Market Insight

Spring 2025

Economic context

April 2, 2025 will remain in economics and finance textbooks as a landmark date. This "Liberation Day", which was supposed to be historic, turned out to be an economic and financial debacle. The tariffs initially announced were clearly amateurish, with potentially devastating consequences for the US economy, whose growth has already been revised downwards (**#1**). The credibility of D. Trump and his team was severely damaged and, in the two days following Liberation Day, investors showed their distrust to the point of pushing D. Trump to suspend the bulk of the new tariffs for 90 days, on the very day they were due to come into force and revert to the initial rate of 10%.

Even so, the impact of current tariffs on the US economy will be substantial. U.S. growth would be revised downwards to just +1% in 2025, and PCE inflation would be 3.4% year-on-year, based on a scenario with +15% average tariffs. However, this does not take into account the negative consequences of tighter financial conditions (widening credit spreads, rising long-term interest rates, falling equity markets, etc.), nor the cost of uncertainty, which is reflected in falling consumer confidence and business leaders' wait-and-see attitude during this period (**#2**).

In Europe, business momentum was picking up, particularly in Germany and France (**#3**), but the impact of customs duties could still be consequent.

Since the United States is one of our main trading partners, exports representing 3% of the zone's GDP. Growth should be revised downwards from -0.3% to -0.6% in 2025, impacted by customs duties, but will remain positive (between +0.5% and +0.8%) due in particular to the various stimulus plans.

Before China's prohibitive tariffs, the beginnings of a recovery were confirmed (**#4**). But the current level of tariffs could reduce growth by around one percentage point this year, to c. +4%. Faced with this trade war, China has powerful arguments at its disposal to bend D. Trump beyond reciprocal tariffs. Indeed, a devaluation of the Yuan would partly erase the impact of the tariffs, as S. Bessent has clearly understood. And let's not forget that China remains the main buyer of US Treasury bonds. If China stopped participating in Treasury auctions, or worse, started selling US debt, US long rates could rise significantly.

Central Banks

In this context, the FED faces a major dilemma between slowing growth due to tariffs and a future rebound in inflation (**#5**). In view of the current uncertainty, J. Powell has decided to take a wait-and- see attitude, even though he notes the greater impact of tariffs on the economy. We can therefore expect no rate cuts from him until at least June.

Conversely, the ECB is not constrained by inflation, which is already very close to the institution's target. It could therefore be much more accommodating to cushion the shock tariffs. The April meeting will conclude with a 25bps cut in the key rate to 2.25%, but we'll be keeping a close eye on C. Lagarde's comments on the current context, particularly in view of the euro's appreciation and the economic consequences of government stimulus plans.

Financial Markets

By derailing American growth, D. Trump succeeded in derailing the financial markets. After Libération Day , the S&P 500 experienced its biggest two-day correction since Covid. The fixed-income markets were not spared, either in terms of credit spreads or US long rates.

On the equity indexes, the S&P500 touched the bottom of a long uptrend channel, swept away by the MAG7 and Nasdaq correction. Volatility hadn't been this high since the Covid, and it swept away everything in its path, including European and emerging equity indices, just as these two zones were beginning to benefit from the return of international investor flows. With such corrections, market valuations have fallen significantly and now partly include learnings forecasts which have not yet been revised downwards. The decline in equity markets and pressure on bond yields reflect heightened uncertainty about the US economy (**#6**), prompting us to adopt a cautious investment stance.

Investment policy

- D. Trump has destabilized not only the global economy, but also the financial markets, which are now in risk-off mode (explosion in volatility and asset re- correlation).
- In view of the growing uncertainty about the US economy, we are increasing our underweight in US equities.
- We remain positive on European equities, which should benefit from stimulus plans.
- We are neutral on Asia-Pacific
- We are reducing duration on sovereign bonds.
- We are taking a more cautious approach to credit, particularly US high yield.
- We are maintaining our position on gold.
- We are gradually increasing our US dollar hedging.

Graphs

#1 The economy was fine until then, but *tarrif* man came ...

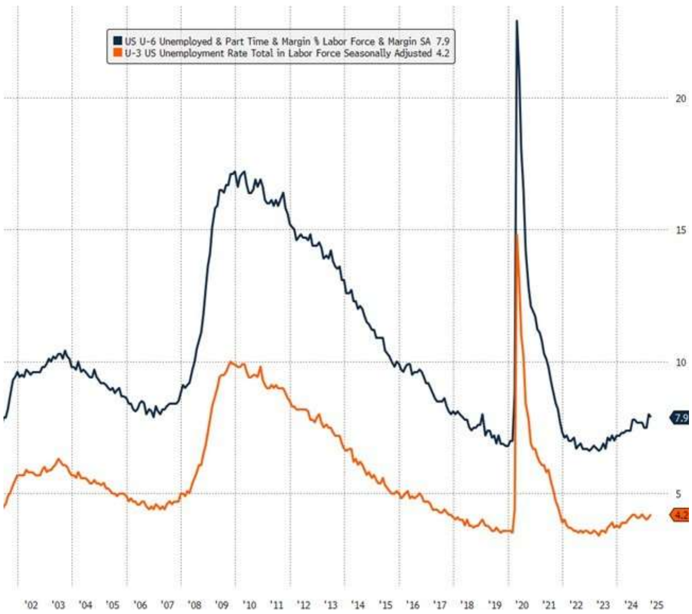
A *liberation day* incomprehensible from a rational point of view

Growth forecasts for 2025

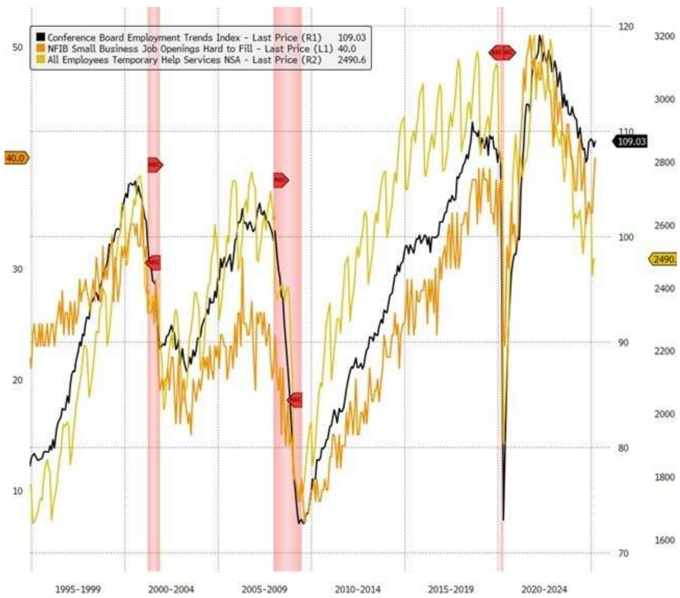
Source: The Economist, Bloomberg

#2 Leading employment indicators point to a worsening labor market

Unemployment rates U3 and U6



Leading employment indicators deteriorate



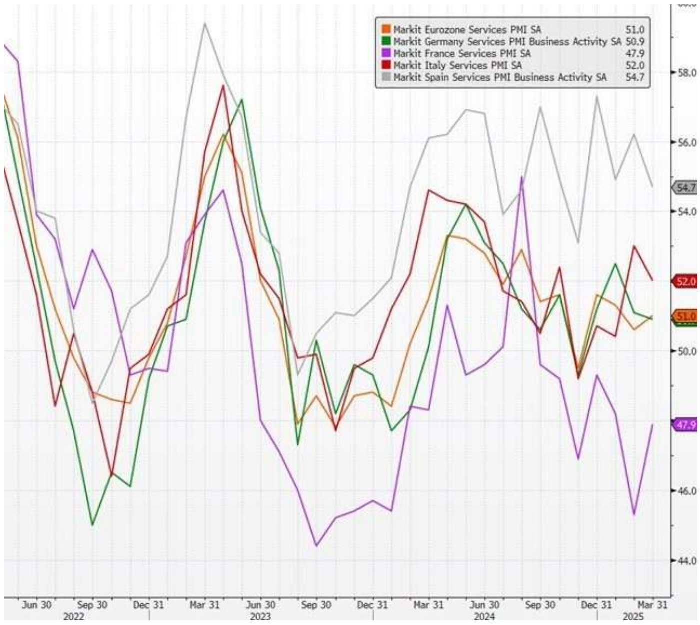
Source : Bloomberg

Source : Bloomberg

#3 Momentum improves in Germany and France

European manufacturing PMI

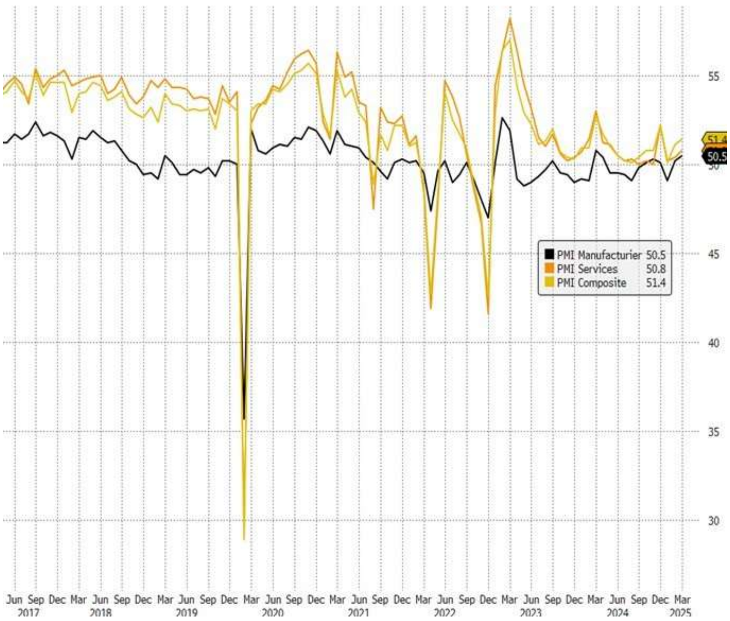
Composite PMI components



Source : Bloomberg

#4 Confirmation of the start of a recovery in China (before tarriffs)

Official Chinese PMI

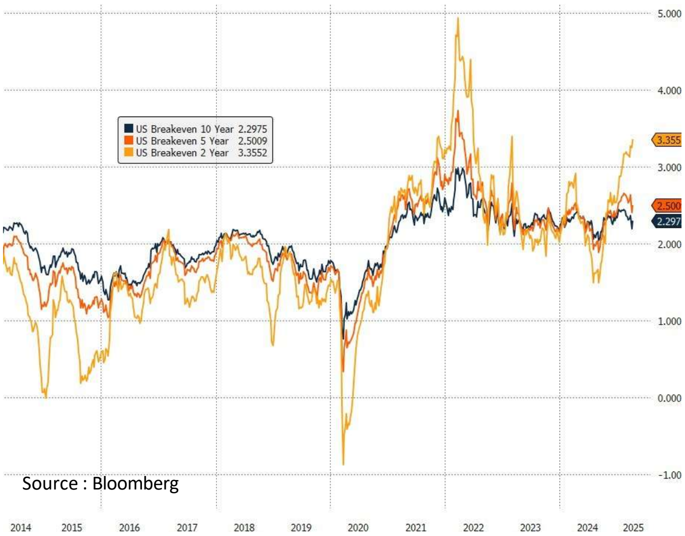


PMI Caixin

Source : Bloomberg

#5 The FED's dilemma: how to support growth while inflation rebounds?

Inflation expectations diverge across time horizons



Source : Bloomberg

J. Powell temporizes

- ✓ *"There's a feeling that* **we don't need to rush**" to make rate adjustments.
- ✓ *"Our obligation is to keep long-term inflation expectations well anchored and* ***ensure that a one-off rise in prices does not become a persistent inflation problem****."*
- ✓ *"Although uncertainty remains high,* ***it is now becoming clear that tariff increases will be significantly higher than expected****."*
- ✓ *"The same is likely to be true of* ***the economic effects, which will include higher inflation and lower growth.***

#6 The loss of confidence in the United States and the dollar is already apparent

Rumours of J. Powell's forthcoming dismissal push up long rates

Source : Bloomberg

The dollar has collapsed since the start of year

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