

## Invictus Tariff and Trade War Recession Scenario

Version 2.0 as of August 19, 2025

The *Invictus Tariff and Trade War Recession 2.0* scenario is intended to reflect (but not predict) a tail-risk outcome for the U.S. economy, driven by fiscal policies regarding tariffs, reciprocal actions by other nations, and a structural shift towards deglobalization influenced by both economic and national security concerns.

Tariffs are assumed to be perpetual rather than temporary, with long-term retaliatory tariffs from foreign nations intensifying. This scenario was forecasted using the same macroeconomic and market factors as the Federal Reserve's CCAR scenario. See Table I below:

Table I: Invictus Tariff and Trade War Recession Scenario 2.0: Domestic variables, Q2:2025-Q2:2027

Quarter	Real GDP Growth	Nominal GDP Growth	Unemployment Rate	CPI Inflation Rate	Fed Funds Rate (lower bound)	3-Month Treasury Yield	10-Year Treasury Yield	Mortgage Rate	Prime Rate	Cumulative Pct Change in the Dow Jones Total Stock Market Index from 2024Q4	Cumulative Pct Change in Housing Prices from 2024Q4	Cumulative Pct Change in CRE Prices from 2024Q4
2025Q2	3.0	5.7	4.1	2.7	4.25	4.41	4.24	6.53	7.50	5.0	0.0	0.0
2025Q3	-3.4	0.0	4.6	3.4	4.25	4.41	4.66	6.91	7.50	-24.5	-6.9	-5.0
2025Q4	-4.0	-0.2	5.2	3.9	4.75	4.91	5.16	7.16	8.00	-28.4	-13.4	-9.7
2026Q1	-3.0	1.5	5.9	4.5	5.25	5.41	5.66	7.41	8.50	-29.5	-19.4	-14.2
2026Q2	-0.9	3.3	6.5	4.2	5.00	5.16	5.66	7.16	8.25	-30.0	-25.0	-18.4
2026Q3	0.3	4.3	7.2	4.0	4.75	4.91	5.91	7.66	8.00	-28.9	-30.2	-22.5
2026Q4	0.5	4.3	8.0	3.8	4.50	4.66	6.16	8.16	7.75	-27.3	-35.0	-26.3
2027Q1	3.2	6.9	7.8	3.6	4.25	4.41	6.41	8.66	7.50	-25.1	-33.7	-30.0
2027Q2	3.0	6.5	7.7	3.5	4.00	4.16	6.41	8.91	7.25	-22.4	-32.0	-28.3

### GDP, Unemployment, and Inflation

In this scenario, escalating tariffs sharply increase input costs, disrupt supply chains, and drive-up consumer prices. Real GDP is expected to decline to a depth roughly half as severe as the Great Recession, as consumer spending, government expenditures, and business investment are curtailed due to heightened uncertainty.

- **Unemployment Rate:** Rises from 4.1 percent in June 2025 to a peak of 8.0 percent by the fourth quarter of 2026.
- **Inflation:** Persistently elevated, with CPI surpassing 4.5 percent year-over-year by the first quarter of 2026 and remaining at 3.5 percent through the second quarter of 2027.

Unlike the Great Recession, inflationary pressures persist, driven by tariffs contributing to a rolling impact on CPI, as industries adjust their pricing strategies incrementally. This also creates waves of increased demand for certain goods even as overall consumer spending slows,

reinforcing inflationary hoarding behavior among consumers and influencing supplier pricing behaviors.

### *The Federal Reserve's Response plus the 10-Year Treasury*

The Federal Reserve (“the Fed”) faces constraints in easing monetary policy due to dual-mandate pressures: managing rising unemployment alongside persistent inflation.

- The Fed observes both rising unemployment and inflation during the third quarter of 2025, which forces them to not cut the Fed Funds rate in September as anticipated by the markets as of the date of this scenario;
- Both unemployment and inflation continue to rise during the fourth quarter of 2025 to 5.2 and 3.9 percent, respectively. The Fed chooses to increase interest rates by 50 basis points, which is designed to reduce inflation, but also loosen real interest rates (using Fed Funds Rate – CPI rate as a proxy) to mitigate the pressure on unemployment.
- The Fed continues to utilize a policy which combines an increase in the Fed Funds rate with loosening real interest rates to attempt to thread the needle of the dual mandate policy. This leads to a peak in the Fed Funds rate of 5.25 percent in the first quarter of 2026, followed by 25 basis point decreases per quarter thereon after as the CPI rate begins to de-accelerate. The Fed Funds rate falls to 4.0 percent by the second quarter of 2027 and starts to loosen on a real interest rate basis as CPI falls and the focus shifts towards alleviating the unemployment rate.
- Quantitative Tightening continues at a steady pace, reducing up to \$35 billion in mortgage-backed securities and \$5 billion in U.S. treasuries monthly.

The 10-Year Treasury Rate increases under this scenario. Higher inflation expectations, a decrease in demand from foreign investors, a depreciation of the U.S. Dollar relative to other currencies, and an increase in the supply of treasury bonds from the U.S. Treasury to fund a growing federal budget deficit contribute to upward pressure on the 10-Year Treasury Rate.

### *Sectoral Impacts*

As of the date of this scenario, the United States' Effective Tariff Rate (“ETR”) is estimated to range between 16% and 18%—a sharp increase from 2.2% at year-end 2024 and the highest level recorded since the depths of the Great Depression in 1936. This scenario assumes the ETR remains within this elevated range, with potential for further escalation should trade relations with China deteriorate following the expiration of the current 90-day “pause,” scheduled to conclude in early November.

Tariffs disproportionately impact companies in sectors that depend heavily on international manufacturing for U.S. sales or face exposure to retaliatory measures on overseas exports. Particularly vulnerable industries include consumer durables, manufacturing, automotive and parts, aluminum, steel, copper, pharmaceuticals, electronics, mining, retail, construction, and agriculture. Local markets with concentrated exposure to these sectors—and whose economies are closely tied to their performance—are subject to elevated economic stress.

#### *Asset Prices*

This scenario assumes a sharp decline in stock prices, as measured by the Dow Jones Total Stock Market Index, with a nearly 25% drop during Q3 2025 relative to the June 30, 2025 closing level. The index is projected to bottom out in Q2 2026, marking a cumulative decline of approximately 30%. A gradual recovery is expected to follow, driven by easing in the Fed Funds rate, a deceleration in CPI inflation, and early signs that the unemployment rate has peaked.

Housing prices are expected to decline by nearly 35 percent from current levels due to the sharp increase in the unemployment rate coupled with upward pressure on mortgage rates, which remain strongly correlated to the 10-year treasury.

By the end of Q1 2027, CRE prices are projected to decline approximately 30%, compounding the 12% drop already observed since their peak in Q2 2023. This sustained pressure reflects a combination of rising capitalization rates—driven by an increase in the 10-year Treasury—and mounting concerns over occupancy amid a weakening economy and elevated unemployment. Retail CRE assets are particularly exposed, as anchor tenants face margin compression and reduced consumer spending. Land values are expected to fall even more sharply, exacerbated by rising construction costs linked to tariff-driven input inflation.

#### *Impact on Financial Institutions*

Banks will all be impacted differently based upon the unique composition of their balance sheet, loan portfolio, and business model. A given bank's vulnerability to this scenario will also be different than its vulnerability to an alternative recession scenario such as Federal Reserve's CCAR scenario or a scenario comparable to the 2008 Great Recession due to sharp differences in inflation, interest rates, and the sectors of the economy which most impacted. As a result, stress testing this scenario must be calibrated differently for effective risk management and capital planning.