Corporate Federal Credit Union

Economic Update

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THIS MONTH

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Commentary

A string of disappointing economic data has the markets worried that an economic slump is on the near-term horizon. Policy actions by the Trump administration thus far have heightened uncertainty. The administration's initial focus has been on areas that many economists believe could hamper short-term growth such as tariffs, immigration restrictions, and spending cuts. The stock market declined by 1.5% in February (based on the S&P 500 index) but is up by 1.25% for the year and 3% since election day.

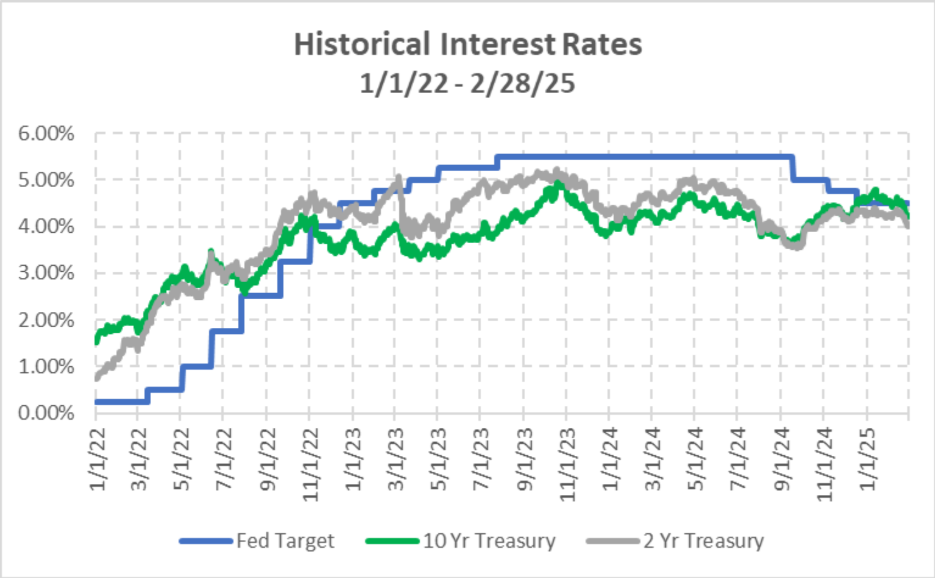
On the tariff front, the one-month pause on 25% tariffs on Canada and Mexico is nearing its deadline (March 4). An additional 10% tariff on China is also set to be implemented on that same day. That would bring the total trade-weighted tariff on Chinese imports to 30%. The president has also mentioned significant tariffs on EU imports, but the details and timing have been unclear. We continue to believe that the tariffs on Canada and Mexico will be far less than 25% since they would have a larger negative impact to U.S. economic growth, but risks are skewed towards the higher tariff scenario.

It appears that the threat of higher tariffs brought forward consumer spending into late 2024. Consumer spending soared in the fourth quarter of 2024. Spending has cooled off considerably as we start 2025. Consumer spending in January experienced its largest monthly decline (on an inflation-adjusted basis) in almost four years. Gauges of consumer sentiment have declined significantly as consumers' views on current and future economic conditions have deteriorated.

The big question is whether the consumer is just taking a breather after aggressive spending last year or if spending will be more modest in 2025. Given heightened employment uncertainty (especially for federal government employees and contractors), we expect consumer spending to cool this year. Coupled with lower government spending, we look for gross domestic product (GDP) growth closer to 1.5% in 2025 versus the near 3% rate for each of the two previous years.

Fixed Income Outlook

Treasury bond yields fell during the month of February on fears of slowing economic growth. Yield on 2 to 10 year bonds fell by approximately 30 basis points and are at their lowest levels since mid-December. The market is pricing in the next rate cut to occur in June and another cut by year-end. Inflation expectations will need to ease before the Fed will be willing to move rates lower again. Long-term consumer inflation expectations reached an almost three-decade high based on the latest University of Michigan consumer survey. Inflation expectations are likely to remain elevated until there is more certainty of tariffs. June appears like a reasonable timeframe for that to occur, and therefore, we believe that Treasuries are fairly valued at current levels.


Historical Interest Rates
1/1/22 - 2/28/25
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
1/1/22
3/1/22
5/1/22
7/1/22
9/1/22
11/1/22
1/1/23
3/1/23
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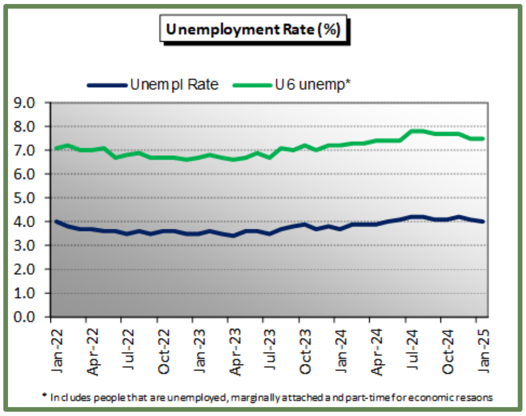
Fed Target
10 Yr Treasury
2 Yr Treasury

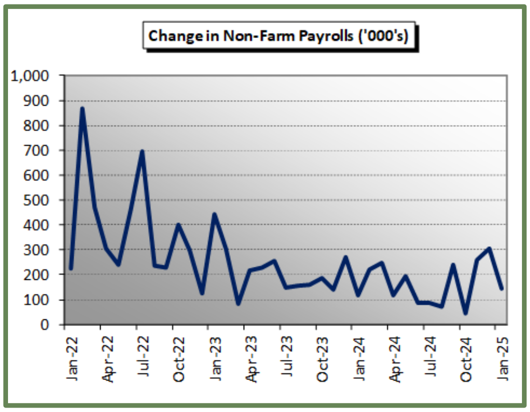
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Declines Again

The unemployment rate in January declined for the second consecutive month and stands at 4%, the lowest level since May. The January data release includes the annual population control updates. The revisions closed the monthly job growth gap between the two main labor reports (the household and the employment surveys). The household survey's 12-month average monthly job growth was increased from 45,000 to 225,000.

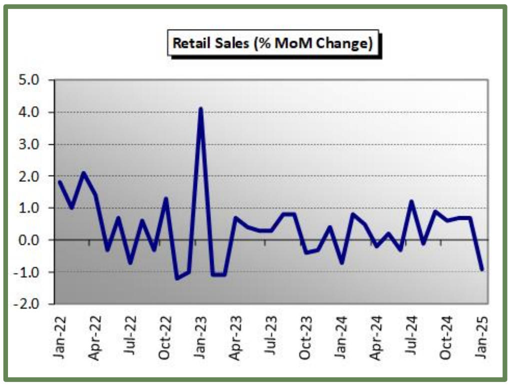


Payroll Growth Shows Mixed Results

Payrolls were lower than expected in January, but large revisions to the prior two months show a labor market that is still relatively strong. Payrolls increased by a net 143,000 jobs in January versus an estimated 175,000 gain. The prior two month's payrolls were revised upwards by 100,000 jobs. Three-month average payroll growth stands at its highest level since March 2023.

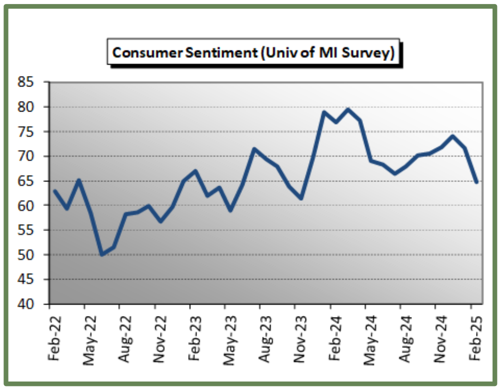
Consumer Readings

(Data source: Bloomberg)



Retail Sales Sharply Decline

Retail sales in January experienced the largest decline in almost two years. Sales dropped by .9% versus an estimated decline of .2%. Nine of the 13 sales categories decreased.

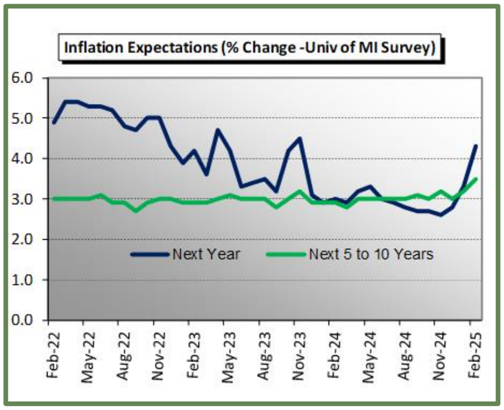


Consumer Sentiment Declines

Consumer sentiment fell more than expected in February and stands at its lowest level in over a year. All five components in the index decreased this month with the largest decline in "buying conditions for durables" due to tariff concerns.

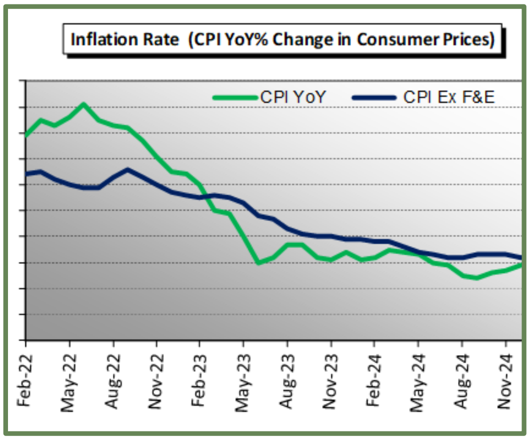
Inflation Readings

(Data source: Bloomberg)



Inflation Expectations Rise Sharply

Consumers' long-term inflation expectations for the next 5-10 years rose to the highest level in almost three decades in the latest survey in February. Inflation expectations over the next year also rose substantially, but that measure is more volatile. Inflation expectations can be self-fulfilling, so the Fed will pay close attention. For now, the sharp rise appears linked to tariff concerns, so they may drift back down depending on what tariff actions actually occur.



Consumer Inflation Hotter Than Expected

Consumer inflation rose more than anticipated to begin 2025. The headline inflation rate rose by .5% on a month-over-month basis, the largest increase since August 2023. On a year-over-year basis, consumer inflation rose to 3.0% from 2.9% the prior month. Core inflation also rose more than expected. Some economists believe that there's little reason to be alarmed, as much of the inflation gain is due to the "January effect" and will be reversed in the ensuing months.