

Economic and Geopolitical Outlook: US Market Analysis and Sentiment

Executive Summary

The current state of the United States economy reflects a growing divergence characterized by a "K-shaped" recovery, where affluent consumers benefit from stock market gains while lower-income brackets face significant pressure from rising inflation and job insecurity. While the US initially maintained a stronger position than Europe following the onset of the war in the Persian Gulf, economic sentiment is deteriorating rapidly in the second quarter of 2025.

Critical takeaways include:

- **Inflationary Resurgence:** Personal Consumption Expenditures (PCE) inflation has reached 3.3%, driven by high energy costs, tariffs, and the growing electricity demands of AI infrastructure.
- **The "K-Shaped" Divide:** A stark split exists between the high-income cohort, buoyed by the tech and AI boom, and lower-income consumers who are pulling back on spending as gasoline prices exceed \$4 to \$5 per gallon.
- **Monetary Policy Tension:** The newly appointed Federal Reserve Chairman, Kevin Warsh, faces immediate political pressure from the Trump administration to cut rates, despite an economic reality that may require rates to remain steady or even increase.
- **Geopolitical Strain:** The ongoing three-month war with Iran—initially predicted to be a "short excursion"—is significantly impacting consumer sentiment and energy prices, with 75% of Americans disapproving of the conflict.
- **Trade and Tariffs:** Despite legal challenges from the Supreme Court, the administration continues to pursue a tariff-heavy trade policy, the costs of which are largely being passed on to US consumers.

1. The State of the US Economy: Sentiment and Deterioration

While the US economy entered the year with relative optimism, current data suggests a significant downward shift in executive and consumer confidence.

Sentiment Trends

- **CEO Sentiment:** Analysis from the Conference Board indicates that CEO sentiment is "remarkably lower" in the second quarter compared to the first.
- **CFO Perspectives:** While CFOs have largely adapted to higher interest rates, they remain concerned about the ongoing Iran war, energy prices, and the impact of tariffs.

- **Comparative Health:** The US remains in a better position than Europe, where sentiment and economic indicators have taken a more severe hit over the past three months.

The K-Shaped Economy

The US economy is experiencing a profound divergence in consumer experience:

Sector/Cohort	Economic Experience	Key Drivers
Affluent Consumers	Stable/Positive	Stock market gains, job retention, AI-driven growth.
Lower-Income Cohort	Deteriorating	Job losses, stagnant income, high inflation.
Growth Industries	Booming	AI development, data center construction.
Consumer Retail	Pressured	Fast food chains and fashion brands catering to low-income groups are seeing pullbacks.

2. Inflationary Pressures and Consumer Impact

Inflation has become a central political and economic issue, accelerating at its fastest two-month rate since 2021.

- **PCE Data:** Core Personal Consumption Expenditure inflation stands at 3.3%, significantly above the Federal Reserve's 2% target.
- **Energy and Gasoline:** At the pump, Americans are seeing prices between \$4 and \$5 per gallon. In California, prices are even higher due to local levies. Since the beginning of the year, gasoline prices have risen approximately 50-60%.
- **The AI Factor:** The construction of data centers to fuel AI applications has led to "significant increases in energy prices." There is currently no resolution regarding who—consumers or corporations—will ultimately bear these rising costs.
- **Consumption Risk:** Because consumption accounts for two-thirds of the US economy, the "gut feelings" and sentiment of the consumer are critical indicators for the 2025 and 2026 outlook.

3. Monetary Policy and the Federal Reserve

The appointment of Kevin Warsh as Federal Reserve Chairman has introduced a period of potential friction between the executive branch and the central bank.

- **The Mandate vs. Reality:** Warsh was nominated with the expectation that he would lower interest rates. However, with inflation trending higher, "the economic backdrop really doesn't necessarily... scream for a rate cut."
- **Political Pressure:** President Trump has publicly called for lower rates almost immediately following Warsh's swearing-in, citing the burden of high mortgage rates.

- **Business Sentiment:** Interestingly, CFOs report that high interest rates are not their primary concern; most businesses have "gotten used to dealing with them." The business community is more focused on geopolitical stability and energy costs.
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4. Geopolitics: The Iran War and China Relations

The Iran Conflict

The war in the Persian Gulf has surpassed the three-month mark, defying early predictions of a swift conclusion.

- **Approval and Impact:** 75% of Americans do not approve of the war. Its continuation is stifling consumer spending as the retail industry looks toward the critical Christmas holiday season.
- **Strategic Leeway:** Iran maintains significant leverage through its influence over the Strait of Hormuz, complicating US efforts to bring the conflict to a close.

Relations with China

A recent two-day state visit by President Trump to Beijing has highlighted the complex rivalry between the two powers.

- **Perception of Success:** While the visit was viewed domestically as successful, it did not resolve underlying tensions regarding global trade and rare earth elements.
 - **Strategic Shift:** From the Chinese perspective, recent US actions—including tariffs and the Iran war—portray the US as "unreliable." This perception is leading other nations to readjust their alliances and refocus away from the United States.
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5. Trade Policy and the Midterm Elections

Tariffs as a Consumer Burden

The administration's trade policy remains centered on tariffs, despite the Supreme Court striking down significant portions of them earlier this year.

- **Cost Absorption:** Businesses have generally accepted that some form of tariffs will remain. Approximately 50% of these costs are being passed directly to consumers.
- **Public Awareness:** It has become a "generally accepted fact" among the public that US consumers, rather than foreign nations, are bearing the brunt of tariff costs.

The Midterm Outlook (November 3rd)

The political landscape is shifting as the midterm elections approach:

- **Polling Trends:** There is a realistic chance for Democrats to win the House and potentially the Senate.

- **Presidential Approval:** Satisfaction with President Trump's major policies is currently lower than during his first term and lower than the levels seen during the Biden administration's peak inflation periods.
- **Governance Style:** Trump's tendency to govern by "presidential decree" suggests that even if Democrats take control of Congress, the administration may continue to bypass legislative hurdles, leading to a "combative stance" in Washington.