Trump's policies, the main question mark surrounding the global economic outlook

Developing forecast scenarios in economics is far from an exact science and the forecasts that are produced are always subject to a certain margin of error. However, the current context is especially challenging, as Trump's second term seems more unpredictable, generating more economic uncertainty and financial volatility. In fact, in less than a month, Trump has signed more than 60 executive orders, three times the number signed in the first 100 days of his first term and almost twice as many as Biden in the same time interval. These measures have focused, above all, on controlling immigration and raising tariffs.

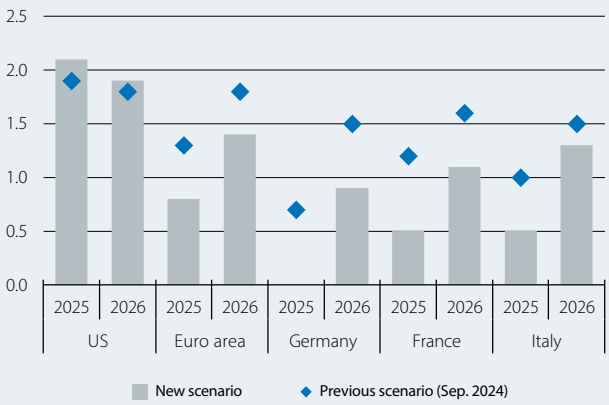
Trump uses tariffs as a negotiating tool, following a pattern similar to during his first term: he announces strong measures, signs the executive order, and then postpones its application in order to open negotiations, which in some cases can lead to the initial tariff being reduced or even eliminated. Thus, at the close of this report, we have on the table 20 additional pps to be imposed on products originating in China (China has responded with a tariff of 10%-15% on energy products, cars and various agricultural products); an increase of 25 pps in the tariff on imports from Mexico and Canada and of 10 pps on Canadian energy; 25% on steel and aluminium, and reciprocal tariffs on the EU and other economies currently being studied (a tariff of 25% «generally speaking» has been mentioned in the case of the EU); and a tariff on all agricultural imports from 2 April has been announced. He also announced that the customs exemption for all shipments from China with a value of less than 800 dollars will remain in place until appropriate systems for processing and collecting tariff revenues are developed.

We are therefore heading towards a context with higher tariffs and in which, most likely, there will be some reconfiguration of global value chains in an attempt to compensate, insofar as possible, for the loss of attractiveness of the US market. Consequently, we are moving towards a world with greater fragmentation, lower economic growth and the risk of higher inflation. In elaborating the new forecast scenarios, we have assumed a situation with a contained trade war in which there is no escalation and in which the new rules of the game are established by the middle of the year.

The euro area, in a weak starting position to face a year of challenges

The euro area closed 2024 practically stagnant (0.1% quarter-on-quarter in Q4 2024), with Germany and France recording negative GDP growth. The first indicators of 2025 point to a certain stabilisation of activity, but we cannot expect to see any significant upturn in the short term (see the International Economy - Economic Outlook section of this same report). Therefore, the euro area is in a rather weak starting position to overcome the significant challenges it faces, which are not just limited to the impact of a tariff hike by the US. There are also domestic factors which could impair activity growth in the region's large economies during the first half of the year. On the one hand, the political instability in France still persists and the possibility of new elections this summer cannot be ruled out. On the other hand, in Germany, the elections held on 23 February handed victory to the CDU/CSU with 28.5% of the votes and they could form a coalition government with the SPD (16.4%). However, the strong performance of the AfD (21%) and of the radical left party Die Linke (9%) gives them enough seats to block changes to the «debt brake», which requires the approval of two-thirds of the House. All this is taking place while progress is being made in the sphere of fiscal consolidation, on the objectives of the so-called Competitiveness Compass presented in February by the European Commission and on the recommendations of the Draghi report, and also while the need to substantially boost defence spending is being addressed, now that it is clear that Europe cannot rely solely on NATO to guarantee its security. Consequently, growth for 2025 is estimated at 0.8% and for 2026 at 1.4%, 0.5 pps and 0.4 pps, respectively, lower than the previous forecasts. We will have to wait to see if there is any response on the fiscal side that can stimulate activity in the coming quarters.

GDP growth forecasts for the US and euro area
(%)



Source: *CaixaBank Research.*

The impact on inflation, meanwhile, is not so clear. The imposition of reciprocal tariffs on the US represents an upside risk for prices, which could be offset by weak domestic demand, the limited ability of companies to translate the tariff hikes to final prices and the potential redirection of trade flows from China to the euro area. Therefore, we have kept the inflation scenario virtually unchanged, which also limits the modest adjustments in our expectations for the ECB's interest rates. Thus, after the 25-bp cut already approved in January, we expect the depo rate to be in the lower end (1.75%) of the range considered neutral, before returning to 2% in 2026.

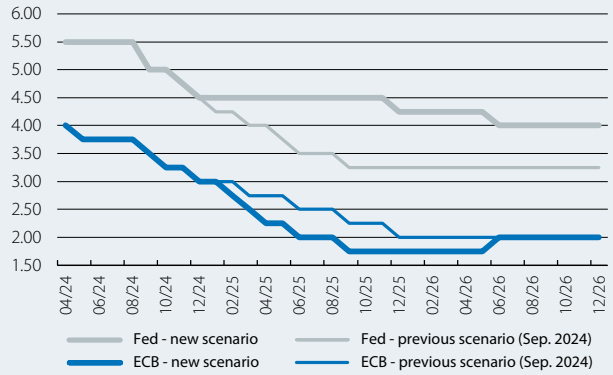
Trump's political agenda would negatively affect US growth and raise inflation

The US economy has been performing better than expected in the past two years, but this could change going forward. The Trump administration's agenda, designed to *Make America Great Again*, could have the opposite effect. The attempt to cut the size of the public sector considerably could lead to a certain demand shock due to job losses, reduced public spending and increased uncertainty linked to cuts in social programmes. Coupled with the supply shock that could be triggered by the restrictive immigration measures and the tariff hikes, this will have a negative impact on growth and increase the risk of higher inflation. However, the positive inertia of the economy will persist during the first half of the year and it will not be until the second half of 2025 and early 2026 that the impact of the measures on growth will be felt more intensely. This explains why we anticipate GDP growth of 2.1% in 2025 and of 1.9% in 2026, slightly above the previous forecasts. However, this good outlook masks the fact that, in the absence of Trump's measures, average growth in both years could have been around 0.5 pps higher. Regarding headline inflation, we estimate that it will reach 3.1% this year and 2.7% in 2026, which would be around 0.2 and 0.4 pps higher, respectively, than without the Trump agenda.

This higher inflation, in a context of relative buoyancy in the economy, explains the substantial adjustment we have made to expectations for the Fed's interest rates, with a much less aggressive and more gradual pattern of rate cuts than had been expected up until now. Thus, we anticipate a single rate cut at the end of the year of 25 bps, which would place the upper band of the Fed Funds rate at 4.25%. We then expect it to remain at that level until around mid-2026, when another 25-bp cut could bring it down to 4.0%, where it would remain for the rest of the year.

Expectations regarding Fed and ECB interest rates

(%)



Note: *Fed fund upper bound rate for the Fed and depo rate for the ECB.*
Source: *CaixaBank Research.*

China, one of the main targets of Trump's tariff policy

The Chinese economy just about managed to meet the 5.0% growth target in 2024, but expectations for this year are somewhat more pessimistic. One of the goals of the new Trump administration is to reduce the trade deficit with China and, to this end, it has already begun a cycle of tariff hikes on its imports, as promised during the election campaign. In response to the renewed US protectionism, China has already approved tariffs on certain products, with the automotive and energy sectors being the most affected, as well as restrictions on exports of critical minerals. In addition, the Chinese authorities have launched an antitrust investigation against Google and added US companies to their list of untrusted entities, suggesting that they are preparing to retaliate if the upcoming bilateral tariff negotiations fail. Given the weakness that lies ahead for the country's foreign demand, the Chinese authorities have already shown their commitment to continuing to support growth this year. In this regard, there is still a great deal of uncertainty regarding the magnitude of the fiscal stimulus and we will have to wait for the conclusion of the «Two Sessions» at the start of March to learn more about it, but all the indicators suggest that it will depend on how the negotiations with the US evolve.

What seems clear is that the impact of the ongoing trade war will cause a slowdown in the economy and we anticipate growth of 4.2% in 2025 and of 3.9% in 2026, around 0.5 pps lower than would have been achieved in the absence of this surge in global protectionism.

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