

Section 2

WHERE IS THE U.S. ECONOMY HEADING?¹⁾

HONDA, Yuzo

1. The U.S. real economy

In January 2025, the four-year Biden administration under the Democratic Party ended, and the second Trump administration under the Republican Party started. One notable feature of the Biden administration period was that the United States (U.S.) economy performed remarkably well compared with countries in the eurozone and other non-U.S. G7 nations.

Figures 1-2-1, 1-2-2, and 1-2-3 show economic indicators from 2017 to 2025. Figure 1-2-1 depicts the U.S. economic growth rate, Figure 1-2-2 the percentage change in the consumer price index (CPI), and Figure 1-2-3 the unemployment rate, respectively.

In Figure 1-2-1, we find a sharp dip in the middle, which was caused by the COVID-19 pandemic. After this exogenous shock, the economy has been growing steadily since 2021 until today. The GDP growth rate has been stabilized roughly within the range of 2% to 3%. Figure 1-2-2 reveals that the inflation rate surged sharply after 2021, reaching more than 9% in 2022. This was largely driven by high global resource prices (an exogenous factor for the U.S.

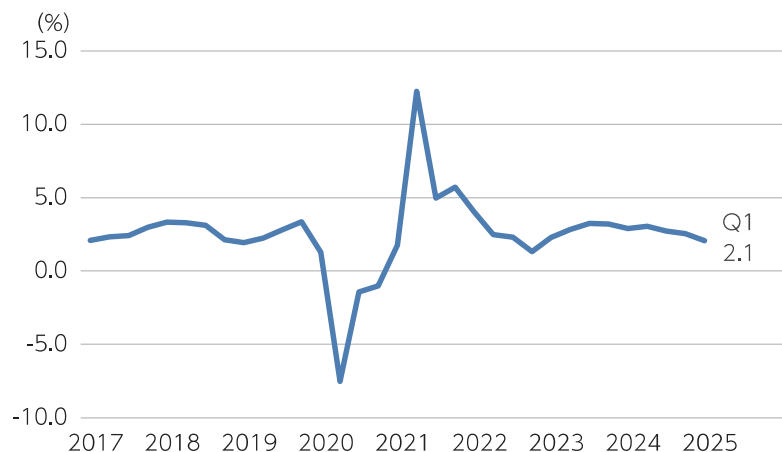


Figure 1-2-1 U.S. real GDP growth rate (YoY)

Source: Federal Reserve Bank of ST. LOUIS

1) I would like to express my gratitude to Mr. Kenta Koyama for his assistance in drawing the figures for this section.

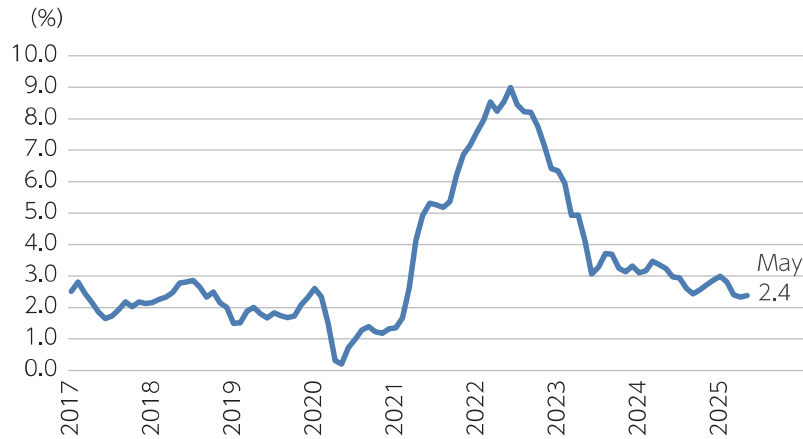


Figure 1-2-2 U.S. CPI inflation rate (YoY)

Source: Federal Reserve Bank of ST. LOUIS

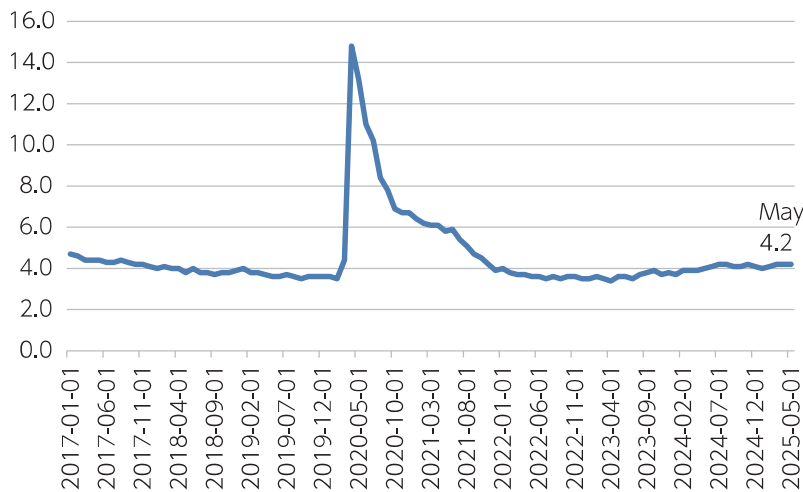


Figure 1-2-3 U.S. unemployment rate (YoY)

Source: Federal Reserve Bank of ST. LOUIS

economy). Excluding this exceptional period, the inflation rate has generally remained within the 3% range at most.

Figure 1-2-3 indicates that the unemployment rate deteriorated to a record high of 14.7% in April 2020, when the COVID-19 pandemic spread across the U.S. However, excluding this period, the unemployment rate has been around 4%.

As described above, excluding exogenous factors such as the COVID-19 pandemic and the global surge in resource prices, the U.S. economy has demonstrated remarkably robust performance throughout the four years of the Biden administration. What are the fundamental reasons for this? While technological innovation during this period undoubtedly played a significant role in supporting the robust U.S. real economy, another crucial factor lies in the economic

policies implemented by the U.S. government and the Federal Reserve Board of Governors (FRB).

In this section, we will first review the economic policies implemented during the Biden administration. We will then introduce the economic policies of the second Trump administration, which began approximately six months ago, and consider these policies as well as the future of the U.S. economy.

The organization of this section is as follows. Subsection 2 explains the fiscal policy of the Biden administration, and the fiscal and tariff policies of the second Trump administration. Subsection 3 discusses the monetary policy pursued by the FRB under both the Biden and the second Trump administrations. Subsection 4 examines the impact of the high tariff policy adopted by the second Trump administration. Subsection 5 considers how these policies have affected the U.S. economy thus far and what effects they may have in the future.

2. Fiscal policy and tariff policy

In this subsection, we briefly review the fiscal policy of the Biden administration, and then the fiscal and trade policies of the second Trump administration.

(1) Expansionary Fiscal Policy of the Biden Administration

Fiscal and monetary policies under the Biden administration had a prominent characteristic. The U.S. government and the FRB implemented their respective policies independently and yet ultimately in a coordinated manner in response to two major exogenous negative shocks, the rapid spread of COVID-19 and the global surge in resource prices. As far as fiscal policy is concerned, in March 2021, shortly after President Biden took office, the Biden administration introduced the American Rescue Plan Act, amounting to approximately \$1.9 trillion, to counter the economic stagnation caused by the spread of the COVID-19 pandemic. After that the Biden administration kept seamlessly large-scale expansionary fiscal policies, such as its infrastructure development plan. For example, in April 2024, a foreign aid bill worth approximately \$95 billion for Ukraine, Israel, and Taiwan was approved by Congress and implemented. The aid to Ukraine and others means the government would purchase approximately \$95 billion worth of weapons, increasing fiscal spending, stimulating the domestic economy, and raising the inflation rate and interest rates.

Expansionary fiscal policy raises interest rates and increases total spending. This seems to be one of the key factors supporting the robust U.S. economic growth rate for the period under the Biden administration. We will discuss monetary policy in subsection 3.

(2) Fiscal Policy and Tariff Policy of the Second Trump Administration

Will the robust U.S. economy change with the advent of the second Trump administration? In the rest of this subsection, we will explain the economic policies implemented by the second Trump administration over the past six months.

The second Trump administration has primarily implemented three economic policies to date: 1) Department of Government Efficiency (DOGE), 2) high tariff policy, and 3) the “One Big Beautiful Bill (OB BB)” (U.S. tax cuts and spending bill).

1) DOGE

As soon as President Trump took office, he issued an executive order establishing the DOGE to improve government efficiency. The DOGE concept is in line with President Trump’s presidential campaign pledge to reduce federal spending, and shrink the size of government and the federal budget deficit. When the second Trump administration took office, Elon Musk and the DOGE team gained access to most of the U.S. federal government. In addition, hundreds of thousands of U.S. federal government employees were laid off, and a large number of public records were modified or deleted from federal government agency websites and databases. To date, 19 federal government agencies, including the U.S. Agency for International Development (USAID), have been targeted for dismantling or downsizing by DOGE, resulting in the layoff of agency employees and the abolition or downsizing of programs involving those agencies. In terms of macroeconomics, DOGE’s activities represent a reduction in government spending in the short run, decreasing total expenditure across the economy. In the long run, however, it is quite possible that the laid-off government employees could achieve higher productivity in new jobs in the private sector, potentially increasing U.S. productivity.

2) High Tariff Policy

The second Trump administration has implemented a series of tariff policies since February 2025. These tariffs imposed by the second Trump administration (hereafter referred to as “Trump tariffs”) can be broadly categorized into three types. The first type consists of tariffs on specific goods, such as automobiles, iron and steel, and aluminum. The second type involves a flat 10% tariff imposed on all exporting countries to the U.S. The third type comprises country-specific additional tariffs, where extra duties are imposed on individual nations based on their trade balances. The second type, the flat tariff, was already enacted and implemented on April 5, 2025. Regarding the third type, the country-specific

additional tariff (also referred to as “reciprocal tariffs”), a 90-day suspension order was issued, and as of June, negotiations between the U.S. and exporting countries were under way. This 90-day suspension period is set to end on July 6, 2025.

Despite these differences in tariff types, their economic impact is fundamentally the same. First, they raise the overall price level in the U.S. by increasing the tax-inclusive price of imported goods. Second, imposing higher tariffs on imports is just like raising the consumption tax on those goods, thereby reducing consumers’ real income. Moreover, unlike a consumption tax hike, the impact extends beyond consumer goods to include capital goods as well. Clearly, these two effects, increasing the price level and decreasing consumers’ real income, are negative for the U.S. economy.

However, the effects of tariffs do not stop there. By raising tariff rates, the U.S. government can increase tax revenue. It could then use this revenue to boost the purchasing power of citizens (e.g., by reducing income taxes) or to improve domestic production infrastructure (e.g., by reducing taxes on businesses), thereby increasing per capita productivity. This latter effect is positive for the economy. Whether the negative effects on the economy mentioned above dominate or the latter positive effects dominate differs on a case by case basis. Moreover, when the U.S. raised tariffs this time, countries like China and Canada immediately implemented retaliatory tariffs. Retaliatory tariffs clearly have a negative effect on the U.S., but the magnitude of that effect also varies case by case. Thus, as of May 2025, the U.S. economy and the global economy are operating under great uncertainty.

3) “One Big Beautiful Bill” (U.S. Tax Cuts and Spending Bill)

On July 4, 2025, President Trump signed into law the “One Big Beautiful Bill” (a major tax cuts and spending bill), centered on making permanent the Trump tax cuts (time-limited tax cuts implemented during his first administration). The tax cuts include provisions such as deductions for domestic research and development expenses and special depreciation for capital investments, providing a tailwind for businesses. According to the Congressional Budget Office (CBO), this law will result in a \$3.4 trillion (approximately JPY 490 trillion) deficit. However, newspaper reports indicate that the White House has released an explanatory statement claiming this bill will reduce the fiscal deficit by \$4.5 trillion, leaving assessments on this point still undetermined. While the bill largely extends existing tax cuts, so its overall economic stimulus effect may be limited, it is fundamentally centered on tax reductions and is therefore expected to have a positive effect on total economic spending.

The above outlines the fiscal and tariff policies implemented under the Biden and second Trump administrations.

3. Monetary policy

In this subsection 3, we will explain the monetary policy under the Biden and second Trump administrations.

Since March 2020, COVID-19 infections rapidly spread across the U.S. Simultaneously with the spread of the infection, total spending and total production plummeted, and the U.S. unemployment rate reached a staggering 14.7% in April 2020. This is the highest unemployment rate since the Great Depression. To address this situation, the government and the FRB immediately implemented bold expansionary fiscal policy and expansionary monetary policy, respectively. Some economists sounded the alarm from the outset, warning that the scale of these expansive policies by the government and the FRB were excessive. Looking back now, these warnings were correct. As they feared, the U.S. economy was hit by high inflation.

It was also unfortunate for the U.S. government and the FRB that Russia invaded Ukraine in February 2022. The Russia-Ukraine war triggered soaring global resource prices and surging costs for food and other goods, further exacerbating U.S. inflation. By September 2022, the U.S. CPI inflation rate reached 9.1% YoY (see [Figure 1-2-2](#)). To curb high inflation, the FRB abruptly shifted to tightening monetary policy starting in 2022. For fear that high inflation might become entrenched, the FRB sharply tightened its monetary policy. As a result, as shown in [Figure 1-2-2](#), the inflation rate hit the peak in September 2022, and then began to decline, putting the US economy on track for a soft landing toward the 2% inflation target.

However, starting around the summer of 2023, inflation remained stubbornly high at around 3.5% for nearly one year. The FRB had difficulty in lowering this persistent high inflation rate without recession for about a year, but finally inflation began to decline, putting the US economy closer to its 2% inflation target. The FRB under the Biden administration largely responded appropriately to two negative exogenous shocks—the COVID-19 pandemic and soaring global resource prices—though its response was occasionally somewhat delayed.

The primary challenge for the FRB under the Biden administration was the trade-off between high inflation and the risk of recession. Trump tariffs tend to increase inflation domestically while simultaneously reducing aggregate spending. Therefore, in the short run, Trump tariffs simultaneously exert negative effects on both aspects of the Biden administration's trade-off: high inflation

and recession risk. The current FRB must simultaneously address both issues of rising inflation and reduced aggregate spending caused by higher tariffs. In other words, the FRB has to assess which of the two evils causes greater harm to the American people, the higher inflation or reduced aggregate spending. As of June 2025, the FRB is in a position of waiting for the economic effects of the Trump tariffs to manifest themselves in concrete figures. In this sense, the current Fed is serving as the last line of defense to protect the U.S. economy, taking into account of the effects of fiscal policy and tariff policy by the second Trump administration.

4. Trump Tariffs and the Global Economy

The Trump tariffs in Subsection 2 raise unprecedented new issues in at least three areas: (1) the intensification of the U.S.-China hegemonic rivalry, (2) the significant deviation from free trade principles by the U.S. and the resulting decline in global economic growth rates, and (3) the responses of U.S. trading partners to high tariffs.

(1) The Intensification of the U.S.-China Hegemonic Rivalry

The U.S. holds hegemony in the following four domains: (A) Economy, (B) Currency, (C) Technology, and (D) Military power.

For example, suppose the Tokugawa shogunate minted one-ryō gold coins (a type of Japanese gold coin in Edo period) containing 20 grams of pure gold. If at some point the shogunate halved the gold purity in these 20 gram coins to 10 grams, it could mint two coins from the same 20 grams of gold. The second coin could then be used to cover the shogunate's fiscal deficit. The profit the shogunate gains by issuing this second coin is called "seigniorage".

The U.S. dollar is the world's most trusted currency, making it the most widely used in international transactions worldwide. The dollar serves both as the currency in the U.S. domestic economy, and as the currency in international transactions across countries, earning it the title of a "key currency" or "base currency". The U.S. reaps the seigniorage benefits from the issuance of the dollar used in global transactions. Similar to the example of the Tokugawa shogunate mentioned above, the U.S. gains an immeasurable profit because the U.S. dollar is the dominant currency in global transactions. The status of U.S. as the currency hegemon is one of key factors enabling it to run trade deficits for decades without facing bankruptcy. Furthermore, because the US dollar is the hegemon, U.S. companies, unlike companies outside the U.S., are shielded from foreign exchange risk in their international transactions. These are special

benefits that come from the US dollar's hegemon status. Currently, the U.S. is not only the currency hegemon but also the hegemon in the four domains mentioned above. China has recently emerged as a potential challenger to this U.S. hegemony, and the rivalry for supremacy between the two nations became apparent during the first Trump administration. The high tariff policy on China initiated during the first Trump administration was continued by the subsequent Biden Democratic administration. With the "Trump tariffs" imposed by the current second Trump administration, this policy has been consistently and seamlessly implemented since 2017.

In this round of "Trump tariffs," the U.S. imposed a 30% tariff on imports from China, while China imposed a 10% tariff on imports from the U.S., with both countries agreeing to these measures. However, the rivalry between the two nations over hegemony will undoubtedly continue.

Before World War II, hostile nations each built their own economic blocs and imposed higher tariffs against foes, further exacerbating their antagonistic relations. The world eventually plunged into World War II. Therefore, high tariff policies also heighten the risk that similar events might occur in the future in the worst-case scenario.

(2) A significant deviation from free trade principles by the U.S. and a decline in global economic growth rates

When people in a country that has been producing and consuming within a self-sufficient closed economy are given the opportunity to trade with foreign countries, they become able to exchange goods that previously could not be traded (or sold) domestically. By producing more of the goods in which their country has a comparative advantage and exporting them abroad, they can increase production, while by importing goods in which their country has a comparative disadvantage, they can increase consumption. If trading partners adopt similar measures, both countries may find opportunities to increase both their production and consumption. This can create a win-win relationship where both nations prosper. This is the benefit of trade. The principle of free trade is based on this concept. High tariff policies that shrink trade run counter to the free trade principle, worsening the efficiency of production and consumption in the global economy as a whole. Consequently, it is unavoidable to experience a slowdown in the overall global economic growth rate. The International Monetary Fund also significantly revised downward its forecast of global economic growth in April 2025. An even greater concern is the potential spread of U.S. protectionism to other nations. In July 2025, the Canadian government announced it would impose tariffs of up to 50% on certain imported Iron and

Steel products. The more other countries adopt measures similar to those of the U.S., the further the global economy will deviate from the efficient production based on the principle of free trade, leading to a decline in the global economic growth rate.

(3) Responses from trading partner countries

On April 2, 2025, President Trump announced the introduction of country-specific reciprocal tariffs. Responses from trading partners varied by nation. For instance, Canada and the EU immediately announced retaliatory tariffs, while Japan and South Korea announced they would promptly enter negotiations. Each country's response differed significantly. Amid concerns that it would be practically difficult for the U.S. to negotiate with numerous trading partners, on April 9, the U.S. announced it would suspend the additional tariffs (the portion excluding the flat 10% tariff) for 90 days for countries and regions that did not take retaliatory measures. Furthermore, as the 90-day suspension period neared its end on July 9, the U.S. announced an extension of the suspension period until August.

Here, we will briefly note two points. First, the Trump tariffs will have negative economic effects on trading partners, at least in the short run. High tariffs undoubtedly have a negative impact on the global economy, in the sense that they divert the world economy from its optimal path. Second, the adverse impact of high tariffs on each country could be huge, depending on the respective country. Regarding this point, it is so obvious when we think of the case of Japan. The impact of the Trump tariffs even on one single item such as the automotive industry could be devastating to the entire Japanese economy, since the industry includes not only the core automotive industry but also the broad range of supporting industries it relies on.

5. Concluding Remarks

Approximately six months have passed since the second Trump administration took office. Subsection 2 explained the three main economic policies implemented by the Trump administration during this period: (1) DOGE, (2) high tariff policy, and (3) "One Big Beautiful Bill" (U.S. tax cuts and spending bill).

(1) DOGE aims to streamline administration and reduce government spending. The reduced government spending decreases the total expenditure of the economy in the short run. In the long run, however, personnel previously employed in the government sector may be freed up and could significantly contribute to increase productivity in the private sector. Therefore, it is not possible

to draw a definitive conclusion regarding its impact on the U.S. economy.

(2) The high tariff policy directly reduces U.S. domestic consumption by raising the price of relevant goods. Simultaneously, it also has the effect of raising domestic prices due to the increase in the price of imported goods. Both of these have negative effects on the U.S. domestic economy.

(3) Regarding the effects of the U.S. tax cuts and spending bill, we presume that they will increase total spending, though there are currently differing views between the Congressional Budget Office and the White House.

The combined effects of these three policies are expected to significantly influence the future trajectory of the U.S. economy. However, since all policies are currently ongoing and each carries substantial uncertainty, it is difficult to provide a comprehensive assessment of these policies at this time. What is certain is that these economic policies are already exerting a major impact on both the U.S. and global economies. In particular, the three points regarding the Trump tariffs highlighted in Subsection 4 will likely hold significant implications for the future of both the U.S. and global economies.

Since the first Trump administration, the U.S. government has largely implemented appropriate macroeconomic policies, supporting the strong performance of the U.S. economy. Therefore, it is reasonable to expect that the U.S. economy will maintain its strong performance for some time to come. To achieve this, it is essential that the FRB acts as the final bastion of economic policy as it has been in the past. It must fulfill its role of ultimately steering the economy in the desired direction through monetary policy, while taking into account the real economy and other economic policies. Crucially, the independence of the central bank must be safeguarded. This independence has been built upon the long-term experience, wisdom, and academic accumulation of knowledge regarding the U.S. economy.