



MACROMATRIX

Twin-Shock Contraction, Fragile Stimulus, and Stagflation Risks



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Executive Overview

The U.S. economy is navigating a fragile and asymmetric landscape defined by weak real activity, a deteriorating labor market, and the conflicting impulses of protectionist trade policy and deficit-financed stimulus. Real GDP's apparent rebound in Q2 masks demand erosion, while payroll growth has slowed sharply and unemployment has risen to 4.3%, signaling an early-stage downturn in the business cycle. The Federal Reserve's dual rate cuts to 3.75–4.00% reflect its pivot from inflation control to employment stabilization, even as tariffs sustain cost-push pressures.

The “*twin-shock*” policy mix—broad-based import tariffs and the expansive One Big Beautiful Bill Act (OBBBA)—is contractionary in net effect: tariffs act as a consumption tax, while OBBBA's benefits skew toward upper-income cohorts, reducing aggregate demand. Fiscal fragility persists with debt above 100% of GDP and a record-low NIIP, amplifying sovereign-risk premia. Consensus forecasts anticipate only 1.4% GDP growth in 2025 and a transitory 2026 rebound, constrained by stagflation risks. Markets remain resilient on AI-driven earnings, yet underlying macro conditions suggest caution—particularly across leveraged and import-dependent sectors. Policy missteps could easily transform the current slowdown into a stagflationary recession, reinforcing the need for selective, data-anchored investment strategies.

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Key Takeaway

A weak labor market, contractionary trade policy, and fiscal excess define a precarious 2025 U.S. outlook. The economy risks sliding into stagflation as tariffs lift prices and stimulus fades. While AI-led equities sustain near-term resilience, structural deficits and policy asymmetry argue for defensive, data-driven positioning across fixed income and real-asset exposures.

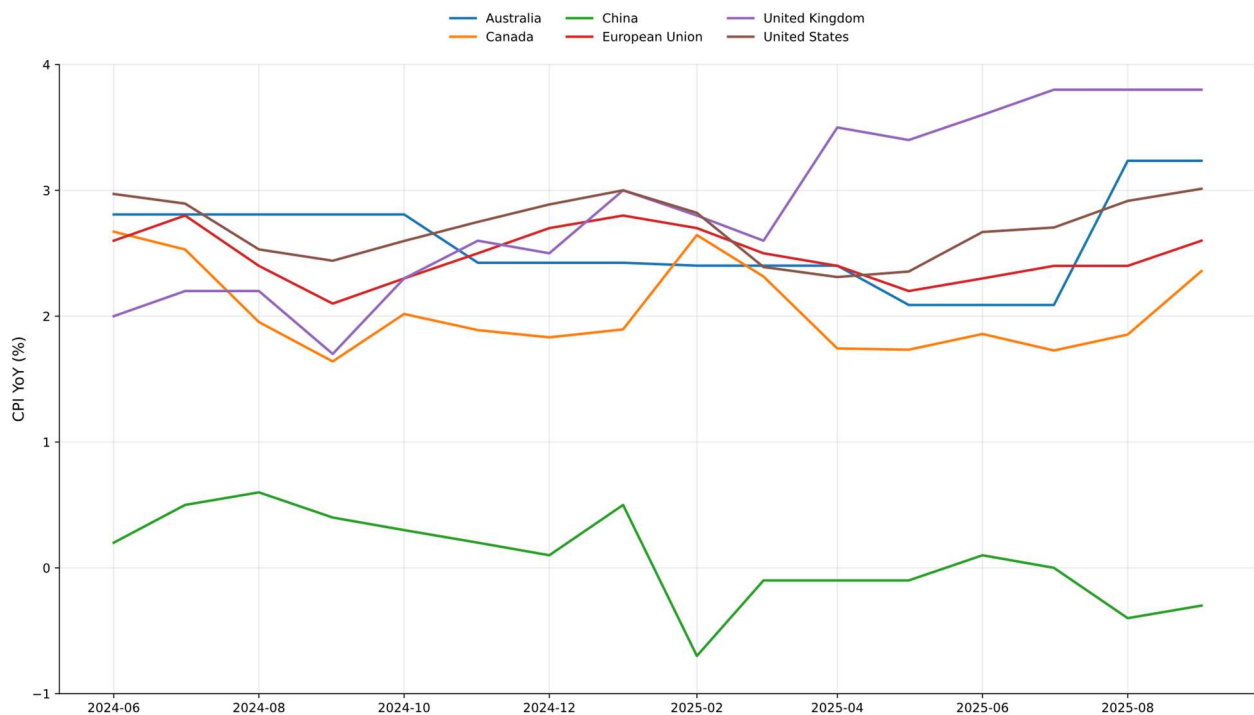
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Real Activity and Labor Market Weakness

We note that real GDP contracted 0.6% year-over-year in Q1 2025, while the Q2 annualized gain of 3.8% is driven primarily by a sharp drop in imports rather than genuine domestic expansion. The import-driven rebound masks underlying weakness in private-sector demand and suggests that the headline growth figure is not sustainable. On the labor front, payroll employment has stalled, falling to roughly 55 k jobs per month in Q2 and 51 k in early Q3, well below the consensus forecast of 73 k. The unemployment rate rose to 4.3% in August 2025, edging toward the Congressional Budget Office's (CBO) estimated natural-rate of 4.4%, indicating that hiring pressures are now on the downside rather than the upside.

We believe the confluence of a contracting real-GDP base, a deteriorating jobs market, and a rising unemployment rate points to a clear downside in the U.S. business cycle for 2025. The labor market softness provides the Federal Reserve with additional policy space, as evidenced by the two 25-basis-point rate cuts in September and October that lowered the target range to 3.75-4.00%. The Fed's justification—*downside risks to employment*—underscores the shift from a previously tight labor market to one that now threatens to drag growth further down.

Figure 1: Inflation Across Major Economies



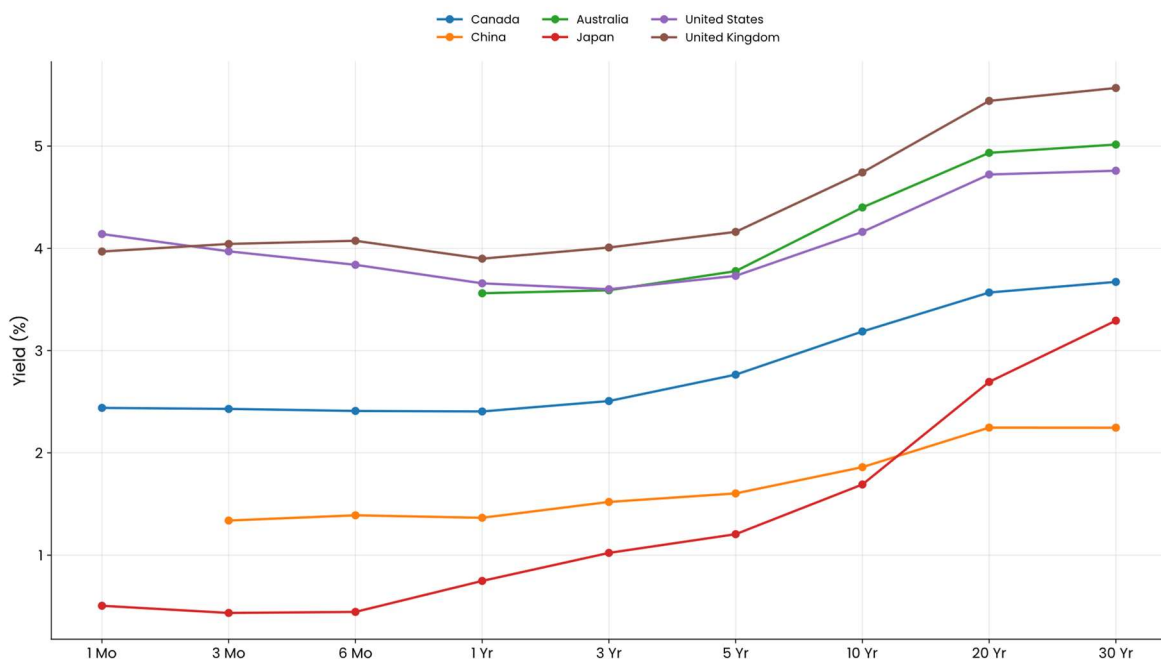
Source: Data sourced from Yahoo! Finance as on November 10, 2025. ^GSPC - S&P 500 Index (US Large Cap), DJIA - Dow Jones Industrial Average (US Industrials), ^IXIC - NASDAQ Composite Index (US Tech), ^RUT - Russell 2000 Index (US Small Cap), ^FTSE - FTSE 100 Index (UK Large Cap), ^STOXX50E - EURO STOXX 50 (Eurozone Equities), ^N225 - Nikkei 225 Index (Japan Equities), VEMAX - Vanguard Emerging Markets Stock Index Fund (Emerging Markets Equities).

Inflation Landscape and Monetary Policy Response

CPI inflation moderated to 2.5% year-to-date and 3.0% on a twelve-month basis, yet core services, gasoline and food prices accelerated in Q3, eroding the headline improvement. The mixed inflation picture reflects both demand-side weakness and supply-side cost pressures, the latter emanating from the aggressive tariff regime. Despite inflation remaining above the Fed’s 2% target, the central bank proceeded with two rate cuts, signaling a willingness to tolerate a temporary overshoot in inflation in order to cushion employment.

We believe the Fed’s accommodative stance, combined with a tariff-induced cost-push environment, creates a policy paradox: *monetary easing is intended to support demand while the tariff structure simultaneously raises consumer prices and suppresses consumption*. This divergence heightens the probability of cost-push inflation persisting even as the Fed attempts to lower rates, a dynamic that could complicate the timing and magnitude of any future tightening cycle.

Figure 2: Yield Curves of Major Global Economies



Source: Data sourced from Yahoo! Finance on November 10, 2025.

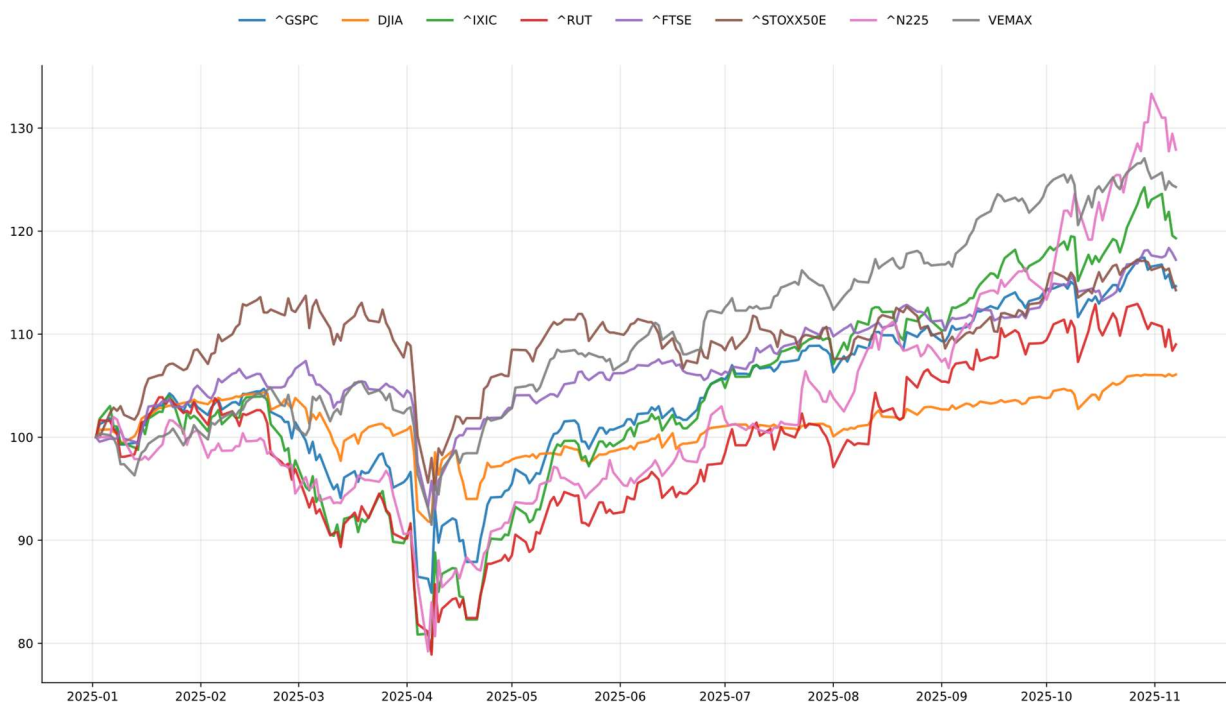
The Twin-Shock Policy Regime: Tariffs and OBBBA

We note that the policy environment is characterized by a “twin-shock” combination of an aggressive tariff regime and the One Big Beautiful Bill Act (OBBBA). The tariff structure imposes a minimum 10% levy on all imports, a 47% rate on Chinese goods, and 35-39% on allied nations, effectively operating as a broad-based consumption tax that raises prices and curtails demand. Simultaneously, OBBBA extends

the 2017 tax cuts and finances a \$4.1 trillion deficit-financed stimulus over 2025-2034, front-loaded to boost consumption and investment.

We believe the net effect of these policies in 2025 is contractionary. The CBO estimates that OBBBA adds \$3.4 trillion to the deficit (plus \$0.7 trillion in interest), raising total debt by \$4.1 trillion, while tariffs generate a \$3.3 trillion deficit reduction (plus \$0.7 trillion interest savings) but extract \$4.0 trillion from the private sector. The distributional analysis shows that OBBBA benefits are heavily skewed toward the top decile, whereas the regressive tariffs depress after-tax income for all but the top 10% and cut bottom-decile household income by roughly 7%. The dominant downside-risk narrative is confirmed by the Fed's rate cuts, indicating that tariff-driven price pressures outweigh the stimulus boost.

Figure 3: Major Global Markets (YTD) – Nikkei 225 Emerging as the Top Performer



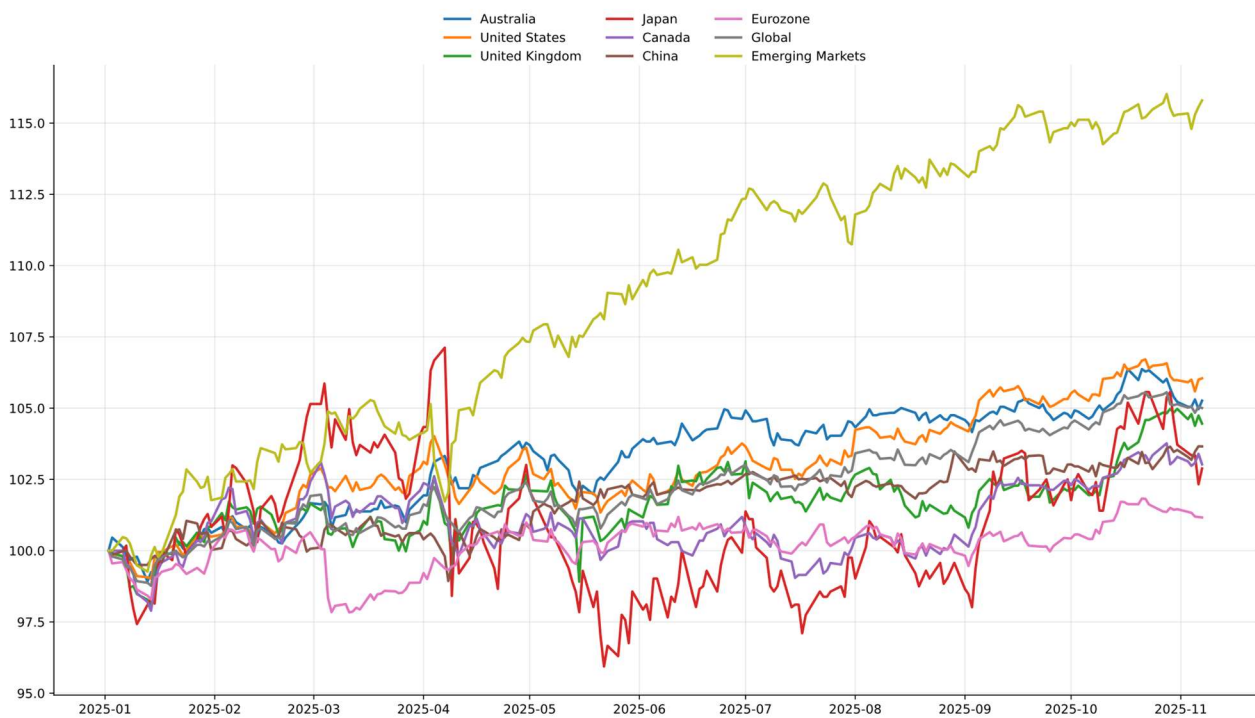
Source: Data sourced from Yahoo! Finance as on November 10, 2025. ^GSPC – S&P 500 Index (US Large Cap), DJIA – Dow Jones Industrial Average (US Industrials), ^IXIC – NASDAQ Composite Index (US Tech), ^RUT – Russell 2000 Index (US Small Cap), ^FTSE – FTSE 100 Index (UK Large Cap), ^STOXX50E – EURO STOXX 50 (Eurozone Equities), ^N225 – Nikkei 225 Index (Japan Equities), VEMAX – Vanguard Emerging Markets Stock Index Fund.

Fiscal Balance, Debt Dynamics, and External Position

The fiscal backdrop is stark. FY 2025 deficit is projected at \$1.8 trillion, roughly 4.5% of GDP, essentially unchanged from FY 2024, signaling the emergence of a new structural deficit regime that has persisted since the COVID-19 crisis. Federal debt has risen to \$38.04 trillion as of 3 Nov 2025 (public debt \$30.57 trillion, intragovernmental \$7.44 trillion), an increase of \$2.17 trillion year-over-year—the fastest annual rise since 2008. The Net International Investment Position (NIIP) deteriorated to a record low of –\$26.14 trillion, reflecting heightened reliance on foreign capital to fund ongoing deficits.

We believe that a debt-to-GDP ratio now exceeding 100 % and a persistently high deficit create upward pressure on sovereign-risk premia and constrain fiscal flexibility. The shrinking NIIP limits the United States' external financing options, making the economy more vulnerable to shifts in global risk appetite.

Figure 4: Emerging Market Bonds Continue to Significantly Outshine Other Major Economies on a YTD basis



Source: Data sourced from Yahoo! Finance as on November 10, 2025. Australia – iShares Core Composite Bond ETF (GOVT.AX), United States – iShares U.S. Treasury Bond ETF (GOVT), United Kingdom – iShares UK Gilts ETF (IGLT.L), Japan – Daiwa ETF-TOPIX Mid Small (2621.T), Canada – iShares Canadian Government Bond Index ETF (XGB.TO), China – VanEck China Bond ETF (CBON), Eurozone – iShares Global Government Bond EUR Hedged ETF (XGLE.L), Global – Vanguard Total World Bond ETF (BNDW), Emerging Markets – VanEck J.P. Morgan EM Local Currency Bond ETF (EMLC)

Macro Outlook Consensus and Divergent Forecasts

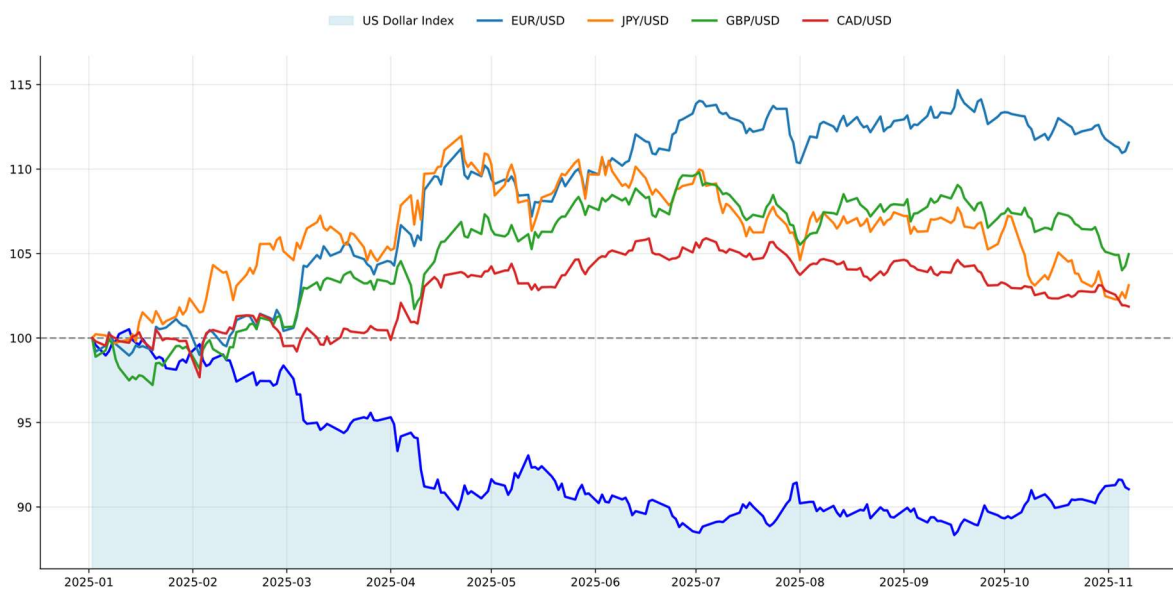
CBO consensus projects real GDP growth of approximately 1.4% for 2025, a downslide from prior expectations. The 2026 outlook features a “sugar-high” rebound to about 2.2% driven by the OBBBA stimulus, before growth settles back to 1.7-1.8% in 2027-28, with unemployment climbing to 4.4-4.5% and inflation persisting above 2%. Alternative forecasts from Deloitte, the Philadelphia Fed, and the IMF broadly align, anticipating modest 2025 growth in the 1.4-1.8% range, a modest rebound in 2026-27, and a subsequent slowdown, while all note rising unemployment and lingering inflation pressures.

We note that the convergence among independent forecasters reinforces the view that 2025 is a transition year marked by weak growth, and that the 2026 stimulus uplift is unlikely to be durable. The consistency across institutions suggests that market participants should price in a near-term growth trough, a brief rebound, and a return to sub-potential expansionary conditions in the medium term.

Structural Risks and Stagflation Potential

The primary risk identified is a cost-push inflation scenario arising from tariffs, combined with demand-pull stimulus and accommodative monetary policy, which could precipitate a stagflationary recession. Should inflation accelerate sharply, the Fed may reverse course with aggressive tightening, raising the probability of a 2026-27 recession and unemployment approaching 5%. Structural vulnerabilities—debt-to-GDP above 100%, persistent \$1.8 trillion annual deficits, and a historically negative NIIP—compound the risk by crowding out private investment and limiting external financing flexibility.

Figure 5: Major Global Currencies Continue to Appreciate Against the U.S. Dollar

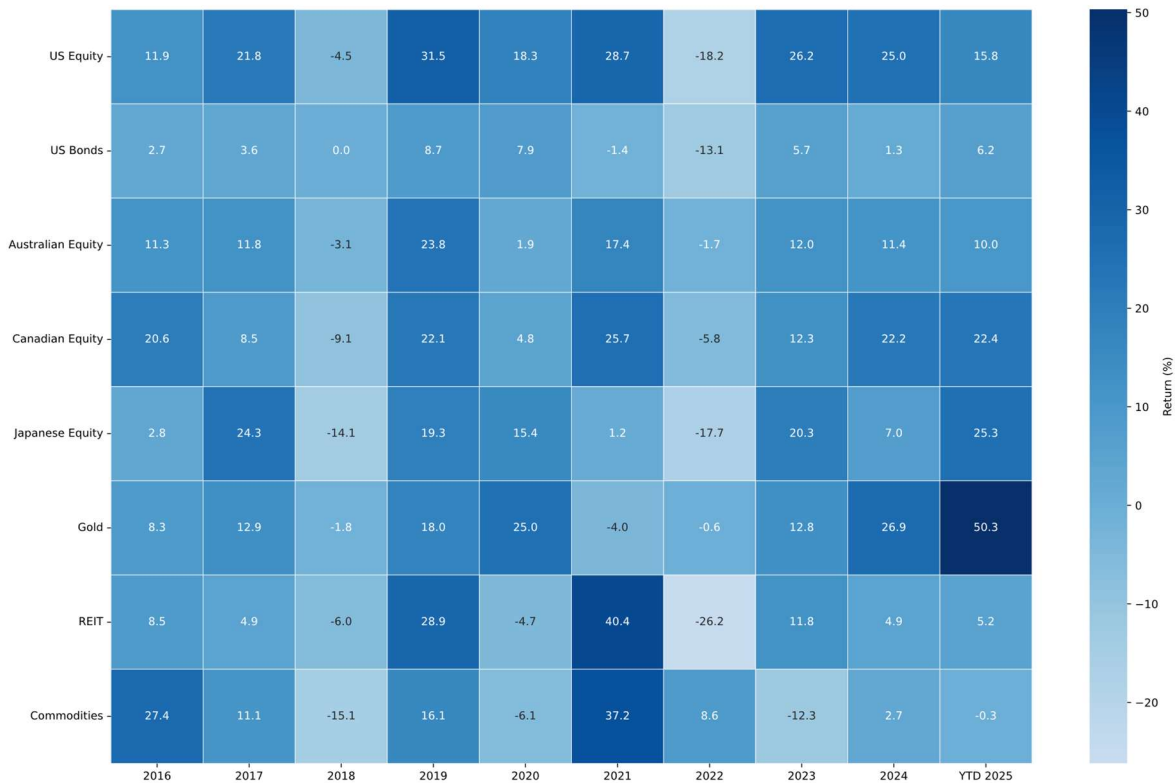


Source: Data sourced from Yahoo! Finance as on November 10, 2025.

We believe that the interaction of these structural constraints with the twin-shock policy environment creates a narrow policy window. Any misstep—either insufficient tightening in the face of rising inflation or premature tightening that stifles the fragile recovery—could lock the economy into a prolonged period of stagnant growth and elevated price pressures, a classic stagflation scenario.

Market Implications Across Asset Classes

Higher sovereign-risk premia are expected as the debt burden expands, pressuring yields on Treasuries and increasing spreads on corporate credit. Corporate earnings will face dual headwinds: higher input costs from tariffs and weaker consumer demand stemming from reduced disposable income. Sectors that stand to benefit from the OBBBA stimulus, such as technology and capital equipment, may offset some exposure to tariff-induced cost pressures, but the net effect is likely muted. Fixed-income investors should embed higher inflation expectations and the possibility of a Fed tightening pivot into pricing models, particularly for longer-duration securities.

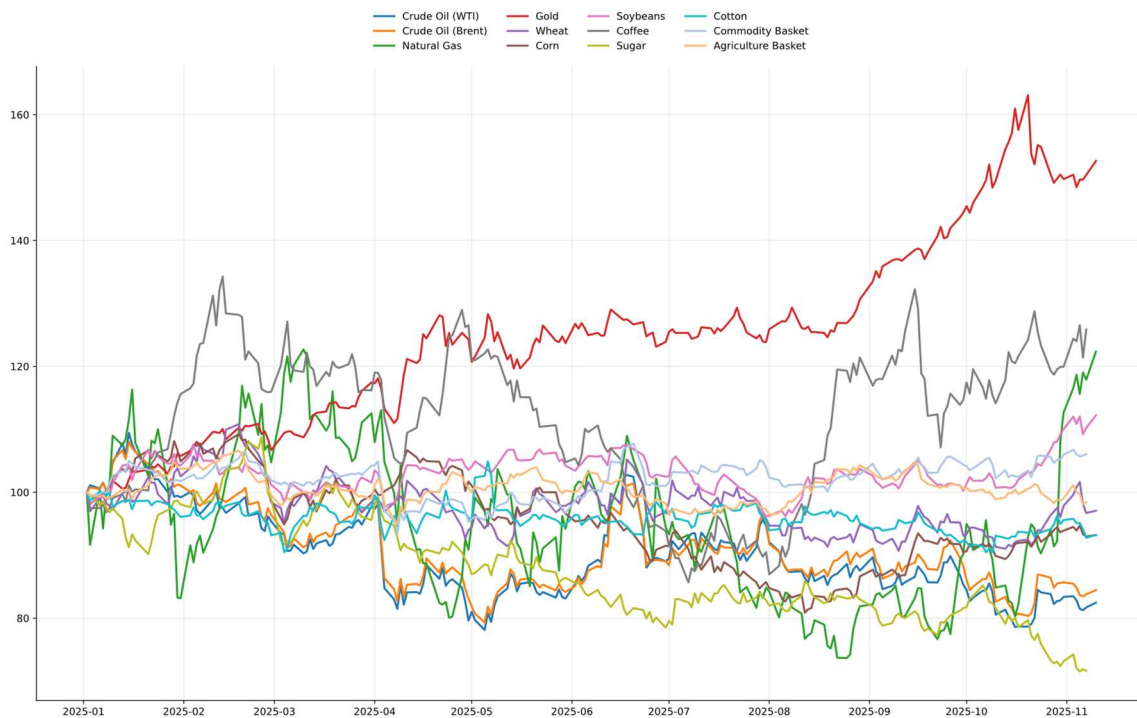
Figure 6: Global Asset Class Performance – Gold Continues to Overheat


Source: Data sourced from Yahoo! Finance as on November 10, 2025. US Equity – Vanguard 500 Index Fund (VFIAX), US Bonds – Vanguard Total Bond Market Index Fund (VBTLX), Australian Equity – Vanguard Australian Shares Index ETF (VAS.AX), Canadian Equity – Vanguard FTSE Canada All Cap Index ETF (VCN.TO), Japanese Equity – iShares MSCI Japan ETF (EWJ), Gold – iShares Gold Trust (IAU), REIT – Vanguard Real Estate Index Fund (VGSIX), Commodities – S&P-GSCI Commodity Index Future (GD=F)

We note that the equity market has been resilient, with the S&P 500 up roughly 3% YTD and on track for its longest streak of monthly gains since 2021. AI-driven megacap earnings (Alphabet, Microsoft, Meta) have delivered a \$60 billion Q4 capex surge, and Meta’s \$30 billion bond issuance underscores rising capital intensity. Nonetheless, the upside from AI themes must be weighed against broader macro headwinds, and we maintain an overweight stance on U.S. equities, especially AI-focused names, supported by anticipated further Fed rate cuts.

Global Context: China, AI, and Trade Dynamics

We note that a U.S.–China trade truce has been confirmed; tariffs remain in place but export volumes stay robust, providing near-term stability to bilateral trade flows. China’s export engine delivered its strongest net-export contribution to GDP growth since 2020, helped by pre-tariff import front-loading. Additionally, China suspended rare-earth export controls for a year in exchange for U.S. tariff relief on ports and shipbuilding, adding short-term supply-chain certainty. Beijing’s new five-year plan emphasizes self-reliance in quantum computing, nuclear fusion, and other high-tech sectors, yet weak housing, low consumer confidence, and an aging workforce keep the overall China equity outlook neutral.

Figure 7: Gold Continues its Upward Trajectory, Amid Natural Gas Registering Vertical Trajectory


Source: Data sourced from Yahoo! Finance as on November 10, 2025. Crude Oil (WTI) – NYMEX WTI Crude Oil Futures (CL=F), Crude Oil (Brent) – ICE Brent Crude Oil Futures (BZ=F), Natural Gas – NYMEX Natural Gas Futures (NG=F), Gold – COMEX Gold Futures (GC=F), Wheat – CBOT, Wheat Futures (ZW=F), Corn – CBOT Corn Futures (ZC=F), Soybeans – CBOT Soybean Futures (ZS=F), Coffee – ICE Coffee C Futures (KC=F), Sugar – ICE Sugar No.11 Futures (SB=F), Cotton – ICE Cotton No.2 Futures (CT=F), Commodity Basket – Invesco DB Commodity Index Tracking Fund (DBC), Agriculture Basket – Invesco DB Agriculture Fund (DBA).

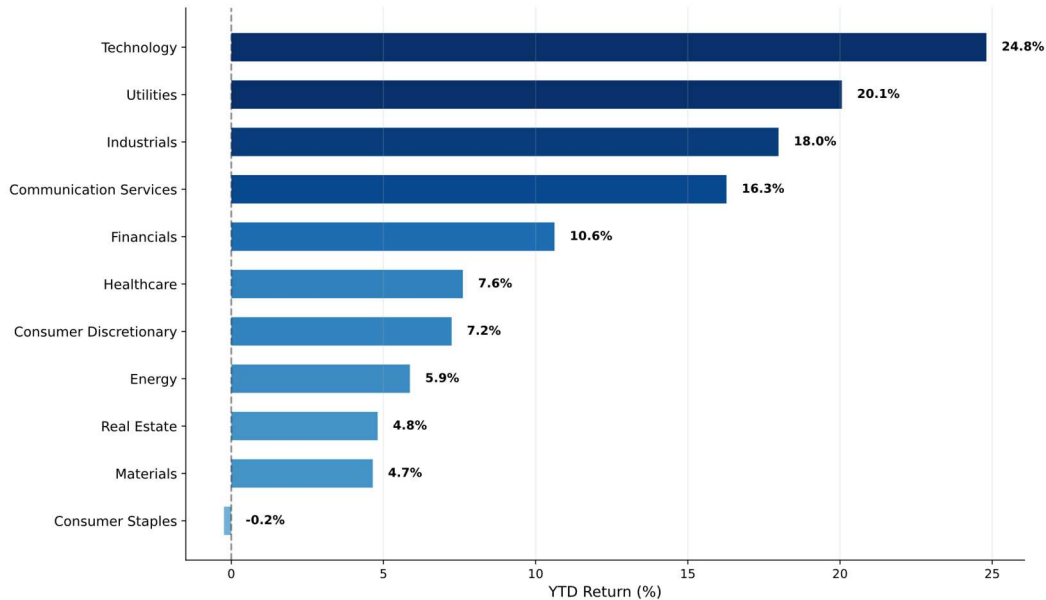
We believe the AI theme is expanding globally, with South Korean equities up 70% (local currency) as chipmakers ink deals with OpenAI, Taiwan’s index up 23%, and copper prices up roughly 30% to all-time highs driven by data-center demand. Infrastructure equity and private-credit assets appear attractive given valuation discounts and financing needs of AI build-out. Selective exposure to Chinese AI remains justified, as Hong-Kong-listed Chinese tech stocks are up about 28% YTD, outpacing U.S. peers.

Tactical and Strategic Asset Allocation Guidance

From a tactical perspective (6-12 months), we recommend an overweight on U.S. equities, leveraging FX hedges on euro-area sovereigns for income (e.g., French/Spanish 10-year bonds yielding >5% when hedged). Strategically (5 years +), we favor short-term inflation-linked bonds, given the upside risk from tariff-driven inflation, and prefer developed-market sovereigns outside the U.S. over global investment-grade credit. Emerging markets, particularly India, offer exposure to a demographic dividend, while Japan is overweighted for an inflation rebound and corporate reforms. Fixed-income granularity calls for an overweight in short-term investment-grade credit, neutrality on long-term IG and global high-yield, and an overweight in agency MBS relative to Treasuries for high-quality yield. Equity granularity maintains an overweight in the United States, neutrality on Europe (watching structural reforms), neutrality on the

UK (potential tax headwinds), overweight on Japan, and neutral stances on China and emerging markets overall.

Figure 8: Five of Ten S&P 500 Sectors Registered a Double-Digit Positive Performance, Led by Technology



Source: Data sourced from Yahoo! Finance as on November 10, 2025.

Bottom-Line Assessment

We believe the U.S. economy in 2025 is not in a boom but in a clear downslide driven by contractionary trade policy, with a temporary stimulus-induced uptick in 2026 that is unlikely to be sustainable. The twin-shock environment of aggressive tariffs and expansive deficit-financed stimulus creates a net contractionary effect, as confirmed by the Fed's rate cuts and the dominance of downside-risk narratives.

Structural vulnerabilities—*excessive debt, persistent deficits, and a record-low NIIP*—limit policy flexibility and heighten the risk of a stagflationary recession should inflation resurge. Investors should price in higher sovereign-risk premia, anticipate corporate earnings pressure, and balance exposure to stimulus-benefiting sectors against tariff-sensitive industries. The macro backdrop remains fraught, and disciplined, data-driven positioning will be essential as policy and external dynamics evolve.



About us

RCK Analytics is a global provider of high-quality investment research, investment banking support, PE/VC insights, Gen AI solutions, market research, analytics, and assurance services. We serve a diverse client base including investment firms, PE/VC funds, asset managers, hedge funds, investment banks, consulting firms, and corporates across sectors. Backed by a skilled team, we deliver data-driven insights and strategic support to help clients make informed decisions and drive financial outcomes.



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