Invesco

Tariffs may lead to stagflation

Tariffs can create an environment of uncertainty where the conditions are right for stagflation.

Talking points

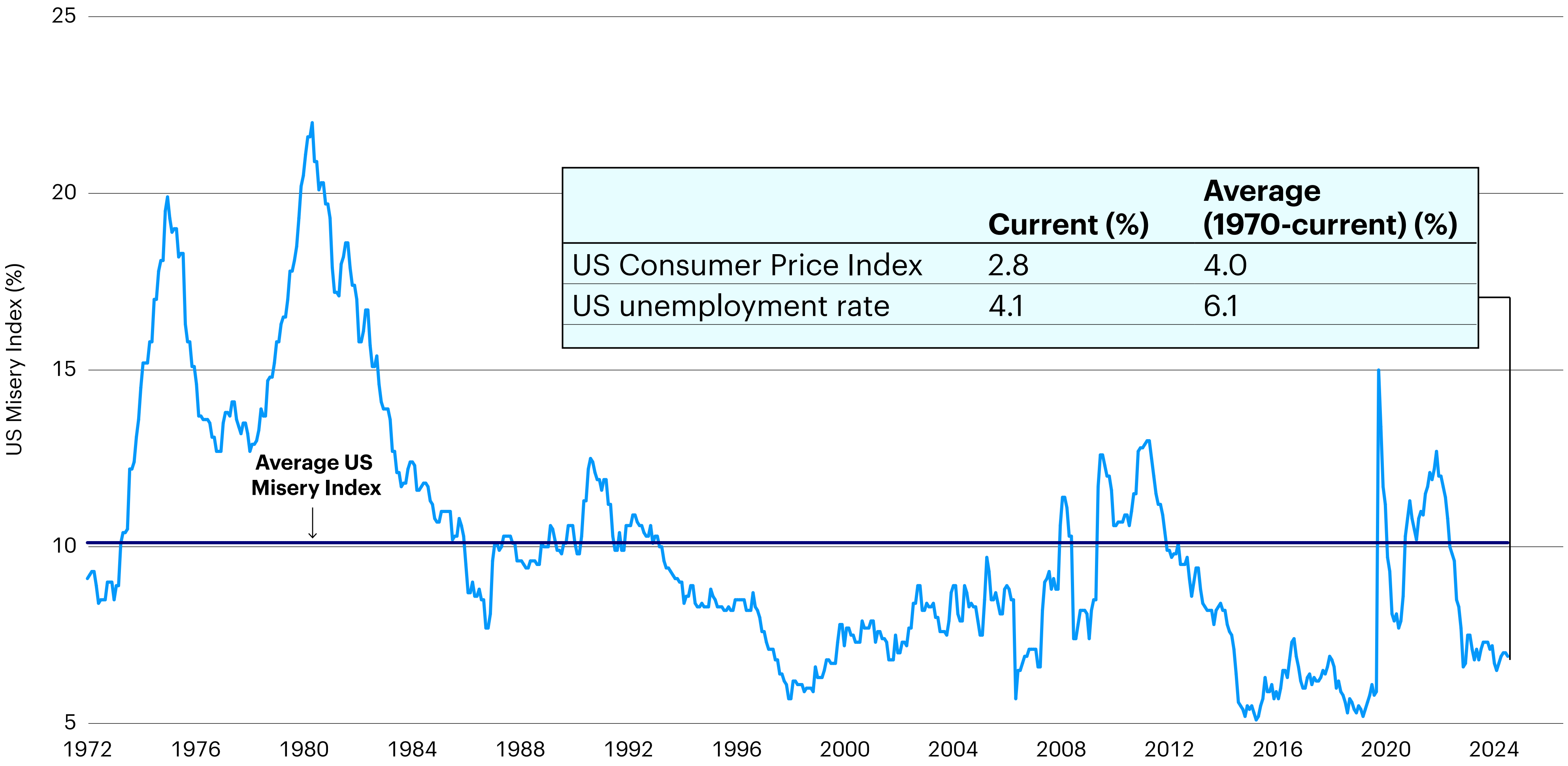
1. Stagflation combines stagnation and high inflation.
2. If the US increases tariffs, other countries may reciprocate.
3. The chances of economic stagnation and higher inflation can rise as business conditions decline.
4. Stagflation can create a tricky investing environment.

Proof points

- Stagnation may happen when an economy slows or stops growing leading to more unemployment and less consumer spending.
- High inflation results from rising prices that erode purchasing power and push up the cost of living.
- Stagflation can be challenging for policymakers. Fighting inflation by raising interest rates risks holding back the economy, while stimulating the economy by lowering interest rates risks increasing inflation.
- Stagflation happened in the 1970s when oil price shocks led to high inflation and stagnant economic growth. Conditions have made stagflation a possibility once again.

Stagflation combines stagnation and high inflation

US Misery Index (US Consumer Price Index + US unemployment rate)



	Current (%)	Average (1970-current) (%)
US Consumer Price Index	2.8	4.0
US unemployment rate	4.1	6.1

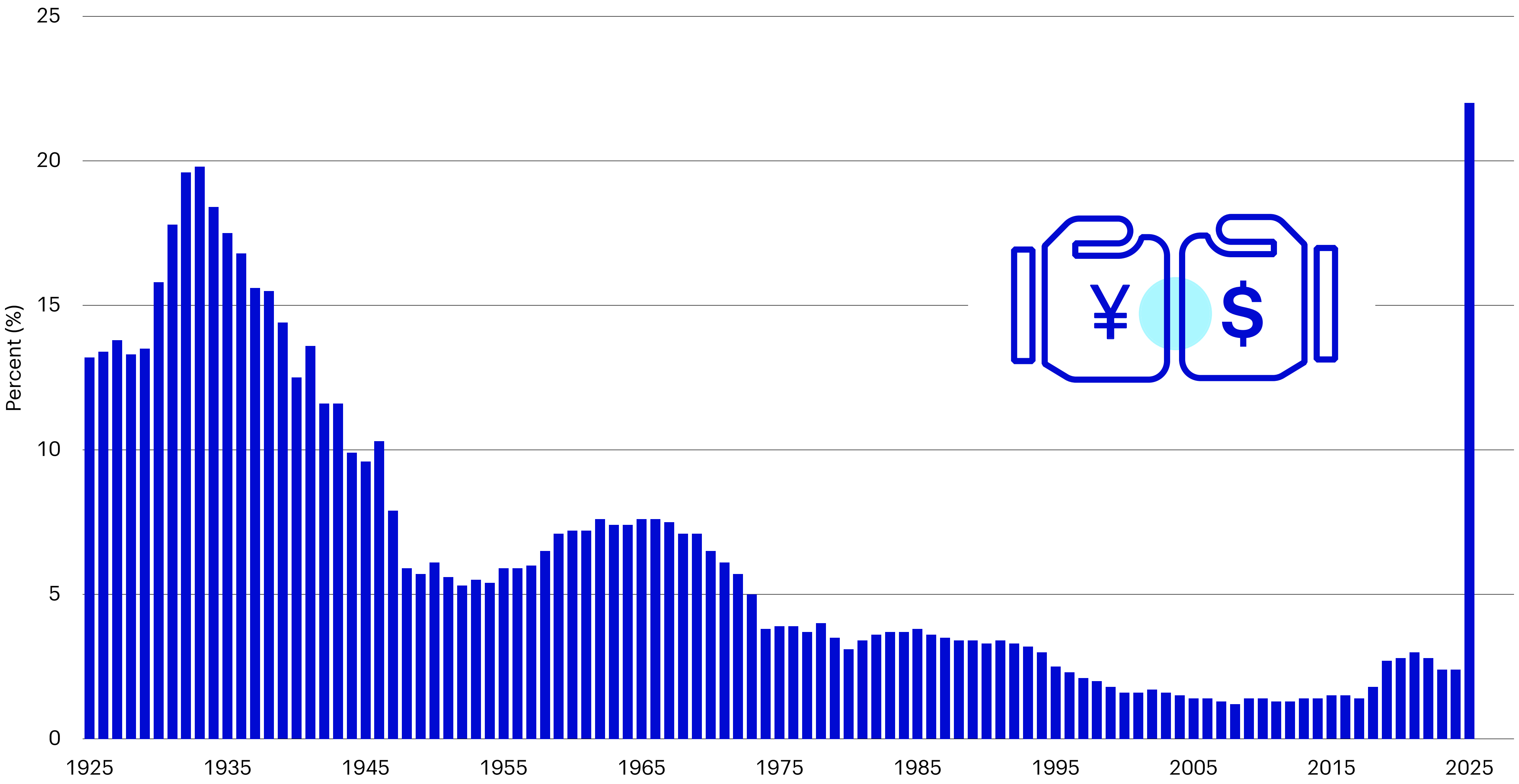
Sources: Bureau of Labor Statistics, Bloomberg, 3/31/25. Based on the U3 Unemployment Rate and the year-over-year percent change in the US Consumer Price Index. The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics. Core CPI excludes food and energy prices while headline CPI includes them. The US Misery Index is an economic indicator that combines the US unemployment rate and US inflation rate.

Proof points

- Originally, a 10% baseline tariff was applied to goods from most countries. Additional tariffs of 10-50% were added to 60 economies. Mexico and Canada faced 25% tariffs over border security and fentanyl issues. This average tariff rate exceeded the average during the Great Depression.
- Many countries announced their own tariffs against US-made goods.
- The Trump administration then announced a 90-day reprieve from tariffs for most countries while raising them for China.
- Tariffs may be the global economy's new reality. Price shocks can result, though exemptions and reductions could happen as well.

If the US increases tariffs, other countries may reciprocate

Historical average tariff rate on all imports



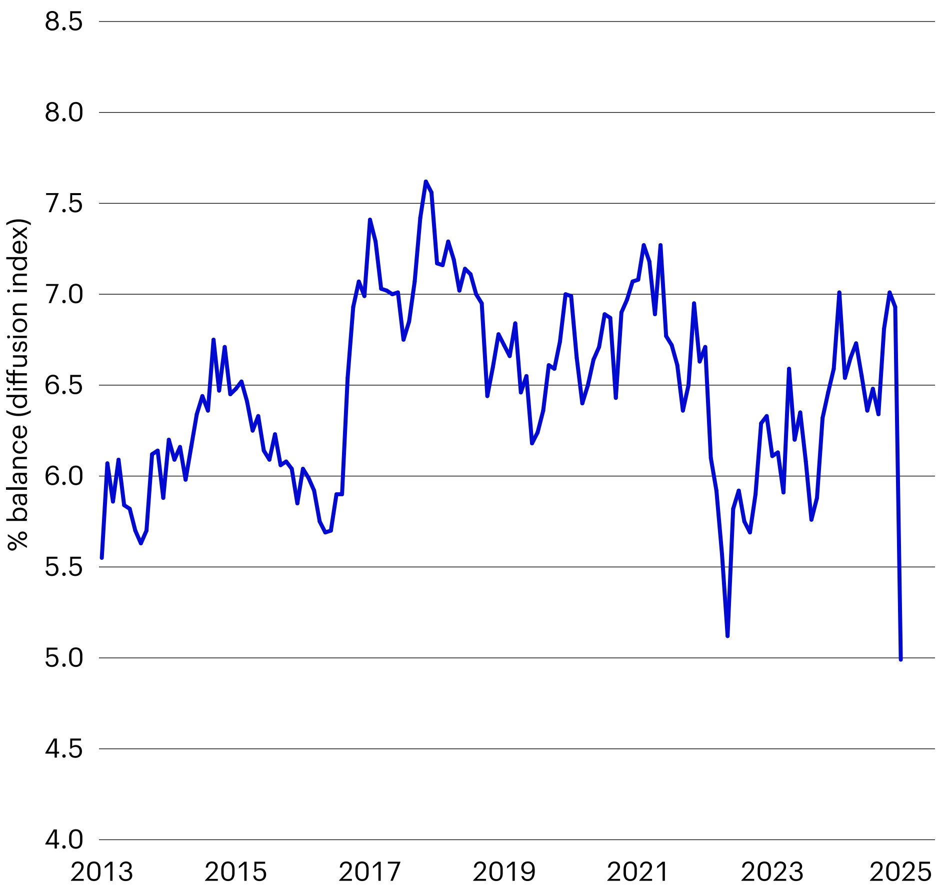
Source: Sources: Bloomberg L.P. and Tax Foundation, 4/2/25.

Proof points

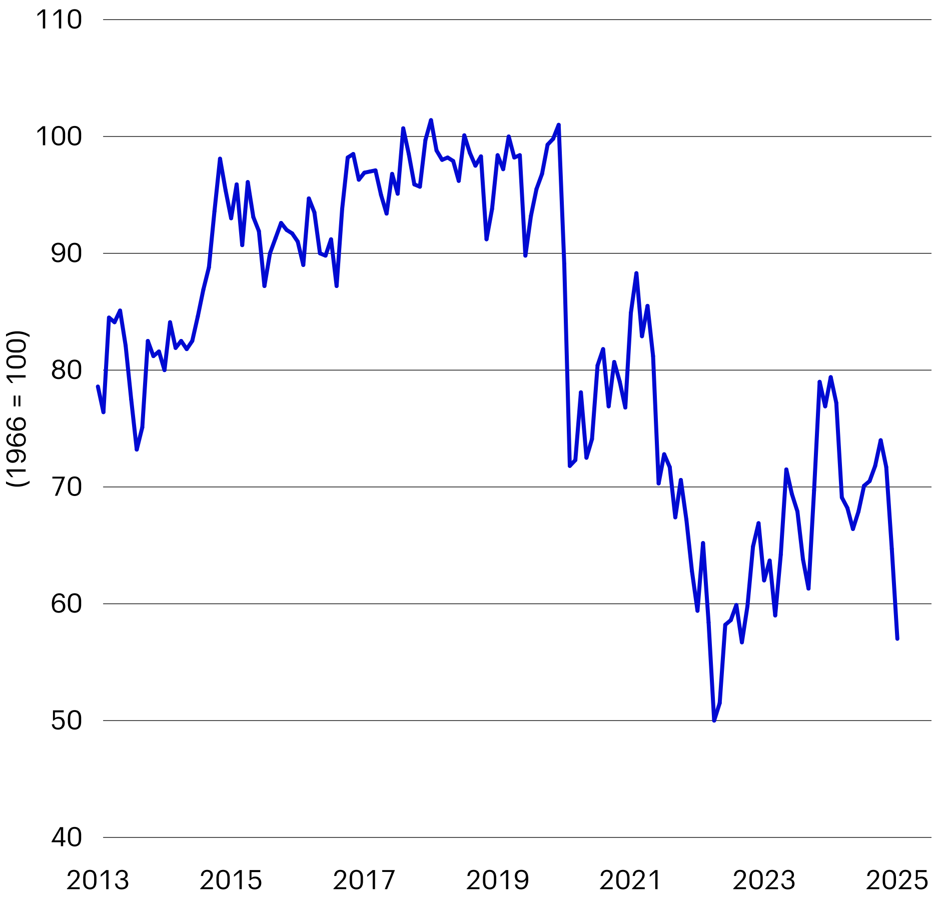
- Business and consumer confidence is eroding, growth expectations are deteriorating, and a price shock may loom.
- Uncertainty persists as investors wonder if tariffs will end up closer to the originally announced rates, the subsequent reprieve rates, or the pre-trade war rates. Where negotiations will lead is unclear.
- An estimated 10% of the core Personal Consumption Expenditures (PCE) Index — the Federal Reserve's preferred measure of inflation — is related to imports. Industries vulnerable to tariff-related price increases and likely to be most impacted include pharmaceuticals, automobiles, apparel, and hospital services.
- A common rule of thumb is that every 1% increase in the tariff rate leads to a 0.1% increase in inflation. A simple calculation suggests that US inflation is likely to rise.

The chances of economic stagnation and higher inflation can rise as business conditions decline

CEO Confidence Index



University of Michigan Consumer Sentiment Index



Source: (left chart): Chief Executive Magazine, 3/25. The CEO Confidence Index measures CEO confidence in the economy one year from now. (Right chart) University of Michigan, 3/25. The University of Michigan Consumer Sentiment Index is published monthly, based on a telephone survey designed to assess US consumer expectations for the economy and their personal spending. A diffusion index is a statistical measure used to gauge the overall direction of change in a particular economic activity or sector. It's typically calculated by taking the percentage of respondents reporting an increase in activity.

Proof points

- Stocks and corporate bonds have tended to underperform in a stagflationary economic environment as companies pull back to navigate the uncertainty.
- Gold and other commodities have tended to excel during stagflation as investors seek a safe haven.

Stagflation can create a tricky investing environment

Average year-over-year total return during different rate/inflation environments (%)

	Stocks	Corporates	Treasuries	Commodities	Gold	REITs
Goldilocks	13.60	9.40	5.70	3.60	7.20	18.00
Disinflation	4.60	6.20	6.70	4.50	4.70	9.10
Reflation	14.60	7.50	4.10	8.00	10.60	13.40
Stagflation	**2.30**	**4.40**	**5.90**	**20.90**	**14.40**	**9.40**

Sources: Bloomberg L.P., Invesco 3/31/25. Goldilocks is accelerating growth and falling inflation. Disinflation is decelerating growth and declining inflation. Reflation is accelerating growth and accelerating inflation. Stagflation is decelerating growth and inflation above the long-term average (1973-current). Growth is determined by the year-over-year percent change in the Conference Board Leading Economic Indicator. Inflation is determined by the year-over-year percent change in the US Consumer Price Index. Stocks are represented by the S&P 500 Index. Corporates are represented by the Bloomberg US Corporate Bond Index. Treasuries are represented by the Bloomberg US Treasury Bond Index. Commodities are represented by the Dow Jones Commodity Index. Gold is represented by the gold spot price. Real Estate Investment Trusts (REITs) are represented by the FTSE NAREIT All Equity REIT Index. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.** The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The Conference Board Leading Economic Index (LEI) is an economic indicator used for forecast changes in the business cycle based on a composite of 10 underlying components. The S&P 500® Index is an unmanaged index considered representative of the US stock market. Bloomberg US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. The Dow Jones Commodity Index is an equal-weight index that tracks the performance of 28 different commodity futures contracts, including metals, agricultural products, and energy commodities like oil and gas. The Gold Spot price is quoted as US Dollars per Troy Ounce. FTSE NAREIT All Equity REITs Index is a free-float adjusted market capitalization-weighted index that includes all tax qualified REITs listed in the NYSE, AMEX, and NASDAQ National Market. Stocks vs. Bonds: Although bonds generally present less short-term risk and volatility than stocks, the bond market is volatile and investing in bonds involves interest rate risk; as interest rates rise, bond prices usually fall, and vice versa. Bonds also entail issuer and counterparty credit risk, and the risk of default. Additionally, bonds generally involve greater inflation risk than stocks. Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

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