

Is a Soft Economic Landing Possible?

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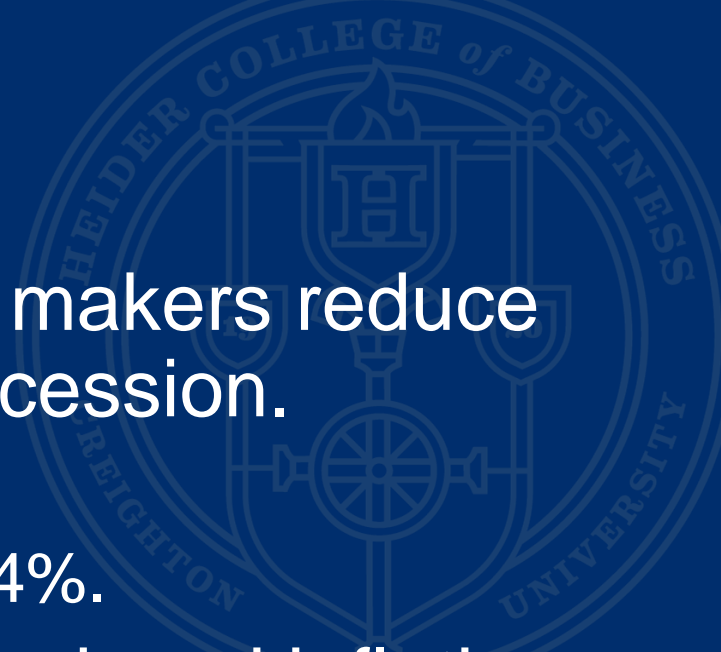
Outline

- What is a “soft landing?”
- The state of the US economy.
- Recession indicators – Sahm Rule.
- Interest rates.
- Questions and answers.



Soft Landing

- A soft landing is when policy makers reduce inflation without causing a recession.
 - Get inflation back to 2-3%.
 - Keep unemployment close to 4%.
- The Fed has rarely (if ever) reduced inflation by this much without causing a recession.



Soft Landing

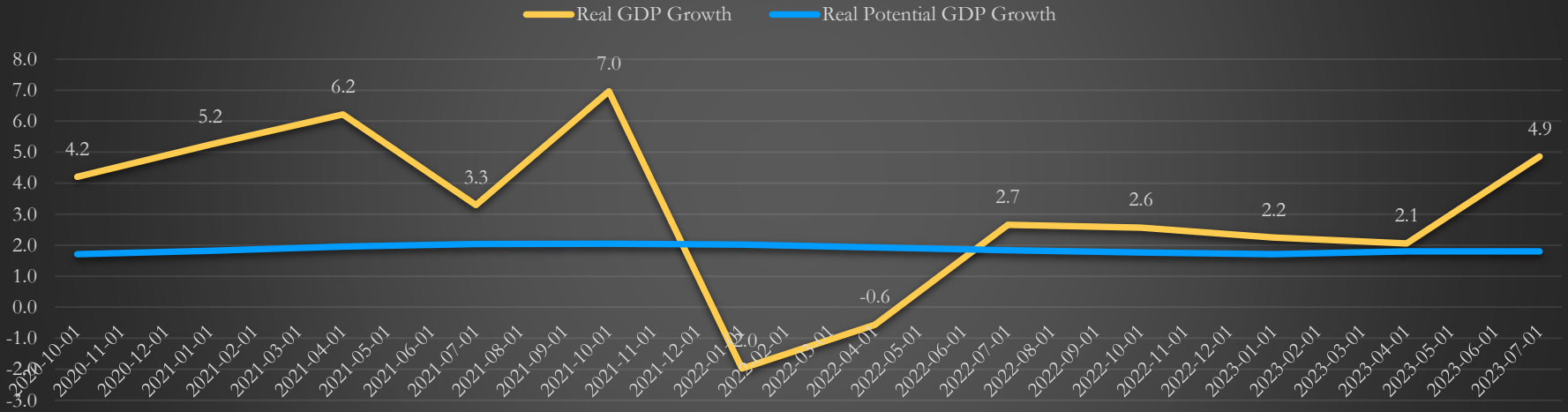
- A year ago, very few economists expected a soft landing.
 - Most, including me, expected a recession.
- Now, most expect a soft landing.
- But there is still plenty that can go wrong.



The State of the US Economy

- Real GDP growth is still above trend.

Real GDP Growth - Compound Annualized

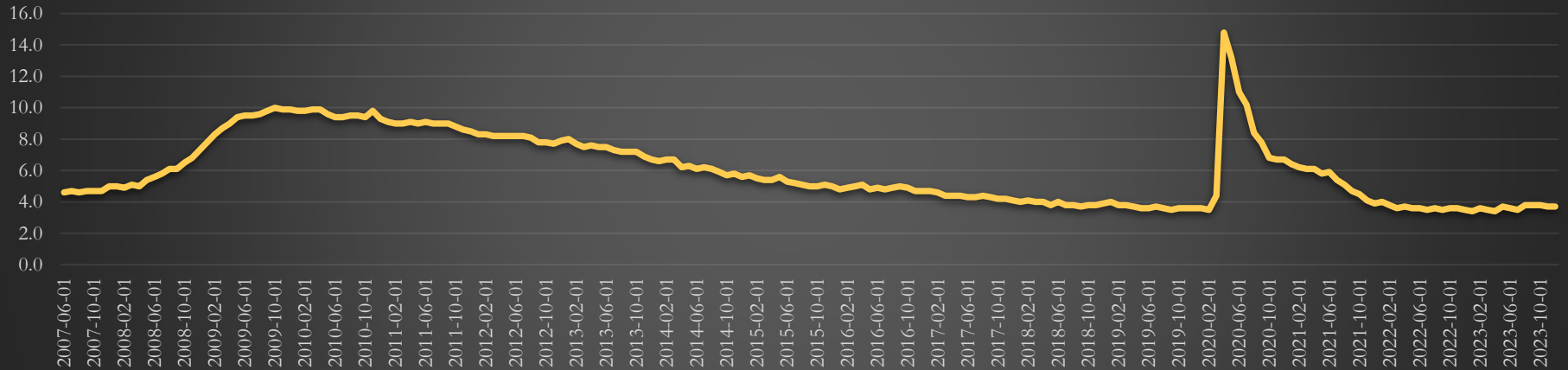


Source: FRED economic data.

The State of the US Economy

- Low unemployment rate: 3.7%
- A strong labor market.

The Unemployment Rate is Still Low

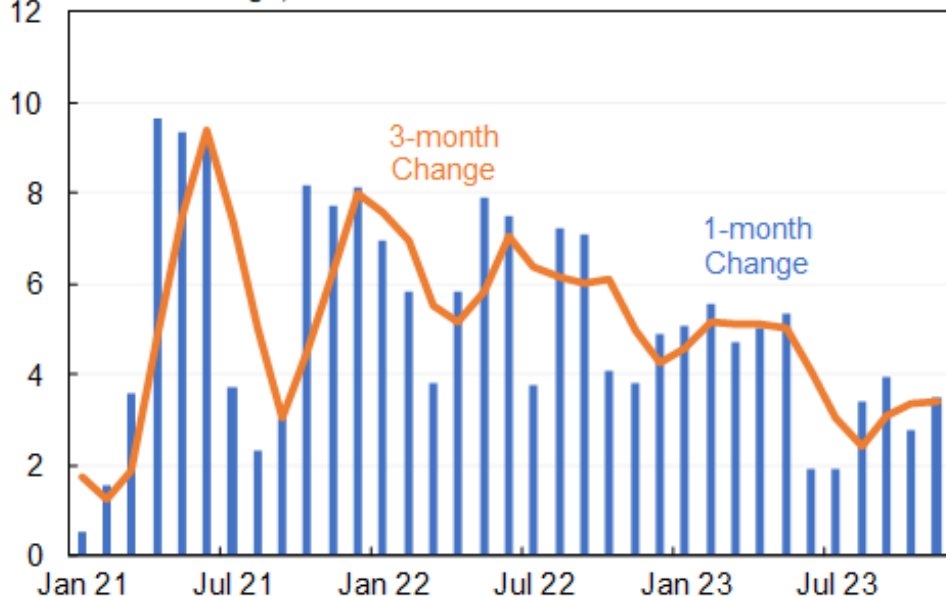


Source: FRED economic data.

The State of the US Economy

Core CPI Inflation

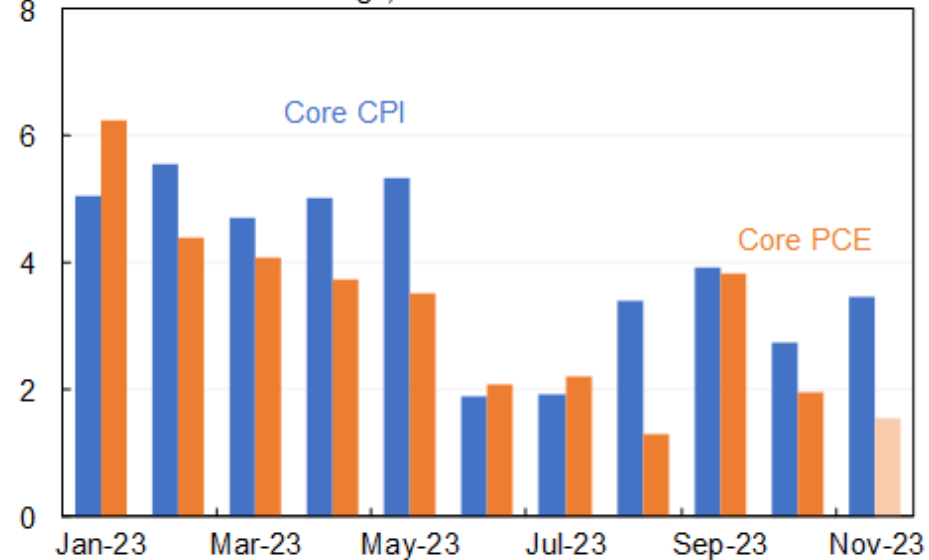
Percent Change, Annual Rate



Source: Bureau of Labor Statistics via Macrobond; author's calculations.

Core Inflation

1-month Percent Change, Annual Rate



Note: Forecast is 0.13% monthly print for core PCE in November.
Source: Bureau of Labor Statistics; Macrobond; author's calculations.

- Inflation has fallen from 9% to 3.3%.

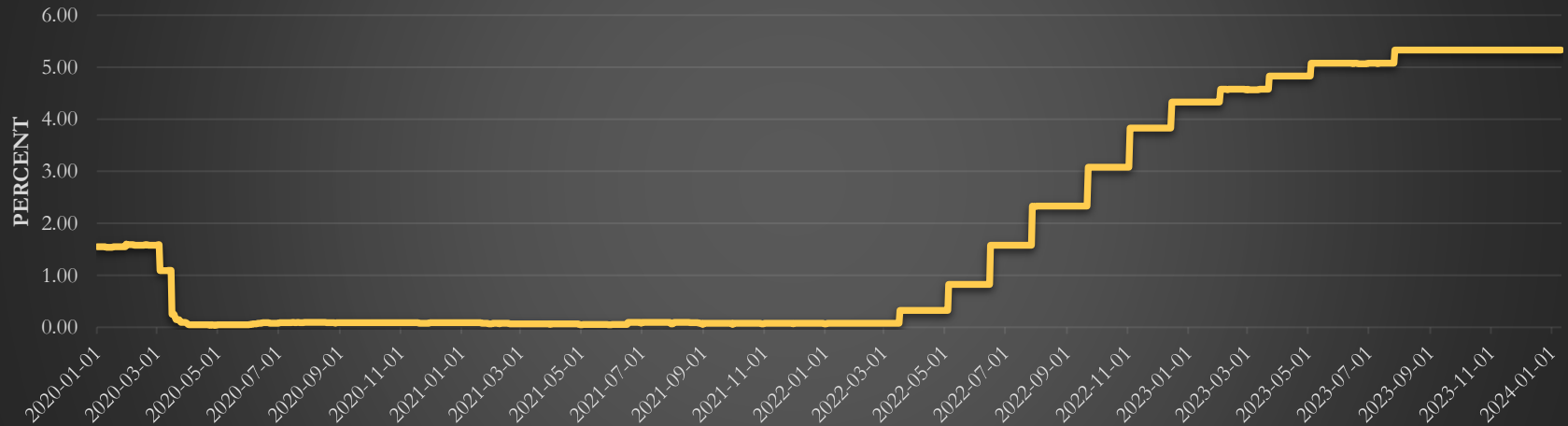
Source: BLS and Jason Furman.

The State of the US Economy

- Rapid increase in the Fed Funds rate.
- Held steady at 5.25-5.50% for months.



The Effective Federal Funds Rate



Source: FRED economic data.

The Sahm Rule - Recession Indicator

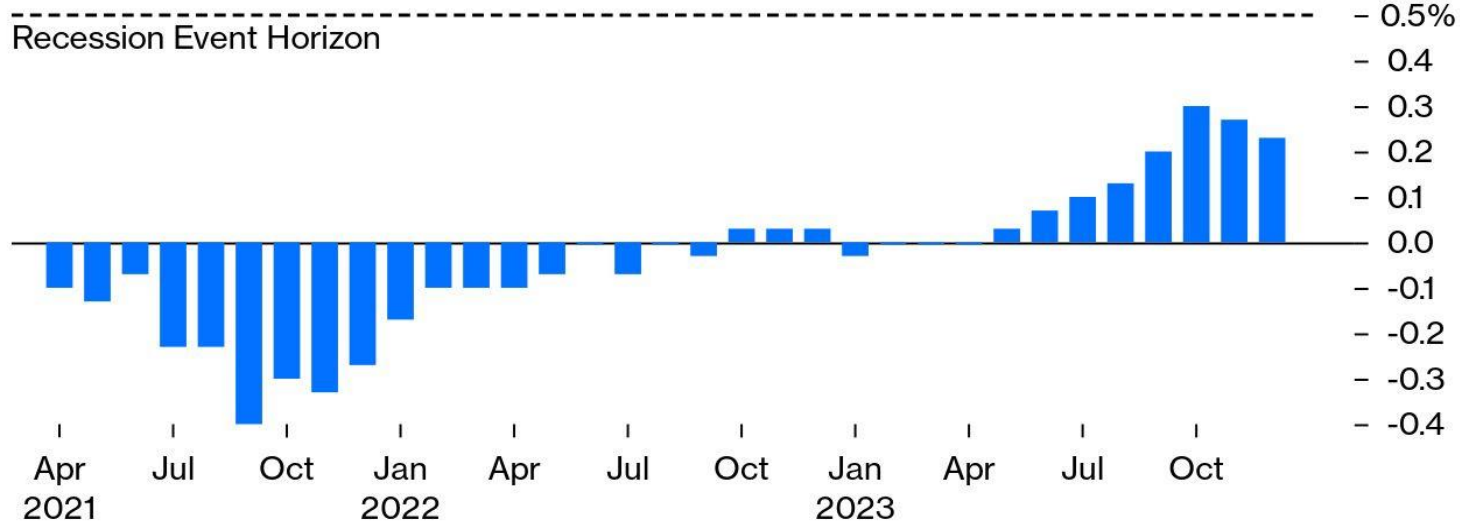
- In the moment we do not know if the economy is a recession.
 - Why? We observe economic data with a lag.
 - Leading indicators are only so reliable.
- Sahm Rule:
 - A recession indicator. Not a leading indicator.
 - Calculation: If the 3-month moving average of unemployment rate rises by half a percentage or more relative to its 12-month low.

The Sahm Rule - Recession Indicator

Recession Risk Receding

Employment numbers are no longer clearly heading towards recession

■ Sahm Rule Indicator



Source: Bloomberg

Bloomberg **Opinion**

The Fed Funds Rate

- Expect interest rate cuts. Why?
 - Rates are high now. Policy is “tight.”
 - Inflation has decreased.
- When will The Fed start cutting?
- When will The Fed stop cutting?
 - How low will rates go?



The Fed Funds Rate – Short Term

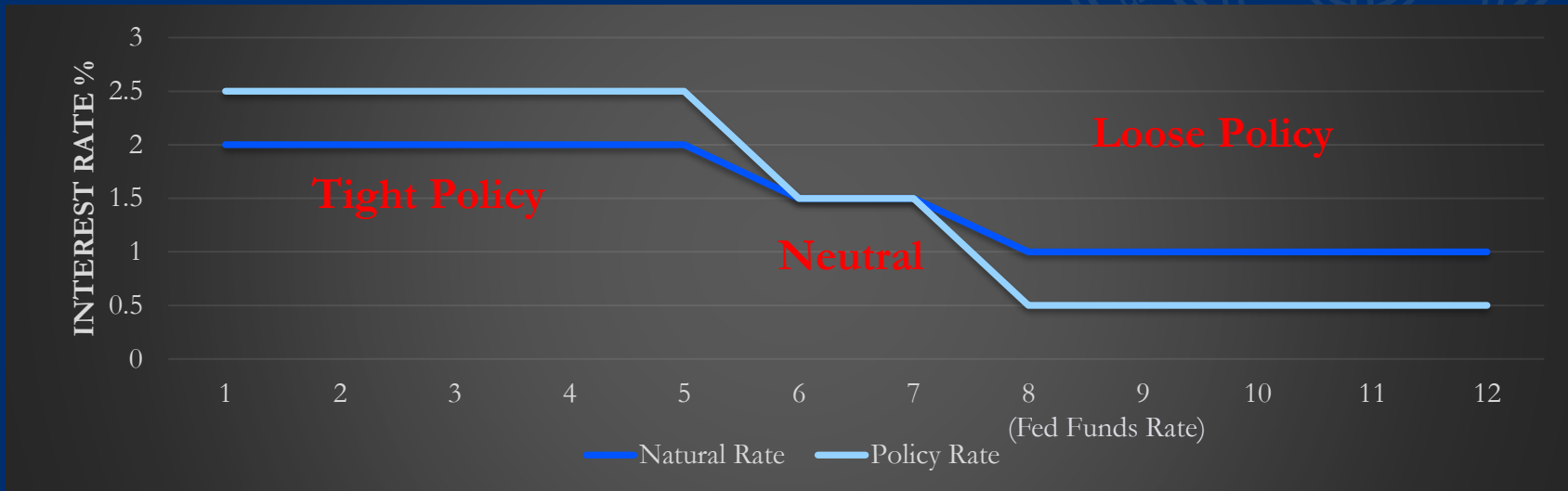
- The Fed will start to cut rates soon. But when?
 - January 31st: No. (2% chance)
 - March 20th: Maybe? (50/50)
 - May 24th: Yes. (85% chance of a cut or more by May)

Source: CME FedWatch Tool



The Fed Funds Rate – Interpretation

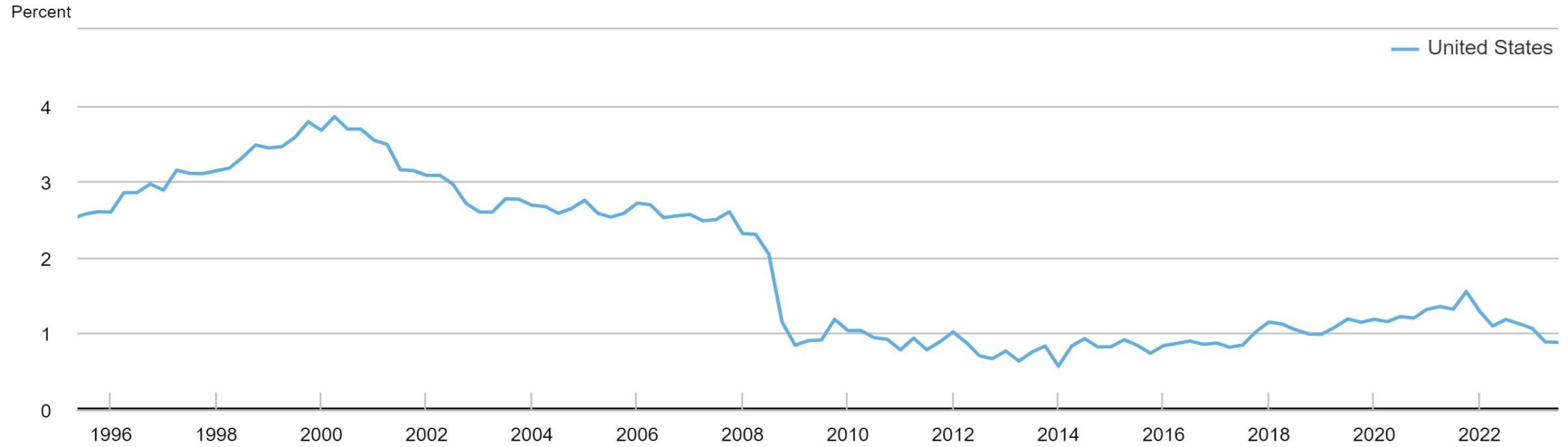
- Low rates do not always mean policy is “loose.”
 - Rates below the neutral rate: Loose policy.
 - Rates above the neutral rate: Tight policy.
- In the long run The Fed wants their policy rate equal to the natural rate.



Estimates of the Natural Rate (R^*)

The Natural Rate of Interest, or R-Star

From To



- Neutral fed funds rate = $R^* + 2\%$
- Has it increased or will it return to low levels?

Source: [Board of Governors Staff Estimates 2022](#). Holston-Laubach-Williams Method



The Fed Funds Rate – Long Term

- How low will the Fed Funds rate go over the next couple of years?
 - In other words, what is the neural rate?
- Is it permanently higher post-covid?
 - Over 4%?
 - Why? More innovation or higher federal deficits & debt.
- Or will it go back down pre-pandemic levels?
 - Closer to 2-3%?
 - Why? Long run demographics and lower productivity.

Economic Outlook: Interest Rates

- The Fed held rates steady at 5.25-5.50%.
- The Fed Predicts (dot plot):
 - 2024: 4.50-5.50%
 - Long run: 2.50-3.50% (skewed towards 2.5%)
- All of this can change due to world events.
 - Oil price spike?
 - AI led boom in productivity?



Conclusion

- Major progress on inflation.
- Minimal evidence of a recession. A soft landing may come to fruition.
- Interest rates will likely start to come down this year.



Q&A

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