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Corporate Federal Credit Union

Economic Update

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THIS MONTH

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Commentary

President Trump has hit the ground running as he enters his second term in office. He had already set a modern record for the pace of his cabinet picks when he signed dozens of executive orders on day one in office. While there were significant emotional reactions to many of the orders, it's important to note that many can be limited in power. First, it is likely that many of the more controversial orders will be met by lawsuits from Democratic attorney generals and/or other parties. Secondly, many of the actions will take time to implement as they need to go through the formal rulemaking process or need Congressional funding.

The more immediate economic impact will be derived from what the Trump administration decides to do with tariffs. Early evidence has shown that Trump is willing to use tariffs as a bargaining chip to get what he wants from countries concerning immigration and illegal drug trafficking. Therefore, it was a surprise when it was recently announced that the 25% tariffs on Mexico and Canada and 10% tariffs on China will be implemented on February 1. We expect that the Mexico and Canada tariffs will be short-lived given the potential negative impact to the U.S. economy, but the tariff battle with China will be a much longer event.

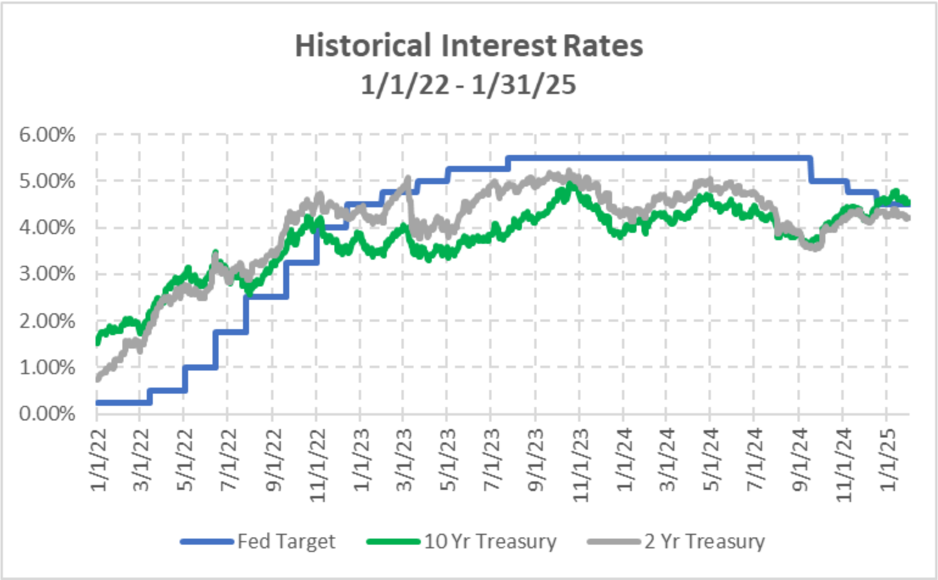
The initial estimate of fourth quarter gross domestic product (GDP) growth was released yesterday and shows an economy that remains resilient. Fourth quarter GDP slowed to 2.3% from 3.1%, but this was mainly due to the more volatile components. A better look at "core" GDP growth comes from the final sales to domestic purchasers, and that was basically unchanged from the previous quarter at 3.2%. Consumer spending was very strong and registered its largest increase in seven quarters. If the labor market continues to show strength, the consumer should be able to continue to power the economy.

The labor market has cooled off from last year. The pace of job growth declined by 800,000 in 2024 versus 2023. The unemployment rate increased to 4.1% from 3.8% on a year-over-year basis. Still, the labor market has improved since the concerns during the summer months. Job growth has bounced back, and the unemployment rate remains historically low.

We continue to look for growth to drift lower in 2025. Uncertainty related to tariffs will likely lead to delayed hiring and growth plans. We see financial conditions tightening with an extended period of high volatility.

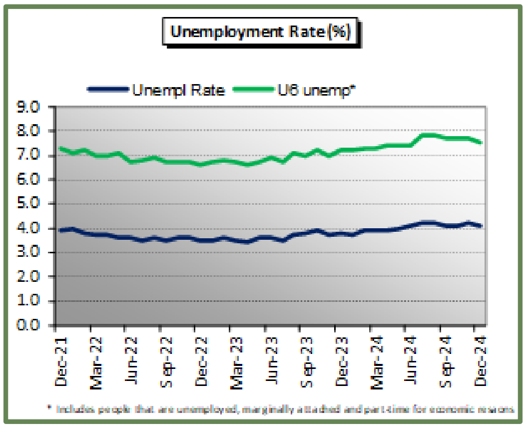
Fixed Income Outlook

Treasury bond yields are largely unchanged from where they stood at the end of 2024. Yields moved higher in the beginning of January given better than expected labor market data. They moved back down over the last few weeks after some softer inflation data. Based on the Fed's statement and the ensuing press conference by Chairman Powell, the Fed appears to be in no hurry to cut rates but is still biased lower as they believe that the fed funds rate is still meaningfully above neutral. The market has the next rate cut expected in June and one more by the end of 2025. We see the risk skewed in the direction of a more aggressive rate cut path.



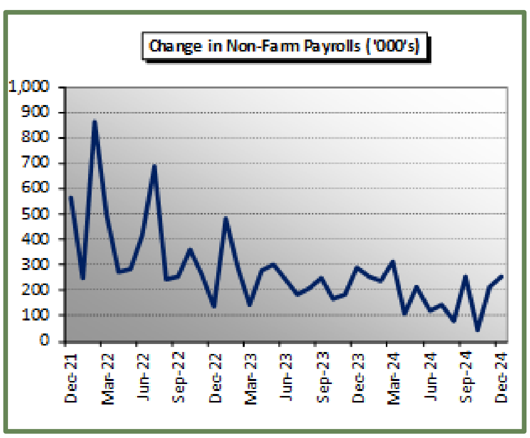
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Ticks Down

The unemployment rate in December marginally decreased to 4.1% from 4.2% the prior month. The market expected the rate to remain unchanged. The underlying details of the report were strong as both the number of employed and the labor force experienced gains from the prior month. The unemployment rate is higher than the 3.8% level from the end of 2023 but has barely moved since the middle of 2024.

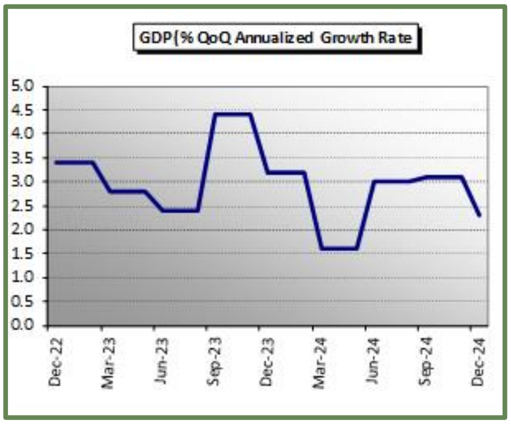


Payroll Growth Stronger than Estimates

Payrolls were higher than expected in December, with a 256,000 gain in jobs versus an expected gain of 165,000. It was the largest payroll gain since March. For the year, the economy added 2.2 million jobs. This was below the three million jobs created in 2023, but above the pre-pandemic level.

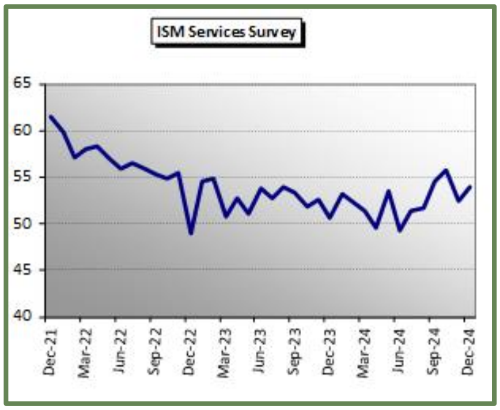
Economic Growth Readings

(Data source: Bloomberg)



Fourth Quarter GDP Below Estimates

The initial estimate of fourth quarter GDP shows an economy that slowed from the previous quarter but still remains strong. Fourth quarter GDP growth came in at 2.3% versus a 2.6% estimate. Consumer spending advanced at the fastest pace since early 2023. For the full year, GDP grew by 2.8% versus 2.9% in 2023 and 2.5% in 2022.



Services Survey Improves

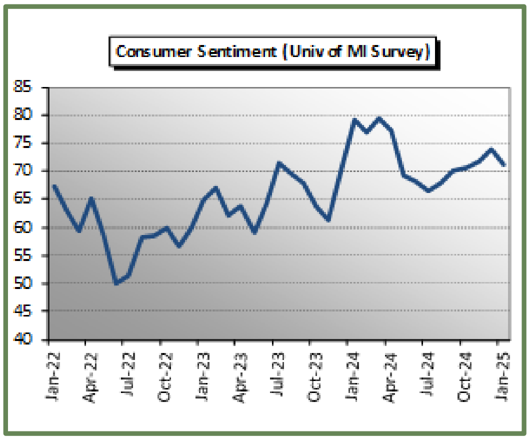
The ISM services industry survey climbed in December to 54.1 from 52.1 the previous month. Readings above 50 indicate expansion. The measure for prices paid surged by six points to the highest level since early 2023 on tariff concerns.

Consumer Readings

(Data source: Bloomberg)

Retail Sales Remain Strong

Retail sales in December were weaker than expected overall, but the control group, which strips out the more volatile components, was stronger than expectations. Overall, it appears that consumer spending slowed down in the fourth quarter but still remains relatively strong as we head into 2025.



Consumer Sentiment Declines

Consumer sentiment fell in January for the first time in six months. Inflation expectations climbed from December's level, with inflation expected to increase at its highest level since May over the ensuing year. Almost half of consumers expect the unemployment rate to rise in the year ahead, the highest percentage since the pandemic-induced recession in 2020.