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Contents

Special: U.S. downgrade, interest rates, and the North American real estate market

Analysts: Tobias Basse // Constantin Lüer

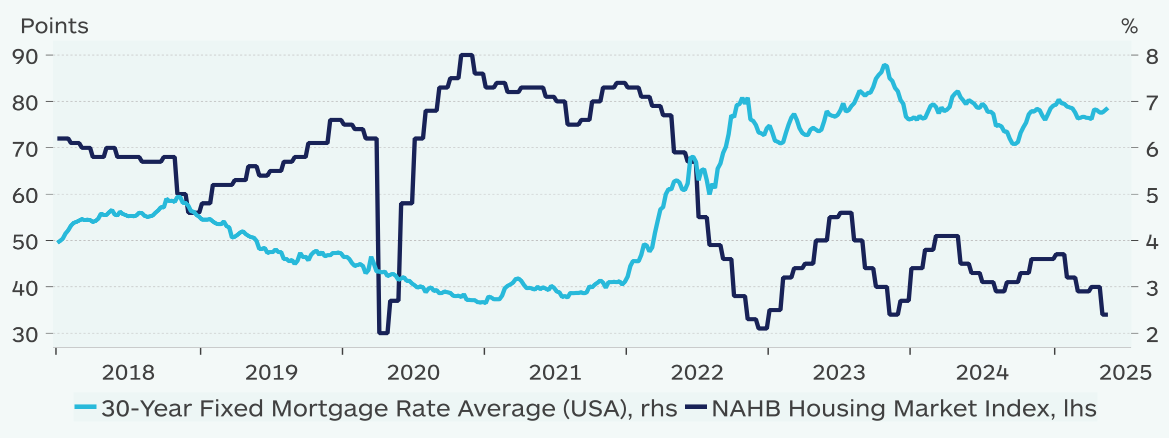
The downgrade and the financial markets

The recent downgrade of the U.S. credit rating by Moody's has already stirred some added movement in the global financial markets. The ratings agency no longer believes the U.S. possesses the necessary fiscal strength to justify its top-tier Aaa rating. As a result, Moody's has lowered the U.S. government's long-term issuer and senior unsecured ratings to Aa1 and changed the outlook to "stable" from "negative". More optimistic voices may argue that Moody's – after prolonged hesitation – has simply followed rivals S&P and Fitch in adjusting its assessment. We have previously highlighted the fiscal challenges facing the USA. Moody's decision to adjust the rating is therefore at best a surprise in terms of timing. In this context, some market observers suggest the agency may also have intended to send a message to Washington. This interpretation of current events could well be accurate. Both the government and Congress in Washington must now not only closely monitor the nation's debt trajectory but also take concrete steps to improve the U.S. fiscal outlook. Moody's downgrade could in fact enhance the appeal of non-dollar-denominated financial assets for investors – a development naturally unlikely to support the U.S. currency. The USD 1.13 per EUR threshold, which is of key importance in the FX segment, has in the meantime been breached again. There was also a noticeable, if brief, response in the stock markets in the wake of Moody's decision.

Moody's decision and U.S. Treasuries

After news of Moody's decision hit the newswires, the North American bond market also saw a pickup in activity. At the start of the week, yields on 10-year U.S. Treasuries jumped back above the psychologically important 4.50-percent mark. This development poses a challenge for the U.S. fiscal policymakers, complicating efforts to finance the federal budget deficit. Scott Bessent had actually planned to ramp up issuance of longer-dated securities in an effort to place the country's finances on a more stable footing. While the strategy remains sound in principle, it may now prove too costly in the near term. The U.S. Treasury Department is reportedly targeting a yield on 10-year Treasuries around the 3-percent mark before shifting issuance towards longer-dated bonds with maturities of up to 30 years. We are currently a long way from seeing that, however. The U.S. government and Congress must now reach consensus on more sustainable fiscal measures, with the monetary policymakers in Washington also coming into sharper focus. Currently, it is above all concerns over elevated inflation expectations among key economic actors that are preventing any reduction in benchmark interest rates. U.S. monetary policy is decidedly restrictive at present. High capital market rates are not only problematic for government financing but are also weighing on the housing market, where mortgage rates at rather unattractive levels are deterring potential homebuyers. The construction sector – a critical component of the U.S. labour market – is feeling the strain. High capital market rates are not only problematic for government financing but are also weighing on the real estate market, where mortgage rates at unattractive conditions are literally deterring potential homebuyers. The construction sector is critically important for the U.S. labour market, however, so the pressure on the FOMC to take action can be expected to mount in the second half of the year.

Chart: NAHB Housing Market Index & 30Y average mortgage rates



Sources: National Association of Home Builders, Freddie Mac, Macrobond, NORD/LB Macro Research

High interest rates strain the real estate market

The still overly restrictive interest rate environment remains a challenge for America's private real estate sector. Through a web of complex interconnections, the short-term policy rates naturally influence the long end of the yield curve. While a range of additional factors come into play in the market's pricing process, the U.S. federal funds rate remains a key driver of 30-year mortgage rates – which are of core importance for the real estate market. In the meantime, the psychologically important mark of 7 percent has come into focus for some financial providers, ultimately also dampening sentiment among potential home buyers. Recent economic concerns have compounded the problem, causing consumers to hold onto their money and postpone major purchases. That said, interest rates are and remain the fundamental problem.

Rate cuts should positively impact both real estate and labour markets

Not only does the construction industry have a critical impact on the labour markets – a robust employment situation on the ground is likewise a key determinant for driving momentum in the local real estate markets. When businesses relocate for various reasons or become less dynamic due to high interest rates, the real estate sector suffers accordingly as well. In Portland, the capital of the U.S. state of Washington, the valuation of the largest commercial building has come under strong pressure of late, partly for these reasons. That said, we expect more movement in the interest rate market again in the second six months of the year at the latest. Given the current development of the economy and the labour market, we expect that the key interest rates will likely be lowered in the future, which could at least favourably impact this factor in the pricing of long-term mortgages. Improved economic expectations may provide some support to the real estate sector, but the primary stimulus for recovery will most likely come from long-term U.S. Treasury yields and mortgage rates – the most powerful levers for restoring momentum to the real estate market in the future.

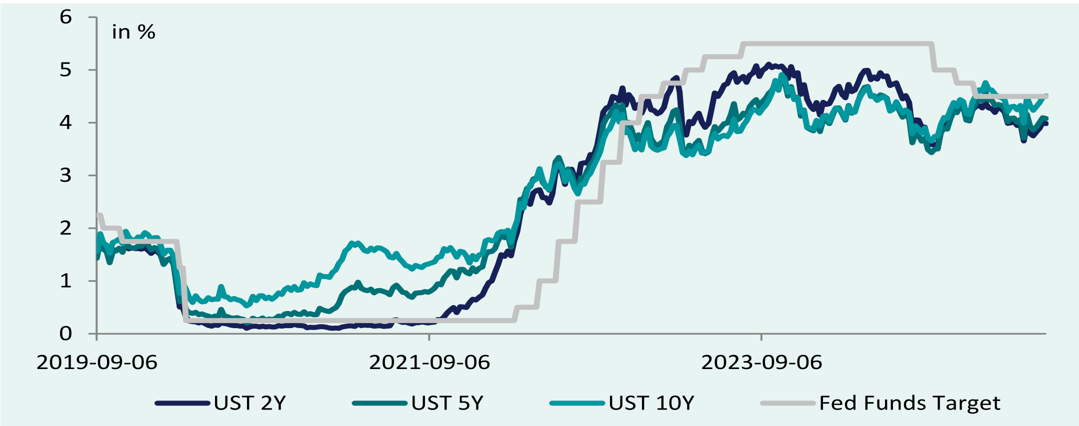
USA: High inflation expectations pose a problem

Analysts: Tobias Basse // Constantin Lüer

Retail sales up slightly in April

Preliminary data indicate that U.S. retail sales posted merely modest growth in April following the sharp increase in March as month under review. This development is not an unfavourable piece of news, however, as consumers had front-loaded purchases towards the end of Q1 due to fears of impending tariff hikes. This was particularly marked in North America's automotive sector, where March sales in U.S. dealerships surged by 5.5 percent month-on-month. This impetus was of course then missing in April, meaning that the current slight decline in retail sales in the motor vehicle sector is not really negative news. It could quite well have been worse. Despite elevated interest rates and marked inflation concerns, household demand evidently remains resilient in Q2/2025 as well. Above all the import surges driven by outright fear of impending tariffs had dampened the U.S. economy's growth of late, with preliminary figures indicating year-on-year GDP contraction of 0.3 percent in Q1/2025. This movement should primarily be seen as a case of data distortion, however. All in all, we are sticking to our existing assessment to the effect that the economy is no longer booming unchecked in the USA either!

Chart: Interest rates in the US



Sources: Macrobond, NORD/LB Macro Research

High inflation expectations pose a problem

The pronounced inflation fears among private households in the USA are currently posing a major problem for the monetary policymakers in Washington. Preliminary May data from the University of Michigan indicate that U.S. consumers' one-year ahead inflation expectations have risen further to 7.3 percent, likely overstating the risks of the developments in the future. Indeed, the consumer survey data from the New York Fed – available so far only up to April – paint a markedly more moderate picture.

FOMC to come under pressure to act at some point in 2025

For now, the FOMC will likely be looking to play for time, given the heightened inflation concerns among U.S. consumers. The labour market situation in the United States can be expected to gradually deteriorate, however. Moreover, inflation will not rise as sharply as pessimists currently appear to expect. U.S. monetary policy is already notably restrictive right now. The relatively high long-term interest rates are, in part, a consequence of the Federal Reserve's decisions. However, given their policy objectives, the central bankers in Washington will likely be compelled to take action going forward, because the unemployment rate is expected to continue rising. That said, lower overall yields in the U.S. could help prevent excessive labour market deterioration. Financing the U.S. government's deficitladen budget would, of course, become easier with a lower Fed funds target rate. The discussions on tax cuts currently being held within the Republican Party are of no help in this context, and these gradually crystallizing plans for Donald Trump's "new" fiscal policy have rather pushed yields higher of late. There will also have to be major savings in Washington. However, the decision-making process here will likely prove to be quite complex, potentially causing significant headaches for policymakers close to the administration. The alliance, which is very broad in terms of its composition and which made Donald Trump's second term possible in the first place, also appears to necessitate some benefits for lower-income voters; for example, tips and overtime pay are to be exempted from tax as soon as possible. It goes without saying that these measures will inevitably not help to improve the fiscal situation of the government.

Fundamental forecasts, USA

	2024	**2025**	**2026**
GDP	**2.8**	1.3	1.6
Private consumption	2.8	1.9	1.8
Govt. consumption	3.4	1.8	1.1
Fixed investment	4.0	1.6	2.3
Exports	3.3	1.6	1.4
Imports	5.3	3.1	1.1
Inflation	3.0	3.0	2.6
Unemployment rate[1]	4.0	4.5	4.4
Budget balance[2]	-6.9	-6.3	-6.0
Current acct. balance[2]	-3.9	-3.9	-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.	3.1	2.4	-0.3	0.8	1.0
GDP yoy	2.7	2.5	2.1	1.5	0.9
Inflation yoy	2.6	2.7	2.7	2.6	3.2

Change as percentage

Sources: Macrobond, NORD/LB Macro Research

Interest and exchange rates, USA

	22.05.	**3M**	**6M**	**12M**
Fed funds target rate	4.50	4.50	4.00	3.50
3M rate	4.33	4.25	3.80	3.30
10Y Treasuries	4.53	4.45	4.10	3.65
Spread 10Y Bund	189	195	160	95
EUR in USD	1.13	1.12	1.11	1.10

Sources: Bloomberg, NORD/LB Macro Research

Euroland: Solid economic performance in Q1 doesn't deter the ECB

Analysts: Christian Lips, Chief Economist // Valentin Jansen

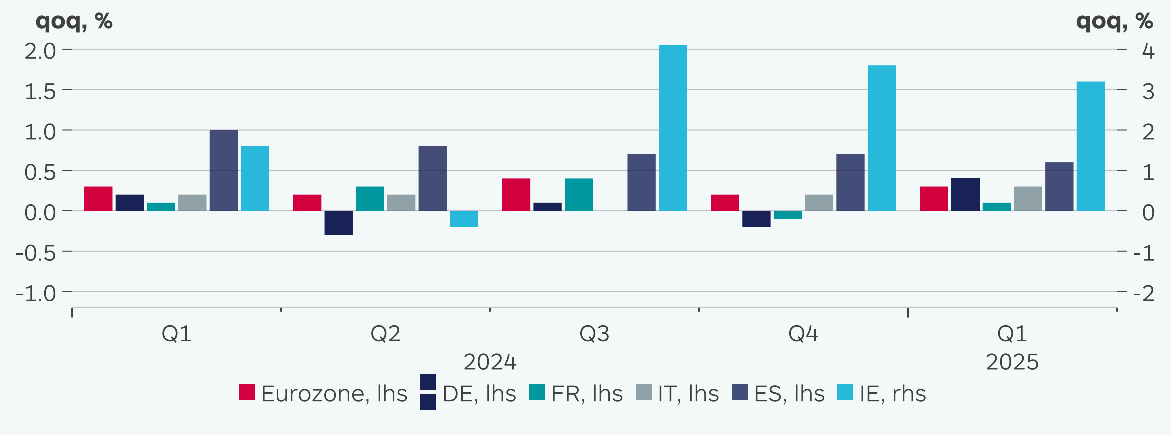
Unexpectedly dynamic start to the year

The economy in the eurozone entered 2025 with unexpected momentum, even if Eurostat's second GDP estimate saw a slight downward revision from its flash reading, indicating that Q1 saw real GDP grow by 0.3 percent qoq, adjusted for seasonal and calendar effects. Following the recent upward revision to Germany's GDP growth, however, the pendulum will likely swing back to 0.4 percent qoq in the next Eurostat report.

Spain once again registered the highest economic momentum among the major economies, with growth of 0.6 percent qoq, followed by Germany (+0.4 percent) and Italy (+0.3 percent). Growth was also reported by France and the Netherlands, each with a rate of 0.1 percent. Ireland's GDP literally surged once again, this time by 3.2 percent quarter-on-quarter, single-handedly contributing a good 0.1 percentage points to the eurozone's growth.

Germany's performance reflected stronger consumption and investment – unlike France, where political uncertainty over fiscal policy and the looming trade conflict already dampened business and consumer confidence in Q1. France's return to positive GDP growth was driven primarily by inventory buildup – a factor that now poses a potential drag on economic momentum in the current quarter. Moreover, Germany's particularly marked increase in net exports suggest that exporters front-loaded shipments ahead of the anticipated Trump tariffs, likely bolstering growth in Q1. Against this background, the pace of growth will likely moderate again somewhat in the near term. The short-term economic prospects have clouded over due to ongoing trade policy uncertainties, despite an uptick in hopes for new deals.

Chart: GDP development in selected European economies



Sources: Eurostat, Macrobond, NORD/LB Macro Research

A measured rapprochement – new cooperation agreement between the UK and EU

Five years after Brexit, Britain and the EU are cautiously moving closer again. On 20 May, a comprehensive cooperation package was agreed in London – the first major initiative since the 2020 split. The deal focuses on strengthening defence collaboration but also covers energy, fisheries, food standards, and youth mobility. A key component is a new security pact designed to give British defence companies access to the EU's €150 billion defence fund – contingent on a joint procurement agreement with UK involvement. The package also explores potential British integration into the EU electricity market,

closer alignment of emissions trading systems, streamlined travel for Britons at EU borders, and the easing of non-tariff trade barriers.
On the domestic front, Prime Minister Starmer is experiencing headwinds from the Conservative and right-wing opposition for his initiatives towards the EU. Meanwhile, Brussels, in a shifting geopolitical landscape, is increasingly seeking reliable partners. From an economic perspective, the agreement is no game-changer, but it marks a political step toward greater stability and closer alignment between the EU and the UK – though on a measured basis.

Market interest rate expectations swing wildly – ECB not yet done with easing
Donald Trump's erratic policy shifts have triggered significant volatility in financial markets, not just in the USA. The rapid swings between risk-off and risk-on sentiment have also led to unusually sharp fluctuations in market expectations in terms of ECB rate adjustments. At times, the market participants even speculated on a major rate move by the ECB in June. However, as markets have stabilized somewhat, such drastic action now seems off the table, but there is much to suggest a continuation of the central bank's monetary easing course. This is also indicated by the minutes of the ECB's last meeting and recent remarks by ECB officials. While the central bankers are avoiding any firm commitments amid lingering uncertainty, they are striking a relatively dovish tone. Inflation held at 2.2 percent yoy in April, despite Easter distortions, and will likely decline further in May. Wage growth also slowed noticeably, dropping to just 2.4 percent yoy in Q1. And while the Q1 GDP figures appeared strong at first glance, the ECB is unlikely to be swayed – given potential front-loading effects – and will likely proceed cautiously with further easing as early as June.

Fundamental forecasts, Euroland

	2024	2025	2026
GDP	0.8	1.0	1.1
Private consumption	1.0	1.4	1.6
Govt. consumption	2.7	2.0	2.8
Fixed investment	-1.9	1.9	4.2
Net exports[1]	0.4	-0.5	-1.1
Inflation	2.4	2.0	1.8
Unemployment rate[2]	6.4	6.2	6.1
Budget balance[3]	-3.1	-3.3	-3.4
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	0.4	0.2	0.4	0.0	0.1
GDP sa yoy	1.0	1.2	1.2	1.1	0.8
Inflation yoy	2.2	2.2	2.3	2.1	1.8

Change as percentage

Sources: Macrobond, NORD/LB Macro Research

Interest rates, Euroland

	22.05.	3M	6M	12M
Repo rate ECB	2.25	2.00	1.75	1.75
3M rate	2.05	1.80	1.70	1.75
10Y Bund	2.64	2.50	2.50	2.70

Sources: Bloomberg, NORD/LB Macro Research

Germany: Q1 GDP growth and new government offer a glimmer of hope

Analysts: Christian Lips, Chief Economist // Christian Reuter

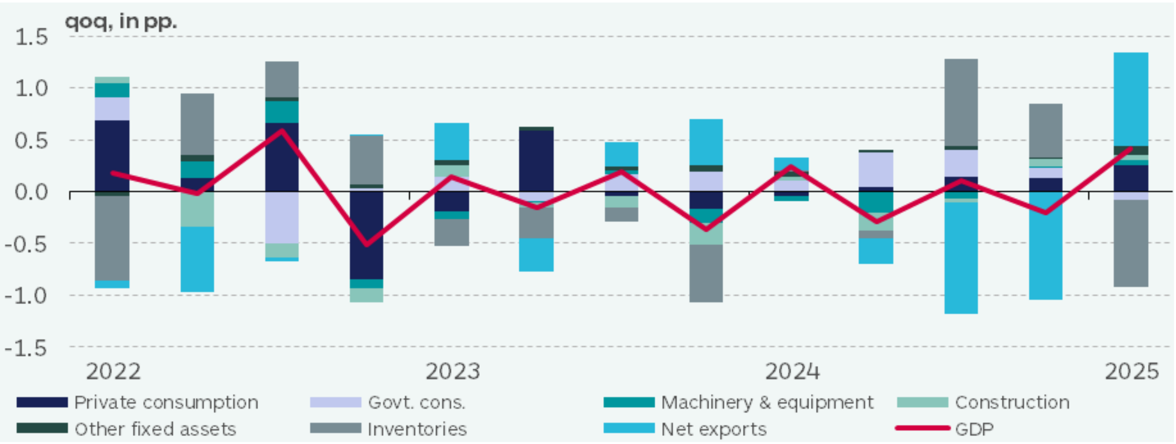
Front-loading effects drive strong Q1 growth for the German economy

The German economy started the year with significantly stronger momentum than expected. Seasonally and calendar-adjusted real gross domestic product (GDP) grew by 0.4 percent, quarter-on-quarter, marking the strongest increase since summer 2022. The growth was broadly underpinned (see chart). Private consumption expanded robustly by 0.5 percent qoq, while investment in machinery and equipment (+0.7 percent) and construction (+0.5 percent) also rose, driving gross fixed capital formation up by a total 0.9 percent qoq.

After two weak quarters, foreign trade rebounded sharply in Q1. In anticipation of Donald Trump's tariff policies, front-loading effects boosted exports significantly, with real exports surging by 3.2 percent qoq – far outpacing real imports (+1.1 percent qoq). All told, net exports contributed 0.9 percentage points to overall growth, marking the strongest boost from foreign trade since the summer of 2020. Inventory drawdowns weighed on growth (-0.9 percentage points), however.

The upward revision from the initial flash estimate reflects positive March economic data which, however, were not yet available to statisticians in late April. Industrial output and net exports registered particularly strong expansion in March. So is it a case of March – or Merz – making for change? Of course, the positive performance in March can't be attributed to Friedrich Merz's election victory, especially as coalition talks were still underway at the time. Rather, special factors played a key role in March. Besides front-loaded export activity, the timing of the Easter holidays – falling entirely in the second quarter this year – likely made for further distortions.

Chart: Exports and consumption drive growth in Q1



Sources: Destatis, Macrobond, NORD/LB Macro Research

New federal government in place – expansionary fiscal policy boosts medium-term outlook

The new federal government under Chancellor Friedrich Merz was formed relatively quickly after the late-February elections, and took up its duties in May. Although the coalition nearly stumbled at the outset with a failed first ballot in parliament, the misstep was swiftly corrected the same day – a minor blemish likely to rapidly fade into the background after the government's first few weeks of work. If anything, the experience may actually discipline the coalition partner parties, given the stark reminder of their narrow parliamentary majority.

The new fiscal policy is expected to provide medium-term stimulus, with the outlook for investment now looking particularly positive. The special investment fund ("*Sondervermögen Investitionen*") and

broader government plans to boost investment will support growth in this context, alongside favourable interest rate prospects that could encourage corporate investment.
That said, measurable effects from this will take time to materialize. As things currently stand, the upcoming months will likely be challenging. The trade war has sharply heightened uncertainty, complicating investment decisions. While the EU will seek to de-escalate the tariff conflict, success in this respect hinges largely on the U.S. administration's willingness to compromise. For now, higher tariffs and uncertainty are dampening economic activity. Moreover, front-loading effects are likely to reverse in the course of the year, leaving the economy in 2025 more or less stagnant again (forecast: +0.2 percent).

Deceptive sentiment?
Sentiment in the German economy brightened to an unexpected extent in May. In case of sentix and ZEW this came as little surprise given the steep recovery of financial markets and the fact, that the surveyed are financial market experts. The ifo Business Climate Index rose for the fifth consecutive month, traditionally seen as a clear signal of a turning point. Already in the previous month, business leaders polled by the ifo Institute appeared remarkably unfazed by the turmoil caused by former U.S. President Donald Trump's trade policies.
Above all the sentiment indicators' expectations components have risen of late, while assessments of the current situation remain cautious – despite the recent positive economic data. Beyond the construction sector, sentiment improved most notably in manufacturing and trade, likely reflecting relief over Trump's "tariff pause", and front-loading effects in these sectors. This improvement in sentiment may be deceptive, however. A sustained turnaround is far from certain; with the tariff dispute's trajectory still unclear, the principle of hope appears to be the dominant force for now.

Fundamental forecasts, Euroland

	2024	2025	2026
GDP	-0.2	0.2	1.4
Private consumption	0.2	1.1	1.5
Govt. consumption	3.2	1.6	3.2
Fixed investment	-2.7	1.5	4.7
Exports	-1.8	0.3	2.0
Imports	-0.7	3.1	5.8
Net exports[1]	-0.5	-1.0	-1.4
Inflation[2]	2.5	2.2	1.9
Unemployment rate[3]	6.0	6.3	6.2
Budget balance[4]	-2.8	-2.9	-3.6
Current account balance[4]	5.7	4.3	3.7

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	0.1	-0.2	0.4	0.0	0.1
GDP nsa yoy	0.1	-0.4	-0.2	-0.3	0.3
Inflation yoy	2.2	2.5	2.6	2.1	2.1

Change as percentage
Sources: Macrobond, NORD/LB Macro Research

Switzerland: Growth in Q1 – too good to be true?

Analyst: Christian Reuter

Swiss economy's growth significantly outpaces expectations

The Swiss economy made an unexpectedly strong start to the year. According to preliminary figures from the State Secretariat for Economic Affairs (SECO), seasonally and sports-event-adjusted real GDP grew by 0.7 percent quarter-on-quarter, with year-on-year growth reaching a robust 1.8 percent – well above the average. Both the services sector and industry showed positive momentum, though further details were not published. Behind the scenes, the chaos of U.S. trade policy is becoming increasingly apparent. As reflected in the U.S. trade balance data, importers have been stockpiling inventories aggressively, a trend that also reverberated in Switzerland –particularly in pharmaceuticals trade. Both goods imports and exports surged nominally in Q1. However, in real terms, only imports rose, while exports fell by 5.7 percent qoq, potentially dampening growth contributions from trade. A revision of the flash GDP estimate ought not to come as a surprise. Sentiment in the industrial sector deteriorated sharply in April, despite an 8.5-percent year-on-year increase in production volume in Q1. The Purchasing Managers' Index (PMI) fell from 51.8 to 48.1 points, and consumer confidence also deteriorated. Meanwhile, no solution is yet in sight in Switzerland's trade dispute with the USA. While initial signs of diplomatic thaw have emerged – with both sides committing to expedited talks and Washington labelling Switzerland a priority – the U.S. president then signed an executive order to slash drug prices. This move threatens to hit Switzerland's pharmaceutical industry, a cornerstone of its economy.

Deflation risks on the rise – SNB signals monetary easing

Deflationary pressures from foreign trade brought Switzerland's inflation to a standstill in April. Import prices fell again, down 2.5 percent year-on-year, driven by cheaper oil in U.S. dollar terms and a stronger Swiss franc. The Swiss currency hit a new all-time high in April, with its appreciation against the US dollar being even more pronounced. Even the markets' risk-on mode in May failed to lift the exchange rate against the euro sustainably above the 0.94 mark. With global economic uncertainties unlikely to ease in the coming months, upward pressure on the franc is expected to persist. We now anticipate negative inflation rates in the months ahead, and have adjusted our forecasts accordingly. The Swiss National Bank has secured backing in Washington to ensure greater leeway in its currency policy. It is, after all, no longer a secret that it would intervene in case of doubt. The central bankers have also been unusually vocal of late about the possibility of pushing rates back into negative territory. The market now clearly seems to believe in this scenario, though merely talking about it might suffice for now.

Fundamental forecasts*, Switzerland

	2024	2025	2026
GDP	0.9	1.4	1.5
Inflation (CPI)	1.1	0.0	0.3
Unemployment rate[1]	2.5	2.9	3.0
Budget balance[2]	0.4	0.4	0.3
Current account bal.[2]	5.7	5.6	5.9

Interest and exchange rates, Switzerland

	22.05.	3M	6M	12M
SNB policy rate	0.25	0.00	0.00	0.25
3M rate	-0.05	0.00	0.00	0.25
10Y	0.36	0.35	0.40	0.55
Spread 10Y Bund	-228	-215	-210	-215
EUR in CHF	0.94	0.92	0.93	0.93

* 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: Central bank to proceed cautiously

Analyst: Tobias Basse

Weak growth data

Japan's real GDP contracted by 0.2 percent quarter-on-quarter in Q1 2025, falling short of optimists' expectations for modest consumer-driven growth – which evidently failed to materialize. The ongoing trade dispute with the USA remains a key concern for observers of Japan's economy. Important not only in economic terms, the Asian nation is among the candidates for a fairly swift deal with Washington. The country's crucial auto industry is particularly eager for an agreement, and has been pushing behind the scenes for constructive talks with the new U.S. administration. Tokyo's policymakers appear well-versed in the art of dealing with a trade war, however. Prime Minister Shigeru Ishiba and his inner circle seem to understand that a more hesitant stance could yield better terms – playing, from the perspective of art, the reluctant bride. A deal with Washington is the most likely outcome, and it will probably not be disadvantageous to the United States. Japan, after all, is simply too dependent on America's military might.

Japan: Central bank to proceed cautiously

The growth weakness evident in Japan at the outset of 2025 is certainly not making it any easier for the Bank of Japan to do its job and take meaningful monetary policy decisions. Rate hikes are likely to remain on the table, however, but the central bank will now proceed with extra caution. Compounding the problems, the relatively high level of long-term interest rates is becoming an increasing burden for the heavily indebted country.

The yen remains in focus

Washington, for its part, would generally welcome a stronger yen – though, of course, without pushing for any sustained weakening of the US dollar. This quite complex set of circumstances makes it harder for U.S. policymakers to engage in potential discussions on the future monetary order with all government representatives in Asia. With an eye on Tokyo, even cautious interest rate hikes by the Bank of Japan could buoy the yen – particularly if the Fed funds target rate were to decline noticeably. Should that scenario play out, the exchange rate could well dip below 140 yen to the dollar in the coming months.

Fundamental forecasts*, Japan

	2024	2025	2026
GDP	0.2	0.7	0.9
Inflation	2.7	3.1	2.1
Unemployment rate[1]	2.5	2.5	2.4
Budget balance[2]	-3.0	-3.6	-3.2
Current account bal.[2]	4.8	4.5	4.3

* 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

	22.05.	3M	6M	12M
Key rate	0.50	0.50	0.75	1.00
3M rate	0.77	0.80	0.90	1.10
10Y	0.66	1.50	1.55	1.60
Spread 10Y Bund	-198	-100	-95	-110
EUR in JPY	162	157	153	151
USD in JPY	144	140	138	137

China: Industry and exports reflect uncertainty

Analyst: Valentin Jansen

Front-loaded exports help cushion weaker industrial output

The sentiment among purchasing managers in China's predominantly export-oriented industrial firms proved more resilient than anticipated, according to the privately polled Caixin Manufacturing PMI, which stood at 50.4 points in April. The hard data on industrial output also came in stronger than expected, rising 6.1 percent year on year –though slightly below March's level. Many market participants had braced for heavier fallout from the escalating tariff dispute. Yet, much like recent trade figures, the actual impact proved milder than feared. April's industrial production data showed year-on-year output growth of 6.6 percent in the manufacturing sector. Sectors producing more easily substitutable goods, like textiles for example, appear to already be facing greater headwinds. The robust export growth of 8.1 percent year on year continues to benefit from front-loading effects, likely helping to cushion April's slowdown in production output growth.

Massive tariff cut and 90-day truce pave way for long-term talks

May 12 saw the U.S. and China reach a provisional compromise in their trade standoff. Both sides implemented significant reciprocal tariff reductions effective May 14, with the measures set to expire after 90 days. The USA cut its tariffs on Chinese goods from 145 to 30 percent, while Beijing reciprocated by slashing its duties from 125 to 10 percent. In parallel, the two governments established a new "mechanism" for consultations on trade and economic matters, designed to lay the groundwork for lasting solutions in the coming months. Leading the negotiations will be U.S. Treasury Secretary Scott Bessent and Chinese Vice Premier He Lifeng. In the short term, China's foreign trade stands to benefit from the temporary tariff truce, as American importers will be looking to ramp up shipments from China as far as possible before the 90-day window closes.

PBOC seizes opportunity to adjust its benchmark rate structure

In a shift from its recent wait-and-see approach, the PBOC resumed monetary easing in May by cutting both the one-year Loan Prime Rate (LPR) for corporate loans and the five-year LPR for mortgages by 10 basis points each. This followed an earlier 10bp reduction in the seven-day reverse repo rate. The timing appears well chosen, particularly in light of the PBOC's longstanding commitment to renminbi stability. The compromise on tariffs notably eased depreciation pressure on the Chinese currency, granting the central bank fresh leeway in terms of monetary policy. After briefly nearing the psychologically important threshold of 7.35 USD/CNY in mid-April – the weakest level tolerated by Beijing since 2007 – the daily fixing rate has gradually shifted focus back toward the key 7.20 USD/CNY mark in May.

Fundamental forecasts*, China

	2024	2025	2026
GDP	5.0	4.4	4.0
Inflation	0.1	0.4	1.0
Unemployment rate[1]	5.1	5.1	5.1
Budget balance[2]	-7.4	-5.5	-5.7
Current account bal.[2]	1.4	1.1	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

	22.05.	3M	6M	12M
Deposit rate	1.50	1.50	1.50	1.50
3M SHIBOR	1.64	1.60	1.50	1.50
10Y	1.69	1.65	1.65	1.65
Spread 10Y Bund	-95	-85	-85	-105
EUR in CNY	8.13	8.18	8.10	7.99
USD in CNY	7.21	7.30	7.30	7.26

Britain: Free trade agreements struck at just the right moment

Analyst: Constantin Lüer

Free trade agreement with the USA couldn't be more timely
April saw the UK inflation rise by 1.2 percent month-on-month, a development that, while broadly in line with market expectations, puts pressure on the Bank of England's recently "dovish" interest rate outlook. At the same time, the first trade agreement with the USA provides a degree of planning certainty for key sectors of the island's economy as a whole. As part of the initial deal, the UK and the USA agreed, for example, to adjust tariffs on cars. British car imports into the USA will now face a 10-percent duty for shipments up to a threshold of 100,000 units – a 7.5-percentage-point increase from pre-"Liberation Day" levels, bringing it roughly in line with the tariff rate the UK imposes on American cars. Any vehicles exceeding this quota will be subject to a new 27.5-percent tariff in the USA. Tariffs on aluminium and steel products will be reduced from 25 percent to zero under certain conditions. The agreement represents a lean first draft, with many other details likely to be fine-tuned in the coming weeks.

Thawing ties with the EU as well
Even after the Brexit divorce from the European Union, the two economic blocs are now moving closer again. As already noted, the sectors affected are diverse, but likely central to the rapprochement are endeavours in terms of closer cooperation on security policy – both from a monetary standpoint and within the broader framework of bilateral collaboration. Overall, the warming of relations with the USA and the EU as well, along with the free trade agreement with India, are expected to contribute to a gradual easing of inflationary pressures over the longer term.

Rate cuts in 2025 still on the table
After the Bank of England recently lowered its benchmark Bank Rate to 4.25 percent at its meeting ending on 7 May, the Monetary Policy Committee (MPC) is expected to monitor economic conditions closely rather than rush into further cuts. That said, the MPC still has ample leeway to reduce rates, even in light of future inflation developments. Key factors to watch include the lingering effects of tariff adjustments and whether the pace of price increases shows signs of reversal in the figures for May. Against this background we are therefore maintaining our expectation of rate cuts totalling 50 basis points in the second half of the year.

Fundamental forecasts*, Britain

	2024	2025	2026
GDP	1.1	0.9	1.2
Inflation (CPI)	2.5	3.0	2.3
Unemployment rate[1]	4.3	4.6	4.6
Budget balance[2]	-5.1	-4.1	-3.6
Current account bal.[2]	-2.7	-2.6	-2.5

* Change vs previous year as percentage

Interest and exchange rates, Britain

	22.05.	3M	6M	12M
Repo rate	4.25	4.00	3.75	3.50
3M rate	4.21	3.90	3.70	3.45
10Y	4.75	4.30	4.20	4.05
Spread 10Y Bund	211	180	170	135
EUR in GBP	0.84	0.85	0.85	0.86
GBP in USD	1.34	1.32	1.31	1.28

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

Sources: Macrobond, Bloomberg, NORD/LB Macro Research

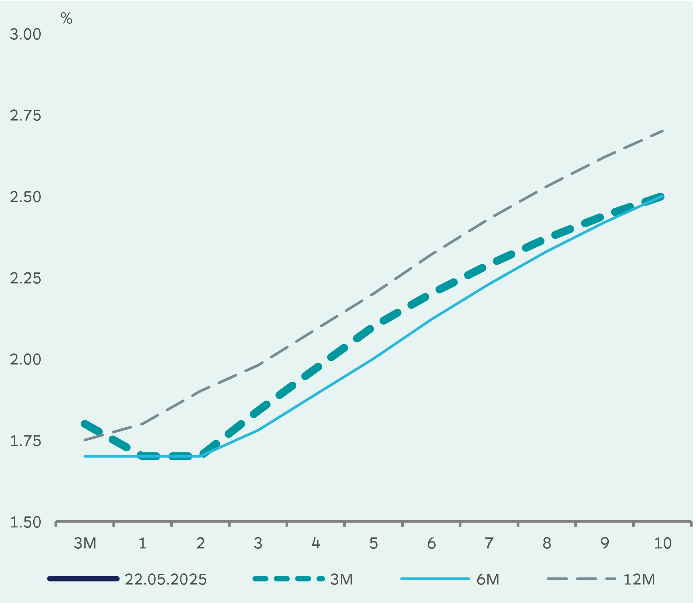
Portfolio strategies
Yield curve, Euroland

Yields and forecasts (Bunds/Swap)

	Yields (in %)	NORD/LB forecasts for horizons...		
	22.05.2025	**3M**	**6M**	**12M**
3M	2.05	1.80	1.70	1.75
1Y	1.80	1.70	1.70	1.80
2Y	1.83	1.70	1.70	1.90
3Y	1.90	1.84	1.78	1.98
4Y	2.05	1.97	1.89	2.09
5Y	2.17	2.10	2.00	2.20
6Y	2.23	2.20	2.12	2.32
7Y	2.35	2.29	2.23	2.43
8Y	2.46	2.37	2.33	2.53
9Y	2.57	2.44	2.42	2.62
10Y	2.64	2.50	2.50	2.70
2Y (Swap)	2.00	1.85	1.85	2.05
5Y (Swap)	2.28	2.15	2.05	2.25
10Y (Swap)	2.61	2.45	2.45	2.65

Sources: Bloomberg, NORD/LB Macro Research

Yield curve forecasts (Bunds)



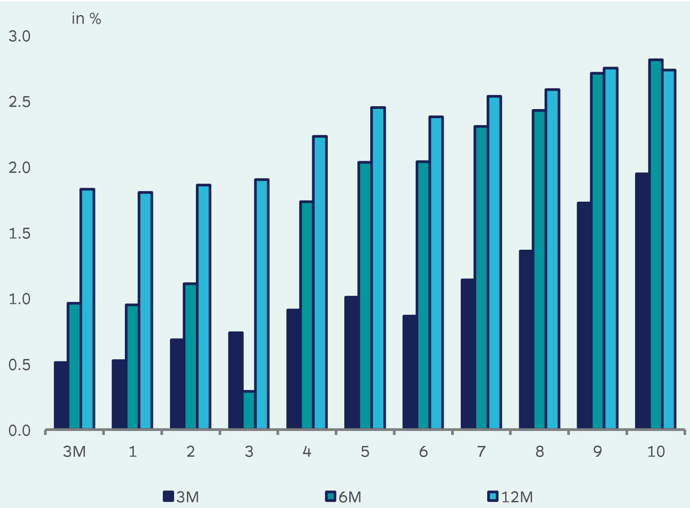
Sources: Bloomberg, NORD/LB Macro Research

Forecasts and total returns

	Total returns (in %) for horizons...		
	3M	**6M**	**12M**
3M	0.51	0.96	1.83
1Y	0.53	0.95	1.80
2Y	0.68	1.11	1.86
3Y	0.74	0.29	1.90
4Y	0.91	1.73	2.23
5Y	1.01	2.03	2.45
6Y	0.86	2.04	2.38
7Y	1.14	2.31	2.54
8Y	1.36	2.43	2.59
9Y	1.72	2.71	2.75
10Y	1.95	2.81	2.74

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	1.9	-0.2	3.5	1.4
2Y	0.7	1.9	0.3	3.6	1.2
3Y	0.7	2.7	0.4	3.4	1.1
4Y	0.9	3.7	0.6	3.6	1.1
5Y	1.0	2.2	0.7	3.9	1.1
6Y	0.9	4.2	1.5	4.0	1.2
7Y	1.1	6.7	1.4	4.4	1.3
8Y	1.4	7.7	2.6	4.6	1.2
9Y	1.7	8.7	2.9	4.6	1.5
10Y	1.9	4.9	3.1	4.4	1.6

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	-0.2
2Y	1.1	1.4	0.0	-0.6
3Y	2.0	1.5	0.0	-0.6
4Y	3.0	1.7	0.1	-0.6
5Y	1.5	1.9	0.4	-0.5
6Y	3.4	2.6	0.5	-0.4
7Y	5.9	2.5	0.9	-0.3
8Y	6.9	3.7	1.1	-0.4
9Y	7.9	4.0	1.1	-0.1
10Y	4.1	4.3	0.9	0.0

Sources: Bloomberg, NORD/LB Macro Research

12-month horizon

Expected total returns (as percentage) in euro					
	EUR	USD	GBP	JPY	CHF
1Y	1.8	6.8	1.5	8.1	0.4
2Y	1.9	7.4	2.1	8.1	-0.1
3Y	1.9	8.0	2.5	8.0	-0.4
4Y	2.2	9.3	3.1	8.1	-0.6
5Y	2.5	10.5	3.7	8.2	-0.7
6Y	2.4	10.5	4.7	8.2	-0.8
7Y	2.5	13.3	4.9	8.5	-0.8
8Y	2.6	14.7	6.8	8.5	-0.8
9Y	2.8	16.0	7.0	8.9	-0.6
10Y	2.7	17.5	7.4	9.2	-0.6

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies				
	USD	GBP	JPY	CHF
1Y	4.1	3.8	0.5	-0.2
2Y	4.7	4.5	0.5	-0.7
3Y	5.3	4.9	0.4	-1.0
4Y	6.6	5.4	0.5	-1.2
5Y	7.7	6.1	0.6	-1.3
6Y	7.8	7.1	0.6	-1.3
7Y	10.5	7.3	0.9	-1.3
8Y	11.8	9.2	0.9	-1.4
9Y	13.1	9.4	1.3	-1.2
10Y	14.5	9.9	1.5	-1.2

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	Status		Performance since	
	22.05.2025	**Prev. month**	**Start of year**	**Prev. month**	**Start of year**
DAX	23,999.17	22,496.98	19,909.14	6.68%	20.54%
MDAX	30,053.54	28,737.65	25,589.06	4.58%	17.45%
EuroSTOXX50	5,424.48	5,160.22	4,895.98	5.12%	10.79%
STOXX50	4,555.23	4,402.62	4,308.63	3.47%	5.72%
STOXX600	550.27	527.48	507.62	4.32%	8.40%
Dow Jones	41,859.09	40,669.36	42,544.22	2.93%	-1.61%
S&P 500	5,842.01	5,569.06	5,881.63	4.90%	-0.67%
Nikkei	36,985.87	36,045.38	39,894.54	2.61%	-7.29%

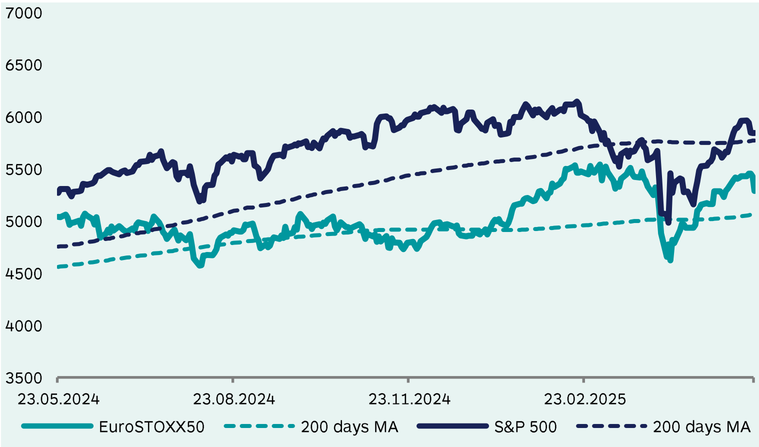
Sources: Bloomberg, NORD/LB Macro Research

Index forecasts

Index	NORD/LB forecast for the horizons ...		
	3M	**6M**	**12M**
DAX	21,000	22,000	23,000
MDAX	26,000	28,000	29,000
EuroSTOXX50	4,900	5,050	5,250
STOXX50	4,200	4,250	4,400
STOXX600	500	510	530
Dow Jones	38,000	39,500	42,500
S&P 500	5,300	5,500	5,950
Nikkei	33,500	34,000	37,500

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, 23 May 2025.**
The next English issue of Economic Adviser will be appearing on **30 June 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	1.3	1.6	3.0	3.0	2.6	4.0	4.5	4.4	-6.9	-6.3	-6.0
Euroland	0.8	1.0	1.1	2.4	2.0	1.8	6.4	6.2	6.1	-3.1	-3.3	-3.4
Germany	-0.2	0.2	1.4	2.5	2.2	1.9	6.0	6.3	6.2	-2.8	-2.9	-3.6
Japan	0.2	0.7	0.9	2.7	3.1	2.1	2.5	2.5	2.4	-3.0	-3.6	-3.2
Britain	1.1	0.9	1.2	2.5	3.0	2.3	4.3	4.6	4.6	-5.1	-4.1	-3.6
Switzerland	1.2	1.4	1.5	2.1	0.0	0.3	2.0	2.9	3.0	0.2	0.4	0.3
China	5.0	4.4	4.0	0.1	0.4	1.0	5.2	5.1	5.1	-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 %	22.05.25	3M	6M	12M
USD	4.50	4.50	4.00	3.50
EUR	2.25	2.00	1.75	1.75
JPY	0.50	0.50	0.75	1.00
GBP	4.25	4.00	3.75	3.50
CHF	0.25	0.00	0.00	0.25
CNY	1.50	1.50	1.50	1.50

Sources: Bloomberg, NORD/LB Macro Research

Exchange rates

EUR in...	22.05.25	3M	6M	12M
USD	1.13	1.12	1.11	1.10
JPY	162	157	153	151
GBP	0.84	0.85	0.85	0.86
CHF	0.94	0.92	0.93	0.93
CNY	8.13	8.18	8.10	7.99

Interest rates (government bonds)

	3M rates				Yields 2Y				Yields 5Y				Yields 10Y			
	22.05.	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**
USD	4.33	4.25	3.80	3.30	3.99	3.90	3.65	3.25	4.09	4.20	3.80	3.30	4.53	4.45	4.10	3.65
EUR	2.05	1.80	1.70	1.75	1.83	1.70	1.70	1.90	2.17	2.10	2.00	2.20	2.64	2.50	2.50	2.70
JPY	0.77	0.80	0.90	1.10	0.06	0.80	0.95	1.00	0.26	1.00	1.05	1.20	0.66	1.50	1.55	1.60
GBP	4.21	3.90	3.70	3.45	4.03	3.75	3.60	3.55	4.20	3.98	3.82	3.68	4.75	4.30	4.20	4.05
CHF	-0.05	0.00	0.00	0.25	-0.20	0.02	0.07	0.25	0.01	0.10	0.15	0.35	0.36	0.35	0.40	0.55

Sources: Bloomberg, NORD/LB Macro Research

Spreads (bp)

	3M EURIBOR				2Y Bund				5Y Bund				10Y Bund			
	22.05.	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**	**22.05.**	**3M**	**6M**	**12M**
USD	228	245	210	155	216	220	195	135	192	210	180	110	189	195	160	95
JPY	-128	-100	-80	-65	-177	-90	-75	-90	-191	-110	-95	-100	-198	-100	-95	-110
GBP	216	210	200	170	220	205	190	165	203	188	182	148	211	180	170	135
CHF	-210	-180	-170	-150	-203	-168	-163	-165	-216	-200	-185	-185	-228	-215	-210	**-215**

Sources: Bloomberg, NORD/LB Macro Research

Annex

Contacts at NORD/LB

Dr. Martina Noss
Head of Research
+49 172 512 2742
martina.noss@nordlb.de

Christian Lips
Chief Economist
Head of Macro Research
+49 172 735 1531
christian.lips@nordlb.de

Tobias Basse
Macro Research
+49 511 361-2722
tobias.basse@nordlb.de

Christian Reuter
Macro Research
+49 152 0412 9316
christian.reuter@nordlb.de

Valentin Jansen
Macro Research
+49 157 8516 7232
valentin.jansen@nordlb.de

Constantin Lüer
Macro Research
+49 157 8516 4838
constantin.lueer@nordlb.de

Other contacts

Sales

Institutional Sales
+49 511 9818-9440

Sales Sparkassen &
Regional Banks
+49 511 9818-9400

Sales MM/FX
+49 511 9818-9460

Sales Europe
+352 452211-515

Sales Asia
+65 64 203136

Origination & Syndicate

Origination FI
+49 511 9818-6600

Origination Corporates
+49 511 361-2911

Treasury

Liquidity Management
+49 511 9818-9620
+49 511 9818-9650

Trading

Covereds/SSA
+49 511 9818-8040

Financials
+49 511 9818-9490

Governments
+49 511 9818-9660

Federal States/Regions
+49 511 9818-9550

Frequent Issuers
+49 511 9818-9640

Corporate Sales

Corporate Customers
+49 511 361-4003

Asset Finance
+49 511 361-8150

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