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The U.S. Economic Outlook for 2023–2024
Executive Summary: February 2023

Private Sector Puzzle

The state of the economy remains extremely challenging to interpret amid conflicting signals about its current condition, future trajectory, and even the recent past.

In the second half of 2022, real GDP expanded at a solid 3.1 percent annualized pace. However, private consumption and business fixed investment contributed only 0.6 percentage points to the headline, and only 0.2 percentage points in 2022Q4. So, domestic private demand growth has stalled. At the same time, private hiring remains remarkably strong. In 2022, monthly private job gains averaged about 380,000, slowing moderately to 265,000 in the final quarter. The employment report for January 2023 saw a blow-out 443,000 private nonfarm jobs added, the strongest reading since July 2022. The unemployment rate ticked down to 3.4 percent, the lowest reading since May 1969.

Something has to give. We believe that job gains will slow markedly by late 2023.

Revisional Madness

As if reconciling the conflicting data wasn't hard enough, recent revisions to key series take the difficulty up another notch. The recent benchmark revision of payroll employment found some 800,000 extra jobs in the economy, cutting deep into estimates of existing labor market slack. Just a week ago, the deceleration of core CPI during the waning months of 2022 looked decisive, with 3-month annualized inflation slowing from 6.0 percent to 3.1 percent between September and December 2022. Revised seasonal factors for the CPI (and the January report) have made the deceleration look less impressive, with the same 3-month average slowing from 6.0 to 4.3 percent in September–December and rising to 4.6 percent in January 2023.

Data Cacophony

While the Institute for Supply Management's index for manufacturing continued to slide deeper into contraction, the December shock collapse of the service sector index into contractionary territory has since reversed almost completely, returning into solidly expansionary territory. The light vehicle annualized sales pace jumped from 14.3 million in 2022Q4 to 15.7 million vehicles in January, beating a weak seasonal for the second year in a row. The University of Michigan's topline Index of Consumer Sentiment, while still depressed in absolute terms, has posted its third straight monthly improvement. According to the Fed's Senior Loan Officer Survey, the share of banks tightening commercial and consumer lending standards has hit recessionary levels for many types of credit.

Housing Bottom in Sight?

Last year saw steep declines in home sales and single-family housing starts. Demand for existing homes may now be leveling off. Weekly mortgage purchase applications fell by over 45 percent between January and October of last year but have since risen modestly. Pending home sales had fallen 37.8 percent year-over-year as of November but increased marginally in December. Also in December, the NAHB Housing Market Index plunged to levels similar to 2012, but it saw a slight uptick in January and a measurable increase in February. The University of Michigan Survey of Consumers' sentiment index of conditions for buying a home also saw modest improvements in January and February.

Longer Landing Strip, Higher Speed

The recent labor market releases and revisions suggest that the Fed has more runway to achieve a soft landing than it previously thought. However, recent inflation data and revisions show that the Fed still has more work to do on inflation. So, the Fed is trying to stick the landing from a higher speed.

Even though the chances of the Fed delivering a soft landing have improved considerably in recent months, our outlook features a moderately turbulent landing that has better than even odds of being called a recession by the NBER.

We project the fed funds rate to reach a terminal range of 5.0–5.25 percent this spring. From then, we expect the Fed to hold the fed funds rate flat for the rest of 2023, letting the lagged effects of its prior tightening finish the work. By early 2024, with inflation falling convincingly toward the Fed's 2.0 percent target and the *labor market softening, we expect the Fed to start cutting rates at a measured pace.*

Glance into the Abyss?

The return of divided government promises some contentious fights in Washington, with the debt ceiling battle already on. We believe that breaching the so-called "X date" at which the Treasury's extraordinary measures will be exhausted would precipitate an immediate economic contraction. It may take some financial market turbulence and a glance or two into the abyss before a deal becomes palatable to all parties. An arrangement similar to the resolution of the 2011 debt ceiling crisis appears plausible—a commission to study ways to constrain the growth of spending, with discretionary spending caps to fall back on should the commission fail.

With higher interest rates persisting, we project federal interest expenses to nearly double between 2020 and 2024. The growth of interest payments over 2023–24 fiscal years more than accounts for all of the projected growth in current expenditures.

The 2023–24 Outlook

We expect headline growth to moderate but remain in positive territory in 2023H1, supported by growing consumption expenditures. In 2023H2, economic momentum fades, and headline growth turns slightly negative, with a cumulative contraction of just over 0.1 percent of GDP. Despite the contraction late in 2023, calendar year growth averages 1.2 percent. GDP growth returns next year. It reaches 2.4 percent by 2024H2, helped by investment spending and loosening monetary policy. GDP growth averages 0.7 percent in 2024.

Price inflation continues to moderate gradually over the next year, as overall consumer demand weakens and a rapidly cooling housing market propagates to lower shelter inflation. Calendar year core CPI inflation, which registered 6.1 percent in 2022, falls to 4.1 percent in 2023 and 2.8 percent in 2024. Headline CPI inflation is projected to remain slightly below core throughout the forecast due to slow food price inflation and flat oil prices.

The economy starts shedding jobs by 2023Q4 as tight monetary policy takes its toll. Total employment declines by about 480,000 jobs from 2023Q4 to 2024Q2 before modest job growth resumes in the second half of next year. Monthly payroll job gains average 36,000 in 2024Q3 and 110,000 in 2024Q4. On a calendar year basis, payroll employment adds 3.2 million jobs in 2023 and holds flat in 2024.

The pace of light vehicle sales gradually climbs to top 15 million units in 2023Q3. Sales then stagnate for several quarters, as high prices and interest rates finally take a bite out of pent-up demand, while the economy goes through a soft patch. As job growth returns in 2024H2, vehicle sales climb toward the 16 million unit pace.

With the peak in mortgage rates behind us, the pace of single-family home starts bottoms at 785,000 units in the second quarter of 2023. It recovers by only 20,000 through 2024Q1, but then improves by another 75,000 through 2024Q4. Multi-family starts hold flat in early 2023, then slide from 542,000 in 2023Q2 to 436,000 in 2024Q4, still a respectable pace by the standards of recent history. Total housing starts fall from 1.6 million units in 2022 to 1.3 million per year in 2023–24.

	Actual		**RSQE Forecast**	
	2021	2022	2023	2024
GDP (billions of current $)	23315.1	25461.3	26712.4	27622.2
Real GDP (billions of 2012 $)	19609.8	20018.0	20254.9	20395.4
% change: year-over-year	5.9	2.1	1.2	0.7
% change: 4th-qtr-to-4th-qtr	5.7	1.0	0.2	1.6
Nonfarm payroll employment (millions)	146.3	152.6	155.8	155.8
Civilian unemployment rate (%)	5.4	3.6	3.5	4.1
Capacity utilization, total industry (%)	77.4	79.7	77.0	75.2
Inflation (private nonfarm GDP deflator, % change)	4.5	7.0	3.7	2.7
Inflation (CPI-U, % change)	4.7	8.0	3.7	2.6
Inflation (core CPI, % change)	3.6	6.1	4.1	2.8
Light vehicle sales (millions)	14.9	13.8	14.9	15.4
Private housing starts (thousands)	1605.2	1555.0	1320.0	1290.6
3-month Treasury bill rate (%)	0.0	2.0	5.0	4.6
10-year Treasury note rate (%)	1.4	3.0	3.7	3.6
Conventional mortgage rate (%)	3.0	5.3	6.0	5.5
Real disposable income (billions of chained 2012 $)	16130.0	15092.5	15404.6	15495.2
% change	1.9	-6.4	2.1	0.6
Corporate profits after tax (billions of current $)	2749.8	2916.8	2910.5	2990.2
Value of U.S. $ (FRB broad index), % appreciation	-3.9	6.8	-1.1	0.0
Current account balance (NIPA basis, billions of current $)	-861.4	-1003.7	-827.6	-666.9
Federal surplus (FY, NIPA basis, billions of current $)	-2948.9	-1092.7	-1308.5	-1386.6