Economic & Market Commentary

The U.S. economy began 2024 on a strong note. There were various indicators of business activity, labor markets, sentiment, and inflation that had generally been moving in a favorable direction.

However, several headwinds including rising consumer debt and elevated interest rates are beginning to weigh on this economic growth.

While there is no longer any forecast of a recession in 2024, it is expected that consumer spending growth will slow and for overall GDP growth to slow, possibly to under 1% over Q2 and Q3 2024.

Afterwards, inflation and interest rates should normalize, and quarterly annualized GDP growth should move toward its potential of near 2% in 2025.

U.S. consumer spending held up remarkably well in 2023 despite elevated inflation and higher interest rates, however, this trend is already beginning to soften in early 2024.

For instance, retails sales growth over the first two months of the year was weak.

Gains in real disposable personal income growth are softening, pandemic savings are dwindling, and household debt is increasing.

Unfortunately, consumers are spending more of their income on servicing existing debt and subsequently, delinquencies are rising.
Additionally, the pay later part of those buy now, pay later plans are growing and will weigh on future spending as the bills come due.

It is feared that the overall consumer spending growth will gradually slow to a standstill in Q3 2024 as households struggle to find a new balance between income, debt, savings, and spending.

While labor market conditions are expected to soften over this period, they are not expected to deteriorate.

As inflation and interest rates decrease, consumption should expand once again in late 2024.

Following a bounce in early 2023, business investment growth slowed in the second half of 2023 as interest rate increases made financing more expensive.

This trend will intensify in the first half of 2024 as the Fed resists calls to cut interest rates, not likely until June 2024 or later.

Residential investment, which had been contracting since 2021, began to grow again in the third quarter of 2023. Persistent demand for homes and a supply shortage was the driver.

Looking ahead, residential investment growth is not expected to sustainably improve until interest rates begin to fall.

Government spending was a positive contributor to growth in 2023 due to federal non-defense spending associated with infrastructure investment legislation passed in 2021 and 2022.
However, growth is likely to slow in 2024 and 2025 as infrastructure spending stabilizes.

Furthermore, political volatility surrounding fiscal policy, debt, and outlays could impact government spending over the next few years.

Labor market tightness has been remarkably persistent over the last year and is expected to continue over the coming quarters and is not expected to collapse even as the economy slows.

The tightness largely reflects a shrinking labor force as Baby Boomers retire. Accordingly, businesses are not likely to lay off workers.

The battle of inflation is expected to experience continued progress over the coming quarters, but there will be bumps.

Source: The Conference Board Economic Forecast for the U.S. Economy 3/21/2024

And the big question of the day is when will the Federal Reserve begin cutting interest rates?

That's the question that has dogged markets for the past few months.

Expectations about the timing and magnitude of interest rate cuts have changed dramatically.

Earlier this year, the federal funds futures market had priced in as many as six 25-basis-point (0.25%) cuts to the federal funds target rate.

Now that number is down to three, implying a year-end federal funds rate of 4.75%.
Some economists are even suggesting that the Fed won't lower interest rates this year at all, due to the strength of the economy and the risk that inflation will remain too high.

One reason for the volatility in expectations is that the Fed has pushed back on the prospect for a rapid pace of rate cuts.

Rather, it has indicated that it is "data dependent," watching every data point to assess the next policy move.

That leaves investors to react to every economic indicator and extrapolate the results into the future, creating a bumpy road for markets.

We still see room for the Federal Reserve to cut by three-quarters of a point this year, but if inflation continues to become stronger than expected, the Fed might prefer to keep the rate elevated and cut less than expected.