

## EcoFlash

### US: Yellow Alert on Activity

**The adverse effects of the Trump administration's trade and migration policies on US economic activity are emerging, as they were reflected in the July Employment Situation report and the economy as a whole is exhibiting further signs of a clear loss of momentum. Meanwhile, the trade agreements recently signed should ease the uncertainty shock. Finally, the rebalancing of risks associated with increased fears about employment could challenge the Fed's wait-and-see stance.**

**Job growth plummets.** Concerns about the negative impact of the Trump administration's protectionist turn on the US economy, which have long been limited to survey data, materialised in July's Employment situation. Nonfarm payrolls (NFPs) came in well below expectations (73k, consensus: 106k) and, most notably, were accompanied by substantial downward revisions to May and June data, totalling -258k. As a result, the 3-month moving average dropped to just +35k, its lowest level since 2010<sup>1</sup>. **The immediate damaging effects of the administration's tariff offensive on activity can be seen in the sharp drop in hiring in May (19k) and June (14k)**, before July's partial rebound possibly linked to the de-escalation.

The unemployment rate remained in line with full employment (4.2%, +0.1pp), mitigating the negative surprise of job growth. Nevertheless, this consistency hinges on a downturn, namely a **weakening in the supply side of the labour market**. Over the past three months, the labour force has shrunk by 0.8 million and the participation rate has fallen by 0.4pp to 62.2%, its lowest level since November 2022. In addition, the non-native labour force has declined by 1.7 million since March<sup>2</sup>. **The US labour market has seemingly been penalised twice over: by weaker labour demand caused by the uncertain environment, and by a labour supply which is also losing momentum against the backdrop of an aggressive migration policy.**

**The loss of momentum in employment was matched by the Q2 GDP data.** While headline growth was favourable (+0.7% q/q, i.e. +3.0% AR), the figure concealed **the slowdown in core private demand for the third consecutive quarter** (+1.2% AR, the lowest since Q3 2022). Finally, measured as a half-yearly average to neutralise the volatility of imports in Q1 (up sharply) and Q2 (down sharply), growth slowed sharply to +0.6% in H1 2025, compared to the previous half year (+1.4% in H2 2024).

**Clarity around tariffs?** The negative 'net effect' of US economic policy, which was expected and is now visible, mainly relates to trade issues and the associated uncertainty and tariffs double shock. **Trade agreements** have been signed with major partners, such as the European Union (27/07) and Japan (22/07), and discussions are underway to extend the 'truce' with China. **These developments are relatively positive, as they reduce the uncertainty shock and help the business cycle to regain some predictability (see our analysis here).** However, **the tariff shock is still significant.** The average effective tariff on imports into the United States is estimated at 17.0%<sup>3</sup> (compared to 2.3% in 2024) after the latest round of announcements. **In addition to the first signs of this shock being transmitted to activity, the effects on prices are also emerging,** with an average effective rate already reaching 8.8% in May, the monthly change in goods inflation (excluding energy and vehicles) reached +0.55% in June, its highest rate since June 2022.

Meanwhile, **a significant step forward has been taken with the use of the tariff policy, with the purpose of starting to use it differently.** In particular, tariffs applied to Brazil have been raised to 50% (compared to 10% on Liberation Day, excluding sector-specific tariffs) and those on Canada to 35% (+10pp, excluding the USMCA and energy). These decisions were made after Donald Trump expressed his disagreement with Jair Bolsonaro's legal situation and Canada's plan to recognise the state of Palestine. Furthermore, they are accompanied by frequent threats to impose secondary tariffs<sup>4</sup>. While agreements have been signed on traditional concerns (bilateral deficits, targeting or sectoral exclusions), **a new and worrying phase may have begun, with economic weapons used for non-trade reasons.**

**The moment of truth is approaching for the Fed. The July Employment Situation report could prove to be a critical turning point for the FOMC.** Until now, the situation was fairly comfortable for the Fed, political pressure aside. The relative strength of the labour market afforded its members patience as they waited to observe the impact of tariffs on prices before adjusting the monetary stance. Those days are likely over, with the latest NFPs pointing to a rebalancing of risks surrounding the dual mandate due to increased concerns about the 'full employment' component. Looking ahead, the August Employment Situation report will be decisive, as signs of further weakening (negative payroll growth, downward revisions and a marked rise in the unemployment rate) could bring forward the rate cuts anticipated in our scenario for 2026. **At this stage, we are sticking to our scenario of**

<sup>1</sup> Apart from the outset of COVID-19.

<sup>2</sup> Non-SA.

<sup>3</sup> Fitch Ratings.

<sup>4</sup> Imposing additional customs duties on country A to discourage it from trading with country B.

**a steady target rate (4.25%–4.5%) for the whole of 2025, but we acknowledge the significant uncertainty now surrounding this call.**

Economic data are not the only pressure point for the Fed. At the FOMC meeting on 29 and 30 July, two governors (Michelle Bowman and Christopher Waller) dissented on the rate decision (they were in favour of a 25-bps cut), something which had not been seen in 32 years. The resignation of Governor Adriana Kugler, whose term was initially set to expire in January 2026, also frees up a seat on the board, from which Jerome Powell's successor will be chosen by President Donald Trump<sup>5</sup>. **As a result, Jerome Powell could find himself facing his replacement at the upcoming FOMC meetings**, with the associated risks of loss of influence and division within the committee.

**Markets are waiting for a rate cut. The financial markets' reaction to the NFPs was, understandably, negative.** The 1.6% daily decline recorded by the S&P 500 on Friday 1 August was the biggest since 21 April, which saw explicit threats of an (attempt of) imminent dismissal of Jerome Powell by Donald Trump. The losses had not yet been balanced out by 5 August. On 1 August, the US 10-year yield fell 14 bps to 4.22%. Finally, **the odds of a rate cut as early as September rose from 43% to 83% on the Fed Funds Futures market**, which weighs on the US dollar (-0.8% on the ICE index on 1 August).

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<sup>5</sup> Subject to confirmation by the US Senate by a simple majority.