January 14, 2025

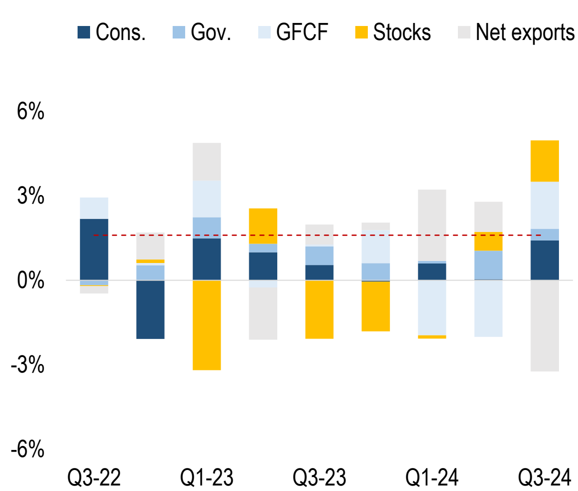
Will the Euro area bounce back?

Green shoots – Economic activity in the Euro area has fared very poorly over the past two years, hard hit by soaring energy costs and tightening liquidity. Since the ECB started raising rates and shrunk its balance sheet (resulting in a sharp drop in credit availability), Western Europe has only grown above trend in two out of nine quarters.

Weak growth in 2023 partly reflected a sharp inventory drawdown, but last year's weakness was primarily due to muted growth in household spending and business investment (F1). In addition, the region's large industrial base has failed to benefit from EUR depreciation, as German factories continue to grapple with high costs and flagging productivity. Indeed, notice from F2 that German manufacturing has entirely decoupled from the global economic cycle.

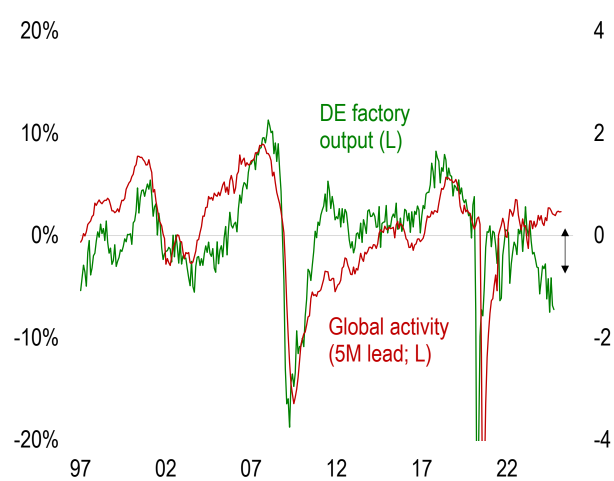
In an encouraging sign, private spending picked up in Q3, allowing the EZ to grow near trend. This reflects improved expectations as real wages recovered, and we expect this trend to continue throughout 2025 (F3). The improvement in fixed investment, in contrast, appears less sustainable, stemming almost entirely from very volatile spending on intellectual property. Larger categories, like housing construction or spending on machinery and transport equipment remained under pressure by a combination of high real rates and very weak business sentiment.

F1: Activity has been hugely disappointing
EZ GDP growth by component (QoQ SAAR)



Note: Chart breaks down the contribution of consumer, government spending, fixed investment, inventories and net exports to real GDP growth in the Euro area. Dashed red line is trend growth (1.6%). Source: Eurostat.

F2: Germany's industrial woes hurting EZ
DE manufacturing vs. Numera activity index



Note: Chart plots cyclical fluctuations in DE manufacturing to 5M prior changes in Numera's global activity index, a frequency proxy of the global business cycle. Both series shown as deviations from trend. Source: Numera Analytics.

T1: Baseline	Quarterly					Annual				
	Q1/24	Q2/24	Q3/24	Q4/24	Q1/25	2022	2023	2024[e]	2025f	2026f
World GDP	2.6%	2.6%	2.9%	2.5%	1.9%	3.1%	2.6%	2.5%	2.4%	2.2%
Euro Zone	1.2%	0.9%	0.6%	1.0%	0.9%	3.3%	0.5%	0.7%	1.0%	1.2%
Other DMs	1.4%	2.3%	2.4%	1.7%	1.0%	2.7%	2.1%	1.9%	1.5%	1.1%

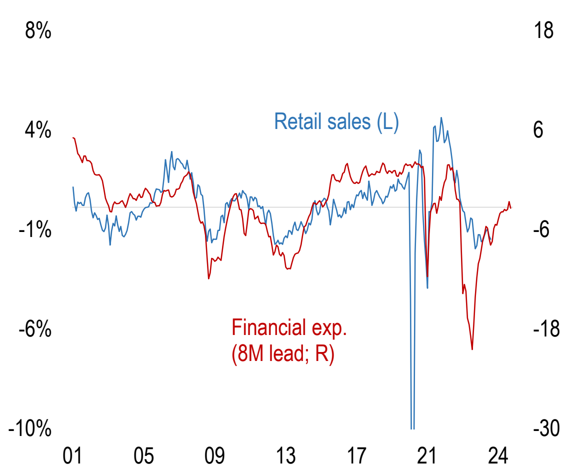
Note: Quarterly figures are QoQ SAAR (%). Source: History: World Bank; Forecast: Numera Analytics

Will overall activity in the Euro area pick up this year? F4 shows our latest probability forecast for EZ growth. The most likely outcome is a 1% gain, with a 62% chance of stronger growth than in 2024. Notice, however, that above potential (1.6%+) growth remains unlikely, preventing regional activity from catching up to its pre-COVID path.

We expect consumers to act as the main source of support, but weak industrial activity should moderate overall gains. One important source of risk, in this regard, are potential trade disruptions from protectionist measures by the US. The US is the largest export market for the EZ, making up for 20% of external revenues. Leading indicators also point to continued downward pressure on German factories, who are struggling to compete in international markets.

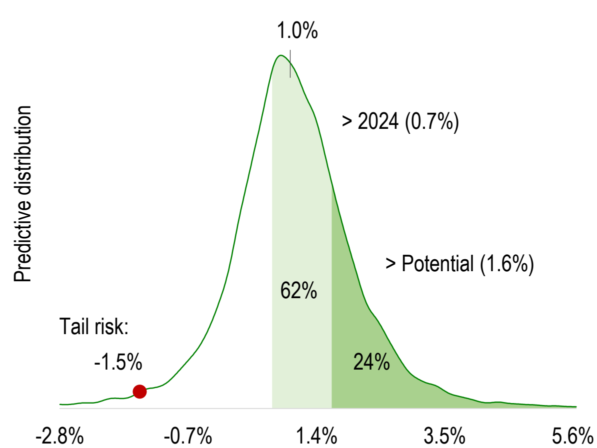
What about ECB policy? – The ECB has so far cut rates faster than other major central banks, a key factor behind recent euro weakness. Monetary policy, however, remains in contractionary territory. We estimate that real policy rates are around 100 bps above ‘neutral’, implying that the ECB would have to cut four times more to stimulate demand. Credit supply, in turn, has only recently started to rise after two years of a very adverse credit impulse.

F3: Spending should pick up this year
EZ retail sales vs. financial expectations



Note: Chart compares cyclical fluctuations in EZ real retail sales against 8M prior changes in consumer expectations of their personal financial situation. Source: European Commission, Numera Analytics on Eurostat data.

F4: Enabling a modest rebound in growth
EZ real GDP growth outlook - 2025 (%)



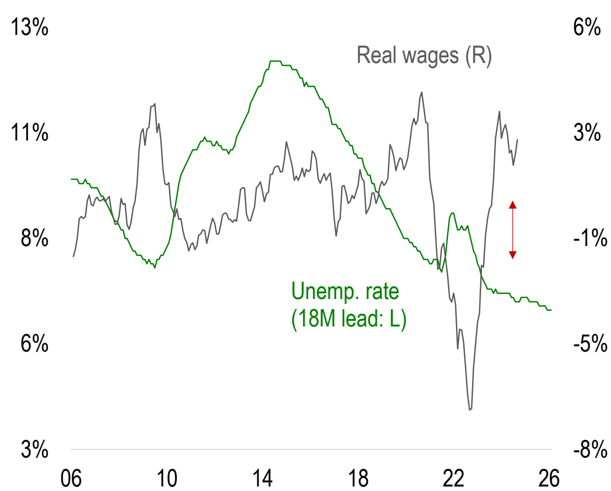
Note: There is a 62% chance that EZ GDP grows faster than in 2024, and a 1.6% probability that growth exceeds its long-term trend (1.6%). Should the economy contract, the worst potential outcome is a 1.5% loss. Source: Numera Analytics.

Whether the ECB continues to cut at a rapid clip depends primarily on the inflation outlook. However, activity has taken a more important role in recent years, through the ECB's secondary goal of 'balanced economic growth'. As for inflation, private forecasters generally expect it to fall below target next year. In this context, markets are pricing aggressive ECB easing, expecting five additional cuts in 2025 for a total of eleven since last year's pivot.

In contrast, our models are picking up higher inflation risks. One important reason for this are tight job market conditions, with unemployment at an all-time low despite subdued demand. Importantly, unemployment in the Euro area leads wage growth by well over a year, pointing to ongoing pricing pressures (F5). Similarly, inflation expectations – while trending down – remain well above historical standards, limiting downside risks on core service inflation.

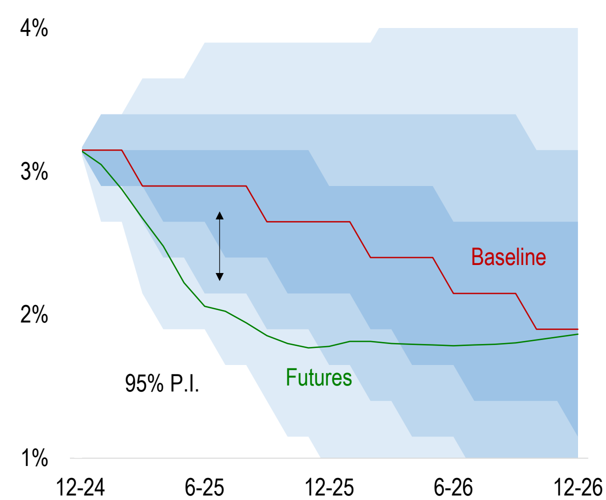
Taken together, these factors translate into a baseline forecast for headline inflation of 2.4% (while market consensus is 1.9%), with only a 26% chance that inflation falls below target. The fact that spending will likely bounce back should also limit the incentive to cut aggressively, partly because this reduces the likelihood of a surge in unemployment.

F5: EZ job market is exceptionally tight
EZ real wage growth vs. unemployment rate



Note: Chart compares real wage growth in major EZ countries against 18M prior changes in the EZ-wide unemployment rate. Source: Numera Analytics, Eurostat.

F6: ECB should slow its pace of easing
ECB main refinancing rate vs. €STR futures



Note: Probability forecast for ECB main refinancing rate against €STR futures. Fan chart denotes 50 / 80 / 95% prediction intervals. Source: Numera Analytics, ICE.

F6 compares our updated forecast for the ECB main refinancing rate against market expectations. In line with markets, we find a high (77%) probability that rates fall further in 2025, and eventually drop below 2% (pushing real rates below neutral). However, notice that the speed of easing differs significantly: While investors expect four cuts in H1, we find that the macro outlook points to a more gradual response amid persistent inflation and low unemployment.

This has important FX implications. The euro fell 6% last year, owing to large growth and expected rate differentials. Traditional macro models point to a reversal in this trend this year, partly due to a high probability of more Fed cuts than the market anticipates. However, this ignores the impact of tariffs, historically associated with a stronger dollar. Accounting for trade uncertainty, we find that the EUR should trade near current levels, with a 53% chance of depreciation. This is 8-points lower than the post-GFC average, suggesting currency risks are broadly contained.

Growth Outlook:

- **All DM** – *Below trend*. Developed market (DM) economies are estimated to have grown by 1.6% last year, a solid outcome considering weak performance outside the US. However, for 2025, DM growth is expected to decelerate, with the US slowing while other DMs improve, supported by lower interest rates, easing inflation, higher real wages, and increased consumption. Overall, we anticipate DM growth to slow to 1.3% in 2025.

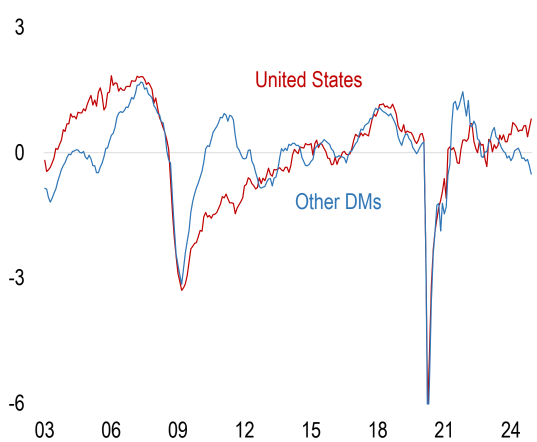
- **Eurozone** – *Recovery*. The Eurozone continues to show signs of a modest rebound following recent economic stagnation, while Germany has likely reached its lowest point and is set for a gradual recovery. However, persistent inflation and a tight labor market are expected to limit interest rate cuts, delaying a return to potential growth. Our baseline projects Eurozone growth to accelerate to 1% this year, up from an estimated 0.7% in 2024.

- **United States** – *Late cycle*. The US economy is projected to finish 2024 with 2.7% growth, continuing its "exceptionalism" as the only developed market consistently exceeding its potential growth rate. However, this momentum is expected to wane in 2025, with early signs of labor market cooling signaling a slowdown. We forecast US growth to slow to 1.5% next year and see just a 16% chance of meeting the consensus forecast of 2%.

- **All EM** – *Resilience*. Emerging markets (EMs) likely grew by 4.1% in 2024, outperforming developed markets (DMs) but still below potential. In 2025, resilience is expected to continue, driven by Beijing's policy stimulus, India still growing above potential, Brazil's overheated economy, and favorable terms of trade supported by rising commodity prices. These dynamics should lift EM growth to 4.2%, moving it closer to its potential rate.

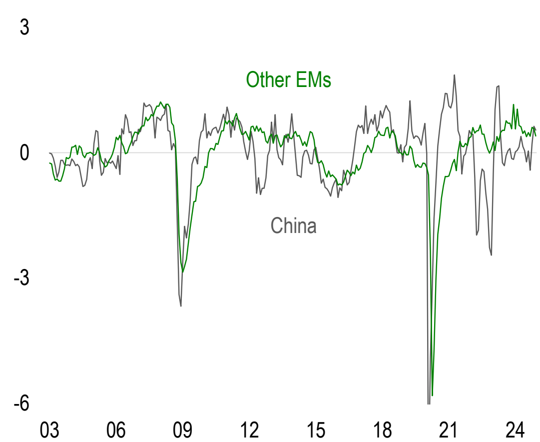
- **China** – *On target*. China's sluggish performance in Q2 and Q3 of 2024 is expected to result in 4.7% annual growth, falling slightly short of Beijing's 5% target. This shortfall has prompted an aggressive fiscal and monetary policy response, designed to restore target growth. While we expect China to meet its 5% growth target in 2025, the oversupply in the housing market remains a key obstacle to achieving a sustained recovery.

F7: Numera DM real activity indices
Deviations from slow-moving trend (Z-scores)



Note: The real activity indices capture common fluctuations in a large panel of country or region-specific economic indicators. Source: Numera Analytics.

F8: Numera EM real activity indices
Deviations from slow-moving trend (Z-scores)



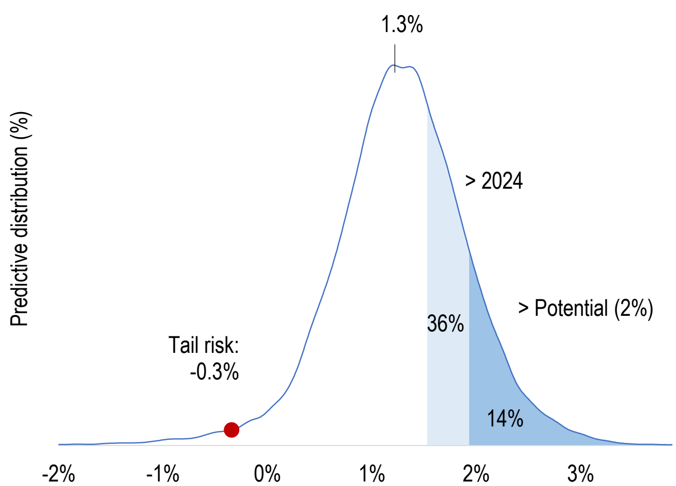
Note: The real activity indices capture common fluctuations in a large panel of country or region-specific economic indicators. Source: Numera Analytics.

T2: DM GDP	Baseline outlook			2025 probabilities (%) Downside risk[1]		Upside		Potential[2]
	2024[e]	2025f	2026f	Growth-at-risk	Recession	> 2024	> potential	
All DM	1.6%	1.3%	1.1%	-0.3%	14%	36%	14%	2.0%
Australia	1.5%	2.4%	1.9%	-0.2%	19%	78%	52%	2.4%
Canada	0.9%	1.6%	2.2%	-2.7%	25%	71%	35%	2.1%
Eurozone	0.7%	1.0%	1.2%	-1.5%	31%	62%	24%	1.6%
France	1.1%	1.1%	1.2%	-2.9%	33%	46%	36%	1.4%
Germany	0.0%	0.6%	1.0%	-2.6%	50%	68%	19%	1.6%
Italy	0.4%	0.3%	0.4%	-4.9%	59%	45%	43%	0.5%
Japan	-0.3%	0.8%	0.6%	-1.4%	47%	86%	47%	0.9%
South Korea	2.2%	1.9%	2.5%	-1.0%	16%	37%	20%	2.9%
United Kingdom	0.8%	1.2%	1.4%	-0.8%	20%	75%	9%	2.2%
United States	2.7%	1.5%	0.9%	-1.1%	24%	6%	16%	2.3%

1. Growth-at-risk refers to expected GDP growth below the 5% quantile, indicating maximum potential output losses. Recession defined as 2+ quarters of contraction.

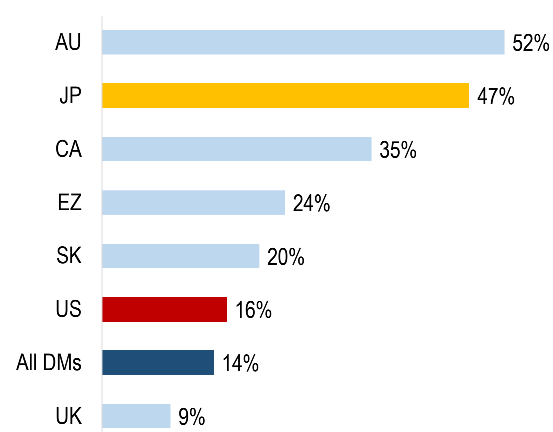
2. Potential growth refers to an economy's sustainable growth path. For the EZ and US, Numera estimates, for other DMs, 2012-19 CAGR.

F9: DM GDP outlook
Real GDP growth (%) - 2025



Note: There is a 36% probability that DM GDP grows faster than in 2024, and a 14% chance that it exceeds its trend rate of growth. Should DM GDP contract, the worst potential outcome is a 0.3% drawdown. Source: Numera Analytics.

F10: Likelihood of above potential growth
Probabilities by DM region - 2025 (%)



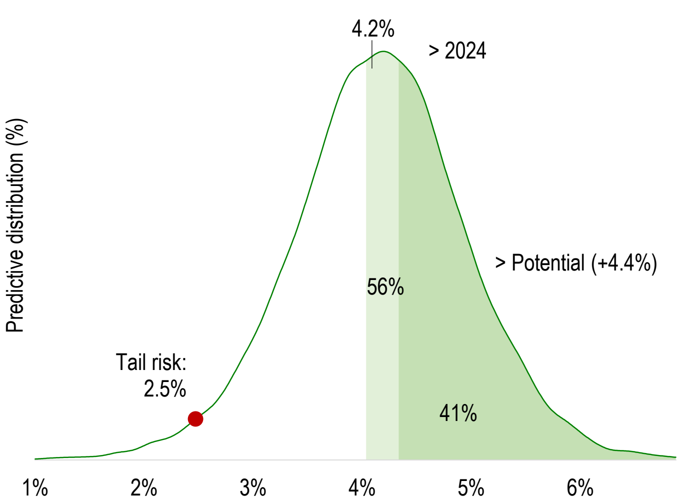
Note: Chart compares the likelihood that real GDP grows faster than potential (2012-19 CAGR) in full-year 2025. Source: Numera Analytics.

T3: EM GDP	Baseline outlook			2025 probabilities (%): Downside risk[1]		2025 probabilities (%): Upside		Potential[2]
	2024[e]	2025f	2026f	Growth-at-risk	Recession	> 2024	> potential	
All EM	4.1%	4.2%	4.0%	2.5%	1%	56%	41%	4.4%
EM Asia	5.2%	5.5%	5.0%	3.1%	1%	62%	43%	5.7%
China	4.7%	5.0%	4.6%	1.8%	2%	60%	14%	6.2%
India	6.5%	6.9%	6.4%	-0.5%	19%	58%	53%	6.8%
Indonesia	5.0%	5.0%	5.1%	0.7%	3%	53%	49%	5.1%
EMEA	2.9%	2.5%	2.9%	-2.4%	25%	42%	52%	2.3%
Russia	3.5%	1.7%	1.9%	-3.0%	31%	16%	67%	0.9%
Turkey	3.4%	2.9%	4.4%	-5.1%	32%	43%	29%	4.9%
Latin America	2.2%	2.2%	1.8%	0.2%	18%	49%	76%	1.6%
Brazil	3.2%	2.6%	1.8%	1.1%	11%	21%	97%	1.2%
Mexico	1.3%	1.5%	1.5%	-1.0%	43%	58%	32%	2.1%

1. Growth-at-risk refers to expected GDP growth below the 5% quantile, indicating maximum potential output losses. Recession defined as 2+ quarters of contraction.

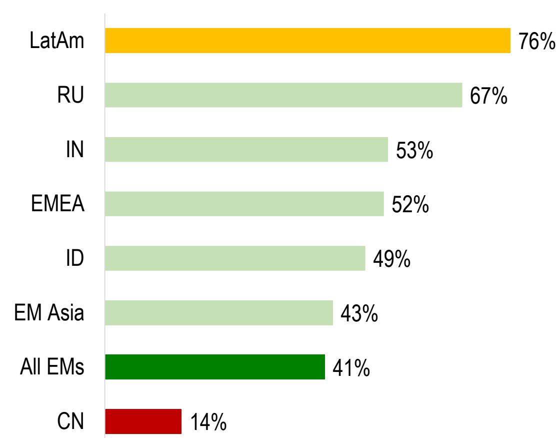
2. Potential growth refers to an economy's sustainable growth path. For all EMs, 2012-19 CAGR.

F11: EM GDP outlook
Real GDP growth (%) - 2025



Note: There is a 56% probability that EM GDP grows faster than in 2024, and a 41% chance that it exceeds its trend rate of growth. Should EM GDP growth decelerate, the worst potential outcome is a 2.5% growth rate. Source: Numera Analytics.

F12: Likelihood of above potential growth
Probabilities by EM region - 2025 (%)



Note: Chart compares the likelihood that real GDP grows faster than potential (2012-19 CAGR) in full-year 2025. Source: Numera Analytics.

Inflation Outlook:

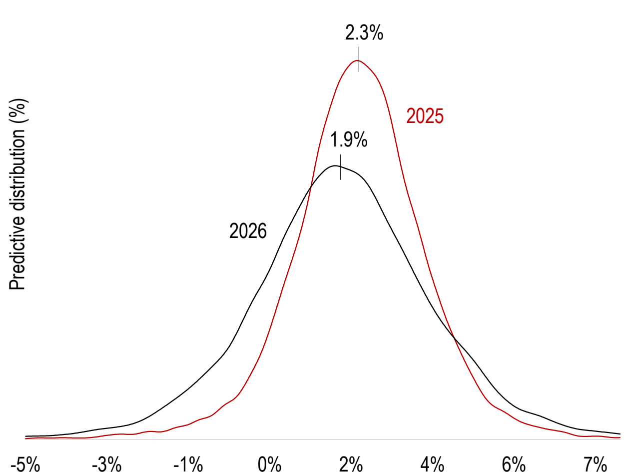
- **Producer prices** – *Easing ahead*. PPI inflation surged to nearly 8% early last year, driven by elevated freight rates and higher commodity prices. However, since June, PPI inflation has been normalizing, settling at around 4%. We expect this trend to continue, with PPI inflation forecast to ease further to 2.3% this year.

- **Consumer prices** – *Above target*. CPI inflation in most developed markets (DMs) has been on a downward trajectory due to tight monetary conditions. This enabled central banks to begin easing policy in 2024, resulting in an estimated CPI inflation rate of 2.6%. We anticipate the disinflationary process to continue, projecting 2.3% for 2025. However, potential tariff impositions by Trump skew risks to the upside moving forward.

				2025 probabilities (%)			
T4: Inflation	Baseline outlook			Deflationary risk		Inflationary risk	
	2024[e]	2025f	2026f	5% quantile	Deflation	> 2024	> target (2%)
DM CPI	2.6%	2.3%	2.1%	1.6%	0%	21%	-
Canada	2.4%	1.9%	1.8%	0.6%	1%	24%	43%
Eurozone	2.4%	2.4%	1.9%	1.5%	0%	50%	74%
Japan	2.7%	2.6%	1.9%	1.2%	0%	53%	78%
United Kingdom	2.6%	2.3%	1.9%	1.3%	0%	30%	69%
United States (PCE)	2.5%	2.2%	2.1%	1.1%	0%	28%	57%

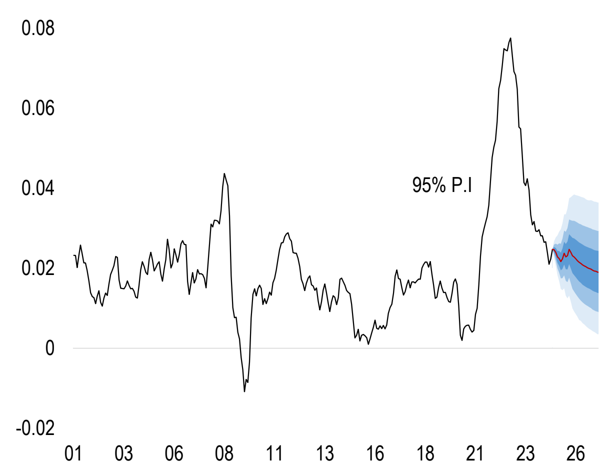
Source: History: Numera Analytics, government agencies; Forecast: Numera Analytics

F13: World PPI inflation
Probability forecasts - 2025/26



Note: Baseline scenarios are the mean of the predictive distribution for 2025 and 2026.
Source: Numera Analytics.

F14: DM CPI inflation
Year-on-year (%)



Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

Currency Outlook:

- **CAD per USD** – *Neutral*. Most currencies experienced significant devaluations in late 2024, driven by heightened trade-related uncertainty following Trump's victory. Although the loonie depreciated 7% since September, we anticipate a recovery in Canadian growth and higher oil prices to support the CAD 12M out.

- **EUR per USD** – *Neutral*. The euro is down 7% since September, driven by expectations of tariffs and markets pricing in rapid ECB cuts. Moving forward, elevated trade policy uncertainty points to modest EUR depreciation 12M out (F15), but downside risks are largely contained as US-EZ growth and rate differentials should narrow.

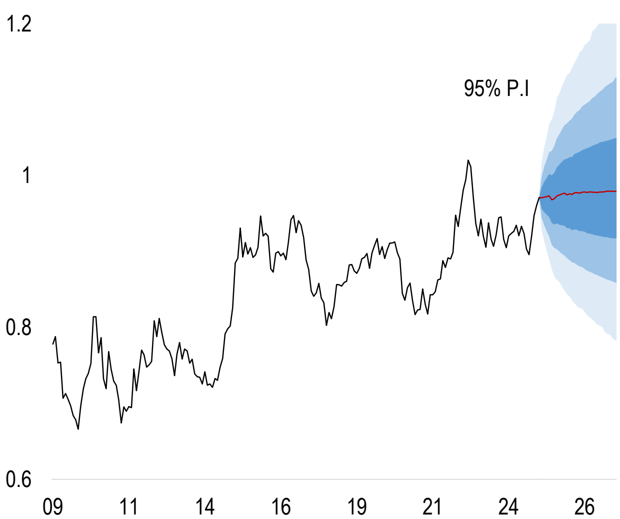
- **GBP per USD** – *Neutral*. The pound depreciated 8% since September amid rising trade uncertainty. Improved post-election sentiment, lower inflation, and higher growth in the UK are expected to support the GBP, even with more rate cuts on the horizon. Indeed, we expect the GBP to remain flat at 0.8 per USD over the next 12 months.

- **JPY per USD** – *Overweight*. The yen depreciated nearly 13% since September, making it the weakest-performing major DM currency. However, this trend is expected to reverse as the Bank of Japan (BOJ) continues normalizing interest rate policy. We forecast the JPY to gradually strengthen, reaching 155 per USD over the next 12M.

- **BRL per USD** – *Neutral*. The Brazilian real was one of the worst-performing EM currencies last year, depreciating almost 30% in 2024. However, this sharp depreciation has pushed the BRL below its fair value. As such, we see limited downside for the BRL and expect only a mild weakening to 6.3 per USD in the next 12 months.

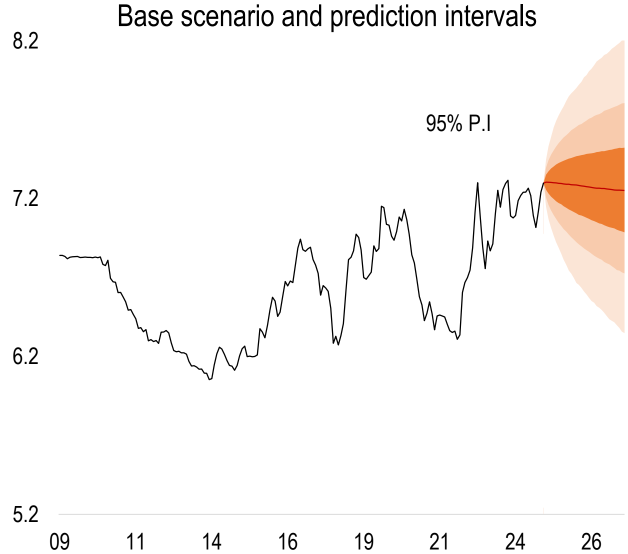
- **CNY per USD** – *Neutral*. The Chinese yuan depreciated over 4% since September despite its historically low volatility. While Beijing implements an aggressive policy mix to stimulate growth, stronger economic activity is expected to stabilize the CNY, pointing to a largely sideways movement over the coming year.

F15: EUR per USD outlook
Base scenario and prediction intervals



Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

F16: CNY per USD outlook
Base scenario and prediction intervals

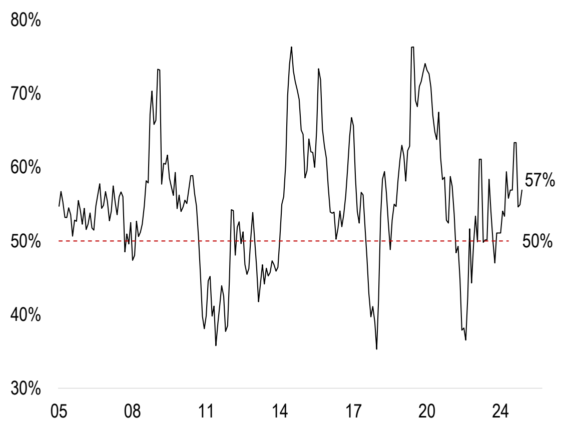


Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

T5: DM currencies Currency per USD	Baseline outlook 01/25	3M	12M	12M probabilities (%) > 5% Dep.	Currency appreciation	> 5% App.
Canadian dollar	1.44	1.44	1.43	17%	57%	27%
Euro	0.97	0.97	0.98	27%	47%	21%
UK pound	0.80	0.80	0.80	27%	51%	28%
Japanese yen	157	157	155	22%	57%	33%

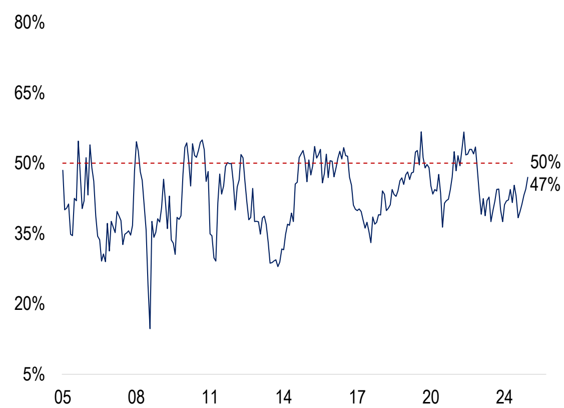
Note: Probability of individual DM currencies appreciating against the US dollar over a 12M horizon. Source: Numera Analytics

F17: CAD appreciation (vs. USD)
12M ahead probability (%)



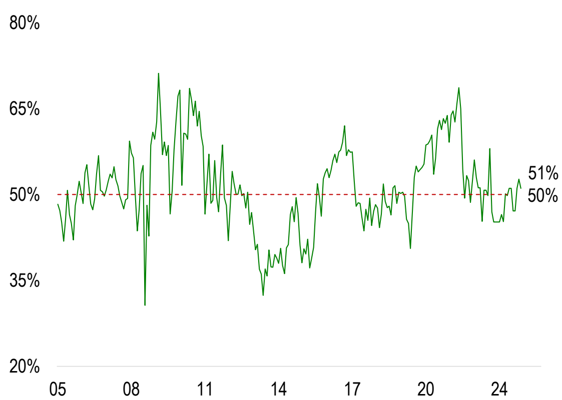
Note: Likelihood of CAD strengthening against the USD 12M out. Probabilities above 50% indicate CAD appreciation is the most likely outcome. Source: Numera Analytics.

F18: EUR appreciation (vs. USD)
12M ahead probability (%)



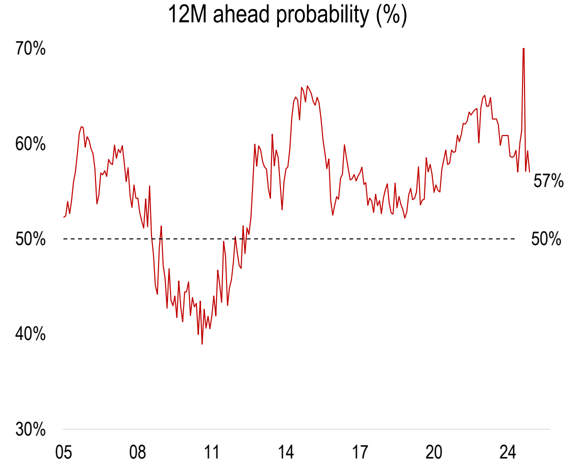
Note: Likelihood of EUR strengthening against the USD 12M out. Probabilities above 50% indicate EUR appreciation is the most likely outcome. Source: Numera Analytics.

F19: GBP appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of GBP strengthening against the USD 12M out. Probabilities above 50% indicate GBP appreciation is the most likely outcome. Source: Numera Analytics.

F20: JPY appreciation (vs. USD)
12M ahead probability (%)

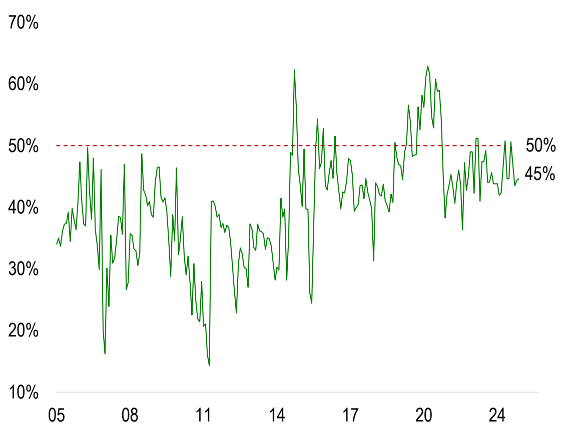


Note: Likelihood of JPY strengthening against the USD 12M out. Probabilities above 50% indicate JPY appreciation is the most likely outcome. Source: Numera Analytics.

T6: EM currencies	Baseline outlook			12M probabilities (%)		
Currency per USD	01/25	3M	12M	> 5% Dep.	Currency appreciation	> 5% App.
Brazilian real	6.17	6.21	6.29	32%	45%	23%
Chinese yuan	7.30	7.30	7.29	9%	52%	10%
Mexican peso	20.2	20.2	20.6	27%	37%	10%
Indian rupee	85.1	85.3	86.0	13%	36%	7%

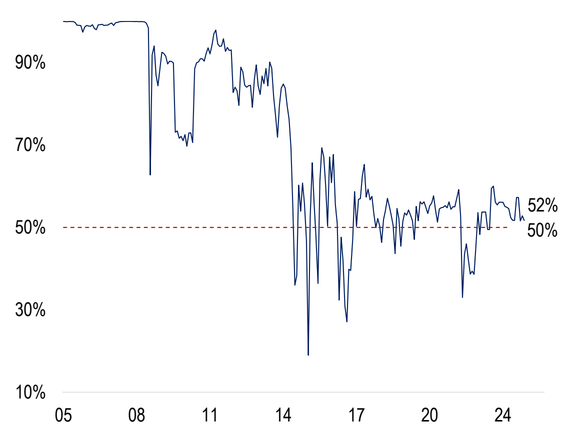
Note: Probability of a given EM currency appreciating against the US dollar over a 12M horizon. Source: Numera Analytics

F21: BRL appreciation (vs. USD)
12M ahead probability (%)



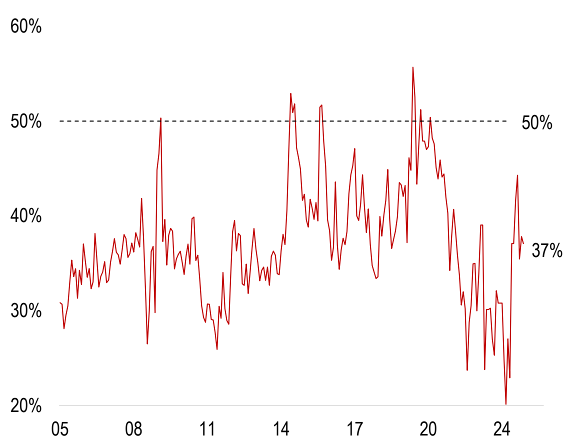
Note: Likelihood of BRL strengthening against the USD 12M out. Probabilities above 50% indicate BRL appreciation is the most likely outcome. Source: Numera Analytics.

F22: CNY appreciation (vs. USD)
12M ahead probability (%)



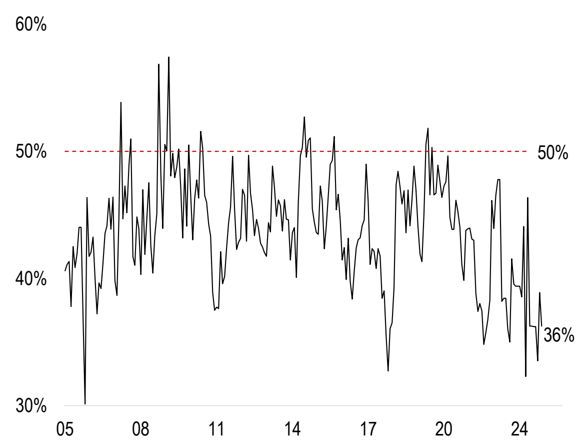
Note: Likelihood of CNY strengthening against the USD 12M out. Probabilities above 50% indicate CNY appreciation is the most likely outcome. Source: Numera Analytics.

F23: MXN appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of MXN strengthening against the USD 12M out. Probabilities above 50% indicate MXN appreciation is the most likely outcome. Source: Numera Analytics.

F24: INR appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of INR strengthening against the USD 12M out. Probabilities above 50% indicate INR appreciation is the most likely outcome. Source: Numera Analytics.