

Growth Outlook Looking Less Cloudy After Partial Tariff Rollback; Rising Inflation and Bigger Fiscal Deficits to Keep the Fed on Hold This Year

April's tariff increases were partially reversed by mid-May, leaving the U.S. average tariff rate about 15 percentage points higher than on January 19th. Higher tariffs are set to weigh on growth and raise inflation, but are less likely to trigger a recession than feared last month. Tariffs do seem to have shifted economic growth into a lower gear, though. Discretionary consumer spending has softened in the first half of 2025, and hiring has slowed. Even so, the May forecast foresees a stronger outlook for real GDP and the job market than the April forecast did. The Fed has signaled that the bar to cut interest rates is higher during an economic shock that raises inflation and lowers growth than during a conventional economic shock, which reduces both. The economy still looks set to register slower growth in 2025 than in 2024. But recession risk is unlikely to worry the Fed enough to corral them into cutting rates. Instead, the Fed is forecast to hold the federal funds target unchanged through the end of 2025.

While tariffs will raise the price of a foreign-made product relative to a domestically-made one, they would have to stay in place for quite a while to spur a big wave of reshoring. Manufacturers who are already on the fence about locating production domestically or internationally face an easy decision to reshore. But many companies produce globally for global customers, or face lower costs sourcing from abroad even after tariffs—they face harder decisions. Many manufacturers are likely to wait to see whether tariffs are made permanent in the 2026 tax law before making expensive, multi-year investment decisions because of them.

Economic growth will get another shot in the arm in 2026 as the 2025 reconciliation bill ("Big Beautiful Bill") cuts taxes and widens the fiscal deficit. Moody's downgraded the U.S. sovereign credit rating on May 16 in reaction to a decade of big deficits that look set to continue for years to come. The fiscal outlook is another reason for the Fed to forgo rate cuts this year. Longer-term interest rates will likely be higher in the second half of 2025 than in the first half, including the 30-year fixed mortgage rate. As a result, the outlook for residential construction, house sales, and house prices in 2025 and 2026 is softer than in Comerica's April forecast. Multifamily construction is forecast to grow faster than single-family construction as high mortgage payments keep young families in rentals for longer.

Risks still seem skewed to the downside. The trade war could re-escalate and tariffs could go back up, raising inflation. The Fed may have to hike. The deficit or other issues could shake investors' confidence in the U.S. and its currency, damaging financial conditions. But there are upside risks as well. Public sentiment could refocus from tariffs to potential benefits from tax cuts and deregulation. That could fuel a recovery of businesses' risk taking and hiring, and help consumer spending to stabilize.

U.S. Economic Outlook, Summary

<i>a = actual f = forecast</i>	3Q'24a	4Q'24a	1Q'25p	2Q'25f	3Q'25f	4Q'25f	1Q'26f	2024a	2025f	2026f	2027f
Real GDP (Percent Change Annualized)	3.1	2.5	-0.3	-1.0	1.5	1.8	2.0	2.8	1.1	1.6	1.6
CPI (Percent Change Year-over-Year)	2.7	2.7	2.7	2.4	3.0	3.2	3.1	3.0	2.9	3.0	2.3
Payroll Jobs (Average Monthly Diff., Ths.)	113	170	181	130	100	89	122	161	125	134	139
Unemployment Rate (Percent)	4.2	4.1	4.1	4.2	4.2	4.2	4.2	4.0	4.2	4.2	4.2
Federal Funds Rate (Period Average)	5.26	4.65	4.33	4.33	4.33	4.33	4.33	5.14	4.33	4.24	3.45
10-Yr. Treasury Rate (Period Average)	3.95	4.28	4.45	4.47	4.75	4.82	4.72	4.21	4.62	4.54	4.17

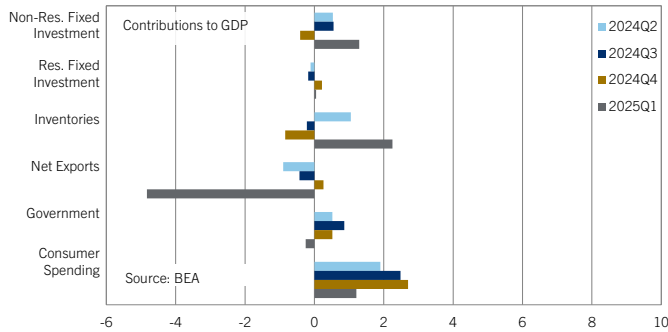
a = actual p = preliminary f = forecast

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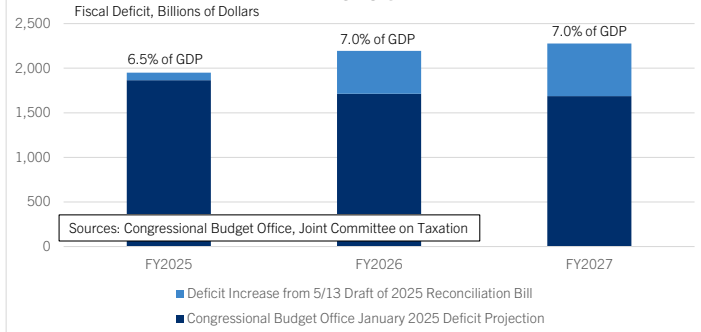
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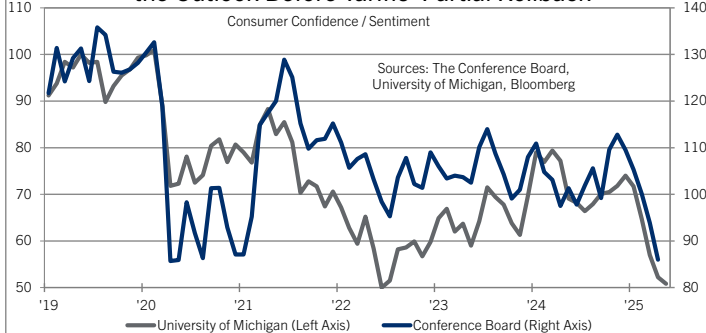
Real GDP Contracted in the First Quarter on a Huge Trade Deficit and Less Government Spending



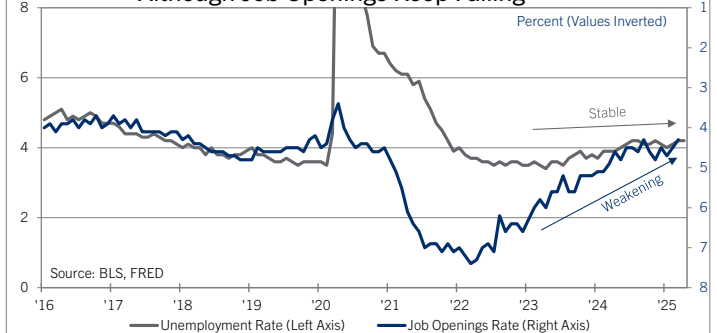
"Big Beautiful Bill" Expected to Increase the Fiscal Deficit



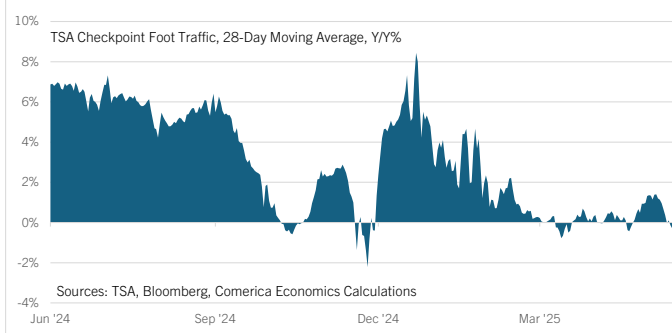
Consumers Were Freaked Out About Inflation and the Outlook Before Tariffs' Partial Rollback



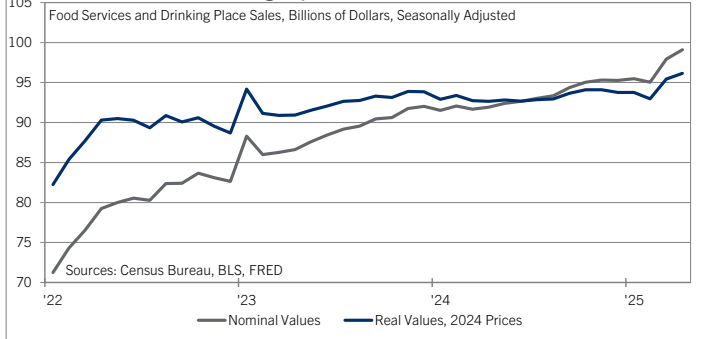
The Unemployment Rate Is Holding Steady, Although Job Openings Keep Falling



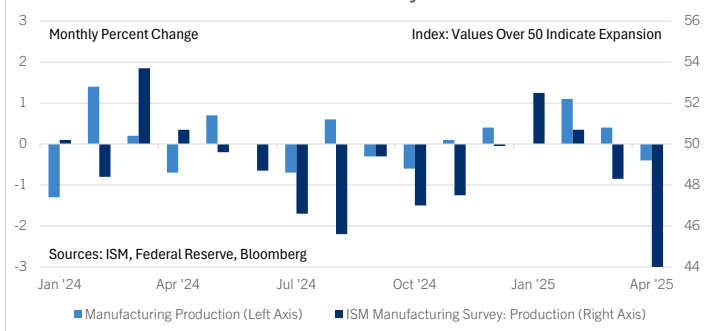
Airport Foot Traffic Has Softened Since the Turn of the Year



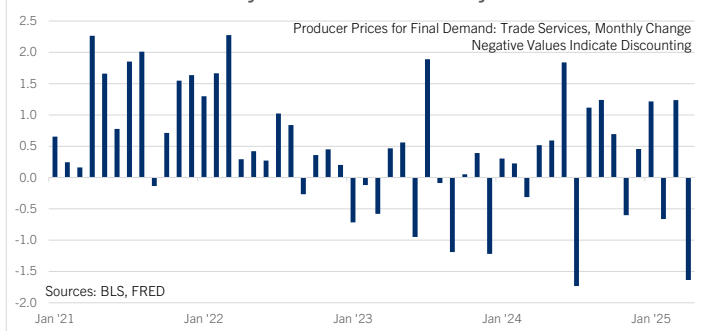
Discretionary Consumer Spending at Restaurants Is Holding Up Better Than Air Travel



Manufacturing Output Weakened Amid Tariff Uncertainty



Many Businesses Discounted in April to Run Down Inventory in Case the Economy Slows



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	3Q'24a	4Q'24a	1Q'25p	2Q'25f	3Q'25f	4Q'25f	1Q'26f	2024a	2025f	2026f	2027f
Output											
Nominal GDP (Billions \$ Annualized Rate)	29,375	29,724	29,978	30,122	30,494	30,866	31,226	29,185	30,365	31,698	32,877
Percent Change Annualized	5.0	4.8	3.5	1.9	5.0	5.0	4.7	5.3	4.0	4.4	3.7
Real GDP (Chained 2017 Billions \$ Annual Rate)	23,400	23,542	23,526	23,466	23,554	23,659	23,777	23,305	23,551	23,933	24,305
Percent Change Annualized	3.1	2.5	-0.3	-1.0	1.5	1.8	2.0	2.8	1.1	1.6	1.6
Pers. Consumption Expenditures	16,113	16,273	16,346	16,352	16,358	16,381	16,452	16,053	16,359	16,571	16,852
Percent Change Annualized	3.7	4.0	1.8	0.2	0.1	0.6	1.7	2.8	1.9	1.3	1.7
Nonresidential Fixed Investment	3,539	3,512	3,595	3,579	3,568	3,567	3,590	3,507	3,577	3,623	3,714
Percent Change Annualized	4.0	-2.9	9.8	-1.8	-1.3	-0.1	2.6	3.6	2.0	1.3	2.5
Residential Investment	787	797	800	799	801	806	809	795	801	816	837
Percent Change Annualized	-4.3	5.5	1.3	-0.4	1.0	2.5	1.5	4.2	0.8	1.9	2.5
Change in Private Inventories	58	9	140	106	36	-10	3	39	68	25	54
Net Exports	-1,069	-1,053	-1,374	-1,392	-1,233	-1,113	-1,108	-1,034	-1,278	-1,147	-1,228
Government Expenditures	3,966	3,996	3,982	3,984	3,987	3,991	3,995	3,942	3,986	4,007	4,039
Percent Change Annualized	5.1	3.1	-1.4	0.2	0.3	0.4	0.4	3.4	1.1	0.5	0.8
Industrial Prod. Index (2007=100)	102.7	102.4	103.8	103.8	103.1	102.3	102.3	102.6	103.2	102.7	104.0
Percent Change Annualized	-0.6	-1.1	5.5	-0.2	-2.6	-3.0	0.0	-0.3	0.7	-0.5	1.2
Capacity Utilization (Percent)	77.6	77.1	77.9	77.7	77.0	76.2	75.7	77.6	77.2	75.4	74.8
Prices											
CPI (Year-Over-Year % Change)	2.7	2.7	2.7	2.4	3.0	3.2	3.1	3.0	2.9	3.0	2.3
Core CPI (Year-Over-Year % Change)	3.3	3.3	3.1	3.1	3.3	3.3	3.2	3.4	3.2	2.8	2.1
PCE Price Index (Year-Over-Year % Change)	2.3	2.5	2.5	2.4	2.9	3.2	3.1	2.5	2.8	2.9	2.2
Core PCE Price Index (Year-Over-Year % Change)	2.7	2.8	2.8	2.8	3.1	3.3	3.1	2.8	3.0	2.8	2.2
GDP Price Index (Year-Over-Year % Change)	2.2	2.5	2.6	2.7	3.1	3.4	3.1	2.4	3.0	2.8	2.2
PPI, Final Demand (Year-Over-Year % Change)	2.2	3.1	3.2	2.9	3.2	3.3	2.9	2.3	3.2	2.3	1.6
Crude Oil, WTI (\$/barrel)	\$77	\$71	\$72	\$62	\$65	\$68	\$70	\$77	\$67	\$70	\$70
Labor Markets											
Payroll Jobs (Average Monthly Difference, Ths.)	113	170	181	130	100	89	122	161	125	134	139
Unemployment Rate (Percent)	4.2	4.1	4.1	4.2	4.2	4.2	4.2	4.0	4.2	4.2	4.2
Labor Force Participation Rate (%)	62.7	62.5	62.5	62.6	62.6	62.6	62.6	62.6	62.5	62.7	62.9
Average Weekly Hours	34.2	34.3	34.2	34.2	34.2	34.2	34.2	34.3	34.2	34.2	34.1
Personal Income											
Average Hourly Earnings (\$)	35.21	35.59	35.91	36.19	36.45	36.68	36.94	35.06	36.31	37.35	38.44
Percent Change Annualized	3.8	4.4	3.6	3.2	2.8	2.6	2.8	4.0	3.6	2.9	2.9
Real Disp. Income (2017 Billions \$ Annualized)	17,506	17,589	17,706	17,787	17,772	17,765	18,039	17,511	17,758	18,331	18,817
Percent Change Annualized	0.2	1.9	2.7	1.8	-0.3	-0.2	6.3	2.7	1.4	3.2	2.7
Personal Saving Rate (Percent)	4.1	3.7	4.0	4.3	4.5	4.7	4.9	4.5	4.3	5.1	5.7
Housing											
Housing Starts (Ths., Annual Rate)	1,332	1,392	1,393	1,385	1,397	1,406	1,415	1,368	1,395	1,427	1,462
Single-Family Housing Starts	971	1,018	1,012	997	1,002	1,007	1,012	1,014	1,004	1,019	1,041
Multifamily Housing Starts	361	374	381	389	395	399	403	354	391	408	421
Exst. SF Home Sales (Ths., Annual Rate)	3,557	3,767	3,737	3,694	3,720	3,687	3,714	3,673	3,709	3,753	3,873
New SF Home Sales (Ths., Annual Rate)	708	673	684	692	698	702	707	684	694	713	737
FHFA Purchase-Only HPI (Annual % Change)	4.5	4.5	4.4	4.1	3.8	2.8	2.4	5.4	3.8	2.2	2.3
Case/Shiller One-Family HPI (Annual % Change)	4.4	3.8	3.7	3.6	3.4	2.7	2.3	5.1	3.4	2.2	2.2
Consumer											
Retail & Food Service Sales (Monthly Avg, Bns)	699.9	712.5	715.1	713.4	716.0	720.7	728.8	696.8	716.3	739.4	762.2
Percent Change Annualized	5.7	7.4	1.5	-0.9	1.5	2.7	4.5	2.6	2.8	3.2	3.1
Consumer Confidence* (Conference Board)	102.2	110.6	99.8	88.8	92.5	96.2	98.8	104.5	94.3	99.6	97.8
Car and Light Truck Sales (Millions)	15.7	16.7	16.6	15.8	15.7	15.5	15.9	16.0	15.9	16.2	16.6
Financial Indicators (Period Average)											
Federal Funds Rate (Effective)	5.26	4.65	4.33	4.33	4.33	4.33	4.33	5.14	4.33	4.24	3.45
Prime Rate	8.43	7.82	7.50	7.50	7.50	7.50	7.50	8.31	7.50	7.41	6.62
1-Month Term SOFR	5.21	4.59	4.31	4.32	4.33	4.33	4.32	5.11	4.32	4.23	3.43
3-Month Term SOFR	5.07	4.50	4.30	4.28	4.31	4.34	4.35	5.05	4.31	4.18	3.30
1-Yr. Treasury Rate	4.45	4.25	4.14	4.06	4.25	4.30	4.20	4.69	4.19	3.93	3.10
5-Yr. Treasury Rate	3.79	4.13	4.25	4.09	4.28	4.25	4.10	4.13	4.22	3.86	3.39
10-Yr. Treasury Rate	3.95	4.28	4.45	4.47	4.75	4.82	4.72	4.21	4.62	4.54	4.17
30-Yr. Fixed Rate Mortgage	6.51	6.65	6.82	6.88	7.09	7.15	6.98	6.72	6.98	6.74	6.32
Corporate Profits After Tax (Billions \$ Annualized)	3,403	3,631	3,509	3,419	3,437	3,455	3,599	3,441	3,455	3,653	3,800
Percent Change Annualized	-1.2	29.7	-12.8	-9.9	2.1	2.1	17.7	12.1	0.4	5.7	4.0

a = actual p = preliminary f = forecast

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