SMBC SMBC Group

US Macroeconomics

September 27, 2024

Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

Gamechanger?

The Bureau of Economic Analysis' annual benchmark to the National Accounts data was consequential. Growth in real gross domestic income (GDI) was revised substantially higher. Previously, GDI had been running substantially below real gross domestic product (GDP) indicating the economy was much weaker and recession prone than the more notable real GDP data had suggested. But this is no longer the case.

Prior to yesterday's GDP report, real GDI was reported to have grown just 1.3% at an annualized rate in both Q1 and Q2 2024. And over the previous four quarters, real GDI was up a modest 2.0%. Post revision, real GDI grew a solid 3.0% and 3.4%, in each of the last two quarters. Over the last year, real GDI is up a solid 3.5%, which is better than the reported 3.0% increase in real GDP.

Nominally, there was a $393 billion upward revision in corporate profits and a $782 billion upward revision to personal income. The latter is particularly noteworthy because the substantial revision to income pushed the personal savings rate up nearly two full percentage points to 5.2% for Q2. US households now have more money at their disposal than what was previously reported, thereby helping to underpin continued gains in consumption.

However, the strength in economic activity as measured by both GDP and GDI is at odds with the weakness in the labor market, which appears to be rapidly losing momentum. Moreover, the strength in the broader economy is also at odds with the increase in the unemployment rate which historically only rises when economic growth is slowing. To further muddy the waters, the Bureau of Labor Statistics recently announced that on a preliminary basis it overstated the level of March 2024 employment by over 800k.

Nonetheless, since inflation continues to moderate, the funds rate will move lower over time. The August core PCE deflator rose just 0.13% after only a 0.16% increase in July. Over the past five months annualized, the core PCE deflator is 2.0%, right in line with the Fed's goal. And since the current funds rate is still well above the Central Bank's median 2.9% estimate of neutral, the Fed has an excuse to further cut rates and prevent a further unwarranted weakening in the jobs market. The jobs market will determine what the Fed does next.

There are two more employment reports before the November 7 meeting. It is these data, and not GDP growth, that will determine the size of Fed rate cuts or the lack thereof. Our preliminary estimate for September is weak: nonfarm payrolls are projected at just 85k with the unemployment rate edging back up to its cyclical high of 4.4% from 4.2% in August. This would solidify a 50 bp cut at the November meeting. But if there is an upward surprise to September jobs and this is followed up with some stability in the October report, then it is possible that the Fed does not cut in November. In fact, this was a reason for our 50 basis point (bp) September rate call.

Macro data generally do not trend in a straight line. Even in weak growth environments, there are still mixed signals. Sometimes the economy can show unexpected strength. It even happens during recessions as our previous work has highlighted. And at potential inflection points, which the economy may be at now, the economic picture is even murkier.

When penciling in a 50 bp September rate cut, we thought this would give the Fed some leeway to skip November if the data warranted. But then an eventual reassertion of poor economic fundamentals would necessitate another 50 bp cut at the December 18 meeting.

The meaningful upward revisions in the National Accounts data do not support a 50 bp November rate cut. And if upcoming jobs data surprise to the upside for whatever reason, the Fed may have a difficult time convincing the bond market that back-to-back rate cuts are necessary. The near-term economic and financial backdrop is unusually uncertain. Investors and market participants may need to buckle up.

Disclaimers

This document is provided by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation, SMBC Nikko Securities America, Inc., and their affiliates, as applicable) for informational purposes only, solely for use by the client(s) or potential client(s) to whom such document is directly addressed and delivered. This document was prepared by SMBC Group's economist(s).

This document has been prepared for and is directed at institutional investors and other market professionals, and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Group does not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion following their own independent analysis and assessment of the merits of any transaction prior to execution, after conducting a careful examination of all documentation delivered, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Group. The trading desks of SMBC Group trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Group may conflict with those of the recipient. SMBC Group may seek to do business with the companies mentioned in this material and the trading desks may accumulate, be in the process of accumulating or have accumulated, long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Group, and its directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.