US economic outlook June 2024

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Economic downshift driven by cost fatigue and high rates

Outlook

It seems May was an inflection point for the US economy, with consumer sentiment, consumer spending, unemployment and inflation all pointing toward a slowdown in economic activity: not a retrenchment, but rather more prudence on the part of consumers and business leaders facing the burn of cost fatigue and higher interest rates.

We foresee a bifurcated consumer spending outlook where modest real disposable income growth forces low- and median-income households to dial back on their outlays amid persistently elevated prices and more expensive credit. Rising election uncertainty will likely curb capex even as easing financial conditions remain supportive of high-return investment opportunities and deal volumes. Overall, we anticipate real GDP growth will moderate below 2% in the second half of the year on slower private sector activity even as the drag from inventories and international trade dissipates. We foresee average GDP growth around 2.4% in 2024 and 1.7% in 2025.

Slowing labor market

While strong on the surface, the labor market sent some mixed signals in May. The combination of robust payroll growth (up 272k), firmer wage growth at 4.1% and weaker labor supply pointed to a labor market that remains tight. Yet the plunge in household employment and rise in the unemployment rate to a 2.5-year high of 4.0% painted a more nuanced picture and corroborated other data pointing to softer labor market conditions. Looking ahead, labor demand is likely to remain under pressure while business leaders curb wage growth and proceed with strategic layoffs to contain costs. We anticipate the unemployment rate will rise further toward 4.3% while job growth slows below trend.

Consumer prudence

Retail sales fell short of expectations in May, posting a tepid 0.1% gain as households continue to exercise prudence and scrutiny amid elevated prices, higher borrowing costs, dwindling savings and signs that financial stress is rising for some households. With real disposable income growth having slowed to a tepid 1.0% year-over-year (y/y) pace, we expect further moderation in consumer spending growth. We expect consumer spending in Q2 to grow around 1.8% annualized,

slightly below the pace of growth seen in Q1. However, it is worth noting that if it were not for the robust carry-over from Q1, consumer spending growth would be tracking at 0.3% annualized in Q2. We project that consumer spending will grow around 2.2% this year and 1.8% in 2025.

More disinflation in the pipeline

Headline Consumer Price Index (CPI) inflation was unchanged in May, lower than expected, while core CPI inflation rose a modest 0.2% month over month (m/m) — its lowest advance in eight months and lower than the average 0.4% m/m gain in Q1. As a result, headline CPI inflation eased 0.1 percentage point (ppt) to 3.3% y/y, while core CPI inflation eased 0.2ppt to 3.4% y/y — its lowest since April 2021. Given unfavorable year-on-year comparisons, CPI inflation is likely to hover around an "uncomfortable plateau" over the summer with headline inflation around 3.3% and core inflation around 3.4%. While softer consumer spending growth due to increased pricing sensitivity, moderating wage growth, declining rent inflation, reduced markups and stronger productivity growth will continue to provide a healthy disinflationary impulse, it's not until September that inflation readings will fall below that uncomfortable plateau. We foresee headline and core CPI inflation at 2.9% and 3.1% 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 2.6% y/y.

Still expecting two Fed rate cuts in 2024

The Federal Open Market Committee (FOMC) voted unanimously to hold the federal funds rate at 5.25%–5.50%. The policy statement was largely unchanged, while the dot plot now indicates only one rate cut this year, down from three in the March dot plot, and four rate cuts next year instead of three. We continue to believe a July onset of the easing cycle would have been optimal given easing inflation and softening labor market conditions, but a September onset is now likely given policymakers' backward-looking hawkish bias. We expect two rate cuts of 25 basis points (bps) in 2024 and 125bps of easing in 2025.

Risks to monitor

Stagflation is a downside risk that could emerge from a spike in energy prices, geopolitical tensions or escalating trade tensions. Concurrently, there is a risk that overly stringent monetary policy could lead to a swift tightening of financial conditions with plunging equity prices and surging interest rates and corporate bond spreads leading to a private sector retrenchment. As the US elections draw near, the outlook for tax, trade and regulatory policy should be monitored closely. The main upside risk to the US economy is non-inflationary growth driven by stronger productivity gains supported by technological advancements, including generative AI (GenAI).

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