Economy grew solidly in 3Q, but growth is expected to slow

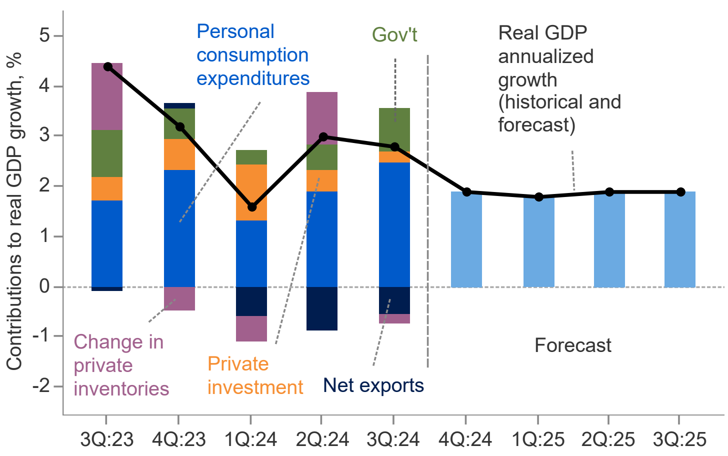
• Real GDP grew at a solid 2.8 annualized rate in 3Q:2024, down only slightly from the previous quarter's 3.0 percent pace (Figure 1). Third quarter GDP was fueled by buoyant consumer spending that has consistently beaten expectations. Activity has cooled from the robust 4.1 percent pace in the second half of last year and growth is expected to slow back to its trend rate of around 2 percent. However, forecasters note that fiscal policies may be more stimulative under the incoming administration which could potentially boost demand and activity above current forecasts.

• Housing construction and auto sales have held up surprisingly well compared to earlier tightening cycles, helping growth exceed expectations (Figure 2). These are key channels through which tighter monetary policy restrains the economy. Housing starts remain above pre-pandemic levels due to a scarcity of existing homes for sale. Many Americans refinanced their mortgages during COVID and locked in low rates, making them reluctant to sell. Moreover, vehicle sales remain solid despite higher financing costs due to strong post-pandemic pent-up demand.

• Headline and core inflation have cooled significantly since April but ticked up in October (Figure 3). Core services inflation increased a bit due to price pressures in transportation and physician's services. But easing compensation growth, the key driver of services inflation, may lead to a cooling trend. Shelter inflation has eased but remains elevated. The measure is based on a survey of how much owners would pay to rent their home rather than own it. These perceptions often lag market conditions. In fact, home price inflation has fallen off sharply since peaking in 2022 and measured only 1.5 percent over the past three months.

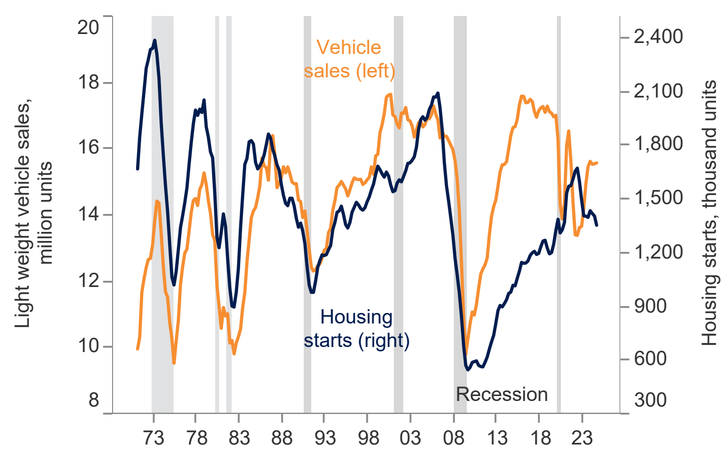
• The Federal Reserve has cut rates by 75 basis points since August (Figure 4). But longer-term bond yields have climbed as solid economic data persuaded investors to scale back hopes of further aggressive monetary easing through next year. Despite lower short rates, the 3 month-10 year segment of the yield curve remains inverted. Most post-WWII inversions have been followed by recessions. So far, the U.S. has avoided a downturn. Post-pandemic effects likely lessened this inversion's predictive power.

Figure 1: Real GDP growth expected to slow in coming quarters



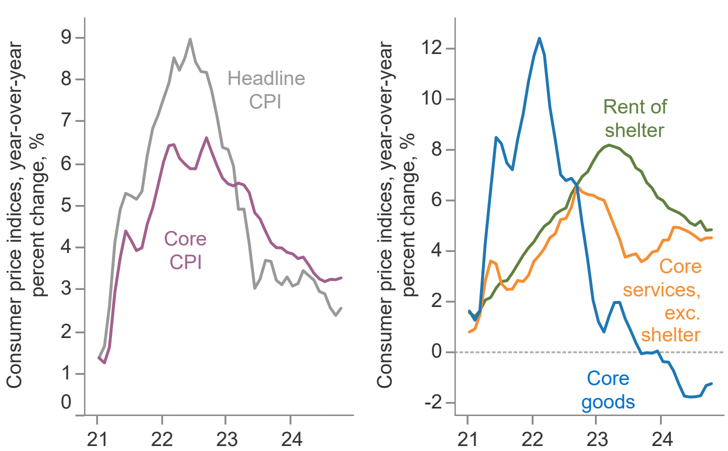
Sources: BEA (3Q:2024), Blue Chip Economic Indicators (Nov. 2024)

Figure 2: The economy has displayed less sensitivity to rising rates than in past cycles



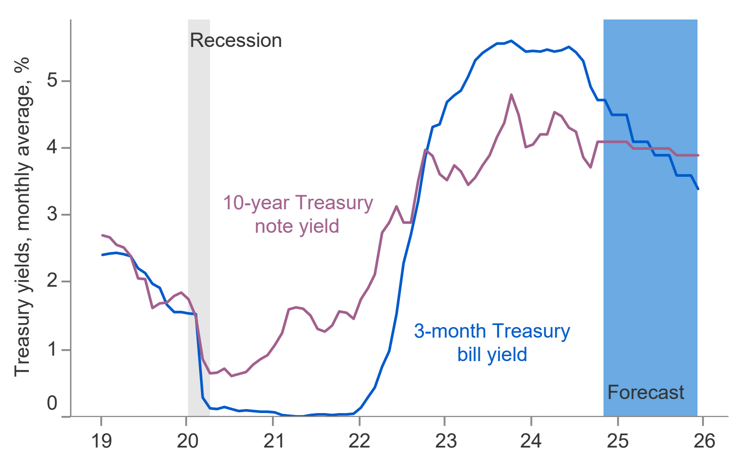
Sources: BEA (3Q:2024), Census (3Q:2024); all data are 3-qtr moving avgs.

Figure 3: Headline and core inflation have cooled since April but remain a bit stickier than anticipated



Source: BLS (October 2024), core goods and services are less energy and food

Figure 4: Yield curve expected to normalize in 2025 as short-term rates fall



Sources: FRB (Nov. 2024), Blue Chip Economic Indicators (Nov. 2024)