

A CONFLICT-PRONE AND INCREASINGLY RISKY ENVIRONMENT



Lorenzo Codogno

Founder and Chief Economist | Lorenzo Codogno Macro Advisors Limited

☎: +44 (0) 758 3564410 | ☎: +44 (0) 20 8295 2291 | ✉: Lorenzo.Codogno@lc-ma.com | @lorenzocodogno, Skype: lcodogno

Visiting Professor in Practice | European Institute, London School of Economics and Political Science

5th floor, Centre Building, Houghton Street, London WC2A 2AE, United Kingdom |

✉: L.Codogno@lse.ac.uk

Visiting Professor | College of Europe

| Dijver 11, B-8000 Brugge, Belgium | ✉: Lorenzo.Codogno@coleurope.eu



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A conflict-prone and increasingly risky environment

- ◆ **Geopolitics:** An increasingly fragmented and conflict-prone world.
- ◆ **Trump's tariffs:** The impact on US growth and inflation, and on the EU.
- ◆ **US economy:** Tariffs vs fiscal stimulus.
- ◆ **Chinese economy:** No longer going for cheap exports.
- ◆ **Global finance & geopolitics:** Weaponisation and the network effect.
- ◆ **Eurozone economy:** A gradual economic recovery amid rising risks.
- ◆ **Monetary policy:** Has the ECB achieved price stability?
- ◆ **Public finances:** Is the Eurozone heading towards another debt crisis?
- ◆ **Sovereign ratings:** What is the outlook? What are the risks?

From trade uncertainty to geopolitical risk?

AND WAR?

FINANCIAL TIMES

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Opinion

A world without rules

America's Trump-led retreat from global leadership is tempting others to push their luck

SEPTEMBER 12, 2025 by The editorial board

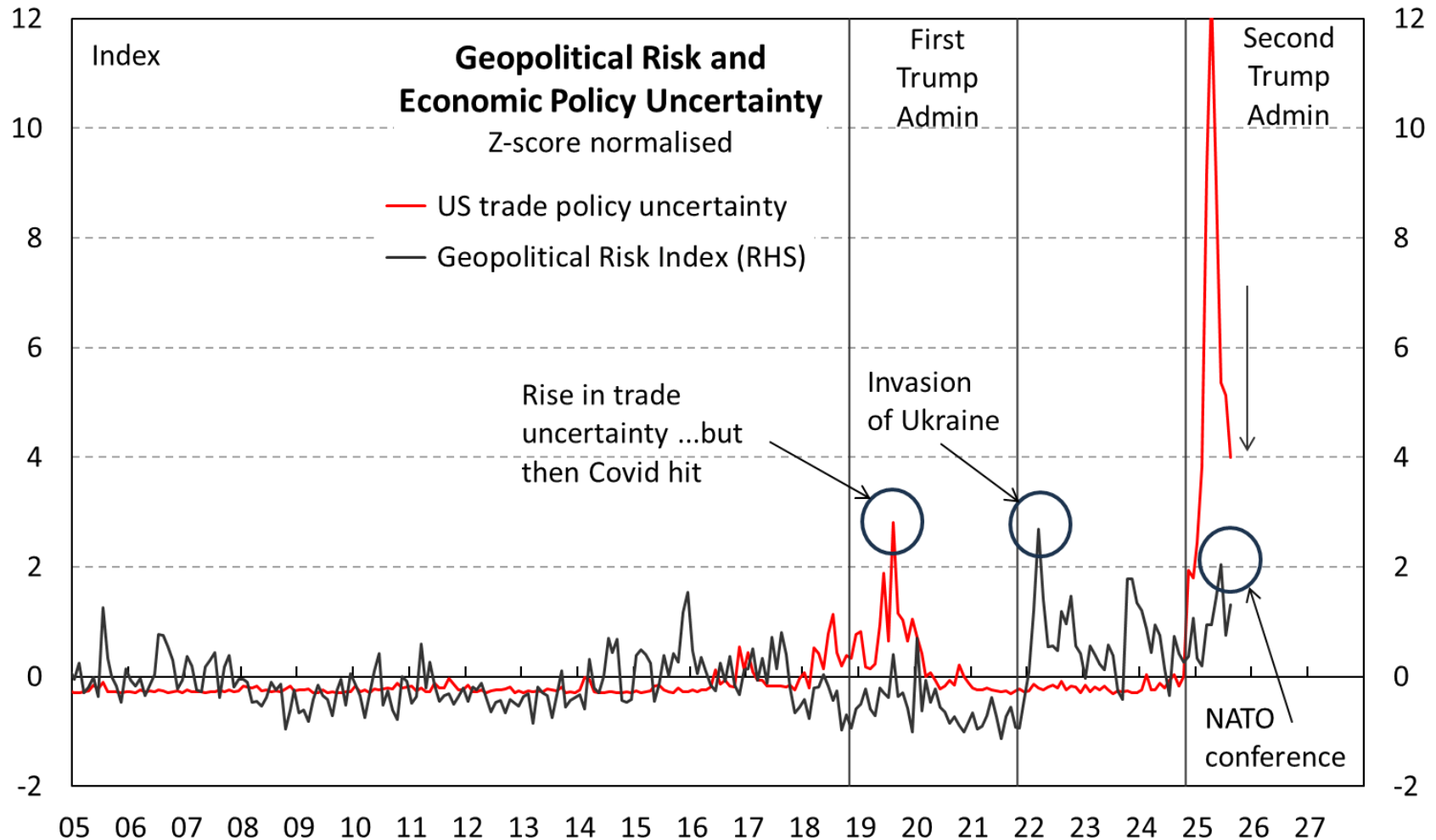
On Tuesday this week, Israel launched a missile strike on a building that was hosting Hamas officials in Qatar, a major non-Nato ally of the US — which is Israel's own staunchest ally. Just hours later, 19 Russian drones flew into Polish airspace, several of them shot down by Polish aircraft and Nato allies, in the most serious incursion into Nato territory since Russia's full-scale invasion of Ukraine in 2022. A few years ago, either incident would have seemed unthinkable. Together, they highlight how the accelerating US retreat under Donald Trump from its global policeman role is creating a no-rules world.



**Unstable
Conflict-prone
Riskier**

GEOPOLITICS

From trade uncertainty to geopolitical risk?



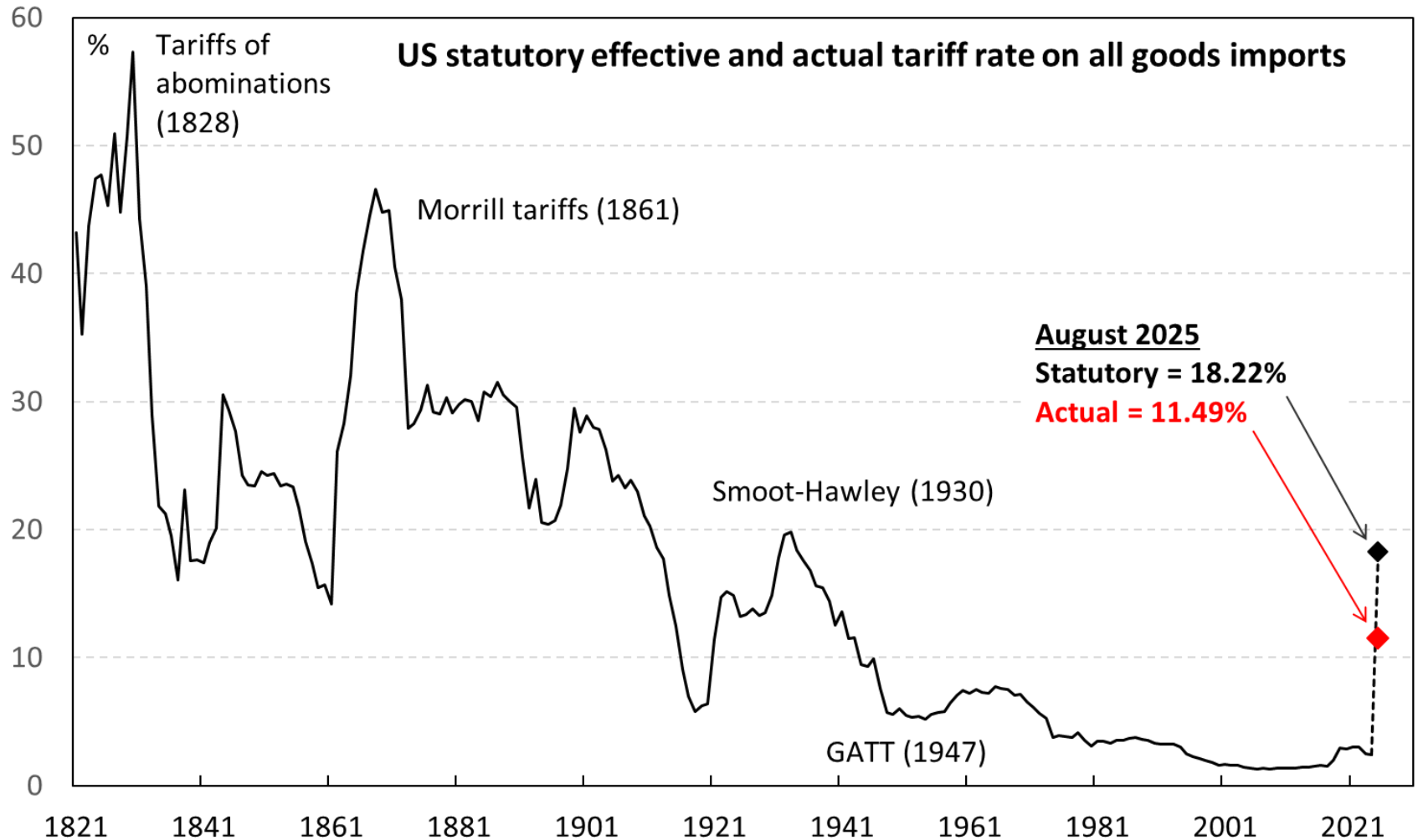
Source: "Measuring Economic Policy Uncertainty" by S.R.Baker, N.Bloom and S.J.Davis at www.PolicyUncertainty.com; current prices, GDP weight. "Measuring Geopolitical Risk" by Dario Caldara and Matteo Iacoviello at <https://www2.bc.edu/matteo-iacoviello/gpr.htm>.

Trump's hybrid trade war: Not just about tariffs

- ◆ **Politically motivated:** 50% on Brazil for “witch hunting” Bolsonaro.
- ◆ **Deportation link:** Freezing of \$70mn USAID funding for Colombia.
- ◆ **NATO:** Disengagement. Pressure to purchase US military equipment.
- ◆ **Quantity & price:** “Better deal on drug pricing” Merck & AstraZeneca.
- ◆ **FDI:** Hyundai battery factory: South Korean workers in chains.
- ◆ **Technological platforms:** G7. Quasi-monopolies leading to tensions.
- ◆ **Section 899:** Coming back? If tax systems are deemed discriminatory.
- ◆ **Financial system:** Weaponisation and fragmentation.
- ◆ **War:** Russian disturbing strategy.
- ◆ **It is about a money and power struggle, not rules or values.**

TRUMP'S TARIFFS

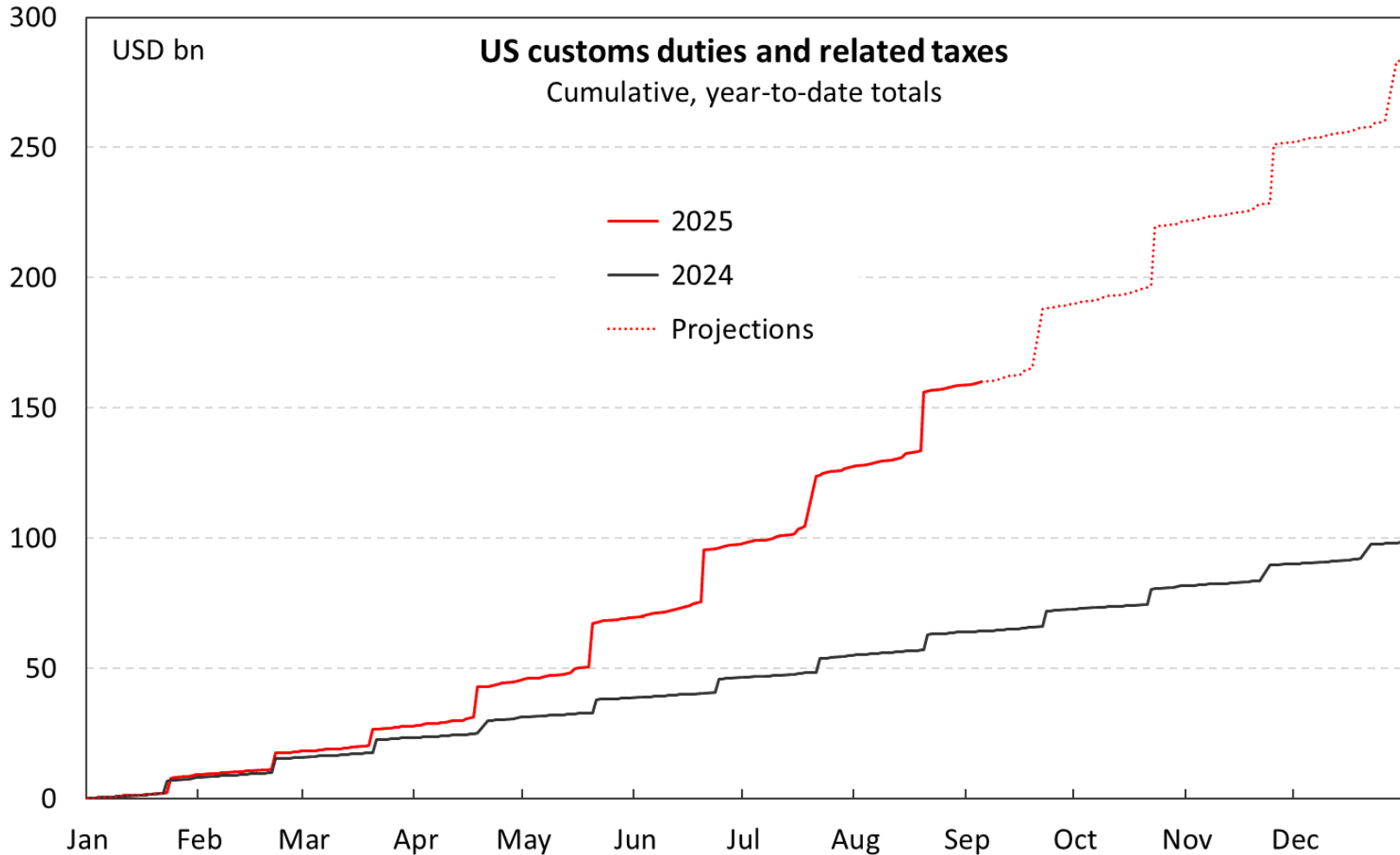
Actual tariff rate is substantially lower than the statutory one



Source: US Bureau of the Census, *Historical Statistics of the United States, 1789-1945*, US International Trade Commission, IMF, US Treasury Dept's Daily Treasury Statement, The Budget Lab Yale, LC-MA calculations.

TRUMP'S TARIFFS

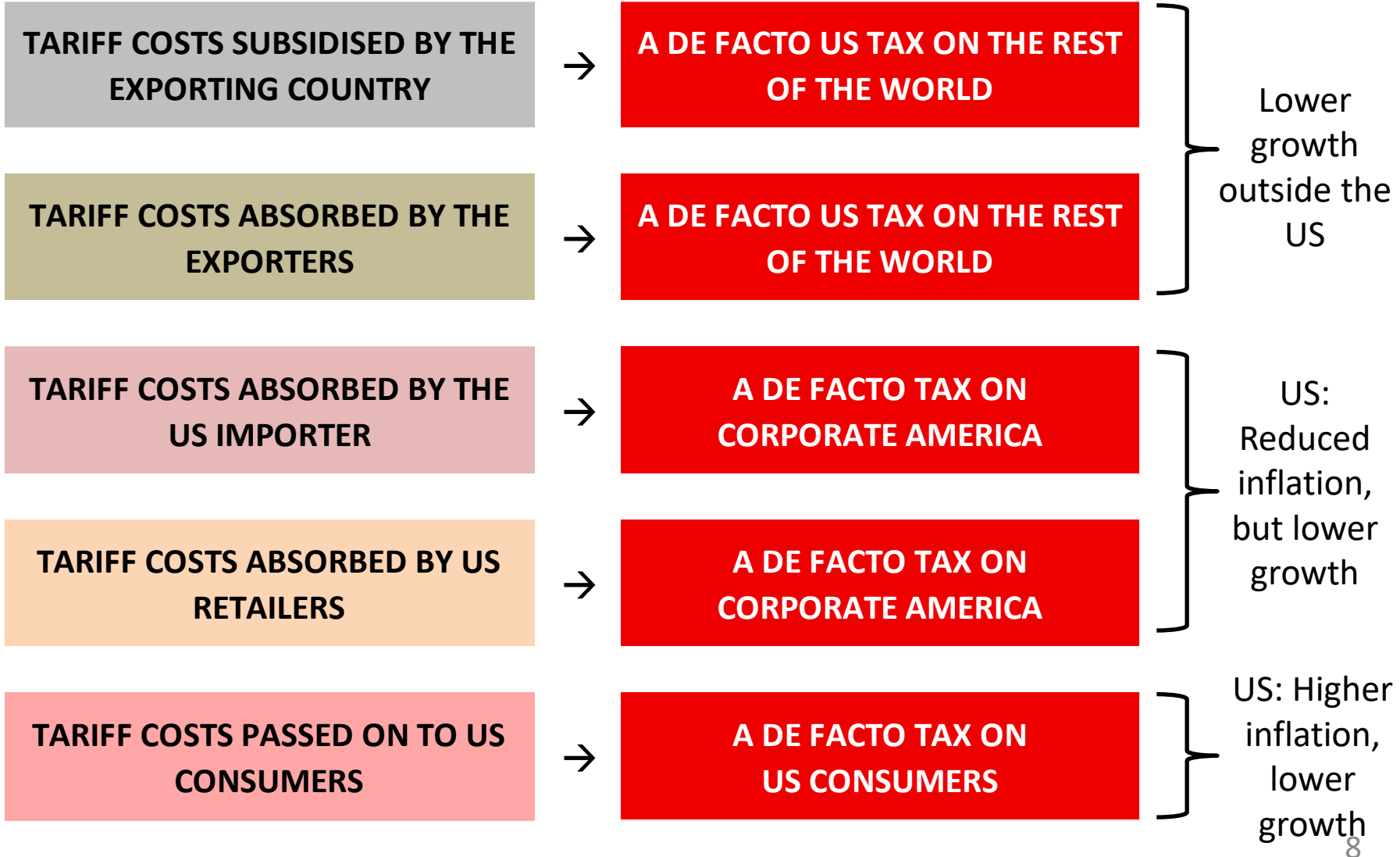
Treasury revenue (actual tariff rate) is what really matters



Source: US Treasury Department's Daily Treasury Statement, LC-MA calculations.

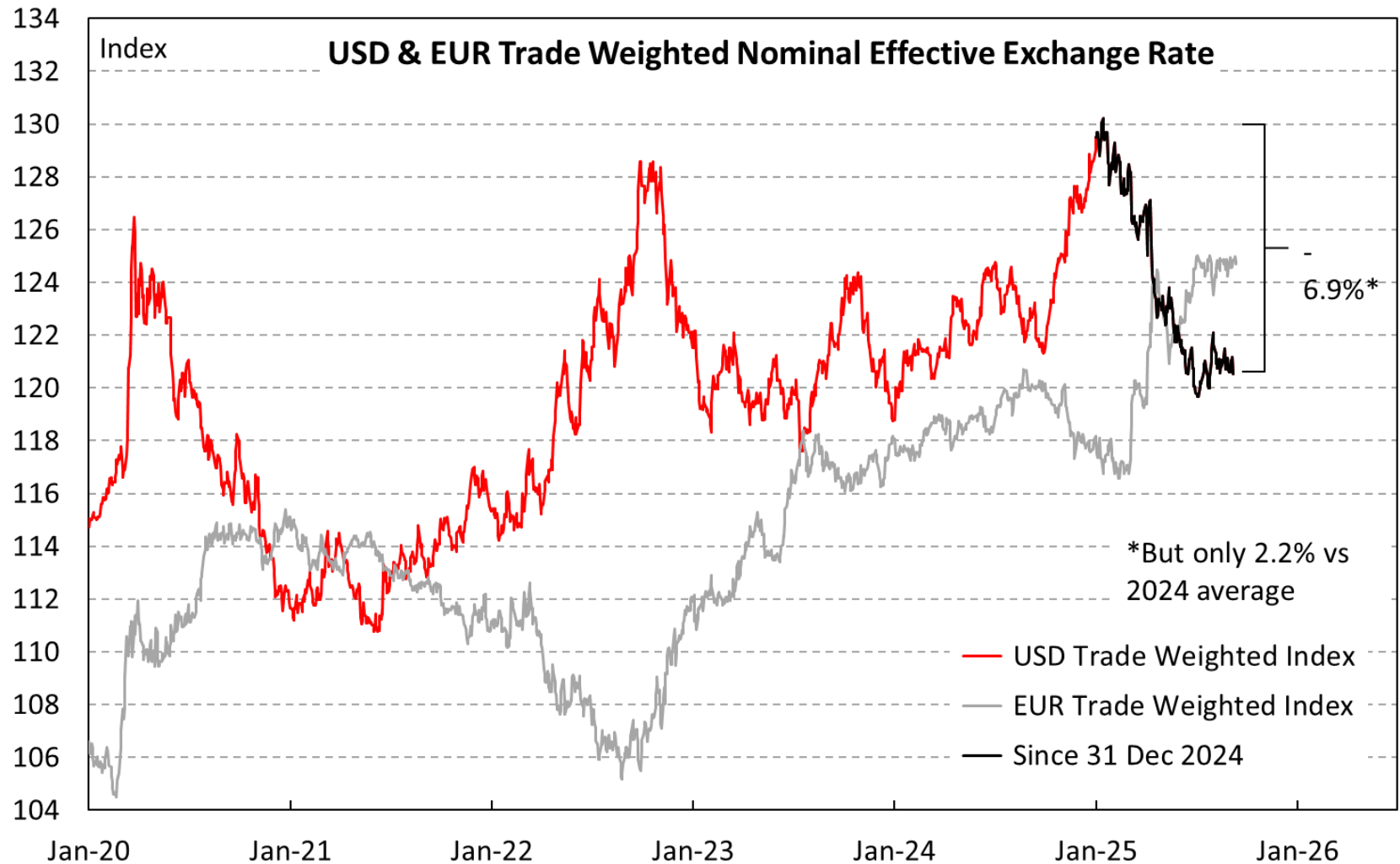
TRUMP'S TARIFFS

L-T= net loss for everyone. N-T= How will higher costs be split?



TRUMP'S TARIFFS

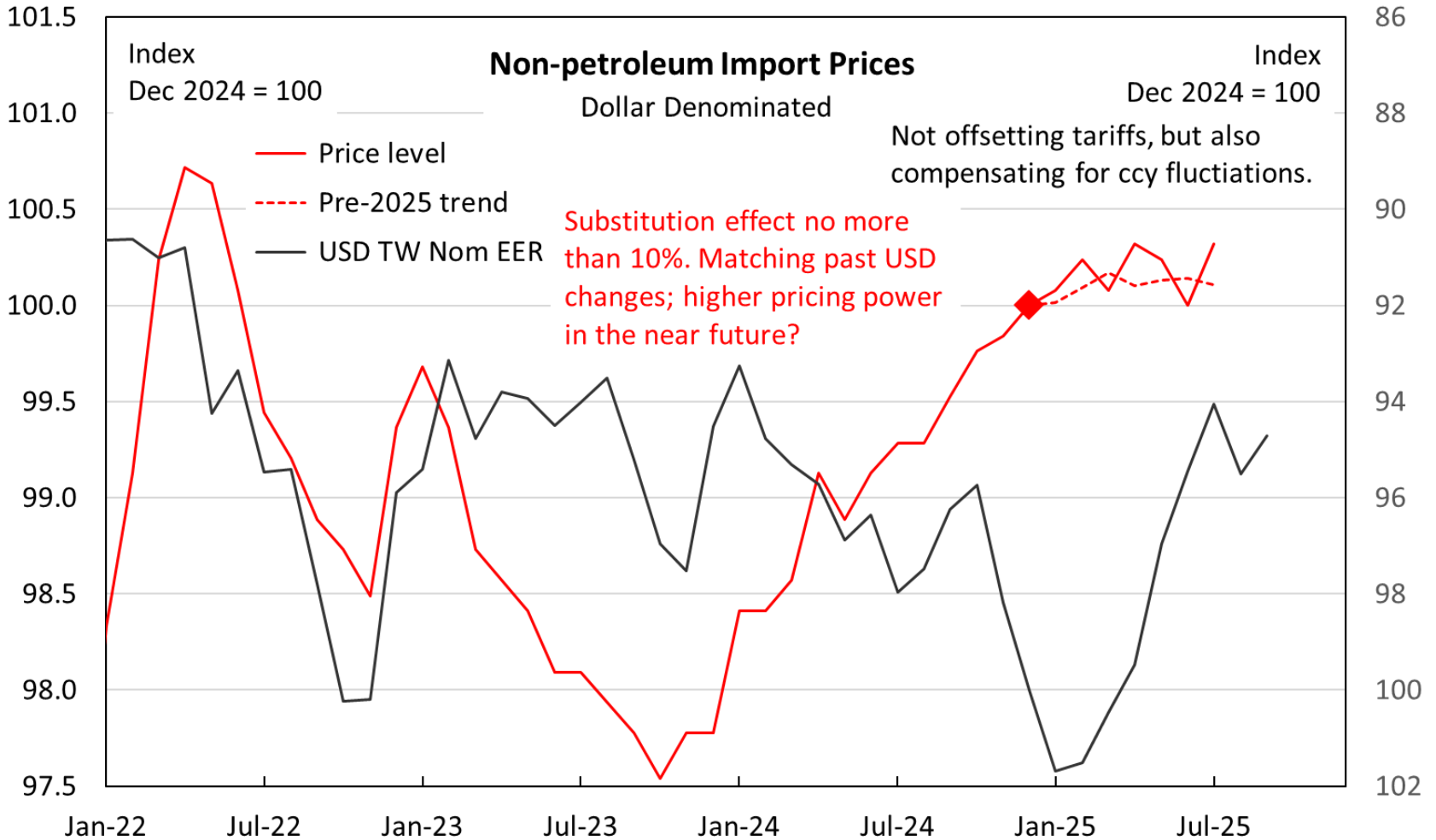
Is USD depreciation amplifying the price impact of tariffs?



Source: LSEG (Datastream), LC-MA calculations.

TRUMP'S TARIFFS

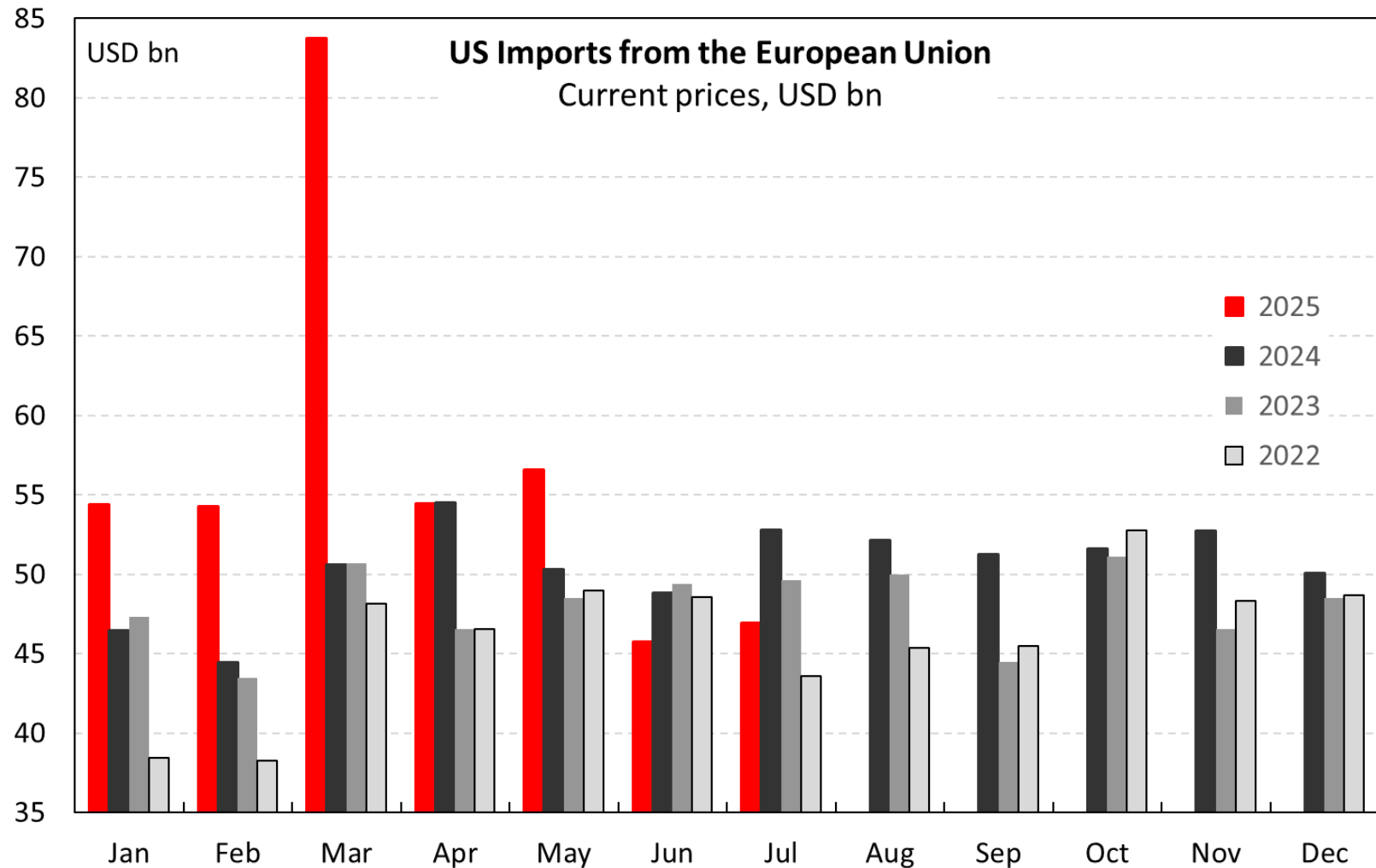
No sign exporters are changing prices significantly (in USD)



Source: LSEG (Datastream), Bureau of Labour Statistics, LC-MA calculations.

TRUMP'S TARIFFS

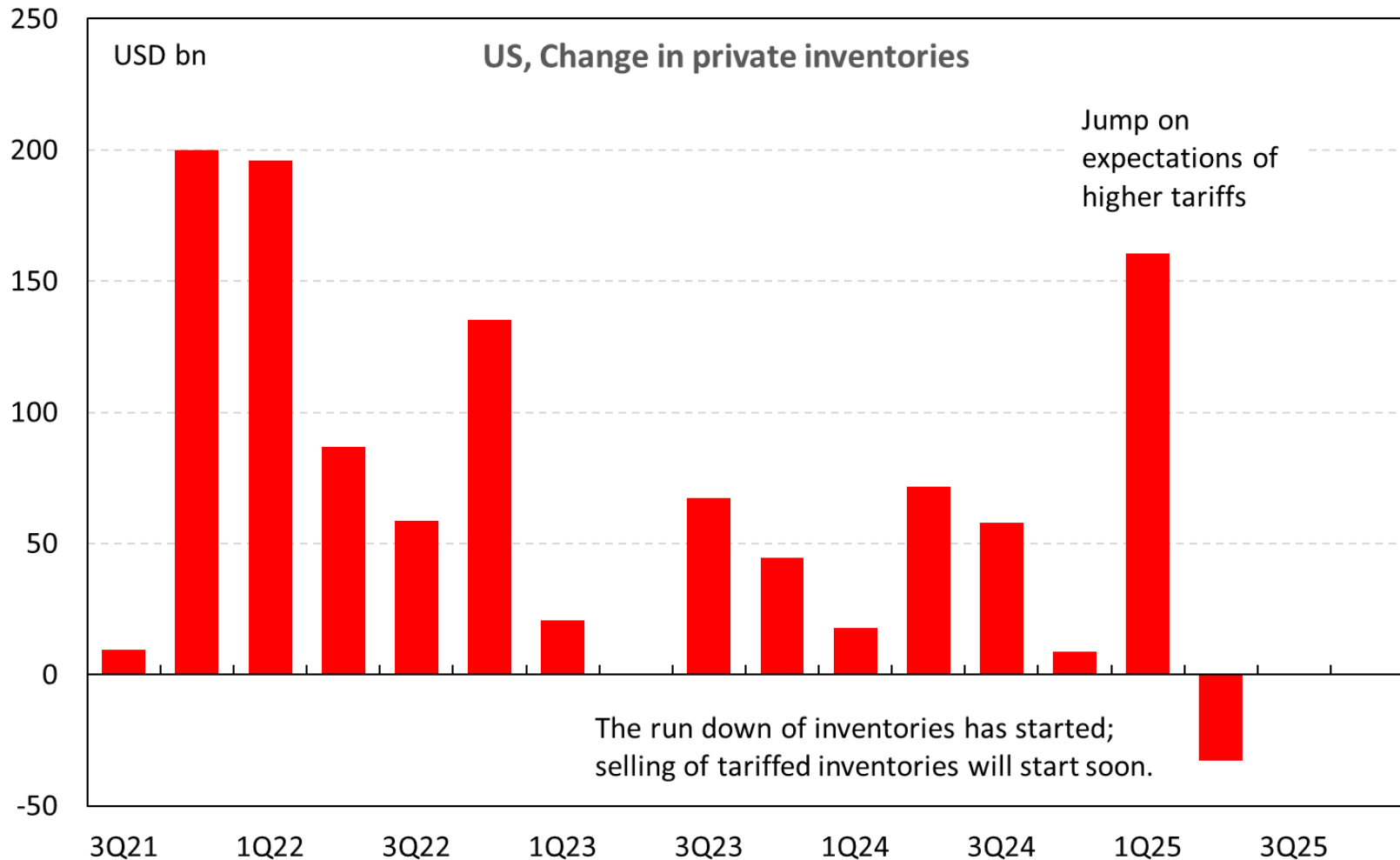
US imports from the EU are slowing but still well above 2024



Source: LSEG (Datastream), US Census Bureau, LC-MA calculations.

TRUMP'S TARIFFS

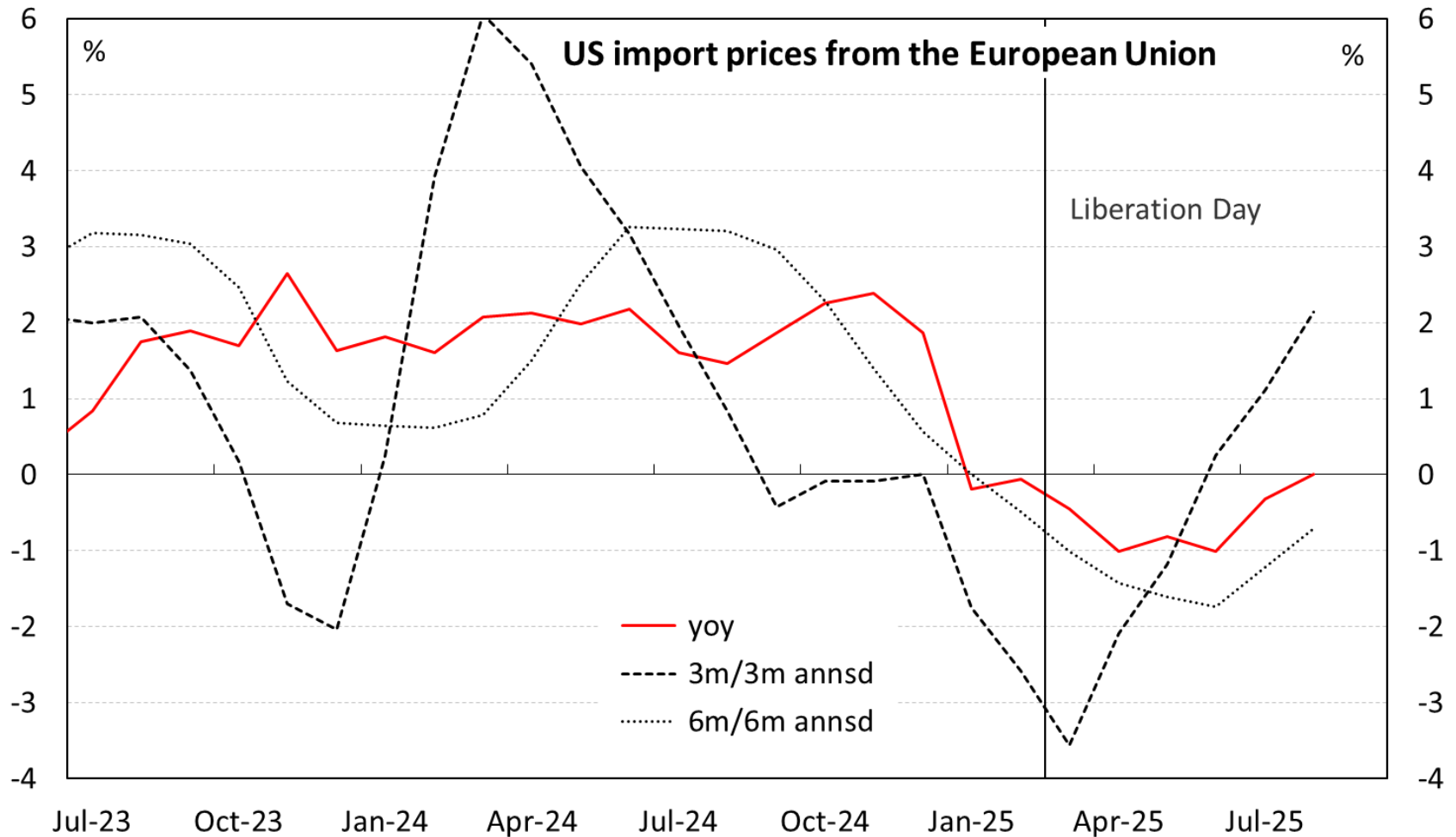
Frontloading allowed retailers to restrain price increases



Source: LSEG (Datastream), US Bureau of Economic Analysis, LC-MA calculations.

TRUMP'S TARIFFS

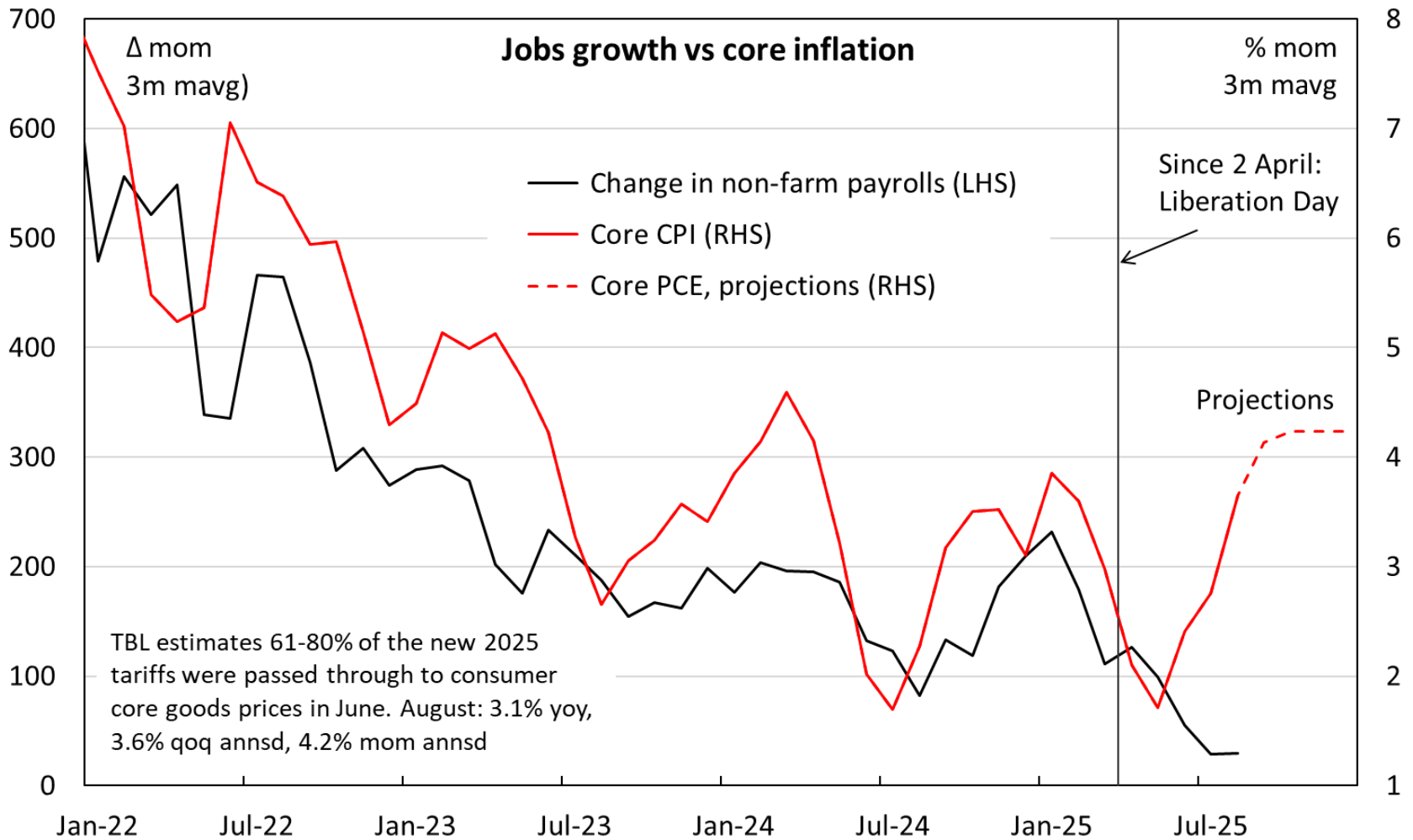
Import prices from the EU are rising not declining



Source: LSEG (Datastream), US Bureau of Labour Statistics, LC-MA calculations.

TRUMP'S TARIFFS

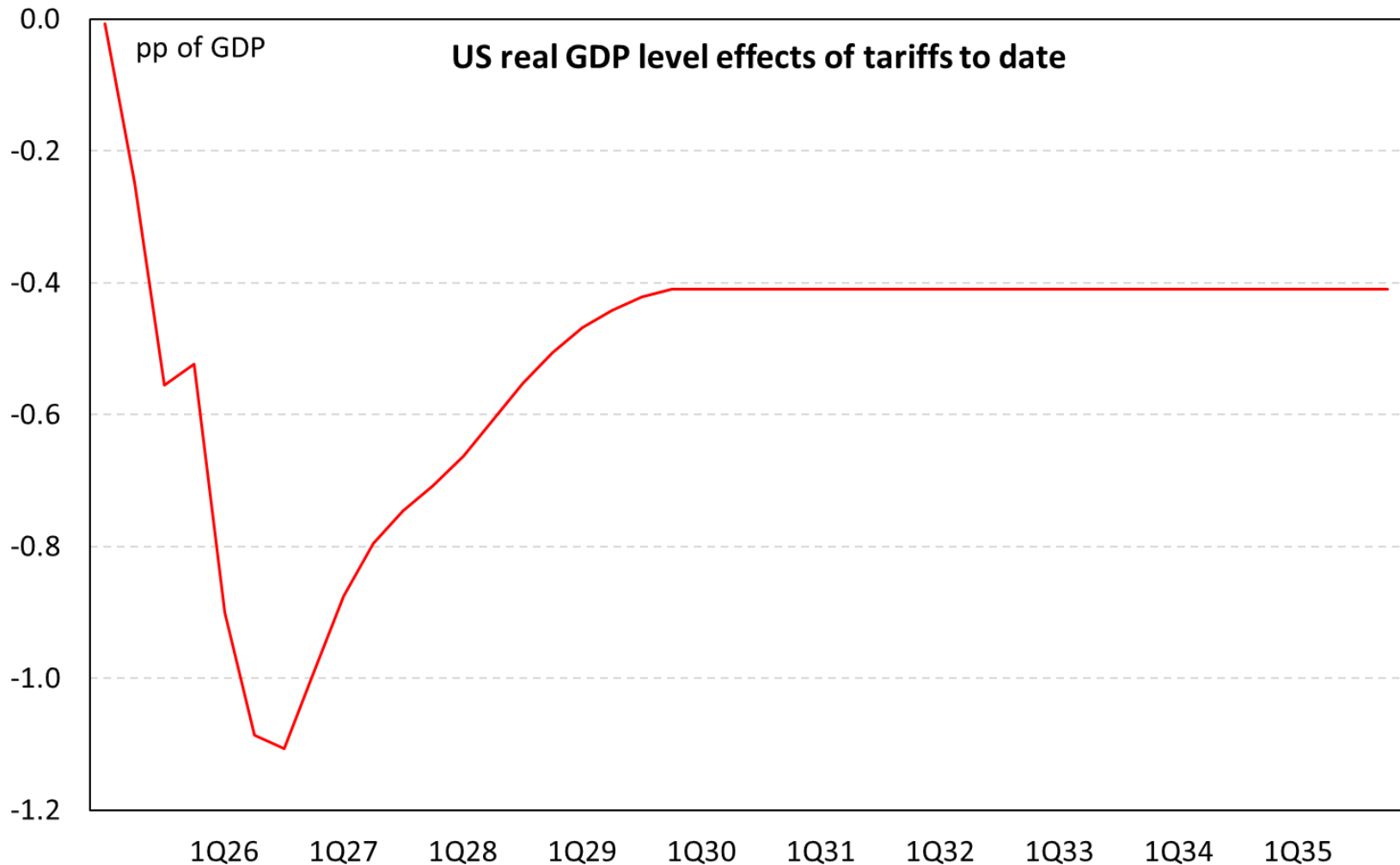
Without second-round effects, inflation will peak at 4.0-4.5%



Source: LSEG (Datastream), Bureau of Labour Statistics, LC-MA calculations.

TRUMP'S TARIFFS

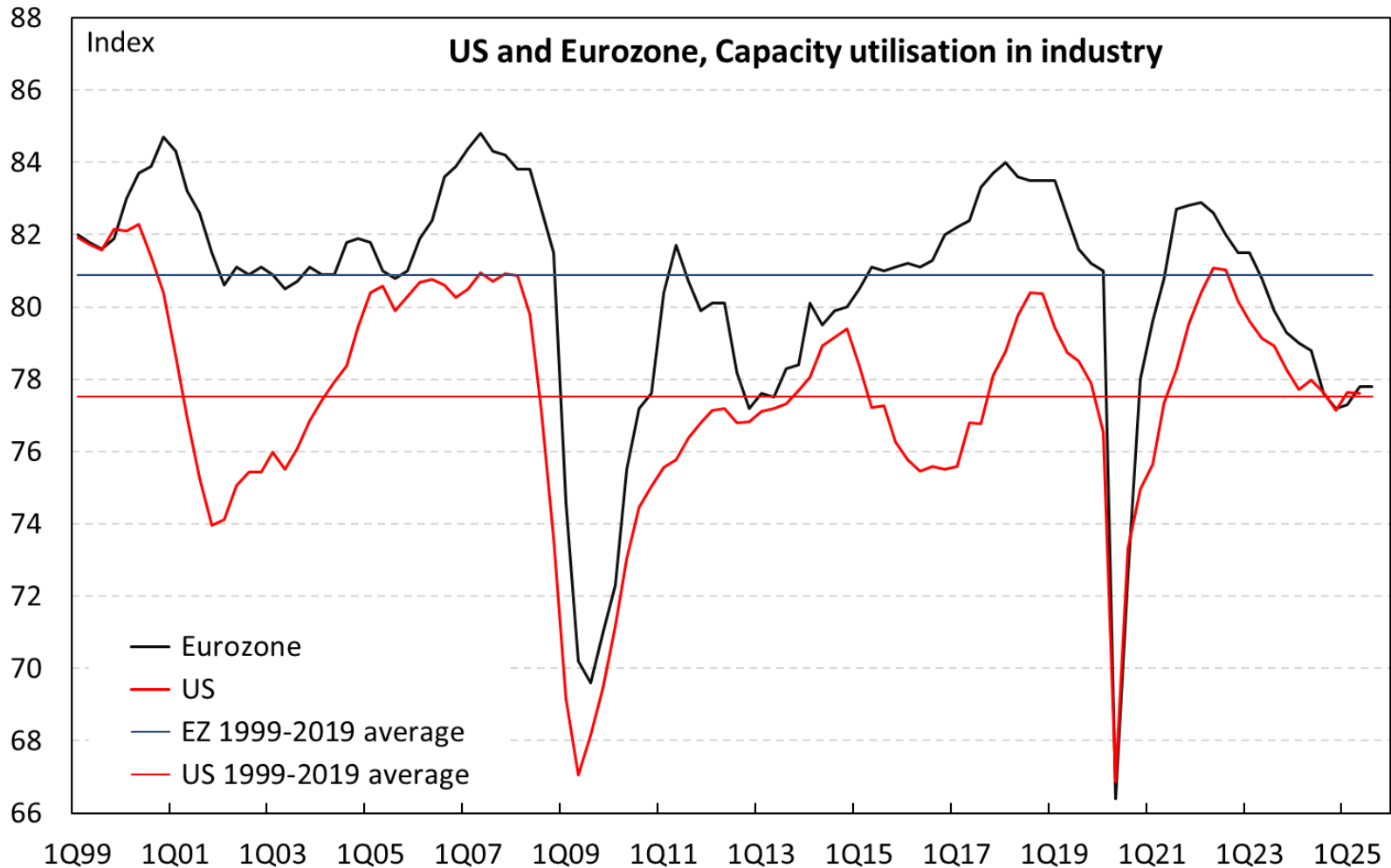
Not different from EZ's energy spike: supply → demand shock



Source: The Budget Lab Yale, LC-MA calculations

US ECONOMY

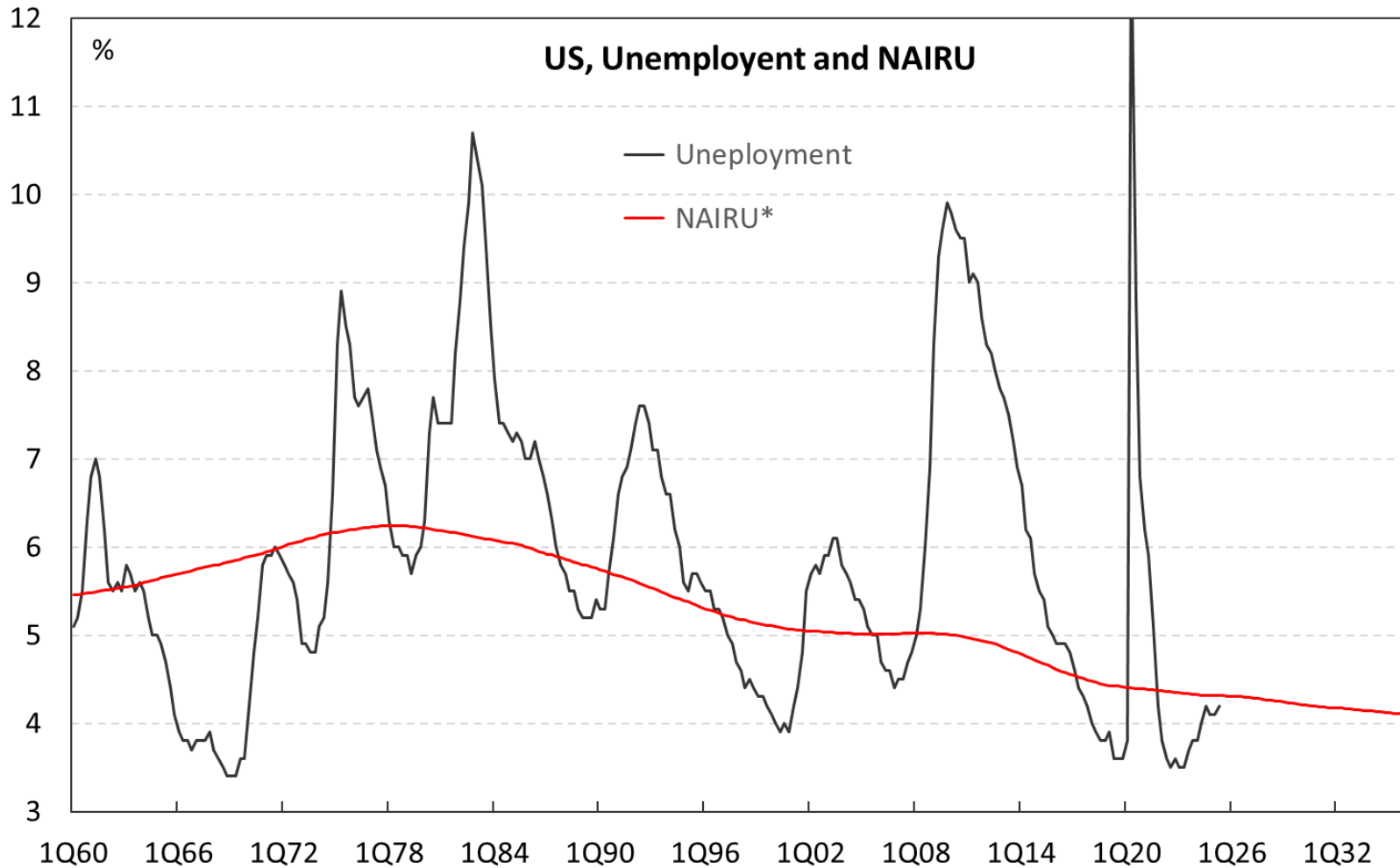
Limited unused capacity in industry; max 10% substitution



Source: LSEG (Datastream), Ameco European Commission, US Federal Reserve, LC-MA calculations.

US ECONOMY

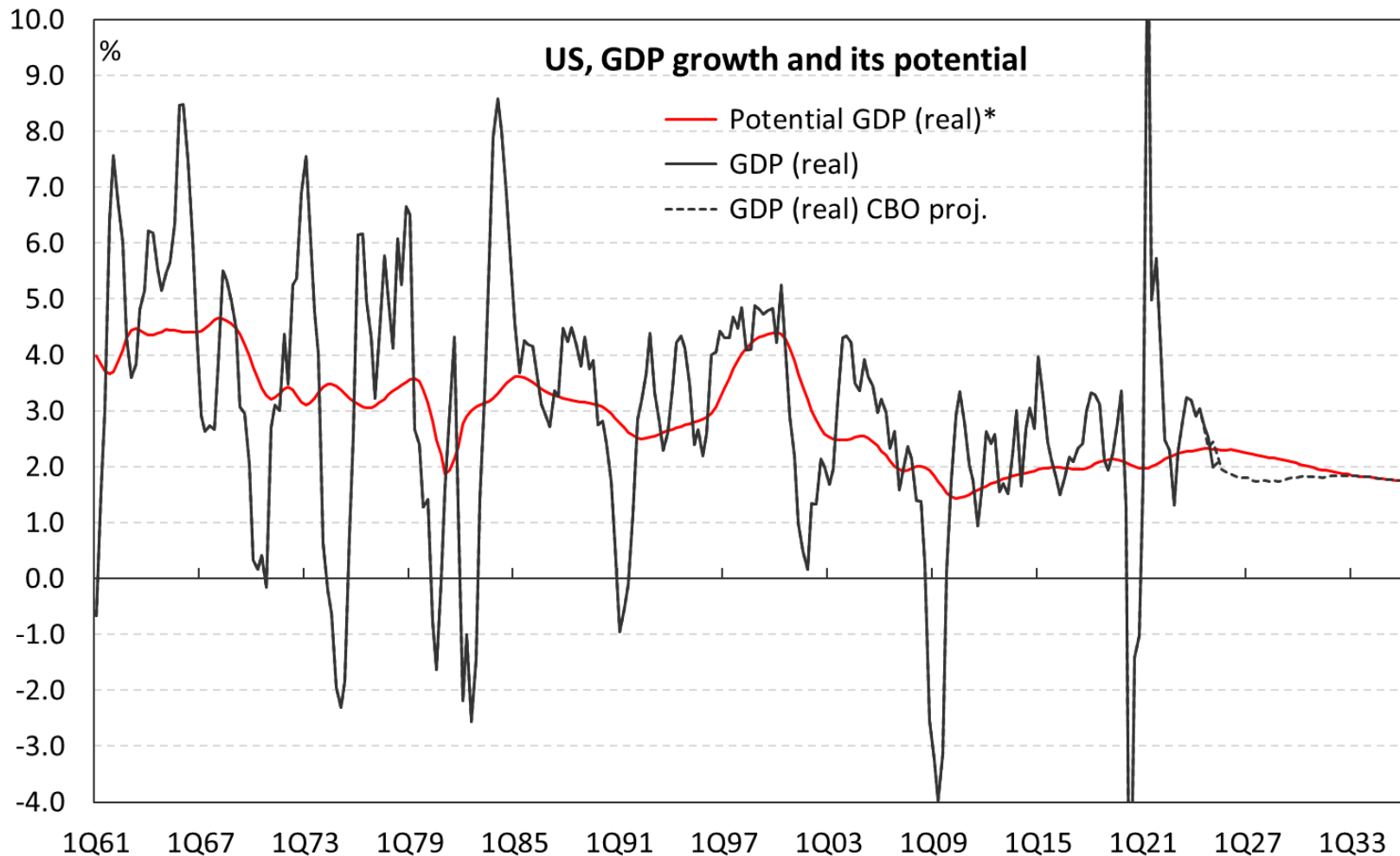
Unemployment is rising, but it is still below the NAIRU



Source: LSEG (Datastream), * estimates by the Congressional Budget Office, Bureau of Labour Statistics, LC-MA calculations.

US ECONOMY

GDP growth not far from potential: not much slack



Source: LSEG (Datastream), *Estimates by the Congressional Budget Office, Bureau of Labour Statistics, LC-MA calculations.

US ECONOMY

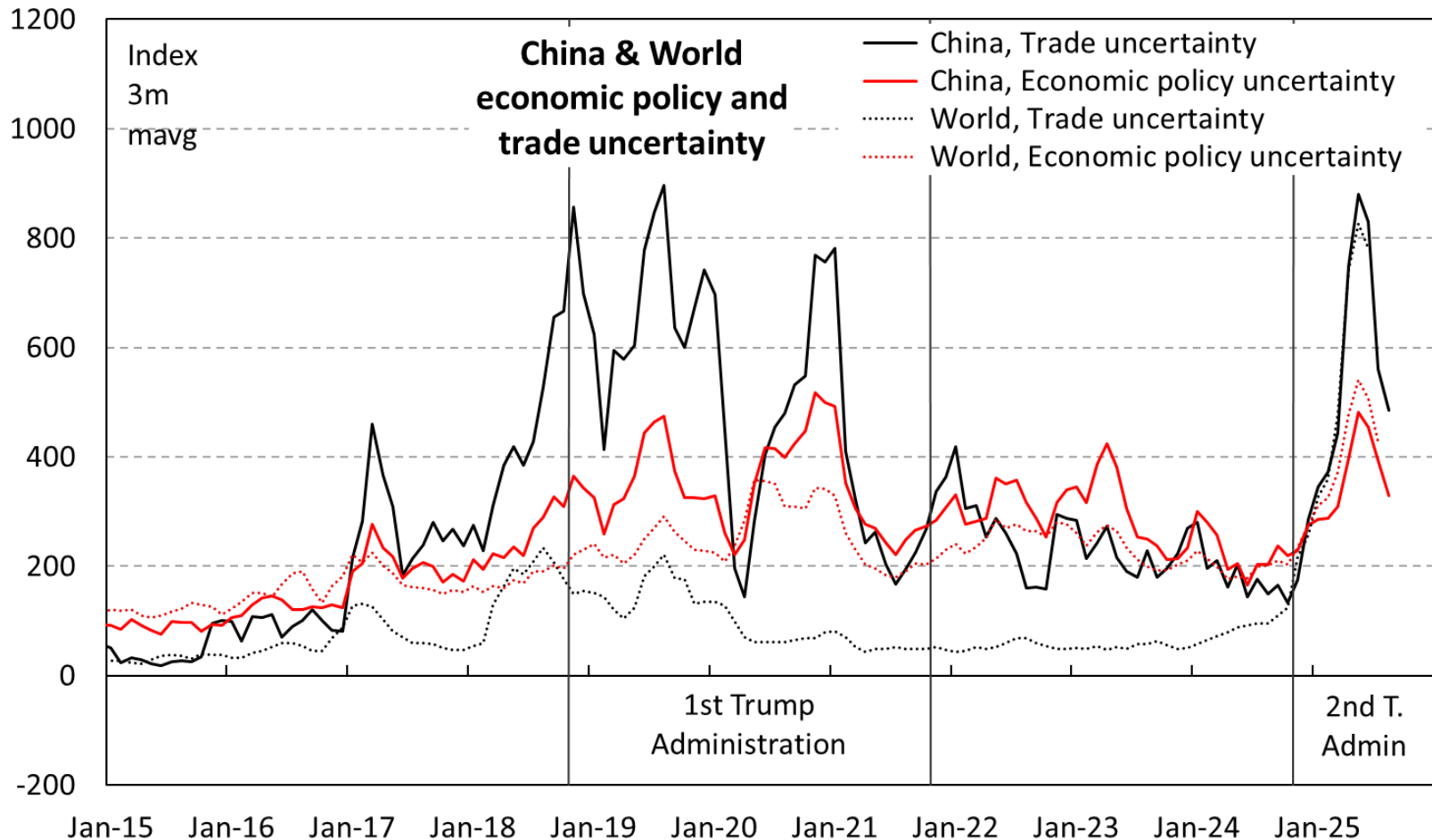
Wages and labour productivity are broadly at equilibrium



Source: LSEG (Datastream), Atlanta Fed, BLS, LC-MA calculations.

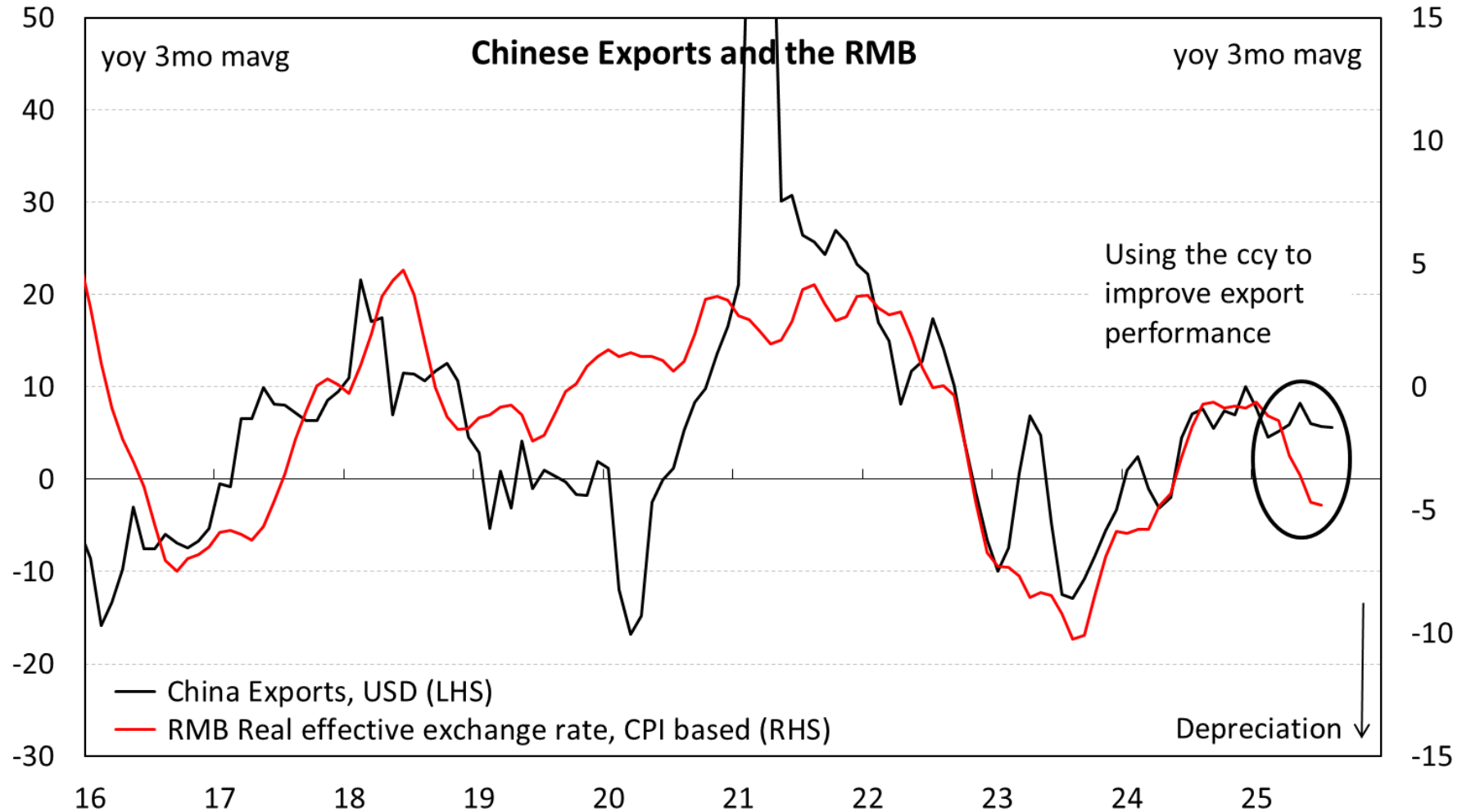
CHINESE ECONOMY

1st Trump: it was about China, 2nd Trump: it is about the world



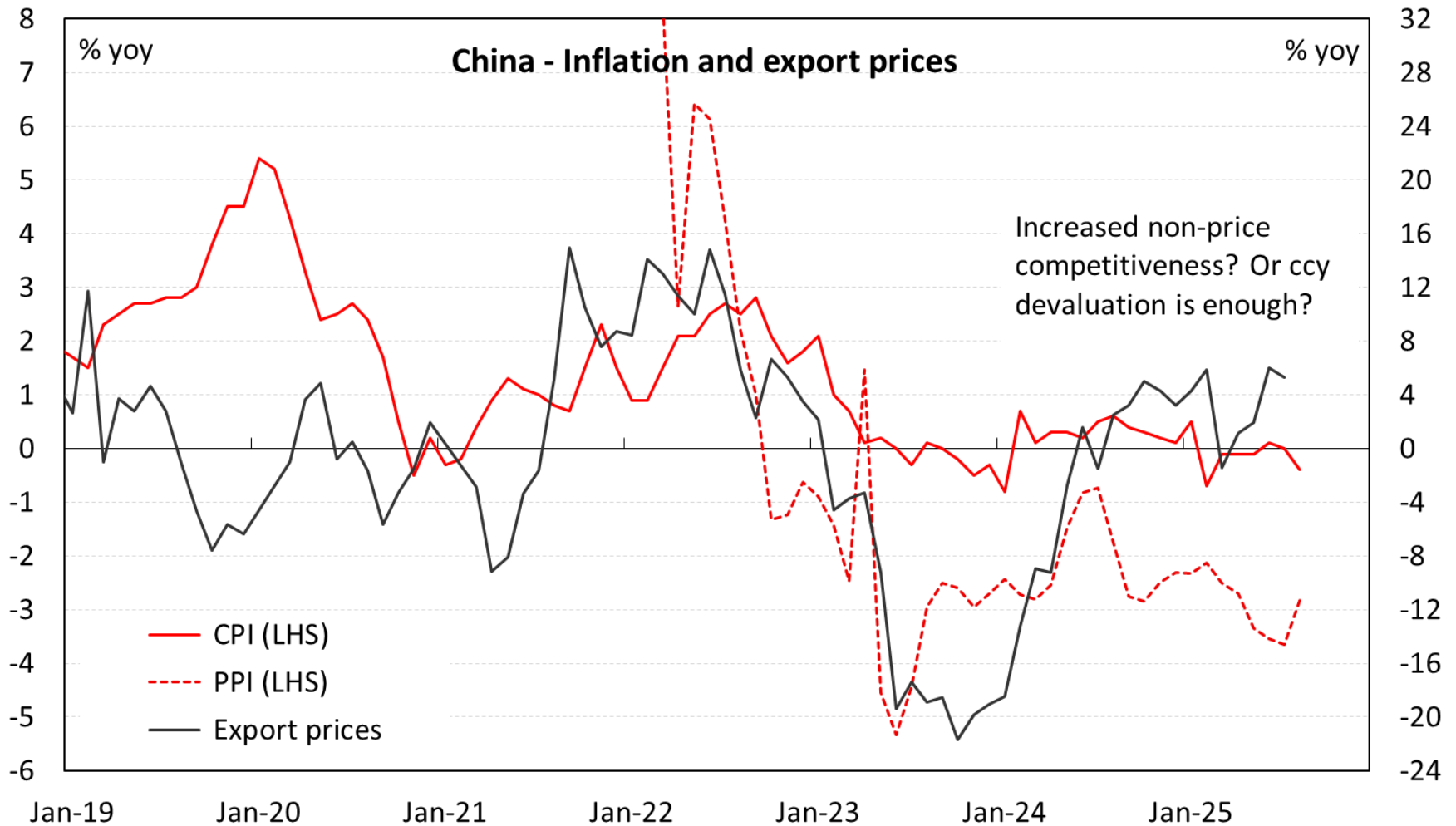
Source: "Measuring Economic Policy Uncertainty" by S.R.Baker, N.Bloom and S.J.Davis at www.PolicyUncertainty.com; current prices, GDP weight. Caldara, Dario and Matteo Iacoviello, "Measuring Geopolitical Risk," working paper, Board of Governors of the Federal Reserve Board, August 2017, LSEG (Datastream), LC-MA calculations.

RMB pre-emptive depreciation (ex USD)



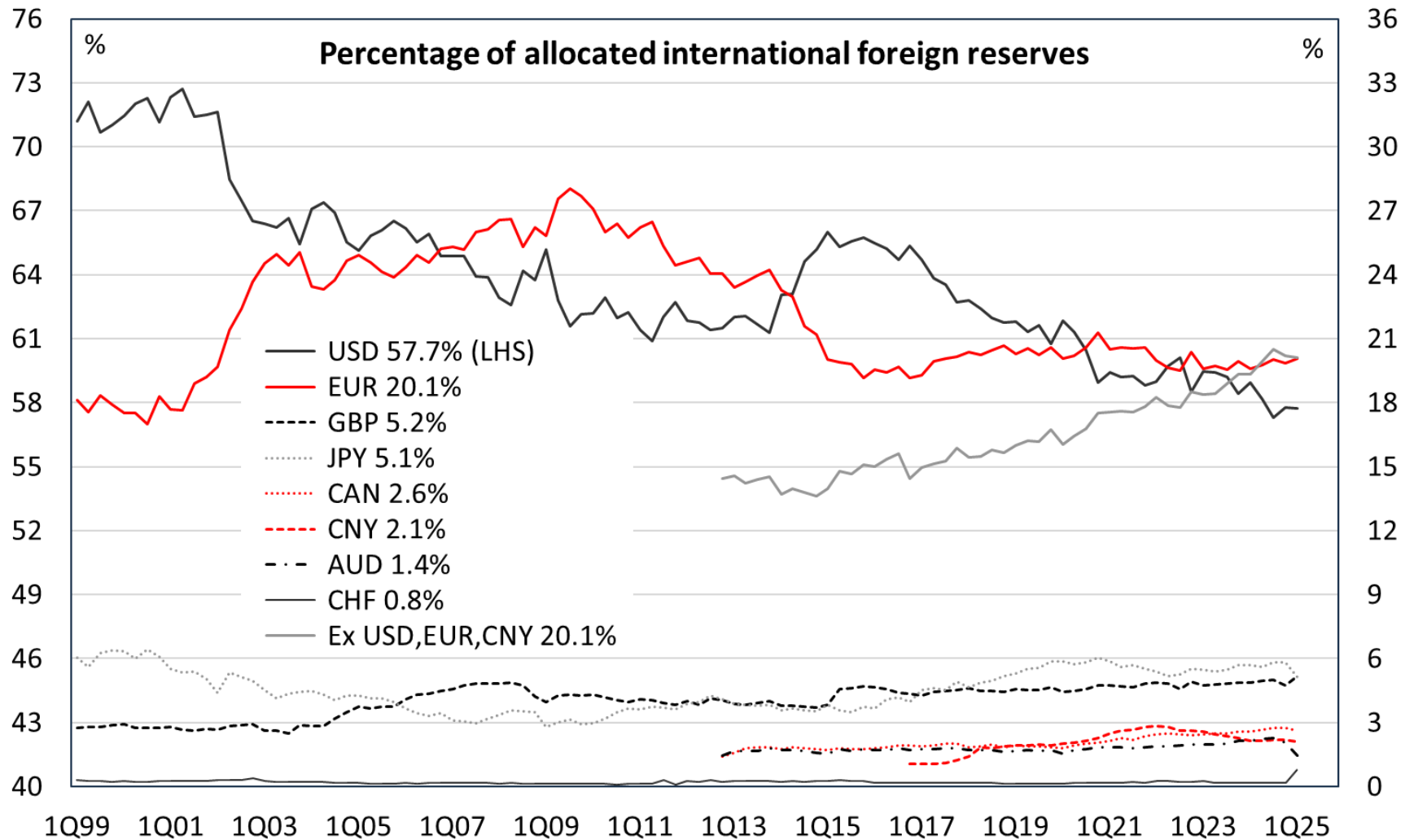
Source: LSEG (Datastream), China Customs, LC-MA calculations.

Chinese export prices are increasing (offset by lower RMB)



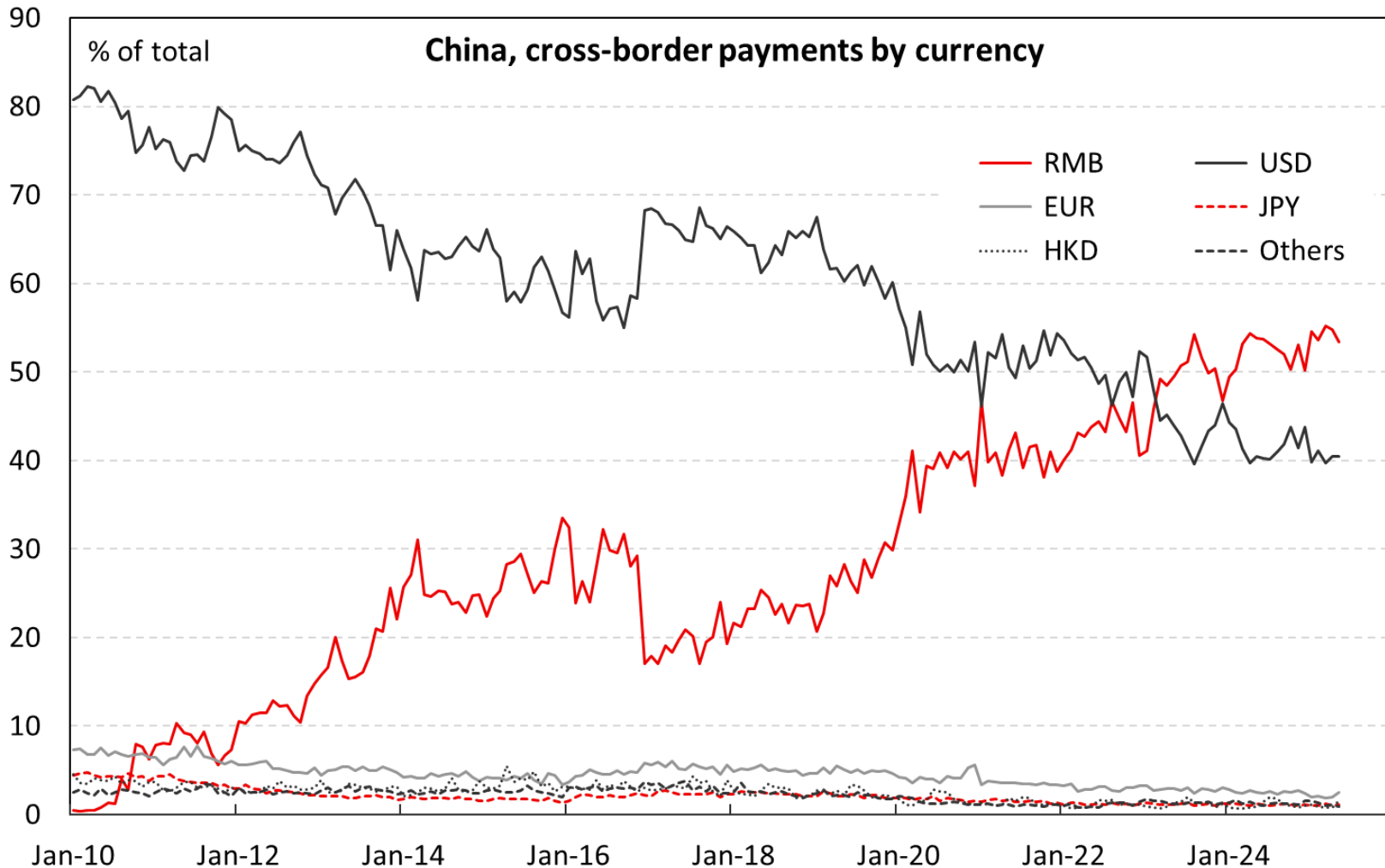
Source: LSEG (Datastream), China Customs, PBC, LC-MA calculations.

The use of RoW reserve currencies is on the rise



Source: LSEG (Datastream), IMF COFER database (149 countries), LC-MA calculations.

China is no longer using the USD for its payments

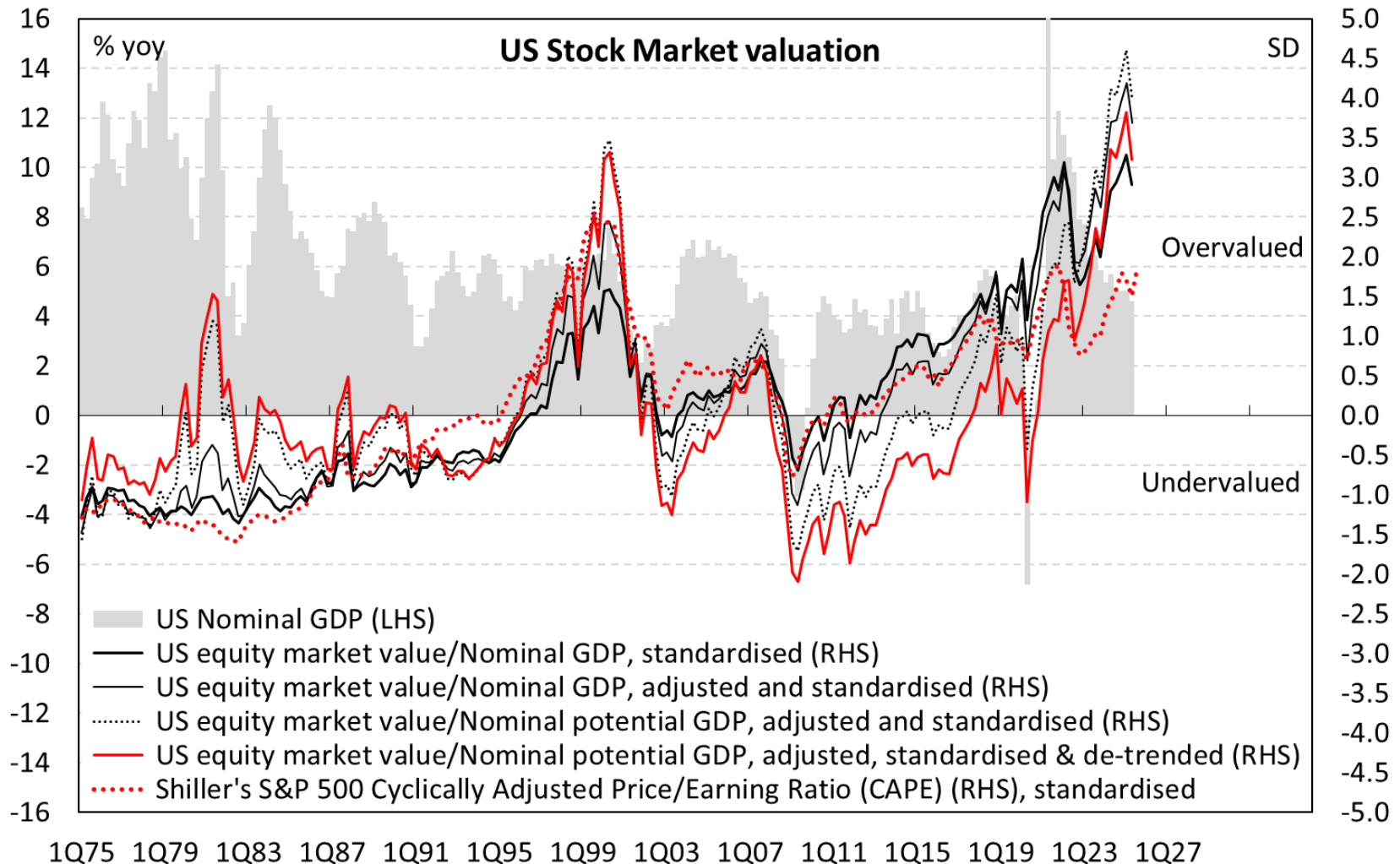


Source: LSEG (Datastream), State Administration of Foreign Exchange of China, LC-MA calculations.

CBDCs vs Cryptos vs Stablecoins

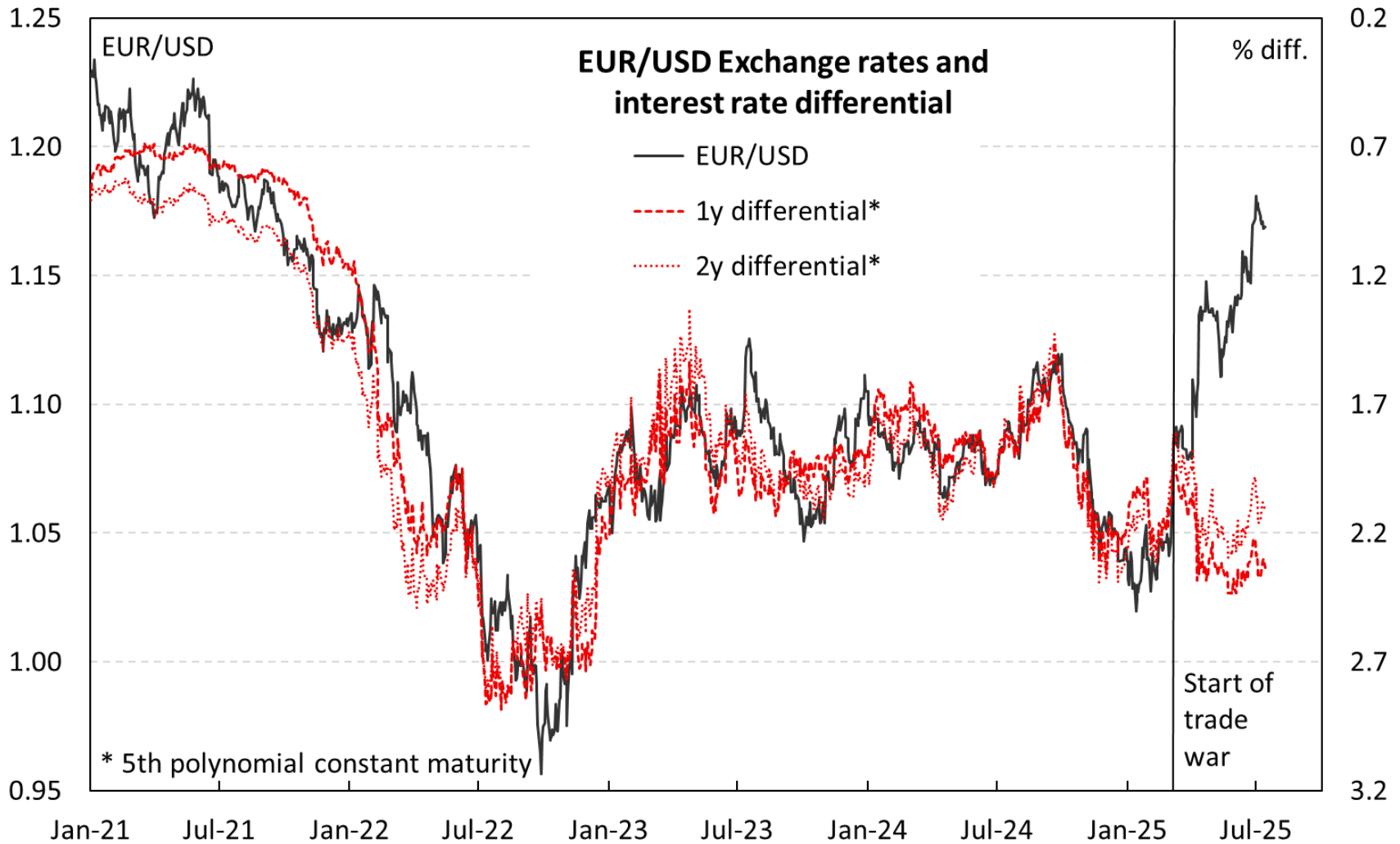
- ◆ **Digital currencies:** CBDCs vs Cryptos vs Stablecoins.
- ◆ **Bitcoin:** An art-like market whose value is in the eye of the beholder. Trump to create a bitcoin reserve? It is a disaster waiting to happen.
- ◆ **Stablecoin:** The USD will become a global currency (1/2 of the world).
- ◆ **Banks:** Crashing intermediation (distributed ledger technology).
- ◆ **Financial Architecture:** Re-writing the rule book. GENIUS, MiCAR, etc.
- ◆ **A global divide:** The world is increasingly polarised into two blocks.
- ◆ **Risks:** Singleness of money, elasticity (liquidity provision), integrity (crime) [BIS]. A massive systemic risk (remember the doom loop?)
- ◆ **Central banks:** Impinging on the transmission of monetary policy?

Is innovation and tokenisation at the root of equity rises?



Source: LSEG (Datastream), various sources, LC-MA calculations.

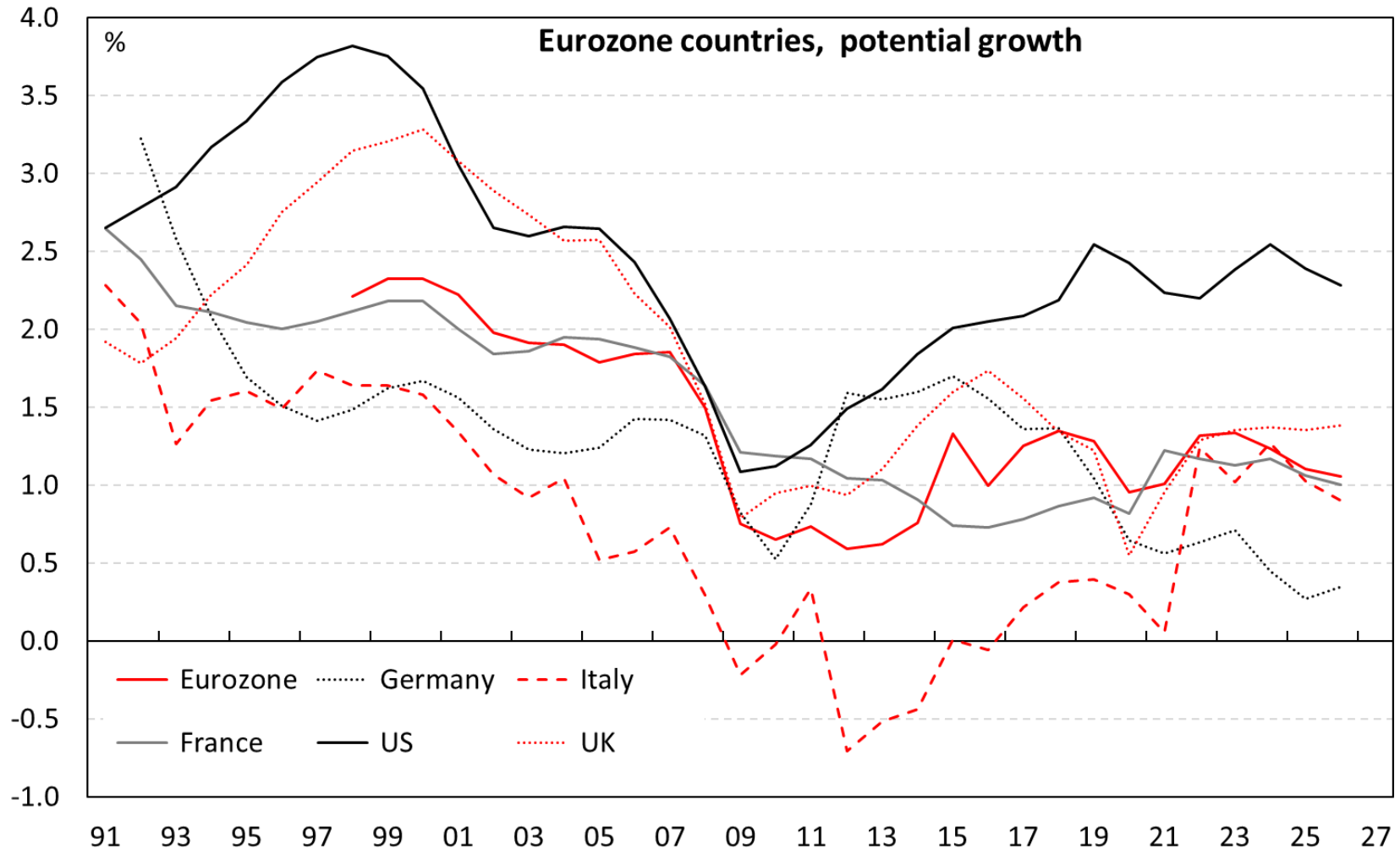
Will a sharp weakening of the USD be the next step?



Source: LSEG (Datastream), LC-MA calculations.

EUROZONE ECONOMY

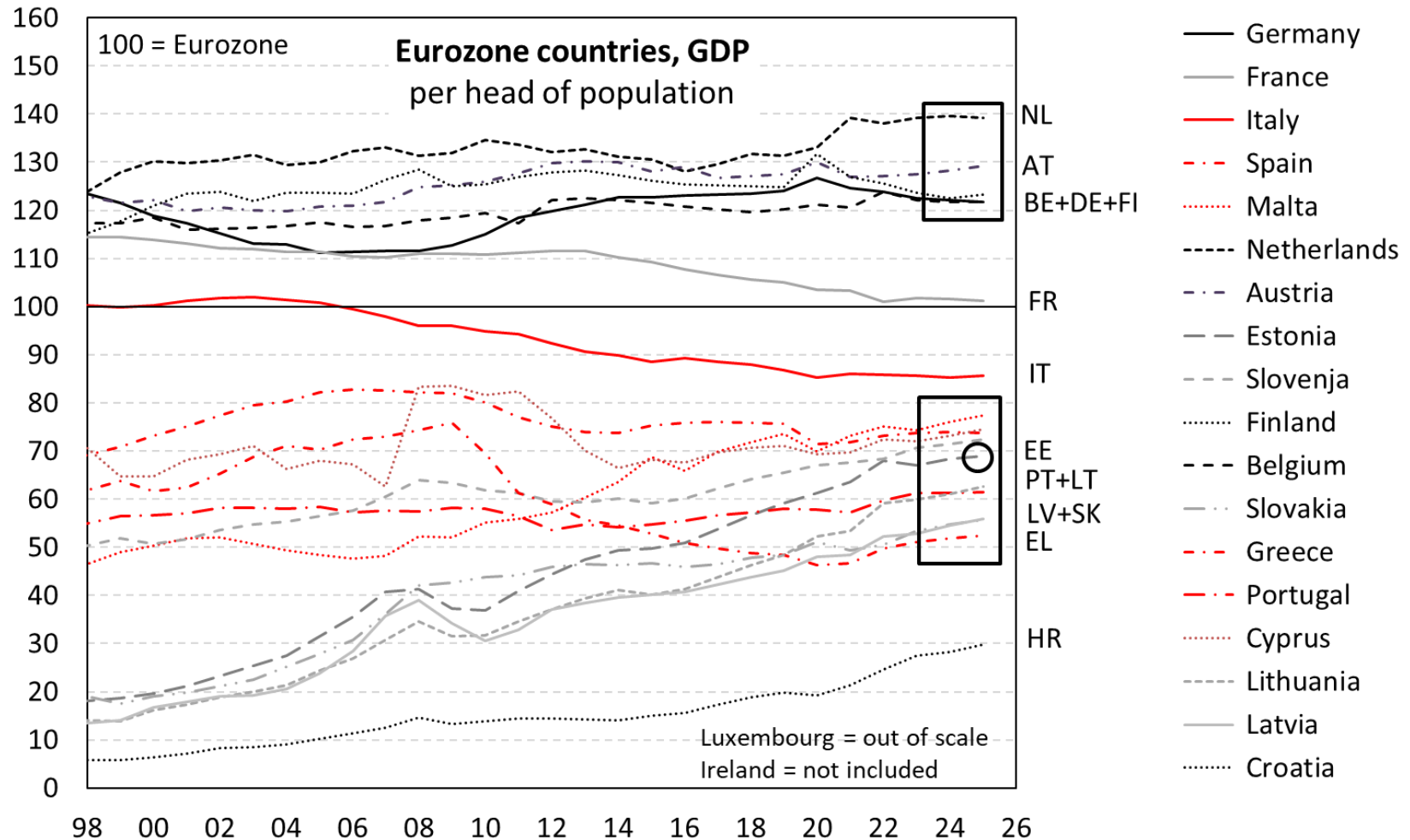
Potential growth is struggling to recover since the GFC



Source: Refinitiv (Datastream), DG Ecfm Ameco, LC-MA calculations.

EUROZONE ECONOMY

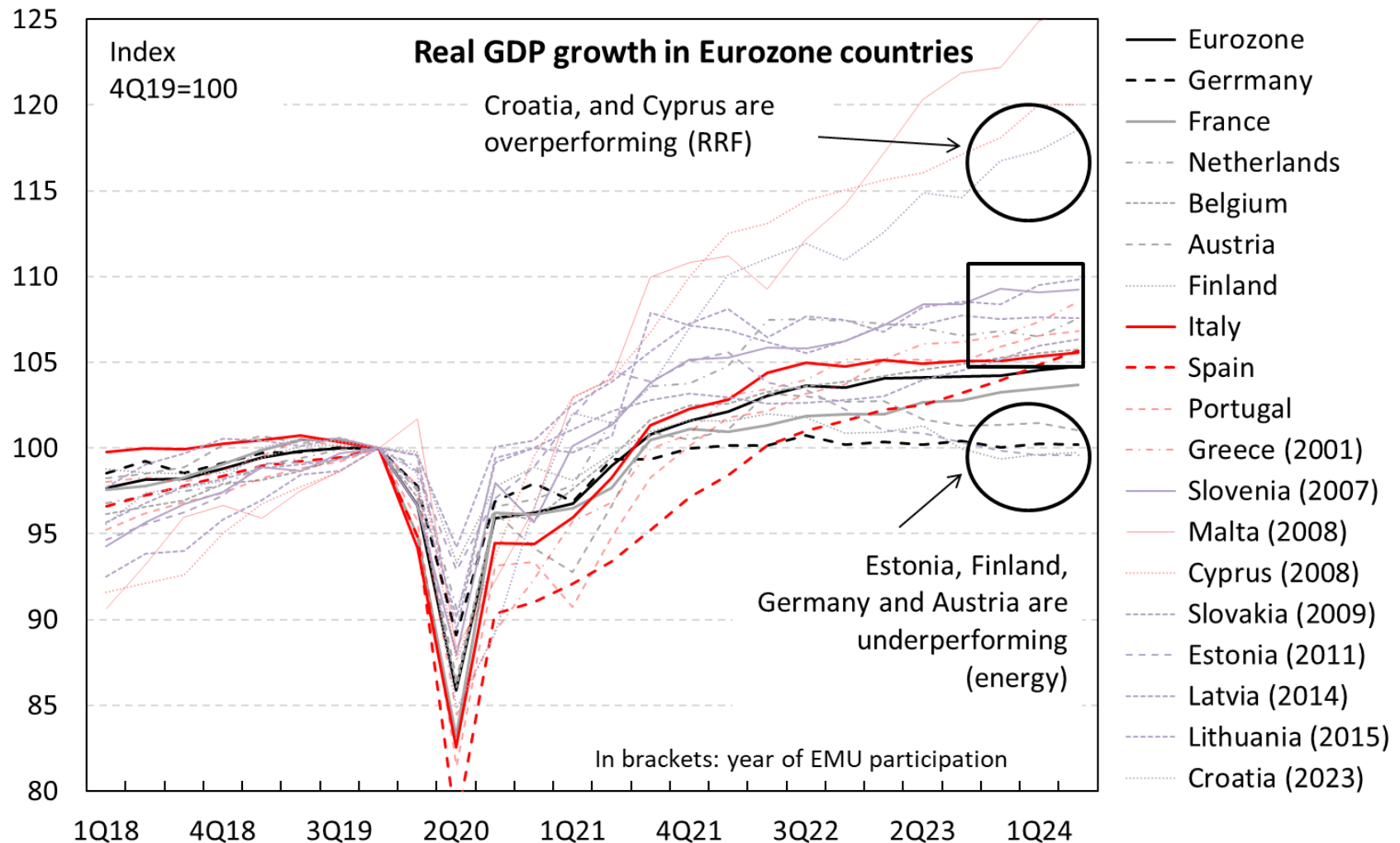
Persistent trends over the years in per capita GDP



Source: Refinitiv (Datastream), European Commission AMECO, LC-MA calculations (2024-2025 are Commission's forecasts).

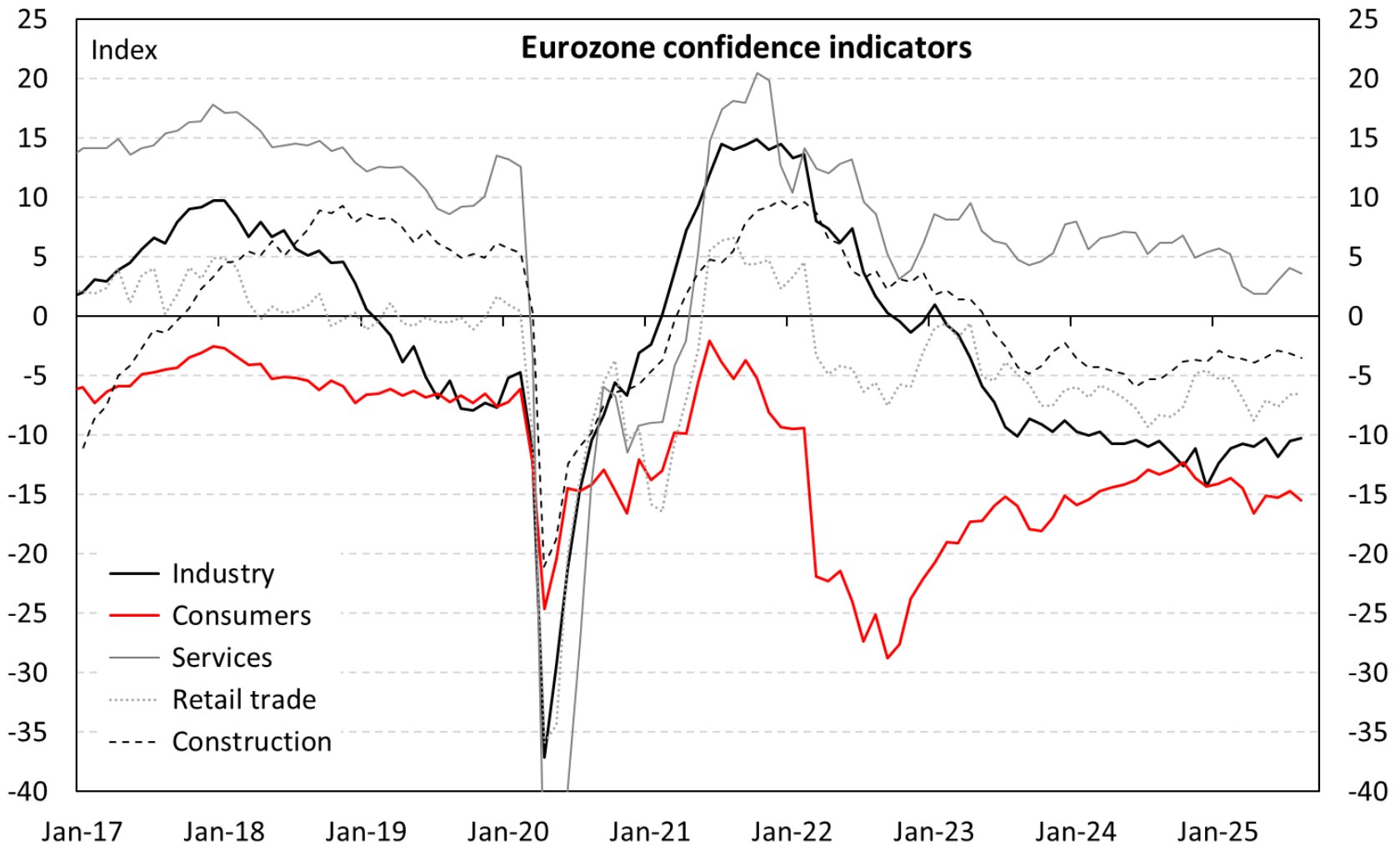
EUROZONE ECONOMY

Some countries are doing well; others are not



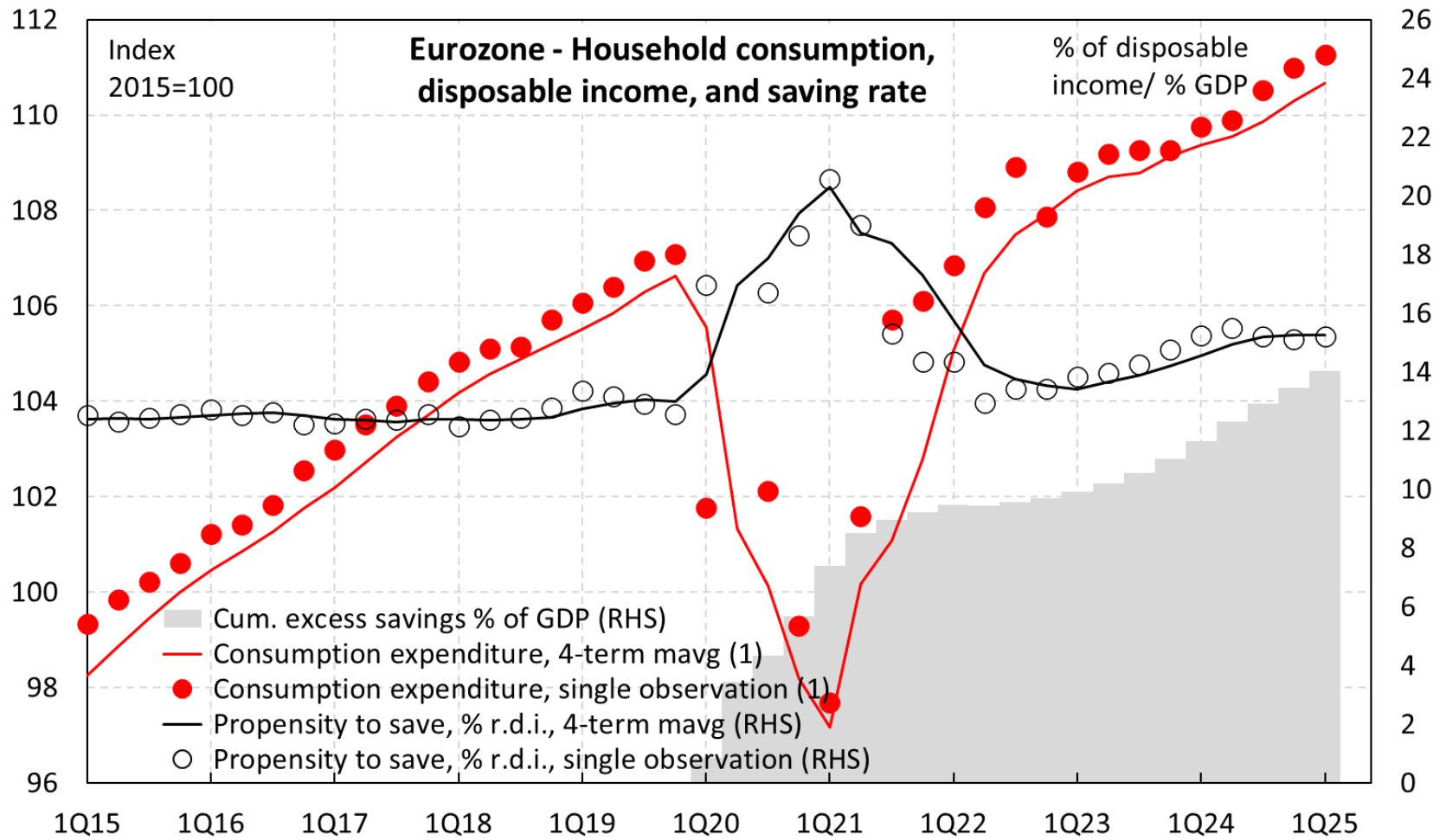
Sources: LSEG (Datastream), Eurostat, LC-MA calculations. Ireland and Luxembourg are not included.

Confidence stabilising amid uncertainties



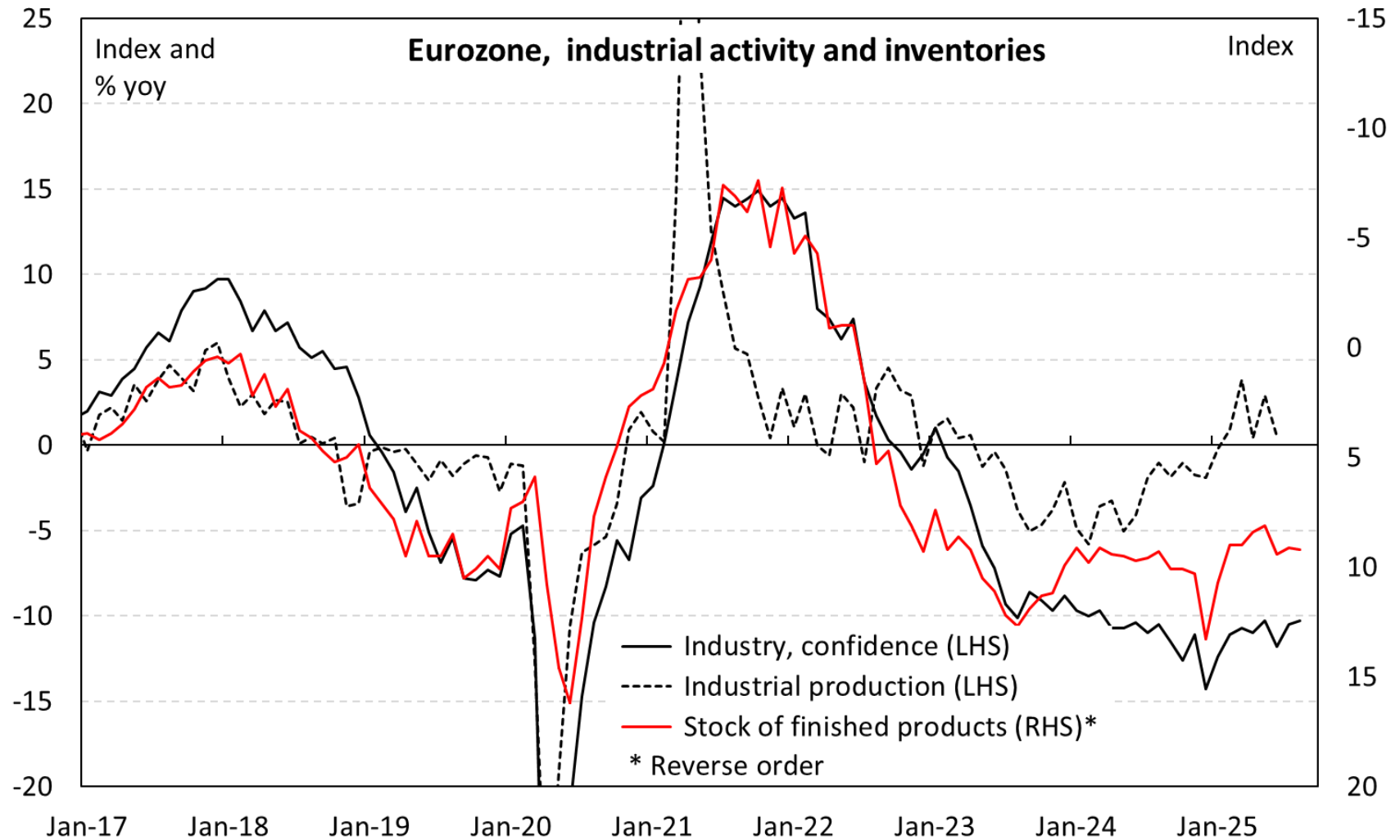
Source: LSEG (Datastream), European Commission, LC-MA calculations.

Extra savings cumulated since Covid not yet used



Source: LSEG (Datastream), Eurostat and LC-MA calculations. (1) Chain-linked volume index, (2) Net of variation in the final consumption expenditure deflator for resident households, Consumer households' savings as % of gross disposable income.

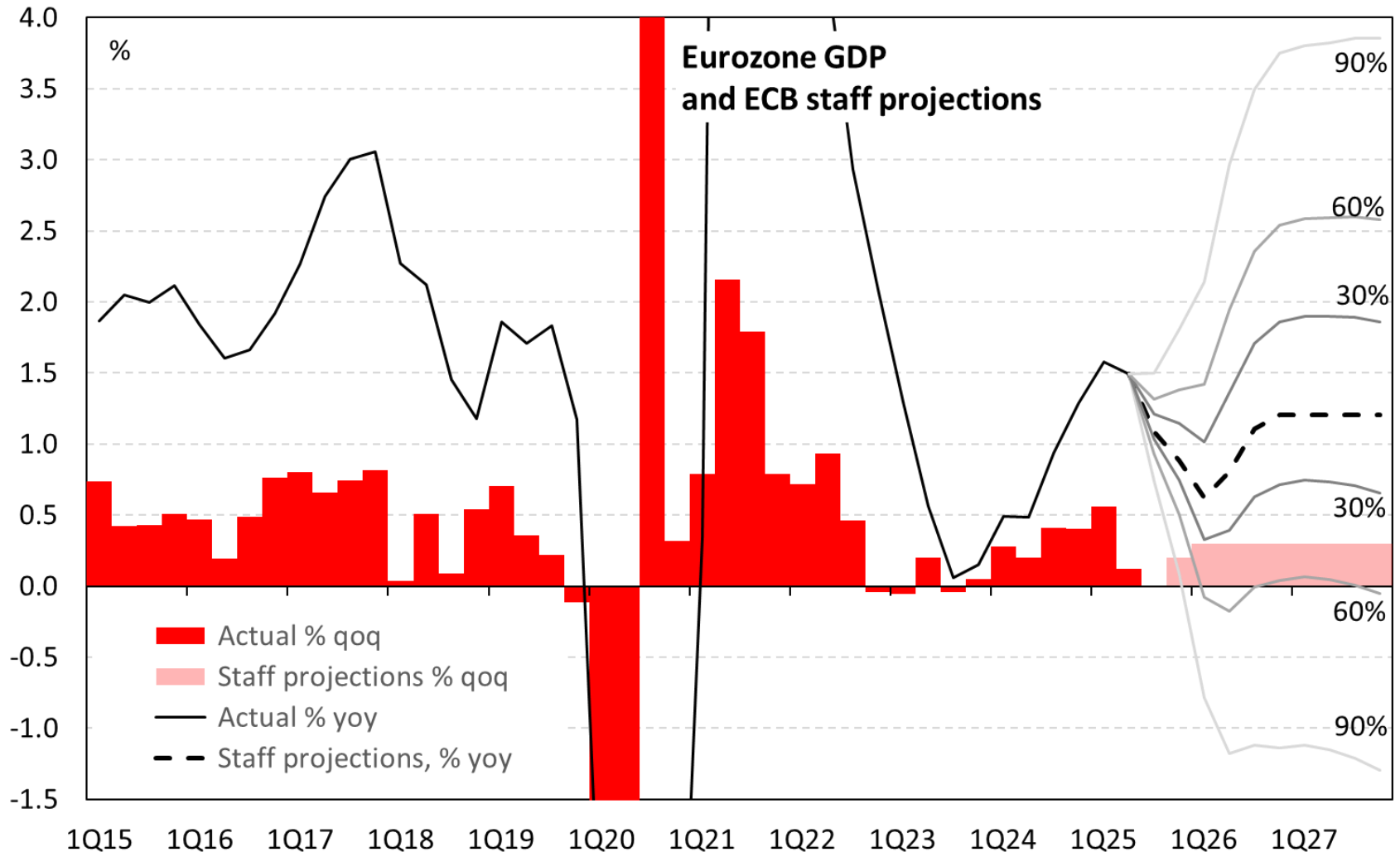
Some stabilisation in industrial output



Source: LSEG (Datastream), European Commission, Eurostat, LC-MA calculations.

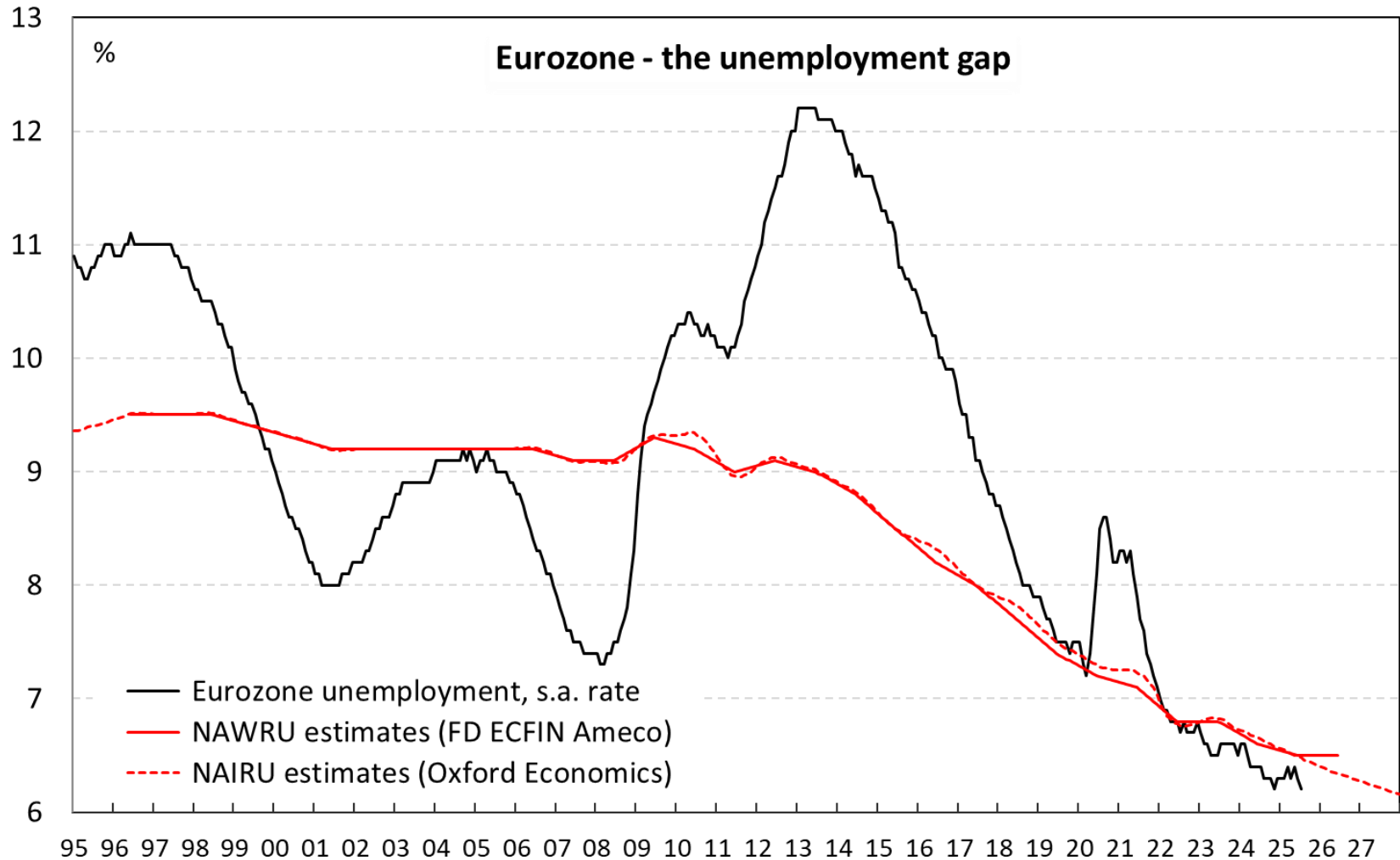
EUROZONE ECONOMY

GDP: A soft patch, but then a gradual recovery



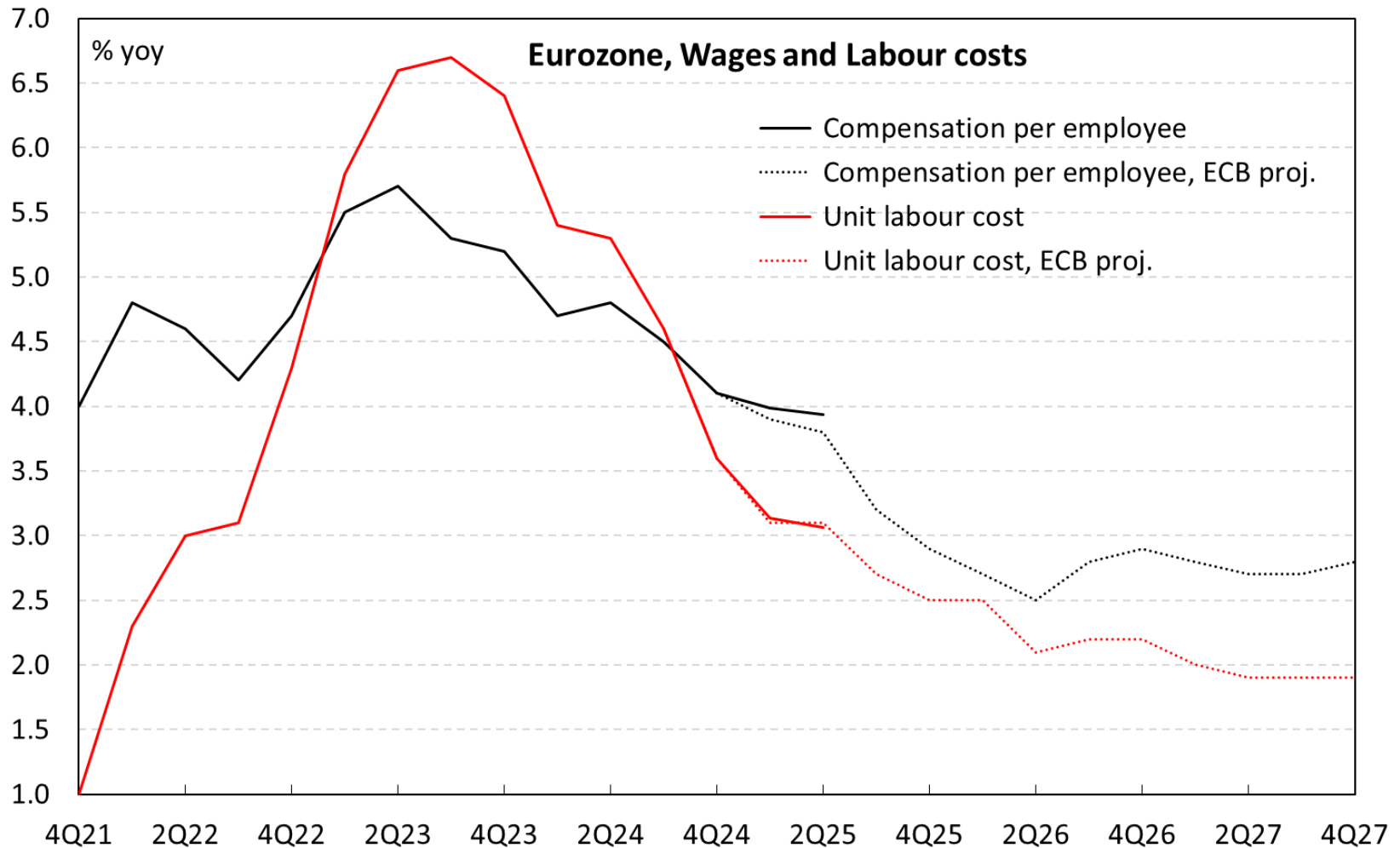
Sources: LSEG (Datastream), Eurostat, ECB, LC-MA calculations.

Labour market: a remarkable structural improvement



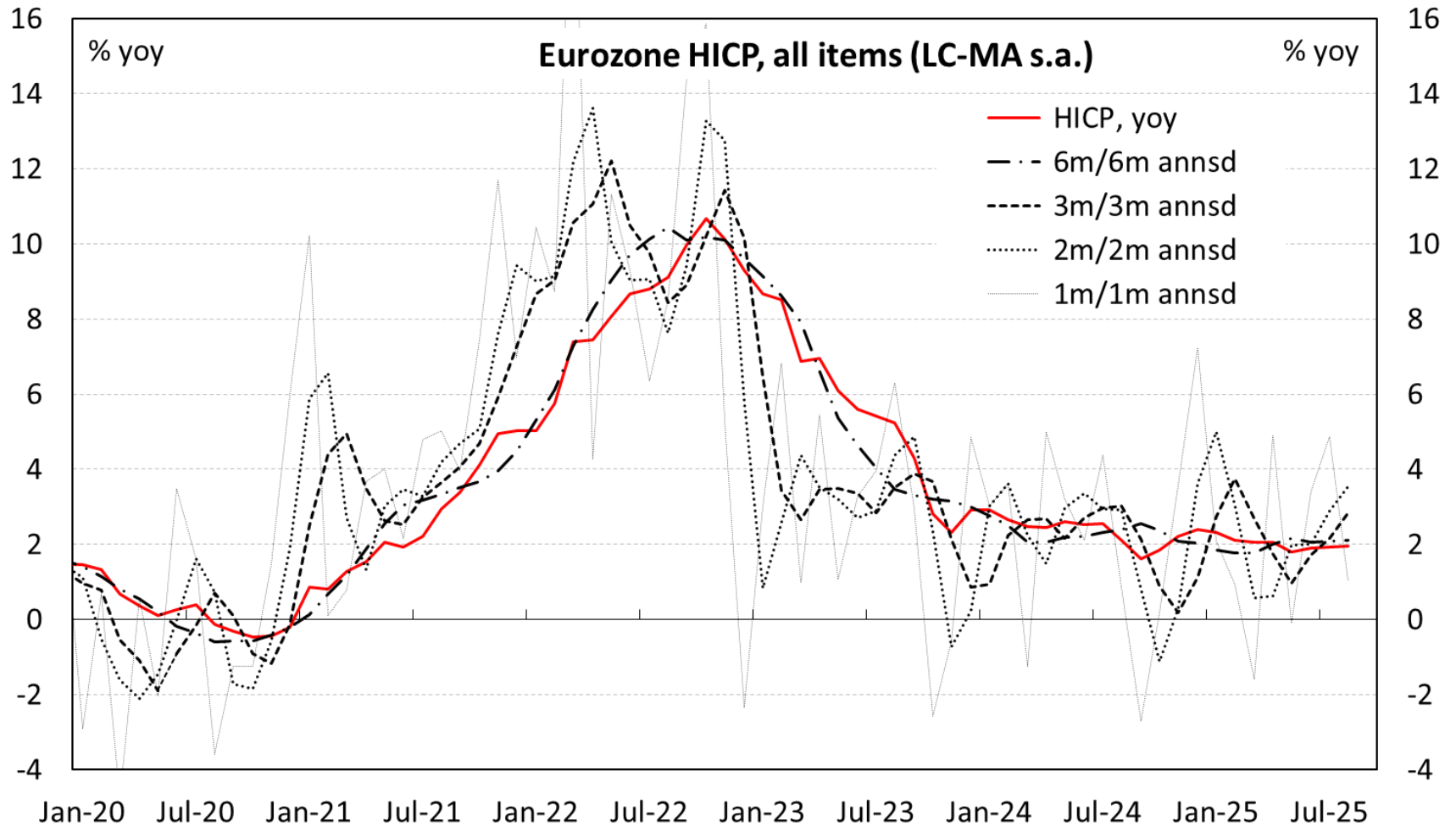
Source: LSEG (Datastream), European Commission (DG ECFIN), Oxford Economics, LC-MA calculations.

Wages are moving to a level consistent with price stability



Source: LSEG (Datastream), ECB, Eurostat, LC-MA calculations.

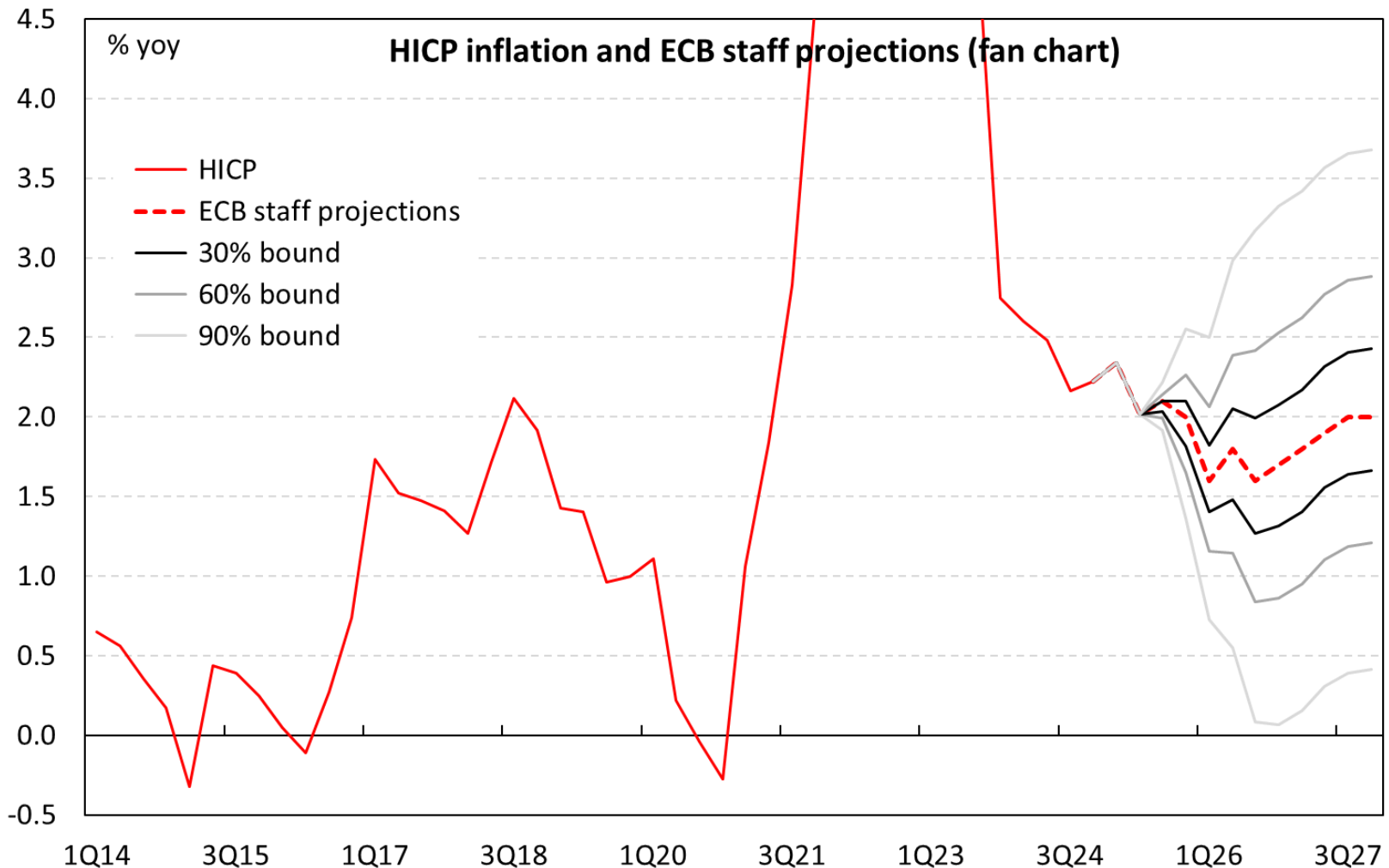
Inflation has stabilised around the 2.0% target



Source: LSEG (Datastream), Eurostat, LC-MA calculations.

MONETARY POLICY

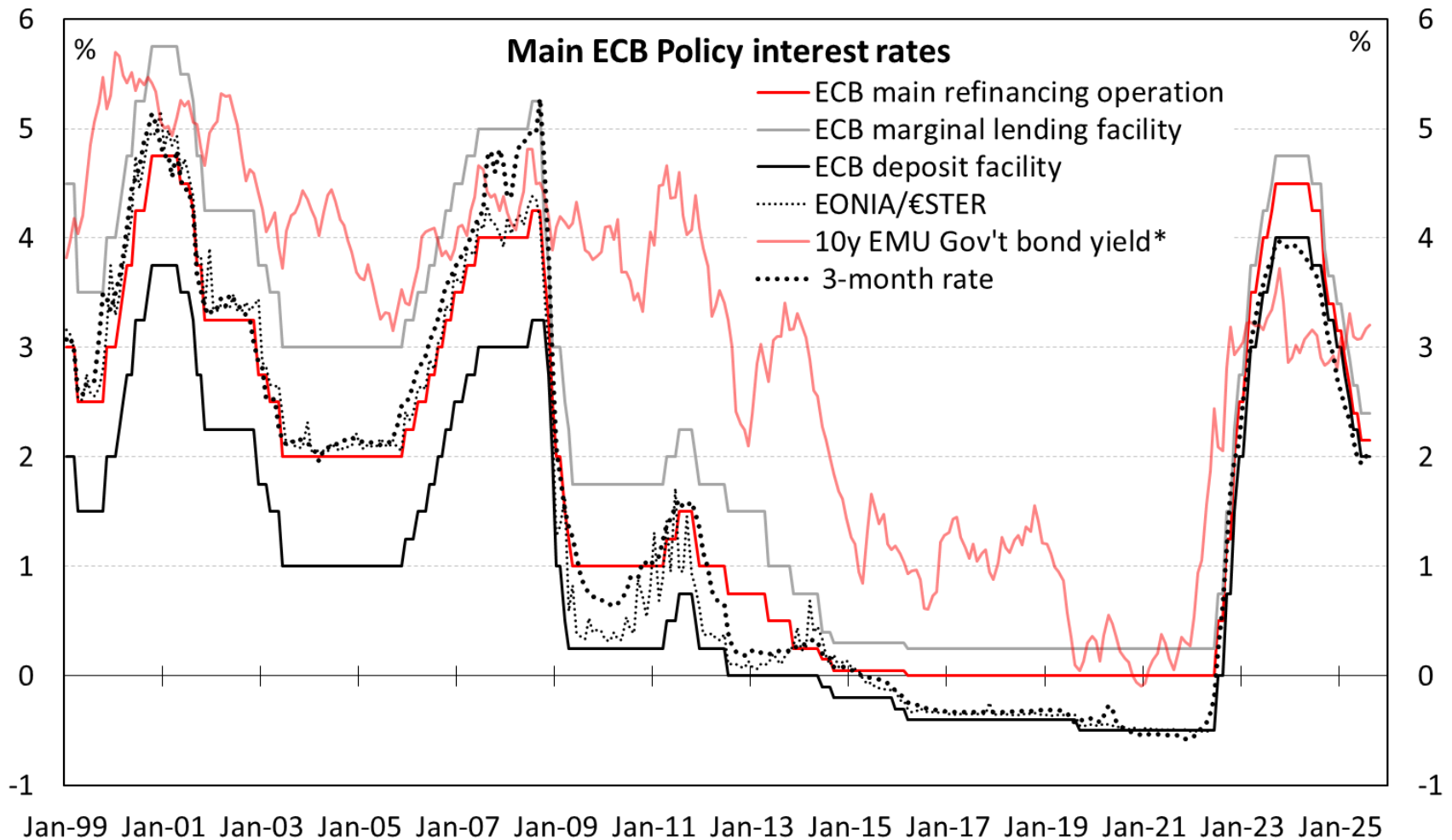
No significant downside risk on inflation, amid uncertainty



Source: LSEG (Datastream), Eurostat, ECB, LC-MA calculations.

MONETARY POLICY

ECB done with policy rates, but uncertainty looms large

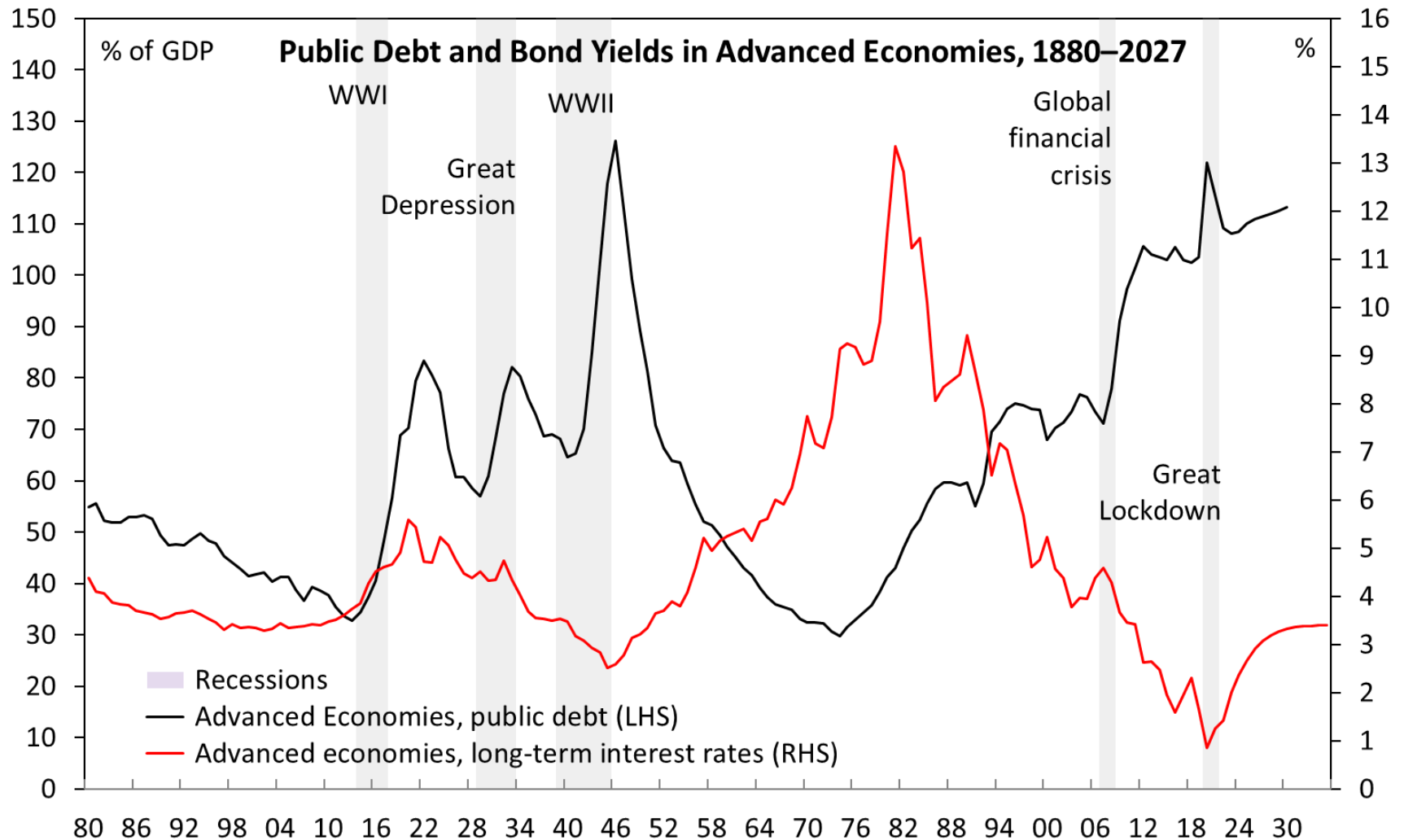


Source: LSEG (Datastream), ECB, LC-MA calculations.

* National government bond yields weighted by the nominal outstanding amounts in the 10-year maturity band.

PUBLIC FINANCES

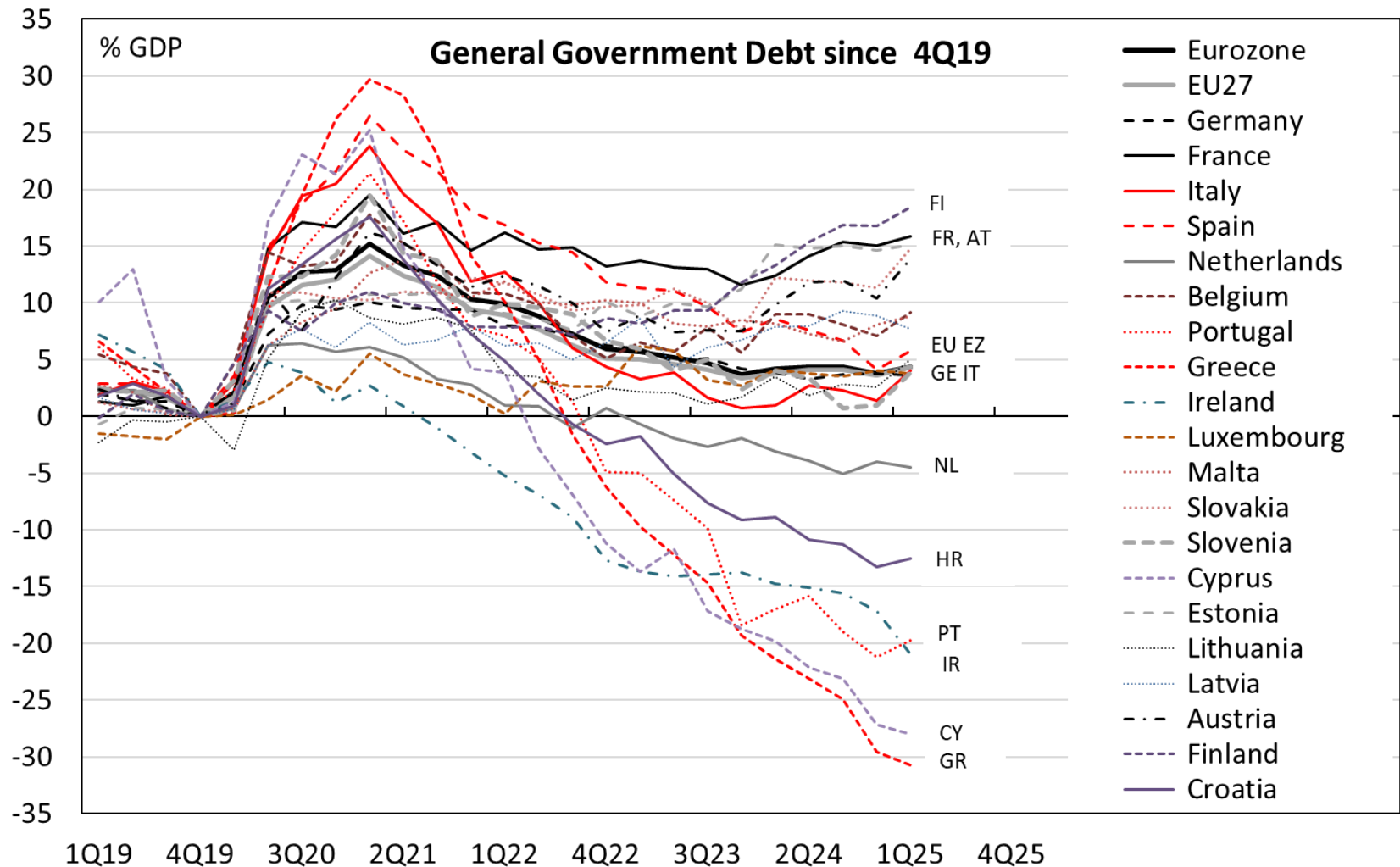
It is a global problem



Source: International Monetary Fund, OECD, LC-MA calculations.

PUBLIC FINANCES

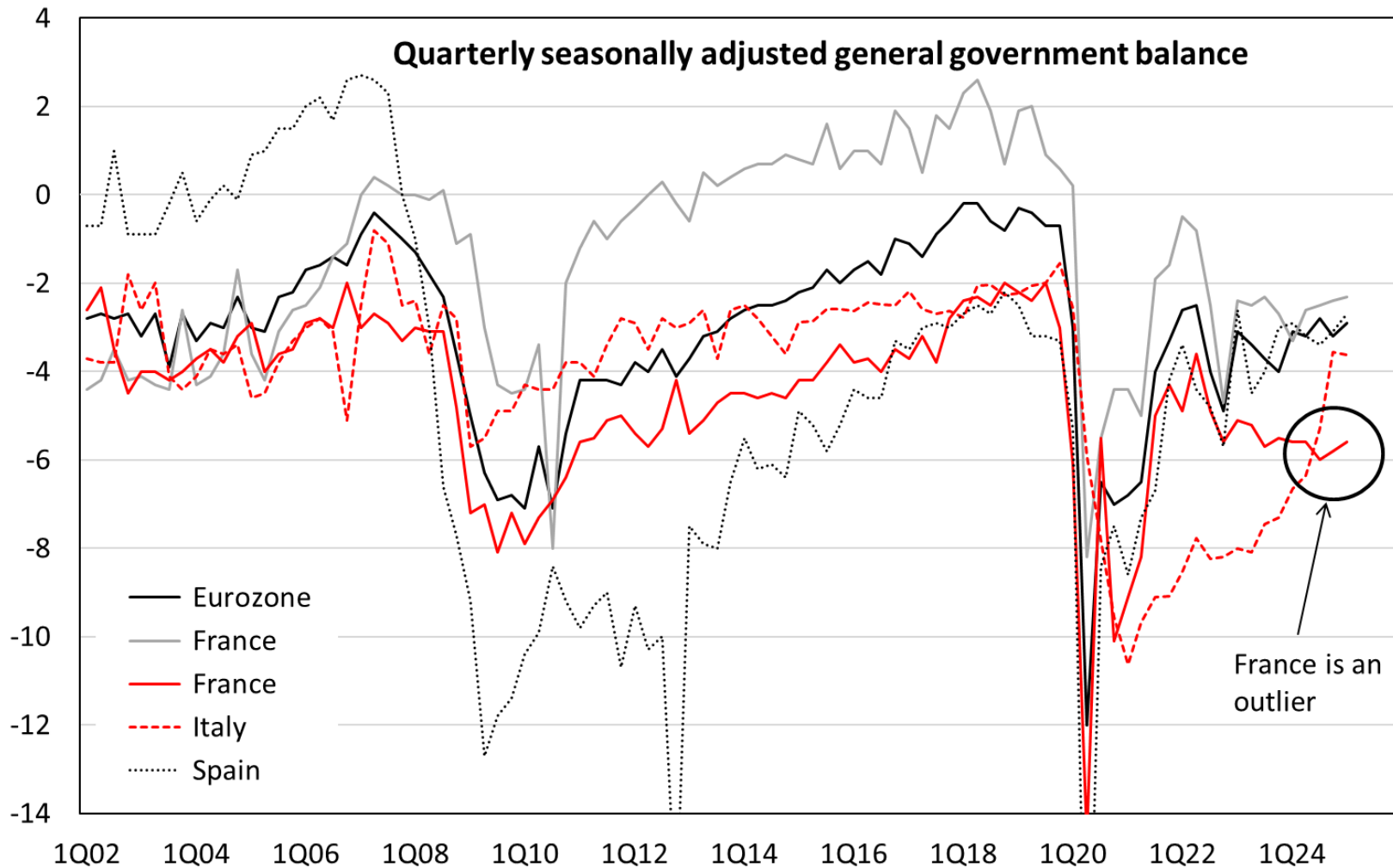
Debt ratio performances have differed since the pandemic



Source: LSEG (Datastream), European Commission, LC-MA calculations.

PUBLIC FINANCES

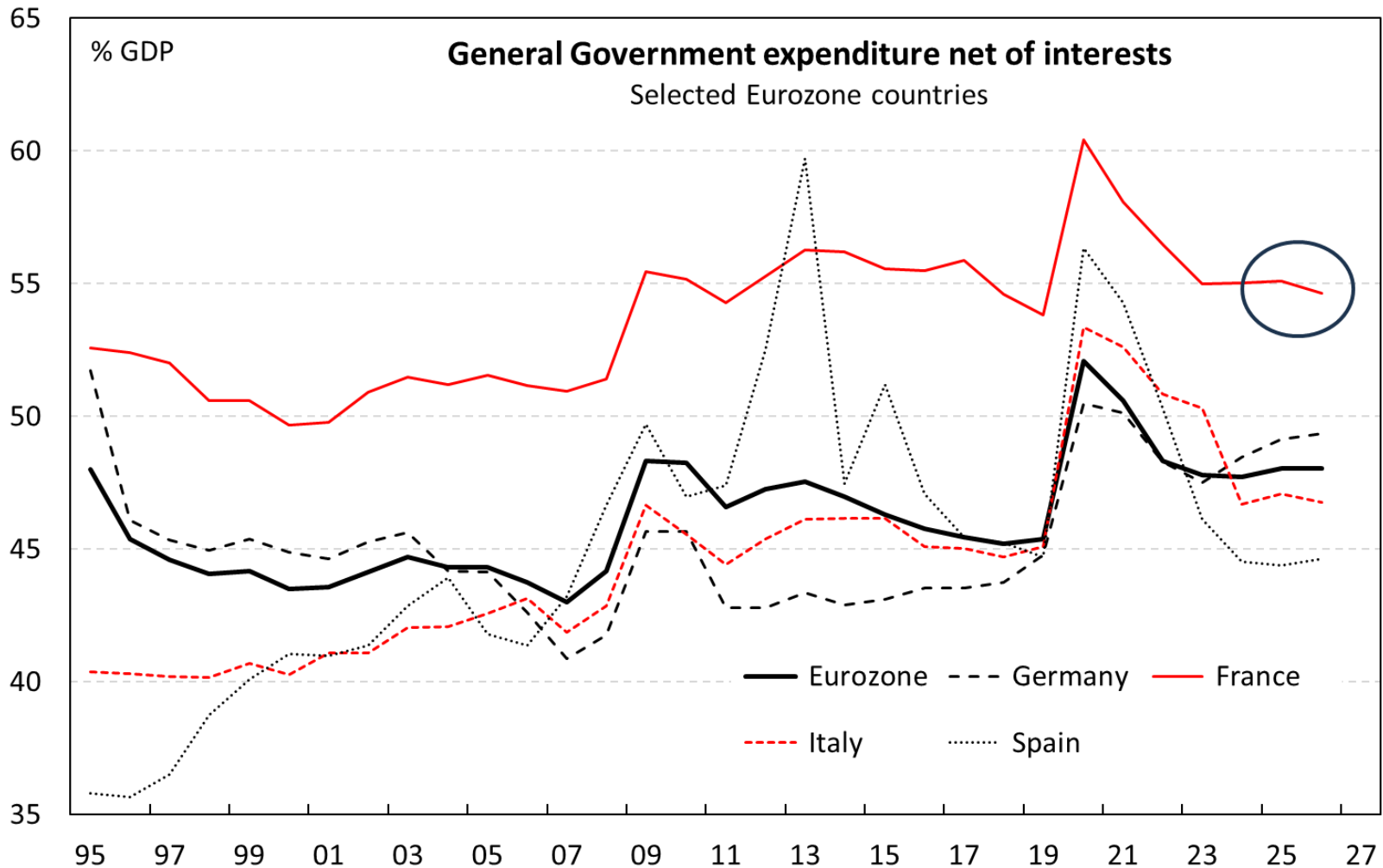
France is an outlier in terms of net borrowing ratio



Source: LSEG (Datastream), Eurostat, LC-MA calculations.

PUBLIC FINANCES

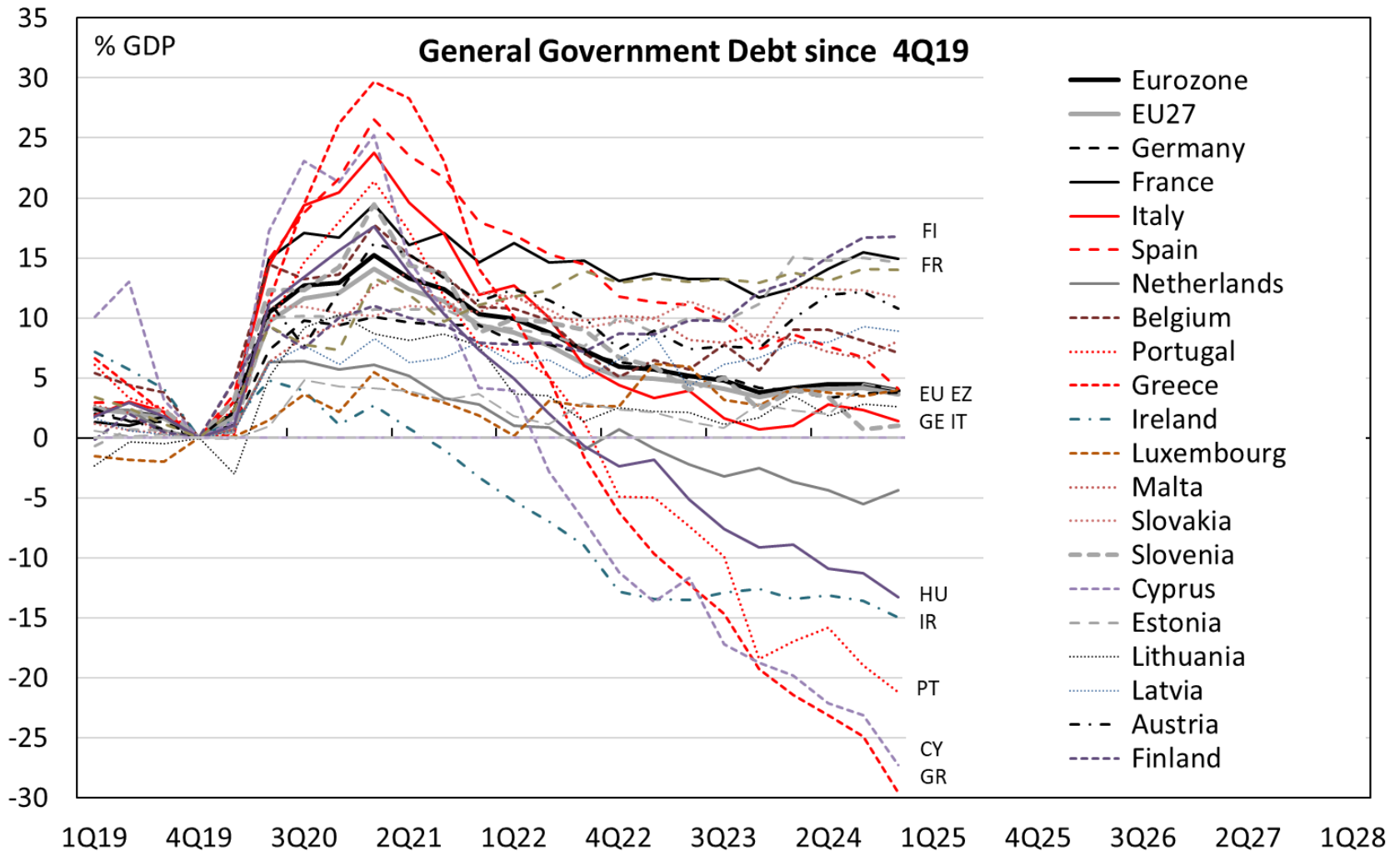
France again has a much higher and rigid expenditure



Source: LSEG (Datastream), European Commission, LC-MA calculations.

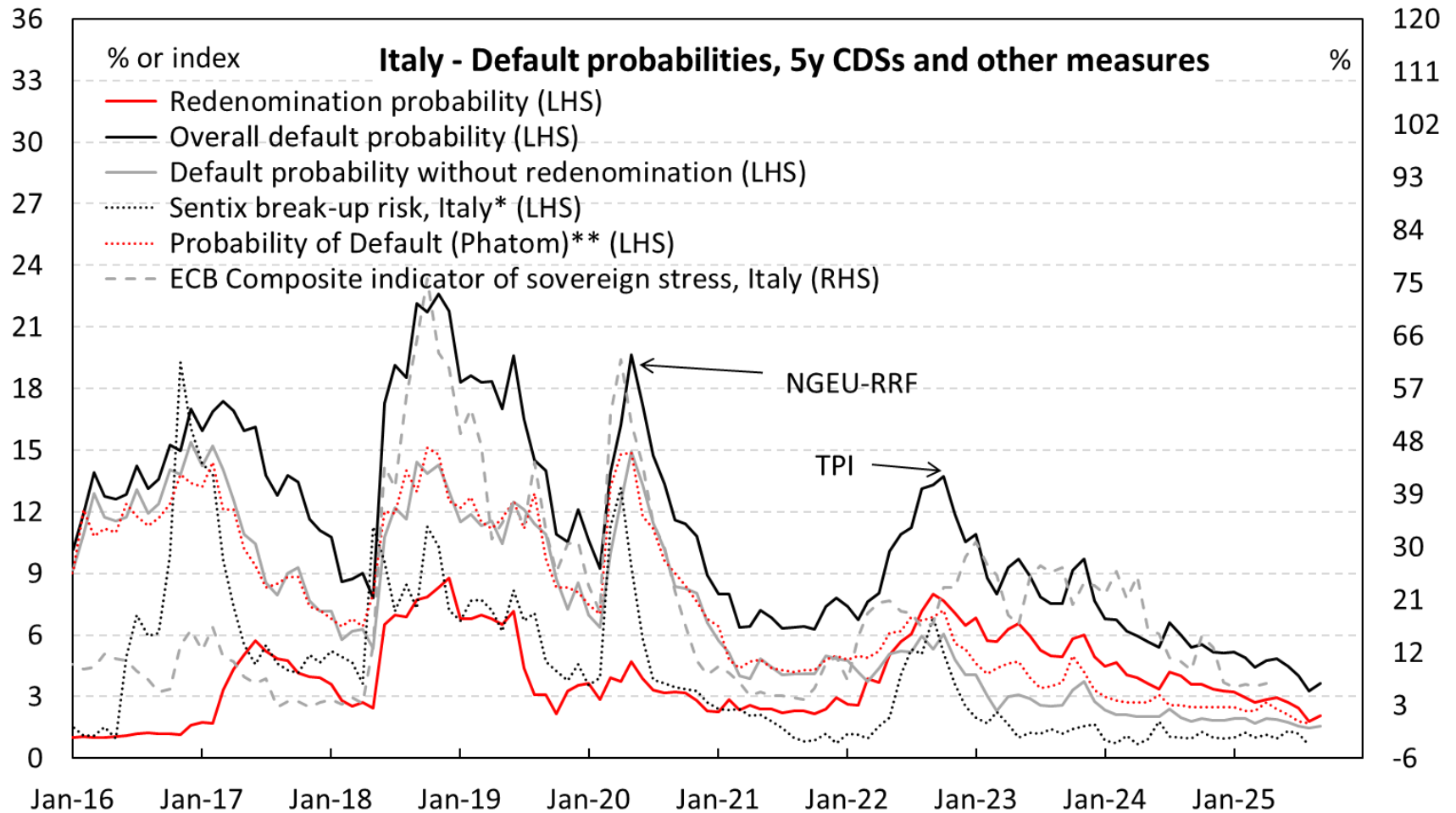
PUBLIC FINANCES

Debt ratio performances have differed since the pandemic



Source: LSEG (Datastream), European Commission, LC-MA calculations.

Credit premia have steadily declined

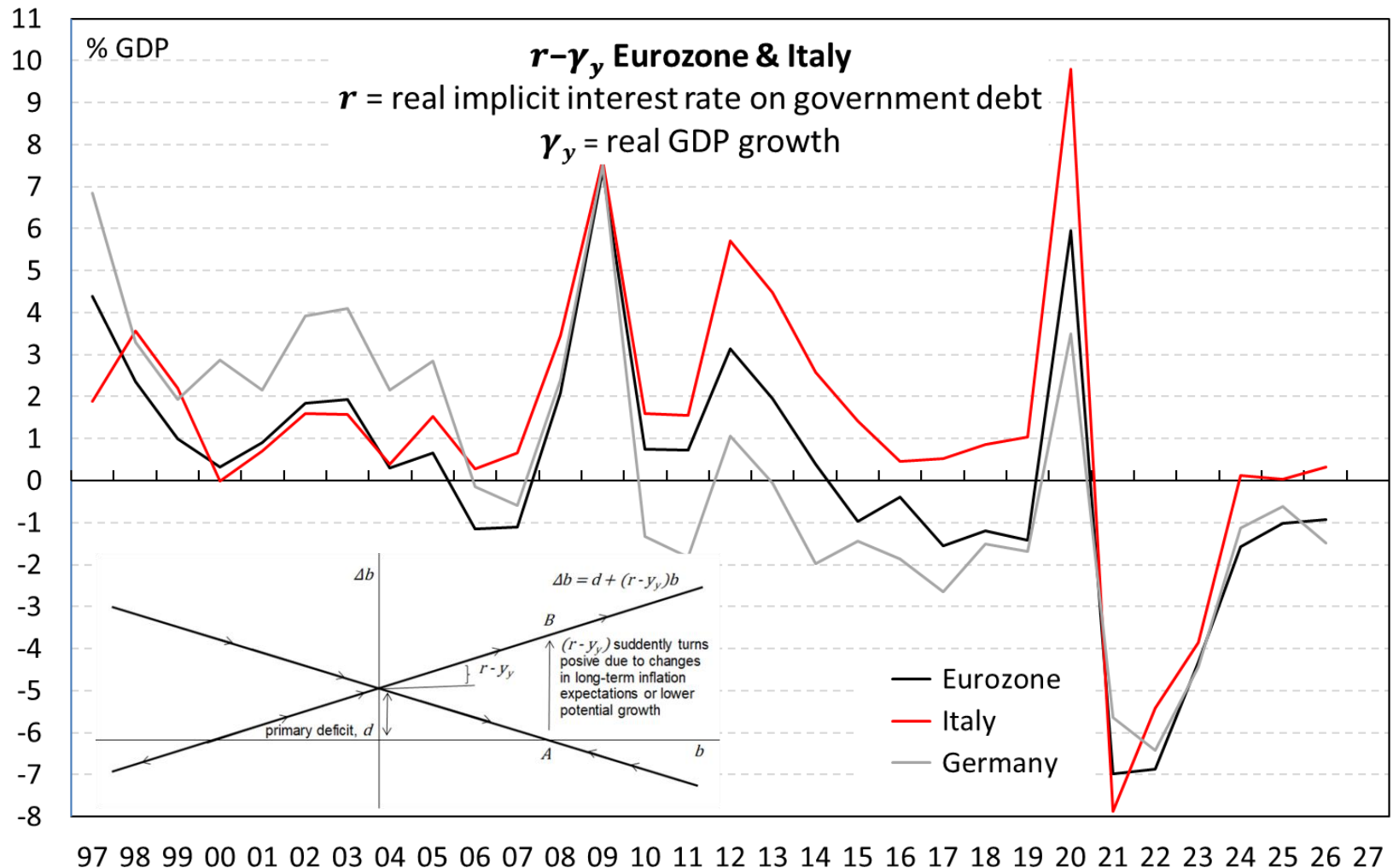


Source: LSEG (Datastream), LC-MA calculations based on a 60% recovery rate.

*Percentage of investors who expect at any given time that at least one country will leave the euro area within the next twelve months. ** Unconditional CDS-implied probability.

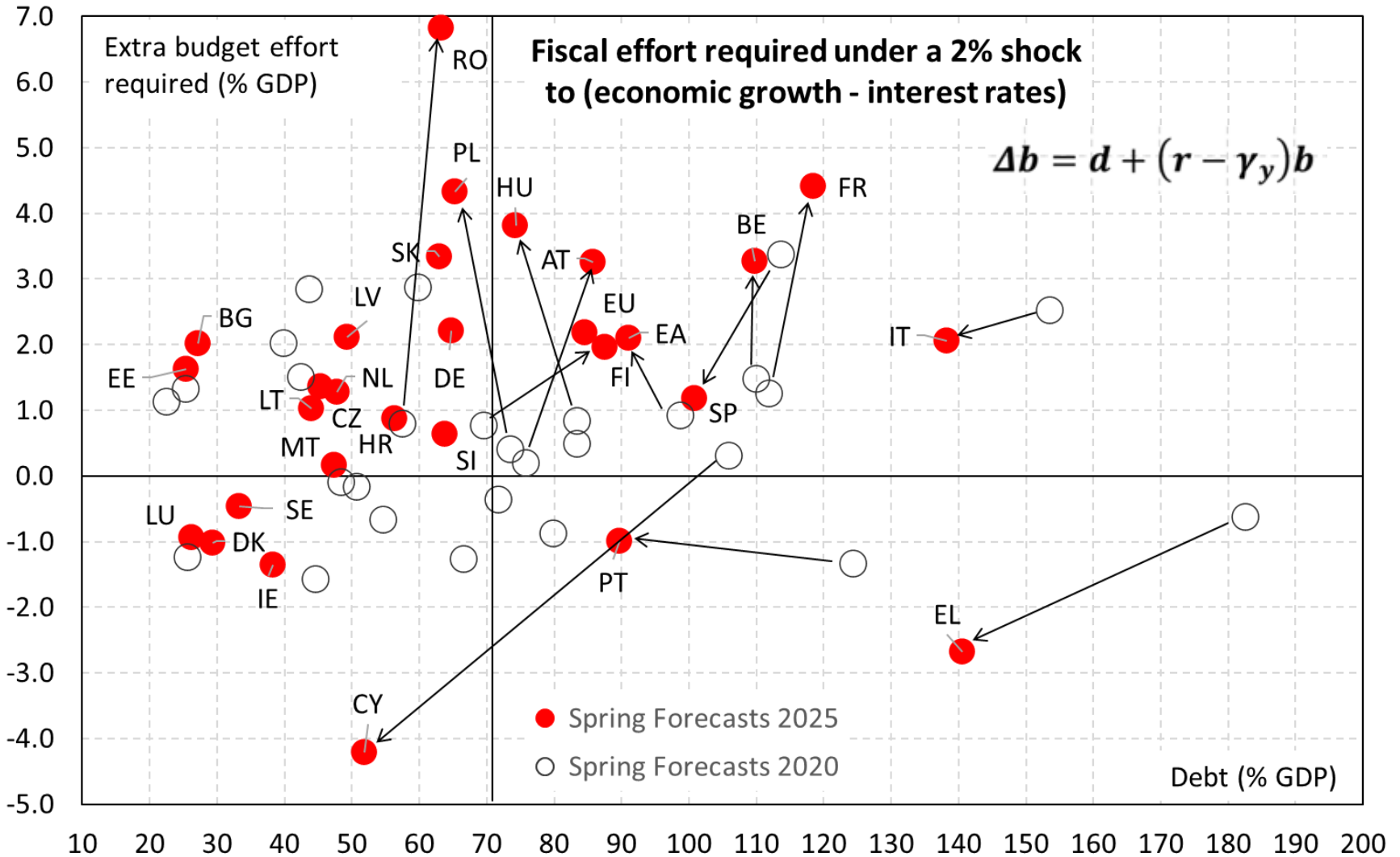
PUBLIC FINANCES

Can $r-y$ stay structurally low?



Source: EU Commission, AMECO, Refinitiv (Datastream), LC-MA calculations. r =implicit interest rates, y =nominal GDP

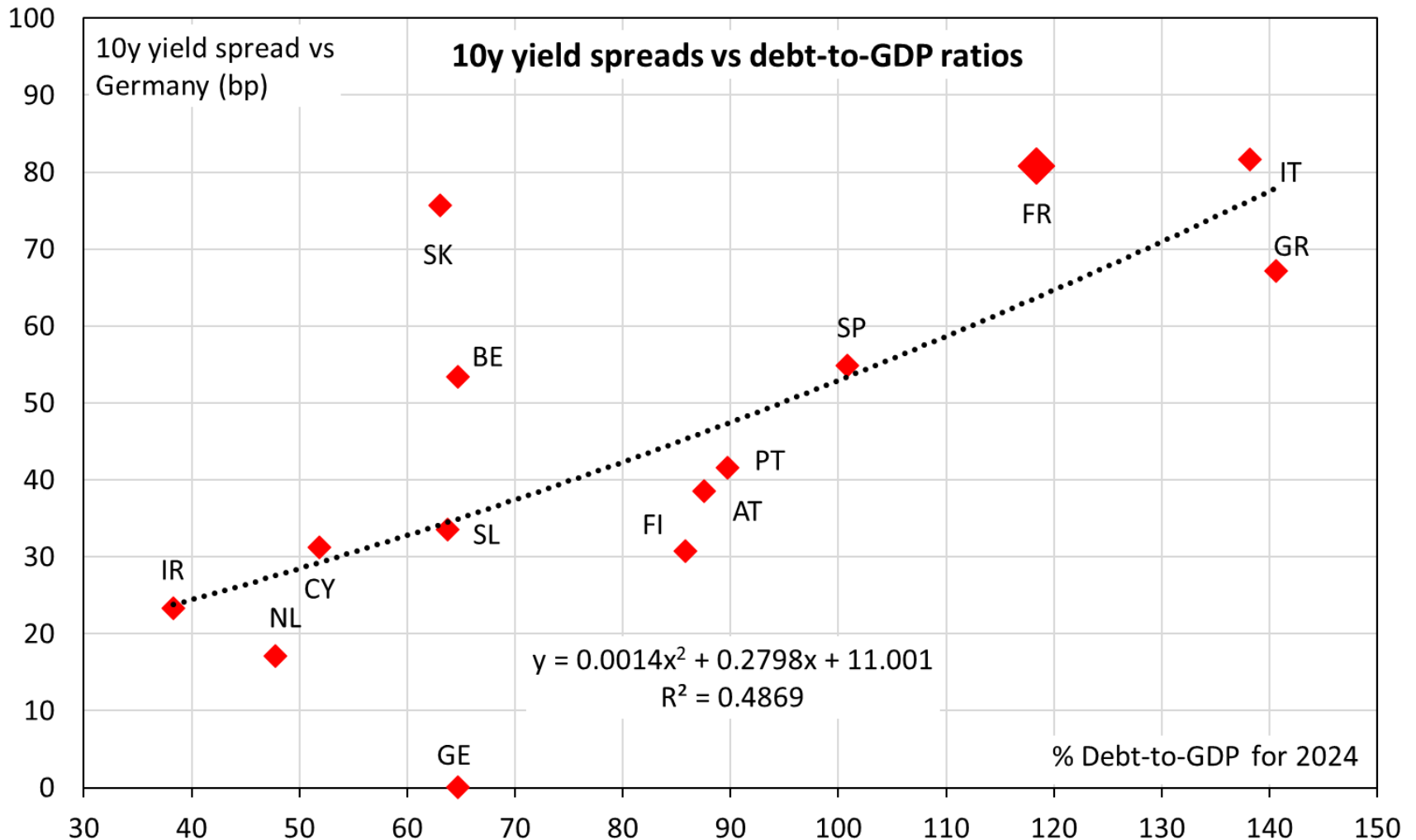
Why is France so problematic?



Source: LSEG (Datastream), European Commission data and projections, LC-MA

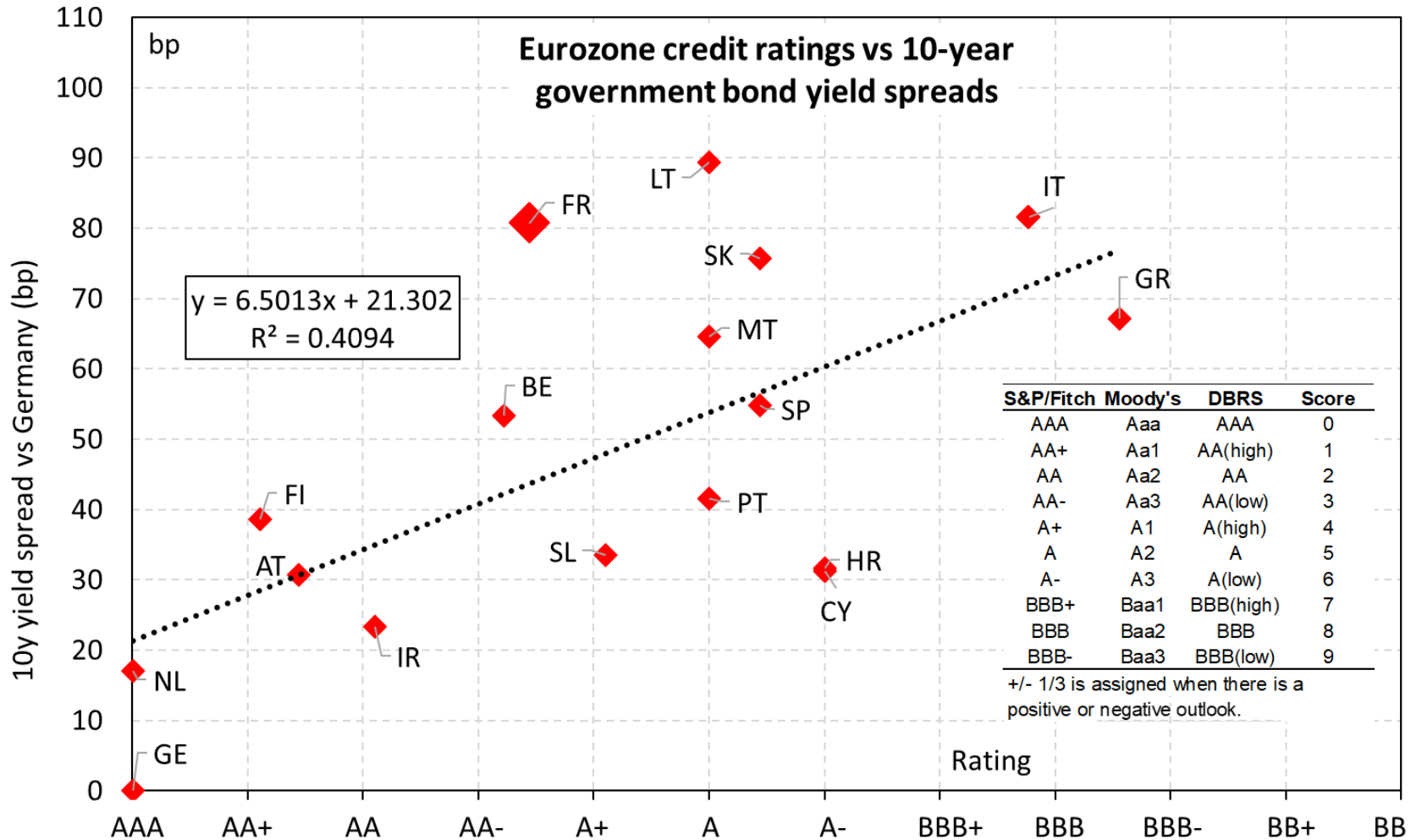
PUBLIC FINANCES

France: Higher premium than what would be justified by debt



Source: LSEG (Datastream), S&P's, Moody's, Fitch, LC-MA calculations. Malta, Croatia, Lithuania, Latvia, Estonia and Luxembourg are not included.

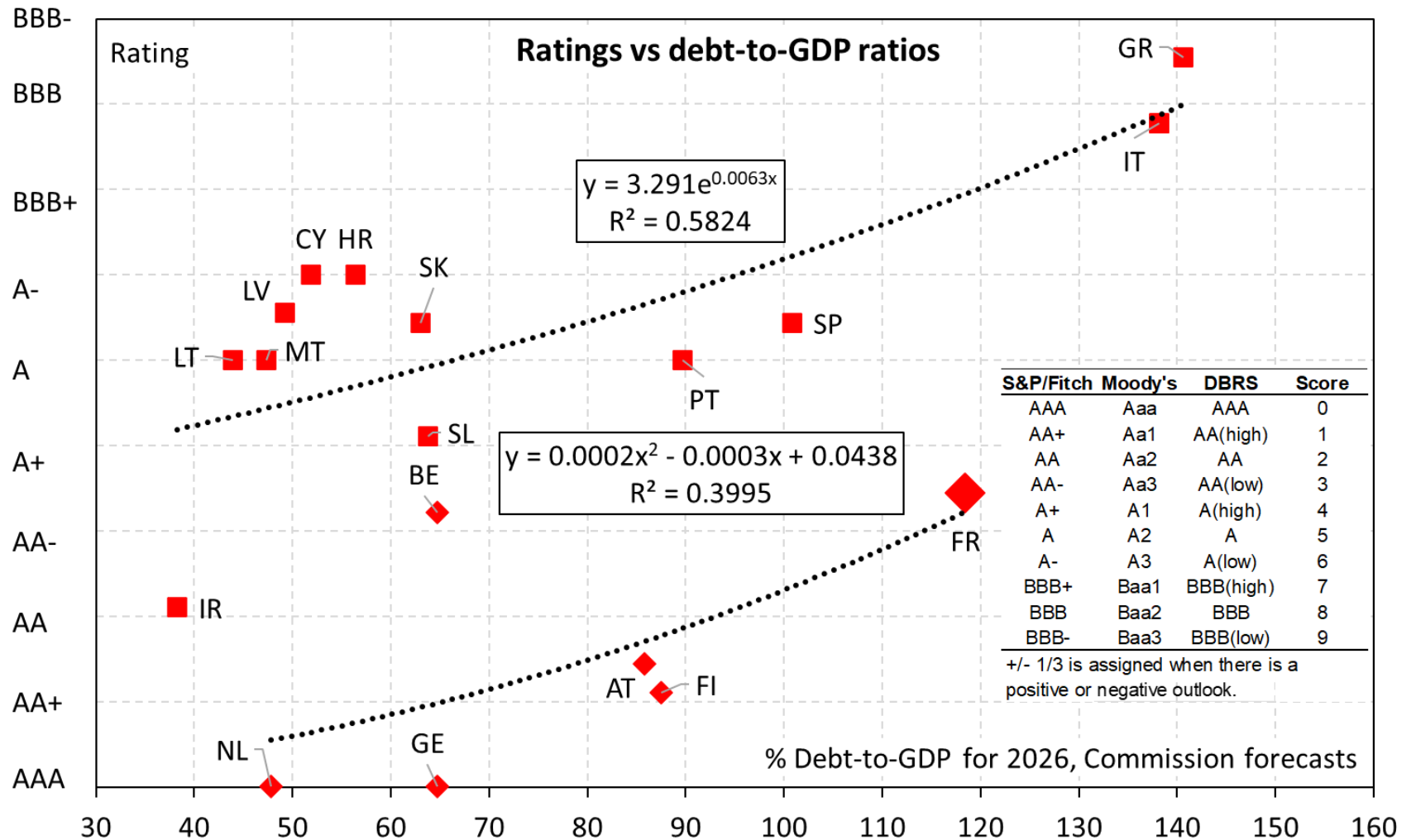
Markets price France for further rating deterioration



Source: LSEG (Datastream), S&P's, Moody's, Fitch, LC-MA calculations. NB: 10y benchmark yields (5y for Latvia). Estonia and Luxembourg are not included.

PUBLIC FINANCES

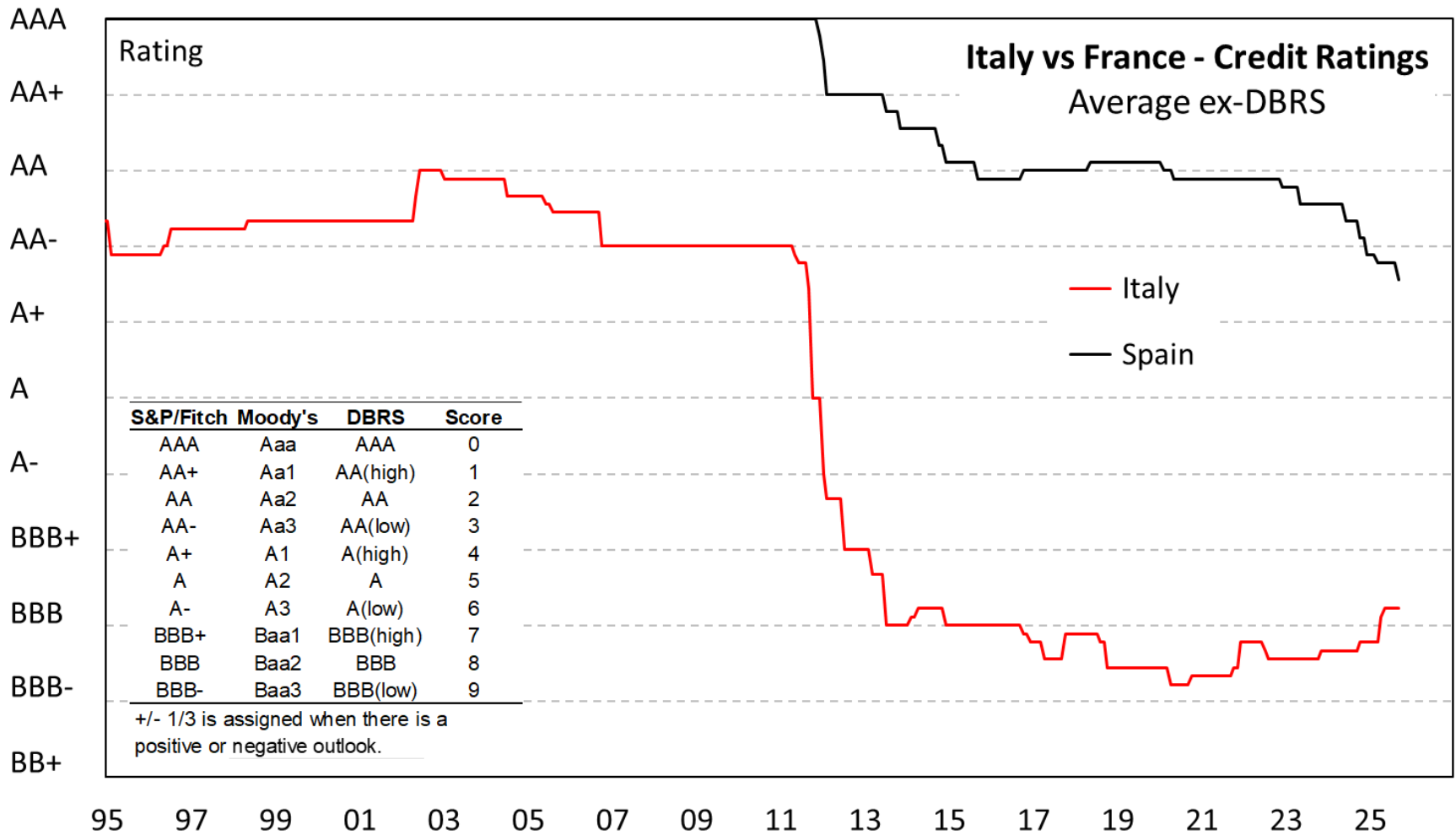
There is still a core-periphery divide when it comes to rating



Source: LSEG (Datastream), S&P's, Moody's, Fitch, LC-MA calculations. NB: 10y benchmark yields (5y for Latvia).

Estonia and Luxembourg are not included.

Italy vs France: A massive credit standing gap to bridge



Source: S&P's, Moody's, Fitch, DBRS, LC-MA calculations.

A conflict-prone and increasingly risky environment

- ◆ **Geopolitics:** Hedge against an escalation of the conflicts/crises.
- ◆ **Trump's tariffs:** US lower growth, higher inflation, no further rate cuts.
- ◆ **US economy:** -1.0pp tariffs likely compensated by fiscal stimulus.
- ◆ **Chinese economy:** Redirection of flows, no substantial weakening.
- ◆ **Global finance & geopolitics:** More tensions to come.
- ◆ **Eurozone economy:** Gradual expansion, resilience, high risks.
- ◆ **Monetary policy:** Stable rates from here, barring another shock.
- ◆ **Public finances:** No immediate risk of a crisis; yet more challenges.
- ◆ **Sovereign ratings:** Buy France and sell Italy? Not for now.



Lorenzo Codogno

Founder and chief economist of LC Macro Advisors Ltd

Visiting Professor in Practice at the London School of Economics and Political Science since March 2015. Visiting Professor at the College of Europe, Bruges, Belgium, since Sept 2021. Senior fellow LUISS LEAP

Chief Economist of the Italian Treasury, in charge of the Economic Analysis and Planning Directorate, between April 2006 and February 2015. Head of the Italian delegation at the Economic Policy Committee of the EU, chaired in 2010/2011 and thus attending Ecofin/Eurogroup meetings with ministers. At the OECD, head of the Italian delegation at the EPC, the EDRC and the WP1 (chaired between 2013 and 2015). Managing Director, senior economist and co-head of European Economics at Bank of America, London, between 1995 and 2006. Before that, Economist in the research department of Credito Italiano (now Unicredit).

Padua University, Italy, and Master's Degree from Syracuse University, NY, USA. Numerous publications, journal articles, and policy papers. A regular commentator on financial media and leading newspapers.



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