Economic Adviser

Macro Research

April 2025 ♦ Date of issue: 28 March 2025

Finanzgruppe

Contents

Special: Fiscal reset in Germany – game changer for infrastructure and growth

Analyst: Christian Lips, Chief Economist

Fiscal reset: green light for infrastructure and defence investments!

With a landmark decision, the Christian Democrats (CDU), Christian Social Union (CSU) and Social Democrats (SPD), in cooperation with the Greens, have agreed on a comprehensive financing package for defence and investment in infrastructure. Firstly, the overall package provides for the establishment of a EUR 500bn special fund to be made available for investments over the next twelve years. Of this total, EUR 100bn are earmarked for the federal states and a further EUR 100bn for the Climate Transformation Fund (KTF). Crucially, the financing follows the principle of additivity – meaning federal investments must be in addition to, rather than drawn from, the core budget. This safeguard ensures that critical spending does not come at the expense of existing fiscal commitments.

Secondly, all expenditures serving the purposes of defence in a broader sense – including funds for civil protection, intelligence services, cybersecurity, and support for states attacked in violation of international law – will be exempted from debt brake rule as long as they amount to over 1.0 percent of gross domestic product (GDP). In addition, the federal states, like the federal government, are given the opportunity to take out structural net loans of up to 0.35 percent of GDP. Any existing state-level budget laws or constitutions imposing stricter debt limits will be overridden by these reforms.

Market reactions: hopes of growth instead of solvency concerns

In our baseline scenario we had already assumed a fundamental reform of fiscal policy and the creation of new financial leeway by the new federal government after the Bundestag elections. However, the pace at which this fiscal reset has now been accomplished has taken us too by surprise. The new Bundestag's majority situation and current geopolitical developments were decisive in swiftly reaching an agreement before the outgoing parliament's term ends though.

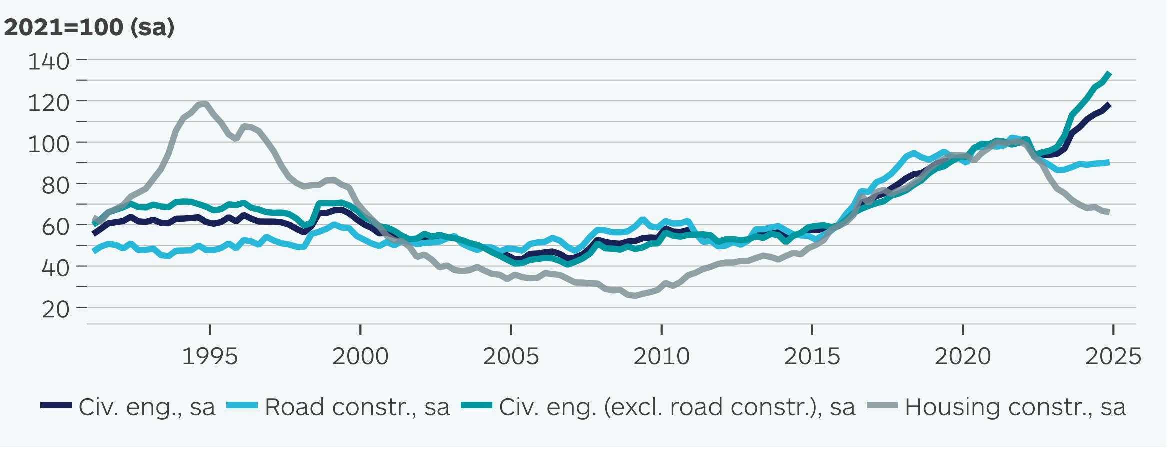
Much about the fiscal package's impact remains unclear, hinging on its implementation, timing – especially that of the spending ramp-ups – and complementary policy measures. Initial market reactions – marked by a sharp rise in bond yields, a surging euro, and higher equity prices alongside stable CDS spreads – suggest a rapid adjustment in the markets to the information shock. The composition of the market reactions thus indicates that the news is taken as a growth-positive signal rather than a threat to Germany's fiscal solidity. Comparisons to the UK's 2022 turmoil under Liz Truss are therefore unwarranted.

Accompanying commentary on the initial reports about this fiscal reset also revealed that exceptionally high (credit) volumes were apparently assumed for investments and defence – especially in the initial phase. This had also triggered a modest rise in medium-term inflation expectations, with the 5Y5Y breakeven inflation rate peaking more than 20 basis points above late-February levels. The surge appears partly attributable to CDU leader Friedrich Merz's "whatever it takes" rhetoric, which may have fuelled exaggerated near-term expectations. Indeed, the surge has in the meantime more than halved, and the current level of 2.07 percent aligns with the ECB's stability target range and thus provides good reason to have no sustained inflationary concerns.

Wild spending spree or simply a necessity? An analysis of the fiscal package
The fiscal package is not a wild spending spree. According to relevant studies, the special fund for additional investments covers a sizeable portion of the investment requirements needed over the next decade in terms of volume. That said, higher borrowing costs and complementary expenditure increases in the core budgets must also be taken into account in the financial planning. The criterion of additivity is central to the package's success – shifting of funds from core budgets must be avoided. This principle is binding only for the federal government's share.
In the area of defence, debt financing is justified solely due to the Bundeswehr's acute modernization backlog and necessary aid for Ukraine. Unlike with the special fund, the total resulting debt volume is uncertain ex ante and theoretically unlimited. Yet this very aspect sends a strong signal outward, particularly in relation to geopolitical challenges posed by actors like Putin and Trump. In the medium term, reducing the debt ratio will be necessary to cover consumptive expenditures through regular revenues again and ensure long-term fiscal solidity. The calibration of the exemption threshold of 1.0 percent of GDP is questionable. Since the renegotiations among the parties led to an expansion of the eligible expenditure purposes, even more leeway was ultimately created in the federal budget than provided for in the original draft.

An assessment of the package's macroeconomic impacts
A preliminary calculation shows that if the special fund were evenly distributed over twelve years, it would amount to approximately EUR 40bn annually – equating to nearly 1 percent of GDP. Additionally, the federal states will be granted new borrowing capacity of 0.35 percent of GDP per year. In the sphere of defence, it is assumed that the magnitude will be similar to that of the investments (around 1.0 percent of GDP), though with a faster ramp-up and high debt-financed expenditures to be expected in the first few years. A medium-term reallocation into the core budget would reverse the initial effect. Under this scenario, GDP could gradually increase by a total of nearly 2.5 percent.
It is important to note, that the boost to economic activity from the direct stimulus occurs only once (level effect). Infrastructure projects typically have relatively long lead times, suggesting a delayed impact that could gradually become noticeable from 2026 onward. While defence spending may ramp up more quickly, it is characterized by a relatively elevated share of imports. Besides the expenditure profile over time, the impact on GDP will also depend on the quality of the programmes, the additionality, the efficiency, and any multiplier effects. The multiplier for investments will likely be well above 1.0, while rather tending to be below 1.0 in the sphere of defence.

Chart: Tight capacities – high order backlog in civil engineering (excluding road construction)



Sources: Destatis, Macrobond, NORD/LB Macro Research

Complementing the fiscal package with supply-side measures to secure its sustainable success

Increased capital needs and higher growth will likely lead to rising capital market interest rates in the medium term. The yields on 10-year Bunds will probably return to the 3-percent rather than 2-percent range. Yet, part of the fiscal stimulus could also translate into higher prices, with the impact heavily dependent on labour market conditions and available capacities. Currently, capacities in the defence industry are constrained – a situation that appears to mirror conditions in civil engineering (excluding road construction), judging by the high order backlog (see chart). The crucial factor will be whether private companies view the long-term increase and stabilization of investment spending as credible and whether they are willing to invest in expanding their capacities.

To maximize the package's success and avoid unwanted side effects, it should be complemented with supply-side measures. This could be done through various actions aimed at boosting the efficiency and effectiveness of the investments. Possible measures include the elimination of planning and procurement deficits as well as bureaucratic hurdles that hinder the rapid implementation of projects. Many of the ideas recently discussed for comprehensive state reform would be helpful in modernizing administration, making it more efficient and accelerating decision-making processes. In addition, the labour supply should be increased, for example through more flexibility in the labour market and controlled immigration to meet the demand for skilled workers. Moreover, tax incentives could be created to boost private investment and generally increase the attractiveness of investment in Germany. Advancing the European single market could likewise help strengthen competition and improve market efficiency.

Ultimately, the additional debt merely makes transparent what has long existed in the form of implicit government liabilities (infrastructure maintenance backlog, neglected defence spending). The success of the package crucially depends on the fiscal policy measures not being viewed in isolation but rather embedded in a comprehensive concept for sustainable growth and innovation. If implemented properly, the debt-to-GDP ratio would likely peak at around just 80 percent before gradually declining. The key lies in boosting growth potential – meaning fiscal stability would be maintained not despite, but because of the fiscal package.

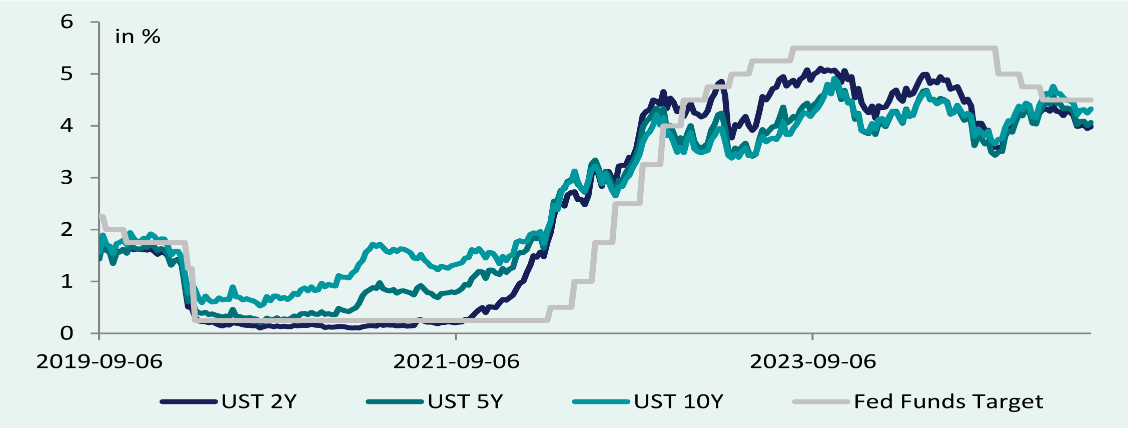
USA: Growth slowdown takes hold

Analysts: Tobias Basse // Constantin Lüer

Growth slowdown takes hold

The final revision of the Q4/2024 GDP figures brought no major surprises for the international financial markets. With an annualized growth rate of 2.4 percent, the data on real US economic expansion points to a certain cooling of momentum in North America's economic activity. This trend is likely to persist in the near term, as reflected in the fact that the Atlanta Fed's GDPNow forecast for annualized Q1 growth has in the meantime slipped below the mark of -2.0 percent, apparently unsettling some observers. However, this volatile indicator is currently distorted by one-off factors, in our view making speculation about an imminent recession in the USA overblown. Growth is simply losing altitude, not collapsing. The latest data on the trend in US retail sales also point in this direction. February's headline index showed almost no sign of the eagerly hoped-for rebound after January's feeble figures. Against this background we have had to downwardly adjust our GDP forecast for Q1/2025 – which was hardly optimistic to start with. All the same, the control group did show signs of a marked rebound effect, enabling us to limit our forecast revisions to cautious tweaks rather than major adjustments, even given the soft consumption figures in early Q1.

Chart: Interest rate trend in the USA



Sources: Macrobond, NORD/LB Macro Research

Gloom prevails across the construction sector

The latest NAHB Housing Market Index figures reveal a deepening crisis in the private real estate industry. This key sentiment indicator plunged by a further 3 points in March as month under review, now standing at just 39 points, meaning that the current developments in mortgage rates have thus far proved insufficient to ease the situation. Builder sentiment remains deeply depressed for now against this backdrop. A particularly close eye now needs to be kept on the capital market yields – lower rates would certainly provide welcome relief for North America's real estate market.

The FOMC remains in focus

As expected, the Fed has been playing for time of late. Yet with slowing growth gradually leaving ever clearer marks on the labour market, key-rate cuts in the land of unlimited opportunity could well be back on the Fed's agenda in the future after all. The macroeconomic price environment remains a problem for the FOMC, nevertheless. In particular the high inflation expectations among some private households, likely fuelled in part by the threat of tariffs, pose a challenge for the monetary policymakers in Washington. While the next interest rate adjustment should be downwards, the central bankers have no great leeway for a further cut in its funds target rate! The capital market rates appear to have stabilized at a lower level in March. Besides what were in all rather weak economic data, the comments by Scott Bessent will likely have helped virtually anchor the yields on 10-year Treasuries in the region of 4.3 percent; in his frequent interviews with the press, the US Treasury Secretary repeatedly emphasizes the need for a sound and savings-oriented fiscal policy. Interestingly, the dollar has failed to capitalize on the Fed's cautious stance. In fact, the exchange rate has recently approached the USD 1.09 per euro mark, bringing this threshold into focus. The economic policy plans in Washington are undoubtedly also playing a role in this context. While Bessent made it clear that the new US administration does not intend to bring about any sustained weakness of the dollar, it is nevertheless planning certain measures towards enhancing the price competitiveness of the industrial enterprises in the land of unlimited opportunity. Against this background the FX market will need to keep a particularly close eye on policy developments in the weeks ahead.

Fundamental forecasts, USA

	2024	**2025**	**2026**
GDP	2.8	1.9	1.7
Private consumption	2.8	2.1	1.8
Govt. consumption	3.4	1.8	1.2
Fixed investment	4.0	2.7	2.8
Exports	3.3	2.4	2.1
Imports	5.3	3.5	2.2
Inflation	3.0	2.6	2.4
Unemployment rate[1]	4.0	4.5	4.4
Budget balance[2]	-6.9	-6.2	-5.9
Current acct. balance[2]	-3.9	-3.6	-3.5

Change vs previous year as percentage; [1] as percentage of the labour force; [2] as percentage of GDP

Sources: Macrobond, NORD/LB Macro Research

Quarterly forecasts, USA

	II/24	**III/24**	**IV/24**	**I/25**	**II/25**
GDP qoq ann.	3.0	3.1	2.4	1.4	1.6
GDP yoy	3.0	2.7	2.5	2.5	2.1
Inflation yoy	3.2	2.6	2.7	2.7	2.6

Change as percentage

Sources: Macrobond, NORD/LB Macro Research

Interest and exchange rates, USA

	27.03.	**3M**	**6M**	**12M**
Fed funds target rate	4.50	4.25	4.00	3.50
3M rate	4.30	4.00	3.80	3.30
10Y Treasuries	4.36	4.30	4.10	3.60
Spread 10Y Bund	159	160	150	80
EUR in USD	1.08	1.07	1.07	1.09

Sources: Bloomberg, NORD/LB Macro Research

Euroland: Disruptive environment urges ECB caution

Analysts: Christian Lips, Chief Economist // Valentin Jansen

Q4 growth revised upwards as economic sentiment brightens

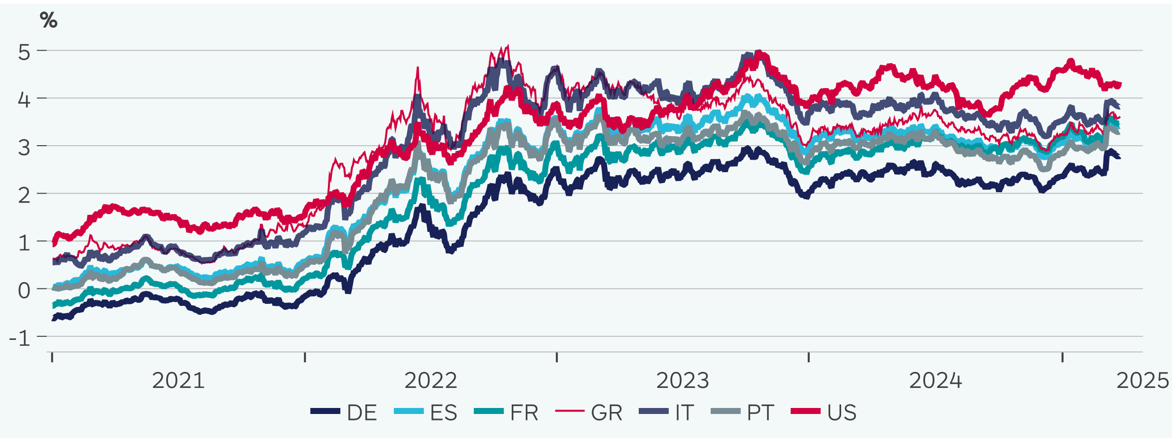
The latest Eurostat data show the eurozone's GDP growth figure for Q4/2024 was revised up to 0.2 percent quarter-on-quarter, meaning that the statistical carry-over effect has also risen slightly to 0.4 percentage points – this being the primary reason for our moderately upgraded 2025 growth forecast. There are signs of a sound GDP trend for Q1 as well, with the composite output PMI consistently above the expansion threshold of 50 points in the first three months of the year.

In the short term, however, there is a threat of new challenges arising from Donald Trump's tariff announcements. It is a regrettable fact that the USA appears to be moving at lightning speed away from its decades-long status as a dependable partner and ally in matters of trade, foreign, and security policy. The EU is well advised to react prudently on the one hand but, on the other, it must unite and decisively counter the US administration's unjustified breaches of the rules.

EU Commission eases debt rules to boost defence spending

The EU Commission is planning the biggest defence initiative ("ReArm Europe") in the history of the European Union, with a total volume of up to EUR 800bn by 2030 – for the financing of which the general escape clause in the Stability and Growth Pact is set to be activated. This enables the member states to temporarily deviate from the established budgetary ceilings and make higher defence expenditures without having to fear sanctions triggered by an excessive deficit (excessive deficit procedure). EU loans amounting to EUR 150bn are to be made available for the purchase of armaments manufactured in Europe. Like the Next Generation EU (NGEU) programme for economic recovery after the COVID-19 pandemic, these funds will be raised through the EU's own bond issuances, enabling the member states to benefit from the Union's more favourable borrowing conditions. The remaining EUR 650bn are to be financed from the national budgets of the member states, with those expenditures facilitated by a more flexible application of the debt rules. EU countries with a relatively strong arms industry – such as France, Italy and Germany – are particularly likely to benefit economically from these additional financing options for member states.

Chart: Political uncertainties, ECB debate and fiscal policy determine interest rate trend



Sources: Macrobond, NORD/LB Macro Research

Disinflation on track, ECB nevertheless more cautious – easing cycle nearing its end

February as month under review saw the rate of inflation in the eurozone fall somewhat more sharply than initially reported, though at 2.3 percent yoy still slightly above the ECB's medium-term stability

target. This development reflects both easing energy price pressures and a further slowdown in service-sector inflation, which has been under particular scrutiny. The latter, combined with more moderate wage data for Q4, reinforces the ECB's case for monetary easing.
The ECB has nevertheless become markedly more cautious of late. While the central bankers lowered their key rates for the sixth time since June 2024, as expected, at their March meeting, and the deposit rate has since been cut by 150 basis points to a current level of 2.50 percent, the Governing Council now sees the current key-rate level as "meaningfully less restrictive". This can be understood as signalling increased likelihood of a slower pace – or a potential rate-cut pause – in April and an approaching end to the current easing cycle.
The high degree of uncertainty – particularly regarding US trade policy – is weighing on the economic outlook and making for near-term downside risks. Germany's fiscal stimulus package could likewise not yet be factored into the latest macroeconomic projections update; its economic impact on growth, activity and inflation will first materialize over the medium term. That said, the recent sharp rise in interest rates (see chart) directly represents an additional – and in the current environment of still-subdued credit growth – unintended tightening of financing conditions. Consequently, the implications for ECB policymaking remain unclear, with no straightforward conclusions to be drawn from the fiscal package in the near term. In fact, markets are now pricing in two full rate cuts this year, while anticipating slightly higher key rates over a three-year horizon.
The ECB sees itself not only confronted with heightened uncertainty but also a time-inconsistency dilemma. The central bankers would be wise to continue making decisions meeting-by-meeting, guided by all new incoming data. We forecast two further interest rate cuts by autumn.

Fundamental forecasts, Euroland

	2024	2025	2026
GDP	0.8	1.1	1.4
Private consumption	1.0	1.6	1.6
Govt. consumption	2.8	1.8	2.7
Fixed investment	-2.0	2.5	5.1
Net exports[1]	0.4	-0.7	-1.2
Inflation	2.4	2.2	1.9
Unemployment rate[2]	6.4	6.3	6.2
Budget balance[3]	-2.9	-3.0	-2.8
Current account balance[3]	2.8	2.2	2.0

Change vs previous year as percentage, [1] as contribution to GDP growth; [2] as percentage of the labour force; [3] as percentage of GDP

Sources: Macrobond, NORD/LB Macro Research

Quarterly forecasts, Euroland

	II/24	III/24	IV/24	I/25	II/25
GDP sa qoq	0.2	0.4	0.2	0.3	0.3
GDP sa yoy	0.5	1.0	1.2	1.1	1.2
Inflation yoy	2.5	2.2	2.2	2.4	2.3

Change as percentage

Sources: Macrobond, NORD/LB Macro Research

Interest rates, Euroland

	27.03.	3M	6M	12M
Repo rate ECB	2.50	2.25	2.00	2.00
3M rate	2.36	2.20	2.00	2.00
10Y Bund	2.77	2.70	2.60	2.80

Sources: Bloomberg, NORD/LB Macro Research

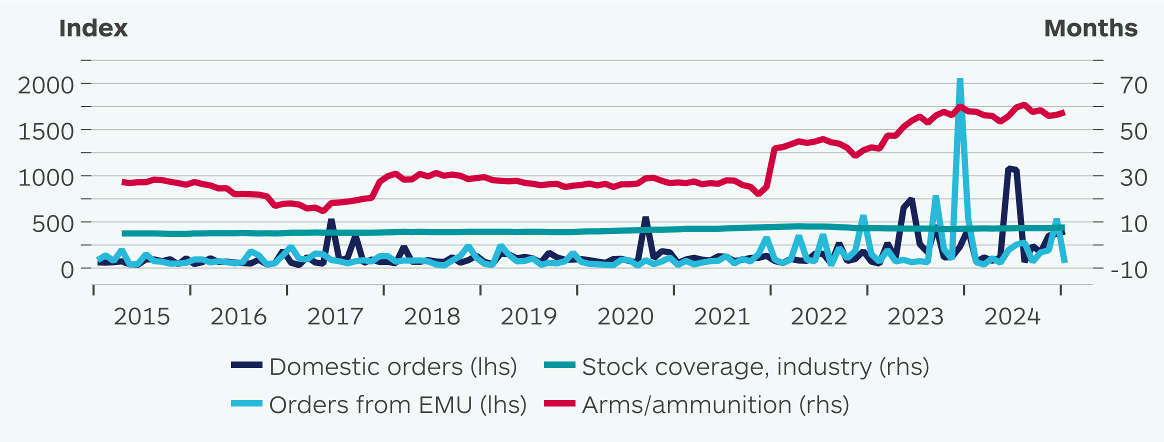
Germany: Fiscal stimulus package lifts business sentiment

Analysts: Christian Lips, Chief Economist // Valentin Jansen

German economy off to a good start into 2025 –vehicle tariffs will likely hurt

Germany's economy appears to have entered 2025 on firmer footing, with early indicators pointing to a return to modest growth following a weak Q4/2024 and industrial output rising by a seasonally adjusted 2.0 percent month-on-month in January. This countermovement came as no surprise, however, given the vacation and bank holiday-induced slowdown in December (-1.5 percent mom). By contrast, order intake saw a sharp decline (-7.0 percent mom), though large orders typically cause significant fluctuations. The fresh tariffs of 25 percent announced by Donald Trump on vehicles and vehicle parts imported into the USA are set to hit the Germany economy. These new burdens, long feared by Berlin, give the fiscal package – freshly approved by both the Bundestag and Bundesrat –added significance in terms of strengthening economic resilience.

Chart: Increase in defence spending requires expansion of production capacities



Sources: Destatis, Macrobond, NORD/LB Macro Research

Ramp-up in defence spending runs up against existing capacity constraints

The planned ramp-up in defence spending is running up against current capacity constraints. Since the onset of Russia's war of aggression against Ukraine, order books in the defence sector have surged in volume. In January, metal processors in the arms and ammunition sector had an order backlog of 57.5 months – compared to just 7.6 months for the manufacturing sector as a whole (see chart). Ramping up production capacity in Germany will undoubtedly take some time. In the short term, procurement will rely heavily on imports, while price effects remain difficult to predict. The speed and scale of domestic capacity adjustments will depend on various factors, including regulatory hurdles (e.g. procurement and approval processes) and, not least, the availability of skilled labour.

The prospect of rising defence spending is already driving adaptation processes in the economy. There is no shortage of anecdotal evidence – an increasing number of companies in Germany are signalling plans to expand or adjust their (defence-related) production capacities. One widely discussed example is Rheinmetall AG, a major armaments manufacturer. As part of its planned production expansion, the company is exploring whether automotive plants in Germany could be converted to manufacture armoured vehicles. Some automotive producers have expressed openness to dedicating more capacity to dual-use production. At the same time, many European automotive suppliers are already signalling interest in forming partnerships with the defence industry.

Economic sentiment in March with "Merz effect"

Economic sentiment among German companies brightened markedly in March, with the ifo Business Climate Index climbing to 86.7 points. Business leaders have notably upgraded their forward-looking expectations, aligning with the more optimistic outlook among financial market experts as already reflected in surveys conducted by sentix and the ZEW Institute. Indeed, March saw sentix register the biggest surge in expectations since the survey's inception. In this respect, the March surveys on economic sentiment reflect a "Merz effect" – on the one hand because of the prospect of a stable government, but above all due to the fiscal reset. The package for more investment and defence spending is in actual fact a game changer, not only in terms of fiscal policy but potentially also in terms of the economy as a whole. The brightening in sentiment is to be seen across all sectors. Particularly striking is the upward trend in the business climate in industry and construction – the two sectors that will likely benefit most directly from the surge in investment in the years ahead. In the building sector, by contrast, the prospect of persistently higher interest rates is weighing on sentiment. After a prolonged sluggish period, March brought a tangible upturn for both the services and retail sectors. That said, a direct effect of the fiscal packages can also be seen among service providers, with growing confidence especially in production-related areas such as architectural and engineering offices. A lot of questions still remain open over the scale, execution, and phasing of Germany's new fiscal strategy. It will require carefully designed accompanying measures to ensure funds are deployed effectively – stimulating sustainable growth without fuelling inflationary pressures.

The fiscal package gives businesses legitimate hope for improvement, though the escalating tariff dispute with Donald Trump and uncertainties as to the details of the fiscal package's implementation are still curbing the euphoria. Simply put, these measures still need to translate into real-world impact – a process historically hampered by Germany's lengthy implementation timelines. Against this background we are holding to our 0.2 percent GDP growth projection for 2025 but expect a marked pickup in economic momentum beginning in 2026.

Fundamental forecasts, Germany

	2024	2025	2026
GDP	-0.2	0.2	1.4
Private consumption	0.3	0.9	1.7
Govt. consumption	3.5	2.6	3.7
Fixed investment	-2.7	0.8	4.8
Exports	-1.1	-0.6	2.2
Imports	0.2	4.4	6.0
Net exports[1]	-0.5	-1.9	-1.4
Inflation[2]	2.5	2.3	2.0
Unemployment rate[3]	6.0	6.3	6.1
Budget balance[4]	-2.8	-2.9	-3.6
Current account balance[4]	5.7	5.2	4.5

Change vs previous year as percentage, [1]as contribution to GDP growth; [2]HICP; [3]as percentage of the civil labour force (Federal Employment Office definition); [4] as percentage of GDP

Sources: Macrobond, NORD/LB Macro Research

Quarterly forecasts, Germany

	II/24	III/24	IV/24	I/25	II/25
GDP sa qoq	-0.3	0.1	-0.2	0.2	0.2
GDP nsa yoy	0.1	0.1	-0.4	-0.4	-0.3
Inflation yoy	2.6	2.2	2.5	2.6	2.2

Change as percentage

Sources: Macrobond, NORD/LB Macro Research

Switzerland: SNB nears zero interest rate threshold in March

Analyst: Christian Lips, Chief Economist

Moderate growth continues – inflation rate near zero as expected

Switzerland's annual inflation rate edged down to just 0.3 percent year-on-year in February, barely remaining in positive territory. The decline was driven partly by lower electricity prices since the start of the year, along with the still relatively strong Swiss franc suppressing import prices. While inflation may not yet quite have reached its lowest point for 2024, a modest rebound is expected in the medium term. In March, the Swiss National Bank, too, slightly adjusted its conditional inflation forecast, now projecting average annual rates of 0.4 percent for 2025 followed by 0.8 percent in both 2026 and 2027.

SNB extends monetary easing in March – and now sees less urgency to take action

The SNB cut its policy rate by a further 25 basis points to 0.25 percent in March, marking its fifth consecutive easing move and bringing borrowing costs to their lowest level since September 2022. In doing so, the central bankers are responding to the weak inflationary pressures and heightened downside risks to price stability, also with the aim of deterring international investors from excessively shifting their investments into the Swiss franc against the backdrop of global uncertainties.

SNB President Martin Schlegel called the current rate "appropriate", but at the same time stressed the central bank's readiness to deploy all monetary tools at its disposal if needed to respond to fresh developments. The central bank sees risks of rapid and significant changes in the overall economic environment, particularly due to shifts in trade and geopolitical dynamics, with growing trade barriers rather viewed as a downside risk for the global economy and price stability in Switzerland. That said, the central bankers also note potential stimulating effects from the more expansive fiscal policy in Europe, especially in Germany.

The franc initially softened in the wake of the SNB's interest rate cut, though there had also been signs of a gradual resurgence of appreciation pressure in the preceding weeks. With the current exchange rate at around CHF 0.95 per EUR, the Alpine republic's price stability is unlikely to come under excessive additional pressure. However, especially in phases of high global uncertainty, the SNB must take account of Switzerland's status as a safe haven and be highly vigilant on the development of the franc's external value. The SNB will therefore be keeping a very close eye on the situation. While not completely ruling out further rate cuts, the central bank is likely keen to steer clear of FX interventions or negative rates as far as possible in order to avoid drawing unnecessary attention from the US government over alleged "unfair currency manipulation." Against this background, the March rate cut may well indeed be the last one for now.

Fundamental forecasts*, Switzerland

	2024	2025	2026
GDP	0.9	1.6	1.6
Inflation (CPI)	1.1	0.2	0.4
Unemployment rate[1]	2.4	2.8	2.8
Budget balance[2]	0.4	0.4	0.3
Current account bal.[2]	5.7	5.6	5.9

Interest and exchange rates, Switzerland

	27.03.	3M	6M	12M
SNB policy rate	0.25	0.25	0.25	0.25
3M rate	0.18	0.20	0.20	0.20
10Y	0.62	0.60	0.60	0.70
Spread 10Y Bund	-216	-210	-200	-210
EUR in CHF	0.95	0.95	0.94	0.94

* Change vs previous year as percentage; [1] as percentage of the labour force, [2] as percentage of GDP

Sources: Macrobond, Bloomberg, NORD/LB Macro Research

Japan: Waiting on key-rate hikes

Analyst: Tobias Basse

Waiting on key-rate hikes

The Bank of Japan left its monetary policy unchanged at the last MPM meeting, holding its key interest rate at 0.50 percent. The decision came as no great surprise. Passed unanimously, moreover, it reflects consensus – at various levels, so to speak! While short-term rates in Japan may continue to face upward pressure, the central bankers in Tokyo are expected to proceed with extreme caution in adjusting their monetary policy stance. For now, the watchword thus remains patience — with further rate hikes likely on hold.

Wary eyes on Washington

There can be no doubt that a shift towards more protectionist trade policies in the USA poses a significant economic threat to export-reliant Japan. The discussions currently in progress in Washington about a potential new "Plaza Accord-style" agreement suggest former President Donald Trump remains focused on boosting the price competitiveness of US industry. The Bank of Japan's key interest rate hike announced in January should probably also be placed in this context. As is well known, the central bankers in Tokyo had announced an interest rate hike of 25bp at the start of the year. One goal at the time may also have been to dampen the pronounced weakness of the yen somewhat; obviously, they do not want to be targeted by US economic policymakers if possible. However, it is interesting to note how openly the Bank of Japan now cites Washington's trade agenda as a material risk factor for the domestic economy.

Does "words over actions" still hold?

The marked rise in capital market rates of late in the Land of the Rising Sun is emerging as an increasingly relevant negative factor for the country's economic activity. Moreover, the higher borrowing costs threaten to gradually become a fiscal problem for Japan's heavily indebted government. These constraints will likely limit Tokyo's leeway for rate hikes in the future. In this environment, the BOJ may indeed be tempted to rely more on hawkish rhetoric than actual tightening – a strategy Governor Kazuo Ueda notably avoided in his recent post-meeting press conference, nonetheless. In other words, the central bankers appear content to live by the motto "wait and see" for now.

Fundamental forecasts*, Japan

	2024	2025	2026
GDP	0.1	1.1	1.0
Inflation	2.7	2.7	2.0
Unemployment rate[1]	2.5	2.4	2.3
Budget balance[2]	-3.0	-3.6	-3.2
Current account bal.[2]	4.8	4.3	4.1

* Change vs previous year as percentage;

[1] as percentage of the labour force; [2] as percentage of GDP

Sources: Macrobond, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, Japan

	27.03.	3M	6M	12M
Key rate	0.50	0.50	0.75	1.00
3M rate	0.82	0.80	0.90	1.10
10Y	0.66	1.50	1.55	1.60
Spread 10Y Bund	-211	-120	-105	-120
EUR in JPY	163	161	155	152
USD in JPY	151	150	145	139

China: Not a bad start to the year – at least in terms of data

Analyst: Valentin Jansen

Not a bad start to the year – sentiment indicators signal modest growth
The economic data on the Middle Kingdom indicate a mild pickup in early 2025, with, for example, industrial output posting year-on-year growth of 5.9 percent in January and February as combined period under review; this was above expectations, but slightly down on the December figure (+6.2 percent yoy). The aggregation of the first two months under review helps smooth distortions from the Lunar New Year holiday. The separately conducted state and private PMIs CLFP Manufacturing (50.2 points) and Caixin Manufacturing (50.8) indicate a modest uptick in performance among China's industrial companies for the first quarter. Retail sales growth edged up to 4.0 percent yoy from December's figure of 3.7 percent yoy, with household appliances (+10.9 percent) and communications equipment (+26.2 percent) posting particularly strong gains — categories among those prioritized in Beijing's domestic consumption push. Car sales, however, were a notable exception, registering year-on-year contraction of 4.4 percent.

US tariff impact barely reflected in the data available to date
Overall, account must be taken of the fact that the latest figures provide little evidence as yet of damage from the tariff conflict with Donald Trump. Having effectively imposed additional 10-percent tariffs on all Chinese imports into the USA in February, Washington then doubled these in the first week of March, following up with a 25-percent tariff on steel and aluminium imports from all exporting countries in mid-March. Beyond the recently imposed car tariffs, the US government is expected to roll out further trade policy measures in April specifically aimed at trading partners running large current account surpluses. Chinese exports surged to a new record high of USD 540bn in the January-February reporting period (+2.3% year-on-year) as businesses accelerated shipments ahead of expected US tariff increases. This final tariff-driven surge will likely prove short-lived. Due mid-April, the March trade data are expected to show the first signs of slowdown, thus accelerating Beijing's strategic pivot towards domestic demand.

PBOC in wait-and-watch mode
With US-China interest rate differentials expected to widen further in 2025, the renminbi faces a certain structural depreciation pressure. Against the backdrop of Washington's trade policy plans, the PBOC remains committed to supporting the renminbi, aligning its daily yuan fixing more closely with the mark of 7.18 against the USD in March. Given the current economic landscape, the PBOC is effectively gaining time to assess the actual materialization of economic risks stemming from frictions with the US before adjusting its monetary policy strategy.

Fundamental forecasts*, China

	2024	2025	2026
GDP	5.0	4.5	4.3
Inflation	0.2	0.4	1.1
Unemployment rate[1]	5.1	5.1	5.0
Budget balance[2]	-7.4	-5.5	-5.7
Current account bal.[2]	1.4	1.3	1.0

* Change vs previous year as percentage

[1] as percentage of the labour force, [2] as percentage of GDP

Sources: Macrobond, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, China

	27.03.	3M	6M	12M
Deposit rate	1.50	1.50	1.50	1.50
3M SHIBOR	1.92	1.48	1.48	1.48
10Y	1.81	1.65	1.65	1.65
Spread 10Y Bund	-96	-105	-95	-115
EUR in CNY	7.84	7.86	7.86	8.01
USD in CNY	7.26	7.35	7.35	7.35

Britain: Monetary policy stalemate

Analyst: Constantin Lüer

Bank of England feels compelled to bide time

After cutting the Bank Rate by 25 basis points at its February meeting, the Monetary Policy Committee paused its easing cycle in March, leaving the UK's key rate unchanged at 4.50 percent. The committee plans to monitor developments in global trade conditions to determine whether the current inflationary pressures are to be seen as a temporary phenomenon or a longer-term challenge. Unsurprisingly, the UK has flagged the US government's tariff announcements as a potential risk factor. Moreover, geopolitical uncertainties and rising volatility in international financial markets are further contributing to a tense economic environment. Although inflation slowed to 2.8 percent year-on-year in February, the MPC forecasts it could climb to as high as 3.75 percent by the third quarter of 2025 before easing again. Nevertheless, real interest rates are expected to remain restrictive enough to preserve leeway for future rate cuts.

Labour market proves hard to predict

The UK's economic outlook remains fraught with challenges. The labour market, currently showing an unemployment rate of 4.4 percent, is displaying signs of weakening momentum, which could soon weigh on the economy. Companies appear increasingly reluctant to hire, while wage and price pressures remain elevated – raising the risk of a wage-price spiral. However, a softening jobs market may well mitigate that risk. The central bankers now find themselves in something of a stalemate situation, therefore, waiting for fresh data to clarify the path forward. The inflation figures have already provided a crucial first signal in this context.

Inflation and declining government spending may aid Rachel Reeves' plans

Despite the potential inflation path previously indicated, outlined among others by the Monetary Policy Committee, a certain easing has become apparent of late. Market watchers had expected a slightly higher reading, but the monthly inflation rate of 0.4 percent mom – while not yet disinflationary –was softer than anticipated. As a result, the annual rate dipped below the psychologically important threshold of 3.0 percent to "just" 2.8 percent yoy. The figures may come at an opportune time for Chancellor of the Exchequer Rachel Reeves, who is set to deliver her Spring Statement next Wednesday. She is expected to announce cuts in government spending – a move seen as necessary to support an economy that has so far lacked strong growth stimuli.

Fundamental forecasts*, Britain

	2024	2025	2026
GDP	0.9	1.1	1.4
Inflation (CPI)	2.5	2.9	2.4
Unemployment rate[1]	4.3	4.5	4.6
Budget balance[2]	-4.5	-3.7	-3.3
Current account bal.[2]	-2.6	-2.8	-2.8

* Change vs previous year as percentage

Interest and exchange rates, Britain

	27.03.	3M	6M	12M
Repo rate	4.50	4.25	4.00	3.75
3M rate	4.38	4.10	3.95	3.65
10Y	4.78	4.40	4.25	4.10
Spread 10Y Bund	201	170	165	130
EUR in GBP	0.83	0.83	0.84	0.84
GBP in USD	1.29	1.29	1.27	1.30

[1] as percentage of the labour force as per ILO concept, [2] as percentage of GDP

Sources: Macrobond, Bloomberg, NORD/LB Macro Research

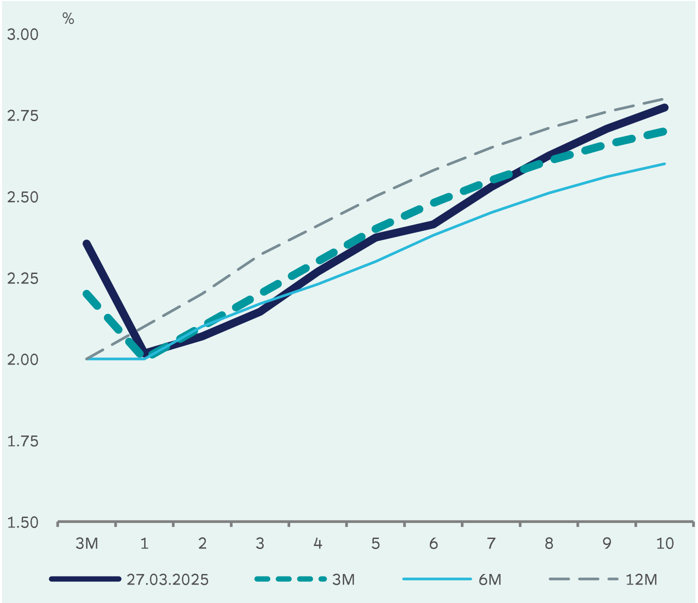
Portfolio strategies
Yield curve, Euroland

Yields and forecasts (Bunds/Swap)

Yields (in %)		NORD/LB forecasts for horizons...		
	27.03.2025	**3M**	**6M**	**12M**
3M	2.36	2.20	2.00	2.00
1Y	2.02	2.00	2.00	2.10
2Y	2.07	2.10	2.10	2.20
3Y	2.15	2.20	2.17	2.32
4Y	2.27	2.30	2.23	2.41
5Y	2.37	2.40	2.30	2.50
6Y	2.41	2.48	2.38	2.58
7Y	2.53	2.55	2.45	2.65
8Y	2.63	2.61	2.51	2.71
9Y	2.71	2.66	2.56	2.76
10Y	2.77	2.70	2.60	2.80
2Y (Swap)	2.22	2.25	2.25	2.35
5Y (Swap)	2.43	2.40	2.30	2.50
10Y (Swap)	2.69	2.60	2.50	2.70

Sources: Bloomberg, NORD/LB Macro Research

Yield curve forecasts (Bunds)



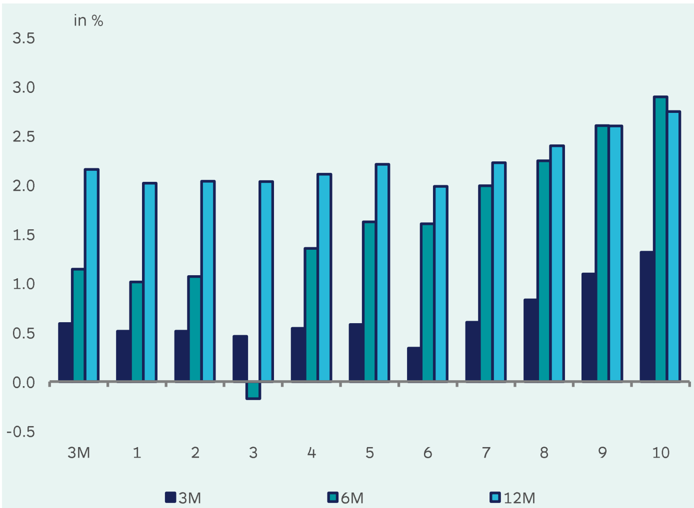
Sources: Bloomberg, NORD/LB Macro Research

Forecasts and total returns

	Total returns (in %) for horizons...		
	3M	**6M**	**12M**
3M	0.59	1.14	2.16
1Y	0.51	1.01	2.02
2Y	0.51	1.07	2.04
3Y	0.46	-0.17	2.03
4Y	0.54	1.35	2.11
5Y	0.58	1.62	2.21
6Y	0.34	1.60	1.99
7Y	0.60	1.99	2.22
8Y	0.83	2.24	2.40
9Y	1.09	2.60	2.60
10Y	1.31	2.89	2.75

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns



Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve change.

Portfolio strategies
International yield curve: 3-month & 12-month horizons

3-month horizon

Expected total returns (as percentage) in euro

	EUR	USD	GBP	JPY	CHF
1Y	0.5	2.1	1.5	1.5	0.2
2Y	0.5	2.3	1.9	1.7	0.2
3Y	0.5	2.5	2.0	1.6	0.2
4Y	0.5	2.6	2.3	2.0	0.2
5Y	0.6	2.2	2.7	2.3	0.1
6Y	0.3	2.0	3.2	2.5	0.1
7Y	0.6	2.3	3.0	3.0	0.1
8Y	0.8	2.4	3.9	3.0	0.0
9Y	1.1	2.4	4.1	2.8	0.1
10Y	1.3	2.6	4.3	2.4	0.2

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies

	USD	GBP	JPY	CHF
1Y	1.1	1.0	0.1	0.0
2Y	1.4	1.4	0.2	0.0
3Y	1.6	1.5	0.2	0.0
4Y	1.6	1.8	0.6	-0.1
5Y	1.3	2.2	1.0	-0.1
6Y	1.1	2.7	1.2	-0.2
7Y	1.4	2.5	1.6	-0.1
8Y	1.4	3.4	1.6	-0.3
9Y	1.4	3.6	1.5	-0.2
10Y	1.6	3.8	1.0	-0.1

Sources: Bloomberg, NORD/LB Macro Research

12-month horizon

Expected total returns (as percentage) in euro

	EUR	USD	GBP	JPY	CHF
1Y	2.0	3.1	3.3	8.0	1.4
2Y	2.0	3.8	4.1	8.2	1.4
3Y	2.0	4.5	4.8	8.1	1.5
4Y	2.1	5.1	5.6	8.4	1.5
5Y	2.2	5.9	6.5	8.6	1.5
6Y	2.0	6.5	7.7	8.7	1.4
7Y	2.2	7.1	8.0	8.8	1.4
8Y	2.4	7.7	9.6	8.8	1.1
9Y	2.6	8.2	9.3	9.1	1.1
10Y	2.7	9.0	9.6	9.1	1.0

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies

	USD	GBP	JPY	CHF
1Y	4.1	4.1	0.6	0.1
2Y	4.7	4.9	0.8	0.1
3Y	5.5	5.5	0.7	0.2
4Y	6.0	6.3	1.0	0.2
5Y	6.8	7.3	1.2	0.2
6Y	7.5	8.5	1.3	0.1
7Y	8.1	8.8	1.4	0.1
8Y	8.7	10.4	1.4	-0.2
9Y	9.2	10.1	1.6	-0.2
10Y	10.0	10.4	1.6	-0.3

Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve and exchange rate change.

Portfolio strategies
Stock market strategy; 3-month, 6-month & 12-month horizons

Levels and performance

Index	Level as at 27.03.2025	Status Prev. month	Status Start of year	Performance since Prev. month	Performance since Start of year
DAX	22,678.74	22,551.43	19,909.14	0.56%	13.91%
MDAX	28,628.56	28,298.44	25,589.06	1.17%	11.88%
EuroSTOXX50	5,381.08	5,463.54	4,895.98	-1.51%	9.91%
STOXX50	4,638.33	4,761.56	4,308.63	-2.59%	7.65%
STOXX600	546.31	557.19	507.62	-1.95%	7.62%
Dow Jones	42,299.70	43,840.91	42,544.22	-3.16%	-0.21%
S&P 500	5,693.31	5,954.50	5,881.63	-4.07%	-2.88%
Nikkei	37,799.97	37,155.50	39,894.54	1.73%	-5.25%

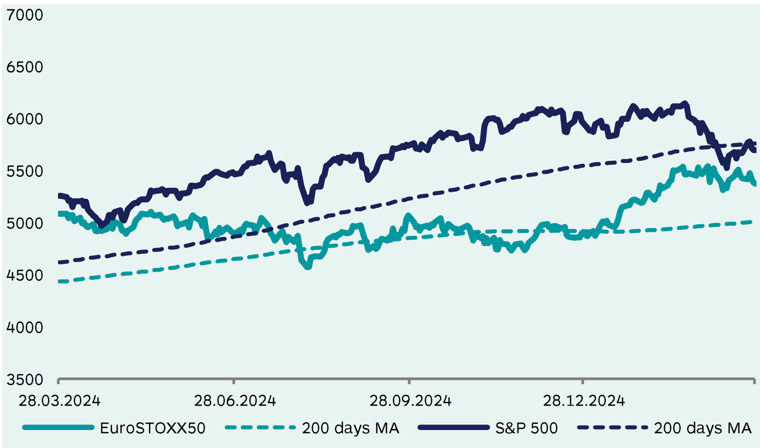
Sources: Bloomberg, NORD/LB Macro Research

Index forecasts

Index	NORD/LB forecast for the horizons ... 3M	6M	12M
DAX	20,500	21,000	22,000
MDAX	26,000	26,500	29,000
EuroSTOXX50	5,000	5,050	5,300
STOXX50	4,300	4,350	4,650
STOXX600	500	510	550
Dow Jones	40,000	43,500	45,000
S&P 500	5,500	5,700	6,100
Nikkei	36,500	3,500	40,000

Sources: Bloomberg, NORD/LB Macro Research

EuroSTOXX50 and S&P500



Sources: Bloomberg, NORD/LB Macro Research

Date of going to press for data, forecasts and texts was **Friday, 28 March 2025.**

The next English issue of Economic Adviser will be appearing on **28 April 2025**.

Overview of forecasts

Fundamental forecasts

in %	GDP growth			Rate of inflation			Unemployment rate[1]			Budgetary balance[2]		
	2024	2025	2026	2024	2025	2026	2024	2025	2026	2024	2025	2026
USA	2.8	1.9	1.7	3.0	2.6	2.4	4.0	4.5	4.4	-6.9	-6.2	-5.9
Euroland	0.8	1.1	1.4	2.4	2.2	1.9	6.4	6.3	6.2	-2.9	-3.0	-2.8
Germany	-0.2	0.2	1.4	2.5	2.3	2.0	6.0	6.3	6.1	-2.8	-2.9	-3.6
Japan	0.1	1.1	1.0	2.7	2.7	2.0	2.5	2.4	2.3	-3.0	-3.6	-3.2
Britain	0.9	1.1	1.4	2.5	2.9	2.4	4.3	4.5	4.6	-4.5	-3.7	-3.3
Switzerland	1.2	1.6	1.6	2.1	0.2	0.4	2.0	2.8	2.8	0.2	0.4	0.3
China	5.0	4.5	4.3	0.2	0.4	1.1	5.2	5.1	5.0	-7.4	-5.5	-5.7

Change vs previous year as percentage; [1] as percentage of the labour force (Germany: as per Federal Employment Office definition); [2] as percentage of GDP
Sources: Macrobond, NORD/LB Macro Research

Key interest rates

In %	27.03.25	3M	6M	12M
USD	4.50	4.25	4.00	3.50
EUR	2.50	2.25	2.00	2.00
JPY	0.50	0.50	0.75	1.00
GBP	4.50	4.25	4.00	3.75
CHF	0.25	0.25	0.25	0.25
CNY	1.50	1.50	1.50	1.50

Sources: Bloomberg, NORD/LB Macro Research

Exchange rates

EUR in...	27.03.25	3M	6M	12M
USD	1.08	1.07	1.07	1.09
JPY	163	161	155	152
GBP	0.83	0.83	0.84	0.84
CHF	0.95	0.95	0.94	0.94
CNY	7.84	7.86	7.86	8.01

Interest rates (government bonds)

	3M rates				Yields 2Y				Yields 5Y				Yields 10Y			
	27.03.	3M	6M	12M	27.03.	3M	6M	12M	27.03.	3M	6M	12M	27.03.	3M	6M	12M
USD	4.30	4.00	3.80	3.30	3.99	3.70	3.60	3.20	4.09	4.10	3.80	3.35	4.36	4.30	4.10	3.60
EUR	2.36	2.20	2.00	2.00	2.07	2.10	2.10	2.20	2.37	2.40	2.30	2.50	2.77	2.70	2.60	2.80
JPY	0.82	0.80	0.90	1.10	0.06	0.85	0.95	1.00	0.26	1.00	1.05	1.20	0.66	1.50	1.55	1.60
GBP	4.38	4.10	3.95	3.65	4.27	4.04	3.84	3.53	4.39	4.10	3.95	3.55	4.78	4.40	4.25	4.10
CHF	0.18	0.20	0.20	0.20	0.16	0.20	0.20	0.25	0.38	0.40	0.40	0.45	0.62	0.60	0.60	0.70

Sources: Bloomberg, NORD/LB Macro Research

Spreads (bp)

	3M EURIBOR				2Y Bund				5Y Bund				10Y Bund			
	27.03.	3M	6M	12M	27.03.	3M	6M	12M	27.03.	3M	6M	12M	27.03.	3M	6M	12M
USD	195	180	180	130	192	160	150	100	171	170	150	85	159	160	150	80
JPY	-153	-140	-110	-90	-201	-125	-115	-120	-212	-140	-125	-130	-211	-120	-105	-120
GBP	202	190	195	165	220	194	174	133	202	170	165	105	201	170	165	130
CHF	-218	-200	-180	-180	-191	-190	-190	-195	-200	-200	-190	-205	-216	-210	-200	-210

Sources: Bloomberg, NORD/LB Macro Research

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Editorial deadline: March 28th 2025, 11:53