MONTHLY
Economic Review

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The data for this report is released on a rolling schedule. The presented numbers are current as of publication and are subject to revision.

SYNOPSIS | **2023 closed the year with surprisingly strong growth**

Recent performance shows that the U.S. economy has been more resilient than expected. Adjusted for inflation, gross domestic product rose at a 3.3% annual rate in the fourth quarter of 2023 as almost every major component of this key gauge of activity expanded. The increase reflected gains in consumer spending, nonresidential fixed investment, exports, and federal, state and local government spending, although these were partly offset by decreases in residential fixed investment, inventory investment and imports. For all of 2023, GDP was up 2.5%, an acceleration from the 1.9% growth recorded in 2022. The economy stayed on a strong footing as private final sales to private domestic purchasers – a key measurement that excludes inventories, government spending and trade to focus on underlying demand by consumers and businesses – increased by 2.6% for the fourth quarter after climbing 3% in the third quarter.

December's personal income and spending reports were encouraging, reflecting lower inflation and showing no sign of a recession. Disposable personal income was up 6.9% from a year earlier and included a 6.5% increase in private wages and salaries. Households spent at a solid pace, with overall consumer spending up 5.9% year over year. Retail sales as defined by NRF – excluding automobile dealers, gasoline stations and restaurants to focus on core retail – rose 3.3% year over year. Combined November-December holiday sales grew 3.8% over 2022, easily meeting NRF's forecast for growth between 3% and 4%. December data also revealed that inflation has fallen meaningfully, with year-over-year growth in the Personal Consumption Expenditures Price Index at 2.6%, down from 5.5% at the beginning of the year. Core PCE, which excludes volatile food and energy prices, was at 2.9% in December, and both overall and core PCE were at their lowest levels since the start of the inflation surge in March 2021. January sales numbers aren't in yet, but consumer sentiment for the month was at its highest level in nearly three years as shoppers appeared to be more upbeat about the economy, income and employment.

Part of the recent pace of economic growth and lower inflation may be explained by the sharp acceleration in productivity. Nonfarm productivity, which measures hourly output per worker, increased at a 5.2% annual rate for the third quarter, its fastest growth in three years, according to the Bureau of Labor Statistics. Increasing productivity is a key factor in economic growth, especially during periods of tight labor markets, inflation and high interest rates. It helps mitigate inflation fueled by supply issues in particular since producing more goods and services in a shorter time reduces unit costs and raises supply.

In September, BLS introduced experimental measurements of retail output and labor productivity so as to provide a fuller understanding the retail industry given significant changes in recent years in how goods and services are delivered. As the industry's landscape has evolved, many retailers have developed their own e-commerce platforms, fulfillment centers, and distribution networks. These changes have accelerated due to the COVID-19 pandemic and have impacted not only retail but also associated industries such as wholesale, transportation and warehousing. NRF has been a strong advocate for the BLS effort as we seek better retail data from government agencies that captures aspects of the industry's transformation that are not reflected in current statistics.

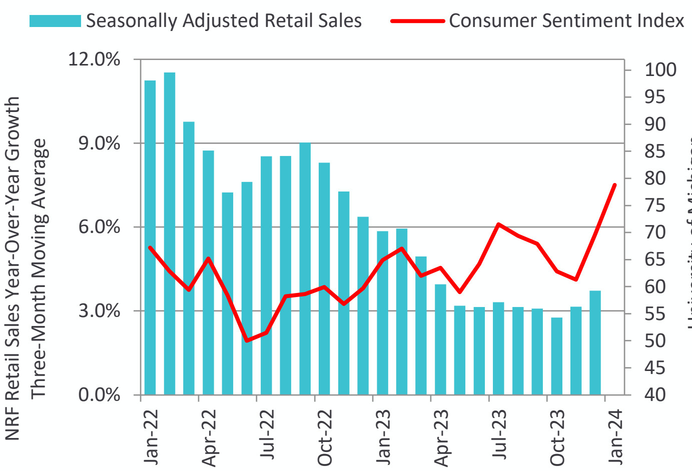
BLS economists discussed the importance of productivity during a recent National Association for Business Economics webinar and explored alternative output concepts in the measurement of retail labor productivity. Ananth Raman, a Harvard Business School professor who participated in the webinar, has been involved with unpacking the experimental BLS measures. He said the recent changes in the industry "are consequential to retail economics and the economy overall" and that "it is important to examine past trends in part to project how these metrics might evolve in the future." His analysis shows retail productivity has outperformed nonfarm labor productivity as a whole and has exceeded manufacturing labor productivity in particular. However, labor productivity has been uneven across different types of retailers. For example, clothing stores have increased sales per hour of labor dramatically while grocery retailers have experienced very small increases despite supermarkets being at the forefront of adopting new technology. Raman has also examined the use of gross profit margin per hour of labor as a productivity measurement along with how labor productivity relates to wages per hour.

While productivity growth offers positive news regarding economic growth and the goal of reducing inflation, there is not enough evidence to be sure it will continue. Federal Reserve Board Governor Christopher J. Waller recently noted that productivity growth over the last two quarters has averaged over 4%, which is "more than double the long-term rate." But he warned that the data can be very noisy – productivity has increased an annual rate of 1.4% over the 15 quarters since the advent of the pandemic, but that's about the same as the 1.5% average over the past 15 years. "So, relying on the productivity growth story to guide the current stance of monetary policy appears to be premature," he said.

Federal Reserve officials have tough policy choices ahead as they decide on what to do and when. There is still a risk that keeping rates too high could curb the economy's momentum more than necessary. Yet if they lower rates too soon, it could allow the economy to re-inflate and make it harder to contain inflation pressures. I remain of the view that consumer spending will continue to grow, but at a rate slightly below overall GDP growth. Consumers were in decent shape heading into the holiday season, but the labor markets, while unlikely to unravel, do look likely to cool, which would impact consumer expectations and, in turn, affect spending decisions. Moreover, the Fed has said consistent and cumulative evidence of inflation easing is necessary before rate cuts will be considered. Weaker job and wage growth would provide part of that evidence and support shifting toward rate cuts to support the economy. On the other hand, if hiring slows too much it could challenge the economy and strain many households further given how long they have been dealing with high inflation. Striking the right balance remains the challenge.

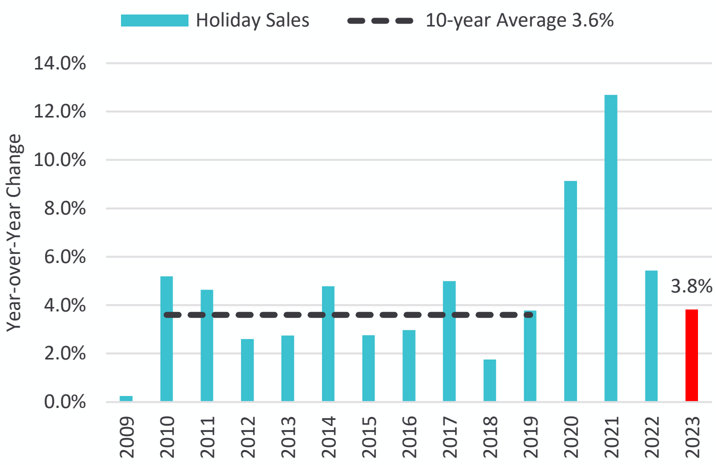
SALES AND SENTIMENT

December retail spending clearly ended the year on an upswing, contributing to a healthy holiday shopping season. In January, consumer sentiment climbed to its highest level since mid-2021.



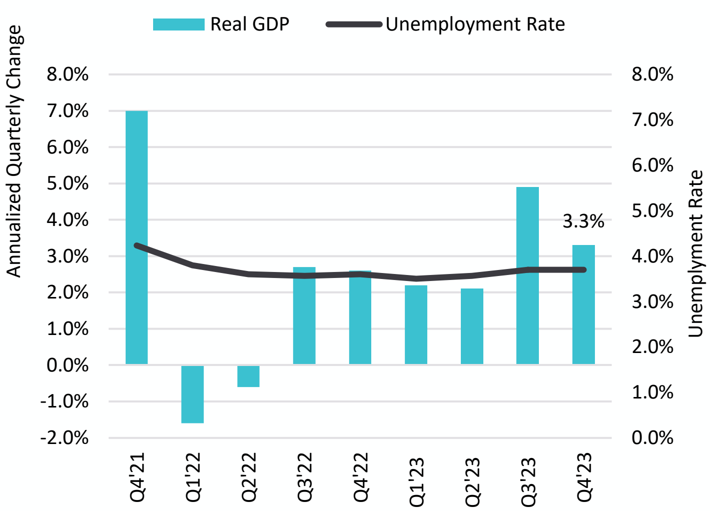
NRF HOLIDAY FORECAST

Holiday sales during 2023 grew 3.8% over 2022, meeting the NRF forecast of between 3% and 4%. A healthy labor market and rising wages helped support holiday shopping.



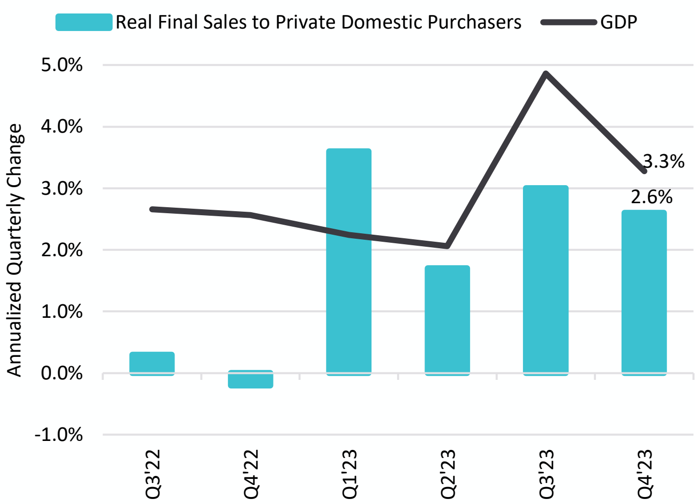
GDP & UNEMPLOYMENT

2023 ended with stronger-than-expected GDP growth, and personal consumption accounted for most of the growth. The unemployment rate was essentially unchanged at 3.7%.



GDP & PRIVATE SALES TO DOMESTIC PURCHASERS

Growth in inflation-adjusted private sales to private domestic purchasers was at 2.6% in the fourth quarter, down from 3% in the prior quarter.



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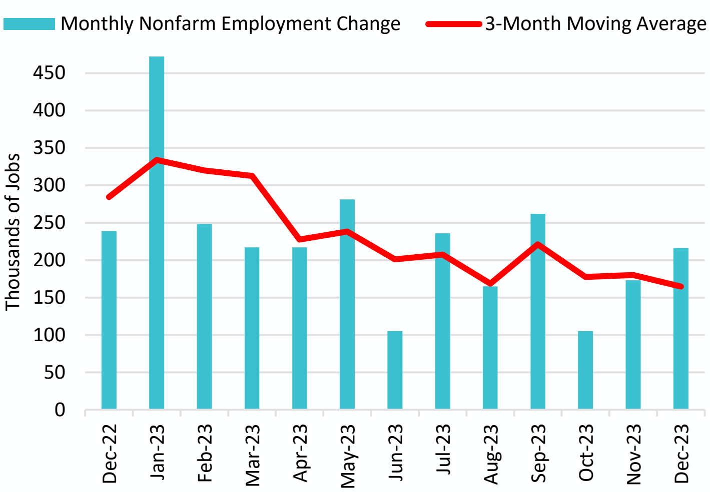
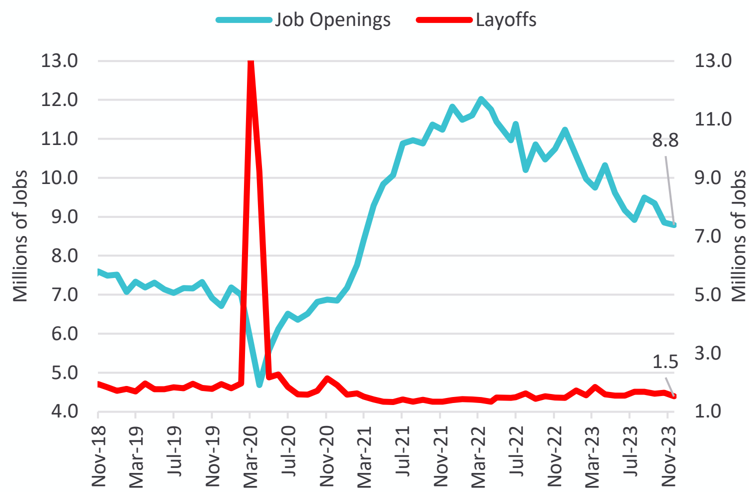
NON-FARM PAYROLLS

Nonfarm payroll employment expanded by 216,000 jobs in December, above expectations. October and November were revised down to 105,000 and 173,000 jobs respectively, a combined reduction of 71,000.



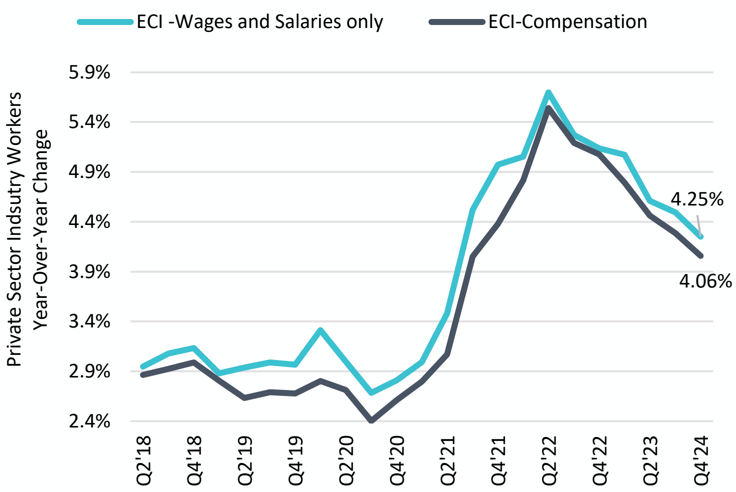
INFLATION

The path of inflation is making headway. The Personal Consumption Expenditure Price index was up 2.6% year-over-year in December, the smallest increase since March 2021.



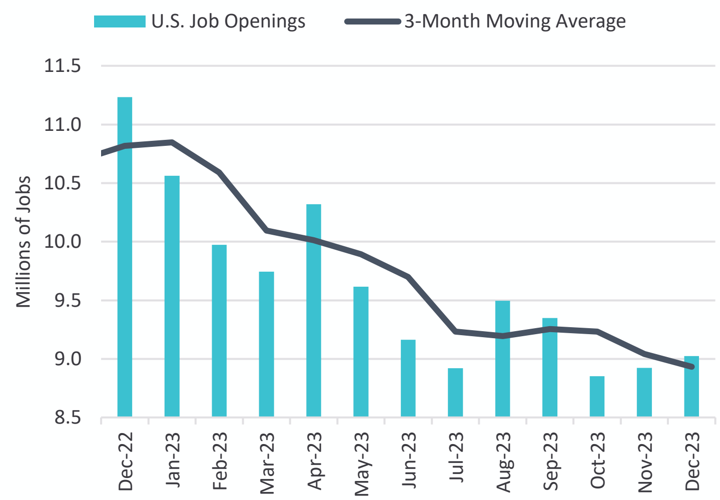
EMPLOYMENT COST INDEX

Wage and compensation growth as measured by Employment Cost Index is slowing, helping to gradually reduce cost pressures and relieving pressure on the Fed to maintain high interest rates.



JOB OPENINGS

Job openings have moderated in fits and starts but still show a strong job market. In December, the number of openings rose to the highest level since September and 29% above their pre-pandemic level.



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