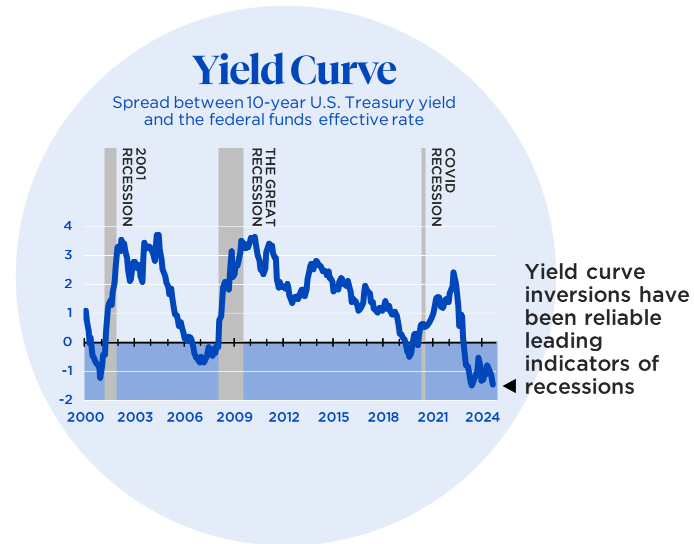
Economic & Financial Markets Monthly Review | September 2024

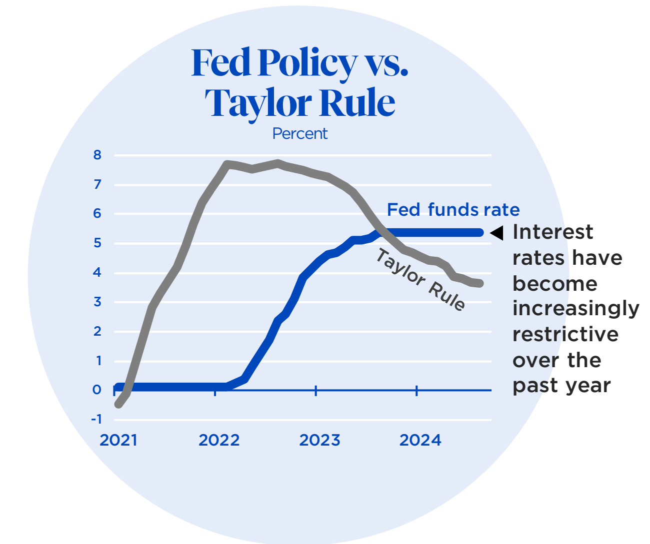
Fed rate cut arrives as labor market softens

Economic Overview

Where is the economy now?

Hiring and spending activity have moderated as the economy shifts into a lower gear in the second half of 2024. The softening in the labor market and increasing stresses for consumers and businesses underscore the need for reduced interest rates. After kicking off its easing cycle in September with a large half percentage point cut, we expect the Fed to lower rates again in November and December — key initial steps to keep a soft landing in the cards for 2025.





Where we are this month

Economy set for slower growth

Growth for the third quarter appears solid, but interest rate headwinds and slower job gains should weigh on consumer activity in the fourth quarter and into 2025.

Yield curve awaits normalization

The spread between the 10-year Treasury rate and the fed funds rate became more inverted this month. However, the full yield curve should steepen as the Fed continues to lower short-term rates and long-term rates hold relatively steady.

Fed policy has gotten more restrictive

The Taylor Rule suggested that the fed funds rate was 175 basis points above the current neutral rate ahead of the Fed's 50bps rate cut, a strong signal that monetary policy should be eased even further.

What does this mean

- While the economy is expected to downshift, a soft landing is still the most likely scenario over the next year. Interest rate cuts from the Fed should prevent a sharp deterioration in consumer spending and the labor market.
- That said, there's a risk that the Fed waited too long to ease monetary policy with relatively restrictive rates expected to linger into 2025. This keeps a mild recession in 2025 as a plausible downside risk to our outlook.

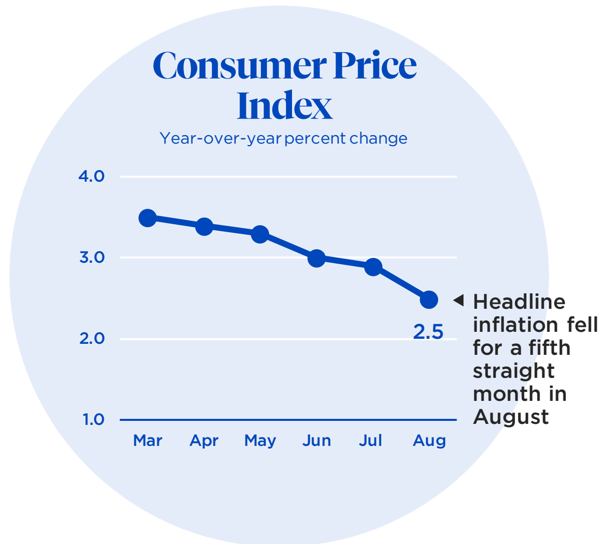
- The spread between the 10-year and 2-year Treasury yields normalized in August as 2-year rates declined with markets pricing in more aggressive rate cuts by the Fed. The fed funds to 10-year spread should follow suit by mid-2025, ending the longest period of yield curve inversion in U.S. history.
- While the yield curve has historically normalized ahead of downturns, the next recession is more likely to be delayed by a soft landing.

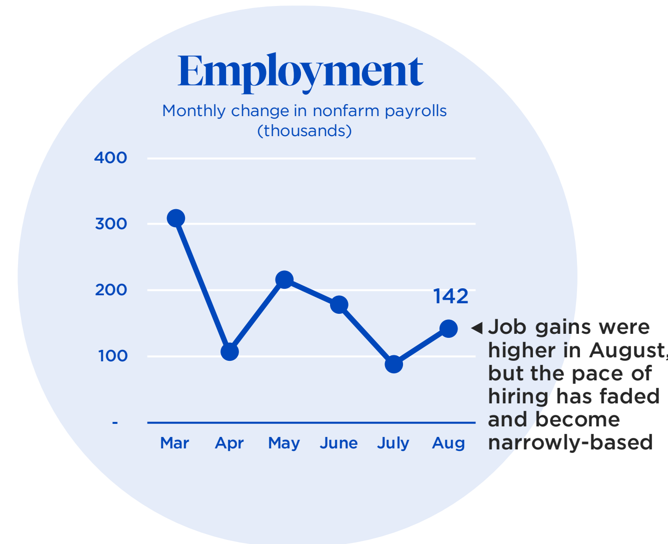
- Representing a guide for policy, the Taylor Rule indicates that the meaningful slowing in the pace of inflation and the modest uptick in the unemployment rate calls for a consistent sequence of rate cuts from the Fed.
- This supports our view that Fed rate declines will be relatively aggressive over the next year to avoid a hard landing for the economy.

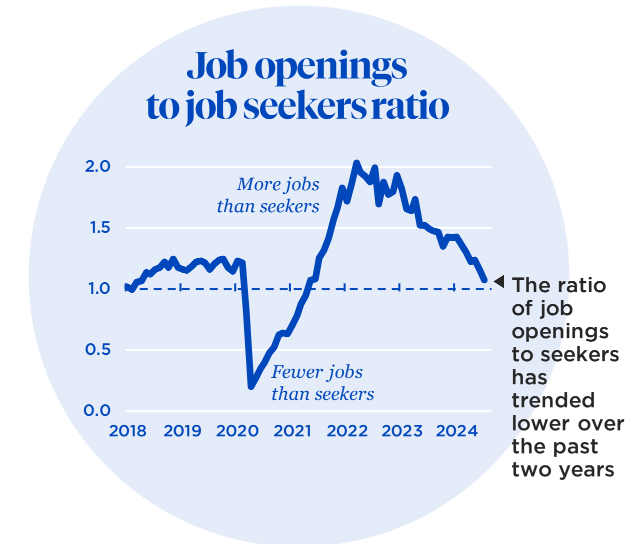
Economic Review

Softer economic and inflation data call for rate cuts

Job gains were slightly stronger in August but the trend for hiring has weakened considerably from earlier this year. Additionally, the ratio of job openings to job seekers fell below the pre-Covid level after being highly elevated for three years — a sign of broadly cooler labor market conditions. With inflation now believed to be on a path back to the Fed's 2.0 percent goal, the downshift in the economic conditions argues for further meaningful policy easing by the Fed.







Where we are this month

Disinflation is being limited by rents

The annual pace for headline CPI fell to 2.5 percent in August, but the core rate was steady at 3.2 percent as housing and services inflation remain elevated.

Labor demand is cooling

August's headline gain in nonfarm payrolls was 142,000, while the unemployment rate fell to 4.2 percent. However, job gains continue to be narrowly-based and the overall trend points downward.

Job openings ratio dips below pre-Covid level

After climbing to a high level over the last three years, the ratio of job openings to job seekers fell to 1.07 in July, dipping below the pre-Covid average.

What does this mean

- The annual headline inflation rate decelerated to its slowest level since February 2021 as declining goods and energy prices support disinflationary trends. The three-month annualized rates for headline and core CPI remained low at 1.2 percent and 2.1 percent.
- Residential rental inflation remains buoyant, climbing 0.5 percent in August to lift the 12-month rate to 5.2 percent. Further slowing of residential rent price increases is needed to bring inflation back to trend.

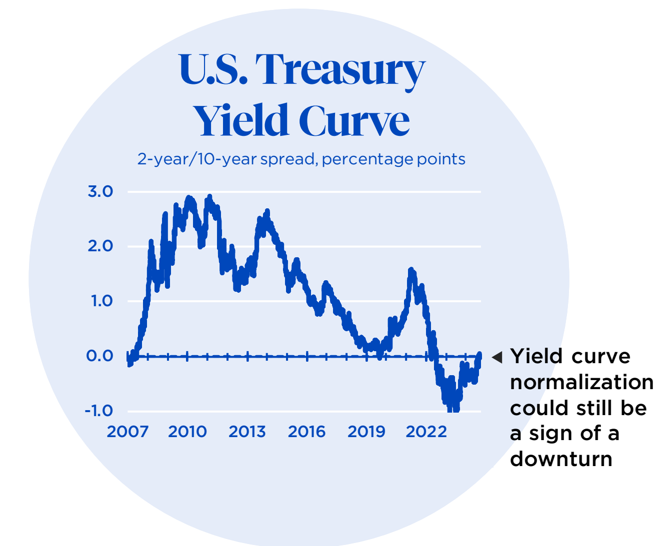
- Momentum in the labor market continues to slow as the three-month moving average for job gains fell in August to 116,000 — the lowest reading since the June 2020. Much of the advance in private payrolls is highly concentrated in acyclical industries.
- While the headline unemployment rate fell, the broader U-6 rate (which includes underemployment) climbed to a nearly three-year high at 7.9 percent as demand for labor eases.

- The current reading indicates that the supply and demand for labor is in much better balance and the labor market is no longer overheating. As a result, wage gains are moderating in many industries which is helping to cool services inflation.
- There are still slightly more openings than unemployed persons, so finding workers remains a challenge for many businesses. But the ratio should continue to ease as growth slows over the next year.

Financial Market Review

Investors cautious on the outlook

Risk assets have been on a wild ride recently as investors adjust to the reality of a normalized economy amid rising concerns the soft landing could turn into a recession. We think the economy will avert a downturn, aided by a total of 100 basis points of Fed policy easing by year end. However, risks for the economy are tilted to the downside as consumers are overextended and the labor market is cooling. We think equities will tread water as investors try to determine whether the Fed can navigate a soft landing or if a hard landing is in store.



Where we are this month

Equities lose steam

Stocks have been volatile in September, building on their August losses. The VIX remains elevated while commodity prices have declined, both signs of rising concerns surrounding the outlook for the economy.

Interest rates fall to year-lows

A softening tone in the economic data is pushing investors into safe assets with the 10-year Treasury yield now at its lowest level since May 2023 and 2-year note yields dropping to three-year lows.

Yield curve dis-inverts

Bond investors are pricing in further large rate cuts due to concerns about the economy and increased confidence in a slower inflation path. This has led the yield curve to dis-invert as short-term yields fall faster than long-term.

What does this mean

- Equities have lost momentum as the economic data increasingly disappoint expectations. The risks are tilted to the downside, but we think lower interest rates will underpin a soft landing rather than a recession. Corporate earnings are expected to stay fairly encouraging as the expansion continues.
- Valuations remain high even as investors are increasingly uncertain of the forward outlook and the eventual payoff from the exuberant investments and expectations surrounding AI.

- Short-term U.S. Treasury yields are falling at a fast pace amid slowing growth and inflation and expectations of significant Fed policy easing over the next year. The 2-year Treasury yield is down nearly 120 basis points (bps) since the end of June.
- We look for the Fed to reduce the Fed funds rate by 100 bps by year end and a total of 225 bps over the next 12 months. The federal government's heavy Treasury issuance lends upside risk to long-term interest rates.

- A return to a more normally sloped yield curve may still be a warning sign for growth. The past four recessions have occurred after the spread between the 2- and 10-year U.S. Treasury yield turned positive.
- The value of the yield curve as a recession indicator has been questioned after it initially inverted in 2022 without a recession following. However, we think it still merits a cautious stance for investors..

Outlook

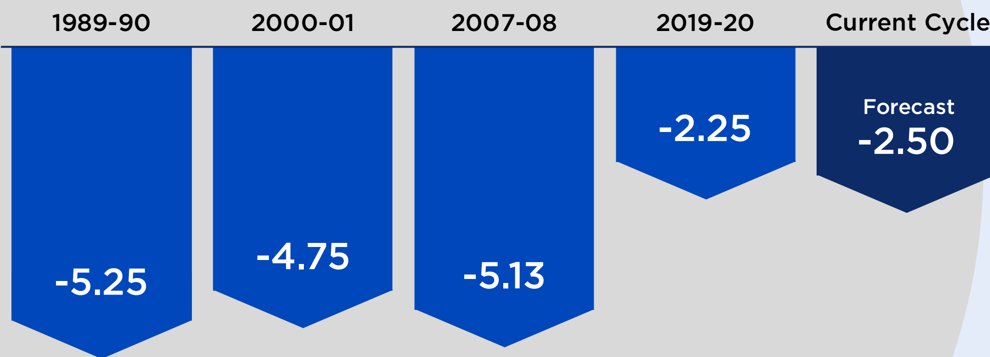
Fed still expected to lower rates less than in past cycles

Estimates of total rate cuts from the Fed over the next year have shifted higher in response to signs that the labor market is cooling faster than expected. With recent inflation trends much closer to the Fed's desired pace, a move away from restrictive monetary policy is needed to prevent further deterioration of labor conditions and to keep hope alive for a soft landing.

After a half percentage point cut this month, we expect the FOMC to lower rates by another 50 basis points combined over November and December meetings. We forecast further significant rate declines over the course of 2025 as the Fed likely lowers the federal funds rate to a range of 3 – 3.25 percent, which represents a neutral interest rate level that is neither expansionary, nor restrictive for growth.

This degree of rate reductions would still be less than typical easing cycles by the Fed since we anticipate a soft landing for the economy that pre-empts the need for the Fed to cut rates more. In the lead up to recessions, the FOMC has cut rates more aggressively as they skip past neutral and into the accommodative range.

Cumulative Fed rate cuts over easing cycles



Podcast
Hear more in our podcast

FIND **ECONOMIC INSIGHTS BY NATIONWIDE** WHEREVER YOU LISTEN TO PODCASTS

Latest Forecast

Data as of September 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.5%	2.6%	1.4%	1.9%	1.8%
UNEMPLOYMENT RATE	3.6%	4.2%	4.8%	4.4%	4.2%
INFLATION [1] (CPI)	3.2%	2.4%	2.2%	2.1%	2.0%
TOTAL HOME SALES	4.75	4.77	5.00	5.88	6.16
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	5.1%	3.3%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.5	15.5	16.2	16.5
FEDERAL FUNDS RATE [2]	5.25%	4.25%	3.00%	2.75%	2.75%
5-YEAR TREASURY NOTE [2]	3.84%	3.65%	3.50%	3.40%	3.40%
10-YEAR TREASURY NOTE [2]	3.88%	3.80%	3.78%	3.80%	3.80%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.20%	5.35%	5.00%	5.00%
MONEY MARKET FUNDS	5.09%	4.97%	3.28%	2.78%	2.78%

[1] *Percent change Q4-to-Q4*
[2] *Year end*

More upside expected for unemployment

As the economy downshifts in a soft-landing scenario, weaker labor demand should cause the unemployment rate to trend higher — topping out just below 5.0 percent in 2025. With improved growth in 2026, the unemployment rate is expected to decline again.

Steady rate declines expected from the Fed

We forecast the fed funds rate to decline a cumulative 100 basis points by year end. Further, we project another 100bps in cuts in 2025, with much of it front-loaded to the first half. Consistent with our soft-landing outlook, we forecast the Fed lowers rates to a neutral policy level (neither expansionary, nor restrictive) by early 2026.

Contributors

Kathy Bostjancic
SVP & Chief Economist

Ben Ayers, MS
AVP, Senior Economist

Oren Klachkin
AVP, Financial Market Economist

Daniel Vielhaber, MA
Economist

Ashleigh Leonard
Economics Specialist

Brian Kirk
Communications Consultant

Sources

Page	Topic	Source
Page 1	**Where is the economy now?**	
	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Taylor Rule vs. fed funds rate	*Federal Reserve Board*
2	**Economic Review**	
	Nonfarm payroll gains	*Bureau of Labor Statistics*
	Rental inflation	*Bureau of Labor Statistics*
	Job openings ratio	*Bureau of Labor Statistics*
3	**Financial Markets Review**	
	S&P 500	*Standard & Poor's*
	10-year Treasury yield	*Federal Reserve Board*
	2-year/10-year Treasury spread	*Bloomberg*
4	**Outlook**	
	Rates declines by easing cycle	*Federal Reserve Board*
	Latest Forecast	*Nationwide Economics*

The information in this report is provided by Nationwide Economics and is general in nature and not intended as investment or economic advice, or a recommendation to buy or sell any security or adopt any investment strategy. Additionally, it does not take into account the specific investment objectives, tax and financial condition or particular needs of any specific person.

The economic and market forecasts reflect our opinion as of the date of this report and are subject to change without notice. These forecasts show a broad range of possible outcomes. Because they are subject to high levels of uncertainty, they may not reflect actual performance. We obtained certain information from sources deemed reliable, but we do not guarantee its accuracy, completeness or fairness.

Nationwide, the Nationwide N and Eagle and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. ©2024 Nationwide

NFM-11356AO.3