US Economic Update 15 Nov. 2024

Stronger data and election result mean a slower path to neutral

- **The combination of stronger recent data and the likely direction of policy changes under Trump means we now expect the FOMC to cut rates more slowly.**
- **We still see a cut in December, but a pause is possible. For 2025, we now expect 100bps of rate cuts (previously 150bp). This reflects the changes to our growth and inflation forecasts as well as an expectation that upside inflation risks will weigh in Fed thinking.**
- **US policy settings will change under a Trump Presidency. We have pencilled in some working assumptions around how much, and when, elements of the Trump agenda will be implemented, but policy uncertainty is likely to remain elevated for a while to come.**
- **We have lowered our GDP, and increased our core inflation, forecasts primarily reflecting a large increase in tariffs which we pencil in to start in mid-2025.**

A change to our Fed track

The Fed cut rates again at its meeting this month, by 25bps, following a 50bp cut in September. We still expect a 25bp cut in December, in line with our view remaining that the initial recalibration that began in September would extend to 100bps of cuts this year. However, the balance of risks have tilted substantially and cuts will be slower through 2025, so a December cuts is far from assured.

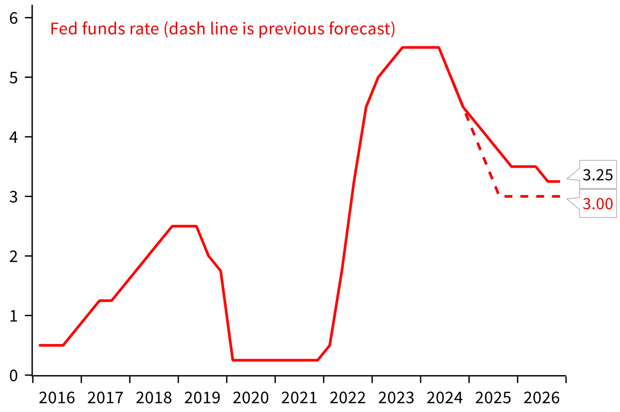
Fed Chair Powell noted in his post meeting press conference that the labour market was not a source of significant inflationary pressure. His assessment was that the labour market is continuing to cool at a modest rate and, importantly, that this is not required to achieve the Fed's inflation goal. He also stated that he considered inflation is on a sustainable path back to 2%. That said, he noted that the Fed was in no hurry to get back to neutral.

Alongside our forecasts, that supports further cuts over time, although we now expect a slower pace of easing through 2025 – one cut per quarter – and an end 2026 policy rate of 3.0-3.25%.

This change reflects not only our baseline macroeconomic forecasts but also how the Fed might assess, and seek to manage, risks to achieving its dual mandate as 2025 unfolds.

Since the initial cut in September, activity data has come in more strongly than expected and the annual revisions to the national accounts data leaves the recent strength in consumption less disconnected from household incomes, signalling less downside risk to the outlook. Moreover, the unemployment rate has eased slightly, alleviating concerns that it was rising quickly (although other labour market indicators, such as job vacancies, continue to cool). Inflation outcomes have been mixed – core PCE inflation grew by 2.2% q/q annualised in Q3, but the September reading was on the high side and it looks like this will also be the case for October (based on October CPI and PPI data).

Fed funds rate (top of target range, end quarter %)



Source: National Australia Bank, Macrobond, Account in-house

In normal times, the Fed would 'look through' the impact of tariff increases on inflation. This is because they represent a one-off adjustment to prices, and once that adjustment is complete then inflation should fall back to its underlying rate. This assumes inflation expectations remain anchored and no major second round effects. However, with inflation now elevated for several years, another inflation upswing may renew concerns over expectations de-anchoring. These concerns could be reinforced were Trump to continue to make noise about having a say in Fed policy. Given we still expect resilient growth, the FOMC will not be overly pressured to proactively lean against downside risk on the employment side of their mandate.

Forecast implications of the election

The election of Donald Trump as US President, as well as Republican control of both houses of the US Congress is likely to lead to material changes in US policy. This includes trade (tariffs), immigration/border security and fiscal policies and perhaps even the independence of the Federal Reserve.

We set out the Trump agenda, and our thoughts on some of the potential impacts, on the trade front, as well as with respect to fiscal, immigration and Fed independence policy prior to the election.

How quickly, and to what extent, the Trump administration seeks to implement its program, or where legislation is required, the degree of Congressional support, is uncertain. The Republican party majority in the House remains is only small, which may limit the extent to which policy changes can be agreed to.

Our forecasts incorporate the following assumptions about the path of policy under Trump:

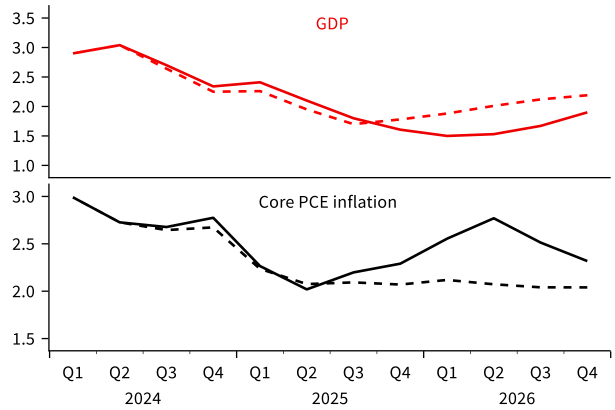
- There is an increase in the average tariff rate on US imports (based on current import levels and country composition) of around 10ppts. This is spread over a year starting in mid-2025. An increase in tariffs of this level represents around two-thirds of the increase implied by a 60% China tariff and 10% tariff on the rest of the world.
- Fiscal policy is neutral over the forecast period. This is consistent with the expiring tax provisions of the Tax Cuts and Jobs Act being extended and any additional tariff revenue being used to fund other campaign promises.
- No change to our population estimates, noting that border crossings have already declined this year on stricter enforcement and our forecasts already embody a slowdown in overall population growth.
- The Fed retains its independence.

The net effect of these assumptions is to lower our growth forecasts, particularly from mid-2025 to mid-2026 as the tariffs impact the economy, partly offset by slightly higher growth in coming quarters (largely reflecting recent data flow). The higher expected path for the federal funds rate will also weigh on activity.

Over 2025 and 2026 GDP growth is around 0.5ppts lower than in our October projections. This still leaves GDP growing by 1.6% over 2025 and 1.9% over 2026, so not that far off its expected long term trend growth. In summary, the economy is expected to remain resilient. We still expect the gradual cooling in the labour market that is underway will lead to a further small lift in the unemployment rate, to 4.4% (currently 4.1%). While the peak is unchanged, our lower growth forecasts suggest it will hold at this level for longer.

The implementation of the assumed tariffs is expected to lift US core PCE inflation by around 0.6ppts, with the change again concentrated between mid-2025 to mid-2026. For both 2025 and 2026 we are projecting core inflation of 2.3%y/y. However, the lift in the USD should put some downward pressure on US inflation in coming quarters, before the tariffs lift inflation to 2.8% y/y by mid-2026. However, by end 2026, with the tariff increases assumed to be in the rearview mirror, quarterly core PCE inflation should be closer to the Fed's target.

GDP and core inflation forecasts (year-ended % chg)



Source: National Australia Bank. Solid lines are current foreast, dash lines October forecast

Forecast risk

The risks to these assumptions – based on campaign announcements – are that the tariff increases are greater (and perhaps sooner), that fiscal policy is stimulatory (in line with central estimates of the budget impact of Trump's specific promises) and that population growth is lower.

In his first term, the scale of Trump's tariff increases was lower than he flagged during his campaign. This was consistent with the notion that tariffs were a bargaining chip (at least in part) to achieve other aims. On fiscal policy, an only narrow Republican majority in the House of Representatives could constrain how much of the Trump agenda can be delivered. Even a few budget hawks could force the leadership to reduce the scope of campaign policies to lower their budget impact and, post-election, there appears to be more focus on spending cuts (e.g. through a new Department of Government Efficiency).

The threat of 'mass deportations' raises the prospect of a turn down in population, but how far Trump will actually pursue this, and how effective legal challenges (and sanctuary cities) will be in averting this if tried, is hard to meaningfully assess.

Outside these policy areas, there are hopes that Trump will usher in a more business friendly environment (less regulation, lower taxes).

These risks to our policy assumptions are, net, ambiguous on growth (fiscal stimulus/less regulation a positive, migration/tariffs negative). They suggest upside risk on inflation (from tariffs/stimulus while the impact of migration is unclear but neutral at best). Another risk comes from outside the US, in the form of retaliatory trade measures – this would put downward pressure on US growth and inflation.

The other policy issue to note is Trump's stated desire to have a role in setting interest rates. Any attempt to do so would be consequential, possibly causing large rises in bond yields, falls in equities and negative impacts on confidence more generally which would lower growth. Our base case is that this does not occur (we think Congress would push back) but clearly the risk is there.

Apart from uncertainty around what policies may be implemented, the range of reasonable estimates of the impacts of any particular policy is wide. So as the Trump presidency unfolds we will have to adjust our forecasts, not only as we gain greater clarity about policy settings, but as the impacts of those policies on the economy becomes clearer.

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U.S. economic forecasts

	2023	2024	2025	2026	2024 Q3	Q4	2025 Q1	Q2	Q3	Q4	2026 Q1	Q2	Q3	Q4
US GDP and Components	year average				q/q%									
Household consumption	2.5	2.7	2.3	1.8	0.9	0.7	0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.5
Private fixed investment	2.4	3.8	2.2	2.7	0.3	0.4	0.6	0.6	0.7	0.7	0.6	0.7	0.8	0.8
Government spending	3.9	3.3	1.6	0.8	1.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Inventories*	-0.4	0.1	0.1	-0.1	0.0	0.0	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Net exports*	0.5	-0.5	-0.3	0.0	-0.2	-0.1	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Real GDP	**2.9**	**2.7**	**2.0**	**1.7**	**0.7**	**0.5**	**0.5**	**0.4**	**0.4**	**0.3**	**0.4**	**0.4**	**0.5**	**0.5**
Note:														
GDP q/q annualised rate					*2.8*	*1.9*	*1.9*	*1.7*	*1.5*	*1.3*	*1.5*	*1.8*	*2.1*	*2.2*
GDP year-ended %	*3.2*	*2.3*	*1.6*	*1.9*	*2.7*	*2.3*	*2.4*	*2.1*	*1.8*	*1.6*	*1.5*	*1.5*	*1.7*	*1.9*
US Other Key Indicators														
PCE deflator-headline	year -ended %				q/q%									
Headline	**2.8**	**2.5**	**2.2**	**2.2**	**0.4**	**0.6**	**0.5**	**0.4**	**0.6**	**0.7**	**0.6**	**0.6**	**0.4**	**0.5**
Core	**3.2**	**2.8**	**2.3**	**2.3**	**0.5**	**0.7**	**0.5**	**0.4**	**0.7**	**0.7**	**0.7**	**0.7**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**4.2**	**4.4**	**4.4**	**4.2**	**4.2**	**4.2**	**4.3**	**4.4**	**4.4**	**4.5**	**4.5**	**4.4**	**4.4**
US Key Interest Rates														
Fed funds rate (top of target range)	**5.50**	**4.50**	**3.50**	**3.25**	**5.00**	**4.50**	**4.25**	**4.00**	**3.75**	**3.50**	**3.50**	**3.50**	**3.25**	**3.25**

Source: NAB Group Economics.

*Contribution to real GDP growth

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