Talk CNY S1Q1

Andrew Fish 0:06
Welcome to market insights, a special series of CenterState CEOs podcast talk CNY, presented by NBT Bank. I'm Andrew fish, Senior Vice President of member and business experience at CenterState CEO. In this quarterly series, we'll be joined by Ken Entenmann, Chief Investment Officer and Chief Economist for NBT Bank. He'll share what's happening in the markets and how it impacts you. Today, Ken and I will discuss the first quarter of 2023 the conflicting messages we're getting from the markets and what individuals and businesses should know. Ken, thank you so much for doing this series with us and for joining us here today. Really excited to be talking to you about what we're seeing in the market, what we're seeing in the economy, how our members and the businesses in Central New York should be thinking about that. And it's, you know, really great to have your expertise here today.

Ken Entenmann 0:52
Well, on behalf of all my colleagues at NBT back, it's great to be here.

Andrew Fish 0:56
So Ken, I want to start off by saying we're seeing some really mixed signals as it relates to the market right now. Right, you've got some strong numbers that are out there unemployment, you're seeing pockets of the tech economy that are maybe seeing some rebounds, but then you've got really weak numbers out there, you know, like the housing market and some of the other things that are just not performing the way that they should? How should businesses and business leaders interpret these things? What should they be thinking about the market right now?

Ken Entenmann 1:21
Yeah, well, first of all, I think they need to take a long term view, because I think the markets are going to be very volatile for the foreseeable future, just as we try to work through the economic data, which by and large, has been pretty weak. But then we have contrasting information on inflation that continues to come down, it's trending in the right direction, but it is still stubbornly high. And the net effect of that is that people are very concerned, the Federal Reserve is going to have to keep interest rates, one- raise them more than what the market was expecting, and two- keep them higher for longer. So what we've seen is over the course of the last really year or so just about a year ago, March 16, is the anniversary of the Feds first rate hike. What we're seeing in the marketplace is areas in the economy that are highly sensitive to interest rates are really troublesome right now. Whereas, you know, Milton Friedman once said that monetary policy works with long and variable lags. And but since that March 16, increase, the Fed has increased rates at really

historic level, they've gone from zero to 475, where we were 450/475, where we sit today. To put that in perspective, the last time the Fed was at a rate hiking cycle was 2010. They started in 2010. Coming out of the financial crisis, they raised rates from 03 and a quarter. And they did it over the course of three years. They've just raised rates from zero to four and a half in the matter of 11 months. And the general market consensus is for rates to go up another 25 basis points at each of the next Fed meetings for the next three meetings. So we're looking at another potential three quarters of a percent to get us over 5%. So what we've seen is that areas of highly sensitive, like housing have collapsed, the existing home sales have come down dramatically, I think it's 11 consecutive months, prices are starting to come down but remain high. And the real driver, there is mortgages, where a year ago, were people getting mortgages with a 3% handle on it, you know, three and three quarters, seven, and now it's six and a half, seven, that really puts a dent in affordability, and it's slow the housing markets. That being said, there are also pockets of great strength, namely the employment market. So the unemployment rate is officially 3.4% Right now, which historically is incredibly low. But I also believe that that is part of some of the dislocation we experienced at COVID. Yeah. And so while the rate is low, one of the things that's driving it is that the labor participation rate is still significant on the sidelines. It's significantly below where we were pre COVID. And we're really struggling. I think there's three areas that have driven that one is early retirements, so people who were close to retirement age that might have been on the fence of retiring, they retired in the COVID period, and they're starting to come back to the workforce but not nearly as much as was hoped for the second area is young workers, workers 20 to 25, particularly males seem to be significantly below and that that's a big hit to the labor market. And then lastly, you have immigration and I don't want to conflate illegal immigration with legal immigration, but legal immigration is about a million people fewer than what we expected. So when you put that together, you have a strong labor market. So in January, the unemployment new jobs numbers came in at 570,000. Yeah, twice what the expectations were. And normally we first Friday would be unemployment day, but because of the short month, it'll be next Friday, and we're expecting another 250 to 300,000 jobs there. So incredibly robust employment market, horrible weak manufacturing and housing market. How do you reconcile the two? It's really, really challenging. And then thirdly, is inflation, inflation remains stubborn. So the Federal Reserve, I don't envy them, because you have lots of economic signals that show the economy weakening, you have a really strong employment market, and you have stubbornly high inflation. That's a really tough set of cards to play for the Fed.

Andrew Fish 5:43
You know, it's interesting, I want to I want to take from the kind of national and look more at the regional here for a second, because, you know, all of those things are true about the housing market, the rates that are out there now, what you're seeing in national trends, but at a recent board meeting, we were actually looking at housing statistics for the Syracuse

MSA (Metropolitan Statistical Area). And we're not seeing necessarily that same slowdown in terms of houses on the market time on the market. In fact, our average is less than Syracuse MSA than nationally, I happen to be in the market for a house right now. So really bad timing on my part, I get that. But you know, we're we're seeing some of the trends nationally not having the same impact on the housing market here. Is that because of some of the historical catch up that we're playing, is that the what we're calling the "Micron Effect" around here? It's a little bit of everything. What's your thoughts on kind of that piece of it?

Ken Entenmann 6:33
Yeah, soI think the Upstate housing market is a little different. I mean, our economy for the last couple of years, and hopefully Micron is going to change that here. We just don't suffer the booms and busts like other other markets. So if you think of markets like Austin, Texas, in Charlotte, North Carolina, where there's just been this massive influx of population and prices are up 20-30%. That's not Syracuse. It really never has been, at least in my 30 years living in upstate New York, I read an article yesterday we're Syracuse is one of the most attractive housing markets. And I think the announcement of Micron is really going to be interesting as, as a bank, as NBT bank, we're not big enough, we're not going to lend directly to Micron or a very large Fortune 500 company. But the impact that we've seen across what we call the "Chip Corridor". So we've seen huge foundries being built up in near Malta on the Saratoga area down in Poughkeepsie, Global Foundries in Albany. And what we've seen is the, the impact of that in the neighborhood is rather dramatic. And if anything, I would think it's going to help drive prices higher in the Syracuse market, because there's going to be demand for housing in and around that Micron area. And we've seen that in our experiences in Malta in the Saratoga Albany area. And we've seen it in Utica, as well with the Wolfspeed. So for right now, Syracuse hasn't experienced the boom bust and from the housing price side, we haven't seen the boom bust. And therefore there's the affordability of homes in Syracuse market is much better than it is on a national compared to the national levels.

Andrew Fish 8:13
Great. So, you know, I think that's exciting, not necessarily for me is I think, continuing to go up and rates being also on the on the rise. But coming back to the market for a minute. I mean, the job numbers, the housing market, those factors, those indicators are not the only confusion in the marketplace right now. Right, because you have that disparity that we're seeing and maybe talk a little bit about what it is if folks don't know, but the disparity between the bond market and the stock market, right. Usually, there's some, you know, I wouldn't necessarily say synergy, but there's some, you know, alignment with how those move. And right now, we're not seeing that our we?

Ken Entenmann 8:47
Yeah, it's been a really interesting three months. So in December, the stock market swelled, while interest rates were coming down because of the economic weakness we talked about earlier. But since then, really in the last six weeks, we had that very strong employment number for January, that that was followed by a whole host, namely the CPI (Consumer Price Index) and the PPI, (the Producer Price Index) both while they were continuing to lower trend for inflation were much higher than expected. So it's that stickiness to stubbornness of inflation. And so in December, you have the market that the equity market saying we're going into a recession, yet the bond market rates were going up because of inflation. And you had that mixed message. Since the employment report that came out in the first week of February, the markets seem to have aligned a little bit closer. January, the equity markets were up very strong. And now they're starting to come down in February as the conclusion was the weak economic numbers were gonna lead us into a recession that was going to force the Fed to pause. So interest rates are going to stabilize at lower levels. And then the recent inflation numbers have kind of concluded that. Now, that's not pausing. They're going to have to continue to raise rates and you've seen the equity markets correct. And so they were sending horribly mixed messages, stocks and bonds earlier in the year since the February data. And it continued yesterday and this week with the personal consumption expenditure index, the inflation numbers in the ISN manufacturing report yesterday, where that came out at 47.7. Below 50. So chose manufacturing, contracting, but the prices paid were over 5%. So contracting, manufacturing, but the prices are higher, really bad combination. So now, I think the stock market is giving up a little bit of that really good run in January, because the interest rates have have risen pretty considerably. And yesterday, and today, for the first time, the 10 year treasuries above 4%. Which it hasn't been in a long, long time.

Andrew Fish 10:48
Yeah. Yeah. I mean, it's, it does seem like I know, you know, kind of as the year rolled in, there was all this debate about, you know, like mini recession, or soft landing. Can you describe what the difference is between those two, maybe mini recessions off? And then I'll get back to my question, but I just want to make sure folks understand that.

Ken Entenmann 11:05
Yeah, so I, you know, and again, that's, that's really dramatic change in kind of attitudes in the marketplace. So, you know, a recession is that the economy recedes, so the growth becomes negative. A soft landing is considered when the economic numbers are slowing. But you either maintain modest growth or you go into very negative very small negative numbers, and the market recuperates quickly. That's, that's the proverbial soft landing. So, you know, a distinction between lower slowing growth but doesn't break zero, and modest negative, I don't know that that's significant. So I would wrap them in the banner of soft

landing. A hard landing is what everybody fears, and that is the Fed raises rates so much that it chokes off economic growth. And you go into a long, prolonged economic recession. So for example, historically, back when Paul Volcker ran the fed back in the late 70s, early 80s, it was kind of a nightmare if interest rates went up into the teens double digit, and it created a prolonged double recession, they were there, there was a recession in the late 70s, early 80s. And then there was a very harsh recession, because inflation came back, the Fed jacked up rates materially. And there was a very ugly recession where the negative growth is severe, and the employment unemployment rate jumps quite a bit. So that's the hard landing that everybody's fearing. But what's interesting is the data is coming in so strong in February, very much opposed to December. Now, now that we have people talking about no landing at all, that the economy, while it may slow a little bit is not going to go into any kind of recessionary territory, and grow more. Kind of good question and which is going to happen.

Andrew Fish 12:53
And you know, I mean, that's, that's the joy of forecasting is that you, you continue to update that as the data rolls in. And obviously, as numbers come out here in the month of March, and you know, as we look back on them, we'll we'll have more information on that. But it's it's fascinating to me. So I guess the kind of the question I was going to ask, and what I think is really interesting is, all of us absolutely are impacted by what happens in a global market. It's a global economy, we have to understand that, you know, this is going to be a multi part question. So I'll try and keep it segmented. But you know, the first question I have is, as we who are affected by interest rates are affected by our, you know, retirement accounts, and how the markets doing and all those things. How do we in central New York, align that not just as ourselves, but as business leaders, with the expectations around being a growth economy in this region, for the first time? As you said, traditionally, that we've never been that no booms no busts. Now, we have these economic factors such as you know, Micron in the supply chain. And just recently, there was a report that came out that Syracuse was the seventh highest city in the United States for in migration of Gen Zs, right? And so you know, and you look at the list, and it was like, you know, DC and Atlanta and, you know, Nashville and places like that above us, and here's, you know, Syracuse, New York, again, punching above our weight class, we love to do that. How do you make decisions in that kind of a market? Right? How do you make decisions as an individual? Do I buy a house now? Do I not? How do you make decisions as a business leader? Do I do that expansion? Do I make that growth? Do I make that investment? Or do I not? And is that too difficult of a question for us to answer here today? Or what do you look at?

Ken Entenmann 14:20
Well, I guess my general answer to that is you have to think long term you cannot think in and as a Chief Investment Officer, Chief Economist, I have the TV on in my office 24/7 And I

read all these periodicals and it frustrates me and annoys me that the time horizon that people on TV talk about when it comes to investing, whether it's for retirement or for investing long term in a business, the life expectancy of that decision is like measured in nanoseconds, it seems, and it's very, very frustrating. So I would say that on the investing side, patience is a virtue. And we have these cycles, they come and go, but you have to think longer term. I think from a business perspective to the members of CenterState CEO, I do think you need to think longer term. I think what's encouraging, at least my gut instinct, while I do expect the Fed to continue to raise rates, I think they are closer to the end than they are the beginning. And if I'm a business person sitting here deciding whether I'm going to put that addition on the, on the plant or build another warehouse, I don't know that another quarter point or half point in interest rates is going to make that much of a difference in that decision. And so a more of a longer term view is important. And, you know, in NBT, we have the benefit of as I said, earlier, we've seen the growth in the marketplace due to the Malta, we've seen that Malta chip fab, we've seen the experience in Utica, which is experiencing tremendous growth, we have some experience down in Poughkeepsie, Albany. So we've, we've seen this, and it's remarkable to see the economic growth, you go through Malta, there are so much growth there. And even as a bank lending and our site, as I said, we're not going to lend to micron, they're too big for us. But so many of our companies, contractors, roads and bridges, people who supply the construction companies have seen this dramatic increase in economic activity. So I think from a Syracuse metro area, I would say that the Micron plan is a giant game changer. That's why the young people are starting to come here, the affordability we talked about is a huge factor. You know, I grew up on Long Island, I went to school at Cornell, and I've been more upstate than I've been downstate now, and it amazes me, the quality of life that we have here, relative to my siblings, still living on Long Island is remarkable. And now that we have this big catalyst, I think the opportunity for long term investing is really great. And whether Fed Funds are at five and a quarter or 5%, I don't think really should be factored into that decision.

Andrew Fish 15:15
Great. So long term view, I love that. I think that that's really good advice for folks. And you know, and you talked about Malta, and the impact that Global Foundries had out there in the Saratoga Region, and Albany in the capitol district, the thing that I get, but I still have a hard time wrapping my brain around as I think about, you know, Global Foundries I think is now working on their third fab out there, they've been, I want to say it's been sipping 12 years 14 years, or something, you know, the scale that Micron is talking about is actually almost from a size and capital investment perspective, like, seven to 10x, what's happened out there, right, and you look at the impact that they've had out there, and it's just like, Oh, my goodness, we, you know, buckle up, you know, strap in, because this is going to be this is going to be an interesting ride for this for this region. And it's exciting. And also, I think

it's going to come with some challenges. Shifting gears a little bit. We talked a lot about the Feds a lot about the rates, economy and politics unfortunately, can't separate those. When you think about the monetary system, when you think about all the ways in which decisions in DC and throughout the country impact that a lot of people are worried about the debt ceiling, a lot of people are thinking about, you know, what's going to happen, and what are the impacts? And, you know, I also think there's a lot of people that just don't really understand what that means. Right. So talk to us a little bit about the what is the debt ceiling? What's the implications of it getting raised or not getting raised? Take the, you know, the politics of the across the aisle banter out of it. And just tell us a little bit about the realities of the economy with a debt ceiling.

Ken Entenmann 18:20
Yeah, so we have a debt ceiling here in the United States that says, you know, our federal government can't exceed a certain level of debt. And we are rapidly approaching that number. We're kind of there already. But there's some gamesmanship where you pull money from here or there and tax receipts, so we're likely to hit the debt ceiling sometime in late summer, July, August, somewhere in that period of time. The significance of that is, you know, obviously, if you don't pay your debts, there's a credit rating issue. And people worry about that. And the implication is that interest rates will go higher, because you didn't pay off your debts in a timely fashion. And as the reserve currency of the world, US dollar our and our treasury market is by far and away the biggest investment bond market in the world, multiple times bigger than any other region, we have the luxury not just as a government, but as individuals that we have very low stable interest rates. And so anything that puts that in jeopardy is going to cause some angst in the marketplace. And that's why you're starting to hear so much about it. My view is I doubt they will do this. We've done this numerous times, it becomes incredibly political. I have a chart that I love sharing with people that goes back to the Kennedy administration, and Democrats and Republicans love to argue over who is the most fiscally responsible? And the answer is neither one of them. The chart that shows government spending, going back to the Kennedy administration, and I quote it red and blue. It just goes straight up. But I do think we're we're we're starting to enter some precarious territory with the level of debt relative to the size of our economy. When you we look back over centuries, and you look at countries or empires, I'm going back to the Ottoman Empire, the Roman Empire, and you think about Great Britain was the dominant, the British pound was, at one point, the reserve currency of the world. So you go back over hundreds of years, when debt starts to exceed 100% of the size of the economy. So think about it as from an individual, what is your debt relative to your income? Well, the income of the United States is our GDP (our Gross Domestic Product) and when you look back over 1000s, of years, when the debt starts to exceed 100% of the economy, it's kind of a tipping point where issues start to arise, and we're there, we're there now. And the other observation I would make is we can argue over tax rates and cut spending cuts. And that's

going to be big news over the course of the next several months. You know, I think the biggest problem and I was very discouraged by the State of the Union. There was an exchange between President Biden and Republican Congressman where they started talking about Social Security. And Biden was chiding the Republicans because they were going to kill it, which they're really not, but then the Republicans responded. So we're not going to touch Social Security. And I found that really disappointing because entitlement spending is the problem for that striving debt. If you think about it, when you when you combine Social Security, Medicare, Medicaid, and some of the pension plans, and then you throw in the interest, it's over 70% of the total spending in the United States goes to entitlements and debt payment. And then when you think of those entitlements, Social Security and Medicare in particular, we have this demographic bulge called the Baby Boomers going through, when Social Security started, there were seven workers for every one recipient. Now, we're encroaching one on one, right, and it's almost becoming pay as you go. But as we get fewer workers, and that's why that labor participation rate is so disconcerting. If you get less, you can't pay as you go. And so we're looking at Medicare, being insolvent in 2028. We're looking at social security, being insolvent in 2034. And then when you look at the demographics as population, we're getting older, as we get older, we spend more money on health care, right, and the rate of growth. So the cost of living adjustment for Social Security was 8.4%. This year, and healthcare costs and Medicare are growing at double digits as well. And so when you say 70% of your budget, or is growing at 10%, and now we're going to cut spending. Boy, the other stuff is what you're left with is what's called non defense spending, which is about 15%. And defense spending, which is about there roughly equal? Well, it's really hard to cut all that other stuff, right to make up for a 10% growth rate. And so I was discouraged. And that I think, as a society, not just the politicians, but we as society, we have to have there's a reckoning coming in terms of how the entitlement spending occur. And if we're going to get our debt under control, we have to have more reasonable spending. And I'm hoping that the politicians in Washington will become a little bit more focused on on the entitlements, because it's 70% of the budget. Yeah.

Andrew Fish 23:23
Now, and it's such a hard, it's such a hard issue, right? Because that 70% is is is where that problem is, and it is also necessarily a part of a lot of people's everyday living. And so how do you? How do you reconcile that?

Ken Entenmann 23:34
Well, and then from a political standpoint, those baby boomers and the recipients of of Medicare are older, by definition, but they are the most active voters, and they're a huge voting bloc. So if you're a politician, it's pretty dangerous to alienate them. And so they but that's the really difficult part of this decision is, and that's why we're saying, well, we're not

going to touch those security. Well, if you don't touch those security, based on various government needs. In 10 years, everybody's going to have a 23% cut in benefits. I don't think anybody wants that. But that does. So when you say we're going to do nothing, we're not going to touch it, you're basically advocating for a 23% cut in benefit payments. But you are doing something, you're forcing, you know, kind of mandatory cuts, which are, would be really draconian for for senior citizens, and nobody wants that. But by you know, the politics of it today are disconcerting, and I think we as a society, and as a government need to get a little bit more focused and serious about that.

Andrew Fish 24:40
So thoughts on where the debt ceiling is gonna go. I know, that's where we started that question. But certainly all those things impact that, you know. My expectation is, it's going to be a political football right up to the deadline, but then I expect given the consequences that would result- it's going to get raised. Is that your thoughts? Or?

Ken Entenmann 24:57
I, that's what's happened at every single time. I have a series of quotes from politicians on both sides of the aisle. And it seems when my guy is in office for raising the debt ceiling, and when the other guy's in office, I don't want to raise the debt ceiling. So there's lots of politics and, and what I would caution people is that will create many, many headlines, some of them very scary. And it's one of the reasons why expect particularly the first half of the year to be very volatile. Obviously, we have inflation and the Fed and slowing economy and all the things we talked about earlier. But throw on top of that, that debt discussion, and all of the nasty headlines that come from that, I think it's going to lead to a lot of volatility. But Andrew, I agree with you completely at the at the 12th hour, they'll raise the debt ceiling and how they get there is going to be a pretty choppy and ugly process.

Andrew Fish 25:52
And it's interesting, because, you know, you we talked, we started this conversation with the stickiness in the market, not necessarily reacting the way we expect it to. But those indicators, and this debt ceiling conversation is probably one of those many factors, right?

Ken Entenmann 25:52
Absolutely.

Andrew Fish 25:53
You know, global conflict things we're hearing about in terms of, you know, challenges around the world, those all might have impacts, but certainly might be why we're getting some of those conflicting messages.

Ken Entenmann 26:13
No doubt. And that's one of the reasons why the Fed has to be vigilant on inflation. Sure, because inflation drives rates. If rates go up, you're talking about debt payments, going up by a half a billion to a trillion dollars if rates continue to rise. That's expensive. And so if you don't get that under control, it really starts to raise the cost of that debt. As I said earlier, I don't envy the Fed. And I don't envy the politicians because it is a really difficult discussion. But we have to become more serious about it and do something good. Doing nothing is not-

Andrew Fish 26:50
We've kicked out again for a lot of years.

Ken Entenmann 26:52
Absolutely.

Andrew Fish 26:53
And there is a there is a wall at the end of that hallway.

Ken Entenmann 26:55
Correct?

Andrew Fish 26:56
Yeah, great. Ken, thank you so much, really looking forward to these conversations quarterly. We'll have you back in June. And we'll do this again and see, see where it is then right and check the forecast and check the temperature but really appreciate not only your time, but the support from M&T Bank as it relates to our podcast series Talk CNY and just looking forward to our next conversation.

Ken Entenmann 27:16
Well, I think it's a great partnership. Looking forward to it.

Andrew Fish 27:19
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