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Economic & Financial Markets Monthly Review | June 2025

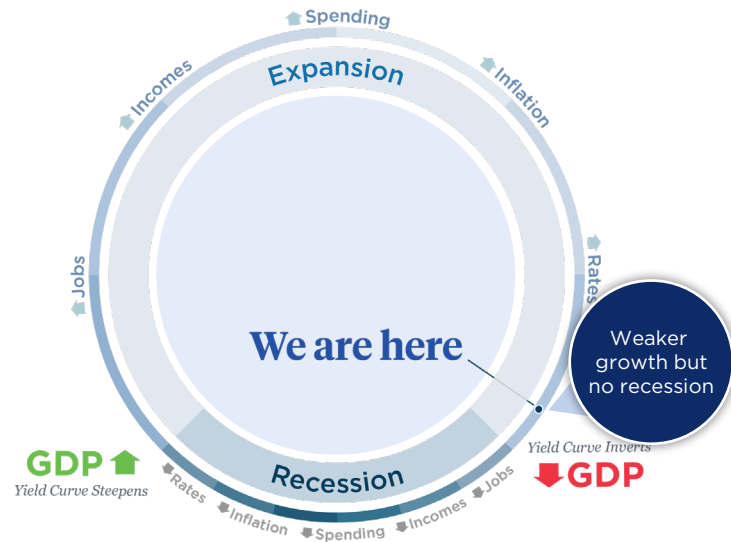
Uncertainty remains high in U.S. and abroad



Economic Overview

Where is the economy now?

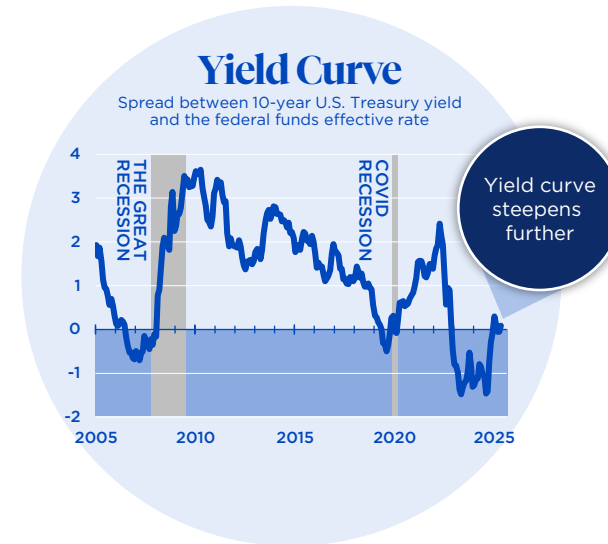
The post-tariff consumer and trade data experience whiplash as the pull-forward of consumer and business purchases in March predictably led to substantially lower demand in April. Peak uncertainty regarding tariffs is likely behind us, but businesses maintain a cautious approach as they deal with ongoing heightened uncertainty, higher costs, and the prospect of weaker demand going forward. The outbreak of war between Israel and Iran and associated geopolitical risks add another layer of uncertainty and shock to the global economy, oil prices, and financial markets. The Federal Reserve remains in a wait-and-see mode as it continues to evaluate the effects of tariff, immigration, and fiscal policy changes and now fresh geopolitical risks.



Sluggish growth outlook

We continue to forecast slowing growth as increased tariffs, reductions in government, and front-loading of consumer spending ahead of the tariffs weigh on economic activity. Heightened geopolitical risks and oil prices could pose headwinds.

- Reduced consumer spending should slow growth over the second half of 2025, but recession concerns are low following the reduction in tariffs on China.
- The combination of trade negotiations and a substantial tailwind from Q2 net exports on growth have raised our baseline forecast. We now forecast real GDP growth of 1.7 percent this year, still below trend but up moderately from our prior forecast of 1.4 percent.



Long-term rates climb higher

The yield curve steepened in the second half of May into June as long-term Treasury rates moved higher while shorter duration yields were little changed.

- The 10-year Treasury rate rose in late April, in part reflecting a higher term premium and concerns about the federal deficit and debt outlook after the passing of the OBBBA. Long-term interest rates are expected to remain elevated over 2025 and into 2026.
- We do not expect the Fed to lower interest rates until September as officials assess the impacts of policy changes on consumer spending, the labor market and inflation.



Trade deficit shrinks from record size

Following March's record deficit, which was led by a massive rise in imports ahead of prospective tariffs, the U.S. trade balance recovered in April on the sharp reversal in goods imports.

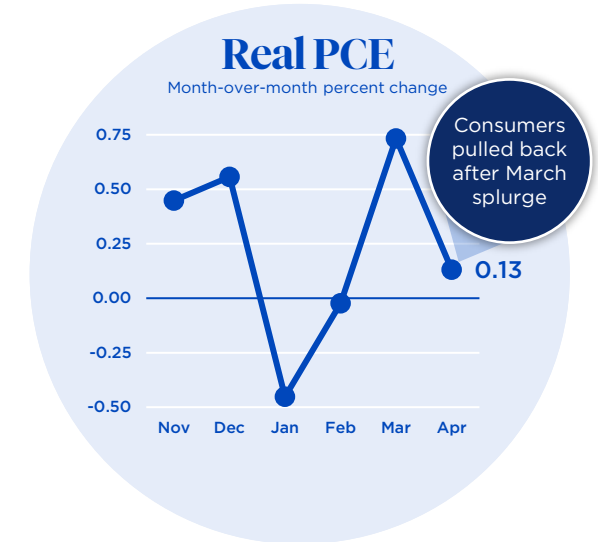
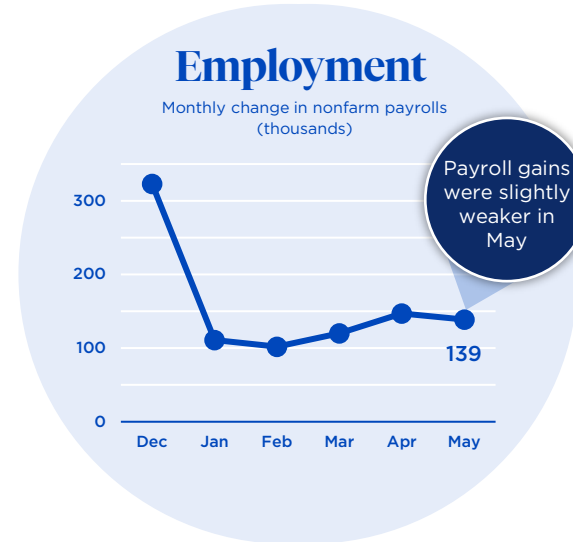
- The level of goods imports plummeted in April to pre-election levels after businesses had pulled forward goods imports in prior months.
- The sharp reversal in imports will provide a boost to Q2 real GDP growth — even as other economic indicators begin to slow. This is the mirror image of how the blowing out of the trade gap in Q1 produced an outsized drag on real GDP growth.

Where we are this month

What does this mean

Consumers pull back, but inflation has yet to pick up

Job gains moderated but were far from collapsing in May and the unemployment rate remained low, albeit with the help of a decline in the labor force participation rate. In sum, the labor market data are showing signs of a gradual softening. On the inflation front, tariff impacts have yet to work their way fully and broadly into the data. Lower oil and gasoline prices have provided a disinflationary effect that could reverse given the outbreak of war in the Middle East. Consumers have pulled back from spending after front-loading purchases ahead of Liberation Day.



Where we are this month

What does this mean

Modest tariff impacts in May CPI data

Tariff impacts have yet to filter into the CPI data on a broad scale as the headline and core indices each climbed a mild 0.1 percent in May. Lower gasoline prices have helped, but the outbreak of war in the Middle East poses upside risks to oil.

- Core goods prices (where we expect to see most of the tariff impacts) were flat in May, and apparel and new and used car prices declined. This should change over the summer once retailers have depleted the inventory build-up from prior to Liberation day.
- We don't expect the pass-through to match the tariff-related cost increases as there will be a mix of strategies between businesses absorbing some or all the cost increases and passing them on.

Job growth is easing

Nonfarm payroll gains slowed to 139,000 in May, while the unemployment rate was steady at 4.2 percent with support from a decline in the labor force participation rate.

- Headline payroll growth ticked down in May and it was even more highly concentrated than the recent norm, with over 90 percent of the gains coming from only two industries. Still, the report was encouraging as job gains appear to be slowing gradually rather than rapidly.
- With input costs rising and consumer demand weakening, we expect labor market data to soften more meaningfully in the coming months.

Consumers pull back after pre-tariff splurge

Growth in real consumer spending was much slower in April, rising a modest 0.1 percent following March's frontloaded pre-tariff purchases. We look for spending to remain dampened in the coming months.

- The slowdown in spending in April was even more pronounced for goods, which contracted by 0.2 percent after spiking 1.5 percent in March. Services, which are less impacted by tariffs, did not experience the pre- and post-tariff swing in spending
- We expect consumer spending to settle into a slower trend in the second half due to payback from the pre-tariff surge, moderation in hiring and wage growth, and as tariff-related cost increases work their way into consumer prices.

Markets focus on tariffs, fiscal policy, geopolitical risks

Improving sentiment around tariffs has underpinned an appreciation of risky assets. However, tariffs have only started passing into producer and consumer prices, as such we anticipate greater impacts on economic activity and corporate earnings in the second half of 2025. Investors are also now showing greater concerns about the federal government's fiscal trajectory as the "One Big Beautiful Bill" works its way through Congress. With war breaking out in the Middle East, heightened geopolitical risks could spark renewed market turbulence.



Stocks look beyond tariff worries

Equity prices have recovered most of their losses in the wake of Liberation Day. However, lingering tensions and elevated trade uncertainty are keeping equities below their historic February high. Increased geopolitical risk could present new turbulence.

- The S&P 500 index has rallied an impressive 20 percent since its April 8th low on hopes that peak trade tensions are behind us as the Trump administration appears eager to reach new agreements with U.S. trading partners.
- The recent relative outperformance of cyclical vs. defensive stocks — a barometer of market sentiment — shows investor sentiment is improving.



Long-term yields track higher

Long-term Treasury yields are extending their upward trend amid declining risks of recession, paring back of Fed rate cut expectations, and rising deficit concerns. An upward climb in Japanese long-term yields is influencing U.S. yields higher.

- A mix of crosscurrents has led the 10-year Treasury yield to remain elevated at around 4.40 percent. We expect long-term interest rates to stay well above their post-Global Financial Crisis averages into 2026.
- Bond market volatility receded this month, another sign of easing concerns after April's tariff announcements. However, the volatility and upward climb in Japanese long-term bond yields is spilling over to impact U.S. long-term rates.



Bond investors worry about fiscal policy

The term premium on 10-year U.S. Treasuries — the extra compensation investors demand to hold long-term debt — is at its highest in a decade.

- A rising term premium partly reflects investor concerns about the fiscal impacts of the "One Big Beautiful Bill" that proposes to make the 2017 Tax Cuts and Jobs Act permanent and add new stimulus.
- Other areas of the financial market, namely foreign exchange, corroborate rising anxieties about the federal government's fiscal health as the U.S. Dollar continues to depreciate on a trade-weighted basis.

Where we are this month

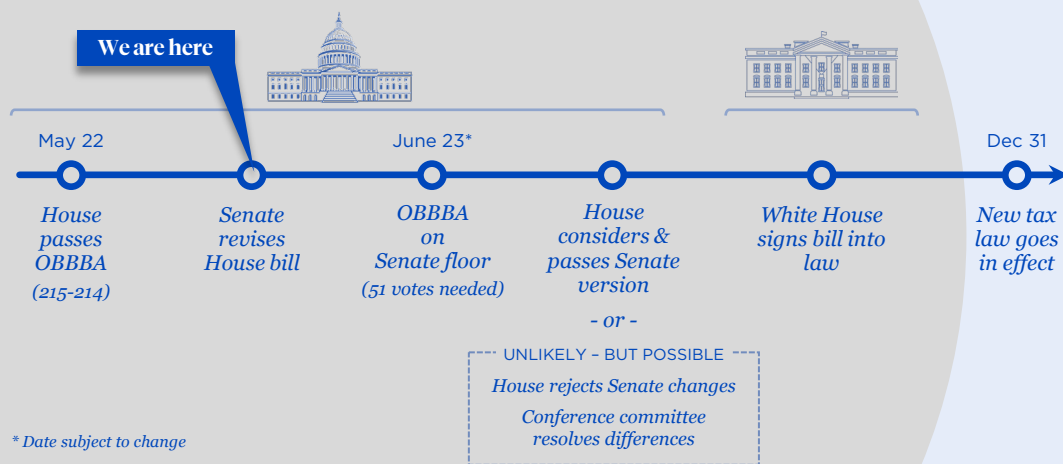
What does this mean

Outlook

Budget bill expected to moderately boost growth in 2026, but adds to deficits

The “One Big Beautiful Bill” Act (OBBBA) passed the House, which would extend the 2017 tax cuts and add over \$800 billion in new, but temporary, tax cuts for individuals and businesses from 2026 through 2029 — provides moderately new stimulus to the economy next year. Spending cuts are more backloaded, including a large \$625 billion reduction in Medicaid expenditures over the next 10 years that stems from new work requirements for adults beginning in December 2026 and an aim to reduce fraud.

While the budget proposals, along with aggressive deregulation, should support economic growth starting next year, there are concerns it could add to already high U.S. debt projections. The non-partisan Congressional Budget Office (CBO) and other bi-partisan budget research groups’ scoring indicates the bill’s provisions could add over \$2 trillion to U.S. debt including interest. And if the temporary provisions such as tax cuts are extended without offsets, then they estimate the extra debt burden will climb to at least \$3.5 trillion.



Latest Forecast

Data as of June 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	1.8%	1.7%	2.4%	2.3%
UNEMPLOYMENT RATE	4.0%	4.4%	4.4%	4.2%	4.2%
INFLATION ¹ (CPI)	2.7%	3.4%	2.9%	2.0%	2.0%
TOTAL HOME SALES	4.75	4.64	5.12	5.85	5.95
S&P/CASE-SHILLER HOME PRICE INDEX	3.7%	3.3%	3.2%	3.0%	3.0%
LIGHT VEHICLE SALES	15.8	14.8	14.4	15.0	15.0
FEDERAL FUNDS RATE ²	4.25%	3.50%	3.50%	3.00%	3.00%
5-YEAR TREASURY NOTE ²	4.38%	3.85%	3.70%	3.55%	3.55%
10-YEAR TREASURY NOTE ²	4.58%	4.25%	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE ²	6.91%	6.60%	5.60%	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.03%	3.28%	3.15%	3.03%

Economic activity held back by tariffs

We project real GDP to rise 1.8 percent in 2025, helped by a steep decline in goods imports related to the tariffs. However, domestic economic activity should be virtually flat through the end of the year due to rising costs for consumers and slower hiring by businesses.

Fed may resume rate cuts in September

The Fed should remain on hold for a few more meetings to gain clarity on how policy changes are impacting growth and inflation. But we expect signs of a weaker economy to drive a larger 50 basis point rate cut in September, followed by an additional reduction in October.

¹ Percent change Q4-to-Q4

² Year end

^a Actual

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Sources

Page 1 | Where is the economy now?

Business Cycle
Yield Curve
U.S. Trade Balance

Nationwide Economics
Bloomberg; National Bureau of Economic Research
Census Bureau

2 | Economic Review

Consumer Price Index
Nonfarm payroll gains
Real PCE

Bureau of Labor Statistics
Bureau of Labor Statistics
Bureau of Economic Analysis

3 | Financial Markets Review

S&P 500
10-year Treasury yield
Term Premium on 10-year Yield

Standard & Poor's
Federal Reserve Board
Bloomberg

4 | Outlook

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