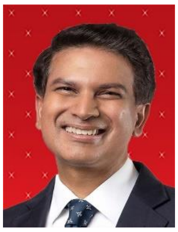
Macro Insights Weekly

Notes from IMF: Widening tail risks

Group Research April 28, 2025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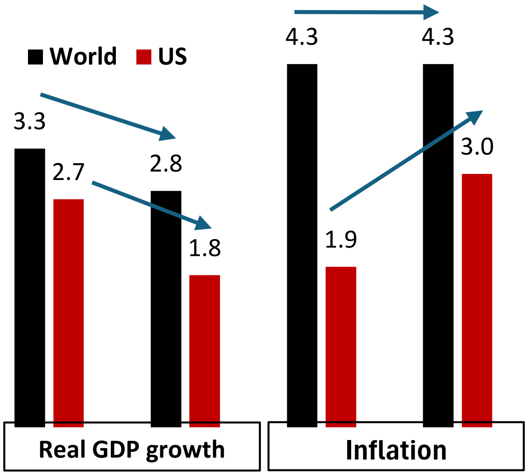
- *The IMF meetings in Washington DC had an air of gloom—there were deep concerns about policy uncertainty and the future of rules-based multilateralism.*
- *The IMF forecast only a modest slowdown in the global economy and the US.*
- *We see wide tail risks around this central scenario.*
- *Markets could slip up if trade negotiations and US fiscal stance falter.*
- *China will be implementing economic support measures; it will also have to strategise around trade*
- *For many countries keen to get deal done with the US, the road will be full of hurdles.*

Chart of the Week: IMF forecast revisions

The IMF's recent global forecast revisions underscore two key points. First, there is considerable downside to the global growth outlook owing to a sharp escalation in trade frictions orchestrated by the US. Second, this development will likely result in a sizeable pick-up in US inflation this year (forecast revised up by 110bps), but likely leave inflation unchanged in the rest of the world. Not an outright recession, but a stagflation-type scenario emanating out of the US, which is likely to keep interest rate and currency volatility high.

IMF forecast revisions for 2025



Source: IMF, DBS. Arrows show the direction of forecast change

Commentary: Widening tail risks

Two major sources of dread loomed over the recently concluded IMF Spring meetings in Washington DC. One was about the US policy-led friction on trade, immigration, and functioning of the government. The other was about the future of rules-based multilateral approach to trade and commerce. The latter, while admittedly in need of reform and improvement, has served the interest of the international community, especially small economies, over many decades. With the US keen to pursue unilateralism, the concern expressed repeatedly was the inexorable move toward multiple spheres of influence, a rise in complexity and distortions, and an increase in instability in trade, finance, and commerce.

Global economic outlook was revised down by the IMF, but given the noise of late, the magnitude of revisions was modest. Widespread recession fears notwithstanding, the IMF sees global growth softening by 50bps this year. The US forecast was lowered, but it is still expected to grow by nearly 2% this year. The underlying factors driving this somewhat sanguine view on the US are as follows:

The US economy stepped into 2025 with a great deal of momentum, with strong consumption and investment offsetting some slowing of public spending. This momentum has fed into sustained strength in the labour market, notwithstanding the job cuts announced under the aegis of the Department of Government Efficiency, which have proven to be of marginal consequence. Latest data on unemployment, job creation, and wage growth continue to attest to this strength. Current uncertainties will dampen consumption and investment, but it does not yet appear that that would lead to a major decline in activity. **The US, a large, domestic demand-driven economy, benefitting from lower energy prices and a likely large tax cut later this year, could well absorb a chunk of the tariff shock**. A period of empty shelves and inflation jump could materialise if some goods from China stop coming, but that could well force a de-escalation of trade frictions. What policy can wrest, it can alleviate.

We think this central scenario is subject to long tail risks. As seen in various surveys, consumer and business sentiment markers have deteriorated sharply in recent months. Markets still have confidence in trade negotiations progressing, but the room for disappointment is ample. Persistently large US fiscal and current account deficits warrant continued goodwill of investors, locals and foreigners. Positioning can unwind dramatically if the White House overplays its hands on trade and finance.

What about **China**? The IMF expects growth to slow there by 100bps this year to 4%, as exporters scramble to find alternative sources of demand, both at home and in non-US markets. Fears of dumping could cause Chinese exporters to face trade restrictions outside US markets. If some countries do deals with the US at the expense of China, that could unleash additional layers of friction as well.

Domestic demand support measures would be rolled out by Chinese authorities, negotiations with the US will eventually take place, and local innovators and entrepreneurs will keep capturing the imagination of the rest of the world, but the ride will be bumpy. Most critically, **the erosion of US-led global order will require China to pursue an open and stable set of policies with the rest of the world**. Just as it sees the world's largest consumer market become increasingly closed, it would need to show the world that its market will be progressively more open.

The Trump administration asserted repeatedly during the week that many countries have reached out for trade deals. We are sure that most government would rather work amicably with the US, but we are worried about the terms they will have to face.

As the 90-day tariff pause moves on, US demands may turn out to be characterised by inconsistencies and escalations. Nations like Mexico, given their dependence on trade with the US, may do whatever is demanded of them, from boosting spending on immigration measures to mirroring US tariffs on China.

In contrast, the likes of Vietnam may find no amount of adjustment would get them tariff relief. For the likes of Japan, South Korea, and Singapore, their close relationship with the US may not be sufficient to revert to the pre-April trade regime.

A 10% tariff on every country outside of USMCA seems like the base case to us. Some exceptions for pharmaceuticals and electronics would be made, and but that could come and go. Nothing can be taken as sacrosanct.

As uncertainties related to trade and investment persist beyond the tariff pause, companies and countries will be seen carrying out short-term strategy vis-à-vis the US such as tariff arbitrage, friend-shoring, and on-shoring. Then there would be long-term strategy for the rest of the world, including multiple supply chains and regional trade deals. Shocks to exporters would have to be offset by boosting domestic demand through supportive policies.

The US authorities made sure that the DC meetings were not overwhelmed by questions on the weaponisation of the USD and USD assets. US fiscal outlook is mired with downside risks, given Trump's multitrillion-dollar tax plans and a rigid spending envelop marked by ballooning defence, interest, and social security payments. Treasury Secretary Scott Bessent expressed support for a strong dollar policy, but there was an important caveat. The US does not want an appreciating currency, rather it just wants to assure investors that US asset markets would remain open and attractive for investment. This was done, in our view, to distance the administration from the thoughts expressed by the Stephen Miran, head of Council of Economic Advisers, which include charging a user fee on US bond holders.

The week was not marked by a charm offensive by US officials, but there was some push to reduce the temperature. The US is not walking away from multilateralism, but it would demand forcefully that the system serves its purpose. The world would have to take such demands as a given. There is no going back; the genie is out of the bottle.

Taimur Baig

FX: Pushing the USD's limits

After serious consideration, we acknowledge the USD's longer-term downside risks in our currency forecasts.

US President Donald **Trump's** "Make America Great Again" or **MAGA agenda**, especially his tariff proposals on Liberation Day, **have shaken investor confidence in the foundational pillars** – US economic strength, institutional trust, and geopolitical influence – **that upheld the USD's preeminence as the world's dominant currency** after World War II.

The first risk is a less exceptional and less stable US economy. The IMF expects Trump's tariffs to lower US GDP growth to 1.8% in 2025 from 2.8% in 2024, adding that **US recession risks have increased to 37% from 25%**. The sweeping tariffs have disrupted established trade patterns, which major US retailers warned could empty supermarket shelves. Grappling with heightened uncertainty, US businesses will likely delay investment and hiring decisions. US consumers face higher prices, increased job uncertainty, and acute market volatility that directly impact their retirement accounts, such as 401(k)s and IRAs, which are heavily invested in equities.

The **high tariffs that the US and China** – the world's two largest economies – **imposed on each other** (145% on China and 125% on the US) **were likened to a trade embargo that threatened global trade and the world economy**. The IMF now sees global growth lower at 2.8% in 2025 vs. its previous 3.3% forecast in January, below the historical average of 3.7% from 2000-2019.

The second risk is financial market stability. Trump's protectionism and unpredictable policy decisions have started to erode the confidence in the US as a prime destination for foreign investment, which was painstakingly renewed after the Global Financial Crisis. Trump risks transforming the US from the investment magnet he seeks into a risk that international investors may hesitate to take.

Trump's approach to fixing global imbalances through tariffs and pressure for countries to buy more US goods converts them from USD earners into USD spenders, **risks undermining the recycling system that financed America's deficits**. Surging gold prices to lifetime highs reflect the disincentive for countries to add more to their US holdings. The 26.5% rise in gold prices this year looks poised to overtake the 27.2% increase for all of 2024.

The third risk is institutional trust. Since taking office, Trump's actions saw the US steering away towards a new international order. The world is questioning America's political leadership, which established the post-war global order based on rules, free trade, open markets, and collective security based on trustworthiness. They raise hard questions for foreign governments that rely on the USD to anchor foreign reserves, global institutions that hold Treasuries as risk-free benchmarks, and private investors who anchored portfolios around US assets and trusted the USD as a haven in volatile times.

Trump used the lessons from his first term to circumvent the traditional checks and balances to advance his MAGA agenda with unprecedented speed and assertiveness in his second term. It raises concerns about the two pillars – monetary policy independence and sustainable fiscal management – supporting the USD's status. Despite Trump's assurance that he has "no intention" of firing Fed Chair Jerome

Powell, investors viewed Trump's interference in the Fed's independence as inevitable, whether soon or after Powell's term expires in May 2026. We can expect Trump to criticize Powell again for not cutting rates at the May 7 FOMC meeting. Trump's desire for lower rates appeared tied to financing his ambitious tax cut pledges totaling more than USD10 trillion over the next decade.

The Trump administration's fiscal policy will draw scrutiny this summer. US Treasury Secretary Scott Bessant is prioritizing securing the permanent extension of the USD4 trillion 2017 Tax Cuts and Jobs Act by Independence Day (July 4), days before the 90-pause on the "Liberation Day" tariffs expires. Bessent will seek to increase the federal debt ceiling by USD5 trillion through budget reconciliation before the estimated "X-date" in June or July.

Bessant also advocated that the Treasury take a stronger role in crafting bank regulation. His proposal to ease the regulatory burden of banks' leverage limits brought back memories of the Silicon Valley Bank collapse in March 2023. Following the regulatory rollbacks in 2018, SVB significantly increased its holdings of short-term bonds (Bessent is targeting long-term bonds), exposing it to losses from high inflation and hefty Fed hikes, triggering a bank run that led to its insolvency.

There is no certainty that the ongoing trade negotiations will significantly lower tariffs by the end of the 90-day pause on reciprocal tariffs in July. China has learned from its experiences during Trump 1.0. Beijing has become less deferential towards Washington, has shown its readiness to retaliate with punishing tariffs, and has resisted one-sided trade negotiations.

While Japan and South Korea have not mirrored China's tough stance, they appeared willing to resist without escalating confrontation while preparing contingency strategies – protecting industries and expanding global market reach. Many countries likely resent that Trump is leveraging America's position as the world's largest buyer to pressure companies to invest more in the US and less in the rest of the world, especially the transshipment hubs. Other countries are looking to like-minded peers to uphold the global common good, safeguard open markets, and preserve the multilateral order that has supported international stability and economic growth since WW2.

In the end, someone must foot the bill – Trump demands that it won't be America, forcing countries to choose whether their private or public sectors absorb the cost, even as they settle for lower tariffs and reduced market access. How countries manage this trade-off will ascertain their economic resilience and their future ties with the US. **By forcing countries into short-term choices, Trump risks remaking global trade patterns in ways that will ultimately weaken America's own position over the longer term**.

Overall, the **Trump administration is trying to achieve too much too fast, and markets are taking notice**. Each initiative carries risks, which collectively amplify market concerns about high tariffs and trade negotiations, rising inflation and job insecurity, the Fed's independence, fiscal discipline, financial sector stability, and the USD's status.

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