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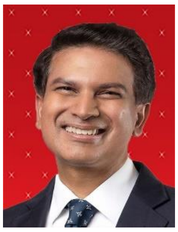
Macro Insights Weekly

Recession watch?

Group Research

March 10, 2025



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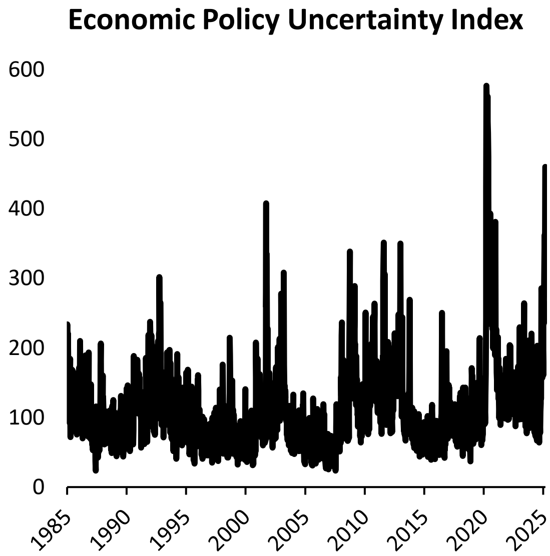
- *In a remarkable change in economic momentum over two months, the US economy is sputtering. Recession may not be around the corner, but worrisome undertones are building up.*
- *Key driver of weakening GDP is a surge in imports, making net exports' contribution negative.*
- *There are concerns about consumption and investment outlook as well.*
- *Growth markers may be weakening, but inflation remains sticky.*
- *Fed policy calculus would become challenging if such dynamics persist.*
- *Forthcoming tax policy measures would add further complication to the equation.*

Chart of the Week: Spike in US policy uncertainty

Relentless back and forth on trade, national security, and government operations have raised consumer and business anxiety in the US. Additionally, policy uncertainty has risen substantially. An index of policy uncertainty, calculated by tallying relevant keywords appearing daily on US media, shows the index reading at its second-highest in 40 years, the only exception being the early months of the Covid pandemic. During this century, spikes in the index have coincided with recessions. Worrisome reading indeed.



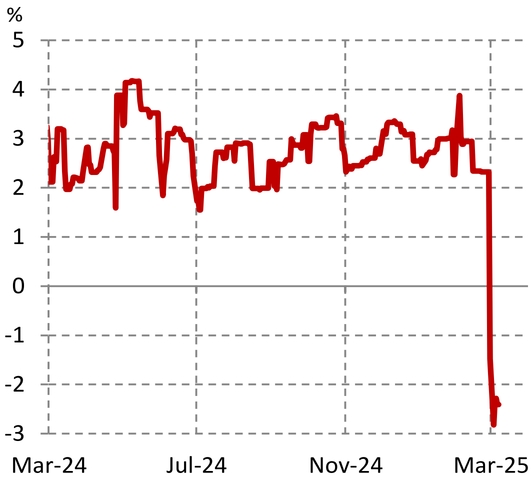
Source: St Louis Federal Reserve, DBS

Commentary: Recession watch?

In a remarkable change in economic momentum over two months, the US economy is sputtering. The signs are noisy and could be subject to seasonality, but the fact is the first quarter of 2025 is presently on track to record a contraction over the previous quarter. Atlanta Fed's real GDP Nowcast model is presently tracking minus 2.4% growth, annualised, for the quarter, a most striking fall from tracking nearly 4% just a couple of months ago.

The key driver of the contraction is a surge in imports, which makes net exports' contribution of GDP substantially negative. This most likely reflects front-loading of exports ahead of a myriad of Trump tariffs. But there are also signs, both from surveys and actual data, of consumption and investment slowing amidst rising uncertainty about the policy environment. Public spending is also a source of concern, with a range of job rationalisation measures underway under the direction of Elon Musk. Some of the downside in the Atlanta Fed GDP tracker may fade as one-offs disappear, but these are extraordinarily opaque times for the growth outlook.

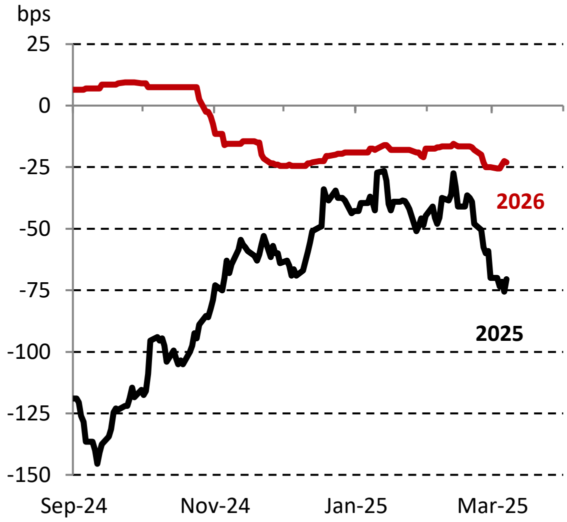
US GDP Nowcast (Atlanta Fed)



Source: Bloomberg, DBS

Markets have taken note. The S&P500 has given up all its gains since the November elections. Risk-on assets like bitcoin have sold off. Long-term bonds have gained. Market pricing for the Fed Funds rates, despite rising risks to inflation, has begun to move toward more rate cuts.

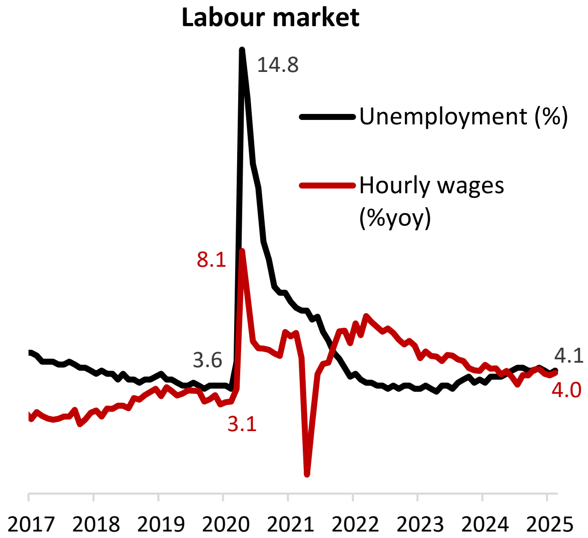
Pricing for Fed Hikes(+)/Cuts(-)



Source: Bloomberg, DBS

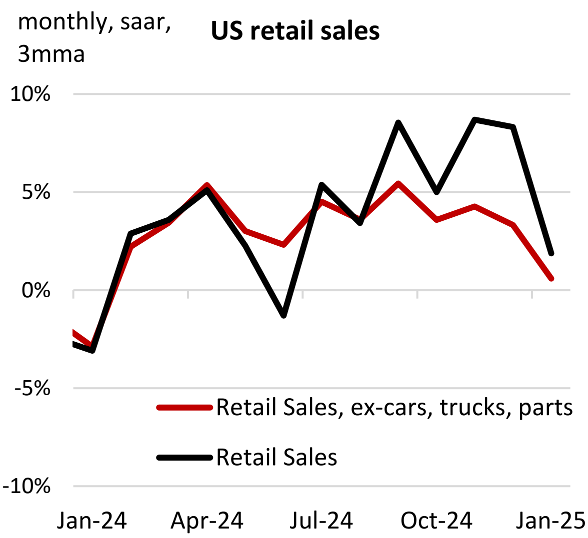
In his latest speech, Fed Chair Powell displayed little concern with regards to the economy or the need for imminent rate cuts. He conceded that some uncertainty has been created by President Trump's escalating trade war but kept the message about the Fed's reaction function clear—the central bank would cut rates only after it is assured of the path toward 2% inflation. If the Fed stays steadfast in its inflation target, large number of rate cuts in 2025 would be unlikely.

The Fed appears not worried about the noise coming from layoffs in the public sector. Granted, through the end of February, there has been no discernible weakening of labour market indicators, with the February unemployment rate steady at 4.1% and wages up 4%yoy.

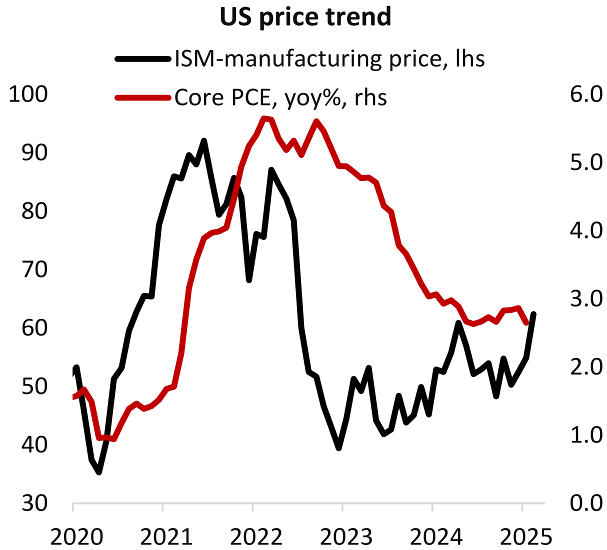


Source: CEIC, DBS. Data through Feb 2024

But consumers have gotten nervous and have begun postponing purchases, as seen by the surprisingly weak January retail sales data. University Michigan survey of consumers shows a sharp deterioration in confidence, while inflation expectations have risen both among consumers and businesses. It remains to be seen how the stagflationary mix of weakening consumer confidence and rising inflation expectations can sustain, but as long as trade war related noise persists, this may well be the making of things to come.

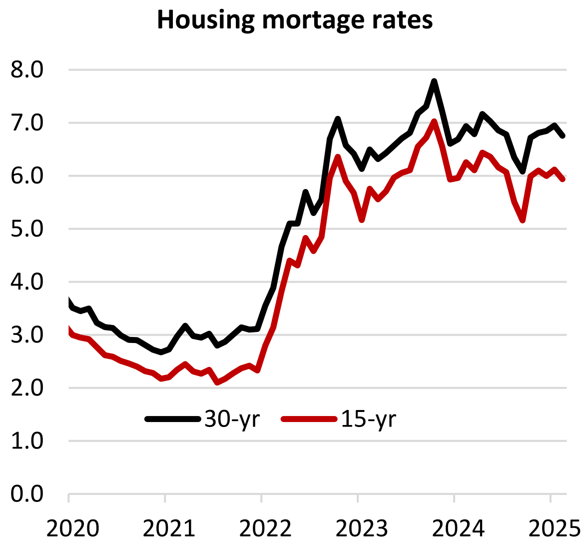


Source: CEIC, DBS.



Source: CEIC, DBS.

The upshot of the ongoing policy whiplash is that long-term interest rates have fallen in expectations of Fed easing, which has in turn weakened the USD. Mortgage rates have also eased a tad. These developments act as modest offsets to the erosion in asset values.



Source: Bloomberg, DBS

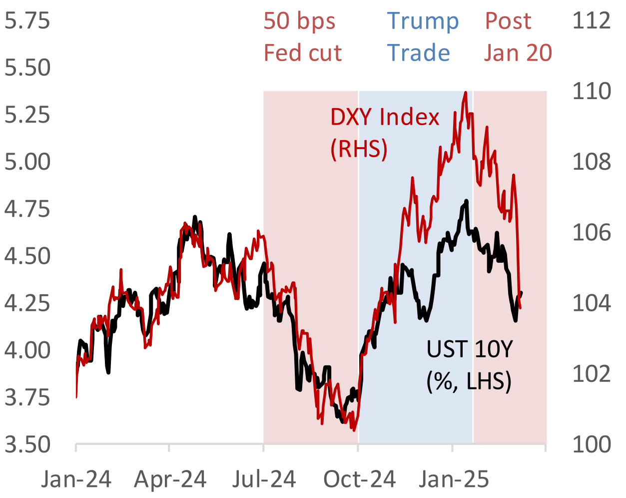
We don't think a recession is around the corner in the US, but an unpleasant combination of weaker growth and sticky inflation is certainly on the cards. This would create a range of policy complications, from monetary policy to tax cuts. No free lunch in macro management.

Taimur Baig

FX: The USD's weak momentum carries potential risks too

Following last week's aggressive sell-off, we are staying vigilant regarding factors that can hurt or reverse its downward momentum. Last week, the DXY and the S&P 500 indices returned to levels observed around the November 2024 US elections. **Investors perceived Trump's trade and geopolitical actions as undermining the narrative of US exceptionalism.** However, after the greenback's aggressive sell-off last week, the 14-day RSI indicated that the DXY has entered oversold territory, while the EUR and GBP have reached overbought levels.

USD gave back Trump Trade premium

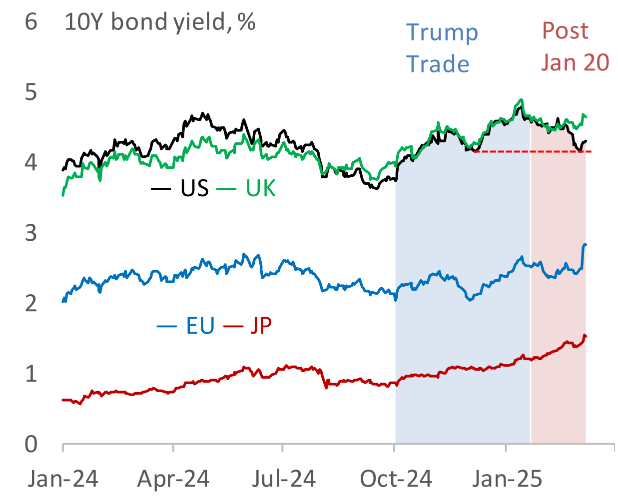


Sources: DBS Research, Bloomberg data

The DXY's recoupling with the US 10Y bond yield may move it away from Trump's erratic announcements towards a more fundamentally driven market.

Before this week's Fed blackout period, **Fed Chair Jerome Powell played down growth worries** after last Friday's lower-than-expected nonfarm payrolls, adding that the **Fed was separating the signal from the noise**. Powell emphasized the Fed was well-positioned to wait for greater clarity on the net effects of the White House's four main policy thrusts – trade, immigration, fiscal policy, and regulation – before making any adjustments to interest rates. Here, markets will seek guidance in the Fed's Summary of Economic Projections, given the forgone conclusion that the Fed Funds Rate will stay unchanged at 4.25-4.50%.

US 10Y bond yield may have found support



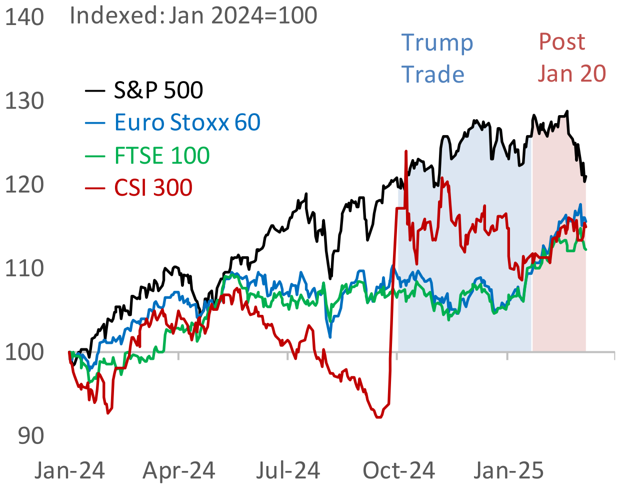
Sources: DBS Research, Bloomberg data

On tariffs, the Fed will pay attention to longer-term inflation expectations. Today, the **New York Fed inflation expectations** at the 1Y, 3Y, and 5Y horizons may extend their rises above 3% in February. This **coupled with upside surprises in CPI inflation** (out on March 12th), **could lift the US Treasury 10Y yield and the DXY**. If so, this could undermine the JPY and the CHF as alternative havens to the USD.

Despite Trump's inconsistent approach to tariffs on US imports from Canada and Mexico, characterized by temporary delays and partial exemptions, he warned of possible **reciprocal tariffs on Canadian lumber and dairy products** this Friday. Neither Canada nor Mexico will be spared from the 25% **tariff on steel and aluminum** taking effect on March 12th. Trump promised a wave of **reciprocal tariffs on April 2nd which will target EU goods** with a 25% tariff.

Trump was **unwavering in incrementally escalating tariffs on Chinese goods** from 10% on February 4th to 20% on March 4th. Canada and China have retaliated with tariffs on US goods, with Mexico and the EU promising to do the same. **Most countries**, including the US, **believe tit-for-tat tariffs would hurt the global economy, a factor that could reinstate the USD's haven status**.

Other stock markets stopping rising too



Sources: DBS Research, Bloomberg data

Besides his trade policy escalating global trade tensions, Trump's foreign policy affects international relationships.

The DXY's decline last week was driven by the whopping 4.4% surge in the EUR, its largest component. Following the Trump-Zelensky clash in the Oval Office on February 28th, EU nations collectively reinforced their commitment to uphold security and sovereignty in Ukraine and Europe in response to greater external threats from America's withdrawal of support. The **EU 10Y bond yield surged 43 bps to 2.84% on the "ReArm Europe" plan** to mobilize up to EUR800bn to enhance the EU's defence infrastructure by relaxing the EU budgetary constraints. However, the **EU's consensus-based decision-making process can delay the implementation of the ambitious defence initiatives**.

Moreover, the EU's goal to deter future Russian aggression could be perceived by the Kremlin as provocations, resulting in a hardening stance that makes it challenging to achieve sustainable peace in Ukraine. Washington's withdrawal of military aid and intelligence has emboldened Russia to intensify military operations against Ukraine to weaken Kyiv's political will.

US and Ukrainian officials will meet in Saudi Arabia to resume dialogue on the Washington-led peace initiative with Russia. Ukrainian President Volodymyr Zelensky will meet Saudi Arabia's Crown Price but not attend the talks led by US Secretary of State Marco Rubio. The Ukrainians will want to establish whether Washington will resume military support for Ukraine upon signing the minerals deal and whether the US is pushing for elections in Ukraine.

Overall, it is still premature to expect significant progress towards peace or a ceasefire between Ukraine and Russia. Finding a middle ground remains challenging, given Ukraine's determination to defend its sovereignty and territorial integrity against Russia's insecurity regarding Western encroachment.

Hence, the **EUR's upward momentum may wane or even correct** if worries return over Ukraine's precarious situation and potential US tariffs on EU goods or if US inflation and inflation expectations start surprising.

Philip Wee

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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