The U.S. economy in 2024: A tale of transition

2024 U.S. ECONOMIC OUTLOOK FROM WELLINGTON MANAGEMENT

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My base case for the US economy in 2024 is slower nominal growth and policy normalization. There are a variety of risks to watch for, including monetary policy taking a bite out of growth, a maturing business cycle leading to credit deterioration, and geopolitical turmoil driving heightened economic uncertainty. In this context, efforts by corporate America to cut costs and boost productivity could be important offsets. In the coming year, the Federal Reserve (Fed) will slowly reward an improving core inflation backdrop, and US elections will merit attention given the large prevailing fiscal deficits.

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1 Shifting trends in spending

In 2023, US consumers benefited from lower inflation, strong jobs growth, and termed-out debt on private-sector balance sheets — all of which helped to shield consumers from the impact of higher interest rates, for a time at least. But in 2024, I expect consumer spending to slow as the resumption of student debt payments, weaker jobs growth, rising energy bills, and fading fiscal support curb household disposable income growth.

Service areas such as travel, leisure, and entertainment all benefited this past year from the unleashing of pent-up consumer demand, but I think that catch-up spending has largely played out. I also expect government spending to slow, as some of the surplus funds that state and local governments received from the federal government during the pandemic have been used up.

On the other hand, investment spending, an area with room to grow, could see some gains if clarity on the economic outlook improves enough to motivate companies that have been holding back. The tight labor market, a long-term economic challenge that I wrote about recently, will incentivize companies to invest in automation technology and other tools that can help reduce labor costs. One notable area of focus is, of course, generative artificial intelligence (AI). While it is unclear how quickly companies will reap the benefits of the technology, the breadth of industries that could leverage AI brings hope for a more productive future in the medium term (my colleague writes about the potential productivity impact of AI here).

Investment spending should also benefit from an end to the destocking cycle that occupied many industries in the ailing goods economy after they found themselves working off post-pandemic excess inventories. In addition, US industrial policy, including provisions of the Inflation Reduction Act, the CHIPS Act, and the Infrastructure bill, have helped spark a dramatic increase in construction spending, including new plants for semiconductor production and for electric vehicle batteries and other manufacturing associated with the energy transition. While construction spending will slow meaningfully as this ramp-up fades, the output from these factories could boost investment spending.

2 Worries over the global economy and profit margins

Global developments in 2023 didn't make things any easier for the US economy. China's reopening failed to ignite global growth as the real estate sector dragged down domestic spending and the global destocking cycle in goods dampened prices. Sticky wage inflation kept the European Central Bank in tightening mode even as growth disappointed in parts of Europe. The war in Israel and Gaza impacted thousands of lives and brought the threat of a broader Middle East conflict. Energy prices rose sharply in recent months as the world grappled with tight supplies and two wars, clouding prospects for the global economy and prolonging the central bank fight against inflation.

Weaker economies overseas, where manufacturing plays a bigger role in the aggregate economy, held back US export growth. That said, we may be nearing the bottom of the global manufacturing slump, which should mean stronger US exports.

In the meantime, while tight labor markets are a feature across much of the developed world, a somewhat better balance between labor demand and supply has emerged in the US as immigrants have regained share in the US workforce, reducing upward pressure on wages. That, coupled with improving supply chain bottlenecks, means that companies have seen profit margins stabilize even as revenues have slowed, given that costs decelerate faster. However, given my expectation that nominal growth will slow further in 2024, companies will likely find the environment more challenging on the margin front. It is plausible that after robust gains in the job market, the coming year will see a rise in the unemployment rate. Companies that commit to cutting costs and gaining efficiency in their businesses should be relative winners.

3 A big year for policy and politics

Monetary policy is now restrictive and its impact has been felt in the slump in housing activity, in rising delinquencies in consumer credit, and in the tightening of bank lending standards, especially following the failure of Silicon Valley Bank. Fiscal policy will lose steam as some of the cost-of-living-adjustment payouts made to consumers in 2023 normalize in the next year. This means that in 2024, the Fed should get to a place where it can slowly reward progress on core inflation and work to aid growth and employment rather than being so singularly focused on its inflation target.

With 2024 being an election year in the US, all eyes will be on the economic agendas of the presidential candidates. This election takes on additional significance since former President Trump's tax cuts are set to expire by the end of 2025. Will the US show the willingness to conduct fiscal consolidation, especially if the economy is weakening? This question will be of utmost importance in financial markets as bond vigilantes focus on the prevailing large US fiscal deficits. US/China relations will also stay in the spotlight and be a key geopolitical risk for market participants to navigate.

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