

Robust Jobs and Tight Credit: Will the Consumer Keep Spending?

February 13, 2024

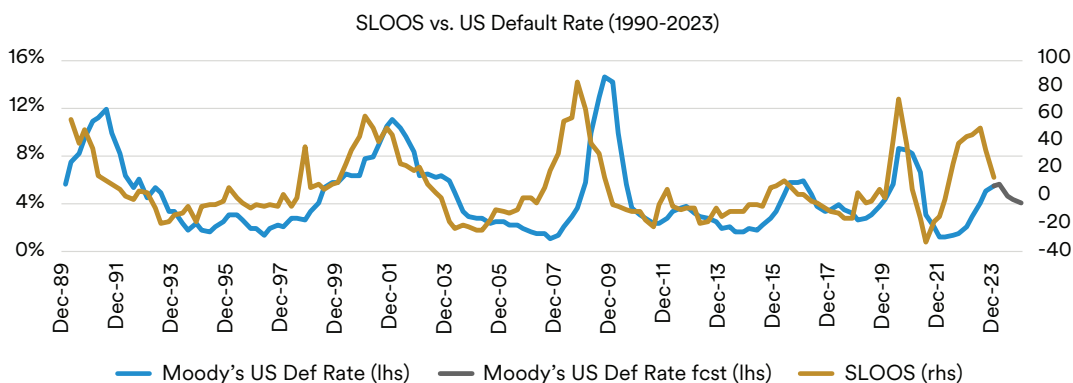
Economic reports have been promising so far this year, with consumers shored up by a robust job market. An alien (one that has studied intergalactic macroeconomics) landing on Earth might even wonder why the Federal Reserve isn't *hiking* rates given above-2% inflation and low unemployment.

We wouldn't go quite that far, but the economy continues to appear strangely unbothered by monetary policy tightness. The economy is certainly not out of the woods—consumer loan delinquencies are an acute concern—but there are paths to avoiding a recession.

Senior Loan Officer Opinion Survey: SLOOS as She Goes

The Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS) is, we believe, one of the best leading indicators of corporate default rates. The one-year forward default rate implied by SLOOS shows an improvement to 5.2% by year-end 2024. We expect that default rates will be even lower than that. First, high-yield issuers have already extended their maturity wall. Second, the high-yield bonds distress ratio improved throughout 2023 and remained mild in January 2024.

Chart 1 | SLOOS Suggests a Declining Default Rate by Year-End.



Source: Moody's, Federal Reserve, MIM

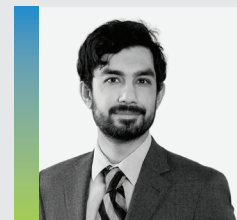
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Credit conditions continue to tighten overall, but relatively more banks reported unchanged lending standards than reported tightening standards. The pattern was present across loan types, including commercial and industrial (C&I) loans, commercial real estate (CRE) loans—particularly at smaller banks—and consumer segments such as credit cards and auto loans.

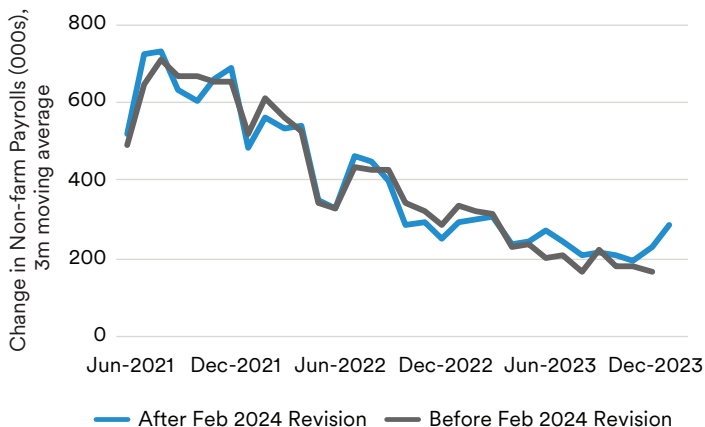
On the demand side, a significant net share of banks reported demand for C&I and CRE lending falling. Falling CRE loan demand was more widely reported by smaller banks than by large banks. Demand for auto and credit card loans was also weaker, but more modestly.

The January 2024 SLOOS also included special questions on banks' expectations. Looking forward, banks expect lending standards to tighten through the year for consumer categories such as auto and credit card loans, but standards for C&I loans and CRE loans are expected to remain more or less the same. Notably, banks are expecting both stronger loan demand and a deterioration in loan quality across loan types.

Labor Market Revisions Produce Huge Job Growth

February's Bureau of Labor Statistics employment report¹ gave a surprising increase in non-farm payrolls of 353,000. More notably, nine out of the 12 months of 2023 were revised upwards, particularly toward year end. The revisions mean the economy added almost 360,000 more jobs over 2023 than initially thought, or approximately 3 million for the year.

Chart 2 | Revision Shows Milder Deceleration and a Stronger Year-End



Source: BLS, Haver, MIM

Aggregate numbers aside, job increases were broad based across sectors, and even softer sectors such as construction and hospitality continued to add jobs, although fewer than their recent trends.

A stronger-than-expected labor market reduces the likelihood of a near-term recession. We do not expect rate cuts until at least the May meeting, as the labor market could be strong enough to hamper the decline in inflation. On the flip side, more hikes could be expected if inflation re-accelerates. However, we do not expect more hikes due specifically to labor market strength, as the labor market may not be “too strong.” In 2021 and 2022, the labor market added approximately 7, and 4.5 million jobs respectively, partly due to recovering job losses from the pandemic. Last year was a continuation of that trend towards the longer-run average level of 2 million new jobs per year.

State level data remains a concern. If we assume that the state-level unemployment rates remain the same (as the national level did), then we anticipate three more states (for a total of 22) triggering the Sahm Rule, which indicates a deterioration in their labor markets consistent with a potential recession, as we discussed in our [January Monthly](#). We will continue to monitor state-level unemployment data, as the divergence warrants close attention.

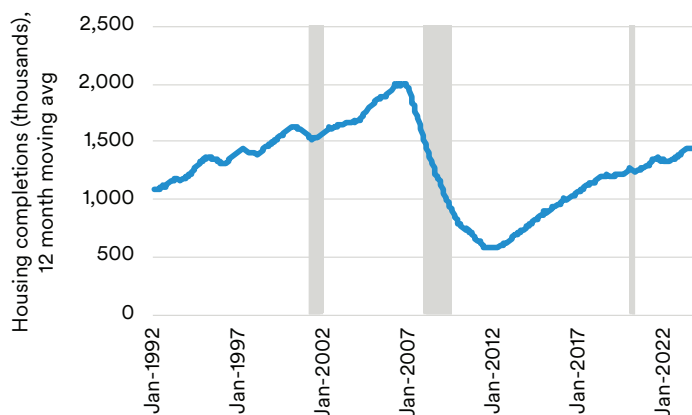
Unclogging the Housing Market

Households moved residences approximately 8.1 million fewer times than usual in 2021 and 2022 combined, according to a study by the U.S. Census Bureau². We can assume that 2023 would be similar, given the low transactions in housing, although the data are not out yet. There is a large reservoir of pent-up demand.

We believe 2024 could see substantially more transactions in the housing market. 2023 saw the fewest number of homes sold since the post-financial crisis stretch from 2008 to 2011. Mortgage rates are expected to fall to the low- to mid-6% range, a modest improvement over the peak in rates of 7.6% in October 2023.³ This represents up to 15% lower monthly payments for buyers and would induce some current homeowners to put their homes on the market. Finally, there has been a substantial increase in housing completions (see Chart 3), meaning an increase in available new homes. Housing completions increased by 5.0% in 2023 according to the U.S. Census, the fastest growth since 2019 and the highest level since 2007.

Housing-adjacent expenditure—appliances, furniture, lawn equipment, renovations—would likely also increase. Households moving into a newly purchased home tend to spend between two and four times as much on such items

Chart 3 | Rising Housing Completions Could Alleviate Supply Shortages



Source: U.S. Census Bureau, NBER, Haver, MetLife Investment Management. Data as of Dec 2023.

than do non-movers, and perhaps surprisingly tend to do so without cutting back on other expenses.⁴

The unclogging of the housing market is likely to be moderate, however, as rates are still likely to remain high relative to historic—and current homeowners’—mortgage rates and demand pressures mean that housing prices are likely to rise rather than fall.

U.S. Outlook Summary

We revise our outlook up to account for the stronger-than-expected recent data, particularly the annual revision to the payrolls report. We expect GDP to rise by 1.0% in 2024, up from our previous forecast of no growth for the year.

We continue to expect a recession in 2024. A few concerns factor into this view. First, credit conditions remain tight despite recent stabilization. Second, delinquency rates are rising—with consumer loan delinquencies at their highest level in over 10 years and the second-sharpest increase in commercial real estate delinquencies since 2010.

We believe the Fed has finished hiking rates this cycle, given that the core personal consumption expenditure (PCE) deflator moderated to 2.9 percent by year-end. We expect 150bps worth of Fed Funds rate cuts beginning around midyear 2024. Whether or not there is a recession, the Fed is likely to cut as it eases from the current tight conditions.

We expect a particularly mild increase in unemployment relative to prior recessions—these have seen unemployment increase by at least two percentage

points—due to this cycle’s unusually tight labor market conditions, although without a recession we believe market expectations of approximately five rate cuts are excessive.

After a wild Q4, the 10-year Treasury fell to 3.82 in the last few trading days of the year. Yields have historically peaked ahead of cuts to the Fed Funds rate; with cuts on the horizon and inflation on a downward path, we expect yields to have peaked for the cycle. Relative to January’s average of 4.19%, we expect the 10-year yield to migrate to 4% by year end; this does not preclude substantial swings through the year especially as the timing and extent of Fed rate cuts remains uncertain.

MIM Forecast

U.S.	2023	2024	2025
GDP	2.5*	1.0 (0.0)	1.4 (1.1)
CPI	3.2*	2.8	2.8
10 Year	3.88*	4.00	3.50
Policy rates (upper bound)	5.50*	4.00	2.00
Unemployment	3.7*	4.4 (4.6)	4.3 (4.5)

Note: GDP is annual average growth rate, CPI is Q4 year/year, 10 year is year-end, policy rate is the upper bound year-end rate. Figures in purple denote forecast revisions, with old forecasts in parentheses.

*Denotes actual data; the rest are forecasts.

Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management

Risks to the Outlook

We continue to recognize mitigating factors that work against our call for a recession in the first part of 2024. First, labor market robustness could continue to support consumer spending. Consumer confidence continues to improve (while still at surprisingly low levels). Second, the manufacturing sector has shown some signs of recovery and may boost GDP in 2024 as industrial policy spending ramps up. Finally, home starts gradually picked up in 2023, giving some hope to a moderation of shelter inflation.

Endnotes

¹ Source: Bureau of Labor Statistics, February 2024. <https://www.bls.gov/news.release/empst.nr0.htm>

² Source: U.S. Census Bureau, November 2023. <https://www.census.gov/data/tables/2022/demo/geographic-mobility/cps-2022.html>

³ Forecasts include 6.1% (Mortgage Bankers Association), 6.5% (Realtor.com) and 6.6% (Redfin).

⁴ From a study by the National Association of Home Builders by Natalia Siniavskiaia, “Spending Patterns of Home Buyers”, June 1, 2022, based on the U.S. Consumer Expenditure Survey.

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