

Markets on edge

Geopolitics, trade war and AI disruption

- The ECB's latest rate cut, geopolitical shocks, trade tensions, and technological shifts are adding new layers of complexity to an already uncertain global economic landscape.
- Financial markets are reacting to heightened uncertainty, with sectors like defense, technology, and manufacturing experiencing significant shifts as investors reassess risks and opportunities.

The ECB's latest rate cut in March 2025 has widened the divergence with the U.S. Federal Reserve's monetary strategy, adding new complexities to global markets

Financial markets in 2025 are navigating a complex landscape shaped by geopolitical tensions and rapid technological advancements. Events range from sharp geopolitical disruptions to paradigmatic specific events in the AI industry. Key episodes, such as the recent Oval Office confrontation between U.S. President Donald Trump and Ukrainian President Volodymyr Zelenskyy, the emergence of China's DeepSeek in the artificial intelligence (AI) sector, and escalating tariffs, and possibly trade wars, are exerting significant influence on global economic dynamics. The recent decision by the ECB on 6 March 2025, which again lowered interest rates 25bp, widened the divergence with the U.S. Federal Reserve's monetary strategy. The future of interest rates globally will likely be affected by the potential impact on inflation and economic growth prospects.

The latest news comes from the European reaction to geopolitical events, particularly, the end of U.S. financial aid to Ukraine. The plan to substantially increase defense spending across the EU and Britain has had a considerable impact on financial markets' performance. European stock markets witnessed increases in share prices while the cost of borrowing for governments significantly increased. The highlights include Germany's expansionary fiscal plans for both defense and economic infrastructure. The latter entails a €500 billion infrastructure fund for transportation, energy grids and housing.

Geopolitical tensions: The U.S.-Ukraine rift

The halt in U.S. aid to Ukraine not only strains U.S.-Ukraine relations but also raises concerns about the stability of Eastern Europe, prompting investors to reassess risks associated with the region

In late February 2025, a heated exchange occurred in the Oval Office between President Trump and President Zelenskyy. The confrontation arose over differing approaches to the ongoing conflict in Ukraine, with Trump accusing Zelenskyy of prolonging the war and gambling with global security. This meeting concluded abruptly, leading to a suspension of U.S. military aid to Ukraine. The halt in aid not only strains U.S.-Ukraine relations but also raises concerns about the stability of Eastern Europe, prompting investors to reassess risks associated with the region.

Trade wars and tariff turbulence

The U.S. administration's decision to impose steep tariffs on imports from Canada and Mexico has escalated trade tensions, with both nations considering retaliatory measures. These actions disrupt established supply chains and introduce inflationary pressures, affecting industries reliant on cross-border trade. Uncertainty stemming from potential trade wars contributes to market volatility, as businesses and investors grapple with the implications of rising protectionism for global economic growth.

The U.S. administration's steep tariffs on imports from Canada and Mexico are fueling trade tensions, disrupting supply chains, and introducing inflationary pressures

Technological disruptions: DeepSeek's entry into AI

In January, China's DeepSeek made a groundbreaking entry into the AI industry by developing cost-effective, high-performance AI models. Utilizing innovative techniques, DeepSeek significantly reduced the resources required for AI development, challenging established players like OpenAI and Google. This democratization of AI technology is expected to lower barriers to entry for smaller firms, intensifying competition and potentially leading to reduced profit margins for incumbent tech giants. Investors are closely monitoring these developments, as they may lead to a revaluation of technology stocks and shifts in market leadership within the sector.

China's DeepSeek has upended the AI sector by developing cost-effective, high-performance models, intensifying competition and reshaping market dynamics within the sector

Economic and financial market implications

The convergence of these geopolitical and technological events is creating a volatile environment for financial markets. Investors are exhibiting heightened sensitivity to news related to geopolitical conflicts and technological disruptions, leading to increased market fluctuations. Sectors directly impacted by these developments, such as defense, technology, and manufacturing, are experiencing notable shifts in valuations. The suspension of military aid to Ukraine has led to a reevaluation of defense stocks, while DeepSeek's AI advancements are prompting a reassessment of technology companies' competitive positions. Additionally, industries exposed to international trade are facing uncertainties due to escalating tariff disputes.

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Outlook for the coming months

Looking ahead, financial markets are expected to remain sensitive to geopolitical developments and technological innovations. The trajectory of U.S.-Ukraine relations and the potential for further escalation or resolution will significantly influence investor sentiment. Trade policies and the possibility of new tariffs or trade agreements will continue to be critical factors shaping global economic prospects, potentially impacting inflation and growth perspectives. These evolving dynamics make navigating the uncertainties of 2025 more challenging.