GLOBAL ECONOMY : TOWARDS ANOTHER TURBULENT SIX MONTHS?

The first half of 2025 was marked by two major turning points: the outbreak of a global trade war by the United States and, on the European side, announcements regarding rearmament efforts and the German investment plan, supporting the Old Continent's economic revival. The second half of the year will be marked by the aftermath of these announcements and is likely to be as hectic as the first, given the continuing uncertainty surrounding the outcome of the tariffs. The uncertainty surrounding the extent of their inflationary impact in the US and the duration of the Fed's monetary policy status quo is also significant. The risk of a derailment caused by fiscal policy remains. For now, financial markets are looking to see the glass as half full, but they remain nervous and vulnerable to bad news. It is more likely that there will be more bad news on the other side of the Atlantic.

At the beginning of the year, to determine whether 2025 would be a good year or not, we identified five critical questions for the global economy and from a European perspective[1]:

1/ Will the United States set off a global tariff war?
2/ Will China finally stimulate domestic consumption in a structural way?
3/ Will fiscal policy be a derailer?
4/ Will Europe heed the wake-up calls it received in 2024?
5/ Can the United Kingdom shake off the doom and gloom of 2024?

Six months later, it is time to take stock and refine some of the questions for the second half of the year, with one overriding question: Will the second half be as hectic as the first?

The short answer to the five questions posed at the beginning of the year is:

1. Yes: We would have preferred a negative answer, but the United States has triggered a global tariff war.
2. Yes and no: Chinese authorities are seeking to stimulate domestic consumption to offset the negative effects of the US tariff offensive on economic activity. But no, for the time being, this support does not appear sufficient to bring about a lasting rebalancing in the drivers of Chinese growth.
3. No: Fiscal policy has not been a derailer, but the issue remains highly topical.
4. Yes: Europe has heeded the warnings that sounded in 2024, and that is the best news of the first half of the year.
5. The last question remains unanswered, but at least the UK's rapprochement with the European Union is a clearly positive development.

Where will the global tariff war triggered by the US end? The tariff war remains as relevant as ever, and the initial question is now changing to: where will tariffs end up? Uncertainty remains. It is not yet clear what kind of agreement will emerge from the 90-day negotiation truce period, particularly those between the US and the EU by July 9 and those between the US and China by August 12.

The legality of "reciprocal" tariffs is also being questioned in the US. Additional sectoral tariffs are still looming (particularly on semiconductors and pharmaceuticals, which are currently exempt) and further increases on sectors already affected cannot be ruled out (such as the doubling of tariffs on steel and aluminum from 25% to 50% announced on June 3). However, it is almost certain that average effective tariffs will end up higher than before Donald Trump returned to the White House. The exact scale of the tariff shock and its repercussions remain uncertain, but there will definitely be a shock. And the shock of uncertainty that doubles it is just as disruptive and damaging to economic activity, if not more so.

For the moment, the traces of the tariff shock in activity or in inflation are not evident. This is partly because it is too early, and all the more so because there have been many U-turns by the Trump administration, the situation is far from stabilized, uncertainty is generating a wait-and-see attitude, and the phenomenon of front-loaded purchases before the tariff hikes is introducing a lot of volatility into the data. Forecasters now agree that the US economy will slow significantly between 2024 and 2025 (by around 1 percentage point), while the outlook for the Eurozone is less unfavorable and even positive[2]. According to their latest forecasts, the IMF anticipates only marginally lower growth in 2025 (0.8% in annual average terms after 0.9% in 2024), while the ECB expects growth to be marginally higher (0.9% after 0.8%) and the OECD slightly higher (1% in 2025 after 0.8%). Our own scenario is more optimistic, as we are forecasting 1.2% growth in 2025 for the Eurozone.

Will the tariff shock have an inflationary impact in the United States? For the time being, the inflation figures available for the United States (up to April) show no significant impact from the tariff increases already in effect, particularly those on China. The early warning signs are limited to a sharp rise in household inflation expectations and a marked upturn in input prices in business climate surveys. However, in our view, there is no doubt that US inflation will rise as a result of higher tariffs: the question is how much. Three factors are likely to limit the increase: if companies agree to accept lower margins[3], the slowdown in demand and, at least in the short term, lower oil prices. An appreciation of the US dollar would also weigh on US inflation, but this is not currently on the cards. And looking ahead to the second half of the year, the greenback is likely to continue its slide. Given the prevailing uncertainty, it should also be borne in mind that the process of passing on tariff increases to consumer prices will take time, spreading and diluting their upward impact on inflation over time.

1 Ecoweek editorial by Isabelle Mateos y Lago, Happy New Year? (January 7, 2025).
2 The latest World Bank forecasts, published on June 10, stand out somewhat, anticipating a sharper slowdown in the US economy (-1.2 percentage points between 2024 and 2025) and a 0.2-point decline in Eurozone growth (0.7% in 2025 after 0.9% in 2024).
3 This does not seem to be entirely the case at the moment. According to a survey by the New York Fed, margin preservation appears to be the prevailing behavior, with most companies in the region passing on at least part of their cost increases to consumers via price increases (Are Businesses Absorbing the Tariffs or Passing Them On to Their Customers? - Liberty Street Economics, June 4, 2025).

EDITORIAL

Will the Fed maintain its status quo on rates until the end of the year? Our central scenario for the US is stagflationary: higher inflation despite lower growth. In this scenario, the Fed has no choice but to maintain its monetary status quo until the end of the year, according to our forecasts. It cannot resume its rate cuts given the upside risks to inflation, and as long as the economic slowdown remains contained (which is the case at this stage, particularly in view of developments in the labor market), there is no need for rate cuts. Conversely, the Fed cannot raise its policy rates to counter inflationary risks given the downside risks to growth. The status quo seems the best option while waiting to see how the situation might evolve more clearly in one direction or the other. The ECB does not face the same dilemma. Until June, the conditions were fairly clearly in place for it to continue cutting rates (inflation back on target and weak growth). Begun a year ago, the ECB's cycle of rate cuts is nearing its end: we expect a final 25 basis point cut in September given the downside risks to growth.

Will fiscal policy be a derailer (second)? This question, already asked in these terms at the beginning of the year, remains relevant. In the first six months of the year, there were several episodes of tension on long-term rates. Even the US is now under scrutiny: the deterioration in its public finances, which the 'One Big Beautiful Bill Act' currently under discussion is likely to exacerbate, is no longer going unnoticed. In Europe, Germany's fiscal turnaround and the ReArm EU plan also raise important financing questions, but potential support for growth is clearer than in the US.

Will the second half of the year be as hectic as the first? Once again, uncertainty reigns, which is one of the reasons why we should expect and prepare for another turbulent six months. Financial markets are looking to see the glass as half full, but they remain nervous and vulnerable to bad news. It is more likely that there will be more bad news on the other side of the Atlantic.

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