FEDERAL RESERVE BANK *of* ST. LOUIS

US Economic Outlook

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Opinions expressed are those of the authors and do not necessarily reflect those of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

2023 Year in Review

Key Themes of 2023

- **Economic outlook started the year very dim and brightened throughout the year.**
- In January 2023, professional forecasters had 65% probability of recession beginning 2023
  - Real GDP Forecast of 0.5%
  - Unemployment Rate rising to 4.8%
  - Inflation falling to 2.3%
  - Interest Rates (10yr Treasury) at 3.3%
- Why did the economy outperform forecasters expectations?
  - Global economy averted two early crises:
    - Warm winter helped Europe avoid energy crisis and recession
    - China's economy reopened after ending COVID restrictions.
  - Domestic:
    - Strong rebound in labor supply cooled hot labor market while sustaining job growth
    - Consumption spending holds due to excess savings from pandemic
    - Increase outlays from state and local governments
- Result: increases in both demand and supply → output increases and prices stabilize

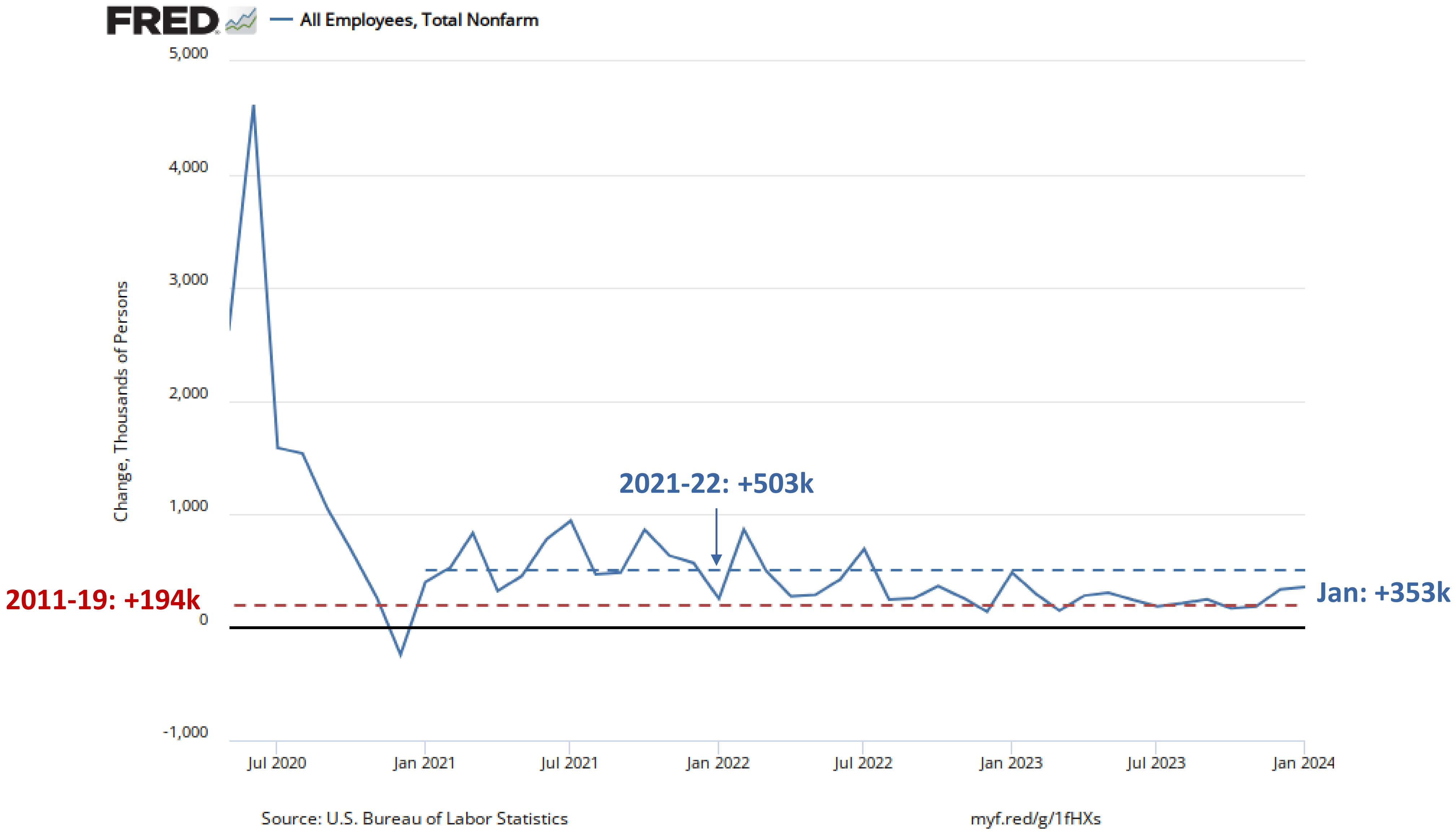
Summary of key US economic indicators

	Real GDP Growth	PCE Inflation Rate	Unemployment Rate	10yr Treasury Yield	Federal Funds Rate
2023	**3.1**	**2.6**	**3.7**	**3.9**	**5.3**
2022	0.7	5.4	3.5	3.9	4.1
2021	5.4	6.2	3.9	1.5	0.1
2011-2019 (Avg.)	2.4	1.5	5.6	2.3	0.7

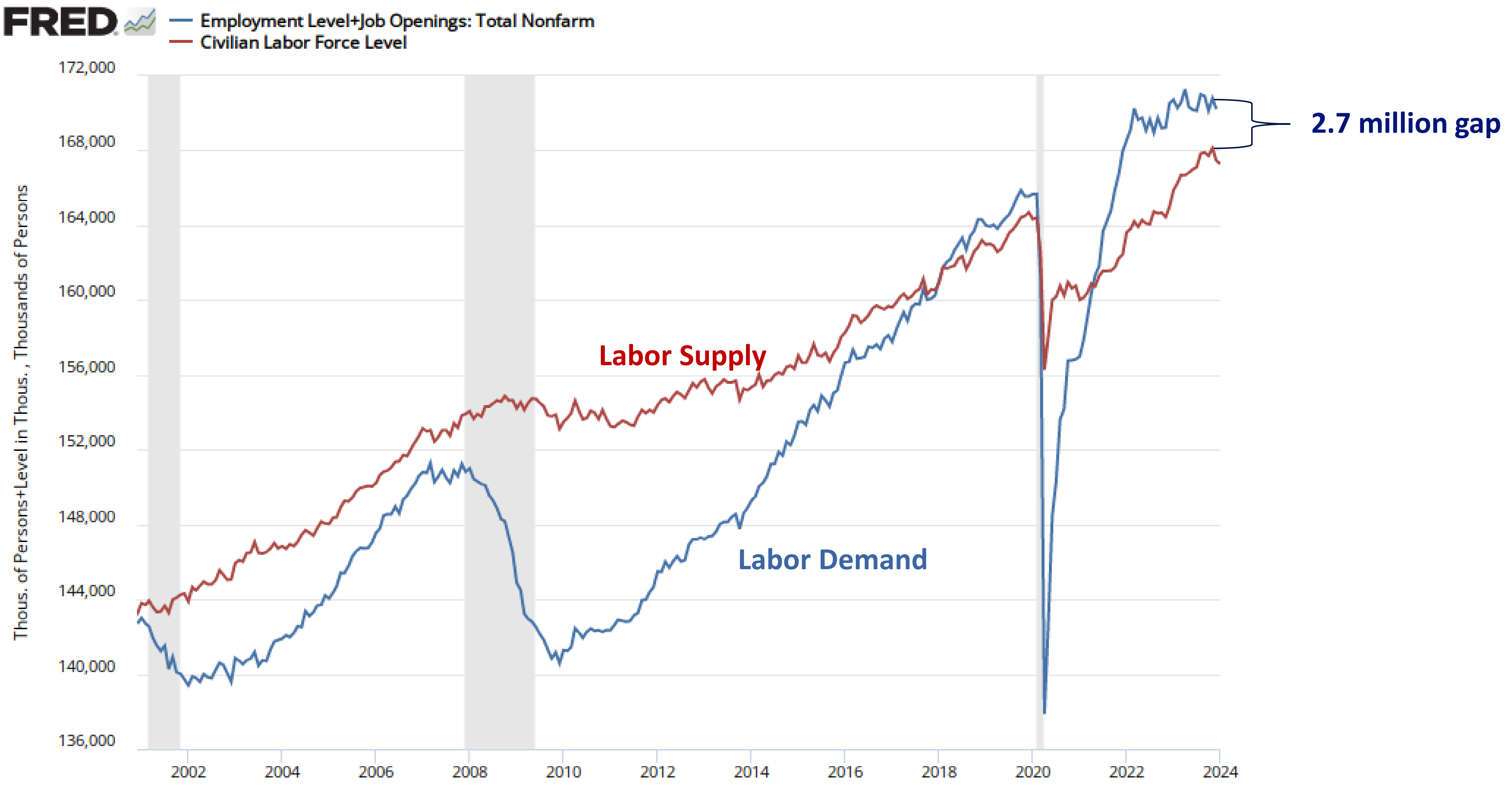
Note: Values are percentage points calculated at end of year. Real GDP and PCE inflation values are percentage change from one year ago.
Source: St. Louis Fed, FRED Database (link to data)

Current economic conditions

Job growth slowing, but remains consistent with past expansions



Labor market remains tight, but supply and demand coming into balance



Source: U.S. Bureau of Labor Statistics

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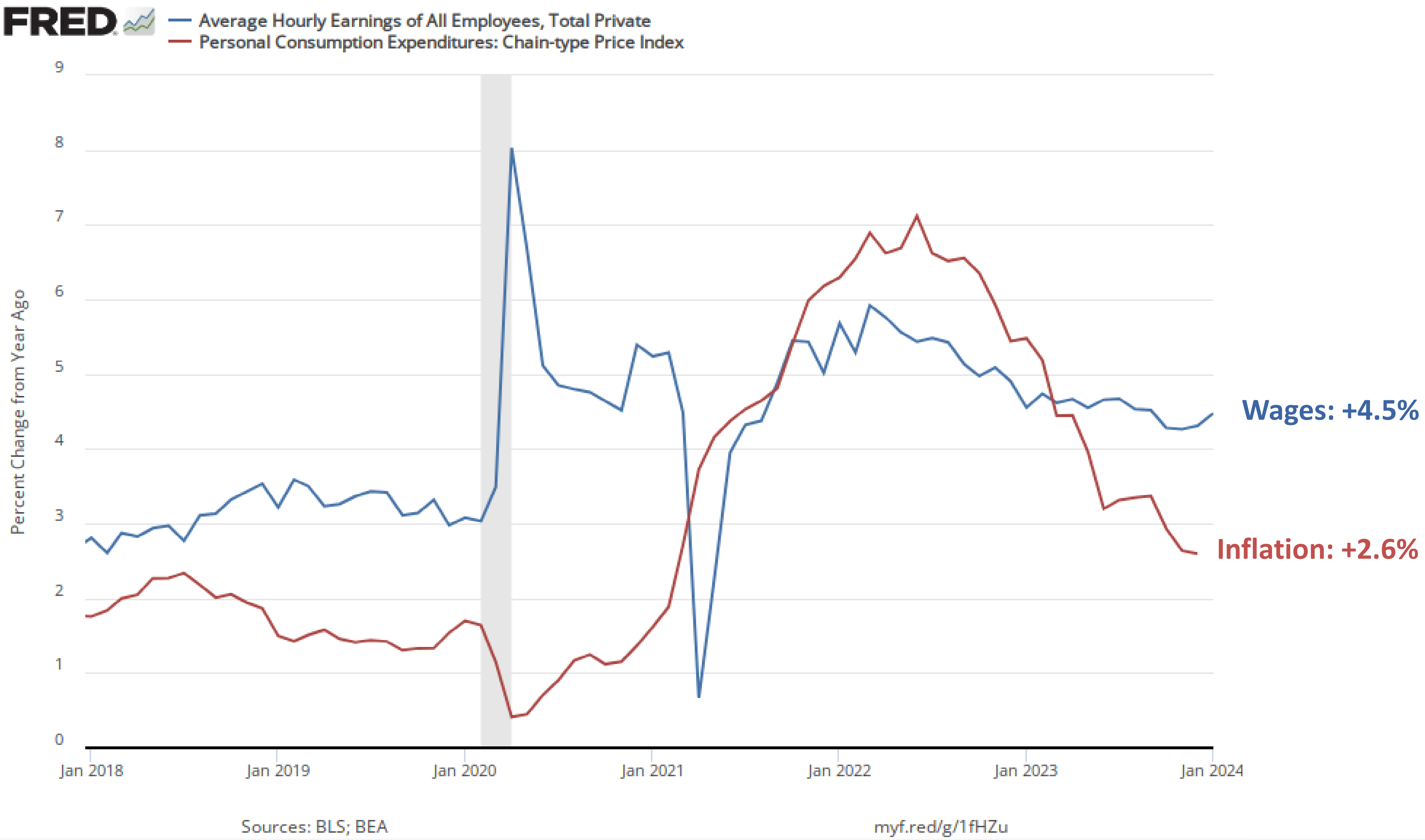
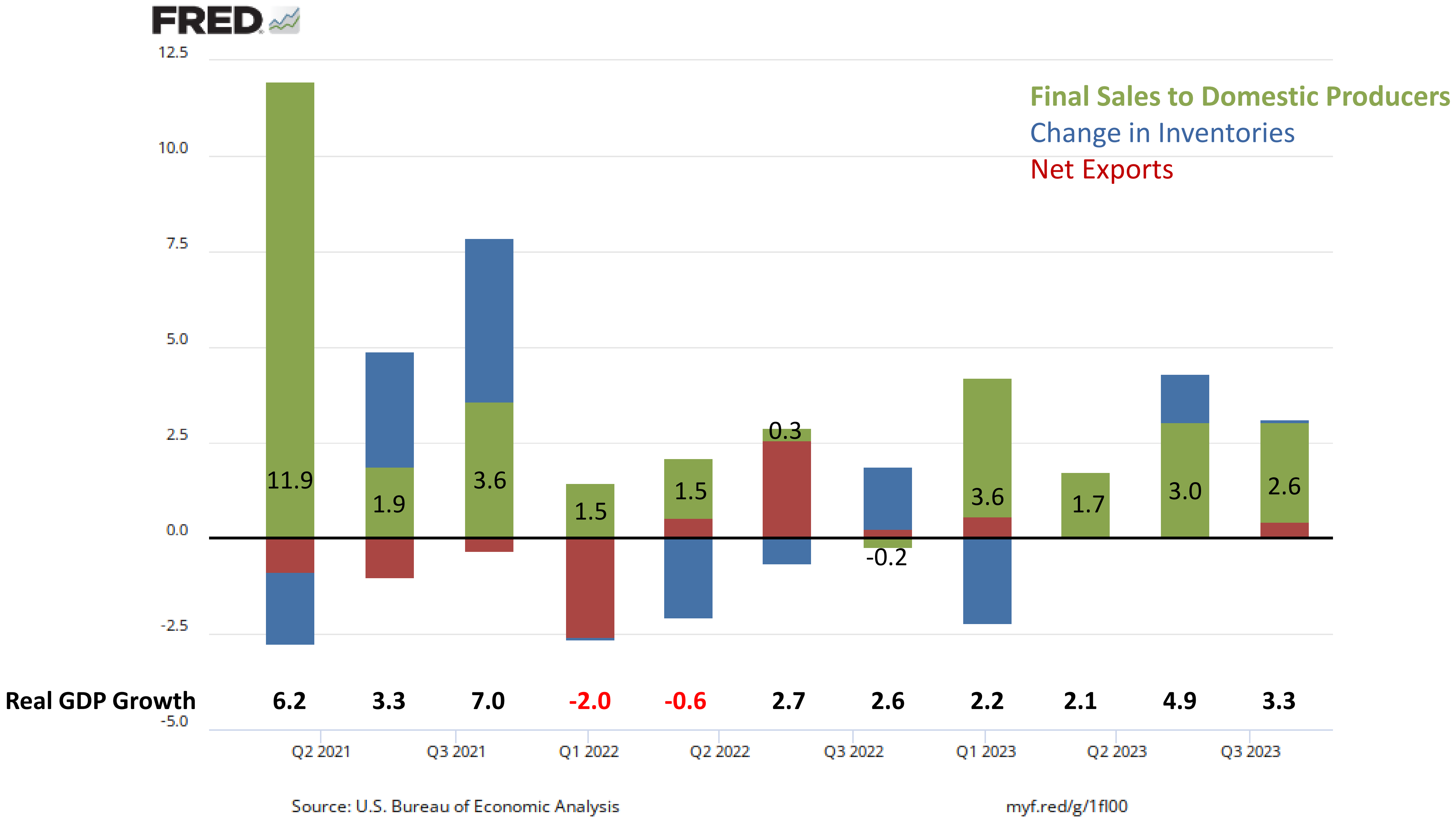
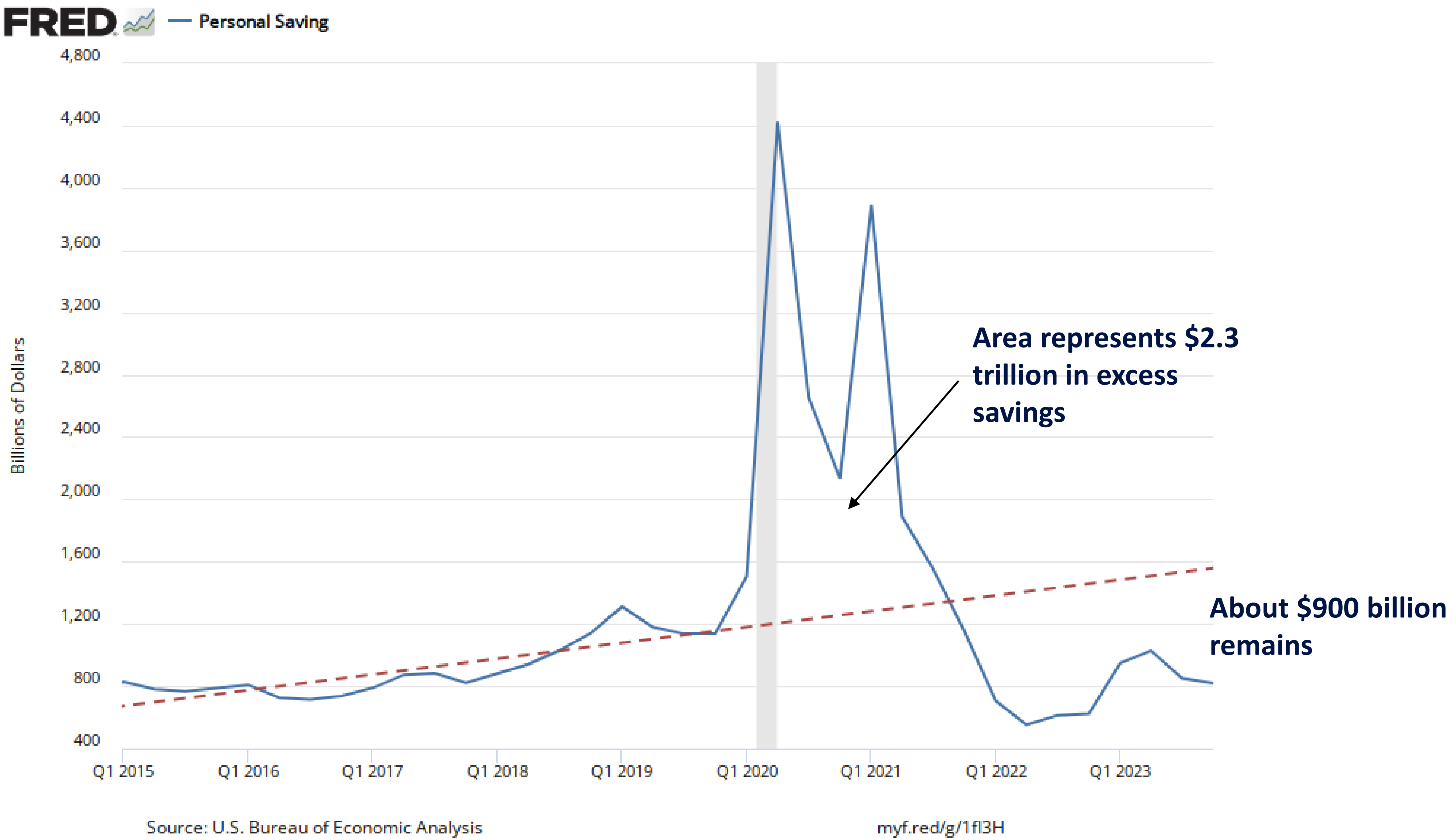
Wage growth has slowed but is outpacing inflation



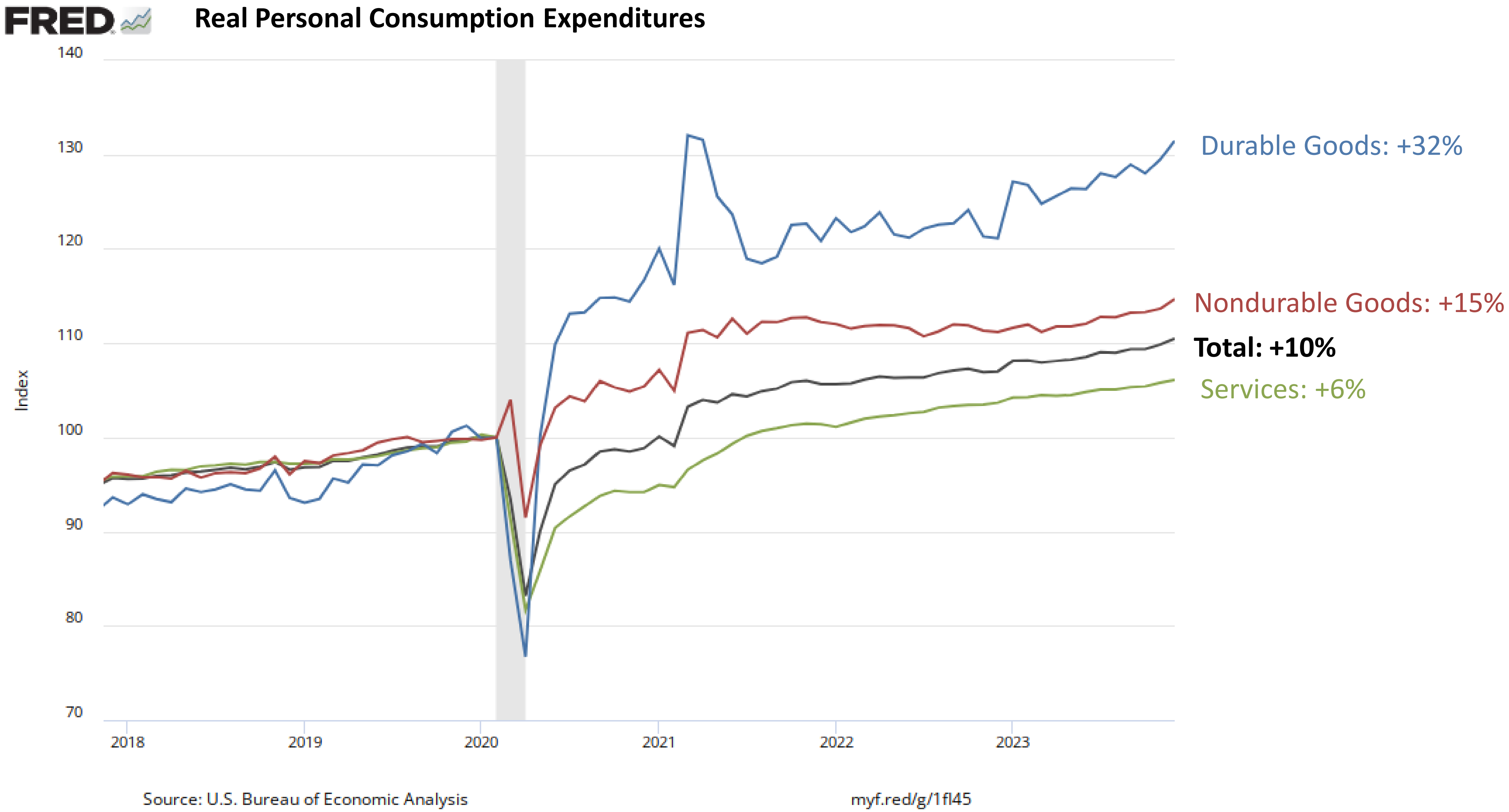
Green shoots of recovering economy hidden by supply-chain disruptions



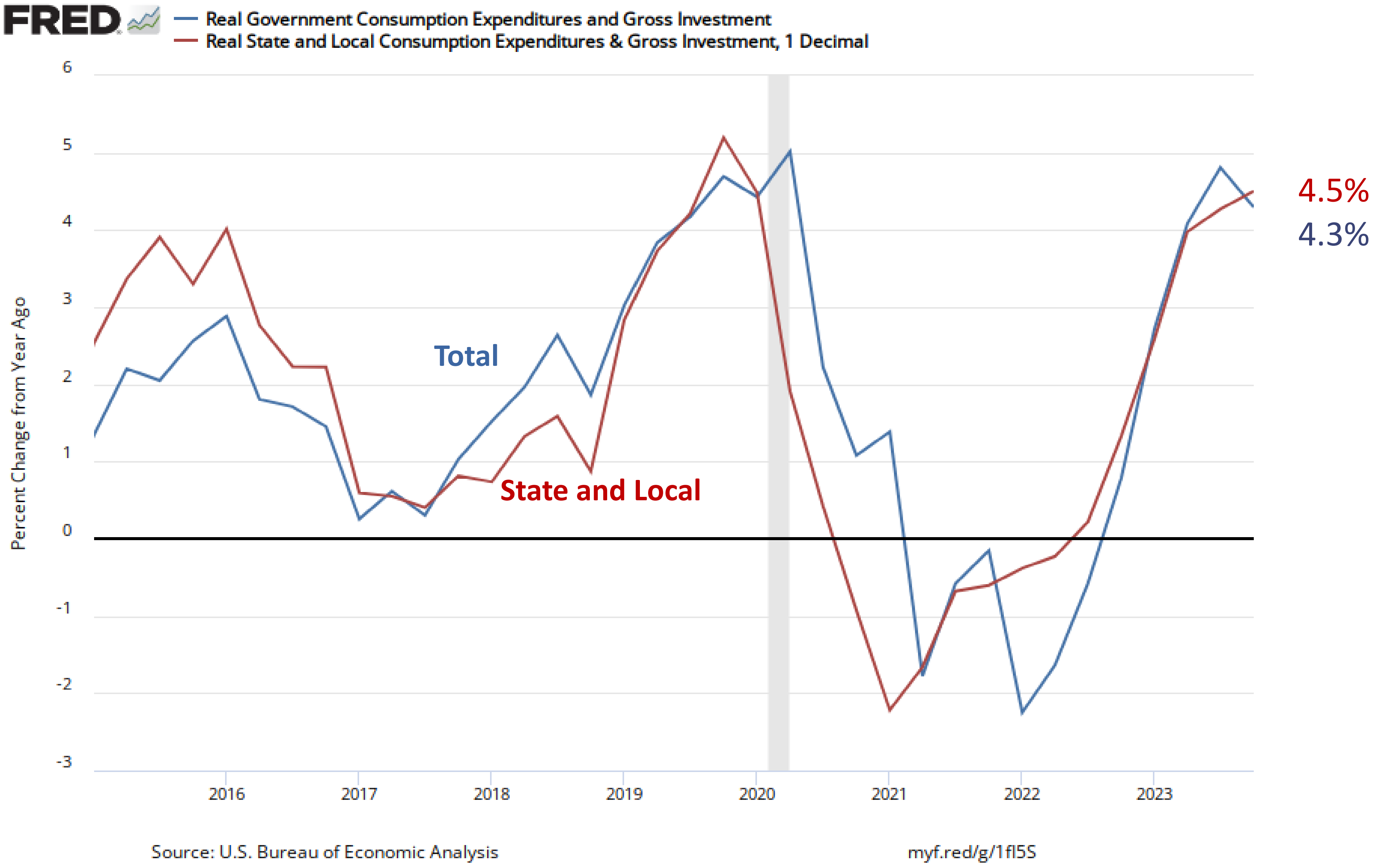
Households accumulated significant savings during pandemic



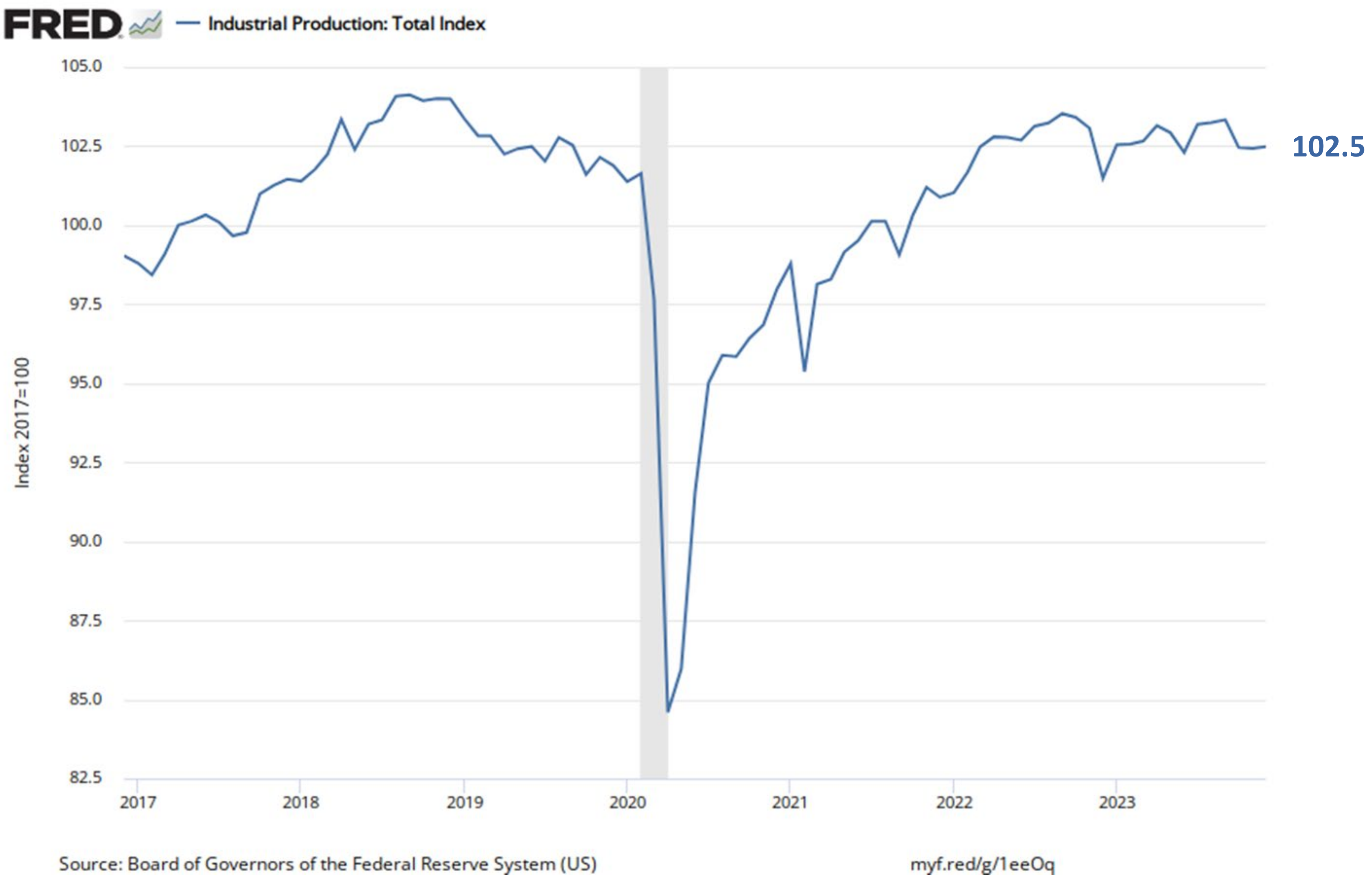
Spending growth healthy, with pivot back to services



Strong growth in government consumption and investment

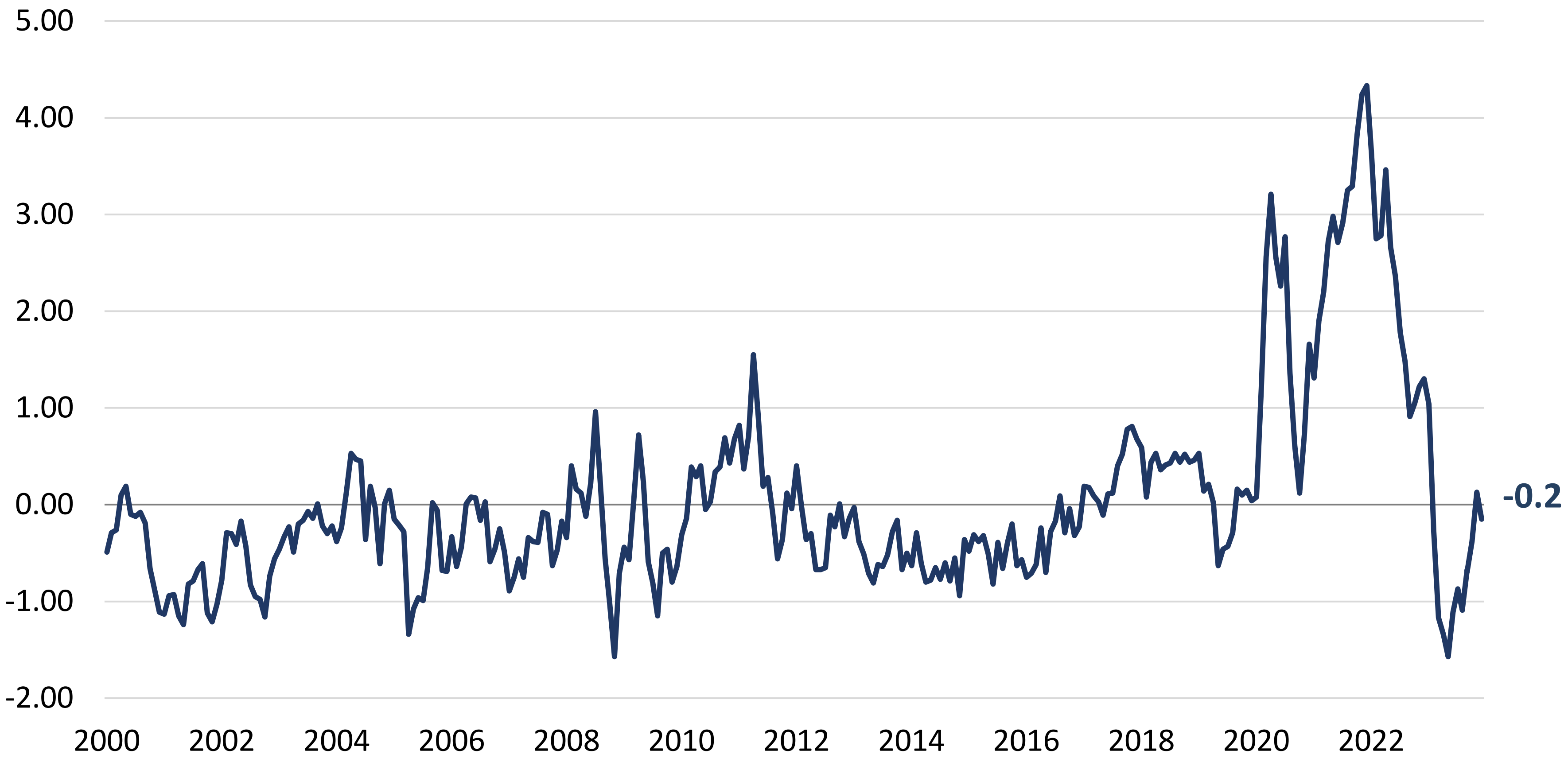


Manufacturing production slows as firms report slow growth in orders



Supply chains are returning to “normal” operations

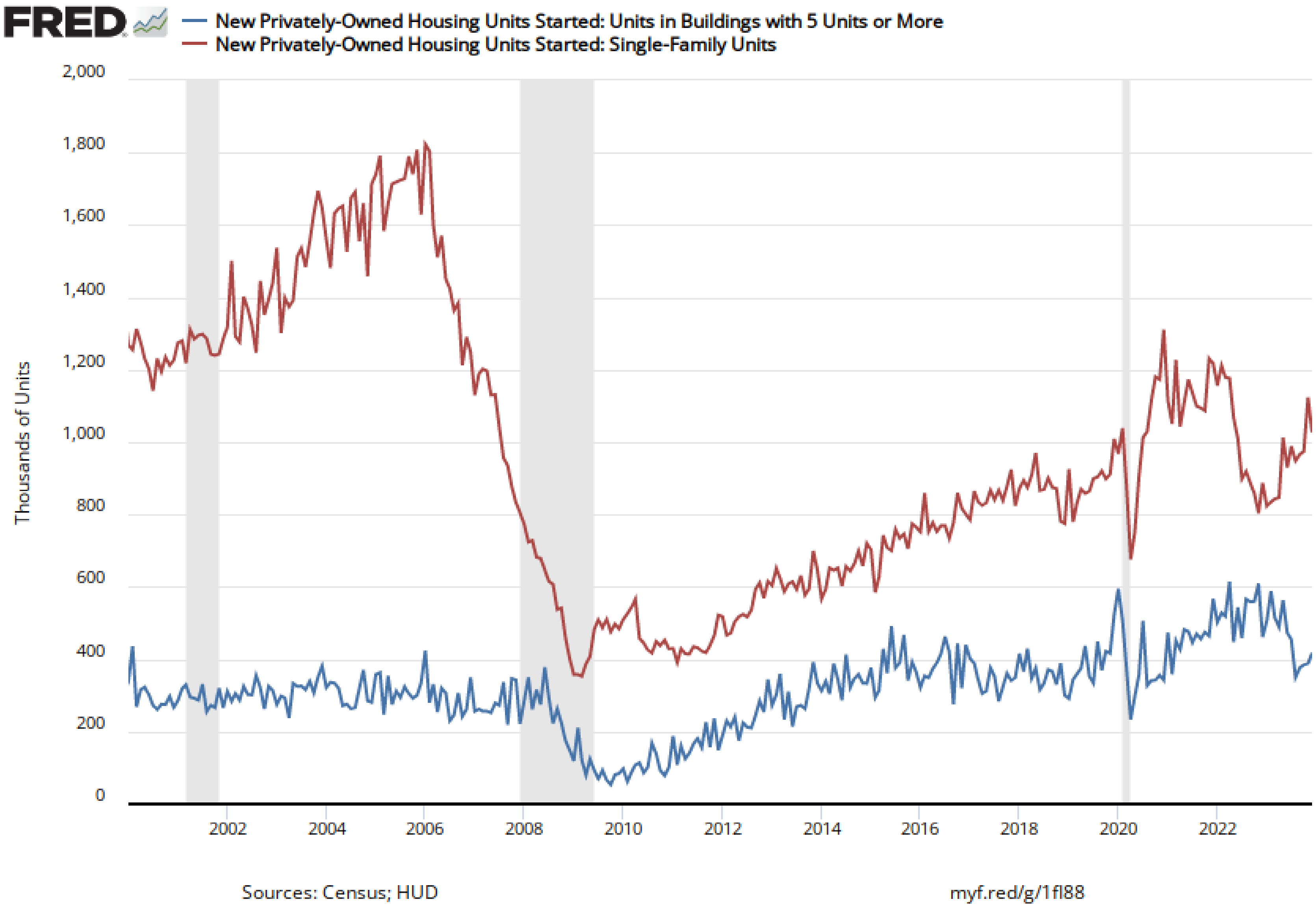
FRBNY Global Supply Chain Pressure Index
Std. Dev. Pts



Source: Federal Reserve Bank of New York (link to data)

Residential investment hit by rising interest rates, starting to recover

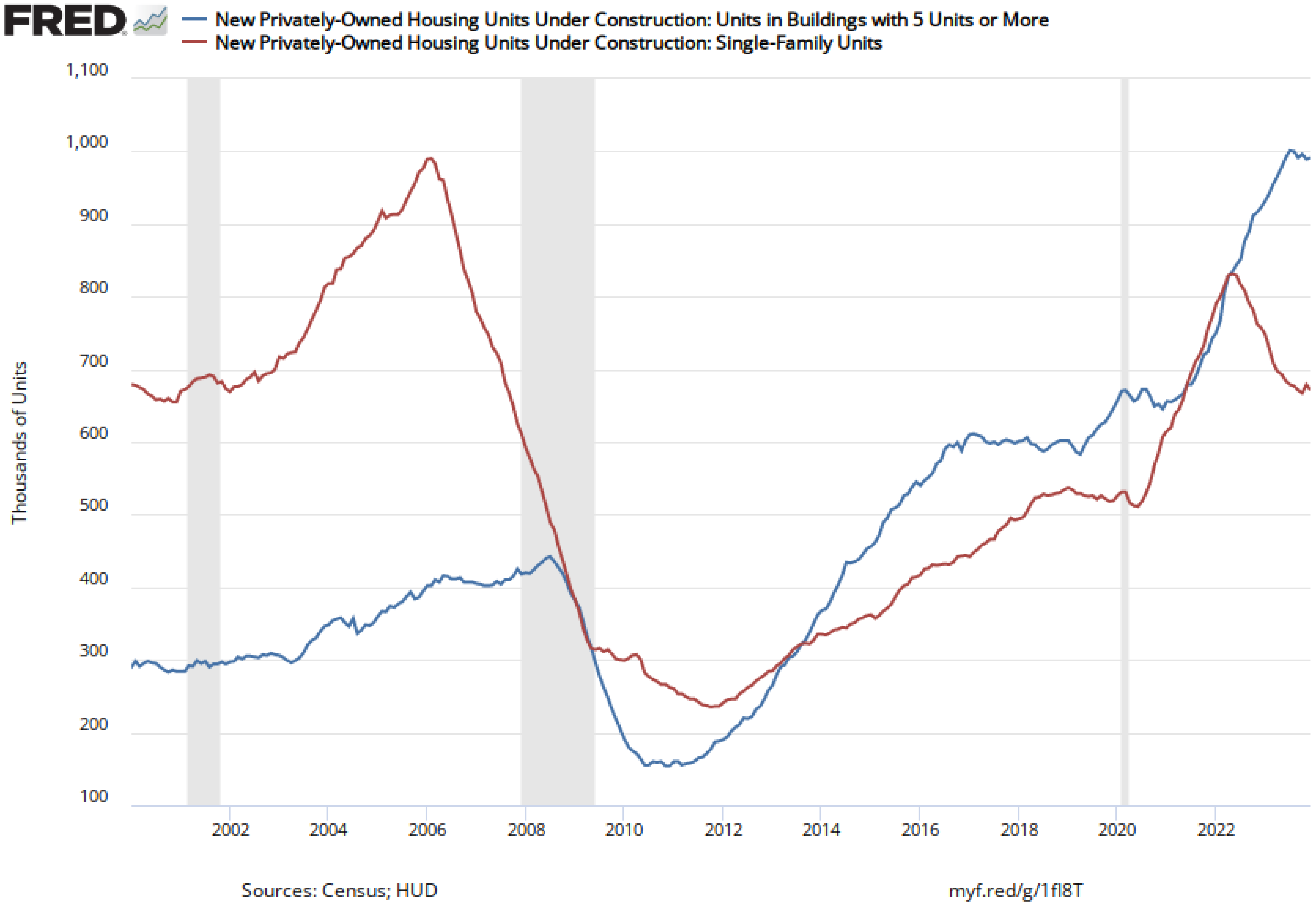
Housing starts appear to have bottomed out and are recovering



Single Family: +15.7% y/y

Multifamily: -9.5% y/y

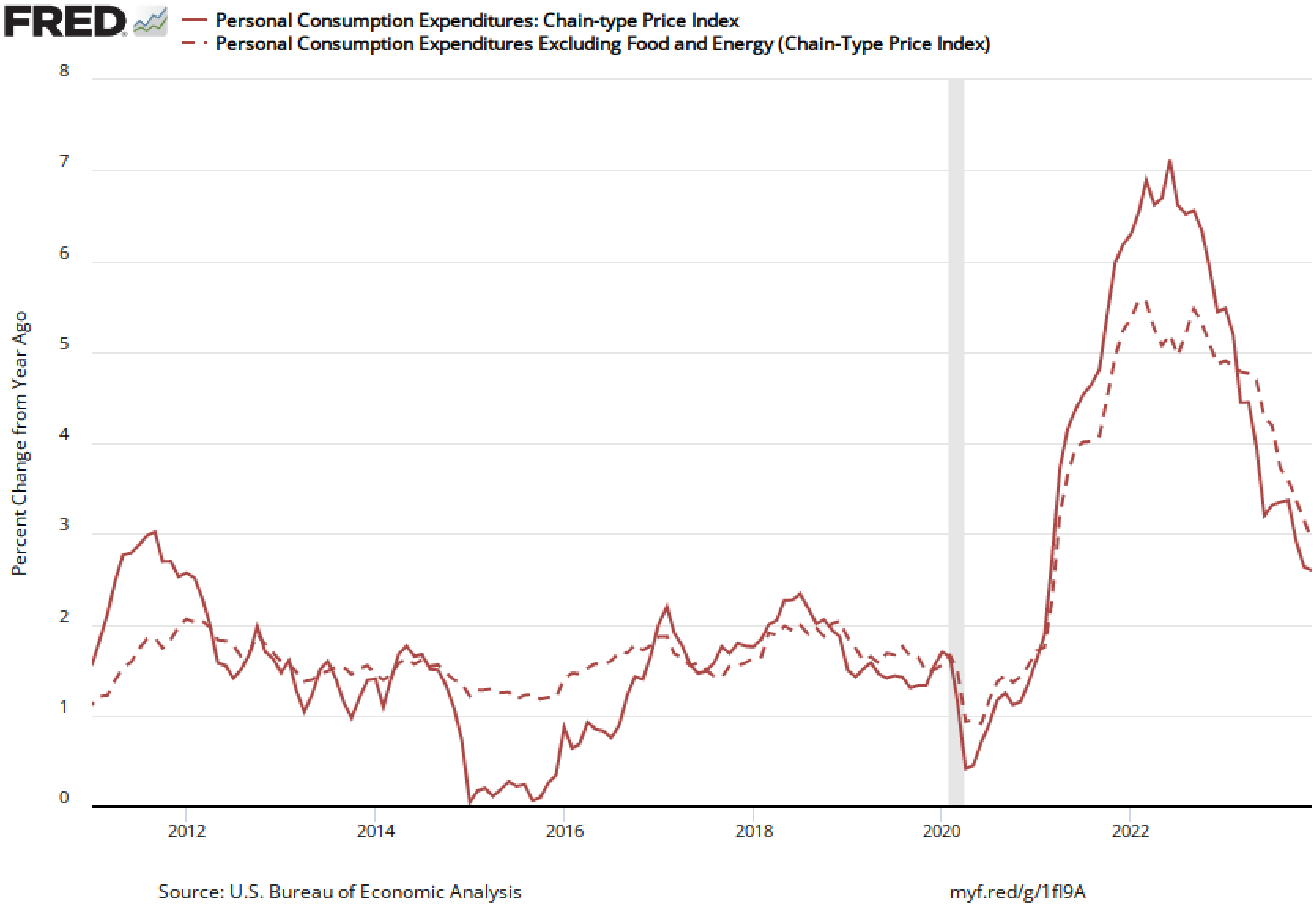
Slower time to completion leads to elevated construction activity



Multifamily: +7.5% y/y

Single Family: -11.3% y/y

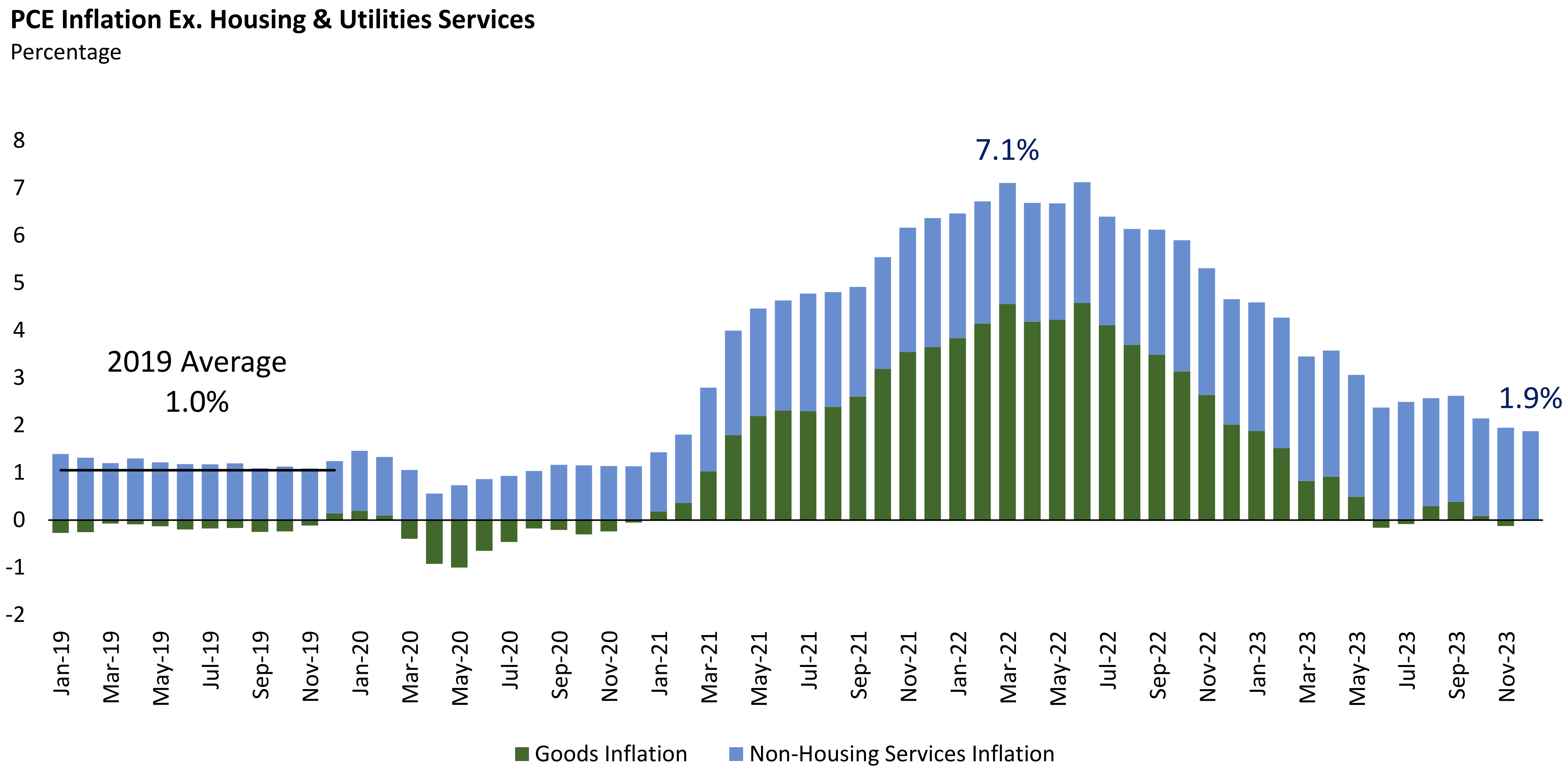
Cooling demand + improving supply = slower inflation



Ex. Food and Energy: +2.9%

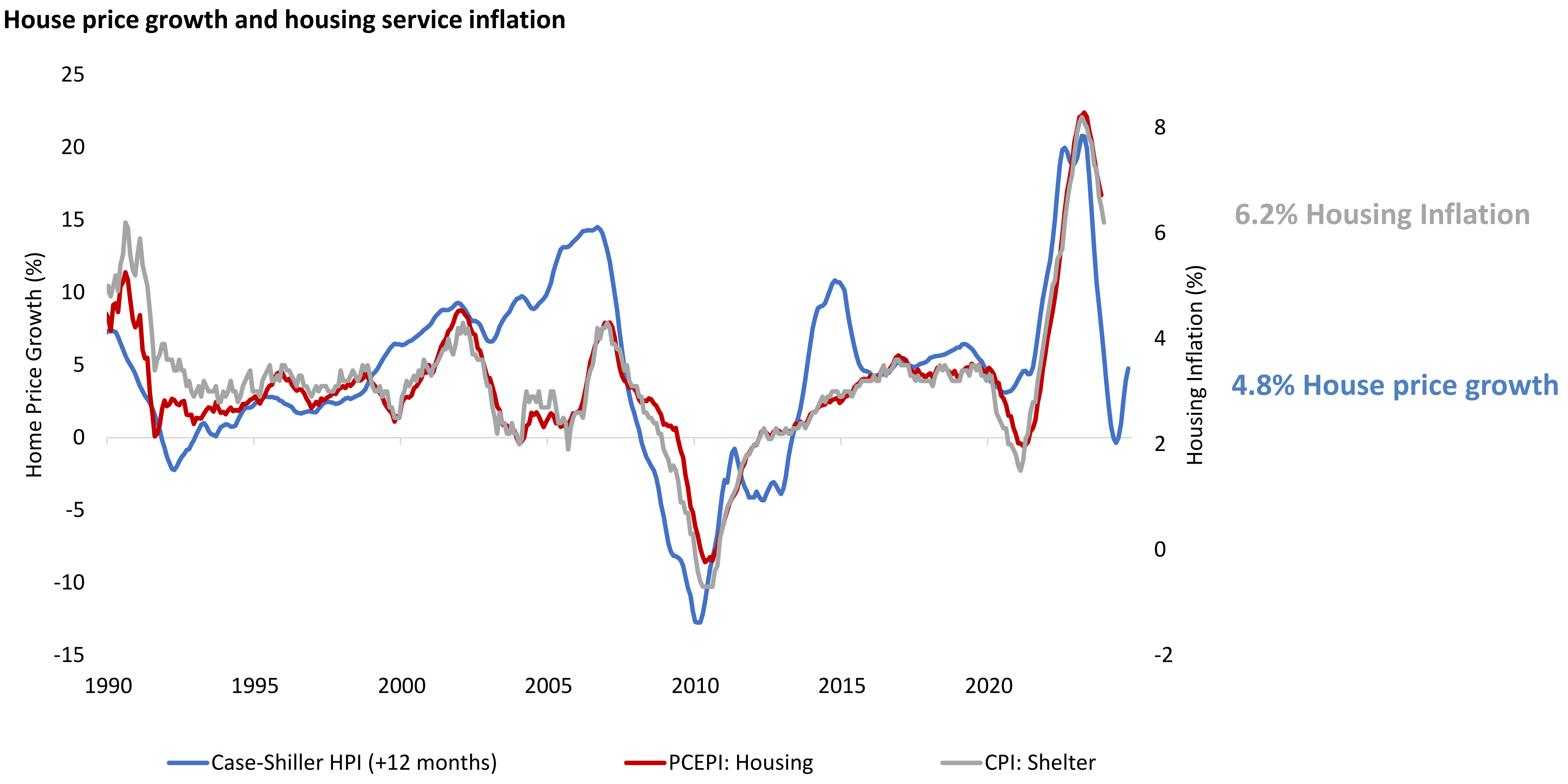
Headline inflation: +2.6%

Goods inflation near 0%, but non-housing services trends close to 2%



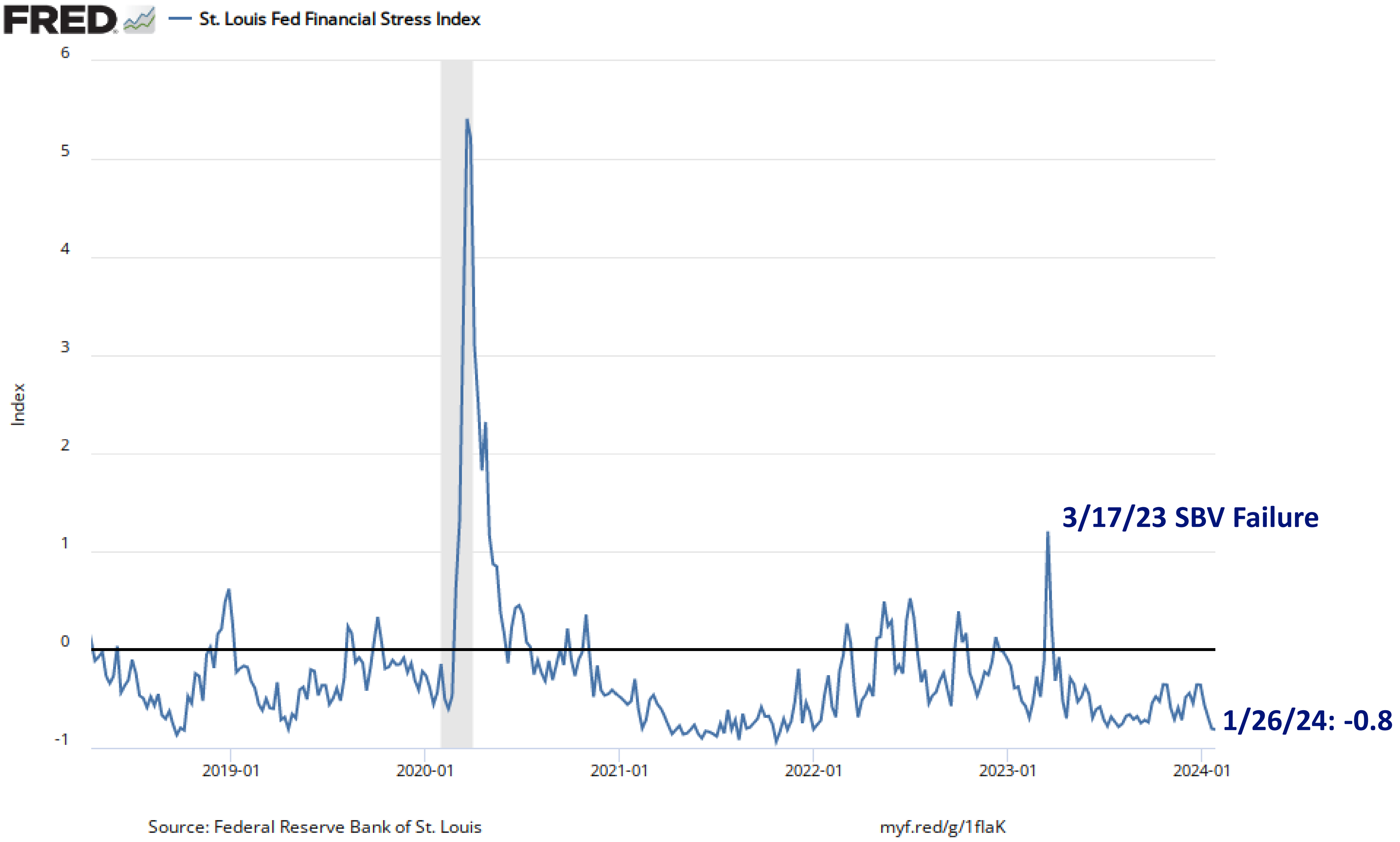
Total goods and non-housing services PCE inflation calculated using nominal goods and non-housing household services consumption as weights for subcomponents inflation values

Housing prices flat while housing inflation persists

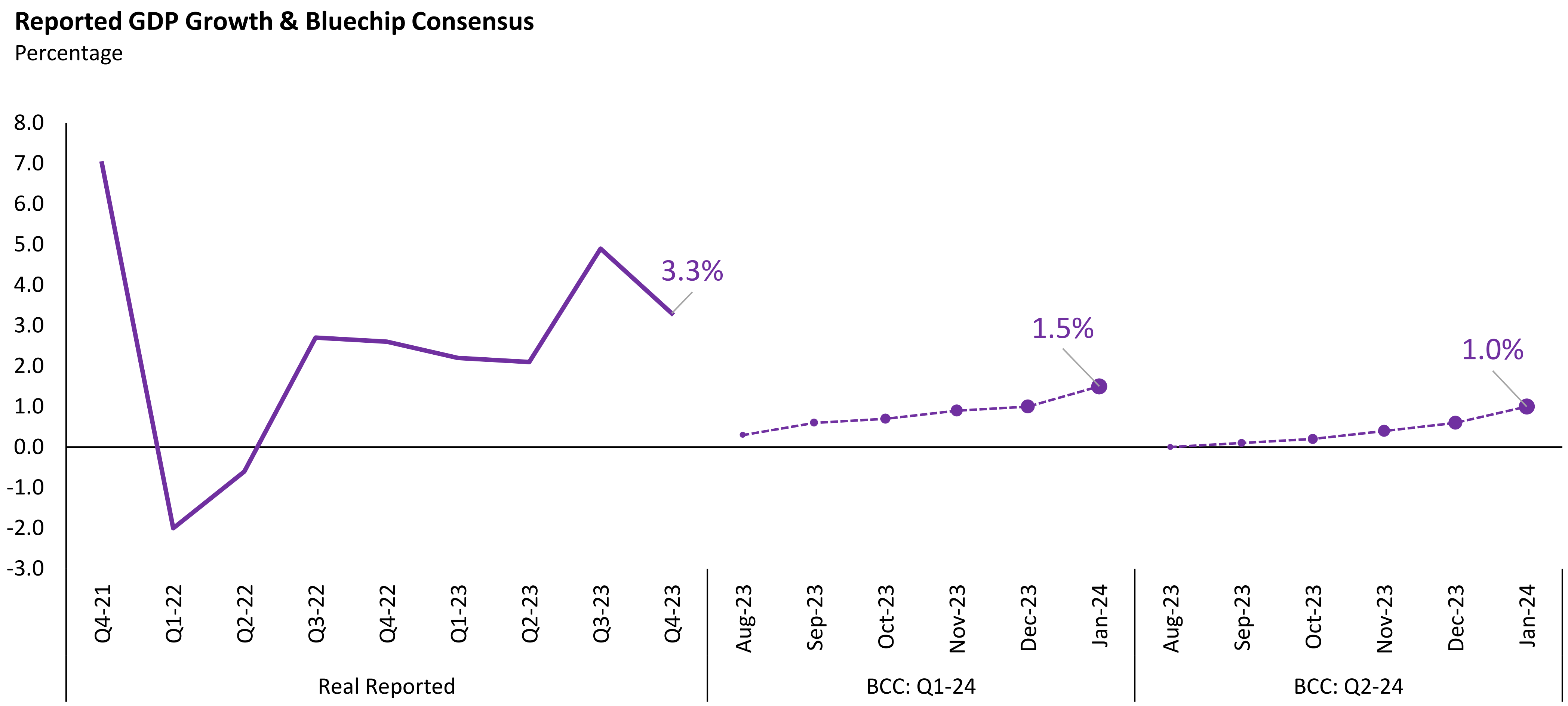


Near-term outlook

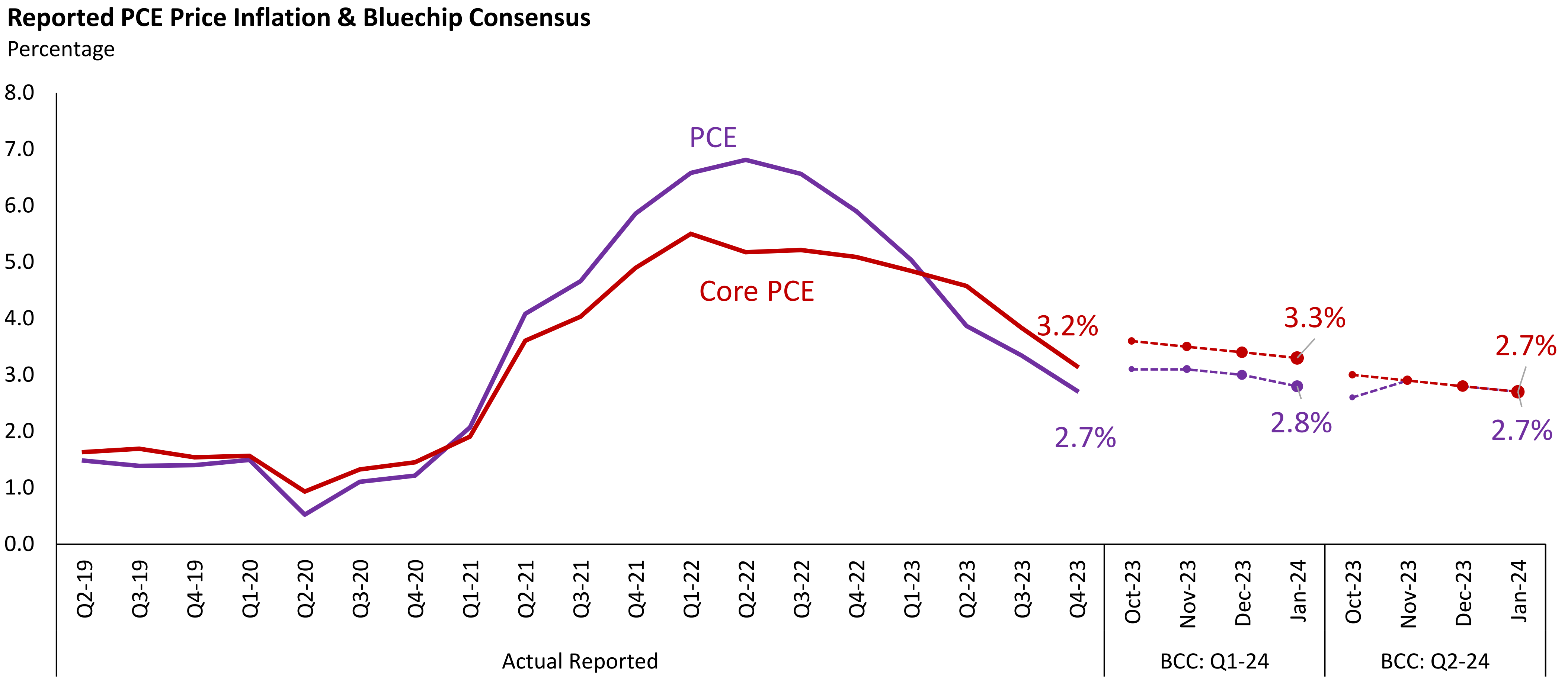
Financial market stress at below average levels



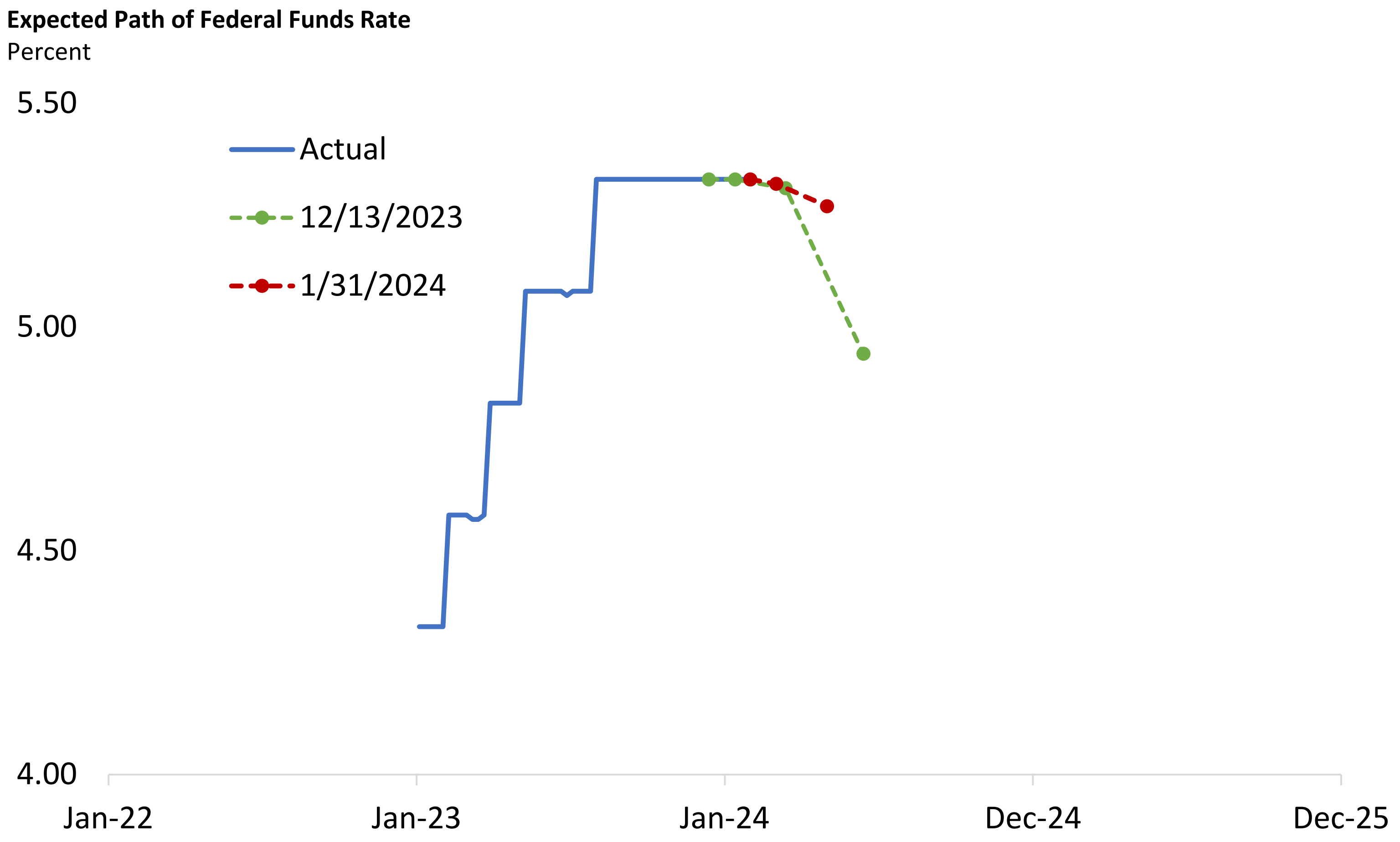
Forecasters expect slower growth in Q1 and further deceleration in Q2



Forecasters expect inflation will decline slightly over next few quarters



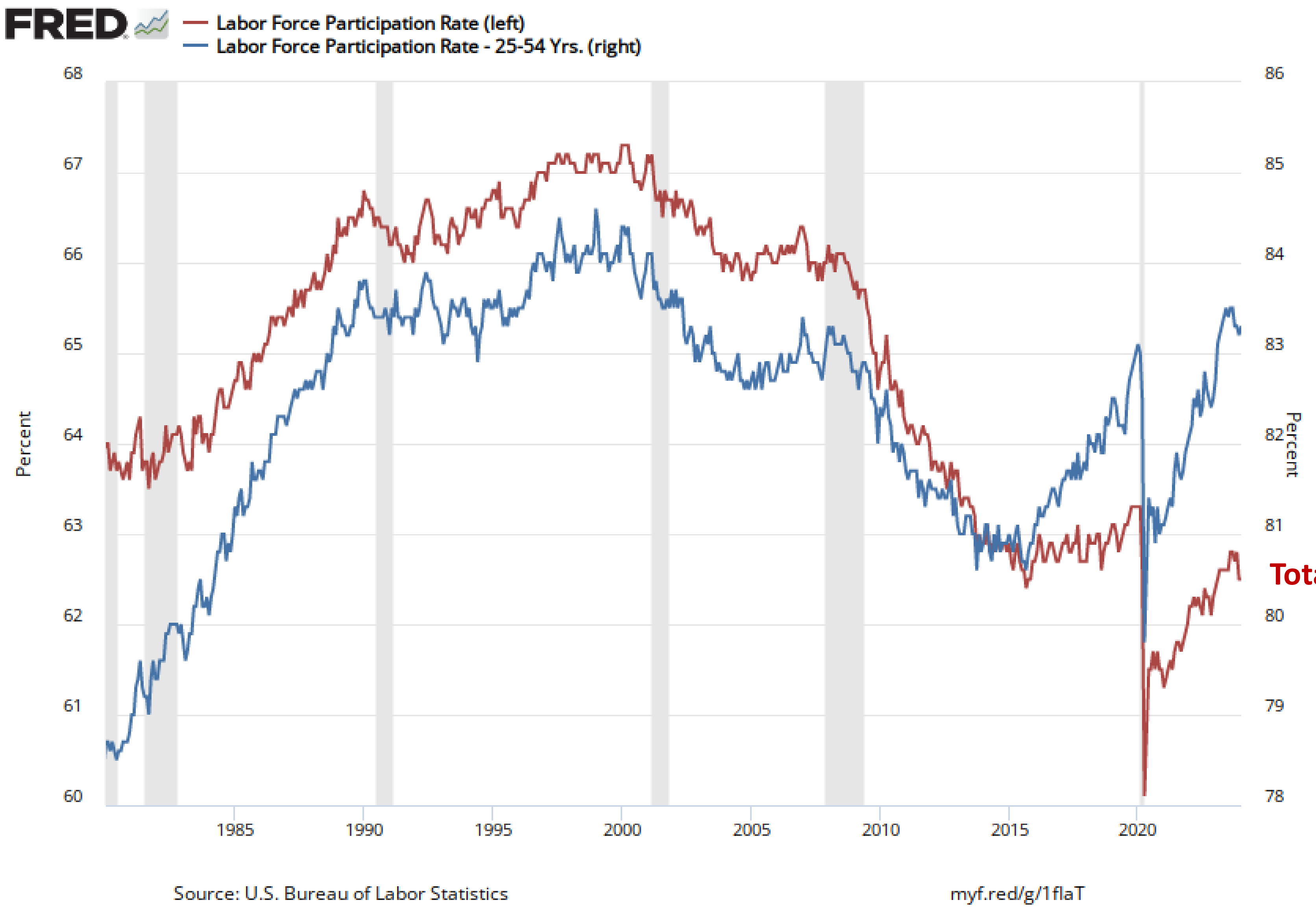
Financial markets now expect policy rate to remain unchanged at next meeting



Note: Dashed lines are expected path based Fed Funds Futures contracts.

Medium-term Outlook

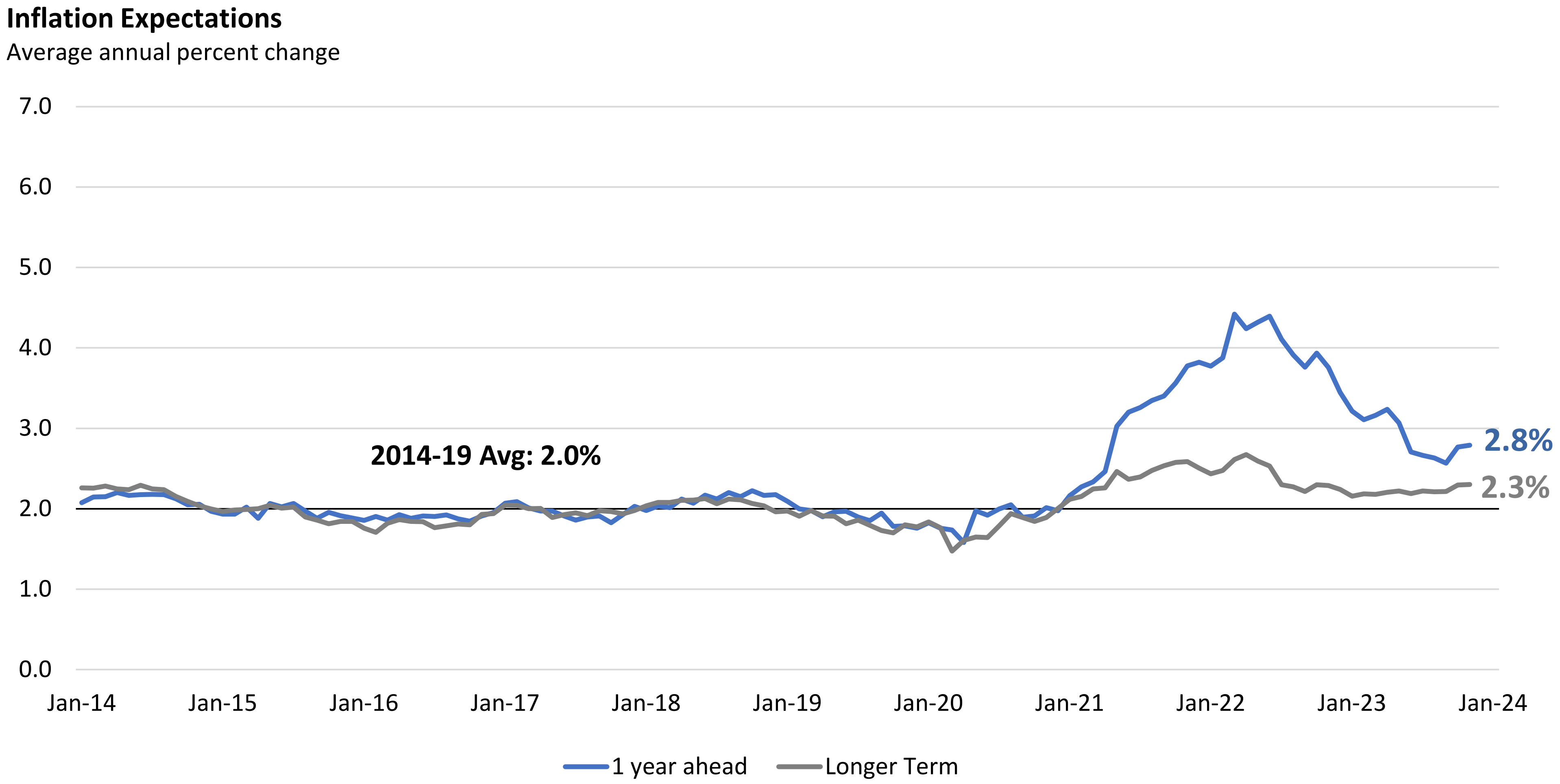
Constrained by aging population, labor market expected to remain tight



Prime-Age: 83%

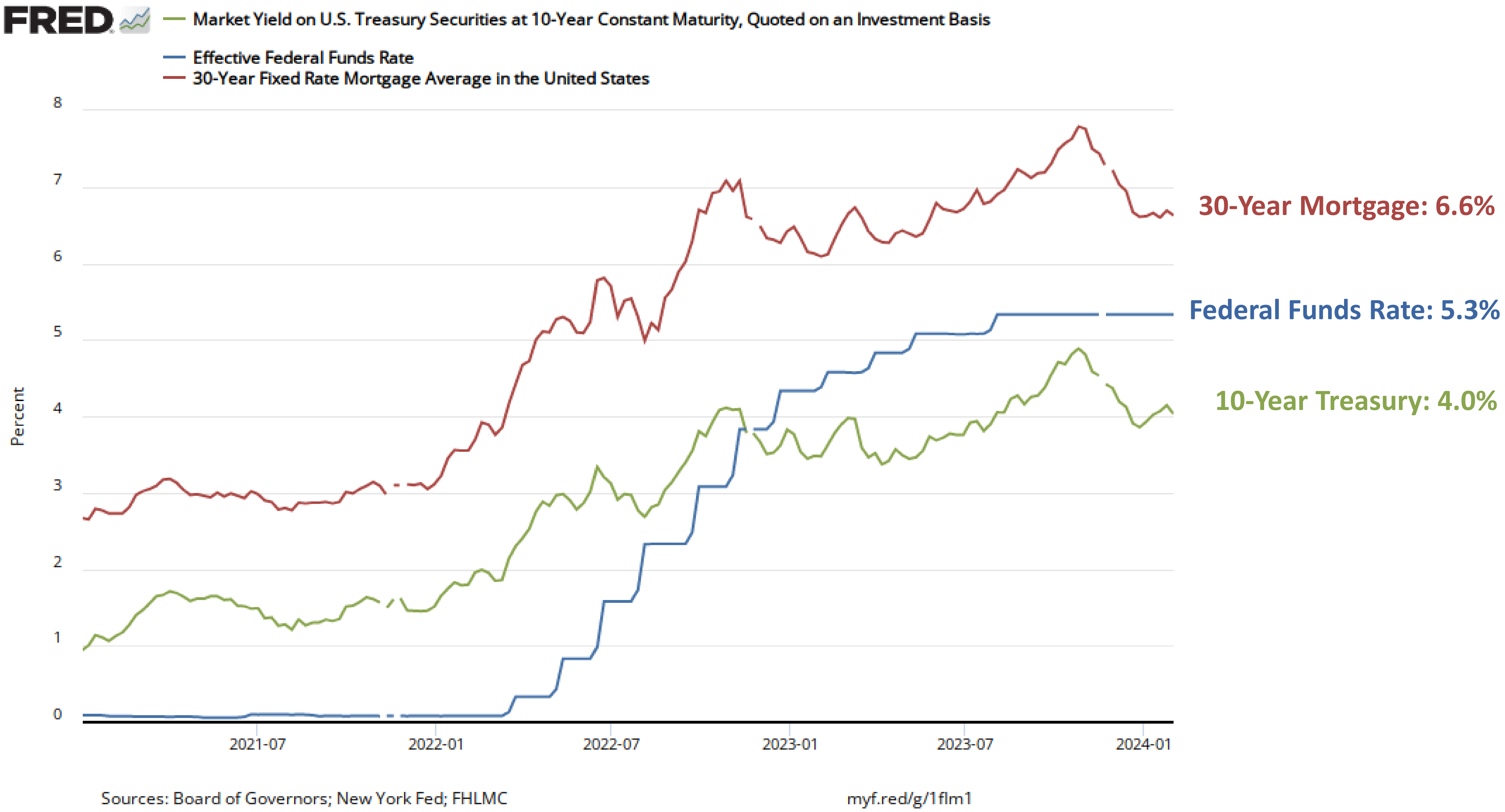
Total: 63%

Inflation expectations returning to pre-pandemic levels

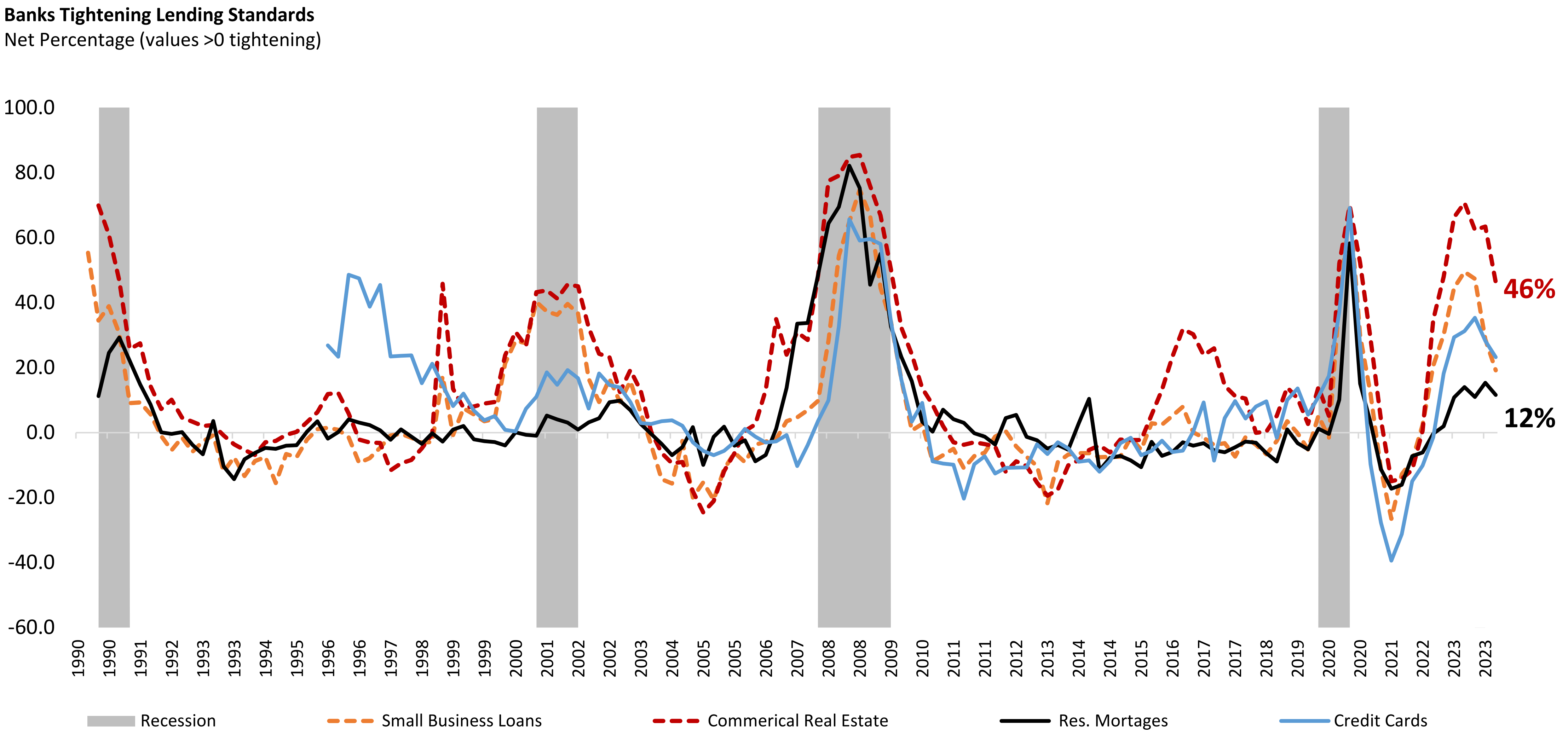


Source: Values are authors calculations based on surveys conducted by FRB NY, FRB ATL, Blue Chip Professional Forecasters, University of Michigan, and expected inflation based on US TIPS

Higher interest rates raise the cost of borrowing, incentives to save

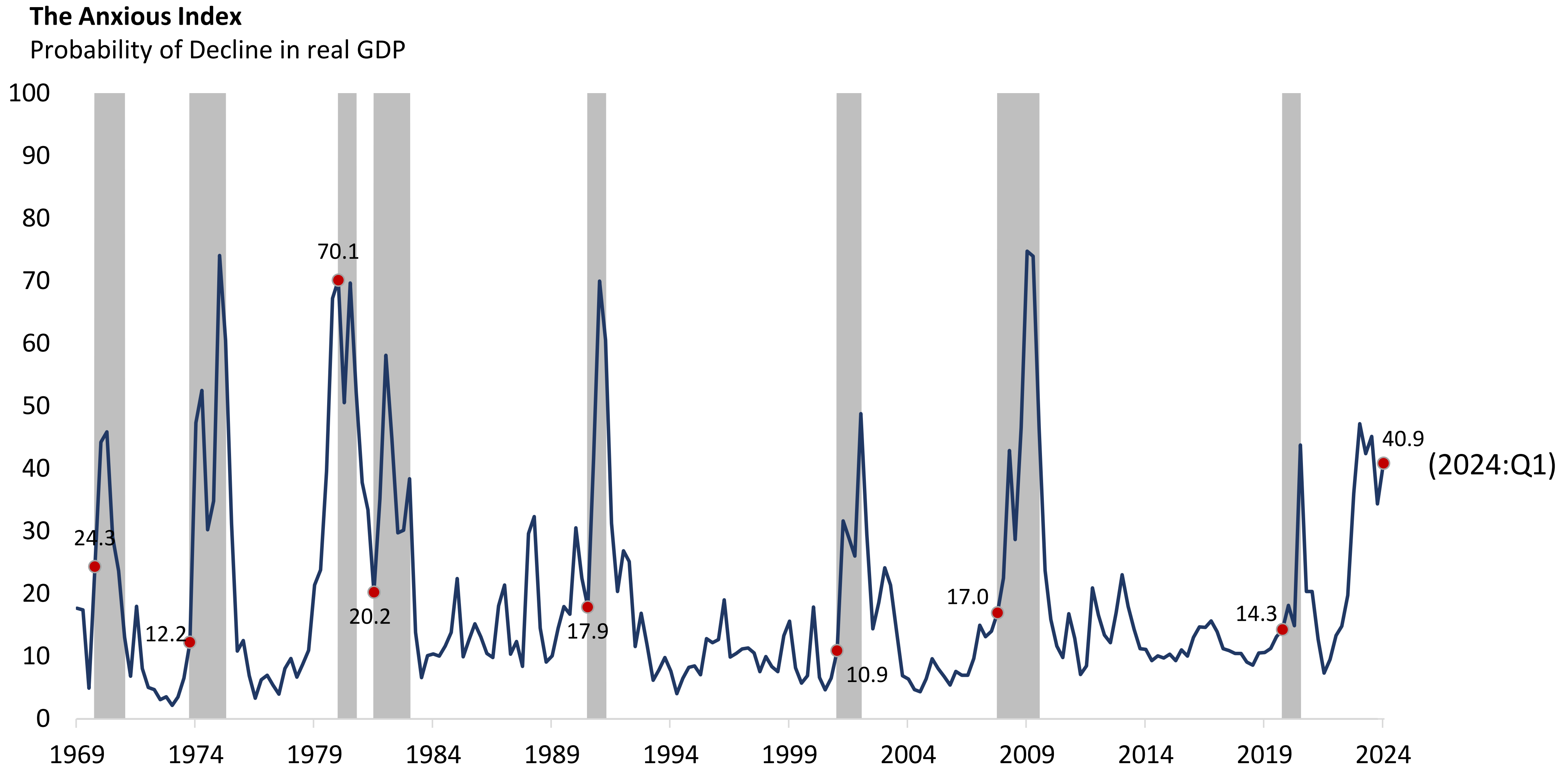


Fewer banks report tightening lending standards



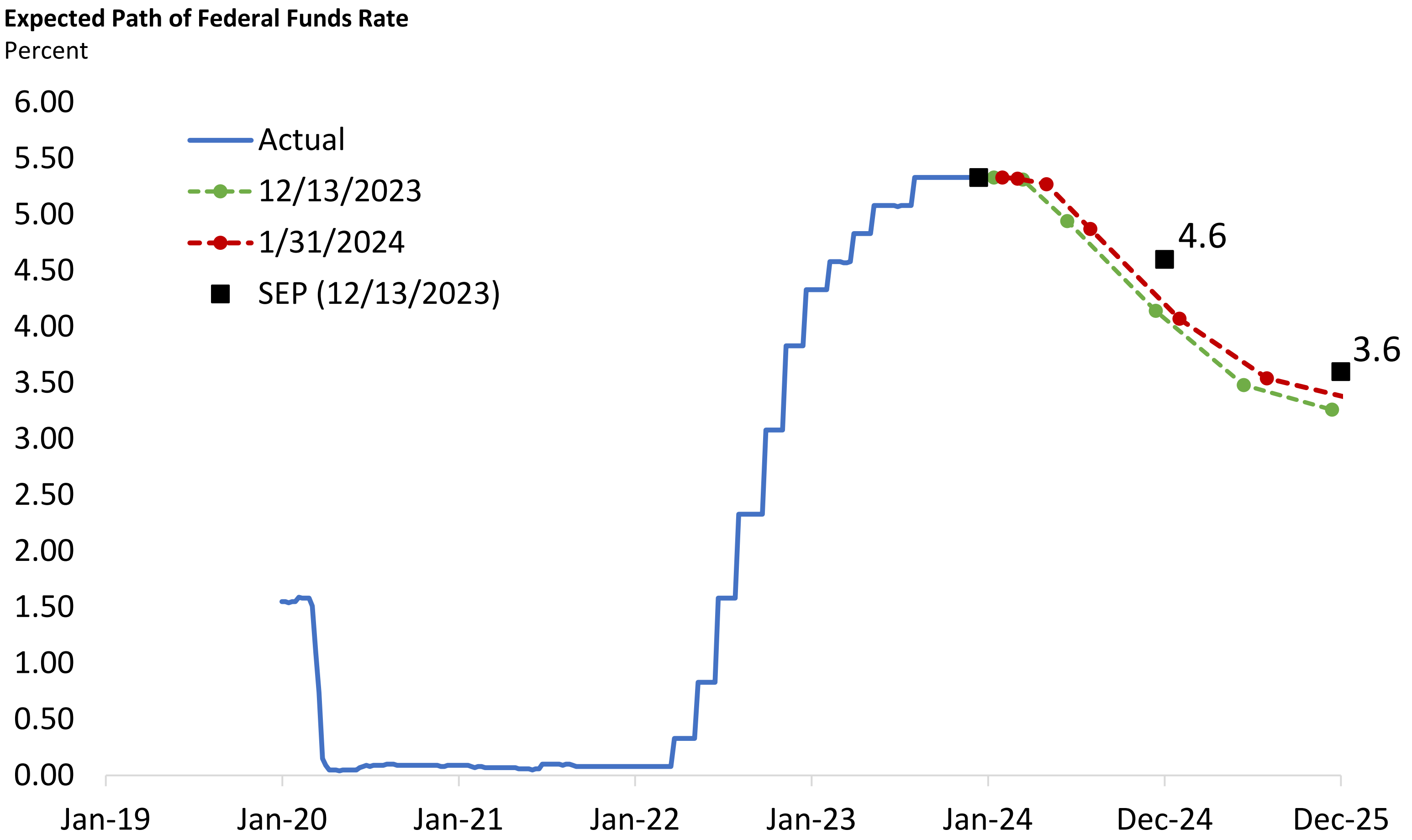
Note: Shaded areas indicate NBER recessions
Source: Federal Reserve Senior Loan Officer Opinion Survey (link to data)

If recession occurs, it will be the one of the most anticipated in history



Note: Shaded areas indicate NBER recessions
Source: Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters (link to data)

Markets expectations are shifting closer to FOMC December projections



Note: Black squares are median of FOMC members path of the appropriate Fed Funds Rate. Dashed lines are expected path based Fed Funds Futures contracts.

FOMC Summary of Economic Projections for end of 2024

	Real GDP Growth	PCE Inflation Rate	Unemployment Rate	Fed Funds Rate
Median	**1.4**	**2.4**	**4.1**	**4.6**
Top	2.5	2.7	4.5	5.4
Bottom	0.8	2.1	3.9	3.9

Note: Projections are under the assumption of appropriate monetary policy. Real GDP, PCE Inflation are Q4/Q4 Growth, Unemployment and Fed Funds are Q4 Averages
Source: Federal Open Market Committee (FOMC) Summary of Economic Projections Dec 2023. See Macro Snapshot for Data

Key Takeaways

- Data indicate the economy continued to expand in 2023 with inflation slowing.
- Economic growth expected to healthy during first quarter and return to trend in 2024
- Labor market moving better into balance, unclear the extent labor supply can continue increase given demographics
- Inflation pressures expect to moderate, with slower housing inflation an important driver
- Reasons for pessimism:
  - Inflation remains elevated and persistent in areas like services
  - Tightening credit conditions reign in household and business investment
  - Weakness in manufacturing and construction typically signal of recession
- Reasons for optimism:
  - Housing market appears to have bottomed out and showing signs of improvement
  - Labor constraints are easing on higher participation rates and recovering immigration rates
  - Low unemployment and healthy real wage growth will sustain consumer spending

Inflation has eased from its highs, and this has come without a significant increase in unemployment. That’s very good news. But inflation is still too high, ongoing progress in bringing it down is not assured, and the path forward is uncertain. As we look ahead to next year, I want to assure the American people that we’re fully committed to returning inflation to our 2 percent goal. Restoring price stability is essential to achieve a sustained period of strong labor market conditions that benefit all.

-Federal Reserve Chair Powell, December 13,2023