EDITORIAL

HAPPY NEW YEAR?

Will 2025 fulfil all the good wishes being exchanged across the globe as these lines are being written? Probably not, sadly. But narrowing it down to the field of global economics, I see five critical questions that will determine how good 2025 will turn out.

1. WILL THE US SET OFF A GLOBAL TARIFFS WAR?

On tariffs like on other issues, nobody knows what President Trump will do. But this is the policy area on which he has been the most consistent in words and deeds. Therefore, it is likely that tariffs on some US trading partners will go up meaningfully. The question is, by how much and what will these trading partners do in response? Under the previous Trump administration, global trade flows were rerouted but not fundamentally weakened. And, of course, the US trade deficit didn't decline. This is precisely why tariffs need to be higher and more comprehensive this time around say Trump's pro-tariff advisors. Markets and most firms could probably digest without much hiccup some additional tariffs, provided 3 conditions are met: that there is still a way around them via re-shoring; that the impact on US inflation is perceived as limited; and that trading partners keep their own economies largely open, or better still try to deepen free trade among themselves. If not, costs will be high. A generalized trade war would be stagflationary for the world and the biggest risk to its prosperity.

2. WILL CHINA FINALLY STIMULATE DOMESTIC CONSUMPTION IN A STRUCTURAL WAY?

Chinese exports surged in 2024, growing by 12% in volume even as global trade was growing at a mere 3. Meanwhile, import growth collapsed. This means China relied ever more on external demand to reach its GDP growth target of "around 5%" growth despite strong domestic headwinds (from the slow deflation of its debt-fuelled property bubble, and generally depressed economic sentiment). With US tariffs leading to a marked decline in China's share of US imports, China's rising share of global trade has happened largely at the EU's expense. Since last October, the Chinese authorities have multiplied stimulus announcements. However, these have been vague, limited in size, and focused more on helping the stock market, local governments and the real estate sector, than on boosting consumption. Yet, at 39% of GDP, Chinese households' consumption ranks 137th in the world (out of 146 countries covered by World Bank data) and stands 14 percentage points below the global average. This may be about to change: recent policy pronouncements by Chinese authorities have more consistently referred to consumption as a growth driver, and President Xi himself has just started mentioning social safety net policies. Remedying their near complete absence would remove a key driver of China's sky-high savings rate. Long-awaited, such a policy turn would be good for both Chinese people and the world.

3. WILL FISCAL POLICY BE A DERAILER?

All over the world, fiscal deficits and public debts have grown significantly since 2020, and adjustment is needed. In most countries, this can happen gradually and need not be a concern. Indeed, it will help monetary policy to normalise (i.e., ease). But in a few cases, including countries that still don't have a 2025 budget, fiscal policy could be a real spoiler. In the case of the US, the negative consequences would be global. One concern has to do with governance, notably the recurring political dramas around the debt ceiling (expected to be reached in the next couple of weeks and start biting within a few months) and government shutdowns if Congress doesn't pass a funding bill in time (the most recent one, voted in extremis on 21 December 2024, expires on 14 March, 2025). These issues eventually get resolved but can cause lasting uncertainty and market volatility.

The second and deeper concern has to do with the magnitude of the government's borrowing needs. Again, the US is not the only offender, but it is the largest. The budget deficit of the Federal Government is already running at USD2Trillion per year, and the policy proposals of the Trump campaign would worsen the public debt by anywhere between USD1.7 and USD15.5 Trillion, with a central scenario of UDS7.5Trillion by 2035 according to the apolitical Committee for a Responsible Federal budget. These are enormous amounts of debt issuance for the market to swallow, not least at a time when some of the largest Treasury holders are actively looking to diversify away from them for geopolitical reasons. Further upward pressure on US Treasury yields is likely, and this will pull up rates everywhere else in the world. Like with tariffs, a moderate upward drift would be a manageable headwind. A persistent large upward move could be far more damaging. If history is any guide, it could even trigger sovereign debt crises around the world given today's wide prevalence of historically large debt burdens.

4. WILL EUROPE HEED THE WAKE-UP CALLS IT RECEIVED IN 2024?

The reports delivered by Enrico Letta and Mario Draghi, and the election of Donald Trump to a 2nd term all signalled with urgency that business-as-usual will lead Europe down a *cul-de-sac*. There are early indications that European policymakers took notice, but it remains too soon to predict with any confidence that action will follow. Leaders disagree on some key elements of policy response, notably on trade and common borrowing. France and Germany, traditionally leading the debate, can be expected to remain focused on domestic politics for a few quarters.

Still, there are areas where the EU Commission could impel meaningful progress by identifying a few early deliverables, and thereby create a good catalyst for a turnaround in investor sentiment. Some good places to start? Pausing new regulatory requirements while reviewing existing red tape, and setting an agenda for breaking the most economically costly internal market barriers.

5. CAN THE UK SHAKE OFF THE DOOM AND GLOOM OF 2024?

The UK economy has been mired in stagflation for at least a semester, as we analysed in *Ecobrief* : Bank of England: no change, but more fears about economic activity. Economic sentiment from both households and businesses is low. While our (and consensus) forecast expects a pickup in growth to around 1.4% in 2025, this hinges on the effects of the mild fiscal stimulus voted in Autumn and continued very gradual rate cuts by the Bank of England to lift the mood of economic agents. A more compelling growth narrative from the government, supported by productivity-boosting reforms, could be another helpful catalyst to improve the odds of the base case scenario.

While the answer to these questions will be key to 2025 economic outturns, their relevance extends well beyond the coming year. Indeed, they will weigh on the next decade or even quarter century. Let's not forget that the latter half of the roaring [19]20's carried the seeds of the great depression and all the misery that ensued. Now like then, democratic politics are challenged and looking weak across the world, and international relations—whether economic or otherwise—lack strong and widely accepted underpinnings. Prosperity shared by a greater number is imperative. Or else, our collective ability to tackle the truly existential challenges of our era: climate change and AI, will be at stake.

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