

Economy Continues to Surprise

All Eyes Turn to Rate Cuts in 2024

The U.S. economy outperformed expectations in 2023. Of course, those expectations set a low bar, with many expecting a recession, yet growth cleared it with plenty of room to spare: the unemployment rate stands at 3.7%, close to the lowest rate in over 50 years, U.S. employers added about 2.7 million jobs over the course of the year, and inflation slowed markedly and is currently running at a 3.4% year-over-year pace.

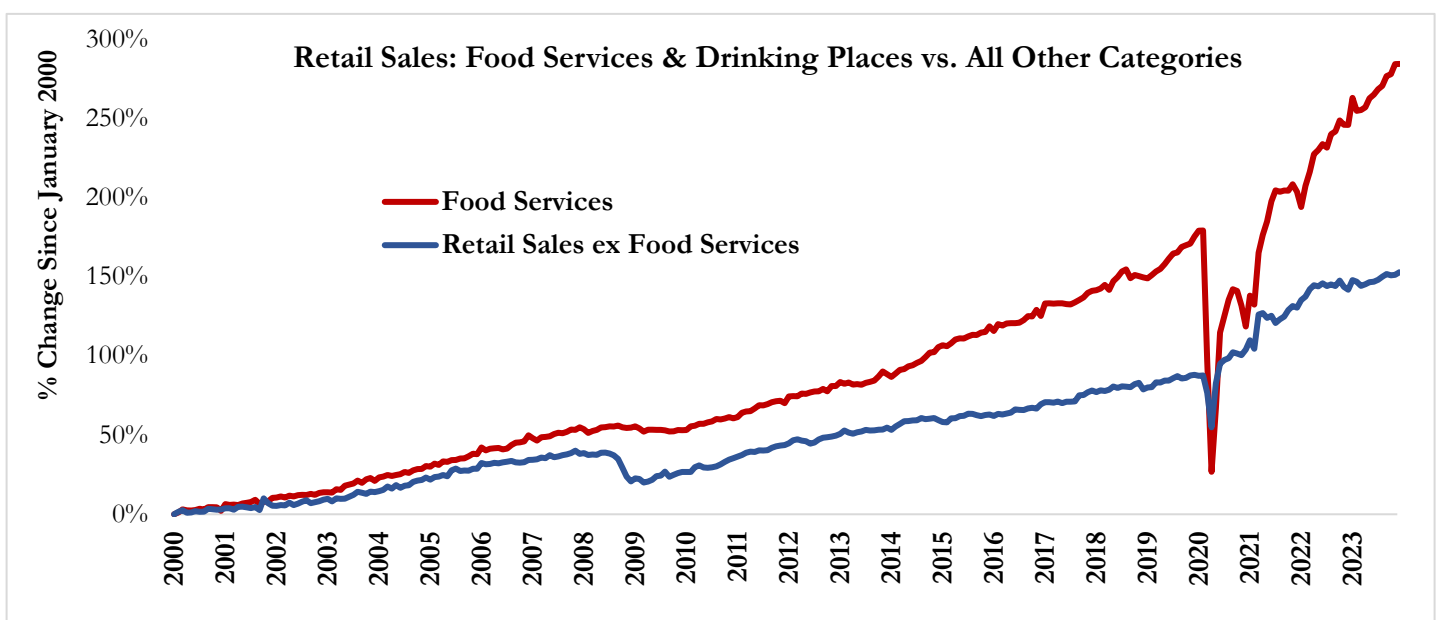
A driving factor behind ongoing economic momentum is consumer strength. Retail spending surprised to the upside in December, rising 0.6% for the month, and has thoroughly outpaced inflation over the course of 2023. Retail sales at food services and drinking places have performed especially well, increasing 11.1% in 2023, a faster rate of growth than in any of the other categories tracked by the Census Bureau.

Given this surprising economic momentum and the rapid decline in inflation, the biggest economic question has shifted from “how high will the Fed raise rates and how long will they stay there?” to “when will the Fed cut rates and how far will they fall?” While the answer is entirely dependent on how prices behave over the next several months and how the labor market holds up, most forecasters anticipate the equivalent of three to four 25 basis point rate cuts in 2024.

Those same forecasters still expect the economy to slow, although the share predicting a recession over the next twelve months has fallen to the lowest level since early 2022. While the prospect of a soft landing remains very much at play, there are still risks. A rebound in inflation could seriously imperil the outlook, and that has become marginally more likely with piracy in the Red Sea causing a rapid increase in global shipping rates.

Three Key Takeaways

1. The economy exceeded expectations throughout 2023.
2. Consumer spending, including on food services, continues to surprise to the upside.
3. Interest rate cuts appear likely in 2024.



Source: U.S. Census Bureau

Pirates, Lag Effects, & Other Risks

If you had a bingo card of economic risks for 2024, you almost certainly wouldn't put piracy on there. Yet pirates—actual pirates—in the Red Sea are causing serious issues for global supply chains. Due to ongoing attacks on civilian shipping vessels, a significant portion of traffic has diverted from the Suez Canal to instead go around the Cape of Good Hope. As a result, global freight rates, as measured by the Freightos Baltic Index, have increased a staggering 127% since the last week of 2023.

While that alone doesn't imperil the U.S. economy, it's not the only headwind pushing on growth. Interest rates have now been elevated since the Federal Reserve started tightening monetary policy in March 2022. It's typically thought that higher interest rates take 12 to 18 months to impact economic growth, and we're now well past that window, but it remains possible that the lagging effects of elevated borrowing costs could significantly diminish growth this year.

And then there's labor shortages. While labor availability has gradually improved over the past year—job openings have declined from a record 12 million in March 2022 to a still-elevated 8.8 million in November 2023—there are still far too few workers to meet employers' demand for labor. This has put upward pressure on wages which, as of December, are still rising at a pace that is consistent with a return to 2% inflation.

Geopolitics represents yet another risk factor. Conflict in the Middle East and Europe is ongoing, although that is not currently having a meaningful impact on the domestic economy, and 2024 will be a record year for elections, with approximately half of the global population slated to vote in elections this year.

Gas Prices Continue to Plummet

Gas prices have now fallen in sixteen consecutive weeks and are, as of this writing, below \$3.18/gallon for the first time since the middle of 2021. This is largely due to record domestic oil production, which currently stands at 13.3 million barrels per day.

This decline in gas prices saves U.S. consumers hundreds of millions of dollars a day, fueling spending in other categories. Beyond the immediate consumer impacts, lower fuel prices reduce shipping costs, alleviating price pressures even as demand increases.

Wholesale Food Prices Fall to End Year

Prices received by domestic food wholesalers fell modestly in December and are up just 1.3% over the past year, meaning they have fallen in real (inflation adjusted) terms. Input prices, however, have also declined along many dimensions.

Unprocessed foodstuff prices plunged 2.5% in December and are down about 17% over the past year, and diesel prices remain near the lowest level since the middle of 2023. That, along with declining demand for freight services across many industries, has led to an 18% year-over-year decrease in inferred domestic freight rates, according to Cass Information Systems.

Labor Shortages Drive Up Labor Costs

Employment at food services and drinking places returned to pre-pandemic levels in October 2023, almost a year and half later than the broader economy reached full recovery. Due to widespread labor shortages, the food services industry has struggled to attract a sufficient number of workers, and that has put significant upward pressure on wages.

Average hourly earnings for industry employees have risen at a faster pace than the all-industry average in each of the past four months and are up nearly 29% since the start of the pandemic, well above the 20% increase across all industries. Demographic factors suggest labor will remain scarce, putting continued upward pressure on menu prices.

The Outlook

Growth is expected to slow in 2024, yet most forecasters no longer predict a recession in the imminent future. As inflation continues to drift back toward the Fed's 2% annual target, rate cuts become a distinct possibility in the coming quarters.

Industry at a Glance

	Value			Change From		Forecast
Labor Market	Dec-23	Nov-23	Dec-22	Nov-23	Dec-22	Jan-24
Payroll Employment (thousands)	157,232	157,016	154,535	0.1%	1.7%	157,409
Average Hourly Wages	\$34.27	\$34.12	\$32.92	0.4%	4.1%	\$34.40
Unemployment Rate	3.7%	3.7%	3.5%	0.0 pp	0.2 pp	3.7%
Labor Force Participation Rate	62.5%	62.8%	62.3%	-0.3 pp	0.2 pp	62.6%
Retail Sales (\$ Millions)	Dec-23	Nov-23	Dec-22	Nov-23	Dec-22	Jan-24
Retail & Food Services Sales	\$709,890	\$705,981	\$672,336	0.6%	5.6%	UP
Grocery Stores	\$74,591	\$74,416	\$73,945	0.2%	0.9%	UP
Food Services & Drinking Places	\$94,559	\$94,527	\$85,079	0.0%	11.1%	UP
Consumer Price Index	Dec-23	Nov-23	Dec-22	Nov-23	Dec-22	Jan-24
Food and Beverages	324.3	323.6	315.7	0.2%	2.7%	UP
Food at Home	305.0	304.5	301.0	0.1%	1.3%	UP
Food Away from Home	361.6	360.4	343.6	0.3%	5.2%	UP
Producer Price Index	Dec-23	Nov-23	Dec-22	Nov-23	Dec-22	Jan-24
Food Wholesaling	134.7	135.7	132.9	-0.8%	1.3%	UP
Food Manufacturing	251.3	252.5	254.2	-0.5%	-1.1%	FLAT
Frozen Food Manufacturing	183.3	183.2	171.8	0.1%	6.7%	UP
Pork Products Except Sausage	157.1	160.0	168.3	-1.8%	-6.7%	FLAT
Beef & Veal Products, Fresh or Frozen	307.1	306.9	255.1	0.0%	20.4%	FLAT
Processed Poultry	167.2	166.4	185.2	0.5%	-9.7%	UP
Processed Fruits & Vegetables	291.5	290.3	265.2	0.4%	9.9%	UP
Truck Transportation	185.3	187.0	196.3	-1.0%	-5.6%	DOWN
Chicken Eggs	275.2	321.5	782.2	-14.4%	-64.8%	DOWN
Crude Oil WTI (NYM \$/bbl)	1/5/24	12/8/23	1/6/23	12/8/23	1/6/23	Feb-24
Front Month Crude Oil Price	\$72.49	\$70.71	\$74.27	2.5%	-2.4%	FLAT
Real Gross Domestic Product	2023-Q3	2023-Q2	2023-Q1	-	-	2023-Q4
% Change from Preceding Period	4.9%	2.1%	2.2%	-	-	2.1%
Personal Consumption Expenditures (\$ Billions)	Nov-23	Oct-23	Nov-22	Oct-23	Nov-22	Dec-23
Total PCE	\$18,859	\$18,812	\$17,893	0.2%	5.4%	UP
Food PCE	\$1,459	\$1,454	\$1,431	0.4%	2.0%	UP

Glossary

Indicator	Source	Definition/Notes
Labor Market Terms		
Payroll Employment	Bureau of Labor Statistics (BLS); Current Employment Statistics (CES) Survey, also known as the Establishment Survey	Payroll employment, also commonly known as Total Nonfarm or Total Nonfarm Payroll, is a measure of the number of U.S. workers in the economy that excludes proprietors, private household employees, unpaid volunteers, farm employees, and the unincorporated self-employed. This measure accounts for approximately 80% of the workers who contribute to Gross Domestic Product (GDP) and provides useful insights into the current economic situation because it can represent the number of jobs added or lost in an economy.
Average Hourly Wages	BLS; CES/Establishment Survey	Average hourly wages, (or average hourly earnings) reflect the average gross earnings per hour among all payroll employees across all private industries in a given month. Average hourly wages are measured as gross payrolls divided by total hours for which employees receive pay—including sick pay or vacation pay—during the pay period that includes the 12th of the month. Average hourly wages are not a measure of total compensation or employers' total compensation costs because they exclude items such as employee benefits, irregular bonuses and commissions, retroactive payments, and the employer's share of payroll taxes.
Unemployment Rate	BLS; Current Population Survey (CPS), also known as the Household Survey	The unemployment rate represents the number of unemployed people as a percentage of the labor force (the labor force is the sum of the employed and unemployed).
Labor Force Participation Rate	BLS; CPS/Household Survey	The labor force participation rate is the percentage of the population that is either working or actively looking for work. In technical terms, it is the number of people in the labor force as a percentage of the civilian noninstitutional population.
Retail Sales		
Retail Sales	Census Bureau; Advance Monthly Retail Trade Survey	Retail sales are estimates of monthly sales for companies in the retail trade and food services sectors. Estimates are derived from the Advance Monthly Retail Trade Survey which is a voluntary survey covering retail companies with one or more establishments that sell merchandise and related services to final consumers. These firms provide data on dollar value of retail sales for selected establishments.
Price Indices		
Consumer Price Index	BLS; Consumer Price Index (CPI) program	The Consumer Price Index (CPI) program measures the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The CPI measures price changes from the perspective of the consumer.
Producer Price Index	BLS; Producer Price Index (PPI) program	The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The PPI measures price changes from the perspective of the seller.
Gross Domestic Product		
Real Gross Domestic Product	Bureau of Economic Analysis (BEA); National Income and Product Accounts (NIPA)	Gross domestic product (GDP) is the value of the goods and services produced by the nation's economy less the value of the goods and services used up in production. GDP is also equal to the sum of personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment. Real GDP values are inflation-adjusted estimates—that is, estimates that exclude the effects of price changes.
Personal Consumption Expenditures		
Personal Consumption Expenditures	BEA; NIPA	Consumer spending, or personal consumption expenditures (PCE), is the value of the goods and services purchased by, or on the behalf of, U.S. residents. PCE shows how much of the income earned by households is being spent on current consumption as opposed to how much is being saved for future consumption.