Viewpoint

Our Thoughts

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The Economic Mood in the U.S. Continues to Brighten

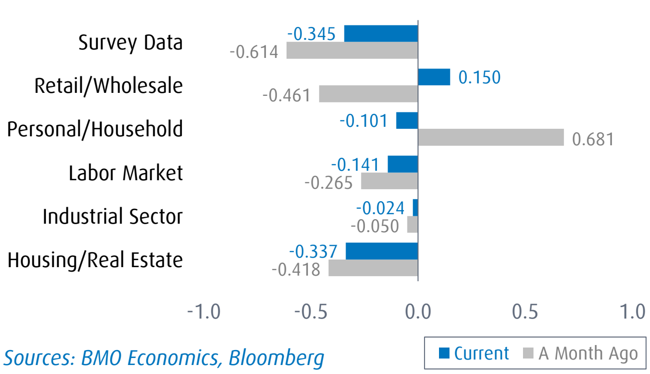
Scott Anderson
Chief U.S. Economist
scotta.anderson@bmo.com

The worst fears over the shock to the labor market and inflation from tariffs have not yet materialized. This is helping to support a rebound in consumer and business sentiment from the lows seen in April and May, despite sizable fresh new tariff threats against many of America's biggest trading partners effective August 1. **Economic surprises, while still net negative, have turned a corner over the last couple of weeks and appear to be leveling off** (*Chart 1*). Compared to a month ago, we have seen improvement in the direction of travel from consumer and business surveys, retail sales, initial and continuing jobless claims, industrial production, and housing (*Chart 2*).

Chart 1
Economic Surprises Turning the Corner
United States (as of July 18, 2025)
Bloomberg Economic Surprise Index

Sources: BMO Economics, Bloomberg

Chart 2
Improvement in the Direction of Travel
United States — July 18, 2025 (std. dev. from normal)
Bloomberg Economic Surprise Indexes



Sources: BMO Economics, Bloomberg

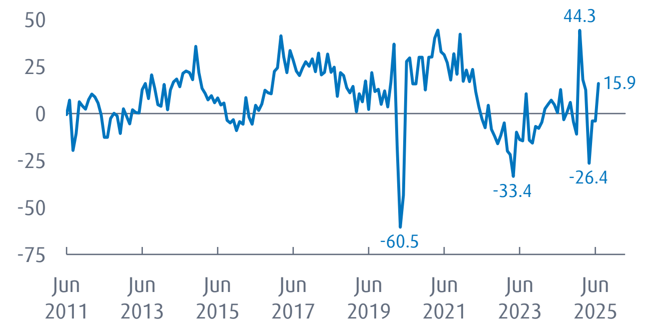
The manufacturing rebound was one of the biggest highlights of the week in my opinion. The Empire State manufacturing index jumped to a positive 5.5 in July, its first positive reading since February. The Philly Fed index made a similar leap to 15.9 in July, its first positive reading since March and highest level since February (*Chart 3*). These upbeat early reports on regional manufacturing activity foreshadow another month of improvement in the national ISM Manufacturing PMI closer to the breakeven level of 50 from a contractionary 49 in June.

June industrial production beat consensus expectations too, increasing at a 4.0% annualized pace, racking up solid monthly gains in primary metals, petroleum products, furniture, machinery, and apparel manufacturing last month (*Chart 4*). U.S. manufacturing production has been on a general upswing since last December, after two consecutive years of general contraction. **The turn to U.S. protectionism and sharp increase in tariff rates on nearly all major trading partners may be having some of its intended effect** of shifting more manufacturing production to the states from abroad. It's still too early to know for sure. The move to cut a percentage point from the Fed funds target rate last year, the weaker U.S. dollar, and two years of languishing production are also likely important contributors to the manufacturing recovery. **Industrial production is on track to increase about 1.6% Q4/Q4 this year, the best performance since 2022.** This week's data increase the upside risks to our call.

Some economists quickly penciled in a recession this year after the April 2nd tariff announcement, but we have never been in the recession camp and so far that has been the right call. **Economic and financial conditions are looking better today than they have in months, but downside growth risks continue to fester in the**

Chart 3
Strong PMI Readings for July

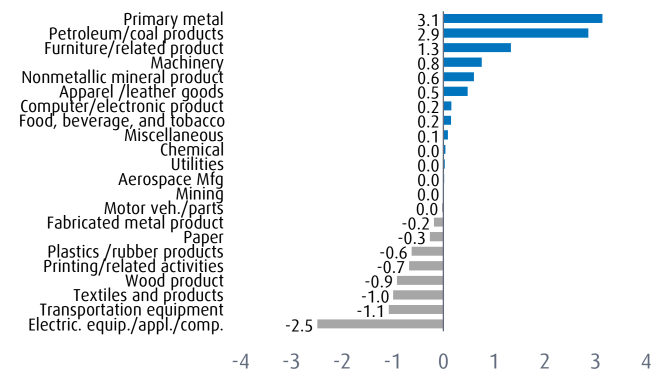
United States (diffusion index : % balance : s.a.)
Philly Fed Business Outlook Survey



Sources: BMO Economics, Haver Analytics, FRB Philadelphia

Chart 4
Metals, Petroleum & Machinery Production Increases

Industrial Production Growth — June 2025 (m/m % chng)



Sources: BMO Economics, Board of Governors of the Federal Reserve System

second half of the year. We will likely see more tariff uncertainty and shocks in just a couple of weeks. The Supreme Court has just greenlighted the President's plans for significant federal government layoffs, and of course mass deportations loom.

Tariff pass-through has been delayed but that doesn't mean it will never arrive. CPI inflation was remarkably mild in the second quarter, rising at only a 1.6% annualized pace. That gave consumers some breathing room to continue spending as real disposable personal income growth firmed and the unemployment rate remained low. But once the tariff shock fully arrives, we think CPI inflation could still significantly increase from the current mild pace. Consumers today are likely stockpiling purchases like businesses have, bracing for the inevitable inflation shock. If so, the spending let down could be just as dramatic when it hits. We welcome the "Good Vibrations" from manufacturers and consumers this summer but recognize the fall and winter could look quite different.

Inspecting Prices for Tariff-prints

Michael Gregory, CFA
Deputy Chief Economist
michael.gregory@bmo.com

June's consumer, producer and import price indices were released this week. We combed the statistics for signs of tariffs. The 'collected' average tariff rate was 9.7% in the month and rising, well above last year's 2.4%.

The CPI for goods increased 0.3% in June or at a -0.4% annualized pace since January (tariffs started increasing in February). Food at home rose 0.3% and 1.4% annualized, with energy commodities up 1.0% but still down 19.1% annualized. Core goods prices increased 0.2% or just 0.8% annualized, as **tariff pressures haven't bubbled to the surface yet**.

But they're there, scattered **below the surface**. For example, among the price categories with high import content, window and floor coverings along with other linens were up 4.2% in June alone. This was the largest monthly move in 27 years of data, which was also the extreme registered by appliances (up 1.9%) and (non-TV) video equipment (up 4.5%). Toys were up 1.8% in June after 1.3% in May, recording the second-largest two-month jump in 48 years of data. But these and other less extreme tariff influenced price hikes were still not widespread enough, or collectively not large enough, to counter the sea of calmer prices elsewhere.

At the factory gate, finished core consumer goods prices were up 0.2% in June and 3.3% annualized since January. The latter is just a little elevated. Further up the production pipeline, for all goods, the impact of higher priced imported inputs is more noticeable. Materials for manufacturing are up 6.1% annualized over the past five months and 17.6% for durable goods. But these pressures have yet to make their way downstream. But **at the border**, imported consumer goods prices (not including automotive items) were up a large 0.5% in June (seasonally adjusted), the second-largest leap in the past 11 years. To what extent will retail prices be influenced?

The impact of U.S. tariffs on U.S. consumer prices is likely being delayed or muted by several factors. Domestic importers and foreign exporters could be absorbing the tariffs via **narrower profit margins**. The duties have evolved in an erratic fashion and are still (barely) in single digits overall. Firms could be temporarily taking the hit until the tariff landscape becomes more stable and the average rate itself becomes more onerous (the recent tariff 'letters' are pointing to above 20%). Meanwhile, this strategy is turning out to be more painful for foreign firms given the depreciation of the U.S. dollar (the narrower margins are being translated into even fewer local currency units).

Imports rocketed to a record high in March, capping a **stockpiling frenzy** to front-run tariffs that saw real imports grow more than 80% since the election. It was going to take some time to deplete these stockpiles, permitting pre-tariff selling prices to persist. Finally, some multinational consumer product companies are using the occasion of U.S. tariffs to **lift their global prices**. As such, U.S. prices don't have to rise to reflect the full impact of tariffs because narrower U.S. profit margins can be offset by wider non-U.S. margins. And raising prices globally also provides some political cover for lifting U.S. prices.

It's uncertain how long these delaying and muting forces can last, particularly amid a rising (collected) average tariff rate. It might still be only a matter of time before consumer prices succumb.

Consumers: What Trade War?

Sal Guatieri
Senior Economist
sal.guatieri@bmo.com

Someone forgot to tell American shoppers there's a trade war going on. After earlier front-running to beat tariffs, retail sales were widely expected to nearly stall in June. Instead, they jumped 0.6% on broad-based strength. The measure that feeds into estimates of personal spending rose nearly as much and is up 5.0% in the first half of the year compared to the same period last year. And, if you think the increase was inflated by tariffs, note that core consumer goods prices have barely risen this year.

While overall consumer spending (including services) has cooled a little, it **remains healthy**—up 2.7% in the five months to May from the same time a year ago. Demand for durable goods is 5.4% higher, led by new automobiles, which partly reflects buyers racing ahead of tariffs. Spending on services (the sector least affected by tariffs) is up 2.2%, weighed down by recreation services (amid soggy consumer confidence) and accommodations (amid fewer foreign tourists). Overall, **consumer spending likely picked up moderately to a 1.6% annualized rate in Q2**—about a percentage point slower than the quarter-century average, but likely good enough to push real GDP forward at a similar pace following the previous slight contraction.

Apart from tariff front-running, several other factors are helping households. Despite less hiring, **unemployment remains low**. Outside the federal government and tech sector, layoffs have been limited, keeping wages flowing. As a result, personal income is up a healthy 4.5% in the past year to May. **Real income growth is solid** at 2.1%, aided by some moderation in inflation amid limited tariff pass-through. Meanwhile, the **rollicking equity market** is juicing wealth. And, don't forget that even though policy rates are moderately restrictive, household debt service costs have plateaued at around 11% of disposable income, which is slightly below the five-year pre-pandemic norm.

Considering that some demand was pulled forward and that the trade war will likely lift inflation and unemployment moderately, consumer spending is expected to slow somewhat in the second half of the year. But this should mark the low point in the cycle, paving the way for an upturn in 2026 as the Fed resumes easing and trade tensions settle down.

Olivia Yong
Summer Intern
olivia.yong@bmo.com

Indications of stronger growth and a move toward price stability are ***good news*** *for the economy.*

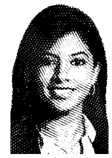
	Good News	Bad News
United States ▪ Consumers remain resilient ▪ Still no major signs of tariff pass-through ▪ Fed likely to remain on the sidelines in July ▪ Pres. Trump plans to place 10% or 15% tariffs on *"well over 150 countries"*	**Retail Sales** +0.6% (June) **Industrial Production** +0.3% (June)—and **Capacity Utilization** +0.1 ppts to 77.6% **Producer Prices** slowed to +2.3% y/y; **Import Prices** -0.2% y/y (June) **Initial Claims** -7k to +221k (July 12 week) **Housing Starts** +4.6% to 1.321 mln a.r.; **Building Permits** +0.2% to 1.397 mln a.r. (June) **NAHB Housing Index** +1 pt to 33 (July) **U. of Mich. Sentiment** +1.1 pts to 61.8 (July P) —and inflation expectations fall	**Consumer Prices** picked up to +2.7% y/y (June) —and **Core** +2.9% y/y (June)
Canada ▪ Stubborn core inflation and last week's firmer job data suggest no July rate cut… ▪ Canada's Prime Minister suggests any trade deal with U.S. to include some tariffs	**Existing Home Sales** +2.8% s.a. (June)—third straight month of improvement **New Motor Vehicle Sales** +5.0% y/y (May) **Housing Starts** +0.3% to 283,734 a.r. (June) **Residential Mortgage Credit** +4.7% y/y (May) **Wholesale Trade** +0.1% (May)	**CPI-Trim** stuck at +3.0% y/y (June)—and **Median** picked up to +3.1% y/y **MLS Home Price Index** -3.6% y/y (June) **Manufacturing Sales** -0.9% (May) **Global investors** sold a net $2.8 bln in Canadian securities (May) **Construction Investment** -2.2% (May)
China ▪ Tariff front-running in the first half of the year masks underlying economic weakness	**Real GDP** +5.2% y/y (Q2)—above expected **Exports** +5.8% y/y; **Imports** +1.1% y/y (June) **Industrial Production** +6.8% y/y (June) **Aggregate Yuan Financing** climbed to 22.8 trln (Jan.-to-June)—and **New Yuan Financing** rose to 12.9 trln **Fixed Asset Investment** rose to 2.8% (Jan.to-June)	**Retail Sales** slowed to +4.8% y/y (June)
Japan ▪ Upper house Sunday election could move JGB yields	**Imports** +0.2% y/y (June)	**CPI ex. Food & Energy** +3.4% y/y (June)—fastest pace since Jan. '24 **Exports** -0.5% y/y (June) **Core Machine Orders** -0.6% (May)
Europe ▪ ECB poised to hold steady next week amid tariff uncertainty	**Euro Area —Industrial Production** +1.7% (May) **Euro Area—Trade Surplus** grew to €16.2 bln (May) **Germany—ZEW Survey Expectations** +5.2 pts to 52.7 (June) **Italy—Consumer Prices** +1.8% y/y (June)	**U.K.—Consumer Prices** picked up to +3.6% y/y (June) **U.K.—Payrolls** -41,000 (June) **U.K.—Unemployment Rate** (3m/3m) +4.7% (May)
Other ▪ Australia's easing labor market conditions bolsters case for RBA to cut in August	**Australia—Westpac Cons. Confidence** +0.6% (July)	**Australia—Unemployment** +2,000 (June)—and **Jobless Rate** +0.2 ppts to 4.3% (June)

Economic Forecast Summary for July 18, 2025

	2025				2026				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2024	2025	2026
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-0.5	1.6	1.5	1.2	1.6	1.6	1.8	1.7	2.8	1.5	1.5
Consumer Price Index (y/y % chng)	2.7	2.5	3.1 ↓	3.2 ↓	2.9 ↓	3.1 ↓	2.7	2.5	3.0	2.9 ↓	2.8 ↓
Unemployment Rate (percent)	4.1	4.2	4.3	4.5	4.6	4.6	4.6	4.6	4.0	4.3	4.6
Housing Starts (mlns : a.r.)	1.40	1.33	1.34 ↓	1.38	1.40	1.41	1.41	1.42	1.37	1.36	1.41
Current Account Balance ($trlns : a.r.)	-1.80	-1.14	-1.14	-1.15	-1.15	-1.16	-1.16	-1.17	-1.19	-1.30	-1.16
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	4.38	4.38	4.29	4.04	3.79	3.54	3.29	3.04	5.15	4.27	3.42
3-month Treasury Bill	4.34	4.37	4.40	4.10	3.85	3.60	3.30	3.00	5.18	4.30	3.45
10-year Note	4.45	4.36	4.40 ↑	4.30 ↑	4.20	4.15 ↑	4.05	4.00	4.21	4.35	4.10
EXCHANGE RATES	(average for the quarter)										
C$/US$	1.43	1.38	1.36	1.35	1.35	1.34	1.34	1.33	1.37	1.38	1.34
¥/US$	152	144	146 ↑	143	142	141	141	140	151	146	141
US$/Euro	1.05	1.13	1.17	1.19	1.19	1.20	1.20	1.21	1.08	1.14	1.20
US$/£	1.26	1.34	1.36	1.37	1.37	1.38	1.38	1.39	1.28	1.33	1.38
CANADA											
Real GDP (q/q % chng : a.r.)	2.2	-0.8	-0.3	1.0	2.1	1.7	1.8	2.1	1.6	1.3	1.3
Consumer Price Index (y/y % chng)	2.3	1.8	1.9	1.8	1.6	2.0	2.1 ↑	2.3	2.4	2.0	2.0
Unemployment Rate (percent)	6.6	6.9	7.2	7.5	7.4	7.2	7.1	6.9	6.4	7.1	7.2
Housing Starts (000s : a.r.)	223	283	248 ↑	247 ↑	240 ↑	232 ↑	225	225	245	250 ↑	230 ↑
Current Account Balance ($blns : a.r.)	-8.5	-67.5	-62.0	-61.9	-59.7	-56.6	-53.5	-50.2	-14.1	-50.0	-55.0
Interest Rates	(average for the quarter : %)										
Overnight Rate	2.92	2.75	2.67 ↑	2.42 ↑	2.17 ↑	2.00	2.00	2.00	4.48	2.69 ↑	2.04 ↑
3-month Treasury Bill	2.85	2.63	2.60 ↑	2.35 ↑	2.10 ↑	1.95	1.95	1.95	4.37	2.60 ↑	2.00 ↑
10-year Bond	3.12	3.21	3.45 ↑	3.40 ↑	3.35 ↑	3.30 ↑	3.25 ↑	3.20	3.34	3.30 ↑	3.25
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	-149	-173	-177 ↑	-173 ↑	-174 ↑	-164	-137	-108	-53	-168 ↑	-146 ↑
10-year	-133	-115	-93 ↑	-90 ↑	-87 ↑	-84 ↑	-81 ↑	-80 ↑	-87	-108 ↑	-83 ↑

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

Key for Next Week



Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

Existing Home Sales

Wednesday, 10:00 am

June (e)	**4.10 mln a.r. (+1.7%)**
Consensus	*4.00 mln a.r. (-0.7%)*
May	4.03 mln a.r. (+0.8%)

Existing home sales are expected to climb again in June amid higher pending home sales. Despite the gain, the housing market has largely remained subdued for the past couple of years. Given still-elevated interest rates and the worst affordability in decades, buyers are largely sidelined. Looking ahead, it's unlikely we'll see a burst of strength in the housing market anytime soon, unless prices come down and/or mortgage rates drop (still stuck just under 7%). — P.T.

Durable Goods Orders

Friday, 8:30 am

	Durable Orders	Core Orders
June (e)	**-10.0%**	**+0.2%**
Consensus	*-10.8%*	*+0.2%*
May	+16.4%	+1.7%

After skyrocketing in May, **durable goods orders** likely faltered last month amid some reversal in the transportation component (Boeing bookings lost altitude in June). Still, the details should be more solid, with orders ex. transportation up for a third straight month, and **core capital goods orders** likely rising further after a large jump the prior month. Meantime, the **control measure of core shipments** is likely to rebound. Overall, the report is expected to showcase that factories are holding up despite heightened uncertainty about trade policies and still-elevated borrowing costs. — P.T.

United States

Monday July 21

10:00 am	**Leading Indicator**	
June (e)	**-0.2%**	
Consensus	*-0.2%*	
May	-0.1%	
11:30 am	13- & 26-week bill auctions $155 bln	

Tuesday July 22

8:30 am	**Fed Chair Powell gives welcome remarks at regulatory conference**
	Fed Speaker: Vice Chair for Supervision Bowman (1:00 pm)
11:00 am	4-, 8- & 17-week bill auction announcements
11:30 am	6-week bill auction $80 bln

Wednesday July 23

7:00 am	**MBA Mortgage Applications**	**30-year FRM**
July 18		
July 11	-10.0%	6.82%
10:00 am	**Existing Home Sales**	
June (e)	**4.10 mln a.r. (+1.7%)**	
Consensus	*4.00 mln a.r. (-0.7%)*	
May	4.03 mln a.r. (+0.8%)	
11:30 am	17-week bill auction	
1:00 pm	20[R]-year bond auction $13 bln	

Thursday July 24

8:30 am	**Initial Claims**	
July 19 (e)	**228k (+7k)**	
July 12	221k (-7k)	
8:30 am	**Continuing Claims**	
July 12		
July 5	1,956k (+2k)	
9:45 am	**S&P Global PMIs**	
	Mfg.	**Services**
July P (e)	**52.7**	**53.1**
June	52.9	52.9
10:00 am	**New Home Sales**	
June (e)	**660,000 a.r. (+5.9%)**	
Consensus	*650,000 a.r. (+4.3%)*	
May	623,000 a.r. (-13.7%)	
11:00 am	6-, 13-, 26-week bill, 2-, 5-, 7-year note, 2-year FRN auction announcements	
11:30 am	4- & 8-week bill auctions	
1:00 pm	10-year TIPS auction $21 bln	

Friday July 25

8:30 am	**Durable Orders**	**Core Orders**
June (e)	**-10.0%**	**+0.2%**
Consensus	*-10.8%*	*+0.2%*
May	+16.4%	+1.7%

Canada

Monday July 21

8:30 am	**Industrial Product Price Index**	**Raw Materials Price Index**
June (e)	**-0.1%**	**+0.5%**
May	-0.5%	-0.4%
10:30 am	**BoC Business Outlook Survey and Survey of Consumer Expectations (Q2)**	

Tuesday July 22

11:15 am	Cash management bond buybacks $0.5 bln

Wednesday July 23

8:30 am	**New Housing Price Index**	
June (e)	**-0.2%**	**-0.9% y/y**
May	-0.2%	-1.0% y/y
Noon	2-year bond auction $6.0 bln	

Thursday July 24

8:30 am	**Retail Sales**	**Ex. Autos**
May (e)	**-1.0%**	**+0.2%**
Consensus	*-1.0%*	*-0.2%*
Apr.	+0.3%	-0.3%
8:30 am	**Manufacturing Sales**	
June A		
May	-0.9%	
Noon	10-year (Jun37 reopening) bond auction $0.5 bln	

Friday July 25

Ottawa's Budget Balance[D]	
May '25	
May '24	+$1.1 bln
Apr. '25	
Apr. '24	-$5.0 bln

[C] = consensus; [D] = date approximate; [R] = reopening

Upcoming FOMC Policy Meetings: July 29-30, Sep. 16-17, Oct. 28-29

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