

MACROECONOMIC SCENARIOS  
UNITED STATES ECONOMIC SERVICE

# MACRO ECONOMIC REPORT

FEBRUARY 2025



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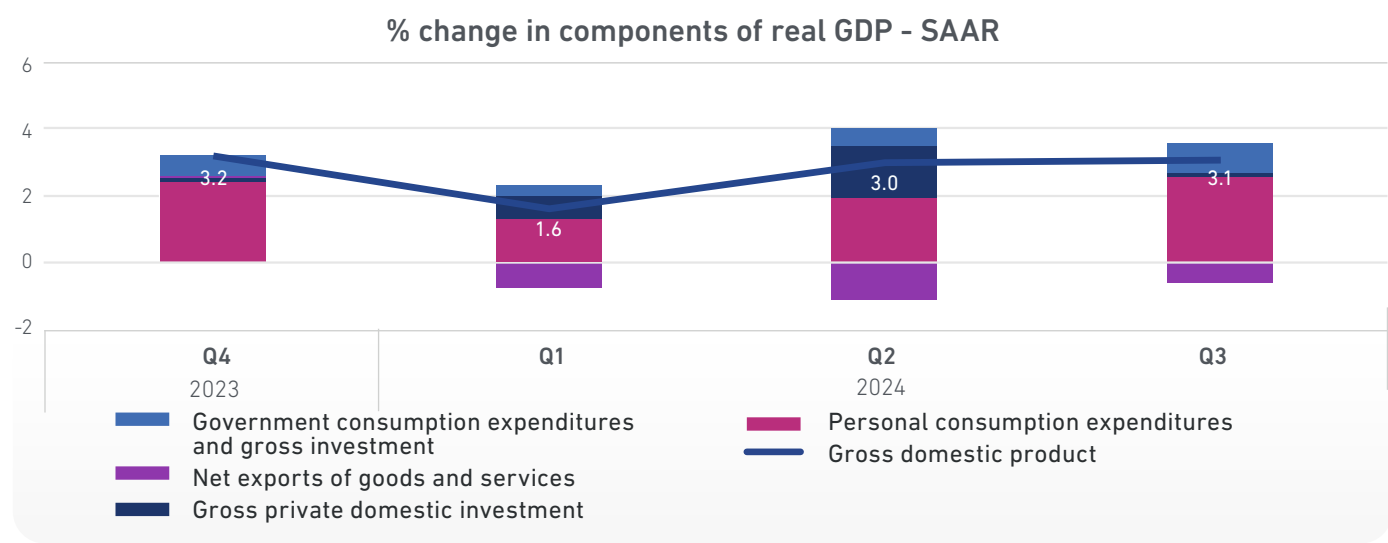


## Latest developments

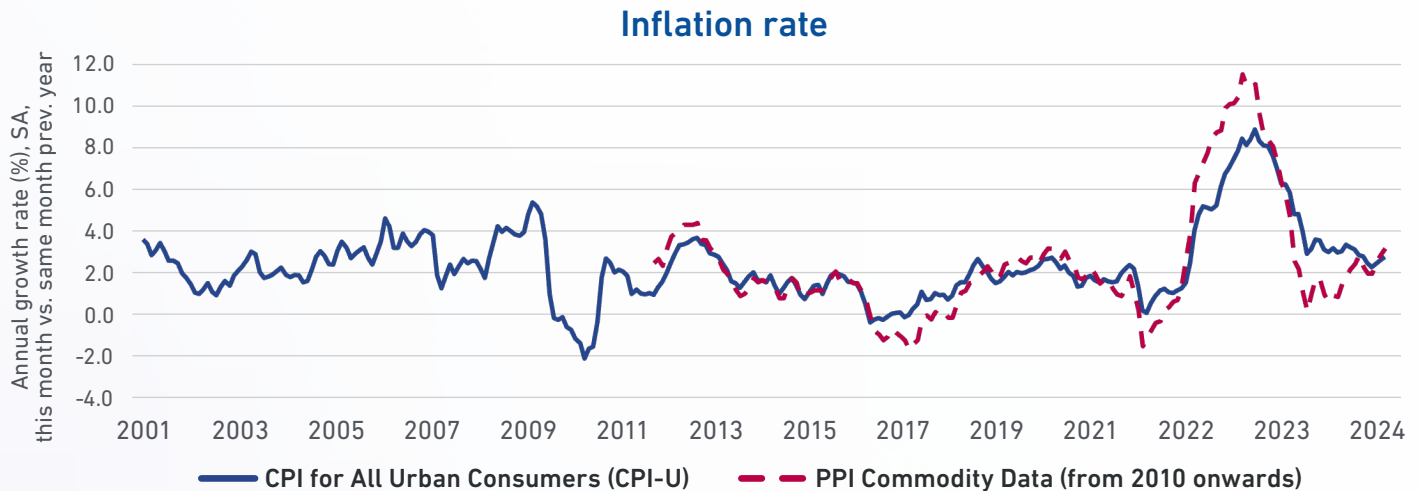
The U.S. economy grew strongly in 2024 aided by a strengthening in consumer spending as inflation started to dissipate, rising business investment as sentiment improved, easing interest rates in the latter half of the year, and an increase in government spending. This positive momentum is expected to continue into 2025 supported by a strong labor market and robust real wage growth, aiding consumer spending and encouraging further expansion in business investment. However, growth is projected to be weaker than last year, primarily due to the uncertainty surrounding president-elect Trump's proposed policies, including potential import tariffs and mass deportation of immigrants. While inflation is expected to ease, it will likely remain above target levels, prompting the Fed to maintain higher interest rates for a longer period. As such, elevated borrowing costs could dampen private investment and consumption.

## Recent data and trends

**The US economy expanded by 3.1% SAAR in the third quarter of 2024.** This growth was driven by robust consumer spending, increased exports, and higher federal government expenditure. The easing of borrowing costs and improved business and consumer sentiment also played significant roles. However, despite these positive factors, interest rates remain elevated compared to recent years. Additionally, ongoing supply chain disruptions have negatively impacted the construction sector, leading to declines in residential fixed investment and private inventory investment.



In November 2024, industrial production in the US fell by -0.1% on a month-on-month basis. Manufacturing output, which accounts for 78% of total production and final products, rose by 0.2%. Conversely, mining decreased by -0.9% and utilities output fell by -1.3%. It is anticipated that we will see industrial production increase over 2025 aided by the pro-business Trump office and the expected business tax cuts helping to promote growth within the US. If the new President proceeds with protectionist tariff policies, manufacturing is likely to see the largest share of the benefits as domestic consumers switch from imported to US goods. However, those intermediary manufacturers who rely on imports for parts, will see costs rise which may result in a squeeze on their bottom line.



Source: Bureau of Labor Statistics

**Total retail sales in the US increased by 0.4% month-on-month in December 2024 and were 3.9% higher than a year earlier**, in part due to Black Friday weekend and Cyber Monday sales as households took advantage of the discounts in the lead up to Christmas. It is anticipated that retail sales will remain on an upward trend as real wages continue to grow into 2025 improving overall affordability.

**The CPI 12-month inflation rate rose to 2.9% in December 2024 from 2.7% in November, in line with market expectations.** This rise was partly driven by base effects as energy costs declined less significantly compared to the previous year. Additionally, food inflation rose as producers continue to pass higher wage and shipping costs to consumers. However, shelter costs decreased to 4.6%, the lowest rate since January 2022, supported by falling borrowing costs.

The labor market remains tight, with the unemployment rate falling slightly from 4.2% in November to 4.1% in December and employers adding 256,000 jobs in December. **Long-term unemployment increased by 278,00 compared to a year earlier, remaining relatively unchanged from the previous month and making up 22.4% of the unemployed population.** There are concerns that the Fed will reduce interest rates at a more gradual pace due to expectations that inflation will stay above the 2% target rate while the labor market is currently remaining healthy, despite elevated interest rates.

**The Consumer Sentiment Index, from the University of Michigan, for the US, fell slightly to 73.2 in January compared to 74.0 in December.** Strong sentiment in recent months has been driven by easing concerns over the current cost of living. However, the dip in January reflects worries of the future path of inflation for the year ahead.

In line with expectations, the Fed cut the fed funds rate by 25 basis points in November and December, **to a range of 4.25-4.50% due to signs that inflation was easing towards the 2% target.** However, the Federal Open Market Committee aired caution, highlighting that it would only lower the base rate twice more in 2025, lower than market expectations. This is due to forecasts for core inflation to stay above the 2% target next year, driven by strong wage growth and rising shelter inflation as prior increases in mortgage rates are passed onto renters. The Fed will remain vigilant due to the potential implementation of tariffs, tax cuts and mass deportations when Trump takes office, which may become inflationary.

### Scenario overview

The US economy experienced robust growth throughout 2024, a trend that is likely to persist into 2025. The new administration is expected to implement business deregulation and tax cuts fostering increased business investment and stronger wage growth. However, the uncertainty surrounding president elect Trump, particularly his proposed import tariffs, could have a negative impact on business and consumer sentiment. The latest economic activity indicators reveal a resilient picture although considerable downside risks remain. Linger above-target inflation and geopolitical tensions are expected to continue, posing considerable challenges to international trade and the global economy. Additionally, the Fed is predicted to maintain higher interest rates for an exceeded period, which could dampen private investment and consumption due to elevated borrowing costs. On a positive note, supply chain disruption has been minimal, and inflation is expected to continue to ease, albeit more slowly than previously forecast, while the labor market remains strong for the time being. This should lead to the third base rate cut being implemented in May.

**Sales of previously owned homes in the US surged by 4.8% month-over-month in November, reaching a seasonally adjusted annual rate of 4.15 million units, the fastest growth since March 2024.** This upward trend is expected to persist into 2025, driven by falling interest rates, improved affordability from strong real wages, and prior elevated savings rates that will help first-time buyers enter the housing market.

Personal income in the US expanded by 0.3% month-over-month in November 2024, as reported by the Bureau of Economic Analysis. The monthly rise in overall personal income was primarily attributed to increased compensation, partially offset by the decrease in personal income receipts on assets and personal current transfers. Similarly, real disposable personal income (DPI), which factors in personal

current taxes, saw a monthly increase of 0.3%. The Personal Consumption Expenditures (PCE) price index (a measure of inflation) increased by 0.4% in November.

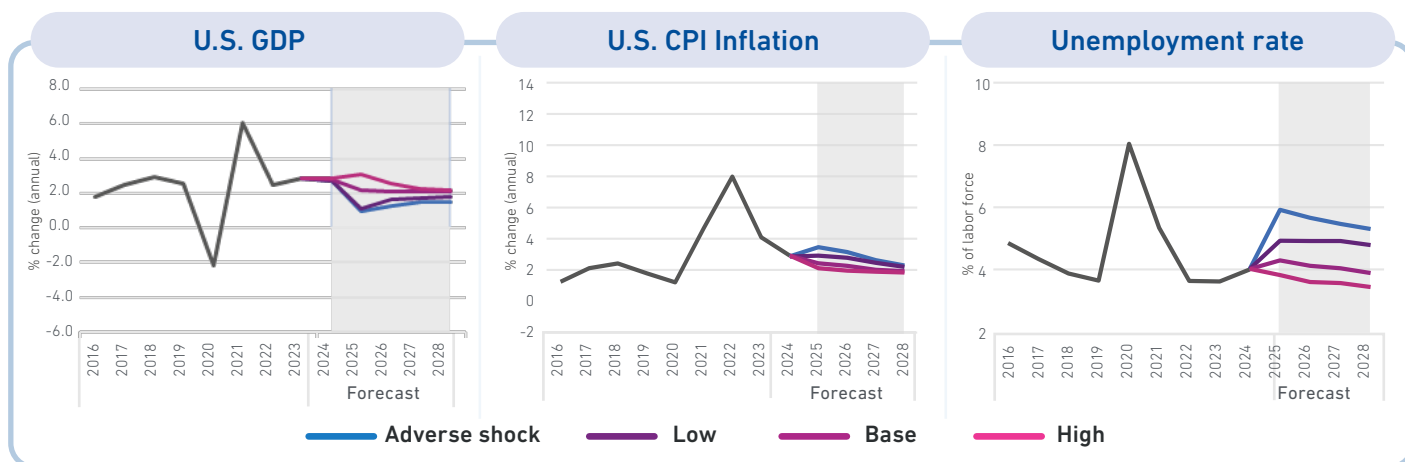
**US consumer prices (on the CPI measure)**

**rose by 0.4% from the previous month**, partly driven by base effects as energy decreased at a slower pace compared to the previous year. The annual core consumer price inflation rate, which excludes volatile items such as food and energy rose 3.2% year-on-year in December 2024. Looking ahead, it is anticipated that inflation will stay above the 2% target rate in 2025, mainly due to continued pressure from energy, rental and food costs, although these are expected to ease. However, if Trump proceeds with significant import tariffs and mass deportation of immigrants, it could lead to upward inflation pressure as increased import and labor costs are passed onto consumers.

The labor market has shown significant strength, experiencing a rise in payrolls, stable wage growth and low unemployment. However, we expect that the high-interest rate environment over the past year and expectations that rate cuts will come only gradually will weigh on firms hiring plans and the retention of employees.

## Macroeconomic scenarios

Base	<p><b>The base scenario sees GDP expand at an annual rate of 2.2% for 2025 overall.</b> Persistent core inflation, prolonged elevated interest rates, tighter lending standards and heightened uncertainty from the Trump administration are expected to pressure economic activity and pose challenges for households and corporations. Consumer spending has shown resilience and is likely to continue as the Fed progresses with its base rate cutting cycle, albeit more slowly than previously anticipated. We believe CPI will remain above the Fed's target of 2% until 2027. The labor market, while resilient, is expected to weaken slightly, with the unemployment rate edging up to 4.3% in 2025 and 4.1% in 2026 reflecting the lagged effects of prior interest rate hikes.</p>
High	<p><b>The underlying assumptions behind the optimistic scenario reflect that inflation will ease more swiftly to around 2.2% in 2025,</b> which encourages the Fed to drop interest rates more aggressively. This scenario indicates that economic growth holds steady at 3.1% for the year aided by the potential deregulation and business rate tax cuts promoting private investment. This outlook is bolstered by positive spill-overs from the global economy, minimal further supply chain disruption, and consumption remains robust despite heightened uncertainty. The labor market remains tight, and the unemployment rate falls to 3.8% in 2025, helped by lower borrowing costs.</p>
Low	<p>This scenario assumes inflation will prove stickier than expected averaging 3% in 2025. Economic activity will be muted, with GDP growth easing to 1.1% for 2025. <b>This scenario anticipates the imposition of tariffs on Mexico, Canada and China, resulting in upward inflationary pressure and no cuts to the interest rate in 2025.</b> Consequently, high borrowing costs are expected to squeeze firm profitability, resulting in workforce downsizing and significant reductions in job openings and hiring. This underpins an unemployment rate of 4.9% in 2025 and 2026.</p>
Adverse shock	<p>The adverse shock assumes the realization of several downside risks including the escalation of the conflict in the Middle East, a more severe negative impact of high interest rates, increased geopolitical tensions, and Trump tariffs imposed to Canada, Mexico and China leading to persistently high inflation. <b>This scenario assumes relative resilience in the economy with growth of 0.9% registered in 2025.</b> Inflation remains above 3% until 2027, due to a surge in import prices for goods, oil and gas as well as heightened supply chain disruptions. These factors will adversely affect household budgets, spending and investment, though increased energy independence in the US will lead to some dampening of the impact. Unemployment increases to 5.9% in 2025, reflecting the difficulties of the corporate sector and significant cost reduction plans.</p>



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