PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Global Prospects are Clouded by Policy Shocks and Uncertainty

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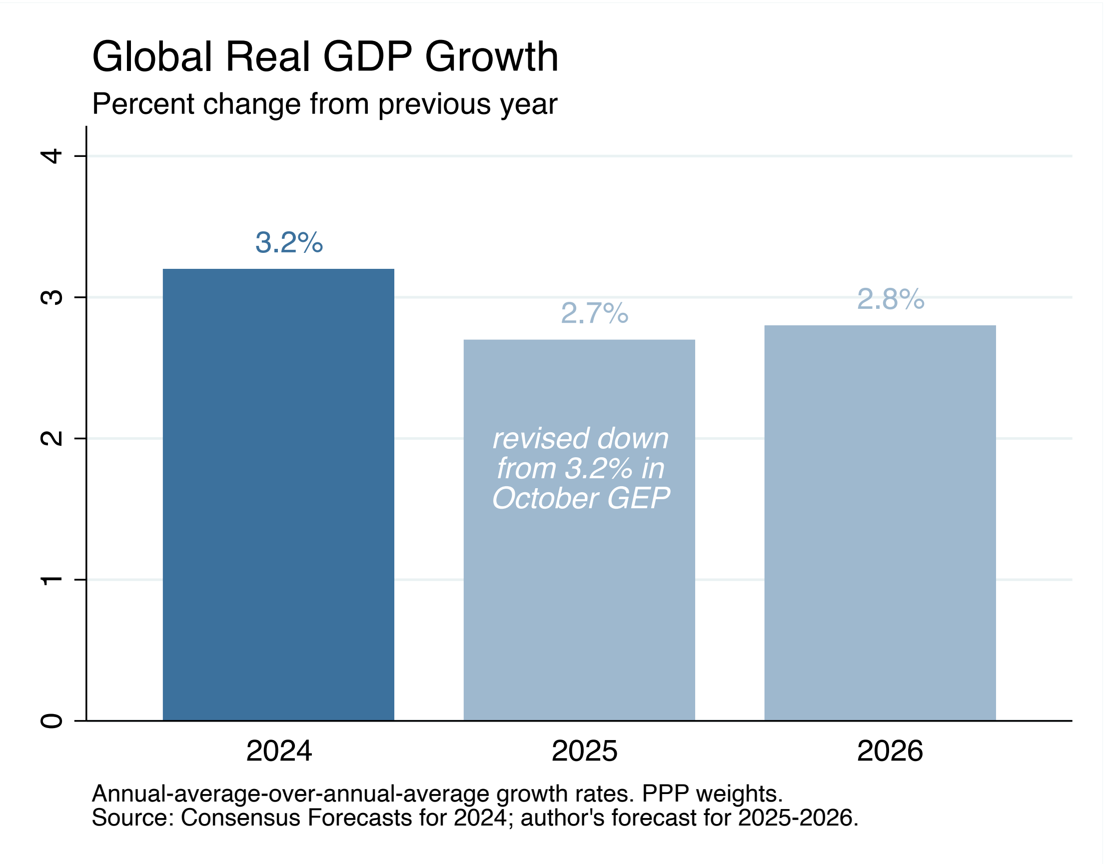
The outlook for global growth has weakened markedly



Under the assumption that the tariffs currently announced by the Trump Administration are mostly kept in place—and some retaliation occurs—**many countries will experience significantly slower growth in coming quarters** than expected six months ago

Uncertainty is high, and the outlooks for different countries vary widely (1)

United States

Solid foundation on track to give way to **stalled growth and higher inflation** due to policy shifts (much more to come)

Rest of North America

Hit hard by higher US tariffs; Mexico likely to see worse terms in USMCA revisions but may benefit from more near-shoring

Europe / UK

Positive (albeit subdued) growth probable notwithstanding higher US tariffs; **euro area to benefit from common action on debt issuance and increased defense spending**

Uncertainty is high, and the outlooks for different countries vary widely (2)

China

Growth **likely to fall well short of 5% target** given heightened US tensions, ongoing structural challenges, and weak household response to stimulus weigh on the economy

Asia outside of China

Broader Asia exposed to risks from potentially large increases in US tariffs; **India remains a bright spot**, continuing to draw in foreign investment

Other EMEs

Tariff-related drag likely to be **amplified by slower global growth**

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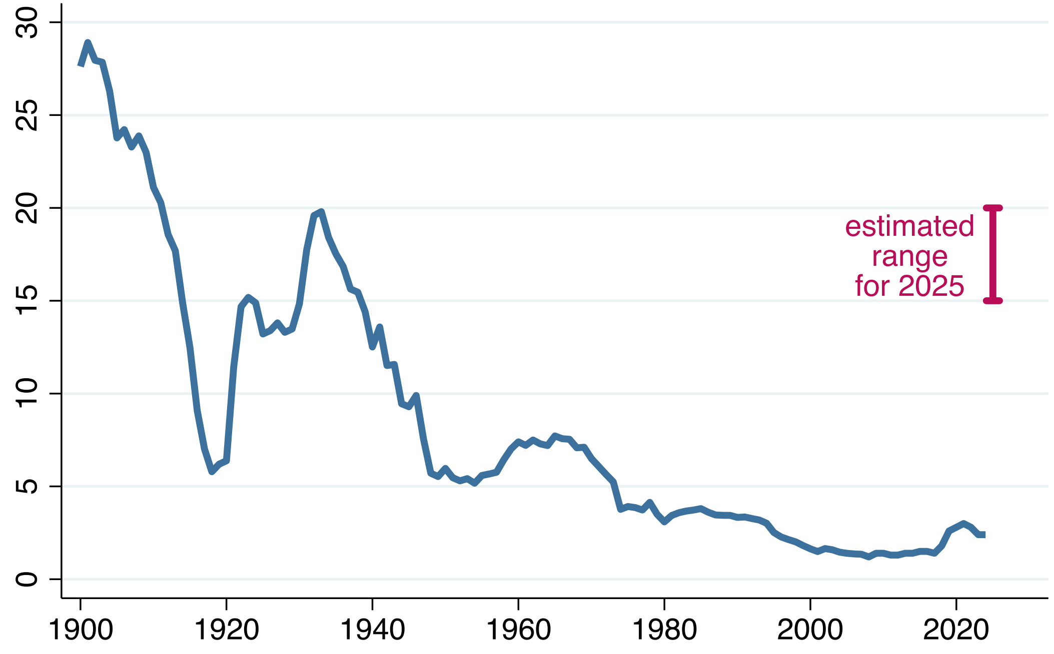
In the US, tariffs will raise prices, reduce real incomes, disrupt supply, and impede decisions

US Average Tariffs

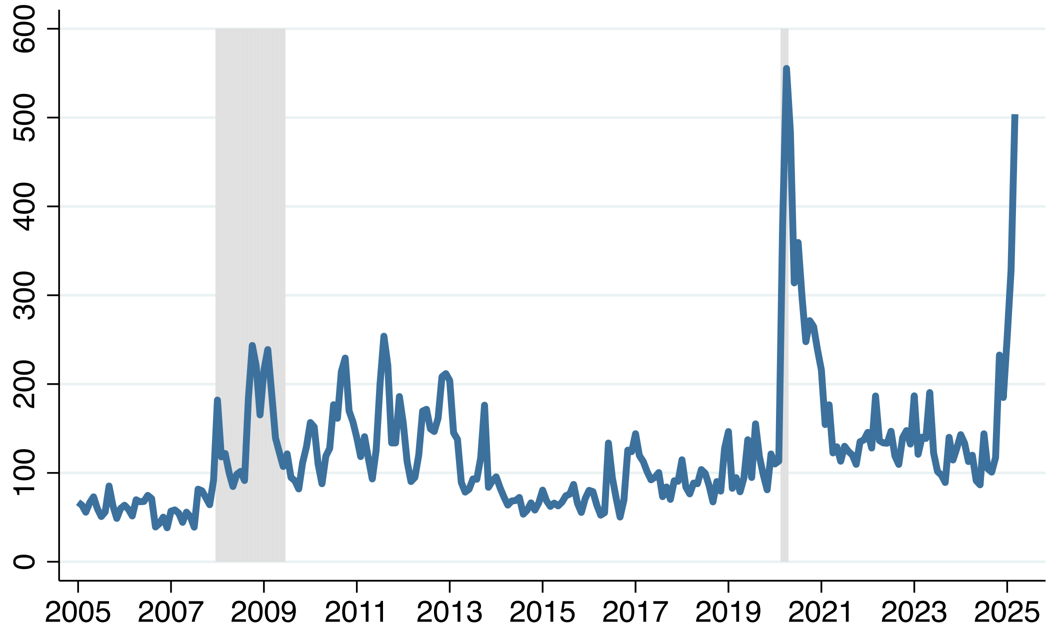
Percent



Data source: Bown and Irwin.

Economic Policy Uncertainty

Index



Data source: Baker, Scott R., Bloom, Nick and Davis, Stephen J. (via FRED).
Shaded areas correspond to recessions. Last data point: April 2025 (to date).

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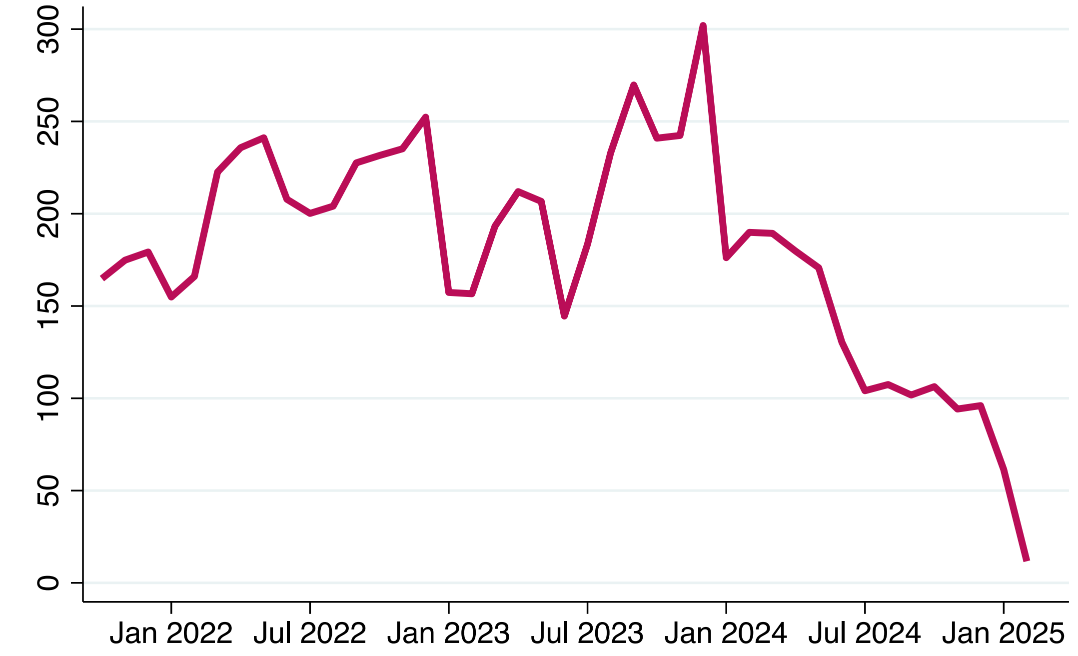
A drastic reduction in immigration will slow growth in US potential output and demand

Southwest Land Border Encounters

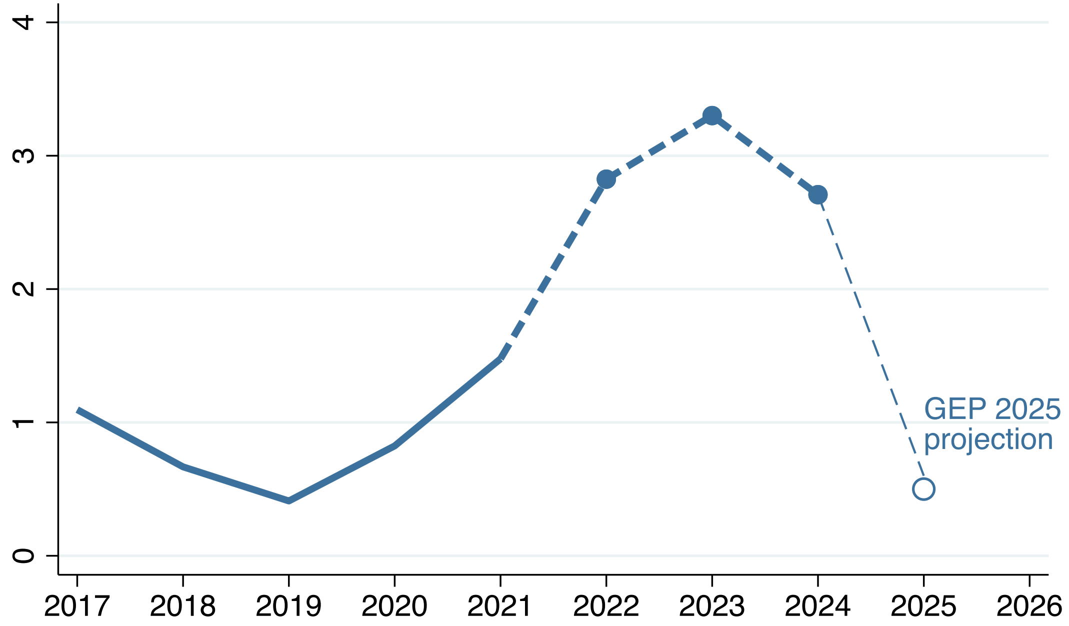
Thousands



Data source: US Customs and Border Protection. Last data point: February 2025.

Net Annual Immigration to the United States

Millions



Data source: Author's projection and Congressional Budget Office 2025 Demographic Outlook. Filled circles are CBO estimates. Hollow circle is GEP projection.

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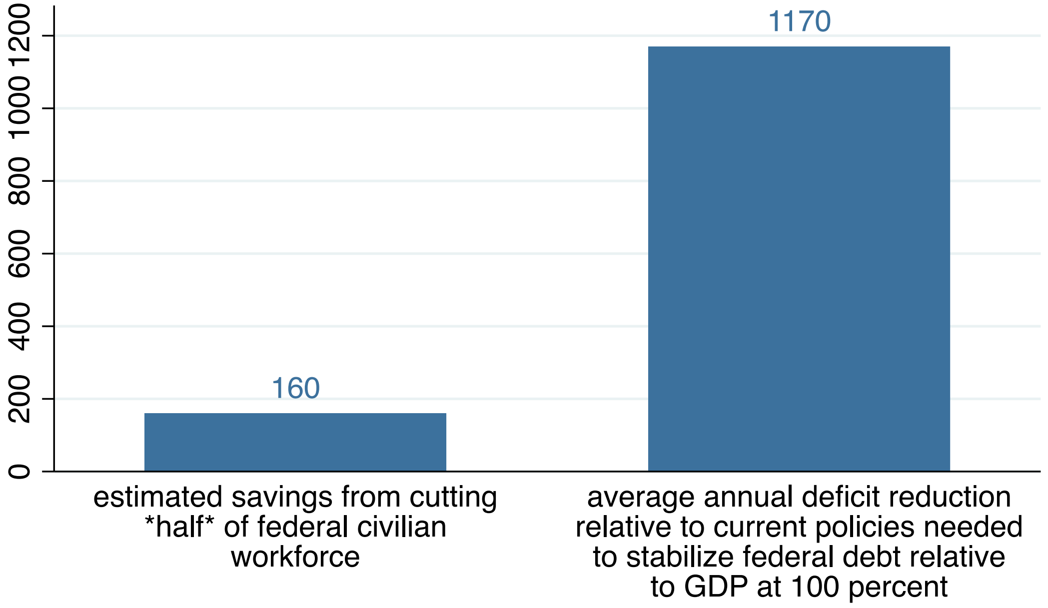
DOGE is not reducing government spending much and is not increasing efficiency

Putting DOGE Savings in Perspective

Billions of dollars



Data sources: Compensation estimated by author based on data from the Congressional Budget Office and Office of Personnel Management FedScope. Deficit reduction figure from the Committee for a Reponsible Federal Budget (current policy baseline).

The direct savings from laying off workers is **relatively small** (and may be partly offset by reduced IRS enforcement)

Operational disruptions are **reducing efficiency in the near term**

Cuts in research and development will **lower productivity and output in the longer run**

Relative to current policies, the fiscal package will modestly reduce deficits and demand

Likely changes on tax side	Likely changes on spending side	Aggregate demand effects relative to 2024 level of fiscal support
Major: • Extend expiring 2017 tax cuts Limited: • Increase investment incentives • Raise threshold for state and local tax deductions • Lower taxes on tips and overtime	Major: • Cuts to Medicaid Limited: • Cuts in other programs	**Small negative net effect:** • Extension of tax cuts will be close to neutral • Limited additional cuts to taxes will be slightly outweighed by spending cuts

NOTE: Tariff revenue will help a bit with deficit reduction but also reinforce the negative demand effects—especially because it shifts the tax burden to people with higher MPCs (Clausing and Obstfeld)

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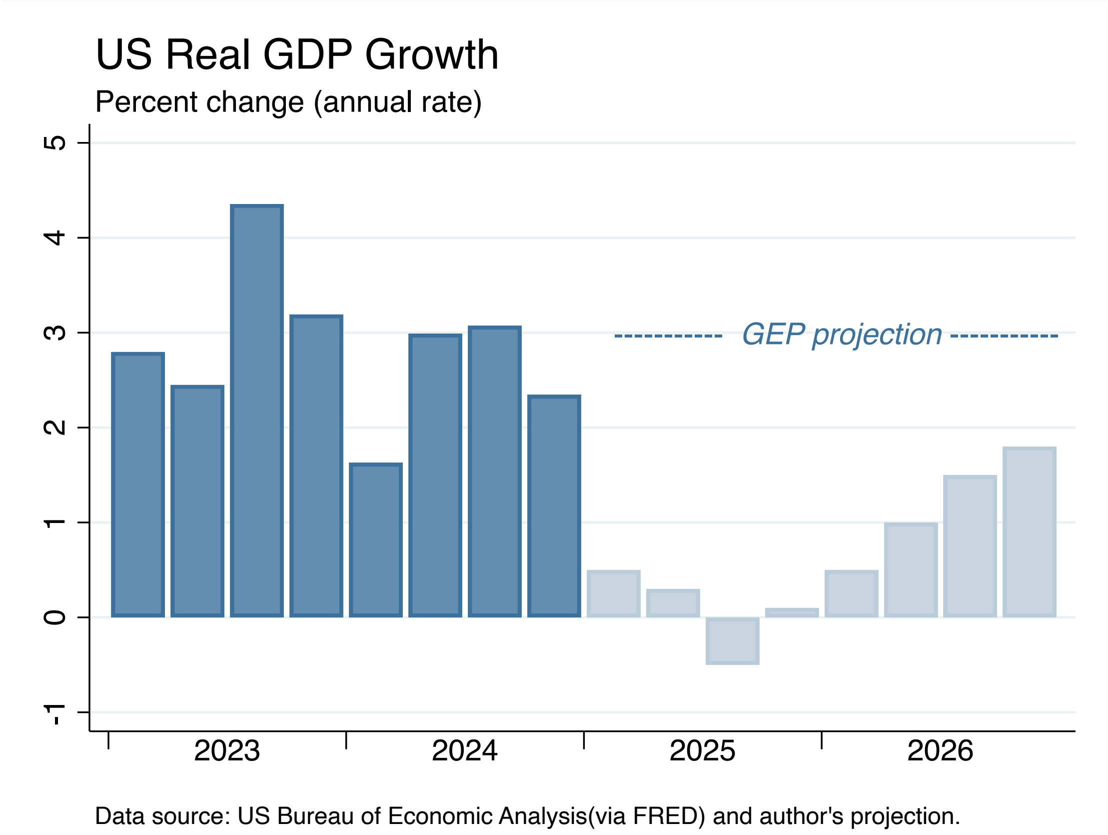
US economic growth is likely to stall this year, and US inflation is likely to pick up sharply



	2024	2025p	2026p
GDP growth (Q4/Q4)	2.5	0.1	1.2
GDP growth (Y/Y)	2.8	1.1	0.6
Unemployment rate (Q4)	4.1	5.0	4.7
PCE inflation (Q4/Q4)	2.5	4.0	3.2
Core PCE inflation (Q4/Q4)	2.7	4.1	3.3

p - projected
Sources: US Bureau of Economic Analysis, US Bureau of Labor Statistics, author's projections

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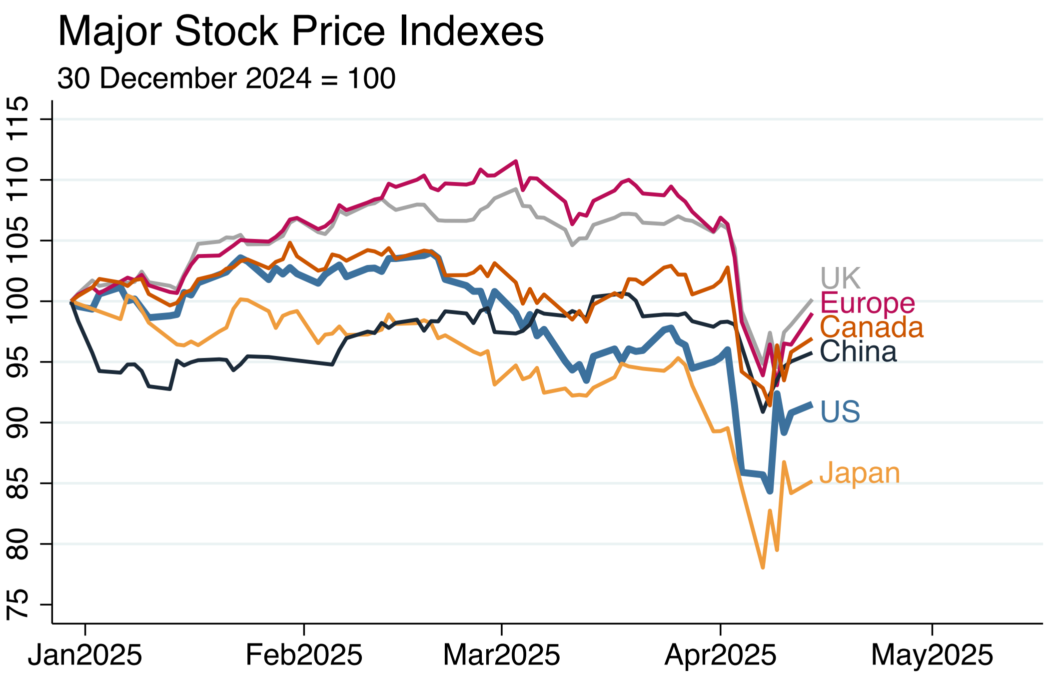
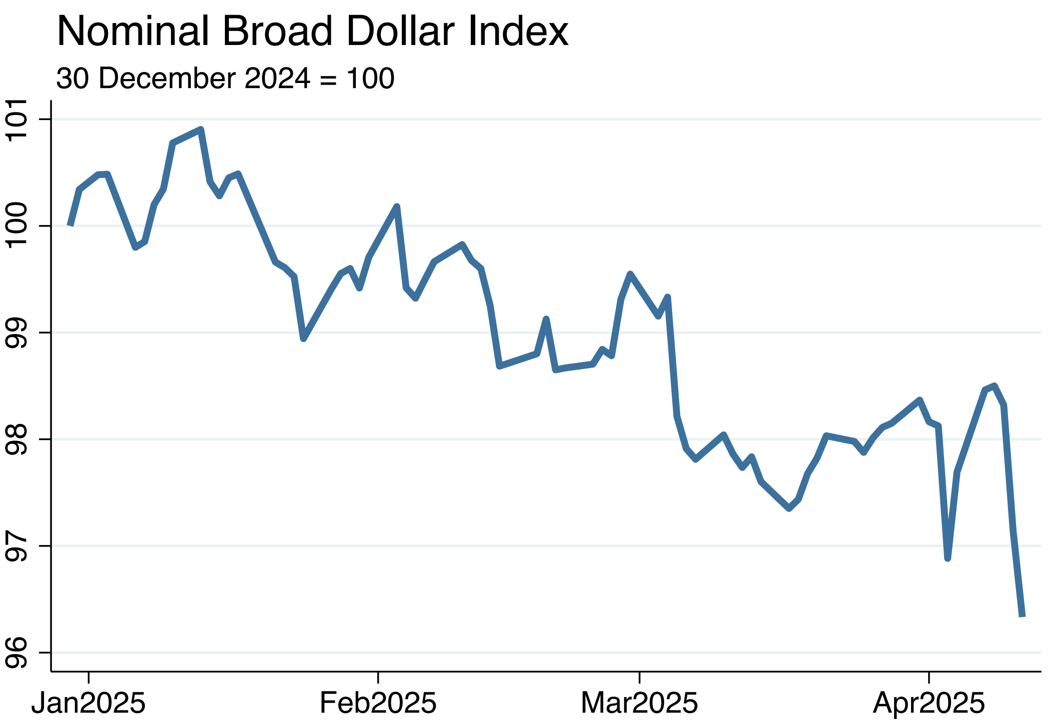
Markets are reading US policy changes as a big negative for the US and global economies

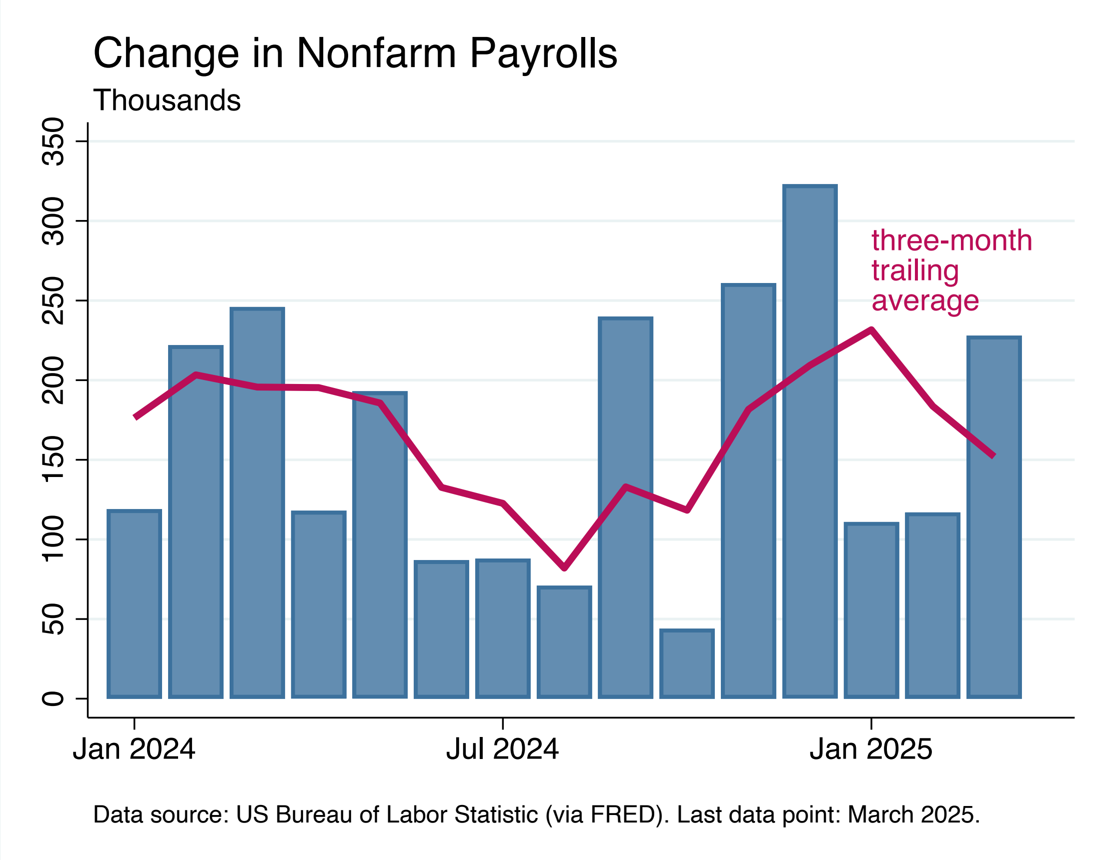


Indexes used are S&P/TSX for Canada, Shanghai Composite for China, STOXX 600 for Europe Nikkei 225 for Japan, FTSE100 for the UK, and S&P 500 for the US.
Data sources: Federal Reserve (via FRED) and Tullet Prebon (via Wall Street Journal).
Last data point: April 14, 2025.



Data source: Federal Reserve Board (via FRED). Higher values associated with stronger dollar.
Last data point: April 11, 2025.

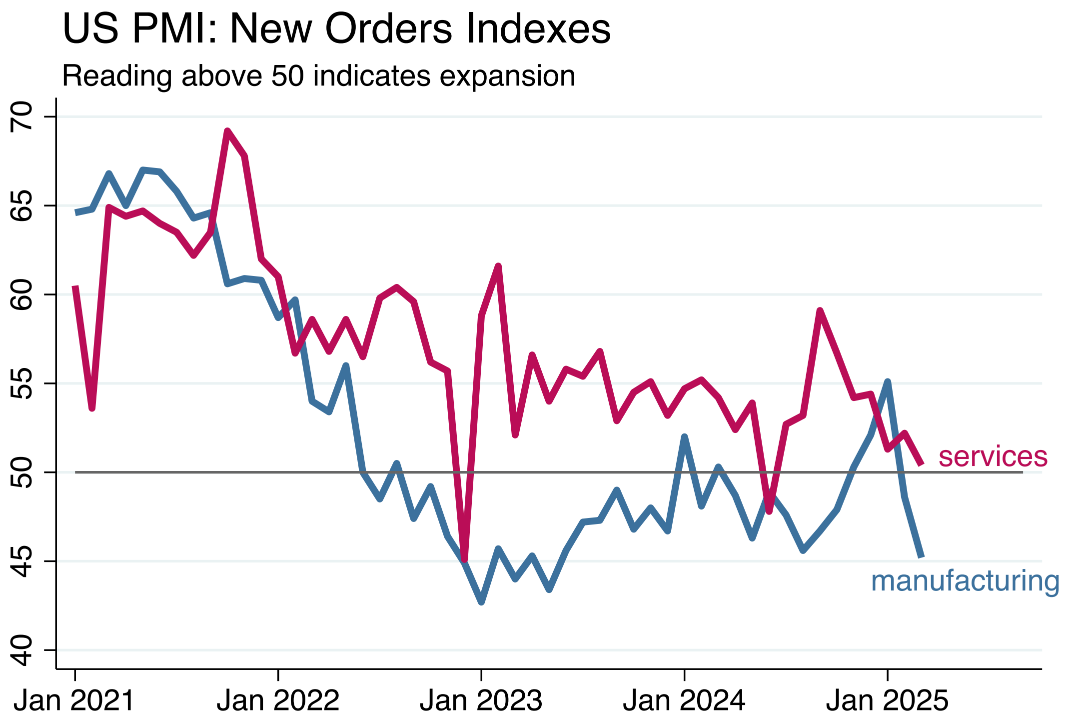
Hard data do not show much evidence of a fall-off in demand yet



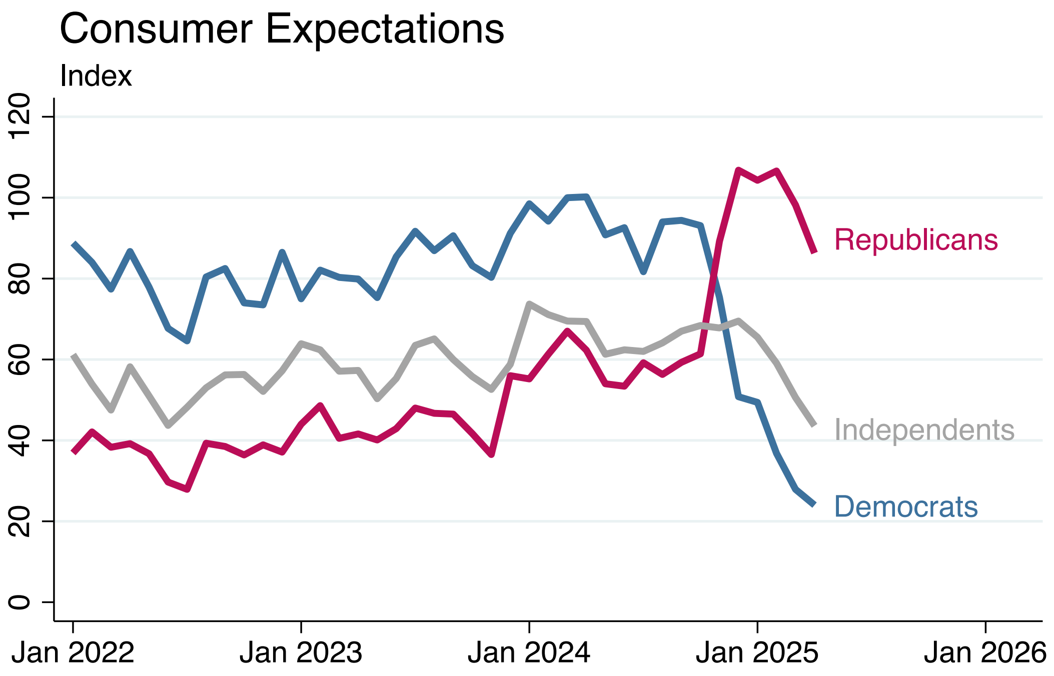
Limited signs of weakening in the labor market through March

The interpretation of hard spending data has been clouded by households and businesses pulling forward purchases ahead of tariff-related price increases—for example, new motor vehicle sales surged in March to a level 8 percent above their 2024 average

Soft data more consistent with weakening but consumer surveys may incorporate partisan bias



Data source: Institute for Supply Management (via Macrobond).
Last data point: March 2025.



Index based on responses to questions about expected personal finances over the next 12 months, business conditions over the next 12 months, and business conditions over the next 5 years.
Data source: Surveys of Consumers, University of Michigan. Last data point: April 2025.

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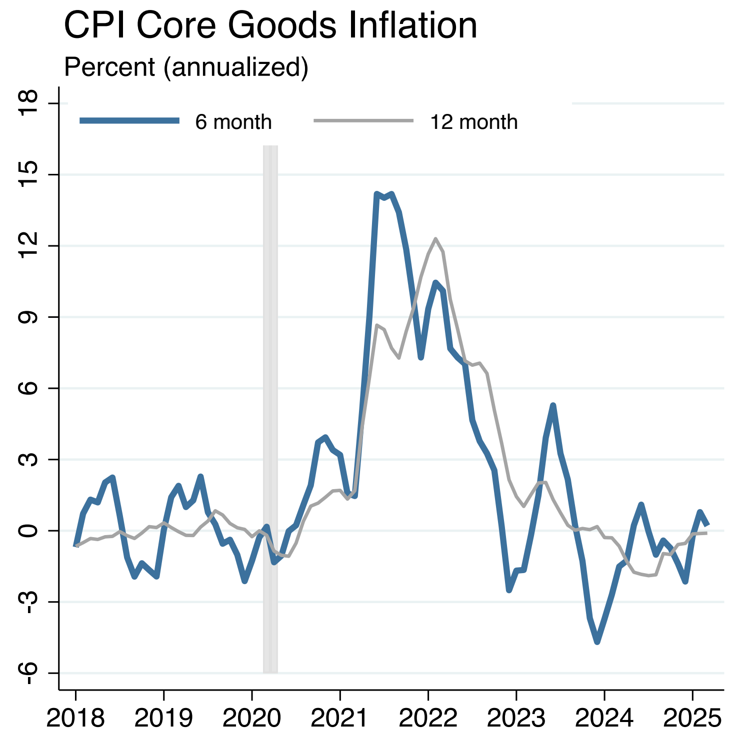
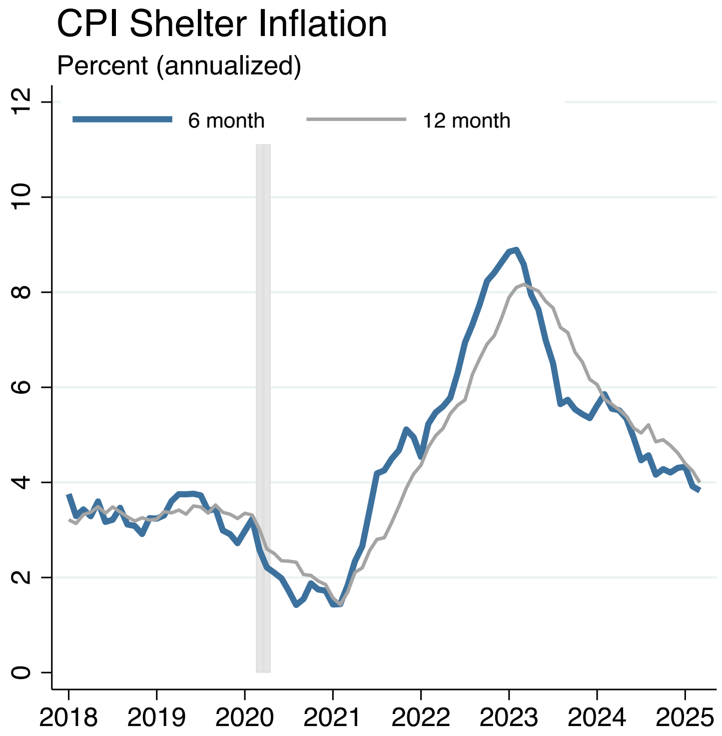
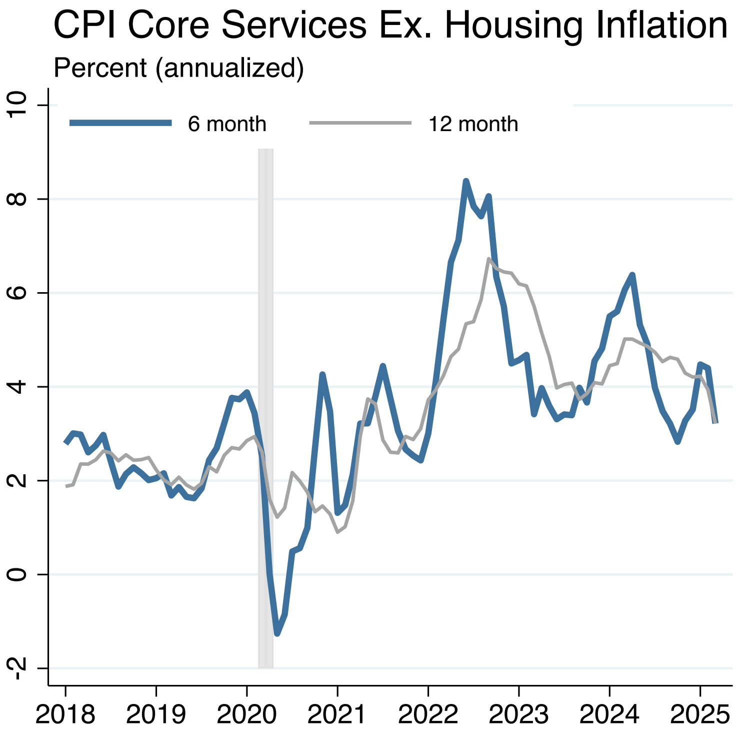
Inflationary effects of tariffs will build on inflation that is too high by the Fed's standards



Data source: Bureau of Labor Statistics (via FRED).
Last data point: March 2025. Shaded area corresponds to recession.



Data source: Bureau of Labor Statistics (via FRED).
Shaded area corresponds to recession. Last data point: March 2025.



Data source: Bureau of Labor Statistics (via FRED), author's calculations.
Shaded area corresponds to recession. Last data point: March 2025.

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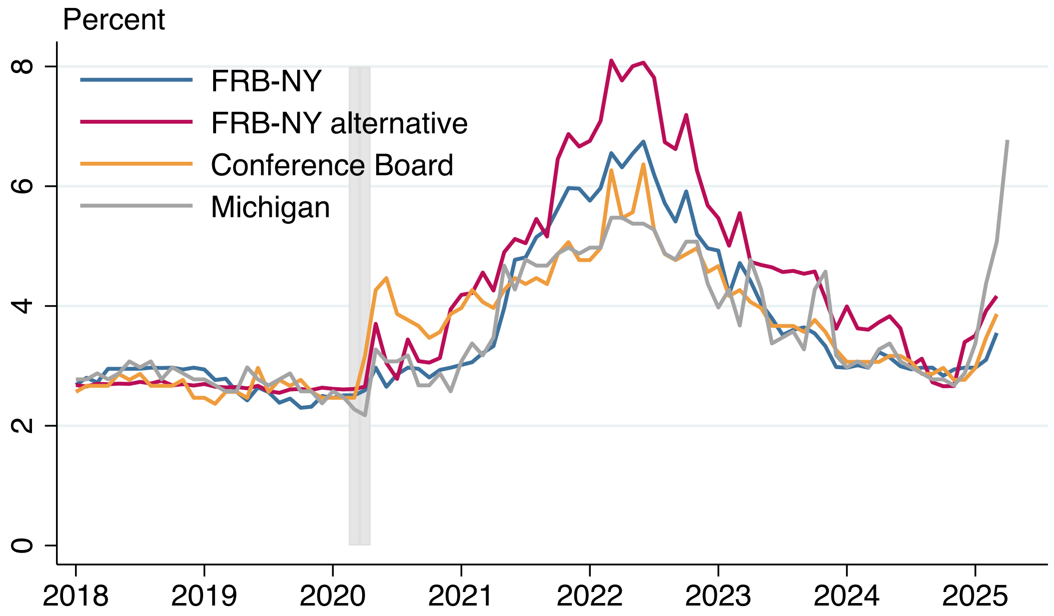
Uncertainty about inflation expectations and the neutral rate also presents challenges

Median 12-Month-Ahead Expected Inflation



Data sources: FRB-NY Survey of Consumer Expectations, Conference Board, and University of Michigan Survey Research Center (via MacroBond). Shaded area corresponds to recession. Last data point: April 2025 for Michigan and March 2025 for others. Series rebased to equal Michigan Survey 2018-2019 average.

Different measures of household inflation expectations **are sending different signals**—even measures capturing roughly the same concept

Most FOMC policymakers say that the neutral policy rate is well below the current setting, but recent experience and other factors suggest **the neutral rate may be higher**

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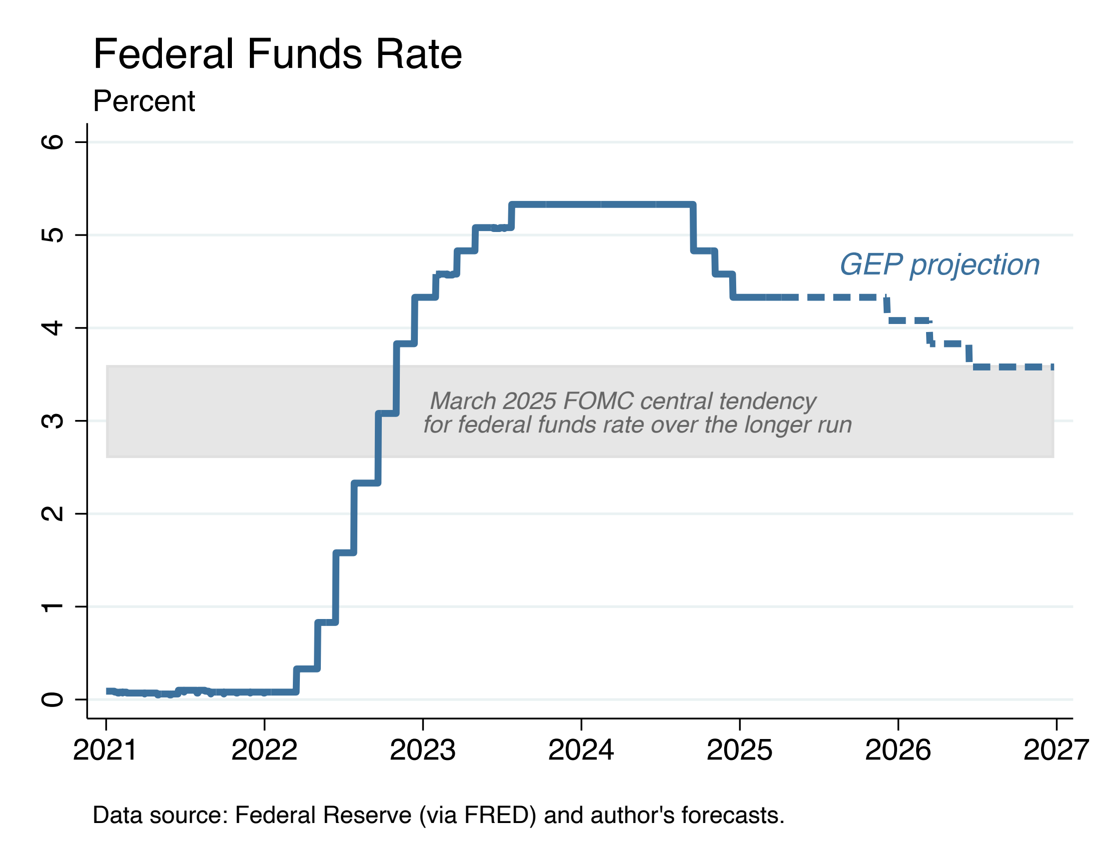
The Fed is likely to hold steady until the end of this year

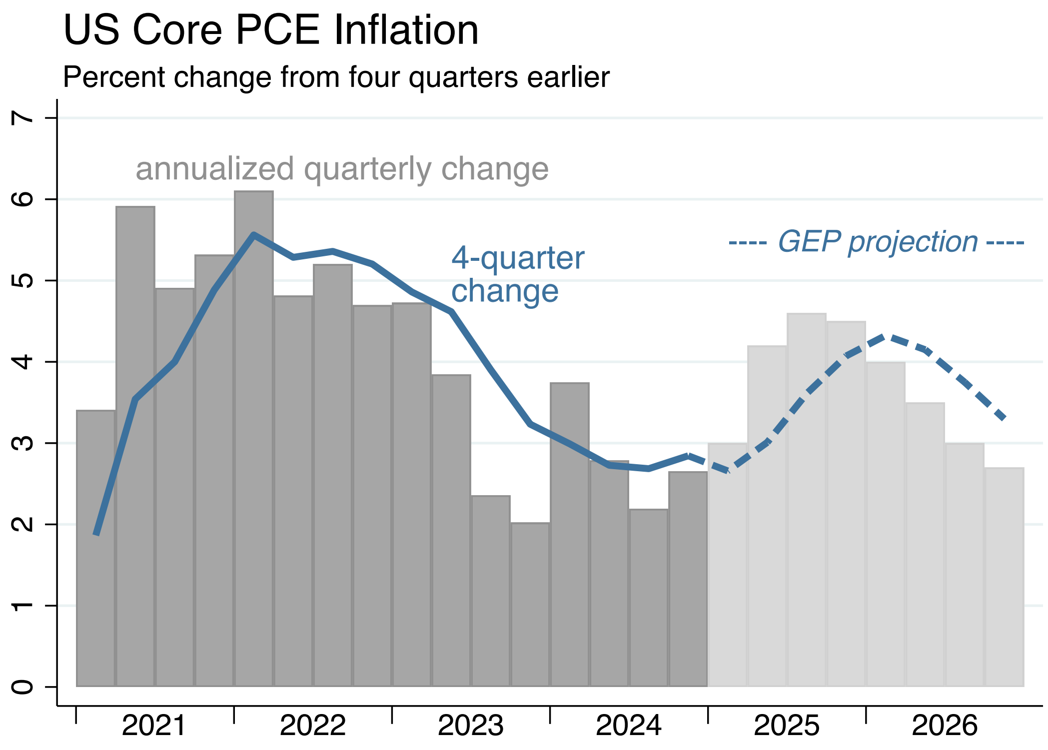


The FOMC will be weighing higher unemployment against higher inflation

Inflation well above target and fears of expectations becoming unanchored will discourage cuts

A significant rise in unemployment will eventually induce some easing once higher-frequency inflation readings appear to be subsiding

Inflation and unemployment will both increase materially in coming quarters



Source: Bureau of Economic Analysis, author's forecast.

Source: Bureau of Labor Statistics, author's forecast.

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The major downside risks stem from potential developments in the United States

US recession odds at 40 percent

No historical precedent for gauging the impact of the policy shocks that are reducing growth; **economic weakness could be amplified by:**

- **A larger stock market decline**—in part because the market may have been overvalued already
- **A loss of confidence in US fiscal management**—due to persistent large budget deficits and a generalized breakdown of institutional norms
- **A need for the Fed to tighten policy**—if high inflation looks to become self-sustaining

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Is there upside risk?

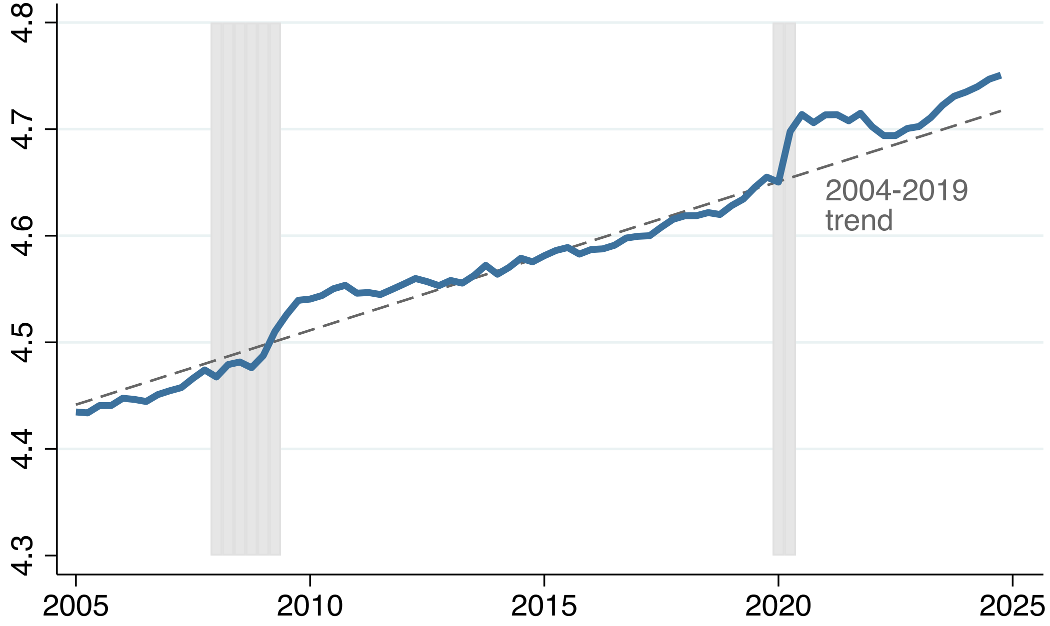
Yes—the Administration would have to materially reverse its tariff increases

If that happens, then AI, deregulation, investment tax incentives, and business animal spirits could sustain further strong productivity gains and restore solid growth

Still, **growth above 2.5 percent is highly unlikely** as limited immigration will greatly suppress potential labor force growth

Labor Productivity

Log of Index, 2017=100



Data source: Bureau of Labor Statistics (via FRED).
Shaded areas correspond to recessions. Last data point: 2024:Q4.

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