



# US economic outlook

## August 2024

August 26, 2024



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## A late Fed pivot to buffer the economic downshift

### Outlook

Despite elevated financial market volatility and softer economic data, worries about an imminent US recession are overstated. Labor market conditions have visibly softened, but economic momentum remains positive. The US economy is still moving forward at a modest to moderate pace.

We expect slower economic activity heading into 2025 as still-elevated prices and interest rates curb private sector activity. Households will spend more prudently as labor market conditions and income growth soften further while elevated financing costs lead businesses to hire and invest with discretion. Still, business leaders and consumers are not retrenching, and financial market volatility is more a reflection of the Federal Reserve being behind the curve in terms of easing policy than reflective of any fundamental economic weakness. This is positive as Fed policy easing in the coming months should support the economy and reduce financial market volatility. We foresee real GDP growth averaging 2.5% in 2024 and easing to 1.7% in 2025.

### Unmistakable labor market cooling

The soft July jobs report points to a deterioration in labor market conditions, in line with several other labor market indicators. The economy added a weaker-than-expected 114k jobs last month, wage growth eased markedly to 3.6% year over year (y/y) and hours worked fell 0.3% month over month

(m/m) to a post-pandemic low. The unemployment rate has nearly risen a full percentage point (ppt) to 4.3% in July, its highest level since October 2021. And, while much of the increase in the unemployment rate results from strong labor supply, restrictive monetary policy will continue to apply downward pressure on labor demand. We expect business leaders will continue to curb wage growth, hire with caution and proceed with strategic layoffs to contain costs. While Fed Chair Jerome Powell recently stressed that the Fed doesn't "seek or welcome further cooling in labor market conditions," we foresee the unemployment rate rising further toward 4.5% heading into 2025.

### Consumers' resilient downshift

The strong July retail sales report assuaged recession fears and confirmed consumer spending resilience. But while there is no sign of retrenchment, households are nonetheless becoming more prudent amid a less vibrant labor market and a more challenging economic environment. With real disposable income growth having slowed to a modest pace, we expect households (especially median- to lower-income families) will curb their spending as elevated prices and interest rates weigh on household finances. We project consumer spending growth will slow below trend in the second half, averaging 2.2% in 2024, before slowing to 1.8% in 2025.



## More disinflation confidence

The July Consumer Price Index (CPI) report offered convincing evidence that inflation pressures are abating. Headline CPI rose 0.2% m/m, in line with expectations while core CPI rose a modest 0.2%. As a result, headline CPI inflation eased 0.1ppt to 2.9% y/y - the lowest since March 2021 - while core CPI inflation eased for a fourth consecutive month to 3.2% y/y - the slowest pace since April 2021. Going forward, the combination of softer spending growth, increased pricing sensitivity, reduced markups, moderating wage growth and declining rent inflation will continue to provide a healthy disinflationary impulse. We foresee headline CPI inflation at 2.6% and core CPI inflation at 2.9% y/y in Q4 2024, while we anticipate the Fed's favored inflation gauge, the deflator for personal consumption expenditures (PCE), to end the year around 2.5% y/y.

## Three Fed rate cuts in 2024

With the disinflation process continuing and labor market conditions softening, the question is no longer whether the Fed will ease in September, but what will be the pace of easing? The Fed has fallen behind the curve, but Fed Chair Powell is playing catch-up, announcing at the Jackson Hole Symposium that the "time has come for policy to adjust." Powell appears

to be more dovish than his peers. His candid pivot and a lack of pushback against policy gradualism signal he is open to bringing policy closer to neutral more rapidly than other Fed officials. Still, unless labor conditions deteriorate materially in the coming weeks, we continue to expect a majority of policymakers will favor a 25 basis points (bps) cut in September. We foresee rate cuts of 25bps in September, November and December.

## Risks to monitor

Sticky services inflation, commodities price spikes and global trade disruptions and tariffs could stoke inflationary pressures leading to a higher-for-longer stance from central banks. This could weigh on private sector activity and provoke a sudden tightening of financial conditions. Pro-cyclical budget deficits and rising interest burdens could become a pressure point for many economies, especially where political and policy uncertainty are high. As the US elections draw near, the outlook for tax, trade and regulatory policy should also be monitored closely, especially with President Biden deciding not to run for re-election. The main upside risk to the US economy is non-inflationary growth driven by stronger productivity gains supported by technological advancements, including generative artificial intelligence (GenAI).

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CS no. 2407-4565112

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