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Keeping score on the 'roar'

Blog

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The US economy has come back to earth after a red-hot second half of 2023, when real GDP grew at a 4% annualized rate. It's on track to grow nearly 2% in 1H24, based on the 1.3% growth in Q1 and the Bloomberg consensus forecast of 2.1% for Q2. It's a solid number to be sure, right around the assumed long-term trend rate and consistent with our expectation that growth would moderate in 2024. So it may seem contradictory to say that our conviction for a "Roaring '20s" outcome for the US economy has actually gone up marginally since last November. We came to that conclusion in our latest assessment of this macro regime, arguing that "the roar is getting a little louder," with growth being only one part of our assessment

As a reminder, our criteria for a Roaring '20s outcome is a decade with real GDP growth averaging 2.5% or better; inflation of 2-3%; the 10-year Treasury yield around 4%; and the Federal funds rate at 3–4%. Nearly halfway through 2024 (and the 2020s), US economic conditions are still in-line with these criteria. While the recent economic strength mostly reflects cyclical factors that are likely to fade over the next year, the economy may continue to run at a faster clip for the time being because of the unexpected increase in immigration that significantly boosted labor supply and a stronger-than-expected growth impulse from fiscal legislation.

Structurally higher growth (i.e., a higher trend rate) has not yet materialized in an obvious way, but there is increasing reason for optimism. When we first asked whether another Roaring '20s for the US was possible, we concluded that it hinged on the supply side of the economy. We focused on four supply megatrends, two of which—capex boom and AI—are most relevant for a Roaring '20s outcome. A capex boom due to prior underinvestment and the need to substitute capital for scarce labor, and AI being deployed across industries are necessary drivers for Roaring '20s-level productivity gains.

To evaluate supply side developments, we created a "roar score" for capital, labor, and productivity factors to gauge the Roaring '20s likelihood. Over the long term, growth is a function of labor and capital inputs, and productivity gains. A Roaring '20s requires the capital contribution (K) and productivity gains (A) to be nearly comparable to their 1990s levels. We map developments in the supply megatrends to these three factors and track capital investment, labor supply, AI deployment, business dynamism, and

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productivity gains to determine whether they're at sufficient levels to support a Roaring '20s regime.

Based on the scores, our conclusion is that Roaring '20s regime is marginally more likely than it was in 4Q23, but it's still the bull case (Fig. 1). The continued strength of the economy, including strong household finances in aggregate, accelerated investment in AI, surging capex in specific areas, and the availability of risk capital all fundamentally support a higher probability of this regime. Productivity growth has been elevated, though not likely because of the preceding factors. Disinflation progress gives us confidence that sticky inflation will not be an impediment to this regime. The probability of this regime is getting closer to 50% with no other scenario clearly more likely.

Fig. 1: 'Roar Score' assessment: a little bit louder now

Factor	Confidence Nov 2023	Confidence June 2024
Capital (K)		
Labor (L)		+
Dynamism / Technology (A)		
Productivity / Output (Y)		+

Source: UBS, as of 21 June 2024

A wildcard for a Roaring '20s is the future paths of monetary and fiscal policy. The fundamental case for a Roaring '20s is solid, but policy could go in multiple directions that make it either more or less likely. Large deficits and debt for the foreseeable future point to fiscal consolidation, a growth headwind, but there is currently little political appetite to significantly shrink the deficit. Monetary policy should become less restrictive in the next year as the Fed tries to set the policy rate around the neutral level. But it's also at risk of fiscal dominance, whereby the Fed has to tolerate higher inflation (and growth), all else equal, because of the high debt levels. On net, we expect policy is still more likely to be a headwind than a tailwind.

The bottom line: The US economy is slowing, but foundational drivers for a Roaring '20s decade are still being laid. This certainly doesn't guarantee that this outcome will happen, but its potential should not be underestimated. In 1995, growth also slowed in response to the Fed's aggressive rate hiking cycle in 1994. But growth subsequently accelerated in 1996 and stayed elevated for the rest of that decade as the productivity benefits of a different technology revolution took hold. History doesn't repeat, but it often rhymes.

Appendix

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