HOUSE VIEW

# Outlook 2025: Euro area

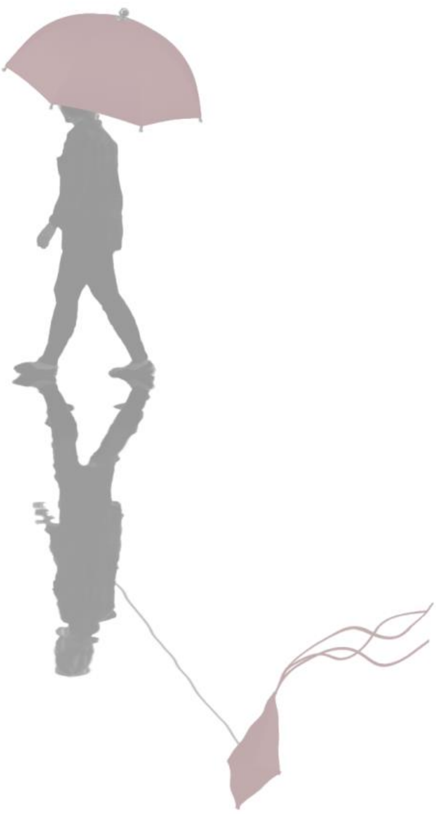
December 2024

## 3 Things to know

**1.** We see euro area growth of 1.0% in 2025; risks tilted to downside.

**2.** We are overweight euro sovereign bonds, underweight euro area equities.

**3.** Expect more Euro weakness vs dollar given growth and inflation differentials.



### MACROECONOMIC VIEW

We expect euro area economic growth to pick up slightly in 2025 to 1.0% from 0.8% in 2024. Easing monetary conditions will be the main factor supporting activity, as we expect the ECB to cut interest rates at every one of its policy meetings up to July 2025, bringing the deposit rate down to 1.75%. Monetary easing should translate into higher household spending by reducing incentives to save and by supporting a recovery in residential investment.

**Risks to our growth outlook are tilted to the downside**. High trade policy uncertainty could weigh directly (via exports of goods) and indirectly (via consumer and business confidence) on euro area growth. Our baseline scenario supposes that Trump administration tariffs will have a modest impact on growth, but the timing and the nature of tariffs as well as the EU's response are key.

Country wise, **we see Spain outperforming the other main euro area economies**, but to a lesser extent than in 2024. More generally, we see growth moderating in southern Europe, but countries there should prove more resilient to external shocks due to a larger services sector than in more manufacturing-heavy northern European countries, which are more exposed to trade tensions and competition with China.

We expect **headline and core inflation in the euro area to converge towards 2% by the end of 2025, averaging 1.9% and 2.2%** respectively. Disinflation will mainly be driven by further cooling in services prices due to continued post-covid normalisation.

### INVESTMENT IMPLICATIONS

**Overweight euro sovereign bonds.** The threat of US tariffs and political uncertainty, coupled with ECB rate cuts, are likely to push the 10-year German Bund yield down to 1.8% by mid-year before rising global yield dynamics lead it back up to 2.1% by year-end.

**Positive on euro area investment grade debt (EUR IG).** We are overweight EUR IG and see it as more attractive than cash. However, tight spreads mean that most of the return will come from the carry.

**More euro weakness.** We expect further euro weakness against the dollar as growth and inflation differentials translate into to a widening of the policy rate spread. We expect the exchange rate to trend towards parity over the course of the year.

**Staying underweight euro area equities.** While sentiment is depressed, geopolitical uncertainty remains high, valuations are not yet cheap in absolute terms and we expect earnings-per-share growth of just 4% next year from euro area equities, below our forecast for other regions. However, if events prove more benign than feared we could see a sharp recovery in euro area equities at some point next year given today's very low expectations.