Surprising State of the U.S. Economy: Growth, Inflation, Interest rate and Soft Landing

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- It has been two years since forecasters felt this good about the economic outlook.
- Business and academic economists lowered the chances of a recession within the next year to 29%, the lowest probability since April 2022, when the chances of a recession were set at 28%.
- Economists, in fact, don’t think the economy will get even close to a recession.
- The U.S. economy has far outperformed expectations over the past year and a half.
- Much has changed since economists were last this optimistic.
- Two years ago, the Fed’s benchmark federal-funds rate was set between 0.25% and 0.5%.

- Inflation was high, few economists thought it could come down without help from the Fed.
- That help in terms of raising interest rates were widely believed to cause a recession.
- Instead of stumbling under the weight of the Federal Reserve’s most aggressive interest-rate-raising campaign in four decades, the U.S. economy continued expanding at a robust clip.
- In 2023, the fed-funds rate sat between 5.25% and 5.5% and the economy grew at 3.1% clip.
- In a nutshell, the economy defied economic theory and economic history.

First, Forecast in Short

- **GDP growth** - Real GDP rose 3.1% in 2023. Growth continues at 2.5% in 2024 and 1.4% 2025.
- **Consumer spending** - Consumption dropped from 2.5% in 2022 to 2.2% in 2023. Growth continues at 2.4% in 2024 and 2.1% in 2025.
- **Business fixed investment-** Increases 4.2% in 2023, 1.4% in 2024, and 1.3% in 2025.
- **Housing** - Housing starts fell from 1.55 million in 2022 to 1.42 million in 2023, falls to 1.39 million in 2024, and ticks up to 1.30 million in 2025.
- **Monetary policy** - We expect the federal funds rate to reach its peak at 5.33% by mid 2024.
- **Productivity growth** - Moved up from -1.9% in 2022 to 1.3% in 2023 and will rise to 1.9% 2024 and to 1.5% in 2025.
- **Oil prices** (Dollars/ barrel) - Average price of Brent crude oil fell from $101/barrel in 2022 to $83 in 2023, rises to $84 in 2024 and falls to $76 in 2025.
- **Stock markets** -The year-end value of the S&P 500 fell 19.4% in 2022. The index grew 24.6% over 2023 and slows to 7.5% in 2024 and 2.0% in 2025.
- **Inflation (PCE)** - Core personal consumption (PCE) price inflation fell from 5.2% in 2022 to 4.1% in 2023, will moderate to 2.8% in 2024, and 2.2% in 2025.

- **The Moral of the Story:**
- ***US GDP growth to slow during 2024***
- We achieved most of the 2023 growth through productivity gains at rates that we do not believe can be sustained. The GDP growth slows sequentially through 2024.
- In broad terms, this slowing is in response to monetary tightening, increasingly stingy bank lending standards for both consumers and businesses, and a projected flat profile for equity values, among other factors.
- ***What about inflation?***
- Surprisingly, as the US economy expanded rapidly last year, core inflation eased.
- Indeed, over the second half of 2023, core inflation was running at the Federal Reserve's 2% target, even as the unemployment rate remained well below the "natural rate."
- Was this set of circumstances too good to be true?
- Perhaps.
- In January, the core PCE price index accelerated sharply, and the estimate for the core inflation has begun to trend upward. This raised the forecast of first-quarter core PCE inflation to roughly 3.5% (quarter-over-quarter).
- This served as a reminder that, when it comes to inflation, we are not out of the woods yet.

- **Unemployment rate to rise, inflation to ease:**
- The slowdown in GDP growth that we expect will be just sufficient to nudge the unemployment rate on an upward track.
- By mid-2026, the unemployment rate is forecasted to reach a peak of 4.5%.
- This should lower core PCE inflation to 2.0% by 2027.
- **Labor markets:**
- Nonfarm payroll employment rose 325,000 in March, considerably above expectations.
- While the labor market remains broadly healthy, there have been some modest signs of loosening.
- Jobs Openings and Labor Turnover Survey showed that quits fell by 54,000 to 3.39 million.
- We anticipate that the labor market to continue to cool.

- **Inflation:**
- Inflation has remained a major concern for consumers at every level. For the poor and the rich.
- The price of food and household staples continues to weigh heavier on consumers' minds than other economic concerns.
- Grocery prices were up 1% in March from a year earlier. They were up 10.2% in February 2023 versus a year earlier and were up 1.2% in February 2019 from a year earlier.
- Prices for hundreds of grocery items have increased more than 50% since 2019 as food companies raised their prices.
- Businesses say that higher prices are needed to offset their own rising costs for ingredients, transportation and labor.
- Many have criticized food companies for using tactics such as shrinkflation, in which companies shrink their products—but not their prices.
- The Wall Street Journal analyzed NielsenIQ data, reflecting a selection of commonly purchased items that were valued at $100 in 2019.
- Today, that same grocery list costs 36.5% more.
  - The price of some items, such as eggs and sport drinks, climbed more than 40%.
  - Price of cooking oil +54% since 2019
  - Beef +51%
  - Mayonnaise +50%
  - Applesauce +51%

- **Is the Elusive Soft Landing Coming into View?**
- The strong economic rebound following the pandemic pushed inflation to four-decade highs of 9.1% in 2022.
- In response, the Federal Reserve raised interest rates to a range between 5.25% and 5.5%, the highest level in 22 years.
- The idea was to slow down the GDP and inflation rate.
- In the past 80 years, the Federal Reserve has never managed to bring inflation down substantially without sparking a recession.
- A year ago, the consensus among economists surveyed by The Wall Street Journal was that the economy would enter a recession over the next 12 months. In recent surveys, the average forecast of economists is calling for no recession.
- We expect the economy to weaken a little, but it looks like it might avoid an outright contraction in gross domestic product.

- **Inflation within spitting distance of 2%. Is Being Close Good Enough?**
- Recent reports showed inflation had come down to 3.2% - 3.5% range.
- More encouraging, core inflation, which excludes food and energy, ran at a 3% annual rate, within a spitting distance of 2% and well below the 5.1% annual pace in the first five months of the year.
- The big drop happened while employers continued to add a lot of jobs and with no obvious sign showing economic growth was petering out.
- Still, a soft landing isn't guaranteed.
- Inflation hasn't made it all the way to 2%. The economy may yet crumple under the delayed impact of higher interest rates.
- Outside forces like energy prices or a financial crisis could intervene.

- **What Happened? How did we get to the soft landing?**
- In late 2023, the supply chain rebound finally showed up.
- Bottlenecks eased.
- Rising immigration and workforce participation boosted the labor force, and a pandemic-era boom in newly built apartments hit the market.
- Those tamped down goods prices, rents and wages.
- Having more workers enter the labor force was a relief valve that allowed “wage growth to slow without having a big correction in demand”.

- **Will supply and productivity gains last?**
- No. Our streak of luck will end.
- At some point and sooner than later, the economy will slow down.
- **Labor Market?**
- Stein's law, named after the late economist Herbert Stein says: "If something cannot go on forever, it will stop."
- Job growth slowed sharply in the second half of 2023, a sign the U.S. economy was cooling after a torrid summer.
- Since the beginning of 2024, however, employers have been adding close to 300,000 jobs every month.
- The unemployment rate remains around to 3.7%, which is alarmingly low.
- This trend can not keep up.

- **FED Rate Cut**?
- Inflation cooled at the end of 2023 faster than most economists inside or outside the central bank had expected, particularly given unexpectedly brisk hiring and growth.
- Those broad-based inflation declines offered reasons to think maybe, contrary to the conventional wisdom, the proverbial last mile of the inflation battle wouldn’t be difficult.
- Meaning, after inflation declined from 7% in June 2022 to 3% in 2023, it is possible that inflation might gently fall back to the Fed’s 2% goal without causing the “pain” in the labor market that we were once warned about.
- There are two distinct possibilities.
- One is that inflation continues to move lower but in an uneven and “bumpy” fashion and with bigger bumps.
- A second possibility is that inflation, rather than on a “bumpy” path to 2%, it is getting stuck at a level closer to 3%.
- With the second scenario, without evidence that the economy is slowing more notably, the case for cuts that could scrap altogether.

- **Why Reaching the Soft Landing and Interest Rates Cuts Are Important**?
- The market has been priced for a soft landing, and if we get either a second wave of inflation or an increase in unemployment that feeds on itself and produces a recession, the market is going to sell off really, really significantly.

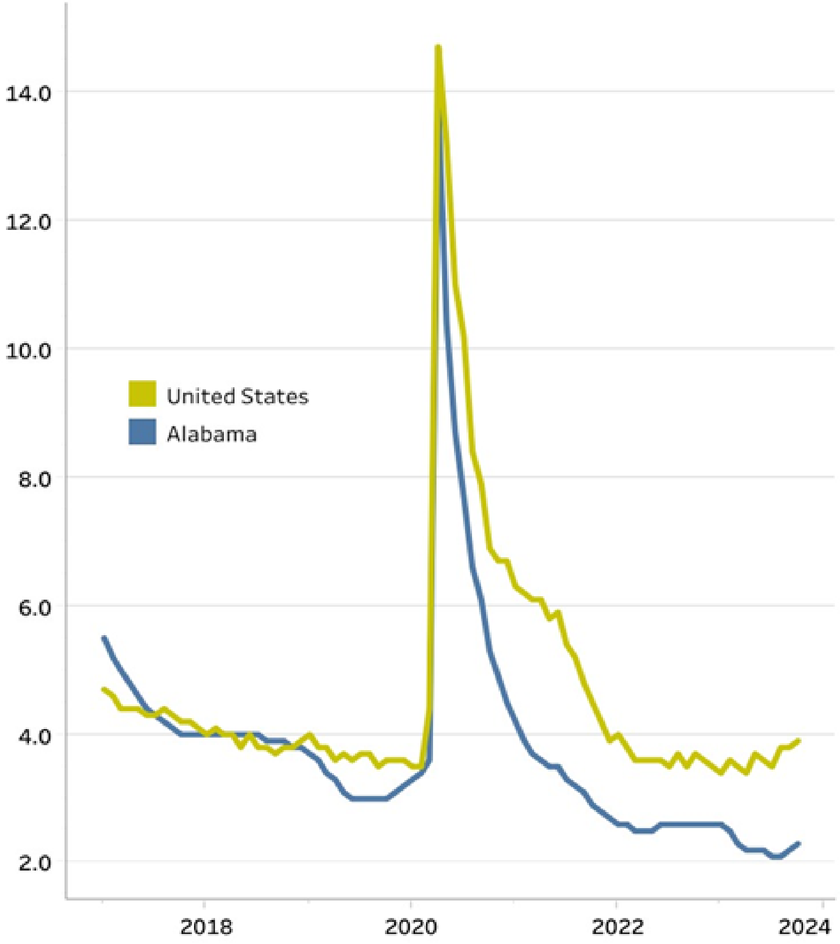
The Alabama Economy

- It appears that the labor market continued its growth in 2022 and 2023.
- Based on the recent reports released by the Alabama Department of Labor, Alabama’s unemployment rate in 2023 stood at 2.3%, which is more than one full percentage point below that of the U.S.

2019: +41,430
2020: -81,790
2021: +31,900
2022: +51,000
2023: +25,000

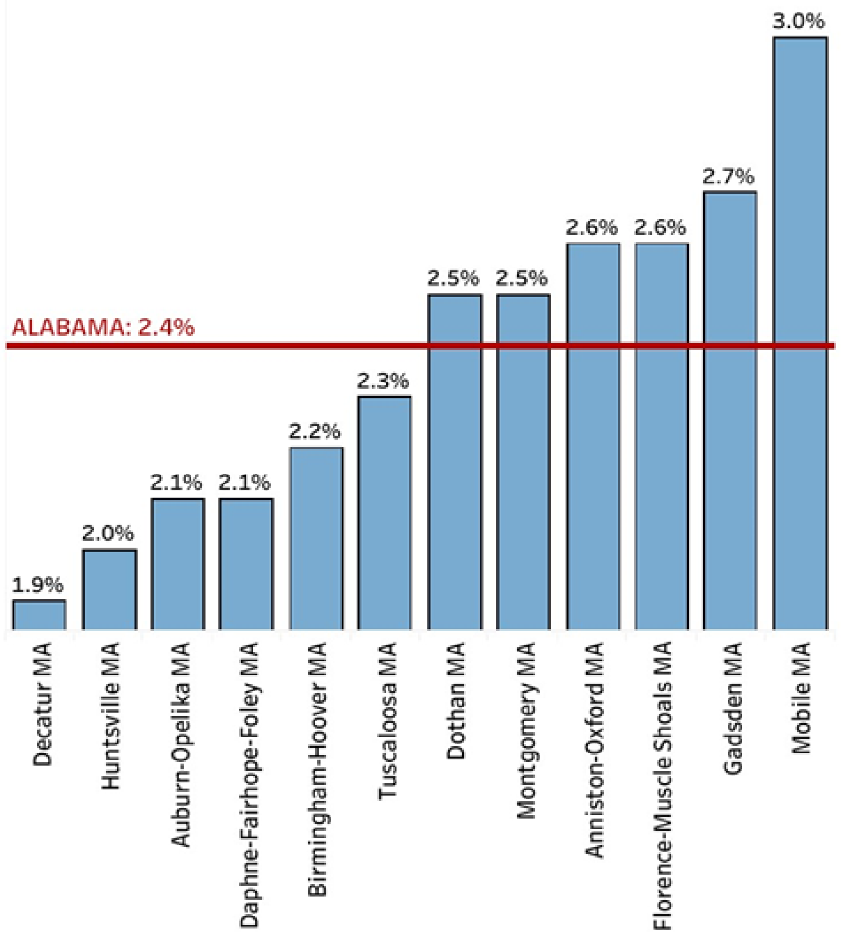
United States and Alabama

2017-2023 (Seasonally Adjusted)



Metropolitan Unemployment Rates

October 2023 (not seasonally adjusted)

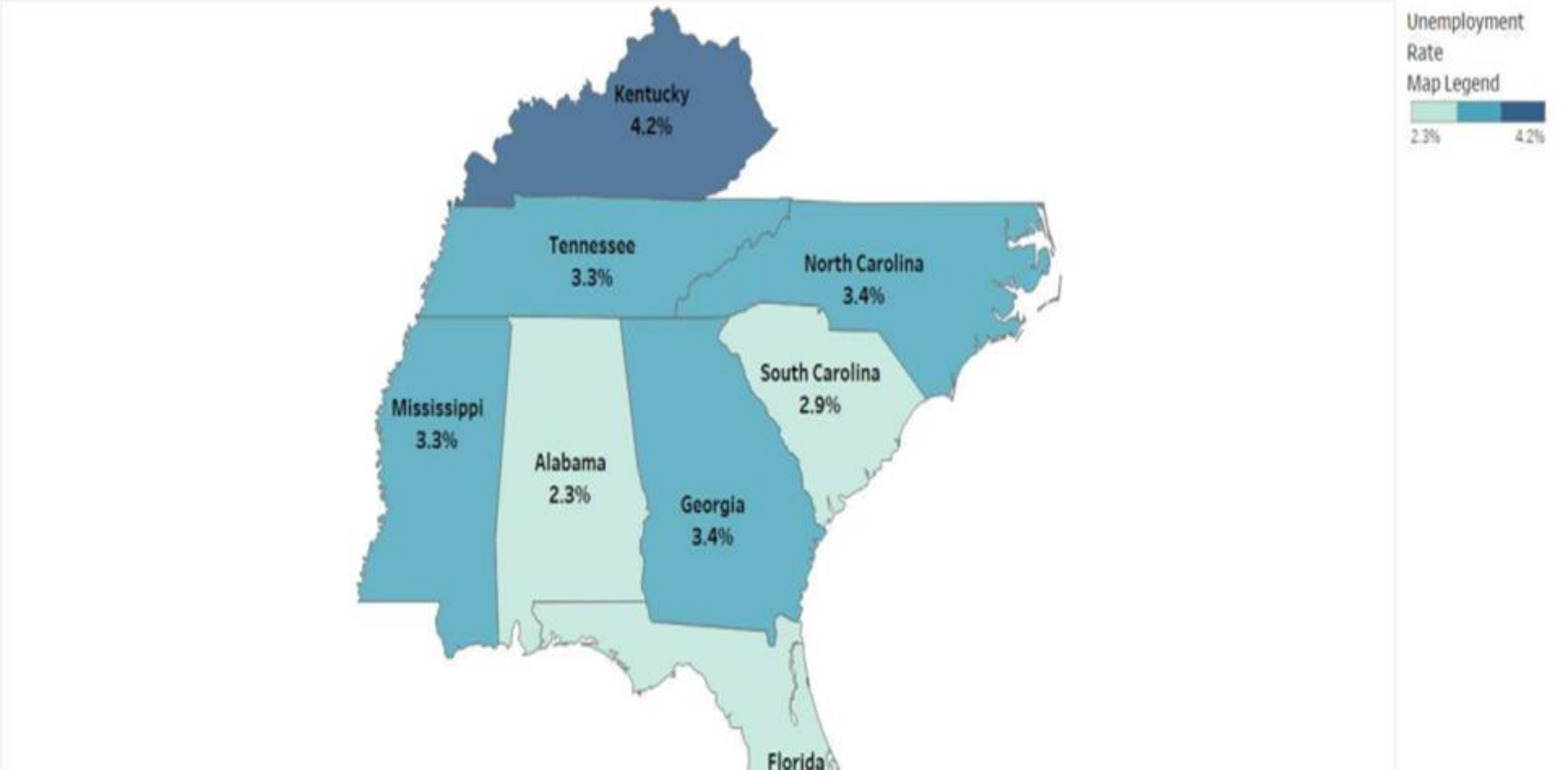


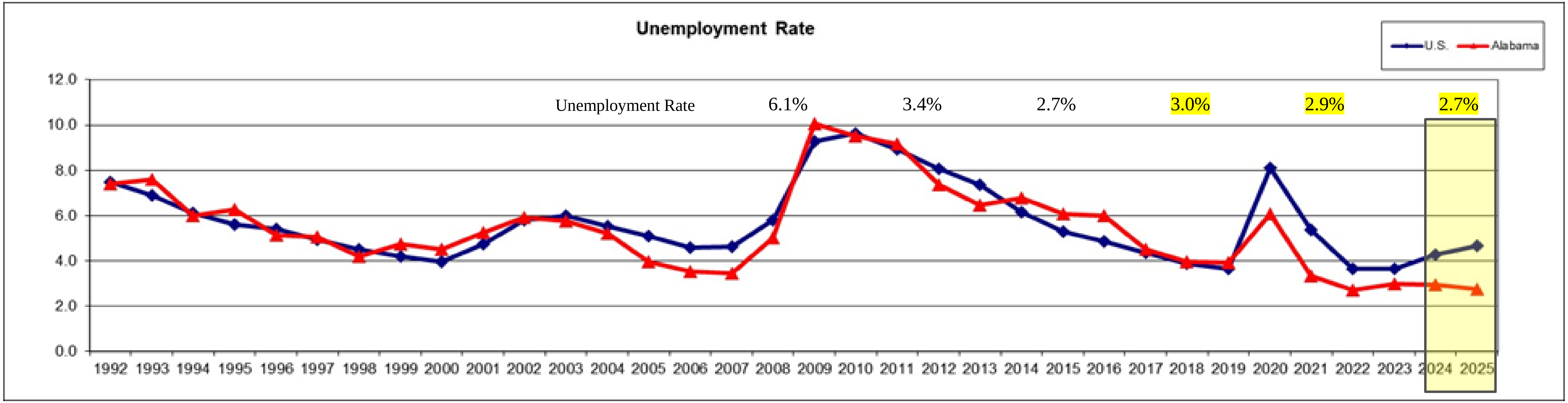
View More Unemployment Statistics

October 2023 Preliminary

Southeastern United States, Seasonally Adj, Unemployment Rates (%)

Prepared by the Alabama Department of Labor, Labor Market Information Division





Unemployment Rate	6.1%	3.4%	2.7%	3.0%	2.9%	2.7%

	2018	2019	2020	2021	2022	2023

Questions?

Economic Update

Thursday, May 2nd (11:00am-12:00pm)

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