Flash Economics

N° 43
April 22, 2025

Tariffs decided by Donald Trump, why this sharp setback in US and European equity markets?

Since February 18, 2025, the S&P 500 index has declined by 15.9% and the Euro Stoxx 50 index by 10.8%. But the two mechanisms behind this very sharp drop in stock market indices are different.

In the United States, it was the anticipation of a slowdown in consumption (domestic demand) arising from the additional inflation linked to customs duties that explains the fall in stock market indices. Even if the customs duties collected are paid back in the form of tax cuts, these tax cuts will mainly benefit businesses and high-income households, while low-income households will suffer from the higher prices of imported products.

In Europe, it is the decline in exports to the United States or the squeeze in profit margins that explains the decline in share prices.

However, the setback in stock market indices seems to be an over-reaction to the shock caused by the increase in customs duties which, in the 9 April 2025 version, is moderate, except for the customs duties on US imports from China.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

Sharp decline in stock market indices

The decline in stock market indices since the beginning of 2025 **has been impressive, in the United States and in the eurozone (Charts 1a/b)**.

Chart 1A
Stock market indices (01.01.2010 = 100)

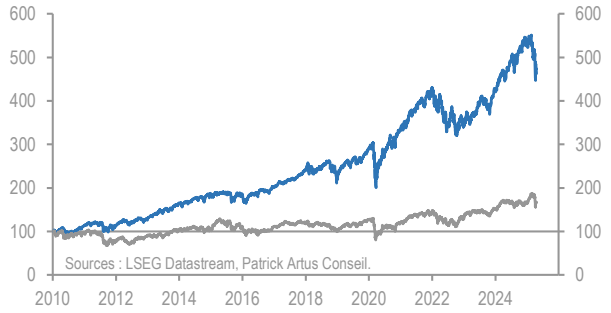
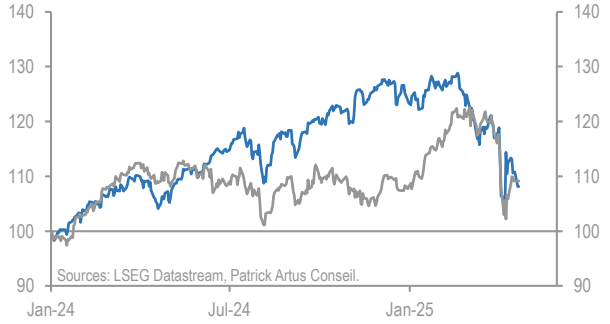


Chart 1B
Stock market indices (01.01.2024 = 100)



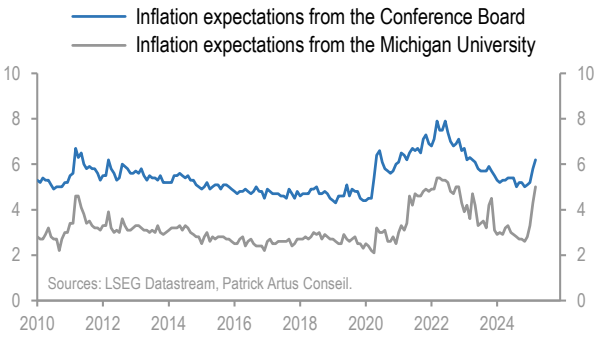
In the United States, the downturn began with the emergence of doubts about the business model for artificial intelligence: the investment required was massive, and agile competitors (such as DeepSeek) to the major US technology companies were emerging.

But it was the announcement, on 2 April 2025, of the introduction of very high tariffs on US imports that triggered a violent sell-off in US and European equities, even though these tariffs were reduced on 9 April, **except in the case of US imports from China**.

Causes of the drop in US equities

In the United States, the expectation that **tariffs will trigger a sharp rise in inflation (Chart 2**) is the cause of the decline in stock market indices.

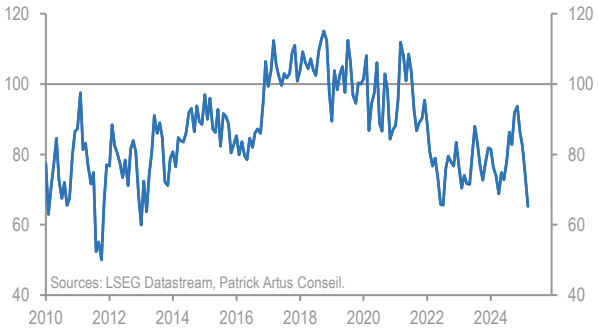
Chart 2
United States: Consumer's inflation expectations for the year ahead (as %,)



The mechanism is as follows: the indexation of wages to prices is very loose in the United States, which means that an anticipated increase in inflation results in households expecting a decline in their purchasing power and consumption.

We can also observe the decline in the Conference Board's expectation index (Chart 3).

Chart 3
United States: Consumer confidence index - Expectations index (Conference Board, 1985 = 100)



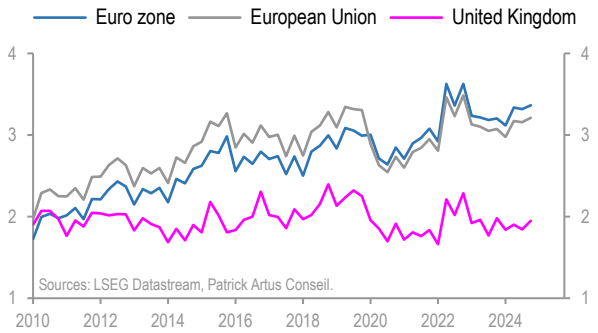
In addition, the drop in the stock market indices implies a reduction in the **value of American pension funds** (pension wealth) and amplifies the fall in consumption. According to available estimates, a 10% drop in US stock market indices will lead to a 0.4% slowdown in US household consumption.

Even if the additional customs duties are returned to businesses and households in the form of tax cuts, these tax cuts will mainly benefit businesses and wealthy households, while modest households will suffer from higher import prices and a reduced purchasing power.

Causes for the drop in stock market indices in Europe

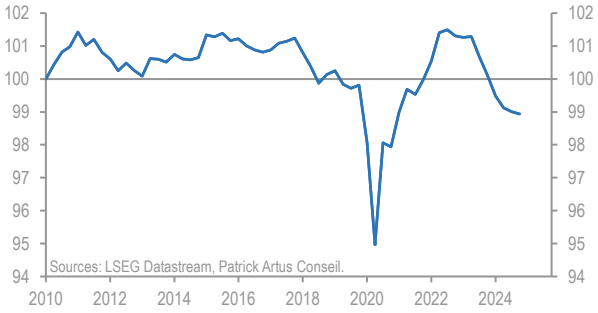
In the European Union, **it is the prospect of slowing exports to the United States** that explains the decline in stock market indices. Exports of goods to the United States account for 3.3% of GDP in the eurozone, 3.2% of GDP in the European Union and 2% of GDP in the United Kingdom (Chart 4).

Chart 4
Exports of goods to the United States (as % of nominal GDP)



Even if the volume of exports falls only slightly, the existence of customs duties (10% duty on EU exports to the United States) would mean a drop in profit margins on products exported from the EU to the United States, which would further exacerbate the low margins of European companies (Chart 5).

Chart 5
Euro zone: Ratio between GDP deflator and unit labour cost (2010.Q1 = 100)



Summary: it is reasonable for stock market indices to retreat when protectionist measures are announced in the United States, but the scale of the decline may come as a surprise

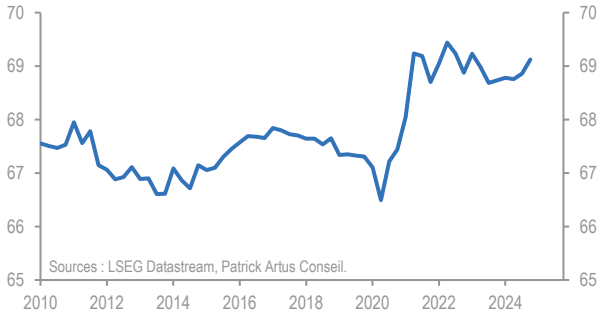
Higher tariffs in the US normally cause stock market indices to fall in the US (due to inflation and the resulting loss of purchasing power) and in Europe (due to lower exports to the US or lower profit margins).

But the scale of the decline in stock market indices seems exaggerated. If import prices rise by 13% in the United States (which is a maximalist hypothesis), domestic prices would rise by at most 1.8% (taking into account the weight of imports in GDP, **Chart 6A**), and the slowdown in consumption, cushioned by the variation in the household savings rate, would imply a loss of around 0.7 points of GDP (taking into account the weight of consumption in GDP, **Chart 6B**). This estimate is a maximum because the rise in import prices has, in the past, been partly offset by a fall in distributor margins. A 15.9% decline in US stock market indices for a 0.7 point drop in GDP seems exaggerated.

Chart 6A
United States: Imports of goods and services (as % of nominal GDP)



Chart 6B
United States : Household consumption (as % of real GDP)



If exports to the United States fall by 10% in Europe, given the weight of these exports, GDP will shrink by 0.3%. An 10.8% fall in European stock market indices for a loss of 0.3 points of GDP would appear to be an over-reaction by European equity markets.

Even if overall world trade stagnates (the WTO is forecasting a 0.2% drop in world trade in volume terms, instead of a 2.7% rise previously), the negative effect of this stagnation on eurozone GDP would be 0.6 points at most.

Disclaimer

Ossiam, a subsidiary of Natixis Investment Managers, is a French asset manager authorized by the Autorité des Marchés Financiers (Agreement No. GP-10000016). Although information contained herein is from sources believed to be reliable, Ossiam makes no representation or warranty regarding the accuracy of any information of which it is not the source. The information presented in this document is based on market data at a given moment and may change from time to time. This material has been prepared solely for informational purposes only and it is not intended to be and should not be considered as an offer, or a solicitation of an offer, or an invitation or a personal recommendation to buy or sell participating shares in any Ossiam Fund, or any security or financial instrument, or to participate in any investment strategy, directly or indirectly. It is intended for use only by those recipients to whom it is made directly available by Ossiam. Ossiam will not treat recipients of this material as its clients by virtue of their receiving this material. All performance information set forth herein is based on historical data and, in some cases, hypothetical data, and may reflect certain assumptions with respect to fees, expenses, taxes, capital charges, allocations and other factors that affect the computation of the returns. Past performance does not predict future returns. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. Ossiam assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from, an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. This information contained herein is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Ossiam to any registration requirements in these jurisdictions. This material may not be distributed, published, or reproduced, in whole or in part.