ECONOMIC OUTLOOK

DECEMBER 14, 2023

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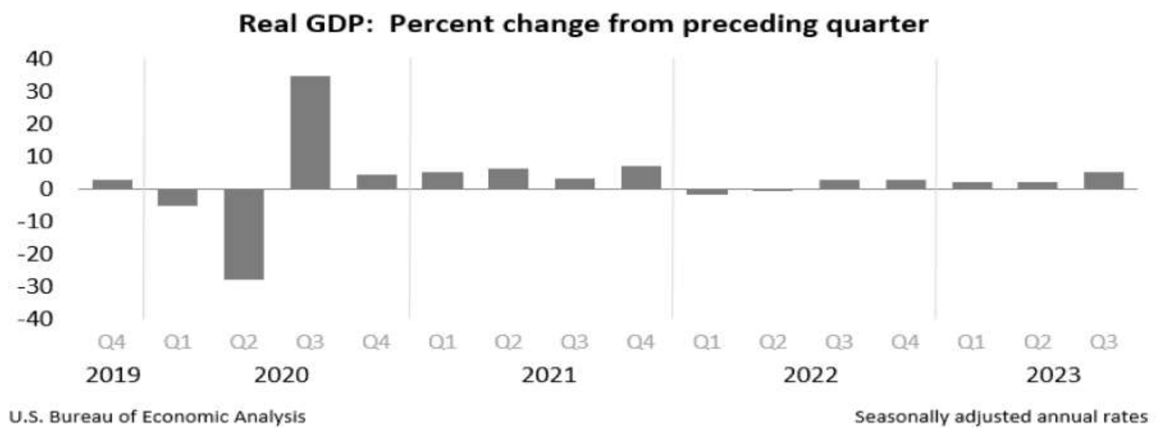
Q3 GDP GROWTH WAS +5.2%. DEC Q4 NOW CAST AT +1.2%.

Note: This report has four sections – Key Points, This Month's Topics, Conclusion(s) and Our Economic Projections

SECTION 1: KEY POINTS

A. U.S. real gross domestic product (GDP) increased at an annual rate of +5.2% in Q3 of 2023 (see table below), according to the "second" estimate released by the Bureau of Economic Analysis on Nov. 29th, 2023. In Q2, real GDP increased +2.1%.



- ***This revision, producing very strong Q3-23 GDP growth, reflected increases in:***
  - Consumer spending,
  - Private inventory investment,
  - Exports,
  - State and local government spending,
  - Federal government spending, and
  - Residential fixed investment.
- These were partly offset by a decrease in nonresidential fixed investment.
- Imports, which are a subtraction in the calculation of GDP, increased.
- The "second" revision update primarily reflected upward revisions to nonresidential fixed investment and state and local government spending. They were partly offset by a downward revision to consumer spending. Imports, which are a subtraction in the calculation of GDP, were revised down.

- **Current-dollar GDP** increased +8.9% at an annual rate in Q3, much higher than a +3.8% final Q2 estimate.

- A **price index for gross domestic purchases** increased +3.0% in Q3 versus +1.4% in Q2.

- The **PCE price index** increased +2.8% in Q3, versus +1.4% in Q2. *This is the broad economy-wide consumer inflation data the FOMC cares about. Yet, backward-looking.*

- Next release: Dec. 21st, 2023, at 8:30 a.m. ET. GDP, Q3-2023 (Third and Final Estimate)

- Forward look: Dec. 7th Atlanta Fed GDPNow has a Q4 real GDP growth rate at **+1.2%.**

Want a credible Wall Street view? An excerpt of **Goldman Sachs' 2024 Economic Outlook, done November 2023:**

"The U.S. economy is on its final descent to a soft landing"

"After defying recession fears this year, the U.S. economy is forecast by **Goldman Sachs Research** to easily beat consensus expectations again in 2024."

"U.S. GDP is projected to expand 2.1% in 2024 on a full-year basis, compared with 1% for the consensus of economist forecasts surveyed by **Bloomberg**.

Goldman Sachs Research reaffirms its longstanding view that the probability of a U.S. recession is much lower than commonly appreciated — at just 15% over the next 12 months.

"'It was fair to wonder last year whether labor market overheating and an at times unsettling high inflation mindset could be reversed painlessly,' David Mericle, Goldman Sachs Research chief U.S. economist, writes in the team's report titled 2024 U.S. Economic Outlook: Final Descent.

"'But these problems now look largely solved, the conditions for inflation to return to target are in place, and the heaviest blows from monetary and fiscal tightening are well behind us,' Mericle writes.

How did U.S. inflation fall without a spike in unemployment?

"At the start of 2023, **Goldman Sachs Research** argued that the key risk was not recession, as most forecasters thought, but rather that the economy would re-accelerate amid still-high inflation."

"In that case, the team assumed that the Federal Reserve would simply hike rates more aggressively to subdue demand growth so that supply could continue to catch up."
"But that didn't happen. In the spring, banking stress heightened concern about raising rates too much, and by the summer it became clear that strong GDP growth wasn't keeping the labor market from continuing to rebalance or wage growth and inflation from continuing to fall, according to Goldman Sachs Research."

"How has the U.S. managed to have both strong growth and progress in bringing down inflation this year? Our economists note that labor supply has more than recovered. Transitory influences on wages and prices have faded or reversed. And high prices have cured themselves by, for example, incentivizing massive construction of rental housing."

"A bit more surprisingly, labor demand has been contained even as final demand for goods and services accelerated and recession fears faded. The Beveridge curve, which is a way of showing the relationship between unemployment and job openings, may help explain why.

"'Extremely tight labor markets create a feedback loop between workers quitting and employers pre-emptively posting more job openings,' Mericle writes. This interplay 'can heat up quickly but can cool down quickly too,' Mericle writes.

"The hard part of the inflation fight looks over, according to Goldman Sachs Research.

"The unemployment rate has barely changed, but other measures of labor market tightness have fallen sharply and are on average only slightly above pre-pandemic levels. This cooling off is likely good enough, or nearly good enough, because inflation was a bit too low before the pandemic.

"This means further below-potential growth is no longer needed."

B. Update on the U.S. Consumer Price Inflation (CPI) Index

- The NOV Consumer Price Index got released at 8:30 am ET on Tuesday, Dec. 12th.
- The U.S. Bureau of Labor Statistics reported the Consumer Price Index for All Urban Consumers (CPI-U) rose +0.1% in November on a seasonally adjusted basis, after being unchanged in October.
- The All-Items index has increased +3.1% over the last 12 months.
- The All-Items less Food and Energy index has risen +4.0% the last 12 months.
- The energy index has decreased -5.4% over the last 12 months, while the food index has increased +2.9% over the last year.
- The subindex for shelter remains a dominant contributor to the monthly all-items increase.
  - Shelter's rise was +0.4% m/m in November. A +0.3% rise showed in October, +0.6% showed in September; then back to a +0.4% m/m rise in August, and a +0.4% in July. Shelter was up +0.6% back in May.
  - In y/y terms, Shelter was +6.5%. Progress!
  - Housing is 44% of broad CPI.
- Seven sub-categories increased strongly in November:
  - Utility Piped Gas (+2.8%),
  - Used Cars and Trucks (+1.6%),
  - Transportation Services (+1.1%)
  - Electricity (+1.4%),
  - Medical Care Commodities (+0.5%),
  - Food Away from Home (+0.4%), then
  - Shelter (+0.4%).

- One Sub-category looked static in November.
    - Food at Home (+0.1%).
- Four sub-categories declined in November:
    - Gasoline (-6.0%),
    - Fuel Oil (-2.7%),
    - Apparel (-1.3%),
    - New Vehicles (-0.1%).

C. The University of Michigan Consumer Sentiment Index

- U. of Mich. Consumer Sentiment rose +13.2% to 69.4 in NOV, up from 61.3 in OCT.
- In turn, year-on-year change in U.S. consumer sentiment remains up +16.1%.

Read DEC 2023 comments from U. of Michigan Survey Director Joanne Hsu:

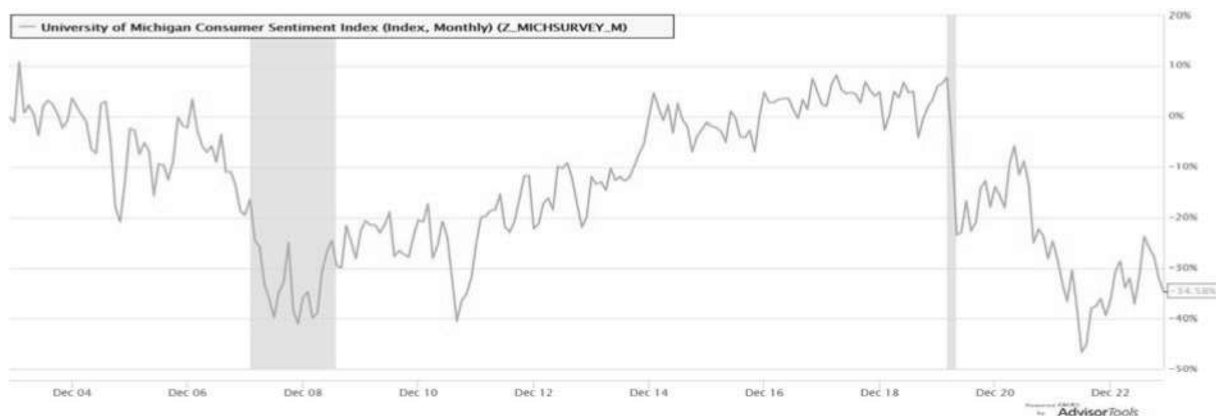
- "Consumer sentiment soared +13% in December, erasing all declines from the previous four months, primarily on the basis of improvements in the expected trajectory of inflation."
- "Sentiment is now about +39% above the all-time low measured in June of 2022 but still well below pre-pandemic levels."
- "***All five index components rose this month, led by surges of over +24% for both the short and long-run outlook for business conditions***."
- "There was a broad consensus of improved sentiment across age, income, education, geography and political identification."
- "A growing share of consumers—about 14%—spontaneously mentioned the potential impact of next year's elections."
- "Sentiment for these consumers appears to incorporate expectations that the elections will likely yield results favorable to the economy."
- "Year-ahead inflation expectations plunged from 4.5% last month to 3.1% this month. The current reading is the lowest since March 2021 and sits just above the 2.3-3.0% range seen in the two years prior to the pandemic."

- “Long-run inflation expectations fell from +3.2% last month to +2.8% this month, matching the second lowest reading seen since July 2021.”

- “Long-run inflation expectations remain elevated relative to the 2.2-2.6% range seen in the two years pre-pandemic.”

The U of Michigan consumer sentiment time series chart is shown below.

University of Michigan Consumer Sentiment (1996 = 100)



D. Labor Markets.

- On Dec. 8th, the Federal nonfarm NOV 2023 jobs report came in at +199K. That was a positive surprise, above consensus.
- The DEC 2023 Federal BLS report started with: “Total nonfarm payroll employment increased by +199K in November, and the unemployment rate edged down to 3.7%.”
- “Job gains occurred in Health Care and Government.”
- “Employment also increased in Manufacturing, reflecting the return of workers from a strike.”
- “Employment in retail trade declined.”

For bulls:

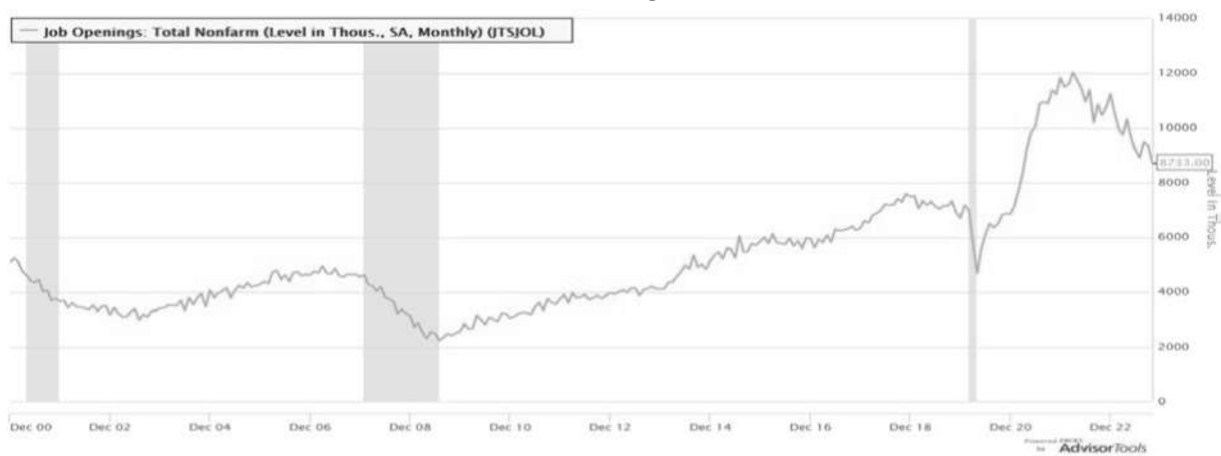
- The average monthly gain over the last 12 months to NOV 2023 is a solid +240K.
- The change in total nonfarm payroll employment for SEP was revised down by
- -35K, from +297K to +262K, and the change for OCT remained at +150K.

- With these revisions, employment in SEP and OCT combined was -35K lower than previously reported.
- Leisure and Hospitality job additions continued to trend up. It added +40K jobs, almost entirely in Food Services and Drinking Places. This industry has averaged +51K per month over the last 12 months.
- Government added +49K, in line with the 12-month average gain of +55K.
- Health Care added +77K jobs, well above the 12-month average gain of +54K.
- Most remaining NOV 2023 jobs data showed a solid labor market.
  - First, the labor force participation rate, at 62.8% in NOV, changed little.
  - Second, the number of persons not in the labor force who currently want a job was 5.3 million in NOV, little different from the prior month.
  - Third, among those not in the labor force who wanted a job, the number of persons marginally attached to the labor force, changed little at 1.6 million in NOV.
  - Fourth, the long-term unemployed (jobless for 27 weeks or more) edged down to 1.2 million. The long-term unemployed accounted for 18.3% of all unemployed persons.
  - Fifth, the number of persons employed part-time for economic reasons decreased by -295K to 4.0 million in NOV.
- The lagging U.S. household unemployment rate edged down to 3.7% in NOV.

For bears:

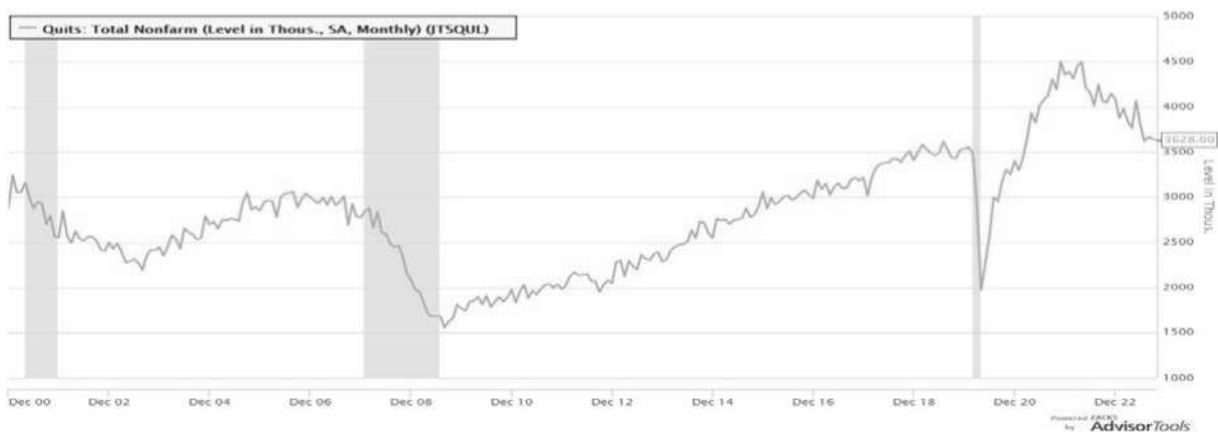
- The U.S. showed a lower 8.73M job openings in OCT 2023 versus 9.35M in SEP. The data remains in a trend down from a MAR 2022 peak at 12.027M job openings. Pre-COVID job openings trended at ~7M.
- Job Opening topping action remains easy to identify. +1.7M extra openings now!

Total Nonfarm Job Openings (2000 to OCT 2023)



- OCT 2023 quits were at 3.63M, similar to SEP at 3.65M. A quits peak came in Nov. 2021 at 4.501M. This data is now at a pre-COVID level.

Total Nonfarm Quits (2000 to OCT 2023)

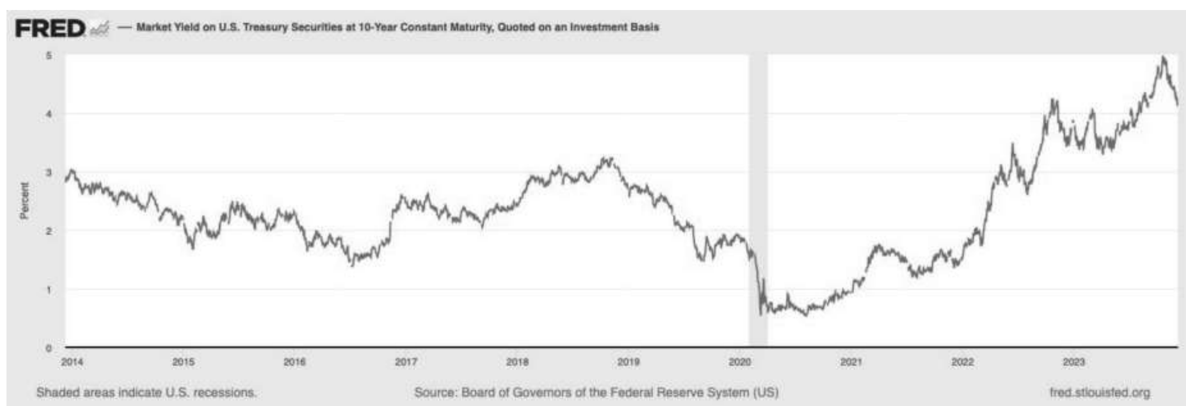


- Layoffs and discharges were at 1.64M in OCT, versus 1.61M in SEP.
- Over the past 12 months, average U.S. hourly earnings rose +4.0%. That's in line with a core CPI rising +4.0% thru November.

E. Fixed Income

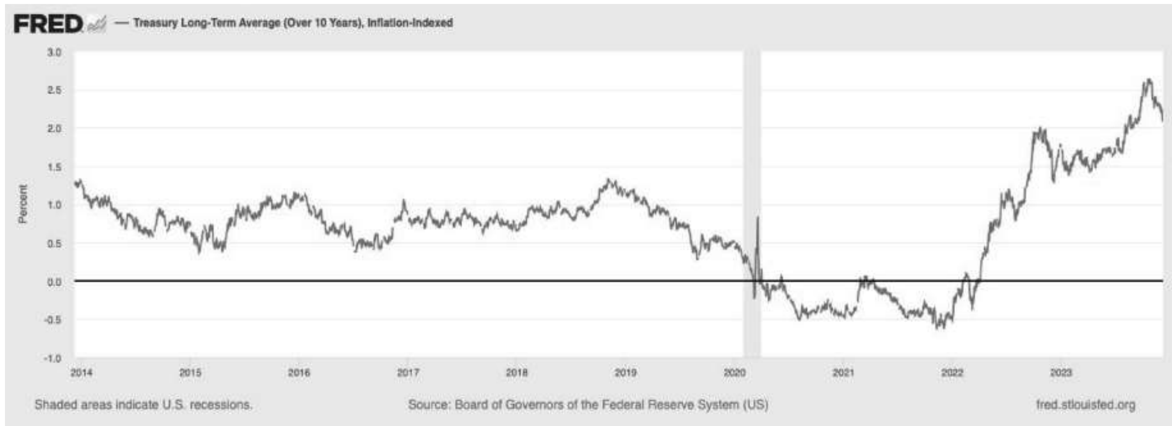
- In fixed income, markets saw a broad across-the-board returns rally in November.
- U.S. high yield was up +8.8% YTD to Dec 8th. Convertible bonds were up +9.8%. EM bonds in USD terms were up +7.4%, Investment Grade Corporates were up +5.8% TIPS were up +1.9%. (Source: Charlie BiLello)
- Long Duration Treasuries were still down -2.1% YTD. (Source: Charlie BiLello)
- The 10-year U.S. Treasury benchmark yield traded at 4.19% on Dec 12th.
- Consult the following chart for a longer timeline, running across the last 10 years.

Market Yield on U.S. Treasury Securities at 10-year Constant Maturity, Quoted on an Investment Basis (Dec. 2013 to Dec. 2023)



- The key bullish transition in NOV? The next chart also shows a falling 'real' inflation-adjusted U.S. Treasury 10-year yield.
- Back in time, this U.S. Treasury 'real' chart shows an inflation-indexed U.S. 10-year Treasury range between +0.5% and +1.5%, running from 2014 to 2019.
- A pre-COVID 'real' inflation indexed yield peak was seen on Nov. 2nd, 2018 at 1.34%.

Treasury Long-Term Average (Over 10 Years),
Inflation-Indexed (from Dec. 11th, 2013 to Dec. 11th, 2023)

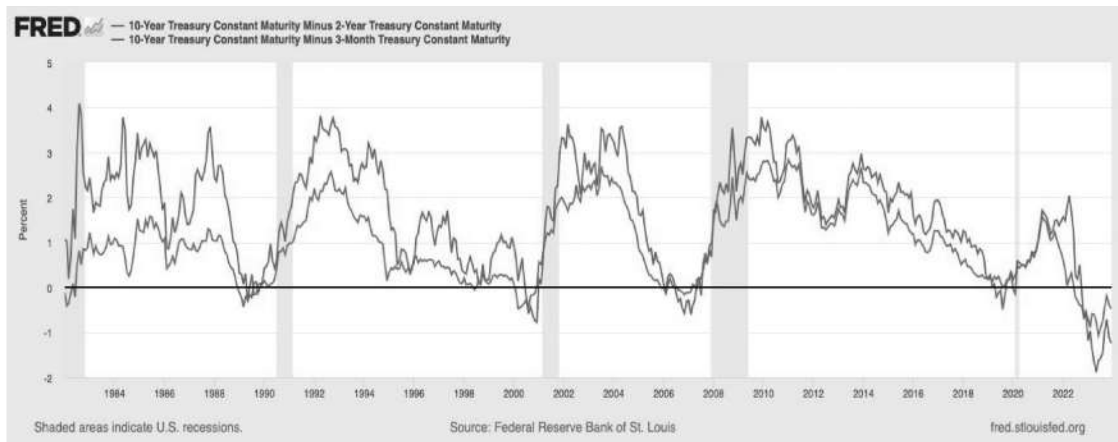


- ***To Dec. 11th, 2023, this 'real' LT Treasury yield has fallen back 50 basis points, from 2.63% to 2.13%.***
- The next technical levels to keep track of? This Long-Term 'real' avg. Treasury yield measure hit a 1.98% peak on Nov. 9th, 2022. It then fell. Real inflation adjusted yields receded to 1.29% by Dec. 7th, 2022.
- Markets have not seen ~2.0% 'real' bond levels since 2009, nearly fifteen years ago! Can we get a U.S. recession from +2.13% 'real' long-term U.S. Treasury yields? Yes.
- This risk-free benchmark real yield can break back to its recent high. U.S. equities sell-off, when algorithmic asset allocators run their real-time 'risk-parity' operations. Recession 'worry' tips up, with that selling.
- ST policy hikes can push LT 'real' yields up. We could get +25 bps, in 1H-2024. But it is much less likely now, given the downturn seen in consumer inflation rates.

1. One signal portending a U.S. recession is intact: Treasury Yield Curve Inversion.

- A third chart (below) shows the 10-year Treasury minus the 2-year U.S. Treasury rate spread, along with the 10-year to 3-month U.S. Treasury rate spread.

10-yr Treasury Constant Maturity minus 2-yr Constant Maturity (blue)
and **10-yr Treasury Constant Maturity minus 3-Month Constant Maturity (red)**
Jan. 4th, 1982 to Dec. 11th, 2023



- We still have a U.S. Treasury yield curve inversion. Though, it has softly de-inverted. This typically foretells a domestic U.S. recession in 18 to 24 months!
- The 1st Fed Funds rate hike started on March 17th, 2022 — 21 months ago.

2. The J.P. Morgan global manufacturing PMI has now run below 50 for 15 months.

- IHS Markit posted global manufacturing PMI matters (including USA) Dec. 1st, 2023:
- "The November PMI® surveys saw the global manufacturing sector move closer to stabilization."
- "Although the downturn in output extended to six consecutive months, the rate of contraction was negligible and the weakest during that sequence."
- "Business optimism also ticked higher, as companies' outlooks brightened despite the current continued market uncertainty and cost-caution."
- "The J.P. Morgan Global Manufacturing PMI® rose to a six-month high of 49.3 in November, up from 48.8 in October, but remaining below the neutral 50.0 mark for the fifteenth month in a row.
- "Although all five of the PMI components continued to signal a deterioration in overall operating conditions, four (new orders, output, stocks of purchases and employment) signaled lesser rates of decline than in the prior survey month."
- "November data indicated that the downturn in world manufacturing production was mainly centered on the intermediate goods sector, where output contracted for the sixth month in a row (albeit at a slower pace).
- "In contrast, consumer and investment goods producers both saw increases."
- "Ten out of the 31 nations for which November PMI data were available saw expansions of production, including the US, mainland China and India."
- "The main blot on the copybook remained Europe, with output contracting across the euro area (on average) and the UK. Japan also saw output decline. Signs of the manufacturing downturn softening were also seen in the trends in new orders, employment and purchasing during November."
- "Although further declines were signaled for each, rates of contraction were slower than one month ago."
- "Job losses were nonetheless registered for the third month running, with cuts signaled in the U.S., the euro area, mainland China and Japan (among others)."
- "The level of incoming new business fell for the seventeenth straight month, although the rate of decline eased and was one of the slowest during that sequence."
- "Part of the drop in total new business reflected a further reduction in intakes of new export work. The subdued demand environment and cost-caution also led to a further decline in purchasing activity and lower inventory holdings of both inputs and finished products.
- "Vendor delivery times improved again, as global supply chains continued to repair following the strains caused by the global pandemic and subsequent solid economic recovery."
- "Price inflationary pressures eased in November, as rates of increase in input costs and selling prices both slowed to three-month lows. In the case of purchasing costs, the rate of inflation remained (on average) higher in emerging markets compared to their developed market counterparts. Rates of increase in output charges were broadly similar for both developed and emerging markets, however."

3. Three major developed-country government bond yields declined this month too.

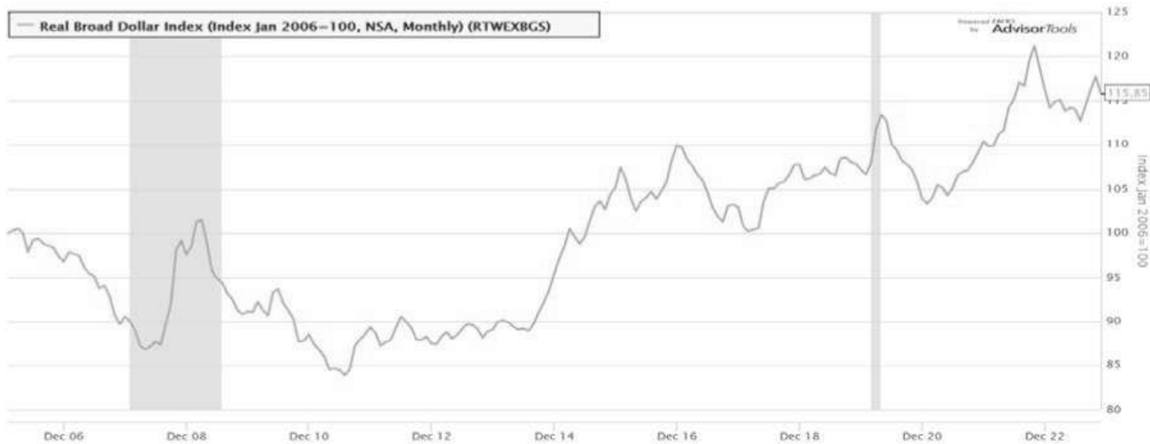
- Zacks stays on top of sovereign bonds and macro data in Germany, Italy, and Japan.
  - Germany is now well below its recent OCT 2023 peak of 2.89%: **On Dec. 12th, 2023, it was 2.22%.**
  - Italy: *On Oct. 1st, 2023, the Italian 10-yr peaked at 4.93%.* **On Dec. 12th, 2023, it was 4.00%.**
  - Japan: *On Oct 29th, 2023 the 10-yr JGB peaked at 0.92%.* **On Dec. 12th, 2023, it was 0.74%.**

- Reacting to the divergence between the Japanese 10-yr bond yields relative to much-higher U.S. 10-yr Treasury yields, the Japanese Yen depreciates.
- The yen went from trading at 115 per USD in March 2022 to an Nov. 13th, 2023 high near 152 per USD. On Dec. 12th, 2023 the Japanese yen traded at 145.3.

4. FX consequences of a U.S. rates disparity — to foreign sovereign bond rates.

- Over the last 21 months, as the U.S. Fed raised its Fed Funds rate rapidly, vis-à-vis its major trading currency partners. This drives up the value of the U.S. dollar.
- However, the FX markets likely put in a multi-decade high on the U.S. dollar's (USD) value in late 2022.
- The U.S. dollar hit 121.65 in October 2022. The 52-week low for USD was 103.19, seen on Jan. 2021.
- The Nov. 1st, 2023 real broad USD data showed a 115.84 print.

Real Broad U.S. Dollar Index (Jan. 1st, 2006 =100, data to Nov. 1st, 2023)



F. Zacks Expectations for Fed Policy

1. Get core Consumer Price Inflation expectations to +2.0%: Chair Powell's focus.

- However, the FOMC and Chair Powell do not solely focus on getting long-term Consumer Price Inflation (CPI) expectations under control.

- They reference a 'dual-track,' after the March 2023 banking crisis. Commercial Real Estate lending is a key concern, particularly on Office lending.

- The next chart shows how the consumer price inflation battle looks. Zacks provides the **U.S. 10-Year Breakeven Inflation Rate** across the last 10 years.

USA 10-Year Breakeven Inflation Rate (Dec. 11th, 2013 to Dec. 11th, 2023)

- **On Dec. 11th, 2023 this was 2.19%.**

- The April 22nd, 2022 breakeven U.S. 10-year rates at **2.98%** rests as the recent high. From April 2022, these inflation rates have trended lower.

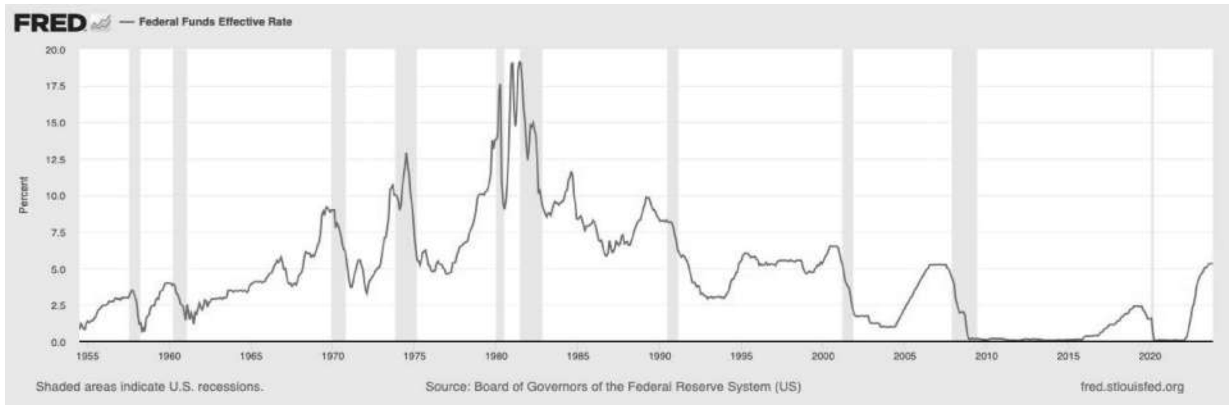
- A Dec. 11th, 2023 breakeven inflation rates at 2.19% is 19 basis points above the Fed's +2.0% statutory mandate for expected core CPI (best thought of as core PCE), and 42 bps above pre-COVID 2019 levels.

- Sticky consumer price inflation could remain as an enduring 2024 story. But the last month's down-trend could stand as a major development.

2. Compare this Fed Funds rate to other central banks.

- The FOMC --to Dec. 12th, 2023— has lifted the Fed Funds effective rate well above its pre-COVID early 2020 level, to 5.33% (a midpoint in a range from 5.25% to 5.50%).
- Is there a likely 'terminal' rate at 5.50% or 5.75%? That is likely as high as it gets, given the OCT 2023 core PCE rate was at +3.5%. The FOMC likes a +1.0% 'real' rate.

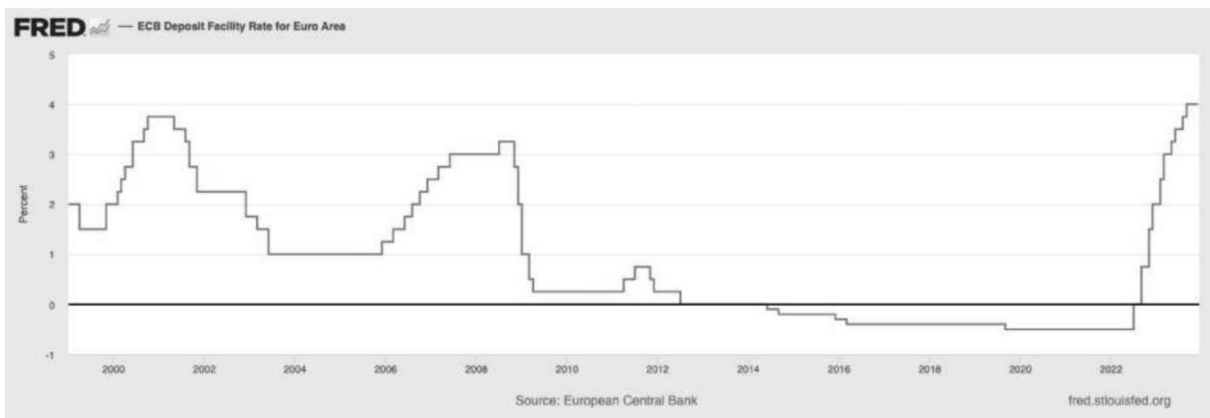
U.S. Federal Funds Effective Rate (1955 to DEC 2023)



- With the Fed Funds at 5.33% — in early December — here are regional monetary policy rates tracked by Charlie BiLello, to Dec. 14th, 2023:
  - The U.S. Fed Funds rate was 5.33%.
  - In Europe, the Eurozone's ECB got to 4.00% (USD-Euro FX is ~1.09). The U.K.'s BoE has a 5.25% policy rate.
  - The European list has the Czech Republic (7.00%), Poland (5.75%), Norway (4.50%), Sweden (4.00%) and Russia at (15.00%).
  - In Latin America, Argentina (133%, yes, that is correct!), Brazil (11.75%), Chile (9.00%), Colum-bia (13.25%), Mexico (11.25%) and Peru (7.00%).
  - In Asia, Australia (4.35%) and South Korea (3.50%) and Indonesia (6.00%),
  - Mainland China shows a Loan Prime Rate at 3.45%. The PBoC cut their real central bank rate 10 basis points in AUG 2023.

- ECB rates had been negative — below 0% — for eight years until it hiked in July 2022.

ECB Deposit Facility Rate for the Euro Area (1999 to Dec. 2023)



3. On Dec. 13th, 2023, the Fed issued their final 2023 FOMC Statement.

Note: The first two FOMC meetings in 2024 run from Jan 30th-31st and March 19th-20th.

- "Recent indicators suggest that growth of economic activity has slowed from its strong pace in the third quarter. Job gains have moderated since earlier in the year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated."
- "The U.S. banking system is sound and resilient. Tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation. The extent of these effects remains uncertain."
- "The Committee remains highly attentive to inflation risks."
- "The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent."
- "The Committee will continue to assess additional information and its implications for monetary policy. In determining the extent of any additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."
- "In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective."
- "In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals."
- "The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments."

4. Fed Chair Jerome Powell made these remarks after the DEC FOMC 2023 meeting.

On Dec. 13th, ABC News reported –

"The Federal Reserve expects to begin cutting interest rates next year, Fed Chair Jerome Powell said at a press conference in Washington, D.C., on Wednesday."

"Policymakers at the central bank believe interest rates likely stand at or near their peak, Powell added, voicing cautious optimism about the possibility that the Fed would markedly dial back its fight against inflation by the end of 2024."

"The forecast came after the Fed decided to leave interest rates unchanged on Wednesday, extending a pause of its near-historic series of rate hikes deployed to fight inflation."

“The interest rate decision arrived a day after the release of government data showing that price increases slowed slightly last month.”

«***Inflation has eased from its highs and this has come without the significant increase in unemployment — that’s very good news***,” Powell said on Wednesday.

«***But inflation is too high, ongoing progress in bringing it down is not assured, and the path is uncertain.”***

“Inflation has fallen significantly from a peak of about 9% last summer but remains more than a percentage point higher than the Fed’s target.”

“Inflation has eased over the past year but remains elevated,” the Federal Open Market Committee, the Fed’s decision-making body on interest rates, said in a statement Wednesday.

“The choice to leave rates unchanged matches decisions made by the Fed at its previous meetings in November and September, when the central bank paused its inflation fight amid growing optimism that the U.S. could achieve normal price levels without falling into a recession.”

“Many economists and observers had expected the Fed to begin instituting rate cuts as soon as next year.”
“Since last year, the Fed has raised its benchmark interest rate at the fastest pace in more than two decades in an effort to slow prices increases.”

“The rate hikes appear to have put the brakes on the housing market and discouraged businesses from major investments that would carry onerous borrowing costs.”

“The economy maintained robust employment growth last month but fell well short of the breakneck pace exhibited over the previous year, data from the Bureau of Labor Statistics on Friday showed.”

“Still, consumer spending has proven resilient. Black Friday sales did gangbuster business as the nation entered a holiday shopping season expected to test shoppers, who account for nearly three-quarters of U.S. economic activity.”

“Resilient holiday spending could provide additional fuel for the economy as observers hope for continued expansion but fear the downward pressure imposed by interest rate hikes.”

“Lately, the economy has rebuked such concerns. The gross domestic product grew at an annualized pace of 4.9% over three months ending in September, more than doubling growth of the previous quarter and easing worries about a possible recession, a report from the Bureau of Economic Analysis in October showed.”

“The process of getting inflation sustainably down to 2% has a long way to go,” Powell said.
“We remain strongly committed.”

5. Zacks Fed policy rate outlook follows futures trader's Fed Funds rate bets.

- Fed Funds remained at 5.25% to 5.50%, after the Dec. 13th meeting.
- By March-2023, the CME FedWatch tool (on Dec 13th, 2023) had futures pricing:
    - A 12.2% chance of 475-500 bps Fed Funds rate (a 50-bps cut).
    - A 66.1% chance of 500-525 bps Fed Funds rate (a 25-bps cut).
    - A 21.7% chance of 525-550 bps Fed Funds rate (no cut).
- Stay consistent within your U.S. policy rate outlook.
    - CME Fed Funds futures and the FOMC SEP 'dot plot' suggest a 5.25% to 5.50% 'terminal' rate.
    - *The CME FedWatch tool at **DEC 2024** shows the following odds for the Fed Funds rate, at that time.*
    - A 3.8% chance of 325 bp or 350 bps Fed Funds rate.
    - A 25.9% chance of 350-375 bps Fed Funds rate.
    - A 37.3% chance of 375-400 bps Fed Funds rate.
    - A 23.6% chance of 400-425 bps Fed Funds rate.
    - A 7.8% chance of 425-450 bps Fed Funds rate.
    - A 1.4% chance of 450-475 bps Fed Funds rate.
- One major implication for financial markets like stocks and bonds: There are 86.8% odds for 125 to 175 basis points of easing by YE 2024.

6. Conclusions

- The FOMC 'pivot' is officially in. A 'terminal' or 'neutral' Fed Funds rate in DEC 2023 was correctly pegged by CME futures traders at the current 5.25% to 5.50% level, as the median YE 2023 'dot plot' fell 20 bps, from 5.4% to 5.6%.
- Traders keep ~78% odds on the FOMC cutting 25, even 50 basis points, off the Fed Funds policy rate at the March 19th-20th 2024 FOMC meeting. Note: There is a Jan. 30th-31st meeting too.
- Traders keep very conclusive 86.8% odds that the FOMC is cutting 125 (five 25 bps cuts) to 175 bps (7 bps cuts) by Year-end 2024.

SECTION 2: THIS MONTH'S KEY TOPIC

A 2023 Christmas Holiday Season Shopping Report

We are midway thru the typically strong seasonal Christmas holiday shopping season.

Let's tap the best U.S. retail sales data, and study the state of the U.S. consumer.

What better time than this? To best assist any macro analyst, the U.S. Census produces the Advance Monthly Retail Trade Surveys **(MARTS and MRTS), the Annual Retail Trade Survey (ARTS),** and the **Quarterly E-Commerce Report**. Click that hotlink to access these surveys.

Together, these U.S. Census reports produce the most comprehensive data available on retail economic activity in the United States.

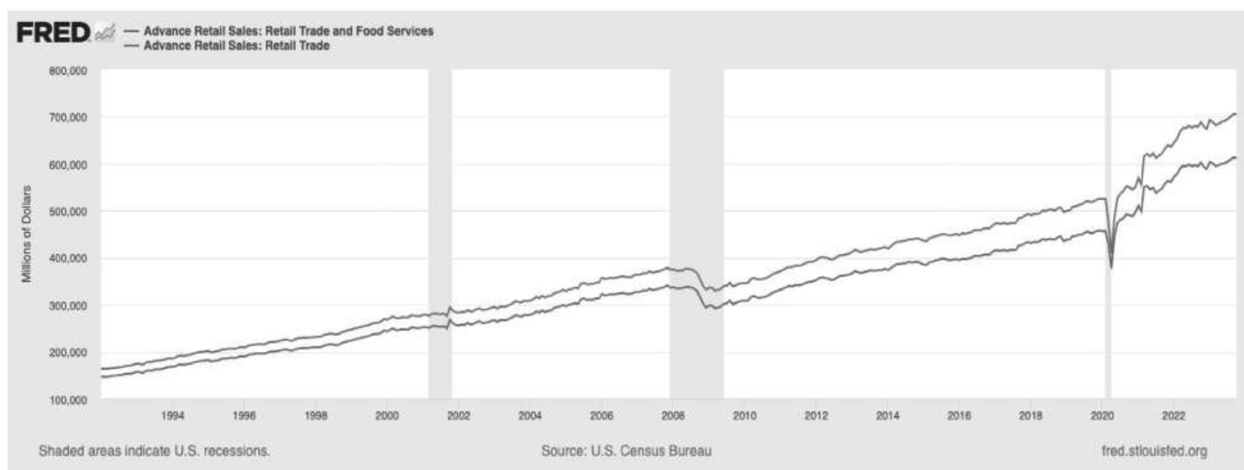
I. The Broad U.S. Retail Sales Scene: Long-term Trends Remain Intact

Just before this 2023 Xmas season began, the Oct. Census report began with —

"Advance estimates of U.S. retail and food services sales for October 2023, adjusted for seasonal variation and holiday and trading-day differences, but not for price changes, were $705.0 billion, and up +2.5% above October 2022."

In comparison to that +2.5% adjusted retail sales number? The U.S. real GDP Growth rate in the U.S economy in Nov. 2023 is tracking at +2.4%. Basically, matching its trend.

That $705B Oct. 2023 number can be put into a much longer context too. Consult a Fed of St. Louis (FRED) 30-year timeline, shown below. The blue line (below) is Advance Retail Trade and Food Services. The red line is just the Retail Trade numbers.



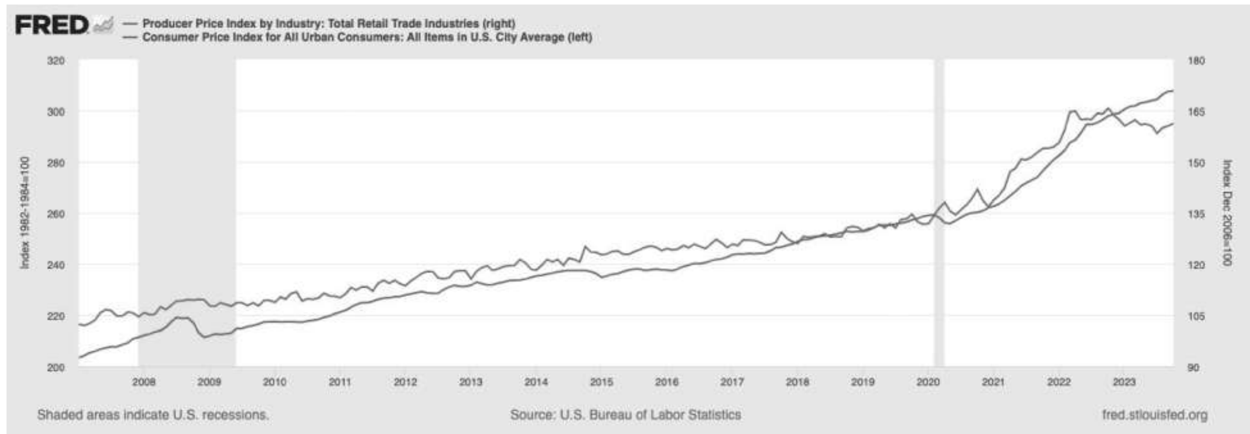
Note: The FRED chart data source above, is the same U.S. Census Bureau.

You can see, quite easily: post-COVID U.S. macro retail spending has been robust.

There is a bit of a chart illusion in play, though. The annualized nominal retail spending trend is actually similar, when compared to the five years prior to COVID.

- For the 45 post-COVID months, I computed around +4.2% as an annualized U.S. Retail Sales gain.
- For the five years from Feb. 2015 to Feb 2020, I found a +4.1% annualized gain.

In the next chart, I show any budding retail spending analysts the Total Retail Trade Industries Producer Price Index against the CPI for All Urban Consumers.

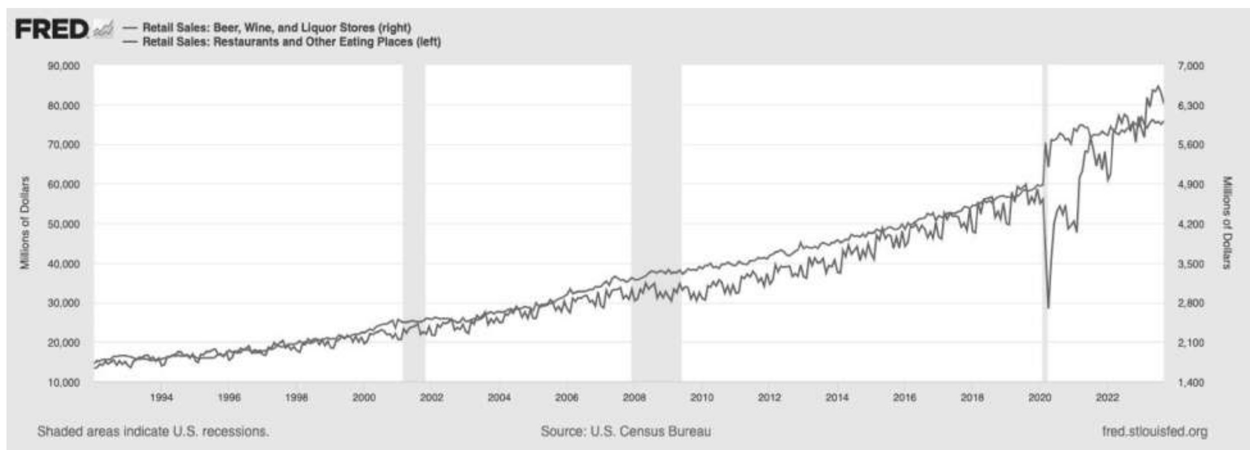


In terms of relative prices, there has been a net improvement seen for the U.S. Retail Trade environment, broadly.

In short, there has been a relative price improvement, assisting U.S. retailers.
- On Feb. 2020, the full pre-COVID retail trade number stood at $525.4. That made for a +34.3% **Retail Trade and Food Services** sales gain across the next 45 months of time.
- Across that identical 45-month period, the **U.S. Consumer Price Index for All Urban Consumers** went up +18.7%.
- That nets out to a +15.6% 'real' gain in underlying U.S. retail sales over those 45 months.

You may not be able to afford a very expensive home, or a very expensive car, with much higher interest rates on any loan. But you can still get out there, and eat and shop, at a much lower price point.

The next chart I show has Beer, Wine, and Liquor Stores and Restaurants and Other Eating Places.

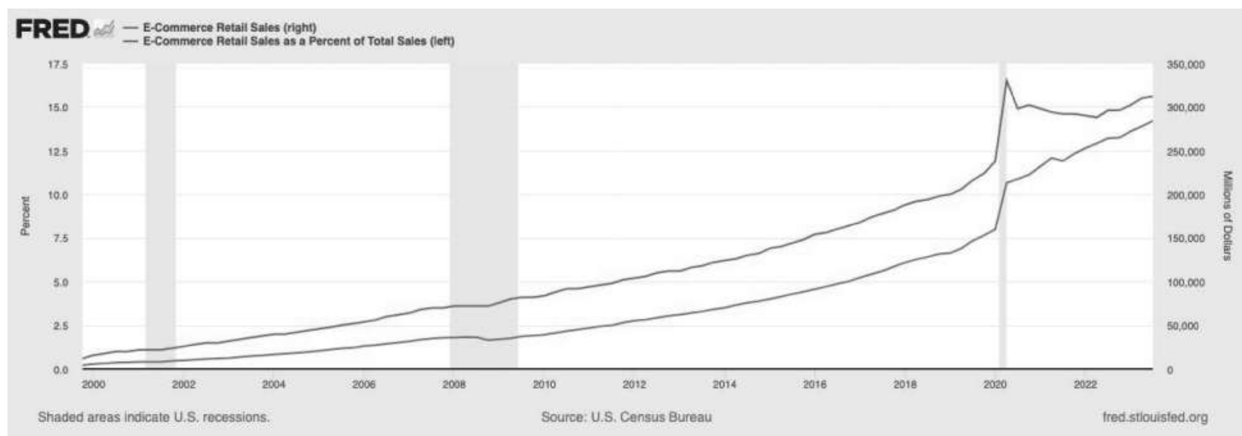


Since the **Restaurants** data (above) ends well above the **Beer, Wine, and Liquor** store data in 2023, you can infer this: Getting out on the town, with family and friends, has indeed been a major attraction, *across the last year.* Parties and gatherings got bigger, and happened more often.

Next, there is the need to update you on the **E-Commerce Retail Sales** data. In percentage terms, this stands at 15.6% of Total U.S. Retail Sales. Pre-Covid? In Q1-2020, I marked a 11.9% number.

In Q1-2015, I marked 6.9%. That is a 5.0% e-commerce gain, across 5 years of time. So, +1.0% in annual e-commerce retail penetration should be the underlying trend.

45 months of U.S. post-COVID retail sales time should have racked up 3.75% in added sales penetration. Here's the math (11.9% plus +3.75% = 15.65%).



That means actual e-commerce penetration (15.6%) is nearly identical to what any diligent analyst should have expected (15.65%).

So much for COVID having accelerated the e-commerce spending advance! That did not happen.

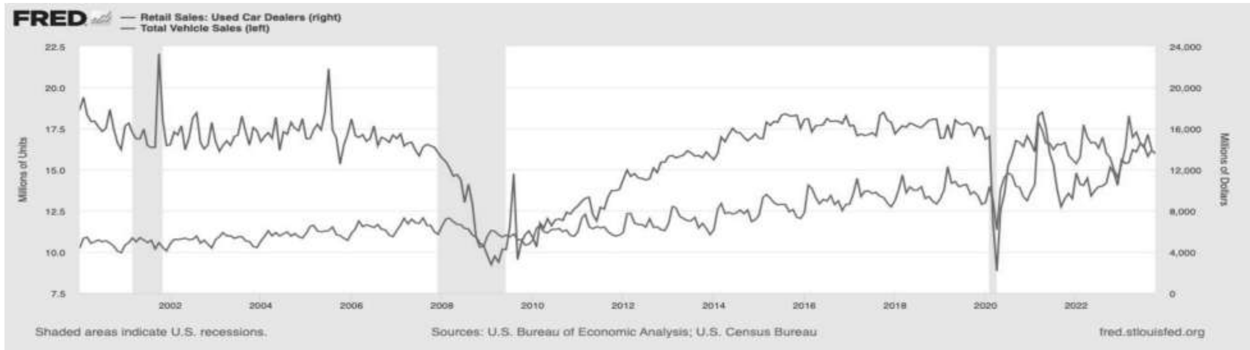
II. The Motor Vehicle Sales Scene: Still Missing 1M in Final Sales

In Oct. 2023, **Total Vehicle Sales in the United States** amounted to 15.97M units, at a seasonally adjusted annual rate. In Feb. 2020, they were running at 17M.

That is a -6% decline, amounting to a 1 million annual reduction in U.S. vehicle sales.

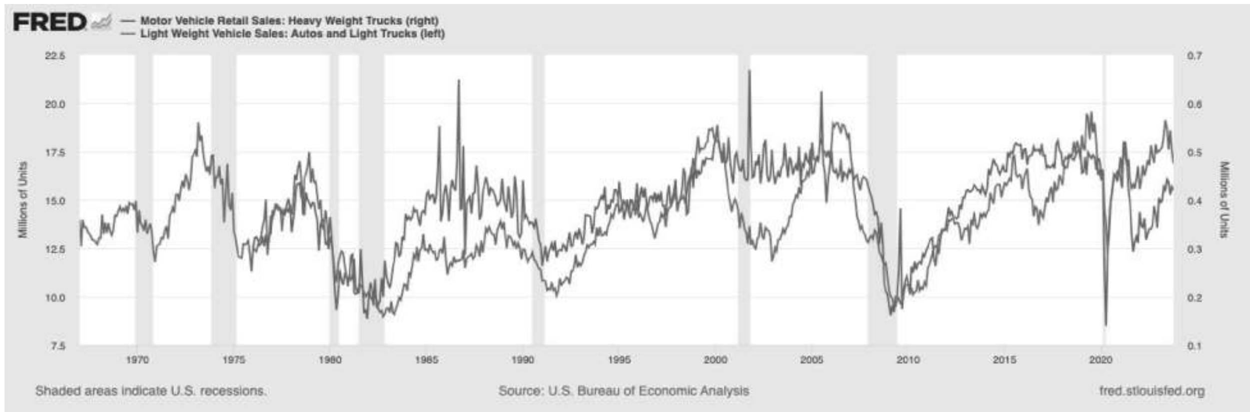
What is happening? Part of this is the post-COVID remote worker, not needing an auto to commute. Part of this is a shift away from autos, dues to much higher monthly payments. FRED data says the **Average Amount Financed for New Car Loans at Finance Companies** was $38,689 in June 2023. In Dec, 2019, this was $31.692.

The following chart show Used Car Dealer Retail Sales against Total Vehicle Sales.



Yes! A cheaper used car has been looking more attractive to U.S. consumers.

The next FRED chart puts Heavy Weight Truck Retail Sales up against Auto and Light Truck Vehicle Sales.



Again, you can see a relative loss of traction, in terms of **Light Weight Vehicle Sales.**

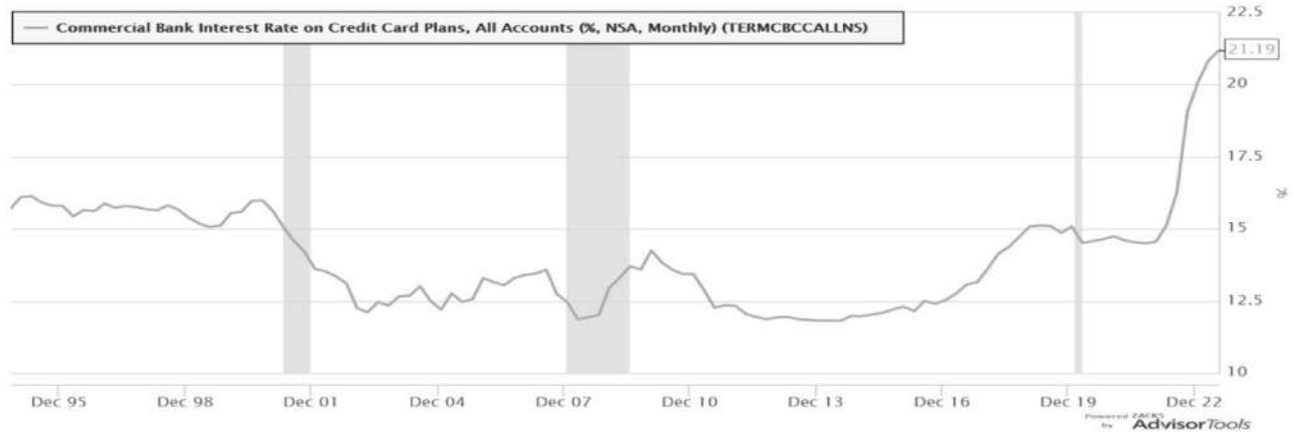
That takes us to our final stops: **Retail Business Formation** and the **Retail Job Scene.**

III. Loan Sharking Folks: With Super High Credit Card Rates

I did flag another very bearish element in the retail landscape.

Keep an eye on your credit card interest rate!

Commercial banks — in response to stiff Fed Funds rate hikes — moved **Credit Card Interest Rates**, from 14.56% in Feb. 2022 to an incredible loan-shark 21.19% rate in August 2023.



Yet, keep your confidence on the U.S. consumer high. Strategist Ryan Detrick shared these facts:

(A) Credit card debt as a percentage of disposable income has dropped two months in a row. This measure is at 6.3%, well off the peak of 9.5% in 2008 and slightly below pre-COVID levels of 6.5%.

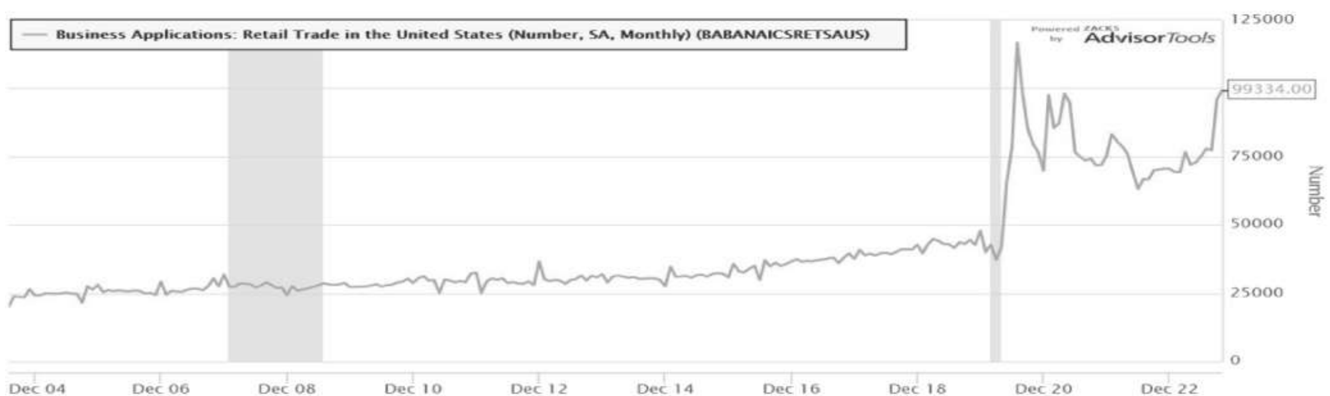
(B) Delinquencies are moving higher in some places (credit cards). But not on auto and mortgages.

Overall, there are still no major cracks forming yet.

IV. A Jump in United States Retail Business Formations: The Bulls Will Love This Data

For a gauge of underlying fundamental strength, coming from the supply side, not the demand side, let's look to **Business Applications for Retail Trade in the United States.**

As the next chart reveals to you, Business Applications for Retail Trade in the United States look excellent.



When you shutter nearly all retail stores during a pandemic, and then re-open that forever dynamic game, there is a changed physical landscape.

That changed landscape has opened up the opportunities, to set up new retail businesses, ***en masse.***

As to the future?

Over the next four quarters, Projected Business Formations for Retail Trade in the United States look strong too…

The chart (above) strongly suggests. 2024 is not likely to see a downturn in U.S. retail sales.

We will see even more new retail store openings.

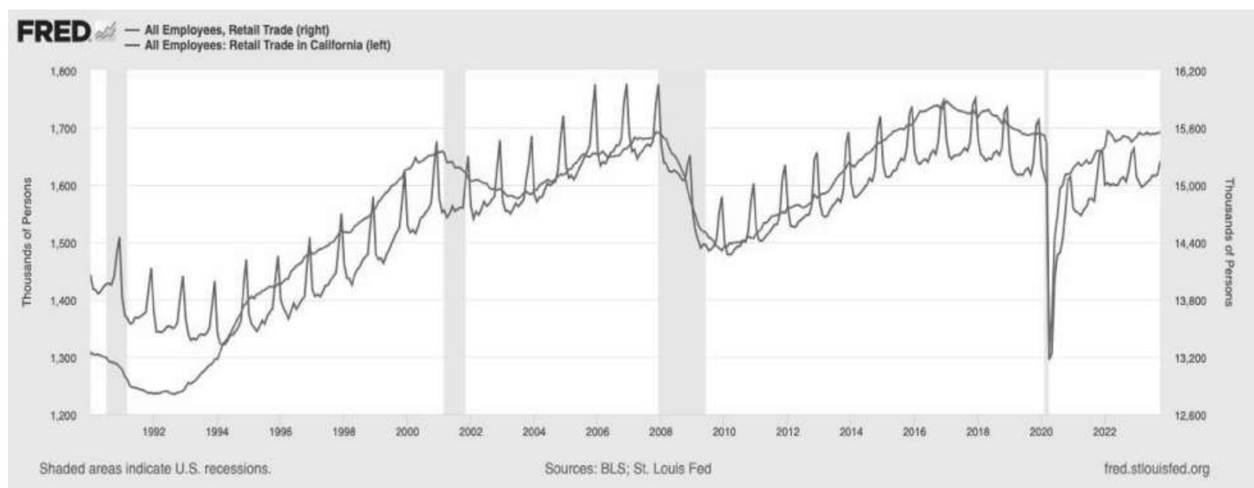
(C) Remember:

- 97% of all payments are current versus 95.3% pre-pandemic.
- Just 1.5% are derogatory versus 2.8% pre-pandemic.

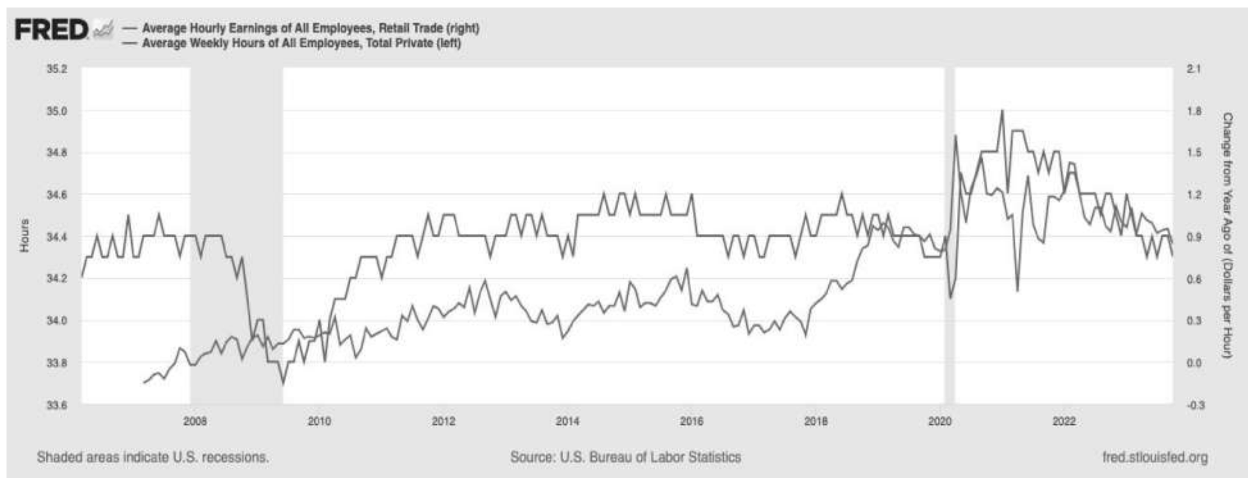
V. United States Retail Trade Jobs: Back to Pre-COVID Levels.

Reflecting the same lack of broad spending change seen in broad **Retail Trade** patterns, the Retail jobs scene is not much different either.

- On Nov. 3rd, 2023, the United States counted 15.5M Retail Trade jobs. In Feb. 2020, we counted 15.5M Retail Trade jobs. The same.
- In bellwether California, I noted 1.6M Retail Trade jobs. In Feb. 2020, there were 1.6M Retail Trade jobs. The same, once again.



Finally, the **Average Hourly Earnings of Total Private Employees** and United States **Retail Trade Employees,** are back to a long-term trend, too.



VI. Conclusions

Can you believe this? It has been almost four years since COVID hit the U.S. economy?

Time does fly by.

In light of the U.S. Census data I have just presented, I think you will agree with me:

1. The 2023 Christmas holiday package shopping season is going to look a lot like prior years — in terms of its stimulus to the overall U.S. economy.

2. There will be lots of new physical retail stores to try, with fresh omni-channel abilities.

3. Restaurants and bars are going to be more crowded, and

4. A new car's price tag is going to be considerably less attractive, electric or not.

That's it for this season's update. This Xmas season of 2023 is likely to remain a merry one. Enjoy!

SECTION 3: CONCLUSIONS

(1) Incremental change from September 2023 FOMC median projections to December 2023 median projections can best be termed a 'best case' outcome. It was better than 'goldilocks.'

Why do I write that? For 2023, a -0.5% y/y move downwards happened in the FOMC 'dot plot' projections, for both broad and core PCE; and a +0.5% y/y upwards move happened to U.S. real GDP growth. That is lower consumer inflation arriving with stronger real GDP growth.

The 2023 inflation progress was remarkable: The median broad PCE projection went from +3.3% y/y in the September meeting, to +2.8% y/y in December (a 'two-handle' driven by falling oil/gasoline prices). Core PCE went from +3.7% in September to +3.2% in December.

Add to this U.S. economy-wide inflation progress, a stronger 2023 real GDP growth rate: The median GDP projection went from +2.1% y/y in the September meeting to +2.6% y/y in December.

(2) In 2024? The Fed rate focus shows a true 'pivot' to achieving a 'soft' landing, via the real GDP growth rate. For 2024, the median real GDP growth projection is +1.4% y/y.

So, the current tight 5.33% Fed policy rates, with a lag, are pegged to take real GDP growth from +2.6% y/y in 2023 to that +1.4% y/y real GDP growth rate in 2024. We shall see. This is difficult.

Then the regional Fed groups see long-term trend real GDP growth stability emerge in 2025 (+1.8%) and 2026 (+1.9%). Note: +1.9% is the Fed's long-term trend growth.

(3) The key Fed Funds rate portion of the latest DEC 'dot plot' projections is put forth below:

	2023	**2024**	**2025**	**2026**	**Longer Run**
Dec. Federal Funds Rate	5.4	4.6	3.6	2.9	2.5
September Projection	5.6	5.1	3.9	2.9	2.5

The table (above) shows an -80 bps lower Fed Funds policy rate in 2024, vis-a-vis the new -20 bps lower 'terminal' policy rate of 5.4% at YE 2023 (aka a 'pivot' down from 5.6% in September).

A -100 lower Fed Funds rate over the next year? That is what sent the 10-year U.S. Treasury yield from 5.0% in late October towards 4.0%, as the deeper consumer inflation weakness showed up.

A year further out, the FOMC thinks it supplies a -100 bps lower Fed Funds policy rate in 2025.

(4) As for asset allocations? You have to be more bullish on U.S. stocks and bonds, but only after the FOMCs 'pivot' to a lower policy rate is well and truly in.

A number of macro consulting firms are front-running the Fed: March 2024 may be when FOMC rate cuts begin. On Dec. 13th, the CME FedWatch shows a 66.1% chance of a 25-bps policy rate cut, and even a 12.2% chance of a 50-bps cut.

SECTION 4: ECONOMIC PROJECTIONS

Zacks DEC 2023 Forecasts

+5.2% Q3-23 growth, then a +1.2% Q4-23 Atlanta Fed Nowcast, got built into our forecast.

The Conference Board shows a -1.0% recessionary GDP growth rate in Q1-24 and -0.8% in Q2-24. They offer up a +1.9% expansion in Q3-24 and +2.2% in Q4-24.

The Q4-23 Philly Fed survey "risk of a negative quarter" is 41% in Q1-24 and 40% in Q2-24.

The Dec. 2023 London economist consensus has a +4.1% core consumer inflation rate for 2023 sinking to +2.6% in 2024. The London view shows 5.3% ST rates in '23 and 4.3% in '24. This implies 100 basis points of FOMC easing.

- **For real GDP growth updates?** Zacks mixes four outside outlooks.
- The Dec.7th Atlanta Fed GDPNow has **+1.2% growth for Q4-23.** NY Fed has **+2.33%.**
- Nov. '23 Conference Board has **+0.8% Q4-23** GDP growth and **-1.0% Q1-24** growth.
- Dec. '23 Consensus Econ. GDP growth shows **+2.4% across 2023** and **+1.2% in 2024**.
- Q4-23 Philly Fed economist consensus shows Q4-23 at **+1.3%,** Q1-43 at **+0.8%**, Q2-24 at **+1.3%,** Q3-24 at +**1.5%, and Q4-34 at +1.7%**.

	Real GDP	**Unemployment Rate**	**Payroll (000s/ month)**	**Core PCE**
2023:Q1	+2.2%	3.5%	312	5.0
2023:Q2	+2.1%	3.6%	280	3.7
2023:Q3	+5.2%	3.8%	169	3.9
2023:Q4	+1.4%	3.8%	149	2.7
2024:Q1	+0.8%	4.0%	66	2.7
2024:Q2	+1.0%	4.0%	98	2.4
2024:Q3	+1.5%	4.2%	82	2.3
2024:Q4	+1.7%	4.2%	119	2.2
2023	+2.6%	3.7%	297	3.5
2024	+1.4%	4.1%	120	2.4
2025	+2.1%	4.2%	n.a.	2.1