Euro area – Macro radar

Germany to pass its stimulus plan, EU to endorse boost to defence spending


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■ Last week, **we updated our macroeconomic scenario to reflect the recent newsflow**. We also provided **some scenario analysis on how the situation in Ukraine might resolve itself**. Four channels are in play, as we see it: energy prices, defence spending and the fiscal stance, policy uncertainty, and the flow of Ukrainian refugees (**see here).** Uncertainty remains heightened (ultimately very hard to assess how the tariff war will develop), and we have had to make significant assumptions that are likely to be adjusted in the coming months. We assume a 10% US tariff increase on European exports, which would shave 0.1pp off euro area GDP after two years, but the impact would likely be deeper in the first few quarters. The inflation impact would be negligible. We also assume that the share of defence spending in European NATO countries will increase from 2.0% of GDP to 2.5% by 2027. Moreover, we expect higher fiscal spending in Germany, both military and infrastructure (+1.1pp of German GDP by 2027), which should meaningfully raise GDP growth in 2026-28. The overall public deficit in the euro area should hover just above 3% of GDP for the coming years, which means countries other than Germany will continue tightening their fiscal belts, despite higher defence spending. We still expect a gradual economic growth acceleration in 2025, driven by ongoing recovery in consumption, the housing market stabilising and both monetary and fiscal policy becoming increasingly supportive. We expect GDP growth to accelerate this year to 1.1% vs 0.8% in 2024. We also see growth above potential up to 2029 (probably in the range of 0.5-1% p.a.), constrained by the shrinking labour force, at around 1.2% p.a. Given our inflation estimate and the ECB's inflation forecasts (close to 2% next year), we expect the ECB to cut deposit rates to 2.25% in April (within our range for the neutral rate). We see no reason to make the policy stance expansionary at this stage. However, medium term, there is a risk that the ECB will need to resume rate hikes if supply conditions (labour) remain tight.

■ **Last week in politics**. **Both Ukraine and Russia agreed to discuss the terms of a potential ceasefire.** Lots of questions remain unanswered, such as the land that must be kept by each side, the monitoring of this ceasefire, and the prospects for a long-lasting peace deal. President Putin indicated that a ceasefire should "eliminate the causes of this crisis".

■ **In Germany, there was a breakthrough in the negotiations to endorse the new stimulus plan** proposed by the CDU/CSU and the SPD continued (see here). The original plans remain intact with the Greens able to secure that €100bn out of the infrastructure fund (€500bn) will be channelled into the Climate and Transformation Fund for climate change projects.

■ **Meanwhile, the tariff war continued.** Last Thursday, President Trump threatened to put a 200% tariff on US imports of EU alcoholic beverages. This comes after the EU retaliated after the US imposed a 25% tariff on steel and aluminium products last week. The EC countered by saying it would raise 25% levies on €26bn of US exports to the EU (same amount as the taxed EU exports to the US). This decision comes in two stages. **From 1 April, the same list of import products as in 2018 (i.e. Bourbon, Harley Davidsons, beef, poultry, soybeans, textiles, etc.) amounting to €8bn will be subject to a 25% tariff hike.** In a second stage, around mid-April, new countermeasures will be proposed, affecting €18bn of US exports to the EU. This time, they could target luxury goods, fashion items, furniture, electronics and industrial goods, but are likely to exempt critical goods (energy, medicines, weapons). The EC approach is to target products for which there exists substitutes elsewhere, to reduce the damaging impact on the EU economy. It would take 100 days before this second list starts being implemented. If on 2 April, the US administration imposes a set of new tariffs (Trump mentioned his willingness to compensate for differences in tariffs, VAT and EU taxes on digital services), the EU would likely threaten to retaliate too by adding a third list. But EU policymakers continue to hope they can reach a deal with the US administration, for instance by reducing tariffs on car imports.

- **Last week in monetary policy.** On Wednesday, **we attended the ECB watcher conference in Frankfurt**. Against a backdrop of global trade shifts and domestic changes in fiscal policy, defence spending in particular, President Lagarde acknowledged it would be harder to keep inflation stable. She called for agility and transparency, guiding market participants about the ECB's reaction function, to help reduce uncertainty. This concerns shocks that are supposed to have a temporary impact on inflation and that central banks used to overlook. Scenarios could be provided. **The results of the review of its monetary policy strategy will be published in 2H25.**

- **Last week in data.** Last week was light on data. **Euro area industrial production started the year on the right footing, up 0.8% mom in January (0.0% yoy).** The release was accompanied by upward revisions of 0.3pp in 2H24. This increase was partially driven by a big increase in the manufacture of cars (+5% mom after -98.5% in December). **Another piece of good news is that production of energy-intensive activities (particularly, chemicals) has stopped falling since last July.** It remains weak, though, printing 11% below the levels observed before the war in Ukraine. As has been the case for the past two years, industrial output is set to continue dragging down GDP growth. But we do expect the downward trend to ease. Industrial sector survey data suggests that production will continue to remain weak, albeit less of a drag to GDP growth than it has been since 2022. The European Commission's z-score for the ratio of order books to inventories improved again in February to -0.4, its best score since September last year. Overall, the political uncertainty surrounding tariffs will likely dampen industrial levels in the short term. In contrast, proposed increased military spending by European countries and infrastructure spending in Germany will likely represent a boost to medium-term industrial production levels. Moreover, we expect consumption to strengthen this year.

Euro area economic data heatmap

Country	Data	Period	Prior	Actual	SGf	Consensus	Revised
Growth data							
Germany	Industrial Production SA (% MoM)	Jan	-2.4	2.0	1.3	1.6	-1.5
Germany	Industrial Production WDA (% YoY)	Jan	-3.1	-1.6	-3.0	-2.8	-2.2
Germany	Trade Balance SA	Jan	20.7	16.0	19.3	20.0	
Germany	Exports SA (% MoM)	Jan	3.5	-2.5	-1.2	0.5	2.5
Germany	Imports SA (% MoM)	Jan	2.7	1.2	-0.2	1.2	1.6
Euro area	Industrial Production WDA (% YoY)	Jan	-2.0	0.0	-1.6	-0.8	-1.5
Euro area	Industrial Production SA (% MoM)	Jan	-1.1	0.8	0.0	0.7	0.4
Inflation and unemployment data							
Germany	CPI EU Harmonized (% MoM)	Feb F	0.6	0.5	0.6	0.6	
Germany	CPI EU Harmonized (% YoY)	Feb F	2.8	3.0	2.8	2.8	
France	CPI EU Harmonized (% MoM)	Feb F	0.0	0.1	0.0	0.0	
France	CPI EU Harmonized (% YoY)	Feb F	0.9	0.9	0.9	0.9	
France	CPI (% MoM)	Feb F	0.0	0.0	0.0	0.0	
France	CPI (% YoY)	Feb F	0.8	0.8	0.8	0.8	
France	CPI Ex-Tobacco Index	Feb	119.0	119.0	119.0	--	
Spain	CPI (% MoM)	Feb F	0.4	0.4	0.4	0.4	
Spain	CPI (% YoY)	Feb F	3.0	3.0	3.0	3.0	
Spain	CPI EU Harmonised (% MoM)	Feb F	0.4	0.4	0.4	0.4	
Spain	CPI EU Harmonised (% YoY)	Feb F	2.9	2.9	2.9	2.9	

Source: Bloomberg. SG Cross Asset Research/Economics.

- **This week in politics. On the policy front, the German Bundestag (18 March) and the Bundesrat will vote (21 March) on the new stimulus plan. We expect the 2/3 majority to be achieved.** A vote can be held as late as 24 March, the day before the new parliament is convened.

- **European heads of state and government are to meet on 20-21 March.** They are expected to endorse EC proposals to help finance defence spending: i) the suspension of fiscal rules for defence spending (activating the national escape clause); ii) a new defence instrument to provide loans at attractive rates to members states, up to €150bn and related to defence equipment; iii) the ability to use unused EU cohesion funds (€93bn cumulatively over 2025-27) for defence-related projects (build up of production capacity). They are also expected to call for increased defence investments from the European Investment Bank, as well as commercial banks and capital markets. EU leaders will also urge the EC to cut back on red tape, lower energy prices, and complete the Savings and Investment Union.

- **This week in data.** The agenda this week is also light on data. The final release of February HICP inflation should not bring any surprises (headline inflation at 2.4% yoy, core inflation at 2.6%). We expect low energy inflation to push headline inflation to just above 2.0% yoy by end-2025. March consumer confidence should continue improving to levels close to its long-term average, consistent with our view that consumption has now become the main engine of growth in the euro area. In France, we expect business confidence to stay weak at the end of 1Q, against a backdrop of fiscal tightening and still-high political uncertainty.

Euro area economic calendar

Day	Country	Data	Period	Previous	SGf	Consensus
Tue	Germany	ZEW Survey Expectations	Mar	26.0	39.0	50.3
	Germany	ZEW Survey Current Situation	Mar	-88.5	-80.0	-80.5
Wed	Euro area	CPI (% YoY)	Feb F	2.5	2.4	2.4
	Euro area	CPI (% MoM)	Feb F	0.5	0.5	0.5
	Euro area	CPI Core (% YoY)	Feb F	2.6	2.6	2.6
Fri	France	Business Confidence	Mar	96	95	96
	France	Manufacturing Confidence	Mar	97	96	97
	France	Production Outlook Indicator	Mar	-15	-15	-13
	France	Own-Company Production Outlook	Mar	6	4	6
	Euro area	Consumer Confidence	Mar P	-13.6	-12.9	-13.0


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