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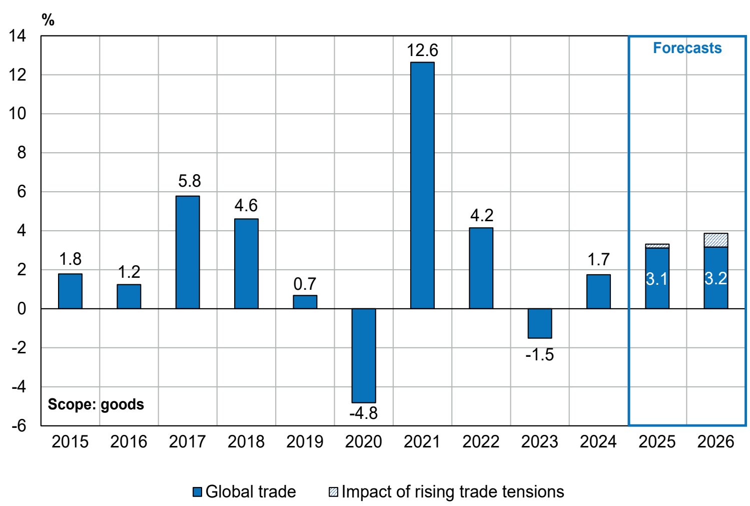
World Economic Outlook in Spring 2025 Growth Amid Global Turbulence

French Treasury (DG Trésor) International Forecasting Teams

- The international scenario, set on 21 February, assumes that the United States will double its existing tariffs on imports from the European Union, China, Canada and Mexico from the 2nd quarter of 2025 onwards. Equivalent countermeasures by these trading partners are also assumed to take effect at the same time. The ensuing turbulence is expected to reduce global GDP growth by 0.1 percentage points (pp) in 2025 and by 0.2 pp in 2026. Similarly, world trade is projected to shrink by 0.2 pp in 2025 and by 0.7 pp the following year.
- In line with these assumptions, and provided uncertainties around US economic and trade policies resolve quickly, the global economy should still perform fairly robustly, though somewhat weaker than predicted in September 2024. Global GDP is projected to grow at a steady 3.2% in both 2025 and 2026, roughly in line with 2024, and only marginally below the average pace recorded during the 2010s.
- Among advanced economies, economic prospects diverge. Growth is expected to remain solid in the United States – if financial stability persists and investment is not excessively dampened by trade policy uncertainties – and in Spain. Germany, however, faces sluggish prospects, weighed down by delays in the emergence of the recently unveiled investment plans' effects (announced after the forecast cut-off date), while Italy and the United Kingdom are likely to fall in the middle. These differences reflect differing exposure to tariff hikes and varying growth momentum for 2025, established at the end of 2024. By 2026, these disparities are expected to narrow somewhat.
- In the major emerging economies, namely China, India, Brazil and Turkey, economic activity is expected to slow down in 2025. China's performance is expected to be particularly hampered by enduring structural imbalances. For 2026, the trajectory for emerging economies is expected to be closely tied to the course of monetary policy.
- Paradoxically, despite tightening trade policies, global trade volumes are set to pick up speed in 2025 and 2026 after two years of subdued momentum. However, this recovery should be partial and notably weaker than anticipated in the previous September forecast (see Chart). Global trade is expected to continue to be driven by emerging economies, and as a result France should experience comparatively modest demand growth.
- These forecasts come with substantial risks – primarily emanating from uncertain global trade policy developments: recent tariff announcements by the US administration amplify downside risk significantly with regard to the assumptions adopted.

Global trade in goods



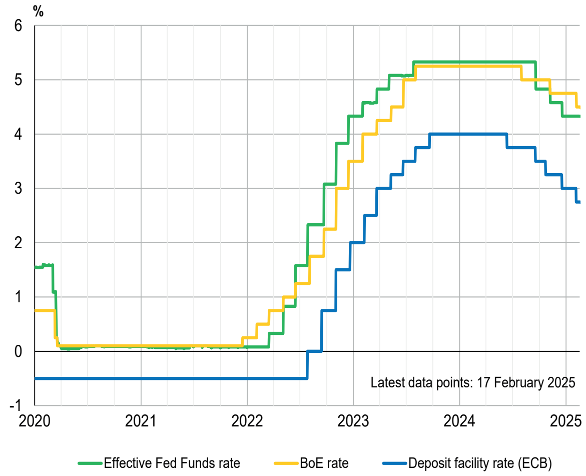
Sources: OECD, IMF, and national statistical institutes for historical data; French Treasury for projections.

1. Scenario assumptions: trade policy tightening and monetary policy easing

These forecasts were set on 21 February 2025.[1] They assume a significant increase in tariffs (see Box 1), while the overall policy mix would be broadly supportive.

The scenario incorporates ongoing monetary easing by major advanced economies, which began in 2024 (see Chart 1), with the extent and pace of easing differing across central banks.[2] This includes: (i) the European Central Bank's (ECB) four basis-point cuts for 2025 – of which two have already been carried out – bringing its deposit facility rate[3] to 2.0% by the end of 2025; (ii) the Bank of England's (BoE) three rate cuts of 25 basis points – of which one has occurred – reaching 4.0% by late 2025; (iii) and the Federal Reserve's (Fed) one cut, also landing at 4.0% in late 2025. Compared to the September 2024 forecast[4] the ECB is expected to ease slightly more aggressively, whereas the Fed and BoE adopt a more cautious approach. Stable key rates are projected for all three central banks in 2026.

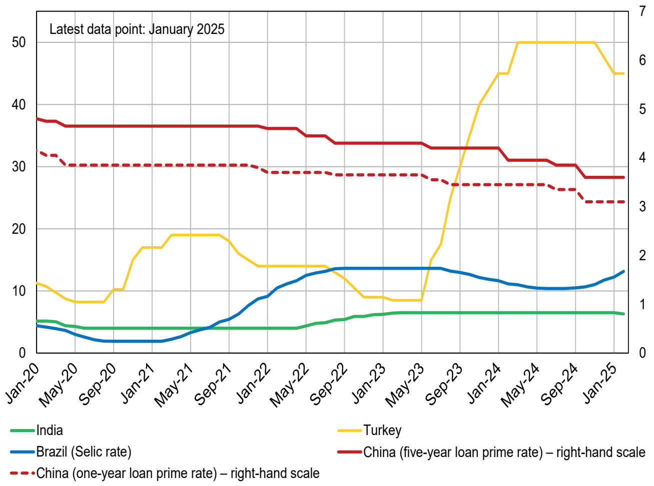
Chart 1: Key rates in major advanced economies (%)



Sources: ECB, Fed, BoE.

Most major emerging economies are also expected to continue easing their monetary policy, apart from Brazil (see Chart 2), which initiated a tightening cycle in September 2024 to bring inflation closer to its target. India will likely adopt a gradual approach to monetary easing, while China is expected to implement more pronounced measures in line with its stated policy objectives. After a restrictive stance in 2024, Turkey is expected to initiate key rate cuts in 2025, though its interest rates will remain high.

Chart 2: Key rates in major emerging economies (%)



Sources: National central banks.

In terms of fiscal policy, the United States is expected to move towards greater austerity in 2025 and 2026, driven by substantial public spending cuts introduced by the new administration, outweighing the fiscal impulse from tax relief measures, most of which involve extensions of existing provisions. In addition, US trade policy could generate additional inflationary pressures (see Box 2). Conversely, the United Kingdom is planning notable increases in public spending for 2025, which are expected to provide some support to economic growth. Germany's fiscal trajectory presents an upside risk to the forecast. A proposed reform of the constitutional debt brake and the creation of a dedicated investment fund – backed by both the CDU and SPD political parties – could offer additional fiscal

(1) The forecasts were prepared by Louis Adjiman, Alban Aubert, Marion Bachelet, Louis Blanco, Lina Bourassi, Léocadie Darpas, Lorelei Durand-Agache, Rizlaine Embarek, Juliette Flament, Eléa Giraud, Omer Gourry, Patrick Kanda Tunda, Aymeric Lachaux, Nicolas Lefebvre, Jules Luye and Laure Noël.
(2) Key rate forecasts for the ECB, Fed and BoE reflect market expectations as of 17 February. At that time, market pricing for the ECB included three additional 25-basis-point cuts, including the one executed on 6 March.
(3) The rate at which central banks remunerate overnight deposits from commercial banks.
(4) See "World Economic Outlook in Autumn 2024: Monetary Easing and Geopolitical Tensions", *Trésor-Economics* No. 349.

space to support growth. In Spain and Italy, economic growth should continue to benefit from accelerated disbursements made under the EU's National Recovery and Resilience Plan (RRP).

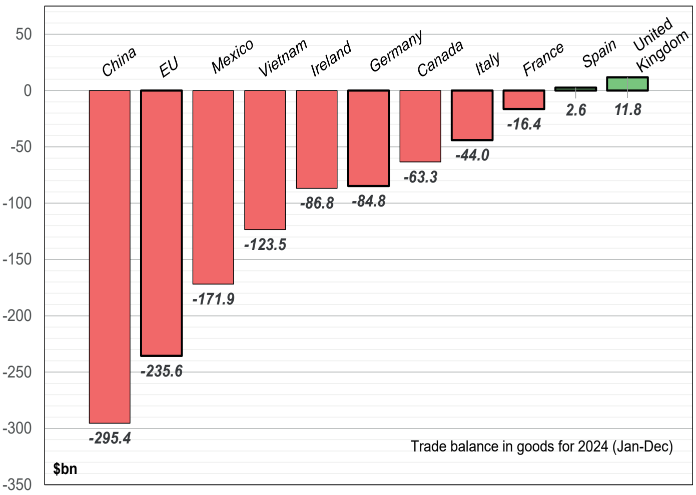
The global oil market, meanwhile, has continued cooling, with Brent crude (the European benchmark) averaging $80.5 per barrel in 2024, down from $82.5 in 2023 and $100.9 in 2022. Upward price pressures in the first half of 2024 due to worsening Middle Eastern tensions and OPEC+ production cuts were later offset in the second half of the year by global economic weakness, notably in China, and rising supply from other major oil producers like the United States and Canada. Even so, oil prices remain well above pre-pandemic levels, which averaged $57.4 per barrel from 2015 to 2019. For projection purposes, the price of Brent crude is conventionally held constant at $75.8, based on its average from 29 January to 17 February 2025. Preliminary data for 2025 suggest the average price will reach $76.1 in 2025 and $75.8 in 2026, somewhat lower than previously anticipated in the September 2024 forecast, which had assumed $79.8 for 2025. The euro-dollar exchange rate is fixed at $1.04, its average over the same late-January to mid-February window.

Box 1: Tariff increases included in the global forecast

Since taking office on 20 January 2025, the second Trump administration has embarked on a vigorous campaign of tariff increases aimed at, among other things, reducing bilateral trade deficits with certain partners, particularly China, the European Union, Canada and Mexico (see Chart 3).

The first wave of tariff increases was announced on 1 February and included: (i) additional tariffs of 25% on all imports from Mexico and Canada, excluding Canadian energy products, which were subject to a more moderate tariff of 10% – these measures were suspended for one month immediately upon implementation, reinstated on 4 March, and again partially suspended on 6 March for another month – and (ii) additional tariffs of 10% on all Chinese imports, effective 4 February, then doubled to 20% on 4 March. On 10 February, the White House also imposed 25% tariffs on imports of steel and aluminium (including all aluminium-based products), effective on 12 March. Additionally, on 13 February, the administration announced a "Fair and Reciprocal Plan" whose objective was to achieve parity by implementing "reciprocal tariffs" – tariffs on US imports equivalent to estimated foreign tariff and non-tariff barriers imposed on US exports. More details are expected to be announced on 2 April. Among the proposals mentioned by President Trump were 25% tariffs on European goods (see below), although as of the forecast cut-off date, specific details remain uncertain regarding the scope or timing of these measures. As a result, they were not included in the baseline.

Chart 3: US trade balance with key trading partners (BEA data)



Source: Bureau of Economic Analysis (BEA).

How to read this chart: These figures are drawn from 2024 data published by the US Bureau of Economic Analysis (BEA), using the valuation method applied in the United States' international economic accounts.[a]

a. Government surplus and deficit figures may differ by source due to two different accounting methods. The BEA data used reflect the price actually paid for goods at the foreign port of export, excluding US import duties, freight, insurance, and other costs incurred in delivering goods to the United States.

Given the rapidly evolving nature of these announcements, the international scenario, set on 21 February, is based on the assumption of an overall twofold increase in the existing average tariffs compared to the rates prevailing before President Trump's inauguration on imports from the aforementioned partners from the second quarter of 2025 onwards. The average effective tariff rate on imports from China would thus reach 40%, up from 20% at the end of 2024, while imports from the EU, Mexico and Canada would see their average tariffs rise to 6%, up from 3%. This scenario also includes equivalent countermeasures from the affected countries, assumed to come into effect within the same timeframe.

This baseline scenario incorporates the initial 10% additional tariffs imposed on China in early February, the 25% tariffs on steel and aluminium imports applied globally, and the "reciprocal tariffs"[b] expected to be announced on 2 April according to the US government. Although the precise details for these "reciprocal" tariffs remain unclear, the scenario assumes that their application would mainly impact the EU (raising the average effective tariff rate by an additional one to two pp), as well as specific sectors in Canada (notably dairy products and softwood lumber), and emerging economies, which generally maintain higher tariffs than those currently imposed by the United States.[c] Additionally, an announcement made on 27 February, after the forecast cut-off date, introduced a further 10-pp increase in tariffs on Chinese goods, effective 4 March. This measure aligns with the scenario's assumptions, bringing China's effective tariff rate to the anticipated 40%.

Other announcements made after the cut-off date nonetheless introduce a downside risk to the scenario (see Box 3). The global 25% tariff on all European products mentioned by President Trump on 26 February would result in an effective rate well above the level assumed in the baseline. That said, the scope of these new tariffs remains undefined as of the time of writing. President Trump made only oral remarks, referring broadly to new tariffs while placing particular emphasis on agricultural and automotive products. As of the publication date, no specific implementation timeline has been announced for these tariffs targeting the EU. However, the date of 2 April is still expected to serve as the reference point for broader announcements regarding the so-called "reciprocal" tariffs. The introduction of an additional 25% in tariffs on imports from Canada and Mexico, announced on 4 March after a one-month suspension, and subsequently narrowed on 5 March to apply only to imports non-compliant with the terms of the USMCA,[d] would also go beyond the assumptions used in the scenario – were these tariffs to be made permanent. Additional sector-specific tariffs are also expected: the Trump administration has already announced forthcoming measures primarily targeting pharmaceuticals, semiconductors, copper (for which an investigation was announced on 25 February), shipbuilding, and lumber (with an investigation opened on 2 March). These new tariffs could disproportionately affect trade with Canada (which supplies 26% of US copper imports), China, and the EU. Lastly, a White House memorandum published on 21 February confirms the US administration's intention to impose countermeasures, including tariffs, on countries that apply taxes or other measures deemed discriminatory. This includes European regulations (notably the Digital Markets Act and Digital Services Act) and France's digital services tax.

b. The scenario does not account for possible equivalent reciprocal measures targeting non-tariff barriers (e.g., health standards) or non-trade economic policy tools (e.g., VAT), which are difficult to quantify due to their high level of uncertainty.

c. Among the regions mentioned, only the European Union and, to a very limited extent, Canada currently apply tariffs on US imports that exceed those applied by the United States in return. For the EU, this gap is small and limited to sectors like aerospace and automobiles. The application of "reciprocal" tariffs by the EU is expected to increase the US effective average tariff on EU goods by one to two pp (excluding any additional reciprocal tariffs tied to measures like VAT). Additionally, the newly announced tariffs on steel and aluminium would increase the effective EU tariff rate by another 0.5 pp. Overall, the effective average tariff on EU goods is expected to rise to approximately 5.5%, in line with the 6% assumption used in this scenario. In Canada's case, the products affected by this gap are limited to dairy products. However, since these goods account for just 0.1% of US imports, the impact of reciprocal tariffs in this case would be negligible. China and Mexico, on the other hand, do not impose higher tariffs on US goods than the United States currently applies to theirs.

d. The USMCA (United States-Mexico-Canada Agreement) is the trade agreement that replaced NAFTA (which had been in force since 1994) following its renegotiation in 2017-2018. According to the White House, only 50% of Mexican imports and 38% of Canadian imports currently meet USMCA rules of origin and have a new one-month reprieve.

2. A less favourable global outlook for France than anticipated in September 2024

2.1 Global growth and trade revised downward

In 2025, global trade in goods is expected to rebound following two sluggish years, supported by growth momentum in late 2024, when trade grew by 1.9%. However, the pace of this recovery is expected to be much weaker than anticipated in the autumn forecast. Global trade growth is now forecast at 3.1% in 2025 (a downward revision of 0.9 pp) and 3.2% in 2026. The rebound remains only partial, constrained by the significant rise in tariffs (see Boxes 1 & 2) and a downgrade to growth prospects in Europe.

Global GDP is expected to grow at a stable pace of 3.2% in both 2025 and 2026, matching the 2024 figure (see Table 1). This represents a 0.2-point downgrade for 2025 compared to the autumn 2024 outlook, reflecting weaker prospects for global trade and lingering difficulties in certain European economies, particularly Germany. A less accommodative stance in US and UK monetary policy and rising uncertainty are also partly behind the revision. Overall, global growth is expected to remain slightly below its late-2010s average of 3.4% (from 2015 to 2019).

Table 1: Global growth forecasts

	2015-2019 average	2022	2023	2024	2025	2026	2024	2025
				The French Treasury forecasts			Revisions to September 2024 forecasts	
Global growth	**3.4**	**3.6**	**3.3**	**3.2**	**3.2**	**3.2**	**0.0**	**–0.2**
Advanced economies[a]	**2.2**	**3.0**	**1.7**	**1.7**	**1.7**	**1.7**	**0.0**	**–0.1**
Euro area[b]	2.0	3.6	0.5	0.7	1.0	1.1	–0.1	–0.4
Germany	1.8	1.4	–0.1	–0.2	0.1	0.6	–0.3	–0.8
Spain	2.8	6.2	2.7	3.2	2.5	1.8	0.5	0.3
Italy	1.0	4.8	0.8	0.5	0.7	1.1	–0.4	–0.5
United Kingdom	2.0	4.8	0.4	0.9	0.9	1.2	–0.2	–0.4
United States	2.6	2.5	2.9	2.8	2.3	2.2	0.3	0.4
Emerging economies	**4.4**	**4.0**	**4.4**	**4.2**	**4.2**	**4.3**	**–0.1**	**–0.2**
Brazil	–0.5	3.0	3.2	3.4	2.4	2.2	1.2	0.0
China	6.7	3.0	5.2	5.0	4.7	4.4	0.0	0.1
India[c]	6.7	7.0	8.2	6.2	6.5	6.5	–0.5	–0.1
Turkey	4.1	5.5	5.1	2.7	2.6	3.4	–0.8	–0.7
World trade in goods[d]	2.8	4.2	–1.5	1.7	3.1	3.2	–0.3	–0.9
World demand for French exports	3.3	5.5	–2.4	0.6	2.6	2.8	–0.3	–1.0

a. Aggregate forecast figures for “advanced economies” and “emerging economies” are estimated based on IMF projections, with figures adjusted using DG Trésor projections for the countries in the table above and adjusted for revisions to national accounts.
b. The euro area aggregate derives from quarterly accounts adjusted for working days. Forecast figures are estimated based on European Commission projections adjusted by those of DG Trésor for Germany, France, Italy and Spain. The current forecast was set on 21 February 2025 and does not incorporate the most recent euro area GDP estimate. Following the release of the euro area’s annual GDP estimate on 7 March 2025, annual growth for 2024 was revised by 0.1 pp to 0.8%.
c. India’s growth is for the fiscal year running from the beginning of April to the end of March.
d. Global trade, calculated as the sum of imports, covers 40 countries representing 85% of global imports.

Sources: IMF, World Economic Outlook Update, January 2025; OECD, Economic Outlook, December 2024; European Commission, Autumn 2024 Economic Forecast; DG Trésor calculations and forecasts.

Emerging economies are projected to continue to be the main drivers of global growth. Their growth rates are expected to converge towards pre-pandemic levels over the forecast period (4.2% in 2025 and 4.3% in 2026, compared to 4.4% on average from 2015 to 2019), whereas advanced economies are forecast to lag significantly behind (1.7% in both 2025 and 2026, compared to 2.2% in the 2015-2019 period).

Taken together, these projections suggest a less favourable international environment for the French economy than anticipated in September 2024. Foreign demand for French exports, a key measure of the international market's pull on the French economy, is now forecast at 2.6% in 2025 (a downward revision of 1 pp) and 2.8% in 2026. This is expected to remain significantly weaker than global trade overall, reflecting the fact that French exports are more heavily concentrated in advanced economies than emerging markets.

2.2 Growth trajectories vary significantly among advanced economies

In the United States, economic growth is expected to slow to 2.3% in 2025 (down from 2.8% in 2024), and to a lesser extent in 2026 to 2.2%. Although disinflation was underway in the second half of 2024, tariff increases are expected to drive a resurgence in inflation from the second quarter of 2025, before easing again in 2026. Household consumption is expected to suffer from the rebound in inflation, while business investment should hold steady in 2025 and gather momentum in 2026, assuming the Trump administration's regulatory and tax policies prove supportive for businesses. However, this assumption is subject to considerable downside risk, as the administration's stop-and-go policy approach and the uncertainty it breeds – especially in financial markets – may prompt economic agents to delay investment decisions. Households' residential investment, for its part, should continue to be hampered in 2025 by the still-elevated level of mortgage rates, before experiencing a modest rebound in 2026.

In the euro area, growth remained sluggish in 2024 at 0.7%, but is expected to pick up slightly to 1.0% in 2025 and 1.1% in 2026, driven by a rebound in household consumption. Rising consumption will be fuelled by stronger purchasing power as inflation drops below 2% by 2026. Looser monetary policy should also bolster investment.

In Germany, the economy is expected to stagnate once again in 2025, with GDP growing by just 0.1%, following two consecutive years of mild contraction (–0.1% in 2023 and –0.2% in 2024). Germany's economic weakness is due to three main factors: (i) trade exposure to the US market – in 2023, 10% of Germany's exports were destined for the United States, and so the increase in tariffs is expected to slow German exports starting in the second quarter of 2025, exacerbating the decline in performance observed since the pandemic; (ii) domestic political uncertainty – ahead of the February 2025 federal elections, political uncertainty led households and businesses to adopt a cautious approach during the winter of 2024-2025; and (iii) structural challenges in German industry – the industrial sector is facing difficulties due to rising energy prices and competition from China. These factors are particularly detrimental to investment in capital goods. By 2026, German activity is expected to pick up to 0.6%, driven by a rise in private investment (especially in residential construction), an increase in public investment (notably in defence), and a rebound in household consumption. The country's fiscal policy represents a potential upside risk to this outlook, owing to recent government announcements regarding additional spending on defence and investment. However, the implementation timeline and actual scope of these measures remain uncertain (see Box 3).

In the United Kingdom, growth is expected to remain steady at 0.9% in 2025, before picking up to 1.2% in 2026. This recovery will be supported by the marked increase in public spending announced in the October 2024 budget introduced by the new Labour government. However, the government's accompanying tax hikes eroded business and consumer confidence at the end of 2024, which will likely result in subdued consumption and a sharp decline in business investment in 2025. Private demand is projected to recover in 2026 as household consumption benefits from a drop in the savings rate, which had reached unusually high levels. Given that the United States runs a bilateral trade surplus with the UK, the scenario assumes no new tariffs will be imposed on UK imports, limiting the impact of US trade policy on the British economy.

In Italy, growth is expected to remain modest in 2025 at 0.7%, following 0.5% in 2024. Activity will be weighed down by the phase-out of the *Superbonus* scheme (a tax incentive for energy-efficient renovations) and by the impact of US tariffs, as the United States is Italy's second-largest trading partner. Growth is projected to accelerate to 1.1% in 2026, as these drag factors play a lesser role and the economy continues to benefit from disbursements made under the National Recovery and Resilience Plan (RRP) and buoyant household consumption.

In Spain, GDP growth far outpaced that of other major European economies in 2024, reaching 3.2% (against 0.7% for the euro area). Performance was buoyed by the gradual disbursement of RRP funds, high levels of immigration, and a resurgence in tourism since the COVID-19 pandemic. Growth is expected to remain robust in 2025 (2.5%) and 2026 (1.8%), still supported by private consumption, which continues to benefit from a robust labour market, rising wages and falling inflation. Investment, having only just regained its 2019 level, is set to continue rising, helped by looser monetary policy and ongoing funding from the RRP. However, the positive contribution of net exports is expected to gradually decline amid a slowdown in tourism and rising imports driven by stronger investment activity.

2.3 Activity in major emerging economies remains robust but is expected to slow

China's economy is set to lose momentum, with growth slipping to 4.7% in 2025 and 4.4% in 2026, from 5.0% in 2024. Upward revisions of 0.4 pp in both the second and third quarters of 2024 allowed the country to meet its growth target for the year. The impact of additional US tariffs on all Chinese imports, coupled with China's countermeasures targeting energy and agricultural products, are expected to be partially offset by stronger fiscal and monetary support, as announced by the government in late 2024. The stimulus is expected to focus primarily on private consumption, which was designated a new national "priority" at the Central Economic Work Conference in December. Nonetheless, the fundamentals of China's growth model – self-sufficiency and industrial upscaling – are not expected to change. Even so, these support measures are unlikely to fully offset the broader slowdown in economic activity. In the medium term, the extent of China's slowdown will depend on its success in shifting the growth model towards domestic demand.

In India, growth is projected to slow down to 6.2% in fiscal year 2024-2025,[5] down from 7.8% the previous year, amid a budget freeze, election-related uncertainty and a delayed recovery in public investment. However, December figures show a clear acceleration, particularly in road infrastructure. At the same time, the monetary easing cycle launched in February 2025 is expected to support domestic demand. However, its pace could be limited by tighter-than-expected US monetary policy, which would place downward pressure on the rupee, as well as by liquidity concerns in the banking system resulting from the central bank's large-scale interventions to safeguard the currency against the dollar. In fiscal year 2025-2026, growth is expected to increase slightly to 6.5%, sustained by the ongoing momentum of public investment already outlined in the budget for the upcoming fiscal year.[6]

In Brazil, growth is forecast to normalise to 2.4% in 2025, following a strong performance in 2024 (3.4%). While net exports are expected to benefit from an exceptional grain harvest in 2025, the main drivers of growth – household consumption and investment – are likely to lose steam, weighed down by the monetary tightening cycle initiated by the central bank in late 2024 and set to continue through 2025. In 2026, growth is expected to slow further to 2.2%, reflecting the lingering impact of monetary tightening and fiscal consolidation.[7]

In Turkey, the economy is expected to remain on a rebalancing path in 2025, with growth projected at 2.6%, supported by a restrictive policy mix. Although the Turkish central bank has started cutting interest rates in response to easing – though still elevated – inflation and softer domestic demand, real key rates remain in positive territory.[8] On the fiscal front, the government deficit is expected to narrow, driven by higher corporation tax revenues and a reduction in post-earthquake reconstruction spending. In 2026, growth is projected to accelerate to 3.4%, supported by rising investment and a rebound in consumption as inflation continues to ease.[9]

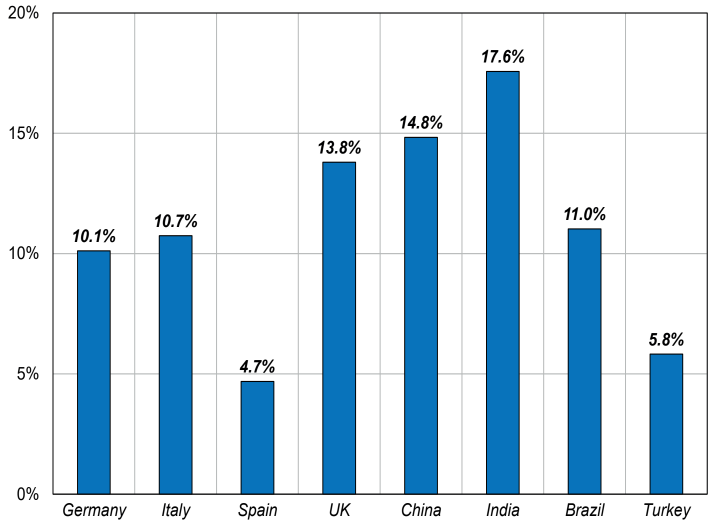
(5) The calendar used by India is the fiscal year, running from April of year N to March of year N+1.
(6) See India's budget presentation for FY 2025-2026.
(7) However, fiscal consolidation could be put on hold in the run-up to the presidential election scheduled for October 2026.
(8) Inflation fell to 41.2% year-on-year in January 2025, down from a peak of 75.4% in May 2024, largely due to base effects. In response, the Central Bank of the Republic of Turkey (CBRT) cut its key rate twice by 250 bps, bringing it to 45% after holding it at 50% since March 2024.
(9) The IMF projects that inflation will decline to 24% in 2025 and 17% in 2026. However, the direction of monetary policy (pace of key rate cuts, adjustments to the minimum wage) remains a key source of uncertainty.

Box 2: The economic impact of rising tariffs

Based on the trade policy assumptions (see Box 1), the scenario anticipates a temporary surge in global trade in Q1 2025, as firms in North America, the EU and China accelerate imports and attempt to build up inventories ahead of the scheduled tariff increases. This frontloading is expected to boost trade in the first quarter, before volumes contract sharply from the second quarter onward. The decline will be most pronounced in the United States, which faces the combined impact of its own tariff increases and countermeasures imposed by its main trading partners. In Europe, the impact will vary by country: Germany and Italy are expected to be most affected, given their higher trade exposure to the United States (see Chart 4), whereas Spain, which is less exposed, and the United Kingdom, which runs a trade deficit with the United States and is assumed to be exempt from tariffs, will be relatively spared. By 2026, trade volumes are expected to recover gradually as firms adapt by establishing alternative channels – rerouting trade flows or replacing trade partners – to circumvent the tariffs.

The introduction of new tariffs is also expected to drive inflation higher from the second quarter of 2025 in most of the targeted economies.[a] In the United States, core inflation is expected to remain high in 2025, averaging 3.5% over the year – slightly above the 3.4% recorded in 2024. A gradual decline is projected to begin in the first quarter of 2026. With this persistent inflation, the financial environment is likely to remain restrictive in 2025 and 2026, as the Fed delivers fewer rate cuts than projected in the September 2024 forecast. This would widen the divergence in monetary policy across advanced economies, particularly between the Fed and the ECB. Indeed, inflationary pressures in the euro area are expected to be more subdued, reflecting the faster disinflation process currently underway in the region. European countries are expected to return to their inflation targets by 2026, with some – such as Italy and Spain – potentially undershooting slightly.

Chart 4: United States share in goods exports by country



Source: UN Comtrade (2023).

How to read this chart: In 2023, the United States accounted for 10.1% of Germany's goods exports.

a. The scale and scope of the new tariff increases, in terms of rates and coverage, are significantly broader than those implemented during the first Trump administration, and come on top of existing measures – particularly those targeting China. The additional tariff increases are unlikely to be fully absorbed by profit margins, which have already been squeezed by earlier rounds of tariff hikes (see Cavallo, Gopinath, Neiman and Tang, 2021), and would therefore be passed on to consumers in the form of higher prices. Moreover, factoring in retaliatory measures from countries targeted by the tariffs would directly result in inflation increases, especially in the United States.
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For their part, emerging economies are expected to be highly exposed due to (i) their reliance on the United States as an export destination, and (ii) their higher average tariff levels compared to those applied by the United States, which makes them particularly vulnerable to reciprocal tariffs (see Chart 4). In addition, the sectoral decomposition of their exports to the United States reveals specific vulnerabilities in key segments, such as pharmaceuticals for India and lumber for Brazil. Overall, emerging economies – except Turkey, whose trade exposure to the United States is relatively limited – are projected to be more affected by this new wave of tariffs than most advanced economies. This reflects both the targeted nature of the measures against China and the high degree of trade exposure and tariff differentials in the cases of Brazil and India. Emerging economies are also heavily exposed in the steel and aluminium sectors, particularly Brazil, for which the United States accounts for 40% of exports in these categories, followed to a lesser extent by India (14%) and China (9%).

Taken together, the tariff increases are expected to exert a measurable drag on global growth and trade. Global GDP would shrink by 0.1 pp in 2025 and 0.2 pp in 2026, mainly due to slower growth in the United States and China. The growth of global trade volumes is also expected to fall by 0.2 pp in 2025 and 0.7 pp in 2026. French exports, however, are likely to be less affected than global trade overall, due to their product and geographic composition. As a result, external demand for French goods is expected to fall by just 0.1 pp in 2025 and 0.4 pp in 2026.

3. Significant risks tilted to the downside

The risks surrounding this scenario are considered particularly substantial and appear to be largely skewed to the downside, notably about the policy agenda of the new US administration.

The risks primarily relate to trade policy. A key concern is the possible implementation of 25% tariffs on all European products, mentioned by President Trump on 26 February 2025. If adopted, such a measure would far exceed the assumptions underpinning the baseline scenario and could have a significantly negative impact on economic growth on both sides of the Atlantic (see Box 3). Moreover, the recent policy announcements from Washington have already led to a marked increase in uncertainty in the United States. This adds further downside risk to the United States growth forecast. Reflecting this, financial markets as of early March were pricing in a greater degree of monetary easing by the Fed than is assumed in this scenario. At the same time, valuations in certain asset classes remain high, and the Trump administration's deregulatory agenda may increase risks to financial stability.

The current stance of US foreign policy has already prompted a number of European countries to reconsider their defence strategies. In particular, the prospect of increased defence spending in Germany particularly represents an upside risk to economic activity in Europe (see Box 3).

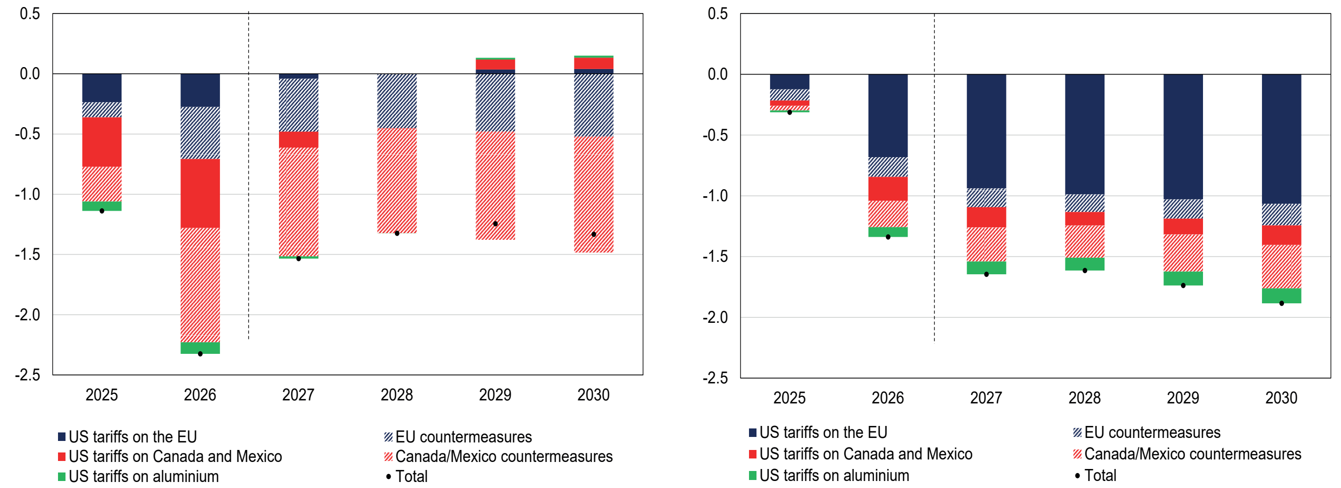
Beyond these uncertainties, other risks already identified in September 2024 remain in play. These risks are more balanced in nature and include the delayed transmission of monetary policy to the real economy, changes in household saving behaviour, and the impact of geopolitical tensions, particularly in the Middle East.

Lastly, the increasing frequency and severity of climate-related events continue to pose a major risk, particularly for emerging economies.

Box 3: Alternative scenarios: tariff escalation and higher public spending in Germany

While the baseline scenario already includes a significant escalation in trade tensions (see Box 1), there is a significant risk that US tariff increases could prove more severe than currently assumed. To account for this possibility, a more adverse alternative scenario has been modelled, incorporating the following additional announcements made by Donald Trump: (i) the United States enacts an additional 22% tariff[a] on all imports from the European Union, Mexico and Canada;[b] (ii) these trade partners respond with proportional countermeasures; and (iii) the tariffs on steel and aluminium are extended to all countries. The results should be interpreted as deviations from the baseline scenario, which already incorporates a degree of tariff escalation. Under this alternative scenario, US GDP is projected to decline by 1.1 pp in 2025 and 2.3 pp in 2026. Some of these effects are expected to ease over the medium term as the initial uncertainty shock dissipates and the US trade balance improves. The economic costs would be even greater for Canada and Mexico, which are both highly dependent on exports to the United States. Canadian GDP is expected to fall by 1.5 pp in 2025 and 4.0 pp in 2026, while Mexico's GDP is projected to shrink by 0.7 pp in 2025 and 2.7 pp in 2026. China and the European Union would also be affected, though to a lesser extent, as their relative exposure to the US market is lower. Chinese GDP is expected to decline by 0.2 pp in 2025 and 0.7 pp in 2026, while the EU should experience a drop of 0.3 pp in 2025 and 1.3 pp in 2026. However, the EU remains vulnerable over the medium term due to its high degree of trade openness.

Chart 5: Simulated impact on GDP from additional tariff increases relative to the baseline scenario in the United States (left) and the European Union (right)

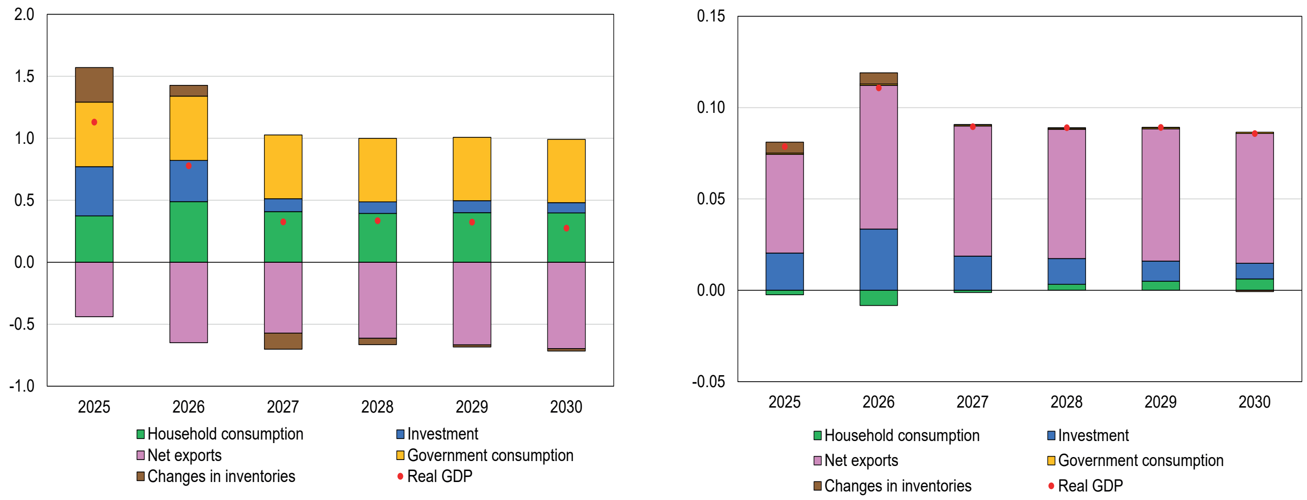


Source: DG Trésor calculations, simulations using the Oxford Economics model.

a. Donald Trump announced additional 25% tariffs, whereas the scenario assumes an increase of just 3%.
b. Canadian energy products (accounting for 30% of Canada's exports to the United States) were subject to only 10% tariffs.

In contrast, a reform of Germany's constitutional "debt brake" rules is expected to support economic growth. In ongoing coalition talks, the CDU/CSU and SPD political parties have proposed amendments to Germany's budget framework to secure funding for defence and infrastructure. Such a reform would require a two-thirds majority in both houses of parliament – the Bundestag and Bundesrat. The draft agreement includes the following measures: (i) excluding defence spending above 1% of GDP from the constitutional ceiling on the annual budget deficit, (ii) creating a €500 billion special fund over ten years dedicated to infrastructure investment, and (iii) raising the annual cap on structural deficits for regional governments (Länder) from 0% to 0.35% of GDP. To illustrate the potential macroeconomic impact, a scenario in which German public spending increases permanently by 1% of GDP per year, distributed across the main categories of federal expenditure would result in a 1.1-pp increase in German GDP in 2025 and a 0.8-pp increase in 2026. The demand surplus would increase GDP in France and other countries (excluding Germany) by 0.1% in both 2025 and 2026. If this hike in defence investment were to be replicated across the other EU countries, it would constitute an additional upside risk to regional growth.

Chart 6: Simulated impact on GDP (and its components) from a sustained 1% of GDP increase in German public spending in Germany (left) and in the euro area excluding Germany (right)



Source: DG Trésor calculations, simulations using the Oxford Economics model.

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