

## **Prepare to Muddle Through?**

By John Mauldin | August 02, 2025



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Newport Beach, British Columbia, and Houston

I am widely known as the “Muddle Through” guy. The giant US economy is part of an even larger global economy that doesn’t change direction easily. Major shifts occur slowly, even when presidents, central bankers, and CEOs want otherwise. They don’t have nearly as much power as they may think.

That said, these people do have the power to set big events in motion, even if they lack control afterward. They can also make noise which now spreads instantly. So, while change is happening, it usually doesn’t happen as fast as we think.

All that comes to mind as we end a particularly news-filled week. Overall, it was a mixed bag—not as bad as some think, nor as good as others claim. But it’s all important as we try to keep our investment strategies aligned with the broader trends. Today I’ll try to put it in perspective for you.

Cutting to the chase... prepare to muddle through. I should point out that I felt that 2025 would be a Muddle Through year at the beginning of the year. We will talk about that below plus look at a lot of charts and yesterday’s rather poor employment data...

## Growth vs. Inflation

On Wednesday we received the initial estimate for Q2 economic growth. Revisions could change this, but at first glance it was a good quarter. Real GDP rose at a 3% annualized pace, much better than the -0.5% drop the prior quarter.

However, both quarters were distorted by the tariff drama. Unusual import/export and inventory changes reduced Q1 growth and then boosted Q2 by a similar amount. Looking at the six-month period, annualized real GDP growth was more like 1.25%. Given the rather significant disruptions to exports and imports caused by various reactions to US tariffs, it's probably better to pay attention to at least six months of GDP rather than any single quarter.

As usual, Peter Boockvar (whom I now call "Mr. Succinct" for his ability to quickly summarize these big reports) [captured](#) the bottom line.

"Highlighting why we need to merge Q1 and Q2 is seen in the trade components. Q1 saw a GDP drag of 460 bps due to trade while Q2 rebounded by 499 bps. Also, inventories boosted Q1 GDP by 259 bps while Q2 reduced it by 317 bps. Elsewhere and with the biggest component, personal consumption up 1.4% was about as forecasted and added 100 bps to GDP after a contribution of 31 bps in Q1. There was no contribution to growth from fixed investment. Spending picked up in software and equipment but dropped very slightly on R&D. Residential construction fell as spending did on other structures. Government had a slight contribution after the detracting in Q1 with help from state and local spending.

"Taking out the impact of trade and inventories we can look at final sales to domestic purchasers and that rose just 1.2% after a 1.9% print in Q2. It grew by 2.9% in Q4 '24 and by 3.4% in Q3 '24.

"Bottom line, as said, first half 2025 GDP growth is 1.3% rounded and annualized. That's your baseline for the 2nd half of the year as we absorb further the impact of tariffs and we can then all debate the outcome to see whether this was all a good idea or not."

A composite forecast from Bloomberg (they track estimates from hundreds of economists) also echoes a less-than-robust, Muddle Through outlook. They project only 1.5% for the rest of the year and are not much more optimistic for 2026 and 2027. This table also has earnings-per-share growth for the S&P 500 and Japan. I find it interesting that the projected growth in earnings doesn't seem to correlate with GDP, at least for the last few years. Over 10% EPS growth is quite robust. Just saying...

EPS Y/Y Growth							
	2021	2022	2023	2024	2025e	2026e	2027e
S&P 500	55.0%	6.8%	-1.7%	10.0%	11.3%	13.5%	10.8%
MSCI Japan (JPY)	95.1%	-4.4%	20.9%	19.6%	-6.1%	11.6%	9.2%
MSCI Japan (USD)	75.4%	-16.0%	12.1%	7.5%	-0.7%	11.6%	9.2%
Source: Bloomberg Composite Forecasts. Data as of 7/22/25							
Real GDP YoY%							
	2021	2022	2023	2024	2025e	2026e	2027e
United States	6.1%	2.5%	2.9%	2.8%	1.5%	1.6%	2.0%
Japan	2.7%	0.9%	1.4%	0.2%	0.8%	0.7%	0.8%
Source: Bloomberg Composite Forecasts. Data as of 7/22/25							

Source: Strategas

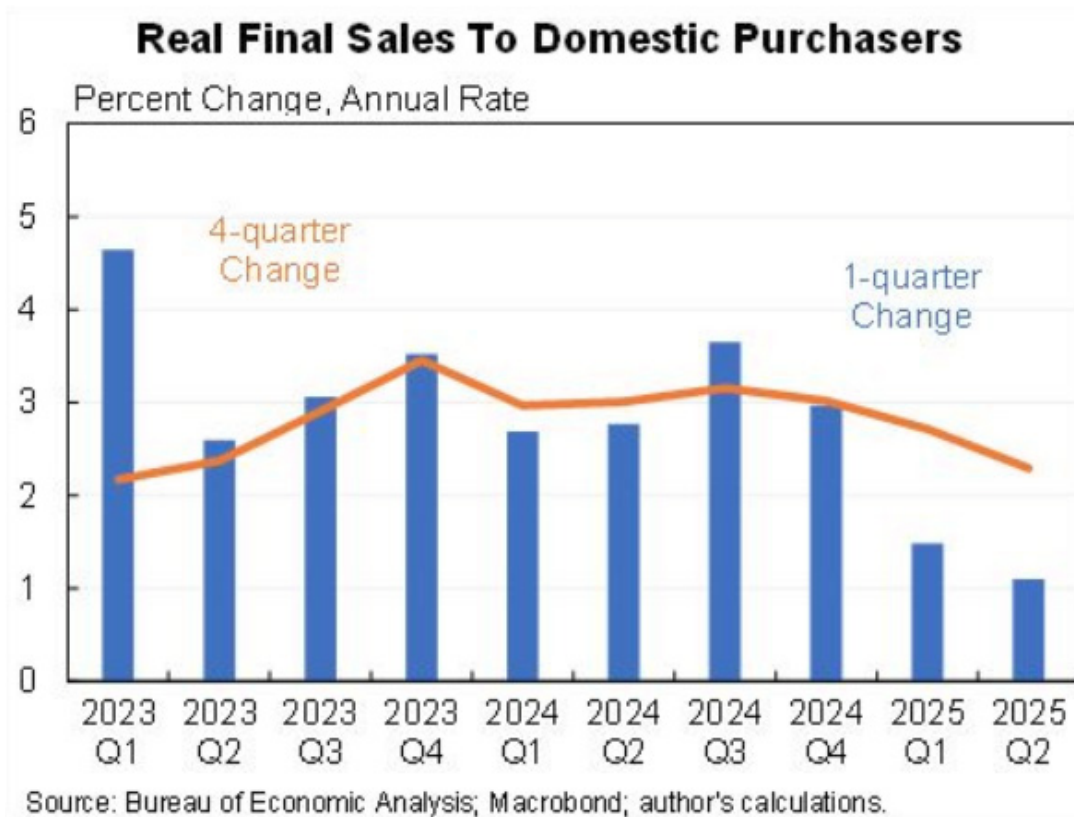
The Congressional Budget Office outlook isn't much better than the Bloomberg composite. They are certainly more optimistic than the bond market (based on market prices) on inflation and tellingly on interest rates. We can only hope the 10-year bond rate is close to the CBO forecast. Note that the wage tax base is not growing with inflation.

## The Economic Outlook, by Calendar Year

	Estimated, 2024	2025	2026	2027	Annual 2028– 2029
Change from fourth quarter to fourth quarter (percent)					
Real (inflation-adjusted) GDP	2.3	1.9	1.8	1.8	1.8
Inflation					
PCE price index	2.5	2.2	2.1	2.0	2.0
Consumer price index	2.7	2.3	2.4	2.3	2.2
Payroll employment (net monthly change, in thousands)	187	90	58	46	52
Annual average (percent)					
Unemployment rate	4.0	4.3	4.4	4.4	4.4
Interest rates					
Effective federal funds rate	5.1	4.0	3.5	3.3	3.3
3-month Treasury bills	5.0	3.8	3.3	3.2	3.2
10-year Treasury notes	4.2	4.1	3.9	3.9	3.9
Tax bases (percentage of GDP)					
Wages and salaries	42.6	42.8	43.1	43.2	43.5

Source: CBO

Going back to GDP, here's a chart showing the "Real Final Sales" figure, which may be more enlightening than the headline number. You might think of it as "Core GDP."

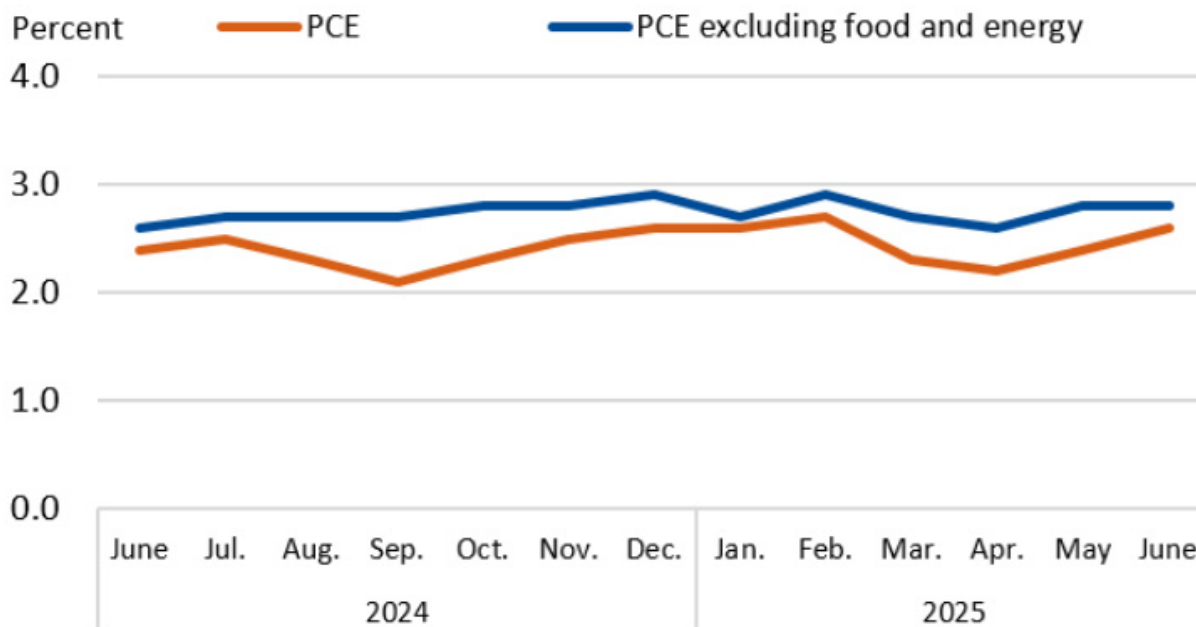


Source: [Jason Furman](#)

Here we see a much smaller difference between Q1 and Q2, with Q1 actually the better of the two. But note the past two years. Looking at the annual change line, 2023 had decent growth, which then stalled in 2024. The first half of 2025 looks markedly worse. Economic growth seems to be slowing significantly even without the tariff effects.

You *could* look at this trend and conclude the Fed should start stimulating pronto, but hold that thought. The GDP release also contained hints that inflation is picking up, implying that core PCE (the Fed's benchmark) accelerated to a 2.8% yearly pace in June. It was 2.6% as recently as April. By this benchmark, at least, inflation certainly isn't improving.

## Percent Change in PCE Price Indexes From Month One Year Ago



U.S. Bureau of Economic Analysis

Seasonally adjusted

Source: BEA

This puts the Fed in a tough spot. Growth is clearly weakening, but inflation isn't weakening with it. Which problem do you fight? If this persists, I suspect unemployment will be the tiebreaker. Further weakness there could offset the inflation concern. And with Friday morning's employment release, that's what we have.

Bluntly, it was ugly. Job growth totaled 73,000 for the month, above the revised June total of 14,000 but below even the meager estimates for gains around 100,000. June and May totals were revised sharply lower, **down a combined 258,000 from previously announced levels**. The three-month job average is just 35,000. That's simply terrible. Unemployment rose to 4.2% and the all-in U6 rate rose to 7.9%. There is simply no way to spin this as good.



While initial market reactions are usually noise, Treasury yields went sharply lower as did stock prices.

## Monthly job creation in the U.S.

Jan. 2022–July 2025

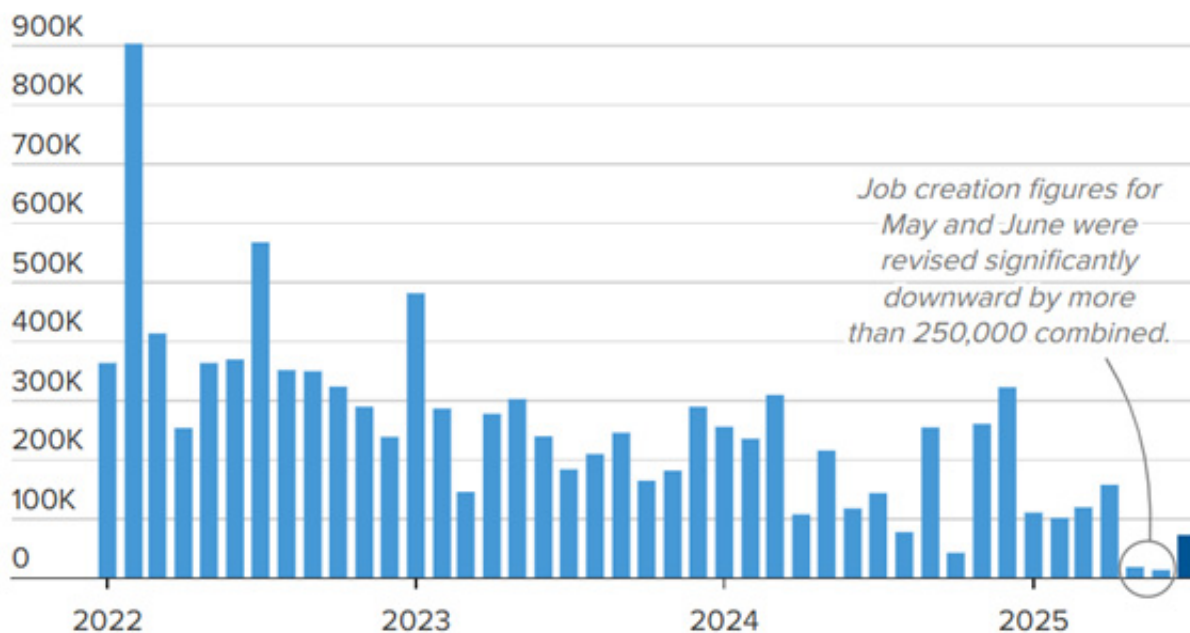


Chart: Gabriel Cortes / CNBC

Source: U.S. Bureau of Labor Statistics via FRED

Data as of Aug. 1, 2025



Source: CNBC

I think three rate cuts are now probable, but lower interest rates will not be the employment panacea it has been in the past. What will be the most helpful is **certainty** about what costs and prices will be as well as how sales settle out. Then businesses will figure out how to grow.

## A Little Clarity

Another big event this week was the announcement of a trade deal with the European Union. The terms of this deal, while important, were not its main significance. The most immediate impact was that it reduced the risk of a much harsher trade war. This is what markets have been anticipating in the post-April rally, and it *seems* to be happening.

With this deal and another recent one with Japan, plus the announcement of tariffs on the rest of the world, a possible endgame to the uncertainty is coming into sight. I'm not saying the tariff outcomes are good, but certainty will help. US importers will pay 15% tariffs on most (though not all) EU and Japanese goods. Most American-made goods will face no tariffs when sold in the EU and Japan.

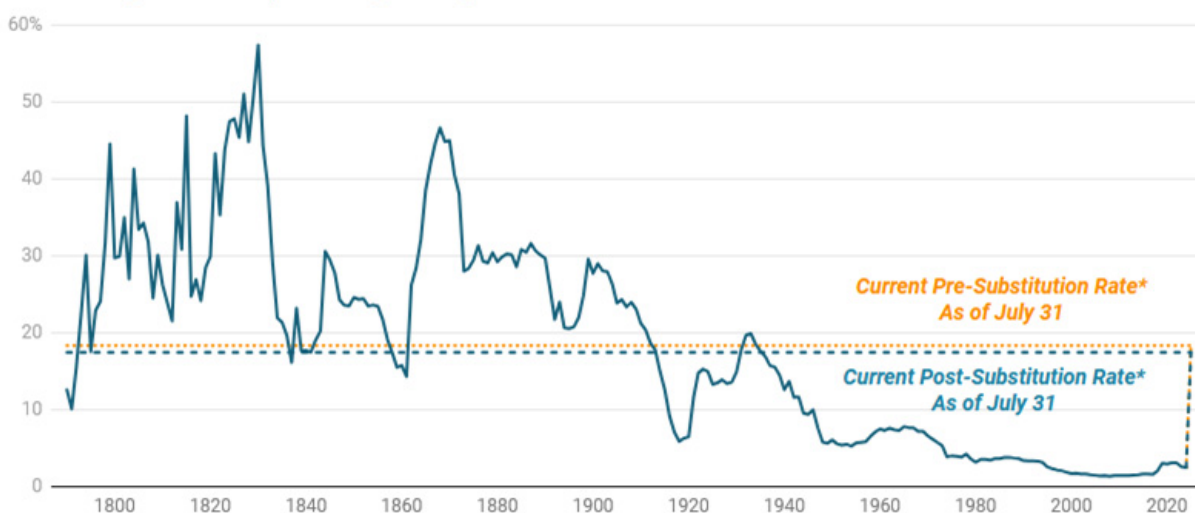
These rates on US imports are much higher than they were a year ago, but much lower than Trump had threatened. I think we would be better off with zero tariffs all around, but these at least provide some much-needed clarity.

Other threads are still hanging, though. Reading the transcript from the tariff appeals court case leads me to believe that the Trump administration's use of one particular interpretation of tariff law will be thrown out. He will have others he can use, but it will limit some of the tariffs that he has imposed. Stay tuned to find out which ones. A little more uncertainty.

Unfortunately, one thing we have clarity on is that US tariffs are back near 1930s Smoot-Hawley levels and seem likely to stay there.

**Figure 2. U.S. Average Effective Tariff Rate Since 1790**

Customs duty revenue as a percent of goods imports



\* Incorporates US-Vietnam framework and July 7 announcements.

Chart: The Budget Lab • Source: Historical Statistics of the United States Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis. • Created with [Datawrapper](#)

Source: [The Budget Lab](#)

I have always been against protectionism and the current tariff rates are historically high. Yet, the current situation isn't quite the same as so much more consumer spending is on services rather than goods than in the 1930s. And for now, at least, it's mostly one-sided. Other governments aren't punishing their citizens with high rates on US goods, so it shouldn't be the same kind of global contagion. (They already have VATs in most cases.)

To the extent tariffs generate revenue for the US Treasury, it should help the debt situation. Estimates of how much that will be are all over the board. Many goods will likely be exempted. But whatever the amount is, it is still a new tax that will ultimately be borne by US businesses and consumers.

To be clear, I like consumption taxes better than income taxes. This particular consumption tax is not what I would prefer. It is regressive, falling hardest on those who can least afford it. Compliance will be a paperwork nightmare for business, particularly small business.

It is also not good that this is happening under executive authority rather than legislation. Any future president can change it, the possibility of which leaves businesses facing more uncertainty. If these deals are really so great, Congress should vote them into law. That would put them on much firmer ground legally, reducing the chance one of the many pending court challenges will change everything yet again.

That aside, the EU deal has some possible geopolitical benefits. The EU side pledged to buy more US energy exports, some of which will likely be natural gas. If this replaces the gas Europe now imports from Russia, it will put more pressure on Putin to settle the Ukraine war.

## Up the Value Chain

Before the EU news, David Bahnsen asked an interesting question in his *Dividend Cafe* letter. Tariff advocates often argue these policies are necessary to revive lost US manufacturing capacity. David wrote about whether that premise is really true.

You should [read the whole thing](#) or listen to the podcast but here are some highlights. It is worth your time.

"I think I can summarize the underlying tension in our societal feelings about today's topic right off the bat: The current national conversation about manufacturing confuses a reduction in manufacturing jobs with a slowdown in U.S. manufacturing. Period. Once we have properly understood this distinction, unpacked the reality of both, cared to look into the causation of both, and fully analyzed what it all means, we will have a much more effective understanding of the larger issue. But identifying this off the top will go a long way in getting to the heart of the matter: Many who say 'the US doesn't make anything anymore' mean to say 'the US uses fewer workers to make the things it makes,' and those two things are not the same.



“It may be that the distinction does not matter to some. One may feel that the objective of our industrial policy should be to employ the maximum number of people, rather than to manufacture the most things, and that position is worth engaging with. However, what confuses the discussion is a failure to properly define terms and accurately establish the premises...

“I don’t believe the data is very ambiguous about where many people in the labor force are opting to go, and I don’t think the data is very ambiguous that there are manufacturing and factory jobs available for those who want them. But if the numbers seem lower than we want, or the percentage it represents in the economy seems sub-optimal (for whatever reason), why? What is driving this result where increased productivity is coming without significant increased labor (at least increased labor on an assembly line)?

“I think you all know what I am about to say, because we all know it is true. The answer, my friends, is technology. From robotics to automation to a host of technological efficiencies, we make more with less, and that has had an impact on headcount. Where there are labor-intensive needs, wages have actually gone much higher, but demand for the positions has not moved in tandem...

“A sober, honest, judicious assessment would conclude that we have a far bigger challenge finding workers in the United States than we do jobs. Some workers have used their rational instincts and moved towards self-interest to opt out of the manufacturing sector due to reasons of lifestyle, physicality, or quality of life. Others have done an economic calculus that concluded stability was undesirable in the space due to cyclical and sensitivity to economic downturns. And still others have seen wage premiums become more attractive outside manufacturing and ‘gone where the money is.’

“But another inconvenient reality is that our manufacturing has simply ‘moved up the value chain.’ We are a rich society, and we can buy a lot of things that can be made for a lower price elsewhere (apparel and textiles), and yet we can be a real leader in manufacturing high-tech items and various defense, aerospace, and high-end industrial machinery. However, that category of manufacturing naturally requires more skills, training, and education. The organic flow here (market forces) has moved to fewer but better manufacturing jobs in higher price-point sectors, while the lower-wage, less desirable positions have become less needed. And I would do anything in the world to see all people, of all skill and education levels, who desire to work hard and have a good life, find meaningful and fulfilling employment opportunity—and saying things like ‘learn to code’ is an asinine, rude, condescending response to the social reality we face. Yet to argue that we have a problem with ‘manufacturing’ in our country, versus an appetite for manufacturing work, is not helping anyone.”

In short, US manufacturing has changed, not disappeared. We manufacture more goods than ever. We focus on more sophisticated technological goods; it's not the kind of assembly line work that disappeared in the last few decades. Those jobs are gone, replaced by other kinds of jobs. The fact that US manufacturers still lack workers says that using tariffs to bring more manufacturing home isn't going to work. We have better things to do and we should focus on doing them as efficiently as possible. Singapore started out 75 years ago making T-shirts and assembling things. They moved up the food chain to where they are now one of the most technological societies in the world. They don't worry that they no longer make T-shirts.

## Muddling Through

Last week I mentioned Lacy Hunt's surprising letter in which he said tariffs are (paraphrasing) "bad but still necessary." This week I caught up with Lacy by phone and clarified what he was saying.

In short, Lacy's big concern is the way tariffs will change global capital flows. This isn't a conjecture; it is math. Reducing world trade will reduce the amount of capital moving between importers and exporters. It can't be otherwise.

The result, Lacy says, will be an endogenous liquidity crunch. Something similar happened in the Great Depression era. The Bank of England (which was predominant at the time) was unable to provide the liquidity the world needed. This sparked a race-to-the-bottom economy and a "Kindleberger spiral."

In the current context, Lacy sees tariffs as a tax that will discourage economic activity in the US. Most imported goods (other than energy) are highly "price elastic." That means demand falls quickly as prices rise. Profit margins are squeezed, then layoffs and other bad things follow.

Lacy sees this outcome as all but certain unless the Fed cuts rates quickly. He thinks a 100-basis-point cut would provide enough liquidity to offset the tariffs. But as we saw this week, the Fed isn't doing that. And even the two FOMC dissenters don't seem to grasp the danger Lacy describes.

Worse, I'm not convinced rate cuts would do much to boost growth anyway. Access to credit isn't the reason GDP growth is stalling. And let's not forget, the Fed *did* cut rates last September and the result was higher rates at the long end. Mortgages got more expensive, not less.

We can debate all day long whether inflation is really a problem. The bond market is more worried about the odds it will *become* a problem over the course of a 10–20–30-year loan. The worse the odds, the higher long-term rates will go as lenders demand compensation for inflation risk.

All that said, let's appreciate what we currently have. Real GDP growth at 1.3% isn't great but it could be worse. Inflation at just under 3% isn't great but could be worse. An unemployment rate around 4.2% isn't great but could be worse. If those conditions persist, it will be the definition of a Muddle Through economy.

The bigger problem: A few years of 1% to 2% GDP growth would drastically change the federal debt outlook. CBO projections assume 1.8% real GDP growth from 2026–2035. Throw a recession or two in there and the average could be much lower. Tariff revenue isn't going to cover that gap. It's just not.

But there *is* a way we can muddle through this. A combination of modest growth, modest inflation, modest tax increases and modest spending cuts *might* get the budget back on track. Keeping all those modest would be a challenge, of course. But this increasingly looks like the best-case scenario. All the others are far worse.

## Newport Beach, British Columbia, and Houston

I will be heading to Newport Beach to meet with David Bahnsen, Brian Szytel, and their team at The Bahnsen Group on Tuesday, August 12. We will be doing some videos and meeting with potential TBG clients in the area. If you would like to meet with me and some of the TBG team, drop me a note a [business@2000wave.com](mailto:business@2000wave.com).

Then at the end of the month, Shane and I will be meeting 33 other friends and readers at the West Coast Fishing Club in far northwest British Columbia trying to find a few hopefully trophy salmon, halibut, and Ling cod (my vote for the ugliest fish with the best taste). It is a true five-star fishing resort on a remote island. You are so far north that when you are out on the water you can see Alaska. I am really looking forward to it.

Then on September 15 I will be at The Bahnsen Group's Houston branch office with David himself. We can host a small group. Let me know if you would like to attend.

And with that, I will hit the send button. You have a great week and don't forget to [follow me on X](#)! I really am trying to be more engaged there.

Your wanting certainty in his own life analyst,



John Mauldin

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