WEEKLY ECONOMICS

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THOUGHTS OF THE WEEK

Let the (Trade) War Begin, or Not: Uncertainty is a Risk to Economic Activity

On March 4, 2025, the Trump administration imposed tariffs of 25% on Canada and Mexico and increased tariffs on Chinese imports to 20% from the previous 10% imposed earlier in the year. Retaliatory measures followed soon after as both Canada and China announced their own tariffs on imports from the US. Mexico, on the other hand, indicated that it will decide on the imposition of tariffs over the weekend, which could indicate that there may be some agreement in the works. Furthermore, reports on Tuesday indicated that the US Secretary of Commerce, Howard Lutnick, said that there may be a compromise agreement between the US, Canada, and Mexico.

On March 5, 2025, President Trump indicated that tariffs on automobiles from Canada and Mexico will have a reprieve of one month to give time for the auto industry to bring more production into the US. One month? It took the US automobile industry more than ten years to retool and adapt after the surge in petroleum prices in the 1970s and early 1980s, and when they finally adapted, Japanese automobile producers had almost taken over the small automobile market.

When we teach economics courses, we say that the ‘long run’ is the time needed for various types of industries to adapt. For an ice-cream parlor the long run is, perhaps, six months, as capital investments to adapt do not take long. However, for the automobile industry, the long run is probably close to five to ten years. That is, one month would make no difference but could push the industry to start importing more to get ahead of tariff increases, and that could put further upward pressure on imports and weaken economic growth further.

On March 6, 2026, the US issued another one-month suspension of the tariffs on Canada and Mexico.

Our readers know that we are no fans of tariffs, as they create more harm than benefits. However, if we are going to impose tariffs, let’s do it and move on. These levels of uncertainty are not good for economic activity as they distort the decision-making process of businesses and also affect consumer behavior to the detriment of sustained economic growth.

We remain in the camp that the threat of tariffs on Canada and Mexico are a negotiating tool and leverage to obtain some other objectives, and they may be short lived and/or lower than the current 25%, but political decision makers have to realize that the current environment will have a cost to the US economy.

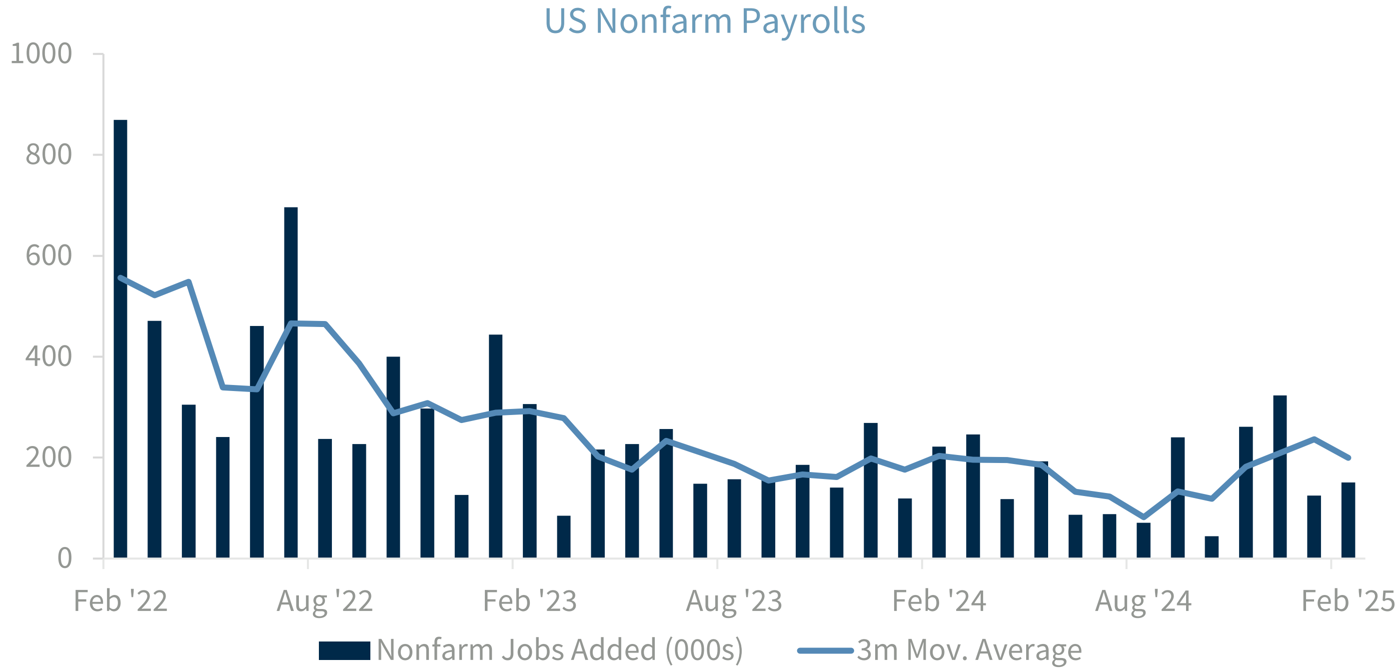
As we have said, one of the reasons the economy has remained in expansion has been the growth in non-residential investment. However, all the noise from this game of ‘impose-it-impose-it-not,’ ‘delay-it-delay-it-not,’ is highly detrimental to economic activity, and the first quarter of the year will probably remind us of just how detrimental it is.

February Employment: Keep Calm and Carry On… At Least for Now

The February nonfarm payroll employment reminded us, again, of what we have always said: “markets take the elevator while the economy takes the stairs.”

We are not naïve and think that all is fine and dandy, but news travels much more slowly in economy-land than in market-land, and the jobs report is a reminder of this. We are still looking for the uncertainty created over the last month and a half to have a larger impact on the labor market than what this report showed, but we are also reminded that all this heightened noise is going to subside, and the economy is going to resume its expansionary path.

Reading headline news reports on how “disappointing” the job numbers were in February supports our argument that news outlets many times use headlines to sell the news. However, there was nothing disappointing in the report. If the creation of 151,000 jobs in one month is disappointing, then we need to change the definition of disappointing.



Source: FactSet, RJ Economics

There was nothing disappointing about today’s job report. Perhaps the most worrisome insights we got from the January and February reports were that jobs related to consumer demand were weak, which is consistent with personal consumption expenditures in January and with what we have heard from businesses reporting from February. Some of this weakness is probably related to the US experiencing the coldest winter since 1988 but also due to heightened uncertainty about the future impact of current policies.

However, nothing in the report indicates that the flow of income from job creation has hindered the ability of the American consumer to continue to consume, at least for now. Again, we do believe that this may change during the next several months, but for now, just “keep calm and carry on.”

Forecast Table

	Actual				Forecast								Actual		Forecast	
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	2023	2024	2025	2026
Real Gross Domestic Product [1]	**1.6**	**3.0**	**3.1**	**2.3**	**2.3**	**2.2**	**2.3**	**2.5**	**2.1**	**2.1**	**2.0**	**2.2**	**2.9**	**2.8**	**2.4**	**2.2**
Real Gross Domestic Product [2]	2.9	3.1	2.7	2.4	2.6	2.5	2.3	2.3	2.3	2.2	2.2	2.1	2.5	2.5		
Consumer Price Index [2]	**3.2**	**3.2**	**2.7**	**2.7**	**2.8**	**2.7**	**3.0**	**2.8**	**2.4**	**2.4**	**2.4**	**2.4**	**4.1**	**3.0**	**2.9**	**2.4**
Ex-food & energy [2]	3.8	3.4	3.3	3.3	3.2	3.1	3.1	2.9	2.5	2.4	2.4	2.4	4.8	3.4	3.0	2.5
PCE Price Index [2]	**2.7**	**2.6**	**2.3**	**2.5**	**2.4**	**2.4**	**2.6**	**2.6**	**2.4**	**2.3**	**2.3**	**2.2**	**3.8**	**2.5**	**2.5**	**2.3**
Ex-food & energy [2]	3.0	2.7	2.7	2.8	2.6	2.5	2.5	2.5	2.4	2.3	2.3	2.2	4.1	2.8	2.5	2.3
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.1**	**4.1**	**4.2**	**4.2**	**4.3**	**4.4**	**4.4**	**4.3**	**4.3**	**3.6**	**4.0**	**4.2**	**4.4**
Fed Funds Rate [3]	4.00	5.50	5.00	4.50	4.50	4.25	4.00	4.00	4.00	3.75	3.50	3.50	5.1	5.1	4.2	3.7

[1] Annualized Quarter-Over-Quarter Growth

[2] Year-Over-Year SA Percentage Change

[3] Upper Bound of the Federal Funds Target Range

Economic Releases

ISM Manufacturing: The ISM Manufacturing Index remained in expansion for the second consecutive month and was lower in February than in January. At the same time, the New Orders Index was in contraction again, while the Prices Index was the highest since June of 2022. Respondents to the survey mentioned concerns regarding tariffs overwhelmingly, while the release indicated that the increase in the Prices Index was due to tariffs. The ISM Manufacturing PMI remained slightly over the expansion line in February, at 50.3 compared to a 50.9 reading in January and expectations for a 50.5 reading, according to FactSet. The New Orders Index fell into contraction once again, at 48.6, compared to a reading of 55.1 in January, while the Production Index weakened a bit, to 50.7, compared to a reading of 52.5 in January. The Employment Index dropped into contraction territory at 47.6, compared to 50.3 in January. The Supplier Deliveries improved to 54.5 in February compared to a reading of 50.9 in January, while the Inventories Index printed 49.9, up from a 45.9 reading in January. The Customers' Inventories Index weakened somewhat to 45.3 in February, while the Prices Index surged to 62.4 in February compared to 54.9 in January. The Backlog of Orders was higher in February, at 46.8, but remained in contraction, while the New Export Orders Index weakened a bit but remained in expansion, at 51.4. Finally, the Imports Index improved to 52.6 from a reading of 51.1 in January. A large number of respondents mentioned high uncertainty created by tariffs and how that is affecting the sector. The Prices Index was the highest reading since June of 2022. The release indicated that "Demand eased, production stabilized, and destaffing continued as panelists' companies experience the first operational shock of the new administration's tariff policy. Price growth accelerated due to tariffs, causing new order placement backlogs, supplier delivery stoppages, and manufacturing inventory impacts. Although tariffs do not go into force until mid-March, spot commodity prices have already risen about 20 percent."

Construction Spending: Construction spending was weaker than expected in January of this year versus December of last year. Private construction spending was down due to lower investment in residential construction, while public construction spending was higher due to increased highway construction spending. Overall, construction spending has remained flat over the last six months as public construction spending weakened during that period while residential construction spending, especially multifamily construction spending, continued to weaken. Construction spending declined by 0.2% during the first month of the year, according to the US Census Bureau, while markets were expecting a flat month. On a year-earlier basis, construction spending was up 3.3% in January of 2025. Private construction spending was also down by 0.2% during the first month of the year compared to December of last year. Residential construction spending was down by 0.4%, while nonresidential construction spending was flat during the year. Residential construction spending was weak because of a 0.7% decline in new multifamily construction spending while construction spending in new single-family units was up by 0.6%, month-over-month. Public construction spending was up by 0.1% in January of 2025, and compared to December of last year, as educational construction spending was down by 0.4%, month-over-month, and highway construction spending was up 0.6% during the same period of time. The impact of the CHIPS and IRA acts continued to fizzle in January of this year as construction spending in manufacturing declined by 0.3%, month-over-month, and was up by 5.6% compared to a year earlier. Recall that this component of construction spending had been the driving force of construction spending and investment during the last several years. Having said this, manufacturing construction spending is still strong, but it is no longer the driving force.

Economic Releases

ISM Services: The better than expected ISM Services PMI will help soothe markets' recent concerns about the state of the US economy. Furthermore, the more restrained increase in the Prices Index compared to what happened to the Prices Index in the ISM Manufacturing PMI clearly shows the difference in pricing pressures faced by the manufacturing sector versus the service sector. However, most of the firms on the service side of the economy mentioned tariffs as well as cuts/freezes in federal funding as risks to their industries' prospects. For now, however, the sector has continued to expand. The ISM Services PMI came in slightly stronger than expected in February, at 53.5, according to the Institute for Supply Management (ISM). FactSet expectations were for a 53.0 print. The ISM Services printed 52.8 in January. The components of the index were almost all positive compared to January. The Business Activity/Production Index was slightly lower, at 54.5 compared to 54.5 in January. The New Orders Index increased from 51.3 in January to 52.2 in February, while the Employment Index increased to 53.9 from a 52.3 reading in January. The Supplier Deliveries Index was also up slightly, to 53.4 in February compared to a reading of 53.0 in January. The Inventories Index was above the demarcation point, at 50.6 compared to a reading of 47.5 in January, while the all-important Prices Index was also up, at 62.6 compared to 60.4 in February. The Backlog of Orders Index had the largest increase, going from contracting in January, at 44.8, to expanding in February, at 51.7. The New Export Orders Index increased slightly to 52.1 in February from 52.0 the previous month. The Imports Index was slightly lower and still contracting, at 49.6 compared to 49.8 in January. Meanwhile, the Inventory Sentiment Index increased to 54.7 compared to 53.5 in January. This was eight consecutive ISM Services PMI prints above the 50 demarcation point and the 54th in 57 months, according to the release. As was the case for the ISM Manufacturing PMI, industry commentaries mentioned tariffs uncertainty as well as "significant cost impact to our project." Comments from the education space also mentioned potential changes being implemented by the new administration.

Trade Balance: Today's surge in the January international trade in goods and services deficit after an already high deficit during December 2024 is a response to the new administration's policy of imposing tariffs on our major trading partners. This is the largest trade in goods and services deficit since at least, 1992. This increase is probably going weaken growth during the first quarter of the year and could potentially push the economy into negative territory if we don't see a reversal of these results in February and March. On the positive side, an accumulation of inventories, which is considered part of investment in GDP calculations, could reduce the negative impact on GDP growth during the next several months and quarters. This is similar to what happened back in Q1 and Q2 of 2022 when firms replenished inventories during the recovery from the pandemic recession. However, the reasons for that increase in imports were very different than what is happening today. The US goods and services trade deficit skyrocketed further in January, up to $131.4 billion compared to a trade deficit of $98.1 billion during December 2024, according to the US Census Bureau and the US Bureau of Economic Analysis. FactSet expectations were for a trade deficit of $96.6 billion. Exports were $269.8 billion, up $3.3 billion from December. Imports were $401.2 billion, up $36.6 billion more than in December of last year. On a Census basis, exports increased by $2.8 billion. Capital goods exports increased by $4.2 billion as civilian aircraft exports increased $1.1 billion, semiconductors exports increased $0.7 billion, computer exports increased $0.5 billion, and civilian aircraft engines increased $0.5 billion. Consumer goods exports increased $1.7 billion as pharmaceutical preparations increased $0.8 billion, while jewelry exports increased $0.6 billion. On a Census basis, imports surged by $36.2 billion as industrial supplies and materials surged $23.1 billion, while finished metal shapes surged $20.5 billion.

Economic Releases

Consumer goods imports increased $6.0 billion as pharmaceutical preparations increased $5.2 billion, while cell phone and other household goods imports increased by $1.2 billion. Capital goods imports increased by $4.6 billion as imports of computers increased 43.0 billion while computer accessories increased $1.2 billion. Finally, telecommunications equipment increased by $1.1 billion. It is clear that tariffs have pushed many industries to push imports forward, and this has been reflected during the last several months.

Jobless Claims: Last week's unexpected increase in initial claims was almost reversed this week as weekly claims for unemployment insurance declined by 21,000 after increasing by 22,000 the previous week. There was a large increase in new claims from federal workers during the week of February 22, according to the release. This is good news, but we should see an increase in this number as the administration continues to cut jobs. We could also start seeing some larger claims as a consequence of the uncertainty that the new policies are generating. Initial claims for unemployment insurance during the week ending March 1, 2025, declined by 21,000 to 221,000, compared to claims of 242,000 during the previous week. The four-week moving average was 224,250, an increase of 250 compared to last week’s four-week moving average. The advanced seasonally adjusted insured unemployment rate was 1.2 percent, unchanged from the previous month. The Labor Department release indicated that there was a large increase in the number of federal employees making claims during the previous week, the week of February 22. During that week, 1,634 federal workers applied for unemployment insurance claims, up from only 330 during the same week a year earlier. This data is not seasonally adjusted, so comparing to last year is the correct comparison to make.

Employment Report: Although the nonfarm payroll number for February came in lower than expected it still showed a strong employment sector, with a recovery in private sector employment mostly due to strong hiring from the health care and social assistance sector. The goods producing sector was also strong, driven by construction and manufacturing jobs. The weakest sector in February was leisure and hospitality, which shed jobs for a second consecutive month. This decline could be related to weather, but it also tends to confirm that consumer demand was weak in January and probably did not recover much in February, which is further supported by a decline in retail trade jobs. Still, with all the noise coming from the new administration’s tough stand on federal workers and deportations, the report showed that the economy may have weakened but employment is still strong. Going forward, we are probably going to see a larger impact from the uncertainty that has been created during the last month and a half. Overall, net job revisions showed 2,000 fewer jobs than originally estimated. Nonfarm payroll employment increased slightly below FactSet consensus during the second month of the year, up 151,000 compared to expectations for an increase of 160,000. The rate of unemployment increased slightly, from 4.0% in January to 4.1% in February. Total private employment increased by 140,000 compared to only 81,000 in January. The goods-producing sector increased jobs by 34,000 after losing 7,000 jobs in January. Construction jobs increased by 19,000 while manufacturing jobs increased by 10,000. The private service-providing sector contributed with 106,000 jobs, with private education and health services adding 73,000, mostly due to a strong health care and social assistance sector, which added 63,100 of those jobs. Leisure and hospitality had another weak month, shedding 16,000 jobs, while professional and business services eliminated 2,000. Financial activities added a strong 21,000 jobs during the month, while transportation and warehousing added another 17,800 new positions. The retail trade sector also showed a decline in jobs in February, down 6,300. The government sector added only 11,000 after increasing jobs by 44,000 in January.

Economic Releases

Average weekly hours remained unchanged in February versus January, at 34.1, while average hourly earnings increased from $35.83 in January to $35.93 in February. Thus, average weekly earnings increased from $1,221.8 in January to $1,225.21 in February. The labor force participation rate declined from 62.6% in January to 62.4% in February. January’s employment number was revised down from 143,000 to 125,000, or 18,000 fewer jobs than originally reported. Furthermore, once again, the Household Survey, which is where the rate of unemployment is estimated, showed a large decline in employment, down 588,000.

Disclosures

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

Employment cost Index: The Employment Cost Index (ECI) measures the change in the hourly labor cost to employers over time. The ECI uses a fixed "basket" of labor to produce a pure cost change, free from the effects of workers moving between occupations and industries and includes both the cost of wages and salaries and the cost of benefits.

US Dollar Index: The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA HPI is a broad measure of the movement of single-family house prices. The FHFA HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties.

Disclosures

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

The ISM Manufacturing Index: The The Institute of Supply Management (ISM) Manufacturing Measures the health of the manufacturing sector by surveying purchasing managers at manufacturing firms. The survey asks about current business conditions and expectations for the future, including new orders, inventories, employment, and deliveries.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index(PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Source: FactSet, data as of 3/7/2025

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