



Strategic Analysis

June 2024

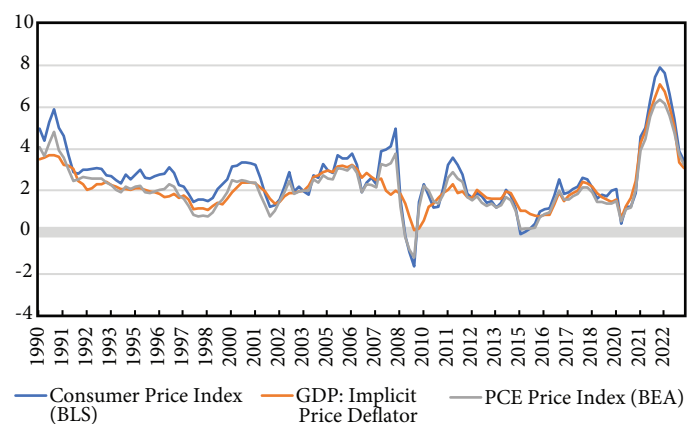
US ECONOMIC OUTLOOK: PROSPECTS FOR 2024 AND BEYOND

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Most economic variables measuring the performance of the US economy show a strong recovery. Accelerated GDP growth and employment, consumption, and investment, as well as easing supply-chain difficulties, are fueling US growth despite the Federal Reserve maintaining high interest rates. Inflation in the US appears to be decreasing, but the Fed is in no hurry for a rate cut in the second half of this year, despite overwhelming evidence of disinflation from the latter part of 2022 into this year (Figure 1)—the uptick in the first few months notwithstanding—and financial market expectations embodied in the run up of equity prices.

Contrarian minority voices at the Fed—Governor Michele Bowman (2024) and economists aligned with Lawrence Summers’ views—consider a possible rate cut a huge mistake and would prefer another rate hike instead. This view, unfortunately, has many followers, with the general public—influenced by the price tags on some daily expenses and by multiple commentators insisting no significant improvement has taken place—believing that inflation has not decreased. More sanguine voices observe the BLS and BEA reports and are convinced of the disinflation trend, expecting the Fed to gradually decrease interest rates later this year. As Nersisyan and Wray (2022) have argued, the wrong-headed tight monetary policy implemented by the Fed to curtail inflation and

Figure 1 US Inflation (annual growth rate)



Source: BEA; BLS

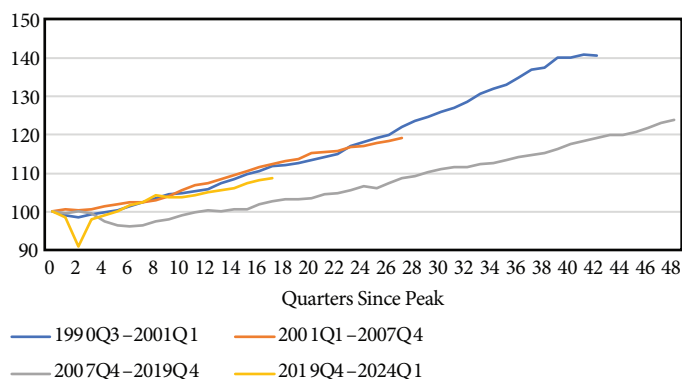
ease inflation expectations is dangerous, especially when the Fed’s own research reveals it has no working theory of inflation (Rudd 2021). It is a policy of flying blind, based on estimates of unobservable variables and perhaps a hope of lowering inflation (Papadimitriou and Wray 2021).

Some omens on the horizon are not encouraging and continuing high interest rates for longer will undoubtedly minimize the possibility of a “soft landing,” if such a possibility ever existed. There are serious economic issues that relate to high interest rates affecting the valuations of and bank exposure to commercial and multi-family buildings (Whalen 2024).

High mortgage interest rates and the strong effects on housing, especially affordable housing, does not bode well for the US economy. In their April 2024 report for existing home sales, the National Association of Realtors shows that the continuing decline began with the Fed’s interest rate hikes that pushed the popular 30-year mortgage rate to the levels observed in 2002 (NAR 2024). At the same time, servicing dollar-denominated debt in developing economies has strained government budgets.

As mentioned before, the Fed’s interest rate hikes seem to have had little effect on US GDP growth after the COVID-19 contraction. GDP growth exhibited a strong recovery—one of the fastest of the recent past for the first nine months—becoming anemic thereafter to the end of first quarter of 2024, as depicted in Figure 2. It was the swift and significant increase in public consumption that, in turn, increased private expenditures, while inflation was primarily caused by exogenous shocks including some remaining supply-chain problems and energy and transportation-related issues emanating from the wars in Ukraine-Russia, Israel-Gaza, and terrorist attacks in the Red Sea.

Figure 2 Recoveries of Real GDP in the Previous Four Cycles (peak=100)

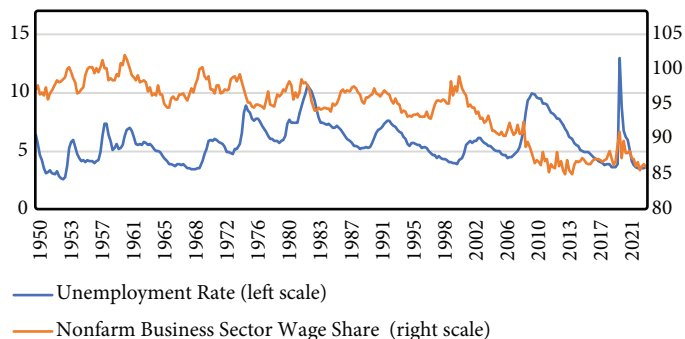


The United States is heading into a presidential election this year in the midst of geopolitical turbulence in Europe and the Middle East and economic challenges at home. Maintaining the GDP growth rates of the recent post-COVID years is not in the cards as will be apparent in our own projections—the low unemployment rate notwithstanding—and those from the Congressional Budget Office (CBO) and other international organizations.

In this report, we review and analyze prevailing conditions, assess the behavior of drivers of growth and/or decline, consider the likely paths of fiscal policy, net exports, and private sector expenditures, and the geopolitical challenges facing the US economy. We then use reasonable assumptions to develop our own growth projections.

We continue to observe, in Figure 3, the insignificant impact of low unemployment on wage inflation, a matter discussed in our report of 2020—also a presidential election year—despite the Biden administration’s efforts to extol the importance of the institution of unions (Papadimitriou, Nikiforos, and Zezza 2020). The wage share in the national income pie has been declining since 2001, except for the small uptick in the last few quarters in 2019 and a few months in early 2020, resuming its declining trend to the end of 2022. An explanation of the declining labor income may be found by examining and comparing the pre- and post-pandemic period changes in the employment–population ratio of the working-age population—25 years and older. This shows the decrease in unemployment to be overwhelmingly the result of the portion of individuals without a high school diploma in low-productivity jobs for unskilled employees, as compared with the

Figure 3 US Unemployment (percent) and the Wage Share (1948Q1=100)



Source: BLS

portions of employees with a high school diploma and those with a bachelor's degree and higher, as illustrated in Figure 4a. Furthermore, the average duration of unemployment may also contribute to the declining share of labor income. As shown in Figure 4b, the average duration decreased since 2011 and then dropped precipitously in the early months of 2020, only to return very quickly to the highest level of the postwar period.

Next, in Figures 5a and 5b, we note both positive and negative components driving GDP growth on annual (2018–23) and quarterly (2023–2024Q1) bases respectively. In both figures, the significance of consumption as the major driver of growth is clearly shown, contributing the lion's share of growth. Government expenditures have been and continue to be important to growth, as both figures illustrate, although in 2024Q1, government spending's contribution to growth is declining as compared to previous quarters in 2023. The increase in

government expenditure in 2023 is most likely due to President Biden's Inflation Reduction Act, Infrastructure Investment and Jobs Act, and the CHIPS and Science Act—all centering on supply interventions and attempts toward the “greening” of the economy, and labeled by many as a revival of industrial policy. On the other hand—the Trump and Biden administrations' strong trade policies notwithstanding—the net exports trend continued to be a stubborn drag on the US economy, unlike the experiences of countries (e.g., China and Germany, among others) relying on export-led growth. It should be noted, however, that imports decreased in 2023—especially in the second quarter—offsetting the dramatic drop in exports, but the overall trend shows a widening trade deficit; we will return to this issue later. Investment, the other driver of growth, showed the business component contributing more in the post-COVID period than residential investment, with the latter being adversely affected by the interest rate hikes. Private nonresidential investment on information processing, software, computers, and

Figure 4a Change in Employment–Population Ratio, 25 Years and Older (percent)

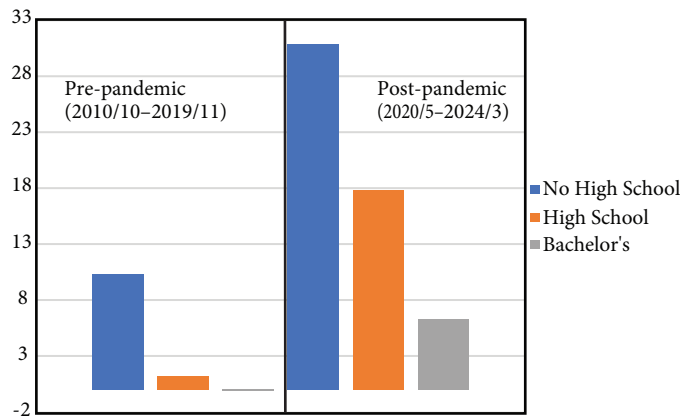
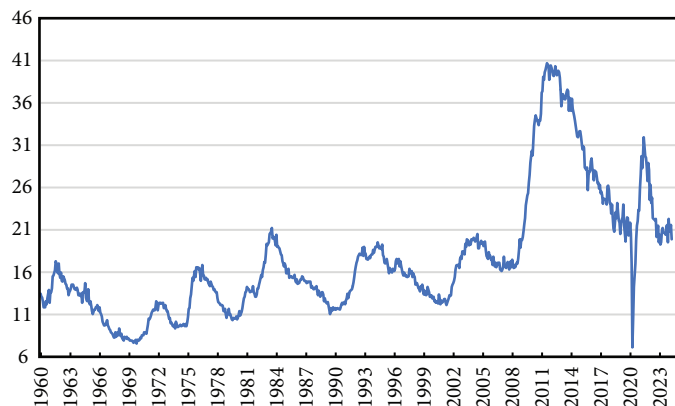
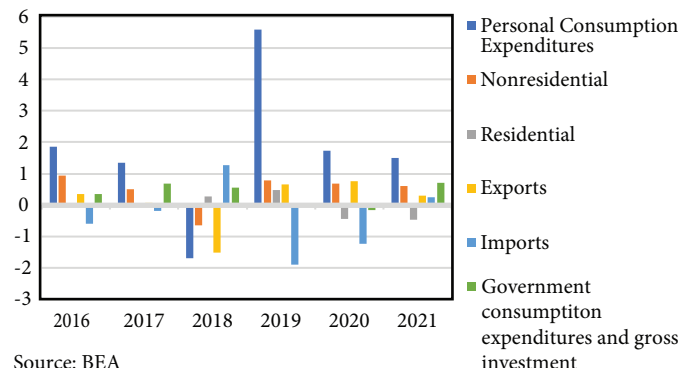


Figure 4b US Average Weeks Unemployed



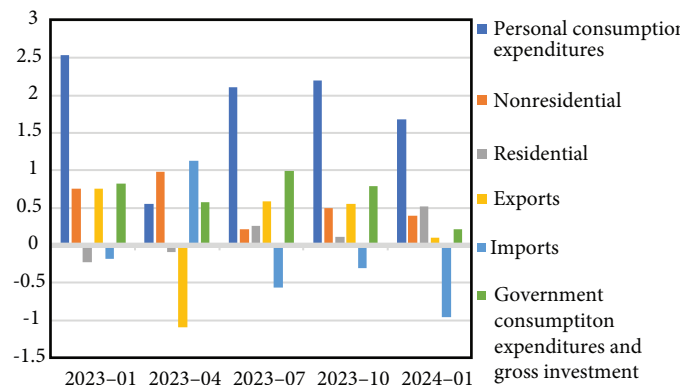
Source: BLS

Figure 5a US Contributions to Real GDP Growth (percent)



Source: BEA

Figure 5b US Contributions to Real GDP Growth (percent)



Source: BEA

peripheral equipment continued its accelerated trend, reaching close to \$162 billion at the end of 2024Q1 (BEA).

Industrial production, as measured by the Federal Reserve, rose 0.4 percent in March 2024, but declined at an annual rate of 1.8 percent in 2024Q1, while manufacturing output increased 0.5 percent in March. Total industrial production in March was unchanged compared with its year-earlier level. Capacity utilization moved up to 78.4 percent in March, but it was 1.2 percent below its long-run (1972–2023) average. The Institute of Supply Management’s March 2024 Purchasing Managers Index was 50.3, while their subsequent report for the April 2024 Index showed a decline to 49.2.

These mixed developments resulted in a slowdown of the annual growth rate of real GDP at 1.3 percent for 2024Q1, less than 40 percent of the annual growth rate of 3.4 percent recorded in 2023Q4. As will be shown in our baseline projections, these conditions will result in a slower real GDP growth rate of less than 2 percent for 2024 and a little over 1 percent for 2025. Furthermore, there is another factor that may contribute to an even slower growth rate of GDP, stemming from a significant correction of the overvalued equities market. In what follows, we discuss our baseline projections while we detail further the crucial factors that form the basis for our assumptions embodied in the baseline.

Baseline

Our point of departure is a review of the CBO growth projections in February and March 2024. The real GDP growth rate on an annual basis accelerated from 1.9 percent in 2022 to 3.1 percent in 2023. In its February projection, the CBO estimated a growth deceleration in 2024 to 1.5 percent, and increased growth to 2.2 percent for 2025–26. In the corresponding March (2024) projection, the growth rates for 2023 and 2024 were revised to 2.5 percent from 3.1 percent and to 1.8 percent from 1.5 percent, respectively.

The contributing factors of demand are detailed in Table 1, while Table 2 lists the GDP growth rates from the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) for each year 2024–26. The deceleration in the CBO growth rate projections is primarily due to the projected declines in consumption and government outlays, while exports and imports will grow minimally with imports a bit higher, contributing more

Table 1 CBO Projections of Real GDP Growth and Its Components

Percentage points	2023	2024	2025	2026	2026	2025
Real GDP	3.1	1.5	2.2	2.2	2.1	1.9
Consumer spending	1.8	0.9	1.3	1.1	1.4	1.5
Business Investment	0.5	0.5	0.8	1	0.6	0.4
Business fixed investment	0.5	0.3	0.4	0.5	0.4	0.4
Residential investment	*	0.2	0.4	0.5	0.1	*
Government purchases	0.7	0.1	0.1	0.2	0.1	0.1
Federal	0.3	*	*	*	*	*
State and Local	0.5	0.1	0.1	0.1	0.1	0.1
Exports	0.2	0.2	0.3	0.3	0.3	0.2
Inventories	*	-0.2	-0.4	-0.3	-0.3	-0.3

* = between 0.05 percentage points and 0.05 percentage points.

Source: CBO, 2024

Table 2 Comparison of Projections

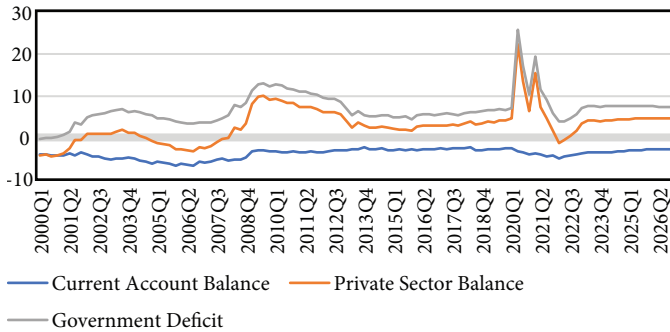
Growth rates	2023	2024	2025	2026
GDP				
CBO (Feb.)	3.1	1.5	2.2	2.2
CBO (Mar.)	2.5	1.8		
IMF (Apr.)	2.5	2.7	1.9	2.0
OECD (May)		2.6	1.8	
Inflation (PCE)				
CBO (Feb.)	2.7	2.1		2.1
CBO (Mar.)	4.1	2.6		
IMF (Apr.)	4.1	2.9	2.0	2.0
OECD (May)		2.4	2.0	

to a negative effect on GDP. The positive contribution is from investment, both business and residential, with the latter projected to increase rather dramatically. There are also inflation projections that—after 2024—all converge to around 2 percent.

The projections from the CBO and other international organizations are optimistic as compared to those of our baseline scenario. The CBO’s projections are mostly based on the US economy following a “business as usual” path. Our model, based on the original Cambridge model (Cripps and Godley 1976) and modified for the US by Godley (1997), produces lower growth rates of 1.8 percent for this year, 1.2 percent for 2025, and 1.3 percent for 2026. These projections are based on the assumed behavior of private and public expenditures and net exports. We avoid projecting beyond the 2024–26 period, since the economy’s development will depend on the priorities set by the administration taking office in 2025.

The assumptions embodied in our simulations are as “neutral” as possible, including an inflation rate gradually decreasing to around 2 percent and a stable nominal exchange rate. Inflation and growth rates of US trading partners are those

Figure 6 US Sectoral Balances (percent of GDP)



Source: BEA and authors' calculation

estimated in the IMF's April 2024 World Economic Outlook (WEO). We further assume equity and real estate prices remain stable, while the effective federal funds rate will gradually decrease to 2.8 percent by 2026. The results of our projections are shown in Table 3. The main differences when compared with the CBO projections are that both private and public consumption and investment expenditures are lower than the CBO baseline, while net exports produce a higher deficit.

The implications of our projections for the financial balances of the three institutional sectors are shown in Figure 6. The government sector's balance shows a deficit of 7.4 percent of GDP, corresponding to a private-sector balance increase to 4.6 percent and a current account deficit of 2.8 percent of GDP.

Household and Firm Financial Conditions

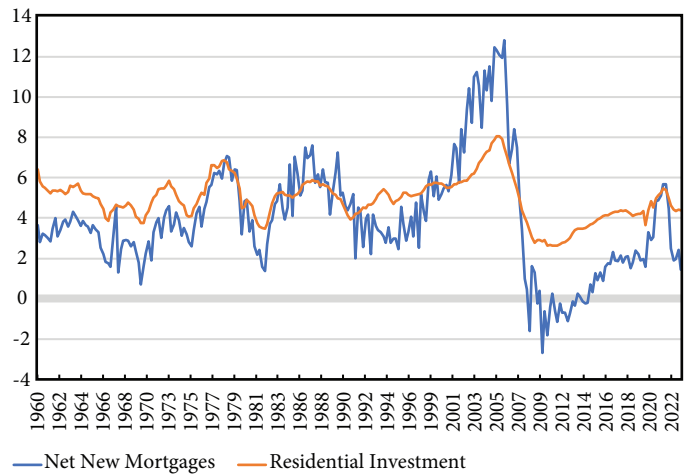
Households

As discussed above, the increased government expenditure in the post-pandemic period had a positive effect on job growth and household disposable income, despite the high interest

Table 3 Baseline Projections

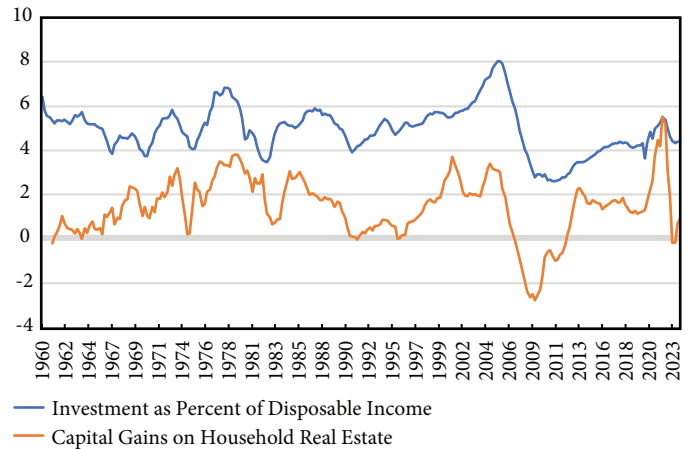
	2023	2024	2025	2026
Real GDP (% growth rate)	2.5	1.8	1.2	1.3
Private expenditure	1.5	1.8	1.3	1.6
Public expenditure	4.1	2.4	0.8	0.8
Exports	2.6	2.3	3.7	4.0
Imports (% of GDP)	15.3	15.5	15.8	16.2
Inflation	3.6	2.5	2.2	2.0
Gov. Debt (% of GDP)	114.3	116.7	119.2	122.3
Current account (% of GDP)	-4.4	-3.6	-3.4	-3.0

Figure 7 US Households: Residential Investment and Mortgages (percent of disposable income)



Source: BEA

Figure 8 US Households: Residential Investment and Capital Gains (percent)



Source: BEA IMA

rates. The gradual interest rate increase, however, had an impact on obtaining new mortgage financing, even though residential investment recovered and, based on the CBO projections, is expected to continue increasing for some years at significant rates of 5–10 percent, anticipating a fall in interest rates. As can be seen in Figure 7, net new mortgage financing—after a drop during the global financial crisis of 2007–9—resumed its growth trend until the pandemic hit. At that point, its declining trend persisted into 2023 as the available data testifies. In Figure 9, we observe the same trend for mortgages as in Figure 7, but also an increasing trend of household short-term debt, primarily on credit cards, motor vehicles financing, and other short-term

Figure 9 US Households: Debt Outstanding (percent of disposable income)

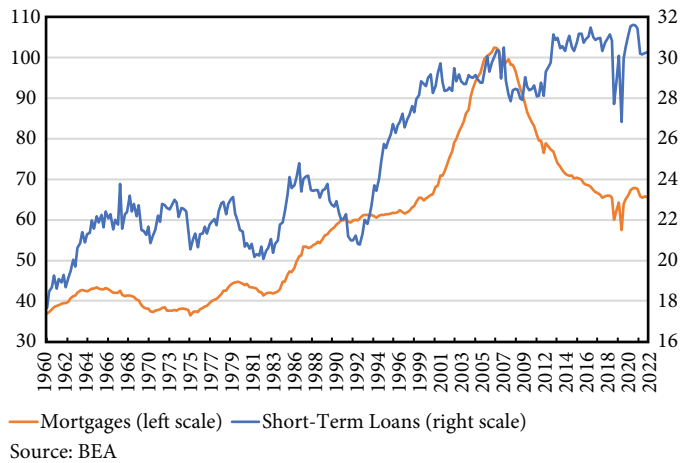
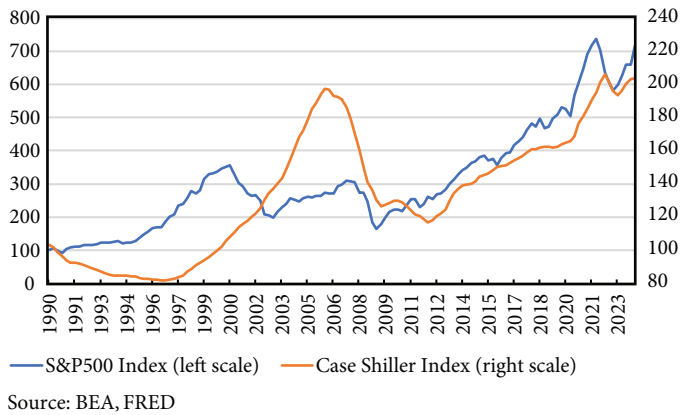


Figure 10 US Real S&P500 and Case Shiller Indices (1990=100)



credit, until 2014, remaining stable thereafter but still totaling over 100 percent of disposable income.

There is evidence to suggest that residential investment appears to be strongly correlated to the behavior of the housing market. In Figure 8, we present—as percentages of disposable income—residential investment, on the one hand, and on the other, the capital gains that can be derived from house sales to households, if housing were to be considered an alternative to equity market investment. What we observe in Figure 8, is that this correlation may have been relevant until 2021, but it has broken down since then, with the capital gains trend having fallen precipitously, unlike with the stock market, as shown by the indices of the S&P 500 and Case-Shiller. This appears to be yet another disincentive for significant residential investment to occur, casting doubts of the optimism of the CBO projections

for the residential investment sector and associated spending to boost GDP growth in the near future.

Unlike the declining returns on residential investment, equity markets have performed very well, as is always the case with overvaluations. The returns on investment in the stock market—as shown by the S&P 500 and the Case-Shiller indices, in Figure 10—have been a source of wealth and disposable income. Whether this, if continued, will be a driver for increased private consumption is not assured given the Biden proposals to increase taxation on the wealthy. Moreover, a stock market correction will have major repercussions in the real economy, as we have witnessed in previous episodes of equity market corrections. The Case-Shiller cyclically adjusted price-earnings ratio (CAPE) shown in Figure 10 illustrates the current valuation matching the valuation of the late 1990s, dot.com bubble, which, when it burst, did not have welcome consequences. Similarly, the S&P 500 index matches the years leading to the global financial crisis. There is then a considerable downside risk that neither the CBO nor our projections take into account—and if it occurs it will in turn have negative feedback effects on GDP growth.

Figure 11 US Nonfinancial Corporate Business (percent of GDP)

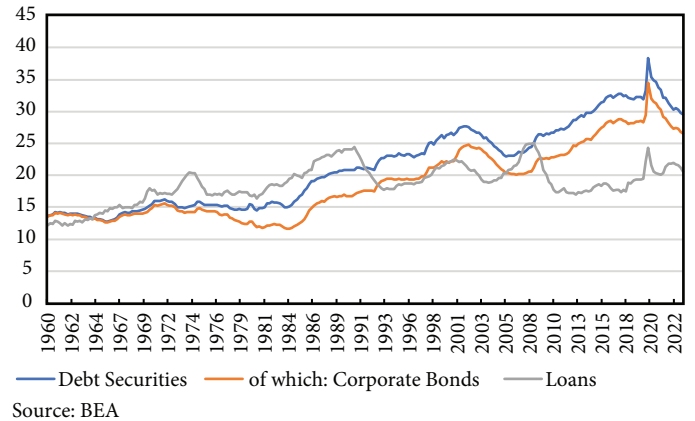


Figure 12 US Balance of Trade (percent of GDP)

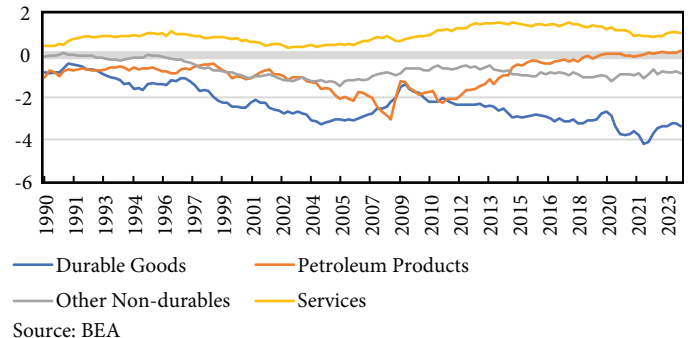
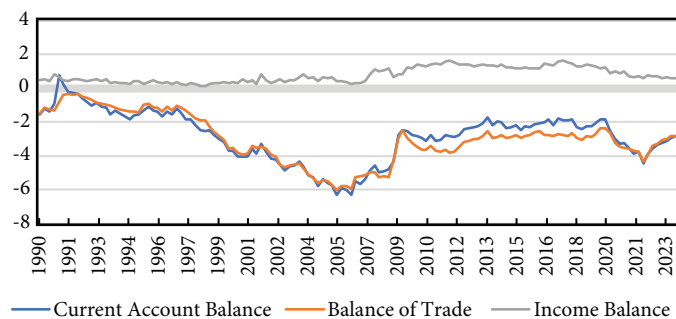


Figure 13 US Balance of Payments (percent of GDP)



Source: BEA

Firms

Contrary to the household financial conditions, firms' debt exposure continued its increasing trend in all forms until the pandemic, when a trend of deleveraging began. In Figure 11, we observe the increasing stock of debt in securities consisting of corporate bonds, municipal securities, and open-market papers until 2020. The latest available data show total business debt to be close to 80 percent of GDP, lower than its peak in 2020 of close to 100 percent, but at the same level as 2015. The post-pandemic deleveraging of the corporate sector introduces doubts of increasing business investment for this and the next years.

Hence, private expenditure—consumption and investment—from households and firms will not increase substantially unless, as in previous years, there is government stimulus.

The Foreign Sector

Trade issues are always a concern for each country. In the US, imports from the rest of the world overwhelm exports and, as Figure 12 illustrates, except for petroleum products and services, durable and non-durable goods have been widening the trade deficit for many years. Both the Trump and Biden administrations imposed tariffs on products from many countries, but mainly focused on imports from China. This was done to encourage production at home, but alas the anticipated reduction of Chinese imports has had little success and seems to have had no impact on the American consumer. Irrespective of the outcome of the 2024 presidential election, the new president will most likely continue and even intensify trade restrictions, imposing even higher tariffs—if one is to take to heart the announcements made by the leading candidates of either political party.

There are significant issues relating to the US trade balance. First and foremost, is that US industrial dominance has

been declining for years and does not seem to be reversing any time soon, even with President Biden's "modern supply intervention," otherwise known as industrial policy, included in the Inflation Reduction Act, Infrastructure Investment and Jobs Act, and the CHIPS and Science Act. Second, as we have argued elsewhere (Papadimitriou, Nikiforos, and Zezza 2020; Nikiforos and Zezza 2018), tariff policies are contradictory with present tax policy and instead cause disruptions in the supply chain of US corporations and increases in the costs of consumption goods. Finally, the only positive component of US trade is in the petroleum sector, as we explained elsewhere (Papadimitriou, Nikiforos, and Zezza 2019), which has improved even more since the Ukraine-Russia war by increasing exports of liquified natural gas (LNG) to Europe. Notwithstanding this notable improvement, it is not sufficient to offset the deficit created from the other components of trade as depicted in Figure 12.

The trade balance is the main determining factor of the balance of payments. Figure 13 shows the trend of the balance of trade and the income balance—repatriation of profits and investment returns—from US investments abroad, which was larger in the 2008–18 period. It began declining since then, still in surplus, but albeit insufficient to offset the trade deficit. The current account balance, still in deficit, has improved in the post-pandemic period, in concert with the improvement of the trade deficit from the petroleum goods trade surplus.

Godley (1999; 2000) warned, however, that when a country continues to run large current account deficits relative to GDP, it would be building up a large and growing foreign debt and this, in turn, implies large and growing interest payments servicing it. Godley, of course, was well aware of the hegemonic role of the US dollar in foreign exchange markets, but argued, nevertheless, that increasing interest payments made to the rest of the world would transfer purchasing power to foreigners that would reduce the potential growth of domestic demand. The US, however, being a sovereign country and issuing a reserve currency (US dollar) has, in Charles de Gaulle's words, "the exorbitant privilege" of incurring large current account deficits. Furthermore, the US has benefited, first, from the low interest rate environment of the last decade keeping interest payments to other countries relatively stable as a percent of GDP, and second, from the income it receives from capital invested abroad: interest payments outflows are less than the foreign income inflows, maintaining the income balance in the foreign sector in a positive territory.

Conclusions

In this report, we discussed the fast but short recovery of the US economy in the post-pandemic period until 2023. Robust consumption and investment and a relaxation of fiscal policy were the drivers of the recovery from accelerated GDP growth. Signs for the same rate of growth are not encouraging. The data, at the time of writing this report, show growth to be anemic, as the 1.3 percent for 2024Q1 indicates. The CBO projection based on significant increases in private-sector expenditures, including residential investments, appears doubtful unless the fiscal policy relaxation continues. The trade balance will continue on the same path of being in deficit, while both the household and corporate sectors deleverage instead of increasing spending. Even though the run up of the stock market may trigger the Keynes effect of additional spending, there are significant risks with its overvaluation levels, as the various indices indicate. Our own baseline projections for the 2024–26 period are more pessimistic when compared with those of the CBO, IMF, and OECD. Tight monetary policy, if it continues for long, would not help matters, especially for residential investment—a key growth driver in the CBO growth projections.

We hope the new administration will expand fiscal policy, especially focused on the transition in the greening of the US economy, covering the deficits in physical infrastructure and basic research and development. The various forms of industrial policy are good ideas, but we are skeptical of such policies being successful in the US, especially in reviving the manufacturing sector that lost its dominance long ago in favor of an ever-expanding financial sector.

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IMF (International Monetary Fund) various reports

OECD (Organization of Economic Co-operation Development)