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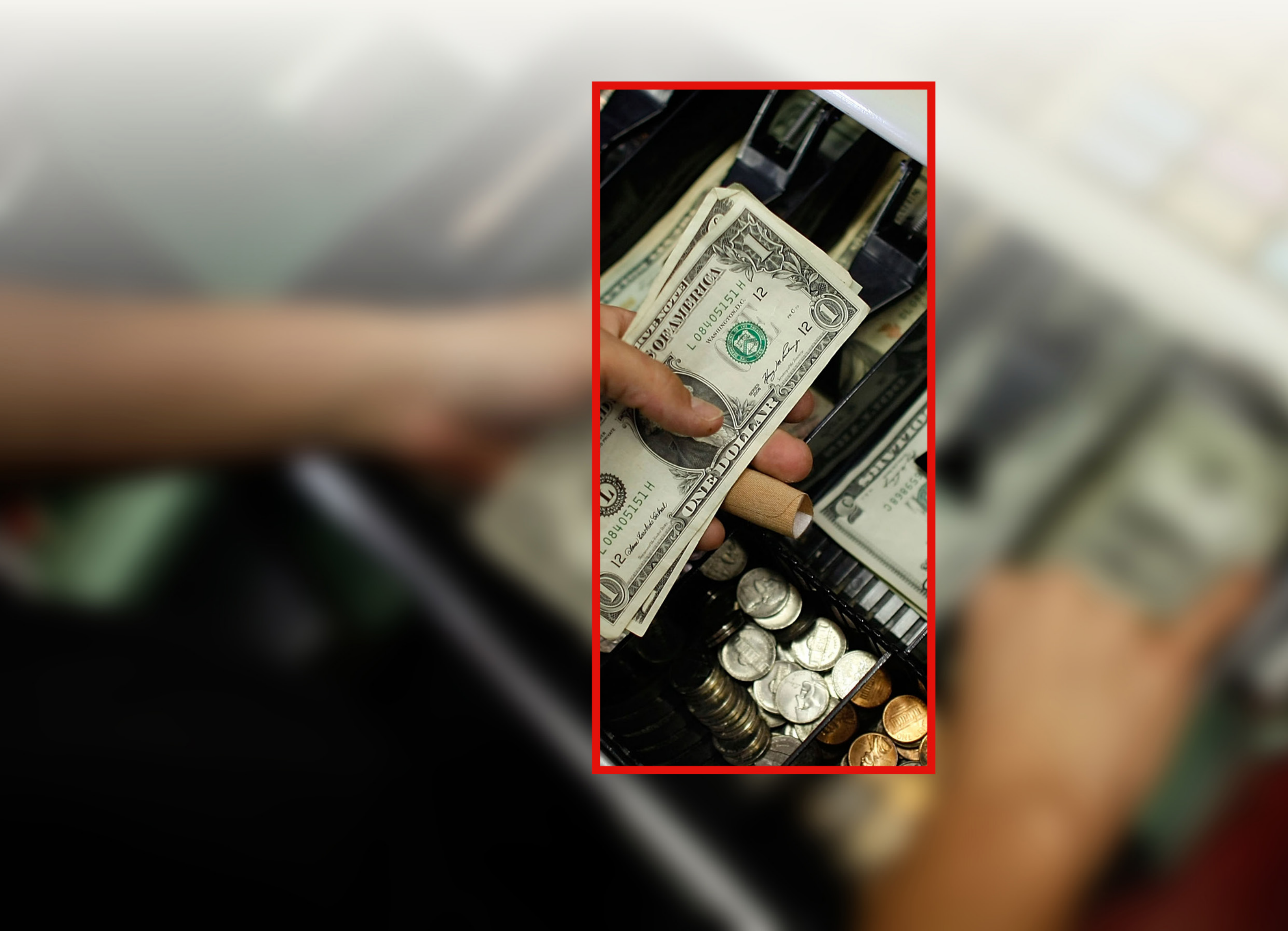
# US economic slowdown

## How to read the mixed signals



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## Contact us


### LONDON

Economist Intelligence
The Adelphi
1-11 John Adam Street, London, WC2N 6HT
United Kingdom
Tel: +44 (0)20 7576 8000
e-mail: london@eiu.com

### GURUGRAM

Economist Intelligence
TEG India Pvt Ltd
Skootr Spaces, Unit No. 1,
12th Floor, Tower B, Building No. 9
DLF Cyber City, Phase – III
Gurugram – 122002
Haryana, India
Tel: +91 124 6409486
e-mail: asia@eiu.com

### NEW YORK

Economist Intelligence
900 Third Avenue
16th Floor
New York, NY 10022
United States
Tel: + 1 212 541 0500
e-mail: americas@eiu.com

### DUBAI

Economist Intelligence
PO Box No - 450056, Office No - 1301A Aurora
Tower Dubai Media City Dubai,
United Arab Emirates
Tel: +971 4 4463 147
e-mail: mea@eiu.com

### HONG KONG

Economist Intelligence
1301 Cityplaza Four 12 Taikoo Wan Road Taikoo
Shing, Hong Kong
Tel: + 852 2585 3888
e-mail: asia@eiu.com


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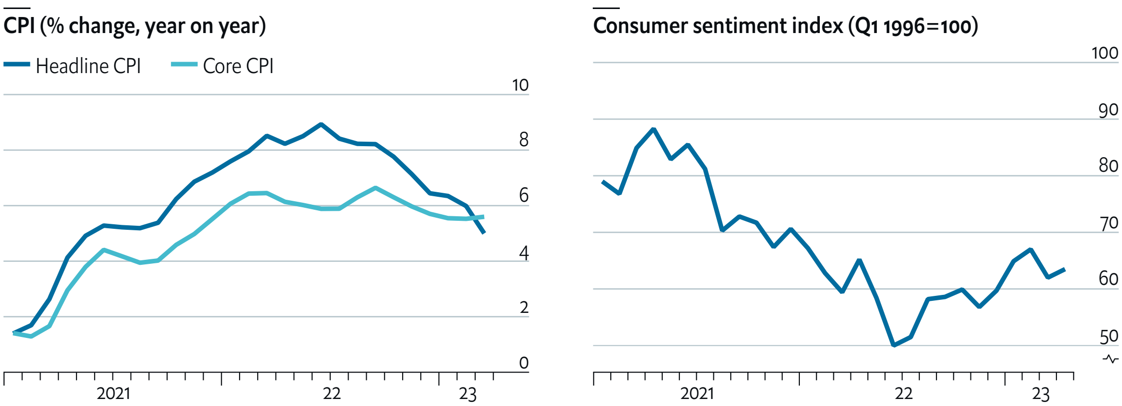
# US economic slowdown: how to read the mixed signals

US economic data sent mixed signals throughout the first quarter of 2023. Firm real GDP growth in January-March, estimated at an annualised rate of 1.1% quarter on quarter, masks a lot of month-on-month variation as well as a months-long slowdown in the manufacturing sector. Consumer confidence wobbled in March but rose again in April, defying still-high inflation and another rise in interest rates; it remains noticeably higher than it was in late 2022. Finally, inflationary trends have diverged. Headline and core inflation shot up in tandem over the first half of 2022; however, while headline inflation has been falling steadily in annual terms since June 2022, core inflation largely remained steady, and even ticked up again in March.

**These mixed signals suggest that the US economy is at a turning point, coming out of a year of robust (but unsustainable) growth in 2022 and heading into a slowdown.** The Federal Reserve (Fed, the US central bank) will therefore have to continue to walk a fine line as it seeks to reduce inflation without unnecessarily deepening the economic slowdown. For now, consumer spending remains the strong point of the US economy, but the EIU expects this to slow more noticeably in the second quarter and contract slightly in the third as prices remain high and the full weight of monetary tightening over the last year comes to bear. **We expect the US economy to experience a mild technical recession in 2023, with two consecutive quarters of contraction, mostly concentrated in the third quarter. Although downside risks persist, we still expect this to feel more like a business-cycle slowdown than a typical recession, with a modest recovery in 2024.**

**Consumer sentiment is above end-2022 levels, despite stubborn inflation**




Sources: US Bureau of Labour Statistics; University of Michigan Index of Consumer Sentiment; EIU.

## First-quarter growth is really a January story

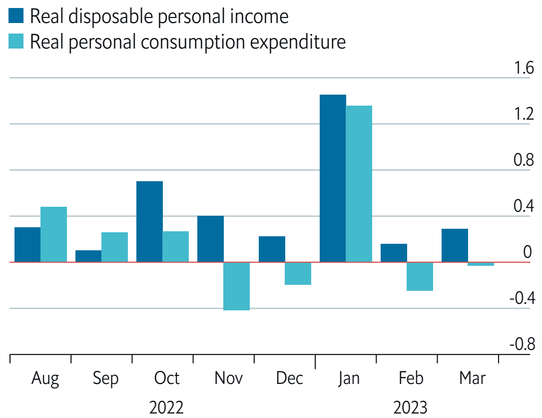
Real private consumption in the first quarter expanded at a fairly robust annualised rate of 3.7% (0.9% non-annualised) , but this masks significant variation from month to month. Real personal consumption surged in January 2023, rising by 1.4% month on month and reversing an average decline of 0.3% in November and December 2022. The jump in spending was driven in part by a large increase in real disposable incomes, which rose by 1.5% month on month—a major acceleration from average income growth of 0.3% in November and December. This mainly reflects an increase in employees' pay packages (0.9% month on month, compared with 0.4% in November-December), as well as a cost-of-living adjustment to social-security payments equivalent to 8.7% year on year, roughly in line with inflation last year. It is also worthwhile to note that a sizeable monthly drop in personal tax payments, of 7.9%, magnified the increase in employees' take-home pay in January. This is unlikely to be replicated in the coming months, particularly following the April 18th tax deadline.

**This jump in real incomes at the start of 2023, together with still-low unemployment, will help to sustain consumer spending in the short term. However, we do not expect this pace of growth to continue.** Indeed, the one-off impact of rising incomes in January has already started to wear off: real personal consumption dipped in both February and March (albeit from a high base), limiting what would otherwise have been a higher first-quarter average.

## Early signs of consumer strain are appearing

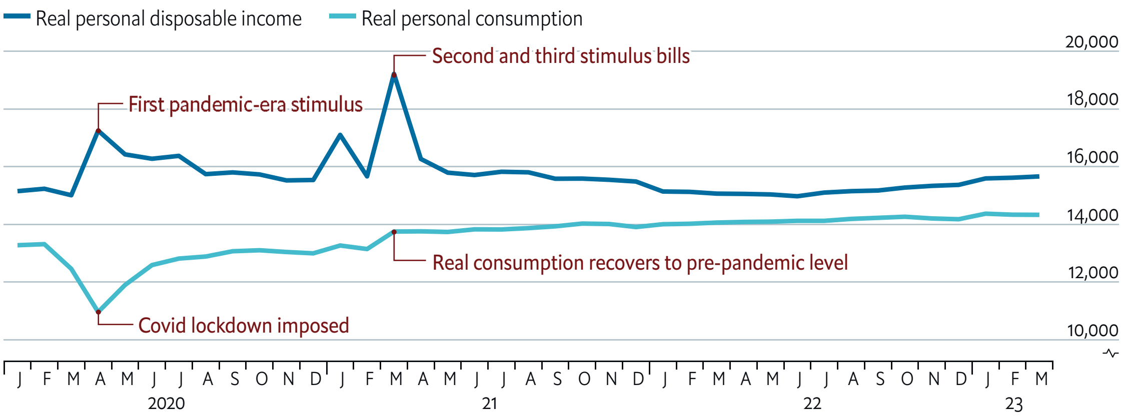
Consumer strength in the first quarter is one of the main factors supporting our forecast for positive real GDP growth of around 1% in full-year 2023, despite mild contractions in the second and third quarters. **Nonetheless, signs of financial strain are starting to appear, which suggests that a consumer-led slowdown is on the way.** For example, the savings rate (savings as a share of personal disposable income) has started to inch up from a 17-year low point of 2.7% in June 2022. The savings rate plummeted in 2022 as households were able to rely on ample savings accumulated during the pandemic in 2020-21 to support rapid consumer spending. The savings rate rose to 4.8% on average in the first quarter of 2023, likely a sign that households have spent down some of these excess savings and are starting to prepare for leaner times ahead (the savings rate tends to rise as the economy enters a slowdown). **This said, the savings rate is still below the pre-pandemic norm of between 7% and 8%. This suggests that still-high prices are constraining household budgets and limiting households' ability to save**. We expect these strains to start weighing more heavily on consumer spending behaviour in the second and, particularly, the third quarter of this year.

**Surge in real incomes and spending in January 2023 was a one-off**
(% change month on month; chained 2012 US dollars)




Sources: US Bureau of Economic Analysis; EIU.

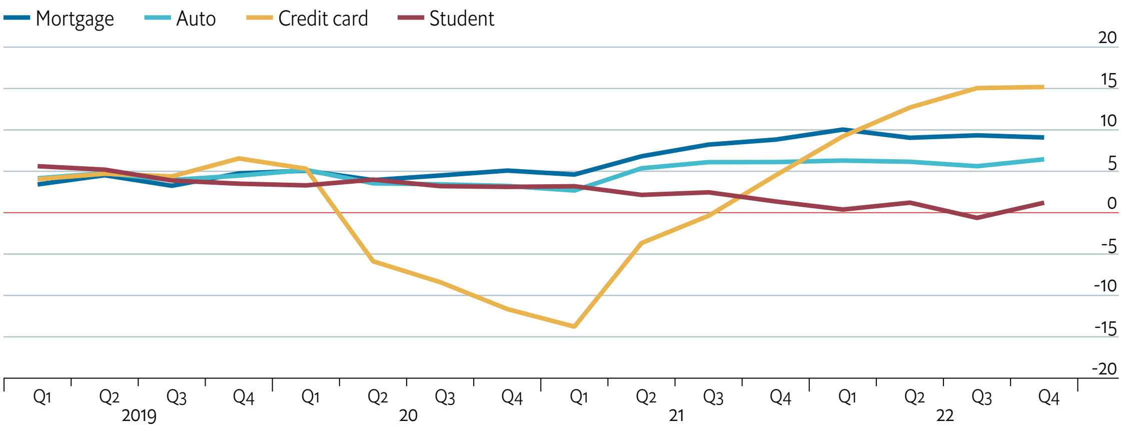
**Gap between income and spending has narrowed sharply since 2020 peak**
(bn chained 2012 US dollars; seasonally adjusted annual rate)




Note: Axis shortened to better show the change.
Sources: US Bureau of Economic Analysis; EIU.

Credit-card balances have also risen steadily, reflecting higher credit lines and the impact of higher interest rates; balances rose by 15% year on year in both the third and fourth quarters of 2022, the fastest annual rise in 20 years. Credit-card debt represents a small share of total household debt—around 6% at end-2022—but it offers a good picture of household finances, as it most often goes to support consumption spending.

**Credit-card balances are the fastest-growing source of US debt**
(% change year on year)

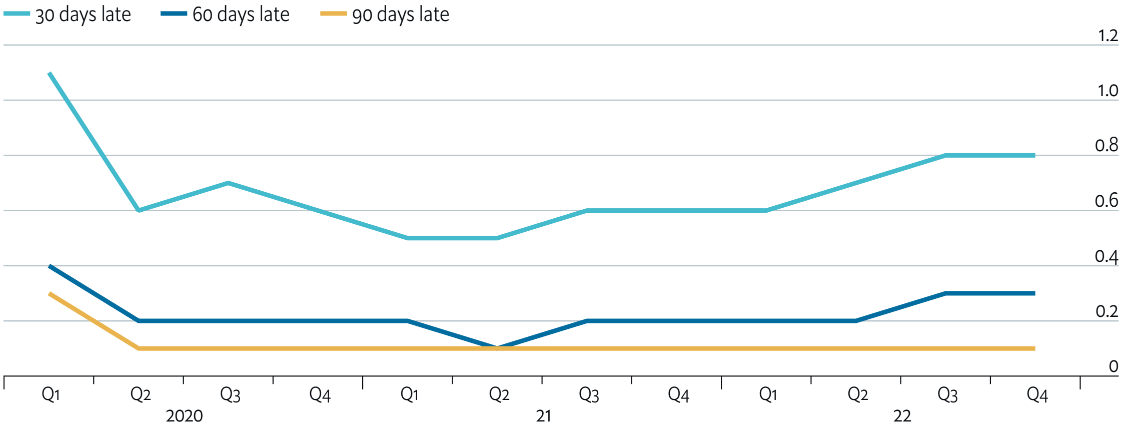



Sources: New York Federal Reserve; EIU.

Overall household debt is also rising, albeit from low levels, as many households used excess savings during the pandemic to pay down debts. For example, credit-card balances returned to their pre-pandemic peak in the third quarter of 2022 and were more than 6% above that peak in the fourth quarter, at nearly US$1trn. The build-up in total household debt (all categories combined) accelerated over the course of 2022 and averaged 8% year on year, double the rate of 3.9% seen in 2019.

The number of loans moving into serious delinquency (90+ days late) is still low, at around 1%, reflecting the pandemic-era reduction in debt. However, the number of loans that have recently moved into delinquency (30+ days late) has almost recovered to pre-pandemic levels, particularly for auto and credit-card debt.

**The share of loans moving into early delinquency is rising from a low base**
(% of total balance of outstanding credit)

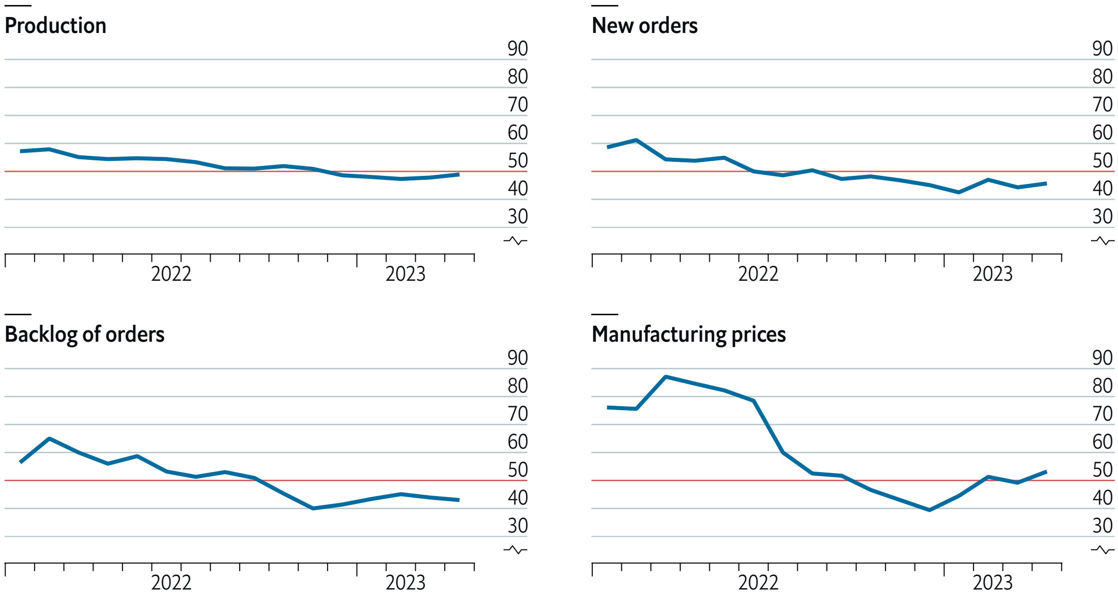



Sources: Federal Reserve Bank of New York; EIU.

## What does this mean for economic growth?

**We expect an impending slowdown in consumption expenditure to drive trends in overall GDP in 2023-24.** This is due to both consumer spending accounting for the majority of economic activity, around 70%, as well as the little support that will come from other parts of the economy. The manufacturing sector has already been slowing for several months, although the impact on GDP has thus far been offset by steady consumption expenditure. The Institute for Supply Management's manufacturing Purchasing Managers Index (PMI) declined for the sixth consecutive month in April, reflecting broad-based declines in new orders (for the past eight months), production levels (five months) and manufacturing employment (two months). One positive outcome of this is that production backlogs are also being worked through, further easing constraints at the end of the supply chain. **Producer prices have also softened since September 2022, which may position manufacturing firms to rebound more sustainably once demand picks up.**

**Manufacturing activity is declining, but so are backlogs and prices**
(manufacturing Purchasing Managers Index value)




Note. Axis shortened to better show the change.
Sources: Institute for Supply Management; EIU.

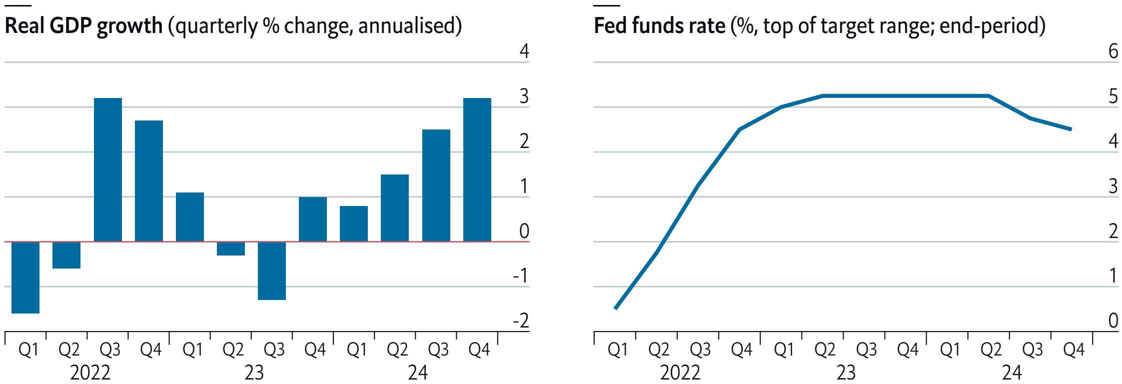
A recovery in fixed investment, which has been steadily declining since the second quarter of 2022, will also be contingent on calming inflation and lower interest rates. Much of the weakness thus far has stemmed from the housing sector, as house prices and turnover is settling back from rapid growth in 2021 and early 2022. **While we expect the Fed to pause its tightening cycle in May 2023, we expect the effective policy rate to remain at or above 5% for some time, most likely until mid-2024, as the central bank seeks to avoid the inflationary rise-and-fall cycle seen in the 1970s.** This is likely to keep pressure on both consumer spending and investment until that time. The recovery is only likely to gather pace in the second half of the year, resulting in still-soft growth of around 1% in full-year 2024.

## The debt ceiling poses downside risks

**Overall, this is as close to a soft landing as the Fed is likely to have been able to engineer under the circumstances, and a fairly benign outcome for the US economy. However, downside risks will loom as long as the debt ceiling issue remains unresolved.** If there is no progress on the debt ceiling by mid-May, rising risk aversion would weigh on the US dollar further (contrary to its usual

**US growth is forecast to pick up in 2024 once interest rates ease**




Sources: Bureau of Economic Analysis; Federal Reserve; EIU.

*Values from Q2 2023 onwards are EIU forecasts.

safe-haven status). Markets have already priced in a higher cost of insuring against government debt, and Treasury yields are likely to rise further in late May if no agreement is in sight. This would help to achieve the Fed's goals of dampening inflation, albeit at the expense of credit conditions (which would tighten) and overall borrowing costs (which would rise across the board, further denting investment). Rising bond yields would put further pressure on the banking sector; although emergency measures introduced by the Fed in March in response to two bank failures will continue to stabilise bank finances, market risk aversion could spike nonetheless. **We maintain our view that a debt default will be averted by a last-minute compromise, but only after additional signs of economic strain appear in May-June.**

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