



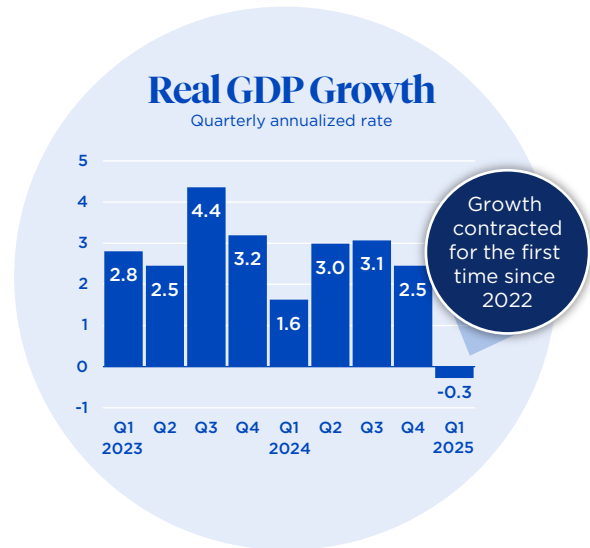
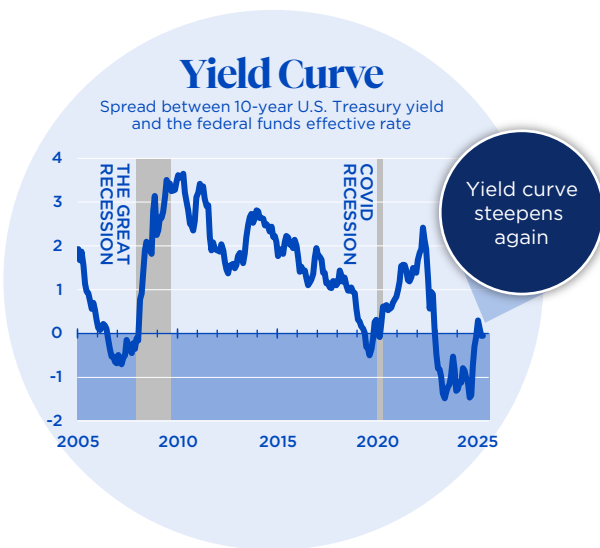
Economic & Financial Markets Monthly Review | May 2025

# Holding in wait-and-see mode



# Where is the economy now?

Tariff impacts are beginning to flow through the economic data as consumers pulled forward spending into March and April to get ahead of price increases. Additionally, the elevated uncertainty for future input costs and demand conditions has forced many businesses to pause hiring and investment plans, although the announced trade deal with China may ease this uncertainty. The Fed also took a cautious approach in May and is in no hurry to lower rates as policy makers assess how tariffs and other policy changes are shifting the economic outlook.



Where we  
are this  
month

What does  
this mean

## Sluggish growth outlook

We continue to forecast slowing economic growth as increased tariffs, reductions in government spending and employment, and front-loading of consumer spending ahead of the tariff increases weigh on economic activity.

- Reduced consumer spending should slow growth over the second half of 2025, but recession concerns were eased by the sharp reduction in tariffs on China.
- We had anticipated a sharp cut in the U.S.-China tariff rates, but the reduction from an increase of 125 percent to 30 percent as per the trade agreement is half of the 60 percent rate we baked into our baseline forecast. As such, we now forecast economic growth slowing to 0.5 to 1.0 percent Q4/Q4 this year, up moderately from our prior forecast of flat growth.

## Long-term rates remain higher

The yield curve steepened over April and into May as long-term Treasury rates moved higher while shorter duration yields priced in greater Fed easing.

- The 10-year Treasury rate rose above 4.30 percent in late April, in part reflecting a higher term premium and concerns about the Federal government deficit during discussions on potential tax cuts. Long-term interest rates are expected to remain elevated over 2025 and into 2026.
- We do not expect the Fed to lower interest rates until September as officials digest the impacts of policy changes on consumer spending, the labor market and inflation.

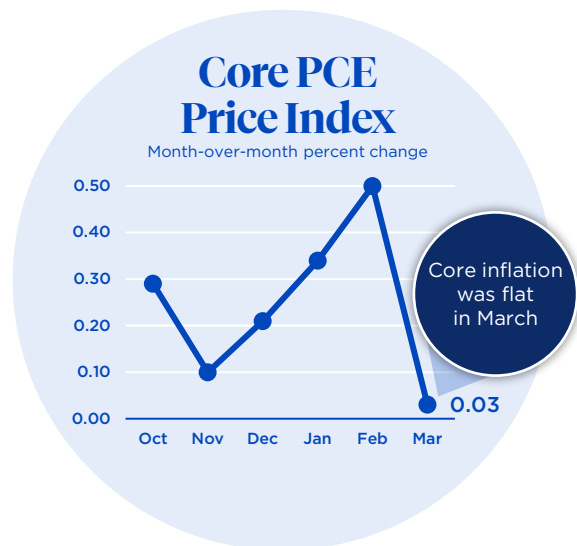
## Negative growth to start 2025

Real GDP contracted in the first quarter due to a surge in imports driven by businesses front-loading of goods ahead of tariff price increases. Net exports detracted an outsized 4.8 percentage points from GDP growth.

- Tariff impacts at the same time also boosted activity in the first quarter as businesses sharply increased wholesale inventories and equipment spending, and consumers pulled forward some purchases to avoid rising prices.
- While there should be some giveback in the second quarter on imports which will arithmetically boost GDP, overall sluggish economic activity should extend into the summer as the tariff price shocks curtail consumer and business spending.

# Sturdy economic data for April but tariff drag awaits

Job gains were solid again in April and the unemployment rate remained low, but hiring is likely to soften going forward as firms look to control costs in the face of new tariffs and elevated interest rates. Despite showing a downtrend through March, inflation is expected to shift higher as tariffs increase goods prices. Businesses reported steady demand during April but are anticipating slower sales and an acceleration in inputs costs ahead.



### Inflationary pressures were low in March

Core PCE inflation was flat in March - the slowest monthly reading since April 2020, although tariff price increases loom in the near-term outlook.

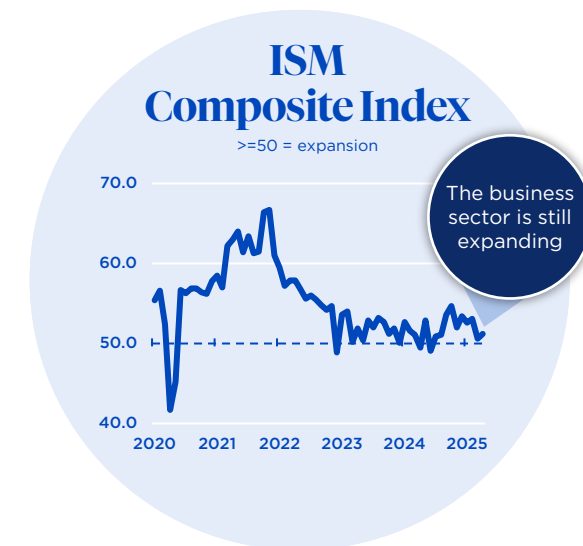
- The 12-month trend rate for core PCE inflation, which excludes the volatile food and energy components, fell to 2.7 percent in March, and price pressures from both goods and services were mild during the month.
- This good news on the inflation front predated Liberation Day so, while inflationary pressures appeared to be fading heading into Q2, the March data cannot be taken as a sign of things to come. We expect prices to rise for goods, offsetting some continued cooling of housing and service costs.



### Labor market was still solid in April

Nonfarm payroll gains slowed to 177,000 in April, while the unemployment rate was steady at 4.2 percent despite an uptick in the labor force participation rate.

- Despite the modest slowdown, headline payroll growth was again stronger than the prior 12-month average of 157,000. However, hiring was highly concentrated within the health care and transportation/warehousing sectors. Job growth for more cyclically-sensitive industries has been negligible in recent months.
- With businesses facing higher costs and weaker demand, we expect payroll gains to slow and the unemployment rate to rise in the coming months - an added headwind for future consumer spending.



### Business surveys remained positive in April

The ISM composite index, which weights services and manufacturing by output, edged higher to 51.2 in April - still indicating mild expansion across the business sector.

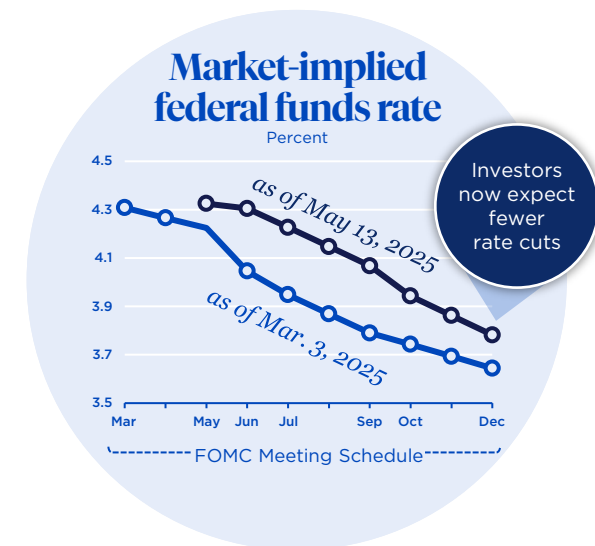
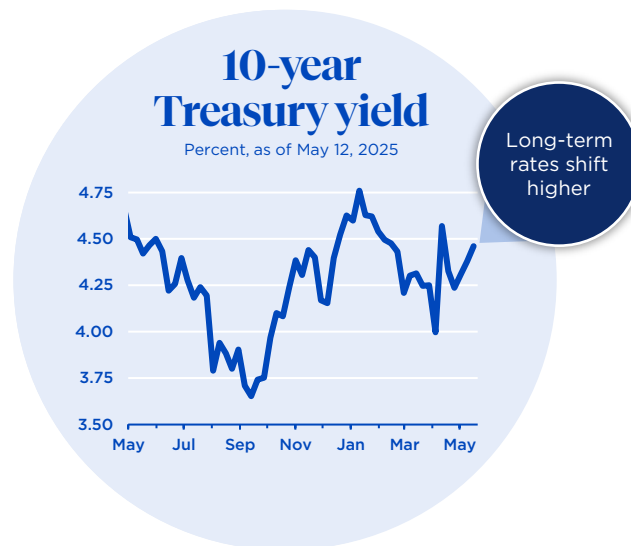
- In aggregate, the ISM business surveys showed only moderate stress following the Liberation Day tariff announcements. But tensions for business sector growth are building under the surface as higher costs and softening demand from consumers start to squeeze profit margins within many industries.
- The prices paid reading within both surveys climbed to multiyear highs in April. Tariff impacts should be greater for manufacturing inputs, but services are not immune from the resultant price pressures.

Where we  
are this  
month

What does  
this mean

# Equity market stages impressive recovery

The stock market has posted an impressive rally after the near-bear market correction in early April. Investors, led by retail buyers, have concluded that peak tariff uncertainty and shock is behind us. However, the still-sizeable tariff increases will place downward pressure on economic activity and hence corporate earnings in the coming quarters, which could be a headwind to equity prices.



Where we  
are this  
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### Stocks recover from Liberation Day lows

After plummeting close to a bear market correction in April, equity prices have staged an impressive rally. The S&P 500 has recovered back to its March level as tariff rates have been pared back and trade agreements are being struck.

- The S&P 500 index has rallied nearly 14 percent from its April 8<sup>th</sup> low, marking one of the strongest 21-day gains since 2000, surpassed only by notable rallies in 2020, 2009, 2008, 2002, and 2001.
- The equity market rally is fueled by retail investors' assessment that peak tariff uncertainty is behind us. However, the still-sizeable tariff increases will place downward pressure on corporate earnings this year which could be a headwind for equity prices and keep institutional investors more wary.

### Long-term yields remain elevated

Long-term Treasury yields remain elevated as Fed rate expectations have been pared and the term premium is higher on concerns about fiscal deficits remaining high.

- The 10-year Treasury rate rose above 4.40 percent mid-May, in part reflecting a higher term premium and concerns about the federal government deficit during discussions on potential tax cuts. Long-term interest rates are expected to remain elevated over 2025 and into 2026.
- Bond market volatility has eased to more normal levels following the surge in volatility following the April 2 tariff announcements.

### Bond market pares Fed rate cut expectations

The bond market has rightly reduced its expectations for rate cuts this year. Fed officials believe the level of interest rates is well positioned to await more clarity on how changes to tariff and fiscal policies will affect employment and inflation.

- The FOMC is potentially facing a challenging and complicated judgement call whereby policymakers might need to balance the actuality of higher inflation unfolding at the same time as rising unemployment.
- We do not expect the Fed to lower interest rates until September. By then officials should have evidence of a weakening in the labor market. We expect them to go a bit larger with a 50-bps rate cut, followed by another cut of 25 bps in October.



# Outlook

## Spending, especially on autos, expected to drop this summer

The spike in auto sales during March and April has been emblematic of consumer behavior ahead of tariff price increases: buy now to pay less. This pulling forward of purchases boosted spending at the end of Q1 and into early Q2 but could fizzle out shortly as pre-tariff inventories of autos and other goods run dry. We project light vehicle sales to fall off sharply starting in June, dropping to monthly sales paces around 13-13.5 million. Soft demand for vehicles is likely to continue through year end as prices for some models climb by \$5,000 or more due to tariffs on imported autos and parts. High loan rates and weaker labor conditions should also weigh on household demand.

The forecast decline for auto sales mirrors the broader pullback in consumer spending expected this year. Much weaker spending activity over the summer and into the second half of 2025 should slow GDP growth to a 1.0 percent annualized pace.

### Light vehicle sales, annualized pace

Millions



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## Latest Forecast

Data as of May 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	1.3%	2.0%	1.9%	2.0%
UNEMPLOYMENT RATE	4.0%	4.4%	4.4%	4.2%	4.2%
INFLATION <sup>1</sup> (CPI)	2.7%	3.4%	2.7%	2.0%	2.0%
TOTAL HOME SALES	4.75	4.64	5.12	5.85	5.95
S&P/CASE-SHILLER HOME PRICE INDEX	3.7%	3.3%	3.2%	3.0%	3.0%
LIGHT VEHICLE SALES	15.8	14.8	14.4	15.0	15.0
FEDERAL FUNDS RATE <sup>2</sup>	4.25%	3.50%	3.50%	3.00%	3.00%
5-YEAR TREASURY NOTE <sup>2</sup>	4.38%	3.80%	3.60%	3.55%	3.55%
10-YEAR TREASURY NOTE <sup>2</sup>	4.58%	4.25%	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE <sup>2</sup>	6.91%	6.60%	5.60%	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.03%	3.28%	3.03%	3.03%

### Reduced trade war cools inflation outlook

Sharply lower tariff rates on Chinese imports reduces the top end of likely tariff price increases this year. Still, nearly all imports face at least a 10 percent levy, which should boost consumer inflation back above 3.0 percent later in 2025, with spillover effects into 2026.

### Fed may resume rates cuts in September

The Fed should remain on hold for a few more meetings to gain clarity on how policy changes are impacting growth and inflation. But we expect signs of a weaker economy to drive a larger 50 basis point rate cut in September, followed by an additional reduction in October.

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

<sup>2</sup> Year end

<sup>a</sup> Actual

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# Sources

<b>Page 1   Where is the economy now?</b>	Business Cycle Yield Curve Real GDP growth	<i>Nationwide Economics Bloomberg; National Bureau of Economic Research Bureau of Economic Analysis</i>
<b>2   Economic Review</b>	PCE Price Index Nonfarm payroll gains ISM Composite Index	<i>Bureau of Economic Analysis Bureau of Labor Statistics Institute for Supply Management</i>
<b>3   Financial Markets Review</b>	S&P 500 10-year Treasury yield Fed rate expectations	<i>Standard &amp; Poor's Federal Reserve Board Bloomberg</i>
<b>4   Outlook</b>	Light vehicles sales Latest Forecast	<i>Bureau of Economic Analysis (history), Nationwide Economics (forecast) Nationwide Economics</i>



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