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MAY 18-21, 2025

An Economic Update: What's Next?

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The Outlook for 2025

Economists are forecasting normalcy but
“Liberation Day” tariffs could derail that

Hard data indicate there is no reason to worry

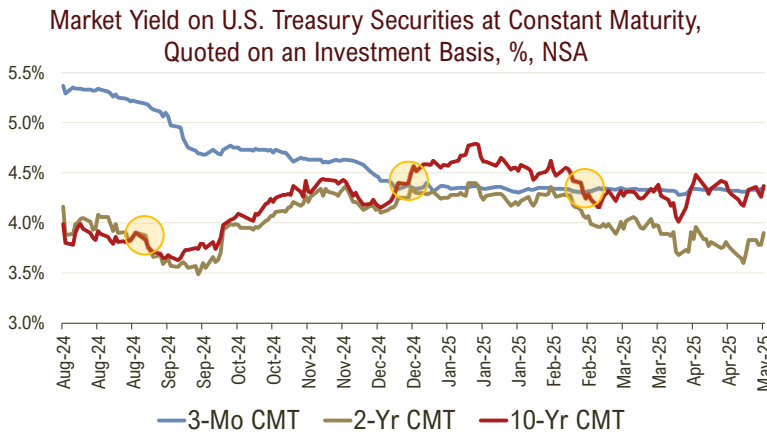
Soft data suggest that the months ahead will be rough

- All data that have been reported thus far – GDP, Inflation, Employment, Spending, Inventories, etc. are from the **Before** period, as in before tariffs became effective.
- Surveys and interviews with business owners and credit managers tell a different story as it is unfolding. This is a lot like when COVID shut things down and when 2019 tariffs went into effect.
- A pause is not a permanent fix



Interest rates had gone back to the natural order

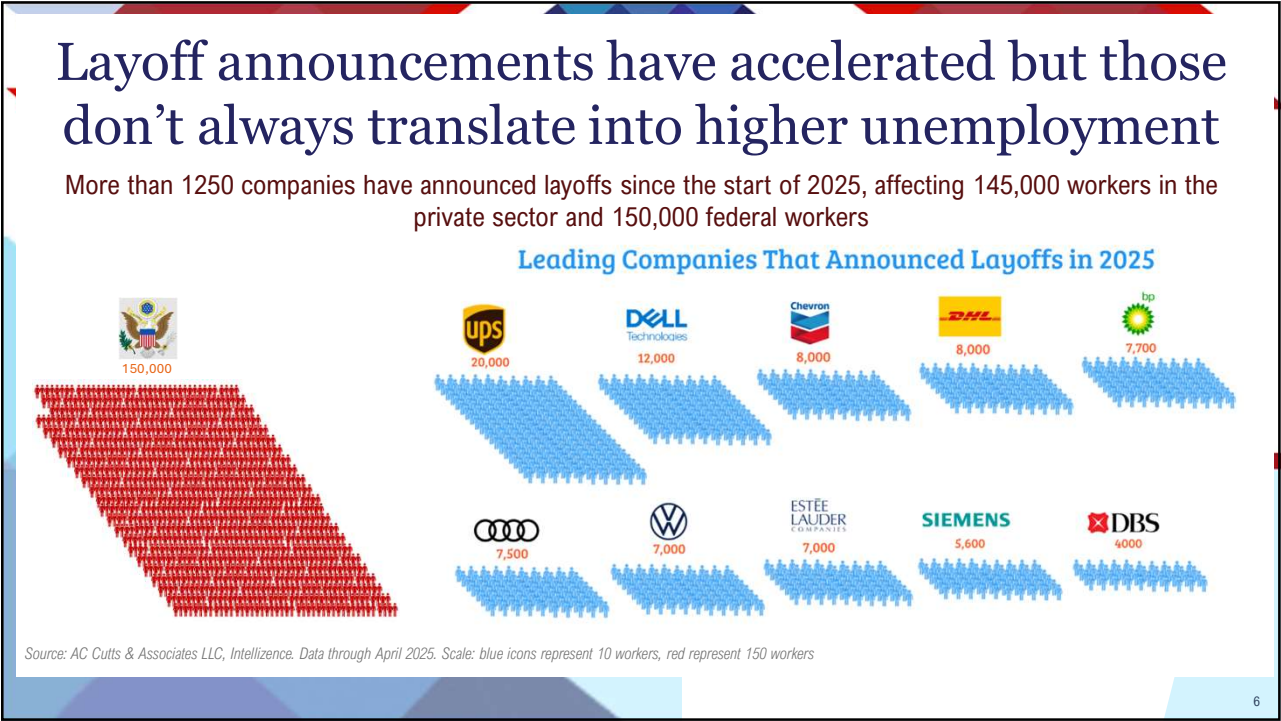
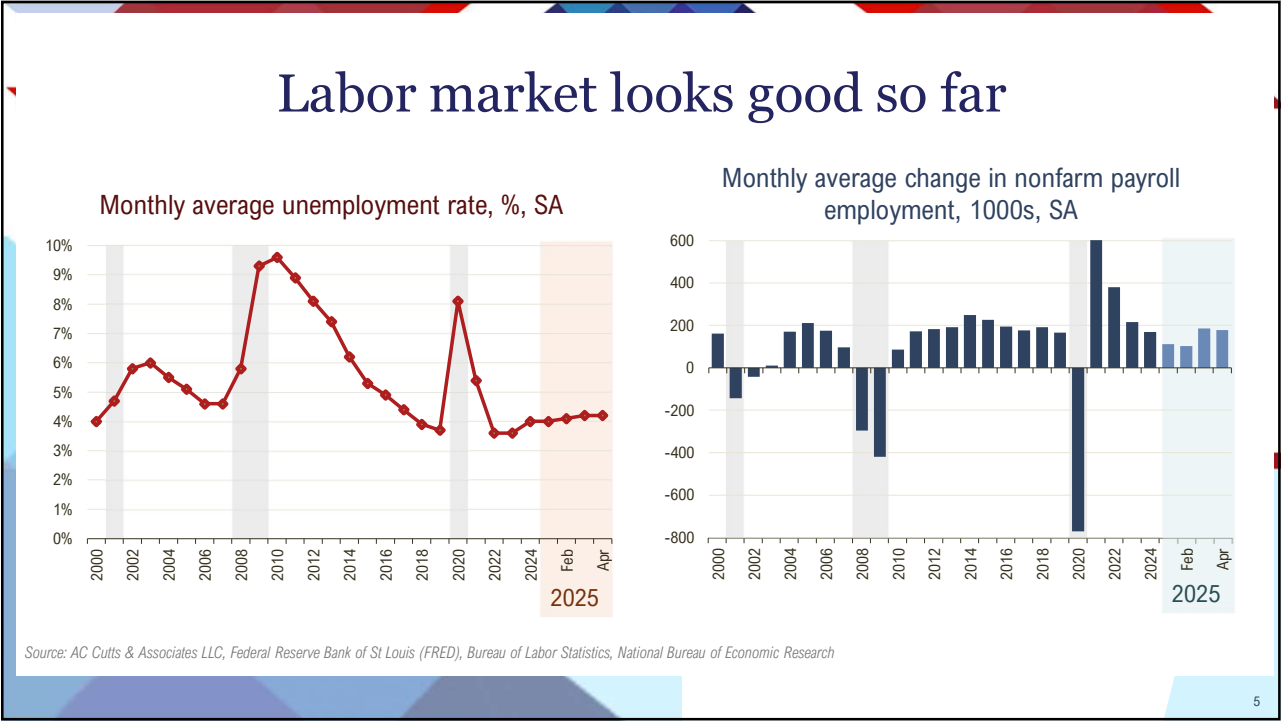
The yield curve un-inverted then re-inverted

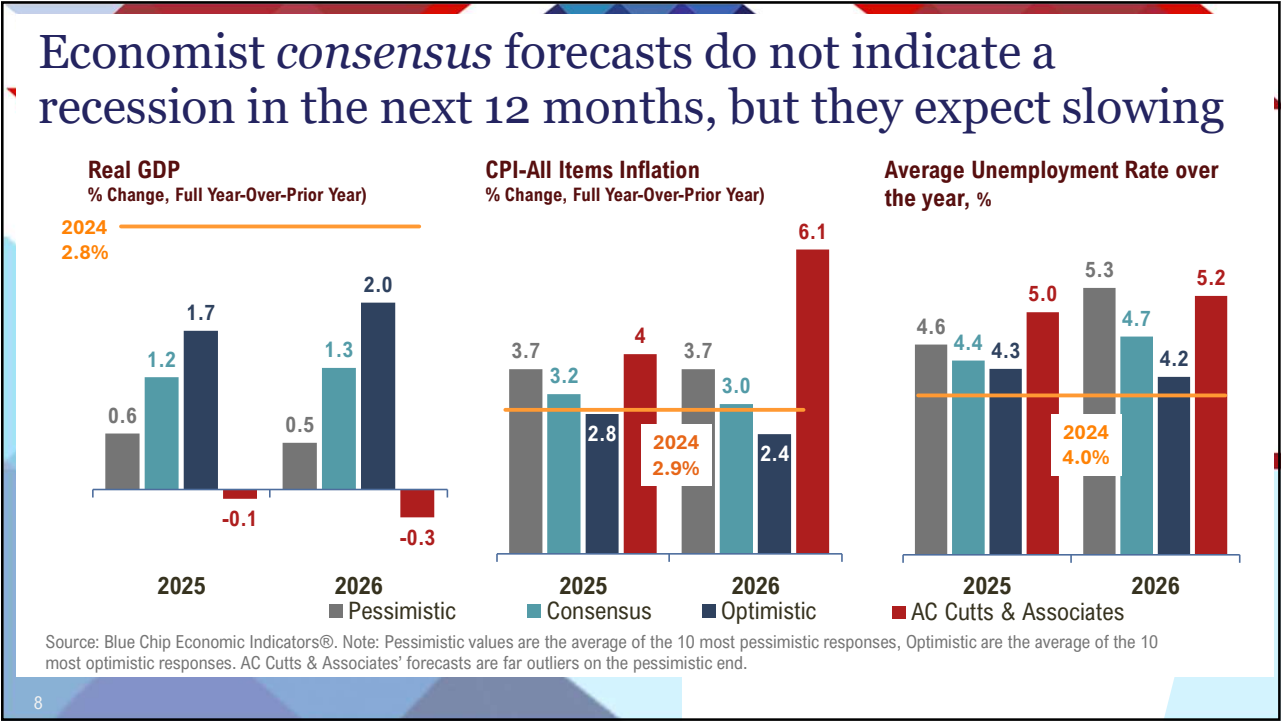
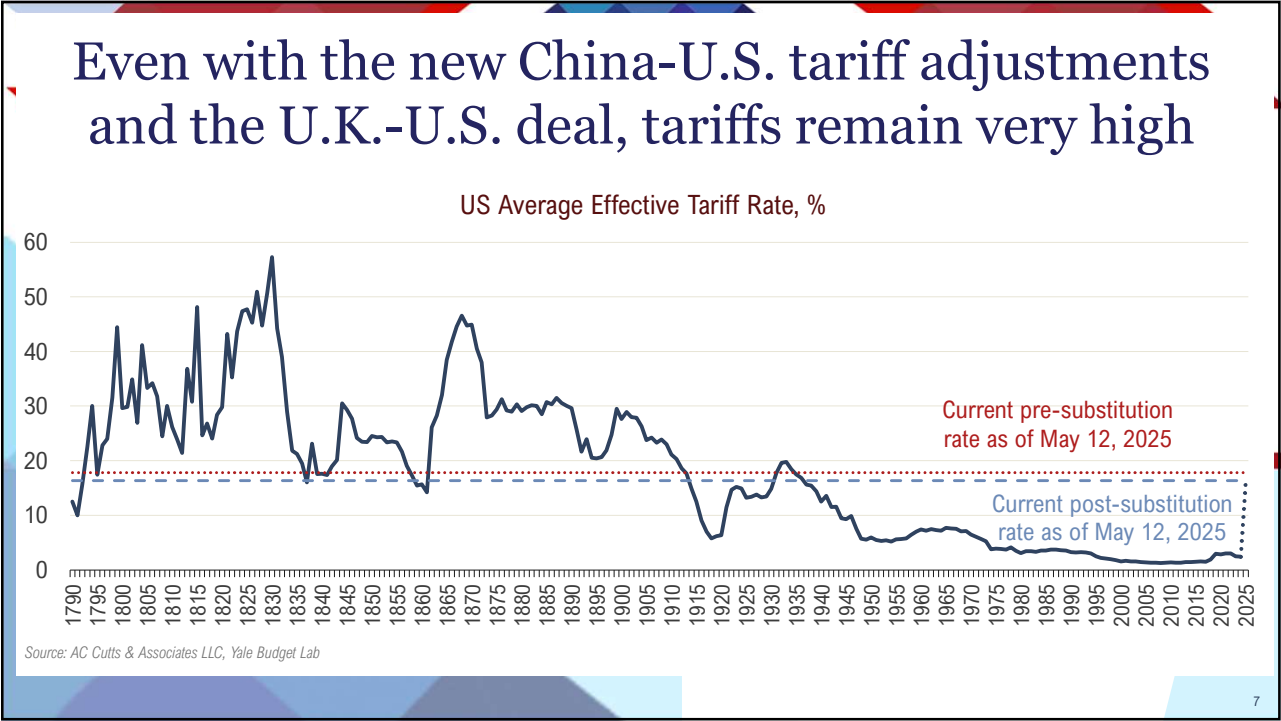


At the end of August, the 2-yr—10-yr portion of the yield curve un-inverted (10-yr yields exceeded 2-yr) but the 3-mo—10-yr relationship stayed inverted until mid-December. The market signals suggest higher inflation going forward, possibly with Fed policy reversal.

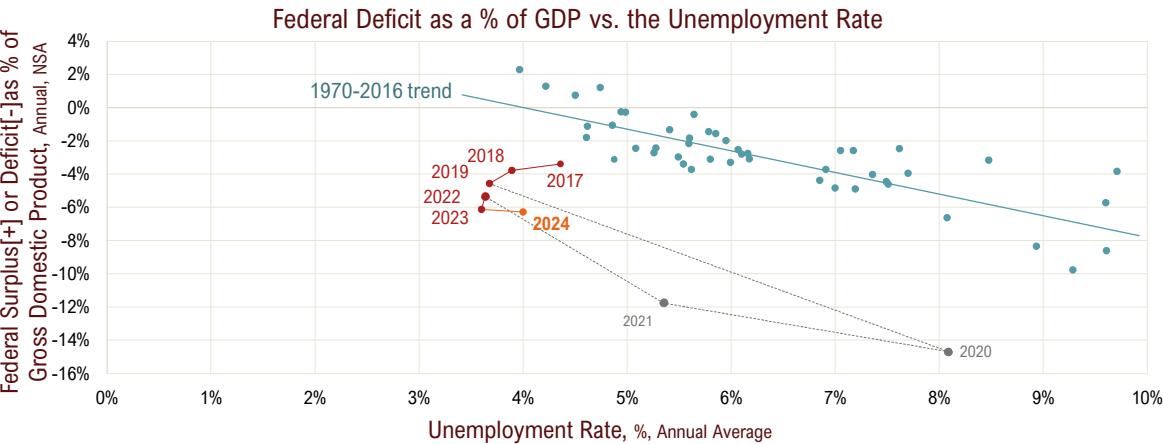
At the end of February, the 3-mo—10-yr curves inverted again, indicating a higher probability of recession over the next year.

Source: AC Cutts & Associates, Board of Governors of the Federal Reserve System, Federal Reserve Bank of St Louis (FRED)



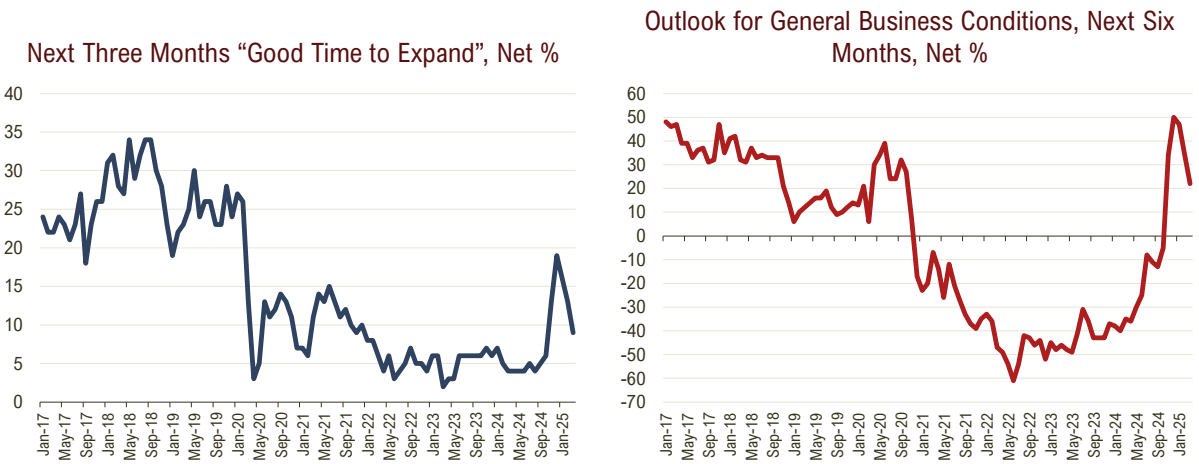


Federal deficit as a share of GDP remains disconnected from pre2016 trend



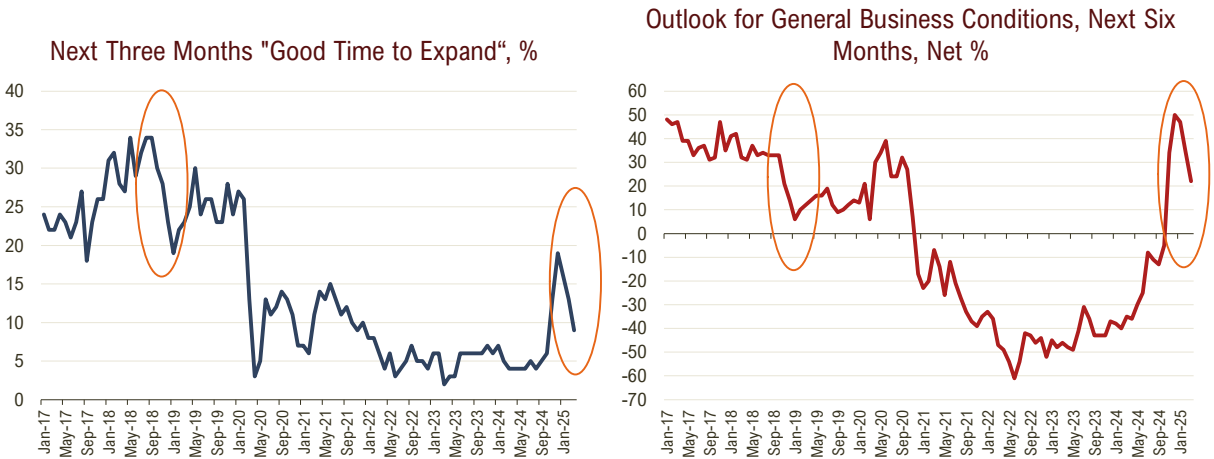
Source: AC Cutts & Associates, Federal Reserve Bank of St. Louis; U.S. Bureau of Labor Statistics; U.S. Office of Management and Budget via FRED®

Small business owners have become less optimistic



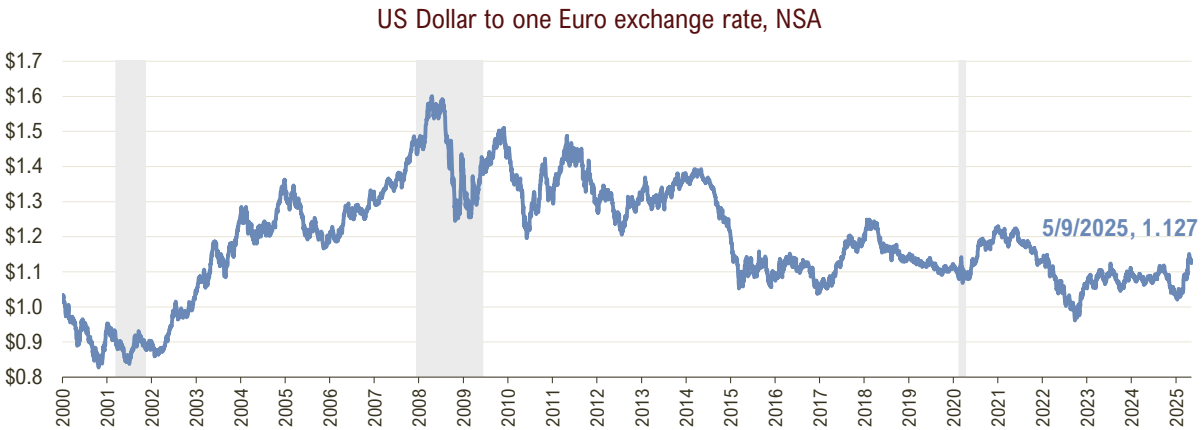
Sources: AC Cutts & Associates LLC, National Federation of Independent Businesses, Small Business Economic Trends Survey, Macrobond. Used under License. Data through March 2025.

Small business owners have become less optimistic Tariffs are on their minds



Sources: AC Cutts & Associates LLC, National Federation of Independent Businesses, Small Business Economic Trends Survey, Macrobond. Used under License. Data through March 2025.

The Dollar has weakened recently but is still historically strong – Good for importers, not for exporters



Source: AC Cutts & Associates LLC, Board of Governors of the Federal Reserve System (US); Federal Reserve Bank of St. Louis via FRED®

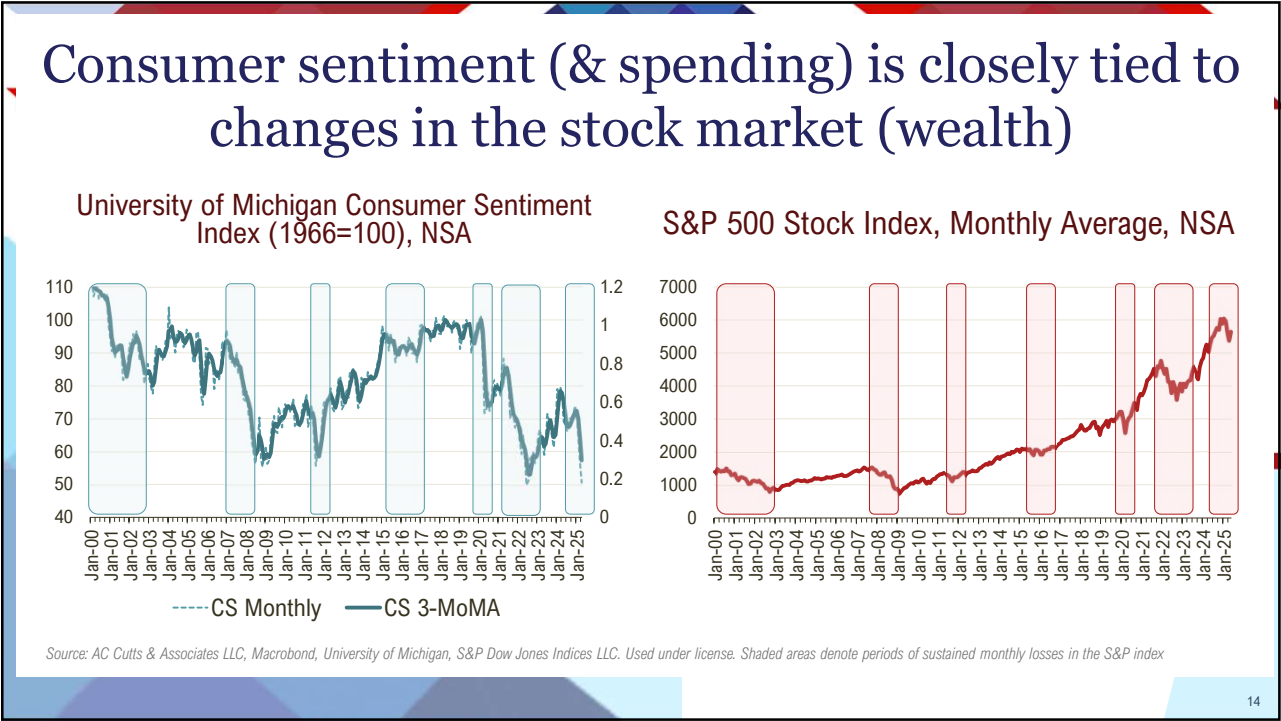
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Wealth Effect will likely be important

Every dollar of increased (decreased) stock market wealth leads to an increase (decrease) in consumer spending of 2.8 cents



3 things affecting aggregate demand today

Decline Start Month	Decline End Month	Change in Value of HH Assets: Equities and MFs
Aug 2000	Sep 2002	-41.4%
Oct 2007	Feb 2009	-49.1%
Apr 2011	Sep 2011	-15.4%
Dec 2019	Mar 2020	-23.1%
Dec 2021	Sep 2022	-24.2%
Jan 2025	Apr 2025	-19.6%*

- Income effect of prices – prices rise, I have to make cuts to stay on budget
- Wealth effect – If my assets lose value I have less to fall back on, so I cut spending (YTD down \$10+ Trillion)
- Savings effect – When I am not confident in the economy, I save more, which means I have less to spend

→ Consumers & businesses are likely to spend less in coming months

Bold values in the table correspond to periods in recession. Sources: AC Cutts & Associates LLC, Sibilis Research, Board of Governors of the Federal Reserve System, Federal Reserve Bank of St Louis (FRED)

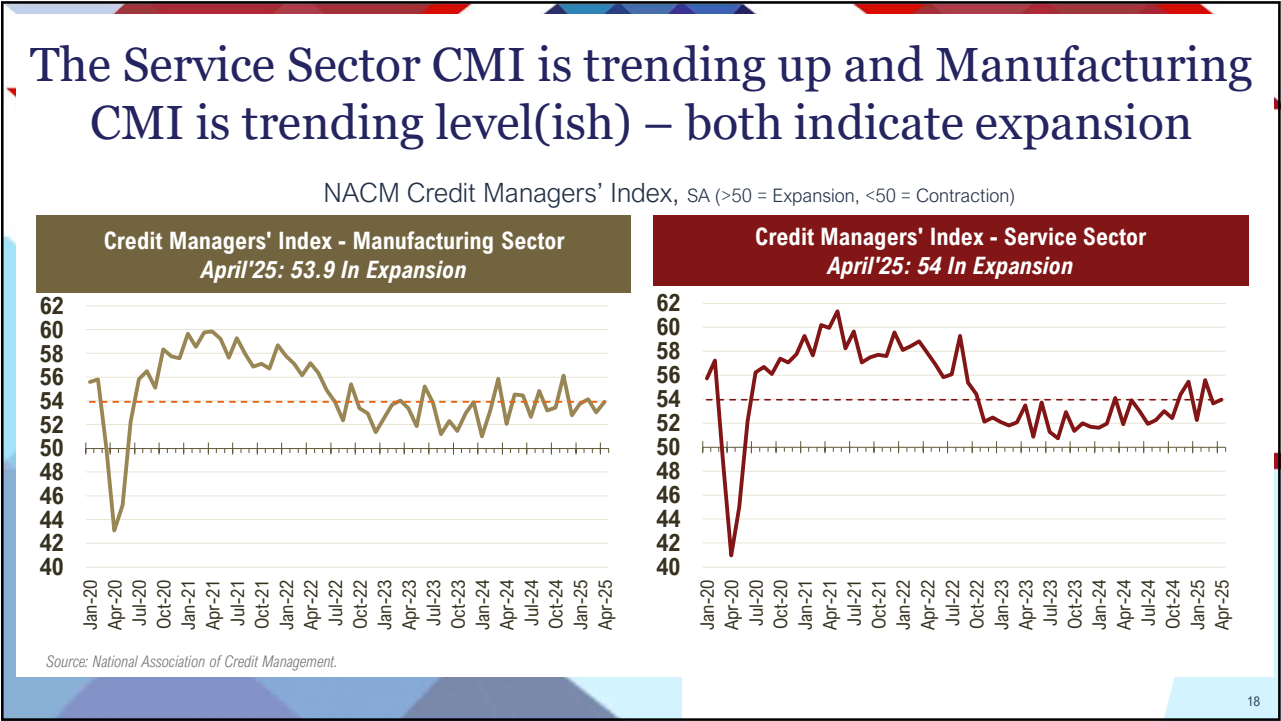
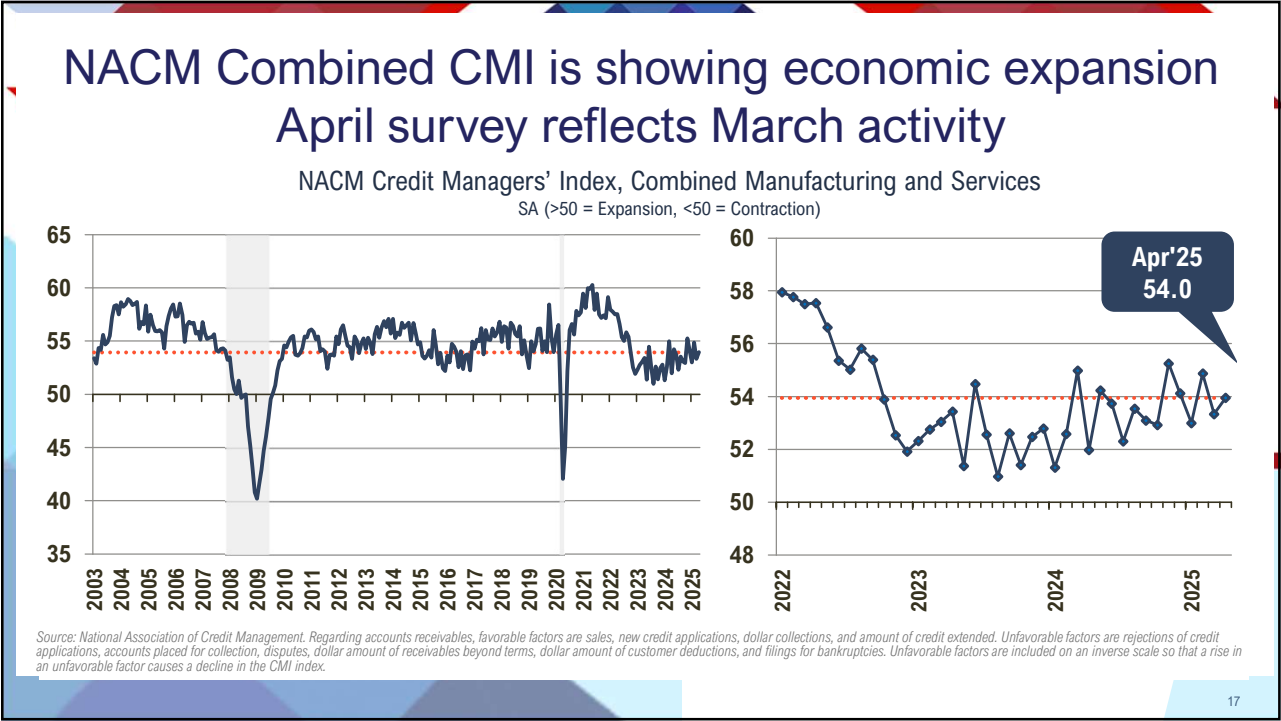
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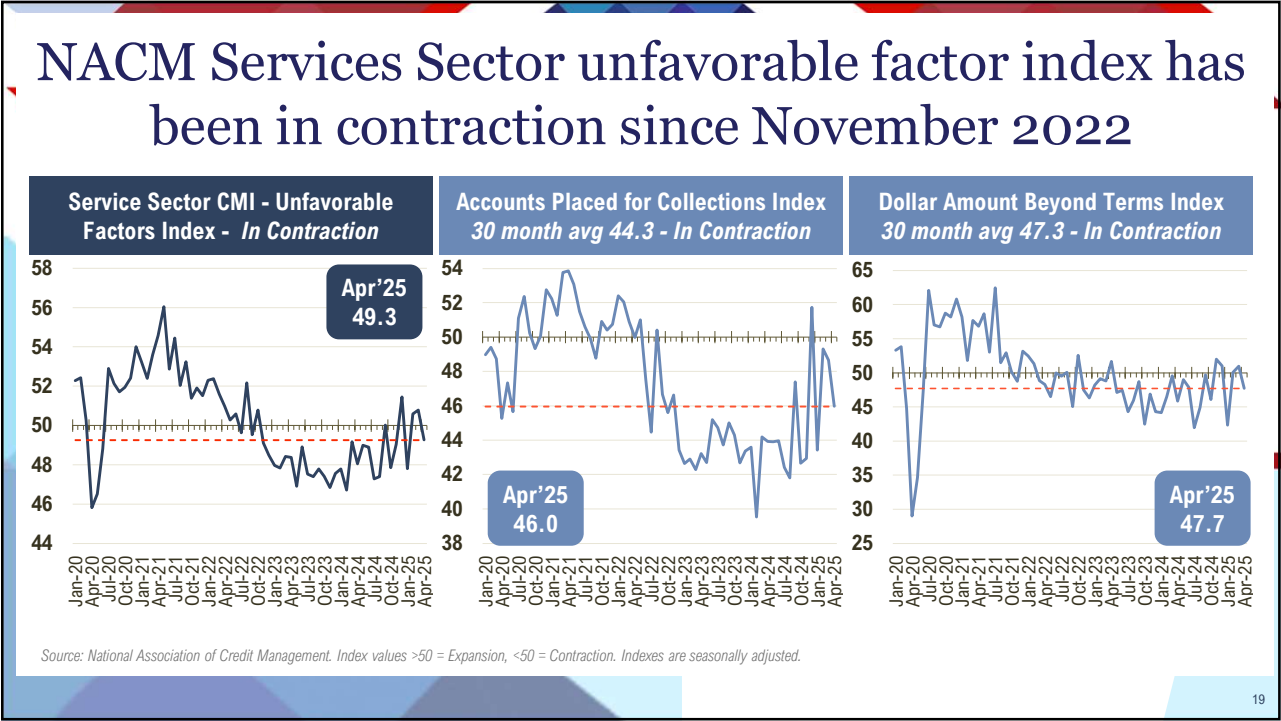
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What the NACM Credit Manager's Index tell us

NACM
CMI
CREDIT MANAGERS' INDEX

April survey is about March activity...
so pre-tariff times





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The Impact of monetary tightening

The Fed's recent inflation fight wasn't like all the others but it is useful in thinking through what might happen next

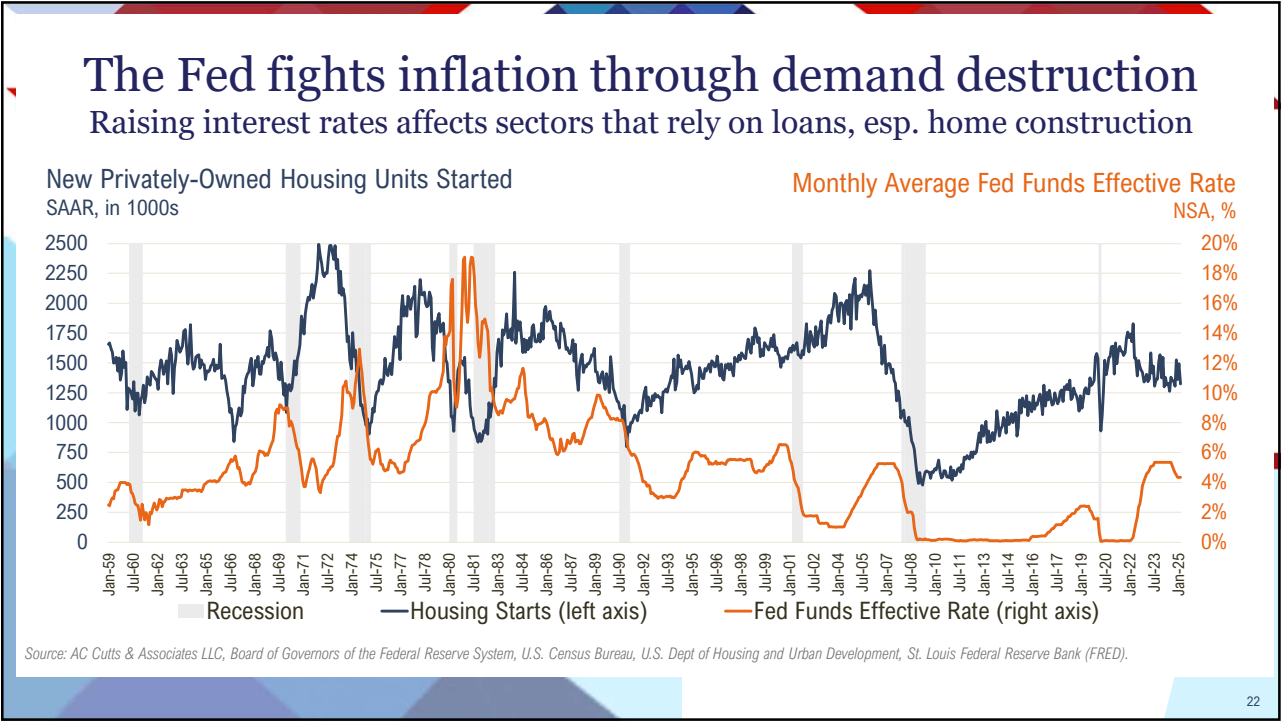
What causes *Inflation*?

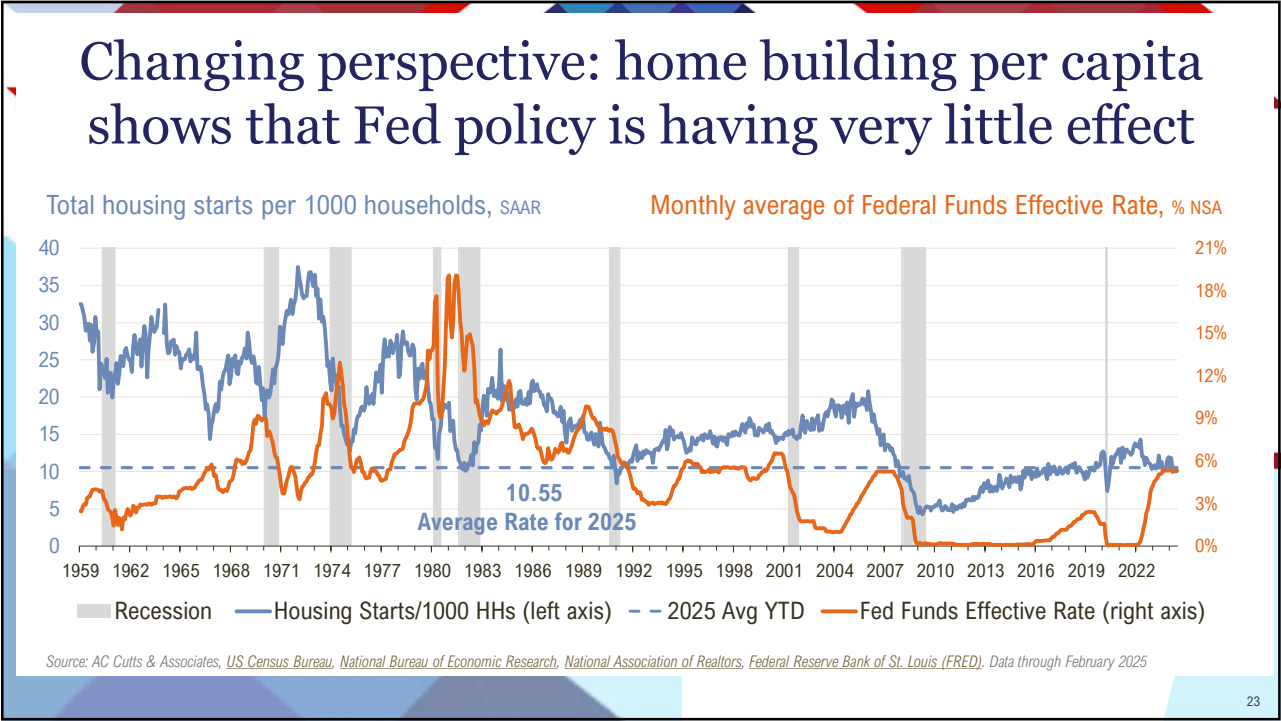
Textbook definition is that there is too much money chasing too few goods – that is, the supply of money is too high and the supply of things to buy is too low.

Another way to think of it is that there is too much aggregate demand for too little aggregate supply, money being one of the things affecting aggregate demand.

Supply shocks can lead to inflation even when demand is not much changed – this was 2022-2023 cause – Tariffs levied in 2019, COVID pandemic, Avian Flu...

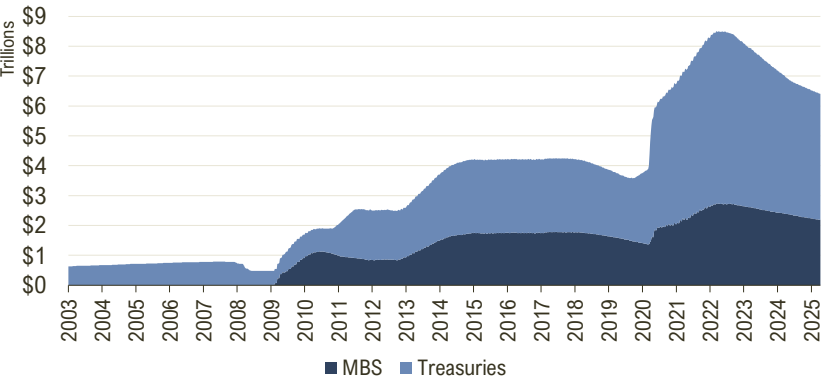
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Fed holdings of MBS and Treasuries are in gradual decline, meaning mild “Quantitative Tightening”

The total face value of U.S. Treasury & GSE Mortgage-Backed Securities held by the Federal Reserve, \$Trillions, NSA



Source: AC Cutts & Associates LLC, Macrobond, Federal Reserve Bank of New York

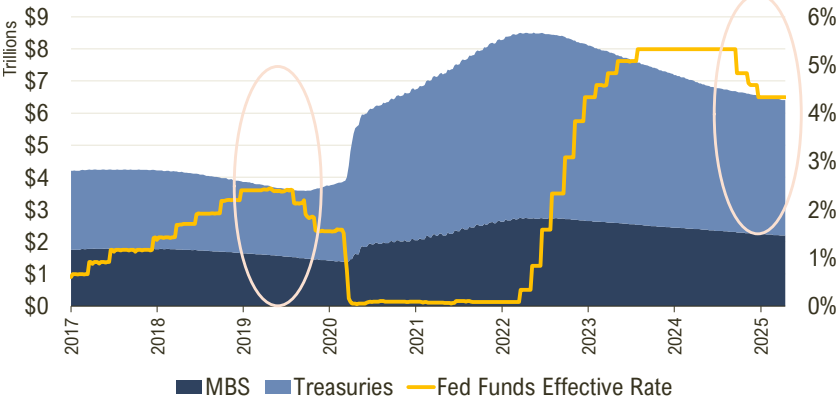
In Q1 2025, the average monthly decline in the MBS portfolio was \$4.2 billion on a total portfolio of \$2.23 trillion at the start of the year, a runoff rate of 0.19%. In 2024 the runoff rate was slightly lower, at 0.15%.

For Treasury holdings, the average monthly decline was \$5.4 billion on a total portfolio of \$4.29 trillion as of the start of the year. The Q1 2025 monthly runoff rate was 0.13%, down from an average 0.20% in 2024.

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Fed Monetary Policy can seem contradictory

The total face value of U.S. Treasury & GSE Mortgage-Backed Securities held by the Federal Reserve, \$Trillions, NSA (left Axis), Fed Funds Effective Rate, %, NSA (right Axis)

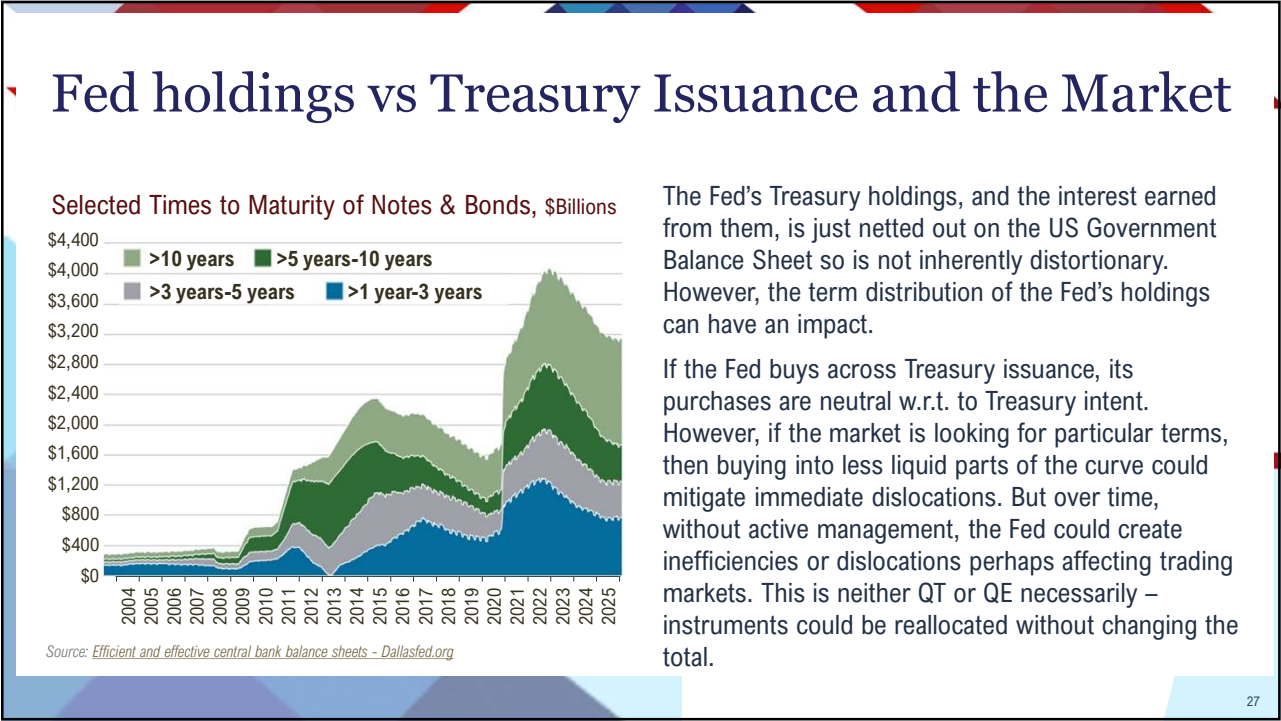


Source: AC Cutts & Associates LLC, Macrobond, Federal Reserve Bank of New York

It is possible and plausible that the Fed will engage in active Monetary Policy (directly targeting the Federal Funds Rate) that contradicts its passive actions through its portfolio holdings.

In 2019, the Fed paused active monetary policy actions but allowed passive tightening. In 2024, the FOMC was actively loosening while passively tightening.

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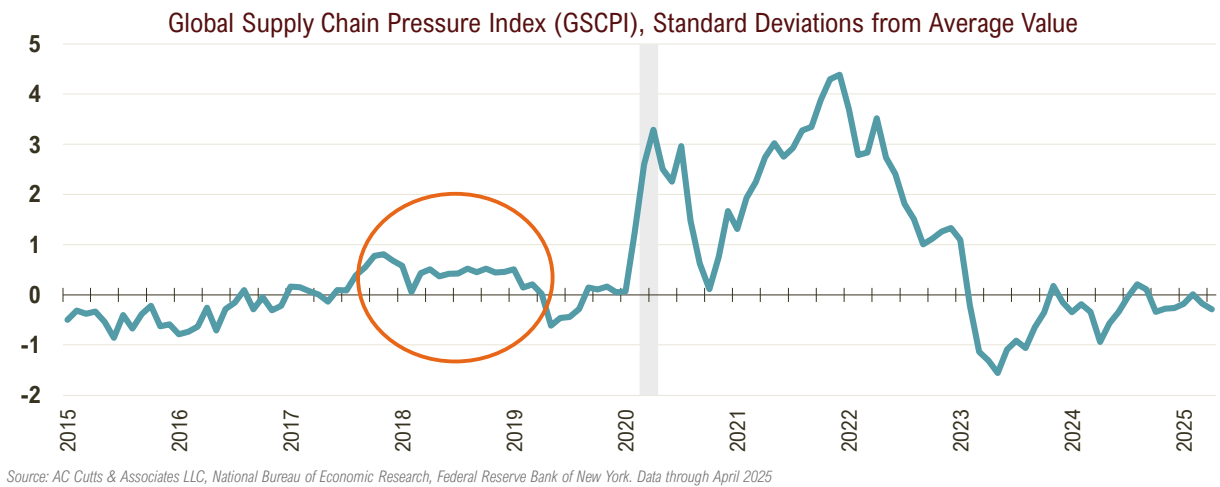
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Supply chains and inflation

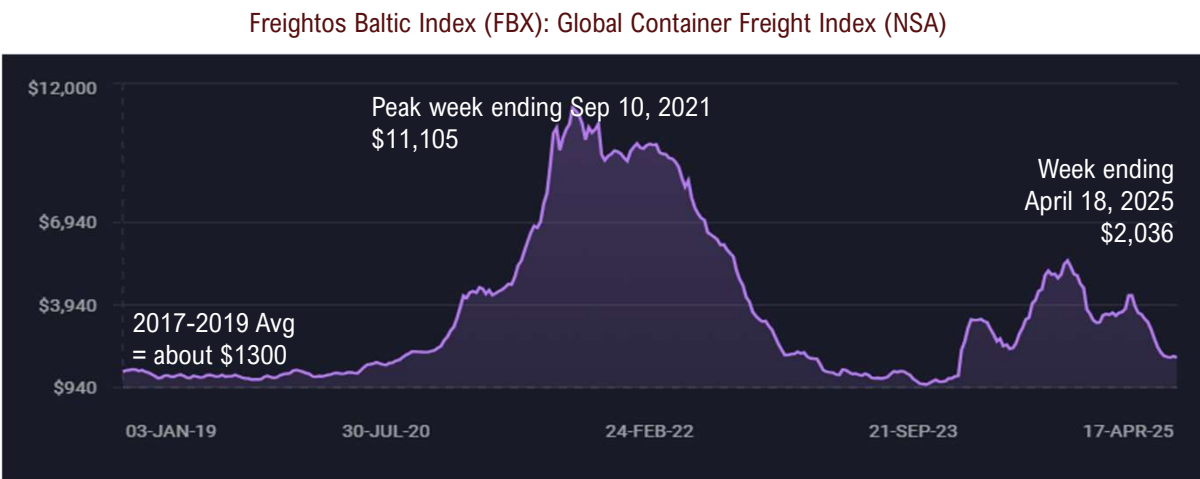
Tumultuous times

Global supply chain pressures are rising but just to mean levels through April



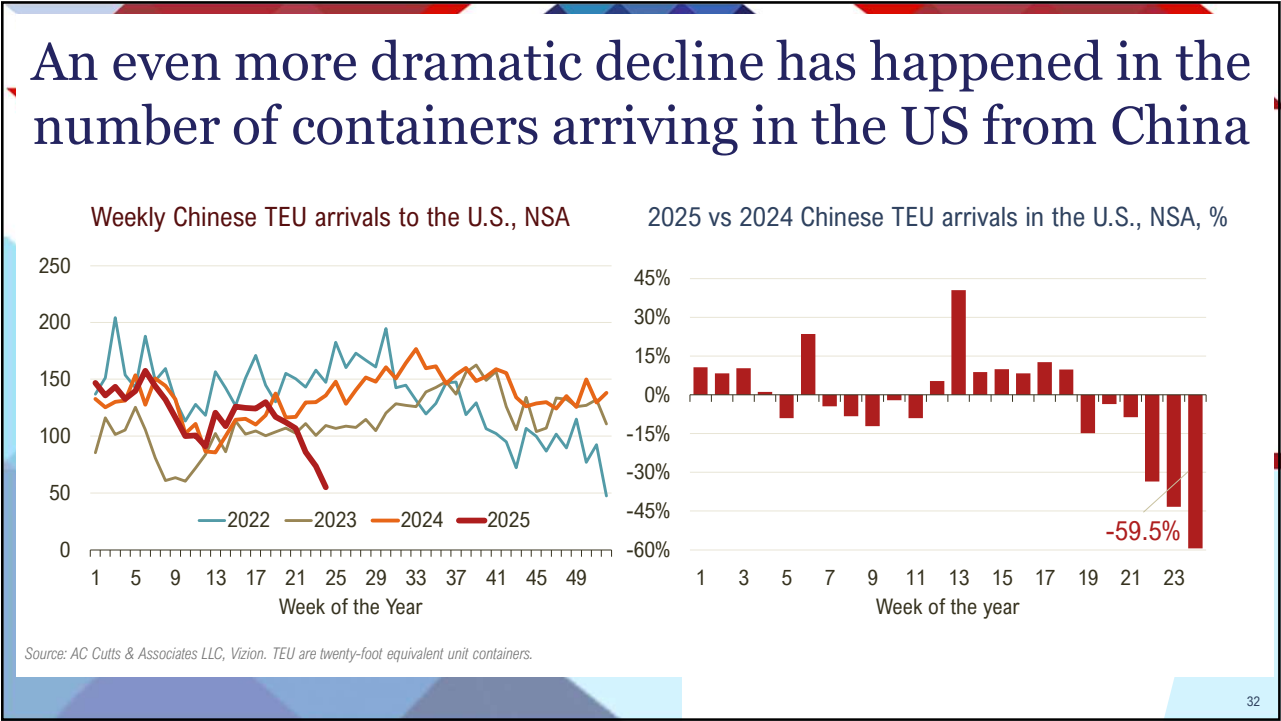
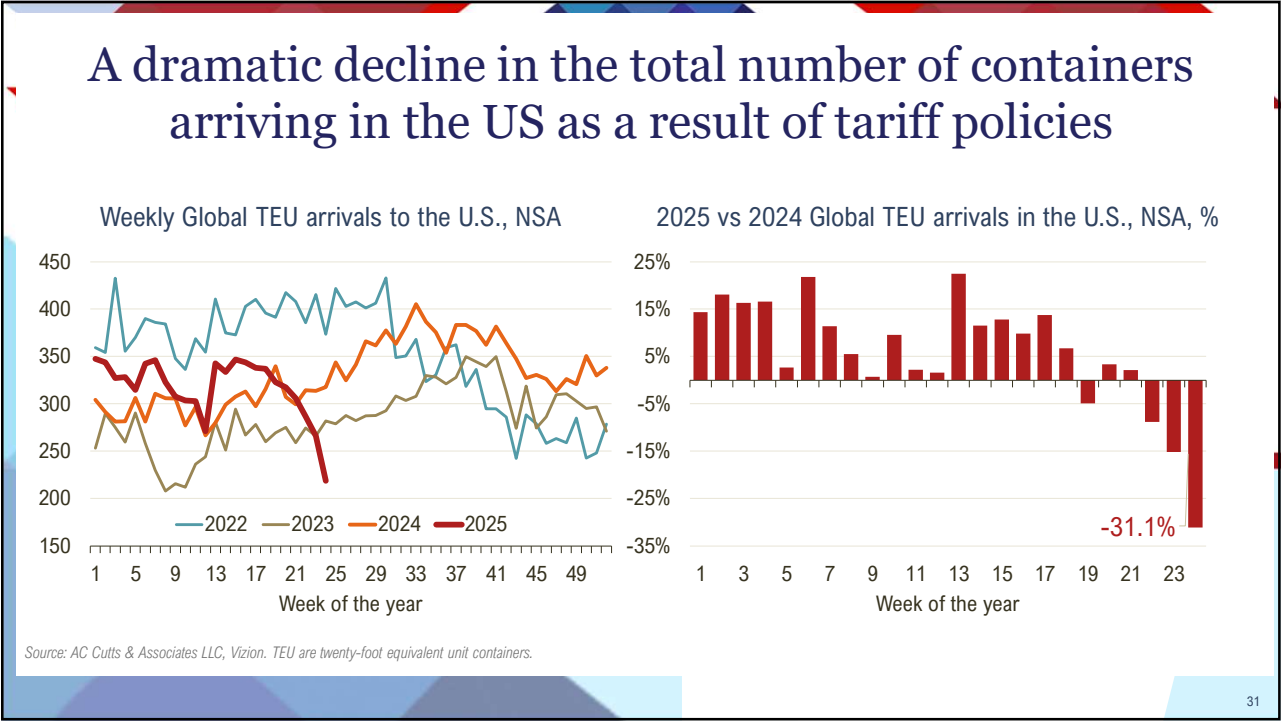
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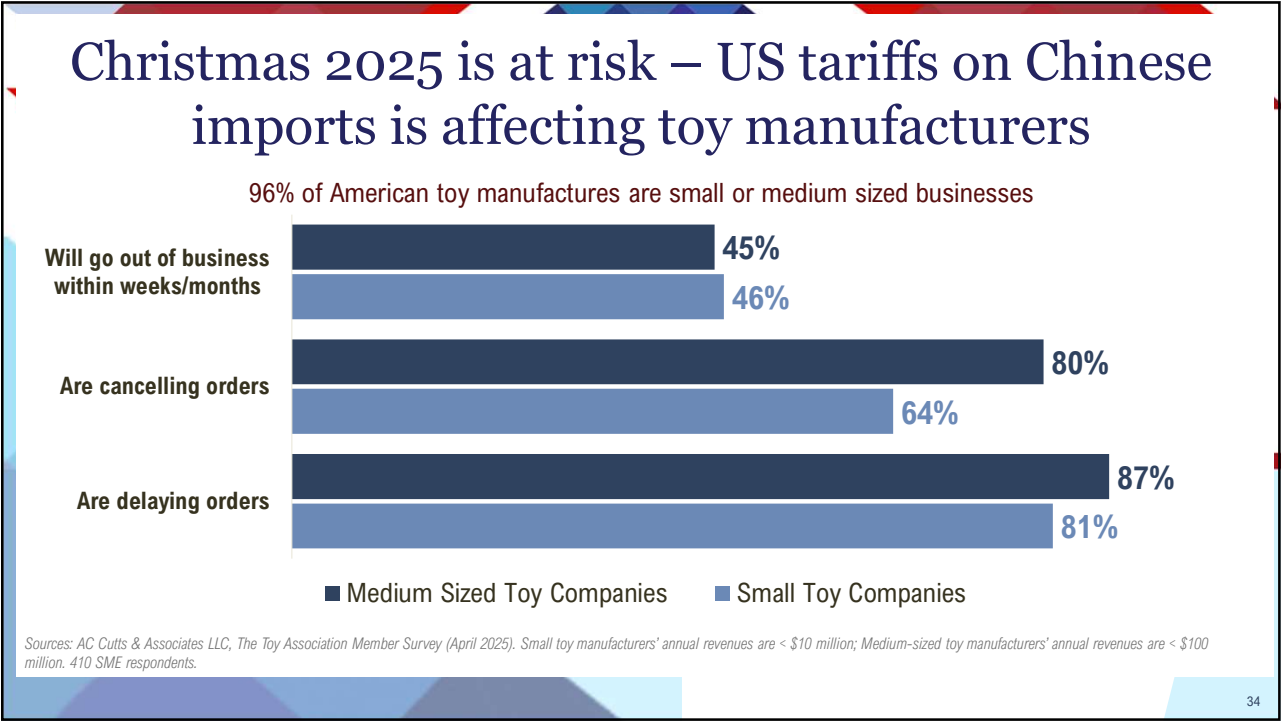
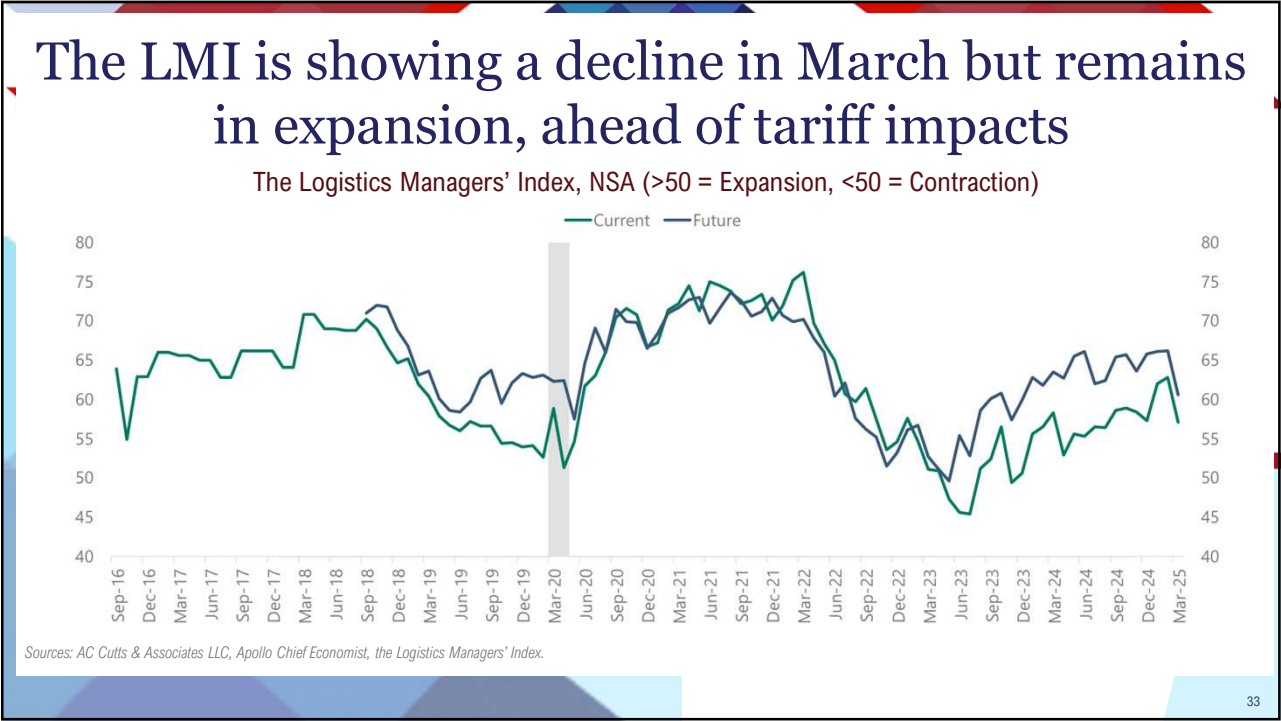
Shipping spot prices have come down but remain higher than normal



Source: Freightos (<https://fbx.freightos.com/>)

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