US Economic Update 14 June 2024

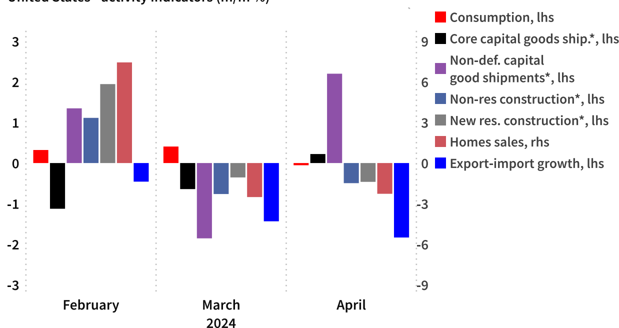
Activity data soft at start of Q2

- **Activity data has been soft early in Q2. While we still expect GDP to grow by around 0.5% q/q in Q2, a downward revision to the Q1 outcome lowers our forecast for 2024 year average growth to 2.3% (was 2.4%).**
- **Labour market pressures continue to ease even as net job creation remains solid.**
- **The spike in monthly inflation readings seen early in the year continues to unwind; the May CPI print came in lower than expected.**
- **The Fed left rates unchanged at its June meeting. While the median Fed member view sees only one 25bps rate cut by end 2024, we still expect 50bps of cuts and see a slightly faster pace of rate cuts over 2025. We now, however, see rate cuts pausing in 2026 when the target range reaches 2.75%-3.00% (previously 2.50 to 2.75%).**

Recent data on the soft side

The second estimate of Q1 GDP saw growth revised down to 0.3% q/q (1.3% annualised) from 0.4% (1.6%). Lower personal consumption growth was the main driver of the revision. Despite the downward revisions, further confirming some slowing from H2 2023, domestic final demand remained robust at 0.7% q/q.

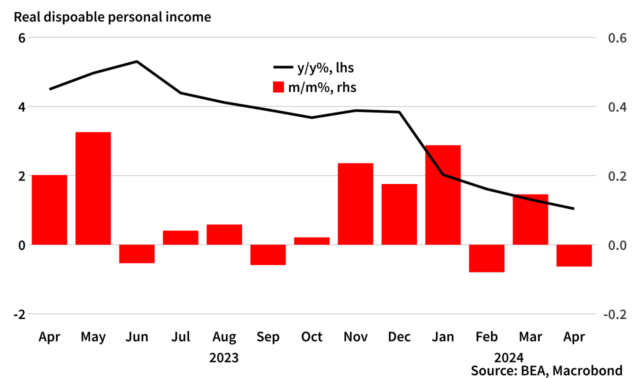
Recent activity data have been weak



Source: Macrobond. * Deflated using PPIs for machinery & equip and non-res. construction, house const.

It is early in Q2 but the available data for April have generally been on the soft side. Notably, personal consumption – the largest expenditure category – fell 0.1% m/m, although this followed strong growth in February and March. Between April 2023 and April 2024 real personal consumption grew 2.6% but real personal income growth was much weaker at 1.0% y/y, which is likely to constrain consumption growth going forward, although rising wealth may provide some support.

Real personal income growth slowing



Source: BEA, Macrobond

After strong growth in Q1, the housing market has clearly weakened as mortgage rates have moved higher this year. Both secondary market sales and new construction contracted in March and April.

Business fixed investment indicators were mixed. Private non-residential construction has fallen in each of the last two months. Core (ex. defence and transport) capital goods orders and shipments signal that underlying business investment remains under pressure and regional Fed surveys of capex intentions remain soft. However, shipments ex. defence (relevant for GDP tracking) jumped higher in April, a positive sign for machinery and equipment investment in Q2.

Net exports detracted from growth and the April data suggesting more of the same with goods exports (after adjusting for price changes) flat while imports grew strongly. That said, there was a large increase in capital goods imports (a positive signal for business investment). Moreover, net exports and inventory contributions are typically negatively correlated and initial data points to this relationship holding in Q2 with initial inventories data consistent with a positive contribution to growth this quarter.

Business survey readings for April also softened; this was driven by service sector weakness, but it bounced back in May. The volatility makes discerning the trend for services difficult, but manufacturing readings have been creeping up for a while. Overall, the survey readings argue against overstating the recent softness in the activity data, but by historical standards the surveys remain at a low level and so are consistent with a drop down in growth this year.

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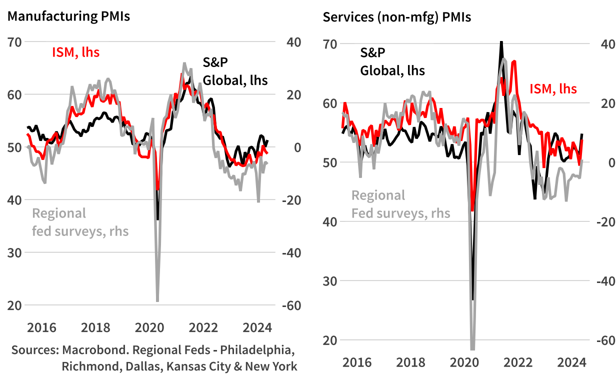
May survey bounce – but still not at a high level



Outlook – growth to slow

Overall, given we are still early in the quarter, we see no reason to change our forecast for Q2 GDP growth (of 0.5% q/q), although some of the components have shifted. While such an outcome would be a bit stronger than in Q1, the details so far point to a slowdown in domestic final demand growth.

However, the downward revision to Q1 GDP does mean that our forecast for 2024 year-average growth eases to 2.3% (from 2.4% previously). Over the course of 2024 growth is only expected to be 1.3% as we continue to expect a soft H2 2024 before some improvement over 2025 and 2026 as policy settings become less of a headwind. That puts our 2024 growth forecasts at the bottom end of the range of FOMC participants, and notably softer than the median June dot for 2.1% growth.

This view is based on monetary policy settings being restrictive, soft global growth and a fading boost from tech sector manufacturing investment and state/local government spending. Federal government fiscal policy – a tailwind last year – is also a headwind this year.

While growth is expected to be soft, we do not see recession risk as high. While monetary policy settings are restrictive, the transmission is not being amplified by financial markets; rather financial stress indicators are at low levels. Moreover, household balance sheets are relatively healthy, while corporate profits have also held up, reducing the risk of a sharp cut back in activity and employment.

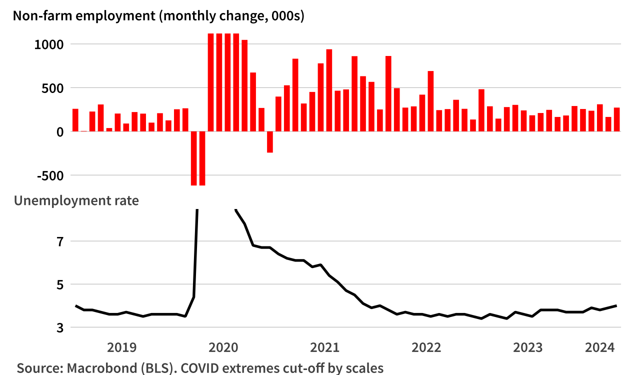
Population growth appears to be currently elevated but changes in immigration policy (and enforcement) could change this quickly. In this regard, the November 2024 elections are potentially important, and they could also see material changes in trade and fiscal policy, as well as to how the Federal Reserve conducts monetary policy.

Labour market – mixed signals

Job creation remains robust in the US, with non-farm employment rising 272k in May, although there was a small downward revision (-15k) to the previous two months.

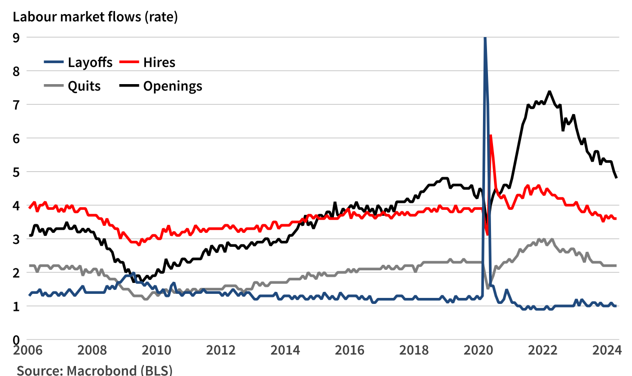
Even so, labour market pressures appear to be easing, highlighted by the gradual rise in the unemployment rate, which increased to 4.0% in May from 3.9%. A lift in population growth (even if not evident in official population estimates) is the factor that reconciles this with still robust jobs growth. Non-farm employment growth has averaged 230k a month over the last year, but the unemployment rate (3mth average) has increased 0.4 ppts (from its post-pandemic trough of 3.5%). Workforce participation has not been a factor as (on a 3mth average basis) it is unchanged over this period.

Job creation robust but unemployment rising



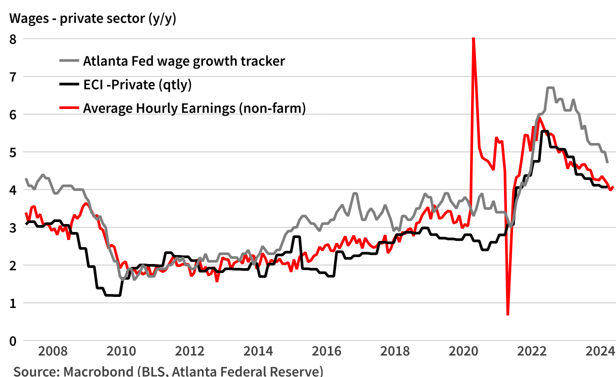
Other indicators also point to labour market pressures easing. Job openings (i.e. vacancies) declined again in April, leaving the openings rate only modestly above its pre-COVID level. Voluntary quits are tracking below their pre-pandemic level, as are hires, with the strength of jobs growth reflecting still low layoffs.

Other indicators point to labour mkt easing



Wage growth picked up in May to 0.4% m/m (4.1% y/y from 4.0%) but this follows several months of modest increases. The data are volatile and affected by changes in employment composition, and we think that the gradual easing in the labour market underway, and the progress to-date on reducing inflation, means that wage growth is likely to ease further. However, the May result, and the higher than expected Q1 employment cost index, adds to the uncertainty around the wage outlook (and by implication, the inflation outlook).

Wage growth has been easing



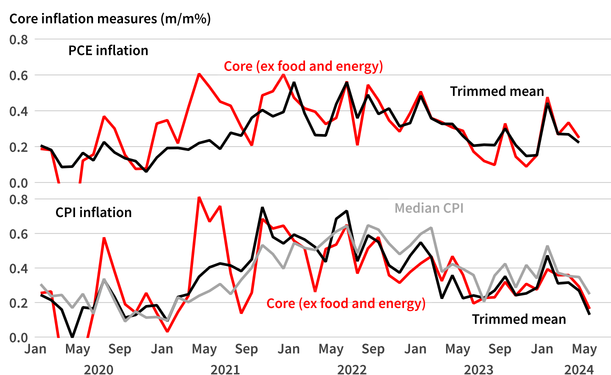
Inflation – early '24 spike unwinding

The spike in monthly inflation readings seen early in the year continues to unwind. In particular, core CPI inflation in May was 0.16% m/m – the lowest m/m reading since August 2021. The fall was broad based, as shown by the lowest trimmed mean reading in over three years. Core PCE inflation of 0.25% m/m in April, while still above the Fed's target, was the lowest for the year so far, and the CPI/PPI data indicate that it will likely be even lower in May (with estimates ranging from 0.11 to 0.16% m/m).

On an annual basis, core CPI again declined, to 3.4% y/y (from 3.6% in April). The headline measure stands at 3.3%. Annual core PCE inflation was unchanged in April at 2.8%, where it has been since February, but is likely to fall to around 2.6% in May.

While the May CPI data are a positive sign, the monthly readings for March/April were still higher than seen in the second half of 2023 (particularly for PCE inflation) and more than one month of good data is needed to materially change the outlook. Between June and December 2023, monthly core PCE inflation averaged 0.16%, so anything above this will push the annual inflation rate up.

Monthly inflation readings – some improvement



We still expect annual core PCE inflation to head back towards 2% over time as economic growth slows and labour market pressures ease further – resulting in lower wage growth and taking the pressure off services inflation – given that inflation expectations remain well-anchored. Indicators of rental inflation for new leases (which should lead the CPI and PCE indicators as they cover all leases) also point to a moderation in rental inflation, although the speed at which this will occur is uncertain.

Chinese export prices have also been declining, which should help keep imported goods inflation down, although a lift in global freight rates and, we expect a decline in the USD, will provide some offset. Outside of shipping issues, the restoration of global supply chains and inventories, and a still elevated dollar should limit goods inflation risk even if demand is stronger than expected. However, a concern is the potential for further tariff increases – recent measures by the Biden administration only affected a small share of imports (and are staggered over time) but Donald Trump has flagged broad ranging, and large, increases in tariffs if he were to be elected.

Monetary policy

As expected, the Fed left the target range for the federal funds rate unchanged at its June meeting.

The Fed's requirements for the commencement of rate cuts are also unchanged. Namely greater confidence that inflation is sustainably moving to 2% or an unexpected weakening in the labour market.

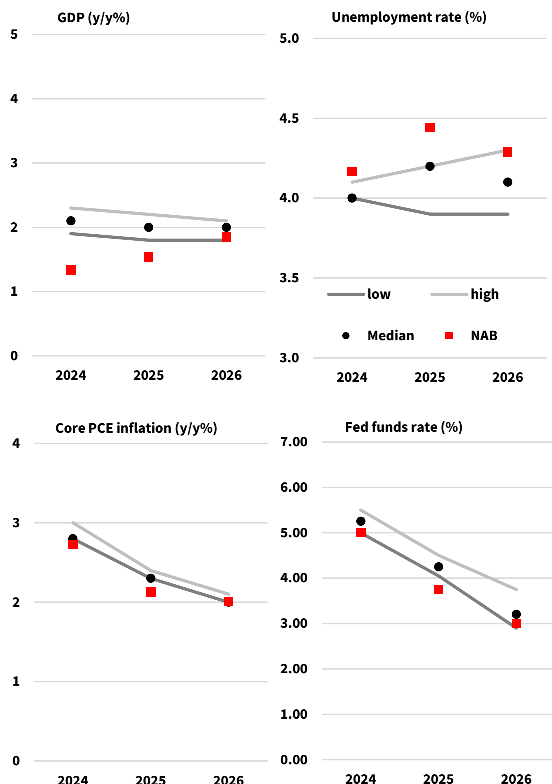
Powell, in his post meeting press conference, noted that the most recent inflation readings represent 'modest further progress' but that more 'good data' are needed. He declined to indicate how many months of better data are required; while the Fed took a signal from the spike in inflation early this year after it had been sustained for three months, he pushed back on the suggestion that three months is the benchmark.

The FOMC median projections for end 2024 now only allows for a single 25bp rate cut (previously 75bps), although 8 of the 19 Fed members expect two cuts. Over 2025, the median view sees a further 100bp of cuts (previously 75bp) so by end 2025 the median projection is just 25bp higher than it was in March (and the end 2026 forecast is unchanged).

It is not entirely clear to what degree the Fed projections were updated for the May CPI outcome, although they probably weren't to any significant degree. While the projections are submitted prior to the meeting, members are able to change them. The Chair did not indicate whether this happened or not this time around, but did say generally most members do not change their forecasts during the meeting following an important data release.

We still see 50bps in rate cuts by end 2024 as the most likely outcome, with a further 125bp reduction seen in 2025. The difference in our expectation for the fed funds rate, relative to that of the Fed, reflects our somewhat more pessimistic view on growth and the unemployment rate. We also have a (slightly) faster track back to 2% inflation.

Fed vs NAB forecasts



As to the most likely start date, we currently have September pencilled in, although we would not at all be surprised if it occurred in November. An earlier start – in July – is extremely unlikely.

The median Fed view on the long-run, or neutral, rate was again lifted – in the December 2023 projections it was 2.5%, rose to 2.6% at the March meeting and is now 2.8%. Moreover, slightly more Fed members have a higher projection (nine) than lower (seven) so the balance of risk is that it moves higher again. The resilience of the economy in the face of the significant tightening in monetary policy settings has raised the question of whether the neutral rate had risen from its pre-pandemic level. While our view has been that 2.5% was a reasonable estimate of the neutral rate – and that it was hard to see what factors had driven it higher – we accept that the risk is that it is somewhat higher.

The median Fed view on the long-term unemployment rate was also revised up to 4.2%. This is close to our end-2026 projection. In the light of this, and the changing Fed view of the neutral interest rate, we have tweaked our funds rate projection for end 2026, lifting the target range to 2.75-3.0% (2.50-2.75%. previously).

Contact the author:

Tony Kelly
Senior Economist
Antony.Kelly@nab.com.au

U.S. economic forecasts

	2023	2024	2025	2026	2024 Q1	Q2	Q3	Q4	2025 Q1	Q2	Q3	Q4
US GDP and Components												
Household consumption	2.2	2.2	1.5	1.8	0.5	0.5	0.4	0.3	0.3	0.4	0.4	0.4
Private fixed investment	0.6	3.6	2.2	3.0	1.5	0.7	0.3	0.3	0.6	0.6	0.7	0.8
Government spending	4.1	2.5	0.9	0.9	0.3	0.4	0.2	0.2	0.2	0.2	0.3	0.3
Inventories*	-0.4	0.0	0.0	0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	0.6	-0.3	-0.1	-0.1	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Real GDP	**2.5**	**2.3**	**1.4**	**1.8**	**0.3**	**0.5**	**0.3**	**0.2**	**0.3**	**0.4**	**0.4**	**0.4**
Note: GDP (annualised rate)					*1.3*	*2.0*	*1.2*	*0.9*	*1.2*	*1.5*	*1.7*	*1.7*
US Other Key Indicators												
PCE deflator-headline												
Headline	2.8	2.6	2.0	1.9	0.8	0.8	0.5	0.5	0.4	0.6	0.5	0.5
Core	**3.2**	**2.7**	**2.1**	**2.0**	**0.9**	**0.7**	**0.5**	**0.5**	**0.5**	**0.6**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**4.2**	**4.4**	**4.3**	**3.8**	**4.0**	**4.1**	**4.2**	**4.3**	**4.4**	**4.4**	**4.4**
US Key Interest Rates												
Fed funds rate (top of target range)	**5.50**	**5.00**	**3.75**	**3.00**	**5.50**	**5.50**	**5.25**	**5.00**	**4.50**	**4.25**	**4.00**	**3.75**

Source: NAB Group Economics

*Contribution to real GDP growth

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Jacqui Brand
Personal Assistant
+(61 0) 477 716 540

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 422 081 046

Brody Viney
Senior Economist
+(61 0) 452 673 400

Lea Jurkovic
Economist – Agribusiness
+(61 0) 452 090 770

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Thao Nguyen
Economist – Data & Analytics
+(61 0) 451 203 008

International Economics

Tony Kelly
Senior Economist
+61 (0)477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Skye Masters
Head of Research
Corporate & Institutional Banking
+(61 2) 9295 1196

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