Monthly Economic Monitor – U.S.

Economics and Strategy

December 2024 – January 2025

More growth, more inflation… and fewer rate cuts

By Jocelyn Paquet

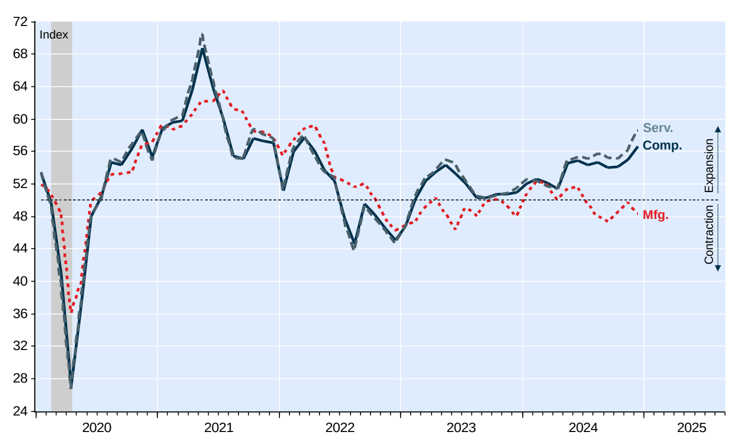
Summary

- The latest U.S. data suggest that the economy will end the year on a high note. As has been the case for some time, the current strength reflects solid growth in consumer spending, due not only to the resilience of the labour market, but also to the steady increase in household net worth.
- As the drivers of recent performance are likely to remain the same in 2025, the U.S. economy should continue to outperform that of other rich countries, provided the new Trump administration sticks to the most pro-growth part of its agenda and keeps its protectionist instincts to a minimum.
- While recognizing the high level of uncertainty surrounding these projections, our best guess at this stage is that the spending cuts announced by the Trump administration will be insufficient to prevent tax cuts from widening the deficit further. We therefore expect fiscal policy to have a positive impact on growth over the next two years. On the international trade front, we believe that Washington will refrain from imposing blanket tariffs, opting instead for a more targeted, less disruptive approach.
- Against this backdrop, we have decided to significantly revise upwards our growth forecast for 2025, to 2.1%. GDP should then grow by 1.7% in 2026.

The latest U.S. data suggest that the economy will end the year on a high note. While the manufacturing sector continues to struggle, this is largely offset by very high levels of activity in the services sector, with S&P Global even reporting the strongest expansion in this segment for 38 months in December.

U.S.: Services sector expanding at a solid rate

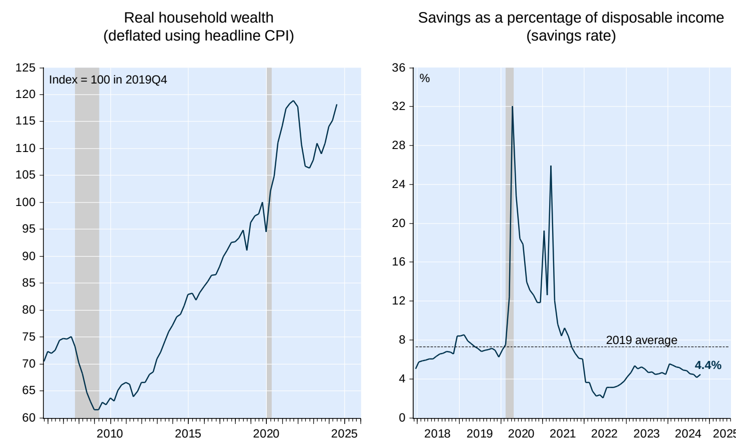
S&P Global Flash PMI. Last observation: December 2024



NBC Economics and Strategy (data via Refinitiv)

As has been the case for some time, the current strength reflects solid growth in consumer spending, due not only to the resilience of the labour market, but also to the steady increase in household net worth over the past two years. Soaring stock prices, in particular, helped lift Americans' real wealth to an almost unprecedented level in the third quarter, boosting their confidence in their financial situation and encouraging them to save a smaller proportion of their income than they were accustomed to before the pandemic.

U.S.: Surge in wealth encouraging households to save less

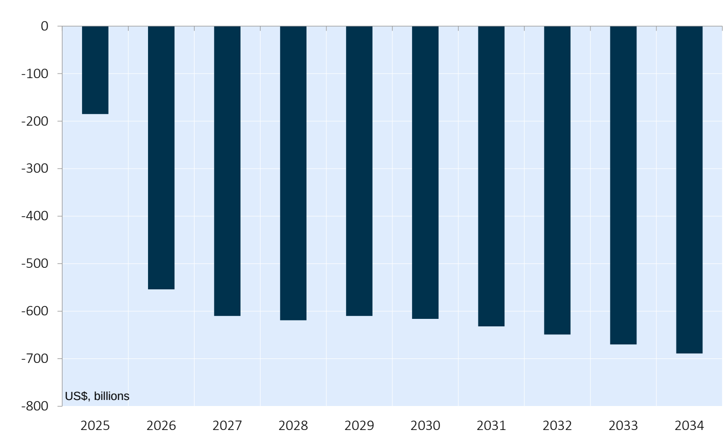


NBC Economics and Strategy (data via Bloomberg)

As the drivers of recent performance are likely to remain the same in 2025, the U.S. economy should continue to outperform that of other rich countries, provided the new Trump administration sticks to the most pro-growth part of its agenda and keeps its protectionist instincts to a minimum. The various tax cuts promised by the president-elect during his campaign, ranging from an extension of the Tax and Jobs Act of 2017 to a reduction in the corporate tax rate from 21% to 15%, could certainly help stimulate growth, but only if they are not financed by increased tariffs on imported products or by a reduction in public spending, two other measures put forward by the new administration.

U.S.: More fiscal stimulus on the way?

Impact of the Trump administration's proposed tax cuts on the primary deficit



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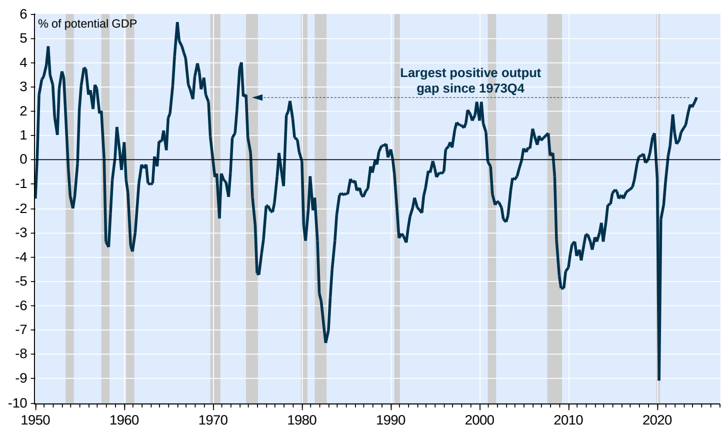
While recognizing the high level of uncertainty surrounding these projections, our best guess at this stage is that the spending cuts announced by the Trump administration will be insufficient to prevent tax cuts from widening the deficit further. We therefore expect fiscal policy to have a positive impact on growth over the next two years. On the international trade front, we believe that Washington will refrain from imposing blanket tariffs, opting instead for a more targeted, less disruptive approach.

If this scenario plays out, the end result should be more growth... but also more inflation. This is because standard economic theory suggests that fiscal stimuli are more likely to generate inflation when implemented at a time when the economy is already operating above its potential. And at present, demand far exceeds supply in the United States.

U.S.: Excess demand has historically translated into above-target inflation
Output gap (Percentage gap between GDP and potential GDP)



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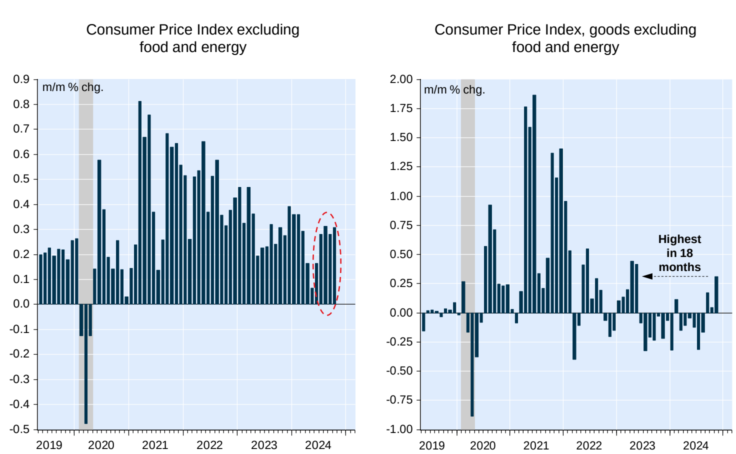
The impact of this situation can already be seen in the inflation data. Take November's CPI, for example. Although the report was in line with consensus expectations, it still contributed to reducing our level of confidence that inflation will return to its target in a sustainable manner. This is partly due to the fact that a number of components that had contributed strongly to disinflation in recent months now appear to be regaining strength, notably food and motor vehicles. More generally, it is the resurgence of the core goods category that has most fuelled our doubts, as prices in this segment saw their biggest rise in 18 months in November.

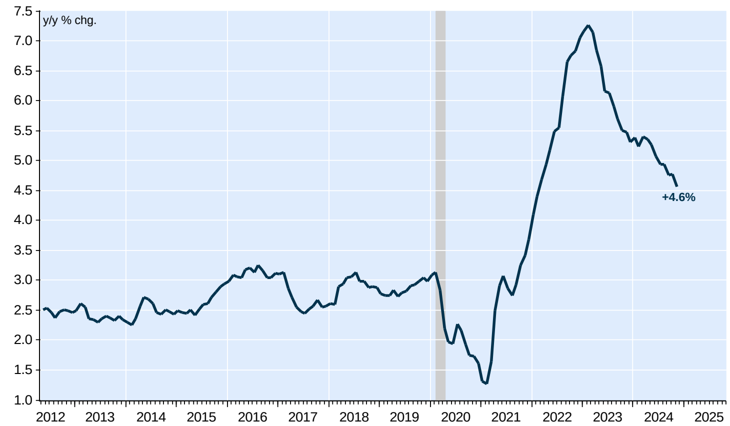
U.S.: Core inflation remains too high for comfort (1)



NBC Economics and Strategy (data via Bloomberg)

Should this rebound be confirmed in the coming months – and the imposition of tariffs proposed by the new Trump administration could certainly add fuel to the fire in this respect – it would complicate the Federal Reserve's task, especially in a context where inflationary pressures in the services segment remain strong.

U.S.: Core inflation remains too high for comfort (2)
Consumer Price Index, services excluding energy



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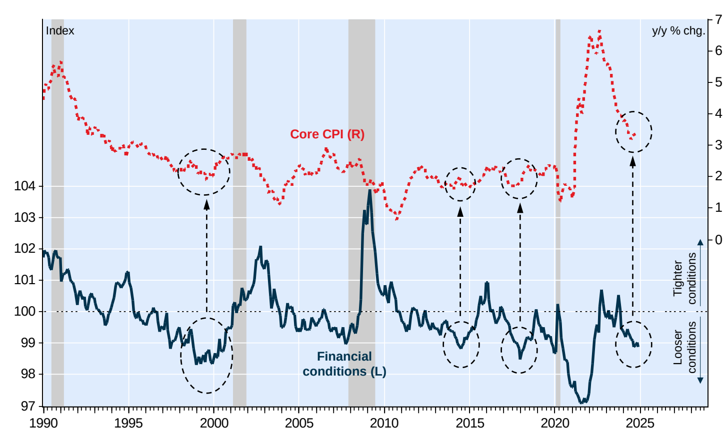
Overly loose financial conditions, reflecting high stock market valuations and compressed credit spreads, are also likely to make the Fed's work harder. Although favorable to growth, such permissive financing conditions have in the past tended to fuel inflation. Excluding the post-pandemic period, core inflation has in fact risen by 0.6% on average the last few times the Goldman Sachs Financial Conditions Index has been as low as it is today (1998M11-2000M05, 2014M06-2014M09 and 2017M11-2018M03). This may have been desirable at the time, as inflation was below target or very close to it. But the same is not true today, when core inflation is still some ways above 2%.

U.S.: Loose financial conditions won't help to bring inflation back to 2%
Goldman Sachs Financial Conditions Index for the U.S. vs. Consumer Price Index excluding food and energy



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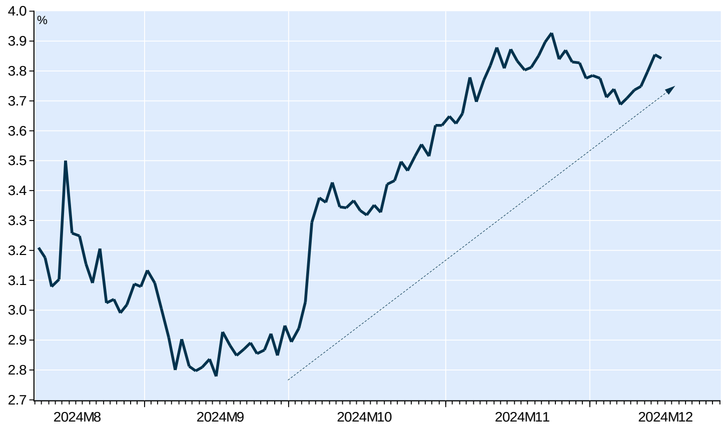
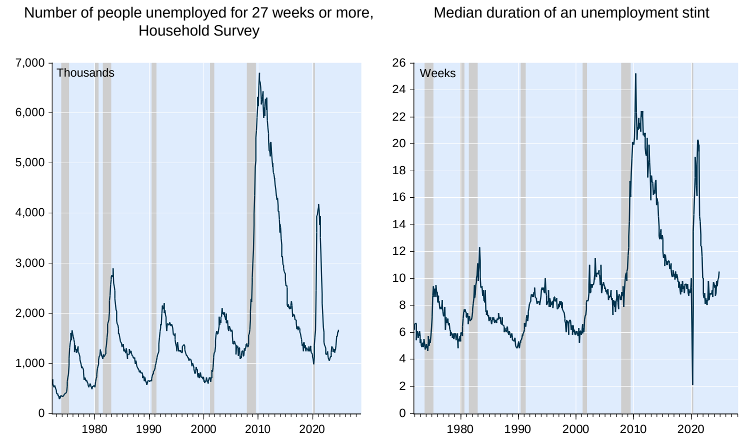
The bond market has not remained impassive in the face of the growing risks of inflation remaining above the central bank's target, with the policy rate anticipated by the futures market at the end of 2025 having been revised sharply upwards in recent weeks.

U.S.: Higher inflation likely to translate into less rate cuts by the Fed
Level of Fed funds rate anticipated by the futures market at the end of 2025



NBC Economics and Strategy (data via Bloomberg)

U.S.: It's getting harder to find a new job after losing one



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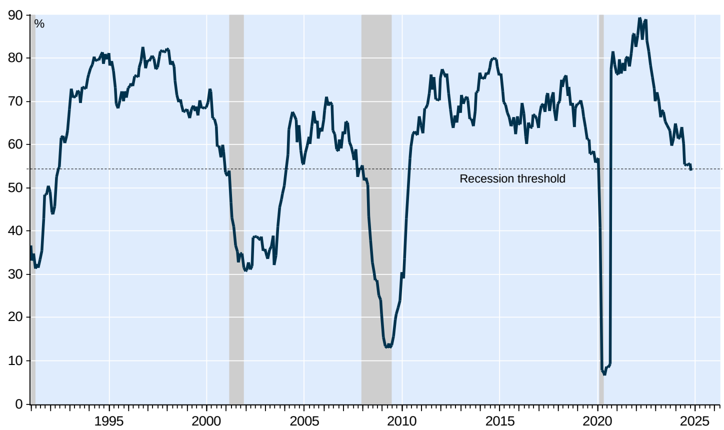
Such a recasting of expectations seems appropriate to us in a context where Fed Chairman Jerome Powell himself has repeatedly mentioned that failure to quickly rein in price pressures could have serious consequences in the longer term, with a delayed return to target likely to entail greater economic costs. But while we agree that keeping inflation under control must remain the central bank's main objective for the time being, we remain concerned about the delayed effect that a tight monetary policy could have on a labour market that is showing some signs of weakness. These include the very weak diffusion of job gains in recent months...

U.S.: Job creation getting less diffuse
Diffusion of employment gains over the past 6 months



NBC Economics and Strategy (data via Bloomberg)

... and the fact that it is increasingly difficult for people who have lost their jobs to find new ones.

Indeed, it is these risk factors that prompt us to maintain a relatively cautious growth outlook for the second half of 2025. But as the below-potential growth at the end of the year is largely offset in our projections by a much stronger-than-expected expansion in Q4 2024 and Q1 2025, our growth forecast for 2025 as a whole has nonetheless been revised sharply upwards, to 2.1%. GDP is then expected to grow by 1.7% in 2026. For obvious reasons, our degree of confidence in these forecasts is rather low. We will be ready to reassess our outlook once the new administration has been sworn in on January 20.

United States
Economic Forecast

*(Annual % change)**	*2022*	*2023*	*2024*	*2025*	*2026*	*Q4/Q4 2024*	*Q4/Q4 2025*	*Q4/Q4 2026*
Gross domestic product (2012 $)	2.5	2.9	2.8	2.1	1.7	2.7	1.5	1.9
Consumption	3.0	2.5	2.7	2.6	1.8	2.9	1.9	2.0
Residential construction	(8.6)	(8.3)	4.0	1.4	2.5	2.1	2.5	2.5
Business investment	7.0	6.0	3.8	1.8	1.3	3.2	1.4	1.4
Government expenditures	(1.1)	3.9	3.4	3.1	2.6	3.1	3.0	2.1
Exports	7.5	2.8	3.0	0.3	0.3	2.3	(0.8)	1.2
Imports	8.6	(1.2)	5.3	2.6	1.5	5.5	1.5	2.1
Change in inventories (bil. $)	119.1	33.1	55.9	30.0	13.8	70.0	5.0	15.0
Domestic demand	2.3	2.7	3.0	2.5	1.9	3.0	2.1	2.0
Real disposable income	(5.6)	5.1	2.7	1.5	2.4	2.1	1.8	2.8
Payroll employment	4.3	2.3	1.6	1.2	0.6	1.5	0.8	0.9
Unemployment rate	3.6	3.6	4.0	4.5	4.5	4.2	4.6	4.5
Inflation	8.0	4.1	2.9	2.3	2.3	2.7	2.1	2.5
Before-tax profits	7.8	6.9	6.7	1.4	2.6	2.2	0.8	3.0
Current account (bil. $)	(1,012.1)	(905.4)	(999.0)	(986.3)	(978.8)	...	...	...

** or as noted*

Financial Forecast**

	Current 12/17/24	*Q1 2025*	*Q2 2025*	*Q3 2025*	*Q4 2025*	*2024*	*2025*	*2026*
Fed Fund Target Rate	4.75	4.25	4.00	3.75	3.50	4.50	3.50	3.50
3 month Treasury bills	4.26	4.00	3.75	3.55	3.25	4.25	3.25	3.35
Treasury yield curve								
2-Year	4.25	3.90	3.70	3.45	3.35	4.15	3.35	3.55
5-Year	4.26	4.00	3.80	3.65	3.55	4.15	3.55	3.75
10-Year	4.40	4.15	4.00	3.85	3.75	4.30	3.75	3.95
30-Year	4.59	4.35	4.20	4.05	4.00	4.50	4.00	4.20
Exchange rates								
U.S.$/Euro	1.05	1.02	1.03	1.05	1.07	1.05	1.07	1.10
YEN/U.S.$	154	145	142	140	137	148	137	130

*** end of period*

Quarterly pattern

	Q1 2024 actual	*Q2 2024 actual*	*Q3 2024 forecast*	*Q4 2024 forecast*	*Q1 2025 forecast*	*Q2 2025 forecast*	*Q3 2025 forecast*	*Q4 2025 forecast*
Real GDP growth (q/q % chg. saar)	1.6	3.0	2.8	3.2	2.1	1.2	1.1	1.5
CPI (y/y % chg.)	3.2	3.2	2.6	2.7	2.5	2.3	2.4	2.1
CPI ex. food and energy (y/y % chg.)	3.8	3.4	3.2	3.3	3.0	2.8	2.9	2.7
Unemployment rate (%)	3.8	4.0	4.2	4.2	4.3	4.4	4.6	4.6

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