QUEST Economic Update | February 2025

US sees robust economic growth with persistent inflation

As 2025 continues, the US economy appears to still be growing, albeit at a more balanced pace. The labor market remains solid, and the economy seems to be moving into cruising speed, with job gains in December limited to 143,000 and the unemployment rate declining to 4.0%. The economy demonstrated resilience in 2024, with a projected GDP growth of 2.8%, supported by strong second and third quarter growth.

Inflation, however, remains elevated, with the Consumer Price Index (CPI) increasing by 2.9% year over year in December and core CPI rising by 3.2% over the same time. After pausing rate changes in January, the Federal Open Markets Committee (FOMC) is not anticipated to cut rates again until May as they seek to balance sustainable growth with effective inflation control.

As the economic landscape evolves, many are closely watching to see what will happen with tariffs and taxes, as these factors could significantly influence consumer spending and business investment. Many expect the US economy to continue growing and maintain momentum while addressing the ongoing inflationary landscape.

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 2/7/2025

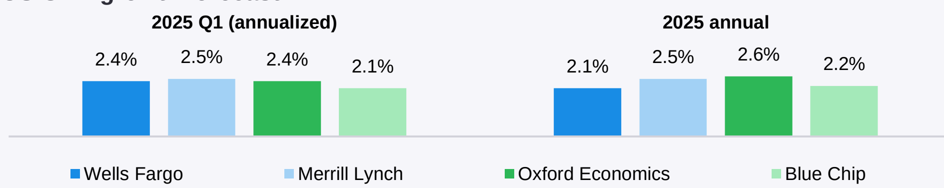
OVERALL US ECONOMY

The US economy continues to grow above trend. The economy expanded by 2.3% during the fourth quarter, and 2.8% for all of 2024. The Atlanta Fed's GDPNow forecast sees GDP increasing by 2.9% during the first quarter of 2025 (as of February 7).

Roughly 2.1% to 2.5% growth
expected for 2025 Q1 (annualized)

Roughly 2.1% to 2.6% growth
expected for 2024

US GDP growth forecast



LABOR MARKETS

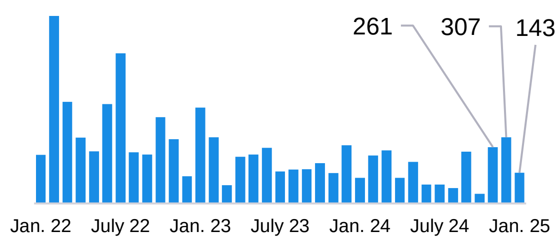
The unemployment rate fell to 4.0% in January, slightly below the 4.1% in December and the 4.3%-4.5% generally viewed as consistent with full employment. The US economy added 143,000 in January, following gains of 307,000 in December and 261,000 in November.

380k job gain
on average in 2022

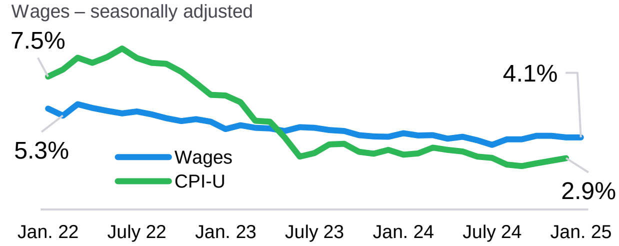
216k job gain
on average in 2023

166k job gain
on average in 2024

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



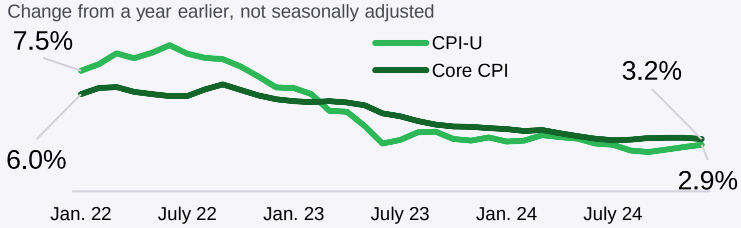
Hourly wages and CPI-U
Change from a year earlier, CPI - not seasonally adjusted, Wages – seasonally adjusted



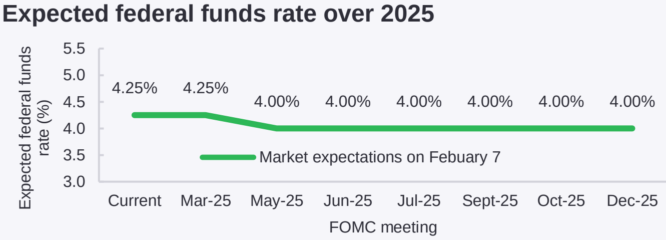
INFLATION / INTEREST RATES

Inflation remains somewhat elevated and persistently so. The overall CPI ticked up slightly in December and core PCE price inflation was 2.8% in December and has been near this level since May 2024, above the Federal Reserve's 2% target. Markets do not expect another rate cut by the FOMC until May 2025, followed by another pause until sometime next year.

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

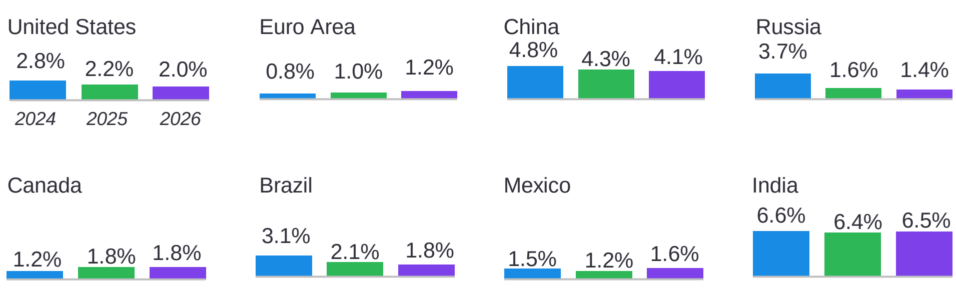


Expected federal funds rate over 2025



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 the softness in 2024. China's economy, however, is facing challenges with consensus forecasts seeing growth falling in 2025.



Source: Blue Chip Economic Indicators (Vol. 50, No. 1, January 10, 2025).

Upcoming economic data releases

- Consumer Price Index for January, February 12
- Q4 2024 GDP (second estimate), February 27
- Employment situation for February, March 7
- Job openings for January, March 11
- Interest rates, Federal Open Markets Committee (FOMC) meeting, March 18-19

Overall US economy

The US economy continues to grow at a steady pace, with GDP expanding by 2.8% in 2024 and early 2025 projections indicating similar momentum. The Atlanta Fed's GDPNow model forecasts 2.9% growth in the first quarter, though higher interest rates and policy uncertainties around tariffs and taxation could slow growth. Consumer spending remains strong but is showing signs of moderation, while business investment has cooled as companies assess economic conditions and potential tariffs.

The labor market remains solid but has slowed. The economy added 143,000 jobs, a slowdown from the 307,000 in December and 261,000 in November. Notwithstanding the drop off in jobs gains, the unemployment rate ticked down to 4.0% in January from 4.1% in December. Wage growth has moderated but remains above inflation. Businesses remain cautious as economic uncertainty lingers with potential rapid shifts in trade policies.

Inflation remains somewhat elevated and persistently so with the December CPI rising by 2.9% year over year and core CPI increasing by 3.2%. The core PCE price index, the Fed's preferred measure, held at 2.8%, where it has remained since mid-2024. Markets expect the Fed to hold rates steady until at least May and then a pause until sometime in 2026 as it tries to balance economic growth with slowing inflation.

Globally, inflation is easing, with price growth below 3% in the Euro Area, UK, and Japan. However, China faces slowing economic growth. All countries seem to be paying close attention to possible tariff policy changes coming out of the United States.

Labor market

US labor markets remain in better balance. The January unemployment rate was 4.0%, down from 4.1% in December and 4.2% in November. The unemployment rate appears to have settled in a range below the roughly 4.3%-4.5% unemployment rate many economists view as consistent with full employment.

The US economy added only 143,000 jobs in January, slightly lower than expectations. Economists generally view the addition of 165,000 jobs per month as neutral, meaning neither adding nor subtracting from the unemployment rate. Job gains from the final two months of 2024 were revised up to 261,000 in November and down to 301,000 in December, and averaged 166,000 during 2024, 216,000 in 2023 and 377,000 in 2022.

Weekly jobless claims have been below pre-pandemic levels for the past month or so. Job openings have been generally falling since their high in early 2022 but remain above unemployment.

The labor force participation rate of 62.6% was unchanged in January. The underemployment rate, which averaged 8.7% from 2015 through 2019, was 7.5% in January. Average hourly earnings were up in January by 4.1% from a year ago, a pace above the 2.9% increase in the overall CPI for December (y/y).

Inflation

The December CPI inflation report ticked up with prices increasing 2.9% since December of last year, compared with 2.7% year-over-year in November.

The monthly December CPI increased by 0.4%, slightly higher than November. The core CPI, which excludes the more volatile energy and food prices, rose by 3.2% (y/y) in December, down from the 3.3% year-over-year growth in November. The monthly core CPI rose by 0.2% in December, lower than the 0.3% in November.

The monthly change was driven by energy costs, which rose 2.6% from the previous month in December and accounted for 40% of the increase. The Federal Reserve Bank of Cleveland's inflation nowcast forecasts the increase in the CPI for January at 2.9% (as of February 7).

The PCE price index, the preferred inflation measure of the Federal Reserve, increased by 0.3% in December. From its level 12 months earlier, the PCE price index increased by 2.1% in September. The core-PCE price index increased by 0.2% in December following its 0.1% increase in November. The core PCE price index has been increasing by around 2.8% since December 2023. The Federal Reserve Bank of Cleveland's inflation nowcast expects the core PCE to increase by 2.4% in December (as of February 7).

While considerable progress had been made on the inflation front, the persistently elevated overall inflation and the slow decline in the core inflation measures over the past few months shifted market expectations from a rapid reduction in interest rates by the FOMC to only one reduction in 2025 at the FOMC's May meeting and then not again until sometime in 2026.

Global growth

Forecasts generally suggest economic growth picking up in 2025 following the softness in 2024. 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 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. All countries seem to be paying close attention to possible tariff policy changes coming out of the United States.

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