Center on Budget and Policy Priorities

1275 First Street NE, Suite 1200
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

April 4, 2024

Economy Strong as 2023 Ended

By Chad Stone

Note: this analysis complements CBPP's "Chart Book: Tracking the Recovery from the Pandemic Recession," which contains data and analysis through the end of 2023.[1]

The U.S. economy entered 2023 with elevated inflation and concerns by many that a recession could be imminent; it ended the year with solid economic growth, moderating inflation, healthy job growth, and low unemployment. Data at the end of 2023, and into early 2024, show an economy that has remained resilient in the face of the Federal Reserve's restrictive monetary policy, while inflation has fallen significantly.

This outcome defies the predictions by a few prominent economists when inflation rose sharply in 2021 that very large increases in unemployment would be needed to bring it down.[2] It also calls into question claims that the demand stimulus from the American Rescue Plan Act enacted in May 2021, which successfully supported the recovery and relieved hardship,[3] was the major source of the inflation. These demand-focused arguments ignore the importance of both the tightening of supply restrictions in raising inflation in 2021 and 2022 and of their later loosening in allowing inflation to come down without depressing economic activity and increasing unemployment.

Fed Chair Powell: "This is a good economy"

At his press conference following the February 2024 meeting of the Federal Open Market Committee, Federal Reserve Chairman Jerome Powell stated that the economy had made significant progress toward lower inflation while maintaining high employment.[4] At that meeting, however, the committee again voted not to change the target range it has maintained for its policy interest rate

---

[1] CBPP, "Chart Book: Tracking the Recovery From the Pandemic Recession," updated April 3, 2024, https://www.cbpp.org/research/economy/tracking-the-recovery-from-the-pandemic-recession.

[2] Ryan Cooper, "Why Were Inflation Hawks Wrong?," The American Prospect, February 7, 2024, https://prospect.org/economy/2024-02-07-why-were-inflation-hawks-wrong/.

[3] CBPP, "Robust COVID Relief Bolstered Economy and Reduced Hardship for Millions," March 6, 2023, https://www.cbpp.org/research/poverty-and-inequality/robust-covid-relief-bolstered-economy-and-reduced-hardship-for.

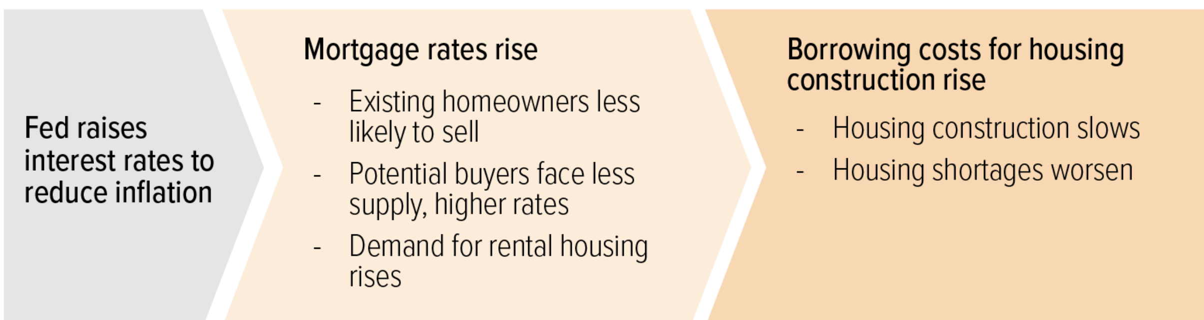
[4] Federal Reserve Open Market Committee, "Transcript of Chair Powell's Press Conference, January 31, 2024," https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20240131.pdf.

since July 2023, even though the inflation-adjusted value of those rates has increased as inflation has fallen, effectively tightening monetary policy.[5] While Powell declined to say that the economy was close to achieving the "soft landing" that he had once described as "very plausible,"[6] and while he hedged about the future, he was clear about the current state of the economy, saying "Let's be honest. This is a good economy."

This "good economy" could be in jeopardy, however, if the Fed waits too long to begin easing its monetary restraint. High interest rates have severely harmed interest-sensitive sectors of the economy, especially housing. With buyers facing high mortgage rates and builders facing high financing costs, the housing market is not functioning smoothly. The cost of housing has been rising as availability has been constrained. (See Figure 1.)

FIGURE 1

High Interest Rates Damage Housing Market, Restrict Housing Mobility



CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

The Fed is still navigating tricky waters, and it wants to be sure inflation is back within its target range. But together with its inflation mandate, the Fed has a mandate to pursue maximum employment.[7]

Economy Ended 2023 on High Note, Continues Strong Into 2024

According to a range of measures, the economy ended 2023 on a high note and has continued to be strong in 2024:

- Both gross domestic product (GDP) and payroll employment ended the year higher than in the Congressional Budget Office's (CBO) pre-pandemic (January 2020) projections for 2023.

---

[5] The Fed's policy interest rate target, the federal funds rate, was raised to 5.25-5.50 percent in July 2023 and has remained there since.

[6] YouTube, "Fed's Powell Sees Path to 'Soft or Softish' Landing," https://www.youtube.com/watch?v=Ue1aDKboQcQ. See also Sam Boocker and David Wessel, "What is a soft landing?" Brookings Institution, September 14, 2023, https://www.brookings.edu/articles/what-is-a-soft-landing/.

[7] Board of Governors of the Federal Reserve System, "Monetary Policy: What Are Its Goals? How Does It Work?" https://www.federalreserve.gov/monetarypolicy/monetary-policy-what-are-its-goals-how-does-it-work.htm.

- December's unemployment rate of 3.7 percent marked the 23rd straight month of unemployment below 4 percent. This streak has continued through February 2024.
- At the end of the year, the share of the population aged 25-54 either working or looking for work (the labor force participation rate) was 0.2 percentage points higher than the pre-pandemic rate of February 2020. The rate has since risen further, in February 2024 reaching a half point higher than its pre-recession rate. The share of the population aged 25-54 with a job (the employment-to-population ratio) in December 2023 was just 0.1 percentage point below the February 2020 rate, and as of February 2024 it has risen 0.2 percentage points above that rate.
- Headline inflation peaked in June 2022 when the consumer price index (CPI) was 9.1 percent higher than a year earlier, but by December 2023 the CPI was just 3.4 percent higher than a year earlier. The CPI dropped further at the beginning of 2024. (See discussion below.)
- The six-month change in the personal consumption expenditure (PCE) price index for all items excluding food and energy — an index the Federal Reserve has followed to assess progress in reaching its goal of reducing inflation to 2 percent — rose just 1.9 percent at an annual rate in both November and December.[8]
- Adjusted for inflation, workers' earnings, especially those in low-paying jobs, were higher at the end of 2023 than in February 2020.

Strong Policy Response a Key Contributor to Rapid Recovery

In the wake of a historic pandemic that created enormous economic dislocation, the economy made a much stronger and faster recovery than expected. A key contributor was the unprecedented federal policy response, which both relieved hardship (see box, "Robust COVID Relief Measures Protected Tens of Millions From Hardship") and stimulated economic recovery by supporting spending and job growth when the economy began to reopen.

Robust COVID Relief Measures Protected Tens of Millions From Hardship

In addition to stimulating a rapid economic recovery, COVID relief measures kept tens of millions of people from hardship. One measure of annual poverty, rather than rising as typically happens during recessions, fell by 10 million people in 2020 — the largest amount on record in data back to 1967 — and poverty fell again in 2021. The number of people without health insurance remained stable early in the pandemic despite large job losses, then fell in 2021 and again in 2022 due to relief measures that made it easier for people to retain Medicaid coverage and made Affordable Care Act marketplace coverage more affordable.

Various data indicate that these and other relief measures reduced poverty, helped people access health coverage, and reduced hardships such as inability to afford food or housing or to meet other basic needs.

See: CBPP, "Robust COVID Relief Bolstered Economy and Reduced Hardship for Millions," March 6, 2023, https://www.cbpp.org/research/poverty-and-inequality/robust-covid-relief-bolstered-economy-and-reduced-hardship-for.

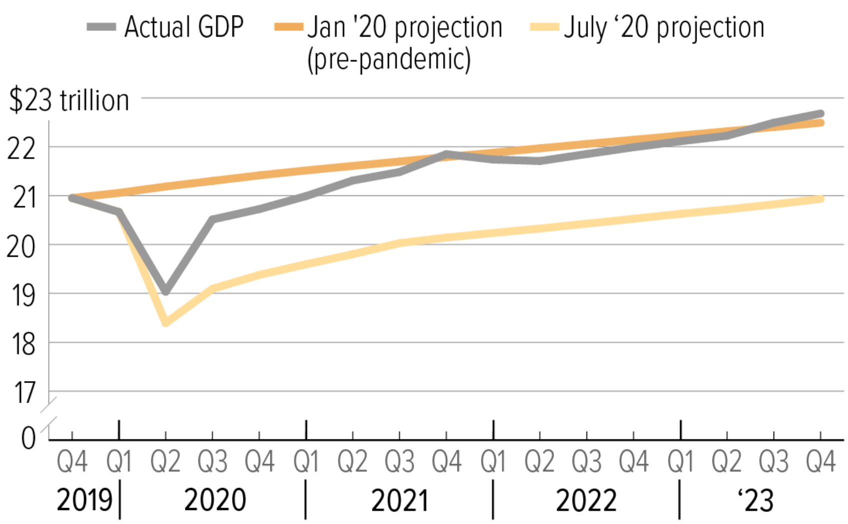
[8] In early 2024, headline CPI and PCE inflation continued to edge down, but near-term inflation expressed at an annual rate increased. As discussed in the inflation section below, the difficult-to-measure housing services component accounted for much of the rise in January.

The bipartisan relief and recovery measures enacted in the spring of 2020 helped stop an economic free-fall and contributed to the rapid partial recovery in the first half of the year. But the growth in non-farm payroll employment (the number of jobs in non-farm establishments) moderated in the second half of 2020; December 2020 is the only month since April 2020 that payroll employment fell. And CBO's July 2020 economic projections showed GDP remaining well below its pre-pandemic projections for at least a decade. (See Figure 2.)

FIGURE 2

GDP Grew Faster Than CBO Projected in Mid-2020

Gross domestic product, in trillions of 2017 dollars



Note: CBO projections are normalized to have the same 2019:Q4 value as the actual data but grow at the same rate as in the CBO projections.

Source: CBPP analysis of Congressional Budget Office (CBO) and Bureau of Economic Analysis data

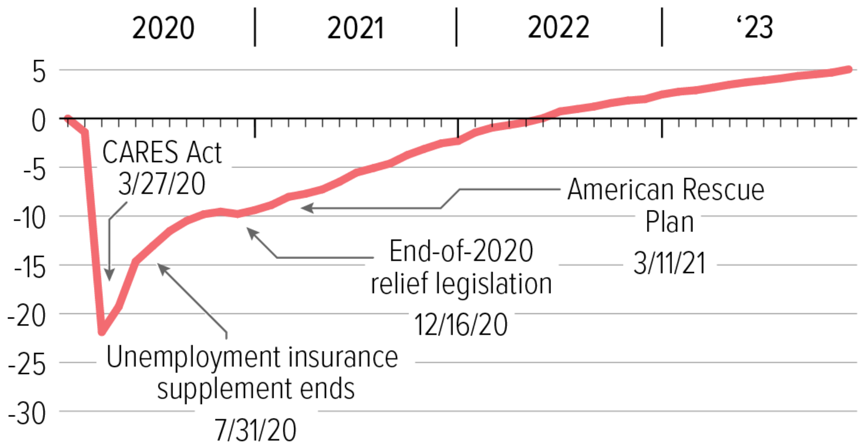
CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

Employment and economic growth picked up, however, following enactment of an end-of-year relief package in December 2020 and the American Rescue Plan Act (ARPA) in March 2021. ARPA was a substantial package, with a cost of $1.8 trillion from 2021 to 2031. Supporters argued that a substantial package was needed to avoid repeating the experience following the Great Recession, when stimulus and relief measures were phased out prematurely, the unemployment rate remained above its pre-recession rate for almost a decade, and preventable hardship was high. The risks associated with doing too much to promote a rapid recovery and relieve hardship were far lower than the risks from doing too little, supporters argued. ARPA opponents, on the other hand, were quick to blame it after inflation began to rise in 2021.

FIGURE 3

Relief Legislation Key to Solid Jobs Recovery

Change in payroll employment since February 2020, in millions of jobs



Source: Bureau of Labor Statistics

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

ARPA achieved its rapid-recovery goals. Payroll employment rose rapidly and surpassed its February 2020 level in June 2022; in December 2023 it was 5.4 million jobs above February 2020. (See Figure 3.) And in the fourth quarter of 2023, payroll employment was 2.1 million jobs above CBO's January 2020 projection for that quarter.

In addition, real GDP surpassed its February 2020 level as early as 2021, and in the fourth quarter of 2023 it was slightly above CBO's pre-pandemic forecast.

Household Employment Measures Have Largely Recovered

The unemployment rate for all workers was 3.5 percent in February 2020; after rising sharply due to the pandemic, it fell back under 4 percent in February 2022 and has remained there, including in the first two months of 2024. Moreover, the share of the population with a job (the employment-to-population ratio) for the prime-age (25-54) population was just 0.1 percent below its pre-pandemic rate in December 2023, and it rose further in early 2024. Also, as noted, the labor force participation rate was back above its February 2020 rate by the end of 2023. High labor force participation increases the supply of workers and eases supply constraints.

Notably, unemployment rates for Black, Hispanic, Asian, and white workers are all back close to their February 2020 pre-pandemic rates, which themselves were historically low, but the rates for Black and Hispanic workers are still well above unemployment rates for white and Asian workers. (See Table 1 and Figure 4.)

TABLE 1

Unemployment by Race/Ethnicity

	February 2020	December 2023
Black	6.1%	5.2%
Hispanic	4.3%	5.0%
Asian	2.5%	3.1%
White	3.0%	3.5%

Source: Bureau of Labor Statistics

Black and Hispanic women aged 25-54, who had particularly large job losses in the recession, have made up all of their lost ground; in December 2023 their employment rate, labor force participation rate, and employment-to-population ratio all matched or exceeded February 2020 levels.[9] White women had smaller (but still substantial) losses in the recession but were not quite back to their February 2020 level of employment in December 2023. Although Black men aged 25-54 have largely erased their recession losses, their unemployment rate, labor force participation rate, and employment-to-population ratio are significantly worse than those of Hispanic, Asian, and white workers.

The number of people immigrating to the United States has also rebounded from depressed pandemic levels, helping to boost the economy. In its latest economic and budget outlook, CBO points to higher projected immigration as a significant positive factor that has led it to project stronger economic growth than a year earlier: "The labor force is larger because net immigration, which began increasing in 2022, remains elevated through 2026."[10] Together, greater labor force participation and increased immigration flows have helped meet employers' demand for workers, increasing employment and output and reducing inflationary pressures.

Despite this good news, Black and Hispanic unemployment rates are consistently higher than white and Asian rates, rise more in recessions, and come down more slowly in recoveries.[11] That pattern was evident in the pandemic recession and subsequent recovery. The current Black and Hispanic unemployment rates of roughly 5 percent are historically low for these groups, but it is important to acknowledge that if *overall* unemployment were at 5 percent, a broad swath of economists and policymakers would consider the economy weak, and many would be calling for policy action. (See Figure 4.)

The persistence of higher unemployment rates among Black and Hispanic workers reflects structural barriers rooted in racism, including hiring discrimination, unequal access to the

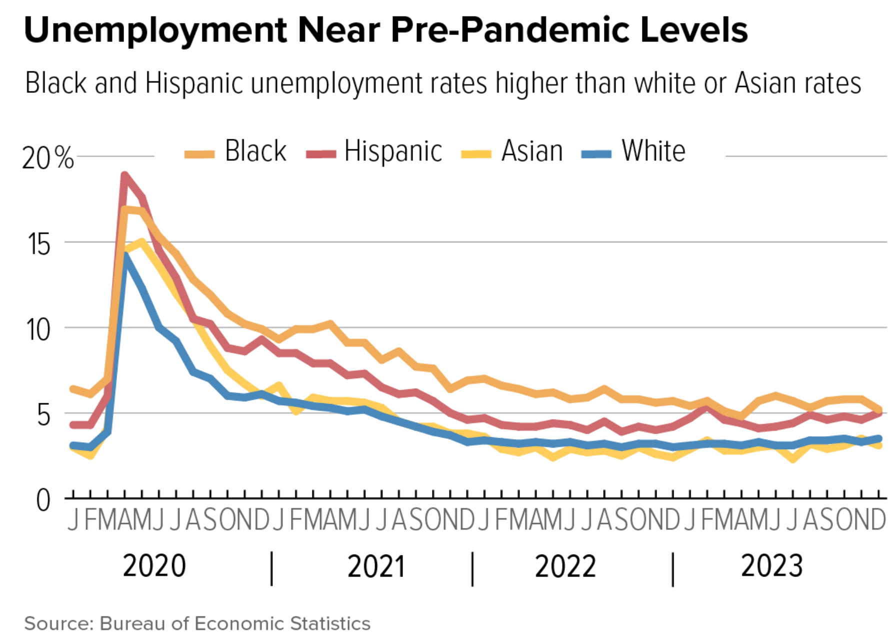
[9] CBPP, "Chart Book," https://www.cbpp.org/research/economy/tracking-the-recovery-from-the-pandemic-recession#gender.

[10] Congressional Budget Office, "The Budget and Economic Outlook: 2024 to 2034," February 7, 2024, https://www.cbo.gov/publication/59710.

[11] Chad Stone, "Robust Unemployment Insurance, Other Relief Needed to Mitigate Racial and Ethnic Unemployment Disparities," CBPP, August 5, 2020, https://www.cbpp.org/research/economy/robust-unemployment-insurance-other-relief-needed-to-mitigate-racial-and-ethnic.

education and training needed to build skills, and over-policing/incarceration. Policy measures to remove these barriers are necessary to address persistent racial employment disparities.

FIGURE 4



CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

Lower-Paying Jobs Seeing Largest Wage Gains in Recovery

Tight labor markets following the worst of the pandemic led to significant wage gains, especially for jobs paying the lowest wages. As of December 2023, real (inflation-adjusted) average hourly earnings for all payroll jobs were 1.1 percent higher than in February 2020, while within that group the purchasing power of average hourly earnings for non-management jobs was 3.3 percent higher. (See Figure 5). In other words, the tight labor market has meant that workers in lower-paying jobs have realized the larger real wage gains.[12]

Moreover, growth in nominal average hourly earnings for non-management jobs was fast enough to put them slightly above their pre-pandemic trajectory. Slower growth in nominal average hourly earnings for all workers left them somewhat below their pre-pandemic trajectory.

[12] Arindrajit Dube, "Credit Bidenomics for Rising US Wages," Project Syndicate, February 8, 2024, https://www.project-syndicate.org/commentary/us-tight-labor-market-result-of-worker-friendly-policies-by-arindrajit-dube-2024-02.

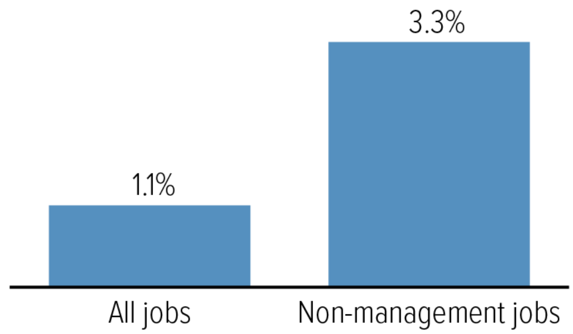
The gains in real wages for workers, and especially for those in low-paid jobs, are welcome on equity grounds. Fed Chair Powell has stated that rising wages weren't a significant factor in the initial surge in inflation,[13] but he has also said repeatedly that an important part of reducing inflation is getting wage growth down to a rate consistent with 2 percent inflation.

Powell and many economists envision a scenario in which nominal wage growth falls from its current rate of more than 4 percent to about 3.5 percent, and inflation falls somewhat faster, to the Fed's 2 percent target. With 2 percent annual increases in prices and an expected 1.5 percent annual growth in labor productivity (output per hour), businesses could raise wages by 3.5 percent annually, on average, while maintaining their current profit margins.

FIGURE 5

Tight Labor Market Drove Higher Wage Gains for Non-Management Employees

Growth in average annual earnings, February 2020 to December 2023



Source: CBPP calculations from Bureau of Labor Statistics data

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

But nominal wages needn't bear the full burden of reducing inflation to 2 percent. Corporate profit margins have been above historical averages; bringing them down to more normal levels would reduce inflation. So too would increasing labor's share of overall business income, which was above 60 percent from 1947 through 2004 but has averaged 57 percent since. Both such developments — lower profit margins and a larger labor share — are more likely to occur in a tight labor market like the current one, which increases workers' wage-bargaining power. Faster labor productivity growth would also boost real wages, and recent productivity growth has been above 1.5 percent.

The Rise and Fall of High Inflation

Following ARPA's enactment, CBO published economic projections in July 2021 incorporating the effects of the relief measures enacted to date, the diminishing constraint on economic activity as social distancing declined, and greater consumer spending.[14] These projections foreshadowed the strong economic growth and solid job gains described above, but they greatly underestimated the effect of supply constraints on inflation, stating:

> Inflation rises sharply in 2021 and then moderates. The price index for personal consumption expenditures (PCE) rises by 2.8 percent this year, as increases in the supply of goods and services lag behind increases in the demand for them, adding to inflationary pressures. By 2022, increases in supply keep up with increases in demand, and PCE price inflation falls to 2.0 percent during the year.

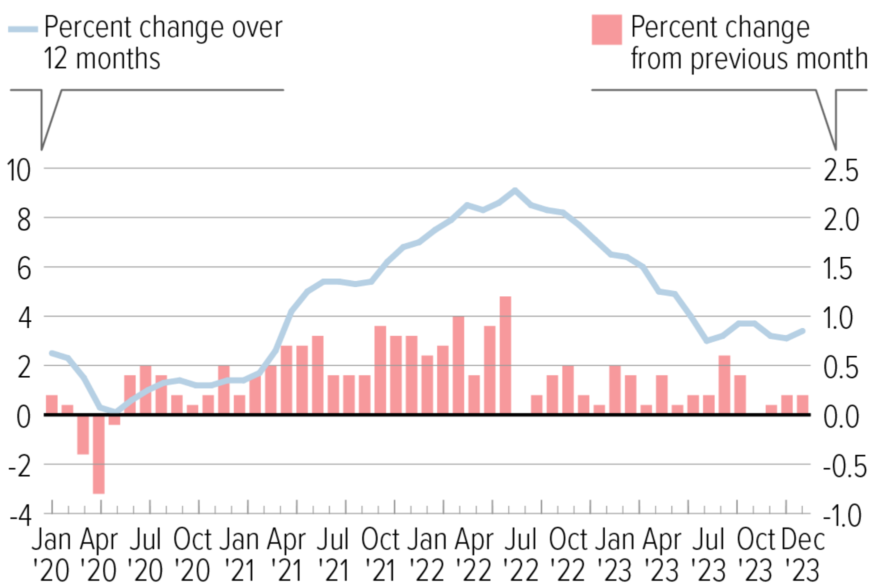
---

[13] Federal Reserve Open Market Committee, "Transcript of Chair Powell's Press Conference, June 14, 2023," https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20230614.pdf.

[14] Congressional Budget Office, "Additional Information About the Updated Budget and Economic Outlook: 2021 to 2031," July 21, 2021, https://www.cbo.gov/publication/57263#section2.

FIGURE 6

Consumer Price Index Inflation Peaked in June 2022



Source: CBPP analysis of Bureau of Labor Statistics data

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

Actual inflation in 2021 and 2022 greatly exceeded those projections, with the 12-month change in the consumer price index (CPI) peaking at 9.1 percent in June 2022. (See Figure 6.) This occurred because strong demand for goods and services bumped up against substantial unanticipated supply constraints, including those associated with Russia's invasion of Ukraine, as CBO explained in its May 2022 Budget and Economic Outlook.[15] Inflation has since fallen considerably as supply constraints have eased, and CBO now projects that inflation will be roughly in line with the Fed's 2 percent target starting later this year and throughout the next decade.[16]

CPI inflation is the most familiar inflation measure, but the Fed's target is 2 percent inflation in the personal consumption expenditure (PCE) price index, which historically has tended to rise a few tenths of a point more slowly than the CPI. The CPI is based on a survey of out-of-pocket expenses paid by urban consumers; the PCE price index is broader in scope and sources its data from businesses. The PCE price index began to surge in 2021 and the 12-month change peaked at 7.1

---

[15] Congressional Budget Office, "The Budget and Economic Outlook: 2022 to 2032," May 25, 2022, https://www.cbo.gov/publication/57950.

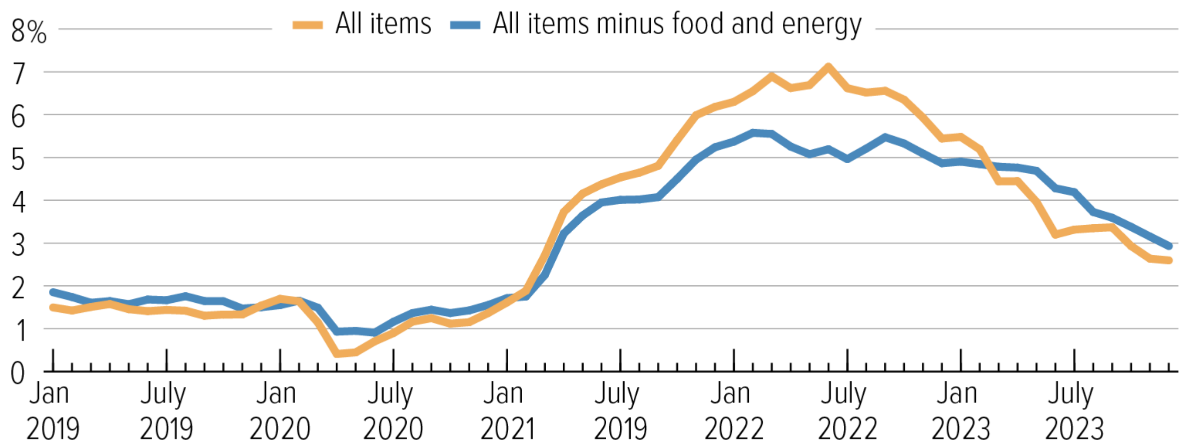
[16] Specifically, CBO says inflation as measured by the PCE price index "will fall from 2.9 percent in 2023 to 2.1 percent in 2024, reflecting softer demand for labor and slower increases in rents. Inflation is projected to tick up to 2.2 percent in 2025 as factors that have tended to limit price increases for food and energy recede and as stronger economic activity modestly increases the pressure on prices for some types of services. CBO projects that inflation will decline to 2.1 percent in 2026 and then average 2.0 percent a year through 2034." See https://www.cbo.gov/publication/59946#_idTextAnchor070.

percent in June 2022 before falling to 2.9 percent at the end of 2023; see Figure 7. (As noted, CPI inflation peaked in June 2022 as well, at 9.1 percent.)

FIGURE 7

Personal Consumption Expenditure Inflation Peaked in June 2022

Percentage change in 12-month intervals



Source: Bureau of Labor Statistics

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

Because housing (technically "rent of shelter") has such a large weight in the price indexes, especially in the CPI, it has a disproportionate effect on overall inflation. Both the PCE and CPI measure housing costs as the amount of money tenants spent on rent and the amount of money owner-occupants would have spent if they had been renting. Housing accounts for a little over a third of the market value of the goods and services in the CPI market basket and about half that in the PCE market basket. But changes in housing costs show up with a lag. The shelter components of both the CPI and the PCE are meant to measure the average cost of housing services across all renters and homeowners, not just new rentals. As a result, when inflation is rising or falling rapidly, changes in market rents will take time to begin affecting inflation measures.

For example, while 12-month inflation in the CPI and PCE peaked in June 2022, 12-month *shelter* inflation in the CPI did not peak until March 2023, at 8.2 percent, and was still 6.2 percent in December 2023. The 12-month change in the inflation rate for all items *excluding* shelter, which peaked at 10.8 percent in June 2022, has been 2 percent or less since June 2023. (One challenge is that the U.S. needs to add significantly to housing supply to meet the needs of communities and to bring down long-term housing inflation. High interest rates, as noted earlier, have constricted supply in recent years; when interest rates fall, that will likely lead to an increase in housing production.)

To evaluate underlying inflation, analysts generally look at the CPI and PCE with food and energy excluded (so-called core inflation) because those items tend to vary for idiosyncratic reasons. Core CPI inflation rose 3.9 percent from December 2022 to December 2023, while core PCE inflation rose 2.9 percent. The 12-month inflation rate does not capture more recent trends in inflation, however, so analysts often look at inflation over the past three or six months expressed at an annual rate. The annualized six-month change in the PCE fell to 1.9 percent in November and December 2023, as noted earlier in this report, but rose to 2.5 percent in February 2024.

Unanticipated supply constraints were an important reason that inflation rose above CBO's July 2021 projections, and the subsequent easing of supply constraints has allowed the economy to continue growing in the face of tight monetary policy. But debate will likely continue about how much of the large increase in inflation in 2021 and the first half of 2022 reflected those supply constraints, how much reflected high demand for goods and services, and how much reflected market concentration that allowed large corporations to raise their prices and profits.[17] As one analyst characterized the situation:

> [I]mpulses from supply- and demand- shocks have lasted longer than were initially predicted, and many key dynamics still remain at play. The subsequent economic trajectory — for better or for worse — will inevitably re-color our perspective on the past four years.[18]

It is clear, however, that single-cause explanations for the rise in inflation that focus on demand stimulus, particularly from ARPA, are misguided. Supply shocks contributed significantly to the rise in inflation in 2021 and 2022. Without an easing of supply constraints, the economy and the labor market likely would not have remained strong given the tight monetary policy of 2023.

Conclusion

---

[17] CBPP, "Chart Book"; Joseph Stiglitz and Ira Regmi, "The Causes of and Responses to Today's Inflation," Roosevelt Institute, December 6, 2022, https://rooseveltinstitute.org/publications/the-causes-of-and-responses-to-todays-inflation/.

[18] Skanda Amarnath, "Ten Thoughts On The Tribal 'Transitory' Debate As We Enter 2024," Employ America, January 1, 2024, https://www.employamerica.org/blog/ten-thoughts-on-the-tribal-transitory-debate-as-we-enter-2024/.

2023 was a very good year for the U.S. economy. Economic activity grew at a solid pace, job creation was strong, unemployment remained low, real wages grew, and inflation fell. Moreover, all this took place as the Federal Reserve kept interest rates high in an effort to keep inflation down.

There are good arguments for the Fed to begin easing its tight monetary policy stance sooner rather than later. Financial markets have been anticipating a rate cut, the Fed admits that market and public expectations for low future inflation remain well-anchored and are highly unlikely to become unmoored, and the fall in inflation since the current rate went into effect last July means that effective interest rates (interest rates minus inflation) have risen. This could prolong the harm to interest-sensitive sectors of the economy, especially housing; it also makes it harder for households and businesses to service their debt. If the Fed waits too long to start cutting, the continuation of high interest rates could weaken the recovery and put at risk important post-pandemic gains.