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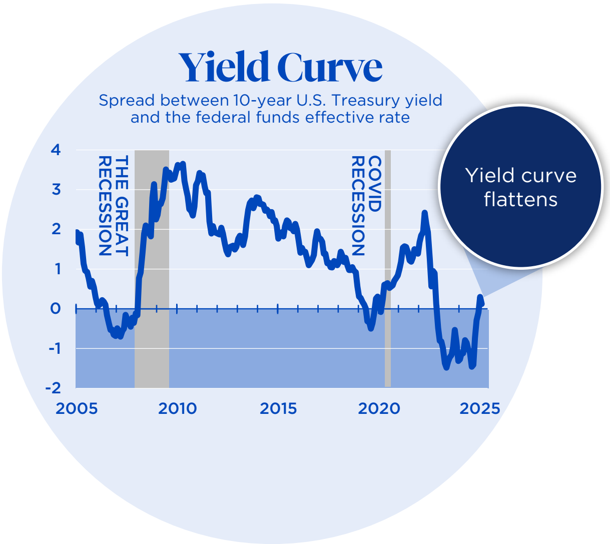
Economic & Financial Markets Monthly Review | March 2025

Near-term growth outlook takes a hit

Economic Overview

Where is the economy now?

Near-term economic activity is being hurt by a mix of uncertainty surrounding on-again, off-again tariff announcements, increases in tariffs, and reductions in government workers and contractors. These negative growth measures are preceding the potential longer-term pro-growth impacts from aggressive deregulation, tax cuts, and a more efficient government sector. The economy should be strong enough to sustain a temporary hit to activity, but the risks of a deeper slowdown are building as confidence among businesses, consumers, and investors has been shaken.



Where we are this month

Economic momentum is fading

While businesses are optimistic about deregulation and lower taxes, the volatile policy environment has shifted many firms into a wait-and-see approach for now. Plus, concerns rise about the near-term hit from tariffs and reductions in government spending and employment.

Growth concerns lower long-term rates

Concerns about slowing economic growth sent long-term interest rates lower, causing the Treasury yield curve to flatten. Shorter-term rates are also declining on expectations for faster and deeper Fed rate cuts.

Inflation fears resurface

Consumers' inflation expectations spiked in February due to rising concerns that tariffs will lift prices higher from already elevated levels,

What does this mean

- The labor market remained solid through February, but hires are slowing with many businesses awaiting greater clarity on tariffs and the impact on prices. Consumers are also holding back given the uncertainty for incomes and inflation.
- Higher interest rates are another headwind for growth, restricting business investment and purchases of autos and homes. We expect the Fed to keep rates steady over much of 2025 as it assesses the economic and inflation landscape given the large policy changes.

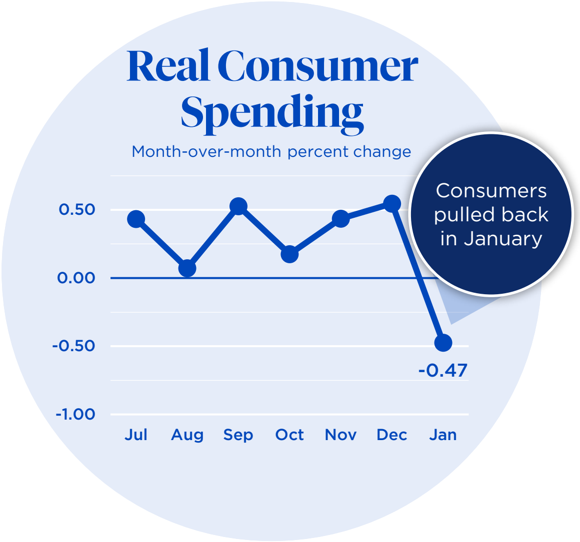
- The spread between short- and long-term rates flattened as investors become concerned about a sharp economic slowdown. Rates across the yield curve declined as investors have priced in the expectation for sooner and more Fed rate cuts this year. The 2-year Treasury yields are now at the lowest level since October.
- However, with the Fed likely on an extended hold, the yield curve may become inverted once again if investors become increasingly bearish on economic growth.

- Survey respondents now expect inflation to run at 4.3 percent over the next year and average 3.5 percent over the next five years. Inflation fatigue after several years of rising prices may cause more households to cut back on spending activity in 2025.
- The Fed keeps a close eye on long-term inflation expectations since it can be a harbinger of higher inflation in the medium-term. As such, the jump in inflation expectations could slow any prospective Fed rate cuts even if economic growth stalls.

Economic Review

Economy on solid footing for now, downside risks building

The labor market remains solid as job gains improved and unemployment remained low in February. Income growth should remain healthy and underpin a rebound in consumer spending after extreme wintery conditions dampened activity in January. Real GDP growth looks to have dipped in Q1, partly from the drop in consumer spending and a surge in imports as businesses rushed to buy foreign goods ahead of prospective tariffs. We look for GDP to rebound in Q2, but the rollout of tariffs and policy uncertainty introduce downside risks to activity.



Where we are this month

Inflation moderated in February

The headline CPI inflation rate fell in February to 2.8 percent after climbing for four straight months, while the core rate slowed to 3.1 percent.

Labor market remains solid

Nonfarm payrolls advanced more strongly in February, while unemployment ticked up to a still-low 4.1 percent. However, downside risks are rising due to direct and indirect impacts from reductions in government employment and spending.

Real consumer spending falls sharply

Real consumer spending declined by 0.5 percent, tempered by wintery conditions. Consumers may have also become more cautious as the savings rate rose in January. It will be important to see if consumers drive it even higher in a defensive move.

What does this mean

- Headline and core CPI climbed a modest 0.2 percent in February. Goods prices are no longer offering a substantial deflationary offset to services inflation, which remains elevated. On the plus side, shelter inflation was moderate again.
- While the February report is encouraging, it offers little insight to what lies ahead in the inflationary environment given the recently enacted tariffs and the possibility of more on the horizon.

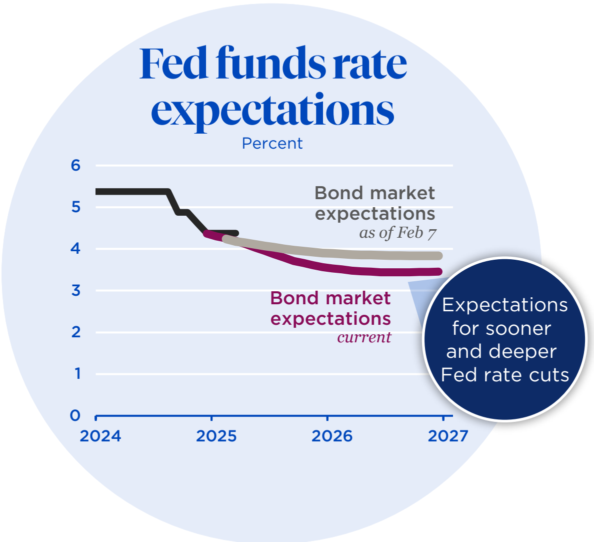
- Job creation solidly improved in February, though it remains highly concentrated with nearly half of the headline gain coming from private education and health care services.
- The unemployment rate ticked up to a still-low 4.1 percent. After a 0.3 percent monthly climb, the 12-month growth in wages held steady at 4.0 percent and continues to underpin solid income gains to support consumer spending power.

- The drop in real consumer spending was the largest in nearly three years, driven by a sharp decline in goods spending. Durable goods — most notably motor vehicles — posted the largest contraction, while spending on services recorded much more modest growth that the norm of the past few years.
- January's weaker spending data follows a surge in spending in late 2024. Consumers, like businesses, look to have pulled forward spending ahead of prospective tariff-related price increases and now can dial back their purchases.

Financial Market Review

Investors turn downbeat on growth concerns

The stock market has fallen sharply into a 10 percent correction and bond yields have tumbled on increasing concerns about an economic downturn. Investors are worried about the negative impact on the economy from increased tariffs, the large uncertainty surrounding further tariffs, and the drag on near-term growth from reductions in government spending and employment, which would also spillover to dampen private sector contract workers and activities. The bond market is now pricing in nearly 75 basis points of Fed rate cuts by year end, starting by June.



Where we are this month

Stocks fall into a correction

After climbing to a record high in mid-February, stocks have taken a nosedive on rising concerns about an economic downturn. The S&P 500 index has retreated 10 percent (as of March 13), representing a technical correction.

Bond yields tumble on growth scare

Bond market investors are also pricing in increased expectations of an economic slowdown. Bond yields across the curve, from short-term 2-year to the key 10-year Treasury benchmark yields have declined since mid-February.

Market expectations for Fed rate cuts rise

The bond market is now pricing in high odds of three 25 basis point rate cuts by year end as investors believe the Fed will pivot to shore up economic activity in the event of slowing growth.

What does this mean

Stocks fall into a correction

- Equity investors are worried about the negative impact on the economy from tariffs already implemented, the prospect of wider tariff actions stemming from reciprocal tariffs on April 2nd, and the policy uncertainty stemming from the stop-and-go rollout of tariff announcements.
- Investors are also concerned about the direct and indirect hit from reductions in government spending and employment on growth. The drag from tariffs and government cutbacks precedes the potential pro-growth tax cuts and deregulation.

Bond yields tumble on growth scare

- The 2-year note yield is at the lowest level since October as expectations of sooner and more Fed rate cuts are being priced in by investors. The key 10-year Treasury note yield has fallen back to its mid-December level, elevated by inflation concerns.
- The broader yield curve spread — 10-year yields less the fed funds rate — has flattened due to concern about an economic slowdown. It has not yet inverted but could if growth concerns rise further but the Fed holds steady due to inflation risks.

Market expectations for Fed rate cuts rise

- Bond investors now see the Fed cutting the policy rate as soon as June, followed by another cut by September and high odds of a third cut by year end. This would total 75 basis points in rate cuts.
- However, the risk is that market investors are too eager in anticipating the Fed will shift to boost the economy. Inflation concerns and policy uncertainty could have the Fed sitting on the sidelines for longer.

Outlook

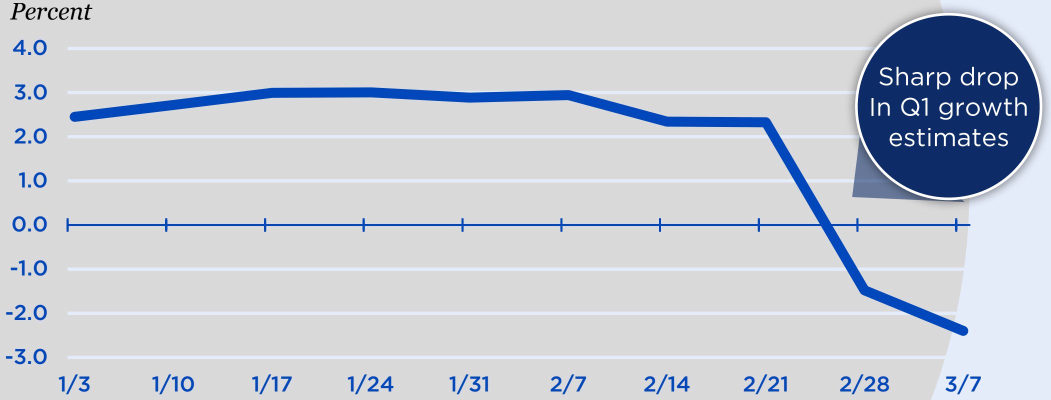
Uncertainty hits growth estimates for 2025

Optimism for economic growth over 2025 has faded in the face of a softer start to the year and policy volatility. A record trade deficit as businesses front-loaded goods imports ahead of tariffs and weaker retail sales in January sank the Atlanta Fed's GDPNow early estimate for Q1 GDP growth to -2.4 percent. Business surveys also suggest that many firms are curtailing hiring plans and investment flows due to disrupted supply chains and rising costs.

Solid job growth for February should calm fears of a sharp decline in near-term growth. But consumers remain highly attentive to price increases and may cut spending due to the price uncertainty created by tariffs on key trading partners. We still expect a positive GDP print for Q1 with a potential rebound in the second quarter as trade balances swing, but the high degree of policy uncertainty is starting to impact behavior and has roiled financial markets. As a result, most forecasts indicate building downside risks for growth in 2025.

Atlanta Fed GDPNow estimate for Q1 2025

Percent



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Data as of March 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	1.9%	2.1%	2.0%	2.0%
UNEMPLOYMENT RATE	4.0%	4.2%	4.1%	4.2%	4.2%
INFLATION [1] (CPI)	2.7%	**2.9%**	**2.3%**	2.1%	2.0%
TOTAL HOME SALES	4.75	4.76	5.61	6.16	6.25
S&P/CASE-SHILLER HOME PRICE INDEX	3.7%	3.1%	3.2%	3.0%	3.0%
LIGHT VEHICLE SALES	15.8	15.8	16.2	16.5	16.6
FEDERAL FUNDS RATE [2]	4.25%	**4.00%**	**3.25%**	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	4.38%	4.00%	3.60%	3.55%	3.55%
10-YEAR TREASURY NOTE [2]	4.58%	4.20%	4.00%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE [2]	6.91%	6.50%	5.30%	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.22%	3.53%	3.03%	3.03%

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[a] *Actual*

Higher inflation expected over 2025

Enacted tariffs and the price impacts for supply chains are already increasing costs for businesses. Even if the tariffs are only temporary, the uncertainty and disruptions for suppliers should push up inflation for goods more than previously expected — lifting our CPI estimate over 2025.

Fed may be on hold for some time

Given the recent uptick in inflation and high policy uncertainty, the Fed may hold interest rates steady until late in the year. Building growth worries may add pressure to lower rates sooner, but we still expect the Fed to focus on inflation for the time being.

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Sources

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	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
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	Consumer Price Index	*Bureau of Labor Statistics*
	Nonfarm payroll gains	*Bureau of Labor Statistics*
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3 |	**Financial Markets Review**	
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4 |	**Outlook**	
	Atlanta Fed GDPNow	*Federal Reserve Bank of Atlanta*
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