

Economy Hit an Air Pocket in January, Lowering 2025's Growth Prospects; Tariffs Are Likely to Keep Inflation Above Fed's Target This Year

Monthly economic data disappointed in January, with declines in retail sales, auto sales, housing sales, and manufacturing production. A number of one-off drags weighed on the month: The LA wildfires, a bad flu season, and (likely having the largest impact) severe winter weather across much of the continental United States. Even as these headwinds faded in February, new drags appeared. The DOGE cuts to federal headcount and suspended payments for federal programs pushed up jobless claims, and will likely translate to a 250,000 to 500,000 cumulative drag on payroll growth in the next six months. Consumer sentiment jumped after the election, but reversed and weakened in January and February. The University of Michigan's consumer survey (Which breaks out sentiment by political affiliation) shows the drop is concentrated among Democrat-leaning consumers, who are the most downbeat since 2008. Republican-leaning sentiment is considerably better. But even surveys whose respondents lean right show growing concern about economic uncertainty, in particular related to higher tariffs. The tariff increases proposed in February and March would be equivalent to a tax increase of between 0.5% and 1.0% of U.S. GDP, equivalent to about half of U.S. corporate tax receipts—in other words, a substantial hike. Whether they end up at those levels, higher, or lower, tariff hikes promise to raise prices in 2025 and 2026.

Inflation entered 2025 trending in the right direction. The core PCE index excluding food and energy slowed in January to the smallest year-over-year increase since March 2021. However, the Fed's focus has shifted from the rear-looking data flow to the forward-looking outlook as tariffs raise goods prices, and as more aggressive immigration enforcement reduces the number of immigrants entering the job market. The Fed also is watching upside pressures on inflation from egg and meat prices as the avian flu sweeps agricultural flocks, and from higher gasoline, diesel, and natural gas prices in January and February. These shocks in combination seem set to keep inflation above the Fed's two percent target in 2025.

The Fed held rates steady at their January decision and signaled they are in 'no hurry' to make further interest rate cuts near-term. Since their decision, financial markets have become unsettled by the January macro slowdown, DOGE, and tariff noise, and have started to price in the possibility of the Fed pivoting to substantial rate cuts by the end of 2025. However, Comerica continues to forecast for the Fed to cut the federal funds target by only a quarter of a percent by year-end, since inflation will remain a source of frustration for them. In addition, Washington will likely start discussions soon on plans to repurpose DOGE's spending cuts and tax revenues from tariffs to pay for tax cuts in 2026, which the Fed would see as a reason to look past a near-term slowdown. Separately, the Fed is forecast to end the run-off of their balance sheet (a.k.a. "Quantitative Tightening" or QT) in July.

U.S. Economic Outlook, Summary

<i>a = actual f = forecast</i>	2Q'24a	3Q'24a	4Q'24p	1Q'25f	2Q'25f	3Q'25f	4Q'25f	2023a	2024p	2025f	2026f
Real GDP (Percent Change Annualized)	3.0	3.1	2.3	2.0	2.4	2.5	2.8	2.9	2.8	2.5	2.8
CPI (Percent Change Year-over-Year)	3.2	2.7	2.7	2.8	3.2	3.8	3.9	4.1	3.0	3.4	3.1
Payroll Jobs (Average Monthly Diff., Ths.)	171	113	168	189	124	140	145	213	161	149	139
Unemployment Rate (Percent)	4.0	4.2	4.1	4.0	4.1	4.0	3.8	3.6	4.0	4.0	3.7
Federal Funds Rate (Period Average)	5.33	5.26	4.65	4.33	4.33	4.12	4.08	5.02	5.14	4.21	3.87
10-Yr. Treasury Rate (Period Average)	4.44	3.95	4.28	4.63	4.69	4.60	4.47	3.96	4.21	4.60	4.20

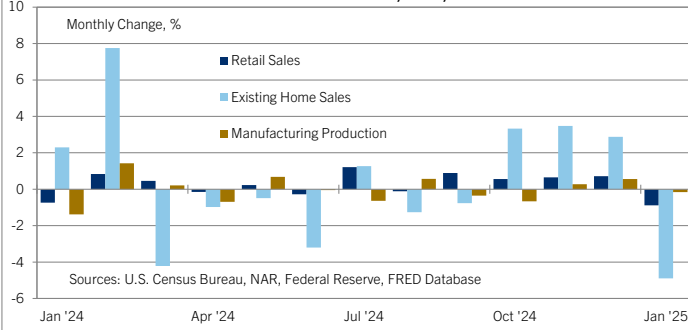
a = actual p = preliminary f = forecast

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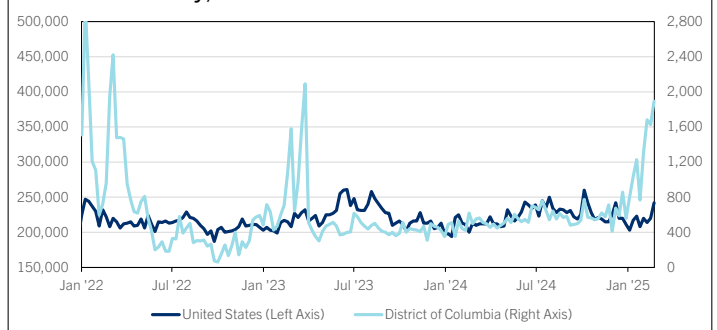
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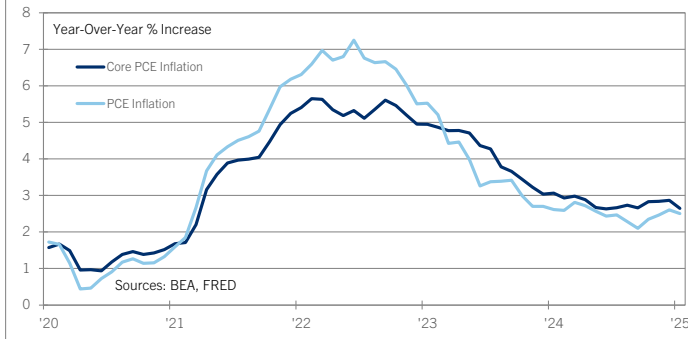
Monthly Indicators Dropped in January Amid Headwinds from Wildfires, Flu, and Weather



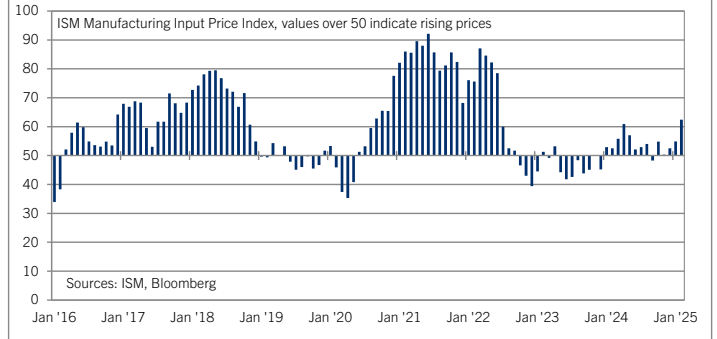
Jobless Claims Hit the Highest Since December in February, Concentrated in Public-Funded Jobs



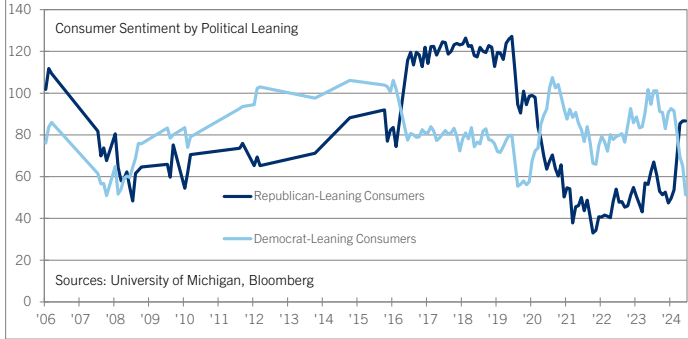
The Inflation Picture Looks Encouraging Through the Rear View



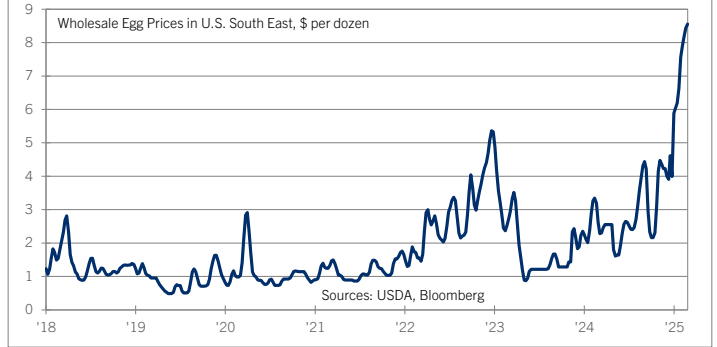
But Looking Ahead, Higher Tariffs Seem Set to Fuel Another Wave of Price Increases



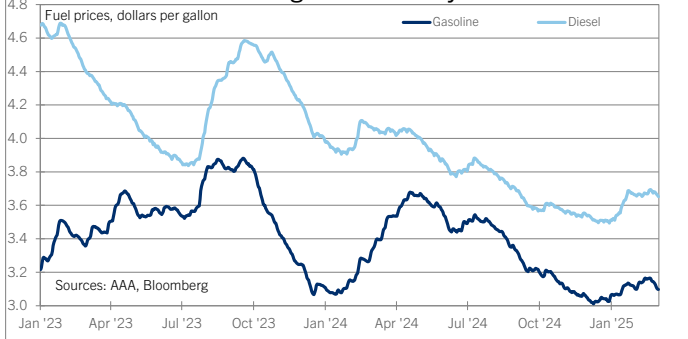
Mutually Unrecognizable Views of the Economic Outlook Across the Political Divide



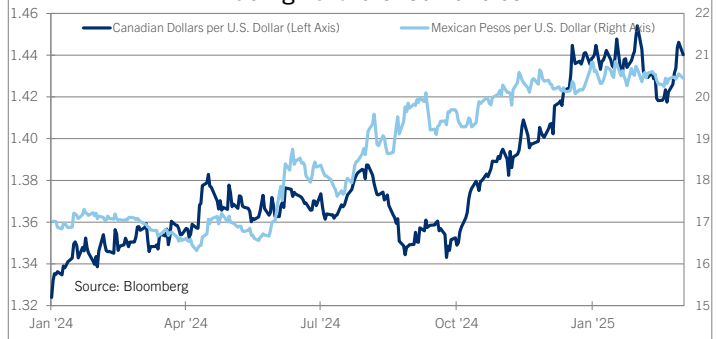
Bird Flu Still Pushing Egg Prices to Record Highs



Gas and Diesel Prices Rose Again in February, But Heading Lower in Early March



Trade War Fears Fueling Depreciation of U.S. Trading Partners' Currencies



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	2Q'24a	3Q'24a	4Q'24p	1Q'25f	2Q'25f	3Q'25f	4Q'25f	2023a	2024p	2025f	2026f
Output											
Nominal GDP (Billions \$ Annualized Rate)	29,017	29,375	29,720	30,085	30,520	30,997	31,493	27,721	29,184	30,774	32,759
Percent Change Annualized	5.6	5.0	4.8	5.0	5.9	6.4	6.6	6.6	5.3	5.4	6.5
Real GDP (Chained 2017 Billions \$ Annual Rate)	23,224	23,400	23,536	23,651	23,795	23,942	24,111	22,671	23,304	23,875	24,548
Percent Change Annualized	3.0	3.1	2.3	2.0	2.4	2.5	2.8	2.9	2.8	2.5	2.8
Pers. Consumption Expenditures	15,967	16,113	16,278	16,365	16,426	16,518	16,643	15,622	16,054	16,488	17,022
Percent Change Annualized	2.8	3.7	4.2	2.1	1.5	2.3	3.0	2.5	2.8	2.7	3.2
Nonresidential Fixed Investment	3,504	3,539	3,510	3,550	3,587	3,620	3,658	3,385	3,506	3,604	3,741
Percent Change Annualized	3.9	4.0	-3.2	4.7	4.3	3.7	4.2	6.0	3.6	2.8	3.8
Residential Investment	795	787	797	800	802	819	842	763	795	815	921
Percent Change Annualized	-2.8	-4.3	5.4	1.4	1.1	8.7	11.6	-8.3	4.2	2.6	13.0
Change in Private Inventories	72	58	10	63	98	90	102	33	39	88	63
Net Exports	-1,036	-1,069	-1,061	-1,109	-1,075	-1,051	-1,075	-933	-1,036	-1,078	-1,128
Government Expenditures	3,917	3,966	3,994	3,973	3,948	3,937	3,932	3,812	3,941	3,948	3,919
Percent Change Annualized	3.1	5.1	2.9	-2.1	-2.5	-1.1	-0.5	3.9	3.4	0.2	-0.7
Industrial Prod. Index (2007=100)	102.9	102.7	102.4	103.6	104.2	104.4	104.8	102.9	102.5	104.3	105.6
Percent Change Annualized	2.4	-0.6	-1.4	4.8	2.3	1.1	1.4	0.2	-0.3	1.7	1.2
Capacity Utilization (Percent)	78.0	77.6	77.1	77.6	78.2	78.2	78.2	79.0	77.6	78.1	77.8
Prices											
CPI (Year-Over-Year % Change)	3.2	2.7	2.7	2.8	3.2	3.8	3.9	4.1	3.0	3.4	3.1
Core CPI (Year-Over-Year % Change)	3.4	3.3	3.3	3.1	3.4	3.7	3.6	4.8	3.4	3.5	2.9
PCE Price Index (Year-Over-Year % Change)	2.6	2.3	2.5	2.4	2.7	3.1	3.3	3.8	2.5	2.9	2.9
Core PCE Price Index (Year-Over-Year % Change)	2.7	2.7	2.8	2.7	2.9	3.2	3.3	4.1	2.8	3.0	2.9
GDP Price Index (Year-Over-Year % Change)	2.6	2.2	2.5	2.5	2.7	3.2	3.5	3.6	2.4	3.0	3.6
PPI, Final Demand (Year-Over-Year % Change)	2.6	2.2	3.0	3.5	3.8	4.5	4.7	2.0	2.3	4.1	4.0
Crude Oil, WTI (\$/barrel)	\$82	\$77	\$71	\$72	\$71	\$70	\$70	\$78	\$77	\$71	\$70
Labor Markets											
Payroll Jobs (Average Monthly Difference, Ths.)	171	113	168	189	124	140	145	213	161	149	139
Unemployment Rate (Percent)	4.0	4.2	4.1	4.0	4.1	4.0	3.8	3.6	4.0	4.0	3.7
Labor Force Participation Rate (%)	62.6	62.7	62.5	62.6	62.6	62.6	62.6	62.6	62.6	62.6	62.5
Average Weekly Hours	34.3	34.2	34.3	34.2	34.3	34.2	34.2	34.4	34.3	34.2	34.2
Personal Income											
Average Hourly Earnings (\$)	34.88	35.21	35.60	35.93	36.25	36.54	36.86	33.70	35.06	36.40	37.77
Percent Change Annualized	3.8	3.8	4.5	3.8	3.6	3.2	3.6	4.4	4.0	3.8	3.8
Real Disp. Income (2017 Billions \$ Annualized)	17,497	17,506	17,617	17,695	17,750	17,789	17,858	17,052	17,518	17,773	18,304
Percent Change Annualized	1.0	0.2	2.5	1.8	1.2	0.9	1.6	5.1	2.7	1.5	3.0
Personal Saving Rate (Percent)	4.9	4.1	3.8	4.1	4.4	4.6	4.8	4.7	4.5	4.4	5.2
Housing											
Housing Starts (Ths., Annual Rate)	1,340	1,332	1,388	1,367	1,376	1,386	1,405	1,421	1,367	1,384	1,430
Single-Family Housing Starts	1,004	971	1,016	990	995	1,002	1,009	949	1,013	999	1,022
Multifamily Housing Starts	336	361	372	377	381	384	396	473	354	385	408
Exst. SF Home Sales (Ths., Annual Rate)	3,630	3,557	3,767	3,695	3,759	3,818	3,899	3,676	3,673	3,793	4,080
New SF Home Sales (Ths., Annual Rate)	693	708	679	675	681	687	693	666	686	684	706
FHFA Purchase-Only HPI (Annual % Change)	5.9	4.5	4.5	4.2	3.9	3.8	3.0	4.9	5.4	3.7	2.8
Case/Shiller One-Family HPI (Annual % Change)	5.9	4.4	3.8	3.5	3.5	3.5	3.1	2.5	5.1	3.4	2.8
Consumer											
Retail & Food Service Sales (Monthly Avg, Bns)	703.1	712.4	725.3	728.9	736.0	746.4	758.5	692.0	710.1	742.5	793.0
Percent Change Annualized	2.0	5.4	7.4	2.0	4.0	5.7	6.7	3.5	2.6	4.6	6.8
Consumer Confidence* (Conference Board)	98.9	102.2	110.6	99.8	97.7	98.5	100.8	105.4	104.5	99.2	101.5
Car and Light Truck Sales (Millions)	15.9	15.7	16.7	16.1	16.3	16.5	16.6	15.6	16.0	16.4	17.0
Financial Indicators (Period Average)											
Federal Funds Rate (Effective)	5.33	5.26	4.65	4.33	4.33	4.12	4.08	5.02	5.14	4.21	3.87
Prime Rate	8.50	8.43	7.82	7.50	7.50	7.29	7.25	8.19	8.31	7.38	7.04
1-Month Term SOFR	5.33	5.21	4.59	4.30	4.30	4.10	4.06	5.09	5.11	4.19	3.85
3-Month Term SOFR	5.33	5.07	4.50	4.31	4.24	4.07	4.06	5.16	5.05	4.17	3.80
1-Yr. Treasury Rate	5.14	4.45	4.25	4.16	4.10	3.99	3.92	5.08	4.69	4.04	3.69
5-Yr. Treasury Rate	4.46	3.79	4.13	4.38	4.33	4.21	4.09	4.06	4.13	4.25	3.77
10-Yr. Treasury Rate	4.44	3.95	4.28	4.63	4.69	4.60	4.47	3.96	4.21	4.60	4.20
30-Yr. Fixed Rate Mortgage	6.99	6.51	6.65	7.00	7.04	6.85	6.64	6.80	6.72	6.88	6.15
Corporate Profits After Tax (Billions \$ Annualized)	3,413	3,403	3,453	3,482	3,512	3,548	3,585	3,069	3,396	3,532	3,783
Percent Change Annualized	12.4	-1.2	6.0	3.4	3.5	4.2	4.2	4.0	10.7	4.0	7.1

a = actual p = preliminary f = forecast

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