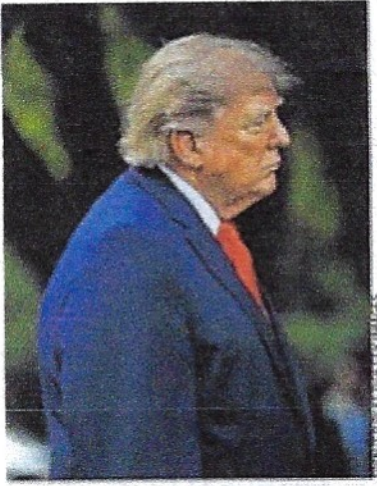


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President Trump's policies have fed price pressures now driving up rates. SPENCER PLATT/ GETTY IMAGES

How Trump's Inflation, Rate Bets Backfired

Tariffs, war and an investment boom have complicated economic promises

BY NICK TIMIRAOS AND MERIDITH MCGRAW

In the early days of President Trump's second term, his economic advisers laid out a simple theory: Show the bond market that Washington was serious about closing its gaping deficits, and long-term interest rates would fall on their own. Trump could leave the Federal Reserve alone.

It hasn't worked out that way.

Inflation is rising, the Fed is raising rates and the 10-year Treasury yield is well above where it stood on Inauguration Day, when the new team blamed high rates on runaway Biden-era spending. Last week, that yield reached the highest level since 2007 as investors weighed a resilient economy, prolonged energy disruptions that threaten to aggravate price pressures and a central bank losing patience waiting for them to fade. *Note*

The White House theory rested on fiscal restraint that never arrived and overlooked how much of Trump's own agenda would feed the price pressures now pushing rates higher. Tariffs raised the cost of imported goods. The war with Iran sent oil and diesel prices soaring. Immigration restrictions shrank the labor force.

"This was entirely predictable," said Jessica Riedl, a former Republican Senate aide who is now a budget and tax fellow at the Brookings Institution. Add tax cuts, new spending and pressure on the Fed to lower interest rates, and "all six of those policies move inflation up, not down," she said. *Note*

The stakes are high. Rising long-term rates raise borrowing costs for home buyers, businesses and the government. Mortgage rates, which dipped to 6% in February, now sit above 7%, a difference that adds roughly \$3,000 a year in payments on a new \$400,000 loan. Workers' pay hasn't kept pace with inflation since March. *Note*

The government's interest payments on its debt topped \$1 trillion for the fiscal year that ends this week, more than it spends on the military. That leaves less room to respond if the economy stumbles.

The economy has been resilient. Unemployment is near 4%, consumers are spending, and growth has been solid. But that strength is part of the problem. When demand is sturdy, businesses can more easily pass higher fuel costs on to customers, and workers can press for raises to keep up. That makes it more likely that an energy shock spreads into broader inflation, giving the Fed more reason to raise rates and investors more reason to demand higher yields. *1*

Some of the pressure is outside Trump's control. The AI building boom, which the White House has cheered, is driving up the cost of chips, electrical components and power equipment. It is also competing with the U.S. government for borrowed money.

That competition would matter less if Washington's borrowing demands weren't also rising. Deficits are running near 6% of gross domestic product, close to the Biden-era levels that Treasury Secretary Scott Bessent last year called the highest ever for a peacetime economy that wasn't in recession.

Inside the White House, some aides are frustrated that the war has overshadowed the momentum they say the economy carried into this year, people familiar with the matter said. Officials have pointed to a construction boom laying the groundwork for the manufacturing revival Trump promised. They acknowledge that high energy prices have stalled that progress and are squeezing family budgets.

"President Trump's longterm economic agenda is yielding results in a historic and durable way for everyday Americans," said White House spokesman Kush Desai.

Over the weekend, the president complained he isn't getting enough credit for the strength of the economy. "Business is growing. Americans are earning more money than ever before," he wrote on Truth Social.

Slaying the deficit

Bessent made deficit reduction a centerpiece of his pitch during the 2024 campaign. Then a hedge-fund manager advising Trump, he championed an agenda called 3-3-3: cutting the deficit to 3% of GDP, lift inflation-adjusted growth to 3% and increase domestic energy production by the equivalent of 3 million barrels of oil a day.

Once Trump took office, advisers trotted out a series of fixes for the deficit. First came the Department of Government Efficiency, which Elon Musk said could find \$2 trillion in savings by eliminating wasteful spending. It delivered very little. Then came tariffs, which brought in record customs revenue until the Supreme Court ruled Trump lacked the authority to impose many of them.

Now the message is that strong economic growth will generate the revenues needed to reduce deficits. "We can grow our way out," Bessent said during a television interview on Aug. 20.

Growth hasn't done much so far.

"Given the performance of the U.S. economy this year, there's every reason to have expected the budget deficit to go down, and the budget deficit's not going down," said Bruce Kasman, chief economist at JPMorgan Chase. He noted that was playing some role in pushing up long-term yields.

Bessent, in the August interview, defended his surprise decision to at least double the Treasury's purchases of longterm bonds after the 30-year yield hit its highest level since 2007. He said the move was justified because yields had run ahead of the economy's fundamentals.

The buybacks reflect the limits of Bessent's position.

He's using "tactical tools to try to defy markets because he doesn't have his hands on the fundamental levers, such as deficit spending and tariffs," said Robert Zoellick, a former World Bank president who served as a senior trade and diplomatic official under President George W. Bush.

Bessent also said last month that a deficit-reduction plan would be unveiled within days, though he later said it wouldn't be released for weeks or months. Trump, meanwhile, pledged this month \$5,000 for every adult if Republicans keep control of the House and Senate in this fall's election.

Twenty months in, the 3-3-3 scorecard is mixed. Energy output has risen and growth has been solid, but the deficit is set to rise for the fiscal year ending Sept. 30 to a level that is at least twice Bessent's target.

"If Bessent were president, I believe that he would try to get the deficit down to 3% of GDP, but he's not the president. Donald Trump never made it a priority," said Andy Laperriere, head of U.S. policy research at Piper Sandler and a former House GOP adviser.

'Look in the mirror'

The deficit doesn't rank high among Trump's priorities, if it registers at all, advisers said. These people say his main preoccupation has been Fed rate cuts, which he saw as a shortcut to shrinking the government's interest bill.

This spring, Trump replaced Fed Chair Jerome Powell with Kevin Warsh, who he expected would deliver lower rates.

This month, Warsh's Fed raised rates for the first time since 2023.

The Iran war and an economy running on the AI boom drove that decision. The Fed spent much of the year anticipating that energy price increases from snarled shipping corridors in the Middle East would subside quickly. When that didn't happen, "you have to look in the mirror and say, 'Inflation looks like it's been here for a while, so maybe we should do something about it,'" Richmond Fed President Tom Barkin said last week.

Having begun to raise rates, the central bank has left investors guessing how far and how fast it will go, adding to uncertainty that is pushing up long-term rates.

With bond yields rising last week, Kevin Hassett, director of the White House National Economic Council, questioned the increase, which was approved unanimously, by suggesting it ignored better recent inflation readings. He expressed frustration with Fed officials' recent public comments, which he said indicated they could continue "hiking unwisely" in the months to come.

The rate increase has divided administration allies. Michael Faulkender, who served as deputy Treasury secretary last year and is now at the University of Maryland, said it won't touch the forces driving inflation. "If anyone thinks truckers are going to truck less and put downward pressure on diesel prices, and if you think AI companies are at all going to be sensitive to a quarter-point increase in their borrowing rate, that's not happening," he said.

Stephen Moore, an informal Trump adviser who was considered for a Fed appointment in 2019, said the hike was the right call because "it is important for Kevin [Warsh] to also establish his inflation-fighting credentials." The real drag on the economy, he said, "is this goddamn hundred-dollar oil price."

Energy has clearly done damage, but the trends on borrowing costs and inflation "were worsening even before the first fighter jet took off," said Riedl, the Brookings Institution fellow.

Some of the administration's actions prove the point, she added. When the White House rolled back tariffs on certain goods or lifted import restrictions on beef to provide cost relief, "they're giving the game away on the effect of their own tariffs."

'Iran gets a vote'

Much depends now on how long the war lasts. Before deciding to strike Iran in late February, Trump was presented with multiple scenarios for how the conflict could unfold, including its potential economic fallout, people familiar with the matter said. While the national security risk of a nucleararmed Iran outweighed those forecasts, few anticipated the war would last this long, and Trump didn't expect gas prices to rise so sharply ahead of the midterm elections.

"People know that Trump wants to end the Iran war, but they can see he doesn't know how," said Zoellick. "And Iran gets a vote."

A sustained energy-price shock that drives up interest rates is the latest risk to an expansion that has already faced several, including rapid Fed hikes in 2022 and regional-bank jitters in 2023. The AI build-out poses another wild card because investment booms built on new technologies often end with overbuilding.

If the economy stumbles, the government would enter a downturn already borrowing heavily. Deficits typically swell in recessions because spending rises as receipts tumble. With the deficit starting near 6% of GDP, a mild recession could push it to 8% or 9%, said Joseph Lavorgna, a former counselor to Bessent who is now chief economist at SMBC Americas. Long-term rates might fall by less than they usually do in a downturn if investors balk at that much borrowing.

Washington has shown little appetite to fix those problems while the sun is shining.

"It's going to require both parties jumping off that cliff together," said Faulkender.

That kind of deal is nowhere in sight. The idea that somewhat higher rates will spur Congress to act is "a fantasy," said Laperriere. "I think it's going to have to be much, much more painful."

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