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NATIONAL HOUSING & REHABILITATION ASSOCIATION

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Keynote Address

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Economic Outlook:

A New Fed Strategy to Tame Inflation: *Skip and Reengage*

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STIFEL

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Hiring Momentum Slowing: 209k Payrolls Added in June

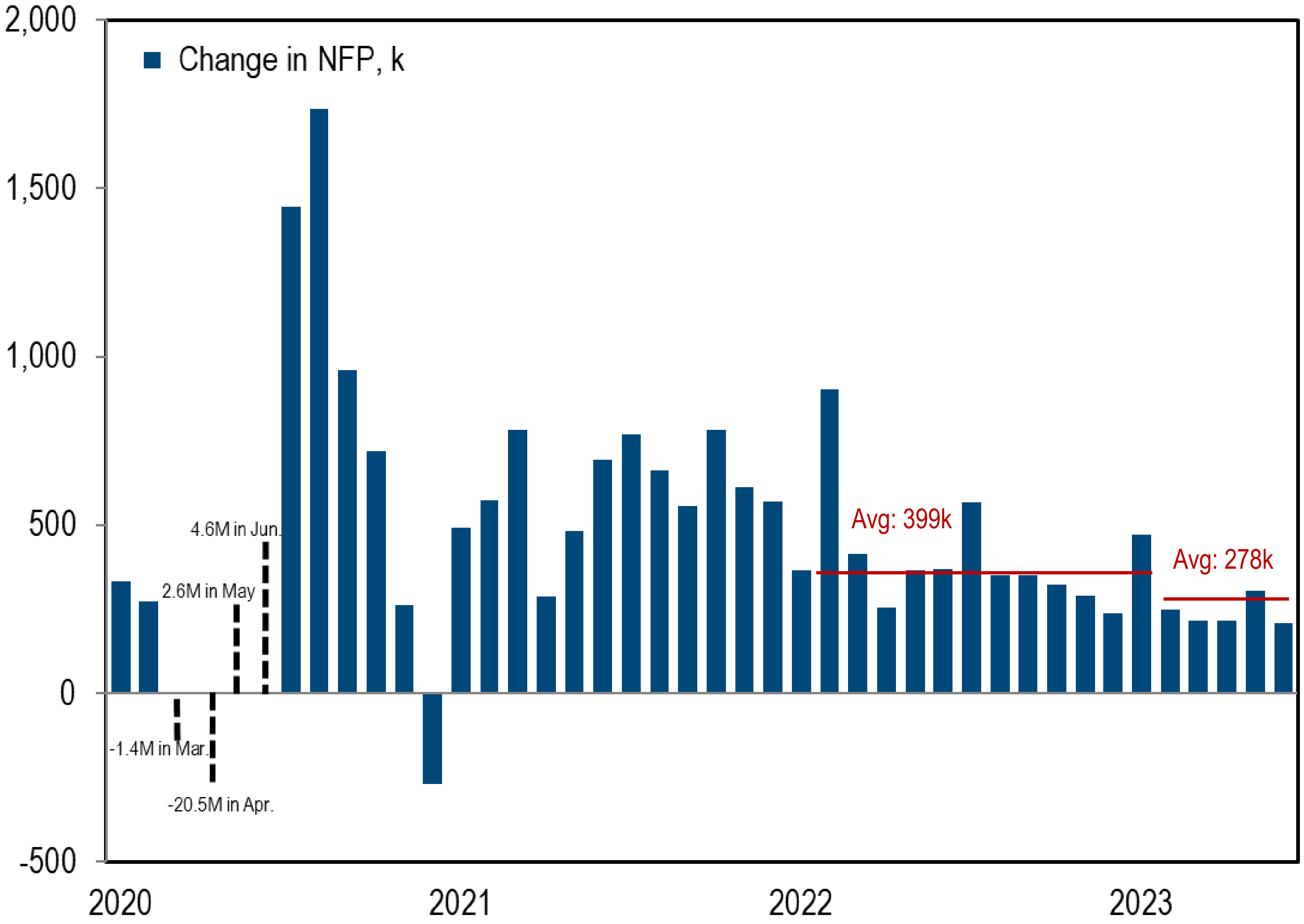
Other sectors of the economy are more clearly showing indications of waning momentum or slower growth, the labor market is not among them

Nonfarm payrolls rose by **209k** in June, the weakest pace of job creation since December 2020

With earlier revisions to previous months, the overall change (June data + net revisions) was 99k

Nonfarm payrolls fell 1.5M in March and 20.5M in April of 2020, the largest monthly decline on record

For the full year of 2022, U.S. employers added 4.8m jobs, the second-best year for job creation on record after 2021's 7.3m gain. Payrolls dropped 9.3m in 2020, the largest decline on record, and more than the combined decline in 2008 and 2009



Source: Bureau of Labor Statistics/Haver Analytics

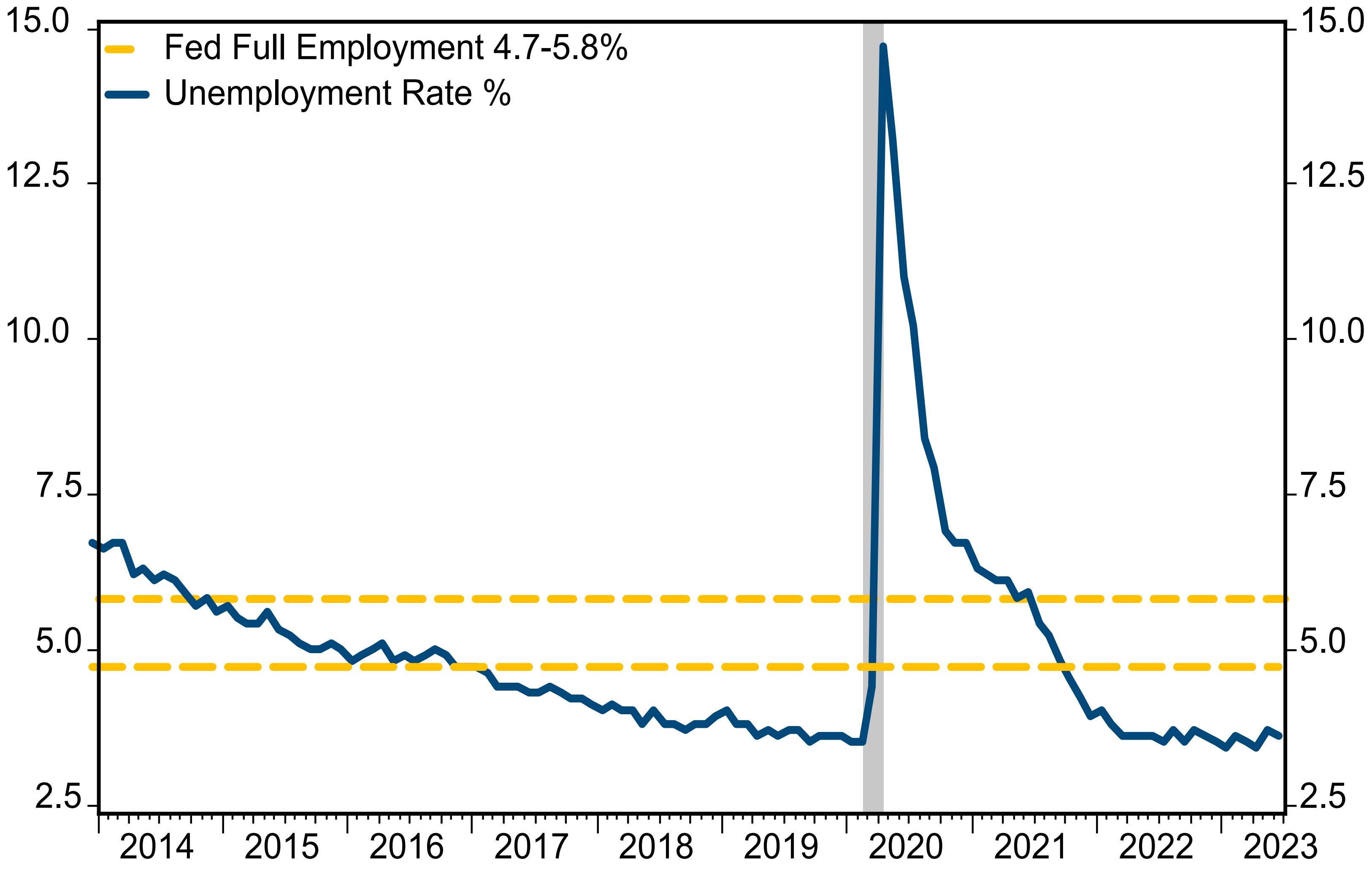
3.6% U.S. Unemployment Rate

The decline in the unemployment rate shows further improvement in labor market conditions

Household employment rose by **273k** in June, and the labor force rose by **133k**, resulting in an unemployment rate of **3.6%** in June, **a five-decade low**

The decline in the unemployment rate reflects more employment *and* sidelined workers

Returning workers will push unemployment rate higher



Source: Bureau of Labor Statistics/Haver Analytics

Participation Rate Still Shy of Pre-Pandemic Level

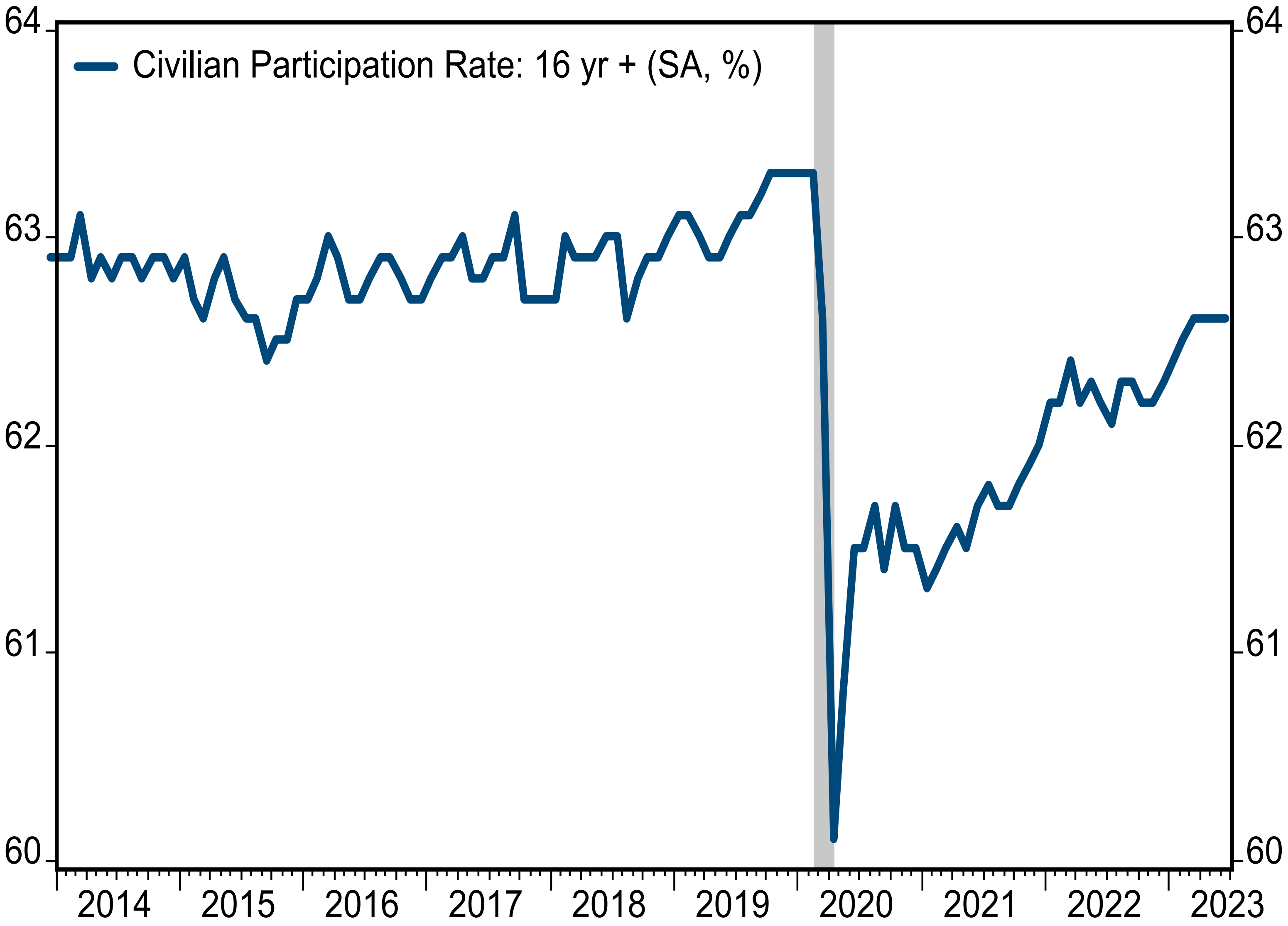
The labor force rose by **133k** in June

The labor force participation rate remained at **62.6%** in June, a three-year high, but still below the pre-crisis peak of 63.3%

The participation rate remains nearly 1.0% below the pre-Covid level, representing a potential gap of roughly 3M workers

The largest drop in participation has been from workers aged 55+, still down roughly 2 percentage points from the start of 2020

Fewer workers is far from the ideal scenario particularly as businesses remain desperate for workers



Source: Bureau of Labor Statistics/Haver Analytics

Average Hourly Earnings Gain Momentum in June

As businesses search for workers, compensation is elevated, although the trend appears to be moderating as businesses struggle to absorb costs

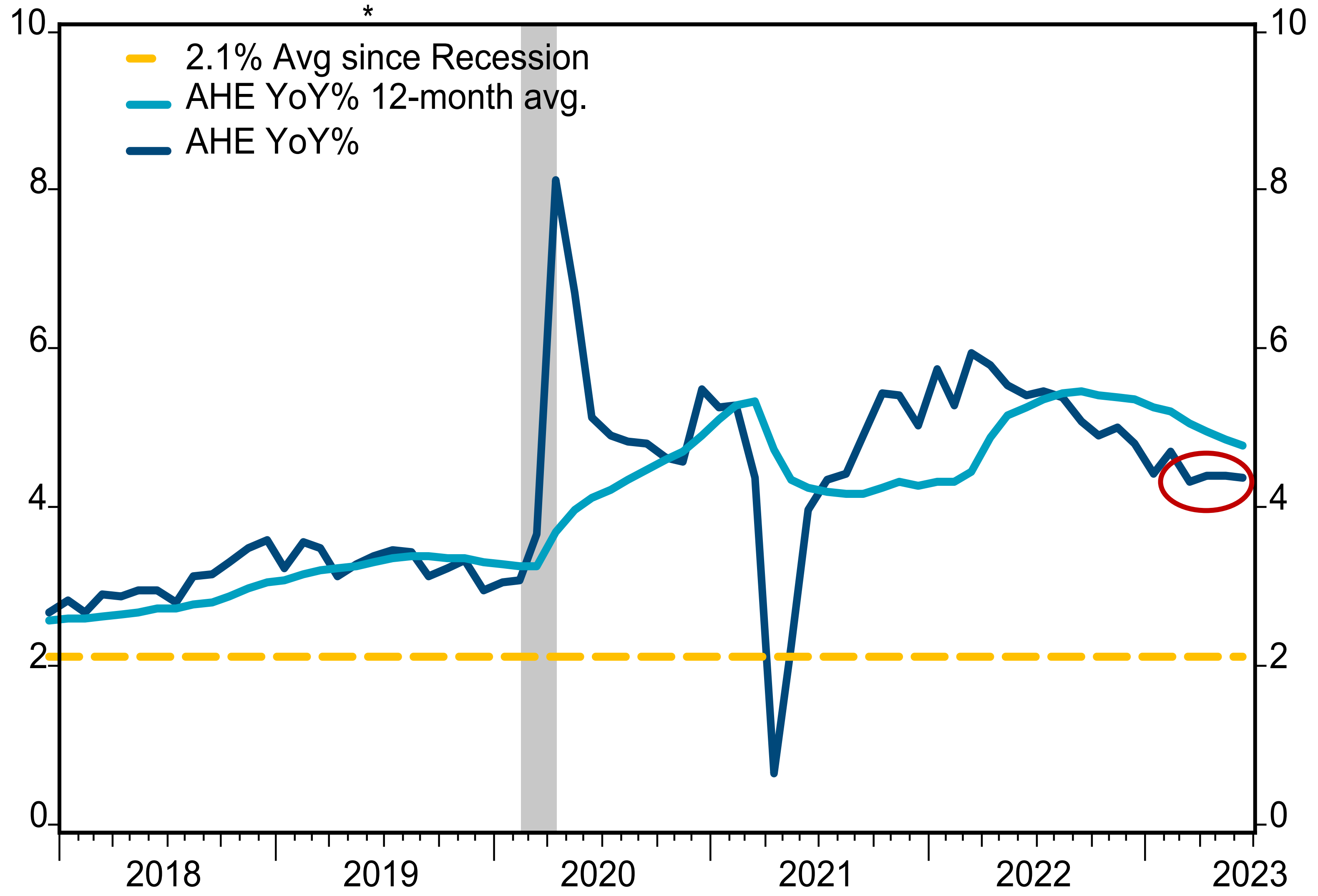
Average hourly earnings rose **0.4%** in June, following a 0.4% rise in May

Year-over-year, wages rose **4.4%** in June, following a similar increase in April and May, and further below a recent peak of 8.2% in April 2020

Longer-term, businesses may turn to technology or close doors

For now, costs are likely to remain elevated as long as labor remains scarce

Average earnings increased early on during the pandemic as lower-wage workers dropped out of the workforce



Source: Bureau of Labor Statistics/Haver Analytics

*Does not include government assistance

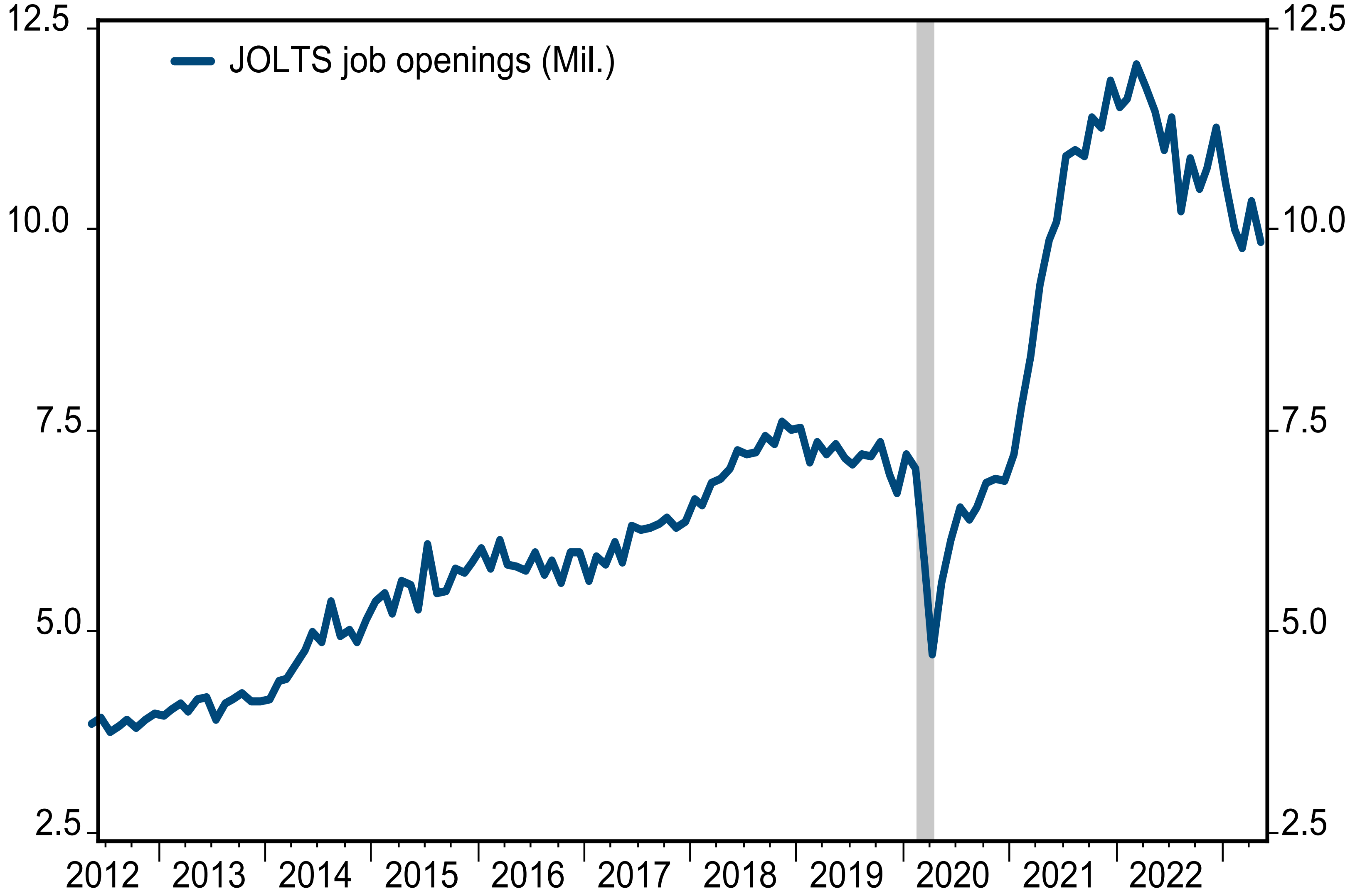
Labor Demand Outpaces Labor Supply

Hiring limited by supply, with demand far outpacing available workers

The number of job openings, according to JOLTS – the Job Openings and Labor Turnover Survey – fell from 10.3M to **9.8M** in May

The 26th straight month above 9M, suggesting producers remain desperate for workers to increase output and meet a still-heightened level of demand for goods and services

There are roughly two vacant positions for every one person seeking a job



Source: Bureau of Labor Statistics/Haver Analytics

Where Have All the Workers Gone?

Some workers have lingering health concerns or ongoing health impacts resulting from the virus

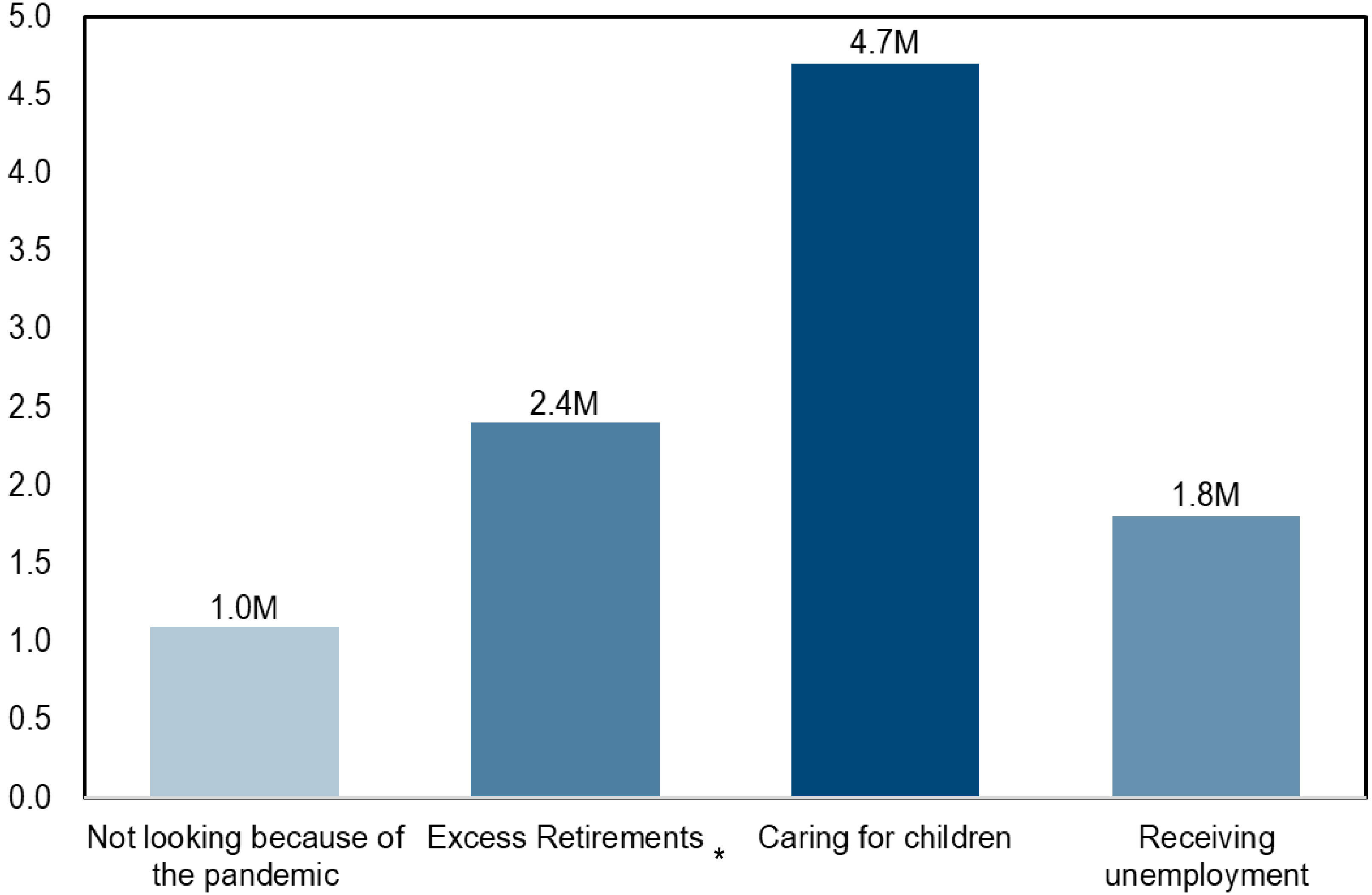
Some face lingering childcare or elder care issues

Labor supply gap will be improved with schools reopen, higher vaccination rates and an end to federal benefits, but It will take time to entice workers back into the labor market

According to the St. Louis Fed, as of April, there were approximately **2.4M** excess retirees in the U.S., still elevated but down from the 3M reported in December 2022

The Census Bureau reports that **4.7M** people are out of work because they were *"caring for children not in school or daycare"*

There is **35%** increase in disability claims over the past 2 years with a **30%** increase in homeschool enrollment since the start of 2019



Source: Census Bureau/St. Louis Fed/Bureau of Labor Statistics

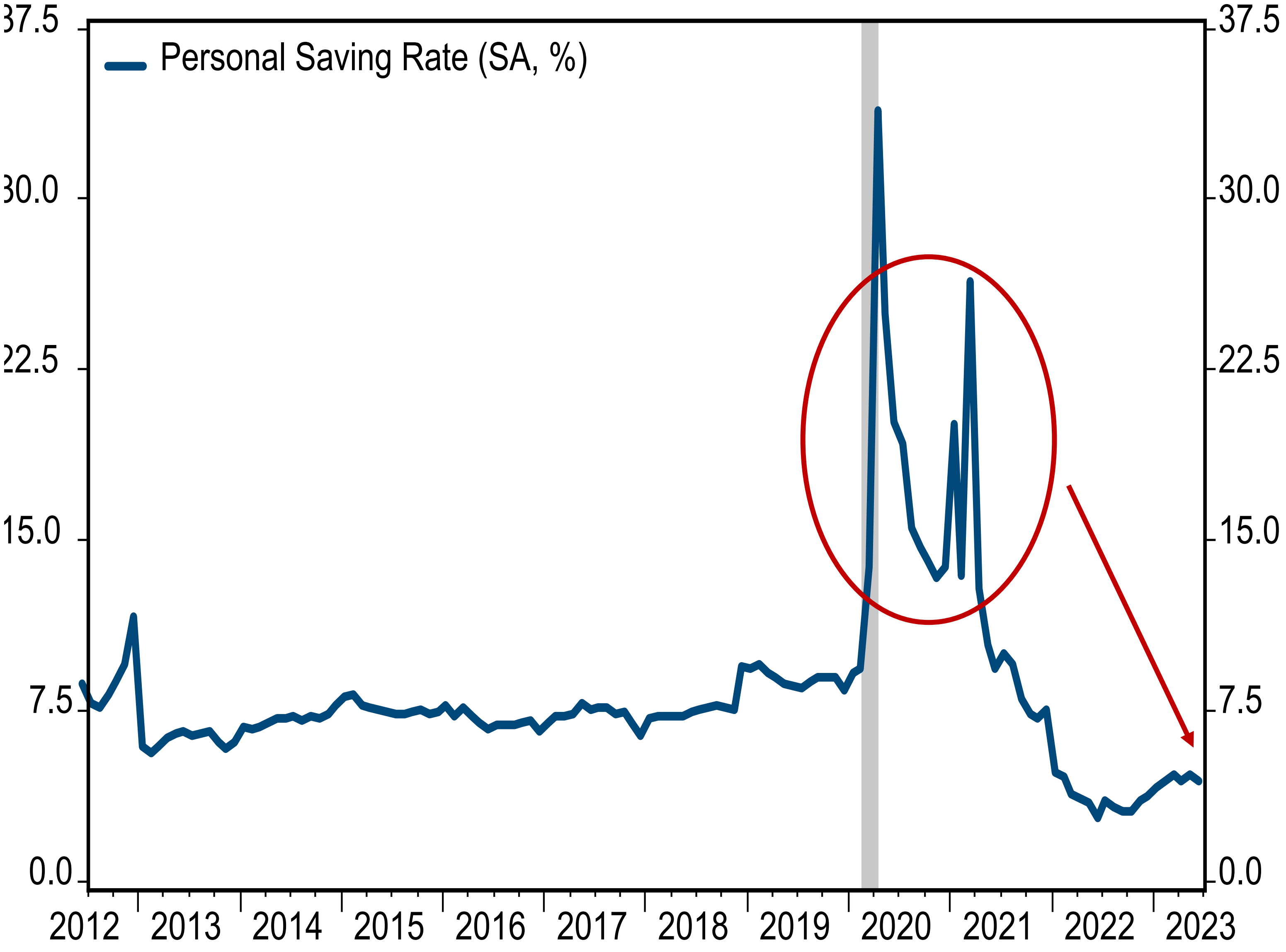
*Excess Retirements is calculated by the St. Louis Fed using trend analysis to compare actual retirees with the natural trend that results from the aging of the baby boomer generation

Trillions in Accumulated Savings Dwindle

The U.S. consumer remains solid with **$862B** in savings and a savings rate of **4.3%** as of June

Additional savings, higher wages and additional federal spending will help supplement the consumer and mitigate the fiscal cliff resulting from an end of pandemic stimulus

Savings won't support potential workers indefinitely – already the savings rate has slowed, and that stockpile of savings has dwindled markedly as spending adjusts back to pre-pandemic patterns, fiscal support wanes and prices rise



Source: Bureau of Economic Analysis/Haver Analytics

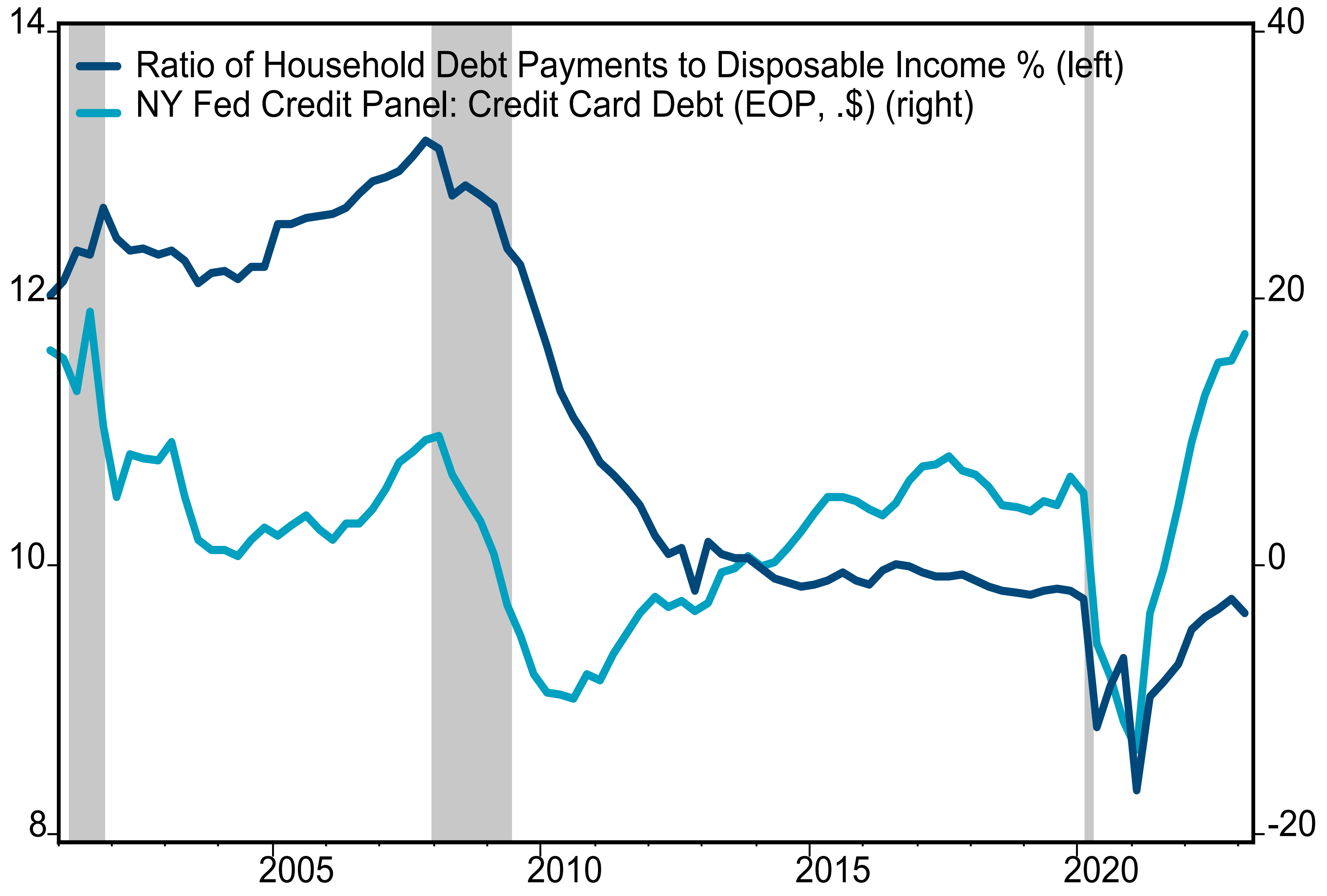
Debt as a Percent of Income Lowest Level on Record

At the same time, consumers are increasingly turning to credit cards and additional sources of debt to perpetuate their spending habits as fiscal support fades and savings dwindle

Credit card debt rose **17.2%** in Q1 from the year prior, the largest increase since Q3 2001

Most households are better positioned to take on at least some additional debt burden

Debt as a percent of disposable income remained at **9.6%** in Q1, near the lowest on record



Sources: FRB, FRBNY/EF/Haver

Retail Sales Volatile and Trending Lower

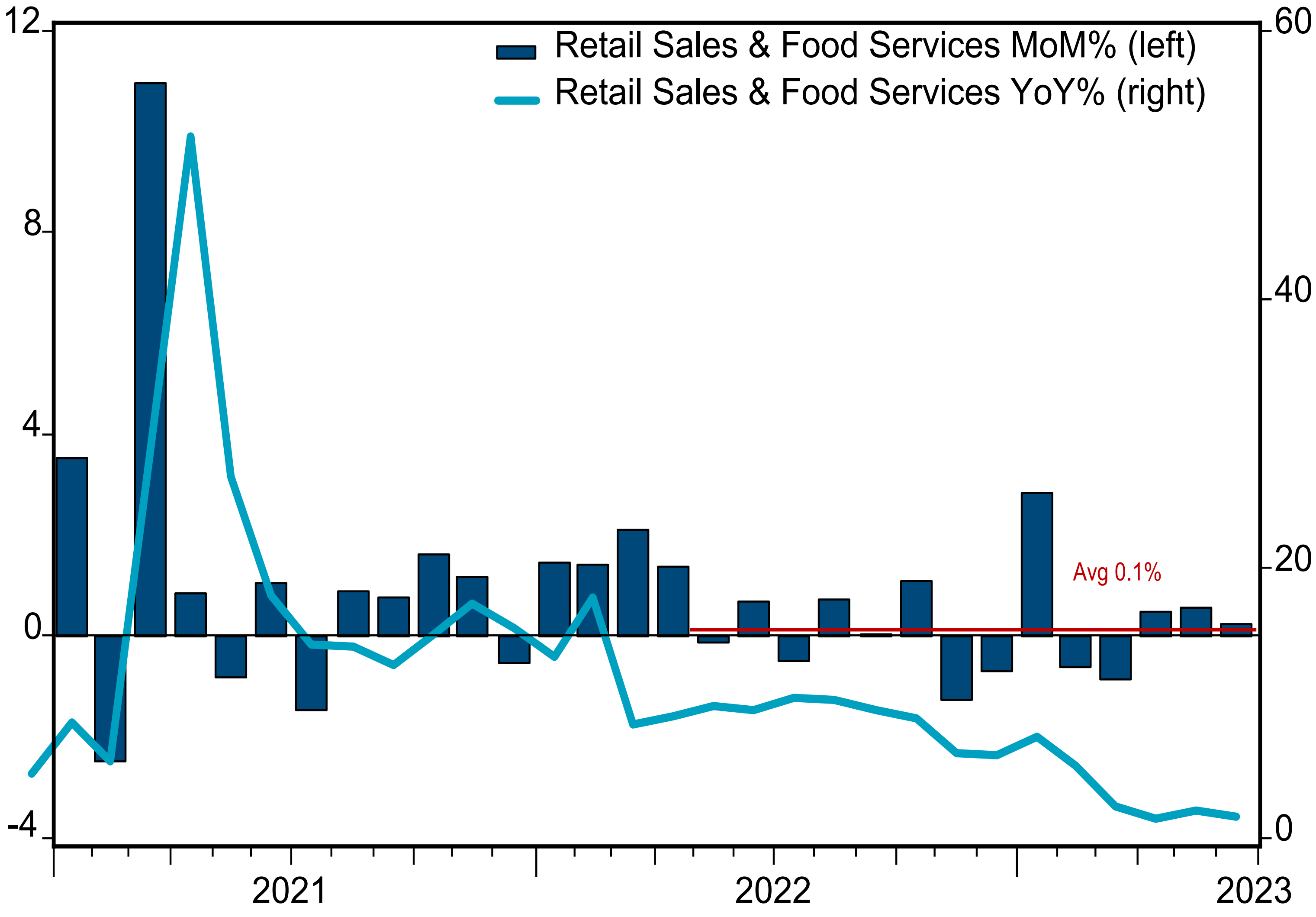
For some, the notion of a reduced or evaporated wealth cushion is causing an outright shift or reduction in spending habits

Trillions in savings and upward momentum in wages has helped consumers to weather different variants and to offset a loss of fiscal support, but inflation is complicating the picture

Large retailers report customers are cutting back as the balance sheet is becoming increasingly fragile amid rising costs and rates

Sales rose **0.2%** in June, following a 0.5% gain in May

Year-over-year, retail sales rose **1.5%** in June following a 2.0% gain in May



Source: Census Bureau/Haver Analytics

Manufacturing Activity Slowing

Even with a *relative* decline in spending, positive nominal spending is keeping pressure on producers

Producers face labor shortages and lingering supply chain disruptions which have improved but remain historically high

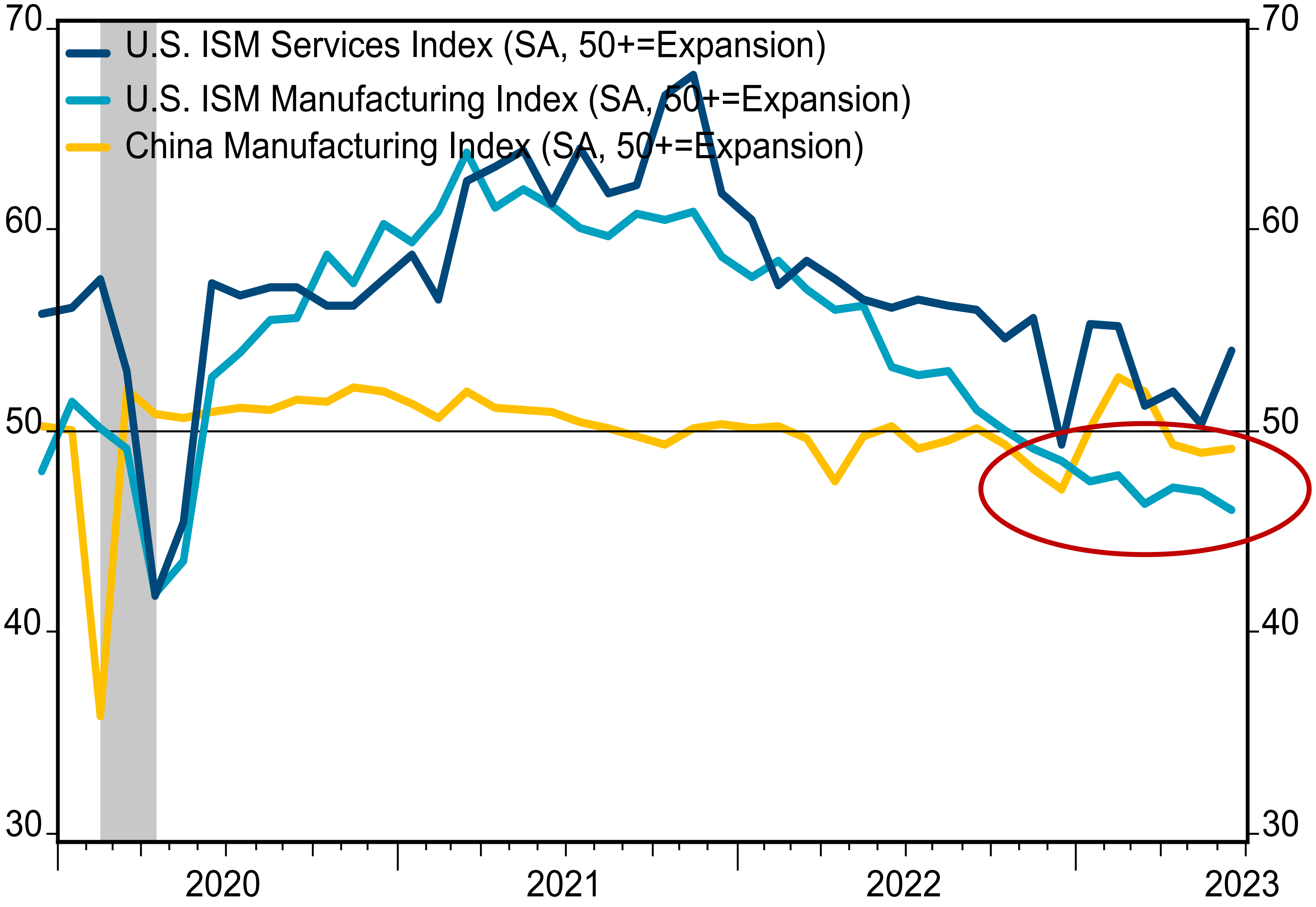
Shortages reported for lumber, tires, wire, etc. leading to extended wait times, higher prices and inventory complications

The ISM declined from a near-term peak of 60.8 in October 2021 to **46.0** as of June, **falling below 50 as of November 2022**

The ISM Services Index, meanwhile, rose to **53.9** in June, a four-month high

The China Manufacturing PMI declined to **49.0** in June, bouncing along breakeven since June 2021

Solution to supply chain disruptions will depend on global policy, trade relations and geo-response to the virus – even domestic producers are impacted resulting in price pressures



Sources: ISM, CFLP/NBS/Haver

“Surprising Rebound” in Home Sales

Americans view their home as a workplace, school and refuge

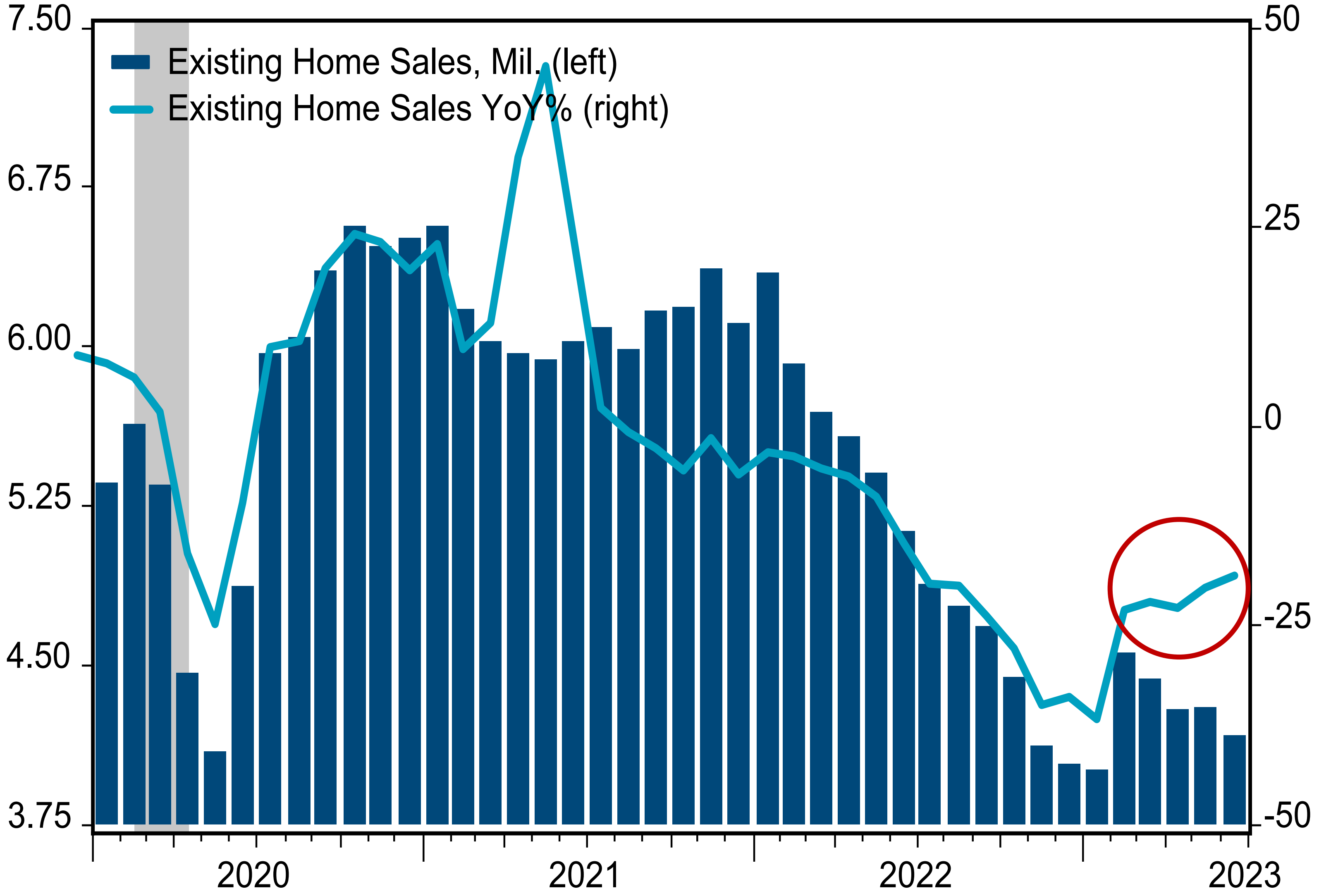
Home sales surged during the pandemic and immediate aftermath

Sales rose 6.6% at the end of 2021, reaching a peak pace of 6.36M units

Rising interest rates, rising costs of materials and declining real income is already taking a toll on some would-be buyers and prompting many more potential sellers anxious to offload in a still-hot market

Existing home sales fell 0.7% in June to a **4.16M** unit pace

Off 34% from peak levels, sales are up 4% in the recent *“rebound”*



Source: National Association of Realtors/Haver Analytics

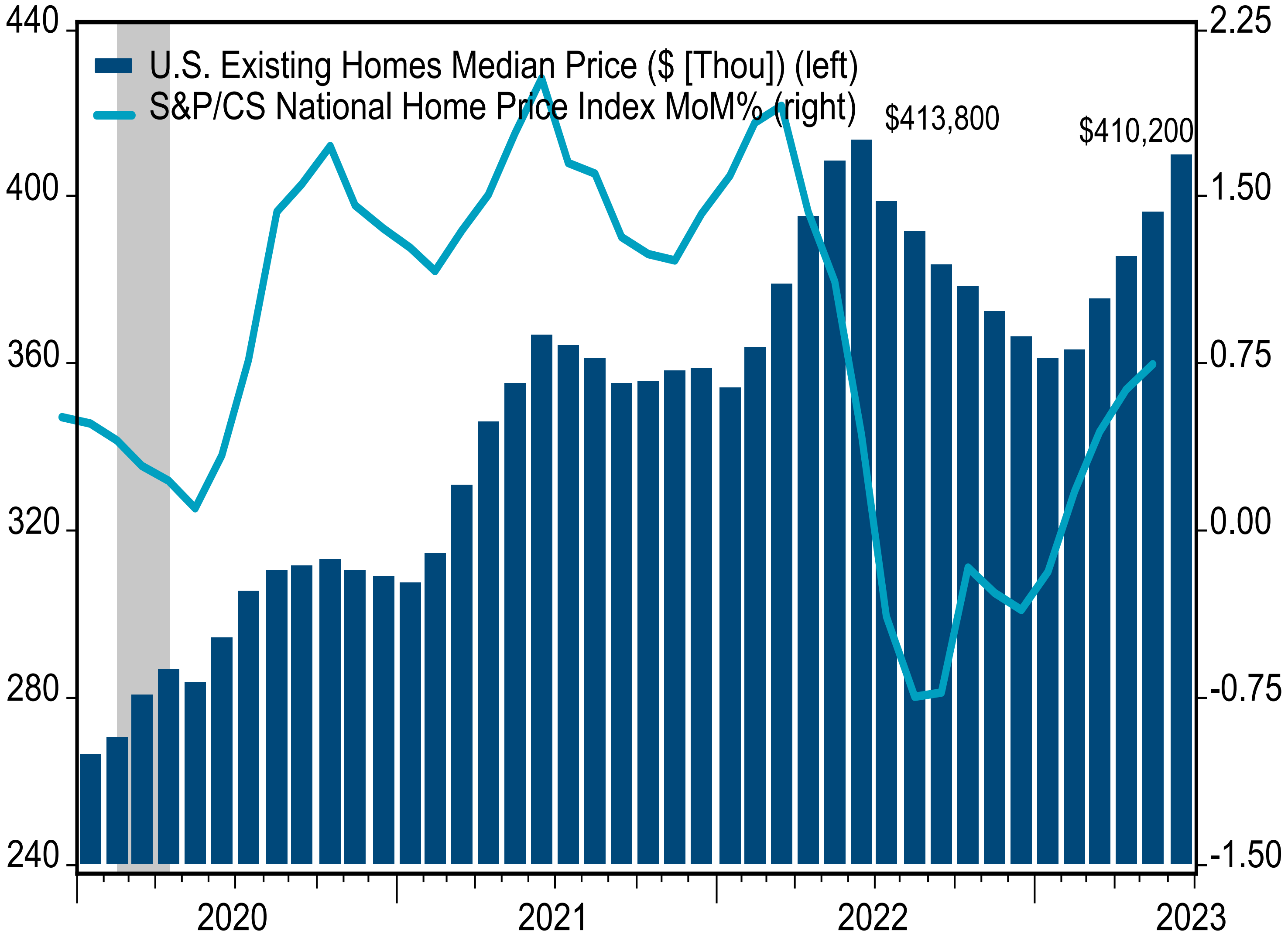
Home Prices Push Higher

Demand is still *relatively* solid, supply is still *relatively* limited, keeping pressure on prices

The median price of an existing home rose to **$410,200** in June, a one-year high

Nationally, home prices rose **0.7%** in May but declined **0.5%** year-over-year, following a 0.1% fall the month prior, and down from the 20.6% peak reached in April, the largest gain in the history of the index dating back to 1987

Price growth is not limited to downtown, urban markets



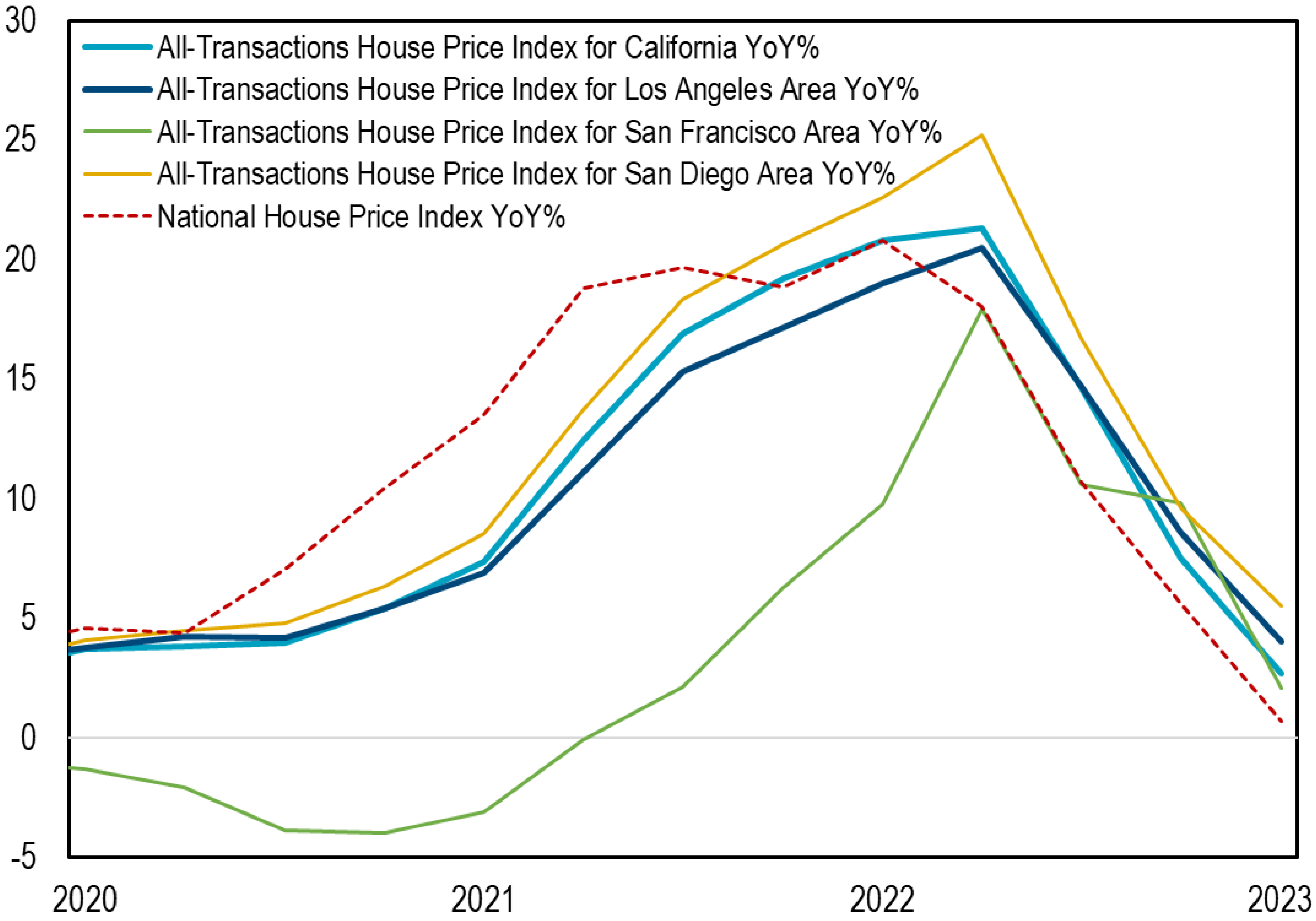
Sources: NAR, S&P/Haver

Home Prices Still Positive… But Slowing

House prices in the California are up **2.7%** in Q1 2023, down from 7.5% in Q4

In the Los Angeles area, house prices are up **4.0%** as of Q1 2023, down from the 8.6% gain in Q4, while prices in the San Francisco area are **2.1%** more expensive from the year prior with prices in the San Diego area up **5.5%** in Q1

Nationally, home prices are up **0.7%** in Q1 2023, down from the 5.6% increase in Q4



Source: FRED

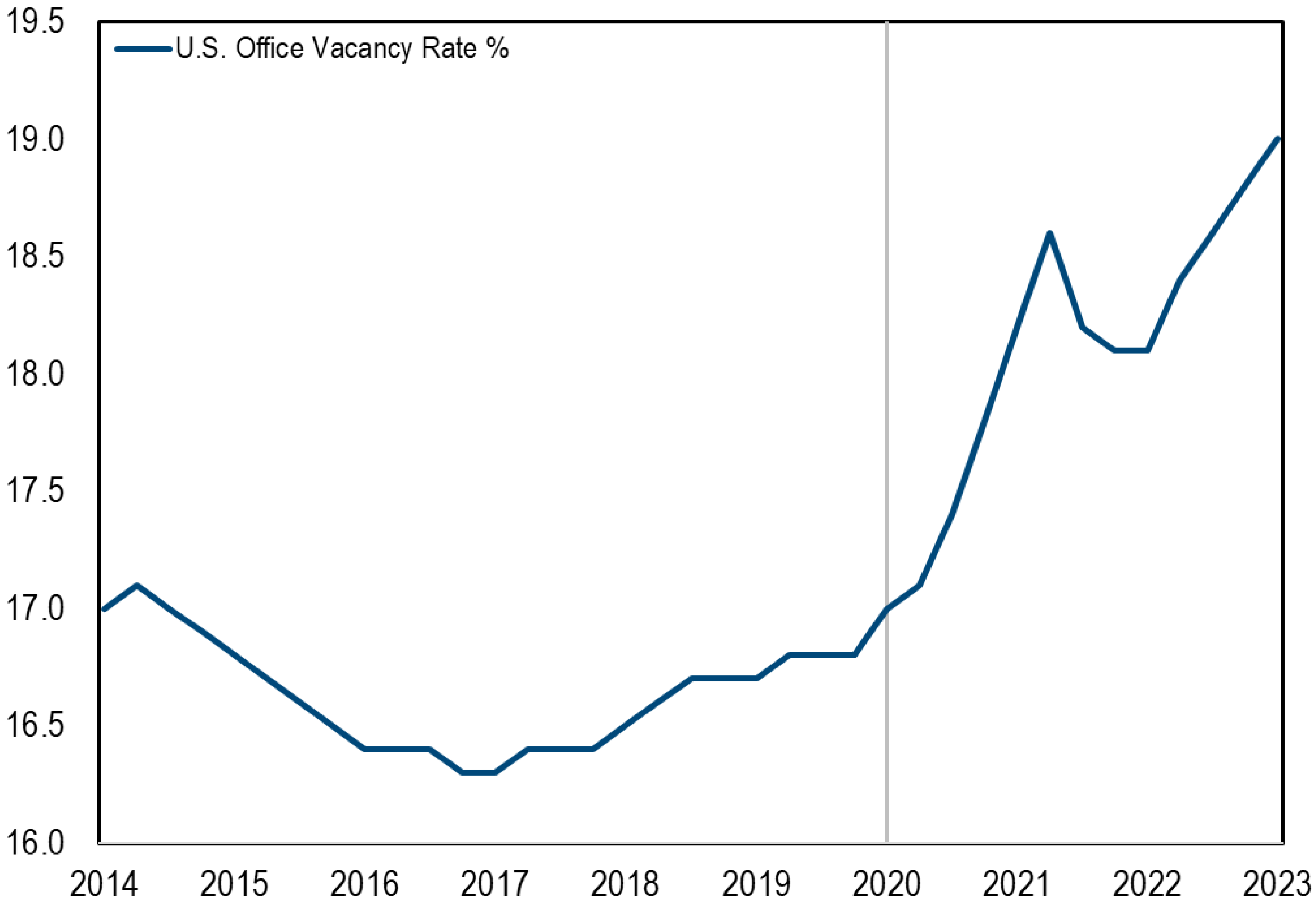
Office Vacancy Rate Hits New Peak

For the local market, as the work-from-anywhere environment has been wholly adopted, a change in structural preferences has resulted in a significant relocation of populations

For the downtown urban centers still experiencing at most a **40-50%** return to office rate, the population support will be more difficult to recapture

According to real estate data firm Trepp, **4.02%** of office loans that make up MBS are at least 30 days delinquent, the largest amount since 2018

Other areas, however, experiencing population booms will need further investment in commercial space to support the emerging growth and demand in everything from shopping centers to office spaces or alternative spaces for work, grocery stores and everything in between



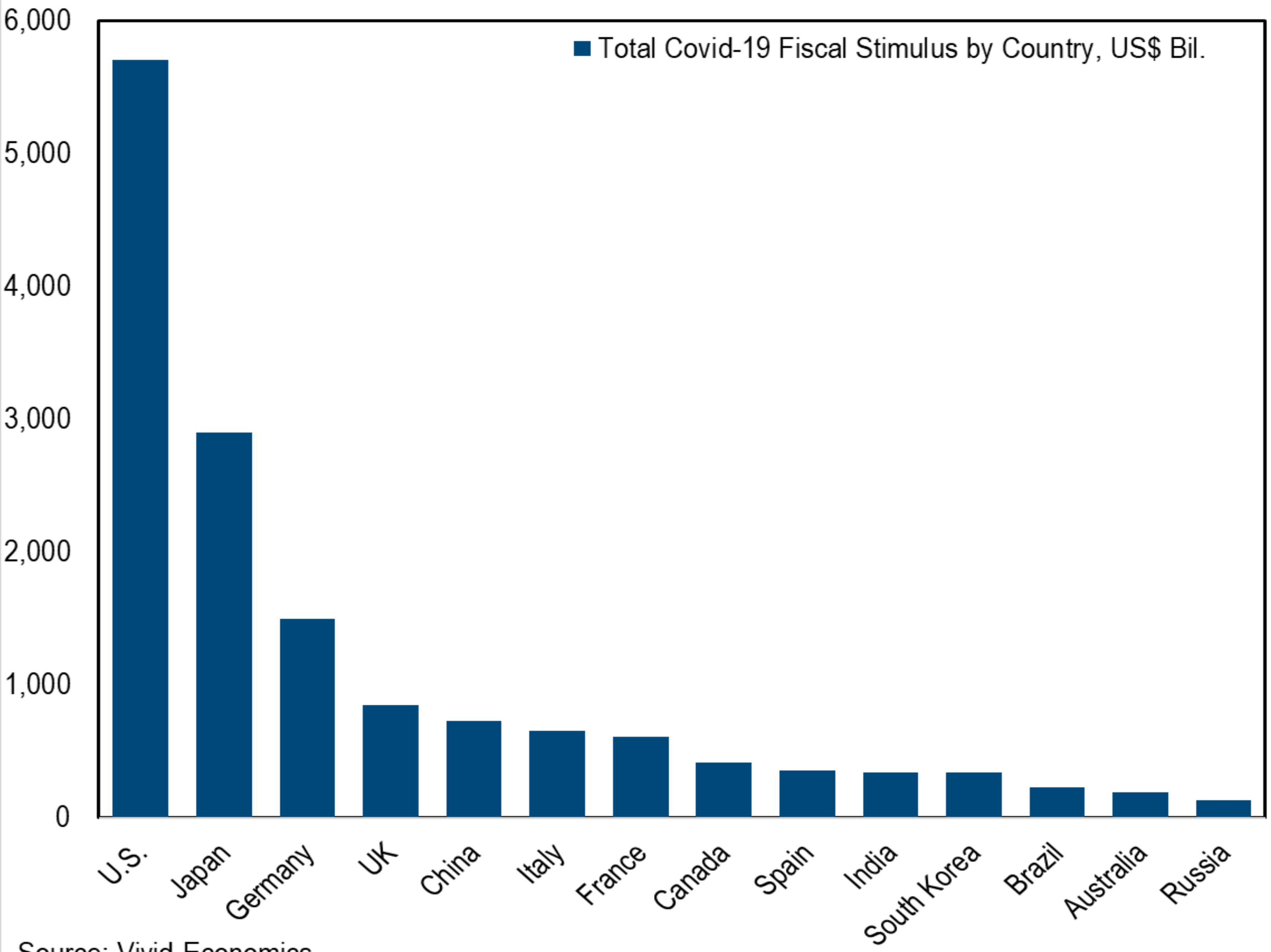
Source: Bloomberg, Reis Inc.

Global Covid-19 Spending

Even without the IRA, the U.S. has spent nearly **$6T** in Covid relief grossly contributing to the nation's inflationary concerns

Developed nations in total spent **$17T** on the pandemic with government spending becoming a greater share of GDP in every major advanced economy, a relentless expansion of government

The U.S., however, spent more than double the next highest spender with much in the way of direct payments, leading to higher inflation rates than almost anywhere else in the world



Source: Vivid Economics

U.S. Debt Rises to All-Time High: $31T vs. $25T Economy

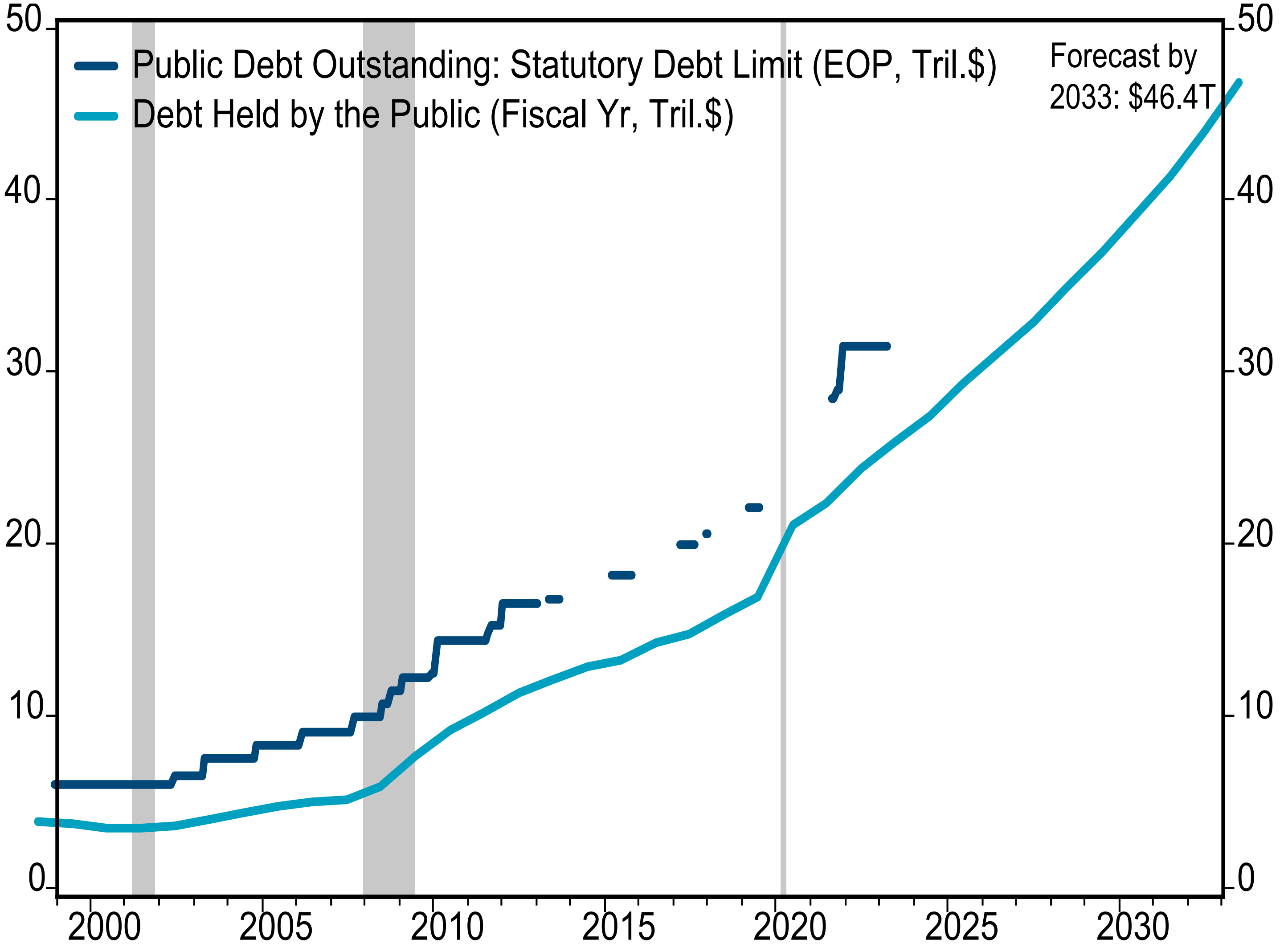
In FY 2022, the federal government ran a deficit of $1.38 trillion

The deficit for FY23, of course, will be markedly less than the year prior given the significant reduction in outlays from the waning federal response to the pandemic

Total public debt outstanding rose from $28T in FY 2021 to $31T in FY 2022, an all-time high

Total public debt is forecasted to reach over $46T by 2033

President Joe Biden and House Speaker Kevin McCarthy reached an agreement on raising the debt ceiling



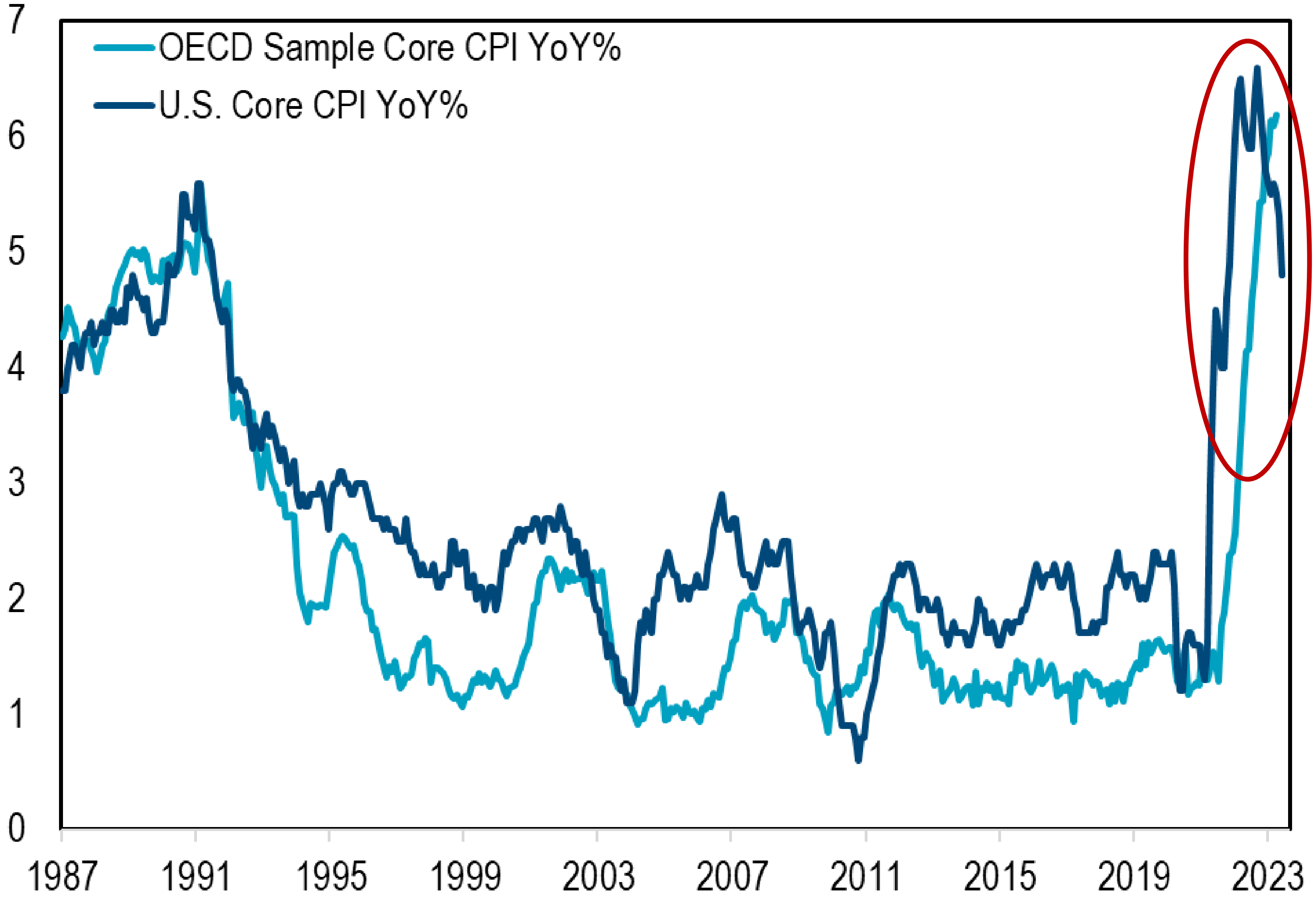
Sources: U.S. Treasury, Congressional Budget Office/Haver Analytics

U.S. Inflation No Longer Higher than Abroad

Countries are reeling from supply-side constraints

U.S. inflation has been exacerbated by fueling demand-side metrics and labor costs resulting from fiscal policy measures

U.S. inflation no longer continues to outpace other countries, rising **4.8%** as of June vs. **6.2%** elsewhere in the developed world



Source: FRED

*Sample includes: Canada, Denmark, Finland, France, Germany, Netherlands, Norway, Sweden, and the U.K.

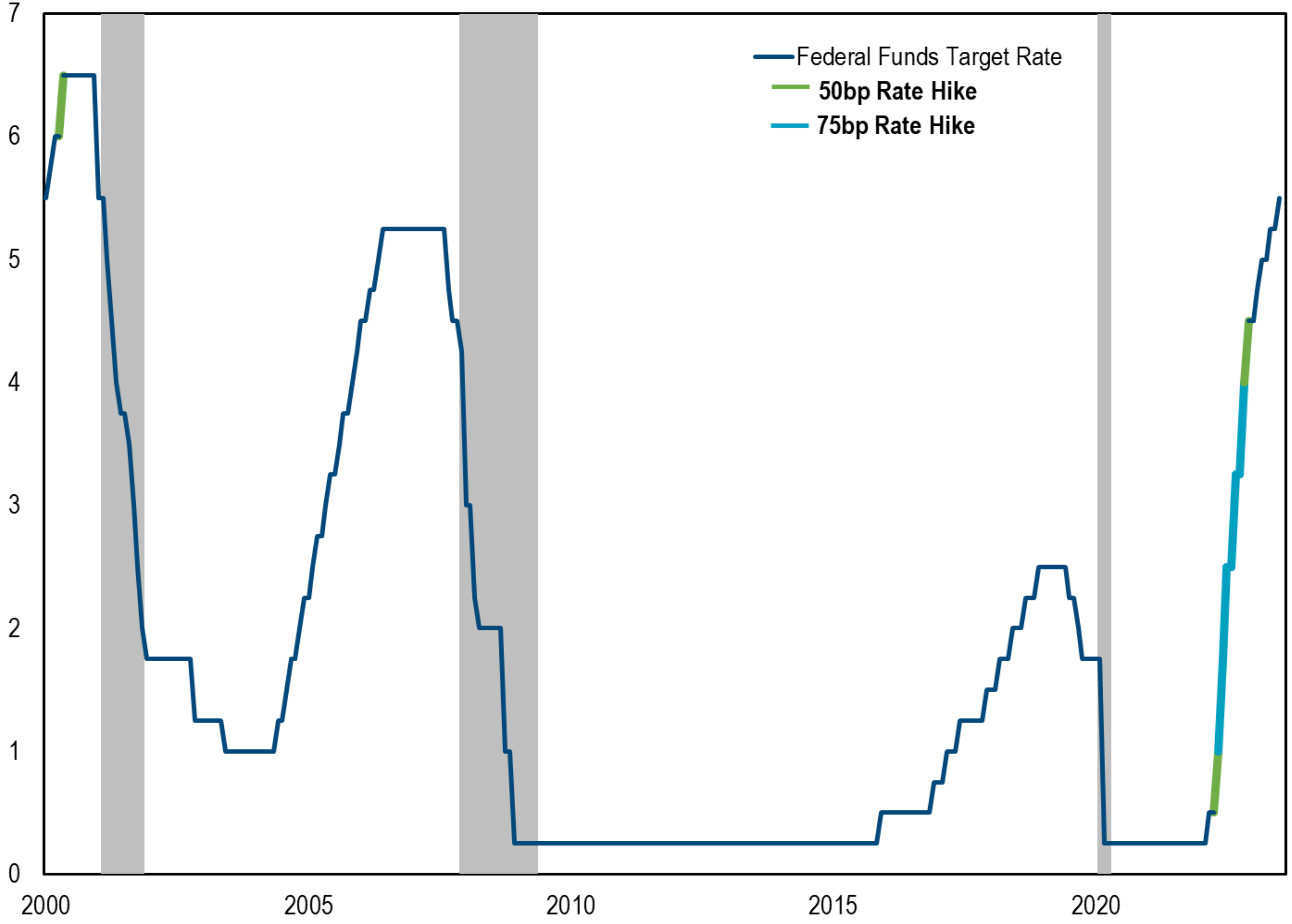
Fed Raises Rates in July after June Pause

In March 2022 the Fed took a decisively more hawkish position

The Fed has raised rates 525bps since March of last year: **25bps** in March, **50bps** in May, **75bps** in June, July, September & November, and **50bps** in December of last year. This year, the Fed has raised rates **25bps** in February, March, May and July reaching **5.25-5.50%**

The Fed's expected rate pathway has markedly increased with inflation still *"too-high"*

In June, the SEP showed expectations for **5.6%** in 2023 with rates slowing to **4.6%** in 2024



Source: Federal Reserve Board

July Statement Implies Further Rate Hikes

*"In determining the **extent of additional policy firming that may be appropriate** to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."*

- July 26 FOMC Statement

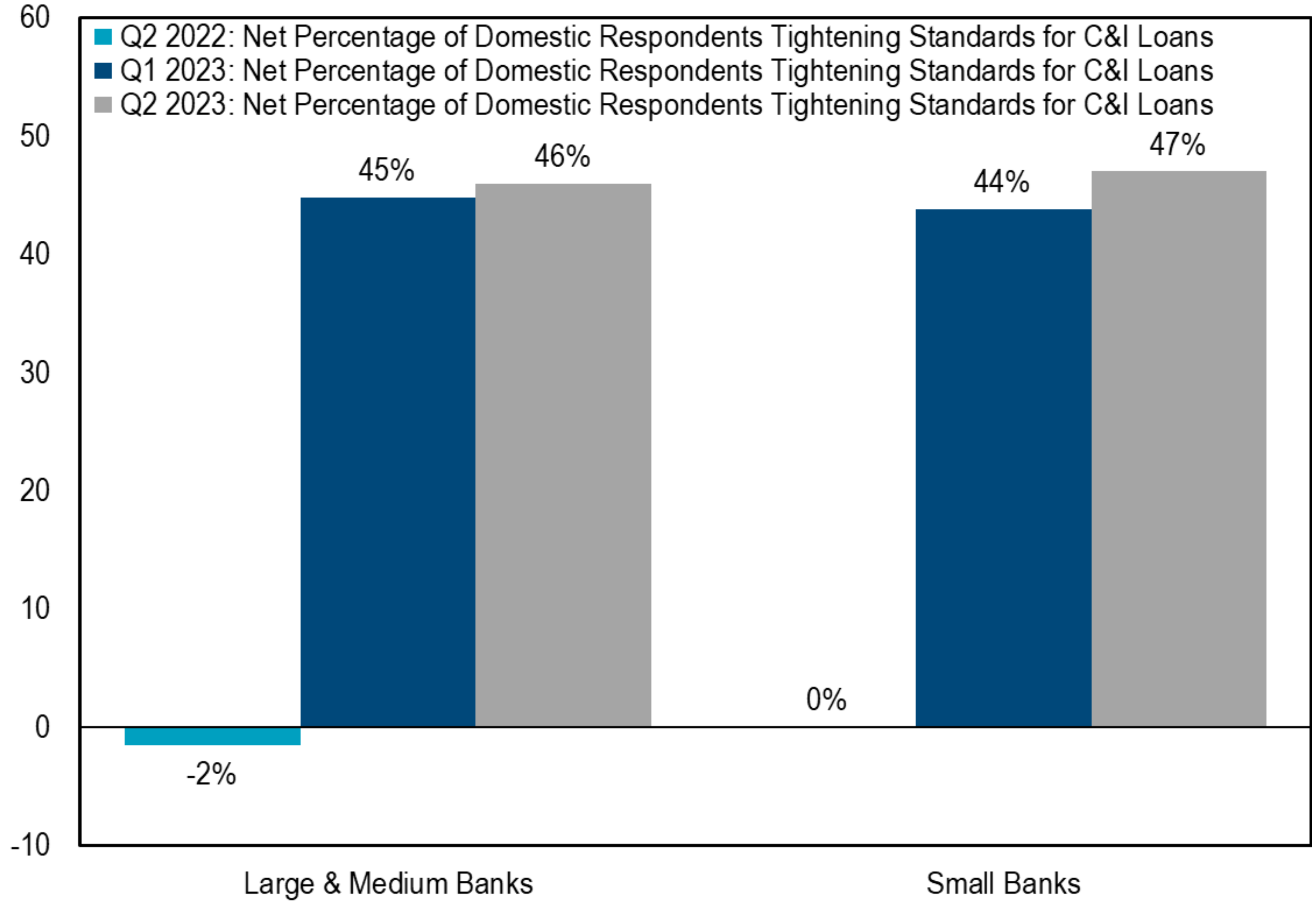
"Economic activity has been expanding at a ***moderate pace. Job gains have been robust*** *in recent months, and the unemployment rate has remained low.* ***Inflation remains elevated****."*

"The U.S. ***banking system is sound and resilient****."*

- July 26 FOMC Statement

So Why Pause in June? To Assess Data and Lending Standards

The Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices reported that major banks tightened lending standards with **46%** of large and medium banks reporting tighter standards in Q2 and **47%** of small banks also reporting tighter standards, up from 45% and 44%, respectively, in the quarter prior and -2% and 0% from this time last year



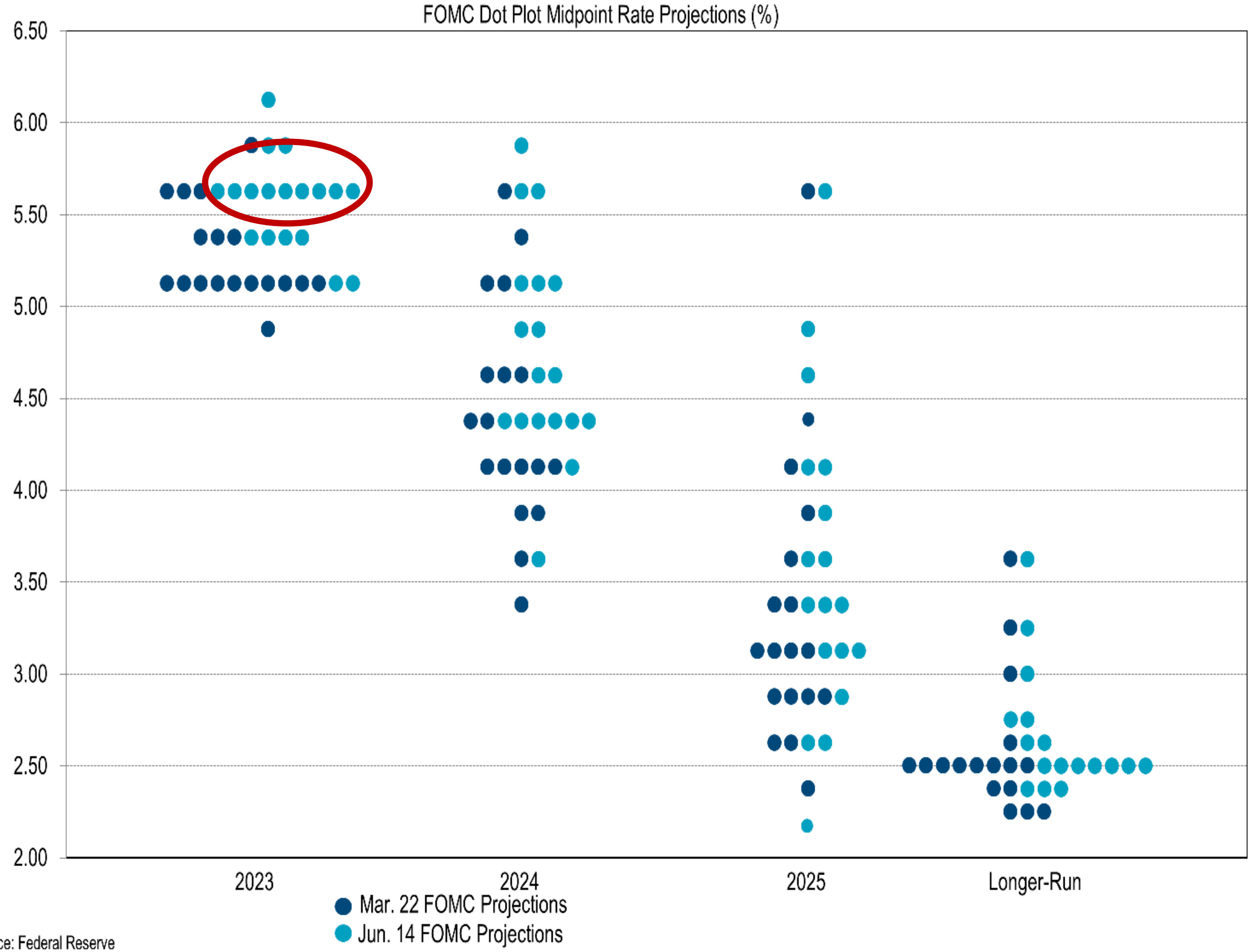
*Small banks = annual sales of less than $50M
*Large & medium banks = annual sales of $50M or more

Source: Federal Reserve Board

Question 1: How High Will Rates Rise?

The majority of Fed officials anticipate a terminal rate still rising above 5% with **three** officials forecasting a rate **between 5.75% and 6.25%,**

Although, two Committee members anticipates no further action by the Fed after the March meeting with the upper bound now at an even 5.25%



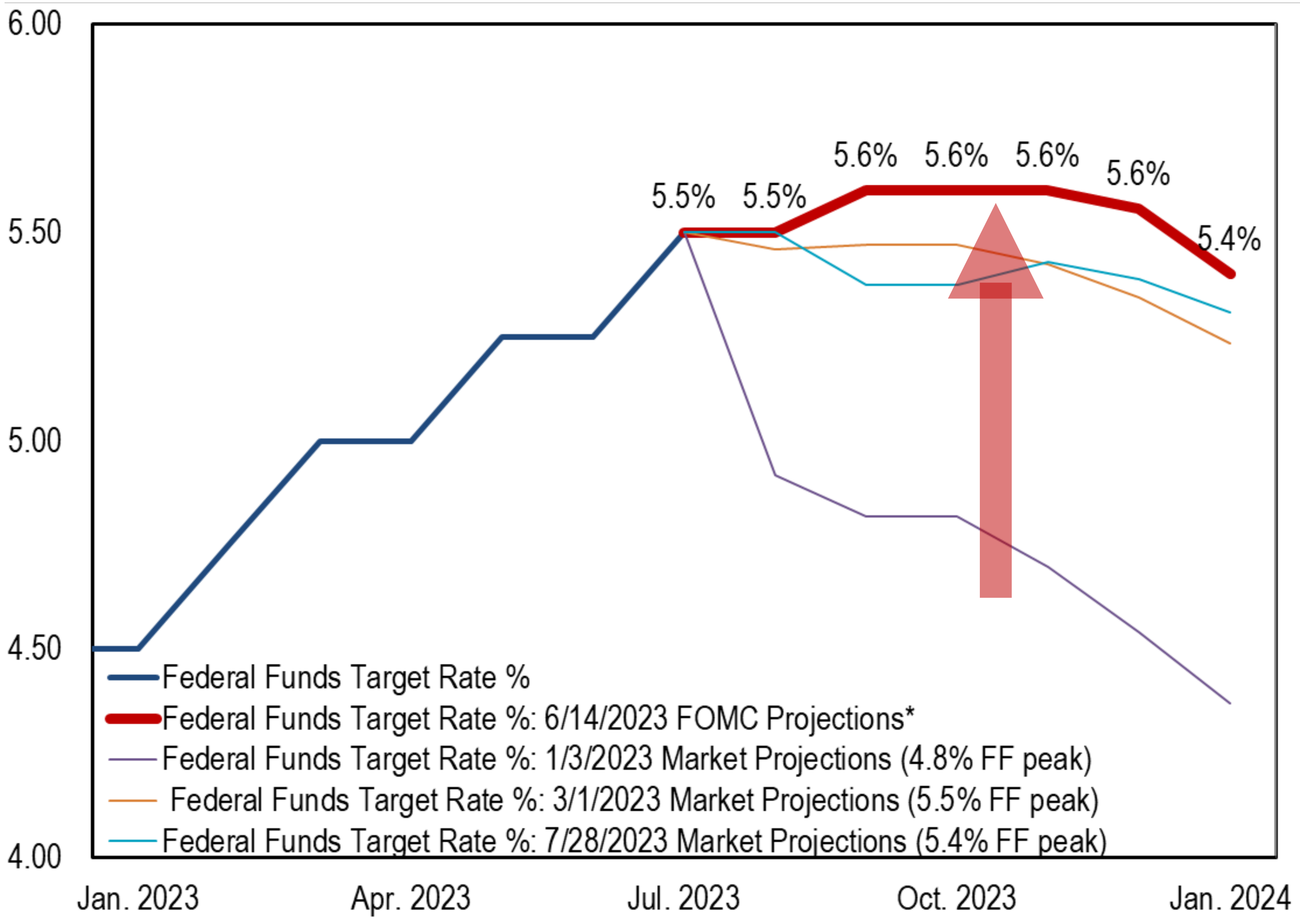
Source: Federal Reserve

Question 2: How Long Will Rates Remain Elevated?

According to the fed funds forward curve, investors are predicting a decisively more dovish pathway relative to that anticipated prior to the March meeting

The market was pricing in a peak fed funds rate of **5.7**% as of early March with the first rate cut delayed until November

Now in the aftermath of SVB, Signature Bank, & First Republic failures, and the latest June policy decision, forward projections expect a **5.5% terminal rate with at least 10bps of cuts at the start of the year**



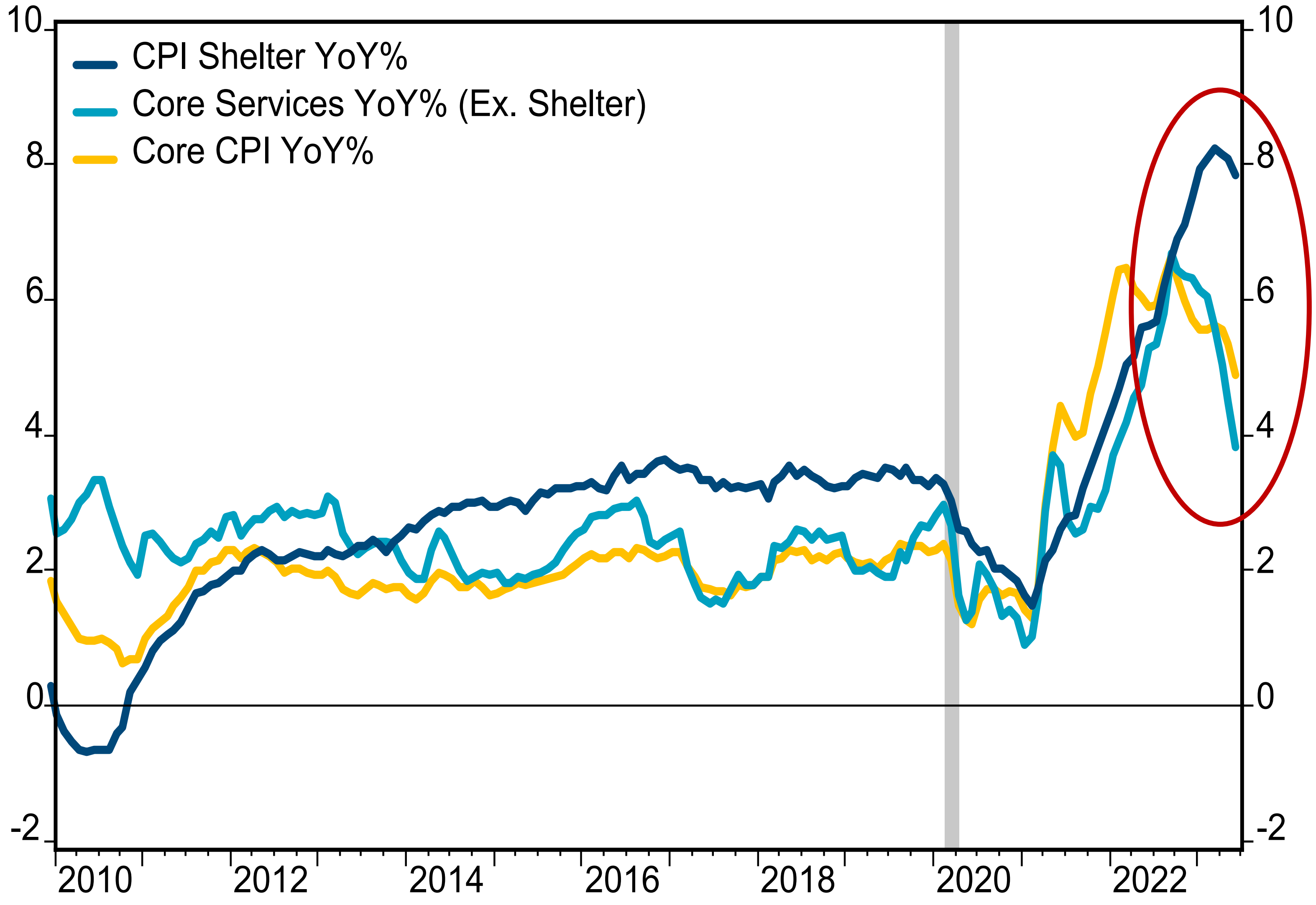
Source: Federal Reserve Board/Bloomberg

*Projections assumed from the figures in June 14 FOMC SEP

Inflation Remains Elevated with Core Services*

The core CPI rose 0.2% in June and **4.9%** year-over-year, down from the 5.3% annual gain in May

Core services excluding shelter, meanwhile, rose **3.8%** year-over-year in June, following 4.5% annual increase in April



Source: Bureau of Labor Statistics/Haver Analytics: BLS, BLS/H

*Core services inflation tracks healthcare, insurance, education, repairs, personal services, etc.

Supply-Side Pressures Transcend Monetary Policy to Determine Timeline for Rate Cut

- *"It will be appropriate to cut rates at such time as inflation is coming down really significantly. And again, we're talking about a couple of years out."* – Federal Reserve Chairman Jerome Powell, June 14 FOMC Press Conference
- Fed anticipates a bit more inflation in 2023, raising forecast from 3.1% to 3.3%
- <u>Wage-push inflation</u>: an overall rise in the cost of goods that results from a rise in wages
- <u>Demand-side inflation</u>: when demand for goods or services rises faster than the supply of those goods and services
- <u>Supply-side inflation</u>: price increases in the energy and food sectors or shortages in certain industries (such as shortages of semiconductor chips) can cause shifts in the demand patterns in other industries (such as automobiles)
    - Russia-Ukraine conflict continues to pose upside risks to inflation
        - Fertilizer, food, and energy commodities flows directed to China as opposed to less friendly countries supporting Ukraine
        - Russia extended an export-permission deal with Ukraine for 60 days rather than a previously offered 120 days
        - Moscow threatened to cease export agreement with Ukraine
- <u>Greedflation</u>: a price rise introduced by companies to take advantage of inflation and boost profit margin

U.S. Economy Showing Signs of Weakness; Recession Looming?

The Fed has vowed to raise rates enough to root out inflation but will it work?

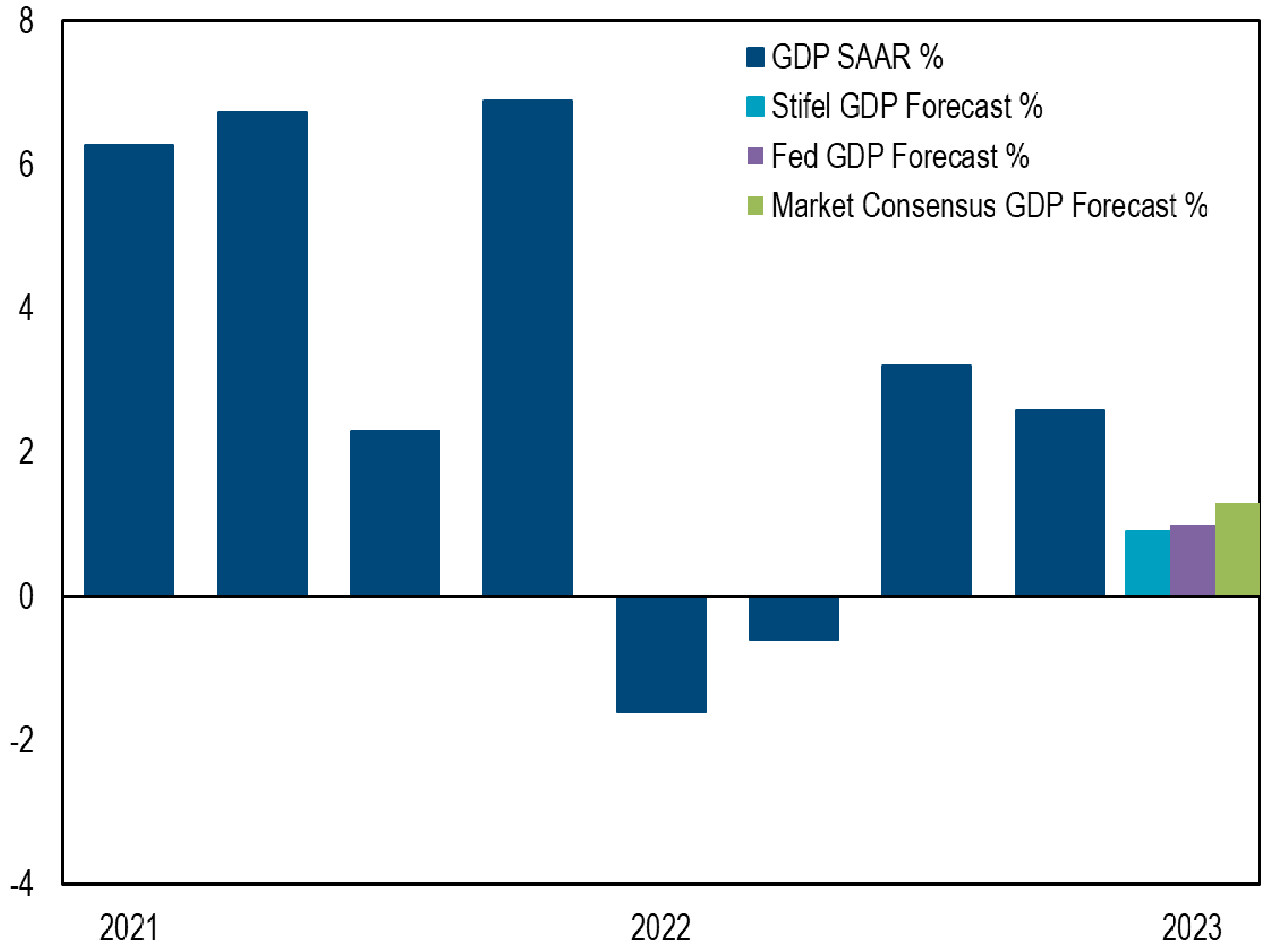
Typically, the Fed raises rates when the economy is overheating versus struggling to gain legs post-pandemic

The majority of price pressures stem from supply side constraints, limiting impact of Fed rate hikes

With an aggressive rate path, growth is likely to slow further into recession

GDP rose **2.4%** in Q2 2023, following a 2.0% rise in Q1

Excluding trade and inventories, final sales to domestic purchasers rose **2.3%**



Source: Bloomberg/Stifel

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