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**Investment Institute**

# Institute Alert

FIRST ANALYSIS

**News or events that may affect your investments** **April 30, 2025**

**Jennifer Timmerman**
Investment Strategy Analyst

**Gary Schlossberg**
Global Strategist

## Less than meets the eye with first-quarter GDP decline

### Key takeaways

- First-quarter U.S. gross domestic product (GDP) printed slightly negative for the first time in three years, posting a decline pretty much in line with consensus expectations. All in, the report was better than feared, considering special factors — capped by an import surge ahead of tariff increases — likely overstated the extent of the first-quarter slowdown.
- The real test for the economy lies ahead, as recent tariff increases squeeze consumer incomes and spending later this year.

### What it may mean for investors

- We recently lowered our 2025 U.S. growth target to account for the material risk of recession from aggressive tariffs.[1] However, we still believe an unusual set of supports will limit the anticipated slowdown, allowing the economy to skirt a recession barring an unforeseen economic events.

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The Commerce Department's initial estimate of first-quarter U.S. GDP showed the economy contracted at an annualized 0.3% pace, the first quarterly decline in three years and in line with expectations. A big increase in the trade deficit was a large negative for economic growth during the opening months of the year, but that was largely offset by a buildup of inventories ahead of expected tariff increases in the spring. Also, surprisingly strong equipment spending likely was spurred, in part, by those same tariff worries. In fact, increased business investment in the first quarter more than offset slowing growth in consumer spending and housing to boost growth of private-sector demand (final sales to private domestic purchasers) from its fourth-quarter pace.

Private-sector spending could have been even stronger, but for special factors that weighed on first-quarter GDP beyond the tariff-related jump in imports. Payback for year-end 2024 buy-in-advance shopping, tariff uncertainties for 2025, severe winter weather, and California wildfires all aggravated the slowdown in spending growth by businesses and consumers, in our view.



1. For more detail see "Institute Alert: Adjusting 2025 targets and equity-sector guidance," April 4, 2025.

## Behind our no-recession call in 2025

The U.S. economy is slowly softening at a time when tariffs are poised to weigh on economic growth in the coming months. We think of tariffs as functioning like a tax. As with taxes, tariffs can have the effect of raising prices on the goods directly affected, but this kind of inflation typically is not self-propagating. The tariff typically raises the price once. We expect most of these price increases in the summer of 2025 and for these price hikes to undercut spending and economic growth.

Statistically, we believe real (inflation-adjusted) GDP's modest decline during the opening months of 2025 increases the chances that the economy will skirt a recession. We see equally unique cushions in this economic cycle that we believe will sustain growth this year:

- Aside from the tariff-related price increases likely this summer, we expect inflation's trend to remain subdued. This is notable because rising – not falling – inflation has been the prelude to past recessions. In turn, we expect inflation's downtrend over time lessens the squeeze on household purchasing power, restrains the rise in U.S. interest rates and limits the increase in financial stress.

- We expect that the effective tax hike from higher tariffs will be at least partially offset by the boost in purchasing power from lower oil prices. The practical effect of lower fuel prices should at least partially offset inflation related to tariffs and blunt some of the sting from resulting increases in goods prices.

- Disinflation has been apparent from price reports through March showing a renewed slowdown in year-on-year price increases to an October 2024 low of just 2.3%, as measured by the Federal Reserve's preferred Personal Consumption Expenditures deflator and paced by lower fuel costs.

## What it may mean for investors

We believe the positives listed above should more than counter headwinds from higher tariffs, whose full impact should be felt by mid-summer. The economy's momentum is slow enough that it remains vulnerable to other potential surprises. Those that we can anticipate, at this point, include additional tariffs, more protracted price increases from the tariffs, and the potential for oil price increases, possibly from a supply reduction.

While the economy remains finely balanced between growth and recession, our portfolio guidance for longer-term investors continues to seek to balance quality, based on strong balance sheets, liquidity, and reliable earnings against a growth recovery later this year. That means favoring U.S. large and midcap stocks in Information Technology, Financials, Energy, and Communication Services over international equities which, we believe, have rallied ahead of their underlying fundamentals. We take the same view toward quality in fixed-income portfolios, where we are neutral on intermediate securities (maturities of 3-7 years) and maintain an unfavorable view of short- and long-term debt.

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