Flash Economics

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US stock market indices can drop a lot further

Since the end of February 2025, US stock market indices have fallen sharply (between 20 February and 31 March, the S&P 500 fell 8.3% and the Nasdaq Composite fell 13.3%).

There are several reasons for this decline: expectations of a slowdown in US growth, issues with the artificial intelligence model developed by technology companies in the United States, which is very capital-intensive, and the expected impact of tariff hikes in the United States and retaliatory measures taken by other countries.

We believe that this downturn in stock market indices could become very significant with:

- The prospect of a trade war;
- Further downward revisions to growth;
- The decline in non-resident investment in US equities, linked to the risk of weak growth and currency risk;
- Consumer pessimism.

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The decline in US stock market indices and its causes

Chart 1 shows trends in the S&P 500 and Nasdaq Composite indices since the beginning of 2022.

Chart 1
United States: Stock market indices (01.01.2010 = 100)



One can notice the significant decline in US stock market indices since the end of February 2025.

This decline has several causes:

- The expectation of slower growth in the US (Chart 2), due to the Trump administration's tariff hikes and the deportation of illegal immigrants, which will cause inflation to rise; inflation is bad for growth in the US because wages are under-indexed to prices, and inflation is now expected to rise (Chart 3).

Chart 2
United States: Manufacturing and services PMI (indices)

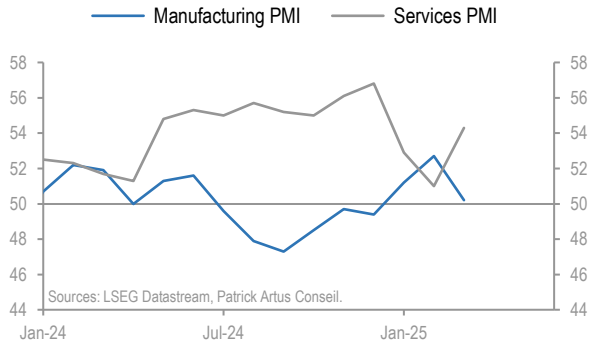
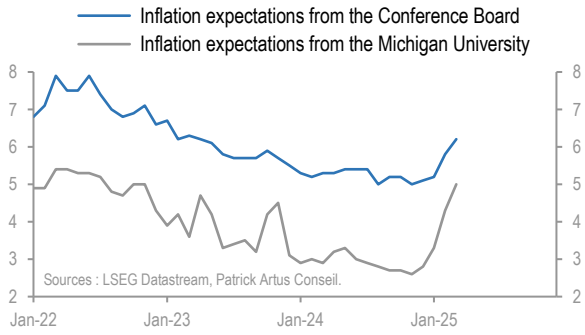


Chart 3
United States: Consumer's inflation expectations for the year ahead (as %,)



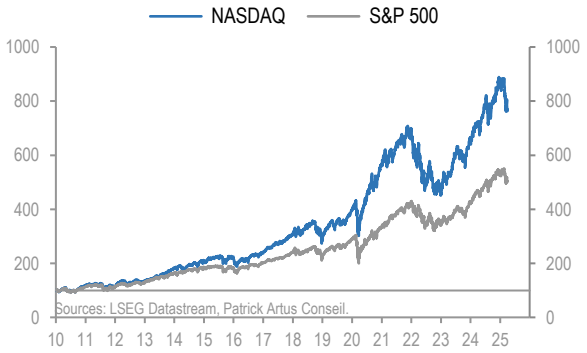
The slowdown in US growth will be magnified if other countries retaliate to the increase in customs duties on their exports to the United States by raising customs duties on their imports from the United States;

- The issues with the artificial intelligence model developed by the major US technology companies: massive need for investment ($325 billion of investment in AI expected by 2025), competition from small, agile companies that are much more capital-efficient (DeepSeek). These hurdles cast a doubt on the profitability of investment in artificial intelligence by the major US tech companies.

The drop in US stock market indices could gain momentum

From a long-term perspective, the decline in US stock market indices is negligible (Chart 4).

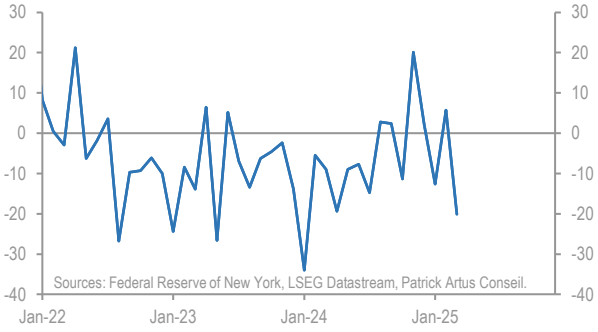
Chart 4
United States: Stock market indices (01.01.2010 = 100



But we think it could get worse for several reasons.

1- The prospect of a trade war, which would significantly reduce growth in the United States (and other countries). The OECD has revised downwards its growth forecast for 2025 in the US to 2.2%, and to 1.6% for 2026, but these are minor revisions, as the picture could be much worse. We should be concerned about the trend in leading indicators, such as the decline in the New York Federal Reserve's manufacturing index (Chart 5).

Chart 5
United States: Empire State manufacturing survey,
General Business Condition (balance of responses)



We can therefore expect further downward revisions to US growth.

2- The decline in non-resident investment in US equities, revealed as the dollar exchange rate depreciates (Chart 6), while long-term interest rates on US Treasury debt remain low after their mid-February 2025 decline (Chart 7).

Chart 6
Euro/dollar exchange rate (EUR 1 = USD...)

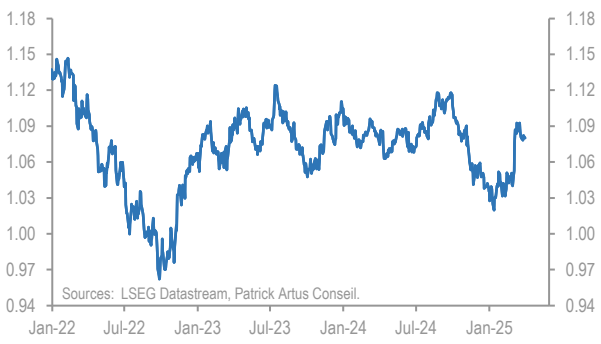
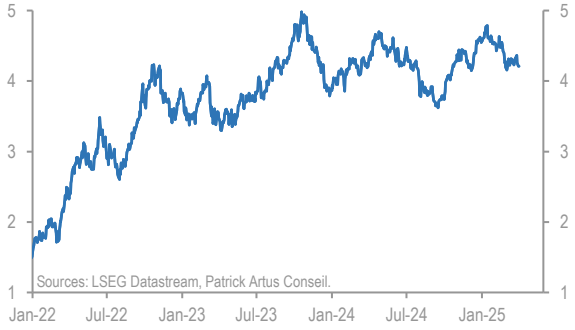


Chart 7
United States: Interest rate on 10-year government bonds
(as %)



Non-resident investors in US equities are legitimately concerned about weak growth and currency risk. This is confirmed by surveys of investors conducted by US investment banks (Bank of America shows a shift from a 17% overweighting of US equities in February to a 23% underweighting in March 2025).

3- **Uncertainty surrounding economic policies**, whether fiscal policy, exchange rate policy or trade policy.

4- **Consumer pessimism**, as seen in the Conference Board surveys (**Chart 8**), which could herald a decline in consumption (**Chart 9**).

Chart 8
United States: Consumer confidence index and consumer confidence index - Expectations index (Conference Board, 1985 = 100)

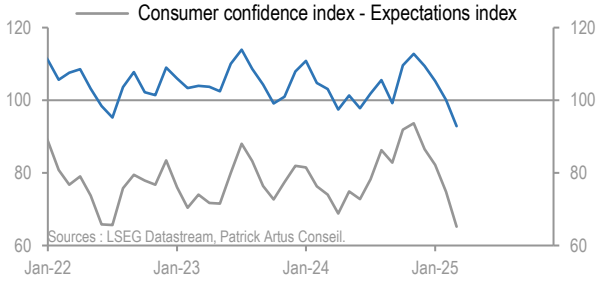
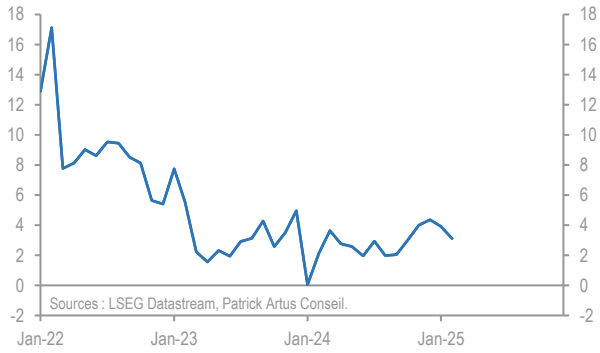


Chart 9
United States: Retail sales (in value terms, Y/Y as %)



Summary: Everything is in place for US stock market indices to drop a lot further

One should indeed account for the combination of:

- The risk of very weak growth resulting from inflation and the trade war;
- Concerns around the profitability of investments in artificial intelligence;
- Uncertainty about economic policy;
- Equity sales by non-residents;
- Consumer pessimism.

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