

Stagnant eurozone economy faces more headwinds

The eurozone economy stagnated in the fourth quarter of 2024. There are some signs of stabilisation, but a significant recovery seems unlikely due to potential trade conflicts with the US. Meanwhile, inflation is decreasing more slowly than anticipated, indicating that the ECB's monetary policy easing will proceed very gradually



Right now, only thing appears to be certain for the eurozone: more uncertainty

Stagflationary pressures from trade conflict

The new year has brought new ambitions in Europe. The European Commission has launched its "Competitiveness Compass," a plan to implement some of Draghi's recommendations. Among the action points are cutting red tape, lowering barriers to the single market, and making the European capital market more efficient. These measures are certainly needed given the headwinds the eurozone economy is currently facing.

It now seems almost certain that US President Donald Trump is planning to levy increased import tariffs on European goods. Whether he will wait until his administration has finished a comprehensive report on US trade policy (deadline 1 April) remains to be seen, but chances are

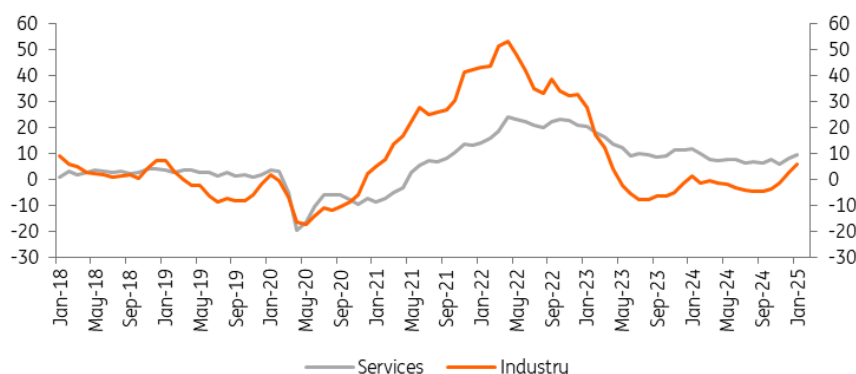
high that the US will impose tariffs on the EU in the second quarter. The EU will likely react with specific retaliations while trying to appease Trump with promises of more LNG and weapons purchases. One thing is certain: more uncertainty. This might weigh on business investment. We anticipate that some exports will be shifted to the first quarter, with some weakening likely hereafter. Even if we are not yet on course for a full-blown trade war, the skirmishes are already stagflationary in nature; growth will be negatively affected, while retaliatory tariffs in Europe are inflationary.

No significant improvement to be expected

The eurozone ended the year on a weak note, with GDP stagnating in the fourth quarter and even contracting in France and Germany. Both the PMI and the European Commission's sentiment indicator slightly increased in January, though they remain at depressed levels. While this seems to point to a bottoming out of the economic cycle, the weak orders component in the survey does not indicate a significant acceleration in the short run. We have slightly tweaked our quarterly growth profile, but our growth forecast for this year remains unchanged at 0.7%. Due to a weaker carry-over effect, we had to lower our 2026 GDP growth forecast to 1.2%.

Selling price expectations are rising again

Business survey: Selling price expectations (divergence from long-term average)



LSEG Datastream

Inflation falling less rapidly than anticipated

The flash estimate of January's harmonised index of consumer price (HICP) inflation came in at 2.5%, the fourth increase in a row. Core inflation remained at 2.7%, with services prices rising 3.9% year-on-year. Most wage trackers are now starting to show a deceleration in wage growth, and the European Central Bank relies on this trend and on tighter profit margins for inflation to return to target. We agree that the inflation trend is still downward, but the further decline in inflation is unlikely to be smooth. Energy and food prices are expected to add to inflation in the coming months. Potential import tariffs are also inflationary. In the European Commission's Business Survey, selling price expectations increased in all major sectors (manufacturing, services, retail, and construction) in January and are now all above their historical averages. Taking this into account, we increased our inflation forecast to 2.4% for 2025 but kept it at 2.2% for 2026.

ECB to continue with gradual monetary easing

The ECB cut interest rates again by 25 basis points in January, bringing the deposit rate to 2.75%. While inflation was still above target, the ECB justified this by stating that monetary policy is still restrictive. However, the closer it comes to the mythical “neutral rate,” deemed to be around 2%, the more cautious the ECB is likely to become. In the wake of weak growth, we do not exclude the possibility of the ECB adopting a slightly expansionary monetary policy, but this will be the end stage of a very gradual process. We therefore expect a 25bp rate cut at every policy meeting to reach 1.75% by summer. Barring a major crisis, the ECB is unlikely to cut any further than this.

Author

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.