MILLER TABAK + CO., LLC

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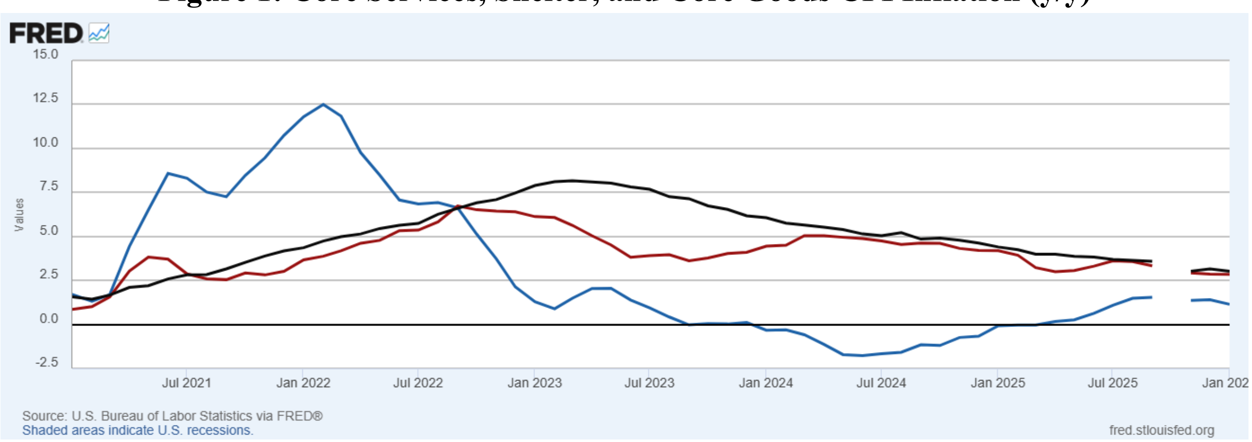
The Supreme Court will Slow the Fed

Although we expected the Supreme Court to strike down President Trump's IEEPA tariffs, we were surprised that the President responded with a 15% blanket tariff rather than trying to reconstruct them using sectoral tariffs. The legal basis for Trump's new tariffs (Section 122 of the 1974 Trade Act) is dubious. It will, however, take far longer than 150 days to mount a successful legal challenge.

The macroeconomic impact of the court's ruling will be small, but slightly negative. Yale's Budget Lab estimates that, if Trump follows through, the average tariff rate will fall from 16.0%, before the court's ruling, to 13.7% afterwards. This drop is more than offset, however, by the added costs of renewed tariff-based uncertainty. Firms have cited this as a reason not to hire, so the new tariff regime is a small blow to the labor market.

Figure 1: Core Services, Shelter, and Core Goods CPI Inflation (y/y)



The change in tariffs comes just when the inflationary impacts of Trump's earlier tariffs had become clear. Figure 1 breaks y/y core-CPI down into three parts. Tariffs show up mostly in core-goods inflation (blue), which rose from around zero to 1.5% in 2025, and showed clear signs of tapering off in recent months. Although tariffs may have smaller effects on services, service inflation, ex-shelter (red) has been steadily declining and is at 2.8%. Were goods inflation zero, then core PCE, ex-shelter, would be very close to the Fed's 2% target. **In other words, if the FOMC is really "seeing through." the impacts of tariffs, then it shouldn't be**

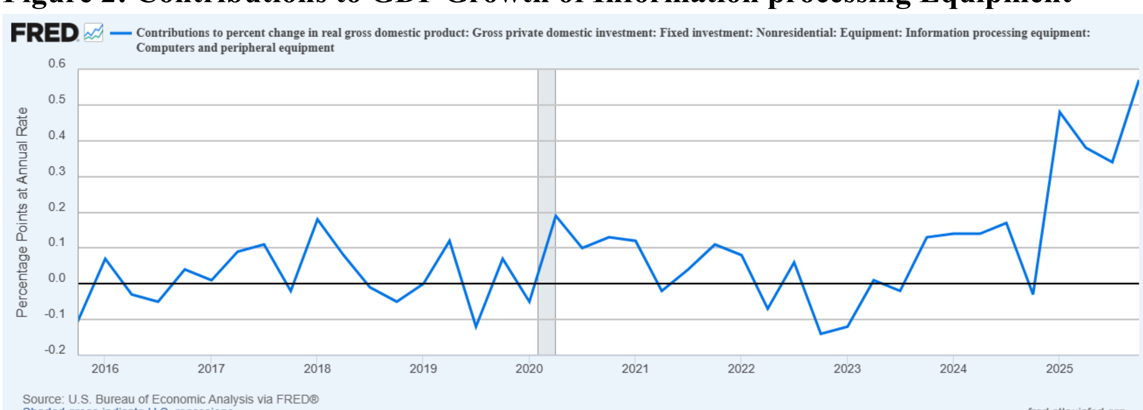
concerned at all. We also note that shelter inflation (black), which is mostly a figment of past housing price growth, is also predictably declining and is down to 3.0%.

Although tariff rates have slightly fallen, the shift in tariff policy may delay the decline in goods-inflation by affecting some prices that were yet to be impacted by tariffs. This would make no difference if the Fed really were seeing through tariffs. The January FOMC minutes, where a few members wanted language suggesting that the Fed's move might be to raise rates, however, shows that they are not. **The FOMC remains too concerned about inflation and we now see their next rate cut waiting until June.** Longer-term, however, we still expect 100 bps of cuts through 1Q2027 to take the Federal Funds rate to 250-275 bps.

Other Developments in Macroeconomics:

1. Our macroeconomic outlook remains a waiting game between whether firms will resume hiring or if layoffs will accelerate. Despite intermittent signs of the latter, the evidence still points towards a continuation of the low-hire, low-fire labor market. One encouraging sign, however, is that ADP's weekly job growth numbers have risen from a four week average of 4,750 in early January to 12,750 this week. As we await next week's employment reports, **the key is whether job growth extends beyond education and healthcare**, two sectors that are insensitive to the business cycle, and which have fueled more than 100% of employment growth in recent months. **Even a strong headline figure will not be good news if employment growth in all other sectors remains negative**.

Figure 2: Contributions to GDP Growth of Information processing Equipment



2. We are not bothered by last week's big miss on 4Q2025 GDP which came in at 1.4%, well below the 2.5% expected. Shutdowns caused federal spending to reduce growth by 1.2%, and much of this will come back in 1Q2026. In other words, the true growth figure is a little over 2%. Consumption growth was also 2.4%, which is good. The data also provides a clearer picture of the role of AI investment. Before 2025, "information

processing equipment," which captures AI investment, had boosted GDP growth by about 0.1% on average. In 2025, this jumped by 0.4% to around 0.5% (it was 0.6% in 4Q2025). **AI is thus a contributor, but not the main driver, of the gap between solid GDP growth and stagnant employment.** The bigger driver of strong labor productivity growth is instead firms streamlining their payrolls following the exceptionally tight labor market of 2022-24

3. We never put too much stock in consumer confidence measures, but we are surprised by the strong favorable reaction to The Conference Board's February reading. The index did increase to 91.2 from 90.0 in January, with the latter figure being revised upwards from a very low 84.5. This measure is, however, two separate indices. The part that is based on expectations of future conditions edged up in February. It has, however, moved sideways since 2022 and is not very interesting currently. The present situation index fell again in February, continuing a decline that began in early 2025. **It is at its lowest level since 2016, reiterating concerns about the labor market and low-middle income households' financial positions.**

-Paul Shea

Strategic Economist, Miller Tabak