VIEWPOINT

Northmarq

SPECIAL MID-QUARTER EDITION

Economic Commentary:

Exploring the Ripple Effects of Tariffs

May 2025

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It's early days in determining the impact of the tariffs imposed by President Trump, but the uncertainty that's been created is visible in the quarterly reports of public companies, the behavior of consumers and in commentary from the Federal Reserve. The surge of purchasing activity by businesses and consumers to get ahead of the implementation of the tariffs has distorted some of the recent data. The Fed is left grappling with the uncertainty of the impact of the tariffs on their two mandates – price stability and maximum employment – and their conclusion could produce two very different paths for monetary policy.

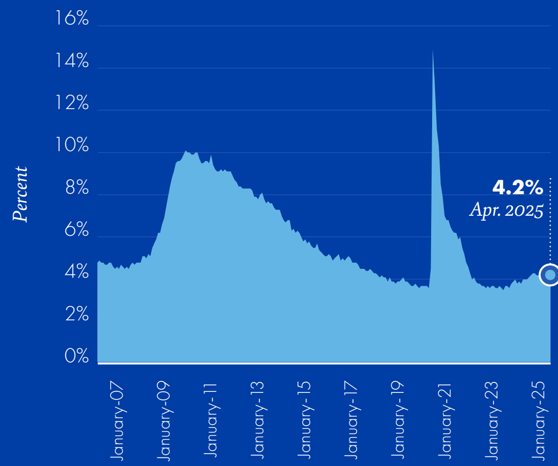
Inflation & Spending

Data on inflation for the month of March was subdued. The Consumer Price Index (CPI) fell 0.1% for the first monthly decline since last June, bringing the year-over-year figure to 2.4%, well below expectations. The Core CPI was up a benign 0.1%, bringing its year-over-year figure to 2.8% from 3.1% in February. Energy prices were a sizable drag on the CPI in March and will likely be in April, as well. Aside from energy, the weakness in discretionary services reflected softer consumer demand. The CPI showed little signs of pass through from the increase in the tariff rate on imports from China between February and March, but this respite in inflationary pressures is likely temporary as the boost from the broader reciprocal tariffs is coming.

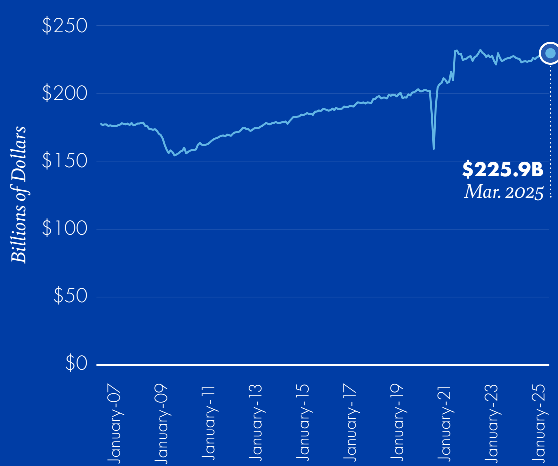
The Core Personal Consumption Expenditure (PCE) Index, the Fed's preferred measure for inflation, was flat during March (+0.0%), causing its year-over-year figure to drop from 3.0% to 2.6%. The tariffs will likely push this measure back above 3.0% in the coming months, thus the Fed's current pause in reducing interest rates.

GROSS DOMESTIC PRODUCT (GDP)

UNEMPLOYMENT RATE



RETAIL / FOOD SERVICE SALES



Source: Northmarq, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census

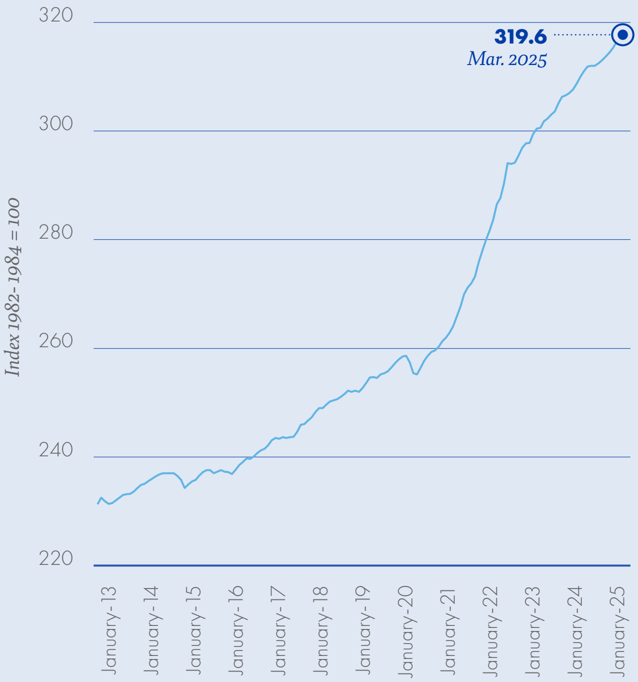
In anticipation of the tariffs, Real Personal Consumption Expenditures increased 0.7% in March. Auto sales provided a notable boost, and most other areas of spending were solid, as well. Real Personal Disposable Income provided support to the spending by growing 0.5%. Real incomes will likely be less robust in the coming months, however, as the tariffs cause at least a temporary increase in inflation. The other question going forward is how much spending is being pulled forward to avoid tariffs that may result in softer demand later in the year.

GDP & Manufacturing

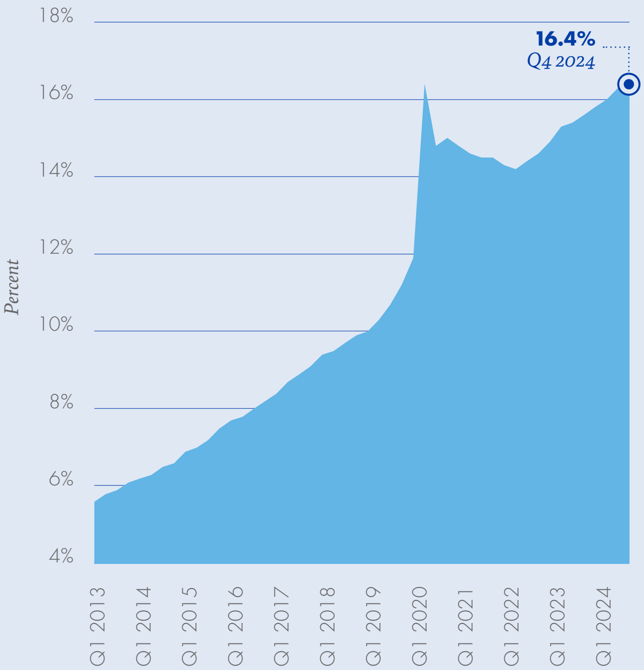
The initial reading for real GDP in the first quarter was -0.3% annualized, but this headline weakness is not as bad as it looks. The contraction was due to softer consumer spending than in fourth quarter 2024, a decrease in government spending, and a pre-tariff import surge in which companies secured merchandise ahead of the tariffs. With imports surpassing exports by a record amount, net exports subtracted 4.8% from GDP. However, real final sales to private domestic purchasers (household consumers and businesses) increased by 3.0% annualized, in line with readings during 2024, and indicated steady demand during the quarter. Some of this 3.0%, however, was associated with pre-tariff purchases, so it is questionable whether it will continue. The surge in imports is likely to reverse in the second quarter, potentially providing some support to the GDP calculation, but weaker consumer and business spending is expected to be an offsetting drag.

The ISM Manufacturing Index for April provided ample evidence of the negative impact that tariffs are already having on the manufacturing sector. The overall index was 48.7, a slight improvement from March's 47.9, but still indicating contraction. Commentary from survey participants showed how the uncertainty around trade policy is accelerating input prices, slowing production and decreasing demand for export orders. With input prices increasing, the challenge will be to pass along these higher costs in the face of slowing demand.

CONSUMER PRICE INDEX (CPI)



E-COMMERCE RETAIL SALES (% OF TOTAL SALES)



Source: Northmarq, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census

The Labor Market

The April Employment report showed an increase of 177,000 in non-farm payrolls, but gains in February and March were revised down by 58,000. The unemployment rate remained at 4.2% as the labor force increased by 518,000, while household employment rose by 436,000, resulting in an increase in the number of unemployed of 82,000. Wages increased by 0.2%, and the three-month trend in wages has eased to 2.6% annualized from 4.0% at the end of 2024. Wage gains are consistent with the Fed's goal of 2.0% inflation.

Looking beyond the headline gain in employment, the number of permanent job losers increased to the highest level since October 2021, and the share of unemployed out of work for more than six months rose to the highest level since September.

The Job Openings and Labor Turnover Survey (JOLTS) indicated that job openings fell 288,000 in March and are now at the second-lowest level since December 2020. Falling job openings are a sign of labor market normalization and a downward pressure on wage growth.

According to the Challenger report, 105,441 were laid off in April, down from March's 275,240, but still 63% higher than April 2024. So far in 2025, a total of 602,493 job cuts have been announced. While a majority of these cuts are in government jobs, the uncertainty surrounding the tariffs is causing companies, in general, to slow hiring plans.

There are cracks developing in the employment picture, which, if continued, will feed into slower economic growth. For now, however, the overall employment picture is strong enough to give the Fed more time to keep policy on hold as it monitors the impact of tariffs.

Fed Funds & Rate Cut Expectations

At the most recent meeting of the Federal Open Market Committee (FOMC) on May 6 -7, the target range for Fed Funds remained unchanged between 4.25% and 4.50%, as expected. The tariff announcement has increased concerns about a possible recession this year. Therefore, the Fed needed to decide between lowering rates to cushion the economy or maintaining (or raising) rates to tame inflation pressures.

Chair Powell and other members of the FOMC have said that the Fed does not need to be in a hurry to act but acknowledged that the economic impact of the new tariffs is likely to be significantly larger than expected and may lead to higher inflation and slower growth. "While tariffs are highly likely to generate at least a temporary rise in inflation, it is also possible that the effects could be more persistent." Powell has stressed that the Fed will be focused on concerns that inflation pressures may become more entrenched.

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John Beuerlein
Chief Economist, Pohlad Companies

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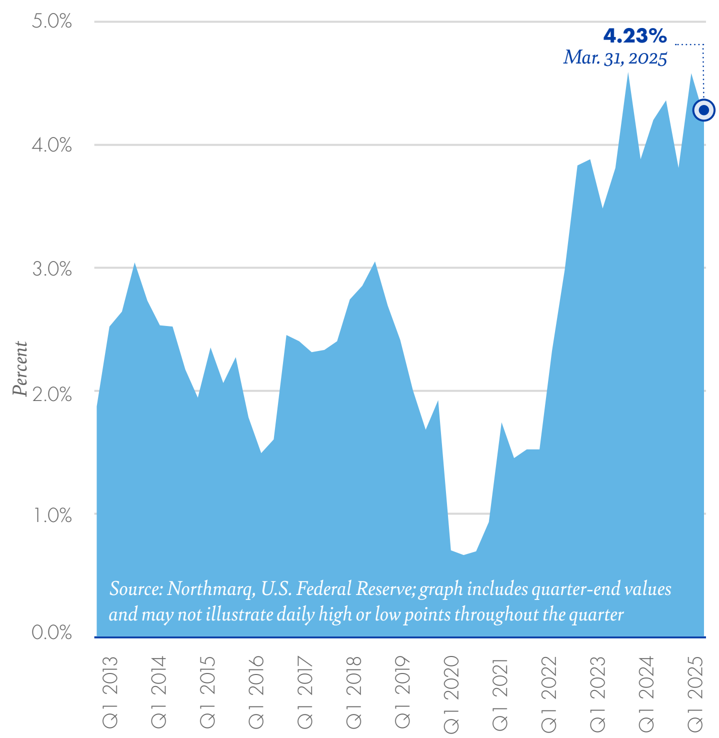
Markets appear to be more concerned about a slowing economy than a renewed acceleration in inflation. Uncertainty over the trade policies and the Fed's reaction to them have generated volatility in the credit markets. Over the past three months, 10-year yields have ranged between 4.6% and 4.0%. They are currently 4.3%. Expectations for rate cuts are now for three cuts during 2025, with the first cut occurring in July. As long as the employment market holds together, the Fed will likely stay on hold.

As mentioned at the outset, we are still in the early days of determining the impact of the tariffs. One thing that is clearly happening, however, is that new strategies and alliances are developing that will slow the globalization of trade, and consequently, slow global economic growth.

10-YEAR TREASURY RATE



Source: Northmarq, U.S. Federal Reserve; graph includes quarter-end values and may not illustrate daily high or low points throughout the quarter

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