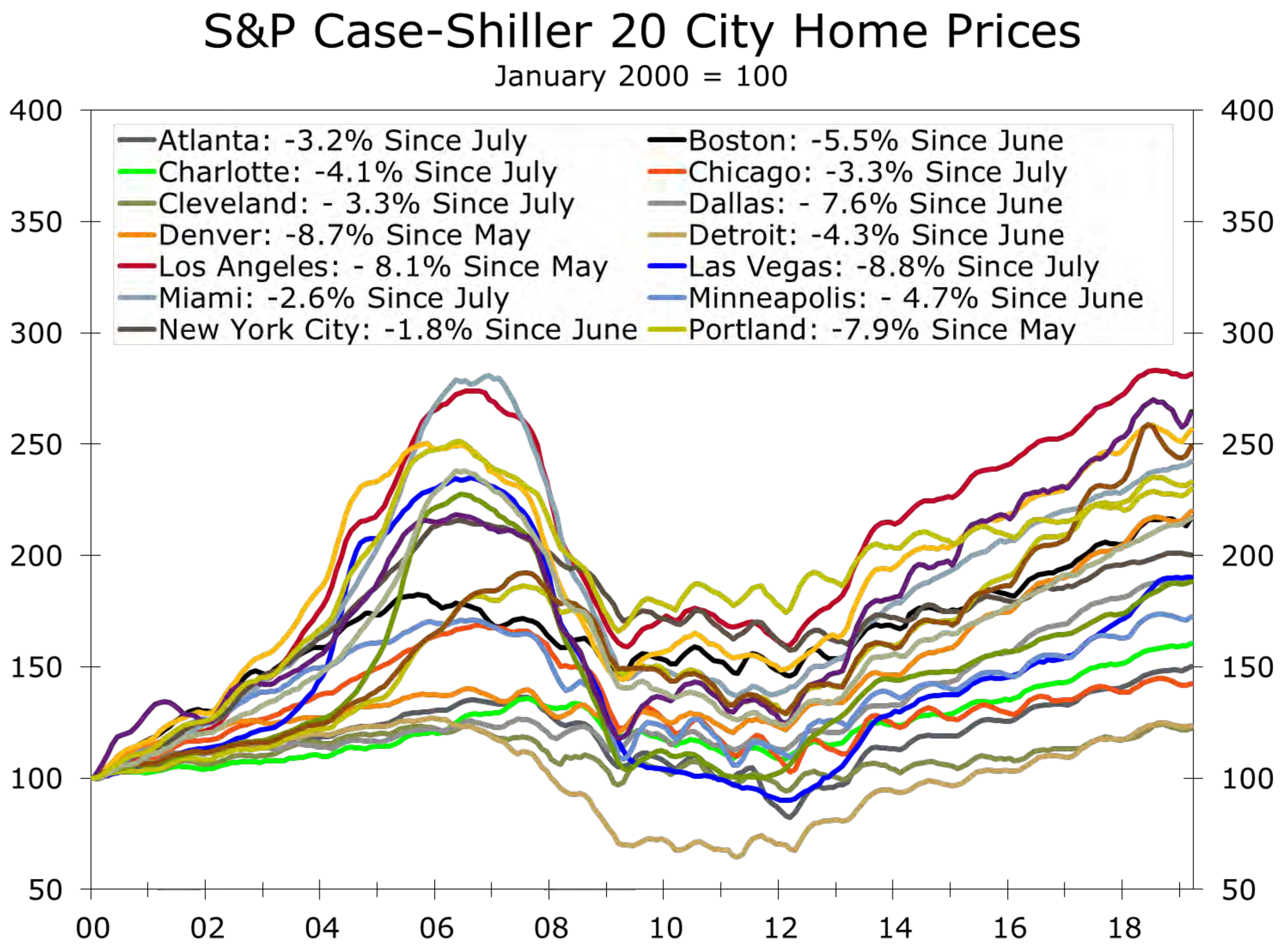
- The Case-Shiller 20 City index has fallen 6.2% since June, while the 10 City index is down 5.9%. The National index has fallen just 4.4%.
- Home prices have been falling most major markets, with the largest declines occurring along the West Coast.
- San Francisco and Seattle have seen the largest drops, with prices falling 16% and 15%, resepectively.



Source: S&P Global

Housing Affordability Has Diminished Substantially

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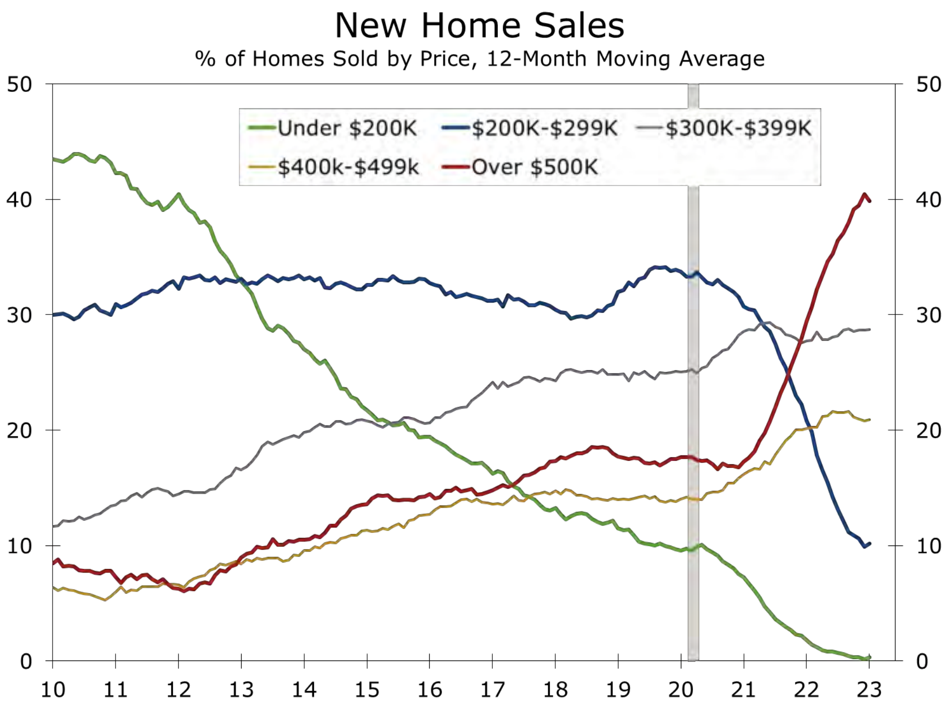
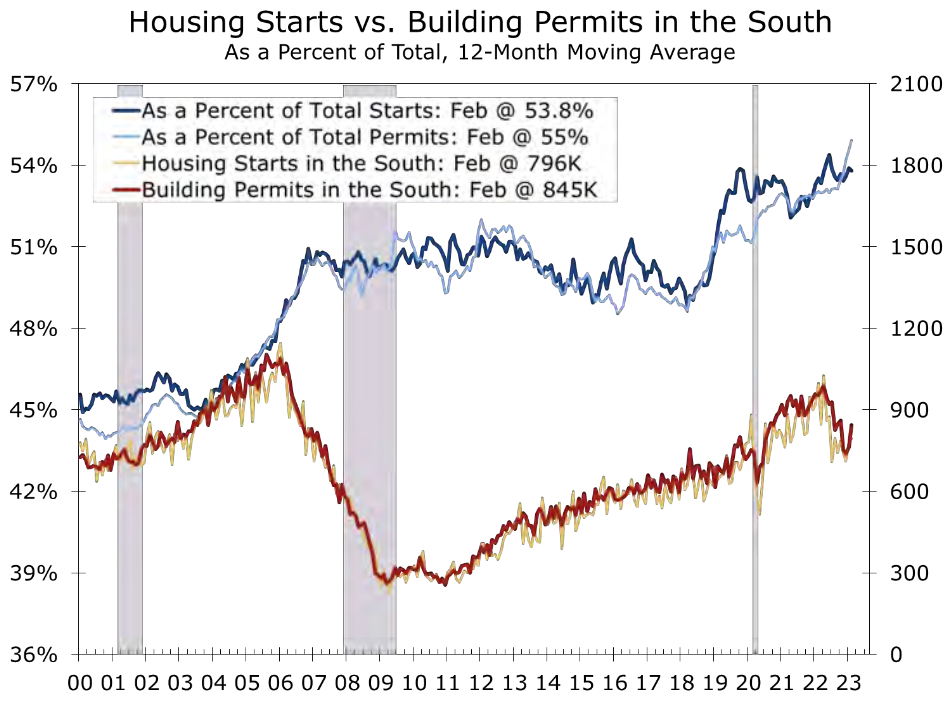
Rising construction and development costs have made it much more difficult to build homes priced at $300,000 or less, even as construction has shifted toward lower cost areas in the South.

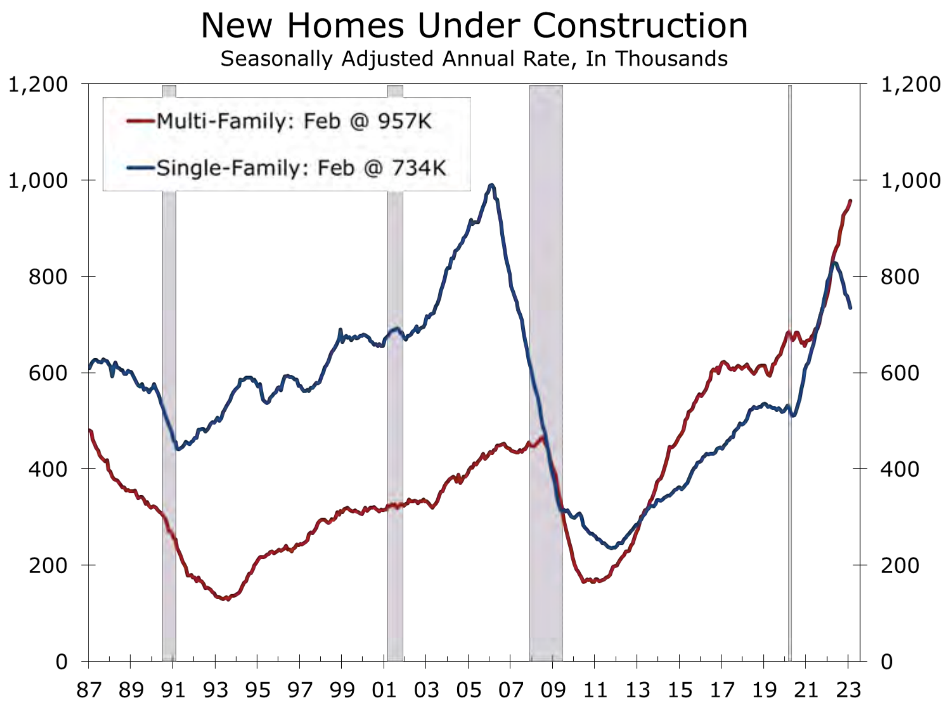


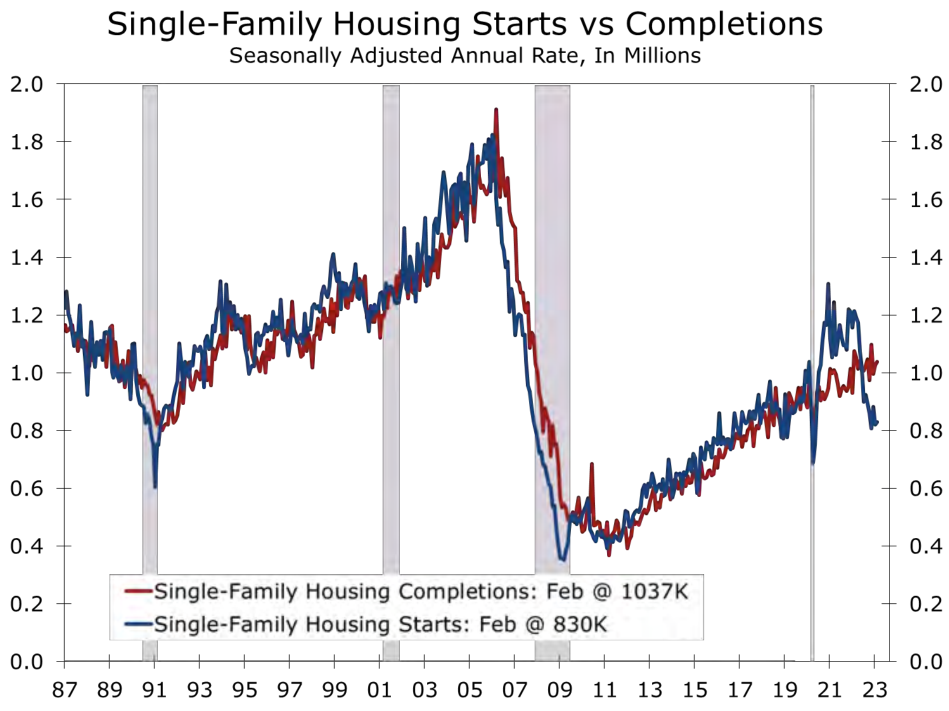


Source: Census Bureau

Home Builders Still Have Significant Work-In-Process

The number of single-family homes under construction has finally begun to decline, as builders slowed starts and milder weather allowed more work to be completed this winter. The number of apartments under development continues to hit new highs but will soon begin to decline as credit tightens.

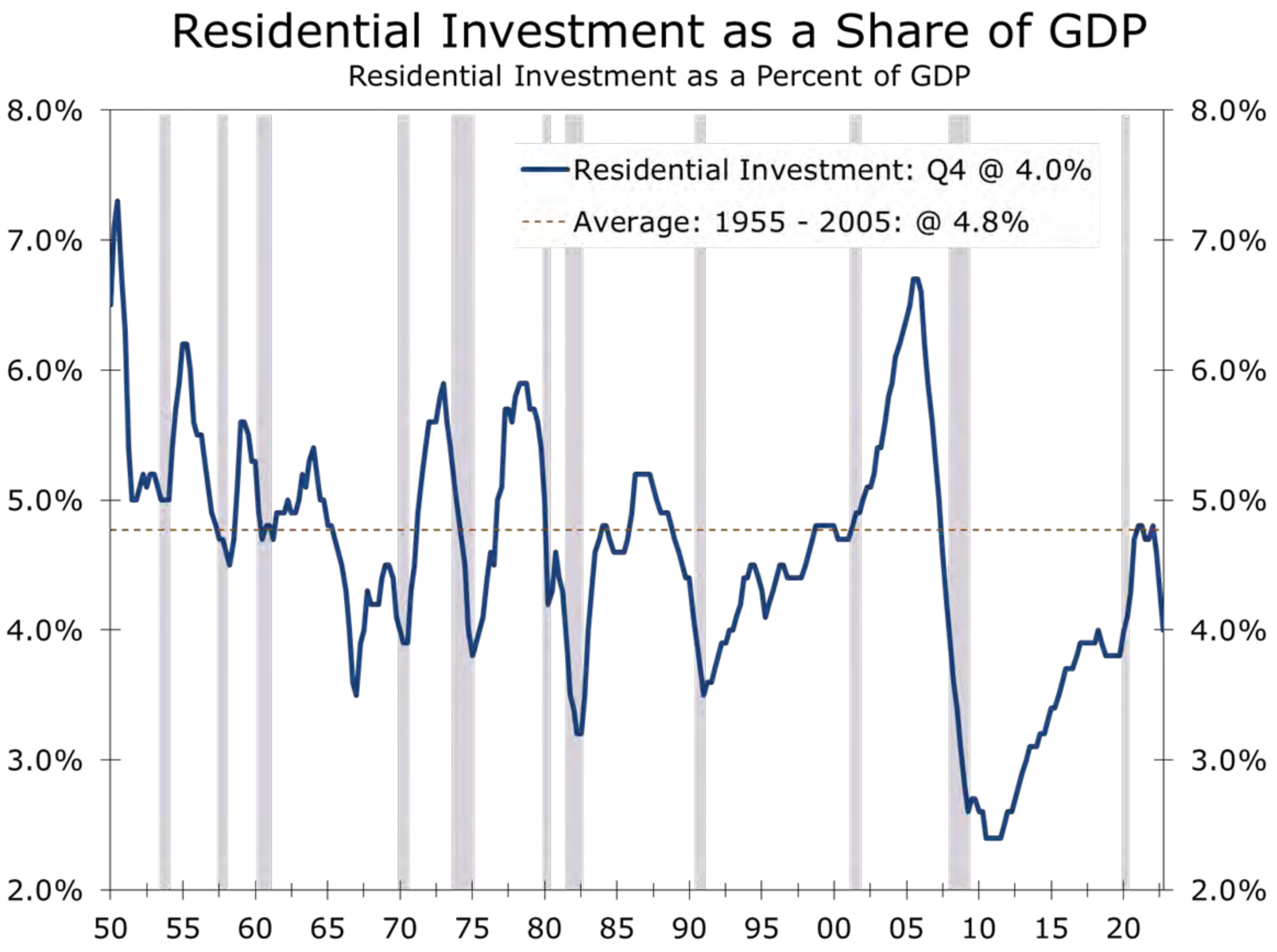




Source: Census Bureau

Residential Investment Only Briefly Reached Its Long-Run Average

- Residential investment briefly reached its long-run average following the pandemic, mostly due to a spike apartment building and commission income on existing sales.
- Single-family housing appears to be significantly underbuilt, but the greatest shortfall is with “affordable” housing.
- With little oversupply, the price correction should be modest.



Source: Bureau of Economic Analysis

Long-Term Interest Rates May Have Hit a Cycle Peak

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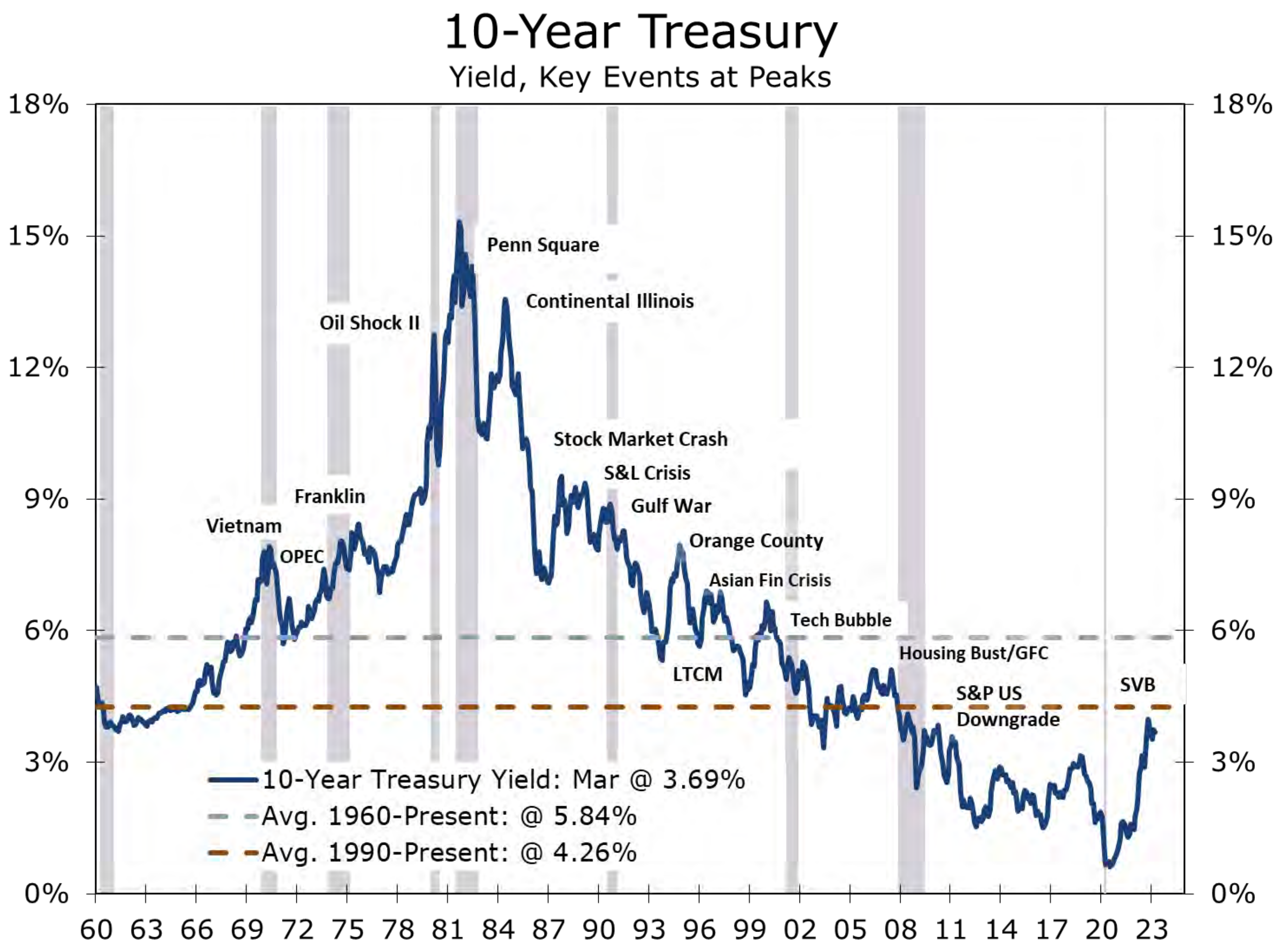
- Large bank failures and other financial crises have typically marked the peak of interest rate cycles.
- The failure of Silicon Valley Bank was somewhat unique in that it appears to have been triggered by poor A/L management
- The cure may be worse than the disease, as regulation of regional banks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

Skepticism About A Soft Landing

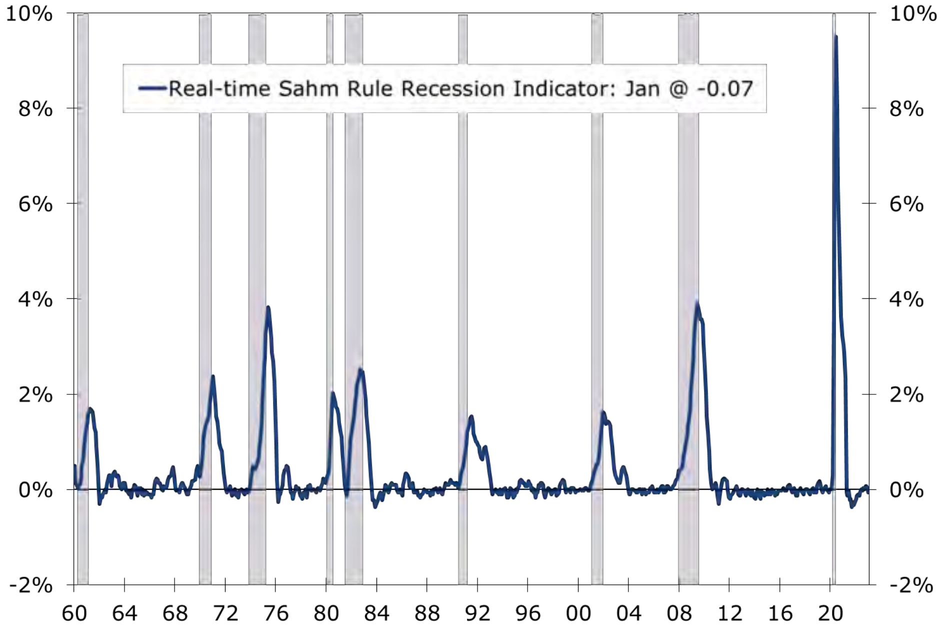
The yield curve has inverted, signaling a recession is likely within a year to 18 month The Fed has never achieved a soft landing when it has had to bring inflation down from its current height or push unemployment marginally higher from its current lows. Most models show a recession is not yet imminent in the US, even tough the yield curve has inverted much further than in past downturns.

Yield Curve Spread

10-Yr Treasury Yield Minus 2-Yr Yield, Basis Points

Real-time Sahm Rule Recession Indicator

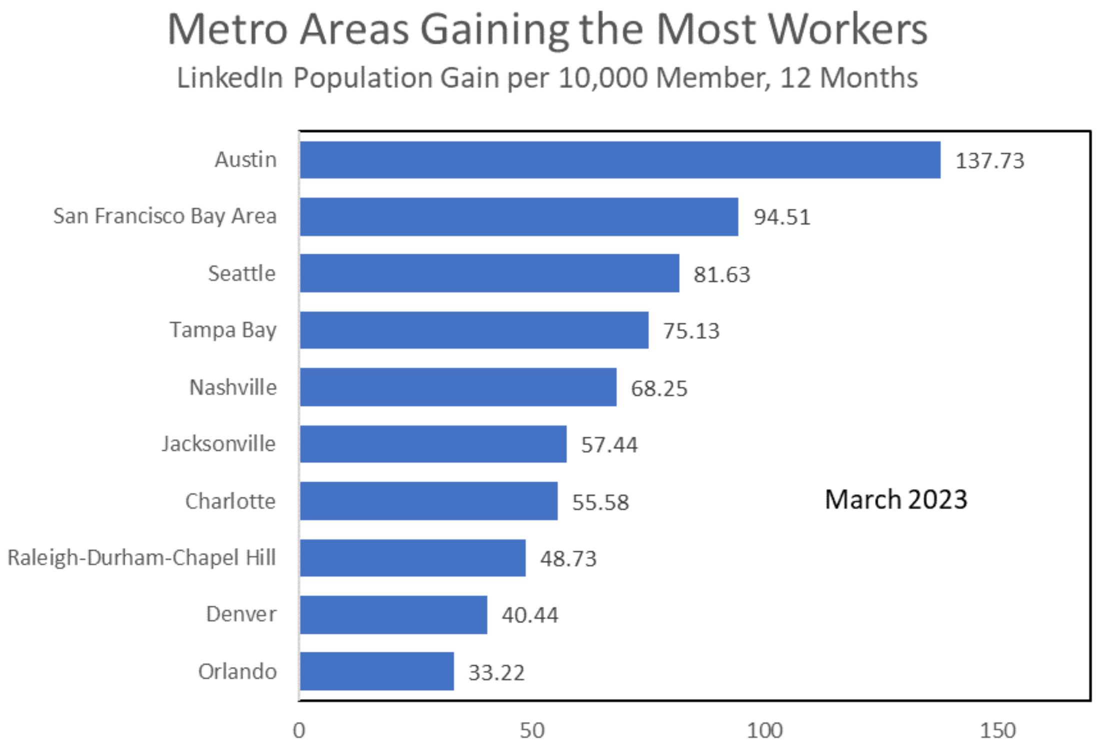
Sahm Rule Indicates A Recession When it Exceeds 0.5%



Source: Refinitiv, Claudia Sahm

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 and Seattle have both moved back into the top ten markets during each of the past four months.
- We believe New York City and Southern California are also seeing stronger inflows.
- Recession concerns may be bringing workers back to the office and workplace.



Source: LinkedIn

Economic Outlook

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US Economic and Financial Outlook

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

	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2021 Actual	2022 Prelim.	2023 Forecast	2024 Forecast	2025 Forecast
Output													
Real GDP	(1.6)	(0.6)	3.2	2.7	2.4	0.8	(1.8)	(1.6)	5.7	2.1	1.3	(0.6)	2.1
Consumer Spending	1.3	2.0	2.3	1.4	2.8	0.9	(0.9)	(0.6)	7.9	2.8	0.9	1.1	2.3
Nonresidential Fixed Investment	7.9	0.1	6.2	3.3	2.2	1.5	(2.5)	(3.0)	7.4	3.8	(0.5)	0.7	3.7
Light Vehicle Sales	14.1	13.3	13.4	14.3	14.2	14.1	14.1	14.3	15.0	13.9	14.2	15.3	16.1
Industrial Production, Manufacturing	3.7	3.3	-0.8	-3.0	1.2	0.6	-1.7	-1.5	5.0	4.3	(2.0)	0.9	2.9
Unemployment Rate (Qtrly Avg)	3.8	3.6	3.6	3.6	3.5	3.7	3.9	4.2	3.9	3.7	3.8	4.5	4.4
Housing Market													
Housing Starts (Units, thous)	1,720	1,647	1,450	1,405	1,330	1,300	1,260	1,250	1,601	1,555	1,285	1,380	1,470
New Home Sales	776	609	580	599	625	540	540	540	771	641	550	630	680
Existing Home Sales	6,057	5,373	4,770	4,197	4,050	3,950	3,960	4,080	6,120	5,030	4,010	4,300	4,550
S&P/Case-Shiller Natl Home Prices (Yr/Yr % Change)	20.1	19.6	8.6	6.0	0.8	(7.2)	(9.0)	(8.9)	18.5	14.7	(6.1)	(5.7)	2.6
Inflation (Year-to-Year % Change)													
Consumer Price Index (CPI)	8.0	8.6	8.3	7.1	5.9	4.4	3.9	3.8	7.1	6.7	4.5	3.4	3.0
Core CPI	6.3	6.0	6.3	6.0	5.5	5.0	4.3	3.9	5.5	6.1	4.7	3.5	2.7
Personal Consumption Deflator	7.5	7.3	4.3	3.7	4.6	4.4	4.2	3.9	5.8	5.8	4.3	3.1	3.0
Core PCE Deflator	5.3	5.0	4.9	4.8	4.5	4.3	4.2	4.0	4.9	4.7	4.3	3.0	2.8
Employment Cost Index	4.5	5.0	5.0	5.1	5.5	5.0	4.6	4.4	3.3	4.9	4.9	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	5.25-5.5	5.25-5.5	5.25-5.5	0-0.25	2.75	5.31	4.80	3.80
10-Year Treasury Note	2.32	2.98	3.83	3.88	3.90	4.10	4.10	4.10	1.45	2.95	4.05	4.00	4.00
Conventional Mortgage Rate (Freddie Mac)	4.42	5.81	6.70	6.42	6.70	6.70	6.60	6.50	2.95	5.34	6.63	6.20	6.00

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