360 ECONOMY AND MARKETS WEEKLY

novobanco

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Fed vs. Trump

Fed to keep policy rates unchanged, awaiting more information.

This Wednesday, the Fed is expected to keep its policy interest rate unchanged at 4.25%-4.5%, in line with recent signals from its top officials. Chair Powell has stated that the uncertainty surrounding the tariffs introduced by the Trump Administration makes it difficult for the Fed to act, since they bring a risk of a slowdown or fall in activity (which would merit an interest rate cut) but also a risk of rising inflation (which would justify raising or maintaining interest rates). Faced with this conflict of risks, Powell indicated that he would favour controlling inflation, arguing that without price stability it would not be possible to promote sustained job creation.

In this sense, Powell argues that it is necessary to wait for more information before making new decisions on key rates. President Trump has been very critical of the Fed's stance and favours a pre-emptive cut in interest rates, but he has backed down on his apparent intention to sack Powell before the end of his term (which was welcomed by the markets). A cut in interest rates this week could raise doubts in the market as to whether the Fed was giving in to political pressure - this makes the monetary authority's actions even more complicated, especially given some signs of cooling economic activity.

The fall in US GDP in 1Q is explained above all by the sharp rise in imports.

Last week, it emerged that US GDP contracted by 0.3% QoQ annualised in the 1st quarter of 2025 (or around 0.07 QoQ, compared to 0.4% QoQ in the Euro Area). In April, job creation fell from 185,000 to 177,000, ISM Manufacturing emphasised the contraction in industrial activity and ISM Services suggested a slowdown in production in this sector (albeit with an acceleration in overall services activity). However, this information shouldn't be enough to move the Fed. The fall in GDP in 1Q is essentially explained by the extraordinary 41.3% increase in imports (QoQ annualised), which in turn resulted from the anticipation and acceleration of consumption and orders, as consumers and firms tried to escape the effects of tariffs. Net external demand thus made a negative contribution of 4.8 p.p. to growth.

Looking at the other components of US expenditure in 1Q, we highlight the 1.8% growth in private consumption (decelerating from the 4% of 4Q'24, but still expanding) and the strong acceleration in private investment, to 21.9% QoQ annualised, mainly via spending on equipment, which should be partly explained by the anticipation of demand to escape tariffs. Taken together, private consumption and fixed investment contributed 2.5 p.p. to GDP growth, which does not suggest an economy in recession. It should be noted that the change in inventories contributed 2.25 p.p. to the change in GDP, while Federal spending took 0.33 p.p. off growth.

With downside risks to the outlook, the market sees the Fed cutting policy interest rates from the summer onwards.

There is anecdotal evidence that many companies are postponing decisions on orders, production and investment, waiting for greater visibility on the outlook. Some statistics point to falls between 45 per cent and 60 per cent in the shipment of goods from China to the US by sea. A more visible fall or slowdown in domestic demand in the US is therefore expected, including through a payback of anticipated spending in 1Q. There is also a risk of rising inflation (following the reduction in inventories of goods that have still escaped the tariffs, forcing them to be replaced at higher prices). If demand and the labour market cool down, the Fed could be forced to start a new cycle of interest rate cuts from the summer onwards (the market still expects 4 cuts by 1Q'26).

Last Week

- In the US, GDP growth fell in 1Q, from 2.4% to 0.3% annualised QoQ. Core consumption deflator decelerated in March, to 2.6% YoY. Job creation fell in Apr to 177 thousand. Unemployment rate stable at 4.2%. Apr ISM suggests contraction in industrial activity.
- Euro Area GDP grew by 0.4% QoQ in 1Q, above expectations (0.2% in Germany, 0.1% in France, 0.3% in Italy, 0.6% in Spain). In Apr, economic sentiment fell and inflation remained at 2.2% YoY (and with core rising to 2.7% YoY).
- In China, Apr PMIs suggest a slowdown in activity, with a sharp drop in industrial orders. In Japan, the BoJ kept its policy rate unchanged at 0.5% and revised GDP forecasts downwards
- 40% of the S&P 500 reports results. Favourable reaction to Meta and Microsoft reports. Apple and Amazon penalised by expected impact of tariffs.
- Mark Carney's Liberals won the General Elections in Canada, without a majority.

This Week

- In the US, the ISM Services Index signaled an acceleration in activity in April. On Wednesday, the Fed is expected to keep its policy interest rate unchanged at 4.25%-4.5%.
- The Bank of England is expected to cut the Bank Rate by 25 bps to 4.25%. Norges Bank (Norway) and Riksbank (Sweden) are expected to keep reference interest rates unchanged at 4.5% and 2.25%.
- Exports fell in Apr in China, due to the effects of tariffs.

PORTUGUESE ECONOMY

(One-off) GDP contraction in 1Q 2025. Stable unemployment rate.

- The economy contracted by 0.5% QoQ (1.4% in 4Q'24), with a nil contribution from domestic demand and a negative one from net exports. The 'blackout' of 28 Apr should have negative but very small impacts on annual GDP growth.
- Economic sentiment fell in Apr, with negative contributions from all sectors ex-industry. Inflation rose from 1.9% to 2.1% YoY. In March, unemployment stable at 6.5%; retail sales slowed down; industrial production fell back.

GDP contracted 0.5% QoQ in the 1st quarter. Year-on-year growth at 1.6%.

The economy contracted by 0.5% QoQ in 1Q 2025, a lower than expected record, after expanding by 1.4% QoQ in 4Q'24. We expected a strong slowdown, mainly via falls in disposable income and private consumption (in 4Q'24, disposable income had enjoyed unusually high growth, through retroactive tax cuts and extraordinary pension payments). But the cooling of activity in 1Q turned out to be greater than anticipated, also with a negative contribution from net external demand. In year-on-year terms, GDP grew by 1.6 per cent, vs. 2.8 per cent in 4Q'24 (more details on demand are not yet available). Annual growth in 2025 should also be slightly penalised by the 'blackout' of 28 April. To assess this impact, it should be taken into account that 1 day of lost activity would correspond to around 1.1% of 2Q GDP, or close to 0.3% of annual GDP. Bearing in mind that activity didn't stop completely and that some of it will tend to be compensated for or recovered, the overall impact should be less than those figures (closer to 0.05%-0.1% than 0.3%).

Unemployment rate stable at 6.5% of the labour force. Inflation rises to 2.1% YoY. Confidence falls.

In a week rich in indicators, the highlights were (i) the deterioration in economic sentiment in April, with falls in confidence in all sectors except industry; (ii) the rise in inflation in April, from 1.9% to 2.1% YoY (the same evolution was seen in core price growth); (iii) in March, the stabilisation of the unemployment rate at 6.5% of the labour force; the fall of 0.6% MoM and slowdown from 4.5% to 4% YoY in the volume of retail sales; and the falls of 4% MoM and 5.5% YoY in industrial production.

GDP growth (% QoQ)

Inflation rate, CPI (% YoY)

Source: INE.

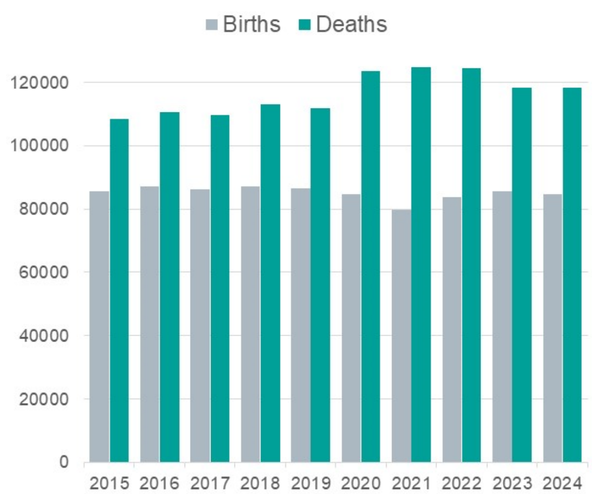
Main Economic Indicators

Real annual growth (%)	2022	2023	2024	2025F
GDP	7.0	2.6	1.9	2.3
Private Consumption	5.6	1.9	3.2	2.4
Public Consumption	1.7	0.6	1.1	1.7
Investment	4.9	2.0	1.7	7.9
Exports	17.2	3.8	3.4	2.5
Imports	11.3	1.8	4.8	4.8
Annual Average Inflation (%)	7.8	4.3	2.4	1.9
Budget Balance (% GDP)	-0.3	1.2	0.6	0.2
Public Debt (% GDP)	111.2	97.9	95.3	93.7
Unemployment Rate (%)	6.1	6.5	6.4	6.4
External Balance (% GDP)	-1.0	1.9	3.3	3.9

E: Estimate; F: Forecast. Sources: INE, Bank of Portugal, novobanco.

Zoom

Population Natural Balance, Nº of Births vs. Deaths



Source: INE.

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