

QUEST Economic Update | February 2024



US economy resilient as 2024 begins with robust growth, slowing inflation, and poised for soft landing

While many economic forecasts see the US economy slowing, the economy continues to exceed expectations. In the fourth quarter, the economy grew at a 3.3% real annual rate, and the Federal Reserve Bank of Atlanta's GDPNow forecasts 4.2% growth during the first quarter of 2024 (as of February 1). The soft landing that many had thought was unlikely a year ago appears to be the most likely path in 2024.

As the economy continues robust growth, labor markets remain tight. While the unemployment rate is forecast to rise from its current level of 3.7% to roughly 4%-4.5% during 2024, some forecasts from a year ago predicted the unemployment rate rising to over 5%. Job openings still exceed unemployed workers, and weekly unemployment claims remain near historic lows.

Inflation's gradual decline adds to the already good economic news. The December Consumer Price Index (CPI) rose 3.4% from a year ago, suggesting inflation is still elevated. However, the Personal Consumption Expenditure (PCE) price index, the measure the Federal Reserve watches more closely, rose 2.6% in December from a year ago. Markets see the good news as setting the stage for the Federal Reserve to start lowering the federal funds target rate by 25 basis points at its May 2024 meeting and a total of 125 basis points by December 2024.

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 02/02/2024

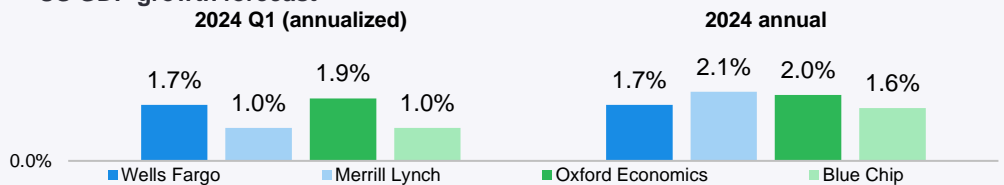
OVERALL US ECONOMY

The economy appears poised to achieve a soft landing with growth slowing perhaps only somewhat. Real annualized gross domestic product (GDP) increased by 3.3% during the fourth quarter of 2023 and the Atlanta Fed's GDPNow forecast has it expanding by 4.2% during the first quarter of 2024 (as of February 1).

US GDP growth forecast

Roughly 1.0% to 1.9% growth expected for 2024 Q1 (annualized)

Roughly 1.6% to 2.1% growth expected for 2024



LABOR MARKETS

With the January unemployment rate remaining at 3.7% and January job gains of 353,000, labor markets remain tight. Job openings have generally fallen but remain above the number of unemployed, and weekly unemployment insurance claims remain near historic lows.

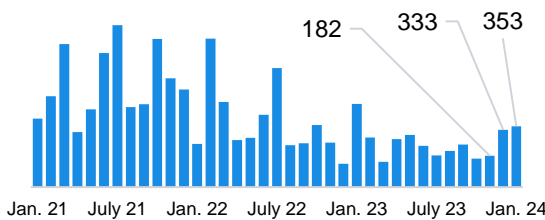
604k job gain on average in 2021

377k job gain on average in 2022

255k job gain on average in 2023

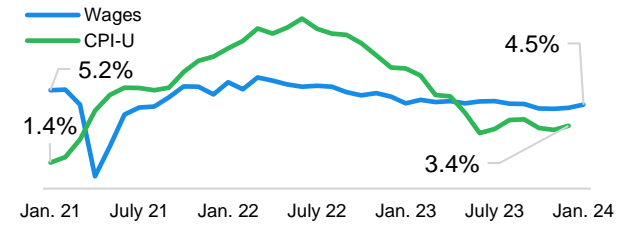
Nonfarm payroll employment

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

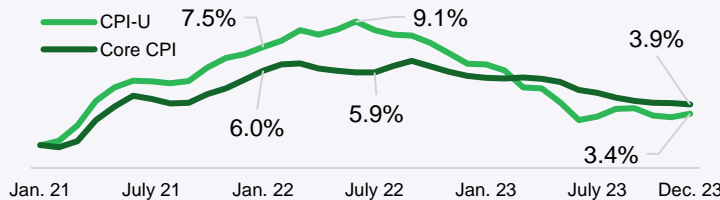


INFLATION / INTEREST RATES

Overall inflation has slowed. In December, the overall and core CPI rose by 3.4% and 3.9%, respectively. The overall and core PCE price index, the inflation measure the Federal Reserve more closely watches when setting monetary policy, rose by 2.6% and 2.9%, respectively, in December, just somewhat above its 2% target. The Federal Reserve is expected to begin lowering its target interest rate in May 2024.

CPI-U and core CPI

Change from a year earlier, not seasonally adjusted



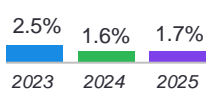
Expected federal funds rate over 2023 and 2024



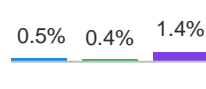
GLOBAL GROWTH

Forecasts, while generally still suggesting slowing global economic growth in 2024, have improved over the past few months. China's economy, however, is facing challenges seen by weak consumer demand and high debt levels, especially in its real estate sector, as well as possible deflation.

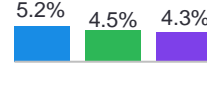
United States



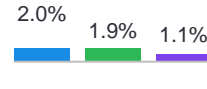
Euro Area



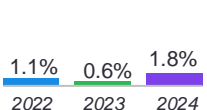
China



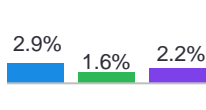
Russia



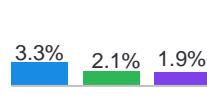
Canada



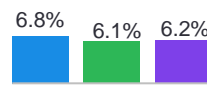
Brazil



Mexico



India



Upcoming economic data releases

- ▶ Consumer Price Index for January, February 13
- ▶ Housing starts for January, February 16
- ▶ Q4 2023 GDP (second estimate), February 28
- ▶ Job openings for January, March 6
- ▶ Productivity for Q4 (revised estimate), March 7
- ▶ Employment situation for February, March 8
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, March 19-20

Overall US economy

The US economy was already on solid footing during the first half of 2023 before economic growth accelerated in the second half of the year. Real annualized GDP growth of 3.3% in the fourth quarter of 2023 followed the blistering 4.9% growth in the third quarter. 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. Retail sales also expanded by 0.6% in December and were 5.6% higher than a year ago.

The US economy's strength could be contributing to the gradually slowing inflation. The overall CPI increased in December relative to November. But the core CPI, which excludes the more volatile energy and food components, declined in December but remains at an elevated level relative to the Federal Reserve's 2% target. The robust

Labor market

US labor markets remain tight. The January unemployment rate remained at 3.7%, the same as November and December. 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 353,000 jobs in January, up from the 333,000 jobs added in December. Job gains averaged 255,000 over the first three quarters of 2023 and 377,000 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.

Inflation

Inflationary pressures appear to have subsided with inflation continuing its gradual descent over the past year and a half, 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 four FOMC meetings. In addition, the Federal Reserve has signaled that it is likely to pivot to reducing interest rates beginning in the middle of 2024.

The overall CPI rose by 3.4% (y/y) in December, following its 3.1% increase in November and 3.2% increase in October. The monthly December CPI increased by 0.3%, after a 0.1% increase in November and no change in October. The core CPI rose by 3.9% (y/y) in December, 0.1 percentage point lower than November. The monthly core CPI rose by 0.3% in December, the same as the increase in November. Shelter prices have risen for 44 consecutive months and contributed to over half the increase in the CPI. The Federal Reserve Bank of Cleveland's inflation nowcast forecasts the January CPI to increase by 3.0% (as of February 2).

Global growth

The global economy is expected to slow during 2024, 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 increasingly optimistic compared to a few months ago, and recession-like risks have almost dissipated in the United States and appear to be subsiding in the United Kingdom and Eurozone.

growth and recent slowdown in inflation is likely a major factor contributing to the Federal Reserve keeping rates the same for the fourth time at its January meeting and its likely pivot to lowering interest rates beginning in mid-2024. The Federal Reserve's dot plot, released at the December Federal Open Market Committee (FOMC) meeting, suggests three rate cuts in 2024. Market expectations suggest possibly five rate cuts by the end of 2024.

Notwithstanding solid economic growth during 2023, the economy is expected to slow into a soft landing with the unemployment rate rising to just above 4% and real annualized GDP growth around 1.5%. Although the economy is expected to slow, the consensus is for a soft landing, and if the economic data continues to outperform projections, forecasts will likely be revised up.

The labor force participation rate remained at 62.5% in January the same as December. The January underemployment rate, which averaged 8.7% from 2015 through 2019, rose to 7.2% from 7.1% in December. Average hourly earnings were up in January by 4.5% from a year ago, a pace above the 3.4% increase in the overall CPI for December (y/y) and the 3.9% increase in the core CPI.

The continued tightness of labor markets has pushed many forecasters to project the unemployment rate rising to the 4.0% to 4.5% range in 2024, lower than previously expected.

The PCE price index, the preferred inflation measure of the Federal Reserve, increased by 0.2% in December, above its 0.1% decrease in November. From its level 12 months earlier, the PCE price index increased by 2.6% in December and by 2.6% in November. The core-PCE price index increased by 0.2% in December, above its 0.1% decrease in November, and by 2.9% over the past 12 months, down from the 3.2% increase reported in November. The Cleveland Fed's inflation nowcast expects the core PCE to increase by 2.7% in January and 2.5% in February (as of February 2), suggesting that inflation will continue to move closer to the Federal Reserve's 2% target.

The FOMC left interest rates unchanged at its meeting in January. It is expected to begin lowering them at its May 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 a total rate reduction of 125 basis points by December 2024.

Although China showed significant strength coming out of its COVID lockdown early last year, 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, as well as possibly deflation.

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