UNITED STATES

POLICY CHANGES HARMFUL FOR THE ECONOMY

After the outperformance of 2023-2024, US growth is expected to slow sharply under the impact of the uncertainty and tariff shocks triggered by the new administration. Recession concerns are returning into the spotlight. Meanwhile, inflation is projected to rebound sharply under the impact of additional tariffs. In this context, the Fed should refrain from easing monetary policy in 2025.

GROWTH: A GLOOMY AFTERMATH?

The United States experienced another year of dynamic growth in 2024 (+2.8% annual average, after +2.9% in 2023) – well above its long-term pace (+1.8% according to the Fed). Growth was largely underpinned by household consumption, strong productivity gains and the supply-side rebalancing of the labour market enabled by immigration.

Growth is expected to slow significantly in 2025. The tariff shock (*see below*) will weigh on activity: its inflationary effect is negative for household demand, which is also exposed to the downturn in the financial markets (wealth effect). The general climate of uncertainty and financial volatility is fuelling the risk of a significant recession, which we estimate at 25%, especially by weighing on investment and hiring decisions. In addition, a possible tightening of financial conditions as a result of a sustained bond sell-off could represent a serious drag on activity. Finally, while the scale of the downturn is uncertain, as it mainly hinges on the landing point for extra tariffs, our central scenario projects a marked slowdown in growth to +0.5% y/y in Q4 2025 (compared with +2.5% in Q4 2024).

For the time being, the negative signs are mainly apparent in survey data. Household sentiment has been deteriorating sharply since November 2024. Small businesses have been reporting substantial uncertainty according to the NFIB survey, while CEO confidence, as measured by the CE Group, fell to its lowest level since 2012 in March 2025.

TRUMP VS. THE TRADE DEFICIT

The US trade deficit reached USD -1,202 bn in 2024 (4.1% of GDP), an all-time record in absolute terms. This situation underlies D. Trump's tariff offensive, which culminated in the announcement, on 2 April, of 'reciprocal tariff reductions' (ranging from 10% to 50% depending on the bilateral trade balance). On 9 April, these were suspended (for 90 days) and replaced by a harmonised 10% tariff following the ensuing market backlash in the wake of the 2 April announcements (plunges in the US dollar, Treasuries and US equities). The tariff movement is part of a bid to reduce the trade deficit, re-industrialise the economy and increase federal revenue. At the same time, it is intended as a negotiating weapon aimed at reshaping global economic relations to the greater advantage of the United States.

As of 10 April 2025, the tariff offensive has been focused on China (extra-tariffs starting from 10% in February and amounting to 145% in April following further steps and Chinese retaliation), Mexico (25%) and Canada (ditto, excluding energy: 10%), excluding goods covered by the USMCA free trade agreement, which are exempt. At sectoral level, 25% tariffs were introduced on steel and aluminium (March 12), followed by motor vehicles (April 3, prior to car parts on May 3). On the other hand, semiconductors and pharmaceuticals are exempt from additional tariffs. Eventually, we expect to see a moderate de-escalation in tariffs, which would not prevent the new levels from settling significantly above pre-Trump 2.0 levels.

We also expect the USD to weaken further against the EUR as the growth differential between the US and the eurozone narrows (and European long-term interest rates rise). In 2026, the resumption of monetary easing by the Fed, combined with a rise in key ECB interest rates in H2, would further strengthen the EUR/USD.

GROWTH AND INFLATION

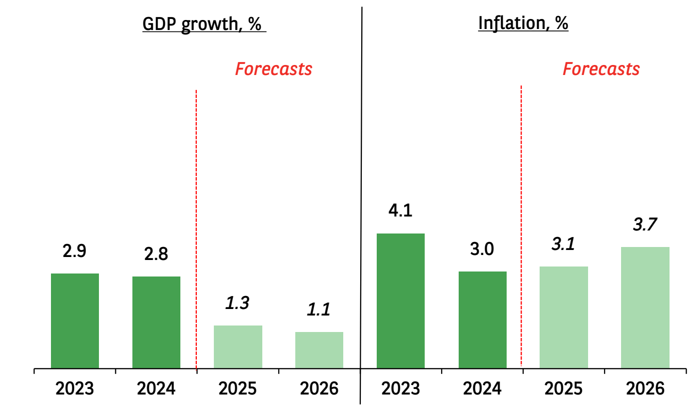

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

LABOUR MARKET: SO FAR, SO GOOD?

Nonfarm payrolls growth was maintained at a monthly pace of +150k - +170k since H2 2024. This is substantially above the equilibrium level, which the Fed's officials estimate at below 100k. At the same time, layoffs were not soaring, and the unemployment rate (4.2% in March 2025) remained below neutral (4.3% according to the Congressional Budget Office, CBO). While households have been gloomy about the unemployment outlook (51% expect more unemployment one year ahead, according to the University of Michigan, the highest level since April 2020), we expect the unemployment rate to rise to 4.6% by the end of 2025. However, the increased recession risk mechanically implies greater downside risks to employment. In addition, the action undertaken by the DOGE (Department of Government Efficiency) is likely to affect federal employment (1.9% of nonfarm payrolls in 2023) and adjacent employment (5.4% in the same year).

INFLATION: IMMINENT TAKE-OFF

Disinflation has been stalling lately. In Q1 2025, CPI headline and core inflation stood at +2.7% and +3.1% y/y, compared with +2.7% and +3.3% in Q3 2024, i.e. at the start of the rate cuts. We anticipate a sharp pick-up in inflation as a consequence of the Trump administration's trade and immigration policies. The main driver should be the rise in the price of goods, which will be directly affected by tariffs. Core inflation is expected to increase to +4.4% y/y in Q2 2026. The first signs of the upturn were visible in the ISM Manufacturing prices paid sub-component, a leading 1-year indicator of underlying inflation, which reached its highest level since 2022 in March.

Household inflation expectations have been soaring since Trump's election. According to the University of Michigan survey, they jumped from +2.7% to +5.0% over 1 year and from +3.0% to +4.1% over 5-10 years (the highest since 1991) between October 2024 and March 2025. At the same time, market expectations for the medium to long term remain well anchored (5Y5Y inflation swap below 2.2% in March), cf. *Chart 2*.

DEBT CEILING LOOMING

The next fiscal challenges relate to the extension and expansion of tax cuts under the Tax Cuts and Jobs Act (TCJA, the signature fiscal law of Trump 1), whose non-permanent provisions expire at the end of the year. In early April, the Senate voted to pass a budget resolution along these lines, which would increase the deficit by USD 5.8 trn over the 2026-2034 period (according to the Committee for a Responsible Budget), if adopted. The issue of debt sustainability (*see box*) would then become even more acute. The debt ceiling question will also quickly come to the fore. The CBO estimates that the 'X-date', i.e. the day after which the Treasury will no longer be able to honour its obligations to its creditors, will occur in August or September 2025 if the debt ceiling (USD 36.1 trillion) is not raised.

EXTENDED PAUSE FOR THE FED

The FOMC halted the easing cycle in 2025, holding the Fed Funds Target Range steady at +4.25% - +4.5% on two occasions, as employment concerns eased, and disinflation stalled. The Committee's position is now to await the 'net effect' (J. Powell's terminology) of the Trump administration's policy decisions – which we believe to be negative for growth overall and upbeat for inflation (due to tariffs and immigration restrictions) – before making any further adjustments. In this context, we expect the policy rate to remain stable throughout 2025. Moreover, despite recession worries, we believe that the prospect of a 'pre-emptive' cut is unrealistic – and risky – given that inflation is persistent and expected to rise. The easing would resume in 2026 (-125bp) in the face of rising unemployment and the start of a drop in inflation. Finally, beyond rate decisions alone, the Fed faces a major challenge in preserving its independence.

HOUSEHOLD' INFLATION EXPECTATIONS SOARING SINCE TRUMP'S WIN

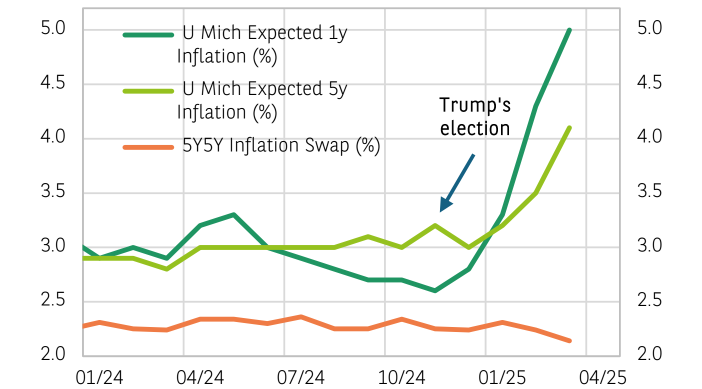

CHART 2

SOURCE: FRED (FEDERAL RESERVE ECONOMIC DATA), UNIVERSITY OF MICHIGAN, BNP PARIBAS

Article completed on 11 April March 2025

Anis Bensaidani
anis.bensaidani@bnpparibas.com

Fiscal Metrics: Thanks to the 'Exorbitant Privilege'

The CBO projects that the US federal deficit, which has been negative since 2001, will reach 6.2% of GDP in 2025, before averaging 5.8% between 2026 and 2035. These levels, unprecedented in the absence of war or recession, would contribute to raising the debt/GDP ratio to an all-time high in 2029. Furthermore, these projections are based on the current state of legislation. For example, they forecast a 1.0pp reduction in the deficit by 2027, due to the end of the TCJA's permanent provisions. However, the Trump/Bessent tandem's objective of extending these provisions poses an upward risk to the deficit (see 'Debt Ceiling Looming'). As for the possibility that tariff revenues or spending cuts (via DOGE actions or a vote in Congress) will help to reduce the deficit, this seems unrealistic given the likely negative effect of these measures on demand. In addition, the US is already facing a significant increase in interest charges, which will exceed discretionary spending (excluding defence) and military spending from this year onwards.

Such fiscal metrics would give rise to legitimate concerns about debt sustainability for any other sovereign. The United States escapes these considerations as the issuer of the USD, the world's reserve currency, and Treasuries, which play a predominant role in financial markets. Nonetheless, the possible implementation of heterodox policies, which cannot be entirely ruled out, aimed at challenging the independence of the Fed and/or depreciating the USD by forcing currency holders to exchange it for perpetual bonds (as mentioned by Stephen Miran, Chairman of the Council of Economic Advisors), would undermine the privileged status of the greenback.