Nordea

14 March 2025

Macro & Markets: Greater risk of inflation than of recession

Marketing communication

Sara Midtgaard

The market seems to be fearing Trump's new tariffs and a possible recession. However, we believe there is a greater risk of higher inflation than of a recession – in the US as well as in Europe.

Trump has threatened once again to impose new tariffs on goods imported into the US, which US companies and consumers will end up paying for. As a result, recession fears are starting to flourish once again – like last summer. The past month the S&P is down 8 percent and Atlanta Fed GDPNow indicator is down to -2.5 percent. But the starting point for the US economy is very strong, and for the Fed, the inflation risk is greater than the risk of an economic downturn. The same applies to the Euro-zone.

"The economy has been growing at a solid pace." Powell said a week ago before the Fed's external communication blackout began. US GDP rose in the fourth quarter at an annualised rate of 2.3 percent, followed by 3 percent growth in the third quarter – well above trend growth. Private consumption has continued to grow at an escalating rate, reaching 4 percent at the end of last year. Even though the reaction to weaker sentiment data is recognizable, we expect US politics to eventually turn to the more growth positive track of tax cuts and deregulation. And, despite firing of government employees, we still think fiscal policy will remain accommodative and support growth in the US economy.

This week we received figures from the US labour market, which show that the number of job openings is rising and so is the number of voluntary layoffs. There are usually two leading indicators of wage growth in the US. It may take time before we see the full effect of more rigid immigration policies reflected in the labour market figures, but we do expect the US labour market to tighten in the coming year. Nevertheless, it will probably not be visible in the non-farm payrolls figures, which may be affected by the DOGE program, but rather in the unemployment rate figures.

Even though the US inflation figures for February came in slightly lower than expected, there is no reason for the Fed to cut interest rates in March. For the past two months, goods inflation has not contributed to the disinflation process as it did last year – and that is even before most of Trump's new tariff rates have been implemented. Therefore, we could still see goods inflation picking up in the coming months and thereby contribute to the upside for core CPI figures.

The Fed appears to share this view of risk, which was mentioned by Powell last Friday as well as in the Fed's meeting minutes: *"Participants generally pointed to upside risks to the inflation outlook. In particular, participants cited the possible effects of potential changes in trade and immigration policy, the potential for geopolitical developments to disrupt supply chains, or stronger-than-expected household spending."*

The promises of Germany's Friedrich Merz "to do whatever it takes" to massively increase spending on defence and infrastructure could limit some of the downside risk for the European economy. They will, however, need the Greens party vote. Allegedly, Friedrich Merz reached an agreement with the Greens on a fiscal reform package today. The German 10-year yield is up as much as 50 basis points since the start of March and EURUSD has again risen to 1.09. However, this package could make the ECB's job somewhat more demanding, Lagarde said on Wednesday at a conference in Frankfurt: *"Trade fragmentation and higher defence spending in capacity-constrained sector could in principle push up inflation."* The ECB's monetary policy is becoming meaningfully less restrictive. Our main forecast is that the ECB will cut rates in April. However, uncertainty remains high and the ECB is now more open to pausing as well.

Norway is in a somewhat similar situation to the US: growth is more or less back at the trend level and unemployment is falling from an already low level. Inflation is well above Norges Bank's forecast and its inflation target. If Norges Bank views the risk picture as we expect it to do, there is a greater risk that inflation will not come down within a reasonable time horizon than of unemployment rising above a normal level. Therefore, we do not see Norges Bank cutting interest rates in the next two years.

To summarise, the market seems to be fearing Trump's new tariffs and a possible recession. However, we believe there is a greater risk of higher inflation than of a recession – in the US as well as in Europe.

Figure 1: The S&P 500 down 10 percent from the top in February

Figure 2: Volatility Index (VIX)

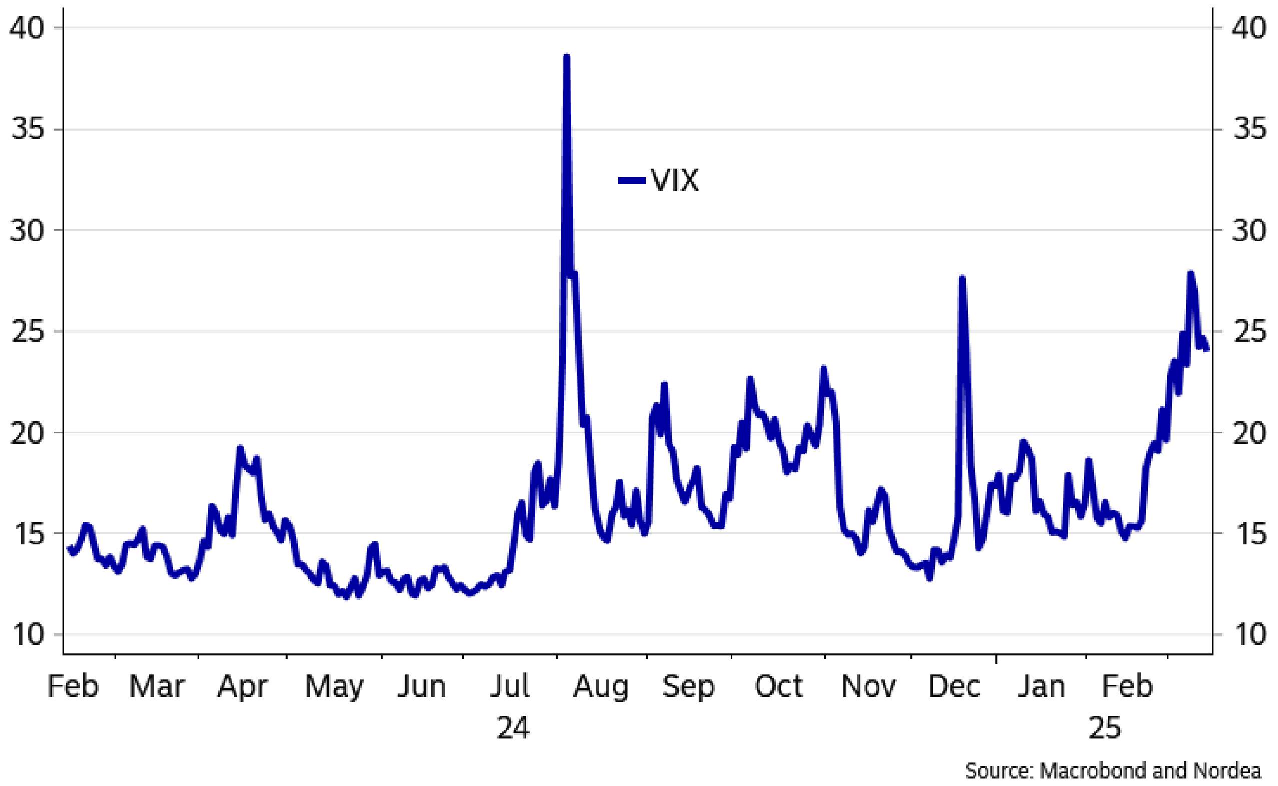

Figure 3: Atlanta Fed GDPNow

Nordea

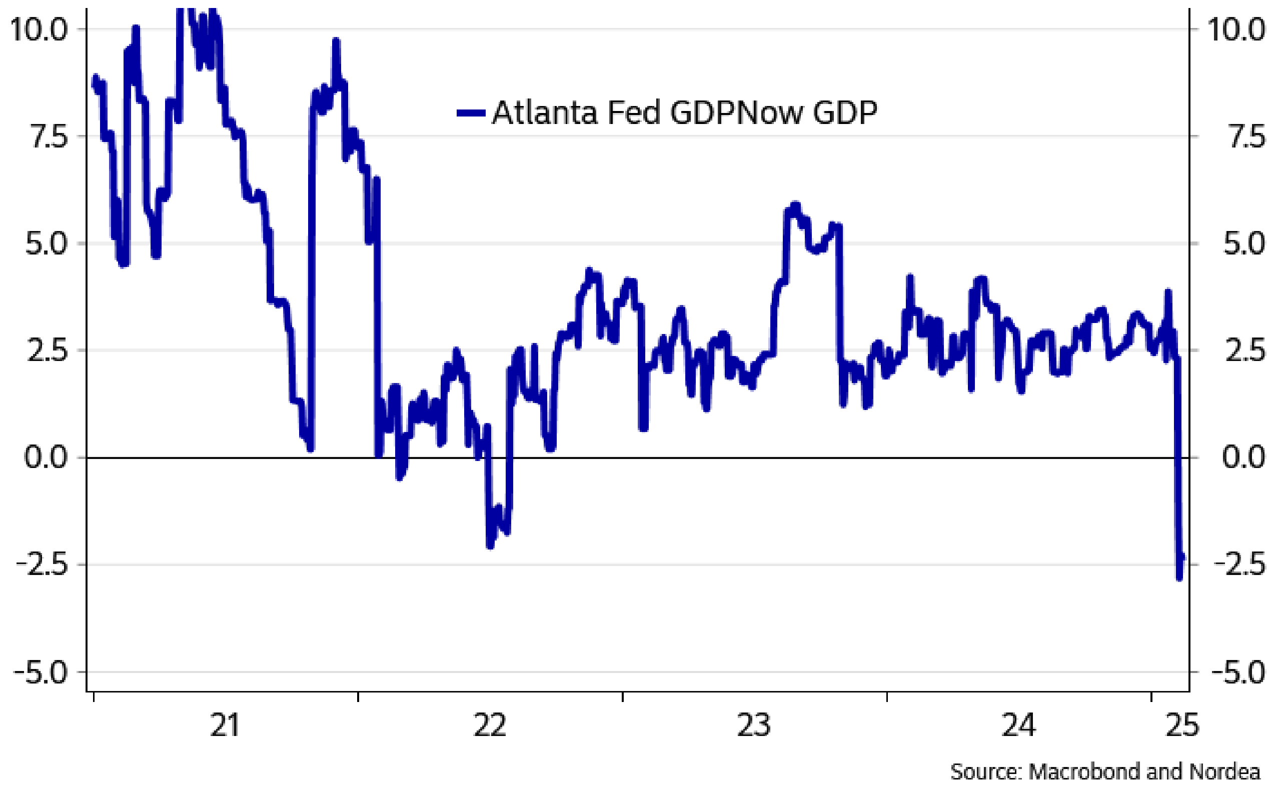

Figure 4: US Job openings a leading indicator for wage growth

Nordea

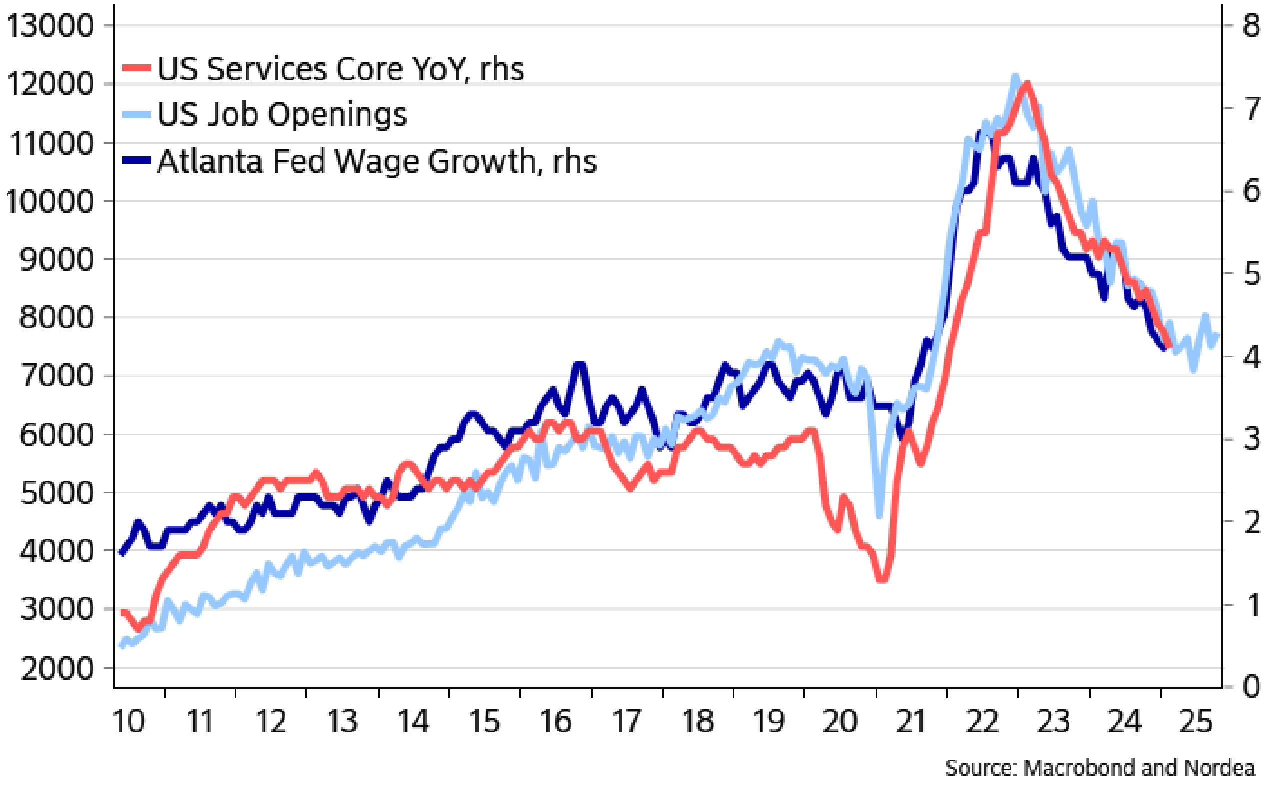

Figure 5: Upside risk to the US goods inflation

Sara Midtgaard
Senior Macro and FX Strategist
sara.midtgaard@nordea.com

DISCLAIMER

Nordea Markets is the commercial name for Nordea's international capital markets operation.

The information provided herein is intended for background information only and for the sole use of the intended recipient. The views and other information provided herein are the current views of Nordea Markets as of the date of this document and are subject to change without notice. This notice is not an exhaustive description of the described product or the risks related to it, and it should not be relied on as such, nor is it a substitute for the judgement of the recipient.

The information provided herein is not intended to constitute and does not constitute investment advice nor is the information intended as an offer or solicitation for the purchase or sale of any financial instrument. The information contained herein has no regard to the specific investment objectives, the financial situation or particular needs of any particular recipient. Relevant and specific professional advice should always be obtained before making any investment or credit decision. It is important to note that past performance is not indicative of future results.

Nordea Markets is not and does not purport to be an adviser as to legal, taxation, accounting or regulatory matters in any jurisdiction.

This document may not be reproduced, distributed or published for any purpose without the prior written consent from Nordea Markets.

In the United States, to the extent that this publication or report includes an analysis of the price or market for any derivative and is not otherwise exempt from the applicable U.S. Commodity Futures Trading Commission (CFTC) regulations, it is approved for distribution in the United States to US persons that are eligible contract participants from a CFTC perspective. Nordea Bank Abp is a provisionally registered swap dealer with the CFTC. Any derivatives transactions with US persons must be effected in accordance with the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Nordea Bank Abp, Satamaradankatu 5, FI-00020 NORDEA, Finland, domicile Helsinki, Business ID 2858394-9

Further information on Nordea available on www.nordea.com