

OCTOBER 2023

ECONOMIC OUTLOOK

The U.S. economy is approaching a tipping point.

By most accounts, the U.S. economy is doing great right now. The unemployment rate is 3.8%, near record lows and the prime-age employment rate is near record highs at 81%. Inflation is high, but it is coming down and wage growth is outpacing inflation meaning workers are seeing an increase in purchasing power. Real U.S. GDP was 4.9% in Q3. Excluding the post-COVID 2020/2021 period, there have only been six quarters out of the last 70 quarters that have recorded growth that high.

While the economy has been rolling along, the Federal Reserve has been raising interest rates along with other Central Banks around the globe. The Fed has moved the short rate by over five percentage points in the 18 months in an effort to tame historically high inflation. These interest rate hikes come after an extended period of historically low interest rates, but thus far higher interest rates have had a minimal impact on both businesses and consumers. Consumers have welcomed slower inflation, but have not yet had to fully grapple with the implications of higher interest rates.

The strength of the labor market, combined with excess savings left over from pandemic-related stimulus measures, has supported consumer spending even in the face of higher prices. Moreover, the tight labor market has allowed workers to negotiate and win higher compensation across numerous industries. UPS ratified a new five-year contract in August that raises pay and improves benefits. Existing part-time workers receive a 48% average total wage increase. Pilots at several airlines negotiated higher wages. American Airlines pilots saw an immediate pay raise of more than 21%, Delta will provide a 34% cumulative pay increase and a lump-sum one-time payment to its pilots, and United pilots will get a cumulative 34.5%-40.2% pay hike over the next four years. Manufacturers have also been impacted. Most recently, the United Auto Workers negotiated higher pay with auto manufacturers after labor strikes across several plants.

SHAWN DUBRAVAC, PHD
CHIEF ECONOMIST
shawndubravac@ipc.org

It can take some time for interest rate policy to fully manifest in the macroeconomy. This is especially true for consumers. Elevated interest rates lead consumers to perceive it as a bad time to make major purchases like houses, vehicles, and durable goods, as they weigh the increased costs of borrowing against their financial goals and budgetary considerations. At the same time, stimulus-induced excess savings have been depleted and consumers are transitioning into a period with less discretionary spending capacity. While the job market will remain relatively tight, slower economic growth will weaken hiring intent and reduce the upward pressure we have been seeing on wages.

A recession is not a foregone conclusion, but the probability that the U.S. will enter a recession sometime in the next 12 months remains high. The NY Fed estimates the probability of a recession sometime over the next year is 56%. This is down from recent readings, but still quite high. Regardless, the U.S. is entering a period of slower growth.

In Europe, the European Central Bank kept interest rates steady for the first time in 15 months, as growing evidence points to a worsening economic downturn in Europe. The war in Ukraine and the Israel-Hamas conflict could further erode confidence and increase uncertainty among businesses and households.

Energy prices have become less predictable due to rising geopolitical tensions and a further escalation of conflict could drive oil prices higher which will dampen Europe's economy further.

Economic growth in Europe remains delicately positive, but that is not the case everywhere in Europe. Both Estonia's and Hungary's economies have been contracting for more than a year now. Europe's largest economy, Germany, continues to narrowly dance around a recession. Germany's economy contracted again in the third quarter, making it the third time in four quarters that the economy has recorded a decline.

The sluggish state of the German economy is aiding in the swift alleviation of price pressures, following last year's most substantial cost of living surge in a generation. Germany's inflation rate dropped to 3% the lowest rate of increase since June 2021. But despite the decline in inflation and relatively strong wage growth, consumer confidence remains subdued and personal consumption is likely to remain weak.

The coming months will provide a clearer picture of the direction in which Europe's economy is heading and whether these economic challenges persist or evolve in 2024. Likewise, while growth is strong in the U.S., maintaining the current momentum will be very difficult in the year ahead.

3.0%

German's inflation fell to 3%, a 28-month low.

4.7%

The manufacturing sector reported 0.5% growth in July, the first rise in 3 months.

2.2%

The U.S. economy is now expected to grow 2.2% in 2023, up from a 0.5% forecast in January 2023.

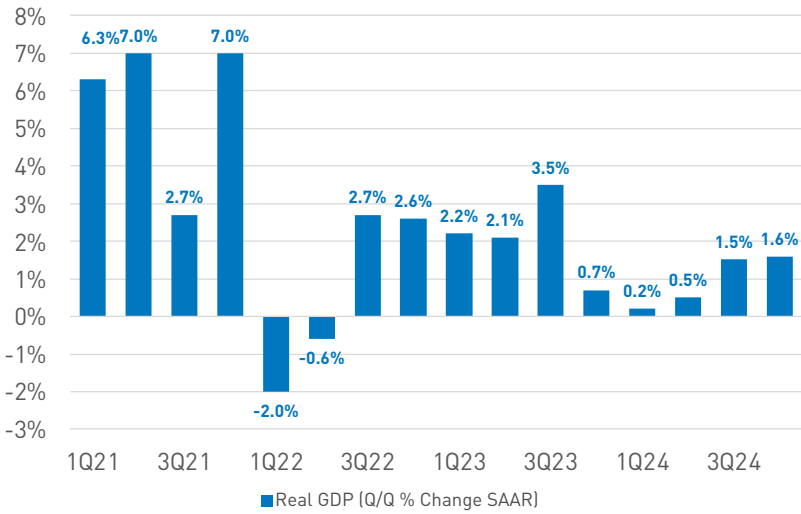
0.7%

Consumer spending was strong in September. Spending is up 5.9% over the last year.

U.S. OUTLOOK

ECONOMIC GROWTH

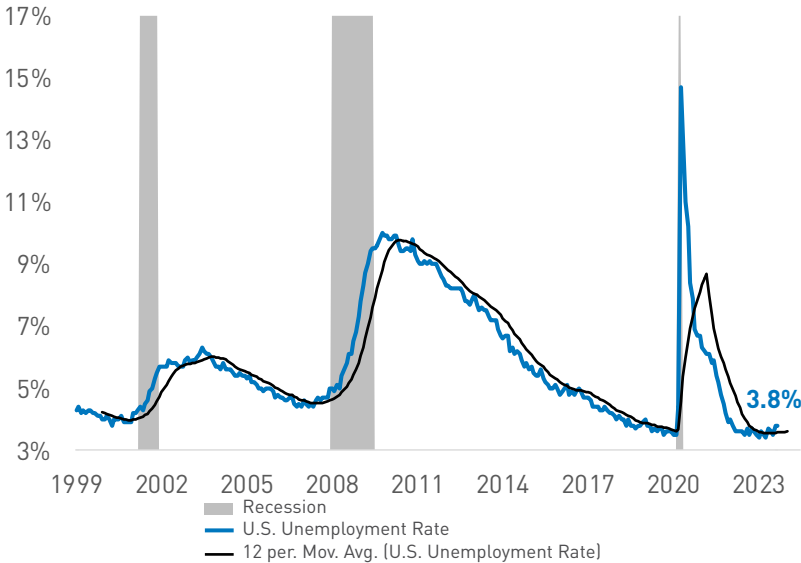
The U.S. economy surged 4.9% in Q3, beating the consensus of 4.5%. This is the fastest growth rate for any quarter since 2014, excluding the post-COVID period of 2020-2021. Consumer spending was a major catalyst, rising 4% during the quarter. “Core” GDP, which includes personal consumption, business investment, and home building, rose 3.3%. But many of the forces driving growth in Q3 will likely reverse in the coming quarters. Growth is likely to moderate notably in Q4. One area of concern in the quarterly results is the decline in business fixed investment. Higher interest rates and tighter money are likely slowing business spending on equipment.



	2023 ECONOMIC GROWTH (GDP % Change)	2024 ECONOMIC GROWTH (GDP % Change)	2023 EXCHANGE RATE (v. USD)	2024 EXCHANGE RATE (v. USD)
UNITED STATES	2.2%	1.1%	N/A	N/A
CANADA	1.2%	1.0%	1.35	1.29
MEXICO	3.1%	1.8%	17.64	18.81
EURO AREA	0.5%	0.6%	1.06	1.13
CHINA	4.9%	4.4%	7.24	6.89

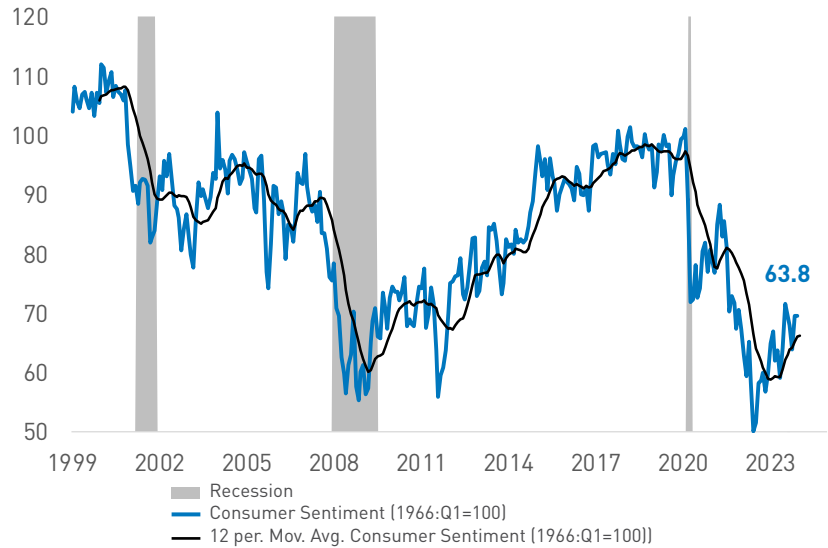
EMPLOYMENT

U.S. nonfarm payrolls rose by 336,000 new jobs in September, easily beating consensus expectations of 170,000 new jobs. Moreover, payroll gains for July and August were revised higher by 119,000 jobs - bringing the net gain to 455,000. The unemployment rate was unchanged at 3.8%. The largest increases in September were for leisure & hospitality (+96,000) and health care & social assistance (+66,000). Manufacturing increased by 17,000, while government hiring rose by 73,000. Average hourly earnings rose 0.2% and are up 4.2% over the last year.



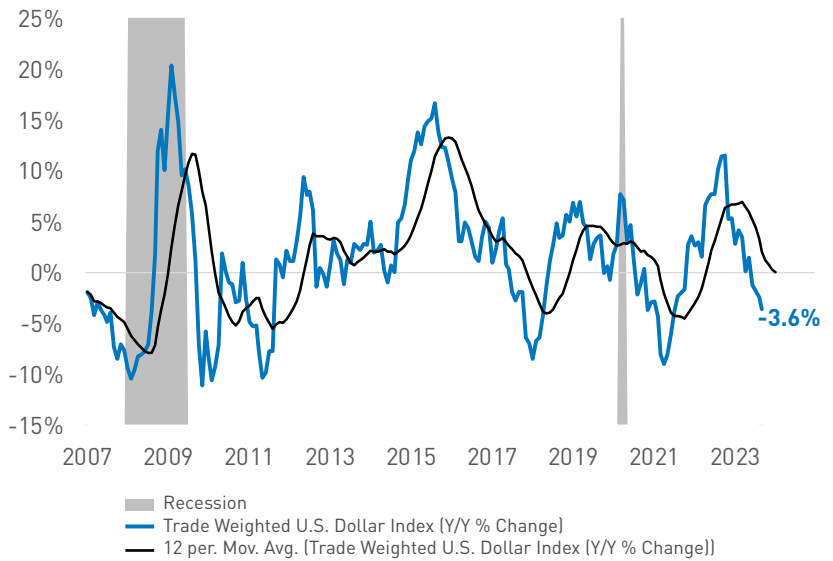
SENTIMENT

Consumer sentiment slipped in October, after two months of little change. The Index of Consumer Sentiment fell 6% to 63.8, driven lower by continued inflationary concerns. The decline was driven by deteriorating assessments of personal finances (down 8%) and one-year expected business conditions (down 16%). Long-run expectations for business conditions remain steady, suggesting consumers feel more near-term downside risk. The fear of an approaching recession is likely continuing to weigh on consumers. Year-ahead inflation expectations rose from 3.2% last month to 4.2% this month, the highest reading since May 2023.



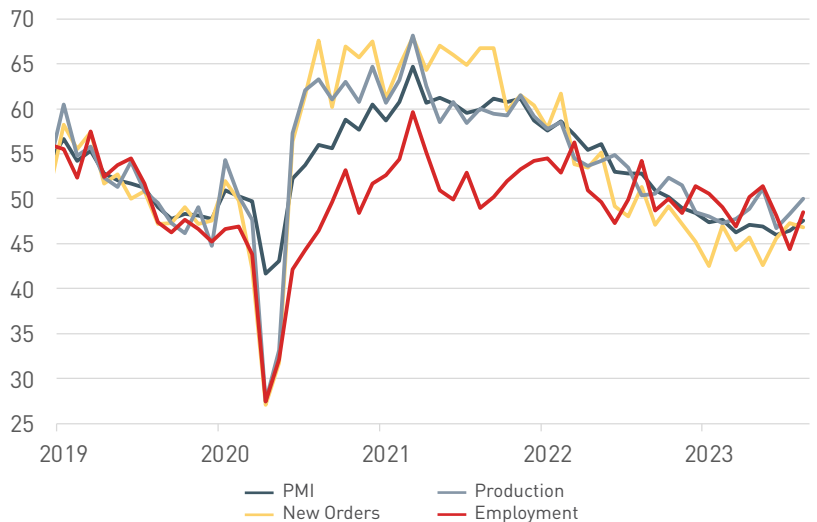
TRADE-WEIGHTED U.S. DOLLAR INDEX

The dollar moved higher this month, reaching levels last seen in the fall of 2022. Several factors have pulled the dollar higher this month. The Israel-Palestinian conflict increased geopolitical tension and pushed investors towards safe havens like the U.S. dollar. This month also saw investors move away from riskier currencies as lackluster corporate results heightened concerns about the economic outlook. The benchmark U.S. 10-year Treasury yield briefly hit 5%, the first time in 16 years, which has also likely drawn funds towards the dollar. Global investors are keeping a close eye on inflation, which will help drive currency returns in the near term.



MANUFACTURERS' SENTIMENT (PMI)

U.S. manufacturing sentiment contracted for the 11th consecutive month in September but rose to the highest level since November 2022. The Manufacturing PMI increased to 49%. The New Orders Index improved to 49.2%, the Production Index increased to 52.5%, and the Employment Index rose to 51.2%. The Backlog of Orders Index fell to 42.4%, suggesting many manufacturers have fulfilled backlog orders and are now depending on new sales to drive production.



U.S. END MARKETS FOR ELECTRONICS

U.S. industrial production rose 0.3% in September. The manufacturing sector rose 0.4% during the month.



AUTOMOTIVE PRODUCTS

Auto production rose 0.4% during the month. Non-auto manufacturing rose 0.3%. Auto production is up 7.1% in the past year and non-auto manufacturing is down 1.4%.



TRANSIT EQUIPMENT

Transit equipment production rose 0.6% during the month. The sector is up 3.5% over the last year.



INFORMATION PROCESSING & RELATED EQUIPMENT

Production in the information processing and related equipment sector fell 0.6% during the month. The sector is down 0.5% over the last year.



INDUSTRIAL & OTHER EQUIPMENT

The industrial sector dropped 1.1.2% last month. The sector is down 3.9% over the last year.



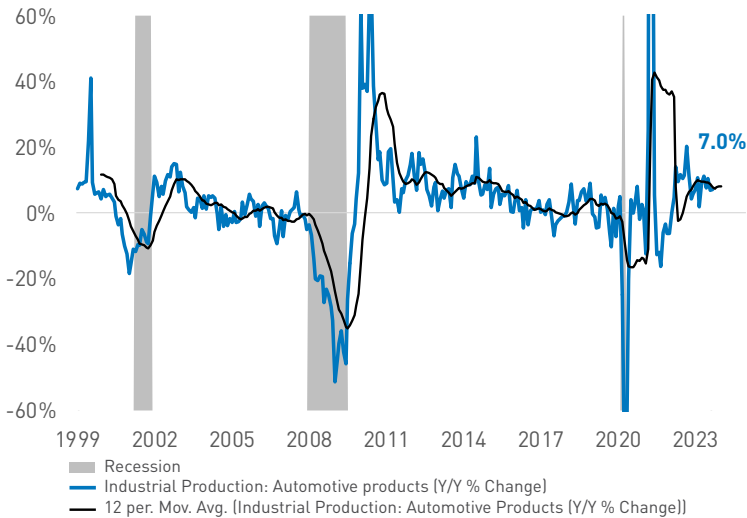
DEFENSE & SPACE EQUIPMENT

The defense and space equipment segment rose 1%. The sector is up 8.7% over the last year.

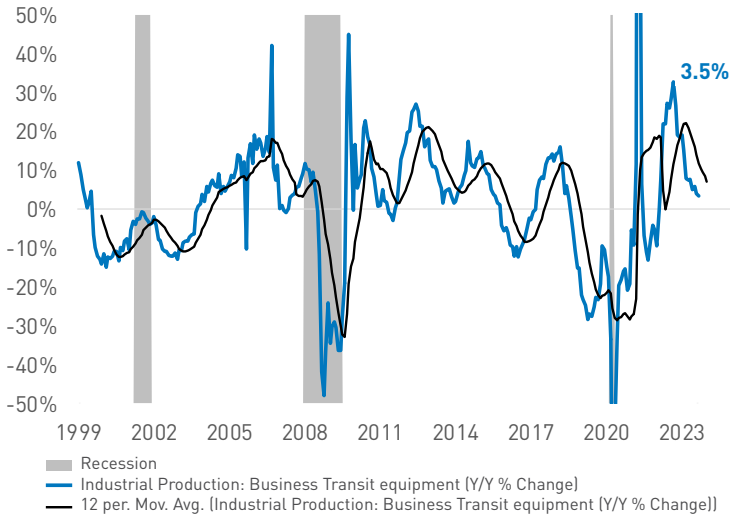
Manufacturing



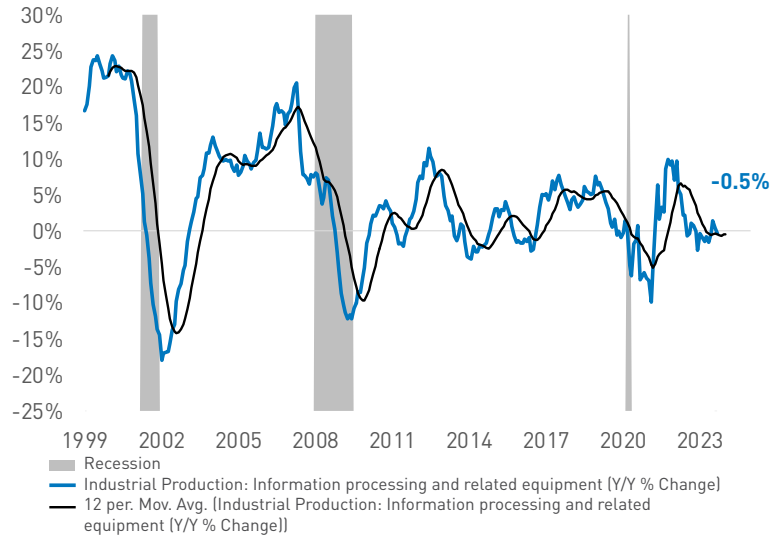
Automotive Products



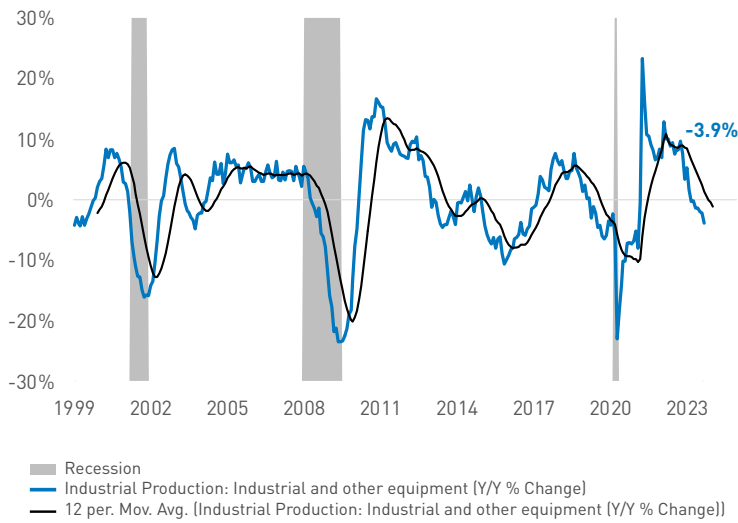
Business Transit Equipment (Y/Y % Change)



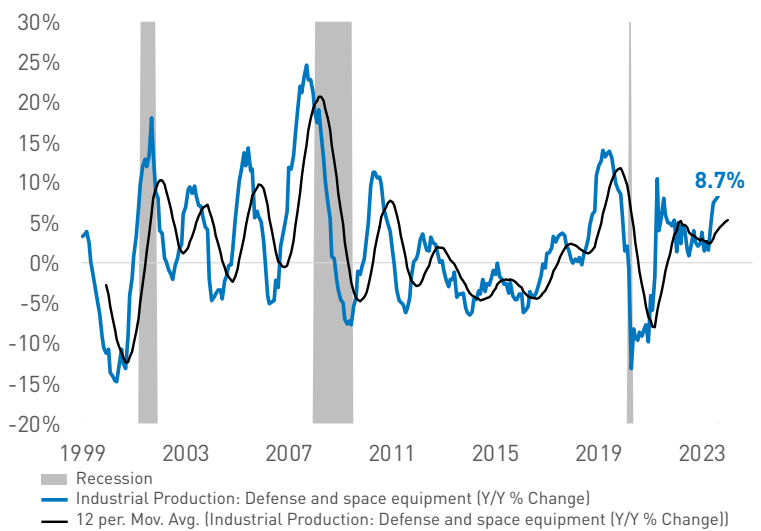
Information Processing & Related Equipment (Y/Y % Change)



Industrial & Other Equipment (Y/Y % Change)



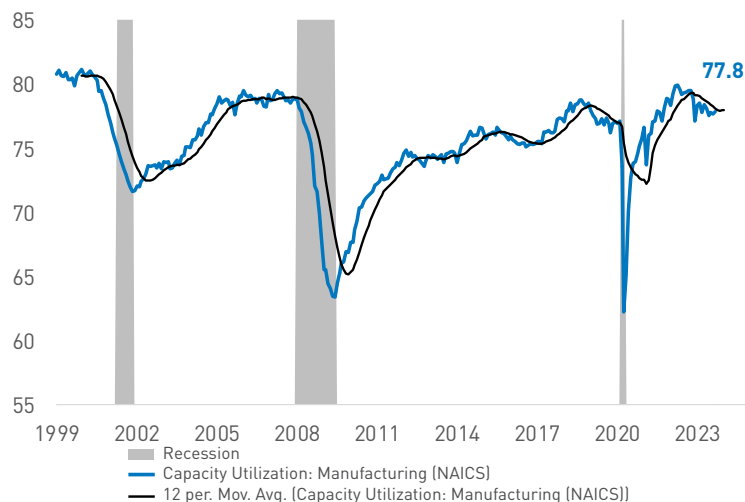
Defense & Space Equipment (Y/Y % Change)



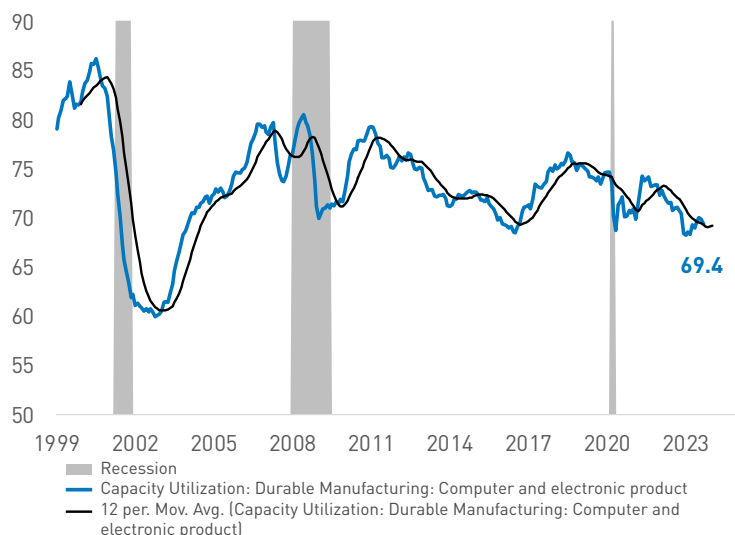
MANUFACTURING CAPACITY UTILIZATION

Overall capacity utilization increased to 79.7% in September from 79.5% in August. Manufacturing capacity utilization increased to 77.8% in September from 77.7%. Computer and electronic production capacity utilization fell 0.8% to 69.4%. Electrical equipment, appliances, and components utilization rose 0.3% to 76.6%. Utilization in the auto sector rose 0.2% to 76.5%. Capacity utilization in the aerospace and miscellaneous transportation equipment sector rose 0.8% to 72.4%.

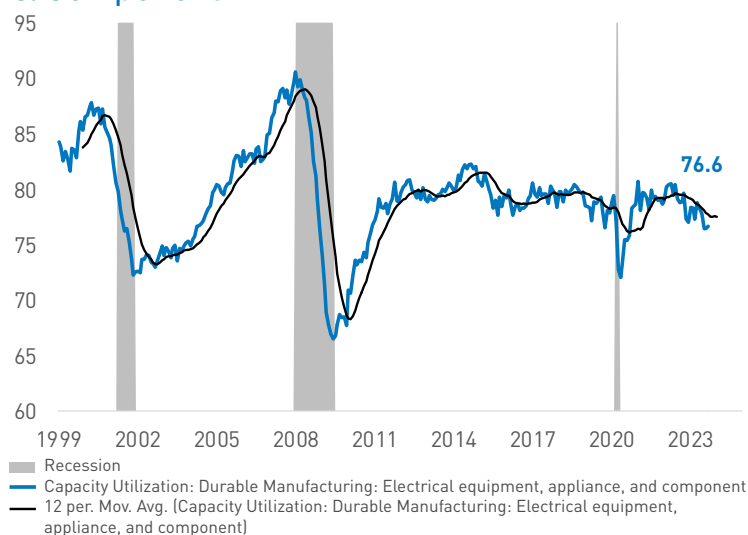
Manufacturing (NAICS)



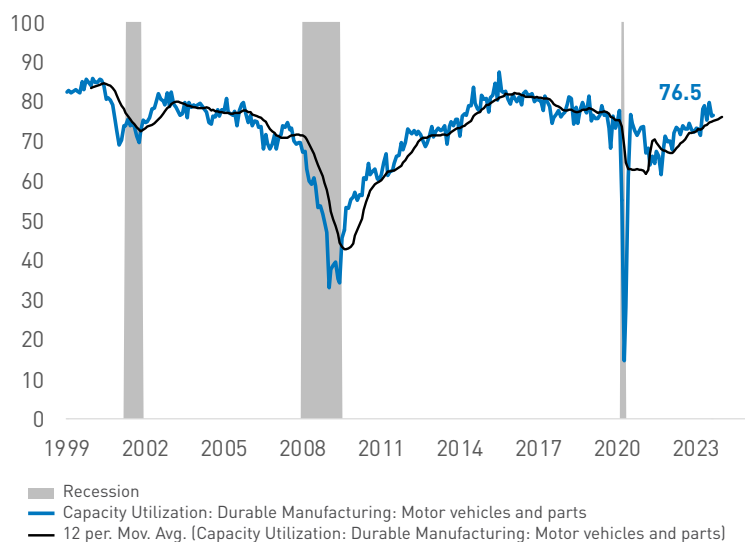
Computer & Electronic Product



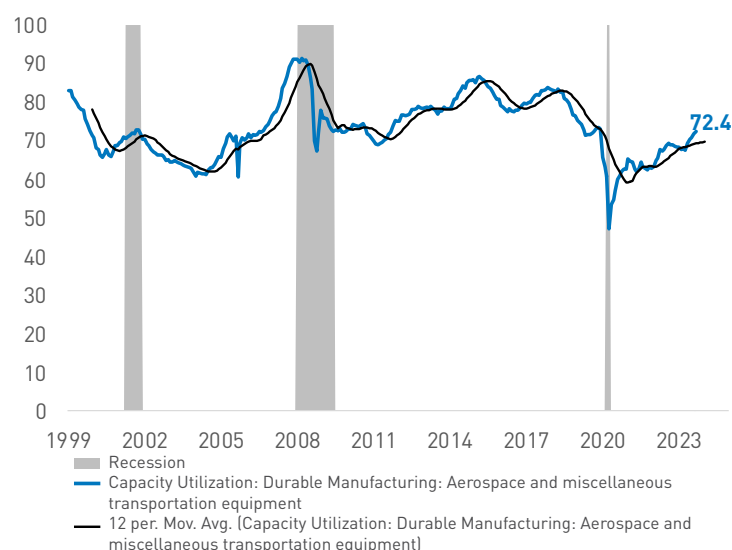
Electrical Equipment, Appliance, & Component



Motor Vehicles & Parts



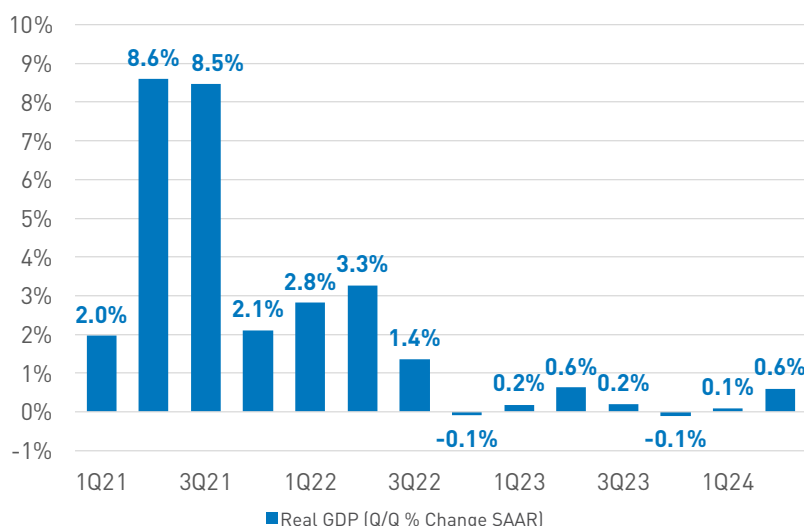
Aerospace & Miscellaneous Transportation Equipment



EUROPEAN OUTLOOK

ECONOMIC GROWTH

Seasonally adjusted GDP in the euro area grew by 0.1% in Q2, while GDP was flat in the EU compared to the preceding quarter. In the first quarter of 2023, GDP increased 0.1% in the euro area and 0.2% in the EU. Compared to the same quarter of the previous year, seasonally adjusted GDP in the euro area saw a 0.5% increase, while GDP rose 0.4% in the EU. This followed increases of 1.1% in both zones during the previous quarter. Early results for Q3 appear mixed. Germany, Europe's largest economy, declined 0.1% after rising 0.1% in the prior quarter. The fall in GDP was driven by a decline in consumer spending, although business investment in machinery and equipment made a positive contribution to GDP. Germany has been teetering on the edge of recession for the last year.

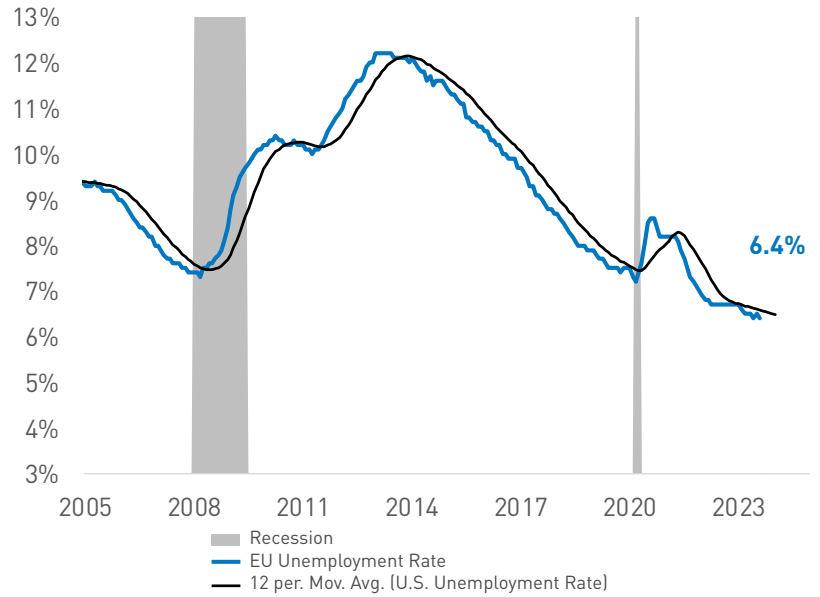


	Q/Q PERCENTAGE CHANGE				Y/Y PERCENTAGE CHANGE			
	2022Q3	2022Q4	2023Q1	2023Q2	2022Q3	2022Q4	2023Q1	2023Q2
EURO AREA (20)	0.3%	-0.1%	0.1%	0.1%	2.3%	1.7%	1.1%	0.5%
EUROPEAN UNION (EU)	0.3%	-0.1%	0.2%	0.0%	2.5%	1.6%	1.1%	0.4%
GERMANY	0.4%	-0.4%	-0.1%	0.0%	1.2%	0.8%	-0.3%	-0.1%
FRANCE	0.3%	0.1%	0.1%	0.5%	1.2%	0.7%	0.8%	1.0%
ITALY	0.3%	-0.2%	0.6%	-0.4%	2.5%	1.5%	2.0%	0.4%
SPAIN	0.4%	0.4%	0.5%	0.4%	4.9%	3.0%	4.2%	1.8%

	2023 ECONOMIC GROWTH (GDP % CHANGE)	2024 ECONOMIC GROWTH (GDP % CHANGE)
EURO AREA	0.5%	0.6%
GERMANY	-0.3%	0.3%
FRANCE	0.7%	0.6%
NETHERLANDS	0.5%	0.9%

EMPLOYMENT

In August 2023, the euro area seasonally-adjusted unemployment rate was 6.4%, down from 6.5% in July 2023 and down from 6.7% in August 2022. The EU unemployment rate was 5.9% in August 2023, down from 6.0% in July 2023 and from 6.1% in August 2022. Unemployment is at its lowest historical level since data compiling began in April 1998. The highest unemployment rates were in Spain (11.5%) and Greece (10.9%). Germany's unemployment rate remains at 3% despite weaker economic growth in the country.



MANUFACTURERS' SENTIMENT (PMI)

The eurozone manufacturing sector contracted again in September, with weakness noted in new orders, employment, and production. Business confidence also declined to a ten-month low. Manufacturers lowered prices in an attempt to stimulate demand and enhance competitiveness, with this being one of the most significant price decreases in 14 years. The HCOB Eurozone Manufacturing PMI fell slightly to 43.4 in September, marking the fifteenth consecutive month of sector deterioration. All countries except Greece experienced downturns, with Germany and Austria leading the declines. Despite progress on backlogs and reduced input prices, employment continued to fall, and purchasing activity decreased for the 15th consecutive month. Manufacturers remained focused on cost reduction and competitiveness, leading to a prolonged decline in prices charged.



E.U. END MARKETS FOR ELECTRONICS

Manufacturing output rose 0.2% in August from the prior month. Output is down 5% from the year-ago period.



COMPUTER, ELECTRONIC, & OPTICAL PRODUCTS

The electronics industry, which includes categories such as components, loaded boards, computers, communications equipment, and consumer electronics, fell 0.5% (month-on-month) in the last month. The sector is down 25.5% over the last year.



MOTOR VEHICLES

Motor vehicle manufacturing output rose 4.1% (month-on-month). The sector is up 11.2% over the last year.



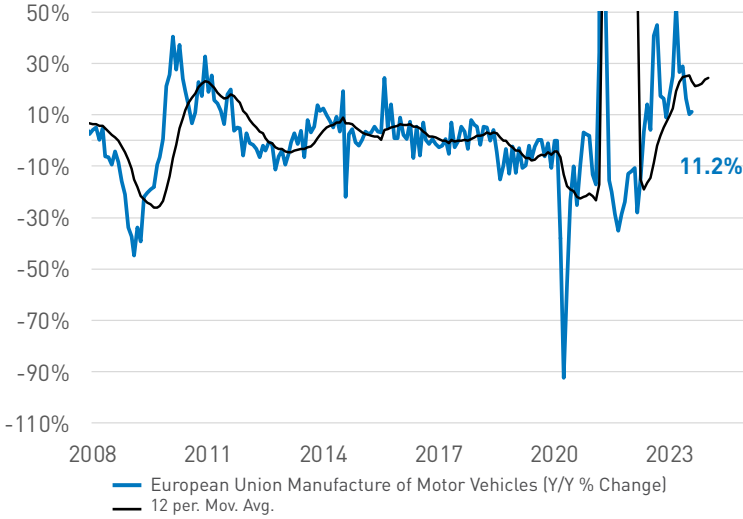
AIR & SPACECRAFT & RELATED MACHINERY

The air and spacecraft manufacturing sector rose 3.8% during the month. The sector is up 16.6% over the last year.

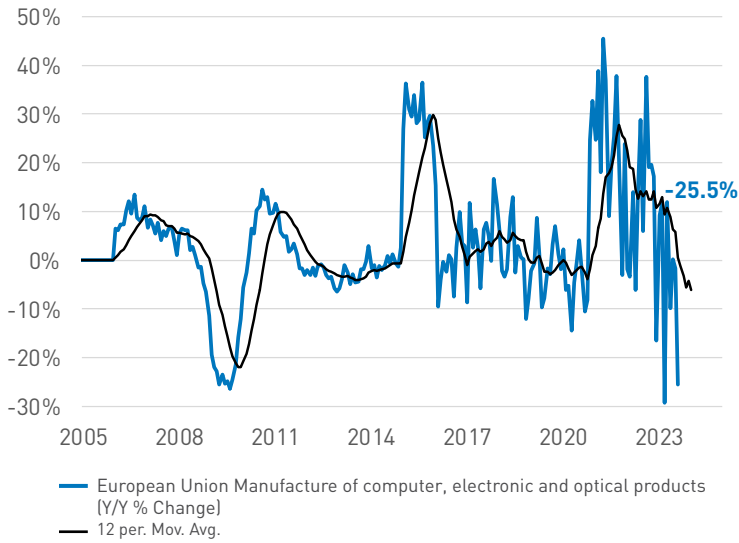
E.U. Manufacturing Output



E.U. Manufacture of Motor Vehicles



E.U. Manufacture of Computer, Electronic & Optical Products (Y/Y % Change)



E.U. Manufacture of Air & Spacecraft & Related Machinery (Y/Y % Change)

