Monthly Macro Insights — March 2025

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President Donald Trump's trade-war salvo, the largest act of American protectionism since the 1930s, combined with his foreign policy's complete shift, are sending significant shockwaves through the global economy. Although the full impact of phenomenal uncertainty is a key unknown, inflation and growth dynamics might well evolve opposite to investor's Goldilocks scenario[1].

Trumpcession ?

Since the pandemic, the US economy has repeatedly proven its resilience, and defied recession forecasts. Still, the shocks are piling up: trade war, immigration and fiscal uncertainty.

Up until recently, investors were of the view that Trump used tariffs' threats primarily as a negotiating ploy to win concessions. However, that view seems naïve, especially considering recent developments.

Indeed, the US Administration announced 25 per cent duties on most Canadian and Mexican imports and the doubling of an existing 10 per cent charge on China to 20 per cent. Consumers and businesses will feel the impact of the new taxes on some $1.5 trillion of US imports, more than two-fifths of the total, whereas the average US tariff rate now stands at the highest level since the 1940s[2].

These tariffs will throw North American supply chains into disarray – namely the automotive industry – and invite legal challenges based on a free-trade agreement Trump himself renegotiated during his first term. They will act as a negative supply shock for the US economy and will raise prices, thus threatening to reignite inflation the Fed is still struggling to fight, especially as more tariffs are likely to come soon.

A 25 per cent tariff is in the works for the European Union. Steel and aluminium tariffs are also set to take effect on 12 March, and in early April, reciprocal tariffs are expected on all US trading partners that have their own levies or other barriers on American products. Additionally, sectoral taxes on cars, semiconductors and pharmaceuticals, are likely to be introduced.

Overall, the new US trade policy will most likely fuel inflation, slow economic growth, cut profits, increase unemployment, worsen inequality, diminish productivity and increase global tensions.

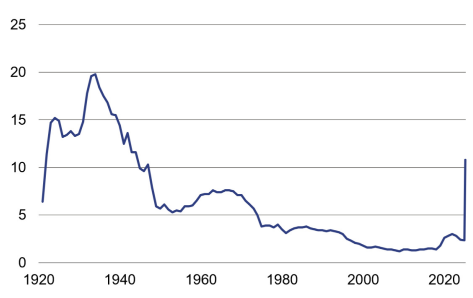
The Atlanta Fed's GDPNow real-time forecasting model is predicting a -2.8 per cent q/q annualised fall in Q1-2025 GDP[3]. The forecast will evidently evolve as new economic data are published, and most investors are reluctant to revise down their growth projections – standing at 2.2 per cent[2] – due to significant uncertainty. Nevertheless, Trump and his allies have dismissed warnings that new trade policy threatens to fuel price growth and will most likely fail to bring in the revenue hoped for to assuage concerns regarding the cost of a tax cut package in Congress costing trillions.

Besides tariffs, other policies are raising red flags regarding the US growth outlook. The crackdown of illegal migrants threatens to leave gaps in the workforce that won't be easy to fill quickly, while a broader immigration slowdown, with fewer net arrivals per year, is also a significant headwind.

Meanwhile, cutbacks driven by Musk's Department of Government Efficiency have seen thousands of federal workers lose their jobs already, with knock-on effects for many contractors. By moving fast, this policy not only concentrates the economic negative effects, but also creates uncertainty.

US - Tariff rate

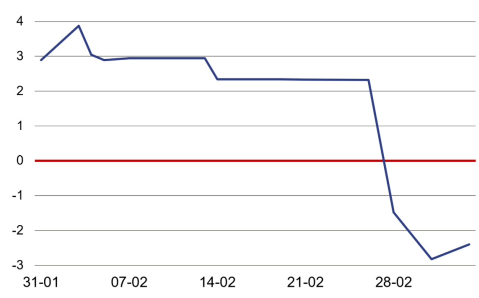
in %, weighted average



Sources : Macrobond, Rothschild & Co Asset Management, February 2025.

US - GDP Nowcast Q1-2025

in %, q/q ann



Sources : Fed Atlanta, Rothschild & Co Asset Management, February 2025.

How the Fed will react?

There are essentially two sources of inflation: demand-side and supply-side. The business cycle drives demand-side inflation, and monetary policy will impact the latter with movements in the policy rate. In that regard, the 2010s were an era of low growth and low inflation that called for easy monetary policy.

Although central banks theoretically should look through supply-side inflation as cost factors are out of their control, inflation expectations play an important role that can be self-fulfilling. Correspondingly, the post-COVID era has been marked by high inflation, calling for tight policy measures. This is in large part the result of value chain disruptions and bottlenecks, i.e. supply-side in nature.

Recent events suggest the second half of the 2020s will be marked by significant geopolitical uncertainty. For central banks, trade tensions muddy the outlook as tariffs are inflationary in the short-term, but also hurt growth, thus eventually leading to deflationary effects. However, if tariffs push inflation expectations higher, central banks might be forced to retain a hawkish bias for some time. The latest data in the US calls for the utmost prudence, as a University of Michigan survey showed that households' inflation expectations have reached the highest level since 1995.

Germany's "Whatever it takes" moment

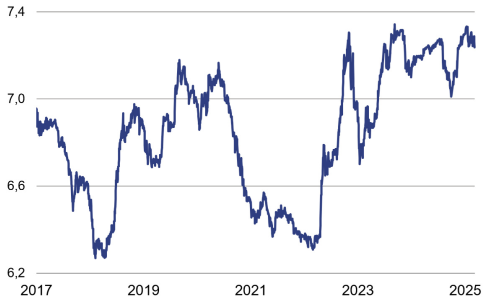
The Trump administration's shift away from its allies and partners has had a tectonic effect on global politics. It has convinced European governments that the US is no longer a dependable source of security and cannot be trusted to uphold its alliance commitments. Correspondingly, the European Commission announced a proposal for a defence package close to €800 billion of spending, presumably over four years from a new ReArm Europe Plan, with which includes €150 billion in loans and €650 billion in additional fiscal space[2].

Yet, the most significant response to the US shift has been Germany's historic turnaround on public spending. This move has sent shockwaves through financial markets, and caused the euro and government borrowing costs to increase significantly. The proposals include a €500 billion special purpose vehicle for public infrastructure investment over the next decade, and a reform of the debt brake rule to exempt any defence spending over and above 1 per cent of GDP[2], effectively permitting open-ended borrowing for defence. The seismic change in fiscal policy should give the struggling German economy a shot in the arm, both cyclically and more structurally.

Although the growth impact of a fiscal package of such historic proportions will be significant, this additional deficit-spending will only be deployed gradually and should initially bring the budget deficit to 5-6 per cent of GDP[2], before the expected growth effects kick in, which may lead to higher interest rates. In fact, the near-term outlook will be dominated by the severe uncertainty shock emanating from US trade and foreign policy.

China – Exchange rate

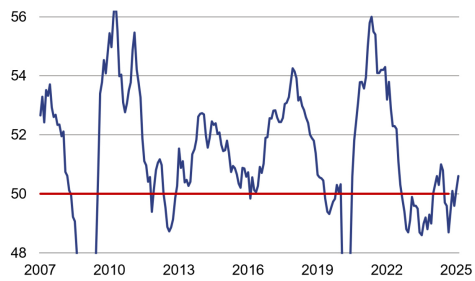
USD/CNY



Sources : Macrobond, Rothschild & Co Asset Management, February 2025.

World – Business confidence

S&P Global, manufacturing



Sources : Bloomberg, Rothschild & Co Asset Management, February 2025.

China

For the third straight year, China has set a forceful economic growth goal at about 5 per cent for 2025 at its annual parliamentary session, raising expectations that more supporting measures will be announced later this year. The authorities buttressed their growth plan with the highest fiscal deficit target in over three decades and a pledge to raise local government bond issuance to record levels. This reflects the government's determination to support growth against a backdrop of external uncertainties, namely the 20 per cent[2] levy put on China's imports by the US (which is already twice the overall level of the Trump 1.0 trade war). This move threatens to cripple the export engine, which last year contributed to almost a third of economic expansion.

However, unleashing greater stimulus to counter the impact of the US trade war could undermine China's efforts to rein in surging debt. What's more, despite the yuan depreciating by more than 10 per cent against the dollar to offset the tariff hike during the first trade spat in 2018 and 2019[2], the already low level of the currency limits further manoeuvrability this time around.

For now, the global manufacturing PMI[4] improved somewhat in early 2025, touching an eight-month high of 50.6 in February[5]. However, there is a significant risk that much of the bounce in the goods sector is related to businesses' front-loading decisions ahead of the war on trade, suggesting it could be short-lived and only temporarily spurring activity. If history is any guide, the manufacturing PMI initially rose during the Trump 1.0 trade policy disruption, before tumbling -10 pts thereafter, despite the magnitude of the threats being meaningfully more modest compared to today.

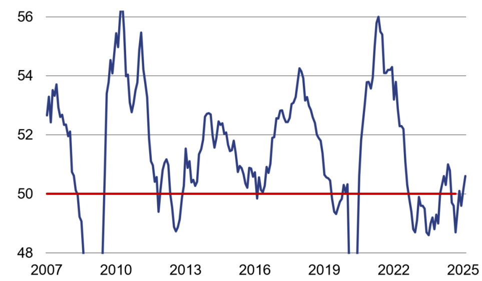
China – Exchange rate

USD/CNY

Sources : Macrobond, Rothschild & Co Asset Management, February 2025.

World – Business confidence

S&P Global, manufacturing



Sources : Bloomberg, Rothschild & Co Asset Management, February 2025.

Performance of the indices and interest rate levels

	Price as of 28/02/2025	1 month % change	2025 % change
Equity markets			
CAC 40	8 112	2.0%	9.9%
Euro Stoxx 50	5 464	3.3%	11.6%
S&P 500	5 955	-1.4%	1.2%
Nikkei 225	37 156	-6.1%	-6.9%
Currencies			
EUR/USD	1.04	0.1%	0.2%
EUR/JPY	156.27	-2.8%	-4.0%

Interest rates	Price as of 28/02/2025	1 month bp[(1)]	2025 bp[(1)]
3 month			
Eurozone	2.40%	-15	-34
United States	4.29%	1	-2
10 years			
Eurozone	2.41%	-5	4
United States	4.21%	-33	-36

(1) Basis point.
Source: Bloomberg. data as of 28/02/2025. Performances in local currency.
Past performance is not a reliable indicator of future performance and is not constant over time. Index's performance is calculated on the basis of net dividend reinvested

Completed writing on 7 March 2025.

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(1) The Goldilocks scenario refers to an economic situation where growth is moderate, inflation is low and interest rates remain stable, creating a favourable environment for financial markets.
(2) Source : Bloomberg, March 2025.
(3) GDPNow, Fed d'Atlanta, February 2025
(4) Purchasing Managers' Index, an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion in activity, below 50, a contraction.
(5) Source : S&P Global, February 2025.

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