Monthly Economic Monitor - World

Economics and Strategy

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Global economy vulnerable to potential trade war

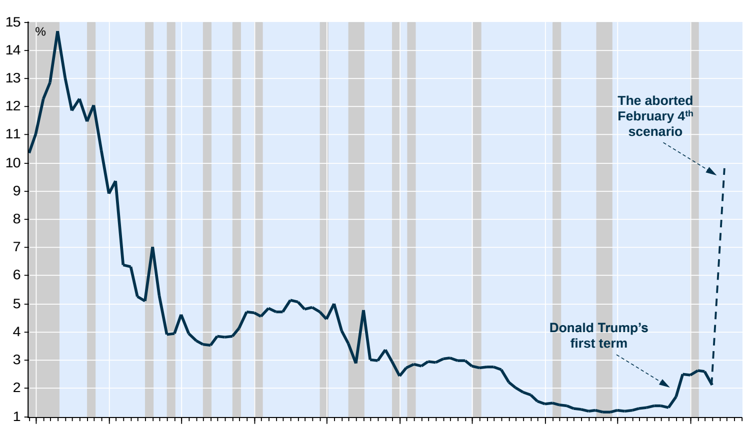
By Jocelyn Paquet

Summary

- The global economic outlook is certainly not uniformly poor at present. The political impasse in France and Germany could yet improve, and conflicts in Eastern Europe and the Middle East could subside. This would certainly be good for growth, as would continued healthy expansion in the USA. The continued monetary easing telegraphed for 2025 by many central banks will also be welcome.
- But all this could pale in the face of rising uncertainty. For, should the election of Donald Trump as President of the United States prove to be a real turning point in modern economic history, should the globalization process of the last 70 years stagnate, or worse, be reversed, many economies would find themselves in a poor position to face the many challenges that such a scenario would inevitably bring.
- Fortunately, this is not our baseline scenario. We continue to believe that Washington's protectionist instincts will remain relatively contained, and that the worst of the trade war can be avoided. This does not mean, however, that global growth will be robust. The mere threat of tariffs is likely to hang over our heads for the next four years and is unlikely to stimulate business investment. And when businesses are less confident, the labour market tends to be less buoyant and consumption less vigorous. We still expect global GDP to grow by 3.0% in 2025. The expansion should be a tad more robust in 2026 (+3.1%).

To say that the last few days have been a rollercoaster of emotions would be an understatement. After promising to impose tariffs on most U.S. trading partners on the first day of his administration, President Trump first relented on his threat, only to reiterate it a few days later. For a time, he even toyed with the idea of imposing 25% tariffs on most products from Canada (excluding oil, which would have been subject to a surtax of “only” 10%) and Mexico, and 10% on those from China, a move that would have set the world back a century when it comes to trade policy.

The world was almost transported back a century
Custom duties as a percentage of total imports

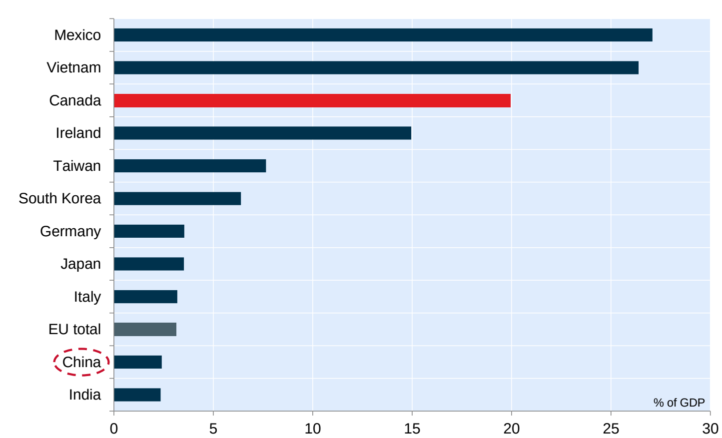


NBC Economics and Strategy (data via Fred St Louis and Peterson Institute)

Following emergency telephone exchanges with the President of Mexico and the Prime Minister of Canada, during which both countries promised to strengthen border security, the threat to the two U.S. neighbours was finally lifted... but only for a month. Tariffs on Chinese products went ahead as planned, prompting a measured response from the world's second-largest economy. The Chinese authorities declared that they would impose a 10% tariff on a series of American products, including crude oil, and that they would tighten export quotas on several rare metals, including molybdenum and tungsten.

The economic impact of these measures is likely to be fairly limited, as exports to the U.S. account for just 2.4% of Chinese GDP, a much smaller share than in Canada (20%) and Mexico (27%). In any case, trade volumes may not fall as much as some fear, in a context where the U.S. may struggle to find alternatives. What's more, even when they do exist, alternatives to Chinese products could remain more expensive, even after tariffs have been applied. In this case, the surtax would have to be internalized by companies (via reduced margins) or passed on to American consumers.

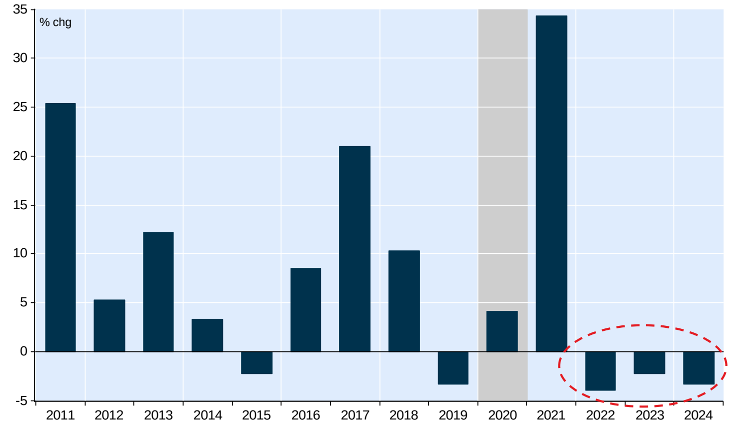
China less dependent on U.S. demand
Merchandise exports to the U.S. as a percentage of 2023 GDP



NBC Economics and Strategy (data via the Census Bureau and the IMF)

However small their impact, tariffs are unlikely to help a Chinese economy that is still struggling to find its feet. Although GDP reached the target set by the authorities for 2024 (+5.0%), corporate profits contracted for the third year running.

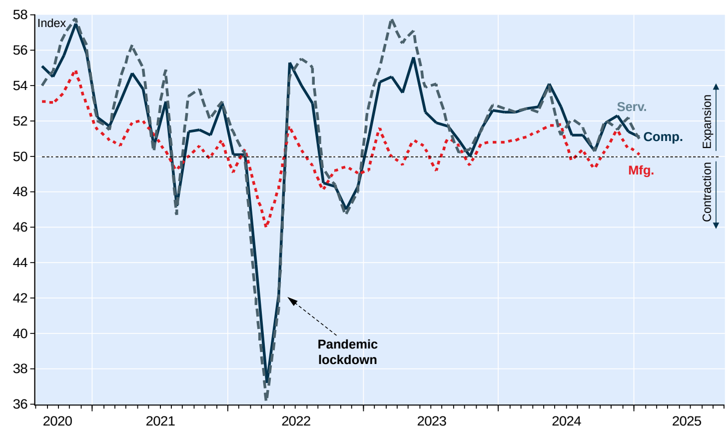
China: Corporate profits contracted for a third consecutive year in 2024
Industrial profits



NBC Economics and Strategy (data via Bloomberg)

And things don't seem to have improved much at the start of 2025, judging by the deceleration in private sector activity reported by Caixin in January.

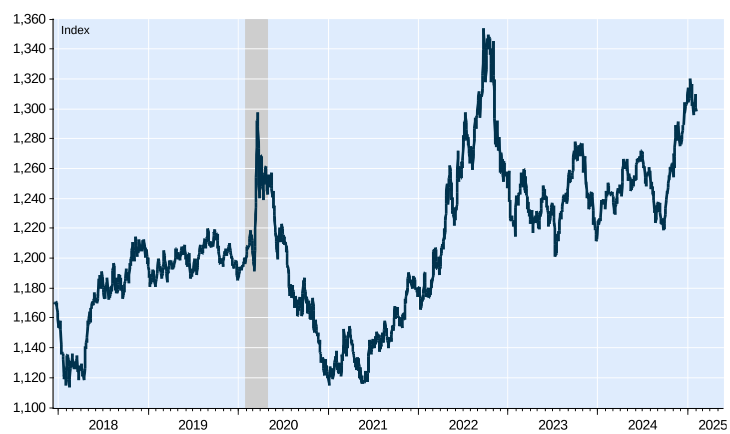
China: Economic activity remains subdued
Caixin Composite PMI. Last observation: January 2025



NBC Economics and Strategy (data via Bloomberg)

Although not directly targeted by Washington, other emerging economies are nonetheless affected by the growing uncertainty surrounding trade policy, if only through a rise in the value of the U.S. dollar...

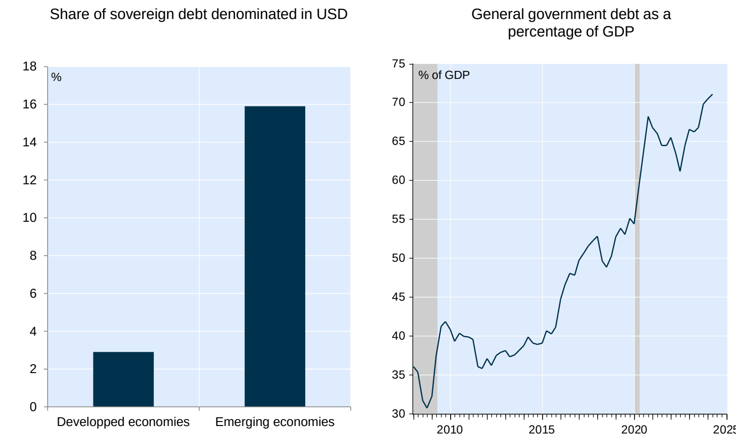
World: Stronger USD a risk for emerging markets (1)
Bloomberg USD Spot Index



NBC Economics and Strategy (data via Bloomberg)

...which is making it more difficult for emerging market governments to service their ever-increasing debt.

World: Stronger USD a risk for emerging markets (2)



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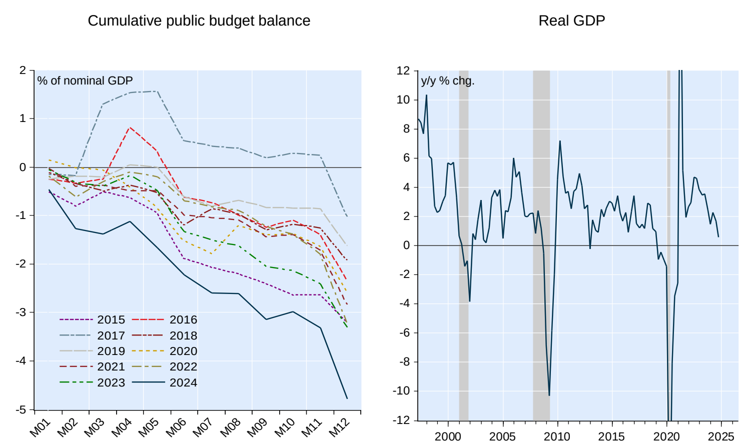
For the appreciation of the greenback has highlighted the main underlying weakness of emerging markets: their lack of fiscal discipline. Related questions about these countries' ability to repay their debts have even had repercussions on currency markets, with the Brazilian real and Indian rupee coming under pressure in recent weeks.

A quick glance at key fiscal statistics suggests that Mexico could also find itself in the crosshairs of investors (and perhaps rating agencies too) in the short to medium term. The country may have obtained a reprieve on the tariff front, but this has not prevented its economic situation from deteriorating significantly, calling into question its ability to maintain such a yawning deficit. Although the authorities seem to have lost control of the purse strings, real GDP still contracted in the fourth quarter of 2024 and showed only a marginal increase over 12 months.

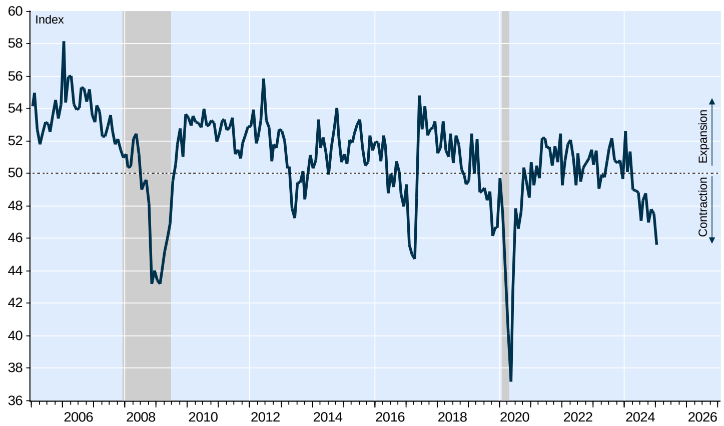
Mexico: Little to show for massive deficits



NBC Economics and Strategy (data via Bloomberg)

The woes of Mexican factories only make the country more vulnerable to a deterioration in trade relations with its northern neighbour, as tariffs would presumably hit the manufacturing sector harder.

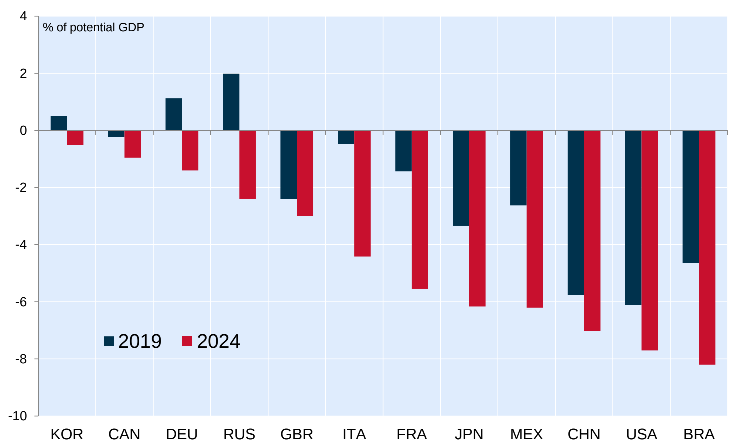
Mexico: Manufacturing takes a turn for the worse
IMEF Manufacturing PMI



NBC Economics and Strategy (data via Bloomberg)

Mexico is not alone in its predicament, however. In fact, from a budgetary point of view, it fits within a wider trend that has seen many countries fail to put their public finances in order after the COVID-19 shock, with the result that most of them now find themselves in a more precarious budgetary situation than before the pandemic.

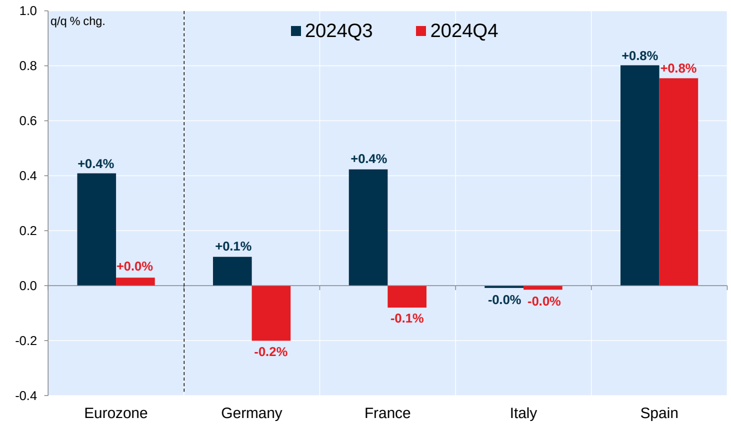
World: The great fiscal slide
General government structural balance



NBC Economics and Strategy (data via the IMF)

Nor has the deterioration in public finances been confined to emerging markets, as the current budget dispute in France demonstrates. But wherever market pressures are likely to force governments to reduce their deficits, growth will be adversely affected. The Eurozone appears to be at risk in this respect, with the economy falling back into stagnation in Q4 after a short-lived revival in Q3.

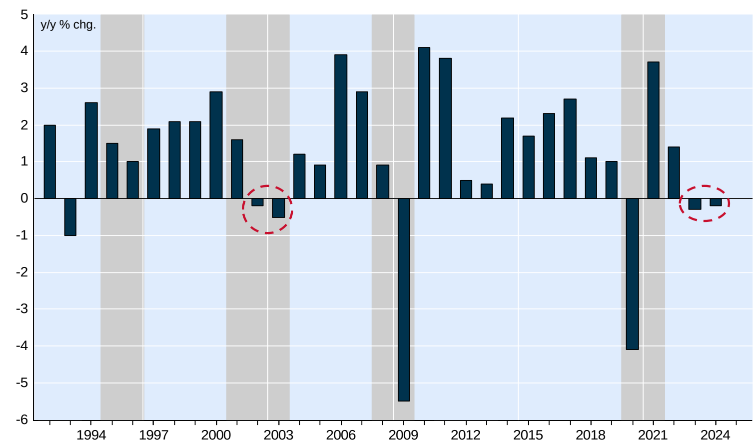
Eurozone: Growth stalled in Q4, Germany and France saw contractions
Change in real GDP



NBC Economics and Strategy (data via Refinitiv)

In Q4, Germany recorded its fifth contraction in the last nine quarters, resulting in a second consecutive annual fall in output, a first since the early 2000s.

Germany: First back-to-back annual contractions in 20 years
Real GDP



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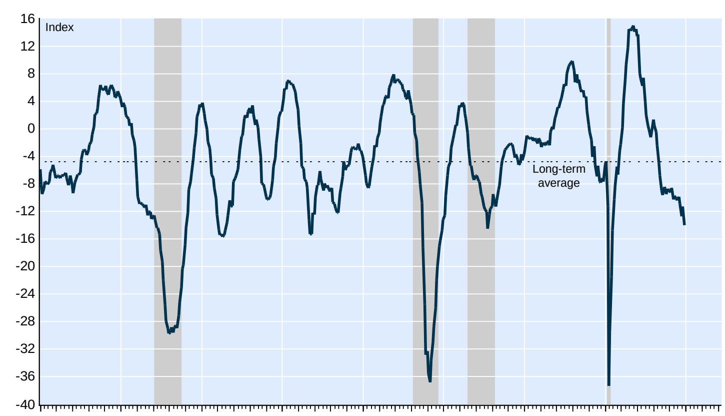
The manufacturing sector has been a major drag here, as it has been throughout the single currency area.

Eurozone: Manufacturing sentiment in the doldrums
European Commission's Manufacturing Sentiment Index. Last observation: December 2024



NBF Economics and Strategy (data via Refinitiv)

And it may be some time before things improve, given the recent rise in the price of natural gas, a key determinant of factory production costs.

Eurozone: Gas prices on the rise again
Price for the equivalent of one megawatt hour of natural gas delivered to the Netherlands in one month

NBC Economics and Strategy (data via Bloomberg)

It is important to note at this point that the global economic outlook is not uniformly poor. The political impasse in France and Germany may yet improve, and conflicts in Eastern Europe and the Middle East may subside. This would certainly be good for growth, as would continued healthy expansion in the United States. The continued monetary easing telegraphed for 2025 by many central banks would also be welcome.

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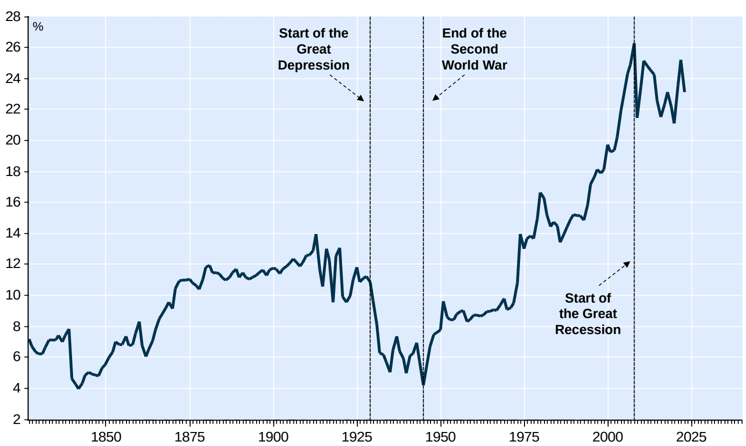
World: Was the post-war era an exception rather than the rule?
Global goods exports as a percentage of GDP



NBC Economics and Strategy (data via Fouquin and Hugot (CEPII 2016), the IMF and the CPB)

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World Economic Outlook

	2024	2025	2026
Advanced Economies	**1.6**	**1.5**	**1.5**
United States	2.8	2.2	1.6
Eurozone	0.7	0.8	1.2
Japan	-0.2	0.8	0.9
UK	0.8	0.9	1.2
Canada	1.3	1.2	1.5
Australia	1.0	2.0	2.3
Korea	2.1	1.4	2.0
Emerging Economies	**4.2**	**3.9**	**4.2**
China	5.0	4.6	4.5
India	6.5	6.0	6.4
Mexico	1.8	0.8	1.6
Brazil	3.3	2.0	2.4
Russia	3.7	1.3	1.8
World	**3.2**	**3.0**	**3.1**

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