

The US economy is expected to experience slower growth and a potential rise in the unemployment rate in the third quarter 2025, with some forecasters predicting a mild recession. Inflation is likely to remain elevated, potentially limiting the Federal Reserve's ability to cut interest rates. Policy uncertainty, particularly regarding trade and fiscal matters, is expected to continue impacting growth. Real GDP growth is predicted to slow down, potentially falling below trend, as high interest rates continue to affect investment and spending. Core consumer price inflation is expected to rise as businesses deplete existing inventories and face higher costs due to tariffs. While tariffs have been a source of market volatility, they are expected to settle below their April 2025 peak but remain higher than in 2024. With a July 9th cutoff for tariff negotiations, there may and already have been extensions (Canada and others). The equity and fixed income markets appear complacent in the face of tariff turmoil if all is not sewn up by the 9th.

The final leg down to 2% inflation is expected to be the most challenging. The unemployment rate is projected to rise, though not sharply, as the labor market cools. The Federal Reserve is likely to keep interest rates steady for now, but future cuts may be limited by persistent inflation. Trade policy changes and potential fiscal policy shifts are expected to contribute to economic uncertainty. Consumer spending is predicted to rise modestly, driven by interest rate cuts, but the overall pace of growth is expected to be slower. It is a dangerous precedent to have a sitting President attempt to interfere/ influence the independence of the Federal Reserve. Independence is crucial for the Federal Reserve's ability to effectively manage monetary policy and maintain economic stability, but inherent lurk several potential dangers. These include political pressure, legal challenges to its structure, and the potential for conflicts with fiscal policy. The Fed's independence is critical for confidence of much needed investment in our financial assets – particularly the financing of our national debt. In my opinion, the spiraling debt levels are extremely problematic. The more imminent danger - increasing interest rates on the long end, as inventors in US debt will need to be compensated for credit risk. The current budget bill as it stands – awaiting final house approval after passage in the Senate, does not address the required level of fiscal responsibility – as various factions of the Republican caucus demand spending benefits for their constituents in order to gain their needed votes with a narrow majority in the Senate and House.

While the budget deficits over the next decade are projections by the CBO (Congressional Budget Office), there is the thought that growth in the economy and resulting tax receipts will offset some portion of the spending. The CBO was overly pessimistic with the last tax overhaul (2017), which resulted in tremendous tax revenue intake from growth in the economy - a surplus which far outstripped the projected deficit spending projections. If the bill makes it through the House review and becomes law there hopefully be reconciliations and other measures to reduce spending over the next few years.

Residential and nonresidential investment is likely to be impacted by high interest rates and policy uncertainty. Recent de-escalation in tariff policy with China has improved the outlook, but uncertainty remains a factor. Several sources forecast below-potential real GDP growth for the U.S. in 2025. Factors contributing to this slower growth include slower population growth, tariffs, and government cost-cutting initiatives. High interest rates and trade policy uncertainty are also expected to dampen residential and nonresidential investment, as well as commercial and consumer spending.

Expect further softening of the labor market in the coming months. The unemployment rate is expected to rise, potentially reaching 4.6% by the first half of 2026 before slowly returning to its long-term average. Payroll employment is projected to slow down, potentially dipping below 100,000 per month due to government job cuts and weaker economic growth. Core consumer price inflation is anticipated to rise, reaching 3.0%-3.5% by the end of the year, as businesses replenish inventory at higher tariff rates. The effects of U.S. tariffs are expected to be felt in the second half of 2025, potentially pushing core inflation in the U.S. over 3%.

There are bound to be disruptions and unforeseen factors that will surface over the near to midterm. Talk of recession, stagflation and other concerns are bound to be front and center. It should be an interesting few months ahead with the tariff showdown and budget concerns. Any significant move lower should be met with increasing equity allocation for investors with a long-term perspective. Please do not hesitate to call or e-mail with any questions or concerns. Thank you, and all the best for a great summer!