US Economic Weekly

Defying gravity

26 January 2024

Economics
United States

Michael Gapen
US Economist
BofAS
+1 646 855 3270
michael.gapen@bofa.com

Aditya Bhave
US Economist
BofAS
+1 646 855 9929
aditya.bhave@bofa.com

Stephen Juneau
US Economist
BofAS
+1 202 442 7429
stephen.juneau@bofa.com

Shruti Mishra
US and Global Economist
BofAS
+1 646 855 1040
smishra44@bofa.com

Jeseo Park
US Economist
BofAS
+1 646 855 8688
jeseo.park@bofa.com

US Economics
BofAS

PCE: Personal Consumption Expenditures

GDP: Gross Domestic Product

BTFP: Bank Term Funding Program

Weekly viewpoint

GDP cooled, but not nearly as much as we expected. The economy continues to defy expectations. Progress on inflation continues despite the resiliency of the activity data. We expect headline and core PCE inflation in December to rise by 0.15% m/m and 0.17%, respectively. Solid growth and falling inflation support our soft-landing view. We expect the Fed to shift to neutral rate guidance next week as it discusses when to begin normalizing its policy rate stance and slow the pace of balance sheet runoff.

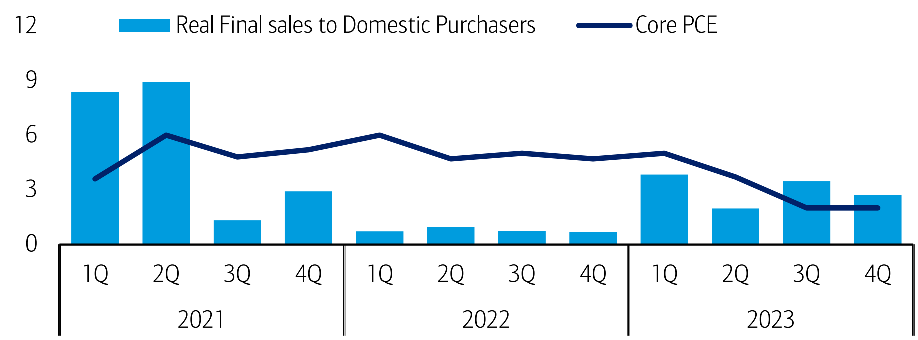
Data preview: The Fed playing for time at the Jan FOMC

We expect the Fed to stay on hold at the January FOMC meeting and to change its policy rate guidance in the post-meeting statement to more neutral language. This would be a de-facto easing bias since most Fed members have indicated the hiking cycle is likely over. In addition, the Fed can accelerate its discussion about when and how it should slow the pace of securities runoff from its balance sheet. The Fed should be pleased with the overall state of the economy. Labor markets have cooled, and inflation has come down more rapidly than expected absent a large rise in unemployment but we don't think the Fed is ready to send a strong signal about its intentions just yet (see: Federal Reserve Watch: January FOMC preview: Playing for time).

Data preview: A gradually cooling labor market

We forecast nonfarm payrolls rose by 175k in January, slightly below the 193k average gain over the previous six months. Job growth should again be narrowly driven by the public and high-touch service sectors. Meanwhile, the unemployment rate is likely to remain at 3.7% and the participation rate should recover to 62.7%. The report will also include annual benchmark to the payroll numbers and updated population estimates will be incorporated into the household survey estimates (see: January US Employment Preview 25 January 2024).

Exhibit 1: Real final sales vs. Core PCE (% q/q seasonally adjusted annualized rate)
Growth finished the year on a strong note and progress on inflation continued



Source: Bureau of Economic Analysis, Haver Analytics

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Defying gravity

- GDP cooled, but not nearly as much as expected. The economy continues to defy expectations.
- We expect headline and core PCE inflation in December to rise by 0.15% m/m and 0.17%, respectively. Solid growth and falling inflation support our soft-landing view.
- The Fed will likely shift to neutral rate guidance next week as it discusses when to begin normalizing its policy rate stance and slow the pace of balance sheet runoff.

The economy continues to defy expectations

Our 2024 outlook includes a resilient consumer offset by softening in non-consumer segments like residential and non-residential investment. While the advance estimate of 4Q GDP surprised sharply to the upside, rising 3.3% q/q saar against our expectation for a 1.5% increase, the mix of activity came in as we expected (see US Watch: Still hot US economy: 4Q GDP at 3.3%). Growth held up due to a resilient consumer, but other sectors of the economy moderated. Overall, growth in economic activity cooled, but not nearly as much as we expected. The US economy continues to defy expectations.

Looking into the details, growth in real consumer spending came in much higher than expected at 2.8% q/q saar on solid spending for both goods and services. In line with our forecast, real business spending seems to be levelling off, with structures investment slowing from its double-digit growth rate. Residential investment posted its second consecutive quarterly gain, albeit a smaller one as high mortgage rates and low inventory continue to constrain activity in the sector.

Inventories, a generally volatile component, surprised to the upside. Autos potentially played a big role in the accumulation in this quarter. Within trade, another volatile component, exports grew at a much stronger pace than we expected while imports came in line with expectations. Additionally, government spending also came in higher than expected, likely driven in part by growth in government employment, which was robust in 4Q.

Keeping aside the volatile trade and inventories print, final sales to domestic purchasers slowed from its 3Q print of 3.5% to 2.7%. Looking ahead, we expect final sales to slow further from its current pace on the back of lagged effects from tighter financial conditions and a moderating labor market.

Exhibit 2: BEA's advance estimate of 4Q US GDP (q/q % saar and pp contribution)
Robust growth on the back of a resilient consumer, strong government spending, and net exports

	%% q.q saar q/q saar	Contribution to real GDP (pp)	% q/q saar	Contribution to real GDP (pp)
GDP	4.9		3.3	
Consumer Spending	3.1	2.1	2.8	1.9
Residential Investment	6.7	0.3	1.0	0.0
Structures	11.2	0.3	3.2	0.1
Equipment	-4.4	-0.2	1.0	0.1
Intellectual Property Products	1.8	0.1	2.1	0.1
Government	5.8	1.0	3.3	0.6
Exports	5.4	0.6	6.3	0.7
Imports	4.2	-0.6	1.9	-0.3
Net Exports (Bil 2012$)	-931	0.0	-908	0.4
Inventory Accumulation (Bil 2012$)	77.8	1.3	82.7	0.1
Final Sales	3.6		3.2	
Domestic Final Sales	3.5		2.7	

Source: Haver Analytics, BEA

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Resilient activity and further disinflation

The GDP report confirms that the economy can continue to expand at a moderate – or even faster pace – while still experiencing disinflation. In addition to the better-than-expected GDP print for 4Q, employment and retail sales data beat expectations in December. Survey data on the business sector and consumer sentiment data also improved recently. As a result, the Bloomberg Economic Surprise index turned positive over the course of December and remains positive in January after tumbling in November (Exhibit 3).

Inflation, meanwhile, was at the Fed's 2% target for a second consecutive quarter as core PCE printed at 2.0% q/q annualized in 4Q. This was in line with our expectation, and in our view, suggests that core PCE inflation in December was likely in line with our forecast — 0.17% m/m. If our forecast does indeed prove to be correct, then it would imply 3m saar and 6m saar growth rates of 1.5% and 1.8%, respectively, for core PCE inflation and a y/y rate of increase below 3.0% (Exhibit 4).

Fed to keep its options open

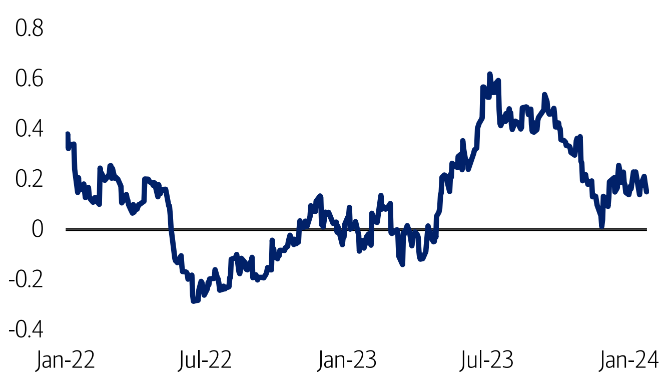
Next week the Fed will hold its first meeting of 2024. As we noted in our preview (see January FOMC preview: Playing for time), we expect it will be pleased with the progress made in returning inflation towards the 2% target without a significant rise in the unemployment rate. However, we think the Fed will remain coy about its intentions for the timing of policy normalization. We think the Fed prefers to see more data before making any decision on whether to start reducing rates in March, as we currently expect.

That said, there has been enough progress to warrant a change in forward guidance in the post-meeting statement. We think the current language referencing "the extent of any additional policy firming" can be replaced with "in determining any additional policy rate adjustments". The literal reading of this guidance would suggest the Fed is just as likely to raise rates as cut them, but the direction of travel in recent changes to policy rate guidance would signal some easing bias, particularly since most Fed communication has implicitly indicated the tightening cycle is over. While we continue to think the Fed can normalize its policy rate on inflation data alone, we acknowledge the upside surprise on 4Q GDP growth may be concerning to some committee members who believe bringing services inflation in line with the inflation target requires more softening in activity and labor markets.

Finally, we expect the committee will have an extensive discussion on how and under what conditions to reduce the pace of balance sheet runoff. In our view, Chair Powell will likely only provide a high-level synopsis of this discussion and we will look to subsequent speeches and the minutes of the January FOMC meeting for further details. We expect no decisions on the balance sheet policies at this meeting.

Exhibit 3: Bloomberg economic surprise index (+ = better than expected data)

Economic data has continued to defy expectations



Source: Bloomberg

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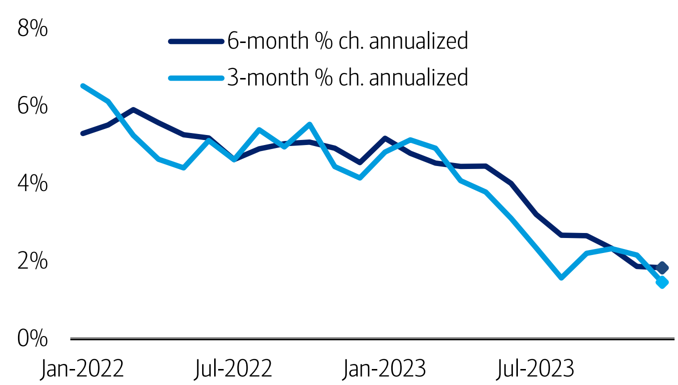
Exhibit 4: Core PCE inflation (diamonds represent expectations for December)

Core PCE inflation is running below the Fed's target in recent months



Source: Bureau of Economic Analysis, Haver Analytics, BofA global research

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US GDP Tracking

4Q advance GDP printed at a robust 3.3% q/q saar

The advance estimate of 4Q US GDP printed at a robust 3.3% q/q saar, well above estimates of trend growth, and following growth of 4.9% in 3Q. This was well above consensus and our expectations of 2.0% and 1.5%, respectively. The main sources of the surprise between the actual print and our forecast were:

- The higher-than-expected personal consumption expenditure print of 2.8%, for which we were tracking 2.0%.
- Volatile trade and inventories components came in stronger than expected with a contribution of 0.4pp and 0.1pp, respectively as compared to our tracking of 0.0pp and -0.7pp, respectively.

Final sales came in closer to our expectations at 2.7%, a deceleration from 3Q but still robust. Next week December construction spending, factory orders and January employment report and vehicle sales will impact our 4Q US GDP tracking.

Exhibit 5: BofA US GDP tracking estimate (% q/q saar)

The advance print of 4Q US GDP came in at 3.3% q/q saar. The main differences from our tracker were largely in the higher-than-expected rise in consumption and in the volatile net exports and inventory component.

Date	Data release	GDP	Final Sales	PCE	Res. Inv.	Struct	Equip	IPP	Gov.	Exports	Imports	Net exports (level)	CIPI (level)
1/11/24	CPI	1.3	2.0	1.9	-0.2	3.3	2.8	2.5	2.3	2.2	2.2	-935.5	26.5
1/12/24	PPI	1.3	2.0	1.9	-0.2	**3.6**	2.8	2.5	2.3	2.2	2.2	-935.5	**27.0**
1/17/24	Retail Sales	**1.4**	**2.1**	**2.0**	**0.2**	3.6	2.8	2.5	2.3	2.2	2.2	-935.5	27.0
1/17/24	Industrial Production, Business Inventories	**1.3**	2.1	2.0	0.2	**3.5**	**2.5**	2.5	2.3	2.2	2.2	-935.5	**26.3**
1/17/24	Import and Export Prices	**1.4**	2.1	2.0	0.2	3.5	2.5	2.5	2.3	**2.4**	**1.8**	**-930.8**	26.3
1/18/24	Housing Starts and Permits	**1.5**	**2.2**	2.0	**0.6**	3.5	2.5	2.5	2.3	2.4	1.8	-930.8	26.3
1/25/24	4Q US GDP Advance Print	**3.3**	**2.7**	**2.8**	1.0	3.2	**1.1**	2.1	**3.3**	**6.3**	1.9	**-908.0**	**82.7**
	GDP tracking	3.3	2.7	2.8	1.0	3.2	1.1	2.1	3.3	6.3	1.9	-908.0	82.7
	Contribution to GDP growth (pp)			1.9	0.0	0.1	0.1	0.1	0.6			0.4	0.1

Source: BofA Global Research. Our GDP tracking estimate reflects the mechanical aggregation of incoming data that directly informs the BEA's GDP calculations. The process is distinct from our official published GDP forecast. Boldface cells indicate where data have implications for tracking estimates.

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Exhibit 6: ISM Manufacturing Tracker

ISM manufacturing tracker is at 47.0

	Print	m/m ch
ISM Manufacturing Index (Dec)	47.2	
Empire ISM adj.	39.7	-5.6
Phil. ISM adj.	41.9	-1.4
Richmond Fed*	35.0	-4.0
KC ISM adj.	45.3	-2.5
Dallas ISM adj.		
Chicago ISM adj		
ISM Manufacturing tracker (Jan)	**47.0**	

Source: ISM, Haver Analytics

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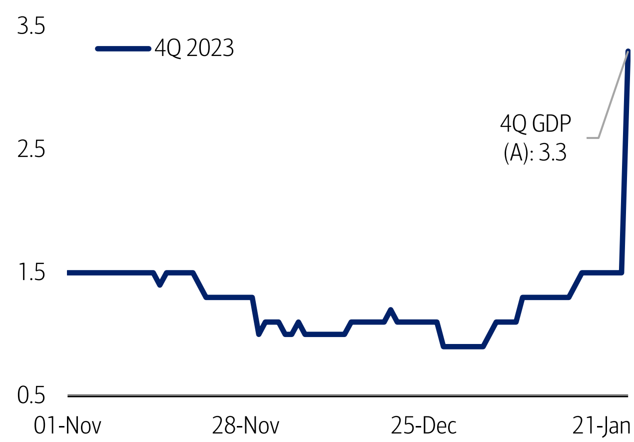
Exhibit 7: GDP tracking evolution (% q/q, SAAR)

4Q GDP came in at a higher than expected 3.3% in its advance estimate



Source: BofA Global Research

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Data in the past week

January 22nd -26th

This week the focus was on the 4Q advance GDP print

Date	Time	Indicator	Period	Actual	Consensus	Previous
1/24/24	7:00	MBA Mortgage Applications	Jan 19	3.7%	—	10.4%
1/24/24	9:45	S&P Global US manufacturing PMI	Jan P	50.3	47.6	47.9
1/24/24	9:45	S&P Global US services PMI	Jan P	52.9	51.5	51.4
1/25/24	8:30	Initial Jobless Claims	Jan 20	214k	200k	189k
1/25/24	8:30	GDP (qoq saar)	4Q A	3.3%	2.0%	4.9%
1/25/24	8:30	Personal consumption (qoq saar)	4Q A	2.8%	2.5%	3.1%
1/25/24	8:30	GDP Price Index (qoq saar)	4Q A	1.5%	2.2%	3.3%
1/25/24	8:30	Core PCE (qoq saar)	4Q A	2.0%	2.0%	2.0%
1/25/24	8:30	Durable Goods Orders	Dec P	0.0%	1.5%	5.5%
1/25/24	8:30	Durables Ex Transportation	Dec P	0.6%	0.2%	0.5%
1/25/24	8:30	Core Capital Goods Orders	Dec P	0.3%	0.1%	1.0%
1/25/24	8:30	Core Capital Goods Shipments	Dec P	0.1%	0.0%	-0.2%
1/25/24	8:30	Wholesale Inventories	Dec P	0.4%	-0.2%	-0.4%
1/25/24	8:30	Advance Goods Trade Balance	Dec	-$88.5b	-$88.7bn	-$89.3b
1/25/24	10:00	New Home Sales	Dec	664K	649K	615K
1/26/24	8:30	Personal Income	Dec	NR	0.3%	0.4%
1/26/24	8:30	Personal Spending	Dec	NR	0.5%	0.2%
1/26/24	8:30	PCE Headline Prices (mom)	Dec	NR	0.2%	-0.1%
1/26/24	8:30	PCE Headline Prices (yoy)	Dec	NR	2.6%	2.6%
1/26/24	8:30	PCE Core Prices (mom)	Dec	NR	0.2%	0.1%
1/26/24	8:30	PCE Core Prices (yoy)	Dec	NR	3.0%	3.2%
1/26/24	8:30	Personal saving rate	Dec	NR	—	4.1%
1/26/24	10:00	Pending Home Sales	Dec	NR	2.0%	0.0%

Source: Bloomberg, BofA Global Research. NR= Not Released

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Data in the week ahead

January 29th – February 2nd

Next week the focus will be on the FOMC rate decision and the employment report

Date	Time	Indicator	Period	BofA Estimate	Consensus	Previous
1/30/24	9:00	Case-Shiller HPI (yoy)	Nov	5.5%	—	4.8%
1/30/24	10:00	Consumer Confidence	Jan	115.0	112.5	110.7
1/30/24	10:00	JOLTS Job Openings	Dec	—	—	8790k
1/31/24	7:00	MBA Mortgage Applications	Jan 26	—	—	3.7%
1/31/24	8:15	ADP Employment	Jan	150k	150k	164k
1/31/24	8:30	Employment Cost Index	4Q	1.0%	1.0%	1.1%
1/31/24	9:45	Chicago Purchasing Managers	Jan	48.0	48.1	47.2
1/31/24	**14:00**	**FOMC Rate Decision (mid-point)**	**Jan 31**	**5.375%**	**5.375%**	**5.375%**
2/01/24	8:30	Initial Jobless Claims	Jan 27	208k	—	214k
2/01/24	8:30	Nonfarm Productivity	4Q P	3.0%	1.6%	5.2%
2/01/24	8:30	Unit Labor Costs	4Q P	0.8%	2.6%	-1.2%
2/01/24	9:45	S&P Global US manufacturing PMI	Jan F	—	—	50.3
2/01/24	10:00	Construction Spending (mom)	Dec	0.5%	0.5%	0.4%
2/01/24	10:00	ISM Manufacturing	Jan	47.0	47.5	47.2
2/01/24	All day	Total Vehicle Sales	Jan	15.7M	15.7M	15.8M
2/02/24	8:30	Change in Nonfarm Payrolls	Jan	175k	185k	216k
2/02/24	8:30	Private Payrolls	Jan	125k	148k	164k
2/02/24	8:30	Unemployment Rate	Jan	3.7%	3.7%	3.7%
2/02/24	8:30	Average Hourly Earnings mom	Jan	0.3%	0.3%	0.4%
2/02/24	8:30	Average Weekly Hours	Jan	34.3	34.4	34.3
2/02/24	10:00	U. of Michigan Sentiment	Jan F	79.0	78.8	78.8
2/02/24	10:00	Factory Orders	Dec	—	0.5%	2.6%

Source: Bloomberg, BofA Global Research

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Federal Reserve Speakers

Exhibit 8: Upcoming policy speakers
Key speaking engagements and news events*

Date	Time	Speaker
Jan 29-30	-	Fed Blackout Period
Jan 31	**14:00**	**FOMC rate decision**
Jan 31	**14:30**	**Fed Chair Powell speaks at post FOMC press conference**

Source: Bloomberg

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Exhibit 9: Summary of Fed speak in the previous week
Below is a summary of key quotes from Fed speakers over the past weeks

Speaker	Date	Quote
Waller (Governor)	16-Jan	"As long as inflation doesn't rebound and stay elevated, I believe the FOMC will be able to lower the target range for the federal funds rate this year." "When the time is right to begin lowering rates, I believe it can and should be lowered methodically and carefully."
Mester (Cleveland)	11-Jan	"I think March is probably too early in my estimation for a rate decline because I think we need to see some more evidence." "I think the December CPI report just shows there's more work to do, and that work is going to take restrictive monetary policy."
Williams (NY fed)	10-Jan	"My base case is that the current restrictive stance of monetary policy will continue to restore balance and bring inflation back to our 2% longer-run goal." "The timing of when [interest rates come down] that happens and the speed at which that happens will depend on how inflation evolves, how the economy evolves." "[FOMC] Intends to slow and then stop the decline in the size of the balance sheet when reserve balances are somewhat above the level it judges to be consistent with ample reserves. So far, we don't seem to be close to that point"
Barr (Vice Chair of Supervision)	9-Jan	Signals BTFP will end on March 11, when it expires
Bowman	8-Jan	"Should inflation continue to fall closer to our 2% goal over time, it will eventually become appropriate to begin the process of lowering our policy rate to prevent policy from becoming overly restrictive." "I will remain cautious in my approach to considering future changes in the stance of policy,"
Bostic (Atlanta)	8-Jan	"We are in a restrictive stance and I'm comfortable with that, and I just want to see the economy continue to evolve with us in that stance and hopefully see inflation continue to get to our 2% level Expects 2 rate cuts this year starting in 3Q "Open question" if and when the Fed should alter B/S reduction pace
Logan (Dallas)	7-Jan	"In my view, we should slow the pace of runoff as ON RRP balances approach a low level" "In light of the easing in financial conditions in recent months, we shouldn't take the possibility of another rate increase off the table just yet."

Source: Bloomberg

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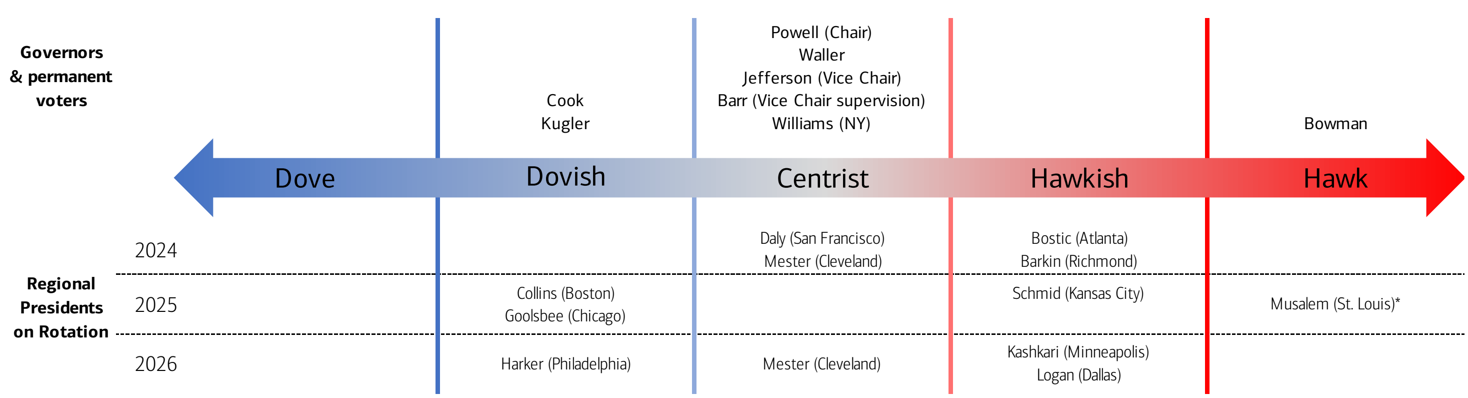
Exhibit 10: BofA US Economics Dove-Hawk chart
This year the regional presidents voting on the FOMC (Federal Open Market Committee) will be Daly, Mester, Bostic and Barkin



Source: BofA Global Research
*Musalem was recently announced as President of the St. Louis Fed. We have yet to hear him comment on monetary policy. Therefore, this is a preliminary placement.

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Federal Reserve Balance Sheet

The balance sheet fell by $35.1bn in the past four weeks

The Fed continues to let up to $60bn of maturing Treasury securities roll off its balance sheet each month, while also reducing holdings of agency mortgage-backed securities by up to $35bn. In the week ending January 24, the Fed's balance sheet increased by $3.3bn (H.4.1 Exhibit 11). In the past four weeks, the balance sheet has shrunk by $35.1bn. Balance sheet runoff continues to reduce take-up in the overnight reverse repo facility (ON RRP), which has fallen by $185.5bn over the past four weeks.

Lending through the BTFP rose by $6.3bn to $167.8bn. In our view, the increase in lending through the BTFP was likely precautionary in nature and related to the expected expiration of the program. The Fed officially announced the BTFP will end on March 11, in line with our expectations (see BTFP to expire on schedule) and raised the rate for new BTFP loans which will now be equal to the interest rate on reserve balances at the time of the new loan.

Exhibit 11: The balance sheet of the Federal Reserve ($bn, Wednesday, end of period values)
Factors affecting reserve balances of depository institutions (H.4.1 Table 1)

$bn, Wednesday, end of period values	24 Jan	7-day chg	4 week chg	Chg since June 1, 2022
Supplying reserve funds (Federal Reserve assets)				
Reserve Bank credit outstanding	7640.9	3.3	-35.1	-1237.7
Securities held outright	7153.3	-4.8	-71.4	-1327.3
US Treasuries	4722.3	-1.7	-68.2	-1048.5
Federal Agency	2.3	0.0	0.0	0.0
Mortgage-backed securities	2428.6	-3.1	-3.1	-278.8
Unamortized premiums on securities held outright	276.9	-0.7	-2.3	-60.3
Unamortized discounts on securities held outright	-25.5	0.2	0.4	-1.0
Repurchase agreements	0.0	0.0	0.0	0.0
Foreign official (FIMA repo facility)	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Loans	173.9	6.7	32.1	153.2
of which:				
Discount window (primary and secondary credit)	2.8	0.5	0.3	1.9
Paycheck protection program (PPPLF)	3.3	0.0	-0.1	-16.5
Bank Term Funding Program (BTFP)	167.8	6.3	32.0	167.8
Other credit extensions	0.0	0.0	0.0	0.0
Other factors supplying reserve funds	62.3	1.9	6.0	-2.4
Total factors supplying reserve funds	7728.0	3.4	-35.5	-1236.4
Absorbing reserve funds (Federal Reserve liabilities)				
Currency in circulation	2329.5	-6.5	-15.1	49.5
Reverse repo agreements	980.1	43.7	-185.5	-1250.5
Foreign official accounts	340.5	-5.6	-6.2	75.0
Others	639.6	49.4	-179.3	-1325.5
Treasury cash holdings	0.4	0.0	0.0	0.3
Other deposits with Federal Reserve Banks	1007.8	67.3	120.4	-20.7
of which:				
Treasury General Account	815.2	41.6	102.1	34.6
Treasury contributions to credit facilities	7.4	0.0	0.0	-10.5
Other Federal Reserve liabilities and capital	-86.9	1.5	-10.8	-136.9
Factors absorbing reserves, other than reserves	4238.3	106.0	-91.0	-1368.7
Reserve balances with Federal Reserve banks	3489.7	-102.6	55.5	132.3

Source: Federal Reserve, Haver Analytics, BofA Global Research. Note: Quantitative tightening began on June 1, 2022.

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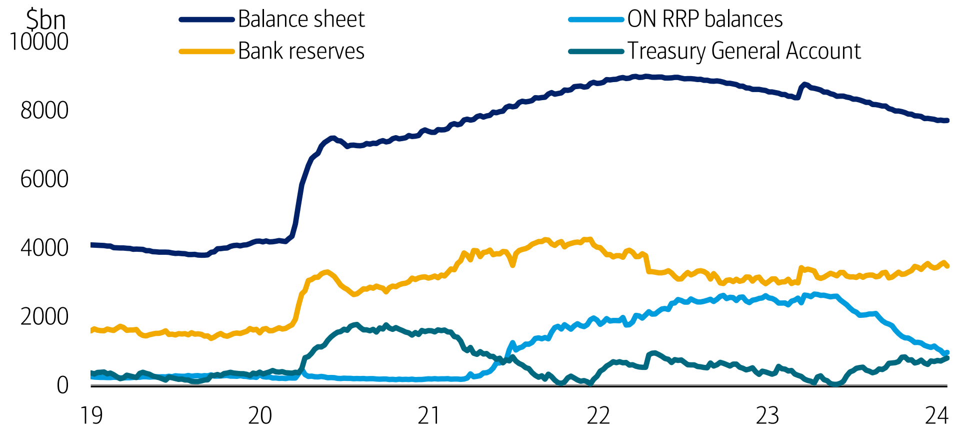
Exhibit 12: The balance sheet, ON RRP balances, bank reserves, and Treasury General Account ($bn)
Nearly all the drain in liquidity from balance sheet runoff has shown up in lower ON RRP balances while bank reserves have been largely stable



Source: Federal Reserve, Haver Analytics, BofA Global Research

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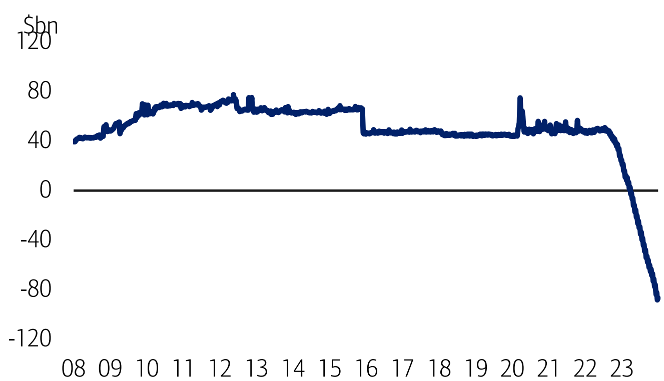
Losses on the Fed's balance sheet: The Fed continues to pay more in interest on reserves than it earns on its securities holdings. Earnings that are retained to cover this loss are booked as a negative liability on the balance sheet under "interest on Federal Reserve Notes due to the US Treasury" in the line item "other Federal Reserve liabilities and capital". The cumulative value of the shortfall in earnings (the "deferred asset") is $86.9bn.

Exhibit 13: Other Federal Reserve Liabilities and Capital ($bn)
Federal Reserve losses are mounting



Source: Federal Reserve, Haver Analytics, BofA Global Research

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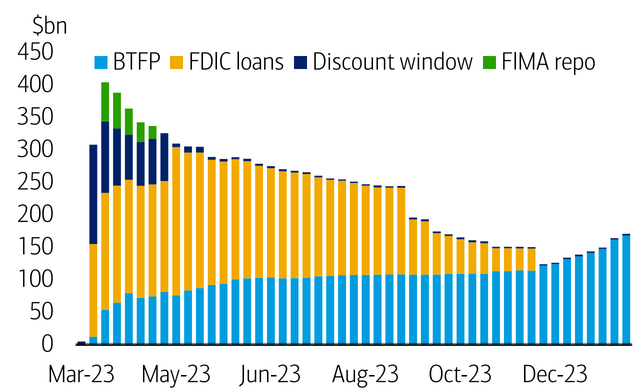
Exhibit 14: Federal Reserve Emergency Lending Facilities ($bn)
Lending through the BTFP has been ticking higher



Source: Federal Reserve, Haver Analytics, BofA Global Research

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Core views

Growth: Soft landing

- After the higher-than-expected 4Q advance GDP print, we continue to expect a soft landing for the US economy. Earlier, we had marked up our forecast for growth in private consumption while maintaining a slowdown in non-consumer related components like residential investment, nonresidential investment, and government spending. We continue to expect growth in real US GDP of 1.2% 4Q/4Q in 2024, up 0.6pp, and 2.0% in 2025 (see Sticking the landing).

Inflation: Moving in the right direction, but sticky

- PCE inflation falls to 2.0% y/y in 3Q25. Core PCE will now likely fall below 3% y/y by 1Q24. But the road to 2% will likely be slower due to sticky core services ex-housing inflation. We expect core PCE to fall to a slightly above target 2.5% y/y by 4Q24.

Federal Reserve policy rates: Fewer cuts than the market expects

- We do not expect any further hikes from the Fed and expect it to remain on hold at the Jan 31st meeting. We continue to expect the first rate cut in March 2024, followed by quarterly 25bp reductions in the policy rate for a total of 100bp of rate cuts in 2024 and 100bp in 2025 (see Sticking the landing).

Federal Reserve balance sheet: An end to runoff in June

- We expect the Fed to reduce the redemption caps on Treasury securities beginning in March and an end to quantitative tightening (QT) in June. We do not expect the Fed to alter redemption caps on MBS securities given its preference for an all-Treasury portfolio. When QT ends, maturing MBS securities will be reinvested back into Treasury securities (see Logan and QT: QT taper now in March). There is considerable uncertainty around the timing of the end of balance sheet runoff given the difficulty in estimating reserve demand.

Structurally higher US interest rates? Think again.

- Our estimate of the neutral real policy rate is hovering around 40bp. During the decade following the global financial crisis, our estimate of the real neutral rate was negative or close to zero. If the post-pandemic surge in participation proves short lived and productivity does not accelerate, then any rise in the neutral rate of interest in the US economy is likely to be modest at best and could prove temporary. This would mean the zero lower bound remains a constraint on monetary policy and the terminal rate in any easing cycle could be lower than we expect (see Structurally higher US interest rates? Think again).

Labor markets: The virtuous cycle continues

- The post-pandemic surge in labor force participation has led to a surge in total hours, and supported growth in disposable income, helping to keep consumer spending elevated despite higher interest rates. We think this has some further room to run in 2024 but foresee the participation rate drifting down toward its underlying demographic trend in 2025 and beyond (see Structurally higher US interest rates? Think again).

Fiscal policy: Caution: drag ahead

- Fiscal policy bills and other idiosyncratic factors contributed to resiliency of the economy in 2023. However, the impulse to growth should turn negative in 2024. Fiscal sustainability is an ongoing concern that could be exacerbated by higher interest rates (see Fiscal impulse: running out of steam).

Economic forecast summary

Exhibit 15: BofA US economic outlook

We continue to expect a soft landing for the US economy

	1Q 23	2Q 23	3Q 23	4Q 23	1Q 24	2Q 24	3Q 24	4Q 24	1Q 25	2Q 25	3Q 25	4Q 25	2022	2023	2024	2025
Real Economic Activity, % SAAR																
Real GDP	2.2	2.1	4.9	3.3	1.0	1.0	1.5	1.5	2.0	2.0	2.0	2.0	1.9	2.5	2.1	1.8
% Change, Year Ago	1.7	2.4	2.9	3.1	2.8	2.5	1.7	1.2	1.5	1.7	1.9	2.0				
Final Sales	4.6	2.1	3.6	3.2	1.5	1.0	1.5	1.5	2.0	2.0	1.5	1.5	1.3	2.9	2.0	1.6
Domestic Demand	3.8	2.0	3.5	2.8	1.5	1.0	1.5	1.5	2.0	2.0	2.0	1.5	1.7	2.2	1.9	1.7
Consumer Spending	3.8	0.8	3.1	2.8	1.5	1.5	1.5	1.5	2.0	2.0	2.0	2.0	2.5	2.2	1.9	1.8
Residential Investment	-5.3	-2.2	6.7	1.2	-0.5	-0.5	1.5	2.0	2.5	2.5	2.5	2.5	-9.0	-10.7	1.0	2.2
Nonresidential Investment	5.7	7.4	1.5	1.9	1.0	1.0	2.0	2.0	2.0	2.0	2.0	2.0	5.2	4.4	1.8	2.0
Structures	30.3	16.1	11.2	3.7	-1.0	-1.0	1.0	1.0	1.5	1.5	2.0	2.0	-2.1	12.7	2.6	1.4
Equipment	-4.1	7.7	-4.4	2.7	1.0	1.0	1.5	1.5	2.0	2.0	2.0	2.0	5.2	-0.1	0.8	1.9
Intellectual Property	3.8	2.7	1.8	2.7	2.0	2.0	2.0	2.5	2.5	2.5	3.0	3.0	9.1	4.3	2.2	2.5
Government	4.8	3.3	5.8	3.3	1.0	0.5	0.5	1.0	1.0	1.0	1.0	1.0	-0.9	4.0	2.0	0.8
Exports	6.8	-9.3	5.4	2.7	1.0	1.0	1.5	1.5	2.0	2.0	2.5	2.5	7.0	2.7	2.0	1.8
Imports	1.3	-7.6	4.2	1.8	1.5	1.5	1.5	1.5	2.0	2.0	2.0	2.0	8.6	-1.7	1.2	1.7
Net Exports (Bil 12$)	-935	-928	-931	-908	-912	-917	-919	-922	-926	-930	-933	-936	-1051	-926	-917	-931
Contribution to growth (ppts)	0.6	0.0	0.0	0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.5	0.5	0.1	0.0
Inventory Accumulation (Bil 12$)	27.2	14.9	77.8	82.7	67.5	60.5	57.5	64.5	73.5	82.5	97.5	112.5	128.1	50.7	62.7	91.7
Contribution to growth (ppts)	-2.2	0.0	1.3	0.1	-0.3	-0.1	-0.1	0.1	0.2	0.1	0.2	0.2	0.6	-0.4	0.1	0.1
Nominal GDP (Bil $, SAAR)	26814	27063	27610	27939	28193	28433	28729	29002	29335	29651	29959	30276	25744	27356	28589	29805
% SAAR	6.2	3.8	8.4	4.9	3.7	3.4	4.2	3.9	4.7	4.4	4.2	4.3	9.1	6.3	4.5	4.3
Key Indicators																
Fed Funds Rate (midpoint, % EOP)	4.875	5.125	5.375	5.375	5.125	4.875	4.625	4.375	4.125	3.875	3.625	3.375	4.375	5.375	4.375	3.375
Industrial Production (% SAAR)	-0.3	0.8	1.7	-2.9	-0.5	0.5	0.0	0.5	1.0	1.5	1.5	1.5	3.4	0.2	-0.3	0.8
Capacity Utilization (%)	79.5	79.4	79.5	78.6	78.5	78.5	78.5	78.5	79.0	79.0	79.0	79.5	80.3	79.3	78.6	79.0
Nonfarm Payrolls (Avg mom ch, 000s)	312	201	221	165	100	75	75	100	100	125	125	150	399	225	88	125
Civilian Unemployment Rate (%)	3.5	3.6	3.7	3.8	3.8	4.0	4.1	4.2	4.2	4.2	4.1	4.1	3.6	3.6	4.0	4.2
Civilian Participation Rate (%)	62.5	62.6	62.7	62.6	62.8	62.8	62.8	62.8	62.8	62.8	62.7	62.7	62.2	62.6	62.8	62.8
Productivity (% SAAR)	-0.8	3.5	4.5	0.0	0.5	1.0	1.0	1.0	1.5	1.0	1.5	1.0	-1.9	1.8	0.9	1.3
Personal Saving Rate (%)	4.8	5.2	3.8	3.8	4.0	4.2	4.5	4.7	5.0	5.2	5.4	5.6	3.5	4.4	4.4	5.3
Light Vehicle Sales (Millions SAAR)	15.0	15.8	15.7	15.5	16.0	16.2	16.3	16.5	16.7	17.0	17.4	17.8	13.8	15.5	16.2	17.2
Housing Starts (Thous. SAAR)	1385	1450	1370	1455	1450	1440	1505	1555	1555	1575	1585	1595	1551	1415	1490	1580
Current Account (% of GDP)													-3.7	-3.6	-3.4	-3.3
US Budget Balance ($bn, Fiscal Year)													-1375	-1695	-1800	-1900
Inflation																
GDP Price Index (% SAAR)	3.9	1.7	3.3	1.5	2.7	2.4	2.7	2.3	2.6	2.3	2.2	2.3	7.1	3.6	2.4	2.4
% Change, Year Ago	5.3	3.5	3.2	2.6	2.3	2.5	2.3	2.5	2.5	2.5	2.4	2.4				
PCE Chain Prices (% SAAR)	4.2	2.5	2.9	1.9	2.0	2.3	2.3	2.0	2.4	2.0	1.8	1.9	6.5	3.8	2.2	2.1
% Change, Year Ago	5.0	3.9	3.4	2.9	2.3	2.3	2.1	2.1	2.3	2.2	2.0	2.0				
Core PCE Chain Prices (% SAAR)	5.0	3.7	2.4	2.1	2.6	2.5	2.5	2.3	2.5	2.2	2.0	2.0	5.2	4.1	2.5	2.3
% Change, Year Ago	4.8	4.6	3.9	3.3	2.7	2.4	2.4	2.5	2.4	2.4	2.2	2.2				
CPI, Consumer Prices (% SAAR)	3.8	2.7	3.6	2.8	2.2	2.5	2.6	2.0	2.5	2.1	2.8	2.4	8.0	4.1	2.6	2.4
% Change, Year Ago	5.8	4.0	3.6	3.2	2.8	2.8	2.5	2.3	2.4	2.3	2.4	2.5				
CPI ex Food & Energy (% SAAR)	5.0	4.7	2.8	3.4	3.3	3.1	2.9	2.7	2.6	2.6	2.5	2.4	6.1	4.8	3.2	2.7
% Change, Year Ago	5.6	5.2	4.4	4.0	3.6	3.1	3.2	3.0	2.8	2.7	2.6	2.5				

Source: BofA Global Research

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Rates and dollar forecast

Table 1: Rates and dollar forecast
We think the Fed is done hiking and will start cutting in March

	Spot	24-Mar	24-Jun	24-Sep	24-Dec	25-Mar	25-Jun	25-Sep	25-Dec
Interest rates									
Fed Funds	5.33	5.00-5.25	4.75-5.00	4.50-4.75	4.25-4.50	4.00-4.25	3.75-4.00	3.50-3.75	3.25-3.50
Fed Effective Rate	5.33	5.13	4.88	4.63	4.38	4.13	3.88	3.63	3.38
2-Year T-Note	4.31	4.75	4.50	4.25	4.00	-	-	-	3.75
5-Year T-Note	4.01	4.50	4.40	4.25	4.15	-	-	-	4.00
10-Year T-Note	4.13	4.40	4.30	4.25	4.25	-	-	-	4.25
30-Year T-Bond	4.37	4.70	4.65	4.65	4.75	-	-	-	4.75
Dollar									
EUR-USD	1.08	1.07	1.10	1.15	1.15	1.16	1.17	1.18	1.20
USD-JPY	148	145	143	142	142	140	138	136	136
USD-CAD	1.35	1.35	1.34	1.32	1.30	1.30	1.30	1.30	1.30
AUD-USD	0.66	0.66	0.68	0.71	0.71	0.71	0.71	0.71	0.71
NZD-USD	0.61	0.60	0.62	0.63	0.63	0.63	0.63	0.63	0.63
GBP-USD	1.27	1.23	1.26	1.31	1.31	1.33	1.34	1.37	1.40
USD-CHF	0.87	0.90	0.87	0.84	0.84	0.84	0.84	0.84	0.83
USD-SEK	10.46	10.93	10.36	9.74	9.65	9.57	9.40	9.24	9.00
USD-NOK	10.46	10.84	10.27	9.57	9.48	9.40	9.23	9.07	8.83
USD-CNY	7.17	7.45	7.40	7.10	6.90	6.90	6.80	6.80	6.70
USD-MXN	17.22	17.80	17.90	18.30	18.50	18.70	18.90	19.10	19.50

Source: BofA Global Research

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Rolling calendar of business indicators

Key economic data over the next three weeks
Next week the focus will be on the FOMC rate decision and employment report

Monday	Tuesday	Wednesday	Thursday	Friday
Jan 29	**Jan 30**	**Jan 31**	**Feb 1**	**Feb 2**
	9:00 am: S&P CoreLogic CS HPI – Nov 10:00 am: Conference Board Confidence – Jan	7:00 am: MBA Mortgage Applications – week ending 1/26/2024 8:15 am: ADP Employment – Jan 8:30 am: Employment Cost Index - 4Q 9:45 am: Chicago PMI – Jan 2:00 pm: FOMC Rates Decision	8:30 am: Initial Jobless Claims – week ending 1/27/2024 8:30 am: Productivity & Costs - 4Q (P) 9:45 am: S&P Global US Manufacturing PMI – Jan F 10:00 am: ISM manufacturing – Jan 10:00 am: Construction Spending – Dec All Day: Wards Auto Sales - Jan	8:30 am: Employment Report – Jan 10:00 am: Factory orders – Dec 10:00 am: U. of Mich Sentiment – Jan (F)
Feb 5	**Feb 6**	**Feb 7**	**Feb 8**	**Feb 9**
9:45 am: S&P Global US Services PMI – Jan F 10:00 am: ISM services– Jan 2:00 pm: Senior Loan Officer Survey		7:00 am: MBA Mortgage Applications – week ending 2/2/2024 8:30 am: Trade Balance – Dec	8:30 am: Initial Jobless Claims – week ending 2/3/2024 10:00 am: Wholesale Inventories – Dec F	
Feb 12	**Feb 13**	**Feb 14**	**Feb 15**	**Feb 16**
2:00 pm: Monthly Budget Statement - Jan	6:00 am: NFIB Small Bus. Optimism – Jan 8:30 am: Consumer Price Index – Jan	7:00 am: MBA Mortgage Applications – week ending 2/9/2024	8:30 am: Initial Jobless Claims – week ending 2/10/2024 8:30 am: Advance Retail Sales – Jan 8:30 am: Import Price Index – Jan 8:30 am: Empire Manufacturing – Feb 8:30 am: Philly Fed – Feb 9:15 am: Industrial Production – Jan 10:00 am: NAHB Housing Index – Feb 10:00 am: Business Inventories - - Dec	8:30 am: Housing Starts & Permits – Jan 8:30 am: Producer Price Index – Jan 10:00 am: U. of Mich Sentiment – Feb (P)

*Projections- subject to revision as additional data become available. P - preliminary reading , S - second reading, T - third reading, F - final reading

Source: Bloomberg

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CPI Forecast table

Exhibit 16: CPI monthly forecast table

We expect CPI inflation to moderate over the course of our forecast horizon given our expectations for restrictive monetary policy and a soft landing

	Non-seasonally Adjusted						Seasonally Adjusted									
	Headline CPI			Energy			Headline CPI					Core CPI				
	Level	m/m	y/y	Level	m/m	y/y	Level	m/m	y/y	q/q saar	y/y (quarterly)	Level	m/m	y/y	q/q saar	y/y (quarterly)
2023: Jan	299.17	0.8	6.4	283.33	3.1	8.7	300.54	0.5	6.3			302.70	0.4	5.5		
2023: Feb	300.84	0.6	6.0	281.67	-0.6	5.2	301.65	0.4	6.0			304.07	0.5	5.5		
2023: Mar	301.84	0.3	5.0	279.08	-0.9	-6.4	301.81	0.1	5.0	3.8	5.8	305.24	0.4	5.6	5.0	5.6
2023: Apr	303.36	0.5	4.9	283.35	1.5	-5.1	302.92	0.4	5.0			306.49	0.4	5.5		
2023: May	304.13	0.3	4.0	279.82	-1.2	-11.7	303.29	0.1	4.1			307.82	0.4	5.3		
2023: Jun	305.11	0.3	3.0	283.85	1.4	-16.7	303.84	0.2	3.1	2.7	4.1	308.31	0.2	4.9	4.7	5.2
2023: Jul	305.69	0.2	3.2	284.83	0.3	-12.5	304.35	0.2	3.3			308.80	0.2	4.7		
2023: Aug	307.03	0.4	3.7	294.33	3.3	-3.6	306.27	0.6	3.7			309.66	0.3	4.4		
2023: Sep	307.79	0.2	3.7	296.00	0.6	-0.5	307.48	0.4	3.7	3.6	3.6	310.66	0.3	4.1	2.8	4.4
2023: Oct	307.67	0.0	3.2	286.75	-3.1	-4.5	307.62	0.0	3.2			311.37	0.2	4.0		
2023: Nov	307.05	-0.2	3.1	277.03	-3.4	-5.4	307.92	0.1	3.1			312.25	0.3	4.0		
2023: Dec	306.75	-0.1	3.4	269.38	-2.8	-2.0	308.85	0.3	3.3	2.8	3.2	313.22	0.3	3.9	3.4	4.0
2024: Jan	307.83	0.4	2.9	268.01	-0.5	-5.4	309.18	0.1	2.9			313.99	0.2	3.7		
2024: Feb	308.94	0.4	2.7	266.31	-0.6	-5.5	309.71	0.2	2.7			314.79	0.3	3.5		
2024: Mar	310.47	0.5	2.9	273.10	2.6	-2.1	310.43	0.2	2.9	2.2	2.8	315.63	0.3	3.4	3.3	3.6
2024: Apr	311.67	0.4	2.7	277.00	1.4	-2.2	311.15	0.2	2.7			316.42	0.2	3.2		
2024: May	312.45	0.3	2.7	280.11	1.1	0.1	311.51	0.1	2.7			317.21	0.2	3.0		
2024: Jun	313.94	0.5	2.9	286.97	2.4	1.1	312.51	0.3	2.9	2.5	2.8	318.00	0.2	3.1	3.1	3.1
2024: Jul	314.41	0.1	2.9	283.79	-1.1	-0.4	312.91	0.1	2.8			318.79	0.2	3.2		
2024: Aug	314.86	0.1	2.6	284.28	0.2	-3.4	313.98	0.3	2.5			319.52	0.2	3.2		
2024: Sep	314.70	-0.1	2.2	278.77	-1.9	-5.8	314.32	0.1	2.2	2.6	2.5	320.24	0.2	3.1	2.9	3.2
2024: Oct	314.77	0.0	2.3	273.79	-1.8	-4.5	314.65	0.1	2.3			320.94	0.2	3.1		
2024: Nov	314.25	-0.2	2.3	269.03	-1.7	-2.9	315.07	0.1	2.3			321.65	0.2	3.0		
2024: Dec	313.94	-0.1	2.3	266.07	-1.1	-1.2	316.10	0.3	2.3	2.0	2.3	322.35	0.2	2.9	2.7	3.0
2025: Jan	315.36	0.5	2.4	269.90	1.4	0.7	316.76	0.2	2.5			323.05	0.2	2.9		
2025: Feb	316.42	0.3	2.4	268.72	-0.4	0.9	317.22	0.1	2.4			323.74	0.2	2.8		
2025: Mar	317.82	0.4	2.4	275.19	2.4	0.8	317.75	0.2	2.4	2.5	2.4	324.44	0.2	2.8	2.6	2.8
2025: Apr	318.91	0.3	2.3	279.02	1.4	0.7	318.36	0.2	2.3			325.12	0.2	2.7		
2025: May	319.64	0.2	2.3	282.89	1.4	1.0	318.67	0.1	2.3			325.80	0.2	2.7		
2025: Jun	321.15	0.5	2.3	291.13	2.9	1.4	319.67	0.3	2.3	2.1	2.3	326.48	0.2	2.7	2.6	2.7
2025: Jul	321.67	0.2	2.3	290.27	-0.3	2.3	320.11	0.1	2.3			327.15	0.2	2.6		
2025: Aug	322.28	0.2	2.4	293.52	1.1	3.3	321.37	0.4	2.4			327.82	0.2	2.6		
2025: Sep	322.25	0.0	2.4	290.46	-1.0	4.2	321.86	0.2	2.4	2.8	2.4	328.49	0.2	2.6	2.5	2.6
2025: Oct	322.42	0.1	2.4	287.35	-1.1	5.0	322.30	0.1	2.4			329.15	0.2	2.6		
2025: Nov	322.00	-0.1	2.5	284.55	-1.0	5.8	322.84	0.2	2.5			329.81	0.2	2.5		
2025: Dec	321.77	-0.1	2.5	283.12	-0.5	6.4	323.98	0.4	2.5	2.4	2.5	330.47	0.2	2.5	2.4	2.5

Source: Bureau of Labor Statistics, BofA Global Research

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