

ECONOMIC OUTLOOK

Kevin Depew

February 2024



Regime change: What comes next

Big-picture changes in the U.S. economy

Moving from pre-pandemic financial and real economy conditions to "what comes next"

1995–2020 pre-pandemic and pre-war era	Post-pandemic economy
Insufficient aggregate demand	Insufficient aggregate supply
Excess savings	Liquidity constraint
Hyper-globalization	Dichotomy of globalization Re-globalization/regionalization Industrial policy: Infrastructure buildout and energy transformation Digital globalization intensifies
Low inflation	High inflation
Low interest rates	Higher interest rates
Plentiful labor	Demographic constraints: Less labor

U.S. Economy: Sustained Expansion



Growth

U.S. Resilient Economic Expansion

- Fed at terminal rate; begins lowering rates May/June
- Recession probability down to 15% (vs. 55% consensus)
- Strong job market and income gains above inflation
- Excess savings, consumption and investment driving growth



Employment

Strong Labor Market

- Unemployment Rate 3.7% and tight labor market
- Prime aged employment near record high
- Median duration of unemployment 8-9 weeks: Laid off workers finding employment quickly
- Wages increased 4.1% Y/Y through December '23



Inflation

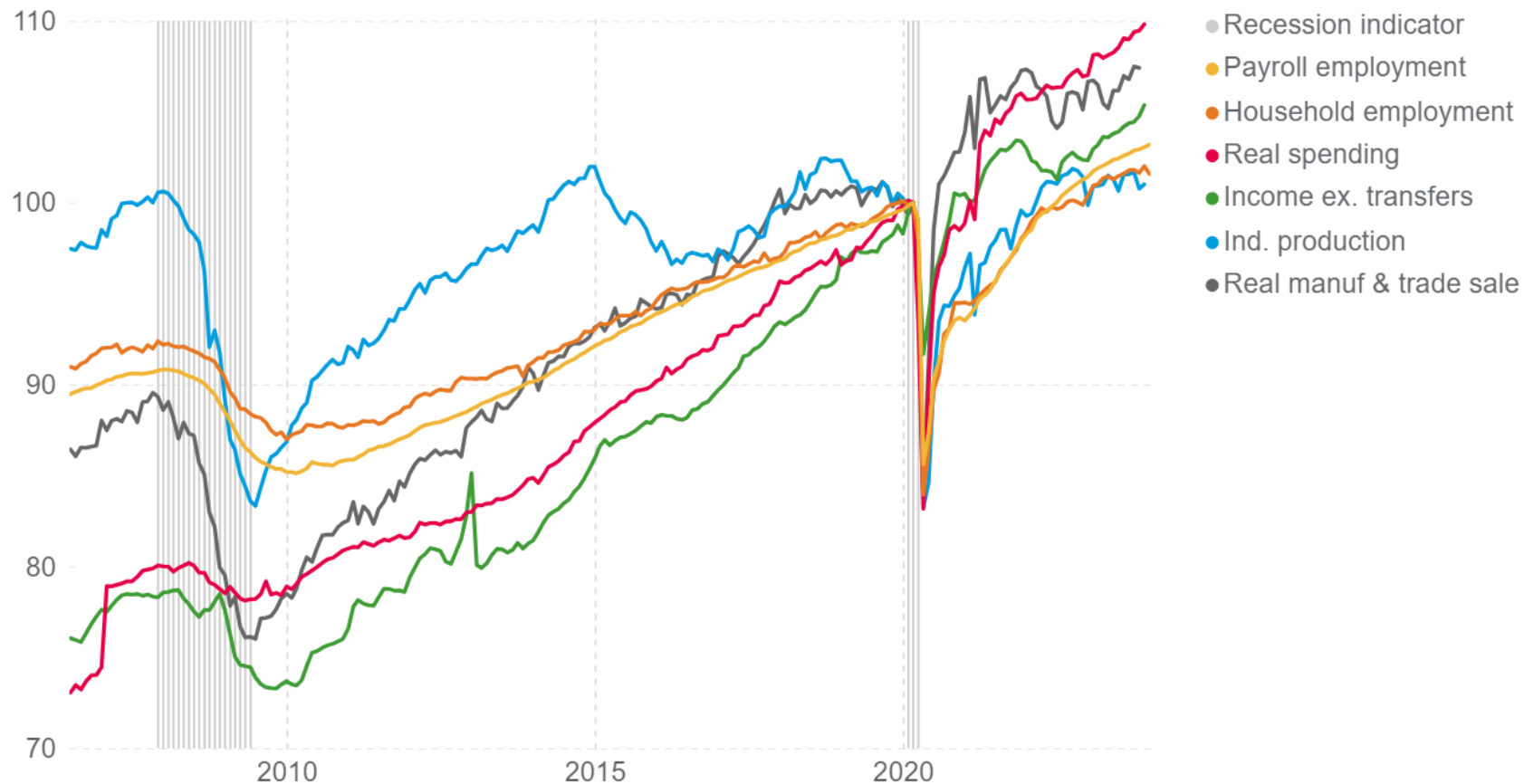
Disinflation Extends Further

- Inflation peaked at 9.1% (June 22) for the cycle
- Back up in treasury yields worth 50 basis points of tightening
- CPI falling notably, service inflation ex-energy has peaked
- 3.2% CPI on a year ago basis (Where it is at currently)
- 4.1% Core services excluding housing at a 6-month average annualized pace

U.S. Economy: What the NBER Looks at for Recession Call

NBER recession key indicators

Normalized with Feb 2020 = 100



Source: BEA, RSM US

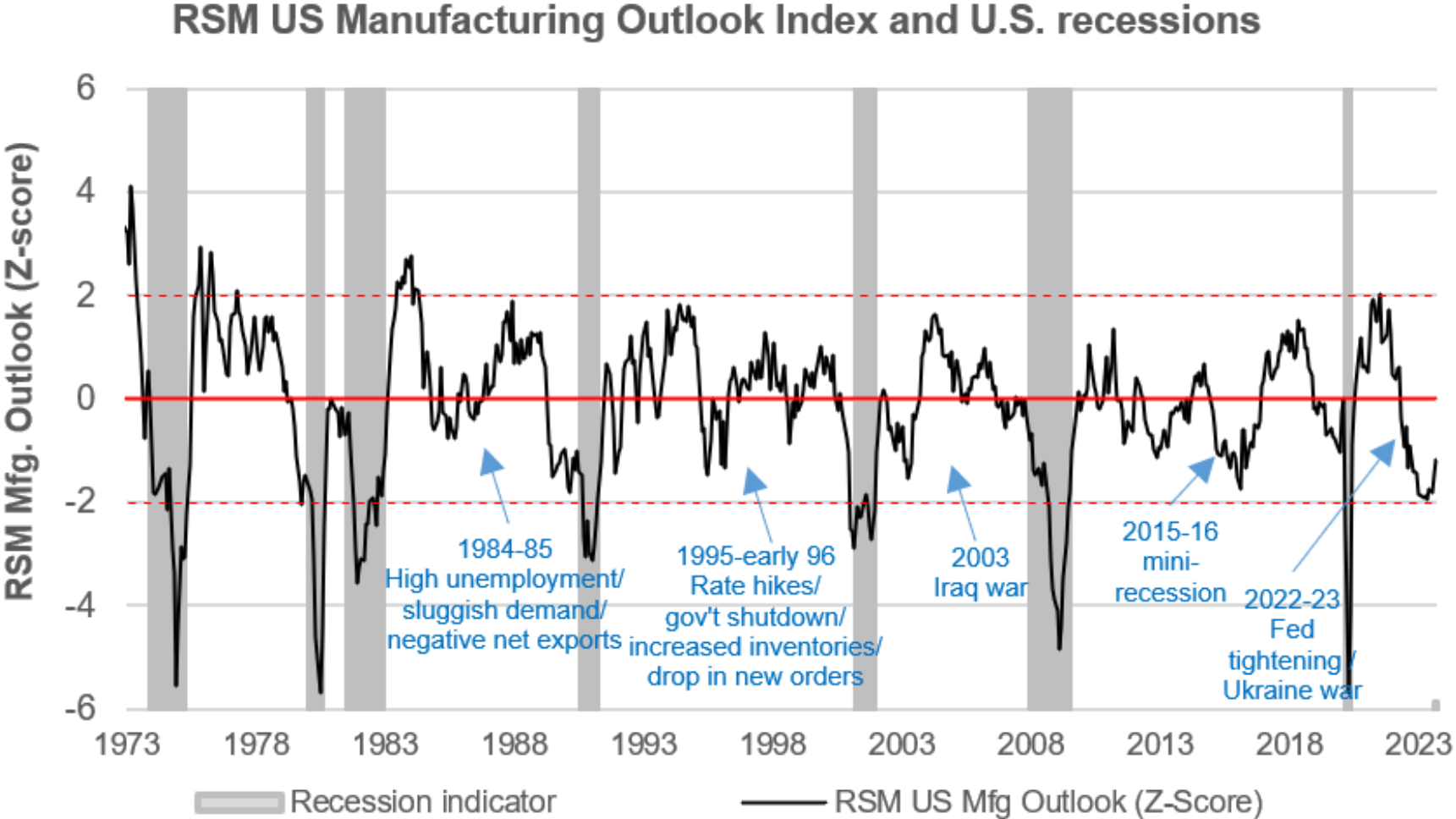
Recession causes: 1972-2009

Recessions	Peak to trough (months)	Proximate cause
Nov. 1973-March 1975	16	External: Oil shock (rising prices)
Jan. 1980-July 1980	6	Internal and external: Rates and Oil shock
July 1981-Nov. 1982	16	External: Oil shock (rising prices)
July 1990-March 1991	8	External: Oil shock (rising prices)
March 2001-Nov. 2001	8	Internal: Corporate debt bubble, dotcom, inventories
Dec. 2007-June 2009	18	Internal: Housing and banking collapse, debt bubble

Average duration: 12 months

Ex-GFC: 10.8 months

RSM Manufacturing Index

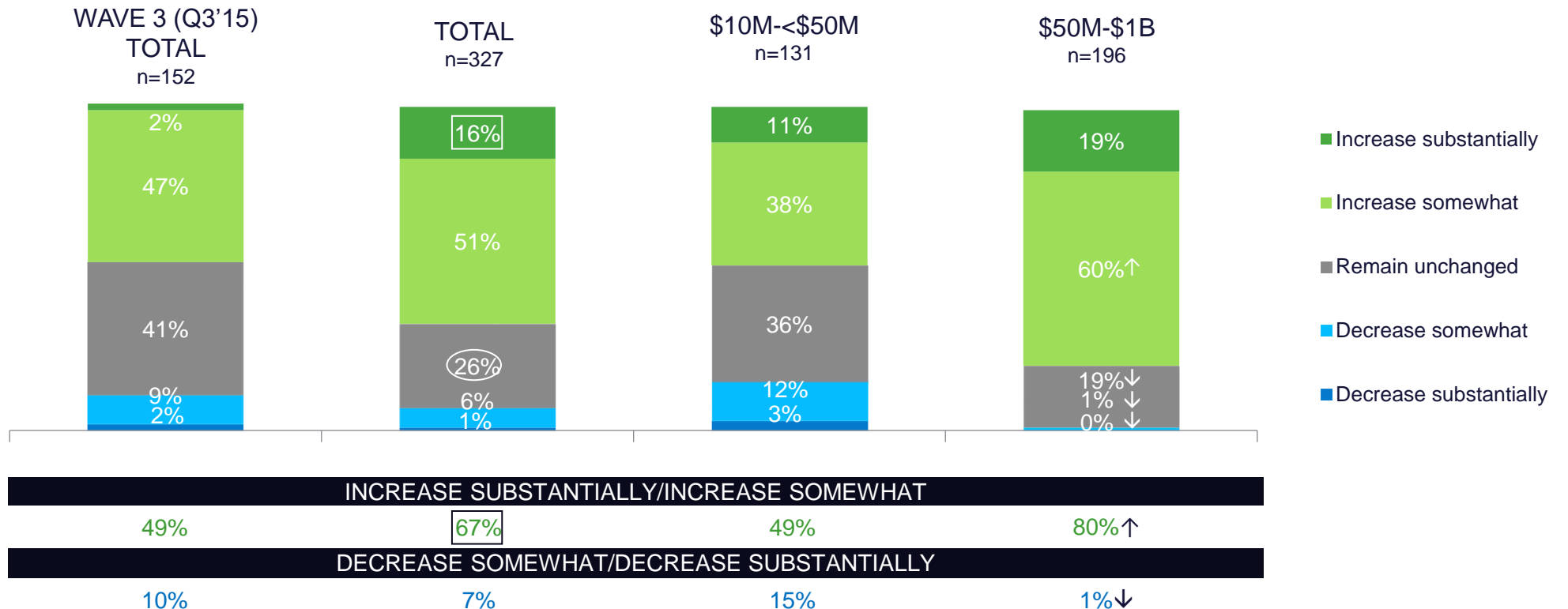


Source: NBER; Bloomberg; RSM US LLP calculations

Working capital needs increasing...

EXPECTATIONS REGARDING WORKING CAPITAL OVER NEXT SIX MONTHS

(BASE = not non-profit and aggregate capital will increase/remain the same)

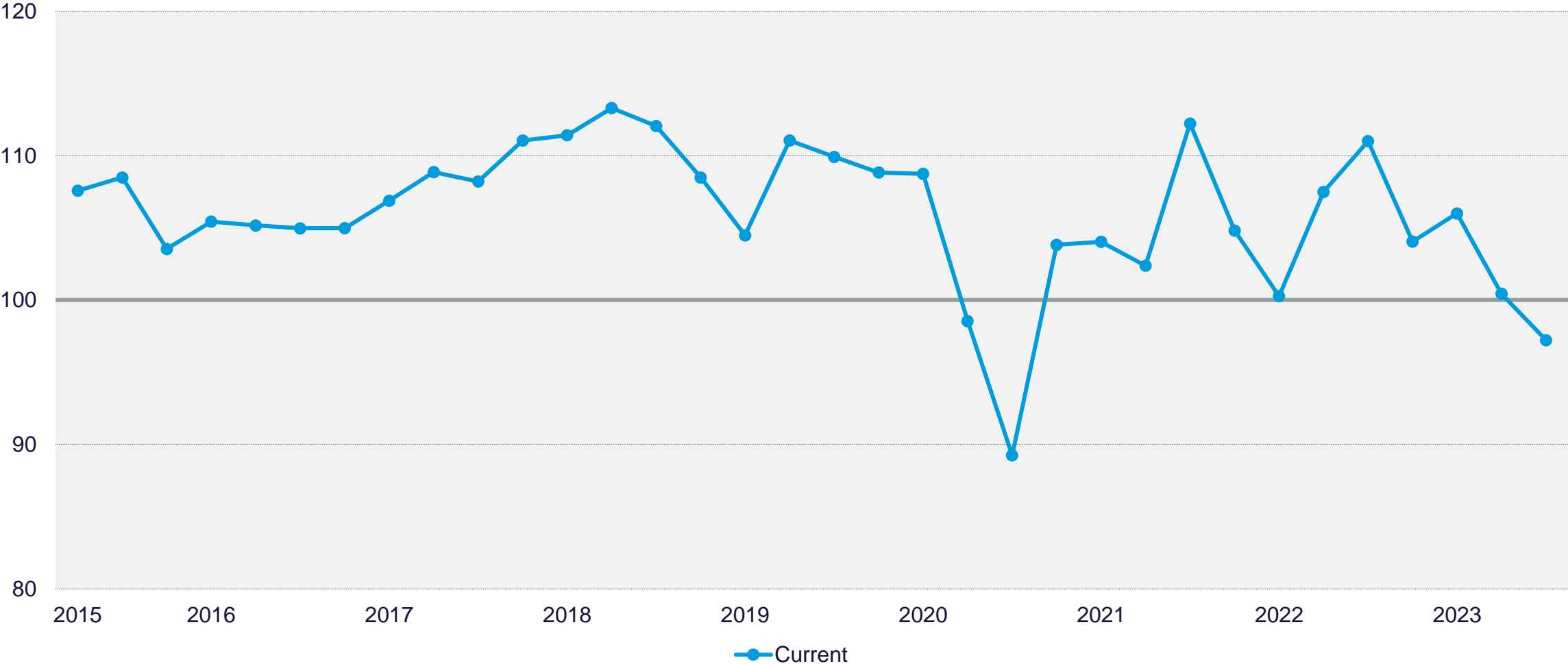


A1 What are your expectations regarding your organization's working capital over the next six months? Do you expect your working capital will...

SQUARE/CIRCLE = Significantly higher/lower than previous wave, respectively, at .05 level of significance

ARROWS = Significantly higher/lower than \$10M-<\$50M at .05 level of significance

Even as access to credit is declining...

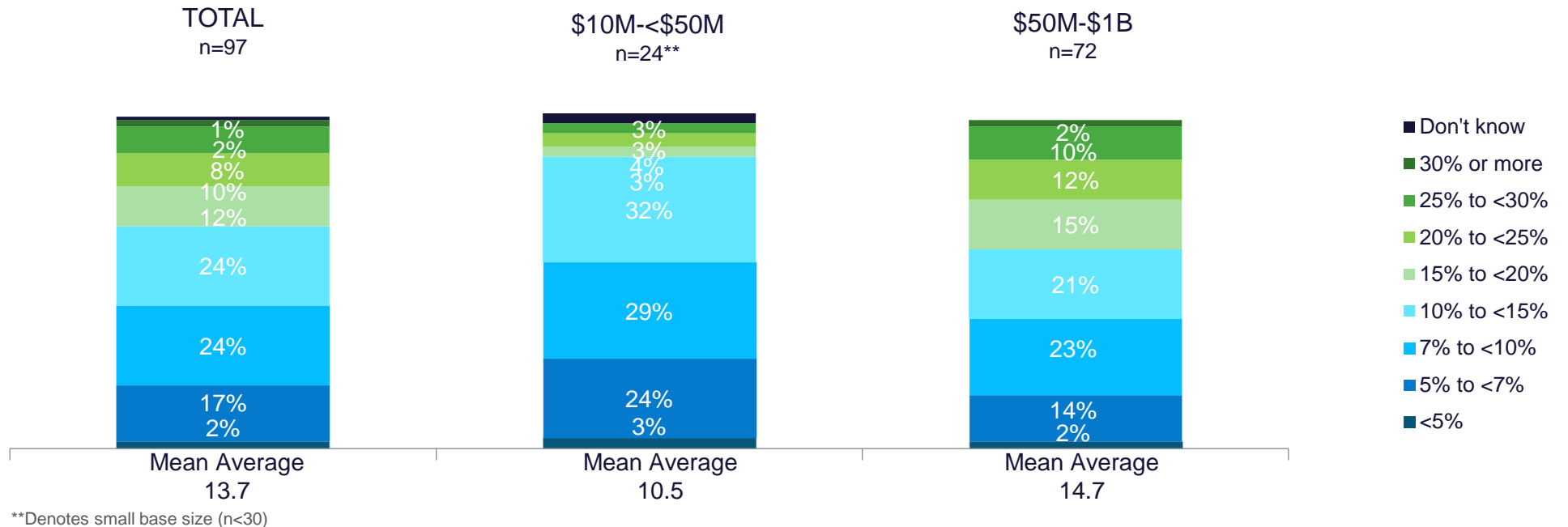


Reading of 100 (orange line) is neutral; reading above 100 indicates optimism; reading below 100 indicates pessimism. Data is seasonally adjusted.

I82 Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit? Would you say that accessing credit is . . .

While cost of capital is much higher

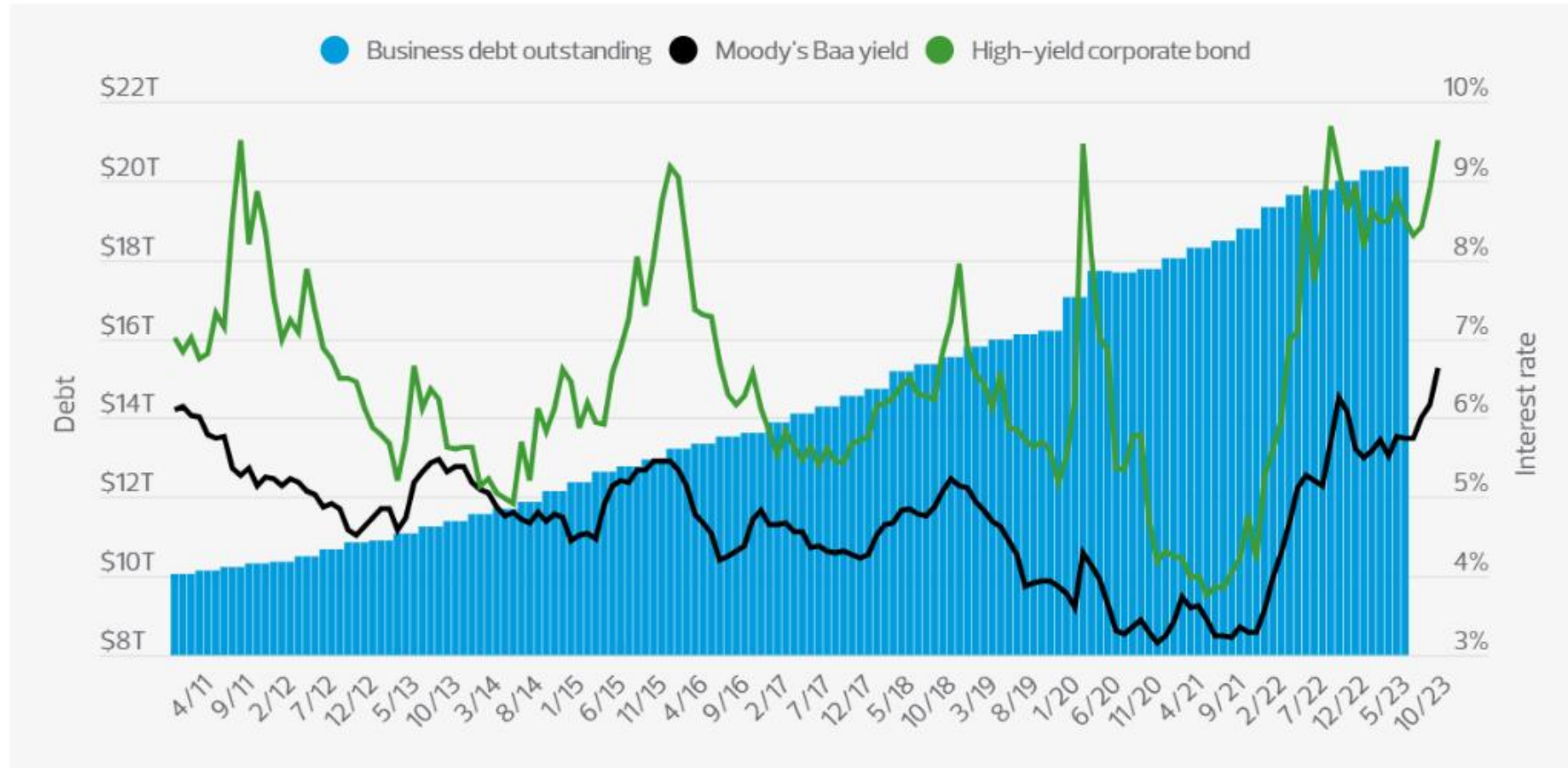
AVERAGE APR PAID OVER PAST TWELVE MONTHS - FINANCE COMPANIES/NON-BANK LENDERS
 (BASE = material sources of funding for investments or working capital during the past twelve months)



A20 For each of the following sources of funding you said your organization uses, please tell us average annual percentage rate (APR) your organization paid over the past 12 months.

Days of reckoning approaching

Corporate debt faces a rollover*

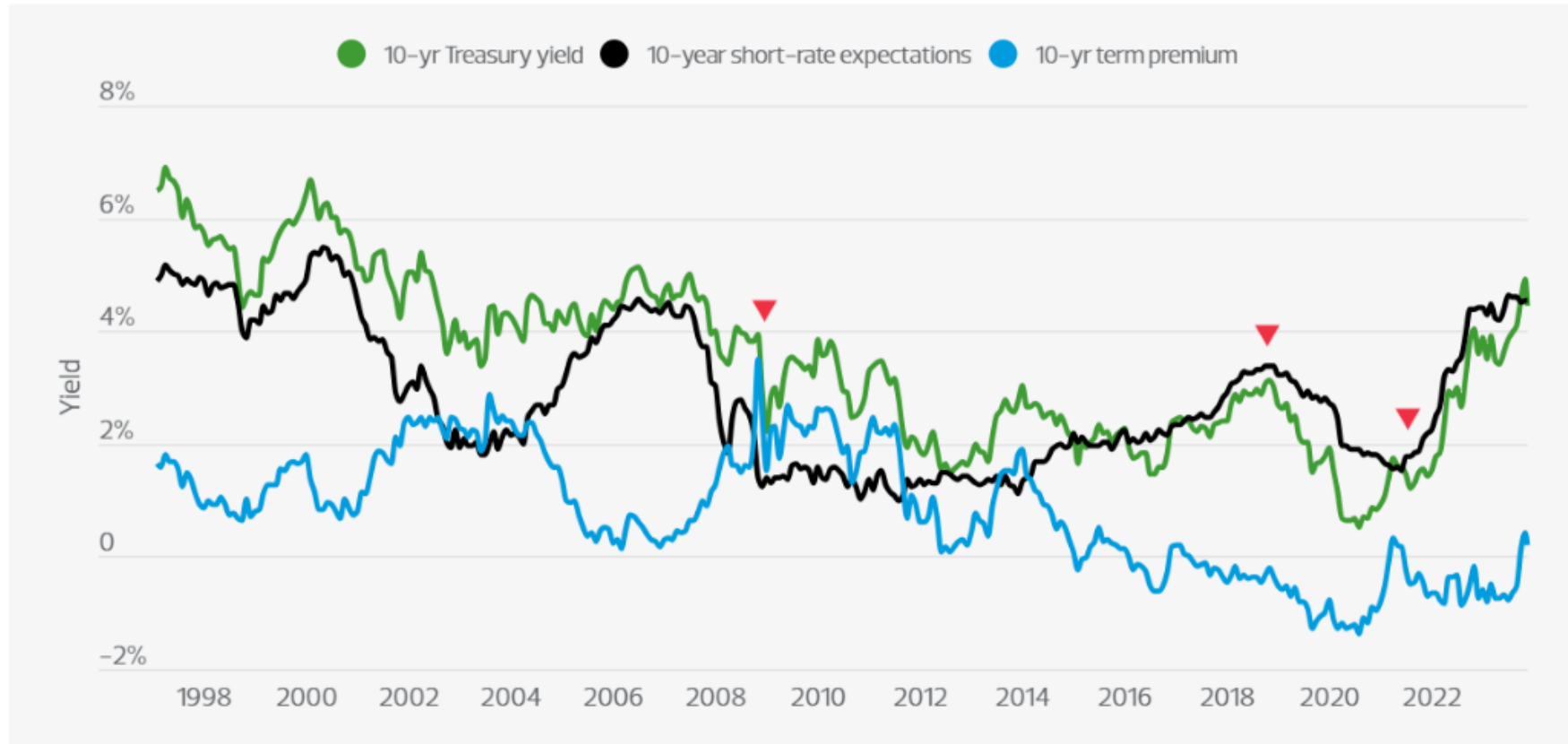


Source: Bloomberg; RSM US LLP

*U.S. nonfinancial business debt and corporate bond yields

Real Rates: 2.5% vs. Average of 0.26% Since 2013

Policy expectations and risk components of 10-year yields*



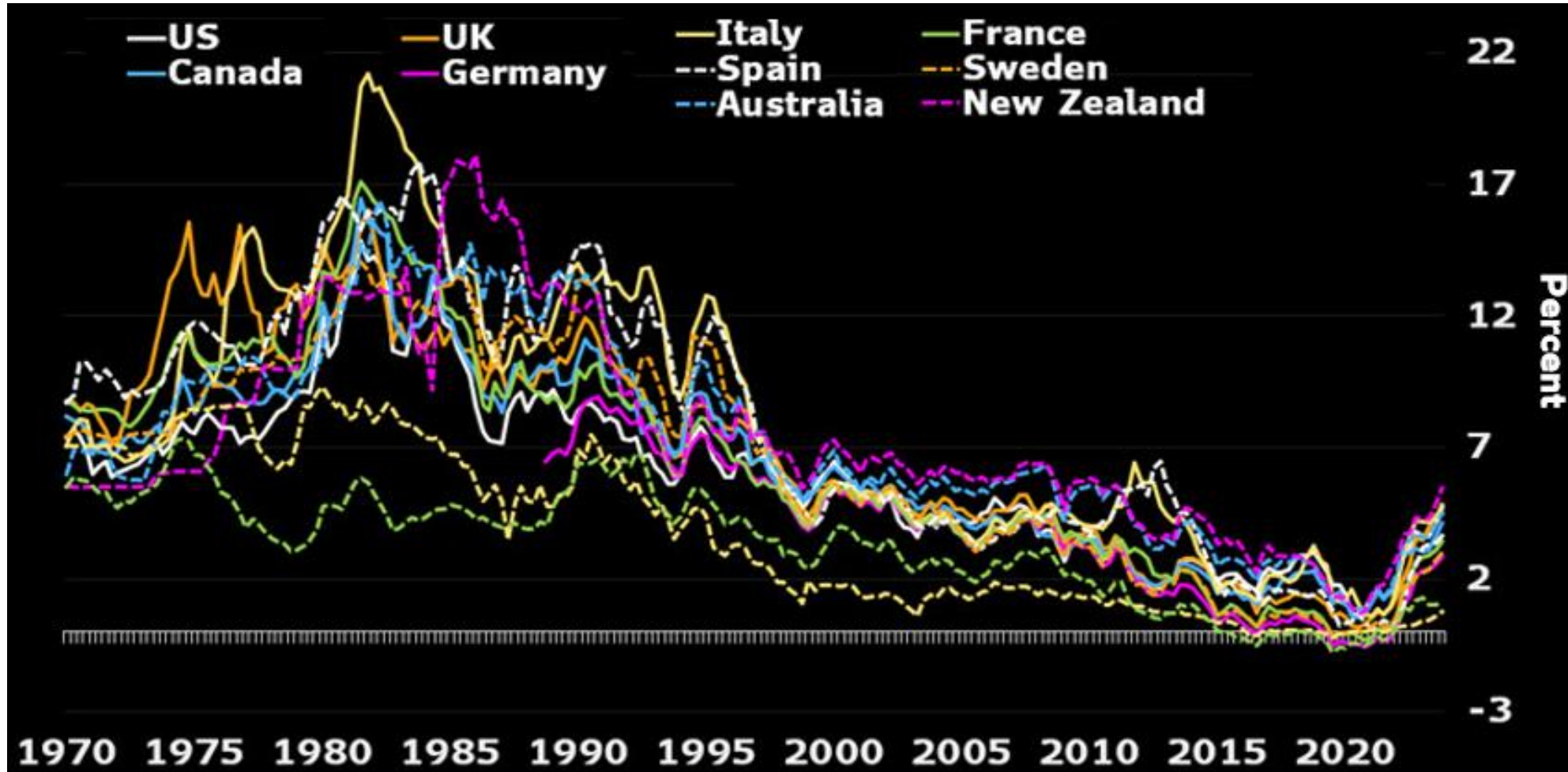
Source: Federal Reserve Bank of New York; Adrian Crump & Moench; Bloomberg; RSM US LLP

*Expectations of the path of short-term rates and the term premium built into 10-year Treasury yields

Every rolling 10-year period back to 1980 saw lower rates...until now

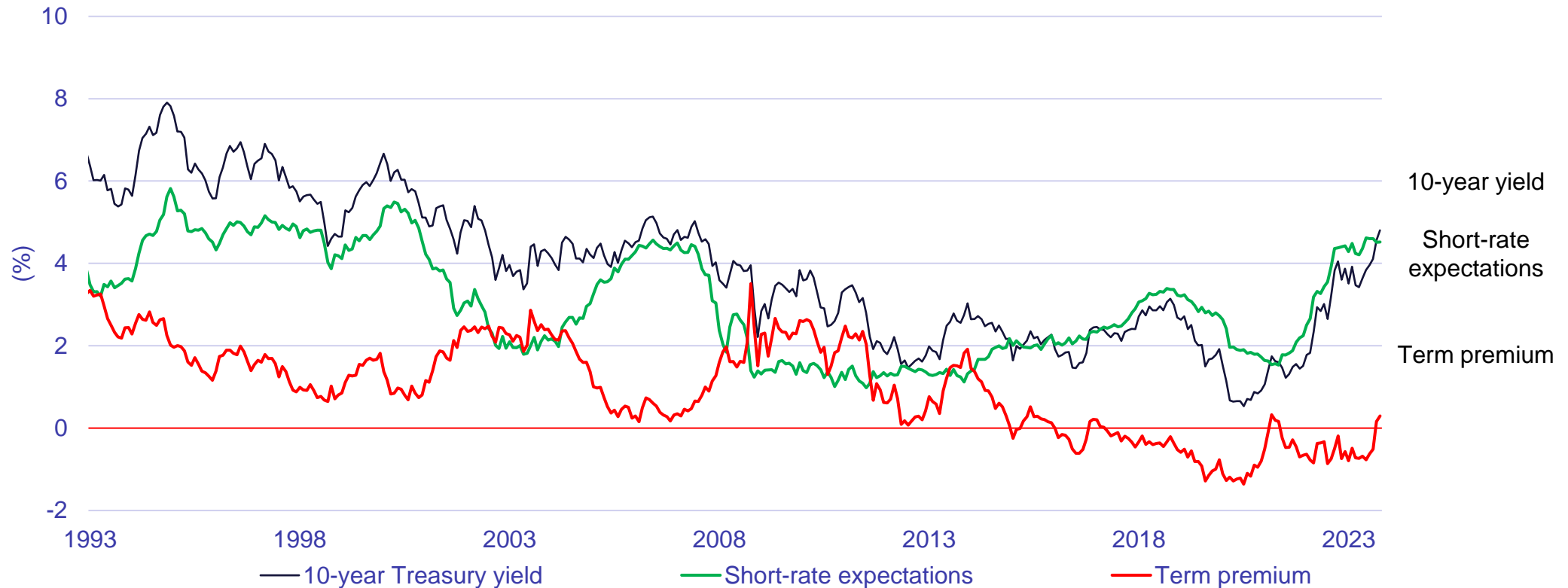


Why no one really believes “higher for longer”



Signs of normalization: Term premium is positive again

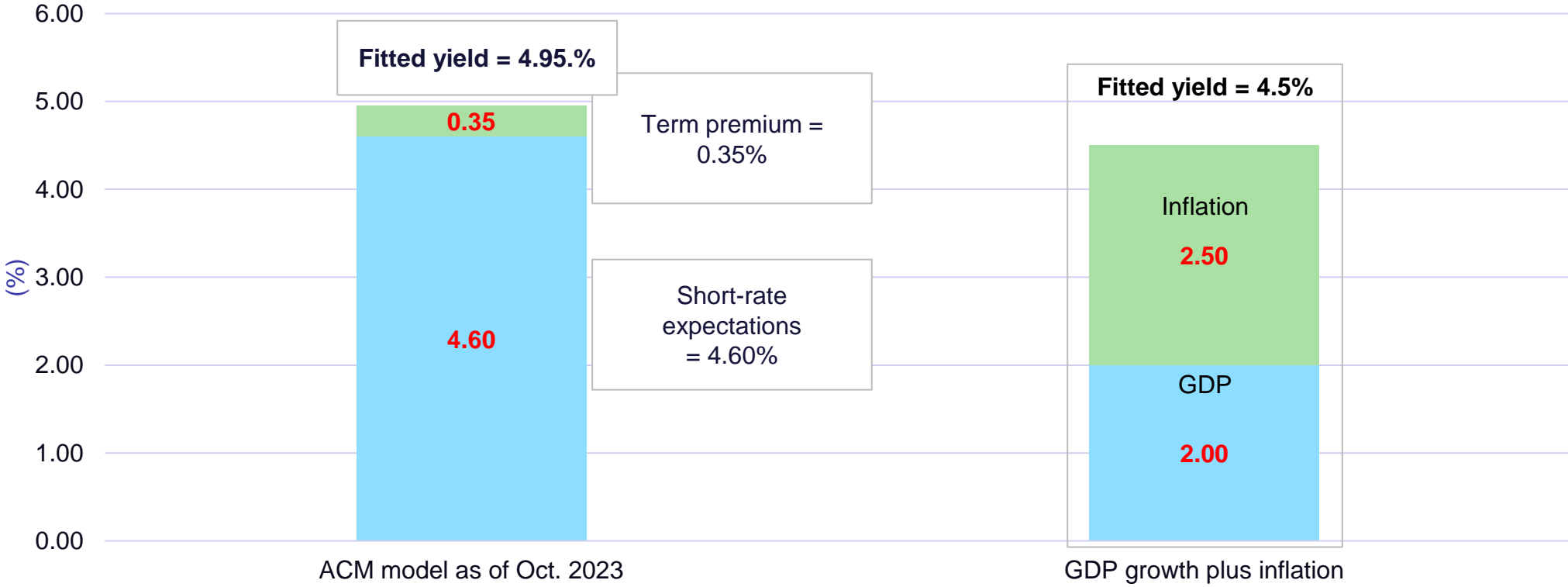
The impact of expectations of monetary policy on 10-year bond yields and the normalization of the term premium



Source: Adrian, Crutch and Moench; NY Fed; Bloomberg; RSM US LLP

Estimating the appropriate yield for 10-year Treasury bonds

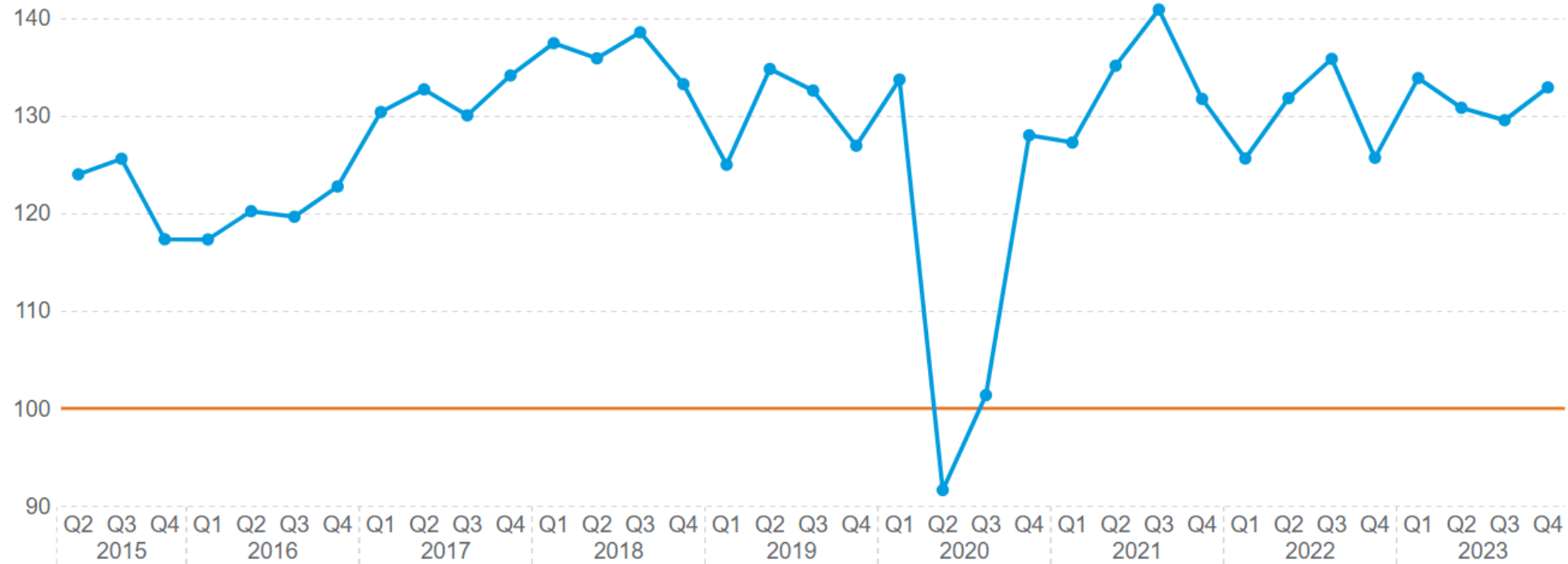
Model-based methods for estimating appropriate 10-year yield



Source: Bloomberg; RSM US LLP calculations

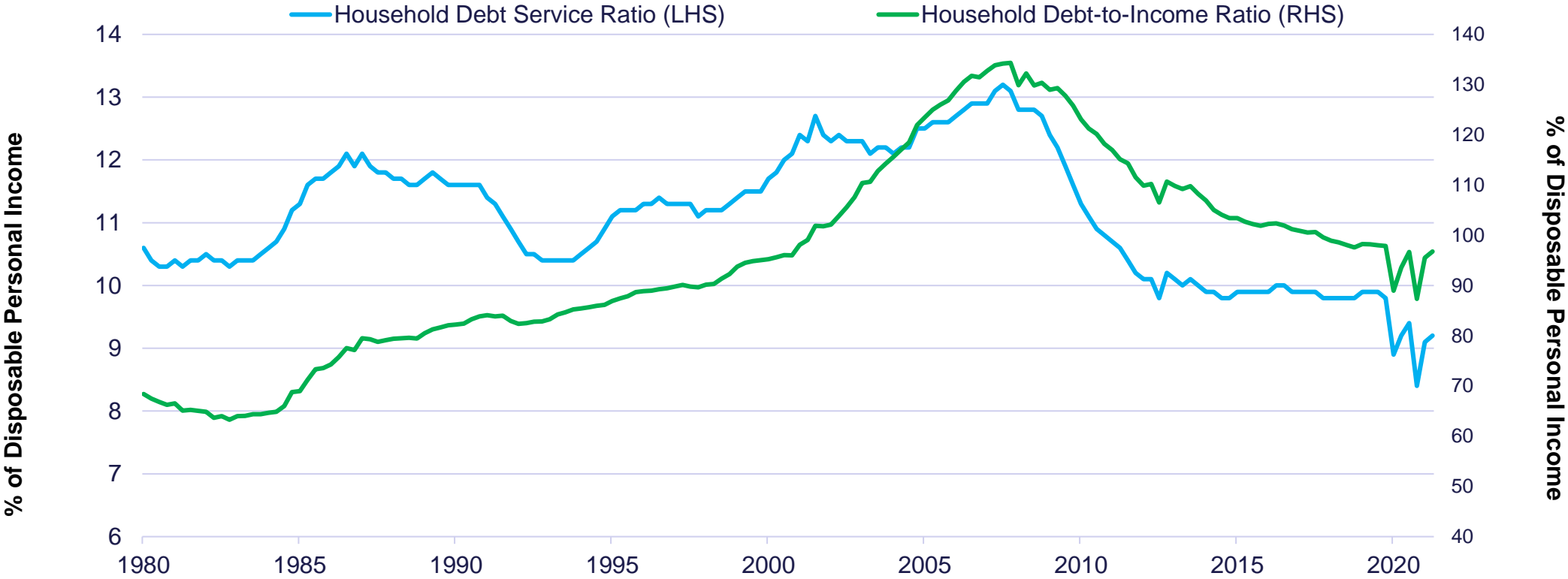
Middle market resilience continues

RSM US Middle Market Business Index
Seasonally adjusted; diffusion index with neutral = 100



Source: RSM US LLP

Household balance sheets strong



Source: Federal Reserve; RSM US LLP

Meanwhile, wage growth has peaked but is resetting higher

Real wages are growing, and are above pre-pandemic levels

Real (inflation-adjusted) hourly wages, measured in Dec 2020 dollars.

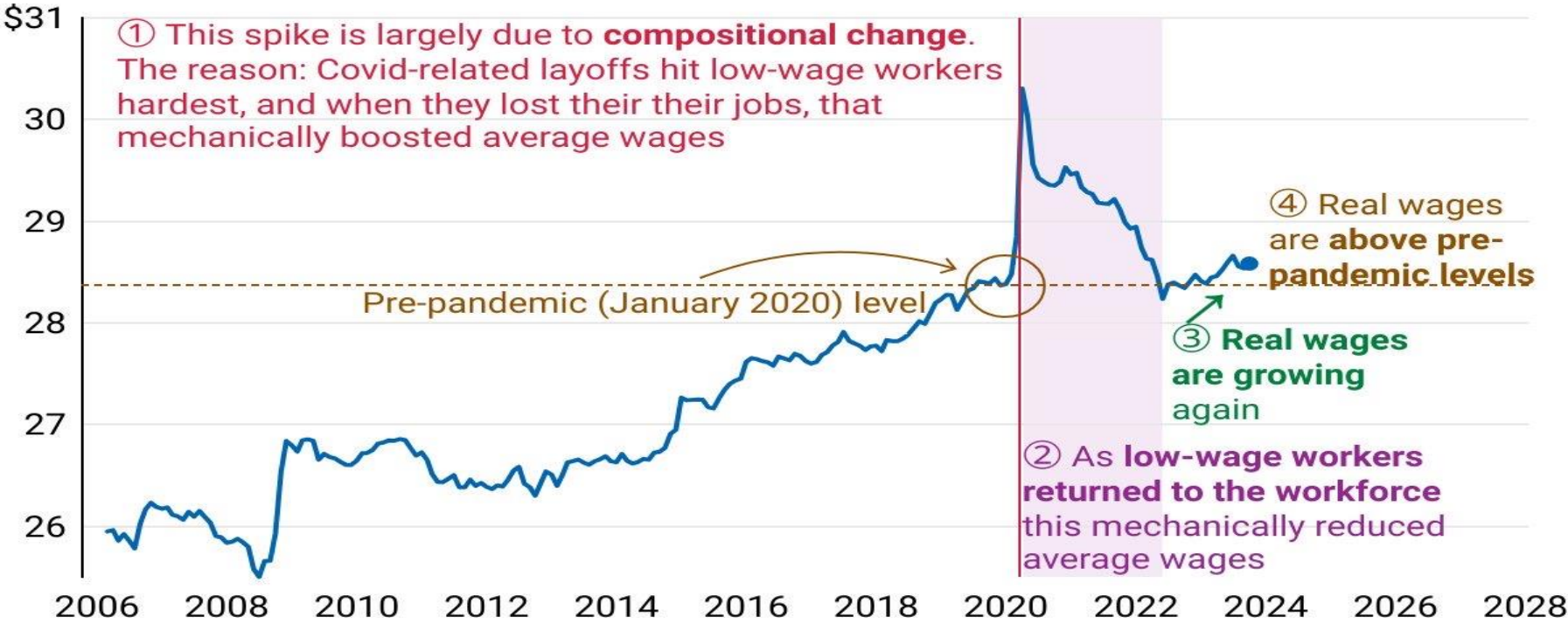
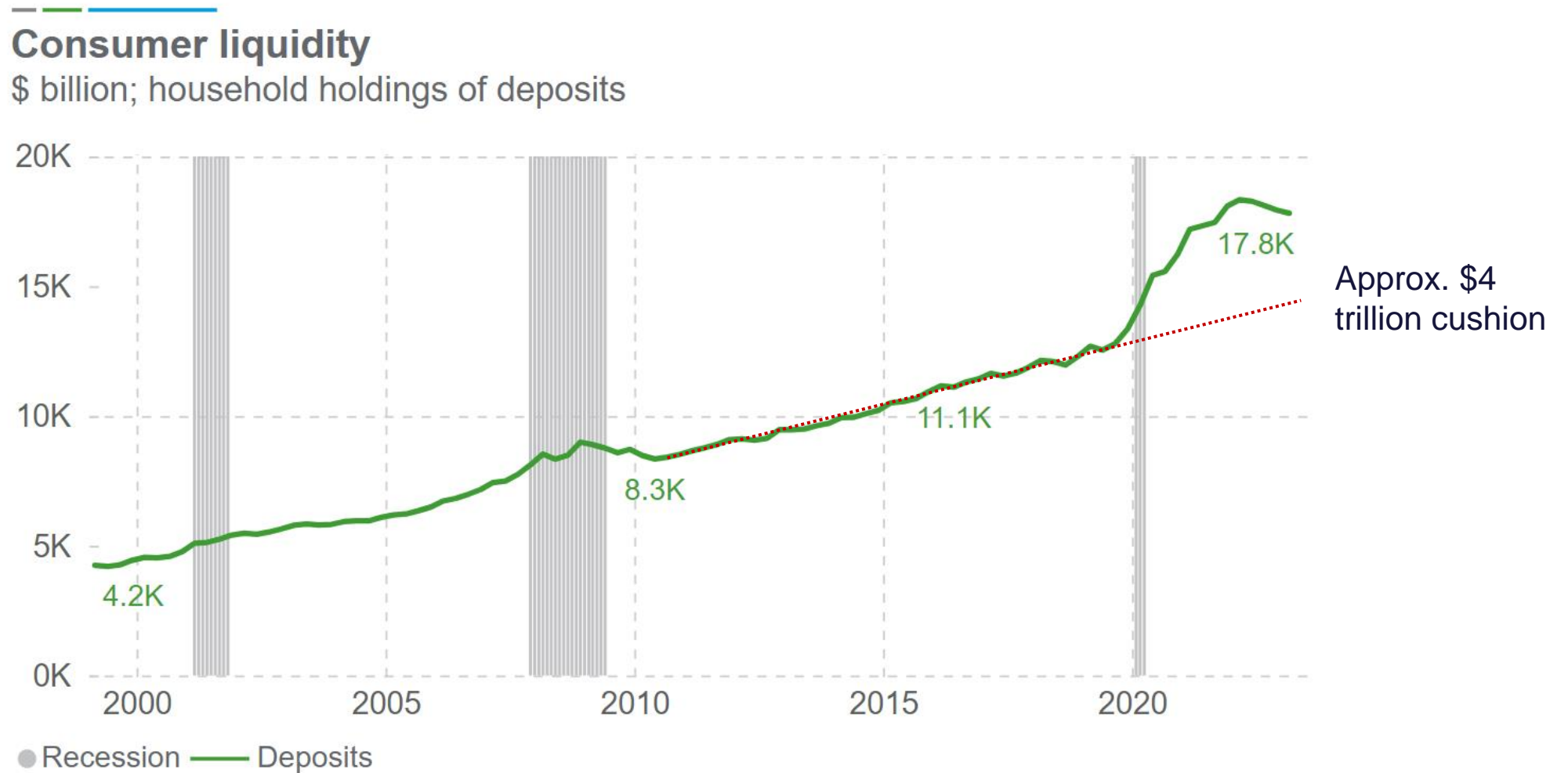


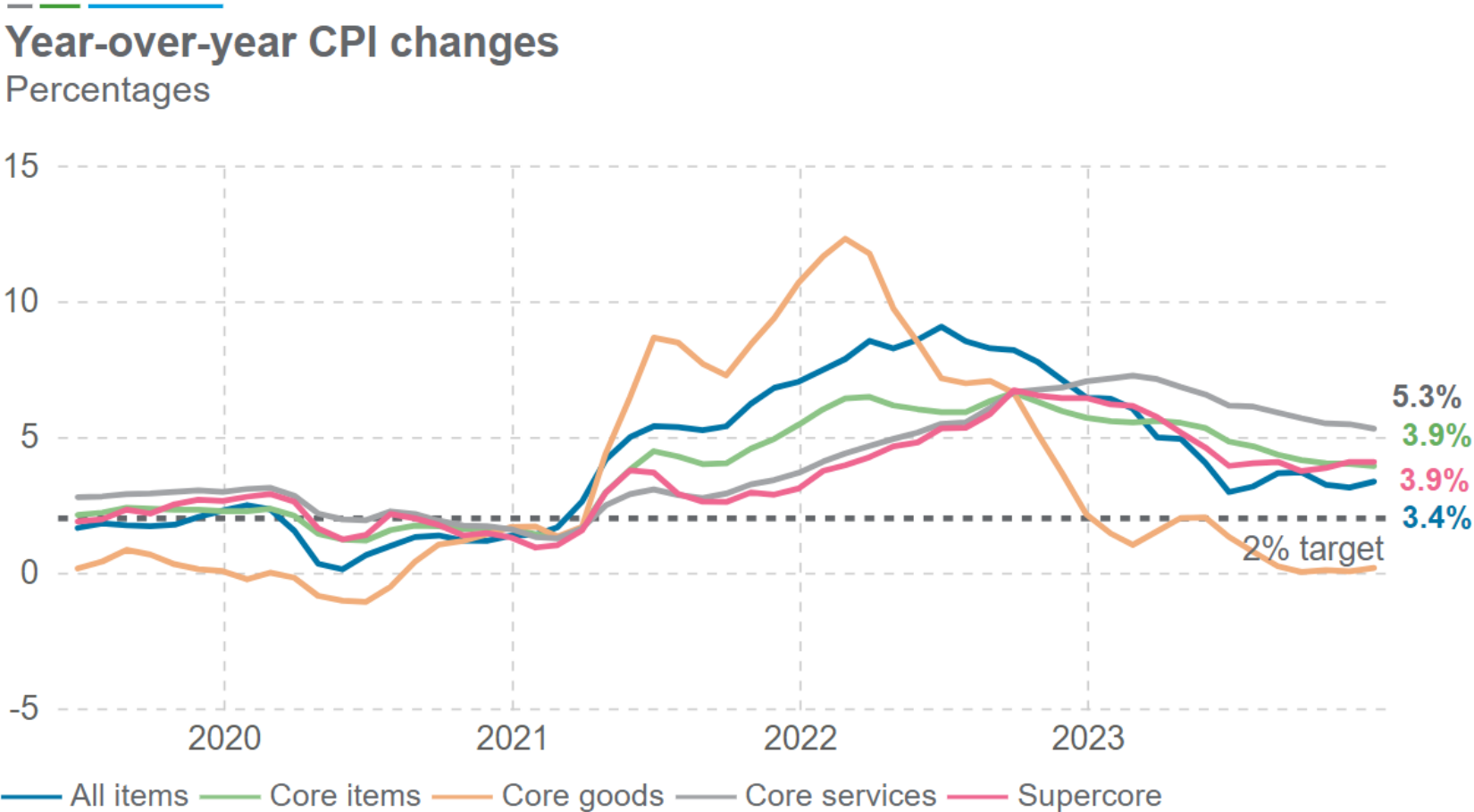
Chart: @justinwolffers • Source: BLS Real Earnings Release

And higher income households are still flush with cash



Source: BEA, RSM US

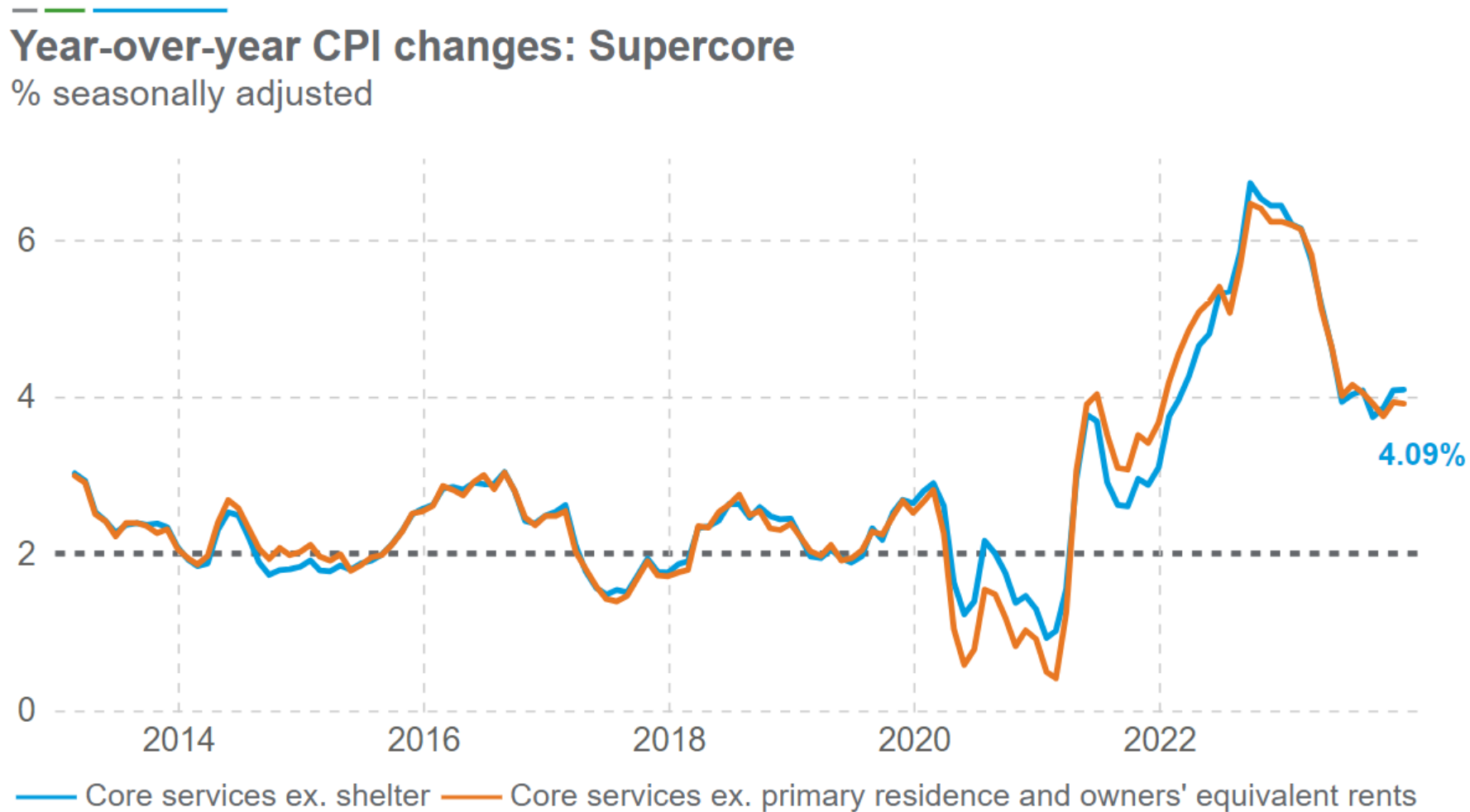
US Inflation: Resetting higher



Source: BLS, RSM US

Source:

US Inflation: Resetting higher



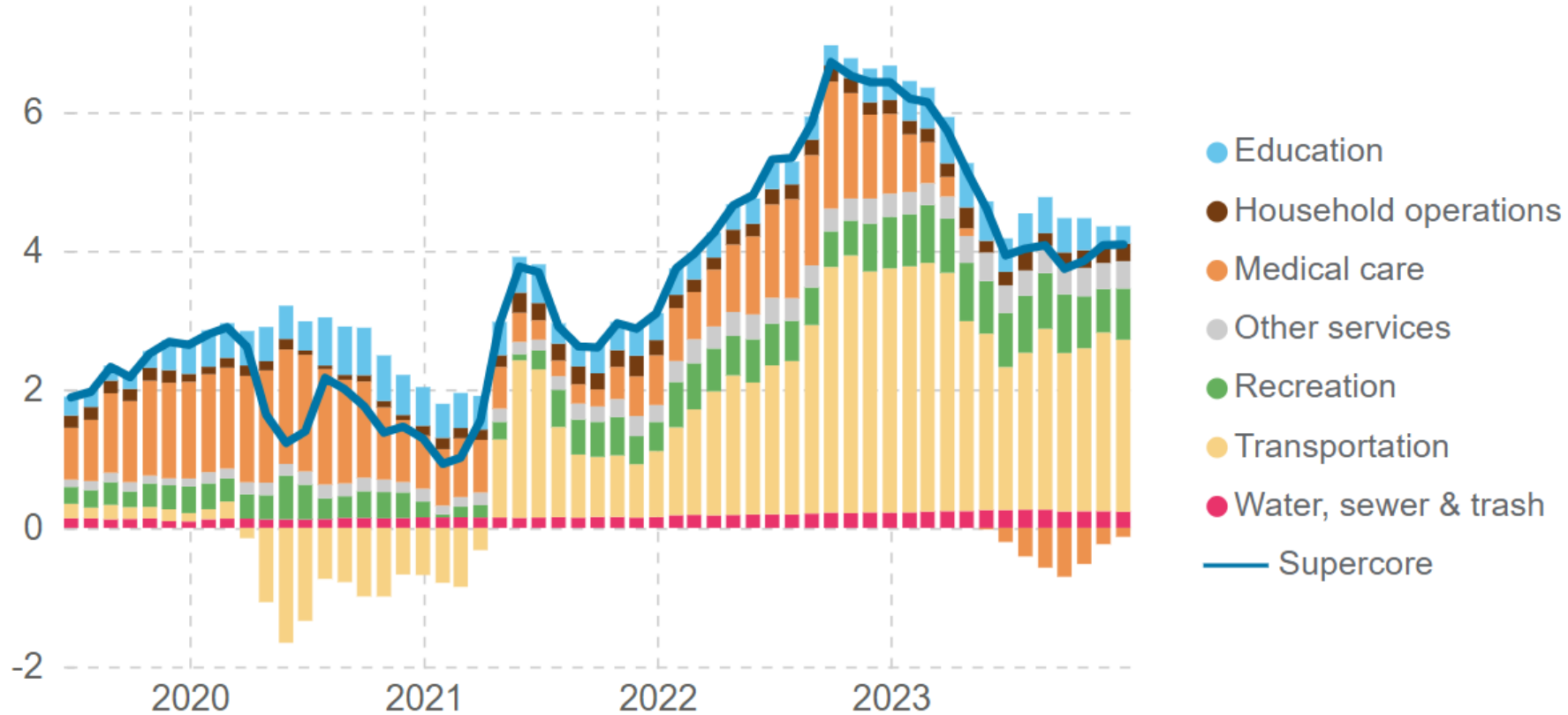
Source: BLS, RSM US

Source:

US Inflation: Resetting higher

Contribution to year-over-year CPI changes: Supercore

% seasonally adjusted; supercore as core services ex. shelter

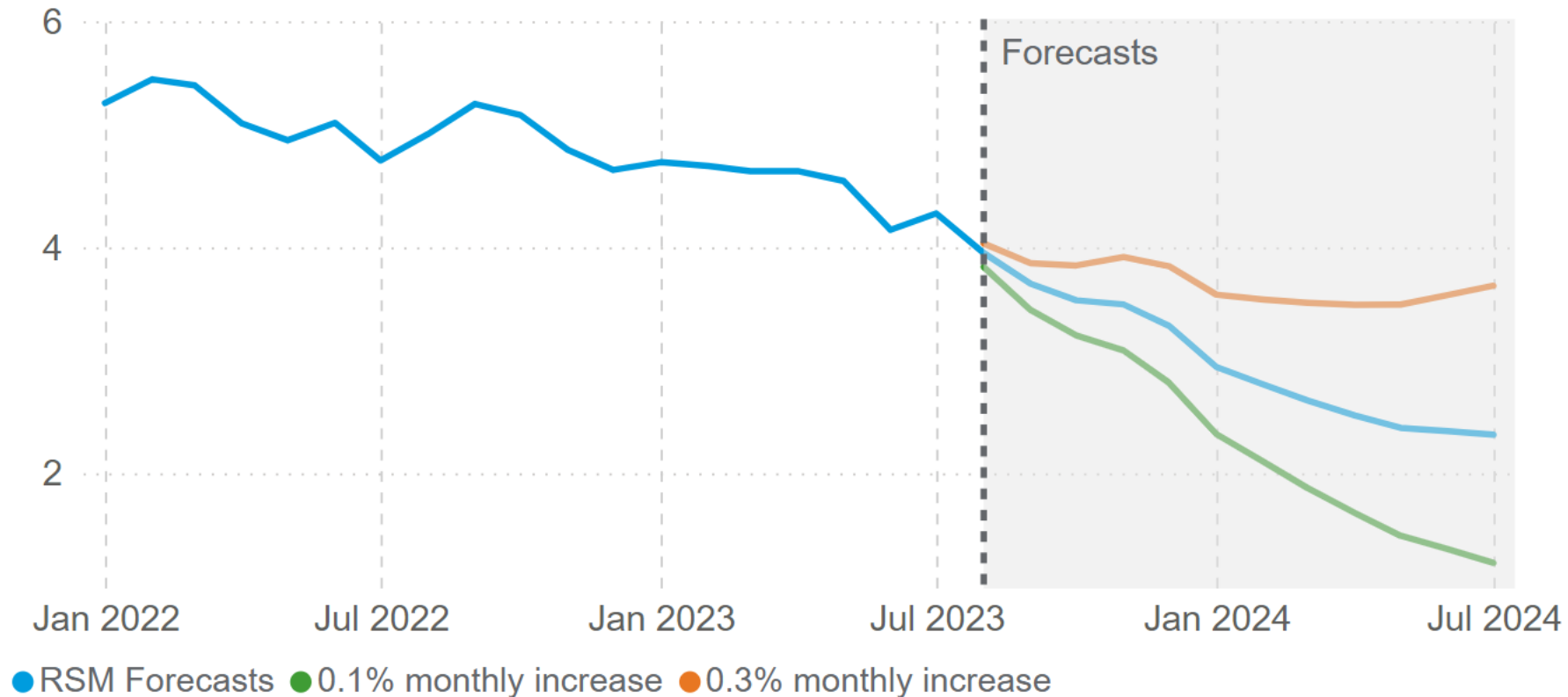


Source: BLS, RSM US

Source:

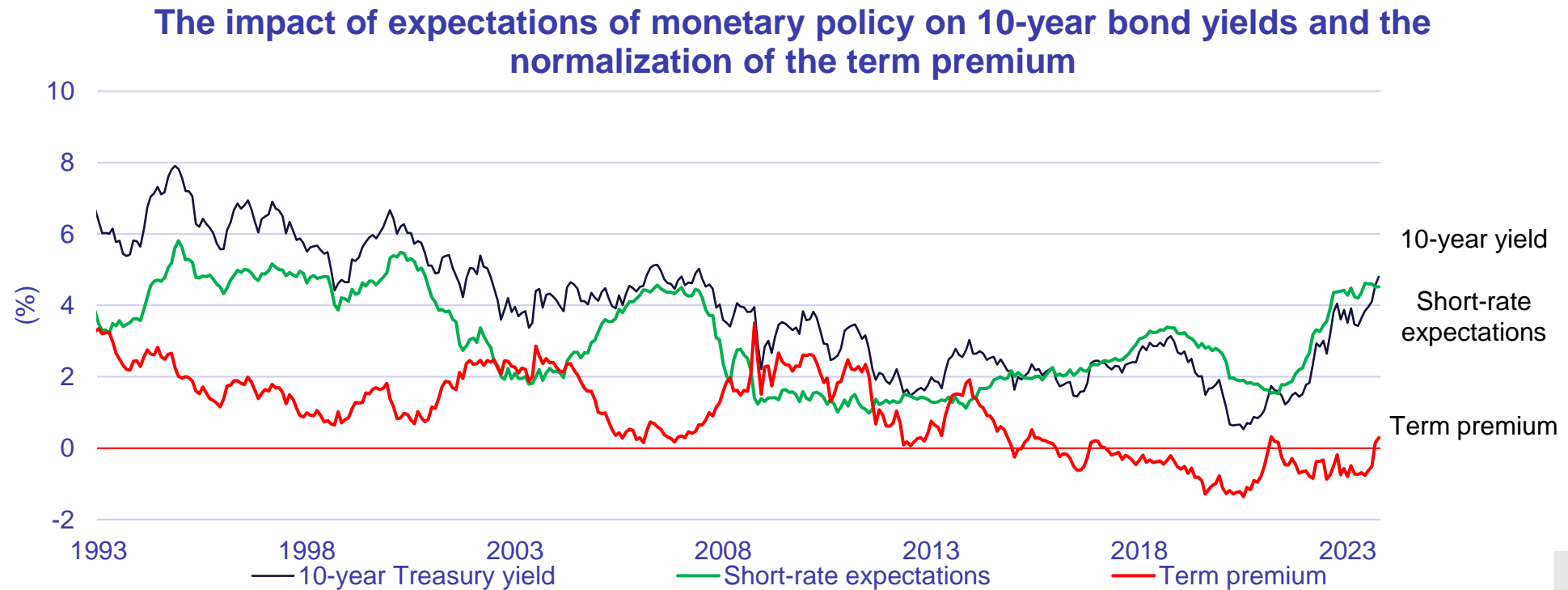
US Inflation path forecasts

PCE core inflation, annual change
In percentages



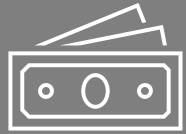
Source: BLS, RSM US

Signs of Normalization -- the term premium is positive again



Source: Adrian, Crutch and Moench; NY Fed; Bloomberg; RSM US LLP

U.S. Economy: Deficit Dynamics and Total US Wealth

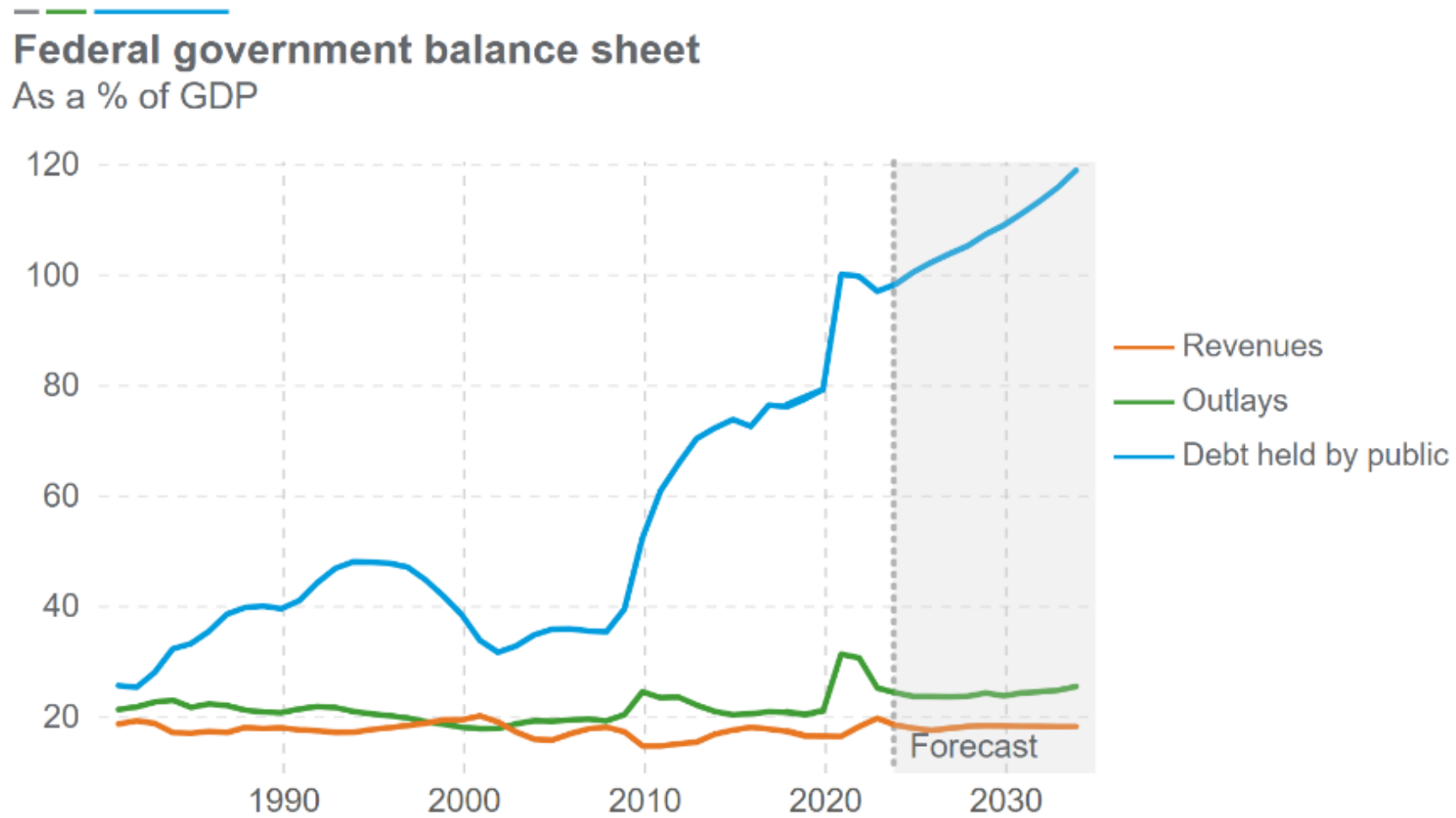


Inflation

U.S. Fiscal Path

- Debt dynamics a political issue **not** economic or financial
- Defense spending to rise, Medicare trajectory an issue
- Total US household wealth near \$155 trillion
- Net interest on debt rising but low relative to 1990's levels

U.S. Economy: Deficit Dynamics and Total US Wealth

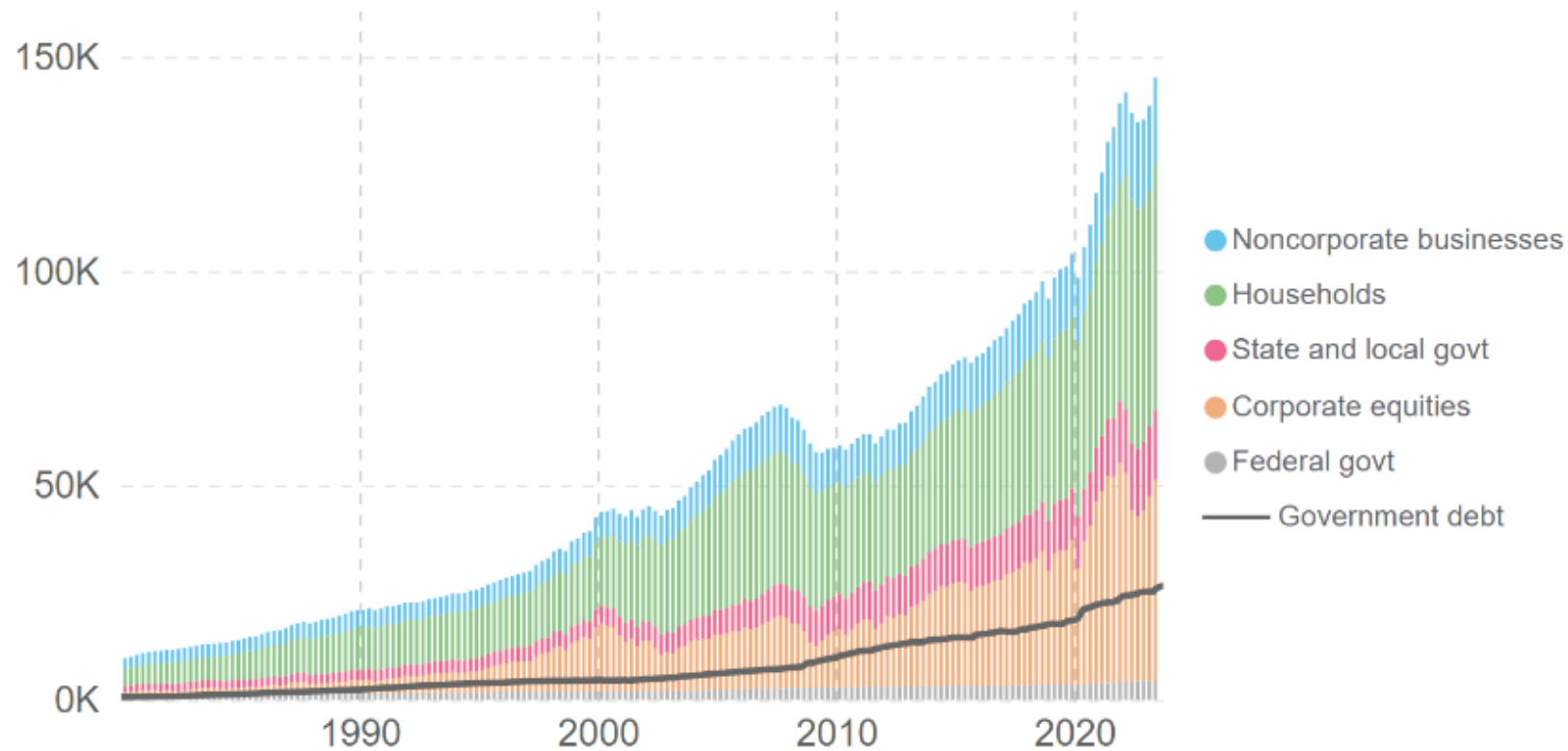


Note: Forecasts based on CBO's May update. Source: US Treasury, Federal Reserve, CBO, RSM US

U.S. Economy: Deficit Dynamics and Total US Wealth

Total U.S. non-financial assets and government debt

\$ billions

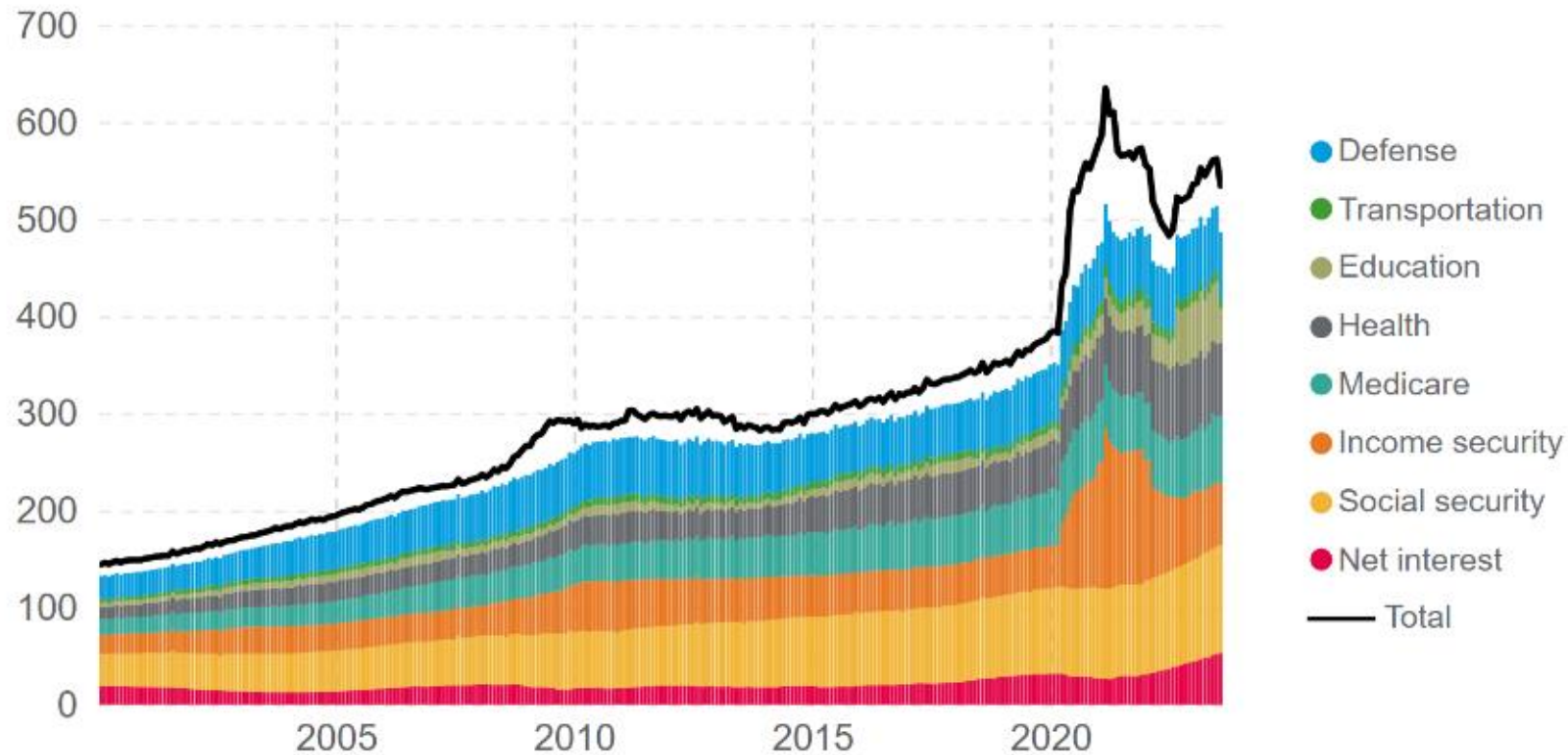


Source: US Treasury, Federal Reserve, RSM US

U.S. Economy: Deficit Dynamics and Total US Wealth

Government monthly expenditure

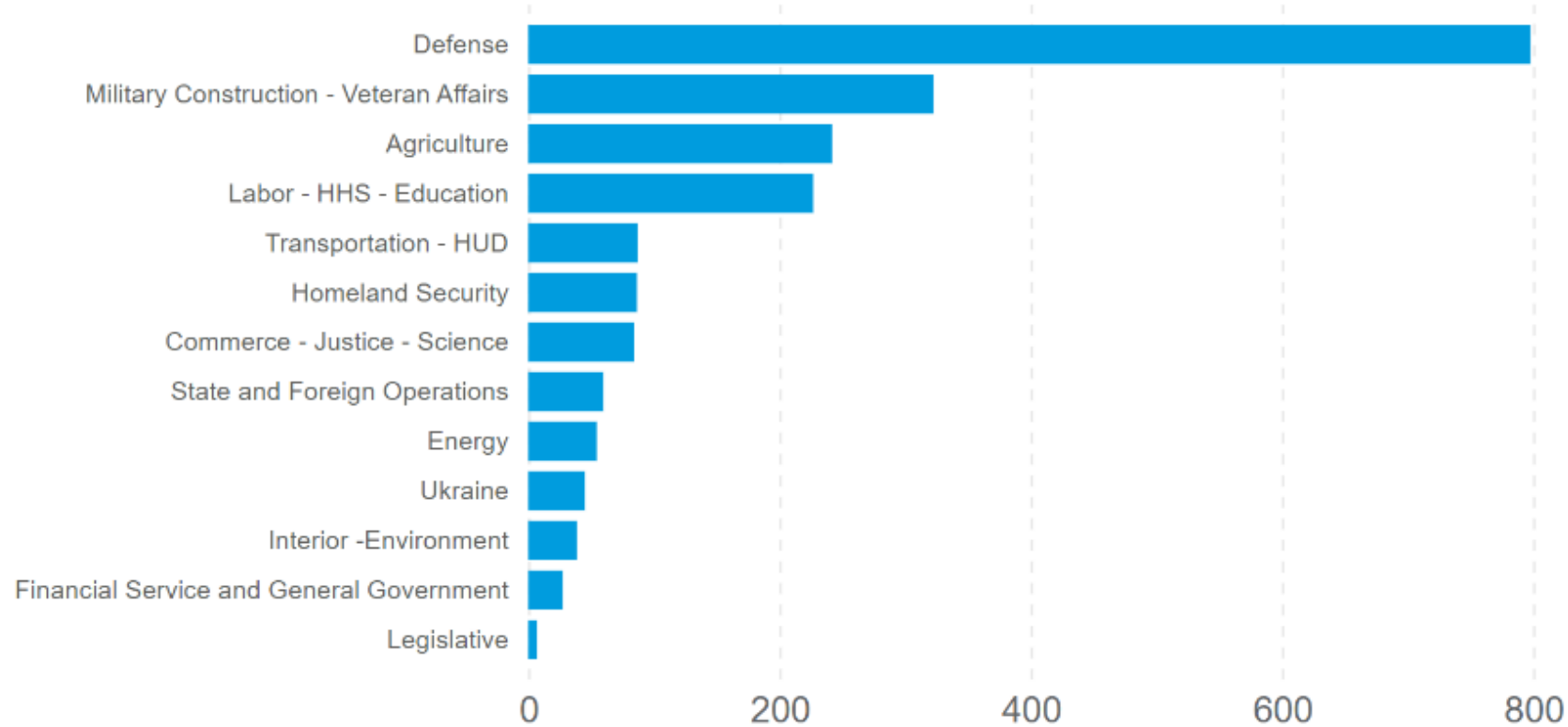
\$ billions, 12-month moving average, NSA



Source: US Treasury, RSM US

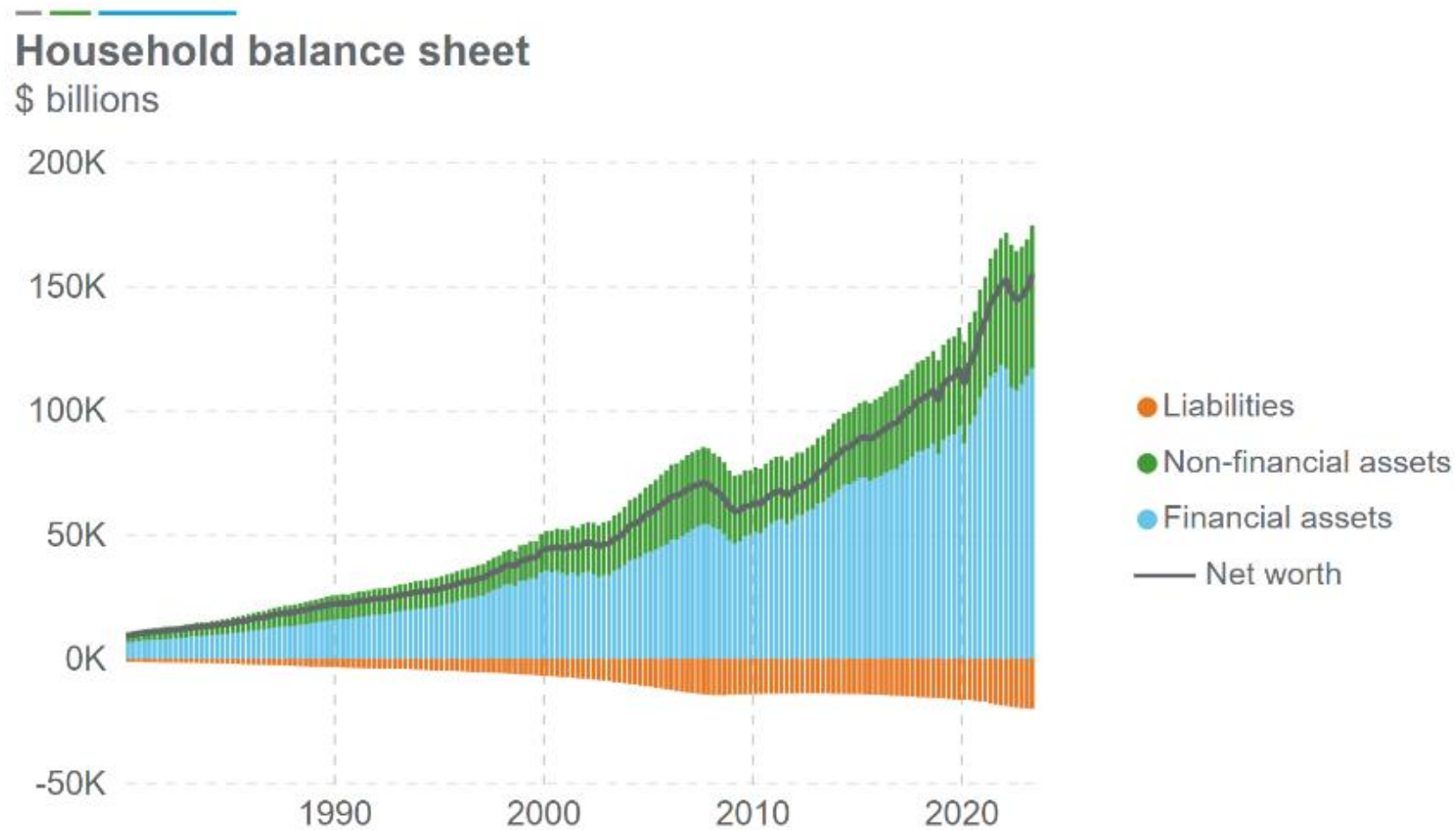
U.S. Economy: Deficit Dynamics and Total US Wealth

Budget appropriations in 2023
\$ billions



Source: White House, RSM US

U.S. Economy: Deficit Dynamics and Total US Wealth



Source: Federal Reserve, RSM US



This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute assurance, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. Internal Revenue Service rules require us to inform you that this communication may be deemed a solicitation to provide tax services. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed.

RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent assurance, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit rsmus.com/aboutus for more information regarding RSM US LLP and RSM International.

RSM, the RSM logo and *the power of being understood* are registered trademarks of RSM International Association.

© 2023 RSM US LLP. All Rights Reserved.