



KPMG Economics

Election year dissonance Midyear economic outlook

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A recent KPMG [poll](#) revealed that consumers assess their own financial situations as better than prospects for the overall economy. Some of that dissonance reflects the divisiveness of our politics. Republicans assess the economy as worse when the White House is occupied by a Democrat and vice versa.

However, the gap we are seeing is more than one of political allegiance alone. Recent [research](#) reveals that people who reside in states that are Republican strongholds experienced the highest inflation and were the largest beneficiaries of in-migration.

Those wealthy newcomers bid up costs, notably of shelter, making it harder for existing residents to make ends meet. Some of that migration was due to the arbitrage that cheaper, second-tier cities offered, including lower income taxes. Many of those same enclaves are now among the most expensive, with inflation outpacing other parts of the country.

The KPMG survey reveals that CEOs are less confident about their companies' performance but more confident in prospects for the overall economy. That is the reverse of how consumers perceive the economy, another seeming anomaly or dissonance in the data.

Some of that discrepancy can be explained by the source of our news. Those who get their news from social media or word of mouth tend to assess the economy much more harshly than those who listen to mainstream or business news. It is not a stretch to assume that CEOs tune in to mainstream and business news.

The gap between consumers' and CEOs' individual situations gets to the frictions we are seeing emerge. Higher interest rates have hit a tipping point. Loans are repricing, especially for mid-sized and small firms, while consumers are pushing back on price hikes, especially on goods.

This is at the same time that the overall economy is slowing under the weight of higher rates. The shift into low fixed rate debt delayed but did not derail the effects of higher rates on consumer and corporate balance sheets.

There is an asymmetry between how people experience economic trade-offs. They see the surge in wages as a reflection of their skills, not a rapid recovery but inflation is more nefarious. They blame it on the government and corporate greed. Many of the same factors that spurred wages also stoked inflation. That has opened the door to populist rhetoric, which fuels public anger, rather than provides effective solutions to inflation.

This edition of *Economic Compass* provides a deep dive into the outlook, the implications for inflation, decisions on interest rates by the Federal Reserve and the trajectory of bond yields. Special attention will be paid to the election and how it could influence the economy. Our divisive politics have consequences. Policy uncertainty acts as a tax on the economy and prompts firms and households to delay big spending decisions.

Election uncertainty jumped to the second greatest threat in the Fed's Spring 2024 Financial Stability Report; 60% of respondents cited it, up from 24% in Fall 2023. Another KPMG [survey](#) revealed similar concerns, with 62% of CEOs saying they would delay investment until after the election. Our analysis suggests that the consequences of policy uncertainty can linger, especially if an election is contested.

Growth slows

Chart 1 lays out the forecast for economic growth during the remainder of 2024 and into 2025. The annual averages for 2024 mask a significant slowdown in the quarter-to-quarter growth rates.

Growth in the first quarter rose only 1.3%, well below the 3.4% pace of the fourth quarter of 2023. Nearly one and a half percentage points of that shortfall was due to a widening of the trade deficit and a drop in inventories.

Growth picks up moderately midyear, only to slow again as we get closer to the election and the start of 2025. Prospects for 2025 are better, with rate cuts acting as a tailwind. The key is the outlook for policy decisions by our elected officials, and whether those spur or undermine confidence in government.

Election noise

Facts in the context of opinions

We have two known, but not especially popular, candidates at the top of the ticket. That ups the ante that third party candidates could siphon votes from the leads. Our next president could win the electoral college but not the popular vote, which adds to the risk of a contested outcome.

Why can't a third party candidate win? Many states do not even put third party candidates on the ballot.

The US elected one independent in its history, George Washington in 1789. He [warned](#) that hyper partisanship and the divisions it created were a threat to unity and our experiment with democracy. His words proved prescient given the repeated threats political polarization have had on democracy.

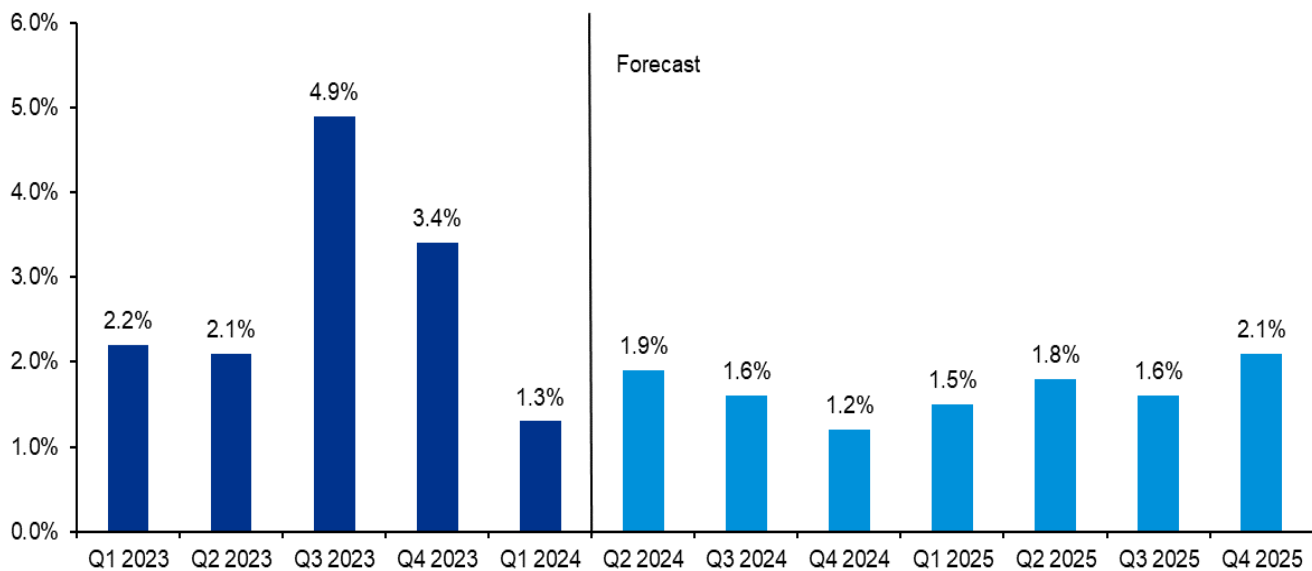
[Research](#) on the polarization we are experiencing shows that it makes policy decisions less reflective of the public and more tied to the affluent. The role that money plays in determining elections has intensified, while the ability to compromise has diminished.

The extremes of the political parties gain traction and votes due to the tendency for people to choose personalities instead of policies. That further erodes representation and widens the gap between people's preferences and the policies enacted.

The result is a tendency to be more insular, less trusting of the government, and sadly each other. That undermines our ability to cooperate globally and intensifies the backlash to large multinational firms. There was a time when our political differences spurred debate around the kitchen table but did not stop us from gathering. That is increasingly hard to do.

Chart 1

Growth slows on a quarterly basis GDP, annualized percent change



Source: KPMG Economics, Bureau of Economic Analysis

Voters have voiced fatigue in the divisiveness in our political rhetoric. The research on how to bridge those divides reveals that facts alone are not enough. We need to subjectively identify with the experiences and share an emotional attachment with someone to better understand our differences and form stronger social bonds. This is where facts and opinions intersect and unify, instead of divide.

The outcome of the election will have repercussions. Both candidates favor more interventionist policies on everything from trade to the role government plays in our lives. The extremes to which they go in those initiatives matter along with the extent to which they foment or add to uncertainty. Firms and households can more easily move forward with fewer restrictions and confidence that policies won't rapidly shift.

Downside risks. Everything from the bite of higher rates to the delays to investment triggered by the election itself could further suppress economic activity. The risk of a misstep and full-blown recession cannot be ruled out.

Consumers lose some of their mojo

Consumer spending has already slowed in response to higher rates and the lingering burn of inflation. The situation for consumers is expected to remain strained until inflation further decelerates and interest rates can be cut more rapidly in 2025.

Consumer attitudes about the economy remain low, given the strength of the recovery. The largest single issue is inflation; the level of prices remains elevated, despite some slowing in the pace of increase.

Wage gains have begun to moderate but remain well above their pre-pandemic pace. Employment gains remain solid. Most of the excess savings amassed during the pandemic have been depleted for all but the highest earners. That is slowing the rate at which consumers can spend.

Debt-to-income ratios have moved back above pre-pandemic levels but remain historically low. However, much of the loan forbearance, which boosted credit scores, has lapsed. This is at the same time that delinquencies have picked up, which is curbing access to credit, especially among low credit score borrowers.

Consumers are pivoting from big-ticket items, which require financing, into services. The slowdown in home buying in recent months is expected to exacerbate those trends; we tend to fill and remodel the homes we buy.

One upside is net worth, which hit another record in the first quarter of 2024. Those gains accrue the most to high-income households but are broader-based than they once were. Nearly 60% of households now own stocks, a record high, while home values have increased along with stock prices. This is in addition to the higher interest savers are earning on their deposits.

Consumers are tapping home equity lines of credit, which could provide a floor under remodeling activity and big-ticket spending. Vehicle sales picked up in April and May from the trough hit earlier this year.

The Fed has begun to talk about the increase of buy now, pay later loans at the Federal Open Market Committee (FOMC) meetings. Those appear to be on the rise but are hard to track as they are initiated outside of traditional banks.

Separately, consumers prefer to spend with companies that align with their personal values and beliefs. That can prove to be a land mine in a year when emotions due to the vitriol in our politics are already heated.

Look for spending gains to pick up a bit and become more balanced in 2025 as rates drop. Spending on big-ticket items, which tend to follow the lead of the housing market, should get the largest boost.

Constrained rebound in housing

Home buying and building surged at the start of the year after mortgage rates dropped in anticipation of rate cuts. Home values accelerated as the market picked up. A rebound in rates has locked first-time buyers out of the market and put a damper on overall activity.

Home buying sentiment has hit a new low, while the number of those who think it is a good time to sell has softened but remains elevated. Listings are up along with inventories of new homes on the market but supply shortages persist.

Reports of price cuts have picked up. However, it is unclear whether that is just a slowdown in the pace at which home values are appreciating, which jumped in recent months, or an actual cooling. The difference matters for inflation.

Housing affordability is at the lowest level since the mid-1980s. Those measures do not include the rise in other housing-related costs, from insurance to maintenance and repairs; all have surged.

Home builders have moved downscale and offered mortgage discounts to tap the pent-up demand by millennial buyers. However, builder discounts are not as aggressive as they once were, given the upward pressure on materials costs due to the surge in weather-related damages and waning hopes of a rate cut this year. Costs of inputs to construction are 39% higher than early 2020, even as many items have come off record highs.

Those who can't buy are renting. That is helping to absorb the excess supply of apartments in the hottest post-pandemic markets and placing a floor under rents.

The rebound in housing activity once mortgage rates start to fall is expected to be solid but not spectacular. Millennials now represent the largest generation of thirty-somethings we have ever seen. That is the median age of first time buyers, fueling demand amidst supply constraints.

Many sellers remain locked into ultra low rates and are reluctant to list, while baby boomers continue to age in place. That is limiting the stock of existing homes for sale, while builders are struggling with shortages of workers, materials and land for development. Water shortages and the stress on the electrical grid are additional hurdles.

Another wild card is weather. An increase in severe storms could compound the damages to property we have already seen, keep materials costs high and trigger construction activity later in the year and into the start of 2025.

“Policy uncertainty acts as a tax on the economy and prompts firms and households to delay big spending decisions.”

Business investment softens

Business investment accelerated at the start of the year, buoyed by subsidies for chip plants and the surge in demand for data warehousing. Intellectual property investments are catching up after last year's writers' strike and investment in AI.

Investments in generative AI (GenAI) are rising from a low base. Recent surveys by the Census Bureau suggest they follow a U-shape and are concentrated in large firms and startups. The insatiable demand for energy created by data warehousing and GenAI is stressing energy grids. That has focused Silicon Valley's attention on renewables and cheaper non-carbon sources of energy, including nuclear.

The hurdle is high interest rates and the maze of regulations surrounding government loans for and permitting of renewables. This is before the losses associated with office leases repricing in 2024 and 2025. Much of what was due to reprice in 2023 was delayed until rates were expected to fall. It is unclear how many more of those payments can be deferred. [Unrealized](#) losses in the financial system have increased in recent years.

The Fed has flagged private credit markets, which have expanded, as a place to watch. They are opaque; officials have no way of knowing how systemic the risks of a large failure in that market might be for the overall economy.

The uncertainty surrounding the election and its outcome could further suppress investment. There is considerable uncertainty regarding the fate of expiring tax cuts; corporate tax cuts could now lapse under both candidates due to a broad lack of trust in corporate America. Small businesses are viewed much more favorably than large businesses.

Both party leads favor more protectionist policies, although those favored by the former president are more extreme when it comes to tariffs and immigration. The United-States-Mexico-Canada-Agreement (USMCA) is unique in that it was negotiated with a sunset clause; that is suppressing investment in all three countries as it removes the certainty of avoiding tariffs.

The trade agreement is up for renegotiation in 2026. The US has the largest sway in the review process, which makes who the president is sitting at the negotiating table crucial. The former president was much more critical of the trade pact than the current president, hence the escape clause.

Why do we care? Because a failure in the review process could set off a chain of events that boosts tariffs and creates more hurdles to trade within North America more broadly. The literature on tariffs is split on whether consumers or firms in the country that enacts them pay the greater costs; either way, they are a tax.

Inventories are replenished

One of the few bright spots in the economy is the drawdown in inventories we saw in late 2023 and early 2024. That sets the stage for some rebuilding during the Spring and Summer. The cost of carrying inventories has risen with the jump in bond yields since the start of the year. That could delay a full rebuilding of inventories until rates come down in 2025.

Government spending posts short-term gains

The resolution of federal budget battles earlier in the year means that much of what is left of the budget will need to be spent before the end of the fiscal year, which ends October 1. The biggest obstacle for 2025 is the fiscal cliff; 25 tax cuts associated with the 2017 Tax Cuts and Jobs Act (TCJA) are slated to expire by the end of the year.

The chances of getting a deal on the TCJA early in the year are slim, which pushes most of the economic consequences into 2026. Our baseline forecast has tax cuts for corporations lapsing at year-end, but not for households. Both parties favor keeping at least a portion of the individual tax cuts, which covered more than half of all households.

Spending by state and local governments is expected to hold up better, as earlier stimulus is still being spent. Many states have shored up their rainy-day funds. However, revenues have begun to slacken, which suggests a larger headwind for spending in fiscal 2025, beginning over the summer for many states.

Fiscal policy is expected to be a drag on growth in 2025. Federal deficits are expected to continue to mount, as Congress debates where and how to raise revenues or reduce spending; neither party has a recent record of achieving either, while the upward pressure due to aging demographics mounts.

Estimates on potential deficits are large and rising under both candidates but the figures are all over the place due to the uncertainty of outcomes, including immigration policy. In the absence of immigration the overall population is projected to contract by 2040.

The latitude of state and local governments, which make up the lion's share of spending, is limited. They cannot rely upon deficit spending the same way that the federal government can. Their revenues are expected to continue to slow as they enter fiscal 2025.

The drag from trade dissipates

The US continues to outperform many of its trading partners, even as its economy slows. That has put upward pressure on imports relative to exports. The push by businesses to get under the wire before new tariffs go into effect has further fueled imports. Those shifts will front-load the widening of the trade deficit.

A slower glide path by the Fed is another hurdle, as it has triggered a widespread strengthening in the dollar against the currencies of all our major trading partners. That makes imports cheaper and our exports more expensive. The lags on the dollar suggest that the largest effects of those moves will hit late this year and early 2025.

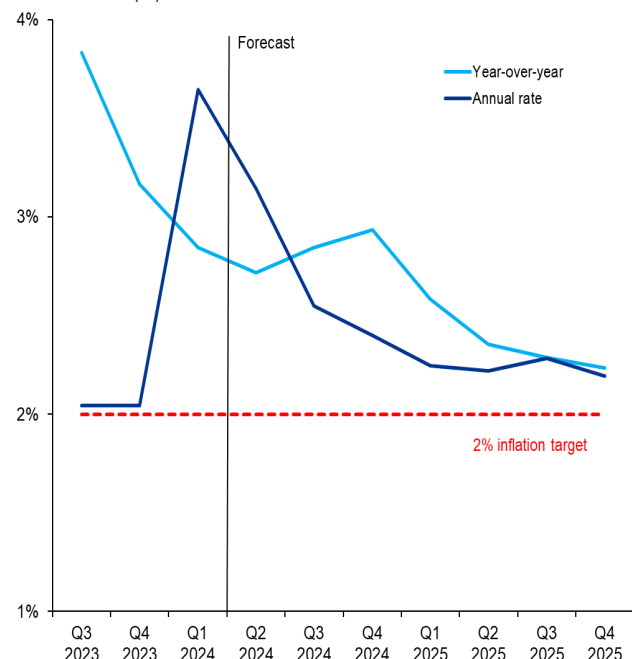
Inflation slowly cools

Chart 2 shows the trajectory for the core personal consumption expenditures (PCE) index, which strips out food and energy. The year-over-year and the quarterly movements are both tracked. The year-over-year core PCE rises in the second half due to the sharp deceleration in 2023.

Chart 2

Inflation slowly cools

Core PCE Index (%)



Source: KPMG Economics, Bureau of Economic Analysis

That makes for bad headlines on inflation but is not the only factor affecting decisions by the Fed. Quarterly measures of core PCE are more important when it comes to determining the momentum in inflation. Those figures are expected to move closer to the Fed's 2% target as we get into the second half of the year.

Many of the country's largest retailers have announced plans to roll back prices on nondurable goods. The hope is to make up in volume what they give up in margins. The largest retail behemoths tend to set the trend for the entire industry. That should add to the downward pressure on prices due to a stronger dollar.

Shelter costs are poised to roll over and place a drag on overall inflation in the second half. The question is whether they can stay low, given the pivot to rentals by millennials.

Service sector prices, excluding shelter costs, which make up half of the core PCE, look stickier. This is where wage growth has a larger impact, as it represents a higher percentage of costs in a sector with less productivity growth to offset increases. That includes [childcare](#) costs, which continue to rise and are a major issue for working parents.

Vehicle insurance prices slowed in April, but homeowner and healthcare premiums continued to climb. Much of the rise in insurance costs is structural as opposed to cyclical. Many insurers are still playing catch-up on losses due to earlier weather disasters. The National Oceanic and Atmospheric Administration is forecasting another record-breaking year for storms in 2024. Aging demographics are a challenge for healthcare costs.

Lower inflation risks. The risks to the outlook are for weaker growth, which should result in downside risks to inflation. The wildcards are everything from the level of tariffs to the severity of disruptions due to extreme weather events, which continue to add to insurance costs.

Higher for how long?

The Fed will release new forecasts for its trajectory on rate cuts in June. We expect most participants at the June meeting to forecast two or fewer rate cuts for the year and a slow glide path on cuts in 2025.

The Fed has made clear it does not want to repeat the mistakes of the past and cut prematurely. That would risk stoking a more persistent inflation, or worse, stagflation.

Hence, the Fed wants to be sure that inflation is coming down "convincingly" before it cuts. That is not likely to happen until late in the year, given our forecast for inflation. The first cut in rates is expected in December.

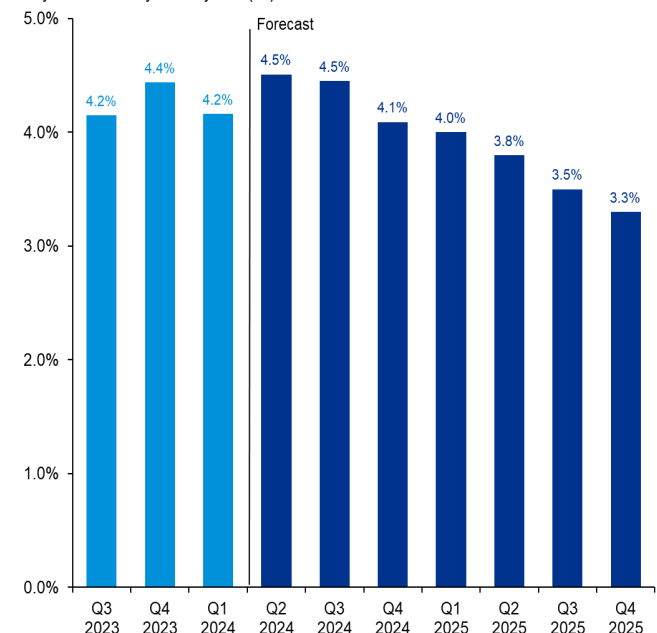
Another six cuts are forecast in 2025, which would bring the fed funds rate down from its current 5.25% to 5.5% range today to a 3.5% to 3.75% range at the end of 2025. The fed funds rate is expected to hit a terminal rate of 2.75% to 3% in 2026, which is still well above the 1.5% to 1.75% in February 2020.

What would prompt the Fed to cut more aggressively? A much more abrupt weakening of labor market conditions. The Fed's most recent Beige Book report highlighted a slowdown in hiring, but that has yet to show up in the payroll data.

The election poses an existential threat to the Fed. The former president made his dislike for the Fed Chairman, whom he appointed, well known. Some in his campaign have pledged to curb the Fed's independence by picking leaders more loyal to the president. History is littered with central banks that succumbed to political pressures. That is what helped stoke the stagflation of the 1970s.

Chart 3

Long-term rates remain elevated until Fed cuts
10-year Treasury bond yield (%)



Source: KPMG Economics, U.S. Treasury

Lower short-term rate risks. The Fed is “data-dependent” but data on the economy lags. That ups the risk that the Fed overtightens and adds to the policy uncertainty surrounding the election.

Bond yields slowly descend

Chart 3 shows the forecast for the 10-year Treasury bond yield, which impacts everything from mortgage rates to the yield on corporate and municipal bonds. Long-term rates are expected to remain elevated until a rate cut is imminent later in the year. Long-term rates are expected to end 2025 at 3.3%, more than double the rate in February 2020. Bond yields fell as COVID cases began to spread.

Uncertainty surrounding the election could exacerbate volatility in the bond market and delay the rally in rates. Government debt is mounting; we can't rule out a return of what are known as “bond vigilantes,” or bond investors who punish unsustainable deficits or threaten to default due to political jockeying. The debt ceiling is set to expire again on January 1, 2025.

Debt crises result when a government refuses or is unable to pay its debts. As a reserve currency, the thought that we might deliberately default on our debt for political gain was once unimaginable. That is no longer the case. Our debt has been downgraded due to “an erosion of governance.” Mounting debt, that compounds at much higher rates of interest, adds to the chinks in our armor as a safe haven.

Higher long-term rate risks. Threats to the Fed's independence and a fear that we might renege on our debt obligations could boost the risk premium we are forced to pay investors. That would keep long-term rates higher than forecast and further dampen growth.

Bottom Line

The economy is slowing. The uncertainty and noise triggered by the election will likely exacerbate that weakness. The forecast is still for a soft landing but the risks to the downside are mounting. We have proven remarkably resilient, but that will be tested; risks of a recession are not inconsequential. The extent to which a candidate stokes or undermines certainty is an important determinant of how the economy will perform in 2025.

My kids are young adults, with strong views on the world, which often differ from my own. That has prompted me to more openly listen to their perspectives and what is driving them. The more I listen to and talk with, instead of at them, the deeper our bonds have become. Facts without context do not unify. We need to understand how people are experiencing the world via their own lived experiences to find the commonality in our existences. Learning from them has made me a better person. Pay it forward.

Economic Forecast — June 2024

	2023	2024	2025	2023:4(A)	2024:1(A)	2024:2	2024:3	2024:4	2025:1	2025:2	2025:3	2025:4
National Outlook												
Chain Weight GDP ¹	2.5	2.3	1.6	3.4	1.3	1.9	1.6	1.2	1.5	1.8	1.6	2.1
Personal Consumption	2.2	2.3	1.8	3.3	2.0	2.1	2.2	1.5	1.9	1.7	1.7	2.2
Business Fixed Investment	4.5	3.1	2.0	3.7	3.3	3.6	1.5	1.4	2.1	2.3	1.9	2.0
Residential Investment	-10.6	2.6	0.0	2.8	15.4	-5.8	-5.6	-5.7	2.4	2.7	4.9	7.5
Inventory Investment (bil \$ '17)	44	56	75	55	28	66	62	67	60	78	81	81
Net Exports (bil \$ '17)	-928	-1010	-1051	-919	-975	-1019	-1022	-1024	-1035	-1046	-1057	-1066
Exports	2.6	1.9	3.3	5.1	1.2	-0.3	4.2	3.3	2.9	3.4	3.9	4.5
Imports	-1.7	3.8	3.5	2.2	7.7	4.8	3.4	2.6	3.3	3.7	4.0	4.1
Government Expenditures	4.1	2.5	0.7	4.6	1.3	1.1	1.3	0.7	0.7	0.4	0.4	0.4
Federal	4.2	1.6	1.1	2.4	-0.7	0.7	2.0	1.2	1.3	0.8	0.9	0.8
State and Local	4.0	3.1	0.4	6.0	2.6	1.4	1.0	0.4	0.3	0.2	0.2	0.2
Final Sales	2.9	2.2	1.5	3.9	1.7	1.2	1.7	1.1	1.7	1.5	1.5	2.1
Inflation												
GDP Deflator	3.6	2.6	2.5	1.6	3.0	2.9	2.5	2.4	2.4	2.4	2.6	2.5
CPI	4.1	3.3	2.3	2.7	3.8	3.6	2.9	2.2	1.8	1.7	2.9	3.0
Core CPI	4.8	3.6	2.7	3.4	4.2	3.7	3.1	2.7	2.5	2.5	2.5	2.4
Special Indicators												
Corporate Profits ²	5.1	3.8	2.5	5.1	7.2	9.8	7.6	3.8	4.6	2.6	2.0	2.5
Disposable Personal Income	4.1	1.5	2.9	0.9	1.9	1.0	2.0	2.8	3.7	3.2	2.7	3.0
Housing Starts (mil)	1.42	1.37	1.37	1.48	1.40	1.35	1.38	1.34	1.35	1.36	1.39	1.40
Civilian Unemployment Rate	3.6	4.0	4.3	3.8	3.8	3.9	4.0	4.1	4.2	4.3	4.3	4.3
Total Nonfarm Payrolls (thous) ³	2936	2051	403	617	772	580	430	269	133	70	100	100
Vehicle Sales												
Automobile Sales (mil)	3.1	3.0	3.1	3.1	2.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Domestic	2.3	2.1	2.1	2.3	2.0	2.2	2.2	2.1	2.1	2.1	2.1	2.1
Imports	0.9	0.9	1.0	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0
LtTrucks (mil)	12.4	12.7	12.9	12.6	12.4	12.8	12.7	12.8	12.8	12.9	13.0	13.0
Domestic	9.9	10.0	10.0	9.9	9.9	10.1	10.0	10.0	10.0	10.0	10.0	10.0
Imports	2.5	2.7	2.9	2.6	2.5	2.7	2.7	2.8	2.8	2.9	3.0	3.0
Combined Auto/Lt Truck	15.5	15.7	16.0	15.7	15.3	15.8	15.8	15.8	15.9	16.0	16.1	16.1
Heavy Truck Sales	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Total Vehicles (mil)	16.0	16.2	16.5	16.2	15.8	16.4	16.2	16.3	16.4	16.5	16.5	16.6
Interest Rate/Yields												
Federal Funds	5.0	5.4	4.4	5.3	5.3	5.4	5.4	5.3	5.1	4.7	4.2	3.8
10 Year Treasury Note	4.0	4.3	3.7	4.4	4.2	4.5	4.4	4.1	4.0	3.8	3.5	3.3
Corporate Bond BAA	5.9	6.0	5.8	6.2	5.7	6.0	6.0	6.1	6.0	5.9	5.6	5.5
Exchange Rates												
Dollar/Euro	1.08	1.09	1.10	1.08	1.09	1.08	1.09	1.09	1.10	1.10	1.10	1.10
Yen/Dollar	140.5	152.1	142.3	147.8	148.6	155.0	152.0	150.0	147.0	145.0	140.0	137.0

¹ In 2023, GDP was \$22.4 trillion in chain-weighted 2017 dollars.

² Corporate profits before tax with inventory valuation and capital consumption adjustments, quarterly data represents four-quarter percent change.

³ Total nonfarm payrolls, quarterly data represents the difference in the average from the previous period. Annual data represents 4Q to 4Q change.

Quarterly data are seasonally adjusted at an annual rate. Unless otherwise specified, \$ figures reflect adjustment for inflation. Total may not add up due to rounding.

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