Global Economy Risk Assessment

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Outlets preparing macroeconomic forecasts these days will likely prepare different scenarios based on different assumptions about US tariff policy. However, the US tariffs have the potential to act as a catalyst that reveals underlying vulnerabilities in the global economy that could result in a much more severe macroeconomic scenario. These vulnerabilities include debt sustainability concerns in advanced countries, namely the US and Japan, a global asset price bubble in equity markets, and a crisis in China's opaque financial system. We have prepared 3 scenarios:

April Update: the global growth outlook is revised substantially down by 0.5 pp as US tariffs act as a significant stagflationary force on the global economy. The tariffs reduce output in the US and counteract the recent optimism in the Euro Area and China from new large fiscal packages.

Global Growth Recession: This scenario assumes a trade war between the US and China persists and therefore their outlooks lead the global economy into a deeper growth recession over the next three years.

Global Macro Crisis: There are many options on how a global macroeconomic crisis could manifest. We assume that equity markets anticipate the vulnerabilities within fiscal and the banking system where a large asset price correction occurs that leads to a moderate financial crisis about half of the Global Financial Crisis.

The **Better Policy** Project

Global Economy Risk Assessment

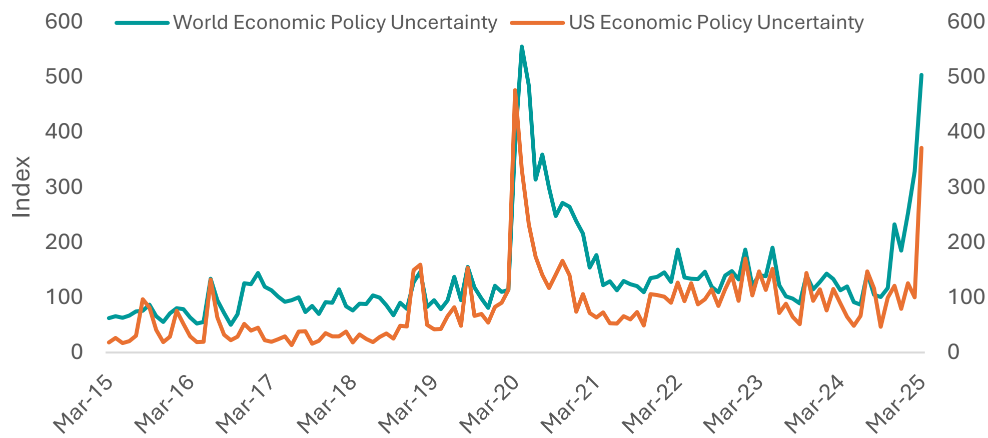
Global Economy Growth Outlook

		Real GDP Growth				Forecast change			
Country/Region	**Scenario**	**2024**	**2025**	**2026**	**2027**	**2024**	**2025**	**2026**	**2027**
US	March scenario	2.8	1.8	1.9	1.9				
	April Update	2.8	1.5	1.3	2.3	0	-0.3	-0.6	0.4
	Global Growth Recession	2.8	1.0	0.3	1.9	0	-0.8	-1.6	0
	Global Macro Crisis	2.8	0.0	0.0	1.9	0	-1.8	-1.9	0
Euro Area	March scenario	0.8	1.2	1.6	1.6				
	April Update	0.8	0.8	1.1	1.6	0	-0.4	-0.5	0
	Global Growth Recession	0.8	0.5	0.9	1.6	0	-0.7	-0.7	0
	Global Macro Crisis	0.8	0.0	0.0	1.3	0	-1.2	-1.6	-0.3
China	March scenario	5.0	4.9	4.4	4.4				
	April Update	5.0	4.4	4.4	4.7	0	-0.5	0.0	0.3
	Global Growth Recession	5.0	3.9	4.2	4.4	0	-1.0	-0.2	0.0
	Global Macro Crisis	5.0	3.4	3.6	4.4	0	-1.5	-0.8	0.0
Oil Importing Economies	March scenario	3.7	3.7	4.1	4.1				
	April Update	3.9	3.3	3.6	4.4	0.2	-0.4	-0.5	0.3
	Global Growth Recession	3.9	3.0	3.0	4.1	0.2	-0.7	-1.1	0.0
	Global Macro Crisis	3.9	2.7	2.5	3.8	0.2	-1.0	-1.6	-0.3
Rest of the world	March scenario	2.1	1.9	2.4	2.4				
	April Update	2.1	1.3	1.8	2.8	0.0	-0.6	-0.6	0.4
	Global Growth Recession	2.1	1.2	1.1	2.4	0.0	-0.7	-1.3	0.0
	Global Macro Crisis	2.1	0.3	0.6	2.2	0.0	-1.6	-1.8	-0.2
World	March scenario	3.1	3.0	3.1	3.1				
	April Update	3.1	2.5	2.6	3.5	0.0	-0.5	-0.5	0.4
	Global Growth Recession	3.1	2.1	1.9	3.1	0.0	-0.9	-1.2	0.0
	Global Macro Crisis	3.1	1.4	1.6	2.9	0.0	-1.6	-1.5	-0.3

*Key assumptions include**:** the April Update assumes the US tariff policy as of April 22, 2025, are in place in the short term i.e. the reciprocal tariffs, 145% on China with exceptions, 25% on steel, aluminum, autos. However, after a brief period the average tariff is negotiated down. Expansionary fiscal policy in the US and China support growth. The Global Growth Recession assumes the current tariff policy is prolonged and bilateral trade between the US and China; hence they drive global growth down. The main assumption in the Global Macro Crisis scenario is a crisis in confidence in the US that leads to a 30% equity price correction.

Global Economy Risk Assessment

Our overall assessment is that the global economy is highly vulnerable from large fiscal deficits and possible equity price bubble in the US, where the high uncertainty backdrop could be the catalyst to a much worse scenario that goes beyond tariffs.



Source: FRED

Global Economy Risk List

Higher Inflation Risks	Lower Inflation Risks
The US fiscal situation has already raised the question of a possible debt monetization risk but Fed independence being questioned would accelerate this risk. The recent rise in 10-year bond rates while the USD weakened is a symptom of this risk. Inflationary pressures from possible policy shift in the US – tariffs, tax cuts, immigration restrictions. New fiscal packages have the potential to boost growth across the Euro Area and China. Inflationary pressures in Russia, coming from tight labor markets and rise of domestic demand. Geopolitical tensions in the Middle East, Iran sanctions put an upward risk on oil prices. Strong demand in the US due to high asset prices supporting consumption through a large wealth effect.	The US fiscal situation could lead to serious fiscal consolidation or debt sustainability concerns could send sensitive equity prices to nosedive and generate a recession. Rising US policy uncertainty erodes consumer confidence, threatening domestic and global investment and spending. Slowdown in China due to property market problems leading to weaker domestic demand, consumer and financial market sentiment. US tariffs depressing Chinese exports, deepening stagnation and threatening China's opaque financial system. US stock market is in a possible bubble where a correction would dampen demand. Mere policy uncertainty could be the catalyst. Concerns over weak demand in China combined with economic uncertainties, are adding downward pressure on global oil demand.

Global Economy Risk Assessment

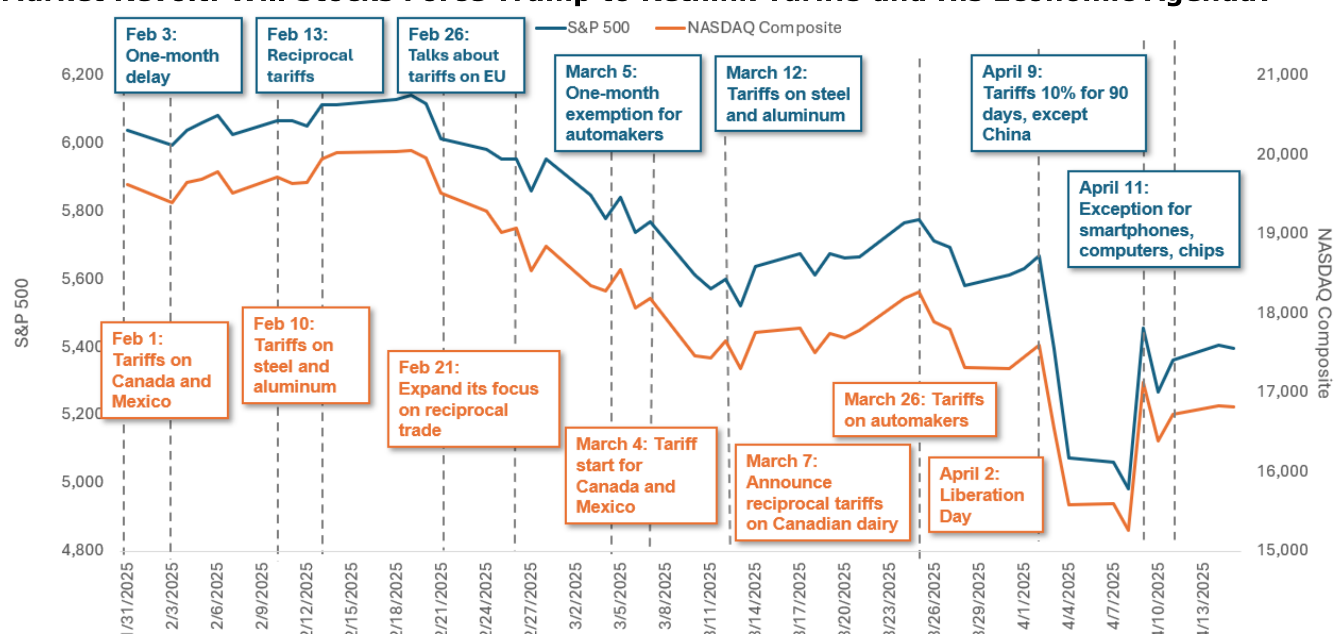
Trump Policy Era: Everything, Everywhere, And All at Once

The Trump administration tariff policy and subsequent retaliatory actions by countries has exceeded expectations and therefore should weigh down the outlook. The tariff war expanded beyond its anticipated scope — not only targeting Mexico and Canada in an effort to curb immigration, and China as part of a broader strategy to reshore manufacturing amid retaliatory measures — but also extending to other trading partners under the banner of ending “unfair” trade practices. These policies range from having relatively small to rather big inflationary or deflationary implications depending on the transmission of the shock. Furthermore, how strongly you think the economy is anchored will likely play an important role for the direction of monetary policy.

The immediate impact of most policies is stagflationary. Tariffs raise the price of imported goods and reduce output in the tariff-origin country. When one country imposes tariffs, retaliation often leads to reciprocal actions, as seen in the ongoing US-China trade conflict. The US recently raised tariffs to 145% on Chinese imports, with temporary exemptions for smartphones, computers, and chips. In response, China imposed 125% tariffs on US goods. The extent of the trade war threatens to stop bilateral trade between the two countries, something akin to the supply-chain disruption during the pandemic but isolated to two of the biggest economies in the world.

The rising economic uncertainty could escalate into a "crisis of confidence," sharply curbing consumer spending and investment activity in both the U.S. and the global economy. Amid declining investor sentiment, financial markets may become increasingly fragile, potentially triggering a 20-30% equity price correction and erasing over $20 trillion in household wealth. While such a downturn could ultimately steer inflation toward a sustainable 2% path, it remains a highly precarious route, carrying significant risks of financial contagion and broader systemic instability.

Market Revolt: Will Stocks Force Trump to Rethink Tariffs and His Economic Agenda?



United States

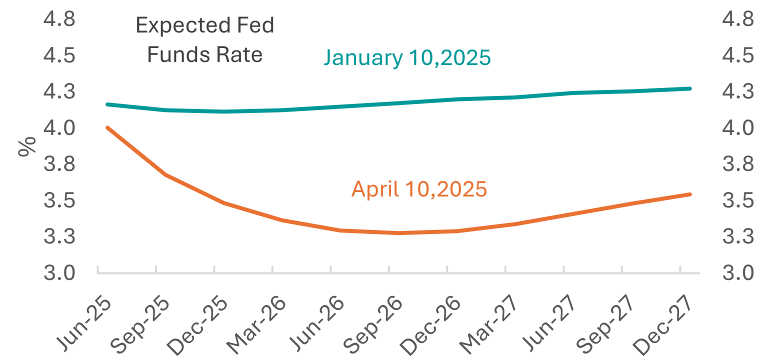
The expected trajectory of the Fed funds rate has shifted lower, with financial markets now pricing a terminal rate of approximately 3.6%, still exceeding the Fed's longer-run projection of 3.0%. This repricing reflects heightened recession risks, largely stemming from policy uncertainty in global trade. Equity prices have also corrected substantially over this time with an early indication that households may pull back on consumption stemming from a wealth effect. However, trade tensions and other potential policy shifts such as a restriction in immigration and geopolitical risks have largely inflationary implications pushing the economy towards a more stagflationary scenario.

Despite sticky price inflation showing some moderation, it remains elevated, indicating that inflationary pressures persist. This supports the view that an inflation premium exists and could complicate the inflationary process ahead of a tariff shock to imported prices. Furthermore, a restrictive migration policy threatens to tighten the labor market, thereby putting pressure on wages to rise. Such dynamics could necessitate a higher Fed funds rate path.

Uncertainty stemming from trade policies continues to mount, surpassing levels observed during the COVID era. The rise in US policy uncertainty has manifested in the bond market where treasuries—traditionally seen as safe-haven assets—are now being offloaded, pushing yields higher and signaling a broader loss of confidence in U.S. economic policy. However, the term premium remains subdued despite clear risks suggesting uncertainty is being underpriced in financial markets.

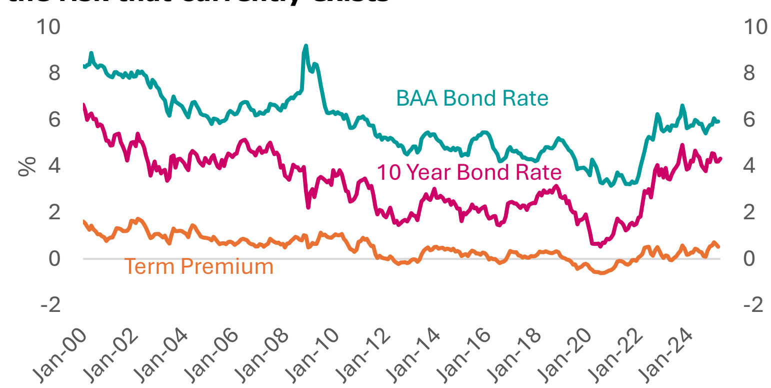
The fiscal outlook for the U.S. remains troubling. The DOGE initiative, aimed at reducing wasteful spending, has demonstrated limited effectiveness in achieving meaningful fiscal consolidation, as evidenced by the downward revision of budgetary projections in April. The situation is further exacerbated by recent budget proposals—tied to substantial tax cuts—are poised to significantly widen the federal deficit.

Recession fears have so far outweighed the inflationary impact of tariffs with a downward revision in the expected path of the policy rate



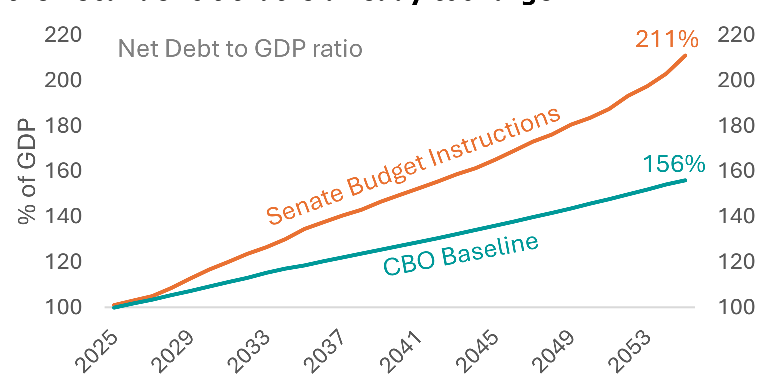
Source: Atlanta Fed Market Probability Tracker

The 10-year bond rate has risen but the term premium remains subdued, potentially underpricing the risk that currently exists



Source: FRED

The proposed tax cuts by the US Senate are substantial and pose significant risks of widening the fiscal deficit that is already too large



Source: CBO, Office for Budget Responsibility

Euro Area

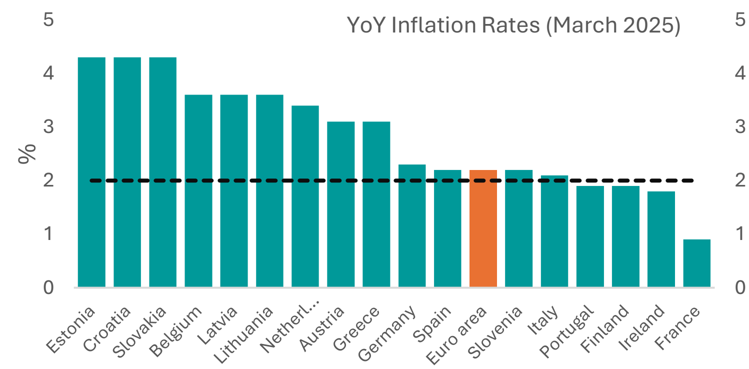
Headline inflation continues to register slightly above the 2% target, driven primarily by elevated services inflation. The unemployment rate remains at a historic low of 6.1% suggestive of a tight labor market, however wage growth continues to moderate at 4.1% YoY. Although inflation has eased from falling energy prices, the ECB still faces persistent inflationary pressure from elevated service price inflation, and inflation remains above target in many countries. The ECB remains in a delicate balancing act, aiming to support a recovery in real economic activity while addressing inflationary pressures in different pockets of the bloc.

In 2024Q4, the Euro Area continued to experience stagflation, with GDP stagnating at 0.2% QoQ. However, Germany is opening up promising prospects with its new fiscal plans, taking the lead among EA countries and encouraging others to amplify their defense spending. The significant increase in defense and infrastructure spending is expected to support economic growth, potentially raising Germany's real GDP growth by 1pp in 2026 providing possible positive spillover effects on the broader EA economy if long-term interest rates do not rise too much. Nevertheless, targeted tariffs and trade policy uncertainties could reduce economic growth by as much as 0.5pp in 2025.

In response to Germany's fiscal expansion plan, markets reacted swiftly—evidenced by a spike in bond yields and a strengthening euro. While yields have since gradually declined, the euro continues to appreciate, recently reaching its highest level in over three years. This appreciation has been particularly pronounced since the escalation in U.S.-China tensions, reinforcing the view that investors are re-evaluating the US as a safe-haven currency.

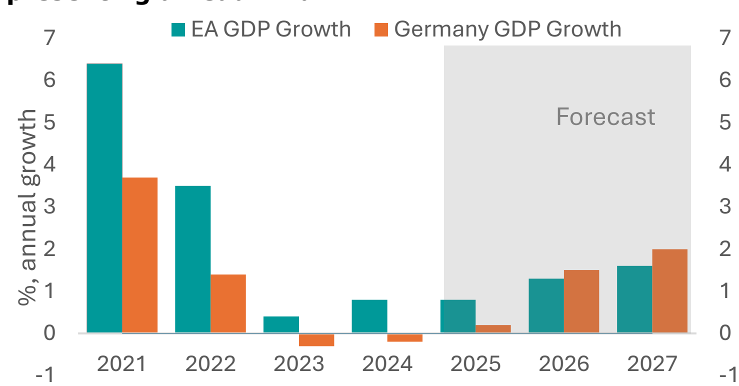
While a stronger euro may temporarily ease inflationary pressures by lowering import costs, it simultaneously weighs on export competitiveness, a concern that could be further exacerbated by U.S. trade tariff policies.

Inflation within the Euro Area remain uneven but March inflation was a step in the right direction



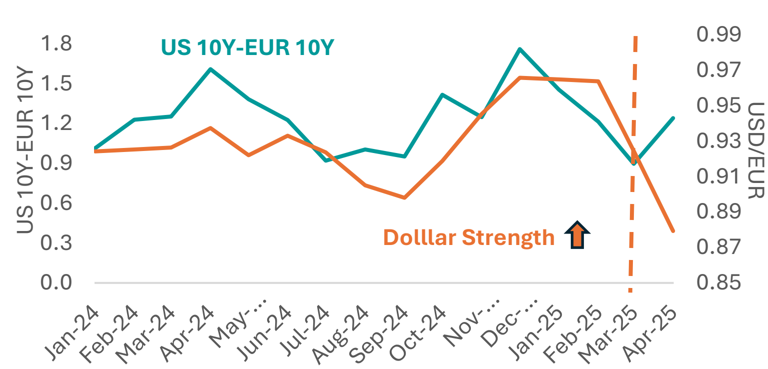
Source: Eurostat

Germany is creating a positive outlook for overcoming stagflation but the global economy is presenting a headwind



Source: Eurostat, Goldman Sachs

The 10-year bond spread between the US and Euro Area and USD weakening suggests there are serious risks about US economic policy, namely fiscal



Source: Eurostat, FRED

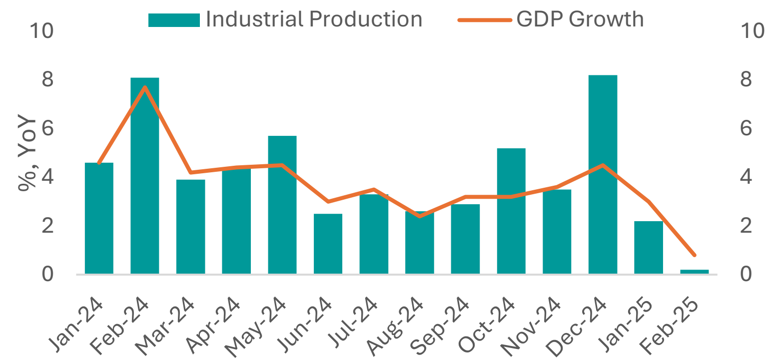
Russia

The Russian economy, after experiencing 4.3% growth annually—largely driven by wartime spending—has entered a period of significant slowdown in early 2025. Economic activity which is increasingly concentrated in defense-related industries, with other sectors like transport, wholesale trade, and mineral extraction experiencing stagnation. Moreover, falling oil prices, due to global market concerns and potential U.S. import tariffs, have reduced revenues from Russia's main export. Additionally, ongoing Western sanctions continue to exert pressure on the economy. However, the high-inflation environment persists, creating a challenging economic environment for monetary policy.

Amid conditions of excess demand in the economy, inflation remains elevated, reaching 10.3% YoY in March 2025. Inflationary pressures are further exacerbated by tight labor market conditions, with the unemployment rate remaining at a record low of 2.4% in February and real wage growth standing at 6.5% in January. In response to these developments, the Bank of Russia kept its key interest rate unchanged at 21% in March. Meanwhile, an excessively expansionary fiscal policy continues to undermine efforts to curb excess demand, creating additional challenges for monetary policy.

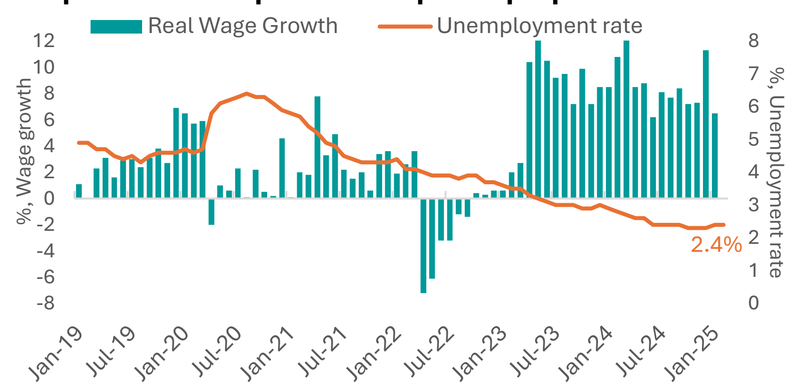
Against the backdrop of negotiations in the Russia-Ukraine conflict, financial markets have shown signs of improvement. However, the response appeared to be an overreaction to premature expectations of a swift end to the war, which faded as markets reassessed amid ongoing conflict and persistent macroeconomic risks. Expectations of potential sanctions relief have also been reflected in the appreciation of the ruble. Unlike the MOEX, the ruble has not undergone a correction and continues to appreciate, consolidating around the 82 RUB level. This sustained appreciation is largely attributed to higher export volumes and tight monetary policy, which has supported renewed capital influx into Russia. However, recent price volatility in the oil market has raised concerns about the outlook.

Economic growth is showing some slowdown as expected and part of a stagflationary scenario



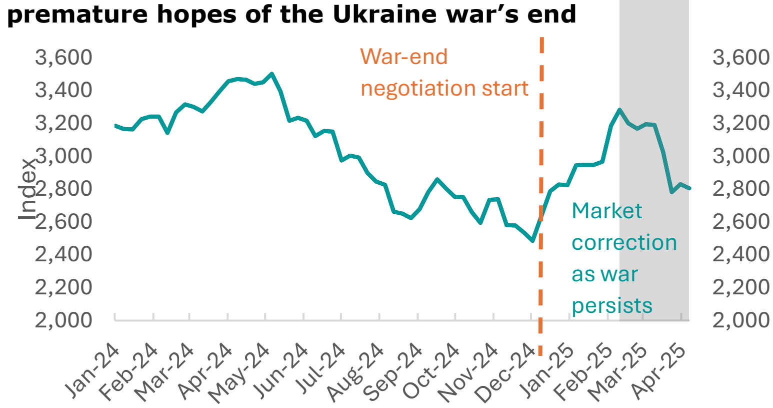
Source: Rosstat

Labor market is extremely tight, punctuated by ongoing labor shortages as domestic resources compete between private and public purposes



Source: Rosstat

The MOEX surge reflects a market overreaction to premature hopes of the Ukraine war's end



Source: investing.com

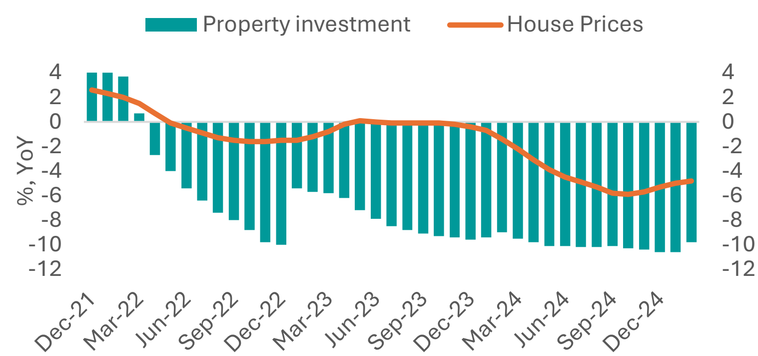
China

China's economy grew by 5.3% YoY in Q1, outperforming market expectations of 4.8%. This was largely driven by strong industrial output and fixed-asset investment, signaling a solid start to the year. Industrial activity benefited from early-year stimulus and a surge in exports ahead of anticipated tariff hikes, while infrastructure and high-tech sectors contributed to the strength in fixed investment. However, persistent weakness in the property market has eroded household wealth undermining consumer confidence. In response, Chinese policymakers have unveiled a "special action plan" to boost consumer spending.

However, rising trade tensions with the US will likely more than offset any positive changes from the latest fiscal measures. China's 10-year bond yield, which had recorded notable rebound driven by aggressive fiscal stimulus measures, has since retreated to its pre-stimulus level of around 1.6%. This renewed decline is largely attributed to intensifying trade tensions with the US, weakening global demand, and heightened uncertainty—all of which have reignited investor concerns about deflationary pressures and long-term economic stagnation.

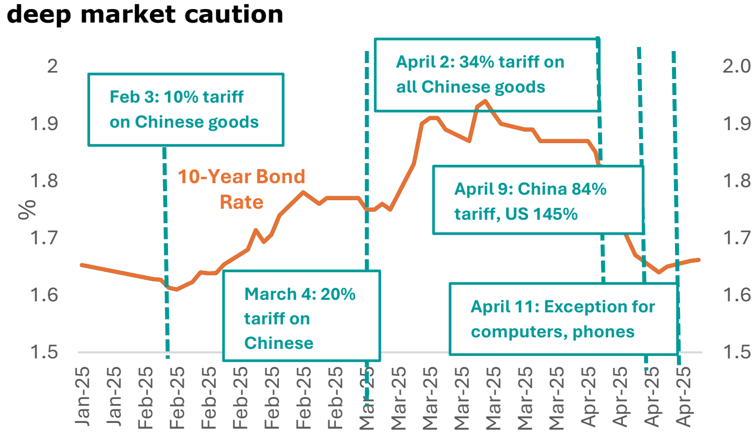
The USD/CNY exchange rate has historically reflected shifts in U.S.-China trade tensions, with key depreciation episodes. In 2018, the U.S. imposed 25% tariffs on Chinese imports, triggering a 10% depreciation of the yuan within months as markets priced in the economic strain. This devaluation was likely a response to offset the impact of tariffs by making Chinese exports more competitive. The situation is very fluid but the Yuan does not seem to have fully priced-in the impact the current tariff policy in place that would suggest the Yuan needs to depreciate to dampen the effect from a decline in US exports (3% of GDP).

China's property sector remains fragile making the economy especially vulnerable to the shock of US tariffs that threaten the export industry



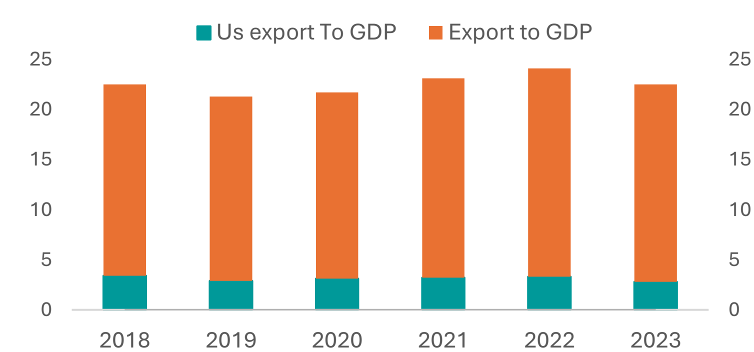
Source: National Bureau of Statistics of China

China's bond yields stay low as tariffs rise, signaling deep market caution



Source: National Bureau of Statistics of China

The yuan continues to weaken amid mounting tensions



Source: National Bureau of Statistics of China