CBRE

ECONOMETRIC ADVISORS

Q4 2023
U.S. Macro Outlook

REPORT

FEBRUARY 1, 2024

2024 CBRE Econometric Advisors' Economic Forecast Brief

- Continued economic growth paired with the 'Fed pivot' suggests that the U.S. economy is heading toward a 'soft landing'. But regardless of whether GDP has a '+' or '-' sign in front of it, the pace of growth will likely be much more modest than in recent quarters. A key reason for the slowdown is that consumers are unlikely to repeat their strong showing in 2023 as most households have less cash on hand and overall credit growth is slowing. Further, the business sector is a mixed bag. Interest rate sensitive sectors, such as autos and housing, are holding steady. Currently, many large corporates appear skeptical about growth prospects in 2024. The greatest investment is centered around technology and the potential productivity boost it can bring.

- This cautious tone from firms is filtering into the labor market. Although conditions remain tight the demand for labor is rebalancing from its heights of 2021 when the job openings rate hit 8%—nearly double pre-COVID levels. Today the openings rate is down to 5.6%. This trend coincides with slower wage growth and inflation. Our Baseline forecast expects that progress on inflation is enough to halt the Fed's tightening cycle, but it probably will not quickly return to the Fed's 2% target either. This suggests that interest rates will remain elevated relative to past cycles. Other uncertainties confronting inflation and financial markets include an array of conflicts and elections around the world.

- On a positive note, the latest data suggests we will get a mix of continued economic growth amid easing interest rates and financial conditions. This is good news for both real estate fundamentals and capital markets. Regarding the latter, some leading indicators suggest this thaw is beginning and cap rates are likely near their peak for most sectors.

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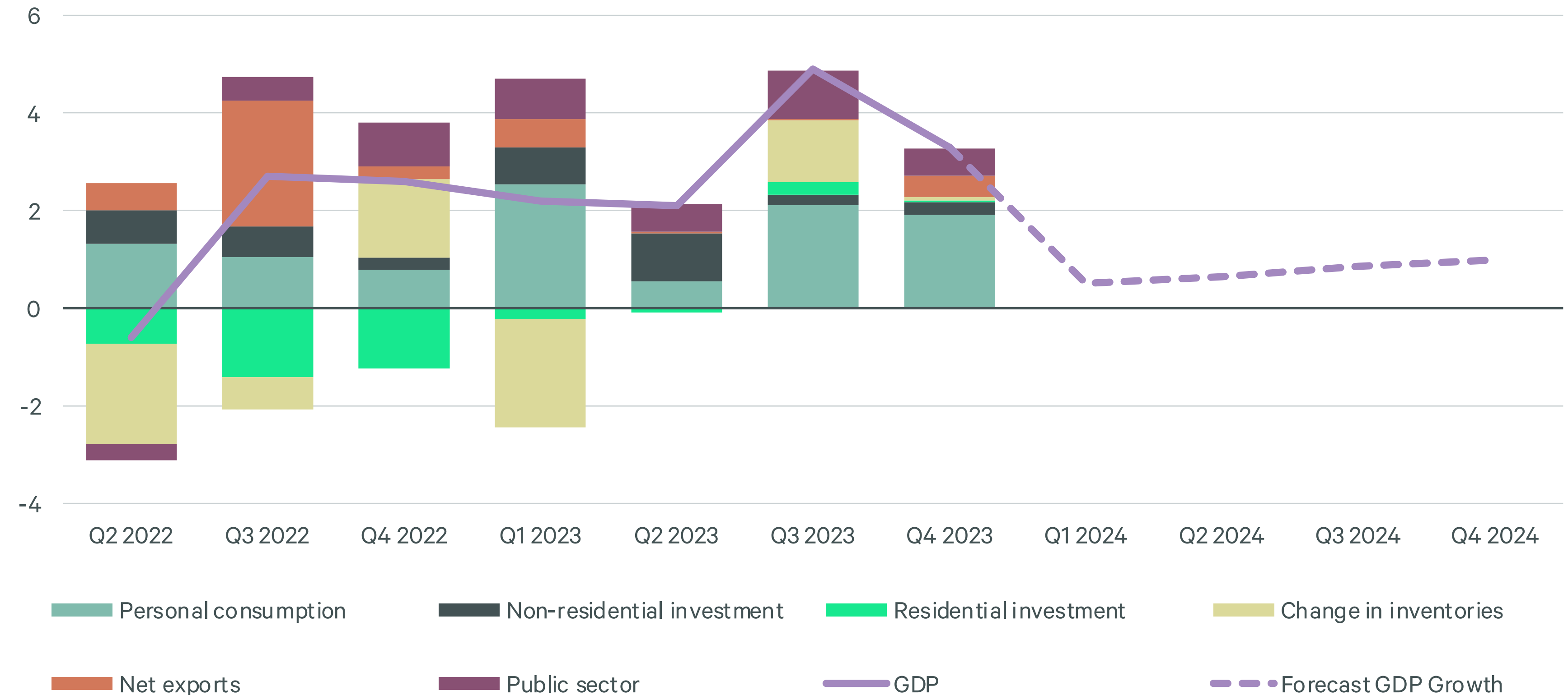
What will drive the slowdown in growth?

Most key economic indicators suggest that the U.S. economy is on the path for a 'soft landing' rather than a very moderate recession. We do expect that the pace of economic growth will slow this year relative to 2023. Key reasons include:

- The U.S. consumer was a key factor in 2023's sturdy performance but we doubt there is enough spending power, especially amongst lower-income households, to drive outsized growth.
- Inventory growth contributed to GDP during H2 2023, but their cyclical nature suggests they will likely be a drag on growth in H1 2024.
- Perhaps the most uncertain component of growth is the public sector. Government stimulus continues to circulate throughout the economy and has contributed to growth during the past six quarters.



Source: Bureau of Economic Analysis, CBRE Econometric Advisors

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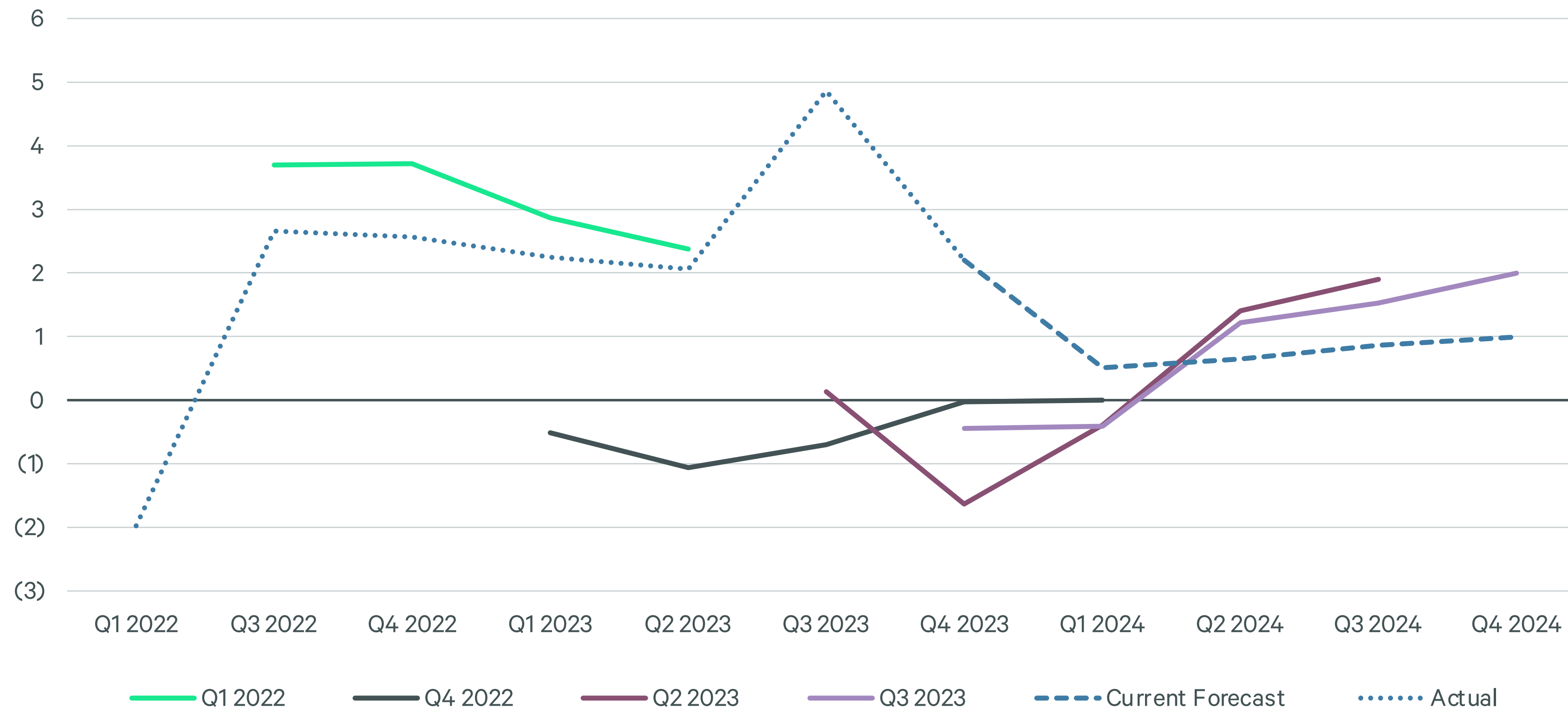
How our outlook has changed

- CBRE EA's macro-outlook has undertaken a data dependent evolution in recent years, tracking the rise and fall of inflation and a very dramatic tightening cycle.

- Concerns surrounding tighter financial conditions began to weigh on our economic outlook during H2 2022. This stance was emboldened by a string of bank failures in early 2023. However, monetary policy was balanced enough to quell the banking crises, allow for a benign decline in inflation, and maintain growth. This disconnect was a key driver of our forecasting error in recent quarters.



Source: CBRE Econometric Advisors

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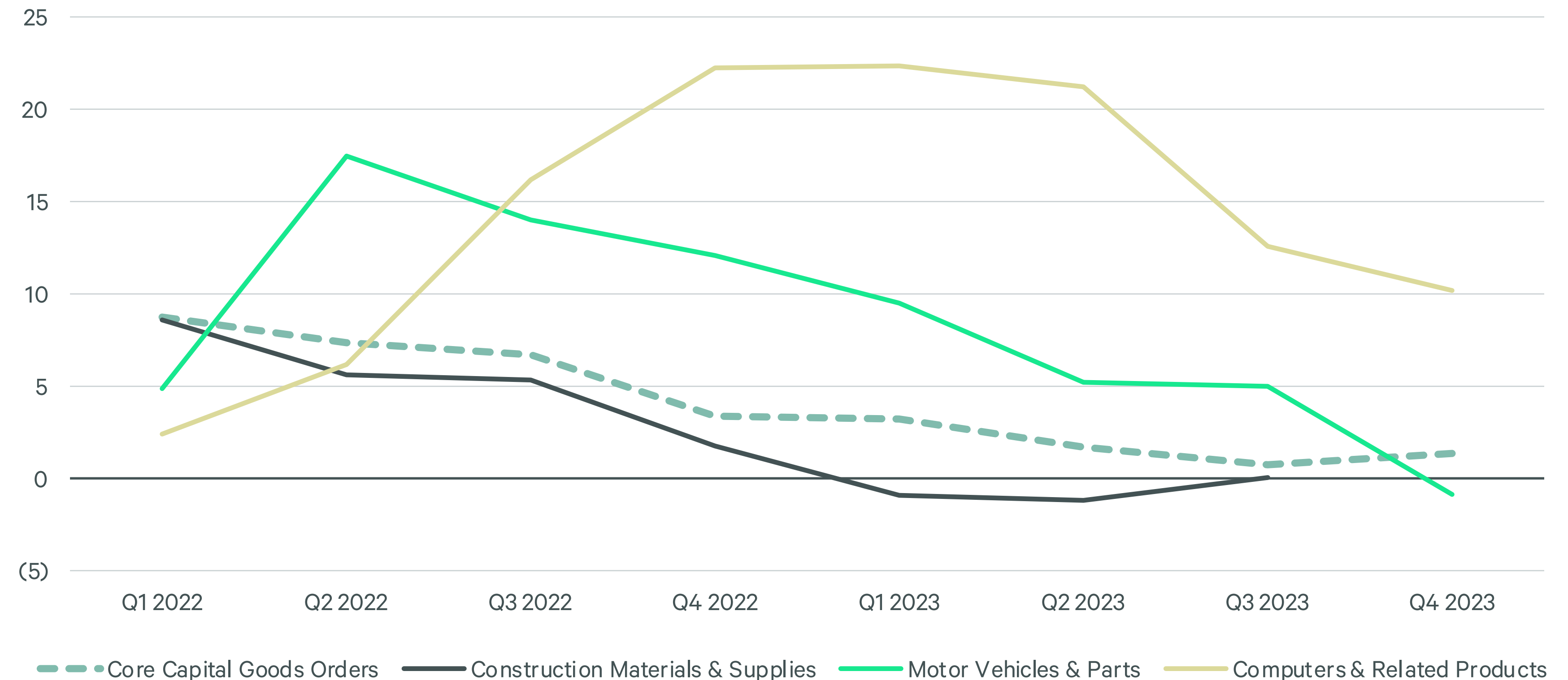
Technology is driving business orders

- Core capital goods orders, a reliable barometer of economic health, are settling at a lower range as supply chains are normalizing.

- Capital goods orders in the auto space have slowed dramatically and are now beginning to contract. This reflects the post-COVID rebalancing but also higher interest rates weighing on sales. Similar factors have influenced orders for construction products.

- High-tech is a clear winner as investments in AI and other productivity enhancing tools are driving orders (and equity market performance).



Source: U.S. Census

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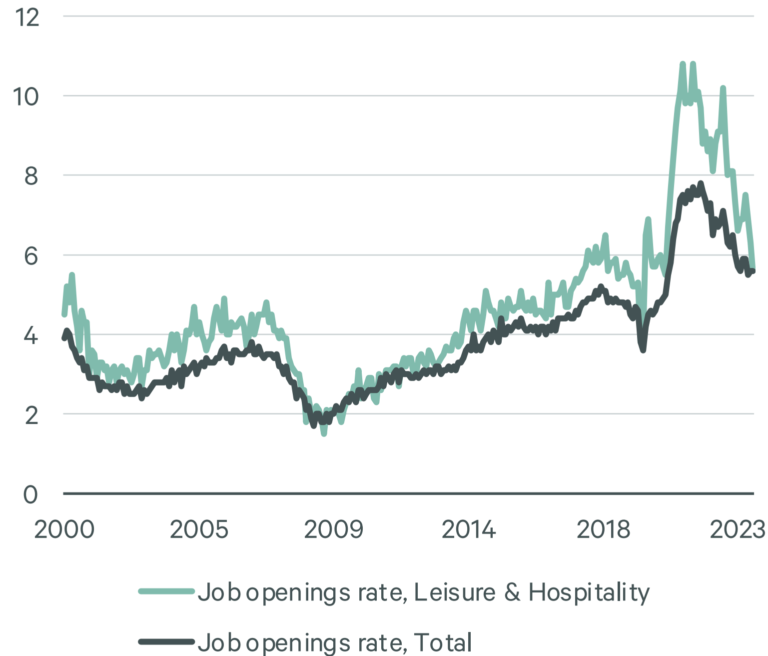
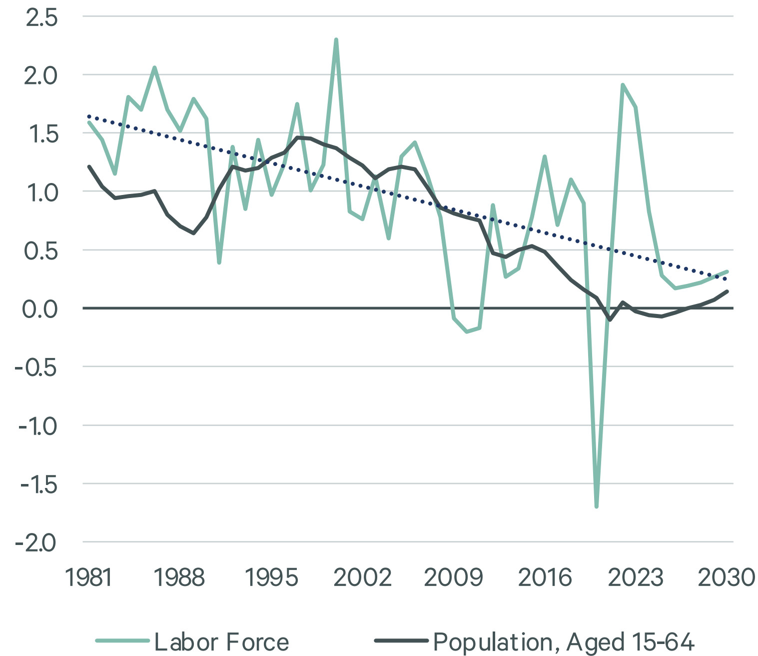
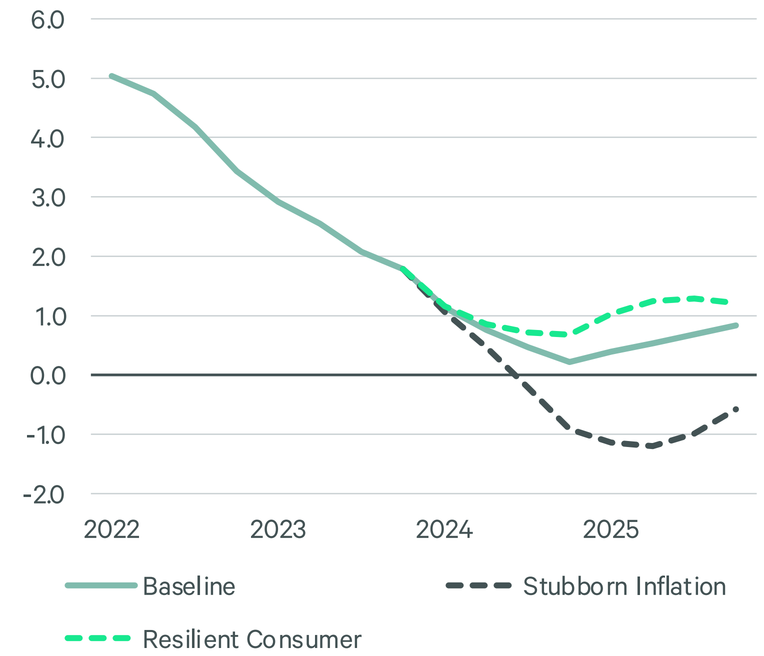
Demand for labor is moderating but remains healthy



Source: U.S. Bureau of Labor Statistics



Source: U.S. Bureau of Labor Statistics, U.S. Census Oxford Economics



Source: U.S. Bureau of Labor Statistics, CBRE Econometric Advisors

- The job openings rate continues to fall. Interestingly, openings within the once over-heated hospitality sector are now on a par with the broader labor market.
- Future hiring will be constrained by limited labor force growth, as the growth of the working-age population is expected to stall in coming years.
- Because the surplus supply of labor is already so thin, job growth would only be marginally better within our Upside, or 'Resilient Consumer' scenario. There is much more room to fall should stubborn inflation keep interest rates elevated long enough that growth eventually stalls.

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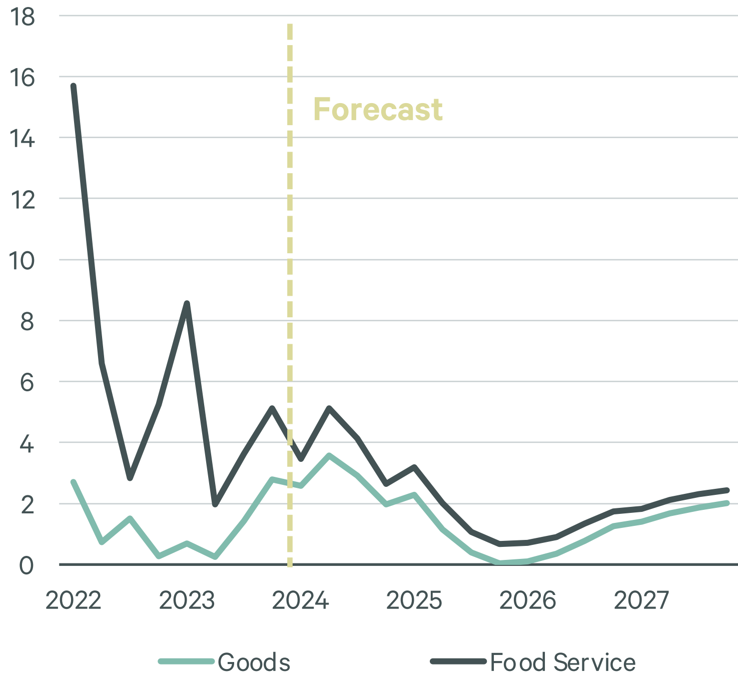
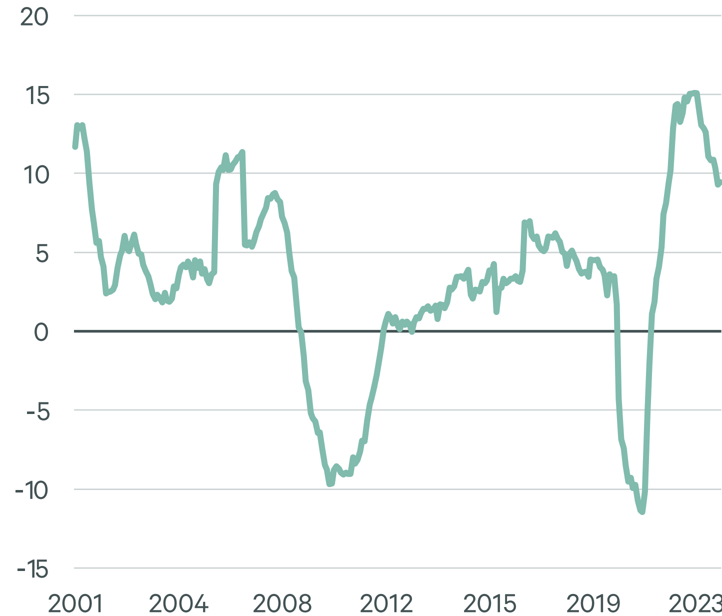
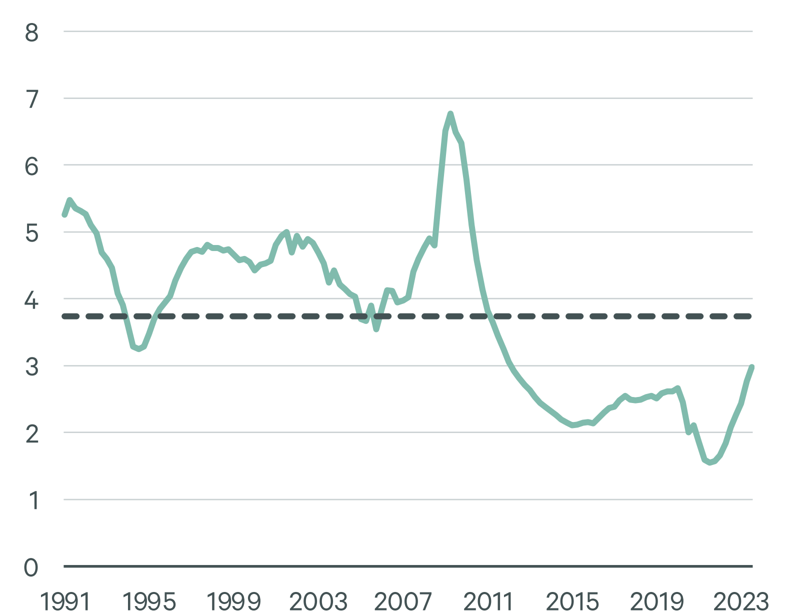
The labor market is supporting consumption



Source: U.S. Census, CBRE Econometric Advisors



Source: Federal Reserve, CBRE Econometric Advisors



Source: Federal Reserve, CBRE Econometric Advisors

- Consumer services (e.g., dining out, travel, recreation) has driven the boom in consumption. Our upgraded economic outlook for 2024 now expects spending growth on discretionary services will continue this year—albeit an acceleration is unlikely.
- It is unlikely U.S. consumers will maintain spending via borrowing due to very high credit costs. Indeed, the pace of credit growth is decelerating. Also, some consumers are struggling with their existing debt load. Although credit card delinquencies remain below-average they are quickly trending upward.

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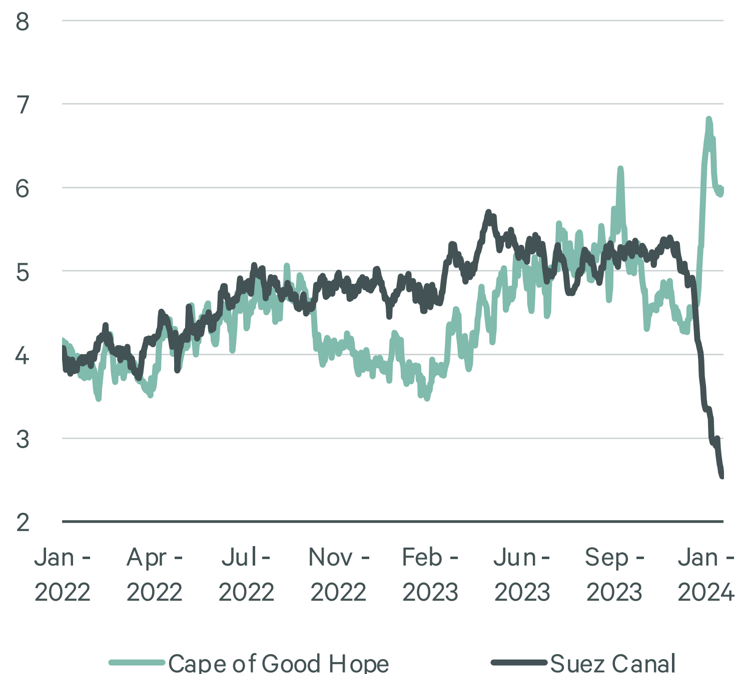
Conflicts and politics could impact U.S. inflation



Source: Port Watch/IMF

Source: Shanghai Shipping Exchange

Source: Peterson Institute for International Economics, CBRE Econometric Advisors

- Shelling of commercial ships in the Red Sea is forcing trade to divert away from the Suez Canal and travel around Africa. This has the effect of putting upward pressure on shipping costs, as shown by Shanghai Freight Index. Presently, the risk to the U.S. economy is manageable but the backdrop is a cause for concern.
- There are some domestic policy risks for U.S. inflation in the medium term. Presently, both leading 2024 U.S. Presidential candidates support more trade barriers. Donald Trump is considering a 60% tariff on all imports from China. Reportedly, these goods account for just 2% of the CPI index; however, such a dramatic tariff could have a significant one-off impact on U.S. inflation.

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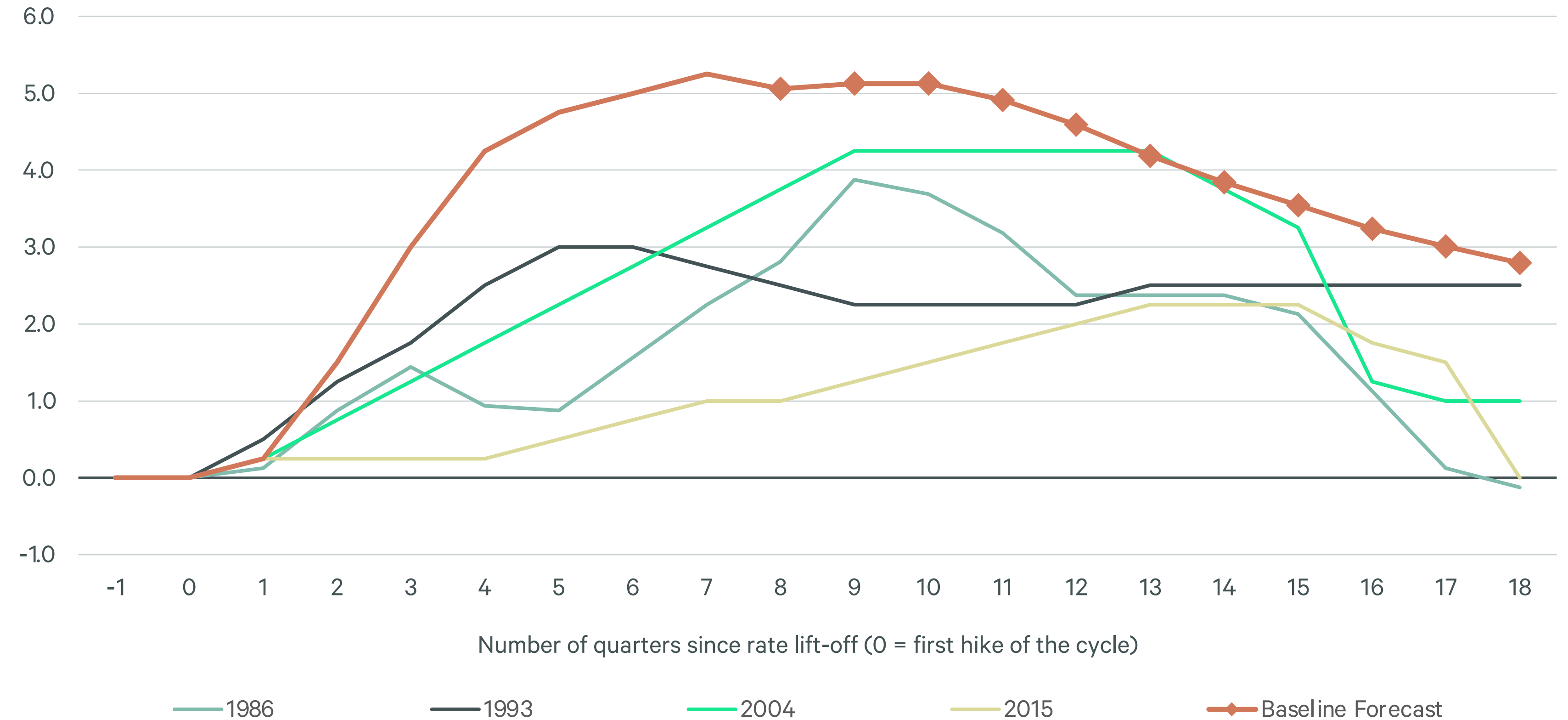
Policy rates are likely to stay higher than past cycles

- Easing Y-o-Y inflation suggests the Federal Reserve will take a pause on future hikes. But they are also unlikely to make significant cuts in the very near-term. Rather, the Committee will wait until inflation shows clear signs of progressing toward its 2% target. We believe the first cut will occur in May 2024.

- CBRE EA expects that the Fed Funds Rate will remain relatively heightened compared with previous tightening cycles. This 'higher-for-longer' outlook will have implications for CBRE EA's cap rate and value growth forecast. Presently, the conviction that rates have peaked has sparked a spirit of cautious optimism across real estate capital markets.

Change In Fed Funds Rate From Beginning of Each Tightening Cycle (Percentage Points)



Source: The Federal Reserve, CBRE Econometric Advisors

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EA Scenarios

‘Baseline’ Scenario

- The Baseline Scenario assumes that economic growth will persist into 2024, albeit at a moderated pace relative to H2 2023. This expansion will ultimately be driven by a steady labor market that will guide the economy toward a soft landing.
- Although recent CPI reports indicate an uptick in some components, we believe inflation overall will continue to trend downward. Some components of inflation, such as consumer services, could remain stubbornly higher than goods prices. Inflation would hit to the Fed’s target rate by 2025.
- The combination of peaking inflation and softer economic growth suggests that the Fed is done hiking this cycle. The Baseline Scenario expects the first rate hike will be in May 2024.

Y-o-Y Change (%); 10-Year Treasury Displays Quarterly Yields

	GDP	Employment	CPI	US 10-Year
2021 Q1	1.6	(5.4)	1.9	1.3
2021 Q2	12.0	8.6	4.8	1.6
2021 Q3	4.7	4.7	5.3	1.3
2021 Q4	5.4	4.6	6.8	1.5
2022 Q1	3.6	5.0	8.0	1.9
2022 Q2	1.9	4.7	8.6	2.9
2022 Q3	1.7	4.2	8.3	3.1
2022 Q4	0.7	3.4	7.1	3.8
2023 Q1	1.7	2.9	5.8	3.6
2023 Q2	2.4	2.5	4.1	3.6
2023 Q3	2.9	2.1	3.6	4.1
2023 Q4	2.8	1.8	3.2	4.4
2024 Q1	2.4	1.1	2.8	4.0
2024 Q2	2.0	0.8	2.7	3.7
2024 Q3	1.1	0.5	2.3	3.6
2024 Q4	0.8	0.2	2.2	3.6
2025 Q1	1.0	0.4	2.1	3.5
2025 Q2	1.3	0.5	2.1	3.5
2025 Q3	1.6	0.7	2.0	3.4
2025 Q4	1.9	0.8	2.0	3.4

Source: Oxford Economics, CBRE Econometric Advisors

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‘Stubborn Inflation’ Scenario

- In this scenario, inflation shows signs of escalation in early 2024 prompting the Fed to tighten further, holding Treasury yields above 4% during 2024. This change causes a retrenchment across financial markets and firms shelve expansion plans. The labor market rolls-over by H2 2024, which will eventually allow CPI to fall below our Baseline view in 2025.
- The ‘Stubborn Inflation’ Scenario will have a disproportionate impact on the commercial real estate sector, which leans on regional banks as a key source of financing. With the key driver of this scenario being higher interest rates the impact on cap rates and valuations would be quite negative.

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2024 Q1	2.2	1.1	3.3	4.3
2024 Q2	1.5	0.5	3.1	4.4
2024 Q3	(0.0)	(0.2)	2.6	4.5
2024 Q4	(0.9)	(0.9)	2.4	4.6
2025 Q1	(0.9)	(1.1)	1.8	4.2
2025 Q2	(0.7)	(1.2)	1.7	4.1
2025 Q3	(0.1)	(1.0)	1.7	4.1
2025 Q4	0.7	(0.6)	1.7	4.1

Source: Oxford Economics, CBRE Econometric Advisors

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‘Resilient Consumer’ Scenario

- The more upbeat scenario is driven by consumers continuing to surprise on the upside but with limited impact on inflation. Thus, the economy gets the benefit of more activity without the tax of higher interest rates. In fact, dissipating inflation would encourage the Fed to cut quicker than our Baseline outlook. It should be noted that this scenario would not yield significantly stronger job growth given the labor market is already quite tight.
- More clarity around the path of interest rates provides some relief for rate sensitive sectors, such as real estate. The benefit to real estate would be two-pronged with lower rates supporting greater deal volume and stronger economic growth supporting healthier fundamentals and NOI growth.

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2025 Q2	2.2	1.2	2.4	3.7
2025 Q3	2.2	1.3	2.4	3.7
2025 Q4	2.0	1.2	2.4	3.7

Source: Oxford Economics, CBRE Econometric Advisors

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‘Severe Downside’ Scenario

- In this scenario the U.S. economy is shocked by a major exogenous event. There could potentially be an unknown financial threat triggered by the continued uptick in interest rates. This event would not take hold immediately but rather begin to bite as rates drift higher in early 2024.
- Such an event would trigger a severe recession in coming quarters analogous to the *Global Financial Crisis*. A key feature of this scenario would be lasting economic scarring as households, firms and the financial system struggles to regain its footing.

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2024 Q2	(1.0)	(1.1)	2.7	4.4
2024 Q3	(3.2)	(2.5)	2.1	4.2
2024 Q4	(4.3)	(3.7)	1.8	4.0
2025 Q1	(3.2)	(3.6)	1.4	3.9
2025 Q2	(2.1)	(3.1)	1.5	3.8
2025 Q3	(1.4)	(2.6)	1.5	3.6
2025 Q4	(0.3)	(1.9)	1.6	3.6

Source: Oxford Economics, CBRE Econometric Advisors

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Thank you.

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