

US Macroeconomics

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Dour Consumers = Downbeat GDP

Consumer sentiment has been strikingly weak the past few years even though overall real GDP growth has been strong and unemployment has been low. Our best guess is that this was the result of elevated inflation which has eaten into households' purchasing power, thereby lowering their living standards. However, the latest sentiment weakness is troubling in a different way because it suggests much weaker real GDP growth in the quarters immediately ahead.

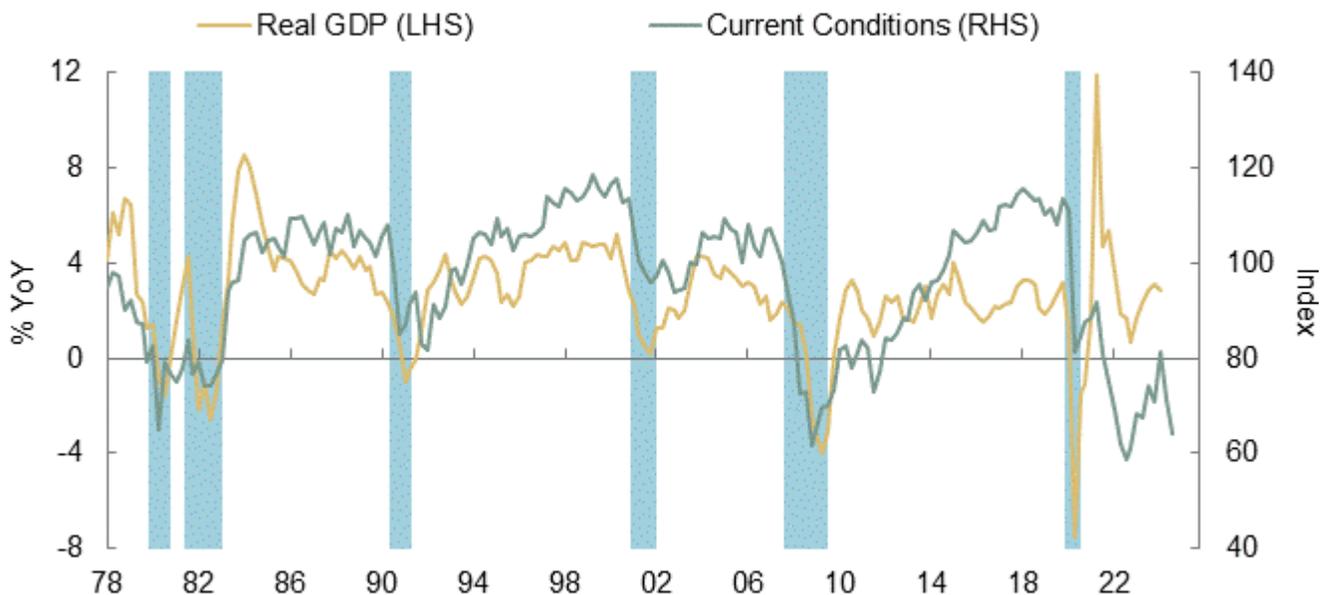
Consumer sentiment can be broken down into current conditions and expectations. Both series fell in the preliminary July report, but the former is down to its lowest level since December 2022. And this is happening with the inflation rate sharply slowing. If anything, consumer sentiment should be on a noticeable rebound in light of this development but it is not as clearly shown in the chart below. Instead, **current conditions are trending lower again**, which hints that GDP growth may soon tip over.

As we can see, over the last four decades, year-over-year real GDP growth has closely tracked the level of current conditions. But a yawning gap has emerged between the two series over the last few years. This may have been due to some combination of pandemic-related distortions and the aforementioned surge in inflation. Yet with confidence re-weakening, we worry this signals fundamental problems with the economy.

Taken literally, **current conditions are consistent with significant sequential annualized changes in real GDP growth**. However, our best guess is that output will not be anywhere near as weak as the sentiment data suggest because of big ongoing gains in government spending. Nevertheless, real economic activity is expected to continue to slow which suggests the unemployment rate should continue to rise.

Perhaps this is why the bond market is now discounting Fed rate cuts at the September, November, and December FOMC meetings. Unfortunately, this may not be enough to brake the downward momentum in the economy because of the long and variable lags in the monetary transmission mechanism.

It would be ironic that just as the consensus abandoned its hard landing call earlier this year, the economy then fell into one. Stay tuned.



Source: BEA, University of Michigan, Haver, SMBC Nikko

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