



THE WHITE HOUSE  
WASHINGTON

# U.S. Economic Outlook

*ESRI International Conference, July 2023*

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Chair, Council of Economic Advisers

# U.S. Macro: Tailwinds & Headwinds



## Headwinds:

- Strong consumer spending supported by persistently tight labor market
- Inflation has eased, as has nominal wage growth
- But inflation has fallen faster than wage growth, leading to real wage gains
- That's starting to show up in confidence, sentiment

## Tailwinds/Risks:

- Higher interest rates
- Bank (and non-bank) credit tightening
- Some parts of inflation still sticky
- Sacrifice ratio could grow
- “Own goal kicks”

# Recent dataflow: Supportive of transition to steady growth

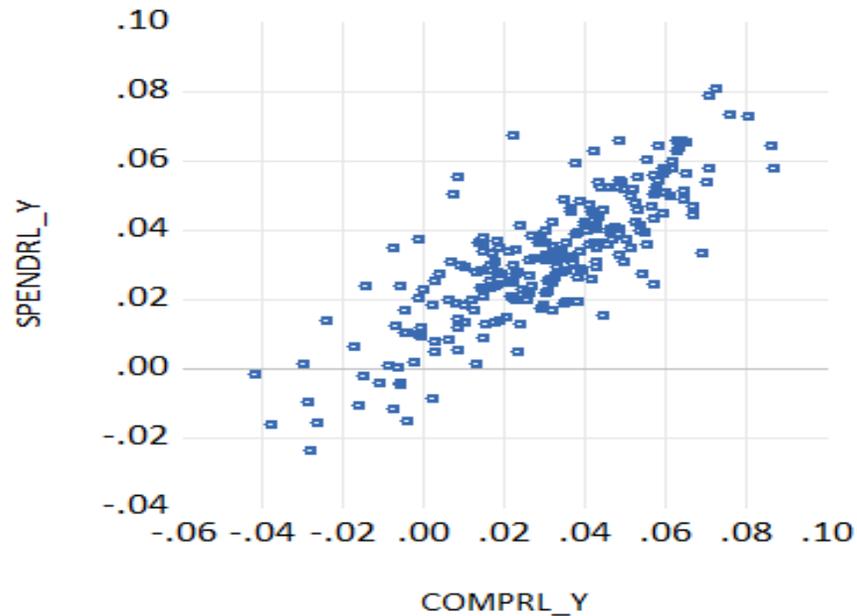
- Inflation: CPI, PPI, PCE
  - Disinflation, some deflation, core finally “breaks lose”
- Real GDP
- Nominal wages slower, real wages up
  - Employment Cost Index: Fed’s preferred gauge
  - Shows some deceleration though nominal wage growth still elevated relative to Fed target
  - Real wage gains
  - Quit rates down
- Consumer sentiment, confidence—less underwater



# Consumer spending is 68% of US nominal GDP

- Consumer spending adjusted for inflation has been resilient; averaged 2¼% over the past four quarters, the same average pace as 2010-2019

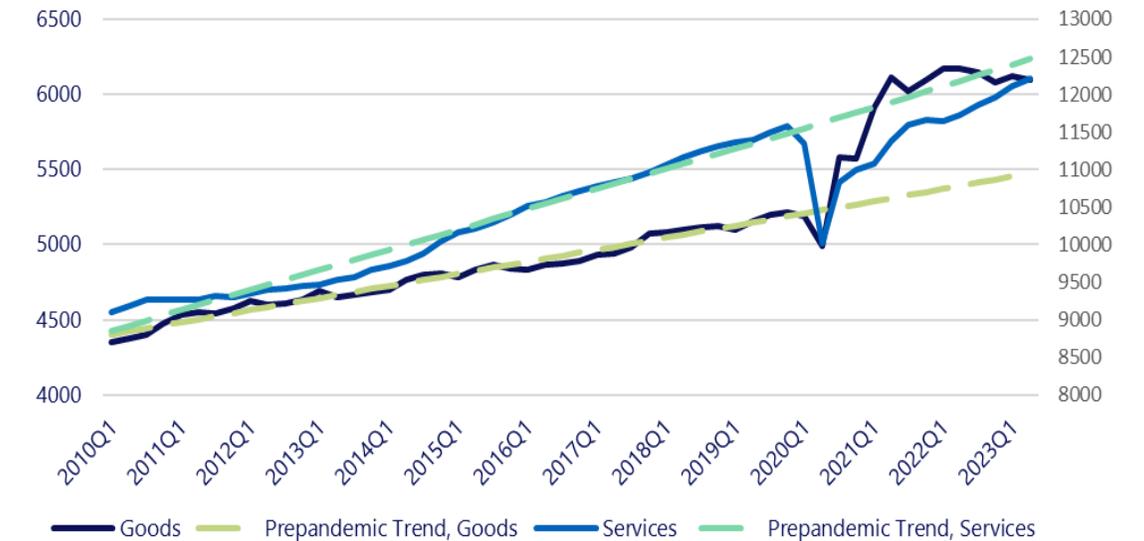
- **Supported by strong labor market**



## Consumer Spending

Billions 2023Q2 Dollars, Goods

Billions 2023Q2 Dollars, Services



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Note: Data are quarterly and extend through 2023:Q2.

Source: Bureau of Economic Analysis.

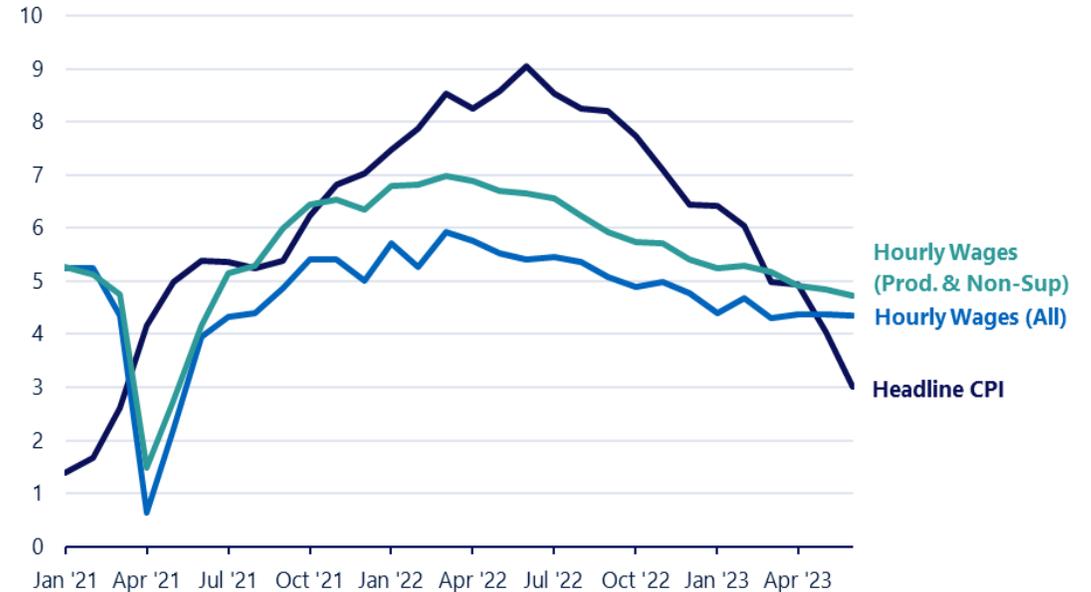


# Real wage growth: nominal wage deceleration < disinflation

- The turn down in headline price inflation raises real wages
  - Tight labor market disproportionately helps mid/low wage earners



Change in Headline CPI and Nominal Hourly Wages  
Year-on-year percent



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Sources: Bureau of Labor Statistics; CEA calculations.

As of July 12, 2023 at 8:30am.



# US labor market: strong job gains, increasing LFPR...some welcomed cooling.



- Labor demand is cooling but remains elevated
  - Other measures from the labor market (vacancies, quits, etc.) cooling but elevated
- Labor supply has returned to pre-pandemic levels
  - LFPR for prime-age women: 78%, the highest rate since modern data began in 1948
  - Immigrant share of labor force has returned to pre-pandemic trend

Job growth over the last three months averaged 244,000.



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Sources: Bureau of Labor Statistics; CEA calculations.

As of July 7, 2023 at 8:30am.

Prime Age Labor Force Participation Rate

Labor Force Participation Rate  
Percent of population age 25-54



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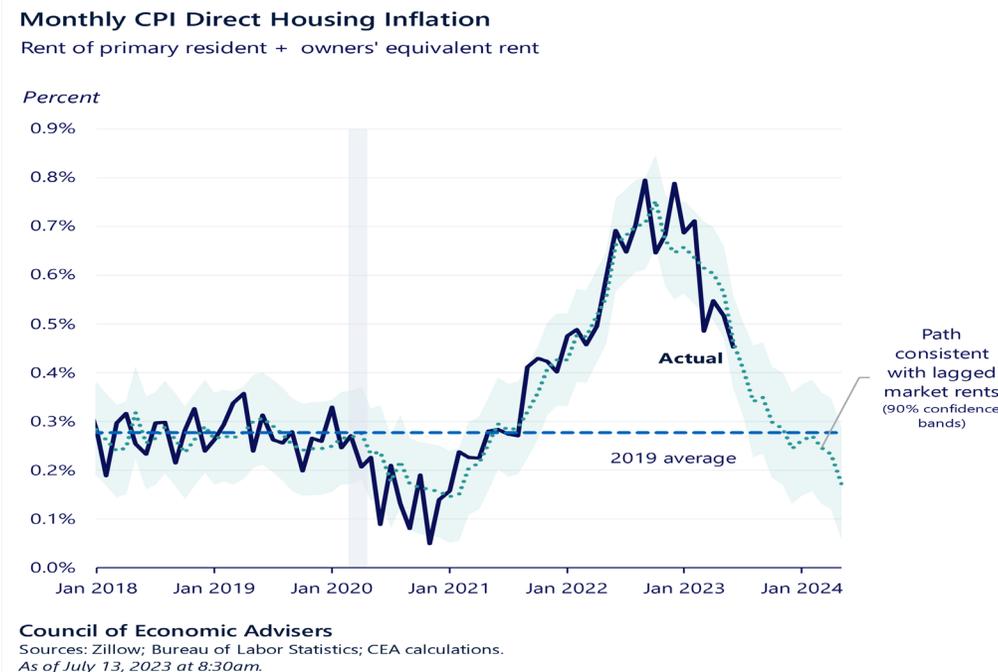
Sources: Bureau of Labor Statistics; CEA calculations.

As of July 7, 2023 at 8:30am.



# The U.S. inflation story

- 2021: Strong demand + plus constrained supply (+ expectations)
  - Demand: forced savings, fiscal/monetary support
  - Supply snarl-ups: COVID, pipeline clogged by preference shift towards goods
- Today: must decompose to understand
  - Energy/food (weight: 20%)
  - Goods (21%)
  - Housing (35%)
  - Non-housing services (NHS) (24%)
    - Labor intensive NHS (~13%)

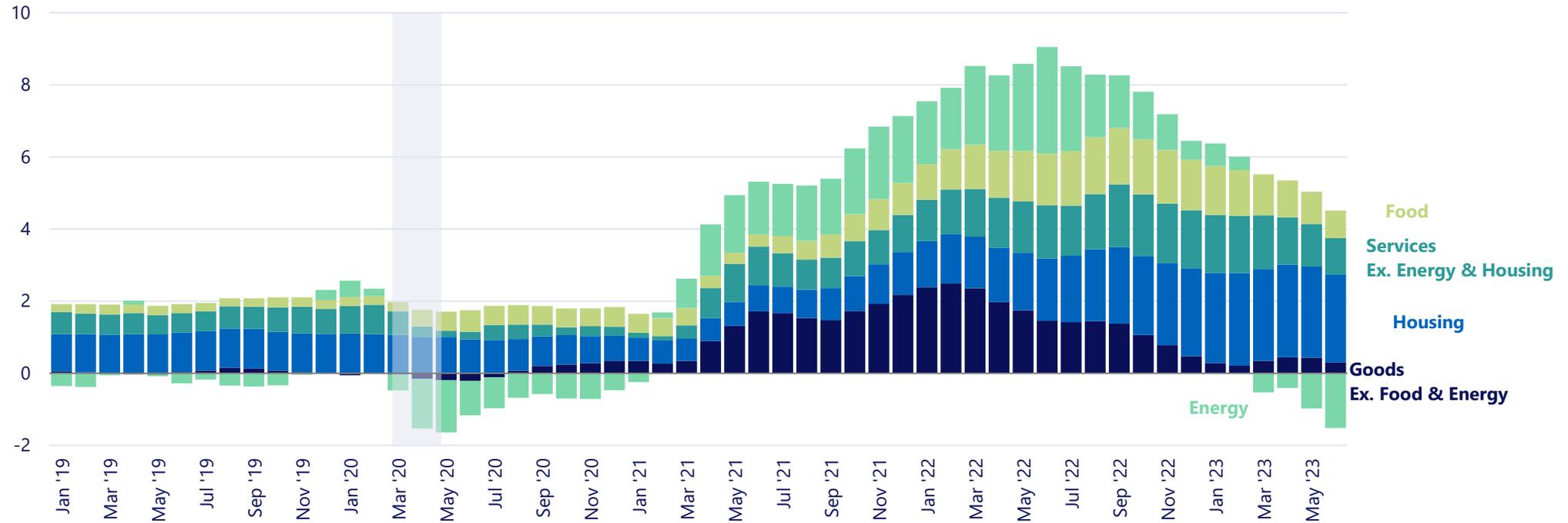


# Inflation easing, though still elevated

## Headline CPI Inflation

Contribution to year-on-year headline CPI inflation

Percentage points



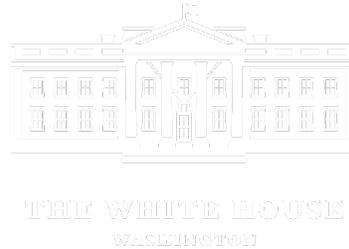
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Sources: Bureau of Labor Statistics; CEA calculations.

As of July 12, 2023 at 8:30am.



# Inflation outlook



## Forces for continued disinflation:

- Fed funds rate
- Housing rollover
- Unsnarled supply chains
- Labor market, nominal wage cooling
- Burning off excess savings & return of price elasticity of demand

## Forces for continued price pressures:

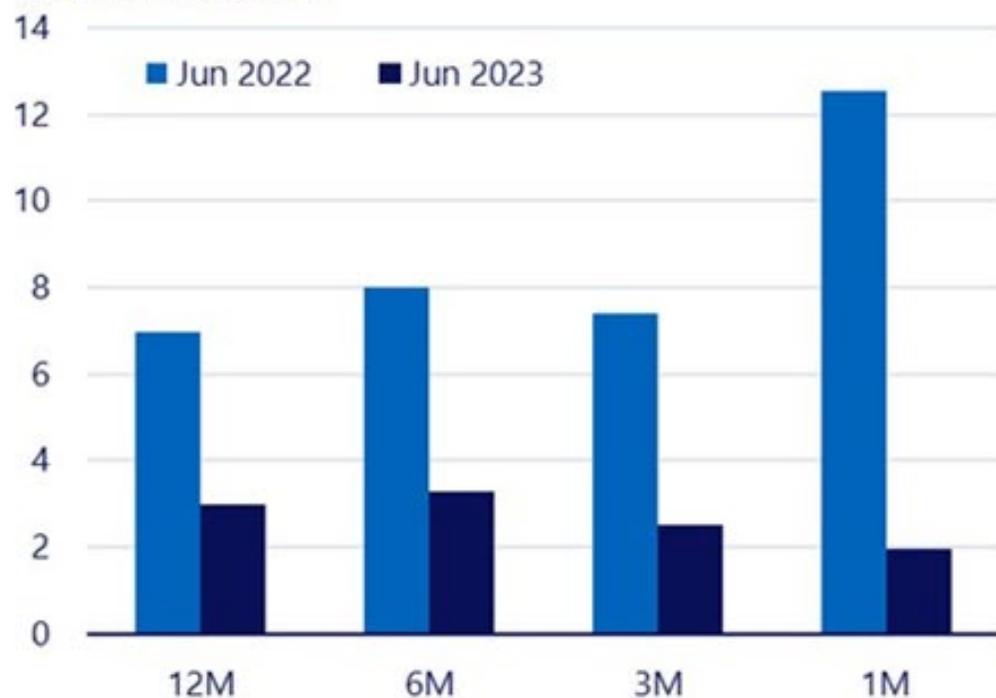
- Retail gas prices up, inventories low
- Core still elevated, though less sticky
- Labor market still hot; nominal wage growth still elevated, though cooling
- Services demand still strong



## Across different frequencies, PCE inflation is lower than a year ago.

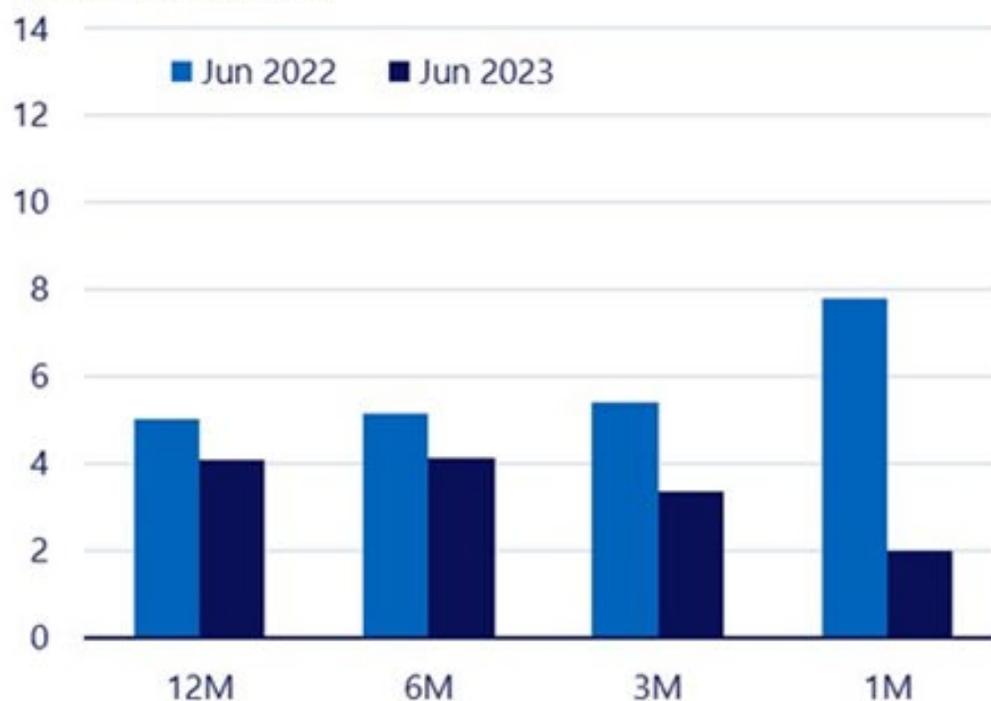
### A. Headline PCE

*Percent annualized*



### B. Core PCE

*Percent annualized*



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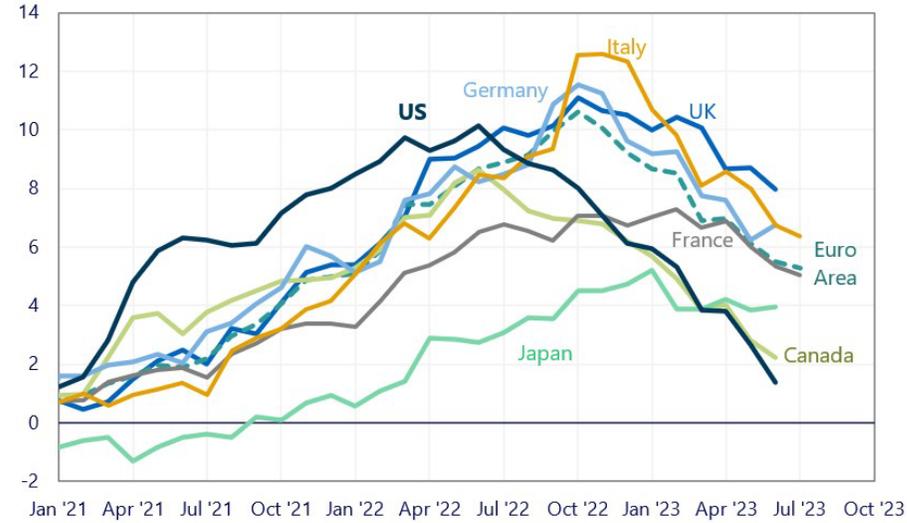
Source: Bureau of Economic Analysis; CEA calculations.

*As of July 28, 2023 at 8:30am.*

## Harmonized Headline HICP Inflation in the G7

All items, HICP basis

Year-on-year percent



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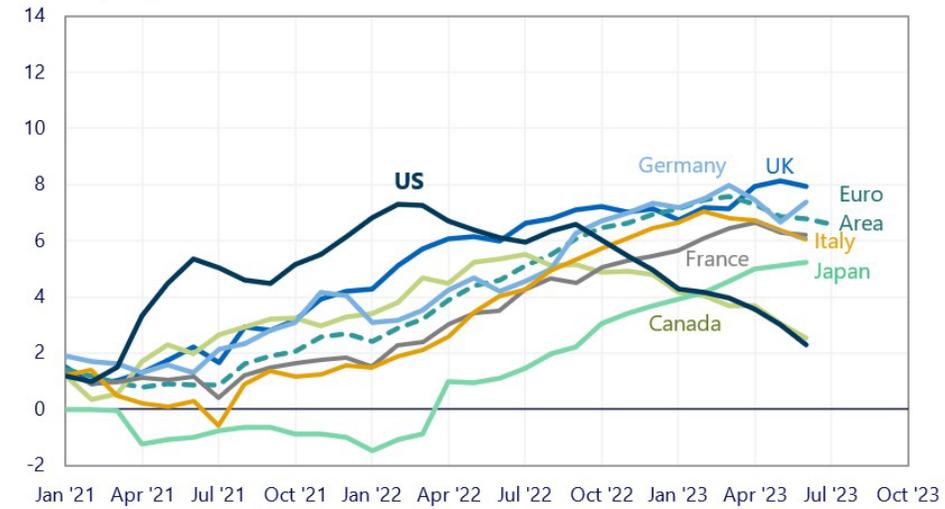
Sources: Eurostat, ONS, BLS, Statistics Canada, MEI, CEA analysis.

Note: Euro Area: HICP; UK: CPI; US: R -HICP-U; Canada: CPI ex Mortgage Interest, Replacement Cost, & Property Taxes ; Japan: CPI ex. Imputed Rent.

## Harmonized Core HICP Inflation in the G7

All items less energy and unprocessed food, HICP basis

Year-on-year percent



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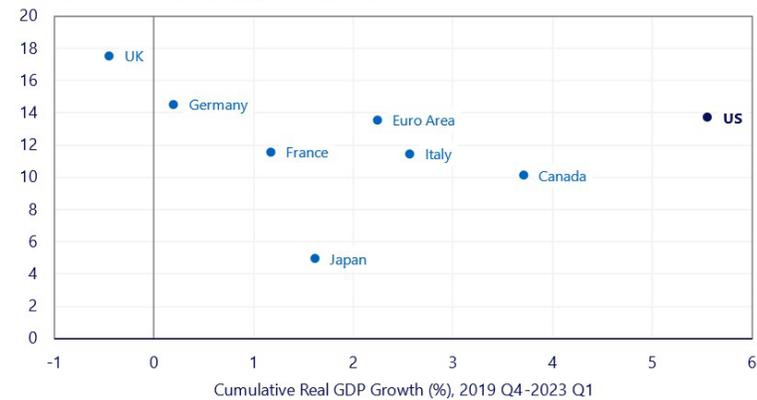
Sources: Eurostat, ONS, BLS, Statistics Canada, MEI, CEA analysis.

Note: Euro Area: Core HICP; UK: CPI ex. Energy & Unprocessed Food; US: Core R -HICP-U; Canada: CPI ex. Energy, Food Purchased at Stores, Mortgage Interest, Replacement Cost, & Property Taxes ; Japan: CPI ex. Fresh Food, Energy, & Imputed Rent.

## Real GDP Growth & Harmonized Core Inflation

2019 Q4/Jan 2020 to 2023 Q1/June 2023

Cumulative Core HICP Growth (%), Jan 2020-June 2023



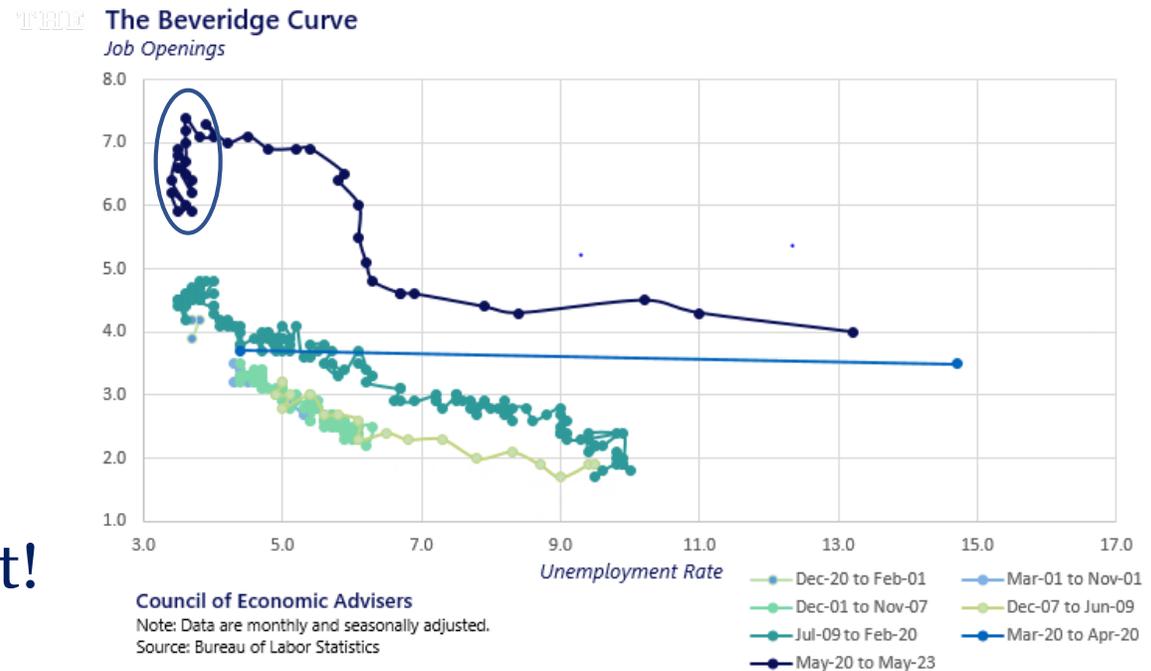
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Sources: Eurostat, ONS, BLS, BEA, Statistics Canada, MEI, CEA analysis.

Note: Euro Area: Core HICP; UK: CPI ex. Energy & Unprocessed Food; US: Core R -HICP-U; Canada: CPI ex. Energy, Food Purchased at Stores, Mortgage Interest, Replacement Cost, & Property Taxes; Japan: CPI ex. Fresh Food, Energy, & Imputed Rent. All inflation series seasonally -adjusted by CEA using X13 -ARIMA-SEATS.

# Analytic Pit Stop: How are we getting inflation reduction without demand destruction?

- Sacrifice ratio (slope of price Phillips Curve)
  - Historically, trade off has been costly in terms of activity
- What's different?
  - By definition, supply side must be in play
  - Reduced profit margins
  - Move back down to old, lower Beveridge Curve
- Pandemic economics are different!
- Transition not over; no victory laps
  - Full disinflation unlikely to be “immaculate”



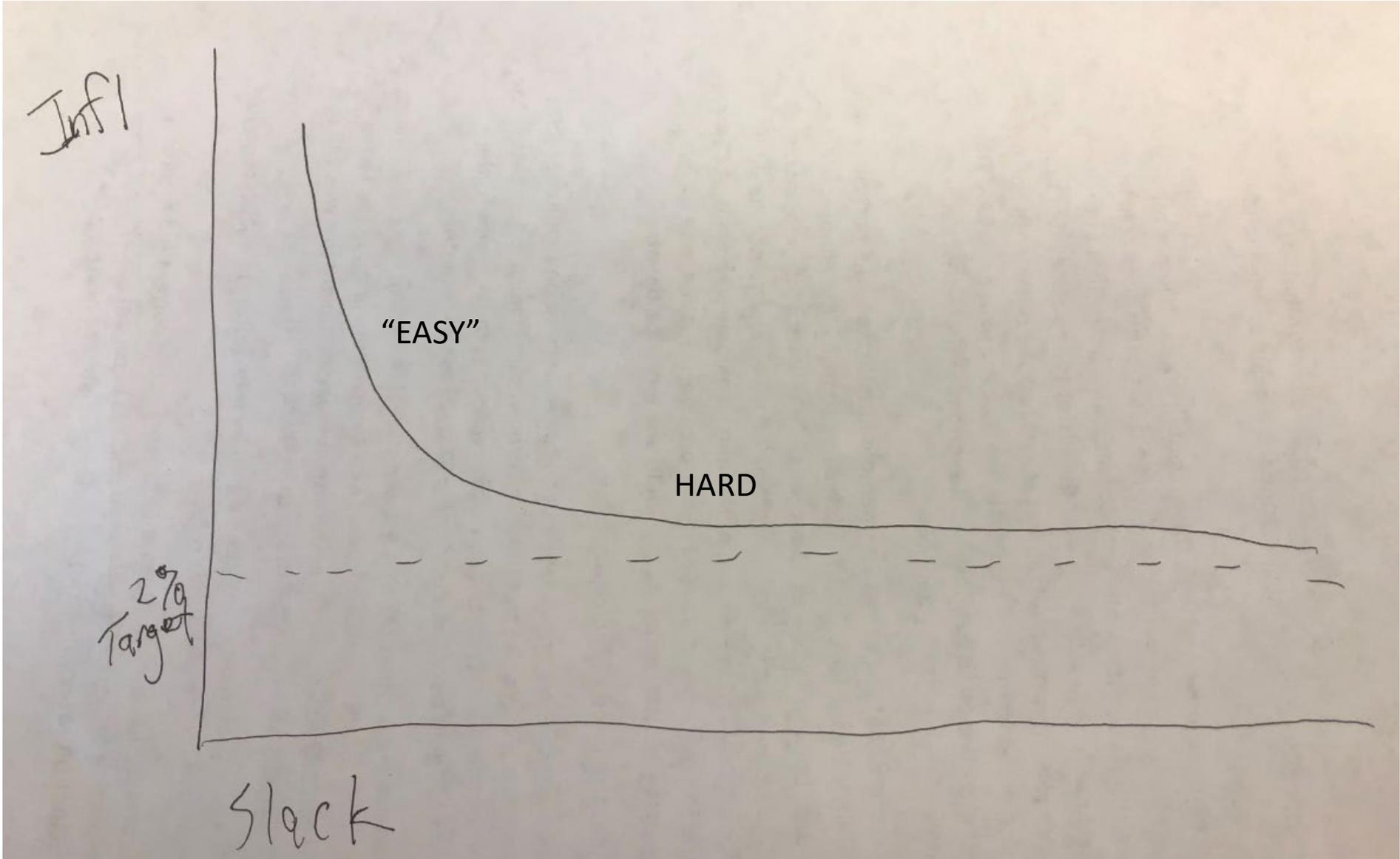
Inf1

"EASY"

HARD

2/3  
Target

Slack



# Opportunities and risks to longer-term forecast

## Opportunities

- Bidenomics investment agenda: Reversing decades of disinvestment in public goods.
  - Crowd in private investment
  - Standing up domestic production in key areas
- Care agenda
- Climate mitigation

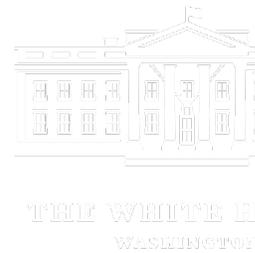


## Risks

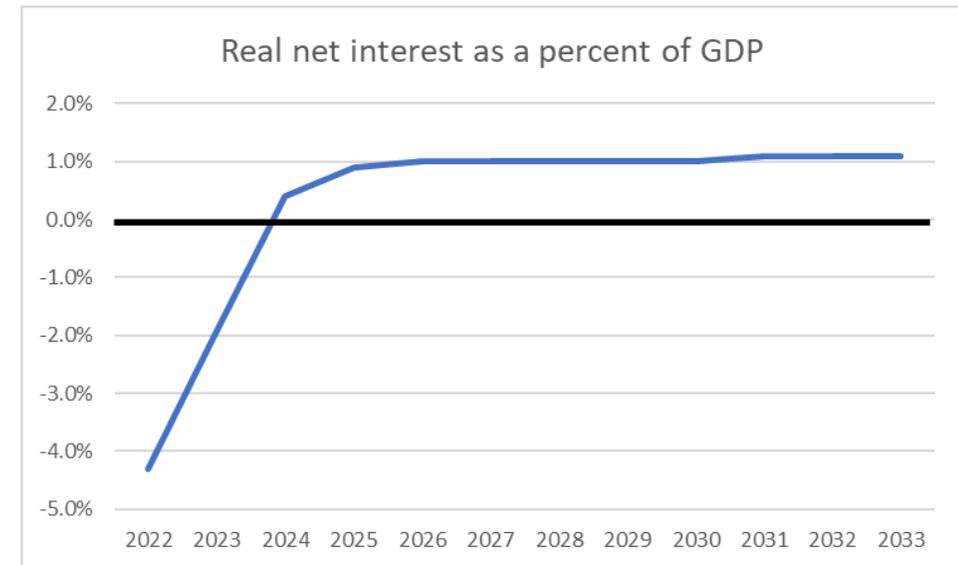
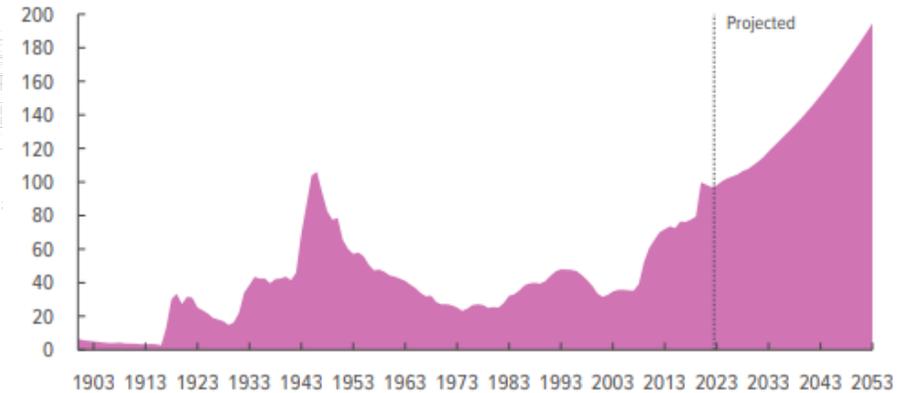
- Fiscal
- Finance

# Fiscal outlook: Medium-term RNI stable; longer-term, hit to revenues increasingly clear

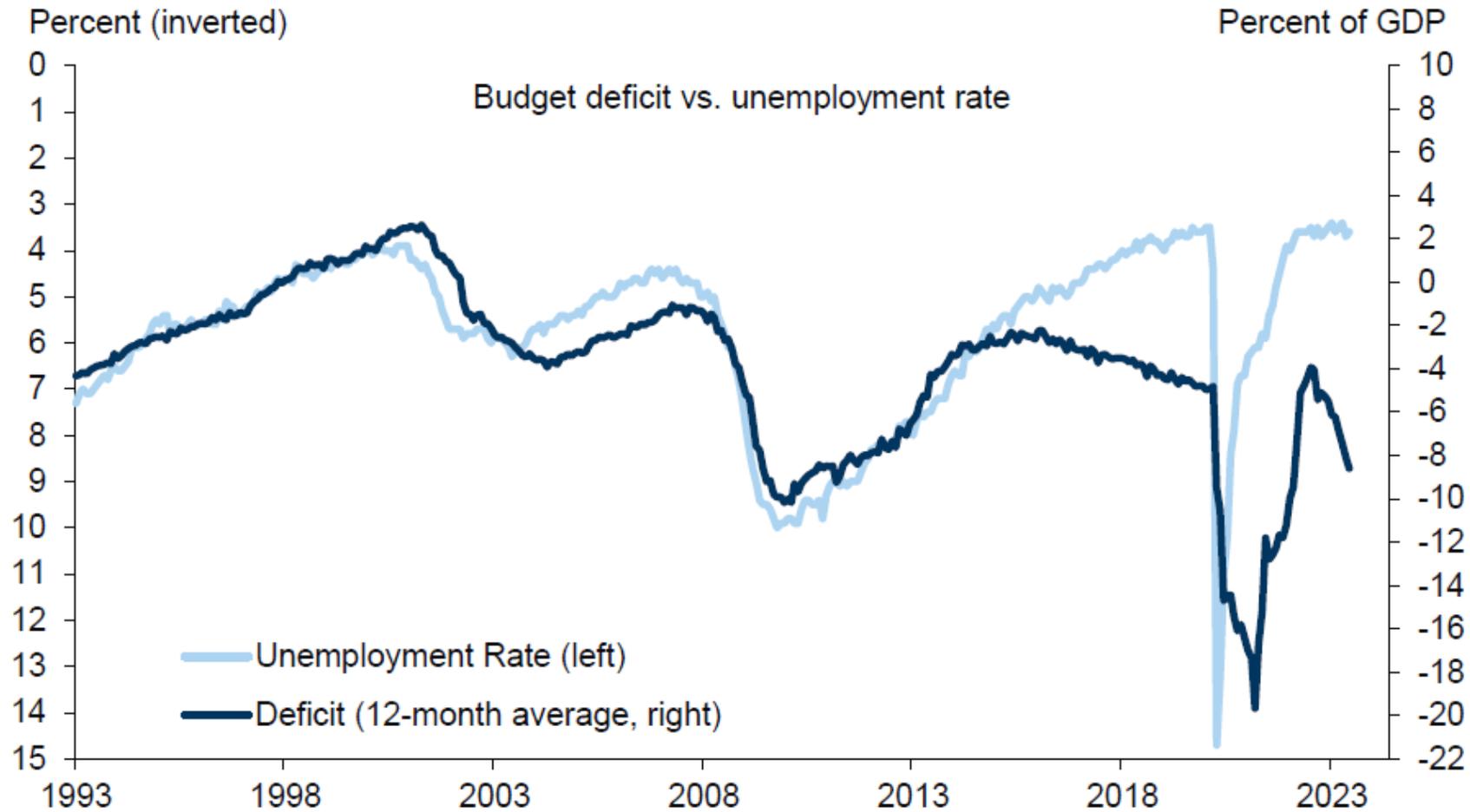
- CBO: Debt/GDP
- Our budget, with \$2.6 trillion in deficit reduction, shows real net interest/GDP stable over the window.
- The delinking of unemployment/deficit relationship: Revenue slippage



**Federal Debt Held by the Public, 1900 to 2053**  
Percentage of Gross Domestic Product



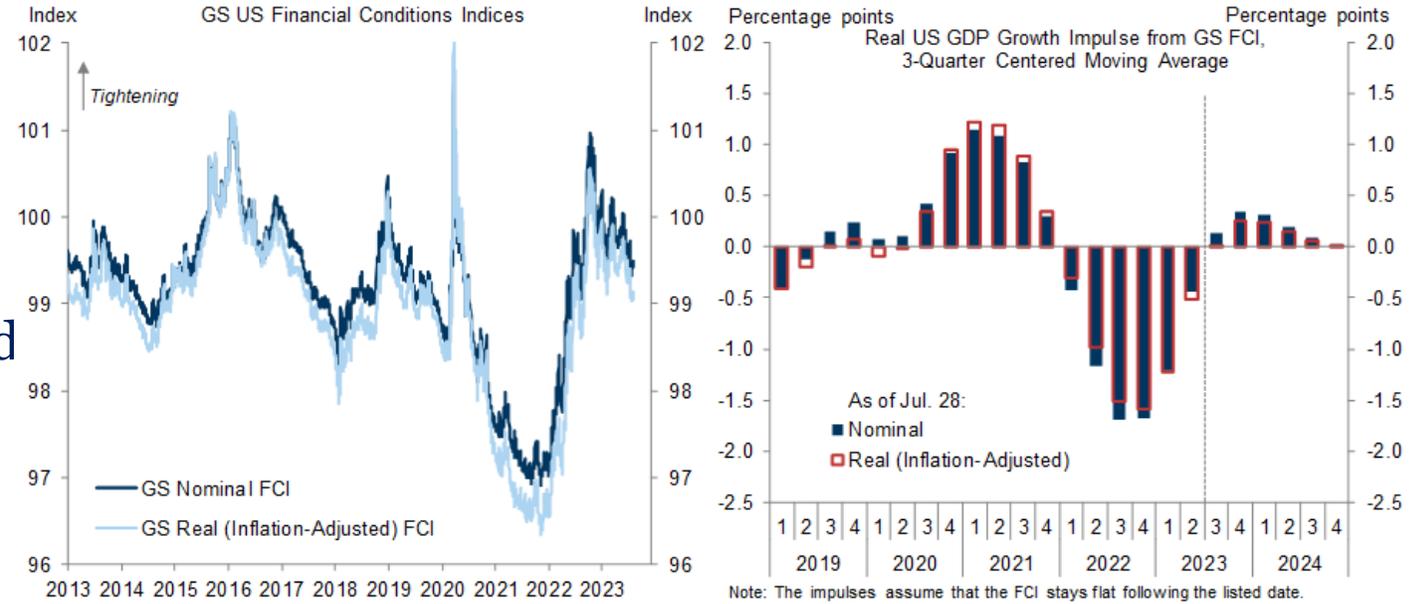
### Exhibit 1: A sharp deterioration in the budget deficit



Source: Treasury, Department of Commerce, Goldman Sachs Global Investment Research

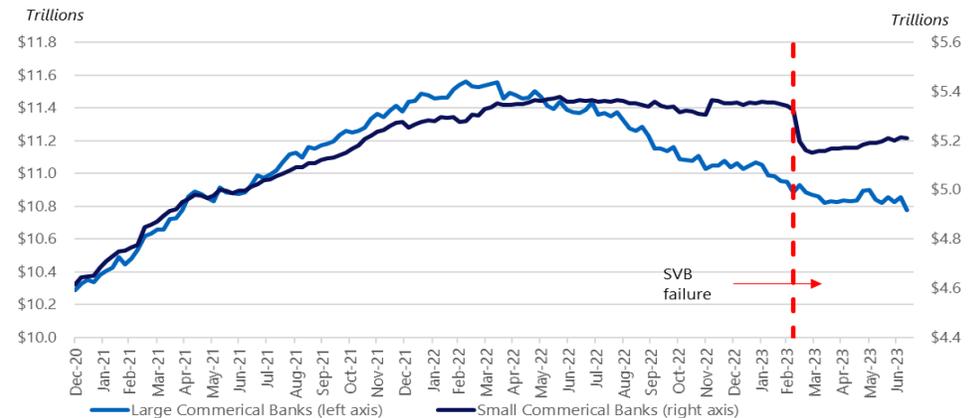
# Financial risks

- Financial conditions moving toward neutral (Goldman-Sachs index). →



- Deposit outflow has stabilized, banking system has remained resilient, but credit constrained as per Fed and deposit insurance awareness.

Deposits by bank size

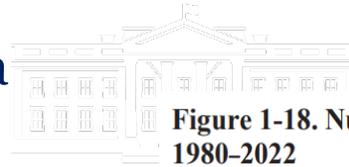


Source: Federal Reserve via Haver

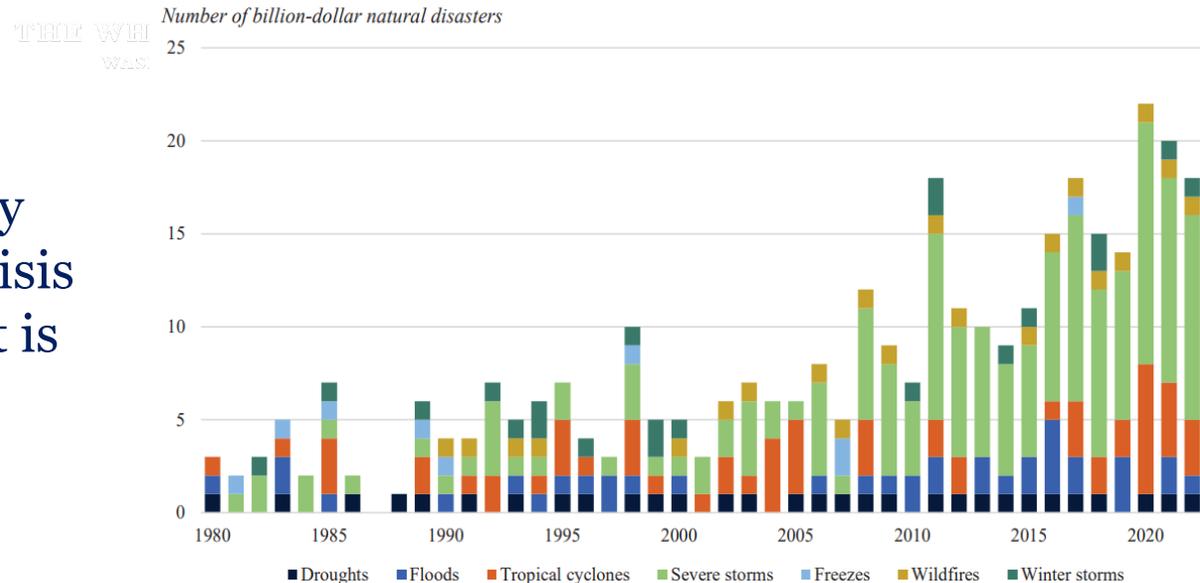


# Risk & Opportunity: Climate agenda

- Physical risks of climate change are a large drag on the U.S. economy
- Hottest summer on record
- POTUS speech: “Even those who deny that we're in the midst of a climate crisis can't deny the impact of extreme heat is having on Americans.”
  - Upgrading grid
  - Climate agenda: IRA tax credits



**Figure 1-18. Number of Billion-Dollar Natural Disasters in the United States, 1980-2022**



Source: NCEI 2022.

Note: Disaster costs are adjusted for inflation using the Consumer Price Index for All Urban Consumers.



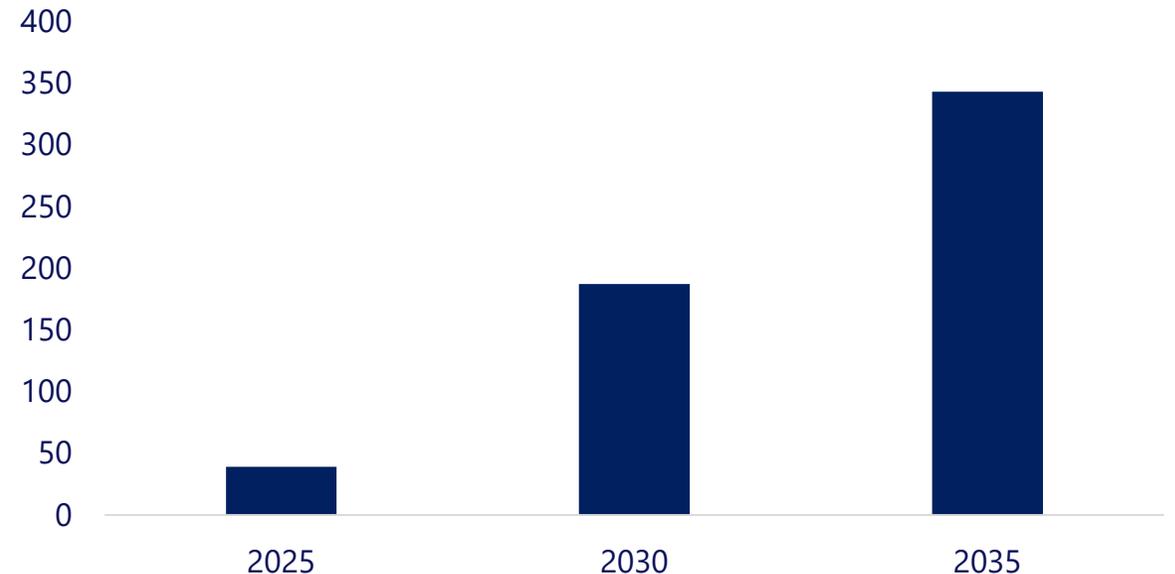
# Savings associated with climate transition

- Price points have largely converged
  - Unit costs of producing energy from fossil fuels have been flat for 20 years
  - Unit costs of producing renewables are decreasing with scale
  - The sooner we can transition, the better



Estimated annual savings on energy system operation and maintenance with a fast transition to net-zero, relative to current policies, by year

*billion 2022\$*



# Other opportunity agenda items



- Child and Elder Care
- Enhanced Child Tax Credit
- Boosting housing supply
- Fiscal consolidation through progressive revenue raisers:
  - Higher corporate rate
  - “Billionaire’s tax:” Withholding tax on future realizations
  - Fund the IRS (reduce the tax gap)





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