

International Scene | 11 September 2025

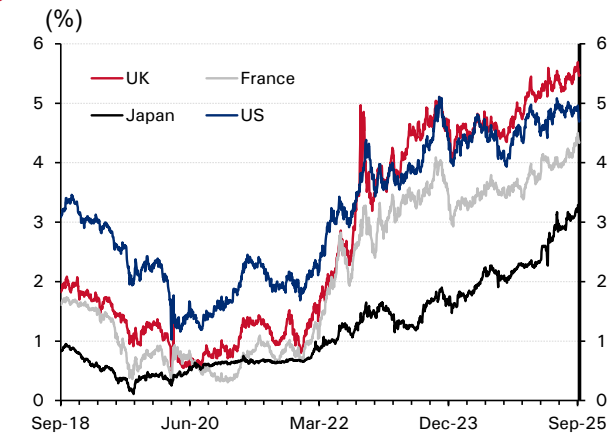
Economic growth resilient as peak uncertainty behind us for now but tariff drama might not be over

Growth among the major economies has come in stronger-than-expected recently and the IMF has upgraded its global growth forecast for 2025 and 2026. While peak uncertainty seems to be behind us for now, the tariff drama might not be completely over. The US economy is facing a weakening labor market and rising inflation although underlying economic activity has remained relatively decent. Meanwhile, the Fed faces an unprecedented attack on its independence which could have global repercussions. In the Eurozone, the EU-US trade agreement has restored some stability to the economy, but the growth outlook remains mediocre. The UK economy has to grapple with a looming fiscal tightening in the November budget. In Japan, the political developments have aggravated fiscal vulnerabilities with long-term bond yields at multi-decade highs. In China, the economy is poised to achieve the government's 'around 5%' growth target for this year with the de-escalation of the trade war with the US likely to be sustained.

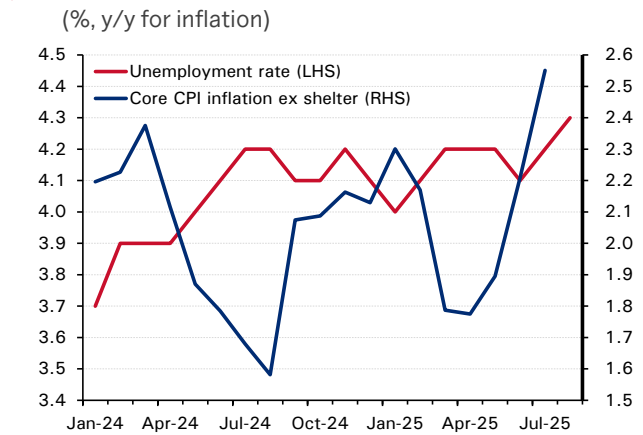
US: Weakening labor market and rising inflation; the unprecedented attack on the Fed is a key risk

Tariffs are pushing up inflation with core CPI excluding shelter increasing by 2.7% y/y through August versus 1.8% in April. Absent no additional tariff shocks, we think it is going to take several more months for the full impact of the tariffs to be seen. The labor market has weakened materially recently with average monthly job gains of only 27K during the May-August period while the unemployment rate rose to 4.3%, the highest since October 2021. Job growth may remain lackluster, even with rate cuts, as labor market weakness is driven by both the demand side and supply side. The futures market is currently indicating cumulative easing of around 150 bps from now through end-2026. However, this carries high uncertainty and, even if it materializes, a lower yield curve (other than for short-dated securities) is not guaranteed. The trade agreements reached between the US and some of its key trading partners have lowered uncertainty and improved sentiment. Nevertheless, the tariff-related drama may not be over yet given still no agreements between the US and some of its largest trading partners and more sector-specific tariffs in the pipeline. Furthermore, the legality of the country-specific tariffs is now in the hands of the US Supreme Court, and uncertainty will heat up again if that court revokes these tariffs.

On another note, damage is already being done from the unprecedented attack by the US administration on the Fed's independence, with the most challenging time for the Fed, in our view, being after Fed Chair Powell's term ends in May 2026. While the market has taken that threat in stride for now, we think this will not be the case if it is judged that this independence is actually compromised. On a more positive note, despite the very high levels of uncertainty that prevailed for most of this year, economic activity remained broadly resilient with 'real final sales to private domestic purchasers' growing by 1.9% (annualized) in both Q1 and Q2, though lower than the 3% average in 2024. GDP growth, which has been volatile on a quarterly basis due to trade disruptions, is seen at around 2% in 2025 down from nearly 3% in 2023-2024.

Chart 1: Government 30-year bond yields

Source: LSEG

Chart 2: US unemployment and inflation

Source: Haver, LSEG

Eurozone: The US-EU trade agreement restores some stability for now; high bar for further easing by the ECB

The Eurozone economy has continued to beat expectations so far this year, although it grew by a modest 0.1% q/q in Q2, down from an outsized 0.6% in Q1 that was driven by significant export-led tariff frontloading. The EU's trade deal with the US, which puts a tariff rate of 15% on most EU exports to the US, lowered uncertainty and restored some stability to the largest trading relationship in the world. However, other than the US-imposed tariff rate, other key terms of the deal (such as the EU purchasing \$750 billion of US energy products over three years and EU companies investing \$600 billion in the US by 2029) are either unrealistic targets or just expressions of interest. The EU's trade relationship with the US continues to be developing with President Trump recently threatening to launch a Section 301 trade investigation against the EU in response to the EU slapping Google with a \$3.5 billion fine for antitrust violations. Such developments, in addition to other matters such as the digital services tax that several EU countries levy on US technology companies, and which Trump staunchly opposes, indicate that the current status quo is on shaky grounds and a re-escalation in trade tensions can still happen. Separately, NATO members' decision in June to increase defense spending from 2% to 5% of GDP by 2035 is positive for economic growth across the Eurozone. After the ECB kept rates unchanged in its meeting last week, the futures market is indicating that rates will remain on hold, or be cut by a maximum of 25 bps through end-2026. With the collapse of the government, political paralysis in France, the bloc's second-largest economy, adds to downside risks to growth.

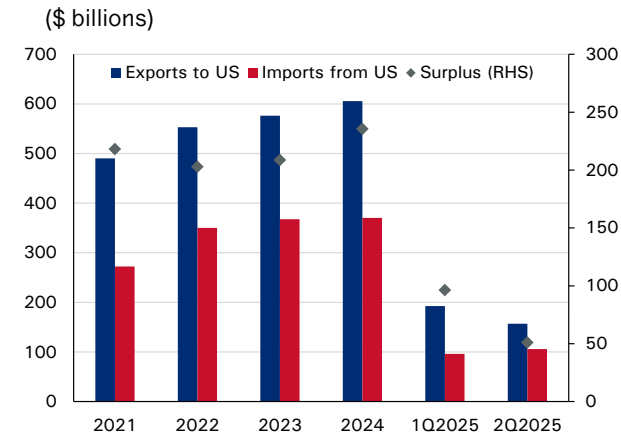
UK: Growth seen broadly stable despite inevitable fiscal tightening and limited room for BoE easing

After the frontrunning of higher US tariffs and property stamp duty changes in Q1, GDP growth in Q2 slowed, but to a higher-than-expected 0.3% q/q from Q1's 0.7%. The outlook is generally uninspiring given a looming fiscal tightening and a weakening labor market; the number of jobs has fallen by a combined 164K (0.5%) since July 2024 after the hikes in national insurance contributions and minimum wages. The government faces an ongoing poor fiscal position and, making matters worse, has already annulled plans to cut some welfare spending after political opposition. This, coupled with concerns about higher government borrowing, led to a recent surge in long-term gilt yields (30Y near its highest since 1998), shrinking Chancellor Reeve's already-limited headroom of meeting current spending with revenues by 2029-30. In the upcoming budget, which has been pushed until November, the Chancellor will likely unveil higher taxes and/or spending cuts. Though essential for fiscal consolidation, this tightening could weigh on growth, with the BoE forecasting only a slight improvement in GDP growth to 1.2%-1.3% in 2025-2026 (1.1% in 2024).

Still, there are signs of optimism, with the composite PMI rising to a 12-month high in August (53.5), driven by solid improvement in services while the expectations gauge hit the highest level since October 2024.

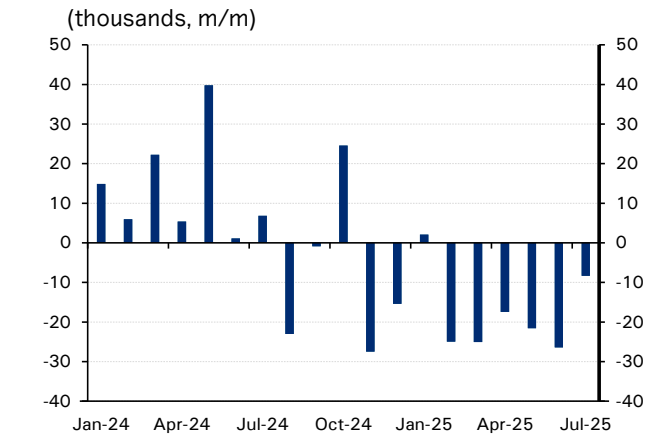
Meanwhile, CPI inflation rose to an 18-month high of 3.8% y/y in July with the BoE expecting a peak of 4% in September and then a gradual softening, hitting 2% in Q2 2027. Given the inflation dynamics and following a narrow MPC vote (5 to 4) to cut the bank rate by 25 bps in August (bringing cumulative easing to 125 bps since August 2024), the futures market currently indicates no further rate cuts this year.

Chart 3: EU's merchandise trade with the US



Source: US Census Bureau

Chart 4: UK's growth in payrolls*



Source: ONS, * based on employment tax records

Japan: Political developments aggravate fiscal vulnerability; long-term bond yields at multi-decade highs

Japan's economy has beaten expectations so far this year with growth in Q2 at 0.5% q/q, driven by a rebound in exports (+2.0% q/q) following a contraction in Q1. Private consumption, which accounts for more than half of GDP, increased by 0.4% after being flat in Q1, underscoring a moderate recovery in demand. The recently-finalized trade agreement with the US, which sets a tariff of 15% on most imports from Japan, reduced uncertainty but continued to weigh on external demand with the manufacturing PMI remaining in contraction territory in July and August. Meanwhile, consumer price inflation moderated to 3.1% y/y in July, but the core-core measure (excluding fresh food and energy) remains elevated and sticky at 3.4%, reflecting persistent price pressures in non-subsidized categories.

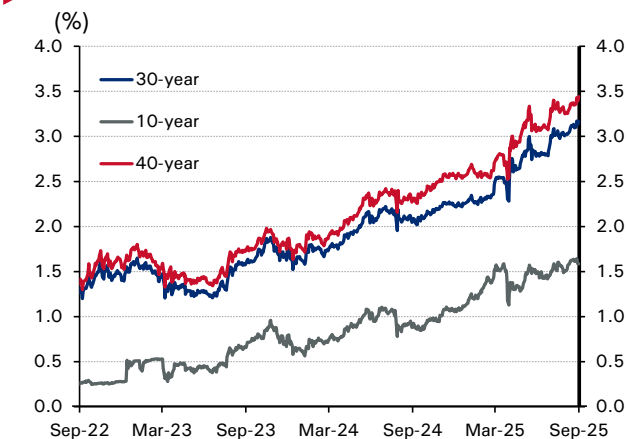
On the political front, the ruling Liberal Democratic Party coalition's loss in July's parliamentary elections and the gains of the Sanseito Party, which campaigned on tax cuts, added to the market's concern over fiscal sustainability, driving long-dated Japanese bond yields higher. Prime Minister Ishiba's recent decision to step down is putting further pressure on the bond market, given the perception of a looser fiscal policy ahead. Amid all the political, trade, and fiscal uncertainties, the Bank of Japan (BoJ) kept its policy rate at 0.5% for the fourth consecutive meeting in July but raised its forecast for core inflation (excluding fresh food) to 2.7% (from 2.2%) and 1.8% (from 1.7%) for FY2025 (ending in March 2026) and FY2026, respectively. The BoJ is widely expected to keep rates unchanged at its 19 September meeting, with the futures market currently indicating one 25 bps rate hike by Q1 2026 or earlier.

China: GDP growth well poised to hit the target this year; US-China de-escalatory stance to likely sustain

The Chinese economy continued to defy expectations, growing by 5.2% y/y in Q2 and remaining on track to achieve the government's "around 5%" growth target for 2025. The 25% y/y plummet in exports to the US since April has been compensated by higher exports elsewhere, with total exports climbing by 6% y/y in 8M2025, which is remarkable given the global trade headwinds during that period. The trade truce with the US has been extended by another 90 days, and while it remains a non-permanent agreement, we think that the most plausible scenario going forward is that the de-escalatory stance will sustain. Meanwhile, despite ongoing stimulus initiatives by the authorities, the economy continues to suffer from weak domestic demand with imports falling by around 2% y/y in 8M2025 and consumer prices in deflation (-0.4% y/y in

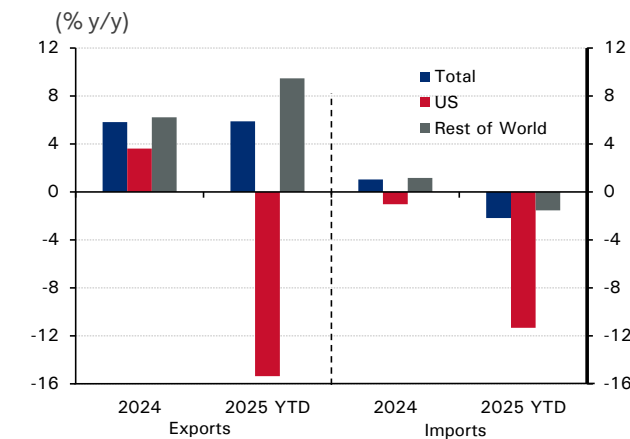
August). However, on a positive note, core inflation has been steadily increasing, standing at 0.9% y/y in August, the highest rate since early 2024. The PPI has been in deflation for nearly three years now, although that eased to a four-month low of 2.9% y/y (and 0% m/m) in August, a preliminary sign that the authorities' recent efforts to combat overcapacity and excessive price cuts might be starting to have an impact. The all-important property sector continues to be a drag, though early signs of stabilization are emerging; while new home prices continue to drop on a y/y basis, that narrowed to 2.8% in July, a softer decrease for the ninth straight month and the smallest since March 2024. The People's Bank of China has recently signaled no urgency to cut interest rates, pointing to the economy's general resilience and to the uptrend in core inflation, while sticking to its "moderately loose" monetary policy as announced in late 2024.

Chart 5: Japan's government bond yields



Source: Haver

Chart 6: China's exports and imports growth



Source: Haver; 2025 YTD is through August

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