



US economic outlook May 2024

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Patience is a virtue, but prudence is one, too

Outlook

Sometimes things aren't as they appear. With inflation surprising to the upside in the first quarter of the year, many commentators and policymakers have argued that monetary policy needs to remain restrictive for longer; some have even floated the notion of a reaccelerating economy, suggesting that monetary policy isn't sufficiently restrictive. The reality is much different. While economic activity remains robust, momentum is gradually slowing with labor conditions cooling, younger and lower income consumers exercising more scrutiny, and businesses re-evaluating their talent needs while focusing on productivity gains.

As we look ahead, we anticipate gently moderating consumer spending growth that may mask more pronounced financial difficulties for the bottom three income quintiles facing the strenuous combination of higher prices, larger interest burdens and softening job prospects. This bifurcated economy may benefit some businesses while restraining others. It will also lead to conflicting inflation signals with some sectors experiencing outright deflation and others experiencing

persistently elevated inflation. While Fed patience at these higher interest rates could be seen as a virtue, prudence in avoiding excessively tight policy would be one too. Overall, we anticipate real GDP growth at 2.5% in 2024, slowing to 1.7% in 2025.

Cooling job growth

The labor market remains the key pillar of resilience for the US economy, but the April jobs report confirmed that a broad cooldown in labor market conditions is underway with job growth easing to a sub-200k pace, wage growth falling below the 4% mark, the unemployment rate ticking higher and hours worked declining. Overall, labor demand and supply are better balanced, with the labor force participation rate close to a cycle high and wage growth easing. We foresee softer labor market conditions with cooler hiring, localized layoffs and a 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 4.2% by year-end.



More prudent consumers

The flat reading for retail sales in April confirms that consumers are acting with more prudence as labor market conditions soften and prices remain persistently high. Adjusted for inflation, retail sales fell 0.3% while control sales (which feed into GDP calculations) declined 0.6%. Positive labor market gains should prevent a consumer retrenchment, but we continue to expect some moderation in consumer spending this year as cost fatigue and softer labor market conditions curb income growth and constrain households' spending power. We project that consumer spending will grow around 2.5% this year reflecting strong momentum at the start of the year, following a 2.2% advance in 2023.

Disinflation reasserts itself

Headline Consumer Price Index (CPI) rose 0.3% month over month (m/m) in April with 70% of the advance driven by higher gas prices and shelter costs while core CPI rose a moderate 0.3% m/m. As a result, headline CPI inflation eased 0.1 percentage points (ppt) to 3.4% year over year (y/y) while core CPI inflation eased 0.2ppt to 3.6% y/y – its lowest level since April 2021. We still believe a broad disinflationary trend remains in place and five key elements should bring more disinflation throughout 2024: mildly softer consumer spending growth, slower wage growth, declining rent inflation, narrower profit margins and stronger productivity growth. Still, given the hotter Q1 inflation prints, we have revised our headline and core CPI inflation forecast up to 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.

Expecting two Fed rate cuts in 2024

We anticipate headline CPI inflation will hover around a 3.5% plateau through the summer while core CPI inflation gently eases below the 3.5% mark. This should translate into a similar plateau for PCE inflation around 2.7% while core PCE inflation moves toward 2.5%. Such a plateau is not so far above the Fed's 2% target that it would warrant excessively tight monetary policy. We continue to expect two 25 basis points (bps) rate cuts in 2024, in July and November, as core disinflation reasserts itself and labor market conditions soften.

Risks to monitor

It is essential to remain vigilant of several potential risks that could impact the economic landscape. These include the possibility of enduring inflation due to rising commodity prices, geopolitical tensions and escalating trade disputes. Concurrently, there is a risk that overly stringent monetary policy could lead to a swift tightening of financial conditions, which, coupled with increasing worries about the fiscal trajectory, may lead to a private sector retrenchment.

As the US elections draw near, the outlook for tax, trade and regulatory policies should also be monitored closely. Meanwhile, the primary opportunity for sustainable growth that does not fuel inflation hinges on a robust job market supported by enhanced productivity gains driven by technological advancements, including generative AI (GenAI).

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