

Businesses Ride to the Rescue

April 12, 2024

We now expect the economy to avoid a recession in 2024. Businesses are emerging as a backstop. High and rising profit margins, a rebounding manufacturing sector, and a resilient services sector present the opportunity to maintain labor force expansion and, with it, consumer spending.

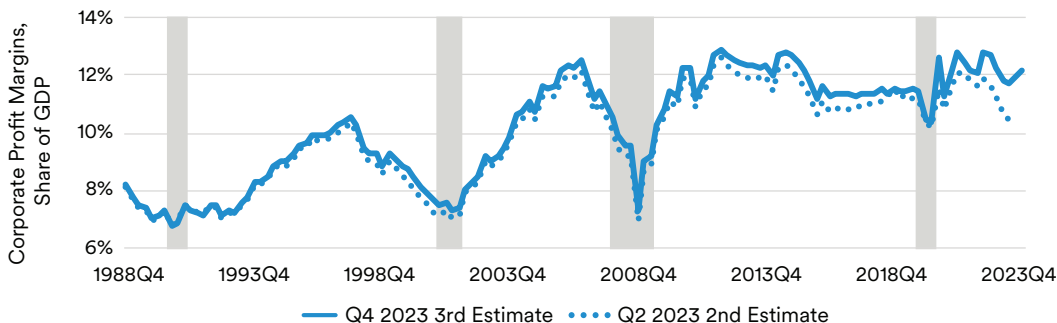
However, the ability of consumers to keep spending is dependent on companies' ability to keep hiring. Until now, companies have largely succeeded. Taking a longer-term perspective, we have some concerns for ongoing consumer strength and we remain watchful for signs of weakness.

Corporate Profit Strength Never Really Left Us

Corporate profits appear to be on an upswing. Publicly traded firms are seeing increases in corporate earnings, after a negative Q2 2023.¹ The corporate profit measured by the Bureau of Economic Analysis, which provides a more complete measure of employment-related corporate profits,² also shows improvements to profit margins as a share of GDP.

Chart 1 shows the substantial improvements in corporate profit margins over the past six months, both due to data revisions and due to an upturn in margins since Q2 2023. Rather than nearing pandemic-level profit, profits are now above the post-pandemic (i.e. since Q4 2022) median and well above the levels we had seen in the two years before the pandemic.

Chart 1 | Improvement in Profit Margins



Note: Shaded areas represent recession. Data as of March 28, 2024.
Source: BEA, NBER, Haver, MIM

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If profit margins remain this strong, it is difficult to see companies laying off workers *en masse* soon. Also, after a relatively cautious year of investing—aside from some investment in manufacturing structures that were likely driven by the CHIPS and Science Act—we would expect to see companies investing more confidently given their healthy profit margins and a more optimistic economic outlook.

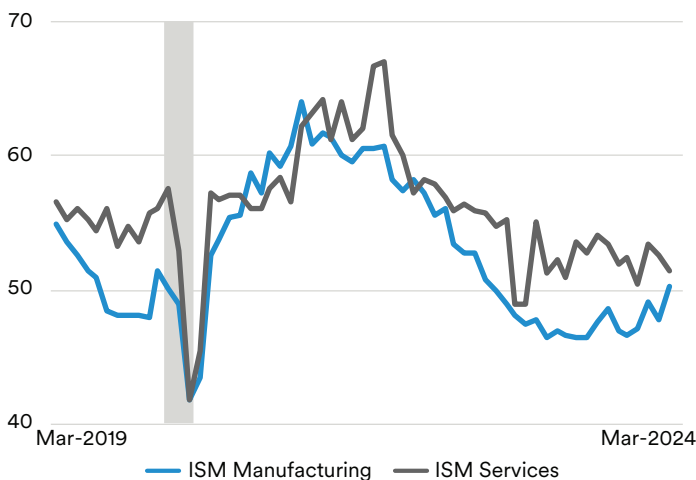
Manufacturing and Services PMIs Are Stabilizing

Both manufacturing and services ISM indexes have traced a more optimistic path since December 2023. The manufacturing PMI registered 50.3 in March, its first reading above 50 in 16 months, while the services PMI marked its 15th consecutive month of expansion, partly reversing its Q4 2023 deceleration.

Demand seems to be at the early stages of recovery, with new orders and new export orders expanding, and contractions in inventories in both sectors. We believe these positive signs demonstrate consumer resilience and will translate into higher economic growth.

By the same token, with better growth prospects, prices in the manufacturing sector also picked up via a jump in the prices-paid index. If the expansion is strong enough, inflationary pressures may develop further, which may add more uncertainties to the path for inflation and interest rates in 2024. Raw materials supply chains continue to be fragile, as suggested by the supplier deliveries index nearing neutral in the manufacturing sector.

Chart 2 | PMIs Are Stabilizing



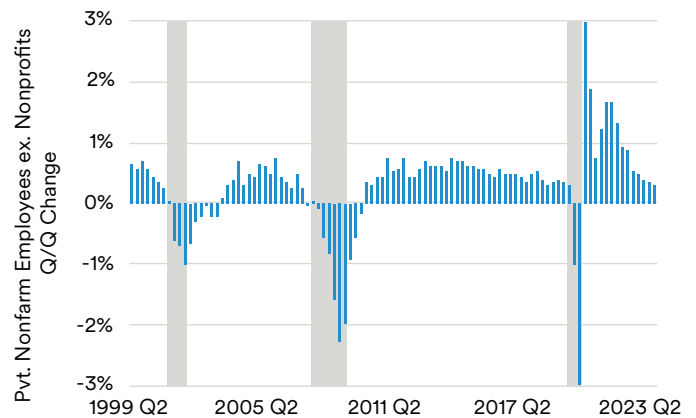
Note: 50 represents no growth; above 50 represents positive growth and below represents decline.
Source: ISM, NBER, Haver, MIM

The price index in the services ISM has decelerated substantially in the last few months to its lowest level since before the pandemic, indicating that at least services are moving in the right direction despite continued expansion.

Employment Is Not Deteriorating

Employment and hiring remain robust. In the most recent Bureau of Labor Statistics (BLS) employment report for March 2024, the unemployment rate decreased to 3.8% and non-farm payrolls increased by over 300,000, along with net strengthening revisions to prior months. The unemployment rate, which would be expected to jump sharply at the onset of a recession, has moved sideways at record lows of 3.4% to 3.9% for the last year, and (as we discussed in our [February monthly](#)) end-of-year revisions mean that the labor market was even stronger in 2023 than we initially thought. On top of that, the BLS JOLTS survey shows that the gradual decline in openings from record pandemic highs has started to stabilize at a level higher than it was before the pandemic.

Chart 3 | Employment Growth has Normalized



Source: BLS, Haver, NBER, MIM. As of Q4 2023.

While there has been weakness in certain sectors including professional services and specific manufacturing subsectors, other firms need to hire and should continue to support labor demand going forward. Firms' comments on the ISM Manufacturing Index indicate companies are nearly equally split between expanding and reducing headcounts, and the Federal Reserve's Beige Book noted that companies continue to have difficulties filling specialized positions in (for example) healthcare, engineering, and welding.

U.S. Outlook Summary

We expect growth in 2024 to soften compared to 2023 but to remain healthy. Residential investment appears headed for growth, after contributing negatively to GDP in 2023. We expect corporate investment to be healthy in 2024, backed by strong profit margins and a growth outlook less clouded by recession. The government sector, while pulling back vis-à-vis 2023, is still expected to contribute quite a bit to growth as various industrial policies at the Federal level and continued tax revenue growth at the local level induce spending. We are relatively more worried by consumers. They appear in a weaker situation than they were in 2023, with segments of the population struggling with high interest rates and unemployment.

We expect the Federal Reserve to cut rates by a total of 75 bps by year end, although if it is not able to cut by July due to persistent inflation, this could decrease to 50 bps. For the 10-year yield, we now expect it to end the year at 4.50%, as fewer rate cuts, a lower recession probability, a shallower inflation path, and higher growth going forward maintain upward pressure on rates.

We believe that the key economic components—consumers, residential investment, corporate investment, and governments—will all contribute positively to economic growth this year, making for solid growth for the balance of the year.

MIM Forecast

| U.S. | 2023* | 2024 | 2025 |
|----------------------------|-------|------|------|
| GDP | 2.5 | 2.0 | 2.2 |
| CPI | 3.2 | 2.8 | 2.8 |
| 10 Year | 3.88 | 4.50 | 4.2 |
| Policy rates (upper bound) | 5.50 | 4.75 | 4.00 |
| Unemployment | 3.7 | 4.4 | 4.3 |

Note: GDP is annual average growth rate, CPI is Q4 year/year, 10 year is year-end, policy rate is the upper bound year-end rate. Our core PCE forecast for 2024 is 2.5%.

*Denotes actual data; the rest are forecasts.

Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of March 2024.

Risks to the Outlook

We also recognize a number of factors that keep us cautious, even as we turn to a generally more optimistic base case. The concerns, particularly at the consumer level, have not disappeared. Delinquency rates are high and rising quite sharply, credit remains tight, and unemployment is rising for some segments of the population.

Persistent inflation has also reemerged as a risk. Inflation—while unlikely to return to 2022 levels—appears to be decelerating more slowly than in the last half of 2023. Most Fed officials doubt that inflation will return to 2% before 2026 but stubborn or rising inflation would likely alter the Fed's rate cut path and potentially economic growth.

Endnotes

¹ Bloomberg, as of March 2024.

² The Bureau of Economic Analysis (BEA) data encompasses both public and private corporate profits, while public companies – which, according to a study by Schlingemann and Stulz (“Have exchange-listed firms become less important for the economy?” Journal of Financial Economics, September 2021) – employed only about 23% of U.S. private sector workers as of 2018.

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