ECONOMIC OUTLOOK

REGIONS

December 2024

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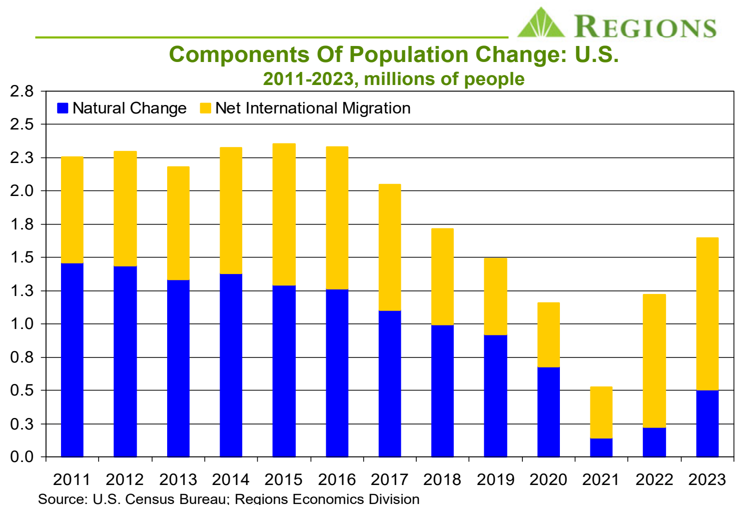
Policy Contours Forming, Details Have Yet To Take Shape

That the Presidential and Congressional elections are behind us does not mean that the uncertainty around those elections is behind us. Though the broad contours have started to form, the specific details on what could be potentially significant changes to fiscal, trade, regulatory, and immigration policy have yet to be revealed. The lack of specific details makes forecasting the path of the U.S. economy over coming quarters an even trickier endeavor than is typically the case, which is a point that we will no doubt make early, and often, next month in our annual outlook edition. When it comes to our forecast for 2025, about the only thing we can be sure of at this point is that however it ultimately looks is likely to be quite different from how it initially looks. That is simply us acknowledging that we'll be revising our forecast(s) accordingly as details on the various policy fronts emerge.

Two policy areas in which the incoming Trump Administration seems likely to seek potentially sweeping changes are immigration and trade. Again, with no specific details to go on, it would be somewhat pointless to go into any sort of detailed discussion of how policy changes on these fronts will alter the path of the U.S. economy in 2025 and beyond. That of course isn't stopping some from doing just that, as we've seen some very specific forecasts of the impact of higher tariffs on the path of inflation. Moreover, even as the details on policy proposals emerge, any assessments of how the paths of real GDP growth, employment, inflation, and interest rates, to name but a few metrics, in the U.S. will change will be far from definitive, as that will in turn depend upon how domestic firms, domestic consumers, foreign firms, and foreign governments respond to the shifting U.S. policy landscape.

All of that will unfold in due time and, as that occurs, we'll adjust our forecasts accordingly. For now, however, we do think it worth making a few general points that will be worth keeping in mind as you process potential impacts of changes to immigration and trade policy. For instance, we've heard some argue that reduced immigration flows will lead to slower house price appreciation or, more broadly, lower rates of overall inflation. The premise being that less demand, whether for housing or for overall goods and services, will put downward pressure on prices.

The problem with arguments based solely on demand is that they are, well, based solely on demand and, as such, ignore demand's pesky friend, a/k/a supply. Aside from foreign-born residents being far more likely to be renters than owners, particularly earlier in their tenure in the U.S., the reality is that lack of adequate supply, rather than too much demand, has been the much more powerful driver of house price appreciation over the past several years. More broadly, less demand doesn't mean more supply. Moreover, given the extent to which rapid growth in the supply of foreign born labor has been a primary driver of faster growth in total labor supply over recent years, to the extent that immigration reform acts as a brake on the pace of growth in labor supply and, in turn, employment, it could be that the corresponding hit to supply results in greater upward pressure on prices that would offset any downward pressure stemming from there being less demand. This is a point apparently lost on those who argue immigration reform will curb the pace of house price appreciation, given the extent to which foreign born labor is a key source of construction labor.



We spend a good deal of time discussing the importance of demographic trends, particularly as they pertain to the economy's "speed limit," i.e., the sustainable rate at which it can grow over time. For any economy, the speed limit is a function of two factors, the rate of growth of total labor input, and the rate of productivity growth. The chart above breaks down growth in U.S. population over the past several years into its two component parts – natural change, or, the difference between births and deaths in any given year, and net international migration. Note that net domestic migration is the third component of total population growth on the metro area and state levels but zeroes out on the national level. The rate of natural population growth has been slowing for many years, a trait by no means limited to the U.S., meaning that net international in-migration has become an increasingly important driver of growth in the total population of the U.S. (as a side note, the detailed 2024 population data will be released in early-2025).

In turn, foreign born labor has been an increasingly important driver of growth in the supply of labor, one factor which has facilitated faster growth in the supply of goods and services. The impact on growth in the supply of labor can be seen in the household survey data presented in the monthly employment reports. Amongst the various demographic cuts of the household survey data is that between native born and foreign born labor

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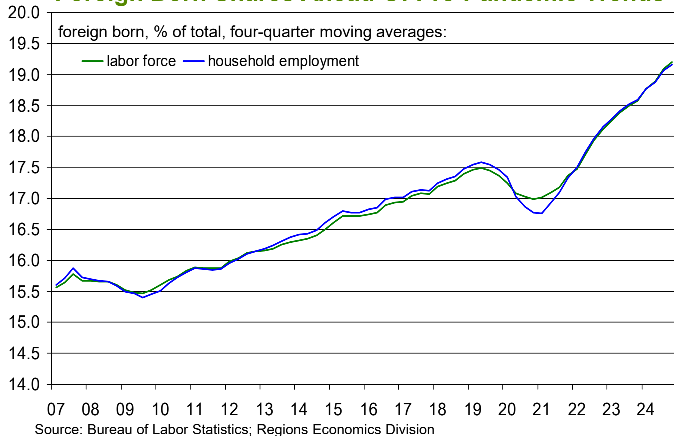
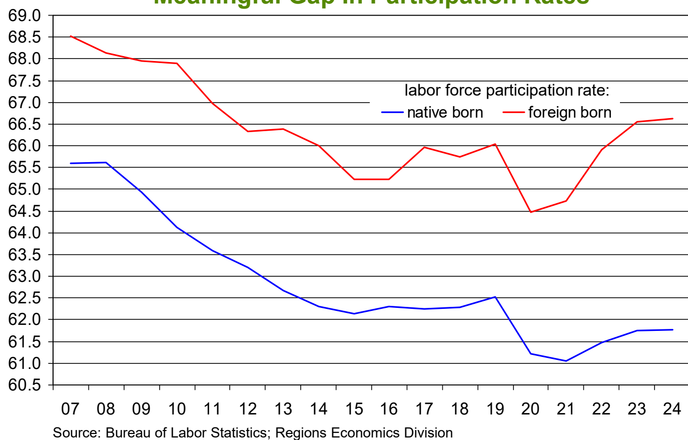
market participants. Note that survey respondents are not asked about their immigration status, i.e., whether they are in the U.S. legally or illegally, so while there are various estimates of the numbers of working immigrants in each category, there is no estimate that links to the household survey data. Either way, foreign born participants have accounted for rapidly rising shares of the labor force and household employment over recent years.



The chart above shows the four-quarter moving average for each series as a means of smoothing out what are clear seasonal patterns in the data. As of November, foreign born participants accounted for 19.2 percent of the U.S. labor force and 19.1 percent of household employment. These shares are higher than would have been the case had the pre-pandemic trends remained in place, meaning that growth in foreign born participation in the U.S. labor market has been faster over the past few years than had been the case in the years leading up to the pandemic. On both fronts, labor force and household employment, growth amongst foreign born participants has been much faster than growth amongst native born participants since 2022.



Moreover, as seen in the above chart, the labor force participation rate amongst the foreign born population is meaningfully higher than the participation rate amongst the native born population, with a particularly striking disparity in male participation rates. It is the combination of faster inflows of immigrants and higher participation rates amongst them that has led to the pickup in foreign born participation in the U.S. labor force over recent years.

This helps illustrate a point we've made over the past several months, which is that the upward pressure on the unemployment rate has been much more a function of faster growth in the labor force than of greater numbers of people losing their jobs, which is a distinction we think very much matters. We have, however, noted that we did not think the rapid rate of growth in foreign born participants seen over the past few years would be sustained indefinitely. The corresponding slowdown in labor force growth would, in turn, cap any increase in the unemployment rate stemming from a slower pace of job growth.

Immigration reform, regardless of the specific form it takes, would buttress our argument. The perception of a less favorable climate could in and of itself act to curb the flow of immigrants. Either way, the broader point is that less foreign born labor would mean slower growth in the labor force, potentially putting renewed upward pressure on wages while at the same time curbing growth in the production of goods/provision of services, with the result being renewed upward pressure on prices. Agriculture, leisure and hospitality services, construction, and transportation services are sectors that would likely be most impacted and in which upward pressure on wages/prices could be more intense. While one can make the argument that faster productivity growth can at least partially offset slower growth in total labor input, we'd counter that while that is true in a broad sense, the industry groups we specify here are labor intensive to the point that a lack of labor won't likely be fully made up for by faster productivity growth.

The point here is not to argue that there is no need for immigration reform; indeed, we cannot think of any plausible argument for that case. Instead, our point is that along with immigration reform could come potentially significant disruptions in labor supply and, in turn, the broader economy. Any such reform will hopefully be crafted with the points we've made here in mind, and these points will guide our assessment of the specific policy details that emerge.

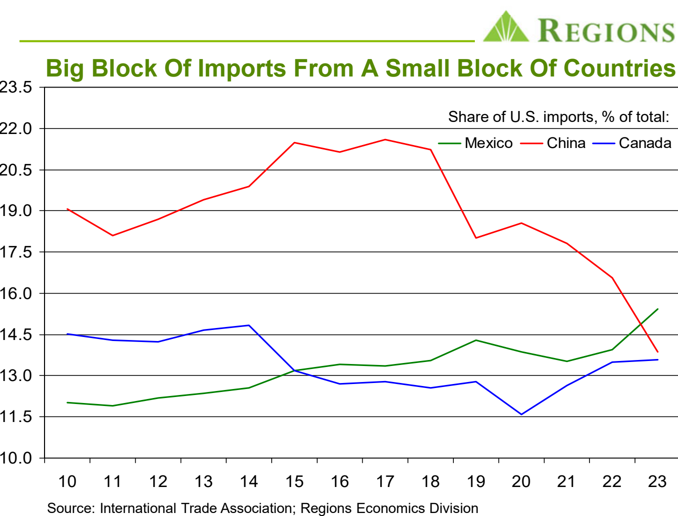
Along the same lines, though it is obviously too soon to launch into a detailed assessment of the potential effects of expanded tariffs, we do think there are some general points to keep in mind as the specific details on trade policy emerge over coming months. Starting with the most obvious point, campaign rhetoric does not necessarily translate into specific policy moves. So, while it is a good bet that tariffs will be expanded, that does not necessarily mean they will be expanded to the degree bandied about on the campaign trail. One question to consider is what the point of expanded tariffs would be. Expanded tariffs could be intended as: 1) a means of raising revenue to help offset higher spending and/or the costs of extending the 2017 tax cuts or implementing any additional tax cuts; 2) a means of addressing trade practices perceived as being unfair to the U.S. or, as we've already seen, other policies perceived to be at odds with U.S. interests; 3) a means of protecting domestic producers from foreign competition deemed to be unfair; or 4) a means of or directing manufacturing activity to/back to the U.S.

While a specific tariff on a single foreign nation can be some of those things, it cannot be all of those things, which suggests that

we are unlikely to see "blanket" tariffs at a specific rate aimed at every foreign trading partner. In the second case above, it could be that the threat of expanded tariffs is sufficient to bring other nations to the negotiating table – that tariffs were deployed in the first Trump Administration should remove any doubt as to whether the threat of expanded tariffs is indeed a credible threat.

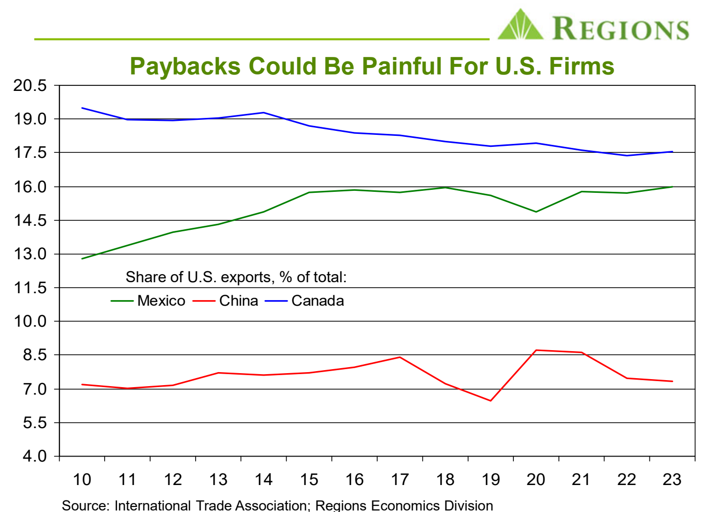
Beyond that, however, there just aren't a lot of specifics at this point, and indeed there may not actually be many, or any, specifics at this point to reveal. In contrast, it is fairly easy to catalog what we do not yet know about expanded tariffs but will need to know in order to make a plausible assessment of potential impacts. We do not know: which foreign nations will be subject to either new or expanded tariffs; how high tariff rates will be for each foreign nation; which particular goods will be subjected to higher tariffs; how foreign producers hit with higher tariffs will respond; whether foreign nations will respond to higher tariffs imposed by the U.S. in the form of retaliatory tariffs on U.S. goods, targeted currency devaluations against the U.S. dollar, or in some other manner; whether there will be one round of tariffs imposed by the U.S. and trading partners or whether there will be successive rounds of tariff hikes; whether, or to what extent U.S. firms would be willing and/or able to absorb some portion of higher tariffs; and how U.S. consumers would ultimately respond to higher prices.

Wowza, that's a lot of stuff to not know, and we can't even be sure that is an exhaustive list, but you probably get the point. Sure, one could, as some have already done, forecast the impacts of tariffs on the U.S. economy, but any such forecast would be so dependent upon so many assumptions – see above list – that it wouldn't be worth much. Which is why we're not in a rush to do so until we have more details. We do, however, think it worthwhile to look at where imports into the U.S. come from, which helps put our earlier point about the purpose of raising tariffs into context.



Of the roughly $3.1 trillion of goods imported into the U.S. in 2023, forty-three percent came from just three nations – Canada, China, and Mexico. To put that in perspective, you'd have to add up the shares of the next nineteen countries on that list arrive at a combined share of forty-three percent. Note from the above chart that the share of imports coming from Mexico topped the share coming from China while the share coming from Canada almost matched the share coming from China. Further note how the share of imports coming from China began to erode rapidly in the wake of tariffs put into place during the first Trump Administration. While we cannot attribute all of this erosion to the tariffs, given that rising labor costs had already led to manufacturing activity shifting away from China to other nations, primarily in Asia, neither can one make a plausible argument that the tariffs had nothing to do with this erosion. Even so, while part of China's eroding share of U.S. imports is due to U.S. firms resourcing supply chains as a means of averting tariffs, part also reflects Chinese companies relocating manufacturing activity, or, perhaps more accurately, assembly activity, to other nations. In other words, component parts can be made in China and shipped elsewhere to be assembled into finished goods, which are then shipped to the U.S. from where the assembly took place as a way around tariffs.

We'd expect to see the same reactions in response to higher tariffs on Chinese-made goods, particularly if tariffs were raised as high as has sometimes been suggested. Think about this in the context of the intent of the tariffs, however, and it points to the difficulty in using tariffs to achieve specific objectives, such as a source of government revenue. This suggests significantly higher tariffs on Chinese goods would be unlikely to raise targeted amounts of revenue, and that tariffs would have to be imposed on a wider group of countries, and tariff rates would have to be higher, to achieve the same revenue objectives.



That U.S. exports are similarly concentrated amongst the same group of countries could be seen as suggesting the U.S. has little to fear from other nations imposing retaliatory tariffs on U.S.-made goods. Of the roughly $2.0 trillion of exports of U.S. goods in 2023, forty-one percent went to either Canada, China, or Mexico – you'd have to add up the shares of the next eighteen countries on that list to get to a similar combined share. That said, if, Canada and Mexico were to be subject to significantly higher tariffs on imports into the U.S., as has been suggested, that could easily result in more U.S. firms feeling significantly more pain from Canada and Mexico imposing retaliatory tariffs.

These are just a few illustrations of our broader point, which is that even once details of changes to trade policy come to light, the implications of these changes will be anything but straightforward

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and are likely to take time to fully play out. This adjustment process will likely be something that sends forecasters back to the drawing board given the number of possible permutations, in both policy changes and the reactions to those changes, that can impact the paths of output, employment, and inflation. We'll close this section with some additional points we think are worth keeping in mind in the context of potential changes to trade policy.

First, many argue that a smaller U.S. trade deficit will bolster real GDP growth. Sure, in the context of simple GDP math, GDP = C+I+C+X, with the "X" being net exports (exports minus imports), a larger value of X would, all else equal, mean a larger value of GDP. What this argument ignores, however, is that roughly one-half of all imports into the U.S. are either raw materials or intermediate capital goods used by firms in the U.S. to produce final goods and services which, ultimately, contributes to GDP growth. Limiting such imports would, ultimately, lead to slower GDP growth, and making such imports more costly would lead to higher prices of final goods, slimmer profit margins for the firms that produce these goods, or some combination of the two.

Second, the flip side of a trade deficit is a surplus in the capital account, i.e., a capital inflow. This "imported" capital helps finance domestic investment, particularly critical for a country in which the federal government budget deficit is equivalent to over six percent of GDP. Absent this capital inflow, larger budget deficits absorb more domestic saving, leaving less domestic saving available to finance private sector investment, which in turn acts as a powerful drag on GDP growth over time.

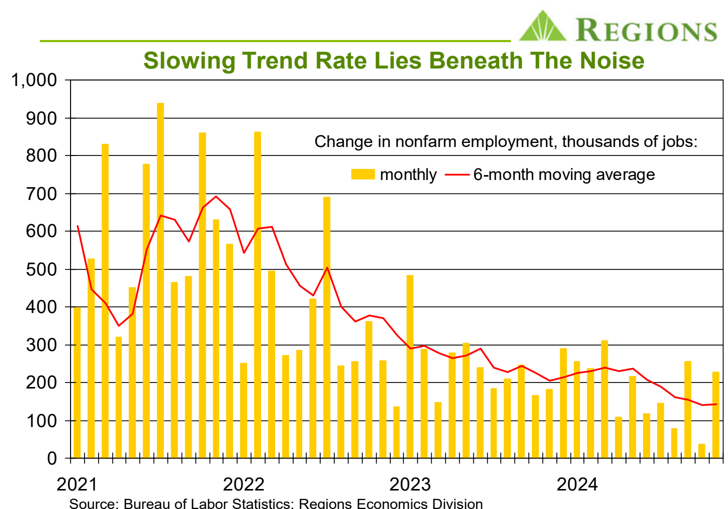
Third, while driving manufacturing activity to/back to the U.S. may be a laudable goal, it isn't clear to us that people have a realistic picture of what that might look like. Many seem to harken back to a time when the U.S. economy, as were most economies, was a fairly closed economy and manufacturing accounted for over one-third of private sector nonfarm employment. That share is at present just under ten percent, and while it would increase due to "onshoring" of manufacturing activity, there is a limit to the extent it will do so. In part, this reflects manufacturing having become increasingly technologically advanced over the decades, which in part has lessened the role for labor. Put differently, manufacturing facilities built today will be more capital intensive and less labor intensive than had historically been the case.

That raises the related point of whether, where labor is required, firms would be able to find enough of it, which ties back in with our earlier discussion. With demographic trends yielding slower growth in the native born labor force and immigration reform likely curbing the supply of foreign born labor, labor supply constraints could make manufacturing that much more capital intensive. Even before we get to that point, there's the reality that the regulatory process and the construction process take time, meaning that to the extent we do see it, onshoring of manufacturing activity is a long-term process as opposed to a quick fix.

November Employment Report

Much was expected of the November employment report, some of which was actually delivered. Recall that the October employment report was heavily impacted by the Boeing strike and the effects of Hurricanes Helene and Milton, yielding an initial estimate of an increase of only 12,000 jobs in total nonfarm payrolls and a decline of 28,000 jobs in private sector payrolls. At 47.4 percent, the initial collection rate to the October establishment survey was the lowest in any month since January 1991, which left open the possibility of significant revisions to those initial October estimates. With the Boeing strike having been settled ahead of the November survey period and at least some of the disruptions from the hurricanes reversed, it was generally anticipated that the November data would show an outsized increase in nonfarm employment.

The trick would be sussing out the underlying trend in job growth amid the considerable noise in the October and November data. It was generally held that the best approach would be to take the average of reported job growth over the two months, which would allow for revisions to the initial estimate of October job growth. As it turns out, the initial estimate from the BLS shows total nonfarm payrolls rose by 227,000 jobs in November, with private sector payrolls up by 194,000 jobs and public sector payrolls up by 33,000 jobs. At the same time, October job growth was revised modestly higher, now reported to have risen by 36,000 jobs. The November print was in line with the consensus forecast but shy of the 274,000 jobs increase we expected. That said, nonfarm payrolls increased by an average of 132,000 jobs over October and November, whereas our forecast of the November data would have put that average at 143,000 jobs. So, in that sense, the November employment wasn't all that out of line with our standing assessment of labor market conditions.



The chart above shows monthly job growth and the six-month moving average, which is more indicative of the underlying trend rate of job growth. As of November, the six-month moving average stood at 143,000 jobs, not too far off from where that measure was prior to the onset of the pandemic. As we've noted on several occasions, the slowing trend rate of job growth mostly reflects the slowing rate at which firms are hiring workers rather than workers being laid off at a rising rate. That the pace of hiring has slowed should be neither surprising nor alarming, but the more relevant question is whether the trend rate of job growth is settling back into the par-pandemic rate or will continue to slow. While we think it is the former rather than the latter, it is too soon to know for sure. A surefire sign that something less benign is at hand would be a meaningful and sustained increase in layoffs, which is why we continue to closely watch the weekly data on initial claims for unemployment insurance benefits which.

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Q2 '24 (a)	Q3 '24 (p)	Q4 '24 (f)	Q1 '25 (f)	Q2 '25 (f)	Q3 '25 (f)	Q4 '25 (f)	Q1 '26 (f)		2022 (a)	2023 (a)	2024 (f)	2025 (f)	2026 (f)
3.0	2.8	2.5	2.2	2.0	2.3	2.2	1.9	Real GDP[1]	2.5	2.9	2.8	2.3	2.0
2.8	3.5	2.7	2.0	2.2	2.2	2.1	2.1	Real Personal Consumption[1]	3.0	2.5	2.7	2.4	2.2
3.9	3.8	-0.4	2.4	3.2	4.5	5.2	4.8	Real Business Fixed Investment[1]	7.0	6.0	3.7	2.7	4.2
9.8	10.6	-3.3	3.6	3.3	5.8	7.2	6.5	Equipment[1]	4.4	3.5	3.7	3.9	5.2
0.7	2.5	3.0	3.1	4.2	5.0	5.2	5.1	Intellectual Property and Software[1]	11.2	5.8	4.1	3.4	5.1
0.2	-4.7	-1.8	-1.8	0.6	0.8	1.0	0.3	Structures[1]	3.6	10.8	3.2	-1.1	0.1
-2.8	-5.0	8.4	4.0	0.1	-1.4	-1.1	-1.0	Real Residential Fixed Investment[1]	-8.6	-8.3	4.3	1.4	-0.7
3.1	5.0	-0.1	2.0	1.9	1.1	0.8	0.5	Real Government Expenditures[1]	-1.1	3.9	3.2	1.8	0.7
-1,035.7	-1,077.6	-1,066.7	-1,065.0	-1,076.5	-1,083.7	-1,103.9	-1,117.3	Real Net Exports[2]	-1,041.7	-932.8	-1,039.2	-1,082.3	-1,126.7
1,004	970	997	984	982	974	970	965	Single Family Housing Starts, ths. of units[3]	1,006	949	1,008	977	961
336	362	355	335	332	330	329	330	Multi-Family Housing Starts, ths. of units[3]	546	473	350	332	333
4.6	3.6	3.1	2.6	2.4	1.8	1.4	1.5	CoreLogic House Price Index[5]	13.1	4.1	4.2	2.1	1.8
15.7	15.6	16.3	16.2	16.2	16.3	16.2	16.3	Vehicle Sales, millions of units[3]	13.8	15.5	15.8	16.2	16.3
4.0	4.2	4.2	4.2	4.3	4.3	4.2	4.1	Unemployment Rate, %[4]	3.6	3.6	4.0	4.2	4.0
1.7	1.5	1.4	1.2	1.1	1.0	1.0	0.9	Non-Farm Employment[5]	4.3	2.3	1.6	1.1	0.9
1.0	0.8	3.3	3.6	1.8	2.1	2.2	3.3	Real Disposable Personal Income[1]	-5.6	5.1	2.9	2.4	2.6
2.6	2.2	2.4	2.2	2.2	2.3	2.4	2.4	GDP Price Deflator[5]	7.1	3.6	2.4	2.3	2.3
2.6	2.3	2.4	2.2	2.2	2.5	2.5	2.5	PCE Deflator[5]	6.6	3.8	2.5	2.3	2.3
3.2	2.6	2.6	2.3	2.3	2.7	2.6	2.6	Consumer Price Index[5]	8.0	4.1	2.9	2.5	2.4
2.7	2.7	2.8	2.5	2.4	2.5	2.5	2.5	Core PCE Deflator[5]	5.4	4.1	2.8	2.5	2.4
3.4	3.2	3.2	2.8	2.7	2.9	2.7	2.7	Core Consumer Price Index[5]	6.2	4.8	3.4	2.8	2.6
5.38	5.31	4.69	4.34	4.09	3.88	3.88	3.88	Fed Funds Target Rate Range Mid-Point, %[4]	1.73	5.07	5.19	4.04	3.88
4.44	3.95	4.21	4.23	4.35	4.42	4.43	4.48	10-Year Treasury Note Yield, %[4]	2.95	3.96	4.19	4.36	4.52
7.00	6.51	6.63	6.61	6.68	6.71	6.68	6.69	30-Year Fixed Mortgage, %[4]	5.34	6.81	6.72	6.67	6.73
-3.7	-3.5	-3.3	-3.3	-3.3	-3.2	-3.1	-3.2	Current Account, % of GDP	-3.9	-3.3	-3.4	-3.2	-3.2

a = actual; f = forecast; p = preliminary

Notes: 1 - annualized percentage change 2 - chained 2017 $ billions 3 - annualized rate 4 - quarterly average 5 - year-over-year percentage change

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