// THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: (609) 529 -1300
www.EconomicOutlookGroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

December 9, 2024

Trump vs Powell: America's Pay-per-View UFC for 2025

There is a buzz in Washington that forces are lining up for a major battle next year between Fed chief Jerome Powell's vow to be apolitical when setting interest rates --- versus a muscular new Administration that's willing to crush any opponent or agency that dares get in the way of its economic goals. This clash will likely test the US central bank's ability to resist external political pressure as never before.

To appreciate the etiology of this coming brawl, we have to take a few steps back. Context is everything.

If the Federal Reserve is truly "data dependent," as it ceaselessly claims, then the decision at their meeting next week should be a no-brainer. It's time to pause; hold rates where they are and assess if inflation is starting to deviate from its downward path. I say this because there's a gnawing sense that progress to embed inflation at 2% has stalled, if not reversed course.

A look at the Fed's dashboard of most-watched metrics reveals an economy that has not only re-energized, but also show signs that inflation appears to be nudging in the wrong direction. Let's check on some of those metrics.

Inflation

One yellow flag was the recent pivot back up in the Fed's key inflation gauge. Instead of moving closer to the 2% target, the headline Personal Consumption Expenditure (PCE) price index rose to an annual pace of 2.3% in October, up from 2.1% the month before. Far worse was the performance of core PCE; it jumped by 2.8% over the year, the fastest pace since last April! Yes, inflation rarely moves in a

straight line. But what makes these numbers more worrisome is that the economic forces that should encourage disinflation appear to be fading. How so?

GDP

Let's start with the pace economic growth. It continues to exceed its non-inflationary speed limit (potential GDP), which is thought to be 1.8% to 2.0%. The economy has expanded close to 3% in the second and third quarter --- and all indications point to it growing even faster this quarter. The *GDPNow* calculation published by the Federal Reserve Bank of Atlanta projects real GDP growth is so far accelerating at a 3.3% rate in Q4. This has to cause a chink in the confidence of Fed officials that inflation will continue to cool.

Employment

The final jobs report of the year came in better than consensus forecast. Payrolls jumped by 227,000 in November, and there were upward revisions to hiring in both September and October. Obviously, there is some statistical noise in the data due to Hurricanes Helene and Milton and the strike at Boeing, so the Fed will not place too much weight on a single report when it deliberates next week. The unemployment rate did tick up to 4.2% from 4.1%, but here again it's likely the storms and strikes further muddled the household survey, which typically has been a highly volatile series.

What can safely be said is the Fed has met one side of its mandate, which is for the economy to reach maximum employment. The question now is whether the central bank is losing its grip on the other side of their mandate --- assuring price stability.

Job openings, quits and layoffs

Now that the economy is picking up speed, employers have posted more open positions. Job openings rose to 7.74 million in October, up 372,000 from the month before, according to the JOLTS report. Most of these vacancies were with small businesses, which is noteworthy since they tend to be more sensitive to shifting winds in the economic cycle. Evidently, these firms see enough clear skies ahead to justify creating these new posts. Consistent with that pattern is that layoffs in October plummeted by the most 1 ½ years. Quits also surged to 3.33 million, the highest in five months.

Consumer optimism

Americans seem to be in an upbeat mood as well. The preliminary consumer sentiment survey by the University of Michigan shows the level of optimism in early December was the highest in seven months! This comes on top of the Conference Board's report that Consumer Confidence in November leaped to the highest in

more than a year! Good news, yes. But I suspect Fed policymakers are somewhat bemused. Americans are faced with record levels of household debt and still high

interest rates. If you look at the data out by the New York Federal Reserve (*Household Debt And Credit Report - 3Q*), it shows serious delinquencies (90 days + overdue) on credit card debt and auto loans soaring to levels approaching the 2008 – 2009 financial crisis. Yet based on these consumer confidence surveys, Americans still seem comfortable enough to keep on spending and borrowing —- and this is a sector that makes up nearly 70% of all economic activity.

Stock market

Then there is the exuberance seen on Wall Street. If Powell is on the lookout for signs of corporate financial distress or trouble accessing credit in the capital markets, he won't find much. All three major stock indexes (Dow, S&P 500 and NASDAQ) keep racing to record highs levels. It reflects investor confidence that revenues, earnings and access to capital will continue to be positive well into 2025. It's another head scratcher for the Fed. Businesses and investors appear virtually impervious to the current state of monetary tightening --- and if that's the case, what's the urgency to lower rates?

Even Powell acknowledged last week at a New York City event how vibrant the economy is. "Growth is definitely stronger than we thought, and inflation is coming in a little higher," he noted.

His comments were further substantiated by the latest Beige Book, which reported that economic activity rose in most of the 12 Federal Reserve districts since October

Wouldn't such a public admission by the Chairman plus the positive feedback from business leaders around the country make it more difficult to justify another 25 basis point reduction --- especially when recent inflation data was not cooperating?

I won't purport to know what Powell is thinking next, but it's not a stretch to assume he and his colleagues are already quietly strategizing how to deal with a potentially new vexing issue. If you spin forward to a Trump 2.0 administration that is determined to slash taxes, curb immigration, and launch an arsenal of import duties next year, how can you have ANY confidence that inflation will remain anchored at 2%. There's not of stick of gum that can hold price changes at that level under such circumstances.

Trump on Inflation? Hey, not to worry!

Trump and his economic advisers have urged everyone to calm down. Fears of inflation escalating during Trump 2.0 are greatly exaggerated, they say. In writings, interviews and speeches, they offer several reasons why his policies won't fire up consumer prices. Indeed, Americans should see the cost of living settle down, as promised during the campaign.

How exactly will that work?

First, they point out, President Trump will push to lower taxes for businesses. That should increase after-tax profits and allow companies to pass those savings on to consumers in the form of lower prices.

Second, he plans to lower personal income taxes by abolishing all taxes on tips, overtime, and even social security. This would boost take home pay and thus dull the forces that generate wage inflation.

Third, lower US taxes should attract more foreign investments. That will increase demand for dollars and cause the US currency to appreciate. A stronger dollar will have a deflationary impact since foreign goods would cost less.

Fourth, the Trump administration will act to depress energy prices by opening up federal lands, remove pesky environmental restrictions and cut red tape that has hindered US production of oil and gas. All these "drill, baby drill" incentives will therefore help reduce energy prices and that translates into lower inflation.

Finally, fifth, with the help of Elon Musk and Vivek Ramaswamy, their DOGE campaign will lacerate government spending, free companies of regulatory shackles and take a chainsaw to dismember much of the current bureaucracy. Such actions should free up corporate America from unnecessary barriers and costly regulations, and the rewards for that should be obvious.
Taken together, these policies will invigorate the American economy and tranquilize inflation (...but then comes the stern caveat)---*so long as the Federal Reserve doesn't get in the way.* (Italics are mine.)

OK, where to begin?

I have to admit the first thought that came to mind was that the Reagan-era character, known as Rosy Scenario, is staging a comeback.

Let's take each of their points.

On lowering taxes for businesses so they can reduce prices to consumers, let me say the following. Such an outcome is certainly possible…theoretically. But how plausible is it? If history is any guide, most of those easy savings will be passed on to shareholders, perhaps in the form of higher dividends or stock buybacks. It's hard to model a scenario where lower corporate taxes of the magnitude the next administration is talking about will materially constrain inflation.

Next, if Trump and Congress agree to lower personal income taxes, it will provide Americans with more funds to spend. Who can complain about that? But all that extra income along with the increase in the wealth effect from higher stock prices,

should also supercharge demand for more goods and services --- and that will put upward pressure on inflation.

Another claim made is that lower US taxes will attract more foreign investments and that should help increase the value of the dollar, which can be deflationary. I agree. The only problem is President-elect Trump has complained the dollar is already too strong and hurting US exports. He regularly has called for a weaker US currency to make American goods more competitive in the global marketplace. The downside of that position is that a weaker dollar will increase the cost of imports --- and that certainly won't chill the embers of inflation. So, their position here is a bit inconsistent.

We now get to Trump's near canonical belief that his "drill, baby drill" policies would quickly galvanize domestic production of oil and natural gas, which would then pull down energy prices and inflation.

It's a noble plan on paper, but there are serious questions whether it will work in the real world. Let's start with the fact the US is already producing more oil than ever before, 13.4 million barrels of oil per day, exceeding the output even of Saudi Arabia and Russia. Yes, it's true the US also imports oil, but that has more to do with chemistry and pipeline distribution. (Most domestically produced oil is of the light sweet variety, but our existing refineries were built long ago to process mostly thick oil that contains sulfur, since that's the type of crude we were importing from Mexico and Venezuela. Bottom line: given our current refinery system and the capacity of our pipelines, it's actually *cheaper* to import and process some heavy sour crude.)

There are other reasons why "drill, baby drill" is nothing more than an inane slogan.

Trump may offer a host of incentives, but he can't command oil companies to rush out and produce more. Many oil giants and smaller producers seem quite content to pass on their savings to shareholders, rather than rush out and dig expensive new wells. These companies are not likely to jump just because the President tells them to jump, especially if the microeconomics do not favor it. After all, the price of West Texas crude has been steadily falling since last spring, which is rather remarkable given the geopolitical tensions across the Middle East and Europe. WTI crude slipped to $67 by last week's end, down nearly 15% from a year ago. The national average price of retail gasoline closed the week at $3.02 a gallon, some 20 cents less than 12 months ago. Producers know that pumping out more oil could further depress prices, risk thinner profit margins and likely infuriate their investors.

And we can buttress that point with one additional reference. In its World Energy Outlook 2023, the International Energy Agency (IEA) concluded ---much to the consternation of the US oil industry --- that demand for oil, coal and gas is set to peak by 2030. That's because there is an inexorable shift underway to reduce reliance on fossil fuel and increase usage of renewable energy sources. If the IEA is right about that date, or even if that peak arrives 5 or 10 years later, it would undercut the rationale for US producers to spend billions more on new oil fields --- when demand for that commodity will soon be waning. One can argue a better long term investment would be developing technology that taps alternate sources of energy, such as solar, wind, battery, hydrogen and bioenergy.

Ironically, developing countries with large oil reserves, irrespective if they are members of OPEC+, read the same IEA report and are now pressed to wonder how soon their prized subterranean asset will lose value over the next decade if left untapped. Venezuela, Guyana, Brazil and the United Arab Emirates possess among the largest reserves in the world and are working to bring more oil to the surface before that black gold loses its luster.

All of this brings me back to my opening point. If December's rate-setting meeting is a "live" event, then any objective reading of the economy --- its accelerating speed this quarter, a sturdy labor market, the upturn in inflation, an undaunted consumer, and a stock market that keeps defying gravity --- makes the case the Fed should think twice about further loosening monetary policy this month. There's clearly no urgency to do so, especially if the winds of inflation are becoming more turbulent.

We will soon see the Fed's next move. But make no mistake, Powell and Trump are already sizing each other up in preparation for a brawl over the future course of monetary policy.

==============================

United States

	I 2025	II 2025	III 2025	IV 2025	I 2026	II 2026	III 2026	IV 2026	I 2027	II 2027	III 2027	IV 2027	I 2028	II 2028	III 2028	IV 2028
Real Gross Domestic Product (GDP):																
%	2.1	3.3	2.8	2.4	1.9	2.6	2.2	1.9	1.2	2.0	1.5	1.8	0.9	1.2	1.4	1.2
Personal Consumption Expenditures:																
PCE %	1.5	1.7	2.0	1.8	1.4	1.8	2.1	2.3	0.9	1.6	1.7	2.1	1.3	1.9	2.0	2.2
Inflation, end of period, year-over-year:																
CPI %	2.9	3.2	3.4	3.5	3.6	3.5	3.5	3.3	3.0	3.3	3.3	3.1	2.9	2.9	2.6	2.8
Unemployment Rate (end of period):																
%	4.0	4.0	3.9	3.8	3.9	3.7	3.6	3.6	3.9	4.1	4.3	4.2	4.3	4.4	4.2	4.1
Non-farm Payrolls, monthly avg. thousand:																
	155	165	160	170	155	170	175	160	145	140	130	130	100	85	95	115
Treasury 10-yr Note Yield % (end of period):																
	4.55	4.65	4.85	5.10	5.05	5.15	5.10	5.10	5.00	5.10	5.05	4.85	4.55	4.45	4.30	4.20
Federal funds rate % (mid-point, end of period):																
	4.63	4.63	4.63	4.63	4.63	4.38	4.13	3.38	3.38	3.38	3.38	3.13	3.13	2.88	2.88	2.88

GDP Growth - Global Economy - Year over Year

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
US	2.6	1.6	2.2	1.8	2.3	2.7	1.8	2.5	3.0	2.6	-2.2	6.1	2.5	2.9	2.5	2.7	2.2	1.6	1.2
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.8	1.6	-6.2	5.7	3.5	0.5	0.7	1.2	1.6	1.3	1.1
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.7	1.6	-10.4	8.7	4.3	0.1	1.1	1.2	1.5	1.3	1.2
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.4	-4.3	2.3	1.0	1.9	0.2	1.3	0.9	0.8	1.0
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.8	1.9	-5.1	5.0	3.4	1.1	1.4	2.3	1.8	1.7	1.6
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.4	4.0	-5.9	9.2	7.2	7.7	6.9	6.4	6.1	6.0	5.8
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.7	6.0	2.2	8.5	3.0	5.2	4.6	4.5	4.3	4.6	4.4
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.4	-3.6	5.3	3.0	2.9	3.1	2.4	2.2	2.7	2.6
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.2	-0.3	-8.8	6.1	3.9	3.1	1.4	1.5	1.9	2.2	2.4
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.7	3.7	1.5	1.5	2.1	2.5	2.2	1.9
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.8	2.2	-2.7	5.6	-1.2	3.6	3.9	2.3	2.4	2.4	2.1
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.7	-3.0	6.2	3.0	2.7	4.4	4.1	3.9	3.9	3.6

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017	End 2018	End 2019	End 2020	End 2021	End 2022	End 2023	End 2024	End 2025	End 2026	End 2027	End 2028
USD/Yen	91	93	81	77	87	105	119	120	117	113	110	109	104	115	131	141	155	148	139	135	130
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.09	1.05	1.20	1.14	1.12	1.23	1.17	1.07	1.10	1.03	1.00	1.04	1.10	1.12

Oil (Brent spot) & Gasoline (U.S. average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017	End 2018	End 2019	End 2020	End 2021	End 2022	End 2023	End 2024	End 2025	End 2026	End 2027	End 2028
Crude oil per barrel	46	78	95	107	111	111	58	38	49	67	54	67	52	78	85	77	75	80	74	71	70
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.00	2.31	2.47	2.26	2.58	2.30	3.38	3.20	3.12	3.10	3.30	3.22	3.10	3.12

© Copyright 2024 ALL RIGHTS RESERVED
THE ECONOMIC OUTLOOK GROUP, LLC