US economic outlook April 2024

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A rosy economy, but not one without thorns

Outlook

Spring is here, and the US economy looks rosy. Economic activity remains resilient powered by consumers' ongoing ability and willingness to spend, even if they are being more scrutinous in the face of high prices. A robust labor market along with positive real wage growth continues to provide a solid foundation to consumer outlays. Meanwhile, businesses are focusing on high return-on-investment projects and productivity-enhancing investments in an elevated cost and interest rate environment.

Looking ahead, we see the economy gently cooling as slower labor demand, easing wage growth, stubborn inflation and tight credit conditions constrain private sector activity. In particular, we note that if inflation proves to be stickier than anticipated, the downside risk to the economy from reduced real income growth, a "higher for longer" Fed stance and tightening financial conditions would be notable.

Overall, we have raised our real GDP growth forecast to 2.5% in 2024 on account of a stronger start to the year, but continue to expect growth will slow to 1.7% in 2025.

Noninflationary job growth

The strong 303,000 payrolls gain in March reinforced the Fed's cautious approach toward rate cuts, as some Fed officials see job growth as being too hot for comfort. Our take, however, is that the details of the jobs report offered welcome signs that labor demand and supply are better balanced with the labor force participation rate rebounding and wage growth easing. Notwithstanding strong immigration flows, we foresee softer labor market conditions with cooler hiring, targeted layoffs and continued moderation in wage growth. We expect job growth to slow below trend over the course of the year and see the unemployment rate rising to 4.1% by year-end.

Consumers still spending

Consumers remain willing to spend on goods and services despite cost fatigue. Retail sales were stronger than expected in March, confirming that persistently high prices are not deterring consumers from spending. Still, with employment and household income growth gradually softening, prices remaining elevated, and interest rates likely to ease only gradually, we expect households will exercise more scrutiny with their outlays. We foresee consumer spending growth of 2.3% in 2024, supported by solid early-year momentum, following a 2.2% advance in 2023.

Slow disinflation

Headline and core Consumer Price Index (CPI) rose by 0.4% month over month in March, surpassing consensus expectations for a third straight month. As a result, headline CPI inflation climbed 0.3 percentage points to 3.5% y/y (year over year) — the fastest rate since September 2023 — while core inflation held steady at 3.8% y/y — its lowest level since April 2021. Rightly, or wrongly, the lack of downward momentum in core inflation in Q1 has made Fed officials increasingly uneasy about cutting rates. Still, while the short-term inflation dynamics indicate slower disinflation over the last three months, we anticipate renewed downward momentum in the coming months. We have revised our headline and core CPI inflation forecast up to 2.7% y/y and 2.9% y/y, respectively, in Q4 2024 while we anticipate the Fed's favored inflation gauge, the deflator for personal consumption expenditures, to end the year around 2.5% y/y.

Rate cuts on hold

Fed communication in recent weeks has had a decidedly hawkish lean. In the face of elevated inflation uncertainty, policymakers have indicated increased reticence to easing monetary policy soon. Fed Chair Jerome Powell — who until now had been willing to balance the hotter-than-expected Q1 inflation prints against the faster-than-expected disinflation momentum in H2 2023 — confirmed the broad sentiment pivot within the Fed. He noted that recent data had clearly not given the Fed greater confidence that inflation would sustainably return to 2% — a necessary condition for the onset of the easing cycle. With Powell indicating the Fed should allow restrictive policy further time to work, and a clear majority of policymakers favoring two or fewer rate cuts, we now expect only two 25 basis points rate cuts in 2024 (down from three previously) in July and November.

Risks to monitor

The two downside risks that we noted last month have taken more prominence. Elevated tensions in the Middle East make an energy price shock more likely, which would bring a terrible combination of higher inflation and lower growth, while the risks of renewed supply chain stress remain significant. Second, the combination of a more hawkish Fed and fiscal sustainability concerns could result in a substantial tightening of US and global financial conditions leading to a retrenchment in private sector activity. The main upside risk stems from noninflationary growth supported by a robust labor market and stronger productivity growth from efficiency improvements and generative AI.

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