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ECONOMIC RESEARCH – JULY 2025

INVESTMENT INSIGHT USA

- ✓ **Leading indicators remain indecisive**
- ✓ **Employment shows signs of cracking**
- ✓ **Dilemma remains intact for Fed**
- ✓ **Price indices yet to react to tariffs**

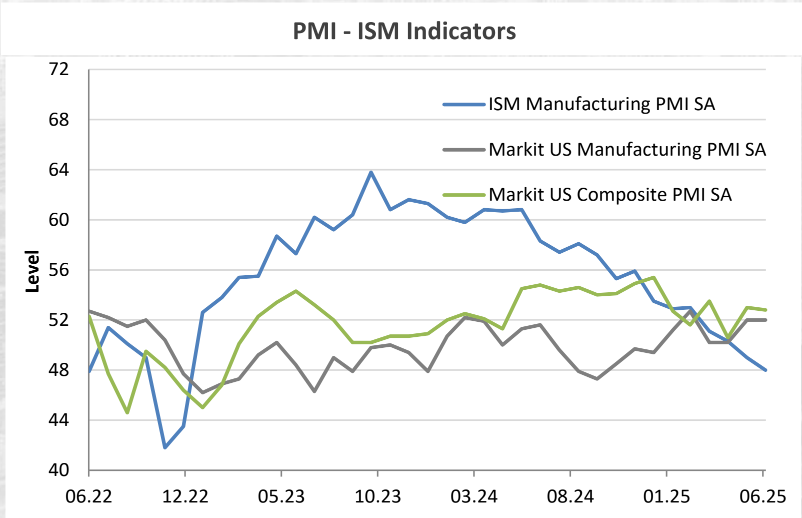
THE HOUR OF TRUTH DRAWS NEAR

Leading indicators signal moderation

Leading indicators for the second quarter of 2025 present a mixed but not catastrophic picture for the US economy, with some rebounding while others remain below growth thresholds. The ISM services index registered its lowest level for twelve months, while the manufacturing index remains in contraction territory, suggesting that political uncertainty is weighing on both sectors.

Labor market shows signs of easing

The job market is finally showing clearer signs of a slowdown. Jobless claims are now consistently above 240,000, and the number of continuing claims has hit its highest level since late 2021. More notably, ADP data recorded the first net job loss since March 2023, with a significant contraction in the service sector. This trend towards reduced labor market tension is a key development, as it will likely alleviate the Federal Reserve's concerns about wage-driven inflationary pressures. While the employment picture gives the central bank more flexibility, the full impact of looming tariff policies on corporate hiring remains uncertain as companies have not yet drawn any definitive conclusions.



Sources : Bloomberg, BBGI Group

Disinflationary trends amidst looming risks

Current inflation data would typically argue for a more accommodative monetary policy from the Fed. Headline consumer prices (CPI) have risen by a modest +2.4% year-on-year, a level not seen since 2021. This disinflationary trend is broad-based, with services inflation continuing to decline. Producer prices have also turned negative, signaling a broader moderation in business costs. Even import prices appear stable, though this is a misleading metric as it excludes the impact of new tariffs. The true inflationary effect of these trade policies has yet to materialize in consumer price indices due to stockpiling and a delayed implementation.

Monetary policy stalls amid uncertainty

The Federal Reserve remains in a state of deliberate inaction, having held its key rate at 4.5% since December 2024. The central bank is grappling with a profound policy dilemma: whether the rising risks of a recession outweigh the mounting threat of tariff-induced inflation. While it acknowledges the resilience of the US economy, the Fed has explicitly maintained a wait-and-see approach, resisting significant political pressure to cut rates. This cautious stance is also reflected in its continued, albeit reduced, program of balance sheet normalization.

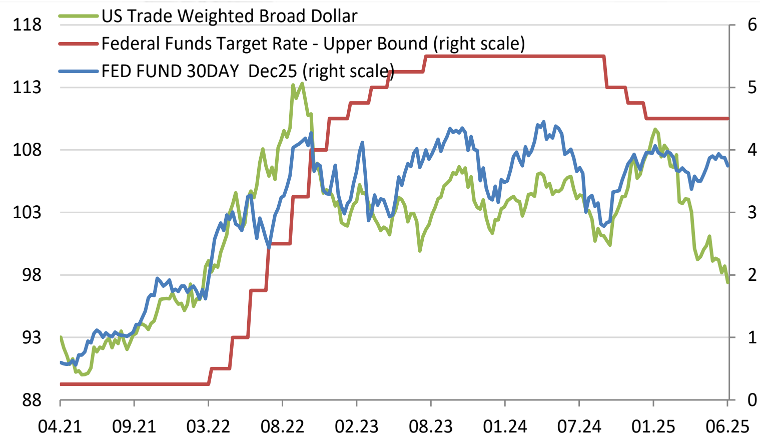
The tariff impact looms large

While official import price indices have remained stable on a monthly basis, this statistic does not account for the new 10% tariff, which has a significant impact on real costs. When these duties are factored in, import prices have actually risen by an estimated +11%. The delayed impact on consumer prices is a result of importers having built up inventories in anticipation of higher costs. The full ramifications of these new policies are expected to show up in consumer price indices later this year.

Navigating a complex economic outlook

The US economy is navigating a highly uncertain and complex period. On one hand, a statistical rebound in Q2 GDP is expected, but this will likely mask growing weaknesses in consumer spending and the labor market. On the other hand, the Federal Reserve is caught between a favorable inflation environment and the risk of significant future price shocks from trade policies. The central bank's actions will depend on how this delicate balance of risks evolves. With the full economic impact of new tariffs still unclear, the path forward remains highly volatile and subject to political and trade-related developments, requiring a flexible approach from policymakers.

Fed funds, key rates and USD (trade weighted)



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