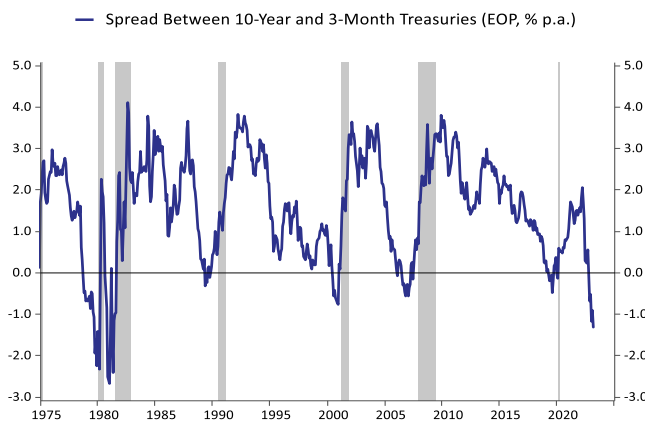


ECONOMIC OUTLOOK: CRUNCH TIME

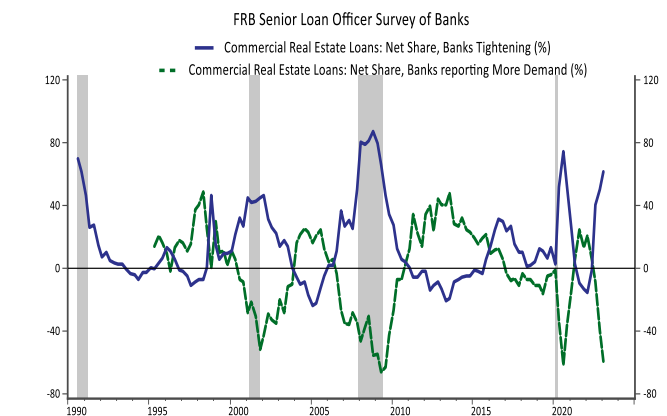
DR. JULIA CORONADO | PRESIDENT OF MACROPOLICY PERSPECTIVES & MCCOMBS CLINICAL PROFESSOR

We have been talking about a recession for about a year now and a number of indicators suggest the economy is certainly at risk. In a March survey by the National Association of Business Economics more than half of all economists expect a recession in the next twelve months. The Treasury yield curve, the difference between the yield on the 10-year bond and the three-month bond has been negative since last October and is usually a leading indicator of a recession. Banks have also started to tighten lending standards; in the Federal Reserve's Senior Loan Officer Survey the net percent of respondents saying they were tightening standards on commercial and industrial loans rose to over 40% in Q1 and the net percent tightening standards on commercial real estate loans jumped to over 60%, both rose from zero in the middle of 2022 and the Q1 readings came before the recent failures of Silicon Valley Bank and Signature Bank so we could see further tightening in the months ahead. Tighter credit standards often contribute to economic contraction.

THE YIELD CURVE IS MORE INVERTED THAN IT HAS BEEN SINCE THE EARLY 1980S AND CREDIT CONDITIONS ARE TIGHTENING



Source: HAVER/Haver/Macropolicy Perspectives LLC



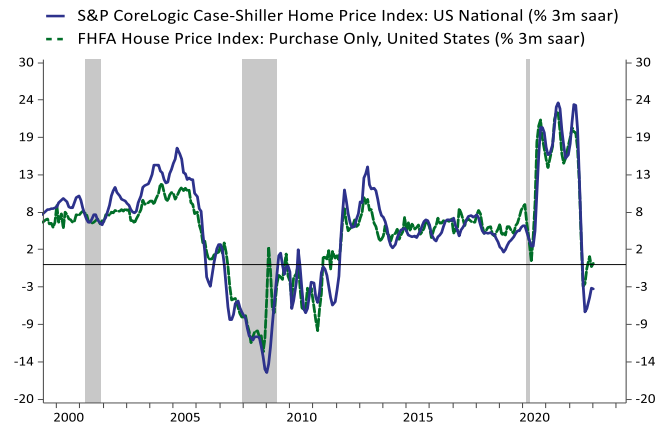
Source: FRB/Haver/Macropolicy Perspectives LLC

Recessions can occur in one of two ways: the economy can develop imbalances that prove unsustainable such as the housing bubble of the mid-2000s or the tech boom of the late 1990s that end with a bursting of an asset price bubble. The more traditional channel is that the economy overheats, and the Fed must raise rates significantly to cool inflation. We may have a bit of both in the present environment. Inflation rose sharply in the recovery from the pandemic and the Fed and other central banks have raised interest rates at the fastest pace since the 1980s, but we also saw real estate valuations and the share prices particularly of technology companies soar during the pandemic. Those valuations may prove unsustainable, particularly if interest rates remain higher than last cycle.

MORTGAGES REMAIN AT LEVELS NOT SEEN IN YEARS AND HOME AND COMMERCIAL REAL ESTATE VALUATIONS HAVE TAKEN A HIT



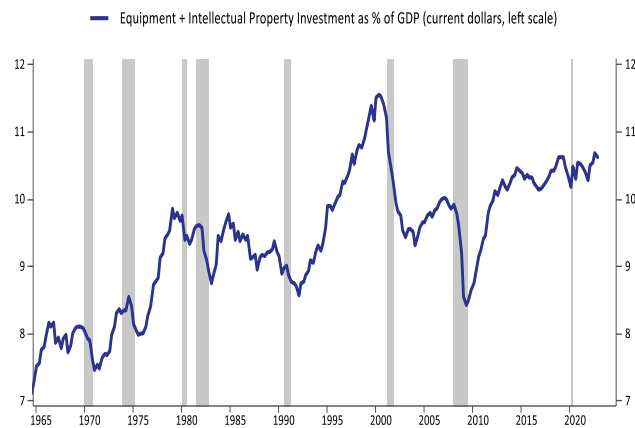
Sources: MacroPolicy Perspectives/WSJ, FHLMC/Haver



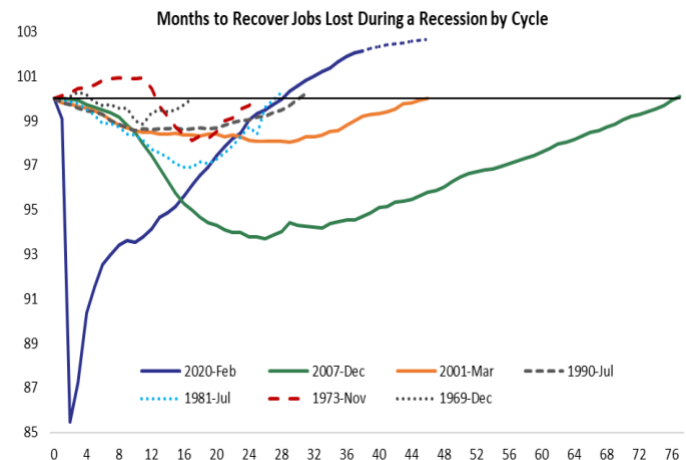
Sources: S&P, FHFA/Haver/MacroPolicy Perspectives LLC

That a recession will happen eventually is a forgone conclusion, that one will happen in the next year certainly is not. This cycle has been caused by an unprecedented shock from the global pandemic and has been unpredictable and surprising in ways that are positive and negative. On the one hand inflation rose to the highest rate in forty years and has been coming down only gradually, leading the Fed to take a hardline approach on interest rates over the past year. On the other hand, we have seen the strongest and most resilient labor market in generations. This is the first recession where household credit quality improved through a downturn and the first where business investment has remained strong throughout. Strong business investment could lead to improving productivity and alongside a resilient labor market could keep the expansion on track.

BUSINESS INVESTMENT NEVER FELL DURING THE COVID RECESSION AND THE JOBS RECOVERY HAS BEEN FAST FROM A DEEP HOLE



Source: Haver/MacroPolicy Perspectives LLC



A key question for the real estate industry whether or not we enter a recession in the near future is whether rates will go back to pre-pandemic levels in the next few years or remain higher. Recessions tend to dampen longer term interest rates, and an aging and slower growing economy likely mean rates will remain low in historical terms. On the other hand, inflation could remain higher and the economy more robust than in the aftermath of the Great Recession which featured years of deleveraging by households and the financial sector and that could mean rates remain above pre-pandemic norms. In the near term banks are struggling with balance sheet losses and an inverted yield curve so credit is likely to remain tight and rates higher making for a bumpy ride this year.