We expect a material slowdown in the US economy in the next couple of quarters to give way to a modest acceleration in GDP growth in the second half of 2024. In effect, the Fed will pull off a “soft-ish” landing. Inflation will continue to fall but at a much more gradual pace than in 2023 driven by a gradual loosening of labor market conditions. This will prompt the Fed to start easing policy toward the end of the year, but rates will be higher for longer than current market pricing. Beyond these headlines, three themes will be key to shaping the economy in 2024.

- **The Fed will get lots of attention, but fiscal policy will be a key driver of the outlook.** We expect the Fed to remain on hold for most of the year but the communication on policy moves is likely to oscillate as it attempts to manage financial conditions. In the background, and largely ignored by the consensus, tight fiscal policy will be a key force slowing economic momentum.

- **Tight credit and political uncertainty will ensure another year of limbo.** The impact of past monetary tightening will keep credit markets frozen and real estate transactions low, preventing price discovery in housing and commercial property markets. Domestic and international political uncertainty will impede activity by increasing the option value to delaying hiring and investment.

- **The economy will remain highly desynchronized.** Just like 2023, we expect a highly differentiated sector outlook. The services sector should slow in line with weaker consumer spending, while the industrial side of the economy is set for a modest rebound.

The US economy surpassed our expectations and those of the consensus by quite a margin in 2023, driven by the consumer’s remarkable resilience in the face of higher interest rates. Real GDP growth is on track to hit 2.4% in 2023 while CPI inflation looks set to end the year around 3.5%. Underlying this remarkable performance is a cautionary tale of macroeconomic policy’s effectiveness and its lagging impacts. This year the impact of monetary policy was dulled by the prevalence of fixed-rate debt in the economy and consumers’ excess savings. At the same time, fiscal policy provided an unexpected boost to the economy.

Chart 1: Overall macroeconomic policy stance is set to tighten in 2024

<table>
<thead>
<tr>
<th>Year</th>
<th>Monetary policy impact</th>
<th>Fiscal policy impact</th>
<th>Overall impact of policy on growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.8%</td>
</tr>
<tr>
<td>1995</td>
<td>1.0%</td>
<td>0.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>2000</td>
<td>2.0%</td>
<td>1.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>2005</td>
<td>3.0%</td>
<td>1.5%</td>
<td>4.5%</td>
</tr>
<tr>
<td>2010</td>
<td>4.0%</td>
<td>2.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>2015</td>
<td>5.0%</td>
<td>2.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>2020</td>
<td>6.0%</td>
<td>3.0%</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

*Source: Oxford Economics/Haver Analytics*
Undeterred by our forecast errors in 2023, we remain pessimistic about the overall outlook for the economy. In our view, those errors were timing-based, not channels-based. In contrast to 2023, we think the impact of excess savings run down is set to diminish, while the impact of tighter monetary policy and tight fiscal policy will be felt (Chart 1). We expect a year of below-potential growth next year at 1% while inflation will fall back further but at a much-reduced pace.

Beyond that broad picture, we think three themes will characterise 2024.

Theme 1: Tight macro policy will weigh on growth

Monetary policy might take longer to work, but it still does work. We think the Fed has finished its rate hiking cycle, but it will be in no rush to cut rates as inflation remains above target. With fading energy price impacts less of a factor in 2024, inflation’s fall back to the Fed’s target will be governed by a loosening labor market. This lags the economic cycle and so our forecast points to a slowdown in growth in H1 and then a further moderation in hiring and wage growth in H2 before the Fed feels comfortable enough to ease rates.

The impact of restrictive policy (Chart 2) on the economy is starting to be felt. Credit quality among households is starting to deteriorate, investment and hiring plans have softened significantly and bank lending standards continue to tighten. As we progress into 2024, the impact of cumulative rate hikes is set to grow as more fixed-rate debt in the household and corporate sectors re-sets to higher levels.

Chart 2: Policy rates are set to remain restrictive throughout 2024

One symptom of the need to keep policy – and broader financial conditions – restrictive is that Fed communication is likely to bounce between hawkish and dovish rhetoric. Broad financial conditions – movements in asset prices and the yield curve – play a key role in the transmission of monetary policy into growth and inflation outcomes. Consequently, the Fed will want to manage financial market conditions, specifically the yield curve. Over the past 18 months, this has mainly been done by raising policy rates, but since the Fed intends to keep its policy unchanged, we think words are likely to be the preferred tool to influence the markets.

As we progress through 2024, markets’ anticipation of the start of the easing cycle will intensify, lowering yields and amounting to an effective easing of policy. This scenario would force the Fed to adopt a more hawkish rhetoric to dampen short-run rate cut expectations and the easing financial conditions until it is ready to cut. Conversely, should markets start to price in higher inflation outcomes, the Fed will be quick to downplay the prospect of more hikes and manage yields down. The result is likely to be volatility in longer term interest rates and oscillating Fed communication at least in the first half of 2024. In that environment, the dollar will likely remain strong until the Fed starts the easing cycle in earnest.

Fiscal policy is set to tighten. Aside from the drawdown in US excess savings – something that has not been repeated in other major economies – a key surprise this year was the loosening of fiscal policy.
Relative to our expectations at the start of the calendar year the budget deficit is wider by more than 2% of GDP despite a stronger economic outlook.

In sharp contrast to the last fiscal year when policy contributed between 0.4ppts-0.7ppts to growth, policy has started to tighten. Our baseline assumes it will subtract between 0.1ppt and 0.3ppts from growth this fiscal year. But like FY 2023, there are risks to this outlook with policy capable of changing quickly.

Fiscal policy usually **loosens in an election year**, but if anything, the risks point to more fiscal tightening than in our baseline for next year. There is a real possibility that the Fiscal Responsibility Act will be triggered at the start of 2024, meaning across-the-board discretionary spending cuts of 1% in Q2.

So, while monetary policy has continued to grab the attention this year and will likely do so again next year, we think that fiscal policy, operating somewhat under the radar, may go a long way to determining the economy’s performance in 2024.

**Theme 2: An economy hamstrung by frozen markets and uncertainty**

**While the impacts of tighter monetary policy on overall output may be small so far, the impact on other areas of the economy such as housing transactions are easy to spot.** Since the start of the hiking cycle housing transactions have been on a continuous downward trend, as sellers remain locked into attractive existing mortgage deals and buyers are deterred by poor affordability. It is a similar story in commercial property markets with transactions falling back to near pandemic lows (**Chart 3**).

**Chart 3: Property transactions are close to pandemic levels**

![Chart showing property transactions close to pandemic levels](source: Oxford Economics/Haver Analytics/MSCI/RCA)

While the direct impact on the broader economy of such low levels of transactions is small, it helps to explain why asset prices have held up and the pass through of monetary policy via wealth effects has been subdued so far.

**This low transaction equilibrium is set to continue into the year ahead.** Without a shock to create forced sellers in the market, breaking the deadlock and forcing some price discovery, the economy is likely to stagnate rather than contract. This will prevent losses from crystallising and ensure a low but steady level of credit is available to the real economy.

**Heightened political uncertainty argues for a stagnating economy in the year ahead.** While the geopolitical environment has rarely looked so volatile, domestic politics will add to the fog surrounding the economy as we head toward next year’s presidential election. Measures of policy uncertainty tend to be elevated in election years and our previous research suggests that business investment and hiring would suffer as a result. Higher levels of uncertainty raise the option value of deferring hiring and investment.

Incorporating policy uncertainty into our models for business investment and private payrolls illustrates that a one standard deviation rise in **policy uncertainty** – as measured by news reports, temporary tax
measures, and forecast dispersion – equates to around a 0.4% hit to business investment and a 0.5% hit to private payrolls. This is not huge but certainly an unhelpful obstacle for the economy to overcome.

**Chart 4: Rising levels of policy uncertainty tend to dampen investment and hiring**

US: impact of higher policy uncertainty

![Impact of 1 standard deviation rise in policy uncertainty index](image)

Source: Oxford Economics/Haver Analytics/policyuncertainty.com

The outlook for fiscal policy beyond the election is particularly uncertain. Unlike most countries, the US has no long-term fiscal rules to ensure fiscal sustainability. Instead, investors must rely on an increasingly chaotic political process to ensure that the deficit and debt remain at appropriate levels. With almost all the provisions from the 2017 Tax Cuts and Jobs Act, known as the Trump tax cuts, set to expire at the end of 2025, whoever controls the legislative agenda at that point will have an enormous influence over US tax policy.

The stakes are high for fiscal policy in this election. Hence we may well see more volatility in longer-term US yields as the election approaches.

**Theme 3: A desynchronized economy**

Since the pandemic the broad economic cycle has been a collection of different sectoral stories, which will continue next year. The services sector roared back from the pandemic in recent years as household spending on a range of recreational services recovered, driven by the drawdown in excess savings. However, as supply disruption fades and goods price disinflation sets in, 2024 is likely to be the year that industry stages a modest comeback as the economy starts to rebalance (Chart 5).

**Chart 5: Services peaked as a share of the economy this year; industry set to make a comeback**

![GVA services (LHS) GVA industry (RHS)](image)

Source: Oxford Economics/Haver Analytics
Even within industry, it is likely to be a highly differentiated picture with some sectors benefiting from targeted support to help offset the macroeconomic forces. Pent-up demand in the auto sector, as well as lean inventories unlike in the other sectors, will help to maintain a robust short-term outlook but beyond that organic demand, it will need to pick up to maintain healthy growth rates. Power generation equipment should experience a boost from investment flows related to the Inflation Reduction Act and electronics will also make an important contribution as targeted policy support helps it defy the wider economic forces. so we expect these two sectors to drive gains in overall industrial production. In contrast, we expect only a modest rebound in construction activity as well as other capital goods – housing and energy related goods – as the impact of higher financing costs bites in these sectors, condemning them to lag behind the broader economy.

We expect the services sector to slow. We anticipate consumer spending growth on arts, recreation, and accommodation services will decelerate next year as the share of households spending split between goods and services continues to rebalance. Although, technology-producing sectors such as software, internet, data and cloud computing are set to outperform the broader economy, as they benefit from ringfenced budgets devoted to AI and cybersecurity.

Taken together this means the economic cycle will continue to be difficult to read in 2024. Different sectors will transition through various phases of the economic cycle and, as such, aggregate metrics like GDP growth will suffer from the “flaw of averages” – failing to accurately represent the realities of a given sector or subnational location. As a result, next year is likely to feel a\'aqlike a grinding, slow recovery.