GPA GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—April 14th, 2025

The shape-shifting nature of President Trump's tariff threats continued to roil the financial markets this week, producing one of the wildest gyrations in stock and bond prices seen outside of shock-induced major crises. What's more, it's not likely that volatility will subside anytime soon. The sigh of relief when Trump postponed onerous reciprocal tariffs on most trading partners for 90 days did not last long. Within the blink of an eye following that concession, trade tensions with China escalated; Trump upped tariffs on China to 145 percent and China quickly retaliated by increasing its tariffs on U.S. exports to 125 percent. The deteriorating relationship between the world's two largest economies shows no sign of easing, although China signaled that it would not engage in further tit-for-tat tariff increases.

So far, the financial markets are bearing the brunt of the turmoil created by the administration's aggressive tariff push, but the real-world effects will soon become more evident. It's unclear when the drastic hit to confidence will cause major behavioral changes among households and businesses, as incoming data indicate that consumption and employment trends have held up reasonably well through the first quarter. Likewise, the inflationary implications of the highest tariffs on imported goods in nearly a century have yet to be seen in the data. Indeed, the latest inflation reports for March were extremely comforting, as both consumer and producer prices came in far softer than expected.

The consumer price report was particularly encouraging. Seen in a vacuum, it strongly suggested that the stalled inflation retreat was back on track. The overall consumer price index slipped 0.1 percent between February and March, the largest setback since the tail-end of the pandemic recession in the spring of 2020. Compared to a year ago, the CPI fell from 2.8 percent to 2.4 percent. And while a 6.3 percent plunge in gasoline prices was a big drag on the index, the core inflation rate that excludes volatile food and energy prices was also remarkably tame. The core CPI edged up by a slim 0.1 percent and the year-over-year increase receded from 3.1 percent to 2.8 percent, the weakest since April 2021. The details of the CPI report were as encouraging as the headline readings, as broad-based softness was seen in both goods and services. Core services excluding shelter prices, which is closely followed by the Fed, fell in March, lowering the advance from a year ago to 2.9 percent from 3.8 percent in February. It was the first time in five years that this so-called supercore inflation rate fell below 3 percent.

That said, it would be a mistake to draw too much encouragement from the backward-looking consumer price report. We are reminded of pitcher Satchel Page's famous quote, "Don't look back, something may be gaining on you." That trailing suspect is tariffs, which will hit American goods in short order and abruptly reverse the disinflation trend seen in March. How sharply prices increase will depend on a host of factors, including how much of the increased input costs businesses will absorb instead of passing on to customers. They may have bought some time, as many companies bulked up their inventories in advance of the tariffs and, hence, can hold the line on prices until their shelves are drawn down.

But that should not take long as consumers have also pulled forward purchases to beat higher prices. Indeed, consumer inflation expectations are skyrocketing. That trend was startlingly revealed in the University of Michigan's preliminary survey of household sentiment for April released on Friday. Unsurprisingly, the headline-grabbing tariff wars sent the overall sentiment index sharply lower, dragged

down by mounting fears of recession and job losses. But those dismal perceptions of a weakening economy were also accompanied by soaring inflationary expectations, not something that would be expected amid a doomsday mindset. Yet households expect inflation to surge to 6.7 percent over the next year, the highest since 1981, when double-digit inflation was still raging in the U.S.

Whether consumers engage in binge-shopping before tariffs kick in or close their wallets due to recession fears remains to be seen. The inflation retreat in March against another month of solid wage gains provided households with more purchasing power to keep their wallets open for a while. With paychecks outpacing price increases, real earnings posted another sturdy gain in March. Encouragingly, nonmanagement workers saw the biggest increase, which is timely because they are the ones that will be mostly squeezed by the tariff-induced price increases. Higher earners have more disposable income to absorb higher prices on essentials, such as shoes and apparel, that have yet to come. Prices on footwear, which comes mainly from China, fell by 0.1 percent in March, a reprieve that will soon wither under the looming tariffs from China.

A key variable in the outlook is whether the punishing level of tariffs remain on the books or whether negotiations between the U.S. and its trading partners succeed in bringing about a truce, restoring a much lower level of levies. The 90 day pause in the reciprocal tariffs on countries outside of China has a better chance of sticking than the onerous tariffs on China. If not, the odds of a recession later this year would increase exponentially. As it is, the tariffs implemented earlier that are still in effect together with the surge in uncertainty will strip the economy of considerable vigor. We expect growth to slow to near stall speed later this year even as inflation ramps up to 4.5 percent, preventing the Fed from cutting interest rates anytime soon.

Importantly, while the stock market stabilized late this week, recouping a big chunk of the “liberation day” bloodbath, market yields continued to move sharply higher, with the bellwether 10-year Treasury yield staging the biggest weekly increase since 2001. The increased yields portend higher borrowing costs for households and businesses. For households, that means it would be much costlier to unlock the trillions of dollars of appreciated housing equity in recent years that surging home prices has provided. Not only would it be more expensive to borrow, but homeowners are also finding it harder to access loans as banks are rejecting loan applications at the highest rate in more than ten years. Hence, the healthy balance sheets that contributed importantly to consumer spending in recent years may provide less juice via the wealth effect to support consumption this year.

FINANCIAL INDICATORS

INTEREST RATES	April 11	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.33	4.26	4.30	5.37
6-month Treasury bill	4.21	4.10	4.25	5.35
2-year Treasury note	3.98	3.66	4.03	4.91
5-year Treasury note	4.16	3.72	4.10	4.57
10-year Treasury note	4.49	4.01	4.32	4.53
30-year Treasury bond	4.87	4.42	4.62	4.63
30-year fixed mortgage rate	6.62	6.64	6.65	6.88
15-year fixed mortgage rate	5.82	5.82	5.80	6.16
STOCK MARKET				
Dow Jones Industrial Index	40,212.70	38,314.86	41,488.19	37,983.00
S&P 500	5,363.36	5,074.08	5,638.94	5,123.41
NASDAQ	16,724.46	15,587.79	17,754.09	16,175.09
COMMODITIES				
Gold ($ per troy ounce)	3,255.60	3,056.10	2,993.60	2,360.20
Oil ($ per barrel) - Crude Futures (WTI)	61.47	62.32	67.20	85.45

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (March) - % change	-0.1	0.2	0.5	0.3
Core CPI (March) - % change	0.1	0.2	0.4	0.2
Producer Price Index (March) - % change	-0.4	0.1	0.6	0.2

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