Economic Roundup

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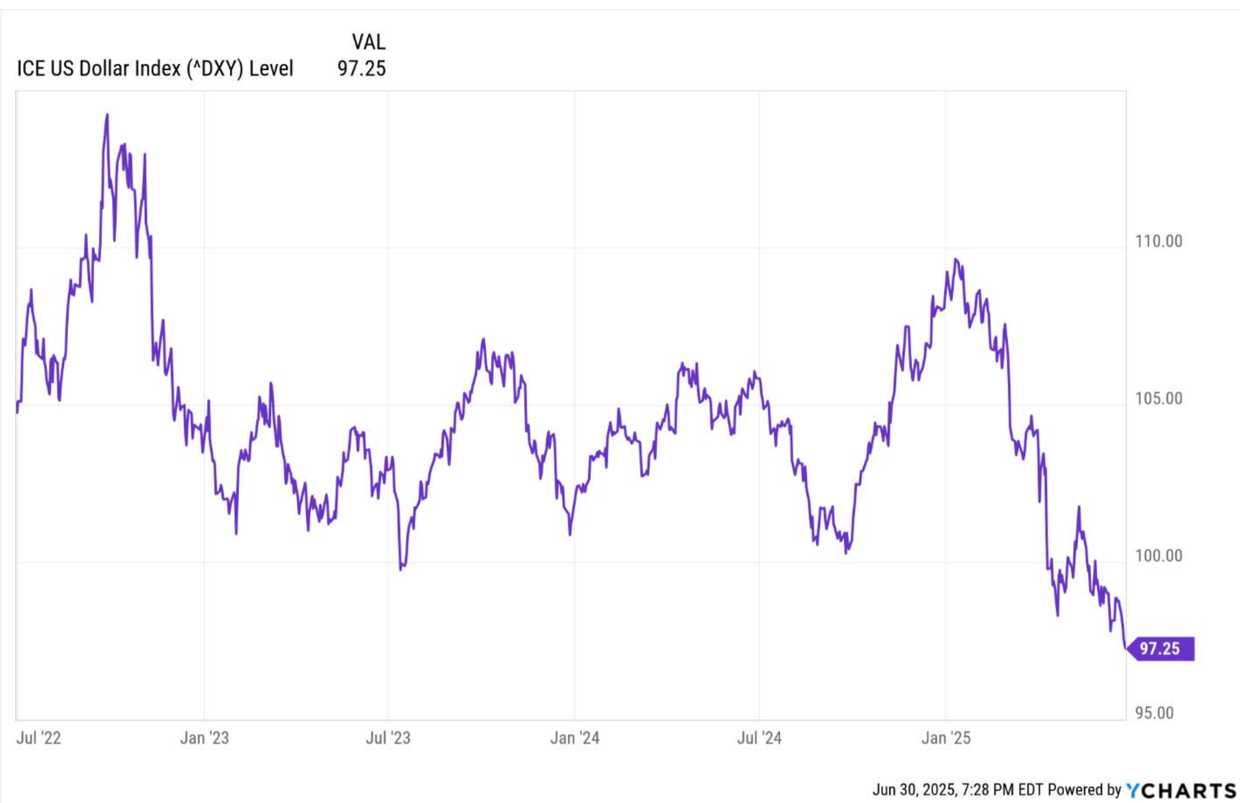
The Bureau of Economic Analysis (BEA) released their third estimate for the first quarter of 2025 real GDP which declined at an annual rate of 0.5%. Private fixed investment was strong but was outweighed by the negative impact of imports in anticipation of higher domestic tariffs. The price index for gross domestic purchases increased by 3.4% during the first quarter, which is high relative to the Federal Reserve's target. The Atlanta Fed's GDPNow forecast model expects improvement for the second quarter just ended with a current estimate of 2.5% growth in real GDP.

On April 9, the US imposed country-specific tariffs based on trade imbalances. They were paused for 90 days to allow time for bilateral trade negotiations. If the US is unable to reach a trade agreement with a country by July 9, the higher country-specific tariffs will become effective. The impact of tariffs varies by industry, but Barron's estimates that if tariffs are imposed as planned on July 9, it will raise car prices by as much as 15% and reduce US vehicle sales by as much as 20%.



The US balance of trade had a record deficit of $140.5 billion in March due to an increase in imports before the imposition of higher tariffs. The trade deficit declined to $61.6 billion April, which is still a large trade imbalance. This is the most obvious reason why the US dollar has experienced a steady decline since the beginning of 2025 after appreciating in the fourth quarter of 2024.

The Federal Reserve Open Market Committee maintained the fed funds rate at 4.25-4.50% after their mid-June meeting. However, the Fed's "dot plot" which summarizes the rate expectations of Federal Reserve officials anticipates two rates cuts of 0.25% during the remainder of 2025. Reflecting more disagreement than usual, seven of the nineteen Fed officials do not currently want any rate reductions for the remainder of the year.

Geopolitical risk has increased with the Russia-Ukraine war and the Middle East war both escalating. Iran's parliament is in favor of closing the Strait of Hormuz, but it has remained open for now. Approximately 20% of global oil production is transported through the Strait of Hormuz, so a blockade would increase oil prices sharply.

The Senate passed the One Big, Beautiful Bill and the House is expected to pass the revised version by July 4. The legislation would extend the 2017 tax cuts and end taxes on tips, overtime, and Social Security benefits. It also includes higher spending for immigration enforcement, defense (or war) and increases the nation's debt limit by $5 trillion. Various alternative energy credits will be reduced or eliminated. The bill also cuts spending on Medicaid and other programs.

The S&P 500 Index had earnings of $214 for 2024. Standard & Poor's analysts currently have S&P 500 earnings estimates of $236 and $275 for calendar years 2025 and 2026, respectively.

Investor complacency is evident with the price/earnings ratio of the S&P 500 Index currently at 29.7, based on trailing twelve-month GAAP earnings. So far, the financial markets have ignored the war escalations, higher tariffs, large federal budget deficits, and a few other potential economic hiccups. Although federal deficit spending may stimulate the economy, the lack of fiscal responsibility has not gone unnoticed by the fixed income markets.

If you have any questions or comments, please contact me.