US Economic Update 16 May 2025

US-China Tariff agreement - eases tariff growth headwind, delays Fed cuts

- We have lifted our US economic growth expectations for 2025 (up 0.4ppts to 1.0% on a year-ended basis) following the US-China tariff agreement.
- Uncertainty remains, and the US economy is still facing a major increase in tariffs (not only on China but also the rest of the world). Growth of 1.0% is weak and much slower than 2024. Both the unemployment rate and inflation are still expected to increase.
- We still do not expect the tariff shock to lead to persistently higher inflation, but now expect the Fed to start easing in October (previously July).

US-China tariff cuts

The 12 May agreement between the US and China to significantly reduce bilateral import tariffs, if it holds, means tariffs will weigh less on growth and add less to inflation.

Under the agreement, each country reduced the bilateral tariff rates by 115ppts. In both cases, 24ppts of the reduction is only for a 90 day period pending further discussions. This still means that, this year, the US tariff rate on China imports has increased by 30ppts (with some sectoral differences), and the China tariff on US imports by at least 10ppts. China also agreed to suspend or remove non-tariff barriers put in place since 2 April.

The previous tariff rates were at such punitive levels that they were likely to slow trade between the world's two largest economies to a trickle. In this light, the agreement reduces the risks of major global supply chain disruptions.

The shock to trade policy can be amplified through financial market, sentiment and uncertainty channels. The de-escalation mitigates some of these indirect effects as well, but considerable uncertainty remains.

The pause of reciprocal tariffs above 10% for countries other than China is due to expire on 9 July, the US is in trade negotiations with many countries, section 232 investigations into sectors such as semi-conductors and pharmaceuticals are expected to lead to further tariffs and, US/China tariffs of 24% are only paused until mid-August. This environment will see investment decisions deferred.

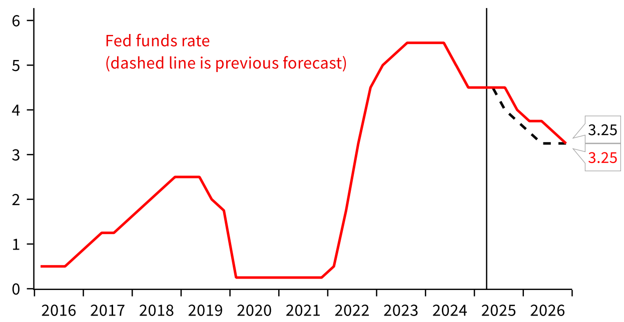
We now see US growth over 2025 of 1.0% (from 0.6%). That remains well below our view of its long-term trend level (around 1¾%) and a large step back from last year (2.5% over 2024). We also see a lower peak in the unemployment rate (now around 4½% down from 4¾% previously) and in core PCE inflation (3½% from 4%).

Our forecasts are based on tariff rates currently in place and forecast error bands remain very wide.

Delaying Fed cuts

The Fed has indicated that it will move cautiously as it seeks more clarity on the balance of inflation and unemployment risks. We had expected rate cuts to commence at the Fed's July meeting, but we now think a more likely start date is the October meeting.

Fed funds rate (top of target range, end quarter %)



Source: National Australia Bank, Macrobond, Account in-house

While the forecast has been lowered, inflation is still expected to rise substantially from here. This leaves in place the risk that inflation expectations de-anchor, a risk that the Fed will seek to lean against. A more modest slowdown and less opening up of spare capacity also leaves more risk of second round effects and also reduces pressure on the Fed to move.

By October, we expect that a weakening in the labour market, with slow rates of economic growth pointing to unemployment remaining above its full-employment level, will see the Fed decide to make its policy settings less restrictive. Once it starts cutting, we still think it will move at a relatively slow pace, with 50bps of cuts in Q4 followed by a further 75bps over 2026 (taking the fed funds rate target range to 3.00 to 3.25%).

There is still a path to earlier cuts (July/September meetings), particularly if the labour market deteriorates more than we expect (both because it would push the Fed further away from its full-employment mandate but also because it would ease concerns about persistent inflation). However, if the economy remains resilient, or there is evidence of broader price pressures, the FOMC may keep rates unchanged for longer. Much will depend on how policy develops – not only tariffs but also the budget reconciliation process underway in Congress (and what it means for FY2026 fiscal settings).

Contact the author:

Tony Kelly	Taylor Nugent
Senior Economist	Senior Economist, Markets
Antony.Kelly@nab.com.au	taylor.nugent@nab.com.au

U.S. economic forecasts

				2024		2025				2026			
	2024	2025	2026	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	year average			q/q%									
Real GDP	2.8	1.6	1.7	0.8	0.6	-0.1	0.5	0.3	0.3	0.4	0.5	0.6	0.6
Note:													
GDP q/q annualised rate				*3.1*	*2.5*	*-0.3*	*2.0*	*1.3*	*1.1*	*1.4*	*1.9*	*2.4*	*2.4*
GDP year-ended %	*2.5*	*1.0*	*2.0*	*2.7*	*2.5*	*2.0*	*1.8*	*1.4*	*1.0*	*1.4*	*1.4*	*1.7*	*2.0*
US Other Key Indicators													
PCE deflator-headline	year -ended %			q/q%									
Headline	2.5	3.3	2.0	0.4	0.6	0.9	0.6	1.0	0.8	0.6	0.5	0.5	0.5
Core	2.8	3.5	2.2	0.5	0.7	0.9	0.8	1.0	0.8	0.6	0.5	0.5	0.5
Unemployment rate - qtly average (%)	4.2	4.4	4.4	4.2	4.2	4.1	4.2	4.3	4.4	4.5	4.5	4.5	4.4
Fed funds rate (top of target range)	4.50	4.00	3.25	5.00	4.50	4.50	4.50	4.50	4.00	3.75	3.75	3.50	3.25

Source: NAB Group Economics.

*Contribution to real GDP growth

Note:										
core PCE inflation y/y%	2.7	2.8	2.8	2.9	3.4	3.5	3.3	3.0	2.4	2.2

Group Economics

Sally Auld
Group Chief Economist
+(61 0) 422 224 752

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Jacqui Brand
Personal Assistant
+(61 0) 477 716 540

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 422 081 046

Michelle Shi
Senior Economist
+(61 0) 426 858 831

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Thao Nguyen
Economist – Data & Analytics
+(61 0) 451 203 008

International Economics

Tony Kelly
Senior Economist
+61 (0)477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Skye Masters
Head of Research
Corporate & Institutional Banking
+(61 2) 9295 1196

Taylor Nugent
Senior Economist, Markets
Corporate and Institutional Banking
+(61 3) 8619 1008 |
Mob: 0452 671 752

Important notice