ACCESS/FORECASTS

SEPTEMBER 2024 SCENARIOS

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September scenario swap:

- **Baseline: Fed Soft Landing (60%):** Economic fundamentals remain modest, but policy realigns just in time to stave off a recession. The Fed makes two more 25bps cuts at the November and December meetings before pausing in January to see if inflation will drop for technical reasons at the start of 2025. This gives the economy enough juice until March when the Fed makes a 50bps cut in response to falling inflation and slower growth and investment. What happens after is even more uncertain, but we've penciled in three more 25bps every other meeting through the end of next year, which brings the 2025 yearend policy range to 3.00% - 3.25%.

    - **Since last week, we've tweaked our November rate forecast a bit—from no cuts to 25bps—in response to slightly more dovish language from FOMC members coming out of the blackout.**

- **Downside: Mild Recession (40%):** Too little, too late. The data remain mixed, which hides the economic weaknesses that continue to build beneath the surface. The inflation data don't cooperate enough for some policymakers to feel comfortable fully responding to emerging cracks with a 50bps cut in November and December, opting for the 25bps cuts outlined in our baseline forecast. Markets wake up to the fact that they've overpriced rate cuts, causing a mild rise in long-term yields, tightening credit conditions just as the economy needs more support. Many businesses and consumers stay on the sidelines, waiting for rates to bottom out, significantly reducing consumer spending and investment over the remainder of 2024. The economy limps through the holidays but falls apart in Q1 of next year. Without a financial event, the Fed is unable to assess the severity of the downturn with just backward-looking data and doesn't respond until March when they lower rates by 75bps, with another 200bps in cuts in April, bringing the policy range to 1.25% - 1.50%.

- **The election is complicating forecasts**. The 2024 election is likely to impact the economy more than in previous Presidential election years. There is still too much uncertainty to adequately model the effects of various election outcomes, so we've chosen to focus on three general scenarios that we believe have the highest likelihood of occurring. We've incorporated the most likely one into our baseline and downside forecasts.

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Election scenarios

- **Baseline: Dems win WH, split Congress. (50%).** What a difference a few weeks makes. After switching up the top of the ticket the two big M's – momentum and money – have given the Dems the inside track to winning the White House. However, we believe the down-ballot races will be close, which puts control of both houses of Congress up in the air. A split appears to be the most likely outcome, but this forecast is likely to change as we approach November. This would lead to a stalemate and few policy changes. The one exception is that we'd expect both parties to agree to extend much of the 2017 TCJA tax cuts as both parties will be unable to push their proposals across the finish line, and neither will want to raise taxes on key constituents.

- **Alternative 1: Dems win WH, sweep Congress (10%).** The turnaround in the Democratic ticket has been striking. Right now, we give a slight edge to the scenario where Congress is split between the Democrats and Republicans, but we wouldn't be surprised to see alternative 1 as our baseline in September as down-ballot candidates are likely to get another boost following the convention. This scenario would have broader economic implications than our current baseline where the houses are split and not much is accomplished. Harris has adopted Biden's budget proposal to raise taxes on corporations and high earners to close the deficit. Enactment of a version of that budget proposal is likely under this scenario.

- **Alternative 2: Republicans win WH, split Congress (40%).** The recent surge in democratic support makes a complete sweep extremely unlikely. That would lead to an economic legislative environment that would be similar to our current baseline scenario – not much accomplished. However, a re-elected President Trump has promised major executive policy changes that would impact the economy such as currency depreciation, tariffs and sacking Fed officials. He can't do much about the latter, and Republicans are already pushing back on the extent and size of tariffs, but he may be able to use the US Treasury to depreciate the dollar by buying foreign notes.

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Unprecedented:

- Never before have policymakers lowered rates in an expansion while having their hands tied by forward guidance and the Summary of Economic Projections (SEP). Here's why that matters.

    - Forward guidance, the policy of explicitly signaling the future direction of monetary policy, was a powerful tool implemented in the early 2000s to reduce market volatility from rate decisions. Following the Global Financial Crisis, it was an essential strategy that kept long-run rates like the benchmark 10-year Treasury yield in check, providing the economy even more accommodation.

    - While Powell and many FOMC members have dialed back explicit communication noticeably this year, they still provide a hefty amount of guidance to reporters and markets who have come to expect it. The same is true of the SEP forecasts, which are a form of forward guidance. That communication builds consumer and market expectations, allowing them to partially front-run Fed decisions. The effect has grown in the age of the internet and centralized communication networks.

    - However, policymakers are about to feel the other edge of the sword as their explicit forecasts and communication on how much they expect rates to drop will cause consumers and businesses to wait for borrowing costs to come down a lot more, causing consumer spending and investment to at least cool, and potentially contract.

    - Unfortunately, there isn't an easy way out. Policymakers would have to end the SEP and drastically change their communication strategies, which would roil markets and the economy.

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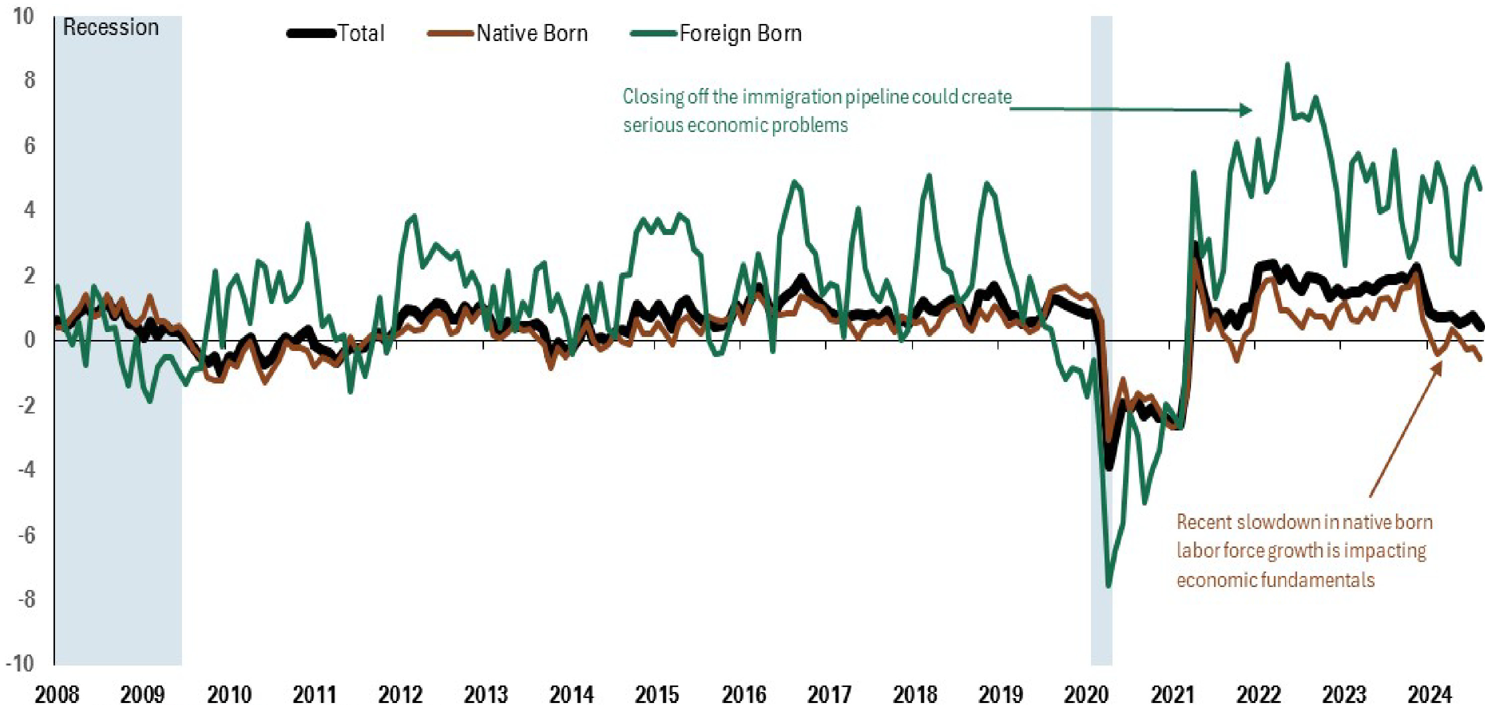
A key fundamental is losing even more steam



Strong labor force growth is likely over

- Immigrants have so far saved U.S. labor force growth in 2024.
- Growth in native-born workers plummeted late last year, reducing the supply of workers.
- Some of the impact was blunted by strong growth in the foreign-born workforce.
- However, immigration has slowed this year, suggesting that foreign-born labor force growth is headed for a slowdown – made worse by potential post-election changes in immigration policies.
- The good news: there may still be some momentum in the pipeline. It takes time for immigrants to enter the workforce, particularly if they're asylum seekers, as many were last year. That backlog should help soften the blow as the immigration boost subsides.

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It's unclear if the Fed is ahead of the curve

Did the Fed wait too long?

No

Economy doesn't need major rate adjustments in 2024.

Soft landing

Likelihood: 60%

Yes

100bps – 125bps in cuts isn't enough

Mild recession

Likelihood: 40%

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Labor market showing additional strain

Data revisions show more labor market decline

(Weather-adjusted employment gains, 3m moving avg., thousands)

400
350
300
250
200
150
100
50
0

Pre-Revision
Post-Revision
2017 - 2019 Avg.

Jan-23
May-23
Sep-23
Jan-24
May-24

Sources: Federal Reserve Bank of San Francisco, Bureau of Labor Statistics, Access/Macro.

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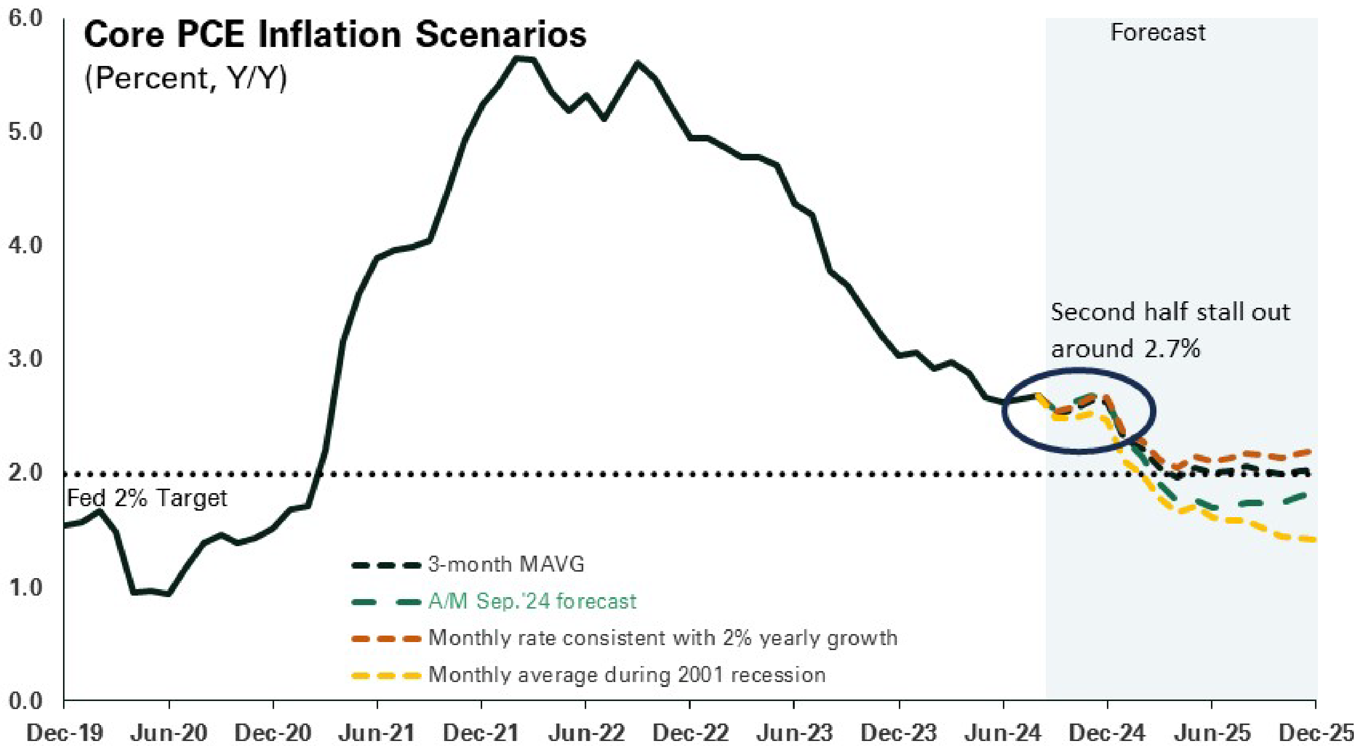
Inflation to stall before falling in early 2025



The latest data was encouraging

- The latest m/m growth rate for core PCE came in at 0.13% - a heartening sign that inflation is slowing. Even if we continue to get soft monthly readings like we did in the August data, the y/y will stay stuck around 2.7% in 2024 for technical reasons.
- An increasing number of policymakers will look through the H2 stall out if the monthly pace of core PCE growth remains weak as help is coming in early 2025 when the y/y rate is all but guaranteed to fall.
- The m/m pace needed to hit 2% over 12 months is 0.165% monthly. When inflation is above that, we need an even slower month to even out.

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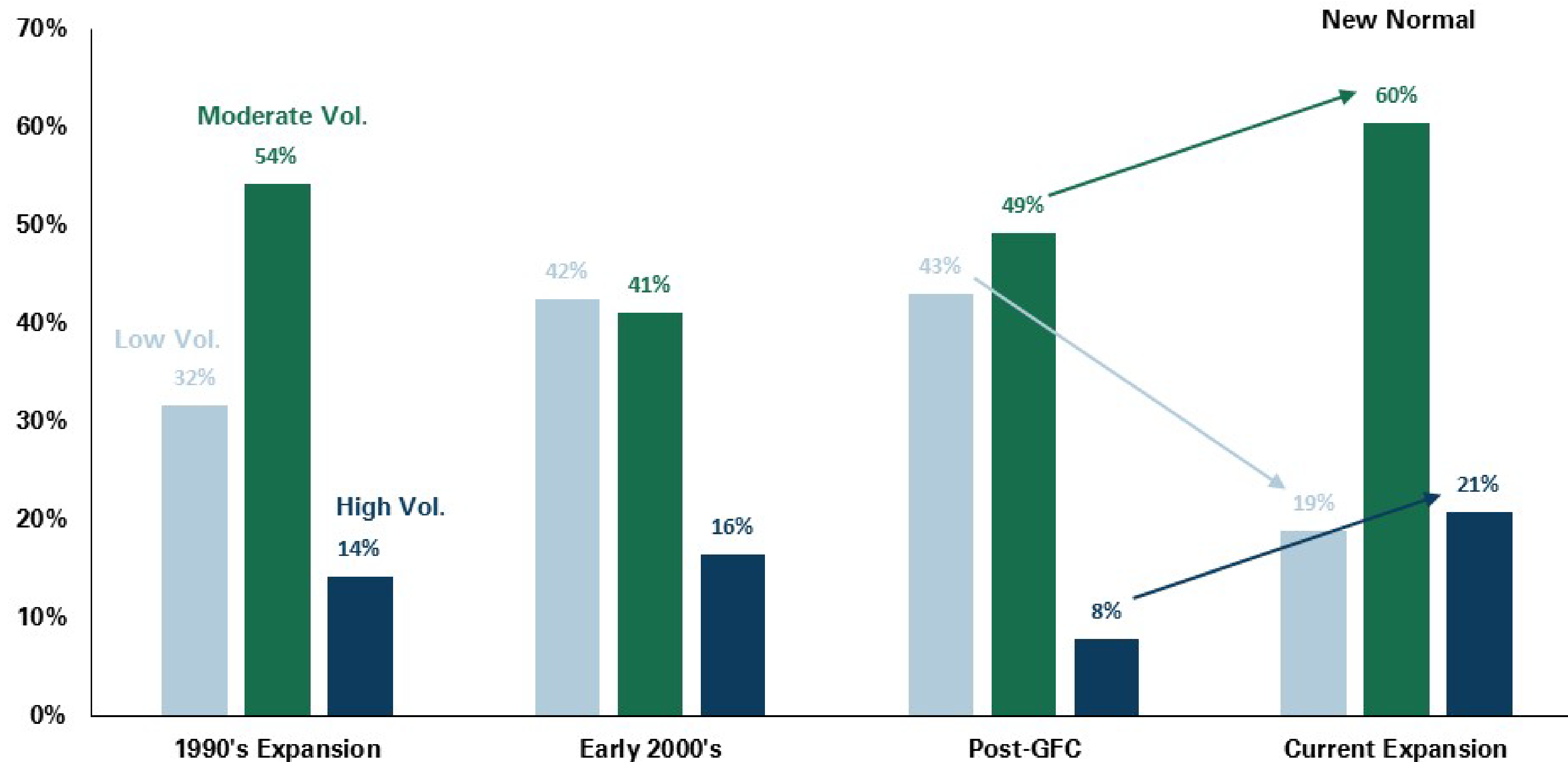
It’s a new era of market volatility



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What would make us more confident that …

…that economic fundamentals aren't easing:

1. Job gains rise above 200k/month, AND the unemployment rate continues to increase. This would be a sign that the supply of workers remains abundant and employers can absorb entrants.

2. AND, productivity jumps again in the third quarter.

… a recession is imminent:

1. Personal consumption expenditures (household purchases) contracts for two consecutive months.

2. The weather-adjusted monthly change in employment contracts for two consecutive months.

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Meet the Access/Macro team

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Tim is known for going beyond the usual economic jargon to make macroeconomics relatable and actionable for executives and decisionmakers in real-time. He spent 12 years as an economist, economic business consultant, and sought after speaker who has been a trusted advisor to monetary policymakers, executives at Fortune 50 companies, and Boards in just about every industry you can imagine. He has extensive public policy experience having worked as a forecaster at the International Monetary Fund and Federal Reserve Bank of San Francisco, and spent two years as the chief of staff and senior advisor to both the President and the COO of the SF Fed. His research remains influential with policymakers, and he is regularly quoted in major media outlets.

Tracy Basinger
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Tracy is a strategic leader with extensive executive experience. She served as the head of bank supervision from 2017 to 2021 at the Federal Reserve Bank of San Francisco, leading a 350-person team that conducts prudential and consumer protection supervision across a portfolio of community, regional, foreign and large complex banking institutions. During her 30-year career at the Fed, Tracy formed the Fed System's first Fintech team, served as a representative on the Basel Committee's Task Force on Financial Technology and led the System team charged with developing recommendations to enhance the Main Street Lending Program to better serve SMEs, CDFIs and MDIs.

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Kevin is a mostly retired bank regulator with over 34 years of bank regulatory and risk management experience. He retired from the Federal Reserve Bank of San Francisco in 2022 as a Senior Vice President with oversight responsibilities for Regional, Community and Foreign Financial Institutions. During his career with the Federal Reserve, Kevin served in various roles, including officer over the Applications and Enforcement areas, the Risk and Analysis function, and oversight for the Bank's Asia program. His experience includes credit portfolio analysis, risk management, market and liquidity risk, and bank operations. And he has a soft spot for community and regional banks. From 2011 to 2022 he served on the board of directors of the Pacific Coast Banking School.

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