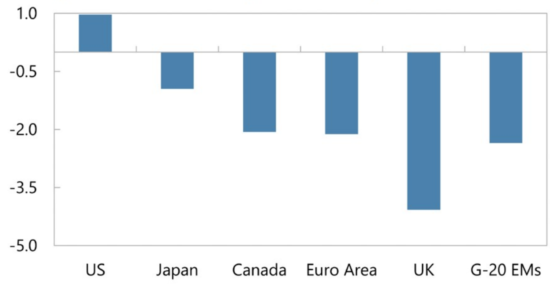
A RESILIENT ECONOMY

1. The U.S. economy has turned in a remarkable performance over the past few years. Rather than facing lasting negative hysteresis effects from the pandemic, the U.S. is the only G20 economy that is now operating above the levels of output and employment expected prior to the pandemic. Q4/Q4 growth in 2023 (at 3.1 percent) was almost three times that expected at the time of the last Article IV and core PCE inflation was almost 1 percentage point lower. The rebound has been characterized by important gains on both the demand *and* supply side which has allowed inflation to head back to the FOMC's medium-term target without a major dislocation in the real economy. The strength of the U.S. economy and the relatively quick disinflation have had large, positive spillovers to the world economy.

2023 Real GDP
(percent deviation from pre-crisis trend)



Sources: IMF World Economic Outlook.
Note: Bars show the difference in real output in 2023 and anticipated output for the same period prior to the crisis (January 2020 WEO).

A. What Has Underpinned the Post-Pandemic Strength in Demand?

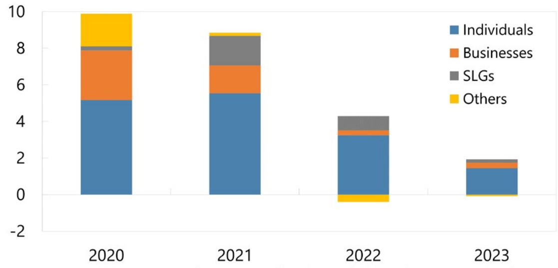
2. The unprecedented increase in the fiscal deficit during the depths of the pandemic provided significant fuel to demand. The cumulative increase in federal spending in 2020–21 was around 19 percent of GDP. While somewhat smaller than that of the Euro Area, the extraordinary breadth of this (relatively untargeted) fiscal support is providing a material boost to aggregate demand in 2023–24 through multiple channels:

- Federal transfers to households (through stimulus checks, food assistance, child and earned income tax credits, and unemployment insurance), combined with foregone consumption and debt rescheduling (e.g., of mortgages and student loans), added an estimated 10 percent of GDP to household savings by end-2021. These resources were then subsequently available to support consumption even as real disposable income fell (due to the post-pandemic burst of inflation).

- Large transfers to state and local governments prevented a drawdown of rainy-day funds in the pandemic, providing subnational governments with sizable buffers which, in turn, allowed them to maintain their spending above pre-pandemic levels.

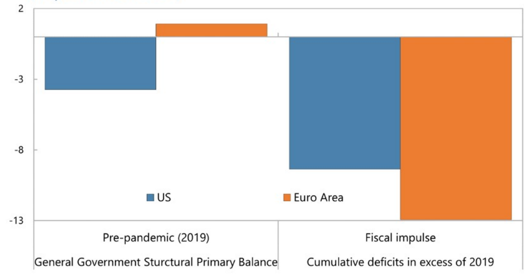
- Around 3½ percent of GDP in federal loans provided through the Payroll Protection Program were subsequently forgiven, bolstering corporate balance sheets. Other targeted pandemic measures (e.g., for airlines) also supported the corporate sector.

Federal Government Spending[1]
(percent of GDP; relative to the 2019 level)



Source: U.S. Department of Tresury; Small Business Administration; Congressional Research Services; Office of Management and Budget; IMF staff calculation.
Note: [1]Federal spending is measured as the increase relative to the 2019 level; Others included defense spending, capital investment, interest spending, and other items not directly attributable to firms, households, or subnational governments.

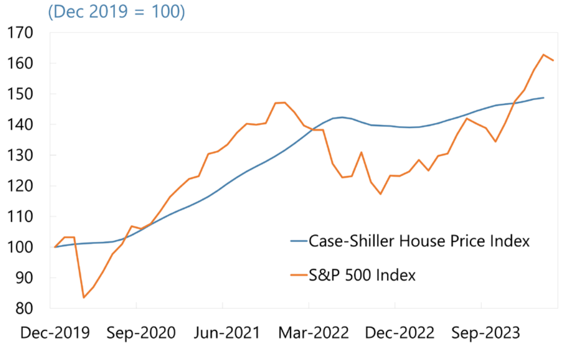
General Government Structural Primary Balance
(in percent of GDP)



Source: IMF World Economic Outlook.
Note: Fiscal impulse is calculated as the cumulative sum of general government structural primary deficits exceeding 2019 levels over the period 2020-2023.

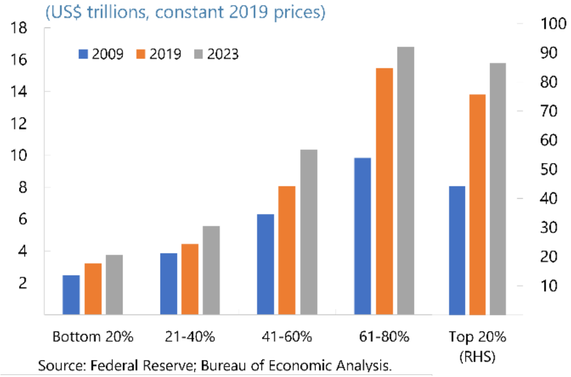
3. Rising household wealth has been a key determinant in supporting consumer demand (Box 1). The significant build-up of savings during the pandemic (described above) allowed households to pay down costly revolving credit, build-up financial assets, and subsequently benefit from the post-pandemic run-up in asset prices. In addition, homeowners benefited from an almost 50 percent increase in the average house price since end-2019. As a result, real median net wealth in the U.S. has grown by 34 percent since 2019 (compared to a 5 percent increase in the Euro Area over the same period).[1] Notably, wealth rose across the whole income distribution (albeit with much larger gains for the highest income households).

Asset Price Indices
(Dec 2019 = 100)



Source: S&P Dow Jones Indices LLC; Haver.

Net Worth across Income Quintiles
(US$ trillions, constant 2019 prices)

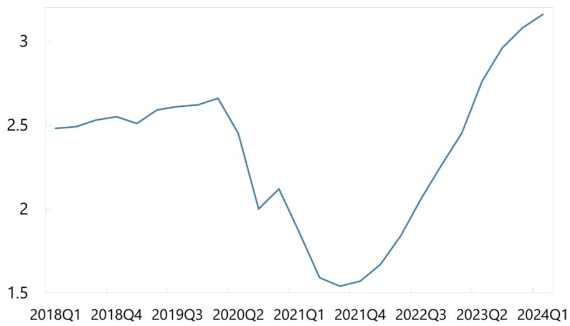


Source: Federal Reserve; Bureau of Economic Analysis.

[1] Data on net wealth is drawn from the Survey of Consumer Finances and Financial Accounts of the United States produced by the Federal Reserve Board, and the Household Finance and Consumption Survey and Quarterly Sector Accounts produced by the European System of Central Banks. The change in real median net wealth is calculated from 2019Q3 to 2022Q3.

4. This strength in aggregate consumption, however, masks an upswing in poverty and rising signs of economic distress among low-income households. During the recovery from the pandemic, labor shortages lifted real wages at the bottom of the income distribution and led to a compression of wage inequality.[2] Despite these gains, poverty increased by 4.6 percentage points in 2022 and the child poverty rate more than doubled.[3] This rise in poverty can be directly attributed to the expiration of pandemic-era assistance, particularly changes that had been made to the Child Tax Credit and the Earned Income Tax Credit (EITC). The increased pressure on lower income households is becoming more visible in an upswing in delinquencies on revolving credit. Furthermore, worsening housing affordability has aggravated access to shelter, particularly for the young and lower income households. This is evident in the number of people experiencing homelessness, which has risen to the highest level since data began to be compiled in 2007.[4]

Deliquency Rate on Credit Card Loans - All Commercial Banks
(percent, seasonally Adjusted)



Source: Federal Reserve.

5. Both households and corporates have been insulated from the impact of higher interest rates.

- During the pandemic, both corporate and household borrowers locked in low rates at long maturities, paying down higher cost, floating rate debt. Around one half of mortgages reset at lower rates during 2020–21 (either through refinancing operations or when the mortgage refreshed through home sales). As a result, by end-2021, over 95 percent of mortgages were at low, fixed rates.[5] Similarly, the average duration of investment grade corporate bonds rose during 2020–21 with new debt being contracted at relatively low yields.

- Firms and households were able to increase their holdings of short duration financial assets. Households extracted around US$0.5 trillion in home equity during 2020–21 which, alongside the higher savings described above, increased their holdings of bank deposits and money market funds by almost 3 percent of GDP. Similarly, nonfinancial corporates now hold 2.3 percent of GDP more in bank deposits and money market funds than they did at end-2019.

Together, these two dynamics have resulted in a muted impact of higher interest rates on consumption and corporate investment.[6] Indeed, over the past two years, the combination of low-

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[2] See, for example, Autor, Dube and McGrew (2023).

[3] As measured by the supplementary poverty measure that accounts for income and payroll taxes, tax credits, and non-cash transfers while using geographically adjusted poverty thresholds (Census Bureau, 2023).

[4] See Annual Homelessness Assessment Report, December 2023.

[5] See A. Haughwout et al., "The Great Pandemic Mortgage Refinance Boom", Federal Reserve Bank of New York.

[6] Higher interest rates did though have a clear impact through other channels, notably subtracting around ½ percent from growth in both 2022 and 2023 as a result of the decline in residential investment.