Atakan Bakiskan, US Economist | atakan.bakiskan@berenberg.com | +44 20 3207 7873

NO COUNTRY FOR FAST GROWTH: AMERICA'S SLOWDOWN

Berenberg Macro View

How is the US economy faring under President Donald Trump? One year ago, the data did not allow us to come up with a clear verdict. Although his "liberation day" tariffs had triggered a large slump in business hiring and investment plans by injecting a massive dose of uncertainty last April, his subsequent reversal helped sentiment to recover somewhat. But nearly a year and a half into Trump's second presidency, his impact on the economy is -- in most cases – getting clearer.

Upon returning to office in January 2025, Trump inherited an exceptionally strong economy -- one that had stayed resilient through the most aggressive Fed tightening cycle since the 1980s; one that nearly every market economist forecast to slide into recession but that continued to expand. The economy even broke traditional business cycle metrics and defied traditional leading indicators such as the Conference Board Leading Economic Index and the inverted yield curve. The post-pandemic surge in immigration, fiscal support and COVID stimulus checks, and investments into artificial intelligence (AI) helped the now-$32 trillion US economy to largely shrug off the negative impact of elevated interest rates. To this day, investment in AI is at full speed (not very sensitive to rates or tariffs, as capital continues to flow into what is seen as the "next big thing") -- with Big Tech alone poised to spend nearly $700 billion this year in capex (around 2% of US GDP). Fiscal support, though not as large as the $5 trillion "helicopter money" deployed through stimulus cheques during and shortly after the pandemic, is still expansionary in 2026. Trump's "One Big Beautiful Bill" of 2025 is poised to add close to a full percentage point to growth this year. No tax on overtime income and tips, as well as the extension and expansion of full expensing for new capital investments and factory construction, will likely expand both the supply and demand sides of the economy. Not to mention that households have also enjoyed additional tax refunds, as some provisions in the Trump megabill are retroactive -- a good thing that they happen to coincide with the Iran conflict; otherwise, higher prices at the pump would hurt US consumers even more.

Amid a surge in petrol prices caused by the closure of the Strait of Hormuz, the University of Michigan's measure of consumer sentiment has nosedived to 49.8 in April. This is the worst reading in the last 74 years -- worse than the summer of 2022 when inflation was running at 9% yoy and worse than the winter of 2010 when the unemployment rate was at 10% (compared to 4.3% now). And this is despite the fact that consumer balance sheets are strong by historical standards. The debt-to-income ratio, at 87%, has been on a gradual decline since the 2007 peak of 129%. Similarly, the debt-service ratio (at 5.4 as of Q4 2025) has been essentially flat since 2012, and overall delinquency rates are only a tad higher than pre-pandemic levels (the percent of balances that are 30+ days delinquent stands at 5.6% compared to 4.6% in 2018).

How can households have dry wallets when their exposure to an equity market that is booming courtesy of the bets on artificial intelligence (AI) is at record highs? They now have more than 30% of their financial assets in stocks (the share is close to 50% for those in the top income decile). As the equity market continues to post strong gains, consumers continue to increase their spending. Thanks to this "wealth effect," consumers are spending more than they earn -- personal income excluding transfer payments is only up 0.5% yoy (after adjusting for inflation), while consumer spending has risen 2.5% since this time last year. But the savings rate (now at 4%, down from 5% when Trump first took office) can only fall so much. High-income consumers are doing the heavy lifting in consumption. The 70% of US GDP that is consumption now relies more on spending by wealthy households, and their spending depends heavily on gains in the equity market. This dependence exposes the US economy to a major risk. A sharp equity market correction could push the US toward a recession potentially more severe than the downturn after the dot-com bubble burst. Unlike in 2000 and 2001, when the US ran a budget surplus, it now runs deficits of around 6% and lacks the fiscal space to fight a downturn. Automatic stabilizers alone (the tax and spending shifts that occur as the economy recedes) would push US deficits to about 8% in the event of a recession. The next crisis, when it occurs, could be a challenging one.

Fiscal support and investment in AI will support growth this year, but what is missing from the US economy -- the nation of immigrants -- is the inflow of foreign talent. After welcoming nearly 3 million immigrants in 2023 and 2024, net immigration into the US fell to merely around 100k last year. This year, it will likely be similar to 2025 with a clear risk that it might even be negative. The Trump administration's restrictive immigration policies have resulted in a drought in labour supply. The 150-200k nonfarm payroll prints that we once got used to post-pandemic are now in the rear-view mirror. With constrained labour supply, the US economy only really needs to add around 10-20k jobs for the unemployment rate to stay stable. Deportations are on the rise, arrests by ICE are averaging around 30k per month -- well above 4-5k per month four years ago -- and encounters at the southern border have fallen sharply, from around 250k per month in the fall of 2023 to now around 10k. Last year, undocumented immigrants accounted for most of the decline in population growth. The Dallas Fed estimates that this resulted in nearly a full percentage point deduction in real GDP growth. This year, in addition to far less undocumented immigration, the inflow of international students and workers will also decline substantially as Trump signed a proclamation last September requiring a $100k application fee to obtain an H-1B visa (a US work visa for skilled foreign professionals). We see this as a major blunder. Between 1990 and 2010, H-1B holders accounted for 30% to 50% of all innovations behind U.S. productivity growth -- that is remarkable, considering that by 2000 the US had only a little over 350k H-1B visa holders (around 0.1% of the population). Putting a hard stop on immigration, documented or undocumented, is crimping US potential growth.

For the first time since the 1918 Spanish Flu, the World War II, and the COVID-19 pandemic, the US resident working-age population may decline on a year-over-year basis in 2026. In addition, the anti-growth impacts from tariffs, erosion of institutions, on-and-off policymaking and the resulting crippling uncertainty will also take their toll. As a result, we expect US growth to slow down to 1.8% in 2026 (after 2.8% in 2024 and 2.1% in 2025) and further to c1.5% in 2027 and 2028. Whereas trend growth in the US used to be around 2%, Trump policies have now curtailed the sustainable growth rate to roughly 1.5%, in our view. Longer-term, the troubling fiscal outlook will also take its toll through higher financing costs. Even after accounting for tariff revenue, federal debt held by the public is on track to rise from its current level of 100% of GDP to 120% in less than a decade.

The hard cap on immigration will not only dent trend growth. It will also keep inflation sticky as it will drive renewed wage pressure in a tighter labour market. Through higher energy prices, the Iran conflict has already pushed inflation up from 2.4% yoy in February to 3.3% yoy in March. It might well prove transitory as oil prices normalize when the conflict eventually ends (the labour market is not tight enough for workers to demand wage increases that would trigger a wage-price spiral). But so too was post-pandemic inflation, according to the Fed at the time. One transitory shock after another -- and now inflation has been above the Fed's 2% target for the past five years. That said, under Kevin Warsh's new leadership, the Fed may still deliver a 25bp cut in June. But further cuts look unlikely, as the policy rate is not too far from officials' assessment of neutral and the labour market is not weak enough to push inflation into the back seat and justify additional easing.

Of course, the Fed only controls the short end of the yield curve. Where long-term rates end up depends on the bond market. Weak Fed credibility and political pressure to cut rates despite above-target inflation are a recipe for higher long-term inflation expectations. Continued threats to the Fed's independence could further raise the risk premium on US assets. Together, higher long-term inflation expectations and rising risk premia will probably keep long-term borrowing costs elevated -- even if the Fed cuts rates.