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A strong economy... pending the presidential elections

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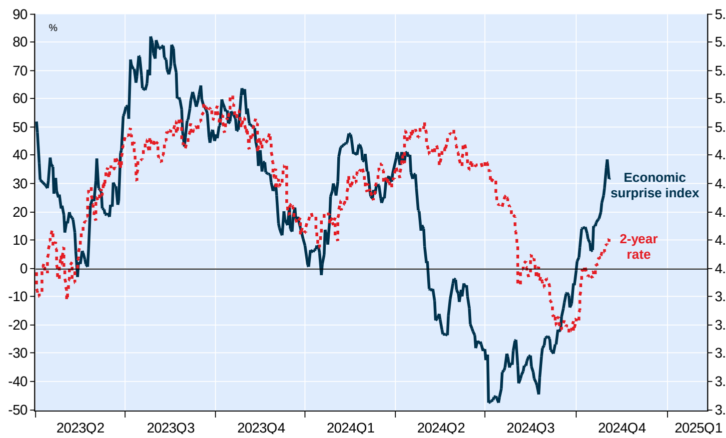
Summary

- The U.S. economy continues to show resilience, with GDP growing at an annualized rate of 2.8% in the third quarter of the year. This solid performance coincides with a government that has put its foot on the accelerator when it comes to spending, contradicting the IMF's scenario published in April, which forecast a significant improvement in the structural balance of general government in the U.S. in 2024.
- In addition to government spending, consumer spending also remained robust, growing at an annualized rate of 3.7%, the strongest in 6 quarters. We continue to believe that this situation cannot last indefinitely, and that consumer spending will depend on the labour market over the coming months.
- On this front, the news is currently mixed. The establishment survey showed an increase of just 12K jobs in October, but actual job creation was probably higher, the result having been impacted by temporary factors. It should be borne in mind, however, that these data have been subject to significant downward revisions in previous months.
- For the time being, we are raising our growth forecast by a tenth in 2024 and 2025 to take account of the recent momentum in the U.S. economy (2.7% in 2024 and a slowdown to 1.3% in 2025). However, we will wait to see the outcome of the elections before making any more substantial changes to our growth path in 2025.

While the global economy remains weighed down by restrictive monetary policies, the U.S. economy continues to stand apart. Although the Economic Surprise Index revealed disappointing economic performance for Uncle Sam at mid-year, the situation has improved rapidly since September. At the end of the third quarter, investors were expecting the policy rate to fall below 3% by mid-2025. Given the resilience of the U.S. economy, expectations of interest rate cuts have been drastically reduced, with the forecast interest rate now standing at 3.75%. The 2-year government interest rate has therefore recently started to rise again.

U.S.: Stronger economy pushes up interest rates

Citi Economic Surprise Index and 2-year government bond yields

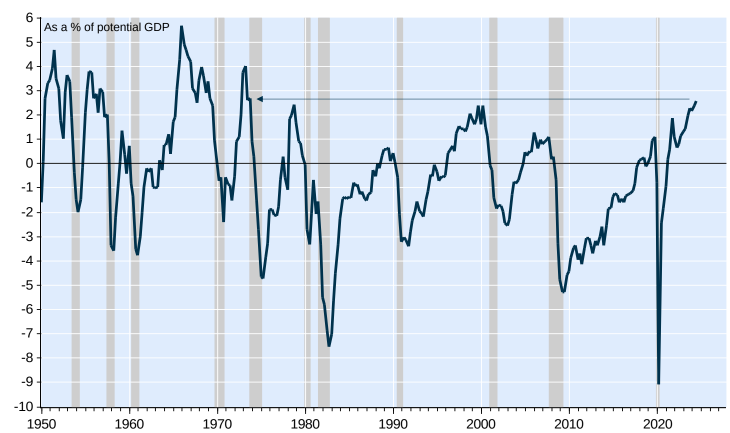


NBC Economics and Strategy (data via Refinitiv)

The performance of GDP in the third quarter, up by a solid 2.8% at an annualized rate, reflects the recent strength of the economy. Over the last nine quarters, GDP has outpaced potential economic growth estimated at 2.1% by the Congressional Budget Office (CBO) on eight occasions. As a result, the output gap has continued to widen, reaching its highest level since 1974.

U.S.: The economy is in even greater excess demand

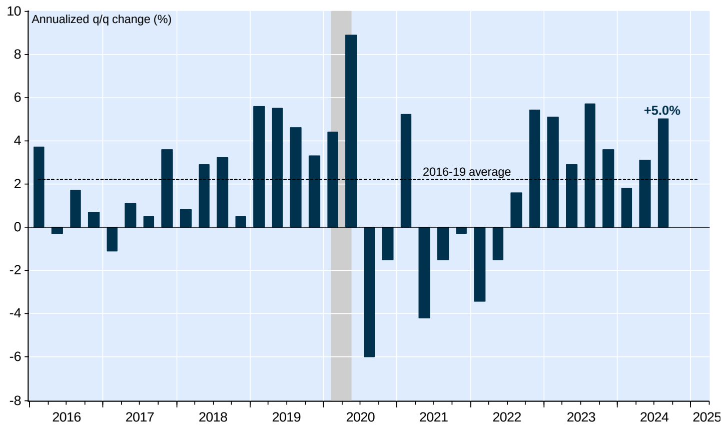
Output gap (% gap between GDP and potential GDP)



NBC Economics and Strategy (data via Bloomberg and Fred St. Louis)

This solid performance over the past two years coincides with a government that has put its foot on the accelerator when it comes to spending. In the third quarter, government spending continued to grow at a brisk pace, posting annualized growth of 5.0%.

U.S.: The government continues to spend lavishly
Government spending, quarterly annualised change



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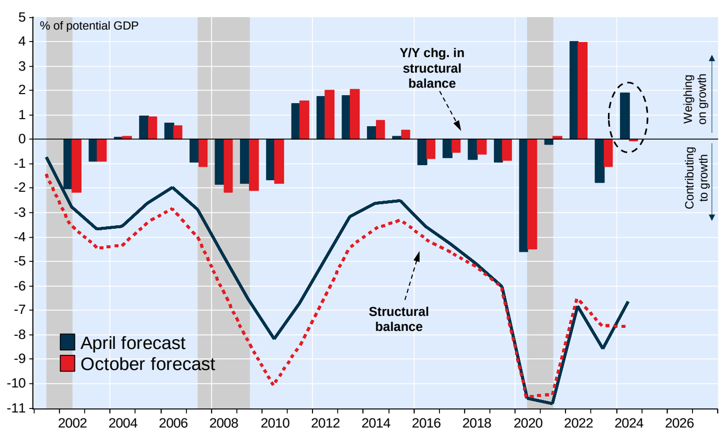
This is contrary to the IMF's prediction in April for a significant improvement in the U.S. general government structural balance by 2024, a process which, if it had occurred, would have weighed significantly on economic growth, as we expected. But the reality turned out to be very different, and the deficit actually increased slightly, keeping growth (and inflation) at a higher level than would otherwise have been the case. It turns out that the most recent estimates indicate that the cost of the Inflation Reduction Act (IRA) has risen significantly compared with initial projections, which may partly explain the larger deficits. At the time of enactment, the CBO estimated that the energy and climate change portion would cost $400 billion through 2031. The most recent estimate is $870 billion, given the strong demand for tax credits.

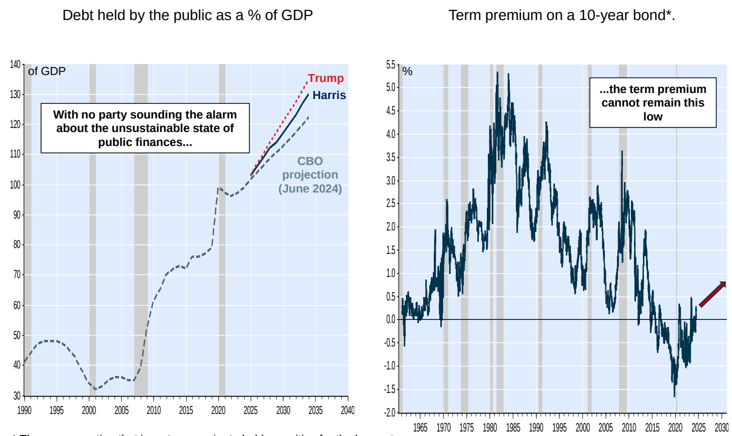
U.S.: The fiscal consolidation that never happened
General government structural balance as a share of potential GDP



NBF Economics and Strategy (data via the IMF)

And judging by the proposals of the two presidential candidates, it is unlikely that there will be any significant reversal by 2025. On the contrary, both Donald Trump's proposed economic policies and those of Kamala Harris are likely to increase the deficit further. Based on estimates from the University of Pennsylvania, we calculate that the total deficit (primary deficit plus interest expenditure) estimated by the CBO at 6.2% on average over the next decade, an already astronomical level, would be 7.7% if Trump's plan materialized, and 7.0% for Harris'. This would translate into a debt-to-GDP ratio above 130% in 2034 under either administration. It is important to note that these scenarios assume uninterrupted economic growth over the next decade, which is a very optimistic assumption. Despite the long-term unsustainability of such a policy, this fiscal path would help to sustain growth over the coming quarters. Of course, this assumes that the bond market remains calm in the face of a rapid deterioration in public finances, a scenario that is likely but not guaranteed. In our view, the term premium will have to rise further in this context.

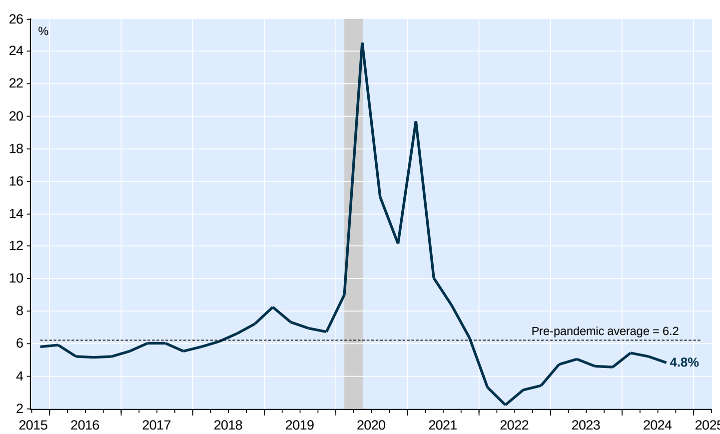
U.S.: Fiscal indiscipline can't fly under the radar forever



* The compensation that investors require to hold securities for the longer term
NBC Economics and Strategy (data via CBO, University of Pennsylvania and internal calculations)

But the solid performance of the third quarter was not solely attributable to government profligacy. In addition to government spending, consumer expenditure also remained vigorous, growing at an annualized rate of 3.7%, the strongest in 6 quarters. Given the upward revisions to the data on real disposable income that we commented on in the last edition of this monthly economic monitor, the trend in consumption in 2024 makes a little more sense. But even taking these revisions into account, U.S. consumers appear to be spending beyond their means of late, with real spending rising at a much faster rate than real disposable income. As a result, the savings rate remains well below pre-pandemic levels.

U.S.: Consumption underpinned by low savings rate
Savings as a percentage of disposable income (savings rate)

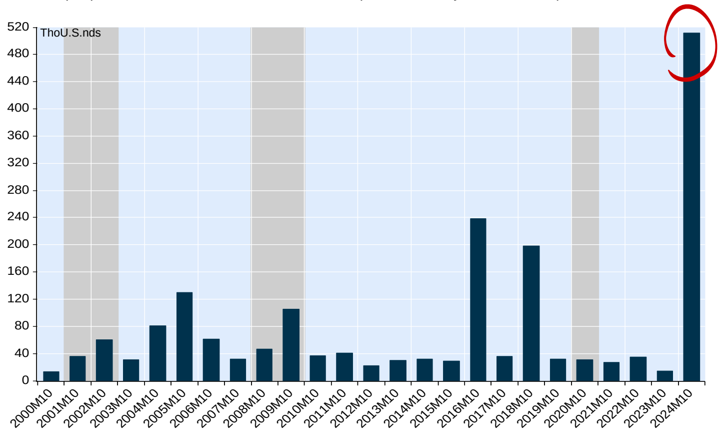


NBC Economics and Strategy (data via Fred St. Louis)

We continue to believe that this situation cannot last indefinitely, and that consumer spending will depend on the labour market over the coming months. On this front, the news is currently mixed. On the one hand, the survey of establishments showed an increase of just 12K jobs in October, but actual job creation was probably higher, the result having been impacted by temporary factors. The strike at Boeing affected 44K jobs in the transport equipment manufacturing sector, while hurricanes Helene and Milton prevented many workers from getting to work. According to the BLS, no fewer than 512K people were in this situation, a record number for a month of October.

U.S.: Bad weather had a major impact in October

Number of people absent from work due to bad weather (October each year since 2000)

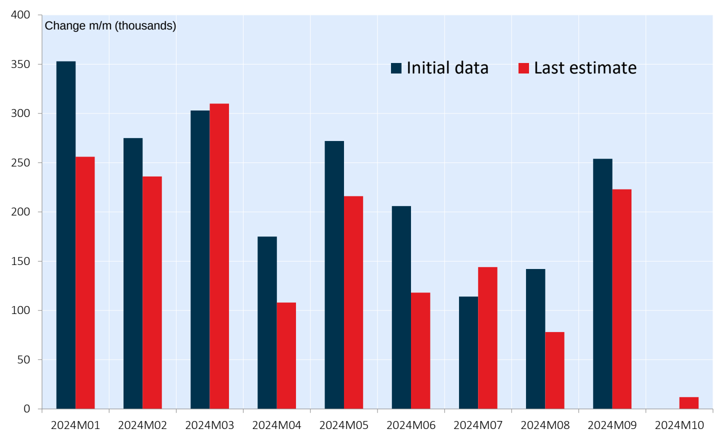


NBC Economics and Strategy (Data via Refinitiv)

On the other hand, we will have to wait a little before concluding that the U.S. labour market is reaccelerating on the basis of this survey. The major downward revision to the data for previous months certainly comes to mind here, including the 112K announced for August and September. On average, between the first release and the current reading, no fewer than 7 out of 9 months have been revised downwards. For the 9 months, the average downward revision was 45K.

U.S.: Figures tend to be revised downwards this year

Changes in employment, survey of establishments

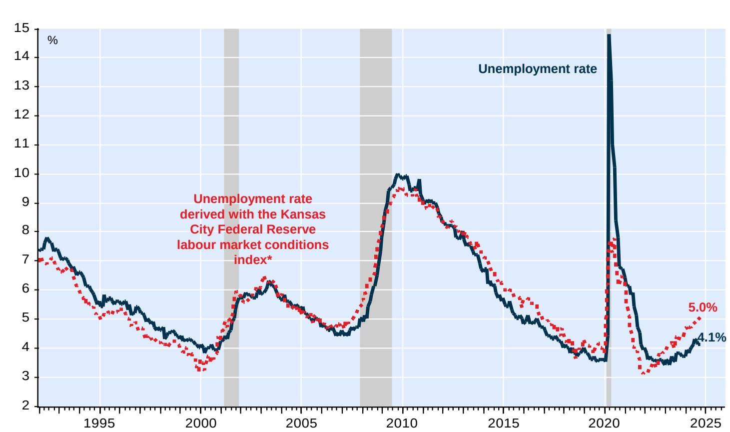


NBC Economics and Strategy (data via Bloomberg)

This is especially true as the household survey unveiled at the same time showed some signs of weakness. It should be remembered that, unlike the establishment survey, the household survey counts people absent from work due to bad weather as being employed. Despite this, employment fell by 368K during the month after a solid 430K in September. As a result, the unemployment rate rose from 4.06% to 4.14%, a rise that would have been more pronounced had it not been for the fall in the participation rate. Moreover, a number of other indicators of the strength of the labour market point to a slowdown in demand for workers. In this respect, the aggregate index of labour market indicators published by the Federal Reserve of Kansas City provides a broader picture than that indicated by the unemployment rate. By deriving an unemployment rate based on this indicator, we observe a faster and more pronounced slowdown in the labour market than suggested by the official rate.

U.S.: Unemployment does not fully reflect the slowdown

Unemployment rate and rate adjusted with the Kansas City Fed labour market conditions index



*Linear regression of the unemployment rate against the level of activity, momentum, and the interaction between activity and momentum

NBC Economics and Strategy (data via Refinitiv and Kansas City Federal Reserve)

For the time being, we are raising our growth by a tenth in 2024 and 2025 to take account of the recent momentum in the U.S. economy (2.7% in 2024 and a slowdown to 1.3% in 2025). However, we will wait to see the outcome of the elections before making more substantial changes to our growth path in 2025, bearing in mind that the tax cuts announced by the candidates are only likely to be implemented if the party that wins the presidency also secures a majority in both houses. As the chances of this happening are still relatively low, we will have to wait before making any definitive projections for fiscal policy. As for the potentially disruptive future U.S. tariff policy, we will have to wait until early this year, after the next President has been sworn in.

United States
Economic Forecast

*(Annual % change)**	*2021*	*2022*	*2023*	*2024*	*2025*	*Q4/Q4 2023*	*2024*	*2025*
Gross domestic product (2012 $)	6.1	2.5	2.9	2.7	1.3	3.2	2.4	0.9
Consumption	8.8	3.0	2.5	2.7	1.8	3.0	2.8	1.1
Residential construction	10.9	(8.6)	(8.3)	3.9	0.3	2.5	1.8	1.6
Business investment	6.0	7.0	6.0	3.5	(0.1)	5.0	2.1	(0.3)
Government expenditures	(0.3)	(1.1)	3.9	3.3	2.2	4.3	3.0	1.7
Exports	6.5	7.5	2.8	3.2	0.6	2.0	2.9	(0.1)
Imports	14.7	8.6	(1.2)	5.2	1.5	1.2	5.2	0.6
Change in inventories (bil. $)	11.6	119.1	33.1	48.6	8.8	44.6	45.0	10.0
Domestic demand	6.9	2.3	2.7	2.9	1.6	3.5	2.7	1.1
Real disposable income	3.5	(5.6)	5.1	3.1	1.1	4.6	2.7	1.1
Payroll employment	2.9	4.3	2.3	1.6	(0.2)	1.9	1.3	(1.2)
Unemployment rate	5.4	3.6	3.6	4.0	4.7	3.7	4.2	4.8
Inflation	4.7	8.0	4.1	2.9	2.2	3.2	2.5	2.2
Before-tax profits	27.6	7.8	6.9	6.3	1.0	10.5	1.4	0.8
Current account (bil. $)	(970.3)	(1,012.1)	(905.4)	(999.0)	(935.0)	...	...	...

** or as noted*

Financial Forecast**

	Current 11/04/24	*Q4 2024*	*Q1 2025*	*Q2 2025*	*Q3 2025*	*2023*	*2024*	*2025*
Fed Fund Target Rate	5.00	4.50	3.75	3.00	2.75	5.50	4.50	2.50
3 month Treasury bills	4.44	4.10	3.40	2.80	2.55	5.20	4.10	2.30
Treasury yield curve								
2-Year	4.17	3.90	3.35	2.85	2.60	4.23	3.90	2.45
5-Year	4.17	3.95	3.50	3.05	2.85	3.84	3.95	2.70
10-Year	4.31	4.15	3.85	3.55	3.40	3.88	4.15	3.35
30-Year	4.50	4.35	4.10	3.85	3.75	4.03	4.35	3.70
Exchange rates								
U.S.$/Euro	1.09	1.07	1.05	1.07	1.09	1.10	1.07	1.12
YEN/U.S.$	152	148	145	142	140	141	148	133

*** end of period*

Quarterly pattern

	Q1 2024 actual	*Q2 2024 actual*	*Q3 2024 forecast*	*Q4 2024 forecast*	*Q1 2025 forecast*	*Q2 2025 forecast*	*Q3 2025 forecast*	*Q4 2025 forecast*
Real GDP growth (q/q % chg. saar)	1.6	3.0	2.8	2.0	0.6	0.1	0.7	2.1
CPI (y/y % chg.)	3.2	3.2	2.6	2.5	2.2	2.1	2.3	2.1
CPI ex. food and energy (y/y % chg.)	3.8	3.4	3.2	3.1	2.6	2.3	2.3	2.2
Unemployment rate (%)	3.8	4.0	4.2	4.2	4.4	4.7	4.8	4.8

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