



ANALYSIS

April 2025

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Economic Outlook Testimony: United States & Rhode Island

UNITED STATES

The outlook for the U.S. economy in the coming year has been downgraded in response to the intensifying trade war. The April forecast now expects that the global trade war will result in a meaningfully weaker economy. Business and consumer confidence have fallen sharply, financial conditions are tightening, and recession risks are high.

The Trump administration has dramatically expanded tariffs on most imported goods, and trading partners are responding. If all of the tariffs announced by the administration are ultimately implemented, the effective tariff rate will increase to an estimated 21.5%. This would be the highest since the early 1900s. Underpinning the current no-recession baseline, however, is the expectation that the Trump administration will de-escalate the war. By next summer, U.S. tariffs on most of the world will largely normalize. Tariffs on China will also fall back, but will remain high compared with where they were before the trade war began.

The extraordinary uncertainty created by the trade war is already weighing on spending, hiring and investment decisions. With tariff policies changing unexpectedly, companies struggle to plan for the future. Investment decisions and hiring plans are being put on hold. Consumer confidence is also flagging.

Equity markets have sold off. This has erased nearly \$10 trillion in market capitalization and household wealth. So-called negative wealth effects, resulting from the decline in stock prices, contribute to concerns over the economic fallout of the trade war. The wealth effect holds that households adjust their spending and saving depending on changes in their wealth. When their stocks, housing and other assets are appreciating in value, households are more confident and spend more. Conversely, when their holdings fall in value, they feel the need to save more and become more cautious spenders.

This negative wealth effect may be more potent now than in the past, as the wealthy are increasingly older and consequently more attuned to their portfolios, which they need for retirement. Stockholdings have also become especially concentrated among households in the top

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part of the income and wealth distribution, and this group is doing an increasing share of consumer spending. If stock prices fail to recover, the wealth effect will reduce consumer spending in the coming year equal to more than 0.5% of GDP.

Increased prices for imported goods will be felt broadly. The higher prices passed on through tariffs are effectively a tax increase, with the typical household required to spend approximately \$2,600 more per year to purchase the same goods if the tariffs are fully implemented. Households are already highly sensitive to inflation given the bout of high inflation suffered in the wake of the pandemic and the Russian war in Ukraine. Consumer inflation expectations have surged as the implications of tariffs on prices have sunk in. This is especially problematic as the higher inflation expectations may mean that the boost to prices caused by the tariffs will not be one-time but may be more persistent.

CPI inflation will accelerate through 2025 as tariffs increase and the labor market remains tight with immigration and labor force growth slowing. Moody's Analytics expects the Federal Reserve to cut the policy rate three times in 2025 from its current target range by 25 basis points each in June, September and December. Then, the Federal Reserve is expected to gradually reduce the rate by 25 basis points per quarter to a neutral level of 3% in late 2026. A recession can be avoided if the Trump administration backpedals on most of the reciprocal tariffs, but near-term job and output growth will be minimal until federal policy stabilizes and uncertainty recedes.

RHODE ISLAND

Rhode Island's economy entered 2025 on a solid footing. Employment growth has moderated in recent months and is underperforming the nation, but remains squarely in line with the Northeast regional average. Job openings remain steady and above their pre-pandemic level. However, the household survey's measure of resident employment shows job losses and the unemployment rate has risen. Through the first half of 2024, this increase was due to strong gains in the labor force, but labor growth is now softening while unemployment continues to climb.

As with the nation, shifting federal policy has dimmed prospects for the state's near-term growth. Rhode Island's industrial mix will provide some insulation from the trade war in that it is not as exposed as the manufacturing-heavy Midwest or South, but it will not be immune. Business costs in Rhode Island are already relatively high and are set to rise further as tariffs make input costs more expensive.

After several years of sturdy growth, healthcare hiring will slow as providers shift toward stabilizing strained finances. The sizable senior population and low uninsured rates relative to the nation create strong demand. However, costs for labor, medical supplies and drugs remain elevated and exceed insurance reimbursement, resulting in diminished or negative hospital margins. Following a string of recent bankruptcy filings and announced restructuring and consolidation efforts, hospitals will prioritize operational efficiencies rather than hiring in the near term.

The state's financial services driver has been struggling under elevated interest rates, but it will turn the corner as the Federal Reserve cuts interest rates further. As the flow of credit picks up, this will improve bank conditions and spur modest payroll growth. Ultimately, however, the extent of the Federal Reserve's ability to resume monetary easing will be constrained by how much inflationary pressure the tariffs create.

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On the consumer side, households face lower housing affordability and higher living costs than much of New England. The dearth of housing supply is keeping housing costs elevated. While homebuilding remains steady and is expected to pick up in the near term, tariffs will make building materials more expensive, placing strain on developers' ability to get more units onto the market. To make matters worse, wage growth will soften as job creation slows. Consumers will be forced to absorb higher prices on essential purchases, but will rein in discretionary spending.

Rhode Island will lose jobs on net over the coming year, and the state's unemployment rate will rise through 2026. Conditions will subsequently improve thanks to an anticipated resolution to the trade war and less restrictive monetary policy.



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