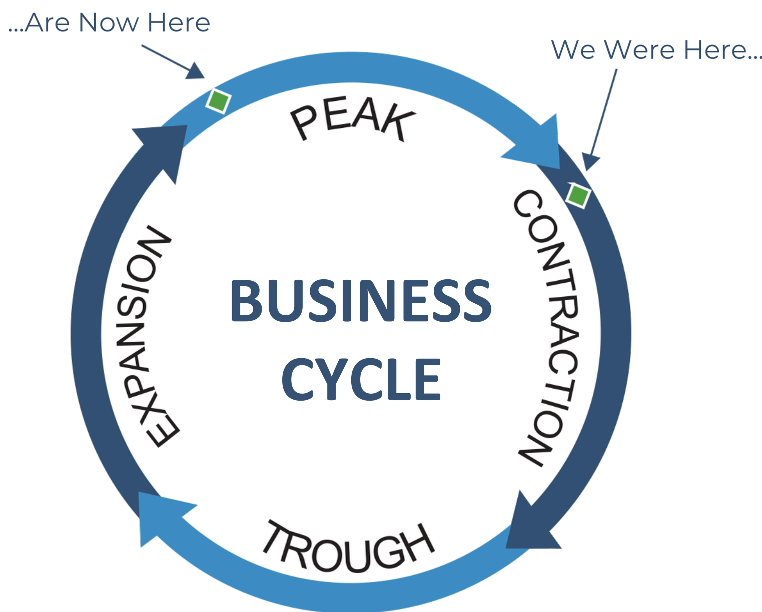
THE U.S. ECONOMY:
A CYCLE UNLIKE ANY OTHER

The current business cycle is anything but ordinary, diverging significantly from historical norms and shaped by transformative structural shifts. These changes, driven by exogenous shocks and powerful trends, have altered the traditional cyclical trajectory of expansion, peak, contraction, and trough. As we entered last year, many experts predicted a slowdown or even a recession, citing indicators such as weak manufacturing activity, an inverted yield curve, and aggressive monetary tightening. Yet, the U.S. economy defied gravity, exhibiting a rare combination of robust GDP growth and moderating inflation. It begs the question, how were so many economists and forecasters wrong about the direction of the economy?

Heading into 2024, various traditional economic indicators pointed to contraction, leaving many to wonder if their recession calls were not wrong, just premature. The answer lies in the fundamental changes and pivotal policies in recent years that have extended the growth runway beyond traditional expectations. Key themes, such as massive fiscal spending, the explosion of investment in the AI revolution, and a resilient consumer base, have created unique tailwinds that continue to drive the U.S. economy ahead. We anticipate these developments to sustain solid, albeit slower, U.S. growth into 2025, with consumer spending serving as a core driver. While the conventional economic playbook still holds relevance, it may need to step aside to accommodate the forces that are fundamentally reshaping the modern economic landscape.



Source: Waterloo Capital

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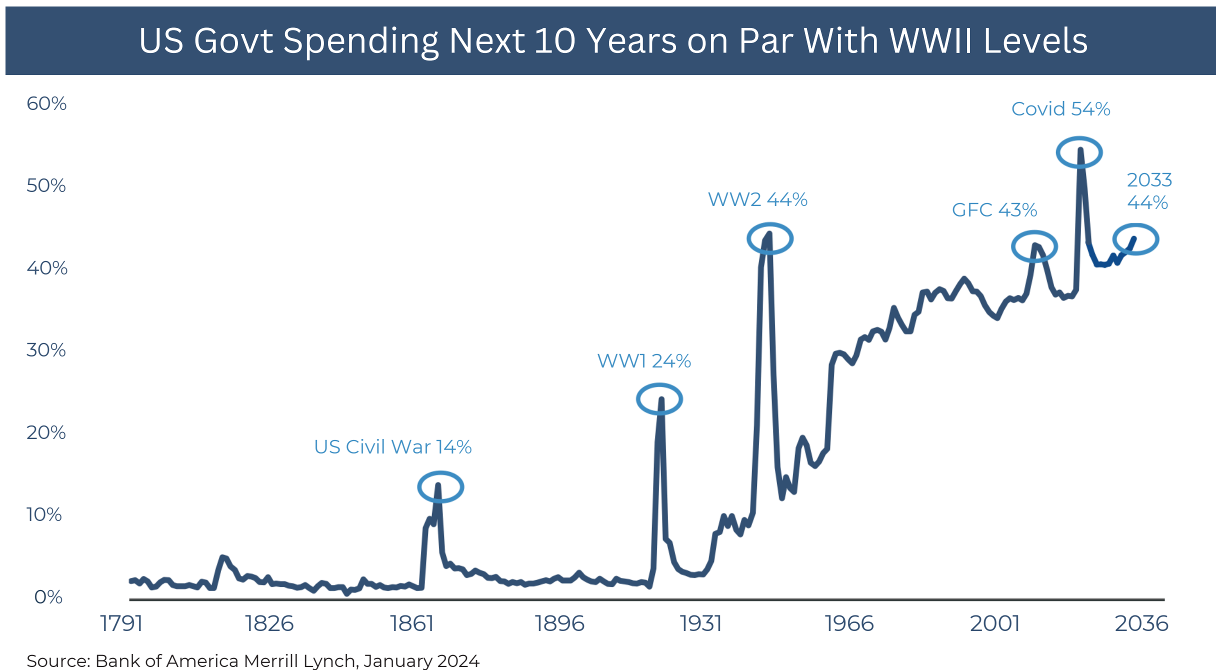
Fiscal policy has undergone a notable transformation during this business cycle, with government spending playing a far more active and sustained role than in prior periods. Historically, fiscal interventions during downturns, such as the 2008 financial crisis, focused heavily on stabilizing corporations and financial markets to restore confidence. In contrast, the present cycle has been characterized by direct, targeted expenditure that has benefited both consumers and businesses, profoundly altering the economy.

As a result, government spending as a percentage of GDP has surged, reaching levels not seen since World War II and reflecting the unprecedented scale of modern fiscal intervention. Pandemic-era government transfer payments directly bolstered main street, boosting aggregate demand and enabling consumers to sustain spending far longer than in past cycles.



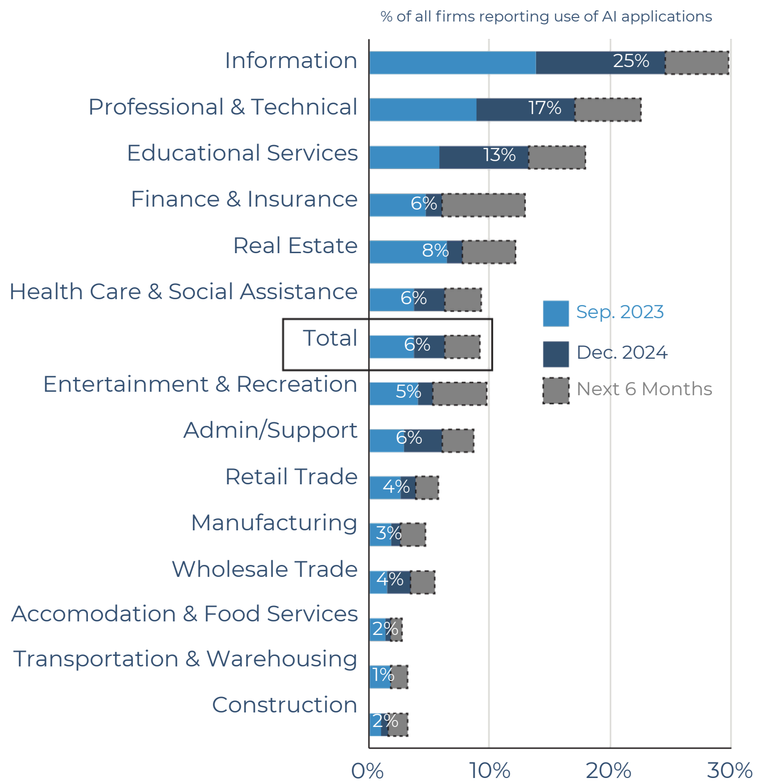
Beyond direct support to consumers, legislative programs have reshaped fiscal policy's role in driving long-term growth. These initiatives reflect a strategic transition toward supply-side fiscal spending, designed to enhance productivity and economic capacity rather than merely stimulate short-term demand. Given this trend, government spending is expected to remain a key contributor to growth in the years ahead. By directly supporting strategic sectors and consumers, fiscal policy has overridden the traditional business cycle's natural slowdown mechanisms. While this approach has fueled a strong recovery and expansion, the growing reliance on government spending raises long-term sustainability concerns, particularly as the U.S. debt-to-GDP ratio climbs.

Building on the growth impacts of fiscal policy, the artificial intelligence boom and scaled adoption of large language models have structurally altered our economy. Not long ago, tools like ChatGPT were viewed as novelties - simple applications for casual use. Today, AI has evolved into a productivity powerhouse, creating strong tailwinds for the U.S economy.

This AI boom has provided a critical shot in the arm at a time when typical economic slowdowns might otherwise have taken hold. Comparisons can be made to the 1995 soft landing, which was marked by a surge in computing power and the widespread adoption of the World Wide Web. This time around, productivity gains are even more pronounced, with applications that seamlessly integrate into everyday tasks rather than being limited to the internet. This convergence of technology and productivity has ignited a new era of exceptional economic growth. Companies are pouring unprecedented levels of capital into AI infrastructure, such as data centers and energy solutions, positioning the U.S. as the epicenter of this technological revolution. This investment is not only enhancing efficiency but aiding innovation and job creation, fueling broader economic activity and offering the U.S. another crack at growth in the business cycle.

> "The A.I. boom has offered the U.S. economy another crack at growth in the business cycle."

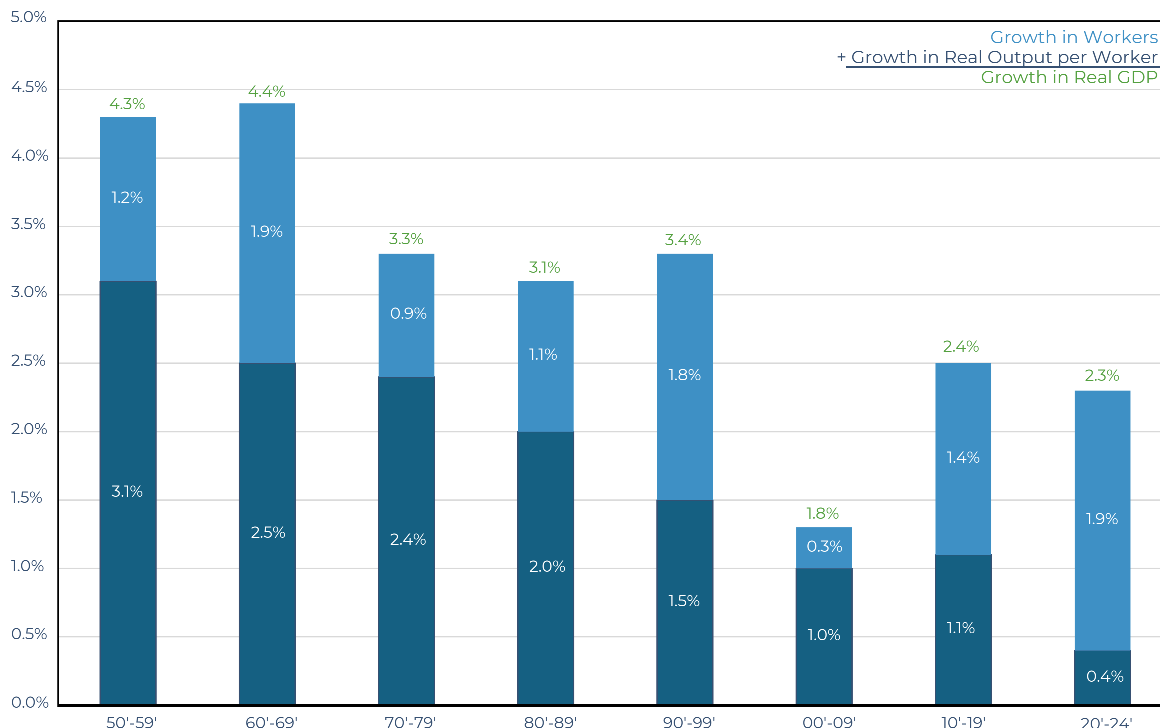
Businesses Using AI to Produce Goods & Services



Source: J.P. Morgan Guide to the Markets. Waterloo Capital

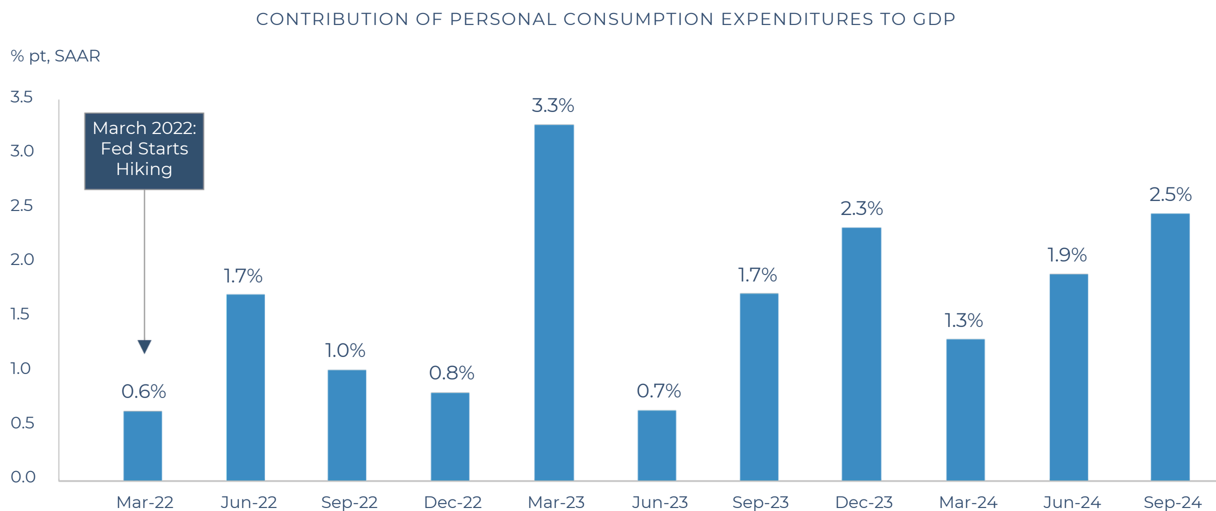
Drivers of GDP Growth

Average year-over-year % change



Source: J.P. Morgan Guide to the Markets. Waterloo Capital

These transformative shifts in fiscal spending and the rise of artificial intelligence may deviate from traditional economic cycle playbooks, but one constant endures: the consumer remains the anchor of U.S economic resilience and growth. Accounting for 68% of GDP, consumer spending expanded at an impressive 3.1% annualized pace as of Q3 2024, though this growth is expected to slow to around 2.0% in 2025. What stands out is the source of this strength, even in the face of higher interest rates, primarily driven by the top income earners, who contribute 40% of total consumption. These households have significantly benefited from rising equity and real estate prices, bolstering their net worth. Equity ownership as a percentage of household net worth is at its highest level since 2000, while credit card debt as a percentage of disposable income remains historically low. Coupled with strong wage growth and a sturdy job market, these factors have fortified the balance sheets of higher-income households, providing a solid foundation for sustained spending into 2025.



Sources: BEA, Haver Analytics, Apollo Chief Economist. Data as of September 2024.

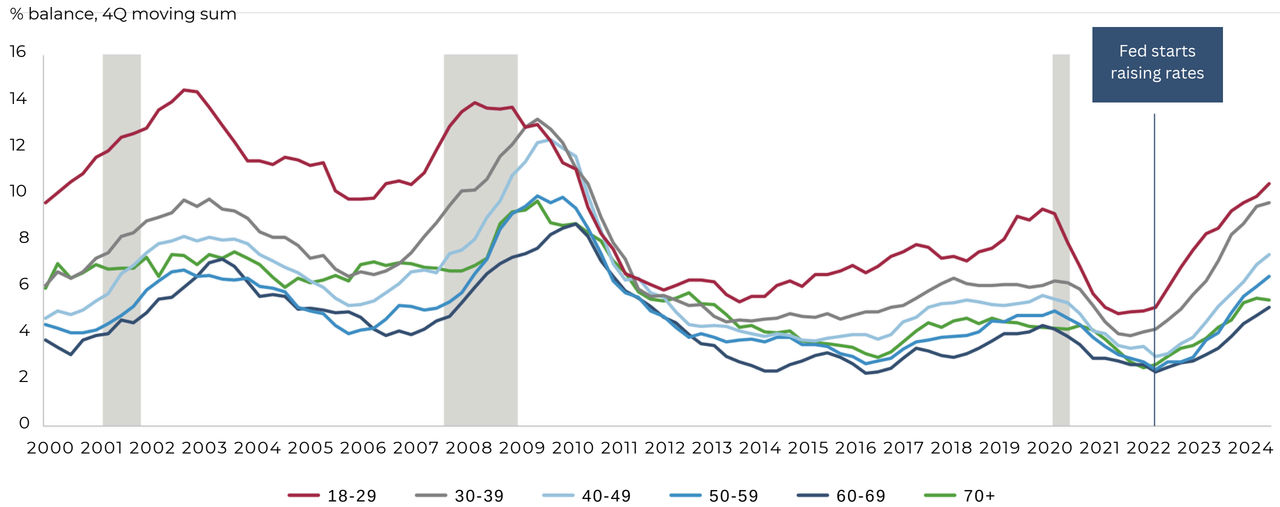
Yet, the disparities among income groups cannot be ignored, as they pose potential threats to sustaining economic growth in 2025. Lower-income households and younger consumers are bearing the brunt of rising interest rates, resulting in increased credit card and auto loan delinquencies. Many of these groups have yet to rebuild their savings to pre-pandemic levels, leaving them more susceptible to economic shocks. These mounting pressures could push the U.S. economy toward a tipping point, where weakened consumer demand jeopardizes its momentum.

Households at the lower end of the income spectrum have also been disproportionately affected by inflation. Recent data showed price pressures intensifying within recent months and complicating the Federal Reserve's path to achieving its 2% target. Over the last four years, cumulative inflation has reached about 23%, significantly eroding purchasing power for much of the population and tightening household budgets. This economic fragility has the potential to create a negative feedback loop: restrained spending could hurt corporate revenues, prompting firms to cut back on hiring or even lay off workers. Such a crack in the labor market would further dampen consumption, amplifying risks to the economy.

> "Consumers have yet to rebuild their savings, leaving them more susceptible to economic shocks."

Younger Households Are Feeling The Pinch In Their Credit Cards...

CREDIT CARD TRANSITIONS TO SERIOUS DELINQUENCY (90+), BY AGE



Sources: New York Fed Consumer Credit Panel/Equifax, Apollo Chief Economist
Data as of June 2024 .

Looking at 2025, there is a lot to digest. In a cycle unlike any other, the U.S. economy has rewritten the rules, defying traditional expectations as an expected waning growth was replaced by remarkable resilience and transformation few anticipated. This newfound strength comes with complexities this year such as rising income disparities, mounting debt, and upside pressure on inflation leave headwinds gathering on the horizon. The story of this extraordinary cycle is still unfolding, and economic resilience may increasingly hinge on the strength of the consumer.

Labor shortages, excessive spending, and widening income disparities risk reigniting inflationary pressures and weakening the broader consumer base - the backbone of economic activity. As the U.S. economy stands at a unique crossroads, there is optimism for growth in 2025. Yet, this cycle has defied the traditional playbook, extending its run against historical norms. While we believe slower growth is inevitable and these trends, that have prolonged our expansion, will not shield the economy forever, we ultimately anticipate they will drive stable growth in the year ahead.

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