Global Macro Views

TARIFFS INHERENTLY DISINFLATIONARY FOR THE EURO AREA

June 2025

INVESTMENT VIEWS
FROM THE BNY INVESTMENT INSTITUTE

Tactically upgrading our view on government bonds and downgrading our view on cash

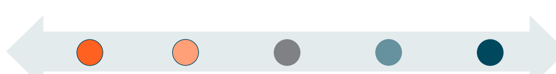
We think that the euro area may see softening growth and weaker inflation. Our probability-weighted forecast sees growth in the euro area in 2025 close to 0.5% (below consensus) and inflation at 2% (below consensus). We think this backdrop allows for more growth-supportive policies from the European Central Bank (ECB), leading to lower cash rates.

The fixed income market has been volatile in recent weeks, and we think this could continue given that policy headlines were the primary drivers. With inflationary pressures very much existent in the U.S., without hard data deterioration in the labor market, we think the U.S. Federal Reserve (the Fed) will keep rates on hold. In May, we increased our view on government bonds, funded from cash. Visit **Checkpoints** for monthly updates on macro and asset class views from the BNY Investment Institute.

An update to our scenario probabilities

On April 2, shockwaves hit the global economy as the White House announced universal tariffs with certain trading partners taking on a larger toll. U.S. equity markets fell over 12% in the following four days. U.S. bond markets showed equivalent stress, with yields surging as the dollar sold off. In the weeks after the news, a number of reciprocal tariff measures were rolled back or reduced. Despite the rollback, the effective tariff rate on U.S. imports remains at historically high levels — levels that warranted a shift in our latest **Vantage Point**. We see a 50% probability of a 'slowdown,' 30% probability of a 'stagnation,' and 20% probability of an 'expansion.'

Asset	View	Delta*
Global Equity	●	— —
Government Bonds	●	▲
Credit	●	— —
Real Assets	●	— —
Cash	●	▼

Unfavorable  Favorable

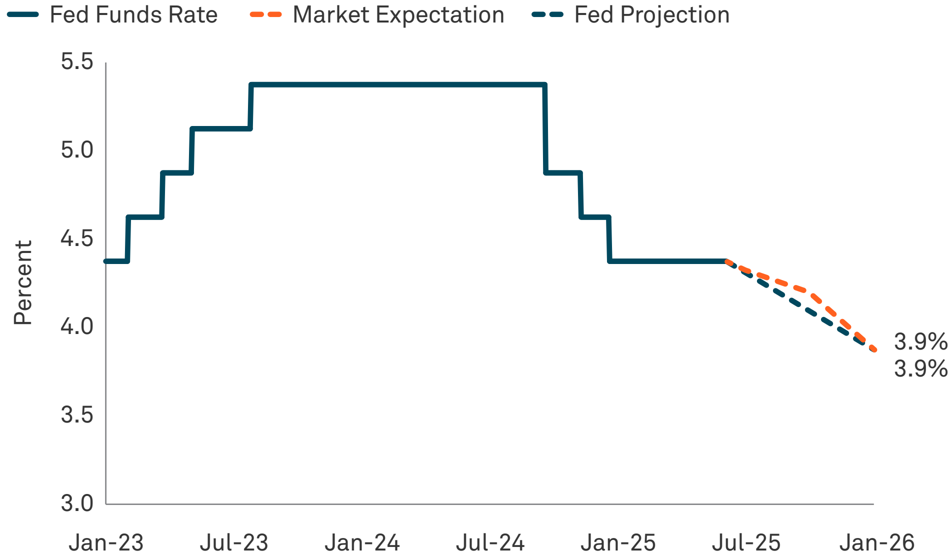
BNY Investment Institute as of May 22, 2025. * Delta represents change from previous month. **Past performance is no guarantee of future results.**

Fed likely to be slow and cautious

A key macro implication from our shifts in scenarios is a large short-term inflation spike that overwhelms domestic demand. While some tariffs have been temporarily reduced, trade tensions remain with China.

With this backdrop, the Fed likely faces challenges in achieving its dual mandates of maximum employment and price stability. Despite facing a slowing growth outlook, we think a potential supply shock that increases inflation leaves the Fed hesitant to lower rates. Our updated probability-weighted forecast sees inflation above 3.5% by the end of 2025. Current market pricing of over two rate cuts (at time of writing) would require the Fed to disregard inflation rising above target. Our current expectation is for less than two rate cuts by the Fed.

FED PROJECTIONS VS. MARKET

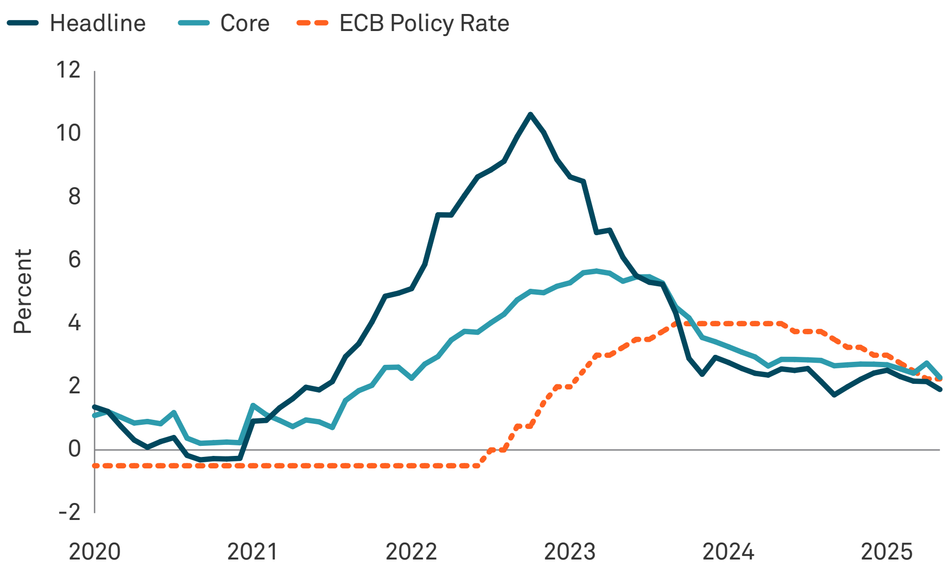


Source: BNY Investment Institute as of June 4, 2025. Projections based on latest Summary of Economic Projections (SEP).

More scope to cut for the ECB

On June 5, the ECB proceeded to cut 25bp, lowering policy rates to 2% as growth concerns continue to be forefront. Tariffs will also push down on euro area growth in 2025, but we think the U.S. bears the burden of higher inflationary pressures (as the imposer of tariffs). Inflation has been falling towards target in the euro area and labor costs are expected to further ease in 2025.

EURO AREA INFLATION



Source: BNY Investment Institute as of June 4, 2025.

Charts are for illustrative purposes only. **Past performance does not guarantee future performance.**

(i) Euro Area is highly dependent on global trade

Imports and exports make up, combined, roughly 75% of gross domestic product (GDP) (for context, U.S. total trades make up about 18% of GDP and China total trades make up about 34% of GDP). A successful bilateral trade negotiation with the U.S. would be helpful, but a slowdown in global trade will likely weigh on growth, regardless. ECB President Lagarde was explicit about such risks during the last two ECB meetings.

COUNTRY EXPOSURE TO THE U.S. TARIFF SHOCK

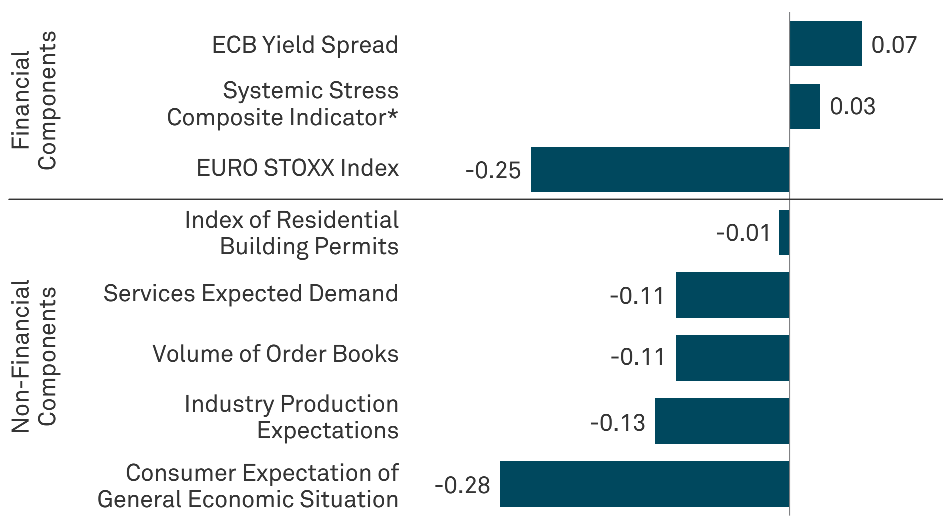
Source: BNY Investment Institute as of June 4, 2025. * Domestic value added in exports.

(ii) A soft underbelly isn't shielding the region from a global trade shock

Tariffs will most likely lead to lower demand for euro area goods, and we think uncertainty will weigh on both firms' investment and hiring intentions and consumers' appetite to spend through the year. April's Purchasing Managers' Index (PMI) results, which were collected after the U.S. tariff announcements, suggests softening expectations for activity in the region, and underlying growth momentum remains weak in Germany and France, the two largest economies of the region.

While the fiscal package announced by Germany is welcome, we think the true positive impulses to growth will be felt from 2026 onwards. Uncertainty and soft underlying growth momentum introduces some vulnerability to the region with potential scope of worsening if trade tensions continue to escalate.

THE CONFERENCE BOARD LEI AND COMPONENT CONTRIBUTIONS (%)



Source: BNY Investment Institute as of May 20, 2025. * Inverted series: a negative change in this component makes a positive contribution. LEI = The Leading Economic Index.

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(iii) Tariffs will be mostly disinflationary for the Euro Area

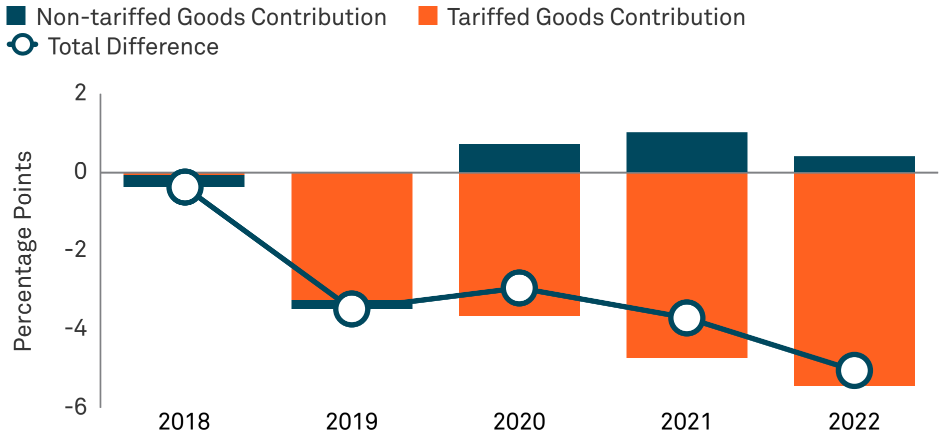
U.S.-China trade tensions in 2018 (effective tariff rate on Chinese goods was estimated to be around 18% during the 2018–19 trade war) led to a significant decline in Chinese exports to the U.S., with research finding that tariffed products contributed most to the decline.[1]

The next question poses itself naturally — who absorbs these goods?

Given structural similarities with the U.S. (i.e., large consumer market, developed infrastructure and logistics, being technologically advanced) and a similar demand profile (9 of the top 10 import categories overlap), the euro area was an important alternate destination for redirected final Chinese exports during the first trade war.[2] More importantly, the redirected goods saw lower price tags.[3]

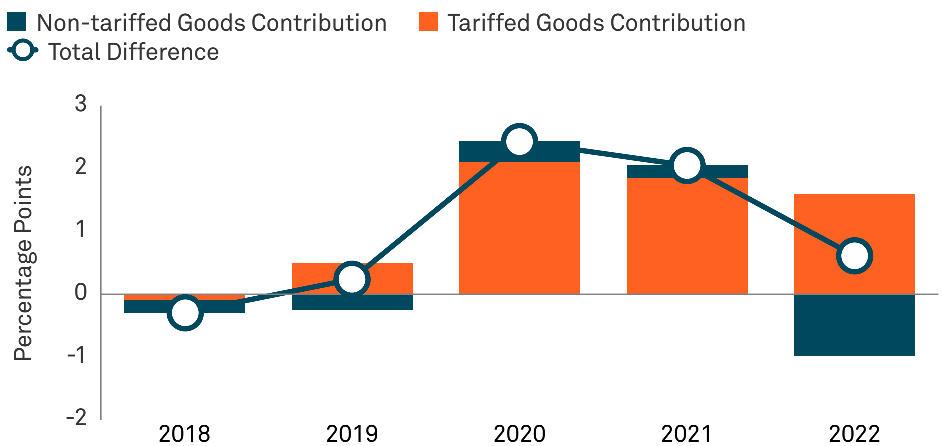
Should history rhyme, trade redirection paired with lower import prices will be disinflationary for the euro area. Additionally, a potential demand shock to the euro area will likely see a more accommodative ECB.

CHANGE IN CHINA'S SHARE OF U.S. IMPORTS



Source: U.S. Census Bureau; U.S. Federal Reserve Board staff calculations; accessed April 2025.

CHANGE IN CHINA'S SHARE OF EUROPEAN UNION IMPORTS



Source: United Nations Comtrade database; U.S. Federal Reserve Board staff calculations; accessed April 2025.

About the BNY Investment Institute

Drawing upon the breadth and expertise of BNY Investments, the Investment Institute generates thoughtful insights on macroeconomic trends, investable markets and portfolio construction.

	% of Total Imports	
Import Categories* from China	**U.S.**	**Europe**
Electrical Machinery & Equipment	28%	31%
Machinery & Mechanical Appliances	19%	19%
Toys, Games & Sports Equipment	7%	3%
Plastics & Articles Thereof	4%	3%
Furniture	4%	4%
Vehicles ex. Railway	4%	5%
Articles of Iron or Steel	3%	2%
Medical or Surgical Instruments	3%	3%
Apparel & Clothing Accessories	2%	2%
Footwear**	2%	2%

Sources: U.S. Census Bureau, Eurostat, BNY Investment Institute as of May 8, 2025.
* Categories ranked by top 10 U.S. imports from China. ** Not a top 10 import category for Europe.

Charts are for illustrative purposes only. **Past performance does not guarantee future performance.**

[1,2] The U.S. Federal Reserve, Global trade patterns in the wake of the 2018–2019 U.S.-China tariff hikes, April 2025. ECB, The implications of US-China trade tensions for the euro area — lessons from the tariffs imposed by the first Trump Administration, March 2025.

[3] SSRN, The Impacts of the U.S. Trade War on Chinese Exporters, accessed April 2025.

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The **EURO STOXX 50** tracks the Eurozone's super-sector leaders, resulting in a diversified and liquid portfolio. The index's weighting is based on free-float market capitalization, with a maximum weight of 10% per constituent. Investors cannot invest directly into any index.

The **Purchasing Managers' Index (PMI)** is an economic indicator derived from monthly surveys of private sector companies.

The **Leading Economic Index (LEI)** published by the Conference Board is used to predict the direction of global economic movements in future months.

The Investment Institute consists of BNY Advisors' macroeconomic research, asset allocation, manager research and operational due diligence teams.

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