

Invictus Tariff and Trade War Recession Scenario

Version 1.0 as of April 7, 2024

The *Invictus Tariff and Trade War Recession 1.0* 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 Tarrif and Trade War Recession Scenario: Domestic variables, Q1:2025-Q1:2027

Quarter	Real GDP Growth	Nominal GDP Growth	Unemployment Rate	CPI Inflation Rate	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
2025Q1	-2.8	0.0	4.1	2.8	4.3	4.2	6.6	7.5	-5.2	0.5	0.5
2025Q2	-3.4	0.1	4.8	3.5	4.3	3.8	6.1	7.5	-24.5	-7.3	-1.7
2025Q3	-4.0	0.0	5.4	4.0	3.8	3.6	5.6	7.0	-28.4	-10.4	-3.4
2025Q4	-3.0	0.8	6.1	3.8	3.6	3.3	5.1	6.8	-29.5	-12.8	-5.6
2026Q1	-0.9	2.7	6.7	3.6	3.3	3.6	5.1	6.5	-30.0	-14.5	-9.0
2026Q2	0.3	3.6	7.4	3.3	3.1	3.6	5.3	6.3	-28.9	-15.5	-12.8
2026Q3	0.5	3.4	8.0	2.9	2.8	3.8	5.8	6.0	-27.3	-16.2	-16.2
2026Q4	3.2	5.9	7.8	2.6	2.6	4.1	6.3	5.8	-25.1	-16.7	-19.6
2027Q1	3.0	5.3	7.7	2.3	2.3	4.1	6.6	5.5	-22.4	-15.8	-22.5

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 March 2025 to a peak of 8.0 percent by the third quarter of 2026.
- **Inflation:** Persistently elevated, with CPI surpassing 4.0 percent year-over-year by the third quarter of 2025 and remaining above 3.0 percent through the third quarter of 2026.

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 “toilet paper” behavior among consumers and influencing supplier pricing behaviors.

The Federal Reserve’s Response plus the 10-Year Treasury

The Federal Reserve faces constraints in easing monetary policy due to dual-mandate pressures: managing rising unemployment alongside persistent inflation.

- Following two consecutive quarters of negative GDP growth and an unemployment rate reaching 4.8% by Q2 2025, the Fed hesitates to cut rates due to CPI climbing from 2.80% to 3.50%.
- By Q3 2025, the Fed introduces a 50-basis point rate cut as it prioritizes unemployment over inflation, followed by gradual 25-basis point reductions over the next 6 quarters, culminating in a total reduction of 200 basis points. However, inflation challenges limit the Fed to this gradual pace of rate reductions as opposed to a faster pace seen in previous recessions such as the 2020 Pandemic or 2008 Global Financial Crisis.

Quantitative Tightening continues at a steady pace, reducing up to \$35 billion in mortgage-backed securities and \$5 billion in U.S. treasuries monthly.

Sectoral Impacts

The recession disproportionately affects companies in industries heavily reliant on international manufacturing of goods for sale in the U.S. or exposed to retaliatory tariffs for overseas sales. Industries which are especially vulnerable include but are not limited to consumer durable goods, manufacturing, mining, retail, construction, and agriculture. Local markets concentrated in these sectors face heightened stress.

Asset Prices

The Dow Jones Total Stock Market Index depreciated by 5.2 percent as of the end of the first quarter of 2025 versus year-end 2024 (and 9.3 percent from its peak in Feb 2025). This scenario assumes stock prices as measured by this index depreciate by as much as 30 percent from year-end 2024 levels before starting to rebound in the middle of 2026 when investors start to see a path for the Federal Reserve to have both sides of the dual mandate under control in the future.

Housing prices are expected to decline by nearly 17 percent from current levels due to the sharp increase in the unemployment rate. Mortgage rates only modestly decline due to their correlation with the 10-year treasury (although the spread between them is projected to gradually tighten), and therefore fail to provide meaningful relief to the housing sector.

CRE prices decrease by approximately 23 percent by the end of the first quarter of 2027, which is in addition to the 12 percent decrease it has already experienced from peak level in the

second quarter of 2023. Pressure on CRE prices is caused by a combination of rising capitalization rates caused by a widening of the spread over the 10-year treasury and concerns about occupancy rates triggered by a declining economy and rising unemployment. Retail CRE properties prove to be more vulnerable as anchor tenants struggle with thinner margins and reduced spending. Land values are projected to decrease at a greater rate due to the increase in construction costs due to tariffs.

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.