# UNITED STATES



## INFLATION SET TO PICK UP AGAIN

**A turbulent 2025 is expected to follow a 2024 marked by dynamic growth and the start of a monetary easing cycle. While growth is expected to slow towards its long-term level, the political plans associated with the change of president and Senate majority suggest an increase in inflationary risk. As a result, the Federal Reserve is expected to put a premature end to rate cuts.**

### BETWEEN RESILIENCE AND « EXCEPTIONALISM »

The dynamism of the US economy continued unabated in the third quarter, as illustrated by the stability of the GDP growth rate at +0.7% q/q. More than ever in this cycle, household consumption is the driving force behind growth. It is underpinned by the catching-up of real incomes, as the year-on-year change in average hourly earnings has exceeded the annual change in the consumer price index since May 2023, and is being maintained by a limited deterioration in the labour market (see next section).

Overall, US economic activity has been particularly resilient to monetary tightening. However, the full effects of this have yet to be felt, particularly through mortgage lending. The size of the growth gap with its counterparts in developed countries links back to the concept of American «exceptionalism». In fact, we expect an average annual growth rate of +2.8% for the United States in 2024, compared to +0.8% for the eurozone and -0.2% for Japan. However, the gap is expected to narrow somewhat in 2025, as quarterly advances in US GDP slow towards their long-term level, to +0.5% q/q in Q1 and then +0.4% in subsequent quarters. As a result, the average annual growth rate would fall to +2.1%.

Our central scenario is changing from a soft landing to an uptick in inflation. The year-on-year price change should have continued to move towards its 2% target without this being accompanied by an economic recession. However, the outcome of the elections and the assessment of their implications for inflation (see related section) suggest that inflation will pick up again from Q2 2025 onwards. This will also have a downward effect on growth, mainly from 2026 onwards.

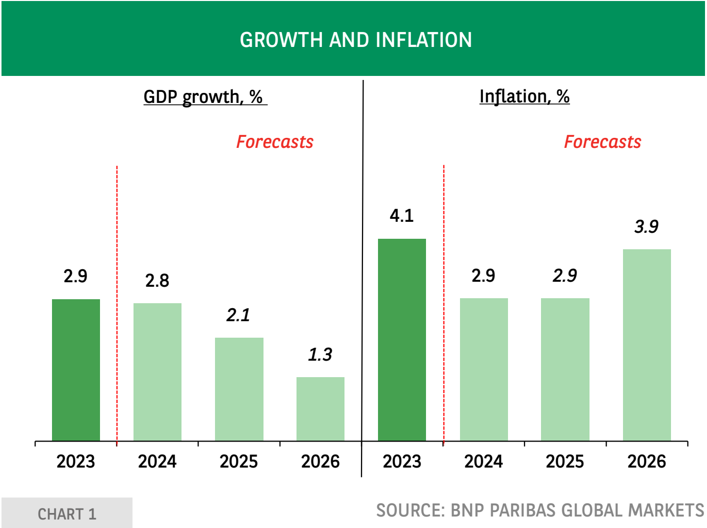


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

### EMPLOYMENT: AVOIDING A SLIPPERY SLOPE

Labour market indicators continue to reflect a clear softening of the prevailing highly-tight situation at the start of monetary tightening (Q1 2022). Beyond the significant monthly variability (e.g. +78k in August and +223k in September), non-farm payroll job creation is displaying a clear slowdown on an annualised basis (12-month moving average). The annualised rate was +190k in November. The ratio of job vacancies to unemployed people (known as the «v/u ratio», one of the most closely watched gauges of labour market tensions), stood at 1.1 at the start of Q4 2024, compared with over 2.0 when the rate target was raised in March 2022. Finally, the unemployment rate gradually rose in 2024, until it stealthily triggered the recessionary signal of the so-called «Sahm rule». It currently stands at 4.1% (+0.4 pp YTD).

However, this downward trend is not synonymous with a worrying situation in absolute terms. In fact, the state of the indicators mentioned above suggests a less tense but still dynamic market. The current pace of net job creation is fairly robust, while the v/u ratio is only slightly below its pre-pandemic levels. The unemployment rate is still below the estimated neutral level (4.4%, according to the Congressional Budget Office), and the proportion of people unemployed as a result of redundancy out of the total number of people affected is still below the cumulative figure for voluntary redundancies and new entrants or returns to the market. In this respect, the start of the monetary easing cycle in September was intended as a preventive measure to avoid a further deterioration, which could prove more problematic for growth.

### THE NEW INFLATIONARY RISK

US disinflation is continuing but has lost some of its momentum. The latest CPI data (November 2024) show a slight rise in the headline index to +2.7% y/y (+0.1 pp), while core inflation is stable at +3.3% y/y. Underlying trends, as measured by the 3m/3m annualised rate, are relatively unfavourable, rising in both dimensions. Inflation in non-energy housing and non-housing services is on a generally downward trend, but the potential for deceleration in the former could be constrained by higher real rates for longer.

Above all, the political plans of the future Trump administration are associated with a significant increase in inflationary risk. The main channels would be trade policy, with the final impact of tariff hikes borne by consumers, and migration policy, with downward pressure on labour supply linked to a significant reduction in the number of new arrivals, which would in turn increase tensions on the labour market. The re-acceleration in inflation is expected to take hold from Q2 2025 (+2.6% y/y, compared to +2.4% in Q1) before continuing, gradually, until mid-2026 (+4.0% y/y in Q2 2026). This would have negative consequences for growth, by squeezing real incomes and having a second-round effect on financial conditions (see section on monetary policy).

### THE PERMANENT DEFICIT

The lack of fiscal consolidation following the support linked to the pandemic crisis has set the US budget deficit at new, historically high levels. The most recent projections (June 2024) from the Congressional Budget Office (CBO) put it at 7.0% of GDP in 2024, before averaging at

6.2% over the 2025-2034 period, fuelling the rise in the public debt ratio even more. In addition, Donald Trump's victory comes with upward risks to public finances, as the Committee for a Responsible Budget estimates that the new president's plans will cause the debt/GDP ratio to deviate by 18 pp from current CBO estimates by 2035.

2025 should see the extension of the Tax Cuts and Jobs Act, which came into force in 2018 and whose non-permanent clauses expire at the end of the year. A positive impact on growth, albeit moderate, can be expected via the investment channel. However, the US economy is currently close to full employment, reducing the potential effectiveness of Donald Trump's budget plans. On the other hand, the impact on public finances will almost certainly be negative, due to a loss of revenue that cannot realistically be offset by an increase in the tax base.

At the same time, the configuration of the 119th Congress (2025-2027, with the Senate and House of Representatives predominantly Republican) will in all likelihood provide a quick resolution to the issue of the debt ceiling, whose suspension expires in January 2025, by raising it.

## MONETARY EASING THAT HAS FIZZLED OUT?

Comparative developments in inflation and the labour market have led to a rebalancing of the risks surrounding the Federal Reserve's dual mandate. As a result, the Fed was able to initiate a cycle of interest rate easing, with an initial major cut of 50 bps in September followed by a more usual cut of 25 bps in November, taking the target range to +4.5% - +4.75%. However, this phase of easing is likely to come to an end in the short term. The combination of robust growth, the upward momentum of inflation and the contained cooling of the labour market means that, for the time being, further rate cuts are «*not urgent*», as Jerome Powell has admitted. Above all, however, the re-acceleration in inflation from Q2 2025 should force the Federal Reserve to maintain a restrictive monetary policy.

THE NEW INFLATIONARY RISK

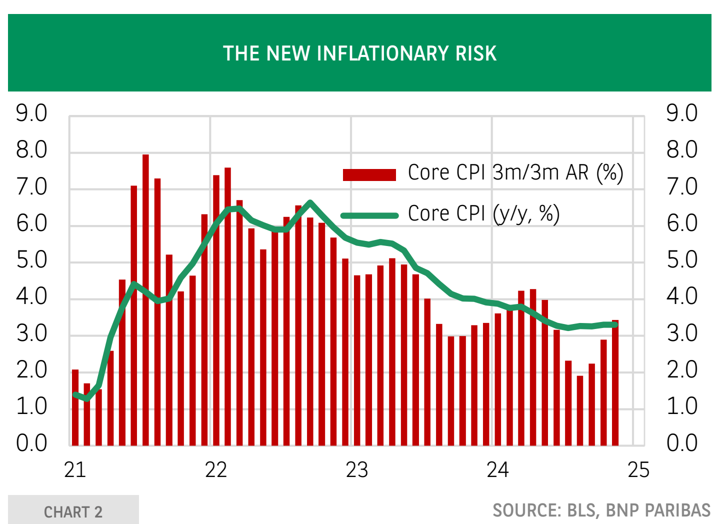


CHART 2 SOURCE: BLS, BNP PARIBAS

We expect a final rate cut (-25 bps) at the December FOMC meeting, before the rate target remains unchanged throughout 2025, at +4.25% - +4.5%. The last meeting of 2024 will also see the publication of the first Summary of Economic Projections (SEP) since the election. Therefore, while Jerome Powell asserts that the Fed does not «*speculate, guess, or assume*» and will not be influenced by political plans until they are implemented, the new projections could provide valuable insights into the vision of the members of the Monetary Policy Committee.

Article completed on 11 December 2024

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### TRUMP 2.0

Donald Trump will return to the presidency of the United States for a four-year term beginning on 20 January 2025, following a landslide victory in the presidential election. The former and future president won the popular vote and all seven swing states. At the same time, the Republicans retained control of the House of Representatives and regained a majority in the Senate. This configuration, known as the "trifecta", will give the new president a great leeway to carry out his political plans.

While there is some uncertainty about the timing and scale of the programme's implementation, Trump's fundamentals are centred around four pillars: trade protectionism (tariffs), tax cuts (Tax Cuts and Jobs Act), a particularly aggressive stance on migration issues (mass deportations and a substantial reduction in net new arrivals) and deregulation (which will also apply to environmental issues).

Nevertheless, Trump's election in 2024 comes in a decidedly different macroeconomic environment from the one in 2016. This is illustrated by above-target inflation, fiscal metrics (public deficit and debt as a % of GDP) and substantially higher interest rates. This is part of our scenario on the inflationary risks associated with the president-elect's political plans.