Executive briefing

Macroeconomic outlook and impact on businesses

June update
Week of June 17, 2024
## Table of contents

<table>
<thead>
<tr>
<th>Topics and EY-Parthenon perspectives</th>
<th>Page(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global snapshot: The global economy is moving along at a modest pace, with the US serving as a key engine and Europe gradually accelerating</td>
<td>3-5</td>
</tr>
<tr>
<td>US outlook: As consumers turn more prudent with their spending and businesses more discerning with their hiring, the economy is cooling</td>
<td>6-8</td>
</tr>
<tr>
<td>Employment: A hiring slowdown is taking hold amid weaker labor demand and signs that unemployment is drifting higher</td>
<td>9-10</td>
</tr>
<tr>
<td>Consumer behavior: Spending fatigue is setting in amid softer income trends and rising financial stress for some households</td>
<td>11-13</td>
</tr>
<tr>
<td>Housing and real estate: Affordability is still depressed, but single-family construction activity is rebounding and easing rates should support demand</td>
<td>14</td>
</tr>
<tr>
<td>Business activity: Business investment growth should gradually improve on easing rates, efforts to drive efficiency and slowly rebounding final demand</td>
<td>15</td>
</tr>
<tr>
<td>Inflation: Disinflation is back on track; we see core PCE hovering around 2.6% by year-end and approaching 2.0% in 2025</td>
<td>16-18</td>
</tr>
<tr>
<td>Federal Reserve: A backward-looking Fed now sees only one rate cut this year; we continue to anticipate 50bps of easing in September and December</td>
<td>19</td>
</tr>
<tr>
<td>Financial conditions: Signs of cooler demand and inflation are fueling a bond market rally</td>
<td>20</td>
</tr>
<tr>
<td>Fiscal outlook: Debt sustainability concerns are growing amid persistently elevated deficits and rising debt-interest payments</td>
<td>21</td>
</tr>
<tr>
<td>Risks and opportunities: Interest rates staying too high for too long and geopolitical tensions remain key downside risks</td>
<td>22</td>
</tr>
<tr>
<td>Sector considerations and implications of the US outlook</td>
<td>23</td>
</tr>
<tr>
<td>Strategies for transforming uncertainty into opportunity</td>
<td>24</td>
</tr>
<tr>
<td>Meet the team</td>
<td>25-26</td>
</tr>
</tbody>
</table>

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The global economy is moving along at a modest pace, with the US serving as a key engine, the Eurozone returning to growth and mainland China remaining a soft spot.

### Y/y percentage change in real GDP
2022-25F

<table>
<thead>
<tr>
<th></th>
<th>Global</th>
<th>US</th>
<th>Euro area</th>
<th>UK</th>
<th>Japan</th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>Developed markets¹</th>
<th>Emerging markets²</th>
</tr>
</thead>
<tbody>
<tr>
<td>2022</td>
<td>3.4</td>
<td>3.0</td>
<td>3.2</td>
<td>1.9</td>
<td>2.5</td>
<td>0.5</td>
<td>0.1</td>
<td>0.6</td>
<td>3.4</td>
<td>4.0</td>
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<tr>
<td>2023</td>
<td>3.0</td>
<td>3.0</td>
<td>2.4</td>
<td>2.2</td>
<td>1.7</td>
<td>0.8</td>
<td>0.6</td>
<td>0.7</td>
<td>3.0</td>
<td>4.1</td>
</tr>
<tr>
<td>2024F</td>
<td>3.5</td>
<td>1.7</td>
<td>2.2</td>
<td>1.9</td>
<td>0.9</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>3.0</td>
<td>4.0</td>
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<tr>
<td>2025F</td>
<td>3.2</td>
<td>2.6</td>
<td>2.0</td>
<td>2.0</td>
<td>1.6</td>
<td>2.9</td>
<td>2.0</td>
<td>1.6</td>
<td>3.1</td>
<td>4.1</td>
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1. Includes G7, Euro area, as well as Australia, Czech Republic, Denmark, Hong Kong, Iceland, Israel, South Korea, New Zealand, Norway, Singapore, Sweden, Switzerland and Taiwan.
2. Includes China Mainland, India, Indonesia, Malaysia, Philippines, Thailand, Russia, Poland, Turkey, and most economies in Latin America and the Caribbean, Middle East, Central Asia, and Sub-Saharan Africa.

Source: EY-Parthenon
Global inflation trends continue to cool as goods prices have stabilized in many regions, but core inflation remains elevated amid tight labor markets.

1. Most recently available data point shown for all geographies.
2. Euro area includes 20 countries.

The global easing cycle is now underway across advanced economies, with the ECB and Bank of Canada leading the way ahead of a more hawkish Federal Reserve.

Central bank rates
January 2002–June 2024

1. Most recently available data point shown for all geographies.
2. Based on Bloomberg analysis.

Source: Respective countries' central banks; Bloomberg; EY-Parthenon
**Outlook:** It seems May was an inflection point for the US economy, with consumer sentiment, consumer spending, unemployment and inflation all pointing toward a slowdown in economic activity. Not a retrenchment, but rather more prudence on the part of consumers and business leaders facing the burn of cost fatigue and higher interest rates.

We foresee a bifurcated consumer spending outlook where modest real disposable income growth forces low- and median-income households to dial back on their outlays amid persistently elevated prices and more expensive credit. Rising election uncertainty will likely curb capex even as easing financial conditions remain supportive of high-return investment opportunities and deal volumes. Overall, we anticipate real GDP growth will moderate below 2% in the second half of the year on slower private sector activity even as the drag from inventories and international trade dissipate. We foresee average GDP growth around 2.4% in 2024 and 1.7% in 2025.

**Slowing labor market:** While strong on the surface, the labor market sent some mixed signals in May. The combination of robust payroll growth (up 272k), firmer wage growth at 4.1% and weaker labor supply pointed to a labor market that remains tight. Yet the plunge in household employment and rise in the unemployment rate to a 2.5-year high of 4.0% painted a more nuanced picture and corroborated other data pointing to softer labor market conditions. Looking ahead, labor demand is likely to remain under pressure while business leaders curb wage growth and proceed with strategic layoffs to contain costs. We anticipate the unemployment rate will rise further toward 4.3% while jobs growth slows below trend.

**Consumer prudence:** Retail sales fell short of expectations in May, posting a tepid 0.1% gain as households continue to exercise prudence and scrutinize amid elevated prices, higher borrowing costs, dwindling savings and signs that financial stress is rising for some households. With real disposable income growth having slowed to a tepid 1.0% year over year (y/y) pace, we expect further moderation in consumer spending growth. We expect consumer spending in Q2 to grow around 1.8% annualized, slightly below the pace of growth seen in Q1. However, it is worth noting that if it were not for the robust carry-over from Q1, consumer spending growth would be tracking at 0.3% annualized in Q2. We project that consumer spending will grow around 2.2% this year and 1.8% in 2025.

**More disinflation in the pipeline:** Headline Consumer Price Index (CPI) was unchanged in May, lower than expected, while core CPI rose a modest 0.2% month over month (m/m) – its lowest advance in eight months and lower than the average 0.4% m/m gain in Q1. As a result, headline CPI inflation eased 0.1pt to 3.3% y/y, while core CPI inflation eased 0.2 percentage points (ppt) to 3.4% y/y – its lowest since April 2021. Given unfavorable year-on-year comparisons, CPI inflation is likely to hover around an “uncomfortable plateau” over the summer with headline inflation around 3.3% and core inflation around 3.4%. While softer consumer spending growth due to increased pricing sensitivity, moderating wage growth, declining rent inflation, reduced markups and stronger productivity growth will continue to provide a healthy disinflationary impulse, it’s not until September that inflation readings will fall below that uncomfortable plateau. We foresee headline and core CPI inflation at 2.9% and 3.1% y/y in Q4 2024 while we anticipate the Fed’s favored inflation gauge, the deflator for personal consumption expenditures (PCE), to end the year around 2.6% y/y.

**Still expecting two Fed rate cuts in 2024:** The Federal Open Market Committee (FOMC) voted unanimously to hold the federal funds rate at 5.25%-5.50%. The policy statement was largely unchanged, while the dot plot now indicates only one rate cut this year, down from three in the March dot plot, and four rate cuts next year instead of three. We continue to believe a July onset of the easing cycle would have been optimal given easing inflation and softening labor market conditions, but a September onset is now likely given policymakers’ backward-looking hawkish bias. We expect two rate cuts of 25 basis points (bps) in 2024 and 125bps of easing in 2025.

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**Source:** EY-Parthenon
We expect the US economy to continue its gradual descent this year, with softer economic growth and gentle disinflation setting the stage for two rate cuts in H2 2024.

**Risks:** Stagflation is a downside risk that could emerge from a spike in energy prices, geopolitical tensions or escalating trade tensions. Concurrently, there is a risk that overly stringent monetary policy could lead to a swift tightening of financial conditions, with plunging equity prices and surging interest rates and corporate bond spreads leading to a private sector retrenchment.

As the US elections draw near, the outlook for tax, trade and regulatory policy should also be monitored closely.

The main upside risk to the US economy is non-inflationary growth driven by stronger productivity gains supported by technological advancements, including generative AI.

Source: EY-Parthenon
Soft GDP growth in Q1 was driven by the most volatile components – inventories and net exports, but underlying domestic momentum remained solid at around 3%

Real GDP growth was revised lower by 0.3ppt to 1.3% annualized in Q1, following a strong 3.4% gain in Q4 2023 and above-2% growth in the prior six quarters. Overall, the GDP report continued to paint the picture of an economy with resilient but cooling momentum. Indeed, final demand to private domestic purchasers – a better gauge of the underlying pace of economic activity that strips out the volatile components – posted a 2.9% advance compared to 3.1% previously estimated:

- **Consumer spending** grew 2.0% annualized, revised downward from 2.5%. A fall in consumer spending on goods was the major driver, with durable goods registering a larger fall. However, consumer spending on services continued to show strength.

- **Residential investment** posted a remarkable 15.4% growth in the revised estimates – one of the strongest gains of the last decade – supported by resilient construction activity.

- **Business investment** grew a moderate pace of 3.3%, driven primarily by healthy growth in intellectual property products offsetting a slowdown in structures investment.

- **Restocking efforts** were slightly revised downward as inventories imposed a 0.5ppt drag on GDP growth.

- **Net trade** drag remained unchanged with a 0.9ppt drag on GDP growth, but this was essentially good news, as it reflected the strongest gains in imports in two years driven by goods and services demand.

- **Government spending** growth was revised slight upwards to 1.3%, as the contraction in federal spending was offset by an increase in state and local outlays.

We anticipate real GDP will grow around 2% annualized in Q2 before slowing below trend in H2 2024, and average 2.4% this year and 1.7% in 2025.
The labor market continues to show healthy job gains, but cooler demand and elevated labor costs are leading companies to become increasingly discerning with their talent.

While strong on the surface, the labor market sent mixed signals in May. The combination of robust payroll job creation, firmer wage growth and weaker labor supply pointed to a labor market that remains tight. Yet the plunge in household employment and rise in the unemployment rate to a 2.5-year high painted a more nuanced picture and corroborated other data pointing to softer labor market conditions.

The economy added 272k jobs in May, well above consensus expectations, while prior estimates of job growth in March and April were revised lower by a cumulative 15k jobs. The reacceleration in job gains was broad based, with the private sector adding 229k jobs and the government sector adding 43k jobs, confirming the weakness in April was likely a blip.

A 157k increase in unemployment pushed the unemployment rate 0.1ppt higher to 4% in May, its highest level since January 2022. New weekly filings for unemployment benefits have also been trending higher in recent weeks and reached their highest level since August in the week ended June 8, suggesting the slower final demand and high labor costs are leading companies to become increasingly discerning with their hiring.

Overall, we expect the labor market to maintain enough forward momentum to carry the consumer throughout the rest of the year, but the pace of job creation is poised to slow as softer consumer demand, reduced pricing power and lower profitability lead companies to become more pragmatic with hiring and wage increases. Against this backdrop, job growth will likely slow below trend over the course of the year, and the unemployment rate will rise toward 4.3% by year-end.

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Source: Challenger, Gray & Christmas; Bureau of Labor Statistics; Department of Labor; EY-Parthenon
Labor market conditions continue to normalize, with stronger labor supply fueled by higher immigration along with cooler labor demand helping reduce wage pressures.

The labor force participation rate fell 0.2ppt to 62.5% in May, but the decline was mostly driven by workers between the ages of 20 and 24. Encouragingly, the prime-age labor force participation rate (workers aged 25 to 54) rose to 83.6% last month, its highest level in more than two decades.

The sharp rebound in immigration over the past two years has been a key factor driving the labor supply higher as it helps offset demographic headwinds from an aging population, thereby partially alleviating the labor supply challenge. Baby boomers have been entering retirement age since 2011, but the cohort of US-born workers entering the workforce is smaller.

The Job Opening and Labor Turnover Survey (JOLTS) data brought further evidence of cooling labor market conditions. Job openings fell to their lowest level since February 2021 to 8.06m in April, and the job opening rate also fell 0.2ppt to 4.8%. The number of job openings per unemployed worker – an indicator of labor market tightness – declined to 1.24 in April, within the pre-pandemic range of 1.25-1.30.

Further signs of labor market rebalancing are visible in the quits rate, which is a leading indicator of wage growth. It fell 0.1ppt to 2.2% in November, the lowest level since 2018 (excluding the pandemic). The hiring rate also declined, falling from 3.7% to 3.5%, the lowest since 2014 (excluding the pandemic).
Retail sales fell short of expectations in May and posted a tepid 0.1% m/m gain as households continue to exercise caution and are spending more wisely amid elevated prices, higher borrowing costs, dwindling savings and signs that financial stress is rising for some households. Adjusted for inflation, retail sales volumes also rose 0.1% as consumer prices were unchanged last month.

Control retail sales, which is a key gauge of broader consumer spending trends that strips out the volatile components, posted a stronger 0.4% increase. However, the advance was offset by downward revisions to April sales, which are now estimated to have declined 0.5%, instead of a 0.3% contraction previously reported.

E-commerce remains the largest area of retail sales growth, though momentum has moderated in recent months; online sales are up 6.8% from a year ago and 80% compared to pre-pandemic levels. In contrast, retail sales categories that outperformed during the pandemic, such as furniture, electronics and sporting goods, have been relatively flat over the past year.

Overall, the May retail sales data and downward revisions to the prior months’ figures point to soft momentum in goods consumption growth and overall spending as the second quarter progresses. We expect consumer spending in Q2 to grow around 1.8% annualized, slightly below the pace of growth seen in Q1. However, it is worth noting that if it were not for the robust carry-over from Q1, consumer spending growth would be tracking at 0.3% annualized in Q2.
We continue to expect softer consumer spending trends as cost fatigue and cooling labor market conditions curb income growth and lead households to exercise more spending restraint.

Following a 2.2% advance in 2023, we project that consumer spending will grow around 2.2% this year and 1.8% in 2025.

Consumers are not retrenching, but spending fatigue is setting in for low- to median-income households amid softer income trends, elevated prices and expensive credit.

Consumers remain willing to spend, but pricing sensitivity has increased, and savings are dwindling, leading to more prudence. Real consumer spending fell 0.1% m/m in April (the May data will be released later this month), as modest appetite for services was offset by reduced spending on goods.

With real disposable income also falling 0.1% m/m, the personal savings rate held steady at a 16-month low of 3.6%.

Real consumer spending grew 2.6% y/y in April compared to 2.8% y/y in March, but real disposable income growth slowed to a tepid 1.0% y/y pace in April – the slowest pace since January 2023.
Rising delinquencies on consumer loans represent warning signs that the financial health of younger and less affluent households are deteriorating.

- Consumers are growing more downbeat about the economy, as elevated prices, softening labor market conditions and eroding consumer finances are taking a toll on consumer morale.
- The University of Michigan Consumer Sentiment Index fell 3.5 points to an eight-month low of 65.6 in early June, reflecting a decline in both current and expected conditions.
- While the methodological shift of transitioning from cell phone interviews to web-based surveys is leading to a slight downward bias in sentiment readings and upward bias in inflation expectations, consumers' assessments of personal finances are dipping due to rising concerns over high prices as well as weakening incomes.
- The latest New York Federal Reserve's Household Debt and Credit Report shows a rise in severe delinquencies — those more than 90 days overdue. Credit card debt is particularly troubling, with severe delinquencies (10.7%) at their highest since 2012.
- This trend is particularly pronounced among younger age groups, notably those 18-29 and 30-39 years old, illustrating a divided economic landscape where the financial burdens weigh more heavily on the younger and less affluent.
- In this context, it is imperative for the Fed to manage monetary policy with prudence, ensuring that it does not maintain or introduce an excessively restrictive stance.

Source: The Conference Board; University of Michigan; Federal Reserve Bank of New York Consumer Credit Panel; Federal Reserve Board
Depressed affordability and elevated mortgage rates point to continued sluggish housing demand, while home prices should continue to rise modestly amid tight supply.

- Housing data continues to point to some ongoing softness in activity. Housing starts plunged 5.5% to 1.28m in May following a 4.1% advance in April. Single-family starts fell 5.2% m/m, while multifamily starts partially reversed their April 22.5% surge and declined 6.6%. We expect single-family construction activity will continue to support housing starts throughout the remainder of the year, while multifamily construction will likely remain under pressure as supply has risen in excess of demand in many markets.

- On the demand front, we expect new and existing homes sales to gradually recover heading into 2025 as rate cuts by the Federal Reserve and continued positive labor market gains help release some pent-up demand. On the construction front, limited supply should support growth, but tight lending conditions along with higher cost of construction will limit the upside.

- Home prices grew at a more modest pace in March. The S&P CoreLogic Case-Shiller Home Price Index rose 0.3% m/m in March, while the Federal Housing Finance Agency (FHFA) House Price Index rose by 0.1% m/m.

- As a result, annual home price growth remained steady, with the S&P CoreLogic Case-Shiller index up 6.5% y/y in March. Meanwhile, the FHFA index slowed to 6.7% y/y from 7.1% y/y in February.

- Looking ahead, if tight supply conditions continue, we expect home prices can continue to see moderate gains.

1. Existing home sales shown through April.

Source: Mortgage Bankers Association; Census Bureau; National Association of Realtors; Trading Economics; EY-Parthenon
Industrial activity is expected to gradually recover this year, but elevated interest rates, tight lending standards and softer consumer demand will remain a constraint.

The Institute for Supply Management (ISM) manufacturing slid further into contraction territory in May amid a significant pullback in new orders. The index fell to 48.7 after dipping to 49.2 in April, with half of 14 industries reporting contraction.

The decline was driven by a fall in the new orders and inventories subcomponents. The forward-looking new orders index declined further from 49.1 to 45.4. While remaining in expansionary territory, the production subindex also declined to 50.2 from 51.3.

On the employment front, the employment index rose by 2.5 points to 51.1 in May, entering expansionary territory for the first time in eight months.

Industrial production was stronger than expected in May after stalling in April. Industrial production grew by 0.9% m/m last month — the strongest increase in 10 months. The upturn was led by a rise in manufacturing output, which expanded by 0.9% m/m — on broad-based gains — following two consecutive months of decline.

Still, industrial production is only up 0.4% y/y, while manufacturing is nearly flat, up 0.1% y/y, with capacity utilization 1.1ppt below long-run average, at 77.1%.

Looking ahead, we expect modest growth in industrial activity for the rest of the year, as tight lending standards and still high real interest rates continue to weigh on the sector.

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1. The Institute for Supply Management measures PMI (Purchasing Managers' Index) by surveying manufacturing and service firms on their orders, production, employment, deliveries and inventories. The index indicates business activity in both sectors. This is a diffusion index, with readings above 50 indicating expansion and readings below 50 indicating contraction in activity.

2. Includes manufacturing as well as mining and electric and gas utilities.

Source: Federal Reserve; Institute for Supply Management; EY-Parthenon
Consumer price inflation surprised on the downside in May, with headline CPI remaining unchanged on the back of lower energy prices. Core CPI rose a modest 0.2% m/m – its lowest advance in eight months – pointing to ongoing disinflation. As a result, headline CPI inflation eased 0.1pt to 3.3% y/y while core CPI inflation eased 0.2ppt to 3.4% y/y – its lowest since April 2021.

Core goods prices were flat on the month while core services prices only rose 0.2%. Shelter cost advanced a moderate 0.4% m/m and fell 0.2pt to 5.4% in May, a rate well below its 8.2% peak of April 2023. Meanwhile, lower hotel and airfare prices along with the first monthly decline in auto insurance prices since October 2021 drove the cooler headline gain.

Given unfavorable year-on-year comparisons, CPI inflation is likely to hover around an “uncomfortable plateau” over the summer with headline inflation around 3.3% and core inflation around 3.4%. While softer consumer spending growth due to increased pricing sensitivity, moderating wage growth, declining rent inflation, reduced markups and stronger productivity growth will continue to provide a healthy disinflationary impulse, it’s not until September that inflation readings will fall below that uncomfortable plateau.

We see headline and core CPI inflation easing to 2.9% and 3.1% y/y in Q4 2024, respectively, while we anticipate the Fed’s favored inflation gauge, the deflator for personal consumption expenditures, to end the year around 2.6% y/y.

1. Headline CPI includes the prices on a fixed basket of goods. Core CPI removes the CPI components that can exhibit large amounts of volatility from month to month, such as food and energy.

Source: Bureau of Labor Statistics; EY-Parthenon
Inflation

Shelter costs and elevated auto insurance premiums are key factors keeping inflation high, but falling car prices and reduced rent inflation point to easing pressures

- The Fed’s favorite “supercore” CPI gauge (core services prices excluding shelter costs) fell by 0.04% in May – the first decline since late 2021.
- Most of the downside surprise came from transportation services prices which fell 0.5% m/m, the first decline since September 2021, as motor vehicle insurance prices fell 0.1% – the first decline since October 2021.
- Airfares plunged 3.6% m/m and are now 5.9% below their year-ago level.

1. Includes water, sewer and trash collection services; household operations; and other personal services, leased vehicles, vehicle rental, vehicle maintenance and repair, vehicle fees, and public transportation (including airline fares).

Source: Bureau of Labor Statistics; EY-Parthenon
While wage pressures remain too elevated for comfort, moderation should continue as labor demand softens and comes into better balance with labor supply.

- Despite ongoing labor market rebalancing along with wage growth compression efforts by employers, the Employment Cost Index (ECI) rose a stronger-than-expected 1.2% quarter over quarter (q/q) in Q1 2024 – the largest gain in a year and higher than the 1.0% average gain over the prior four quarters. Wages and salaries rose 1.1% – in line with the average gain over the prior four quarters – while benefits also increased 1.1%.

- The all-important private-sector wages and salaries gauge also advanced a stronger-than-expected 1.1% q/q – the largest gain in a year and in line with the average 1.1% over the prior four quarters.

- Disappointingly, stronger-than-expected sequential momentum meant that headline ECI compensation remained unchanged at 4.2% y/y, while private sector wage growth held at 4.3% y/y.

- The monthly average hourly earnings measure showed renewed momentum following a soft 0.23% m/m reading in April and grew a stronger-than-expected 0.4% m/m in May. As a result, wage growth rose 0.2ppt higher to 4.1% y/y.

- Looking ahead, with the number of workers voluntarily quitting their jobs at its lowest level since March 2018 outside of the pandemic, and a falling share of small companies planning to raise compensation, the moderation in wage growth is likely to continue in H2 2024.

- The common belief is that wage growth around 3.5% is consistent with the Fed’s 2% target; this implies productivity growth of 1.5%. With productivity growth currently trending above 2%, wage growth around 4% is considered non-inflationary.

- Still, we foresee modest downward pressure on wage growth in the coming months.

Source: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; EY-Parthenon
Federal Reserve

A backward-looking Fed is leaning toward a later onset of the easing cycle amid a Q1 inflation scare; we foresee 50bps of rate cuts this year in September and December.

The Federal Open Market Committee voted unanimously to hold the federal funds rate at 5.25%-5.50%. The statement was largely unchanged, while the dot plot now indicates only one rate cut this year, down from three in the March dot plot, and four rate cuts next year instead of three. While the overall growth picture was unchanged, inflation projections were upgraded to reflect higher-than-expected inflation in Q1.

During the press conference, Fed Chair Jerome Powell failed to provide any forward guidance on policy and monetary policy transmission. He simply reiterated that the inflation data has so far not provided policymakers with greater confidence that inflation is moving sustainability toward 2% and that gaining such greater confidence would require seeing “more good inflation readings” and improvements in the “totality of the data.”

When asked about the current policy stance, Powell noted that “the evidence is pretty clear that policy is restrictive” and “about right” and that “the question of whether it’s sufficiently restrictive is going to be one we know over time.” He also highlighted the two-sided risks of easing monetary policy too soon or too late while keeping a neutral tone and avoiding putting emphasis on one side of the Fed’s mandate.

We continue to believe a July onset of the easing cycle would have been optimal given easing inflation and softening labor market conditions, but a September onset is now more likely given policymakers’ backward-looking hawkish bias. We expect two 25bps rate cuts in 2024 and 125bps of easing in 2025.

1. “Dot plot” charts the median interest rate projection from the FOMC. The projections for the federal funds rate are the values at the end of the specified calendar year.

Source: Federal Reserve Board; EY-Parthenon
Financial conditions

Signs of cooler inflation and growth are fueling a bond market rally; meanwhile, the dollar is surging as rising political uncertainty has sparked a flight to safety.

- Continued disinflation signs along with moderation in consumer spending have led to a significant bond market rally as investors reassess their rate cut expectations. The 2-year Treasury yield has fallen nearly 30bps since its late May peak to around 4.7%, while the yield on 10-year Treasuries has declined by about 40bps to 4.2%.
- The yield curve, measured as the spread between the 2-year and 10-year Treasury yields, has been continuously inverted since early July 2022, the longest such stretch on record. While an inverted yield curve is historically a reliable predictor of an impending recession, the US economy has showed surprising resilience to the Fed's hiking cycle partly because consumers have been able to rely on their excess savings to power their spending in the face of elevated inflation and higher borrowing costs.

- After a pullback at the end of 2023, the broad trade-weighted dollar index has appreciated markedly year to date. With the US economy performing well, the Fed lagging behind other central banks in cutting interest rates, and rising political uncertainty in Europe and emerging markets, the dollar has strengthened to its highest level since November 2022 and is up 4.3% since the start of the year.
- With the dollar likely to remain strong throughout the remainder of 2024, US companies doing business internationally will continue to face higher export prices and downward pressure on the value of overseas profits.

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1. The trade-weighted dollar is a weighted average of the foreign exchange value of the US dollar against the currencies of a broad group of major US trading partners.

Source: Federal Reserve Board; Bloomberg; EY-Parthenon
Rising debt burdens and federal debt interest payments threaten to reduce spending on discretionary and mandatory programs while crowding out private sector investment.

**Fiscal outlook**

**US federal budget deficit or surplus (percentage of GDP)**

**US interest payments on government debt (percentage of GDP)**

- **Budget outlook**: The Congressional Budget Office (CBO) anticipates the federal budget deficit will reach $1.9t–$2.0t in fiscal year 2024, or 7.0% of GDP, and grow to $2.8t by 2034, or 6.9% of GDP—significantly more than the 3.7% that deficits have averaged over the past 50 years. As a result, federal debt held by the public rises from 99% of GDP in fiscal year 2024 to 122% in 2034, surpassing its previous high of 106% in 1946. Rising interest costs and mandatory spending are expected to outpace decreases in discretionary spending and growth in revenues.

- **Higher cost of debt**: Deteriorating debt dynamics generally lead investors to demand higher rates to compensate for the increased risk of default (risk premium). This increases the cost of borrowing for the government and favors the potential for a further acceleration in debt costs.

- **Crowding out private sector investment**: Excessive government borrowing can also push up borrowing costs for the private sector, leading to reduced business investment, residential investment and consumer spending growth.

- **Impact on currency and treasuries**: Persistent and uncontrolled budget deficits could lead to a decrease in the global appetite for US Treasuries and dollar-denominated assets. If investors begin to question the ability of the US to service its debt, the demand for these assets could decrease, potentially weakening the dollar and increasing borrowing costs.

Source: Haver Analytics; EY-Parthenon, Congressional Budget Office
Downside risks to growth stem from tightening financial conditions, restrictive monetary policy and geopolitical tensions, while stronger productivity growth is a key upside risk.

**Characteristics of a potential optimistic case:**
- The labor market comes into better balance, with labor force participation continuing to rise amid stronger immigration flows and productivity growth accelerating, driven by a combination of firm-level efficiency gains and tech-driven innovation led by generative AI adoption.
- Real GDP growth picks up, as the US consumer shows resilience supported by more robust disposable income growth while businesses turn more optimistic about the outlook, focusing on long-term investment and hiring decisions.
- Amid a noninflationary growth environment, the Fed pivots to a less hawkish stance and embarks on an earlier policy easing cycle. Less restrictive monetary policy leads to easing global financial conditions, thereby supporting stronger economic and transaction activity.

**Characteristics of a potential pessimistic case:**
- A surge in inflation amid rising geopolitical tensions puts upward pressure on the cost of goods and services, while constrained labor force participation keeps wage growth elevated and pressures companies’ margins.
- Elevated inflation and rising inflation expectations force the Federal Reserve to tighten monetary policy further, pushing the Fed funds rate well above 6% and leading to a severe tightening of global financial conditions and plunging stock prices.
- Consumers grow increasingly reluctant to spend amid persistently high inflation and unrelenting efforts from central banks to tame inflation. Continued cost pressures and elevated uncertainty erode business sentiment and prompt firms to implement broader layoffs. Recessionary dynamics grip the economy, with labor market conditions deteriorating rapidly and the unemployment rate rising sharply.

Source: EY-Parthenon
Sector considerations and implications of the US outlook

<table>
<thead>
<tr>
<th>Industry and sector</th>
<th>Perspectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private equity</td>
<td>In the private equity (PE) sector, supply chain disruptions, rising interest rates and increased volatility are shifting PE firms’ primary value creation strategy from multiple expansion to operational value-add. Exit activity has slowed markedly, causing holding periods to extend by up to three years longer than historical average. In order to favor optimal returns, private equity firms should prioritize operational value-add strategies by reassessing the ways in which they leverage cash, evaluate cost, attract talent, adapt technology and embrace ESG initiatives. (How the drivers of PE value creation are changing).</td>
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<td>Health care and life sciences</td>
<td>As US health care costs rise, more health systems are evaluating the transition to value-based care (VBC) to prioritize patient outcomes as well as improve financial profile. Contrary to the traditional fee-for-service (FFS) model, which focuses more on quantity of treatment, VBC could act as a more sustainable option that promotes better health care and lower costs over time for patients and that favors long-term growth and recovery from margin erosion. Although the transition to VBC involves a highly complex execution strategy, health systems with strong balance sheets and adequate governance that successfully embrace the VBC model will be able to reap the dual benefits of higher efficacy care and improved financial performance. (How value-based care can help boost health system revenue). The biopharma industry is facing a “patent cliff”: ~$200b of biopharma products, which accounts for ~15% of global market size, will reach the end of patent protection by 2030. Given the highly complex and diverse global regulatory and tax environment as well as operational challenges, biopharma companies will require tailored, market-specific entry strategies to effectively pursue this sizeable, global opportunity. (Key steps for improving biopharma expansion into new markets).</td>
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<td>Government and housing</td>
<td>The pressure is on local governments to provide housing cost relief in their communities. Localities are doing so via four approaches. (How local governments can address the housing affordability crisis): - Zoning reform: increasing areas approved for residential construction and multi-unit residential structures to increase density in relevant areas - Developer incentives: expediting permitting approvals for developers to drive efficient project timelines, impacting costs - Tenant protections: rent control, eviction standards, rent increase laws, affordable housing laws - Public-private partnerships: government projects leveraging of private funds and construction expertise to fuel housing project activity</td>
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<td>Energy</td>
<td>The energy sector is witnessing a meaningful consolidation, with numerous large M&amp;A transactions grabbing headlines. Firms are looking to secure current and future production, shore up cash flow profiles, drive customer confidence, and position themselves favorably for the ongoing shift toward affordable and reliable sustainable and alternative energy. These complex deals and associated diligence processes are increasingly requiring tangible assessment of the impact of M&amp;A on carbon goals and impact. (Energy M&amp;A Quick Takes).</td>
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<tr>
<td>Tech, media and telecom</td>
<td>Roughly 40% of tech CEOs plan to execute M&amp;A activity in the next 12 months according to a recent EY survey. Given the sustained higher cost of capital, there is increased pressure on tech M&amp;A to evidence potential growth and value drivers during the diligence process and develop plans for deployment and integration before deal execution, which is contributing to increased deal scrutiny and tempering activity. The antitrust and regulatory environment is also potentially metering some large, transformational M&amp;A activity in the space. AI continues to drive deal activity, as firms look to build out their tech and talent on this front via deal activity. (Tech M&amp;A Quick Takes).</td>
</tr>
</tbody>
</table>

Source: EY-Parthenon
Be realistic and opportunistic.

Understand where you play and play where you understand.

Amid elevated rates, don’t hold your breath — start swimming.

Adapting strategic priorities to position for growth in a highly uncertain environment

Scenarios are your friend.

You can’t price your way out anymore, and supply matters.

Strategies for transforming uncertainty into opportunity

Slower growth; a higher cost of doing business; shifting preferences; and rising trade, geopolitical and regulatory uncertainty underscore the importance of being proactive.

Source: EY-Parthenon
Meet the EY-Parthenon Macroeconomics Team

Gregory Daco
Chief Economist
New York
gregory.daco@parthenon.ey.com

Lydia Boussour
Senior Economist
New York
lydia.boussour@parthenon.ey.com

Marko Jevtic
Senior Economist
New York
marko.jevtic@parthenon.ey.com

Dan Moody
Director
Denver
dan.moody@parthenon.ey.com

Harry Song
Senior Associate
Boston
harry.song@parthenon.ey.com

Dipesh Khati
Associate
Boston
dipesh.khati@parthenon.ey.com

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Individuals above are members of Ernst & Young LLP.
Please direct initial questions and requests to Dan, Harry and Dipesh.
Meet the team

Meet our colleagues from across the EY network, fellow economic insight thought leaders with various geographic focus areas

Marek Rozkrut
Chief Economist – Europe and Central Asia
Warsaw, Poland
marek.rozkrut@pl.ey.com

Peter Arnold
Chief Economist – UK
London, UK
parnold@uk.ey.com

Cherelle Murphy
Chief Economist – Oceania
Canberra, Australia
cherelle.murphy@au.ey.com

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US SCORE no. 23762-241US
2406-4550812

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