NORTHERN TRUST

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U.S. ECONOMIC & INTEREST RATE OUTLOOK

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We came into the year with low expectations, forecasting modest growth and acknowledging legitimate risks of a recession. As we close this year's books, we look back on a better year than anyone anticipated. The domestic economy had its resiliency put to the test by high interest rates, persistent inflation, a contracting money supply, geopolitical tensions, strikes and bank failures. If we could weather all of this in 2023, we have confidence that we can handle the challenges the new year will bring.

Risks are ever-present. Inflation has trended downward, but unevenly; a resurgence is still possible. Hiring and manufacturing activity have slowed. The pressure of high interest rates will weigh on small businesses and home purchases. Next year's election will be a source of uncertainty and anxiety. However, cooler inflation, rising wages and the prospect of falling interest rates will help to keep the economy on track.

Our overall expectation for the economy is evident in the title of our Annual Outlook for 2024: Sticking the Soft Landing. We have seen how capable we are of overcoming economic adversity. The descent to the soft landing—lower inflation without a recession—may be turbulent at times, but the trajectory remains in place.

Key Economic Indicators

	2023				2024				Q4 to Q4 change			Annual change		
	23:1a	23:2a	23:3a	23:4f	24:1f	24:2f	24:3f	24:4f	2022a	2023f	2024f	2022a	2023f	2024f
Real Gross Domestic Product (% change, SAAR)	2.2	2.1	5.2	0.8	0.9	1.1	1.4	1.5	0.7	2.2	1.2	1.9	2.3	1.3
Consumer Price Index (% change, annualized)	3.8	2.7	3.6	3.2	2.8	2.5	2.3	2.2	7.1	3.3	2.4	8.0	4.2	2.8
Civilian Unemployment Rate (%, average)	3.5	3.6	3.7	3.9	4.0	4.2	4.1	4.0				3.6*	3.7*	4.1*
Federal Funds Rate	4.52	4.99	5.30	5.38	5.38	5.38	5.13	4.63				1.69*	5.05*	5.13*
2-yr. Treasury Note	4.34	4.26	4.92	4.85	4.80	4.70	4.50	3.90				2.98*	4.59*	4.48*
10-yr. Treasury Note	3.65	3.60	4.15	4.50	4.40	4.30	4.20	4.10				2.96*	3.97*	4.25*

a=actual
f=forecast
*=annual average

Influences on the Forecast

- Recent labor market readings continue to offer evidence of calming. In November, 199,000 jobs were added. The labor force grew, bringing the unemployment rate down two tenths to 3.7%, a welcome break from its upward trend for the prior three months. Wage gains over the trailing twelve months cooled to 4.0%.
- The Job Openings and Labor Turnover Survey (JOLTS) for October showed a surprising decline of 617,000 job openings, the lowest level in 2½ years. The current estimate of 8.7 million vacancies is still more than a million higher than the pre-

pandemic record, but is a welcome decline from the peak of over 12 million early last year. The ratio of openings to available workers fell to 1.3, close to the pre-pandemic level of 1.2 (which was considered tight at the time!). The JOLTS report also showed steady rates of hiring and quits, and no increase in layoffs, all of which are favorable signals.

- Recent inflation data shows prices remain firm but are marginally improving. The consumer price index (CPI) for November rose 3.1% on the past year, supported by low fuel prices. Core inflation (excluding food and energy) was little changed, holding at 4.0% year over year. Shelter inflation has stayed stubbornly elevated through this year. Meanwhile, the deflator on personal consumption expenditures was unchanged from September to October, driven by lower energy prices. On a core basis, the index fell to 3.5% at an annual rate, its lowest since the inflationary surge of spring 2021. This progress toward the Fed's 2% target adds to confidence that the rate hiking cycle is complete, but near-term cuts are unlikely.
- The estimate of real gross domestic product (GDP) for the third quarter was revised up to an annualized rate of 5.2%, with consumer spending gauged to be even stronger than the initial estimate. The current and upcoming quarters are certain to post slower growth, but economic momentum remains intact.
- Market tensions have played out most clearly in fixed income markets. Worries of instability and tight policy added to term premia and pushed the 10-year U.S. Treasury yield to nearly 5% in October. As the case for a soft landing became clearer in subsequent weeks, bonds rallied and yields corrected by 80 basis points. The relative calm of other risk assets has been surprising amid so many reasons for worry. In the year ahead, we hope to see yields chart a steadier path, with the risk that volatility could spread to other asset classes.
- Through September, house price indices continued their remarkable year-to-date increase. As of September, the measure compiled by the Federal Housing Finance Agency showed a 6.1% annual gain. The housing market is critically undersupplied, and homes are still finding qualified buyers despite high prices and financing costs. Inventories of vacant homes for rent or for sale are holding at multi-decade lows.
- The U.S. House of Representatives passed another continuing resolution to extend the fiscal year 2023 federal budget, with appropriation expiries staggered across mid-January and early February. Shutdown risk still looms in the near future. Without a 2024 budget in place by the end of April, the nation will face an automatic 1% sequester of funding to all federal agencies.

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