A Trump recession?

Sentiment indicators for the US economy have turned down recently. The aggressive and erratic economic policy of the Trump administration is unsettling many consumers and companies. We examine the risk of a US recession.

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Disruptive economic policy unsettles firms and consumers...

Donald Trump has set about implementing his election promises. Tariffs such as the 25% on auto imports announced this week are being aggressively used to decouple from foreign countries and bring production back to the US. At the same time, federal agencies are being ruthlessly restructured or dissolved to reduce the government's influence on the economy and society and to save money. This is weighing on the economy for a variety of reasons:

- There is currently no sign of a coordinated and consistent economic policy that sets a stable framework for trade and investment. On the contrary, tariff policy in particular is extremely erratic. Time and again, additional tariffs are imposed – including on close US allies – but in some cases they are suspended or postponed after only a few days.
- The markets had assumed that the new administration would first ease the economic burden by cutting taxes or deregulating, and only then would it tackle costly projects such as raising tariff walls. This order was apparently reversed.
- During Trump's first term in office, the government usually backtracked as soon as the financial markets came under pressure. Now, however, the government seems to be willing to accept price losses on the financial markets. For example, Treasury Secretary Bessent pointed out that corrections are normal and even healthy.

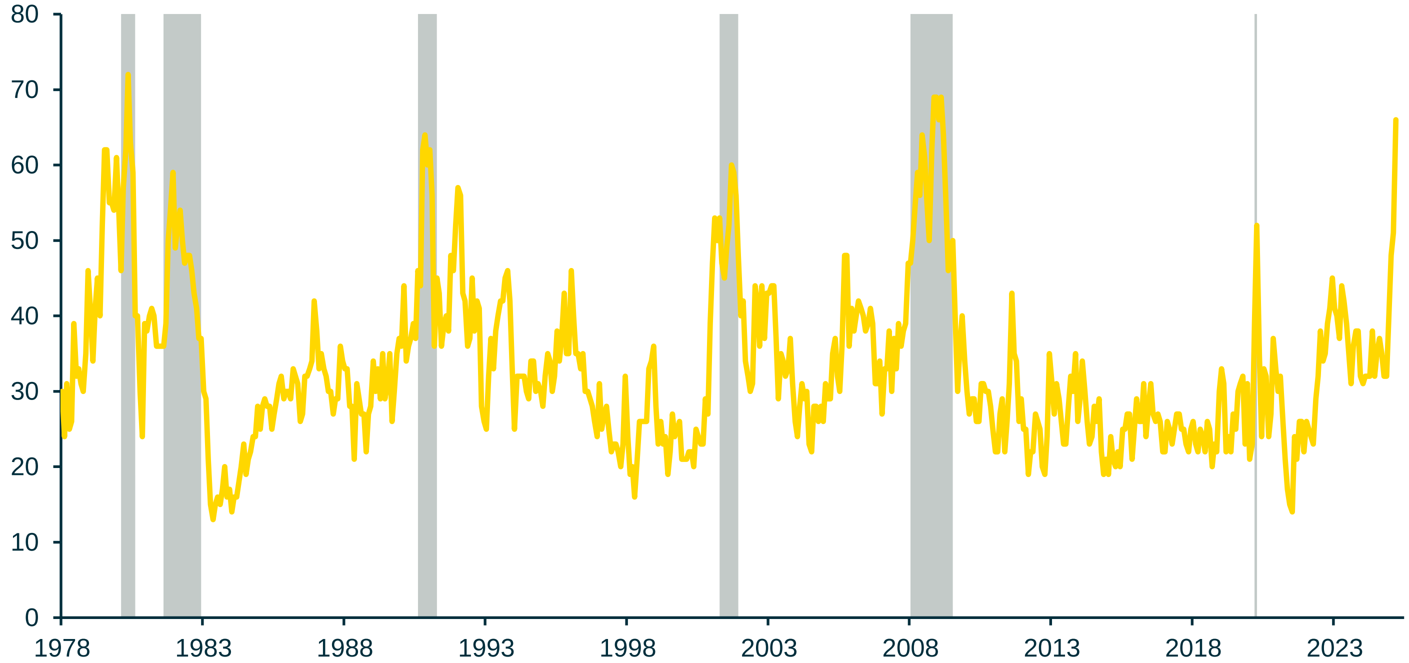
... and weighs on sentiment

As a result of these developments, economic policy uncertainty has increased massively (title chart). According to surveys, consumer sentiment has also deteriorated noticeably. The outlook for the labor market, for example, is being viewed much more pessimistically. In the University of Michigan's March survey, two-thirds of respondents expected unemployment to rise within a year. This share has doubled since Trump's re-election in November. In the past, a rise of this magnitude has typically been a sign of a recession (Chart 1).

One of Trump's recent TV interviews, in which he refused to rule out a recession, has caused additional unease. He said that the US was currently in a transition phase. It might take a while, but then everything would be great.

Chart 1 - Consumers fear for their jobs

University of Michigan's survey: share of those expecting unemployment to increase in the next year, monthly data in %. Grey-shaded areas: recessions as determined by the NBER



Source: NBER, S&P Global, Commerzbank Research

An uncertainty shock ...

A growing sense of insecurity is weighing on the economy. After all, companies prefer reliable framework conditions when they commit to long-term investment projects. In the current unclear situation, investments could therefore be postponed. The same applies to consumers who fear for their jobs. Expensive purchases – cars or apartments – are then likely to be postponed.

... to which the Fed will not react quickly

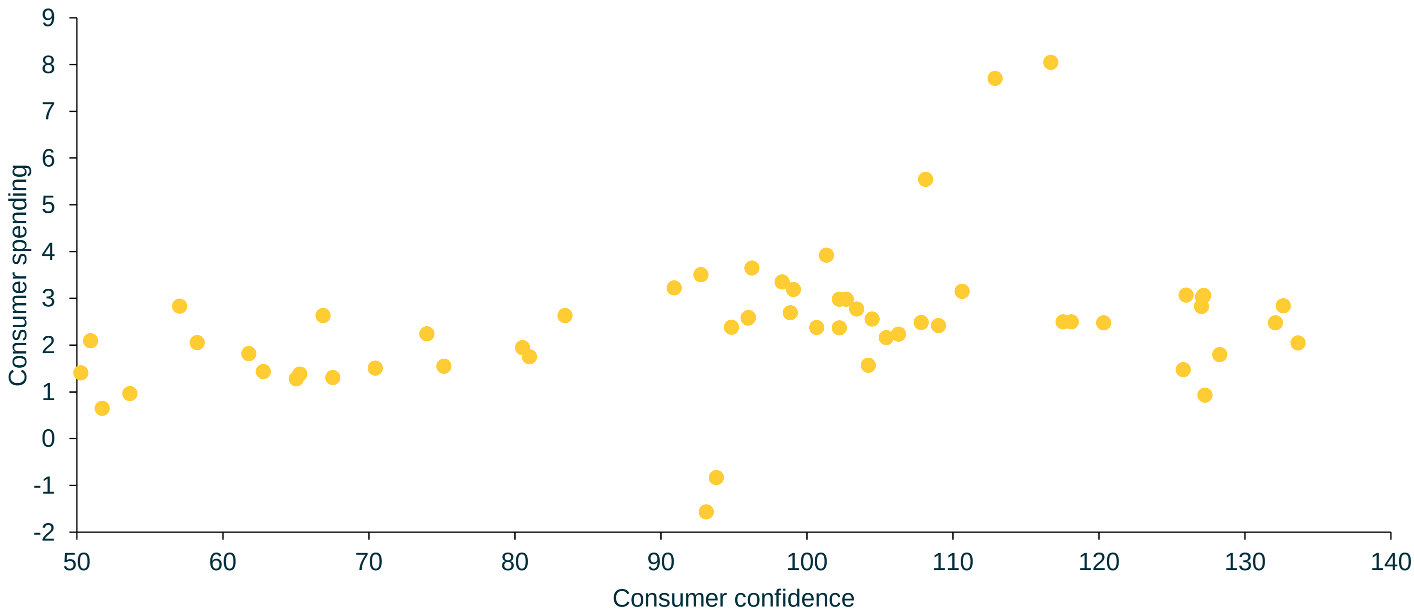
The Fed would normally respond to the significant increase in economic risks by lowering interest rates. At 4.5%, the upper bound of the fed funds target range, the key interest rate is still quite high. On first glance, therefore, there is ample room to cut. However, inflation is still well above the Fed's target of 2%. In addition, the potential for Trump's tariff plans to drive up prices has led to a noticeable increase in inflation expectations among private households. According to the University of Michigan survey, long-term inflation expectations rose to 3.9% in March, the highest level in thirty years. Stable inflation expectations are considered an essential prerequisite for keeping prices under control. Even if market-based inflation expectations have not yet shown a similarly strong increase, the combination of rising inflation expectations and a deteriorating labor market is a very unfavorable one for the Fed. Even if stagflation, as in the 1970s, still seems a long way off, the Fed is hardly in a position to cut interest rates quickly at the moment. For that to happen, economic pressure would have to increase further – and then the question is whether a loosening of monetary policy would come soon enough to prevent a downturn.

So far, a slump is more of a risk than a reality, ...

However, it is not clear that the current uncertainty is great enough to slow the economy noticeably or even trigger a recession. In the past, the correlation between sentiment – which is undoubtedly in the doldrums at the moment – and real economic activity was by no means close. Rather, with the exception of the pandemic, private consumption has expanded fairly steadily over the past 15 years at rates of around 2%, regardless of sentiment (Chart 2).

Chart 2 - Hardly any link between sentiment and actual spending

Consumer confidence (Conference Board, index 1985 = 100), real private consumer expenditures (year-omn-year change in %, extreme movements during pandemic cut off). Quarterly averages since 2010



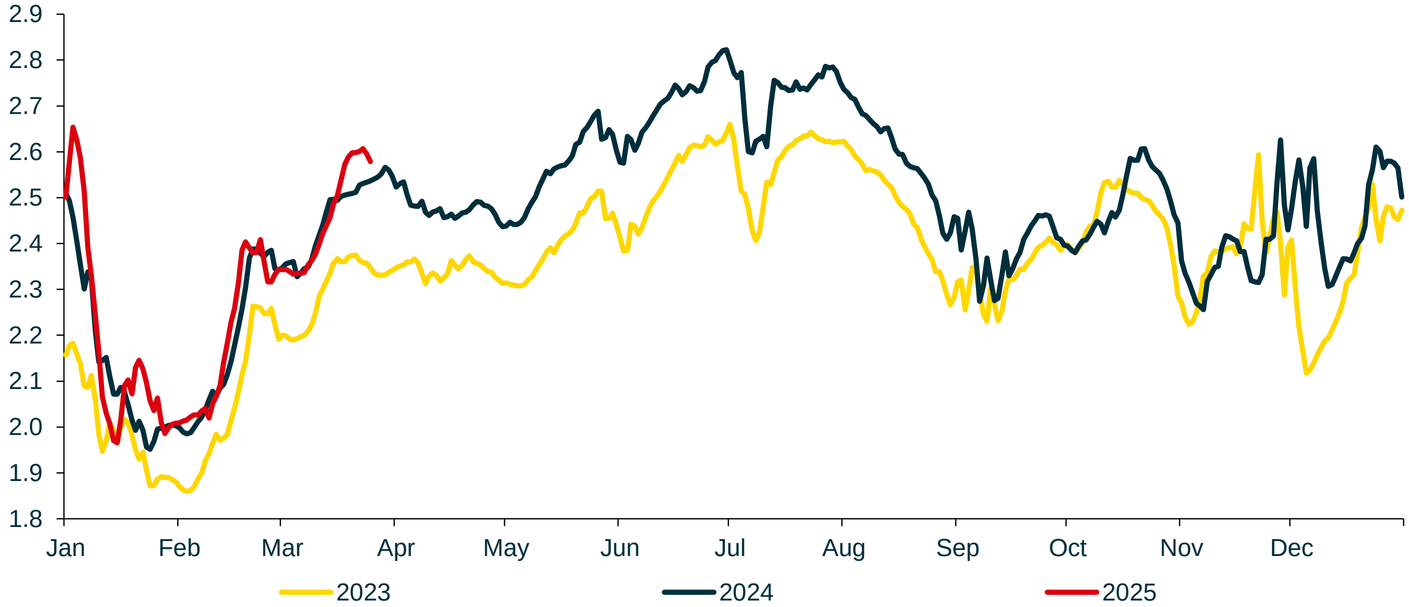
Source: BEA, Conference Board, S&P Global, Commerzbank Research

And a look at the “hard” data does not yet show a clear picture, especially since only a few figures are available for the period after Trump took office. One of the data points already available for February is retail sales. At first glance, the 0.2% increase over the previous month does not indicate any weakness. However, this small increase follows a 1.2% drop in January, which was probably partly due to the weather. When adjusted for price changes, retail sales actually performed somewhat worse. So far, though, it is too early to speak of a slump.

No comparable comprehensive data is available for service spending. However, there are individual data points for certain services such as movie theater visits and the number of airline passengers. While movie theater attendance depends heavily on individual box office hits, the number of airline passengers appears to be a good economic indicator. This is because in a downturn, savings on this service would likely be made quite early. Even though the bosses of several US airlines recently complained about weak bookings, there are no signs of a slump here. Rather, air passenger numbers have so far remained at or above the 2024 level (Chart 3).

Chart 3 - Number of air passengers at or above 2024 level

TSA checkpoint travel numbers, 7-day moving average, in million



Source: TSA, Commerzbank Research

… also because labor market has been largely stable so far

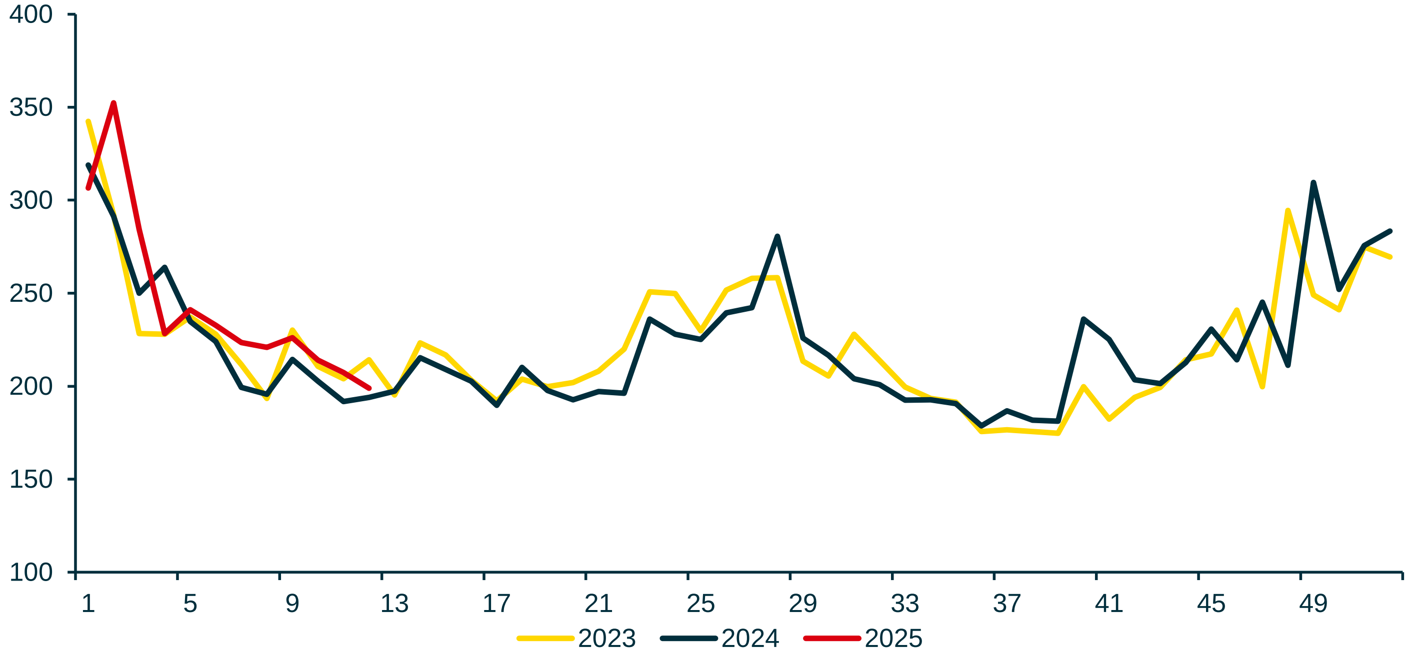
In addition, it is worth taking a look at the labor market, which has played a central role in the current upturn. Employment has risen every month since January 2021. Only before the pandemic had there been an even longer period of continuous job growth.

The most readily available data here are the weekly initial claims for unemployment benefits. These figures are hovering at the low level of the last two years (Chart 4). So here, too, there are no signs so far that companies are laying off more employees.

However, the fact that the employment report showed a significant increase in the number of people involuntarily working part-time is a cause for concern. Their number rose from 4.48 million to 4.94 million in February, the highest level since May 2021. It seems plausible that companies would reduce the working hours of employees before laying them off. However, this statistic is based on a survey of private households that is struggling with declining response rates, which is why it is considered less reliable. There was a similar jump last summer, but it proved to be short-lived. Accordingly, it remains to be seen whether these figures will be confirmed in the coming months. For an overview of the indicators that experience has shown to be particularly sensitive to economic cycles, see the box at the end.

Chart 4 - Initial claims for unemployment-related benefits: stable at a low level

Initial claims for unemployment-related benefits, not seasonally adjusted, calendar weeks 2022 - 2024, in thousands



Source: DOL, S&P Global, Commerzbank Research

Risk of recession on the rise

To sum up, the aggressive and erratic policy of the Trump administration has significantly increased the probability of a recession. We would currently estimate it at 30-35%, although a recession is still not our base case scenario. The political headwind could ease in the coming months. The recent congressional approval of funding the US government until September has averted a shutdown of government agencies. In addition, the outlines of reciprocal tariffs are to be announced on April 2, which would mean that significant parts of the tariff measures would then be on the table. This, too, should reduce uncertainty. And, most importantly, the announced major tax package could be approved in early summer. The announced deregulation measures could then also become more concrete. All of this could boost sentiment in the short term, even if the actual relief may not materialize until 2026.

The US economy is like a supertanker that cannot be easily diverted from its course, especially since the financial situation of companies and households still looks quite solid. Thus, a noticeable weakening of growth is probably the most likely scenario. Even if this spares the economy a recession, the unemployment rate is likely to rise gradually.

Box: What to watch out for

In the near future, it will be important to monitor the economic data for signs of an economic downturn. However, there is no *single* indicator that always clearly and accurately indicates a recession. After all, US recessions are very rare and often occur in the context of special situations, such as after the bursting of the real estate bubble in 2007 or the technology bubble in 2001, which is why different indicators sometimes send warning signals.

It therefore makes sense to look at a wide range of indicators for private consumption, private investment and the labor market:

- For **consumption**, these are in particular the retail sales figures already mentioned, as well as short-term indicators that are available in near real time, such as the number of airline passengers and restaurant visits.
- For **investments**, these would include orders for durable goods, purchases of heavy trucks, and figures from residential construction such as building permits, impending home purchases, and weekly mortgage applications.

- In the **labor market**, initial jobless claims tend to react quickly in a downturn. In addition, financial market data such as indicators of financing conditions are certainly of interest, even if, according to a bon mot, the stock market correctly predicted ten of the last five recessions.

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