NORTHERN TRUST

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U.S. ECONOMIC & INTEREST RATE OUTLOOK

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- **Never A Dull Moment**

This economic cycle has been an ongoing story of unexpected outcomes. The latest news continues to keep us on our toes.

Much attention is focused on the economic consequences of the U.S. election. However, significantly altering our forecast at this time would be speculative. Inauguration is still two months away. From there, new policies will take time to craft and enact, and even more time to become evident in the data. We are attuned to the inflationary risks of new tariffs and labor supply reduction from tighter immigration policy.

For the year ahead, we believe the prospects for the soft landing are still favorable. The strength of activity and the stickiness of inflation have led us to stretch out expectations for rate cuts from the Federal Reserve, but we still expect both to settle down. The economy has shown resilience through a great deal of uncertainty in this cycle, and we expect that to continue.

Following are our thoughts on recent data and developments.

Key Economic Indicators

	2024				2025				Q4 to Q4 change			Annual change		
	24:1a	24:2a	24:3a	24:4f	25:1f	25:2f	25:3f	25:4f	2023a	2024f	2025f	2023a	2024f	2025f
Real Gross Domestic Product (% change, SAAR)	1.6	3.0	2.8	2.4	1.5	1.7	1.8	2.0	3.1	2.3	1.7	2.5	2.7	1.9
Consumer Price Index (% change, annualized)	3.8	2.8	1.2	2.4	2.6	2.6	2.7	2.7	3.2	2.8	2.4	4.1	3.0	2.4
Civilian Unemployment Rate (%, average)	3.8	4.0	4.2	4.3	4.3	4.3	4.2	4.2				3.6*	4.1*	4.3*
Federal Funds Rate (average, midpoint of range)	5.38	5.38	5.31	4.68	4.17	3.84	3.59	3.32				5.05*	5.19*	3.73*
2-yr. Treasury Note (average)	4.48	4.82	4.03	4.15	4.23	4.06	3.91	3.79				4.58*	4.37*	4.00*
10-yr. Treasury Note (average)	4.16	4.44	3.95	4.30	4.50	4.60	4.60	4.60				3.96*	4.21*	4.58*

a=actual
f=forecast
*=annual average

Influences on the Forecast

- The October employment report showed job gains of only 12,000, a startling decline from the January-September average of 188,000 per month. However, manufacturing was weighed down by labor strikes that have since been resolved, and Hurricanes Helene and Milton interfered with establishment survey collection. The unemployment rate held steady at 4.1%. With no other employment data indicating stress, we expect this was an aberration, and a steadier labor market trend will resume.
    - Tighter immigration will be a day one priority for the incoming administration. We expect an immediate halt to border crossings. Constraining the labor supply should keep the unemployment rate low, but brings the risk of vacancies and

wage inflation in sectors that rely on immigrant labor.

- Inflation appears to be settling into a steady but above-target pace. The October Consumer Price Index (CPI) grew 2.6% over the past year, or 3.3% at the core level (excluding food and energy). Though inflation is not reheating, its improvement has stalled. Core inflation has ranged from 3.2%-3.4% over the past six months; in the cycle before the pandemic, this measure never exceeded 2.4%. The Fed's preferred measure, the deflator on personal consumption expenditures, has also been rangebound on a core basis. Further cooling of shelter and service prices will be needed to reach the 2% target.
- U.S. real gross domestic product (GDP) grew by a solid 2.8% annualized pace in the third quarter. Consumer spending accelerated to 3.7%, and business fixed investment gained 3.3%, offsetting some weakness in residential investment, inventory accumulation and a wider trade deficit.
- Higher tariffs next year seem assured, with uncertainly only around their scope and size. We expect importers to front-load their orders before trade policy is changed. This inventory accumulation will support GDP in the near term. However, tariffs will be an added cost to many durable goods that will limit their deflationary potential in the year ahead.
- The policy rate remains sufficiently restrictive to justify continued interest rate cuts. The Federal Open Market Committee proceeded with a 25 basis point reduction at their November 7 meeting, and we expect the same decision on December 18. However, as growth has been unimpeded and inflation risks tilt to the upside, we are reconsidering the pace of reductions thereafter. Consistent with signals from other major central banks, we now expect a less urgent course of easing, with rate reductions slowing to a pace of one per quarter in mid-2025. We still expect the policy rate to settle at 3.0%, but not for some time.
  - At his November press conference, Fed Chair Powell sidestepped multiple questions about political matters. At some point, the Fed's official forecasts will have to reflect an updated policy path. The high level of interest rates may invite comment from the incoming administration, as it did prior to the pandemic.
- Following the election, U.S. Treasury bonds sold off. The fixed income repricing reflects an adjustment to an expected path of more borrowing and greater inflation. The outlook for a prolonged fiscal imbalance is likely to hold yields higher. The adjustment to a higher path of expected interest rates has renewed the dollar's momentum, supporting domestic purchasing power but limiting export potential.

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