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

<table>
<thead>
<tr>
<th>Year</th>
<th>Real GDP Growth</th>
<th>PCE Inflation Rate</th>
<th>Unemployment Rate</th>
<th>10yr Treasury Yield</th>
<th>Federal Funds Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2023</td>
<td>3.1</td>
<td>2.6</td>
<td>3.7</td>
<td>3.9</td>
<td>5.3</td>
</tr>
<tr>
<td>2022</td>
<td>0.7</td>
<td>5.4</td>
<td>3.5</td>
<td>3.9</td>
<td>4.1</td>
</tr>
<tr>
<td>2021</td>
<td>5.4</td>
<td>6.2</td>
<td>3.9</td>
<td>1.5</td>
<td>0.1</td>
</tr>
<tr>
<td>2011-2019 (Avg.)</td>
<td>2.4</td>
<td>1.5</td>
<td>5.6</td>
<td>2.3</td>
<td>0.7</td>
</tr>
</tbody>
</table>

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

Source: U.S. Bureau of Labor Statistics

myf.red/g/1fHXs
Labor market remains tight, but supply and demand coming into balance

2.7 million gap
Wage growth has slowed but is outpacing inflation

Wages: +4.5%
Inflation: +2.6%
Green shoots of recovering economy hidden by supply-chain disruptions

Real GDP Growth

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2021</td>
<td>11.9</td>
</tr>
<tr>
<td>Q3 2021</td>
<td>1.9</td>
</tr>
<tr>
<td>Q1 2022</td>
<td>3.6</td>
</tr>
<tr>
<td>Q2 2022</td>
<td>1.5</td>
</tr>
<tr>
<td>Q3 2022</td>
<td>0.3</td>
</tr>
<tr>
<td>Q1 2023</td>
<td>3.6</td>
</tr>
<tr>
<td>Q2 2023</td>
<td>1.7</td>
</tr>
<tr>
<td>Q3 2023</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Final Sales to Domestic Producers

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2021</td>
<td>1.5</td>
</tr>
<tr>
<td>Q3 2021</td>
<td>1.5</td>
</tr>
<tr>
<td>Q1 2022</td>
<td>0.3</td>
</tr>
<tr>
<td>Q2 2022</td>
<td>-0.2</td>
</tr>
<tr>
<td>Q3 2022</td>
<td>3.6</td>
</tr>
<tr>
<td>Q1 2023</td>
<td>1.7</td>
</tr>
<tr>
<td>Q2 2023</td>
<td>3.0</td>
</tr>
<tr>
<td>Q3 2023</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Change in Inventories

Net Exports

Source: U.S. Bureau of Economic Analysis

myf.red/g/1f00
Households accumulated significant savings during pandemic

Area represents $2.3 trillion in excess savings

About $900 billion remains

Source: U.S. Bureau of Economic Analysis
myf.red/g/1f3H
Spending growth healthy, with pivot back to services

Real Personal Consumption Expenditures

Durable Goods: +32%
Nondurable Goods: +15%
Total: +10%
Services: +6%

Source: U.S. Bureau of Economic Analysis
myf.red/g/1f145
Strong growth in government consumption and investment

Source: U.S. Bureau of Economic Analysis

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Manufacturing production slows as firms report slow growth in orders
Supply chains are returning to “normal” operations

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

Headline inflation: +2.6%

Ex. Food and Energy: +2.9%
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

House price growth and housing service inflation

- 4.8% House price growth
- 6.2% Housing Inflation
Near-term outlook
Financial market stress at below average levels

Source: Federal Reserve Bank of St. Louis

myf.red/g/1flaK
Forecasts expect slower growth in Q1 and further deceleration in Q2

Reported GDP Growth & Bluechip Consensus
Percentage

Q4-21 Q1-22 Q2-22 Q3-22 Q4-22 Q1-23 Q2-23 Q3-23 Q4-23 Aug-23 Sep-23 Oct-23 Nov-23 Dec-23 Jan-24
Real Reported
BCC: Q1-24
BCC: Q2-24
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

Inflation Expectations
Average annual percent change

2014-19 Avg: 2.0%

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.

Federal Funds Rate: 5.3%
10-Year Treasury: 4.0%
30-Year Mortgage: 6.6%

Sources: Board of Governors; New York Fed; FHLMC
myf.red/g/1fm1
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

The Anxious Index
Probability of Decline in real GDP

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

Expected Path of Federal Funds Rate
Percent

- Actual
- 12/13/2023
- 1/31/2024
- SEP (12/13/2023)

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

<table>
<thead>
<tr>
<th></th>
<th>Real GDP Growth</th>
<th>PCE Inflation Rate</th>
<th>Unemployment Rate</th>
<th>Fed Funds Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>1.4</td>
<td>2.4</td>
<td>4.1</td>
<td>4.6</td>
</tr>
<tr>
<td>Top</td>
<td>2.5</td>
<td>2.7</td>
<td>4.5</td>
<td>5.4</td>
</tr>
<tr>
<td>Bottom</td>
<td>0.8</td>
<td>2.1</td>
<td>3.9</td>
<td>3.9</td>
</tr>
</tbody>
</table>

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](https://www.federalreserve.gov)
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