United States of America Staff Concluding Statement of the 2024 Article IV Mission

June 27, 2024

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Washington, DC – June 27, 2024:

The U.S. economy has proven itself to be robust, dynamic, and adaptable to changing global conditions. Activity and employment continue to exceed expectations (notably, relative to those at the time of the 2023 Article IV consultation) and the disinflation process has been considerably less costly than many had feared. Nonetheless, the fiscal deficit is too large, creating a sustained upward trajectory for the public debt-GDP ratio. The ongoing expansion of trade restrictions and insufficient progress in addressing the vulnerabilities highlighted by the 2023 bank failures both pose important downside risks.

A Dynamic Economy

The U.S. economy has turned in a remarkable performance over the past few years. Hysteresis effects from the pandemic did not materialize and both activity and employment now exceed pre-pandemic expectations. Real incomes were diminished by the unexpected rise in inflation in 2022 but have now risen above pre-pandemic levels. Job growth has been particularly fast, with 16 million new jobs created since end-2020. However, income and wealth gains have been uneven across the income distribution and poverty remains high, particularly following the expiration of pandemic-era support.

The outlook is for continued healthy growth supported by:

- A significant (and ongoing) rise in household wealth which should bolster consumer demand. Homeowners, in particular, have benefited from an almost 50 percent increase in the average house price since end-2019.
- A household and corporate debt service burden that has been insulated from increases in market interest rates. Notably, even as policy rates moved higher, net interest payments by nonfinancial corporates fell and net interest outlays by households saw only a modest increase.
- A material improvement in the terms of trade, in large part a product of the U.S. being a net exporter of natural gas, crude oil, and petroleum products.

- Large and ongoing supply gains from migrant inflows (expanding the workforce by almost 3 percent over the past three years), increased participation by native-born workers (particularly female, black and Hispanic workers), and rising labor productivity.

The near-term distribution of risks for activity are assessed to be broadly balanced. Consumption and investment could exceed expectations, driven by a healthy labor market, rising real incomes, and wealth gains. Similarly, supply side gains from higher productivity and the inflow of foreign labor could persist. On the other hand, downside risks could arise from the complex global geopolitical environment or from a slower path of disinflation and a resulting higher path for interest rates.

Progress in Disinflation

The ongoing disinflation has taken a relatively light toll on the economy. PCE inflation peaked at 7.1 percent in mid-2022, the highest level since the early 1980s. The Federal Reserve responded by raising the policy rate by 525bps which bolstered policy credibility, provided an anchor for wages and prices, and helped guide inflation back toward the FOMC's 2 percent goal. Policymakers were also fortunate that their efforts were accompanied by important supply-side gains. PCE inflation was 2.7 percent in April and is expected to return to 2 percent by mid-2025.

There are important upside risks to the outlook for inflation. The expected decline in shelter inflation may materialize more slowly, or reverse more quickly, than expected. Also, even with the sizable expansion in labor supply, nominal wage growth remains relatively high which could forestall the expected softening of non-shelter services inflation. An escalation of geopolitical tensions (e.g., from the Middle East conflict or war in Ukraine) could add to energy costs which would subsequently pass-through to wages and core inflation.

Monetary Policy

Despite the important progress to-date in returning inflation toward its 2 percent goal, the Federal Reserve should wait to reduce its policy rate until at least late 2024. With the economy humming along at an impressive rate, the U.S. has not paid a high cost to current monetary policy settings (i.e., in terms of slower growth, job losses, or reduced labor force participation). This provides significant room for maneuver within the Fed's mandate of price stability and maximum employment. Given salient upside risks to inflation—brought into stark relief by data outturns earlier this year—it would be prudent to lower the policy rate only after there is clearer evidence that inflation is sustainably returning to the FOMC's 2 percent goal. Furthermore, in the event that incoming inflation data runs hot in the coming months, serious consideration may have to be given to removing the loosening bias in Fed communications and, potentially, even further raising the federal funds rate. Continuing to clearly communicate the FOMC's interpretation of incoming data, and adjusting forward guidance accordingly, should ensure that needed shifts in the monetary stance are well understood and smoothly absorbed.

The decision to reduce the pace of run-off of the Fed's holdings of Treasuries will provide more time to judge the appropriate long-term size of the Fed's balance sheet. The decision on when to stop the shrinking of the balance sheet will need to be handled carefully so as to prevent inducing volatility in short term funding markets.

Fiscal Policy

There is a pressing need to reverse the ongoing increase in public debt-GDP ratio. The general government fiscal deficit and debt are, as a share of GDP, both projected to remain well above pre-pandemic forecasts over the medium term. Specifically, under current policies, the general government debt is expected to rise steadily and exceed 140 percent of GDP by 2032. Similarly, the general government deficit is expected to remain around 2½ percent of GDP above the levels forecast at the time of the 2019 Article IV consultation. Such high deficits and debt create a growing risk to the U.S. and global economy, potentially feeding into higher fiscal financing costs and a growing risk to the smooth rollover of maturing obligations.

These chronic fiscal deficits represent a significant and persistent policy misalignment that needs to be urgently addressed. To put debt-GDP on a clear downward trajectory, a frontloaded fiscal adjustment will be needed that shifts to a general government primary surplus of around 1 percent of GDP (an adjustment of around 4 percent of GDP relative to the current baseline). There are various tax and spending options to achieve this adjustment over the medium-term. However, policies will need to go beyond finding efficiencies in discretionary, non-defense federal spending. Policymakers will need to carefully consider raising indirect taxes, progressively increasing income taxes (including for those earning less than US$400,000 per year), eliminating a range of tax expenditures, and reforming entitlement programs. Putting these measures in place will necessitate taking difficult political decisions over the course of multiple years. Some of the fiscal savings from these efforts should, though, be deployed to increase spending on programs to alleviate poverty. This should include reinstating a more generous, refundable Child Tax Credit (that is carefully targeted to lower income households) and raising the income threshold for eligibility for the Earned Income Tax Credit for workers without children.

The U.S. should also address shortcomings in its fiscal institutions that periodically lead to political stand-offs over the debt limit and the funding of the federal government. These create systemic risks to the U.S. and global economy that are entirely avoidable. Institutional changes should be designed to ensure that, once appropriations are approved, the corresponding space is automatically added to the debt ceiling. Similarly, in situations where the funding of federal agencies lapses because of an inability to approve appropriations, provisions should be made to automatically fund the federal government at some fraction of previous year's funding until a full-year appropriations bill can be signed into law.

An Economy Returning to Balance..

Overall, the evidence suggests that the U.S. economy has largely returned to balance. Labor market imbalances have been mostly resolved with the economy now appearing to be operating slightly above maximum employment. By mid-2025, inflation is expected to return to the FOMC's 2 percent goal which will, in turn, allow the policy rate to return to a neutral setting. The external position is assessed to be broadly in line with the level implied by medium term fundamentals and desirable policies. However, as described above, the fiscal deficit is much too large and the public debt is well above prudent levels.

... But With Important Risks Ahead

While the economy is showing a better overall balance there are risks ahead to financial stability and from the ongoing increase in trade and subsidy distortions:

Financial System

Financial stability risks have diminished since the time of the 2023 Article IV consultation and some critical financial sector reforms are being implemented. For example, welcome steps have been taken to strengthen the functioning of the Treasury market and to better insulate money market funds from liquidity shortfalls. However, concrete actions have been lacking in mitigating the banking system vulnerabilities that came to light in 2023—including failings in bank supervision, the large share of uninsured deposits, and the risks created by the regulatory "tailoring" that was undertaken in 2018. There is a need, therefore, to fully implement the final components of the Basel III agreement, apply similar regulatory requirements to all banks with US$100 billion or more in assets (including supervisory stress tests), further strengthen supervisory oversight and practices, re-examine the coverage of deposit insurance, and recalibrate bank liquidity requirements and liquidity stress tests (to better take account of the potential for fast-moving deposit outflows and the potential losses that could be realized when long duration assets are liquidated). There is also a continuing need to increase the resilience of nonbank mortgage companies, particularly given the critical role they play in servicing a sizable share of U.S. mortgages.

Trade

The ongoing intensification of trade restrictions and the increased use of preferences in the treatment of domestic versus foreign commercial interests represent a growing downside risk for both the U.S. and the global economy. The U.S. should actively engage with its major trading partners to address the core issues—including concerns over unfair trade practices, supply chain fragilities, and national security—that risk undermining the global trade and investment system. Tariffs, nontariff barriers, and domestic content provisions are not the right solutions since they distort trade and investment flows and risk creating a slippery slope that undermines the multilateral trading system, fragments global supply chains, and spurs retaliatory actions by trading partners. These policies are ultimately bad for U.S. growth, productivity, and labor market outcomes and the evidence suggests their costs are largely borne by U.S. consumers and firms. The U.S. should unwind obstacles to free trade and seek instead to bolster competitiveness through investments in worker training, apprenticeships, and infrastructure. The U.S. should engage fully with efforts to strengthen the WTO (including through the restoration of a well-functioning dispute settlement system by end-2024), find common ground in areas such as tariffs, farm and industrial subsidies, and services trade, and conclude new WTO-based market-opening agreements. Finally, industrial policies should be confined to specific objectives where externalities or market failures prevent effective market solutions and, even then, they should minimize trade and investment distortions, be consistent with international obligations, and avoid discriminating between domestic and overseas producers.

United States: Selected Economic Indicators

			Projections					
	2022	2023	2024	2025	2026	2027	2028	2029

Real GDP (annual growth)	1.9	2.5	2.6	1.9	2.0	2.1	2.1	2.1
Real GDP (q4/q4)	0.7	3.1	2.0	1.8	2.1	2.1	2.1	2.1
Output gap (% of potential GDP)	0.4	0.6	0.6	0.2	-0.2	-0.2	-0.2	-0.1
Unemployment rate (q4 average)	3.6	3.7	4.2	4.3	4.3	4.2	4.0	3.9
Current account balance (% of GDP)	-3.8	-3.0	-2.9	-2.8	-2.5	-2.2	-1.9	-1.6
Federal funds rate (end of period)	4.4	5.4	5.1	4.1	3.1	2.9	2.9	2.9
Ten-year government bond rate (q4 avg.)	3.8	4.4	4.1	3.5	3.3	3.2	3.2	3.2
PCE inflation (q4/q4)	5.9	2.8	2.4	1.8	1.9	1.9	1.9	1.9
Core PCE inflation (q4/q4)	5.1	3.2	2.5	1.9	2.0	2.0	2.0	2.0
Federal government fiscal balance (% of GDP)	-5.4	-6.3	-6.8	-6.6	-6.1	-5.4	-5.6	-5.3
Federal government debt held by the public (% of GDP)	95.8	97.3	99.2	102.1	104.7	106.3	108.1	109.5
General government fiscal balance (% of GDP)	-4.1	-7.6	-7.8	-7.6	-7.2	-6.7	-6.7	-6.5
General government gross debt (% of GDP)	119.8	120.7	123.2	126.7	129.6	131.8	134.0	135.9

Sources: BEA; BLS; Haver Analytics; and IMF staff estimates.