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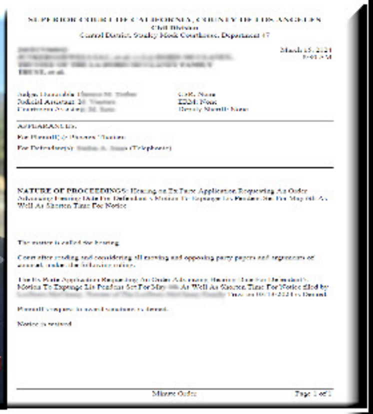

News & Markets Update- March 17, 2024

17 MARCH

The biggest surprise about this economy: It just keeps chugging along, despite efforts by the Federal Reserve to slow it to combat inflation. Not even the fastest sequence of interest rate hikes in 40 years has been enough to cause a real stumble.

THE ECONOMY Not long ago, 2024 looked like a down year. Now, growth is on track to equal last year, with GDP expanding by about 2.5%. In fact, this year may end up a bit better than last year, which in turn was surprisingly good, given the Fed's rate increases. Many forecasters, ourselves included, had expected that the spike in rates would cause a sharp slowdown, if not an outright recession. Yet so far, the economy has shrugged off higher rates and is holding up OK.

Growth will eventually slow down.

But it'll be a return to the long-term trend, with the economy averaging about 2% GDP growth. That appears to be the economy's likely speed limit in the coming years, when you add small increases in the labor force to moderate gains in productivity. (That's an average figure...there will be recessions and bursts of faster expansion from time to time.)

Economic Forecasts

GDP growth NEW
2.5% in '24 after 2.5% in '23; 1.9% in '25

Interest rates
First cut in short rates in June; 10-year rate hovers in low 4's

Inflation
Ending '24 at 2.6% after gradually declining during the year

Unemployment
Rising to 4.0% by end '24, up from 3.9% now

Crude oil
Trading from $80 to $85 per barrel this spring

Retail sales
Rising 2.0% in '24 (from 3.4% in '23); in-store sales, up 1.0%

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For the near term, the tight labor market will keep the economy on track. Job creation is slowing, but only gradually. Certain sectors...health care, food service, state and local government...are likely to keep hiring solidly, for differing reasons. State and local agencies got understaffed during the pandemic and are catching up. Food service is a labor-intensive industry. Health care is chronically short of workers.

The coming move by the Fed to trim interest rates a little ought to help, too. Odds still favor the Fed's June meeting for an initial quarter-point rate cut, followed by a couple more after the election in November. Financing costs won't fall by much, but it should be enough to give businesses that had been holding off on investments some confidence to pull the trigger. That would bode well for the manufacturing sector, which should finally return to growth later this year after its long contraction.

Still, there are some risks that could derail this mostly upbeat projection:

Global shipping disruptions could worsen. For now, the major problems are limited to the world's two most critical canals, Panama and Suez, due to drought and terror attacks in the Red Sea, respectively. Some new trade snarl can't be ruled out.

Regional banks remain under pressure, due in some cases to exposure in their loan portfolios to struggling office buildings. More bank failures are likely.

And inflation, while down, is not beaten. If price gains, especially wages, don't cool fast enough, the Fed may defer the rate cuts that borrowers are counting on. February's CPI report was a reminder that more progress is needed to justify rate cuts. We think inflation will fall further. But it could take longer than the Fed is hoping.

HOUSING The White House wants to make homeownership more affordable. That will start with federal agencies pushing to lo[illegible]ertain housing costs. The Federal Housing Finance Agency will now waive title insurance requirements on mortgage refinancings it acquires from certain lenders, as part of a pilot program. The FHFA oversees Fannie Mae and Freddie Mac, which usually require title insurance on the loans they purchase. The typical cost for borrowers is 0.5% of the loan amount. The Consumer Financial Protection Bureau will also pursue potential new rules to scrutinize anticompetitive closing costs imposed by lenders on buyers and sellers, which the White House says can add thousands to the up-front costs of a mortgage.

A host of other proposals are likely going nowhere anytime soon. The White House wants to offer a tax credit for first-time home buyers. In addition, President Joe Biden is proposing a separate $10,000 tax credit for homeowners who sell their "starter home" to move into a bigger house, thus adding to inventory of more affordable homes on the market, which are sorely lacking these days. Neither proposal stands to gain traction in Congress, especially ahead of the elections.

GLOBAL ECONOMY Central banks will probably continue to push back on rate cut expectations. The Federal Reserve, the European Central Bank and the Bank of Canada left rates unchanged during their most recent meetings. Their message has been that rate cuts will not happen as soon as markets seem to expect. Given the extent to which inflation has overshot central banks' targets over the past couple of years, bank officials are worried about causing further damage to their credibility.

The focus will be on labor markets. The European Central Bank believes that only by June will it know enough about wage trends to justify a first rate cut. The Bank of Japan is expected to actually hike rates in March due to the demands from labor unions for inflationary pay increases in 2024. Japan has held interest rates in negative territory to combat long-running deflation, so hiking now is quite a switch. The Bank of England will also watch average weekly earnings as it mulls a first cut.

June appears to be the timeframe when central banks foresee rate cuts. Many feel that by June they will have enough data showing whether inflation is easing sustainably. Expect the ECB and BOE to move faster than their counterparts in the U.S. or Canada, given that Europe's economies are struggling or in recession.

Beijing has set an ambitious growth target for China's economy in 2024. During China's annual National People's Congress, the country's leadership announced a 5% growth target. That's unchanged from last year, but it'll be harder to achieve. Even though China's economy was set for a reopening rebound last year following its strict lockdown in 2022, it only narrowly achieved its growth target. Now, the country's recovery is hampered by weak domestic demand. In particular, consumption will struggle amid a decline in asset prices and a slow labor market.

Beijing's new fiscal package is unlikely to solve China's economic woes. While the most recent spending program is modest compared with its predecessors, Beijing wants to pursue pro-growth policies without significantly adding to its debt. The priority in 2024 will be to offset the downturn in real estate with greater activity in other areas of the economy, particularly in high-end manufacturing.