US economic outlook July 2024

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Prudence over exuberance

Outlook

The US economy is decelerating moderately as we pass the midyear point. Nothing alarming, but labor market momentum is cooling with initial claims for unemployment on a gentle uptrend, the unemployment rate creeping up past 4%, payrolls gently slowing, hours worked moderating and wage growth easing.

With real disposable income growth having slowed to a modest pace, consumers are favoring prudence over exuberance. Lower- and median-income households with higher debt burdens and weaker savings buffers are showing more price sensitivity and discretion in their purchases while higher-income families are still spending relatively freely.

Businesses are also being more judicious with their hiring and investment decisions while offering discounts and incentives to draw more price-discriminating customers. The housing market remains largely frozen with limited supply and depressed affordability constraining demand. Looking ahead, cost fatigue and general macroeconomic uncertainty around the elections, policy and geopolitical developments have kept expectations in check. We foresee real GDP growth averaging 2.3% in 2024 and moving slightly below potential at 1.7% in 2025.

Softening labor trends

The June jobs report confirmed that a softening of labor market conditions is underway. While the economy added 206k jobs last month, above consensus expectations, prior estimates of job growth in April and May were revised lower by a cumulative 111k jobs and the unemployment rate moved higher to 4.1% as wage momentum cooled. The labor market appears to be fully back in balance, but with monetary policy still well into restrictive territory, labor demand is likely to remain under pressure. We expect business leaders will continue to curb wage growth and proceed with strategic layoffs to contain costs. We foresee the unemployment rate rising further toward 4.3% while job growth slows below trend.

Consumer discretion

While retail sales were flat in June, sales excluding the volatile auto and gasoline components rose a robust 0.8% on broad-based gains. The better-than-expected increase in core retail sales points to resilient but more prudent consumer spending. While there is no sign of retrenchment, consumers are growing increasingly cautious as they feel the pinch from higher prices and borrowing costs. We expect consumer prudence will continue in H2 as elevated prices and interest rates take a growing toll on households' finances. We project that real consumer spending will grow 2.0% in 2024 and slow to 1.7% in 2025.

Sustainable disinflation

Disinflation momentum gathered pace in June with headline Consumer Price Index (CPI) falling 0.1% month over month (m/m) and core CPI rising a modest 0.1% m/m — its lowest advance since January 2021. As a result, headline CPI inflation eased to 3.0% year over year (y/y) — the lowest since March 2021 — while core CPI inflation eased a tick to 3.3% y/y — the lowest since April 2021. Given unfavorable year-on-year comparisons, CPI inflation is likely to hover at an "uncomfortable plateau" this summer. Still, softer consumer spending growth due to increased pricing sensitivity, reduced markups, moderating wage growth and declining rent inflation will continue to provide a healthy disinflationary impulse. We foresee headline and core CPI inflation at 2.8% and 3.0% 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.

Still expecting two Fed rate cuts in 2024

Most policymakers appear open to the idea of a September rate cut, and we suspect a few may have favored a July onset to the easing cycle given recent economic data. As Fed Chair Jerome Powell stated during his semiannual address to Congress, inflation is no longer the only risk the US economy faces. Maintaining excessively restrictive monetary policy when the labor market appears to be fully back in balance could lead to an undesired weakening of employment growth and the economy. We expect the late-July Federal Open Market Committee (FOMC) statement may signal openness to a rate cut in September, and we foresee two 25 basis points (bps) rate cuts before year-end, followed by 125bps of easing in 2025 if the economy evolves in line with our baseline.

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 is 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 reelection. The main upside risk to the US economy is non-inflationary growth driven by stronger productivity gains supported by technological advancements, including generative AI.

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