THE BEACON OUTLOOK
UNITED STATES

Winter 2024

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THE OUTLOOK FOR 2024: LESS GROWTH, MORE UNCERTAINTY

Over the past few years, Beacon Economics has commented regularly about the widening gap between our nation's social narratives and its economic realities. But the current interpretations and explanations about what happened to the U.S. economy in 2023 have pushed this chasm to nearly Kafkaesque proportions.

Well into 2023 the standard narrative asserted by a majority of economic forecasters and on display by nearly every major news outlet, was that the United States was on the brink of a recession due to inflation and rising interest rates. Yet, according to the narrative, we ultimately dodged that bullet, a change in fortune that is being largely credited to the man at the helm of the Federal Reserve, Jerome Powell (we can assume to the chagrin of President Biden's reelection campaign). More significantly, 2023 saw slowing inflation and, since the final Federal Reserve FOMC meeting, the running narrative now includes an expectation of interest rate cuts in the year ahead, which has caused equity markets to surge to near record high levels.

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UNITED STATES FORECAST

U.S. FORECAST - OUTPUT

	Current	Forecast			
	Q3-23	Q4-23F	Q1-24F	Q2-24F	Q3-24F
Real GDP (Billions, 2012$)	**19,917.5**	19,976.3	20,042.0	20,123.6	20,242.7
Real GDP (% Change from Preceding Period, SAAR)	**4.9**	1.2	1.3	1.6	2.4
Consumer Spending (Billions, 2012$)	**13,777.6**	13,858.1	13,914.4	14,004.6	14,105.2
Consumer Spending (% Change from Preceding Period, SAAR)	**4.0**	2.4	1.6	2.6	2.9
Fixed Investment (Billions, 2012$)	**3,902.7**	3,880.8	3,915.2	3,917.0	3,950.3
Fixed Investment (% Change from Preceding Period, SAAR)	**8.4**	-2.2	3.6	0.2	3.5
Nonresidential Investment	**3,745.5**	3,763.3	3,796.4	3,813.9	3,838.0
Nonresidential Investment (% Change from Preceding Period, SAAR)	**0.8**	1.9	3.6	1.9	2.6
Residential Investment (Billions, 2012$)	**71.3**	36.7	37.3	23.4	30.9
Residential Investment (% Change from Preceding Period, SAAR)	**3,328.1**	3,333.3	3,341.4	3,346.8	3,351.1
Change in Private Inventories (Billions, 2012$)	**4.6**	0.6	1.0	0.6	0.5
Government Spending (Billions, 2012$)	**-1,050.2**	-1,063.3	-1,101.3	-1,122.4	-1,143.5
Government Spending (% Change from Preceding Period, SAAR)	**4.4**	5.1	15.1	7.9	7.7
Exports (Billions, 2012$)	**2,339.2**	2,378.1	2,389.5	2,410.7	2,431.2
Exports (% Change from Preceding Period, SAAR)	**6.2**	6.8	1.9	3.6	3.4
Imports (Billions, 2012$)	**3,389.4**	3,441.4	3,490.8	3,533.1	3,574.7
Imports (% Change from Preceding Period, SAAR)	**5.7**	6.3	5.9	4.9	4.8

Source: U.S. Bureau of Economic Analysis; Forecast by Beacon Economics

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U.S. FORECAST - KEY INDICATORS

	Current	Forecast			
	Q3-23	Q4-23F	Q1-24F	Q2-24F	Q3-24F
Industrial Production (Index)	**103.4**	102.6	103.3	102.8	102.7
Nonfarm Payrolls (Quarterly Change, 000s)	**608.7**	559.0	80.3	-98.1	-204.3
Civilian Unemployment Rate (%)	**3.7**	3.8	4.0	4.2	4.3

Source: U.S. Bureau of Economic Analysis, California Employment Development Department, U.S. Census Bureau; Forecast by Beacon Economics

U.S. FORECAST - INFLATION

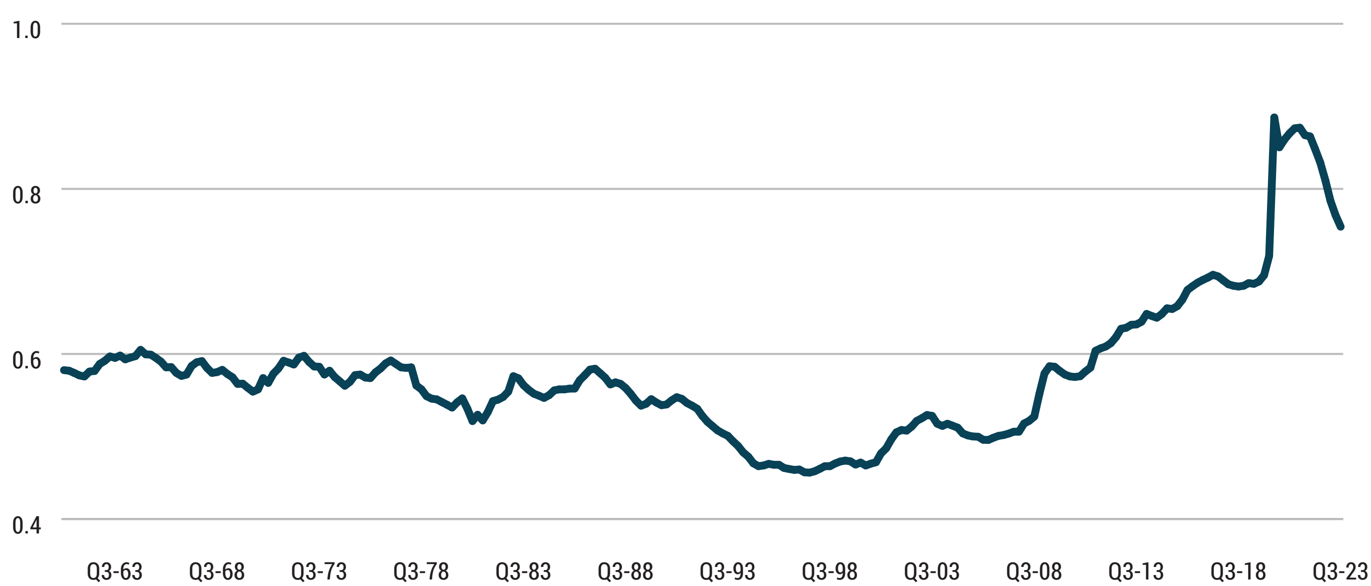
	Current	Forecast			
	Q3-23	Q4-23F	Q1-24F	Q2-24F	Q3-24F
Consumer Price Index (% Change, Year-over-Year)	3.4	3.2	2.8	2.8	2.7

Source: U.S. Bureau of Labor Statistics; Forecast by Beacon Economics

As we see it, the key elements of this narrative are essentially detached from the economic reality of 2023. As Beacon Economics argued throughout all of last year, there was practically no chance of a recession in 2023 outside of the Fed itself causing one through its quixotic monetary policy choices. Our optimism was based on the simple concept that there was no reason for the U.S. economy to slip into a downturn. Inflation is a problem of excess demand, while recessions are caused by a lack of it—one does not lead to the other. And while rising interest rates can cause a recession in the extreme, the changes in rates over the last couple of years extended from absurdly low to normal, vis-à-vis recent decades, a range that does not qualify as extreme.

In short, the Fed did not orchestrate the proverbial 'soft landing'—a recession was never going to happen in the first place. And as for the recent slowing of inflationary pressures, that has not come from smart Fed policy, given that their primary tool of inflation control—raising the price of and limiting access to credit—was having very little impact on the consumer. Rather, inflation has slowed because of the re-equilibration between the money supply and the size of the economy, at least as indicated by the trend in unit money supply.

UNIT MONEY SUPPLY



Source: Board of Governers of the Federal Reserve System; Analysis by Beacon Economics

This isn't to say that some sectors of the economy didn't and aren't still feeling stress from the sharp hike in interest rates, as banks, REITS, and real estate brokerages will surely attest. But those pressures are little more than collateral damage, judging by the fact that the U.S. economy averaged 3% growth in 2023, a significantly better year for growth than 2022. It certainly never looked like an economy on the brink of a recession.

But now, the running economic narrative is becoming more optimistic about the year ahead, while the economic reality is looking less so. Beacon Economics doesn't see 2023 as being a positive turning point for the economy, as the narrative suggests. Rather it was a year where the economy experienced another surge of growth largely fueled by excessively high asset values, excessive amounts of on hand household cash, and the stimulus effect of the widening Federal budget deficit. All of these forces are weakening, and as such, so is the consumer.

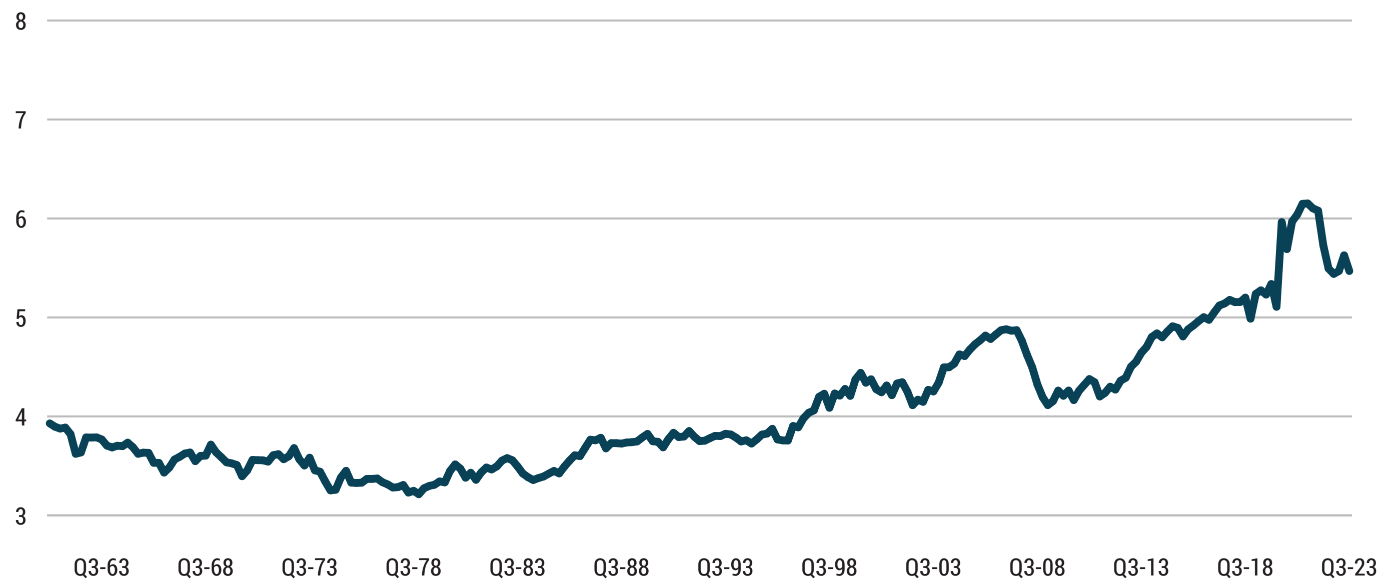
The other side of the equation is not much prettier. As Beacon Economics recently **posted**, the chance of rate cuts by the Fed is substantially smaller than what is being priced into the economy by the markets. But this is beside the point. The real issue is that longer-term rates are unlikely to follow short-run rates down, given the Fed's continuing program of quantitative tightening **(read our post on QT)**. That strategy is causing the money supply to contract as the demand for credit grows due to excessive Federal borrowing and consumers turning to credit now that the cash cushion left over from the pandemic's excessive stimulus is starting to diminish. In a nutshell, the economy will slow in 2024, although it is still far from tipping into a recession.

The ultimate irony is that the man behind the growing instability, Jerome Powell, is being credited for the supposed 'soft landing'. In fact, the Fed is largely responsible for the wild turns in the economy over the past few years; first by profoundly overreacting to the pandemic, and then doing the same in response to inflation. [1] But more significantly its policies have ultimately left the U.S. economy with large imbalances that have yet to be grappled with.

1 The Federal Reserve itself was the source of the $5 trillion in quantitative easing that fueled the too-many-dollars problem, which set off the run of inflation in the first place. Yes, it's true that the U.S. Congress was the authority that decided to firehose excessive liquidity across the economy, but that could never have happened without the Fed's enabling actions.

Consider consumer spending. Price levels may be stabilizing, but real consumer spending trends are not. The savings rate is low and consumer spending has risen to 70% of GDP—that is back to the highest level seen in the run up to the 'Great Recession'. This profligate spending is being driven by excessively high asset values—from home values to equity prices—all of which jumped sharply in 2020 and 2021 as a result of the Fed's excessive pandemic stimulus. That assets are overvalued can be clearly seen in what we call our nation's P/E ratio, measured by the ratio of household net worth to nominal GDP. This metric remains near a record high level, suggesting that asset prices are far beyond anything resembling a normal range.

P/E RATIO



Source: FRED; Analysis by Beacon Economics

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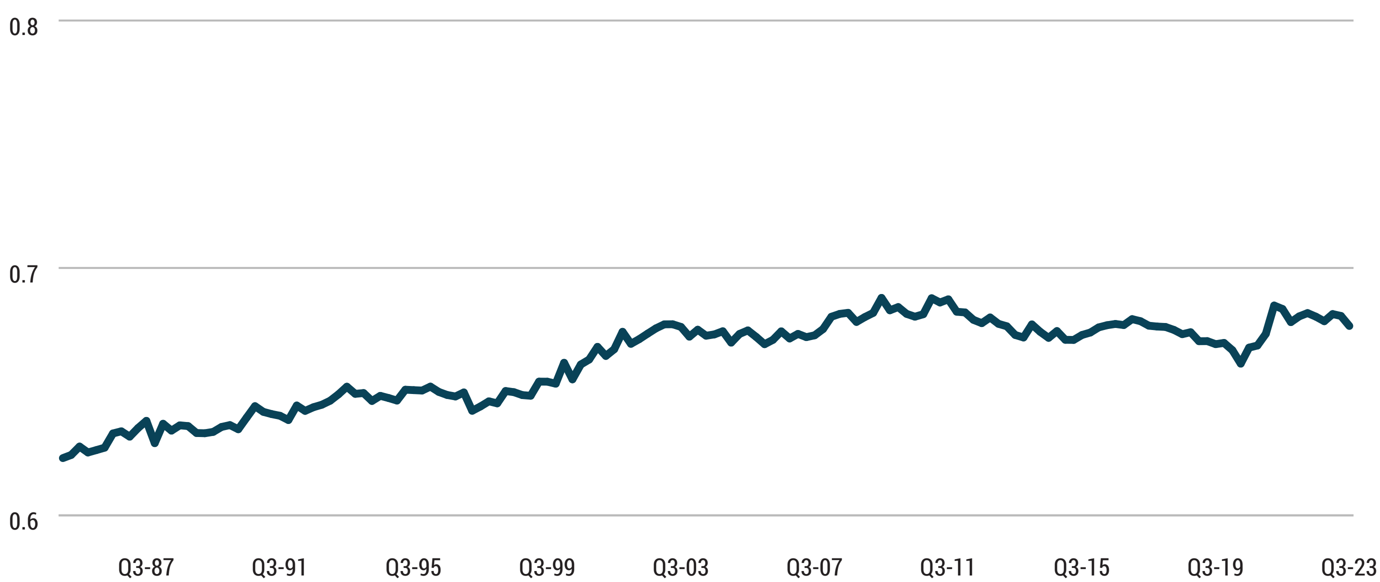
Then there is the national deficit, which has grown to 8.7% of U.S. GDP, the largest ever seen in a full employment economy. And this is happening as the national debt also hits record levels. With interest rates up, the cost of simply carrying that debt will cause the deficit to grow. Clearly the nation is in the midst of a spending binge, even though consumer confidence is low and political surveys continue to suggest that Americans are upset about the direction of the economy. It really is one of the most bizarre aspects of our world—all the data suggests households have never had it so good, and yet people are so angry.

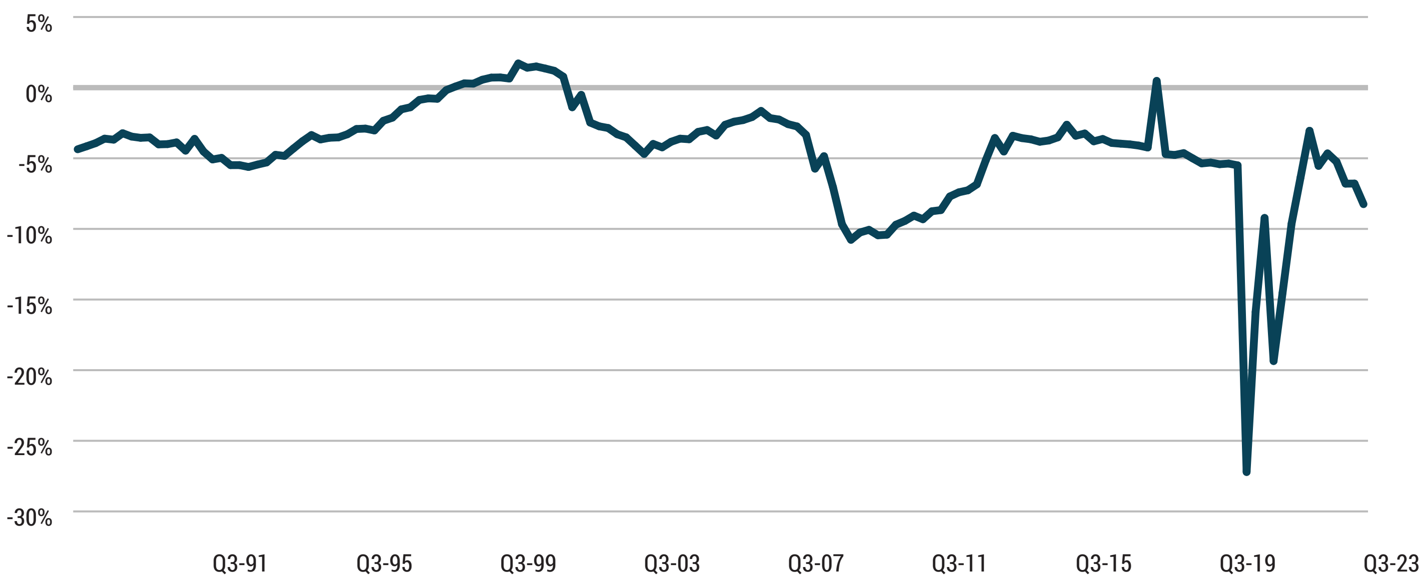
U.S. CONSUMER SPENDING AS A PERCENT OF GDP



Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics

The million-dollar question is how the economy will respond when the current driving forces finally peter out, and what economic imbalances will start to form in the meantime. If the drivers end quickly, it may not be too deep a hole to climb out of. The longer they linger, the harder the crash will be when they do come to an end. This is why our uncertainties are growing rather than fading.

FEDERAL DEFECIT AS A PERCENT OF U.S. GDP



Source: FRED; Analysis by Beacon Economics

To sum up, Beacon Economics' 2024 economic outlook forecasts slower growth than in 2023 but certainly no recession. Labor shortages and higher long-run interest rates will continue to vex businesses and debt-sensitive parts of the economy. Inflation will run warm, not hot, implying fewer rate cuts than the market has priced in. We're saving our biggest worries for the years beyond 2024, where storm clouds are clearly forming even as policymakers and economic pundits continue celebrating a fictitious victory based on a bizarre and false narrative about what has happened to the economy over the past few years.

Economic reality will inevitably impose itself on the festivities, and when it does, it may end up being downright ugly. Considering how angry Americans are in the current era of false prosperity, you can only wonder what public sentiment will look like then.

BEACON ECONOMICS

THE BEACON OUTLOOK
CALIFORNIA

Winter 2024

Sean Windle, Research Manager

HIGHLIGHTS

Despite Headwinds, No Recession In Sight

Although California's massive budget deficit has reinvigorated fears of a recession, Beacon Economics sees slower growth in 2024, but not a contraction.

Employment U-Turn

Not long ago, California had too many jobs for too few workers; today, interest rate hikes have cooled the labor market and the number of job seekers and job openings has converged.

Demand For Housing In California Continues

On a quarterly basis, Beacon Economics expects California home prices to surpass their pandemic peak by the midpoint of 2024.

KEY INDICATORS

1.04 Million

$58 Billion – Budget Bust

The Legislative Analyst's Office is projecting a three-year $58 billion budget shortfall through 2024-25.

6.4%

7.6% - Home Price Growth Accelerates

California home prices rose 7.6% year-over-year in October.

-$2.3 Million

36% - Weak Home Sales Continue

California home sales continue to fall and are 36% below the pre-pandemic peak in February 2020.

-$2.3 Million

4.8% - Unemployment Ticks Up

The unemployment rate in California was 4.8% in October, up from 4.1% a year earlier.

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OVERVIEW

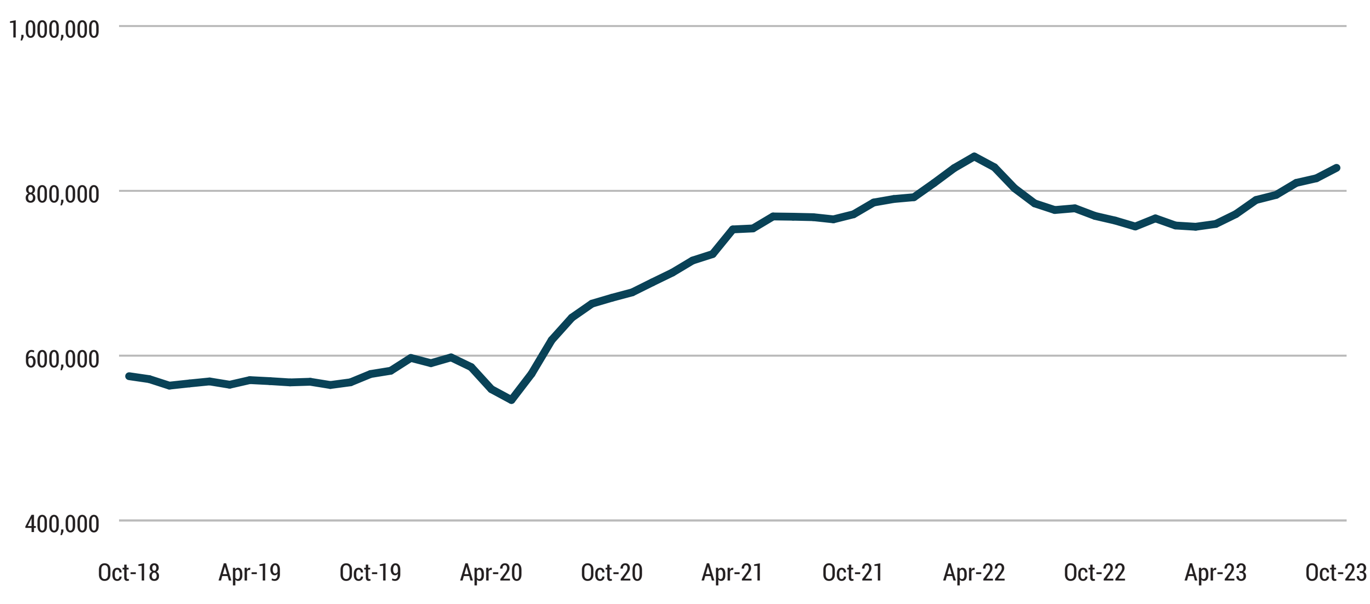
After 29 months of post-pandemic jobs growth dating back to April 2021, employment growth in California was flat in September and declined in October. Unemployment is rising, and California consumers and businesses are dialing back spending. Home sales continue to decline amid rising mortgage rates, accelerating home price growth to levels seen during the peak of the pandemic housing market. The cooler labor market has already negatively impacted the state budget, with officials projecting budget shortfalls on the magnitude of the Great Recession in 2008.

These economic and budget headwinds have occurred despite the economy not falling into a recession. While Beacon Economics does not expect an economic calamity to materialize in California, we expect slower growth in 2024. In fact, in its December fiscal outlook, the California Legislative Analyst's Office (LAO) declared that the California economy is in a 'downturn'.

HOME PRICES NEARLY BACK TO PRE-PANDEMIC PEAK

After nine straight months of year-over-year declines stretching back to October 2022, the median sale price for an existing single-family home in California returned to growth in July, rising 1.3%. Since then, price growth has accelerated, reaching 7.6% year-over-year in October 2023, the most recent month of data available. Currently, home prices are 38.5% above the pre-pandemic peak in February 2020, and 1.6% below the pandemic peak in March 2022. On a quarterly basis, Beacon Economics expects home prices to surpass the pandemic peak by mid 2024.

SINGLE-FAMILY HOME SALES

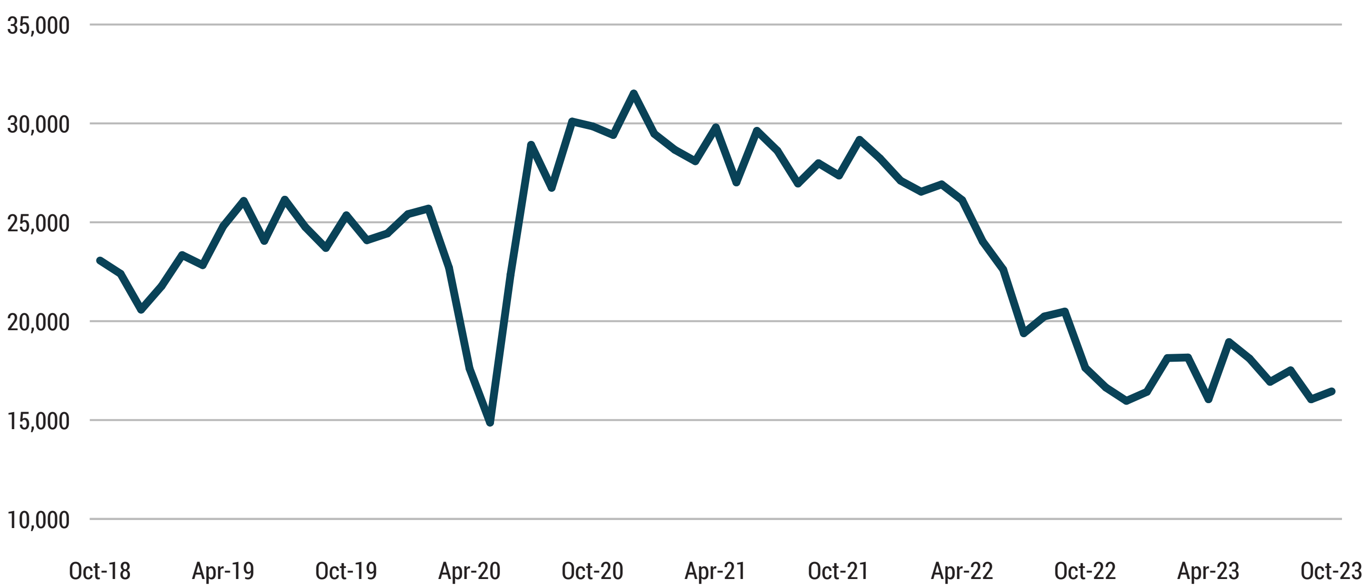


Source: Redfin; Analysis by Beacon Economics

HOME SALES CONTINUE TO FALL, BUT APPEAR TO BE BOTTOMING OUT

On a year-over-year basis, as of October 2023, seasonally adjusted existing single-family home sales have declined 26 consecutive months, dating back to September 2021. Rapidly rising interest rates have further exacerbated California's chronic housing shortage, as homeowners locked into historically low mortgage rates are either unwilling or financially unable to sell. However, home sales appear to be reaching a trough. In October, home sales fell 6.7%, marking the first single-digit year-over-year decline since April 2022. While home sales are expected to remain weak heading into 2024, Beacon Economics expects the beginnings of a housing market thaw in the latter half of the year as mortgage rates begin leveling off.

SINGLE-FAMILY HOME SALES



Source: Redfin; Analysis by Beacon Economics

JOBS GROWTH AT AN INFLECTION POINT

California total nonfarm employment has grown 17.9% since the trough of the pandemic; however, employment declined 0.2% year-over-year in October, the latest data available. Furthermore, on a quarterly basis, employment has declined in each month going back to July. Similarly, the state's unemployment rate increased to 4.8% in October, up from 4.1% a year earlier.

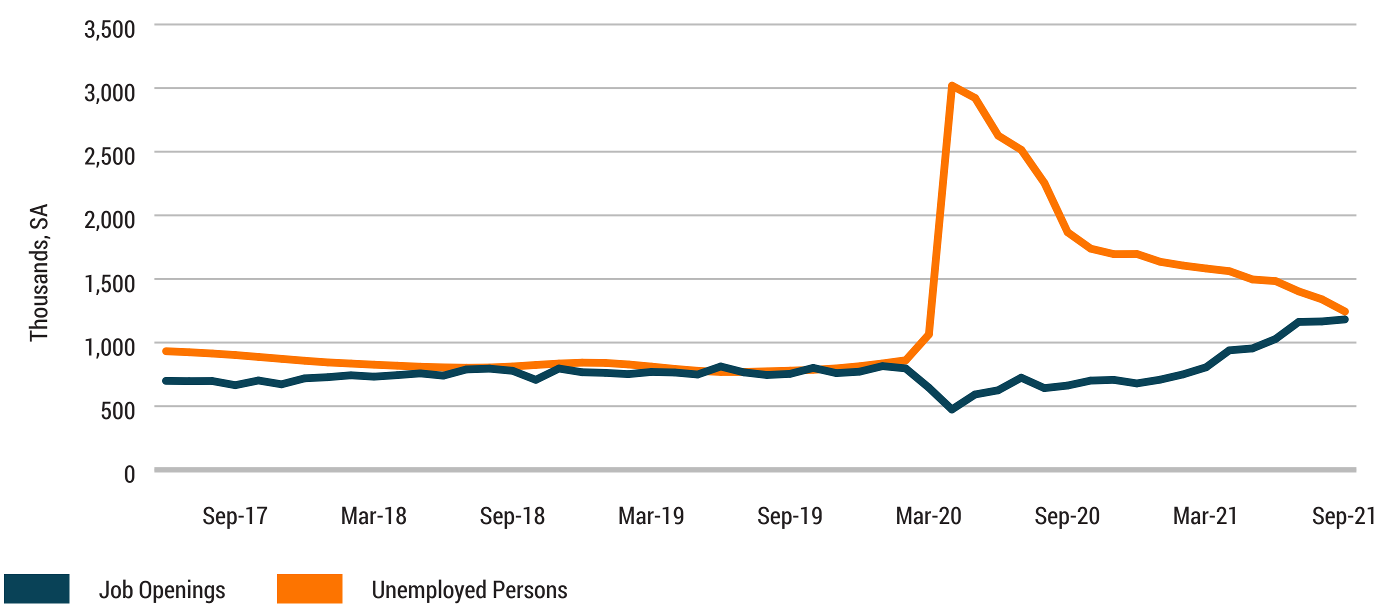
CALIFORNIA RESIDENTIAL BUILDING FAILING TO KEEP PACE WITH EMPLOYMENT

	October 2023	Change Since May 2020	Change Since October 2022
Total Nonfarm Employment	18,442,100	17.9%	-0.2%
Unemployment Rate	4.8%	-10.9pp	+0.7pp
Total Housing Units Authorized By Building Permits	1,245,359		
Share of New Housing Units That Are Multifamily	51.3%		

Source: California Employment Development Department, U.S. Census Bureau; Analysis by Beacon Economics

During the peak of California's labor market in July 2022, there were roughly 2 job openings for every unemployed worker. Since then, however, the number of job openings and job seekers has converged. In September 2023, there were an estimated 911,000 job openings and 913,500 job seekers, yielding a ratio of 1.003. A ratio of 1 means there is 1 job opening for every unemployed person. The cooling labor market is a lagged response to interest rate hikes during the past year and a half.

CALIFORNIA JOB OPENINGS AND UNEMPLOYED PERSONS



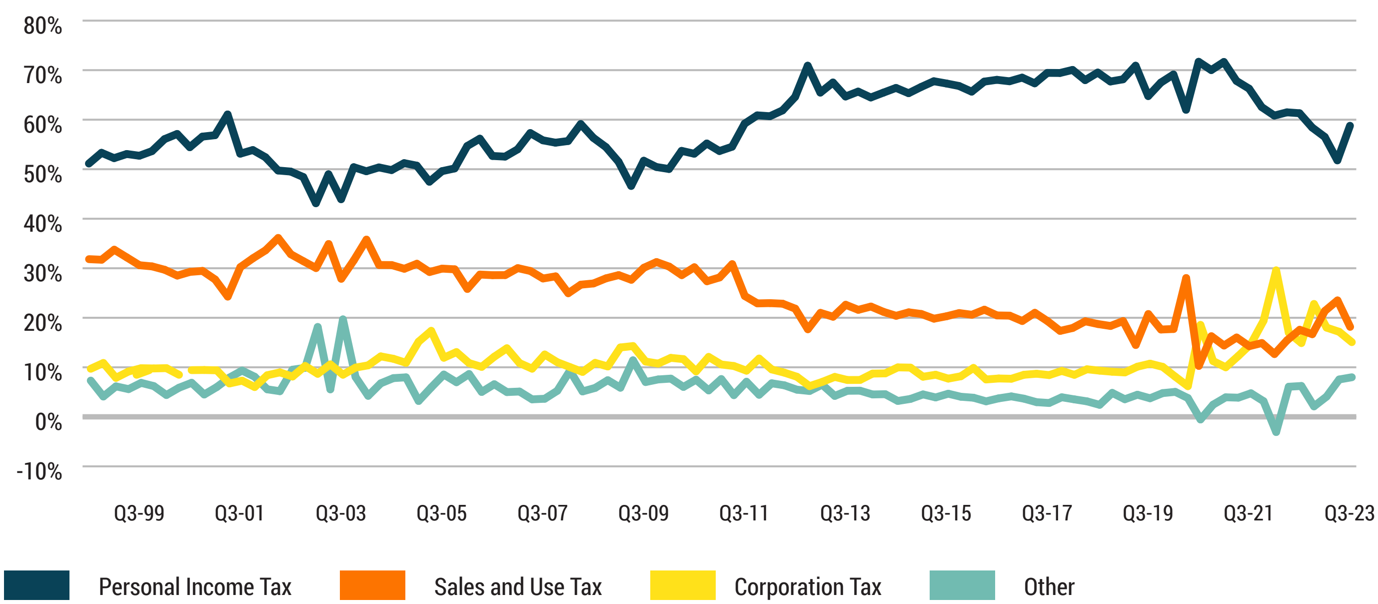
Source: Bureau of Labor Statistics; Analysis by Beacon Economics

$58 BILLION BUDGET DEFICIT PROJECTED THROUGH 2024-25

A bleaker budget outlook is taking shape in Sacramento as various postponed tax payments came in significantly weaker than expected, and as economic headwinds take their toll on state revenues. The nonpartisan Legislative Analyst's Office (LAO) estimates a budget shortfall of $26 billion for fiscal year (FY) 2022-23, with a cumulative three-year budget shortfall of $58 billion through the next two fiscal years.

California is heavily dependent on personal income tax, which accounts for well over half of major general fund money, and which includes volatile capital gains. According to Governor Newsom's revised 2023-24 budget proposal released in May, the top 1% of income earners paid about half of all personal income taxes in 2021, with more than 11% of all personal income tax coming from capital gains during the same year.

CALIFORNIA REVENUE RELIES HEAVILY ON PERSONAL INCOME TAX



Source: California State Controller; Analysis by Beacon Economics

The one-two punch of persistent inflation and the Fed's rapid pace of rate increases has raised borrowing costs and cooled investment, spurring a significant downturn in U.S. stock indices in 2022 after three years of gains. Tighter credit and the cooling labor market have also reduced income tax withholdings from low- and middle-income earners as businesses have less money available to hire additional workers and expand operations. The LAO estimates that the portion of personal income taxes collected directly from employee paychecks was down 2% over the last twelve months compared to the preceding year.

What's more, monetary tightening has hit startups and the technology sector especially hard, which are segments of the economy that have an outsized importance to California. And despite above-average growth in consumer prices, sales tax revenues have declined, falling 6.6% and 1.7% year-over-year in the second and third quarters of 2023. Moving forward, the LAO is watching for weakness to shift somewhat from personal income tax to sales tax and corporate tax in 2023-24 as the labor market continues to cool.

CALIFORNIA FORECAST

CALIFORNIA FORECAST - KEY INDICATORS

	Current	Forecast			
	Q3-23	Q4-23F	Q1-24F	Q2-24F	Q3-24F
Nonfarm Payrolls (000s, SA)	**18,104**	18,292	18,318	18,331	18,345
Unemployment Rate (%, SA)	**4.6**	4.7	4.8	4.9	5
Real GDP (Millions 2012$, SAAR)	**3,031,125**	3,046,713	3,065,500	3,086,366	3,102,421
Home Prices ($, SA)	**694,774**	697,310	694,674	700,694	710,527

	Forecast				
	Q4-24F	Q1-25F	Q2-25F	Q3-25F	Q4-25F
Nonfarm Payrolls (000s, SA)	18,359	18,391	18,442	18,504	18,570
Unemployment Rate (%, SA)	5.1	5.1	5	4.9	4.7
Real GDP (Millions 2012$, SAAR)	3,117,880	3,136,101	3,157,283	3,180,970	3,204,507
Home Prices ($, SA)	716,658	727,804	738,971	749,659	759,611

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, CoreLogic; Forecast by Beacon Economics

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