Corporate Federal Credit Union

Economic Update

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Commentary

Tariff policy continues to drive the markets. On May 12, the Trump Administration unexpectedly announced a reduction in the tariff rate on imports from China. The effective Chinese tariff rate was essentially cut in half until at least July (although it's still much higher than where is stood in 2024). Stock markets soared, as the risk of a stagflationary economic scenario was reduced by the news. The S&P 500 gained 6% in May and stands at slightly positive territory for the year.

The other major economic news on the month was the House passage of the budget bill (a.k.a the "One Big, Beautiful Bill"). Heading into 2025, U.S. fiscal policy was already in a precarious state. Public debt-to-gross-domestic-product was almost 100%, and the U.S. has been running annual deficits around 6% (levels typically only seen during recessions). The House bill, which narrowly passed by a one vote margin, extends the 2017 tax cuts from Trump's first term. It also adds tax relief through the elimination of taxes on tips, overtime pay and Social Security benefits. The bill also expands spending on several Republican priorities, including national defense and border security. Some of those increased costs would be offset by reduced spending on Medicaid and nutrition assistance.

The House budget would increase the deficit by almost $3 trillion over the next decade versus doing nothing and letting the 2017 tax cuts expire (as they are set to do at the end of this year). The bill now goes over to the Senate where they can make changes before sending it back to the House for final approval. They hope to complete the process by July 4. At a minimum, we expect the final bill to extend all the expiring tax cuts.

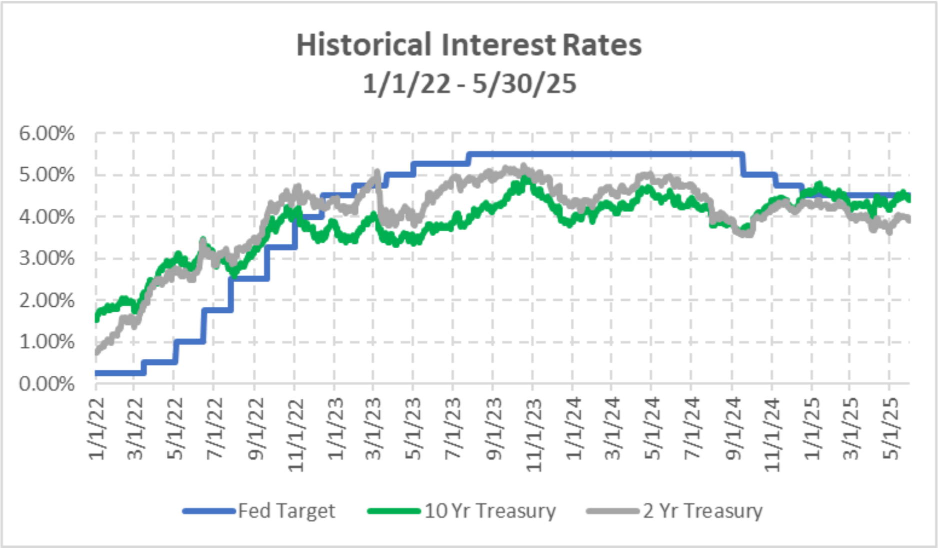
The hope was that some of the increase in deficits would be offset by increased tariff revenues. That was thrown into doubt after the U.S. Court of International Trade deemed that the president did not have the authority to impose the majority of tariffs that have been levied thus far via the International Emergency Economic Powers Act of 1997. That ruling would void almost all the new tariffs, but the decision has been "stayed" by a federal court for now, and thus the current tariffs remain in place. The cloudy tariff outlook gets even murkier now with the recent ruling, and we can look for an extension of the tariff battle as many countries are unlikely to sign trade agreements as the matter moves to the courts where they may see a more fortuitous outcome.

We continue to see increased risks of a recession. Trade uncertainly will weigh on business activity. Labor market activity and consumer spending are likely to soften further in the months ahead.

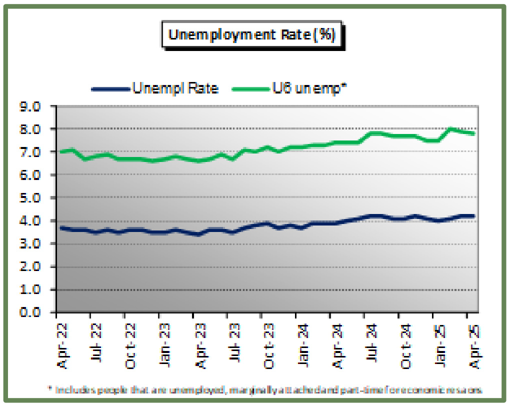
THIS MONTH

Fixed Income Outlook

Treasury rates moved higher during the month of May largely due to a perceived improvement in the economic backdrop with the reduction in the Chinese tariffs. The 30-year Treasury rate moved above 5% for the first time since 2023 on concerns on the U.S. fiscal outlook (accompanied by a downgrade of the U.S. debt rating by Moody's). The market is now pricing in a rate cut at the September Federal Open Market Committee (FOMC) meeting and another in December. That seems reasonable to us, and we see the bond market as fairly valued at current levels.

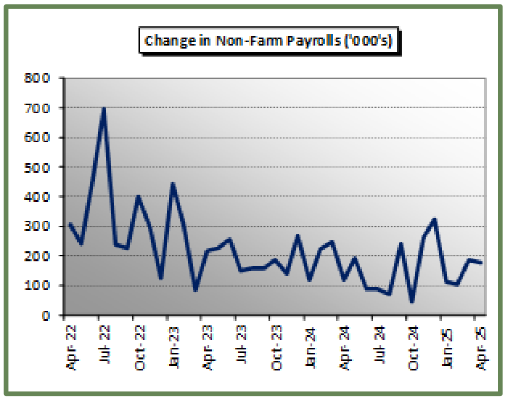


Labor Readings
(Data source: Bloomberg)



Unemployment Rate Holds Steady

The unemployment rate in April remained at 4.2%, in line with expectations. The underlying details of the report were strong as both the labor force and the number of people employed experienced significant gains.

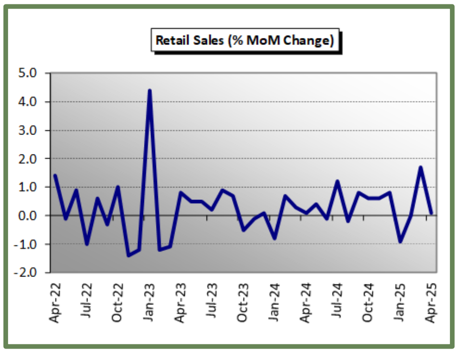


Payroll Growth Stronger than Expected

Payroll growth in April was higher than expected. Payrolls increased by a net 177,000 jobs versus an estimated 138,000 gain. The prior two months were revised downwards by 58,000 jobs. The labor market continues to cool gradually, but economists fear a sharper drop-off starting next month as tariffs start to impact hiring.

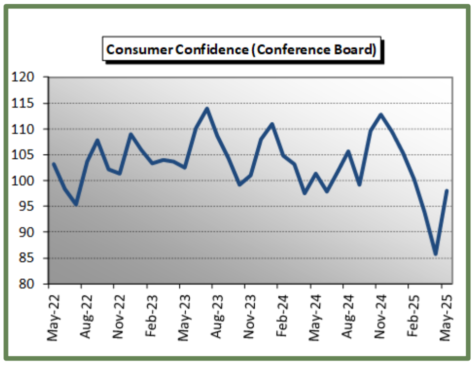
Consumer Readings

(Data source: Bloomberg)



Retail Sales Relatively Flat

Retail sales in April grew at just a .1% monthly pace. Sales for March were revised upwards to 1.7%, which was the largest increase in over two years. The large gain in March was due to consumers purchasing ahead of impending tariff increases. The concern is that the recent buying spree will be followed by a period of slow consumer spending in the months ahead.

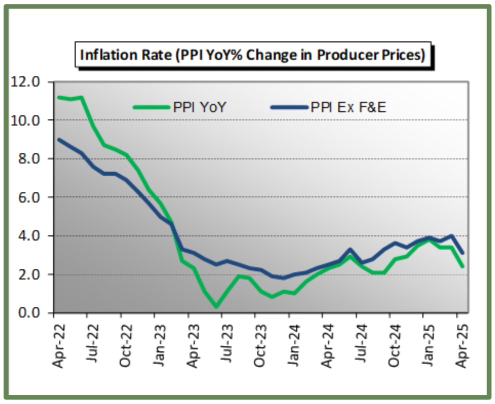


Consumer Confidence Jumps

Consumer confidence gained by the most in four years in May due to improving tariff news. Confidence jumped from almost a five-year low in April. The biggest gain came from consumer expectations, which increased by the most since 2011. Despite the improvement, confidence remains well below the levels experienced over most of the past few years.

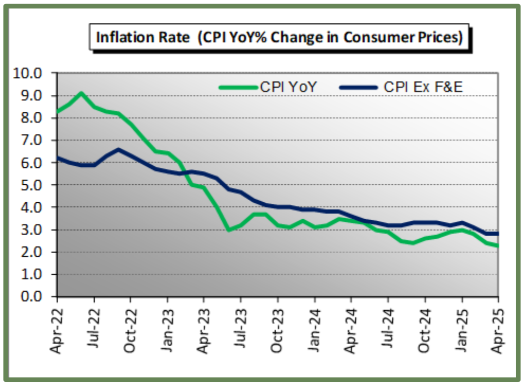
Inflation Readings

(Data source: Bloomberg)



Producer Prices Decline

Producer prices in April declined by .5%, the largest monthly decline in five years. This caused the year-over-year change to decrease by more than expected. The data suggests that manufacturers and service providers are refraining from passing along the increased prices due to tariffs. For now, producers are accepting lower margins.



Consumer Inflation Continues to Moderate

Consumer inflation in April declined to its lowest level in over four years (on a year-over-year basis). The report showed tariff-related price increases in goods, which was offset by deflation in the services sector. Despite the soft inflation report, the Fed is not likely to act given the uncertainty on where we ultimately land with tariffs.