NORTHERN TRUST

MAY 2025

U.S. ECONOMIC & INTEREST RATE OUTLOOK

IN THIS ISSUE

- **Storm In Sight?**

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A recent Cub Scouts meeting with my children reminded me of a simple meteorology lesson: By counting the seconds between seeing lightning and hearing a thunderclap, we can estimate how far away the bolt struck. The shorter the interval, the more urgently we should seek shelter.

An economic storm took shape as a slew of tariffs were announced. Now, we are left counting the time until the consequences are felt. The skies immediately above us are still reasonably clear: "hard" economic indicators are not deteriorating. But "soft" data is suggesting an oncoming threat.

Glimmers of sunshine have emerged as the White House has taken steps toward de-escalation and negotiation. As long as the winds continue to lead away from greater tensions, the pending storm need not be a disaster.

Following are the latest readings and what we will watch as we calibrate our view of the economy.

Key Economic Indicators

	2024	2025				2026				Q4 to Q4 change			Annual change		
	24:4a	25:1a	25:2f	25:3f	25:4f	26:1f	26:2f	26:3f	26:4f	2024a	2025f	2026f	2024a	2025f	2026f
Real Gross Domestic Product (% change, SAAR)	2.4	-0.3	1.3	1.0	0.5	0.7	1.3	1.5	1.5	2.5	0.8	1.2	2.8	1.5	1.0
Consumer Price Index (% change, annualized)	3.0	3.8	4.7	4.8	4.0	3.2	2.5	2.3	2.2	2.7	4.4	2.5	3.0	3.7	3.3
Civilian Unemployment Rate (%, average)	4.1	4.1	4.3	4.6	4.7	4.8	4.8	4.7	4.7				4.0*	4.4*	4.8*
Federal Funds Rate	4.69	4.38	4.38	4.34	4.13	4.13	3.88	3.88	3.63				5.19*	4.31*	3.88*
2-yr. Treasury Note	4.15	4.15	3.80	4.10	4.26	4.27	4.08	4.06	4.03				4.37*	4.08*	4.11*
10-yr. Treasury Note	4.28	4.30	4.40	4.50	4.60	4.60	4.60	4.60	4.60				4.21*	4.45*	4.60*

a=actual
f=forecast
*=annual average

Influences on the Forecast

- Trade policy had a noteworthy effect on the first quarter estimate of gross domestic product (GDP). The -0.3% annualized decline was depressed by an outsized gain in imports, a sign that businesses tried to accumulate inventories under the old tariff regime. Following downsizing efforts, government spending was also a drag, declining by -1.5% at an annualized rate. However, consumer spending and business investment continued their gains. Businesses notably increased their spending on equipment, also likely influenced by uncertain costs ahead.
    - We expect consumption and investment to carry momentum into the second quarter, then soften in the second half of the year. The trade balance will

normalize away from being a significant drag, but no component of GDP is poised to rally in the near term.

  - Promised upsides of tighter trade policy, like increased investment in domestic production facilities and employment, will take time to materialize. In the near term, the fog of uncertainty is creating an incentive to defer investment decisions and postpone orders.

- The U.S. gained 177,000 jobs in April, and the unemployment rate was unchanged at 4.2%. Readings of job turnover through March showed steady hiring, few layoffs and a modest slowdown of openings. The ratio of openings to unemployed workers is hovering around 1:1, consistent with a still-tight labor market.
  - We are especially attuned to real-time labor market indicators, like layoff announcements and weekly initial jobless claims. Strains are not yet apparent. We will watch policy-exposed sectors like transportation, hospitality and higher education for signs of stress.
- In March, the deflator on personal consumption expenditures, the basis of the Federal Reserve's 2% inflation target, was unchanged from February. Prices gained 2.3% over the past year, or 2.6% excluding food and energy.
  - The risks of tariff-driven inflation are top of mind for monetary policymakers. A recent Federal Reserve research paper found that trade disruptions will tend to hold inflation rates higher for two years. Tariffs are a tax on imports that will flow through to final prices, but at a gradual pace, a frustration for forecasters.
- We reiterate our expectation of the next Fed rate cut in September. Cutting sooner would require deterioration that is not yet evident in the data. Firm inflation supports a case for slower easing, and inflation is poised to rise.
- We are watching movements in the long end of the yield curve closely, not least because several presidential advisers have pointed to it as a gauge of success. We foresee yields settling somewhat higher than prevailing rates today, as markets grow accustomed to policy variability and a widening deficit.
- Our forecast, which does not include a recession, builds from a premise that trade tensions do not escalate. The maximal 145% tariff rate had effectively halted most imports from China, which will cause shortages. The 90-day climbdown should allow shipments to resume, but at tariff rates that remain historically high. Any renewed trade threats will increase the risk of a downturn.