

An analysis by McQueen Financial Advisors

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MFA Economic Outlook 2023 – 4th Quarter

We observed a peak in inflation during 2022, followed by a downward trend in 2023. Inflation remains a key aspect of the current economic landscape. The Consumer Price Index (CPI) has declined to 4.10%, as indicated in the graph below.

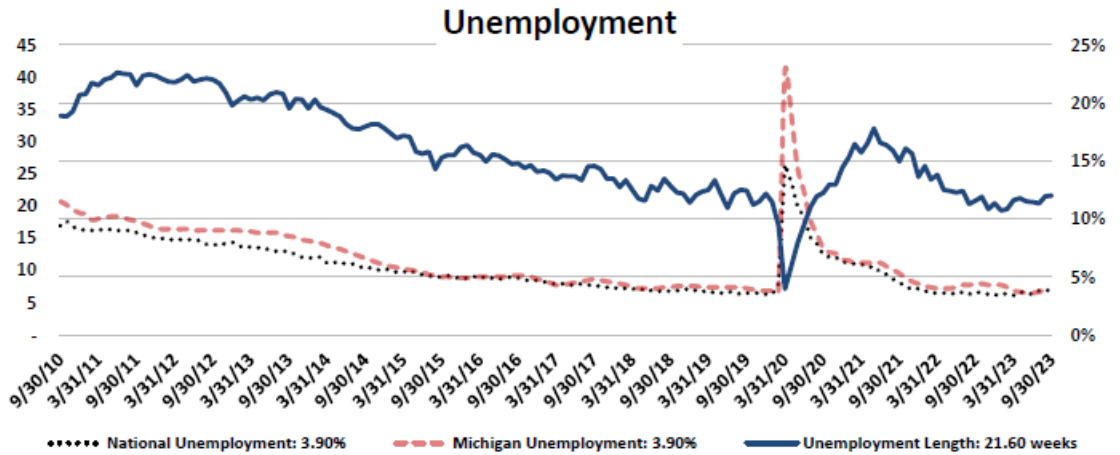


Inflation is currently increasing at a slower pace, with Core Personal Consumption Expenditures (PCE) at 3.87% and Core CPI decreasing to 4.14%.

Looking ahead to 2024, inflation is projected to be higher but closer to the target of 2%, with significant impacts on energy and oil due to ongoing conflicts. Energy prices are gradually decreasing, and the Federal Reserve (FED) is actively working to maintain price stability.

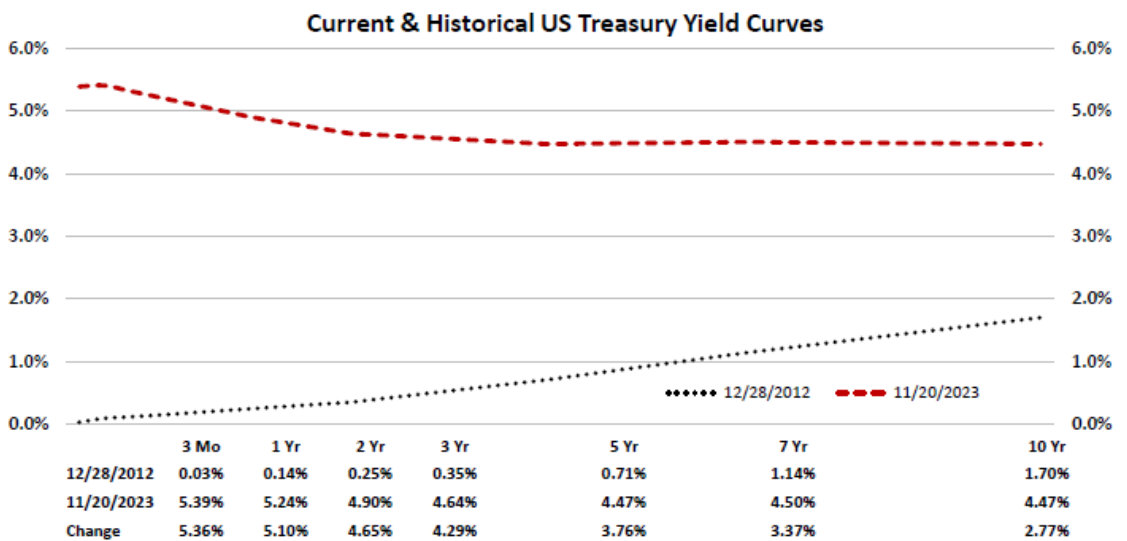
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Achieving price stability may require some trade-offs in terms of employment. The result of higher interest rates should lead to higher unemployment. Labor strikes in various sectors are affecting unemployment rates but are not counted in official unemployment statistics.



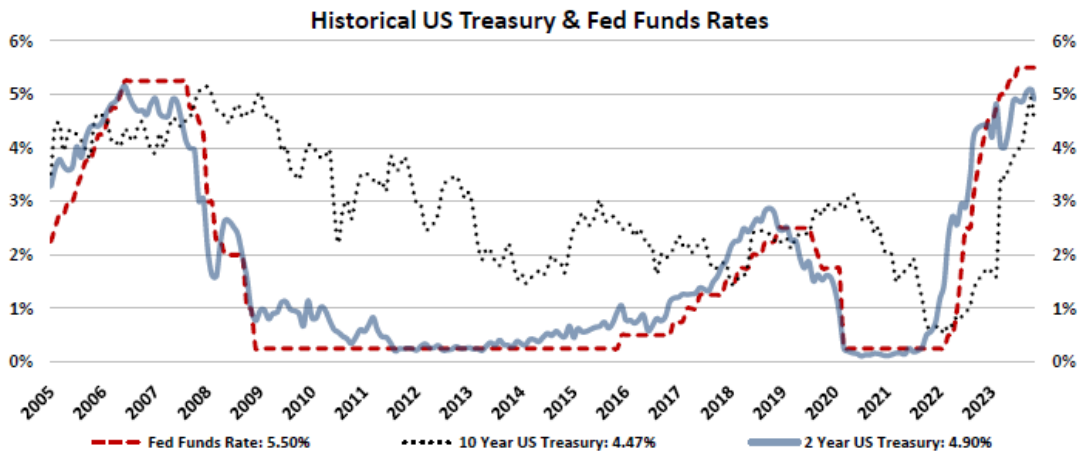
“Inflation is projected to be higher but closer to the target of 2%.”

The yield curve continues to flatten and de-invert. This is the result of the market believing that the FOMC is on hold and that we are near the top of interest rates in this cycle.



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By looking at the yield curve in an 18-year view (graph below) we can see the pattern that the FOMC has followed in the past. First, they increase rates. Second, rates top out. Third, they lower rates to stimulate the economy. It appears that we are in the second stage.



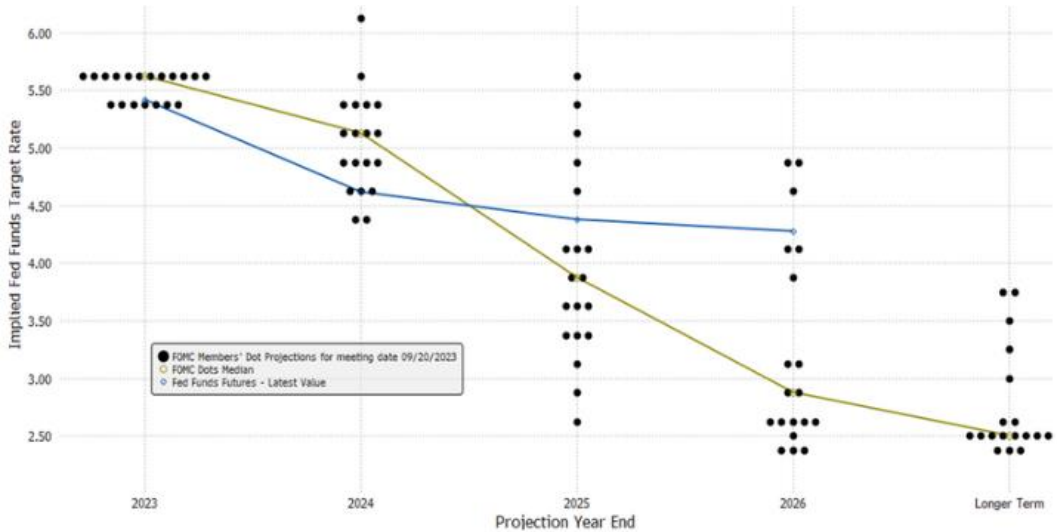
“Interest rates appear to be topping.”

The stock market is showing agreement with the topping of rates. It is now looking for direction as a recession will cause lower stock values and a soft landing will increase stock values.



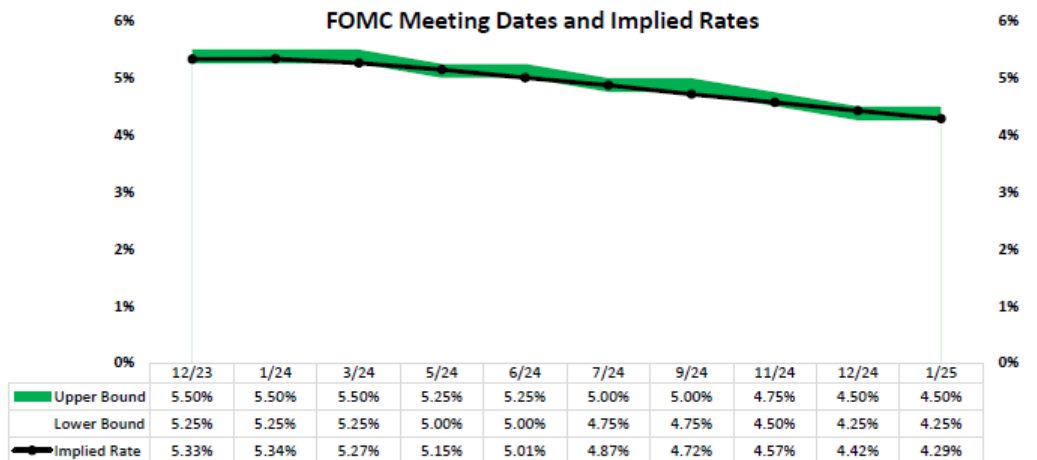
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The graph below displays the Fed members' predictions on the future of the Federal Funds rate. On average they are predicting rates to decline in 2024, 2025, and 2026.



The graph below is the projected Federal Funds rates by the betting in the federal funds futures market. This also shows the FOMC lowering rates in 2024.

“The FOMC is predicting lower rates in 2024.”

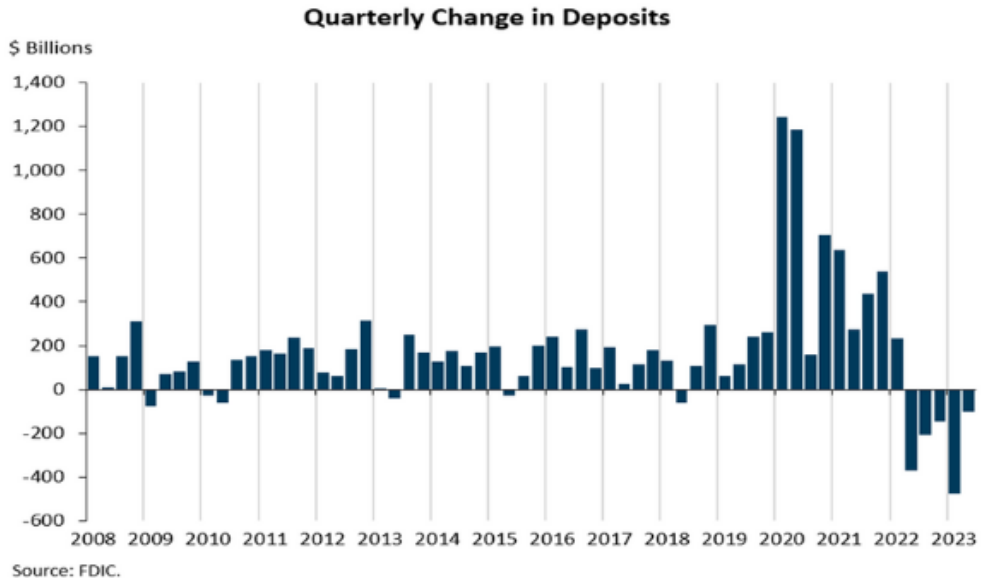


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The graph below displays the change in deposits at all banks in the USA. It is easy to see the stimulus money that was added in 2020 and 2021. Additionally, the quantitative tightening is pulling money out of banks, and we can see the deposit reduction over the past five quarters. Mathematically, there is a lot more money that needs to leave the system.

We expect that deposits in banks and credit unions will decline by 4% to 9% in 2024. This will result in continued margin pressure.

“We expect deposits to decline 4% to 9% in 2024.”



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Investment portfolio management will be a significant conversation in 2024. As yields appear to be topping, investing in longer-term securities without negative convexity will be key. In 2024 you should avoid callable securities and amortizing securities.

“Focus on securities without negative convexity.”



The graph below compares the yields on several investment asset classes.



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As we look forward to 2024 we see the following high-level areas to take into account and manage:

1. High-interest rates for most of 2024
2. The FOMC will start to lower rates in the second half of 2024
3. Unemployment will grow as high-interest rates slow the economy
4. Deposits will be difficult to grow as quantitative tightening works
5. Deposit costs will increase due to competition
6. Housing prices will remain elevated as supply and demand are misaligned
7. Commercial real estate will continue to be of concern

“Prepare for potentially increasing loan losses”.

Focus on keeping loans on the books, taking advantage of rising yields, and preparing for potentially increasing loan losses and delinquencies in 2024. Careful credit analysis is paramount, making it a favorable time to build your investment portfolio.

Margin will be a key focus in 2024.

Our predictions for 2024:

	Actual	Projected			
	Nov-2023	Dec-2023	Mar-2024	June-2024	Sept-2024
Federal Funds Rate	5.50	5.50	5.50	5.25	4.75
SOFR	5.31	5.35	5.35	5.10	4.60
Prime Rate	8.50	8.50	8.50	8.25	7.75
2-Year Treasury	4.88	4.65	4.30	4.00	3.90
5-Year Treasury	4.40	4.30	3.95	3.70	3.60
10-Year Treasury	4.37	4.35	4.00	3.80	3.75
GDP - Annualized	4.90	3.00	2.00	1.00	0.75
CPI-X-YPY	4.00	4.00	3.50	3.00	2.00