4Q24 Economic Summary

The spotlight on the Fed dimmed a bit during the fourth quarter as investor focus shifted to the U.S. presidential election and what impact the new administration's policies may have on the economy. President Trump's victory combined with the "red sweep" of Congress increased the potential for significant policy changes, including tax cuts, deregulation, higher tariffs, and stricter immigration control. Equity markets rallied and bond yields surged after the election, reflecting investor expectation that these policies will spur both growth and inflation.

The U.S. economy continued to power ahead in the fourth quarter. Consumer spending remained the backbone of economic growth as Americans got into the holiday spirit and ramped up purchases of goods and services. While wealthier shoppers continued to spend on big ticket items, there was some pullback from low-income consumers as still high inflation reduced purchasing power. Business activity picked up in the second half of the quarter, reflecting optimism that the incoming administration will be more business friendly in terms of regulation, taxes, and energy policies. Purchases of computer equipment and software remained strong as companies raced to build the infrastructure needed to meet the rapidly expanding demand for AI computing. While still sluggish, the housing market appeared to be gaining momentum as rising new and existing home inventories began to draw buyers off the sidelines. Affordability remains a challenge and will likely keep a ceiling on sales, but consumers have become more accepting of mortgage rates above 6%.

Labor market data was volatile during the quarter. After hurricanes and strikes weakened payrolls in October, hiring rebounded in November and December. In all, the U.S. added a stronger-than-expected 511,000 jobs during the quarter, the most since 1Q24. Although manufacturing remained a weak spot, hiring was broad-based across most service sectors with healthcare and leisure and hospitality jobs leading the way. The unemployment rate fell to 4.1% in December as layoffs remained low and the increase in hirings outpaced the rise in the labor force. Job openings rose during the quarter, particularly in business services, while the quits rate declined slightly. Average hourly earnings continued to increase at a moderate clip, solidly outpacing inflation and further supporting consumption. All told, the cooling in employment data seen during the summer months appears to have stabilized during the fourth quarter, putting the labor market on solid footing to end the year.

Inflation data was also mixed during the quarter. After four straight months of stubbornly high core inflation, the December CPI came in cooler than expected. Headline inflation accelerated as prices for food and gas rose, but core inflation eased a bit as shelter costs continued to move in the right direction. While the improvement was welcome, inflation remained sticky and progress toward the Fed's 2% inflation goal appears to have stalled.

After kicking off the easing cycle with a larger-than-usual 50 basis point cut in September, the Fed decreased the magnitude of rate reductions in the fourth quarter. The Committee lowered the fed funds rate by 25 basis points at both the November and December meetings, resulting in a target range of 4.25%-4.50% at year-end. The continued easing of monetary policy reflected the Fed's desire to support the labor market and its belief that, although still elevated, inflation was on a sustainable path to 2%. The December decision was not unanimous, however. Fed Governor Hammack voted against the cut, preferring to leave the Fed funds rate unchanged. She cited the uneven progress made on inflation along with the strength of the economy and the labor market as reasons to hold the funds rate at a "modestly restrictive" level. The minutes to the meeting further suggested that the December decision was a close call, revealing "almost all participants judged that upside risks to the inflation outlook had increased." As such, policymakers believed that they were "at or near the point at which it would be appropriate to slow the pace" of rate cuts.

This more hawkish outlook was reflected in the December dot plot projection, which reduced the number of rate cuts forecasted for 2025 from four 25 basis point cuts to two. Market expectations for Fed easing also declined, resulting in a rise in long-term yields during the quarter despite the reduction in the fed funds rate. The steepening of the yield curve not only reflected a slower pace of rate cuts but also uncertainty surrounding fiscal policy. While Chair Powell said that the Fed will take a wait and see approach to how President Trump's policy agenda impacts the economy, Fed officials cited potential changes in trade and immigration policy as factors that could delay the cooling of inflation. Given the high degree of uncertainty, Committee members believe a more gradual approach to adjusting monetary policy is warranted in 2025.

Any opinions herein, including forecasts, reflect our judgment as of this date and are subject to change.
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