

# Global Monthly

Group Economics – Macro Research | 26 February 2025

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## Cracks emerge amid tectonic shifts

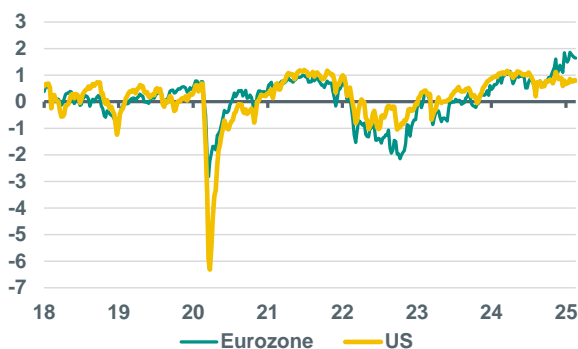
- The fracturing of the transatlantic alliance is going to mean higher defence spending in Europe over time, though the immediate macro-economic implications of this are likely to be modest
- The most imminent threat still comes from higher US trade tariffs, with a host of measures due as soon as next week. Last month, Trump blinked at the last moment on the biggest tariff rises...
- ...will souring confidence in the US make him do so again?
- **Spotlights:** 1) European defence spending: We summarise the available options for an increase and the macro implications; 2) German election: We look at the likely policy agenda of the new *GroKo*
- **Regional updates:** We expect the ECB to pause rate cuts in April, as the [Eurozone](#) evolves in line with our base case, while in the [Netherlands](#), 2024 ended on a strong note, helped by solid domestic demand
- Trump is moving at a blistering pace in the [US](#), with policy uncertainty paralysing the Fed
- The outlook for [China](#) is still shaped by the extent of further stimulus versus the threats from US tariffs.

## Global View: Brewing shocks are starting to have an impact. Is Trump going to blink?

It has been a month of geopolitical earthquakes, and economic tremors. The most shocking development – the fracturing of the post-WW2 western alliance – does not yet pose immediate implications for the macro outlook. European defence spending is surely set to increase over the coming years, but the timing, magnitude, and composition of that increase remains highly uncertain. A significant moving part in all of this will be coalition negotiations following Merz’s expected victory in the German elections. We look at some of the broad implications of both of these themes in our two Spotlights this month, and we will have much more to say over the coming months as the details begin to crystallise. For now, the most imminent threat to the global economy remains US trade tariffs, with massive new Mexico and Canada tariffs perhaps coming as soon as next week. In recent days, we have published [an overview](#) of the main threats and what they specifically mean [for the eurozone](#). In the meantime, while the hard macro data suggests the US economy continues to coast along for now, yesterday’s market reaction to a downside surprise in consumer confidence – which followed a spate of weaker survey data – suggests cracks in the market’s belief in US economic resilience. It wasn’t long ago that the talk was of Europe being left behind by a gold rush of investment to the US amid the new administration’s deregulation drive, and yet since then, European equity markets have outperformed those in the US – visible in the divergence in financial conditions indices – while consumer and business sentiment in the US has also softened, contrasting with the stability in Europe. The latest consumer confidence report cited renewed worries over inflation in the US, amid recent upside surprises and ongoing tariff threats. If the usual political checks and balances in the US don’t stop Trump, might souring economic and market sentiment? Watch this space.

### US financial conditions lag the improvement in EZ...

Financial conditions indices



Source: Bloomberg, ABN AMRO Group Economics

### ...as confidence in the US sours

Consumer confidence indices (normalised)



Source: Bloomberg, ABN AMRO Group Economics

## Spotlight: European defence spending

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- Recent comments by Trump have suggested a diminished US commitment to NATO, prompting European nations to consider significant increases to defence spending
- Various financing options were discussed at the Paris defence summit, including the exclusion of defence expenditures from EU fiscal rules, utilizing existing EU funds and facilities, and creating a new EU defence fund financed through joint debt issuance (similar to the NGEU programme post-COVID)
- All else equal, higher defence spending could put upward pressure on growth and inflation, but the case for a prolonged ECB rate cut cycle remains very much intact

***This Spotlight summarises our note [EU defence spending could shake EGB market](#)***

European nations are under mounting pressure to increase their defence spending due to the shifting geopolitical landscape, highlighted by the United States' reduced emphasis on NATO commitments under President Trump. This situation poses significant implications for the European Government Bond (EGB) market as countries strive to meet higher defence spending targets.

Among the eurozone's largest countries, only Germany and France are projected to meet NATO's 2% GDP defence spending target by 2024, with the Netherlands nearly reaching it. However, countries such as Italy, Spain, and Belgium still fall short and may be required to substantially increase their defence investments. In a scenario where the NATO target increases to 3%, the EU's largest six economies would need to augment their spending by an estimated EUR 156 billion.

At the recent Paris summits, various financing options were discussed to manage these expenditures:

**1) Excluding defence Expenditures from the EU fiscal rules:** One direct approach is financing at the national level by excluding military spending from the EU's stringent budget deficit limits. This would allow member states to finance defence spending through higher deficits without breaching fiscal rules. However, this could lead to increased bond issuance and higher borrowing costs, heightening fiscal concerns among investors and exerting upward pressure on bond yields, especially for heavily indebted countries like Italy, Spain, and Belgium.

**2) Utilising existing EU programmes:** Some European politicians proposed using existing EU programmes to finance the increase in defence spending. Redirecting parts of cohesion or structural funds, such as the NGEU programme, towards defence-related investments could provide a temporary solution. However, this would require unanimous approval from EU member states and potential legal reforms. While this could alleviate immediate financial pressure on fiscally vulnerable states, larger economies like Germany and France would likely bear a bigger portion of the financial burden, potentially resulting in an underperformance of their bonds.

**3) Creating a new EU programme/facility financed by joint debt issuance:** Another option is establishing an EU defence fund programme through joint debt issuance, similar to the post-COVID NGEU instrument. While this could offer long-term funding stability and bolster domestic defence industries, achieving EU consensus for such a programme would be challenging and time-consuming. This approach might primarily benefit peripheral economies that currently fall short of NATO targets, potentially leading to the outperformance of their bonds.

### **Macro-economic impact and implications for the ECB**

It is too early to draw concrete conclusions given how fluid the situation is, but all else equal, higher defence spending on the scale described above would put upward pressure on growth, inflation, and – depending on the timing – could lead to the ECB pausing rate cuts sooner than our current base case. We note however some caveats. First, any increase in spending is unlikely to fully offset the slowdown from the US tariff threat, which if anything is tilting towards [a more negative scenario](#) than our base case. Second, to the extent that other EU funds are redirected towards defence spending, this would not lift growth beyond our base case, as it would mean less spending in other domains. And third, it would take time for the EU defence industry to ramp up and to respond to higher spending, meaning that initially a significant portion of higher spending is likely to 'leak', i.e. be spent on higher imports (mostly from the US). This will dampen the growth and inflation impact.

# Spotlight: CDU's Friedrich Merz poised to be the next German chancellor

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- AfD and Die Linke are the biggest winners of the German elections, whereas FDP and BSW failed to reach the 5%-threshold, thus boosting the number of seats of the remaining parties.
- Though the middle parties lost ground, Union and SPD are likely to form 'Grand Coalition' government once again.
- Merz wants to reach agreement by Easter. Negotiations between Union and SPD will be tough though given the differences of their elections programs.
- Even when supported by Greens, the 'Grand Coalition' can't attain the two third parliament majority required to change the debt brake.
- More fiscal space is needed to ramp up defence spending, which is urgently required given the changes in US governments' security priorities.

**This Spotlight is a follow up of our note [Germany – 'Groko' likely amid further political fragmentation](#)**

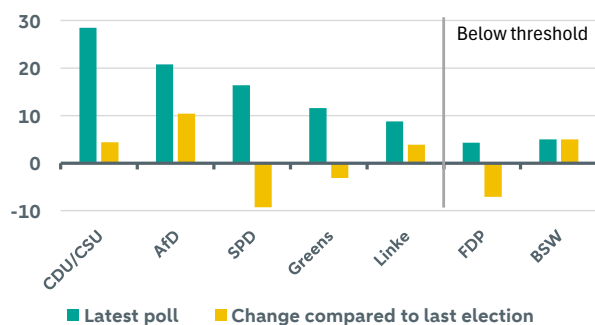
Sunday 23 February, Germans voted in a crucial election impacting not only their economy and domestic policies but also European policy-making amid geopolitical tensions involving Ukraine, NATO, and potential US tariffs. The highest voter turnout in decades underscored the importance of this election. In line with the polls, the CDU/CSU with leader Friedrich Merz has won the election. This puts the CDU/CSU in the driver's seat for the coalition talks. Current chancellor Olaf Scholz's Social Democratic party won just 16.4% of the votes, down around 10% from last election.

The liberal democratic FDP and far-left BSW failed to reach the electoral threshold, thereby boosting the seats of the remaining parties. This makes a two-party majority and the revival of the Groko (Grand Coalition) between the CDU/CSU and the SPD the most likely next coalition. Even more so as the Greens disappointed at just 12% of the votes which does not make them a possible alternative for the SPD.

The election underscored further political fragmentation – While a centrist 'GroKo' still seems the most likely outcome, it has to be noted that support for Germany's traditional big parties has declined as the political landscape has further fragmented. The far-right Alternative for Germany has recorded its best result yet, now 20.8% of the votes, roughly doubling their backing since 2021. In East-Germany, the AfD was often the biggest party. While Merz has vowed to keep the AfD behind the 'Brandmauer' i.e. excluding them from coalition talks, the AfD is set to become a dominant opposition party in parliament.

## CDU/CSU wins the vote, but support for AfD growing

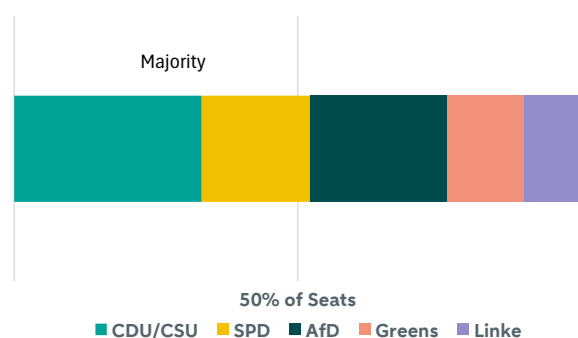
Share of votes, %-change



Source: bundeswhalleiterin, ABN AMRO Group Economics

## Grand Coalition between CDU/CSU and SPD has

Index (2021=100)



Source: bundeswhalleiterin, ABN AMRO Group Economics

A new government by Easter? – Merz urged that formation talks should be quick to address the many challenges Germany faces as the “world out there will not wait for us”. As it stands now, a new Grand Coalition between the CDU/CSU and the SPD seems the most likely outcome. However formation talks are expected to be difficult. Most importantly as the SPD has clearly lost in the election. While the AfD has been quick to announce their willingness to support a CDU/CSU minority government, Merz has ruled out governing together with the AfD.

Merz inherits a challenged economic growth model – The next coalition will have to face Germany's stagnating economy caused by a mixture of structural as well as cyclical headwinds which together challenge Germany's export-led growth model. We do expect some cyclical improvement as consumer demand picks up, rate cuts feed through

and frontloading effects – US firms increasing import orders in anticipation of tariffs – provide an impulse to exports. However, structural factors, such as high energy prices, a changed competitive landscape for German exporters and suboptimal infrastructure continue to weigh on the outlook. Together this underpins our expectations for a sluggish but positive growth rate of 0.4% in 2025 up from -0.2% in 2024. Still, Germany is expected to continue underperforming the broader eurozone.

The incoming coalition will struggle to find fiscal room to fund all of its ambitions – Supporting the economy, while reversing the course of infrastructure underinvestment, and ramping up defence spending, is all going to add up. The incoming government faces a difficult landscape how to free up fiscal wiggle room to fund these ambitions. Firstly because the current trajectory of public finances is one of already significant budget deficits. Merz, however, has voiced his intention to cut spending, especially on social programmes and welfare to free up space. The second challenge comes from changing the debt-brake, which looks difficult given the make-up of parliament. Currently the German constitution prohibits a structural deficit larger than 0.35% of GDP. Changing the constitutionally enshrined debt brake requires a two-thirds majority in parliament and the Bundesrat, and with the election results yesterday, the Left and AfD appear to have a blocking minority for any changes to the debt brake.

While a lot is uncertain at this stage, there could be three avenues forward. First, the debt brake has an emergency escape clause, for instance used during the pandemic. It is unclear whether the changing attitude of the US regarding European security and NATO would qualify as such an emergency. Second, the Left has indicated openness to change the debt brake (or allowing the creation of off-balance sheet funds) for instance for infrastructure spending, but is unwilling to do so for defence spending. It remains to be seen whether the incoming coalition can strike a compromise with them. A third option is to reform the debt brake before the new parliament takes office.

To form a coalition, the Union and the SPD will have to tackle various tough issues. Both parties entered the elections with very different programs, for instance regarding migration. The Union wants a much stricter policy that, according to the SPD, partly contravenes European rules. Nevertheless, given the strong growth of the AfD, it is likely that the Union and the SPD will tighten policies in this area. Support for Ukraine will also be more explicit than before. During the elections, Merz stated that the goal is for Ukraine to win the war, a formulation that Chancellor Scholz consistently avoided.

There are also differences in the tax proposals of both parties. The Union wants to abolish the solidarity tax, which was introduced after the fall of the Berlin Wall to finance German reunification, while the SPD wants to maintain it. Additionally, the Union wants to lower income tax rates and only apply the top rate at a higher income level. In contrast, the SPD wants to lower income taxes for the bottom 95% income groups and fund this by increasing taxes for the top 5% income groups. Furthermore, the Union wants to reduce corporate taxes, but the SPD fears that companies will use this advantage primarily to buy back shares. Therefore, they propose giving tax incentives to companies that invest. Finally, the Union advocates for lowering the VAT-rate for the hospitality sector, while the SPD advocates for reducing VAT on food.

Another point of debate is the rising pension costs and how to address them. The Union hopes to finance these costs by stimulating GDP growth. The SPD is more realistic, assuming that social contributions and taxes will need to increase. However, taxes and social contributions relative to gross income are already relatively high in Germany. There is little support in either party for the alternative proposed by think tanks—raising the retirement age.

Then there are welfare and the minimum wage. The Union wants to cut costs by abolishing the new welfare scheme introduced by the Scholz government, which is not popular among the public. The SPD is not in favour of this, although there seems to be some room within the party when it comes to sanctions for those who refuse to accept work. The SPD wants to raise the minimum wage from 12.82 to 15 euros per hour, but the Union wants the decision on the minimum wage level to be left to an independent committee designated for this purpose, which will give its verdict in June. Considering inflation, it is likely that the committee will decide to increase the amount.

Finally, both parties agree that energy costs need to be reduced, especially for businesses. Under the Scholz government, the electricity tax was temporarily reduced to the EU minimum of 0.05 cents per kilowatt-hour. Both parties want to make this reduction permanent. They also both endorse the goal of being climate neutral by 2045 and using more renewable energy. However, a difference is that the Union is open to nuclear energy. Furthermore, the Union and the SPD have different views on how the higher energy system costs should be borne. The Union wants to use CO2 levies for this purpose. In contrast, the SPD is considering a higher fee for the transmission network of 6.65 cents per kilowatt-hour and investments from a newly formed investment fund of EUR 100 billion.

## Eurozone: Keep calm and carry on

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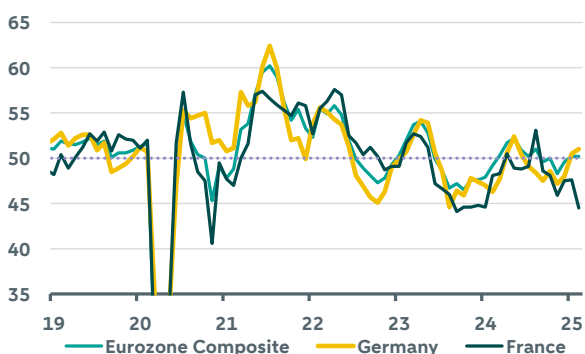
- Amid the geopolitical earthquake, the eurozone economy is for now evolving in line with our base case
- Growth is subdued but still on a recovery path, while inflationary pressures continue to slowly ease
- The ECB is expected to pause as it nears neutral; tariff shock to drive extensive rate cuts thereafter

Europe is currently in the throes of massive geopolitical tectonic shifts, and it will take time to discern the precise macro-economic constellation that will result. We have given our initial takes on the impact of US tariffs and higher defence spending, and will build on this analysis as the details begin to crystallise. But broadly speaking and from a purely macro-economic standpoint, we continue to think the tariff shock is going to be the overwhelming factor impacting growth over the coming year. In the meantime, the economic backdrop is evolving in line with our base case. Growth remains subdued, notwithstanding the slight upward revision to Q4 GDP growth (to 0.1% q/q from 0% in the flash estimate). However, as signalled by the February PMIs, the economy remains on a recovery path, with the composite PMI holding steady just above the expansion threshold at 50.2. The stability in the aggregate eurozone PMI masks a significant reversal in fortunes of [France and Germany](#), with Germany recovering and France surprising sharply to the downside. At the same time, the periphery continues to outperform both of the eurozone's big hitters. Overall, we expect growth to pick up in the first half of 2025, driven by stronger consumer spending and possible frontloading of exports to the US ahead of likely tariffs, with growth expected to slow in the second half of 2025 as the tariff shock hits.

Inflation meanwhile surprised slightly to the upside in February but was broadly steady at 2.5%. As expected and similar to January, the details showed a temporary lift from energy – both from base effects but also the recent rise in gas and electricity prices (which are already rapidly retracing in wholesale markets). More promisingly, services inflation came in a touch cooler than expected – albeit still elevated – while the Indeed wage growth tracker moved another leg down to a new post-energy crisis low of 2.6% y/y. The more lagging negotiated wages measure also slowed sharply in Q4, to 4.1% from 5.4% in Q3, and the ECB's forward-looking tracker suggests a further significant slowdown over the coming year. While elevated wage growth is likely to keep services inflation on the high side for some time yet, we do expect it to cool gradually as the year progresses. As the ECB has noted, there are increasing signs that businesses are to some extent absorbing higher wage costs in their margins rather than passing them on to consumers as readily as previously. This perhaps reflects the cooling in services demand, as trends such as the post-pandemic 'revenge travel' fades and consumers switch back to goods. We continue to expect inflation to be sustainably back at the ECB's 2% by the middle of this year, and to fall below target as we move into 2026.

### France is currently the main drag on the recovery

Composite PMI, Index; >50 = expansion



Source: LSEG, ABN AMRO Group Economics

### Wage growth is normalising

% y/y



Source: LSEG, ABN AMRO Group Economics

As for the ECB, recent weeks were notable for the shift in tone from Governing Council hawks such as Isabelle Schnabel and Pierre Wunsch. Schnabel called for a debate to 'pause or halt' rate cuts, while Wunsch warned against 'sleepwalking' into too many rate cuts. These comments come as no surprise to us, because we expected division on the Governing Council to start increasing again as rates approached the upper bound of neutral estimates. While we expect the ECB to cut again when it meets next week, taking the deposit rate to 2.5%, we have pencilled in a pause at the April meeting. But this pause is unlikely to last: the timing will depend on when exactly new US tariffs land, but when they do, we expect the ECB to keep cutting until the deposit rate reaches 1%, likely by early 2026. See also our [ECB preview](#).

## The Netherlands: Solid domestic demand fuels growth

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- The Dutch economy grew by 0.4% q/q in Q4, marking a solid year with overall growth of 0.9% y/y
- We expect GDP growth will rise to 1.8% y/y in 2025, before slowing to 1.0% in 2026
- The unemployment rate is expected to remain low, averaging 3.8% in 2025 and 4.1% in 2026

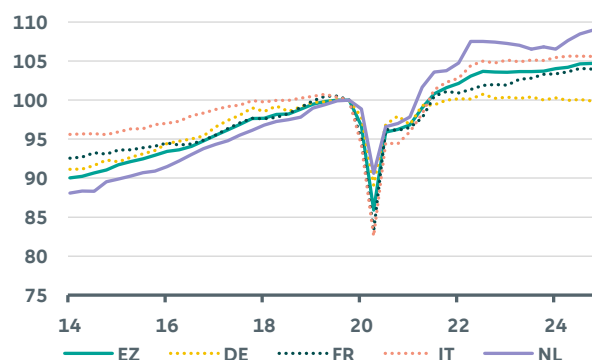
In the fourth quarter, the Dutch economy grew by 0.4% q/q, following robust growth of 1.1% and 0.8% in the previous quarters, respectively. This performance marks a solid year for the Dutch economy, with an overall growth rate of 0.9% y/y, standing out compared to other eurozone countries. All GDP components contributed positively to the Q4 growth figure, with internal demand being the primary driver. Firstly, investment rose by 3% q/q, particularly in transport such as cargo vans, likely coinciding with the changed tax regulations in 2025. Investment remained strong throughout 2024, which is remarkable given high interest rates, (geo)political uncertainty, a weak German economy, and a tight labour market. Secondly, household consumption increased by 0.9% q/q. Despite initial household hesitance and a preference for saving and deleveraging, rising real incomes have translated into increased consumption in recent quarters. This uptick in consumption occurs despite strong pessimism among households. Notably, towards the end of 2024 purchases of durable goods surged, likely driven by government policy changes in 2025 regarding subsidies for electric cars and heat pumps. Thirdly, the Dutch government's expansionary fiscal policy continued to contribute to growth, with a 0.9% q/q increase in Q4, particularly fuelled by higher healthcare spending.

The trade balance also contributed significantly to Q4 growth, as exports rose by 0.4% q/q while imports declined by 0.6%. The reduction in imports is likely linked to developments in the gas markets. Despite falling gas stocks, less gas was imported, possibly due to changes in European gas supply. However, the faster drawdown of gas inventories due to colder weather offset the trade balance's positive contribution to GDP, reducing growth by 1.6pp. As gas inventories continue to deplete in Q1, this will likely weigh on the growth figure.

Looking ahead to 2025, growth is expected to recover further. Households continue to benefit from higher real incomes, supporting consumption. The government is also contributing to growth through spending on healthcare, public administration, defence, and public investment, along with indirect support via the purchasing power package announced on 'Prinsjesdag'. Foreign demand is expected to pick up due to increasing growth in the eurozone. In our forecasts we assume Trump's import tariffs will take effect in the second half of 2025, possibly leading to a short-term 'frontloaded' surge in exports to the US as companies avoid the tariffs. While there is some anecdotal evidence of this, we are yet to see it in the macroeconomic figures. Once tariffs are implemented, they will dampen foreign demand for Dutch exports. Overall, we project GDP growth to rise to 1.8% y/y in 2025 before slowing to 1.0% in 2026.

### Dutch economy continues to outperform neighbours

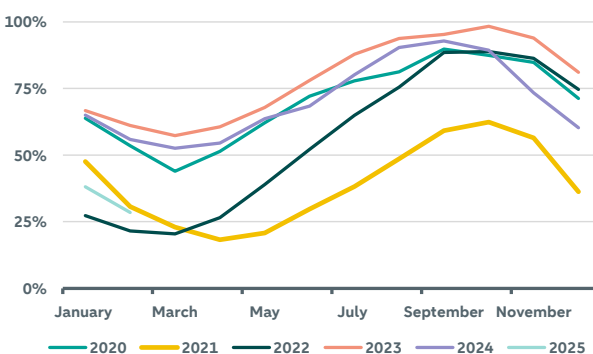
Index, 2019Q4=100



Source: LSEG, ABN AMRO Group Economics

### Gas stocks decreased significantly

%



Source: NED, ABN AMRO Group Economics

The Dutch labour market continues to be a bottleneck. Companies continue to report that labour market tightness is their primary challenge. Although the unemployment rate has climbed to a two-year high of 3.8%, it remains historically low. As cyclical pressures fade, the labour market is expected to gain some breathing space. Still, given high labour demand, limited labour supply, and a greying population, we think the unemployment rate will remain low, averaging 3.8% in 2025 and 4.1% in 2026, up from 3.7% in 2024.

## US: Trump policy forces Fed to stay put

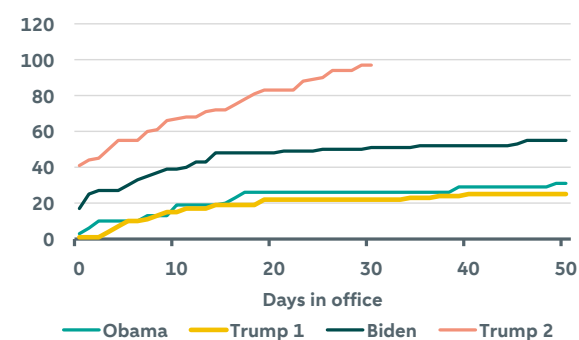
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- The Trump administration is moving at a blistering pace, with little regard for institutions or law.
- Inflation and inflation risks picked up over the past month; labour market risks also increased.
- Fed effectively paralyzed, unlikely to change rates

The US political and economic landscape has drastically changed since our last Monthly. Then, we had just seen the initial flurry of executive orders which dealt with, amongst others, immigration, inflation, reducing the government footprint and an unwinding of Biden policy. Before entering the oval office, Trump had already threatened substantial tariffs on Canada, Mexico and China which were set to be enacted on February 1<sup>st</sup>. Ultimately, only China faced a new 10% tariff, and the Canada and Mexico tariffs were postponed until March. These moves were all just the initial ascent on an unprecedented rollercoaster of US policy, with no braking zone in sight. Based on the number of executive orders, Trump is moving at more than four times the speed of Obama and Trump's own first presidency, and double the speed of Biden, who had learnt from Trump's late-term executive order antics.

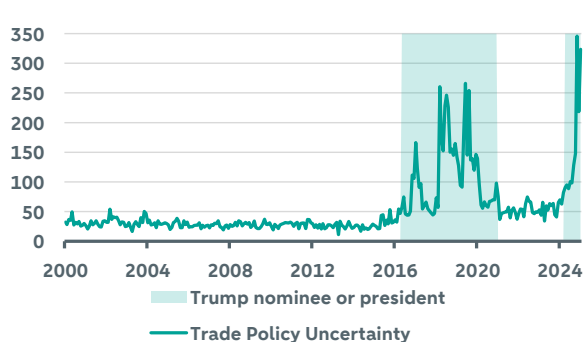
### Trump hit the ground running

Sum of executive orders, Memoranda and Substantive Proclamations



### Trade policy uncertainty at all-time high

Index



Source: The American Presidency Project, ABN AMRO Group Economics

Source: Caldara et al. (2020), ABN AMRO Group Economics

The political implications of already enacted policies are large, and beyond the scope of this macro update. The economic implications of *confirmed* policy are relatively mild, for now. Policies on immigration and the federal workforce increases [downside risks to the labour market](#), and put some mild pressure on inflation. The bigger economic impact is expected to come from tariffs, which are still surrounded by substantial uncertainty. The trade policy uncertainty index is at an all-time high, exceeding even the most uncertain times during the first Trump administration. In a recent note, we summarized the [first month of tariff threats](#) and quantified their potential impact. The Canada/Mexico tariff that is set to start next week has a substantial potential impact on all three economies, likely plunging Canada and maybe Mexico into a recession. The US gets a significant growth shock of around 0.9% spread over the year, and a shock to core PCE inflation of up to 0.7%. The design of the 'reciprocal' tariffs, which appears to replace the previous 'universal' tariff is still largely unknown, but the parameters outlined in the White House memorandum allow for a wide range of outcomes with no clear upper bound. Details of the reciprocal tariff plan are set to be revealed by April 2<sup>nd</sup>. The total package of proposals could lead to an increase in the trade weighted tariff of almost 20%, compared to a level of about 2.5% at the start of the Trump term, and far beyond our base-case assumption of an increase of about 8.5%. At the same time, backtracking and renegotiation shows that the magnitude of the ultimately implemented tariffs is highly uncertain.

While we wait for the impact of Trump's policies to materialise, the underlying macro picture continues to evolve. GDP growth remained robust at 2.3% SAAR for 2024Q4, predominantly on the back of strong consumption. The January unemployment rate ticked down again to 4.0%, after a relatively solid jobs report. The big surprise came from January inflation which came in hotter than expected, with a headline CPI rate of 0.5% m/m, and core CPI also increasing by 0.4%. On the more positive side, PPI data suggests core PCE will come in at 0.3% m/m, and an update of seasonal adjustment factors made the last months of 2024 look marginally more benign. Still, [disinflation has stalled](#), and while pressures from wages and shelter have largely subsided, the outlook compared to last month has moved towards increased upside risks stemming from both tariff and non-tariff pressures.

Considering the above, the prudent approach is for the Fed to stay put. Compared to the start of the easing cycle, the labour market looks better, and inflation risks tilted to the upside. Evolving fiscal policy is likely to have a bigger impact on the inflation rate than the unemployment rate, tilting the Fed towards a more restrictive stance in the future. Further easing in the near term would be risky. In light of the dual mandate, there appears to be no real benefit to easing at the current juncture, except to please Trump. Rather, easing risks a future U-turn, hurting credibility at a vulnerable time.

## China: Navigating property challenges amidst ongoing US threats

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- After weak January PMIs, credit and LNY spending data provide some green shoots
- Outlook still shaped by further measures taken to stabilize property and demand, on the one hand...
- ...and by US import tariffs and other trade and investment measures, on the other

### After weak January PMIs, credit and LNY spending data provide some green shoots

Monthly activity data for China are a bit scarcer than usual at the start of each calendar year, as due to the Lunar New Year (LNY) break January/February data are combined and published in March. Looking at the data that are available, the January PMIs were disappointing, and did not match the picture of improving macro data seen in Q4-24 (see our comment [here](#)). Still, lending growth expanded stronger than expected in January, showing evidence that Beijing's policy pivot from September 2024 is filtering through. Other moderately positive signals came from the tourism and spending data for the LNY holiday. On the inflation side, CPI remained low in January, but picked up in line with our expectations, climbing to a five-month high of 0.5% y/y (partly impacted by LNY spending). Producer price inflation remained in negative territory though, for the 28<sup>th</sup> month in a row, staying at -2.3% y/y.

#### Bond yield signals fading deflationary pressures?

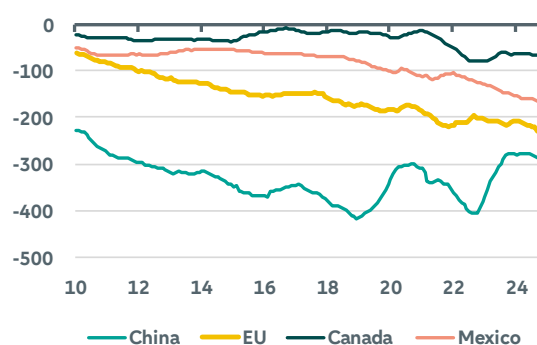
China 10-year bond yield, %



Source: Bloomberg

#### US goods trade balances with key trade partners

USD bn, 12 months' rolling sums



Source: ABN AMRO Group Economics, Bloomberg, US Census Bureau

### Outlook still shaped by measures on stabilizing property and demand on the one hand

China-related market sentiment has improved in recent weeks, but this is driven more by tech enthusiasm (DeepSeek's breakthrough, Beijing's more lenient stance on job-creating internet platforms) than by macro developments. Looking through the volatility of the recent data, China's recovery is still led by the supply side. The macro outlook will continue to be shaped in the first place by concrete measures aimed at breaking the negative feedback loop from property (to confidence/demand), with the recovery in new home sales looking short-lived so far. Beijing's treatment of the large state-owned property developer Vanke is a key litmus test in this context. More broadly, we expect more clarity on Beijing's 'stepwise' fiscal support stance (on top of what's already been rolled out) to follow at the annual National People's Congress in early March. On the monetary front, we still expect additional policy rate and RRR cuts (even a bit more than in 2024), although the timing thereof will likely be shaped by currency and other "tactical" considerations.

### ...and by US import tariffs and other trade and investment measures on the other

US president Trump recently hinted at a potential US-China trade deal. Note that China still has the largest bilateral trade surplus in goods with the US, but it is the only key US trade partner whose surplus has clearly fallen compared to the first tariff war in 2018-19. In our base case, we assume the US will raise China import tariffs by an additional 25% (on top of the 10% levied in February, and the  $\pm 10\%$  already in place), to an average tariff rate of 45% by Q2-26. Should tariffs rise by less, this would shift the balance of risks regarding our growth forecasts (4.3% for 2025 and 4.2% for 2026) in a positive direction, but it may also mean that additional support from Beijing will be less. The US is currently studying its trade policies and trade relationship with China. The outcome of these studies could form the basis for further China-specific tariffs, while China may also be hit by future product-specific (but country non-specific) tariffs (see [here](#)). What is more, a recent US memorandum calls for new investment/trade restrictions on China. This includes a proposal to sharply raise fees on Chinese/Chinese-built ships visiting US ports to reduce China's dominance in global shipbuilding, which may – if implemented in full – have material [repercussions for global shipping](#).



## Key views on a page

President Trump's tariff threats have surprised even our pessimistic expectations. Our base case sees a significant rise in US import tariffs in 2025, but recent threats raise the risk of a more negative scenario. China and the US's neighbours may bear the brunt, but Europe will also be hit. Global trade and growth will initially benefit from a frontloading ahead of the tariff rises, before slowing sharply later in 2025. Against this backdrop, domestic demand is recovering in the eurozone and China, helped by falling interest rates and targeted fiscal measures in China, while in the US, deregulation and tax cuts will help blunt the real income shock from tariff rises. Inflation in the US is expected to reaccelerate, but to fall below target in the eurozone. All of this is likely to drive a divergence in Fed & ECB policy, with Fed policy staying on hold from here, and the ECB deposit rate ultimately falling to 1%. This is expected to push the euro below parity against the dollar in the course of 2025.

Macro	Central Banks & Markets
<p><b>Eurozone</b> – The eurozone recovery is continuing, helped by rate cuts and real income gains supporting consumption. However, recent tariff threats suggest the downside risks have grown. In the first half of 2025 frontloading effects are likely to boost quarterly growth. Afterwards, we see growth and inflation negatively impacted by the gradual rise in US import tariffs from 25Q3 onwards. In 2026 inflation will undershoot the target. Growth is expected to average 1.2% in 2025, slowing to 0.8% in 2026. Higher defence spending poses some upside risks, but tariffs are likely to overwhelm this impact.</p>	<p><b>ECB</b> – We expect the ECB to cut rates again in March. We see the ECB pausing in April as uncertainty over tariffs as well as policy rates approaching the ECB's assessment of neutral are reason to adopt a wait-and-see approach. A pause has also been signaled by some on the Governing Council. As tariffs hit growth and inflation, we see the ECB resuming its easing cycle at the June meeting, and cutting rates by more than markets currently price, until the deposit rate reaches 1% in early 2026. A year from now the ECB will therefore have moved from a restrictive to an accommodative policy stance.</p>
<p><b>The Netherlands</b> – The Dutch economy grew by 0.4% q/q in Q4, after solid growth in Q2 and Q3. This marks 2024 as a strong year with an overall growth of 0.9% y/y. In 2025, growth is expected to recover further, before slowing on the back of US import tariffs. Growth will be domestically driven and will average, 1.8% in 2025, and 1.0% in 2026, compared to 0.9% in 2024. Unemployment will increase slightly, but the tight labour market remains a constraining factor. Inflation is expected to stay above the 2% target in the coming years, driven by still high wage growth.</p>	<p><b>Fed</b> – After the December rate cut, the Fed's upper bound on fed funds rate stands at 4.5%. With another upside surprise in January, inflation is unlikely to come down sufficiently to allow for any easing before it rises again following a new impulse from tariff policy. Risks to inflation and the labour market are currently roughly in balance, but likely to tilt to inflation in the second half of the year. Therefore, the Fed keeps rates at the current, restrictive, level indefinitely, lowering the risk of being forced to undo recent rate decisions. Neither inflation nor the labour market is expected to provide a cause for rate changes in the near term.</p>
<p><b>UK</b> – The government's expansionary fiscal stance, alongside rising real incomes, is likely to keep the economy on a solid recovery path for now, though structural challenges remain. New US trade tariffs pose downside risks to growth in H2 25, but the UK is less vulnerable than the eurozone as it is less export dependent. Services inflation is stubbornly high, with wage growth still well above levels consistent with 2% inflation. A sustained return to 2% inflation will take longer than elsewhere, due to historically higher inflation expectations in the UK.</p>	<p><b>Bank of England</b> – The MPC lowered Bank Rate to 4.75% in February, in line with our expectations. Incoming data suggests stubbornly high underlying inflationary pressure, and sticky wage growth. The government's expansionary fiscal stance, alongside continued elevated wage growth, poses upside risks to medium-term inflation. This is likely to keep rate cuts at a more gradual pace than for the ECB. We expect three more 25bp rate cuts in 2025 and Bank Rate to settle at 3.5% in early 2026.</p>
<p><b>US</b> – Growth and consumption remain strong, while the labour market gradually cools. Upcoming stimulative policy notwithstanding, a weakening labour market, pockets of financial stress among households are likely to contribute to a slowdown in growth into 2025. Tariffs will be a further drag on growth in the course of this year, whilst also raising inflation. Our 2025 growth forecast stands at 2.1% on the back of still strong momentum, dropping to 1.6% in 2026. The tariff impact implies average PCE inflation of 2.4% in 2025, rising to 2.8% in 2026.</p>	<p><b>Bond yields</b> – Trump's statements continue to weigh on European rates. Over the past weeks, EU defence spending has become the new investors' concerns in the EGB market. This development suggests that EU countries may need to increase government spending, likely financed through higher deficits and, consequently, increased borrowing requirements. As a result, higher bond issuance anticipation shifted the longer end of the curve higher, and this may continue if no joint EU debt issuance deal is found by the EU member states.</p>
<p><b>China</b> – Following weak January PMIs, lending and LNY spending data provide some green shoots, while deflationary pressures seem to start fading. The outlook will continue to be shaped in the first place by real measures aimed at breaking the negative feedback loop from property. We expect more clarity on this front to follow at the annual NPC in early March. Developments in US-China relations are another important driver. We expect more US import tariffs to follow on top of the 10% implemented in February; the US administration is also considering broader measures affecting trade and investment.</p>	<p><b>FX</b> – In recent weeks the US dollar has given back gains and the euro as rebounded. This mainly because the market waits how developments will play out geopolitically but also on the economic front. We expect EUR/USD to move towards 0.98 again as we expect more ECB rate cuts than the market is currently pricing in and the Fed not to cut anymore in our forecast horizon. Our forecast for EUR/USD at the end of 2025 stands at 0.98.</p>

## Main economic & financial market forecasts

	GDP				Inflation				Policy rate			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Eurozone	0.5	0.7	1.2	0.8	5.4	2.4	2.0	1.5	4.00	3.00	1.25	1.00
Netherlands	0.1	0.9	1.8	1.0	4.1	3.2	2.6	2.4				
Germany	-0.1	-0.2	0.5	0.7								
UK	0.4	0.9	1.2	1.6	7.3	2.5	3.2	2.8	5.25	4.75	3.75	3.50
US	2.9	2.8	2.1	1.6	3.8	2.5	2.4	2.8	5.50	4.50	4.50	4.50
China	5.4	5.0	4.3	4.2	0.2	0.2	0.8	1.3	3.45	3.10	2.70	2.60

Note: Annual average for GDP and inflation, end of period for the policy rate

	2024	24/02/25	Q2 25	2025	2026	Energy	2024	24/02/25	Q2 25	2025	2026
	US Treasury	3.88	4.40	4.70	4.55		4.55	Brent - USD/bbl*	74.64	74.78	68
German Bund	2.02	2.47	1.90	1.50	1.45	WTI - USD/bbl*	71.72	70.70	64	58	55
EUR/USD	1.03	1.05	1.02	0.98	1.05	TTF Gas - EUR/MWh*	46.68	37.70	33	40	30
USD/CNY	7.30	7.25	7.60	7.80	7.60						
GBP/USD	1.25	1.26	1.20	1.19	1.24						

\* Brent, WTI: active month contract; TTF: next calendar year

	2024				2025				2026			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>GDP (q/q)</b>												
Eurozone	0.3	0.2	0.4	0.1	0.4	0.4	0.1	0.2	0.1	0.2	0.2	0.3
Netherlands	-0.3	1.1	0.8	0.4	0.0	0.9	0.2	0.0	0.3	0.3	0.2	0.3
US (saar)	1.6	3.0	3.1	2.3	2.1	1.3	1.9	2.0	1.8	1.4	1.3	1.4
China (y/y)	5.3	4.7	4.6	5.4	5.0	4.7	4.2	3.4	3.4	4.1	4.5	4.7
<b>Inflation</b>												
Eurozone	2.6	2.5	2.2	2.2	2.3	2.2	1.9	1.8	1.4	1.4	1.5	1.7
Netherlands	3.0	2.9	3.3	3.7	2.9	2.7	2.4	2.3	2.8	2.5	2.3	1.9
US (PCE)	2.7	2.6	2.3	2.4	2.2	2.5	2.9	3.1	3.1	3.1	2.9	2.7
China	0.0	0.3	0.5	0.2	0.5	0.6	0.7	1.2	1.0	1.1	1.3	1.7
<b>Unemployment</b>												
Eurozone	6.5	6.4	6.3	6.3	6.4	6.5	6.7	6.7	6.7	6.7	6.7	6.6
Netherlands	3.6	3.6	3.7	3.7	3.7	3.8	3.9	4.0	4.1	4.1	4.2	4.2
US	3.8	4.0	4.2	4.1	4.3	4.5	4.6	4.6	4.6	4.7	4.7	4.7
<b>Policy rate</b>												
Eurozone	4.00	3.75	3.50	2.75	2.50	2.25	1.75	1.25	1.00	1.00	1.00	1.00
US	5.50	5.50	5.00	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
UK	5.25	5.25	5.00	4.75	4.50	4.25	4.00	3.75	3.50	3.50	3.50	3.50
China	3.45	3.45	3.35	3.10	2.90	2.80	2.70	2.70	2.70	2.60	2.60	2.60

Source: LSEG, Bloomberg, ABN AMRO Group Economics

(saar = season adjusted annual rate)

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