Yardeni Research

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# Morning Briefing

## Stress Testing
## A Resilient Economy

*Check out the accompanying chart collection.*

**Executive Summary:** How damaging to the US economy are Trump's on-again, off-again tariff proclamations? The stock market is barely reacting to them anymore, but consumers remain worried about the inflation implications of tariffs, according to "soft" survey data. Even so, they're still breaking out their billfolds, feeling well supported by the strong labor market. Indeed, the "hard" economic data confirm that the US economy remains remarkably resilient despite Trump's Tariff Turmoil. Today, Dr. Ed walks us through the data as the US economy deals with Trump's stress tests. ... Also: Dr. Ed reviews "The Narrow Road to the Deep North" (+).

**US Economy I: The Art of the Steel.** President Donald Trump may or may not be a loose cannon, i.e., an unpredictable person who is likely to cause unintentional damage. That's been particularly evident in the unpredictable way he has been conducting his tariff negotiations and policies. Perhaps that is all attributable to his "three-dimensional chess" approach to making deals that he perfected as a real estate developer in New York City. He had to negotiate with contractors, labor unions, and politicians. There undoubtedly was plenty of blustering and bullying during those heated discussions until deals that allowed all sides to declare victory were eventually struck.

Trump seems to be using the same Big Apple approach to negotiating with global leaders to get better trade deals for the US. We are all hoping it works. At first, stock investors were put off by the extreme positions that Trump initially declared. That resulted in an 18.9% correction in the S&P 500 from February 19 through April 8 (*Fig. 1*).

But investors started growing jaded about Trump's blustering and bullying since April 9, after he postponed his shocking April 2 Liberation Day reciprocal tariffs for 90 days, and they turned even more so in early May when he lowered his high tariffs on China for 90 days. The S&P 500 soared 18.6% from April 8 through Friday's close. Investors have learned that Trump's extreme initial positions are postpone-able and negotiable.

So what did stock investors do after Trump announced Friday morning in a social media post that China "HAS TOTALLY VIOLATED ITS AGREEMENTS WITH US"? Nothing. With investors' hardened shells in place, the S&P 500 and Nasdaq barely budged. On Friday evening, Trump literally doubled down by doubling the 25% tariff on aluminum and steel to 50%. We expect Monday's stock market reaction to this latest "tariffying" development to be muted as well.

Tariff Man is now also the Man of Steel. That's great for domestic producers of steel. That is likely to be very costly for importers of steel products that aren't currently manufactured in the United States. We will be watching the price of steel in the US, along with the steel components of the Producer Price Index, for the inflationary consequences of Trump's 50% tariff on steel (*Fig. 2*).

**US Economy II: Anatomy of Recent Resilience.** Trump's Tariff Turmoil (TTT) continues to weigh on so-called "soft" economic data, such as surveys of consumer and business confidence. So far, however, it has barely affected the "hard" data, which continue to depict a remarkably resilient economy. That the economy would remain resilient in the face of challenges has been our prediction for the past three and a half years. So far, so good.

Consider the following signs of resilience in the latest GDP numbers:

(1) *Q1-2025*. Last Thursday, the Bureau of Economic Analysis revised its estimate of Q1's real GDP to show the economy shrank at an annual rate of 0.2% (saar), compared with the previously reported 0.3% drop. However, that contraction was attributable to a 42.6% spike in imports—driven largely by companies' racing to get ahead of Trump's tariffs (*Fig. 3*). So total imports subtracted 5.2ppts from Q1's real GDP, while exports added only 0.3ppt (*Fig. 4*). Excluding these tariff-related effects, the underlying strength of the economy remained intact.

Final sales to private domestic purchasers rose 2.5%, revised down from an initial 3.0%. Real consumer spending was revised down from 1.8% to 1.2%. However, much of that weakness was caused by unusually cold weather during January and February.

More significantly, spending on nonresidential fixed investment of equipment soared 24.8%, led by information processing equipment.

(2) *Q2-2025*. The Atlanta Fed's GDPNow model is showing real PCE tracking at 3.8% during Q2 (*Fig. 5*)! That's because imports dropped sharply during April (*Fig. 6*). Importers

scrambled to beat Trump's tariffs during the first four months of the year and lowered them back to more normal levels after Liberation Day.

Meanwhile, the GDPNow model is showing Q2's final sales tracking up 4.6%, with still lots of strength in business investment in intellectual property (which includes software) and equipment. Also strong is consumer spending, which is tracking at a 3.3% pace.

**US Economy III: Consumers Continue To Carry On.** Now, let's examine the sources of the consumers' resilience. It has been quite surprising in the face of depressed surveys of consumer confidence.

Debbie and I construct a Consumer Optimism Index by averaging the Consumer Sentiment Index (CSI) and the Consumer Confidence Index (CCI) (*Fig. 7*). It rebounded slightly during May but remained depressed at 74.4. It was weighed down by the CSI, which fell to 50.8 last month, while the CCI was relatively high at 98.0. The CCI tends to reflect consumers' assessments of the labor market, while the CSI tends to reflect their outlook for inflation.

In any event, as the Atlanta Fed's GDPNow tracking model shows, consumer spending is on pace to rise to yet another record high during Q2. That's because the labor market remains robust, more than offsetting concerns about expected inflation. The actual inflation rate remains very low. In fact, wages have continued to rise faster than consumer price inflation. So consumers' real purchasing power is also rising in record-high territory.

Let's have a closer look at the latest batch of consumer incomes, spending, and saving:

(1) *Personal income.* Hourly wages have been rising to record highs in both nominal and real terms. Here are the nominal wage rates for low-wage workers, all workers, and high-wage workers in April: $31.06, $36.06, and $58.05 (*Fig. 8*). Here they are adjusted for inflation using the PCED: $24.67, $28.65, and $46.12. Real average hourly earnings for low-wage workers (i.e., production and nonsupervisory workers in private industry, who account for about 80% of payroll employment) have been rising faster than their long-term uptrend for the past two years (*Fig. 9*).

Aggregate hours worked, reflecting payroll employment and the average weekly hours in private industry, rose to another record high during April (*Fig. 10)*. This, combined with record real hourly wages, is pushing real wages and salaries in personal income to record highs (*Fig. 11*).

Wages and salaries accounts for 49.9% of personal income currently (*Fig. 12*). Nonlabor personal income (i.e., interest, dividends, rent, and proprietors' income) accounts for 27.9% of personal income, while government social benefits is 18.2% of personal income. Nonlabor income rose to another record high in April in both nominal and real terms (*Fig. 13*).

The same can be said about government social benefits: They're also at a record high, excluding the pandemic period. The latter rose 2.8% m/m during April, led by a 6.9% jump in Social Security, accounting for much of the strength in personal income (up 0.8%) during April (*Fig. 14*). Nevertheless, wages and salaries increased solidly by 0.5%, while nonlabor income edged up by only 0.1%.

In any event, nominal disposable income (DPI) rose to a new record high in April, as did inflation adjusted DPI excluding the pandemic period, when it was boosted by government supports (*Fig. 15*).

(2) *Personal consumption expenditures.* Real personal consumption expenditures (PCE) is driven by real DPI. So it's no surprise that real PCE remains on a solid uptrend in record-high territory, led by spending on services (*Fig. 16*). That's especially evident when PCE is shown on a per-household basis (*Fig. 17* and *Fig. 18*).

(3) *Personal saving, wealth, and debt.* There are a few signs of stress among consumers, especially evident in rising delinquency rates on credit card, auto, and student loans (*Fig. 19*). Tariff-related price increases may still be ahead. They could reduce the purchasing power of consumers. Low gasoline prices should continue to provide some relief on this front.

In any event, we still believe that one of the major drivers of consumer spending is retiring Baby Boomers. This age cohort has roughly $80 trillion in net worth, accounting for about half of the household sector's net worth (*Fig. 20*). As they retire and no longer earn labor incomes, their personal saving rates will turn negative as they spend more on health care, restaurants, cruises, hotels, light trucks, furniture, and renovating their homes. Their spending is already boosting employment to record highs in many of these industries.

**US Economy IV: Construction Remains Resilient.** In the past, the tightening of monetary policy usually depressed construction activity, including employment in the industry (*Fig. 21*). The weakness was usually led by residential construction. This time is different: Despite still-tight monetary policy, total construction spending is at a record high through

March, and so is construction employment through April.

Single-family residential construction has remained remarkably resilient as mortgage rates have risen over the past three years, while multi-family residential construction has weakened over the past couple of years (*Fig. 22*). Meanwhile, construction spending on home improvements recently rose to a new record high as housing turnover has slowed, causing more homeowners to renovate their homes. So on balance, total residential construction and employment have held up well.

Furthermore, nonresidential construction has soared, led by onshoring of new manufacturing facilities, which was boosted by various incentives provided by the Biden administration. Public construction has also soared, as the Biden administration allocated more funds for rebuilding and replacing public infrastructure.

Construction spending should continue to flourish during the Trump administration since most of the projects started over the past couple of years will continue until they are completed. Furthermore, the new administration has been getting more commitments from various companies and countries to invest in the US.

For example, look at a recent Bloomberg Originals video titled "*Inside OpenAI's Stargate Megafactory with Sam Altman*." You'll see a huge construction project funded by Stargate in Abilene, Texas. It is a joint venture among OpenAI, SoftBank, and Oracle to build one of the largest AI data centers in the world.

**US Economy V: High-Tech Capital Spending Rolling Along.** Capital spending may also continue to discredit the economic "hard-landers," who believe that relatively tight monetary policy and chaotic tariff policy will force companies to retrench.

The US economy has been experiencing a Digital Revolution since the 1950s, when IBM mainframe computers proliferated in business, government, and academia. The Digital Revolution is all about data processing, i.e., processing more and more data faster and faster at lower and lower cost.

From this perspective, AI is an evolutionary development in the Digital Revolution. AI allows more data to be processed faster than ever before and at a lower cost, as DeepSeek has demonstrated. So much data can be processed that we need large language models (a.k.a. LLMs) to make some sense of it all and use it to increase productivity.

High-tech now accounts for 50% of nominal business capital spending, up from close to 20% in the mid-1960s. We believe that businesses will continue to increase their spending on high-tech hardware and software to boost their productivity so that they remain competitive.

**Movie.** "The Narrow Road to the Deep North" (+) is a 2025 Australian drama miniseries. It follows the life of a fellow named "Dorrigo Evans" during three periods. Just before he is deployed to fight in World War II in Southeast Asia, he gets engaged and has an affair with his uncle's wife. Then he spends much of the war as a medic in a horrible Japanese prisoner-of-war labor camp building a railroad through Burma. The series also examines his reflections on his life many years later. It is sometimes too realistic during his internment. However, it is an interesting reflection on life based on one man's experiences. (See our movie reviews *archive*.)

## Calendars

**US: Mon:** ISM M-PMI & Prices-Paid Index 48.7/70.2; Construction Spending 0.3%; Goolsbee. **Tues:** JOLTS Job Openings; Factory Orders -3.1%; Total Vehicle Sales 16.3mu; Goolsbee; Logan. (FXStreet estimates)

**Global: Mon:** Eurozone, Germany, and France M-PMIs 48.4/48.8/49.5; UK M-PMI 45.1; Lagarde. **Tues:** Eurozone Headline & Core CPI 2.1%/2.5%y/y; Eurozone Unemployment Rate 6.2%; Italy Unemployment Rate 6.1%; China Caixin M-PMI 50.6. (FXStreet estimates)

## Strategy Indicators

**Global Stock Markets (US$ Performance)** (*link*): The US MSCI index rose 1.9% last week and improved to 3.9% below its January 23 record high. That compares to a 0.3% gain for the AC World ex-US index, which has been hitting new record highs since May 14 for the first time since June 15, 2021. The US MSCI has outperformed the AC World ex-US in just five of the past 19 weeks. EMU was the best performing region last week, with a gain of 0.9%, ahead of EAFE (0.8%), Europe (0.7), and the AC World ex-US. EM Latin America was the worst regional performer, with a decline of 1.6%, followed by EM Asia (-1.2), EM (-1.2), and EMEA (-0.6). The Korea MSCI index performed the best among country indexes last week, with a gain of 3.6%, ahead of the US (1.9), Germany (1.4), Japan (1.3), and

Canada (1.1). The China MSCI index was the worst performer w/w, with a drop of 2.8%, followed by Brazil (-1.5), Taiwan (-1.4), Mexico (-1.3), and India (-0.7). In terms of ytd performance rankings, the US MSCI index is among the worst country performers and trails the 12.4% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EMU now leads with a gain of 22.4%, followed by EM Latin America (19.5), Europe (18.4), EAFE (15.0), and the AC World ex-US. EM Asia is the worst ytd performer, albeit with a gain of 6.4%, followed by EM (7.6) and EMEA (8.9). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 37.6%, followed by Germany (28.8%), Mexico (25.4), South Africa (22.0), and Sweden (18.8). The worst performing countries ytd: Taiwan (0.4), the US (0.6), India (2.6), Australia (6.6), and Japan (8.8).

**US Stock Indexes** (*link*): All of the 48 major US stock indexes that we follow rose during the week ending May 30, up from all 48 indexes falling in the prior week. These four indexes were the best performers, with gains of 2.3%: Russell 1000 Growth, S&P 500 LargeCap Growth, Russell 3000 Growth, and S&P 100. The S&P 500 Transportation index, with a gain of 0.1%, was the worst performer, followed by Dow Jones 15 Utilities (0.5), S&P 400 MidCap Value (0.8), S&P 400 MidCap (0.8), and S&P 400 MidCap Growth (0.8). Sixteen of the 48 indexes are now higher so far in 2025, down from 47 rising ytd in mid-February. With a gain of 5.9%, the Dow Jones 15 Utilities index is in the top spot as the best performer so far in 2025, ahead of Russell MidCap Growth (4.3), S&P 500 LargeCap Pure Growth (3.9), S&P 100 Equal Weighted (3.4), and S&P 500 LargeCap Growth (2.1). The worst performing major US stock indexes ytd: S&P 600 SmallCap Value (-11.9), S&P 600 SmallCap Pure Value (-11.8), S&P 600 SmallCap Equal Weighted (-10.1), S&P 600 SmallCap (-8.8), and Russell 2000 Value (-8.2).

**S&P 500 Sectors Performance** (*link*): Ten of the 11 S&P 500 sectors rose during the week ending May 23, but only three were ahead of the S&P 500's 1.9% gain. That compares to all 11 S&P 500 sectors falling a week earlier, when six sectors were ahead of the S&P 500's 2.6% decline. The outperformers last week: Real Estate (2.7%), Information Technology (2.4), and Communication Services (2.1). The underperformers last week: Energy (-0.4), Materials (0.8), Utilities (1.1), Industrials (1.5), Consumer Discretionary (1.7), Financials (1.8), Consumer Staples (1.8), and Health Care (1.8). The S&P 500 is now up 0.5% ytd, with seven of the 11 sectors positive ytd and ahead of the index. Industrials still wears the crown as the best ytd performer, with a gain of 8.2%, ahead of Utilities (7.7%), Consumer Staples (7.5), Financials (5.2), Communication Services (3.2), Materials (2.8), and Real Estate (2.2). These four sectors are lagging the S&P 500 so far in 2025: Consumer Discretionary (-6.2), Energy (-5.4), Health Care (-3.8), and Information Technology (-1.8).

## US Economic Indicators

**Personal Income & Consumption** (*link*):  Personal income in April was stronger than expected, and there was an upward revision to the March data. *Personal income* rose 0.8%, more than double the consensus estimate of a 0.3% gain, while March's gain was revised upward to 0.7% (from 0.5%). The increase in April's personal income was led a 2.8% jump in *personal current transfer receipts*, accelerating from March's 1.1% gain, while *employee compensation* rose 0.5%, matching March's pace. *Disposable personal income* also rose 0.8% in April, consistent with increases of 0.7% and 0.8% the prior two months. Meanwhile, *personal consumption expenditures* rose only 0.2% in March, slowing from March's 0.7% gain, as *services consumption* increased 0.4%, slowing from March's 0.6% increase, and *goods consumption* fell 0.1% after posting a 1.0% jump in March. Within goods consumption, *durable goods* spending contracted 0.3%, while *nondurable goods* spending was flat.  *Adjusted for inflation*, *real PCE* ticked up only 0.1%, slowing from March's 0.7% gain, as *real goods consumption* slipped 0.2% following March's 1.5% jump and *durable goods* spending fell 0.8%; *nondurable goods* consumption was little changed, edging up 0.1%. *Real services* consumption rose 0.3%, a tick below March's 0.4% gain and accelerating from February's 0.1% downtick. *Personal saving* rose $140.8 billion to $1,116.9 billion during April, with the *personal saving rate* jumping to 4.9% in April from 4.3% in March; it was at 3.5% at the end of last year.

**Personal Consumption Deflator** (*link*): Both the *headline and core PCEDs* ticked up 0.1% in April, with their yearly rates easing. *Headline PCED* slowed for the second month to 2.1% y/y from 2.6% during February, while the *core rate* eased to 2.5% from 2.9% over the same period. The headline and core rates peaked at 7.2% and 5.6%, respectively, during June 2022 and September 2022. *Goods* prices remained in negative territory in April after slipping below zero in March for the first time since last November, falling to -0.4% y/y in April from -0.3% in March. *Durable goods* prices fell 0.3% y/y, while *nondurable goods* dropped 0.4% over the comparable period. There's a mixture of inflation and deflation in *durable goods* prices. There's still deflation in prices for recreational goods & vehicles (-1.7%) and furnishings & durable household equipment (-0.9), while inflation rates for both motor vehicles & parts and motor vehicles & accessories were just above zero in April at 0.6% and 0.8%, respectively, and the rate for net purchases of used motor vehicles (1.1) moved back above zero. Meanwhile, the rate for other durable goods (1.5) remained above zero, but the rate eased slightly. *Within nondurable goods*, magazines, newspapers, & stationary (3.4) and pharmaceuticals & other medical products (1.6) have higher inflation rates, though they have eased recently, while several remain around zero: recreational items (0.0%), household supplies (-0.1), and personal care (0.4); the rate for clothing & footwear (-1.0) fell further into negative territory. *Within services*, *housing* costs remain stubbornly high but are down from recent peaks: owners' equivalent rent (to 4.3% from 8.2%), tenant rent (4.0 from 8.8), and housing & utilities (4.2 from 8.3). Looking at *nonhousing* services, personal care (2.1%), recreation (3.4), education (2.6), transportation (3.1), and medical care (2.4) remained above zero, while communication (-2.5) fell further below zero.

**Consumer Sentiment Index** (*link*): Consumer sentiment was unchanged in May after four straight months of sharp declines; it turned the corner in the latter half of May following the temporary pause on some tariffs on China goods. *Consumer sentiment* was unchanged at 52.2 in May after tumbling from 74.0 in December to 52.2 in April. The *current conditions* component fell for the fourth month, from 75.1 in January to 58.9 by May, while *expectations* edged up to 47.9 in May after slumping from 76.9 in November to 47.3 in April. *Turning to inflation*, year-ahead inflation barely budged, edging up to 6.6% in May from 6.5% in April, posting the smallest increase since the election. Meanwhile, long-run inflation expectations fell from 4.4% in April to 4.2% in May—the first decline since December 2024, ending an "unprecedented four-month sequence of increases," according to the report.

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