Yardeni Research

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Morning Briefing

Testing The Resilience Of The US Economy

Check out the accompanying chart collection.

Executive Summary: We continue to bet on the resilience of the American economy. Yes, the Atlanta Fed's GDPNow model lowered its Q1 GDP forecast significantly on Friday. The volatile model swung in response to January's surge in imported goods ahead of Trump's tariffs. In addition, consumer spending was depressed by a colder-than-usual January, but consumer spending and the model are bound to rebound in February. Eric explains why we believe pessimism about the economic outlook is unwarranted. … Also: The uncertainty introduced by Trump 2.0's flurry of aggressive actions has lured bears out of their caves. Eric provides counterarguments to their most common growlings. ... And: Dr Ed pans "Zero Day" (-).

YRI Weekly Webcast. Join our live webcast with Q&A on Mondays at 11 a.m., EST, with Ed and Eric. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Strategy I: Addressing the Growth Scare. On Friday, the Atlanta Fed's Q1 *GDPNow* model fell from 2.3% to -1.5% (q/q, saar) (*Fig. 1*). Naturally, that amplified the ongoing concerns that the US economy is quickly slowing, perhaps due to uncertainty attributable to Trump 2.0. While much of the drop in the model's estimate did have to do with Trump 2.0, January's trade data that triggered it don't portend a significant economic slowdown. Neither do January's consumption data, in our opinion. Both were released on Friday.

Here's more:

(1) *Frontrunning tariffs*. In the GDP calculation, when US imports rise faster than exports, that weighs on real GDP growth. In January, goods imports soared to a record high, causing the trade deficit to widen 70% y/y to $153.3 billion, or a $1.8 trillion annualized deficit (*Fig. 2*). The bulk of this surge represented importers getting ahead of potential tariff increases. Imports of industrial supplies increased by 63.2%, and imports of consumer goods rose by 25.9%.

The trade data went from weighing on the GDPNow model's expected Q1 growth by -0.41% to -3.70%, leading to the huge swing (*Fig. 3*).

(2) *Wait for the February data*. The problem with the GDPNow model is that it can be erratic, and its latest swing catches only the surge in imports. The reason net exports are subtracted from overall GDP is that usually imports are already accounted for in consumption and inventory investment data—that's why they typically correlate with US economic growth. Consumption was weak in January because of the coldest January weather since 2011. We expect that consumption will rebound while imports weaken in February and March. If so, then real GDP should grow at least 1.5% in Q1 and 2.5% in Q2.

(3) *Markets' reaction*. The 10-year Treasury yield now stands just below the bottom of our 2025 expected range of 4.25%-4.75%, hovering around 4.20% (*Fig. 4*). It had been around 4.25% on Friday—and stocks had been up on the day—until Ukrainian President Volodymyr Zelenskyy's public meeting with President Donald Trump and Vice President JD Vance turned into a chaotic shouting match. Stocks managed to finish the day higher thanks to some month-end markups (or window dressing).

In any event, the markets may be reading too much into the trade data that are temporarily weighing on GDP expectations. We're still expecting a rebound in the February and March economic data; however, growth will likely slow during Q1 and perhaps Q2 before accelerating in the back half of the year as uncertainty fades.

Strategy II: Animal Spirits Trump Uncertainty. If you're searching for a bearish narrative, take your pick. Bearish prognosticators have been licking their wounds since the no-show recession of 2022 and 2023 and since the 2024 summer slowdown proved to be a head fake. Trump 2.0 seems to be bringing them out of hibernation.

Among the many economic challenges ahead cited by the growing cohort of bears are:

- Fiscal stimulus will diminish, weighing directly on GDP. In other words, a fiscal cliff is coming soon.
- Consumers will retrench because they are too leveraged or have run out of excess savings.
- The positives of Trump 2.0's pro-business stance are outweighed by the negatives of policy uncertainty, drummed up by daily executive orders and tariff announcements. This uncertainty will restrain capital spending and is already spurring a slowdown in the services economy.

- The Department of Government Efficiency (DOGE) is slashing the federal workforce and contracted workers. That will jack up unemployment and knock down consumer spending.
- Should DOGE fail in its aims of narrowing the budget and slowing the growth in federal spending, then higher interest rates and a fiscal crisis are inevitable. Corporate defaults, slimmer profit margins, and lower stock prices surely would follow. The reduced net wealth effect would weigh doubly on consumer spending. Construction employment would suffer from the housing market malaise under higher rates.

So whether DOGE succeeds or fails, the thinking goes, the economy is doomed. Woe is us! The wall of worry grows a brick row higher each day.

We believe the current uncertainty will be offset by the US economy's dynamism. The economy has demonstrated its resilience since the pandemic started. That's especially true over the past three years, when monetary policy turned restrictive to beat down inflation yet the economy continued to grow. There hasn't been a recession since the pandemic lockdowns during the first two quarters of 2020.

We expect that pro-business policies, as they emerge, will boost longer-term confidence, allaying short-term uncertainties related to Trump 2.0. We think the naysayers are hanging too much significance on what drove economic growth in the years that followed the pandemic and not enough on what will drive it going forward.

Ironically, their excuse for being wrong in expecting a recession over the past three years is that fiscal policy was stimulative, which staved off the downturn. Now that it is likely to turn less stimulative, the odds of a recession are increasing again, in their opinion. That is such yesterday thinking! We are thinking ahead to tomorrow, focused on future developments that are already stimulating the economy such as the tech-led productivity boom at the crux of our Roaring 2020s outlook. In short, our long-held bullish stance remains intact.

Consider some rebuttals to the bears' concerns:

(1) *Government vs private sector spending*. There's a certain fatalism in believing that the US economy is heading for a debt crisis but at the same time believing that anything done to avert it would plunge the economy into a recession caused by a fiscal cliff anyway.

Some chalk up America's real GDP growth in the post-pandemic period mostly to massive fiscal stimulus. We agree that the pandemic-time fiscal stimulus was excessive, as the sticky inflationary pressures still evident four years later attest. But more importantly, we believe that the private sector can offset the slowdown in government spending and is likely to do so by allocating capital to more productive projects and sectors.

For instance, the Biden administration focused too much on electric vehicles and green energy and not enough on semiconductors, defense, and the electric grid. The CHIPS and Science Act (around $53 billion in appropriated funds) paled in comparison to the Inflation Reduction Act (a $400 billion hit to the federal deficit), and the Infrastructure Investment and Jobs Act (around $550 billion in new spending). But the AI boom is already boosting massive private-sector spending on R&D, information processing equipment, and software, which now account for half of all nonresidential fixed investment (*Fig. 5* and *Fig. 6*). Between Apple's latest announcement and Stargate (Microsoft/OpenAI, Oracle, and SoftBank), there's $1 trillion of planned capital spending over the next four years.

(2) *Offering outlay relief.* We were encouraged by the latest budget bill passed by the House of Representatives, which includes $2 trillion of directed spending cuts over the next decade. All else equal, lower federal spending means slower economic growth. If federal spending does fall by $2 trillion by 2035, GDP growth will be lower unless consumption and investment rise and/or the trade deficit narrows. We are optimistic that all three of these will occur.

Can personal consumption expenditures and fixed investment increase by an extra $2 trillion over the next 10 years? Certainly. Consumption is 68% of GDP, or $19 trillion, and will likely breach $25 trillion within the next decade (*Fig. 7*). Investment is 18% of GDP, or $5 trillion, and will likely breach $7 trillion. Given our expectations that productivity growth reaches 3.0%-3.5% by 2030, an extra $2 trillion is achievable (*Fig. 8*). We expect both tax cuts and deregulation to accelerate consumption and capital spending, helping to quicken those productivity gains.

(3) *Taming trade*. The trade deficit can also do some lifting. Reducing net exports from the current -3.1% of GDP to -1.5% would improve GDP by $663 billion by 2035 (assuming annualized nominal GDP growth of 4%). So consumption and investment combined would have to pick up by only $1.3 trillion. These are not mutually exclusive events. Increased domestic investment is the likely result of Trump 2.0's nascent trade policies, which are also aimed at improving the trade deficit. This scenario includes consumers' spending more on domestically produced goods and services.

(4) *Reducing revenues? Or raising them?* The $2 trillion of spending cuts in the House bill were paired with $4.5 trillion in tax cuts. The reduction in receipts from the baseline would roughly reduce federal revenues by about 1.0%-1.5% of GDP through the next decade (*Fig. 9*). In our opinion, the stimulative impact of lower taxes and encouraged investment in the US will offset a portion of the cuts with higher growth.

(5) *Putting a dent in the deficit*. If outlays grow at a 5% average annualized rate—which is roughly average for the 2014-19 period—then the $2 trillion in spending cuts will push federal outlays down to about 20% of GDP. That would be historically normal and consistent with a budget deficit that's 3% of GDP (*Fig. 10* and *Fig. 11*).

We're doing very back-of-the-envelope math here, but the point is that lower federal spending is not a doom scenario for the US economy and Trump 2.0's economic goals are more realistic than they get credit for. In other words, the markets aren't pricing in these optimistic possibilities.

(6) *Consumers keeping it cool, not cooling*. The US consumer is fine. Since the root cause of rising unemployment last year was mostly immigration and increased labor force participation, we do not believe DOGE-related firings will spiral into mass layoffs (*Fig. 12*). Government employees make up just 12.5% of total payrolls, and state and local governments should be less affected by DOGE than the federal government (*Fig. 13*). As long as the unemployment rate remains in the 4.0%-4.5% range that we expect—which is likely now that immigration has slowed substantially—consumers will continue to spend apace.

Last Monday on *CNBC*, JP Morgan CEO Jamie Dimon, long bearish on consumer spending, said he now sees consumers as nearly "back to normal": "[T]hey don't have all the extra money, but they have jobs. Wages are going up. …So you are starting to see what I put at normal. Credit costs have normalized. So it's just almost back to what I call a normal environment."

Dimon was among the most worried about the consumer throughout 2022 and 2023. As he suggests, real wages are rising (*Fig. 14*). We expect rising productivity growth to keep that train on track (*Fig. 15*).

(7) *Uncertainty abounds*. Certainty is good for business. The outlook has gotten more uncertain over the past few months (*Fig. 16*). But we do not expect this uncertainty to persist. While the S&P Global NM-PMI contracted slightly this month, it tends to be more

volatile than the ISM NM-PMI (*Fig. 17*). Redbook retail sales are still up 5.9% y/y (*Fig. 18*). And based on regional Fed manufacturing surveys, we expect the ISM M-PMI to post a second straight month above 50.0, indicative of expansion (*Fig. 19*). Last month marked the index's first foray into expansion territory since the Fed started tightening in early 2022 and suggests the manufacturing sector has finally entered a rolling recovery.

(8) *Housing horror show*. The housing market has been a mess for several years, if not since the turn of the century. With overall construction employment around record highs, several observers have insinuated that the economy is entering a cyclical slowdown as housing permits and starts fall (*Fig. 20* and *Fig. 21*).

But as Austin, Texas shows us (see this recent Bloomberg *story*), deregulation is the answer to high home prices. We believe Trump 2.0 will tackle this on a national level, stimulating more housing starts and permits and thereby keeping employment elevated.

Meanwhile, the supply of construction employment has fallen with decreased immigration, so employers are likely to hold onto their workers. And though many in construction are working on nonresidential buildings, it's notable that roughly half of residential construction employment is remodelers (*Fig. 22*). That suggests that construction employment is relatively shielded from any potential housing slowdown, and that construction skills are transferable across different types of projects.

(9) *Winning with the wealth effect*. The excess-savings-depleting story that led to a lot of worry about the economic outlook over the past couple years was a nonstarter, in our opinion, mostly because retiring Baby Boomers were sitting on huge nest eggs that continued to appreciate. Between near-record stock prices and high home prices, the Baby Boomers now hold roughly $83 trillion of the $160 trillion in US household wealth (*Fig. 23*). So we haven't been worried about the relatively low personal savings rate; in fact, we think it may fall into negative territory by the end of the decade.

Could the wealth effect reverse? A bear market in stocks and much lower home prices likely would lead consumers and businesses to pull back some of their spending. But that would be likely only in a recession, which we see as improbable at the moment. If a recession were to become more likely, automatic stabilizers and the ease-first-ask-questions-later Fed would quickly restimulate markets and the economy. Both a recession and a fiscal crisis are in our 20%-probability what-could-go-wrong bucket of economic scenarios. We still apply an 80% subjective probability to outcomes that are bullish for US stocks.

Movie. "Zero Day" (-) stars Robert De Niro as former US President George Mullen, who is tasked with heading a commission to investigate a cyber-attack that kills thousands of Americans. It is a who-done-it Netflix series. De Niro seems to be bored by the plot. That's because it is boring and predictable, mostly because it is inane. The problem with conspiracy movies is that they are competing with all too many conspiracy theories swirling around on social media. So it is hard for screenwriters to come up with an original conspiracy. (See our movie reviews *archive*.)

Calendars

US: Mon: ISM M-PMI & Price Index 50.8 & 56.2; S&P Global M-PMI 51.6; Construction Spending 0.2%. **Tues:** None. (FXStreet estimates)

Global: Mon: Eurozone Headline & Core CPI 2.3% & 2.6% y/y; Eurozone, Germany & France M-PMIs 47.3, 46.1 & 45.5; UK M-PMI 46.4; Japan Jibun Bank M-PMI 49.9; Japan Unemployment Rate 2.4%; China Caixin M-PMI 50.3. **Tues:** Eurozone Unemployment Rate 6.3%; Japan Consumer Confidence 35.7. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): Last week saw the US MSCI index rise fall 1.1% w/w and outperform the 1.8% drop of the AC World ex-US index. The US MSCI finished the week 3.3% below its January 23 record high. The AC World ex-US dropped to 4.7% below its June 15, 2021 record high, but it had been just 0.7% below at the end of September. Europe was the best performing region last week, with a gain of 0.2%, followed by EMU (-0.3%), EAFE (-0.8), and the AC World ex-US. EM Asia was the worst regional performer, with a decline of 4.6%, followed by EM Latin America (-4.5), EM (-4.4), and EMEA (-2.5). The Spain MSCI index performed the best among country indexes last week, with a gain of 2.8%, followed by the UK (1.5), Hong Kong (1.0), and Germany (0.4). Korea was the week's worst country performer, falling 7.2%, followed by Brazil (-5.7), South Africa (-5.6), and India (-4.6). On a ytd basis, the US MSCI index is up 1.2%, but trails the 5.3% gain for the AC World ex-US. Among regional indexes, EMU is ahead of the pack ytd, leading with a gain of 11.3%, followed by Europe (10.6), EAFE (7.1), EM Latin America (6.9), and the AC World ex-US. The worst performing regions so far in 2025: EM Asia (1.2), EM (2.0), and EMEA (4.9). Looking at the major selected country markets that we follow, Spain is now the best ytd performer with a gain of 18.1%, followed by Sweden (15.8), Germany (13.4), China 12.5), and Switzerland (11.9). The worst performing countries ytd: India (-7.2), the US (2.3), Taiwan (-2.4), Canada (3.0), and Japan (3.3).

US Stock Indexes (*link*): Twelve of the 48 major US stock indexes that we follow rose for the week, up from just one rising in the prior week. The Dow Jones Industrials index was the best performer, with a gain of 1.0%, ahead of S&P 100 Equal Weighted (0.9%), Russell 1000 Value (0.8), S&P 500 LargeCap Pure Value (0.8), and Russell 3000 Value (0.8). The Nasdaq Composite index, with a decline of 3.5%, was the worst performer, followed by Nasdaq 100 (-3.4), Nasdaq Industrials (-2.8), Russell MidCap Growth (-2.6), Russell 1000 Growth (-2.6), and Russell 3000 Growth (-2.6). Twenty-four of the 48 indexes are still positive so far in 2025, down from 37 rising ytd a week earlier, 47 of 48 the week before that, and 46 rising in 2024. The S&P 100 Equal Weighted index is in the top spot as the best performer so far in 2025, with a gain of 5.2%, ahead of Russell 1000 Value (4.9), S&P 500 Transportation (4.8), Russell 3000 Value (4.6), and Dow Jones Industrials (3.0). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-6.5), Russell 2000 Growth (-3.9), S&P 600 SmallCap Equal Weighted (-3.7), S&P 600 SmallCap Value (-3.7), and S&P 600 SmallCap (-3.2).

S&P 500 Sectors Performance (*link*): Seven of the 11 S&P 500 sectors rose last week, and the same seven beat the S&P 500's 1.0% decline. That compares to five S&P 500 sectors rising a week earlier, when the same five were ahead of the S&P 500's 1.5% gain. The outperformers last week: Financials (2.8%), Real Estate (2.1), Health Care (1.7), Consumer Staples (1.3), Industrials (1.1), Materials (0.7), and Energy (0.1). The underperformers last week: Information Technology (-4.0), Communication Services (-2.5), Consumer Discretionary (-2.1), and Utilities (-1.5). The S&P 500 is up 1.2% ytd, with nine of the 11 sectors in positive territory and a whopping nine ahead of the index. Health Care now wears the crown as the best ytd performer, with a gain of 8.1%, ahead of Financials (7.8), Consumer Staples (7.6), Real Estate (5.9), Materials (5.4), Energy (5.3), Utilities (4.1), Industrials (3.3), and Communication Services (2.1). These two sectors are lagging the S&P 500 so far in 2025: Consumer Discretionary (-5.4) and Information Technology (-4.3).

US Economic Indicators

Personal Income & Consumption (*link*): Personal income in January was more than double consensus estimates, while consumer spending fell on both a nominal and real basis. *Personal income* accelerated 0.9% (vs 0.4% expected) in January, the strongest increase since last January, following monthly gains of 0.4% and 0.3% the prior two months. *Disposable income* followed the same script, also posting a 0.9% gain last month—its largest increase in a year—and up from 0.4% and 0.3% during December and November, respectively. *Personal consumption expenditures* fell 0.2% in January, led by a 1.2% drop in goods consumption—with durable goods spending tumbling 3.0% during the month and nondurable goods spending posting a 0.2% downtick. Services consumption rose 0.3%, slowing from December's 0.7%. Adjusted for inflation, *real PCE* dropped 0.5%, with goods consumption contracting 1.7% and services consumption ticking up 0.1%. Within goods consumption, durable goods spending contracted 3.4% and nondurable goods spending posted a 0.8% setback. *Personal saving* soared $247 billion in January to $1.01 trillion, with the *personal saving rate* jumping from 3.5% at the end of 2024 to 4.6% at the start of 2025. Turning to pricing, the *headline PCED* increased 0.3% in January, in line with expectations and matching December's gain, while the *core PCED* also was in line with expectations, climbing 0.3%, a tick above December's 0.2% increase. On a yearly basis, *headline PCED* rose 2.5% y/y, down from 2.6% in December, while the *core PCED* rose 2.6% y/y, slowing from December's 2.9%.

Durable Goods Orders & Shipments (*link*): Durable goods orders snapped a two-month losing streak, rebounding 3.1% in January, beating expectations of a 2.0% gain. January's advance was driven by a big jump in nondefense aircraft orders, which soared 94% as Boeing's net orders jumped from seven aircraft in December to a more normal 36 in January. Defense orders rose slightly, extending its string of gains to four months; excluding transportation, orders was flat. Meanwhile, *nondefense capital goods orders excluding aircraft* (a proxy for future business investment) climbed 0.8% in January and jumped 7.7% (saar) over the three months through January, with some of the strength reflecting an attempt to beat tariff-related price increases. Orders for motor vehicle & parts sank 2.5% in January, its fourth straight monthly decline. There were signs of life in some sectors, with *computers and electronic products* increasing 1.7%, boosted by a 7.1% surge in computer orders, while *communication* orders posted its third successive monthly gain, and *machinery* orders moved higher for the fourth successive month. Meanwhile, *primary metals* orders climbed to its highest level since summer 2023, while *fabricated metals* orders continued trending lower.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for both the EU and the Eurozone rose in February, with the EU measure climbing by

1.1 points to 97.1 and the Eurozone by 1.0 points in the Eurozone to 96.3. ESIs among the *six largest EU economies:* Poland (+3.4 to 100.9) posted the largest gain, followed by France (+2.3 points to 98.6), Germany (+1.2 to 89.3), and the Netherlands (+0.8 to 100.3), while Spain (-2.0 to 102.3) and Italy (-0.4 to 99.8) were drags on the ESIs. *By sector*, for the overall EU, industry (+1.4 to -10.0) and consumer (+0.4 to -12.9) confidence moved higher, while construction (-1.0 to -6.0) and retail (-0.2 to -3.5) confidence moved lower—with services (0.0 to 6.5) confidence holding steady.

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