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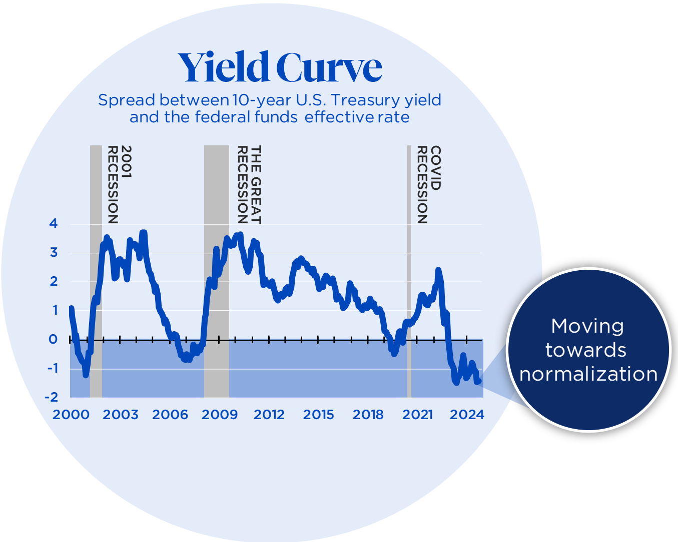
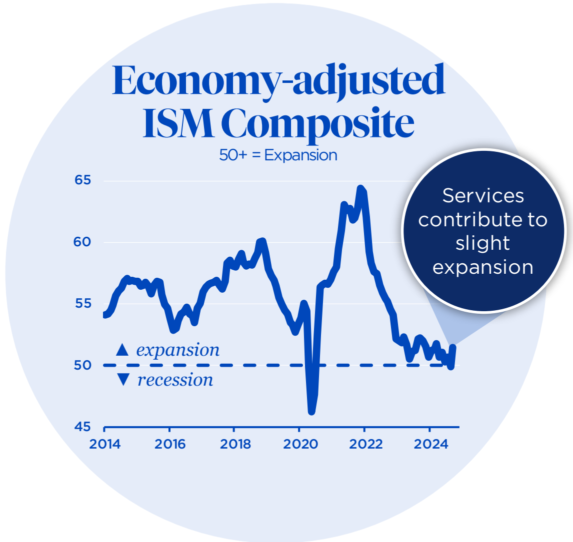
Economic & Financial Markets Monthly Review | October 2024

Improved data calm growth concerns

Where is the economy now?

Solid hiring and spending trends extended through the end of the third quarter. However, economic growth is expected to downshift in the fourth quarter due to the drag from elevated interest rates, inflation fatigue felt by consumers, and an additional hit to growth from hurricanes Helene and Milton. After the Fed jump-started its easing cycle with a large rate cut in September, more modest rate decreases are expected in November and December as the Fed continues to recalibrate policy to a less restrictive stance.





Where we are this month

Soft landing odds are still higher

Economic growth should run below trend in the fourth quarter and into 2025 as consumer activity wanes, but the downside should be limited.

Yield curve steepens further

The spread between the 10-year Treasury rate and the fed funds rate tightened considerably following the Fed's large rate cut in September.

Services still leading the way

The ISM composite index (a waited share of manufacturing and services) rose in September and still shows modest expansion.

What does this mean

- A soft landing is still the most likely scenario over the next year as sharp interest rate declines from the Fed should ease cost pressures on businesses and prevent widespread job losses.
- There are downside risks for the economy from geopolitical tensions and concerns that the Fed might have waited too long to ease monetary policy. This keeps a mild recession in 2025 as a plausible risk to our outlook.

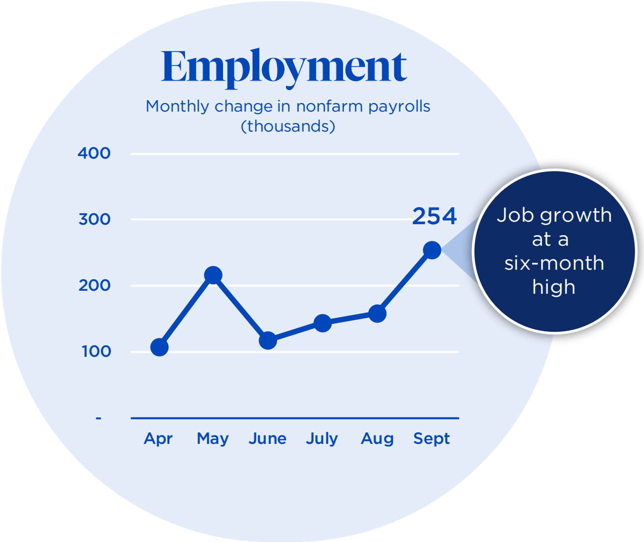
- With the Fed expected to pursue successive rate cuts at upcoming FOMC meetings, the fed funds to 10-year spread should dis-invert by mid-2025, ending the longest period of yield curve inversion in U.S. history. We expect the curve to steepen further into 2026 with long-term rates holding relatively stable.
- While the yield curve has historically normalized ahead of downturns, the next recession is more likely to be delayed by a soft landing.

- The service sector remains the growth engine for the economy as consumers continue to shift their purchases towards travel, eating at restaurants, and other service activities over buying goods. But there are growing signs that more households have reached their spending limits.
- Manufacturing is still mired in slight contraction with demand for goods down both domestically and within the international market.

Economic Review

Uptick in hiring and spending to end Q3

Job gains jumped in September and upward revisions to the prior two months indicate stronger hiring demand than previously anticipated. Additionally, the unemployment rate fell, and wage growth climbed to a four-month high. The resilient rise in jobs and wages suggests that Fed officials are likely to opt for a smaller 25 basis point (bp) rate cut in November, after the large 50 bp reduction in September. The overall downward trend in inflation provides reason for Fed officials to continue lessening the still-restrictive stance of monetary policy.



Where we are this month

Inflation advances more than forecast

The annual pace for headline CPI fell to 2.4 percent in September, but the core rate climbed slightly to 3.3 percent as services inflation remains stubbornly fast and good prices firmed.

Job growth surprises to the upside

Nonfarm payrolls climbed a surprising 254,000 in September, while the unemployment rate fell for a second straight month to 4.1 percent.

Demand for services remain high

The new orders component of the ISM services index climbed in September to 59.4, indicating strong growth in new orders in the service sector.

What does this mean

- Headline and core inflation was modestly faster than expected in September. Annual core inflation climbed for the first time since March 2023 due to large gains in both medical care and transportation services.
- Residential rental inflation climbed a relatively soft 0.3 percent in September, but the 3- and 6-month annualized rates are still highly elevated at 4.8 and 4.6 percent, respectively. Further cooling of rents will be key to bringing inflation back to trend.

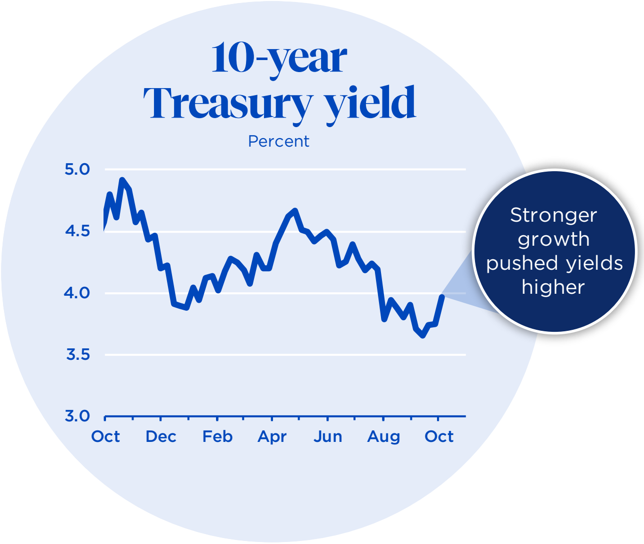
- Job gains spiked to a six-month high in September, but most of the advance remains concentrated in a few sectors — led by health care and social assistance, leisure and hospitality and government. While overall employment gains signal resilience, it is not a broad-based booming labor market.
- The unemployment rate fell to a three-month low 4.1 percent, while wage growth climbed back to 4.0 percent — both indicate a tight labor market, albeit looser than over the past few years.

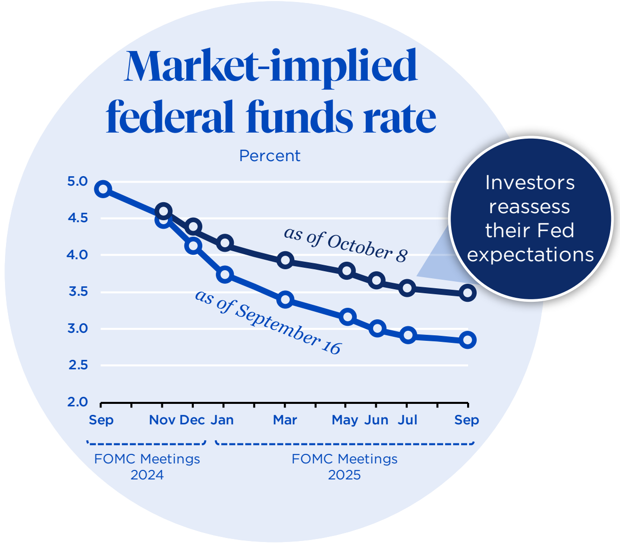
- After dipping briefly into contraction in June, new orders for services have rebounded sharply over the past three months. Now at the highest level since early 2023, the latest reading suggests continued solid spending on services ahead.
- New orders often lead the broader index, suggesting a downturn in services shouldn't be expected over the rest of 2024 and should continue to be the driving force behind economic growth.

Financial Market Review

Investors see the glass half full

A persistently buoyant economy is lifting investors' spirits and spurring a recalibration of Fed interest rate expectations. We think the economy will maintain healthy momentum through year end as an additional 50 basis points of Fed easing supports continued hiring and spending activity. We expect the Fed to scale back the size of its rate cuts to 25 basis points per meeting as policymakers recalibrate the level of interest rates to a less restrictive level that is consistent with ebbing inflation.





Where we are this month

What does this mean

Equities climb higher

Stocks have resumed their upward trend after a minor retrenchment. In a sign of lingering anxiety, the VIX remains elevated, and commodity prices stand not far above their recent lows.

- Equities regained their vigor as the economic data — particularly on the labor front — portray firm growth. Despite the potential for turbulence, the economic and corporate backdrop should support equities into the new year.
- Valuations remain lofty despite prevailing uncertainties on multiple fronts. And in a sign of underlying vulnerabilities, the gains are still concentrated in a select number of stocks.

Interest rates increase

A firmer than expected economic environment led interest rates to reverse course with 10- and 2-year Treasury yields now at their highest levels since late July 2024.

- Short-term U.S. Treasury yields have unwound recent declines amid less conviction the Fed will loosen policy quickly. The 2-year Treasury yield is about 50 basis points (bps) above its recent low.
- We forecast another 50 bps of Fed easing before 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.

Investors rethink their Fed views

Bond investors are trimming their Fed rate cut bets after the September jobs report greatly exceeded expectations and the wider set of economic data dash hopes of another 50 basis point rate cut.

- Investors welcomed the positive economic news amid greater confidence in a soft landing. However, they are also confronting the reality the Fed may not loosen policy as quickly as desired.
- We think the Fed remains committed to reducing the burden of elevated borrowing costs. Our forecast shows further policy easing unless growth and inflation surprise consistently to the upside.

Outlook

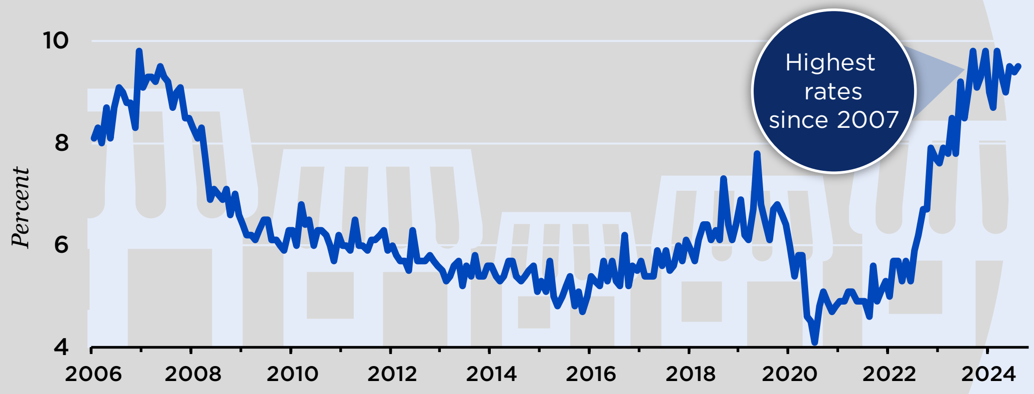
Lower rates should lift business investment

Cost pressures from high interest rates and rising operating costs have caused many businesses to curtail investments this year to maintain profit margins. Small and medium sized firms have been hit the hardest with borrowing rates running at the highest levels since 2007 and banks maintaining tight lending standards. Unsurprisingly, only four percent of small business owners responded that “now is a good time to expand” within the NFIB August survey.

Credit conditions for businesses are set to ease over the next year with the Fed projected to sharply lower interest rates. This should lead to more attractive loan rates for businesses to fund expansions in operations. The favorable economic backdrop should also encourage banks to loosen lending standards a bit. Reduced inflation for input and labor costs should also provide capital for firms to invest.

If lower interest rates can prevent businesses from cutting workers and, instead, start to make investments, then chances improve for the economic expansion to continue throughout 2025.

Interest rate paid by small business borrowers



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Data as of October 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.9%	2.7%	1.6%	1.9%	1.8%
UNEMPLOYMENT RATE	3.6%	4.1%	4.6%	4.4%	4.2%
INFLATION [1] (CPI)	3.2%	2.6%	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%	4.8%	3.2%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.6	15.6	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%	3.55%	3.50%	3.40%	3.40%
10-YEAR TREASURY NOTE [2]	3.88%	3.75%	3.78%	3.80%	3.80%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.00%	5.20%	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*

Inflation to settle into a cooler trend

The downshift in economic growth to a soft-landing pace should help inflation to stabilize just above 2.0 percent in 2025. Upside risks from geopolitics and housing costs remain, but the broad fundamentals suggest cooler inflation from here.

Lower mortgage rates to support home sales

Falling loan rates should help to boost sales activity as borrowing costs for buyers decline. But an influx of listings from current owners may not materialize until rates approach 5.0 percent, which is not expected to occur until late 2025 or 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

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	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Economy-adjusted ISM index	*Institute for Supply Management; Nationwide Economics*
2 |	**Economic Review**	
	Nonfarm payroll gains	*Bureau of Labor Statistics*
	Rental inflation	*Bureau of Labor Statistics*
	ISM Services: New orders index	*Institute for Supply Management*
3 |	**Financial Markets Review**	
	S&P 500	*Standard & Poor's*
	10-year Treasury yield	*Federal Reserve Board*
	Fed funds expectations	*Bloomberg*
4 |	**Outlook**	
	Interest rate for operating loans	*National Federation for Independent Business*
	Latest Forecast	*Nationwide Economics*

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