ECONOMIC OUTLOOK

March 27, 2025

Daniel E. Laufenberg, Ph.D.
Stonebridge Chief Economist

The Forecast

When the economy is in trouble, everyone wants the economist telling them that it will not last forever. However, when the economy is doing well, the last thing they want is an economist telling them it will not last forever. Not surprisingly, my message in this update is that it will not last forever. The problem is that I am not sure what that means for the economic outlook over the next year or so. At the moment, economic surveys tend to suggest that the economy is in trouble, while the hard economic data suggest that the economy, using Federal Reserve Chair Powell's word, is "solid."[1] One thing I learned from my 52 years of economic forecasting is to listen to what people say but watch what they do.

At the moment, people are still feeling the economic pain of higher prices from past inflation, which essentially reduces the purchasing power of all consumers and may explain why consumer confidence has declined recently. However, the official data suggests that inflation has slowed considerably from its pandemic peak. In particular, consumer price inflation, as measured by the percent change in the overall Consumer Price Index, increased 2.8 percent over the twelve months of 2024, which was down markedly from 7.0 percent in 2021, 6.4 percent in 2022, and 3.4 percent in 2023. Inflation has clearly slowed over the last four years, but it still has left prices higher. Of course, the drop in confidence may reflect in part the concern about inflation reaccelerating again due to a potential trade war leading to the departure of the United States from global trade.

A year ago, the U.S. economic forecast for 2025 included slower real output growth, steady inflation around 2.5 percent, and a moderately higher unemployment rate. The basic features of the current forecast for 2025 are the same. However, the aggressive use of executive orders by President Trump to impose disruptive trade, immigration, and fiscal policies, as well as threats of more of the same, apparently have raised the risk of geopolitical backlash triggering a more pronounced slowdown. Indeed, President Trump and his economic advisers have even mentioned the pain of a recession as a fair trade for imposing his vision of an economy less dependent on income taxes and more robust in domestic manufacturing.

All of President Trump's actions since he took office have created confusion, apparently in the hope that it can be used as a negotiating tool to make a deal, the details of which are intentionally obscure so that any deal negotiated could be claimed a success. The concern is that such a strategy may generate some very unpleasant unintended economic consequences, not to mention serious geopolitical risks. For example, real gross domestic product (GDP) in the first quarter is now expected to increase 1.2 percent at an annual rate, which is slower than the 2.0 percent gain shown in the previous forecast.[2] More importantly, even a 1.2 percent growth rate in the first quarter may be too optimistic, given how sluggish the economy was in January.

Ironically, the bulk of the downgrade in first-quarter real GDP was due to a sharp deterioration in our trade deficit, led by a surge in imports in January in an attempt to avoid the tariffs that were originally scheduled to be imposed in February. Indeed, according to the widely followed GDPNow model of the Federal Reserve Bank of Atlanta, net exports were estimated to detract a

[1] Jerome Powell, Chair, Board of Governors of the Federal Reserve System (Transcript of FOMC Press Conference, March 19, 2025).
[2] Daniel E. Laufenberg, Chief Economist, *Stonebridge Economic Outlook*, January 6, 2025.

whopping 4.0 percentage points from real GDP growth in the first quarter based on the international trade data in January.[3] The question is whether President Trump's decision to delay the tariffs for a month in early February and again in March triggered another surge in imports in advance of the tariffs. As such, it is very likely that the drag on first-quarter real GDP growth from real net exports will be less than 4 percentage points. Moreover, imports alone may be a drag on GDP—because they are not produced within the United States—but they generally are allocated to other categories of GDP, including consumption, investment, or inventories. For that reason, I still expect an increase in real GDP in the first quarter, once all of the economic data are available.

In addition, real personal consumption expenditures in the first quarter are expected to expand about 1.5 percent at an annual rate, somewhat slower than anticipated earlier but still well above the 0.4 percent pace currently estimated by the Atlanta Fed's GDPNow model. All of the expected weakness in consumer spending in the first quarter likely occurred in January. Consumer spending is expected to improve moderately in February and March, given that the consumer sector continued to acquire the means to spend due to a solid gain in real disposable personal income in January. In fact, the level of real disposable income in January was already 2.9 percent at an annual rate above the average for the fourth quarter of 2024, which should be more than enough to offset any drag on spending coming from the recent stock market correction. After all, the marginal propensity to spend from income is far greater than the marginal propensity to spend from wealth. The conclusion is that consumer spending will slow in the first quarter, but not to the extent currently estimated by the Atlanta Fed's GDPNow model. In addition, it may be that the unusually severe winter weather in January had an adverse effect on spending, which means that just a return to normal weather conditions in February and March should help boost spending in each month.

Another reason for my more optimistic first-quarter real GDP growth was that U.S. manufactured output, as reported by the Federal Reserve Board[4], jumped 0.9 percent in February, and is on track to grow at a 4.1 percent annual rate in the first quarter. Because this factory output is produced in the U.S., it adds to real GDP as final sales to domestic purchasers, inventories, or exports.

Of course, the outlook for inflation matters and what happens to tariffs is a large part of that story. A tariff is essentially a tax on imported goods that raises the cost to the purchaser. President Trump incorrectly claims that all of the tariff will be paid by our trading partners, when in fact it is paid by the companies that import the products. Such companies may pressure their foreign suppliers to lower the cost of their products shipped to the United States, but the bulk of the new tariffs will be passed through to consumers in the form of higher prices. For example, when President Trump imposes a 25 percent tariff, it means that with all things equal, the prices of those imports when sold in domestic markets will increase 25 percent.

---

[3] According to the Federal Reserve Bank of Atlanta website, "GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available economic data for the current measured quarter. There are no subjective adjustments made to GDPNow—the estimate is based solely on the mathematical results of the model."

[4] Board of Governors of the Federal Reserve System, Industrial Production and Capacity Utilization – G17, Manufacturing (NAICS), March 18, 2025.

Table 1
U.S. Economic Forecast

	Annual	2025 Quarterly				Annual	
	2024	**Q1*f***	**Q2*f***	**Q3*f***	**Q4*f***	**2025*f***	**2026*f***
Real Gross Domestic Product	2.5	**1.2**	**2.0**	1.5	1.0	**1.4**	1.0
Civilian Unemployment Rate	4.2	4.1	4.2	4.4	**4.8**	**4.8**	5.5
GDP Chain-Type Price Index	2.4	2.3	2.2	2.1	2.0	2.1	2.2
Consumer Price Index, All	2.7	2.8	2.6	2.4	2.2	2.5	2.5
Consumer Price Index, Core	3.2	3.0	2.8	2.6	2.4	2.7	2.5
Price of WTI crude oil ($/bbl)	71.0	71.4	69.0	68.5	68.0	68.0	70.0
Trade-Weighted Dollar	126.0	127.9	124.0	122.0	121.0	121.0	121.0
S&P 500 Operating Earnings	233.5	60.0	61.0	59.4	57.2	237.6	235.0
Percent vs. Year Ago	9.3	3.9	6.9	14.2	7.6	2.4	-1.1
91-Day Treasury Bill Rate[n]	4.6	4.3	**4.2**	**3.8**	3.4	3.4	2.5
10-Year Treasury Note Yield[n]	4.2	4.4	**4.3**	**4.1**	4.0	4.0	4.0
30-Year Mortgage Rate	6.6	6.8	6.8	6.7	6.6	6.6	6.5
Bank Prime Rate	7.6	7.3	**7.2**	**6.8**	6.4	6.4	5.5

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Standard and Poor's, Federal Reserve Board, Department of Energy, and Federal Home Loan Mortgage Corporation.

Annual changes in real gross domestic product (GDP) and all measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. The annual estimates of the unemployment rate, the price of crude oil, the trade-weighted dollar, and all interest rates are averages for the last quarter of the year indicated. S&P 500 operating earnings per share are for the period indicated.

Quarterly changes in real GDP and all measures of inflation are percent changes from the previous quarter at annual rates. For the unemployment rate, the price of crude oil, the trade-weighted dollar, and all interest rates, quarterly estimates are averages for the quarter indicated. S&P earnings are per share for the period indicated. Trade-weighted dollar is the new broad index from the Federal Reserve Board.

n*—The 3-month and 10-year Treasury yields are at "constant maturities," which are interpolated by the U.S. Treasury from the daily yield curve for Treasury securities. This curve, which relates the yield on a security to its time to maturity, is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market that are obtained by the Federal Reserve Bank of New York.*

f*—forecast: data points in bold type reflect a major change from the previous forecast.*

The exact timing of when the tariffs will translate into higher prices is unclear. It depends on the exclusions from the tariffs, if any, and whether they are viewed as temporary or permanent. I suspect that businesses will have limited success pressuring foreign suppliers to cut prices, which means that the only relief will be from exclusions or a quick removal of the tariffs. So far, it appears that President Trump is more inclined to threaten tariffs than impose them. However, to the extent that the objectives of his tariff strategy are to promote America's manufacturing sector and reduce our reliance on income taxes, he will eventually need to impose them. The problem may be that these two goals counter each other; that is, any manufacturing that returns to the United States replaces imports and the tariffs that go with them.

As shown in Table 1, real gross domestic product (GDP) over the four quarters of 2025 is now expected to increase 1.4 percent, which is still very much in line with the 1.6 percent increase shown in the previous Economic Outlook. A weaker first quarter is expected to be largely offset by a somewhat stronger second quarter, but that too will depend on the tariffs actually imposed by the Trump administration on April 2—what Trump has referred to as "Liberation Day." Who or what is liberated by more tariffs is unclear. The Trump administration may feel the same way, given the latest news that the tariffs scheduled to go into effect April 2 may be narrower than previously suggested.

Moreover, the unemployment rate is expected to remain steady at about 4.1 percent as long as the U.S. economy is expanding at a pace close to its potential output, which I estimate to be about 1.5 percent. Once economic growth slows below its potential on a sustained basis, which it is expected to do later this year, the unemployment rate should edge higher. In this regard, the forecast now shows the unemployment rate ending the year at 4.8 percent (see Table 1). Given the possible changes to the labor force owing to President Trump's immigration directives, the unemployment rate may not climb as high in response to economic weakness as it has in the past, but it still is expected to rise.

Corporate profits, as measured by the operating earnings of the S&P 500 companies, are expected to increase over the four quarters of 2025 but at a much slower pace than they did in either of the previous two years; that is, an increase of 2.4 percent this year versus 9.3 percent in 2024 and 8.4 percent in 2023. The key assumption underlying the profits projection is that the actual tariffs will be far less extensive than proposed, suggesting that they are more of a bargaining tool than a revenue generator or an attempt to boost U.S. manufacturing. If I am wrong and President Trump follows through with massive tariffs, then the hit to corporate profits will be far more severe, either because businesses will be forced to lower profit margins dramatically to absorb some portion of the tariff or lose sales due to higher prices if they do not.

Of course, under such circumstances, I expect the Federal Reserve to be hesitant to cut rates until there is some evidence that the U.S. economy is fading fast. Although the intent will be to avoid a recession, the Fed may be incapable of doing so. The dilemma facing the Federal Reserve's Federal Open Market Committee (FOMC)[5] is that given the new world order being promoted by

[5] The Federal Open Market Committee is responsible for the primary tool of monetary policy, which is open market operations—the purchase and sale of securities in the open market by the central bank. It consists of twelve voting

the Trump administration's trade and immigration policies, inflation never falls to the FOMC's target level on a sustained basis without a recession.

Interest Rate Outlook

The FOMC currently expects to lower short-term interest rates by 25 basis points twice this year for a total of 50 basis points, which would set the target range for the federal funds rate at 3-3/4 to 4 percent. I expect the FOMC will find themselves somewhat behind the curve and will need to cut the federal funds rate more aggressively in an attempt to avoid a recession. Exactly how aggressive the FOMC will be depends on what happens to tariffs and fiscal policies, and their net impact on the economy, over the remainder of this year.

Based on Chair Powell's comments at the FOMC Press Conference on March 19, the Federal Reserve is in a wait and see mode. I do not blame them. That seems to be my approach to this forecast in the current environment of "government by tweak" as noted by Bloomberg's Mike McKee, which apparently refers to the frequent changes to policy initiatives. Such changes are made possible primarily because many of the policy initiatives are in areas that debatably allow President Trump to use executive orders to implement. Frequent revisions or delays in various policies clearly complicates monetary policy. After all, monetary policy tends to impact the economy with a relatively long lag, making it difficult for the FOMC to be confident that the appropriate policy is being pursued. In other words, when in doubt, do nothing!

That said, Chair Powell also noted that he thought that the FOMC would have a clearer picture of the economic outlook sometime this year. I agree. However, I doubt it will occur in time for monetary policy to prevent the economy from slowing markedly. Indeed, I expect that the FOMC will lower its target range for the federal funds rate to 3-1/4 to 3-1/2 percent by the end of this year. Unfortunately, by then the credit quality of U.S. government debt may be jeopardized by the more isolationist policies of the Trump administration such that longer-term interest rates fail to follow short-term interest rates lower. According to the forecast, I expect the yield on the 10-year Treasury note to change very little over the remainder of this year, ending 2025 at about 4.0 percent.

There are two items that are expected to keep long-term Treasury yields elevated over the next year. First, the level of federal debt outstanding will increase faster than GDP again in 2025, which will raise concern among bond investors about the federal government's ability to service that debt. After all, one of the factors adding to the deficit will be the renewal of the Trump tax cuts from his first term that are scheduled to sunset this year. Of course, there is considerable optimism expressed by the Trump administration that the efforts of the unofficial Department of Government Efficiency (DOGE) will succeed at reducing government spending. However, from all indications, any reduction in spending that might be achieved by DOGE will be used to fund border security, deportation activities, and defense spending. The implication is that the share of U.S. tax revenue needed to service the debt will climb, which could be a problem if tariffs fail to generate the revenue that is expected to offset lower income tax revenue. Of course, there is no way that tariffs

members, including the seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The New York Federal Reserve Bank President is always one of the five Presidents on the FOMC.

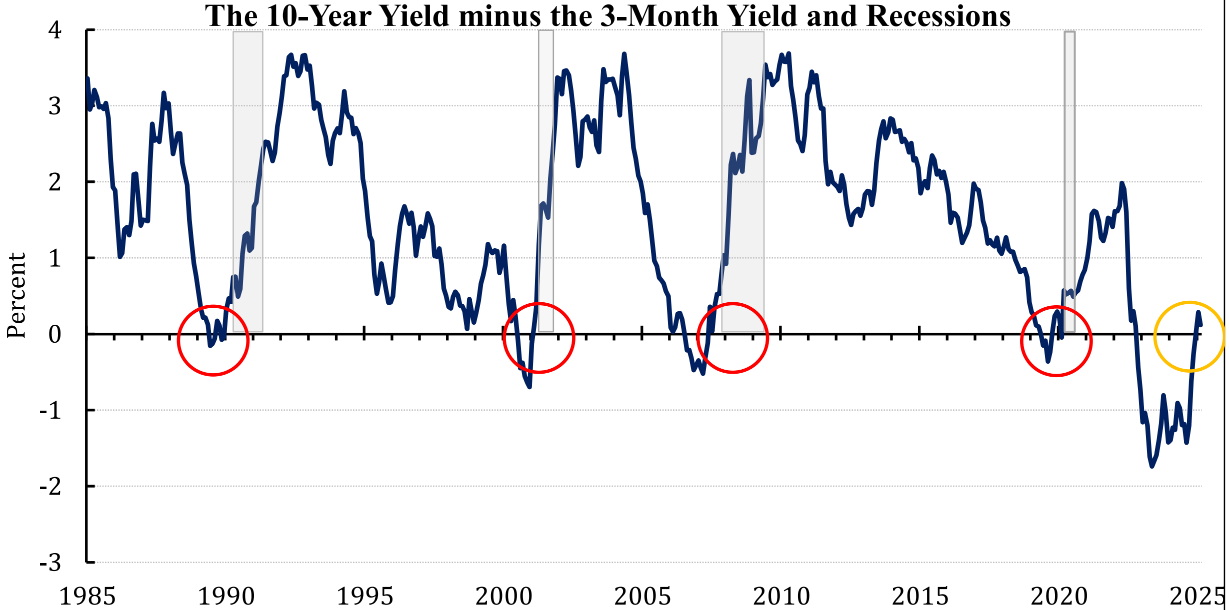
will generate that much revenue. As a result, fixed-income investors may demand a higher yield on U.S. Treasury obligations to compensate for the added risk.

Second, the persistent threat by President Trump of a trade war has already caused a decline in the exchange rate value of the dollar, a deterioration in international trade, and a possible dent to the U.S. dollar as a global reserve currency. If tariffs are imposed as aggressively as advertised and are made permanent, they most likely would pose an even more serious threat to U.S. dollar as a reserve currency. I doubt that the Trump administration will allow it to go that far. The loss of this status could incent foreign investors to reduce their exposure to dollar-denominated financial obligations. In this regard, foreigners currently own roughly 33 percent of all Treasury securities outstanding, as well as about 27 percent of all U.S. corporate debt and 17 percent of U.S. equities. This flight from dollar-denominated assets could cause prices to fall and yields to rise. Of course, if U.S. investors fill the gap left by foreign investors, it would soften the blow to U.S. financial markets. On balance, I expect the yield on the 10-year Treasury note, which is currently 4.3 percent, to remain in a range of 4 to 4-1/2 percent most of this year, as the increase in the premium for credit risk is offset by the Federal Reserve's cuts in short-term interest rates as the year unfolds.

The Yield Curve -- Again

I thought that a discussion of the yield curve was worth another mention. However, this time, I did not confuse the point by including the unemployment rate in Chart 1. Only the shape of the yield curve (the blue line) and the last four recessions (the shaded

Chart 1
The 10-Year Yield minus the 3-Month Yield and Recessions



Sources: Board of Governors of the Federal Reserve System and National Bureau of Economic Research. Shaded areas represent recessions.

areas) are plotted. When the yield on the 10-year Treasury note is above the yield on the 3-month Treasury bill, the yield curve is considered to be normal, but when the 10-year note yield is below the 3-month bill yield, the yield curve is considered to be inverted. In Chart 1, when the blue line is positive, the yield curve is normal, and when the blue line is negative, the yield curve is inverted. As shown, the yield curve has inverted before every recession, but the lag between when it inverts and the recession varies considerably—from a few months to years.

I contend that a more reliable indicator of a forthcoming recession may be when the yield curve turns normal again after a period of inversion. These events are shown in Chart 1 by the red circles, which identify the yield curve returning to normal just before each recession since 1985, including the pandemic recession of 2020.

Also in Chart 1, the yellow circle identifies the more recent return to a normal shaped yield-curve after a period of inversion, suggesting that a recession may be in our near future. This return to a normal positive spread between the 10-year and 3-month Treasury yields is due to the combination of lower yields on the 3-month Treasury bill in response to the Federal Reserve cutting rates late last year and the upward trend in the yield on the 10-year Treasury note over the last five months. Stay tuned on this one.

Data Integrity

Howard Lutnick, the U.S. Secretary of Commerce, mentioned recently that he planned to change the way the government reports data on gross domestic product (GDP) in order to remove the impact of government spending. The Bureau of Economic Analysis (BEA), which is responsible for measuring GDP, falls under the banner of the Commerce Department, so Secretary Lutnick has authority over its operations. However, according to the BEA's website, it is "an independent, principal federal statistical agency that promotes a better understanding of the U.S. economy by providing timely, relevant, and accurate economic account data objectively and cost-effectively." Indeed, Congress over the years has insisted that the federal statistical agencies remain independent of political influences, or at least blatant influences.

First, GDP, as reported by the BEA, is a broad measure of all final goods and services produced in the U.S. regardless of who owns the business. It is one of the most closely watched and influential economic indicators that directly affect decisions made by policymakers, business leaders, and the American public. GDP is the measure of final product going to consumption, investment, government, net exports, and the change in inventories, while gross domestic income is the measure of the income going to individuals, businesses, governments, and foreigners. When measured on the product side, the direct spending by all governments is included directly as a separate item but not the spending by the private sector funded by government transfer payments (Social Security and Medicare), which accounts for roughly 36 percent of the federal budget. A transfer payment is a payment made for which not current goods or services are required in return. It is clear that Medicare benefits (15 percent of the federal budget) are primarily spent on healthcare, while Social Security benefits (21 percent of the federal budget) are ambiguously included in personal consumption expenditures or personal savings.

That said, the BEA does provide an estimate of government transfer payments in its measure of personal income. After all, such transfers are a key component of the income of some. In fact, for about 40 percent of the elderly, transfer payments represent their primary source of income. Although there is no comparable detailed breakdown of transfer payments on the spending side, I believe it is safe to say that the bulk of such payments are spent and not saved. If we want more details about how the money is spent, we need to collect more detailed data, which is not impossible but very expensive and a threat to privacy. One way to do this might be to establish a highly regulated digital currency that would be managed and monitored by the central bank using blockchain technology. To the extent that this digital currency would be required for all transactions, there would be a record of every transaction made in every individual account at the central bank. However, this might be "too BIG BROTHER" for most.

Finally, there is already a subset of GDP reported by the BEA that excludes all direct government spending from a measure of GDP. It is called final sales to private purchasers—but there is more to it than simply excluding government spending. It also excludes the change in inventories and exports. It also includes imports. The reason for this is that it attempts to measure private sector purchases of all final goods and services, regardless of where they are produced. Many economists use this measure of final sales to assess the strength or weakness of aggregate demand in the private sector.

My recommendation is that the Commerce Department should be focused on making sure the economic data reported are as accurate and complete as possible (which may cost more, not less) rather than making changes to definitions to suit a political rather than an economic purpose. How politicians spin the data is up to them, but the data collection and reporting should be totally apolitical.

Important Disclosure Information

All information herein is as of March 27, 2025, unless otherwise indicated.

The views expressed here reflect those of Daniel E. Laufenberg, Ph.D. as of the date noted and not necessarily those of Stonebridge Capital Advisors. They may change as economic fundamentals and market conditions change. This commentary is provided as a general source of information only and is not intended to provide investment advice for individual investor circumstances. Past performance does not guarantee future results. Please see the end of this document for important definitions and disclosures.

Advisory services offered through Stonebridge Capital Advisors, LLC., an investment advisor registered with the U.S. Securities & Exchange Commission. The information herein provided is for educational and discussion purposes only and should not be construed as financial or investment advice, nor should any information in this document be relied on when making an investment decision. The views and opinions expressed are those of the author, Stonebridge Chief Economist, as of the date noted and are subject to change.

Any hyperlinks to third-party websites in this document are provided for reader convenience only. There can be no assurances that any of the trends described herein will continue or reverse. Past events and trends do not imply, predict or guarantee, and are not necessarily indicative of future events or results. Unless otherwise noted, information included is presented as of the dates indicated. This document contains information that may change at any time without notice. Stonebridge Capital Advisors does not have any responsibility to update the document to account for such changes.

Certain information presented in this document may be “forward-looking” in nature. Due to various risks and uncertainties, actual events or results may differ materially from those reflected in such forward-looking statements. As such, undue reliance should not be placed on such forward-looking statements, which may be identified by the use of terminology including, but not limited to, “anticipate”, “believe”, “contend”, “continue”, “expect”, “estimate”, “forecast”, “project”, “should”, “target”, or the negatives thereof or other variations or comparable terminology.

Risk Considerations

Forecasts and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. There can be no assurance that any investment strategy will be successful and meet its investment objectives. Investments fluctuate with changes in market and economic conditions and across different environments due to multiple factors, some of which may be unpredictable. Asset allocation and diversification do not guarantee investment returns or eliminate risk of loss. All investing involves risks, including the possibility of a loss of principal. Past performance is not necessarily indicative of future results.

Additional information may be available upon request.