Funcas Intelligence

THE POLITICIZATION OF MARKETS AND INSTITUTIONS: HOW GOVERNMENTS ARE RESHAPING ECONOMIC RULES

November 2025

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Funcas Intelligence (FI) is a publication directed towards a broad base of international and Spanish readers. Funcas Intelligence´s focus is to identify and assess the game changers and relevant events of the global economy and the financial sector with potential impact for Spain.

FI is produced by the staff of Funcas under the direction and supervision of Managing Editors Ms. Alice Faibishenko and Mr. Juan Núñez-Gallego. We would like to especially thank Santiago Carbó Valverde for providing the views expressed in the article titled, *Central Banks Navigate Late 2025.*

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Large negative revisions to employment data have complicated the Federal Reserve's task of gauging the degree of slack in the economy, with concerns related to the reliability of U.S. economic data adding to the already uncertain economic outlook. 2026 is set to mark the sixth consecutive year of inflation above the Federal Reserve's two-percent target, heightening risks to its institutional credibility as prolonged price pressures could erode public and investor confidence in the Fed's independence and effectiveness.

Central Banks Navigate Late 2025

Crossroads with markets weighing a soft-landing scenario

→ The Fed delivered another rate cut, signaling cautious flexibility amid early signs of cooling growth, while the ECB held rates steady, emphasizing patience as inflation nears target and recovery stabilizes.

→ Financial markets appear to be embracing a soft-landing narrative despite persistent geopolitical and financial crosscurrents.

United States: Second cut and strategic patience

On 29 October the Federal Reserve lowered the federal funds target range by 25 basis points, to 4.00–4.25%, marking its second rate cut since September. The decision reflects growing confidence that inflation is on a durable path towards the 2% objective, but also recognition of emerging slack in the labor market and weaker business investment.

Chairman Jerome Powell emphasized that "policy will remain data-dependent," signaling that further easing is possible but not pre-committed. While headline inflation has eased to 3.0%, core inflation remains sticky, particularly in services and shelter components. The Fed's challenge is to balance the softening macro momentum with the risk of reigniting inflation through premature cuts.

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The government shutdown is delaying the publication of key macroeconomic statistics. In any event, the U.S. economy continues to expand at a moderate pace, sustained by resilient household spending and a still-firm services sector, though the manufacturing outlook has dimmed. Fiscal support remains limited as the partial government shutdown extends uncertainty into Q4. Bond markets have welcomed the Fed's move—yields on 2-year Treasuries dropped and are now around 3.60%, signaling market confidence in a gradual normalization path.

Bond markets have welcomed the Fed's move, with yields on 2-year Treasuries falling, signaling market confidence in a gradual normalization path

Euro Area: A "good place" to pause

In contrast, the European Central Bank maintained its key policy rates unchanged, keeping the deposit facility at 2.00%, and reaffirmed its stance that rates are "in a good place." The ECB's messaging leaned toward patience, reflecting comfort with the ongoing disinflation trend and early signs of stabilization in growth.

Euro area inflation in October stood at 2.1% headline and 2.4% core, levels that have strengthened the argument for a prolonged pause before considering any policy change[1]. Activity data suggest a modest rebound led by services and a gradual recovery in German industry. This was reflected in the 0.2% GDP growth of the euro area for the third quarter. However, credit conditions still remain tight. Policymakers remain wary of cutting too soon given potential second-round effects. This is illustrated by the latest ECB quarterly survey showed that euro zone banks unexpectedly tightened access to corporate credit in the third quarter, with German lenders leading the way on fears over the economic outlook and tariffs.

Markets largely interpreted the decision as an acknowledgment that the easing phase may come later, possibly in early 2026, contingent on wage dynamics and fiscal alignment across member states. The euro is trading near 1.15-1.16 per dollar explained by factors such as a relative policy stability and a narrowing inflation gap and rate differentials with the U.S.

Global markets: Fragile equilibrium

Investors are navigating a landscape where optimism over a "soft landing" coexists with structural fragilities

Investors are navigating a landscape where optimism over a "soft landing" coexists with structural fragilities. Equity markets remain buoyant but increasingly selective. Technology and energy continue to outperform, while cyclicals lag amid fading growth expectations. Credit spreads have tightened modestly, yet pockets of stress are emerging in high-yield and leveraged loan markets.

Monetary divergence between the Fed's cautious easing and the ECB's extended pause underscores the asymmetry of global policy cycles

Monetary divergence between the Fed's cautious easing and the ECB's extended pause underscores the asymmetry of global policy cycles. This divergence has fueled volatility in currency and rate markets, encouraging more hedged and barbell positioning among institutional investors.

Meanwhile, global uncertainty—from geopolitical tensions to trade reconfigurations—continues to test investor sentiment. The post-pandemic drivers of demand and liquidity have largely dissipated, leaving financial markets more exposed to confidence shocks.

French Contagion

Political fragility and fiscal slippage as the Eurozone's new core risk

→ Political paralysis and fiscal slippage in Paris have turned a founding EU member from anchor to epicenter, reviving contagion fears once confined to the periphery.

→ Rising OAT–Bund spreads and credit downgrades expose how instability in France could fracture market confidence, test European Central Bank backstops, and reshape the balance of power in Europe's fiscal union.

Introduction

France, once considered the Eurozone's anchor, is now in the middle of a dangerous fiscal and political crisis. After expansionary budgets and political turmoil, its fiscal deficit reached 5.8% of GDP, and its public debt climbed to 113% of GDP at the end of 2024.[1]

France's political fragility and fiscal slippage are mutually reinforcing and amplify contagion risks across the Eurozone. Unlike the 2011-2012 sovereign debt crisis, in which instability was concentrated in the periphery, the current crisis involves a core member. This creates a fragmentation risk, in which a country's fiscal stress threatens the stability of its banking sector and challenges the credibility of the European Central Bank's (ECB's) defense mechanisms.

France's political fragility and fiscal slippage are mutually reinforcing and amplify contagion risks across the Eurozone

In modern monetary unions, contagion operates not only through market channels but also through political expectations and institutional credibility. France's case blurs the traditional core-periphery divide, testing the resilience of the ECB's credibility and the EU's fiscal governance model.

France's fiscal and political fracture

France is experiencing a political crisis on top of a fiscal crisis. Its fragmented parliament has made it extremely difficult to form a stable coalition, leading to five governments in the past 21 months.[2] In July 2024, the European Council launched the Excessive Deficit Procedure (EDP) against France to compel it to implement an action plan to lower its deficit.[3] France has proposed a budget to reduce the deficit from 5.4% of GDP in 2025 to 4.7% in 2026, but the parliament has thus far rejected it.[4]

This instability reflects deeper structural changes, including the erosion of traditional party systems, the rise of anti-establishment movements, and growing voter polarization. Such entropy poses a more durable fiscal risk than temporary deficits.

The prospect of radical policy shifts from a highly divided parliament have fueled investor fear

The prospect of radical policy shifts from a highly divided parliament has fueled investor fear. The resulting market volatility is reflected in the spread between French 10-year government bonds (OATs) and the German benchmark (Bunds). As of 3 November, the 10-year OAT yield is 3.44%[5] and the OAT Bund spread is 78 bps.[6] Following downgrades from Fitch and DBRS, S&P Global cut France's credit rating on 20 October, citing political instability that prevents the country from managing its finances.[7]

Transmission channels of contagion

The risk of French fiscal distress spilling into the wider Eurozone operates through three primary channels.

The Sovereign-Bank Nexus. Mark-to-market losses on OATs can weaken financial institutions across Europe and cause panic, making it more expensive for other countries to borrow. OAT losses weaken bank balance sheets by causing mark-to-market losses on high-quality liquid assets. A weaker sovereign is less able to support banks, tightening funding and amplifying stress.

During the 2011–2012 Euro crisis, banking failures required government interventions, dramatically increasing public debt and sovereign credit risk.[8] While French banks are generally diversified, the scale of the French sovereign bond market makes this channel a significant concern.

Bond Market Spillovers. A rapid widening of the OAT-Bund spread can trigger a re-pricing of risk across the entire Eurozone sovereign spectrum, increasing borrowing costs for all member states. A sudden, sharp sell-off could lead to a reordering of the Eurozone sovereign credit spectrum. Despite recent fiscal improvements, investors may demand higher interest rates for Spanish Bonos and Italian BTPs given their high absolute debt levels.

France's current spread of approximately 80 bps remains well below the 2011-2012 extremes, but euro area sovereigns exhibit bilateral and time-varying spillovers in their yield spreads. From 2011-2012, the OAT-Bund spread briefly reached 195-200 bps, causing shocks across sovereign curves. And in March 2020, the ECB's asset purchases quickly compressed spreads and warded off risks of financial fragmentation.[9]

Stress in a founding core member like France represents a political and psychological shock to the EU

Confidence Shock. Stress in a founding core member like France represents a political and psychological shock. It raises political and legal questions about the euro project and the ECB's latitude, which can spook global investors and lead to capital flight, pushing up funding costs for all European assets. The ECB is monitoring spreads and stands ready to use its toolkit if "disorderly" dynamics emerge.[10]

Possible scenarios

Three scenarios are plausible over the next year, differentiated by speed and intensity. Markets currently price in the "gradual erosion" scenario, though surprises in political cohesion or ECB signaling could shift expectations.

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Stabilization at a higher premium. Partial but credible fiscal adjustment under the EDP keeps the deficit on track and aligns the 2026 budget with EU net spending ceilings. The OAT-Bund spread steadies at 60-100 bps, signaling a higher but stable premium. Market volatility eases, and the ECB's backstops remain unused while EU confidence improves.

Gradual erosion. A gradual erosion of confidence follows if political gridlock blocks consolidation and the government fail to meet EDP milestones. The early warning signs would be a sustained OAT-Bund spread above 100 bps, a failure to pass or implement key adjustment measures, and a negative rating outlook or downgrade. Such developments would indicate a weakening policy anchor and loss of reform momentum. Capital would begin to flow toward the stronger euro area core. EU fiscal surveillance would tighten, and the ECB would increase rhetorical pressure, signaling readiness to act if market conditions deteriorate further.

Sharp loss of confidence. A sharp loss of confidence could follow a political or ratings shock—such as a failed budget, government collapse risk, or disorderly auctions—triggering capital outflows and debt repricing. In this setting, the OAT-Bund spread would likely surge to 150-200 bps, accompanied by declines in bank equities and signs of liquidity stress in sovereign auctions. The ECB would then face mounting pressure to intervene.

The Eurozone's defense architecture

Contagion containment falls on the ECB and the EU's fiscal governance framework.

The ECB's Transmission Protection Instrument (TPI) can address unwarranted fragmentation if a member state is broadly compliant with the fiscal framework, faces no severe macroeconomic imbalances, and maintains sustainable policies. The Outright Monetary Transactions (OMT) is the heavier backstop, activated only with a European Stability Mechanism (ESM) program and strict conditionality. Any large-scale intervention could face legal scrutiny from Germany, which has historically challenged the legality of non-conventional monetary policy. As the ECB stresses that markets are not "disorderly," credibility rests on the national government's actions.[11]

The EDP is the EU's framework for fiscal discipline. It sets a multi-year net expenditure path to reduce the deficit below 3%.[12] It also enforces net expenditure ceilings and milestones to lend credibility to a member state's commitment to reform and limit spillovers. Credibility rests on enforcement and realistic plans. However, the case of France presents a quandary for the EU as sanctions against a core member risk political fragmentation, while inaction creates moral hazard and undermines the EDP's credibility.

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Implications and recommendations for Spain

France's current challenges should remind Spain and other member states of the importance of fiscal credibility, consistent communication, and institutional coordination. Spain's experience during its 2010 and 2012-2013 fiscal crises and its responses may also offer France some relevant lessons.

Notably, the contagion from the French sell-off has been limited so far, with Spanish spreads remaining contained and, at times, tightening relative to French OATs

Spain's sovereign risk has improved significantly in recent years. Its debt ratio has decreased from a peak of 115% of GDP to approximately 102% of GDP, and its credit ratings have also improved.[13] Notably, the contagion from the French sell-off has been limited so far, with Spanish spreads remaining contained and, at times, tightening relative to OATs. This limited spillover suggests it is differentiating itself from its highly indebted Eurozone peers.

The following is a reminder to Spain of the actions it should take to mitigate contagion risk.

<u>High priority</u>

Build fiscal buffers, maintain Treasury discipline, and communicate Spain's improving debt metrics to markets. Ask Banco de España to conduct stress tests for direct and indirect exposures to French sovereign and financial sector assets. Track the contribution of sovereign holdings to liquidity cover ratio buffers and identify concentrations.

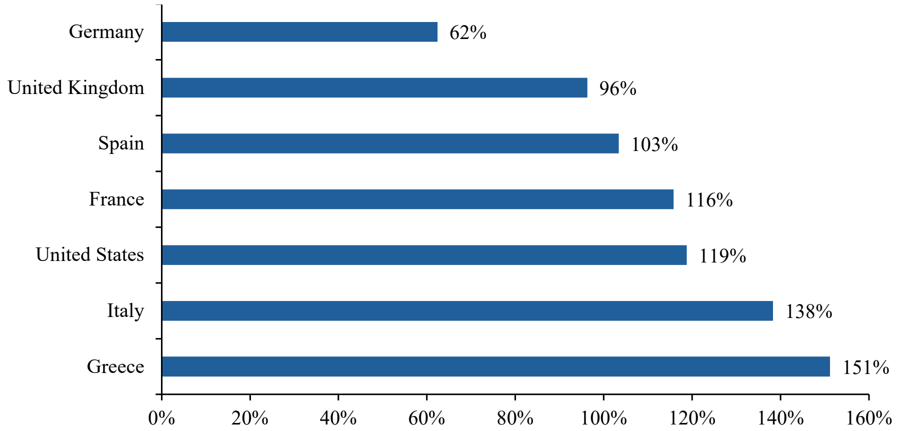
<u>Medium priority</u>

Strengthen surveillance and macroprudential readiness, ensuring flexible capital buffers and steady debt management in the event of spillovers.

<u>Contingency</u>

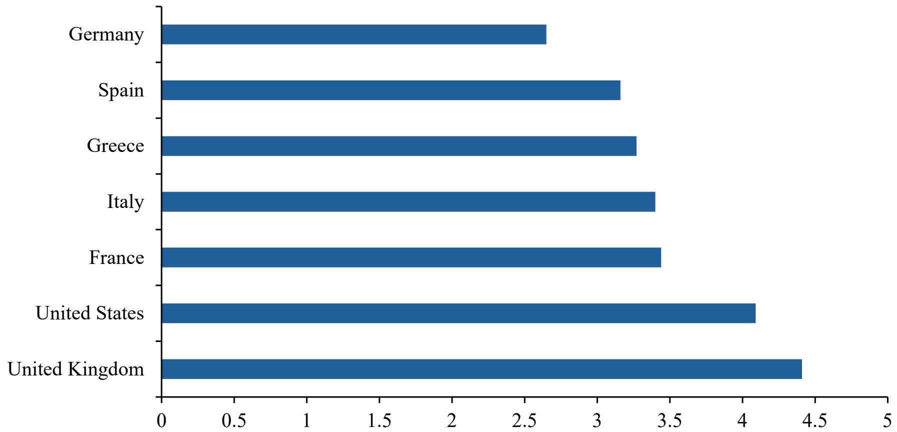
Support credible EU fiscal enforcement and coordinate with ESM partners so the OMT safety net remains operational if needed.[14]

EXHIBIT 1.0 – TOTAL PUBLIC DEBT AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT



Note: Data through 30 June 2025.
Sources: European Central Bank, Federal Reserve Bank of St. Louis, UK Office of National Statistics.

EXHIBIT 2.0 – 10-YEAR GOVERNMENT BOND YIELDS, %



Note: Data as of 3 November 2025.
Source: Bloomberg.

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Frozen Russian Assets

The EU's plans for a "reparations loan" for Ukraine

→ The EU's innovative proposal to leverage frozen Russian assets for a €140 billion "reparations loan" to aid Ukraine has hit a significant legal and political impasse, as Belgium blocked the plan over concerns of litigation and financial liability.

→ The EU's central challenge is to mobilize funding to support Ukraine meaningfully, preserve the euro's credibility as a reserve currency, stay within the law, and avoid legal and financial liability for Belgium and other EU member states holding assets if Russia successfully retaliates.

Introduction
Russia's invasion of Ukraine in 2022 triggered sanctions that immobilized approximately €300 billion in Russian central bank assets worldwide.

As Ukraine's financing needs grow and U.S. support has waned, the European Commission floated a "reparations loan" that would raise €140 billion by leveraging the frozen principal as collateral. Ukraine would repay the loan if Russia eventually provides war reparations.

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However, the EU plan hit an impasse when Belgium blocked it from moving forward at a 23 October European Council leaders meeting.[1] A follow-up technical meeting was held on 7 November, but it failed to break the deadlock.

The proposed loan
The proposed vehicle would sit on top of the G7 "Extraordinary Revenue Acceleration" loans, which are backed by windfall profits generated by the immobilized assets.[2] It would raise about €140 billion from the roughly €210 billion of Russian assets held in the EU after settling a prior €45 billion loan.[3] Rather than confiscating funds, it would channel maturing cash balances into EU instruments. Proceeds would be lent to Ukraine with repayment contingent on future reparations.

The vehicle would raise about €140 billion from the roughly €210 billion of Russian assets held in the EU after settling a prior €45 billion loan

Belgium's position and impact on Ukraine
Belgium, as custodian of the Euroclear depository, holds nearly €170 billion of Russian cash reserves.[4] Leading up to the 23 October meeting, Belgium requested guarantees that it would not face legal or financial consequences if Russia successfully retaliated against the reparations loan.[5] Specifically,

it sought protections in the event of an adverse judicial ruling and burden-sharing if it was forced to repay the money.[6]

EU diplomats tried to address Belgium's concerns while still including language in the draft joint statement to instruct the Commission to develop a legal proposal for the reparations loan. Belgium was dissatisfied with the EU's assurances and watered down the statement. Leaders agreed on 23 October to make a final decision on the issue at the next summit, currently scheduled for 18 December, after exploring alternatives.

Belgium's concerns illustrate the tension between national financial stability and collective EU solidarity; while some countries may prefer stronger, more ambitious action, Belgium's significant exposure makes it more vulnerable to Russian retaliation

The impasse reveals a broader collective action dilemma within the EU. Belgium's concerns illustrate the tension between national financial stability and collective EU solidarity; while some countries may prefer stronger, more ambitious action, Belgium's significant exposure makes it more vulnerable to Russian retaliation.

Moreover, Belgium's opposition undermines the Commission's goal of approving additional financial support for Ukraine by the end of the year.[7] It also complicates Kyiv's budget planning as it seeks help to cover its $60 billion budget gap for 2026-2027.[8] The Ukrainian government spent more than 60% of its total budget on the army in the first nine months of the year.[9] The country is heavily reliant on financial support from its Western partners to meet its social and humanitarian spending.[10]

Policy precedent and legal trade-offs

There are few modern precedents for confiscating a central bank's assets when the sanctioning states are not at war

There are few modern precedents for confiscating a central bank's assets when the sanctioning states are not at war. The handling of Iraqi assets in 2003 followed authorization by the UN Security Council, which directed the release of frozen funds to the Development Fund for Iraq.[11] In 2011, the UN Security Council voted to impose sanctions on Libya, including an asset freeze on certain individuals and entities, but it was not a wholesale collateralization or redistribution.[12] In the case of Afghanistan, a Swiss-based trust was created in 2022 to hold part of the frozen central bank reserves for macroeconomic stability, yet those funds were not securitized.[13] By contrast, the EU proposal is neither a UN-sanctioned reallocation nor a conventional countermeasure under international law.

The use of windfall profits (extraordinary revenues) collected by Euroclear has passed legal muster. It is servicing the existing G7 loan to Ukraine.[14] By contrast, de facto principal confiscation—or collateralization that functions similarly—would be vulnerable to litigation.[15]

Freezing state assets as a countermeasure can be justified under international law when responding to grave breaches such as aggression; collateralizing or monetizing those assets, however, moves beyond traditional countermeasure doctrine. Specifically, the UN Charter authorizes collective security measures, and the Vienna Convention on the Law of Treaties imposes limits on interfering with sovereign property.[16] However, the EU proposal risks blurring the line between lawful restraint and *de facto* expropriation without UN Security Council authorization.

Financial and geopolitical implications

The European Central Bank warns that repurposing sovereign reserves can erode trust in the euro as a reserve asset.[17] The euro's share of global foreign-exchange reserves averaged 19.7% in 2024, compared with 21.2% in 2013, when the euro area was emerging from the sovereign debt crisis.[18] This long-term erosion in the euro's international role suggests that even modest shocks to legal credibility could accelerate diversification away from euro-denominated assets.

Moving from immobilization to collateralization of principal could be seen as a step change, prompting some central banks—especially in non-aligned countries—to trim euro exposures or shift custody. Reserve managers are currently diversifying, notably via steady gold purchases.[19] Crypto, though, is not a meaningful reserve alternative for sovereigns.[20]

Moving from immobilization to collateralization of principal could be seen as a step change, prompting some central banks—especially in non-aligned countries—to trim euro exposures or shift custody

When compared with the potential risks posed by the post-2012 crisis, the current plan would test the euro's legal credibility. In contrast, the driver of the post-2012 crisis was financial fragmentation risk as doubts emerged about the stability and future of the monetary union. The post-2012 crisis resulted in a 1.9% loss (from 23.1% to 21.2%) in currency shares in foreign exchange reserves from 2010 to 2013. A similar shift away from euro-denominated holdings would imply a capital reallocation of nearly $250 billion, based on the $13 trillion in foreign-exchange reserves disclosed globally in 2025Q2.[21] The EU's proposal appears to pose a subtler risk, suggesting that if the EU implemented it, the losses would be smaller.

Because Euroclear holds the largest share of these assets, aggressive measures without ironclad legal protection could trigger lawsuits, impair the Central Securities Depositories' balance sheet, and force public backstops. For many non-Western creditors, commandeering sovereign assets—even indirectly—looks like expropriation. Normalizing such use of immobilized reserves lowers the barrier to similar steps in future crises and erodes trust in Western legal frameworks.[22]

Possible scenarios include:

- The EU limits actions to windfall profits, and any cash balance measures are tightly ring-fenced and sunsetted; the markets remain calm, and disputes play out in court.

- Litigation creates uncertainty, causing some reserve managers to diversify incrementally into gold or non euro custody. Funding costs tick up but remain manageable if guarantees are mutualized and risk limits are clear. However, clear, joint communication and backstops help prevent a systemic turn.

- If Russia escalates counter-sanctions and China condemns principal action, leading official investors limit their exposure to the euro.[23]

The proposed reparations loan, in its current form, is a high-stakes gamble that risks undermining the euro's standing and creating contingent liabilities for EU Member States and taxpayers, in return for a temporary funding boost unlikely to match Russia's resource mobilization or to determine the war's military trajectory

Policy recommendations

The EU wants to make Russia, the aggressor, pay and provide increased financial support to Ukraine. However, the proposed reparations loan is a high-stakes legal and financial gamble that risks undermining the euro's standing and creating contingent liabilities for EU Member States and taxpayers, in return for a temporary funding boost unlikely to match Russia's resource mobilization or to determine the war's military trajectory.

Instead, the EU should consider a more credible and conservative path.

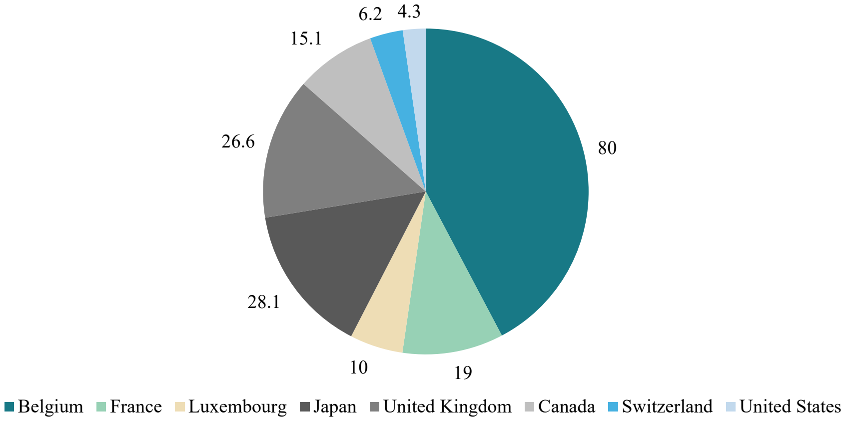
1. Preserve the legal line between principal and the windfall profits the immobilized assets generate. Direct the windfall profits to the Ukraine support mechanism and avoid principal confiscation or collateralization.

2. If borrowing beyond extraordinary revenues, back it with joint EU guarantees to share risks.[24]

3. Include an explicit, limited mandate; ring-fencing; clear beneficial use limits; robust governance; transparency; and sunset clauses that emphasize the unique nature of the response.

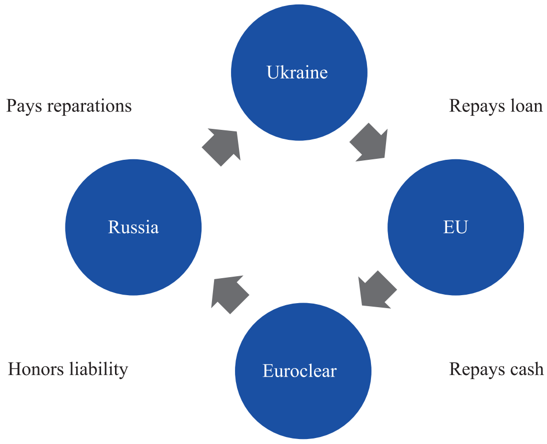
This approach could sustain EU support for Ukraine and uphold accountability while protecting the euro's credibility and the stability of Europe's financial architecture.

EXHIBIT 3.0 – MAIN EU AND NON-EU JURISDICTIONS OF FROZEN RUSSIAN ASSETS, 2025 (€ BILLION)



Source: The European Parliament.

EXHIBIT 4.0 – HOW THE PROPOSED EU REPARATIONS LOAN WOULD WORK



Source: Euronews.

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Trump's Corporate Nationalism

Implications for the EU

→ Donald Trump's "corporate nationalism" marks a new era of U.S. state capitalism—blending ownership, control, and regulation to extract rents from strategic sectors.

→ Europe should respond by moving forward in creating a single market, as recommended by Mario Draghi's 2024 report on EU competitiveness.

Introduction

Donald J. Trump's second-term economic strategy is redefining the relationship between the U.S. government and corporate America. Trump's "corporate nationalism" marks a new era of U.S. state capitalism, combining financial control, selective ownership, and regulatory leverage to pursue political and national security objectives. It accelerates earlier interventionist trends rooted in U.S. economic security traditions—from the Defense Production Act in 1950 to the CHIPS Act and the Inflation Reduction Act in 2022—yet its novelty lies in subordinating market logic to transactional sovereignty.

Trump's approach—best described as corporate nationalism—combines financial control, selective ownership, and regulatory leverage to pursue political and national security objectives

New modalities

Trump's model departs from classical protectionism and coherent industrial policy as it is transactional, discretionary, and rooted in populist economic nationalism.[1] It relies on novel, often legally ambiguous, instruments that extend state control beyond regulation or subsidies. The administration has used regulatory chokepoints—such as export licenses, merger approvals, and federal loans—to negotiate ownership rights, governance influence, and revenue participation in private firms.

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The most striking example from U.S. economic orthodoxy is the U.S. government's "golden share" in U.S. Steel, which it secured during Nippon Steel's acquisition. This share gives Washington veto power over significant corporate decisions, production changes, and future sales. It does not require financial investment, granting strategic control while preserving the appearance of market ownership.[2] It symbolizes the state's reassertion of authority in strategic sectors once considered sacrosanct to private capital.

A second mechanism involves equity-for-funding exchanges. The federal government has taken minority stakes in companies receiving public support, including chipmaker Intel and rare-earth producer MP Materials, converting grants or loans into ownership positions.[3] A similar arrangement with Lithium Americas Corp. tied public financing to government-held warrants and revenue participation.[4] These transactions mark a departure from rule-based subsidies toward conditional equity control—effectively creating a portfolio of semi-state assets across strategic industries.

Revenue-sharing deals with firms like Nvidia and AMD further blur the lines between commercial and fiscal interests.[5] In exchange for renewed export licenses to China, these companies agreed to provide 15% of the companies' China-related revenues from those sales.[6] This creates a precedent that introduces "pay-to-play" elements into foreign trade policy and risks politicizing access to global markets.

Taken together, these measures constitute a hybrid model of state capitalism through negotiation, combining industrial policy, regulatory leverage, and fiscal opportunism. It aligns corporate behavior with national security imperatives while eroding the boundaries between public and private decision-making.

Implications of a new U.S. model

By attaching ownership stakes and veto rights to strategic firms, the government directly influences corporate governance in sectors such as semiconductors, critical minerals, and steel

This approach shifts the United States from a rules-based subsidy regime to one of discretionary control. By attaching ownership stakes and veto rights to strategic firms, the government directly influences corporate governance in sectors such as semiconductors, critical minerals, and steel. Proponents argue this ensures supply-chain security and aligns private incentives with national priorities. Critics counter that it introduces cronyism, politicized capital allocation, and long-term legal uncertainty, potentially chilling foreign direct investment. The resulting system resembles a form of transactional sovereignty, in which national security justifies selective intervention that subordinates economic efficiency to political expediency.

This approach also includes many contradictions that undermine its economic policy objectives. The U.S. government distorts capital efficiency by channeling public funds and regulatory privileges toward politically favored sectors. This incentivizes companies to align with political priorities rather than market signals and encourages lobbying and rent-seeking over innovation.

Corporate nationalism replaces competition with transactional allegiance. Firms that demonstrate political loyalty or symbolic "patriotism" receive access to subsidies and contracts, while others face punitive tariffs or regulatory exclusion. This logic favors rent extraction—profits derived from state privilege—rather than productivity gains. Over time, the resulting drop in efficiency can erode competitiveness.

Corporate nationalism yields political dividends—repatriated jobs, reshored factories, and the appearance of national self-sufficiency. Yet the underlying economic structure becomes weaker and dependent on sustained state intervention and fiscal expansion.

U.S. favoritism in strategic industries, particularly energy, defense, and advanced manufacturing, creates inflationary pressures. Public subsidies and domestic-content mandates raise input costs across supply chains, amplifying price rigidities and undermining monetary stabilization efforts. The result is circular: higher costs justify further subsidies, deepening fiscal deficits, and embedding inflationary inertia.

Warnings for the EU

The U.S. turn toward corporate nationalism should serve as an urgent wake-up call for the EU.

Trump's corporate nationalism is a competitive challenge and a governance warning. It threatens to reshape transatlantic economic relations and intensify global subsidy races.

European firms may face heightened politicization of cross-border mergers and acquisitions. Washington's use of equity and veto rights may complicate European investments in U.S.-linked supply chains and expose firms to unpredictable political conditions. Strategic sectors such as automotive, renewables, and defense could experience disruptions or re-routing of key inputs.

The U.S. shift also risks triggering intra-EU subsidy competition. The EU's relaxation of State aid rules under the Temporary Crisis and Transition Framework has already allowed wealthier member states to deploy disproportionate support, threatening Single Market cohesion.[7] Replicating U.S.-style discretionary tools could deepen fiscal divergence and undermine common competition principles.

Finally, the new U.S. approach exposes the EU's structural limitations in responding and deploying a unified response. Decision-making through regulation and subsidiarity, while effective for long-term integration, is slower and less agile than the United States' executive-driven model.[8]

The new U.S. approach exposes the EU's structural limitations in responding to this new era of global economic competition and in deploying a unified response

EU policy recommendations

The appropriate European answer is to make progress in creating a single market, as recommended by Mario Draghi's 2024 report on EU competitiveness, rather than attempting to replicate U.S.-style interventionism.[9]

The appropriate European answer is to make progress in creating a single market rather than attempting to replicate interventionism

Conclusion

Trump's corporate nationalism reflects a decisive U.S. turn toward interventionist capitalism—a competitive challenge and a cautionary tale for the EU. It exposes the EU's vulnerabilities in strategic agility. Deepening its structural unity can help sustain Europe's competitiveness and autonomy in an increasingly politicized global economy.

Beyond the economic dimension, corporate nationalism represents a normative challenge to rules-based global governance

Beyond the economic dimension, corporate nationalism also represents a normative challenge to rules-based global governance. It redefines sovereignty not as a legal principle but as a transactional currency. Defending rules-based multilateralism is therefore an economic and constitutional imperative.

Notes

[1] https://www.iiss.org/online-analysis/online-analysis/2025/09/americas-quiet-turn-towards-state-capitalism

[2] https://www.washingtonpost.com/business/2025/06/18/steel-nippon-golden-share-trump

[3] https://www.reuters.com/business/us-take-10-equity-stake-intel-trumps-latest-corporate-move-2025-08-22/

[4] https://www.energy.gov/articles/department-energy-restructures-lithium-americas-deal-protect-taxpayers-and-onshore

[5] https://www.iiss.org/online-analysis/online-analysis/2025/09/americas-quiet-turn-towards-state-capitalism

[6] https://www.washingtonpost.com/technology/2025/08/10/nvidia-amd-china-chips-deal-trump

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[8] https://www.europarl.europa.eu/news/en/press-room/press-tool-kit/1/all-you-need-to-know-about-the-eu-s-long-term-budget

[9] https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en

Data Integrity and Monetary Policy Credibility

The Federal Reserve, data revisions, and the course of U.S. monetary policy

→ Large negative revisions to employment data have complicated the Federal Reserve's task of gauging the degree of slack in the economy, with concerns related to the reliability of U.S. economic data adding to the already uncertain economic outlook.

→ 2026 is set to mark the sixth consecutive year of inflation above the Federal Reserve's two-percent target, heightening risks to its institutional credibility as prolonged price pressures could erode public and investor confidence in the Fed's independence and effectiveness.

Shifting U.S. outlook amid job losses and data revisions

Extremely large negative revisions to the level of employment, and a string of weak jobs reports were nearly overshadowed by the dismissal of the U.S. Bureau of Labor Statistics (BLS) Commissioner on August 1st. While the firing of the BLS chief is an important development, the recent softening in the U.S. labor market is likely to be more consequential over the year ahead. Not only has the pace of job creation slowed, but revisions to historical data also revealed that over 2024-2025 far fewer jobs had been created than previously estimated.

This year's revision equates to roughly 5 months of jobs creation at 2023-24's average pace and is the largest in recent history

Released in September, the BLS's annual preliminary benchmark revisions to U.S. nonfarm payrolls data showed that 910,000 fewer jobs were created compared to initial estimates for the year ending in March 2025, mirroring a similarly large negative revision of — 818,000 fewer jobs— in September 2024. This year's revision equates to roughly 5 months' of jobs creation at 2023-2024's average pace and is the largest in recent history. The scale of revisions has grown since the pandemic, with 2025's preliminary benchmark revision nearly double the size of 2019's 501,000 negative revision, the largest in the period prior to the pandemic (Exhibit 5.0).

Rate cuts resume despite tariff-driven inflation

While the Federal Reserve resisted political pressure to reduce interest rates over much of 2025, it could not resist the pressure coming from the slowing labor market

After revised data indicated that the labor market was significantly weaker than previously thought the Fed swiftly reduced the federal funds rate by 25 basis points (bps) in mid-September, and again in late-October. The combined 50 bps in cuts followed a nearly 10 months pause in easing and brought the federal funds rate to the 3.75-4.00 percent range, 1.5 -1.75 percentage points below the pandemic era peak of 5.25-5.5 percent.

The decision to ease appears to be at odds with the path of inflation —at least for now— with the Federal Reserve's preferred gauge of inflation, the Personal Consumption Expenditure (PCE) Price Index remaining stubbornly above the two percent inflation target. In August both total and core PCE inflation accelerated as the effect of tariffs and the weaker U.S. dollar contributed to an acceleration in goods inflation.[1] While disinflation took hold in 2023, and total and core inflation have both declined from their pandemic-era peak of 7.2 percent and 5.6 percent respectively, they have both tracked above the Federal Reserve's target for some time, plateauing just beneath three percent since late 2023 and early 2024.

Data revisions fuel uncertainty

Large negative revisions to employment have made gauging the degree of slack in the economy increasingly difficult. While elevated inflation in the context of a robust labor market is consistent with expectations about the relationship between employment and inflation, accelerating inflation coupled with a softening labor market is more worrying, potentially pointing to stagflation. Weaker job creation suggests that the economy may not be as resilient as what was thought just a few months ago. On the other hand, slowing job creation may reflect elevated uncertainty and hesitancy to expand payrolls, as employers take a cautionary approach amid still steady activity. In either case, distrust and questions over the data reliability and quality are only complicating the assessment.

Large negative revisions to employment have made gauging the degree of slack in the economy increasingly difficult

With the government shutdown delaying the BLS's September's employment and inflation reports, and possibly October's, challenges related to data availability is adding to concern related to reliability. The shutdown is also contributing to risks related to U.S. governance and is part of a pattern of rising political disfunction that is eroding trust in key U.S. institutions including the Fed, Treasury and the BLS.

Signals coming from U.S. GDP and inflation are also adding to the uncertainty. Over 2025 GDP data has consistently surprised to the upside, even after tariffs took effect, while inflation has been more muted than anticipated to date. Indeed, in October the International Monetary Fund (IMF) warned that this might be the result of several temporary factors converging, rather than a sign of durable economic strength.[2]

Frontloading of consumption and investment ahead of tariffs temporarily boosted activity in the first half of 2025, while trade shifted to third countries to avoid increased tariffs.[3] Over the same period, various factors such as delayed tariff collection, running down of inventories, holding orders, pre-established prices, and the testing of consumer price sensitivity are thought to have collectively delayed the pass-through of rising tariff-related costs to inflation, suggesting more may be to come.[4]

With elevated uncertainty, rising political pressure, and a softer labor market, the Fed's communications strategy pivoted at September's press conference

Fed shifts messaging amid labor market slowdown

With elevated uncertainty, rising political pressure and disfunction, and a softer labor market, the Fed's communications strategy appeared to pivot in September and October.[5] Following each of the cuts, messaging at the FOMC press conferences appeared to shift from prioritizing inflation, to prioritizing employment as part of the Fed's mandate to conduct monetary policy to "support the [dual] goals of maximum employment and stable prices".[6] Indeed, Powell cited a changing balance of risks – with weight shifting from inflation toward weakness in the labor market, and when pushed by reporters in October, suggested that the cuts were part of a "risk management strategy", which appears to be focused on protecting against a rapid slowing in activity.[7]

The decision to cuts rates is not without peril, and doubts about data reliability will only add to uncertainty

The Fed's credibility challenge

The decision to cuts rates is not without peril, and doubts over data reliability will only add to uncertainty. With tariff-driven inflation surging, and the final magnitude of tariff pass-through to prices unclear, 2026 will mark the 6th consecutive year with above target inflation. Moreover, the risk management approach given to justify cuts create a degree of tension with the idea that slowing job creation "is mostly a function of the change in the supply of labor", as monetary policy is ill-equipped to influence workforce growth. The current circumstance runs the possibility of creating a "time inconsistency problem" for the Federal Reserve. That is, with the passing of time, and in the context of a changing political and institutional environment, meeting the inflation target may no longer be perceived to be optimal.[8]

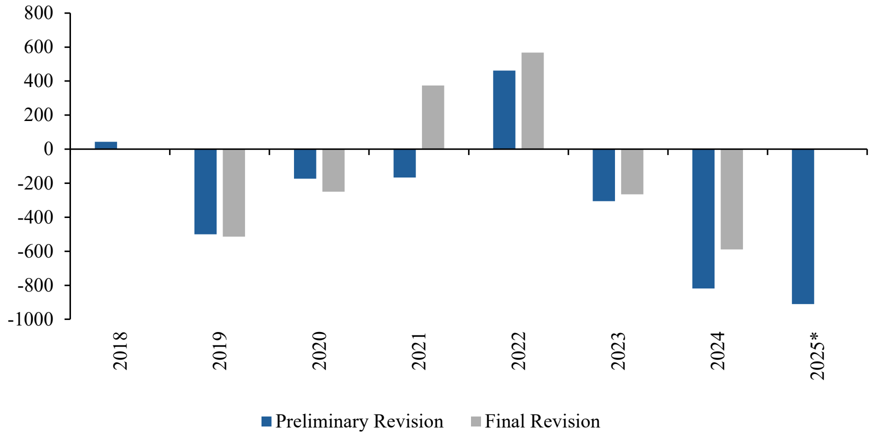
Such circumstances would generate a serious credibility challenge for the Federal Reserve with deteriorating data reliability exacerbating the situation. Concerns over the independence and effectiveness of the Fed, as well as other institutions, would also increase. Taken together with rising political interference and growing U.S. fiscal deficits, markets may increasingly question the long-term credibility of U.S. economic and financial policy making, potentially leading to increased financial volatility and risks.

The Federal Reserve, and its conduct of monetary policy, need to continue to be perceived as independent and credible

U.S. monetary policy must remain credible

With tariff driven goods inflation continuing to rise, and with uncertainty, supply chain damage, and restrictive immigration policy remaining possible triggers of second round inflationary effects, the Fed must be clear in the coming months that it is committed to bringing inflation back to target, even if that means sacrificing growth and the labor market. Petitioning for another "immaculate disinflation" is not an effective strategy.

EXHIBIT 5.0 – ANNUAL REVISIONS TO U.S. EMPLOYMENT (THOUSANDS)



Note: Data shows preliminary and final benchmark revisions to current establishment survery data to the National Current Employment Series (CES) for total nonfarm payrolls (thousands) at the national level. Benchmark revisions indicate indicate adjusted estimates for the 12 months ending in March of corresponding year.

*Final revisions to 2025 will be released by the BLS in early 2026.
Source: : U.S. Bureau of Labor Statistics.

Notes

[1] Total PCE inflation (including food and energy) rose about 0.15 percentage point (pp), to 2.75 percent in August; Core PCE inflation (excluding food and energy) rose by about 0.1 pp, to 2.9 percent in August.

[2] https://www.imf.org/en/Publications/WEO/Issues/2025/10/14/world-economic-outlook-october-2025; https://www.wsj.com/economy/trade-tensions-weigh-on-imfs-outlook-for-global-economy-8ed17b31?gaa_at=eafs&gaa_n=AWEtsqfQUPOpMgchPlEmQzHMb2u6yZ1MdTTMKfN1C6GeObYOQiVstelAp-D2&gaa_ts=68f51b49&gaa_sig=diRAq1sb8T6qoWYj0FUvzw2kvwjwybp5p1K48QoFOISXj2Ov-GRUP0Qyk7W8wvMBiQsys_cRuQCM6S8dMrw5Qg%3D%3D

[3] https://www.imf.org/en/Publications/WEO/Issues/2025/10/14/world-economic-outlook-october-2025

[4] *Ibid*; Bauer, Haltom, and Martin 2025: https://www.richmondfed.org/region_communities/regional_data_analysis/regional_matters/2025/why_businesses_say_tariffs_delayed_effect_inflation

[5] https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20250917.pdf; https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20251029.pdf; https://www.federalreserve.gov/monetarypolicy/fomcpresconf20250917.htm

[6] https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm

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Notes

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