QUEST Economic Update | November 2023

US economy closing 2023 with robust growth but elevated inflation

As 2023 begins to close, the economic outlook provides many reasons to be thankful. Economic growth is stronger than expected and the labor market continues to create jobs and keep the unemployment rate low. Although inflation remains higher than expected, it is gradually falling, and economic forecasts suggest the economy may be achieving the rare soft landing.

After robust gross domestic product (GDP) growth in the first half of 2023, the economy experienced a blistering 4.9% growth in the third quarter. The labor market remains tight with an unemployment rate of 3.9% in October 2023. Both the economic growth and tight labor market occurred as the Federal Reserve conducted a historically rapid increase in interest rates to over 5%.

Although inflation remains elevated, the year-over-year change in the Consumer Price Index (CPI) had its first decline since June as it fell to 3.2% in October from 3.7% in September. Retail sales fell by 0.1% in October, the first-time retail sales fell since March. These could indicate that the economy is slowing as interest rates remain higher than many anticipated.

Building a better working world

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 11/28/2023

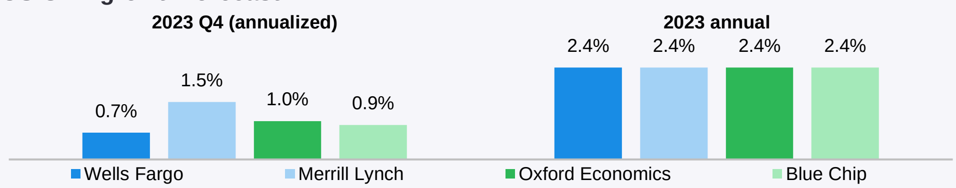
OVERALL US ECONOMY

The economic picture appears to have improved with the Blue Chip Economic Indicators lifting its November consensus for GDP growth to 2.4% for 2023 and 1.2% for 2024. While many forecasts see economic growth slowing in 2024, the consensus is for a soft landing, rather than an economic contraction.

Roughly 0.7% to 1.5% growth
expected for 2023 Q4 (annualized)

Roughly 2.4% growth
expected for 2023

US GDP growth forecast



LABOR MARKETS

Labor markets remain tight. The October unemployment rate was 3.9%. This is 0.1 percentage point higher than September, but still at historically low levels. Job gains have slowed, but unemployment claims remain below pre-pandemic levels.

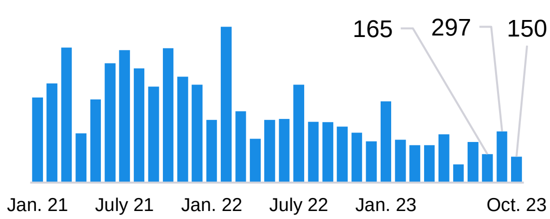
606k job gain
on average in 2021

399k job gain
on average in 2022

249k job gain
on average in the first three quarters of 2023

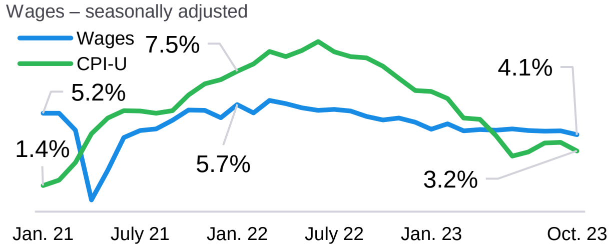
Nonfarm payroll employment

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

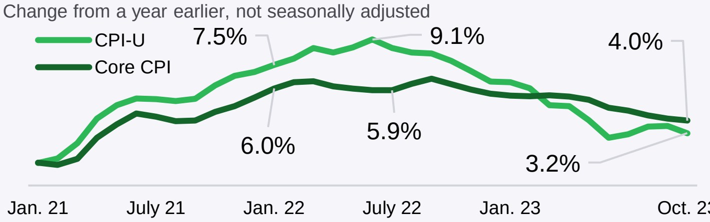


INFLATION / INTEREST RATES

Overall inflation as measured by the CPI has slowed, rising by 3.2% in October after increasing by 3.7% in both August and September. The strong economy and cooling inflationary pressures have pushed the market to expect the Federal Reserve to hold rates constant through March 2024 and begin to lower them in May 2024.

CPI-U and core CPI

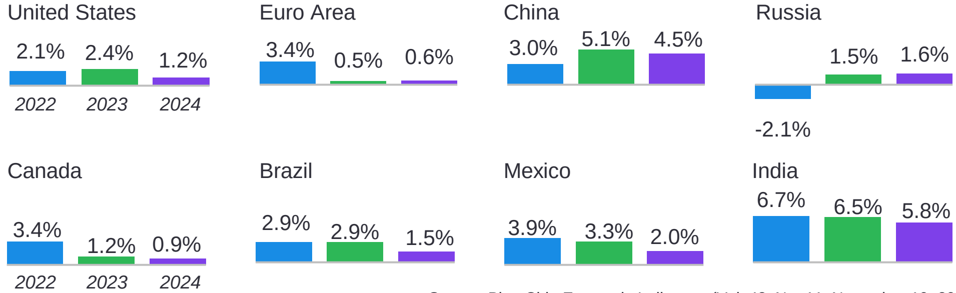
Change from a year earlier, not seasonally adjusted



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.



Source: Blue Chip Economic Indicators (Vol. 48, No. 11, November 10, 2023).

Upcoming economic data releases

- GDP for the Q3 of 2023 (second estimate), November 29
- Job openings for November, December 5
- Employment situation for November, December 8
- Productivity for Q3 (revised estimate), December 10
- Consumer Price Index for November, December 12
- Interest rates, Federal Open Markets Committee (FOMC) meeting, December 12–13
- Housing starts for October, December 19

Overall US economy

The US economy was already on solid footing during the first half of 2023 before economic growth accelerated in the third quarter. Real annualized GDP growth of 4.9% in the third quarter is the fastest growth since fourth quarter of 2021. 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 and low weekly unemployment claims.

The US economy's strength appeared to drive an inflation uptick that may have peaked. The overall CPI fell in October relative to September but remained at an elevated level relative to the Federal Reserve's 2% target. While the Federal Reserve's dot plot suggested one additional 25-basis point rate increase in 2023, the latest inflation reading and the minutes from the most recent Fed meeting suggest a pause for the rest of 2023. Even so, the market expects interest rates to be "higher for longer" especially in response to the strong US economy and persistent inflation over the past several months.

There are, however, some concerning economic indicators. Retail sales fell by 0.1% in October, the first decrease since March. In addition, the Conference Board's Leading Economic Index has fallen every month since April 2022, and it continued to decrease in October. While economic growth is expected to slow in the coming quarters, the consensus forecast is still for a soft landing.

Labor market

US labor markets remain tight. The October unemployment rate increased to 3.9% from 3.8% in September. It is still close to historic lows and well below the roughly 4.5% rate at which the economy's resources are fully employed.

The economy added 150,000 jobs in October, down from the 297,000 jobs added in September. Job gains averaged 249,000 over the first three quarters of 2023 and 399,000 during 2022. Weekly UI claims remain below pre-pandemic levels. Job openings have been generally falling since their high in early 2022 but remain well above unemployment.

The labor force participation rate fell to 62.7% in October from 62.8% in September. The October underemployment rate, which averaged 8.7% from 2015 through 2019, rose to 7.2% from 7.0% in September. Average hourly earnings were up in October by 4.1% 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 4.0% 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 the beginning of 2024.

Inflation

Inflationary pressures appear to have slowed but remain at elevated levels that could stay persistently higher than the Federal Reserve's 2% target. Higher inflation for longer could potentially prompt additional rate hikes by the Federal Reserve but this is not currently expected by markets.

The overall CPI rose by 3.2% (y/y) in October, following its 3.7% increase in both September and August. The monthly October CPI remained unchanged, following its 0.4% increase in September and 0.6% increase in August. The core CPI rose by 4.0% (y/y) in October, as compared to a 4.1% increase in September. The monthly core CPI rose by 0.2% in October, as compared to 0.3% in September. Shelter prices have risen for 42 consecutive months, offsetting the decrease in energy prices. The Federal Reserve Bank of Cleveland's inflation nowcast forecasts the November CPI to increase by 3.0%.

The personal consumption expenditure (PCE) price index, the preferred inflation measure of the Federal Reserve, increased by 0.4% in September and by 3.4% over the past 12 months, the same as in August. The core-PCE price index increased by 0.3% in September, higher than the 0.1% increase in August, and by 3.7% over the past 12 months, down from the 3.8% increase reported in August. The strength of the US economy and resurfacing of inflationary pressures had the FOMC indicate one additional rate hike this year in its dot-plot release following its September 19-20 meeting, but 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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