Global Risks 2025 Midyear Update

MACRO STRATEGY | July 2025

Key Takeaways

- We expect global economic risks from U.S. policy changes to remain high, as we expect little domestic resistance to the U.S. administration's ever-shifting policies.
- Complacency or fatigue has led markets to look beyond most U.S. policy announcements in recent months, but we remain concerned about the eventual real effects on U.S. businesses and valuations.
- Our U.S. growth forecast also faces upside risk from stimulative fiscal policy, tighter labor markets driven by immigration policy, strong margins and less variable government policy going into the midterms.

2025	Growth (% y/y)	10-yr Yield (YE, %)	Policy Rate (YE, %)	Inflation (Dec, % y/y)
U.S.	0.7 (-160bps)	4.25	4.00	3.0 (+20bps)
Eurozone*	0.6	2.80 (+60bps)	1.50 (-25bps)	1.6 (-30bps)
U.K.	1.0	4.45 (+45bps)	3.50	2.8 (+40bps)
Japan	0.6 (-40bps)	1.40 (+30bps)	0.50	2.8 (+60bps)
China**	4.7 (+20bps)	1.50 (-40bps)	1.20 (-20bps)	0.6 (-60bps)

Source: MIM. Changes in parentheses represent forecast changes since December 2024.
**10-yr yield for Bund, ECB deposit rate.*
***China 7-day reverse repo replaces previous Loan Prime Rate quoted in December 2024.*

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Risk 1. Evolution or Revolution in Global Trade?

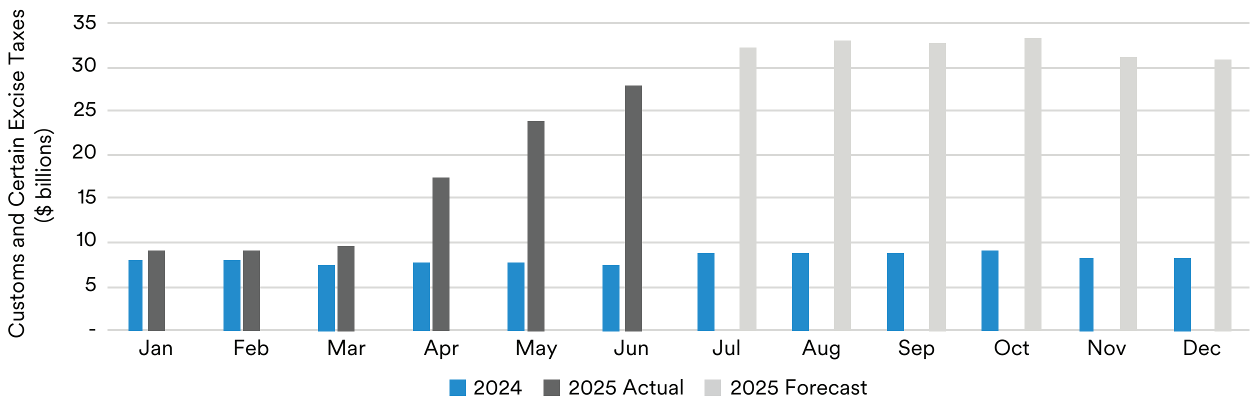
The first five months of the second Trump administration have been a historic turning point in global trade.

The scale of the hike in average U.S tariffs is shaping up to be material, regardless of where they wind up. We continue to see risks of longer-term tariff effects. Universal tariffs are perhaps the most important policy change, as they represent a shift by the U.S. from a baseline of trade liberalization to one of protectionism.

Tariffs have become a significant revenue source: We estimate an excess $180 billion in tariff revenues this calendar year and substantially more over a full fiscal year. This is both an enormous additional cost burden for businesses and ultimately consumers to absorb and creates inertia around reducing tariffs rates in future administrations.

The biggest surprise by far has been the Trump administration's aggressive stance against historical allies such as Canada, Japan and the European Union (EU), which together make up one-third of U.S. goods imports. While we would expect an eventual resolution, particularly with Canada and Mexico as USMCA negotiations continue into next year, we also have substantial concerns about how favorable the terms will ultimately be for U.S. and global economic conditions.

Figure 1 | Tariff Revenues Have Exploded Since April 2



Note: Forecast baesd on average excess revenues versus 2024 tariff revenues.
Source: U.S. Treasury, Treasury General Account. As of 7/11/2025.

Negotiations between the U.S. and the EU are proving particularly difficult, with the Trump administration in mid-July threatening a baseline tariff rate of 30% on EU imports from 1 August (10 percentage points above the "Liberation Day" announced level) should an agreement not be reached. The EU is hoping to negotiate a 10% baseline tariff level with the U.S. and get carve-outs from some of the higher sectoral levies, e.g., the 25% tariff on car imports and 50% tax on imported steel and aluminum. We ultimately think that a negotiated settlement between the EU and U.S. will be reached, but fear that relations could get worse before then, and that the EU may well eventually implement some of the counter-tariffs on imports from the U.S. that it has so far delayed while negotiations are underway.

For now, markets appear to be taking comfort from the relatively less chaotic tariff environment that has prevailed since the beginning of May, when the U.K. and U.S. announced the first tentative framework trade agreement. However, we worry that markets have become either complacent or exhausted and are not fully reckoning with longer-term tariff effects. In other words, we see the mid-year benign market environment as tenuous.

Fundamentally, however, the greatest risk that we see is that the U.S. presidency has broad unilateral authority over tariffs. Although there has been pushback,[1] authority remains largely with the President. Unless this authority is wrested back by Congress, the possibility of sudden and capricious changes to tariffs remains — not just in a Trump administration but in any future administration that wishes to modify tariff policy to suit their priorities.

Risk 2. Policies of the U.S. Administration

The two off-base-case risks we raised in our Global Outlook 2025 piece — investment and inflation — remain relevant, and both are influenced by the President's fluctuating priorities.

Our base case included a rebound in investment, which had been on the sidelines ahead of the presidential elections. There was indeed a spike in investment following the election. But this fell off rapidly as major trade announcements started coming in March 2025.

This highlighted our first off-base case risk of investment failing to reignite following the election. National account data from the BEA show that in the first quarter of 2025, investment grew a massive 24%, as firms tried to preempt tariffs on equipment. So, while investment may not have disappointed, it arguably grew for the "wrong" reasons — and it is unlikely that firms can continue purchasing at that pace going forward.

Figure 2 | Post-Election Pullback in Durable Goods

Source: U.S. Census Bureau, NBER (National Bureau of Economic Research), MIM. As of 7/14/2025.

The One Big Beautiful Bill Act (OBBBA) also reduces some provisions of the Biden administration's Inflation Reduction Act, designed to incentivize private investment but permits expensing of R&D investment. Thus, the net effect on investment remains to be seen, but we do expect companies to start ramping up R&D spending.

In our December outlook, we also discussed upside risks to inflation. Our base case was that inflation would moderate. In the current high tariff regime, we continue to believe that tariffs are not likely to lead to a very substantial increase to consumer prices.

However, the risk remains. Tariffs take time to work through the supply chain; increased government spending may be inflationary; and new immigration policy could tighten the labor market and raise average wages. With inflation higher than the 2% target for more than four years, risks of unanchored inflation expectations continue to mount.

Going forward, fiscal policy will continue to be a key risk for investment and inflation. Even though the 2026 midterm elections seem far away, political strategists and candidates of both parties have already started planning and taking action to prepare. The administration's policy between now and the elections may be more cooperative or pro-growth as the Republican party tries to maintain its control of the House and Senate.

Risks are still posed by the administration needing to pass the appropriations bills to keep the government funded after October 1, when the March continuing resolution expires. The appropriations process will be made more complicated because lawmakers will have to decide whether to formalize cuts made by DOGE, which may have further implications for investment and inflation. History and prediction markets favor Democrats[1] in the midterms, but we see the possibility of continued Republican control, which would mean continued, unfettered policy risk emanating from the White House.

Risk 3. Monetary Policy

There has been no pause in the monetary policy loosening cycle in Europe. The European Central Bank (ECB) continued to cut rates gradually in 2025 for a total of 100 bps during the first half of the year. We expect another 50 bps of cuts by year-end.

The Bank of England (BoE) has cut rates twice since the start of the year for a total of 50 bps. Our central expectation is for another 75 bps of cuts by year-end, albeit with the balance of risks tilted to 50 bps, should underlying inflationary pressure prove stickier than expected.

In Japan, after a single 25-bp hike in January, the BoJ has paused it tightening cycle. We expect the pause to continue through year-end.

In the U.S., we have indeed seen a pause. However, we expect cuts to resume later in the year, which would bring Federal Reserve policy in sync with the ECB and BoE.

For the U.S., the greatest risk is markets believing that President Trump has found a path to get the Federal Open Market Committee (FOMC) to cut more than economic conditions warrant. That may not cause immediate economic damage, but — like the Liberation Day tariffs — would shake markets and gradually undermine the U.S.'s position as the global center of economic activity.

Ironically, better-than-expected economic growth could exacerbate the risk of conflict between President Trump's avowed low-interest-rate inclinations and appropriate monetary policy. The passage of the OBBBA is unlikely to help President Trump's cause of lower rates. It is broadly expected to be stimulative. Although it would be implemented next year, it could help provide reassurance to businesses that the economy is stabilizing.

Figure 3 | OBBB Act Expected To Be Near-Term Stimulative

Estimating Group	Bill Version	10-year GDP Effect
Tax Foundation	Senate Finance Committee	1.0% increase spread over 10 years
Joint Committee on Taxation	House Ways and Means Committee	0.4% increase spread over 10 years
Congressional Budget Office	House	0.5% increase spread over 10 years
Council of Economic Advisors	Senate Finance Committee	4.6-4.9% increase spread over the next 2 years with total 2.4-2.7% increase spread over 10 years
AEI's Kyle Pomerleau	House	0.6% increase spread over 10 years
Penn Wharton Budget Model	House	0.4% increase spread over 10 years
The Budget Lab	House	0.1% decrease spread over 10 years

Source: William McBride, "Will the Big Beautiful Bill Lead to an Economic Boom or Just Modestly Higher Growth?" Tax Foundation, June 26, 2025.

Our U.S. forecast faces upside risk of stronger economic growth. One feasible scenario is a positive growth story driven by the stimulative nature of the OBBBA, a less variable and more business-friendly policy direction heading into the midterms, continued strong margins at large businesses that fuel continued consumption, a tighter labor market, given lower supply from immigration measures, as well as burden sharing of tariffs across the supply chain.

Risk 4. Geopolitical Crisis or Agreement?

In our view, the U.S.-China trade negotiations remain the most economically significant, near-term geopolitical quandary.

The Geneva Accord — including a 90-day tariff reprieve — and subsequent London framework agreement have provided an anchor for ongoing U.S.-China trade negotiations. Subsequent talks have codified commitments made in Geneva and London, particularly on the countries' respective export restrictions. Beijing recently announced tighter controls over two fentanyl precursors, reflecting its strong desire to reduce fentanyl-related tariffs (20% of the total 40% at present). U.S. Ambassador David Perdue is also engaged with Chinese officials on the ground, serving as a key interlocutor for President Trump. The U.S. and China each have strategic chokepoints on the other, due to export restrictions on rare earths and high-end semiconductors, effectively serving as a deterrent against further tit-for-tat retaliation.

Our baseline is for a "fragile truce" to persist ahead of the August 12 Geneva Accord expiration date, although with ongoing headline risks. For example, Beijing has promised to resume exports of rare earths and magnets in exchange for the same on U.S. semiconductors. China contends that it has reduced the licensing approval timeframe from 90 to 20 days; however, there is no proof of these flows normalizing yet, nor has Beijing offered any detail on how fast and at what scale these approvals will occur. China's export restrictions on the more politically sensitive rare earths magnets used for the U.S. military complex are likely to remain in place, which could be an additional source of tension.

Finally, we believe there is general complacency in the market that the current 40% tariff will hold come August 12, given myriad points of contention in the U.S.-China relationship, including on issues such as Taiwan.

Endnote

[1] E.g., on the Kalshi betting site. Historically, a party with Senate, House and Presidential control has lost control of at least one legislative body in the subsequent midterm elections.

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