

## Fiscal and Monetary Policy at Odds

### **Recent Economic Data (since last update):**

#### **May 13, 2025**

- Core CPI (m/m): 0.2% (U.S. Bureau of Labor Statistics)
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- CPI (y/y): 2.3% (U.S. Bureau of Labor Statistics)

#### **May 15, 2025**

- Initial Unemployment Claims (week ended May 10): 229,000 (U.S. Department of Labor)
- Core PPI (m/m): -0.4% (U.S. Bureau of Labor Statistics)
- PPI (m/m): -0.5% (U.S. Bureau of Labor Statistics)
- Core Retail Sales (m/m): 0.1% (U.S. Census Bureau)
- Retail Sales (m/m): 0.1% (U.S. Census Bureau)

#### **May 22, 2025**

- Initial Unemployment Claims (week ended May 17): 227,000 (U.S. Department of Labor)
- Flash Manufacturing PMI: 52.3 (Institute for Supply Management)
- Flash Services PMI: 52.3 (Institute for Supply Management)

### Difference between March 18 v May 7 FOMC

The Fed's dual mandate of maximum employment and stable prices remains in place, but its strategy shifts with changing conditions (Fed 2025a; Fed 2025b). Recent fiscal actions, particularly new tariffs, have raised concerns over inflation and growth.

Comparing Powell's March and May FOMC statements shows a shift in tone. The economy went from "strong overall" and making "significant progress" toward the Fed's goals to being in a "solid position" with "heightened uncertainty" (Powell 2025a; Powell 2025b).



Despite tariffs, the Fed maintains that "most measures of longer-term expectations remain consistent with our 2 percent inflation goal" (Powell 2025b). However, Powell warns that sustained tariff hikes could lead to higher inflation, slower growth, and increased unemployment (Powell 2025b). These effects could be short-term or persistent, depending on the tariffs' size, duration, and the anchoring of inflation expectations.

Powell also acknowledges the potential for the Fed's goals to conflict. "We may find ourselves in the challenging scenario in which our dual-mandate goals are in

tension," he said (Powell 2025b). For now, the Fed remains cautious, "well positioned to wait for greater clarity" before changing our policy stance (Powell 2025b).

#### President Trump in Focus

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On May 8, the U.S. and U.K. agreed to cut auto tariffs to 10% for up to 100,000 cars, with excess shipments subject to 27.5% (BBC 2025). Beef tariffs were removed and quotas raised from 1,000 to 13,000 metric tons; quotas were reciprocated (BBC 2025). Steel and aluminum tariffs were eliminated and replaced with quotas under most-favored-nation terms (BBC 2025).

On May 12, the U.S. and China paused tariffs for 90 days: U.S. rates fell from 145% to 30%, China's from 125% to 10%, effective May 14. China also suspended non-tariff retaliation, including rare-earth export restrictions and blacklists (CNN 2025).

That day, President Trump also signed an executive order enforcing most-favored-nation pricing for prescription drugs, granting U.S. patients access to the lowest prices in peer nations (White House 2025).

In the same week, the president toured the Middle East, securing over \$600 billion in investments across aerospace, defense, AI, infrastructure, and energy (Dorn 2025).



The President has also touted a new budget as "one big beautiful bill" which passed last week in the House of Representatives by a narrow one vote margin. Most notably it is counter to the initial sentiment of the administration to cut costs and lower the deficit. Instead this new budget is expected to increase spending and cut more taxes on top of the continued 2017 tax plan. The bill is expected to raise the debt ceiling by 4 trillion dollars (CBS 2025).

This comes off the heels of Moody's downgrade to the US economy from AAA to Aa1, the last of the big three credit agencies to downgrade the US credit rating, citing concerns of rising national debt and increased interest payments (Moody's 2025).

To add to the uncertainty surrounding US fiscal policy, Trump has recently threatened 50% tariffs on the EU due to slow and reluctant trade talks. Only a day or so later, a call with the EU's trade commission president Ursula Von der Leyen and President Trump led to another delay on the tariff for more than a month as they both agreed to fast track negotiations (BBC 2025).

#### Bond Loyalty or Royalty?

Following the credit downgrade and growing deficit, 10-year and 30-year Treasury yields topped 5%, unseen since 2008 (U.S. Treasury 2025). Although rates have exceeded 5% historically, today's higher debt load and rate-sensitive economy amplify their impact. Elevated yields raise borrowing costs and curb the Fed's maneuverability. The yield curve's uninversion, moving from negative spread to positive, often precedes a slowdown, further fueling market uncertainty and debate over U.S. debt as a safe asset (Fitch 2025).



### The Carry Trade Unwind

The yen carry trade, borrowing in low-rate yen to buy higher-yield U.S. Treasuries, has driven capital flows for years. The BOJ raised its short-term rate to 0.5%, the highest in 17 years, reducing yen borrowings (BOJ 2025). About \$200 billion of the \$1 trillion+ exposure has unwound so far, mostly in a controlled manner (Reuters 2025). Safely unwinding depends on gradual BOJ hikes, steady yen gains, and stable risk appetite; rapid yen strength or shocks could force deleveraging (Reuters 2025). Recent dollar weakness—its lowest close since July 2023—and a 0.5% yen rally on hawkish BOJ signals highlight the tightrope between orderly and disorderly flows (Bloomberg 2025).



### The Road Ahead

It is well known that the majority of both houses of congress will allow Trump's tax bill and budget to pass (CBS). The concern lies in investor's reactions and it does not paint a favorable light. However, equities seem to have maintained a resilience in the face of a somewhat digested uncertain trade policy as well as a credit downgrade that some would argue as not surprising and overdue (Bloomberg; Moody's). It's important to note that once trade deals are finalized that there is little chance of any tariff increase or uncertainty of trade policy. The tariffs appear to only have one direction from its hike- which is downward. It is likely that these deals will bring certainty to markets and any major effects are likely to be localized by sector. The real worry is and has remained to be so, is the gradual debt and steepening

real worry is and has remained to be so, is the gradual doubt and steepening negative sentiment concerning the ability of the United States to pay back its debt at higher rates. This turns the investor's eye to the fed and explains the President's criticism and push for Fed Chair Jerome Powell to cut rates. The impact of recent tariffs has yet to be seen in the economic data and the Fed has maintained a pause on changing interest rates. According to the CME Fed Watch Tool, the probabilities of a rate cut increase in Q4 for the September, October, and December meetings (CME Group 2025). As highlighted earlier by the sentiment in the May FOMC meeting, the new concerns are inflationary, however only in the short term (Fed 2025b). It does not appear a rate hike will be necessary at all nor the benchmark goal of 2% inflation to shift upward. Though all factors considered, a gradual equity rise with mixed volatility seems probable as investors navigate persistent uncertainty.

Concerning economic data, investors look to preliminary GDP data q/q to release on Thursday, May 29 which will be a key factor in assessing the impact of tariffs and uncertain US trade policy on the economy. the forecast in line with advance expectations of -.3%. Unemployment claims also release on the same day. Monthly Core PCE data releases on Friday the 30th which weighs more as a key measure of inflation and the Fed's decision for interest rates (Forex).

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