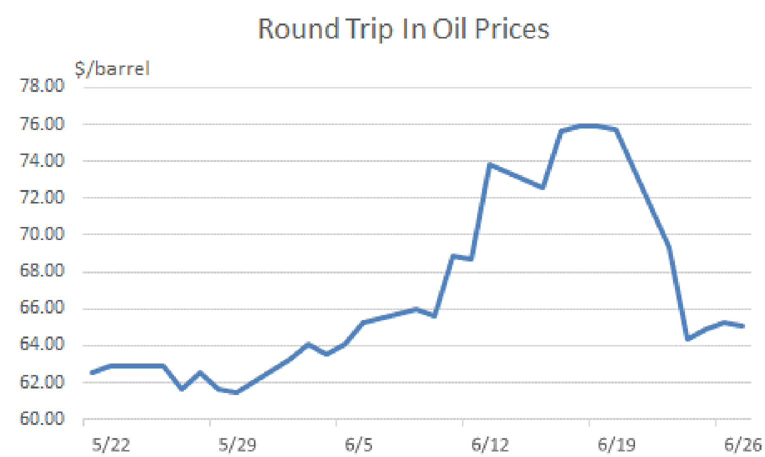
GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—June 30th, 2025

Judging by the performance of the financial markets, the sun is shining brightly on the economic landscape. Stock prices are racing to new highs, bond yields are falling, and investors are snapping up new corporate and Treasury issues with abandon. For the moment, the angst and handwringing over tariffs, the imbroglio over tax and spending bills in Congress, geopolitical conflicts, growing schism over monetary policy within the Fed, and sinking business and household confidence have all been put aside. It's always a fool's game to explain the reasoning behind the market's performance, which as history fully documents, can shift on the dime.

That said, some positive things have clearly surfaced in recent weeks that, for now, seem to be sounding an optimistic note in the markets. For one, the Middle East conflict did not morph into a catastrophe. A truce seems to be holding and the feared spike in oil prices that is a time-honored response to Mid-East tensions faded as quickly as it began. After a brief surge to over $75 when Israel bombed Iran's nuclear sites, the price of a barrel of crude abruptly plummeted, falling back to the low to mid-60s, where it currently resides and about where it stood prior to the outbreak. In the unlikely event that Iran closes the Strait of Hormuz – the biggest threat behind the initial upwards spike – a looming oil crisis has probably been squashed.

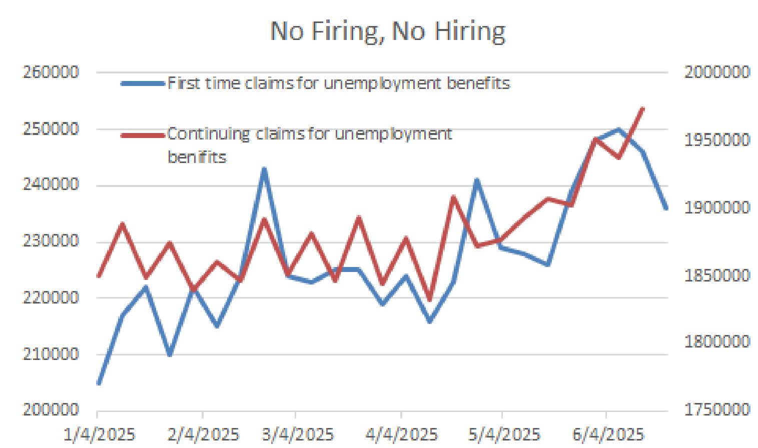


For another, the much-heralded inflationary impact from tariffs has yet to appear. True, importing firms are still selling merchandise at pre-tariff prices, as they built up inventory before tariffs kicked in. For its part, the Fed is holding rates steady until it sees what inflation will look like in coming months when the depleted inventory is replenished with the more expensive goods. If the tariffs are fully passed through to consumers, prices would undergo a significant boost. If they are eaten by importers, the inflation impact would be much less. Lately, an alternative explanation for subdued inflation has made the rounds, expressed by Minneapolis Fed president Kashkari.

Simply put, he thinks many businesses believe that a wave of deals by the White House will lower the current elevated level of tariffs, making them more willing to absorb the tariffs now, and take a brief hit, rather than antagonize their customer base. Recall that Trump promised to make 90 deals with trading partners over the 90 days he paused the most aggressive tariff increases. The end of that 90-day period is less than two weeks away, so time is running out. We'll see how that affects the mindset of companies whose patience is limited by their tolerance for a profit squeeze. For many retailers that operate with thin margins, we suspect it is not very long. That said, Kashkari's reasoning, along with two Fed governors – Christopher Waller and Michelle Bowman – who recently opined that they would be open to a rate cut as early as July – has increased the odds that a rate cut might come sooner rather than later.

We, along with the consensus among Fed policymakers, believe that July would be too soon to pull the rate-cutting trigger, as only one more month of data would be available at the time of that meeting in late July. At this juncture, the data on hand justifies the wait-and-see approach the Fed espoused at its latest meeting in mid-June and reaffirmed by Fed chair Powell at this week's semi-annual testimony on monetary policy before Congress. For sure, the one catalyst that might jump-start the Fed into an earlier cut, perhaps even in July, would be a sudden collapse in the job market. We will get the June employment report this coming week and while some further cooling on the jobs front is expected, it should not be dramatic enough to cause a panicky move by the Fed.

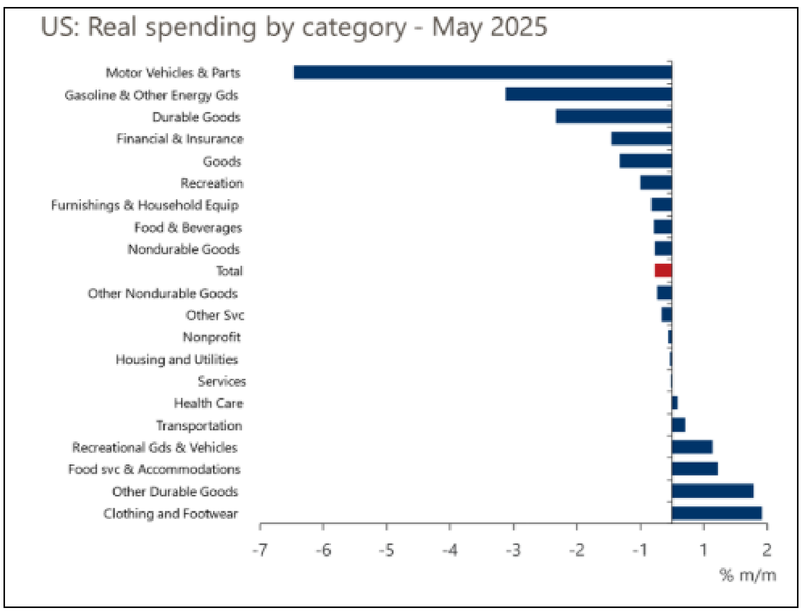
Still, there is little doubt that evidence of a softening labor market is growing. Young adults with freshly minted college degrees are having trouble finding a suitable position, as AI is replacing many white-collar entry-level slots. Even where AI is not a factor, companies are holding back on hiring until they get a clearer view of tariffs. Keep in mind that tariffs have a dual impact – boosting prices and impairing demand. Employers are just as worried about the latter as the former. While they are not laying off workers until a better sense of sales and revenues is grasped, the freeze on hiring is giving the cold shoulder to job seekers on the unemployment line. This shines a brighter spotlight on the conflicting trends seen in the jobless claims data. The number of unemployed workers filing for recurring benefits jumped again this week, hitting the highest level since November 2021. But initial claims remained subdued, reflecting the hoarding of workers by employers.



As we noted before, this is not a sustainable condition. The longer unemployed job seekers are forced to collect benefits due to weak hiring, the more insecure job holders become about retaining their paychecks. In time, heightened job insecurity prompts workers to save more of their paychecks, which is the flip side of spending cuts. That, in turn, leads to cost cutting by businesses to protect the bottom line; among the first victims of the axe are workers. This sets in motion a feedback loop wherein the layoffs prompted by spending cutbacks, leads to more layoffs and spending cuts, thus fueling a vicious cycle that eventually ends with a recession. We are far from that point but the risk that the Fed may be downplaying nascent cracks in the economy's foundation is increasing, raising the prospect of it overstaying its wait-and-see approach.

On the surface, the main economic reports this week reveal more weakness in real activity than accelerating inflation, making a stronger case for an earlier Fed easing move. The Fed's preferred inflation gauge, the personal consumption deflator, edged up by a slim 0.1 percent in May, leaving the inflation rate over the past year at 2.3 percent, not far from the Fed's 2 percent target. The core PCE, which excludes volatile oil and gas prices, also rose by 0.1 percent and is up 2.7 percent over the year. But over the past three months, the core index is up by an annual rate of 1.7 percent, so by this metric the target has been hit.

Meanwhile, personal income fell by 0.4 percent, the first monthly setback since September 2021 and spending slipped by 0.1 percent, the first setback in five months. However, we doubt the Fed will be overly swayed by the May personal spending and income report, as it reflects more noise than substance. Income declined only because one-off social security back payments had boosted incomes in the prior month. Averaging across the two months, incomes are still growing steadily, reflecting solid payroll gains and nominal wage increases. In May, wages and salaries gained a sturdy 0.4 percent, comfortably outpacing inflation. On the spending side, a big chunk of the weakness was also due to a payback, as auto sales slumped following a surge earlier in the year as consumers rushed in to buy before tariffs took effect. We expect a reversal in both trends in coming months, as the tariffs wend their way to consumer prices, boosting inflation, and incomes snap back, supporting a rebound in spending. The noise from tariffs won't subside until at least the fall and, by then, the Fed will have much more data – the substance – to make an intelligent decision as to whether, and by how much, to cut rates.



GPA SOLUTIONS

FINANCIAL INDICATORS

INTEREST RATES	June 27	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.30	4.32	4.34	5.37
6-month Treasury bill	4.24	4.30	4.31	5.33
2-year Treasury note	3.75	3.92	3.91	4.77
5-year Treasury note	3.84	3.97	3.97	4.38
10-year Treasury note	4.29	4.38	4.41	4.40
30-year Treasury bond	4.83	4.90	4.94	4.57
30-year fixed mortgage rate	6.77	6.81	6.89	6.86
15-year fixed mortgage rate	5.89	5.96	6.03	6.16

STOCK MARKET				
Dow Jones Industrial Index	43,819.27	42,206.82	42,270.07	39,118.86
S&P 500	6,173.07	5,967.84	5,911.69	5,460.48
NASDAQ	20,273.46	19,447.41	19,113.77	17,732.60

COMMODITIES				
Gold ($ per troy ounce)	3,286.10	3,384.40	3,313.10	2,337.00
Oil ($ per barrel) - Crude Futures (WTI)	65.08	75.00	60.79	81.50

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
New Home Sales (May) - 000s	623.0	722.0	659.0	671.0
Existing Home Sales (May - mlns	4.0	4.0	4.0	4.1
Personal Income (May) - % change	0	1	1	0
Personal Consumption (May) - % change	0	0	1	0
Savings Rate (May) - Percent	4.5	4.9	4.4	4.3