Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

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Tariffs Deliver a Gut Punch, But Not a Knockout

The dog days of summer are almost upon us, and the controversies over the economy, monetary policy, tariffs and inflation are heating up. Ask a two-handed economist whether things are looking good, and the answer is likely to be — yes and no. One hand says yes because fundamentally the landscape seems fine. Unemployment is low, incomes are rising, the financial markets are generating good returns and fears of recession, so prevalent earlier in the year, have receded. But the naysayers on other hand say no, because under the hood bad omens are popping up. It's taking longer to find a job, the inflation retreat has stalled, immigration constraints are reducing the supply of labor, and the public mood is still in the dumps.

Both arguments are credible, but a bit infuriating to policy makers who need to make important decisions amid such an ambiguous backdrop. Not surprisingly, officials at the Federal Reserve are sticking with a wait-and-see strategy, holding off on the much-heralded rate cuts until they get a clearer picture of growth and inflation trends. Odds are, cuts will be coming, but patience is clearly the right path to take given the heightened uncertainty that is unlikely to be resolved anytime soon. The main source of uncertainty, of course, is the still evolving trade policy that is keeping everyone – consumers and businesses – on tenterhooks; no one knows how high tariffs will go, whether they will be renegotiated later on, prompt reciprocal action by trading partners or, most important, how the unfolding trade wars will impact costs, prices and demand.

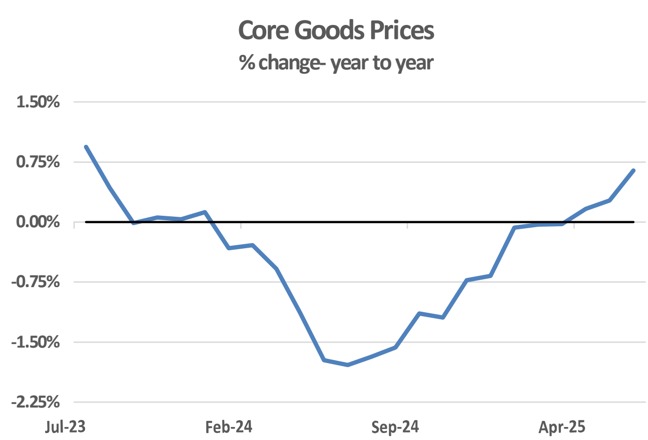
The prevailing view at the Fed is that tariffs will cause a one-time boost to the price level but not drive up the inflation rate. That prospect leaves the door open for rate cuts once the price shock is absorbed and the disinflationary trend resumes. At that point, the Fed can focus on whether – and to what extent – tariffs weakened demand and, most important, the job market; it then can decide how many rate cuts would be needed to keep the economy afloat. There are a lot of ifs before that decision needs to be made; but by the fall, we should have a better grip on what tariffs looks like and how the economy is responding.

Price Impact Starting to Appear

That two-handed economist would have a field day with the latest consumer price report. Look at the headline, and there is nothing to fret over. Overall consumer prices rose 0.3 percent in June, about as expected and a tad faster than the average 0.2 percent increase over the previous five months of the year. Compared to a year ago, the CPI is up 2.7 percent, a bump up from the 2.4 percent increase in May but slower than the 3.0 percent annual inflation rate at the start of the year. A similar theme is seen with the core CPI, which economists view as a better measure of underlying inflation trends because it excludes volatile food and energy prices. This gauge rose by 0.2 percent, also a smidgeon higher than the previous month, but spot-on with the average increases over the previous five months.

On the surface, therefore, it appears that all the hoopla over tariff-induced inflation is more bark than bite. But that would be a simplistic, and misleading, conclusion. For one, timing is everything. Normally, it takes several months before tariffs reach consumers, as there are numerous stops along the supply chain before imported goods reach customers. But the lag this time has been stretched out because companies and consumers front loaded their purchases before the tariffs were imposed. Companies tend to hold three or four months of inventory, so the sales of the replenished goods carrying the tariffs are just now being sold.

So why aren't the tariffs on those goods being passed through to consumers? In part they are. But it's important to remember that most consumer purchases are for services and their price increases have been well contained, anchoring the increase in the consumer price index. But a peek under the hood shows that the tariffs are starting to push up the price of goods which had led the inflation retreat over the second half of last year. For the first time in 15 months, goods prices stopped deflating in April and have since been increasing compared to year-earlier levels. The biggest increases, unsurprisingly, have been for those products that are most exposed to tariffs, such as furniture, appliances and clothing, which are heavily manufactured in China and elsewhere overseas.



More to Come

Given that the latest price data are for June, only two months since the first round of broad-based tariff hikes were imposed in April, it is not surprising that the passthrough effects are barely visible. As we write this, a huge drop of tariffs that were postponed from July 9 is scheduled on August 1. It's unclear how this will play out, but the renegotiated duties will come on top of the 10 percent base that is already on the books. Whatever the outcome, the effective tariff rate will be the highest in nearly a century.

There is no question that these levies will lead to higher prices. The only question is how much of a price bump is on the way, and how will it impact the inflation trend. One positive development if all the announced tariffs are put in place is that it would resolve a lot of uncertainty linked to the on-again, off-again pattern of tariff announcements. Many businesses say they were reluctant to raise prices because of the possibility tariffs would be reduced or repealed in the future. Rather than antagonize customers – and lose sales – they would rather eat the cost of tariffs temporarily and sacrifice some profits to keep consumers happy.

That, of course, is time limited, particularly for smaller companies that rely heavily on imports and operate on thin profit margins. Even the 10 percent tariff base on goods imported from all countries (except Canada and Mexico) that has been in effect since April 2 is prodding these companies to raise prices, according to the latest small business survey by the National Federation of Independent Businesses, the trade group for mom-and-pop establishments. The planned increases are relatively mild, as most of these firms can live with a 10 percent tariff rate, absorbing part of it and covering the rest with modest price increases. However, a bigger tariff load scheduled to drop in August would be another story, posing critical decisions for owners and management – offset the cost of tariffs by laying off workers or raising prices more steeply and risk losing customers.

Plunge in Immigration

On a broader scale, that Hobson's choice is what gives the Fed nightmares. If tariffs lead to cost-cutting layoffs, the case for lower interest rates becomes more urgent. If the tariffs lead to higher prices and more inflation, just the opposite would be true. Time will tell which dominates, supporting the wait-and see approach the Fed is embracing. But if uncertainty over the tariff threat to inflation and jobs isn't enough to befuddle policy makers, they also must grapple with how another signature policy of the administration will impact the economy: the crackdown on immigration. According to custom authorities, the number of unauthorized immigrants plunged from 250 thousand a month in late 2023 to 12 thousand a month so far this year.

Meanwhile, those entering legally are also falling like a stone, as immigrant visas fell 20 percent in May from a year ago. In 2024, 670 thousand immigrant visas were issued, so if that percentage drop holds the number of authorized immigrants entering the country would plunge by 134 thousand this year. Most of those migrants would have joined the U.S. labor force, filling much needed positions in some critical industries, including construction and health care, where labor shortages are a growing problem.

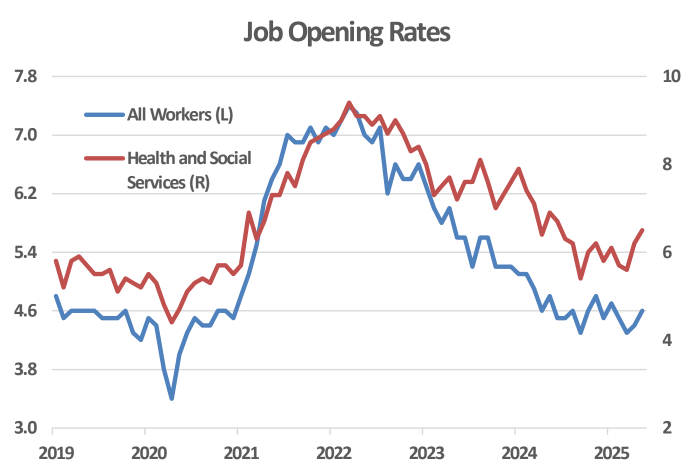
Indeed, foreign born workers account for more than 40 percent of home health aides, a vital need amid an ageing population. In May, there were 1.6 million job openings in the health care and social assistance sector, accounting for 6.2 percent of that sector's workforce. That compares to a 4.6 percent job opening rate for all nonfarm workers. The rates for both have come down significantly since the pandemic when workers, flush with government stimulus payments amid heightened health fears, stayed home. But while job openings have held steady for all workers, it has risen markedly in the health care sector since last fall, when the job opening rate stood just over 5 percent. No doubt, immigration polices have exacerbated the shortage of workers in this sector.

Less Immigrants, Less Workers and Demand

Ironically, the cutback in labor supply due to reduced immigration helps keep the unemployment rate low, as fewer jobs are needed to accommodate a slimmer workforce. But if the demand for labor remains the same amid a smaller labor pool, employers must jack up wages to attract workers. Higher labor costs, in turn, puts upward pressure on inflation, discouraging the Fed from cutting rates. That prospect, plus the tariff impact on inflation, is keeping the Fed on the sidelines for now.

But even as a tougher immigration policy reduces the supply of labor, it also reduces a major source of demand for goods and services. Keep in mind that immigrants spend money just as native-born Americans do, so the exit of 134 thousand potential consumers from the U.S. also removes a major source of spending power in the economy.Indeed, the incomes of immigrants tend to be lower and, hence, most of their earnings are spent rather than saved. This means that the removal of this earning stream delivers a bigger blow to spending than would be the case if higher wage earners exited the economy.

Simply put, tariff and immigration policies threaten to both increase inflation and slow growth, a combination that complicates the challenge facing the Federal Reserve. It will take several months to see how this plays out, but the tariff shock will soon be in the rear-view mirror and its inflation impact will fade towards the end of the year. That should enable the Fed to focus more on the risks to growth and the job market, setting the stage for a series of rate cuts. The economy as well as the financial markets have been remarkably resilient so far despite policy-induced heightened uncertainty. Once the tumult over tariffs is removed, the economic landscape should look much brighter.



KEY ECONOMIC AND FINANCIAL INDICATORS

Financial Indicators *

	June	May	April	March	February	January	December	12-Month Range High	12-Month Range Low
Prime Rate	7.50	7.50	7.50	7.50	7.50	7.50	7.65	8.50	7.50
3-Month Treasury Bill Rate	4.23	4.25	4.21	4.20	4.22	4.21	4.27	5.20	4.20
5-Year Treasury Note Rate	3.96	4.02	3.91	4.04	4.28	4.43	4.25	4.43	3.50
10-Year Treasury Note Rate	4.38	4.42	4.28	4.28	4.45	4.63	4.39	4.63	3.72
30-Year Treasury Bond Rate	4.89	4.90	4.71	4.60	4.68	4.85	4.58	4.90	4.04
Tax-Exempt Bond Yield	5.24	5.22	5.18	4.30	4.20	4.19	4.04	5.24	3.83
Corporate Bond Yield (AAA)	5.46	5.54	5.45	5.29	5.32	5.46	5.20	5.54	4.68
Conventional 30-Year Mortgage Rate	6.82	6.82	6.73	6.65	6.84	6.96	6.72	6.96	6.18
Dow Jones Industrial average	42753	41864	39876	42092	44209	43524	43656	44209	39876
S&P 500 Index	6030	5811	5370	5684	6039	5980	6011	6039	5370
Dividend Yield (S&P)	1.28	1.32	1.43	1.34	1.24	1.26	1.24	1.43	1.23
P/E Ratio (S&P)	26.4	25.1	23.8	24.0	25.5	27.2	26.5	27.2	23.8
Dollar Exchange Rate (vs. Major Currencies)	121.0	122.7	124.5	126.5	128.1	129.0	127.8	129.0	121.0

* Monthly Averages

Economic Indicators

	June	May	April	March	February	January	December	12-Month Range High	12-Month Range Low
Housing Starts (Thousands of Units)	1321	1263	1398	1355	1490	1358	1514	1514	1263
New Home Sales (Thousands of Units)		623	722	659	642	662	718	726	623
New Home Prices (Thousands of Dollars)		427	411	404	412	431	423	431	398
Retail Sales (% Change Year Ago)	3.9	3.3	5.0	5.1	3.9	4.6	4.6	5.10	2
Industrial Production (% Change Year Ago)	0.7	0.7	1.3	1.1	1.2	1.4	0.4	1.4	-0.9
Operating Rate (% of Capacity)	77.6	77.5	77.6	77.7	78.2	77.7	77.6	78.2	76.8
Inventory Sales Ratio (Months)		1.39	1.38	1.38	1.39	1.40	1.39	1.41	1.38
Real Gross Domestic Product (Annual % Change)				-0.2			2.5	3.1	-0.2
Unemployment Rate (Percent)	4.1	4.2	4.2	4.2	4.1	4.0	4.1	4.3	4.0
Payroll Employment (Change in Thousands)	147	144	158	120	102	111	323	323	44
Hourly Earnings (% Change Year Ago)	3.7	3.8	3.8	3.9	4.0	4.0	4.0	4.2	3.6
Personal Income (% Change Year Ago)		4.5	5.3	4.7	4.6	4.3	5.2	5.4	4.3
Savings Rate (Percent of Disposable Income)		4.5	4.9	4.4	4.4	4.2	3.5	4.9	3.5
Consumer Credit (Change in Blns. Of Dollars)		5.1	16.9	6.6	-1.3	9.0	-110.3	17.6	-110.3
Consumer Prices (% Change Year Ago)	2.6	2.4	2.3	2.4	2.8	3.0	2.9	3.0	2.3
CPI Less Food & Energy (% Change Year Ago)	2.9	2.8	2.8	2.8	3.1	3.3	3.2	3.3	2.8
Wholesale Prices (% Change Year Ago)	2.4	2.8	2.5	3.3	3.4	3.7	3.4	3.7	2.1

Louisiana Corporate Credit Union

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First Quarter 2025 - By the Numbers

$5.67 billion	Total credit union issuance outstandings.
1,598	Number of credit unions that have issuance agreements in place, prepared to issue share certs, should the need arise.
432	Number of credit unions that currently have custodial share certificate issuance balances through SimpliCD.
$100 million	Largest issuance in a single transaction to date.

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