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# December 2023 Economic Outlook:
# U.S. Economy Showing Clear Signs of Cooling

## Key takeaways:

- **Labor market flows are normalizing, putting downward pressure on wage growth.**
- **Consumer spending is softening with most spending growth coming from household essentials and services.**
- **Inflation continues to trend in the right direction and demand-side pressures likely to ease further; a long-awaited and welcomed trend for the Fed.**

This December Economic Outlook report provides an overview of the economy's current state and highlights some of the evidence that the economy is cooling from its robust third quarter performances.

First, we'll discuss the labor supply and demand gap that is starting to ease. This is putting some downward pressure on wage growth, a good sign for future inflation, but maybe not so good for consumer spending.

Next, we'll talk about some early signs of slowing consumer spending. The hard numbers for October showed retail sales contracted during the month and Personal Consumption Expenditures slowed. Furthermore, some of the weekly data, higher frequency early estimates, suggests that that softness likely persisted through at least the first few weeks of November.

Finally, we'll discuss inflation. The 'disinflation' trend has continued as the demand side pressures ease.

This downward movement in the rate of inflation is a long-awaited trend for the Fed, and confirms that they are not likely to have to raise interest rates further in 2024.

## Labor market flows normalizing

Job openings per unemployed persons, which measures the number of open jobs to the number of people seeking jobs, remains historically high. However, the trend is well below its 2022 peak and the drawdown rate in job openings indicates that the demand for labor is cooling significantly compared to last year.

There has been a significant decline in the number of total nonfarm job openings this year. At the same time, the four-week moving average of continued jobless claims continues to trend higher and is above the average of the three years before the pandemic. Unemployed people are taking longer to find jobs while job openings are declining, indicating that the labor market is loosening.

It is still a tight labor market by historical standards, yet, even with the labor supply and demand imbalances, the tightness of the labor market is trending in the right direction. The balancing of labor and demand is welcome to the Fed and its ultimate goal of bringing down inflation.

## Labor flows normalizes, but with imbalances

Even as total private job openings continue to decline, labor demand still outweighs supply. This puts pressure on wages. However, that imbalance is shrinking, indicating that the robust year-over-year wage growth of 2022 is long behind us.

While labor demand is still outpacing supply, the pace is easing. The gap is getting more narrow. Normalizing supply and demand is good news, but why?

Labor market tightness impacts wages when demand outpaces supply. In these scenarios, businesses seek more workers than are currently available in the job market. One of the most considerable implications is putting upward pressure on wages as companies have to compete more aggressively for talent.

With the supply and demand gap easing, there is a direct downward pressure on the rate of wage growth. The labor supply and demand gap is a six-month leading indicator of wage growth. Easing imbalances means that there will likely be continued downward pressure on the year-over-year rate of wage growth for the next six months or so.

Decelerating wage growth is good news for inflation because it will help mitigate increased costs for the service sector which can reduce the rate of price increases. Slower wage growth will also continue to ease demand-side inflationary pressures. These signals indicate that the labor market is still healthy and tight, but we're seeing these trends are moving in the right direction.

## Spending showing signs of cracking

Easing consumer spending started early in the fourth quarter of this year and retail sales numbers suggest the first signs that consumer spending is cracking.

The Census Bureau reports on weekly consumer spending. It estimates nominal spend, and the percentage represents relative to pre-pandemic spending levels. Before the run-up to Black Friday, we would expect the data to soften and then rebound with data from Black Friday and the holiday shopping season. In October and November, estimates were well below any prior years since the pandemic. Even though there tends to be a pullback in early November before the holiday shopping season, it is significantly lower than before. This signals that November spending is likely to be soft unless there is a significant resurgence with the officially released Black Friday numbers.

According to the Census Bureau, spending in October declined versus spending in September, adjusted on a seasonal basis. The consumer pulled back on their retail spending in October, and most of the spending growth happened in household essentials, things like health and personal care, and grocery. Then, we started to see a decline in most discretionary categories.



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In October, miscellaneous and general merchandise retailers also saw a pullback in consumer spending. Spending declined in building materials, sports, hobbies, vehicles, home furnishings, and mixed categories.

The consumer has to prioritize household essentials, and there is a pullback to discretionary spending at the total retail level. Our weekly data suggests that some of these headwinds in this pullback will likely continue in November, which isn't surprising.

Prevedere has been expecting a significant slowdown in consumer spending in the fourth quarter of this year for quite a while now, but we are starting to see that conjuration. And while we don't typically talk about a pullback in consumer spending as a good thing for many of you who sell to the consumer, it may not necessarily be a direct good thing.

## Disinflation trend continuing

Flexible price inflation has fallen rapidly as production, supply chain, and transportation bottlenecks dissipated in the second half of 2022 and 2023. Sticky price inflation remains elevated, although more recent data has shown a promising disinflation trend.

The sticky inflation side of things has remained higher and will be slower to decelerate. Some examples of sticky price inflation are food away from home, housing and rent, medical care, and household furnishings. The good news is the disinflationary trend in sticky inflation indicates inflation is heading in the right direction. The easing pressure on wage growth and slowing consumer spending will help support further disinflation into 2024.

Despite the disinflationary trend likely here to stay, that doesn't mean the path back down to the Fed's target rate will be linear. Expect headline inflation by year-end to remain elevated by historical standards but below inflation rates of the past year at 3.3%—core inflation to hover around 3.7% due to the persistence of sticky prices and wage pressures.

## Higher prices still hitting consumers

Although inflation is decelerating, price pressures weigh heavily on consumers. Remember, inflation is the rate of increase in prices over the price for those goods last year, so the inflation rate is how much higher prices are today than at the same time the previous year. Consumers are continuously facing higher prices than last year's headline, it's just the rate of increase is slowing.

Looking at the drivers of inflation, housing and food and beverage are still significant drivers on both a month-over-month and a year-over-year basis. With housing and food a large portion of consumers' budgets, especially for lower-income consumers, higher prices are expected to continue to weigh on their ability to spend.

In October, the contribution from transportation eased due to declining gas prices, a welcome trend by consumers heading into the holiday season.

Slowing inflation doesn't necessarily coordinate with price declines. It might be the case for some things at the broader aggregate, but we still expect higher prices generally in 2023 than last year and in 2024, which will continue to subdue consumer spending, especially as wage growth eases.

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# Conclusion

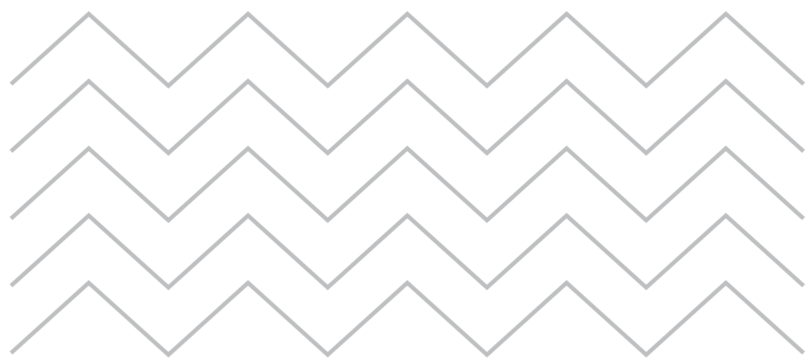
In summary, the economy is cooling. The labor market, wage growth, and consumer spending are all slowing. Disinflation trends are also persisting but consumer spending is showing signs of easing as we head into the year's final month. This is relatively good news for the Fed.

Despite clear signs of a cooling economy, we still expect the Fed to keep interest rates elevated for an extended period. The Fed wants to make sure that they genuinely have stamped out inflation. So, higher interest rates for longer is still the trend. We don't expect to see lower interest rates until at least the second half of next year. This headwind to consumer and business spending from these higher interest rates will impact the economy through the first half of 2024.

On the positive side, the labor market imbalance is normalizing in what appears to be a stable and healthy way. That has eased some of the upward pressure on wages, which was putting upward pressure on inflation. Consumer spending is both positive and negative because, for businesses, a pullback in consumer spending might not necessarily be best in the near term. But on the positive side, consumer spending is slowing, which is what the Fed needs to see so that inflation does not kick back up and it does not have to raise rates further.

Moving forward, we need to keep an eye on making sure the crack in consumer spending is minor stuttering rather than the bottom falling out of the consumers' willingness and ability to spend. Or that the labor market breaks and we see a significant increase in the unemployment rate.

Expect further headwinds as we head through the end of this year and start early 2024. Things are going to continue to cool and soften. Expect higher interest rates to remain through the first half of next year. However, we will likely see things pick up again and possibly begin to reaccelerate in the second half of 2024.



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