A Soft Landing? Prospects for the US Economy in 2024 and Beyond

HARVARD Kennedy School

Karen Dynan

Harvard University

Harvard Institute for Learning in Retirement Forum

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A year ago, most forecasters were predicting the United States was about to enter a recession

Economists in WSJ Survey Still See Recession This Year Despite Easing Inflation

Forecasters put 61% probability of recession in next 12 months

By Harriet Torry Follow *and Anthony DeBarros* Follow

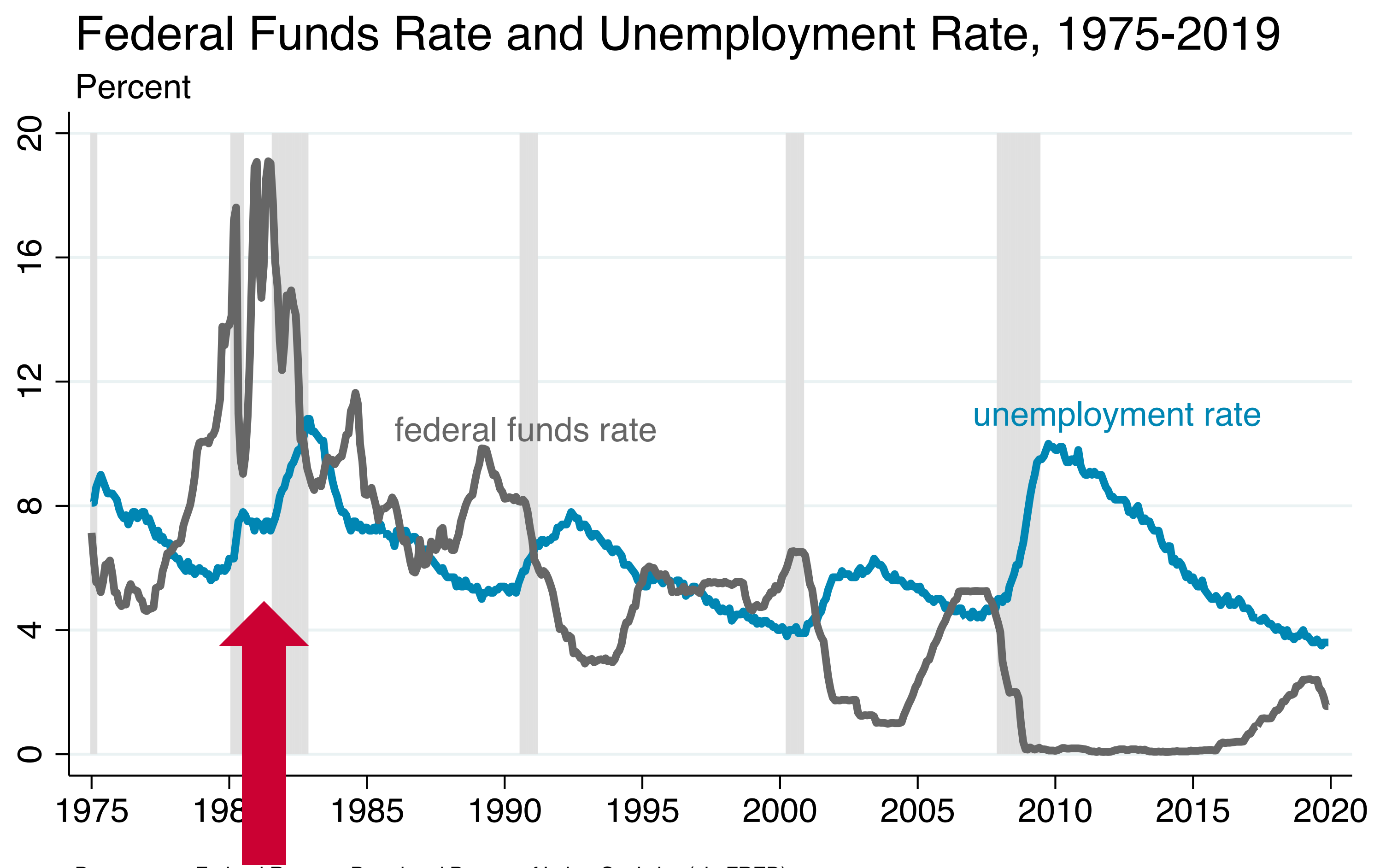
Jan. 15, 2023 5:30 am ET

Headline from the *Wall Street Journal*, January 2023

They had good reason to think a recession was coming

After the Fed tightens policy, the economy usually weakens and unemployment jumps

(Most famously in the early 1980s)

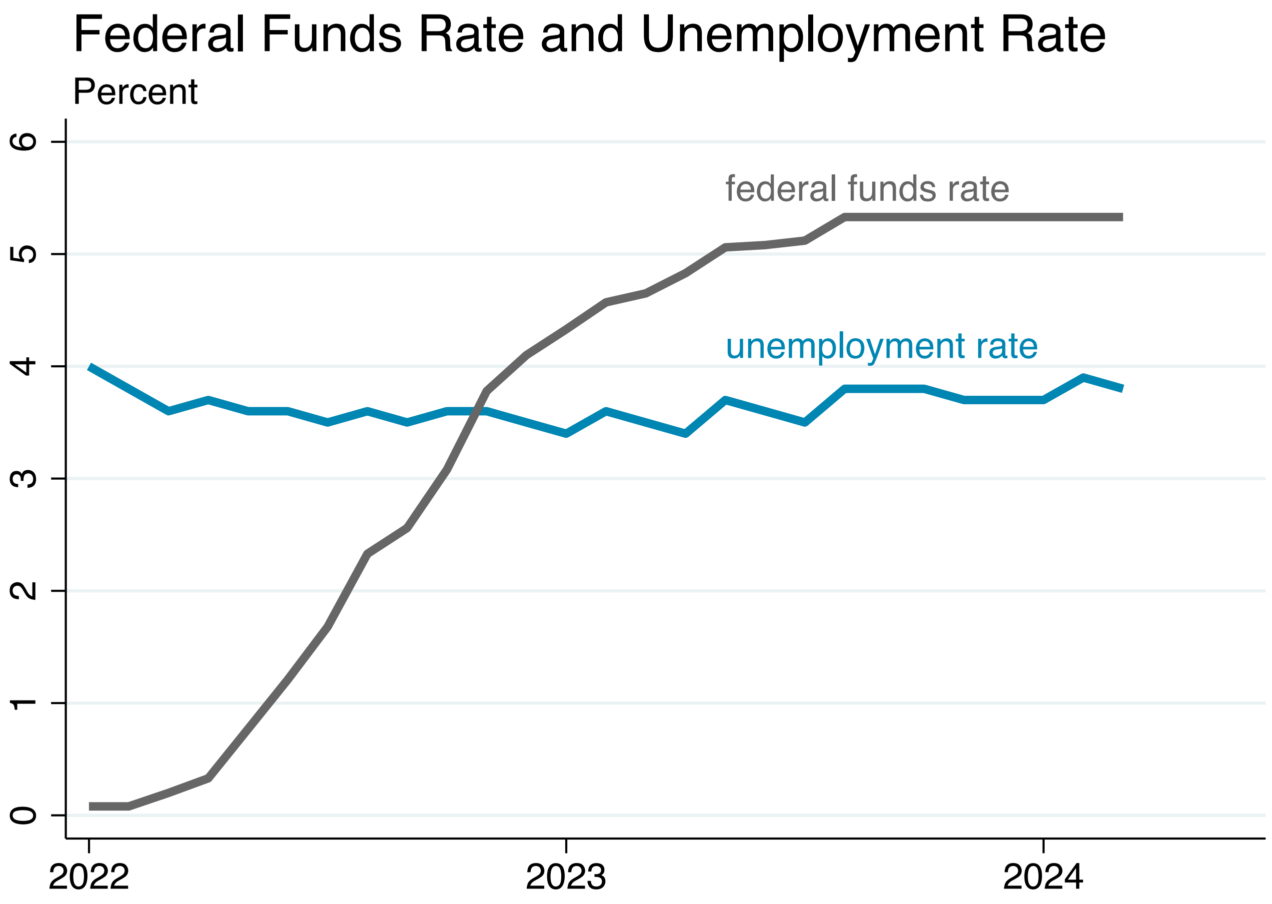


Data source: Federal Reserve Board and Bureau of Labor Statistics (via FRED).
Shaded areas correspond to recessions.

But the unemployment rate has not jumped this time

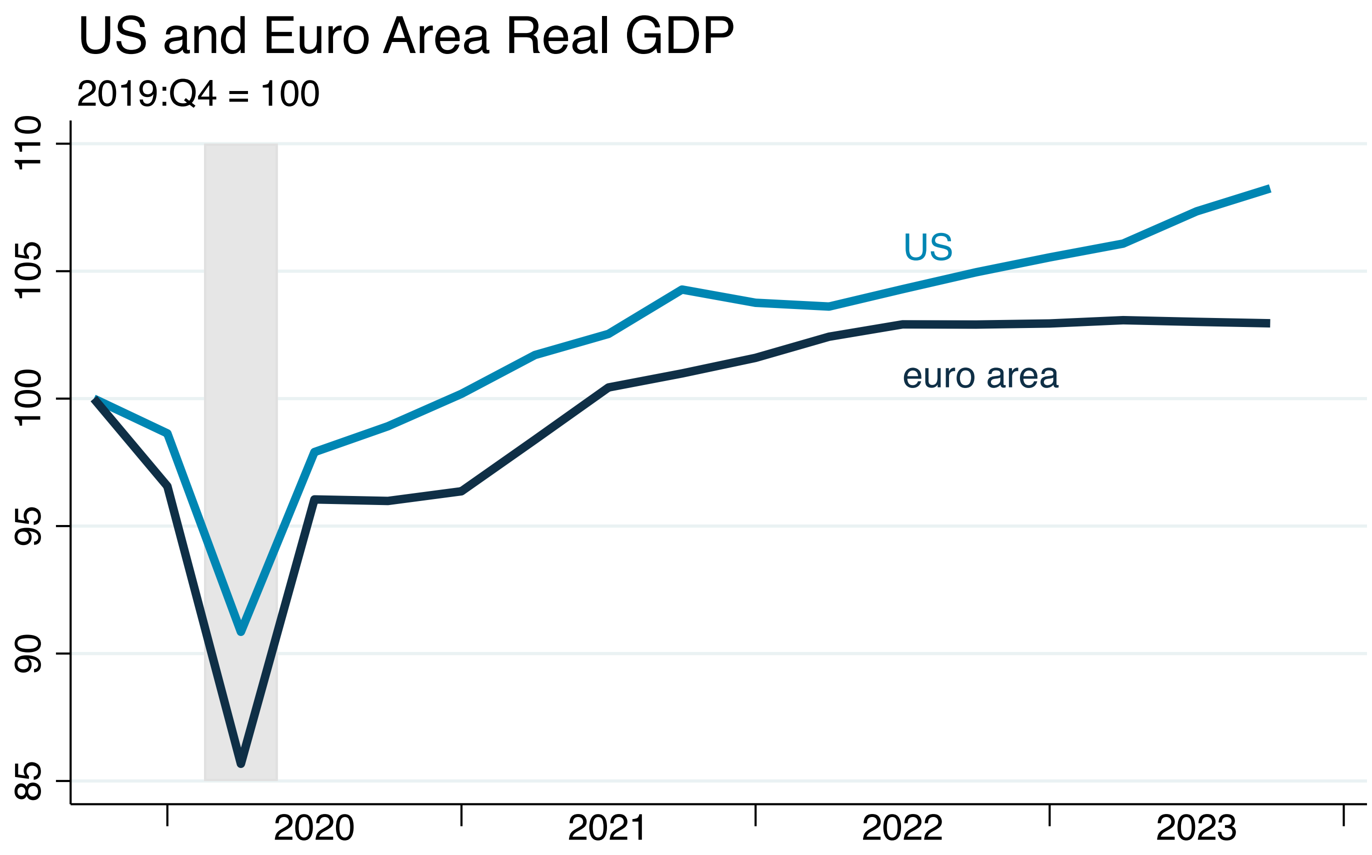
In response to high inflation, the Federal Reserve has raised rates more than 5 percentage points since early 2022

And yet unemployment remains at the low end of its range in recent decades



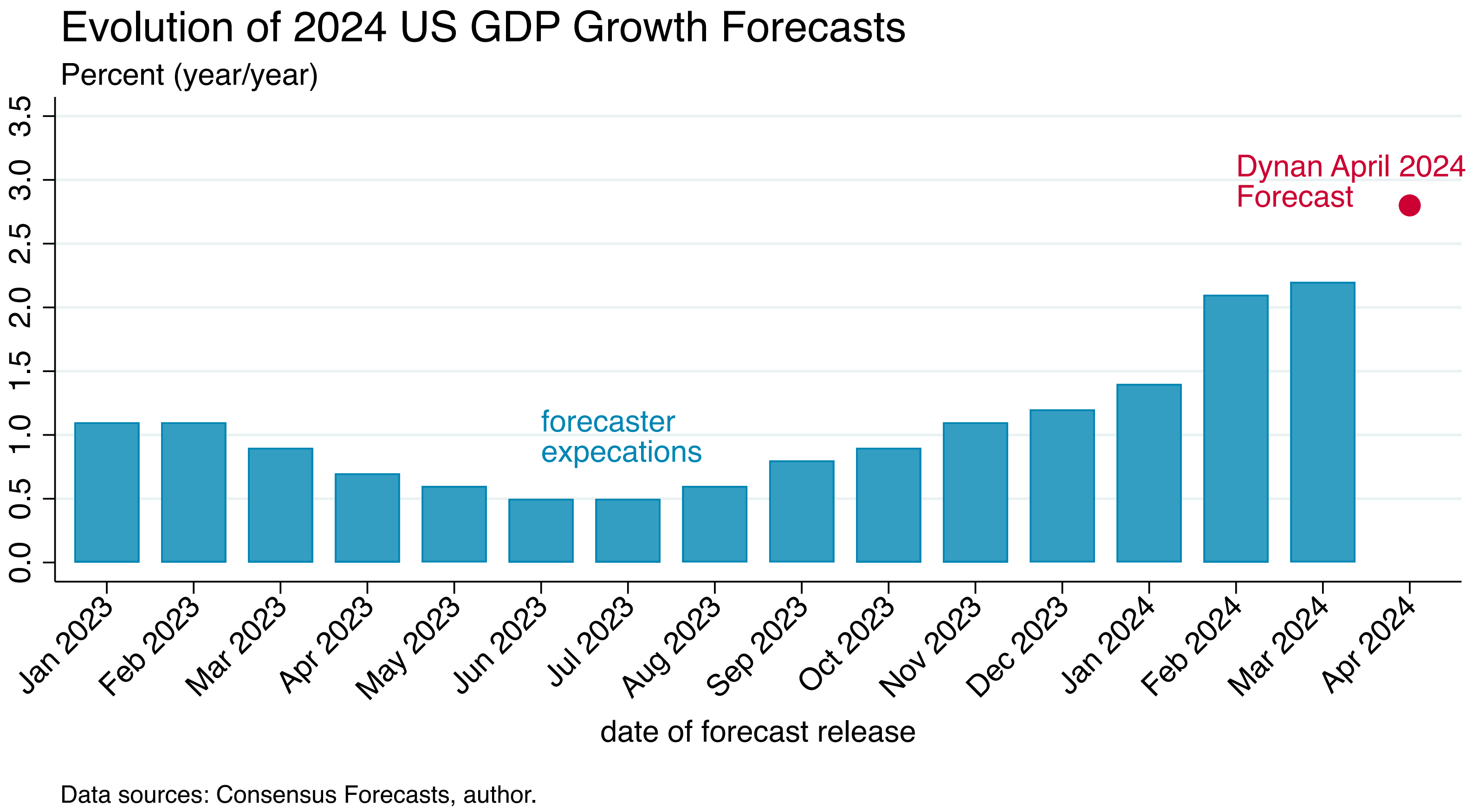
Data source: Federal Reserve Board and Bureau of Labor Statistics (via FRED).
Shaded areas correspond to recessions. Last data point: March 2024.

In fact, US GDP rose much faster in 2023 than that of our international counterparts



Data sources: Bureau of Economic Analysis and Eurostat (via FRED).
Euro Area series is for 19 countries.
Shaded area corresponds to US recession. Last data point: 2023q4.

And forecasters have sharply raised their forecasts for 2024 GEP growth since last summer



My current forecast is that 2024 US GDP growth will be 2.8 percent—one of the biggest annual gains this century

Meanwhile, US inflation has fallen substantially below its recent peaks

The Fed’s preferred measure of **overall inflation**:

Over the last six months—**2.5 percent**

At its recent peak in March 2022—**8.1 percent**

The Fed’s preferred measure of **underlying (core) inflation**:

Over the last six months—**2.9 percent**

At its recent peak in March 2022—**5.9 percent**

Notes: six-month change in PCE deflators at an annual rate; underlying excludes food and energy

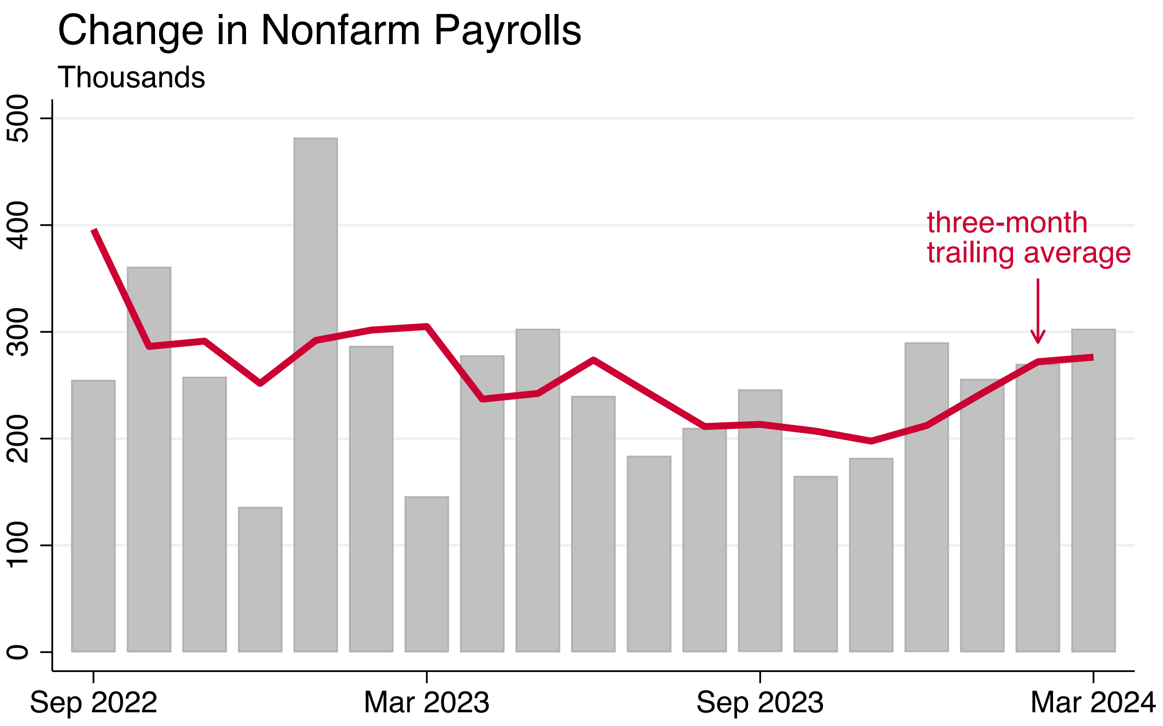
These developments beg two questions

Why has the US economy been performing so (seemingly) well when interest rates are so high?

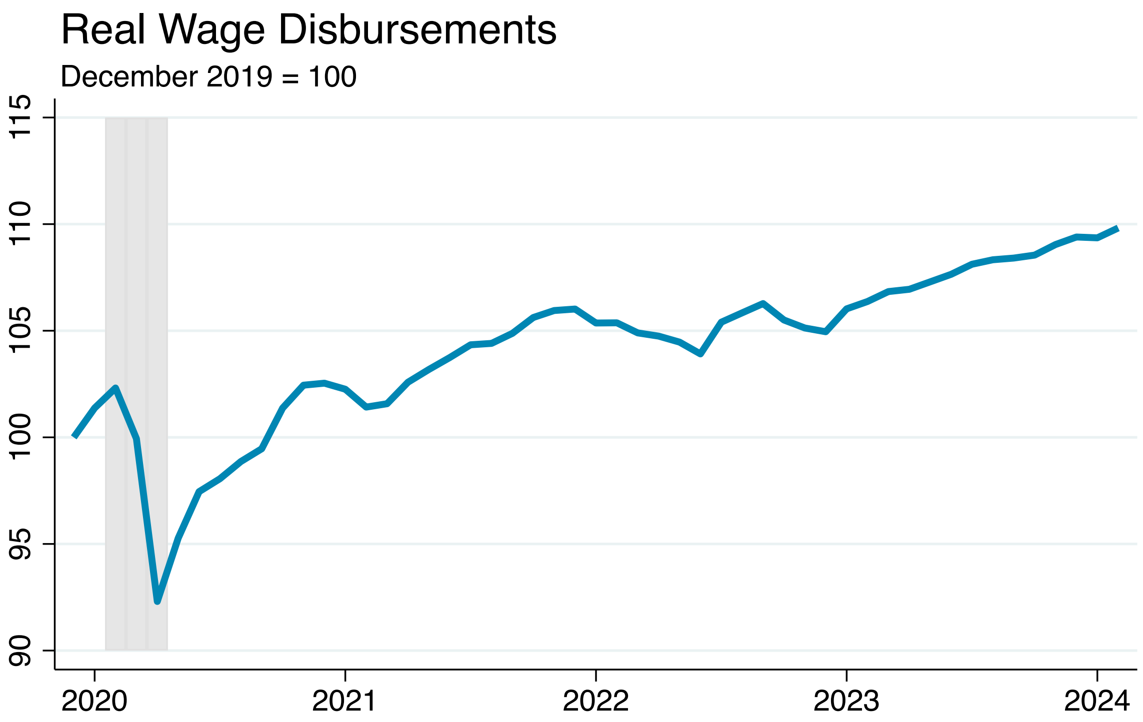
How can the US economy be growing so strongly without causing more inflation?

Demand fundamentals remain strong (1)

A robust labor market has led to **solid growth in inflation-adjusted income**



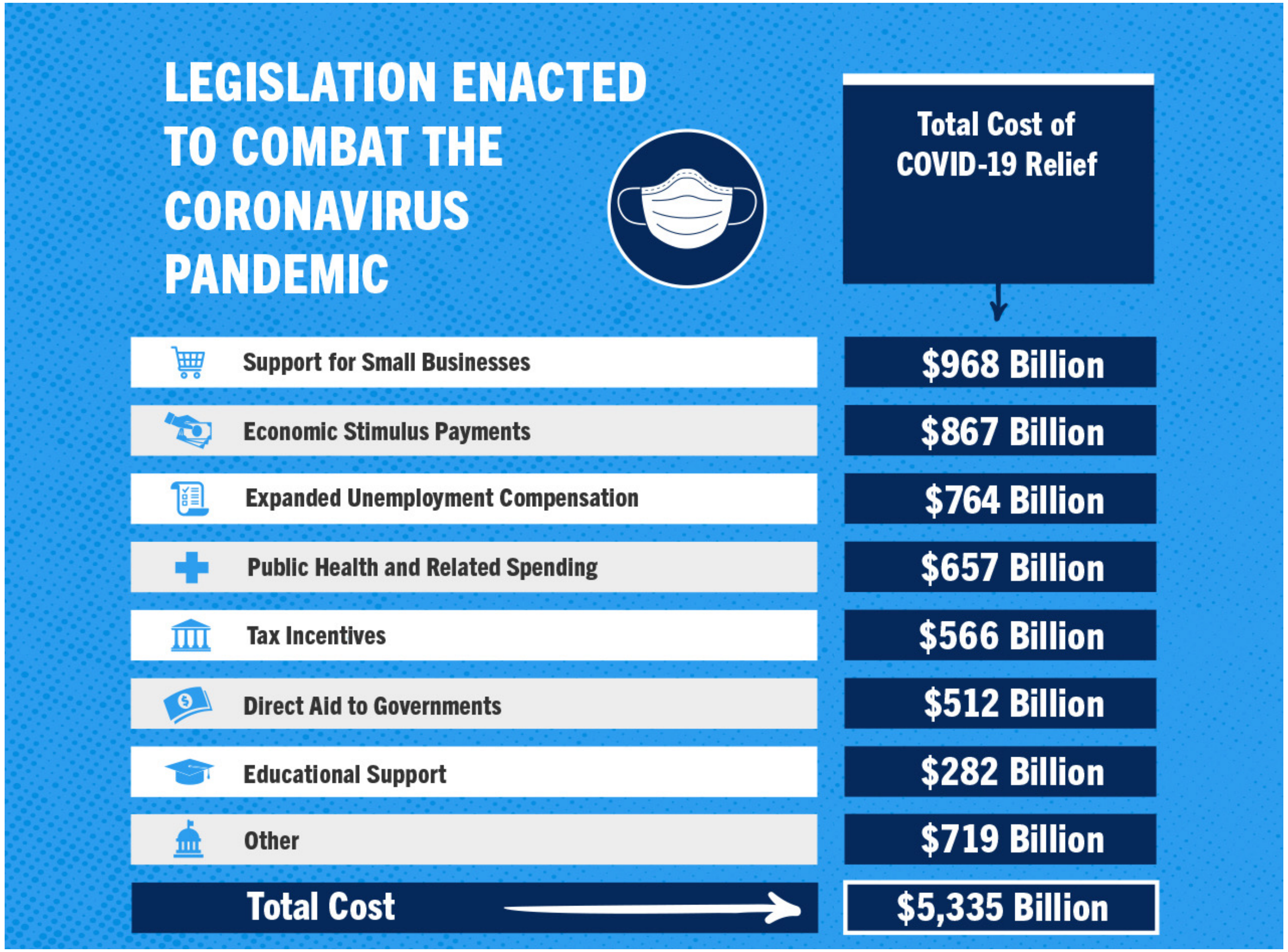
Data source: Bureau of Labor Statistics (via FRED).
Last data point: March 2024.



Data source: Bureau of Economic Analysis (via FRED) and author's calculations.
Shaded area corresponds to recession. Last data point: February 2024.

Demand fundamentals remain strong (2)

Many households have **leftover savings from generous COVID fiscal support**



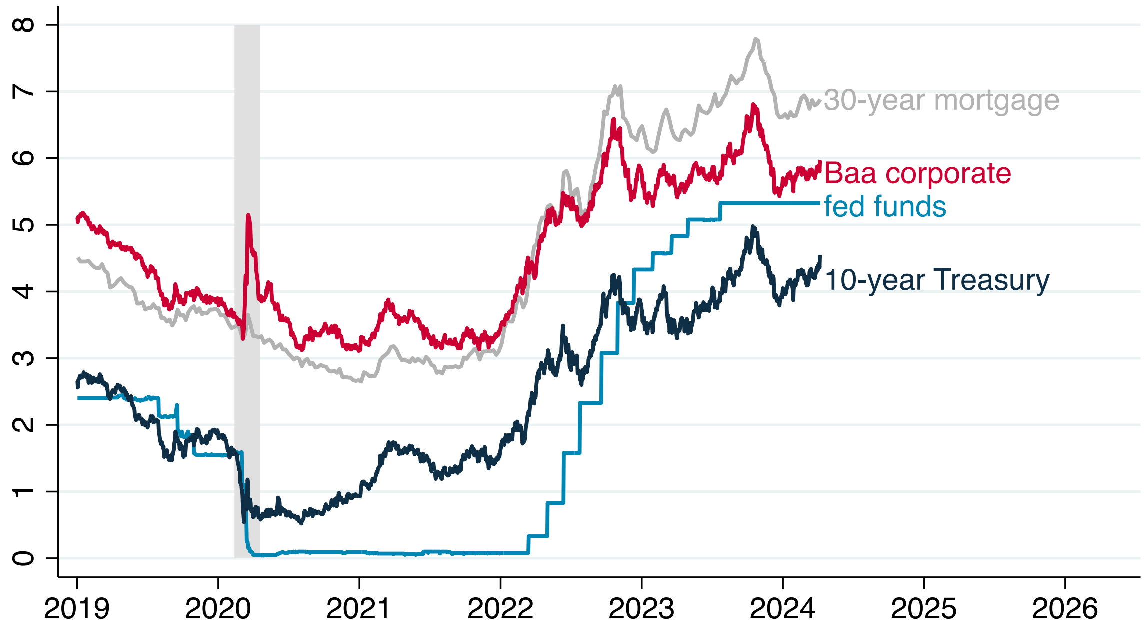
Screenshot from Peter G. Peterson Foundation

Demand fundamentals remain strong (3)

Even though interest rates are high, broader financial conditions are not that tight because of **stock market gains**

US Interest Rates

Percent



Data sources: Federal Reserve, Freddie Mac, Moody's (via FRED).
Shaded area corresponds to recession. Last data point: April 11, 2024.

S&P 500 Stock Price Index

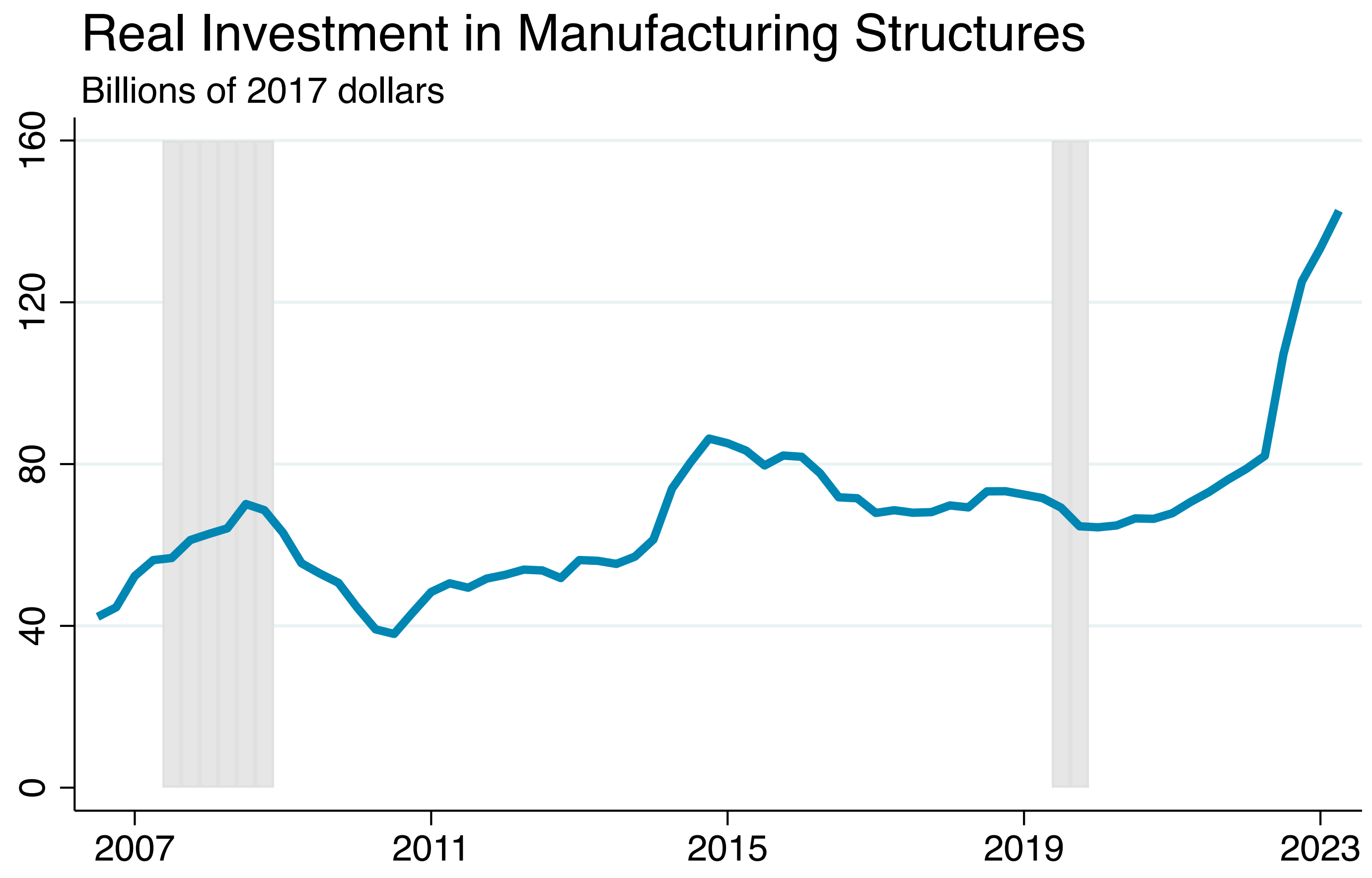
31 December 2019=100

Data sources: S&P Dow Jones (via FRED).
Last data point: April 12, 2024.

Demand fundamentals remain strong (4)

"Industrial policy" fiscal legislation has substantially boosted some components of US business investment

The increase in manufacturing structures investment at right contributed about ¼ percentage point to GDP growth in 2023



Data source: Bureau of Economic Analysis. Shaded area corresponds to recession.
Last data point: 2023q4.

But doesn’t strong demand cause inflation?

Strong demand *can* overheat the economy if the “supply side” of the economy does not expand to meet it

Most economists think **the combination of strong demand and post-pandemic supply constraints was a major driver of the surge in inflation in 2021 and 2022**

Post-pandemic constraints on supply

Shutdowns to contain the virus

Supply chain disruptions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TOYOTA · Published 2 hours ago

Toyota cutting production in February due to semiconductor shortage

Bottlenecks

Cargo Ships Continue To Arrive, Just To End Up Waiting To Get Into Ports Of LA, Long Beach

Worker shortages

Despite ongoing strong demand, inflation subsided in large part because these constraints have eased

Ships were cleared from the ports; other transportation bottlenecks dissipated

Semiconductor production increased

The **rolling shutdowns stopped** after more people were vaccinated, and the virus became less virulent

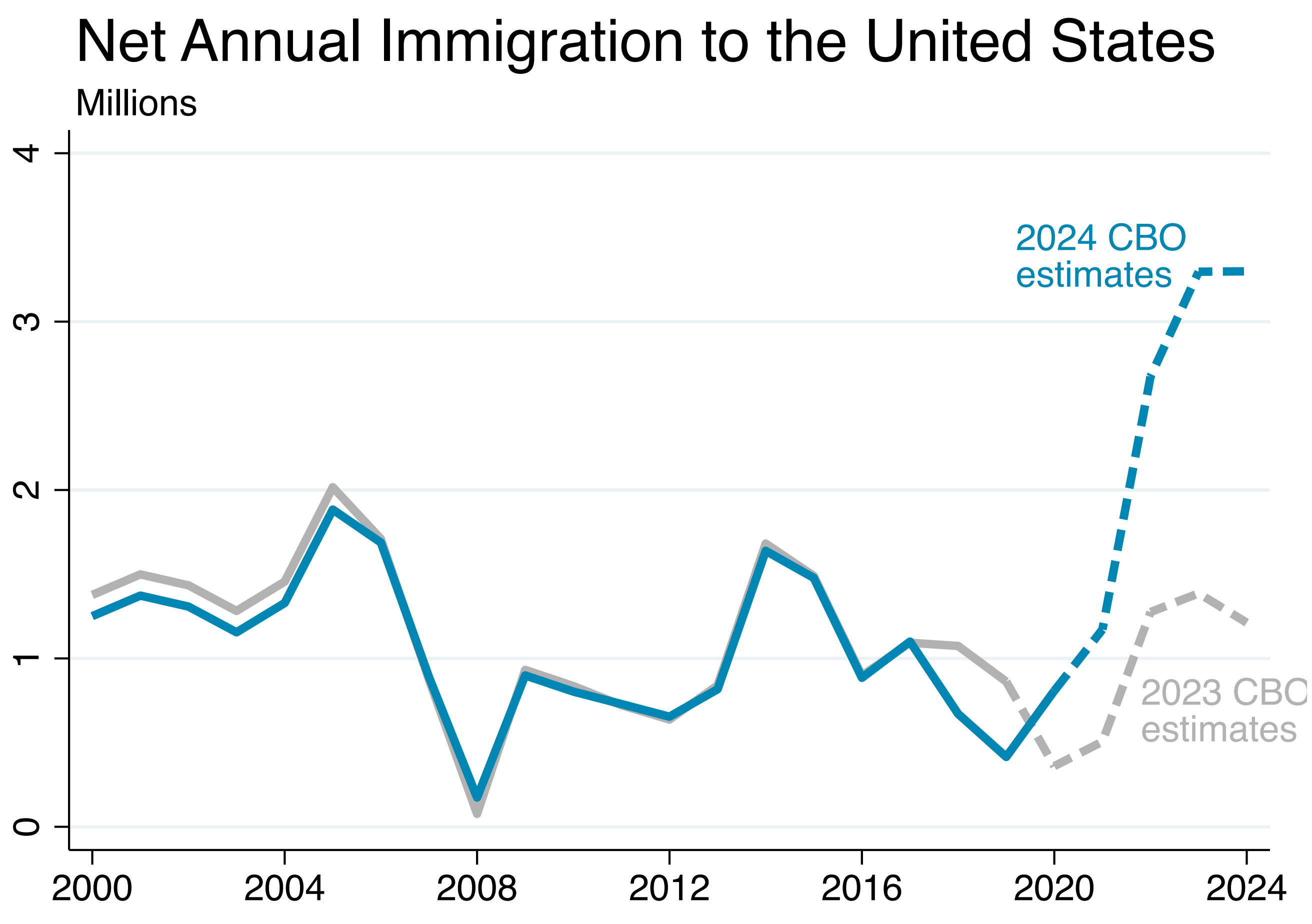
The **US labor shortage eased** as:

- The strong job market drew people back into the labor force
- Immigration surged

The biggest development allowing supply to expand recently has been the surge in immigration

CBO recent revised up its estimate of net immigration from 2021 to 2024 **by 6 million people** based on analysis of Homeland Security data

This implies much more increase in labor supply than economists previously recognized



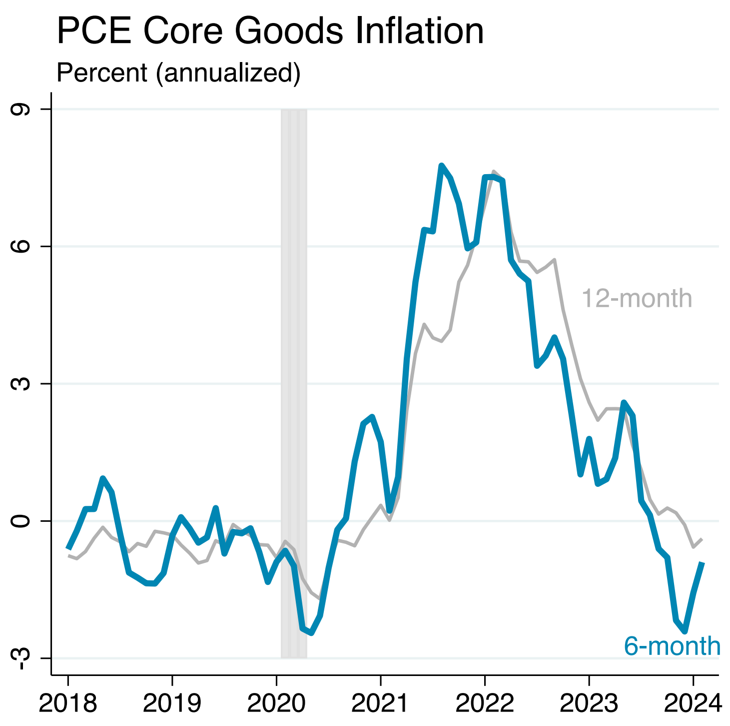
Data source: Congressional Budget Office 2024 Demographic Outlook.

Fed policy also played a role in reducing inflation

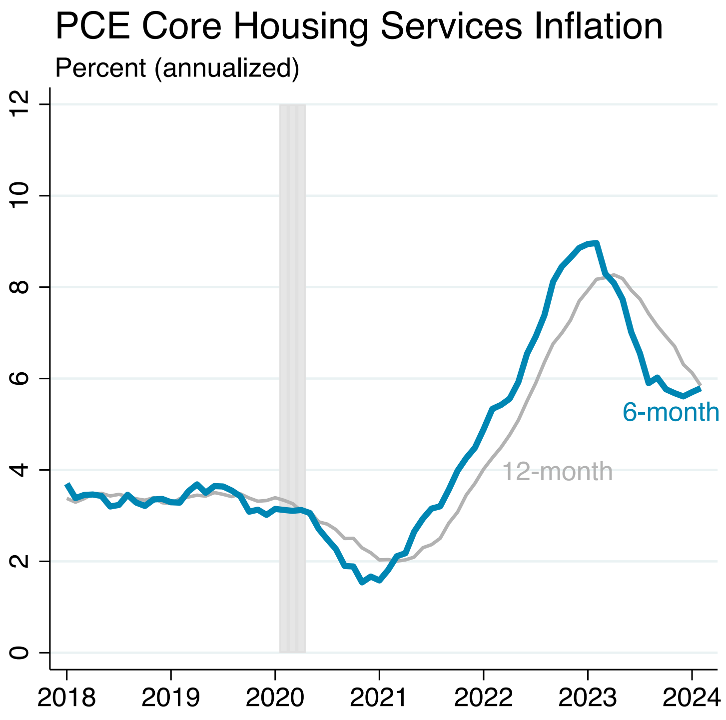
Fed interest rate increases have kept **demand lower than it would otherwise be**

These increases, along with strong words from Fed leaders about their commitment to reducing inflation, has kept **inflation expectations in check**

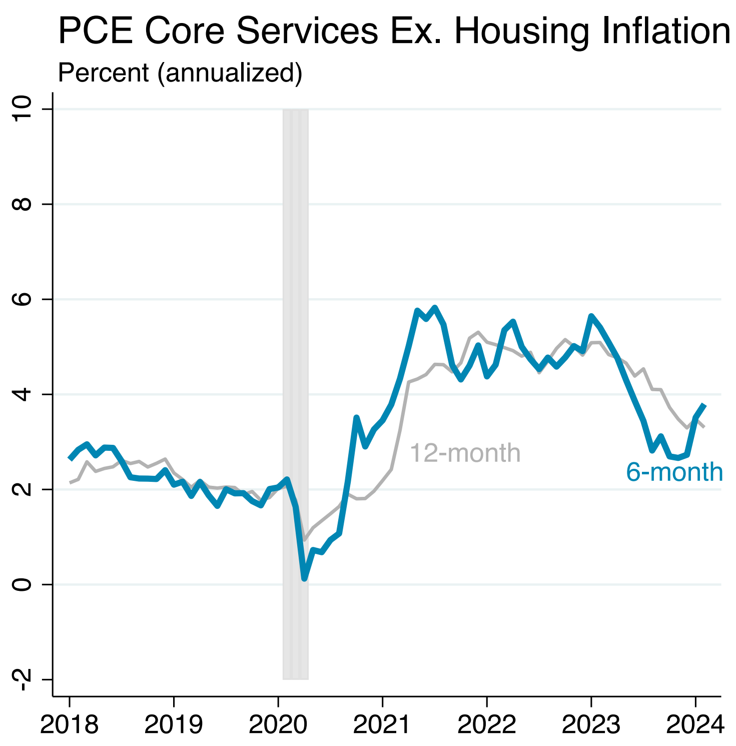
Looking ahead, we are not "out of the woods" as recent data hint inflation may be picking up again



Data source: Bureau of Economic Analysis.
Shaded region corresponds to recession. Last data point: February 2024.

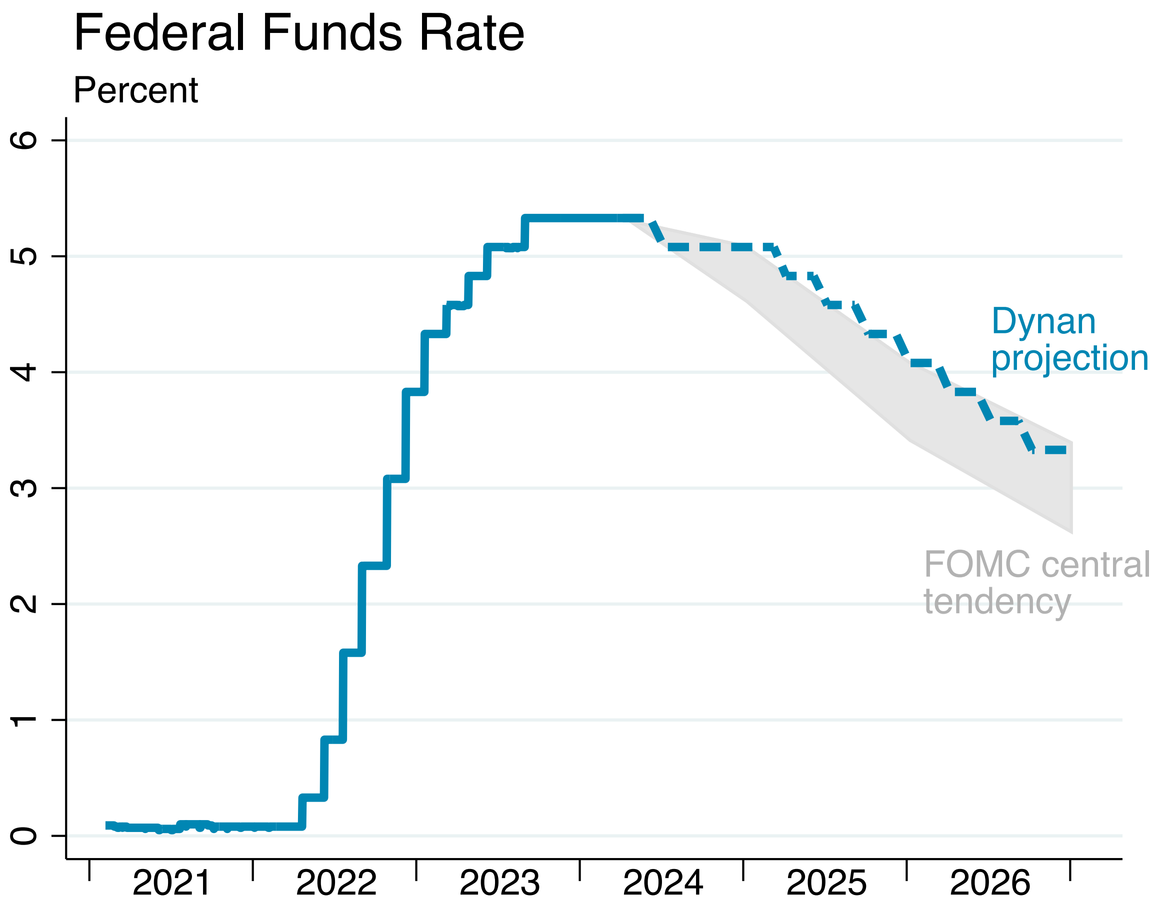


Data source: Bureau of Economic Analysis and author's calculation.
Shaded region corresponds to recession. Last data point: February 2024.



Data source: Bureau of Economic Analysis and author's calculation.
Shaded region corresponds to recession. Last data point: February 2024.

So, even with favorable supply-side developments, the Fed is likely to be slow to lower rates



Data source: Federal Reserve Board and author's projections.

I think only one rate cut is likely in 2024 (maybe no cuts)

After inflation more convincingly resumes its retreat, the pace of rate cuts is likely to step up

Still, I'm optimistic about a US soft landing

US Spring 2024 Forecast Details

	2023	2024	2025
GDP growth (year/year)	2.5	2.8	1.9
GDP growth (Q4/Q4)	3.1	2.1	1.9
PCE inflation (Q4/Q4)	2.8	2.4	2.3
Core PCE inflation (Q4/Q4)	3.2	2.5	2.3
Unemployment rate (Q4 level)	3.7	4.1	4.1

Author's forecast for 2024-2025.

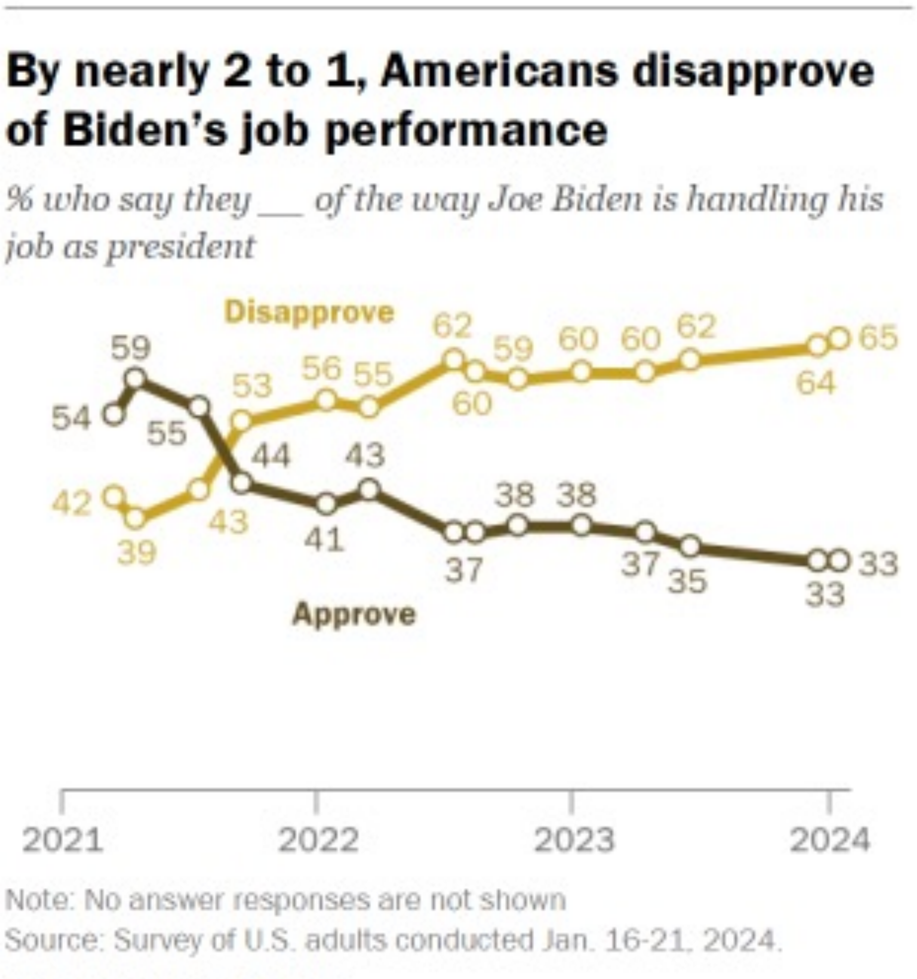
This is the **"soft landing" forecast** that I prepared for a recent event at the Peterson Institute for International Economics

At the same time, I think **recession risk remains higher than normal** given geopolitical uncertainties as well as the potential for more inflationary supply shocks and asset price corrections

What else is keeping me up at night? (1)

Although inflation is significantly lower than its recent highs, **many people are still very angry about the cumulative increases in prices** and blame the current Administration

This has the potential to be politically destabilizing



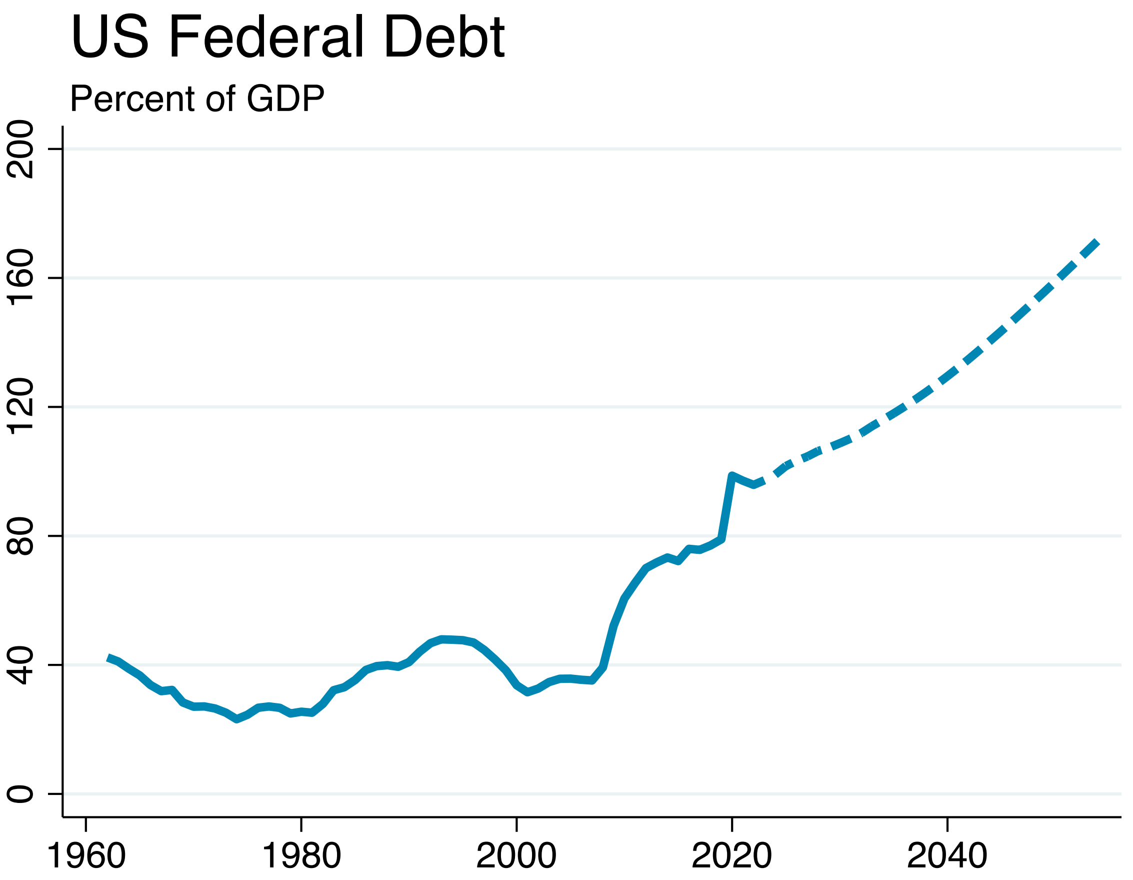
Screenshot from [Pew](Pew) (2024)

What else is keeping me up at night? (2)

Although economic outcomes have been much better for many Americans than after the Great Recession, the COVID fiscal response has left us with **even bigger government debt challenges**

Politicians need to face up to these problems and stop making unrealistic promises about taxes and spending

See my recent piece [here]



Data source: Congressional Budget Office 2024 Budget and Economic Outlook. Dashed line shows projection. Last data point: 2054.

Thank you!