Strategic Analysis

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U.S. Economic Outlook: Prospects for 2024 and Beyond

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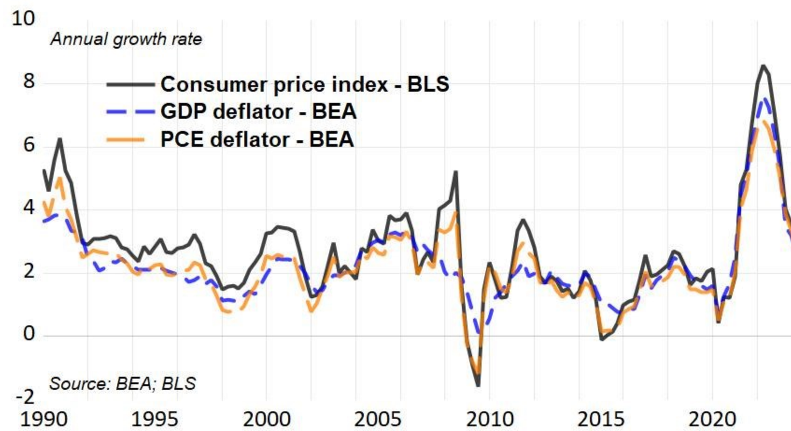
Most economic variables measuring the performance of the U.S. economy show a strong recovery. Accelerated GDP growth and employment, consumption and investment as well as easing supply-chain difficulties are fueling the U.S. growth despite the Federal Reserve's maintaining high interest rates. Inflation in the U.S. appears to be decreasing, but the Fed is in no hurry for a rate cut, in the second half of this year, despite overwhelming evidence of disinflation started in the latter part of 2022 and continuing to this year as shown in Figure 1 –the uptick in the first few months notwithstanding—and financial market expectations embodied in the run up of equity prices.

Contrarian minority voices at the Fed, Governor Michele Bowman (2024), and economists aligned with Lawrence Summers' views consider a possible rate cut a huge mistake and would prefer another rate hike instead. The contrarian view, unfortunately, has many followers: the general public believing that inflation hasn't decreased, as encountered daily in necessary expenses and listening to many commentators insisting on no significant improvement. Sanguine voices observe the BLS and BEA reports and are convinced of the disinflation trend expecting the Fed to gradually decrease interest rates later this year. As Nersisyan and Wray (2022) have argued, the wrong-headed tight monetary policy implemented by the Fed to curtail inflation and ease inflation expectations especially when from their own research have admitted they have no theory of inflation (Rudd, 2021) is dangerous. It is a policy of flying blind, based on estimates of unobservable variables and perhaps hope in lowering inflation (Papadimitriou and Wray, 2021).

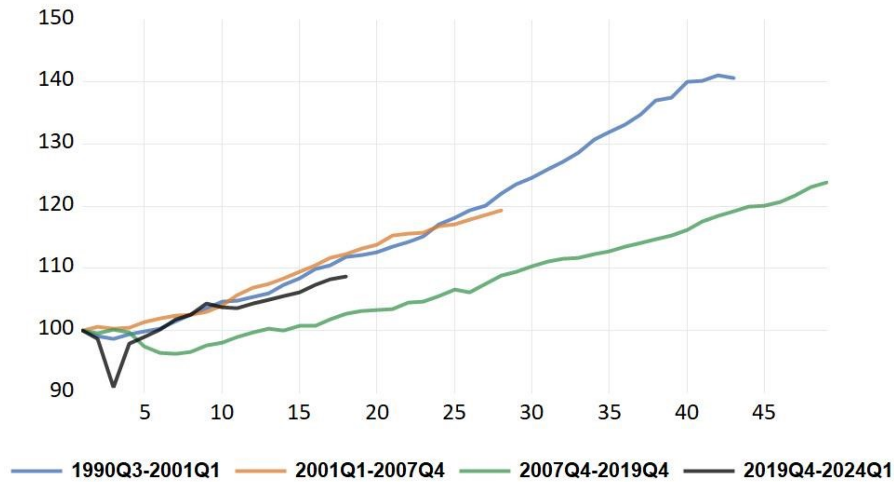


Some omens in the horizon aren't encouraging and continuing the high interest rates longer will undoubtedly minimize the possibility of a "soft landing" if such possibility ever existed. There are serious economic issues relating absolutely to high interest rates affecting the valuations of commercial and multi-family buildings and bank exposure to them (Whalen 2024)

High mortgage interest rates and the strong effects on housing, especially affordable housing does not bode well for the U.S. economy. The National Association of Realtors in their report in April 2024 for existing home sales show the continuing decline began with the Fed's interest rate hikes that pushed the popular 30-year mortgage rate to levels observed in 2002. At the same time, servicing dollar denominated debt in the developing economies has strained government budgets.

As mentioned before, the Fed's interest rate hikes seem to have had little effect on U.S. growth of GDP after the Covid-19 contraction. It was reversed exhibiting a strong recovery and one of the fastest of the recent past for the first 9 months, becoming anemic thereafter to the end of first quarter of 2024 as depicted in Figure 2. It was the swift and significant increase in public consumption which in turn increased private expenditures affecting inflation primarily caused by exogenous shocks including some remaining supply-chain problems and energy and transportation-related issues emanating from the wars in Ukraine – Russia, Israel-Gaza and terrorist attacks in the Red Sea.

The United States is heading into a presidential election, this year, in the midst of geopolitical turbulence in Europe and the Middle-East and economic challenges at home. Maintaining the GDP growth rates of the recent post-Covid years are not in the cards as we will notice in the projections



from CBO, other international organizations and our own, the low unemployment rate notwithstanding.

In this Report, we review and analyze prevailing conditions, assess the behavior of drivers of growth and/or decline, consider the likely paths of fiscal policy, net exports and private sector expenditures and the geopolitical challenges facing the U.S. economy. We then use reasonable assumptions to develop our own growth projections.

We continue to observe in Figure 3, the insignificant impact of low unemployment on wage inflation, a matter discussed in our report of 2020 –again a presidential election year (Papadimitriou,

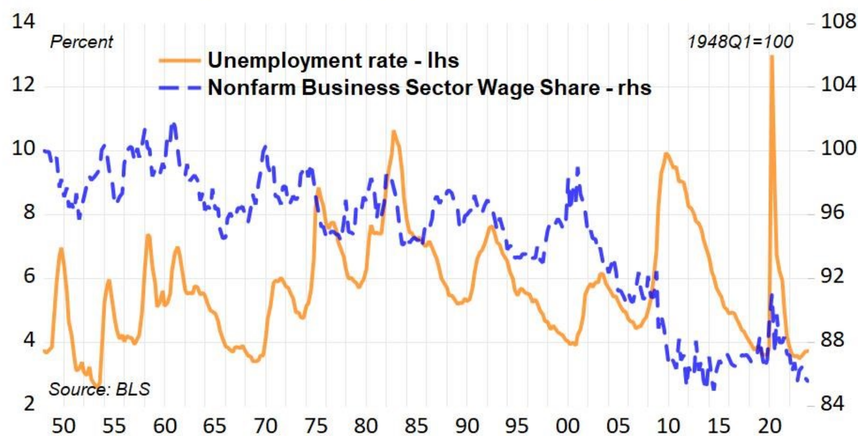


Figure 4a. Change in Employment–Population Ratio, 25 Years and Older

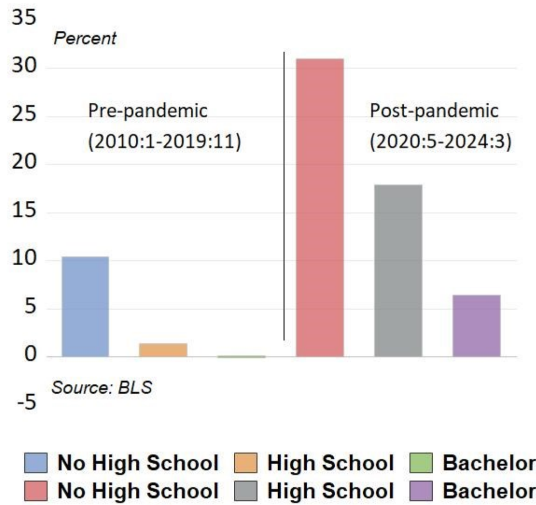
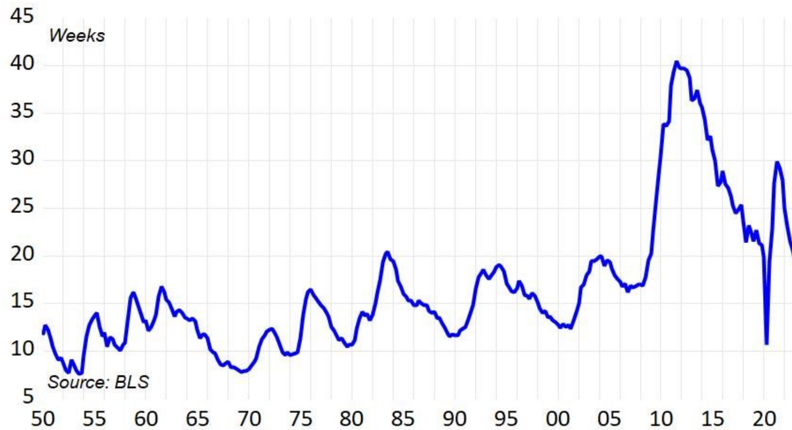
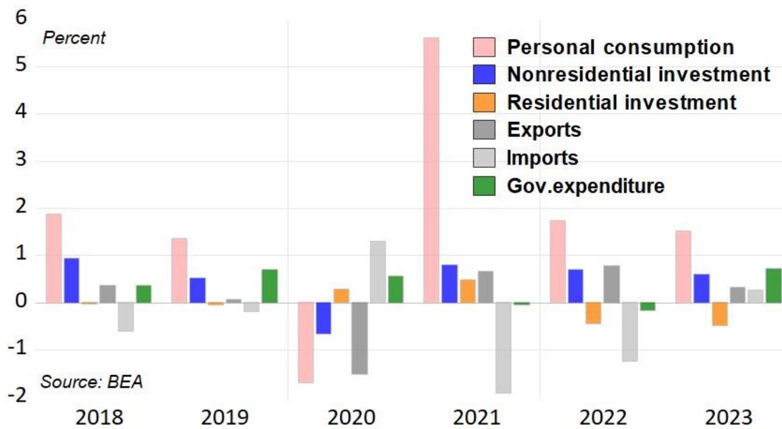
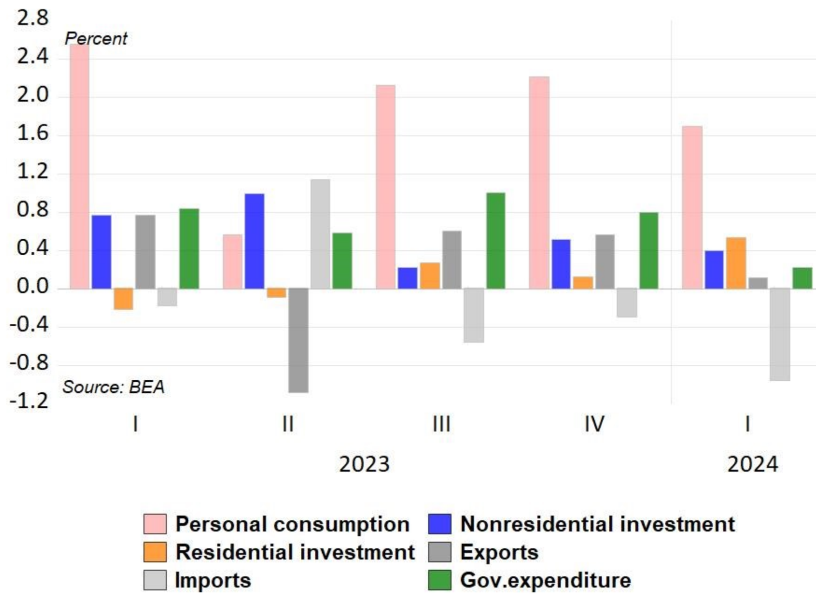


Figure 4b. U.S. Average weeks unemployed



Nikiforos and Zezza, 2020) despite the Biden administration's efforts to extol the importance of the institution of unions. The wage share in the national income pie has been declining since 2001, except for the small uptick in the last few quarters in 2019 and a few months in early 2020, resuming its declining trend to the end of the 2022. An explanation of the declining labor income may be found by examining and comparing the pre- and post-pandemic period changes in the employment-population ratio of the working age population –25 years and older—showing the lowering of the unemployment to be the result in the overwhelming portion of the no high school diploma individuals in low-productivity jobs for the unskilled employees as compared to the portions of employees with high school diploma and those with a bachelor degree and higher, as illustrated in Figure 4a. Furthermore, the average duration of unemployment may also contribute to the declining share of





labor income. As shown in Figure 4b, the average duration has been decreasing since 2011 and dropped precipitously in the early months of 2020 only to return very quickly to the highest level of the postwar period.

Next, in figures 5a and 5b, we note both positive and negative components driving GDP growth on an annual (2018-2023) and quarterly (2023-2024Q1) bases respectively. In both figures, the significance of consumption as the major driver of growth is clearly shown contributing the lion's share of growth. Government expenditures have been and continue to be important to growth and both figures illustrate it, although in 2024Q1 is declining as compared to previous quarters in 2023.

The increase in government expenditure in 2023 most likely is due to Biden's Inflation Reduction Act, Infrastructure Investment and Jobs Act and the CHIPS and Science Act –all centering on supply interventions and attempts toward the "greening" of the economy labeled by many as a revival of industrial policy. On the other hand, the Trump and Biden administrations strong trade policies notwithstanding, the net exports trend continued to be a stubborn drag on the U.S. economy unlike the experiences of other countries --China and Germany among others—relying on export-led growth. It should be noted, however, that imports decreased in 2023 –especially in the second quarter—offsetting the dramatic drop in exports, but the overall trend shows a widening trade deficit; we will return to this issue later. Investment, the other driver of growth showed the business component contributing more in the post-Covid period than residential investment being adversely affected by the interest rate hikes. Private non-residential investment, however, on information processing, software, computers and peripheral equipment continued its accelerated trend reaching close to $162 billion at the end of 2024Q1 (BEA).

Industrial production, as measured by the Federal Reserve, rose 0.4 percent in March, but declined at an annual rate of 1.8 percent 2024Q1 while manufacturing output increased 0.5 percent in March. Total industrial production in March was unchanged compared with its year-earlier level. Capacity utilization moved up to 78.4 percent in March, but it was 1.2 percent below its long-run (1972–2023) average. The Institute of Supply Management's March 2024 Purchasing Managers Index was 50.3 while their subsequent report for the April 2024 Index showed a decline to 49.2.

The mixed developments discussed resulted in a slowdown of the annual growth rate of real GDP at 1.3 percent for 2024Q1, less than 40 percent of the annual growth rate of 3.4 percent recorded in 2023Q4. As it will be shown in our baseline projections, these conditions will result in a slower real GDP growth rate of less than 2 percent for 2024 and a little over 1 percent for 2025. Furthermore, there is another factor that may contribute to an even slower growth rate of GDP stemming from a significant correction of the overvalued equities market. In what follows, we discuss our baseline projections while we detail further the crucial factors that form the basis for our assumptions embodied in the baseline.

Baseline

Our point of departure is a review of the Congressional Budget Office (CBO) growth projections in February and March 2024. Real GDP growth rate on an annual basis accelerated from 1.9 percent in

2022 to 3.1 percent in 2023. In its February projection CBO was estimating a growth deceleration in 2024 to 1.5 percent, and increased growth to 2.2 percent for the years 2025-26. In its March (2024) projection the growth rates for 2023 and 2024 were revised to 2.5 percent from 3.1 percent and to 1.8 percent from 1.5 percent respectively.

The contributing factors of demand are detailed in Table 1 while Table 2 lists the GDP growth rates from the IMF and OECD for each year 2024-2026. The deceleration in the CBO growth rate projections is primarily due to the projected declines in consumption and government outlays while exports and imports will grow minimally with imports a bit higher contributing more to a negative effect on GDP. The positive contribution is from investment, both business and residential with the latter projected to increase rather dramatically. There are also inflation projections which after 2024, all converge to around 2 percent.

Table 1: CBO Projections of Real GDP Growth and Its Components

Percentage points	**2023**	**2024**	**2025**	**2026**	**2027-2028**	**2029-2034**
Real GDP	3.1	1.5	2.2	2.2	2.1	1.9
Consumer spending	1.8	0.9	1.3	1.1	1.4	1.5
Business Investment	0.5	0.5	0.8	1	0.6	0.4
- Business fixed investment	0.5	0.3	0.4	0.5	0.4	0.4
- Residential investment	*	0.2	0.4	0.5	0.1	*
Government purchases	0.7	0.1	0.1	0.2	0.1	0.1
- Federal	0.3	*	*	*	*	*
- State & Local	0.5	0.1	0.1	0.1	0.1	0.1
Exports	0.2	0.2	0.3	0.3	0.3	0.2
Inventories	*	-0.2	-0.4	-0.3	-0.3	-0.3

*Source: CBO, 2024. * = between -0.05 percentage points and 0.05 percentage points.*

The projections from the CBO and other international organizations are optimistic as compared to those of our baseline scenario. The CBO's projections are mostly based on the US economy following a "business as usual" path. Our model based on the original Cambridge model (Cripps and Godley, 1976) and modified for the US by Godley (1997) produces lower growth rates of 1.8 percent for this year, 1.2 percent for 2025 and 1.3 percent for 2026. These projections are based on our assumed behavior of private and public expenditures and net exports. We avoid projecting beyond the 2024-26 period since the economy's development will depend on the priorities set by the incoming administration taking office in 2025.

Table 2: Comparison of Projections

Growth rates	**2023**	**2024**	**2025**	**2026**
GDP				
CBO (Feb.)	3.1	1.5	2.2	2.2
CBO (Mar.)	2.5	1.8		
IMF (Apr.)	2.5	2.7	1.9	2.0
OECD (May)		2.6	1.8	
Inflation (PCE)				
CBO (Feb.)	2.7	2.1	2.2	2.1
CBO (Mar.)	4.1	2.6		
IMF (Apr.)	4.1	2.9	2.0	2.0
OECD (May)		2.4	2.0	

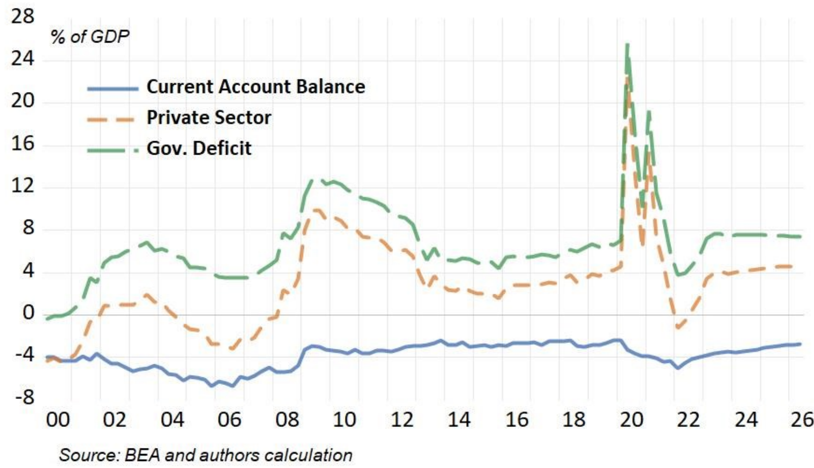
The assumptions embodied in our simulations are "neutral" as possible including an inflation rate gradually decreasing to around 2 percent and a stable nominal exchange rate. Inflation and growth rates of US trading partners are those estimated in International Monetary Fund's (IMF 2024) April 2024 World Economic Outlook (WEO). We further assume equity and real estate prices remain stable, while the effective federal funds rate will gradually decrease to 2.8 percent by 2026. The results of our projections are shown in Table 3. The main differences when compared with the CBO projections, are that both private and public consumption and investment expenditures are lower than the CBO baseline while net exports produce a higher deficit.

Table 3: Baseline Projections

	2023	**2024**	**2025**	**2026**
Real GDP (% growth rate)	2.5	1.8	1.2	1.3
Private expenditure	1.5	1.8	1.3	1.6
Public expenditure	4.1	2.4	0.8	0.8
Exports	2.6	2.3	3.7	4.0
Imports (% of GDP)	15.3	15.5	15.8	16.2
Inflation	3.6	2.5	2.2	2.0
Gov. Debt (% of GDP)	114.3	116.7	119.2	122.3
Current account (% of GDP)	-4.4	-3.6	-3.4	-3.0

The implications of our projections for the financial balances of the three institutional sectors are shown in Figure 6. The government sector's balance shows a deficit of 7.4 percent corresponding

Fig 6: US. Sectoral Balances



to the private sector balance increase to 4.6 percent and a current account deficit of 2.8 percent of GDP.

Household and Firm Financial Conditions

Households

As discussed above, the increased government expenditure in the post pandemic period had a positive effect on job growth and household disposable income despite the high interest rates. The gradual increase of interest rates, however, had an impact in obtaining new mortgage financing even though residential investment recovered and based on the CBO projections is expected to continue increasing for some years at significant rates of 5-10 percent anticipating a fall in interest rates. As it can be seen

Figure 7. U.S. Households: Residential investment and mortgages

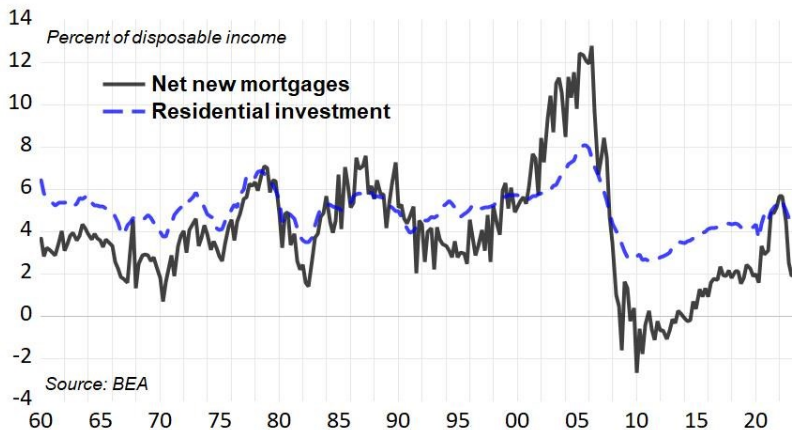


Figure 8. U.S. Households. Residential investment and capital gains

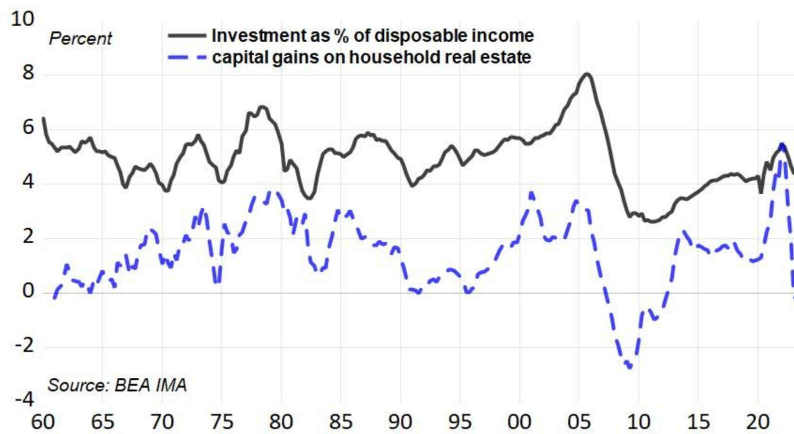
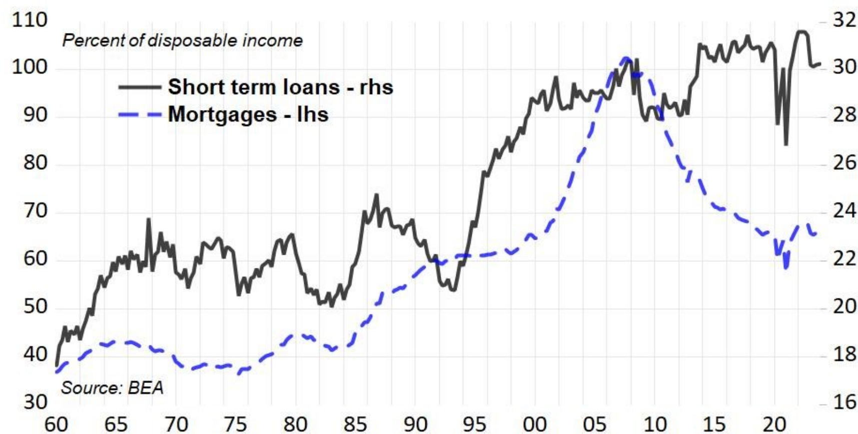
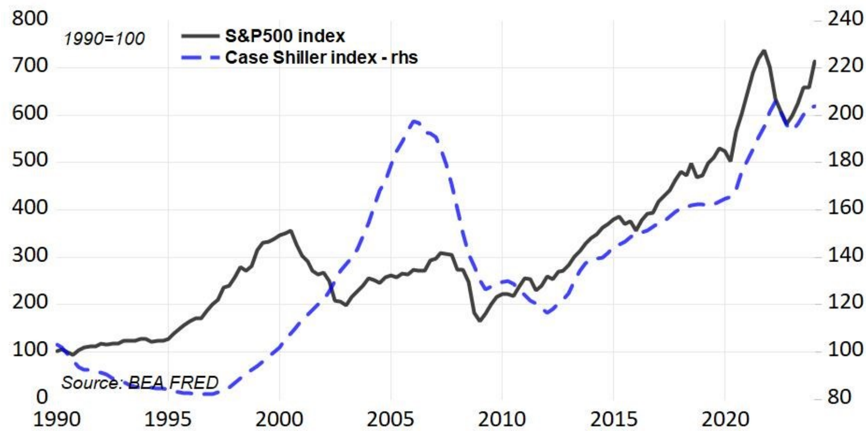


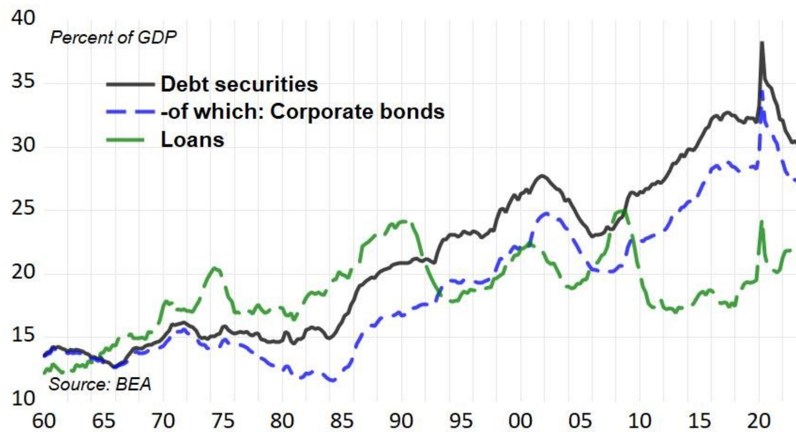
Figure 9. U.S. Households: Debt outstanding



in Figure 7 net new mortgage financing after a drop during the Global Financial Crisis of 2007-09 resumed its growing trend until the pandemic hit when its declining trend returned to 2023 as the available data testifies. In Figure 9, we observe the same trend of mortgages as in Figure 7, but in addition, an increasing trend of household short term debt primarily on credit cards, motor vehicles financing and other short-term credit until 2014 remaining stable thereafter, but still totaling over 100 percent of disposable income.

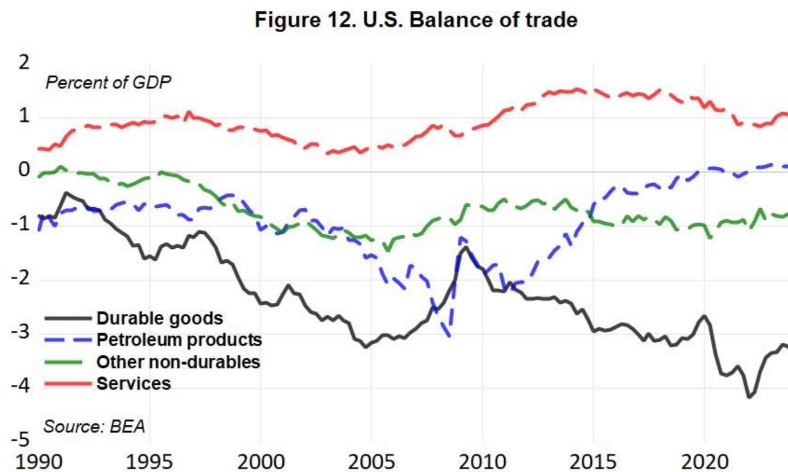
There is evidence to suggest that residential investment appears to be strongly correlated to the behavior of the housing market. In figure 8, we present, as percentages of disposable income, residential investment, on the one hand, and on the other, the capital gains that can be derived from house sales to households, if housing were to be considered an alternative to the equity market investment. What we observe, in Figure 8, is that this correlation may had been relevant until 2021,





but it broke down since then with the capital gains trend to have fallen precipitously unlike with the stock market as the indices of S&P 500 and Case-Shiller show. This appears, yet, another disincentive for significant residential investment to occur casting doubts of the optimism of the CBO projections for the residential investment sector and associated spending to boost GDP growth in the near future.

Unlike the declining returns on residential investment, equity markets have performed very well as is always the case with overvaluations. The returns on investment in the stock market as shown by the S&P 500 and the Case-Shiller indices, in Figure 10, have been a source of wealth and disposable income. Whether this, if continued, will be a driver for increased private consumption is not assured, given the Biden proposals to increase taxation on the wealthy. Moreover, a stock market correction will have major repercussions in the real economy as we have witnessed in previous episodes of equity market corrections. The Case-Shiller cyclically adjusted price-earnings ratio (CAPE) shown in Figure



10, illustrates the current valuation matching the valuation of the late 1990s, dot.com bubble, that when it burst did not have welcome consequences. Similarly, the S&P 500 index matches the years leading to the global financial crisis. There is then a considerable downside risk that neither the CBO nor our projections take into account which, if it occurs, will, in turn, have negative feeding effects on GDP growth.

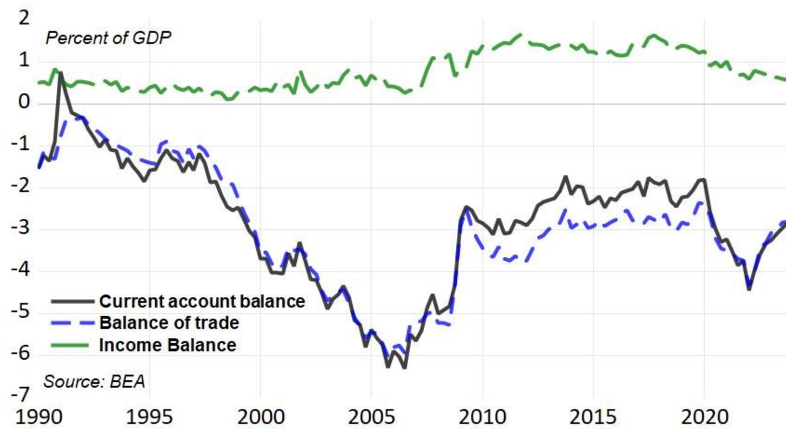
Firms

Contrary to the household financial conditions, firms' debt exposure continued its increasing trend in all of its forms until the pandemic hit when a trend of deleveraging began. In Figure 11, we observe the increasing stock of debt in securities consisting of corporate bonds, commercial paper, municipal indentures and loans until 2020. The latest available data show total business debt to be close to 80 percent of GDP, lower from its peak in 2020 of close to 100 percent, but at the same level of 2015. The post-pandemic deleveraging of the corporate sector introduces doubts of increasing business investment for this and next years.

Hence, private expenditure –consumption and investment—from households and firms would not increase substantially unless as in previous years there is government stimulus.

The Foreign Sector

Trade issues are always a concern of each country. In the US, imports from the rest of the world overwhelm exports and as Figure 12 illustrates except for petroleum products and services, durable and non-durable goods have been widening the trade deficit for many years. Both the Trump and Biden administrations imposed tariffs on products from many countries, but mainly focused on imports from China. This was to encourage production at home, but alas the anticipated reduction of



Chinese imports has had little success and seems to have had no impact on the American consumer. Irrespective of the outcome of the 2024 Presidential election, the new President will most likely continue and even intensify trade restrictions imposing even higher tariffs, if one is to take at heart the announcements made by the leading candidates of either political party.

There are significant issues relating to the US trade balance. First and foremost, is that the US industrial dominance has been declining for years and does not seem it will be reversing any time soon, even with President Biden's "modern supply intervention" otherwise known as industrial policy included in the Inflation Reduction Act, Infrastructure Investment and Jobs Act and the CHIPS and Science Act. Second, as we have argued elsewhere (Papadimitriou, Nikiforos and Zezza, op.cit, and Nikiforos and Zezza, 2018) tariff policies are contradictory with present tax policy and instead they cause disruptions in the supply chain of US corporation and increases in the costs of consumption goods. Finally, the only positive component of US trade is in the petroleum sector, as we explained elsewhere (Papadimitriou, Nikiforos and Zezza 2019) which has improved even more since the Ukraine-Russia war by increasing exports of Liquified Natural Gas (LNG) to Europe. Notwithstanding this notable improvement, it is not sufficient to offset the deficit created from the other components of trade as depicted in figure 12.

The trade balance is the main determining factor of the balance of payments. Figure 13 shows the trend of the balance of trade and the income balance—repatriation of profits and investment returns—from US investments abroad which was larger in the 2008-2018 period. It began declining since then, still in surplus, but albeit insufficient to offset the trade deficit. The current account balance,

still in deficit, has improved in the post-pandemic period in concert with the improvement of the trade deficit from the petroleum goods trade surplus.

Godley (1999, 2000) warned, however, that when a country continues to run large current account deficits relative to GDP, it would be building up a large and growing foreign debt and this, in turn, implies large and growing interest payments servicing it. Godley, of course, was well aware of the hegemonic role of the US dollar in foreign exchange markets, but argued, nevertheless, that increasing interest payments made to the rest of the world would transfer purchasing power to foreigners that would reduce the potential growth of domestic demand. The US, however, being a sovereign country and issuing a reserve currency (US dollar) has in Charles de Gaulle's words "the exorbitant privilege" to incur large current account deficits. Furthermore, the US has benefited, first, from the low-interest rate environment of the last decade keeping interest payments to other countries relatively stable as a percent of GDP, and second, from the income it receives from capital invested abroad so as interest payments outflows are less than the foreign income inflows maintaining the income balance in the foreign sector in a positive territory.

Conclusions

In this report, we discussed the fast but short recovery of U.S. economy in the post-pandemic period until 2023. Robust consumption and investment and a relaxation of fiscal policy were the drivers of the recovery from accelerated GDP growth. Signs for the same rate of growth aren't encouraging. The data, at the time of writing this report, show growth to be anemic as the 1.3 percent for 2024Q1 document. The CBO projection based on significant increases in private sector expenditures including residential investments appear doubtful unless the fiscal policy relaxation continues. The trade balance will continue on the same path of being in deficit while both the household and corporate sector to be deleveraging instead of increasing spending. Even though the run up of the stock market may trigger the Keynes' effect of additional spending, there are significant down risks with its overvaluation levels as the various indices indicate. Our own baseline projections for the 2024-26 period is more pessimistic when compared with those of the CBO, IMF and OECD. Tight monetary policy, if it continues for long, wouldn't help matters especially for residential investment a key growth driver in the CBO growth projections.

We hope the new administration will expand fiscal policy especially focusing on the transition in the greening of the US economy, covering the deficits in physical infrastructure and basic research

and development. The various forms of industrial policy are good ideas, but we are skeptical of such policies being successful in the U.S. especially in reviving the manufacturing sector that lost its dominance long ago in favor of an ever expanding financial sector.

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