Monthly Macro Insights — May 2025

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Economic activity remained relatively resilient in early 2025, although this stability was supported by temporary factors. In fact, global growth projections have been revised markedly down in recent weeks, reflecting tariff rates at levels not seen in a century and a highly unpredictable environment, while inflation risks have increased.

Stagflation or recession?

Front-loading in the face of threatened tariff hikes has boosted industrial activity, which explains the resilience of the global economy. However, a drop in business sentiment in response to the trade war is likely to become increasingly apparent in the coming months. The recent slide in April's PMI[1] output sub-index indicates a deterioration in global economic activity in early Q2-2025, while consumer confidence, particularly in the US, has sharply declined.

According to the latest IMF's World Economic Outlook, global growth is expected to decelerate sharply this year, to 2.8 per cent from 3.3 per cent in 2024[2], which would be the slowest pace since 2002 excluding the 2009 and 2020 recessions. This deterioration reflects the rise of uncertainty, especially related to trade policy, to unprecedented levels, impacting economic activity through trade and financial linkage spillovers, and worsening sentiment.

Historically, recessions have been caused by rising macroeconomic vulnerabilities in the face of shocks. In that regard, the actual trade war constitutes a negative supply shock, especially in the US. Indeed, resources are reallocated towards the production of less competitive items, resulting in higher production prices. Looking ahead, tariffs will likely decrease competition and innovation and increase rent-seeking, thus weighing on productivity growth.

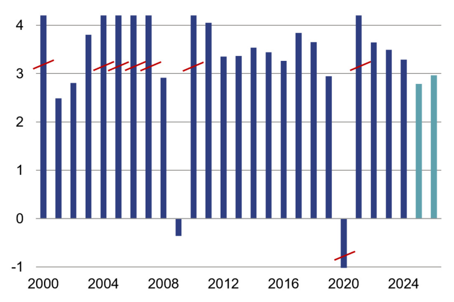
Integrated global supply chains can also magnify the effects of tariffs and uncertainty, as most traded goods are intermediate inputs that cross borders multiple times before being turned into final products - the US-Canada auto sector being a notable example of this. Overall, disruptions can propagate up and down supply chains, while businesses will likely reduce investment and cut spending amid uncertain market access.

On the demand side, tariffs are mostly a negative shock for US consumers facing much higher prices for a large variety of imported goods. This negative shock will also hurt the US's trading partners, driving American customers away from their products. However, some countries might experience a slight benefit from trade diversion.

Admittedly, market sentiment was recently boosted as President Trump and Treasury Secretary Bessent signalled progress towards trade agreements with several countries. It might be premature, however, to anticipate a material reduction in the tariff rates. This is especially the case as there is no evidence of substantive negotiations taking place with China, the EU or within the USMCA, which account for almost two-thirds of US imports. Ironically, a retreat to 60 per cent tariffs on China and a universal 10 per cent elsewhere would still keep the US average effective tariff rate at a significantly high 16 per cent[3]. This would be the highest in several decades and aligning with investors' worst-case scenario during the US presidential campaign. Moreover, it remains uncertain what damage has already been inflicted on the global economy, and if this could be reversed.

World - GDP growth

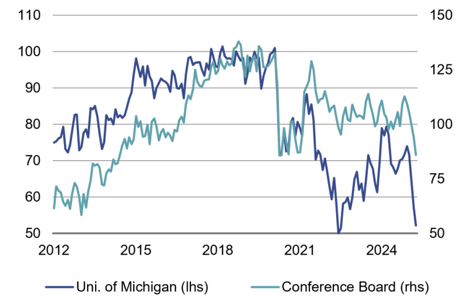
in %, y/y



Source : IMF, Rothschild & Co Asset Management, may 2025

United States - Consumer confidence

index



Source : Macrobond, Rothschild & Co Asset Management, may 2025

Monetary policy facing a complex challenge

The US trade policy will raise inflation, not only on imported goods but also on domestic prices, as input costs rise and demand increases on domestic products. Meanwhile, supply chain disruptions will also translate into higher prices.

Yet, growth will also be negatively impacted. So far, investors seem to think that the growth effect will dominate, demonstrated by the increasing expectation that the Fed will cut rates swiftly to support the economy, in part due to its dual mandate of full employment and price stability. However, this rationale is incomplete in two important ways.

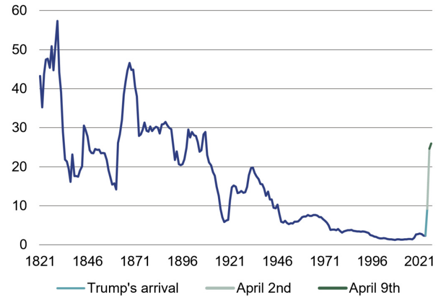
First, the slowdown in economic activity may not generate slack in the labour market as quickly as in the past. With illegal immigration collapsing, the labour force growing slowly, and the Trump administration significantly increasing deportations, even minimal monthly job gains could be sufficient to prevent a significant rise in unemployment rate, at least in the short term.

Second, tariff-related price increases will be hard for the Fed to disregard if they drive up inflation expectations. As of April this year, respondents in the University of Michigan's Surveys of Consumers expected long term inflation to average 4.4 per cent, the highest level in almost 35 years.

Incidentally, Fed Chair Powell made it clear that the Federal Open Market Committee will not take pre-emptive action, emphasising its obligation to keep longer-term inflation expectations well-anchored, and to ensure that a one-time increase in the price level does not become an ongoing inflation problem.

United States - Effective tariff rate on imports

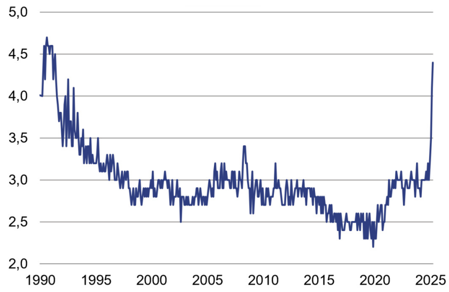
in %



Source : IMF, Rothschild & Co Asset Management, may 2025

United States - Long term inflation expectations

in %, University of Michigan survey



Source : Macrobond, Rothschild & Co Asset Management, may 2025

Restructuring the global trading system?

According to the views of US President Trump's new Chief Economic Adviser Stephen Miran, international trade and financial systems are unfair, which is one of the arguments justifying the use of the new disruptive trade policy. Following this view, the actual System maintains the USD too high to reduce the significant current account deficit as global demand for liquid, dollar-denominated assets is increasing faster than US GDP. What's more, it puts downward pressure on interest rates, thus encouraging US private and public borrowers from taking on even more debt and correspondingly jeopardising sustainability and financial stability.

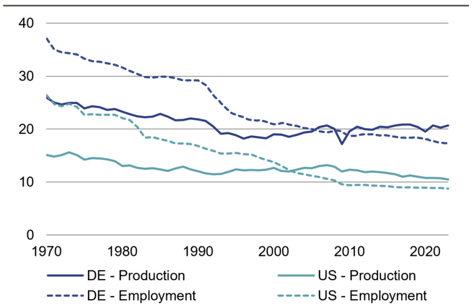
In fact, the US financial balance sheet is made up of high-risk, high-yield investments on the asset side, and low-yield, risk-free bonds on the liability side. Admittedly, in times of crisis, this balance sheet is unfavourable to the US, since assets depreciate while the value of its liabilities remains unchanged. However, over the long term, the return on assets greatly exceeds the yields on liabilities, so that the US's net external position (i.e. the stock of financial assets less liabilities) deteriorates less than the cumulative trade deficits. The corollary is that the USD is indeed supported by strong demand, therefore higher than it should be, given deep government and trade deficits, which is what economists called twin deficits. Yet, in addition to seigniorage gains (the USD earns no interest to its holder), the US benefits from the ability to borrow in its own currency, without exchange rate risk and at low interest rates.

The US administration seems to believe that both their strong currency and globalisation are the main causes of the deindustrialisation of the US economy. However, the share of manufacturing employment in advanced economies has been in a secular decline in countries running trade surpluses, such as Germany, or deficits, like the US. In fact, the deeper force behind this decline is technological progress and automation, not globalisation. However, the output share of manufacturing has remained stable in both countries.

Consequently, evidence suggests that the Miran's dissatisfaction with the international monetary system turns out to be exaggerated, if not unfounded. Economists have long understood that higher tariffs do not, in general, reduce trade deficits. In fact, global data indicate that countries with higher tariffs actually have higher trade deficits.

World - Share of manufacturing

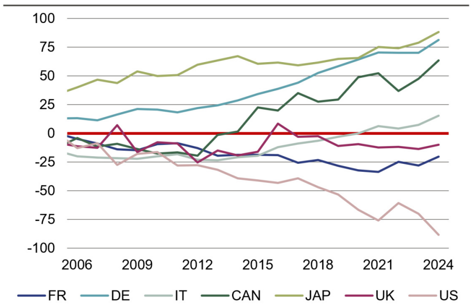
in %



Source : IMF, Rothschild & Co Asset Management, may 2025

G7 - Net international investment position

in % of GDP



Source : Macrobond, Rothschild & Co Asset Management, may 2025

Performance of the indices and interest rate levels

	Price as of 30/04/2025	1 month % change	2025 % change
Equity markets			
CAC 40	7 594	-2,5%	2,9%
Euro Stoxx 50	5 160	-1,7%	5,4%
S&P 500	5 569	-0,8%	-5,3%
Nikkei 225	36 045	1,2%	-9,6%
Currencies			
EUR/USD	1,13	4,7%	9,4%
EUR/JPY	162,0	-0,1%	-0,5%

Interest rates	Level as of 30/04/2025	1 month change bp[1]	2025 change bp[1]
3 month			
Eurozone	2,07%	-23	-66
United States	4,29%	-1	-3
10 years			
Eurozone	2,44%	-29	8
United States	4,16%	-4	-41

(1) Basis point.
Source: Bloomberg. data as of 30/04/2025. 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 2 May 2025.

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(1) 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.
(2) Source: IMF World Economic Outlook, April 2025.
(3) Source: Rothschild & Co Asset Management, May 2025.

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