QUEST Economic Update | August 2024

Inflationary pressures wane and labor markets come into better balance

The Federal Reserve appears close to a soft landing in a manner consistent with its twin goals of maintaining stable prices and full employment. Inflationary pressures have lessened over the past few months and are again moving towards the Federal Reserve's 2% target rate. At the same time, labor markets have come into better balance. While they have weakened, they are not weak, and forecasters generally expect the US economy to continue to grow.

The overall Consumer Price Index (CPI) fell to 2.9% in July, falling every month since March 2024 and at its lowest level since March 2021. The Personal Consumption Expenditures (PCE) price index, the measure more closely tied to monetary policy, fell to 2.5% in June and has also had a downward trajectory over the past several months.

Labor markets have softened, with the July unemployment rate rising to 4.3% and July job gains at just 114,000. The annual benchmark revision for April 2023 through March 2024 had 818,000 fewer job gains than previously estimated, a 30% reduction, suggesting that labor markets were weaker than initially thought. Notwithstanding the softening, the unemployment rate is within range of the rate consistent with full employment.

The recent inflation and jobs data have set the stage for the Federal Open Markets Committee (FOMC) to begin to reduce interest rates, possibly at their next meeting on September 17-18. Markets currently anticipate a 25-basis point reduction in September, reductions totaling 100 basis points by year-end, and reductions totaling 200 basis points by summer 2025.

Building a better working world

Ernst & Young LLP's Quantitative Economics and Statistics (QUEST) group's Economic Update summarizes the latest US economic trends and significant global developments.

Current as of 08/23/2024

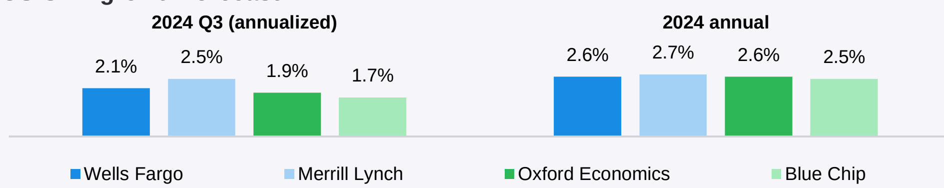
OVERALL US ECONOMY

The consensus is that the economy will slow somewhat in the fourth quarter but achieve above-trend economic growth of 2.4% for 2024 overall. Real annualized gross domestic product (GDP) increased by 2.8% during the second quarter. The Atlanta Fed's GDPNow forecast sees GDP increasing by 2.0% during the third quarter of 2024 (as of August 16).

Roughly 1.7% to 2.5% growth
expected for 2024 Q3 (annualized)

Roughly 2.5% to 2.7% growth
expected for 2024

US GDP growth forecast



LABOR MARKETS

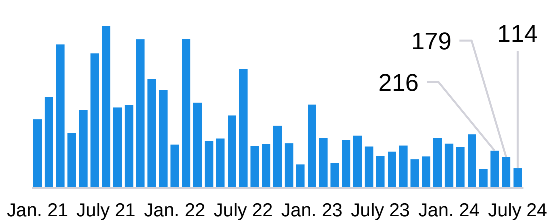
In July, the unemployment rate rose to 4.3% and job gains slowed to 114,000. The unemployment rate has gradually risen over the past year. Job openings have generally fallen but remain above the number of unemployed. Overall, the data suggests labor markets are coming back into balance.

377k job gain
on average in 2022

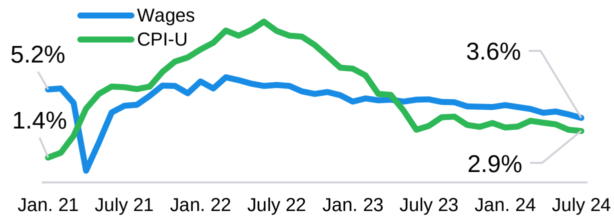
251k job gain
on average in 2023

203k job gain
on average in first half of 2024

Nonfarm payroll employment
Month-over-month change (in thousands), seasonally adjusted



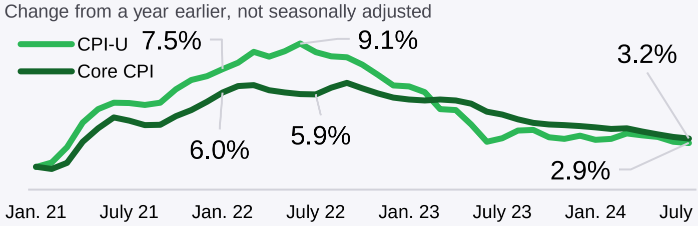
Hourly wages and CPI-U
Change from a year earlier, CPI - not seasonally adjusted, Wages – seasonally adjusted



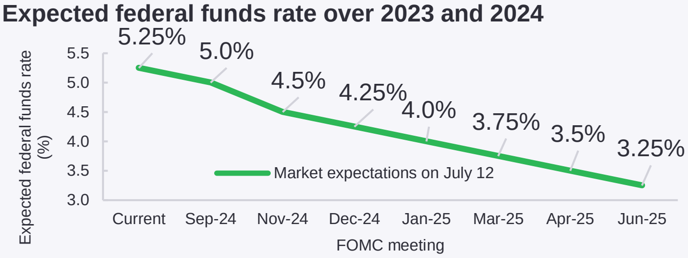
INFLATION / INTEREST RATES

Inflation pressures have been subsiding over the past months. In July, the overall and core CPI rose by 2.9% and 3.2%, respectively. In June, the overall and core PCE price index, the Federal Reserve's preferred inflation measure when setting monetary policy, rose by 2.5% and 2.6%, respectively. Market expectations suggest the FOMC will begin to lower interest rates in September with reductions totaling roughly 200 basis points by summer 2025.

CPI-U and core CPI
Change from a year earlier, not seasonally adjusted

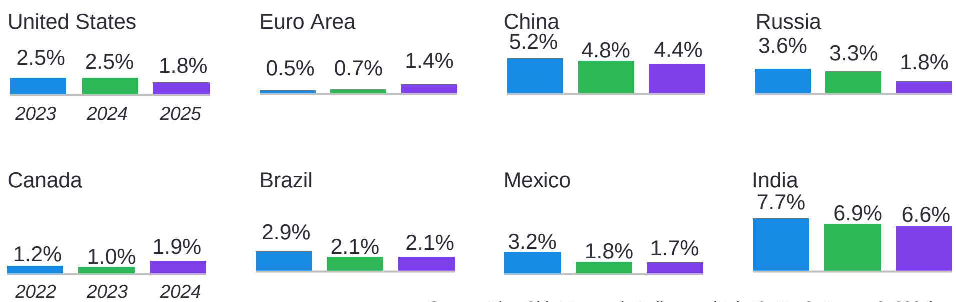


Expected federal funds rate over 2023 and 2024



GLOBAL GROWTH

Recent data has the inflation rate in many developed economies running below 3% (Euro Area, United Kingdom (UK), Japan). Forecasts generally suggest economic growth picking up in 2025 following softness in 2024. China's economy, however, is facing challenges with consensus forecasts seeing growth falling in 2025.



Source: Blue Chip Economic Indicators (Vol. 49, No. 8, August 9, 2024).

Upcoming economic data releases

- Q2 2024 GDP (second estimate), August 29
- Employment situation for August, September 6
- Interest rates, Federal Open Markets Committee
- Consumer Price Index for August, September 11
- FOMC meeting, September 17-18
- Job openings for July, September 30

Overall US economy

After a year of holding the target interest rate well above 5%, the FOMC Chairman Jay Powell said, “The time has come for policy to adjust,” and the Federal Reserve appears likely to make its first rate cut at its September 17-18 meeting. For more than two years, the Federal Reserve increased interest rates rapidly to their highest level in over two decades to tame elevated inflation. The higher interest rates appear to be curbing inflation and, at the same time, have brought labor markets into better balance.

The overall CPI increased by 2.9% in July (y/y) and the core CPI, which excludes the more volatile energy and food components, increased by 3.2%. These are the lowest inflation readings since March 2021 and May 2021, respectively. The June PCE price index increased 2.5% and the core index increased 2.6%. While these readings are above the Federal Reserve’s 2% target, they are trending toward it.

US gross domestic product (GDP) grew at a 2.8% seasonally adjusted annual rate in the second quarter of 2024 after growing at 1.4% rate in the first quarter. In July, the unemployment rate increased to 4.3% from 4.1% in June and the economy added 114,000 jobs. The annual revision by the Bureau of Labor Statistics (BLS) had the economy adding 818,000 fewer jobs than expected between April 2023 and March 2024; that is, the economy added 2.1 million jobs, rather than 2.9 million jobs during this period.

With inflationary pressures subsiding and labor markets better in balance, the Federal Reserve appears ready to begin to reduce its target interest rate. Market participants expect an interest rate reduction of 25 basis points in September, reductions totaling 100 basis points by the end of 2024, and reductions totaling 200 basis points by summer 2025.

Labor market

US labor markets have loosened significantly and are now in better balance. The July unemployment rate increased to 4.3%, 0.2 percentage point above the 4.1% in June, and is in range of the roughly 4.4%-4.5% unemployment rate at which many economists view as consistent with full employment.

The economy added 114,000 jobs in July, down from the 179,000 jobs added in June. Job gains in the first half of 2024 averaged 218,000, 251,000 in 2023, and 377,000 in 2022. The BLS recently reported that the US economy added 818,000 fewer jobs than expected between April 2023 and March 2024. Weekly jobless claims have been below pre-pandemic levels for the past several weeks. Job openings have been generally falling since their high in early 2022 but remain above unemployment.

The labor force participation rate increased to 62.7% in July and is now back to near its pre-pandemic level. The underemployment rate, which averaged 8.7% from 2015 through 2019, increased 0.4 percentage point in July to 7.8%. Average hourly earnings were up in July by 3.6% from a year ago, a pace above the 2.9% increase in the overall CPI for July (y/y).

Inflation

The overall CPI rose by 2.9% (y/y) in July, following its 3.0% increase in June and 3.3% increase in May. The monthly July CPI increased by 0.2%, after a 0.1% decrease in June and no change in May. The core CPI rose by 3.4% (y/y) in July, 0.1 percentage point lower than the rate in June and 0.4 percentage point lower that the rate in May. The monthly core CPI rose by 0.2% in July, 0.1 percentage point lower than the increase in June and the same as the increase in May. Shelter prices rose 0.4% in July and 5.1% over the past year. Shelter prices were responsible for nearly 90% of the CPI increase. The Federal Reserve Bank of Cleveland’s inflation nowcast forecasts the increase in the CPI for August to decrease to 2.6% (as of August 23).

The PCE price index, the preferred inflation measure of the Federal Reserve, increased by 0.1% in June, above its 0.1% increase in May and below its 0.3% increase in April. From its level 12 months earlier, the PCE price index increased by 2.5% in June below the 2.6% increase in May. The core-PCE price index increased by 0.2% in June, above its 0.1% increase in May, and by 2.6% over the past 12 months (the same rate reported in May). The Cleveland Fed’s inflation nowcast expects the core PCE to increase by 2.6% in July (as of August 23).

With the overall inflation rate now below 3% and making steady progress toward the Federal Reserve’s 2% target, it appears that the Federal Reserve is poised to begin to reduce its target interest rate. Markets expect the FOMC to reduce its target rate by 25-basis points at its next meeting on September 17-18, with reductions totaling 100 basis points by year end, and totaling 200 basis points by summer 2025.

Global growth

The global economy is expected to grow faster in 2025 than 2024, with growth in the 2.7% to 3.3% range. Recent data from the Euro area, UK and Germany indicate that inflation is running below 3% and many central banks have begun reducing their policy rates to support economic growth.

The Bank of Japan appears to be an outlier as it has raised its rate twice in 2024 to levels not seen in decades as the Japanese yen depreciated. China’s economy continues to face headwinds with consensus forecasts suggesting economic growth falling somewhat in 2025.

Contacts

For more information, contact: robert.carroll@ey.com
andrew.phillips@ey.com, brandon.pizzola@ey.com

SCORE No. XX0000
1909-3266768
ED None