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The Balancing Act: The Fed, Trade Wars & Global Growth Divergence



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Global Trade, Inflation, and Central Bank Signaling

1

Trade dynamics, inflationary risks, and central bank responses remained central themes over the past fortnight, as the global economy continued to navigate the complex cross-currents of geopolitical tensions, evolving consumer patterns, and monetary policy recalibrations. The US, Eurozone, China, India, and Asia-Pacific central banks each faced unique policy dilemmas, though all were united by the delicate challenge of balancing disinflation goals with sustaining economic growth. The **backdrop of renewed trade activity, particularly US-EU and US-China developments**, heavily colored investor expectations.

Equity markets remain perched near record highs, but cracks beneath the surface suggest rising investor anxiety. The anticipation of a September rate cut has buoyed sentiment, with historical data showing the S&P 500 tends to rally meaningfully once the Fed begins to ease. Still, macro headwinds loom. President Trump's **sweeping tariff regime and a controversial tax bill** are splitting the market's winners and losers, with Morgan Stanley advising a defensive shift in portfolio allocation.

Energy stocks, particularly in the nuclear space, are surging amid policy support and booming AI-driven power demand. Momentum has been fueled by headlines suggesting nuclear reactors could even be deployed on the moon—a symbol of how speculative this rally has become. **Meanwhile, meme stocks are back, reigniting volatility in pockets of the market.** Earnings results from major AI and data infrastructure players like AMD, Super Micro, and Palantir remain robust, but JPMorgan warns that over-concentration in popular tech names is reaching a dangerous extreme.

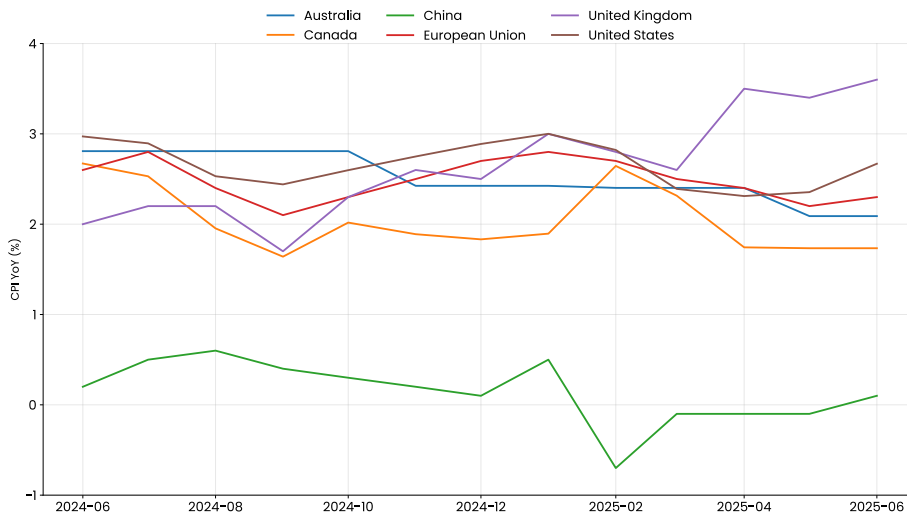
Amid these themes, institutional investors are nervously watching the long-term fallout of tariffs, especially on inflation and supply chains. In short: markets are cruising, but the terrain ahead is uneven and increasingly politicized.

US Trade Policy and Inflation Trajectory

The recent US-EU trade agreement, which imposes a 15% tariff on most EU goods, is a notable development for global inflation watchers. While higher tariffs generally imply upward price pressures, the structure of this deal may have an inverse effect domestically. Specifically, **the administration's use of targeted tariffs as a disinflationary mechanism**—aimed at redirecting supply chains towards cheaper or geopolitically favorable jurisdictions—could suppress price growth in the short run. However, this comes with caveats.

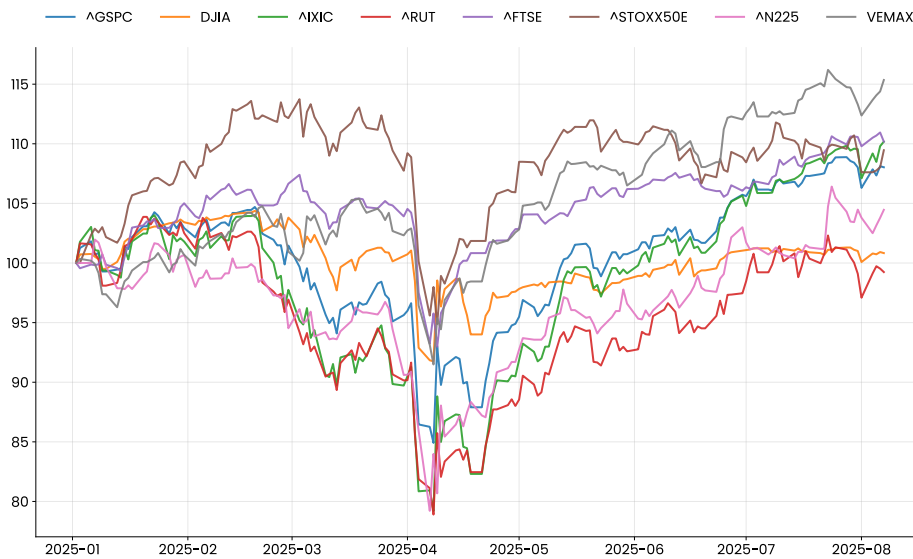
Consumer demand elasticity remains uncertain, and with **core PCE deflator figures showing a 0.3% month-on-month increase in June (2.8% YoY)**, price stickiness remains a concern for the Fed. On the international front, markets await clarity from the US-China bilateral trade discussions in Stockholm, where both sides are considering a potential delay in implementing new tariffs scheduled for August 12. The stakes are high, particularly for capital-intensive and export-driven sectors in both countries. A delay or rollback in tariffs could buoy investor sentiment, stabilize forward earnings projections, and temporarily ease global financial conditions.

Figure 1: Major Economies Continue Upward on the Inflation Trajectory



Source: Data sourced from Yahoo! Finance as on July 28, 2025. ^GSPC – S&P 500 Index (US Large Cap), DJIA – Dow Jones Industrial Average (US Industrials), ^IXIC – NASDAQ Composite Index (US Tech), ^RUT – Russell 2000 Index (US Small Cap), ^FTSE – FTSE 100 Index (UK Large Cap), ^STOXX50E – EURO STOXX 50 (Eurozone Equities), ^N225 – Nikkei 225 Index (Japan Equities), VEMAX – Vanguard Emerging Markets Stock Index Fund (Emerging Markets Equities)

Figure 2: Major Global Markets Performance (YTD)



Source: Data sourced from Yahoo! Finance as on July 28, 2025. Crude Oil (WTI) – NYMEX WTI Crude Oil Futures (CL=F), Crude Oil (Brent) – ICE Brent Crude Oil Futures (BZ=F), Natural Gas – NYMEX Natural Gas Futures (NG=F), Gold – COMEX Gold Futures (GC=F), Wheat – CBOT, Wheat Futures (ZW=F), Corn – CBOT Corn Futures (ZC=F), Soybeans – CBOT Soybean Futures (ZS=F), Coffee – ICE Coffee C Futures (KC=F), Sugar – ICE Sugar No.11 Futures (SB=F), Cotton – ICE Cotton No.2 Futures (CT=F), Commodity Basket – Invesco DB Commodity Index Tracking Fund (DBC), Agriculture Basket – Invesco DB Agriculture Fund (DBA)

However, while trade rhetoric moderates, underlying tensions remain embedded in policy. Export inspections data from the US show strength across soybeans, wheat, and corn—**up 11.1% YTD from 2024**—which partly offsets the domestic supply risks flagged in the July 28 crop progress report. That report showed deteriorating good/excellent ratings for spring wheat, corn, and cotton—suggesting that despite strong export volumes, price volatility in agri-commodities could resurface, particularly if

weather or logistics issues escalate. For the USDA and market participants, the next few weeks could determine the tone of US farm sector inflation expectations.

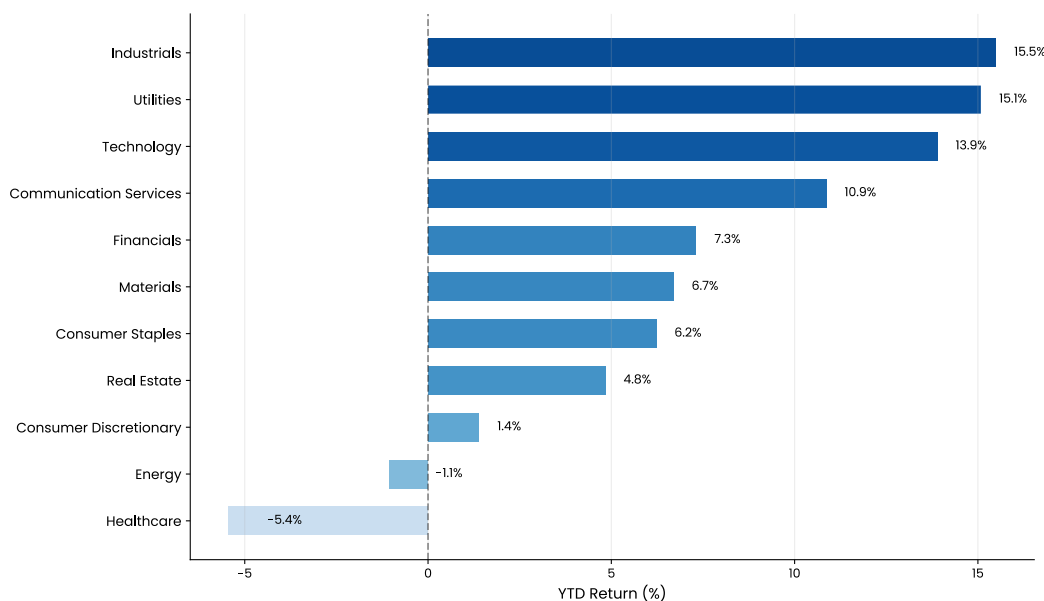
Europe’s Dilemma: Growth Fragility and Mixed Confidence Signals

Across the Atlantic, the **Eurozone continues to project a fragile recovery trajectory**. Preliminary GDP data for Q2 showed only a 0.1% QoQ growth, underscoring the region’s vulnerability to external shocks and internal stagnation. Yet, in a notable divergence, the European Commission’s Economic Sentiment Indicator showed an uptick in confidence across industry, services, and retail in July, even as construction sentiment softened.

In Germany, retail sales rose by 1.0% in June, signaling tentative consumer resilience. Still, underlying challenges persist. German manufacturing orders fell 1.0% in June, driven by a sharp drop in high-value sectors like transport and automotive. That said, domestic demand rebounded with a 2.2% increase, suggesting that the internal engine of the German economy is still functioning, albeit at a cautious pace. France also presented a mixed picture: Q2 GDP grew 0.3% QoQ, but this was heavily reliant on government spending and private consumption, while net trade detracted from growth. The resilience in consumer spending—particularly on durable goods, which rose 1.1%—provides some cushion, yet underlying corporate sentiment remains soft, as seen in the PMI readings. France’s manufacturing PMI declined to 48.2, suggesting contraction, while broader confidence indicators pointed to uncertainty.

These dynamics raise a core policy question for the ECB: should it prioritize maintaining favorable financing conditions to avoid a relapse into recession, or stay hawkish to ensure inflation targets are met? **With euro area inflation holding steady at 2.0% in July, and core inflation sticking at 2.3%**, the case for further tightening remains plausible, though no longer urgent. Market-implied inflation expectations have begun to stabilize, but remain highly sensitive to energy price swings and trade-related shocks.

Figure 3: Industrials Sector Was Again the Front-runner, Healthcare and Energy Registering Negatives



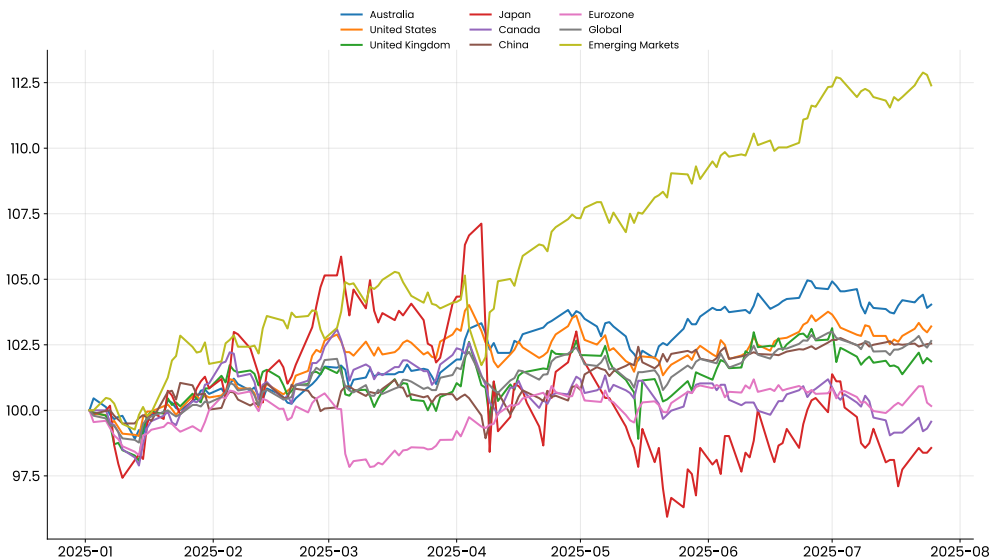
Source: Data sourced from Yahoo! Finance as on July 28, 2025.

Asia-Pacific: Central Bank Divergences and Economic Recalibration

Policy responses in the Asia-Pacific region reflected the nuanced realities of local inflation and demand conditions. Singapore, for instance, maintained its monetary policy stance with the Monetary Authority of Singapore (MAS) targeting a steady pace of appreciation of the Singapore dollar. The city-state's Q2 GDP rebounded to 1.4% QoQ, recovering from a contraction in Q1, but the MAS expects growth to decelerate in H2. Core inflation remains subdued at 0.6%, giving the central bank ample policy flexibility. In contrast, Australia's disinflation narrative gained traction. Headline inflation fell to 1.9% in June, below consensus expectations, bolstering the case for a rate cut at the next RBA meeting. Supporting this trend, **the NAB Business Survey and Westpac Consumer Sentiment Index suggested a modest pickup in business conditions and consumer outlook**, which may allow the RBA to act preemptively without undermining demand.

China's picture is more complicated. CPI stagnated in July and PPI appeared to pick up modestly, raising questions about latent inflationary pressures. Despite ongoing trade tensions with the US, the country's services sector showed strength, with rising output and new orders in July and confidence hitting a four-month high. Meanwhile, the merchandise trade surplus narrowed, but exports to Latin America and Southeast Asia showed resilience—likely due to re-routing around US tariff structures. Domestic retail sales rose 1.5% in June—the fastest pace since July 2023—though this may reflect front-loading of purchases ahead of the August 1 trade deadline. Japan's policy response remained neutral, with the Bank of Japan expected to hold course. However, declining core household spending and a sluggish rebound in domestic consumption remain key concerns for policymakers, as does the stability of inflation expectations in a volatile FX environment.

Figure 4: Emerging Markets Bonds Continue to Register Outlandish Performances YTD



Source: Data sourced from Yahoo! Finance as on July 28, 2025. Australia – iShares Core Composite Bond ETF (GOVT.AX), United States – iShares U.S. Treasury Bond ETF (GOVT), United Kingdom – iShares UK Gilts ETF (IGLT.L), Japan – Daiwa ETF-TOPIX Mid Small (2621.T), Canada – iShares Canadian Government Bond Index ETF (XGB.TO), China – VanEck China Bond ETF (CBON), Eurozone – iShares Global Government Bond EUR Hedged ETF (XGLE.L), Global – Vanguard Total World Bond ETF (BNDW), Emerging Markets – VanEck J.P. Morgan EM Local Currency Bond ETF (EMLC)

India presents an interesting contrast. Industrial production growth has accelerated, and the manufacturing PMI hit a 16-month high of 59.1 in July, reflecting robust output and new orders.

However, the Reserve Bank of India's recent rate cut underscores its concerns about growth momentum amid persistent global trade volatility. The services sector too remains strong, and combined with moderate inflation trends, the RBI may continue easing incrementally to support investment and domestic consumption.

Labor Markets & Corporate Signals

2

The interplay between labor market dynamics, corporate earnings signals, and shifting financial conditions shaped much of the market narrative from late July to early August 2025. **While employment data continues to reflect resilience in parts of the economy, a closer look reveals softening momentum, rising layoff activity, and stagnation in participation—all of which could pressure central banks to respond more aggressively.** Meanwhile, corporate earnings reports, particularly from the US, have become a window into broader economic trends, while treasury markets and interest rate expectations reflect growing market sensitivity to inflation, policy credibility, and capital allocation risks.

The Shifting Terrain of US Labor Markets

Labor market conditions in the US showed a stark turn during this period. **The July nonfarm payrolls report, released on August 1, showed just 73,000 new jobs—far below the 110,000 consensus estimate.** Even more concerning were the downward revisions to prior months, which signal not just a weak monthly print but a possible trend shift. These developments, coupled with a rising unemployment rate (to 4.2%) and a falling labor force participation rate (now at 62.2%), imply that the labor market is now entering a softer phase. The decline in participation suggests deeper structural or confidence issues. It could reflect discouraged workers leaving the labor force, skill mismatches, or the growing effects of long-term policy and business cycle transitions. **These dynamics are particularly relevant for the Fed, which, as of July 30, left interest rates unchanged but hinted at data-dependence for future moves.** At the same time, two FOMC members dissented, preferring a rate cut, highlighting the growing internal divergence within the Fed.

Leading indicators support this view. **The ISM Manufacturing Index dropped to 48.0 in July, with new orders and employment both in contraction territory.** Job openings, as per the JOLTS report, declined to 7.437 million in June, continuing a gradual but persistent downtrend. Meanwhile, layoff announcements rose 29.3% to 62,075 in July, with technology companies once again leading the charge. This mismatch between headline unemployment and rising layoffs could signal delayed spillovers into consumption. The Employment Cost Index (ECI) rose by 0.9% in Q2, showing modest but stable labor cost pressures—wages rose 1.0% QoQ, benefits rose 0.7%. Still, the decline in hiring activity implies that wage growth may soon plateau or even decelerate, aligning with slowing inflation indicators and increasing recession probabilities.

Corporate Earnings and Forward-Looking Growth Signals

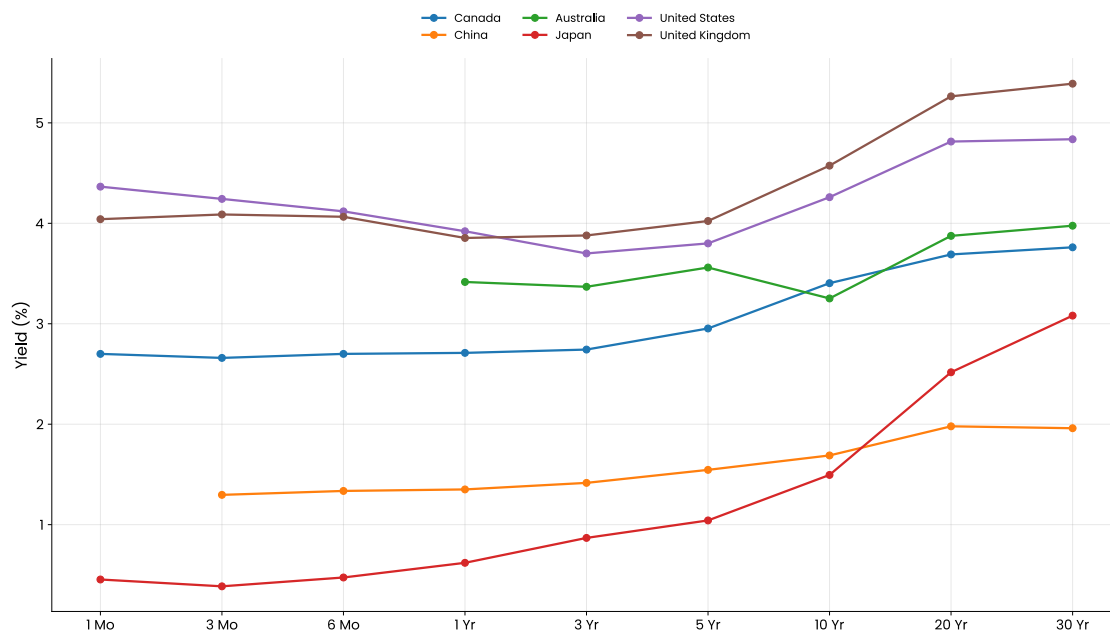
Q2 earnings season has played a key role in shaping investor expectations about the health of the corporate sector and its role in the broader macro landscape. In particular, earnings reports from the

US tech majors—the so-called “Magnificent Seven”—have provided meaningful insight into capital expenditure plans, inventory levels, pricing power, and labor absorption capacity. While full earnings data was not detailed in this window, commentary from corporate guidance and forward-looking statements suggested a soft but not dire outlook. **Retail and industrial firms alike noted persistent input cost pressures—especially in categories exposed to tariffs—but also displayed optimism about pricing power and downstream demand resilience.**

Construction spending, however, contracted by 0.4% in June, with residential spending falling 0.7%. That’s consistent with elevated mortgage rates and a slowing housing market. However, mortgage applications did see a 3.1% rebound in the August 1 week, possibly reflecting a minor pullback in rates. This points to tentative stabilization in housing-related demand but also to a very rate-sensitive segment of the economy. Corporate inventory data also bears watching. Wholesale inventories rose 0.2% in June, retail inventories by 0.3%, largely driven by motor vehicles. However, any inventory build without corresponding final demand pickup could imply future production slowdowns, or worse, mark-down-driven profit margin compression.

The Fed’s balance sheet continues to decline, with the week of July 31 showing a \$15.137 billion drop, mostly due to a reduction in MBS (mortgage-backed securities) holdings. The cumulative balance sheet drawdown has now reached \$2.15 trillion since June 2022. The implications for liquidity are significant—especially when juxtaposed with weak auction performance in the US Treasury market. The 10-year and 30-year bond auctions in early August were poorly received, suggesting growing investor caution amid uncertain inflation outlooks and concerns over Fed independence. The weak bid-cover ratios indicate a market reluctant to commit capital to long-dated US debt, even as inflation seems to be moderating. This raises the risk of higher long-end yields, which would tighten financial conditions further.

Figure 5: Yield Curves of Major Global Economies



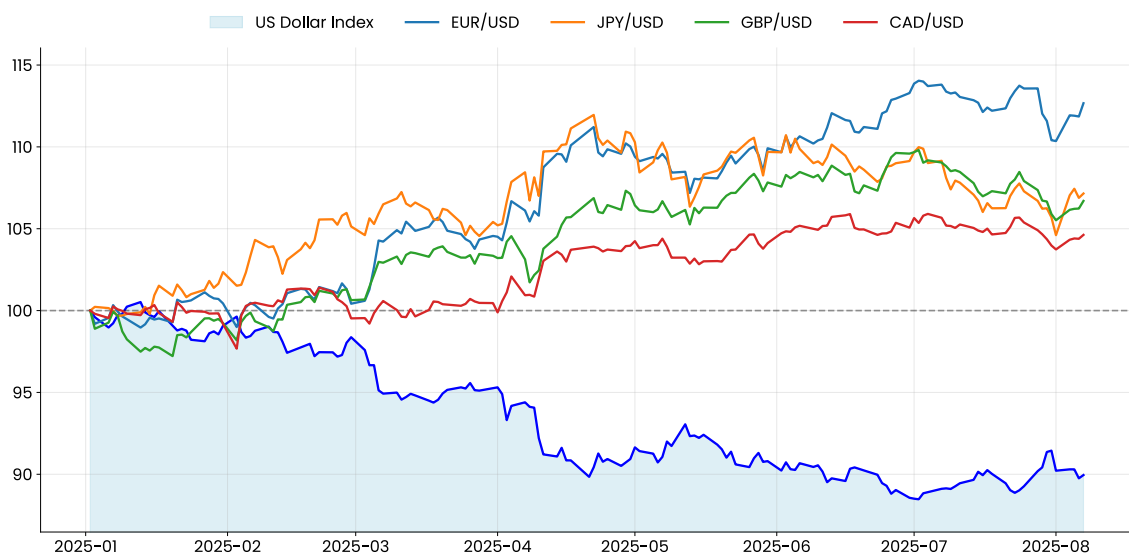
Source: Data sourced from Yahoo! Finance as on July 28, 2025.

Inflation, Credit, and the Fragility of Financial Conditions

Despite growing fears of economic slowdown, inflationary risks remain present and asymmetrically distributed. **The PCE deflator rose by 0.3% in June, and the core PCE was up 2.8% YoY. Tariffs remain a structural risk to disinflation: input costs rose in July due to renewed levies, and final selling prices also moved higher.** Businesses report being able to pass on these costs for now, but that power may diminish if demand falters.

Consumer sentiment remains fragile. **Although there was a slight improvement in July, year-ahead inflation expectations remain elevated at 4.5%, and consumer credit growth is beginning to slow.** Notably, revolving credit—mostly credit card balances—declined, hinting at tighter household budgets. This could lead to a feedback loop of weaker consumption and weaker earnings, even as inflation sticks above target.

Figure 6: Major Currencies Continue to Strengthen Amid Weakening Dollar Index



Source: Data sourced from Yahoo! Finance as on July 28, 2025.

One emerging area of concern is the increasing divergence between nominal GDP and long-term rates. As inflation expectations anchor higher, and productivity growth falters, real rates could remain elevated despite nominal rate cuts—further weighing on growth-sensitive assets. The Treasury market’s behavior corroborates this. **On August 6, the 10-year note auction saw a bid-cover ratio of just 2.35, and a high yield of 4.255%. The market is sending a message: it expects more inflation volatility and demands compensation for holding longer-duration risk.** Meanwhile, unit labor cost data remains a mixed signal. While productivity rose in Q2, unit labor costs still represent an inflationary overhang. This keeps the Fed in a bind—it cannot cut rates too quickly, yet economic softness is already feeding through hiring, investment, and inventory cycles.

Central Bank Signals: Policy Calibration Under Pressure

The clearest takeaway from central bank communication in this period is that policy decisions are now data-dependent and time-inconsistent. The Federal Reserve’s messaging has turned more dovish—San

Francisco Fed President Mary Daly hinted at a September cut, and markets are now pricing a 90% probability of such a move. Futures markets also show a 60% chance of a second cut in October, suggesting a steep shift in expectations. Fed officials have emphasized that their actions will depend on forward-looking inflation and employment data. At the same time, concerns around the Fed's balance sheet, its independence, and its ability to navigate fiscal-monetary interaction risks are gaining traction in investor circles.

Globally, the picture is similar. The Reserve Bank of India has paused, but with a dovish tilt. The Bank of Canada held at 2.75% while projecting a pick-up in H2 growth but flagged tariff-related uncertainty. The Bank of England cut rates, citing confidence in the disinflation trajectory, though wage dynamics remain a concern. In emerging Asia, the PBoC and the Bank of Korea appear poised to maintain an easing bias. Taiwan's central bank kept its rate at 2.00%, and officials noted that food-price-driven CPI pressures (from weather-related supply shocks) are likely to moderate into year-end. **The macro implication is clear: monetary authorities are navigating a path with narrow policy bandwidth.** Too early a cut could re-ignite inflation, while too late a response risks deepening cyclical slowdowns. Investors, meanwhile, are recalibrating forward yields and credit risk premiums accordingly.

Sectoral and Regional Divergences

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While the global macro landscape has become increasingly driven by broad forces—like monetary policy normalization, trade tensions, and inflation expectations—sectoral trends and regional divergences are now playing an outsized role in shaping the trajectory of economic activity. The patchiness of the data across different geographies and industries highlights not only the fragility of the global recovery but also the asymmetric transmission of shocks, policies, and pricing power across the macroeconomy.

Industry Trends: Manufacturing Weakness vs. Services Resilience

In the developed world, the manufacturing sector continues to struggle with contractionary conditions. The US ISM Manufacturing Index dipped to 48.0 in July, firmly in contraction territory. New orders remained stagnant, and export orders declined, both of which reflect an erosion of external demand amid a backdrop of tariff-induced uncertainty and tighter financial conditions. Input costs rose due to the trade measures, yet firms continued to raise output prices, reflecting persistent inflation pass-through in the supply chain.

Globally, the JP Morgan Global Manufacturing PMI echoed similar sentiments. It declined to 49.7 in July, marking the fourth month of contraction and underlining the synchronized weakness in global goods production. This aligns with data out of Germany, where factory orders fell 1.0% in June, dragged down by weakness in transport equipment and metals. **While domestic orders showed resilience (+2.2%), the broader trend reveals a heavy dependence on episodic, high-value export orders—raising concerns about demand sustainability.** In contrast, services have continued to show moderate strength. In the US, the ISM Services Index for July dipped to 50.1, a sign of slowing but still positive momentum. However, the employment component contracted for the fourth time in five months, suggesting that service

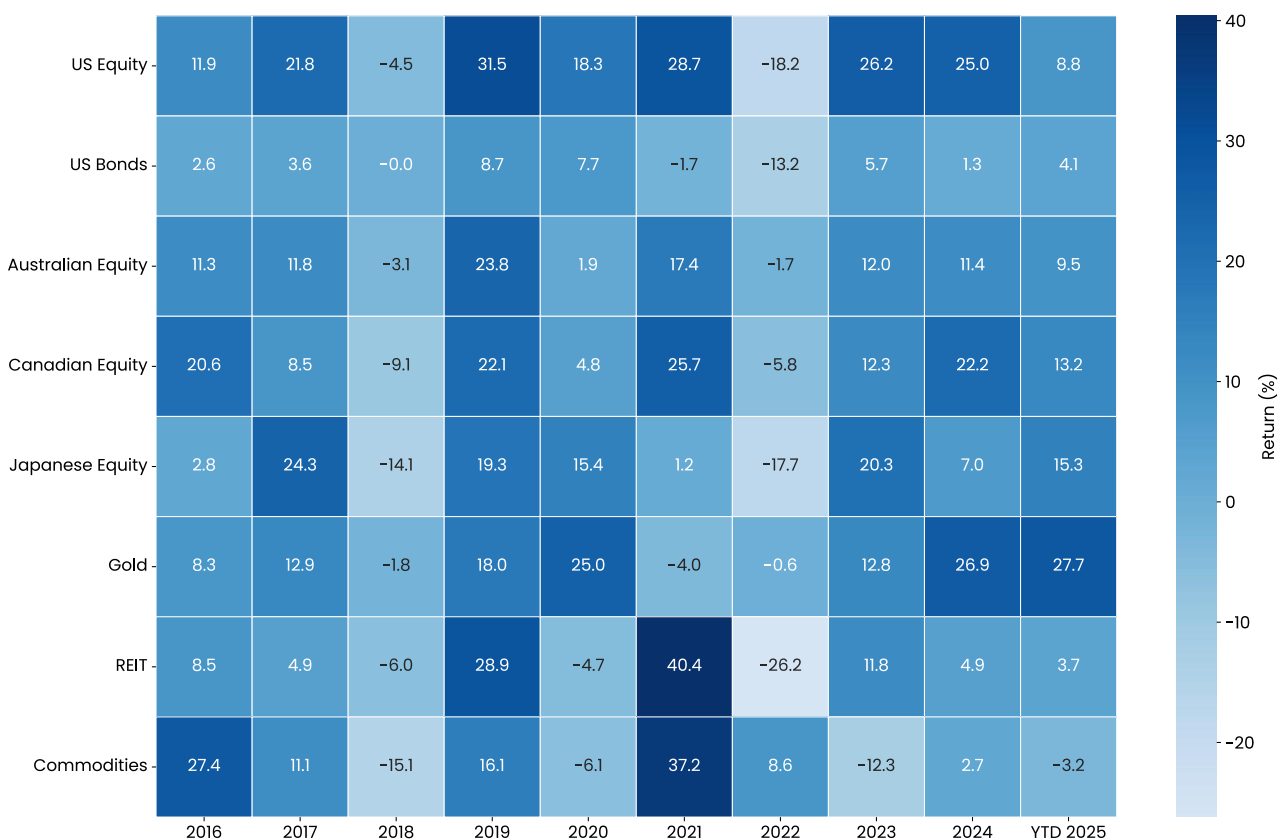
sector job creation is plateauing. Globally, the Composite PMI held at 52.4, pointing to modest expansion. The divergence between goods and services reflects post-COVID consumer behavior, where demand has shifted more toward experiences and less toward durable goods.

India stands out as an exception in both categories. The Indian manufacturing PMI surged to 59.1 in July, a 16-month high, bolstered by strong new orders and resilient output. **The services PMI also showed solid growth.** This indicates that India's domestic demand engine is still running hot and may partially offset global drags. Conversely, France's manufacturing PMI fell to 48.2, while services activity contracted again, suggesting that the core euro area economy continues to underperform.

Regional Spotlights: From Asia's Divergence to Europe's Soft Patch

China's economy is showing signs of stabilization, but momentum remains tepid. **Retail sales rose 1.5% in June, the fastest since July 2023, but analysts believe this may have been a reflection of front-loaded purchases in view of the US tariff deadline.** On the export front, China's merchandise trade surplus narrowed in July, but exports to Southeast Asia and Latin America increased, suggesting rerouting in response to US trade actions.

Figure 7: Global Asset Class Performance



Source: Data sourced from Yahoo! Finance as on July 28, 2025. US Equity – Vanguard 500 Index Fund (VFIAX), US Bonds – Vanguard Total Bond Market Index Fund (VBTLX), Australian Equity – Vanguard Australian Shares Index ETF (VAS.AX), Canadian Equity – Vanguard FTSE Canada All Cap Index ETF (VCN.TO), Japanese Equity – iShares MSCI Japan ETF (EWJ), Gold – iShares Gold Trust (IAU), REIT – Vanguard Real Estate Index Fund (VGSLX), Commodities – S&P-GSCI Commodity Index Future (GD=F)

In Southeast Asia, Singapore's July PMI improved to 52.7—up from 51.0 in June—fueled by output and new orders, signaling moderate momentum in one of Asia's most trade-exposed economies. The Monetary Authority of Singapore (MAS) maintained its policy stance, citing confidence in macro stability. Inflation remained low at 0.6%, with full-year forecasts of 0.5–1.5%, giving the central bank flexibility to support growth if necessary.

In Europe, regional divergence is more acute. While Germany saw a brief recovery in retail sales (+1.0% MoM in June), other indicators such as factory orders and unemployment (steady at 6.3% with declining vacancies) point to deeper structural weakness. France showed better consumption resilience (0.3% GDP growth in Q2), but private sector confidence and PMI readings signal that the momentum may not last. In the UK, the data is mixed. House prices have regained some momentum, with 2.4% YoY growth in July, supported by slightly softer mortgage rates. However, the construction sector contracted sharply, with the PMI falling to 44.3, its worst reading in over five years. Labor market data points to high wage costs and weaker demand for new hires, suggesting a need for targeted fiscal or credit measures. **The Bank of England's rate cut in early August suggests growing concern about disinflation risks and a willingness to support fragile demand.**

Commodities, Agriculture, and Trade Corridors

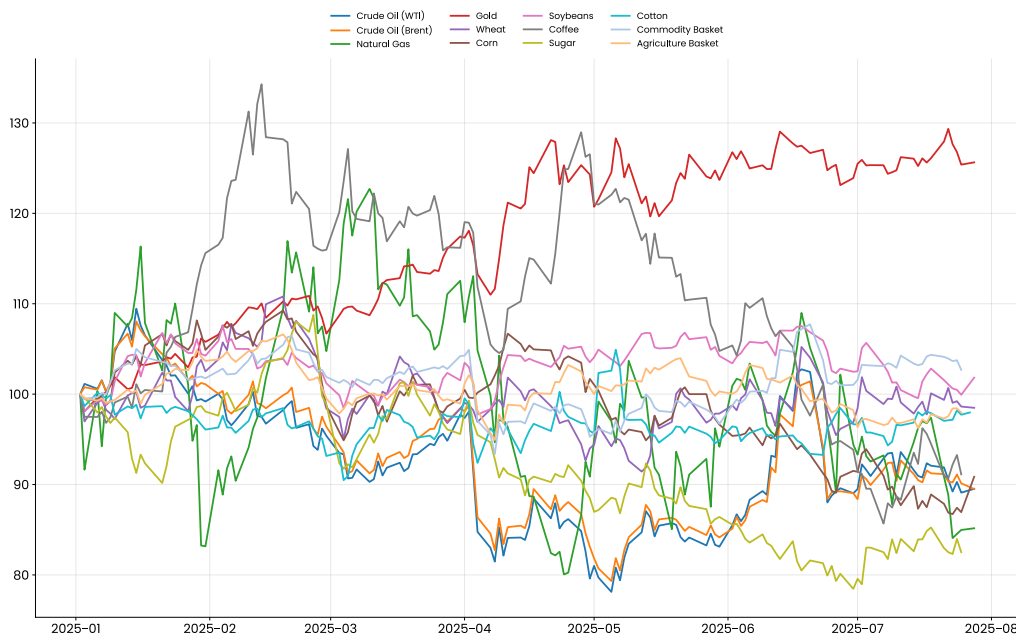
A major undercurrent shaping the global inflation and trade dynamics is the state of agricultural output and commodity logistics. **In the US, crop progress reports continue to reflect stress. Ratings for spring wheat, corn, and cotton have declined, raising concerns about yields, especially with the El Niño weather pattern extending longer than expected.** However, export inspections for soybeans, corn, and wheat are up over 11.1% YTD, supporting agricultural trade revenues.

The net effect of poor crop quality but strong export volumes is price stickiness in food commodities—a risk for both consumers and policymakers. In the long term, any decline in US agricultural output may push emerging markets to diversify away from traditional import corridors, potentially boosting exporters like Brazil or Ukraine. Meanwhile, **energy markets have reacted to supply-side signals. Crude oil inventories in the US fell by 3.0 million barrels, while gasoline demand dropped 2.2% YoY.** That mismatch between product supply and end-use demand reflects cautious mobility patterns and rising fuel substitution. However, product demand overall is up 1.6%, suggesting a broadening use case for refined products in commercial and industrial sectors.

Finally, the Baker Hughes Rig Count, a proxy for North American energy production capacity, is being closely watched for supply guidance. Any decline would tighten global oil markets further, potentially aggravating inflation expectations and putting central banks in a tighter spot.

Credit Markets, Consumer Behavior, and the Next Phase

Credit dynamics continue to reflect caution. While consumer credit growth remained in line with expectations in July, revolving credit declined, potentially hinting at reduced risk appetite or tighter household finances. **On the corporate side, rising high-yield spreads and tepid issuance activity suggest a less accommodative environment for risk assets.** Mortgage data shows that modest dips in rates are providing some reprieve to housing demand, but the overall volume of new originations and refinancing remains below historical averages. Real estate-sensitive sectors, particularly in Europe and Canada, are bracing for further policy recalibration.

Figure 8: Gold Continues its Rally, Oil Prices Stabilizing After an Uptick


Source: Data sourced from Yahoo! Finance as on July 28, 2025.

Australia’s NAB Business Survey and Westpac Consumer Sentiment Index pointed to stability in July. However, the upcoming RBA Statement of Monetary Policy will be crucial in assessing the longevity of domestic demand. Rising consumer sentiment could bolster corporate earnings, but it also raises the risk of sticky inflation. In Italy, trade and CPI data imply latent inflation pressures, likely to influence ECB policy. While the CPI rose only modestly, wage expectations are adjusting upward, complicating the real interest rate path and creating challenges for monetary authorities.

Closing Thoughts

The global economy is entering a phase where broad synchronization is giving way to divergence—between sectors, between regions, and even between asset classes. Manufacturing is in retreat, services are softening, and consumers are becoming more selective. Policy responses are necessarily fragmented: some central banks are pausing, others are easing, and a few are contemplating renewed tightening depending on their inflation trajectories.

What is clear is that this moment in the cycle is deeply transitional. With labor market cracks emerging, corporate signals flashing amber, and regional differences widening, investors, policymakers, and businesses alike must recalibrate expectations—about growth, inflation, policy, and risk.



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RCK Analytics Private Limited

www.rckanalytics.com

info@rckanalytics.com

Mobile +91 72194 74999

Phone: +91 (20) 4604 6669