Weekly Economic Commentary

May 16, 2025

Millennium
CORPORATE CREDIT UNION

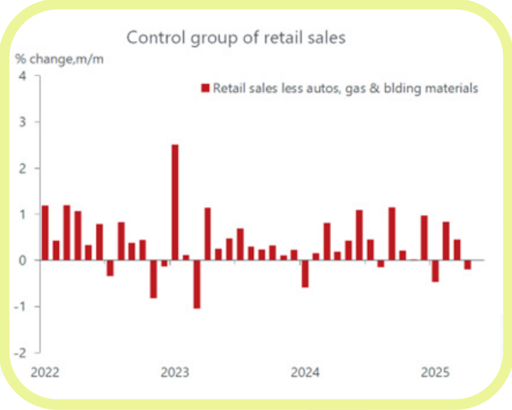
The stagflation case lost some credibility this week, as fresh data revealed an economy that remains resilient and an inflation backdrop that is once again cooling. Meanwhile, tariffs continue to dominate the headlines, highlighted by a détente between the U.S. and China that dialed back the onerous reciprocal levies before the ink on their announcements had a chance to dry. To be sure, the hard data coming out continue to be distorted by tariffs, both before and after modifications. Front-loading to beat tariff-related price hikes pulled forward consumer spending and shipments from overseas, leaving some softness in its wake. Importantly, while tariffs were scaled back, uncertainty remains elevated. The pause in reciprocal tariffs with most of our trading partners and the détente with China are time-limited, leaving many wondering what comes after the hiatus ends.

This is particularly the case for businesses, where tariff uncertainty undercuts investment plans, as assessing the costs and the availability of supplies from overseas is difficult to make. Many CEOs have already announced that capital spending plans are being put on hold until they have more clarity on trade policy. For consumers, the impact is more nuanced. Household sentiment has deteriorated severely amid ongoing concerns over tariff-related price hikes. In the preliminary University of Michigan survey of household sentiment for May, released on Friday, the report noted that: "Tariffs were spontaneously mentioned by nearly three-quarters of consumers, up from almost 60% in April; uncertainty over trade policy continues to dominate consumers' thinking about the economy." Yet, while sentiment has been plunging – down almost 30 percent since the start of the year – households have continued to spend, punctuating the ongoing divide between soft and hard data.

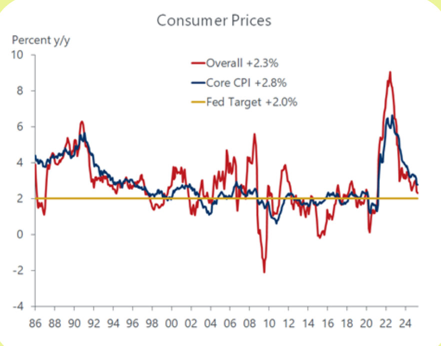
This week's retail sales report provided an early indication of consumer spending at the start of the second quarter. On the surface, it appears that momentum from the first quarter has vanished, as sales eked out a slim 0.1 percent increase in April. But that follows a sturdy increase in March that was revised upward from an already muscular 1.4 percent gain to 1.7 percent. Importantly, the tariff footprints are all over the retail sales reports. The strength in March, for example, reflects in good part the pulling forward of big-ticket purchases, such as autos and other goods to beat tariff-related price hikes. But even excluding autos – which accounts for 20 percent of total retail sales – the sales gain in March was revised up from 0.5 percent to a solid 0.8 percent.

Likewise, the control group of sales, excluding food, autos, building materials and gas, which enters the calculation of personal consumption in the GDP accounts, came in weak in April; but the 0.2 percent decline followed an upwardly revised 0.5 percent gain in March and an even stronger 0.8 percent increase in February. Hence, the second quarter is starting off of a higher base and, barring an unexpected collapse in May and June, real consumer spending should notch another quarter of decent growth, albeit a touch slower than the 1.8 percent seen in the first quarter. Since consumers account for 70 percent of GDP, it should keep the stag out of the stagflation prospect for the time being.

That said, tariffs will erode the firepower behind consumer spending later in the year. Keep in mind that the temporary reduction of levies with China from 145% to 30% while retaining a 10% base rate on goods from the rest of the world still leaves the effective tariff rate at the highest level since the 1930s. While companies will absorb some of the higher costs to maintain market share, a good portion will be passed on to consumers, That, in turn, will cut into disposable incomes and slow the pace of consumer spending. The extent of the slowdown will depend on how severe is the feedback loop that inevitably follows, as weaker sales will feed back into weaker hiring. That, in turn, sets a downward cycle in motion, which continues until the Federal Reserve believes recession risks outweigh the tariff-induced inflation boost, prompting rate cuts that stop the loop from spiraling out of control.

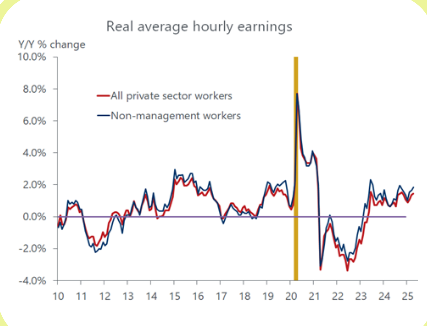


Happily, there is no urgency for the Fed to act anytime soon. For one, the tariff impact on inflation has yet to be seen. Consumer prices in April came in a tad softer than expected, with both the overall and core CPI rising 0,2 percent from March to April. That lowered the year-over-year increase in the overall index from 2.4 to 2.3 percent, the weakest pace since February 2021. The annual increase in the core CPI held steady at the same 2.8 percent as March but those increases were also the weakest since early 2021. Hence, there is no sign yet that tariffs have arrested the disinflation trend.



But as is the case with consumer spending, tariff-induced frontloading contributed to the inflation reading last month, as companies stocked up on goods before tariffs kicked in. Hence, they were able to hold the line and sell goods from inventory at pre-tariff prices. That benign practice, however, will last until inventories are depleted and the higher prices linked to tariffs on replacement goods take effect. The lag will take several months and only gradually seep through to prices. Nonetheless, the effects should become more visible by the summer and cause a meaningful rise in the inflation rate – and a bigger dent to disposable income. However, unless the tariff wars re-escalate, the result should be a one-time boost to the price level not a sustained increase in the inflation rate.

Meanwhile, the benign inflation trend in recent months is boosting household purchasing power, lending near-term support to consumer spending. While wage growth is slowing, it continues to outpace inflation. Hence, the annual growth rate in real average hourly earnings has increased for four consecutive months. Significantly, nonmanagement workers have received the biggest raises and their earnings are running nearly 2 percent ahead of inflation. With the steep price increases on essentials, most notably -- until last month – groceries, including the headline-grabbing surge in egg prices, that becomes even more important for this slice of the population. That said, wage growth is slowing and is not a source of inflationary pressure. While the tariff-induced inflation boost and resilient consumers will keep the Fed on the sidelines until late this year, we expect policy to resume easing in 2026 as the economy will have less firepower to withstand the elevated level of rates now in place.



Key Financial Indicators

Interest Rates	May 16	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.34%	4.33%	4.32%	5.38%
6-month Treasury bill	4.27	4.25	4.20	5.36
2-year Treasury note	4.01	3.91	3.81	3.84
5-year Treasury note	4.09	4.02	3.94	4.45
10-year Treasury note	4.48	4.39	4.33	4.43
30-year Treasury bond	4.95	4.84	4.80	4.56
30-year fixed mortgage rate	6.81	6.76	6.83	7.02
15-year fixed mortgage rate	5.92	5.89	6.03	6.28
Stock Market				
Dow Jones Industrial Index	42654.74	41249.38	39142.23	40003.59
S&P 500	5958.38	5659.91	5282.70	5303.27
NASDAQ	19211.10	17928.92	16286.45	16685.97
Commodities				
Gold ($ per troy ounce)	3205.30	3329.10	3328.40	2419.80
Oil ($ per barrel) - Crude Futures (WTI)	62.48	61.06	64.68	80.00

Key Economic Indicators

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Consumer Price Index (April) - 5 change	0.2	-0.1	0.2	0.2
Core CPI (April) - % change	0.2	0.1	0.2	0.2
Retail Sales (April) - % change	0.2	1.1	0.5	0.3
Industrial Production (April) - % change	0	-0.3	0.9	0.3

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