

The Macroscope.



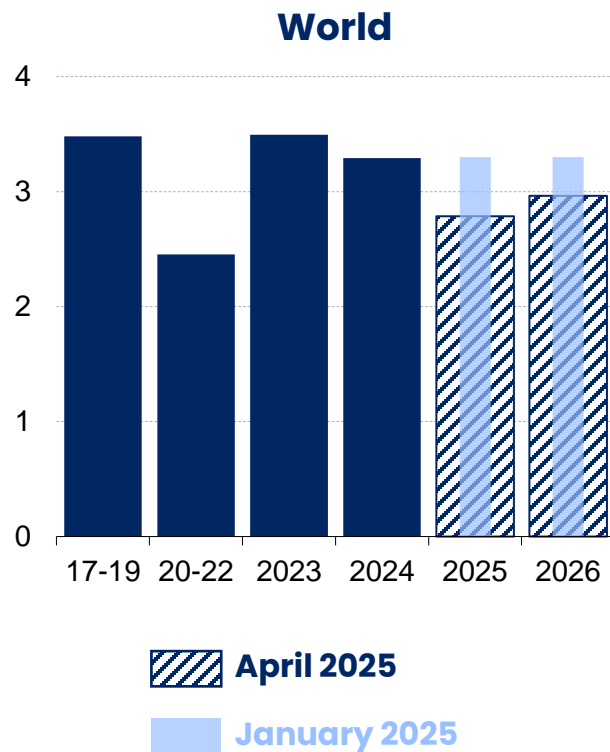
June 2025

1 Global economy

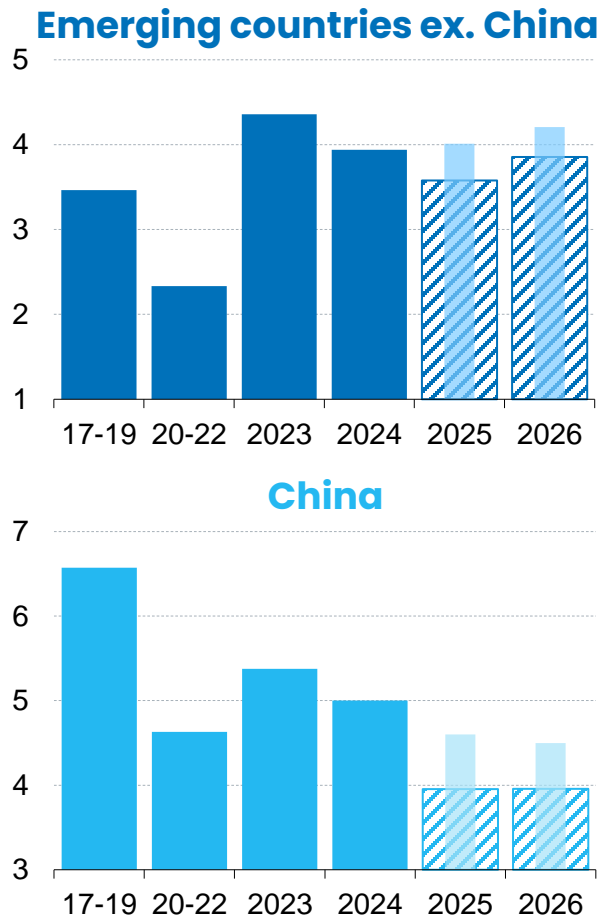
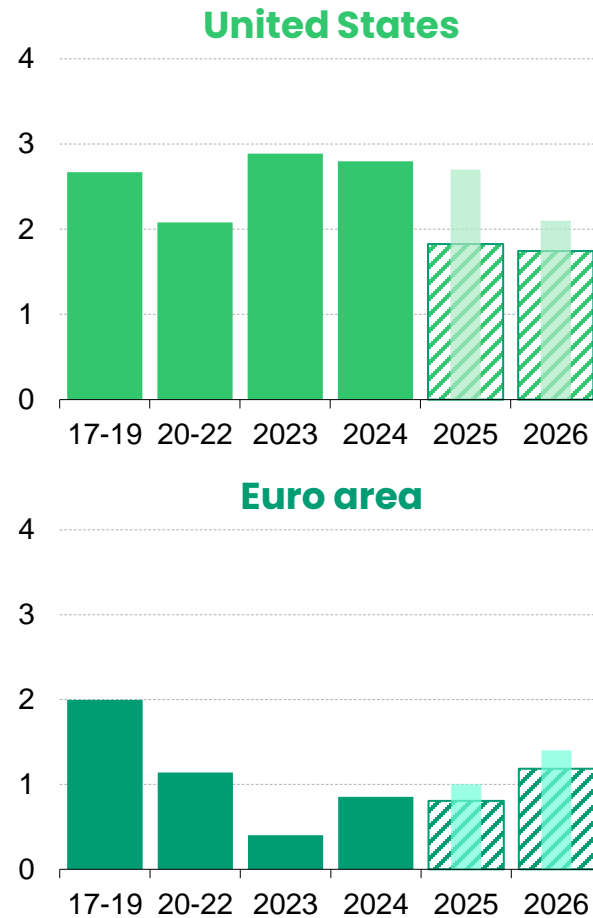
Rising uncertainty...



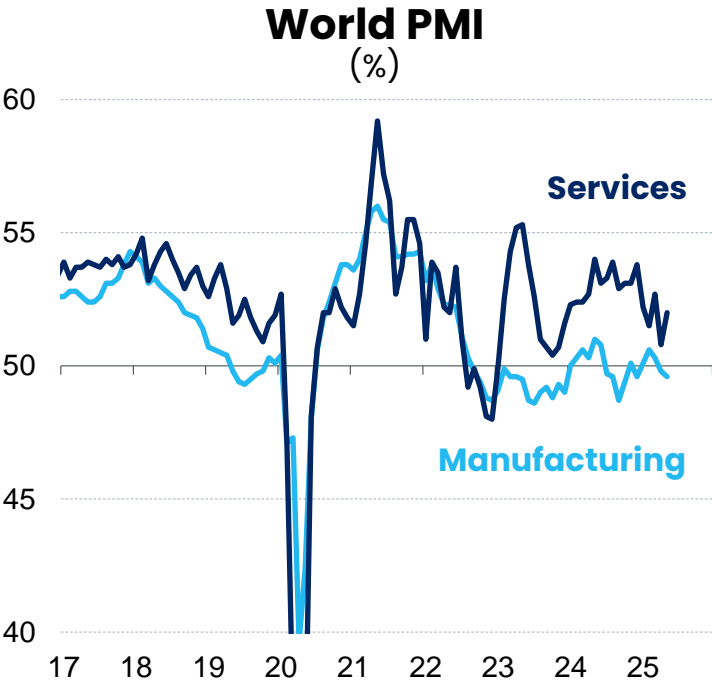
The IMF has revised downward its growth forecasts for 2025 and 2026



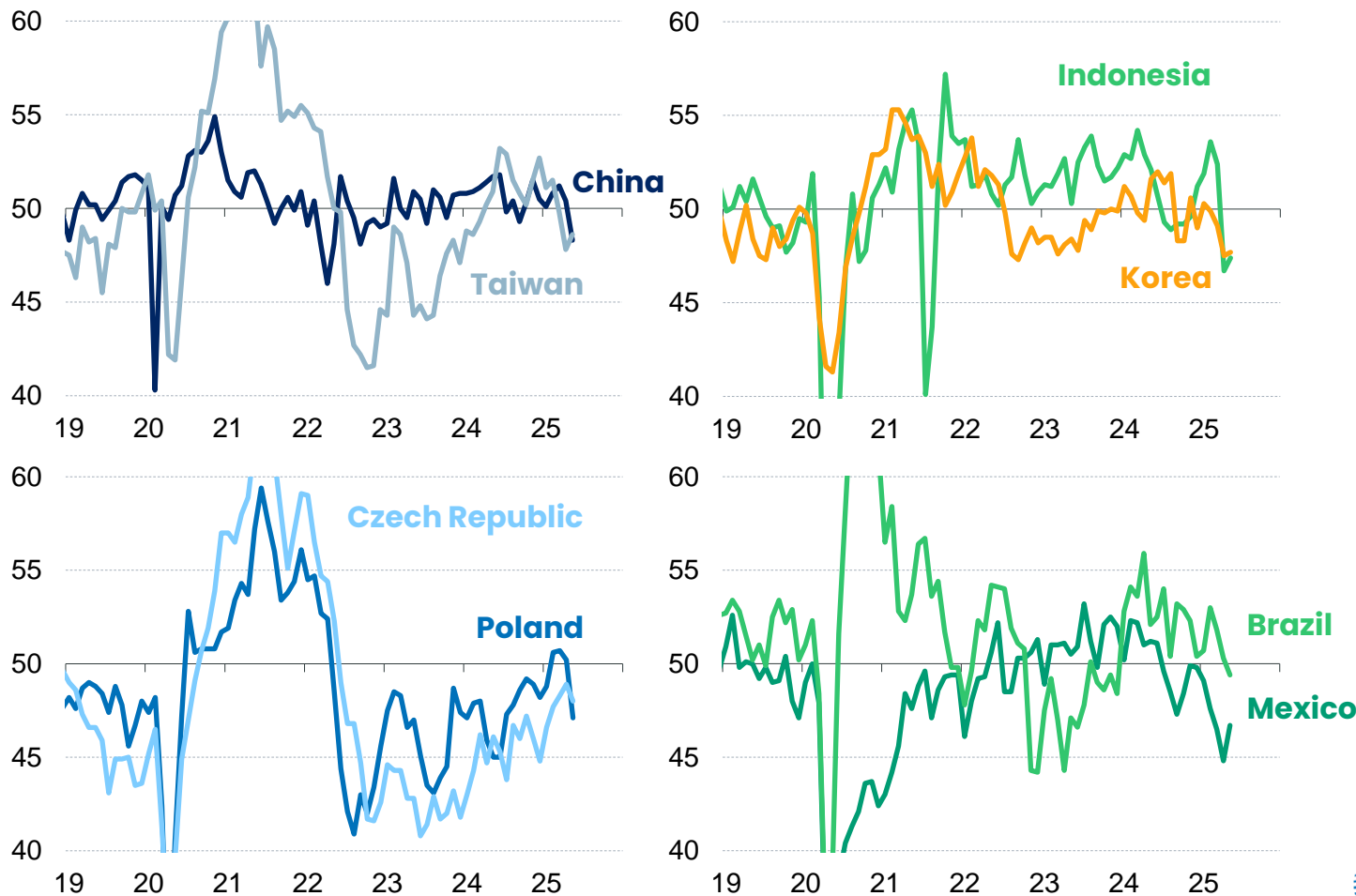
IMF GDP growth forecasts (% annual rate, April 2025)



In most countries, manufacturing PMIs have significantly fallen

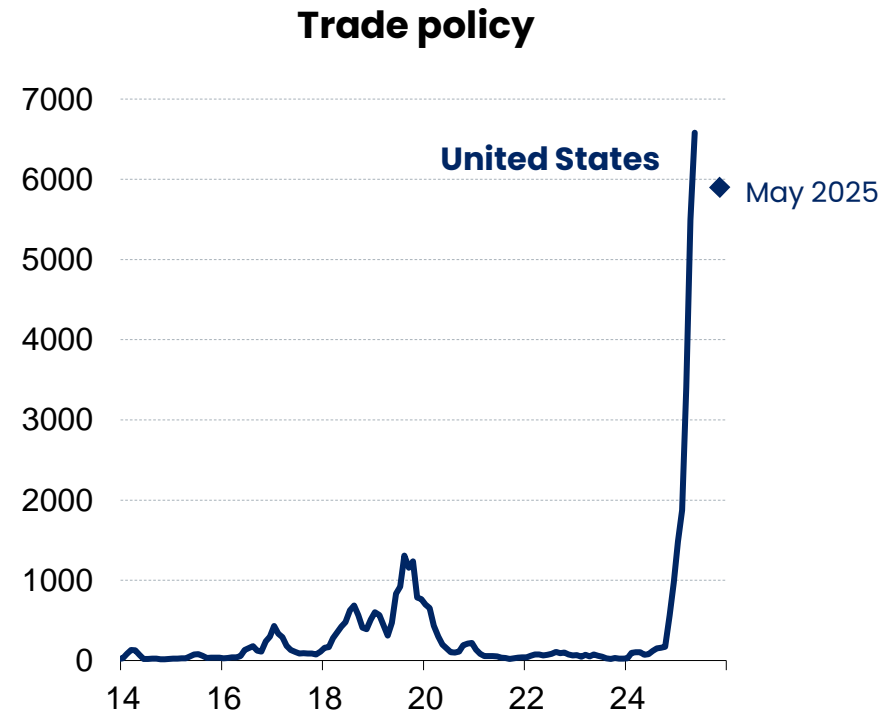
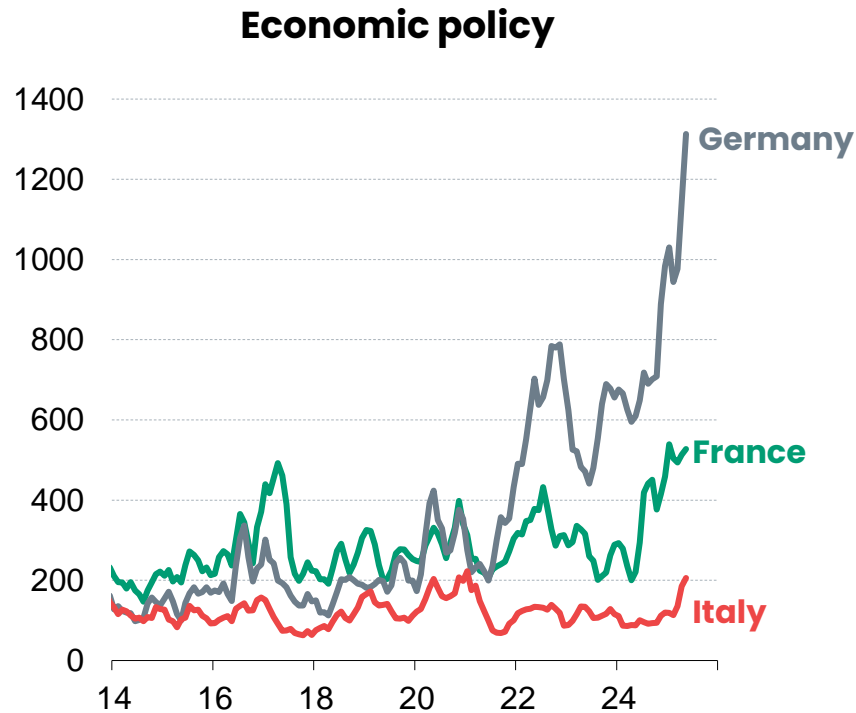


Manufacturing PMI indices in some emerging countries (%)



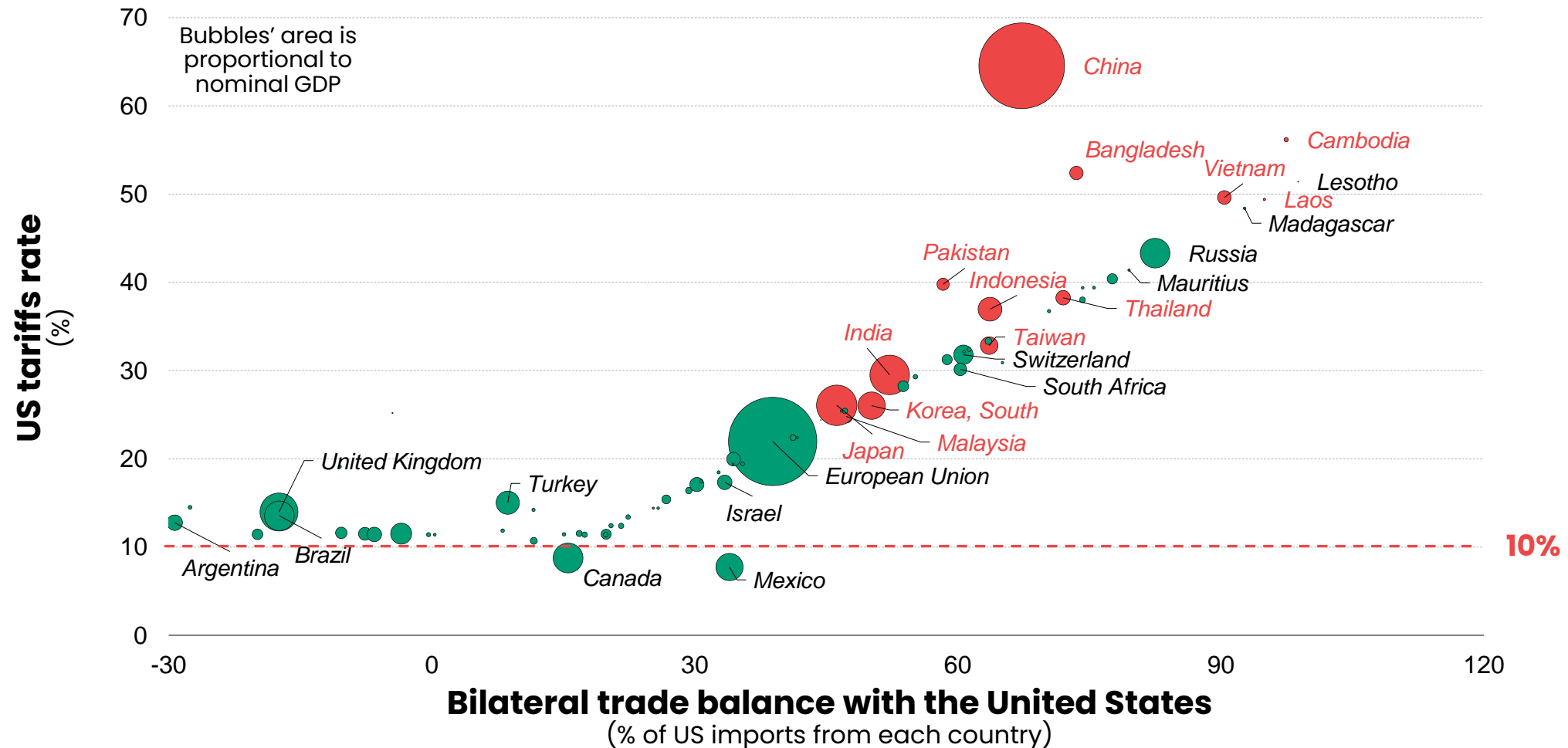
Over the last few months, uncertainty has considerably risen!

Political uncertainty indices (3-month moving average)



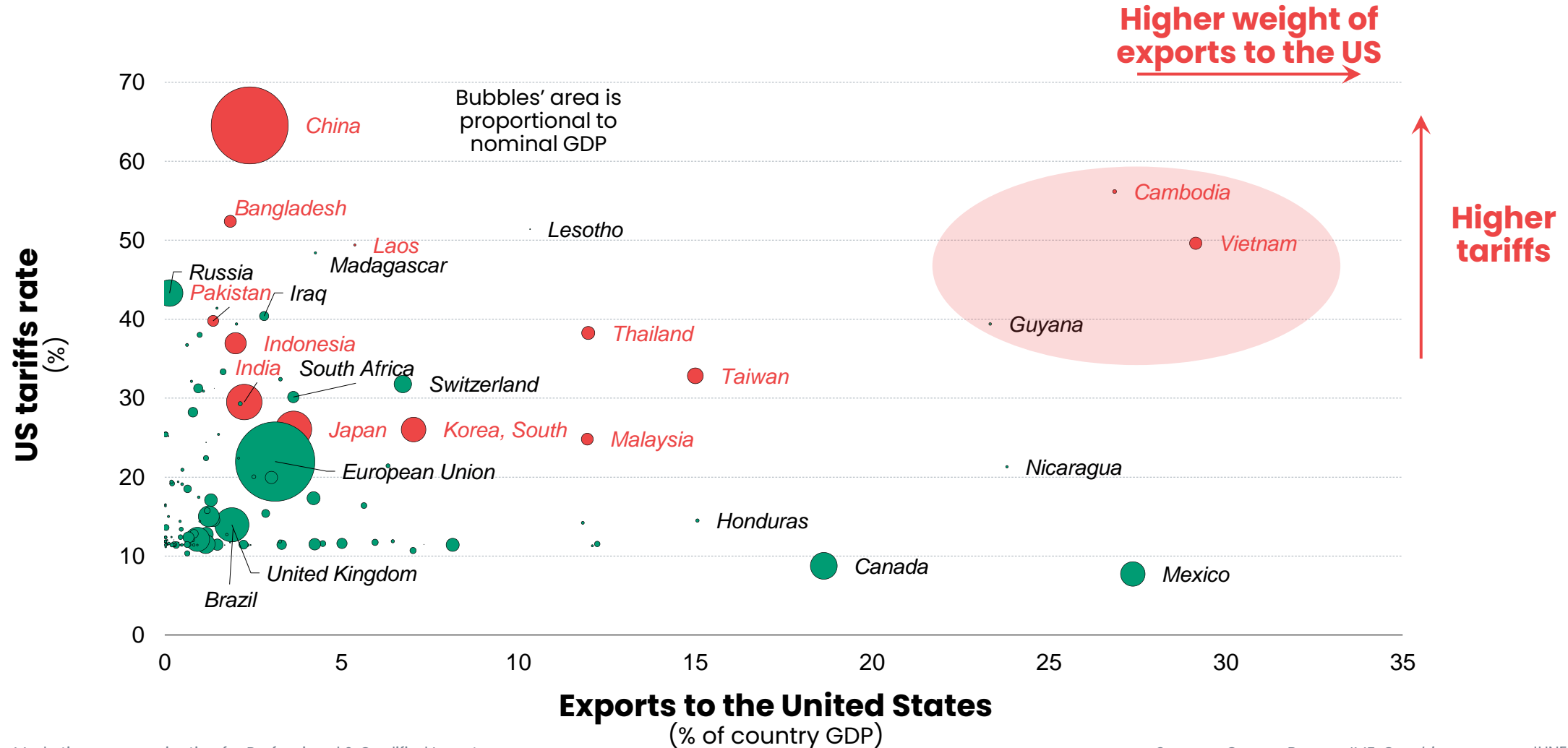
After “Liberation Day”, tariffs rate were especially high for many Asian countries (I)

**US tariffs and bilateral trade balance with the United States
the day after “Liberation Day”**



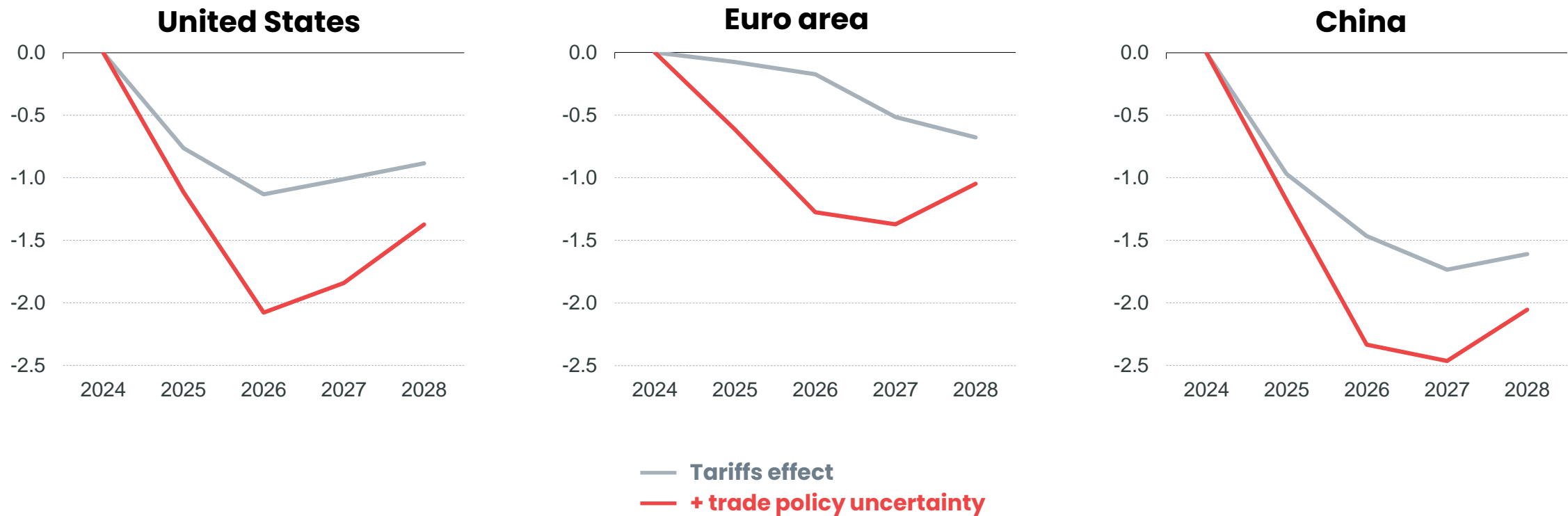
After “Liberation Day”, tariffs rate were especially high for many Asian countries (II)

US tariffs and weight of exports to the United States the day after “Liberation Day”



Such elevated tariffs would have severely weighed on activity

Effect of a trade war* on GDP (%)

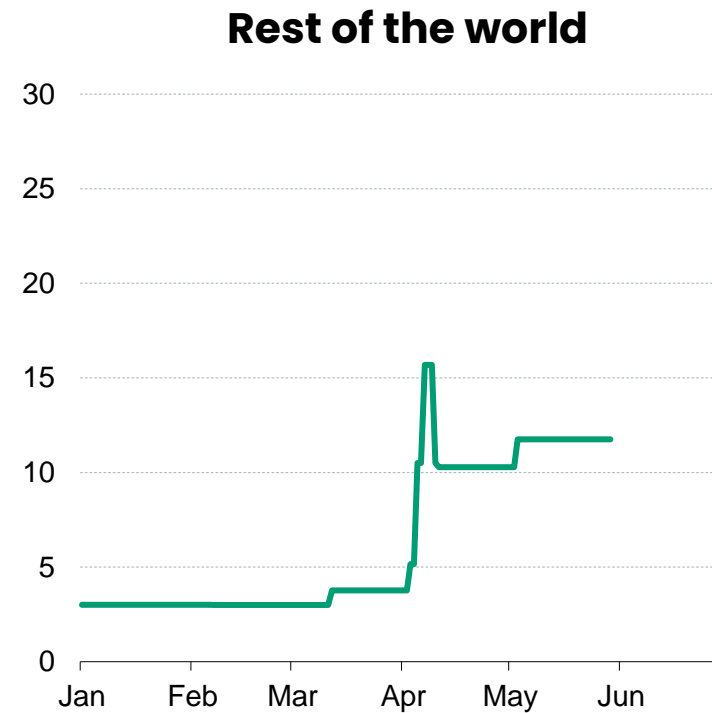
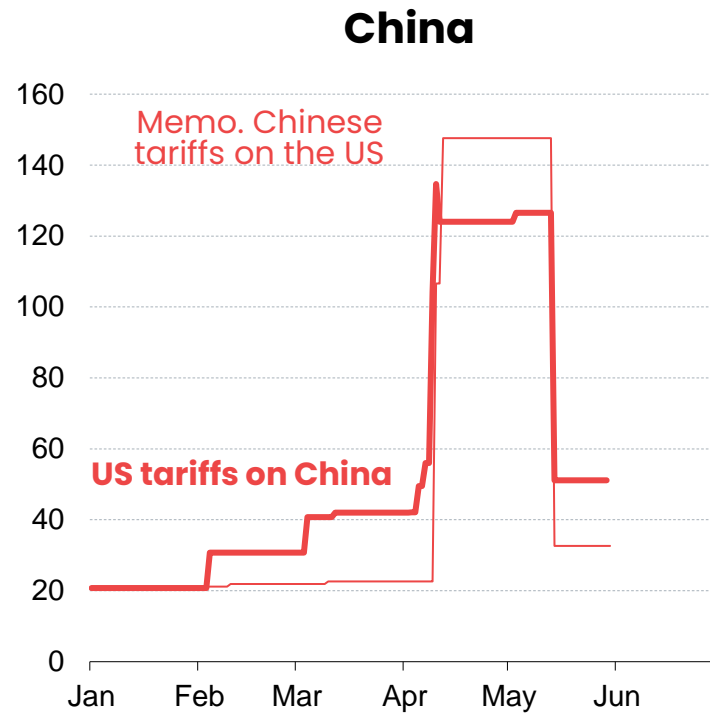


(*) The US impose 60% tariffs on China, 20% on the euro area and the rest of the world. China and the euro area retaliate with 20% tariffs on the US.

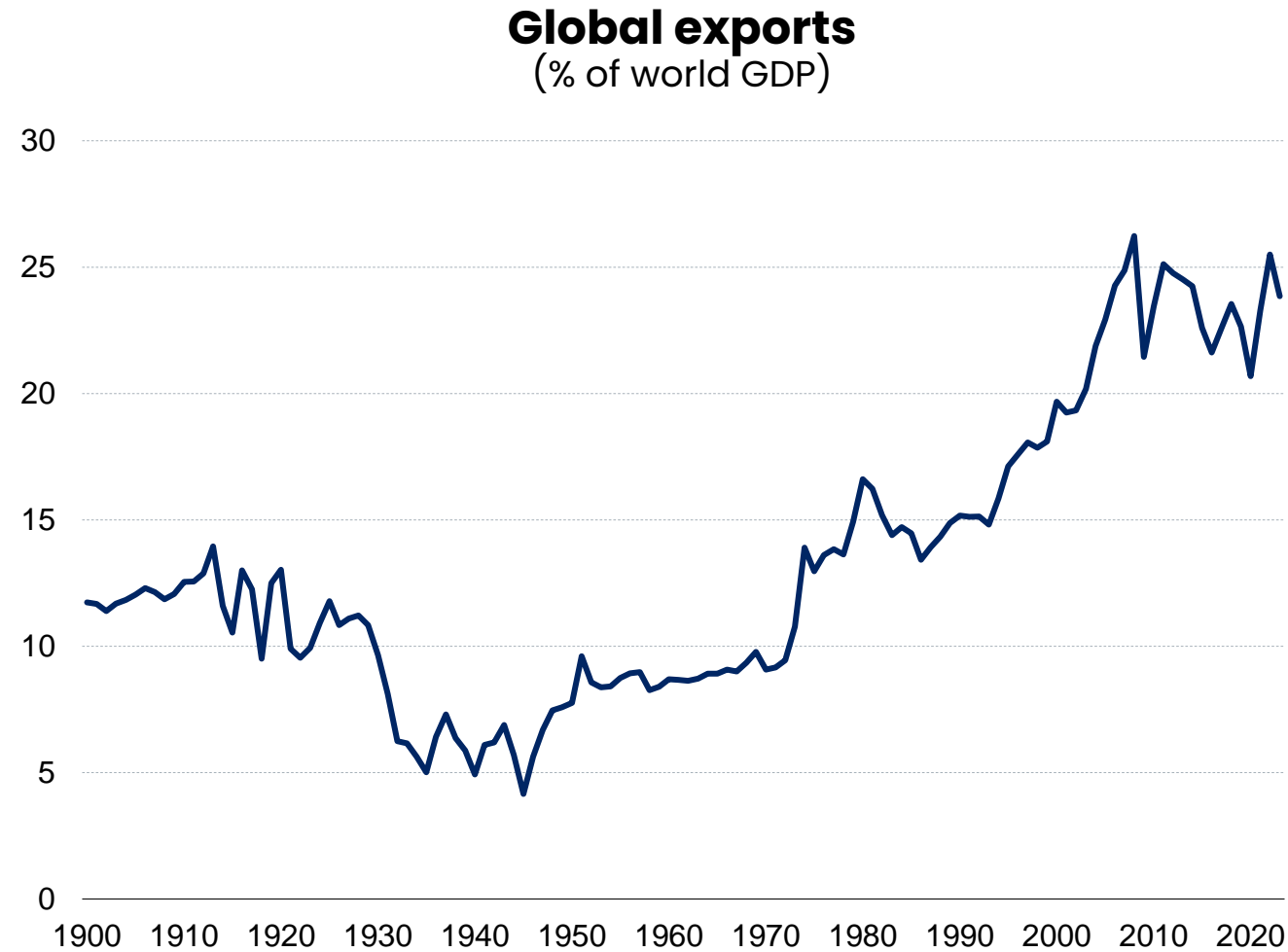


Despite some de-escalation, the rise in US tariffs remains significant...

Evolution of US tariffs rate in 2025 (%)



... in a global economy where trade is much more developed than at the beginning of the last century

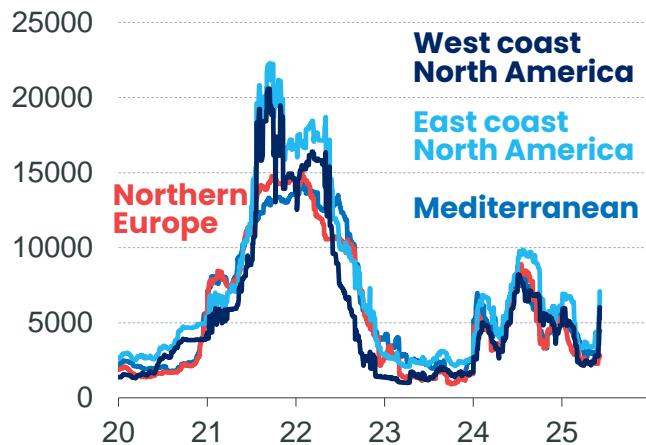


The trade war and port fees on Chinese-build vessels could revive somewhat tensions on supply chains

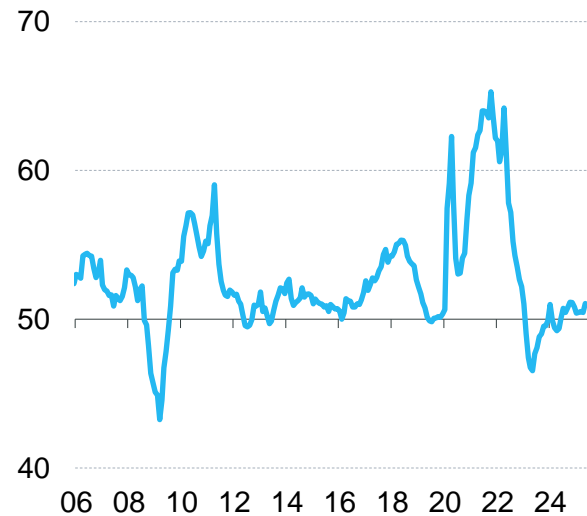
Harper shipping index
(January 2019 = 100)



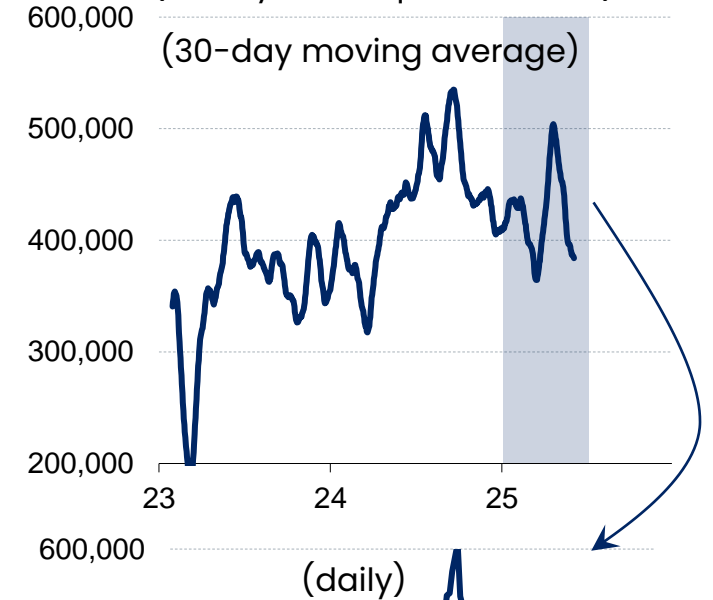
Freight costs
(\$ per 40-foot container, from China & East Asia to...)



Global suppliers' delivery time
(manufacturing PMIs)

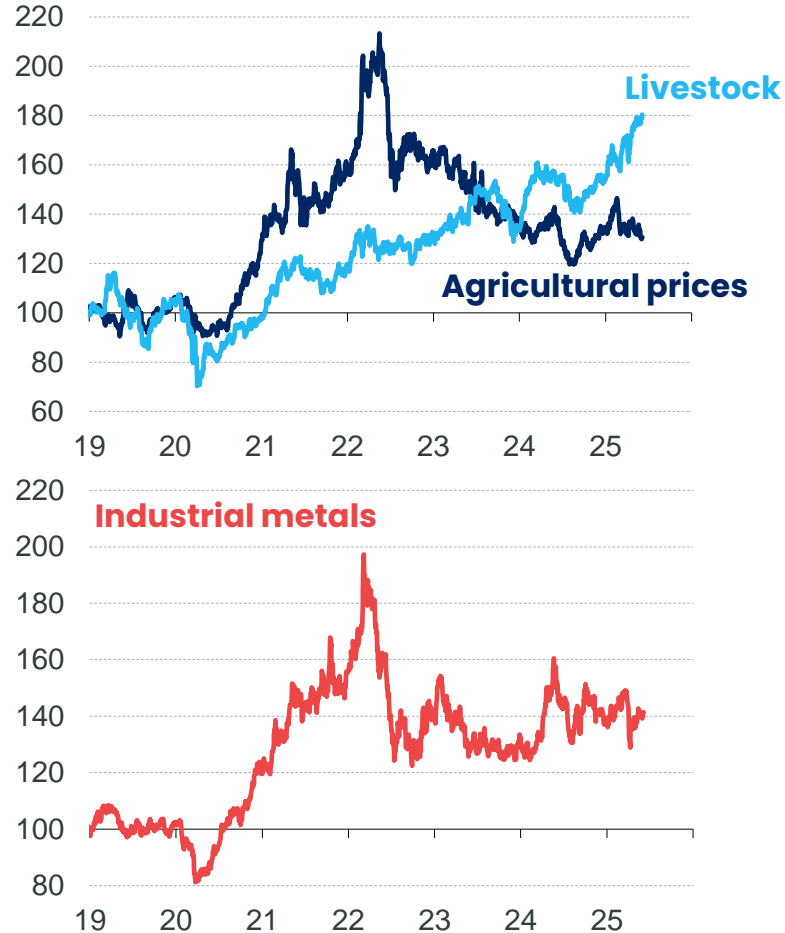


Container ship tonnage departures from China to the US
(twenty-foot equivalent unit)
(30-day moving average)



The recent fall in energy prices should cushion the tariffs' shock somewhat

GSCI commodity prices
(January 2019 = 100)



Crude oil price
(Brent, \$ per barrel)

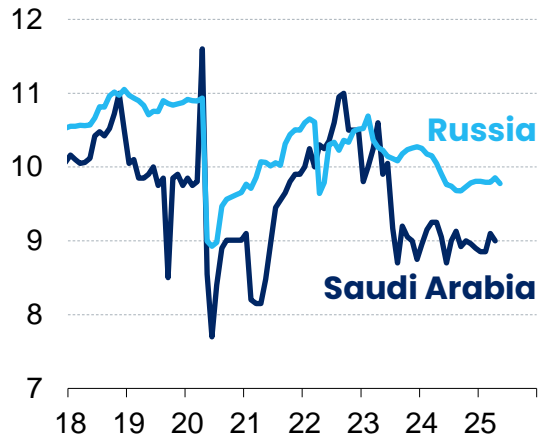


Natural gas price
(January 2019 = 100, in local currency)

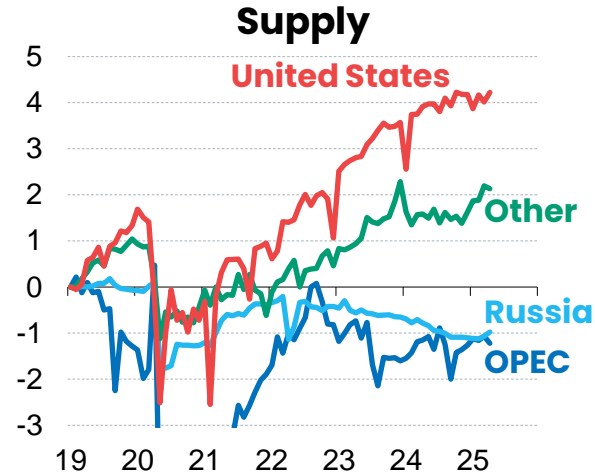


Given the rise in OPEC+ production and weaker oil demand, oil prices could stabilize around \$60 per barrel...

OPEC+ crude oil production
(million barrels per day)



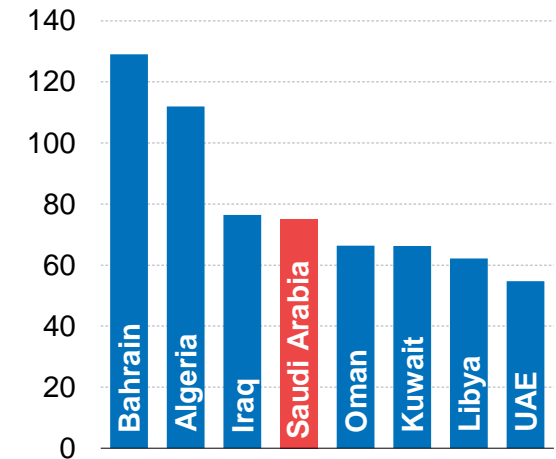
Cumulated change in global oil supply and demand
(million barrels per day, since January 2019)



OPEC spare capacity
(million barrels per day)



Breakeven fiscal oil price by country
(\$ per barrel)

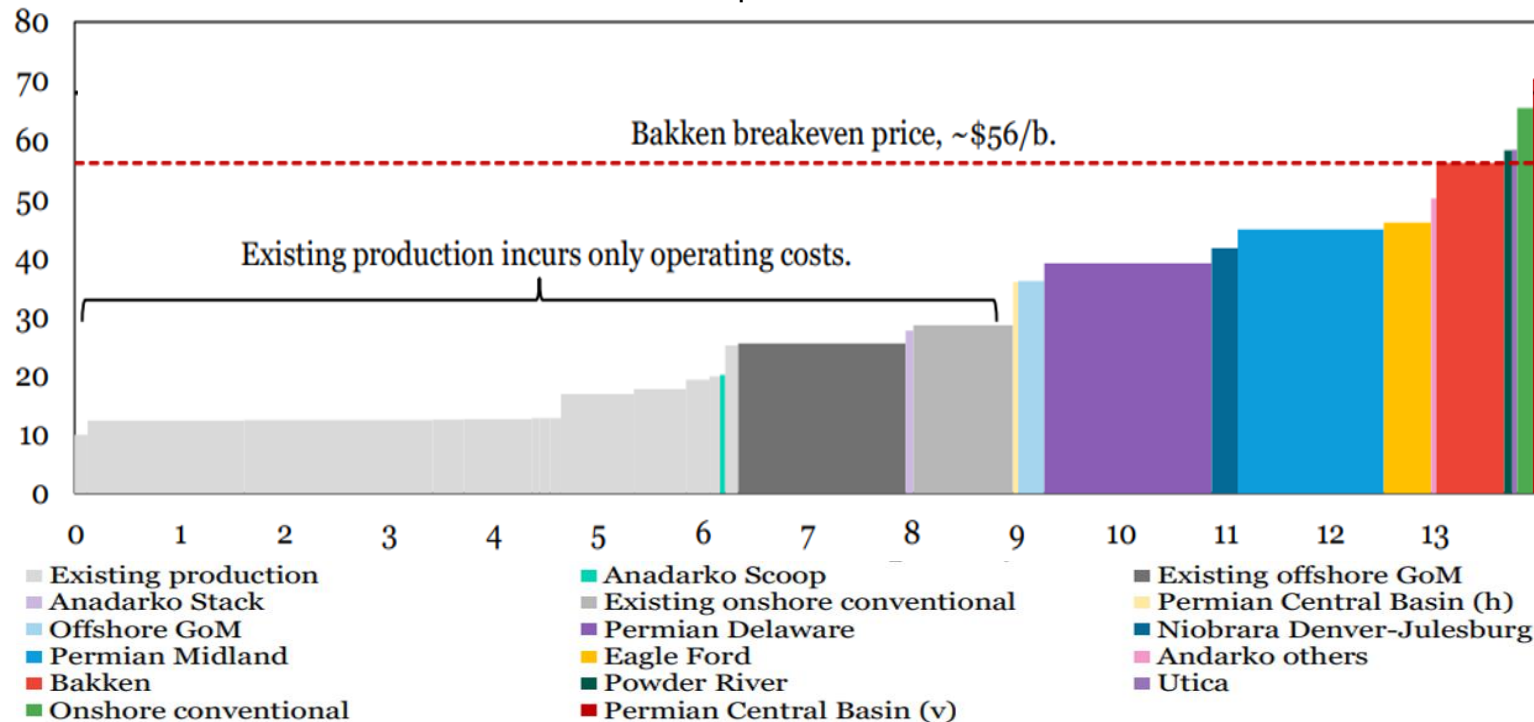


... or slightly below if the US administration takes measures to reduce the breakeven oil price for US producers

President Trump initiated a shift by declaring a “national energy emergency” through a series of executive orders aimed at “unleashing” the US oil and gas industry.

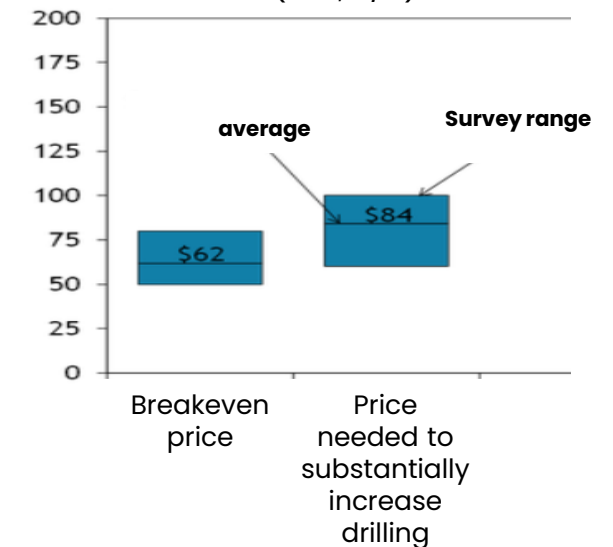
Breakeven oil price by region in the United States

(\$ per barrel)



Kansas City Fed Q4 energy survey

Oil price needed for drilling to be profitable (WTI, \$/b)



Trump's policies could reduce the current breakeven price by:

- Reducing royalties on federal leases from 16.67% to 12.5% lowers breakeven costs by \$3/bbl;
- Reducing corporate tax from 21% to 15% lowers breakeven costs by \$3/bbl;
- Reinstating the 100% bonus depreciation from the TCJA lowers breakeven costs by \$9/bbl.



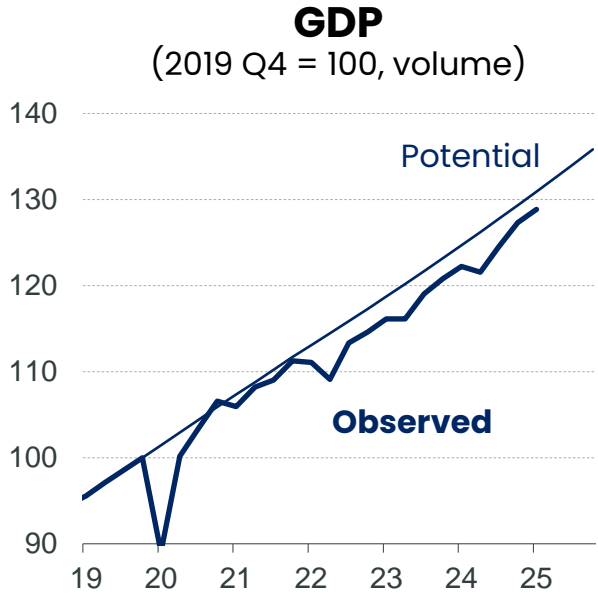


2 China

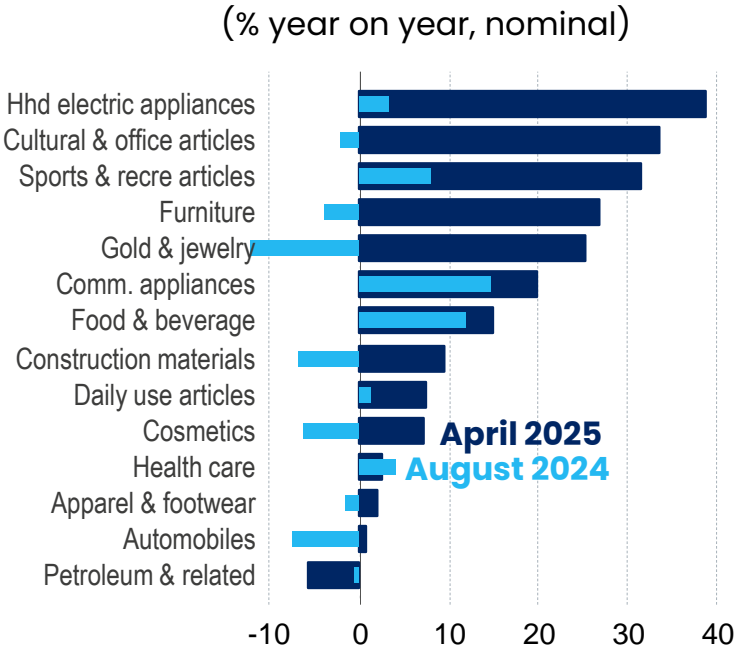
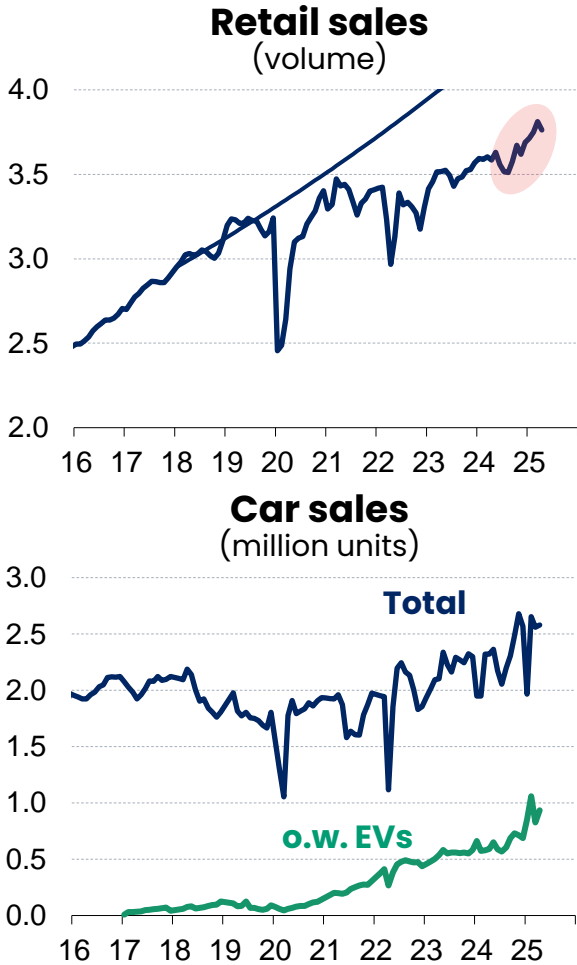
Game of chess or game of go?



Activity was solid in Q1, supported by the trade-in subsidies for durable goods

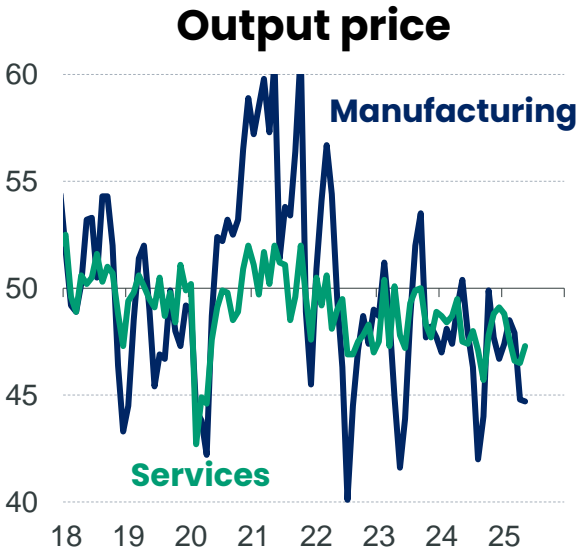
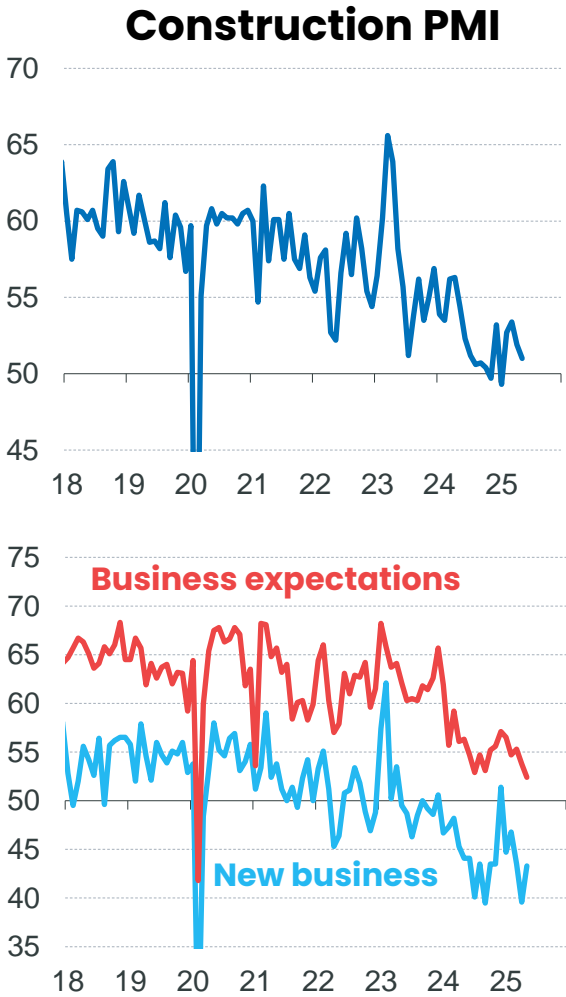
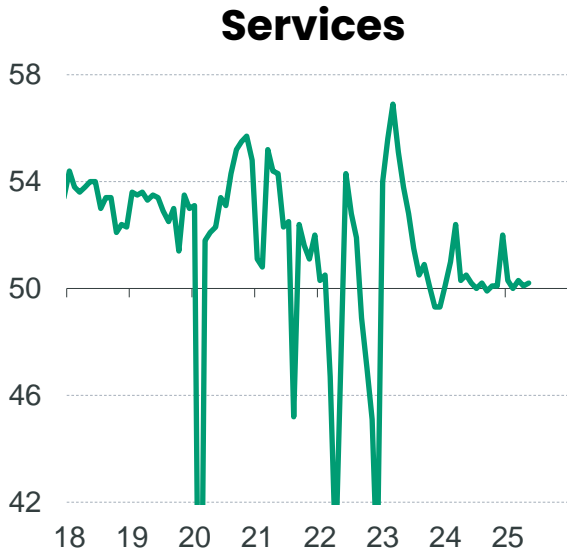
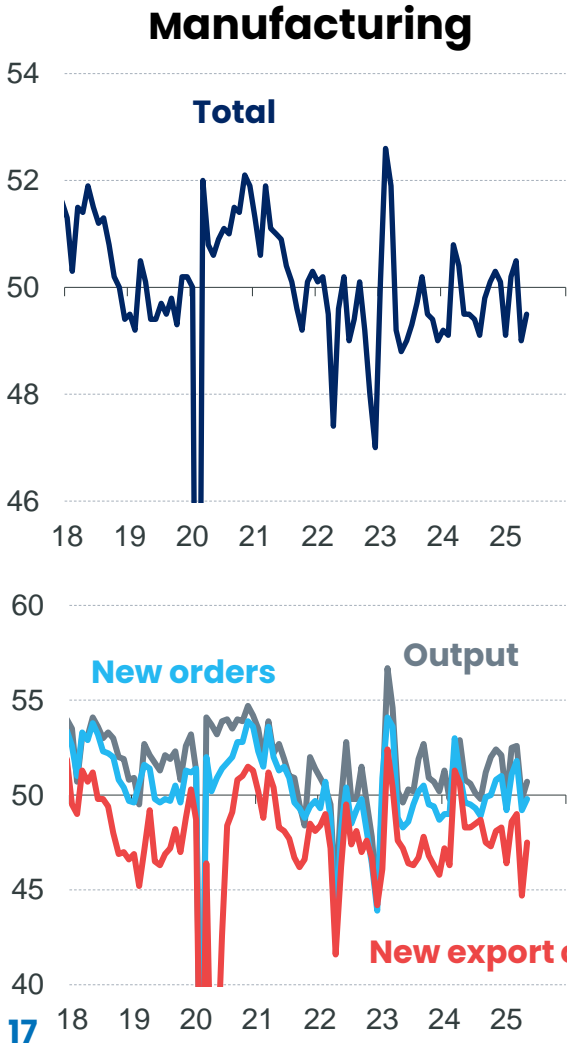


Retail and car sales

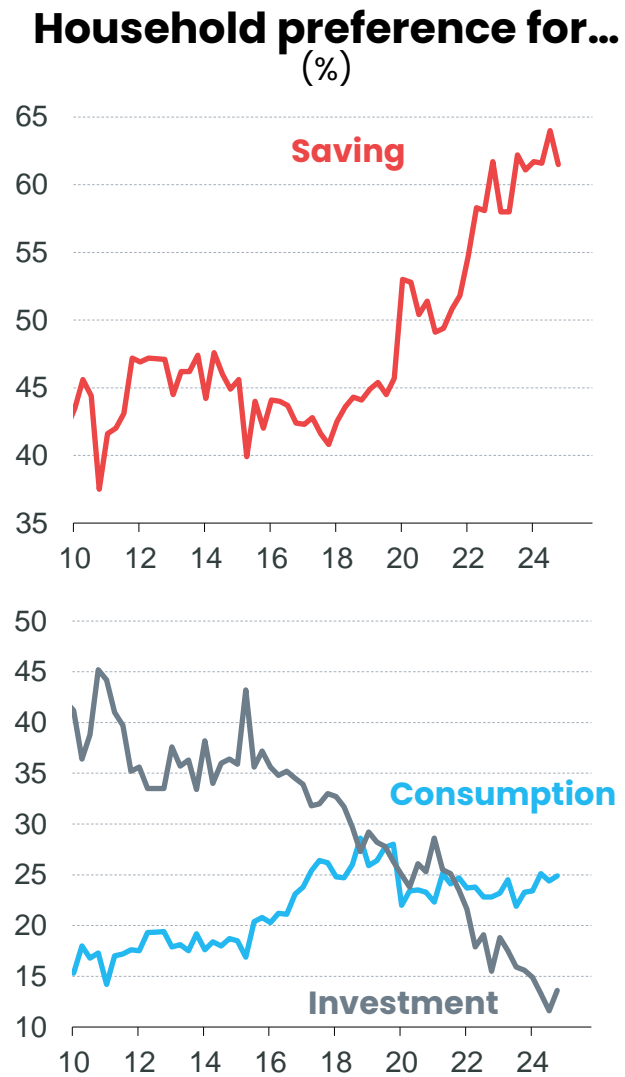
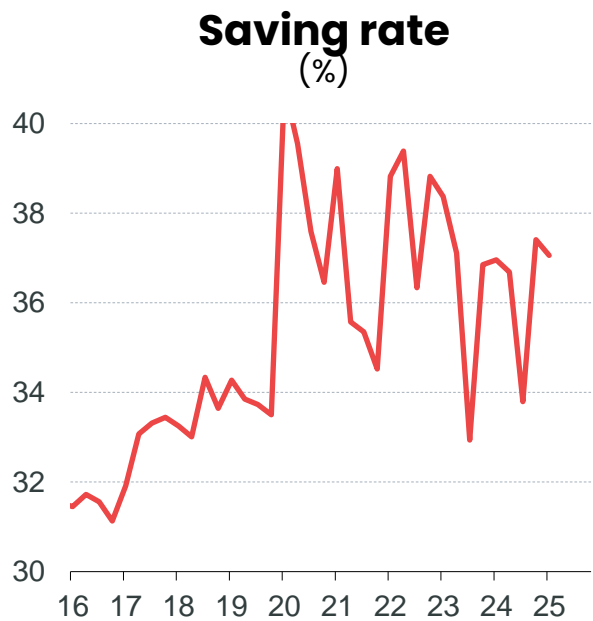
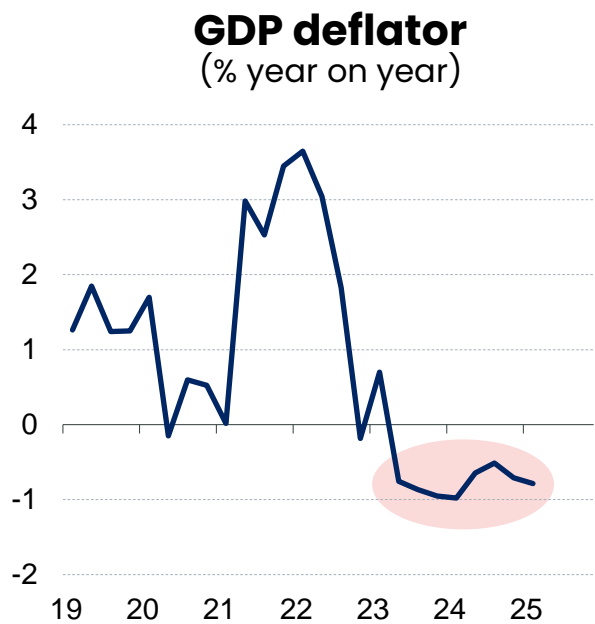


Still, PMI surveys have started to deteriorate in the manufacturing sector as tariffs kicked in

PMI index
(NBS)



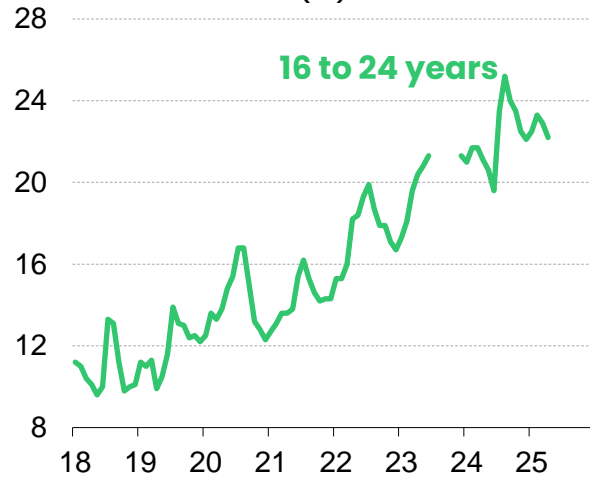
Deflationary forces are still alive...



... and are unlikely to fade anytime soon

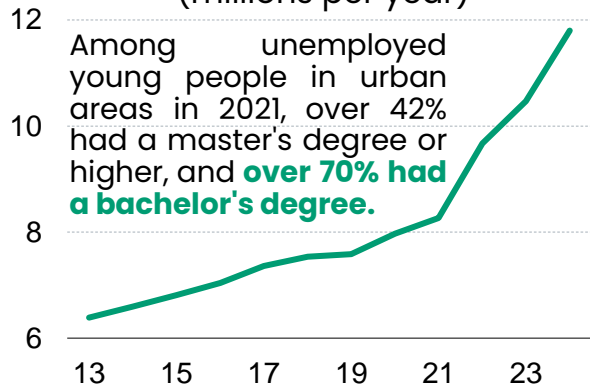
Youth unemployment rate

(%)



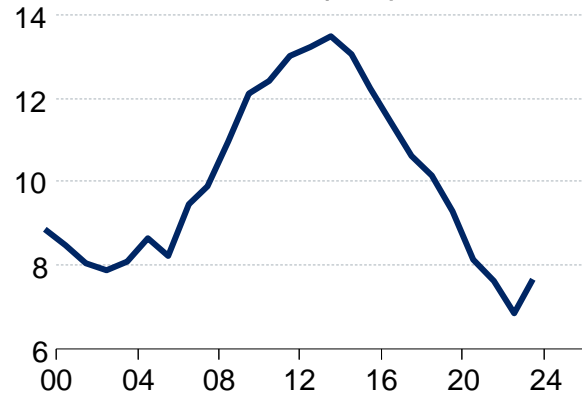
Number of graduates from public colleges and universities

(millions per year)



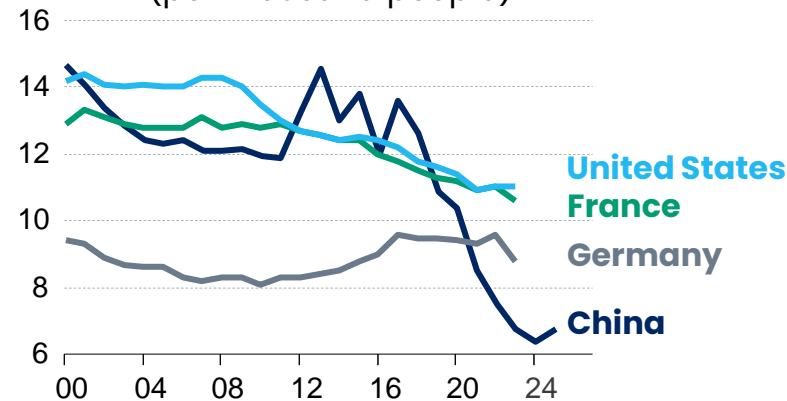
Number of marriages

(millions per year)

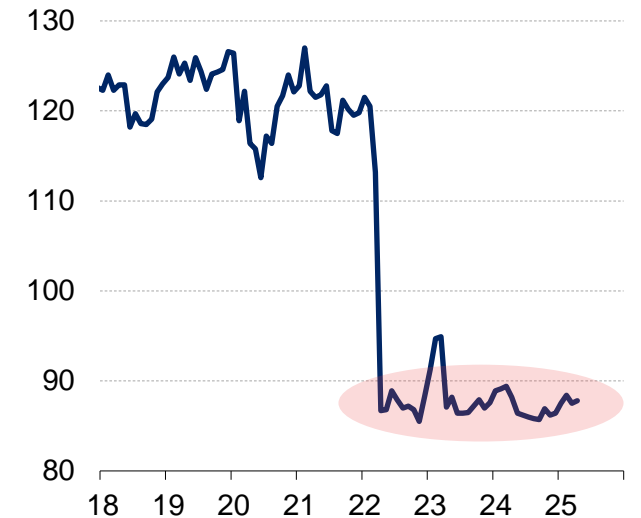


Birth rate

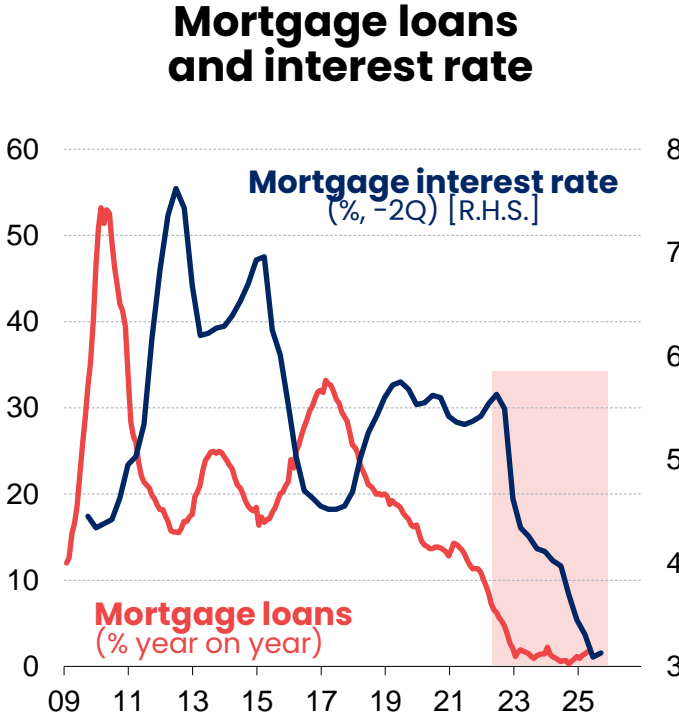
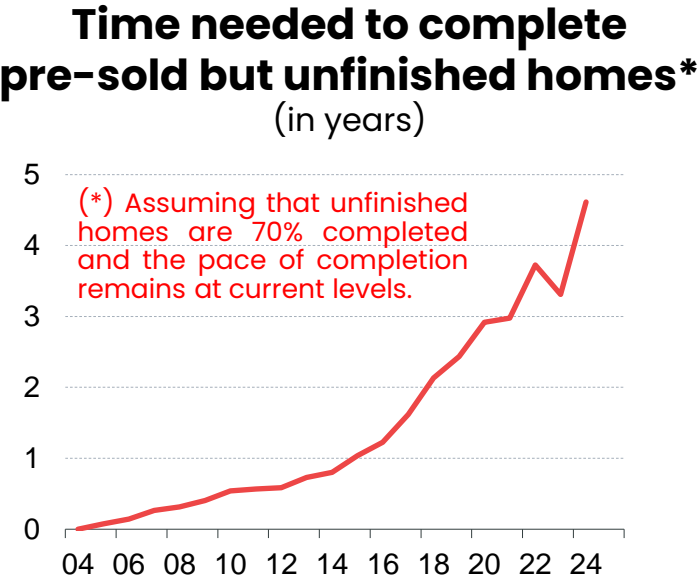
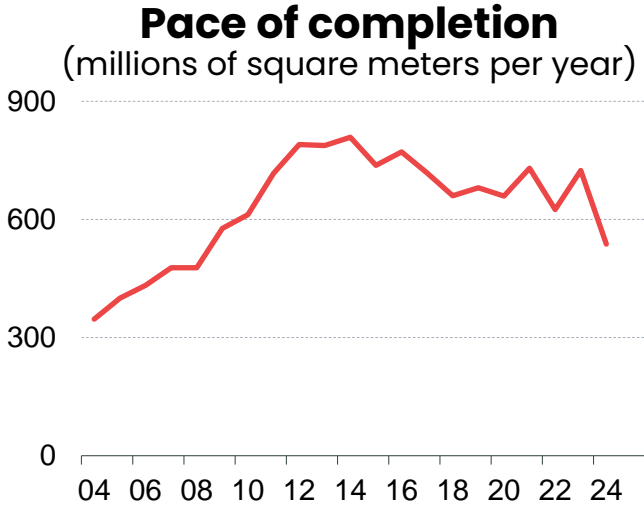
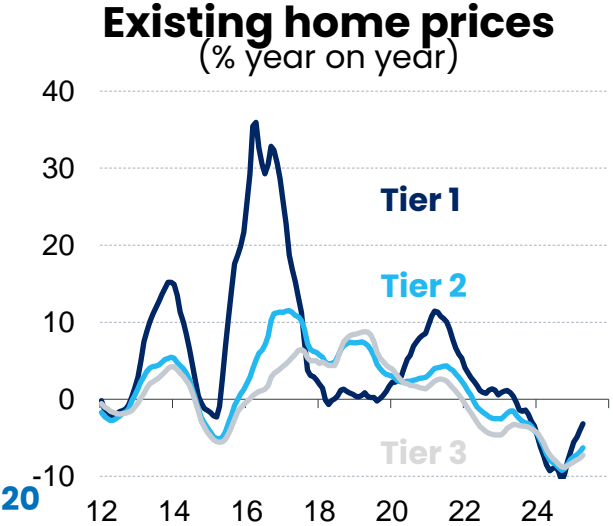
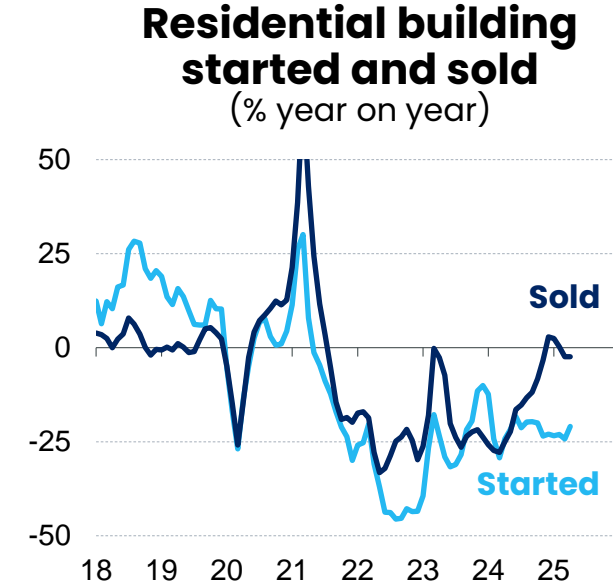
(per thousand people)



Consumer confidence

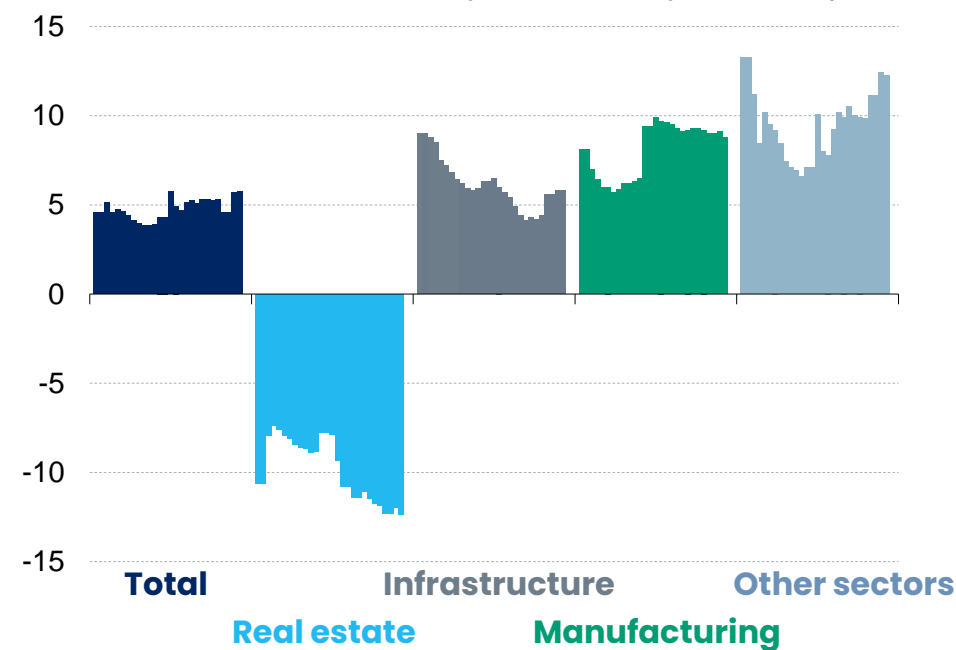


Residential investment continues to curb activity... as monetary policy has little traction on mortgage loans

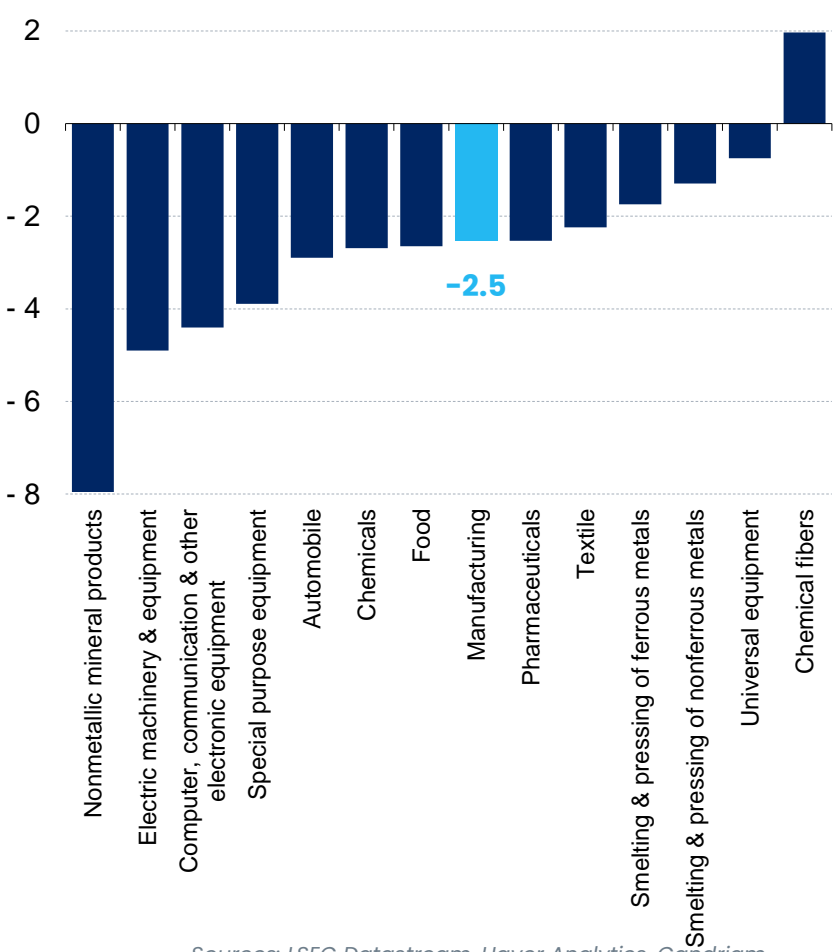


Business investment is unlikely to be very dynamic...

Fixed asset investment by industry
(% year on year growth of investment cumulated since the start of the calendar year, January 2023 – April 2025)

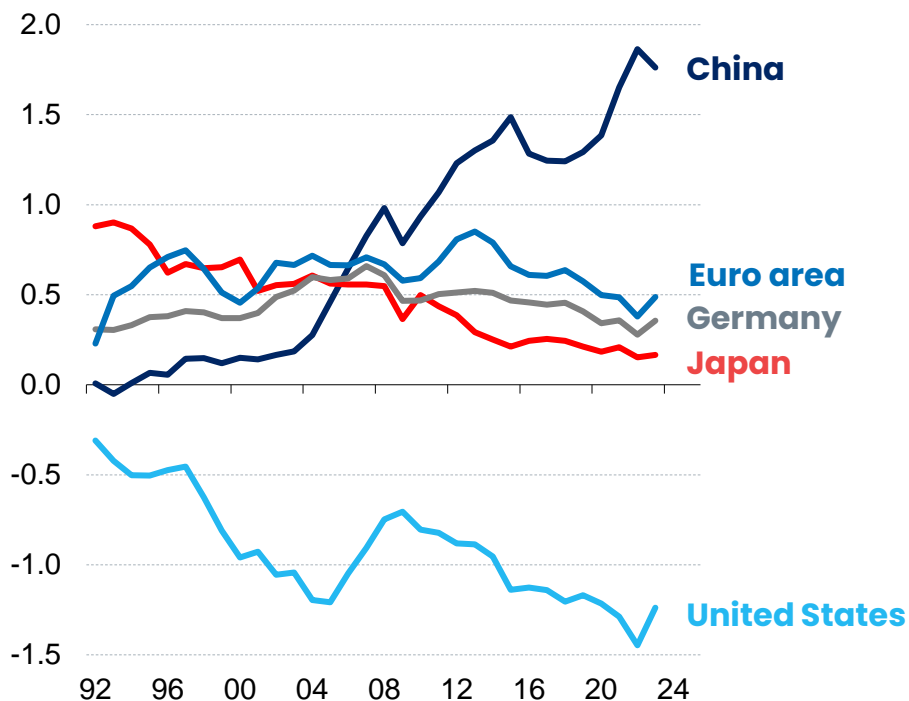


Capacity utilization rate
(% change over 2019 Q4 – 2025 Q1)

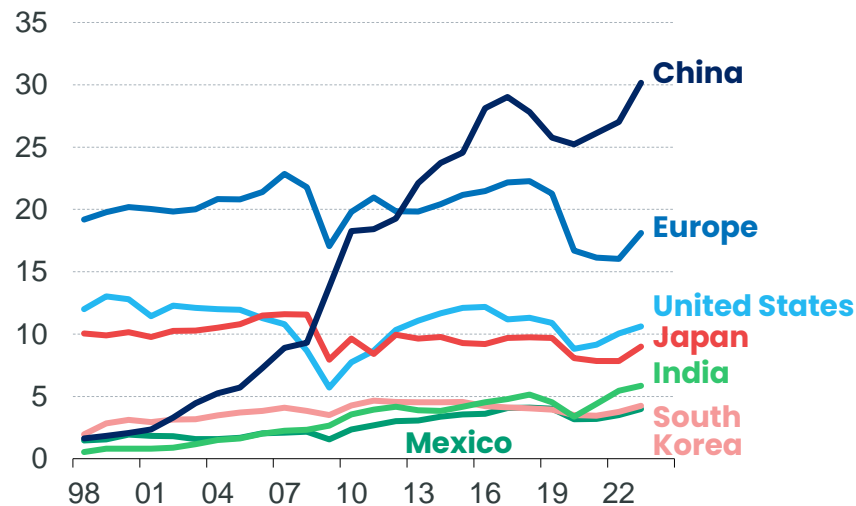


... the more so since China already dominates global manufacturing

Trade balance of manufactured goods
(% of world GDP)



Car production
(millions of units)



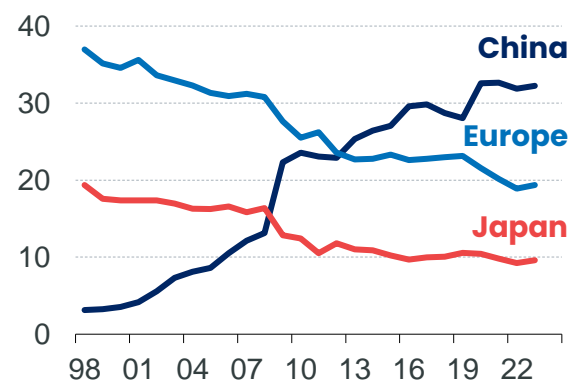
In 2018, China had the capacity to produce 40 million gasoline-powered cars a year, far more than the 25 million its economy needed.

To this is now added the capacity to produce 20 million electric vehicles a year (a figure that could soon reach 30 million).

China now has the capacity to produce around two-thirds of the world's automotive demand (just over 90 million cars by 2023).

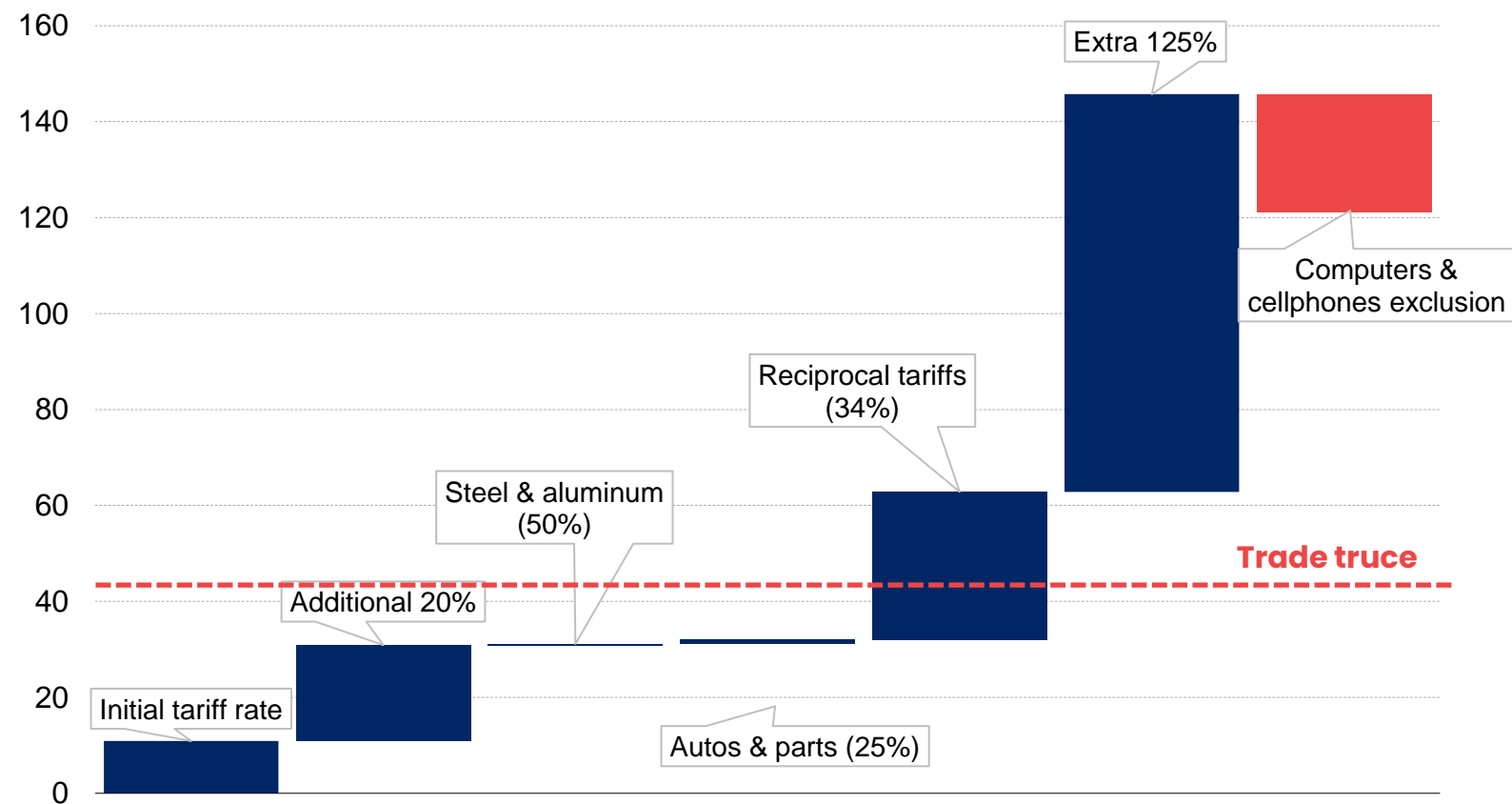
Source: Brad Setser, NYT

Share of world car production
(%)

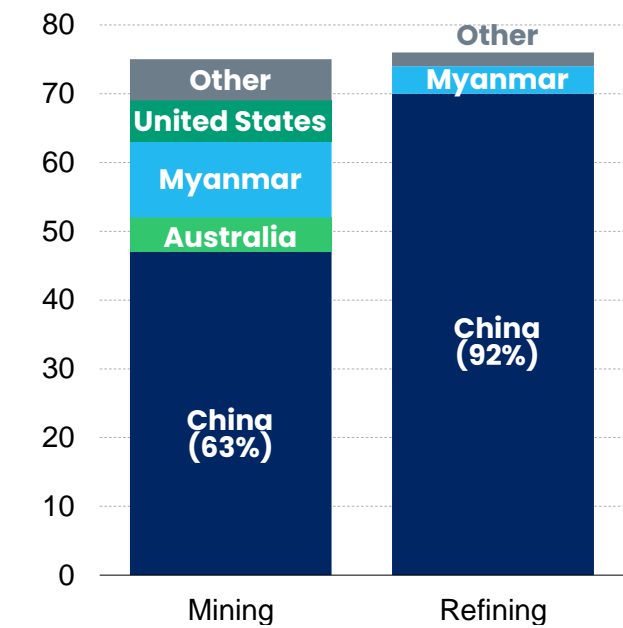


China and the US agreed to roll back tariffs for 90 days

Tariff rate on US imports from China (%)

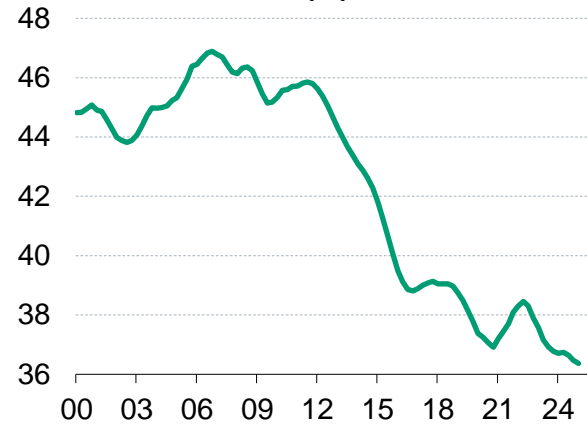


Memo. Rare earth elements supply (thousands of tons)

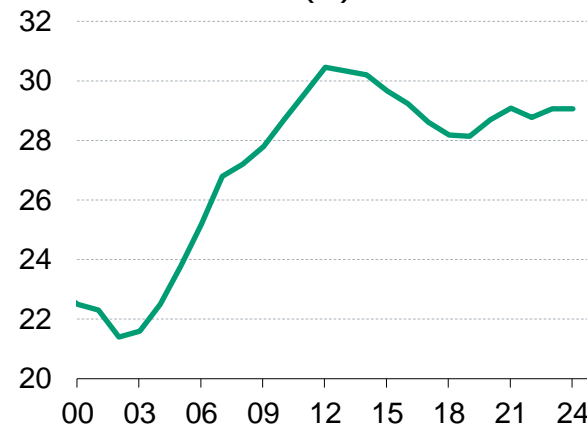


This is good news for China as the weight of the manufacturing sector is still very high

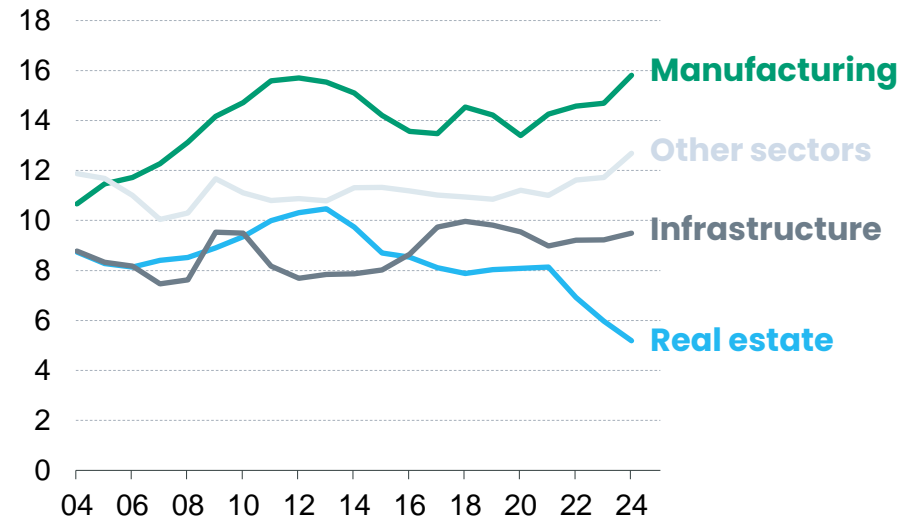
Share of industry in GDP
(%)



Share of industrial employment
(%)

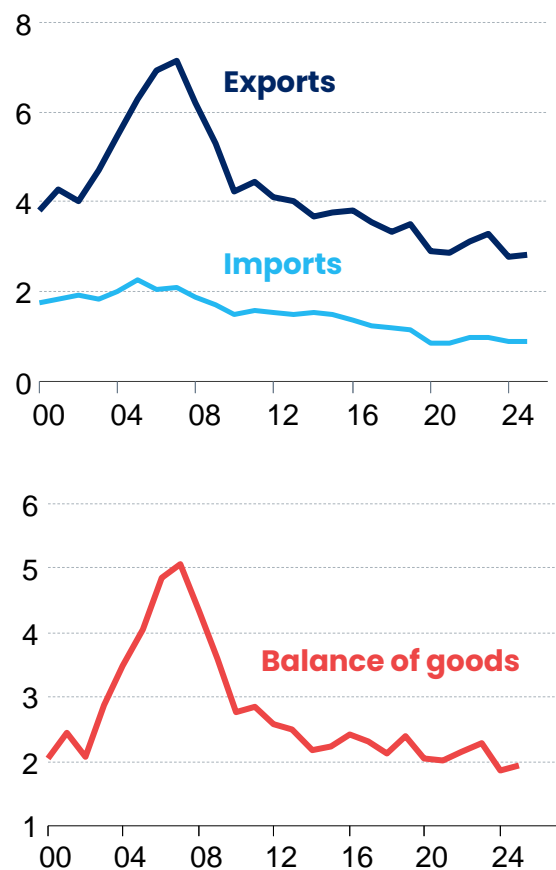


Investment share by sector
(% of GDP)

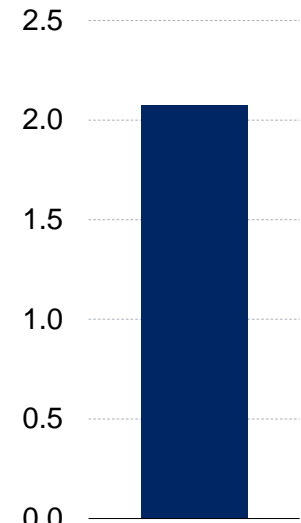


Still, the additional 30% US tariffs could take up to 1% of Chinese growth

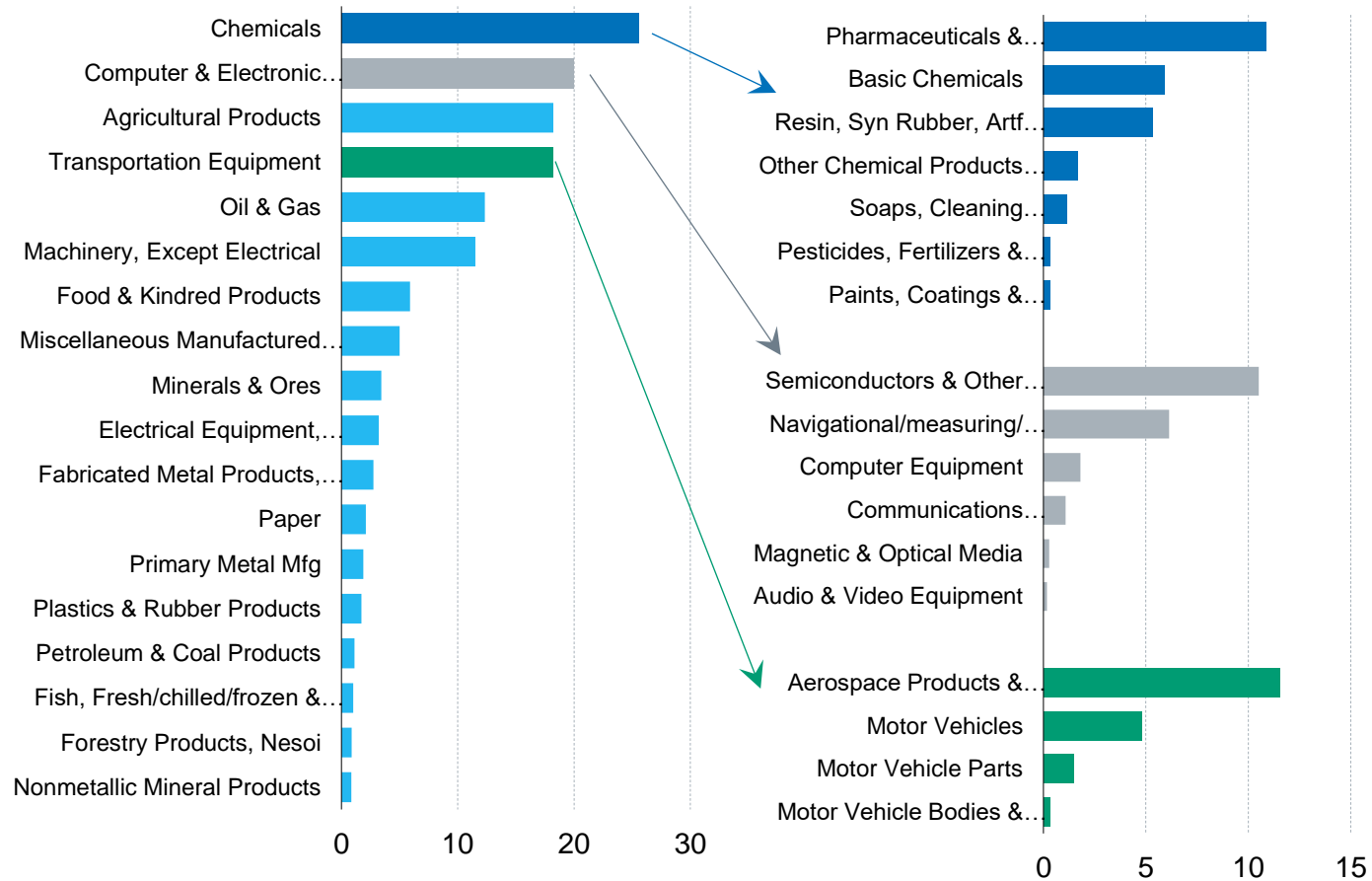
China external trade with the United States
(% of China GDP)



Chinese value added in China exports to the United States
(% of China total VA in 2019)



Imports from the United States
(\$ billion, 2024)



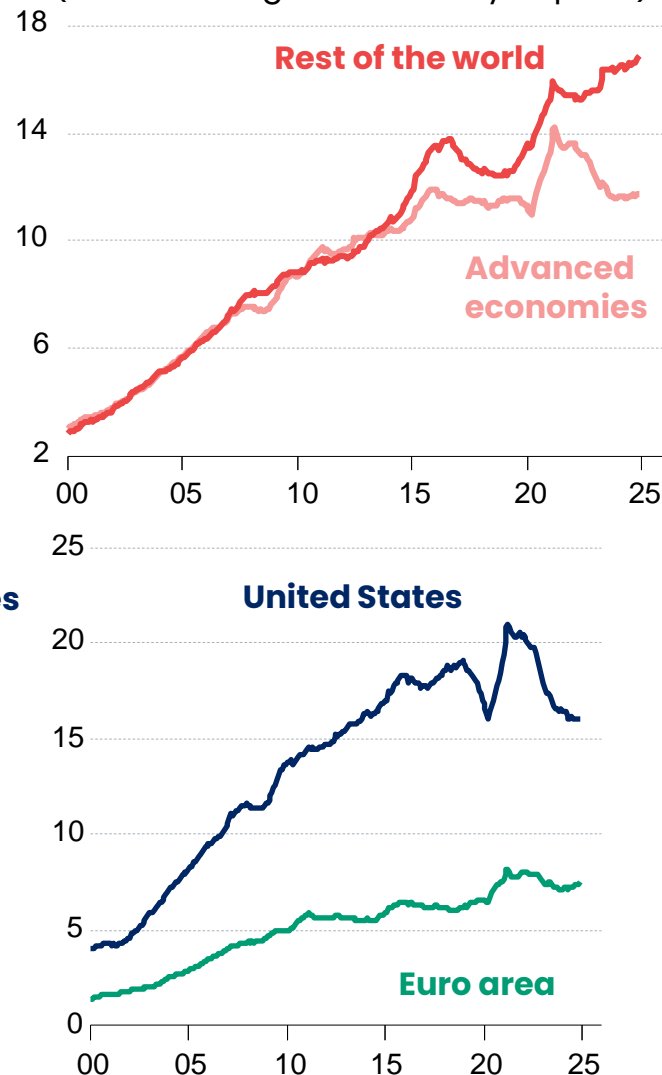
China will try to re-route its exports and to increase its penetration of foreign markets... but trading partners are likely to resist

China's exports to...
(\$ billion, 2 months moving average)



(*) Indonesia, Vietnam, Laos, Brunei, Thailand, Myanmar, the Philippines, Cambodia, Singapore and Malaysia

Penetration of China's exports
(% of each region or country imports)

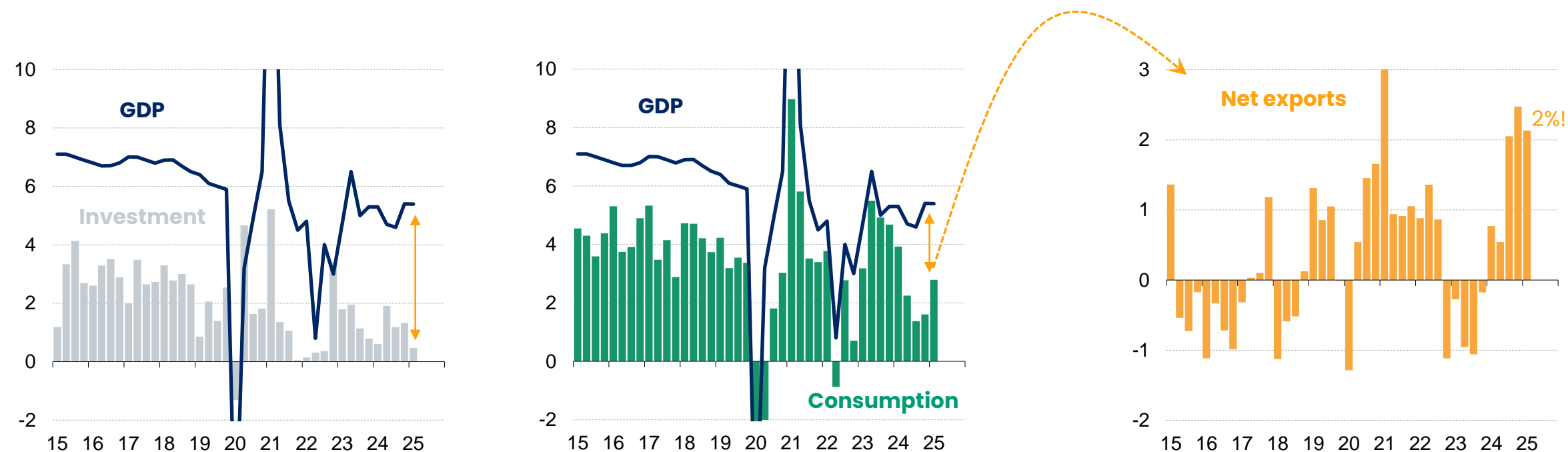


China trade balance
(\$ billion, cumulated over 12 months)



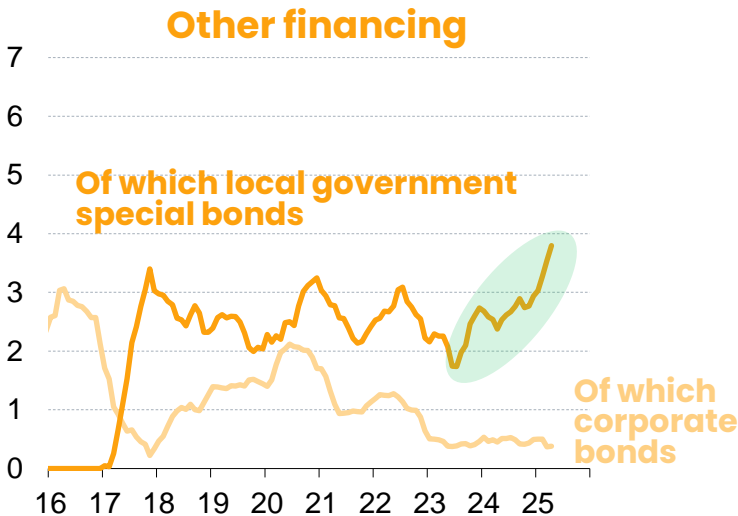
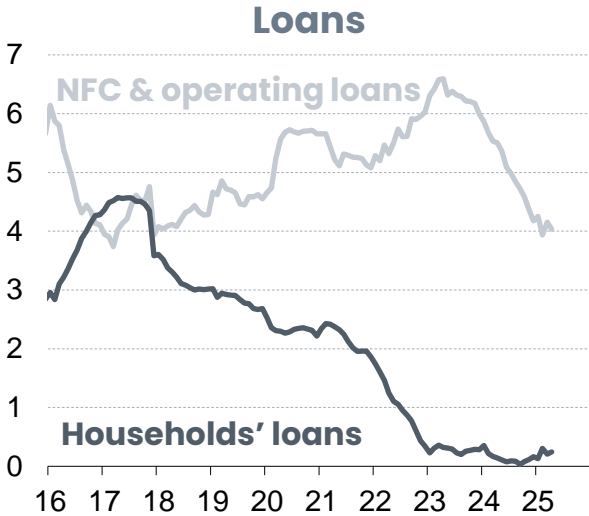
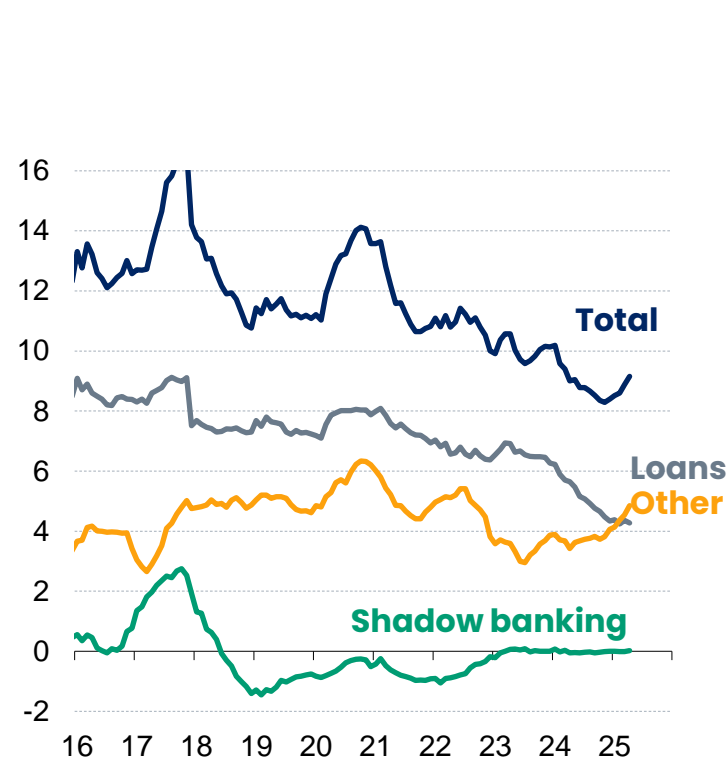
Redirecting growth towards consumption is the only long-term option

Contributions to GDP growth
(% year on year)

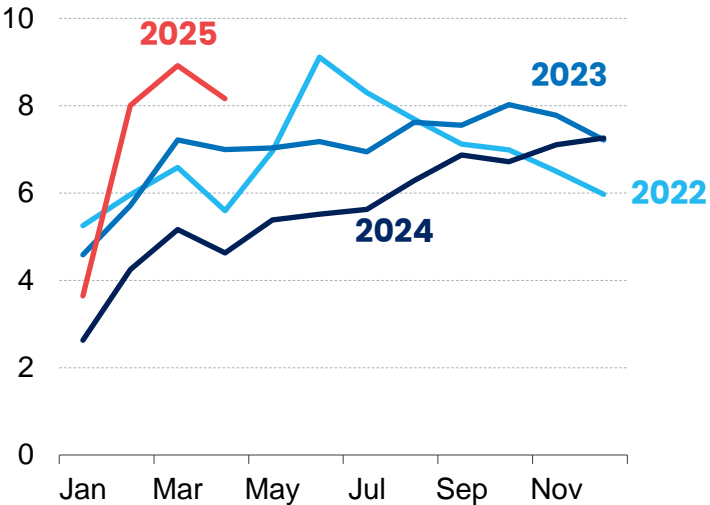


Although the April Politburo showed limited urgency in rolling out new stimulus, the frontloading of government bond issuance...

Total social financing
(% year on year, contributions)



Local government bond net issuance
(% of GDP, cumulated since January)



... shows that Beijing is ready to cushion the shock if needed

Incremental borrowing in 2025

	2024	2025	Incremental borrowing from 2024	
			RMB tln	% of GDP
Official deficit ratio	3.9	5.2	+1.3	+1.0
CGSB	1.0	3.0		
- Major and trade-ins*	1.0	1.3	+0.3	+0.2
- New productive forces**		1.0	+1.0	+0.8
- Recapitalize State banks		0.7		
LGSB	3.6	5.0		
- Debt swap	1.2	0.8		
- Other	2.4	4.2	+1.8	+1.4
Total	7.3	10.9	+4.4	+3.4

Trade-in subsidy		RMB billion
Basic pension	20 yuan per month per person	300
Basic medicare	35 yuan per person per annum	42
Fiscal incentive for new birth		42
Total		384 (0.3% of GDP)

The government seems ready **to support consumption**, to reach its growth target of around 5% in 2025... but **the measures announced so far remain timid at best (0.3 to 0.5 points of GDP)**.

The April Politburo urged to speed up policy efforts... but did not announce any new fiscal support.

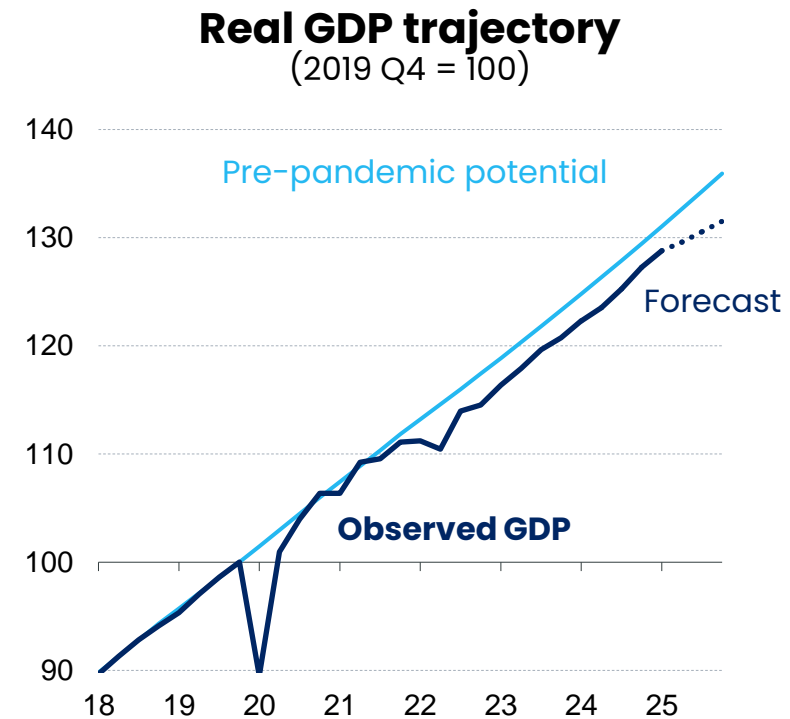
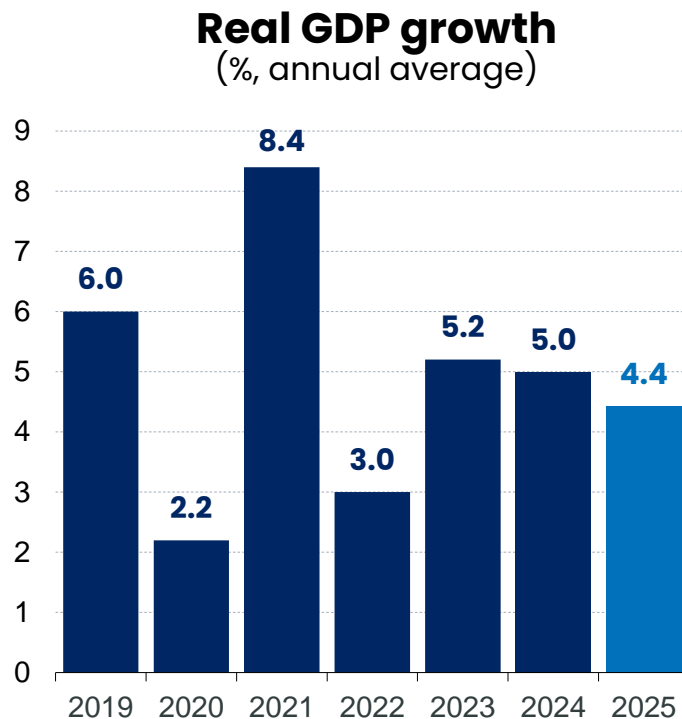
The Politburo meeting recognized external uncertainty.

The meeting emphasized to make full use of “more proactive fiscal policies” and “moderately accommodative monetary policies”.

There was no major policy narrative change other than increasing unemployment insurance refunds for enterprises hit hard by tariffs, and inclusion of foreign trade support from likely newly created structural monetary instruments.



Despite recent trade de-escalation, reaching the 5% growth target will remain challenging





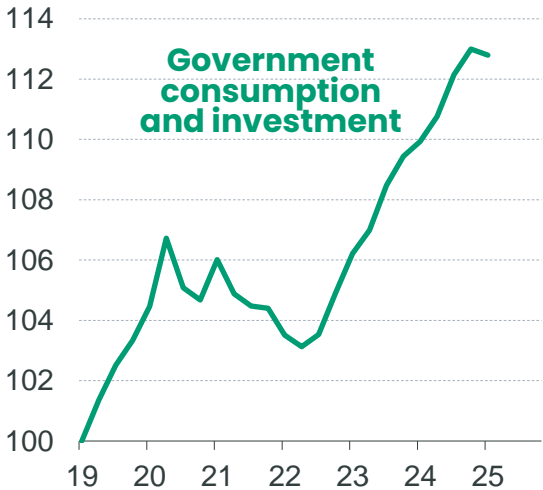
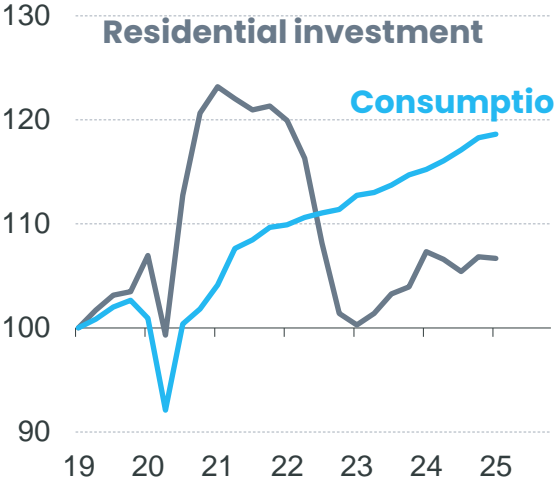
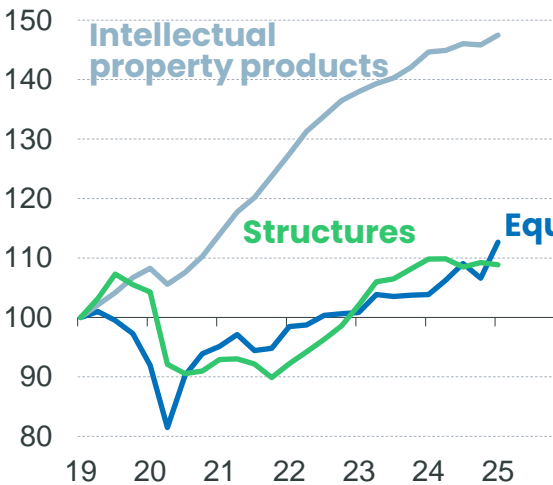
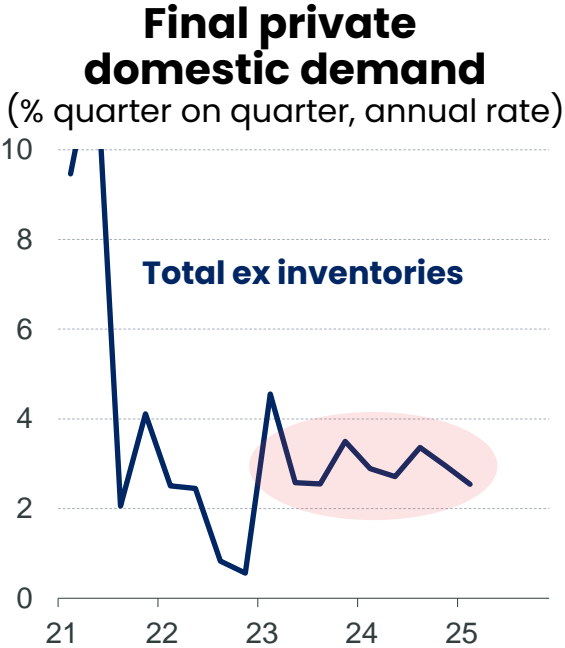
3 United States

A resilient economy... for how long?

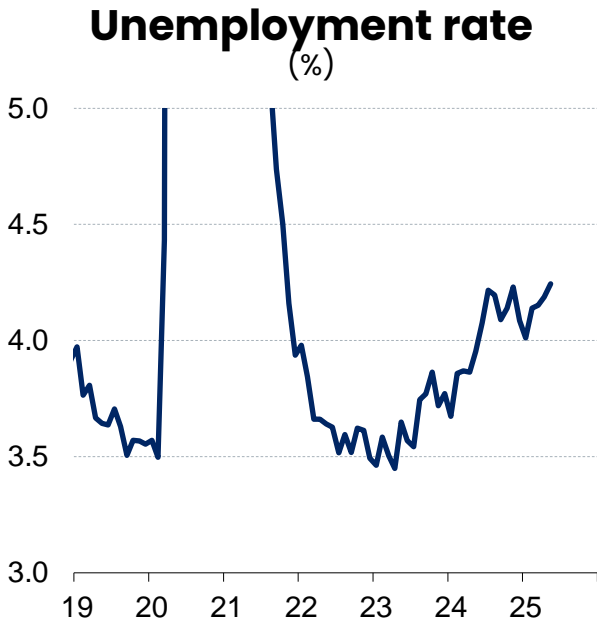


Domestic demand has continued to increase at a solid pace in early 2025

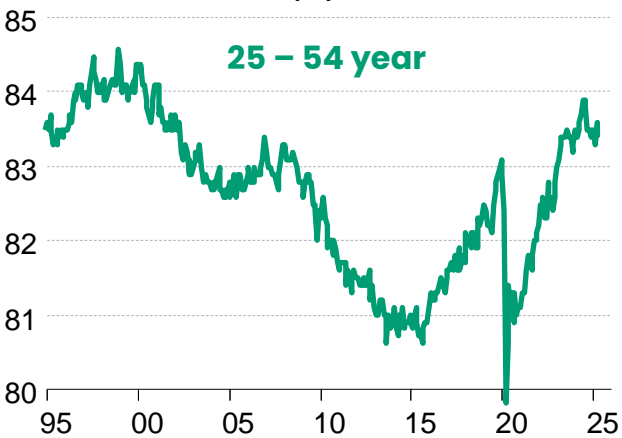
Final domestic demand components
(2019 Q1 = 100)



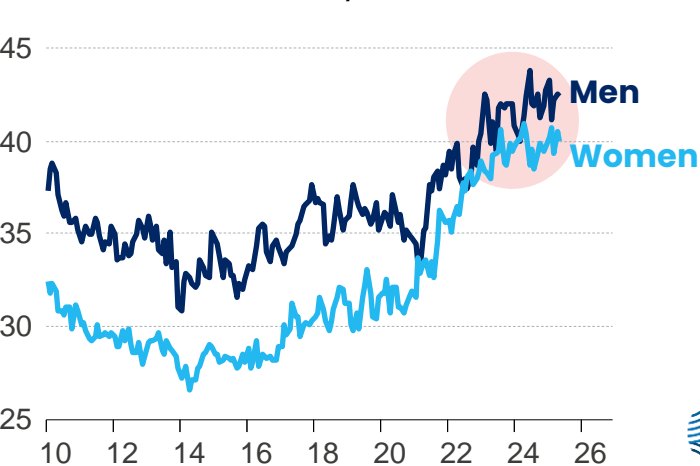
Job creations have slowed but remain solid



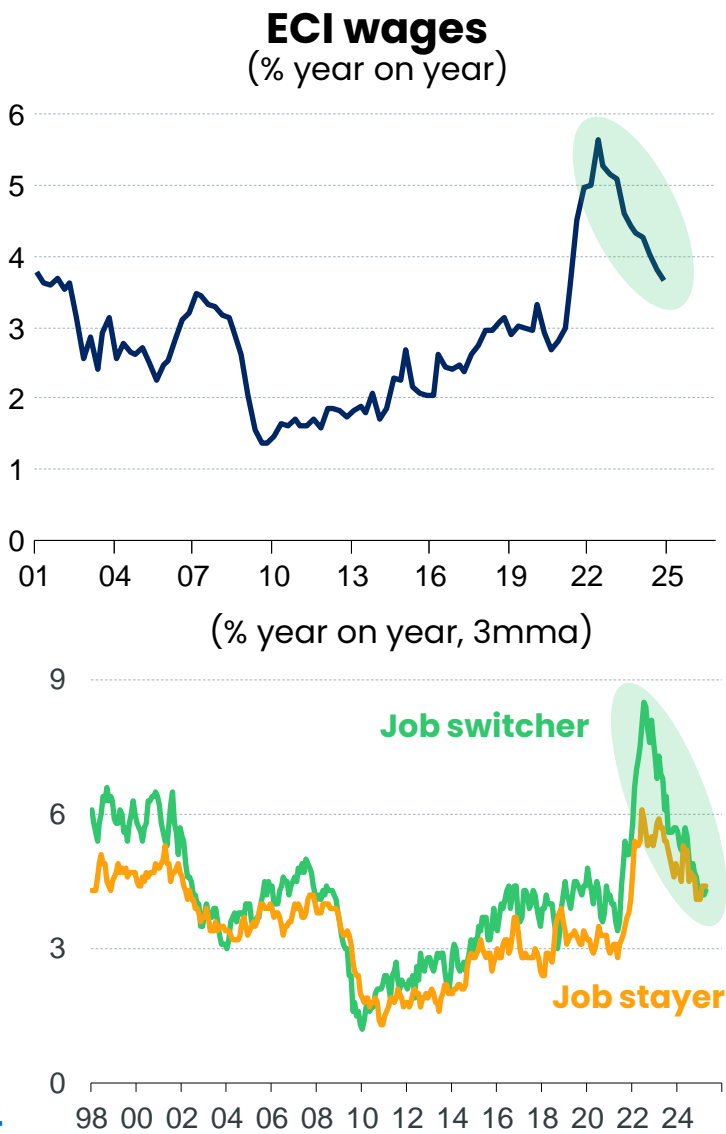
Prime age participation rate
(%)



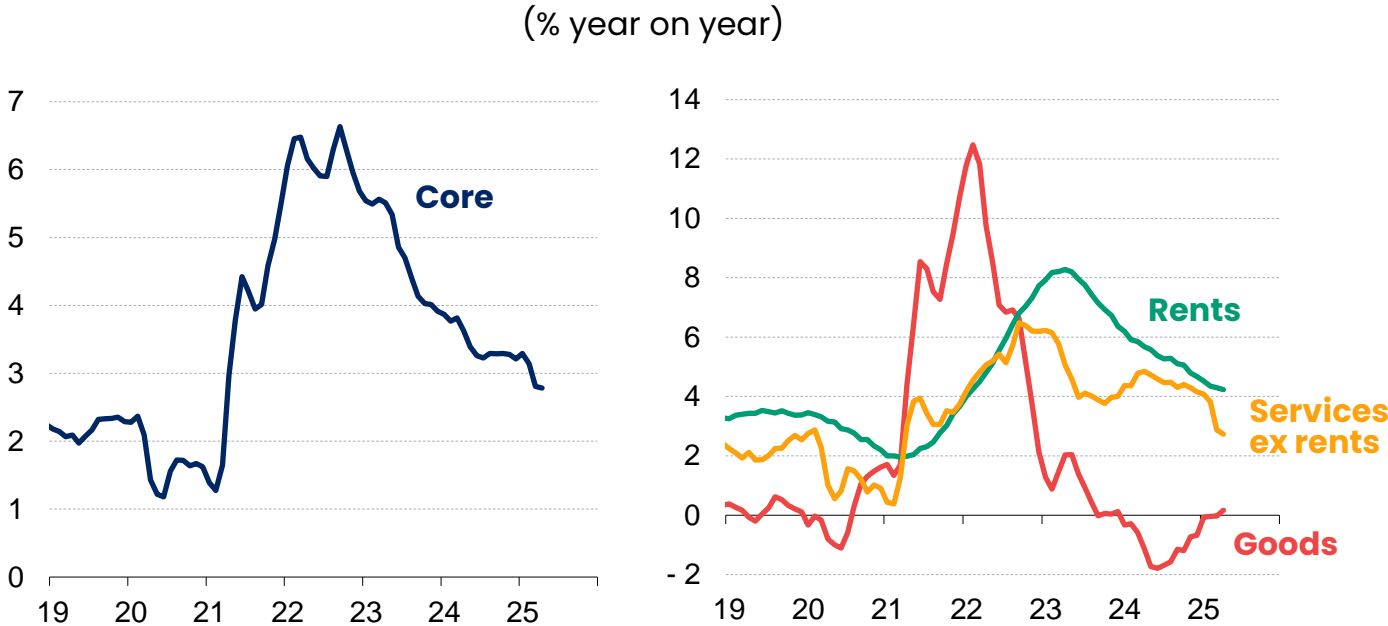
Disabled participation rate
(%, 16- to 64-year-old)



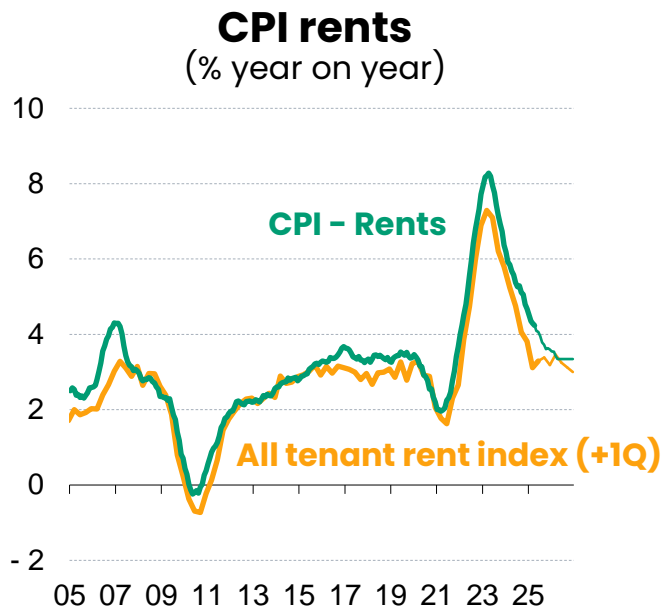
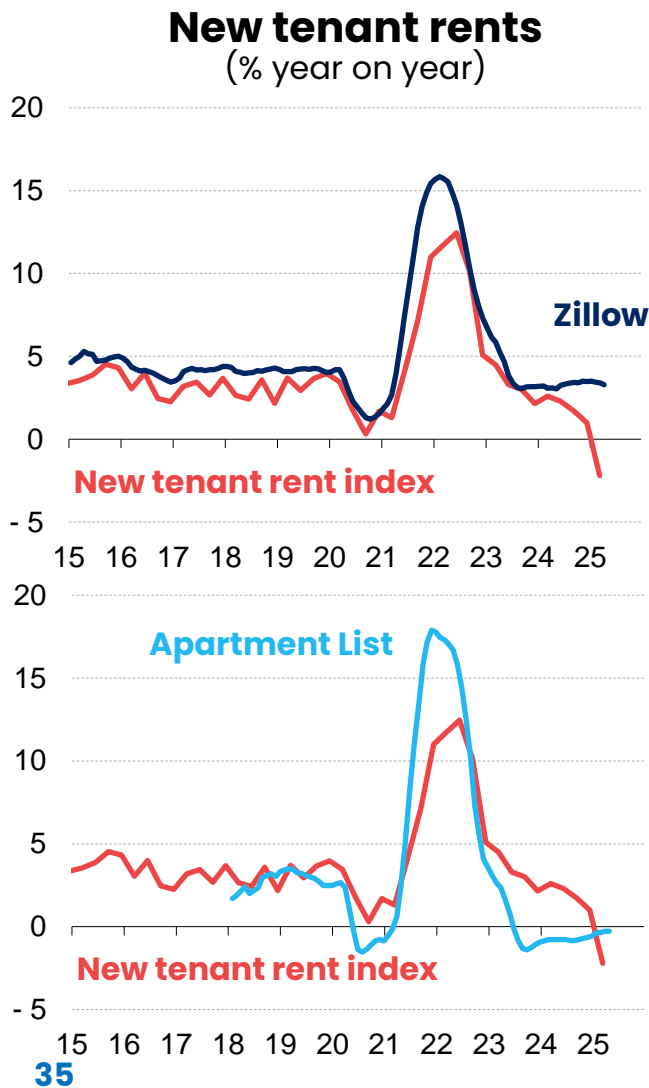
Wages have decelerated and core inflation has continued to recede



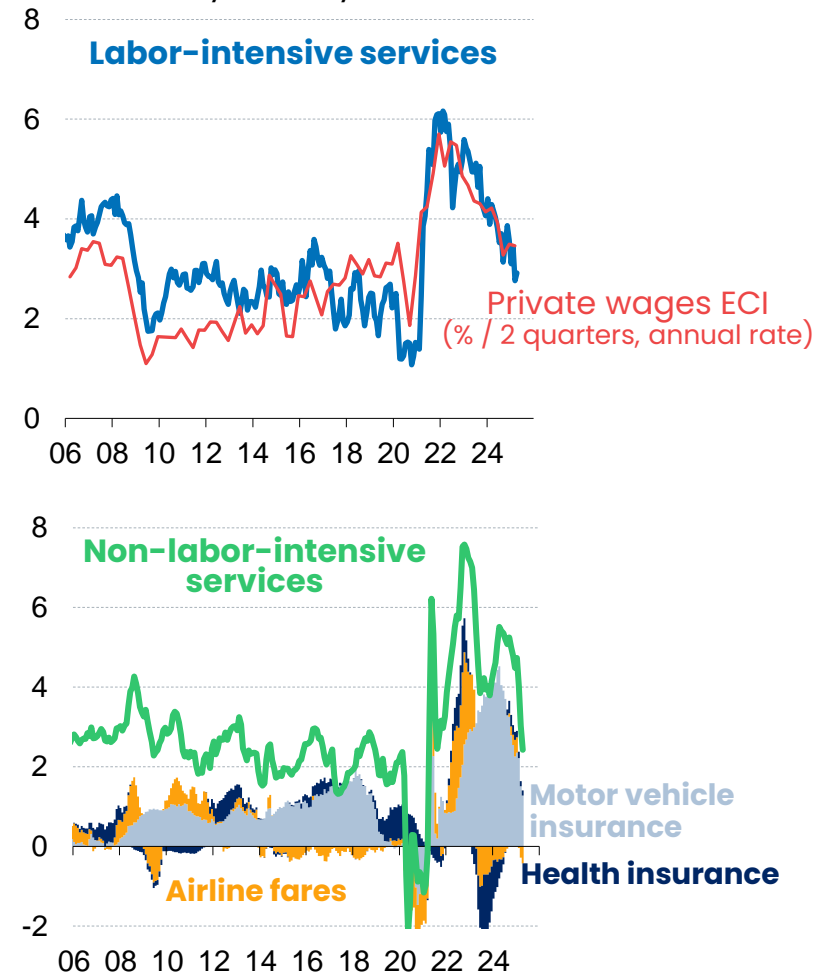
Core CPI inflation



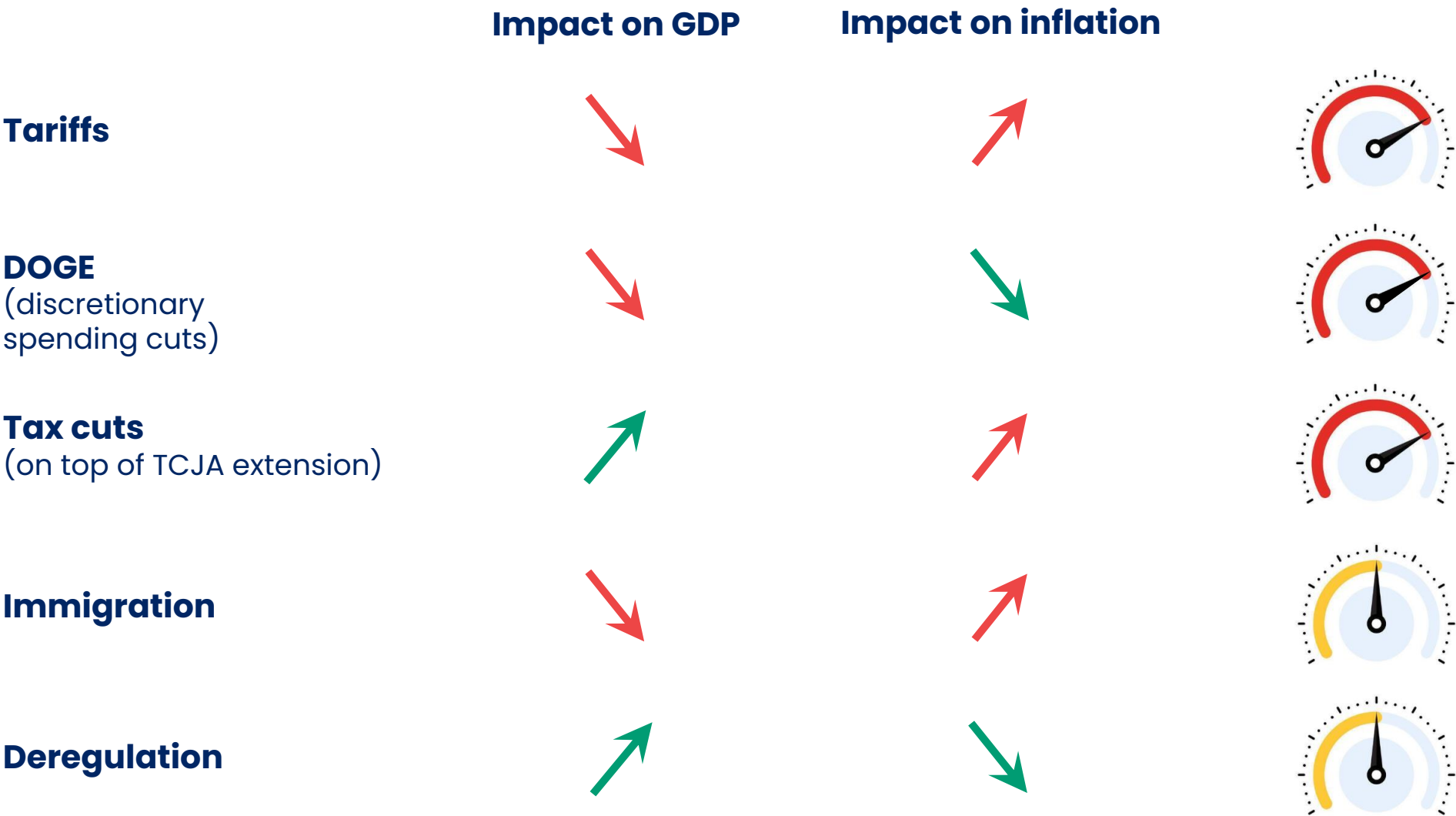
Rents and services prices notably are better oriented



Labor-intensive vs non-labor-intensive services CPI (% year on year)

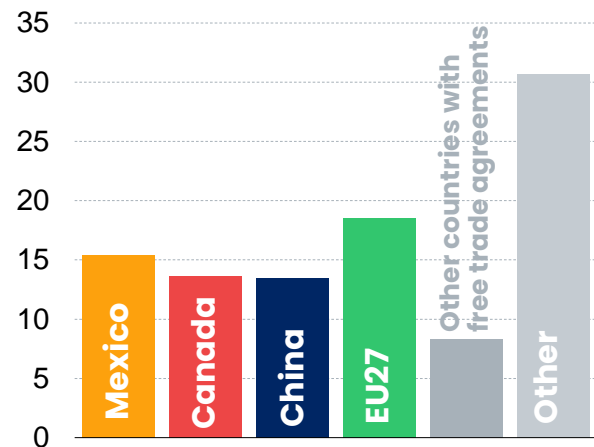


Donald Trump is following the broad lines of his economic program

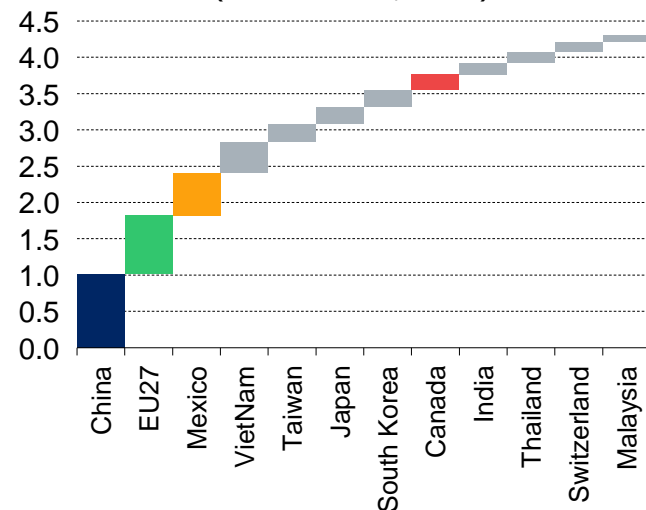


Trade uncertainty is likely to persist for a while

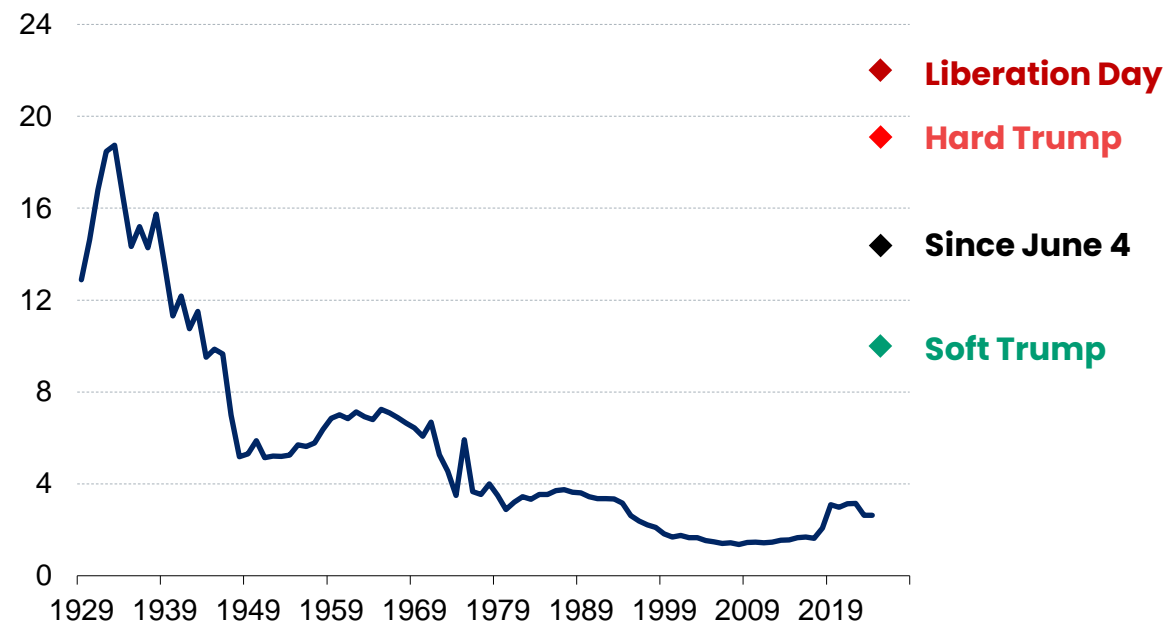
US import by country or region of origin
(% of imports, 2024)



US trade balance by country or region
(% of US GDP, 2024)



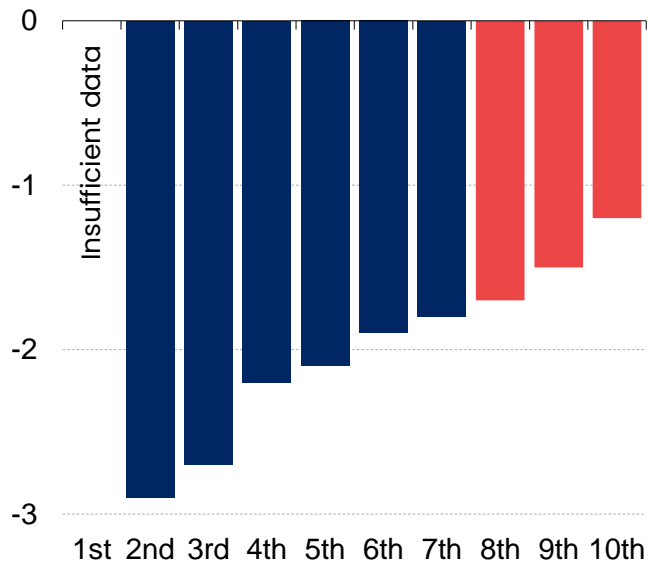
Average US tariff rate
(%, imports weighted)



Despite the de-escalation with China, current tariffs will curb household purchasing power

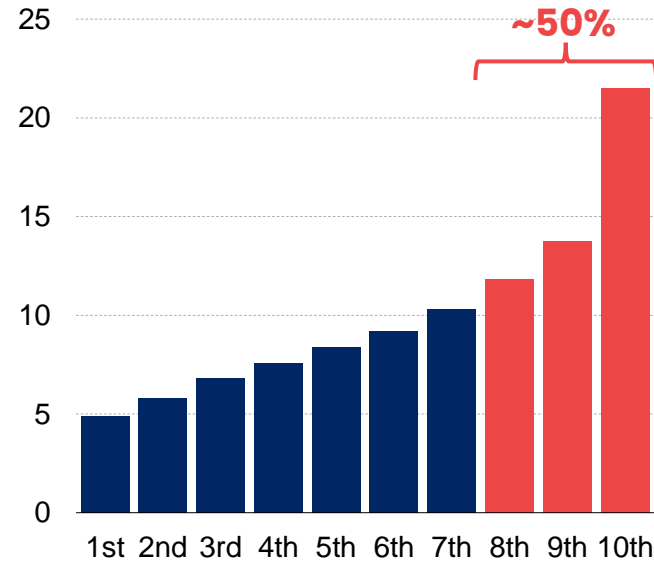
Effect on household income by decile

(%, compared to no tariff scenario)



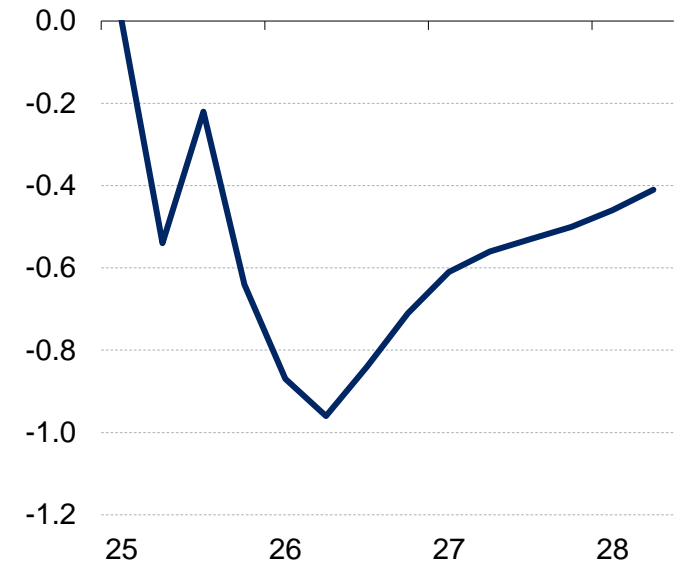
Household consumption by income decile

(% of total consumption, 2022)



Impact* on US real GDP

(% compared to no tariff scenario)



(*) Assuming that the countries affected by the tariff hikes do not retaliate.

→ As of May 12 2025, the rise in tariffs should increase the price level by 1.7% in the short-run, the equivalent of an average per household purchasing power loss of \$2,800 in 2024\$.

→ Annual purchasing power losses for households at the bottom of the income distribution are \$1,300 in 2024\$.



Memo. Despite a setback in court, the President still has many options to decide on tariffs

Possible unilateral presidential actions on trade

Possible Action	Description	
Sec 201 of Trade Act of 1974	Safeguard measures permit temporary tariffs or quotas on products if domestic industry is seriously and substantially injured/threatened by a surge of imports	Solar cells and modules Large residential washing machines
Sec 337 of Tariff Act of 1930	ITC-led investigations typically are used with IP-related issues ; while the ITC is independent, the president can influence it through appointments	
Sec 338 of Tariff Act of 1930	Impose new/additional duties on imports from countries that have taken unreasonable or discriminatory actions that disadvantage U.S. commerce	Easy to use, but tariffs limited to 50%
Sec 307 of Tariff Act of 1930	Customs and Border Protection (CBP) has authority to prohibit US imports of products mined, manufactured, or produced with forced labor .	
Sec 232 of Trade Expansion Act of 1962	Commerce Secretary can determine if imports pose a threat to "national security," and president can decide to impose tariffs or quotas on such imports.	Requires detailed investigations except for steel & aluminum Tariffs must also be terminated after 4 years unless an extension is approved by USTR
Sec 122 of Trade Act of 1974	President may deal with "large and serious" trade deficits by imposing temporary (up to 150 days) tariffs and/or quotas of as much as 15%	Could be utilized as a means to quickly impose universal tariffs on a temporary basis
Section 301 of Trade Act of 1974	Provides wide authority for USTR to respond to unfair trade practices by imposing tariffs and quotas.	Requires detailed investigations except for China
Trading with Enemy Act of 1917	President may use TWEA to regulate commerce and freeze/seize foreign assets; does not permit tariffs and requires US to be at war	
Int'l Emergency Economic Powers Act of 1977	President may use IEEPA to regulate commerce and freeze/seize foreign assets, given "unusual or extraordinary" international threats	The easiest and broadest Unlimited duration
Anti-Dumping, Countervailing Duties	US industries may petition Commerce Department or ITC for dumping; Commerce also can self-initiate. Administration could apply anti-circumvention investigations. US can impose anti-dumping or countervailing duties to offset the dumping or subsidization	

Congressional actions on trade

Reduce de minimis threshold	Imports of goods valued under \$800 (per person, per day) are exempt from US tariffs	"de minimis" imports are estimated to be about \$40-50bn per year (o.w. 64% from China)
Rescind China's Permanent Normal Trade Relations status (PNTR)	The PNTR status makes imports from China subject to base WTO tariff rates	There is support in Congress to revoke PNTR with China. This would increase tariffs on Chinese imports to an average rate of 40% as currently applied to North Korea, Cuba, Russia, and Belarus

Even if DOGE cuts are well below E. Musk's promises...



DOGE Live Tracker
Following the money

\$165.00 Billion



418
Days remaining

\$1,024.84
Per taxpayer

23,067
Initiatives

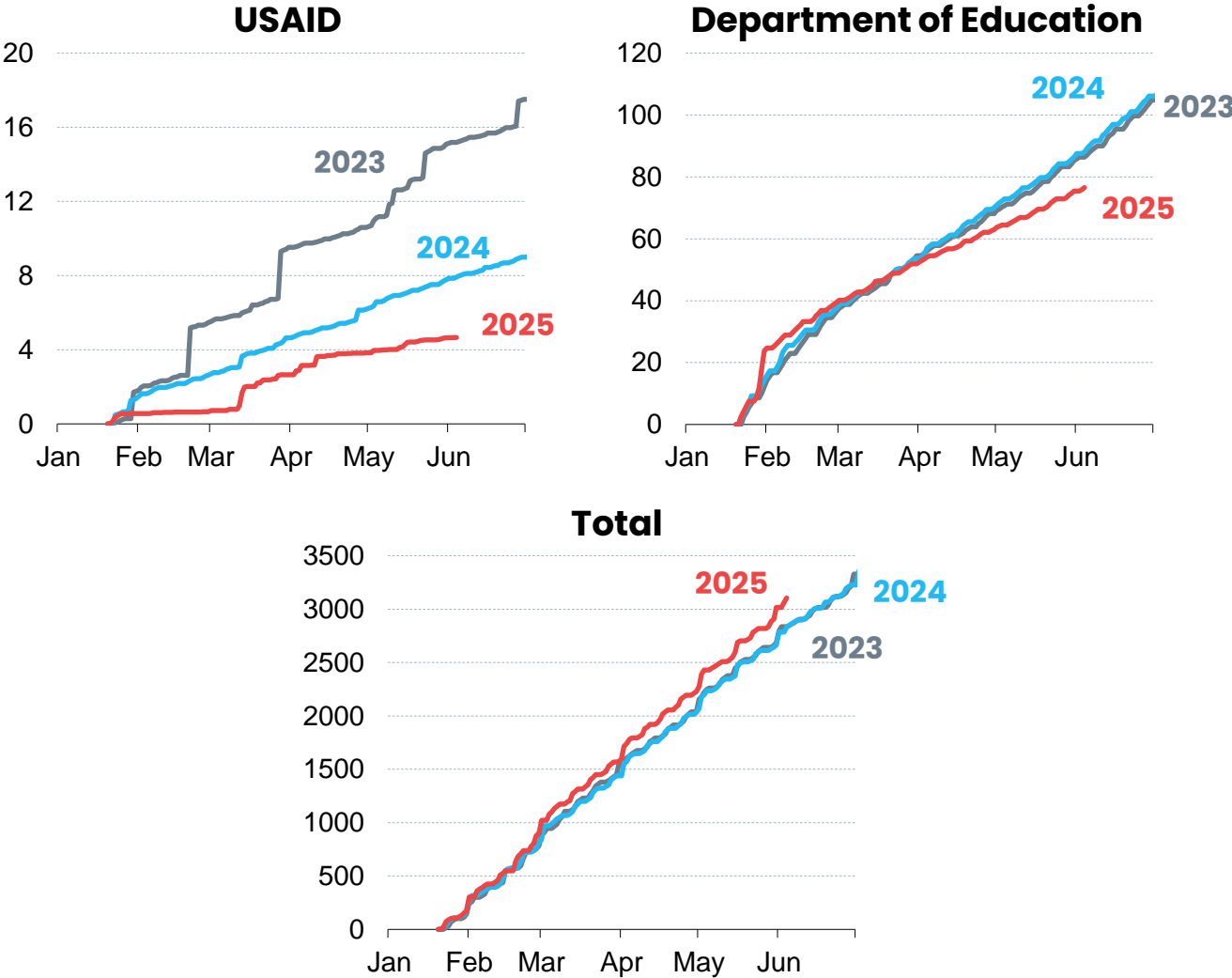
Leaderboard

Top areas of savings

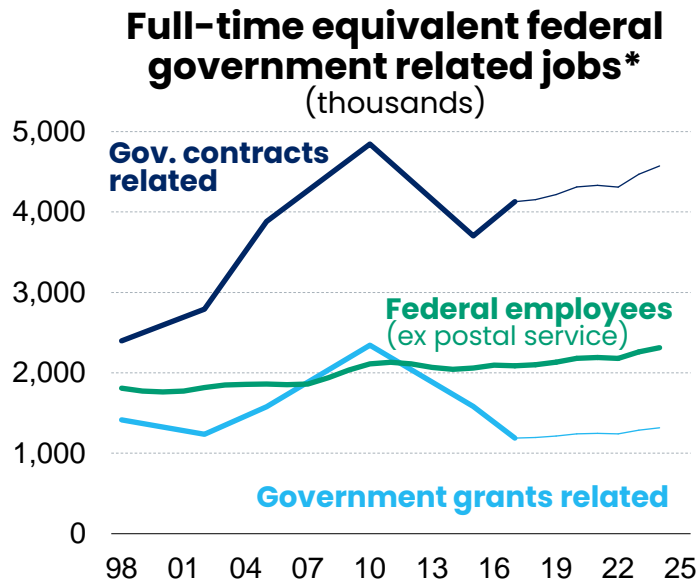
- | | | | |
|---|-----------------------------------------------------------|---|--------------------------------------------------|
| 1 | Department of Health and Human Services
\$47.53B saved | 4 | Department of State
\$2.59B saved |
| 2 | USAID
\$45.21B saved | 5 | Environmental Protection Agency
\$2.45B saved |
| 3 | Department of Agriculture
\$3.45B saved | 6 | Department of Education
\$1.15B saved |

40

Daily tracker of federal outlays (\$ billion, cumulated since January 20 for each vintage)



... credit freeze, contracts' cancelling and civil servants' layoffs will be a negative for growth



(*) From 2018 on, government contracts and grants related jobs are estimated by holding constant their ratio with federal employees.

Possible effect on employment of the freeze of federal government contracts and subsidies in 2025

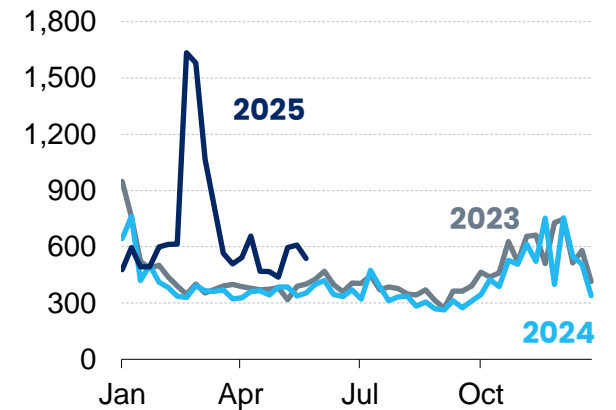
- **Layoffs of 200,000 to 300,000 civil servants** (75,000 accepted E. Musk's offer and resigned, effective September 2025).

- **The freeze on federal government contracts and subsidies has an impact on private employment**
Federal contracts total \$750 billion (41% non-defense / 59% defense). Assuming that these contracts are cut by 5% and 2% respectively, this represents a \$24 billion reduction in spending and 130,000 job losses.
Federal subsidies total \$560 billion (excluding Medicare and Medicaid). Assuming that these subsidies fall by 2%, this would represent over \$10 billion in spending cuts and 115,000 job losses.

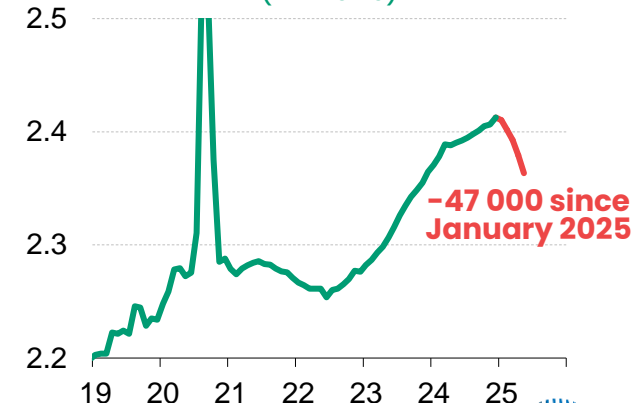
Private employment would be reduced by almost 250,000 in a scenario of moderate spending cuts (-5%/-2%/-2%), but by almost 500,000 if the cuts are more significant (-10%/-4%/-4%).

→ All in all, employment could fall by 450,000 to 800,000... without taking into account the uncertainty created by the DOGE policy.

Initial jobless claims of federal government employees



Federal employees ex postal service (millions)



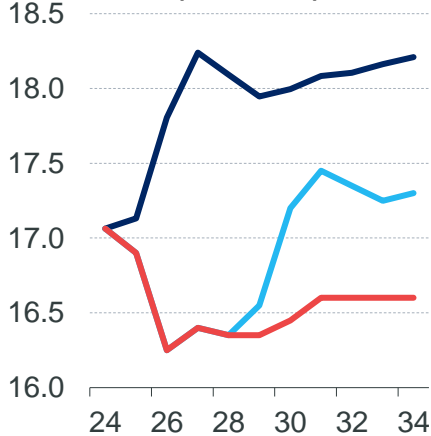
What's in the House Reconciliation Bill? (I)

House Reconciliation Bill (\$ billion, over 10 years)

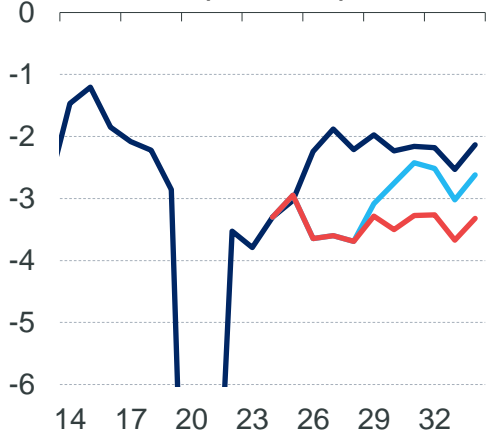
	As written in the law	If made permanent
Extend & expand TCJA individual provisions	-3 899	-4 127
Revive TCJA business provisions	-270	-737
New tax cuts	-662	-1 447
Total tax cuts	-4 831	-6 311
Tax increases*	1 079	1 079
Armed Services	-144	-410
Judiciary	-9	-90
Homeland Security	-79	-120
Total spending increases	-232	-448
Financial Services	5	5
Natural Resources	18	18
Transportation & Infrastructure	37	37
Oversight & Government Reform	12	12
Agriculture	238	238
Education & Workforce	349	349
Energy & Commerce	1 086	1 086
Interactions	-175	-175
Total spending cuts	1 570	1 570
Interest	-561	-725
Total Deficit Impact	-2 975	-4 835

No Tax on Tips Through 2028	-40	-120
No Tax on Overtime Through 2028	-124	-380
Higher Senior Standard Deduction through 2028	-66	-165
No Tax on Car Loans through 2028	-58	-180
Health Savings Account Expansions	-44	-44
Establish "MAGA Accounts"	-17	-35
Other Individual Tax Cuts	-48	-80
Allow Expensing of Factories through 2028	-148	-300
Extend Clean Fuel Tax Credit through 2031	-45	-60
Other Business and Related Tax Cuts	-72	-74
New tax cuts	-662	-1 447

Federal government
revenues
(% of GDP)



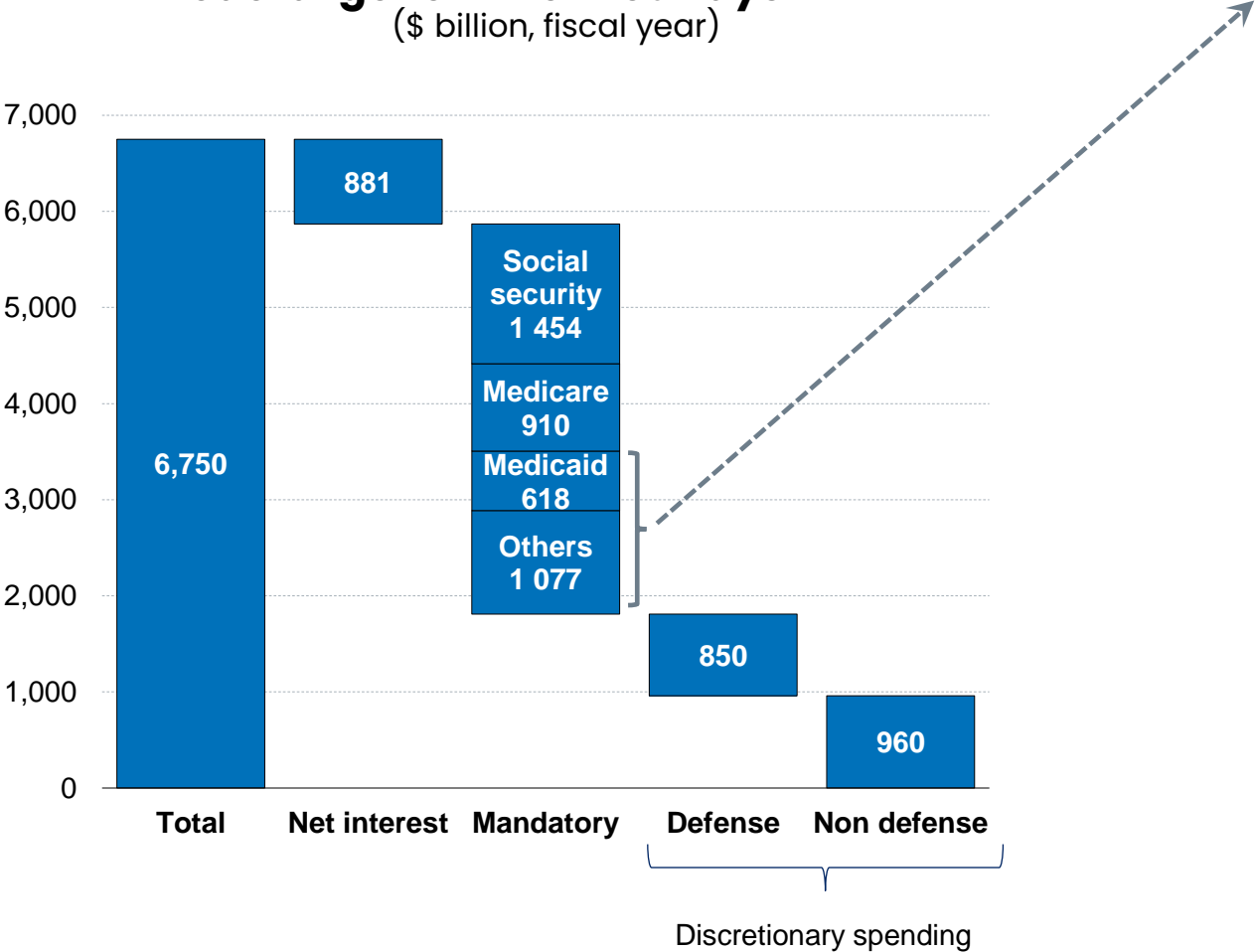
Federal government
primary balance
(% of GDP)



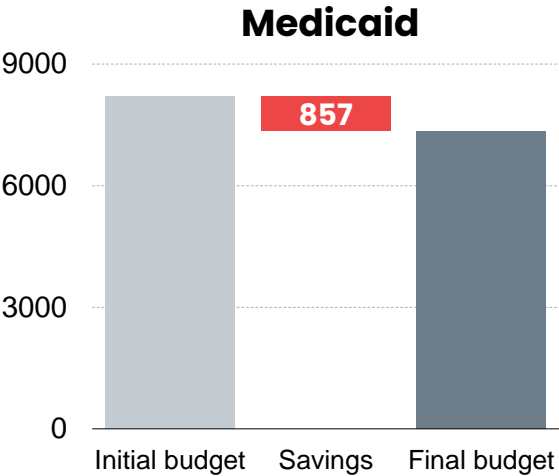
(*) Repeal EV tax credits, repeal or reform other IRA credits, reduce Affordable Care Act payments to immigrants...

What's in the House Reconciliation Bill? (II)

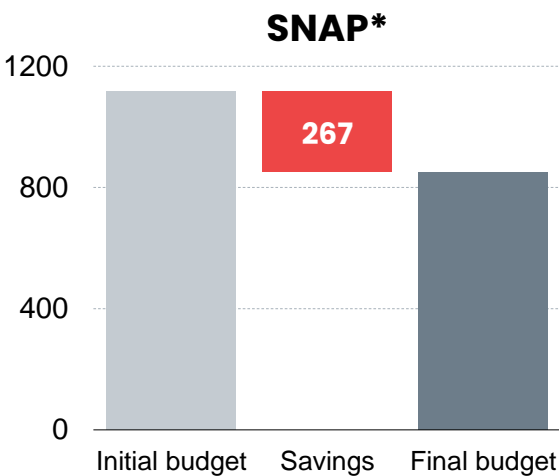
Federal government outlays in 2024
(\$ billion, fiscal year)



Spending cuts embedded in the House Reconciliation Bill
(\$ billion, over 10 years)



The legislation, as currently written, is predicted to result in at least 10.9 million Americans becoming uninsured, according to the Congressional Budget Office.



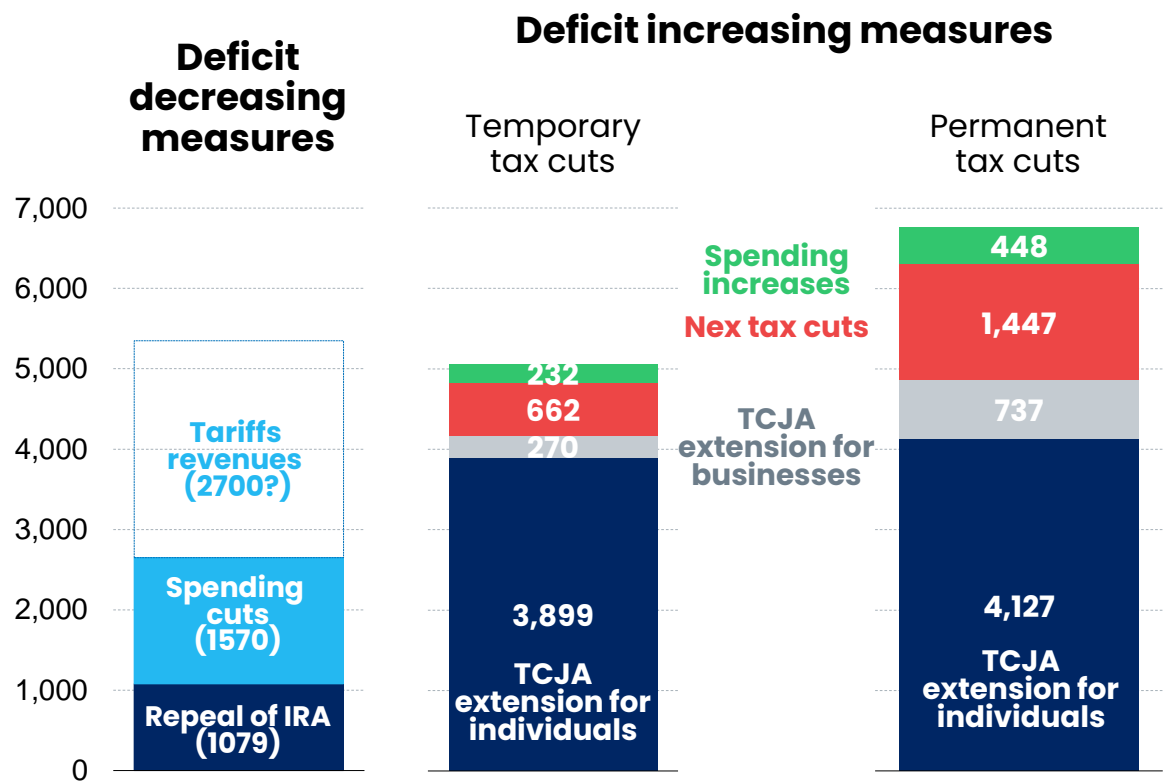
Nearly 11 million people — about 1 in 4 SNAP participants, including more than 4 million children and more than half a million adults aged 65 or older and adults with disabilities — live in households that would be at risk of losing at least some of their food assistance.

*Supplemental Nutrition Assistance Program

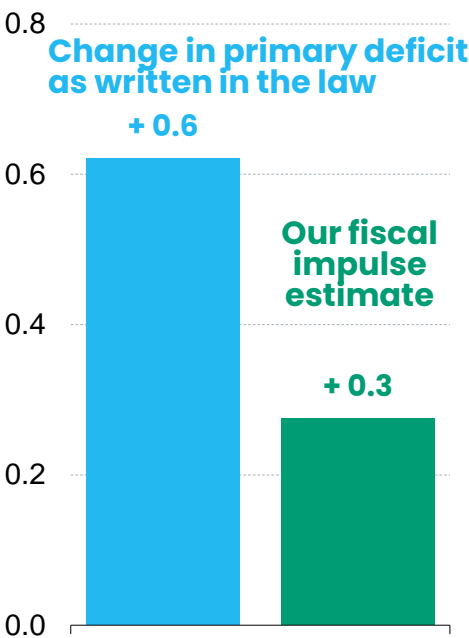


The “one big beautiful bill” should only moderately support activity...

House Reconciliation package
(\$ billion, over 10 years)

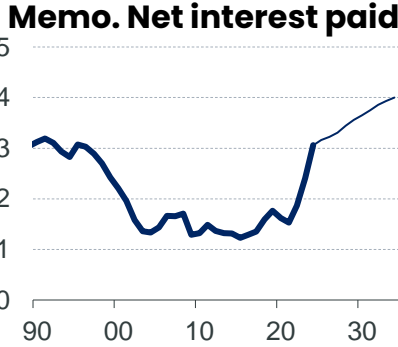
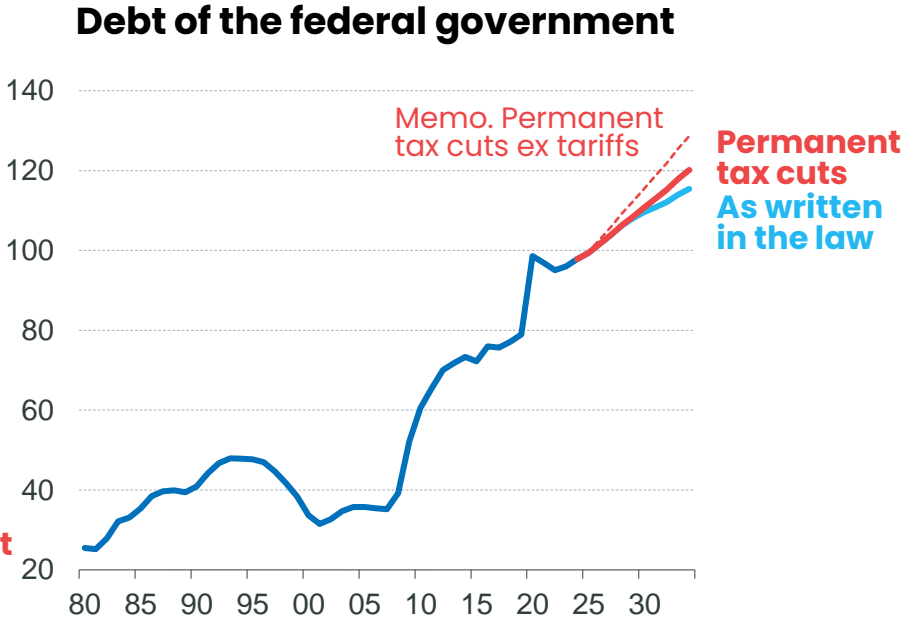
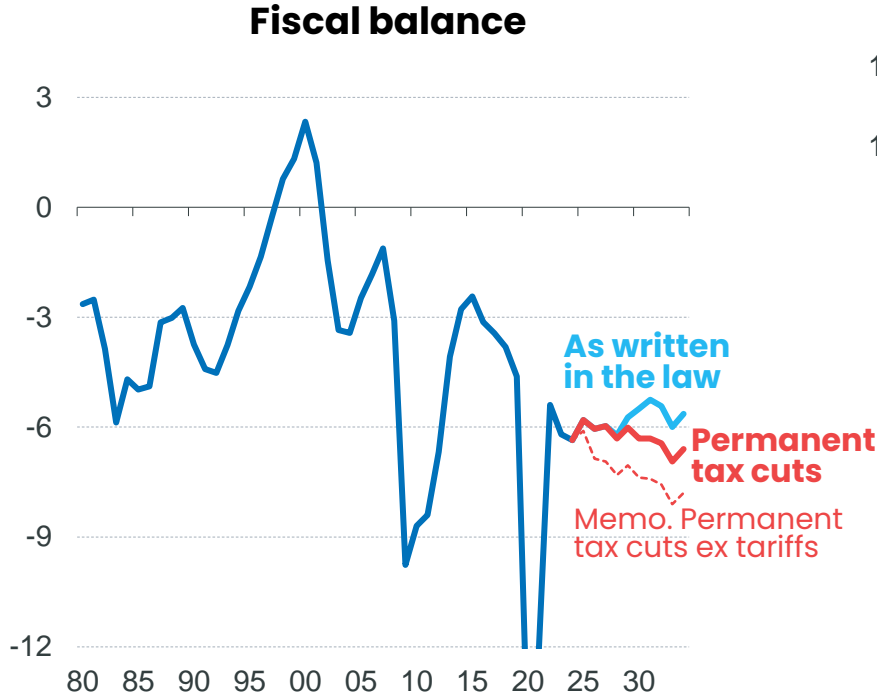
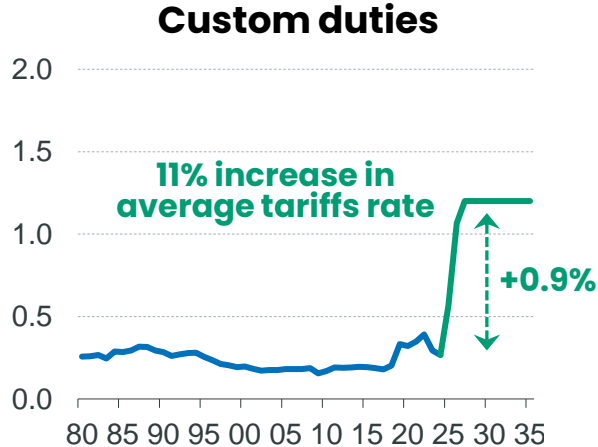
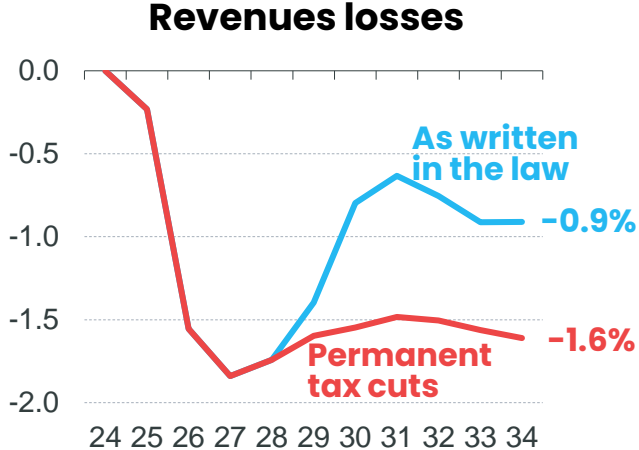


Fiscal impulse in 2026
(% of GDP, calendar year)

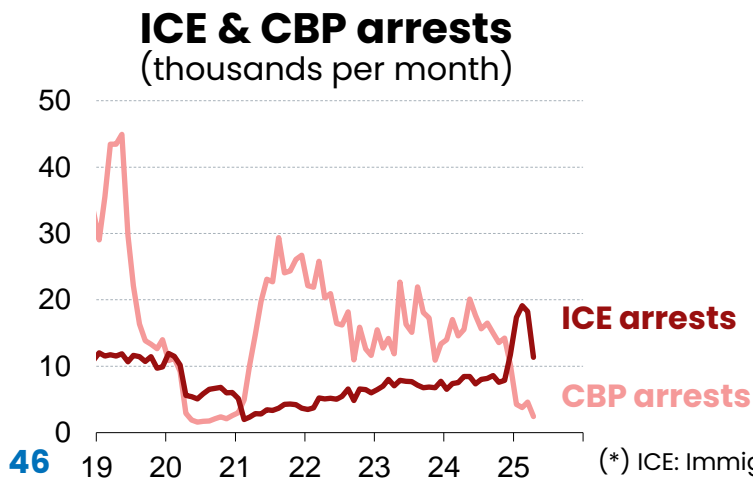
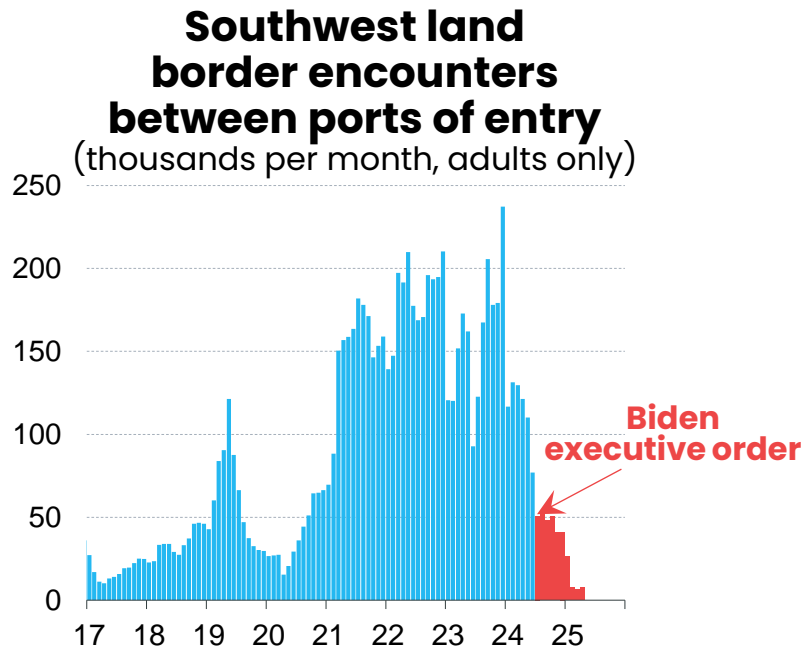


... and will further deteriorate the budget balance

Federal government fiscal balance and debt (% of GDP)



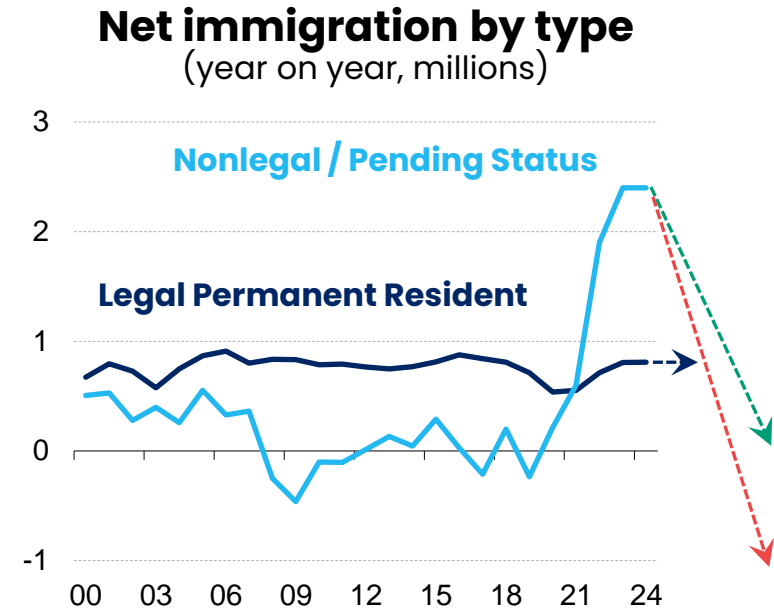
Illegal immigration has been stopped, and deportations have started



(*) ICE: Immigration and Customs Enforcement
CBP: Customs and Border Protection

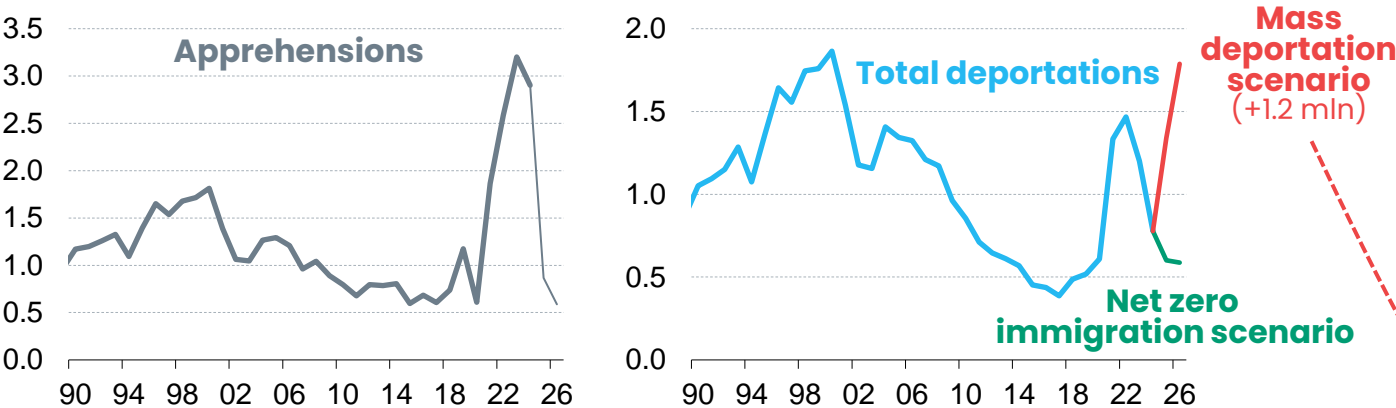
Immigration

- If illegal immigration is halted, the increase in the working-age population would be reduced by 60,000 people per month, and that of the labor force by 40,000. Instead of increasing by +0.8% per year, the labor force would only grow by +0.5%.
- The deportation of 1.2 million illegal migrants would bring labor force growth down to 0%.

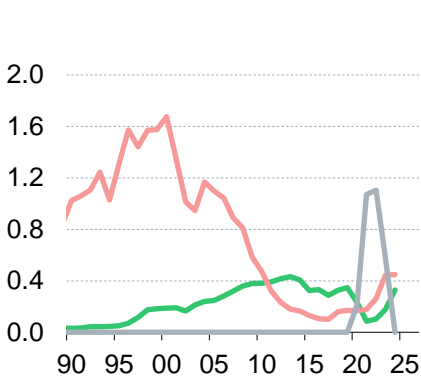


Still, we have not had mass deportations... yet!

Net illegal immigration
(millions , annual rate, fiscal years)



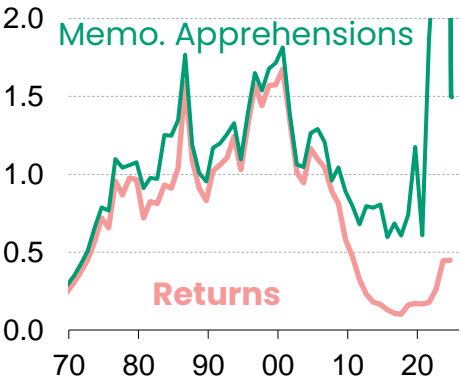
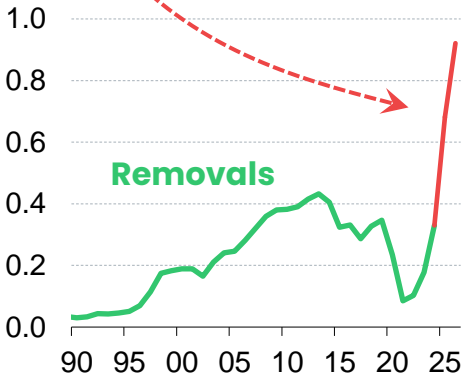
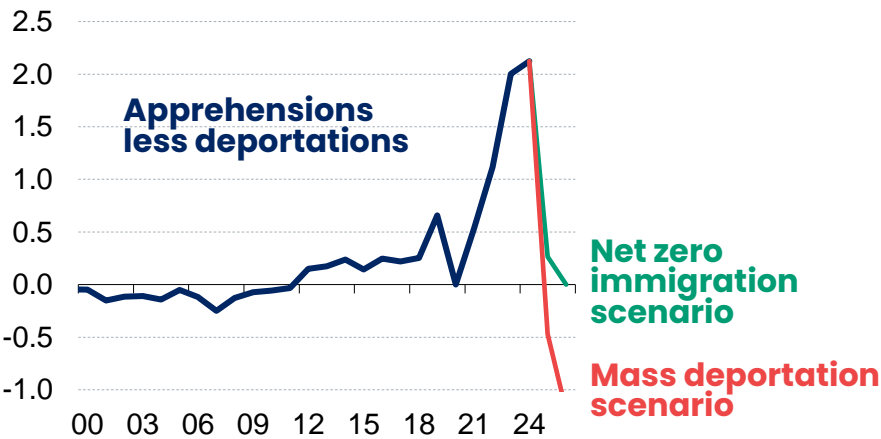
Total deportations
(millions , annual rate)



Returns are the compulsory movement of inadmissible or deportable noncitizens out of the US. They include “administrative” returns (withdrawn applications for admission) and “voluntary” returns.

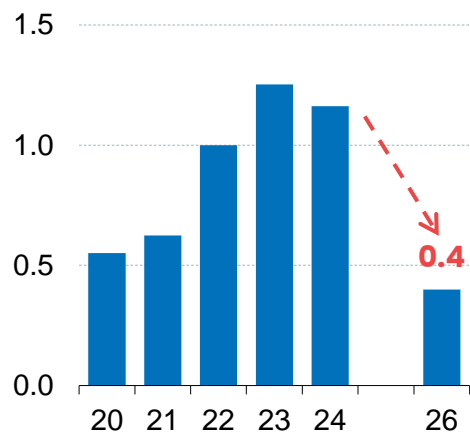
Removals are the compulsory movement of inadmissible or deportable noncitizens out of the US based on an order of removal. A noncitizen who is removed has administrative or criminal consequences placed on subsequent reentry.

Expulsions were decided on public health grounds in response to the COVID-19 pandemic.

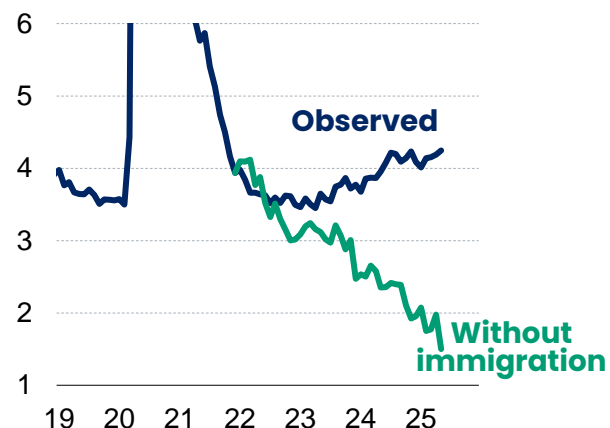


Removing illegal migrants will push potential growth below 1.5%...

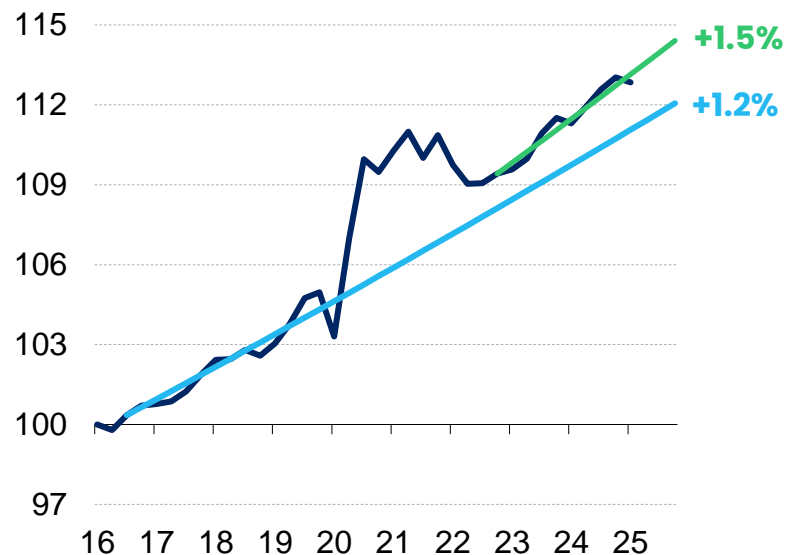
Working age population
(% year on year)



Memo. Unemployment rate
(%)



Real GDP per employee
(2016 Q1 = 100)



Given the slowdown in immigration, the potential rate of growth of the United States is estimated to be 2% at best:

$$0.5\% + 1.2 / 1.5\% = 1.7 / 2.0\%$$

Working age
population

Real GDP
per employee

Potential
growth

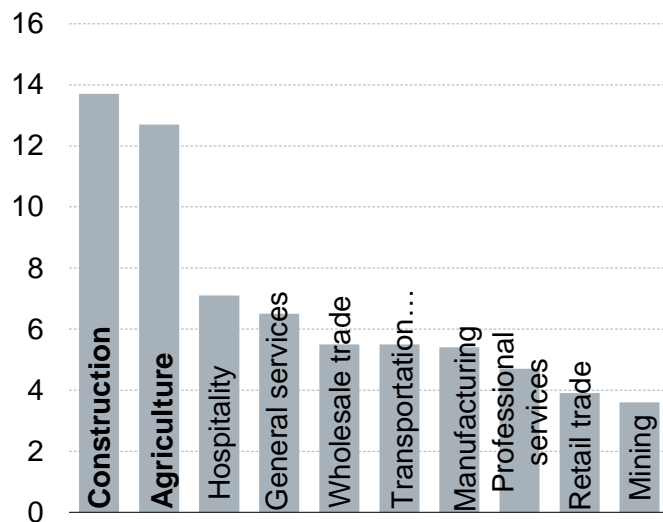
Removing 1.2 million illegal migrants per year would reduce potential growth to 1.5% at best:

$$0.0\% + 1.2 / 1.5\% = 1.2 / 1.5\%$$

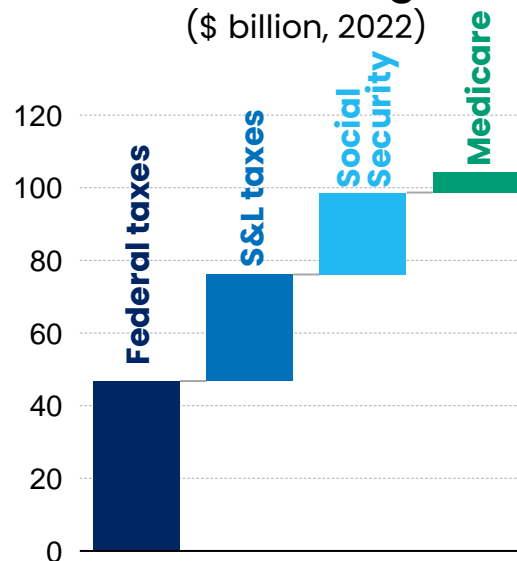


... and would have a cost for America... its economy and its Budget!

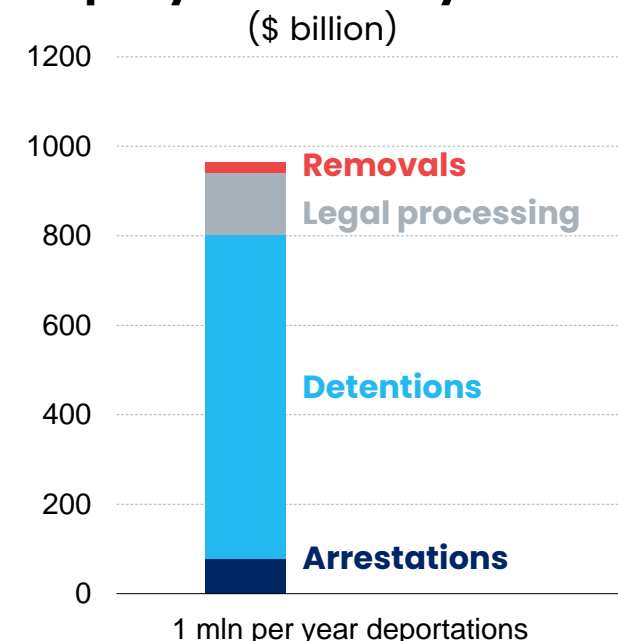
Share of undocumented migrant workers by industry
(%, 2022)



Undocumented immigrants' contribution to budget receipts
(\$ billion, 2022)



Direct financial cost of deporting 1 million undocumented immigrants per year over 10 years



There are around 13.3 million migrants without legal status in the United States.

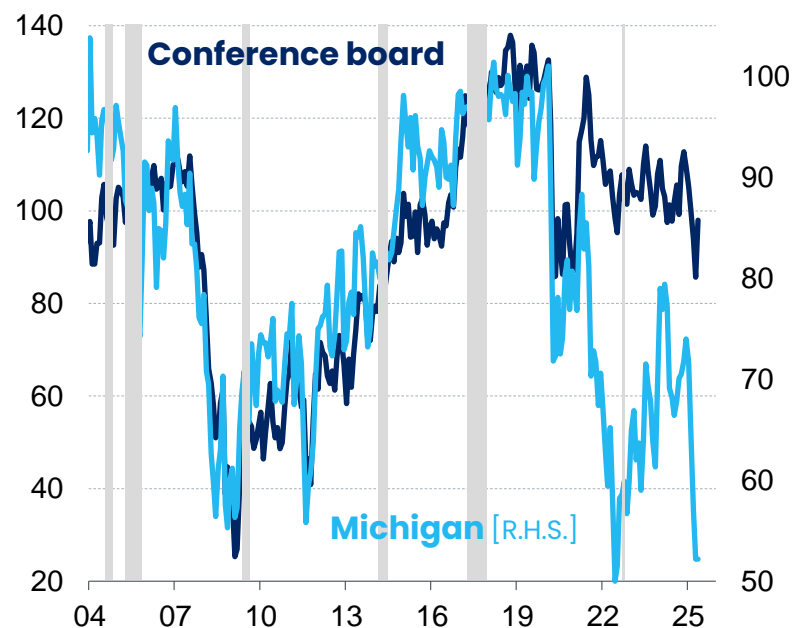
Compared with native-born Americans, documented and undocumented immigrants combined pay more in taxes than they use in government benefits. Cato Institute (2023).

The increase in immigration boosts federal revenues as well as mandatory spending in CBO's baseline projections, **lowering deficits, on net, by \$0.9 trillion over the 2024–2034 period.**

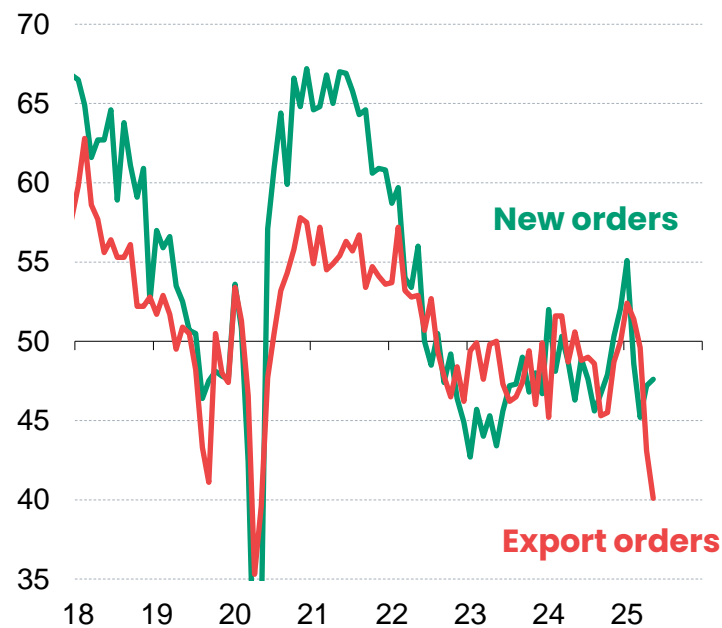


While growth has been resilient so far, the policy shock has already hurt sentiment

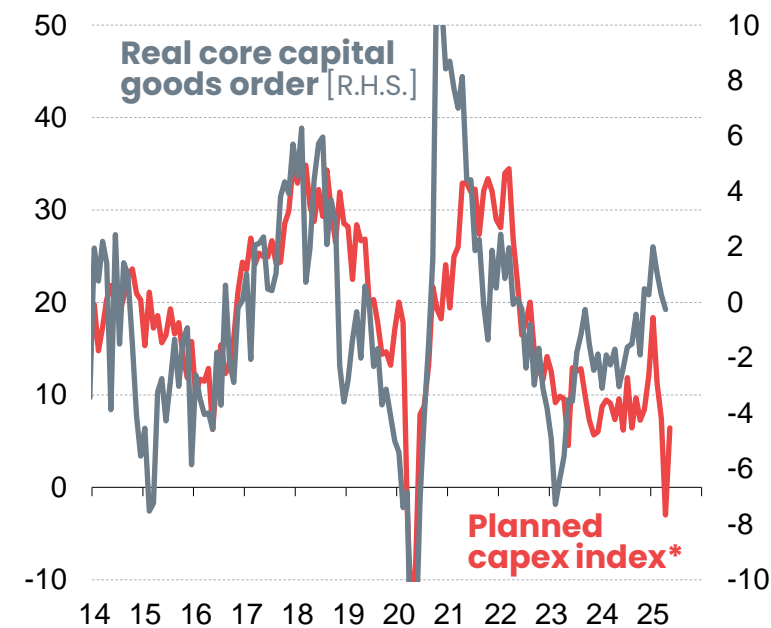
Consumer confidence



Manufacturing ISM



Real core capital goods orders and planned capex

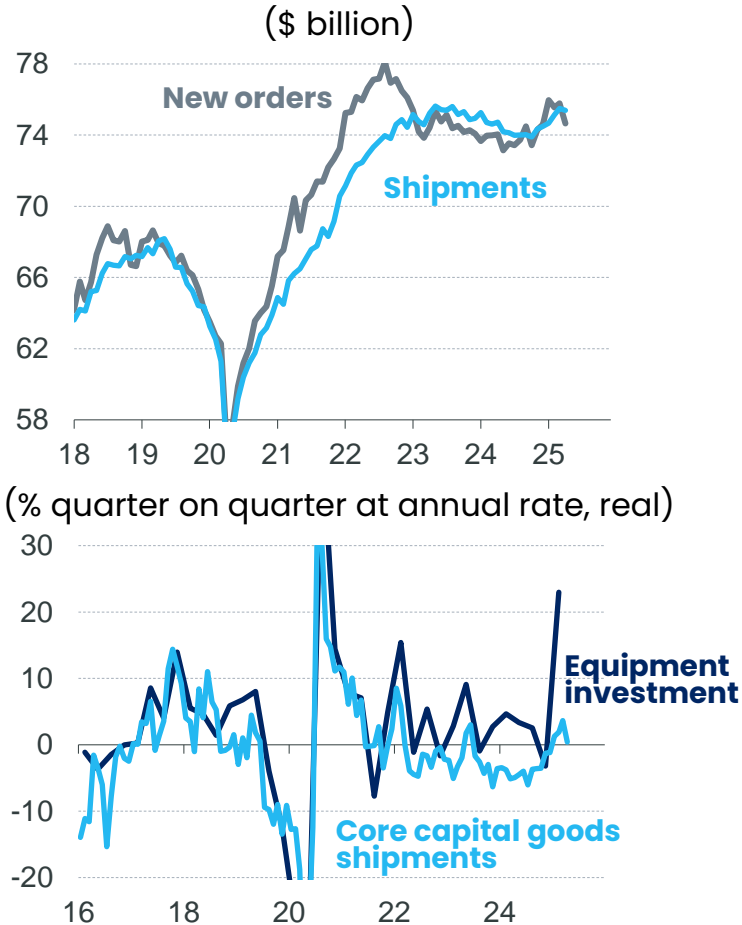


(*) Weighted average of various regional surveys (New York, Philadelphia, Dallas, Kansas, Richmond) by economy size.

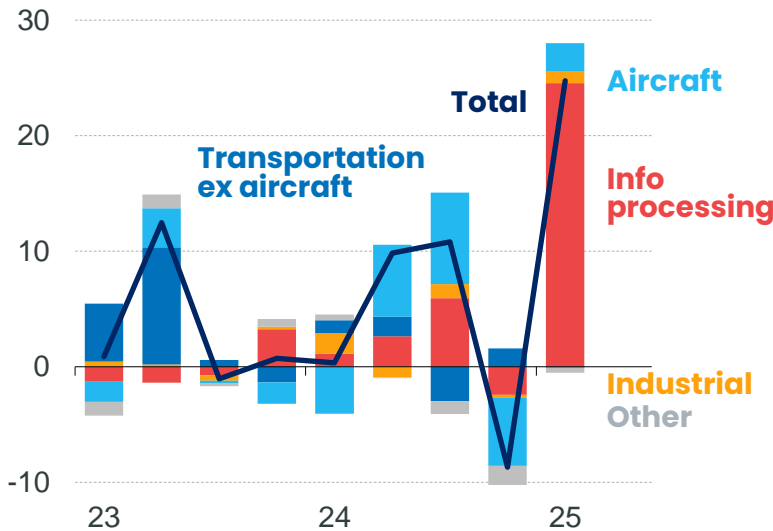


Uncertainty is going to weigh on business investment

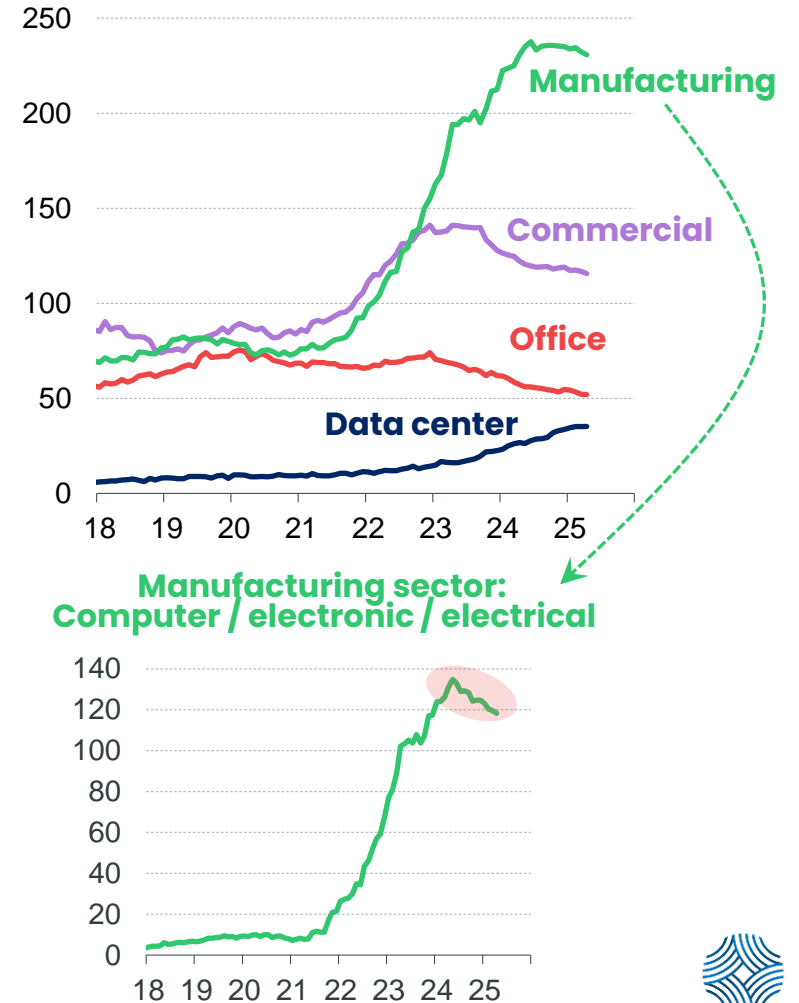
Equipment investment and capital goods shipments and orders
(nondefense ex aircraft)



Contribution to equipment investment
(% quarter on quarter, annual rate)



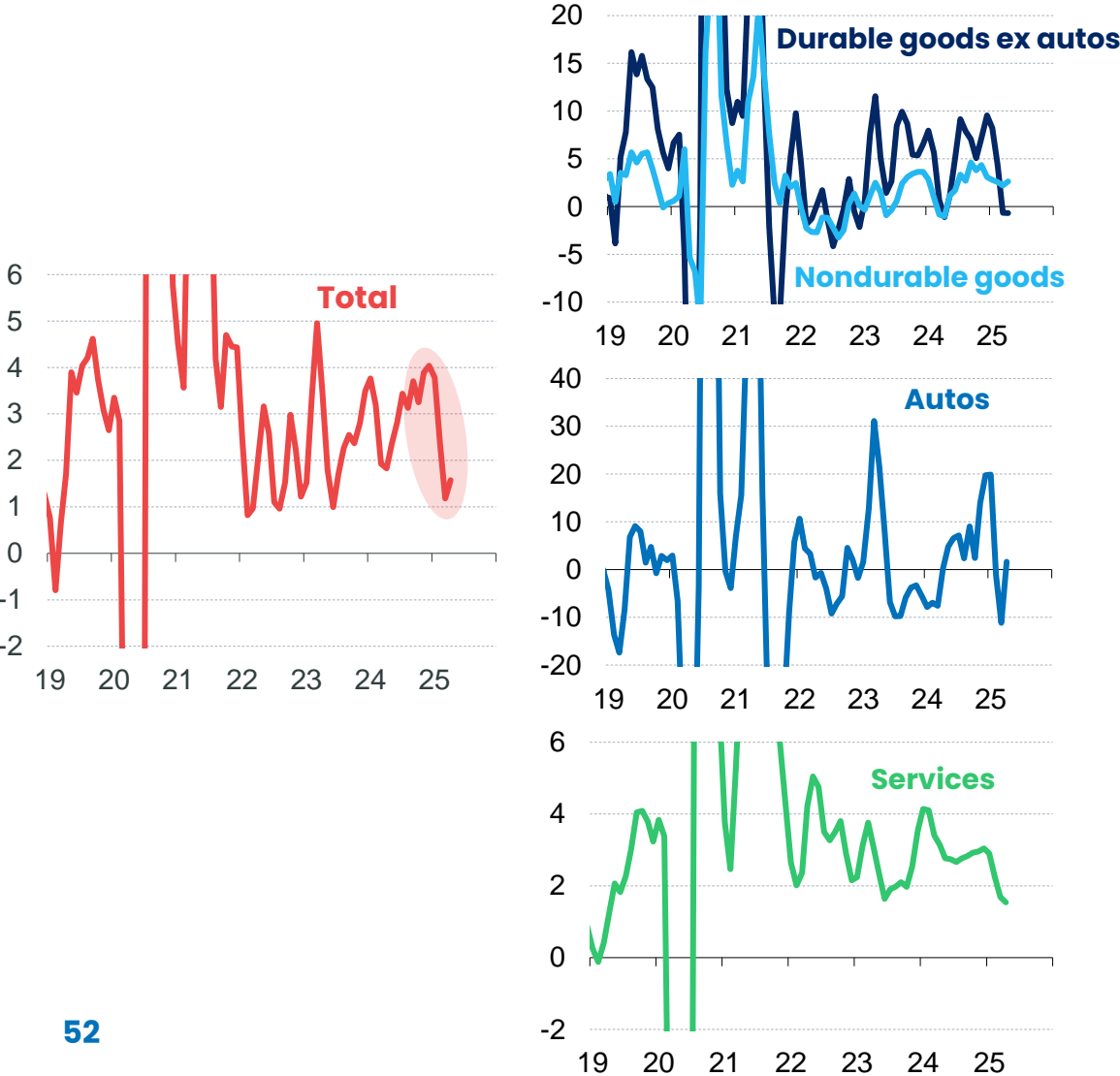
Private investment in non-residential structures
(\$ billion, current prices, annual rate)



Consumption has weakened, but is still quite resilient

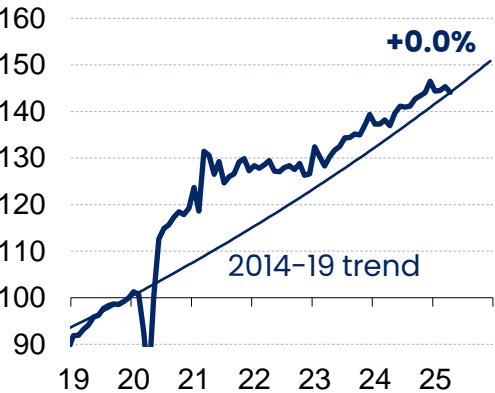
Real consumption

(% contribution / 3 months at annual rate, 3-month moving average)

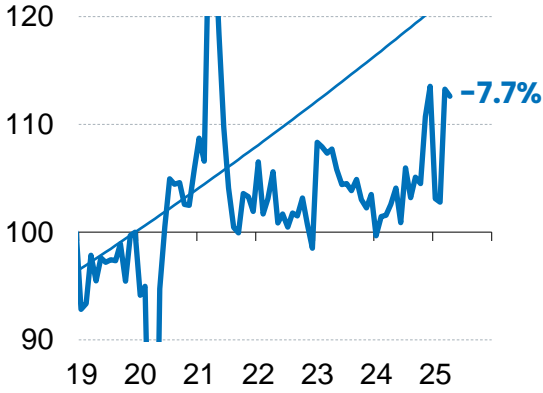


(December 2019 = 100, volume)

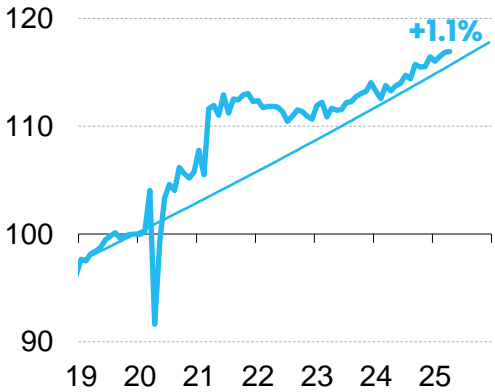
Durable goods ex autos (7.3%)



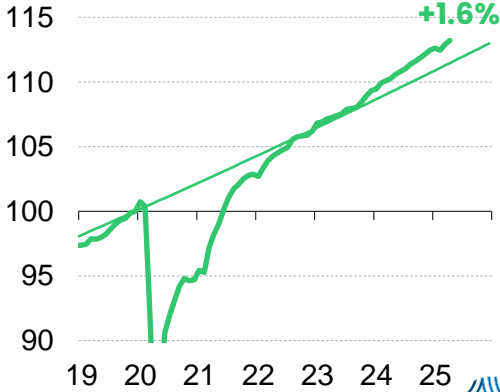
Autos (3.7%)



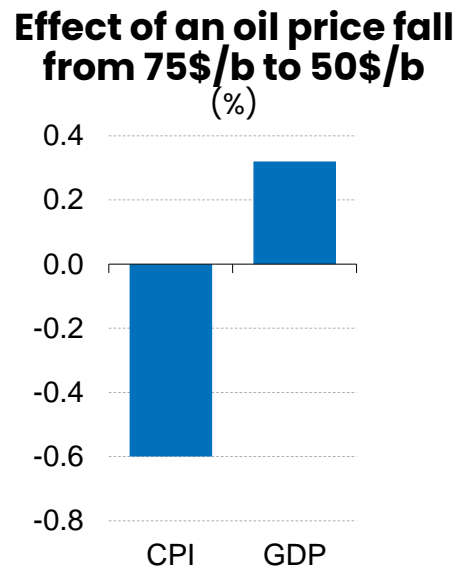
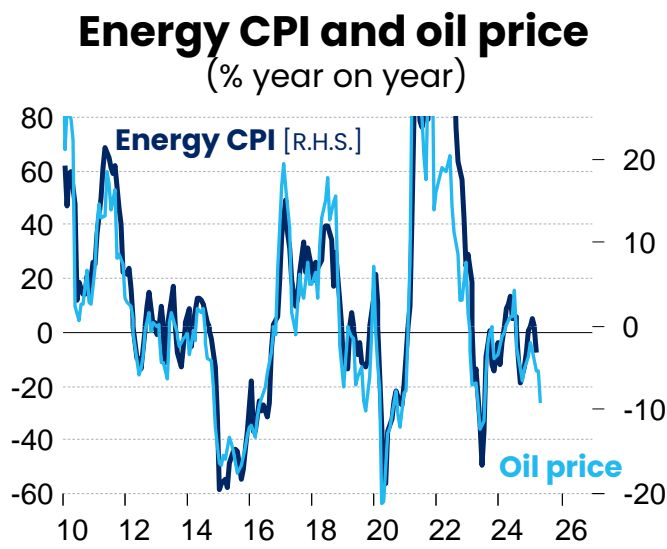
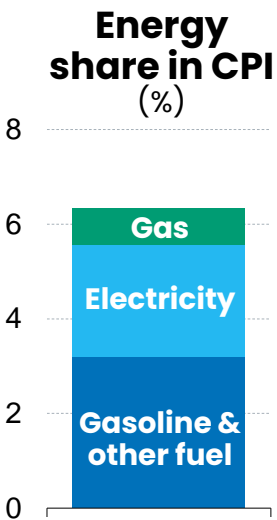
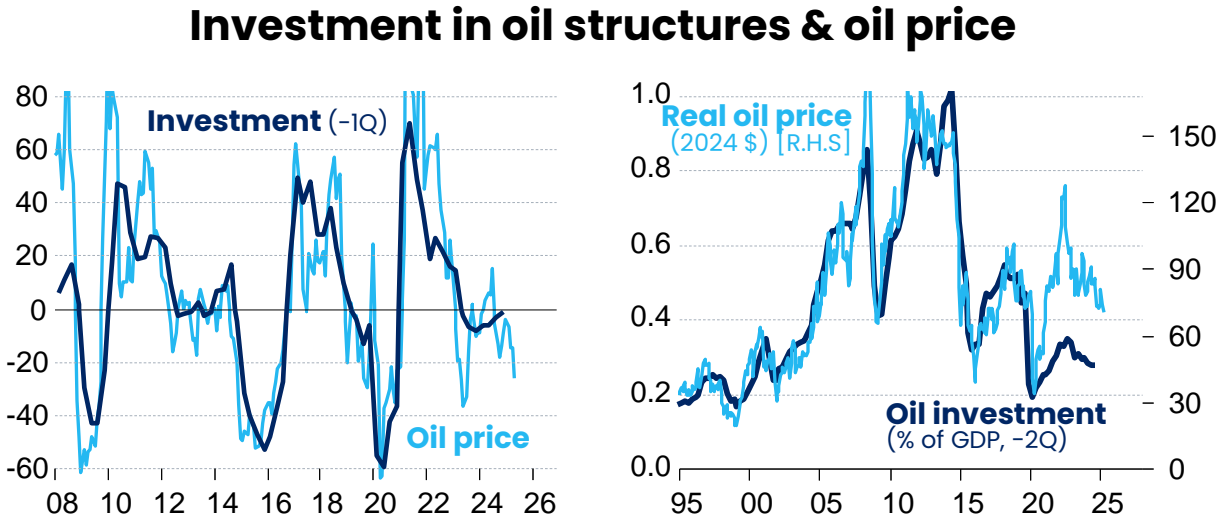
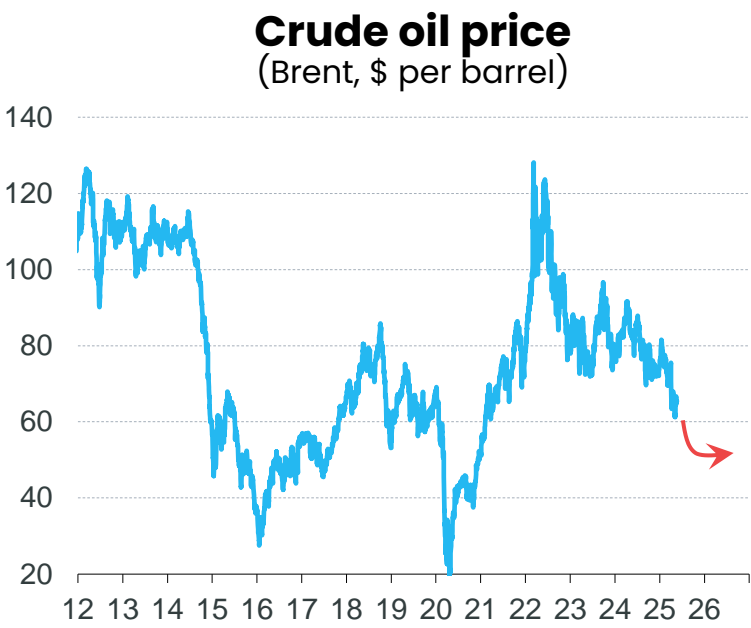
Nondurable goods (20.6%)



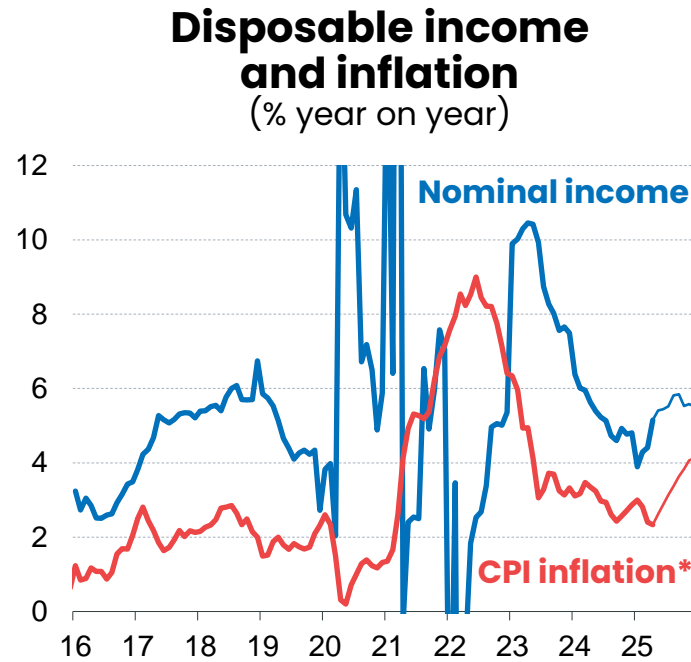
Services (68.5%)



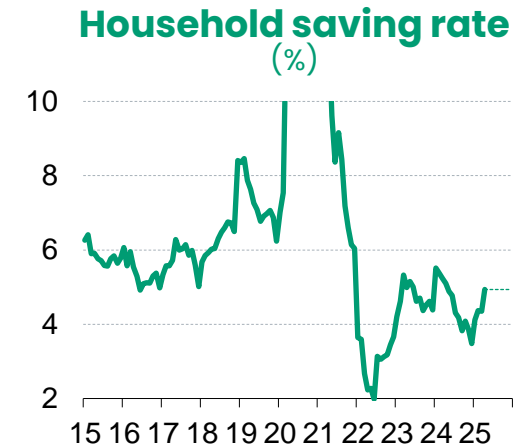
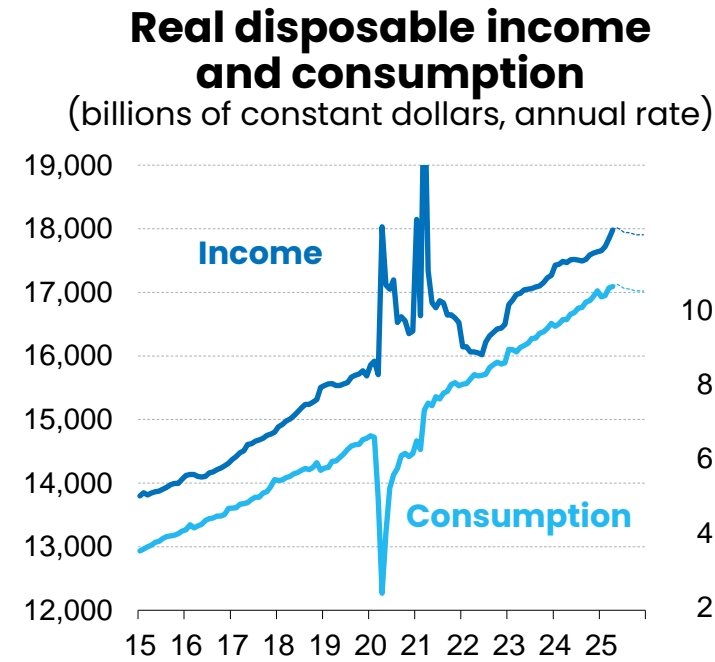
Falling energy prices will provide a marginal support...



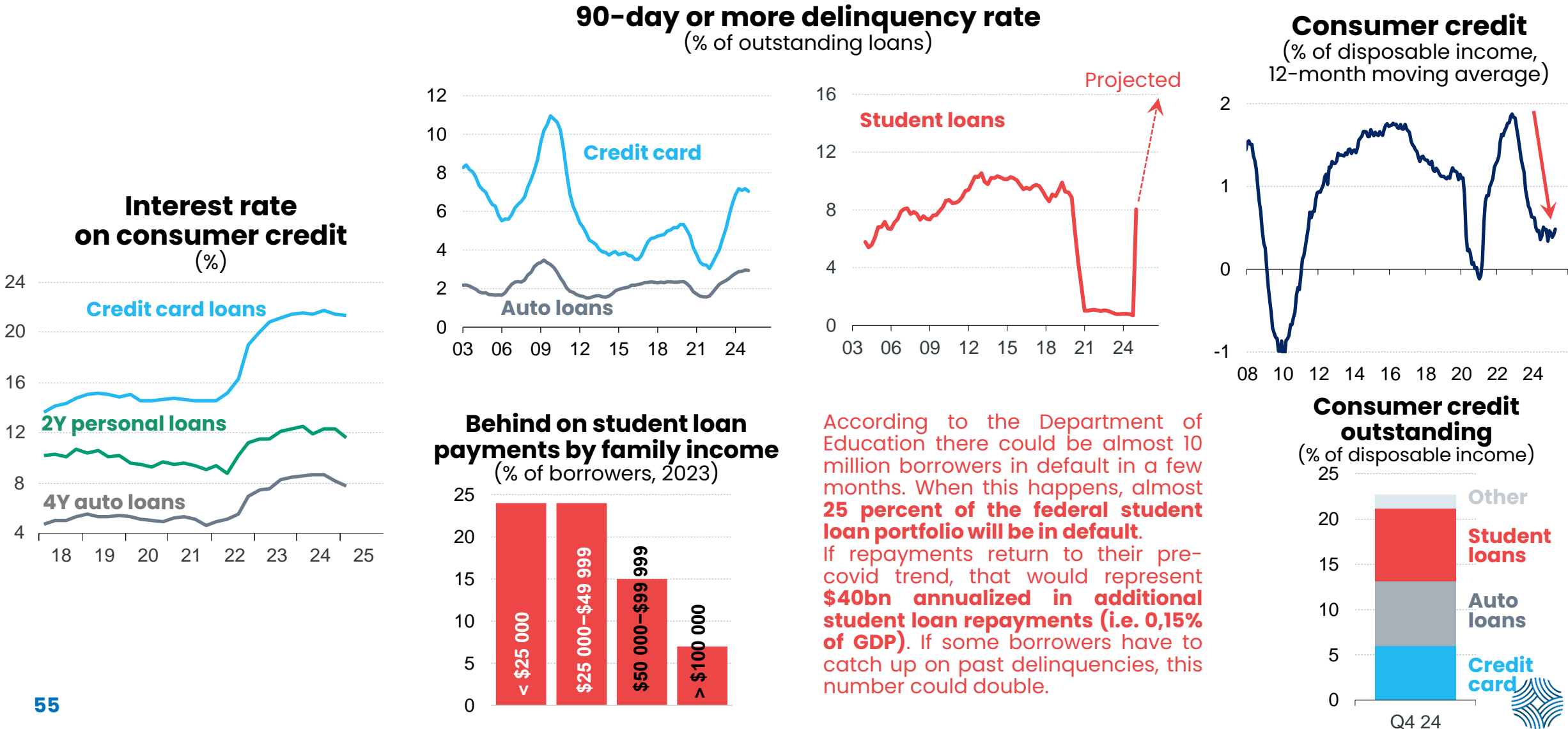
... but will not offset the squeeze in households purchasing power due to tariffs



(*) Forecasts assume additional 35% tariffs on China, 5% on Mexico & Canada, 15% on "dirty 15", 10% on the rest of the world, and 25% sectoral tariffs (autos, steel & aluminum, pharma & semis).

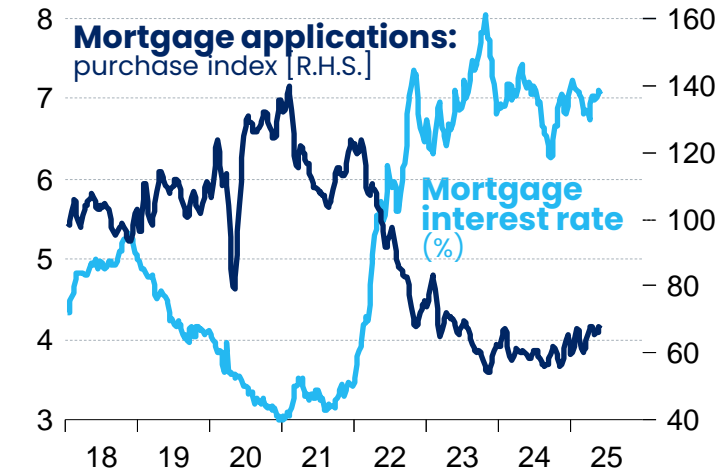


Trump's crackdown on student loans repayments will not help

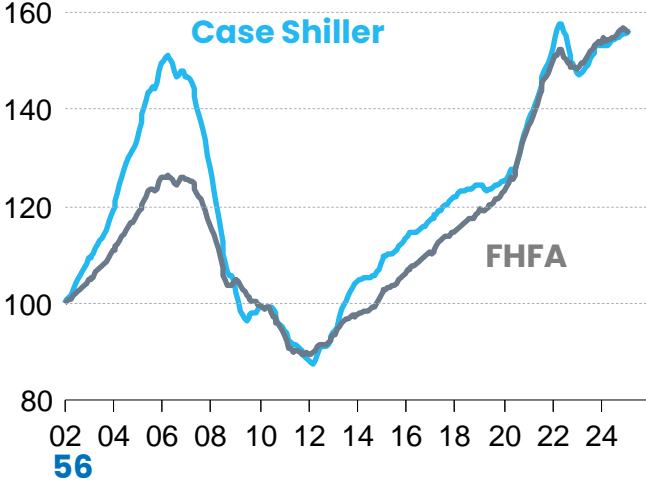


Residential investment is unlikely to provide support

Interest rates and mortgage applications



Home prices (deflated by CPI, January 2002 = 100)

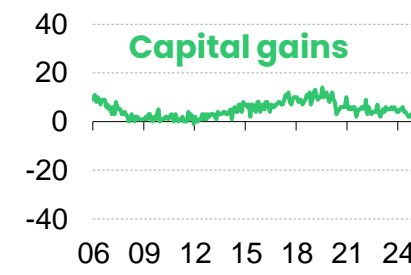
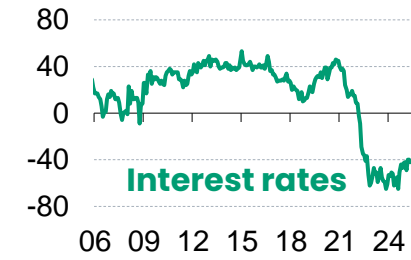
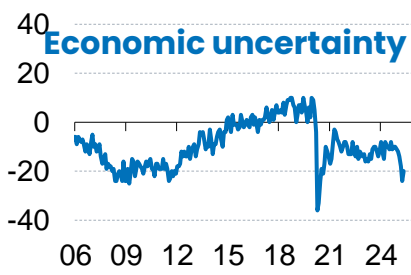
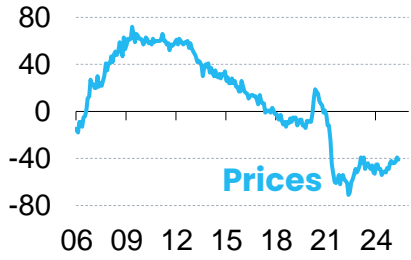


Mortgage service on a median priced home (\$, monthly)



Buying conditions for houses by selected reasons (Michigan survey)

Buying conditions index*



Sources: LSEG Datastream, Bloomberg, Candriam

Within the Administration, the “trade-moderates” seem to have taken the lead... for now!

Effects on the economy (%)

Bending but no breaking

Policy/sentiment shock

		GDP	UR	Inflation		GDP	UR	Inflation
Tariffs	Additional 20% on China and 10% universal tariffs (ex Mexico & Canada)	-0.5	+0.5	+0.8	Additional 35% on China, 5% on Mexico & Canada, 15% on “dirty 15”, 10% on rest of the world, 25% sectoral tariffs (autos, steel & aluminum, pharma & semis)**	-1.3	+1.3	+2.0
Immigration	Illegal immigration is stopped	-0.1	-0.1	-0.3	Deportation of 0.6 mln illegal migrants	-0.2	-0.4	-0.7
Budget	DOGE spending cuts + “one big beautiful bill”	+0.2	-0.2		DOGE spending cuts + “one big beautiful bill”	+0.2	-0.2	
Total		-0.4	+0.2	+0.5*		-1.3	+0.7	+1.3*

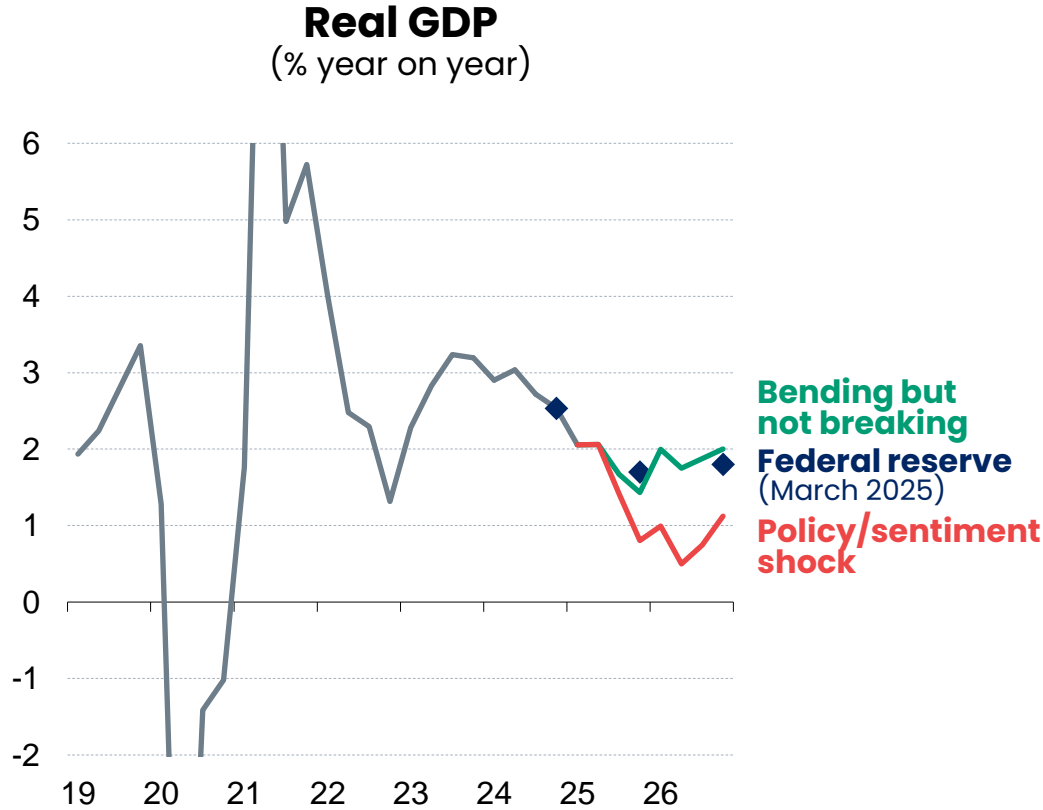
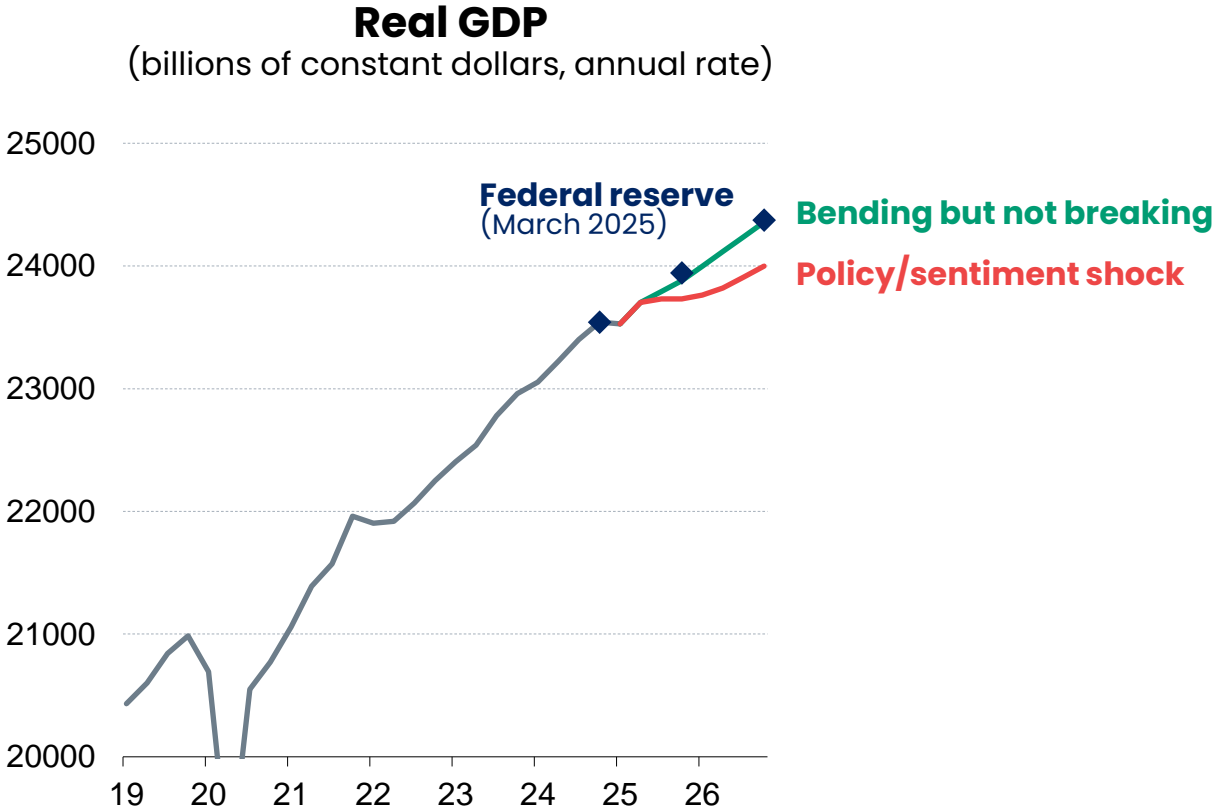
(*) Inflation could be slightly dampened by deregulation in the energy sector.

(**) Equivalent to additional 60% on China and 10% on RoW

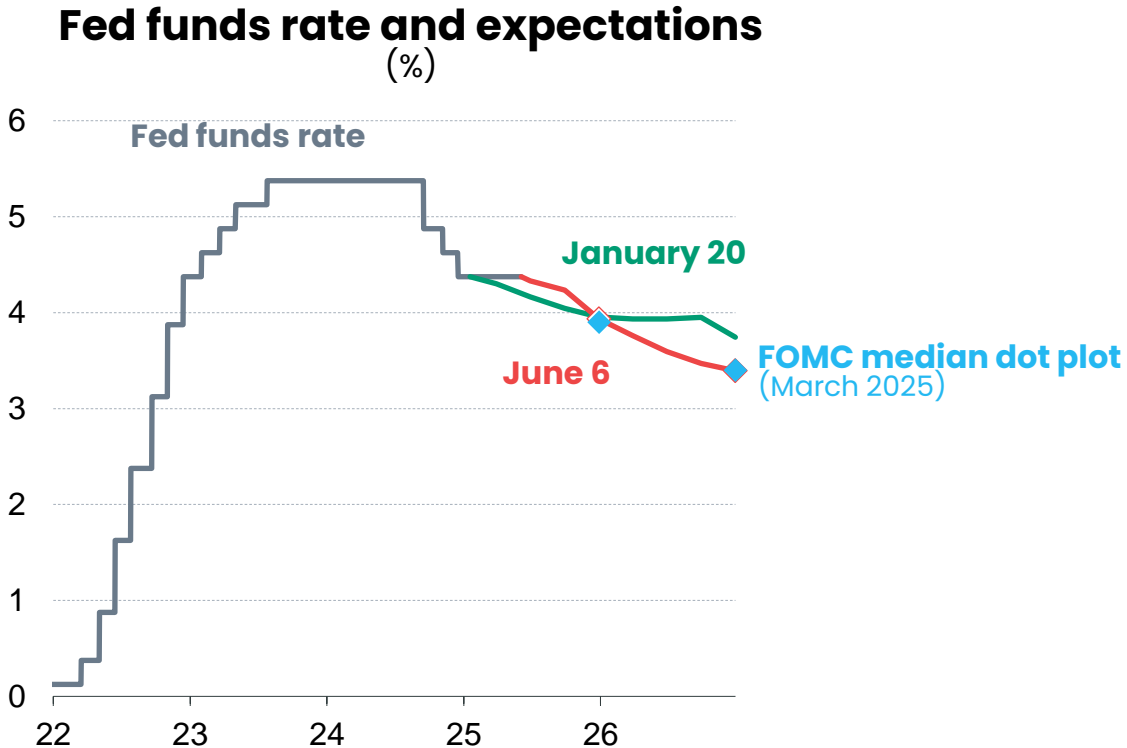
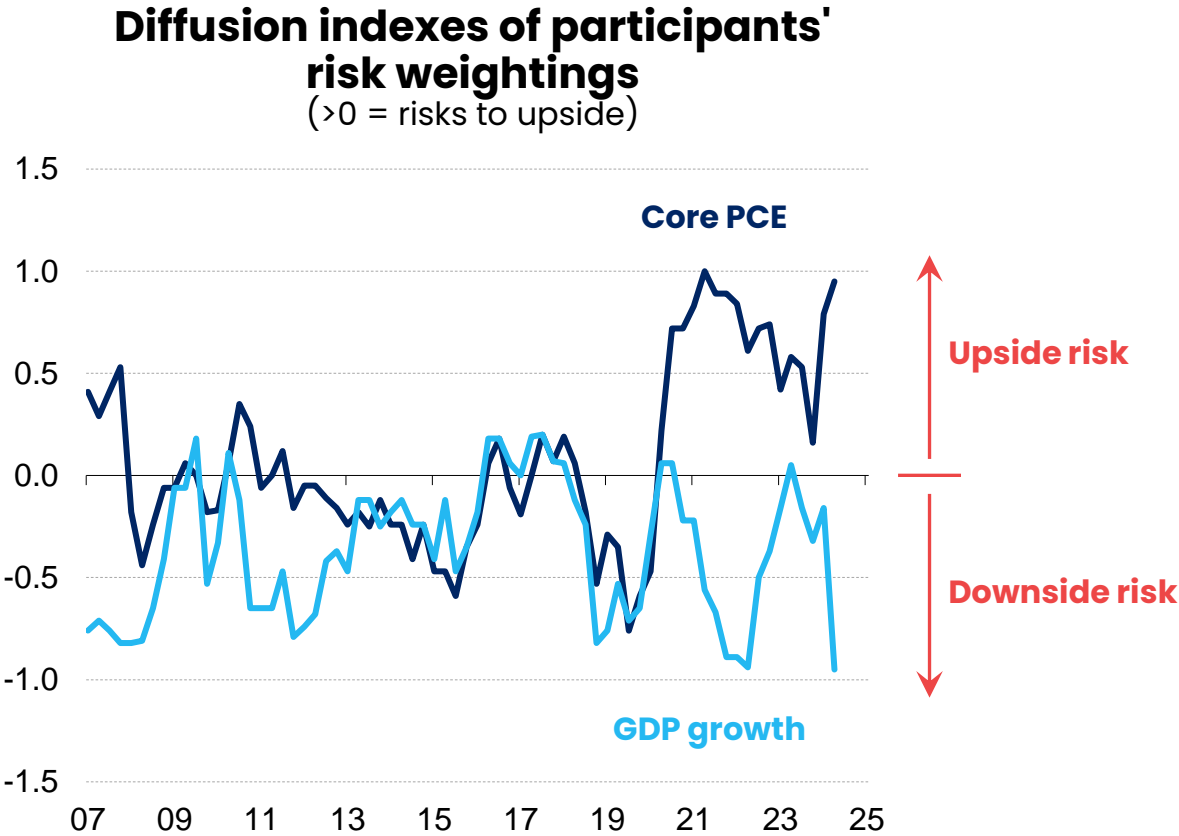
The mechanical effect of higher tariffs and the climate of uncertainty are leading to a clear slowdown in activity.



Higher tariffs and trade uncertainty are likely to significantly curb growth

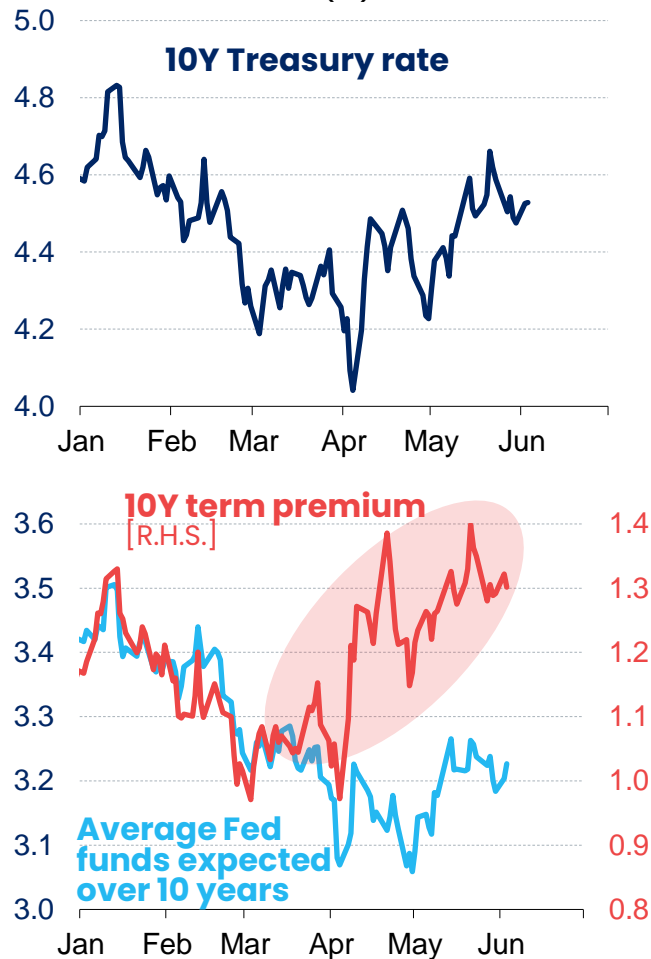


In this environment, the Federal Reserve will continue to be patient



The increase in the term premium is the main reason behind the recent rise in the 10-year Treasury rate

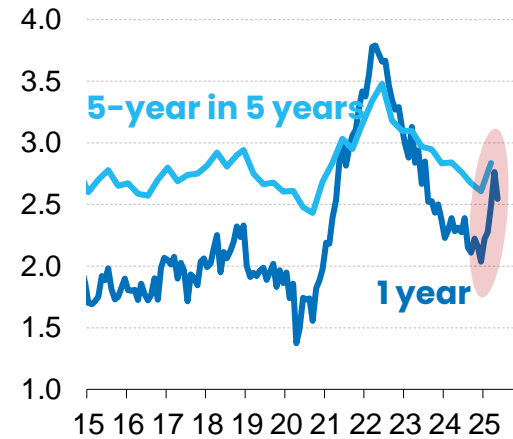
10-year Treasury rate decomposition (%)



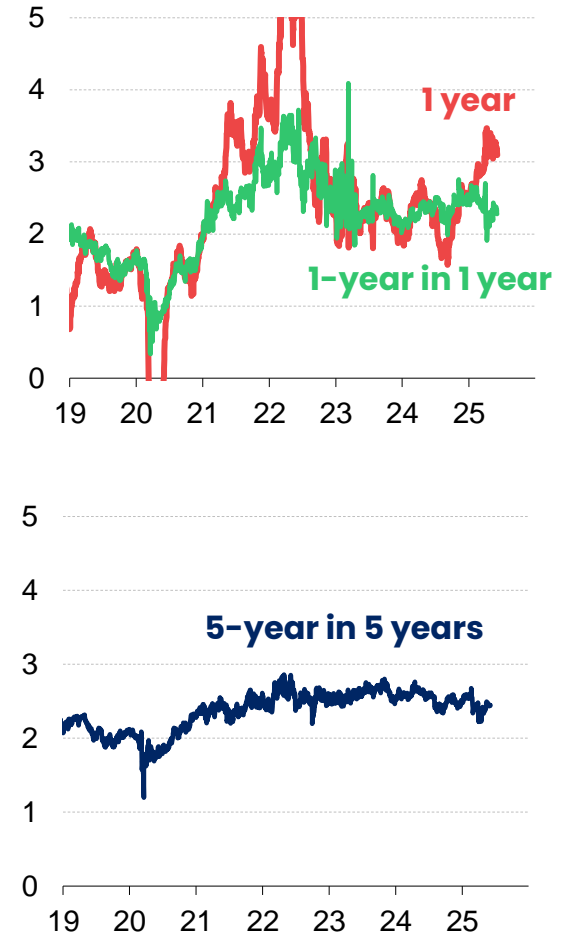
Households' inflation expectations
(%, annual rate, Michigan survey)



Business inflation expectations
(%, annual rate, Atlanta Fed)

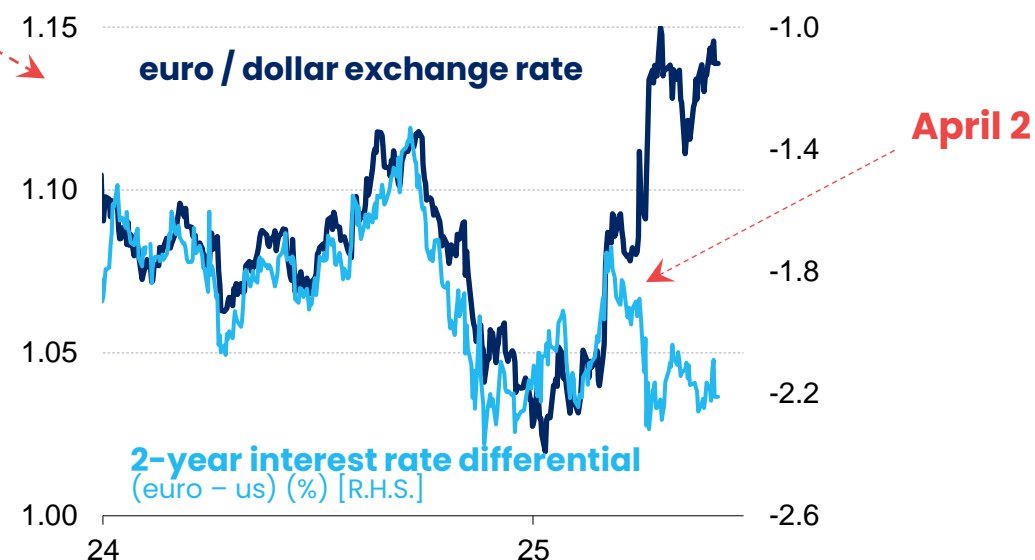
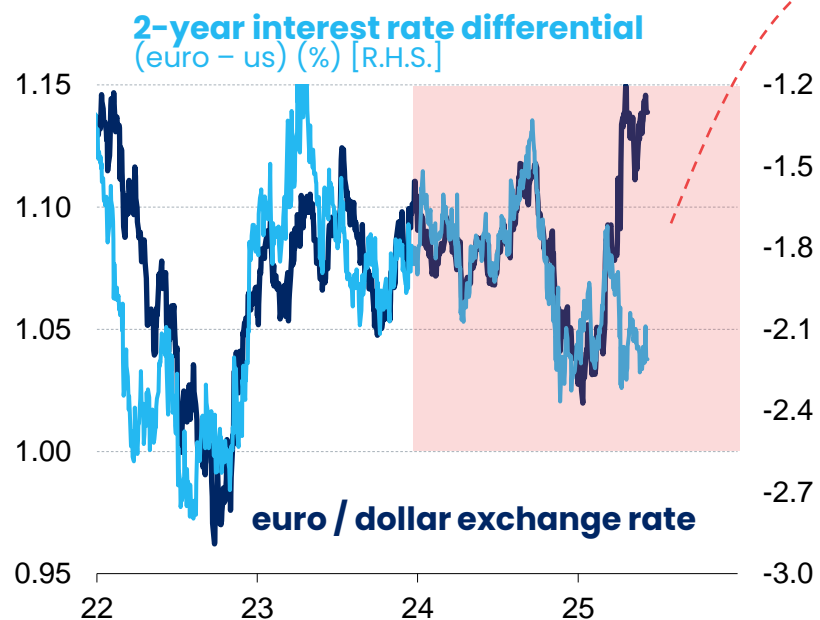


Markets' inflation expectations
(Inflation-linked swaps, %)



Since April 2, the euro/dollar exchange rate no longer follows interest rate differentials

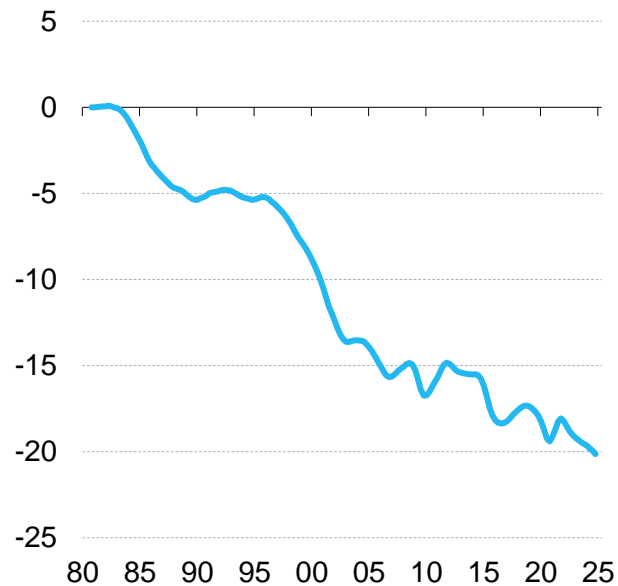
Interest rate differentials and exchange rate



Eroding confidence in the dollar is a dangerous game!

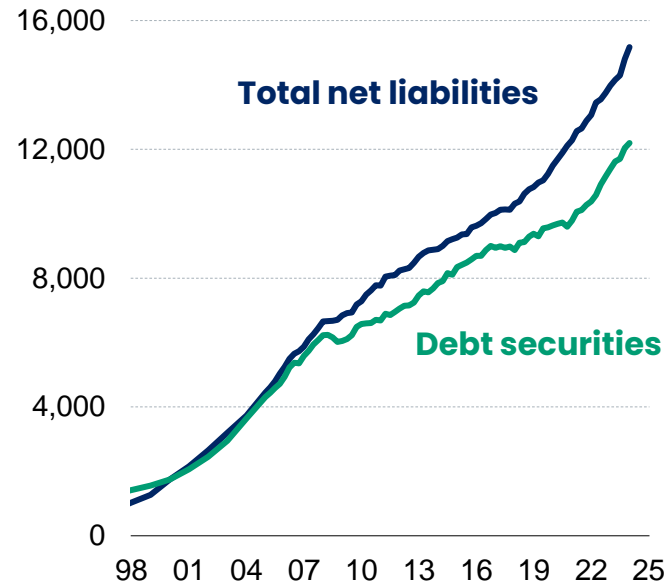
Cumulated US current account balance since 1980

(% of world-ex US GDP)



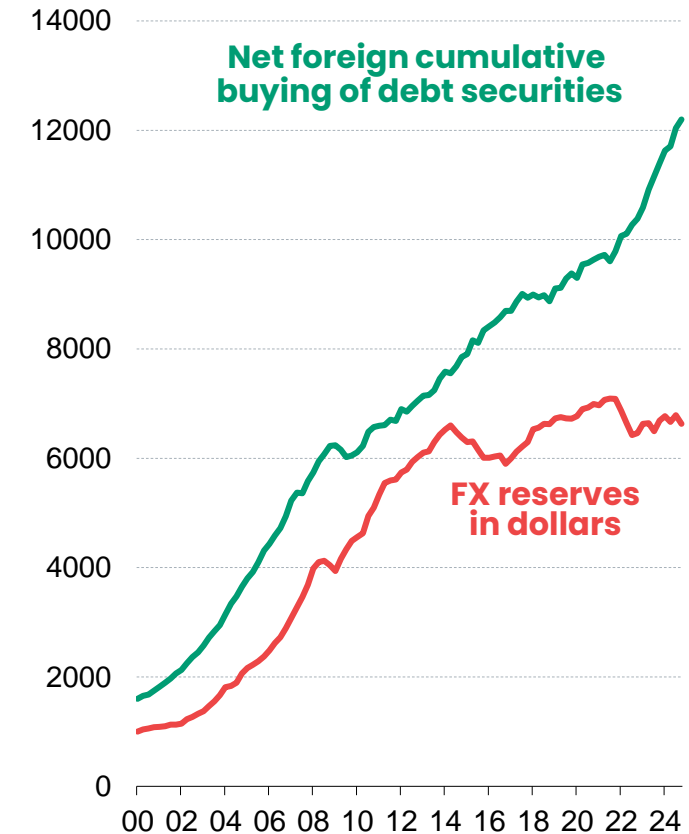
Net liabilities of the United States vis-à-vis the rest of the world

(cumulative flows since 1998, \$ billion)



Financing of the US current account deficit and dollar-denominated foreign exchange reserves

(\$ billion)



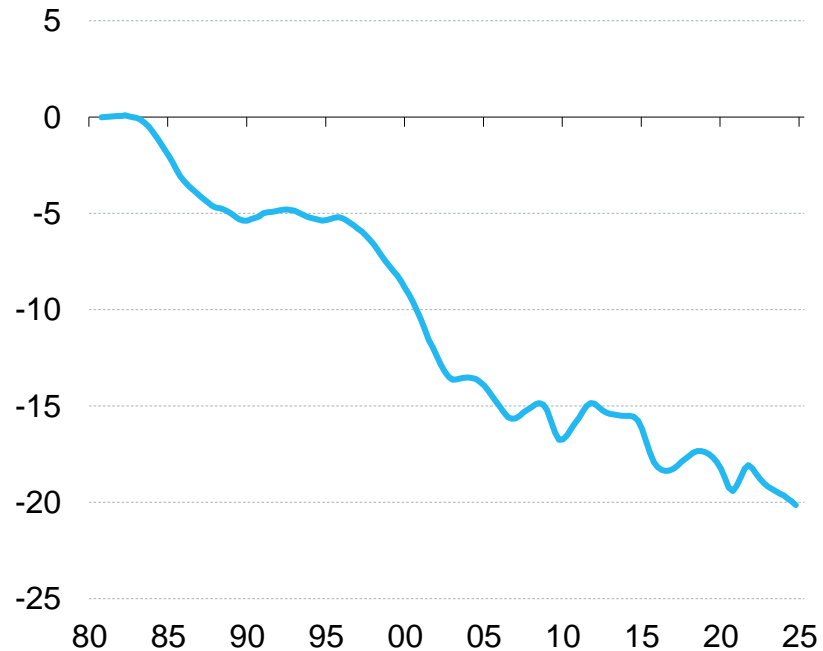


Focus. The US dollar

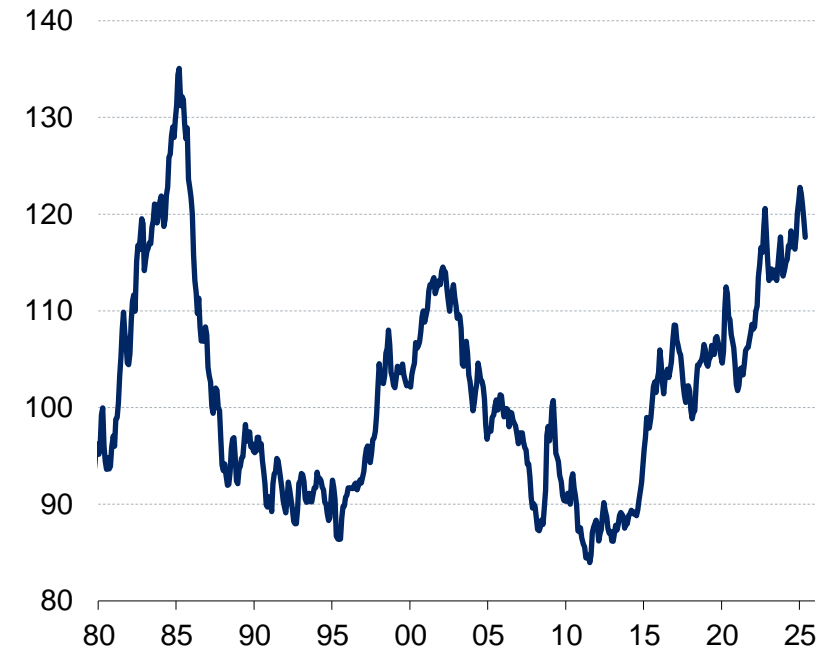
Part 1. An analytical framework

The US piled up current account deficits over the last decades... but the dollar is far from having depreciated!

**Cumulated US current account
balance since 1980**
(% of world-ex US GDP)



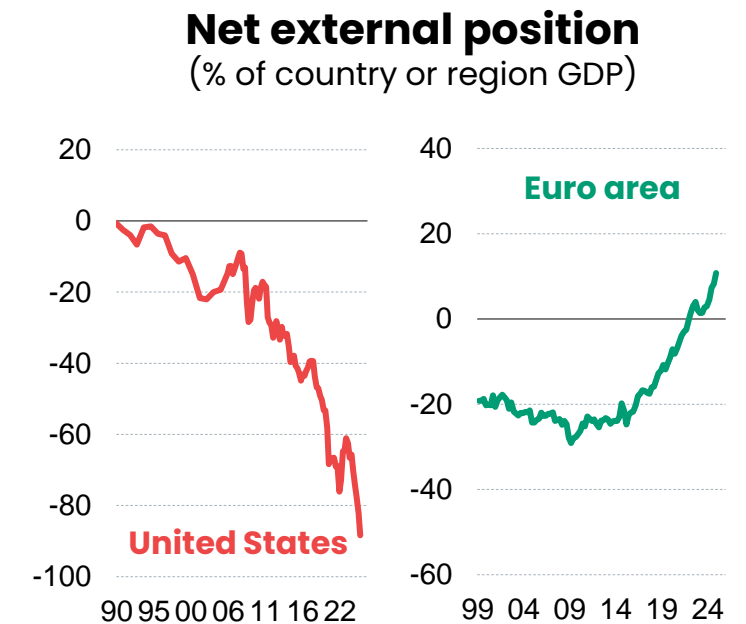
**US dollar real effective
exchange rate**
(index)



In developed economies, financial globalization has become a reality

Net external position of the United States and the euro area at end 2024

(\$ billion)	United States		Euro area	
	Assets	Liabilities	Assets	Liabilities
Direct investment	11 265	17 837	13 068	10 310
Portfolio investment	15 873	33 087	15 172	17 090
– Equities	12 109	18 443	7 837	11 221
– Debt securities	3 764	14 644	7 335	5 869
Other investment	5 521	8 909	7 434	7 981
Reserves	910		1 444	
Total	33 569	59 834	37 118	35 381
Net external position		-26 264	+1 737	

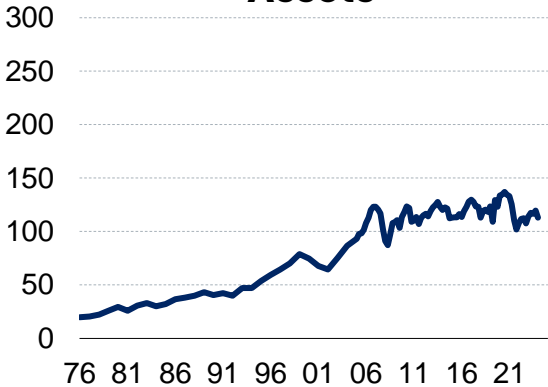


As a share of GDP, external financial assets and liabilities have grown considerably

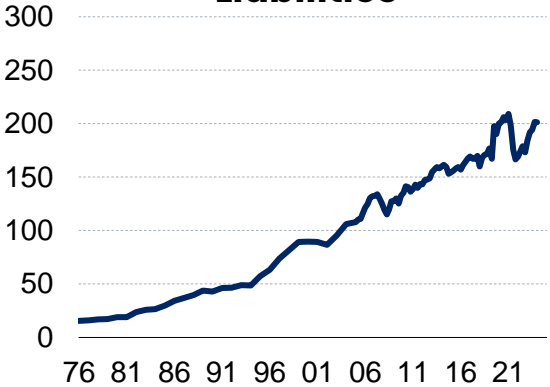
External position
(% of country or region's GDP)

United States

Assets

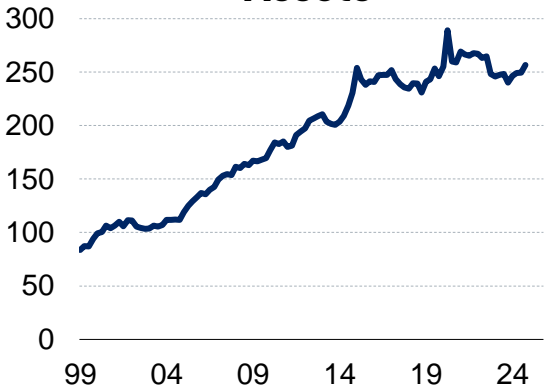


Liabilities

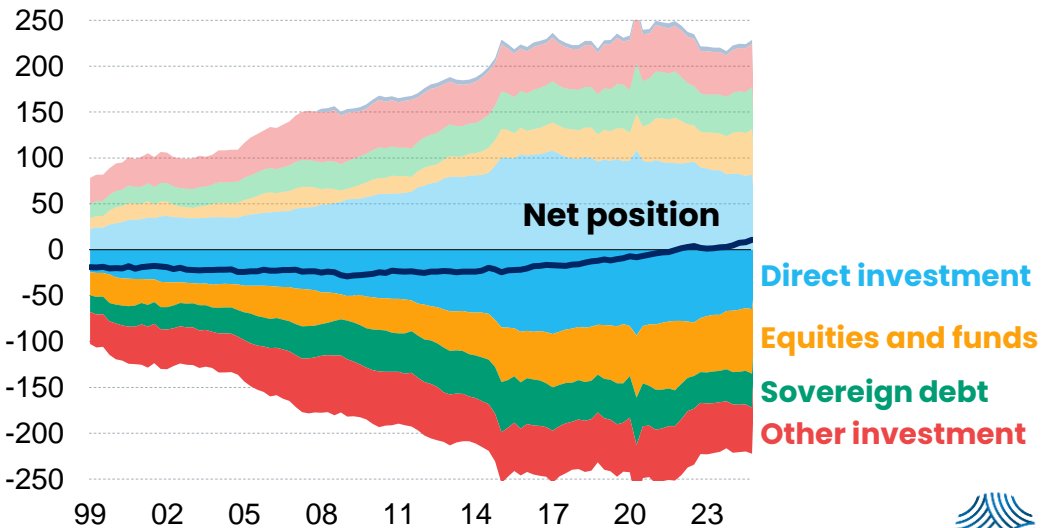
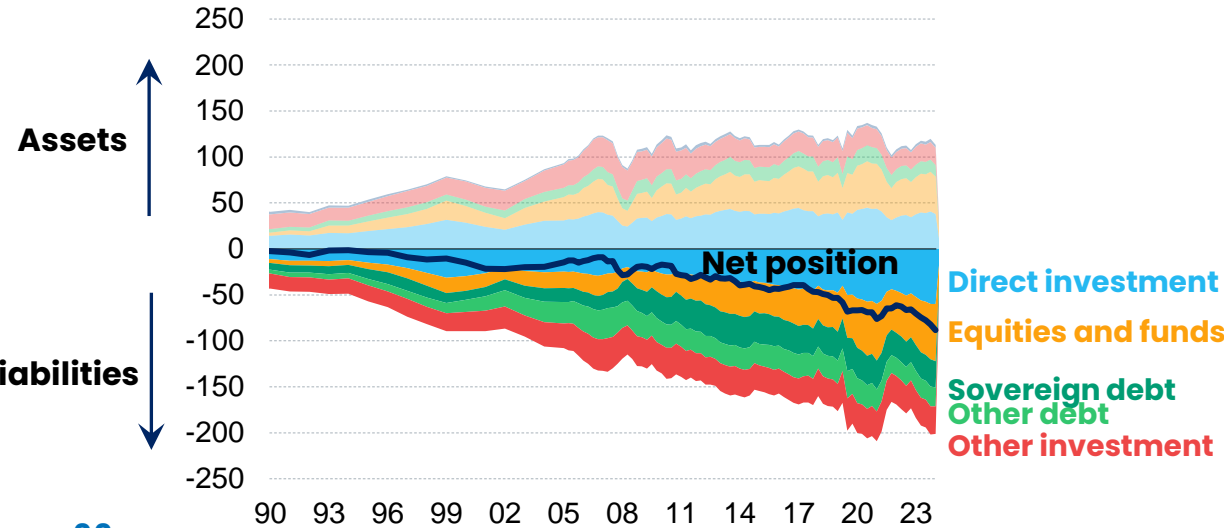
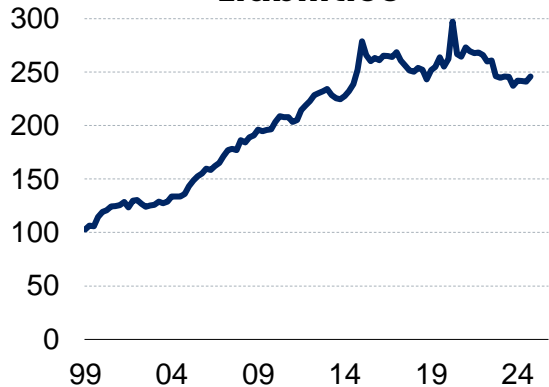


Euro area

Assets



Liabilities



Globalization has lessened the influence of current account imbalances on the exchange rates of major currencies

F = cumulated current account deficit of the US (in dollars)

X = total financial debt issued by each country (X are supposed to be the same in the two areas)

W denotes American residents' wealth in dollars and W* denotes European residents' wealth in local currency

$$W = X - F$$

$$W^* = X + \frac{F}{e}$$

All magnitudes are expressed in domestic currencies and 1 euro = e dollars

$$Y = \text{US GDP}$$

United States

A	L
$(1 - \alpha)W$	$F + (1 - \alpha)W$

Euro area

A	L
$(1 - \alpha)W^*$	$-\frac{F}{e} + (1 - \alpha)W^*$

α = proportion of wealth kept in domestic assets (> 50%)

In a globalized world with two perfectly symmetric countries and where preferred currency habitat is symmetrically diversified (i.e. even without yield differentials there is a demand of currency diversification), the equilibrium exchange rate is as follows:

$$\gamma = \frac{(1 - \alpha)X}{Y} \quad \text{measure the intensity of globalization}$$

$$e = 1 + \frac{\sigma}{\gamma}(2\alpha - 1) \quad \sigma = F/Y, \text{ cumulative current account deficit as \% of GDP}$$

→ The less international diversification (measured by α), the greater the role of the current account imbalance.

→ Globalization (measured here by γ) reduces the influence of current account imbalance (measured here by σ) on the exchange rates of the major currencies.



Countries can depart from their “preferred habitat” under the influence of expected yield differentials

Let e be the exchange rate of the euro against the dollar ($1\text{€} = e$ dollars), we have : $e = k\rho^\beta$

with $k = 1 + \frac{\sigma}{\gamma}(2\alpha - 1)$, ρ is the expected yield differential ($\rho = \frac{(1+r^\text{€})}{(1+r^\text{\$})} \times \frac{e^a}{e}$)

and β is a parameter of risk aversion (the higher β , the lower the risk aversion)

Fundamental forces

$$e = k \quad \text{if } \rho = 1$$

Financial forces

$$e = \left(\frac{1 + r^\text{€}}{1 + r^\text{\$}} \right)^\beta \quad \text{if } k = 1 \text{ and } e^a = e$$

Speculative forces

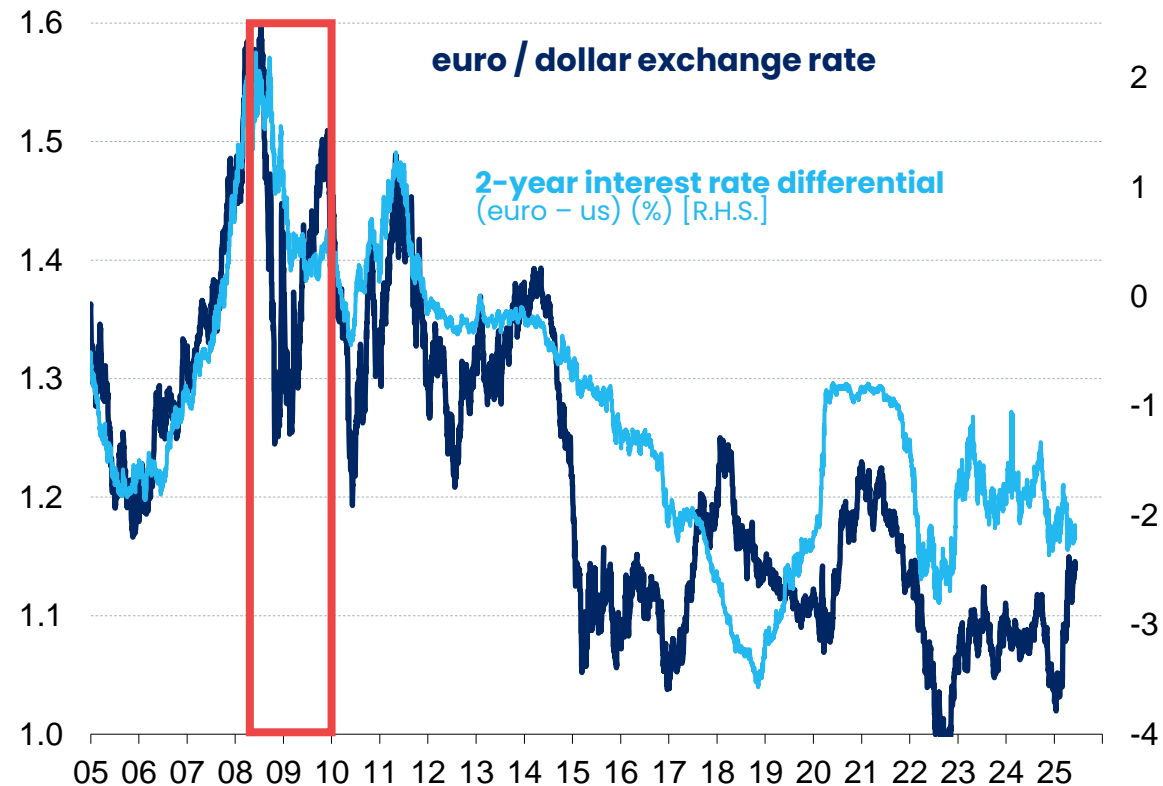
$$e = e^a \frac{\beta}{\beta+1} \quad \text{if } k = 1 \text{ and } r^\text{€} = r^\text{\$}$$

In reality, these different forces are combined in proportions that may vary through time.



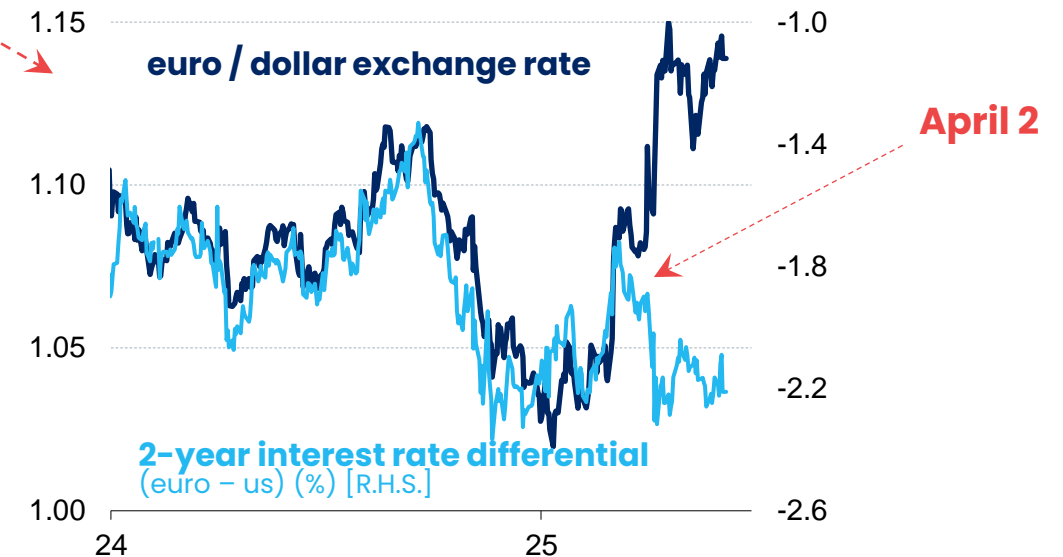
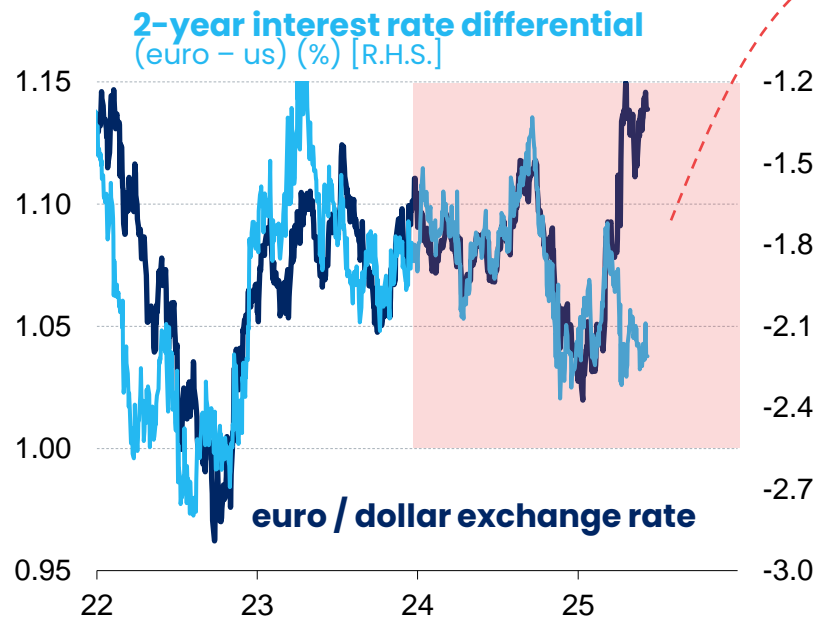
Interest rate differentials very often play a key role in exchange rate moves

Interest rate differentials and exchange rate



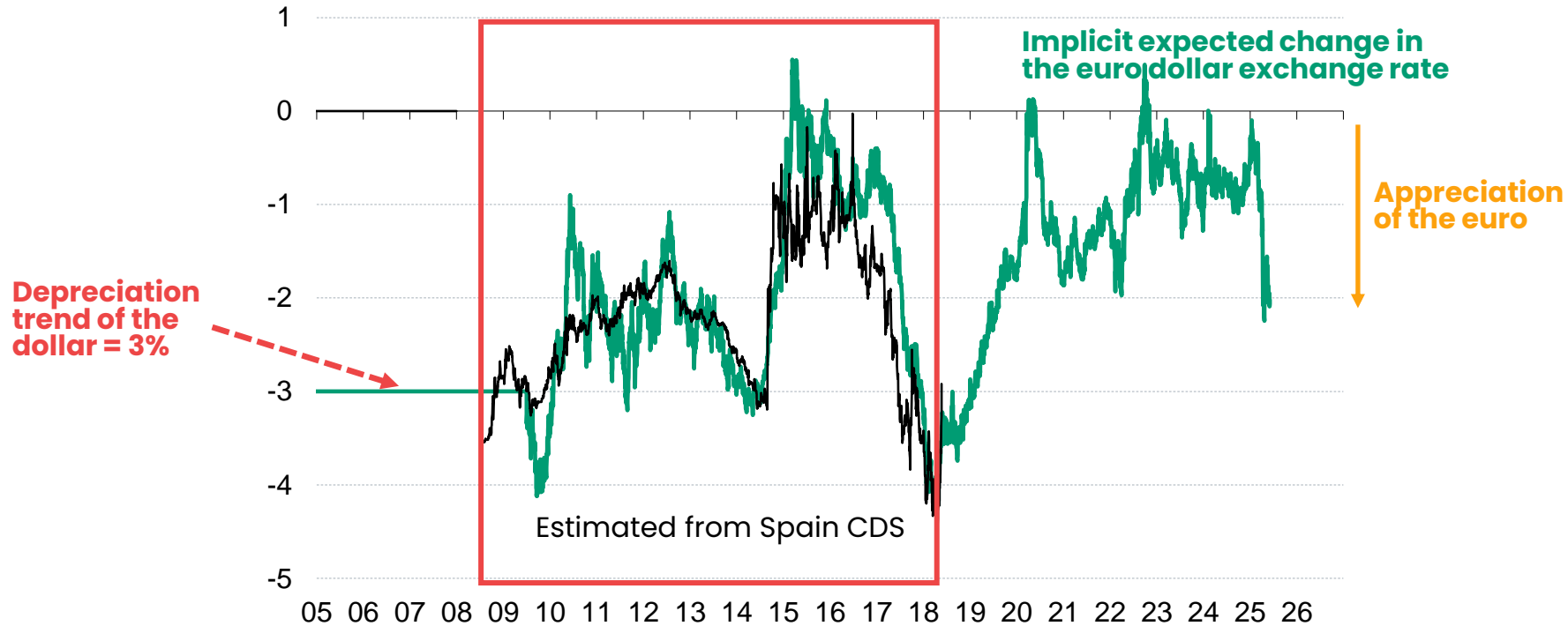
In April of this year however, the euro/dollar exchange rate sharply diverged from interest rate differentials

Interest rate differentials and exchange rate



This time, exchange rate expectations seem to have played a bigger role

Appreciation or depreciation expectations of the dollar against the euro* (%)



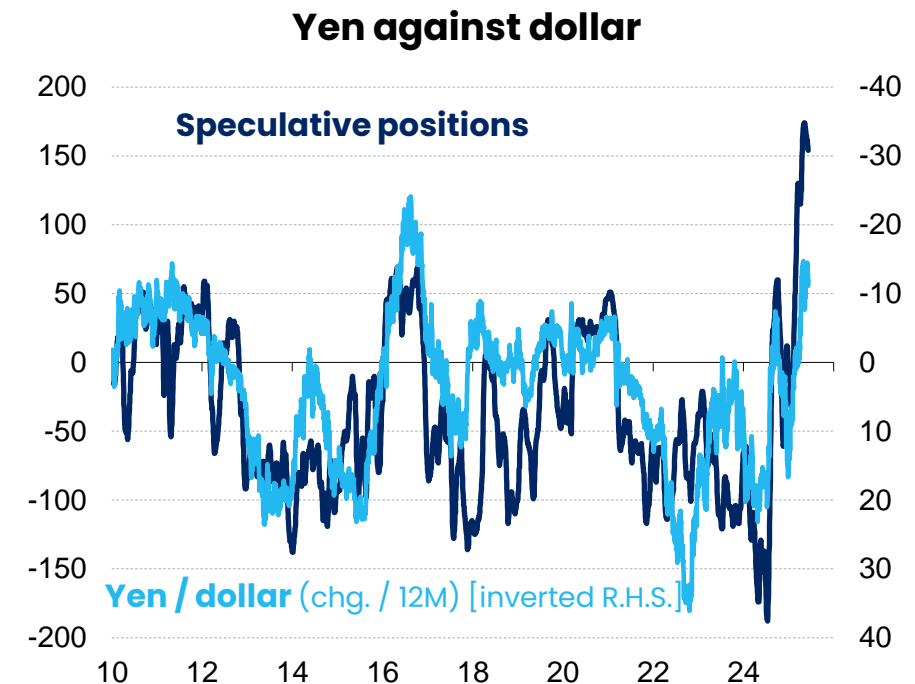
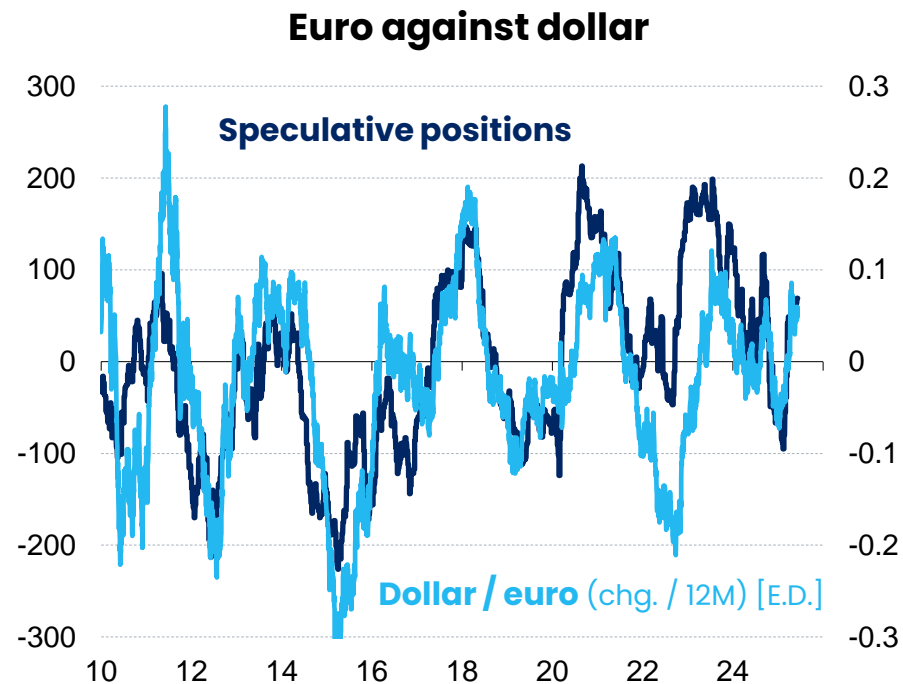
(*) ε was simulated using the following equation: $e = k \times (1 + r_{\text{€}} - r_{\text{\$}} + \varepsilon)^\beta$

Where e is the euro/dollar exchange rate (1 euro = e dollars), $r_{\text{€}}$ is the euro expected 3-month interest rate at a 1-year rolling horizon, $r_{\text{\$}}$ is the US expected 3-month interest rate at a 1-year rolling horizon (both rates are derived from futures' contracts prices), ε is the expected change in the euro/dollar exchange rate (taken as equal to +3 % over the whole period), β is the exchange rate elasticity to the return differentials (when risk aversion rises, β decreases), k is used here as a scale parameter.



Memo. Speculative positions do not seem to have played a major role in the euro's recent appreciation... which is not the case for the yen!

Speculative positions* on the Chicago Mercantile Exchange



(*) Number of non-commercial long positions minus number of non-commercial short positions, thousands of contracts



Focus. The US dollar

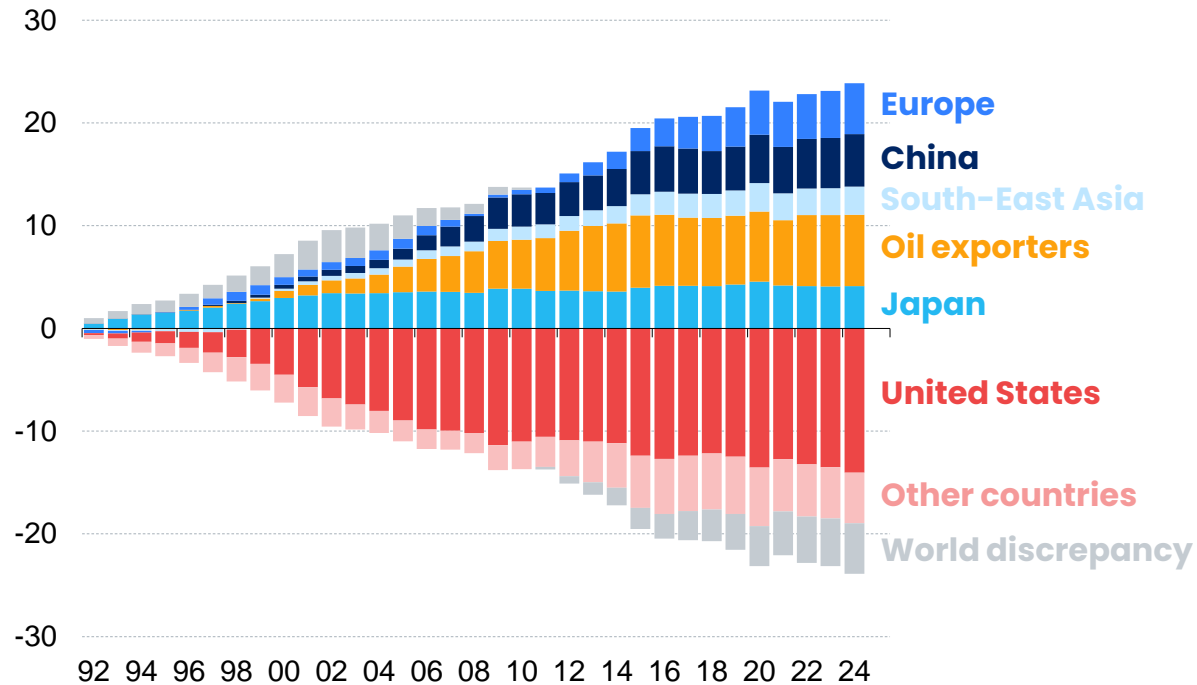
Part 2. Set to lose strength?



The US has played the role of borrower of last resort and has been the main net importer of world savings

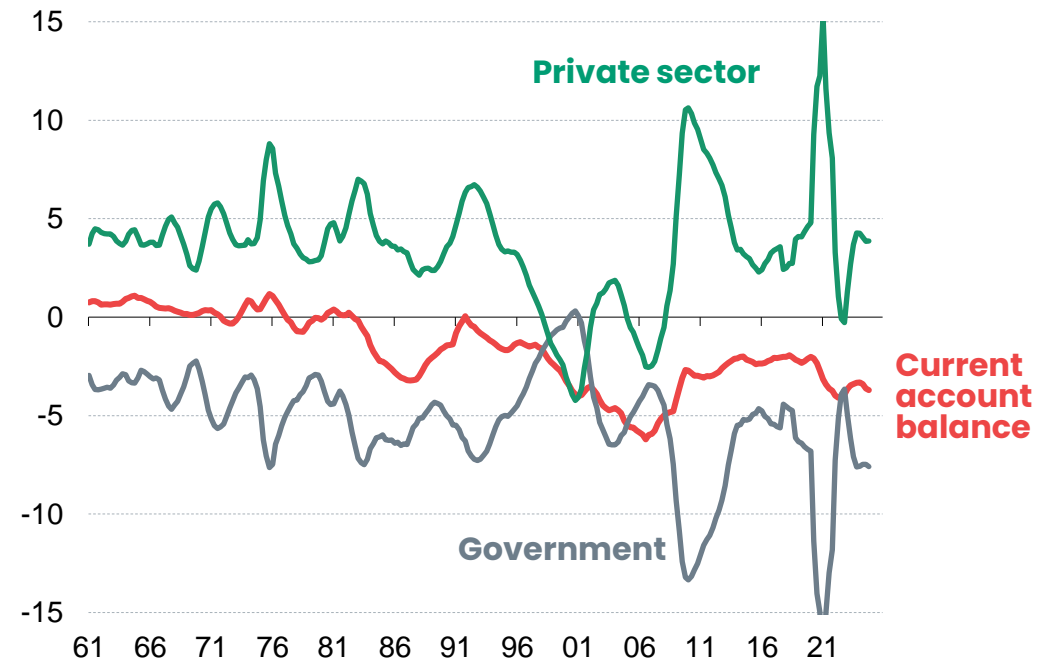
Cumulated world current account balances

(since 1992, % of world GDP)



Net lending (+) or borrowing (-) in the United States

(% of GDP, 4-quarter moving average)

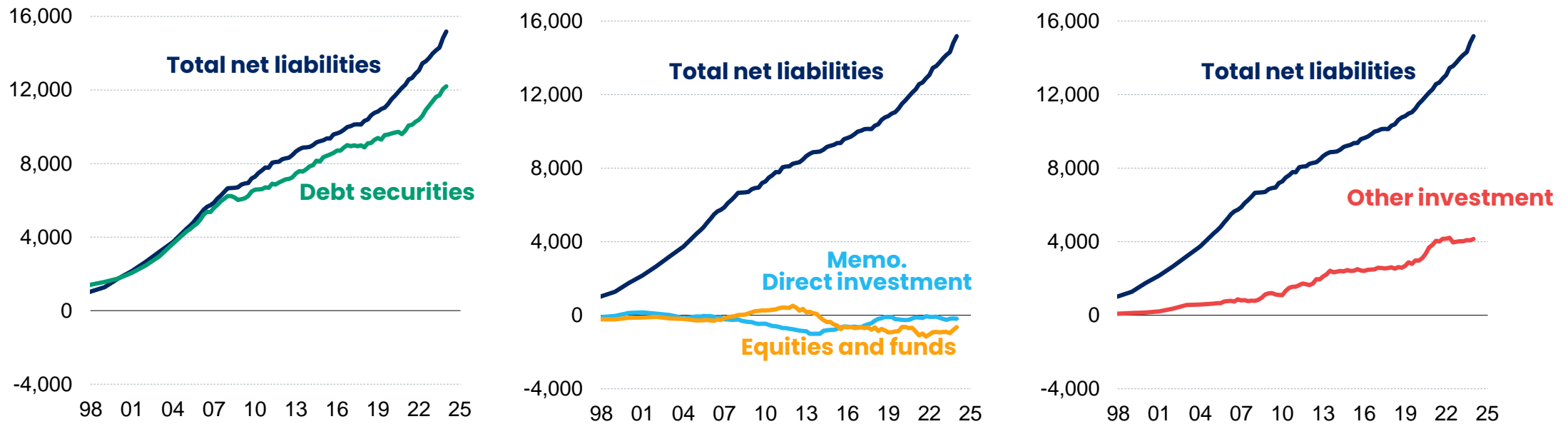


Between 2000 and 2020, the United States played the role of **"borrower of last resort"**. The result was an accumulation of chronic fiscal deficits... and a large current account deficit.



The United States have mainly financed their external deficit by issuing debt securities

Net liabilities of the United States vis-à-vis the rest of the world
(cumulative flows since 1998, \$ billion)

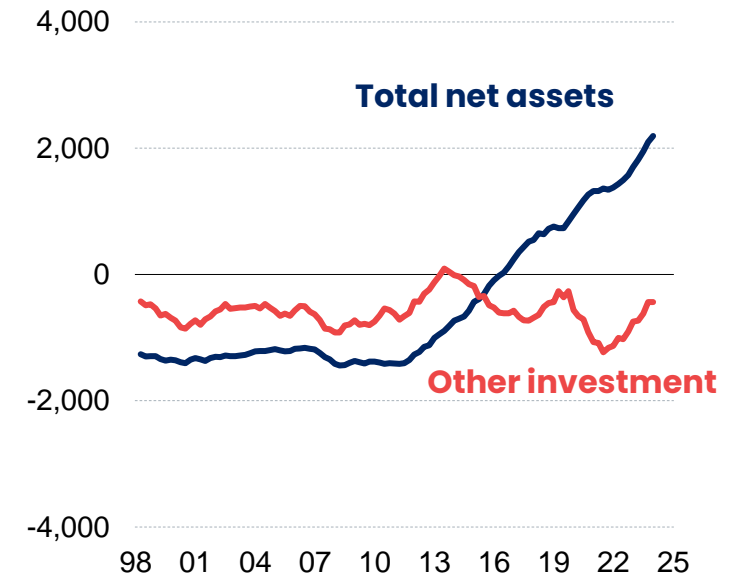
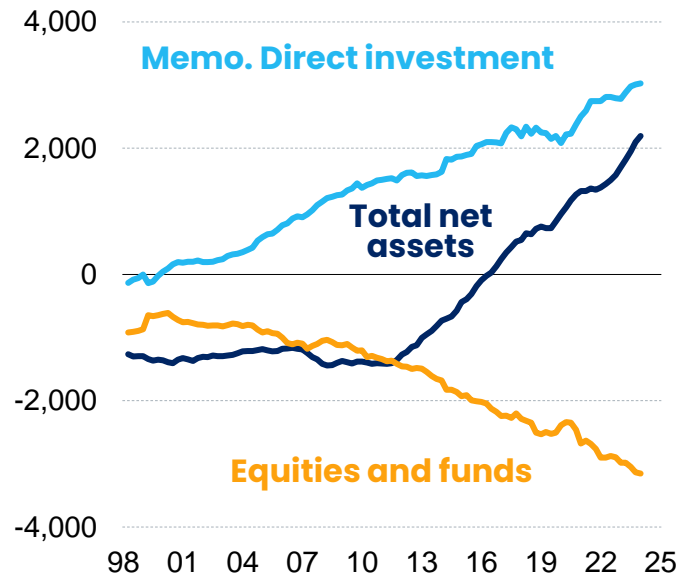
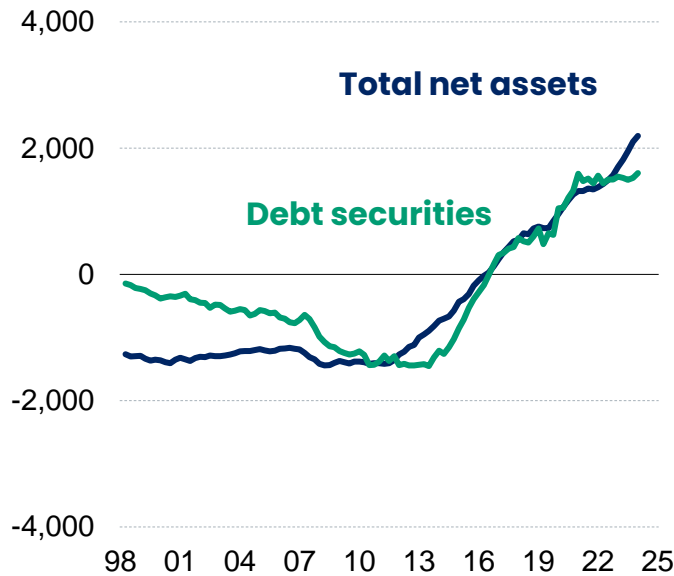


The United States is both the issuer of the international reserve currency – the dollar – and the supplier of “risk-free” assets – Treasury bonds – to the rest of the world.



It supplied the debt securities other regions – the euro area in particular – were looking for

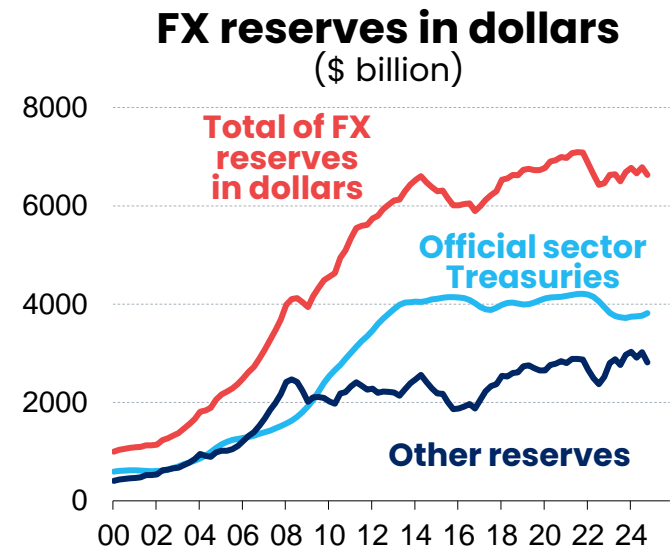
Net assets of the euro area vis-à-vis the rest of the world
(cumulative flow since 1999, € billion)



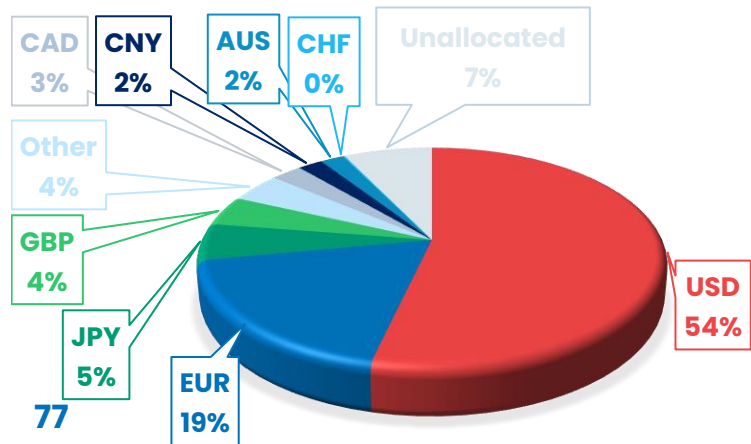
Since the Great Financial Crisis, the eurozone has invested its surplus savings in debt securities issued by the “rest of the world”.



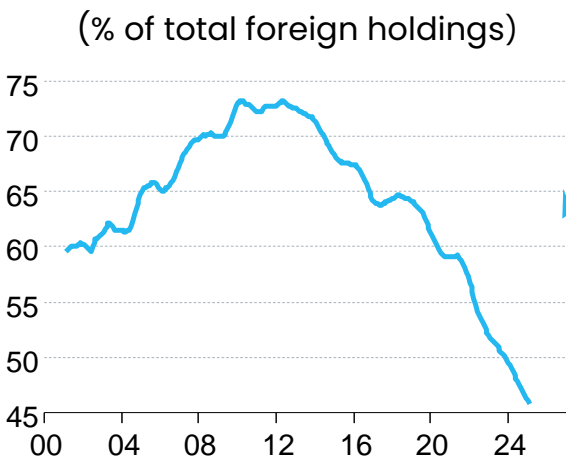
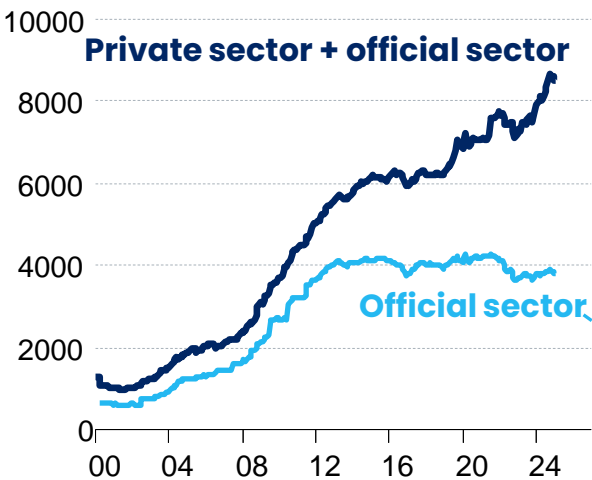
Since 2012, the nature of the rest of the world US debt holders has changed



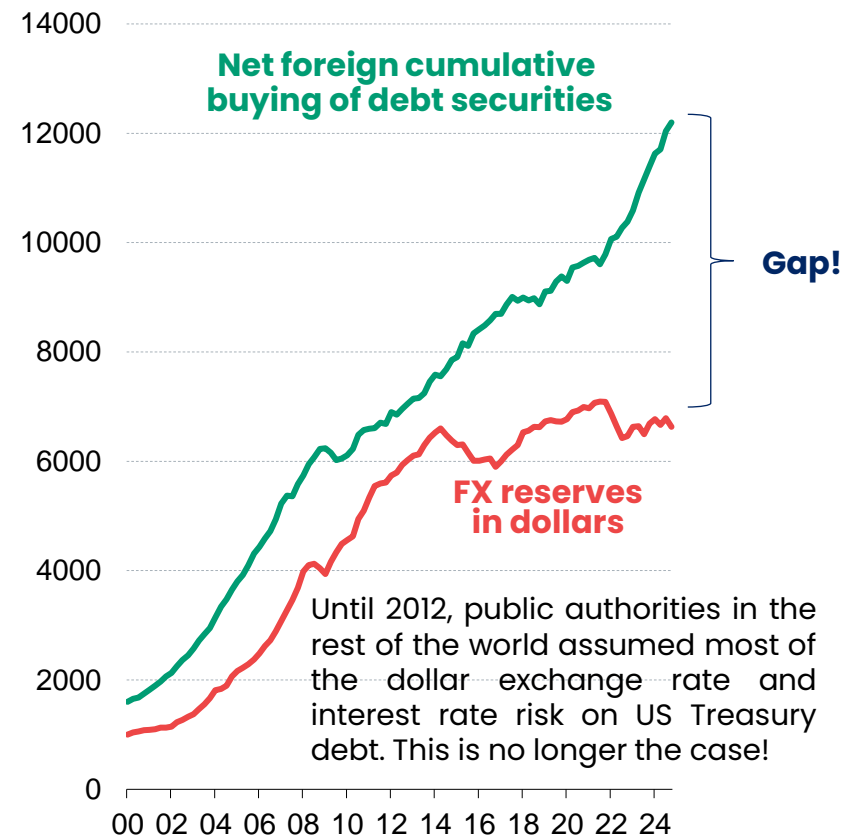
World FX reserves by type of currency



Treasuries held by foreigners (\$ billion)

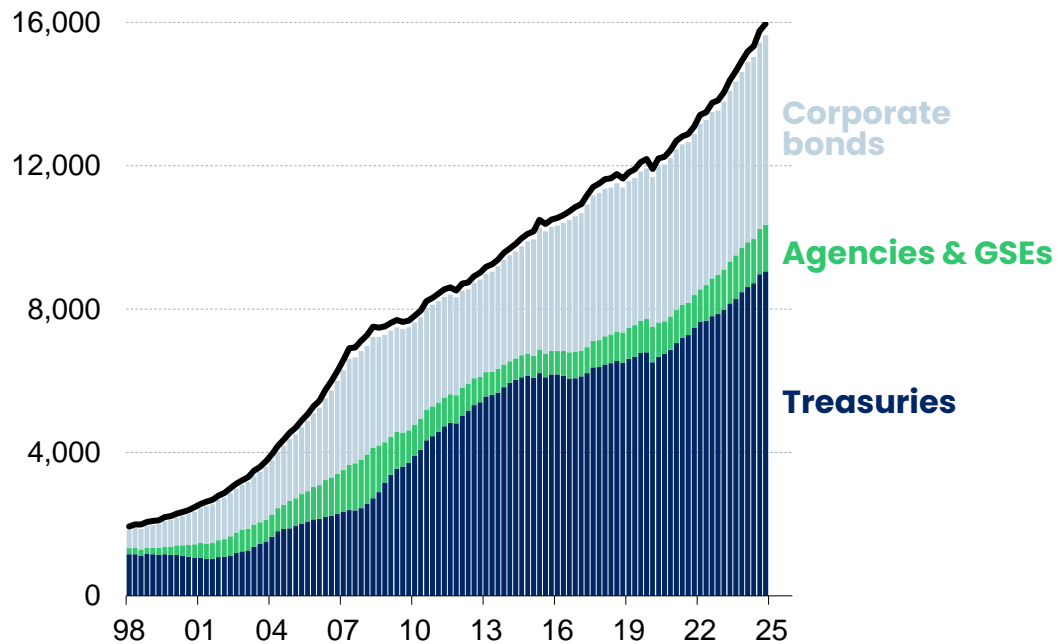


Financing of the US current account deficit and dollar-denominated foreign exchange reserves (\$ billion)



While large-scale foreign liquidation of Treasury holdings appears quite unlikely for lack of credible alternative, foreign holders of US debt securities have become more “return-sensitive”

Gross foreign cumulative buying of US debt securities
(\$ billion)



Large-scale foreign liquidation of Treasury holdings appears unlikely as there is no credible alternative to US Treasuries in the global financial system: no other asset is seen to be as safe, stable, and liquid, as well as available in quantities sufficient to meet the enormous global demand for safe assets.

While foreign exchange reserve accumulation has slowed, **foreign asset accumulation of countries maintaining persistent current account surpluses occurs more and more through sovereign wealth funds**. Whereas reserve managers invest principally in Treasuries, sovereign wealth funds are more likely to take some credit risk. This might have led to a shift towards more “return-sensitive” buyers.



All in all, some forces which supported the dollar are likely to be less supportive in the future

D. Trump's "America First" policies are prompting other major economies to step up their stimulus policies to support growth (fiscal bazooka in Europe, but also in China).

→ **Other regions of the world will have fewer excess savings to export.**

→ **At the same time, with growing US fiscal deficits, the risk of an excess supply of US Treasury securities seems more real than the risk of a shortage.**

"Wall Street consensus that an Administration has no means by which to affect the foreign exchange value of the dollar, should it desire to do so, is wrong. **Government has many means of doing so, both multilaterally and unilaterally.**"

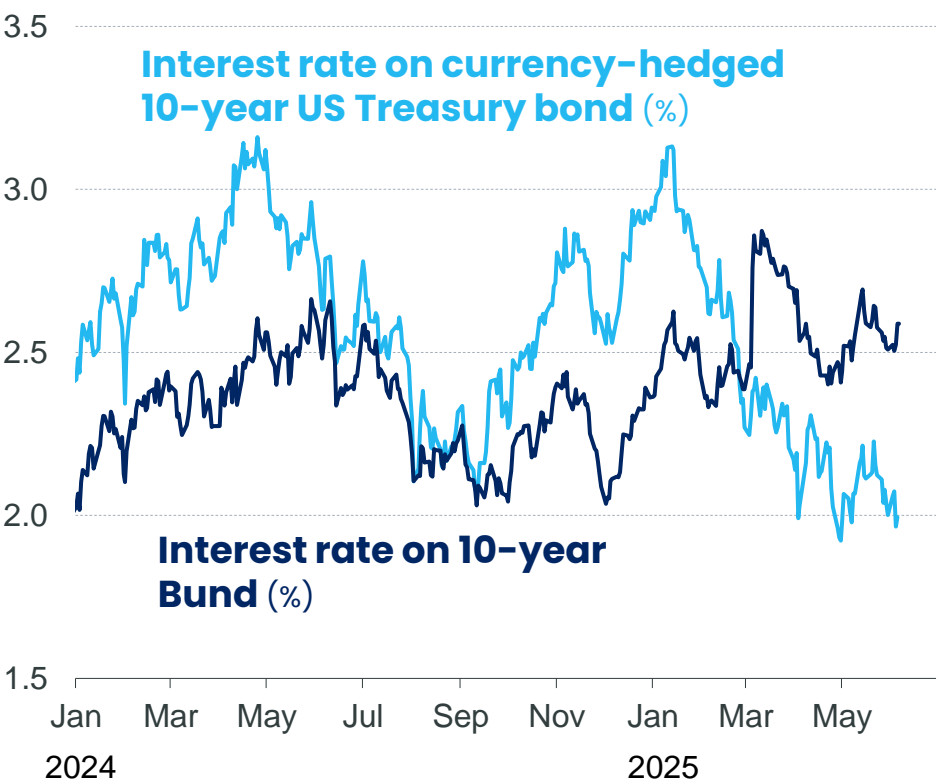
Stephen Miran
(A User's Guide to Restructuring the Global Trading System)

→ **The idea of a grand Mar-a-Lago accord risks eroding confidence in the dollar.**

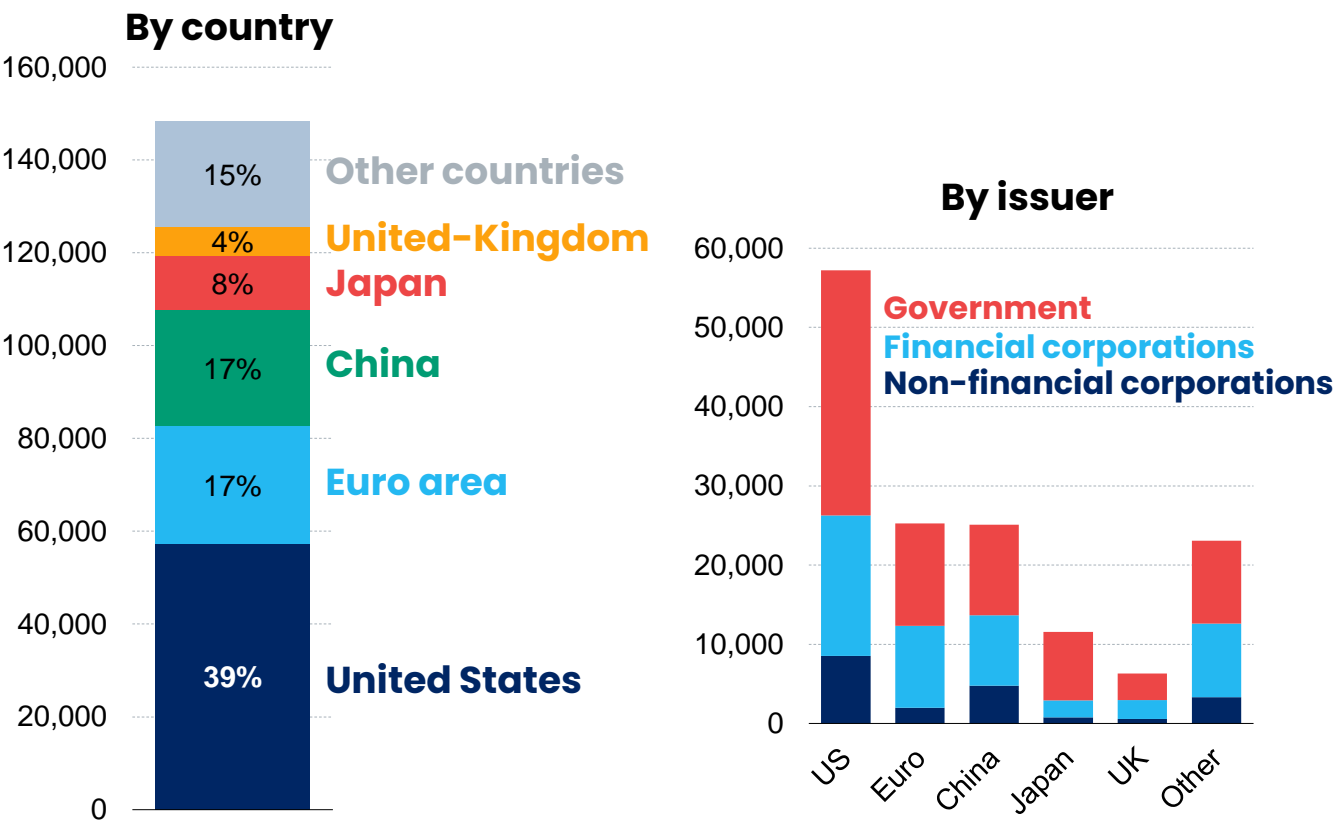


Memo. Holding currency-hedged US Treasury bonds now pays less than buying German government bonds

Comparison of an investment in US Treasury securities and German government securities from the point of view of a European investor



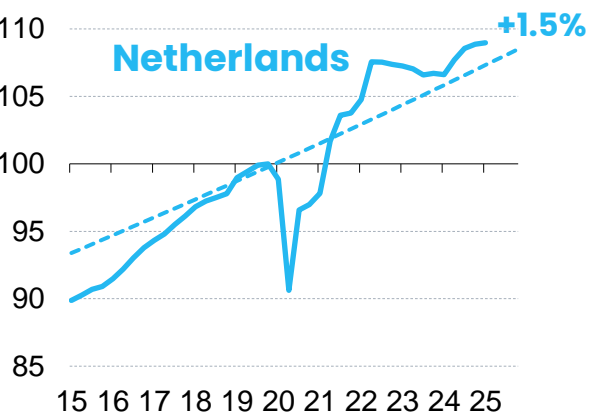
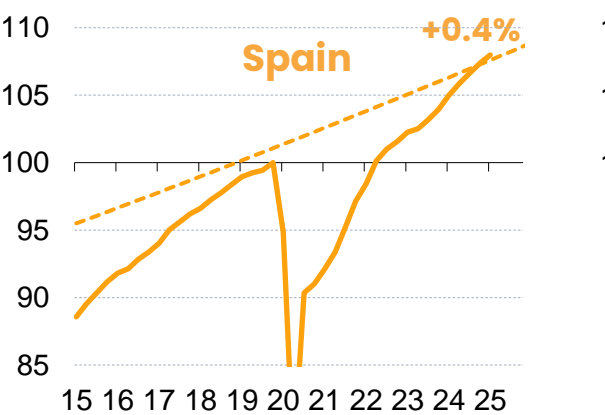
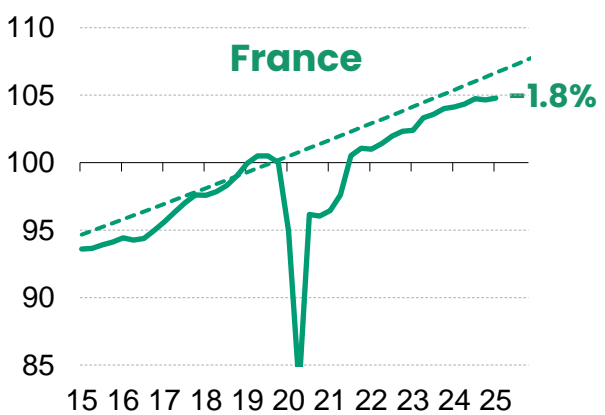
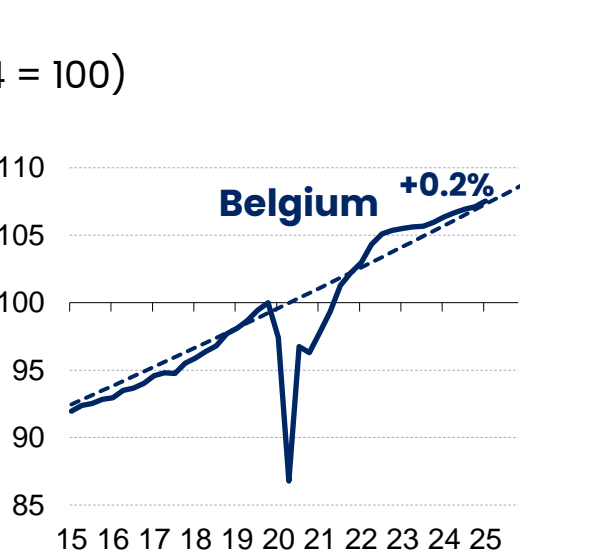
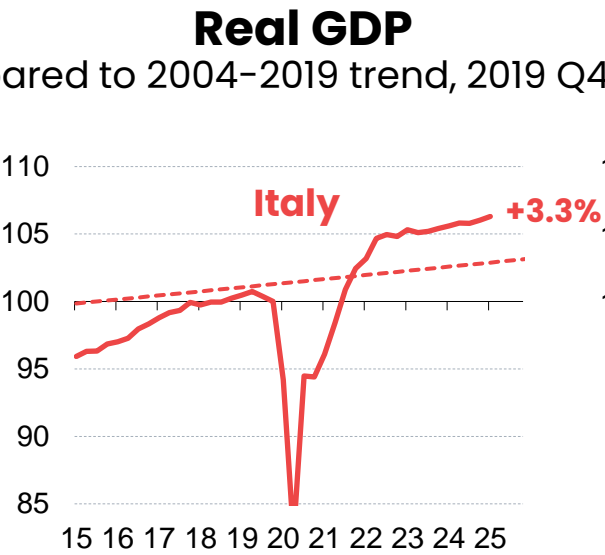
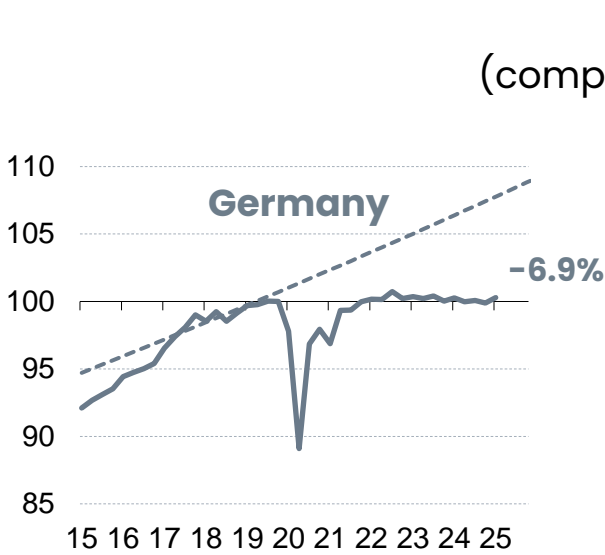
Size of world debt market (\$ billion, end 2024)



3 Euro area Challenged by Trump Administration...

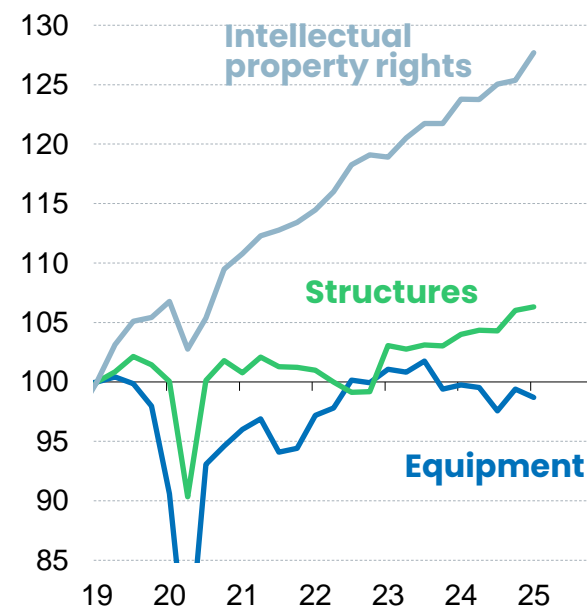
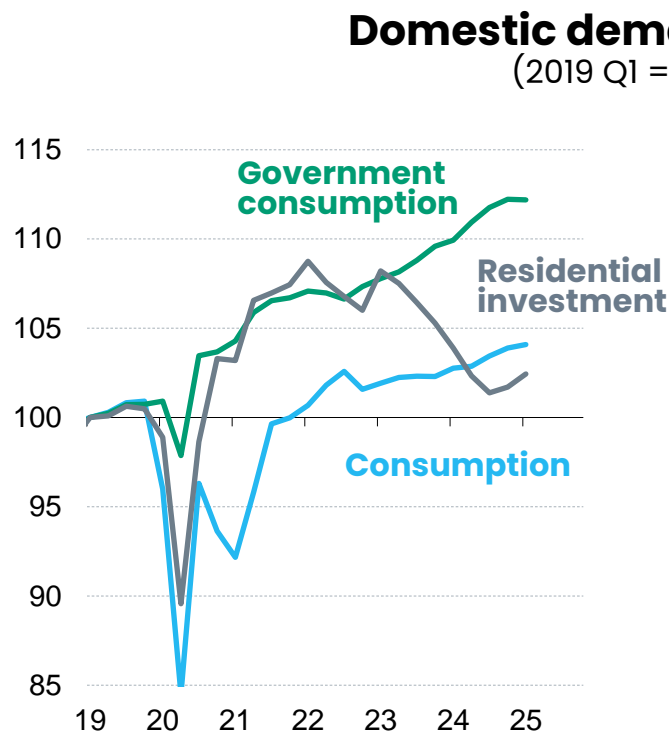
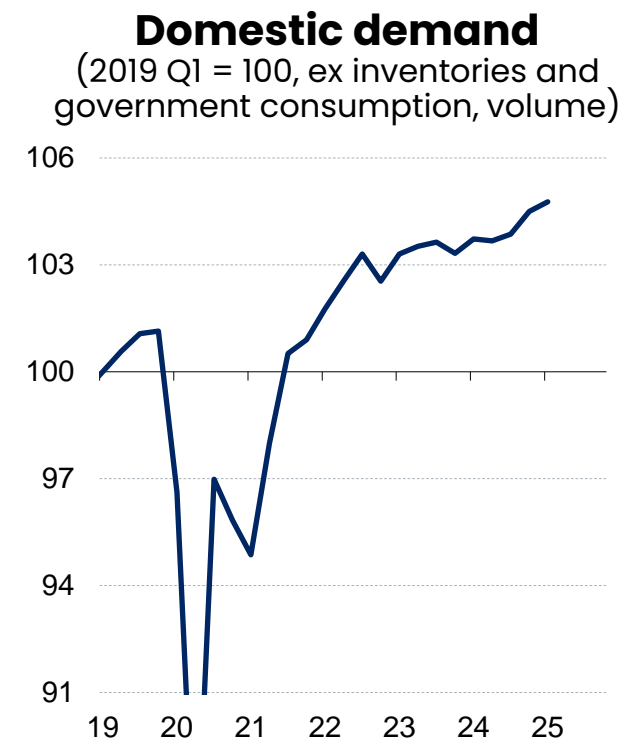


In early 2025, GDP was growing moderately in the euro area and remained well below its pre-covid trend in Germany



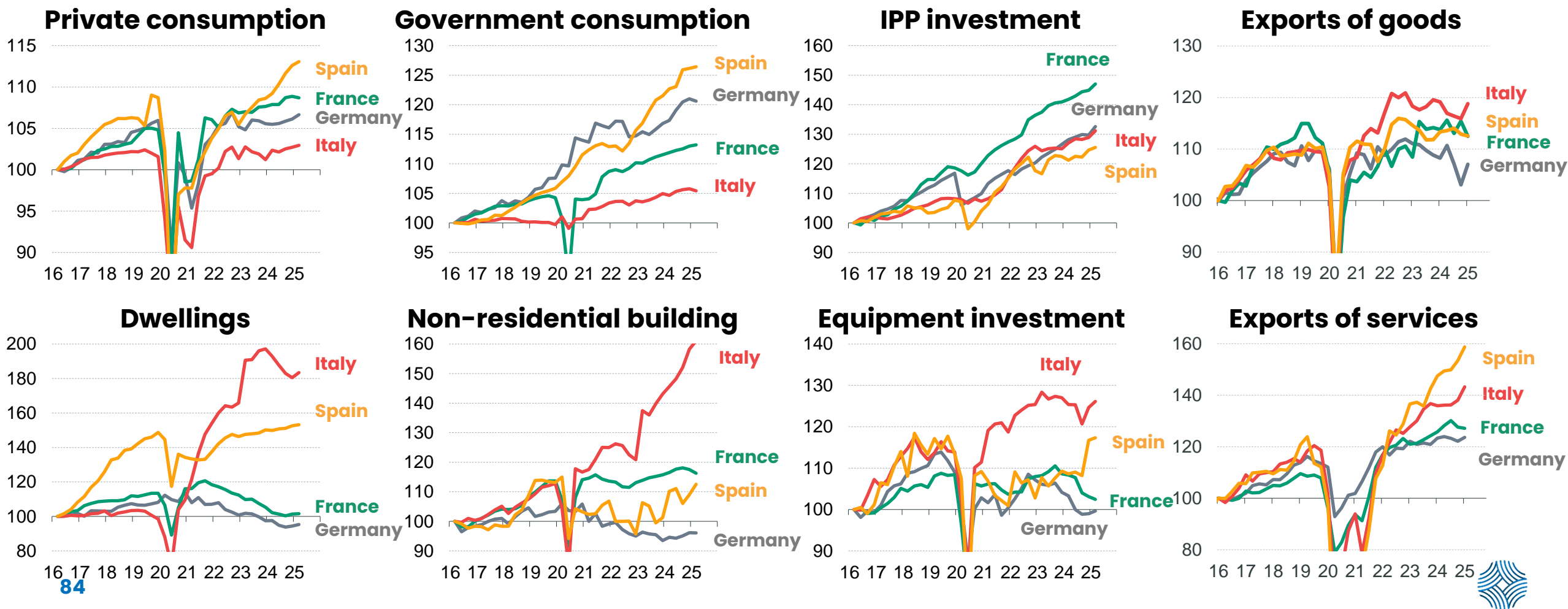
Since last summer, domestic demand has picked up

Euro area ex Ireland domestic demand



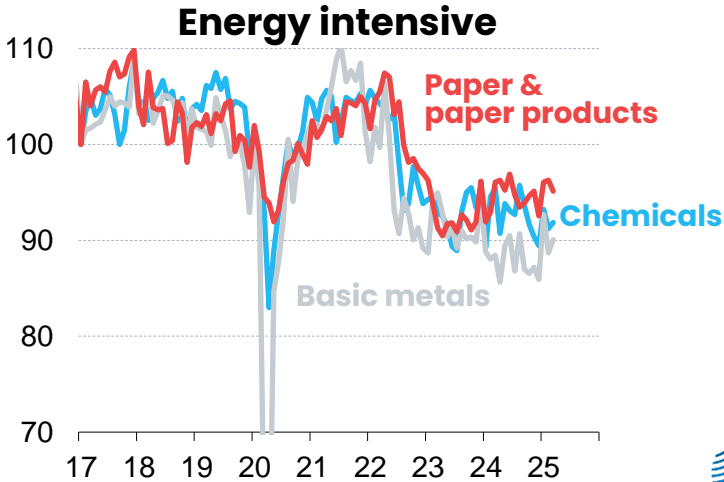
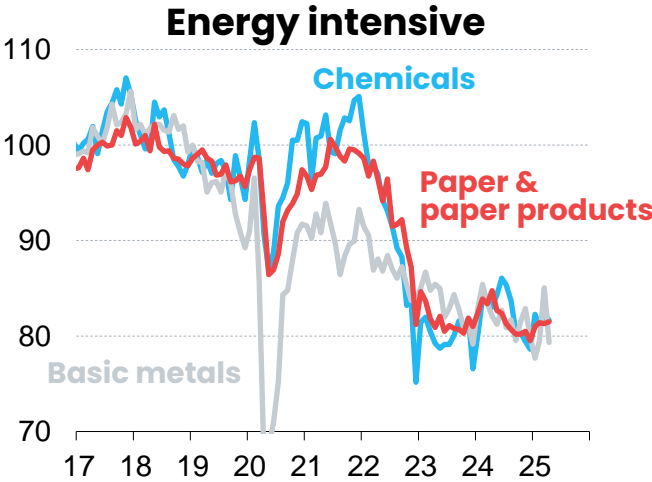
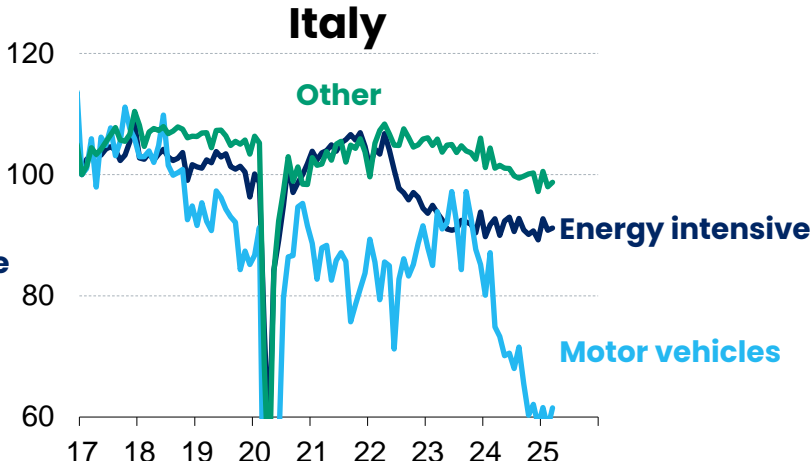
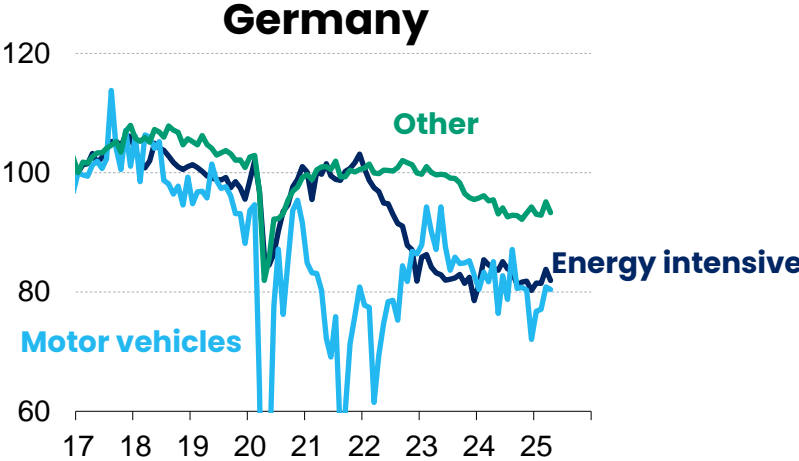
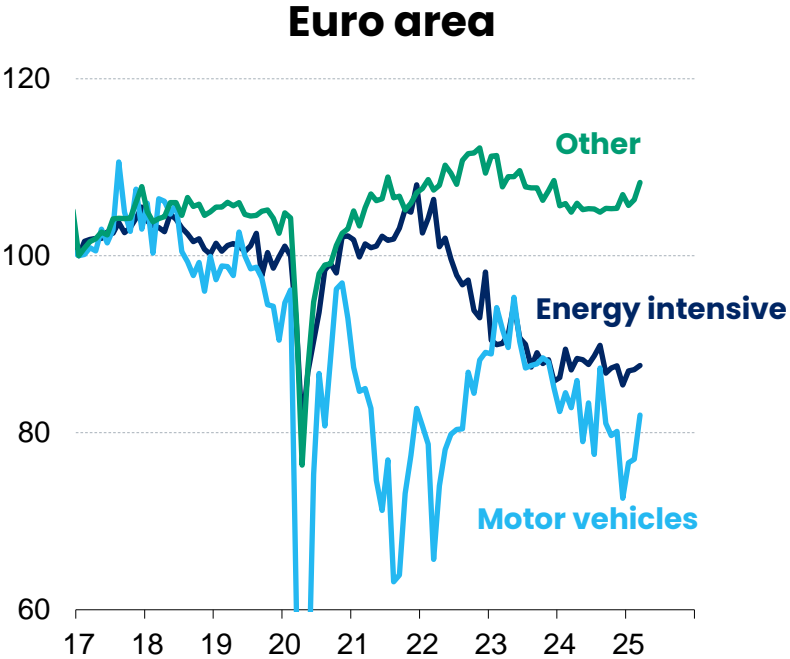
GDP components' evolution has been rather different across countries

(2016 Q1 = 100, volume)



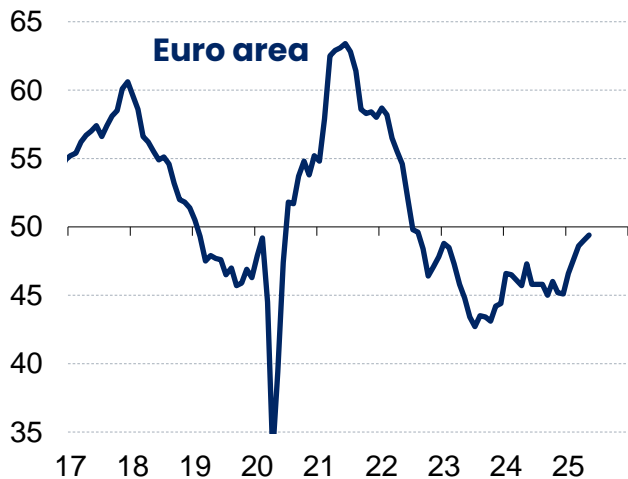
Industrial production is tentatively improving

Industrial production by sector
(January 2017 = 100)

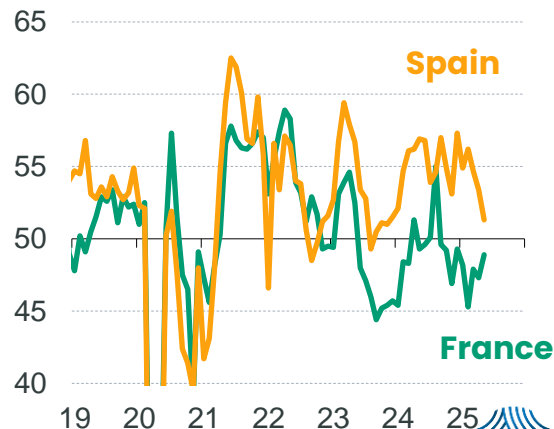
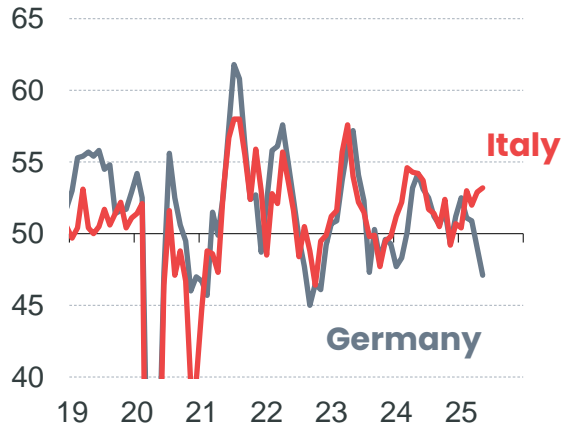
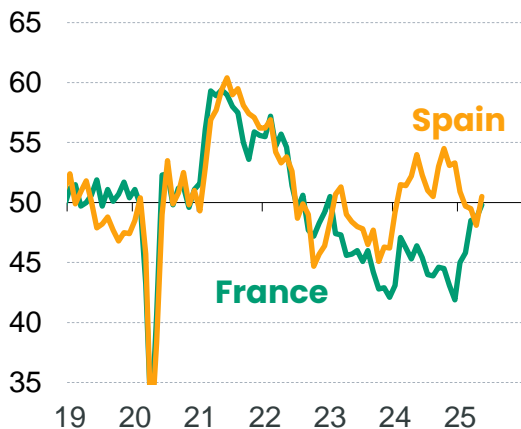
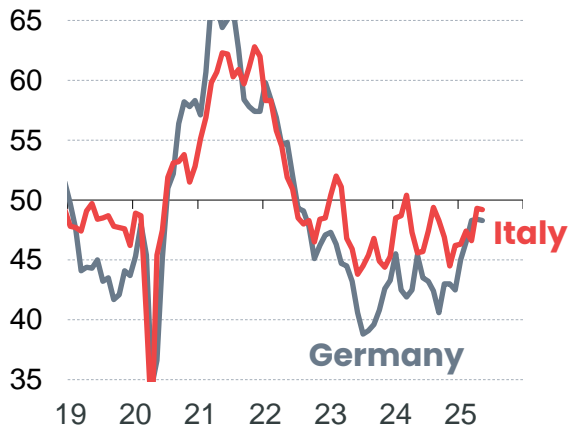
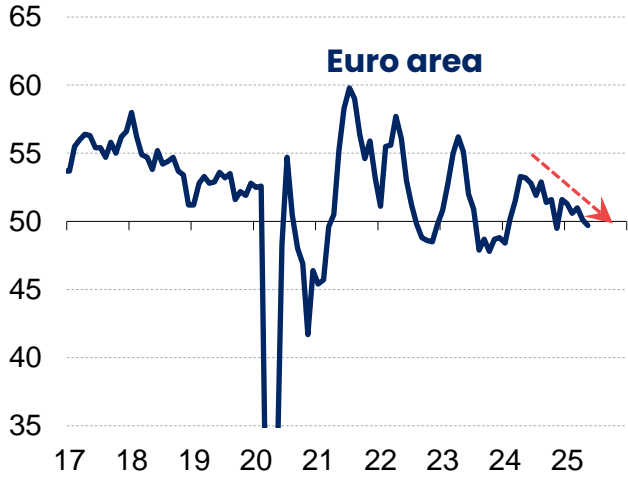


PMI indices improve in manufacturing... but weaken in services

Manufacturing PMIs

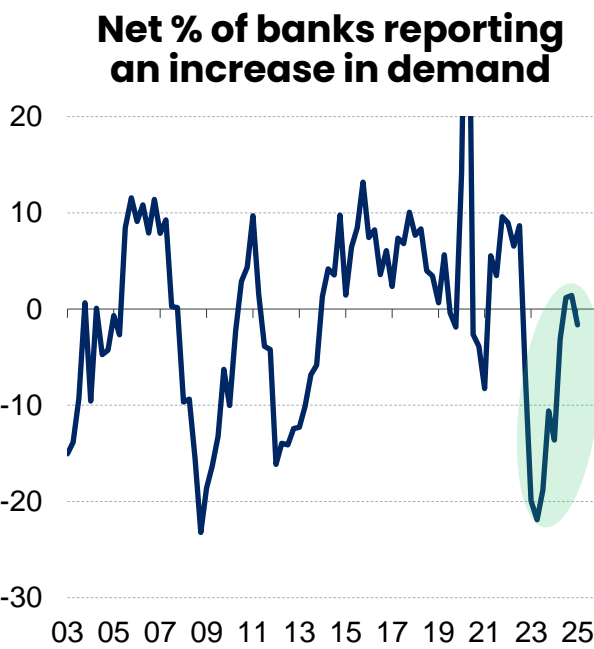
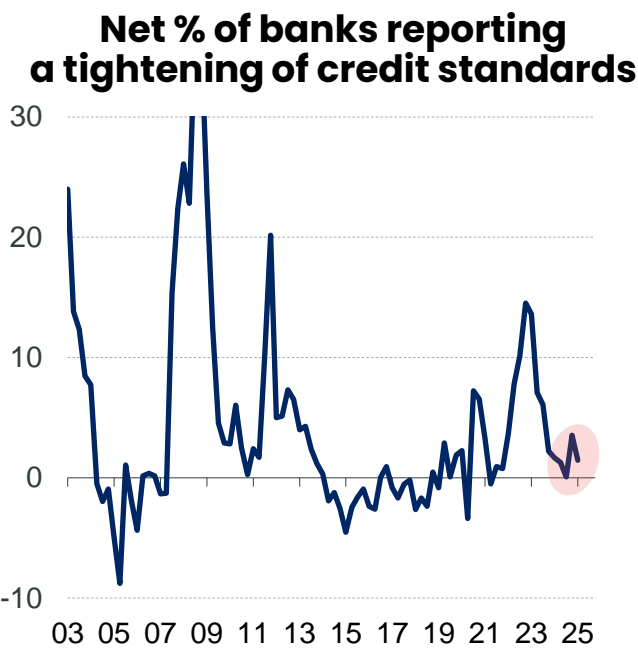


Services PMIs

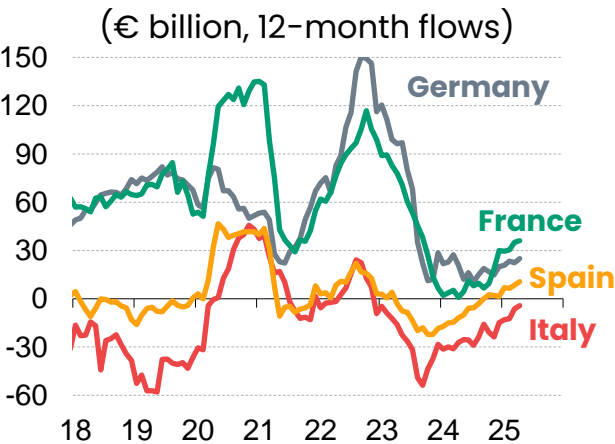
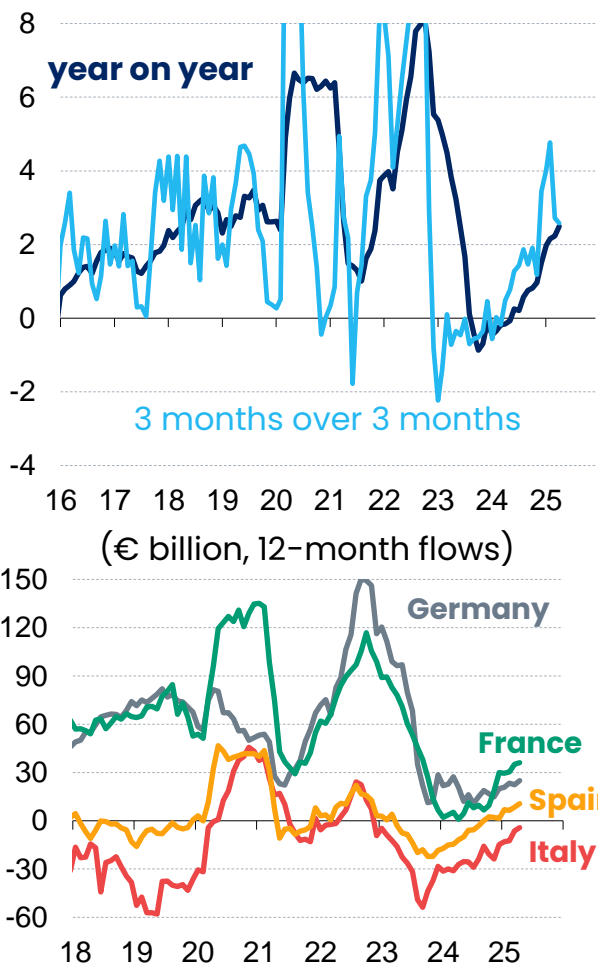


Loans to firms have picked up

Changes in credit standards to enterprises and demand for loans

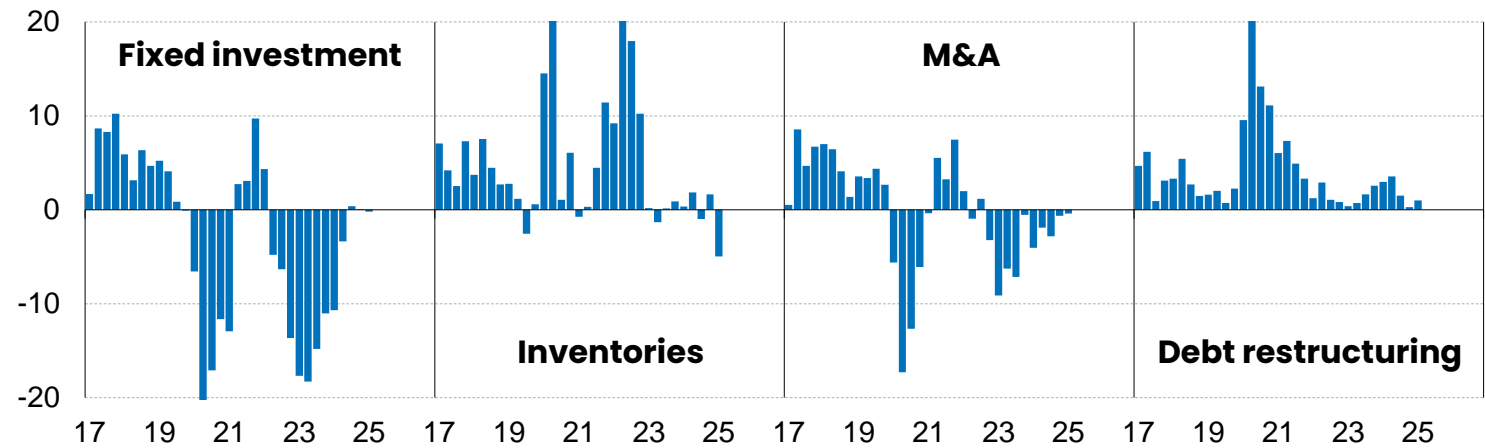


Loans to non-financial corporations (%, annual rate)

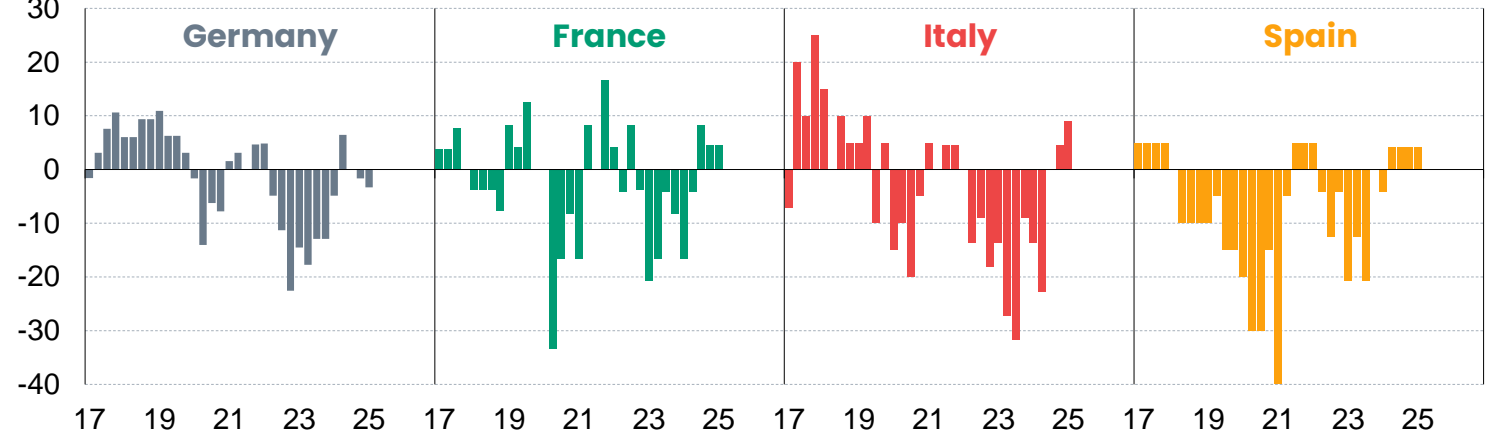


However, firms demand of loans for investment seems weak

Factors contributing to changes in demand for loans to enterprises
(net % of banks reporting an increase in demand)

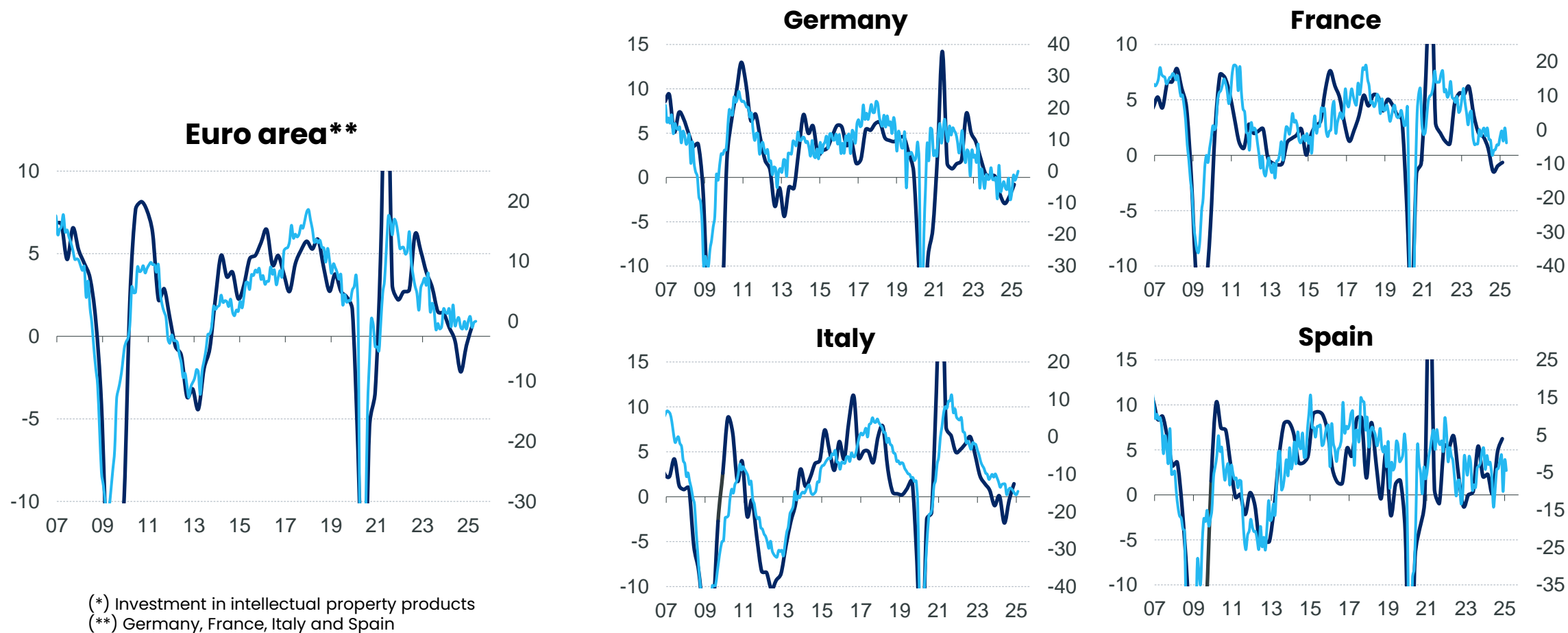


Firms' demand for loans – Fixed investment by country
(net % of banks reporting an increase in demand)



Business investment has little reasons to be robust

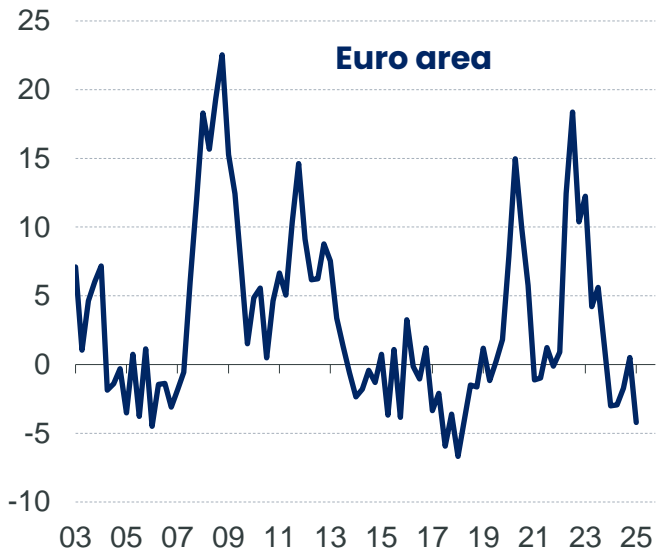
Equipment and IPP* investment versus perceived demand



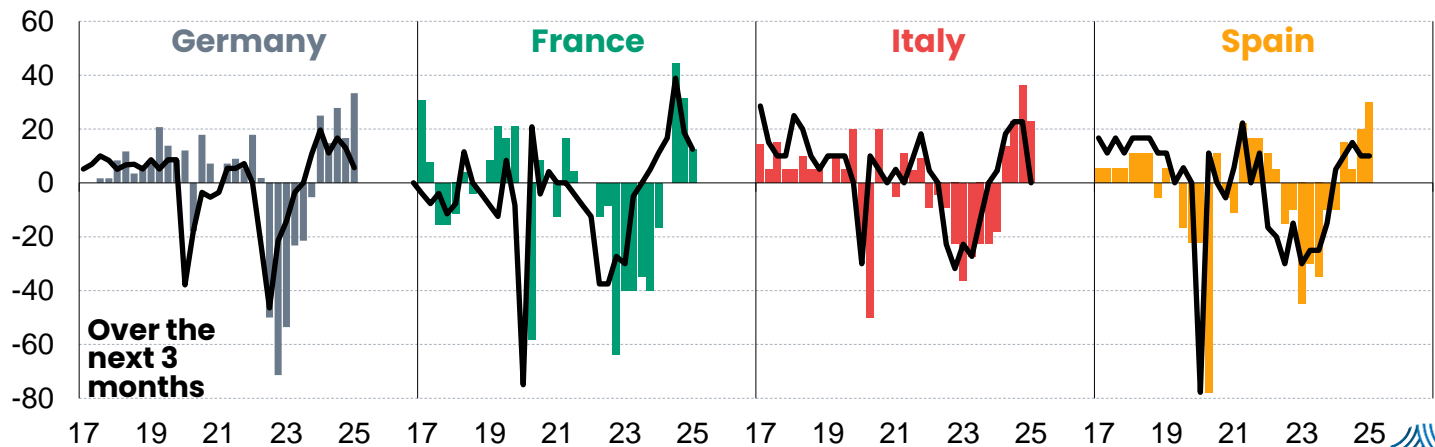
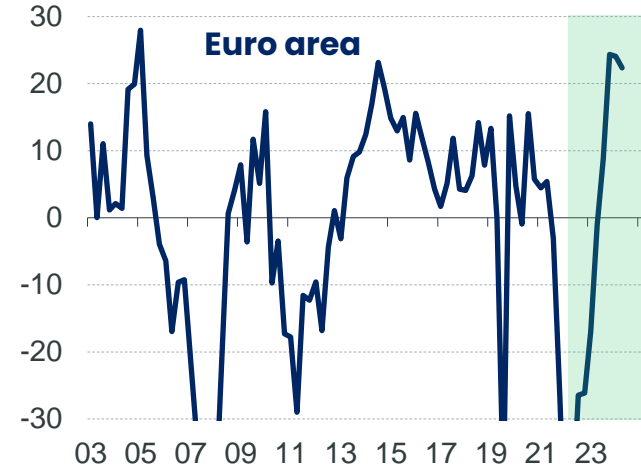
Lending conditions for mortgage loans have eased and demand is recovering

Changes in credit standards for house purchase loans

(net % of banks reporting a tightening of credit standards)

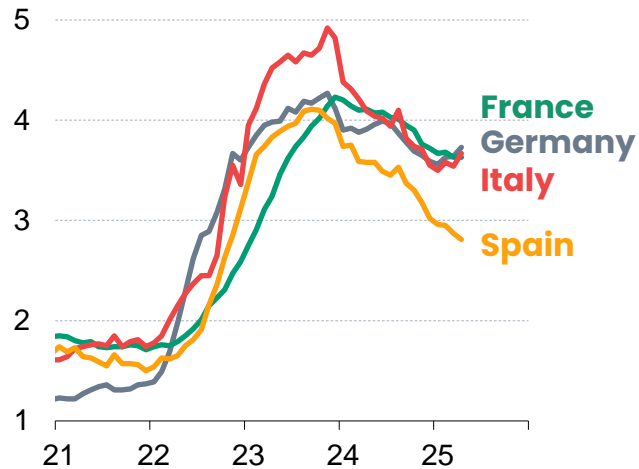


House purchase loans demand (net %)

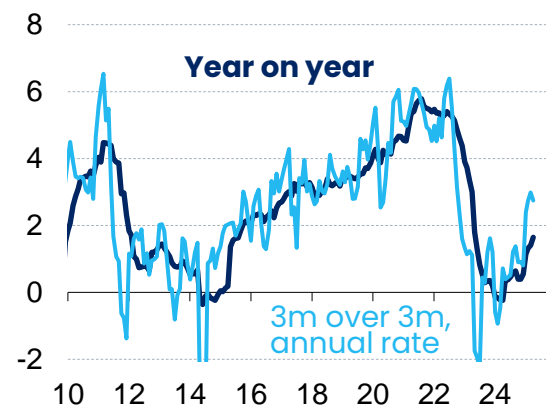


Mortgage loans are picking up... especially in Spain and Italy

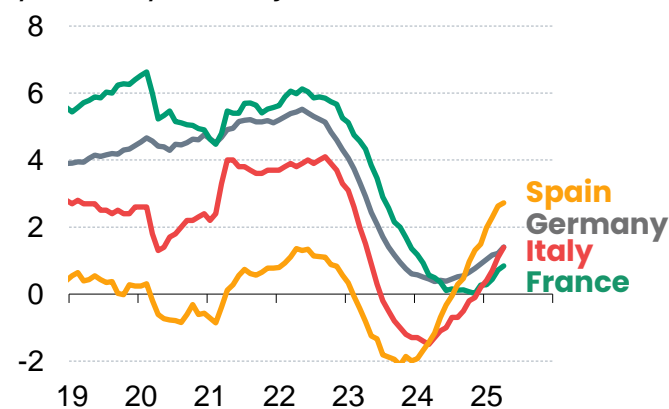
Mortgage interest rates
(%, new business)



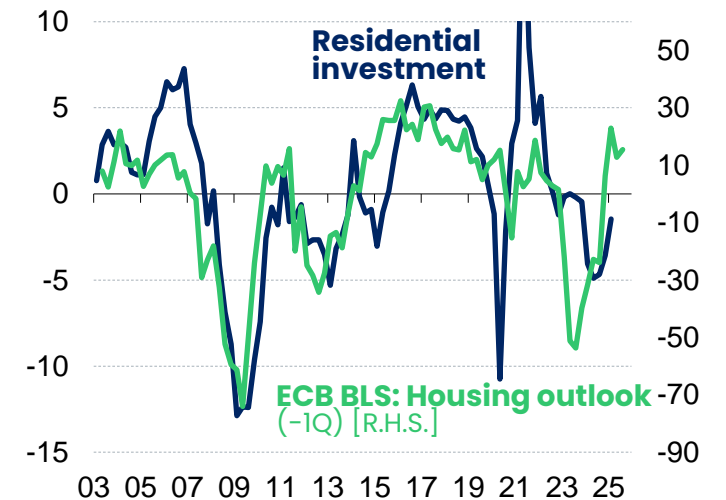
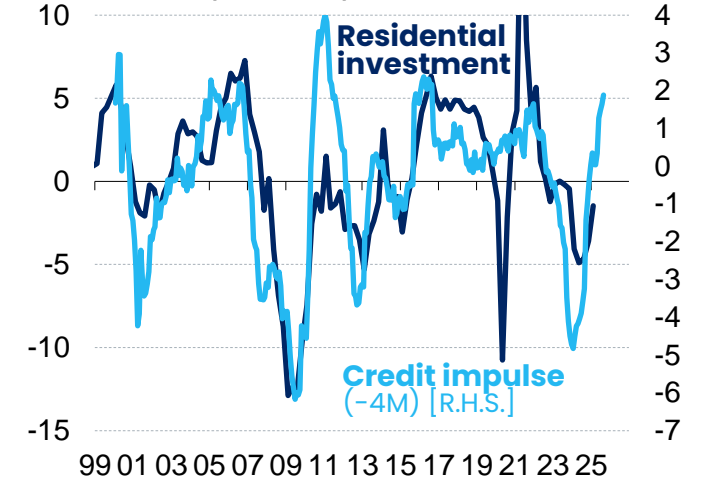
Loans for house purchase
(%)



Total loans to households
(% year on year, adjusted for securitization)

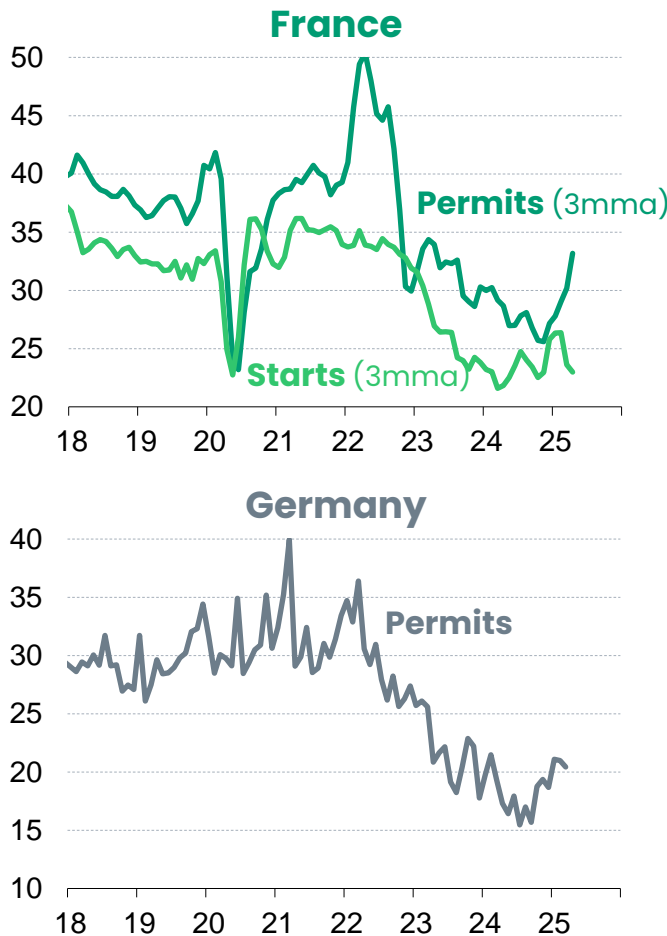
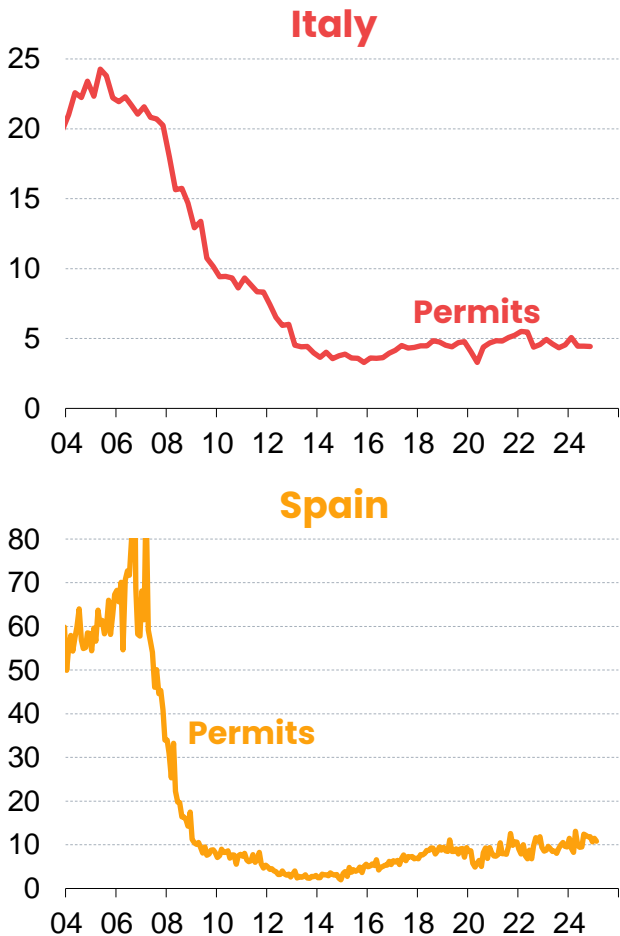


Residential investment
(% year on year, volume)

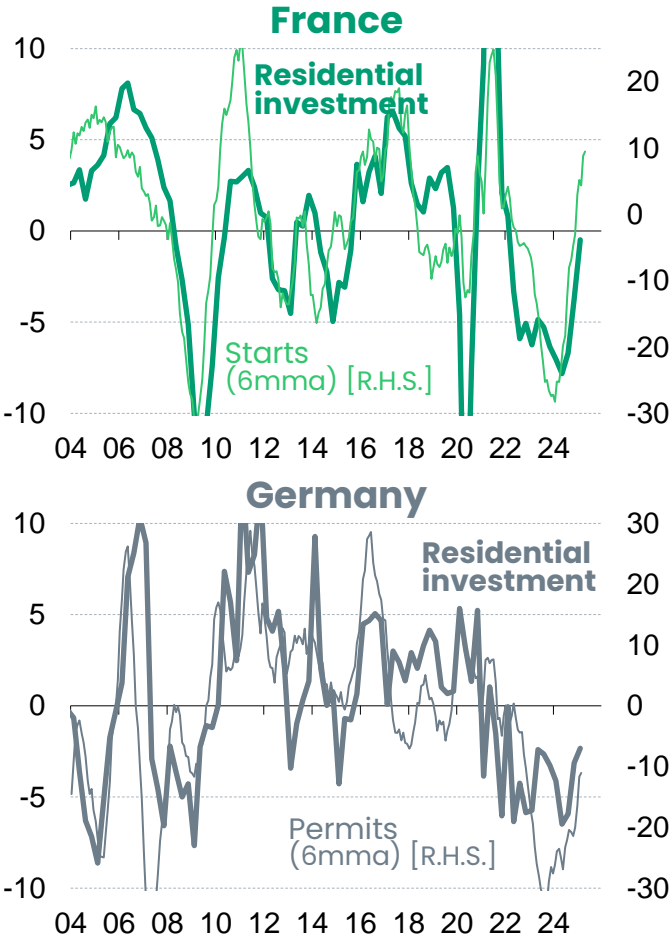


Housing activity gives signs of bottoming out

Housing permits and starts
(thousands of dwellings, monthly rate)

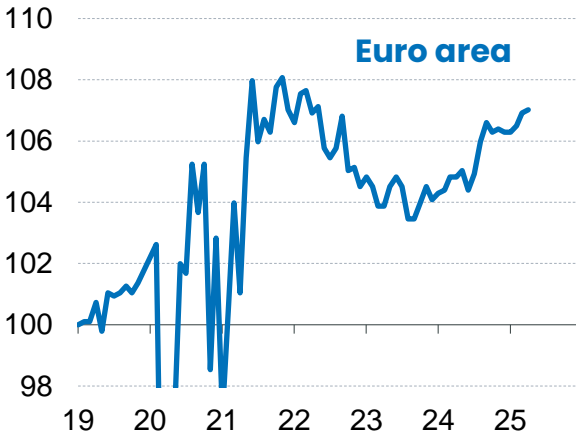


Residential investment
(% year on year, volume)

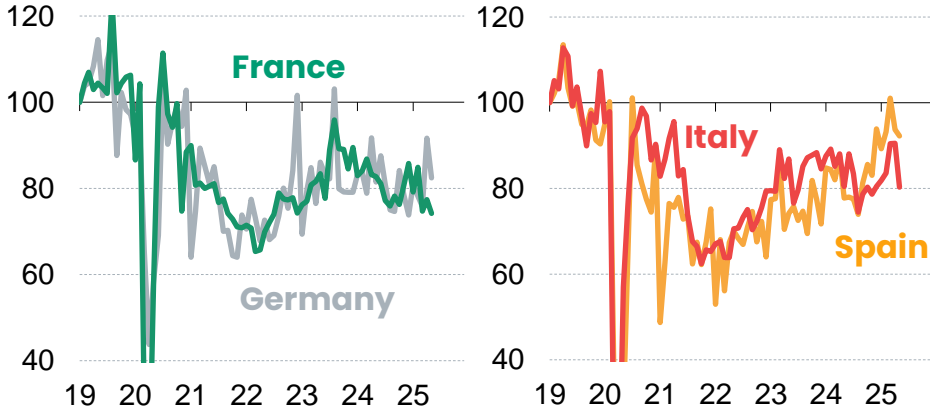
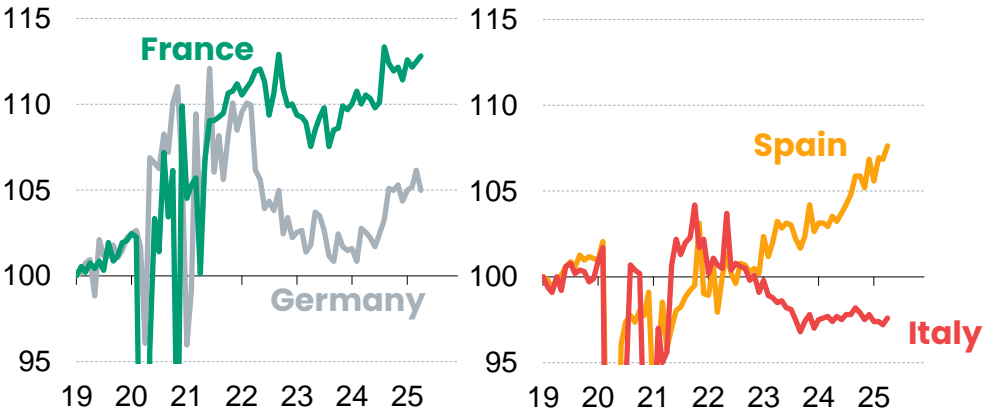
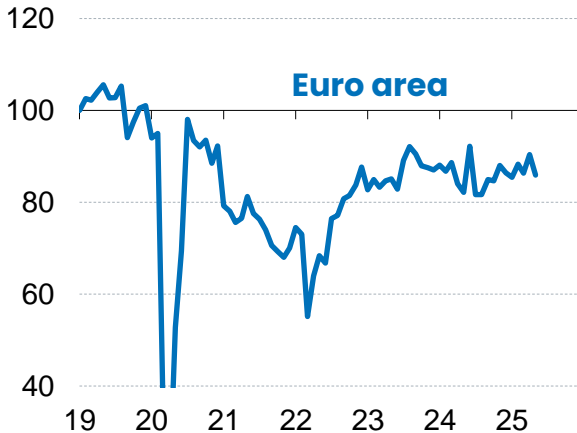


Retail sales have been better oriented at the beginning of this year

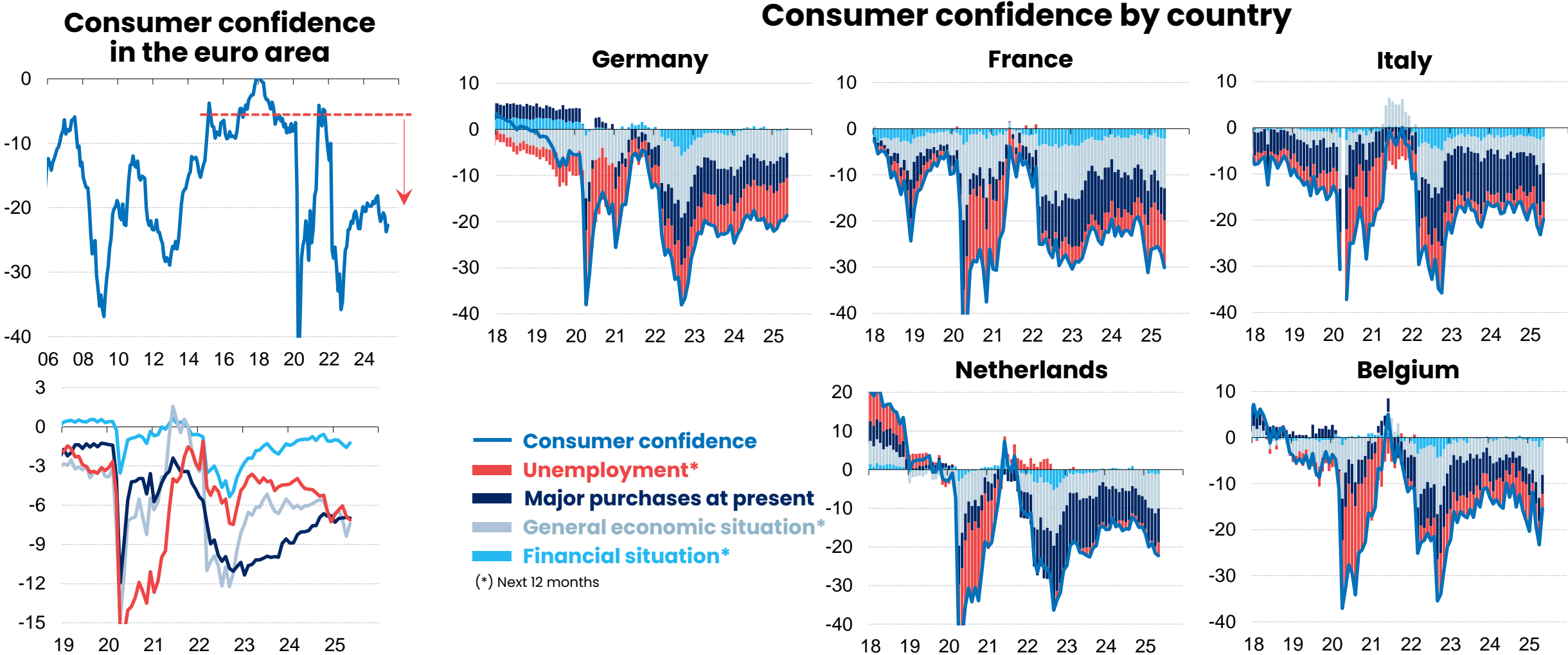
Euro area retail sales
(January 2019 = 100, ex motor vehicles, volume)



New car registrations
(January 2019 = 100)

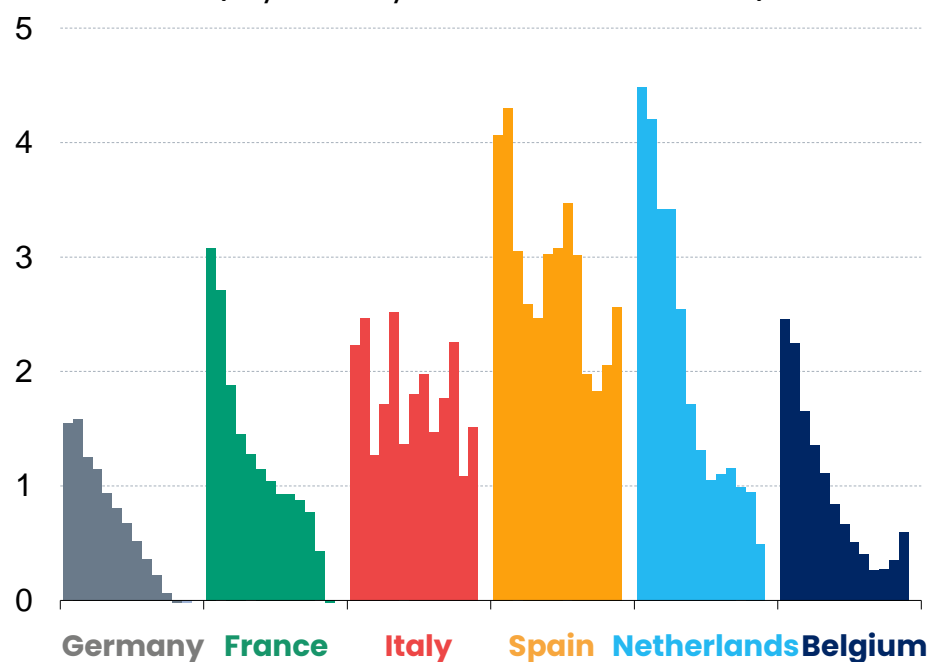


Households worry about the general economic situation

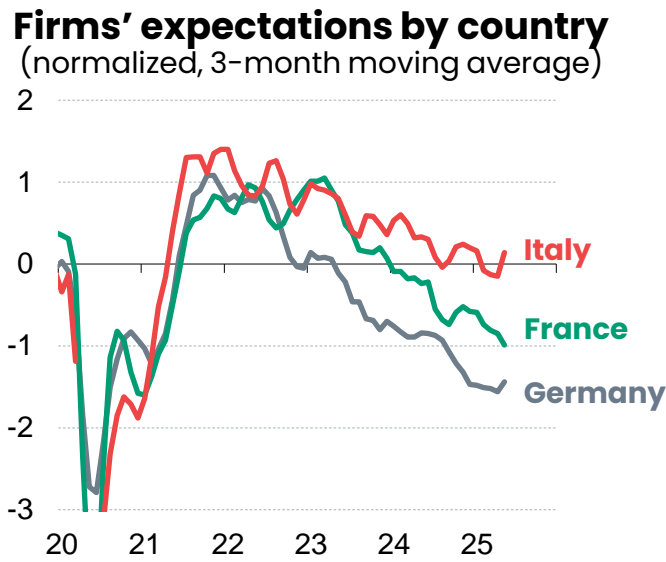
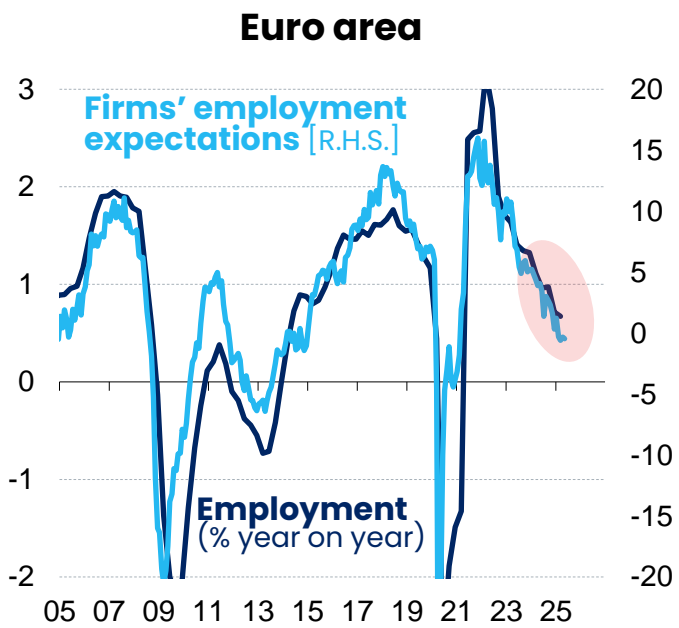


So far, the slowdown in job creations has remained orderly

Employment growth
(% year on year, 2022 Q1 – 2025 Q1)

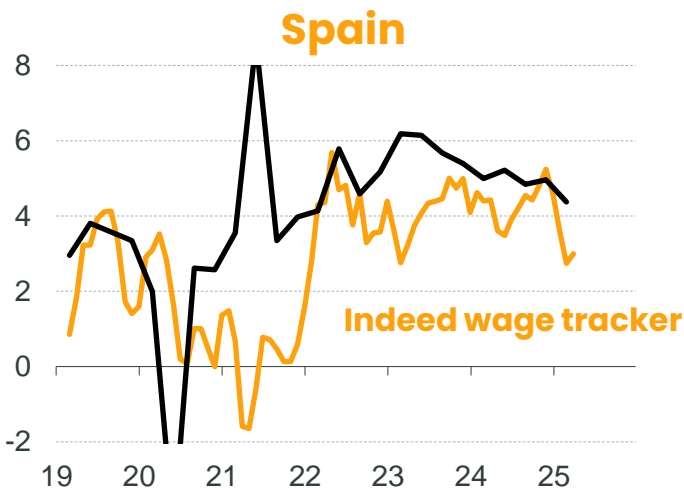
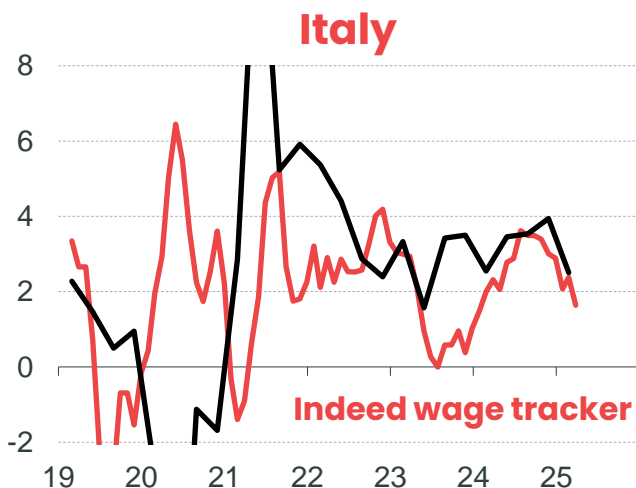
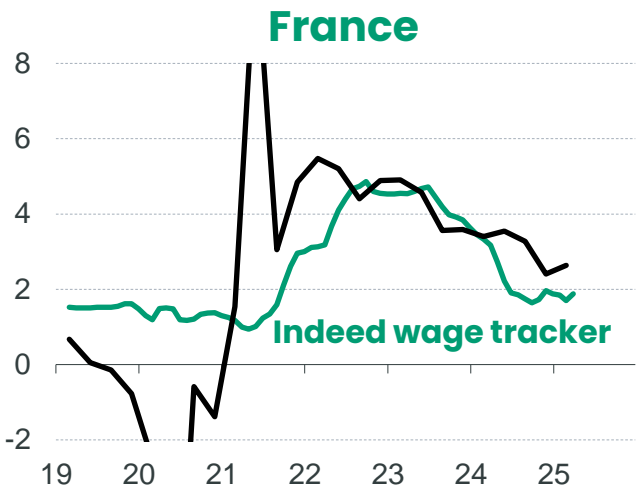
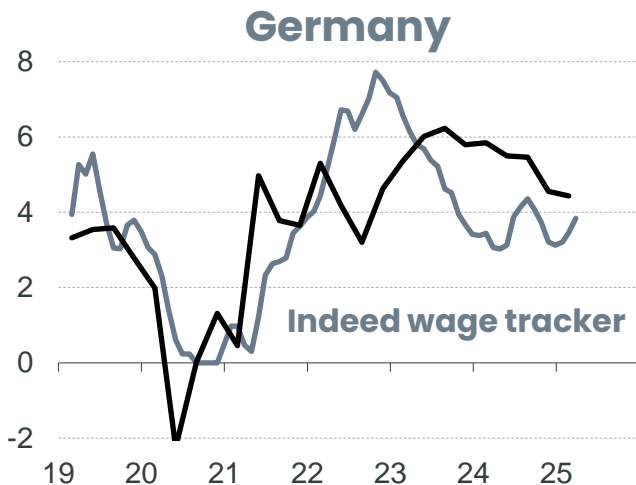
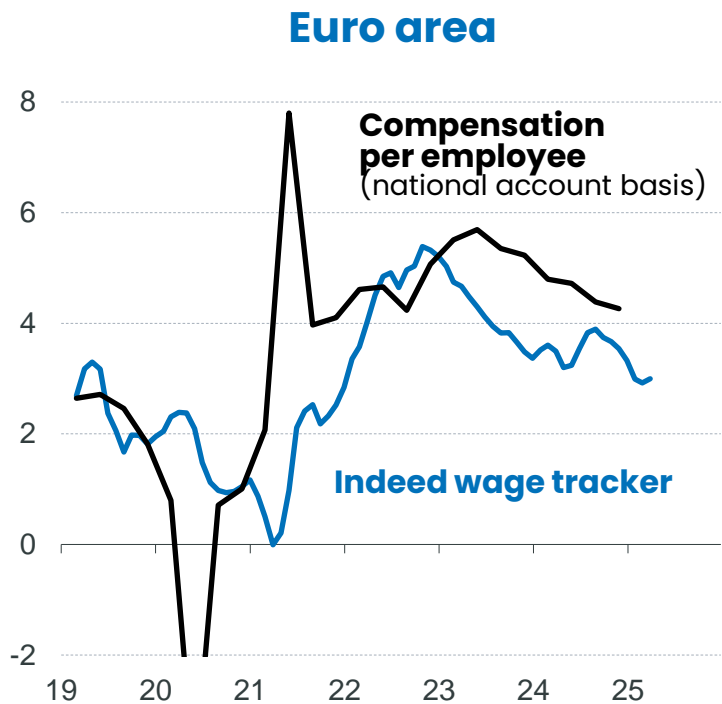


Employment and firms' expectations
(EC survey)

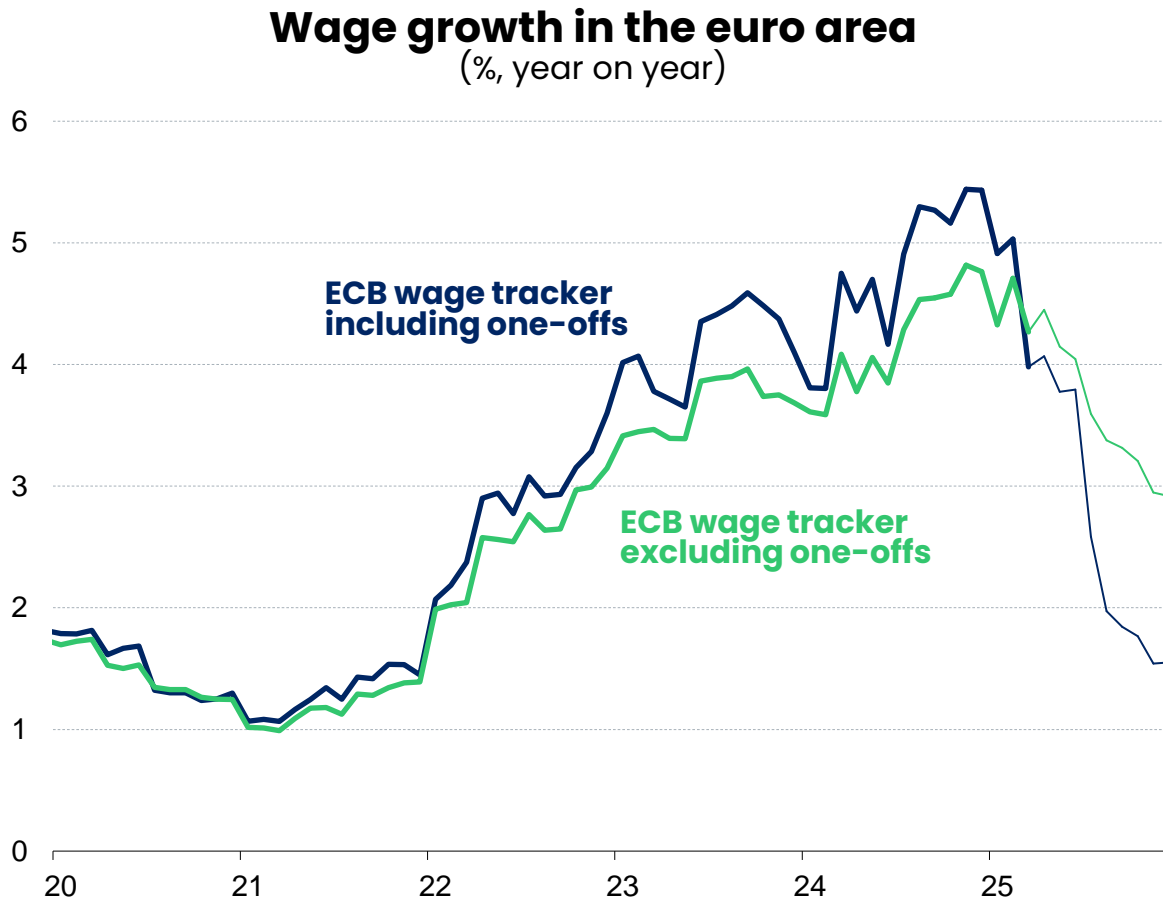


Wages have been decelerating...

Compensation per employee (% year on year)



... and wage negotiations point to a further slowdown



The **ECB wage tracker** uses granular data from collective bargaining agreements that are already in place. Contract by contract information from thousands of agreements between trade unions and employer associations is collected and aggregated. It currently covers developments in Germany, France, Italy, Spain, the Netherlands, Greece and Austria.

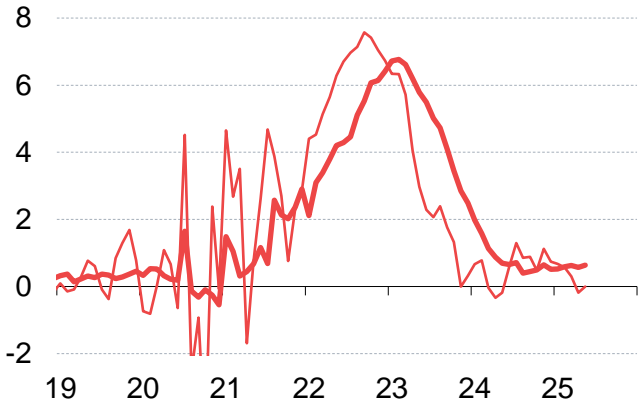


Consumer price inflation pressures continue to ease

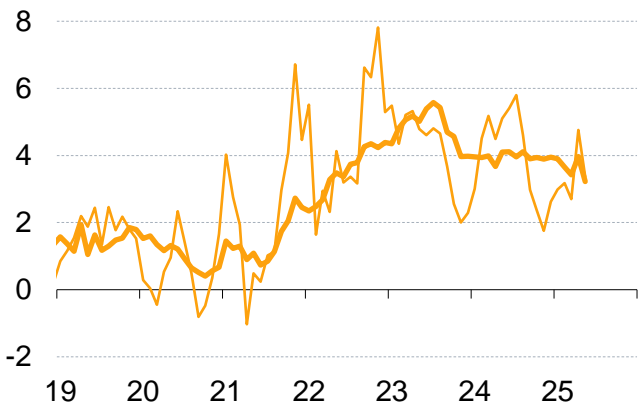
Core CPI inflation
(% annual rate)



Core goods



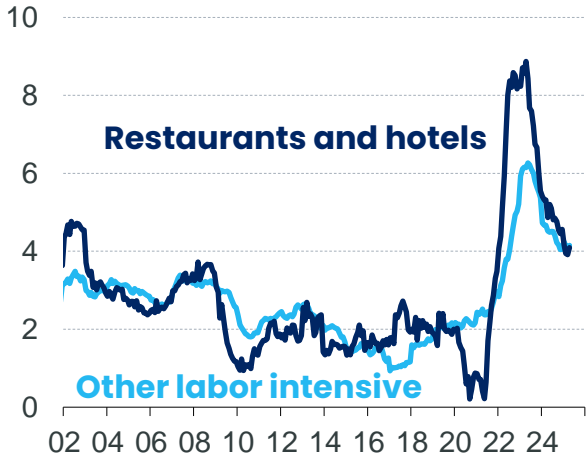
Core services



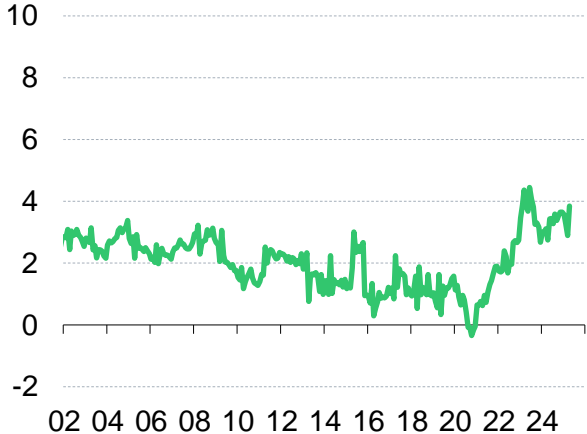
Core services CPI

(% year on year)

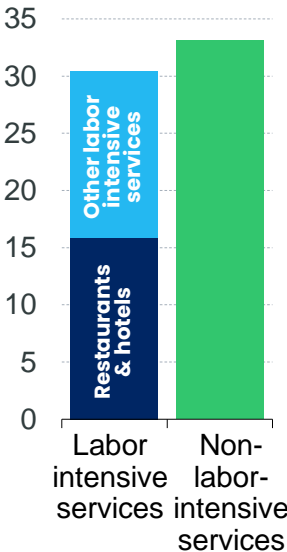
Labor intensive services



Non-labor-intensive services

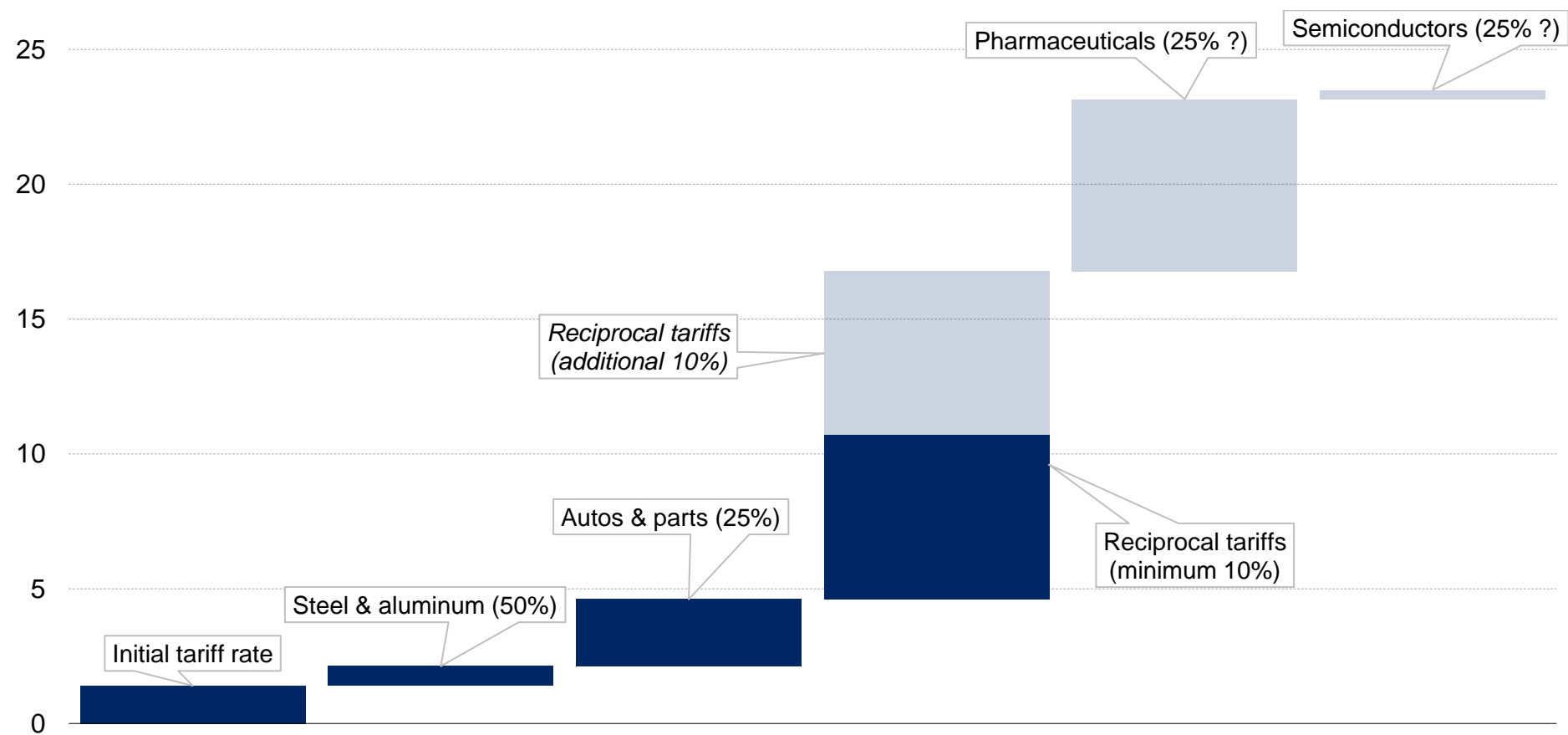


(% share in core CPI)



The final level of US tariffs on Europe is unknown

Tariff rate on US imports from EU (%)



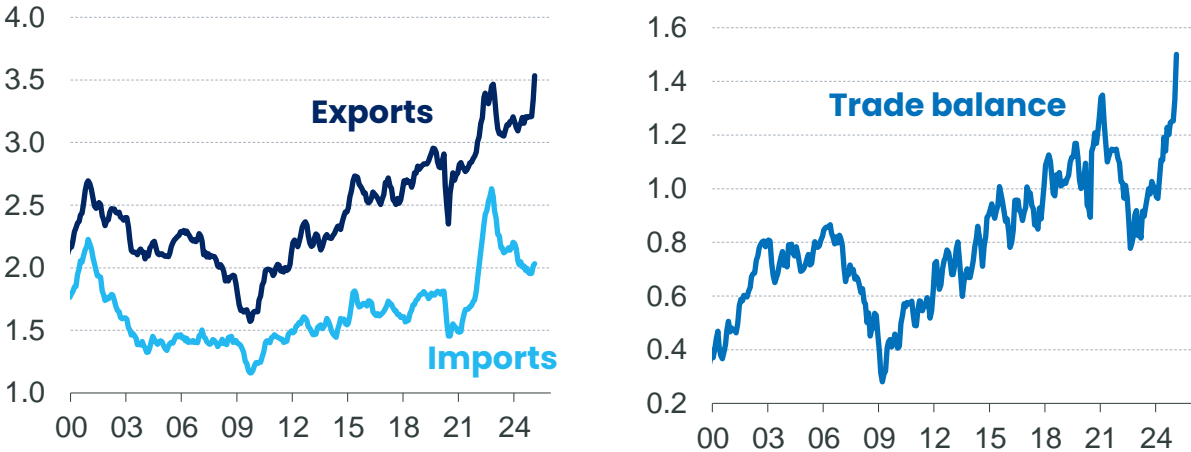
Proposed Section 899 targets corporations, individuals, and governments of countries that impose discriminatory (for instance: **digital service tax**) on US citizens or corporations by subjecting them to increased US tax rates. Under the new tax bill, the U.S. would hit investors from such countries by **increasing taxes on U.S. income by 5 percentage points each year, potentially taking the rate up to 20%.**



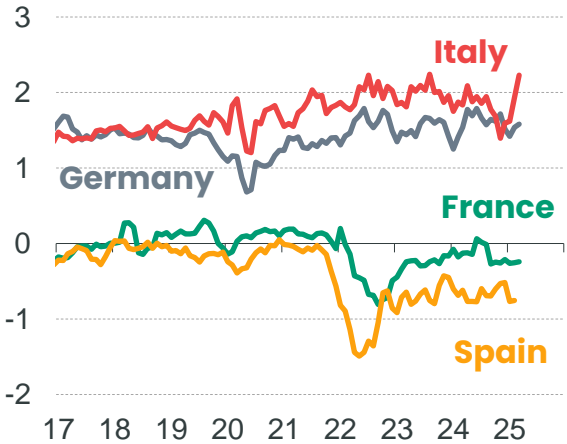
The euro area is vulnerable to a rise in US tariffs...

External trade of goods with the United States
(% of GDP)

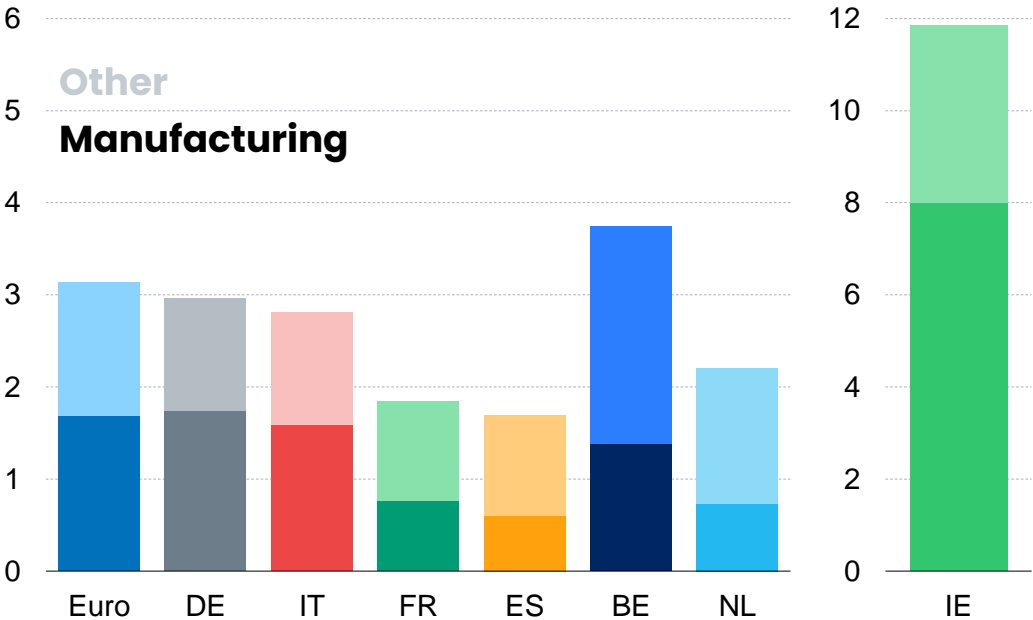
Euro area



Trade balance by country

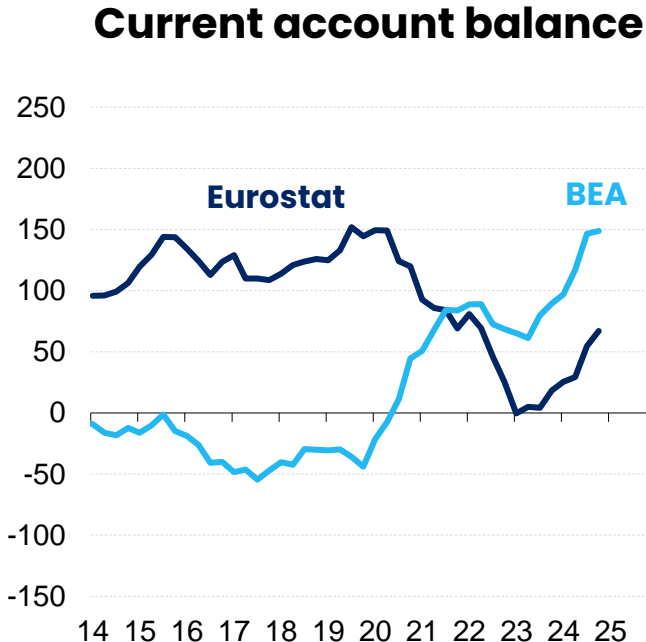
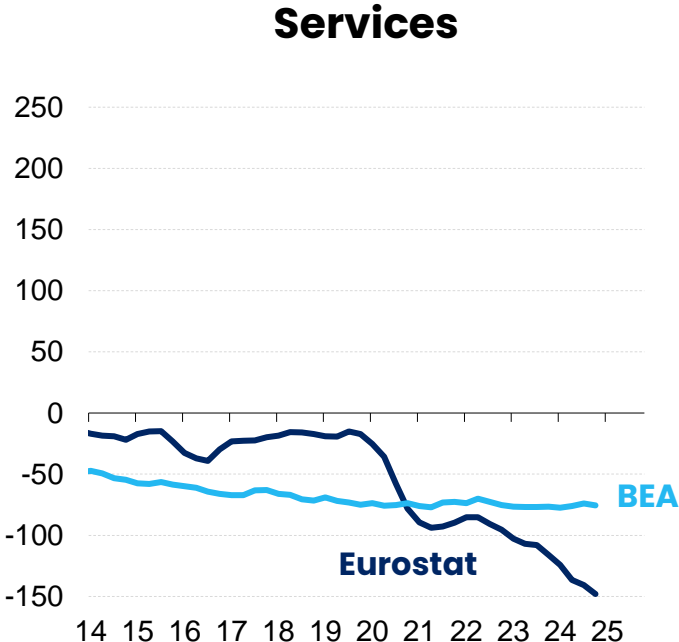
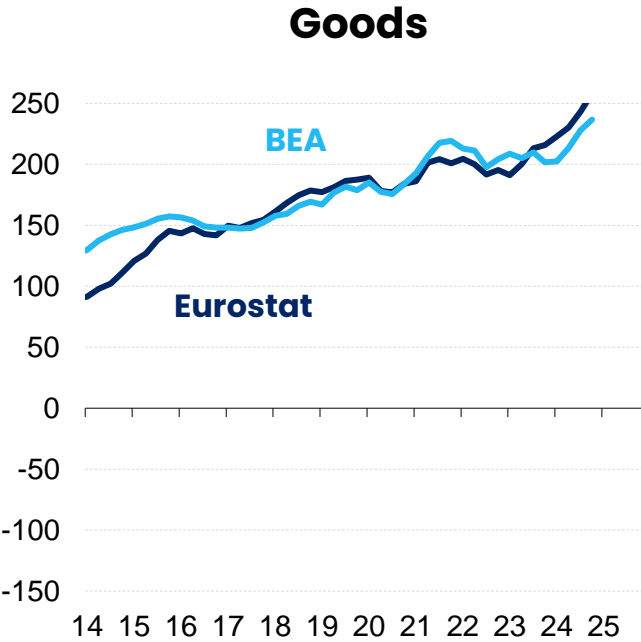


Country's value-added content
in exports to the United States
(% of country's GDP, 2019)



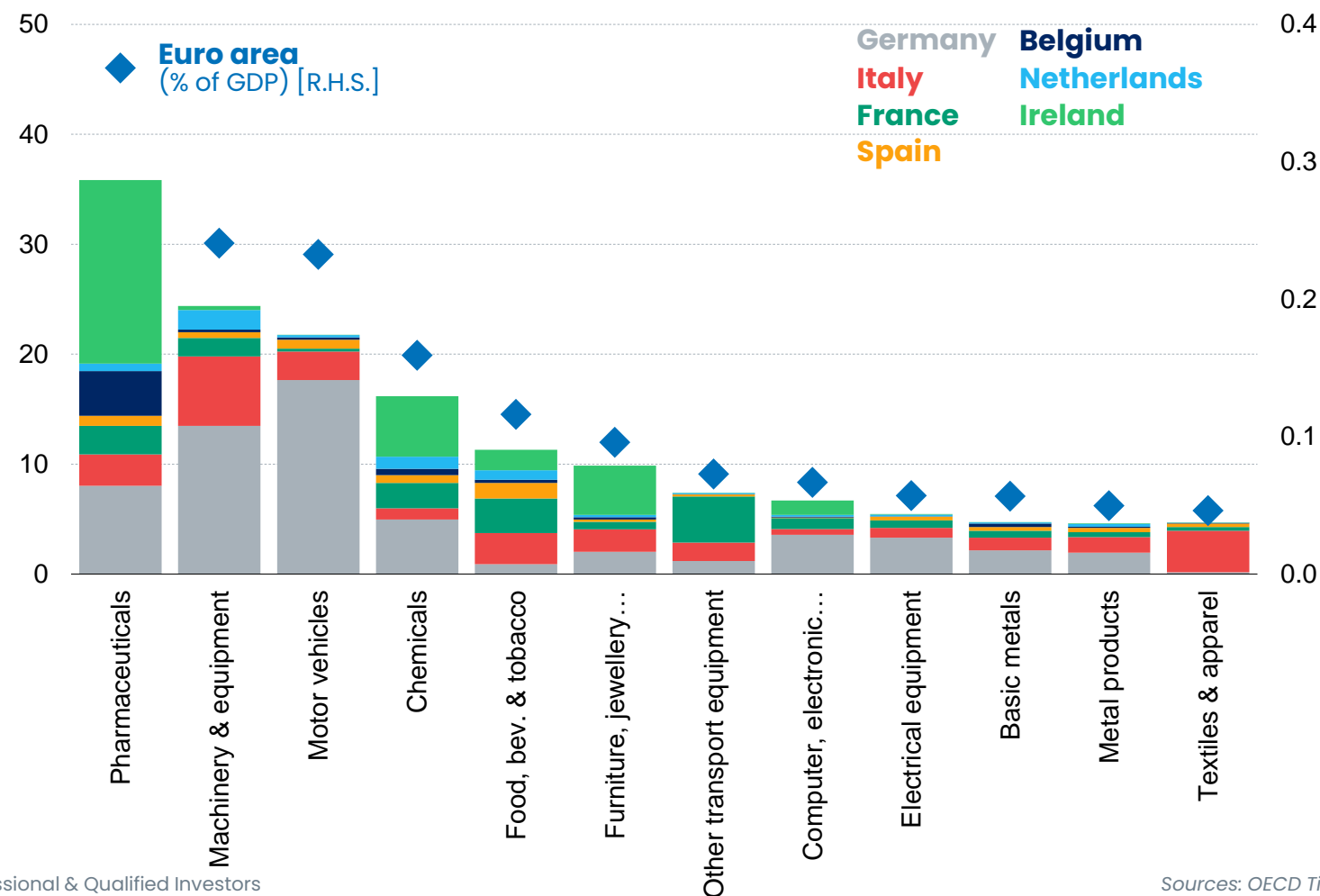
Memo. The EU27 current account surplus with the United States is much smaller than the surplus on trade in goods

European trade balance and current account balance with the United States
(billions of local currency, annual rate)



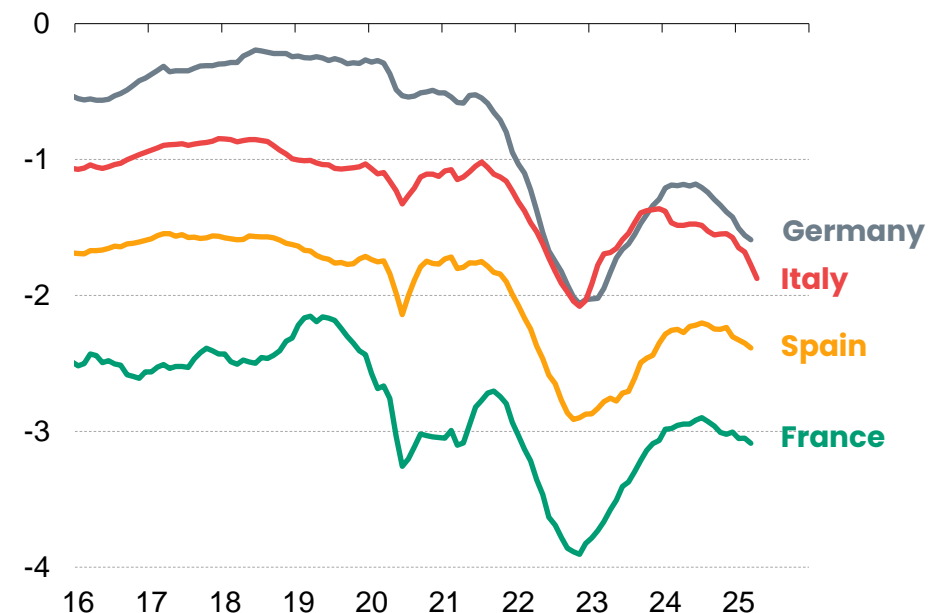
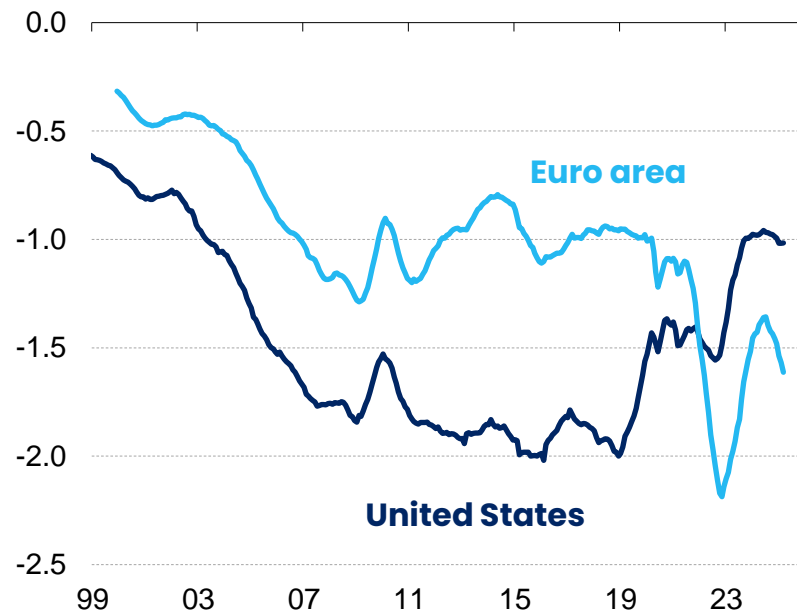
Memo. Pharma, automobile but also equipment and chemicals industries are heavily dependent on US demand

Country's value added in exports to the United States by type of goods
(\$ billion, 2019)



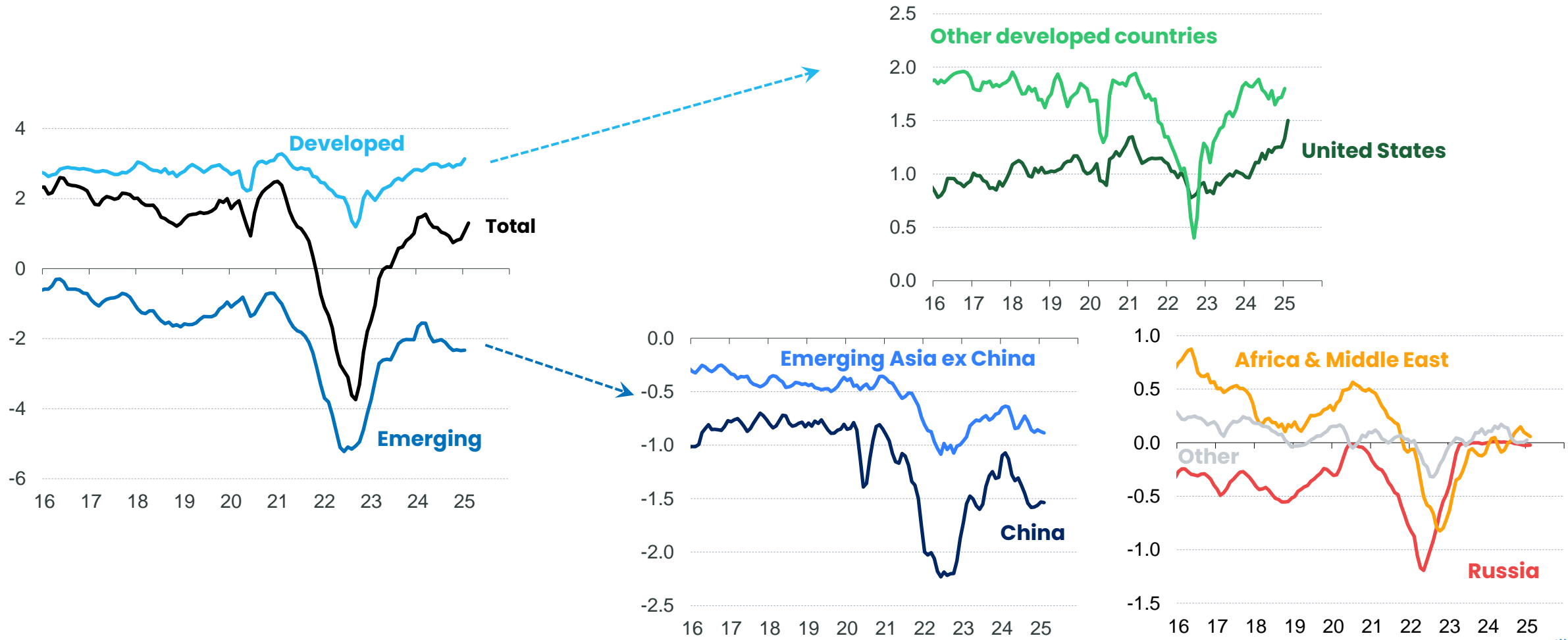
GDP growth could also be fragilized if China tries to increase its penetration of European markets

Bilateral balance with China
(% of country's GDP%, 12-month moving average)



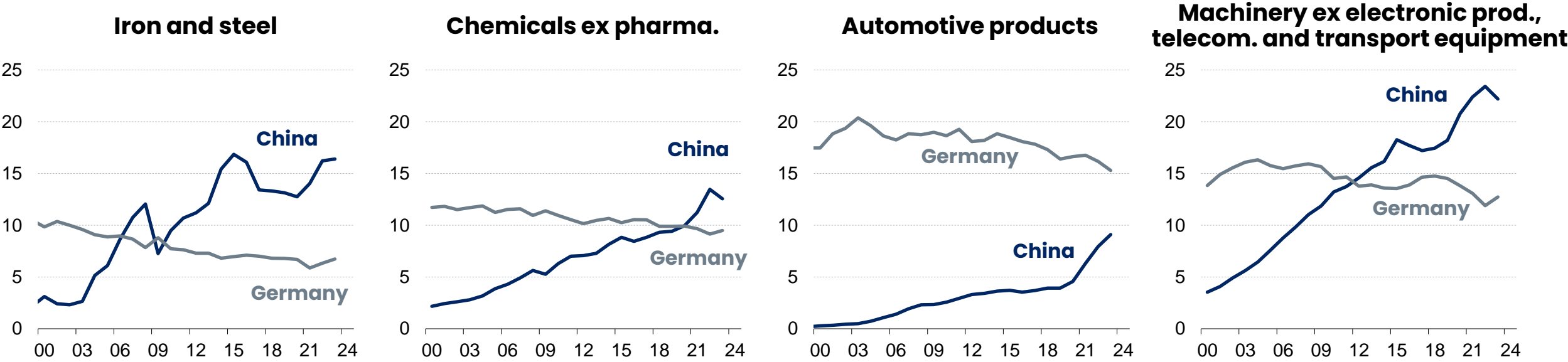
Memo. Euro area external balance by regions

Euro area external trade balance
(% of GDP, 3-month moving average)



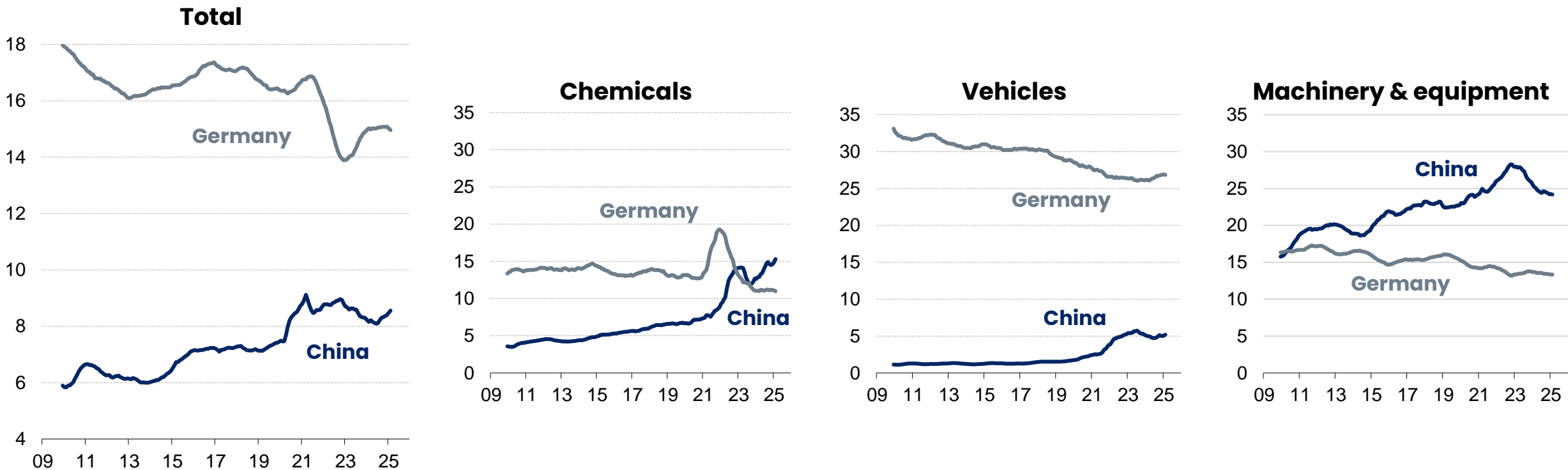
Germany has been suffering from Chinese competition on third markets

China and Germany share in world exports for some products (%)

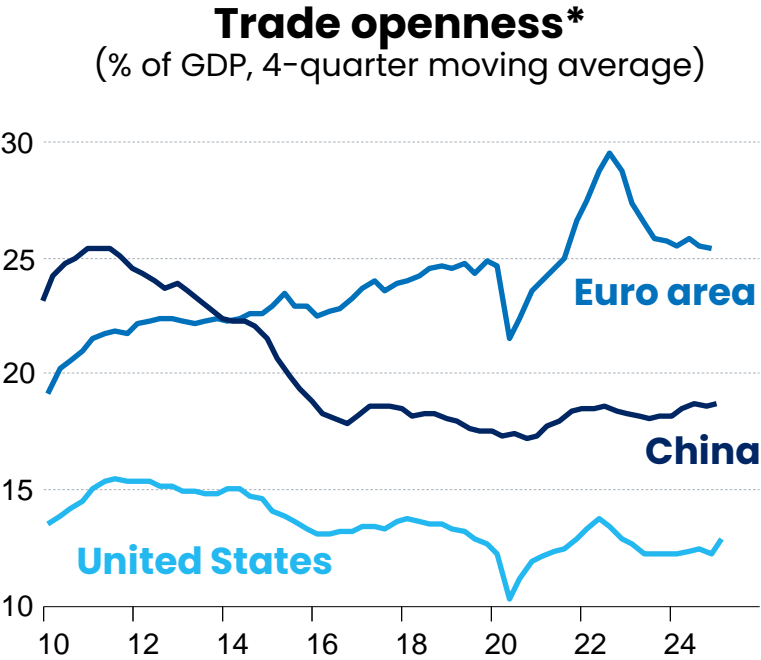


Germany has been suffering from Chinese competition on the European market in particular

China and Germany share in euro area imports by product
(% of euro area ex Germany imports)

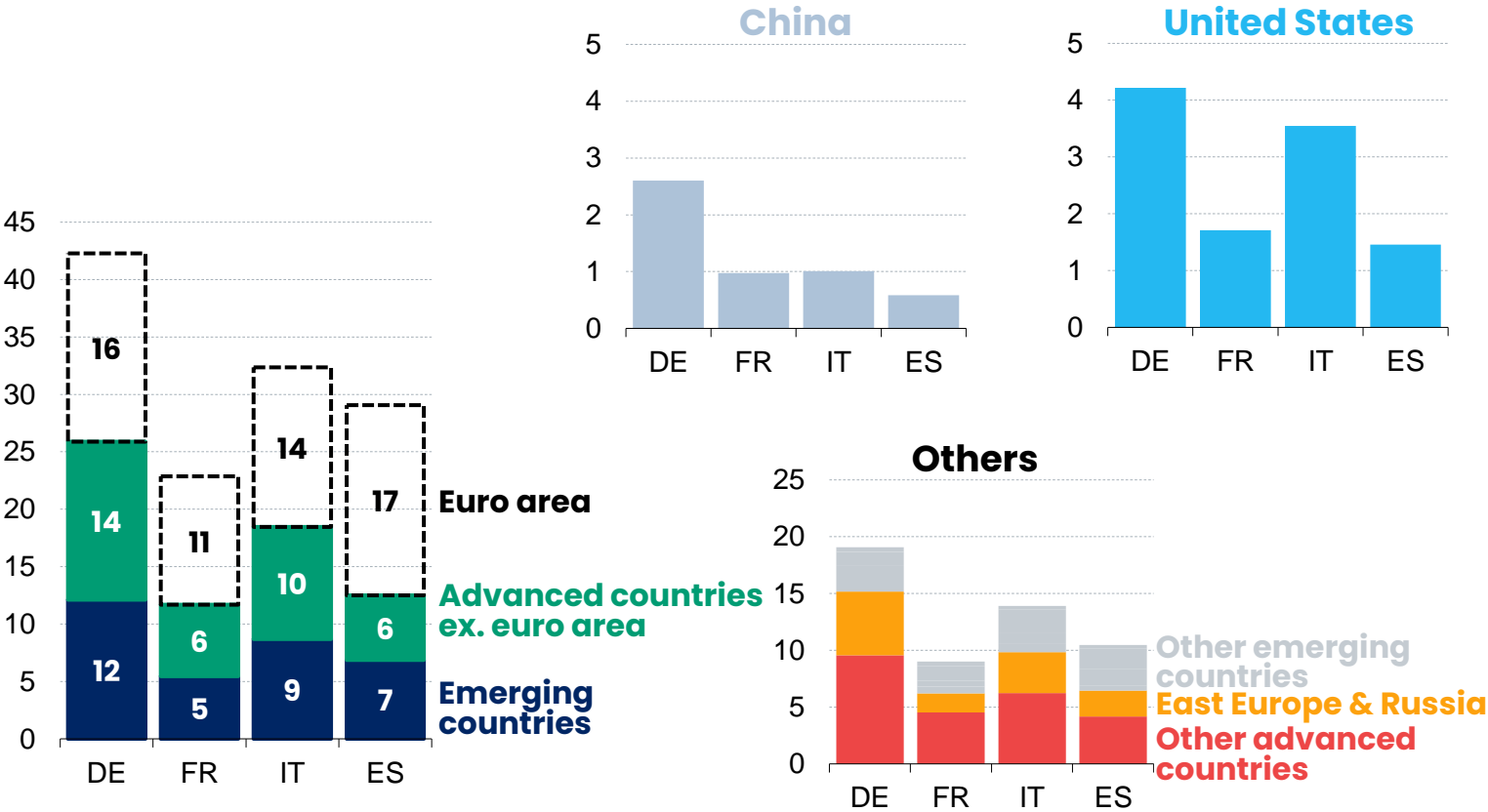


More broadly, the eurozone is also vulnerable to a slowdown in global growth

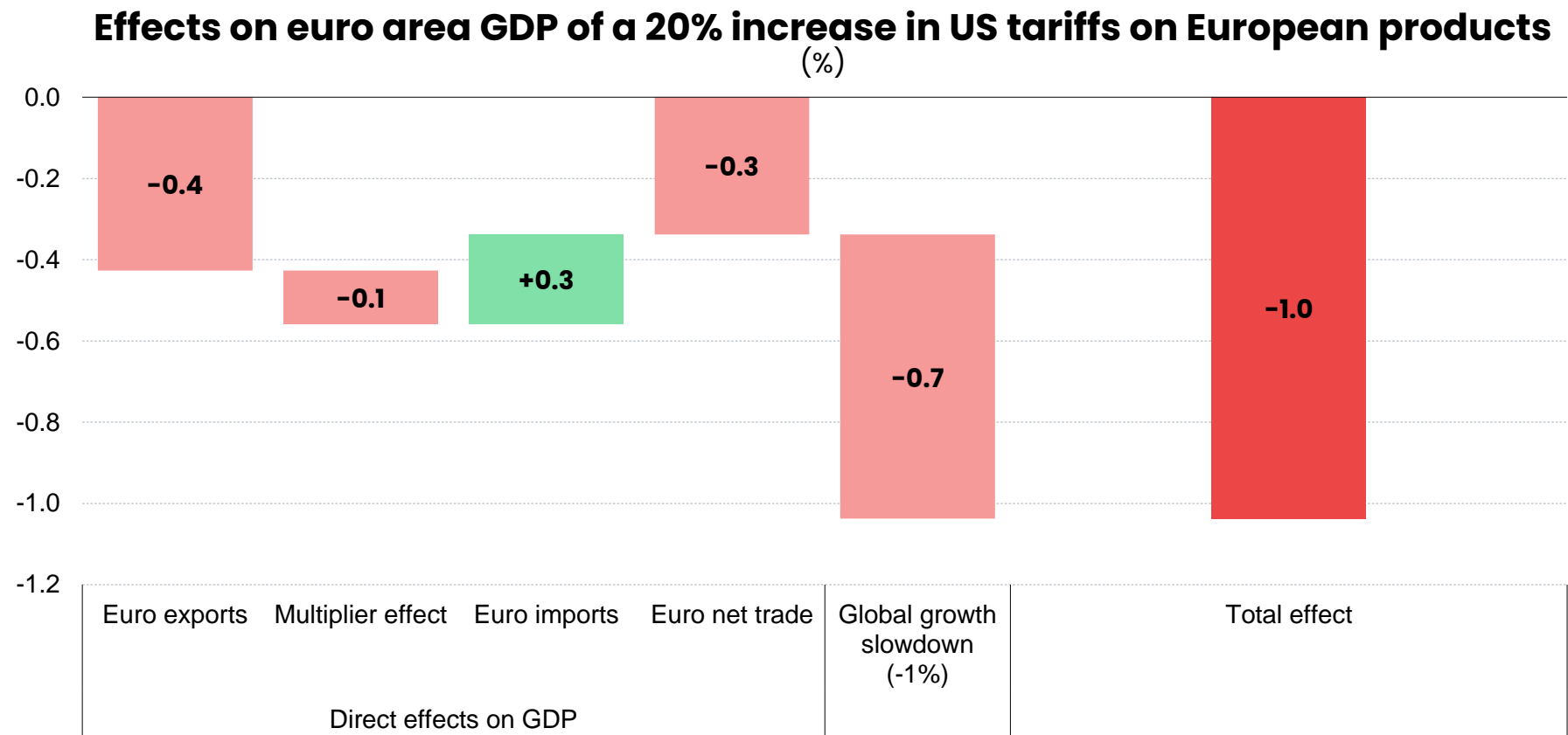


(*) Measured as the half sum of exports and imports to GDP

Euro area goods exports by region (% of GDP, 2024)



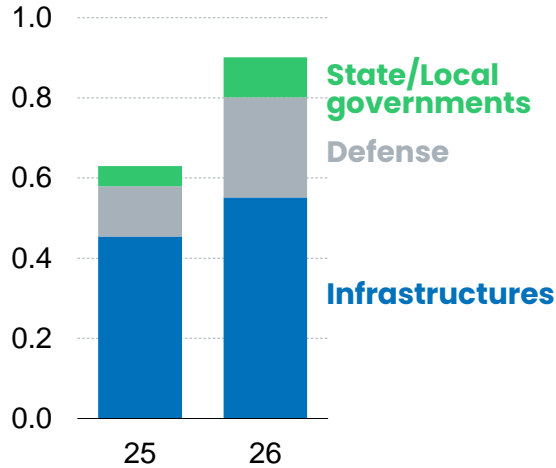
20% tariffs would have a significant impact on growth!



In its main scenario, the ECB assumes US tariffs at their May 12, 2025 level (i.e. tariffs of 40% on China and 10% on the rest of the world, with no retaliatory measures): the cumulative effect on eurozone GDP is estimated at -0.7% over 2025-27.

German announcements along with the EC plan could help cushion the negative impact from the trade war

The German Plan:
maximum growth impulse
(%)



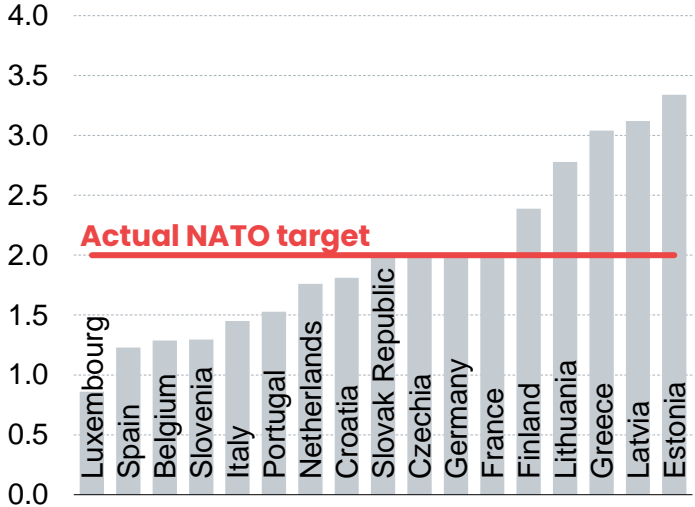
A €500bn Infrastructure Fund to be spent over 12 years: it includes the railways, schools, electricity network, digital infrastructure, etc., with €400bn for the federal level and €100bn at the state/local level.

Exemption of “required” defense spending from the debt brake: any defense spending that exceeds 1% of GDP would not count towards the debt brake calculation.

A 0.35% of GDP deficit allowance for State/Local governments: States and local governments are now allowed to run a structural deficit of 0.35% of GDP.

ReArm EU / Readiness 2030

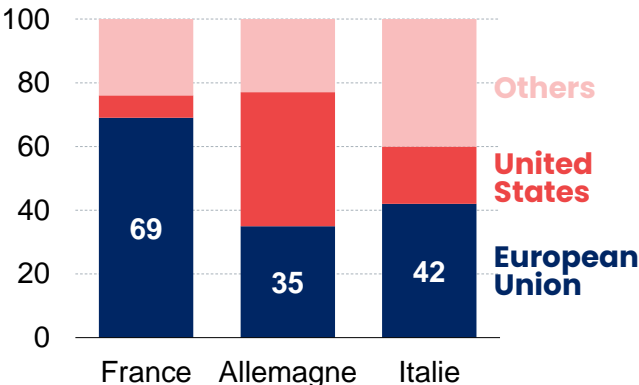
Defense spending
(% of GDP, 2024)



More support from individual countries

Some countries could also support their impacted industries: Spain already unveiled €14 billion plan to soften blow from US tariffs, with 7.4 billion in new financing.

Arms imports
by country of origin
(%)

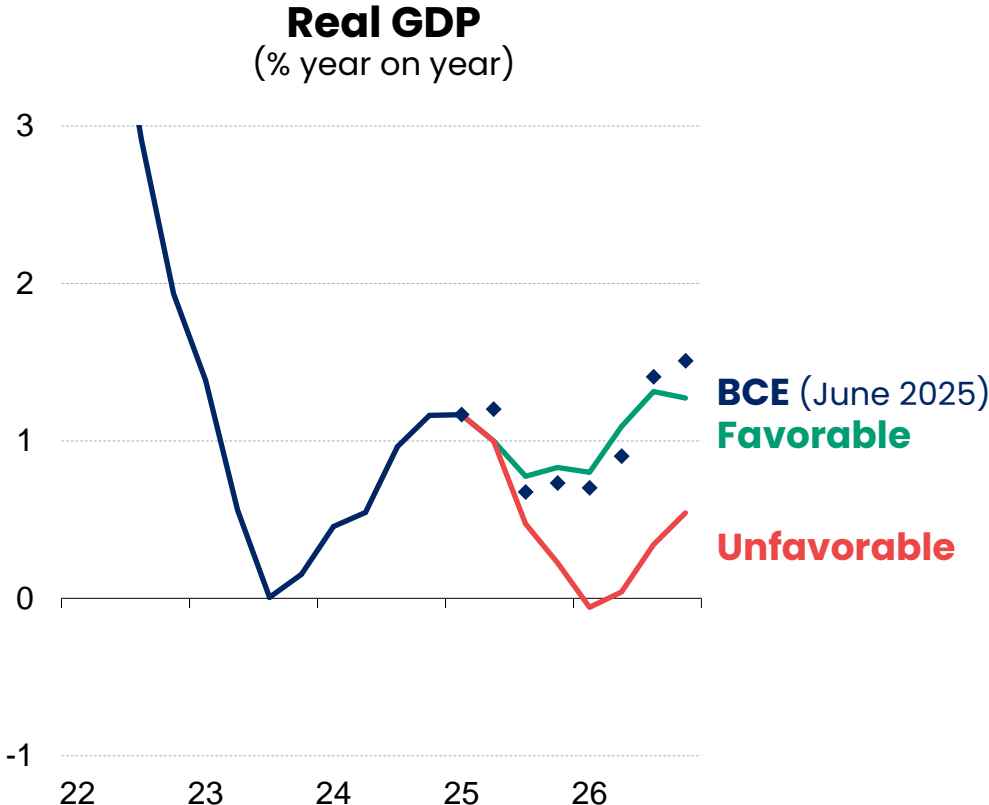
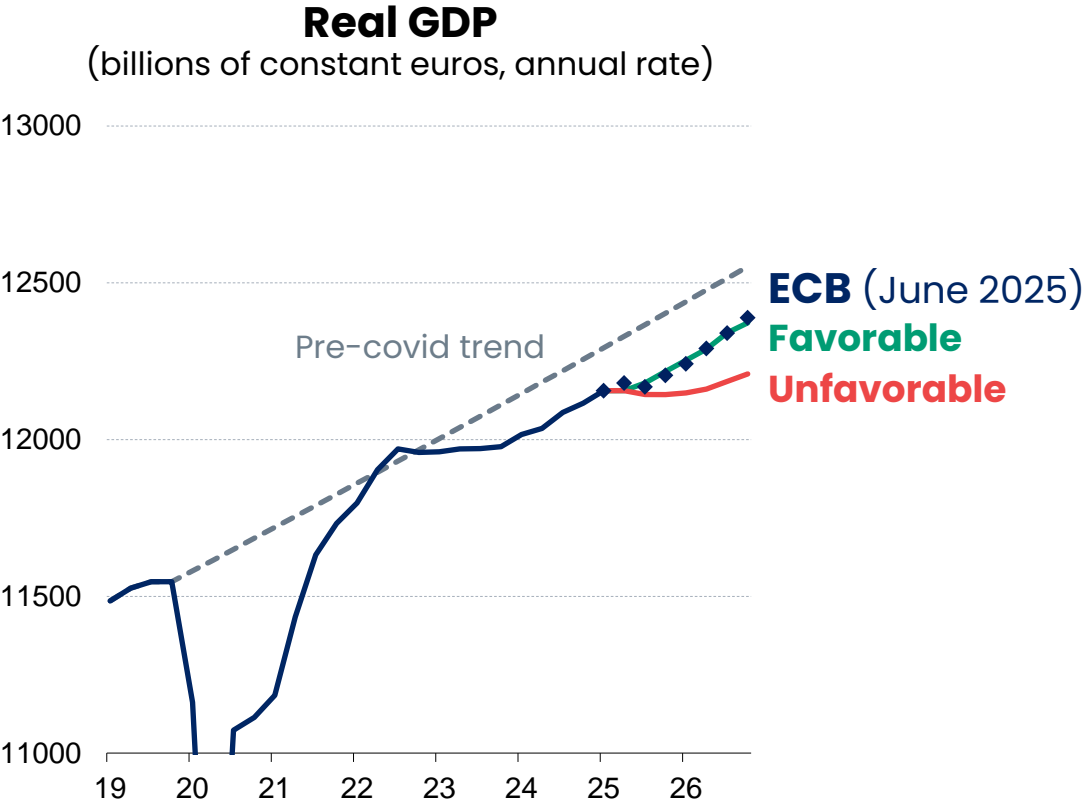


If all NATO member countries in the euro zone increase their defense spending to 2.5% or 3% of GDP (at a maximum rate of 0.5 points of GDP per year), the effect on activity will be around +0.2 points of GDP** per year.

(**) with a multiplier of 0.5

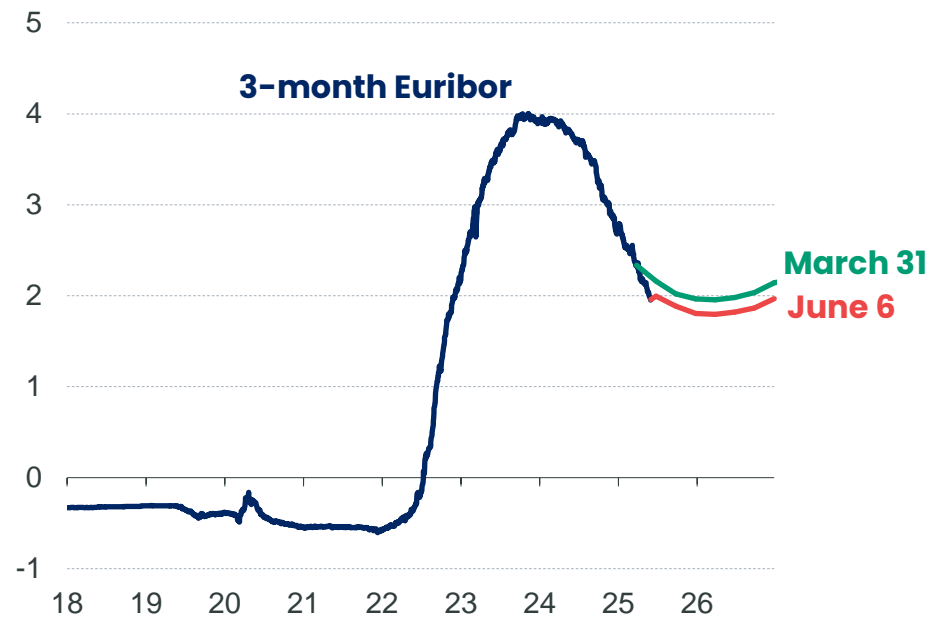


The risk of a marked slowdown of activity is nevertheless significant

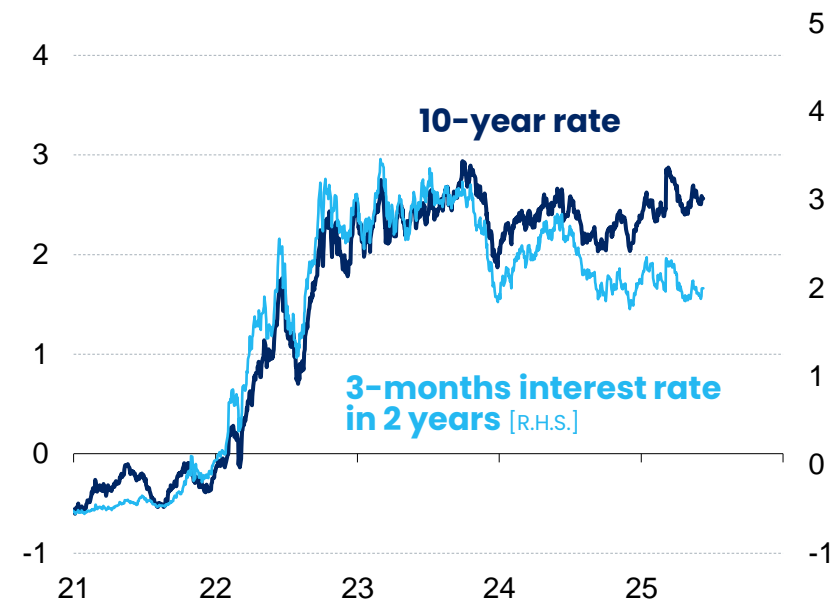


Monetary policy normalization draws to a close... but the ECB could be forced to cut rates again after the summer

ECB interest rate expectations
(%)



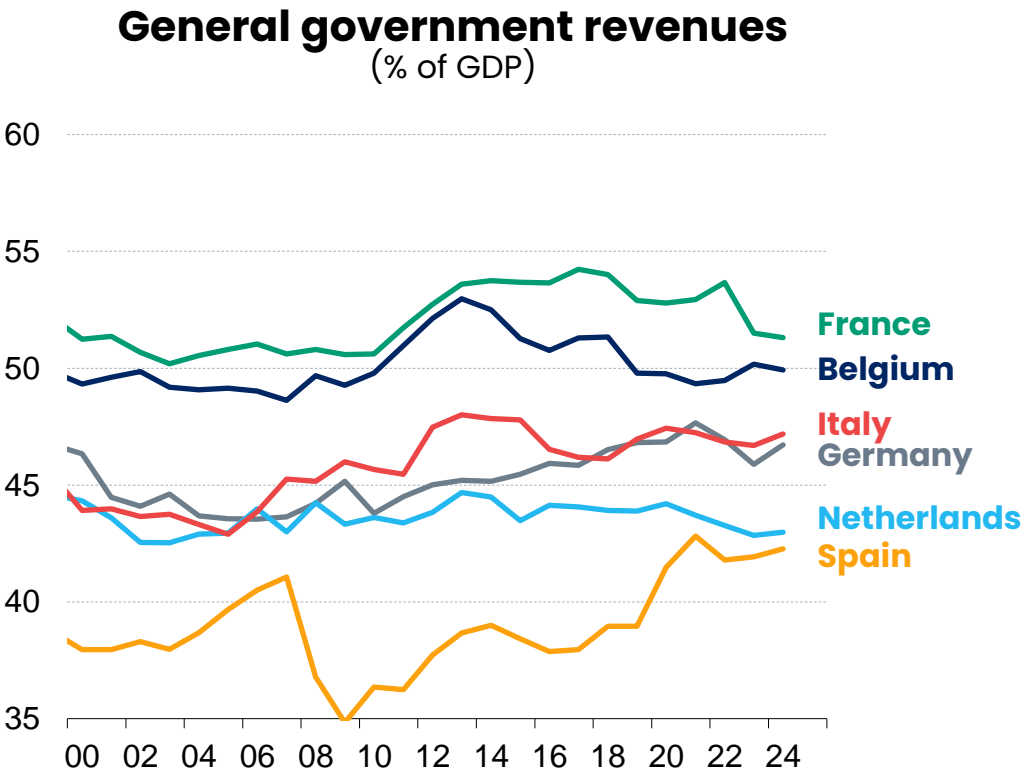
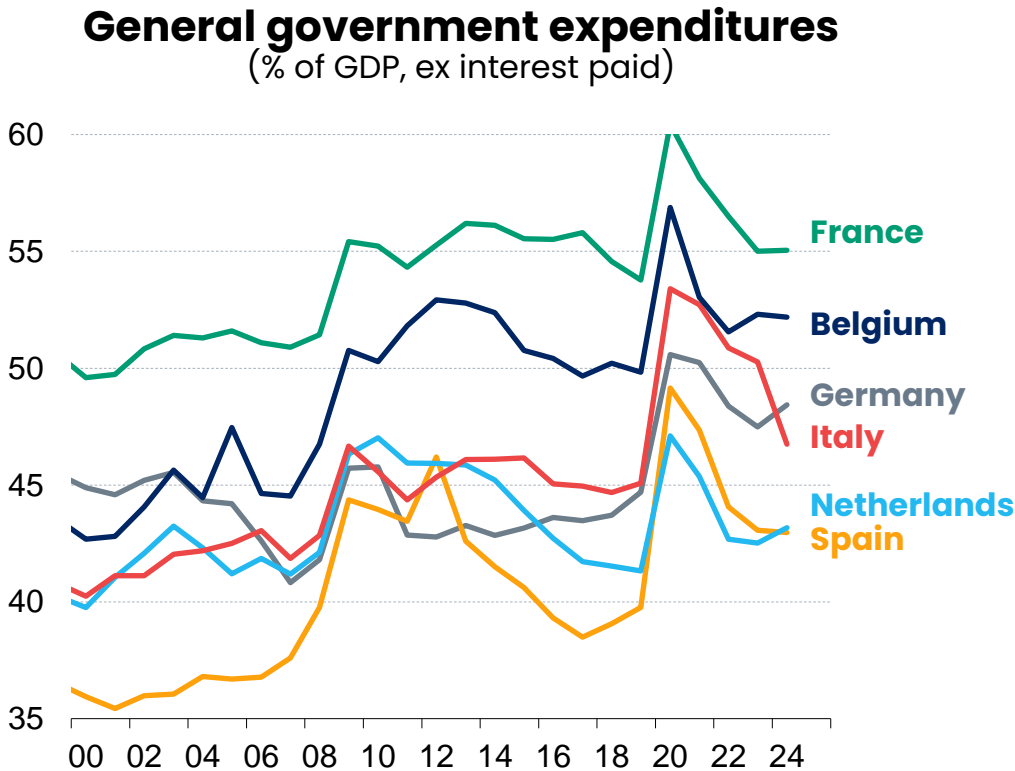
10-year German sovereign rate and short-term rate expectations
(%)





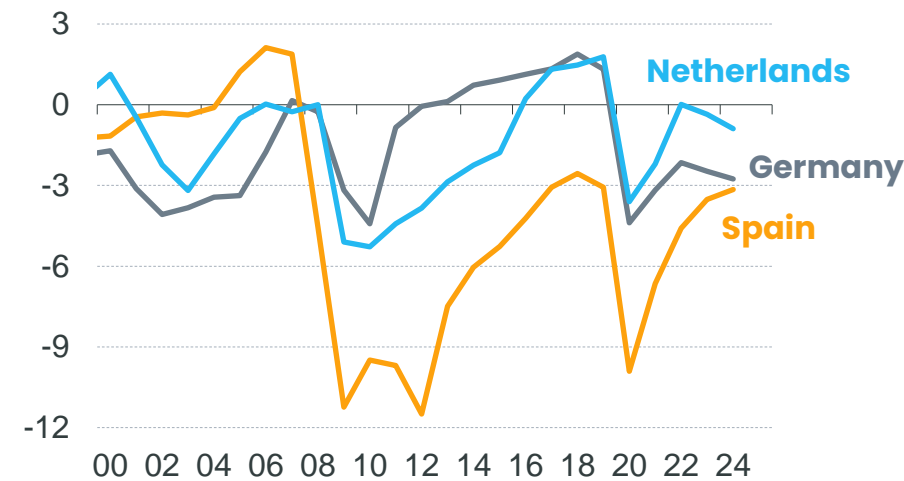
Focus. A closer look at public finances...

Government revenue and expenditure

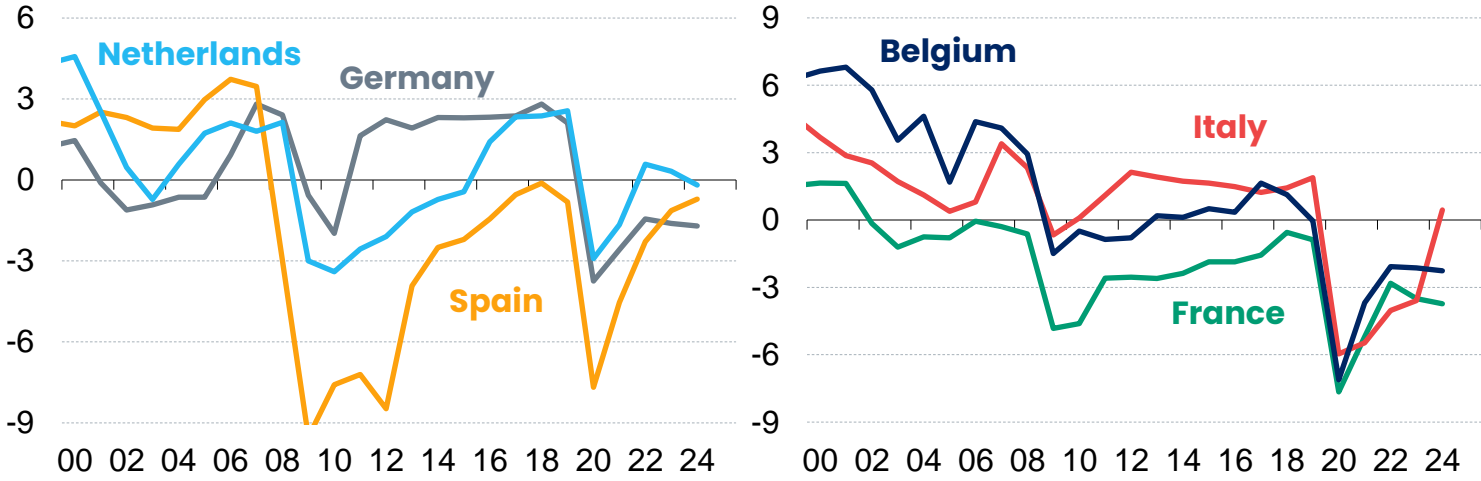


Government balance

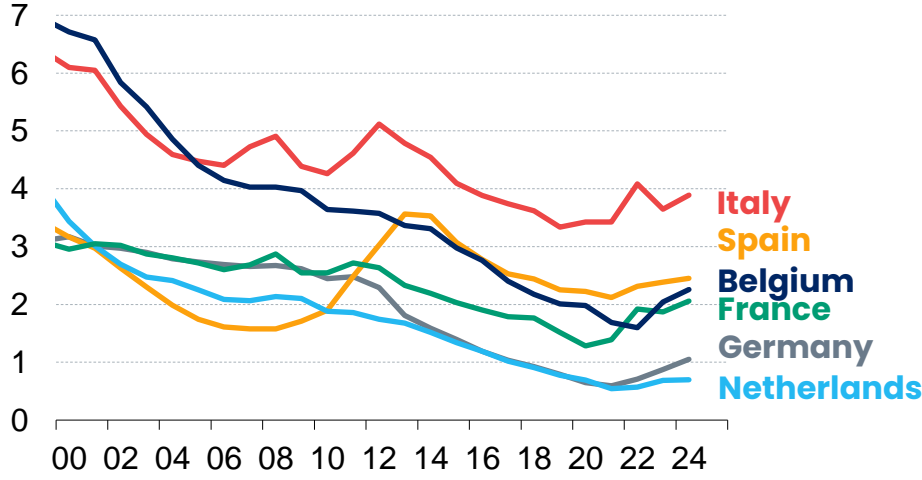
Government balance
(% of GDP)



Government primary balance
(% of GDP)

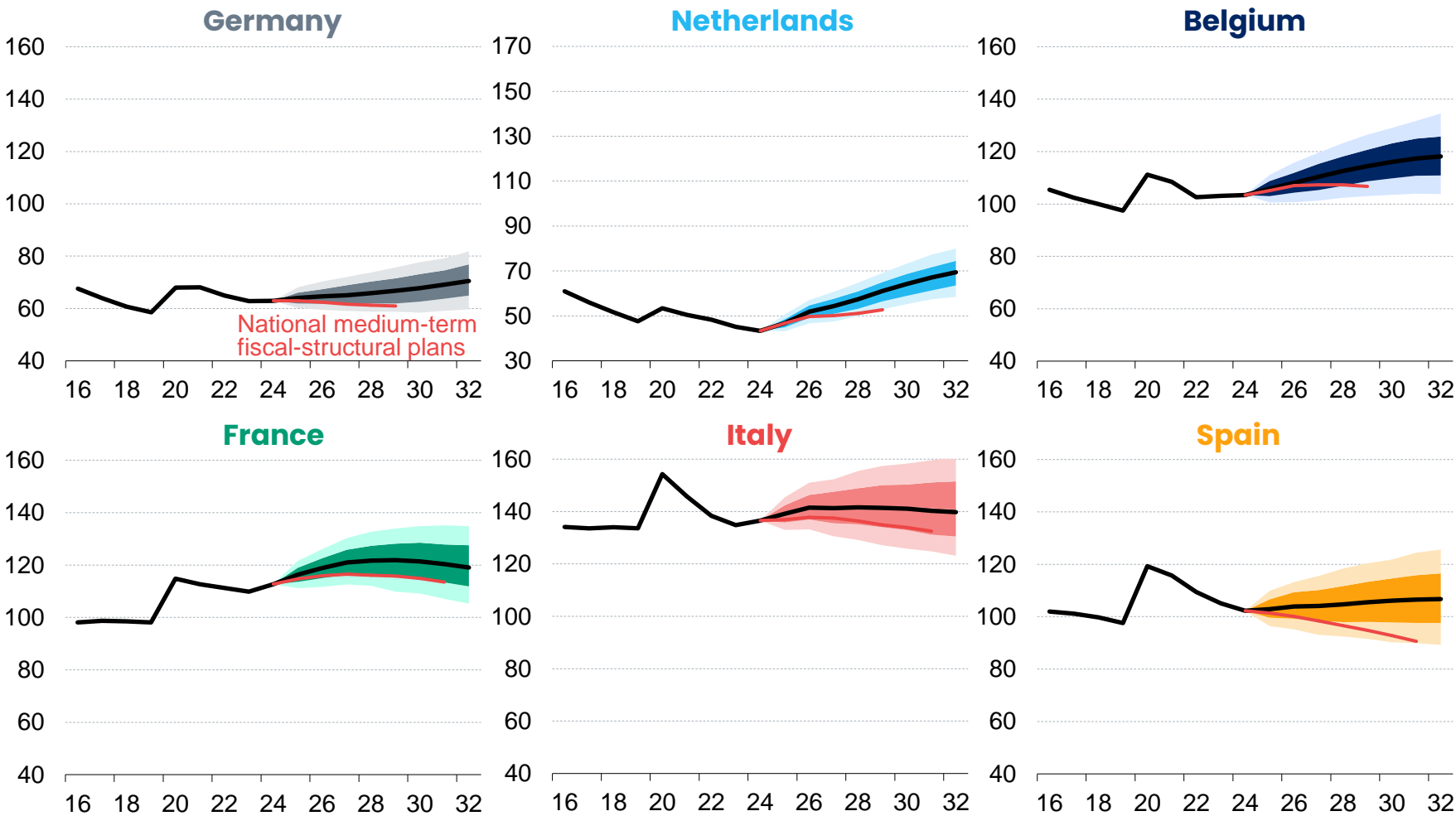


Interest payments
(% of GDP)

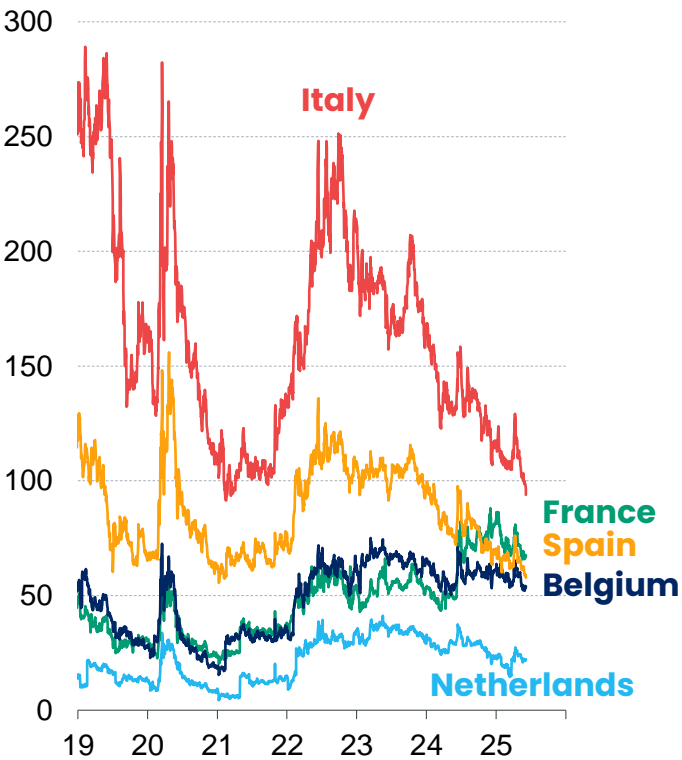


Public debt trajectories for euro area countries

Public debt with rising defense spending and German infrastructure fund
(% of GDP)

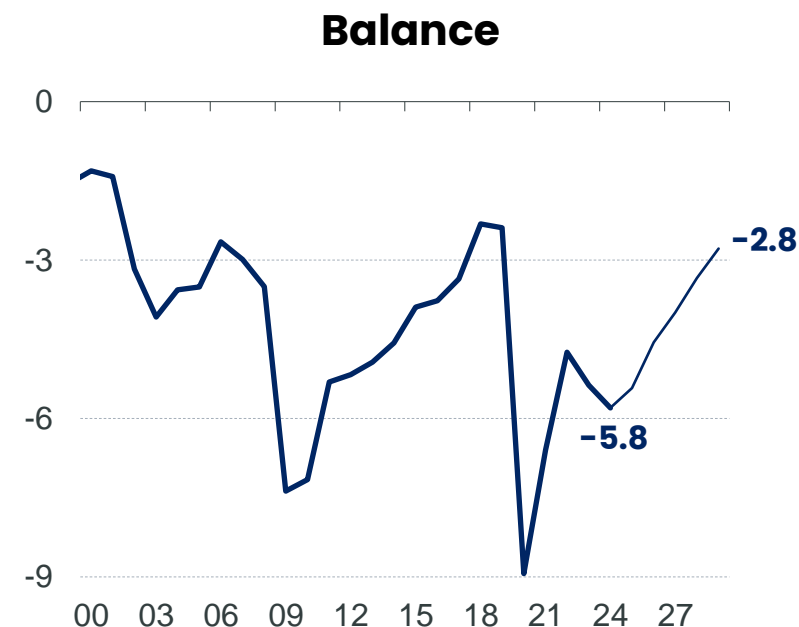
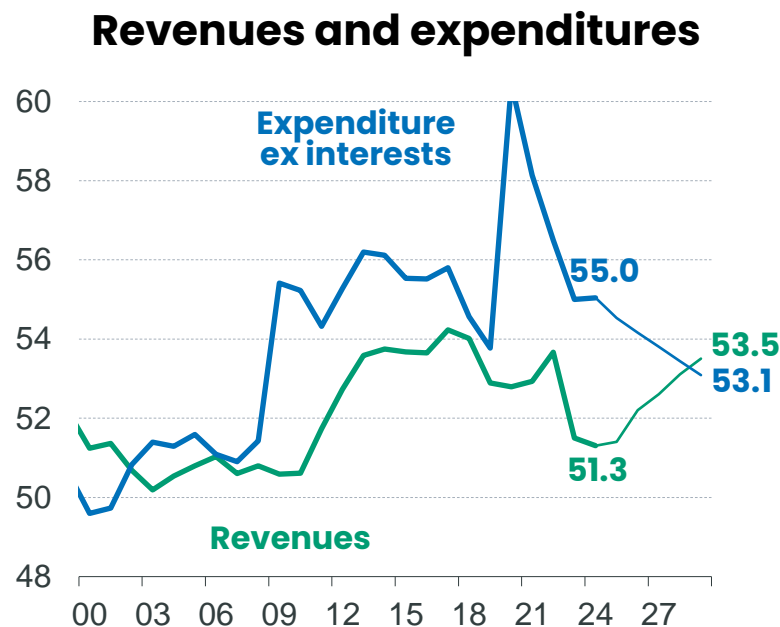
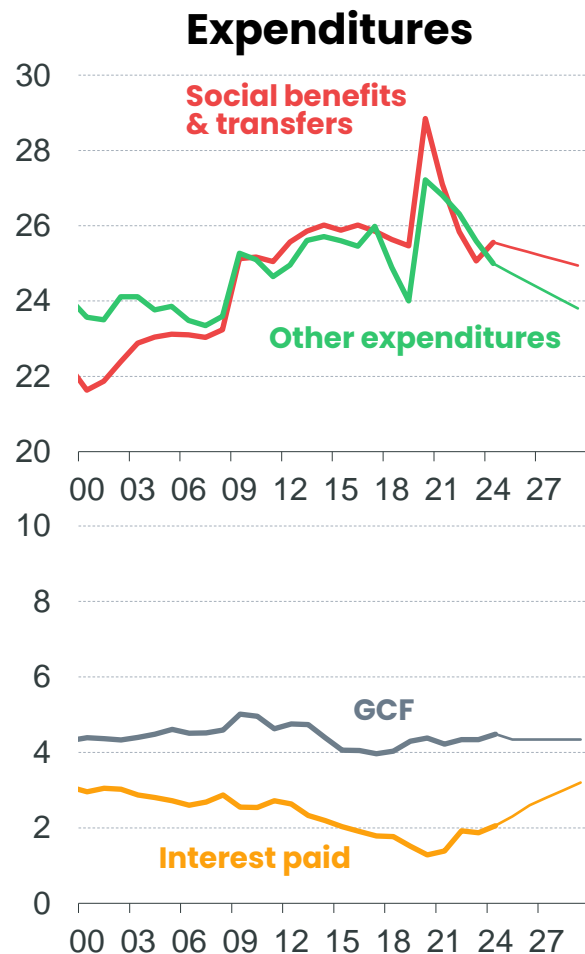


10-year-sovereign spreads to Germany
(basis points)



In France, the rebalancing effort remains a major one... and can hardly be achieved by reducing spending alone

General government revenues, expenditures and balance in France (% of GDP)



Assumptions

Social benefits & transfers: pension and health expenditures increase 0.5% slower than nominal GDP.

Other expenditures: expenditures increase 1% slower than nominal GDP.

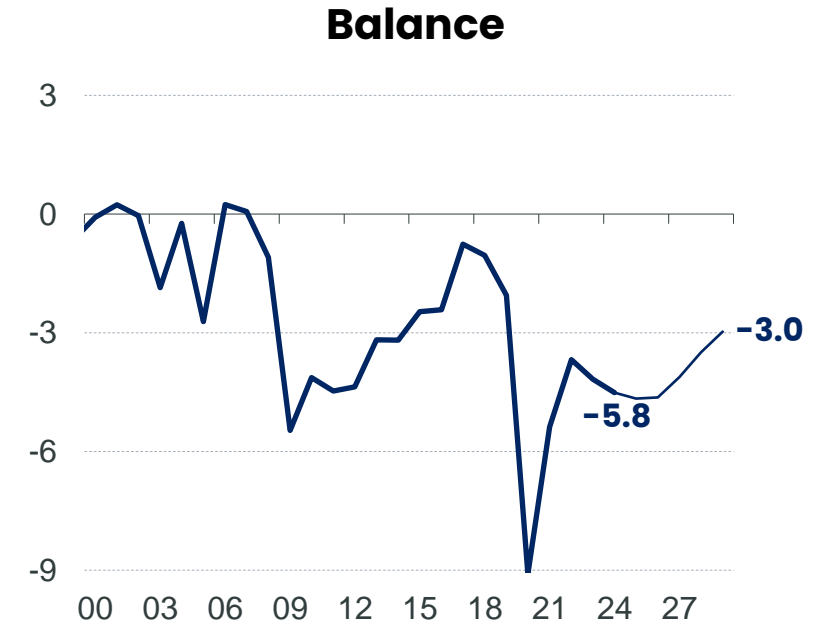
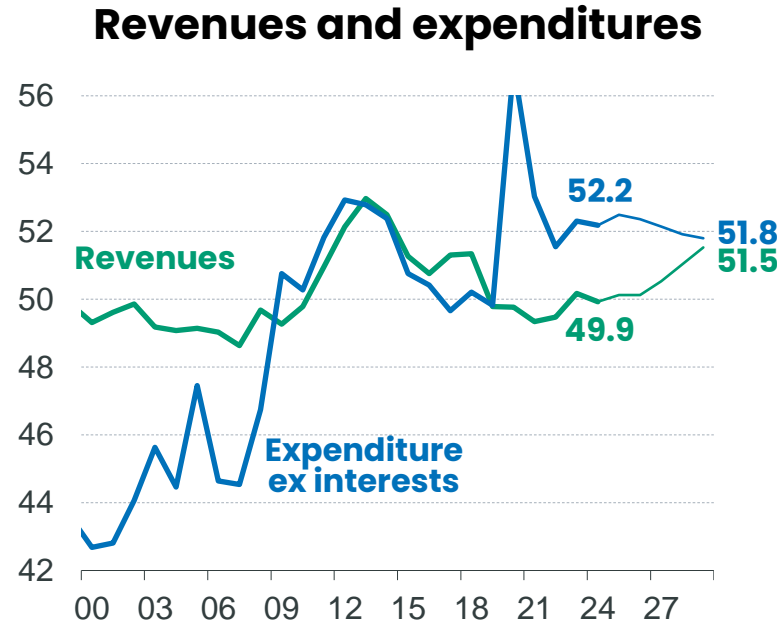
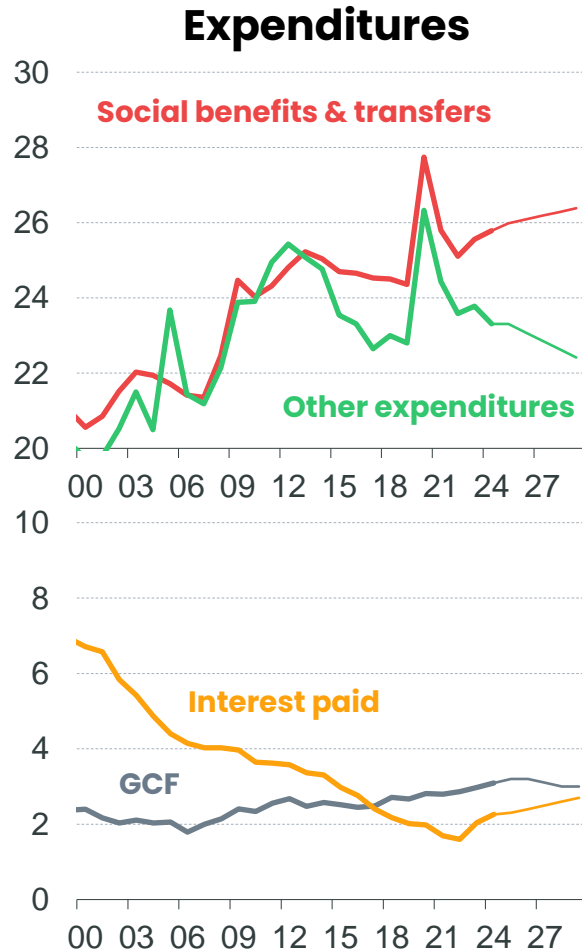
→ To reduce the deficit to below 3% in 2029, revenues would need to increase by 30 billion euros in 2025-26, then by a further 15 billion euros each year (or 0.45% of GDP).

→ Stabilizing expenditure (excluding social benefits and transfers) in real terms would require an increase in revenues of one point of GDP by 2029 (instead of 2.2 points).



In Belgium, the rebalancing effort is smaller... but a reduction in the weight of expenditure is unlikely to be enough

General government revenues, expenditures and balance in Belgium (% of GDP)



Assumptions

Social benefits & transfers: pension and health expenditures increase by 0.1% of GDP per year.

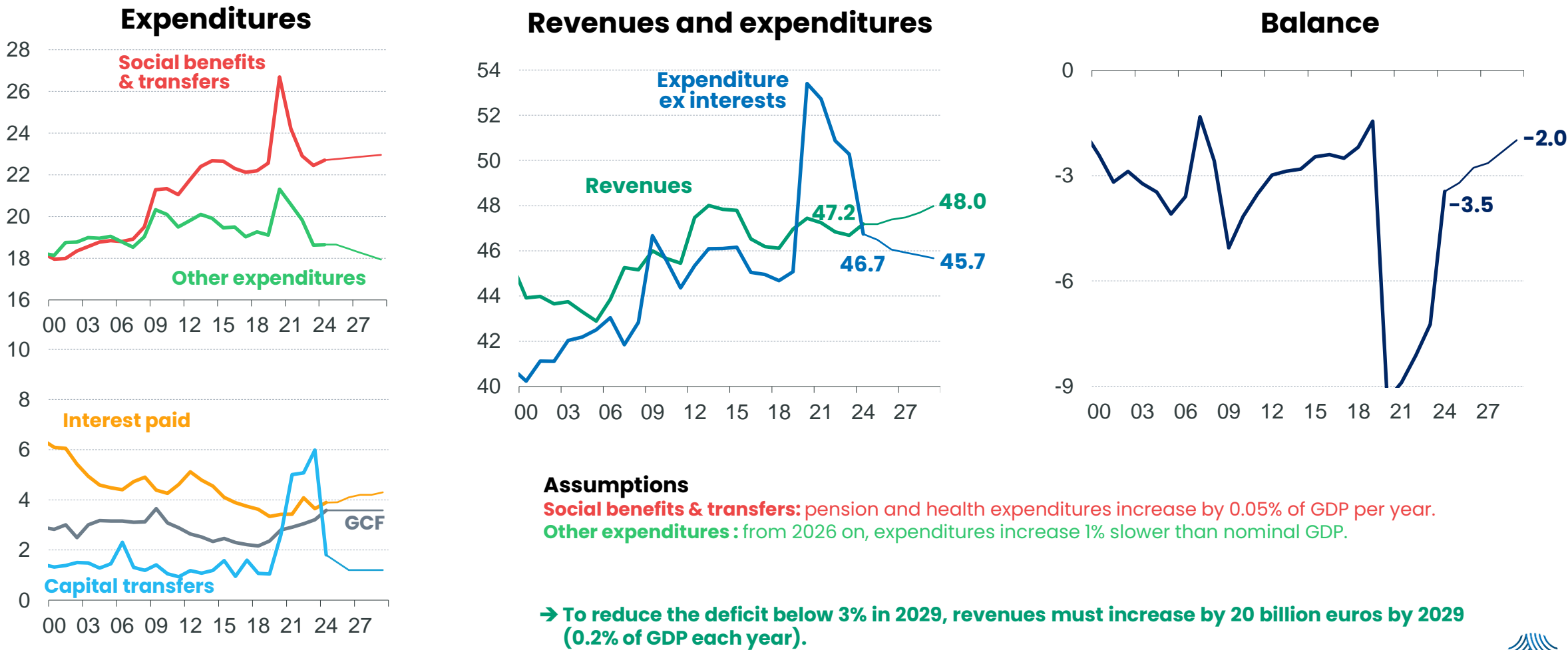
Other expenditures: from 2026 on, expenditures increase 1% slower than nominal GDP.

→ To reduce the deficit below 3% in 2029, revenues must increase by 12 billion euros by 2029 (0.4% of GDP each year).



Italy already has a primary surplus and has less efforts to make to meet its commitments

General government revenues, expenditures and balance in Italy
(% of GDP)



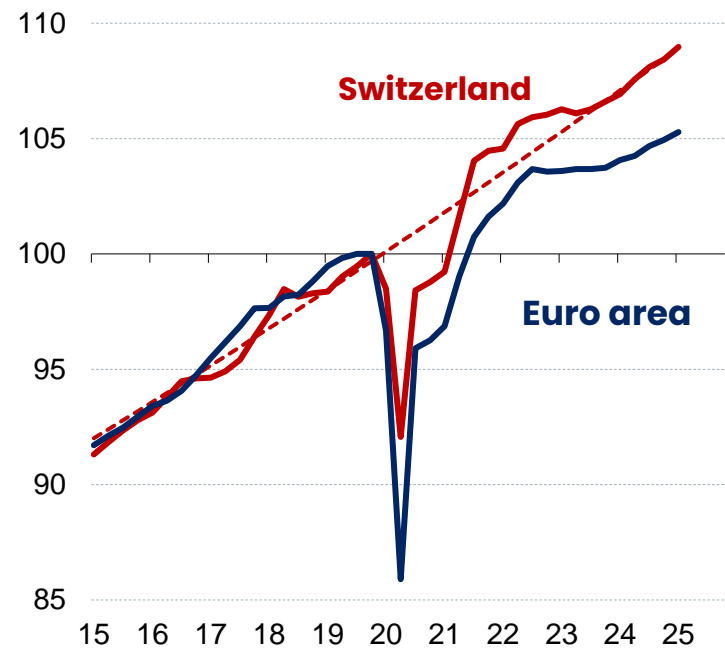
4 Switzerland



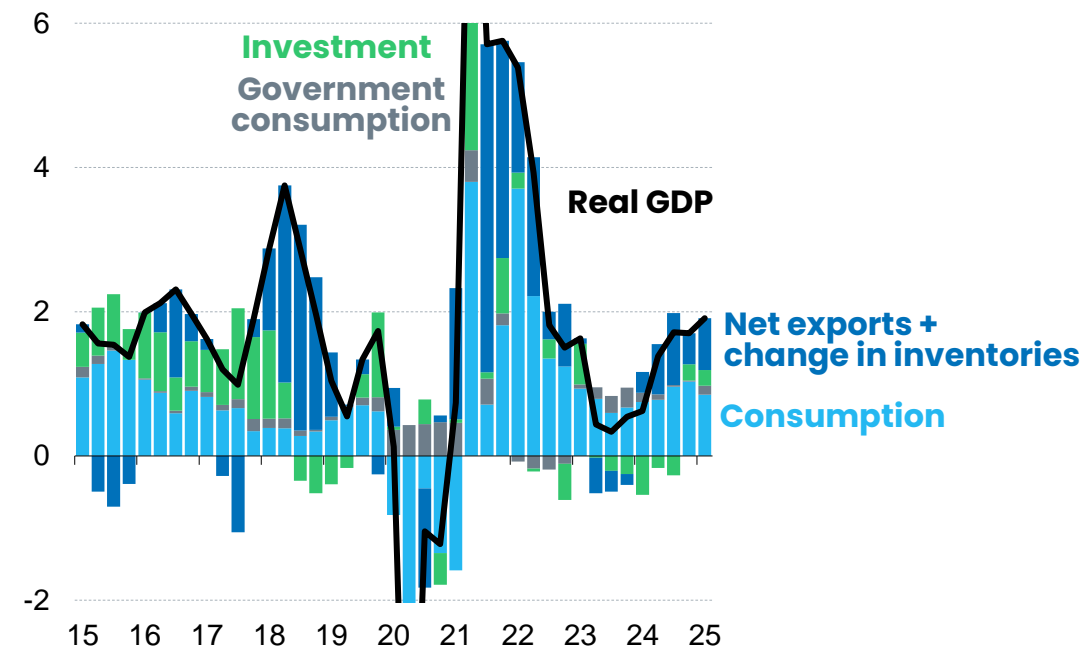
The Swiss GDP in back on trend

Switzerland real GDP

(compared to 2004-2019 trend, 2019 Q4 = 100)

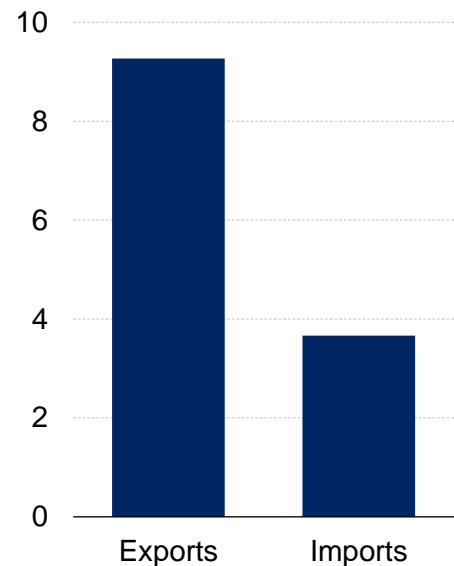


(%, year on year, contributions)

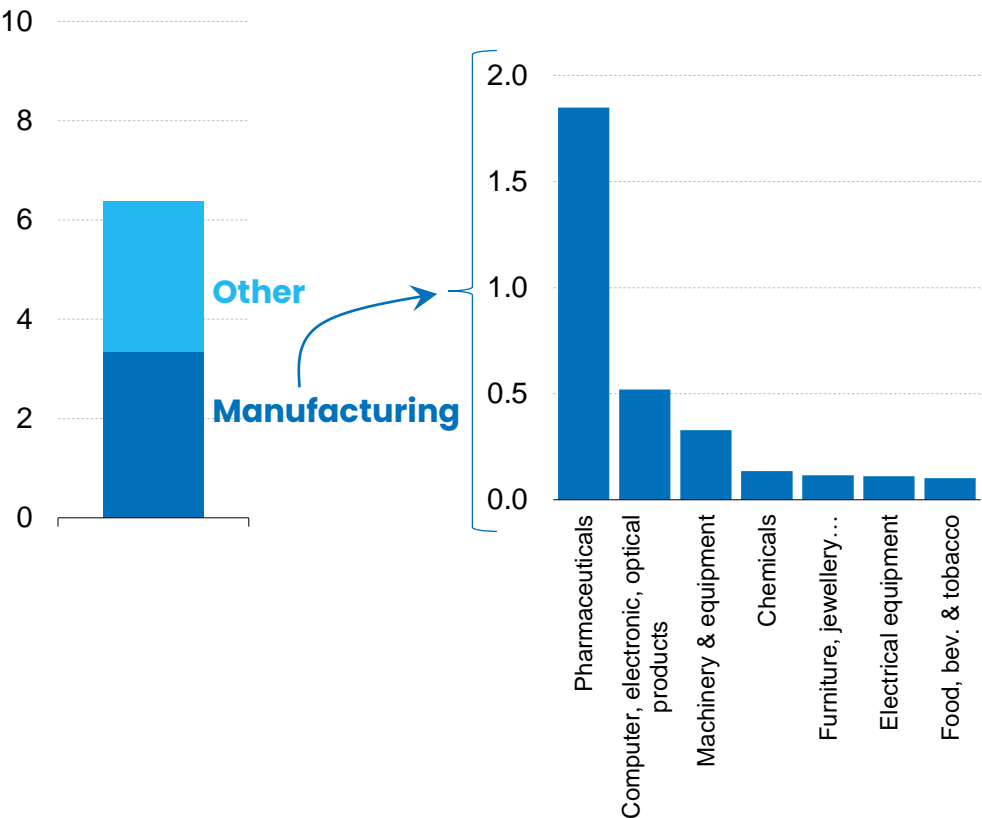


The Swiss economy is particularly vulnerable to tariffs on pharma

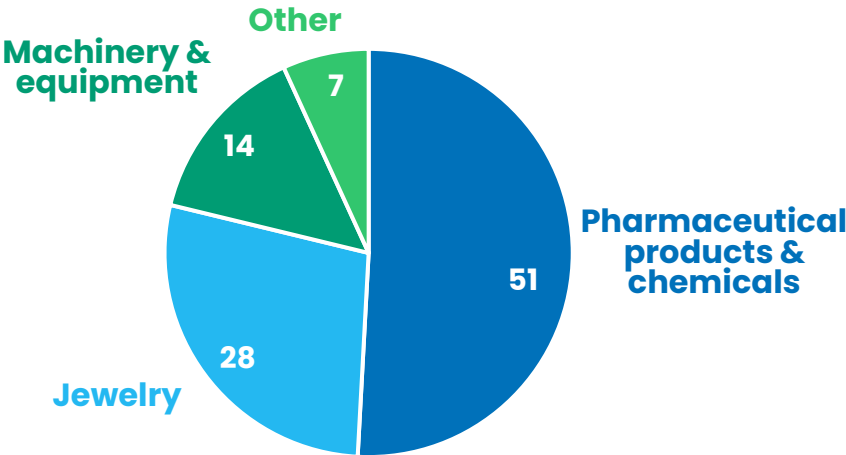
Swiss trade with the United States
(% of GDP, goods & services)



Value added in exports to the United States
(% of total VA, 2019)



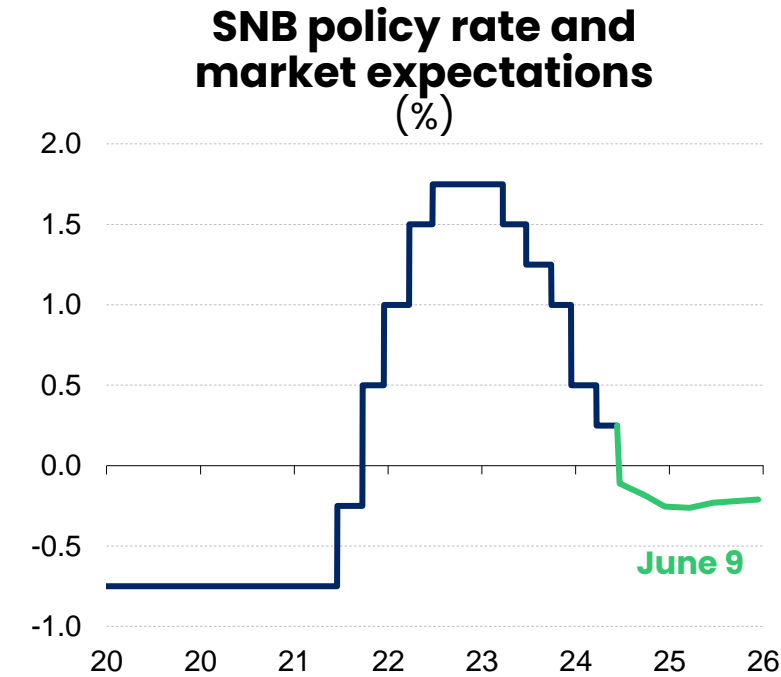
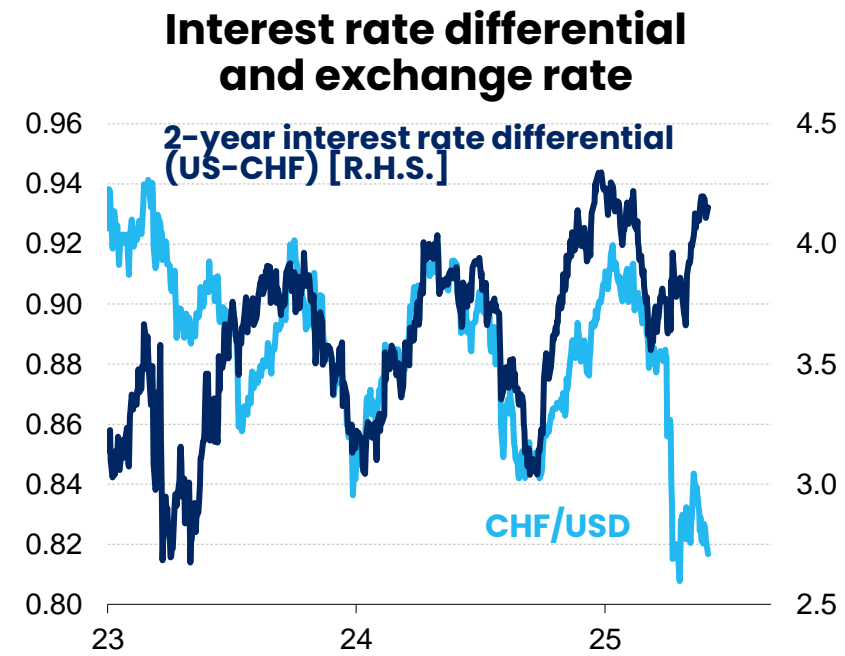
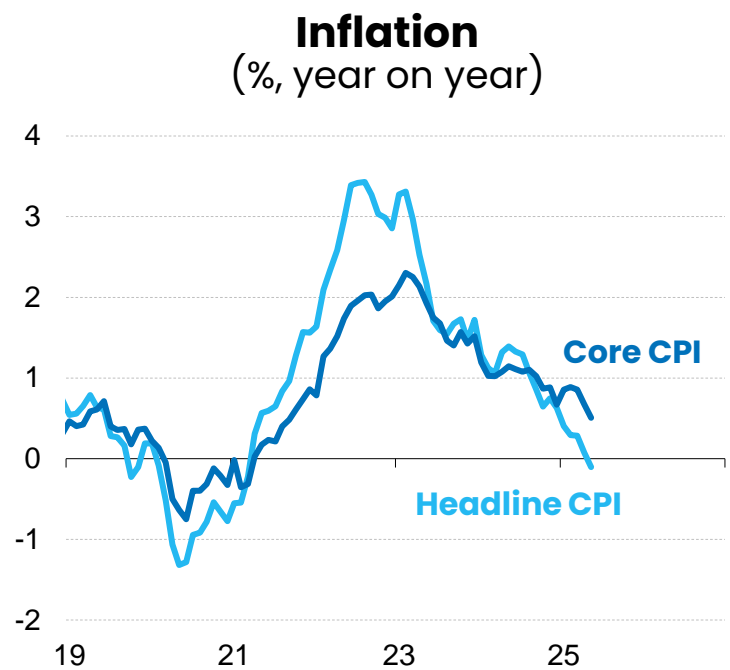
Composition of Swiss exports to the United States
(% of total exports to the US)



- The reciprocal tariff rate announced on April 2 on Swiss exports to the US is 31%. With the current 90 days pause (10% reciprocal) and the exemption of pharmaceutical products, the current average tariff rate stands close to 5%.
- If a 25% tariff rate is imposed on pharmaceutical products, the average tariff rate could increase to 17%.
- If the reciprocal tariff rate goes back up to 31%, the average tariff could go as high as 28%



With weak inflation and a stronger franc, the SNB could continue to ease its monetary policy



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