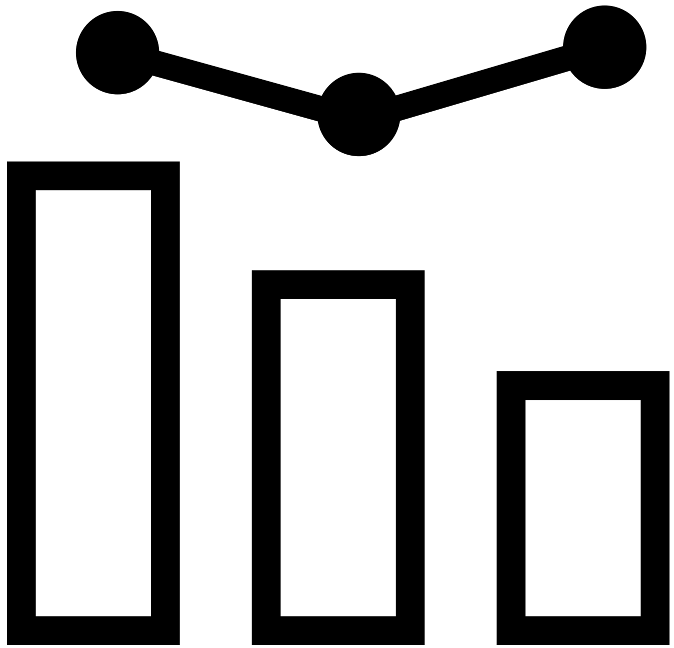


Market update

February 2025

February 2025: Will Europe be the comeback kid of 2025?

European equities are catching up with US equities. This was the best performing asset class in February with a return of 3.6%, while US equities were the worst performing asset class with a return of -1.7% in euro terms. This gives European equities a return of 10% for the first two months of this year, compared to only 1.8% for US equities.

Despite the fact that European equities have been cheap relative to US equities for some time (in terms of price-to-earnings ratios), the turnaround is nonetheless remarkable. There have been no surprisingly good macro figures coming out of the eurozone. For the US, it can be argued that the import tariffs that President Trump wants to impose (and has already imposed to some extent) will also hurt the US economy itself. Markets may be anticipating that the outlook for the eurozone economy has bottomed out while the prospects for the US have peaked.

The risk-off sentiment for the US was also reflected in the yield on 10-year US Treasuries last month, which fell by 0.3% to 4.2% at the end of February. No similar move was seen in the eurozone, as yields on 10-year German government bonds also eased slightly (by 0.05%), while risk-on sentiment prevailed in European stock markets in February. The decline in bond yields meant that February was not a bad month for European government bonds, which increased in price by 0.7%.

Corporate bonds also benefited, with riskier high-yield corporate bonds also partly reflected the positive sentiment on the stock markets and achieved higher returns (of 1%) than those of relatively safe investment grade government bonds, which returned 0.6%.

One asset class that did not benefit was European listed real estate, which fell by 0.2% last month, partly because inflation in Europe is still not declining fast. As a result, the markets may be disappointed with respect to the number of ECB interest-rate cuts they are currently discounting for this year.

The returns on the various asset classes were as follows:

Return (total return, in euro's)	February	Q1	2025	12 mths
Bloomberg Barclays Eurozone Staatsobligaties	0,7%	0,5%	0,5%	4,1%
Bloomberg Barclays Euro Bedrijfsobligaties	0,6%	1,0%	1,0%	6,6%
Bloomberg Barclays Euro High Yield Bedrijfsobligaties	1,0%	1,7%	1,7%	8,8%
FTSE/EPRA Europe Onroerend Goed	-0,2%	2,4%	2,4%	7,0%
MSCI Europe Aandelen	3,6%	10,3%	10,3%	15,7%
MSCI North America Aandelen	-1,7%	1,8%	1,8%	23,3%
MSCI Asia Pacific Aandelen	-0,4%	1,5%	1,5%	13,2%
MSCI World Developed Markets Aandelen	-0,9%	3,0%	3,0%	19,1%
MSCI Emerging Markets Aandelen	0,4%	2,7%	2,7%	15,0%
EUR/USD	0,1%	-0,4%	-0,4%	-4,3%

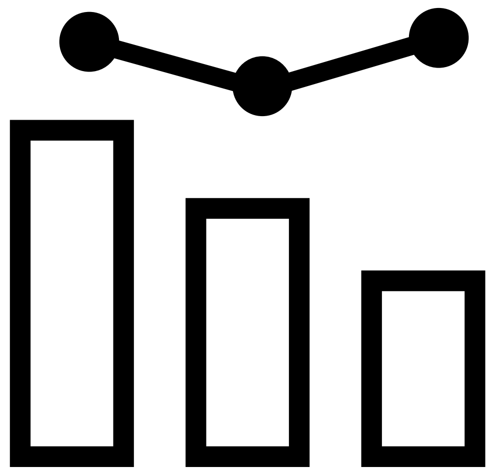
Bron: Bloomberg

Is the European economy going to outperform the US economy?

The growth forecasts for the eurozone and the US are very different. The consensus growth forecast by economists on Bloomberg is 0.9% for the eurozone and 2.3% for the US. These growth rates would be slightly below the long-term average for the eurozone (1.2%) and slightly above average for the US (2.1%). The difference between these two growth rates forecast for 2025 is 1.4%. By comparison, this difference was only 0.3% at the beginning of 2024. At the time, the expectation was that growth in the eurozone would increase slightly and decline slightly in the US. That forecast has now shifted significantly in favour of the US economy. However, this also means that there is more potential for disappointment in the US than in the eurozone.

It does, nonetheless, have to be said that there is currently a great deal of uncertainty regarding the economies of both the eurozone and the US. The eurozone economy could be hit by potential import tariffs from Trump (see below), and is also more sensitive to an increase in energy prices than the US, because the eurozone is a net energy importer and the US is virtually self-sufficient in terms of its energy needs. The recent announcement by the European Commission to increase spending on defence by €800 billion (over 5% of the eurozone's GDP) in the coming years could benefit the eurozone.

In the longer term, the US has more growth potential than the eurozone, mostly because the US economy is more innovative. This is reflected, for example, in the fact that the US has achieved higher productivity growth than the eurozone over the past 20 years (0.4% per year for the US, compared to -0.2% for the eurozone). In the long term, therefore, it still seems likely that the US economy will continue to grow faster than the European economy.



Chinese government to increase economic stimulus this year

Although not widely reported in the media, Chinese stocks have been one of the best-performing equity markets in the first two months of this year. The MSCI China index has risen by almost 13% in 2025 in euro terms. This is even more striking than the situation in Europe, as China is still struggling with weak economic growth (from a historical perspective), a weak real estate sector and high debt, with higher import tariffs from the US on the horizon. This may be due to an expectation that Chinese technology companies could be underrated in terms of their ability to compete with their US counterparts. We have already seen an example of this at the beginning of the year, when the Chinese company DeepSeek was mentioned in the media as a competitor of the American Open AI.

Another explanation could be that investors expect the Chinese government to provide more economic stimulus than in the past, partly in response to US import tariffs on Chinese goods. Chinese exports are declining as a result of these tariffs. The government may wish to compensate for this with more domestic consumption to allow its economy to grow.

More information will come from the Two Sessions meeting currently being held in China, in which the government will announce its plans for the coming period. From what we know so far, the Chinese government does indeed seem to be planning to stimulate its economy more this year, once again setting a 5% growth target for the economy.

Inflation is falling in the eurozone, but rising in the US

Inflation in the eurozone eased slightly in February to 2.4% (from 2.5% in January), following four months of continuous increases. It is thus unclear whether this represents a turn in the uptrend seen in recent months. Fortunately, service inflation has also declined slightly, although it is still high at 3.7%. Core inflation also showed a similar development, easing to 2.6% after a period of five months at 2.7%. The consensus forecast by economists on Bloomberg remains is still for inflation to reach around 2.2% for 2025 as a whole (close to the ECB target).

In the short term, tightness in the labour market still poses a risk. Unemployment is still historically low in the eurozone (at 6.3%) and wage increases still look to be reasonable. It should however be noted that the difference between recent wage growth figures, such as those published by the Indeed vacancy website, and the slightly older figures published by the ECB, has been widening. According to the ECB, CLA-negotiated wages in the eurozone rose by 4.1% in Q4 2024. However, according to the Indeed wage growth tracker, the increase in wages was only 2.6% in January 2025.

Tariffs on imports of foreign goods may also lead to an increase in inflation. The eurozone could furthermore impose tariffs on imports of US good in response to the 25% import tariffs announced by Trump on European goods. Whether eurozone inflation will rise significantly depends on the level of eurozone tariffs on US goods and how serious the effect on the eurozone economy will be. Previously, the CPB calculated that the effect of reciprocal trade tariffs of 10% between the eurozone and the US would increase eurozone inflation by only 0.1%. However, tariffs of 25% could lead to much higher inflation in the eurozone. There is also the unpleasant possibility of a recession in the eurozone as a result of a trade war between the US and the eurozone. This would be deflationary, according to recent calculations by economists at ABN Amro.

Unlike the eurozone, US inflation is rising again, reaching 3% in January (from 2.9% in December 2024). This increase is minor, but the fact that US inflation has risen for four consecutive months is troubling. Moreover, services inflation is still high (4.2%) and core inflation also rose in January, to 3.3% from 3.2%. Finally, import tariffs are not going to help bring inflation down in the short term. Combined with a possible decline in economic growth, this increases the possibility of a stagflation scenario in the US.

A difficult situation for the central banks

The ECB is in a difficult position. Inflation in the eurozone is not falling fast enough, and whether a trade war with the US will be inflationary or deflationary depends on whether this leads to a severe decline in economic activity in the eurozone. For the US economy, it is clearer that the many import tariffs that Trump intends to impose are inflationary. But if a trade war leads to a serious decline in US economic growth, the Fed may need to start easing again, as the Fed is charged with maintaining a high level of employment as well as price stability. This creates uncertainty in the market, as the outlook for monetary policy by the ECB and the Fed this year is less clear.

Germany election results mean higher government debt

Elections were held in Germany last month, in which the centre-right CDU/CSU party won the most votes and is likely to form a coalition with the SPD. An important consequence of this is that the new (prospective) Chancellor Friedrich Merz recently announced that the German budget rules are to be reformed. In particular, that the Schuldenbremse will be reformed to fund defence spending, among other things. The Schuldenbremse is a fiscal rule in Germany's constitution that states that the government's annual budget deficit must not exceed 0.35% of GDP. If this rule is relaxed, there is a real possibility that Germany's public debt will rise. The markets seem to be pricing this in as well, as after the news broke, 10-year German government bond yields jumped by almost 0.2% to 2.7%. German government bond yields can be expected to remain volatile in the coming months.

Trump's tariffs mean lower growth and higher uncertainty

One of the most high-profile events of the past month was Donald Trump's plans to impose import tariffs of 25% on Europe, 10% higher tariffs on China and the previously deferred tariffs of 25% on Canada and Mexico. As we discussed in a previous publication, calculations by ABN Amro and Goldman Sachs estimate that reciprocal import tariffs between the US and the eurozone of 10% would mean a reduction of growth in the eurozone of around 1% (the effect on inflation will be closely linked to how serious the slowdown will be). Given that the eurozone is expected to grow by only 0.9% in 2025, this could lead to a recession. In the case of reciprocal tariffs of 25% on all goods between the US and the eurozone, the effect would be much more severe.

Whether the 25% tariffs will apply to all goods is still uncertain. The US can exert far more pressure on Mexico, for example, with respect to trade in goods than it can on the eurozone, as the US is less important as an export market for the eurozone than the other way around. Only 8% of European goods exports go to the US, while almost 20% of US exports go to the eurozone. It is still highly uncertain whether Trump's tariffs on Europe will apply to all or only some goods.

Clearly, this uncertainty is not good for an economy either. International companies, for example, are less able to assess how to respond to the announced tariffs. The exact levels of the tariffs is still unknown, nor is it clear to which goods (or possibly even services) they will apply. The increased uncertainty is visible in the Global Economic Policy Uncertainty Index compiled by economists Baker, Bloom and Davis. This index has soared since Trump was elected president.

High uncertainty calls for neutral positioning

With a high degree of uncertainty, a neutral position is appropriate. While European equities performed well in February, the question is whether this will continue in the coming period with the threat of a trade war on the horizon. Generally speaking, this uncertainty about a trade war (exactly what tariffs will be imposed and how will countries respond) does not argue for a position in marketable securities. However, the stimulative effect on the eurozone of increased defence spending cannot be ignored entirely either.

There is also a great deal of uncertainty regarding interest rates. Short-term interest rates react closely in line with monetary policy rates, and the outlook for further reductions has become less clear. Bond yields could rise further if investors expect higher debt in the eurozone. However, if fears of a recession in the eurozone resurface, this will put pressure on safe government bond yields and thus benefit prices for these bonds.

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