Economic Update

Mutual Savings Association Advisory Council

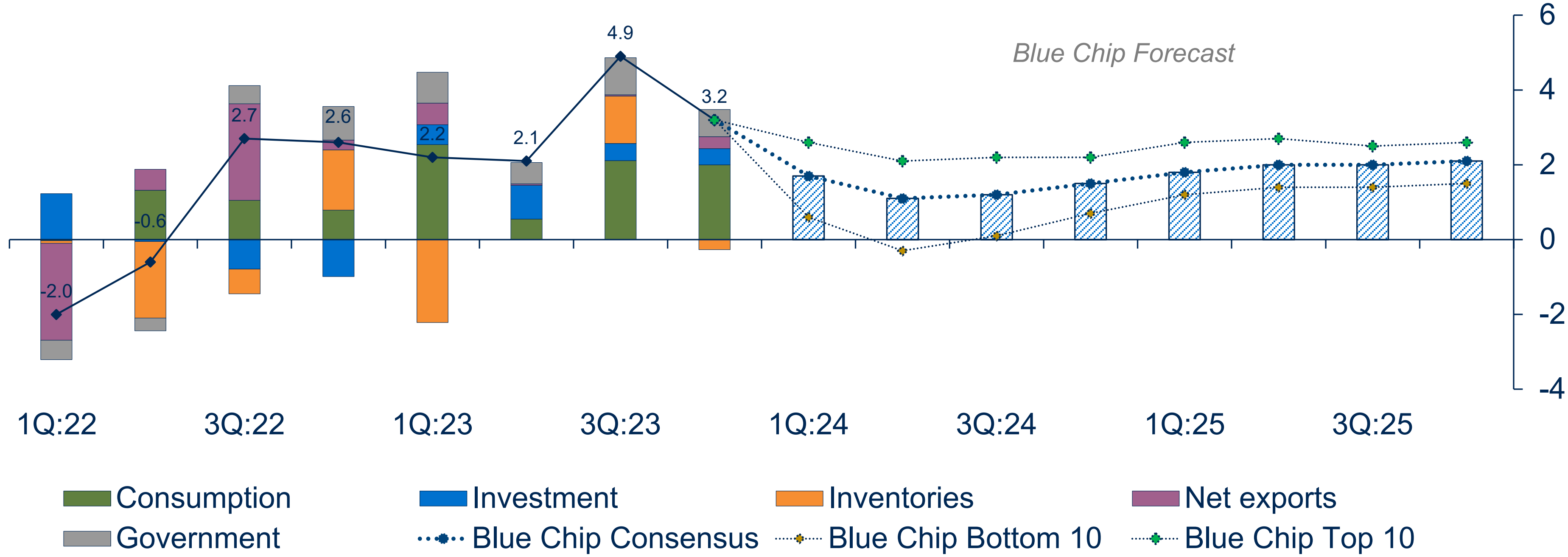
March 5, 2024

Takeaways

- 2023 economy defied recession forecasts; growth came from stronger than expected consumer spending
- Strong labor market and rising incomes continue to boost consumer spending
- Stronger than expected economic growth, coupled with a tight labor market, could forestall Fed rate cuts

Consensus forecast calls for return to 2% real GDP growth

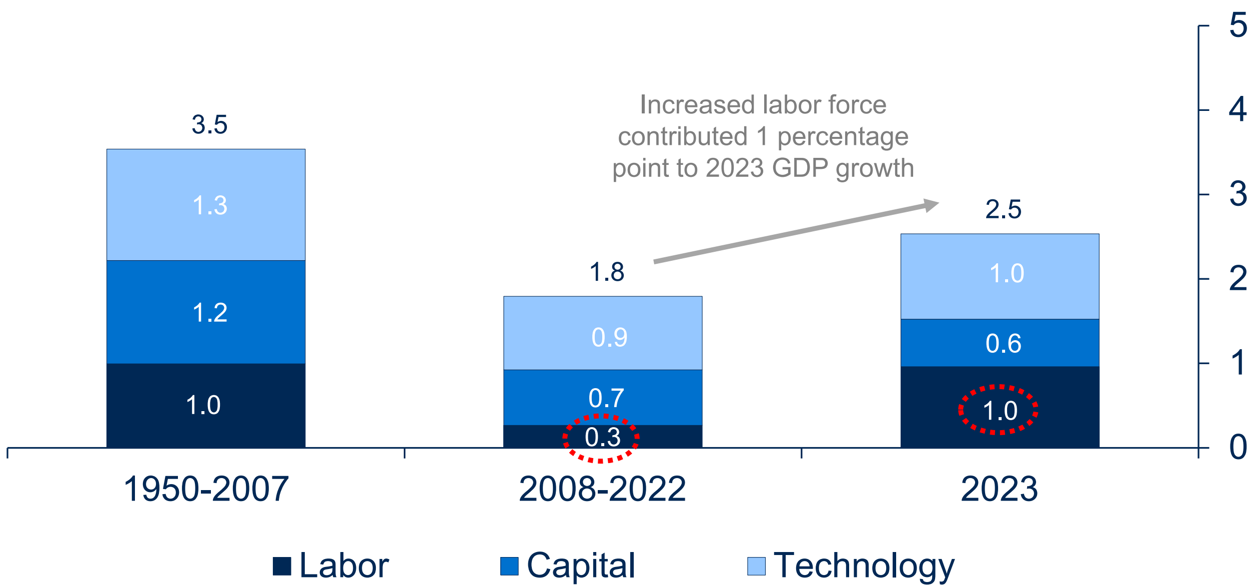
Contributions to real GDP, by component, %



Source: Bureau of Economic Analysis (second GDP estimate); Blue Chip (Feb 2024).

Above-trend 2023 GDP growth driven by increased labor force

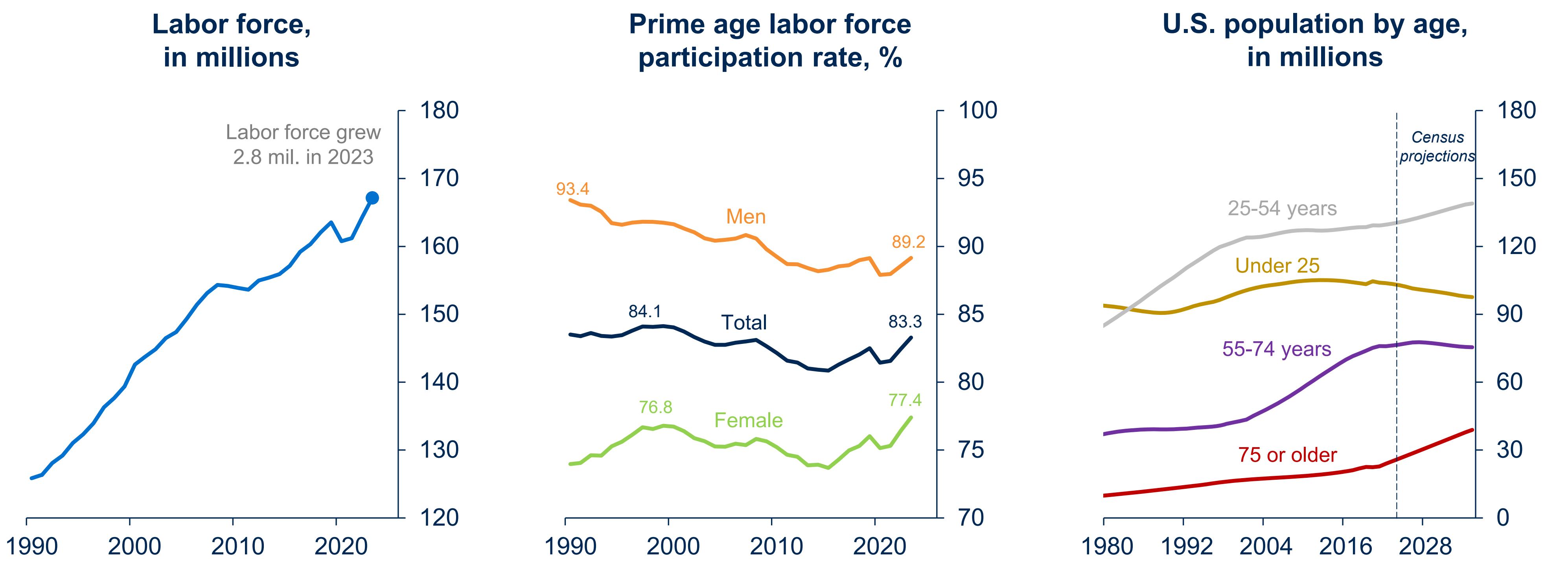
Avg annual real GDP growth by source, %



- Economic growth is driven by 3 factors:
  1) Labor – extra workers can produce more.
  2) Capital – workers with more, or better tools, can produce more.
  3) Technology – This is the portion of economic growth not attributable to labor or capital and considered as the impact of technology on improving productivity.

Source: Bureau of Economic Analysis (advance GDP estimate, data through 4Q:23); Blue Chip Economic Indicators (Feb '24). Average annual real GDP growth by source is calculated by EBC using a version of Robert Sowell's growth accounting model, which breaks GDP growth into annual contributions from labor, capital, and a residual for technology.

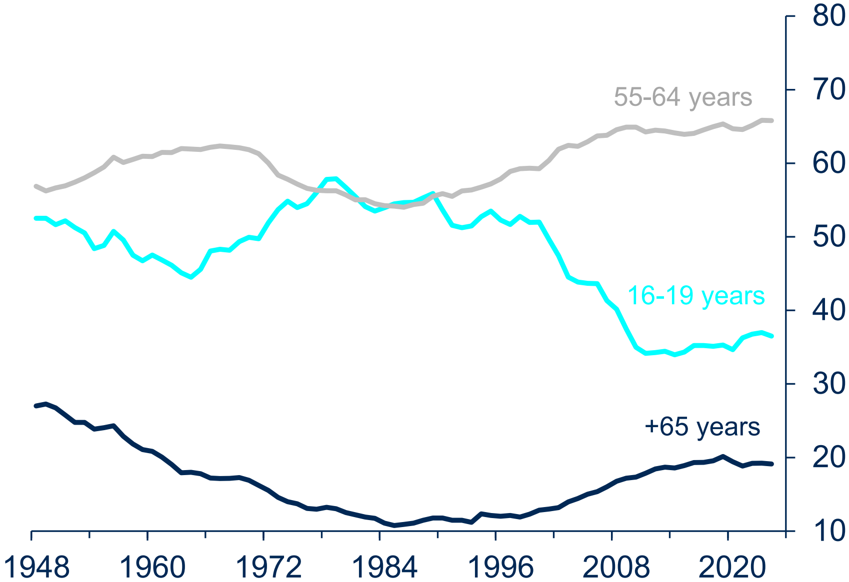
Robust GDP growth from continued labor force gains unlikely



Source: Bureau of Labor Statistics (data through 2023). Prime age is 25 to 54 years old. Census data include population projections.

Further labor growth requires engaging teens and seniors

Labor force participation rate, by age, %



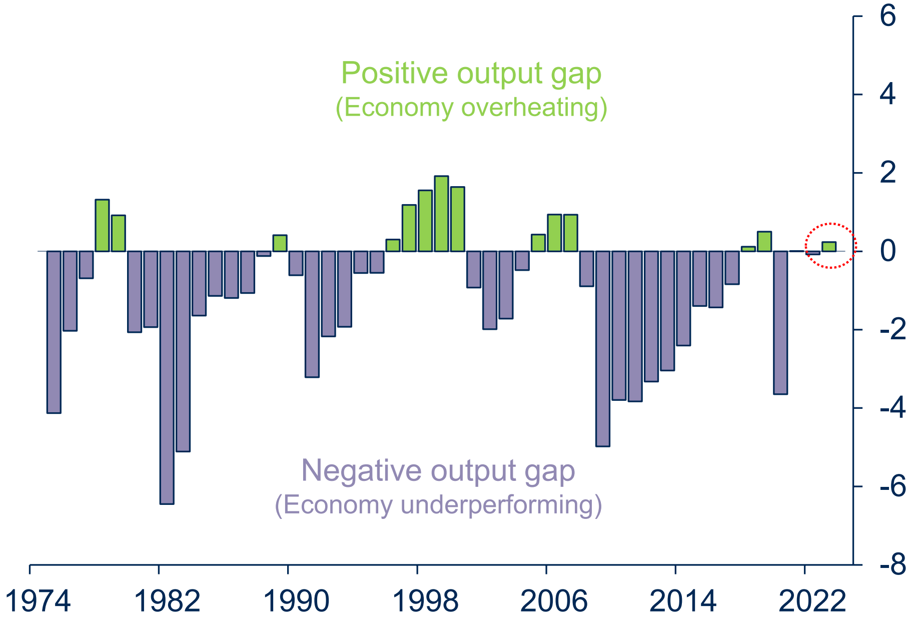
Possible labor force growth from increased labor participation among teens & seniors

	Current population, millions	Difference between current participation and historic peak	Labor force growth if participation returned to historic peak, millions
16-19 years	17	-21%	+3.6
55-64 years	42	0%	0.0
65+ years	58	-8%	+4.6
Total	117		+8.2

Source: Census Bureau (data through Jan 2024).

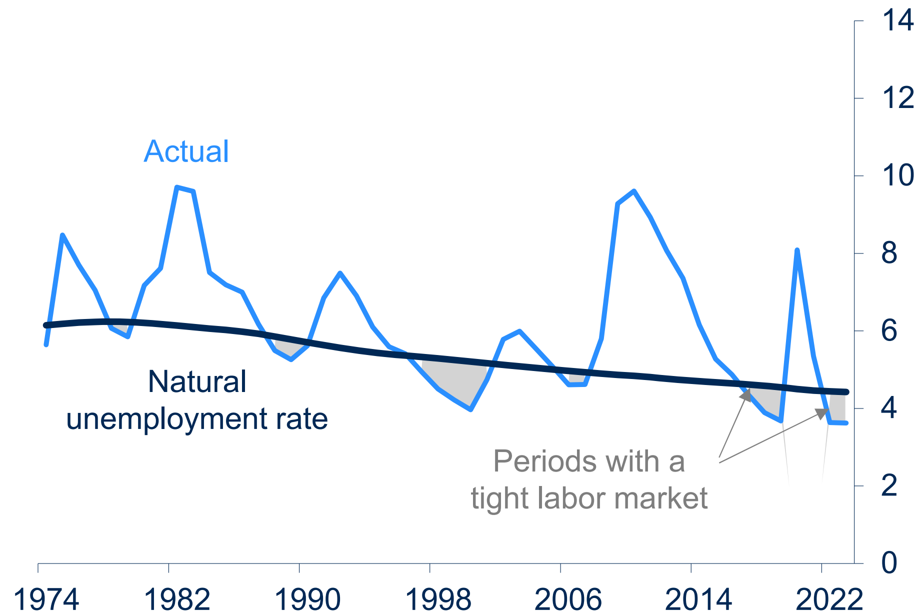
Some indicators suggest economy is overheating

U.S. annual output gap, %



Output Gap = difference between potential and actual GDP

Avg annual unemployment rate, %

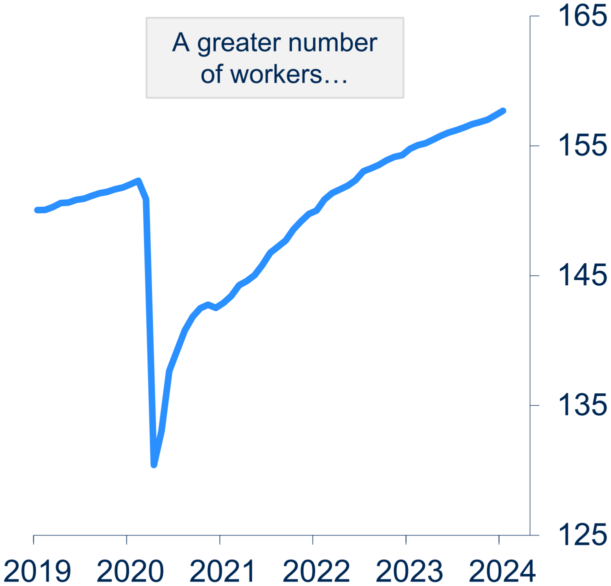


Natural unemployment rate = unemployment arising from all sources except fluctuations in aggregate demand

Source: Bureau of Economic Analysis; Congressional Budget Office; Bureau of Labor Statistics (data through 2023).

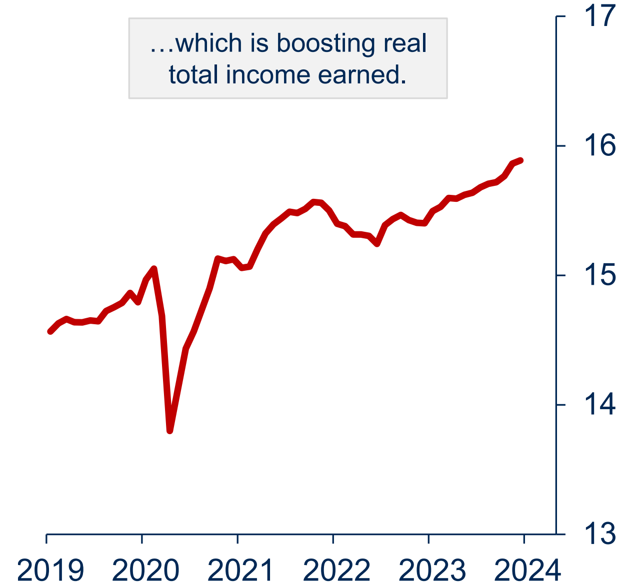
Real incomes increase as more workers earn higher real wages

Nonfarm payrolls, in millions



Real average hourly earnings, $

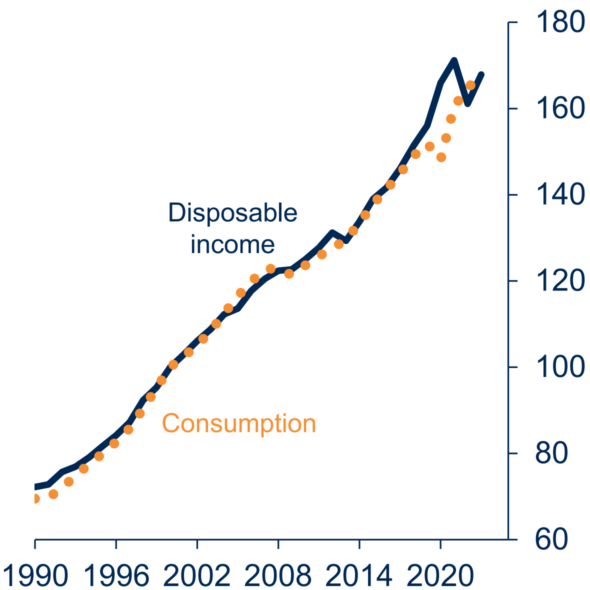
Real incomes excl. govt transfers, $T



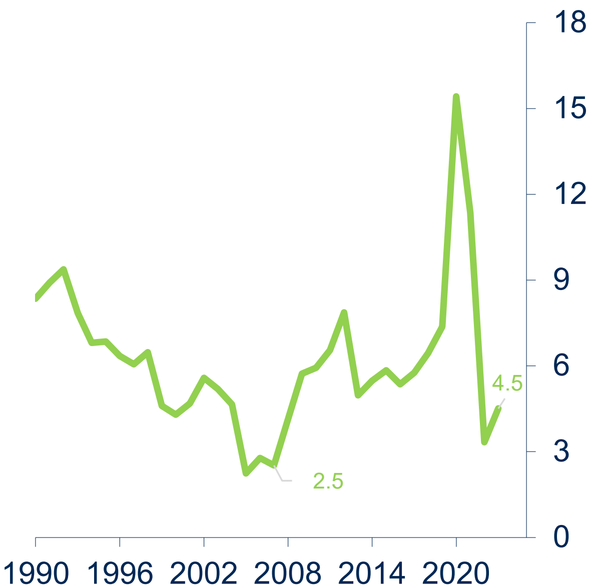
Source: Bureau of Economic Analysis; Bureau of Labor Statistics; EBC calculations. Average hourly earnings of total private production and nonsupervisory employees is deflated using the core PCE. Real personal income is the aggregate personal income earned which include wages, rental income and receipts on assets. o neutralize the effects of the Covid-19 stimulus, real personal incomes exclude government transfers.

Spending is rising in line with incomes; savings rate rebounds

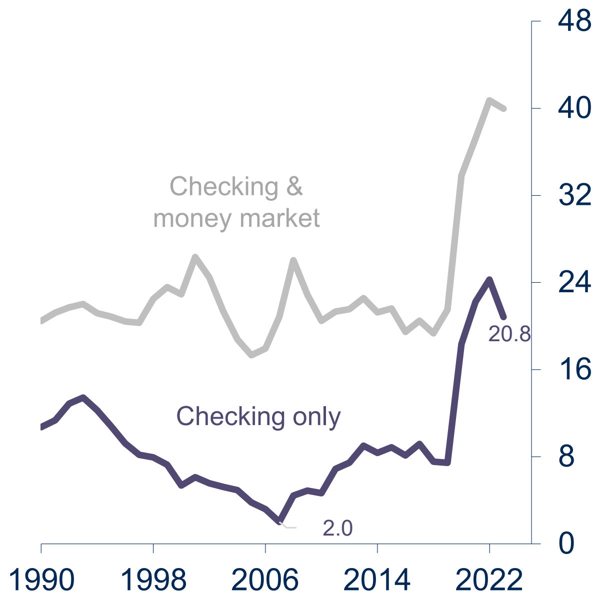
Real consumption & disposable income, 2000 = 100



Annual personal savings rate, %



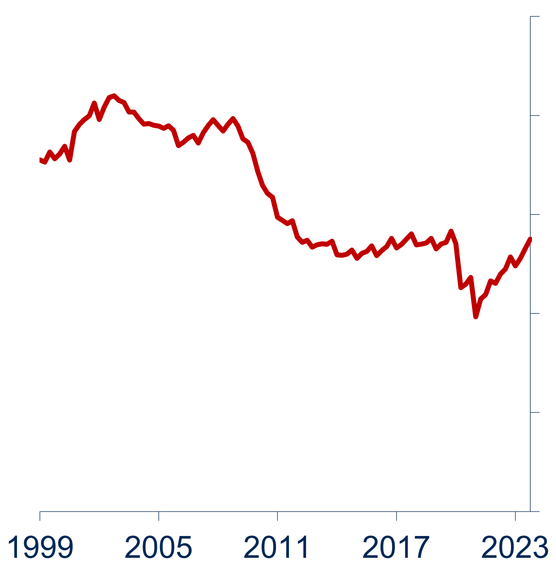
Household cash as a pct of disposable income, %



Source: Bureau of Economic Analysis (data through 4Q:23); Federal Reserve Board (3Q:23). Real consumption comes from the BEA's personal income and outlays and includes personal consumption expenditures. Note that in 2006 consumption does not exceed disposable income, rather consumption's growth rate outpaces disposable income. In the base year of 2000, disposable income exceeds consumption by 5 percent.

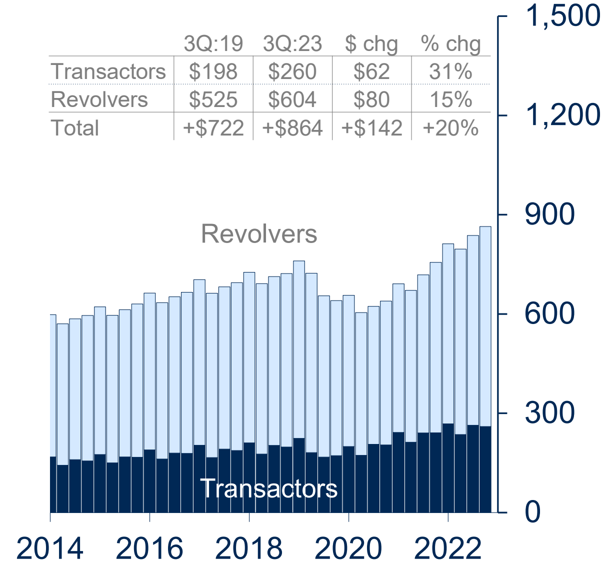
No sign consumers are using credit cards to stretch borrowing

Total credit card debt as a share of disposable income, %



Total credit card utilization rate, %

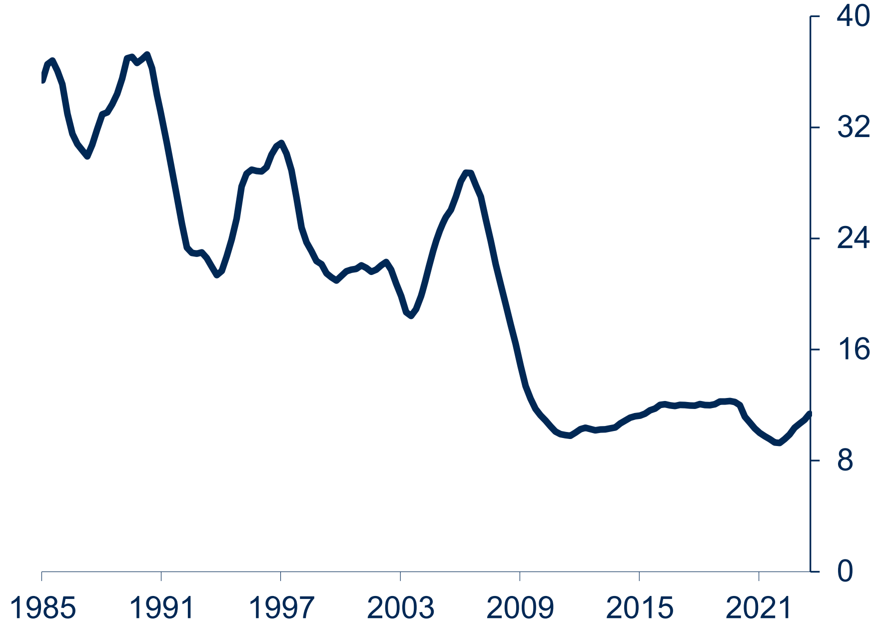
Large-bank credit card balances by purpose, $B



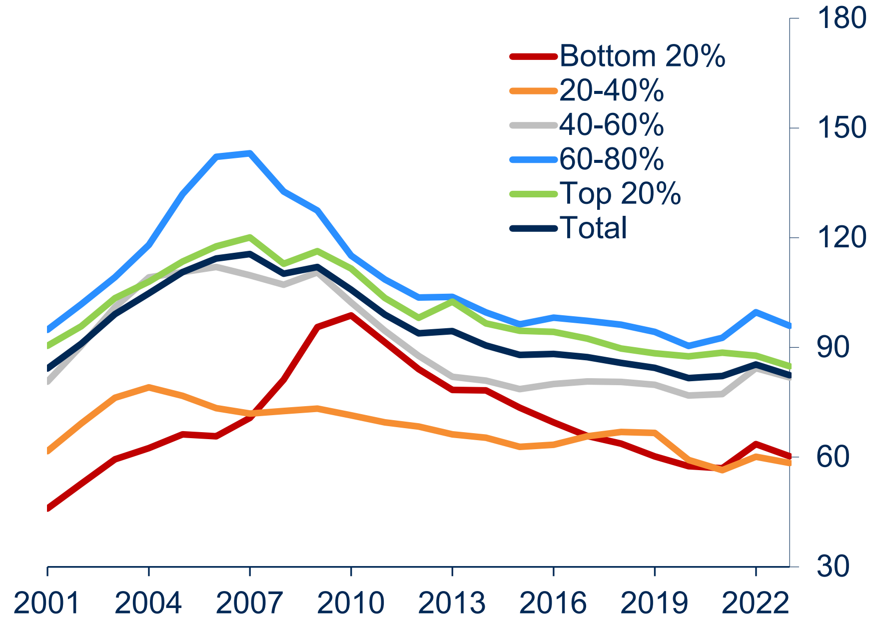
Source: FRBNY Household Debt (data through 4Q:23); Bureau of Economic Analysis (4Q:23); FRB Philadelphia (3Q:23). Large-bank credit card data is based on the FR Y-14M and is published by FRB Philly. This data covers more institutions than the OCC receives since state banks are included. Revolvers are those who carry a credit card balance from month-to-month while transactors pay their balance in full.

Households are more insulated from higher rates this cycle

Share of adjustable rate household debt, %



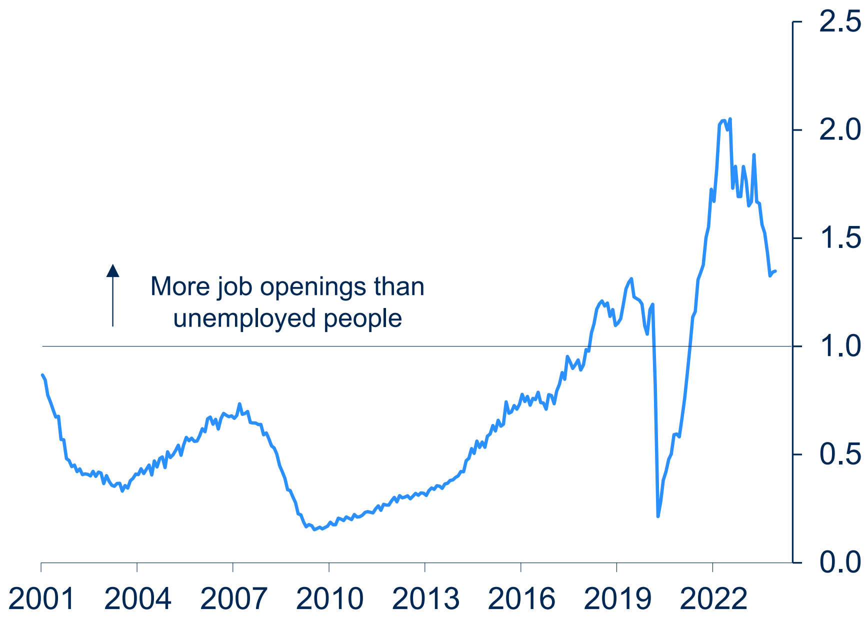
Debt-to-income ratio by income quintile, %



Source: Economy.com (data through 3Q:23); Debt-to-income ratio calculated by dividing household debt levels from the FRB's distributional accounts by the BEA's distribution of personal income. 2023 reflects loan balances as of 3Q:23. Since current year personal income distribution was unavailable, the 2022 observations were applied.

Labor market remains tight despite modest cooling

Job openings per unemployed person

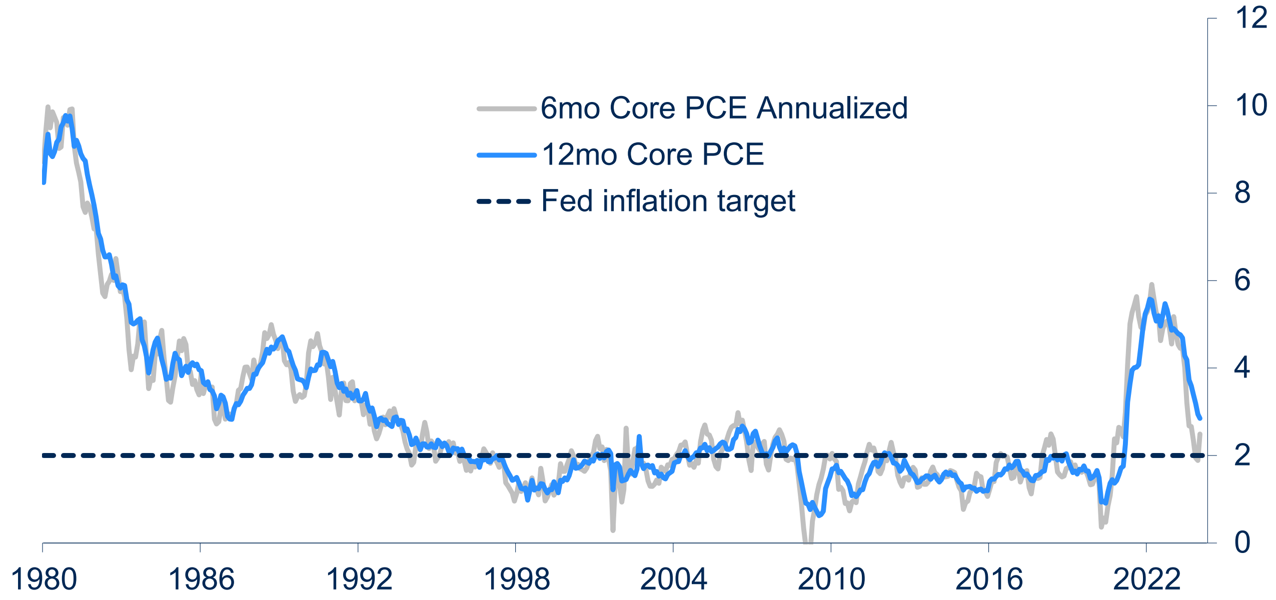


Average hourly earnings YoY pct chg, %

Source: Bureau of Labor Statistics JOLTS (data through Dec 2023); BLS Establishment Survey captures average hourly earnings for production and nonsupervisory employees (Jan 2024).

Fed’s preferred inflation measure continues to decelerate

Core PCE percent change, %



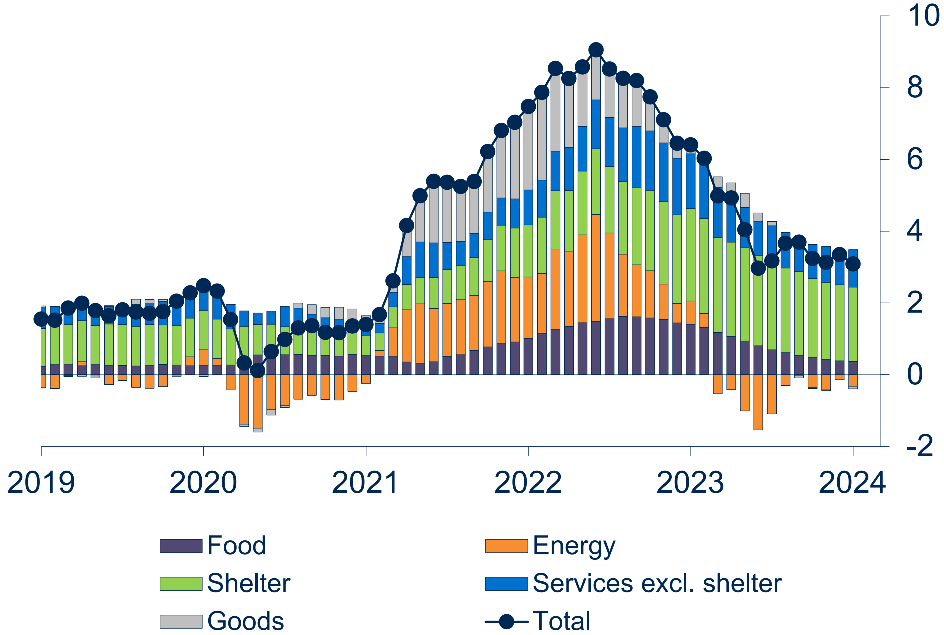
Core PCE = Personal Consumption Expenditure index from Bureau of Economic Analysis that excludes food and energy

- Core PCE is the Fed’s preferred inflation gauge since:
  - Volatile food and energy prices are excluded for a stable measure of inflation
  - PCE captures a broader range of goods and services that consumers purchase
  - PCE allows for adjustment to consumption patterns, while CPI uses a fixed basket of goods
- Traditionally, inflation is measured year-over-year to remove seasonality.
  - However, increased market focus on 6-month annualized core PCE, which is at the Fed’s 2% target.

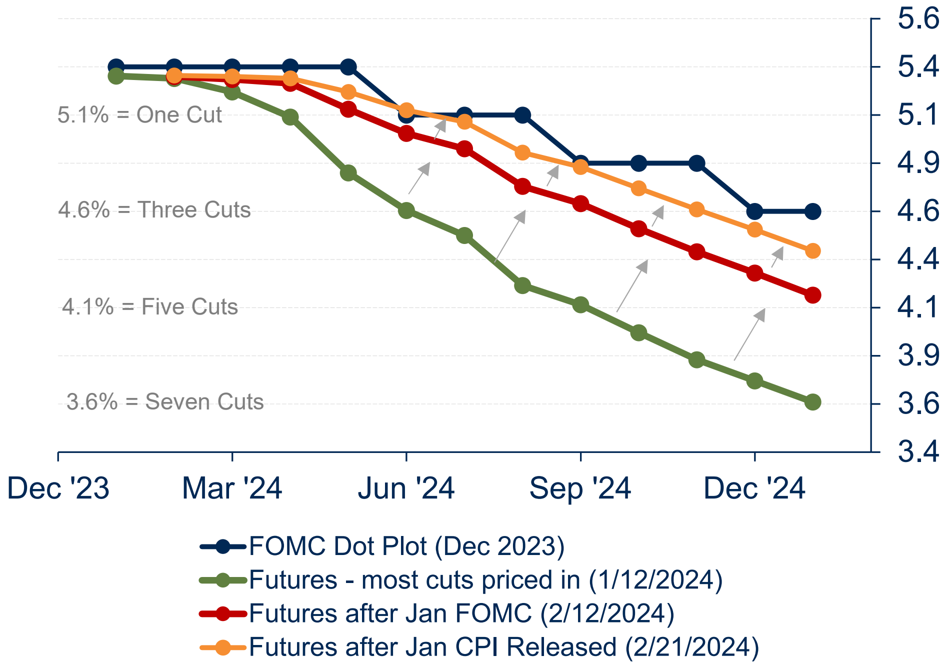
Source: Bureau of Economic Analysis (data through Dec 2023). The Fed officially adopted 2% as a longer-run inflation goal in [January 2012](#).

Markets expect fewer Fed rate cuts this year

Contribution to annual headline CPI, %



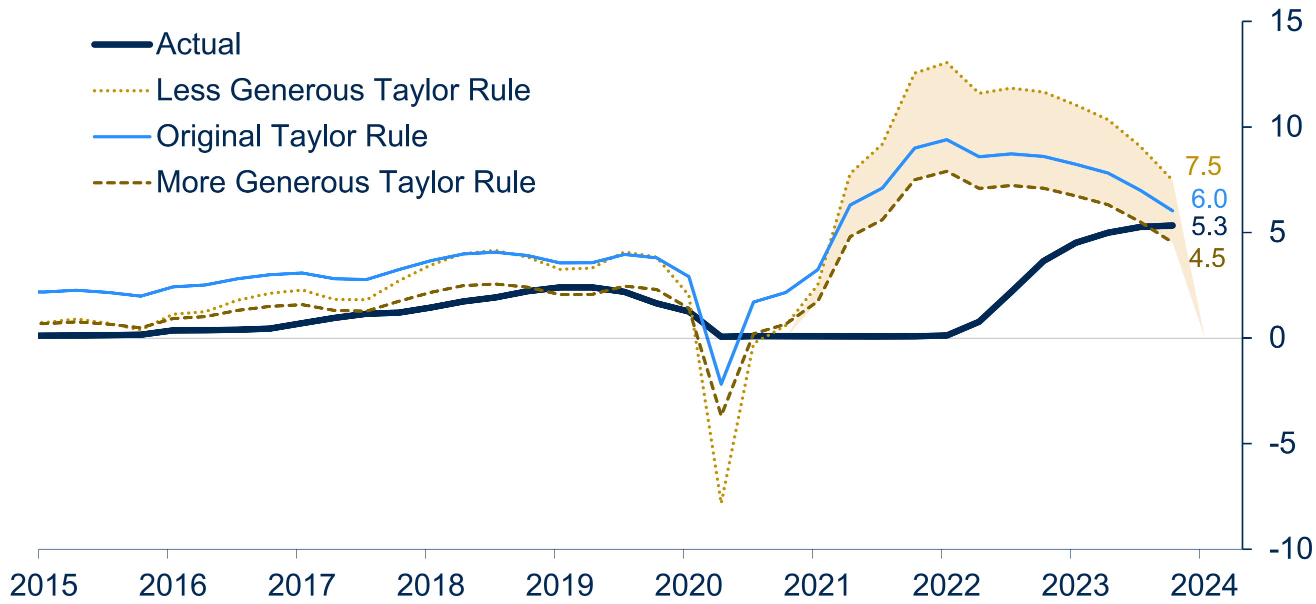
Implied Federal Funds Rate, %



Source: Federal Reserve Board (Dec 2023); Bloomberg LP (data as of Feb 21, 2024).

Fed Funds rate within range of standard policy rule at 4Q:23

Federal Funds Rate, %



- The Taylor Rule is a guideline for central banks to set their target interest rates based on economic conditions.
- At 4Q:23, the original Taylor Rule suggests the Federal Funds rate was accommodative.
- Several versions of the Taylor Rule exist, and these can produce a wide range of Fed Fund estimates.

Source: Federal Reserve Board; Bureau of Economic Analysis; EBC calculations. The More Generous Taylor Rule assumes a 0.5% real interest rate, as opposed to the original 2% rate. The Less Generous Taylor Rule changes the central bank's response to the inflation gap from 0.5 to 1.5. The Both approaches are based on a speech from FRB St Louis President in 2023.

Conclusion

- GDP expected to return to 2008-2022 trend; recession not in Consensus forecast
- Strong labor market and rising incomes support further consumption growth
- Fed's inflation battle may not be over