

US sentiment slump means trade deals can't come quickly enough

Financial markets have bounced back after the chaos and confusion of 'Liberation Day', on optimism that trade deals will be signed and tax cuts will be agreed. But the collapse in economic sentiment suggests these agreements need to materialise quickly to prevent a downturn



US President Donald Trump signing a series of executive orders in the Oval Office of the White House this week

Sentiment sours on trade and inflation uncertainty

US President Donald Trump's decision to rewrite the rules on trade is having a clear impact, not just on trade partners, but on the US economy too. First quarter US GDP was dragged down by a surge in imports as US companies sought to bring as much product in as possible ahead of the imposition of tariffs. Much of this has been accumulated as inventory, but it also helped to facilitate a large increase in consumer spending in March for big-ticket items such as cars, while investment in equipment also performed strongly.

Second quarter GDP should bounce back into positive territory as imports reverse, based on shipping and port data, while April spending also held up as consumers continued to bring forward purchases in advance of tariff-induced price hikes. This, though, will mask a clear shift in the underlying fundamentals of the economy.

Plunge in consumer sentiment points to the threat of outright spending declines



Source: Macrobond, ING

Weak macro fundamentals spread across all sectors

Consumer sentiment has undoubtedly soured since President Trump's election victory last November. Worries about higher prices and squeezed spending power from tariffs, concern about a cooling jobs market and anger and disappointment tied to falling asset prices have caused confidence to plummet to levels typically seen only during recessions. The chart above shows the historically strong relationship between sentiment and spending that is currently warning of a steep decline in demand.

The uncertainty created by the on-off-on again implementation of tariffs and the unclear trading environment companies face is impacting corporate sentiment and leading to businesses becoming more vague on earnings guidance. This, in turn, is likely to mean a growing reluctance to put money to work, which suggests hiring and investment should slow significantly. This comes at a time when the federal government is trying to trim spending, with the President proposing a 23% cut to non-defence discretionary spending next fiscal year.

Another concern is the steep drop-off in foreign visitors, which will hit leisure and hospitality in key regions, while talk of foreign consumer boycotts of US made goods and services makes export forecasts vulnerable to revision.

Market optimism will be tested in the face of waning economic momentum

While there is still the threat of a sharp slowdown, we have to be cautious. Recession was the base case of many economists 18 months ago, yet the economy continued to power on – write the US consumer off at your own peril! This time around there does appear to be more of a headwind with the fiscal policy being tightened and the Fed signalling little prospect of imminent interest rate cuts.

Financial markets, though, are looking at the positives, having fully recovered the losses seen in the wake of the shock from the initial “Liberation Day” announcements. They appear to be taking the president at face value in terms of his promise of trade deals that de-escalate tensions and that he will soon pivot to significant tax cuts that will provide meaningful support to the economy.

That may well be true, but it needs to happen quickly otherwise the loss of momentum caused by tariff uncertainty and consumer worries about prices, incomes and wealth could become entrenched.

Moreover an extension of the 2017 Tax Cuts and Jobs Act on its own will do nothing to lift the economy – it merely prevents a huge tax hike that would heighten the chances of recession. Not taxing tips and a trimming of corporate tax rates will not move the needle much while President Trump's more significant tax cuts relating to social security payments and overtime pay could yet be stymied by Republican fiscal hawks in the Senate.

Weaker services inflation to give the Fed scope for 100bp of rate cuts

Inflation in the very near-term is being held down by the drop off in leisure, tourism and hospitality, with airfares and hotel prices falling sharply. However, goods prices will soon start to rise due to tariffs, which will also feed through into some price hikes for services, such as higher car insurance costs. We expect this to become more apparent from June onwards and risks being amplified by the potential supply shock that port operators, logistics firms and big retailers are warning of relating to the sudden drop in orders of foreign-made goods.

The uncertainty over the duration and scale of the inflationary impact looks set to keep the Federal Reserve from imminent rate cuts, but we continue to anticipate 100bp of easing in the second half of 2025. It may possibly start with a 25bp cut from July with three further 25bp cuts and a fourth in early 2026. However, if the jobs market holds up and inflation is stickier, then it may be a September start with a 50bp lead-off more likely, similar to the Fed's playbook from last year.

Housing inflation by that point could start to influence the story more. Housing is 40% of the CPI basket, and a weaker economy and rising unemployment are going to mean landlords will likely end up being more conservative in their pricing. In this regard, the Cleveland Fed's national new tenant rent series is already falling in year-on-year terms. This decline in service sector inflation, combined with tariff influence on inflation fading next year, sees inflation back at target by late 2026.

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