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Economist's Weekly Market View

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US economy may be succumbing to uncertainty

Following a bumper week of macro data and tariff announcements, the durability of the US economy to the current uncertainty is being called into question by markets and forecasters for the first time since the post 'Liberation Day' period in April. A strong economy has supported markets and the US dollar of late, but this unwound somewhat at the end of last week as investors were roiled by an exceptionally weak US jobs report.

Looking at the trade 'deals' which have been rapidly concluded in recent weeks, they suggest that the landing zone for US tariffs is not far from those announced on Liberation Day in April. For example, the 15% rate agreed with the EU, Japan, and South Korea compares to an initial range of 20-25% in April, while other major trading partners, such as Canada, have received sharply higher rates of 35% on some sectors. According to the Yale Budget Lab, this leaves the average effective US tariff at 16%, compared to the pre-Trump rate 2.5% - a historically rapid increase which brings the US tariff regime back to 1930s levels.

More pertinently, macro data and the Fed's actions (or lack of) have been the primary drivers of the currency over the past week. Investors interpreted Chair Powell's equivocating comments on a rate cut as a hawkish tilt in guidance. Market rate expectations firmed in the aftermath of Powell's comments, reflecting the lack of any clear signal about a September cut. However, that weak jobs report on Friday has now reset rate expectations to below where they were at the start of the week, with more than two 25bp cuts now priced in by end-2025, compared to just one following the Fed meeting. The data showed the US economy added a meagre 35,000 per month on average between May and July. This sharp downward provision prompted a 'shoot the messenger' order by President Trump, removing the head of the statistics agency which compiles the labour market data.

All in, there remains risks on both sides to the US economy. The economy is has continued to grow at a solid rate so far this year, boosted by exceptional investment in areas such as AI. However, markets are now focusing once more on tentative trade deals which might unravel in the coming months, including the uneasy truce with China. The unusual split amongst the Fed's Board of Governors on monetary policy last week (two rebels voted for a 25bp cut) also highlights the nascent risk to the independence of US monetary policy as the government piles pressure on Chair Powell in the final months of his term, and candidates jockey for position in the race to be the next Chair. While President Trump is riding high on his political wins (trade deals, tax bill), the dollar is still around 12% lower against the euro year-to-date, and its recent gains have proved somewhat fleeting in the face of a weak jobs data.

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