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# The economy’s strength surprised forecasters in 2024 — can it maintain momentum in 2025?

**As 2024 draws to a close, data suggest the U.S. economy, supported by strong consumer spending, will end the year on solid footing. But many businesses and consumers still suffering from higher prices and interest rates are looking to a jolt from the holiday season to boost their optimism. While November’s presidential election answered one pressing question, it prompted many more about the economic effects of the new administration’s policy agenda.**

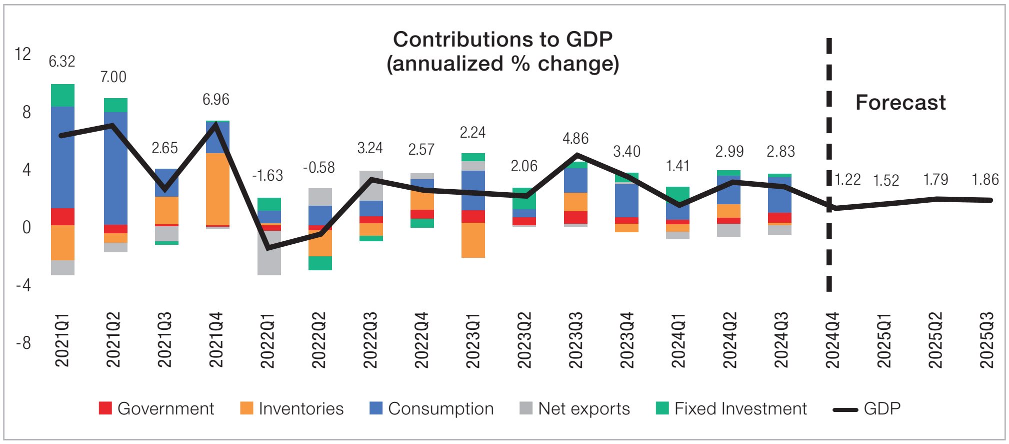
**More clarity in 2025 will likely help consumer confidence make some headway — especially if inflation continues to moderate and interest rates continue to decline. This should help close some of the gap between a cautiously optimistic business climate and a strong economy. However, the strength of the economy may become a little more uncertain, as economists and forecasters don’t necessarily expect the same economic momentum from 2024 to continue through 2025.**

## Overview: The U.S. economy continues to outperform expectations

The U.S. economy continues to perform exceptionally well: It’s operating at full employment, and both the stock market and house prices are at record highs. GDP growth for the third quarter came in at 2.8%, inflation is low and stable, and interest rates have likely peaked.

With the Personal Consumption Expenditures Index (the Federal Reserve’s preferred inflation measure) remaining fairly steady in recent months, the Fed looks positioned to maintain a gradual pace of rate cuts. It made a cut of 25 basis points at its meeting on November 7, 2024, and at the time of publication, odds are a little above 50% that it will do the same at its December meeting. Of course, as policy plans for the first 100 days of Donald Trump’s second presidential term become clearer and take effect, the Fed may adjust its approach, particularly if inflationary forces reemerge.

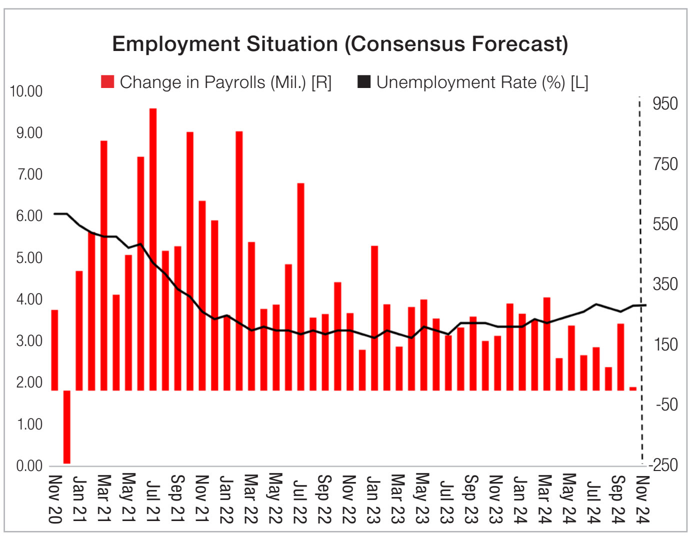
Meanwhile, consumers continue to support broader economic growth via spending, especially as the slowing but still-strong job market boosts incomes over inflation, increasing purchasing power.




**Source:** Bureau of Economic Analysis (BEA), Moody's

## Hurricanes and a strike dent job growth, but consumer confidence ticks up

U.S. payroll employment rose by just 12,000 in October, with the Boeing workers strike and hurricanes Helene and Milton contributing to the decline in job growth. However, one month of weak performance does not suggest a trend. The average gain over the past three months is now 104,000, but it will almost certainly recover in the coming months.




Despite the poor month of job growth in October, consumer sentiment improved incrementally. The Conference Board's Consumer Confidence Index increased more than expected, to 108.7 from an upwardly revised 99.2 in September. This represents its strongest monthly gain since March 2021. However, it remains within the same narrow range it has occupied for the past three years. The University of Michigan Consumer Sentiment Index also inched higher in October to 70.5 (up from September's 70.1).

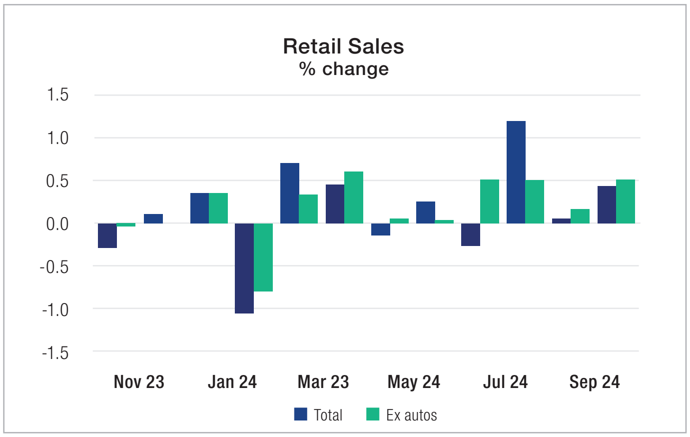
Still, the latest surveys reflected a degree of uncertainty about the outcome of the 2024 election, and many lower-income households are struggling financially, as evidenced by increased credit card and subprime auto loan delinquency rates. However, clarity about the election and resulting policy changes could lead to improved sentiment in 2025. If inflation continues to moderate and interest rates continue to come down, consumers could be more confident in the coming months.

## Consumer spending continues to drive economic growth

Consumer spending was once again the largest contributor to economic growth during the third quarter of 2024. According to Deloitte's financial well-being index, consumers expect to spend more on housing and utilities, as well as leisure and travel, in the coming months. Discretionary spending intentions have increased for four months in a row. At the same time, while financial sentiment is steadily improving among higher-income households, middle- and lower-income households don't share that outlook, with sentiment remaining relatively flat overall since 2022.

Looking ahead, stimulus or other fiscal support for consumers doesn't appear to be on the horizon, and lower earners who are feeling less confident about the economy may start to pull back on spending. Donald Trump talked on the campaign trail about eliminating taxes on Social Security income and tips, which could provide some relief to these households — but whether those policies will come to pass is still to be determined.

Retail sales growth accelerated modestly in October, with total sales rising 0.4% from September, and up 2.8% from a year ago. Services are leading increases in consumer spending as prices for services remain higher, but real service spending growth also remains steady and modestly above goods. However, a risk is that consumers who expect interest rates to decrease over the coming months may delay non-urgent purchases that involve financing, such as major appliances. Less growth in wages as the labor market slows could also become a drag on retail sales. Finally, the amount of excess savings available to consumers continues to decline, but as of yet, this hasn't had a clear effect on spending.




**Source:** Census Bureau

## Business leaders are skeptical, but some look forward to holiday boost

For business leaders, skepticism about the economy persists. The NFIB's Small Business Optimism Index increased 2.2 points to 93.7 in October. This marks the 34th straight month in which optimism has fallen short of its 49-year average, which is 98. The outlook among small business owners may improve with a boost from holiday sales activity and the fading of election-related uncertainty.

A survey of CEOs at larger organizations also showed that sentiment skewed negative in October. Thirty-percent of those surveyed for The Conference Board's Measure of CEO Confidence said economic conditions were worse in the fourth quarter than six months ago (a slight increase over the third quarter) — and only 20% said conditions were better. Thirty-three percent expected economic conditions to improve over the next six months.

On the bright side, lending conditions are slowly loosening, which is a positive development for businesses large and small. And as with consumers, uncertainty over the outcome of the 2024 election likely affected business leaders' confidence to some degree. With a decisive result, confidence may improve in 2025.

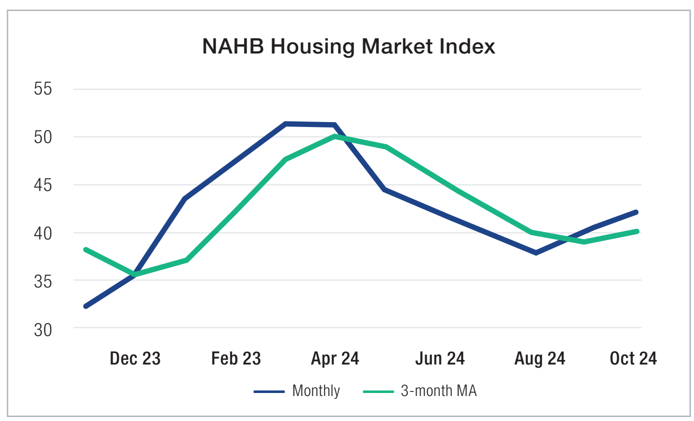
## Manufacturing contracts, services grow, housing market cools

Political uncertainty may also have contributed to a contraction in U.S. manufacturing activity. The ISM Manufacturing Purchasing Managers' Index (PMI) fell to 46.5 in October from 47.2 in September and has now contracted in 23 of the past 24 months. Purchasing and supply executives in the manufacturing sector also expressed concerns about the risk of forthcoming tariffs and national and global economic conditions. Supply chain stress remains manageable, while shipping costs are still higher, with the Drewry WCI composite index increasing 4% in October.

At the same time, the U.S. service sector remains on solid ground. In October, the ISM Services PMI increased from 54.9 to 56. The service sector has expanded in eight months of this year so far. Although it is predicted to slow in the near term, it is still expected to outpace the overall economy.

The U.S. housing market is cooling a bit, but home builder optimism increased slightly in October. According to the S&P CoreLogic Case Shiller Home Price Index, national house prices increased by 4.2% from a year ago in August, following a 4.8% increase in the prior month. Low affordability and a modest increase in the inventory of homes for sale are weighing on the pace of price gains.

Homebuilder confidence rose 2 points to 43 in October, according to the National Association of Home Builders' Housing Market Index. Improving expectations among builders were driven by the Fed's September rate cut of 50 basis points and hopes that it will translate into a lower 30-year fixed-mortgage rate. But at the same time, poor housing affordability weighs on builder sentiment, and the index remains below the 50-point threshold that indicates poor building conditions over the next six months. Despite the September rate cut and the Fed's more recent 25-basis-point November rate cut, 30-year mortgage rates are stubbornly remaining above 6%, and the housing supply shortage continues.




**Source:** National Association of Home Builders

## What comes next after a period of uncertainty

The U.S. economy outperformed expectations throughout 2024, but economists and forecasters don't necessarily expect that momentum to continue through 2025. With the 2024 election in the rearview mirror, uncertainty among consumers and businesses has subsided. But Trump's victory and the Republican party's newly minted majority in both houses of Congress raise new questions about policy priorities and their economic effects.

Supported by lower inflation and interest rates, businesses and consumers should have momentum on their side as we enter 2025. This will likely boost consumer confidence and increase business optimism — albeit incrementally. However, consumers are struggling at the lower end of the income distribution curve, and broader risks to the economy, such as geopolitical conflicts, policy uncertainty, and slowing job growth, could temper momentum.

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## About Benjamin E. Demko

Ben Demko manages the economic research and analytics team focused on macroeconomic, industry, and market risks that impact KeyBank's varied loan portfolios. He is responsible for proprietary, forward-looking perspectives on the economy and real estate markets that are used across the bank for stress testing, loss estimation, asset management, resource allocation, and profit planning. Ben joined KeyBank in 2005 and has nearly 20 years of business analytics, economic research, and risk management experience.