ECONOMIC VIEWPOINT

Does US Economic Resilience Mean a Miracle Is Possible?

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In the US, the economy has been holding up and inflation has been slowing, suggesting a soft landing may be underway. But is that really what's going on? And if so, can the economy and employment escape relatively unscathed? In this *Economic Viewpoint*, we take a look back at the labour market analysis we did a year ago. Since September 2022, job openings have come down without a spike in unemployment. If the resulting slowdown in wage growth continues, it could help get inflation back to the Fed's target.

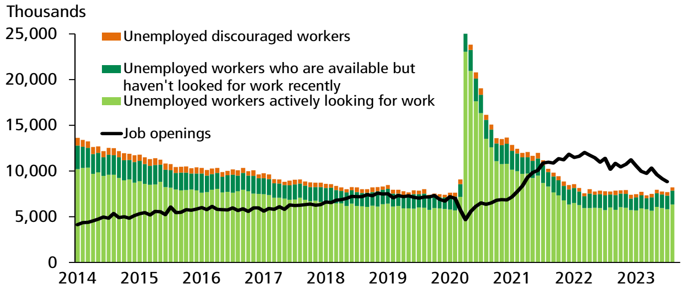
The US economy isn't white hot anymore, but it's still surprisingly resilient. It has withstood a number of challenges that could have brought it down. High interest rates, a housing market correction, a rising cost of living, tighter credit conditions, a shaky global economy, relatively low consumer confidence—any one of these could have slowed growth sharply. Yet after two quarters of roughly 2% annualized real GDP growth in the first half of the year, we expect a gain of nearly 4% in the third quarter.

Even more remarkable? Inflation has fallen considerably over the past year without the Federal Reserve's (Fed) restrictive monetary policy triggering a recession. Once upon a time, a soft landing seemed like a pipe dream. Now we're wondering if the Fed can actually pull it off.

Can inflation really keep closing in on the Fed's 2% target without tanking the economy and the labour market? That was the topic of a September 2022 *Economic Viewpoint* in which we looked at the relationship between wage growth and other labour market indicators, like job openings. A year later, we wanted to see how things have played out.

First, the gap between labour demand and the number of available workers has narrowed (graph 1). It's still relatively easy to find work, but the job market isn't as tight as it was a year or two ago. The same is true of consumer confidence. Not counting the pandemic, this is the first time since 2018 that consumers who say jobs aren't plentiful have outnumbered those who say it's still easy to get a job (graph 2). With labour market optimism waning, workers appear to be less likely to look for better opportunities elsewhere, with quits down 21.2% from their 2022 peak.

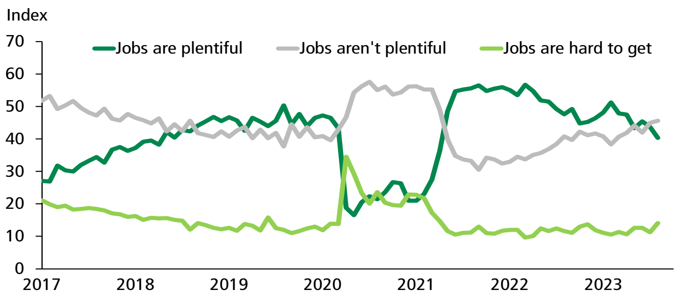
GRAPH 1
The Gap between Worker Supply and Demand Is Narrowing in the US



Sources: Bureau of Labor Statistics and Desjardins Economic Studies

GRAPH 2
Consumer Confidence Readings Suggest the Labour Market Is Gradually Normalizing

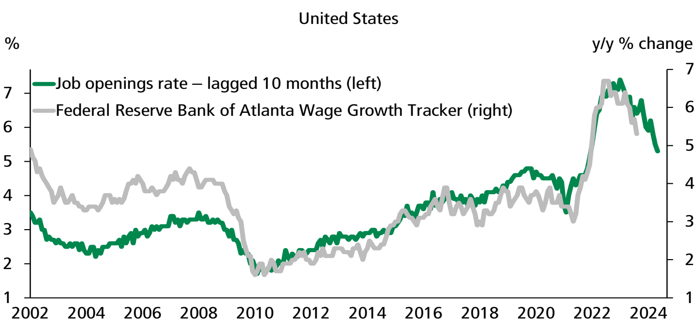
United States: Conference Board consumer confidence index



Sources: Conference Board and Desjardins Economic Studies

This softening of the labour market is affecting worker pay. There's still competition for employees, but it's nowhere near as stiff as it had been, and this has reduced pressure on wages (graph 3).

GRAPH 3
Wage Growth Has Slowed



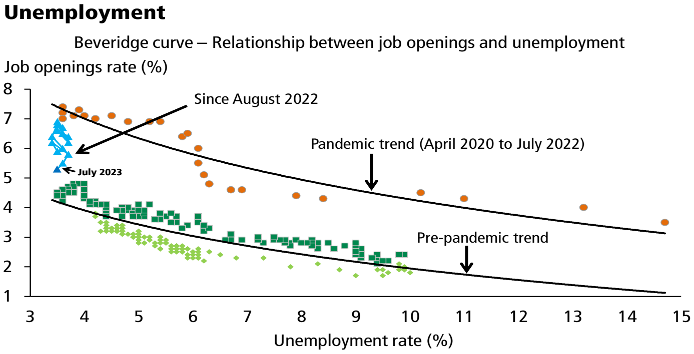
Sources: Bureau of Labor Statistics, Federal Reserve Bank of Atlanta and Desjardins Economic Studies

But wage growth will need to slow further to get inflation back to 2%. Between 2000 and 2019, core inflation averaged 2.0%. According to the Federal Reserve Bank of Atlanta's Wage Growth Tracker, annual wage growth during that time averaged 3.4%. To match that number, wage growth would have to slow another 2 percentage points. That means the labour market needs to soften further, starting with job openings. Can that happen without a spike in unemployment? Until recently, it looked like the answer was no. A recession in the US was therefore very likely. But now, the answer surprisingly seems to be yes.

Miracle on the Beveridge Curve

The Beveridge curve shows the inverse relationship between the job openings rate and the unemployment rate (graph 4). It demonstrates how deteriorating economic conditions would send the unemployment rate higher (towards the right in the graph) and the job openings rate lower. During the pandemic, disruptions in the economy and labour market pushed the whole curve up. After the pandemic, the economy could have continued on this new path or returned to its previous trend. It seems to have done the latter. But now the relationship between job openings and unemployment is breaking down. So far, the decline in job openings has affected wage growth, but not the unemployment rate. As a result, price pressures are easing without hurting the economy.

GRAPH 4
The Trend Appears to Be Changing without a Spike in Unemployment



Sources: Bureau of Labor Statistics and Desjardins Economic Studies

If this new trend continues, we will see a soft landing. Congratulations will be in order for the miracle workers at the Fed. But let's not get ahead of ourselves: the fight against inflation isn't over yet. As we discussed above, the job openings rate would have to fall below 4% to be consistent with wage growth of just over 3%, which in turn would be consistent with 2% inflation. Based on the pre-pandemic trend in the Beveridge curve, a job openings rate below 4% would drive up the unemployment rate to around 5%. This is in line with our baseline scenarios and would almost certainly mean a recession, depending on how quickly we get there. But by the looks of the recent data, it's increasingly likely that we could see another scenario in which job openings continue to fall without unemployment spiking. That's because businesses have had trouble finding skilled workers lately, prompting them to hold on to staff and keeping layoffs low. In other words, that miracle soft landing is still in the cards.