

QUEST Economic Update | October 2023

The US economy begins the fall with strong growth and elevated inflation



One year ago, the economic outlook was filled with pessimism from high inflation, interest rate hikes and recession risks. Now, the near-term economic outlook is optimistic. Forecasts of economic growth remain strong, and the labor market is characterized by a low unemployment rate and robust monthly job gains. Inflation, however, remains more persistent than previously thought. Strong consumer spending continues to help support the economy. The likelihood of recession within the next year continues to decline.

The economy experienced robust GDP growth of 2.2% and 2.1% in the first and second quarter, respectively. This strong economic growth and recent data pushed the GDPNow to forecast rapid growth of 5.4% in the third quarter. The labor market also remains tight with an unemployment rate of 3.8% in September 2023 and US consumer expenditures increased in every month this year except for March. With many recent economic data releases exceeding expectations, economists have been raising their near-term forecasts of economic growth.

Nevertheless, inflation remains persistently elevated. The Consumer Price Index reached 3% (year-over-year) in June but was 3.7% in both August and September. The resumption of federal student loan payments may create some headwinds for consumers. In addition, the rise in market interest rates may also likely dampen economic growth.

Ernst & Young LLP's Quantitative Economics and Statistics (QUEST) group's Economic Update summarizes the latest US economic trends and significant global developments.

Current as of 10/20/2023

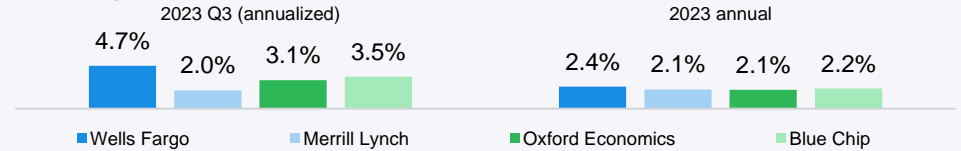
OVERALL US ECONOMY

The economic picture appears to have improved with the Blue Chip Economic Indicators lifting its October consensus for GDP growth to 2.2% for 2023 and 1.1% for 2024. While many forecasts see economic growth slowing in 2024, the consensus is for a soft landing, rather than an economic contraction.

Roughly 2.0% to 4.7% growth
expected for 2023 Q3 (annualized)

Roughly 2.1% to 2.4% growth
expected for 2023

US GDP growth forecast



LABOR MARKETS

Labor markets remain tight. The September unemployment rate was 3.8%, the same rate as August, and still at historically low levels. Job gains have slowed, but unemployment claims remain below pre-pandemic levels.

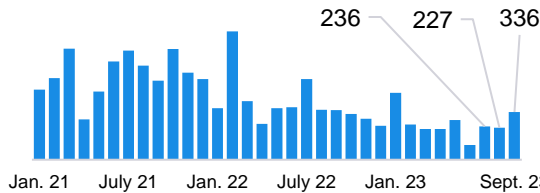
606k job gain
on average in 2021

399k job gain
on average in 2022

260k job gain
on average in the first three quarters of 2023

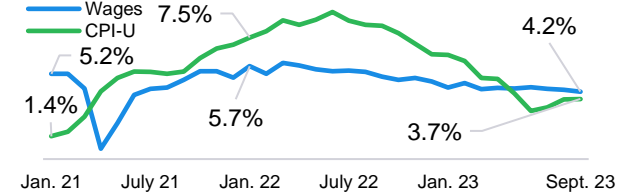
Nonfarm payroll employment

Month-over-month change (in thousands), seasonally adjusted



Hourly wages and CPI-U

Change from a year earlier, CPI - not seasonally adjusted, Wages - seasonally adjusted

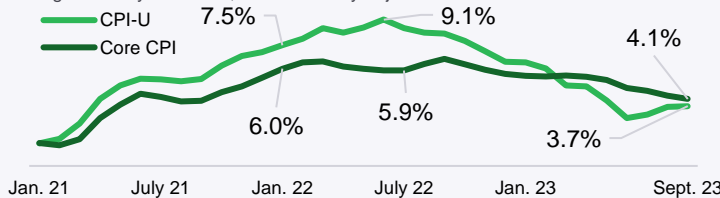


INFLATION / INTEREST RATES

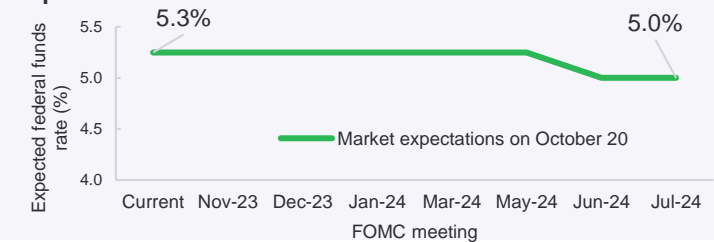
Overall inflation as measured by the CPI has increased for the past three consecutive months rising by 3.7% in September, 3.7% in August and 3.2% in July. The strong economy and renewal of inflationary pressures caused the Federal Reserve to indicate at its September 19-20 meeting that it could raise rates one additional time this year. Recent comments from Federal Reserve Chairman Jay Powell suggest it may hold.

CPI-U and core CPI

Change from a year earlier, not seasonally adjusted



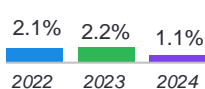
Expected federal funds rate over 2023 and 2024



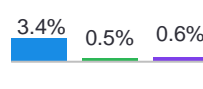
GLOBAL GROWTH

Forecasts, while generally still suggesting slowing global economic growth in 2023, have improved over the past few months. China's economy is facing renewed challenges seen by slowing growth and high debt in its real estate sector.

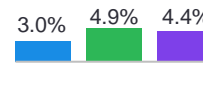
United States



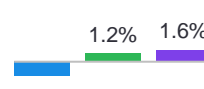
Euro Area



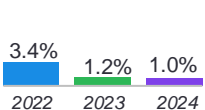
China



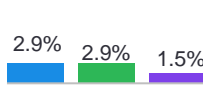
Russia



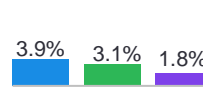
Canada



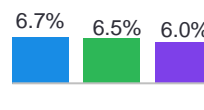
Brazil



Mexico



India



Upcoming economic data releases

- ▶ GDP for the Q3 of 2023 (advance estimate), October 27
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, October 31 – November 1
- ▶ Job openings for September, November 1
- ▶ Productivity for Q3, November 2
- ▶ Employment situation for October, November 3
- ▶ Consumer Price Index for October, November 14
- ▶ Housing starts for September, November 17

Overall US economy

The US economy was on solid footing during the first half of 2023 and economic growth may have accelerated during the third quarter. The Federal Reserve Bank of Atlanta's GDPNow forecast projects real annualized GDP growth of 5.4% for the third quarter (as of October 18). GDP grew at 2.2% during the first quarter and 2.1% during the second quarter. Other signs of resilience include a historically low unemployment rate, low weekly unemployment claims and the fifth straight month of higher retail sales.

The strength of the US economy appears to be driving an uptick, and possibly resurgence, of inflation. The CPI rose to 3.7% (year-over-year) in August and September from a low of 3.0% in June. While the Federal Reserve's dot plot suggested one additional 25-basis point rate increase in 2023, recent comments from Federal

Reserve Chairman Jay Powell indicated a pause for the rest of 2023. The updated economic projections are consistent with the "higher for longer" view that has been emerging in response to the strong US economy and uptick in some of the inflation numbers over the past several months.

There are, however, some signs of economic softness. The Conference Board's Consumer Confidence Index fell again in September to 103.0 from 108.7 in August. In addition, the Conference Board's Leading Economic Index has fallen in every month since April 2022. While economic growth is expected to slow in the coming quarters, the consensus forecast is for a soft landing.

Labor market

US labor markets remain tight. The September unemployment rate remains at 3.8%, the same as August, and is still close to historic lows and well below the roughly 4.5% rate at which many economists view the economy's resources as being fully employed.

The economy added 336,000 jobs in September, up from the 227,000 jobs added in August. Job gains averaged 260,000 over the first three quarters of 2023 and 399,000 during 2022. Weekly UI claims remain below pre-pandemic levels. Job openings rose slightly in September but have generally been falling since their high in early 2022.

The labor force participation rate remained unchanged at 62.8% in September. The September underemployment rate, which averaged 8.7% from 2015 through 2019, fell to 7.0% from 7.1% in August. Average hourly earnings were up in September by 4.2% from a year ago, a pace above the rise in consumer prices, signifying an increase in real wages but possibly raising concerns about future inflation. Despite the current tightness of the labor markets, many forecasters see the unemployment rate rising to the 4.3% to 5.0% range over the next year. Many economic forecasts suggest that the Federal Reserve's higher interest rates will begin to take hold and slow the economy in late 2023 and early 2024.

Inflation

Inflationary pressures appear to be resurfacing with some measures increasing or signaling a continuation of elevated levels that could remain persistently higher than the Federal Reserve's 2% target. Higher inflation for longer may prompt additional rate hikes by the Federal Reserve.

The overall CPI rose by 3.7% (year-over-year) in September, the same as in August, but above the 3.2% increase in July. The monthly September CPI rose 0.4%, following its 0.6% increase in August and 0.2% increase in July. The core CPI rose by 4.1% (year-over-year) in September, as compared to a 4.3% increase in August. The monthly core CPI rose by 0.3% in September, as compared to 0.3% in August. Shelter prices were the largest contributor to the monthly increase. Shelter prices have risen for 41 consecutive months. The Federal Reserve Bank of Cleveland's

inflation nowcast forecasts the October CPI to increase by 3.4%.

The personal consumption expenditure (PCE) price index, the preferred inflation measure of the Federal Reserve, increased by 0.4% in August, higher than the 0.2% increase in July, and by 3.5% over the past 12 months, up from the 3.4% increase reported in July. The core-PCE price index increased by 0.1% in August, lower than the 0.2% increase in July, and by 3.9% over the past 12 months, below the 4.3% increase reported in July. The strength of the US economy and resurfacing of inflationary pressures had the Federal Open Markets Committee (FOMC) indicate one additional rate hike this year in its dot-plot release following its September 19-20 meeting. Market expectations are for rates to remain constant through mid-2024 and then begin to decline.

Global growth

The global economy is expected to slow during the rest of 2023, with growth in the 1.5% to 2.5% range. Economic growth is expected to slow in the United States, the United Kingdom and the Eurozone. That said, recent forecasts are somewhat more optimistic than a few months ago, although recession-like risks remain in the United States, United Kingdom and Eurozone.

Although China showed significant strength coming out of its COVID lockdowns, its economy now appears to be experiencing headwinds due to difficulties in its real estate sector, high debt levels and weaker than expected consumer demand.

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