

Everything is Political...Be Careful

It certainly seems hyper-politicization has come to every piece of economic data. Last week's data are poster children for this. So many overbroad interpretations of the data by investors, the general public, policymakers, and politicians sow confusion.

First, Wednesday's GDP report. The headline was solid, with the real economy growing at a 3.0% annual rate in the second quarter, beating the consensus expected 2.6% pace and rebounding sharply from the 0.5% decline in Q1. Some reacted like the report heralded a new era of prosperity and was a sign that the Trump Administration's policies are successful.

Don't get us wrong, the extension and deepening of the tax cuts enacted in the Big Beautiful Bill (including permanent accelerated business investment expensing) as well as the law's curbs on the growth rate of Medicaid will promote long-term US economic growth. We think the same about efforts to reduce discretionary spending, slimming down agencies, sending workers out of DC, and cutting regulation. But the rebound in economic growth in Q2 wasn't evidence that agenda is already working.

Instead, the drop in real GDP in the first quarter and rebound in the second is largely a reflection of how businesses reacted to the roll-out of tariffs. President Trump promised early this year to raise them. In response, businesses were front-running tariffs in Q1, rapidly filling orders from their foreign suppliers and putting some orders from US producers on the backburner. Because imports are not *domestic* production, they are subtracted from purchases when calculating real GDP. But once higher tariffs actually arrived, businesses slowed orders from abroad and shifted back to US producers. Hence, GDP volatility.

Putting the two quarters together, real GDP was up at a modest 1.2% annual rate in the first half of the year, which is below the 2.0% average of the past twenty years.

Growth at roughly half the rate of the past twenty years then affected Friday's Employment report, and the problem flipped from interpretations that were overly optimistic to ones that could be overly pessimistic, instead. The US economy is certainly not out of the woods when it comes to recession risk. Monetary policy has been tight enough to reduce inflation toward

the Federal Reserve's 2.0% target and is probably still modestly tight today. And a monetary policy tight enough to reduce inflation may also be tight enough to induce a recession, particularly now that the budget deficit is no longer expanding as rapidly as it was in 2023-24. But Friday's jobs report does not by itself signal a recession.

Nonfarm payrolls increased 73,000 in July, lagging the consensus expected 104,000. Worse, payroll gains for prior months were revised down by 258,000, meaning the net *loss* for the month was 185,000. Meanwhile, civilian employment, an alternative measure of jobs that includes small-business start-ups, declined 260,000 in July, helping push up the unemployment rate a tick to 4.2% (4.248%, unrounded). Hence, the widespread negative reaction to the jobs report and evidently cause for Trump to fire the head of the Bureau of Labor Statistics.

But in spite of the weakness in jobs, total private-sector hours worked rose 0.3% in July, as those who were working worked more hours.

Time will tell, but a theory that could explain all this is that stricter immigration enforcement is having a major effect on the job market. The household survey shows that the foreign-born employment is down 1.0 million since January while native-born employment is up 2.5 million. In other words, recent softness in the labor market could reflect fewer illegal immigrants while native-born (and, potentially, legal immigrants) increase jobs and hours worked.

Whatever your view on immigration enforcement, a slowdown in jobs held by foreign-born workers is exactly what we should expect.

There are many moving parts...tariffs, spending cuts, government job layoffs, and immigration reform. Over the next several months we may see more of an impact from slower economic growth on the labor market.

But in the meantime, investors should neither be exuberant nor panicked about the economy. Recession risks remain but economic reports do not show they have arrived. Moreover, if we do get a recession, it is unlikely to be severe. In the meantime, better policies take time to have an impact.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-4 / 9:00 am	Factory Orders – Jun	-4.8%	-4.2%	-4.8%	+8.2%
8-5 / 7:30 am	Int'l Trade Balance – Jun	-\$61.1 Bil	-\$60.9 Bil		-\$71.5 Bil
9:00 am	ISM Non Mfg Index – Jul	51.5	51.5		50.8
8-7 / 7:30 am	Q2 Nonfarm Productivity	+2.0%	+1.9%		-1.5%
7:30 am	Q2 Unit Labor Costs	+1.5%	+2.1%		+6.6%
7:30 am	Initial Claims – Aug 2	222K	220K		218K
2:00 pm	Consumer Credit – Jun	\$7.4 Bil	\$7.0 Bil		\$5.1 Bil