

THE BEACON OUTLOOK **UNITED STATES**

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IT'S NOT THE ECONOMY, STUPID

This is Beacon Economics' last U.S. outlook before November's contentious 2024 Presidential election. I guess that means we should be rolling out that incredibly overused phrase "It's the economy..." ugh, please, let's not say it again, if for no other reason than it really isn't the economy. The U.S. economy is just fine—at least for the moment. Today's signature phrase should be "It's the narrative, stupid," as false narratives about the U.S. economy have driven both presidential candidates to propose worrisome populist policy agendas in a time of plenty, even as they steadfastly ignore the elephants in the room—the unsustainable Federal deficit and the nation's growing external imbalance.

It isn't just our political candidates who are living in a fantasy land—the financial markets have seemingly abandoned reality as well. U.S. equity prices continue to climb to ever higher levels, out of sync with the paths of both corporate profits and interest rates. The Shiller P/E ratio is currently at its 3rd highest point ever, just behind October 2021 when the economy was full of pandemic-stimulus stimulant, and October 1999, the peak of the tech frenzy. Global bond markets also seem blissfully unaware of the nation's deteriorating financial situation as they continue to lend the U.S. government all the money it needs to cover the current deficit. This is happening despite record levels of debt and absent of any effort to stabilize the situation. Indeed, foreign investors seem positively eager to pour money into the U.S. economy, keeping the dollar strong.

While this is creating a buoyant economy in the short run, none of these trends are sustainable in the longer term. And as the global narrative about the relative strength of the U.S. economy shifts over the next few years, the winner of this November's showdown may end up less happy about their victory. As has generally been the case, the next recession is not rooted in the issues we're focused on, but rather in the issues we're ignoring or avoiding.

DON'T BET ON AN OCTOBER SURPRISE

Despite pessimism across most of the forecasting community over the last two years, the U.S. economy has actually performed enviously well, averaging a very respectable 2.8% real growth rate over the past eight quarters. And it looks like the current quarter will enjoy another +2% growth, according to the Atlanta Fed's GDP Now estimate.¹ At the heart of the nation's growth surge is the almighty American consumer, who continues to increase their spending despite their own pessimism, at least according to the University of Michigan Consumer Sentiment Survey data.² And with consumers spending, business investment has bounced back despite higher interest rates,³ home prices continue to rise despite low affordability,⁴ and real exports hit a record high in the 2nd quarter of the year despite the strong dollar.⁵

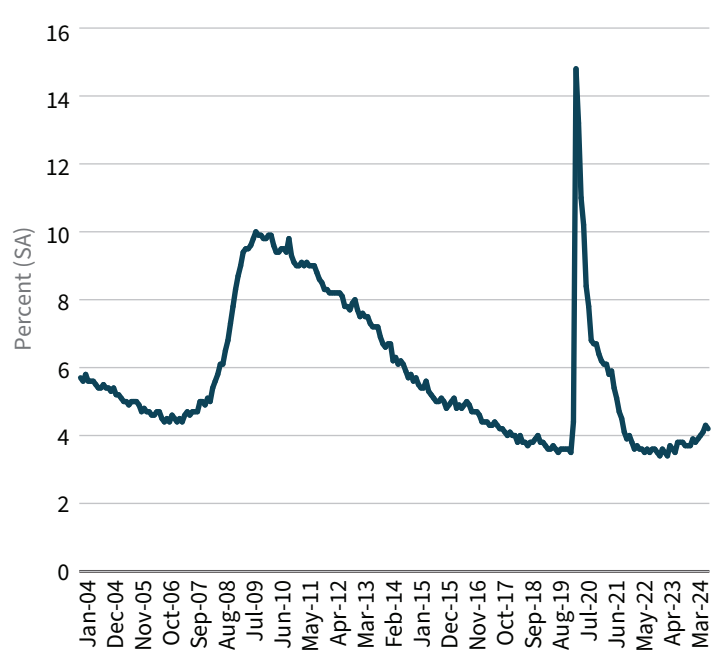
This is a good economy. There are certainly modest signs of slowing—from the labor market to housing—but that's to be expected given the inflation-fighting steps taken by the Federal Reserve. Most importantly, the surge of inflation that had such an outsized impact on confidence over the past two years has faded away as the Fed's ongoing efforts to cool demand and shrink the money supply have finally paid off. According to the U.S. Bureau of Economic Analysis's consumer expenditure price index, inflation has cooled to a moderate 2.6% pace over the last 12 months.⁶

PERSONAL CONSUMPTION EXPENDITURES PRICE INDEX



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

U.S. UNEMPLOYMENT RATE



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

1 <https://www.atlantafed.org/cqer/research/gdpnow>

2 <https://fred.stlouisfed.org/series/UMCSENT>

3 <https://fred.stlouisfed.org/series/PNFIC1>

4 <https://fred.stlouisfed.org/series/CSUSHPISA>

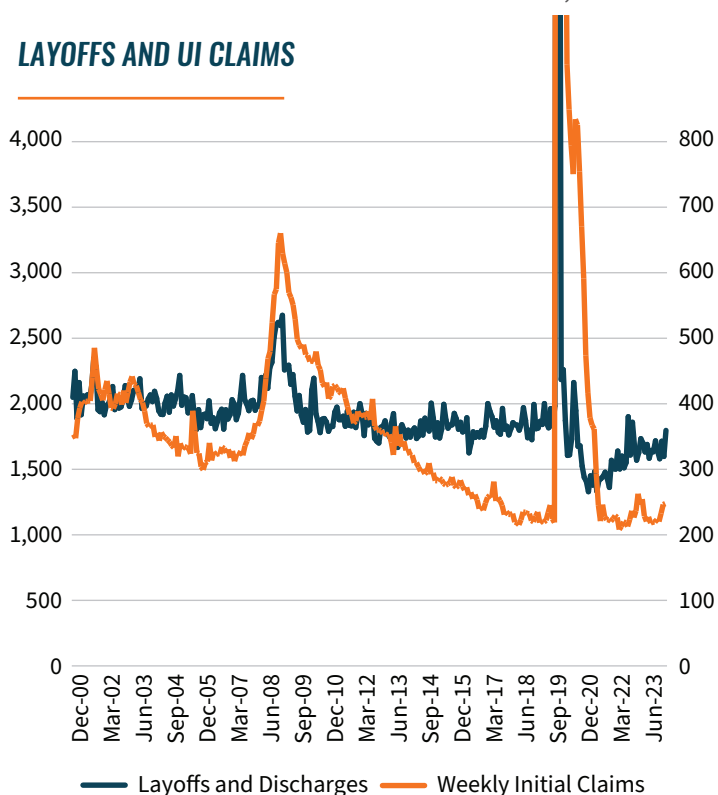
5 <https://fred.stlouisfed.org/series/EXPGSC1>

6 <https://fred.stlouisfed.org/series/DPCERD3Q086SBEA>

All this good news has pushed the 10-year treasury bond rate down to the lowest level since the end of 2023—when the markets were busy pricing in the four expected rate cuts for this year. If it seems odd that one potential rate cut now makes the markets as happy as four cuts did back in December 2023, well, it’s an illustration of the irregular haphazardness of the financial world. {In the midst of this writing, the Federal Reserve followed through and made the rate cut they have been signaling over the past few weeks. Please see the last section of this report for commentary on the Fed’s action.}

Despite all the good news, the most recent Wall Street Journal’s Economic Forecasting Survey still puts the probability of a recession at over 30% for the next 12 months, lower than a year ago, but still significantly higher than normal.⁷ Why are

LAYOFFS AND UI CLAIMS



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

professional forecasters still so pessimistic? It’s hard to say, but one possible reason may be that the yield curve is still inverted—one of the longest and deepest stretches of this odd financial market condition since the 1970s.⁸ An inverted yield curve has been highly correlated with recessions in the past—but correlation is not causation, a simple fact that made a lot of forecasters look silly over the last two years.

It might also be the uptick in the U.S. unemployment rate over the past year (almost a full percentage point in the last 18 months)⁹ and the downward revision in the payroll employment numbers that the U.S. Bureau of Labor Statistics recently announced.¹⁰ But as Beacon Economics’ recent [commentary](#) noted, these trends are not what they appear to be, as there has been no increase in involuntary separations¹¹ nor any increase in workers collecting unemployment insurance.¹² And while past surges of this magnitude in the unemployment rate have happened only in the context of a recession, recognize that the unemployment rate is a lagging indicator; such increases have occurred after a recession has begun and output is already contracting, something that is clearly not happening at the moment.¹³

7 https://www.wsj.com/economy/central-banking/where-do-economists-think-were-headed-these-are-their-predictions-b3db91ea?-mod=article_inline

8 <https://fred.stlouisfed.org/series/T10Y3MM>

9 <https://fred.stlouisfed.org/series/UNRATE>

10 <https://www.bls.gov/web/empsit/cesprelbnk.htm>

11 <https://fred.stlouisfed.org/series/JTSLDL>

12 <https://fred.stlouisfed.org/series/ICSA>

13 In Beacon Economics’ opinion, the rise in the U.S. unemployment rate is being driven mainly by a sharp increase in the pace of labor force growth, a change that is only being partially accounted for in the current data due to the U.S. Census’s underestimate of net international migration. While this is not good news in the short term, it is ultimately a positive in a labor-supply-challenged nation. The downward revision in the payroll employment estimate was predictable given how much more rapidly payroll employment has been growing relative to household employment. The issue isn’t that the job numbers are weaker than expected, rather, they have been stronger than possible. Even with the revisions, there still appears to have been over one million new jobs created in the United States over the last two years held by ghost workers—people who don’t show up in the household data.

From Beacon Economics’ perspective, there is little to suggest a nascent end to the current expansion, which is now past the four-year mark. The core of our optimism in the short run is the financial condition of U.S. households. Despite a softer labor market, earnings growth is still greater than the pace of inflation, with weekly earnings up 3.3% over the past year,¹⁴ according to the Atlanta Fed’s wage tracker. Add to this record household net worth¹⁵ and a low debt burden,¹⁶ and it’s difficult to see how spending could *not* continue to expand over the next year—there will be no October surprise.

THE POLITICS OF ‘MISERABILISM’

While the U.S. economy is clearly on some of its most solid footing in years, we have yet to see that reality in news headlines, in the consumer confidence data, and definitely *not* from the election trail. Both platforms continue to push the ‘miserabilist’ screed, although the right blames unfettered socialism, while the left blames unfettered capitalism. With a lack of real pain points to capitalize on, the economic platforms of both political parties seem almost surreally out of touch. Take food prices as an example. Former President Donald Trump, on a number of occasions, has criticized Vice President Kamala Harris about the sharp rise in food prices during the Biden administration—something that the Harris campaign is clearly sensitive to since one of the first policy positions she staked out was a law against price gouging, particularly for food.

The real truth? Americans don’t actually have a cost-of-food problem. This isn’t to say that food prices haven’t increased—the price of food for off-premises consumption (supermarkets) has risen 19.8% in the last 3 years—almost half again as much as overall consumer prices (13.8%). And over the same period real spending at supermarkets has fallen by 3.4%. A clear sign of growing hunger? Nope. Over the same three-year period real consumption of food at restaurants has gone up by 6.8% despite the 20% increase in the cost of eating out. And given that we are consuming fewer unprepared meals, an inferior good, this shift is representative of an increase in real incomes among Americans. As Beacon Economics has been arguing all along, the rise in prices has been driven by strong consumer demand, rather than inflation hurting consumer demand as is so often erroneously claimed.

3-YEAR CHANGE IN PRICES AND REAL CONSUMPTION

	Change in Prices	Change in Real Consumption
Personal consumption	13.8%	6.8%
Food purchased for off-premises	19.8%	-3.4%
Meals at limited service eating places	21.0%	7.6%
Meals at full service eating places	20.2%	5.9%

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

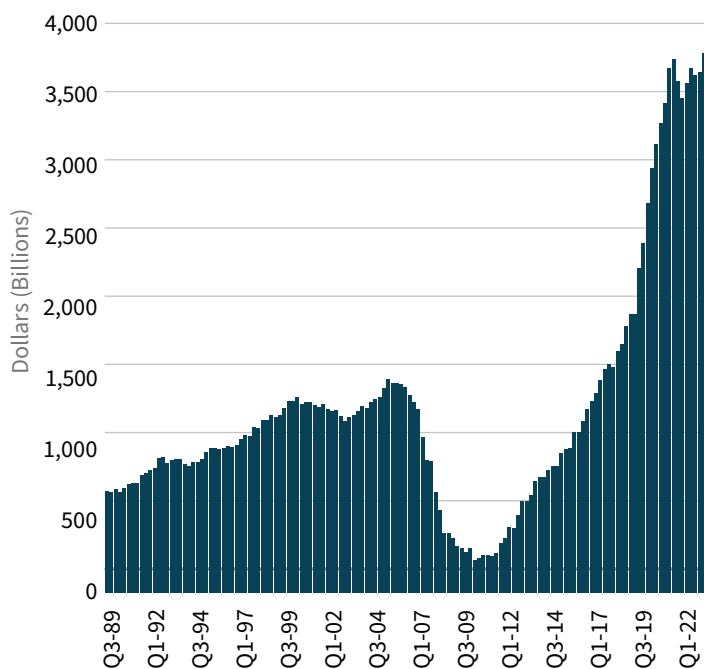
14 <https://fred.stlouisfed.org/series/CES0500000011>

15 <https://fred.stlouisfed.org/series/BOGZ1FL192090005Q>

16 <https://fred.stlouisfed.org/series/TDSP>

And no, this isn't a function of the top 10% living it up while the bottom 90% lose ground. Data from the Atlanta Fed's Wage Tracker shows that the bottom quartile of workers have seen their earnings increase by 20% over the past three years and by 31% over the past five years—much greater than the pace of inflation.¹⁷ Net worth for the bottom 50% of U.S. households has nearly doubled over the past five years.¹⁸ In contrast, the top quartile of earners have seen their incomes rise by 14% over the past three years and 21% over the past five years—at the pace of inflation—while net worth has only increased by about 20% for the 90th to 99th percentile of households.¹⁹ But don't feel too bad for the upper crust—just the gain in net worth over the past five years is greater than the total net worth of the bottom 50%.

TOTAL NET WORTH HELD BY THE BOTTOM 50%



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

SHARE OF TOTAL ASSETS HELD BY THE TOP 0.1%



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

Wealth inequality in the United States is still much too wide—but it is narrowing. The real issue is that the top 0.1% continue to rake in an ever higher share of the wealth pie—now back to a record high 12.2% of all private wealth in the nation.²⁰ The wealth problem in the United States is not between doctors and their patients, but rather the people who own the hospital and everyone else. And recognize that the standard debate over taxes never gets close to the kind of dramatic change needed to tackle this issue (a modest wealth tax for higher net worth families, for example).

All said, none of this has stopped either presidential candidate from proposing aggressive programs to help “rebuild” our full-employment, strong consumer-demand economy. Kamala Harris has focused on subsidies—whether for first time home buyers, families with new babies, or business start-ups. Donald Trump’s policies have revolved around tax cuts, an aggressive plan to remove undocumented immigrants from the nation, and punitive tariffs on U.S. trading partners to deal with the growing trade deficit. All of these ignore the real issues plaguing the U.S. economy, including the one that is most obvious—the massive, and growing, Federal budget deficit. Indeed, the silence from both political parties on this issue is so complete as to be deafening.

17 <https://www.atlantafed.org/chcs/wage-growth-tracker>

18 <https://fred.stlouisfed.org/series/WFRBLB50107>

19 <https://fred.stlouisfed.org/series/WFRBLN09053>

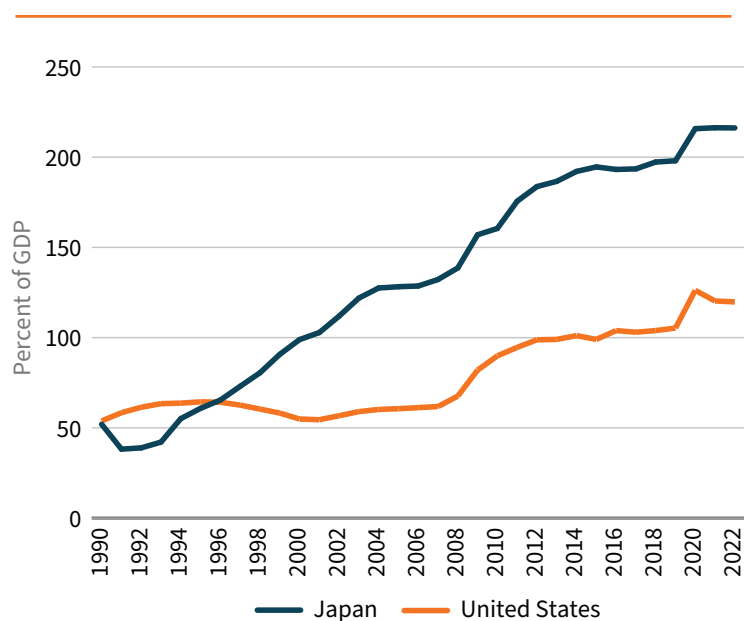
20 <https://fred.stlouisfed.org/series/WFRBSTP1281>

THE 800LB GORILLAS IN THE ELECTION

In 2023, the Federal Government deficit came in at a whopping 6.2% of U.S. GDP—the largest full employment deficit the United States has experienced since World War II. This represents \$2.6 trillion in new debt, roughly \$7,000 per person in the nation. And outstanding Federal debt is now above \$36 trillion, which on a per-person-basis is over the \$100,000 mark—a dubious milestone to say the least. While the nation’s political parties may squabble over who’s to blame for the problem, the reality is that it stems from an accumulation of largely bipartisan tax cuts and spending increases, passed both before and after the pandemic.

As ugly as it is, the U.S. debt burden is not at a crisis point. Most European nations carry similar debt loads and Japan’s current debt is significantly higher.²¹ But the path we are on is clearly unsustainable. The U.S. deficit will grow larger simply on the basis of rising interest rates. Over the last year, the Federal government has paid out over a \$1 trillion in interest payments on its outstanding debt, which implies a blended interest rate of 3.1%, considerably lower than current interest rates in the market. Beacon Economics expects these payments to rise by another half trillion dollars in the next two years—more than enough to offset any gains from the expiring 2017 Trump administration tax cuts. And as noted, neither party has shown any interest in dealing with the current deficit, despite its record size. In fact, the platforms of both parties would expand the deficit, not shrink it.

GENERAL GOVERNMENT DEBT (% OF GDP) JAPAN VS. UNITED STATES



Source: U.S. Office of Management and Budget, World Bank;
Analysis by Beacon Economics

And it isn’t just the Federal government that’s on a spending binge. As noted, Americans are doing quite well from an income and wealth perspective, although there are signs of excess. The personal savings rate (income left over after consumer spending and interest charges are deducted as a share of disposable income) dropped below 3% in July—a dangerous sign of excess that was last seen in the runup to the ‘Great Recession’.²² Back then the excess consumption was fueled by a surge in private borrowing. This time the excess consumption is being fueled by an increase in public borrowing. But in both cases the direct cause of the decline in savings rates has been a large increase in household net worth.

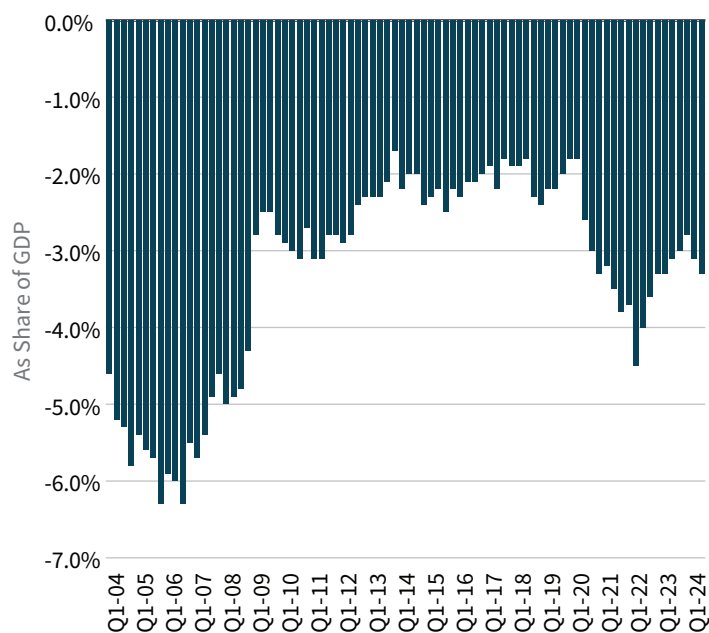
The ultimate result of lower public and private savings has been an increase in the nation’s current account deficit—the sum total of the trade deficit along with our global net income position.²³ While not as bad as in the run up to the Great Recession, we’re clearly trending in that direction. And the situation is less sustainable than it was in the past, given the consistent worsening of net capital balance in the United States—the rest or the world now owns a substantially larger chunk of the U.S. economy than Americans’ own of the rest of the

21 <https://fred.stlouisfed.org/series/DEBTTLJPA188A>

22 <https://fred.stlouisfed.org/series/PSAVERT>

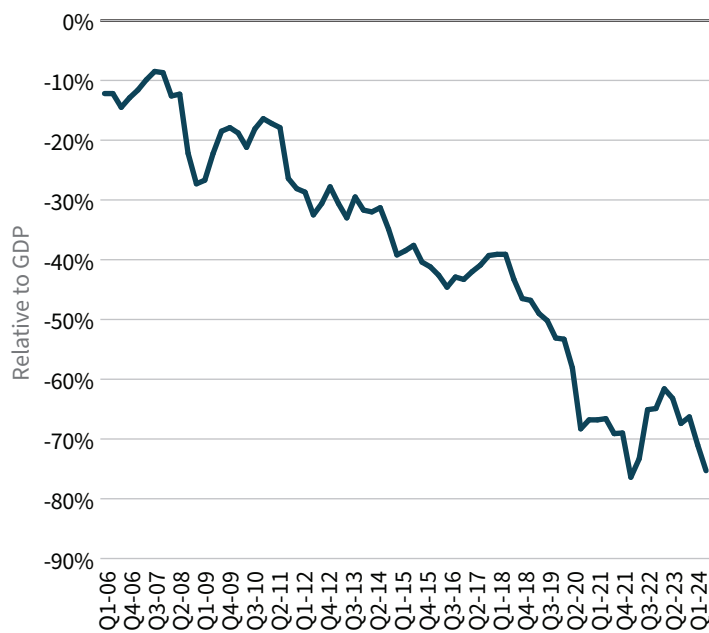
23 <https://fred.stlouisfed.org/graph/?g=mfu>

CURRENT ACCOUNT BALANCE AS % OF GDP



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

U.S. NET INTERNATIONAL INVESTMENT POSITION



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

world.²⁴ But, again, the world seems oblivious to the worsening U.S. financial position given the strong value of the \$US at the moment (at a two decade high).²⁵ Current geopolitical risks may be distracting from these fundamental realities, but if there is a sudden realization that the global safe haven isn't really that safe, then watch out for a drop in the dollar, followed by a sharp increase in interest rates domestically.

THE FED: PASSING THE BUCK

Any clear read of the data suggests that the U.S. economy is still overheated—fueled by the excessive growth in Federal spending and by the rapid surge in asset prices that occurred in the wake of the pandemic stimulus. It doesn't take a Wall Street guru to see that the stock market is ridiculously overpriced. P/E ratios are now on par with the runup to the tech recession at the start of this century.

And that brings us full circle to the Federal Reserve. The excessive reaction of the U.S. government and the Federal Reserve to the pandemic in 2020 and 2021 created three serious issues for the U.S. economy—it caused inflation, an asset bubble, and enabled the Federal deficit to grow even larger. The Fed's aggressive actions to date have cured the inflation problem—but not the other two. That said, the appropriate reaction by the Federal Reserve should be to stay the course, and maybe even tighten further (modestly). It would be wise to keep the heat on Congress by keeping borrowing expensive, and to try and tamp down asset prices.

However, in the midst of this writing, the Fed followed through and made the cut they have been signaling over the past few weeks. Indeed, they went with a full 50-point cut—something that is typically reserved for times of economic distress. But the comments made by Chairman Powell after they announced the cut made it clear that the Fed does not see the U.S. economy tipping into a recession anytime in the near future—a very accurate statement. So, why make this move? The likely answer is the yield curve, which has been inverted now for two years. While this hasn't led to

24 <https://fred.stlouisfed.org/graph/?g=qF7j>

25 <https://fred.stlouisfed.org/series/RTWEXBGS>

the recession many anticipated, it also hasn't un-inverted on its own. That is putting pressure on U.S. credit markets in ways that can lead to adverse outcomes for banks in the long run. If it isn't un-inverting on its own, it's time to do it mechanically.

Backing this up is the fact that the Fed clearly stated they will continue to engage in quantitative tightening (selling assets off the Fed's balance sheet into the bond markets), thus slowing growth of the money supply. If the change in the funds rate was about the economy, we would expect it to be accompanied by a deceleration in the pace of quantitative tightening. The slower growth of M2 will constrain credit supply and put upward pressure on long run rates. Hence, don't expect this change in Fed policy to have major implications for mortgage rates.

Whatever the case, falling rates will give the U.S. economy a boost in the short run, but will likely increase the risks of a larger bubble and inevitable crash down the road. For Jerome Powell, the choice to cut rates now may help in the short run, but ultimately just kicks the can down the road for the next Fed Chairperson to deal with. And that is a conversation for after the election.

UNITED STATES FORECAST

U.S. FORECAST - OUTPUT

	Current	Forecast			
	Q1-24	Q2-24F	Q3-24F	Q4-24F	Q1-25F
Real GDP (Billions, 2012\$)	22,749.8	22,868.5	22,990.6	23,085.0	23,211.8
Real GDP (% Change from Preceding Period, SAAR)	1.3	2.1	2.2	1.7	2.2
Consumer Spending (Billions, 2012\$)	15,777.9	15,881.1	15,988.9	16,062.1	16,166.8
Consumer Spending (% Change from Preceding Period, SAAR)	3.0	2.6	2.7	1.8	2.6
Nonresidential Investment	4,151.7	4,235.4	4,247.4	4,267.2	4,299.3
Nonresidential Investment (% Change from Preceding Period, SAAR)	3.2	8.3	1.1	1.9	3.0
Fixed Investment (Billions, 2012\$)	4,074.5	4,117.1	4,131.1	4,143.2	4,181.0
Fixed Investment (% Change from Preceding Period, SAAR)	6.0	4.2	1.4	1.2	3.7
Change in Private Inventories (Billions, 2012\$)	27.8	65.4	63.0	69.9	64.1
Government Spending (Billions, 2012\$)	3,900.0	3,903.2	3,915.7	3,922.2	3,928.5
Government Spending (% Change from Preceding Period, SAAR)	1.3	0.3	1.3	0.7	0.6
Net Exports (Billions, 2012\$)	-975.3	-1,040.0	-1,063.3	-1,069.0	-1,091.8
Net Exports (% Change from Preceding Period, SAAR)	27.1	29.3	9.3	2.2	8.8
Exports (Billions, 2012\$)	2,535.5	2,536.6	2,561.6	2,580.1	2,598.3
Exports (% Change from Preceding Period, SAAR)	1.2	0.2	4.0	2.9	2.8
Imports (Billions, 2012\$)	3,510.9	3,576.6	3,625.0	3,649.2	3,690.1
Imports (% Change from Preceding Period, SAAR)	7.7	7.7	5.5	2.7	4.6

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

U.S. FORECAST - KEY INDICATORS

	<i>Current</i>	<i>Forecast</i>			
	Q1-24	Q2-24F	Q3-24F	Q4-24F	Q1-25F
Industrial Production (index)	102.4	102.8	103.0	103.2	103.7
Total Nonfarm (Quarterly Change, 000s)	770.7	699.7	673.5	613.2	621.9
Unemployment Rate (%)	3.8	3.9	4.2	4.2	4.1

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

U.S. FORECAST - INFLATION

	<i>Current</i>	<i>Forecast</i>			
	Q1-24	Q2-24F	Q3-24F	Q4-24F	Q1-25F
Consumer Price Index (% Change, Year-over-Year)	3.2	3.1	3.1	3.0	2.9

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