Sunpointe Investments

ILLUMINATIONS

Economic Review

May 2025

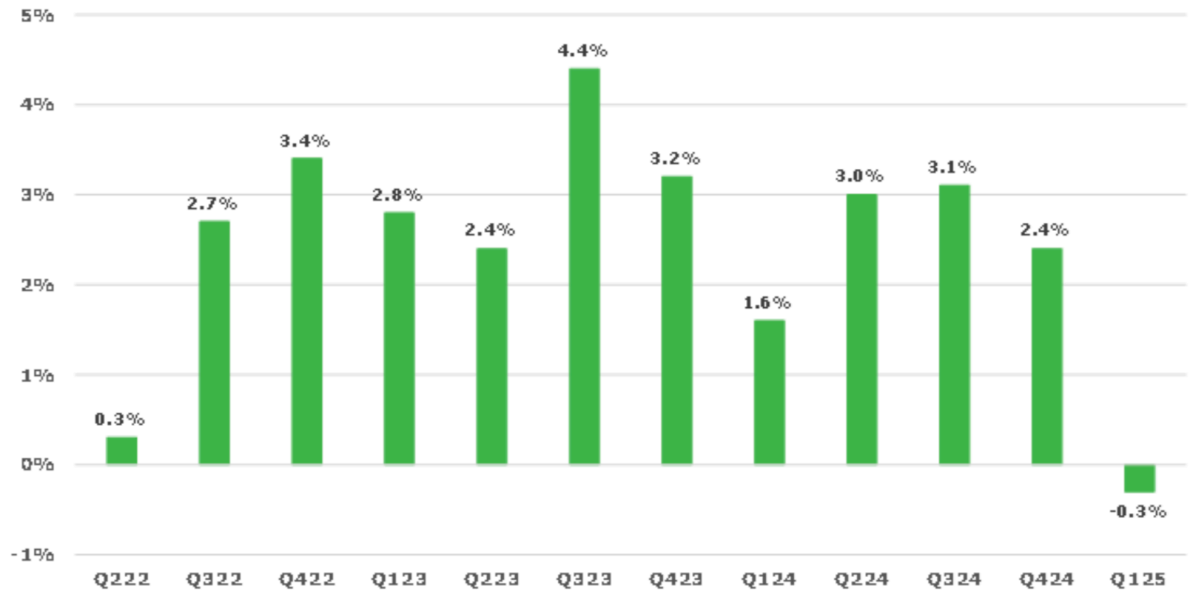
April Employment Report Beats Expectations

U.S. employers added a better than expected 177,000 new jobs to the economy in April, well ahead of the 133,000 estimate. The February and March reports were revised lower by a total of 58,000 jobs. The unemployment rate held steady at 4.2% and the broader U6 unemployment rate edged down to 7.8%. Average hourly earnings rose 0.2% month-over-month (M/M) or 3.8% year-over-year (Y/Y) in April, both coming in below expectations. Health care continued to be a leader in job creation, adding 51,000 jobs. The federal government reported a loss of 9,000 jobs amid efforts by DOGE to cut waste and fraud.

GDP Contracts Due to Trade Imbalances

U.S. GDP fell at a 0.3% annualized pace in Q1, largely pushed by a surge in imports ahead of President Donald Trump's tariffs. Imports soared 41.3%, driven by a 50.9% increase in goods. Imports subtract from GDP, so the contraction in growth may not be viewed as negatively given the potential for the trend to reverse. This was the first quarter of negative growth since Q1 of 2022. A slowdown in consumer spending (+1.8%) and a sharp decline in federal outlays (-5.1%) also contributed to the weak GDP reading.

U.S. GDP GROWTH (ANNUALIZED)



Source: U.S. Bureau of Economic Analysis

Inflation & Manufacturing Soften While "Hard" Consumer/Business Spending Data are Solid

Prices fell more than anticipated in April with headline CPI falling to an annualized rate of 2.3%, down from 2.4% in March. Core CPI, which excludes volatile food and energy, held steady at 2.8% in April. Energy prices rebounded 0.7% in April while food prices fell 0.1%. Egg prices dropped 12.7% but are still up 49.3% Y/Y. Shelter prices gained 0.4% last month although used car prices fell 0.5%. There was little sign of the tariff impact on April CPI, but experts believe the impact will be felt in the May and June reports. Rate cut expectations by the Fed have been varied in recent weeks, but as of May 14, 2025, markets are pricing in 2-3 rate cuts in 2025 with the first cut most likely to occur in September. However, the Fed has indicated a willingness to review data as it arrives and has noted that the potential changes from tariffs may not show in hard data for multiple months.

Manufacturing activity in the U.S. remained in contraction territory last month based on the ISM Manufacturing PMI. The headline reading of 48.7 for April was down from 49.0 in March; numbers below 50 indicate contraction. The ISM Services PMI strengthened in April on the back of new orders and employment.

U.S. retail sales growth slowed sharply in April as the boost from front-loaded purchases faded. Retail sales rose 0.1% after surging 1.7% in March. Core retail sales declined 0.2% after rising 0.5% in March. Sales fell at auto dealerships and sporting goods stores but rose at online retail and bars and restaurants. Retail sales grew 5.2% Y/Y in April, but further softening is expected. Durable goods orders surged 9.2% in March, the third straight monthly gain. The sharp uptick was largely driven by a rush of orders for commercial aircraft. Transportation equipment jumped 27%, mainly nondefense aircraft and parts (139%) and motor vehicles and parts (2.3%). Orders for non-defense capital goods excluding aircraft, a closely watched proxy for business spending plans, edged up 0.1%.

Business Activity Stagnates in the Eurozone

The eurozone flash composite PMI fell to 50.1 in April, slightly below consensus expectations. Services activity fell to 49.7 while the manufacturing index edged up to 48.7 despite trade headwinds. Business activity in Germany decreased for the first time in four months and France remained in contraction territory. The rest of the Eurozone continued to record solid output growth. This report points to stagnant economic conditions although higher defense spending should provide benefits over time. Inflation in the eurozone held steady at an annualized rate of 2.2% in April. Core CPI surprisingly jumped from March's three-year low of 2.4% to 2.7% in April. The March unemployment rate of 6.2% has been flat for the past six months.

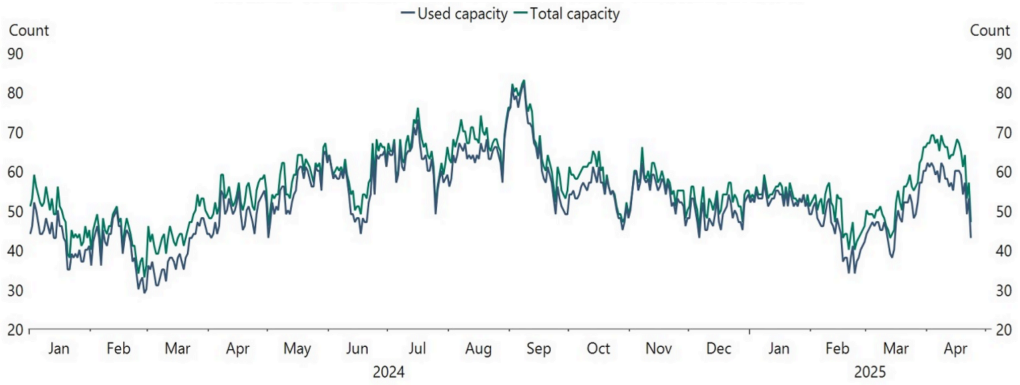
BOJ Downgrades Growth Outlook on Trade Uncertainty

Trade uncertainty is having an impact on the Japanese economy. The Bank of Japan (BOJ) slashed its GDP growth forecast for the year from 1.1% to 0.5%. Trade uncertainties also provided justification for the BOJ to hold interest rates steady at 0.5%. Japan is currently negotiating a new trade deal with the U.S. after exporting $150B of goods last year.

Is China's Export-driven Economy at Risk of Collapse?

China's economy is starting to show signs of stress due to the ongoing uncertainty over tariffs and trade policy. The official manufacturing PMI fell back into contraction territory in April with a reading of 49.0 (down from 50.5 in March). A measure of new export orders plunged to 44.7 in April, the lowest reading since December 2022. This is perhaps an early sign that trade between the U.S. and China is in danger of drying up as U.S. importers cancel or delay orders after a rush to bring in goods earlier this year before tariffs came into effect. According to a Goldman Sachs report, one-third of China's 2024 growth came from exports and an estimated 10-20 million manufacturing workers are dependent on U.S. trade/exports. The official China non-manufacturing PMI fell to 50.4 in April from 50.8 in the previous month.

CONTAINER SHIP COUNT - DEPARTURES FROM CHINA TO THE UNITED STATES



Sources: Bloomberg, Macrobond, Apollo Chief Economist

IMF Lowers Global Growth Forecast

The IMF lowered its 2025 forecast for global growth from 3.3% to 2.8%. They also lowered their GDP growth forecast for 2026 to 3.0%. The IMF now projects that U.S. economic growth will come in at just 1.8% this year, down sharply from its previous forecast of 2.7%. China is also forecast to grow more slowly because of U.S. tariffs. The IMF now expects that the Chinese economy will expand 4.0% this year, down from the previous estimate of 4.5%. The eurozone is expected to grow 0.8% in 2025 while Japan's rate of growth was slashed to just 0.6%.

Let the Trade Deals Begin!

On May 8, the U.S. announced its first trade deal with the U.K. Although the final details are still being finalized, the main points include a lowering of U.K. tariffs on the U.S. from 5.1% to 1.8% and an increase of U.S. tariffs on U.K. goods from 3.4% to 10%. This trade deal should provide access to more than $5B in new exports to the U.K. on goods such as ethanol, beef, and vegetables. New revenue from the increased U.S. tariffs should be around $6B. In addition, the U.K. will reduce or eliminate numerous non-tariff barriers to help make U.S. products more competitive. Some exemptions were given to high end cars and aircraft engines produced by Rolls Royce.

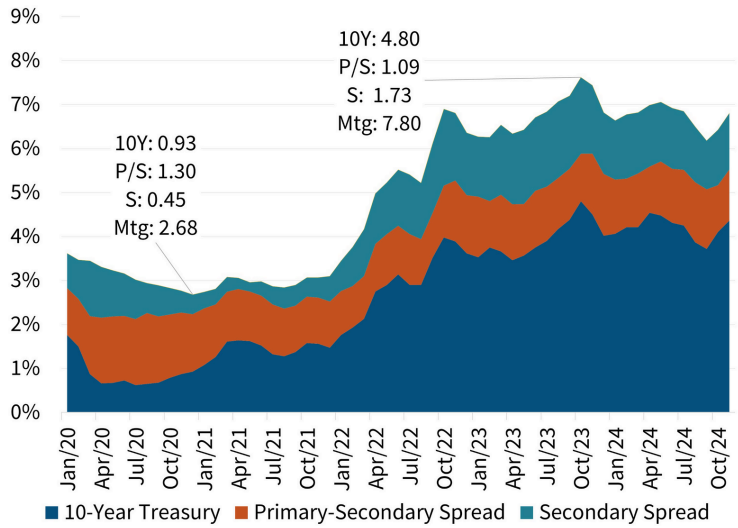
What Can the Fed Do to Bring Down Mortgage Rates?

There are three primary factors that drive mortgage rates in the U.S. The 30-year mortgage rate is benchmarked to the rate of the 10-year Treasury note. As the rate on the 10-year Treasury moves, mortgage rates follow suit. The primary-secondary mortgage spread is the difference between the mortgage rate that is offered to borrowers and the rate on a mortgage-backed security (MBS). This spread reflects industry costs of originating a mortgage and lender margins. The secondary mortgage spread is the difference between the rate on an MBS and the rate on the 10-year Treasury note. This spread reflects the additional risk present in an MBS relative to the 10-year Treasury note.

Since the Fed began raising rates in 2022, the primary-secondary mortgage spread has increased due to the cost of origination, and the secondary mortgage spread has surged with Fed quantitative tightening. Fed rate cuts may help the situation, but an end to QT and any QE for MBS should help reduce the secondary mortgage spread that remains elevated.

MORTGAGE RATE TIMELINE

JANUARY 2020 - NOVEMBER 2024



Sources: Freddie Mac, Federal Reserve Board, Fannie Mae