The Curious Strength of the US Economy: Can It Last?

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1) Where are we coming from?
Inflation was very high coming out of the pandemic

Source: Citi Research, BEA, BLS
Labor market was very tight

Source: Citi Research, BLS

JOLTS Quit Rate (LHS)
Wage growth strong

Source: Citi Research, Atlanta Fed, BLS
Federal Reserve raised interest rates very quickly

Source: Citi Research, Federal Reserve
Housing sector contracted with higher rates

Source: Citi Research, NAR
Manufacturing weakened with softer goods demand

Source: Citi Research, Federal Reserve, ISM
Usual “lag” of monetary policy on overall economic activity 4-6Q

Source: Citi Research, BLS
2) Recent resilience has been surprising, but why?
Job growth has been running consistently strong

Source: Citi Research, BLS
Wages still rising, and now rising even adjusted for inflation

Source: Citi Research, BLS
Aggregate incomes still rising

Source: Citi Research, BEA, BLS
Consumers had substantial excess savings

Source: Citi Research, Federal Reserve, BEA

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Borrowing still lower than pre-pandemic as share of income

Source: Citi Research, Federal Reserve, BEA

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Businesses have also been less sensitive so far to higher rates
Business bankruptcies still historically low

Source: Citi Research, NFIB, US Courts
Some pandemic-induced shifts can be supporting activity

Source: Citi Research, Census Bureau, BLS
3) Can we have a true “soft landing”?
“Soft landing”: Activity slows, but does not contract; inflation falls

Source: Citi Research, BEA, BLS
Bring excess demand for labor down, so demand meets supply

Source: Citi Research, BLS
More balanced labor market can mean wages slow

Source: Citi Research, Atlanta Fed, BLS

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Wages will ultimately be the key determinant of inflation

\[ y = 1.0576x + 0.072 \]
\[ R^2 = 0.6196 \]

Source: Citi Research, BEA, BLS

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Wages will ultimately be the key determinant of inflation

Source: Citi Research, BEA, BLS
3) US recession still a distinct possibility
Activity can still slow due to higher rates

Source: Citi Research, Bloomberg, MBA
Activity can still slow due to higher rates

Interest Rate Paid on Short-Term Loans by Borrowers (NFIB survey of small businesses)

Source: Citi Research, NFIB
Activity can still slow due to higher rates

Source: Citi Research, Bloomberg
Credit conditions have tightened substantially

Source: Citi Research, Federal Reserve
Loan growth can slow further as banks are cautious, deposits fall

Source: Citi Research, Federal Reserve
Bringing labor demand down further could be more painful

Source: Citi Research, BLS

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3) No landing at all, but still high inflation
Housing sector is most rate sensitive, but has bottomed

Source: Citi Research, Census Bureau
Housing supply is constrained

Source: Citi Research, NAR
Home prices are rising again

Source: Citi Research, S&P

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Rising home prices suggest upside to shelter prices in CPI later

Source: Citi Research, NAR, S&P, BLS

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Some signs goods demand picking up again

Source: Citi Research, BEA, Census Bureau, S&P
Upward risks to goods prices with commodities rebounding

Source: Citi Research, Bloomberg, BLS
Labor market might not be loosening enough

Source: Citi Research, BLS, Atlanta Fed
Labor market might not be loosening enough

Source: Citi Research, Indeed.com
High inflation for too long risks becoming embedded

Source: Citi Research, University of Michigan
Appendix A-1

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