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THINK Ahead Eurovision edition: What the hell just happened?

Clutch my pearls... what the hell just happened? I'm talking about America's now-gone 145% tariffs on China and not - surprisingly - the UK's Eurovision song. A bit like the song contest, those tariffs didn't last long, but it felt like a decade. Can we now just move on? Markets seem to think so, but our James isn't so sure

'What the hell just happened?' - a Eurovision song and a fitting slogan for the past few weeks

Room is spinning...

Take a quick glance at financial markets, and you'll be forgiven for thinking the last month didn't happen.

US equities are creeping ever closer to February's high. Volatility is right down. And 2-year swap rates, an indication of Fed policy expectations, are where they were on the eve of 'Liberation' Day on 2 April.

But is it really business as usual?

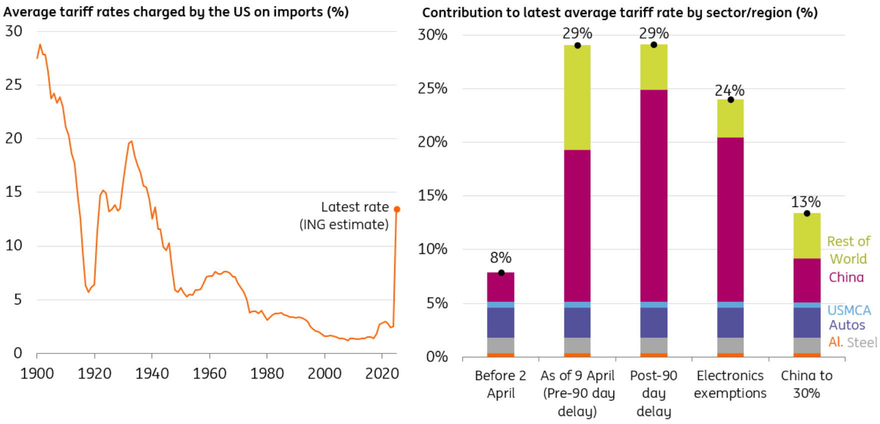
The US-China deal is a game changer, there's no doubt about that. Last week, I aired my concern that it risked being too little, too late. But the cut in tariffs on Chinese goods to 30% was much steeper than just about everybody had expected.

Crucially, as Lynn Song explains, that should allow trade between the two to go more or less back to normal. The fact that those 145% tariffs came and went relatively quickly means that the hit to supply chains should be more manageable. Remember, there was A LOT of stockpiling in the first quarter, judging by the surge in US imports. The risk of a US recession has clearly receded.

Let's face it, though, this whole situation remains far from normal for three key reasons.

First, tariffs are still the highest they've been since World War II. Based on my maths, the average tariff the US is charging across everything it imports is now 13%. That's a big decline from 24%, which is where it was before China's tariff was lowered. But it was 8% before 'liberation day' and 2.5% before President Trump's inauguration. Whichever way you cut it, this is still a substantial tax rise for the US economy.

Chart of the week: How US tariffs have evolved over recent weeks



Source: US Census data, White House, ING calculations

Only non-USMCA compliant goods from Canada and Mexico are subject to a 25% tariff. Coloured bars show the contribution to the latest average tariff rate from the tariffs charged on different countries and products.

Ears are ringing...

Second, that 13% probably represents a floor; it's hard to see that figure getting much lower. The 10% baseline tariff on all countries bar China isn't going anywhere. The UK-US deal made that pretty clear. Nor do we think the exemptions on metals and car tariffs secured by the UK will be replicated widely. A verdict on fresh pharmaceutical tariffs is due at some point, too.

It's also not at all clear what happens when the 90-day delays end, on 8 July for those reciprocal tariffs, and 12 August for China. I suspect many investors have concluded that those delays will get perpetually extended. They may well be right, but could we see some countries hit with their initial, higher reciprocal tariffs again once those deadlines pass? I certainly wouldn't bet against it.

Here in Europe for instance, my colleagues are not particularly optimistic about an EU-US deal. And the fact US-China shipping demand appears to have surged after Monday's tariff climbdown suggests exporters aren't taking the 90-day reprieve for granted, either.

Thirdly – as this whole debate demonstrates – uncertainty is still crazily high. It's hard to imagine consumer confidence fully recovering. And businesses still lack the stability they crave.

It's a lesson we learnt the hard way here in the UK during Brexit. Business investment massively underperformed for four years after the referendum, but has grown faster than in France/Germany since a trade deal was eventually signed in late 2020.

Why? Not because the deal was great for businesses (it wasn't), not because things have changed much since then either; UK-EU efforts to improve things at a summit next week look easier said than done. But because the free-trade deal meant the uncertainty that had clouded those post-2016 referendum years had finally gone.

The net effect of these past few weeks, as James Knightley put it to me this week, is that the wind has been taken out of the sails of the US economy. A process, it's easy to forget, which had already begun well before 'liberation day'.

Remember, tariffs are not the only area of government policy acting as a headwind for growth. Government austerity is a drag, too, and that will show through in the jobs numbers in the autumn. And remember, the tax cuts that eventually make it through Congress are unlikely to be nearly as sizeable or as consequential as the President hopes.

The China de-escalation does, however, remove some of the urgency for the Fed to start cutting rates. Though the short-term inflationary hit now looks smaller, the reduced risk of recession means the medium-term outlook also now looks less deflationary. And that's ultimately what matters more for monetary policy.

That may be true, but don't fall into the trap of thinking the Fed doesn't need to cut rates at all. As James K explained after this week's US inflation data, service-sector price pressures are easing off even as the cost of goods comes under upward pressure. And services hold the much larger weight in the core inflation basket.

James is looking for the first 25 basis-point rate cut in September and thinks markets are probably about right pricing two cuts in total for 2025. And here in Europe, our eurozone team are sticking to their call of two more rate cuts – taking the deposit rate to 1.75%.

China's tariff reprieve may have spared the global economy a painful slowdown. But "business as usual"? Let's be honest—there's nothing usual about it.

THINK Ahead in developed markets

United States (James Knightley)

- **Housing data:** With the 30Y mortgage rate stuck just below 7% and the average mortgage size taken out for a home purchase being $450,000, that works out as a monthly payment just shy of $3000 per month. This underscores the lack of affordability in the US housing market and explains why mortgage applications are so low. Add in the recent financial market volatility that has made potential buyers even more cautious and it's not hard to see why home builders are so depressed – note the steep drop in the National Association of Home Builders (NAHB) sentiment index in May. This all points to a very subdued pace of new and existing home sales.

Eurozone (Bert Colijn)

- **Purchasing Manager's Indices (Thur):** So far, there's no real sign of the economy experiencing a negative shock from the trade war. April's PMI showed surprising strength in manufacturing, which followed an exceptional first quarter for the sector, likely due to front-running US tariffs. May PMI data will show how resilient the sector is to global turmoil. We don't have our hopes up but would love to be surprised.
- **Consumer confidence (Tue):** Having shown sharp declines in recent months, weak confidence suggests consumers are unlikely to fully spend the gains from rising real wage growth. However, if consumers start to become less concerned about the global economic environment, this could result in somewhat stronger domestic demand.

United Kingdom (James Smith)

- **UK-EU summit (Mon):** Though Monday's gathering is focused predominantly on striking a defence partnership, the UK government is also hoping to make progress on economic matters**.** Britain hopes to negotiate alignment on food standards, which would do away with cumbersome border checks. But disagreements on migration and fishing have complicated efforts to improve the economic relationship. Read more
- **Inflation (Wed):** April's data is crucial because it's when a whole host of service-sector prices see annual increases. Data from April 2023 and 2024 was hugely market-moving, and the tendency is for this data to come in hotter than expected. That said, we think services inflation will come in below the Bank of England's forecast of 5%. If we're right, that wouldn't necessarily increase the chances of a June rate cut, but it would help cement one in August.

THINK Ahead in Central and Eastern Europe

Poland (Adam Antoniak)

- **Jobs data (Wed):** April wage growth is projected to increase slightly, breaking the slowdown trend seen over recent months, given that wages in the mining and energy sectors should recover from a surprisingly soft March. At the same time, employment likely continued to decline slightly, amid a falling supply of workers due to demographic pressures and lower net migration.

- **Industry (Wed):** Industrial output is likely to have barely changed and has generally run flat over recent months, with swings around zero annual growth driven mostly by statistical and calendar effects. In April, we foresee a drop in annual terms. The number of working days was the same as in April 2024, but we forecast less intensive manufacturing activity around Holy Week this year. Producer price deflation most likely deepened amid falling prices in mining and energy.

Czech Republic (David Havrlant)

- **Producer prices (Tue):** Tepid industrial price growth probably continued in April, given the cutthroat competitive environment and pressured demand from the main European trading partners. Declining energy prices and a stronger Koruna also fueled a steeper annual decline in industrial producer prices.

Key events in developed markets next week

Country	Time (BST)	Data/event	ING	Prev.
		Monday 19 May		
Eurozone	1000	Apr CPI Final (YoY%)	-	2.2
		Tuesday 20 May		
Canada	1330	Apr CPI (MoM%/YoY%)	0.4/2.2	0.3/2.3
	1330	Apr Core CPI (MoM%/YoY%)	-/-	0.1/2.2
Eurozone	0900	Mar Current Account (EUR bn SA)	28.2	34.3
	1500	May Consumer Confidence	-16.7	-16.7
		Wednesday 21 May		
UK	0700	Apr Core CPI (YoY%)	3.6	3.4
	0700	Apr CPI (MoM%/YoY%)	1.0/3.3	0.3/2.6
	0700	Apr Services CPI (YoY%)	4.7	4.7
		Thursday 22 May		
US	1330	Initial Jobless Claims (000s)	230	229
	1445	May S&P Global Composite PMI Flash	-	50.6
	1500	Apr Existing Home Sales (mn)	4.12	4.02
Germany	0830	May HCOB Manufacturing PMI Flash	49	48.4
	0830	May HCOB Service PMI Flash	48.8	49
	0830	May HCOB Composite PMI Flash	50.3	50.1
	0900	May Ifo Business Climate	87.5	86.9
	0900	May Ifo Current Conditions	87	86.4
	0900	May Ifo Expectations	87.6	87.4
France	0815	May HCOB Composite PMI Flash	-	47.8
UK	0930	May S&P Global Composite PMI Flash	49.5	48.5
	0930	May S&P Global Manufacturing PMI Flash	45.5	45.4
	0930	May S&P Global Services PMI Flash	50.0	49
Eurozone	0900	May HCOB Manufacturing PMI Flash	48.6	49
	0900	May HCOB Services PMI Flash	50.0	50.1
	0900	May HCOB Composite PMI Flash	50.0	50.4
		Friday 23 May		
US	1500	Apr New Home Sales (mn)	0.69	0.72
Germany	0700	Q1 GDP Final (QoQ%/YoY%)	0.2/-0.4	0.2/-0.4
UK	0700	Apr Retail Sales (MoM%/YoY%)	-0.6/3.5	0.4/2.6
	0700	Apr Retail Sales ex fuel (MoM%/YoY%)	-0.6/3.5	0.5/3.3
Canada	1330	Apr Retail Sales (MoM%)	0.1	-0.4
Sweden	0700	Apr Unemployment Rate	-	8.5

Source: Refinitiv, ING

Key events in EMEA next week

Country	Time (BST)	Data/event	ING	Prev.
		Tuesday 20 May		
Czech Rep	0800	Apr PPI (MoM%/YoY%)	-/-	-0.3/-0.3
Hungary	0730	Mar Average Gross Wages (YoY%)	8.5	9.3
		Wednesday 21 May		
Poland	0900	Apr Employment Growth (YoY%)	-0.9	-0.9
	0900	Apr Industrial Output (YoY%)	-1.3	2.5
	0900	Apr PPI (YoY%)	-1.6	-1.1
	0900	Apr Wages (YoY%)	8	7.7
		Friday 23 May		
Poland	1300	Apr M3 Money Supply (YoY%)	10.2	10.3
Hungary	0730	Apr Unemployment Rate	4.2	4.3

Source: Refinitiv, ING

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