CRECE
CENTRO PARA RENOVACIÓN ECONÓMICA, CRECIMIENTO Y EXCELENCIA

ROAD TO PROSPERITY NEWSLETTER

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The Center for Economic Renewal, Growth, and Excellence (CRECE, for its Spanish acronym) and Intelligent Economics have partnered to bring you ***The Road to Prosperity Newsletter***. This periodic publication offers concise yet comprehensive economic analyses, providing insights for informed policy decisions that advance free entrepreneurship and economic freedom in Puerto Rico. From industry overviews to policy impacts, each issue is crafted to be an essential source of information with a primary emphasis on Puerto Rico's recovery efforts post-María and post-COVID, complemented by insights into U.S. and global trends.

Markets Under Pressure: How Public Policy Drives Volatility

Understanding the economic ripples of federal spending cuts, and tariffs

Market volatility refers to the rate at which asset prices increase or decrease for a given set of returns. It's a measure of how much markets fluctuate and how uncertain investors feel about the future. High volatility can indicate nervousness, unpredictability, and risk; meanwhile, low volatility suggests confidence and relative calm. Measured by tools like the VIX index ("the fear index"), volatility can spike as a response to war, inflation, or political instability. Also, volatility can spike due to abrupt government action.

The Impact of Public Policy

Public policy plays a decisive role in shaping market expectations. Whether through trade rules or spending decisions, government actions influence labor markets, cost structures, and long-term investments. Therefore, policy that is coercive or interventionist will cause greater distortion in market signals and heightened volatility.

Puerto Rico is not immune to market volatility. On the contrary, our fragile economy and territorial status increases our exposure to the unintended consequences of U.S. policy and the uncertainty it creates.

In the beginning of President Trump's second term, a series of headline policies created deep market tremors. While the stock market showed positive returns during the first six months of 2025, it was also marked by sharp sell-offs, inflation spikes, and swings in investor sentiment. Let's examine two key policies: federal spending cuts, and tariffs.

Federal Spending Cuts

President Trump's administration has proposed sweeping cuts to social programs, research, and disaster relief. Although many of the proposed cuts have not fully materialized due to Congressional pushbacks, their signaling effects have been clear:

- Sectoral uncertainty for firms dependent on federal contracts or grants.
- Reduced economic stimulus in key areas like infrastructure or disaster response.
- Increased volatility in municipal bonds and healthcare-related equities.

Many of the proposed funding cuts would have a disproportionate impact on Puerto Rico due to our heavy dependence on federal funds. **Federal funds (direct transfers to the government and payments to individuals) account for more than 50% of Puerto Rico's economic activity.** In Fiscal Year 2024, the government of Puerto Rico received approximately $11.96 billion in federal grants, and $38.62 billion in individual transfers, including Social Security, Medicare, veterans' benefits, the Nutritional Assistance Program (NAP), and other programs.

Such level of federal support underscores the island's significant fiscal dependency, which has intensified in recent years. Consequently, any reductions in major federal programs would have profound and far-reaching effects on the local economy.

Although fiscal discipline is necessary, erratic cuts intensify volatility. For many years, Puerto Rico has known that overreliance on federal transfers is neither sound fiscal policy nor sustainable economic planning. Present times demand urgent and affirmative action at the state level to unleash free competition, reduce the tax burden, and get rid of excessive regulation. To build a robust and more resilient economic foundation, Puerto Rico must foster a dynamic private sector, encourage local wealth creation, and expand private investment. Encouraging self-sufficiency will make our local economy less vulnerable to the unpredictability of federal policy changes.

Tariffs and Trade Wars

Possibly, the most market moving policies of the Trump administration is the imposition of tariffs across the board to other countries. Tariffs are sparking a global trade war, including retaliatory dues on the U.S. from major trading partners. Some economic effects include:

- Increased input costs for manufacturers and retailers.
- Disrupted supply chains, especially in tech and agriculture.
- Lower global demand due to uncertainty and retaliatory measures.

In the financial market, tariffs are creating both inflationary pressures (via higher costs) and deflationary signals (via reduced global trade). All major financial U.S. indexes (Dow Jones, S&P 500) have swung during each press conference held President Trump on this matter.

As an import-dependent economy, Puerto Rico is facing higher costs on imports such as machinery, construction materials, electronics, and medical equipment, among others. In the end, the implementation of tariffs is creating barriers to free trade, penalizing consumers, and small economies. To lighten the impact of federal trade controls, the local government should implement policies to encourage the diversification of the supply chain, and maximize the use of tariff-free zones, whenever possible.

While tariffs are increasing the cost of goods, they do represent an opportunity for Puerto Rico to expand its manufacturing base, as companies look to reshore its global operations to minimize the impact of tariffs on their supply chains and products. As a U.S. jurisdiction with manufactured goods and components enjoying the Made in the USA label, Puerto Rico is well positioned to benefit from reshoring strategies. At the state level, it is imperative that we advance structural reforms to improve our competitive advantage, including the streamlining of permits processes, reducing the tax burden on workers, and improving our energy infrastructure.

The Link Between Federal Policies and Our Response

The shocks prompted by spending, and trade policies didn't occur in a vacuum. They are the results of monetary policy guided by inflation expectations.

Inflation began to increase in 2022, as result of increased government spending to lessen the effects of the COVID-19 pandemic on the economy, rising wages and tariff-related cost increases. The Federal Reserve responded with a series of interest rate hikes, prompting sell-offs in equities and real estate. For Puerto Rico, higher interest rates meant more expensive borrowing for consumers, lower investment confidence, and increased pressure on the already-fragile public finances.

The result? A feedback loop:
Policy change → Economic shift → Inflation fears → Fed response → Market volatility

What to do

President Trump's economic policies are offering a clear lesson: markets don't fear ideology, they fear unpredictability. **Volatility rises when governments intervene heavily in trade, labor, or fiscal policy without a clear rule-based framework. Market participants can adapt to most environments - like high taxes, low migration, even tariffs - if the rules are clear and consistent. But abrupt, unilateral decisions create systemic risks and damage long-term planning.**

At the state level, Puerto Rico can mitigate volatility through better governance, transparency, and respect for local market dynamics. The state government should resist populist tactics to fix prices, over-regulate sectors, or expand spending unsustainably in reaction to federal cuts.

Moreover, the local government should provide a stable policy environment, offering predictability in tax, labor, and investment regulations to help reduce perceived risk and attract private capital. Lastly, the government should promote competition and private enterprise. Reducing state monopolies and bureaucracy in all sectors – from energy to telecom - can improve service delivery and shield the economy from outside shocks.

In conclusion, public policy should not try to micromanage the economy, restrict trade or labor flows, or create arbitrary winners and losers, neither here nor in the US. Economic freedom and policy transparency are the foundation of stable markets and economic growth.

ECONOMIC INDICATORS UPDATE
Retail Sales Remain Positive in 2025

In April, retail sales totaled $3.4 billion, 1.5% less than in April 2024. On the other hand, from January to April retail sales totaled $13.5 billion, showing a 4% increase compared to the same period in 2024.

Major Categories	Jan-Feb 2024 (sales in millions)	Jan-Feb 2025 (sales in millions)	% Dif.
New and Used Motor Vehicles	$653.1	$615.6	-5.7%
Pharmacies and Drug Stores	$441.0	$460.8	4.5%
Gas Stations and Convenience Stores	$368.4	$353.3	-4.1%
Department Stores	$2,111.7	$2,363.9	11.9%
Restaurants	$449.5	$471.7	4.9%
Supermarkets	$848.4	$861.5	1.5%
Total	**$6,138.3**	**$6,422.7**	**4.6%**

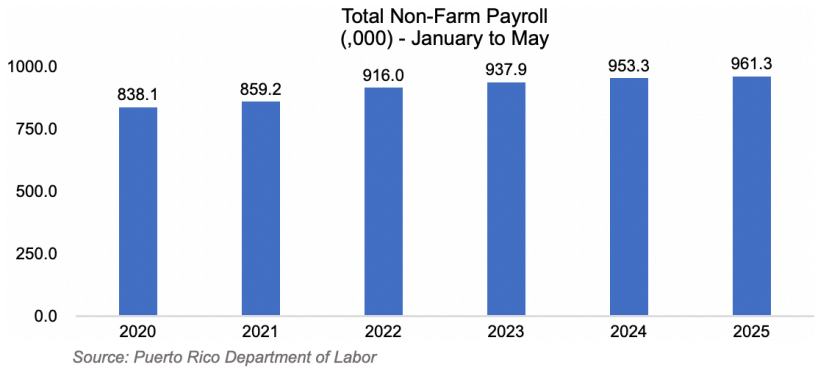
Source: Department of Economic Development and Commerce (DDEC for its acronym in Spanish)

The groups reporting the highest sales increases in April (2025 vs. 2024) were: specialty food stores (+24.5%); hardware and home improvement stores (+11.5%); and pharmacies and drugstores (+6.3%).

The following retail segments reported the most significant declines during the same period: electronics stores (-39.8%); sporting goods, musical instruments, and entertainment stores (-11.8%); footwear stores (-9.2%).

Employment Continues to Increase

From January to May 2025, employment in Puerto Rico averaged 961,300 jobs, an increase of 0.8% compared to the same period in 2024. However, the rate of growth slowed-down compared to the same five-month periods in 2024 (1.6% growth) and 2023 (2.4% growth).



Source: Puerto Rico Department of Labor

Despite persisting concerns about a potential recession in the United States and stagnant sales in certain economic sectors in Puerto Rico, the labor market remains resilient, characterized by strong demand.

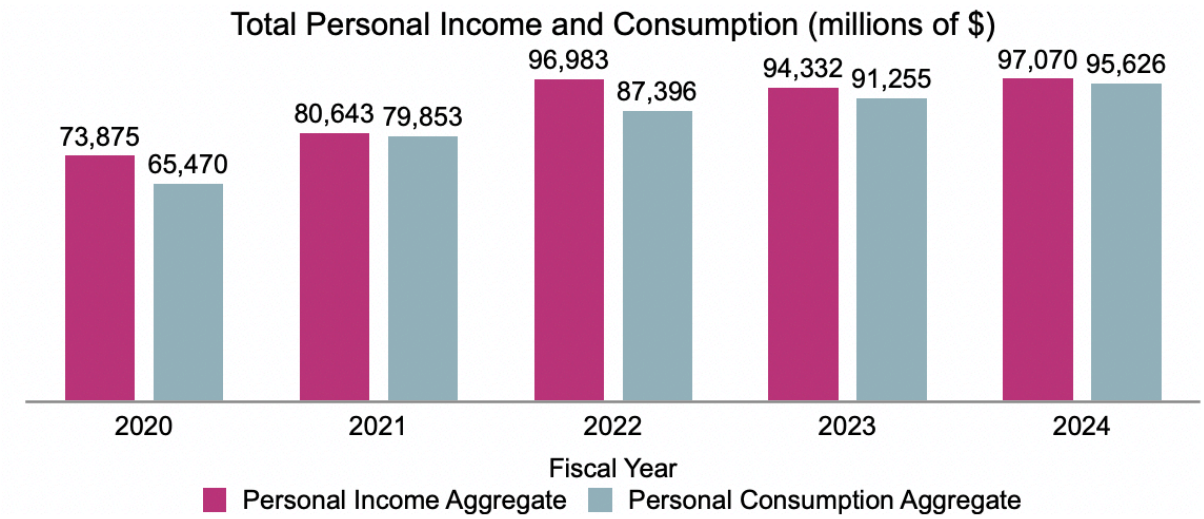
In Puerto Rico, there are currently more than 33,000 job openings. The construction sector alone needs to add 30,000 people to its workforce, while the restaurant and hospitality industries have more than 3,000 job openings. The data underscores a heightened demand for workers across various sectors, due to the economic activity generated by the disbursement of federal funds.

Local Income and Consumption Grew Significantly from 2020 to 2024

Personal income and consumption in Puerto Rico grew significantly from 2020 to 2024. The increase was mainly driven by the unprecedented disbursement of federal funds related to recovery efforts from hurricanes Irma and María, as well as the COVID-19 pandemic. Total personal income rose from $73.88 billion in 2020 to $97.07 billion in 2024—an increase of $23.19 billion or 31.4%. It represents the largest four-year gain on record and underscores the magnitude of federal fiscal stimulus in the local economy.

Prior to 2017, wages and salaries—categorized as employee compensation—were the primary source of personal income in Puerto Rico. However, following the disasters and the implementation of expansive federal aid programs, the structure of income sources shifted dramatically. From 2017 to 2024 more than $34 billion were injected into the local economy through different assistance programs, including direct payments to individuals.

As a result, income from welfare programs became the leading component of personal income. In 2024, the share of income from employee compensation declined to 37.1% from 46.5% in 2014. Meanwhile, the share of personal income from government assistance payments — including Social Security, public pensions, 401(k) withdrawals, the Nutrition Assistance Program (NAP), and other programs — increased to 48.8% in 2024 from 38.2%.



Personal consumption spending showed robust growth, increasing by $30.16 billion or 46.1% from 2020 to 2024. The largest category of consumer spending is Medical Services, which in 2024 accounted for 37.2% of all personal consumption—up from 18.9% in 2014. The dramatic rise is indicative of Puerto Rico's aging population that requires more healthcare services, and the rising cost of medical care, which has accelerated since the pandemic. Other major spending categories include Household Operations (13.2%) and Food (12.1%). Notably, as healthcare costs surged, the relative share of spending in all the other categories declined, highlighting a structural shift in consumption patterns.

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