THE BEACON OUTLOOK
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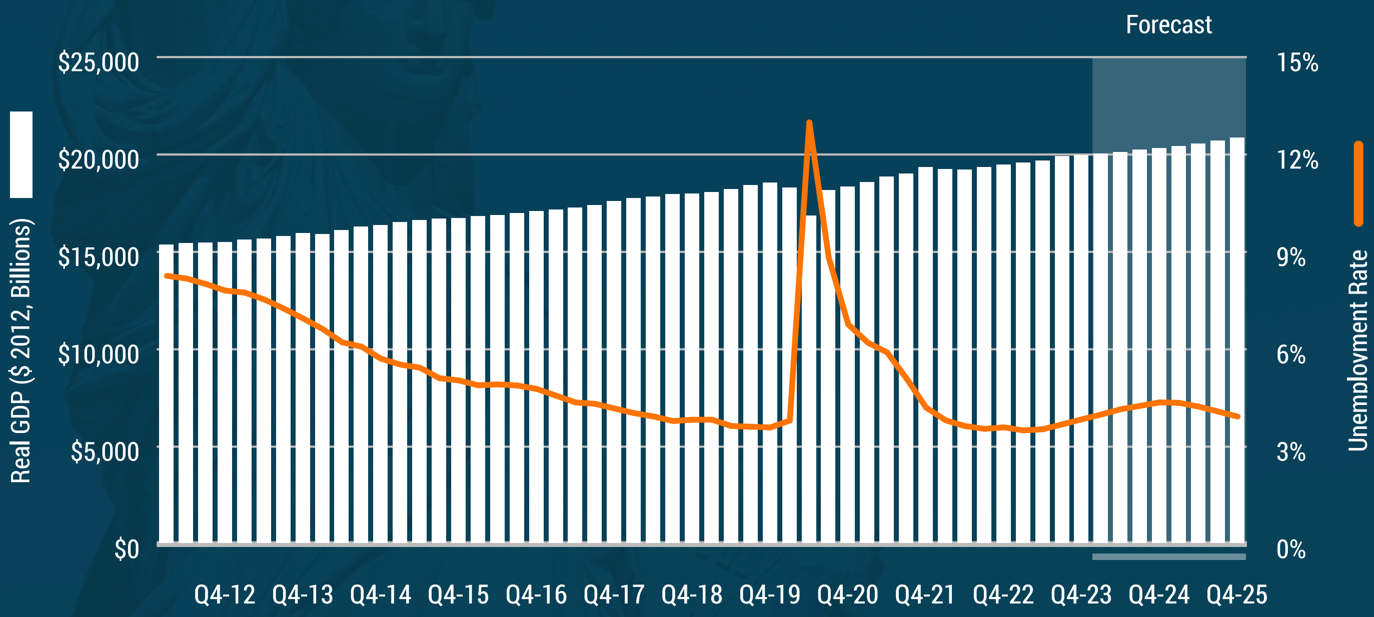
TWO BROKEN NARRATIVES, ONE MUNDANE REALITY

The economic reality today is that the United States will almost assuredly experience a reasonable pace of GDP growth in 2024, led by solid growth in consumer demand. Labor markets will remain tight, industrial production will be steady, and long run interest rates will likely stay in the same range they've been in for the past year. In many ways 2024 will look a lot like 2023 with a solid, moderately expanding economy. Unfortunately, it is almost certain that this simple reality will get scant attention or endorsement amid the cacophony of two dominant false social narratives spinning around, one exceedingly pessimistic and the other exceedingly optimistic.

REAL GDP AND UNEMPLOYMENT RATE

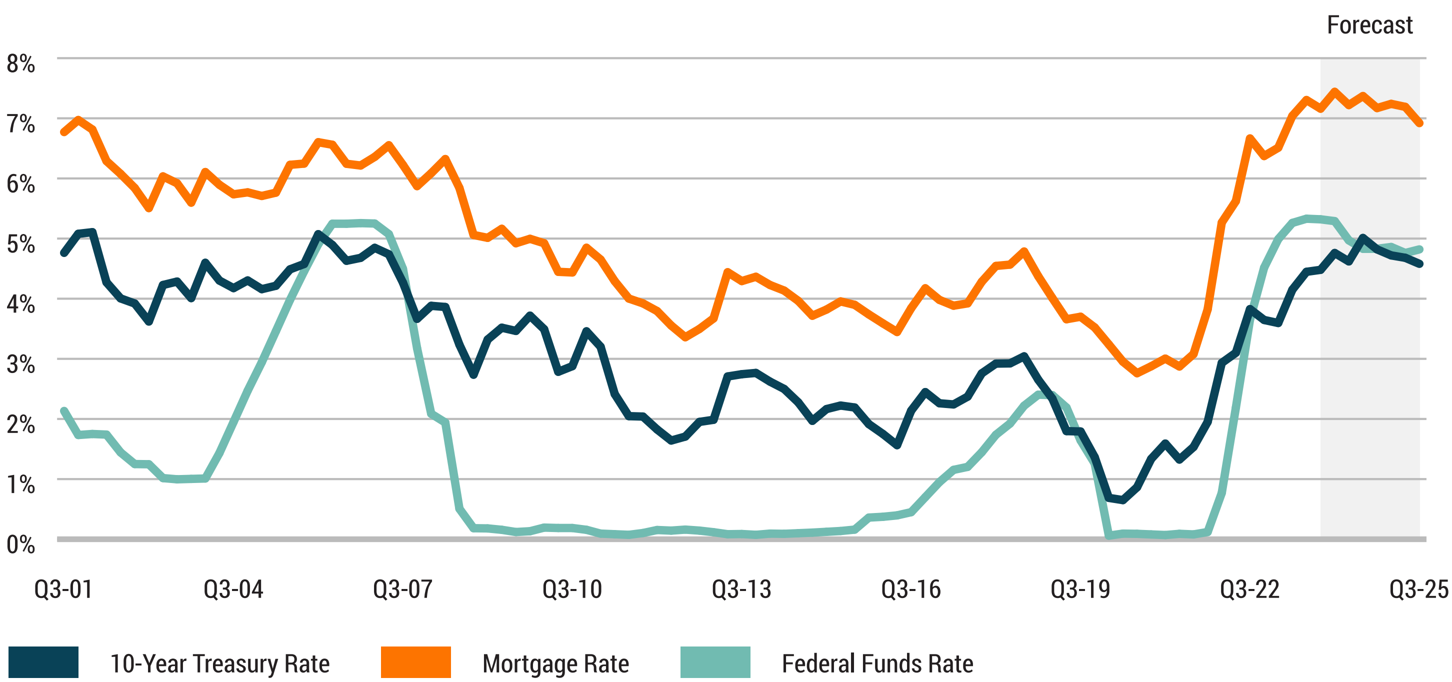


Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics

On the pessimistic side, 'miserabilism' is alive and well in the United States, and positive economic news will continue to be warped and distorted by the catastrophism that has become a staple of modern journalism. And in an aside to the economic negativity, this year we can throw in the additional noise being generated by the extreme hysterics of vying political parties approaching what will be a very contentious national election. The political turmoil doesn't have an immediate impact on the economy—individual voters' choices are influenced far more by personal circumstances than negative headlines—but it does warp policy, and bad policies have dangerous long run consequences.

Yet, even as we are being preached to by the media and from the pulpits about our economic misfortunes, there is another growing narrative coming out of the financial markets that takes an entirely different view—one that may be more dangerous than the miserabilism coming from the pessimists. That narrative is one in which the future looks unrealistically prosperous. At the end of 2023, news about a supposed pivot in Federal Reserve policy caused asset prices to surge higher from the already high base that had been created by the flood of new money unleashed through the pandemic stimulus. Home prices and stock market indexes have jumped to all-time highs, and even cryptocurrencies are seeing a big comeback.

INTEREST RATE FORECAST



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

It is this wealth that is keeping restaurants, entertainment venues, casinos, and airports filled as headlines blare about our declining standard of living—talk about cognitive dissonance! While all this consumer spending is a positive economic driver for now, the potential long run consequences of an emerging financial bubble are concerning.

Beacon Economics' advice? Beware the narrative – both of them.

THE BIG RECESSION CALL WHIFF...

The old canard goes that an economist is someone who will explain to you tomorrow why what they predicted yesterday didn't happen today. Today's economic forecasters seem to have an easier go of it, as those who were loudly predicting recession a year ago have had little to say about their big miss. Most have simply said something along the lines of: we are revising our forecast up because of stronger-than-expected data. In other words, we are changing our forecast because we were wrong. Mind you, the miserabilism of last year hasn't fully faded. The average recession probability in the January 2024 release of the Wall Street Journal's Economic Forecasting Survey was just under 40%—lower than the 62% probability in the January 2023 survey, but still high relative to trends in the current data. The headline of the article that accompanied the latest January survey read "It Won't Be a Recession—It Will Just Feel Like One." [1] We honestly cannot tell you what that is supposed to mean.

Beacon Economics never bought into last year's recession calls because we could not find a cause for one. Recessions don't just happen, there has to be something that instigates a decline in aggregate demand large enough to trigger a business cycle—and we couldn't see what that would be. The pessimists, including most forecasters, pointed to two major reasons why there would be a decline in aggregate demand—inflation and rising interest rates. But this made little sense. Inflation by itself has never caused a recession because it is a function of excess demand, not a dearth of it. On the other hand, the rapid rise in interest rates is a true negative shock to demand, as anyone in the real estate brokerage business will tell you. But throughout last year, rising rates had little impact on consumer demand, largely because most consumer debt is in the form of a 30-year fixed rate mortgage. It has also helped that asset prices are now back to all time high levels, and this has assuaged much of the pain of more expensive capital for investors.

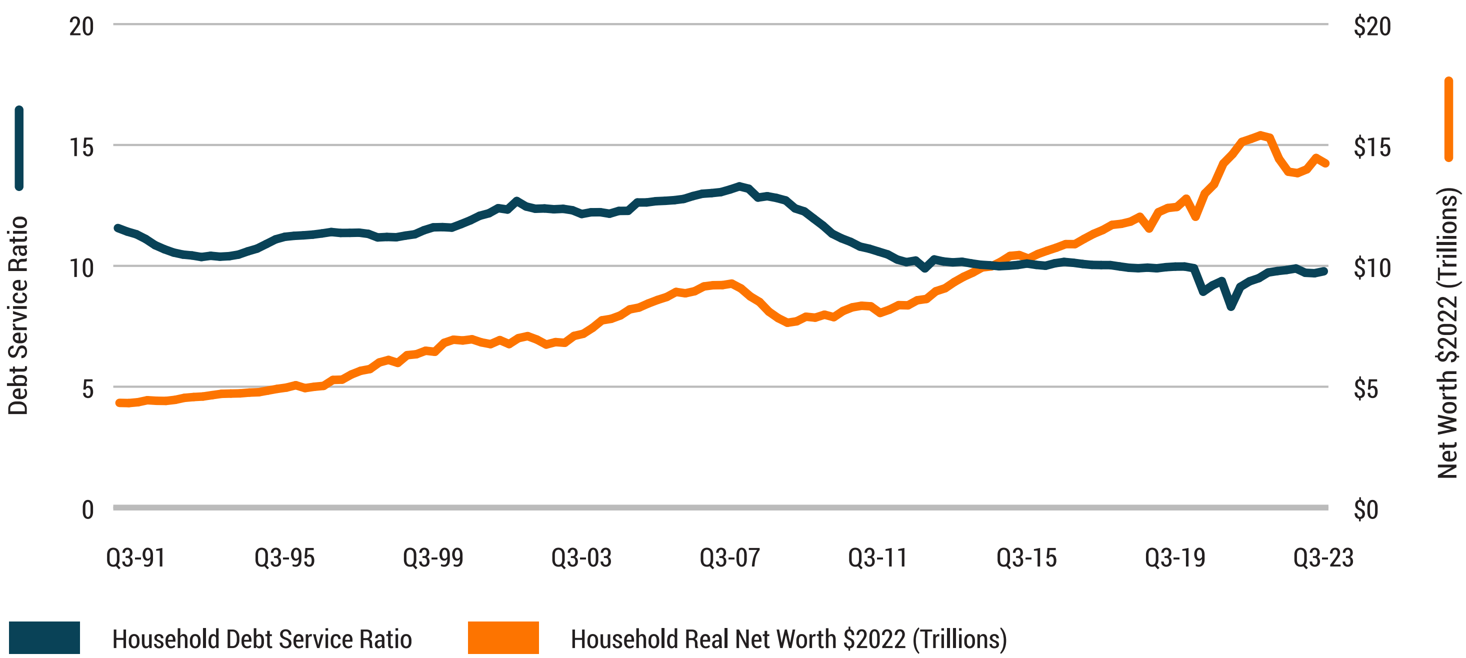
Despite ongoing pessimism from the so-called professionals, most in the media are starting to acknowledge that the nation won't have a recession anytime soon. And according to many of these journalists and editors, our good fortune can be chalked up to the masterful handling of monetary policy by Federal Reserve Chairman Jerome Powell, the man who, however improbably, stuck the 'soft landing'. This may be the most broken narrative of all. As Beacon Economics argued throughout last year, there was almost no chance that the U.S. economy was going to fall into a recession in 2023, and we feel the same about 2024. The strength of the economy was not a surprise, it made sense given the core strength of the U.S. consumer. Far from being a steady hand on the helm, the Federal Reserve's monetary policy has (on net) been more negative than positive for the U.S. economy over the past the last three years, creating more problems than it solved.

1 https://www.wsj.com/economy/it-wont-be-a-recession-it-will-just-feel-like-one-1919267a

STORIES ABOUT THE DEMISE OF THE AMERICAN CONSUMER ARE HIGHLY EXAGGERATED

So where from here? That answer can only come from understanding the health of the almighty American consumer, given that consumer spending is nearly 70% of U.S. GDP. Because of consumers' outsized role, concern over the collapse in consumer confidence during the last two years in the wake of inflation, is understandable. But consumer confidence is a much better gauge of the consumer narrative, not their reality. Despite the decline in *confidence*, consumer *spending* rose a solid 2.6%, inflation adjusted, over the past year. The top categories for spending growth include recreational vehicles and goods (12%), new cars (4%), restaurants and hotels (4%) and recreational services (4%). For all the anger and pessimism, people seem to be having a lot of fun.

CONSUMER STRENGTH



Source: Board of Governors of the Federal Reserve System (US), U.S. Bureau of Economic Analysis

Now that inflation is slowing significantly, consumer confidence is bouncing back. But this tells us nothing about where consumer spending will head. Consumer demand will remain strong in 2024 for any number of reasons that have nothing to do with confidence. Those reasons include:

- Tight labor markets will continue to push up real wages. Real (inflation adjusted) household disposable personal income in the United States rose 4.3% in 2023, while real earnings growth for workers is running at 3.6%. Data from the Atlanta Fed's Wage Tracker shows lower paid workers experiencing a higher pace of earnings growth. Income inequality in the nation remains far too high, but the downward trend is encouraging.

- U.S. households are still flush with new wealth generated by the stimulus-driven surge in asset prices; nominal household net worth is up $35 trillion dollars in 4 years. Even after accounting for inflation this is still about 15% higher than where it was pre-pandemic. The best example of this wealth are checkable deposits for household, which at just under $4 trillion is 4 times higher than in the months before the pandemic. And again, the changes in net worth have been progressive—with proportionately higher gains flowing to lower income households, where it is more likely to turn into spending.

- The credit card debt servicing ratio for U.S. households remains near an all-time low level (despite fretting by some in the media). Household debt levels peaked during the Great Recession at 130% of income; today debt levels are less than 75% of income. Moreover, given that 60% of consumer debt is in the form of a 30-year fixed rate mortgage, what debt there is has been largely shielded from rising interest rates.

TO PIVOT OR NOT TO PIVOT...

A strong consumer is bad news for those looking for lower interest rates, as the market is slowly starting to acknowledge. Strong consumer demand suggests inflation will be running hotter than the 2% pace that Fed Chairman Powell and company are oddly fixated on—a view supported by recent data on both price growth and continued tightness in the labor market. All this seems to imply that the Fed may not cut rates this year.

Yet, the question remains as to why the markets ever thought there would be multiple interest rate cuts. Indeed, one of the most bizarre narratives of 2023 was the bold assertion in the financial press, after the December FOMC meeting, that the Federal Reserve was about to pivot on policy and cut rates multiple times in 2024. This view was widely covered across the globe, and it was this spark that sent stock market prices to new heights, even as longer-term interest rates dropped.

To be clear, neither the Fed's official press release nor the minutes of the meeting suggested anything close to what was being asserted. Quite the opposite, the FOMC was crystal clear that they were still concerned about the pace of inflation, planned on holding the Federal Funds rate steady, and most importantly, were continuing their $90 billion per month pace of quantitative tightening. They said exactly the same thing after their January meeting, yet the financial media continued to report and opine that the Fed was going to cut rates multiple times this year. Chairman Powell even went on 60 Minutes to, yet again, loudly proclaim the Fed had no plans to shift policy.

Where did these distorted beliefs come from? The markets took their optimistic cue from the average of the forecasts that FOMC members provided to the Chair when they convened in December. [1] Mind you, these predictions have a horrible track record generally, and in this specific case were predicated on a projected sharp slowing of the economy—something that seems unlikely given the strength of consumer demand. But coin-shaving Wall Street loves volatility (big moves allow professional traders to make bigger returns from front-running retail traders), so even the faintest whiff of 'major' news is magnified to a ridiculous degree in the financial press and their contacts in finance.

The false narrative of multiple rate cuts is finally starting to fade (perhaps the 60 Minutes interview did the trick?) but that is largely irrelevant. As of this writing, the S&P sits above 5000 for the first time, and the P/E ratio is starting to close in on the heights it saw back in 1999.

This returns us to those competing, and deceptive, narratives that have taken hold today—on one hand the economy is a mess and on the edge of a recession, and on the other hand, financial markets are on fire. Even Bitcoin is back to about $50,000. Is it a bubble? Philosophically, that's a difficult question to answer—but it sure feels like one. Corporate profits have been flat for a year. Typically, asset prices sag after a sharp increase in interest rates—yet, to date, they seem immune to the Fed's best efforts to cool things off. And that is one more reason the Fed is not likely to back off anytime soon. If the whiff of a rate cut can send the market surging, imagine what a real cut would do. The Fed has created an asset price problem. Almost like a tropical depression forming out in the Atlantic in August… we have to wait and see if it burns out on its own or turns into a class 5 monster heading straight for Miami.

IT'S THE NARRATIVE, STUPID!

Back in 1992, Bill Clinton's campaign strategist famously quipped "It's the economy, stupid." For this political season, it isn't the economy, the economy is fine. But of course, neither party will actually acknowledge that. Instead, they will continue to insist that everything is terrible, and (for the record) that it is entirely the other party's fault. And within these narratives lies our nation's greatest problem. A healthy political system is one in which people agree on the basic problem and debate the solution. Today, in the United States, we can't agree on the problem so there can be no middle ground or movement towards a solution.

Whatever the outcome of this November's election, we can be assured that our new government will be just as dysfunctional as the current one, if not more. It's a distressing state of affairs, particularly at a time when the nation's leaders need to come together to deal with any number of critically important issues from closing an unsustainable Federal deficit to immigration reform to labor force shortages, to military and humanitarian crises in Europe and the Middle East, to the ongoing issue of climate change. What will it take to return our focus to vital policy issues? That remains the biggest problem our nation faces—and there seems to be no answer in sight.

1 https://www.federalreserve.gov/newsevents/pressreleases/monetary20231213b.htm

UNITED STATES FORECAST

U.S. FORECAST - OUTPUT

	Current	Forecast			
	Q4-23	Q1-24F	Q2-24F	Q3-24F	Q4-24F
Real GDP (Billions, 2012$)	**19,976.3**	20,042.0	20,123.6	20,242.7	20,325.8
Real GDP (% Change from Preceding Period, SAAR)	**1.2**	1.3	1.6	2.4	1.7
Consumer Spending (Billions, 2012$)	**13,858.1**	13,914.4	14,004.6	14,105.2	14,191.2
Consumer Spending (% Change from Preceding Period, SAAR)	**2.4**	1.6	2.6	2.9	2.5
Nonresidential Investment	**3,880.8**	3,915.2	3,917.0	3,950.3	3,963.8
Nonresidential Investment (% Change from Preceding Period, SAAR)	**-2.2**	3.6	0.2	3.5	1.4
Fixed Investment (Billions, 2012$)	**3,763.3**	3,796.4	3,813.9	3,838.0	3,837.4
Fixed Investment (% Change from Preceding Period, SAAR)	**1.9**	3.6	1.9	2.6	-0.1
Change in Private Inventories (Billions, 2012$)	**36.7**	37.3	23.4	30.9	43.0
Government Spending (Billions, 2012$)	**3,333.3**	3,341.4	3,346.8	3,351.1	3,354.1
Government Spending (% Change from Preceding Period, SAAR)	**0.6**	1.0	0.6	0.5	0.4
Net Exports (Billions, 2012$)	**-1,063.3**	-1,101.3	-1,122.4	-1,143.5	-1,167.2
Net Exports (% Change from Preceding Period, SAAR)	**5.1**	15.1	7.9	7.7	8.6
Exports (Billions, 2012$)	**2,378.1**	2,389.5	2,410.7	2,431.2	2,447.9
Exports (% Change from Preceding Period, SAAR)	**6.8**	1.9	3.6	3.4	2.8
Imports (Billions, 2012$)	**3,441.4**	3,490.8	3,533.1	3,574.7	3,615.1
Imports (% Change from Preceding Period, SAAR)	**6.3**	5.9	4.9	4.8	4.6

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

U.S. FORECAST - KEY INDICATORS

	Current	Forecast			
	Q4-23	Q1-24F	Q2-24F	Q3-24F	Q4-24F
Industrial Production (Index)	**102.6**	103.3	102.8	102.7	102.5
Civilian Unemployment Rate (%)	**3.8**	4.0	4.2	4.3	4.4

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			
	Q4-23	Q1-24F	Q2-24F	Q3-24F	Q4-24F
Consumer Price Index (% Change, Year-over-Year)	3.2	2.8	2.8	2.7	2.4

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