



ODDO BHF

MACROECONOMIC *view*

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Bad policy makes bad economics

KEY HIGHLIGHTS:



- The global economy has held up well so far, but the outlook is gloomy
- Worrying cracks are being heard in the US labor market
- The Fed is expected to cut its policy rates several times in the coming months
- In contrast, the ECB considers that it has successfully recalibrated its monetary policy
- Germany has shed its fiscal austerity, but the investment plan is still pending
- France, relatively highly indebted and politically blocked, threatened with sanctions from the financial markets



After more than six months of Trump's presidency, marked by ruptures many in areas as international trade, geopolitics and the central bank's independence, the world economy has not deviated from its trajectory. In the first half of the year, we estimate that real GDP grew by an annualised 3% globally, barely less than in 2023 and 2024. A 3% economic growth is also what the IMF is now forecasting for the next two years. Does this mean that Trump is much ado about nothing? It would be nice to get off so lightly, but this is unlikely.

Admittedly, some of the US president's heated rhetoric, such as his promise to end all wars across the world within a few days, has not had any concrete effects. It is also usual in expansion phases to see only slow and gradual changes. Economic conditions adjust rapidly for example if there is a financial crisis, a pandemic or a war. The markets' adverse reaction to the Liberation Day tariff shock in early April raised fears of such a scenario, pushing up the risk of a recession. This announcement was followed by many changes of mind and various adjustments that delayed the implementation of new tariffs. When a tariff announced on Monday can be suspended on Tuesday or raised on Wednesday, the best response is to wait. Extreme uncertainty creates a wait-and-see attitude. But this only lasts for a certain time.

In terms of tariffs, the latest announcement shows a more moderate increase of tariffs compared to the announcements made on the day of liberation with a few

exceptions (Switzerland, India and Brazil). The pause in the tariff conflict with China has been extended until November. The EU, Japan and a few other countries have signed trade agreements with the US. None are guaranteed by a formal legal treaty, but at least this gives the companies affected a little planning security. On the basis of these announcements, the average tariff would rise to just over 15% (vs 2.5% in January and 10% in June). According to two court decisions, half of these measures are not even legal. They will stay in place pending a final decision by the Supreme Court within a few months. If its appeal is rejected, the Trump administration has other legal options to achieve the same outcome. In short: While the tariff shock is considerable, it is viewed as a little less disruptive than a few months ago.

Another point of the Trump program was achieved with the adoption of the Big Beautiful Bill Act, which extends tax cuts enacted in 2017 and adds a few others. This avoids raising tax pressure on budget at the start of 2026. That said, no-one except at the White House is forecasting a strong stimulus impact on growth. In reality, the main effect of this plan is to delay any effort to lower the federal deficit, which currently stands at just above 6% of GDP. Pressures on long-term interest rates, partly reflecting a rise in the term premium, suggest that investors are not comfortable with this situation. This weighs indirectly on the cost of mortgages and prolongs the downturn in the construction sector.



The US president has recently increased his pressure on the Fed. He is no longer just talking negative about Jerome Powell, he is also trying to install a majority of loyal confidants onto the Fed's board of directors in order to potentially dismiss the presidents of the regional Feds and thus further expand his influence over the FOMC (Federal Open Market Committee). A vacant post opened up at a timely moment in early August. Another vacant post could follow if Lisa Cook's dismissal is approved by the courts. For Trump, controlling the Fed would not only allow him to accelerate the reduction of interest rates but would also be a way to monetise the national debt. Such a possibility, purely theoretical at this stage, is likely to raise medium-term inflation expectations. This is an upside risk for interest rates and a downside risk for the dollar.

In the US, the resilience of economy does not prevent a correction in future. The US labour market is sending more and more negative signals. Employment growth slows down. Due to persistent inflation, real wage growth is slowing down causing household consumption – the heart of the US growth engine – is tending decline. A crisis in the labour market could further increase this situation. This economic cycle is at great risk of weakening in the short term. The Fed is aware of this and seems ready to resume this month the cycle of cutting interest rates it suspended nine months ago. However, opposing pressures on its dual mandate give it limited scope for action.

In the rest of the world, the economic cycle partly reflects the fluctuations of US growth. In Q1, before tariffs were put in place, US demand for foreign goods increased, causing inventories to grow, before decreasing again in Q2. It is too soon to identify more fundamental changes to the structure of global trade. Asian countries that served as a transit zone for Chinese exports seeking to escape the tariffs of 2018 are threatened with higher tariffs. China, whose growth is highly dependent on exports due to its weak domestic demand, will therefore seek other possibilities and other markets.

In this context, the European economy is facing two problems: in the US market, its exports are less competitive, and in its domestic market it is coming under competition from China. Europe, which opposed a 10% "reciprocal tariff" in April, is all too happy to accept a 15% tariff in August (Trump had threatened 50%). Germany is vulnerable, despite the accommodation reached on automotive tariffs. This is why the new government is seeking a new growth driver by stimulating capital investments. Business confidence has reacted well so far, but this investment plan is proving slow to materialise. It is this plan that partly underpins hopes of an acceleration in the eurozone. The other recovery factor is a reduction in the savings rate of households, also postponed to date. Now that inflation has normalised and the labour market is fairly solid, the ECB's interest rate-cutting cycle is over.

As for France, almost nothing has changed in the past year, with the same toxic interactions between the political and social situation (Stagnation and reform bottleneck) and fiscal problems (deficit reduction). The markets demand a higher risk premium on France, which is logical. Two governments have fallen in less than a year. Households and businesses are concerned about fiscal instability and proposed tax increases and have reduced their investment plans.

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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