QUEST Economic Update | December 2023

US economy appears to be slowing as inflationary pressures subside; soft landing expected

Compared to this time last year, the economic outlook is looking considerably brighter. Economic growth and the labor markets in 2023 were stronger than anticipated last year when many expected a recession. While inflation remains elevated, it continues its gradual decline, and nearly all economic forecasts project that the economy will have a soft landing with moderate growth in 2024.

Defying most expectations of a year ago, gross domestic product (GDP) expanded robustly in the first three quarters of 2023 and grew at a brisk 5.2% pace in the third quarter. Although labor markets have slowed somewhat this year, they nevertheless remain tight with an unemployment rate of 3.7% in November and a 22-month streak with the unemployment rate remaining below 4%. This strong economic performance occurred as the Federal Reserve steeply hiked interest rates to over 5% this year.

In November, the year-over-year change in the Consumer Price Index (CPI) fell to 3.1% and, while elevated, it is half of what it was this time last year. Retail sales rebounded by 0.3% in November after falling in October. All these data indicate that the economy will end 2023 and enter 2024 on strong footing.

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 12/15/2023

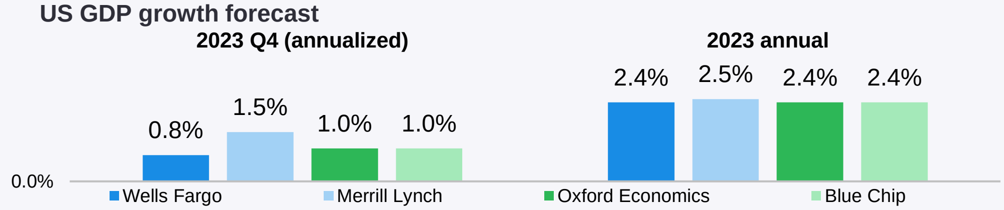
OVERALL US ECONOMY

The economic picture continues to improve with the Blue Chip Economic Indicators increasing its December consensus for GDP growth in 2024 to 1.3%. While many forecasts see economic growth slowing in 2024, the consensus is for a soft landing rather than an economic contraction.

Roughly 0.8% to 1.5% growth
expected for 2023 Q4 (annualized)

Roughly 2.4% to 2.5% growth
expected for 2023

US GDP growth forecast



LABOR MARKETS

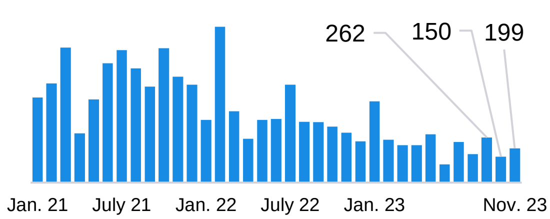
Labor markets remain tight. The November unemployment rate was 3.7%. This is 0.2 percentage point lower than October and remains at historically low levels. Job gains have slowed, but unemployment claims remain below pre-pandemic levels.

606k job gain
on average in 2021

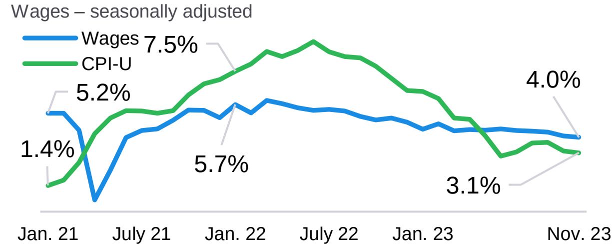
399k job gain
on average in 2022

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

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



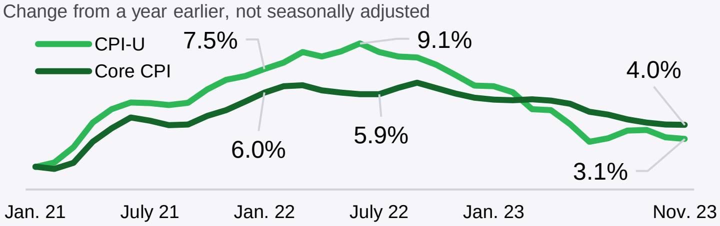
Hourly wages and CPI-U
Change from a year earlier, CPI - not seasonally adjusted, Wages – seasonally adjusted



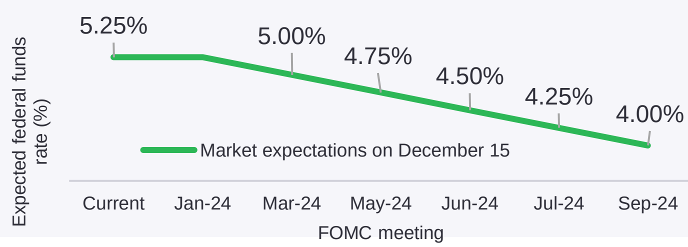
INFLATION / INTEREST RATES

Overall inflation, as measured by the CPI, has slowed, rising by 3.1% in November (y/y) after increasing by 3.2% in October and 3.7% in September. With slowing economic growth and cooling inflationary pressures, market expectations are now for the Federal Open Markets Committee (FOMC) to hold rates at its next meeting in January 2024 and begin to lower them at its March meeting.

CPI-U and core CPI
Change from a year earlier, not seasonally adjusted

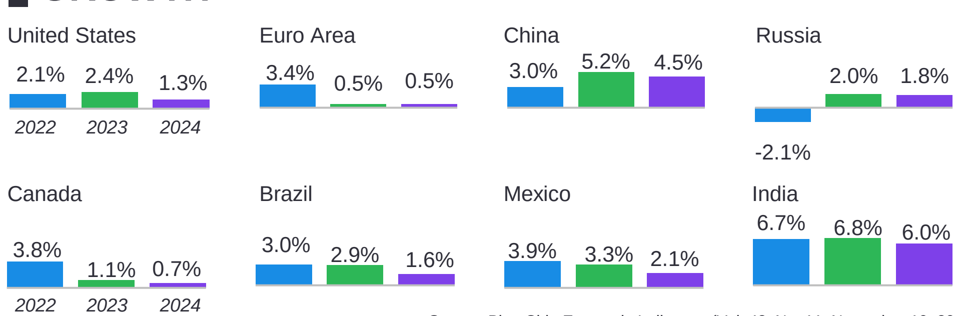


Expected federal funds rate over 2023 and 2024



GLOBAL GROWTH

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



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

Upcoming economic data releases

- Housing starts for November, December 19
- GDP Q3 2023 (third estimate), December 21
- Job openings for November, January 3
- Employment situation for December, January 5
- Consumer Price Index for December, January 11
- Interest rates, Federal Open Markets Committee (FOMC) meeting, January 30-31
- Productivity for Q4 (prelim. estimate), February 1

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 5.2% in the third quarter is the fastest growth since the fourth quarter of 2021 as the economy rebounded from the COVID recession. GDP grew at 2.2% during the first quarter and 2.1% during the second quarter of 2023. Other signs of resilience include a historically low unemployment rate and low weekly unemployment claims and strong consumer spending.

During the summer of 2023, the US economy's strength may have contributed to a several month uptick in inflationary pressures that have since subsided. The overall CPI fell in November relative to October. But the core CPI, which excludes the more volatile energy and food components, remains at an elevated level relative to the Federal Reserve's 2% target. The recent slowdown in inflation is likely a major factor contributing to the Federal Reserve keeping rates the same for the third time at its December meeting and its likely pivot to lowering interest rates beginning in Spring 2024. The Federal Reserve's dot plot, released at the December FOMC meeting, suggests three rate cuts in 2024. Market expectations suggest possibly six rates cuts by the end of 2024.

In addition to the favorable inflation numbers, another concerning economic indicator last month reversed. Retail sales bounced back by 0.3% in November after falling in October by 0.2%. Notwithstanding solid economic growth during the first three quarters of 2023, the economy is expected to slow in the coming months with the unemployment rate rising by perhaps a full percentage point and real annualized GDP growth possibly falling below 1%. Although the economy is expected to slow, the consensus is for a soft landing.

Labor market

US labor markets remain tight. The November unemployment rate decreased to 3.7% from 3.9% in October. The unemployment rate remains close to historic lows and well below the roughly 4.5% rate at which most economists view the economy's resources to be fully employed.

The economy added 199,000 jobs in November, up from the 150,000 jobs added in October. Job gains averaged 245,000 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 rose to 62.8% in November from 62.7% in October. The November underemployment rate, which averaged 8.7% from 2015 through 2019, fell to 7.0% from 7.2% in October. Average hourly earnings were up in November by 4.0% from a year ago, a pace above the 3.1% increase in the overall CPI for November (y/y), but the same as the 4.0% increase in the core CPI.

Notwithstanding the continued tightness of labor markets, many forecasters see the unemployment rate rising to the 4.0% to 5.0% range over the next year.

Inflation

Inflationary pressures appear to have subsided with inflation continuing its gradual descent over the past 18 months, but the inflation rate still remains somewhat elevated and above the Federal Reserve's 2% target. The recent good news on inflation caused the Federal Reserve to keep interest rates the same at the past three FOMC meetings. In addition, the Federal Reserve has signaled that it is likely to pivot to reducing interest rates beginning in Spring 2024.

The overall CPI rose by 3.1% (y/y) in November, following its 3.2% increase in October and 3.7% increase in September. The monthly November CPI increased 0.1%, after remaining unchanged in October, and a 0.4% increase in September. The core CPI rose by 4.0% (y/y) in November, the same as in October. The monthly core CPI rose by 0.3% in November, as compared to 0.2% in October. Shelter prices have risen for 43 consecutive months and offset the decrease in energy prices. The Federal Reserve Bank of Cleveland's inflation nowcast forecasts the December CPI to increase by 3.4%.

The personal consumption expenditure (PCE) price index, the preferred inflation measure of the Federal Reserve, increased by less than 0.1% in October, below its 0.4% increase in September. From its level 12 months earlier, the PCE price index increased by 3.0% in October and by 3.4% in September. The core-PCE price index increased by 0.2% in October, below its 0.3% increase in September, and by 3.5% over the past 12 months, down from the 3.7% increase reported in September.

The FOMC is expected to leave interest rates unchanged at its next meeting in January 2024 and begin to lower them at its March 2024 meeting. The Federal Reserve's latest dot-plot released at the December FOMC meeting suggests that the FOMC will reduce interest rates by 75 basis points in 2024. Market expectations are for possibly a 150-basis point reduction in rates during 2024.

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. Recent forecasts are somewhat more optimistic than a few months ago, and recession-like risks appear to be subsiding in the United State while remaining in the 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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