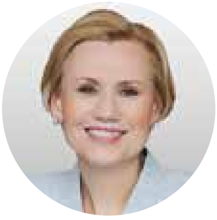
Is the US headed for a drop in GDP growth?

Weekly Market Compass | March 5, 2025



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The list of things to watch in the US continues to grow: the implementation of new tariffs, slowing US growth, inflation concerns, a potential government shutdown, and a wild ride for the 10-year US Treasury yield among them. On top of that, this week brings a European Central Bank meeting and the start of China's National People's Congress. Here are the top things for global investors to keep an eye on in March.

Tariff implementation

The fear of tariff wars has been negatively impacting US consumer sentiment and spending. On March 4, new US tariffs began on goods from Mexico and Canada, and additional tariffs began on China. We also started getting news about retaliatory tariffs. However, if we were to see a quick end to the nascent tariff wars, I believe we would likely see a fast rebound in sentiment and spending. In the near term. I expect them to weigh on US stocks, just as they did in 2018.

Signs of a deterioration in US growth

More signs are appearing of a "growth scare." It's not just a large drop in consumer confidence –we're seeing signs of a slowdown in a variety of economic data:

- US personal spending declined 0.2% in January, which was worse than expected.[1]
- Both retail sales and industrial production for January were lower than expected.
- The flash S&P Global US Services Purchasing Managers' Index (PMI) dropped into contraction territory in February at 49.7, down from 52.9 in January and well below expectations.[2]
- The new orders sub-index of the US ISM Manufacturing PMI Survey fell into contraction territory in February, from 55.1 to 48.6, experiencing the biggest drop since March 2022.[3]
- The Atlanta Fed GDPNow, which forecasts gross domestic product (GDP) growth in real time, has experienced a wild swing as of late. On Feb. 19, the model anticipated 2.3% GDP growth for the first quarter, but as of Feb. 28, that expectation changed to a 1.5% drop in GDP growth.[4]

Yes, the Atlanta Fed is now predicting an actual drop in GDP growth for the first quarter. You may recall that two consecutive quarters of negative growth makes a recession. Now the first quarter is far from over, so the Atlanta Fed GDPNow measure could easily swing back into positive growth territory with additional data points. And any downturn in economic growth could be very short-lived, as it seems to largely be a reaction to concerns about tariff wars. We'll want to follow the data closely to ensure the US economy isn't deteriorating too quickly – that starts this week with the US Employment Situation Report for February, as well as anecdotal information from the Federal Reserve Beige Book to be released this week.

Signs of a US inflation resurgence

There is a lot of concern that there will be a rebound in US inflation. We see it in US consumer inflation expectations, with one-year ahead expectations now at a very high 4.3%.[5] And we see it in market-based inflation expectations; the 5-year breakeven inflation rate has climbed from a low of 1.86% on Sept. 10, 2024, to 2.61% on Feb. 28, 2025.[6] While the most recent Personal Consumption Expenditures (PCE) print was rather tame, the prices paid sub-index of the ISM US Manufacturing PMI survey rose from 54.9 last month to 62.4, a big jump that was well above expectations.[7] As with the University of Michigan Survey of Consumers, this is not what we want to see – a drop in growth and an increase in prices. As I said last week, it raises concerns about the potential for stagflation.

We'll want to follow data releases closely for signs of a resurgence in inflation. I'm most focused on average hourly earnings, which will be released this Friday, March 7, as part of the US Employment Situation Report.

Messaging from the Federal Reserve

Thus far, the Federal Reserve (Fed) has indicated that it is more concerned about inflationary risks than risks to growth. This is rather typical for the Fed. It seems that Federal Open Market Committee members are more worried about avoiding becoming the next Arthur Burns than the next Herbert Hoover.

However, I think the Fed's focus would change if we see more signs of economic deterioration. If this is not accompanied by a rebound in inflation – in other words, the stagflationary environment we all fear — then I expect it will bring us closer to more easing. However, it will be important to pay attention to the Fed's messaging on this to see how its perceived risks are evolving.

The 10-year US Treasury yield

When US Treasury Secretary Scott Bessent said that the Trump administration would focus not on cajoling the Fed into cutting rates but instead bringing down the 10-year US Treasury yield, I didn't think it would happen so quickly – nor did I think it would be driven by expectations of diminishing growth.

The 10-year US Treasury yield has been on a wild ride in recent weeks, peaking at 4.79% on Jan. 14 and falling to 4.21% on Feb. 28.[8] Today it has fallen even further. Now we do have to recognize that a drop in the 10-year yield isn't always a good sign. A decomposition of the 10-year US Treasury yield — looking at the various components that influence it — indicates that the market expects more inflation and less growth given the decline in the real yield. That combination has historically been negative for US stocks. We'll want to tread carefully in the near term.

US fiscal situation and possible government shutdown

House Republicans have introduced a budget proposal that rolls all major Trump campaign promises into one bill. It would extend the 2017 tax cuts and add in new tax cuts, which would cost $4.5 trillion. It would add nearly $3 trillion to the fiscal deficit over 10 years.[9]

There was dissension among House Republicans over this spending bill. To bring fiscal hawks on board, the plan stipulates that House members must find nearly $2 trillion in federal cost savings over 10 years, or else they will have to reduce their planned $4.5 trillion in new tax cuts by an equal amount. It is expected that Senate Republicans will make major modifications to this plan.

This is happening at the same time the US hurtles towards a March 14 deadline to fund the government's current budget, which could easily result in a government shutdown. It seems that House Speaker Mike Johnson will attempt to get a "clean" continuing resolution passed, which would extend the existing budget through Sept. 30, 2025. However, Democrats, alarmed that the Trump administration is cutting federal employees and spending in areas where Congress has already appropriated the funds, want to insert language in the funding bill to ensure that the administration actually spends the money approved by Congress, in keeping with the long-held view that Congress has the power of the purse. Because House Republicans have such a narrow majority, all bets are off in terms of the success of negotiations.

There is so much disorder and uncertainty in Washington, DC, that it is hard to imagine stocks won't be negatively impacted albeit temporarily — especially given they are already experiencing jitters over tariffs.

The European Central Bank

When it meets this week, the European Central Bank (ECB) will be tackling a lot of issues, including sluggish growth, sticky services inflation, the potential for tariff wars, and of course geopolitical uncertainty. Expectations are for a dovish ECB this year. However, we need to ask whether there is anything that could stand in the way of this. I think it's unlikely. While inflation has been relatively sticky in recent months, some disinflationary progress has been made. I think ECB President Christine Lagarde is unlikely to provide any forward guidance this week beyond assurances that the central bank remains very data-dependent, but I expect that to translate into significant easing this year. I expect a rate cut from the ECB this week, and likely three more rate cuts this year. I expect these cuts will in turn be an important driver of strong European equity returns this year.

China's National People's Congress

Chinese policymakers are gathering in Beijing this week for the annual National People's Congress (NPC). The NPC starts on March 5 and lasts for a week. One key thing we'll be looking for is the government's growth target for 2025. We think it's likely to be about 5% with an estimated fiscal deficit of 4% of GDP.

We could see policymakers step up fiscal easing and stimulus to counteract US tariffs or save some dry powder for later. Chinese equities seem to be expecting more stimulus given their strong recent performance. Despite the recent tariff developments, Chinese equities have outperformed their emerging market and global peers, and the renminbi has remained stable.[10]

Earnings growth forecasts

With slowing economic growth in the US, analysts are beginning to downwardly revise earnings expectations for 2025. This could pressure US stocks and should be watched closely.

Dates to watch

Date	Report	What it tells us
Mar. 3	Eurozone Consumer Price Index	Tracks the path of inflation.
	US Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
	US ISM Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
	Eurozone Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
	UK Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
	Eurozone Consumer Price Index	Tracks the path of inflation.
Mar. 4	Eurozone Unemployment Rate	Indicates the health of the job market.
	Australia Gross Domestic Product Growth	Measures a region's economic activity.
	China Caixin Services Purchasing Managers' Index	Indicates the economic health of the services sector.
Mar. 5	Eurozone Services Purchasing Managers' Index	Indicates the economic health of the services sector.
	UK Services Purchasing Managers' Index	Indicates the economic health of the services sector.
	Eurozone Producer Price Index	Measures the change in prices paid to producers of goods and services.
	US Services Purchasing Managers' Index	Indicates the economic health of the services sector.
	US ISM Services Purchasing Managers' Index	Indicates the economic health of the services sector.
	US Federal Reserve Beige Book	Gathers anecdotal information on current economic conditions in Federal Reserve districts.
Mar. 6	Eurozone Retail Sales	Indicates the health of the retail sector.
	US Nonfarm Productivity	Measures the labor productivity of nonfarm workers.
	European Central Bank Monetary Policy Decision	Reveals the path of interest rates.
Mar. 7	US Employment Situation Report	Indicates the health of the job market.
	Eurozone Gross Domestic Product Growth	Measures a region's economic activity.
	Eurozone Employment	Indicates the health of the job market.

Dates to watch

Date	Report	What it tells us
Mar. 7	Canada Jobs Report	Indicates the health of the job market.

Notes

[1]Source: US Bureau of Economic Analysis, Feb. 28, 2025

[2]Source: S&P Global, as Feb. 21, 2025

[3]Source: Institute for Supply Management, March 3, 2025

[4]Source: Atlanta Fed GDPNow, as of Feb. 19, 2025, and Feb. 28, 2025

[5]Source: University of Michigan Survey of Consumers, Feb. 21, 2025

[6]Source: Federal Reserve Bank of St. Louis via FRED, as of Feb. 28, 2025

[7]Source: Institute for Supply Management, March 3, 2025

[8]Source: Bloomberg, as of Feb. 28, 2025

[9]Source: The Penn Wharton Budget Model, as of Feb. 27, 2025

[10]Source: Bloomberg. Year to date as of March 3, 2025, the MSCI China Index has gained 12.46%,
[11]compared to the MSCI EM Index gain of 2.02% and the MSCI All Country World Index gain of 2.57%.

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

The Federal Reserve Bank of Atlanta's GDPNow forecasting model provides a "nowcast" of the official GDP estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis.

Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The Federal Open Market Committee (FOMC) is a committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

Inflation is the rate at which the general price level for goods and services is increasing.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures. Core PCE excludes food and energy prices.

Purchasing Managers' Indexes (PMI) are based on monthly surveys of companies worldwide and gauge business conditions within the manufacturing and services sectors.

Stagflation is an economic condition marked by a combination of slow economic growth and rising prices.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

The Employment Situation Report is released by the US Bureau of Labor Statistics to monitor labor market data on a monthly basis.

Breakeven inflation is the difference in yield between a nominal Treasury security and a Treasury Inflation-Protected Security of the same maturity.

Dovish refers to an economic outlook that generally supports low interest rates as a means of encouraging growth within the economy.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs).

The MSCI Emerging Markets Index captures large- and mid-cap representation across 26 emerging markets (EM) countries.

The MSCI All Country World Index is an unmanaged index considered representative of large- and mid-cap stocks across developed and emerging markets.

The opinions referenced above are those of the author as of **March 3, 2025.** These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.