

QUEST Economic Update | March 2024



US economy continues resilient 2024 start with strong growth, slowing inflation, and a soft landing

What a difference a year makes. Last year, two banks with over \$300 billion in assets failed, sparking concerns of contagion. Market expectations shifted to predicting rate cuts by the Federal Open Market Committee (FOMC) to support a slowing economy, but that did not occur. Instead, the economy grew more rapidly than expected and significantly above trend, with the FOMC continuing to raise rates. Despite some turbulence, most economic forecasts now foresee not only a soft landing but also moderate growth in 2024.

Gross domestic product (GDP) grew by 2.5% in 2023, with the Federal Reserve Bank of Atlanta forecasting 2.3% growth in the first quarter of 2024 (as of March 29). The labor market has slowed somewhat, with the unemployment rate rising to 3.9% in February. Average hourly earnings growth continues to outpace inflation and pre-pandemic averages, indicating the labor market remains tight.

Inflation remains elevated but is nearly half of what it was a year ago. The February Consumer Price Index (CPI) rose by 3.2% compared to a year ago, while the Personal Consumption Expenditure (PCE) price index increased by 2.5% in February. The uptick in CPI inflation likely influenced the FOMC's decision to keep rates unchanged at its March meeting. If inflation continues its gradual decline, both the markets and the FOMC anticipate interest rate cuts totaling 75 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 03/29/2024

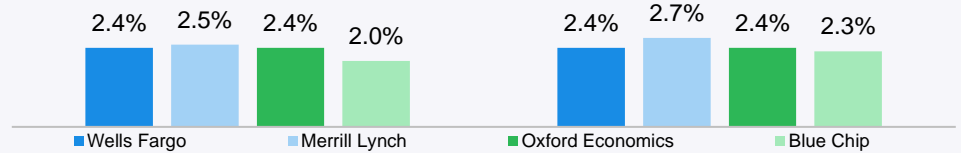
OVERALL US ECONOMY

The economy appears poised to achieve a soft landing with moderate growth. Real annualized gross domestic product (GDP) increased by 3.4% during the fourth quarter of 2023 and the Atlanta Fed's GDPNow forecast sees it increasing by 2.3% during the first quarter of 2024 (as of March 29).

Roughly 2.0% to 2.5% growth expected for 2024 Q1 (annualized)

Roughly 2.3% to 2.7% growth expected for 2024

US GDP growth forecast 2024 Q1 (annualized)



LABOR MARKETS

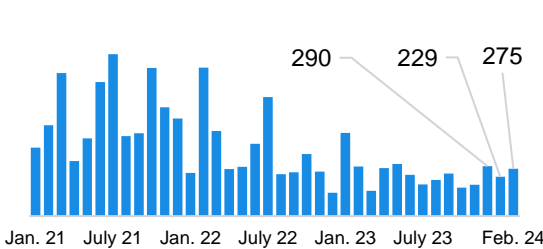
With the February unemployment rate rising to 3.9% and February job gains of 275,000, labor markets remain tight. Job openings have generally fallen but remain above the number of unemployed, and weekly unemployment insurance claims remain near historic lows.

604k job gain on average in 2021

377k job gain on average in 2022

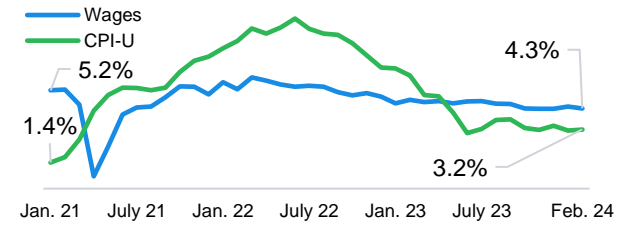
266k job gain on average in 2023

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

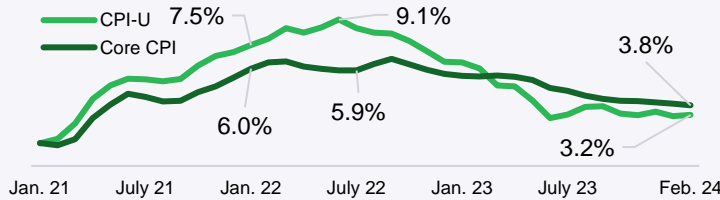


INFLATION / INTEREST RATES

Overall inflation has slowed. In February, the overall and core CPI rose by 3.2% and 3.8%, respectively. The overall and core PCE price index, the inflation measure the Federal Reserve more closely watches when setting monetary policy, rose by 2.5 and 2.8%, respectively, in February, just somewhat above its 2% target. The Federal Reserve is expected to begin lowering its target interest rate in June 2024.

CPI-U and core CPI

Change from a year earlier, not seasonally adjusted



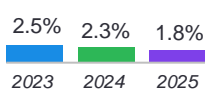
Expected federal funds rate over 2023 and 2024



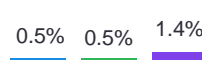
GLOBAL GROWTH

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.

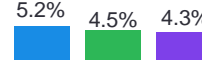
United States



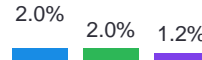
Euro Area



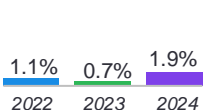
China



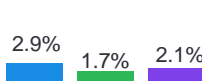
Russia



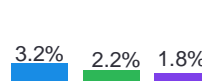
Canada



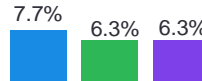
Brazil



Mexico



India



Upcoming economic data releases

- ▶ Employment situation for March, April 2
- ▶ Job openings for February, April 6
- ▶ Consumer Price Index for March, April 10
- ▶ Housing starts for March, April 16
- ▶ Q1 2024 GDP (advanced estimate), April 25
- ▶ Personal Consumption Expenditures for March, April 26
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, April 30 – May 1

Overall US economy

The US economy continued its solid growth in 2024 with over 500,000 jobs created in the first two months, unemployment still below 4% and average wages still growing faster than inflation. This comes after GDP grew by 2.5% in 2023 with the third and fourth quarters experiencing robust growth of 4.9% and 3.4%, respectively. Other signs of resilience include low weekly unemployment claims and strong consumer spending. Retail sales also rebounded by 0.6% in February after falling in January and were 1.3% higher than a year ago.

There may have been an uptick in January and February inflation. The overall CPI increased by 3.2% in February (y/y) and the core CPI, which excludes the more volatile energy and food components, increased by 3.8%. By contrast, PCE inflation is lower. The overall PCE price index increased 2.5% in February (y/y) and the core index increased 2.8%, elevated, but closer to the Federal Reserve's 2%

Labor market

US labor markets remain tight but could be loosening. The February unemployment rate increased to 3.9%, 0.2 percentage point above the 3.7% in January. Although the unemployment rate is above historic lows, it is still well below the roughly 4.5% rate at which most economists view the economy's resources to be fully employed.

The economy added 275,000 jobs in February, up from the 229,000 jobs added in January. Job gains averaged 251,000 during 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 undoubtedly played into the Federal Reserve's decision to keep interest rates the same at the past five FOMC meetings. In addition, the Federal Reserve has signaled that it is likely to begin reducing interest rates at its June 2024 meeting.

The overall CPI rose by 3.2% (y/y) in February, following its 3.1% increase in January and 3.4% increase in December. The monthly February CPI increased by 0.4%, after a 0.3% increase in January and 0.2% increase in December. The core CPI rose by 3.8% (y/y) in February, 0.2 percentage point lower than January. The monthly core CPI rose by 0.4% in February, the same as the increase in January. Shelter prices rose 5.7% in February. Shelter and gasoline prices were responsible for over 60% of the CPI increase. The Federal Reserve Bank of Cleveland's inflation nowcast forecasts the March CPI to increase by 3.4% (as of March 29).

Global growth

The global economy is expected to slow during 2024, with growth in the 1.5% to 2.5% range. Although forecasts of recession have been dissipating, Germany, Japan, and the United Kingdom all likely experienced two quarters of shrinking GDP, which signals they could be in recession. In response, Japan raised its central bank interest rate for the first time in 17 years.

target than CPI inflation.

The recent uptick in CPI inflation and continuing robust economic growth are likely major factors contributing to the FOMC's decision to keep its target interest rate the same for the fifth time at its March meeting. The FOMC is expected to begin lowering interest rates at its June 2024 meeting. Both the Federal Reserve's March dot plot and market expectations suggest three rate cuts totaling 75 basis points by December 2024

Notwithstanding solid economic growth during 2023, the economy is expected to slow. The so-called soft landing is now expected to be characterized by economic growth close to trend, the unemployment rate settling just above 4%, and inflation continuing to abate.

The labor force participation rate remained at 62.5% in February the same as January. The February underemployment rate, which averaged 8.7% from 2015 through 2019, rose to 7.3% from 7.2% in January. Average hourly earnings were up in February by 4.3% from a year ago, a pace above the 3.2% increase in the overall CPI for February (y/y) and the 3.8% increase in the core CPI.

The continued tightness of labor markets has pushed many forecasters to project the unemployment rate will increase 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 0.3% in January, above its 0.1% decrease in December. From its level 12 months earlier, the PCE price index increased by 2.4% in January and by 2.6% in December. The core-PCE price index increased by 0.4% in January, above its 0.1% increase in December, and by 2.8% over the past 12 months, down from the 2.9% increase reported in December. The Cleveland Fed's inflation nowcast expects the core PCE to increase by 2.7% in March (as of March 29), 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 March. It is expected to begin lowering them at its June 2024 meeting. The Federal Reserve's latest dot-plot released at the March FOMC meeting suggests that the FOMC will reduce interest rates by 75 basis points by December 2024. Market expectations currently match the Federal Reserve's dot-plot.

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. Its central bank has indicated it may engage in more monetary easing to support the economy.

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