



Mature Economies

# Quarterly Cyclical Outlook

Quarterly – 2025Q3

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# Global Outlook – Mid 2025

## Navigating global macro in a shifting policy and trade landscape

The second half of 2025 opens in a world marked not by crisis, but by drift. The global economy shows resilience in the aggregate, especially in the US, but the deeper macro-financial architecture is shifting. Institutions, policies, and financial signals are no longer the stable reference points they used to be. The global order is increasingly shaped by fragmentation, political volatility, and the use of economic tools as instruments of power.

This Quarterly Cyclical Outlook outlines the strategic framework for our global scenario exercise. It clarifies what is embedded in our baseline, what is set aside, and how we must operate in a system defined more by its fragility than by its equilibrium.

## Short-term strength, long-term uncertainty

We are not forecasting a global recession in H2 2025. The U.S. economy remains above trend, supported by resilient hard data, EUZ is improving marginally as disinflation eases real income constraints. China continues to manage a structural slowdown with targeted stimulus. But this resilience is uneven, fragile, and increasingly exposed to political and strategic forces.

The dominant features of the global context are:

- Strategic fragmentation: The U.S.–China rivalry now structures trade, investment, and technology choices. Emerging markets are repositioning across new blocs. Trade patterns are regionalizing.
- Policy unpredictability: Fiscal policy is increasingly erratic, monetary policy is data-dependent but politically constrained, and tariffs and investment controls are used as tactical tools.
- Weak signal reliability: Yield curves, inflation expectations, and FX moves no longer reflect traditional macro cycles. Structural regime change, especially in inflation and rates, distorts interpretation.

There is no systemic rupture, but there is no global anchor either. We are operating in a low-visibility regime.

## Clarifying the baseline: what we assume, and what we do not

In this context, the value of the scenario is not to forecast point outcomes but to build a coherent macro narrative that reflects today's dominant forces while recognizing plausible deviations.

## Baseline Scenario – What we assume

- No major geopolitical rupture: U.S.–China relations remain confrontational but controlled. Middle East tensions stay below the threshold of sustained disruption.
- Interest rates stay structurally higher, despite expected volatility. Disinflation continues in Developed Markets economies, but real rates remain elevated. No large-scale monetary easing is assumed.
- US macro resilience fades gradually in H2 2025, with slowing consumption and weakening investment leading to a late-year growth dip, before a rebound in 2026H1 driven by pre-midterm fiscal tailwinds.

- EUZ and UK recover slowly: Domestic demand stabilizes. Fiscal support is limited. The ECB and BoE remain cautious.
- China manages without reflation: Growth remains sub-potential. Policy support is sector-specific and liquidity-focused.
- Trade policy becomes more selective: Tariff levels are maintained at current levels, but we assume a greater use of sector-specific, targeted tariffs, notably in strategic sectors (EVs, semiconductors, pharmaceuticals, key inputs). Tariffs are increasingly treated as a tactical lever by U.S. authorities, adjusted or threatened to gain negotiation power, including with allies.

This last point is critical: the global trade environment remains highly exposed to political cycles, particularly in the US., where tariff policy is no longer reactive but strategic by design.

### **Scenarios we deliberately exclude (for now)**

We explicitly set aside two high-impact shocks, not because they are implausible, but because they lack immediate catalysts. They remain in our risk monitoring, not in the core scenario.

- Major Oil Supply Shock via Strait of Hormuz

A sustained disruption would lift oil prices well above \$120–130/bbl, drive global inflation, pressure household incomes, and delay monetary easing across G10 countries. Market volatility would spike. Emerging markets would face balance-of-payments and financing stress.

We do not include this in our baseline because: (1) Iran would severely damage its own economy by blocking its main export route. (2) Even in past episodes of war or escalation (1980s, 2019), full closure was avoided. (3) A full disruption would likely trigger U.S. or multilateral military response, which deters escalation.

- Financial Crisis Triggered by NBF Stress

The non-bank financial sector is under strain: leverage is high, liquidity is overstated, and many institutions rely on procyclical hedging and synthetic leverage (especially in private credit and real estate-linked products). Mispricing of duration risk is widespread.

However, this risk remains latent rather than imminent: No large institution or funding market is under acute stress. Recent shocks (SVB, UK pensions) were contained. Central banks have shown greater agility. Credit remains available, spreads are elevated but not destabilizing, and equity markets are volatile but orderly.

The ingredients of a crisis exist, but without a spark, the system remains under tension, not collapse.

### **Macroeconomic consequences of a global regime shift**

The global economic environment is no longer shaped by regular business cycles but by a structural regime shift, one that redefines how we interpret macro data, policy signals, and market behavior. This transition has direct consequences for the global outlook and for the tools we use to assess it.

- **Disinflation becomes more uneven and policy-driven**

Inflation is receding globally, but not in a linear or broad-based fashion. Structural drivers, such as re-shoring, tariffs, and fragmented energy markets limit the scope of

a clean return to pre-2020 price dynamics. Core goods inflation is more exposed to trade and supply chain shifts, while services inflation remains sticky due to labor market asymmetries.

Forecasting inflation in this regime means accounting for policy-induced frictions, not just slack. Price dynamics are increasingly subject to discretionary interventions (on tariffs, subsidies, or energy taxes) that can distort signals without necessarily reflecting underlying demand.

– **Rates stay higher, but not in a classical tightening phase**

Interest rates in mature economies are no longer anchored by expectations of a return to a 2% inflation world. Even with disinflation, neutral rates appear structurally higher, and central banks are reluctant to deliver the pace of easing markets had priced at the start of the year. In the U.S., Fed Funds may stabilize around 3.5% by mid-2026, with a flatter path ahead.

However, the credibility of the Federal Reserve is increasingly in question. Should political interference intensify in 2025H2/2026, the risk of unanchored inflation expectations would rise sharply. This would complicate the disinflation process, drive up term premia, and force the Fed to adopt a more defensive posture, potentially maintaining higher real rates for longer despite slowing growth. In such a scenario, market volatility would increase, the dollar could face renewed instability, and the U.S. economy would be exposed to a stagflation trap: lower potential growth, elevated inflation, and a weakened policy response framework.

The implication: the era of policy rates as a primary macro adjustment tool is fading. Central banks operate under tighter political scrutiny and limited forward guidance. Fiscal and industrial policies increasingly dominate macro calibration, but they introduce lagged and more uncertain effects.

– **Growth projections are stable, but more sensitive to external shocks**

In this regime, 2025 global growth remains positive but increasingly vulnerable to non-domestic variables. In the U.S., growth gradually slows as consumption and investment soften, but remains away from recession (under the assumption of a resilient US labor market). In Europe, the recovery depends heavily on sentiment-sensitive components such as business investment and trade. In China, any sustained deceleration in exports could challenge an already fragile domestic trajectory.

This macro environment reinforces the return of a “cycle within the cycle” logic. After a soft patch in the second half of 2025, an impulse is likely in 2026. In the U.S., fiscal tailwinds linked to the political calendar and a more accommodative policy mix may lift growth modestly. In Europe, public investment programmes and stabilising consumption could support a mild rebound. But the recovery will remain shallow, uneven, and dependent on political execution.

**A narrower policy space, and the return of financial repression**

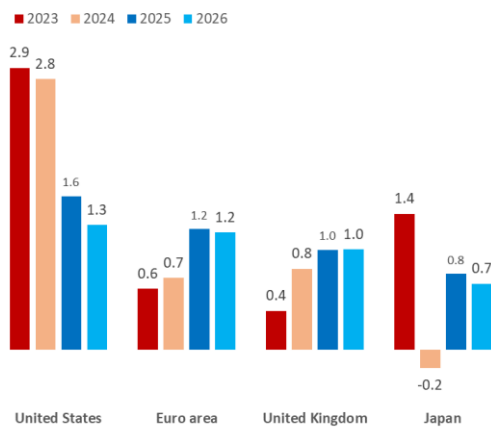
With high public debt and persistently elevated real interest rates, the space for traditional counter-cyclical policies has narrowed. In this environment, financial repression is making a discreet return.

Unlike the post-WWII era, today’s tools are less explicit but serve similar objectives. Regulatory constraints (like LCRs and solvency rules) continue to push banks and insurers toward sovereign bonds. Central banks, though no longer accumulating assets, are slow to unwind QE-era holdings—effectively anchoring long-term yields. In

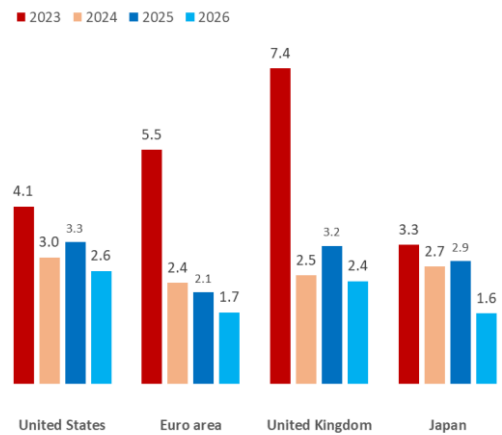
parallel, several governments promote “patriotic finance”, encouraging domestic investors to support public debt issuance. Tolerating mildly above-target inflation also helps reduce the real debt burden without formal restructuring.

Though not officially labelled as repression, these mechanisms lower the cost of public borrowing and reshape macro-financial dynamics. The implications are significant: long rates may be less responsive to monetary signals, private investment could be crowded out, and inflation credibility might suffer if markets detect deliberate policy inaction. This marks a shift toward a more state-steered financial regime.

**Real GDP growth forecasts (Avg y/y, in %)**



**Headline inflation forecasts (Avg y/y, in %)**



Source: TAC ECONOMICS Datalab

# Japan

## Japan economic outlook

	25Q1	25Q2f	25Q3f	25Q4f	26Q1f	26Q2f	26Q3f	26Q4f	2024	2025	2026
Real GDP (y/y, %)	1.7	0.8	0.5	0.1	0.4	0.6	0.8	0.9	-0.2	0.8	0.7
Real GDP (q/q, %)	0.0	0.1	-0.1	0.2	0.3	0.3	0.1	0.3			
CPI inflation (y/y, %)	3.8	3.2	2.5	2.0	1.5	1.5	1.7	1.9	2.7	2.9	1.6
Bank rate (eop*, %)	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	0.25	0.75	1.00
10-year gov. bond (%)	1.4	1.4	1.5	1.6	1.7	1.9	1.9	1.9	0.9	1.5	1.8

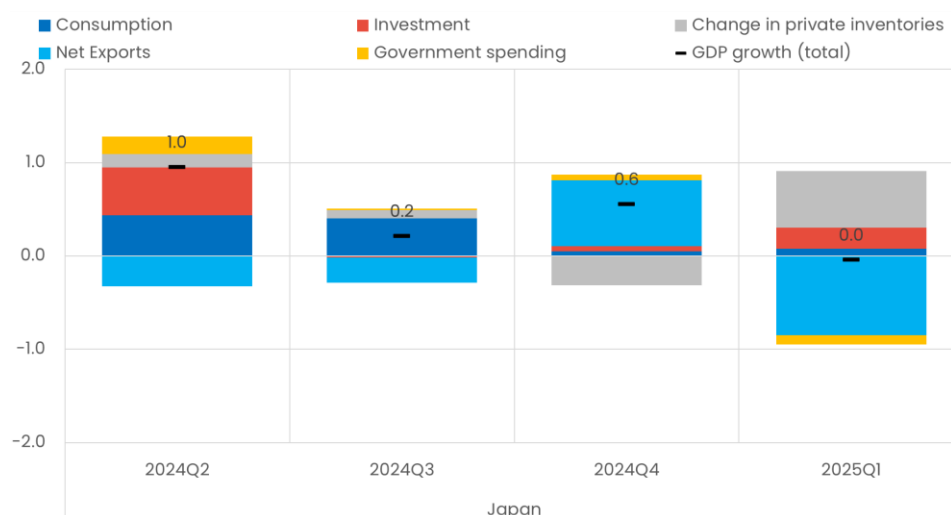
Source: TAC ECONOMICS / \*eop=end of period

### Fragile rebound meets rising political uncertainty

After a weak end to 2024, Japan's economy remains fragile. GDP contracted marginally in Q1, (though better than initially estimated thanks to upward revisions in private consumption (+0.1%) and inventories). Domestic demand contributed positively to growth, offsetting the drag from external trade. However, the **underlying momentum remains modest**. Consumption is constrained by **weak wage growth and lingering inflation concerns**, while **corporate investment lacks broad-based strength** outside of a few sectors such as semiconductors and defence.

**The outlook for Q2 is clouded by ongoing uncertainty around US tariffs, especially in the automotive sector**, which represents a key pillar of Japanese exports. While some temporary resilience is expected in Q2 activity data, the **risk of external disruption remains significant**.

### Japan GDP growth by components (q/q in % and pps)



Source: TAC ECONOMICS Datalab

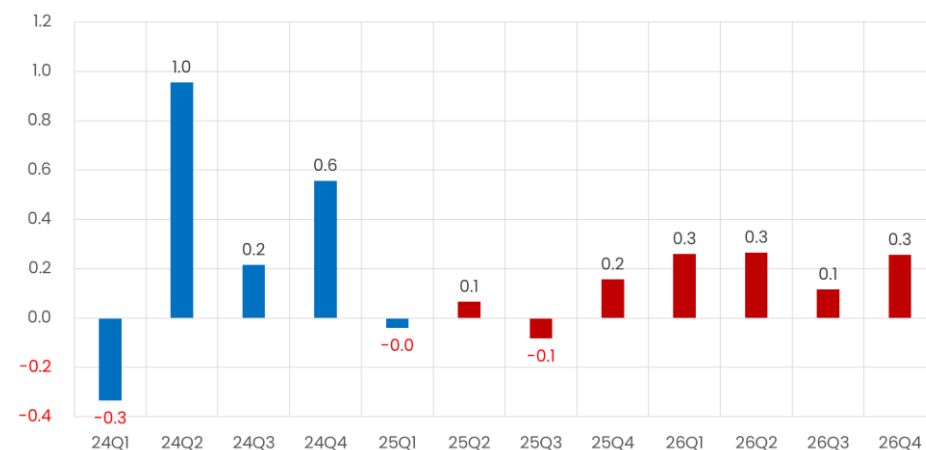
Looking ahead, Japan's growth is expected to remain **below trend through 2025–2026, with GDP expanding by only around 0.8% in 2025 and 0.7% in 2026**. While inflation continues to hover slightly above the Bank of Japan's 2% target, **underlying demand remains fragile, limiting the scope for a robust policy normalization**. The



BoJ is expected to remain cautious, balancing the need to exit ultra-loose policy with the risk of premature tightening in a low-growth environment. Fiscal policy is likely to do most of the heavy lifting, but its effectiveness may be hampered by a deteriorating political backdrop.

Indeed, **Japan's political landscape has grown more fragile** ahead of the July 20 upper house elections. The ruling LDP, led by Prime Minister Ishiba, suffered a historic defeat in the Tokyo assembly vote (winning only 22 out of 127 seats) due to voter frustration over food prices and stagnant wages. This **raises the risk of deeper losses at the national level and threatens Ishiba's leadership**. The rise of regionalist and populist parties adds further uncertainty and could hinder the passage of key fiscal measures such as energy subsidies or VAT adjustments. The combination of macro fragility, trade tensions, and political volatility increases the likelihood of reactive, rather than proactive, policy responses. **Bond markets and the yen are particularly vulnerable should policy clarity deteriorate further heading into 2026.**

#### Japan GDP growth projections (q/q in %)

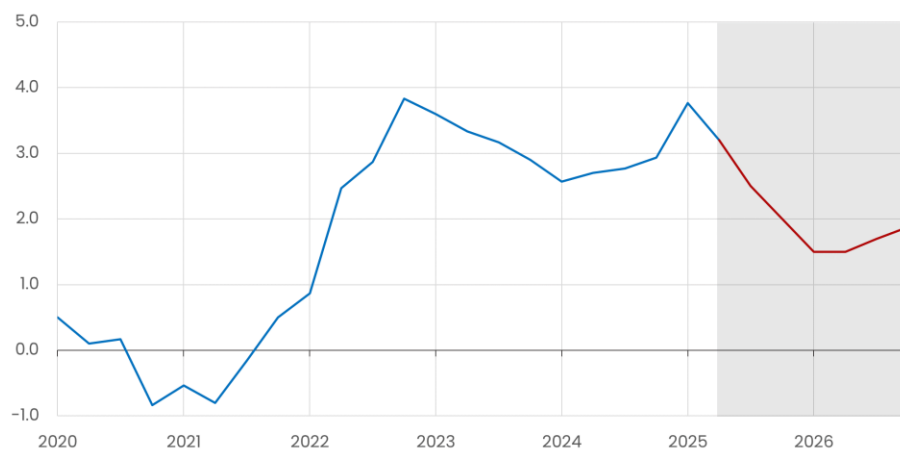


Source: TAC ECONOMICS Datalab

#### Inflation path clouded by yen weakness and looming tariff uncertainty

The **inflationary pressures in Japan have re-emerged in mid-2025**, with headline CPI accelerating to 2.9% year-on-year in May, driven by a **surge in food prices (particularly rice), which has seen double-digit gains due to adverse weather conditions and production disruptions in Southeast Asia**. Core inflation remains stickier than expected at 2.3%, above the Bank of Japan's 2% target, amid broad-based price increases in services and imported goods. **The prospect of new reciprocal tariffs further complicates the outlook**: proposed measures targeting Japanese autos and tech goods could raise import costs and exert downward pressure on the yen, thereby amplifying imported inflation through the exchange rate channel. **The magnitude of this effect remains uncertain at the time of writing**

Looking into 2026, inflation is expected to **gradually moderate towards 1.8% (average 2026H2)**, assuming global commodity prices stabilize and wage growth fails to accelerate meaningfully. The balance of risks remains tilted to the upside.

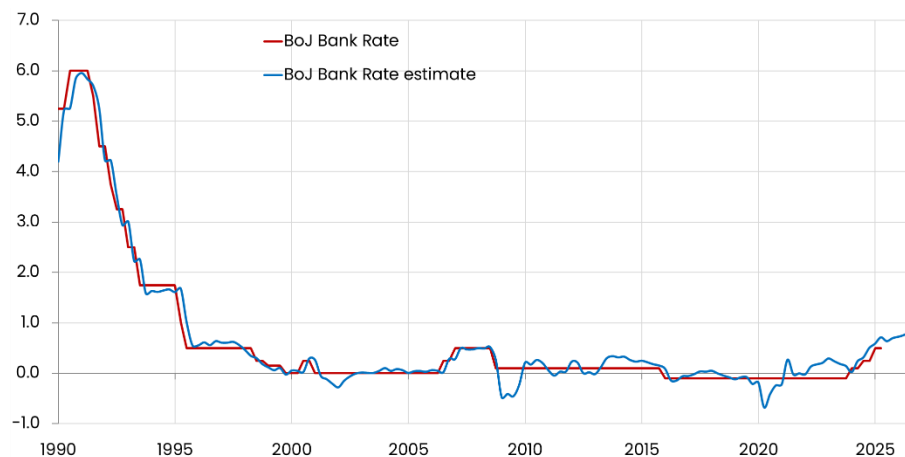
**Japan CPI inflation projections (in %)**

Source: TAC ECONOMICS Datalab

**Japan's bond market stress tests the limits of gradual normalisation**

The **Bank of Japan's cautious exit from ultra-accommodative policy is now as much about managing bond market volatility and global spillovers as it is about domestic price trends**. Recent inflation spikes are not yet supported by broad-based wage pressures, prompting the government to consider additional fiscal offsets such as extended subsidies or delaying the next VAT hike.

Amid this fragile backdrop, **the BoJ is proceeding gradually**, with only 25bp hike expected over 2025H2, **up to 1% end-2026**. But June's sharp sell-off in long-dated JGBs forced the **BoJ to scale back its tapering operations**. While no longer under formal yield caps, the move above 1% **revived fears of renewed instability in a structurally thin and fragile market**.

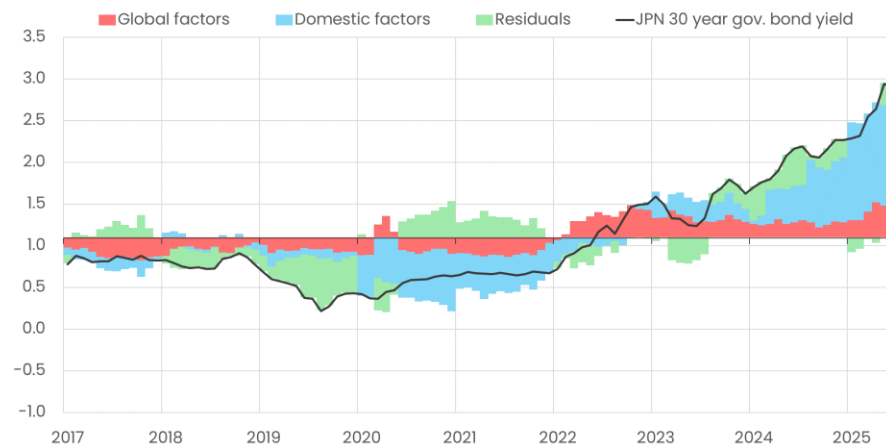
**BoJ policy rate projections (in %)**

Source: TAC ECONOMICS Datalab

While global bond markets have seen renewed volatility, specific estimates suggest that the **rise in Japanese long-term yields has been primarily driven by domestic factors**. Unlike in the EUZ or the UK (where external shocks and US Treasury dynamics play a dominant role in shaping rate movements), **Japan's recent bond sell-off appears more rooted in internal shifts**. This domestic anchoring is **further evidenced by the limited correlation between JGB yield moves and US 10Y Treasuries** in recent weeks, in contrast with past episodes. Instead, the sharp repricing of 10Y JGBs toward 1.15% in June was closely linked to the BoJ's reduction in bond purchase volumes and

market discomfort over fiscal signals ahead of the July upper house elections. This differentiation matters: **while Japan remains exposed to global flows and volatility due to its investment position and thin bond market liquidity, the current pressures are more self-inflicted than imported.** In this context, the **BoJ's policy path will remain highly sensitive to domestic developments**, and the scope for further normalization could be constrained by market tolerance rather than global spillovers.

#### Japan 10 year bond yield contributions (in % and pps)

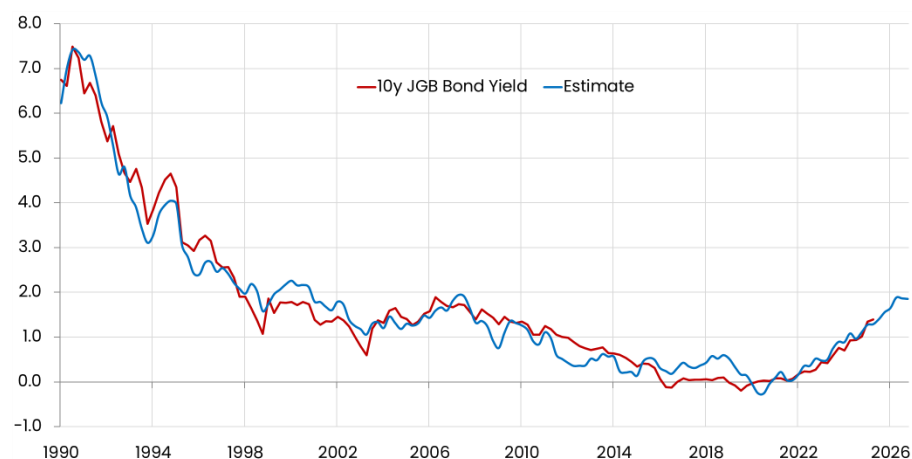


Source: TAC ECONOMICS Datalab

Looking ahead to 2026, we **maintain a baseline scenario of a gradual rise in 10Y JGB yields toward 1.8%, consistent with a terminal BoJ policy rate around 1%.** However, this trajectory is far from guaranteed. **Two main risks stand out.** First, a disorderly repricing in global bond markets could spill over into Japan, tightening financial conditions and forcing the BoJ to intervene again. Second, any domestic fiscal slippage, such as additional spending to mitigate inflation or avoid unpopular tax hikes, could challenge the market's current assumption of a stable public debt path.

In this environment, **BoJ forward guidance and operational flexibility will be critical.** The Bank may be compelled to retain a quasi-stealth yield curve control posture, not by explicit caps, but by adjusting the scale and composition of JGB operations in response to market stress. For now, the message is clear: the BoJ's normalization is happening, but in slow motion, and always with one eye on the bond market's ability to digest change. The June episode was a warning, not of reversal, but of the limits of momentum in a still-fragile system.

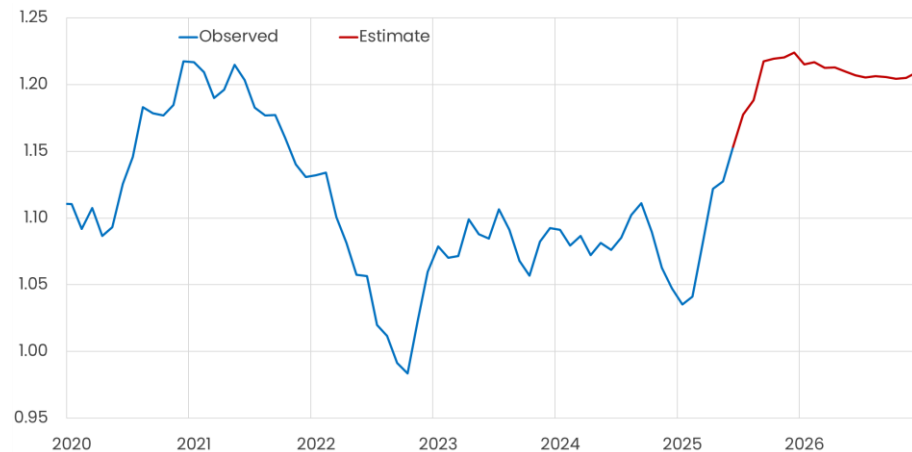
#### Japan 10 year bond yield projections (in %)



# Exchange rate projections

## EUR/USD: Shift toward depreciation

### TAC ECONOMICS EUR/USD Projections



Source: TAC ECONOMICS Datalab

The EUR/USD exchange rate is expected to continue its appreciation in the near term, supported by narrowing interest rate differentials, persistent structural headwinds for the US dollar, and fading European growth pessimism.

With short-term EUR/USD fair value already near 1.15–1.16 according to rate models, and front-end spreads moving further in favor of the Euro amid a cautious Fed and a still-hawkish ECB stance, **the pair has room to overshoot toward 1.20 by early 2026.**

Several reinforcing factors support this path: market speculation about the erosion of Fed independence under the Trump administration, the growing fiscal risk premium attached to the US deficit outlook, and continued FX hedging away from the dollar by reserve managers and global institutions.

Additionally, Trump's tariff agenda is reviving **concerns over the dollar's reserve status and stoking fears of renewed trade fragmentation, further weakening medium-term USD sentiment.** In contrast, the EUZ benefits from a gradually improving macro narrative and from renewed capital inflows as rate spreads stabilize.

However, **this rally is unlikely to persist beyond mid-2026.** As the ECB resumes its easing cycle, potentially cutting rates again by Q2 2026 (though not our central scenario) and US growth proves more resilient than feared, the dollar could regain some ground, especially if Fed credibility is restored and markets refocus on structural euro area vulnerabilities.

Ultimately, while the **EUR/USD rate may briefly test or even exceed 1.20, we expect it to drift back toward the 1.15–1.16 range by late 2026, reflecting a rebalancing of monetary and fiscal narratives across both economies.**

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