2023: Performance Beats Expectations 2024: Resiliency Will Be Tested

U.S. Chief Economist Satyam Panday's Year-End Reflections

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This report does not constitute a rating action

For the final 2023 edition of our Essential Economics newsletter, we asked each S&P Global Ratings chief economist to share their insights on following questions:

- What was the biggest surprise for you in 2023 and what are the takeaways?
- What will you be watching most closely in 2024, and why?

2023: The U.S. Economy Outperformed Expectations

The U.S. economy has fared much better than we had anticipated at this time last year. What seemed like an economy tipping toward recession has instead grown by 2.9% in the last four quarters. For 2023, the economy is on track for a 2.6% growth on a fourth quarter-over-fourth-quarter basis (Q4 2023/Q4 2022). This translates to a 2.4% annual average growth, just about the average of the previous expansion period (2010-2019).

Admittedly, getting the timing of cyclical slowdown in domestic demand has been a trickier endeavor due to the unique features of this cycle. First, a higher share of fixed-rate debt has sheltered households and businesses from higher interest rates during the current rate-hike episode. The cost of servicing existing debt has not risen by much even as the flow of new credit has slowed to a drip. Second, households have been able to draw on the excess accumulated savings of the pandemic. This bolstered spending amid a real disposable income squeeze. Lastly, contribution to growth from the public sector has leaned pro-cyclical.

The government was directly responsible for a substantial portion (26.5%) of overall GDP growth since mid-2022. Additionally, it incentivized private-sector investment in U.S. manufacturing construction with the passage of the CHIPS and Science Act (CHIPS) and Inflation Reduction Act (IRA), creating a surge so fast that nobody had anticipated (see chart 1).

Meanwhile, the continued fading of pandemic-related distortions in both labor and product markets has improved the supply picture. Especially in the labor market, we are seeing younger folks choosing jobs over college, increasing prevalence of women combining parenthood with work, and the rising employment rate among people with disabilities, which together have helped the labor force growth to remain above trend.

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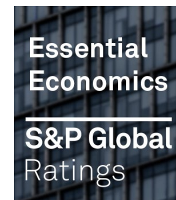

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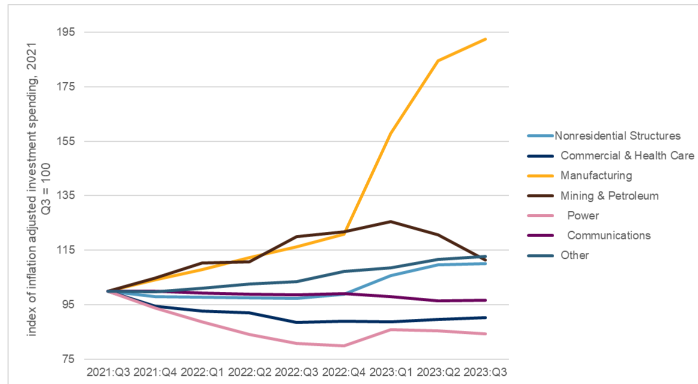
Takeaway: Unusual features of the current cycle on both the demand side and the supply side help explain why the U.S. economy performed much better than we had feared 12 months ago. Whether such a trend can last is another question.

Chart 1

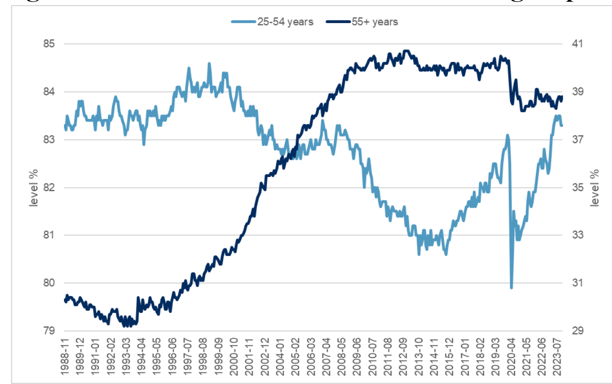
CHIPS and IRA policies are crowding-in private investment in manufacturing structures at an unprecedented scale



Sources: BEA and S&P Global Ratings.

Chart 2

Labor force participation rate is back to normal for prime-aged folks but not so for the 55-and-older group



Sources: BLS, St.Louis FED, and S&P Global Ratings.

2024: Test Of Ongoing Resiliency

The ongoing resiliency of the U.S. economy will be tested in 2024, as real interest rates stay relatively high (relative to the last monetary cycle as well as the longer-run equilibrium rate) and the lags of monetary-policy tightening feed through the economy. Businesses are facing higher costs of capital, the outcome of which will lower capital expenditure and hiring. Consumer spending is poised to be more in line with real income growth, as the firepower from excess cumulative savings has dwindled. The economy will likely still eke out growth, but is poised to cool off in the coming quarters with growth below the long-run potential.

What to watch: *Multiplier effect:* While direct impacts of fiscal policy on demand (including both discretionary fiscal policy and automatic stabilizers) will turn slightly negative in 2024, the indirect impact--the so-called "multiplier" effect--from the CHIPS, IRA, and Infrastructure Investment and Jobs Act is hard to pin down and could continue to provide a larger-than-expected boost to growth (as well as perhaps even increase the speed limit of inflation-neutral growth). *Cyclical legs:* A resurgence in labor force in 2023 is an encouraging sign for 2024, as well as for the longer term. How much more can be squeezed out of the prime-aged pool and will the missing 65-and-older group (roughly 1 million attributed to retirement behavior change) come back? (See chart 2). *Revealed preference in guiding principles of the Fed's policy:* Falling inflation and rising unemployment might change the Fed's calculus on what type of inflation to focus on and its degree of inflation (im)patience. As disinflation progresses towards the 2% target (as we think it will over the year), will the Fed opt to put off cuts for too long, as was the case in 2006-2007; or will it employ "insurance cuts" at the first signs of an uptick in unemployment as in the mid-1990s? Once unemployment starts rising unambiguously, it is often too late to avoid a recession.

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