U.S. Economic Comment

- February inflation: sticky, but tariffs not yet a factor
- A complication for the Fed: potential indirect effects from tariffs
- An update on Q1 growth: sub-one-percent GDP?

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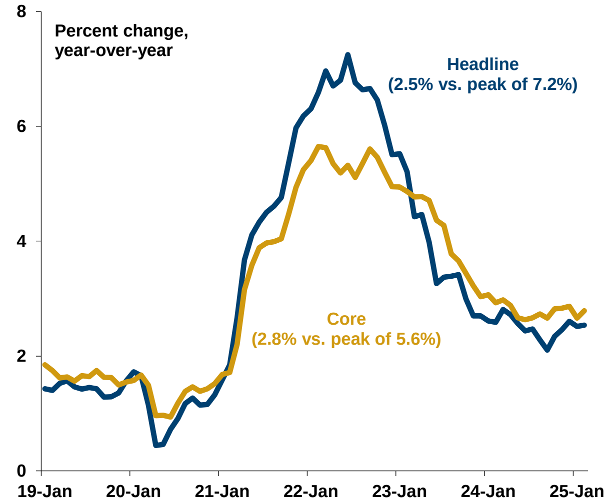
February Inflation: Calm Before the Tariff Storm?

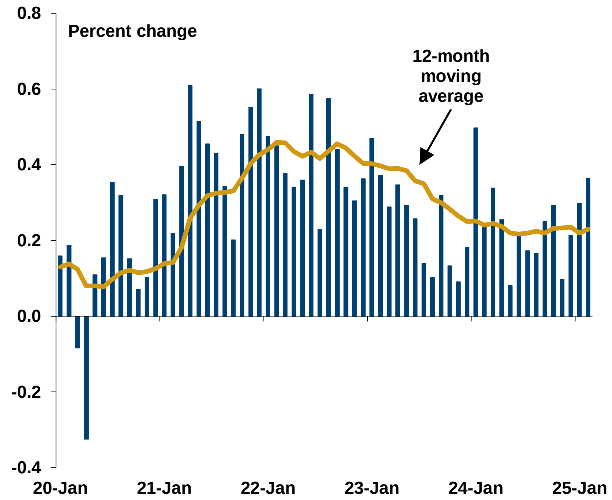
In a sense, the February results for inflation measured by the Price Index for Personal Consumption Expenditures were in line with expectations. Chair Powell indicated last week in his post-FOMC press conference that available data suggested year-over-year advances of 2.5 percent and 2.8 percent, respectively, in the headline and core PCE gauges (versus 2.5 percent and 2.6 percent in January) – results that were realized with today's report (chart, below left). Somewhat unexpected, however, was the month-to-month pressure in the core measure, which rounded up to 0.4 percent (+0.365 percent; the Bloomberg survey of economists' median and mean expectations were both +0.3 percent; chart, below right). Much of the pressure was concentrated in core services, with core goods inflation also showing hints of picking up. The results on face were not overly problematic, as they indicated much of the same with respect to recent inflation dynamics (sticky above 2 percent), but potential additive pressure from tariffs in the months ahead could complicate further the return to the price stability target.

Headline & Core PCE Price Index



Source: Bureau of Economic Analysis via Haver Analytics

Core PCE Price Index

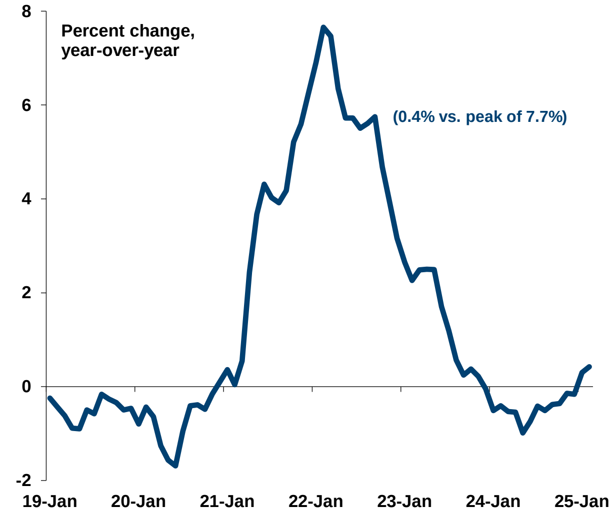


Source: Bureau of Economic Analysis via Haver Analytics

We will be keeping a close eye on core goods inflation in coming months, as pass-through from tariffs will be felt in this broad area (at least initially). With that said, scant evidence is present thus far on goods where import duties would be likely to have an almost immediate impact. As of February, new vehicle prices slipped 0.1 percent (-0.4 percent year-over-year). And, although household appliance prices jumped 1.2 percent, they had fallen in the prior three months and are down 3.2 percent on a year-over-year basis. Even so, while we view price changes in these areas as suggesting the effect of duties has yet to be felt, core goods inflation has still increased 0.4 percent per month in the past two months, with the year-over-year change in positive territory for the second consecutive month (+0.4 percent) after 13 consecutive months of declines (chart, next page, left). Thus, although the latest advance was modest, it is unwelcomed in that it may be signaling that a previous source of disinflation is transitioning to an area of potential concern.

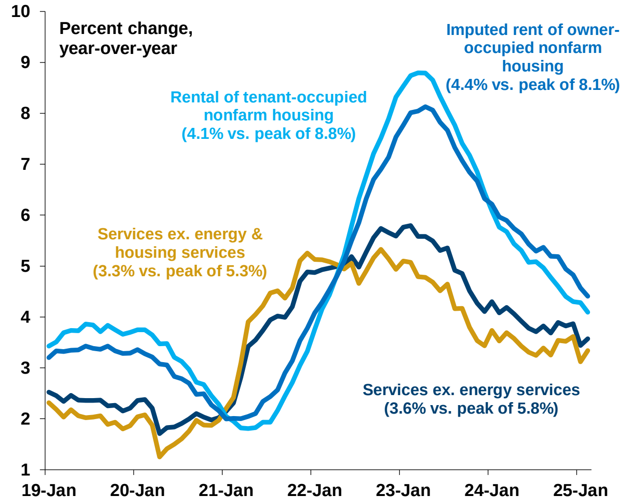
Service inflation excluding energy services tilted to the firm side in the latest month, although developments with respect to the housing components were favorable. Both the rental of tenant-occupied nonfarm housing and imputed rental of owner-occupied nonfarm housing components rounded up to 0.3 percent, with the year-over-year advances each easing by 0.2 percentage point to 4.1 percent and 4.4 percent, respectively – approaching more sustainable pre-pandemic trends. Improvement in core service inflation excluding housing, in contrast, has stalled since last summer. The measure rose 0.4 percent for the third time in the past five months, with the year-over-year advance increasing to 3.3 percent from 3.1 percent previously (a tick faster than the 2024 low of 3.2 percent in July; chart, below right). Consequently, the latest developments justify the cautious approach by the FOMC. Inflation remains stubbornly above 2 percent, and tariff-related pressures later this year could lead to potentially meaningful acceleration.

PCE: Core Goods Price Index



Source: Bureau of Economic Analysis via Haver Analytics

PCE Inflation



Source: Bureau of Economic Analysis via Haver Analytics

Fed Views on Indirect Inflation Effects of Tariffs

In a speech delivered earlier this week, Alberto Musalem, President of the Federal Reserve Bank of St. Louis, underscored the difficulty faced by policymakers in addressing current above-target inflation and in assessing potential (likely) price pressure generated by the tariff regime now being deployed by the Trump administration. Providing context to the inflation outlook, he argued, “Since mid-2024, there has been limited further progress toward 2 percent, even before the potential impact of tariffs or other factors. The risks that inflation will stall above 2 percent or move higher in the near term appear to have increased. New tariffs are expected to have both direct and indirect effects. The direct effects are essentially one-time price-level increases that should not have a persistent impact on inflation. But the indirect, second-round effects on non-imported goods and services could have a more persistent impact on underlying inflation.”

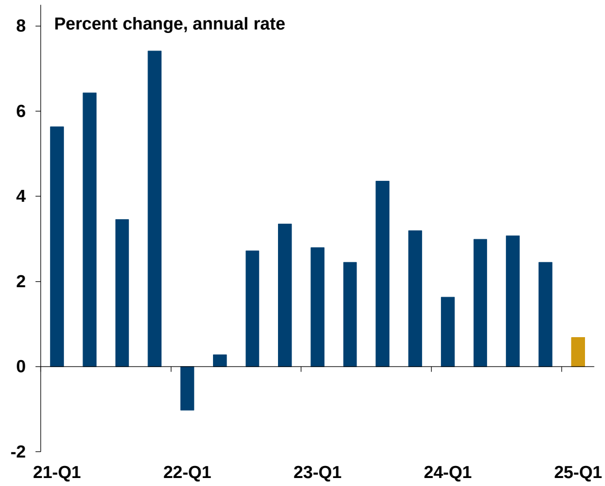
With respect to those potential indirect effects, staff at the St. Louis Fed assessed that a 10 percent increase in the effective U.S. tariff rate (which is consistent with tariff increases announced as of delivery) could boost the PCE inflation rate by up to 1.2 percentage points – with 0.7 percentage point associated with indirect effects. Moreover, while policymakers could avoid responding to the initial price level shift related to import duties, they may potentially have to “lean against” secondary pressures emerging in the economy by maintaining the policy rate at or near current levels for longer. Importantly, longer-term inflation expectations will be a key determinant of the FOMC’s response to anticipated secondary effects of tariff-related price pressures. If expectations remain anchored, then “monetary policy can be responsive to both sides of the dual mandate” (i.e., respond to downside risks to the labor market). However, should longer-term inflation expectations show evidence of slipping, then policymakers may have to look past downside risks to the economy with an eye on ensuring price stability. (For further reading, see: Musalem, Alberto. “Remarks on the U.S. Economic Outlook and Monetary Policy,” Federal Reserve Bank of St.

Louis, March 26, 2025. https://www.stlouisfed.org/from-the-president/remarks/2025/remarks-on-us-economic-outlook-and-monetary-policy.)

Q1 Growth: Likely Unimpressive

As discussed in our previous Weekly Economic Comment, we remain guardedly optimistic that the U.S. economy will remain on a growth track in 2025, although this week's data on international trade and consumer spending have forced us to again revise lower expectations for Q1 and we view risks to the outlook as increasingly tilted to the downside. In light of the results, we now project GDP growth in Q1 of 0.7 percent, annual rate, versus our previous tracking estimate of 1.5 percent (contributing to Q4/Q4 growth of 1.4 percent versus 1.6 percent as of last week; chart).

GDP Growth*

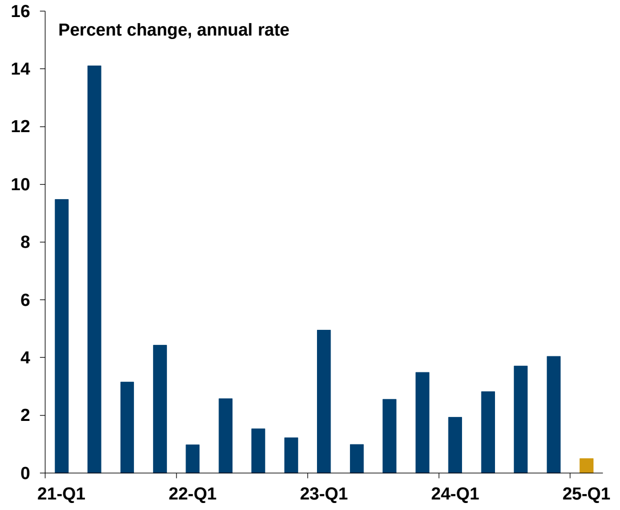


** The gold bar is a forecast for 2025-Q1.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Key to the revision is a sharp easing in consumer spending after a burst of 4.0 percent, annual rate, in 2024-Q4. Concerns about effects of tariffs on household budgets, along with perceptions that underlying labor market conditions have softened, have both likely contributed to the recent performance by households. On the point, real consumer spending rose 0.1 percent in February (versus +0.3 percent expected) after a contraction of 0.6 percent (revised from -0.5 percent) in the prior month. Even with some rebound anticipated for March, we still look for quarterly growth of real consumer spending in the vicinity of 0.5 percent, annual rate (versus 1.2 percent as of our last forecast revision; chart, below left). Beyond the spending data, increased saving by households indicates caution. The personal saving rate has jumped from 3.3 percent in December 2024 to 4.6 percent in the latest month, suggesting that consumers are not only spending more cautiously but also padding reserves to buffer against risks of a downturn (chart, below right).

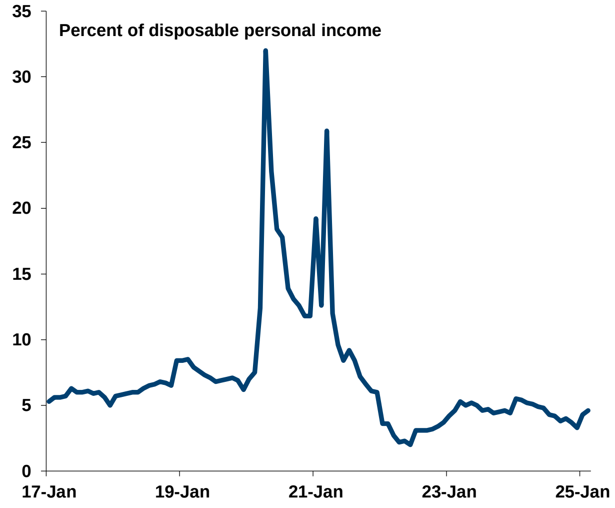
Growth of Real Consumer Spending*



** The gold bar is a forecast for 2025-Q1.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

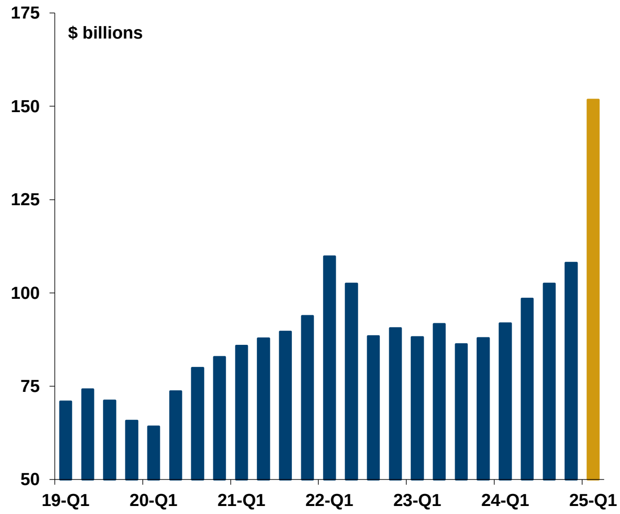
Personal Saving Rate



Source: Bureau of Economic Analysis via Haver Analytics

Also contributing to our expectations for slower growth were new data on international trade in goods for February. Although the goods deficit narrowed to $147.9 billion in February from the record of $155.6 billion, the average of $151.7 billion in Q1 thus far is still significantly wider than the Q4 average of $108.1 billion. Although gold repatriation ahead of tariffs (a financial transaction) will be removed from calculations of net exports in the GDP accounts, and the data will be adjusted to account for inflation, we still look for net exports to be a drag of approximately 1.5 percentage points on growth (versus an estimated drag of 1.2 percentage points in our previous forecast; charts, below). The picture may change with March results, but given attempts by U.S. firms to front-run tariffs, we're not particularly optimistic that results will improve meaningfully. All told, Q1 is shaping up as a disappointing one. Heightened uncertainty associated with policies of the Trump administration have generated caution among firms and consumers rather than prompting an acceleration in growth as broadly hoped for at the time of his election.

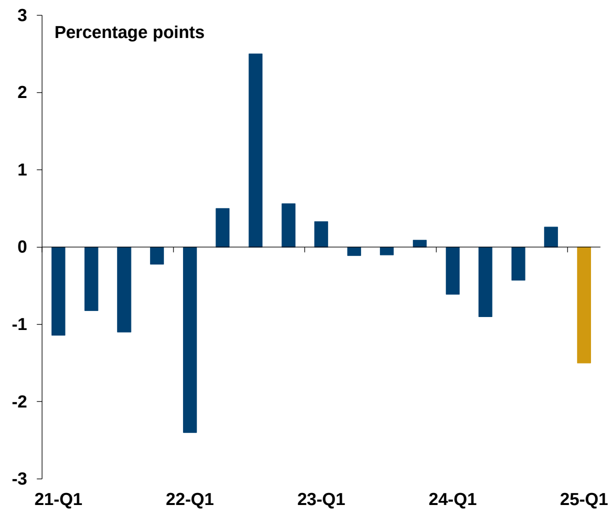
Nominal Trade Deficit in Goods*



** Quarterly average of monthly data. The observation for 2025-Q1 (gold bar) is the average of January and February.*

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Net Exports of Goods & Services*



** Contribution to real percent change in GDP. The gold bar is a forecast for 2025-Q1.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

The Week Ahead

ISM Manufacturing Index (March) (Tuesday)
Forecast: 49.5% (-0.8 Pct. Pt.)

The factory sector appeared to be picking up steam in early 2025, with the ISM manufacturing gauge increasing above the critical 50 percent threshold in the first two months of the year after a 26-month period of contraction. That said, with uncertainty regarding the Trump administration's tariff policies looming large, that momentum could peter out in March. The new orders and production subindexes seem particularly vulnerable to dip as firms exercise vigilance in the current environment of unpredictability (chart).

JOLTS Data (February) (Tuesday)
Forecast: 7.650 Million Job Openings

While the current level of job openings is noticeably off the record high of 12.2 million recorded in March 2022, this development is more consistent with a recalibration in underlying conditions rather than undesirable deterioration. The labor market was unsustainably tight at that time and openings are now broadly in line with what was seen just prior to the onset of the pandemic (2018-2019 range of 6.552 to 7.594 million). Thus, we anticipate that moderation to continue apace in February (chart).

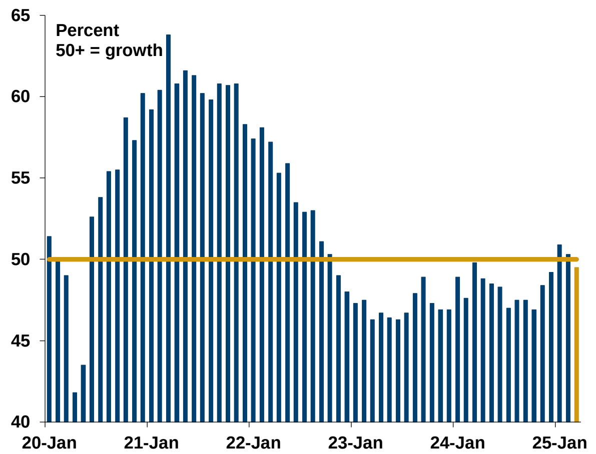
Construction (February) (Tuesday)
Forecast: +0.1%

With choppy housing starts suggesting a restrained performance in residential construction and business-related and government sponsored building flattening out after previously strong trends earlier in the expansion, total construction activity could register only a modest change in February after a 0.2 percent dip in the prior month.

Factory Orders (February) (Wednesday)
Forecast: +0.7%

Following an increase of 3.3 percent in the prior month, durable goods orders rose a more subdued 0.9 percent in February. Recent shifts in the headline have regularly reflected wide swings in the often-volatile transportation category, though it remained mostly contained in the latest month (+1.5 percent). Excluding transportation, orders have drifted higher on balance over the past twelve months. Preliminary shipments data released with the Advance Report on Durable Goods on March 26 indicate a modest increase in the nondurable area (chart).

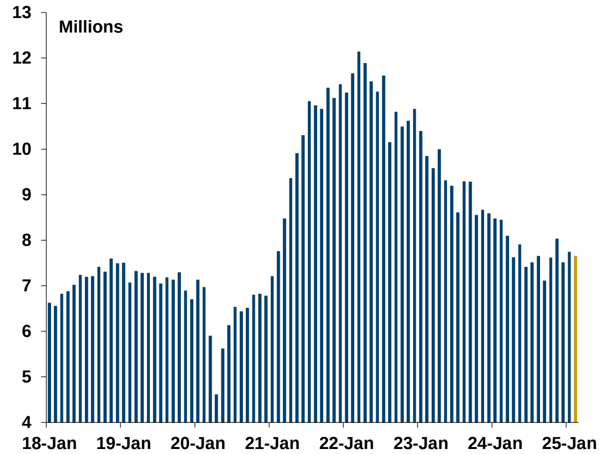
ISM Manufacturing Index*



* The gold bar is a forecast for March 2025.

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

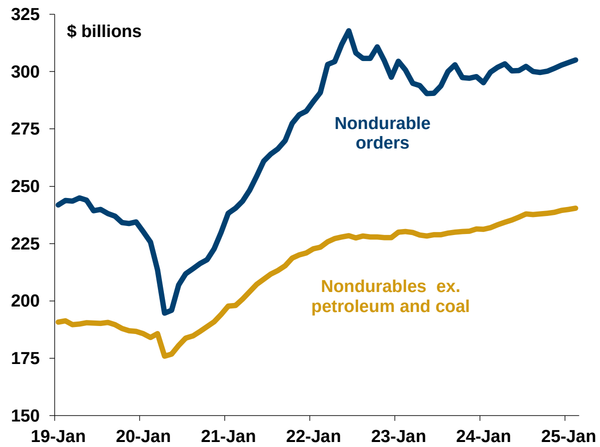
Job Openings*



* The gold bar is a forecast for February 2025.

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

New Orders for Nondurable Goods



Source: U.S. Census Bureau via Haver Analytics

Trade Balance (February) (Thursday)
Forecast: -$124.0 Billion ($7.4 Billion Narrower Deficit)

The decrease of $7.7 billion in the good deficit (published March 27) suggests similar narrowing in the total trade shortfall for February. The expected change, if realized, would only offset a portion of the substantial $33.3 billion widening in January, with results thus far in the first month of 25-Q1 implying that net exports could be a notable drag on economic growth (chart).

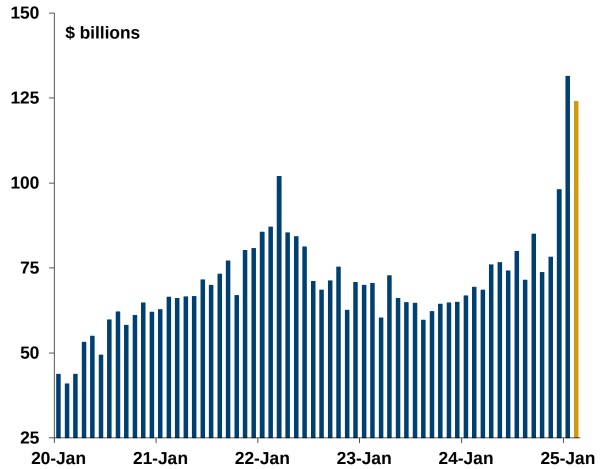
ISM Services Index (March) (Thursday)
Forecast: 53.0% (-0.5 Pct. Pt.)

With the U.S. economy remaining on a growth track, the ISM services index appears poised to remain in expansionary territory for the ninth consecutive month in March, although some downside risk is present. Specifically, February's 0.7 percentage point advance to 53.5 percent reflected a marked increase in the employment subindex (+1.6 percentage points to 53.9 percent, versus a trailing six-month average of 50.8 percent). Thus, a potential reversion to trend could contribute to some easing in the composite index (chart).

Payroll Employment (March) (Friday)
Forecast: 125,000

Payroll growth has softened into early 2025, although recent results should still be considered solid (average of 191,000 in the past six months versus the favorable 2019 average of 166,000). That said, a slowing in private sector hiring along with potential cuts in the federal government suggest that growth could continue to decelerate in the final month of Q1 (chart). The unemployment rate could nudge up 0.1 percentage point with a pick up in the labor force after a sizeable contraction in the prior month. Growth of average hourly earnings could remain close to its solid average of +0.3 percent in the past twelve months (associated with a year-over-year advance of 3.9 percent, which would be one tick lower than February's reading).

Trade Deficit in Goods & Services*



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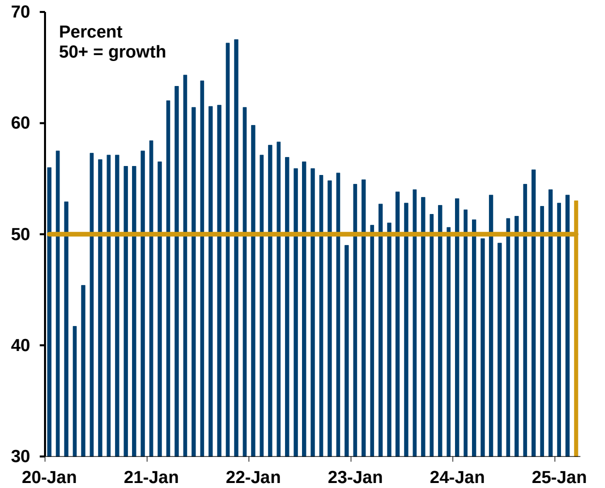
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

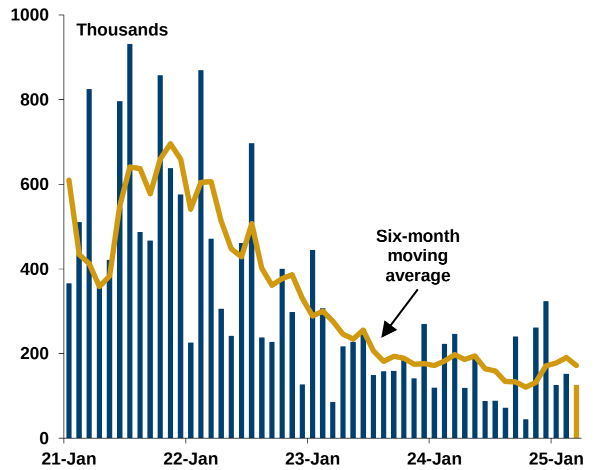
ISM Services Index*



** The gold bar is a forecast for March 2025.*

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Change in Nonfarm Payrolls*



** The gold bar is a forecast for March 2025.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

March/April 2025

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Dec 0.34 -0.06 Jan -0.08 0.07 Feb 0.18 0.15	**FHFA HOME PRICE INDEX** Nov 0.4% Dec 0.5% Jan 0.2% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** Nov 0.5% Dec 0.5% Jan 0.5% **NEW HOME SALES** Dec 0.713 million Jan 0.664 million Feb 0.676 million **CONFERENCE BOARD CONSUMER CONFIDENCE** Jan 105.3 Feb 100.1 Mar 92.9	**DURABLE GOODS ORDERS** Dec -1.8% Jan 3.3% Feb 0.9%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Mar 1 0.224 1.851 Mar 8 0.223 1.881 Mar 15 0.225 1.856 Mar 22 0.224 N/A **REVISED GDP** GDP / Chained Price 24-Q3 3.1% 1.9% 24-Q4(p) 2.3% 2.4% 24-Q4(r) 2.4% 2.3% **INTERNATIONAL TRADE IN GOODS** Dec -$122.1 billion Jan -$155.6 billion Feb -$147.9 billion **ADVANCE INVENTORIES** Wholesale / Retail Dec -0.7% -0.5% Jan 0.8% 0.1% Feb 0.3% 0.1% **PENDING HOME SALES** Dec -4.1% Jan -4.6% Feb 2.0%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Dec 0.3% 0.9% 0.2% Jan 0.7% -0.3% 0.3% Feb 0.8% 0.4% 0.4% **REVISED CONSUMER SENTIMENT** Feb 64.7 Mar(p) 57.9 Mar(r) 57.0
31	1	2	3	4
MNI CHICAGO BUSINESS BAROMETER (9:45) Jan 39.5 Feb 45.5 Mar --	**ISM MFG. INDEX (10:00)** Index / Prices Jan 50.9 54.9 Feb 50.3 62.4 **Mar 49.5 64.0** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Dec 7,508 1.9% Jan 7,740 2.1% **Feb 7,650 2.1%** **CONSTRUCTION (10:00)** Dec 0.5% Jan -0.2% **Feb 0.1%** **VEHICLE SALES** Jan 15.5 million Feb 16.0 million **Mar 15.9 million**	**ADP EMPLOYMENT (8:15)** Private Payrolls Jan 186,000 Feb 77,000 Mar -- **FACTORY ORDERS (10:00)** Dec -0.6% Jan 1.8% **Feb 0.7%**	**UNEMP. CLAIMS (8:30)** **TRADE BALANCE (8:30)** Dec -$98.1 billion Jan -$131.4 billion **Feb -$124.0 billion** **ISM SERVICES INDEX (10:00)** Index / Prices Jan 52.8 60.4 Feb 53.5 62.6 **Mar 53.0 64.0**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Jan 125,000 4.0% Feb 151,000 4.1% **Mar 125,000 4.2%**
7	8	9	10	11
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM INDEX**	**WHOLESALE TRADE** **FOMC MINUTES**	**UNEMP. CLAIMS** **CPI** **FEDERAL BUDGET**	**PPI** **CONSUMER SENTIMENT**
14	15	16	17	18
	EMPIRE MFG **IMPORT/EXPORT PRICES**	**RETAIL SALES** **IP & CAP-U** **NAHB HOUSING INDEX** **BUSINESS INVENTORIES** **TIC FLOWS**	**UNEMP. CLAIMS** **HOUSING STARTS** **PHILLY FED INDEX**	***GOOD FRIDAY***

Forecasts in bold. (p) = preliminary (2nd estimate of GDP), (r) = revised (3rd estimate of GDP)

Treasury Financing

March/April 2025

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
AUCTION RESULTS: Rate / Cover 13-week bills 4.190% 2.96 26-week bills 4.085% 3.27	**AUCTION RESULTS:** Rate / Cover 6-week bills 4.230% 2.92 2-yr notes 3.984% 2.66 **ANNOUNCE:** $60 billion 17-week bills for auction on Mar 26 $75 billion 4-week bills for auction on Mar 27 $75 billion 8-week bills for auction on Mar 27 **SETTLE:** $60 billion 17-week bills $75 billion 4-week bills $75 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.200% 2.78 5-yr notes 4.100% 2.33 Margin / Cover 2-yr FRNs 0.105% 2.87	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.220% 3.14 8-week bills 4.245% 2.68 7-yr notes 4.233% 2.53 **ANNOUNCE:** $144 billion 13-,26-week bills for auction on Mar 31 $70 billion 6-week bills for auction on Apr 1 $50 billion 14-day CMBs for auction on Apr 1 **SETTLE:** $144 billion 13-,26-week bills $70 billion 6-week bills	**SETTLE:** $28 billion 2-year FRNs
31	1	2	3	4
AUCTION: $144 billion 13-,26-week bills **SETTLE:** $13 billion 20-year bonds $18 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes	**AUCTION:** $70 billion 6-week bills $50 billion 14-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 2 $75 billion* 4-week bills for auction on Apr 3 $75 billion* 8-week bills for auction on Apr 3 **SETTLE:** $60 billion 17-week bills $75 billion 4-week bills $75 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $75 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Apr 7 $70 billion* 6-week bills for auction on Apr 8 $58 billion* 3-year notes for auction on Apr 8 $39 billion* 10-year notes for auction on Apr 9 $22 billion* 30-year bonds for auction on Apr 10	**SETTLE:** $144 billion 13-,26-week bills $70 billion 6-week bills $50 billion 14-day CMBs
7	8	9	10	11
AUCTION: $144 billion* 13-,26-week bills	**AUCTION:** $70 billion* 6-week bills $58 billion* 3-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 9 $75 billion* 4-week bills for auction on Apr 10 $75 billion* 8-week bills for auction on Apr 10 **SETTLE:** $60 billion* 17-week bills $75 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $39 billion* 10-year notes	**AUCTION:** $75 billion* 4-week bills $75 billion* 8-week bills $22 billion* 30-year bonds **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Apr 14 $70 billion* 6-week bills for auction on Apr 15 $48 billion* 52-week bills for auction on Apr 15 $13 billion* 20-year bonds for auction on Apr 16 $25 billion* 5-year TIPS for auction on Apr 17 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills	
14	15	16	17	18
AUCTION: $144 billion* 13-,26-week bills	**AUCTION:** $70 billion* 6-week bills $48 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 16 $75 billion* 4-week bills for auction on Apr 17 $75 billion* 8-week bills for auction on Apr 17 **SETTLE:** $60 billion* 17-week bills $75 billion* 4-week bills $75 billion* 8-week bills $58 billion* 3-year notes $39 billion* 10-year notes $22 billion* 30-year bonds	**AUCTION:** $60 billion* 17-week bills $13 billion* 20-year bonds	**AUCTION:** $75 billion* 4-week bills $75 billion* 8-week bills $25 billion* 5-year TIPS **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Apr 21 $70 billion* 6-week bills for auction on Apr 22 $69 billion* 2-year notes for auction on Apr 22 $70 billion* 5-year notes for auction on Apr 23 $44 billion* 7-year notes for auction on Apr 24 $30 billion* 2-year FRNs for auction on Apr 23 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills $48 billion* 52-week bills	*GOOD FRIDAY*

*Estimate