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PURDUE AGRICULTURAL ECONOMICS REPORT

The Outlook for the U.S. Economy In 2024

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Summary: Professor DeBoer explains why so many economists predicted recession in 2023 and why it didn't happen. His analysis indicates slowed growth in 2024 from reduced spending but that recession could be avoided.

It was December 2022, and the leading indicators were flashing recession warnings. The Federal Reserve had already hiked their policy interest rate by 4 percentage points, one of the most rapid increases in its century-plus existence. The Conference Board's index of leading indicators had turned negative. The 2-year Treasury interest rate had risen above the 10-year rate, an inverted spread that nearly always precedes recession. So, many economists predicted recession for 2023.

The recession never happened. Real gross domestic product continued to grow, as did employment. The unemployment rate remained near its 50-year low. Consumer spending continued to rise. The inflation rate fell dramatically.

Now it's December 2023. The Fed increased their policy rate some more, but has kept it stable since August. The Conference Board's index is still negative. The interest rate spread is still inverted, though narrower. Recession is a possibility. But it would be sheer stubbornness to continue predicting recession in the face of so much good news. The guess here is no recession in 2024.

That's what won't happen. What will happen? Start with the components of gross domestic product growth, adjusted for inflation.

Gross Domestic Product

Consumer Spending. Household purchases of consumer goods and services makes up more than two-thirds of gross domestic product. If consumers don't spend, the economy doesn't grow. Since the end of the pandemic, consumers have been spending. Consumer spending increased 2.3% above inflation in the year through the third quarter 2023.

Consumers say they are pessimistic. The University of Michigan's consumer sentiment index has increased since its June 2022 low, but remains well below its 2019 level. It has fallen in the past three months. Prior to 2020 consumer sentiment was a good indicator of the direction of consumer spending. Declining sentiment meant slower growth in household purchases. In the past four years, though, supposedly pessimistic consumers have kept spending.

More telling, manufacturers have received fewer orders for new consumer goods in 2023. Orders declined in eight of the past 12 months, and are 5.7% below the level of November 2022. Apparently retailers and manufacturers think consumers will spend less in the next few months, and are cutting back. That's a better reason to expect consumer spending to slow.

Investment. Higher interest rates were meant to slow investment borrowing and spending. Investment spending did fall from the first quarter of 2022 to the first quarter of 2023, but growth has resumed in the past six months. Investment spending is 2.3% higher than is was a year ago, adjusted for inflation.

Higher interest rates do not seem to have had much effect on business structure and equipment investment, which is is up 4% in the past year. But higher mortgage interest rates have reduced residential investment. Housing starts are down 24% since April 2022.

Capital goods orders are a leading indicator of investment in business equipment. Orders are up slightly, by 1.3% over the past year. Building permits are a leading indicator of residential construction, and are down from the previous year by 3.7%. The Federal Reserve likely is finished with interest rate hikes, and may begin reducing rates by the end of 2024. Interest rates won't cause additional restraint, but probably won't encourage more spending either. The outlook for investment spending is continued modest growth.

Government purchases. Purchases by all levels of government have risen 4.7% above inflation over the past year. Federal purchases contributed 5.7% to this growth, while state and local governments added 4.2%. The Congressional Budget Office forecasts a 5% increase in direct Federal spending on goods and services for fiscal 2024, adjusted for inflation. Federal pandemic aid was a revenue bonanza for state and local governments. That's over, so inflation-adjusted state and local spending growth should slow to normal in 2024, which is about 2%.

The Federal government's budget deficit grew to $2 trillion in fiscal 2023, about 8% of GDP. The CBO says that part of the reason was a large drop in income tax receipts, which had several causes, including postponed IRS deadlines due to natural disasters. This included most taxpayers in California. Another reason, though, was the increase in interest payments on the national debt. Rising interest rates increased the cost of refinancing the debt, which raised interest from 7.6% of the total budget to 10.2%. Lower interest rates and back-payments of income taxes should reduce the size of the deficit in 2024, but its share of GDP will remain historically large.

Exports and Imports. Inflation-adjusted export and import spending have both fallen over the past year. Imports fell 1.5% and exports fell 0.2%, so net exports (exports minus imports) increased. Trade made a small net addition to output growth.

The exchange value of the dollar rose in 2022 in response to the rise in U.S. interest rates. International lenders increased their demand for dollars to take advantage. Once the Fed stopped raising rates, the exchange value fell. The dollar is down 6% relative to the euro over the past year.

A lower dollar exchange value makes U.S. imports more expensive and U.S. exports cheaper. Imports usually rise with consumption spending, but with the lower dollar value, the increase should be modest. The world economy is expected to grow more slowly in 2024, which could reduce export growth. But with the weaker dollar, exports should grow somewhat faster. Again, net exports will contribute a little to GDP growth.

GDP growth in 2024. GDP grew 3% above inflation in the past year. Growth seems likely to slow, a little. Consumer spending should grow more slowly in 2024 than this past year. Investment spending should grow modestly. Both federal government and state and local government purchases will increase less. Trade should add a little to growth, on net. Add it up, and **real GDP should grow about 2.2% in 2024**, slower than in 2023.

Employment and Unemployment

Employment growth slowed in 2023, to 2.8 million jobs, compared to 4.8 million in 2022. Perhaps the Federal Reserve's interest rate hikes worked to dampen the labor market. Or, perhaps employment was constrained by labor force growth, which was about 2.9 million in 2023. Population and labor force participation increased, but with the unemployment rate about as low as it can go, there simply aren't enough new people available to fill more job openings.

The labor market ended 2022 with 11.2 million job openings and only 5.7 million unemployed people searching for work. The unemployment rate was 3.6%. The most recent data from September showed that openings had fallen to 9.4 million, and the number of searchers had risen to 6.4 million. Openings still exceeded searchers by 3 million at in September 2023. The unemployment rate remained near its 50-year low of 3.7%.

GDP growth of 2.2% should be enough to keep job openings above unemployed job searchers. That should keep the unemployment rate from rising very much. **Expect the unemployment rate to be about 4.0% by the end of 2024.**

Inflation

The Consumer Price Index inflation rate peaked in June 2022 at 8.9% over June 2021. As of November 2023 the 12-month CPI inflation rate was 3.1%. This is substantial progress, but still higher than the 1999 to 2019 average of 2.2% per year.

The prices of durable goods, such as cars, appliances and electronics, fell an average of 1% per year in the two decades from 1999 to 2019. Durable goods deflation was the norm. But with the pandemic prices of durables shot upward, by 18.8% as of February 2022. Supply chain problems created shipment delays and shortages, and consumers shifted their spending from services to goods. Consumers have continued to favor goods purchases, but delays and shortages have disappeared as the supply chain recovered. As of November 2023 durable goods *deflation* had returned, with prices 1.6% lower than in November 2022.

Non-durable goods include food, energy and medicines, but the non-durable inflation rate is most influenced by the highly unstable price of gasoline. The monthly average gas price peaked at $4.93 in June 2022. By November 2022 the gas price had fallen to $3.69, and a year later in November 2023 it averaged $3.32. That gas price decrease explains the 0.7% non-durable goods inflation rate, which is lower than the two decade average of 2.1%. The U.S. Energy Information Administration projects a small 1.7% increase in gasoline prices in 2024.

Durable and non-durable goods inflation have returned to normal. Service inflation has not. Service inflation averaged 2.7% per year during 1999-2019, but as of November 2023 it was 5.2%. Services include medical care and entertainment, but the biggest expense is the cost of housing.

The CPI measures housing costs with average rent. Rent tends to lag the price changes of goods, partly because rents are set in leases that last a year or more. Durable goods prices peaked in February 2022; the rent index peaked 13 months later in March 2023, at 8.8% over March 2022. It has fallen in each of the eight months since then, but only to 6.9%.

The Bureau of Labor Statistics' experimental index of New Tenant Rents—rents on new leases—rose only 2.8% in the past four quarters. As this information is incorporated into the CPI index, rent inflation show continue to fall, and so will services inflation. The long-term trend of durable goods deflation should continue. The small rise in gasoline prices should result in an equally small increase in non-durable goods inflation. Combining these changes leads to **Consumer Price Index inflation forecast for 2024 of 2.7%**.

Federal Reserve Policy and Interest Rates

Inflation was rising at the beginning of 2022. The Federal Reserve began raising the federal funds rate—their policy interest rate—in March of that year. It had reached the 5.25%-5.5% range in July 2023. The intent was to decrease borrowing and spending, slow the economy, and bring inflation down. Inflation did fall. Fed policy probably helped, but the main cause of reduced inflation was the recovery of the global supply chain.

Inflation is on a trajectory towards the 2% inflation rate target. The Fed likely has finished raising interest rates. Federal Reserve Board members published their expectations for the economy after the December policy meeting, and their median prediction for the federal funds rate by the end of 2024 was 4.6%. Since the rate is 5.3% at the end of 2023, this implies three quarter-point rate reductions, probably in the second half of 2024.

The 3-month Treasury security interest rate is also 5.3% as of November. It usually follows the federal funds rate, so **expect the 3-month Treasury rate to be 4.6% by the end of 2024**. The 10-year Treasury bond rate averaged 4.5% in November. It usually averages 2 percentage points higher than the 3-month rate. The 10-year rate was been less than the 3-month rate for the past year, a rate spread inversion that is often an indicator of a coming recession. Whether or not a recession occurs, the 3 month rate should approach the 10-year rate by the end of 2024. **Expect the 10-year Treasury bond interest rate to be 4.4% by December 2024.**

2024 shapes up as a pretty good year. GDP will grow modestly. The unemployment rate will remain low. Inflation should continue to edge downward. Interest rates should edge lower by the end of the year. The leading indicators are still signaling recession. They fooled us last year. So: Fool me twice, shame on me. No recession in 2024.