

# Macro Readings

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# Ringside view

- A year full of geopolitical, economic and financial challenges is now two-thirds done. The threat of tariffs has brought globalization under extreme pressure. Countries and companies are scrambling to reduce their exposure to tariffs, greatly accelerating a new cycle of deglobalization. However, equity prices at all-time highs, the markets have largely discounted a future with a fairly benign inflation, growth and trade environment.
- For now, investors are focusing on what is in front of them, which is stronger-than-expected earnings growth, a durable AI secular theme and a still-firm economic backdrop. Still, the path forward remains clouded by unresolved trade issues, the risk of rising inflation pressures and a high degree of uncertainty around overall impacts on the macroeconomic environment. For now, investors appear comfortable reserving judgment on these unknowns
- Economic resilience, rather than the tariffs themselves, means that inflation ought to be the main concern of monetary policy, and that interest rates may not fall dramatically in the months immediately ahead.
- Being neither especially bullish nor bearish can be a difficult stance. It is hardly a table-thumping call – and if you stand in the middle of the road, you are at risk of being run over from both directions. But it makes sense now to stand here for sometime ....

# Tariffs : Bracing for Impact

- After six months of tariff drama, the contours of the US's new trading regime are coming into view. Recent trade announcements have reduced policy uncertainty somewhat and left the effective US tariff rate at 15% – 20%, below the April highs.
- Still, tariff rates for Mexico, Canada, and China, the three largest US trading partners, remain in flux and matter most to companies, consumers, and the Fed.
- It is also possible a US federal court could rule against the Trump administration's use of the International Emergency Economic Powers Act (IEEPA) to impose sweeping tariffs (a ruling is expected in the case in about 4 – 6 weeks), which could force the government to refund tariff revenue. The administration might still find alternative avenues to impose tariffs, but it would likely be more challenging to cover as many countries as quickly as under the IEEPA.
- From a tariff perspective, Walmart, for example, indicated that it did not pass through increased costs on several lower-ticket items; however, it did increase pricing on select higher-margin products. The company expects costs to continue to gradually rise, especially as its inventory will be replenished at higher tariff rates. This aligns with the Fed's comments on near-term inflation trends as well.

# Tariff Tracker

- US ended up agreeing tariff deals in July and August with its biggest trade partners, averting a damaging escalation and renewed uncertainty over the outlook.
- Broadly speaking the US has divided the world into three buckets:
  - Developed markets, whose goods face a baseline tariff of c15% when entering the US,
  - Emerging markets ex-China, with a higher tariff of c20-30%, and
  - China, which faces an effective tariff of c40%.
- Alongside these country specific tariffs, there are higher tariffs for certain sectors such as steel & aluminium and cars, though here as well, there are numerous carve-outs.
- Meanwhile, around 1/3 of US imports – including consumer electronics, pharmaceuticals, and semiconductors – remain entirely exempt of tariffs, at least for the time being.
- Tariffs are still far from universal.

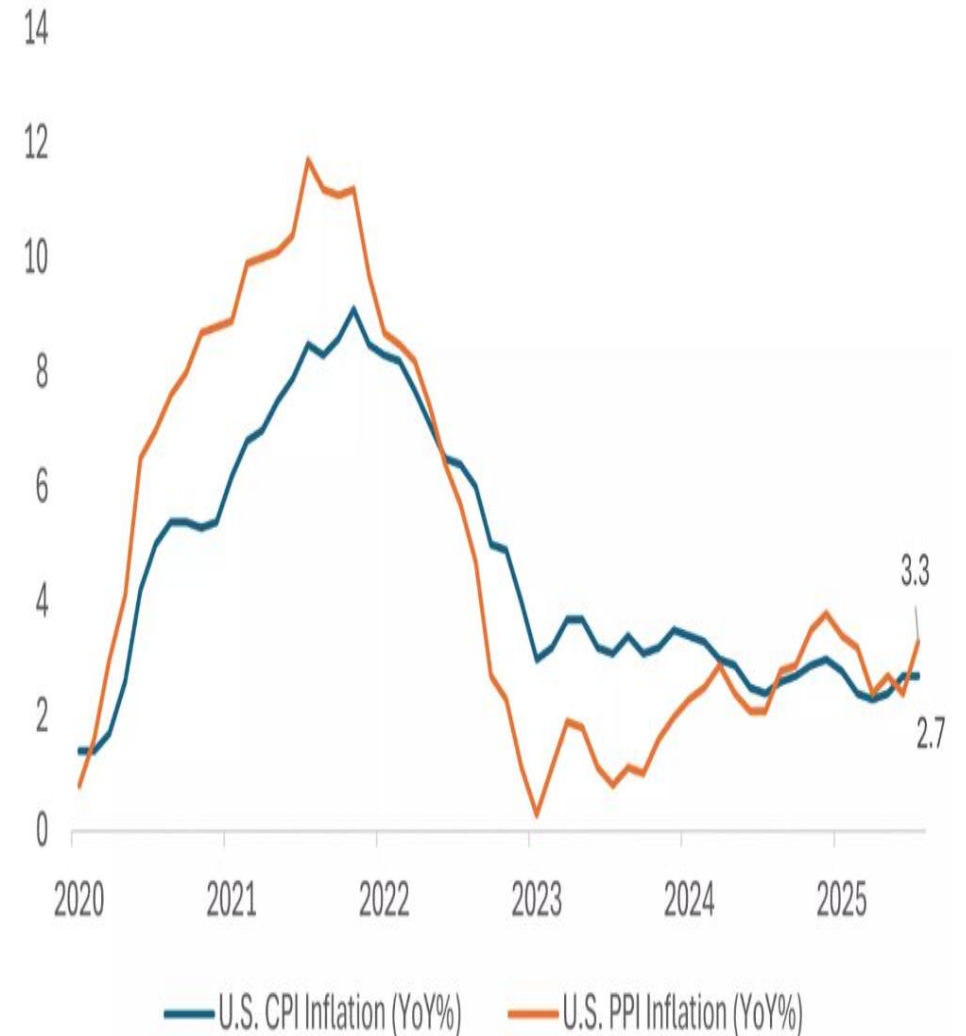
# Impact of tariff on Inflation

- Overall, the impact of tariffs on inflation was muted in the first half of 2025 thanks to several factors, including company decisions to stock up on inventories ahead of tariffs and to take a staggered approach in pushing through price increases.
- Disinflation in energy, services, and shelter was also a key offset. More recently, core consumer prices have started to rise as some of these factors attenuate. In the first half of the year, the US economy absorbed an effective tariff rate of roughly 10%.T
- Today, that rate is in the 15% – 20% range, as noted earlier. I expect consumer prices to rise further in the coming months, with the inflation rate likely peaking in 4Q25 or 1Q26, depending on what happens with tariff rates for Mexico, Canada, and China.
- Slower labor force growth also means that the Fed cannot assume that wage growth, a potential inflation
- Fed is likely to remain cautious around the uncertain transmission of tariffs and the continuation of strong services inflation river, will continue to slow from here, further complicating its task of calibrating interest rate.

# Tale of two numbers

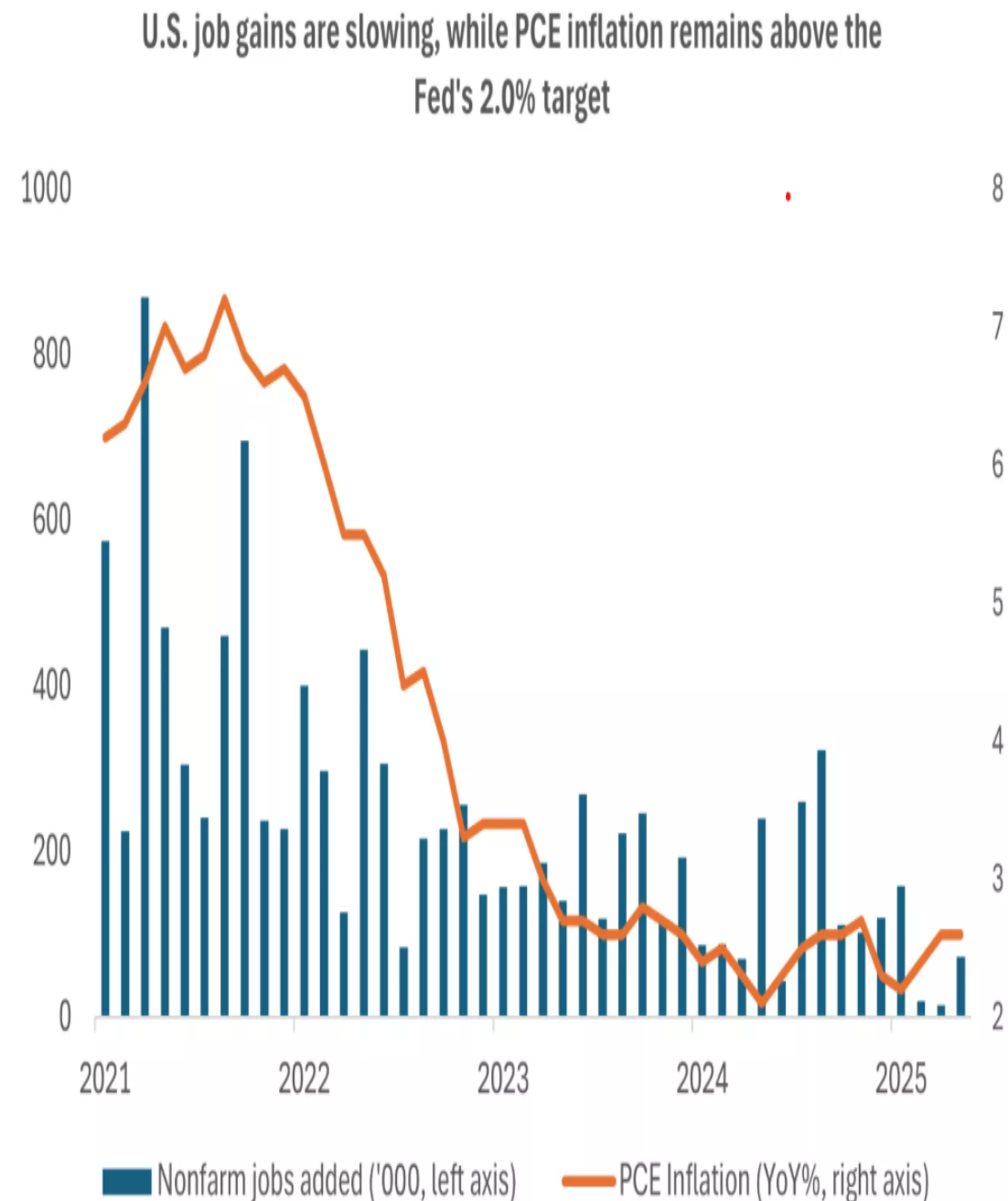
- Last week's U.S. CPI was broadly in line with expectations. Headline inflation remained at 2.7%, while core inflation (excluding food and energy) picked up from 2.9% to 3.1% year-on-year.
- Most of the inflationary pressure came from services including airfares, insurance and recreation.
- Although tariffs did show up in categories like furnishings, auto parts and food, the broader inflationary impact was less severe than feared – at least for now.
- However, the U.S. PPI data told a more cautionary tale. Both headline and core producer prices rose more than expected in July, which points to rising input costs that may gradually feed through to consumer prices.

U.S. producer price inflation has ticked higher, indicating that companies may face more pricing pressure from suppliers (%)



# Curious Balance

- With upside risks to inflation and downside risks to employment keeping the FOMC's dual mandate in tension, Powell was careful not to pre-commit to a policy change at Jackson Hole. However, he kept the prospects for a September rate cut alive and reconfirmed the Committee's existing bias for rate cuts later this year.
- Powell noted that employment was in a "curious balance," with both the supply of labor and demand for labor softening, leaving the unemployment rate at a still resilient 4.2%. However, he also suggested the downside risks are rising, and these could materialize quickly, underscoring the Fed's rationale for potentially moving interest rates lower.





# Economic effect of Deportation

- Almost eleven million unauthorized immigrants live in US , accounting for a little over 3 percent of the total U.S. population. The population of immigrants not authorized to be in US is mostly of working age—two-thirds of them are in the prime working ages of 25 to 54 compared to less than 40 percent of U.S. citizens.
- Immigration-driven inflation is a supply-side shock — something interest-rate changes can't easily fix . the inflationary effects of immigration restrictions will be more persistent than those of tariffs.
- The estimates are that the annual number of immigrants, legal and undocumented alike, has fallen from roughly 4 million at the 2023 peak to just 300,000–350,000. Hiring has slowed because the labor supply has been artificially constrained by Trump's deportations, border closures, and "self-deportations."
- Fed can hold rates steady without worrying about a cascade of layoffs because the weakness in hiring stems from fewer available workers, rather than collapsing demand.
- Only silver lining is that the employment-population ratio, for instance, has been much higher in the past, not so much because unemployment is high – it isn't – but because inactivity rates have risen.

# US Macro through data

- During July, total resales rebounded 2.0%, essentially erasing the decline registered in June. Although the bounce-back was an encouraging sign that activity is not collapsing, the trend in sales has essentially been flat so far in 2025. July sales amounted to a seasonally-adjusted 4.0-million-unit pace.
- Initial jobless claims ticked up in the week ended Aug. 16. New claims have drifted slightly higher over the past several weeks, although they remain generally low at a level consistent with layoffs staying localized and not becoming widespread. That noted, continuing claims also continue to climb, implying that finding a new job is increasingly challenging for those without employment.
- Large retailers, including Walmart, Target, and Home Depot, reported earnings last week. Overall, the companies pointed to consumers that continue to spend, especially on value and discount goods, despite uncertainties around tariffs and the economy.
- The minutes from the July FOMC meeting suggests that participants continued focus on inflation, with a majority feeling that the upside risk to inflation outweighed risks to the labor market. This is hawkish on net, but also stale, as it reflects the feeling before July's weak nonfarm payroll print. Some Fed officials may feel that a pause continues to be warranted, but those conviction levels likely have decreased markedly given the increase in the unemployment rate.

# Stacking FOMC

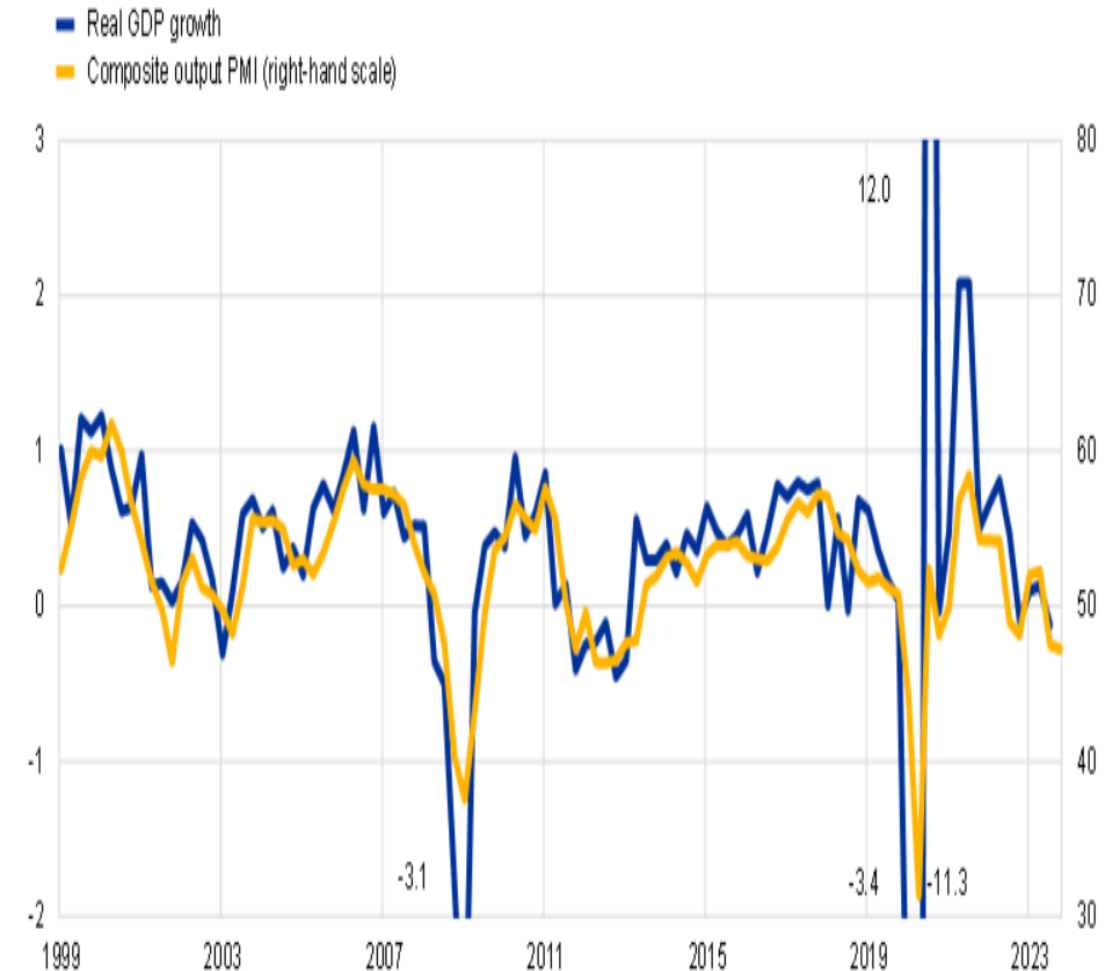
- Perhaps emboldened by the opportunities offered by Kugler's departure, team Trump expanded the attack on the Fed's board. After consistent pressure on Powell, they have now targeted Fed Governor Lisa Cook, exposing alleged mortgage fraud, and calling on her to step down.
- This would offer an additional slot for Trump to fill. With Waller and Bowman quite openly aligning with Trump's monetary policy wishes, another governor slot would lead to four out of seven board governors blatantly supporting Trump's wish to cut rates, and some might go further in supporting Trump's policy wishes. The attack on Cook is the first signal that the Trump administration is casting the net wider, exploring all options to increase their influence on the Fed.
- In any Federal Open Market Committee (FOMC) meeting there are twelve voting members, with the Chair able to decide a draw. Seven of the voting members are on the Fed board, one is the President of the New York Fed, and the remaining four are rotated across the remaining regional Feds. President Trump has the power to nominate Fed board members, who have to be confirmed by the Senate. The regional Feds nominate their presidents, who have to be confirmed by the Fed board members. Governor terms are fourteen years, while regional fed presidents have to be reappointed every five calendar years, the next one February 2026.
- As for monetary policy, due to the presence of the remaining five voters, a majority on just the Fed board is unable to dictate policy. February 2026 is therefore critical. If Trump manages to get another board governor appointed by then, it is conceivable that he'd push the four Trump-aligned governors to not reappoint the more hawkish regional fed presidents, leading to an extremely dovish FOMC.

# Europe : Flash PMIs and growth outlook

- Euro Area Flash Composite PMI has continued to recover in August to 51.1 (12-month high) from 50.9 in July, above consensus expectations (49.7), driven by an improvement in manufacturing (+0.7 point to 50.5, 37-month high) while the service index declined this month (-0.3pt to 50.7)
- The breakdown of the index is mixed this month. Even though, composite new orders have improved again, at the same time, future output declined, and input prices increased.
- Supplier delivery times lengthened for the third straight month, with delays the worst since late 2022. Despite the stronger output and orders, business confidence weakened. Even though new export orders registered a decline in August, domestic new orders are still robust.
- August's figures confirmed a slight improvement in the Euro Area economic activity. This suggests that eurozone GDP is growing at a 0.2% quarterly rate in August, in line with expectations, following a 0.1% GDP increase in the second quarter. However, the pace of expansion remained frustratingly sluggish.

## Euro area composite output PMI and real GDP growth

(left axis: quarterly percentage changes, right axis: diffusion index)



# EU-US Trade relationship

- The Joint Statement establishes new parameters for the EU-US trade relationship. The primary commitments from both parties include:
- **15% Tariff Ceiling:** A maximum, all-inclusive tariff ceiling of 15% on EU products subject to reciprocal tariffs. No additional tariffs will apply to products already subject to Most Favoured Nation (MFN) tariffs equal to or above this threshold.
- **Inclusion of Strategic Products:** The US commits to incorporating EU exports of pharmaceuticals, semiconductors, and lumber under the 15% tariff ceiling upon completion of relevant investigations.
- **Automotive Commitment:** The 15% tariff ceiling will apply to cars and car parts from the first day of the month when the EU initiates tariff reduction procedures.
- **Exemptions to the Tariff Ceiling:** Specific EU products, including unavailable natural resources (e.g., cork), aircraft, and generic pharmaceuticals, will be subject solely to MFN tariffs, which are effectively zero or near zero. The EU and US will explore expanding this exemption list.
- **Addressing Overcapacity:** Both sides intend to collaborate on measures to mitigate overcapacity in the steel and aluminum sectors and to secure supply chains through Tariff Rate Quota (TRQ) solutions. Tariff rate quotas (TRQs) allow a pre-determined quantity of a product to be imported at lower import duty rates (in-quota duty) than the duty rate normally applicable to that product.
- **Reducing Non-Tariff Barriers:** A mutual commitment to lower non-tariff barriers through cooperation on standards and streamlined sanitary and phytosanitary (SPS) certifications. Digital Trade Cooperation: Cooperation on digital trade and maintaining a moratorium on customs duties for electronic transmissions.
- **Increased Private Sector Investments:** Acknowledgement of the EU's plans to significantly increase procurement of military and defense equipment from the US, enhancing transatlantic defense cooperation.

# UK : Macro Turbulence

- While monthly GDP rose 0.4% in June and Q2 GDP rose by 0.3% – which exceeds estimates – the underlying picture is weak. Pretty much all the growth in Q2 was driven by a jump in government spending while the private sector struggled.
- Business investment dropped sharply by 4% as policy uncertainty and tax hikes led firms to put the brakes on expanding. Consumer spending slowed markedly and was close to stagnant as households tighten their belts under economic uncertainty, especially as ongoing speculation about further tax rises in the Autumn Budget keeps people cautious.
- On the labour market, job losses persisted, and job vacancies continued to fall. Although wage growth has slowed as the job market has loosened, it remains elevated at 4.6% year-on-year, which is well above the level consistent with the 2% inflation target. This puts the Bank of England between a rock and a hard place.
- The job market is slowing down, which means interest rates should be lowered – but with wages still rising and inflation higher than usual, a rate cut might not be the best choice. As a result, the hurdle for further policy easing is high and markets are pricing in a 60% chance of another rate cut by the end of the year. The prospect of cutting rates with inflation near 4% is politically and economically challenging. Even small upside surprises could keep policymakers on hold until clearer signs of disinflation emerges.

# China : Involution risk

- In economic policy documents, Beijing's leadership used the term “involution”, neijuan in Chinese, in efforts to combat excessive competition in market segments such as photovoltaics and lithium batteries. It has been one of the most commonly used Chinese words of 2020, and has been deployed to describe many things.
- The crux of the economic problems is the supply-expansion growth model in which economic agents build, invest, and produce first to expand supply to create jobs and, thus, demand. Chinese manufacturers and suppliers have been vastly more competitive than others in making high-quality and reasonably priced products for global consumers. However, Chinese businesses tend to expand production in spite of financial losses.
- The anti-involution campaign by Chinese government has revived some investors' confidence for a few sectors with deep overcapacity. However, it remains unconfirmed whether these efforts will pay off with the challenge of weak demand caused by China's unbalanced national income distribution and economic structure. De-involution succeeds where institutions recalibrate incentives and expectations at scale. The goal is to redirect entrepreneurial energy away from zero-sum price battles and toward higher-value, more sustainable forms of innovation. For China, the challenge is not to transplant foreign models wholesale, but to adapt their underlying logic to domestic institutions.