MACROECONOMIC *view*

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Economic outlook 2025 - The world according to Trump

KEY HIGHLIGHTS:

- For the second year running, the US economy surprised on the upside in 2024.
- On the contrary, hopes of a recovery were partially dashed in Europe and China.
- Donald Trump's return raises major uncertainties, especially when it comes to international trade.
- Disinflation and a recovery in bank lending should support demand in Europe.
- German elections may provide an opportunity to ease the constraints on business.
- While the Fed is in pause mode, the ECB has every reason to ease policy.

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Post-mortem of 2024

For the second year running, the global economy dashed expectations of a growth slowdown. Real GDP grew by 3.2%, about the same as in 2023. The restrictive effects of the monetary tightening initiated in 2022 were cushioned by solid job creation, a recovery in real incomes and various fiscal supports

On closer examination, this positive surprise is due solely to the United States, as reflected in the outperformance of its stock market and the appreciation of the dollar. The American consumer remains the main driver of global demand. In Europe and China, on the other hand, households are wavering between caution and depression. They have increased their already high savings rates. These regions face deep-seated structural challenges, be it industrial malaise in Germany, fiscal irresponsibility in France or the deflating of property bubble in China.

Entering 2025 on very different trajectories

All in all, the three major regions are entering 2025 on very different cyclical paths. On the US side, economic growth, at close to 3%, is above its medium-term trend, with the result that disinflation has been halted for several months.

In Europe, business activity is growing at a much slower pace than normal, coming in below 1%. This is largely due to the fact that the German economy has been at a standstill for the past two years. Inflation is already below the central bank's target in many eurozone countries. Europe has embarked on a timid export-led recovery, but consumption and investment remain weak.

The situation in China is paradoxical. The country's macroeconomic performance is mediocre, with weak domestic demand fuelling deflationary pressures. At the same time, China dominates many cutting-edge sectors (electric vehicles, green energy). To date, the Chinese authorities have done little to stimulate consumption, preferring to encourage supply in sectors deemed strategic. This strategy is only sustainable if China gains export market share. This can only fuel trade friction with the United States and Europe.

The "Trump unknown"

Any economic forecasting scenario inevitably depends on certain random factors, "unknowns" affecting the political situation, monetary and fiscal decisions, trade frictions and diplomatic relations. In 2025, all these questions converge on Donald Trump.

We know everything about his intentions. Since 2016, he has relentlessly advocated the same ideas: fighting illegal immigration, lowering taxes and erecting customs barriers. **This program, summed up by the slogan "*Make America Great Again*", is that of a predator at the top of the food chain.** To survive, you have to be cunning or capable of displaying strength. The difference with his first term is that this time Donald Trump is better prepared, has a more loyal team (albeit with opposing factions on some points) and has set himself more ambitious goals.

The implementation of this program is fraught with uncertainty as to the scale of the various measures and their sequencing. There is no doubt that customs duties will be raised (graph). But when, at what level, on which countries, on which products, etc., are all open questions, given the wide variety of proposals put forward in recent months. Tariff uncertainty could prove more damaging than the tariffs themselves.

While we await further details, we can draw up a hierarchy of shocks. According to the Peterson Institute, an American think tank specializing in international economics, the greatest disruption would come from a challenge to the Fed's independence. The mass expulsion of illegal workers could create labor shortages. As for the tariff war, it will affect world trade, especially if it involves a large number of countries (and not just China) and if there are retaliatory measures. In any case, the US economy will not be immune. Additional customs revenues will never cover the tax cuts promised to households and businesses, Elon Musk's ranting about federal spending cuts is unrealistic, and the budget deficit will grow. Bond markets are reassessing the risk premium and the Fed central bank has activated the pause mode.

What hopes for Europe?

There were good reasons to expect an economic recovery in Europe in 2024: disinflation, the nascent rebound in bank lending and the ECB's monetary pivot. On the other hand, rising political uncertainty in France and Germany has led to spending decisions being suspended or postponed. The business climate is gloomy. At first glance, the economic outlook remains bleak.

However, it is often in the face of adversity that Europe shows itself capable of pulling itself together. Under pressure from Donald Trump, Europe is being forced to seriously rethink its economic model and its security. Defense issues demand investment. It is also essential to regain political stability. In France, the new government seems less vulnerable to a no-confidence vote than the previous one. In Germany, the early elections give us hope that the next coalition will succeed in loosening the constraints on manufacturing activity. Reducing the cost of energy for businesses (via subsidies) and relaxing the debt brake are prerequisites for reawakening the German economy and restoring its role as a driving force for the rest of Europe.

The ECB also has a role to play in easing financing conditions. In the short term, the risk of inflation is pointing down, not up. It's not just a "neutral" monetary policy that the ECB should be aiming for (policy rates between 2% and 2.5%), but a truly accommodating one. Given the cyclical differences between the United States and Europe, the ECB has every reason to decouple its actions from those of the Fed. The coming months promise a series of ECB rate cuts.

US: IMPLIED CUSTOMS TARIFF RATE ON...

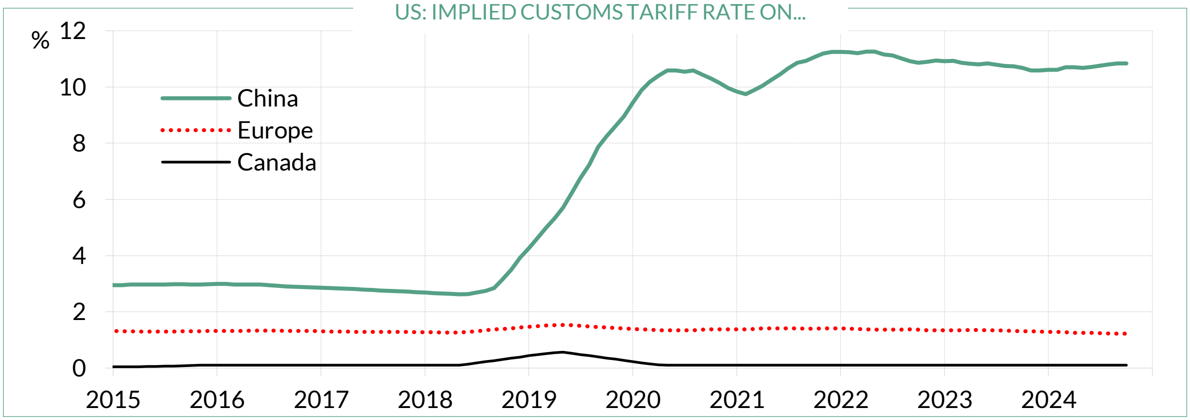

Chart source: Census Bureau, ODDO BHF

Past performance is not a reliable indicator of future returns and is subject to fluctuation over time. Performance may rise or fall for investments with foreign currency exposure due to exchange rate fluctuations. Emerging markets may be subject to more political, economic or structural challenges than developed markets, which may result in a higher risk

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