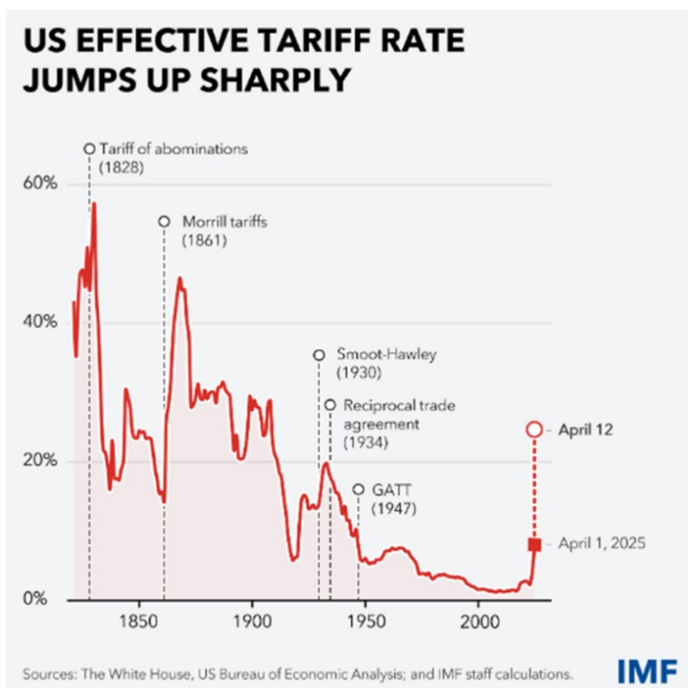
GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—April 21st, 2025

A cynic might say that there is a method to the madness that some believe is driving the chaotic tariff blitz roiling the financial markets. While the markets are climbing a wall of worry, the current economy is reaping the benefits of that worry. Simply put, anxious consumers who are expecting higher prices on the things they buy are ramping up purchases now. And since consumer spending is the main growth driver, the economy is cruising along on a higher gear than it otherwise would. For now, at least, President Trump can claim that the worry is exaggerated, just look at the data.

Of course, payback is coming, and its severity will depend on how much of the tariff threats come to pass. If they are permanently rescinded or considerably watered down for any number of reasons, the setback would resemble a bump in the road: tomorrow's strength was pulled forward to today. With the angst over policy uncertainty eliminated the engine restarts and life goes on. The economy would still be impaired by the growth-retarding effects from the tariffs already on the books—and likely to remain – but it should avoid a recession.

However, if that unlikely scenario fails to materialize, and most, if not all the tariffs come to pass, the setback would be severe, possibly leading to a recession. Indeed, the financial markets are already pricing in more than a 50 percent chance that a recession will set in this year, and most soft data, notably surveys of household and business confidence, have aligned with that perception. Since the tariff drama is still unfolding – most of the April 2 "liberation day" reciprocal tariff blitz has been put on hold for now – the jury is still out as to the likely outcome. But if all the tariff threats, including the ones currently postponed, are put into effect, the effective rate on imports would exceed that imposed by the Smoot-Hawley Act in 1930 – and we know how the economy fared afterwards. The IMF put together a neat chart that reveals what the tariff rate would look like compared to the past. Keep in mind that in the 19th century, tariffs were the main source of Federal revenues. The Federal income tax did not come into existence until 1913.



But in assessing the economy, most economists would agree that it's important to pay more attention to what people are doing, not how they are feeling. On this score, things are holding up quite well, thanks to the support provided by consumers. The latest evidence was provided by this week's retail sales report, which revealed that consumers shopped aggressively in March and their outlays in

January and February were revised higher. Hence, the first quarter received considerably more support from consumers than thought, and forecasts of an outright contraction in GDP during the period due to its weak start are not as widespread. We are still looking for a very mild negative reading if only because the surge in imports, which subtracts from growth, has not yet shown up as increased inventories, which would be a positive for growth. The lagged effect will be reversed in the second quarter.

Looking at the details, the main impetus behind the sturdy 1.4 percent increase in retail sales last month was in auto sales, which staged the largest monthly increase in more than two years. The eye-opening 5.3 percent increase clearly reflected a buy-in-advance mindset to beat the higher prices expected on motor vehicles from tariffs. Excluding autos, sales rose by a more modest – although still solid – 0.5 percent last month. In fact, retail sales overall could hardly be classified as weak. Virtually all the major components showed gains last month, and while autos provided a big boost, sales at service stations were a big drag, plunging by 2.5 percent due to a sharp decline in the price of gasoline. Aside from gasoline, the only other decline was in the relatively small category of furniture sales.

Clearly, the surge in auto sales will not be sustained as a big chunk of the purchases were made to beat tariff-related higher prices. But more than just tariff fears were behind the strength in retail sales last month. If households were cutting back on discretionary spending, it would show up in the one service-related category of the retail sales report—sales at restaurant and bars. But it didn't, as diners showed up in good numbers, driving sales at eating establishments up by 1.8 percent, the biggest gain since January 2023. People don't go out for a meal to beat higher prices, so a swath of the population still has the discretionary funds to keep on spending. We will have a better idea of how strong discretionary spending held up last month when the full report on personal income and spending, including all service-related spending, is released later this month. We suspect that consumers kept their wallets open.

Keep in mind though that these data releases are backward looking and occurred before the April 2 tariff blitz hit the headlines and sent the stock market reeling. Surveys released since then reveal a deeper dive into negativity as well, highlighted by the University of Michigan's index of household sentiment, which tumbled to recession levels in early April. But while households are feeling gloomier by the day, they are not going into hibernation yet. The next few months of retail sales data will continue to be affected by consumers shifting demand ahead of tariffs. The weekly Johnson Redbook sales figures show an acceleration in retail spending in the first few weeks of April; even the downbeat consumer confidence data show a spike in consumers saying now is a good time to buy ahead of tariff-related price hikes.

But as we noted at the outset, the payback is coming as goods purchased in advance to beat tariffs will leave a void later on when those purchases will be absent. What's more, the tariffs will eat into incomes, robbing households of purchasing power. Meanwhile, the tariff-induced boost in prices will lift the inflation rate, making it unlikely that the Fed will cut interest rates anytime soon. That's the message conveyed by Chair Powell in a conference this week, something that also raised the ire of President Trump, who apparently would like to fire Powell as Fed Chairman. But while he has ramped up criticism of the central bank the president is unable, for now, to remove Powell. The law remains on the side of Powell as Section 10 of the Federal Reserve Act says members of the Fed's Board of Governors, which includes the Chair, can be "removed for cause by the president." A disagreement on where interest rates should be wouldn't fit the legal interpretation of cause as being serious misconduct or abuse of power. That said, if tensions between the president and the Fed chair continue to escalate, another layer of uncertainty will reinforce the anxiety that is already creating turmoil in the financial markets.

FINANCIAL INDICATORS

INTEREST RATES	April 18	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.32	4.33	4.29	5.40
6-month Treasury bill	4.20	4.21	4.23	5.37
2-year Treasury note	3.81	3.98	3.96	4.99
5-year Treasury note	3.94	4.16	4.01	4.68
10-year Treasury note	4.33	4.49	4.25	4.63
30-year Treasury bond	4.80	4.87	4.59	4.71
30-year fixed mortgage rate	6.83	6.62	6.67	7.10
15-year fixed mortgage rate	6.03	5.82	5.83	6.39
STOCK MARKET				
Dow Jones Industrial Index	39,142.23	40,212.70	41,985.35	37,986.40
S&P 500	5,282.70	5,363.36	5,667.56	4,967.23
NASDAQ	16,286.45	16,724.46	17,784.05	15,282.01
COMMODITIES				
Gold ($ per troy ounce)	3,328.40	3,255.60	3,026.50	2,403.20
Oil ($ per barrel) - Crude Futures (WTI)	64.68	61.47	68.28	83.34

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Retail Sales (March) - % change	1.4	0.2	-1.0	0.4
Industrial Production (March) - % change	-0.3	0.8	0.2	0.2
Housing Starts (March) - 000s	1,324	1,494	1,361	1,392
Building Permits (March) - 000s	1,482	1,459	1,473	1,468

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