

Heightened Tariff Volatility Is Slowing Growth

This report is excerpted from the *Third Quarter 2025 Fixed-Income Sector Views*.

Fed easing should commence this fall, with some fiscal boost coming in 2026.

The economic landscape continues to be shaped by heightened policy volatility, with historic swings in tariff policy the main source of uncertainty. Despite declining from its peak, the effective tariff rate remains at its highest level in decades at about 15 percent, acting as a tax on the economy. While the full impact of tariff hikes has yet to materialize, the coming months are expected to bring slow growth and rising inflation as businesses absorb some of the higher tariff costs through lower profit margins and pass the rest on to consumers. While peak uncertainty is likely behind us, there is likely to be continued caution from businesses and consumers. Downside risks may be tempered by the administration's reluctance to maintain policies that could inflict significant economic harm.

Meanwhile, the federal budget, shaped by the One Big Beautiful Bill, should provide a modest boost to growth, primarily in 2026. We expect both consumer and business spending to get a lift from tax cuts early next year. Although the bill contains more cost cutting measures than had been anticipated, concerns remain about fiscal sustainability. Even with a potential boost from tariff revenues, fiscal deficits would exceed 6 percent of gross domestic product (GDP) over the next decade. We see U.S. real GDP growth of slightly below 1 percent in 2025, with a modest recovery in 2026. In the near term, households are likely to experience reduced spending power due to

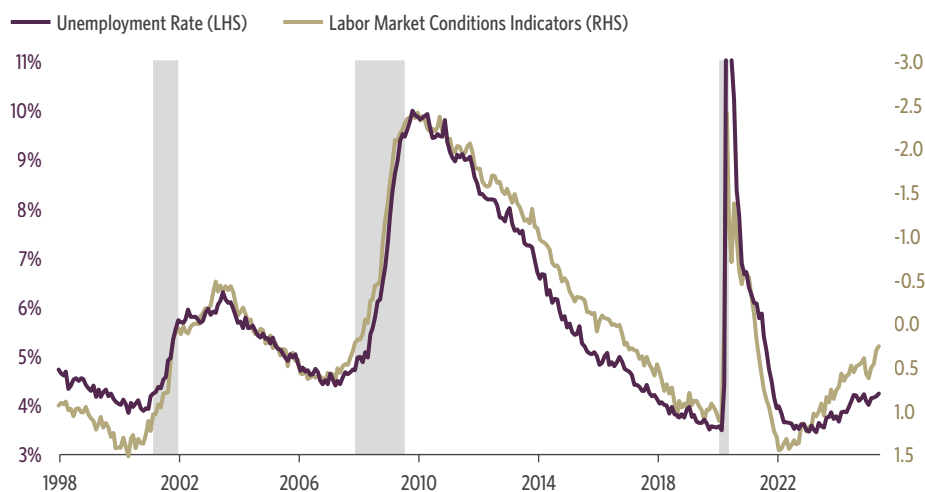
higher prices on imported goods. Indeed, discretionary consumer spending has already seen a sharp pullback in the first half of the year. Business investment is also likely to slow, though AI-related investment remains a notable exception. Weaker consumer and business spending will likely lead to more labor market softening, with unemployment rising to around 4.5 percent by year end.

We see inflation rising above 3 percent by the fourth quarter, driven by tariff-related price increases. However, this is expected to be a one-time boost rather than a persistent trend. Underlying disinflationary forces—such as cooling housing and wage inflation—should eventually prevail as higher unemployment and reduced consumer spending power help contain broader price pressures. The Fed's cautious stance reflects a wait-and-see approach to evolving policy and economic conditions. The Fed might have already been lowering the policy rate again had the uncertainty from tariff policy not been introduced. As some time has now passed, we expect easing to commence later this year as policy certainty increases and labor market weakness becomes more pronounced, with rate cuts accelerating in 2026 to 3.125 percent as the Fed gains comfort that tariff driven price increases will not be an ongoing source of inflation. The Fed is expected to view risks of labor market weakness as a more persistent problem than tariff driven inflation.

By Matt Bush and Maria Giraldo

Easing is expected to commence later this year as labor market weakness becomes more pronounced, with rate cuts accelerating in 2026 to 3.125 percent as the Fed gains comfort that tariff driven price increases will not be an ongoing source of inflation.

A Softening Labor Market Should Prompt Fed Easing Later this Year



Source: Guggenheim Investments, Haver. Data as of 5.30.2025. Gray areas represent recession.

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