US resilience continues to be challenged

The US economy has slowed as we suspected it would, but inflation and the jobs market have been more resilient. That's required the Federal Reserve to keep monetary policy tighter for longer. However the consumer is cooling, unemployment is rising and inflation is showing signs of moderating; we're expecting the first rate cut in September

There's been a lot to cheer about in the US economy but things aren't looking quite so energetic now

The half-time review

Back in December, we were forecasting a swift slowdown in US growth that would allow inflation to hit 2% in the second half of the year and offer the Fed scope to cut interest rates by 150bp. The economy has certainly cooled, with the rate of consumer spending growth halving from the 3%+ rate in the second half of 2023 to a run rate of 1.6% in the first six months of this year. Inflation has been stickier than we anticipated and the jobs market has been a little more resilient. Housing, medical services and insurance were the main factors keeping inflation elevated at the start of the year, but we have seen lower numbers in the past couple of months.

Nonetheless, inflation is unlikely to hit 2% consistently until late into the first quarter of 2025. Given all this, the Fed has remained more hawkish. We now expected the first rate cut to come in September; we had thought it would be in May.

1 Second-half prediction: Rate cut calls are growing once again

We need to see three things for the Fed to cut interest rates as we now expect (75bp in 2024 and 75bp in 2025):

- Core inflation must continue to come in at 0.2% month-on-month or below – the run rate required to achieve 2% annual inflation.
- Unemployment, which has risen from 3.4% to 4.1%, needs to rise further, signalling increased slack in the jobs market with weaker wage pressures.
- The weakening momentum in consumer spending must cool further, as suggested by data showing flat real household disposable incomes, exhausted pandemic-era savings for millions of households, and rising loan delinquencies.

With business surveys indicating moderating activity and hiring in coming months, we continue to see the risks skewed towards more aggressive Fed policy easing than the market is pricing.

2 Second-half prediction: Political uncertainty to cloud the outlook

The US election poses several challenges when making forecasts for 2025. Donald Trump is seen as the favourite candidate to win the presidency after Joe Biden's poor performance in the recent debate, with several members of the Democrat Party questioning whether he should stand aside for a new candidate. Trump's proposals, which are centred on tax cuts, immigration controls, and broad-based tariffs on imported goods, could boost domestic demand in the near term but add to inflationary pressures over the medium to long term. This would likely mean that the Federal Reserve has less of a chance to cut interest rates than if Joe Biden wins the presidency.

However, we have to remember that Congress will determine the timing of implementation and how aggressive Trump may be. If the Republicans win control of Congress, Trump may choose to focus on tax and immigration to start with. But if the Democrats have control of Congress and limit his domestic ambitions, he will likely focus more on trade policy and global geopolitical issues.

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