MACRO STRATEGY | Economic Monthly

Rate Expectations

September 16, 2024

Much has been written about the pace of likely interest rate cuts from the U.S. Federal Reserve. We continue to expect a total of 75 bps by year end, with a first cut of 25 bps at the next Federal Open Market Committee Meeting on September 17-18.

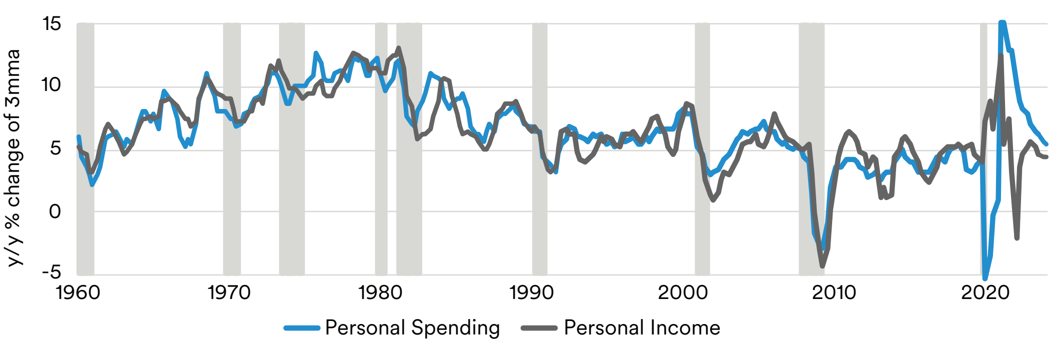
Amid this backdrop, the state of the U.S. consumer remains a pivotal factor for the strength of the U.S. economy. Even without interest rate cuts by the U.S. Federal Reserve, and despite moderating wage growth, we have still seen an improvement in consumer balance sheets. The expected Fed Funds rate cuts should further support the consumer through year-end.

Wage growth is moderating, even as consumers keep spending. The key word here is moderating. So far—and of course this can change—we have not seen the sharp decline in wages typically experienced at the outset of a recession.

Consumers Spending and Not Saving

In August, the savings rate fell to 2.9%. This is one of the lowest rates stretching back to the years preceding the 2008 financial crisis. More recently, we have been in an extended period of consumption growth outpacing income growth. We believe much of this is simply post-pandemic renormalization—the spending down of excess savings.

Chart 1 | Consumers Keep Spending as Wages Moderate



Source: BEA, NBER, Macrobond, MIM. As of September 2024.

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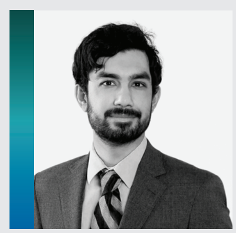

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Although we think this trend has largely played out, today we still see a gap persisting between consumption growth and income growth. Consumers appear strangely resistant in the face of apparent income weakness. During previous periods of rapid income deceleration—such as during the 1981, the 1990, and the 2001 recessions—consumption decelerated just about as rapidly as income.

All these features have some observers worried about the unsustainable pace of consumption by consumers.

However, we are less worried.

The patterns we are currently seeing have not typically preceded recessions. Income often grows more slowly than consumption. Not only that, but the times where income grows the slowest relative to consumption tend to be when the economy is coming out of a recession: for example, during the mid-1980s after the stagflation episodes, or the post-2001 recession recovery.

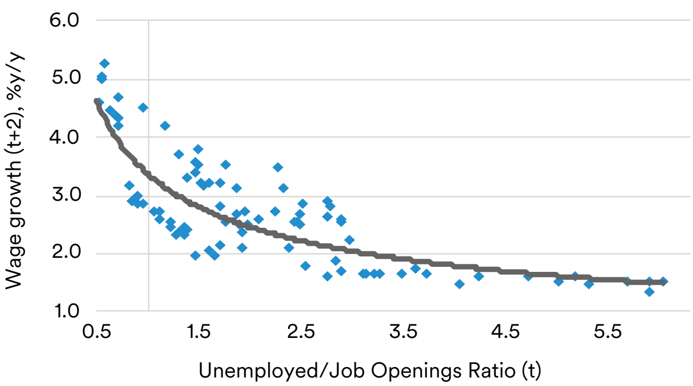
Income has not yet decelerated rapidly enough to worry consumers into pulling back sharply. Indeed, year-over-year income growth has been stable for most of 2024, and its longer-term deceleration beginning mid-2023 is a much milder income deceleration than what is expected before a typical recession episode.

As long as wage moderation remains gradual, we do not see reason to worry about consumer weakness at the point.

Wage Growth Moderating

Changes in job openings and unemployment signal a moderation of wage growth in the near-term.

Chart 2 | Unemployed/Job Openings Ratio Predicts Moderating Wage Growth



Source: BLS, MIM. As of September 9, 2024.

The ratio of unemployed persons to job openings in each quarter is generally predictive of wage growth two quarters into the future. The Bureau of Labor Statistics JOLTS survey shows that post-pandemic, the ratio fell to a low of 0.50 (a level not seen this century)—there were many job openings and a very low unemployment rate, meaning relatively few people were looking to fill those jobs. That labor market environment produced wage growth of over 5% year-over-year.

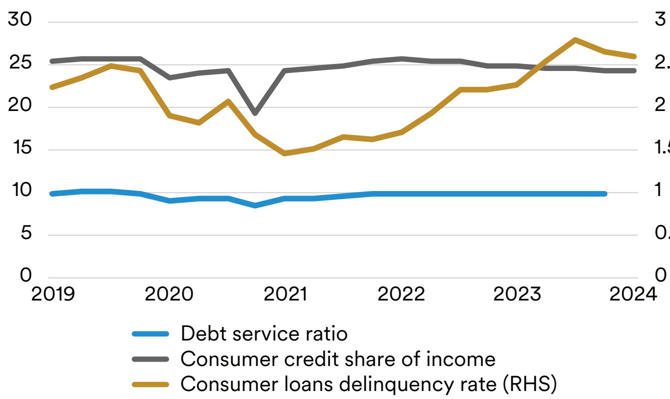
Subsequently, the ratio normalized over 2023 and 2024, reaching its pre-pandemic level of 0.9 in July. We expect that to produce year-over-year wage growth of ~3.5% by the fourth quarter of the year, a further reduction from the 4.2% rate seen in Q2.

Although we expect aggregate wage growth to slow with positive effects on inflation and margins, firms are still having problems finding high-skilled specialized workers. Wages for these workers will likely grow faster than other groups.

Households Still Have Debt Capacity

Despite low savings rates and weak consumer sentiment, consumers still have solid balance sheets. If anything, household balance sheets have improved during 2024.

Chart 3 | Consumer Balance Sheets Are Still Ok



Source: BEA, Federal Reserve, FRBNY, Macrobond, MIM. As of September 2024.

Although consumer delinquencies rose very rapidly in the seven quarters ending Q4 2023. Since then, delinquency rates have declined slightly to around pre-pandemic rates.

Consumer debt as a share of disposable income has declined for most of the past two years. Some of this was a result of inflation devaluing the debt and some was due to pandemic stimulus aiding in its repayment.

Debt service ratios have held steady since the beginning of 2021, despite a 525 bps increase in the Fed Funds rate.

Consumers still have the capacity to spend, even without substantial support from wage increases.

Fed funds cuts—particularly small changes—may not significantly change the equation for consumers, but they are on the margin likely to help rather than hurt household balance sheets.

Given the current strength of the consumer, and the expected assistance from the Fed, we do not expect the consumer to roll over in the current environment.

U.S. Outlook Summary

We continue to expect growth in 2024 and 2025 to be softer than 2023 but remain at or above long-term trend growth with no recession.

Uncertainty around U.S. elections and the Federal Reserve's policy appears to be dampening company investment and hiring until there is more clarity.

The labor market triggered the Sahm rule by rising to 4.3% unemployment in July. Although not a guarantee of a recession, this is certainly a warning to the Fed that labor market weakness has become more pressing.

Despite labor market weakening, we see both consumer consumption and a robust corporate sector as providing a bulwark against recession as the Fed prepares to cut.

We continue to expect the Fed to cut rates by a total of 75 bps by year end. We see recent pricing of as many as four cuts by year end as an overreaction that will be reversed over time.

Risks to the Outlook

We have raised our recession probability for 2025 to ~30%. The Fed has already likely made a mistake—perhaps only a small one—due to their deliberate pace. They are likely to remain cautious in adjusting rates lower in the face of mixed data and *may* wind up behind the curve and unable to prevent a recession. However, our base case is that they succeed in cutting rates sufficiently to underpin growth.

The labor market is in a precarious place, but may be helped by the Fed, resilient profit margins, and wealthier consumers. Re-emergence of inflation remains a risk, although this risk is currently overshadowed by labor market risks.

MIM Forecast

U.S.	2023*	2024	2025
GDP	2.5	2.0	2.0
CPI	3.2	3.1	2.8
10 Year	3.88	4.25	4.00
Policy rates (upper bound)	5.50	4.75	4.00
Unemployment	3.7	4.4	4.3

Note: GDP is annual average growth rate, CPI is Q4 year/year, 10 year is year-end, policy rate is the upper bound year-end rate. Our core PCE forecast for 2024 is 2.8%.
*Actual; other data are forecast.
Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of September 2024.

Both geopolitical and political uncertainty remains elevated even though several of the many of the elections set for this year have already taken place—e.g. in Taiwan, India, U.K. and France. The long run fallout of these is still very unclear. Another key uncertainty is the potential spread of the conflict between Hamas and Israel.

Perhaps most consequentially for the U.S. economy, uncertainty around the U.S. elections has increased relative to early summer and many businesses are holding off decision making because of it. The Democratic candidate switch from President Biden to Vice President Harris and the additions of JD Vance and Tim Walz to the tickets have made both the election outcome and the resulting policy implementations more uncertain.

Polling has settled down somewhat following a volatile summer, but both the Presidential race and the race for control of the House remain extremely tight, while control of the Senate is still very likely to go to the Republican party.

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