Five Themes Defining the 2024 Macroeconomic Outlook

– Phil McAlister, Head of Research

The U.S. economy continues to show resilience in the face of higher interest rates and the removal of pandemic-era stimulus. The labor market remains very tight and the consumer is holding up well. However, an inverted yield curve, weakening leading indicators, and potential headwinds for the consumer may put pressure on Gross Domestic Product (GDP) growth in 2024 and beyond. With inflation continuing to moderate and expected cuts to the Fed Funds rate, 2024 should provide some clarity on whether there is a hard landing or a recession is avoided.

As we look at 2024 and beyond, we will explore five major macroeconomic themes that help define the investment backdrop we find ourselves in, and how we might tailor our strategies to fit within this framework.

Key Takeaways

- Potential long-run GDP growth will be sluggish due to slow growing labor force relative to history and probable headwinds to achieving the same productivity growth as in the past
- Risk of a hard-landing or recession is currently elevated but not certain, and we expect 2024 GDP growth is likely to be soft
- Forward interest rate curves and the Fed Dot Plot suggest a more dovish Fed with roughly 170 basis points of rate cuts projected by year-end
- A reasonable expectation for the 10-year Treasury in 2024 is in the 3 - 4% range
- Inflation has begun its return to normal, currently at 3.1% total or 1.6% with shelter component of Consumer Price Index (CPI) removed

Theme #1 – Long-Run GDP Growth Potential

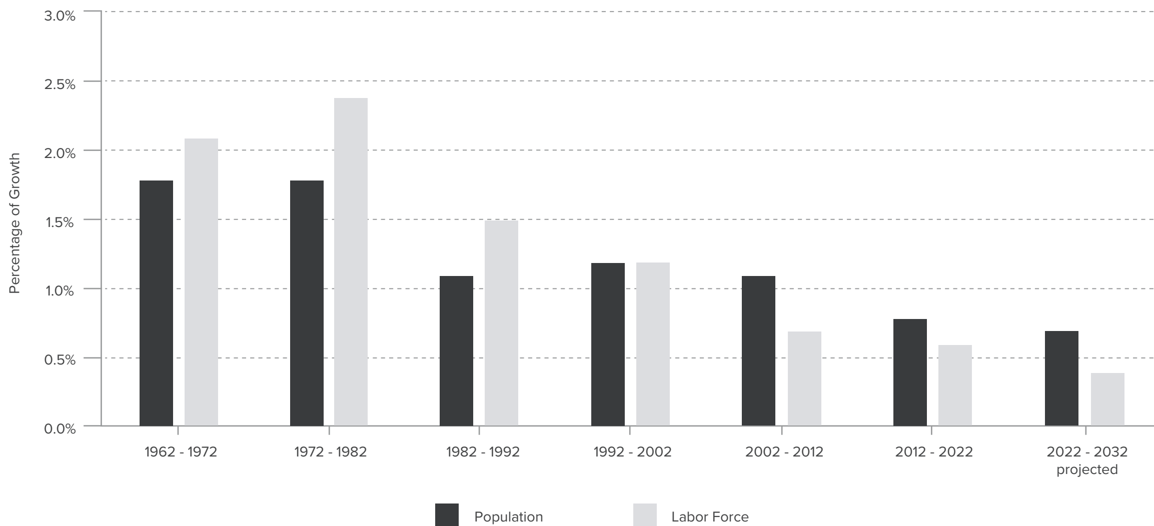
Real GDP growth can be loosely approximated by adding productivity growth and employment growth. For the economy to grow its output, it must either add workers that are producing goods and services, get more production out of the existing workforce, or some combination of these two factors.

The economy's long-term structural growth potential lies in these fundamental building blocks – labor force growth and productivity growth. Labor force growth can be estimated based on demographics (for example, we can see how many people will turn 16 this year because we know how many 15-year-olds there were last year). Immigration and changes in the participation rate can further impact this number.

Productivity growth, however, is a bit tougher to pin down but there are key drivers that provide some guidance. Productivity growth is achieved by businesses investing capital into better machinery, new technology, training programs, and managerial/entrepreneurial talent that enables each worker be able to produce more goods and services in the same amount of time. Presently we see a very slow growing labor force relative to history, as well as some potential headwinds to achieving the same productivity growth as we have in the past. These factors put a fairly low ceiling on potential long-run GDP growth.

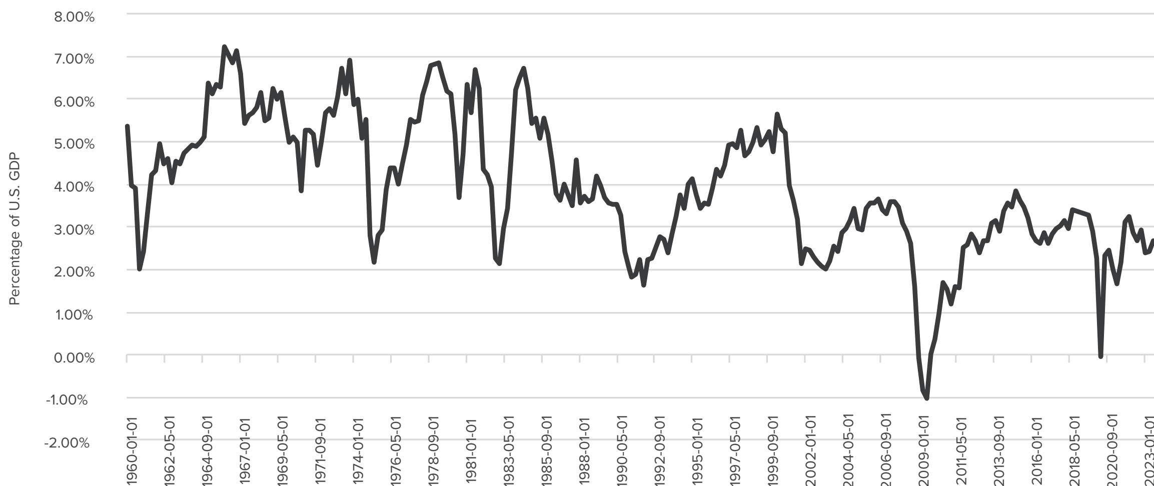
The Bureau of Labor Statistics shows the civilian labor force currently at 167.5 million people, which is projected to increase to 170.7 million by 2032.[1] If we assume a range of unemployment rates from 3.25 percent (extremely low by historical standards) to 5.7 percent (average since 1948), we can reasonably infer that employment will grow by 0 - 0.3 percent annually, on average, over the next eight years. This growth is down significantly from the 1.37 percent annual growth rate in employed persons since 1948.[1]

Population & Labor Force[2]



We believe productivity growth will also be challenged in the coming years. As net investment declines, there is less capital going toward making workers more productive.

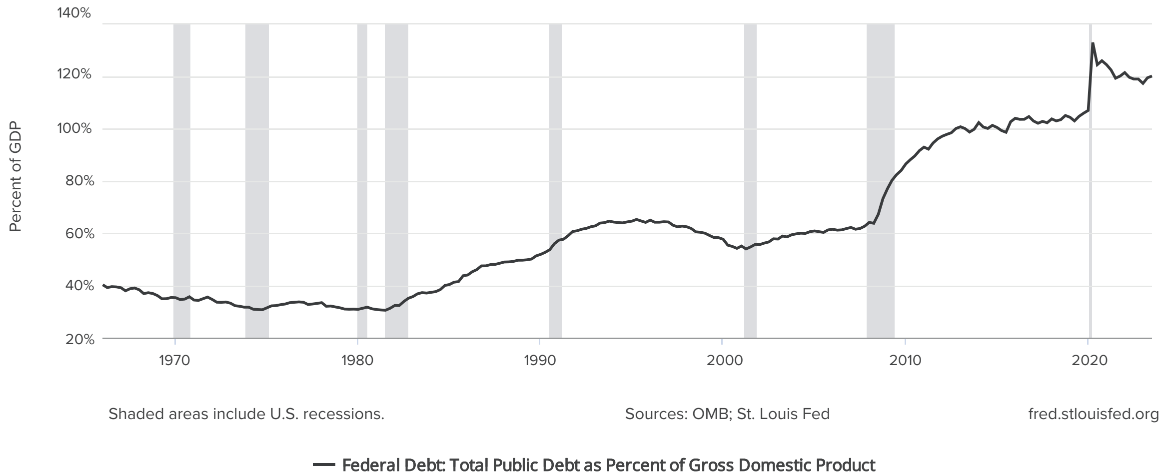
Net Private Investment as % of GDP[3]



[1]U.S. Bureau of Labor Statistics, Employment Level [CE16OV], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CE16OV, January 18, 2024., https://www.bls.gov/opub/mlr/2023/article/labor-force-and-macroeconomic-projections.htm#:~:text=BLS%20projects%20that%2C%20from%202022,will%20grow%200.1%20percent%20annually.
[2]Bureau of Labor Statistics. Labor force and macroeconomic projections overview and highlights, 2022–32. September 2023. https://www.bls.gov/opub/mlr/2023/article/labor-force-and-macroeconomic-projections.htm#:~:text=BLS%20projects%20slightly%20slower%20population,woman%20since%20the%20early%201970s
[3]U.S. Bureau of Economic Analysis, Net domestic investment: Private: Domestic business [W790RC1Q027SBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/W790RC1Q027SBEA, January 19, 2024

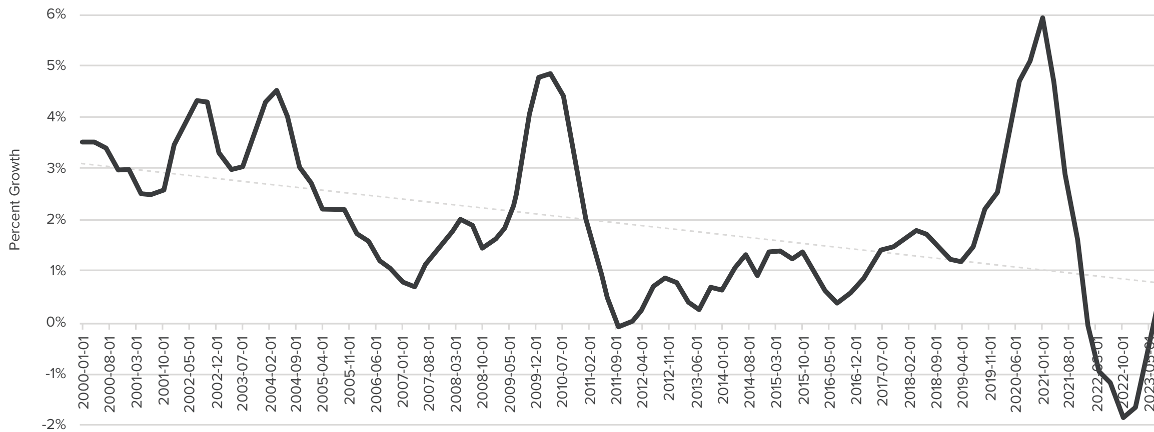
Further, the burden of high fiscal deficits and mounting debt tends to crowd-out private investments. Studies suggest that as debt-to-GDP exceeds 90 percent, GDP growth is negatively impacted.[4] Today, debt-to-GDP stands at 120 percent.[5]

Federal Debt



Productivity growth since 2000 has been trending steadily weaker, and since the point of 90 percent debt-to-GDP was crossed at the end of 2010, production has slowed considerably, averaging just 1.2 percent, well below the 2.1 percent average since 1948.[6] In 2022, productivity turned briefly negative.

Productivity Growth - 4Q Moving Average



[4]https://www.mercatus.org/research/policy-briefs/debt-and-growth-decade-studies#:~:text=For%20debt%20levels%20less%20than,negative%20impacts%20on%20growth%20rates.
[5]U.S. Office of Management and Budget and Federal Reserve Bank of St. Louis, Federal Debt: Total Public Debt as Percent of Gross Domestic Product [GFDEGDQ188S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GFDEGDQ188S, January 18, 2024.
[6]U.S. Bureau of Labor Statistics, Nonfarm Business Sector: Labor Productivity (Output per Hour) for All Workers [PRS85006091], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PRS85006091, January 19, 2024.

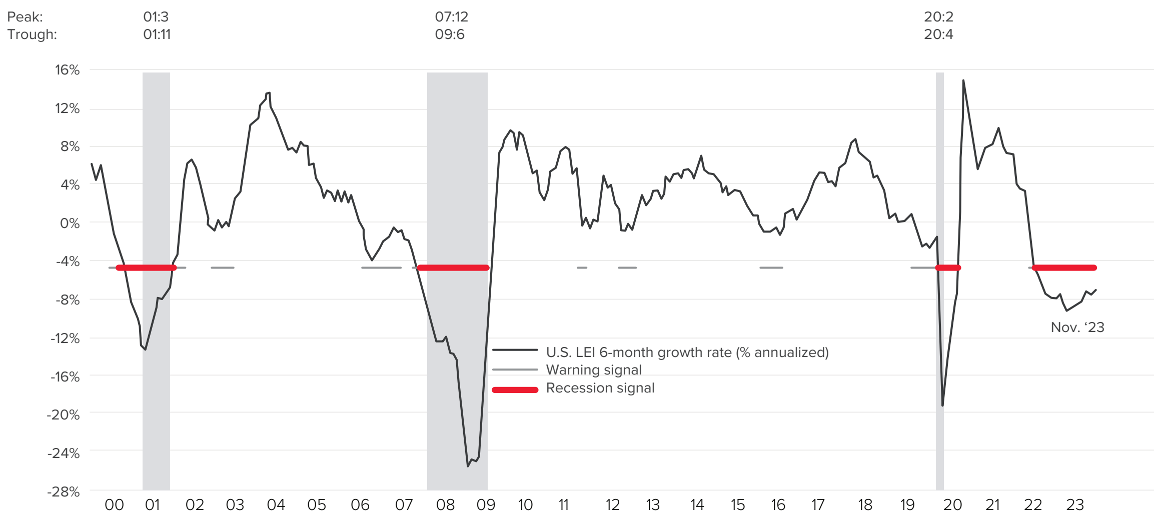
We believe it is reasonable to assume that after the spike and subsequent negative productivity readings associated with the pandemic, we will settle back into a range of 0.5 - 1.5 percent productivity growth, driven by higher debt load, declining net investment, and an aging population.

Coupled with the labor force growth discussion above, an approximate range for overall real GDP growth of 0.5- 1.8 percent annually, on average, we believe can be projected through 2032.

Theme #2 – Recession Risk

Review of a series of data points will help provide an understanding of where we are heading. The Conference Board publishes an index consisting of 10 data points that tend to lead real GDP growth by about seven months. The annual growth rate of the index has been sitting at approximately negative eight percent[7] since early 2023. While far from a guarantee of recession, it is worth noting that since the inception of the index[7], a reading below four percent has predicted each of the last three recessions with no false positives.[7] That said, the U.S. Leading Economic Index (LEI) has been improving from its low in recent months and may be above the four percent threshold in the coming months.

Leading Economic Indicators



Note: Shaded areas represent recessions as determined by the NBER Business Cycle Dating Committee

Source: The Conference Board

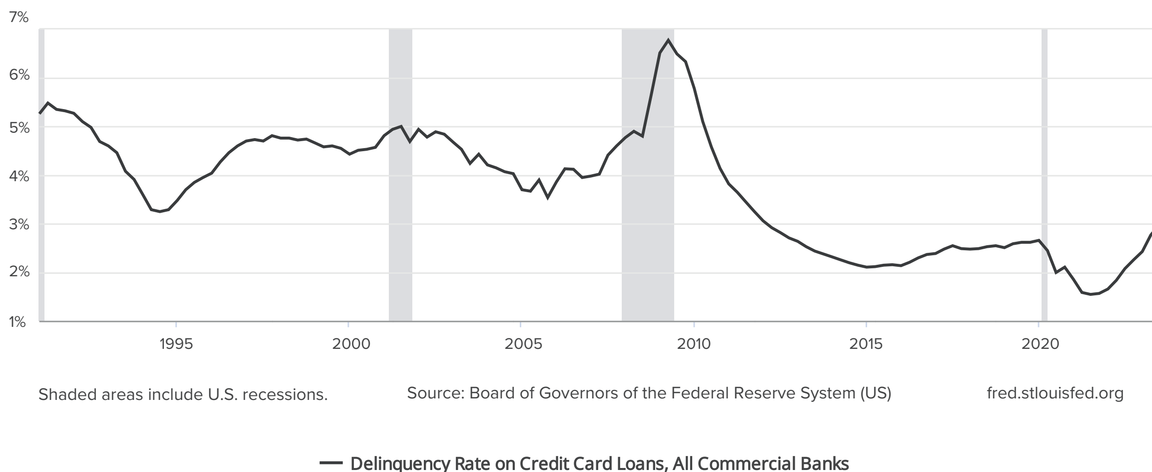
So, what are the powerful data points that can offer insight?

[7]https://www.conference-board.org/topics/us-leading-indicators

The Consumer

We believe consumer spending is likely to moderate in 2024 due to several factors. Curently, the savings rate has dipped to historic lows, only seen in the years building up to the great financial crisis of 2008/2009.[8] At the same time, credit card debt has been rising rapidly. After having deleveraged early in the pandemic, now consumers are saving less and borrowing more, which will reach a limit at some point given the ability to service debt. The resumption of student loan payments late in 2023 will also put stress on the ability to consume, as approximately 28 million people will need to redirect spending to pay off this debt. Some signs of distress can be seen in the uptick in credit card loan default rates. While it remains low by historical standards, we believe the recent swift uptick in delinquencies may suggest that, on the margin, the consumer's financial condition may be starting to weaken.[9]

Credit Card Delinquency



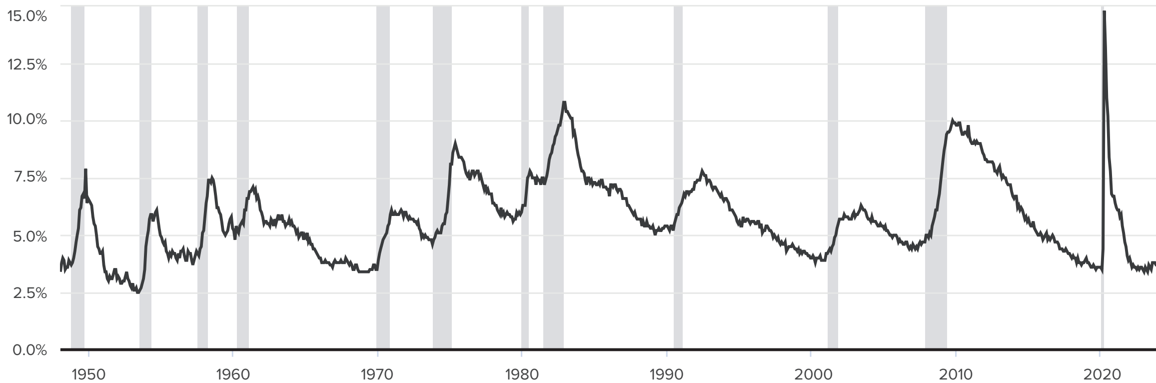
Employment

When the unemployment rate is high, the potential for future economic growth is strong because there is a large pool of workers to bring into the fold, and GDP can grow more rapidly. However, when the unemployment rate is low (as seen with the 3.7 percent unemployment rate as of January 2024, only a growing labor force or increasing productivity of existing workers can generate GDP growth (see above).

In fact, in each prior recession going back to 1950, the unemployment rate was at its low point of the cycle just prior to the start of the recession. Paradoxically, a very low unemployment rate is associated with the end of an expansion cycle and we believe it should not be used as support for predicting further growth. In this sense, the unemployment rate is a lagging indicator, which will only go up once a recession is well underway.[10]

[8]U.S. Bureau of Economic Analysis, Personal Saving Rate [PSAVERT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PSAVERT
[9]Board of Governors of the Federal Reserve System (US), Delinquency Rate on Credit Card Loans, All Commercial Banks [DRCCLACBS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DRCCLACBS
[10]U.S. Bureau of Labor Statistics, Unemployment Rate [UNRATE], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/UNRATE, January 18, 2024.

Unemployment & Recessions



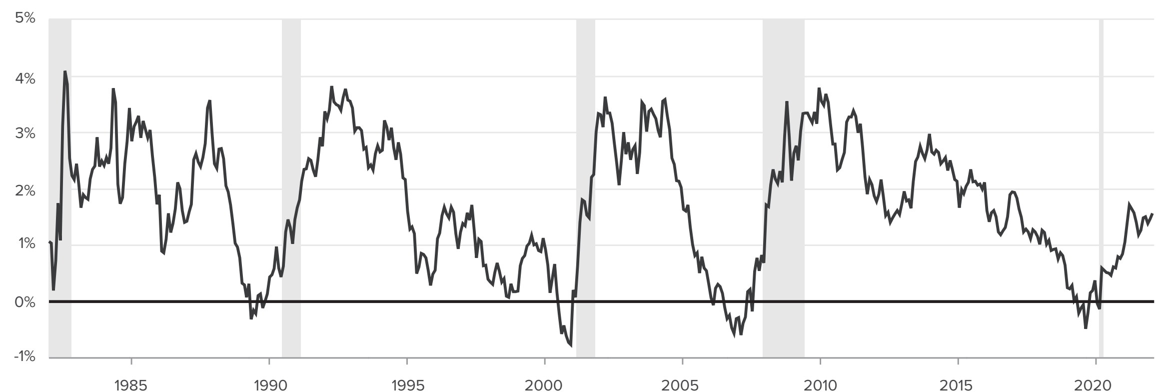
In other words, the low unemployment rate means that everyone is already included in the pool of workers. Fewer individuals are standing on the side ready to jump in, representing more production of goods and services on one side and new wages to be used to purchase goods and services on the other side.

As businesses face a tight labor market, wages are expected to increase relative to profits. Further, with fewer unemployed people getting jobs and earning wages where they were not previously, revenue growth for firms is also expected to slow down (no new customers with fresh incomes to spend). This combination of factors is likely to put a damper on future hiring. If this condition becomes severe enough, we believe layoffs may occur and a recession may follow.

Recession Timing

An inverted yield curve is often associated with a recession in the following 12 to 18 months. Federal Reserve interest rate data shows the 3-month to 10-year Treasury curve inverting before each of the last four recessions with no false positives.[11] This metric is currently significantly inverted, however, we believe this should not be taken to mean a recession is certain, but that present conditions fit with imminent recessions historically.

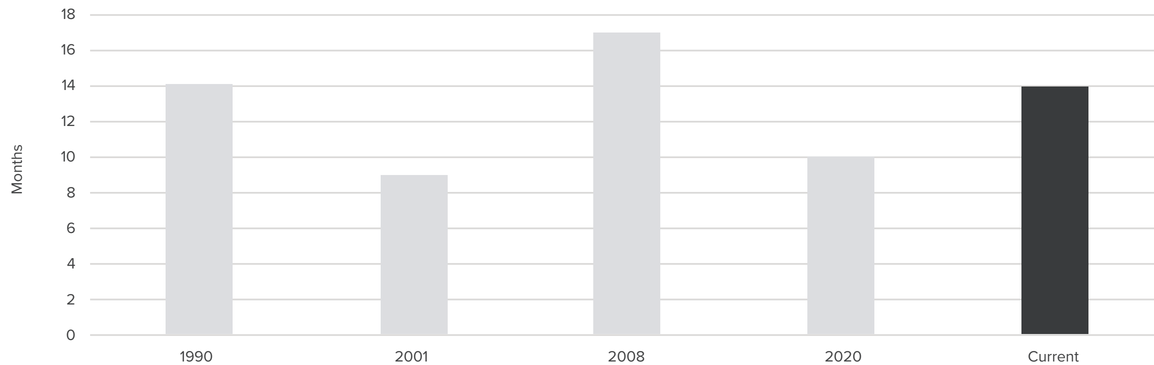
10-Year Treasury, 3-Month Treasury & Recession



[11]Federal Reserve Bank of St. Louis, 10-year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity [T10Y3M], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/T10Y3M, January 19, 2024.

From a timing perspective, we believe we are right in the middle of the range of when previous recessions have historically occurred. At 14 months since the yield curve has inverted, the current post-inversion period is consistent with the time at which past recessions have occurred. The 1990 and 2008 recessions occurred 14- and 17-months post-inversion, respectively.

Months From Inversion to Recession[12]



While leading indicators and the history of yield curve inversions would suggest that recession risk is elevated, a recession is by no means a foregone conclusion. Given the significant disruptions that occurred through the pandemic, including supply chain issues, difficulty hiring employees, (which has led to labor hoarding) massive stimulus checks, unprecedented asset buying from the Fed via quantitative easing or QE, and changes to consumer behaviors, we believe it is possible that this time is different. Further, as we discuss below, the prospect for both lower inflation and interest rates seems likely in 2024, which may allow for a soft landing thus eluding a recession.

Given all of this information, we anticipate the most likely outcome for 2024 is sluggish real GDP growth, which may shake out to include a recession in a hard landing scenario, or 0 - 1.5 percent GDP growth in a more optimistic scenario.

This should be viewed as less of a forecast, and more of a range of potential outcomes based on the current facts. Changes in fiscal or monetary policy, consumer behaviors, or geopolitical events would be expected to alter this range significantly.

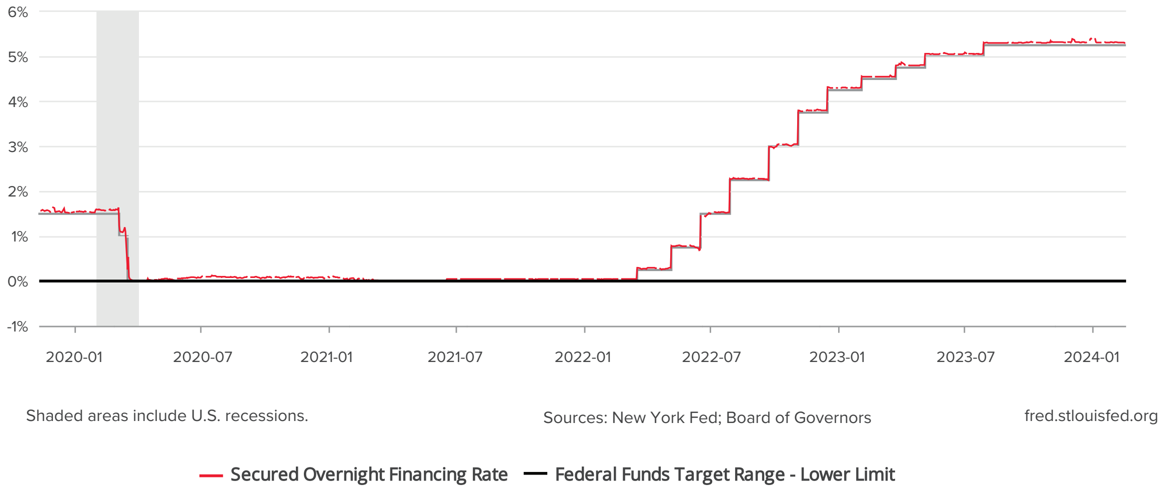
Theme #3 – Short-Term Interest Rates and Fed Policy

The question on everyone's mind: Where are interest rates headed in 2024? For this we need to break down the yield curve into short-term and long-term components. Many real estate investors use short-term, floating-rate debt to finance acquisitions and development. This cohort is feeling the pinch from the rise in the short end of the yield curve and is most impacted by the Secured Overnight Financing Rate (SOFR). Another segment of the industry, however, prefers to use long-term, fixed-rate debt structures with moderate leverage. For these groups, what happens to the 10-year Treasury rate will create the most impact to their business.

[12]Federal Reserve Bank of St. Louis, NBER based Recession Indicators for the United States from the Period following the Peak through the Trough [USREC], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/USRECa; Federal Reserve Bank of St. Louis, 10-Year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity [T10Y3M], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/T10Y3M

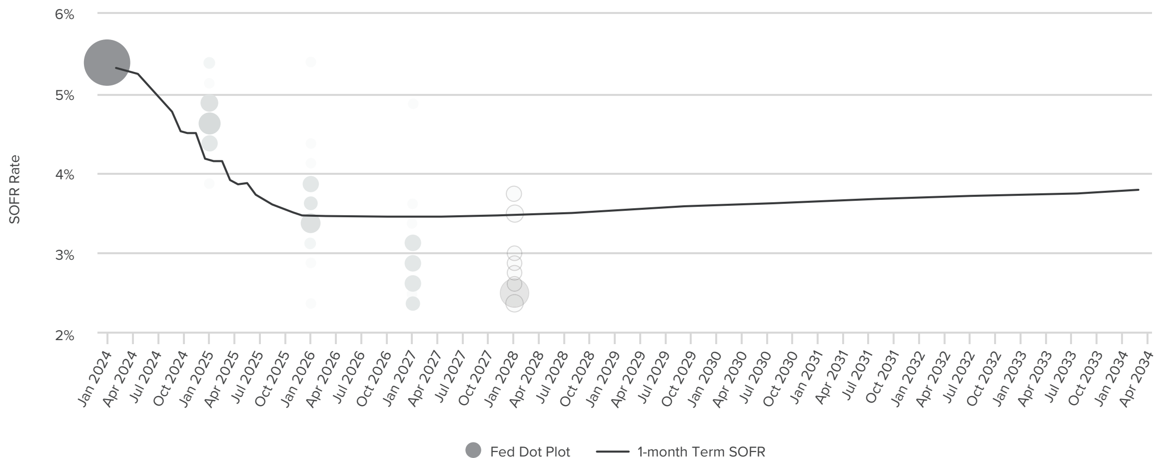
The short end of the yield curve is controlled by the Fed, which is illustrated by the chart below. The SOFR, on which most floating-rate debt is based, moves in near-perfect lockstep with the Federal Funds Rate, the interest rate depository institutions charge each other for overnight loans of funds.[13]

SOFR/Fed Funds Relationship



Therefore, understanding what the Fed is likely to do with the Federal Funds Rate will drive what the short end of the yield curve will do. A review of the forward SOFR and the Fed Dot Plot (see below), a chart updated quarterly that records each Fed official's projection for the central bank's key short-term interest rate may shed some light on Fed policy in 2024.

Forward SOFR Curve & Fed Dot Plot



Source: https://www.chathamfinancial.com/technology/us-forward-curves

[13]Federal Reserve Bank of New York, Secured Overnight Financing Rate [SOFR], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SOFR, Board of Governors of the Federal Reserve System (US), Federal Funds Target Range - Lower Limit [DFEDTARL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DFEDTARL

According to the Dot Plot, Federal Reserve governors see the policy rate somewhere between 3.875 and 5.375 percent at the end of 2024, compared to the current effective Fed Funds rate of 5.33 percent. Fifteen of the 19 governors believe the rate should be between 4.375 and 4.875 percent. Put differently, none of the Fed members see short-term rates going up from here, and it appears to be a question of how far, and how fast they fall.

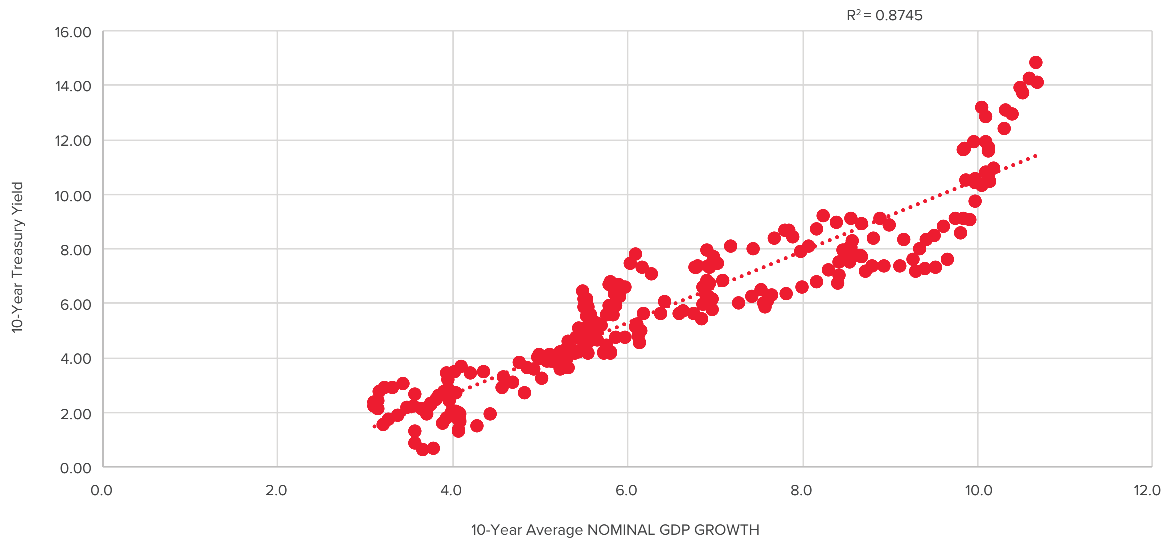
The market seems to think the Fed will ultimately get more dovish and faster. The December 2024 forward SOFR rate is 3.63 percent, suggesting roughly 170 basis points in rate cuts by the end of the year.

Given the leading economic indicators described above, along with the likelihood that the major inflationary impulse has passed, which will be discussed later in this report, our inclination is to believe that the Fed may become more dovish as the year goes on.

Theme #4 – Long Term Interest Rates

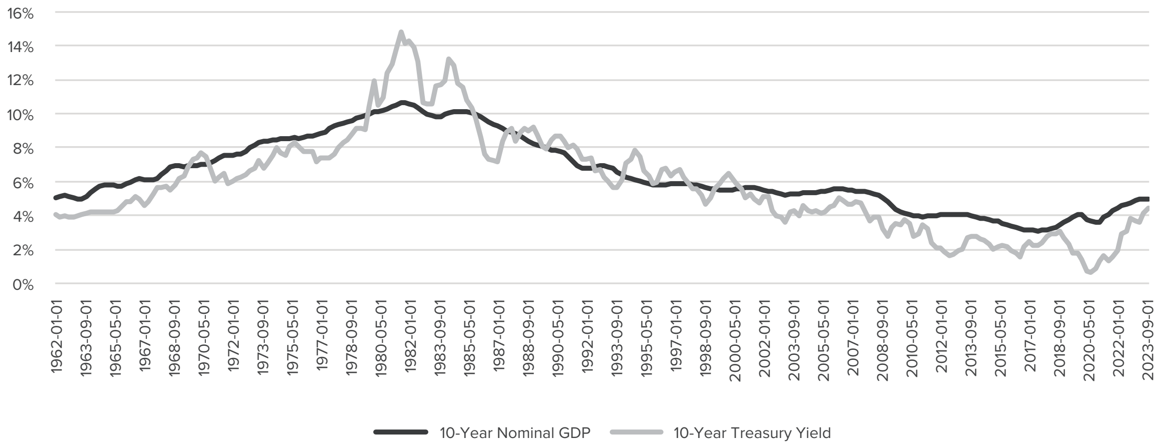
When it comes to the long end of the yield curve, the Fed is able to exert far less control. The charts below demonstrate the strong relationship between historical nominal GDP and the 10-year Treasury Rate. Using the 10-year moving average of nominal GDP growth, it is shown that the 10-year yields tend to cluster around 150 basis points of the nominal GDP growth rate. Also, it is important to note that, outside of the early 1980s, the general tendency has been for the 10-year yield to fall below the prevailing growth rate of the last 10 years. Since 2000, the 10-year yield has averaged approximately 1.25 percent below long-term nominal GDP growth.[14]

10-Year Treasury & 10-Year NGDP Growth



[14]U.S. Bureau of Economic Analysis, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDP; Board of Governors of the Federal Reserve System (US), Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DGS10

10-Year NGDP & 10-Year Treasury Rate



With this knowledge, a reasonable expected range for the 10-year Treasury rate can be obtained by looking at nominal GDP growth, the sum of real GDP growth and inflation. We note above that the long-run Real GDP growth rate is likely to be between 0.5 and 1.8 percent annually, on average, with the 2024 growth rate around 0 - 1.5 percent, depending on how well the consumer and wage growth hold up. The missing variable is inflation.[15]

If we add two percent inflation rate to real GDP growth of 0.5 - 1.8 percent, we may expect nominal GDP growth to be around 2.5 - 3.8 percent on average, with the ability to swing well outside of that range for shorter periods. Based on this assumption, we would expect that the 10-year moving average for nominal GDP, to which the 10-year Treasury is closely correlated, may start to creep down slowly from five percent into the sub-four percent range over time. With this, over the long-term the 10-year Treasury rate should move in a range of approximately 1.5 percent in risk-off periods when the economy is in recession and global demand for treasuries is high, and approximately five percent when the economy is running hot and inflation concerns are more prevalent.

Given the current dynamics of low GDP growth and moderating inflation, we believe it is reasonable to expect the 10-year Treasury to be in the three to four percent range in 2024, unless or until more clarity around a recession, soft-landing, or unexpected resurgence in inflation exists.

With that, detailed on the following page in Theme #5, we can explore the dynamics surrounding inflation in 2024.

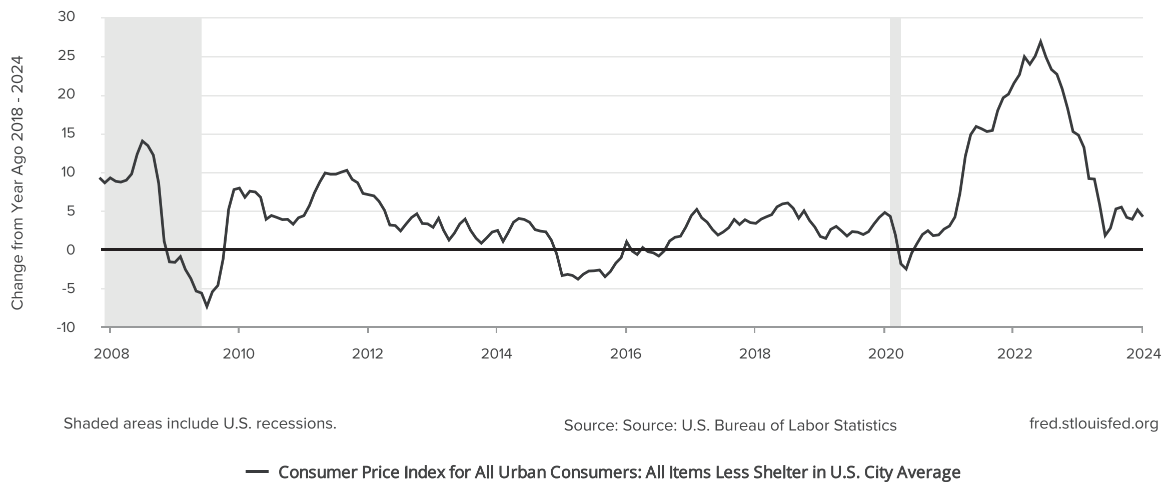
[15]U.S. Bureau of Economic Analysis, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDP; Board of Governors of the Federal Reserve System (US), Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DGS10

Theme #5 – Inflation

While inflation contains a psychological component that is impossible to project, there is a pattern of global disinflationary bias when an economy is aging and highly indebted. Japan is a stark example, where inflation was barely above zero for more than a decade despite massive government deficits and quantitative easing (QE) from the central bank. As economies age, consumer spending is reduced, debt is paid off, and inflation is difficult to generate.[16] While the U.S. economy does not have the grim demographic outlook of Japan, we are nonetheless seeing our government debt picture deteriorate and our overall population age (65 and older) grow from 17 to 23 percent of total population by 2050.[17] We believe this slow-growth environment is likely to keep a lid on inflation going forward.

In fact, if the shelter component of CPI is removed, inflation actually fell as rapidly as it rose, and currently sits at just 1.6 percent: right in-line with the post-GFC (global financial crisis) disinflationary backdrop.[18]

CPI Less Shelter



We believe it is necessary to remove the shelter component due to the methodology of data collection. While all other CPI prices are the spot price in the chart above, measuring the immediate change, shelter is measured on a lag. Because tenants typically sign long-term leases, as the spot rent declines it takes approximately 12 months for that to be fully captured in the economy-wide data.

[16]https://www.atlantafed.org/-/media/documents/research/publications/wp/2022/09/29/12--why-aging-induces-deflation-and-secular-stagnation.pdf
[17]https://www.census.gov/data/tables/2023/demo/popproj/2023-summary-tables.html
[18]U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items Less Shelter in U.S. City Average [CUUR0000SA0L2], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CUUR0000SA0L2

The inflation data since May of 2023 can be described as a return to normal with regards to inflation. While the ability for another spike remains should market psychology change, it appears, for now, that the pandemic era inflation spike was in fact transitory.

Macro Bottom Line

The key takeaway for the 2024 economy is that the current economic cycle is nearing its end, evidenced by the falling leading indicators, inverted yield curve, and low unemployment rate. This, coupled with the lower potential GDP growth due to demographic and debt dynamics, suggests that GDP growth in 2024 will be tepid.

Whether or not the economy tips into full-blown recession is unclear, but we believe the risk of a recession is elevated. Further loosening of financial conditions, strength in the housing market, and an unwillingness of employers to cut jobs due to the difficulty they experienced in hiring during the pandemic may be enough to stave off recession. On the other hand, should wage growth weaken and consumers tighten their belts, while businesses feel the impact of higher input costs and interest rates on profit margins, conditions could weaken enough for a recession to take hold.

Ultimately, we expect that the bias will be toward lower interest rates given the slowing economy and moderating interest rates. Drastic moves in interest rates, however, will only come if recession becomes clear or we see a resurgence in inflation.

inland-investments.com

This report is neither an offer to sell nor a solicitation of an offer to buy any security which can be made only by a prospectus or offering memorandum that has been filed or registered with appropriate state and federal regulatory agencies, and sold by registered investment advisers authorized to do so. The views expressed herein are subject to change based upon economic, real estate and other market conditions. These views should not be relied upon for investment advice. Any forwardlooking statements are based on information currently available to us and are subject to a number of known and unknown risks, uncertainties and factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Past performance is not a guarantee of future results.

The Inland name and logo are registered trademarks being used under license. “Inland” refers to The Inland Real Estate Group of Companies, Inc. which is comprised of a group of independent legal entities some of which may be affiliates, share some common ownership or have been sponsored and managed by such entities or subsidiaries thereof. Inland Securities Corporation, member FINRA/SIPC, is dealer manager and placement agent for programs sponsored by Inland Investments and Inland Private Capital Corporation, respectively. For more information on Inland Securities Corporation, visit FINRA BrokerCheck.