US Economic Update 11 October 2024

The economy is healthy even as the Fed commences 'recalibrating' policy

- **The growth outlook has improved on the back of recent activity data and positive revisions to historical household income and profits. We now expect GDP growth of 2.7% (previously 2.6%) for 2024 and 1.9% (was 1.7%) for 2025.**
- **Solid payrolls growth and a fall in the unemployment rate in September help alleviate concerns employment growth is slowing sharply.**
- **The Fed cut rates in September by 50 bps, and we retain our view that the total reduction in rates by year end will be 100 bps. Recent data indicates the near term risk to this call is a pause rather than another 50 bps cut. While a pause is possible, our view is that this will require a reassessment by the Fed of its view that the labour market is now balanced and inflation is on track to fall back to 2%, the drivers of the 'recalibration' that it started in September.**

Economic overview and the Fed

Recent activity data have been stronger than expected. They also suggest that the foundations of growth are stronger than previously thought, with revisions pointing to appreciably stronger-than-previously-estimated household income and corporate profits.

As a result, we have lifted our growth forecasts. While we see some slowdown in GDP growth from here, it is expected to track at a still decent level before a modest lift over 2025/2026 as the impact of less restrictive monetary policy settings comes through.

Labour market data have also come in stronger. The September employment report showed a fall in unemployment, leaving a far more gradual uptrend in the unemployment rate. The September report also assuaged concerns that employment growth was rapidly weakening. We still expect to see a further increase in the unemployment rate – but only by around 0.3 ppts, to 4.4%, and the risks around the direction of the unemployment rate have become more two-sided.

The Fed kicked off the easing cycle in September as expected, but with a 50 bp cut. We had shifted from a 50 bp expectation to 25 bp ahead of the meeting on the basis of more cautious FOMC commentary, though with a 50 bp move being delivered in September, our view still remains that 100 bp of cuts by the end of this year is likely. The Fed median member projection was in line with this (albeit with a bias towards doing slightly less). We still view this as the most likely outcome, and now expect 25 bp cuts in each of the next two meetings.

Fed Chair Powell described the 50 bp cut as a 'recalibration' which will help to sustain the labour market with inflation moving down to 2%. Powell noted that the "labor market is not a source of elevated inflationary pressures" and that they "…have gained greater confidence that inflation is moving sustainably towards 2 per cent." He also noted that upside inflation risks have diminished and downside risks to employment have increased."

As already noted, the September labour market data suggest the downside risks on employment are less than previously thought. However, one or two monthly data prints are unlikely to be enough to shift the Fed's view of how the labour market is placed. Speaking after the September labour data release, New York Fed President Williams stated that "…this is a labor market that is still solid but is very much in balance."

Given the balanced labour market and the view that inflation is on track to fall back to 2%, there was a need for less restrictive policy settings. Prior to the September meeting, policy rates were over 2 ppts above the Fed's view of their neutral level. This explains Powell's 'recalibration'.

This recalibration is unlikely finished, and so we consider further rate cuts in upcoming meetings are likely. The strength of recent activity and labour data, recent comments by Fed officials and the inclination towards not having multiple 50 bp cuts revealed by the Fed dots all point to 25 bp per meeting reductions from here. As Fed Chair Powell stated recently, "this is not a committee that feels like it is in a hurry to cut rates quickly."

An early pause in this process would require incoming data to question the core Fed views (labour market balance, inflation heading back to 2%). While not our expectation, the possibility of a pause cannot be discounted, with Bostic (Atlanta Fed), speaking after the somewhat higher than expected September CPI data, indicating he is open to this.

Hurricanes Helene and Milton will cause some volatility in upcoming economic data (with this week's spike in initial jobless claims at least partly explained by the former). The Fed will see Hurricane impacts as temporary and will try to 'see through' these impacts.

©National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

As we move into 2025 – and the 'recalibration' becomes more advanced, further cuts will be dependent on our forecasts playing out – which have inflation moving close to 2% y/y early in the year. If this does not occur, the Fed is likely to slow down, if not pause, the rate cuts.

Given that the 'neutral' level of rates is uncertain, even if our forecasts largely play out, it is also possible that the Fed slows down the pace of easing as it gets closer to what it considers neutral (median view is currently 2.9%). As Powell has said, given the uncertainty around where neutral is, they will "know it by its works". Lags in monetary policy transmission may justify moving more slowly, if the economy is still growing solidly, given the possibility that neutral is higher than they currently estimate.

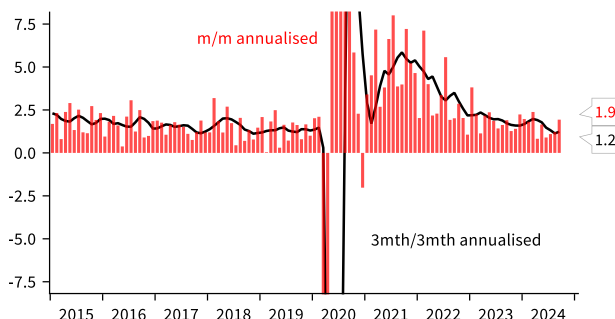
Labour market

The September 2024 employment report was stronger than expected, with the only (slight) wrinkle being a reduction in average hours worked.

Non-farm employment increased by 254,000 – the strongest result since March – and there were upward revisions to the two prior months. At the same time the unemployment rate declined, for the second month in a row, to 4.1%.

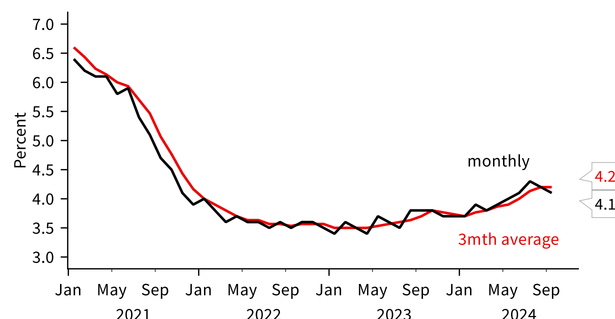
Positive September labour data

Non-farm employment growth (%)



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

Unemployment rate (s.a.)



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

The ups and downs in the labour market data that has occurred are not unusual and a range of other indicators suggest that the labour market has been easing. The job openings rate is now close to its pre-COVID level, while the quits and hiring rates are lower.

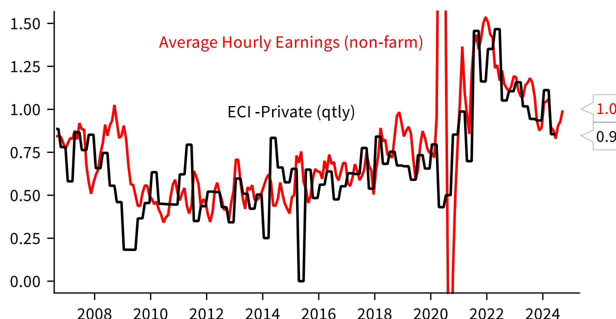
That said, even with the stronger than expected non-farm employment growth in September, the quarterly growth rate (of 0.3% q/q) was the lowest since June 2020 (when employment plunged due to lockdowns). The declines in the unemployment rate followed four consecutive increases and it is still up 0.3 ppts over the last six months.

Job layoffs remain low, suggesting the risk of a particularly sharp increase in the unemployment rate in the near term is not high. We still expect some further increase in the unemployment rate but, given the underlying resilience in economic growth (both actual and expected), we see it peaking at around 4.4%. Moreover, risks around the direction of the unemployment rate have become more two-sided.

Another aspect of the recent employment reports worth noting is that average hourly wage growth has shown some re-acceleration. This series can be volatile, in part because it doesn't adjust for changes in employment composition in the way that the Employment Cost Index does. The Fed would probably consider that some further reduction in wage growth is needed for inflation to sustainably fall to 2%. We think this likely to occur, given the labour market has cooled and inflation – which tends to lead wage growth – has fallen but will need to be watched.

Wage growth re-accelerating or noise?

Wages - private sector (3mth/3mth)



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

Growth – new history = a better future

While there was no change to Q2 GDP growth in the BEA's third estimate (unchanged at 3.0% q/q annualised), there were important revisions to other national accounts data.

We noted last month that GDP growth was again outpacing (the conceptually equivalent) real gross domestic income (GDI) growth. However, the latest revisions have flipped the script, and GDI growth over the last year is now similar to that of GDP and stronger in recent quarters. In short, there is no longer any reason to think that reported GDP data might be overstating growth.

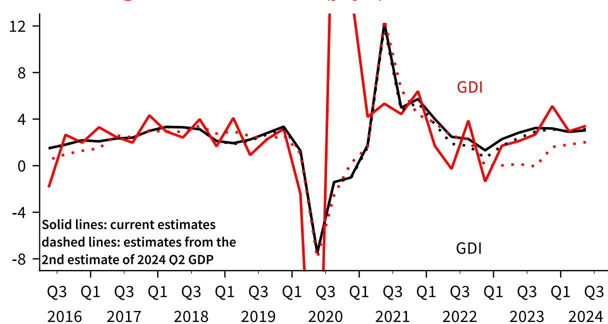
The revisions to the income side included notable upward revisions to household income and to corporate

profits. Over the year to August, personal disposable income is now estimated to have grown at a similar pace to consumption (around 3% y/y). In contrast, at the time of the July consumption estimate, income growth was estimated to be less than half consumption growth. This suggests that the risk of a sudden correction to consumer spending is now much lower.

On the business side, the level of profits has been revised up, including stronger growth over the year to Q2 (11% compared to 8% y/y). Again, this is positive from a risk point of view – making a large pull back in investment (or hiring) less likely and should help underpin further business investment growth.

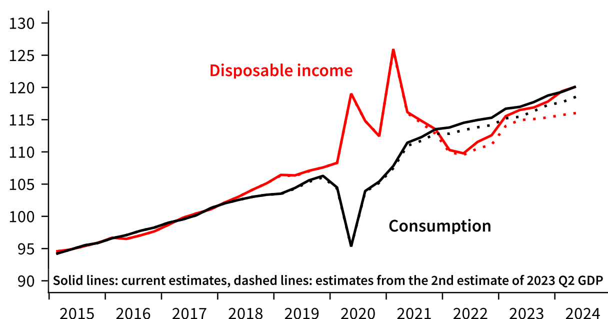
Income side revisions positive for the outlook

Economic growth indicators (y/y%)



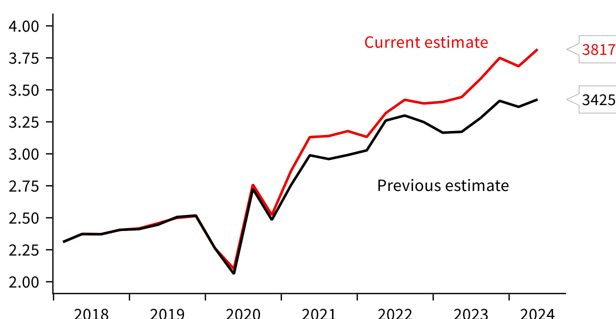
Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Macrobond

Real disposable income & consumption (2017 = 100)



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

Corporate profits ($ million)



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

These stronger underpinnings suggest both a more positive economic outlook and one with less (immediate) downside risk. Accordingly, we have lifted our expected growth profile.

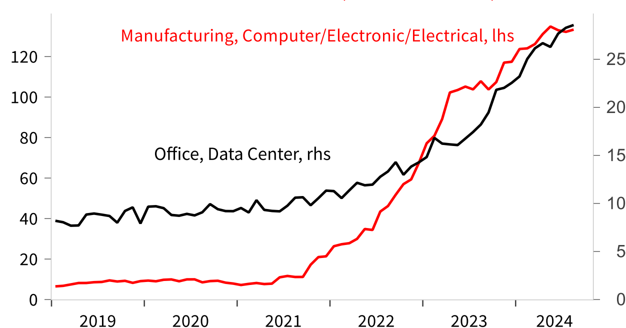
This includes an upwards revision expected Q3 GDP growth (now 2.8% q/q annualised), which reflects data available for the quarter. Consumption is on track for another quarter of robust growth, and business equipment investment looks like it will be buoyed by a lift in the aircraft category. Trade data for August suggest that the net trade contribution for Q3 will be closer to neutral than previously thought. An area of weakness is residential investment, which looks to have fallen in Q3, although declining mortgage rates are likely to support activity going forward.

While the revisions to the income data point to better foundations for future growth, we still see growth slowing from here.

Excluding aircraft, non-defence capital goods shipments remain anaemic and surveys of business capex intentions are also soft. One support for investment has been tech construction and data centres – spurred by Government incentives and AI demand – but tech construction spending has levelled out over the last few months. It might take a further leg up, but the extremely rapid growth seen so far will slow at some point.

Tech investment – how high can it go?

Non-residential construction ($ billion, saar)



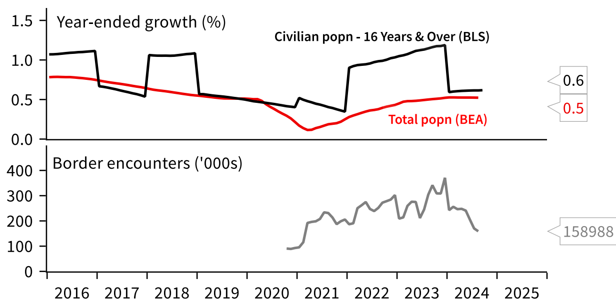
Source: Macrobond

Similarly on the consumption side, while real disposable income was revised up, recent monthly growth rates are not particularly strong – around 0.1% m/m between June and August (albeit these followed a strong outcome in May). We expect employment and wage growth to moderate somewhat further from here which would also weigh on income growth. Consumption has likely also been supported by wealth effects, but equities can't keep growing at over 25% a year, and house price growth has been slowing (although lower mortgage rates should provide support). Both of these factors point to a slower rate of consumption growth ahead.

As the same time one of the positive supply side factors that has boosted the economy – population growth – is likely fading. While hard to get a good handle on this – as the official estimates appear to have understated growth in recent years – border encounters have slowed suggesting a lower rate of immigration. Population adds not just to labour supply but demand for goods and services and so is another factor pointing to some slowdown in growth ahead.

Population growth waning

United States – population growth



Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics (BLS), U.S. Department of Homeland Security, Macrobond

While we see growth as slowing, we expect it to remain at a decent level. Household and business balance sheets are not stressed and there are no major imbalances which could trigger a large correction. While Fed interest rates reductions will take a while to fully flow through to the economy, housing and some other sectors (consumer durables) may see some more immediate benefits.

Reflecting these changes, we now expect year-average GDP growth of 2.7% in 2024 (previously 2.6%), 1.9% in 2025 (was 1.7%) and 2.1% in 2026 (was 2.2%).

As noted previously, the forecasts are based around a neutral view over (non-monetary) policy settings post November's elections. It is possible that there will be major changes to fiscal, monetary policy institutional arrangements, migration and trade policies. However, whether this is the case or not will depend on who is elected President and which party (or parties) control the House of Representatives and the Senate in Congress.

Inflation

Incoming data has remained broadly consistent with the notion that PCE inflation is moving down towards the Fed's 2% inflation target.

PCE inflation (the Fed's preferred measure) on a core basis was only 0.13% m/m in August and the trimmed measure was its lowest since 2020 (in m/m terms).

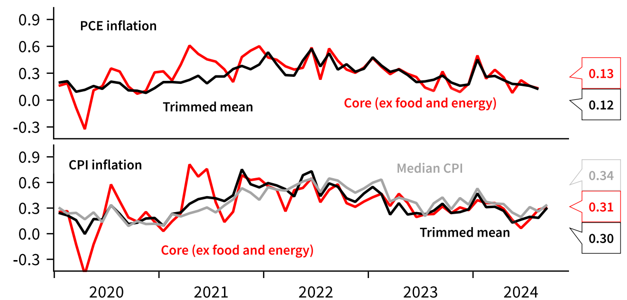
However, core CPI inflation was again 0.3% m/m in September (as in August) – but to two decimal places slightly higher at 0.31 – although this followed several months of low prints. Core PCE inflation for September is likely to be lower, although initial estimates following the CPI data range from 0.20 – 0.28%; tonight's PPI will provide more clarity where September PCE inflation will land.

On an annual basis, CPI inflation was 2.4% in September – its lowest reading since early 2021. Similarly, headline PCE inflation was 2.2% y/y in August. However, the Fed places more weight on underlying measures, and core PCE inflation is still 2.7% y/y (to August) and core CPI 3.3% (to September).

Housing services inflation took a turn down in September, but it has been quite choppy of late. Nevertheless, leading indicators (based on new leases) suggest that rental inflation should eventually settle at a rate that would be consistent with the Fed's inflation target.

Most monthly inflation indicators looking benign

Core inflation measures (m/m%)



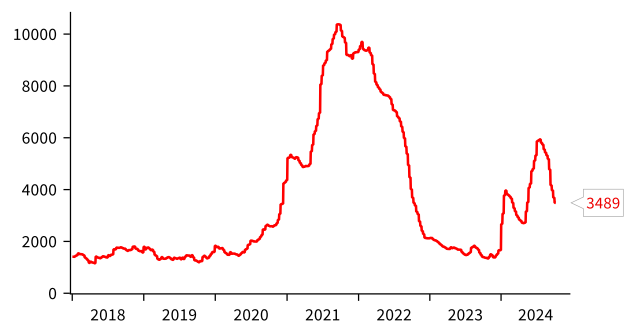
Source: National Australia Bank, U.S. Bureau of Economic Analysis (BEA), Federal Reserve Bank of Dallas, U.S. Bureau of Labor Statistics (BLS), Federal Reserve Bank of Cleveland, Macrobond

Since May, the core PCE has averaged 0.15% m/m and the core CPI 0.20% m/m. However, the Fed is still alert to the risk that this more benign recent data is part of normal volatility or even residual seasonality – but on the low side – and will be alert to a repeat of the spike inflation that occurred in early 2024.

One source of upwards pressure on goods prices has been the lift in global freight rates earlier this year. While this may not yet have fully fed through into domestic US prices, since July freight rates have come off appreciably, so the overall risk from this source has diminished, for now.

Risk from global freight costs has eased

Drewry composite world container index (US$/40ft)



Source: National Australia Bank, Drewry Shipping Consultants Ltd, Macrobond

Inflation expectations are well anchored and with the labour market having normalised and likely to ease a bit further, we continue to expect to see moderate monthly inflation readings from here, with core PCE inflation, on an annual basis, to move close to the Fed's target in 2025.

Contact the authors:

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

Taylor Nugent
Senior Economist, Markets
taylor.nugent@nab.com.au

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	2.5	2.6	2.2	2.0	0.5	0.7	0.8	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.6	0.6
Private fixed investment	2.4	4.0	2.8	3.8	1.6	0.6	0.6	0.4	0.8	0.8	0.9	0.9	1.0	1.0	1.0	1.0
Government spending	3.9	2.9	1.2	0.9	0.4	0.8	0.5	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Inventories*	-0.4	0.1	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*	0.5	-0.4	-0.2	-0.2	-0.2	-0.3	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real GDP	**2.9**	**2.7**	**1.9**	**2.1**	**0.4**	**0.7**	**0.7**	**0.4**	**0.4**	**0.4**	**0.4**	**0.5**	**0.5**	**0.6**	**0.6**	**0.5**
Note: GDP (annualised rate)					*1.6*	*3.0*	*2.8*	*1.6*	*1.7*	*1.8*	*1.8*	*1.9*	*2.1*	*2.2*	*2.3*	*2.2*
US Other Key Indicators																
PCE deflator-headline																
Headline	2.8	2.4	2.0	1.9	0.8	0.6	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.5
Core	**3.2**	**2.7**	**2.1**	**2.0**	**0.9**	**0.7**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**4.2**	**4.4**	**4.2**	**3.8**	**4.0**	**4.2**	**4.2**	**4.3**	**4.4**	**4.4**	**4.4**	**4.4**	**4.4**	**4.3**	**4.2**
US Key Interest Rates																
Fed funds rate (top of target range)	**5.50**	**4.50**	**3.00**	**3.00**	**5.50**	**5.50**	**5.00**	**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

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

Taylor Nugent
Senior Economist, Markets
Corporate and Institutional Banking
+(61 3) 8619 1008 | Mob: 0452 671 752

Important notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.

NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click **here** to view our disclaimer and terms of use.