

December 23, 2025

2026 Economic Update and Outlook

THE ECONOMY

A resilient consumer, positive investment flows and solid gains in productivity, largely attributed to an expansion of technology, will likely result in a positive but far from impressive 2-2.5% growth profile in 2026. The risk of stagflation amid sticky price pressures will also increase.

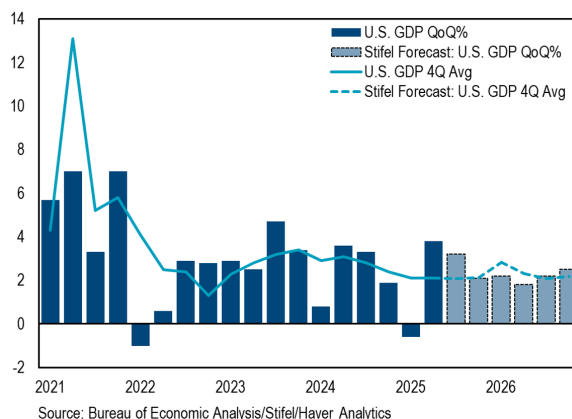
Looking back at the start of 2025, the prospect of restrictive U.S. trade policies lowered growth expectations, and that storyline largely played out in the first quarter as imports jumped nearly 40% in advance of impending tariffs. With more money going out of the U.S. economy, roughly 4.7% was shaved from headline growth, and Q1 GDP dropped 0.6%.

There were welcome offsets in the first quarter from consumption and investment that carried into Q2, suggesting the anxiety about tariffs and other policy adjustments was more of a knee-jerk reaction. After all, businesses don't invest in inventories, which were up \$172 billion from January to March, without a reasonable level of confidence that the consumer will remain strong enough to absorb production.

A rebound in growth to near 4% by the second quarter and an expected pace of over 3.0% in Q3 seemingly discredits any implication of the U.S. being an ailing economy in need of monetary or fiscal policy support.

Going forward, uncertainty remains, and volatility will persist, but a resilient consumer, positive investment flows and solid gains in productivity, largely attributed to an expansion of technology, are likely to result in a positive but far from impressive 2-2.5% growth profile in 2026. The risk of stagflation amid sticky price pressures will also increase.

The risk of recession remains very real at roughly 20% for the U.S. and 30% globally over the next 12 months. The Federal Reserve is hyper-focused on maintaining positive growth and avoiding a downturn in activity. The biggest risk factor for the domestic economy is not a recession, but a period of stagflation. The Fed has been persistently tolerant of above-target inflation for years, which could choke off upside potential growth and result in a non-accelerating economy. Many developed and developing nations are already contending with sluggish activity and elevated prices. This situation is particularly alarming to Fed officials as it renders traditional monetary policy tools ineffective because sluggish economic activity calls for lower rates, while at the same time elevated prices call for higher rates. This conundrum manifests in policy paralysis, and the Fed finds itself in a paradoxical, or “*challenging*” scenario, with the downside risks to employment seemingly balanced with the upside risks to inflation.¹



Economic INSIGHT



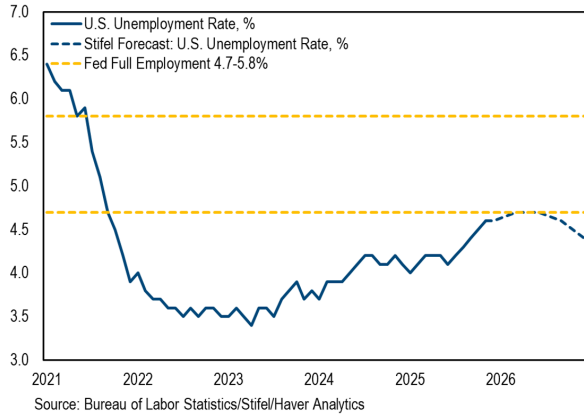
Lindsey M. Piegza, Ph.D.
Chief Economist
piegza@stifel.com



Lauren G. Henderson
Senior Economist
hendersonla@stifel.com

STIFEL

Despite concerns about the economy, inflation and monetary policy, decent gains in the labor market continue to provide support to the U.S. consumer. While hiring momentum has slowed from a more robust monthly average of 168,000 in 2024 to just 55,000 in 2025,² payrolls remain positive and in line with the growth deemed necessary by the Fed to achieve – or maintain – full employment given the aged nature of the recovery. Going forward, with a rise in productivity and increased reliance on technology, a reduced pace of hiring is expected to continue into 2026 nearer 50,000 per month.



The unemployment rate remains nominally low, trending near 4.5% since October 2021. A relatively modest expansion in household employment has been met with equally muted growth of the labor force, which has kept the jobless rate relatively steady.

The minimal upward momentum over the past five months, however, could intensify in the near term, as a modest economic growth profile

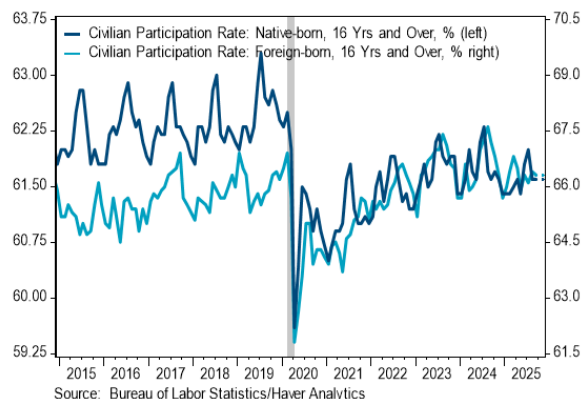
takes shape, tighter immigration policies reduce labor flows, and businesses increasingly utilize artificial intelligence (AI) and other automative programming.

Efficiencies stemming from the adoption of new technologies are having a particularly disproportionate impact on entry-level employees. The unemployment rate of recent college graduates is more than two times the national average.³ That trend is not expected to reverse in the near term.

AI has significantly contributed to improved productivity as well as disinflation, helping businesses to offset the burden of rising costs, particularly labor costs, and spur above-trend, broader based growth. Averaging 1.5% over the past 12 months, AI could add 1.5% to productivity growth each year for the next 10 years and potentially add twice as much for the 20 years after that.⁴ For corporate America, technology has been a cost savings lifeline, but with 80% of tasks potentially automated by 2050,⁵ there will be a sizable displacement factor for current and future labor market participants.

Historically, technological revolutions have been labor-augmenting as opposed to labor-replacing, meaning that while some jobs are lost, new opportunities are also created.

However, this time around, with AI replacing the human component in the production equation, a sizable portion of the working population could potentially be permanently displaced, resulting in a greater reliance on public-sector programs, as well as a material wealth dispersion between those able to participate in the new AI-driven marketplace and those who are not.

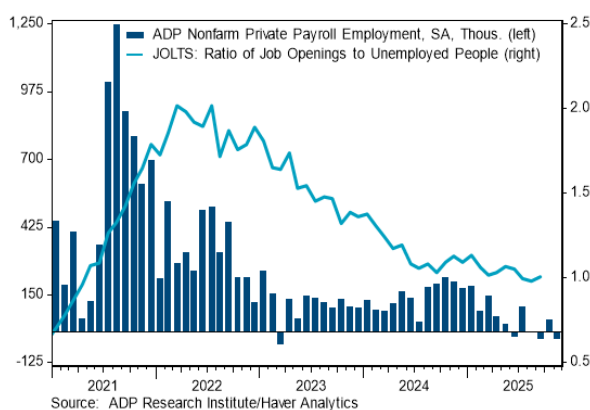


Of course, such displacement comes as the U.S. is facing a sizable demographic challenge. With an aging population and a

lack of upward momentum in the *native* labor force participation rate, still about a full percentage point below the pre-pandemic average,⁶ the vast majority of future growth in the U.S. labor force will expectedly come from immigrants and their children over the coming decades. Yet, according to varying sources, net migration into the U.S. is declining dramatically. Widely expected to fall to just 500,000 in 2025, some sources estimate net migration could be as low as zero or turn outright negative.⁷ And, without immigration, the U.S. population is projected to start shrinking by 2033.

In the near term, the limitation of available workers will continue to prove challenging for sectors understaffed and heavily reliant on immigrant labor, such as agriculture, healthcare and construction.⁸ Fewer workers also mean fewer individuals paying taxes towards social programs. Social Security and Medicare, for example, are already facing solvency issues as they are being increasingly utilized by an aging population.⁹ In the longer run, the review and redesign of U.S. immigration policies will seek to bridge the gap between the need for positive immigration flows to support the job market as well as the need to entice those individuals with the specific skills – math, engineering and coding skills, among others – needed to fill the country’s job vacancies.

Other measures of the labor market, meanwhile, offer additional indications of potential waning momentum that are raising concerns, particularly among Fed officials increasingly focused on the full-employment side of the Fed’s dual mandate. Initial jobless claims, for example, which have been increasingly volatile, dropped to a three-year low and then rose by the most in five years before settling at 224,000 as of late. Continuing claims, or those claiming ongoing unemployment benefits, meanwhile, are still close to the highest level in four years. Job vacancies have declined by nearly five million from an earlier peak

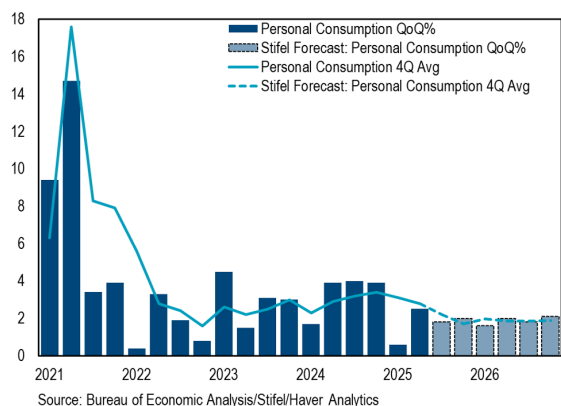
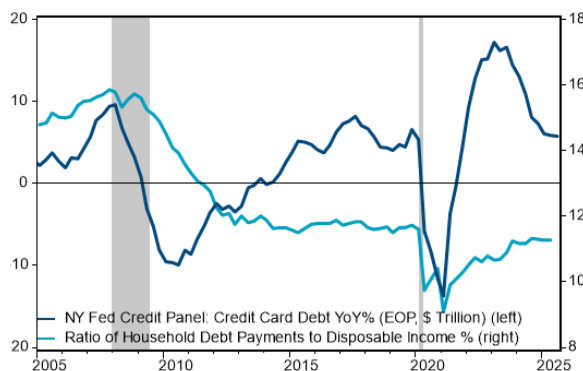


Fed officials as a proxy of the balance between labor supply and demand, rose slightly to 1.007, a three-month high, while wage growth remains solid at a 3.9% average on an annual basis, 70 basis points (bps) above the pre-pandemic trend. The former signals there are now slightly more unemployed people than available jobs, while the latter highlights an ongoing disconnect between the available supply of labor and a higher level of demand. In other words, while hardly gaining momentum, the labor market is a far cry from the worries of a massive deterioration that would force the Fed to take further policy action, at least in the near term.

Longer term, businesses may increasingly turn to technology to close the gap in either instance, although wage growth is likely to remain elevated as long as labor, particularly labor with desired and advanced skill sets remains scarce; nearly 40% of businesses report difficulty attracting and retaining skilled labor, a phenomenon that will expectedly remain in the coming year(s).

Aside from still-solid wages, consumers are increasingly turning to alternatives, including interest earnings, wealth transfers, 401(k) hardship withdrawals, and “*buy now, pay later*” options, to supplement spending behaviors. Savings remain a modest support, as the majority of pandemic savings were spent by the first quarter of 2024. In fact, total excess savings turned negative early last year, indicating consumers spent

all stimulus funds received and then some. Credit cards, meanwhile, remain at the top of the consumer-support list with outstanding balances totaling \$1.2 trillion. Delinquency rates have ticked up, but the still-modest increase remains mostly isolated to those at the lower end of the credit spectrum. And while it is an alarming level of debt, household debt payments as a percentage of disposable income remain near a multi-decade low. This suggests that there is still a good amount of borrowing and, by extension, spending power on the part of the U.S. consumer heading into 2026.



That being said, consumers are not on unshakable footing and continue to suffer the pains of higher prices and relatively elevated borrowing costs. Even with organic and inorganic supports, there has been a loss of momentum, resulting in fewer dollars spent on top of higher nominal debt and rising delinquency rates. Consumers are still spending, but they are doing so at a reduced pace.

Inflation is also complicating the picture as it erodes purchasing power. Higher inflation means consumers are taking home less in return for each greenback spent. Large retailers report customers are becoming more price sensitive, cutting back and more dramatically shifting the goods and services in their baskets each month as the balance sheet is less solid under the weight of higher costs.

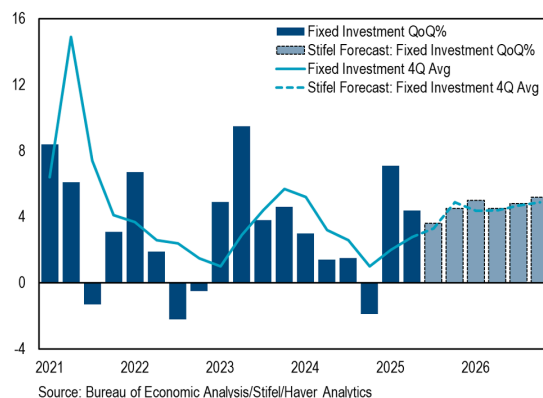
Household balance sheets have grown substantially over the past two and a half years, with the accumulation of over \$31 trillion in net worth resulting from a sizable run-up in asset valuations via the housing and equity markets. That growth, however, has largely been segmented to the upper end of the income spectrum, as those in the middle or lower end are missing out on the run-up in wealth, as they are less likely to own property or have a stake in the equity market. This division, which will likely accelerate into the new year, also perpetuates the prospect of not necessarily a “*K-shaped*” outcome, but certainly an uneven recovery as is historically the case across classes.

Like households, businesses will continue to struggle under the weight of higher prices and elevated costs of parts, materials, rent, and labor. Most of them face a limited ability to pass on rising costs without the risk of losing market share; after years of burdensome price hikes, consumers are already exhausted and unable or unwilling to absorb a further rise in costs, resulting in a muted pass-through rate of tariff-driven inflation and a loss of

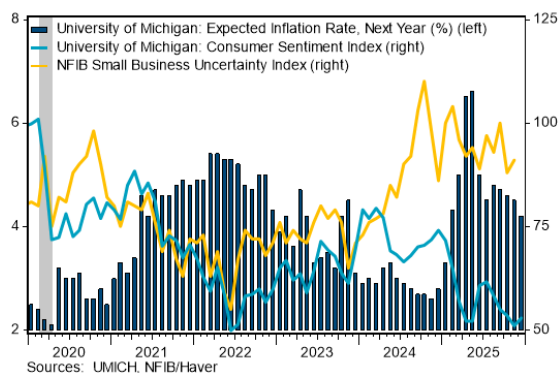
momentum in investment, outside of technology.

Slowing markedly over the past two years, gross capital investment slipped into negative territory in the fourth quarter of 2024. The downward trend was temporarily disrupted in the first six months of '25 as businesses ramped up inventories of production components and front-loaded purchases of everything from aircraft to computers ahead of planned levies.

Averaging quarterly volatility, however, the downward trend remains well established with investment, again outside of technology, likely maintaining a relatively muted pace in the new year as reduced profit expectations from a positive, but more modest, consumer lead to some credit quality problems.



A full pass-through of tariff-related costs could raise inflation by up to 1.5% on an annual basis. Meaning, even a 50% pass-through could result in an eight-tenths of a percentage point increase. The reality thus far has been much more muted, nearer 25% and more recently, a 20% pass-through rate. Although while many businesses were initially able to mitigate the impact of higher prices on the consumer by ramping up inventories ahead of time, or shrinking profit margins to maintain sales volume, at this point, with stockpiles dwindling and broad-based inflation still elevated, additional options or a further willingness to shield consumers appears to be dissipating. In other words, at least some businesses are likely facing increased pressure to pass on additional costs to the end-buyer, raising the risk of a re-acceleration of inflation in 2026 and undermining the Fed's ability to implement a further reduction in rate policy.



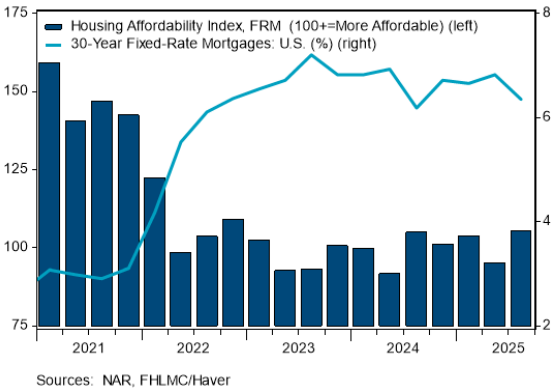
Of course, even with the realized impact of tariffs falling short of earlier expectations, market players continue to anticipate a further backup in prices and more challenging conditions, which should erode confidence for both consumers and businesses alike. Of course, as businesses continue to invest and consumer spending remains stable, both appear to be vocalizing more concern than they are actually

amending behaviors, a disconnect that will likely continue as long as the veil of policy uncertainty remains.

Wreaking havoc on households and businesses, relatively higher rates and prices amid an uncertain environment have created challenging conditions in the U.S. housing market. Elevated costs have for years driven affordability to a near record low, perpetuating a sizable lock-out effect. Particularly for first-time home buyers, the cost of entering homeownership is simply *"too expensive."* At the same time, adjustments in preferences for family formation and child rearing have also impacted demand for homeownership; with the median age for matrimony rising 33% in the last 50 years to 30.8 for men and 28.4 for women¹⁰ and about 50% of women over the age of 30 now without children

for the first time in history,¹¹ many Americans are adjusting, delaying or abandoning the traditional dream of owning a home.

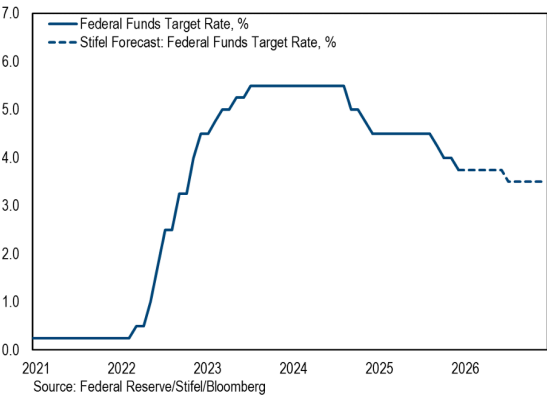
Additionally, with mortgage rates accelerating from near record low levels in 2020-2021, existing homeowners are facing a sizable lock-in effect largely precluding many from offloading their current property for fear of resetting at a significantly higher rate. Even the purchase of a nominally lower-cost asset at a mortgage rate of 6.38% versus sub-3% could result in a higher monthly payment, the burden of which most Americans simply cannot afford.



Of course, even with little reprieve expected for the housing market with the Fed limited in its ability to provide additional accommodation, the biggest risk stems from the commercial side of the market; elevated costs undermine affordability for residential buyers but also *valuations* for investors. There remain trillions in commercial loans coming due in the next one to two years that could reset at relatively elevated rates, driving higher loan-to-value (LTV) ratios. Going forward, the risk is further compounded by the potential resets of earlier years that were temporarily pacified under the expectation of returning to an easy money environment – which has failed to come to fruition. Such pressures, however, could simply get kicked forward if lenders continue to offer extensions beyond 2026.

MONETARY POLICY

Motivated by the fear of mounting weakness in the labor market, the Fed opted to lower its target rate 75 bps in 2025. However, still-nominally-elevated inflation coupled with upside risks to price pressures will further limit the downside potential for policy in 2026 with fresh leadership likely to accelerate balance sheet management.

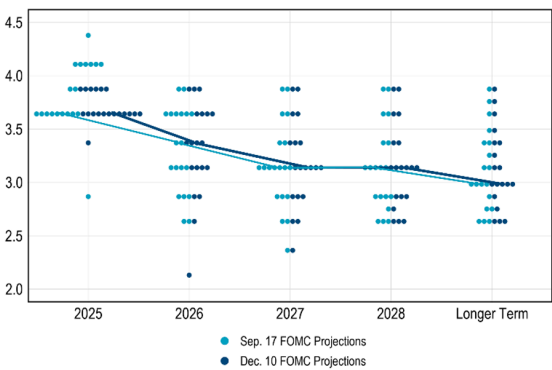


Motivated by the fear of mounting weakness in the labor market, the Federal Reserve Board opted to cut the federal funds target rate three times in 2025 after 100 bps in rate cuts in the second half of 2024. Now 175 bps closer to “neutral” policy in the past four months, going forward, the bar appears to have risen for any additional policy easing. Echoing language used in 2024 prior to taking a pause in rate cuts, the latest December Federal Open Market

Committee (FOMC) statement said the “*extent and timing*” of additional policy moves would depend on changes in the economic outlook. In other words, with no compelling evidence of additional cooling in the jobs market amplified by missing or delayed data, the Committee is likely to cease further rate cuts through at least the first quarter of 2026.

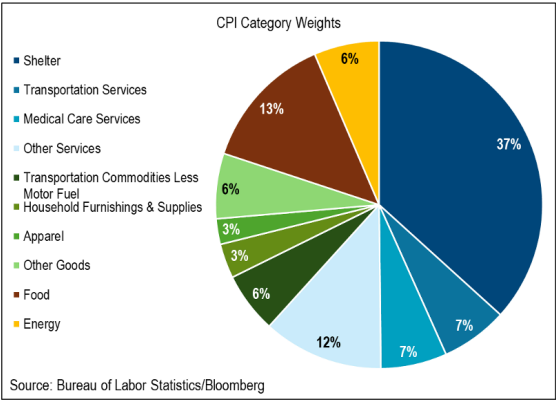
Most Fed officials still anticipate an additional reduction in the target level to an upper bound of 3.50% in the next 12 months. Of course, not all officials are in favor of a dovish pathway; seven members anticipate no further easing in policy in 2026. Coupled with a

rising number of dissenting votes along the way, such a divergence in outlooks underscores the growing divide between those concerned about a lack of momentum in hiring and those still focused on lingering price pressures. It further highlights the trepidation among at least some members of the Committee that any further policy easing could risk an acceleration in price pressures.



Source: Federal Reserve/Bloomberg

The pace of inflation has greatly improved, which is to say the rate of ascent has slowed markedly from earlier peak levels in the aftermath of the COVID pandemic, but it remains materially above the Committee’s longer-run target of 2%. The latest data appear to imply conflicting trends heading into 2026: After accelerating for two months, headline consumer prices, for example, cooled in November to 2.7% with the core Consumer Price Index (CPI) declining to 2.6% after remaining stubbornly above 3% since July. Producer prices, meanwhile, have shown a greater level of improvement, at least excluding food and energy costs, with the core Producer Price Index (PPI) dropping to the lowest reading (2.6%) since June, while the headline PPI has remained stubbornly fixed at 2.7% since April. The Personal Consumption Expenditures (PCE) price index, on the other hand, the Fed’s preferred measure of inflation, accelerated to 2.8% in September, the largest gain since April 2024, with the core PCE holding steady at 2.8% for the second consecutive month. Going forward, inflation is likely to remain notably above the Fed’s 2% target at 2.5-3.0% in 2026, with the Committee unable to reach its 2% goal until 2028 or beyond.



Source: Bureau of Labor Statistics/Bloomberg

While tariff-driven inflation has been the dominant cost-based fear, goods prices have risen an average 0.2% a month from April to September, while services costs have gained 0.3% with key components such as apparel, transportation, and gasoline rising between 0.7% to 4.1% in September.¹² Averaging 0.3% on a monthly basis, housing services costs alone rose 3.0% year-over-year in November following a 3.6% rise in September. Given the large

contribution to the CPI calculation, at nearly 36%, it will be difficult to see more meaningful improvement in broader measures if shelter costs remain elevated. More recently, Fed Chairman Jerome Powell noted an improvement in housing services inflation and, more importantly, an expectation of a further reduction.¹³ Without offering a catalyst for such a reprieve, the assumption is that there will be a significant reduction in demand, potentially from reduced immigration flows or an increase in new construction (supply) stemming from more favorable growth, lower rates, or reduced regulatory environment.

AI remains an inflation wildcard. It raises efficiency and lowers production costs, resulting in slower price growth or an outright reduction in costs. At the same time, there is also an inflationary component with rising demand for infrastructure and AI services, along with a sizable cost associated with substantial energy use that can feed directly into CPI

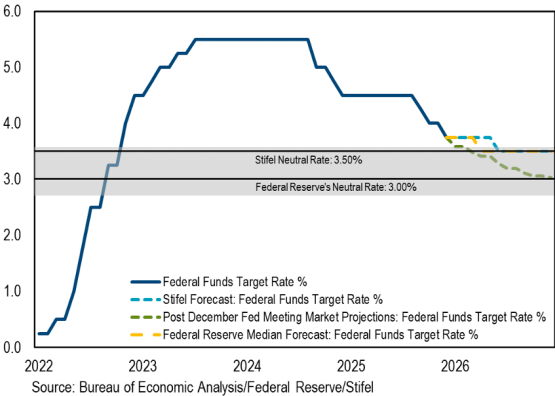
categories, such as utilities that are already up 9.1% over the past 12 months and 50% since 2020.

For officials of a more dovish persuasion, a still-elevated pace of inflation is not cause for concern or seen as a failure of policy but rather a reason to celebrate. With the PCE specifically oscillating around 3%, or otherwise in the broad vicinity of the Fed’s 2% target, and even further below more dire Street predictions of inflation jumping as high as 5% or 6% amid massive alterations to international policy, specifically tariffs, some

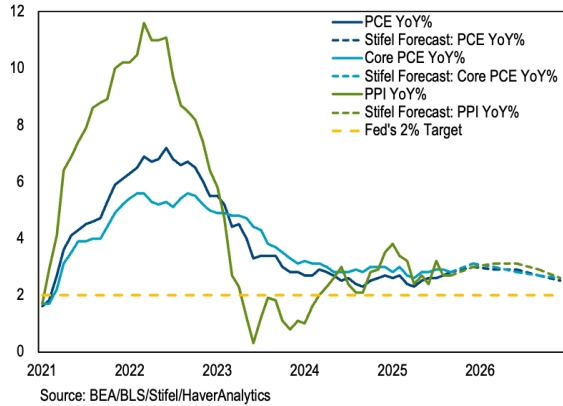
argue the Fed has successfully achieved a soft landing scenario amid a “good enough” assessment on the inflation front. As Powell noted during the December press conference, while all Fed officials agree inflation is too high and needs to come down, the dovish argument contends that the relative improvement has been enough to not only justify earlier rate cuts but warrant additional reductions in the target level going forward.

On the other hand, while the inflation data are not uniformly rising to higher ground, the lack of broad-based disinflation should continue to give the more hawkish-leaning members cause to support a sustained pause in any further policy adjustments, resulting in, at the very least, more amplified commentary, a growing divergence in rate forecasts and/or additional dissents against future proposed rate cuts in 2026.

Taken together, a solid growth profile coupled with still-elevated inflation will presumably limit the broader downside potential for rates, resulting in as few as one additional 25-bp cut over the next six months. Unless inflation unexpectedly and meaningfully decelerates or the employment picture unexpectedly deteriorates, there is little justification, let alone a sense of urgency, to further reduce policy. Thus, rates are likely to remain above expectations, potentially disappointing investors; anticipating further reprieve and/or



towards maintaining full employment. Going into 2026, upside inflationary pressures will presumably accelerate amid a stronger end-of-the-year growth profile, a pickup in consumer activity with still-positive wage growth and relatively reduced fiscal policy unknowns, and/or a more aggressive pass-through ratio of tariff-related costs previously absorbed into the bottom line of corporate America, retarding the Fed’s ability to cut rates even if the desire to do so remains a prevalent line of thought among members and/or incoming leadership.

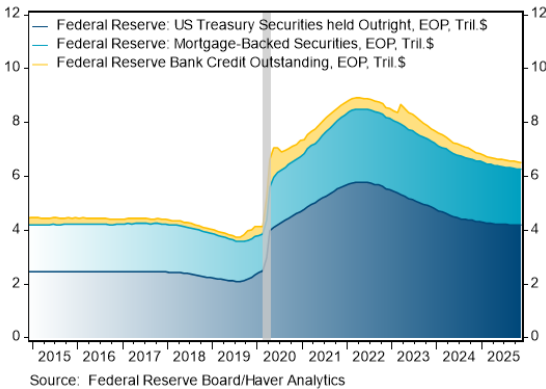


capitulation to external pressures, the market is pricing in at least two additional rate cuts in the coming 12 months, albeit a reduced forecast from a peak prediction of three in October.

Both sides of the Committee continue to recognize a balance of risks to the Fed’s dual mandate, noting job gains have “slowed” and inflation remains “somewhat elevated.” However, it is clear that over the past four months, the Fed’s focus has shifted

At the very least, the increased division within the Committee has and will continue to impact expectations of future rate cuts, as well as market liquidity conditions. Concluding Quantitative Tightening (QT) as of December 1 with a balance sheet of \$6.5 trillion, the Fed will now revert to asset purchases, a mini-version of Quantitative Easing (QE), to counteract a rise in market rates and prevent reserves from falling (further).¹⁴ According to the December FOMC statement, the Fed will initiate short-term Treasury purchases on an ongoing basis, adding a dovish twist to an otherwise hawkish cut at year-end.

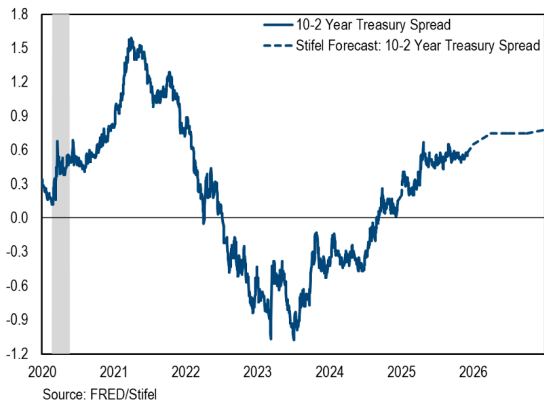
Beginning with \$40 billion of Treasury bills per month as of December 12, the Fed will expectedly purchase up to \$200 billion by the middle of 2026.¹⁵ Targeting the entirety of the short end of the yield curve with purchases extending to other Treasury securities with remaining maturities of three years or less, “if needed,” the Fed’s latest balance sheet management initiative is effectively a form of Yield Curve Control (YCC). Additionally, while seemingly a



sufficient target to replenish reserves in the near term, it will also expectedly play a role in financing the deficit if purchases are continued beyond April 15. Finally, given the direct link between T-bills and the federal funds rate, Treasury purchases will essentially act as a “shadow rate cut” and could limit a rise in yields across the curve.

Less dependent on whether or not the Fed moves forward with additional policy easing in the coming months, the longer end of the yield curve will expectedly face a floor set by the reality of still-heightened price pressures and a massive expansion of the government’s balance sheet to over \$38 trillion, as well as upside pressure the faster the country’s debt burden grows and the longer inflation remains unchecked above the Fed’s 2% target, potentially accelerating inflation expectations, already persistently above 4% for the past 11 months.¹⁶ While such structural adjustments would seem to support a backup in the 10-year to as high as 4.75-5.00% in the new year, for at least the near term, more aggressive balance sheet management by the Fed could reduce the ceiling on the 10-year high to a more modest 4.40%.

Meanwhile, the shorter end of the yield curve will expectedly follow along with movements to the Fed’s target rate and asset purchase program; buoyed lower by any expectation of further easing, should additional Fed action fall short of market expectations as



predicted, shorter-term yields could back up *slightly* to reflect a relatively higher federal funds target rate reality while facing a ceiling resulting from QE. Nevertheless, with the pronounced movement anticipated at the longer end, the resulting shape is expectedly a more normal, steeper sloping yield curve, a welcome scenario for financial institutions.

Of course, while the Fed is increasingly likely to pause and proceed carefully with any policy adjustments in 2026, the

bar for an outright reversal in course remains relatively elevated. With the Fed's preferred measure of price growth trending well above 2% for years, this is clearly a Committee willing to tolerate above-target inflation. Thus, only a persistent and meaningful backup in inflation towards 4% with expectations of ongoing or further upside momentum would prompt consensus support for returning to rate hikes.

The divide among policy officials is likely to intensify with the imposition of new leadership in May 2026 when Powell's term as Chairman of the Federal Reserve concludes. According to reports, the White House may settle on a succession choice in the coming weeks, but a formal announcement is not expected until early next year. The short list is said to include current White House National Economic Council Director Kevin Hassett, former Federal Reserve Governor Kevin Warsh, and current Federal Reserve Governor Christopher Waller.

Hassett has been at his current position since the start of the year, but served as the Chairman of the Council of Economic Advisers during President Trump's first term (2017-2019). Prior to working at the Trump White House, Hassett was an economist at the American Enterprise Institute following a stint as a senior economist at the Fed's Board of Governors. From a policy standpoint, Hassett is also viewed as aligned with the President's push for *significantly* lower rates.

Warsh, meanwhile, served as a member of the Federal Reserve Board of Governors from 2006-2011. In 2017, he was viewed as a top candidate for Fed Chairman, which was ultimately filled by Jerome Powell. Prior to serving on the Fed, Warsh worked on Wall Street but left his position in 2002 to serve as the special assistant to President George W. Bush on economic policy. Warsh studied public policy with an emphasis on economics and statistics at Stanford University and later went on to attend Harvard Law, focusing on the intersection between law, economics, and regulatory policy.

Finally, current Fed Governor Christopher Waller has served as a member of the Board of Governors since December 2020, filling an unexpired term ending on January 31, 2030. Prior to his role on the Board, Waller served as a professor and Chair of Economics at various universities, including the University of Notre Dame, the University of Kentucky, and Indiana University before moving to the Federal Reserve Bank of St. Louis in 2009 where he served as executive vice president and director of research. Waller earned a B.S. in economics from Bemidji State University, along with an M.A. and a Ph.D. from Washington State University.

While the chairman holds only one vote, just like the other members of the Committee, leadership can add a persuasive tone to the conversation and analysis in determining the correct or most appropriate pathway for policy. Furthermore, the unspoken divide between monetary and fiscal policy has seemingly dwindled from a historically firm wall to a fairly translucent sheath. Powell himself came from the Under Secretary of the Treasury to the Fed, former Chairman Janet Yellen went from the Fed leadership to the Treasury Secretary, and more recently, Governor Stephen Miran is taking a leave of absence from his role at the White House¹⁷ while serving out his term on the Board.

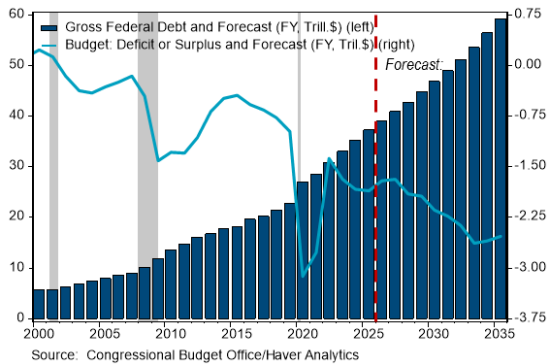
While additional reforms during the 1990s were formally enacted to enhance central bank independence and shield the Committee from political pressure, the revolving door between the federal government and the Federal Reserve raises concerns of political influence, particularly amid an administration that vocally self-identifies as a critic of the Federal Reserve with a persistent call for less restrictive policy. Unfounded concerns aside, Committee members have always based policy on how best to achieve the Central Bank's legally mandated objective of stable prices and full employment, rather than politics.

Hassett, Warsh, and Waller all proclaim to be pro-growth economists and will expectedly support a monetary policy pathway seen as promoting investment, job creation and growth.

FISCAL POLICY

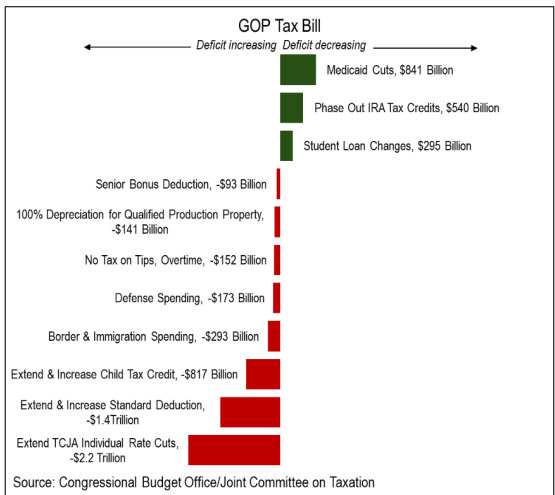
Mounting debt levels, rising budget deficits and uncertain international policies carried into the new year will limit the potential for new legislative initiatives and continue to reshape market expectations for higher longer-term rates, risk additional inflationary pressures, and further complicate the Fed’s pathway towards price stability.

Massive growth in government debt has resulted in a balance sheet surpassing \$38 trillion. With annual budget deficits running near \$1.8 trillion becoming commonplace, the deficit-to-GDP ratio has climbed to around 6%, more than double the historic norm. Mounting debt levels and rising budget deficits carried into 2026 will continue to reshape market expectations for higher, longer-term rates and risk additional inflationary pressures, further complicating the Fed’s pathway towards price stability.



Such a legacy of debt was amassed over decades and administrations. Policies implemented to combat recessionary cycles, the financial crisis, and a forced economic shutdown, not to mention accommodative tax cuts and involvement in international conflict, led to the fastest expansion of the government’s balance sheet on record. As a result, the U.S. continues to head towards a “*debt trap*” in 2026 and beyond that risks tamping down growth as funds are diverted away from investment to cover the higher costs of servicing existing debt. In other words, debt begets more debt. Additional easing by the Fed and balance sheet management initiatives may ameliorate the burden of interest payments but further compound the risk of stagflation.

The balance of debt is further intensified by new initiatives from the White House. Arguably a necessary step to jumpstart the economy and provide support to the consumers and businesses struggling under the weight of years of elevated inflation, the latest legislation, the One Big Beautiful Bill Act (OBBBA) comes at an estimated cost of \$3.4 trillion.¹⁸ That is a sizable price tag, albeit a drop in the proverbial debt bucket. Making permanent¹⁹ the



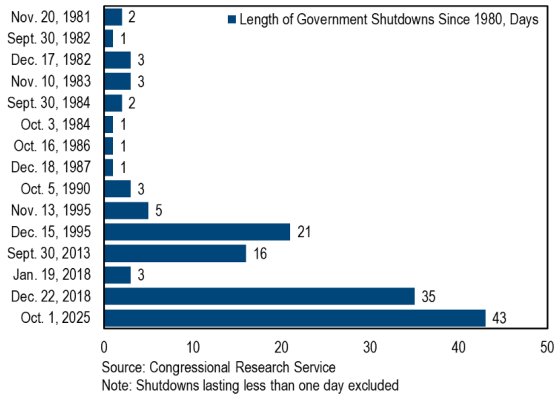
2017 landmark tax cuts implemented under President Trump’s first term, the key “*virtue*” of the bill is arguably consistency, as well as avoiding a reset of tax rates at a higher level. More money in consumers’ pockets is a welcome stimulant for the economy, but not necessarily inflationary. As opposed to a nominal reduction in rates, the expected “*windfall*” is relative and will likely do more to maintain the current levels of expenditures than significantly increase spending into year-end or further into 2026,

particularly given the swelling burden from already elevated prices and the propensity to increase savings amid challenging economic conditions. Additional spending initiatives, including tariff rebate checks or universal basic income programs, among other proposals, however, would expectedly spur an outright increase in expenditures and prove inflationary, while a reduction in outlays, including cuts to Medicare and SNAP benefits, could equally prove disinflationary while increasing the burden on state and local governments.

The OBBBA also included carveouts for businesses, particularly small businesses, with accelerated depreciation. Included in the 2017 legislation, the five-year time horizon arguably stunted the impact. This time around, with the act permanently allowing businesses to deduct 100% of the cost of qualified property in the first year,²⁰ the provision is likely to prove more stimulative, boosting capital expenditures on machinery and equipment, which has been lagging behind technology (AI) investment and adoption over the last year.

At the same time, the Trump administration has reiterated a focus on reducing fraud and government inefficiencies. Broadly, a reduction in waste could potentially offset a loss of government revenues anticipated with an expiration of the 2017 tax cuts at the end of 2025 and soften any inflationary impact from the OBBBA or tariff-related policies, as well as add to longer-run growth. Department of Government Efficiency (DOGE)²¹ has reportedly cut just over \$200 billion from the government budget, approximately 3.1% of the total federal budget (\$7.0 trillion), and 3.5% of the budget without defense (\$6.2 trillion). While falling short of preliminary estimates of \$1 trillion or more, a renewed focus on reducing government waste in 2026, resulting in a smaller, more efficient government, could easily add several tenths of a percentage point to headline growth on an annual basis.

In 2026, the biggest fiscal gambit remains a FY 2026 budget. As the September 30 deadline passed this fall without an agreement, the U.S. government entered a 43-day shutdown, the longest on record. Eventually it ended with a measure that provides full-year funding for Agriculture, Military Construction and Veterans Affairs, appropriations for the legislative branch, and continued funding for other agencies through January 30.



Thus, the next fiscal policy deadline – and potential budget showdown – is rapidly approaching. Of course, with the October-November shutdown still fresh on the minds of legislators, and more importantly, their constituents, there may be less of an appetite for another shutdown in early 2026. At the same time, the political climate is unlikely to be significantly improved, given the main ask for health care extensions remains, and the fallout from another government shutdown is likely to be notably less, as the November 13 spending bill safeguards many agencies, branches, and key programs. That being said, with midterms also rapidly approaching, a lack of short-term action and/or stimulus from the White House and the administration’s allies could result in additional backing for Democrats if constituents view elevated or rising inflation and unemployment as a catalyst to shift support.

The immediate impact of a shutdown is largely felt by government workers being furloughed or laid off. Additionally, a shutdown – especially if prolonged – can have negative consequences for the broader economy by eroding confidence and realized activity levels, potentially reducing GDP, as well as impacting small business loans, and national parks, etc., at least temporarily. The lasting impact, however, is historically muted; after all, furloughed workers entirely recapture lost or delayed compensation, which typically boosts spending in the immediate aftermath of the reopening more than enough to compensate for the temporary dip during the closure. In 2018, for example, the 35-day shutdown that began on December 22,²² the longest in history at the time, resulted in an estimated loss of 0.3%, which was more than offset by a rise in activity by the second quarter of 2019.

The biggest fiscal wildcard, meanwhile, continues to stem from international policy, particularly tariffs, with countless rounds of levies threatened, amended, delayed, negotiated, and renegotiated. The Trump administration has made progress, striking deals with several countries and removing some degree of uncertainty for market participants. Others, however, are still underway or remain contentious,²³ and most face ongoing legal challenges, putting hundreds of billions of dollars’ worth of tariff revenue at risk.²⁴ Thus, as some deals are still being finalized, the exact impact on the economy still remains unknown, with higher levies both feared and realized, at the very least, continuing to erode confidence and compound *concerns* of further inflationary pressures and additional challenging economic conditions to come in the new year.

Country with Trade Agreement	Date Announced	2024 Tariff Rate	Tariff Rate Before Trade Agreement	Tariff Rate After Trade Agreement
UK	May 8	3%	25%	10%
Vietnam	July 2	5%	46%	20%
Indonesia	July 15	8%	32%	19%
Philippines	July 22	6%	20%	19%
Japan	July 23	4%	25%	15%
EU	July 27	5%	30%	15%
South Korea	July 31	1%	25%	15%
Pakistan	July 31	10%	29%	19%
China	May 12	8%	145%	47%*
Switzerland	Nov. 14	1%	39%	15%

Source: CNBC/United States Trade Representative/The White House
 *Note: The U.S. and China have agreed to a one-year truce, with the U.S. lowering fentanyl tariffs to 10% and suspending a rule blacklisting Chinese firms. China has agreed to resume purchases of soybeans and end export controls on rare earth elements

As the administration’s intentions to significantly increase tariffs on international trade became clear early in 2025, forecasts for inflation rose significantly. While nominally elevated and above the Fed’s 2% target, the impact on inflation fell well short of many Street predictions, largely reflecting the calendar and tiered approach of implementation. Rather than a broad-based, blanket increase, adjustments came in waves or tiers,

often impacting only particular sectors or industries with the latest round of levies on over 90 countries ranging from 10-41% coming into effect only as of August 7. Additionally, in many cases, the reality of changed policy was far less intense or punitive than initial proposals; some trading partners have made deals with the U.S. and negotiated rates lower, such as the UK (10% tariff), Japan (15% tariff), and the EU (15% tariff), while others benefit from exemptions (25% tariff on goods from Mexico and Canada, USMCA goods excluded). Of course, other countries have been unsuccessful in reaching a trade deal, such as Brazil, with most imports from this country now facing a 50% levy.

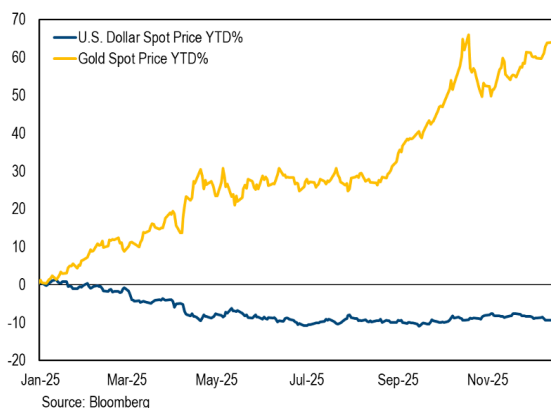
There has also been a dominant theme of a relatively muted pass-through rate of tariff-related costs to the end user. Many firms chose to initially shield consumers from higher prices, either by stocking up on inventories or simply absorbing part, or in some cases, most of the cost increase into the bottom line at the expense of higher margins for fear of losing market share. Looking out to 2026, many companies are facing dwindling stockpiles and compressed margins, raising the risk of additional cost pass-through to consumers, and potentially resulting in further upward pressure on inflation by as much as four-tenths of a percentage point.

Revaluating historical precedents and agreements, many of which have not been altered for years, if not decades, the current administration will continue to test longstanding trade relationships as the global trade landscape is rewritten. Implemented in a more tactical manner, the White House will expectedly continue to use tariffs as a negotiating tactic to not only secure better deals on trade but as pressure to open foreign markets to U.S. exports, secure cooperation in ending illegal immigration and prohibit fentanyl trafficking, ensure access to rare-earth materials, deter military conflict or aggression, and/or encourage allies to spend more on their own defense.

Even with three years remaining until the next presidential election, the market will begin to assess the outlook for international trade in a post-Trump White House environment. Assuming at least some of the current administration's trade policies remain after the 2028 election cycle, the lasting pathway will largely depend on whether the global marketplace chooses to recommit to the historical precedent of trade policies or if pockets of protectionist policies emerge and remain, with some economies retreating into geopolitical trade blocs. With the latter more likely, new relationships or trade alliances are formed throughout the developed and developing world that would continue to foster fluid trade within these coalitions or blocs, but not between them.

Aside from surface-level uncertainty, there are also a plethora of international wildcards that could arise in 2026, any one of which could result in sizable market jitters and extreme movements with investors seeking traditional capital safe havens. Such events could include further aggression from Russia, potentially moving deeper into Eastern Europe, or Iranian retaliation.²⁵ Relations with China could materially decline, threatening access to rare-earth materials amid a greater push to globalize the yuan. There are also the possibilities of a second-round global pandemic or other international health crises with the potential for mutations to any number of existing virus strains, a two standard deviation event that appears slightly more plausible in a post-COVID world.

"Spooked" early on in 2025 by the uncertainty and unknowns triggered by a significant reset in global trade policies, the U.S. dollar lost notable ground, down 9% year-to-date. The recent volatile decline, however, appears first and foremost to be a correction from an earlier, arguably unsupported elevated level. Thus, removing the recent runup to a 22-year high back in 2022, the dollar is simply trading back near the upper range established for the ten years prior. Going forward into the new year, barring international calamity, with the Fed presumably limited in its downside ability to cut rates further, and assuming an ongoing, more muted rollout of additional tariffs and tariff-related responses, including global retaliation, volatility is expected to remain with an ongoing range-bound dollar.



Of course, while the U.S. dollar responds to potential and realized Fed policy movements, gold and bitcoin remain inflation hedges. Rising prices can be interpreted as a mounting fear of still-elevated or potentially rising price pressures amid a more employment-focused Fed. At the same time, gold has also become somewhat of a political barometer whereby a rally – independent of monetary policy – can signal rising uncertainty in fiscal policy –

both domestic and abroad. As such, already up roughly 63% since the start of the year, gold could continue to gain ground into the new year with, bitcoin also facing upside potential.

Lindsey Piegza

Ph.D., Chief Economist

piegza@stifel.com

GLOSSARY

AI – Artificial Intelligence

ADP – Automatic Data Processing

CPI – Consumer Price Index

DOGE – Department of Government Efficiency

EOP – End of Period

FOMC – Federal Open Market Committee

FY – Fiscal Year

GDP – Gross Domestic Product

ISM – Institute for Supply Management

JOLTS – Job Openings and Labor Turnover Survey

LTVs – Loan-to-Value

MBS – Mortgage-Backed Security

NFIB – National Federation of Independent Business

OBBBA – One Big Beautiful Bill Act

PCE – Personal Consumption Expenditures

PPI – Producer Price Index

QE – Quantitative Easing

QoQ – Quarter over quarter

QT – Quantitative Tightening

RRP – Reverse Repo Rate

SNAP – Supplemental Nutrition Assistance Program

USMCA – United States-Mexico-Canada Agreement

UST – U.S. Treasury

YoY – Year-over-Year

YTD – Year to Date

SOURCES

- ¹ “In the near term, risks to inflation are tilted to the upside and risks to employment to the downside — a challenging situation,” Chair Jerome Powell noted at the December press conference.
- ² Nonfarm payrolls have averaged 55,000 from January to November.
- ³ The unemployment rate for college graduates aged 20 to 24 years with a bachelor’s degree or higher stands at a not-seasonally-adjusted rate of 9.5% as of September.
- ⁴ Longer-run projections remain highly uncertain due to a low adoption rate and unknown impact on the current labor force.
- ⁵ Source: <https://www.strategicmarketresearch.com/blogs/ai-replacing-jobs-statistics>; according to the World Economic Forum, 86% of businesses world-wide anticipate AI to have a significant influence on the business by 2030.
- ⁶ The native-born participation rate is at 61.6% as of November, down from the 62.5% average in 2019.
- ⁷ According to the Department of Homeland Security, as of December 10, there have been 605,000 deportations and 1.9 million self-deportations for a total of 2.5 million illegal immigrants leaving the U.S. A study from the Federal Reserve Bank of San Francisco notes migration will be close to half a million people in 2025, down from 2.2 million in 2024, while other sources such as the center-right think tank American Enterprise Institute and the independent policy research group The Brookings Institution estimate net migration to the U.S. could be a negative 525,000 this year.
- ⁸ According to the Federal Reserve Bank of Minneapolis, declining net immigration accounts for 40-60% of the drop in U.S. job growth from May – August 2025. Separately, according to a Pew Research study, as of August, 19% of the U.S. labor force was made up of immigrants, down from 20% and by over 750,000 workers since January.
- ⁹ According to the latest 2025 Trustees Reports and subsequent analyses, the Social Security Old-Age and Survivors Insurance (OASI) trust fund and the Medicare Hospital Insurance (HI) trust fund will both run out of reserves in 2033, and the theoretically combined Social Security Old-Age, Survivors, and Disability Insurance trust fund will run out in 2034.
- ¹⁰ According to the U.S. Census Bureau, the estimated median age at first marriage increased to 30.8 for men and 28.4 for women, up from ages 23.5 and 21.1, respectively, in 1975.
- ¹¹ According to the Census Bureau, about 40% of women ages 30 to 34 were childless in 2024, up from about 29% in 2014.
- ¹² Monthly changes reflect the August to September change as October data was not published due to the government shutdown.
- ¹³ “Good news that housing services inflation has been coming down and is expected to continue to come down,” Chair Jerome Powell noted at the October FOMC Press Conference.
- ¹⁴ Of course, just as purchases in 2019 were not officially recognized as QE, the Fed will presumably again emphasize this is not a QE operation.
- ¹⁵ According to the Federal Reserve’s December 10, 2025, Implementation Note, “Effective December 11, 2025, the Federal Open Market Committee directs the Desk to... Increase the System Open Market Account holdings of securities through purchases of Treasury bills and, if needed, other Treasury securities with remaining maturities of three years or less to maintain an ample level of reserves.”
- ¹⁶ Near-term inflation expectations, or inflation expectations for the next 12 months, from the University of Michigan have been above 4% for the past 11 months.
- ¹⁷ Stephen Miran is taking an unpaid leave of absence from his role as Chair of the White House’s Council of Economic Advisers to serve on the Federal Reserve’s Board of Governors. Therefore, he currently maintains his White House employment status while serving on the Federal Reserve Board.
- ¹⁸ The Congressional Budget Office (CBO) estimated that the “One Big Beautiful Bill Act” (OBBBA) will increase the national deficit by \$3.4 trillion over the 2025-2034 period.
- ¹⁹ At least as permanent as one might expect from Washington policy.
- ²⁰ If acquired and placed in service after January 19, 2025.
- ²¹ DOGE has been disbanded ahead of its scheduled end in July 2026.
- ²² The government shutdown began on December 22, 2018 and concluded on January 25, 2019.
- ²³ As of October 30, the U.S. and China have agreed to a one-year truce, with the U.S. lowering fentanyl tariffs to 10% and suspending a rule blacklisting Chinese firms. China, meanwhile, has agreed to resume purchases of soybeans and end export controls on rare earth elements.
- ²⁴ According to the Treasury Department, the federal government raised \$195 billion in customs duties in FY 2025. However, a potential Supreme Court ruling against the tariffs could force the Treasury to refund nearly \$90 billion in collected revenue, with some estimates suggesting the total could be over \$100 billion.
- ²⁵ In June 2025, the U.S. and Israel launched significant military strikes against Iran’s nuclear program, hitting the Fordow, Natanz, and Isfahan facilities, aiming to cripple uranium enrichment, causing extensive damage and delaying Iran’s nuclear progress.

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