



# THE CAVU COMPASS

Monthly macroeconomic insights and market commentary provided by CAVU Securities and Piedmont Crescent Capital.

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Easing Pressures Clear the Runway for Growth

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# Something Beyond a Typical Soft Landing

## More of a Touch and Go Rather Than a Typical Soft Landing

- ▲ After a volatile first half marked by rapid tariff escalation and market swings, the reciprocal tariff regime is now largely in place. Early signs of progress in trade negotiations with key allies suggest uncertainty could ease later this year and into 2026, reducing market risk premiums and supporting a more stable investment environment.
- ▲ Strong productivity gains, driven in part by AI adoption, and tighter immigration enforcement are reshaping labor supply and demand. This is producing a bifurcated labor market—tight for blue-collar and service roles, yet increasingly slack in many white-collar professions—creating complex challenges for wage growth and policy decisions.
- ▲ Consumer spending is slowing as softer job and income growth collide with higher prices for imported goods. Tariff pass-through is expected to increase in the second half, shifting spending toward essentials and putting added pressure on lower-income households while higher-income consumers remain relatively resilient.
- ▲ Capital spending, previously delayed by policy uncertainty, is showing signs of acceleration. Clearer trade rules are unlocking postponed projects, with reshoring, supply chain diversification, and strategic infrastructure—including data centers and energy investments—set to drive business investment into 2026.
- ▲ While higher interest rates and tariff uncertainty have temporarily slowed momentum, the economy is positioned to regain altitude, supported by a backlog of capital projects, easing financial conditions, and a likely September Fed rate cut. However, the total number of rate cuts may be fewer than markets anticipate.
- ▲ Geopolitical developments—including the Alaska summit on Ukraine, the escalation in Gaza, and last minute extension of the U.S.-China trade truce—are key variables for markets. Alliance cohesion and trade negotiation outcomes over the next few months will shape risk sentiment and global trade flows for the second half of this decade.
- ▲ Outlook: We expect U.S. GDP growth to moderate to 1.3% in 2025 before reaccelerating to 2.3% in 2026 and 2.6% in 2027 (Q4/Q4). Growth will increasingly be driven by business investment, with housing and consumer spending gradually improving as interest rates and policy clarity provide lift. Defense spending is primed to increase as well, with efforts being made to speed up production of aircraft, ships, drones and other munitions.

The U.S. economy enters the second half of 2025 with momentum slowing but not stalling. After turbulence in April and May—marked by volatile markets, trade policy uncertainty, and softer consumer spending—conditions have steadied. Recession risk has eased, having been replaced by a more nuanced outlook: a brief deceleration followed by a cautious reacceleration as clarity improves on multiple fronts.

Rather than a smooth soft landing, the path ahead looks more like a “touch and go.” In aviation, this maneuver involves landing and immediately taking off without coming to a full stop—a staple of naval carrier practice and

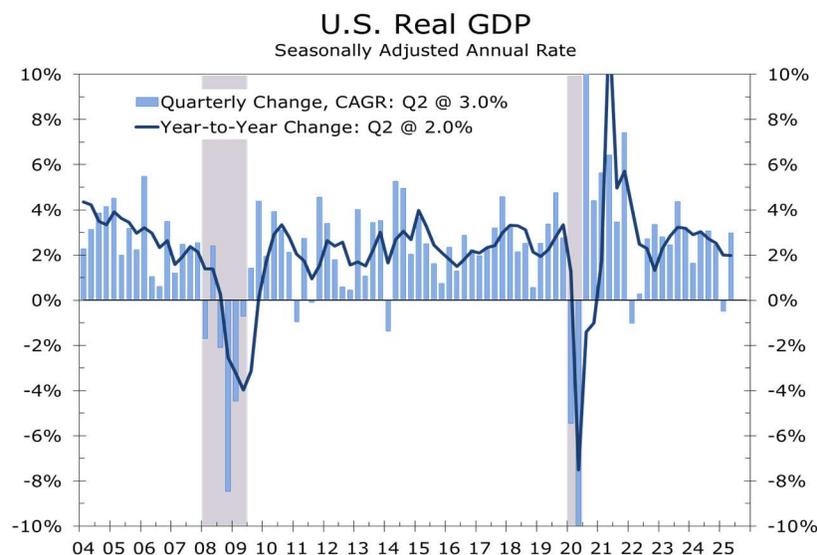
an occasional necessity for commercial pilots when margins narrow and safety demands a go-around. For the economy, the analogy fits: a short slowdown under the weight of higher interest rates and policy uncertainty, followed by renewed lift from capital spending, clearer trade rules, and lower interest rates.

One of the largest sources of uncertainty earlier this year—the rapid escalation and down-to-the-wire negotiations over tariffs—has shifted into a more stable phase. After sending the economy on a wild ride in the first half, the reciprocal tariff regime is now largely in effect. We expect agreements with China and other key nations to emerge later this year or in early 2026. The initial adjustment period produced sharp swings in trade flows—import frontloading in Q1 subtracted about five percentage points from GDP growth, only to reverse in Q2 and add a comparable boost as imports normalized. Beneath this volatility, core domestic demand expanded just 1.2% in Q2, its slowest pace since late 2022.

While the U.S. effective tariff rate has climbed above 15%, the latest measures spared China from new penalties, limiting the risk of major supply disruptions. Financial markets have taken the changes in stride, and some uncertainty has given way to greater policy clarity. Early progress in trade talks suggests the policy backdrop could become less volatile later this year and into 2026. Markets now appear to have a better read on the administration’s trade strategy and are pricing in a potential deal with China and other major partners within the next year.

High tariffs will continue to act as a tax-like constraint on consumers and certain industries, but the near-term bite has been milder than feared. Much of the initial impact on prices was muted as businesses stockpiled goods ahead of implementation, absorbed costs through lower margins, and cut expenses. Those buffers are now largely exhausted, and more of the tariff impact is likely to pass through to prices in the second half, potentially pushing inflation back toward—or slightly above—3%. With goods prices rising, consumers are trimming spending on discretionary services, contributing to less services inflation.

Economic growth is expected to run below potential in the second half—around 1.3% annualized—as weaker real income growth, persistent housing market softness, and lingering policy uncertainty offset tailwinds from inventory restocking and a narrowing trade gap. Still, with the tariff regime more predictable, financial conditions easing, and the prospect of Fed rate cuts ahead, the runway for a late-2025 or early-2026 pickup in growth is beginning to clear. Lower interest rates should help ensure a safe climb-out.



Source: Bureau of Economic Analysis

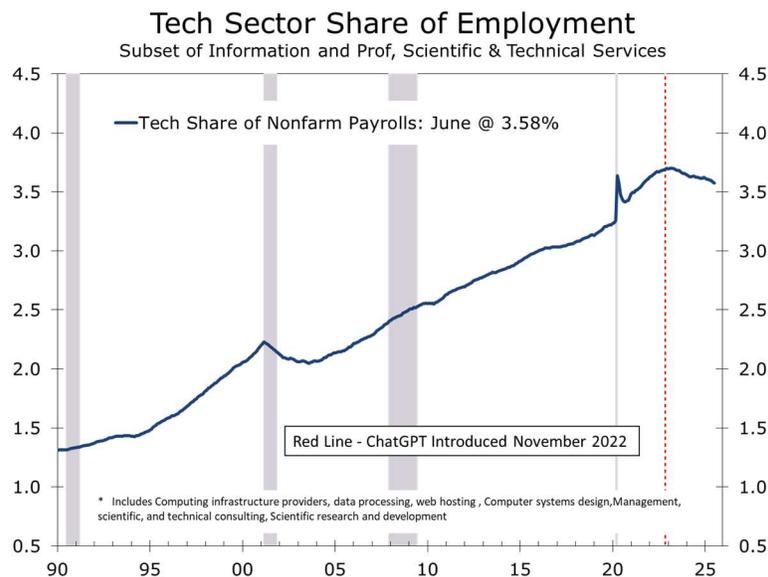
The July employment report confirmed that the labor market is slowing more decisively. Nonfarm payrolls rose just 73,000, and downward revisions erased a combined 258,000 jobs from May and June. Over the past three months, job growth has averaged only 35,000—a pace well below what is needed to keep the jobless rate from rising. The unemployment rate ticked up to 4.2% (4.24% unrounded), but this headline figure masks underlying weakness: labor force participation fell to 62.2%, the lowest since the economy’s initial ascent from the pandemic, and the employment-population ratio slipped to 59.6%. Long-term unemployment rose by 179,000 to 1.8 million, now accounting for nearly one-quarter of total unemployed.

Layoffs are edging higher but remain historically low. Instead, the market is characterized by unusually low turnover—fewer firings but also fewer hirings. Productivity gains, partly driven by the increased use of AI, are contributing to this dynamic. Nonfarm productivity, or output per hour worked, grew at a 2.4% annualized pace in the second quarter. Employment in a narrow set of industries within information technology and professional, scientific, and technical services has fallen sharply, losing 12,300 jobs in June and seeing its share of nonfarm employment decline steadily since ChatGPT debuted in November 2022.

Hiring in sectors such as tech, finance, and business services is flat or contracting, leaving many new graduates facing an unexpectedly tough job market. By contrast, blue-collar and service positions remain tight, particularly in construction, manufacturing, logistics, and healthcare. Stricter immigration enforcement and accelerating retirements are constraining labor supply in these sectors, keeping wage pressures elevated.

Wages remain relatively firm, rising 0.3% in July and 3.9% year-over-year, with stronger gains in lower-paying, labor-intensive industries. This divergence—slack in white-collar work alongside persistent shortages in blue-collar roles—marks a reversal from prior labor cycles. The shift is not yet complete. We expect businesses to accelerate investment in automation and training programs to offset constrained labor supply in trade and service occupations, reshaping the job market in the second half of the decade.

The unevenly cooling labor market also creates a dilemma for policymakers. Easing wage pressures in white-collar sectors provide some room to cut interest rates, but sustained inflation risk from persistent blue-collar shortages limits how aggressive the Fed can be. The challenges to living standards also raise important questions for elected officials and help drive populist sentiment on both the left and right.



Source: The Bureau of Labor Statistics

Consumer spending is losing momentum as softer job and income growth collide with persistently high prices for imported goods. Employment concerns are building as hiring plans slow across a wide range of industries, leaving middle- and lower-income households squeezed by tighter budgets, reduced discretionary outlays, and a growing reliance on savings or consumer credit to maintain basic consumption. Rising credit utilization in these groups is a key signal that the cushion from pandemic-era savings has been largely depleted.

The strain is uneven across the income distribution. High-income households—buoyed by strong equity market gains, rising home values, and relatively secure employment—account for more than half of total consumer spending. By contrast, lower-income families face greater exposure to tariff-driven price increases on everyday necessities, thinner savings buffers, and reduced government support. The result is a bifurcated spending environment: affluent households continue to drive demand in premium goods, travel, and high-end services, while lower-income households cut back, particularly in discretionary retail, dining, and entertainment.

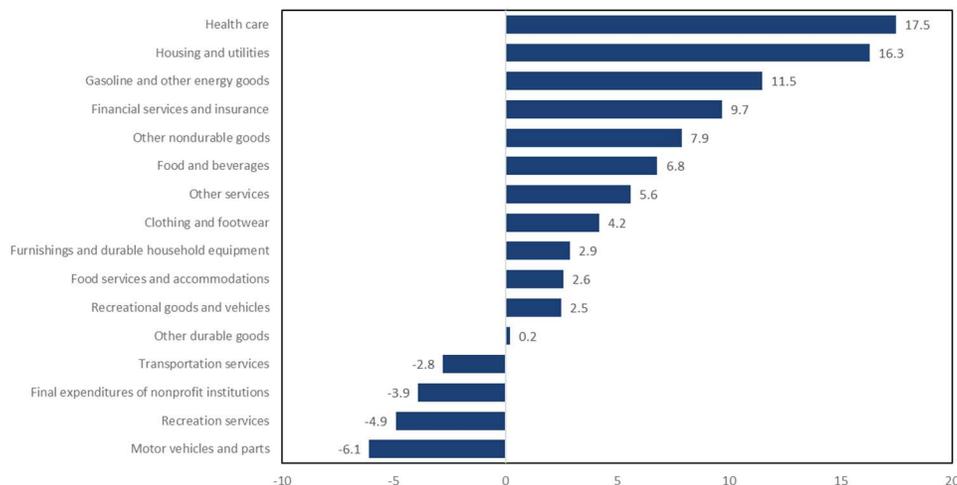
Tariffs are amplifying the pressure. Early mitigation—via import frontloading, margin compression, and cost cuts—has largely run its course, raising the likelihood of more direct pass-through to consumer prices in the second half. With inflation poised to edge back toward or slightly above 3%, households are shifting spending toward staples and away from non-essentials. Recent retail and services data confirm the pivot, with grocery and household goods outperforming while apparel, electronics, and other discretionary categories lag.

Tighter credit conditions are compounding the slowdown. While an expected Fed rate cut later this year should lower borrowing costs, banks are tightening lending standards, especially for households with weaker credit profiles. Credit card delinquency rates are climbing, led by younger borrowers and lower-income households. Mortgage refinancing could provide some relief, but the benefits are concentrated among middle- and upper-income households with strong equity positions—leaving the most financially vulnerable with limited options.

Taken together, the consumer sector is transitioning from broad-based strength to a more fragile and uneven footing. Continued resilience among high-income households should prevent a sharp collapse in aggregate spending, but persistent drag from middle- and lower-income groups will weigh on consumption growth through year-end. For policymakers, the challenge will be ensuring that rate cuts, while supportive, do not disproportionately benefit those least constrained, leaving the regressive impact of tariffs and inflation largely intact for the households that feel it most.

### Consumer Spending Monthly Change By Category

\$ Billions, June 2025



Source: Bureau of Economic Analysis

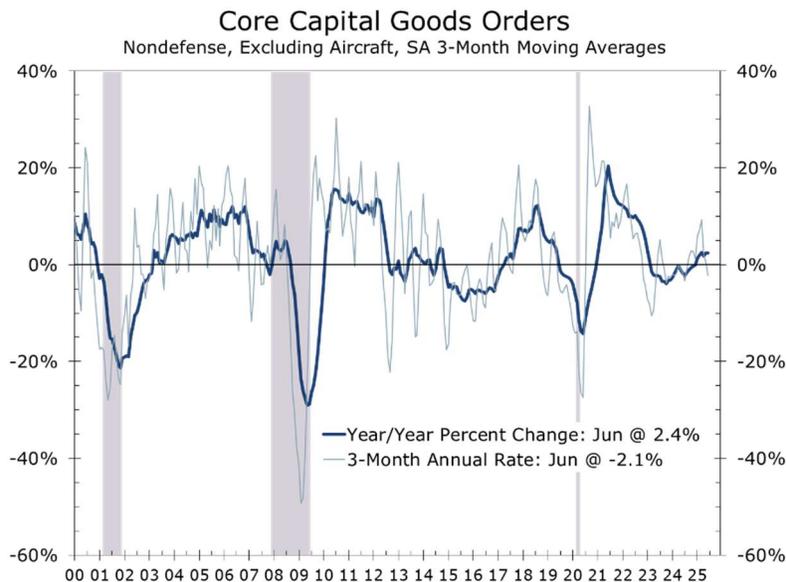
After a year of hesitation, capital spending appears set to regain altitude as clarity on trade policy filters through the corporate sector. The reciprocal tariff regime, now largely in place, has reduced the uncertainty that kept many projects on hold in early 2025. With the rules of engagement defined and negotiations with key allies showing early progress, firms are reviving deferred investment plans, particularly in sectors where long lead times make stability essential.

Manufacturers are leading the way. Reshoring and supply chain diversification, accelerated by geopolitical tensions, are driving renewed investment in domestic production capacity. Industrial construction pipelines are filling again, fueled by the need for massive data centers to support AI expansion and restructuring tied to defense and national security. Energy projects are advancing, with natural gas seen as the quickest way to ramp up output. Small modular nuclear reactors are attracting significant interest but remain years from deployment. Wind and solar projects are moving more cautiously and with less policy support than in the past.

The rebound extends beyond heavy industry. Technology, logistics, and advanced manufacturing firms are expanding capacity in growth markets—semiconductors, AI-driven infrastructure, and EV supply chains. Commercial equipment orders, flat earlier this year, are expected to rebound in the second half as companies position for stronger demand in 2026 and beyond. Clearer trade rules have improved supply chain predictability, lowered risk premiums in project budgets, and freed up capital.

While elevated interest rates and a strong dollar had been headwinds, both are easing. Treasury yields have drifted lower in anticipation of a September Fed rate cut, and corporate bond spreads remain tight, keeping financing favorable for well-rated issuers. Credit for small and mid-sized firms remains constrained, but even here lower rates and policy clarity are boosting confidence.

These shifts suggest the capital spending cycle is moving from standby to taxiing for takeoff—a phase where project pipelines are reactivated, contracts signed, and financing secured, but large-scale execution is still months away. A backlog of deferred projects, targeted reshoring, and improving financing conditions should carry momentum into a robust expansion phase beginning in late 2025 and into 2026. With corporate balance sheets healthy and supply chain bottlenecks easing, growth will be driven more by strategic capital deployment than consumer spending, echoing the tech-driven expansion of the late 1990s.



Source: Census Bureau

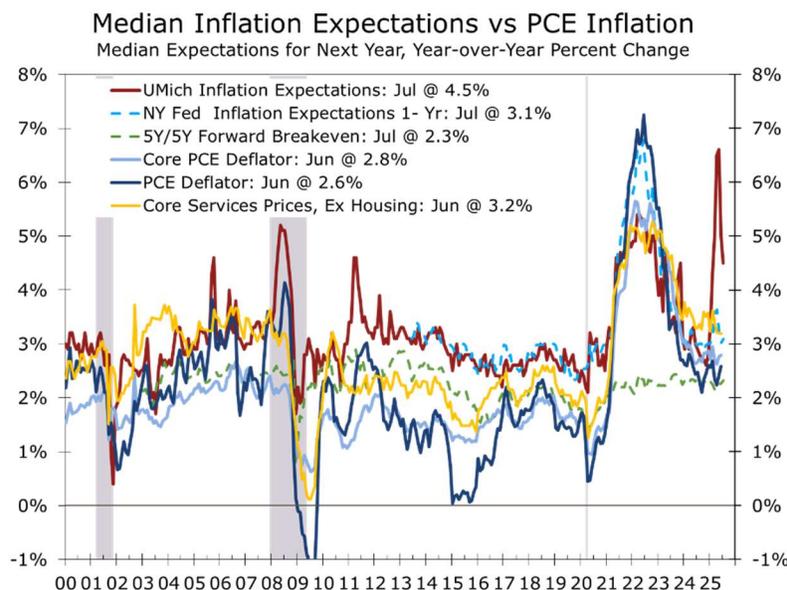
The Fed appears increasingly likely to begin its descent from restrictive policy at the September FOMC meeting. Softer labor market readings and a loss of altitude in consumer spending have brought rate cuts onto the active flight plan. Market pricing now implies near-certainty of a quarter-point move, with many forecasters expecting five or six cuts over the next year. We see a shorter flight path—three or four cuts at most—as inflation remains above target, tariff-related price pressures are still ahead, and the economy, while slowing, is not yet in a hard-landing trajectory.

Recent inflation readings underscore the Fed’s balancing act in the cockpit. Core PCE rose to 2.8% year-over-year in June, up from its spring lows, and is likely to edge above 3% before leveling off. This uptick should be temporary, but it comes at a politically sensitive moment—much like hitting turbulence on approach—complicating the optics of easing. Goods prices in tariff-exposed categories such as electronics, autos, and apparel are climbing, while consumers have responded by pulling back on discretionary services, helping to cool inflation there. Wage growth, though down from its peak, remains firm at 3.9%, adding lift to inflation pressures that will require careful navigation. Stronger productivity growth may give the Fed more room to maneuver.

From the Fed’s vantage point, the runway is visible but with uncertain crosswinds. Financial conditions have already eased on expectations of a September cut, with Treasury yields drifting lower and equity markets climbing. Housing could be an early beneficiary: with the share of mortgages above 6% roughly doubling since 2021, even a modest rate drop could spur refinancing and sales. Credit-sensitive sectors such as autos and consumer durables could also see a tailwind, though tighter lending standards will keep some households.

The Fed’s challenge will be to manage the descent. Move too quickly and it risks reigniting inflation expectations; too slowly, and growth could stall before the aircraft is aligned with the runway. While long-term inflation expectations remain anchored, short-term measures have edged up since tariffs were announced. Unless incoming data show a sharper slowdown in jobs or inflation, the Fed is likely to keep subsequent cuts data-dependent rather than pre-programmed.

In short, September looks like the “cleared for landing” moment for rate cuts, but we expect the touchdown to be brief. Our forecast calls for a touch-and-go—three or four cuts at most—before the economy gains altitude again in 2026, propelled by capital spending, reshoring of critical industries, and a modest rebound in housing.



Source: UMich, NY Fed, BLS & BEA

The mid-August Alaska summit is shaping up as a critical waypoint. Moscow's floated ceasefire would freeze the front lines and cement Russian territorial gains, but Ukraine and its European allies countered on August 9 with a proposal that any talks begin only after a ceasefire or reduction in hostilities—starting from current front lines—and include robust security guarantees to protect Ukraine's sovereignty and territorial integrity. The U.S. has signaled openness to a trilateral meeting including Zelensky, though Putin has resisted direct talks. The Kremlin's strategy appears aimed at dividing Washington from Europe, portraying Ukraine and the EU as obstacles to peace while refusing to compromise on core war aims. On the battlefield, Russia has shifted to infantry-led assaults to reduce tank losses, while Ukraine has extended long-range drone strikes deeper into Russian territory, including its first hit on the Komi Republic's Lukoil refinery.

The stakes are significant. For Russia, a successful summit would lock in battlefield gains and allow a pause before pressing further west when conditions are more politically opportune. For Ukraine, the priority is to hold the remaining portions of Donetsk, harden defensive lines, and maintain strategic ambiguity on NATO. We have previously noted that NATO observer status—paired with cross-training alongside NATO forces but without formal membership—might offer a compromise, though it would be a hard sell in Moscow.

In the Middle East, Israel's cabinet approval of a Gaza City seizure marks an aggressive escalation in the Gaza campaign. Prime Minister Netanyahu frames the move as decisive in defeating Hamas, but European and UN leaders have condemned it as worsening a man-made humanitarian crisis. Germany has suspended certain arms exports, and a bloc of European UNSC members reiterated calls for a halt to hostilities and expanded humanitarian access. The U.S., however, remains firmly in Israel's corner—reinforcing perceptions that Washington will fly solo when strategic imperatives outweigh multilateral alignment. The key risk is that the operation falters, thereby emboldening Hamas and its backers.

These parallel conflicts intersect with U.S.–China trade negotiations. On August 11, the White House extended the U.S.–China tariff truce by 90 days. Beijing will be watching the Trump-Putin meeting closely to see if the U.S. maintains coordinated allied altitude or drifts toward transactional, bilateral deals. A U.S.–Russia arrangement that sidelines Europe, or growing isolation over Gaza, could embolden China to demand more favorable terms, delay market access, or resist export controls. Conversely, disciplined allied formation on Ukraine would strengthen Washington's negotiating lift.

For investors, key instruments to monitor include: the Alaska summit communiqué (especially language on territorial concessions and Ukraine's role), EU and NATO statements, Chinese state media framing, and indicators of Middle East escalation. While the base case points toward temporary ceasefires and an extension of the tariff pause, the geopolitical risk premium is unlikely to descend until alliance cohesion reaches a steadier cruising altitude.

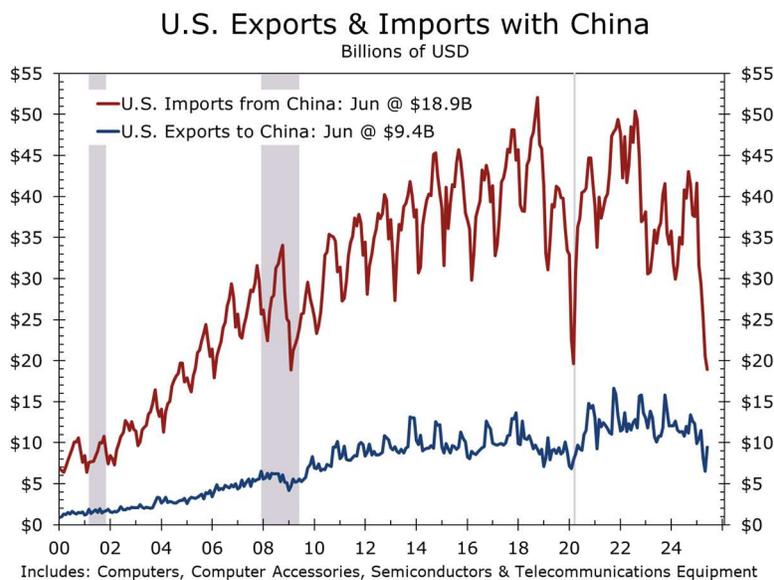
### **Policy Watch – Industrial Policy for a China 2.0 World**

Nvidia and AMD will remit 15% of China-related AI-chip revenue—covering Nvidia's H20 and AMD's MI308—to the U.S. in exchange for export licenses, an unprecedented blend of export control and fiscal capture. The move could trim gross margins and pressure both stocks, while aligning with the Trump administration's broader shift toward state capitalism with American characteristics. That shift began under Biden, with the Inflation Reduction Act and CHIPS Act—different tools aimed at the same strategic objective.

The U.S. response to China's rise is moving beyond traditional free-market playbooks toward a more direct state role in steering capital, shaping industries, protecting strategically important industries, and linking economic

policy to geopolitical goals. Unlike the Cold War, this is not a binary contest between capitalism and communism. China is the world’s second-largest economy and a critical trading partner for most nations. It remains firmly in the communist camp, alternating between strategic competitor and geopolitical foe. The Chinese Communist Party retains full control of political and economic levers, making China a Communist political system that deploys capitalist tools to generate growth and maintain legitimacy. In Beijing’s model, the Party is the ultimate arbiter—capitalism exists at its discretion and serves its political objectives, not the other way around.

The U.S., by contrast, remains a capitalist system increasingly willing to use the state as a strategic instrument. While the American variant is less centralized and disciplined than Beijing’s, it is now prepared to deploy tariffs, investment controls, sovereign wealth funding, and corporate leverage to secure strategic advantage. This shift is likely to endure and may define how market economies contend with the rise of China’s command-and-control model. For markets, this marks a new flight plan: policy risk is now embedded in valuations for strategic sectors such as technology, defense, and critical minerals—and the stakes in resolving the Russia–Ukraine conflict extend well beyond Europe, shaping the balance of power with China and how trade negotiations are likely to proceed.



Source: Census Bureau

### Economic Outlook – Touch and Go Landings Require a Skilled Pilot

With tariffs now largely finalized with many trade partners, the overall regime is beginning to take shape. We expect to see a base tariff of between 10% and 15%, with higher rates on China and on goods transshipped through third countries by China. We also expect an updated USMCA to be negotiated next year, which should help strengthen the North American trade alliance. The effective U.S. tariff rate is likely to be in excess of 15% but less than 20%. China’s rate will likely settle around 35%, while India’s will be considerably lower—provided that some form of ceasefire can be reached between Russia and Ukraine.

While some details remain unsettled, comparisons to the 1930s Smoot-Hawley tariffs are overstated. In the 1930s, consumption was heavily weighted toward goods, which accounted for roughly 75% of total consumption. Today, goods account for only about one-third of consumption. Because tariffs are primarily assessed on goods, their overall impact on the economy is far smaller today than it was during the Great

Depression. This also helps explain why tariff pass-through into broader price measures has been more limited so far.

That said, we expect greater pass-through of tariffs in the second half of this year, which will push headline inflation higher and complicate the Fed’s balancing act. The Federal Reserve will need to convince financial markets that it is easing policy for the right reasons—namely, that downside risks to the economy have increased and that underlying inflationary pressures are still easing despite the tariff-related bump in headline measures. We expect quarter-point cuts in the federal funds rate at the September, October, and December FOMC meetings. If the economy does not respond to lower rates, an additional cut in January is possible.

By spring, stronger economic growth should become evident, increasingly driven by business fixed investment. Home sales and construction are also poised for a modest rebound once mortgage rates fall back to around 6%. Rates are unlikely to fall below that unless the economy weakens more than we expect. We project real GDP to rise 1.3% in 2025, 2.3% in 2026, and 2.6% in 2027, measured from Q4 to Q4.

**US Economic and Financial Outlook**

(% change on previous period, annualized, except where noted)

	2024				2025				2026				2023 Actual	2024 Actual	2025 Forecast	2026 Forecast	2027 Forecast
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4					
<b>Output</b>																	
Real GDP	1.6	3.0	3.1	2.5	(0.5)	3.0	1.1	1.7	1.9	2.3	2.6	2.5	2.9	2.8	2.2	1.8	2.4
Final Sales to Domestic Private Purchasers	2.9	2.7	3.4	2.9	1.9	1.2	1.4	2.0	3.2	2.8	2.8	2.8	2.5	3.0	2.8	2.4	2.6
Consumer Spending	1.9	2.8	3.7	4.0	0.5	1.4	2.4	1.7	1.8	2.1	2.3	2.5	2.5	2.8	2.4	2.0	2.4
Nonresidential Fixed Investment	4.5	3.9	4.0	(2.9)	10.3	1.9	(0.6)	2.8	6.0	4.3	3.8	3.5	4.9	3.5	3.3	3.1	3.4
Light Vehicle Sales	15.5	15.6	15.6	16.5	16.4	16.1	15.5	15.8	16.0	16.2	16.4	16.5	15.5	15.8	16.0	16.3	16.6
Industrial Production, Manufacturing (Yr/Yr)	(0.9)	1.4	(0.7)	(1.4)	0.7	1.0	1.1	1.5	2.2	2.4	2.6	2.8	(0.4)	(0.4)	1.1	2.5	2.8
Unemployment Rate (Qtrly Avg)	3.8	4.0	4.2	4.1	4.1	4.2	4.3	4.4	4.5	4.5	4.4	4.3	3.6	4.0	4.3	4.4	4.2
<b>Housing Market</b>																	
Housing Starts (Units, thous)	1,415	1,343	1,338	1,387	1,401	1,327	1,300	1,280	1,310	1,350	1,380	1,400	1,421	1,368	1,350	1,375	1,450
New Home Sales	677	685	707	671	655	652	660	670	680	700	720	730	666	684	659	710	750
Existing Home Sales	4,143	4,023	3,937	4,163	4,127	3,990	4,020	4,060	4,110	4,150	4,170	4,180	4,090	4,060	4,049	4,153	4,280
S&P/Case-Shiller Natl Home Prices (Yr/Yr % Change)	6.4	6.0	4.4	3.8	3.8	2.2	2.1	2.2	2.1	2.3	2.4	2.5	2.5	5.1	2.6	2.3	3.1
<b>Inflation (Year-to-Year % Change)</b>																	
Consumer Price Index (CPI)	3.2	3.2	2.7	2.7	2.7	2.5	2.8	3.0	2.9	2.8	2.6	2.5	4.1	3.0	2.7	2.7	2.4
Core CPI	3.8	3.4	3.3	3.3	3.1	2.8	3.0	3.1	3.0	2.9	2.6	2.5	4.8	3.4	3.0	2.8	2.3
Personal Consumption Deflator	2.7	2.6	2.3	2.5	2.5	2.4	2.7	2.9	2.8	2.8	2.7	2.6	3.2	2.8	2.6	2.7	2.3
Core PCE Deflator	3.0	2.7	2.7	2.8	2.8	2.7	2.9	3.1	3.0	2.9	2.7	2.6	4.1	2.8	2.9	2.8	2.3
Employment Cost Index	4.2	4.0	3.8	3.8	3.6	3.6	3.5	3.5	3.5	3.4	3.5	3.5	4.5	3.9	3.6	3.5	3.7
<b>Interest Rates (Quarter End and Ann Avg)</b>																	
Fed Funds Target Range	5.25-5.50	5.25-5.50	4.75-5.00	4.25-4.50	4.25-4.5	4.25-4.5	4-4.25	3.5-3.75	3.25-3.5	3.25-3.5	3.25-3.5	3.25-3.5	5.02	5.14	4.12	3.38	3.63
10-Year Treasury Note	4.21	4.33	3.81	4.58	4.23	4.24	4.30	4.20	4.20	4.20	4.30	4.40	3.96	4.21	4.24	4.28	4.50
Conventional Mortgage Rate (Freddie Mac)	6.79	6.86	6.08	6.85	6.65	6.77	6.60	6.40	6.30	6.30	6.30	6.40	6.81	6.72	6.61	6.38	6.50

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