

Inflation Outlook: Tariffs, Trade War, the Treasury, and the Return of the Transitory Debate

Report for the week ending November 28,
2025

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Monologue

The star of this week's note is the Memo. In a longer-than-average edition, we take a detailed look at five significant sources of upside inflation risk. We argue that inflation will rise further from target in 2026, perhaps significantly so.

One question that I didn't have time for in the piece, but which I can offer some thoughts on here, is what the Fed's reaction should be if we're right.

Imagine for a moment that the Fed is less indexed on the labor market than it is at present, and that it does not have an implicit easing bias. Now tell the FOMC that inflation will hit 4% by the middle of next year. A large share of this move is attributable to tariffs, but not all of it; demand has been strong and has contributed.

Should the Fed respond, or should it "look through" the tariff shock? Gird your loins, for we're back in the realms of the "transitory" vs. "permanent" inflation debate.

The direct effect of a tariff on a given imported item on the price a consumer pays for that item (or goods produced using it) is initially transitory by definition. The tariff creates a one-off price increase. For 12 months, the year-over-year inflation rate will incorporate that jump, after which the tariff drops out of the inflation calculation since the numerator and denominator both include it.

This is fine if you're considering a moderate tariff change that is clearly articulated, transparent, and consistent. That's not the world we're in. As we argue in the piece, firms are not dealing with a one-off tariff. They're navigating massive disruptions to global supply chains. They're shifting sourcing, production, and transport arrangements between countries, and often adapting to sudden changes in policy and even market access without warning. All of this is costly, and all of it will drive up both inflation and expected future inflation.

What's more, this is interacting with still-strong demand. Firms have indicated that as they start passing tariff costs onto consumers, they're focusing on high-demand categories. This means that aggregate inflation won't see much in the way of inflation-dampening changes in consumer spending.

All of this points to a sustained period of inflationary pressure, not a short and sharp one-off move. As inflation lingers above target, the Fed will eventually be compelled to respond by cooling demand relative to supply.

Finally, there is a technical but very important consideration for the Fed. Economists agree that it's the real rate of interest (nominal rates less inflation) that matters for policy transmission. When inflation rises, leaving rates unchanged effectively loosens the Fed's policy stance. So to keep treading water as inflation rises, the Fed has to match that increase.

We've already learned this lesson during the 2021–2023 global inflation episode, which many attributed entirely to supply-side shocks—supply chain logjams and a sharp rise in energy prices. In the end they were right—"transitory" meant 18 months. But the Fed still had to embark on its steepest ever rate hiking campaign, because demand effects were playing a role too, and by not responding, real interest rates were declining rapidly as inflation rose, adding fuel to the fire.

Perhaps we should be grateful for this precedent, as it should give the Fed a fresh framework for navigating rising inflation risk. Based on the majority of the committee's recent statements, however, the evidence suggests they will not.

On that note, I'll sign off with a belated "Happy Thanksgiving" to our US-based clients.

Reads of the Week

- **An Anatomy of the Great Reallocation in US Supply Chain Trade:** Unrelated to the Cavallo et al. tariff paper, but published in the same week and something of a companion piece. "We find that: (i) The US has decoupled from China but not from the world overall. (ii) US imports diversified mainly among its top-20 partners, rather than expanding to new source countries." (plus four more findings).

Warning: The Fed Can't Rescue AI: Paul Krugman reflects on the dotcom bubble and long-term unviability of the "Fed Put."

How Much Does AI Rhyme with shAle?: Carlyle points out that big tech now has the capital expenditure profile of energy companies.

Market Monitor

Equity bulls have plenty to be thankful for this week. What's more, they know where to direct their gratitude: directly at the Federal Reserve, or at least the forward markets pricing the odds of their next move.

After two bad weeks, US stocks staged a roaring comeback, posting massive weekly moves. AI-heavy sectors in the S&P 500 that have been under pressure were untethered. Information Technology rose by +4.3% and Communication Services by +5.9%. Equally strong performance came from the Consumer Discretionary sector (+5.3%) and small-caps (Russell 2000 up +5.5%), which is how we know that growing confidence in a Fed cut was behind the week's action. A reminder of just how "blunt" a tool the Fed Funds Rate is.

Interestingly, fixed income went sideways. Even yields on two-year T-Notes were essentially flat, suggesting that bond markets aren't as sanguine on the forward rate profile and inflation as equity markets.

The entire commodity complex was up too. Oil and industrial metals rising in tandem points to sunnier demand projections, while Gold's +2.6% rise on the week is entirely in line with the lower rates outlook.

The Week in Markets

	Latest*	Change since last week (units)	Change since last week (%)	3-month change (units)	3-month change (%)	Year-to-date change (units)	Year-to-date change (%)
Equity							
S&P 500	6849	246	3.7	368	5.7	967	16.4
Information Technology			4.3		7.8		23.7
Financials			3.2		-0.8		10.1
Consumer Discretionary			5.3		2.1		4.6
Communication Services			5.9		14.9		33.8
Health Care			1.9		15.1		14.3
Industrials			2.7		0.3		16.4
Consumer Staples			1.7		-0.4		3.3
Energy			1.0		1.3		4.9
Utilities			2.8		6.2		19.0
Real Estate			1.8		-0.8		2.5
Materials			3.3		-3.6		6.3
Nasdaq Composite	23366	1093	4.9	1776	8.2	4055	21.0
Dow Jones Industrial Average	47716	1471	3.2	2151	4.7	5172	12.2
Russell 2000	6214	325	5.5	315	5.3	672	12.1
Sovereign Fixed Income							
US: 2-year Treasury Note	3.47	-0.04		-0.12		-0.78	
US: 5-year Treasury Note	3.59	-0.03		-0.1		-0.79	
US: 10-year Treasury Note	4.02	-0.04		-0.22		-0.56	
FRA: 10-year OAT benchmark	3.41	-0.05		-0.080		0.23	
GER: 10-year Bund benchmark	2.69	0.02		-0.010		0.3	
CHN: 10-year CGB benchmark	1.84	0.02		0.0424		0.166	
CAN: 10-year GoC benchmark	3.12	-0.08		-0.33		-0.11	
Corporate Bond Spreads							
US: A-rated	76.4	-1.9		-1.3		2.3	
US: BBB-rated	112	-2.6		3.3		10.2	
Leveraged Loan Spreads							
US: B-rated	403	-3.68		5.53		-7.01	
US: BB rated	261	-0.697		3.83		5.14	
US: CCC-rated	1511	15.7		163		240	
Foreign Exchange Rates							
DXY US Dollar Index	99.5		-0.7		1.3		-8.3
EUR/USD	1.16		0.5		-0.7		11.4
USD/CAD	1.41		-0.3		1.6		-2.2
USD/CNY	7.08		-0.5		-1.1		-3.0
USD/JPY	156		-0.7		5.9		-0.2
GBP/USD	1.32		1.0		-2.3		5.0
USD/CHF	0.807		-0.1		0.1		-10.0
Commodities							
WTI Crude	59.5	1.53	2.6	-4.15	-6.5	-12.1	-16.9
Gold	4191	118	2.9	815	24.1	1582	60.6
S&P GSCI Commodities			1.6		1.6		1.0
S&P GSCI Industrial Metals			3.3		11.0		15.4
S&P GSCI Agriculture			1.8		0.4		-8.4

* Weekly closing value. Color indicates positive (green) or negative (red) change since prior week.

Sources: S&P Global, Russell Investment Group, Nasdaq, U.S. Department of Treasury, Macrobond Financial AB, Central Bank of Germany (Deutsche Bundesbank), Bank of Canada, Intercontinental Exchange (ICE), International Monetary Fund (IMF), LBMA (London Bullion Market Association), Robert Shiller, Chicago Board Options Exchange (CBOE), U.S. Department of Labor, Pitchbook | LCD, arcMacro



Macro Monitor

Key Data Published this week:

- **US Beige Book:** Marginally negative, with activity "little changed," employment declining slightly, margins being squeezed, and price pressures rising.
- **Canada Q3 GDP:** Growth rose by a surprisingly robust +0.6%QoQ, or +2.6% YoY, meaning Canada escaped a technical recession.

The major US data releases this week were all stale September data. Given the survey backlog that the BLS is working to clear, and the fact that key November employment and CPI reports are only due to be published in the days after the December 10 meeting, the Beige Book published this week will take on even more salience than usual.

In this context, assuming we're willing to ignore signals that tariff-related inflation is coming down the pike (which the Fed is perfectly happy to do), there was nothing in the report that caused markets to rethink the consensus view that the Fed will cut rates again (forward pricing now pointing to 80% implied odds of 25 basis points of easing). Unless Chairman Powell throws out a banana skin in his scheduled speech on Monday, there are no major catalysts for a change in that view, which should also anchor equity and fixed income markets for the next week and change.

The most watched macro action this week was in the UK, where Chancellor Rachel Reeves presented the annual Autumn Budget Statement. After several weeks of bond market volatility amid rumors that the government could fall, this was a relative non-event.

The budget introduced GBP26 billion in tax increases, mostly through a threshold freeze and adjustment to smaller revenue sources. An improvement in economic forecasts enabled the Chancellor to avoid raising rates in any of the three largest tax categories (personal, corporate, and VAT), keeping a manifesto promise. The taxes will pay for new social spending on child benefits and increase the reserve buffer. Markets did not appear to mind that the spending was front-loaded and the taxes back-loaded in the outer years of the forecast.

10-year gilts closed the week with yields 8 points tighter, which the Starmer government will no doubt accept with a sigh of relief.

Keir Starmer and Rachel Reeves kept bond markets happy

United Kingdom, Government Benchmarks, 10 Year Gilt Yield

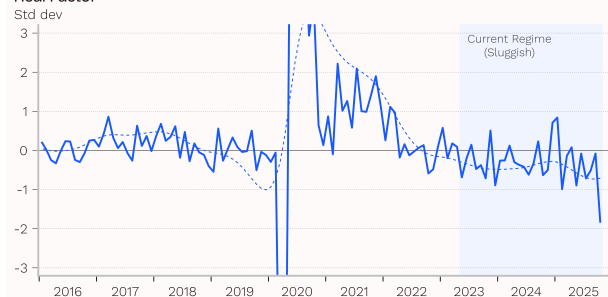


Our private markets clients will be relieved to hear that the industry largely escaped a higher tax burden, [Pitchbook reported](#). The capital gains tax was left unchanged, as was the 20% exit tax on assets being moved abroad. The IPO market even got a shot in the arm, with exemptions for investments in newly listed companies.

arcMacro Real Time Factors

United States, z-score

Real Factor



Price Factor



Financial Factor

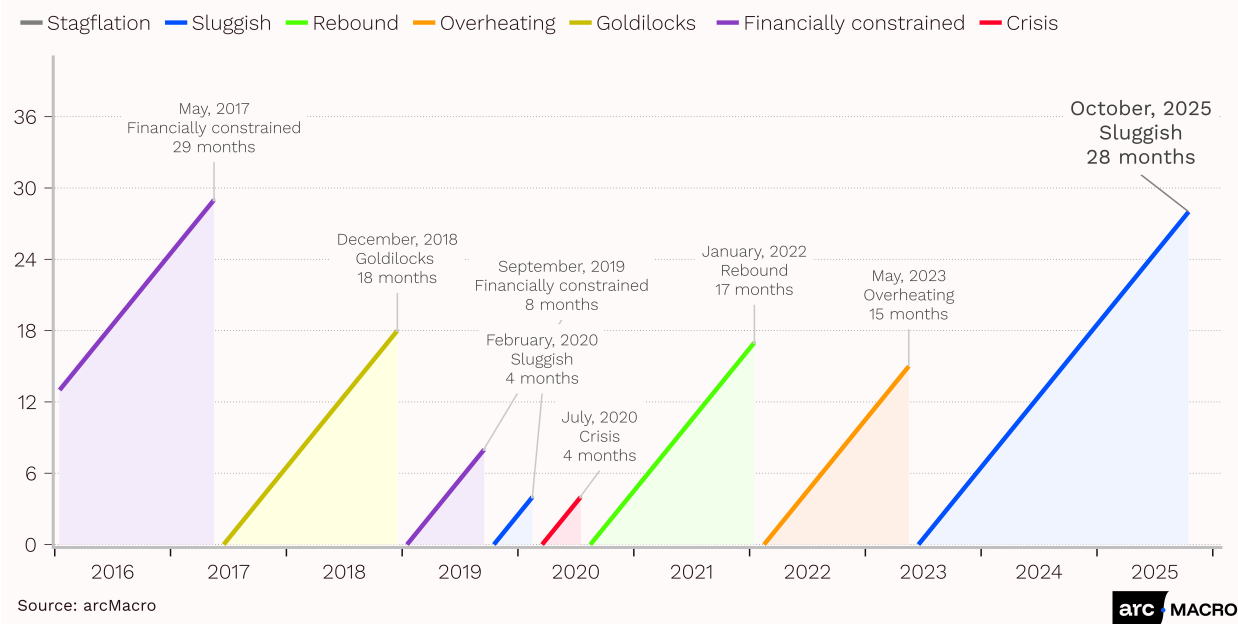


Sentiment Factor



Source: arcMacro

arcMacro Regime Summary United States



See the appendix for the top macroeconomic indicators tracking chart

What we'll be watching next week

- *Fed Chairman Jerome Powell Speech (US)* On Monday, the Chairman will appear in a panel discussion honoring George Shultz. It's unclear whether he will address current economic issues.
- *Manufacturing and Services PMI (US, Nov)*: In one of the first insights into November activity, we'll be looking for an improvement in manufacturing, which is currently in contractionary territory.
- *ADP employment (US, Nov)*: In the absence of timely official data, the ADP payrolls report will be a market-mover. The consensus expectation is for a moderation to +20k after a strong +42k print in October.

Memo

US Inflation outlook: All upside

Bottom line: all signs point to higher inflation in the US. In order of short-term to long-term relevance, we identify (i) direct tariff pass-through, (ii) broader trade-war costs, (iii) a demand pickup, (iv) labor market shortages (yes, you read that right), and (v) the Federal debt burden as key upside inflation risks. If the Fed follows through on its current guidance, it will make itself inflationary force number vi.

Inflation is running at around 3% in the US, having risen from a low of 2.3% in April. This trend alone should be enough to cast doubt on the Fed's ability to deliver the market's expectation of four more cuts by 2027. In our view, price signals are not telling the Fed that the economy needs lower interest rates.

But what really worries us is the constellation of forces that we believe are tilting inflation risk meaningfully to the upside. If we're right, the true concern is not that the Fed over-eases moderately (easy to correct), but that it commits a major policy error and ends up contributing to the inflation problem (difficult and costly to reverse).

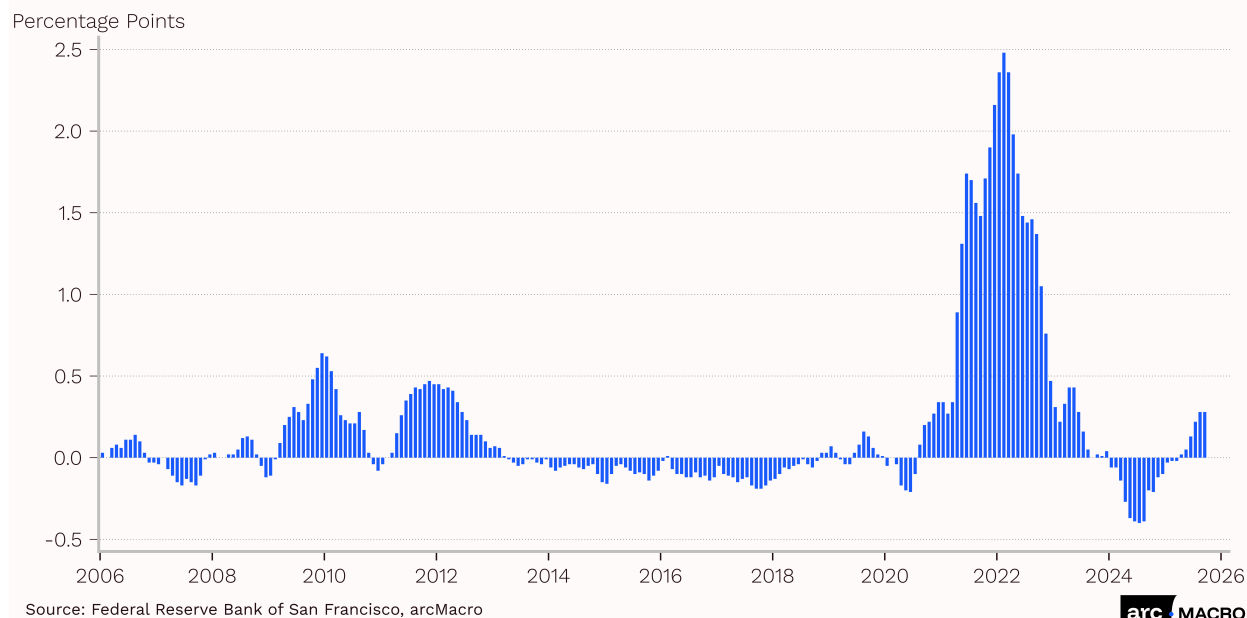
Let's run through the five main reasons we think inflation will rise, ordered from short-term to longer-term risks.

i. Tariff pass-through

Recent September inflation data have begun to signal that tariffs are hitting headline consumer prices through core goods categories, which have gone from outright deflation at the start of 2025 to a +0.3 percentage point contribution to headline inflation.

Goods prices have gone from disinflationary to inflationary

United States, CPI, contributions from core goods



This week the Fed published the [November Beige Book](#) update—a real-time narrative account of the state of the economy gathered from the local business contacts of the regional Federal Reserve Banks. It confirmed that the contribution of goods prices to inflation is likely to grow over the next three to six months. The document reported that "Input cost pressures were widespread in manufacturing and retail, largely reflecting tariff-induced increases."

Up to now, firms have for the most part tried to absorb tariff costs, putting pressure on margins but shielding consumers from price rises. That strategy is running out of room, and after the holidays, significant price increases appear likely. At the national level:

*There were multiple reports of margin compression or firms facing financial strain stemming from tariffs. Prices declined for certain materials, which firms attributed to sluggish demand, deferred tariff implementation, or reduced tariff rates. **Looking ahead, contacts largely anticipate upward cost pressures to persist but plans to raise prices in the near term were mixed.***

This paragraph from the Atlanta Fed is key:

*"Smaller businesses have found little ability to negotiate with suppliers alongside limited pricing power. Alternatively, larger firms have been "sharing the squeeze" on margins through the supply chain, with various suppliers absorbing portions of the tariffs. **However, many firms have exhausted cost-cutting methods and plan to implement price increases in the coming months by targeting increases toward products with stronger demand to minimize broader demand erosion.**"*

Another document published this week, this time a research article from Naomi Halbersleben, Oscar Jorda, and Fernanda Nechio at the San Francisco Fed titled "[The Economic Effects of Tariffs](#)." The authors tackled the historical evidence that tariffs have often been associated with lower inflation because their negative impact on demand outweighs their price effect. This paper finds that inflation indeed falls after tariff announcements—but only for 6 months or so, after which it rises again, well beyond its initial level. If the pattern repeats itself, that puts us on track for accelerating prices around about now.

ii. Indirect trade-war costs

Unfortunately, the upside risks from tariffs are not confined to their direct pass-through to consumer prices. If that were the case, we could treat tariffs as a one-off transitory shock that can be "looked through."

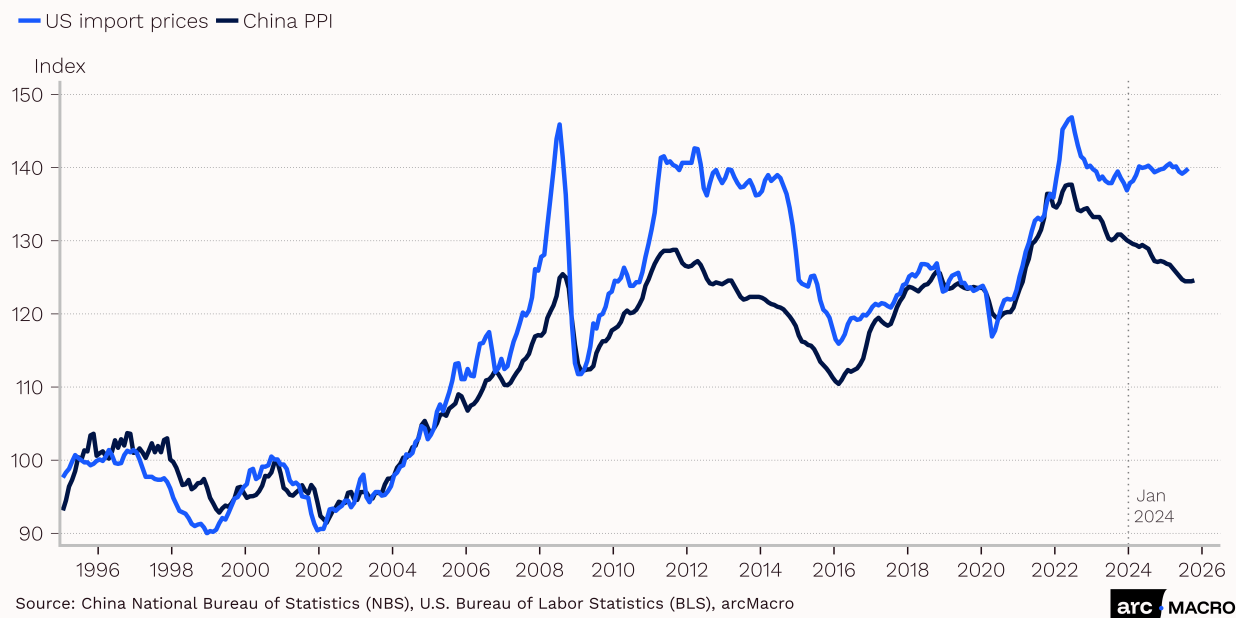
In reality, the economy is far more complex than that. In response to higher tariffs, firms will shift suppliers and entire supply chains, or substitute imported inputs for more expensive or lower quality (or both) local ones.

This activity is costly, requiring investment that could have gone to growing the top line and disrupting efficiencies generated over the years. As a result, we should see higher "background" inflationary pressure for several years.

In the near term, there is a more immediate concern for US prices. The trade war has driven a wedge between deflating Chinese production costs and US import prices. This correlation was a key driver of the long period of low, stable inflation that developed economies experienced over the 30 years between ~1990 and 2020.

The decoupling has arrived

US/China, price indices, Jan 1995 = 100



iii. Sustained demand momentum

We expect economic momentum to pick up in the first half of 2026 as tax breaks under the Trump administration's H.R. 1 or "One Big Beautiful Bill Act" make their way into consumers' pockets, and from there, in short order, to consumption expenditure.

What's more, consumer demand is already robust, and AI-related investment is supporting demand in key pockets of the economy.

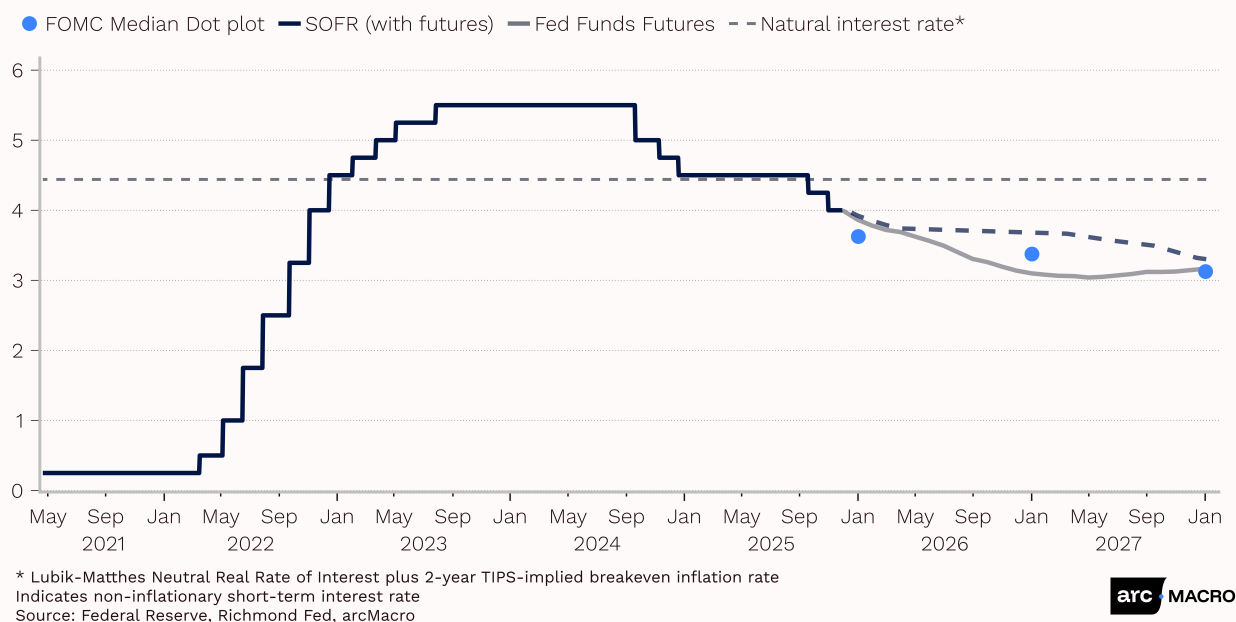
In fact, while it's easy to flag risks to activity, and while we've noted that the economy is "K-shaped" across a number of sectors (consumers, businesses, as well as in deal flow and investment activity), the upshot is that the Atlanta Fed's GDPNow is "nowcasting" Q4 GDP growth at a stellar +4.0% QoQ annualized.

It's hard to call that a disinflationary demand outlook, which is one reason that the most sophisticated estimates of the "natural" short-term interest rate (i.e., the rate that doesn't raise inflation) are above 4%.

This is where the Fed comes in. Should the FOMC lower rates to around 3% over the next year in line with their median "dot plot" guidance, their stance will be meaningfully accommodative, meaning they'll be contributing to inflationary conditions.

Markets are pricing a highly accommodative Fed stance

United States



iv. Wages growth and the labor market

This one might come as a surprise, given that all evidence points to a cooling labor market and many analysts are concerned that the labor market may weaken further. Those analysts would need to explain why average weekly wage growth is clipping along at around 4% and not showing signs of slowing.

Our view on the labor market is very simple. It is likely to continue gradually cooling while also becoming mildly inflationary. The reason is that it is becoming less efficient at meeting skills demands from the private sector. That problem stems directly from the Trump administration's immigration suppression.

Between January and September 2025, the foreign-born labor force shrank by fully one million workers, and that likely underestimates the problem because of difficulties accounting for the role of undocumented workers. In industries that rely on immigration and where demand is solid, we're already seeing wages pick up. And

should the construction industry—an enormous employer that is heavily reliant on migrant labor—escape its cyclical funk, the effect on inflation will be significant.

The Trump administration is shrinking the foreign-born labor force

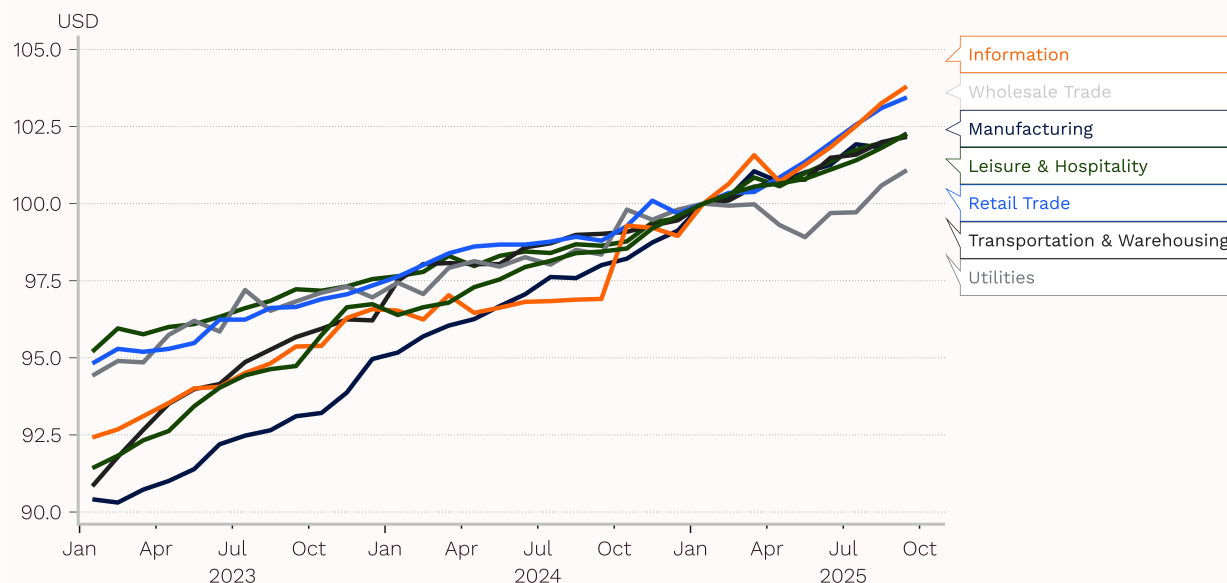
United States, Foreign Born Labor Force, SA



Even in industries that traditionally have a below-average share of foreign workers in their labor force, such as technology and utilities, immigration policy could raise wages because demand is so hot in these sectors, and skills so specialized, that firms need to shop for talent in the global market. The costlier the Trump administration makes this, the more wages for workers already in the country will be bid up.

Early evidence of accelerating wages despite cooling labor market

United States, Average Hourly Earnings, Non-Supervisory Employees, SA, Jan 2025 = 100



Source: U.S. Bureau of Labor Statistics (BLS), arcMacro

arc MACRO

v. Fiscal expansion and an un

Our final inflationary factor is a long-term force that stems from the pernicious effects of a high and continually rising US Federal debt, which is projected by the CBO to rise above 110% of GDP on a net basis over the next five years.

There are two, and only two ways to reduce the public debt burden. The first is to run primary budget surpluses, something that neither Republican nor Democratic lawmakers appear to have identified as a policy goal. The second is to allow inflation to rise. Since debt and interest payments are nominal, this mechanically reduces debt-to-GDP and debt-to-revenue ratios.

Of course, the Federal government does not directly control inflation. But it can make the case that it needs lower interest rates to carry its debt, which, in turn, causes higher inflation than would otherwise be the case. That's exactly the dynamic we're seeing play out between the White House and the Federal Reserve now, as FOMC members are being incentivized to advertise their dovishness.

This is undermining the Fed's inflation-fighting credibility. Bond markets have already cottoned on to the risks and are expecting average inflation of around 3% over the next 10 years. In other words, they do not believe the Fed will achieve its inflation target. Long-run fiscally driven inflation risks are also evident in the global

"debasement trade," in which investors are reducing US Treasury holdings in favor of safer havens such as gold and the bonds of small, low-debt countries.

Investors have priced above-target inflation expectations into Treasuries

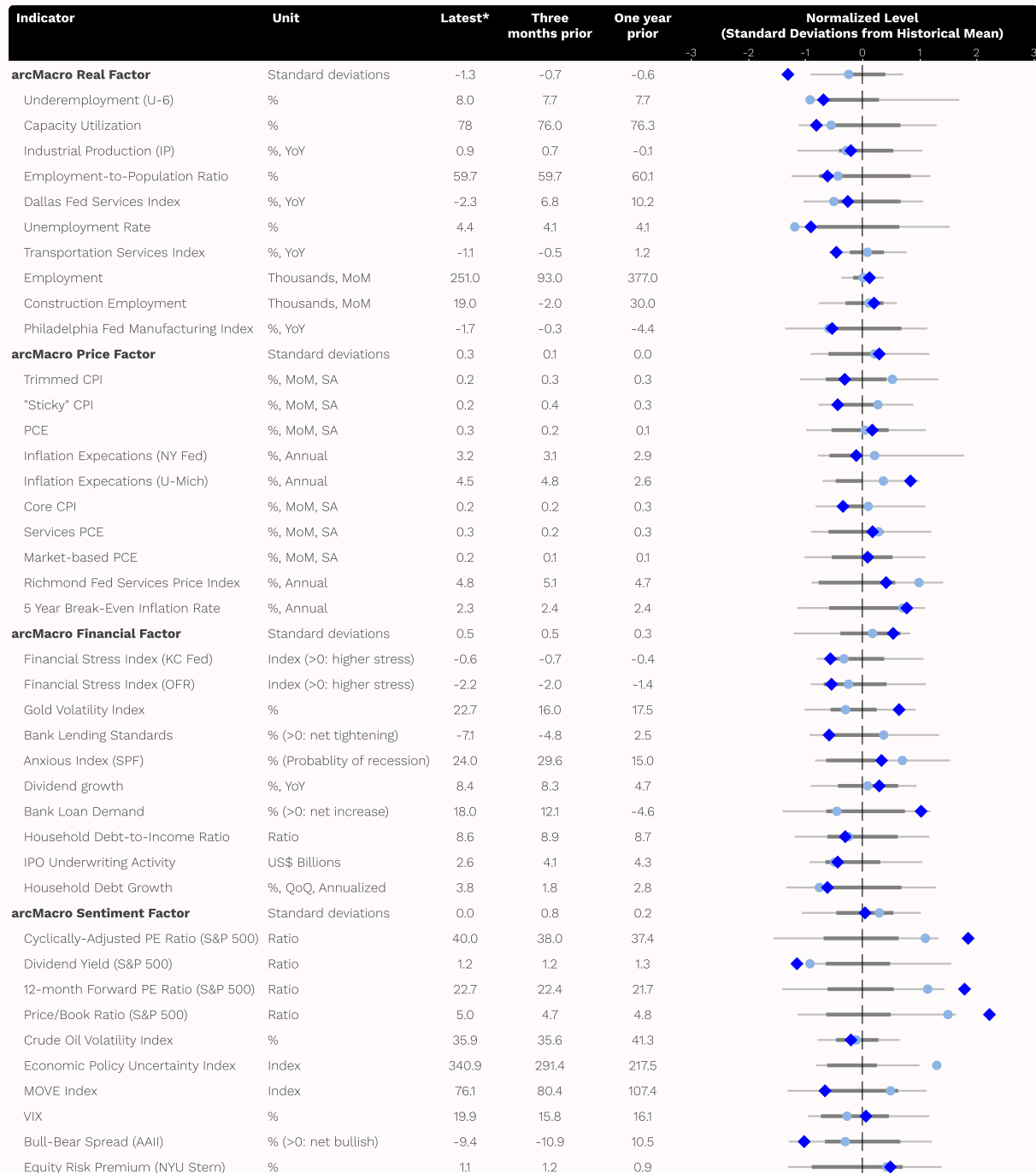
United States, Yield Curve, DKW Term Structure Model, Expected Inflation, 10 Year



Appendix 1: Key Macro Indicators Tracker

arcMacro Factor Input Monitor

Top 10 inputs by factor loading



■ 10th-90th Percentile ■ 25th to 75th Percentile ● Mean of past 5 years ◆ Latest Value

Source: arcMacro, BLS, Fed, Dallas Fed, DOT, Philadelphia Fed, Cleveland Fed, Atlanta Fed, BEA, New York Fed, University of Michigan, Richmond Fed, Macrobond, Kansas City Fed, The Office of Financial Research (OFR), CBOE, S&P Global, SIFMA, Robert Shiller, Economic Policy Uncertainty, ICE BofAML, LJKmf, AAIL
*Most recent published data point. Time period and frequency do not necessarily align.

Appendix 2: US Private Equity Statistics

Private Equity Trends: Deals United States

		Month to date*	Prior month	Same month last year	Quarter-to-date	Prior quarter	Same quarter last year	Year-to-date	Current run rate**	Prior year	Run rate as a % of prior year
		Nov 2025	Oct 2025	Nov 2024	Q4 2025	Q3 2025	Q4 2024	2025	2025	2024	2025
Buyout/LBO	Count (#)	340	472	577	812	1741	1974	6164	7397	7496	99%
	Capital (\$B)	23.8	19.5	42.8	43.3	173.9	130.3	422.1	507.0	375.1	135%
Add-on	Count (#)	273	351	398	624	1233	1371	4536	5443	5448	100%
	Capital (\$B)	3.5	3.4	10.9	6.9	32.0	19.3	95.4	114.0	61.4	186%
Growth/Expansion	Count (#)	107	138	138	245	484	479	1716	2059	1962	105%
	Capital (\$B)	2.3	10.2	3.7	12.6	15.5	24.2	82.0	98.0	98.0	100%
Public-to-Private	Count (#)	5	4	8	9	18	18	63	76	59	129%
	Capital (\$B)	7.5	4.0	24.2	11.5	73.1	55.5	140.6	169.0	103.3	164%
PIPE	Count (#)	154	339	245	493	602	792	2290	2748	2597	106%
	Capital (\$B)	2.3	9.1	8.1	11.4	25.0	26.8	63.3	76.0	72.7	105%

* Incomplete data
** Calculated based on month prior due to current month incompleteness

Pitchbook, arcMacro

Private Equity Trends: Exits United States

		Month to date*	Prior month	Same month last year	Quarter-to-date	Prior quarter	Same quarter last year	Year-to-date	Current run rate**	Prior year	Run rate as a % of prior year
		Nov 2025	Oct 2025	Nov 2024	Q4 2025	Q3 2025	Q4 2024	2025	2025	2024	2025
Corporate M&A	Count (#)	45	65	57	110	172	212	586	703	846	83%
	Capital (\$B)	29.5	20.2	3.5	49.7	106.9	31.2	329.9	396.0	150.8	263%
Secondary buyout	Count (#)	23	41	33	64	100	137	364	437	420	104%
	Capital (\$B)	5.8	47.7	6.4	53.5	42.7	17.5	138.0	166.0	61.9	268%
IPO	Count (#)	-	-	-	0	1	2	2	2	6	33%
	Capital (\$B)	0.0	0.0	0.0	0.0	0.6	0.6	0.8	1.0	7.8	13%

* Incomplete data
** Calculated based on month prior due to current month data incompleteness

Pitchbook, arcMacro