Solid growth despite political uncertainty

- **Fiscal and trade policy uncertainty overshadows US economic outlook, but we maintain our forecast for steady yet gradually cooling growth in 2025. We revise up our 2025 GDP forecast to 1.9% (from 1.5%) partly due to more positive overhang, and see 2026 growth at 2.1%**

- **We expect easier tax policies to lead to a net increase in fiscal deficits especially in 2026 when compared to CBO's baseline. Weaker immigration outlook poses a downside risk to structural growth.**

- **We assume 10% universal tariffs on all imports and 40% on imports from China, likely implemented towards the end of 2025. Trump's announcements suggest some increases could be announced already at the beginning of the new presidential term in January.**

- **Inflation forecasts have been adjusted modestly higher for 2025, with roughly half of the increase reflecting impact from tariffs. We see headline inflation averaging 2.7% in 2025 (from 2.2%) and 2.4% in 2026. Core inflation is set to average 2.9% in 2025 (from 2.4%) and 2.5% in 2026. We keep our Fed call unchanged and expect the Fed to reach a terminal rate of 3.00-3.25% by September 2025, which will be maintained through 2026.**

4 December 2024
Important disclosures and certifications are contained from page 3 of this report.

	2023	Forecast 2024	2025	2026
GDP Growth	2.9%	2.7% (2.5%)	1.9% (1.5%)	2.1%
Inflation	4.1%	2.9% (2.9%)	2.7% (2.2%)	2.4%
Unem-ployment	3.6%	4.0% (4.1%)	4.4% (4.7%)	4.3%
Fed Funds*	5.50%	4.50% (4.75%)	3.25% (3.25%)	3.25%

Paranthesis are the old projections (From September 2024)
**End of period*
Source: Danske Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Fed

Uncertainty over future fiscal and trade policies overshadows the US economic outlook, but we maintain our forecast for steady yet gradually cooling growth in 2025. In these forecasts, we assume that Trump's administration will impose 10% universal tariff on all imports and 40% on imports from China, and that the effects on both prices and demand will be felt gradually over the course of 2025.

Both timing and effectiveness of the tariffs are subject to high uncertainty. If Republicans attempt to use tariffs as a funding source for enacting permanent easing to domestic tax policies, lengthy negotiations could delay implementation of the tariffs towards the end of 2025. However, Trump has already announced plans to impose tariff hikes against China, Mexico and Canada on his first day in the office. Besides the details on implementation, re-routing of trade around the steepest tariffs on China, tariff exemptions for goods US cannot produce domestically and tax avoidance all complicate estimating the final impact on public revenues and economic growth.

We expect the Fed to continue cutting rates despite the tariff threat

Antti Ilvonen, Senior Analyst

Tariffs alone constitute net tightening of fiscal policy, which will be compensated by extending personal income tax cuts implemented under the 2017 Tax Cuts and Jobs Act. Congressional Budget Office has assumed the cuts would expire by the end of 2025, which would have led to modest tightening in expected deficits. But following the election result, we expect public deficits to remain close to 2024 levels also in 2025 and 2026. Note, that extending existing tax cuts does not provide an immediate boost to purchasing power, but tariffs can have the opposite impact, which could cause a negative sentiment effect on consumption during 2025.

We have lifted our 2025 inflation forecast to 2.7% from 2.2%, and roughly half of the increase is due to the tariffs, as several factors help mitigate their inflationary impact. Trade-weighted USD has appreciated approximately 5% since the likelihood of Trump's election win began to increase in early October, and we forecast further upside potential for the greenback in 2025. We would also expect both importers and exporters to absorb part of the cost increase in their margins.

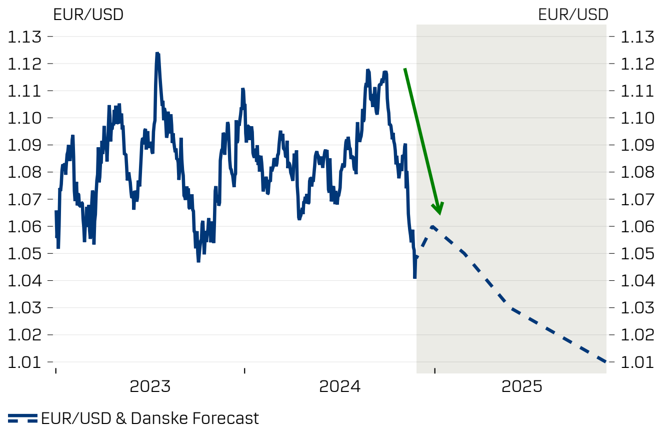
Consequent pressure for cost cuts is one of the most important downside risks to our forecasts. Aside from tariffs, labour costs as a share of GDP have begun to increase in 2024. In 2022-2023, companies were widely able to pass through cost increases to consumer prices, but with excess savings depleted, we think 2025 could be different. If weaker pricing power forces companies to focus more on costs, labour demand could continue to cool further.

In 2025 and 2026, tightening labour supply due to stricter stance on immigration could further push up labour costs. Consequently, we have revised down our forecast for the unemployment rate but underscore that low unemployment rate could still mask underlying demand weakness. Job openings have trended lower and involuntary layoffs have edged higher in 2024, and we will monitor closely whether these trends continue in 2025 as well.

We have revised up our growth forecast for 2025 to 1.9%, which still marks a slowdown from this year's pace. Growth relies increasingly on the consumer, as likely cuts to IRA subsidies could cool down the 2022-2023 boom in private manufacturing investments. We expect residential investments to recover as a growth driver towards 2026 due to tight housing supply, rising prices and declining mortgage rates.

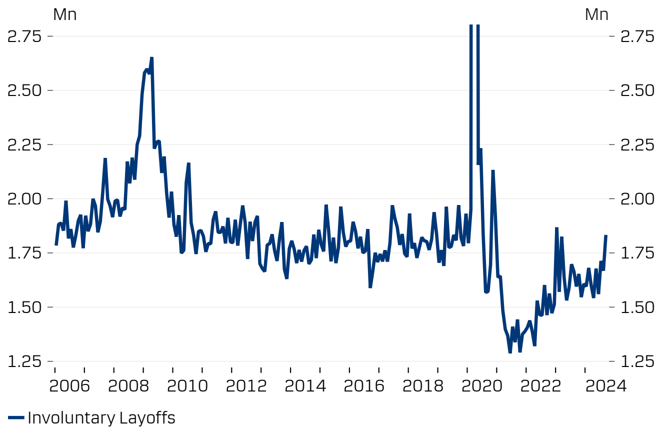
With consumption and labour markets still on cooling trends, and inflation expectations close to target, we think the Fed will continue cutting rates in the coming meetings. We maintain our call for the Fed's terminal rate at 3.00-3.25% and expect no policy rate changes through 2026. We also expect the Fed to continue reducing its balance sheet until the latter half of 2025.

Broad USD appreciation has already mitigated some of the inflationary impact from tariffs, and we expect similar trend to continue in 2025 as well



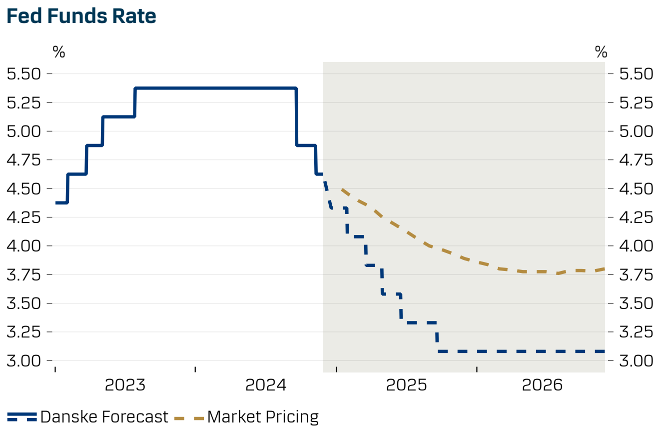
Source: Macrobond Financial, Danske Bank

Firms have increased their layoffs over past months as labour costs continue rising



Source: Macrobond Financial, U. S. Bureau of Labor Statistics

We expect the Fed to continue cutting rates further than markets are pricing in



Source: Macrobond Financial, Danske Bank, CME

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