**Troutman Pepper Podcast – A 2024 Economic Outlook**
**Speakers: Genna Garver and Constance Hunter**
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**Genna Garver:**

Welcome to our latest Troutman Pepper Podcast. I'm Genna Garver. I'm an investment management and funds partner at Troutman Pepper, and here with me today is the legendary chief economist Constance Hunter. Constance has a track record of using data-driven sectoral analysis to be ahead of the curve on pivotal economic events. We are fortunate to have her with us to share her global economic outlook for 2024. Constance has served as a member of AIG's executive leadership team in her role as executive vice president, head of strategy in ESG. She's a former principal and chief economist at KPMG and has served as president of the National Association for Business Economics. She previously served as deputy chief investment officer at AXA Investment Managers where she helped lead the management of more than 500 billion in fixed income assets. Welcome, Constance.

**Constance Hunter:**

Genna, thank you so much. It's great to be with you.

**Genna Garver:**

Constance, you recently joined MacroPolicy Perspectives as a senior advisor. Tell us more about your approach to macroeconomics. What makes your views different from other economists?

**Constance Hunter:**

Yeah, thank you for asking that. MacroPolicy Perspectives was actually founded by two former senior officials at the Federal Reserve and Treasury, and they have real firsthand knowledge of the interplay between policy and the economy. And there's a couple of things that make MPP different. First, we believe that the US economy is inextricably linked from the global economy as well as financial market and credit conditions, and that seems more and more obvious I think the longer we are in business. But when the firm was founded in 2017, there was still somehow a view that the US could be isolated from the rest of the world among some macroeconomists covering the US and that's just not the case.

And then we also give a high weight to demographics as a root cause for many macroeconomic outcomes. And again, this is something that is becoming more commonplace but not something all macroeconomists have been doing for decades. It's a little bit of a different approach.

We have two sort of core constituents as our clients. We serve financial services clients with regular commentary on macroeconomic data, as well as Bloomberg chats that provide traders and portfolio managers with a real-time interpretation of events. And then I lead our corporate business where we are basically an outsourced chief economist. And so we provide customized dashboards and customized indices for our clients as well as regular meetings and updates to help them understand the risks and opportunities for their specific company from what is happening in the economy.

**Genna Garver:**

That's amazing. We really appreciate your work and your willingness to share your views with our audience.

I think we all came into 2023 with low expectations and it's been a rocky year, but we've managed to avoid a recession. There's been lots of talk about it, but we actually managed to avoid it. That being said, it's been a year of really high inflation, bank collapses, rising interest rates, Russia's ongoing invasion of Ukraine, three years of COVID, and now the Israeli-Hamas war. It sounds like the apocalypse.

**Constance Hunter:**

You forgot: China is not a growth engine. That's something that's new.

**Genna Garver:**

It's definitely been a year of firsts and probably most significantly it's the year of the rise of AI. We had ChatGPT reaching a hundred million monthly active users in January. It's just two months after it launched, and what I have read is that's even bigger than TikTok. So things are really going crazy in 2023 when you're surpassing milestones like that of TikTok. What's your take on the current global economic environment and how do you see it evolving for 2024?

**Constance Hunter:**

I'll start by saying that when I was still at AIG at the beginning of the year, I took a lot of heat for saying that I did not think that there would be a recession in 2023. MacroPolicy Perspectives and I were sort of on the same page with that. And so I'm happy to say that our clients, if they heeded our advice, were able to benefit from that information. Nevertheless, as you say, there has been a lot thrown at this year, both positive and negatives that could impact the outlook. And where we sit now is we have a global economy that is slowing. We have a manufacturing and recession pretty much everywhere in the world except for Latin America and India, and we have really high central bank interest rates, certainly across the developed world. This is causing us to forecast slower growth for 2024, but it also means a really different landscape as we go into 2024 because the drivers of growth are going to be very different than they were this year and that they have been in previous expansions.

**Genna Garver:**

I know those of us who aren't economists are always thinking, "Well, oh, this just happened. Is this going to have an impact?" And we don't always think of the global economy in terms of the same inputs that you might be focused on in terms of productivity or this, that and the other thing. And I think a lot of people right now are wondering what the possible implications are of this continued geopolitical turmoil we seem to find ourselves in, but the world's basically a hot mess right now. Is that a real fear in terms of how the economy is going to be shaping out? How is this going to impact the global economy?

**Constance Hunter:**

Yeah, that's a great question and of course when Russia invaded Ukraine in 2022, it definitely had an impact on the global economy in terms of food prices and certainly Europe had to adjust to not receiving natural gas from Russia and that adjustment has taken place. However, there's still a risk that the Ukrainian bread basket falls into Russian hands and that would certainly impact the stability of global food supply, which is an important factor in the consumption basket in many parts of the world, the US included.

With regards to the war in the Middle East, historically this has always pushed up oil prices and I think probably one of the surprises coming out of the most recent conflict is that it has not pushed up oil prices so far. That's in part because the US is now a very large oil producer, which it wasn't previously as the largest in the world, and we also have had an adoption of EV vehicles that is marching forward. Although it's slowed down slightly, it is still continuing to progress both in the US, Europe, China, and what people often forget is that economics happens at the margins. So at the margin this reduces demand and we're seeing that reflected in the prices so far.

**Genna Garver:**

Great. Now let's focus on the United States. 2023 was a tough year for the global M&A market and particularly slumping in the first half of the year, but we have seen since the end of summer, I think the third quarter, an uptick in US activity. So what's your big picture view on the US economic outlook?

**Constance Hunter:**

I think if we look at the first half of 2023, you had a combination of things. You had this anticipation that we were about to go into recession at any minute. We had uncertainty about how swiftly inflation would come down and people did not know how far the Fed was going to go or need to go with regards to interest rates, and that just sort of halted so much M&A activity in the beginning of the year.

Once we got to see really around June, July, that inflation was turning and that continued to be confirmed in the data, this allowed the market to perceive that the Fed it's not going to do an additional rate hike despite what they said in September and that they're likely to not only take out a rate hike but add at least one rate cut for next year. Now, that's not in line with the market, but market expectations started to shift. And again, economics happens at the margin, activity happens in turning points.

So we've now had this inflection point where annual inflation is increasing at a slower rate, where the Fed no longer needs to continue raising rates, and the question now is how much are they going to cut and at what pace? This is starting to drive activity. It's also increasing visibility. I would say the visibility now into 2024 certainly with the rate and inflation outlook is much more clear than it was in the beginning of 2023. And so from that perspective, I think we can expect a continuation in M&A deals and maybe not a pickup certainly to the go-go period we had just after the pandemic, but to a more normal pace we saw in 2018, 2019.

**Genna Garver:**

Great. Well, I love positive news and I will take that for sure. What's your interest rate outlook for 2014? Where should we really be setting our expectations?

**Constance Hunter:**

Before I answer that, the thing to think about and that the Fed is thinking about is where are real interest rates? So if we look at real Fed funds rate, that's the nominal Fed funds rate minus the inflation rate. So as inflation continues to moderate, if the Fed funds rate stays the same, real interest rates go up. This is sort of the big question for 2024 is are they targeting a real rate? They have not said they are, and what do they need to see exactly to begin cutting rates? They have not wanted to answer this question because they don't want the market to focus on when they're going to cut rates because they are still trying to make sure that they anchor inflation expectations.

So now we're getting to the point where they're going to have to start answering these questions. I imagine the best outcome for Powell would be no move on treasuries and no move on the equity market, right? The market's already priced in that they're not hiking anymore. This gets me to our outlook and our anticipation is that they're going to want to see a PC that on a six-month annualized basis is at their 2% target. And we don't expect that to happen until May, which is why we have our first-rate cut in May, but then we have them cutting 25 basis points every meeting until the end of the year. So that's 150 basis points.

**Genna Garver:**

Wow, that sounds great. Hopefully that will play out and hopefully we'll have easier times ahead in 2024.

**Constance Hunter:**

Well, we're going to have softer growth in 2024, and I don't just mean from the blockbuster that we had in Q3. If you think about... Q1 growth was 2.6. We're looking at 1.8% growth next year and maybe it'd be worth taking a minute to talk about where we see that growth coming from. In normal expansions, growth comes from the combination of jobs growth and real wage growth. And what we saw so far in this expansion that's a bit unusual is we saw all that pent-up savings and all the government disbursements being funneled out into the economy. In addition to that, when rates were low, households extracted a trillion dollars of mortgage equity that also got spent. We don't have any of that anymore, so we're going to rely on what we normally rely on in expansions, which is, as I said, real wage growth plus jobs growth. And that should put us at about a 2% consumption growth rate in 2024.

Add to that some tailwind from government spending from the CHIPS Act, the Inflation Reduction Act and the Infrastructure Act, then you're looking at some positive growth. We don't expect trade to be a positive contributor because as I said, the rest of the world is in a slump and we could argue that certain European countries are in recession right now. That's going to take some time to recover in the first half of the year. We don't have China as an impetus to growth globally, and so these things are going to weigh on our trade numbers, but we have enough domestic factors that are positive where we think this will help keep growth steady.

Now, the wild card, and this is a positive wild card, is the productivity. We saw a surge in productivity in the third quarter, and we've seen a lot of things in this expansion that are unique. The first is that we have more CapEx (Capital Expenditure) than any expansion on an index basis since 1981, and that usually sets us up for some good productivity growth, and we are certainly expecting to see that. In addition, we're still seeing benefits from the decline in supply chain frictions and the fact that people are staying at their jobs a bit longer so we don't have the labor market churn. That's really a killer for productivity when you have that kind of labor market churn.

And then finally, as you mentioned in the beginning of the podcast, we have the benefits of machine learning and artificial intelligence, which is being applied at a rather remarkable rate across a variety of businesses and is not only being applied swiftly but is delivering returns to that investment very swiftly.

**Genna Garver:**

When I hear that, that sounds like good news, but that I'm like, but wait, is that good news? I mean, I read all of these articles of leading experts warning that AI could pose an existential threat to humanity in the not-so-distant future, like the next five to 10 years, I think, and we should be concerned about a societal risk on par with pandemics and nuclear war. So is AI already taking away our jobs and what are the implications to the economy if we don't slow down this progress? I mean, is it really all good news when it comes to the progress of AI leading to productivity?

**Constance Hunter:**

There are certainly risks, but as I hear AI experts speak about it, what they're speaking about is the tail risk. So let's say it's a two and a half percent tail or 5% tail. You're talking about 95% of the outcomes being extremely positive, and this 5% chance that it's a devastating risk. And of course a devastating risk is always something to worry about, but the fact that we're talking about it and worrying about it gives me some hope that we will be able to mitigate this risk.

And when we think about the advantages, I mean just in healthcare alone, we wouldn't have had the vaccine at the pace we had it had we not used AI to see if the mRNA technology, which had previously been used in cancer would be applicable to a virus. And so the medical advancements that were going to achieve, again, the productivity and the return on investment that companies are already seeing from this is really extraordinary and something that I think is going to drive a lot of productivity growth over the decade.

**Genna Garver:**

I always think of the dawn of the Internet for those of us who were around for it. It was amazing to see certain industries evolve, particularly like newspapers having to go into an online format and yes, evolve not to dismiss the jobs that were replaced or changed as a result of that innovation, but I think we can all agree that there have been a tremendous number of benefits from the Internet generally.

**Constance Hunter:**

Well, and it also created a number of jobs that did not previously exist. This is the amazing thing about humans is that we have this capacity to create new needs, new desires, new solutions, and we're always creating jobs and creating job categories. So every year the BLS (Bureau of Labor Statistics) is adding about 5% new categories to the jobs that they catalog. Maybe it's every decade, but still the point is that the number of jobs that get described and cataloged just keeps growing.

**Genna Garver:**

And anyone who is still concerned about AI taking over jobs, I always go back to Willy Wonka and I remember the father working at the factory and then the factory jobs were gone. And then he came back with advanced skills and he was the one who was fixing the machines that took over his job. That's one of my favorite scenes from Willy Wonka and gives me hope that we will continue to evolve and develop better skill sets and constantly improve, and that should hopefully also help productivity.

There is also another side to this because we've spent a lot of time this year with our clients working through a number of proposed governmental regulations on AI and just trying to help clients understand how the government might be addressing it. That brings in another risk. Is it a real issue that regulation could hamper some of the positive productivity we've seen coming from the use of AI?

**Constance Hunter:**

Well, sure, and on many levels, regulation hampers productivity because it's resources that you devote to compliance and reporting that you would otherwise devote to advancing economic outcomes in various companies. However, the flip side of this is hopefully you prevent certain risks from occurring and look, wherever there's governments, there's going to be cases of regulatory overreach. I wouldn't want to speculate that we will have perfectly calibrated and perfectly prescient government regulation when it comes to AI. I would say, however, that this is such a highly specialized field that I think government regulations will lag what's happening in the real economy. I'm certainly hopeful that we're not going to really hamper innovation with any regulations that we put out.

**Genna Garver:**

Yeah. And I'm hopeful that we'll see increased participation in the rulemaking process. I'm such a huge fan of that because as a democracy, everyone has the opportunity to participate through submitting comment letters or in other ways of making their voices heard, particularly in this case where so few people even understand what AI is and what it's capable of and how it could possibly be regulated or controlled. And so I do hope that this is yet another opportunity for people to really get involved and help shape what is to come. And that again, even though regulations may lag, having intelligent regulations that are informed by actual participants who have the knowledge of the topic subject to regulation, I think is really key here.

I think we should wrap up with my favorite, which is predictions. I'm not holding you to any of this pure entertainment purposes only, but what are your top three predictions for 2024.

**Constance Hunter:**

For growth in 2024, we're forecasting a slower start and then a pickup, so that total growth will be about 1.8% next year. As I said earlier, slower than 2023, but fairly steady.

We're also forecasting that the PCE (Personal Consumption Expenditure) rate of inflation, the personal consumption expenditure index will reach the Fed's target in the second quarter allowing them to cut rates in May, and we think that there are going to be six rate cuts, so one at every meeting from May until December.

**Genna Garver:**

Wow, that seems like a lot, but really great news.

**Constance Hunter:**

Well, if you think that it doesn't take us anywhere close to the lower bound, it keeps us above the neutral rate of 2.5%, so it is still slightly restrictive monetary policy. And the real wild card for 2024 again is productivity, and we think that there is scope for productivity to be in the 2% range throughout 2024. Of course, it's going to vary from quarter to quarter, but that would be a significant uptick from what we saw coming out of the global financial crisis. It would allow rates to be higher without hurting economic growth because it would allow growth to be stronger without igniting inflation. Economists call productivity the magic elixir, and that's because it really does inject a little magic into what's possible with growth and outcomes.

**Genna Garver:**

Constance has graciously prepared an accompanying PowerPoint for this discussion, which is available for download through our website page where this podcast is hosted, and by clicking through on my LinkedIn post for this podcast. Constance, thank you so much for joining us, and I hope you have a wonderful New Year, and I look forward to continuing our conversation in 2024.