2Q25 Economic Summary

Investors had to tighten their seatbelts as tariff-induced market volatility increased in the second quarter. President Trump's "Liberation Day" announcement on April 2 sent markets into a tailspin. The severity and scope of the reciprocal tariffs took investors by surprise. Equity markets plunged toward bear-market territory and the dollar dropped as investors feared a trade war would send the U.S. into recession. After an initial rally, Treasury bonds also sold off, driving long-term yields higher as investors weighed the inflationary impact of the levies. The panicked market reaction prompted the administration to announce a pause on most tariffs just one week later. A 90-day reprieve was granted to allow trade partners time to negotiate better terms. The de-escalation was welcome news to investors, and equity markets rebounded sharply. The positive momentum continued into May and June as the administration reported progress on deals with key trading partners, including China, Japan and the UK. By the end of the quarter, equity markets were back near record highs, but long-term yields remained elevated as investor concerns about tariff-related inflation and the ever-growing budget deficit persisted.

Amidst the volatility, the U.S. economic engine continued to chug along. After a modest contraction in the first quarter, U.S. GDP growth is expected to have bounced back in the second quarter. The return to growth was due in part to a large reduction in the U.S. trade deficit in April as the front-loading of imports that took place in the first three months of the year slowed. Consumers remained resilient but cautious during the quarter. Uncertainty surrounding tariffs and the economic outlook soured consumer sentiment. As a result, Americans became more discerning in their spending, looking for bargains and pulling back on discretionary purchases like travel and recreation. Lack of clarity on trade policy also made businesses more reluctant to spend, but investment in software and technology remained solid as companies strived to stay ahead in the AI race. Residential investment continued to drag on growth as buyers could find no relief from elevated mortgage rates or home prices that remained near record highs despite increasing new and existing inventories.

The labor market remained solid but continued to show signs of cooling. The U.S. added a total of 449,000 jobs during the quarter, which was a decent gain but slower than the rapid pace of the last few years. In addition, weakness in private sector payrolls began to emerge as businesses slowed hiring to await clarity on trade policy and tax legislation. The unemployment rate fell to 4.1% in June, primarily due to a reduction in labor force participation, particularly among immigrants. Initial jobless claims remained relatively stable but continuing claims ticked up during the quarter, illustrating employers' desire to retain current employees but reluctance to make new hiring decisions. This shift in labor demand resulted in a slight deceleration in wage growth as companies were less inclined to pay up to attract workers.

Inflation data was mixed but trended in the right direction during the quarter. Core CPI came in softer than expected but services inflation ticked up in June after moderating for most of the year. In addition, there were signs that companies are beginning to pass tariff-related costs to consumers. In June, some tariff-sensitive goods, including toys, appliances and household furnishings, rose at the fastest pace in years. That said, other goods prices cooled as businesses were wary of passing on tariff-related increases to price-sensitive consumers.

The uneven cooling in inflation has made it difficult for the Fed to resume rate cuts despite signs of a downshift in economic growth and the labor market. The Committee left the target range of the fed funds rate at 4.25-4.50% in June, marking the fourth consecutive meeting with no change in the policy rate. The fed funds median projection for 2025 remained unchanged, forecasting two rate cuts by year end. However, the June dot plot showed that the number of FOMC participants calling for no cuts moved from four to seven as many expect tariffs could have a lingering inflationary impact. The bias remains toward easing, but the Fed is taking a cautious approach given the "considerable uncertainty" about the timing, size and duration of expected price pressures. Chair Powell stated that "because the economy is still solid, we can take time to actually see what's going to happen."

Markets are in line with the Fed's projection of two cuts this year, with fed funds futures currently forecasting that the first move will come in September. Although the White House is putting immense pressure on Chair Powell to start cutting rates at the July meeting, the Fed is expected to remain on hold as they await further clarity on the outlook for the economy, jobs and inflation.