



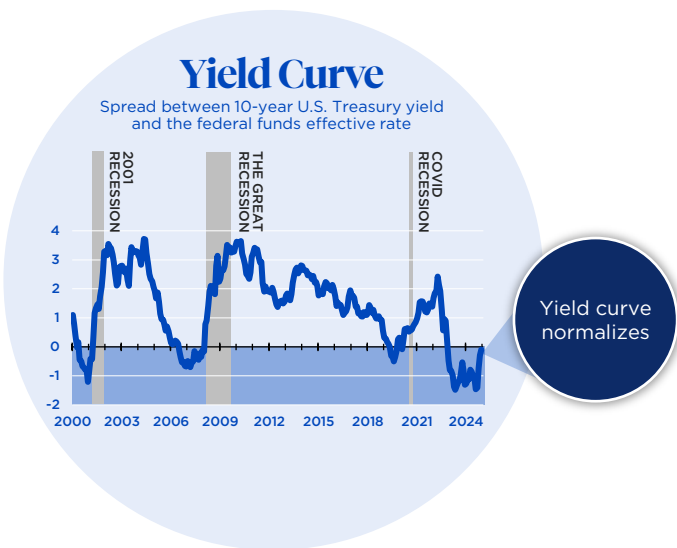
Economic & Financial Markets Monthly Review | January 2025

# Strong momentum carries into new year



# Where is the economy now?

The U.S. economy begins 2025 with solid momentum for consumers as spending continues to be bolstered by a positive labor market. But the tailwinds for growth have faded with the Fed expected to keep interest rates steady over the first half of 2025 while policy uncertainty is weighing on business activity. This sets the stage for a modest downshift in growth over 2025, but economic activity should remain solid.



Where we  
are this  
month

What does  
this mean

## Economic expansion carries into 2025

The economy retains solid fundamental underpinnings at the start of 2025, fed by continued sturdy hiring and consumer spending.

- Despite elevated uncertainty around trade and immigration policy changes, the economy should be strong enough to sustain temporary disruptions with upside potential for growth in the new year.
- Lingering inflation concerns should keep the Fed on the sidelines for the first half of 2025 after successive rate cuts in late 2024. The recent rise in long-term interest rates in part reflects stronger economic activity than expected, as such does not pose a large downside risk outside of the housing market.

## Yield curve steepens considerably

The sharp climb in long-term interest rates in December and into January led the Treasury yield curve to normalize for the first time in more than two years.

- After a 60-basis point (bps) increase since the end of November, the 10-year Treasury rate, which hit 4.80 percent in mid-January, was moderately above both the 1- and 2-year Treasury yields. This is a long-awaited return to a more normalized term premium and yield curve spread for bond investors.
- The spread between the short- and long-term rate is still relatively tight historically, but the recent movements reflect diminished downside risks for the economy and the labor market in 2025.

## Wage growth remains buoyant

While hiring has cooled in some sectors, tight labor conditions continue to boost wages with average hourly earnings up 3.9 percent over 2024.

- Above-average wage growth at the end of 2024 should support consumer spending in early 2025, although purchasing behavior is turning more price conscious in the face of rising prices, tapped savings, and high interest rates.
- Moderately faster wage growth compared to the pre-Covid period helps fuel consumer spending. It is not leading to upward pressures on inflation due to the offsetting impact of stronger productivity growth.

# Strong economic data should drive a Fed pause

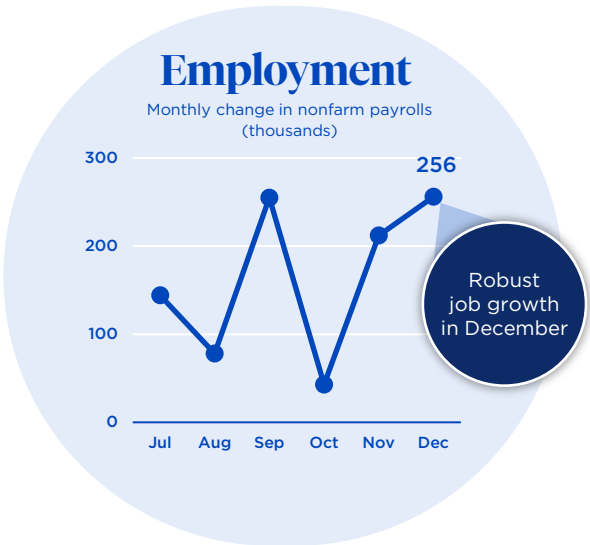
Job gains were strong in December and not as narrowly concentrated as cyclical sectors substantially contributed to the headline number. With job and wage growth continuing apace and layoffs still very low, the consumer is in good shape at the outset of 2025. In combination with inflationary risk from trade policies of the incoming administration, this landscape lowers expectations for rate cuts and delays potential relief for rate-sensitive sectors.



### Core inflation was modest in December

The headline CPI inflation rate climbed for a third straight month to 2.9 percent in December, while the core rate ticked down to 3.2 percent.

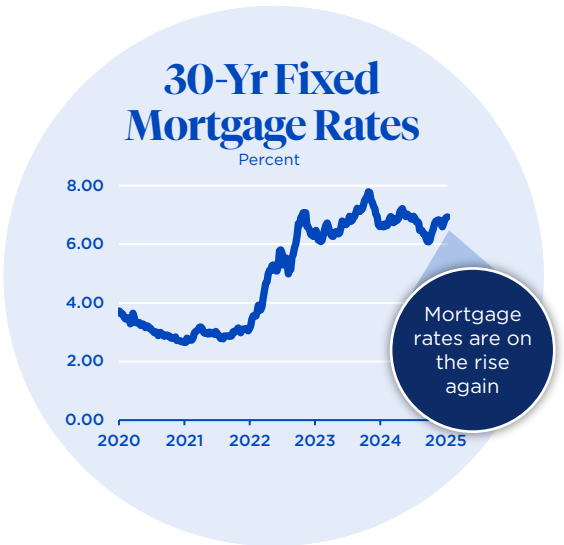
- Headline CPI rose by 0.4 percent in December. However, the gain was boosted by gasoline prices that were lifted by seasonal adjustment. The 0.2 percent rise in core inflation was more benign and is the more important reading for markets and the Fed.
- Looking forward, disinflation is likely to face some headwinds in the form of changes in tariff policies from the incoming administration. This should keep the Fed on the sidelines in H1 2025.



### Labor market finished 2024 strong

Nonfarm payroll growth was stronger in December, climbing by 256,000, while the unemployment rate fell to 4.1 percent. The strong rate of job creation and wage gains will underpin consumer spending.

- Job growth outpaced expectations by a wide margin in December. Additionally, the gain was more broad-based than the 2024 norm as 100,000 net new jobs (or about 40 percent of the total) came from cyclical sectors, such as retail trade and professional and business services.
- The unemployment rate fell to 4.1 percent in December, while annual wage growth slowed but remained buoyant at 3.9 percent after climbing 0.3 percent on the month.



### Mortgage rates climb to six-month high

Since falling to near six percent in September, the 30-year fixed mortgage rate has climbed above 7.0 percent — the highest level since May.

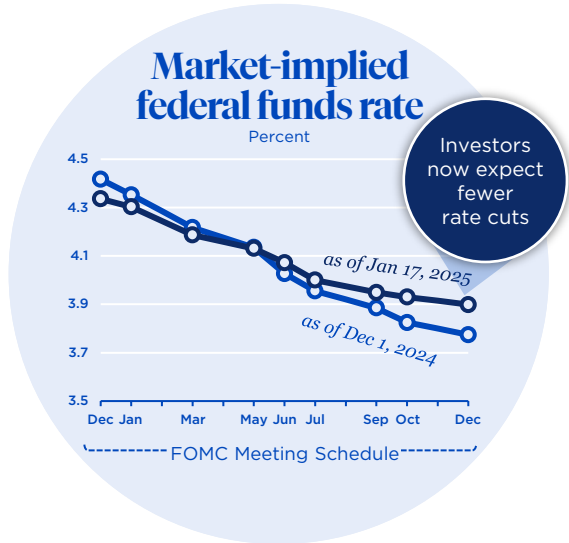
- Existing home sales, which recovered in fall 2024 on lower rates, are expected to struggle in the first half of 2025. Affordability concerns remain paramount for potential buyers. Limited supply will remain an issue with more current homeowners locked in to well-below market rates.
- The higher-for-longer interest rate outlook further delays any potential relief for industries sensitive to rates. A more sustained recovery within the housing market is now not expected until 2026 or later.

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are this  
month

What does  
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# Investors were less enthusiastic early in 2025

Risks assets are starting 2025 on a cautious note after an ebullient 2024. The stock market lost some upward momentum in January as resilient growth and inflation as well as uncertainties on the timing and scope of potential economic policy changes have raised market interest rates and deflated hopes for near-term Fed rate cuts. We anticipate a continuation of encouraging earnings and economic growth trends this year though we now expect only 50 basis points of Fed easing coming in the second half of the year.



Where we  
are this  
month

What does  
this mean

## Stocks took a breather

The stock market was off to a hesitant start of the year, but this comes on the heels of a very strong performance after the S&P 500 rose more than 20 percent in 2024.

- While 2025 is off to a relatively softer start from an equity returns perspective, the fundamental backdrop remains encouraging. Solid corporate earnings and economic trends should keep a firm floor under equity valuations.
- Investors remain cautiously upbeat about 2025, casting aside domestic and global uncertainties, namely on the policy front amid a contentious global geopolitical environment.

## Interest rates renew their ascent

The economy's resilience, slower disinflation, less expressed desire among Fed policymakers to loosen policy and some concern over the U.S. fiscal path have raised interest rates in recent weeks.

- Short-term Treasury yields have risen as the Fed has signaled a slower easing cycle in 2025. The 2-year Treasury yield has risen about 30 basis points (bps) since the end of November.
- We now expect 50 bps of Fed rate cuts in 2025, with the first cut likely delayed until H2 2025. The federal government's debt burden continues to lend upside risk to long-term interest rates.

## Investors rethink their Fed expectations

The Fed proceeded with a rate cut in December amid less confidence that inflation will ease in 2025 and elevated uncertainties surrounding potential economic policy changes on the horizon.

- The strong economy and healthy spending and hiring, has left policymakers with less confidence that inflation will continue to slow in the coming months. As a result, policymakers have said they will proceed cautiously when it comes to additional rate cuts.
- Fed policymakers are unclear how much the incoming administration will change economic policy, namely on the tariff, immigration, fiscal, tax and regulatory fronts.

# Outlook

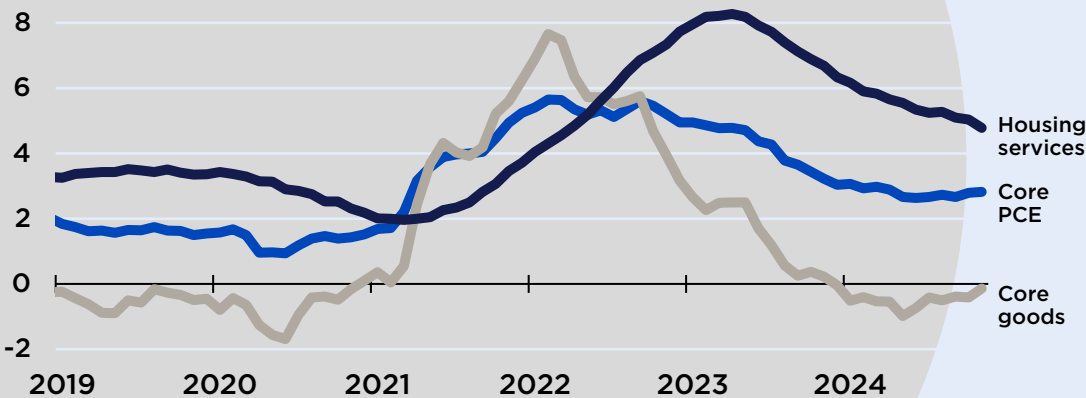
## Stalled disinflation has policy implications

Annual inflation for the core PCE price index, the Fed’s preferred inflation measure, dropped from a recent peak of 5.6 percent in early 2022 to 2.6 percent by mid-2024 in response to the Fed’s inflation-fighting efforts. But this disinflation stalled in the second half of 2024 with annual readings edging higher. Housing costs have eased, but remain elevated, while the pace of core goods deflation has slowed materially.

Cooler trends for housing and service costs are expected to prevail in 2025, but annual figures could remain elevated for some time. There could be considerable upside risk for goods costs from tariffs and supply chain disruptions in the year ahead. Given the inflation unease, the Fed is expected to keep rates steady over the first half of 2025 to gain renewed confidence that inflation is on a sustainable downward path.

### PCE Inflation

Year-over-year percent change



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## Latest Forecast

Data as of January 2025

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.9%	2.8%	2.2%	2.0%	2.0%
UNEMPLOYMENT RATE	3.6%	4.0% <sup>a</sup>	4.4%	4.2%	4.2%
INFLATION <sup>1</sup> (CPI)	3.2%	2.7%	2.6%	2.0%	2.0%
TOTAL HOME SALES	4.75	4.71	4.86	5.80	6.16
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	3.9%	3.2%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.8 <sup>a</sup>	16.0	16.2	16.5
FEDERAL FUNDS RATE <sup>2</sup>	5.25%	4.25% <sup>a</sup>	3.75%	3.25%	3.00%
5-YEAR TREASURY NOTE <sup>2</sup>	3.84%	4.38% <sup>a</sup>	3.95%	3.60%	3.55%
10-YEAR TREASURY NOTE <sup>2</sup>	3.88%	4.58% <sup>a</sup>	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE <sup>2</sup>	6.61%	6.91% <sup>a</sup>	6.10%	5.10%	5.00%
MONEY MARKET FUNDS	5.09%	4.96% <sup>a</sup>	4.09%	3.47%	3.03%

### Moderating growth for the U.S. economy

While there is a solid handoff for growth from 2024 to 2025, consumer activity is expected to slow in the face of fading tailwinds for spending. Policy uncertainty adds to the downside risk as many businesses await clarity on prospective policy changes and price conditions for the year ahead.

### Fewer rate cuts expected in 2025

After 100 bps of cuts later in 2024, the Fed is projected to pause its easing cycle over the first half of 2025 to assess policy impacts and inflation readings. Modest rate declines may resume later in 2025, especially if inflation shows signs of cooling back to the Fed’s desired 2.0 percent goal.

<sup>1</sup> Percent change Q4-to-Q4

<sup>2</sup> Year end

<sup>a</sup> Actual



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# Sources

Page 1	<b>Where is the economy now?</b>	
	Business Cycle	<i>Nationwide Economics</i>
	Yield Curve	<i>Bloomberg; National Bureau of Economic Research</i>
2	<b>Economic Review</b>	
	Consumer Price Index	<i>Bureau of Labor Statistics</i>
	Nonfarm payroll gains	<i>Bureau of Labor Statistics</i>
3	<b>Financial Markets Review</b>	
	S&P 500	<i>Standard &amp; Poor's</i>
	10-year Treasury yield	<i>Federal Reserve Board</i>
4	<b>Outlook</b>	
	Fed funds expectations	<i>Bloomberg</i>
	Real GDP estimate for 2025	<i>Bloomberg</i>
	Latest Forecast	<i>Nationwide Economics</i>

