Flash Economics

N° 76
July 1st, 2025

Why are financial markets so unresponsive?

Equity markets fell sharply in April 2025 following the Trump Administration's announcement of significant tariffs on US imports.

However, since the beginning of May 2025, financial markets (including equities and the exchange rate) have shown only a very limited reaction:

- To Donald Trump's announcements regarding tariffs or the taxation of non-residents;
- To the outlook for the US public deficit or public debt;
- To the war between Israel and Iran.

Where does this muted reaction by financial markets come from?

- Regarding the Trump Administration's policy, it stems from the conviction that Donald Trump will avoid taking any action that could harm US equity markets or the public debt market;
- As for the war between Israel and Iran, it is based on the assumption that Iran will not block the Strait of Hormuz (such a blockade would trigger a sharp surge in oil prices), which, for now, appears to be the case.

Financial market participants therefore continue to adopt an optimistic outlook, which explains the limited reaction of markets to such shocks.

However, adverse developments remain a concern — such as the failure of negotiations between the United States and the European Union, or weak returns on investments in artificial intelligence.

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.

Since the beginning of May 2025, financial markets (interest rates, equities, exchange rates) have shown virtually no reaction to shocks

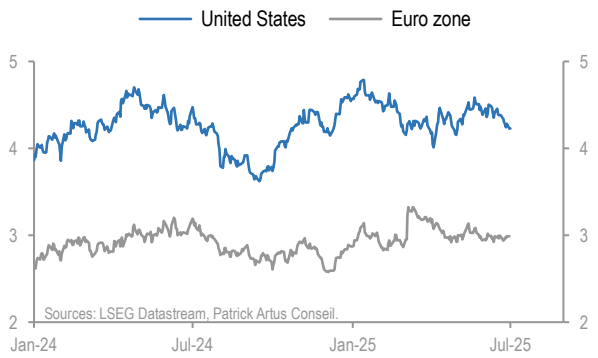
Equity markets in the United States and Europe fell sharply in April 2025, following Donald Trump's announcement of very high tariffs (**Chart 1**).

Chart 1
Stock market indices (01.01.2024 = 100)



Long-term interest rates also declined in April 2025, due to the negative impact on expected growth resulting from the sharp increase in tariffs (**Chart 2**).

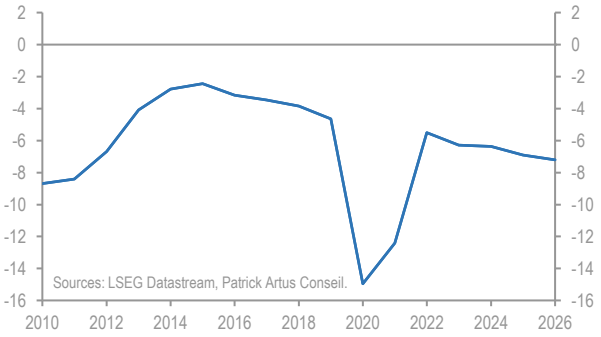
Chart 2
Interest rate on 10-year government bonds (as %)



However, **since the beginning of May 2025, stock market indices and long-term interest rates have been very stable** (Charts 1 and 2 above), despite:

- Announcements by Donald Trump regarding tariffs, with alternating declarations of tariff increases and reductions;
- The risk that capital income earned by non-residents on their holdings of US assets may be subject to heavy taxation (this is Section 899 of the *Big Beautiful Bill*); after the meeting of G7 in June 2025, the proposals for a 15% minimum tax on multinationals and the taxation of digital services having been scrapped, this threat is no longer relevant and will be removed from the Big Beautiful Bill;
- The prospect of **a persistently high public deficit in the United States** (**Chart 3**), as tax cuts clearly outweigh any reductions in healthcare spending or increases in tariff revenues.

Chart 3
United States: Budget deficit (as % of nominal GDP)



- **The war between Iran and Israel**, which has so far ended with a ceasefire.

One might have expected these events to lead to a sharp decline in stock market indices in the United States (due to weaker growth resulting from tariffs and reduced capital inflows) and in Europe (with tariffs and taxation measures unfavourable to European firms), as well as a rise in long-term interest rates in the United States (due to a very high public deficit) — and, through the correlation of long-term interest rates, in the euro area. However, **these moves in equity indices and long-term interest rates have not been observed**.

Why has there been such a muted reaction from financial markets since the beginning of May 2025?

The limited responsiveness of financial markets to shocks since early May 2025 can be explained by:

- **The conviction that Donald Trump will avoid any action that could be detrimental to US equities or the US public debt market**; investors, as a result, do not believe in the likelihood of significantly higher tariffs (given their impact on inflation and growth), in heavy taxation on US assets held by non-residents (due to its effect on capital inflows into the US), or in an unsustainable public deficit (due to its consequences for long-term interest rates);
- **The belief that Iran will not dare to close the Strait of Hormuz**, given the negative effects such a move would have on its own oil revenues (**Chart 4**).

Chart 4
Iran: Oil production (million bbl/day)



Summary: Have financial market participants become too optimistic?

Financial market participants currently do not believe that an adverse scenario could materialise. We believe they are being too optimistic. Indeed:

- Negotiations between the United States and the European Union may fail, as Europe is unwilling to abandon its regulations (on health, the environment, digital policy, and competition). If the talks collapse, tariffs will be imposed, leading to a decline in equity indices in both the United States and the euro area;
- Expectations regarding the profitability of investments in artificial intelligence in the United States, and projections for additional revenue in the European defence industry, have likely been overly optimistic — which could trigger a downward correction in equity markets.

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.