STONEBRIDGE
Capital Advisors

ECONOMIC OUTLOOK: SPECIAL UPDATE

April 7, 2025

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

2025 Stonebridge Capital Advisors. All Rights Reserved.

STONEBRIDGE
Capital Advisors

Transitory Stagflation!

Given that the long-awaited tariffs imposed by President Trump on April 2 were considerably larger and far more inclusive than I had assumed in the Economic Outlook published on March 27, major changes to the forecast were required.[1] In particular, I now expect flat real output growth, an uptick in price inflation, a more pronounced increase in the unemployment rate, flat to slightly higher interest rates, much weaker corporate profits, and a lower foreign exchange value of the dollar this year. Recall that even before Trump's shocking tariffs, I had expected the U.S. consumer economy to slow considerably in 2025 from a year earlier, due in part to President Trump declaring a national emergency to legally justify his actions. After all, consumer sentiment was already deteriorating before the tariffs were imposed; that is, the University of Michigan Consumer Sentiment Index was 64.7 in February, down substantially from 74.0 in December 2024 but still well above the recent low of 50 in June 2022.

Of course, this forecast could change again, if Trump quickly rescinds or meaningfully relaxes the tariffs. During an interview the day after he imposed the tariffs, Trump hinted that he would be willing to ease or rescind them if he was offered a "phenomenal" deal. Since Trump has never provided any specifics about what a phenomenal deal would look like, he has a lot of discretion to define any deal as phenomenal. However, in a social media post a day later, he declared that the tariffs are here to stay. For now, I assume that the tariffs will remain in place at least through the end of 2025 and have revised the economic forecast accordingly.

First, real gross domestic product (GDP) growth is expected to slow far more than shown in the March 27 forecast. With regard to the first quarter, it still looks like real gross domestic product (GDP) growth will be positive, despite the widely followed GDPNow model from the Federal Reserve Bank of Atlanta suggesting a decline in real GDP ranging from 0.8 percent to 2.8 percent at an annual rate.[2] Based on the latest economic data points, I now estimate first-quarter real GDP growth at 0.8 percent, reflecting the expectation that real consumer spending in March will register a solid gain and that the surge in imports in January will eventually surface as either final sales or additions to inventories in February and March — either of which would counter the drag on GDP growth from imports alone.

A similar outcome could be estimated by using a supply-side approach to GDP in which total output is assumed to reflect the combination of total hours worked and the output per hour worked. According to the employment reports for the first three months of 2025 from the Bureau of Labor Statistics, the total hours worked in the private sector rose 0.5 percent at an annual rate. Of course, the chaotic attempts to shutter a host of federal agencies and reduce federal payrolls most likely reduced the total hours worked in the government sector. On balance, we assume that total hours worked by all workers probably grew 0.4 percent in the first quarter. The other component is output per hour worked or labor productivity in the first quarter. Based on the latest data, we expect that labor productivity in the nonfarm sector increased a mere 0.4 percent at an annual rate in the first quarter, following a gain of 2.0 percent in the fourth quarter of 2024. The implication is that total

---

[1] Daniel E. Laufenberg, Chief Economist, *Stonebridge Economic Outlook*, March 27, 2025.

[2] 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."

hours worked for all sectors increased at which means that for the first quarter could be estimated by adding total hours worked and the output per hour worked.

Moreover, real GDP in each of the remaining three quarters of 2025 is now expected to contract — only slightly in the second and third quarters but more decidedly in the fourth quarter. The negative effects on the global economy from the "trade war" now underway will build as the year unfolds. The U.S. certainly will not be immune to those effects. Indeed, the U.S. economy may be the hardest hit, since it may be much harder for us to find new supply sources at reasonable prices than it will be for our trading partners to find new customers outside of the U.S. for their products. Africa, South America, Europe, India, and even Canada and Mexico may increase their international trade with China or with each other and reduce their reliance on the United States. Imports are expected to fall but now exports are expected to fall as well. Without an offsetting boost to domestic manufacturing, the loss of trade could be a net negative for consumption and the economy.

Tariffs are a tax and are generally paid to the government at the point of entry by the U.S. companies importing the foreign-produced goods into the United States. The cost of the tariff (tax) is then passed onto the ultimate consumer of those goods in the form of higher prices. Hence, consumer price inflation, regardless of how it is measured, is expected to rise. Indeed, I contend that the initial price increases will be gradual, as the inventories of imports accumulated prior to the tariffs are replaced with imports subject to the tariffs. Whether the higher prices paid by consumers will reflect the entire tariff will depend on how much of the tariff is passed through to consumers. For example, the foreign supplier may be coerced by the U.S. companies importing the goods to sell their merchandise at a lower price, which could be used to deflect some of the final price increase to consumers. Another way to limit the final price increase to consumers would be if the company importing the goods was to reduce their profit margin a bit rather than pass the entire tariff through in the form of higher prices. Although the importing company may be in a position to deflect some of the burden through coercion or lower profit margins, the prices paid for imports by consumers will still bear most of the burden of the higher tariffs.

Moreover, many of the goods manufactured in the U.S. rely on imported products for some of their inputs, which means the cost of those inputs will increase with tariffs. Higher costs, all else equal, will force U.S. firms to raise their prices as well. The price increase will depend on the share of inputs that are imported as well as their penchant to protect profit margins. In other words, price increases could be far more widespread than just on imported consumer goods. We could take this even further and suggest that service prices will also increase indirectly in response to the tariffs on imports. After all, service providers are consumers of goods as well. As such, they will demand higher wages to compensate for the higher goods inflation they will encounter. Higher wages will raise costs to service companies, which in turn will force them to raise their prices. Of course, if companies are able to improve productivity and lower costs by incorporating cost-cutting technology, inflation could be less severe than the tariffs alone might suggest. However, companies may be reluctant to spend the money to make such investments in technology if they are unclear about the future demand for their products.

STONEBRIDGE
Capital Advisors

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	**0.8**	**0.2**	**-0.1**	**-1.0**	**0.0**	1.0
Civilian Unemployment Rate	4.2	4.1	**4.3**	**4.8**	**5.2**	**5.2**	**5.9**
GDP Chain-Type Price Index	2.4	2.3	**3.0**	**3.2**	**3.0**	**2.9**	2.2
Consumer Price Index, All	2.7	2.8	**4.4**	**5.7**	**4.5**	**4.4**	3.0
Consumer Price Index, Core	3.2	3.0	**4.5**	**5.8**	**4.5**	**4.4**	3.0
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	**59.5**	**57.4**	**52.0**	**228.6**	**220.0**
Percent vs. Year Ago	9.3	3.9	**1.4**	**-3.0**	**-15.0**	**-2.0**	**-3.8**
91-Day Treasury Bill Rate[n]	4.6	4.3	**4.3**	**4.3**	**4.3**	**4.2**	**3.5**
10-Year Treasury Note Yield[n]	4.2	4.4	**4.2**	**4.4**	**4.6**	**4.6**	4.0
30-Year Mortgage Rate	6.6	6.8	**7.0**	**7.2**	**7.5**	**7.5**	**6.8**
Bank Prime Rate	7.6	7.3	**7.3**	**7.3**	**7.3**	**7.2**	**6.5**

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 unemployment rate is now expected to be somewhat higher over the remainder of 2025. Generally, employers do not lay off or dismiss workers until they have no other cost-cutting alternatives to offset the slack in demand that the higher prices likely will trigger. It will be discretionary consumer spending that likely suffers initially, and if consumer price inflation persists, it will eventually work its way to nondiscretionary spending as well. In some cases, it will force consumers not only to shop less but to shop at discount stores when they do. If the tariffs remain in place for only a short period, which is still uncertain, the economic fallout will be an average recession of about ten months. On the other hand, if the tariffs persist for years, the recession could be longer and more severe, causing the unemployment rate to climb even higher.

The outlook for interest rates seems mixed. Following the tariff announcement, the yield on the 10-year Treasury note dropped about 21 basis points within two days, reflecting the expectation that the Federal Reserve would cut short-term interest rates in response to a weaker economy and the likely uptick in unemployment to follow. Some financial firms revised their interest rate forecast to include the Fed cutting its targeted range for the federal funds rate four times this year, which ironically is what we thought the Fed would do before Trump's "reciprocal" tariffs announcement. It seems that bond investors completely ignored the risk that inflation will likely return under Trump's tariff plan. Indeed, such a combination of higher unemployment and higher inflation (typically referred to as "stagflation") complicates monetary policy considerably, given that its duel policy objectives of low inflation and low unemployment generally call for opposite policies. If the focus is on reducing unemployment, the Fed tends to follow an accommodative policy (by lowering short-term interest rates), but if the focus is on reducing inflation, the Fed would follow a restrictive policy (by raising short-term interest rates). Not until the economy is in a recession and disinflation has been reestablished is it likely that the Fed will feel comfortable cutting short-term interest rates again. That said, I do not expect the Fed to hike rates this year either. The implication is that the Fed's targeted range for the federal funds rate is held steady through the end of 2025. After all, my forecast has the unemployment rate increasing this year, but to a level (5.2 percent) that still could be considered low by historical standards.

Corporate profits, as measured by the operating earnings per share of the S&P 500 companies, are now expected to decline over the four quarters of 2025, reflecting slow sales growth, higher costs, and narrower profits margins. Indeed, depending on how long the tariffs are in place, the drop in operating earnings could be more severe than shown in Table 1. In the previous outlook, I noted that "if 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."[3]

Finally, the foreign exchange value of the U.S. dollar is expected to decline as inflation rises, the economy weakens, and unemployment rises as a result of the Trump administration's various policies. However, the tariffs announced on April 2 were far more aggressive than I had assumed in my outlook of a few weeks ago. I do not expect the tariffs to cause further weakness in the U.S. dollar exchange rate, but they make the dollar's decline more likely, as well as increase the probability of the dollar weakness continuing well beyond 2025. Although I doubt that the dollar

[3] Daniel E. Laufenberg, Chief Economist, *Stonebridge Economic Outlook*, March 27, 2025.

will lose its reserve currency status, it could be compromised somewhat, which could contribute further to a lower foreign exchange value of the dollar.

Important Disclosure Information

All information herein is as of April 7, 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.