US Economic Update September 2024

The Fed to start cautiously but more cuts to come

- **August employment data confirmed the labour market has cooled much more than the Fed had earlier expected.**
- **While the FOMC looks set to start cautiously with 25bp next week, we continue to expect 100bps of cuts this year.**
- **We have revised up our GDP growth forecasts –we expect growth of 2.6% (previously 2.5%) for 2024 and 1.7% (was 1.5%) for 2025. This is in part due to the strength of consumption through to July. However, consumption has outpaced income and we still expect it to moderate and for the economy to slow.**
- **Monthly core CPI inflation was a bit higher in August but this was not replicated in other measures of underlying inflation. Core PCE inflation for the month is likely to be lower than the CPI and in line with recent modest prints.**

Summary

The August employment data showed the unemployment rate ticked down to 4.2%, as widely expected, but payrolls growth has slowed and a trend rise in the unemployment rate is still intact.

After the July Payrolls data, we increased our expectation of Fed policy rate cuts this year to 100bp. While we think the labour market data support a 50bp move to kick off the long-awaited cutting cycle next week, FOMC officials have not made that case, and the data is not emphatic enough to force their hand. We retain the view the Fed will deliver 100bp of cuts and think a larger cut will now come in November or December.

While the unemployment rate remains low by historical standards and layoffs have not picked up, recent data shows a labour market that is no tighter than the 2018-19 period and is unlikely to be a source of persistent risk for inflation. Inflation has not yet been beaten, but the balance of risks has shifted sufficiently for the Fed to dial back the degree of restriction and we expect the data to evolve in a way that supports an ongoing march towards more neutral settings. Beyond this year, we expect 25bp of cuts per meeting, until the Fed Funds Rate reaches 2.75-3.0% in Q3 2025.

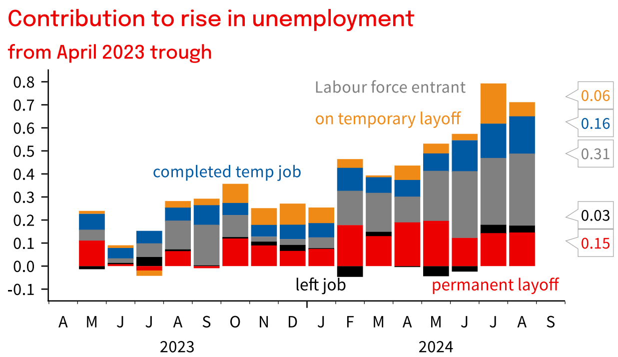
A key uncertainty is how quickly the economy will respond as the level of restriction is eased back toward neutral. Less benign inflation prints, or a sustained stabilisation (if not a recovery) in the labour market combined with a continuation of the surprising resilience in US growth, would slow the cadence of rate cuts. Balancing against that risk is the potential for a faster deterioration in activity and the labour market, which would result in a more aggressive cutting cycle.

Labour market

The unemployment rate was 4.2% in August, as widely expected. The 2-tenth rise to 4.3% in July was partially reversed, as the number of people unemployed due to temporary layoff, which unusually spiked higher in the last report, unwound. But the payback from August wasn't emphatic.

Unrounded, the unemployment rate fell just 4bp, as an ongoing increase in those unemployed after entering the labour force or having completed a temporary job mostly offset the decline in those on temporary layoff. Hiring has slowed, and more people are sitting in unemployment longer as they search for a job.

Rise in unemployment not driven by layoffs



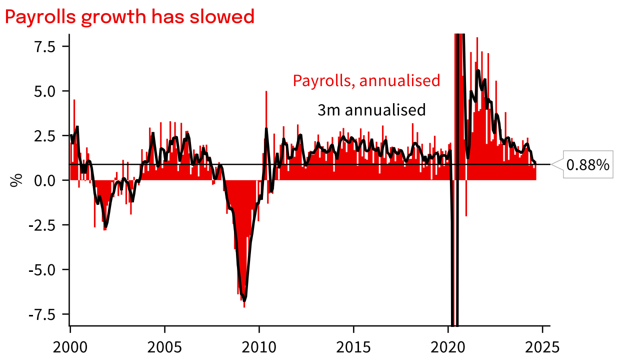
Source: National Australia Bank, U.S. Bureau of Labor Statistics (BLS), Macrobond

Mitigating the slowdown in hiring is that unemployment due to a layoff remains low and continues to track sideways over the past 6 months, consistent with the data from initial jobless claims. This is good news, and reduces the risk of an imminent downturn and a particularly sharp increase in the unemployment rate in the near term.

While it is historically unusual that layoffs have remained so low as the unemployment rate has risen, we shouldn't overstate it. The labor market is still cooling. Research by Simon Mongey at the Minneapolis Fed makes the point that variation in the job finding rate, not the rate of job loss, historically explains most of the variation in unemployment.

The August data also showed a noticeable slowdown in the recent pace of hiring. Non-farm payrolls rose 142k in August, but downward revisions to prior months mean that 3-month average jobs growth slowed to 116k from 170k in July. That is weaker than all but 2 months since 2010.

Job growth has slowed



Source: National Australia Bank, U.S. Bureau of Labor Statistics (BLS), Macrobond

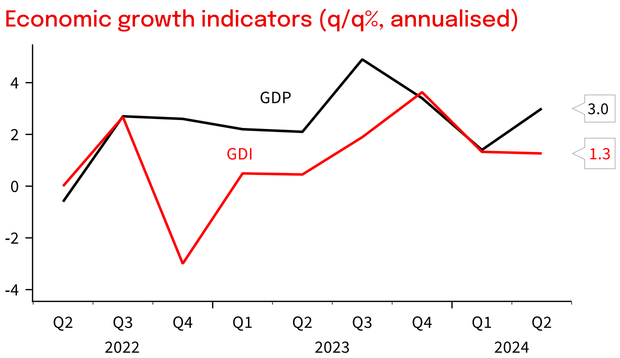
With our growth forecasts anticipating slowing, if still resilient, growth, expect the trend of ongoing cooling in the labour market to continue, which would take the unemployment rate up to 4.4% by year end before peaking around 4.6% next year.

Growth indicators & outlook

US GDP was revised up for Q2 in the for the quarter, although it was only a small revision – from 2.8% q/q annualised, to 3.0%.

The latest accounts provided more detail on the income side of the economy, including real gross domestic income (GDI). Conceptually, GDI should equal GDP but in Q2 it grew at 1.3%, less than half the rate of GDP growth for the quarter. In practice, the two measures regularly differ but the discrepancy since 2023 is higher than normal. We base our growth forecasts on the GDP data, but note the GDI data point to a risk of downward revisions to recent estimates of GDP growth.

Return of GDP/GDI divergence

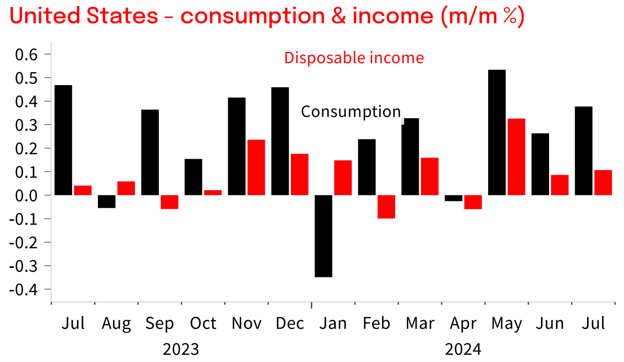


Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Macrobond

While the upwards revision to Q2 GDP growth was small, it was more significant for household consumption (revised to 2.9% q/q annualised, from 2.3% q/q Each month of the quarter was revised higher and this implies a higher starting point for Q3 growth.

The strength in consumption continued into early Q3, with the growth of 0.4% m/m in July, which was again, well above real disposable income growth (0.1% m/m). Over the year to July, consumption has risen by 2.7% while real disposable income growth has been more muted at 1.1%.

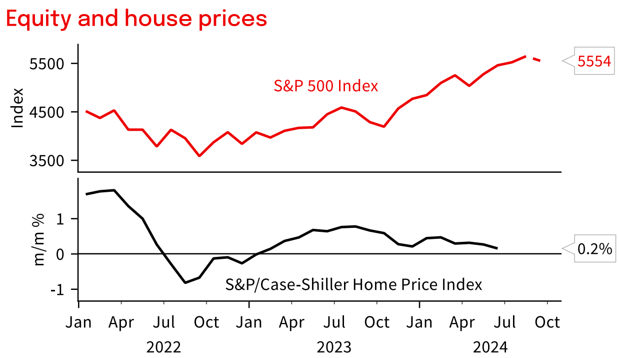
Consumption outstripping income growth



Source: Macrobond

This can be partly explained by wealth effects – particularly strong growth in equities prices (over 20% y/y to July) and continuing house price growth. Equity prices are little changed since mid-July (with the large dip between mid-July to early August largely recovered). House prices are continuing to grow, although there has been some gradual moderation in the pace. It is likely that wealth impacts on consumption will fade from here – while it is hard to predict share markets with any confidence, 20% annual growth is not sustainable.

Wealth effects have been positive



Source: National Australia Bank, S&P Global, Macrobond

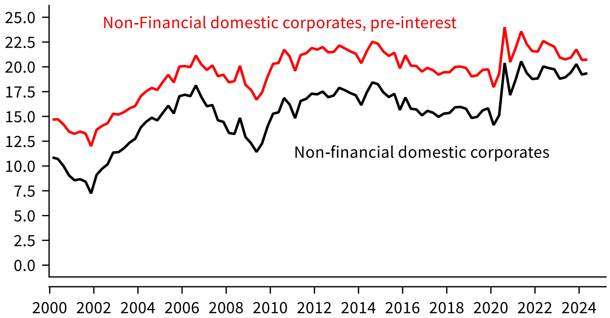
That said, household financial indicators are generally in good order. They are not highly geared (in aggregate) and while the debt servicing ratio has risen from its trough, it has stabilised over the last year and is not high by historical standards. Mortgage loan delinquency rates remain low, although there has been a clear rise in consumer loan delinquencies, so there are pockets of stress emerging.

The slowdown in employment and wage growth point to continued modest real income growth which will likely temper consumption going forward. However, we have marked up our expectations for Q3 and, to a lesser extent, Q4 consumption growth to reflect the data revisions to Q2, the strength of July consumption and the boost to household budgets from the fall in oil prices since July (although we expect this will at least be partially reversed).

In some ways it is a similar story for businesses, with profits at healthy levels and no signs of major stress. While gearing is at moderate levels, net interest (and other miscellaneous) payments are low, suggesting debt servicing is under control. Loan delinquencies have risen for commercial real estate – but the level is not high – while for commercial and industrial loans they have been tracking at a low level.

Profits remain healthy

Corporate profits (% net value added)



Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Macrobond

That said, while the level of profits is high (in nominal terms), as a share of gross value added they are either tracking sideways or trending down, depending whether assessed on a before or after interest basis.

Business survey indicators of capex are also still soft, and core capital goods orders & shipments (which exclude aircraft and defence) and non-residential construction expenditure fell in July. However, aircraft shipments, as well as imports of capital equipment, point to the possibility of another quarter of strong machinery & equipment investment, which has led us to revise upwards our business investment forecast for Q2.

In contrast, dwelling investment is likely to fall by more in Q2 than it did in Q1. Nominal new residential construction expenditure fell by 1.5% m/m in July (the fourth consecutive monthly fall). House sales did improve in July but were still below their Q2 average and mortgage purchase applications to August are very weak, despite the fall in mortgage rates since June.

Despite the Q2 pickup, economic growth slowed materially in H1 2024 (from H2 2023) and we expect some further moderation in H2 2024. This reflects our view, as already noted, that consumption growth should ease from here, still restrictive interest rate settings, and a waning impetus from state and local government spending and manufacturing tech construction.

To the extent that a positive labour supply shock – from migration – has provided a fillip to US growth, this is also likely fading as border encounters have fallen rapidly since end 2023 and are back to around early 2021 levels.

We continue to discount the signal from the 'Sahm-rule" and do not consider it likely that the US will fall into recession. Household and business balance sheets show no obvious sign of stress or major imbalances which could trigger a large correction. While cuts to the federal funds rate will take a while to fully flow through to the economy, some sectors, such as housing, are likely to see some more immediate benefits. As a result, we expect growth to stabilise in H1 2025 before starting to pick up in the second half of the year.

Reflecting the revision to Q2 GDP and the forecast revisions for expected consumption and business investment noted above, we now expect year-average GDP growth of 2.6% in 2024 (previously 2.5%), 1.7% in 2025 (was 1.5%) and 2.2% in 2026 (unchanged).

These forecasts are based around a neutral view over policy settings post November's elections, but there is a risk that there will be substantial changes to fiscal, migration and trade policies depending on who is elected President and which party (or parties) control the House of Representatives and the Senate in Congress.

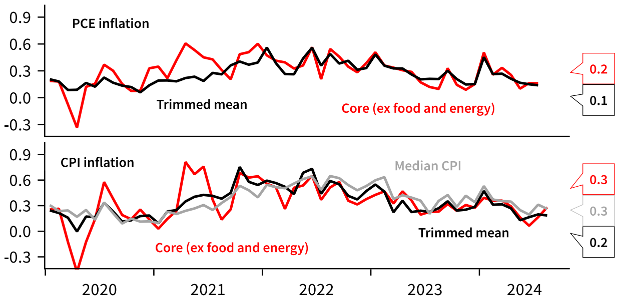
Inflation

Core CPI inflation was higher than expected in July at 0.3% m/m. While a reminder that inflation remains an issue, it doesn't materially alter the outlook.

It follows several months of low prints and on a 3mth (on previous 3mth) basis it grew by 1.9% annualised. Alternative measures of underlying inflation – the median CPI and trimmed mean – either fell or were unchanged and look to have shifted down to a lower level in recent months.

Small August core CPI surprise

Core inflation measures (m/m%)

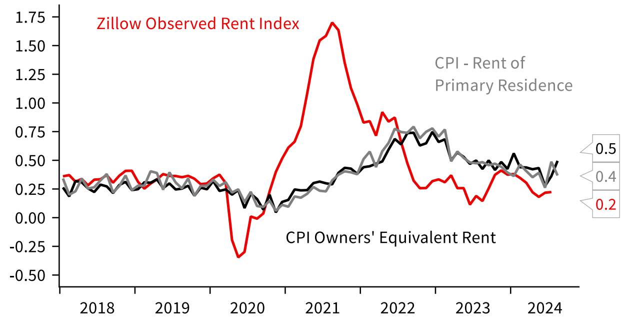


Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Federal Reserve Bank of Dallas, U.S. Bureau of Labor Statistics (BLS), Federal Reserve Bank of Cleveland, Macrobond

One of the factors behind the lift in m/m core CPI in August was a spike in owners-equivalent rent, which has a large weight in the CPI. Leading indicators of rental inflation based on new rentals (the CPI and PCE cover all rents), such as Zillow observed rents, suggest that rental inflation should moderate from here, although the timing and speed at which this occurs is uncertain given there still appears to be an element of catch-up to past market increases in rents for existing rentals.

August rise in owners-equivalent rent in August unlikely to be sustained

Housing rent inflation (m/m%)



Source: National Australia Bank, Zillow, U.S. Bureau of Labor Statistics (BLS), Macrobond

The weight on housing services is also much smaller in the PCE measure. Based on the relevant details in the CPI and PPI releases, core August PCE inflation is likely to be between 0.13-0.17% m/m in August, following 0.2% m/m in July. This would leave the 3mth (on previous 3mth) growth rate a bit below 2% annualised.

On an annual basis, inflation remains elevated at 3.2% y/y for core CPI in August and 2.6% for core PCE in July (and likely to tick up to 2.7% in August). Concerns over residual seasonality or over interpreting normal data volatility mean that the Fed is likely to remain cautious in declaring the inflation battle won, at least until it sees that the high monthly prints seen earlier this year are not repeated in early 2025.

With inflation expectations remaining well anchored and the labour market (including wage growth) easing, we continue to expect moderate monthly inflation readings from now, with core inflation, on an annual basis to move close to the Fed's target in 2025.

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U.S. economic forecasts

					2024				2025				2026			
	2023	2024	2025	2026	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components																
Household consumption	2.2	2.5	1.9	2.2	0.4	0.7	0.8	0.5	0.4	0.4	0.5	0.6	0.6	0.6	0.6	0.6
Private fixed investment	0.6	3.9	2.7	3.8	1.7	0.7	0.4	0.3	0.8	0.8	0.8	0.9	0.9	1.0	1.0	1.0
Government spending	4.1	3.0	1.1	0.9	0.4	0.7	0.4	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Inventories*	-0.4	0.0	0.0	0.0	-0.1	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	0.6	-0.4	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real GDP	**2.5**	**2.6**	**1.7**	**2.2**	**0.4**	**0.7**	**0.4**	**0.3**	**0.3**	**0.4**	**0.5**	**0.6**	**0.6**	**0.6**	**0.6**	**0.5**
Note: GDP (annualised rate)					*1.4*	*3.0*	*1.8*	*1.3*	*1.4*	*1.6*	*1.9*	*2.2*	*2.3*	*2.3*	*2.3*	*2.2*
US Other Key Indicators																
PCE deflator-headline																
Headline	2.8	2.5	1.9	1.9	0.8	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	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**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	3.8	4.4	4.6	4.4	3.8	4.0	4.3	4.4	4.5	4.5	4.6	4.6	4.6	4.5	4.4	4.4
US Key Interest Rates																
Fed funds rate (top of target range)	5.50	4.50	3.00	3.00	5.50	5.50	5.25	4.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.00

Source: NAB Group Economics

*Contribution to real GDP growth

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