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THINK Ahead: More spending, more growth? Don’t be so sure

Governments on both sides of the Atlantic are turning on the taps when it comes to fiscal stimulus. But will that really propel growth and interest rates higher, like we saw after the Covid pandemic? James Smith isn’t so convinced. Buckle up as our team guides you through another big week for markets

If 2020 showed us how government spending really matters, then 2025 will prove that how it's spent matters even more

More spending, more growth? Don’t be so sure

Can you believe it's been five years since the Covid-19 pandemic kicked off? Those cringey TikTok dances and depressing Zoom ‘socials’ may seem like a distant past. But the seismic economic shifts? I suspect they’re still etched firmly into the memory of the world’s central bankers.

Above all, the pandemic period reminded us just how powerful governments can be in driving economic growth, in a way that monetary policymakers can frankly only dream of.

Just think of those US stimulus checks, or more recently, the vast quantities of cash European governments spent shielding households from higher gas prices. Interest rates are still so high in no small part because of those bold policies.

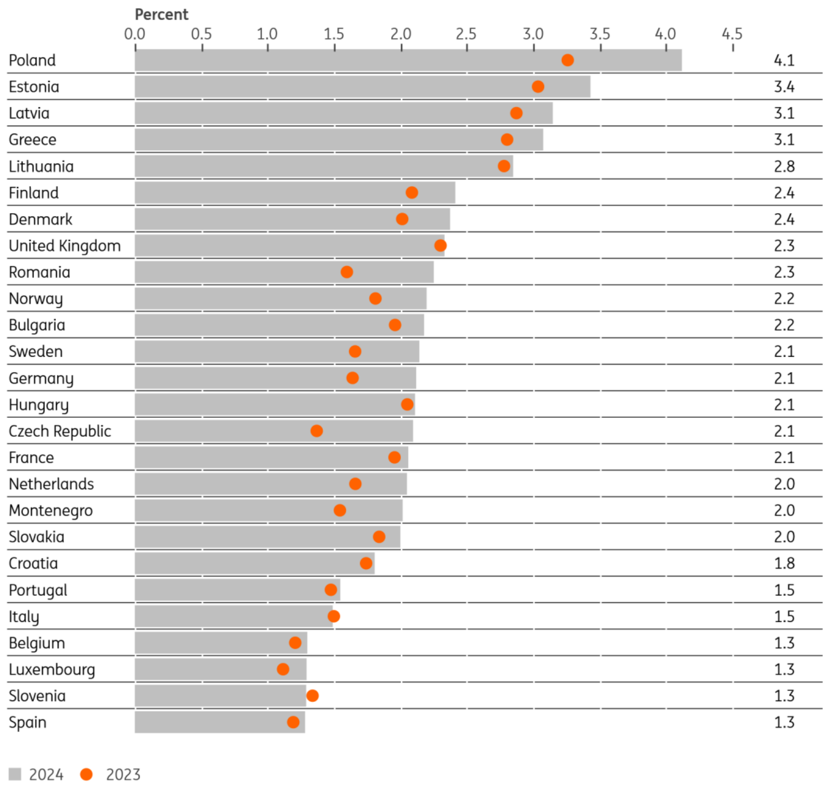
But here’s the thing: maybe fiscal stimulus is losing its bite. As Europe mulls over more defence spending, or Washington touts multi-trillion dollar tax cuts, I can't help thinking that the impact on economic growth might not be nearly as game-changing this time around.

Take Europe and its ambitions to boost NATO spending. Carsten has a nice explainer on how the continent might pay for it, and two of his statistics really stand out. One, if – a big if – NATO spending expands from 2% of GDP to 4%, it would cost Europe EUR 340bn extra per year. And two, since Russia's invasion of Ukraine, 80% of European defence procurement was sourced outside the EU.

European leaders are waking up to the fact that they need their own domestic supply chain. But that's a multi-year exercise and the reality is any immediate spending increases are going to be largely spent beyond Europe's borders.

In short, that extra spending probably won't give the European economy the shot in the arm it so dearly needs – or at least not over the sort of time horizon the European Central Bank is interested in. And if extra defence spending means austerity elsewhere, we could actually see the opposite.

Chart of the week: NATO defence spending (% of GDP)



Source: NATO
2023 and 2024 are estimated by NATO

For now, nothing has formally changed. And until it does, Carsten makes the point that the ECB can only act on official government policy. He's still expecting the ECB to take the deposit rate down to 2% and probably below.

The more immediate headache for the ECB is the bond markets. Debt issuance looks set to rise, regardless of how the European Commission decides to relax the rules surrounding the Stability and Growth pact. In the absence of pan-European borrowing, the risk is that sovereign debt concerns bubble back to the surface, which our Rates Strategy team warns could morph into wider spreads between member states. In an extreme scenario, as Carsten writes, we know the playbook: increased asset purchases from the ECB.

All of this bears some resemblance to what's happening over in Washington. US President Donald Trump has this week endorsed a budget blueprint touted by the House of Representatives, which if passed, would unlock $4.5 trillion extra in tax cuts over the next decade.

That's a big number, but speaking to our US expert James Knightley, it's one that could be entirely eaten up by the cost of extending Trump's 2017 tax cuts beyond this year. And remember, that extension would make no actual difference to household income.

If the Republicans want to create new tax cuts on top – exempting tips and overtime from income tax, to give two prominent examples – more funding is going to be needed.

That could be a challenge. Under Washington's complicated system of budget reconciliation, any new fiscal stimulus would need to be deficit-neutral over a 10-year period. In practice, big savings or extra revenue will be needed to offset the extension or even expansion of tax cuts.

James K is sceptical of the government's ability to save the proposed $1.5 trillion, not least because of much of its is slated to come from the politically-sensitive Medicaid. For added context, even if every Federal worker were fired, James calculates the Treasury would barely save $230 billion per year in salary costs. And of course, that would leave nobody to run the government! Even if cuts on the scale proposed are achieved, the hit to economic growth could be noticeable.

That arithmetic and the need for extra money is one of the central reasons our team thinks sizeable tariffs are coming in the spring. And tariffs which aren't offset by meaningful tax cuts or a large dividend from deregulation could challenge the narrative of US exceptionalism as we go into 2026. That's partly why we think the Federal Reserve will still cut rates twice more in the second half of this year.

The bottom line is this: If 2020 showed us how government spending really matters, then 2025 will prove that how it's spent matters even more.

THINK Ahead in developed markets

United States (James Knightley)

- The most interesting data points will be out next Friday with the release of the January personal income and spending report. Retail sales were surprisingly weak, which was possibly cold weather-related with some marginal impact from LA fires, but the fact that we saw internet sales also drop suggests that the softer consumer confidence numbers may be translating into cooler spending. There are some signs of stress amongst lower income households with a record 11% of credit card holders only making minimum monthly payments. This report will add in services spending so we will see if that can provide some offset.
- **Inflation (Fri):** The report also includes the Fed's favoured inflation measure – the core personal consumer expenditure deflator. Core CPI came in far too hot for comfort at 0.4% month-on-month (and wasn't too far away from a 0.5% outcome). However, the

components that feed into the core PCE deflator from the CPI and PPI reports looked less threatening and the different weights for components included imply a more palatable 0.3% MoM outcome. Nonetheless, we need to be consistently averaging 0.17% MoM over time to bring inflation to the 2% year-on-year target, so we don't see any prospect of additional rate cuts until the September FOMC meeting at the earliest.

THINK Ahead for Central and Eastern Europe

Poland (Adam Antoniak)

- **Retail (Mon):** Goods spending remains subdued, but has improved after a poor third quarter. We expect the January retail sales reading to be similar to December, and 2025 household consumption growth to be close to 2024. That's despite slower disposable income growth, as consumers should tap savings amassed last year.
- **Unemployment (Tue):** Registered unemployment remains close to an all-time low and the increase in January's unemployment rate reflects purely seasonal factors. Many businesses still face shortages of skilled labour and with lower positive net migration and declines in the domestic working age population, workers remain scarce.
- **GDP composition (Thu):** We expect the StatOffice to confirm its flash estimate of fourth-quarter GDP for 2024 at 3.2% YoY alongside the breakdown. Seasonally adjusted data suggests that Polish economic growth gained momentum in the final months of 2024. Our estimates show an improvement in annual household consumption growth relative to the third quarter, while fixed investment growth remained slow. A further deterioration in foreign trade likely translated into a negative contribution of net exports, while a change in inventories contributed postively.

Hungary (Peter Virovacz)

- **Labour market (Tue/Thu):** We believe that the difficult business year will be reflected in lower one-off payments in December compared to a year ago. Against this backdrop, average wage growth is likely to slow further. The unemployment rate will rise in January due to seasonal and cyclical factors. Anecdotal evidence points to labour shedding in the manufacturing sector, which sooner or later will show up in the statistics.
- **Interest rates (Tue):** The National Bank of Hungary's stance is crystal clear: rate cuts are off the table, but it is too early to talk about hikes, especially given the recent HUF strengthening. The latest inflation data, including underlying inflation, has surprised on the upside. In contrast to previous months, when financial market instability was the main reason for caution, risk sentiment has improved significantly. But it can't outweigh the deteriorating inflation outlook. We expect the central bank to keep the base rate at 6.50%, with a repeat of last month's hawkish forward guidance.

Czech Republic (David Havrlant)

- **PPI (Tue):** Industrial price growth likely gained pace in January on a monthly basis, driven by increasing wage costs and a weaker koruna against the dollar. Meanwhile, annual price growth softened at the beginning of the year due to a high comparison base with the previous January. It is difficult for firms to pass increasing input costs on to their customers, given that lukewarm demand in European manufacturing amplifies price competition.
- **GDP (Fri):** The Statistical Office will likely confirm the previous GDP estimate, showing the economic rebound gaining traction. The expenditure breakdown is set to confirm the

consumer as the primary driving force.

Turkey (Muhammet Mercan)

- **GDP (Fri):** While we saw a technical recession through the second and third quarter, early indicators covering the last quarter of 2024 imply quarterly growth was positive. However, given the continued tight financial conditions, activity likely remained soft in the fourth quarter, with 2.0% YoY growth translating into a growth rate of 2.9% in 2024 as a whole.

Key events in developed markets next week

Country	Time (GMT)	Data/event	ING	Prev.
		Monday 24 February		
Germany	0900	Feb Ifo Business Climate	84.7	85.1
	0900	Feb Ifo Current Conditions	86.3	86.1
	0900	Feb Ifo Expectations	83.5	84.2
UK	-	BoE Lombardelli, Ramsden, Dhingra Speeches	-	-
Eurozone	1000	Jan CPI Final (YoY%)	-	2.7
		Tuesday 25 February		
US	1400	Dec Case-Shiller 20 (MoM%/YoY%)	0.2/4.2	0.4/4.3
	1500	Feb Consumer Confidence	103	104.1
Germany	0700	Q4 GDP 2nd Est. (QoQ%/YoY%)	-0.2/-0.2	-0.2/-0.4
UK	1400	BoE Pill Speech	-	-
Eurozone	1300	ECB Schnabel Speech	-	-
		Wednesday 26 February		
US	1500	Jan New Home Sales (mn)	0.68	0.698
	1700	Fed Bostic Speech		
Germany	0700	Mar GfK Consumer Sentiment	-22.8	-22.4
		Thursday 27 February		
US	1330	Initial Jobless Claims	225	219
	1330	Jan Durable Goods Orders (MoM%)	1.3	-2.2
	1330	Q4 GDP 2nd Est. (QoQ%)	2.3	2.3
Italy	0900	Feb Consumer Confidence	99.4	98.2
Spain	0800	Feb CPI (MoM%/YoY%)	-/-	0.2/2.9
Switzerland	0800	Q4 GDP (QoQ%/YoY%)	-/-	0.4/2
Eurozone	1000	Feb Economic Sentiment	-	95.2
	1230	ECB Minutes	-	-
		Friday 28 February		
US	1330	Jan Personal Income (MoM%)	0.3	0.4
	1330	Jan Personal Consumption (MoM%)	0.1	0.7
	1330	Jan Core PCE Price Index (MoM%)	0.3	0.2
	1445	Feb Chicago PMI	41.5	39.5
Germany	0700	Jan Retail Sales (MoM%/YoY%)	0.8/1.3	-1.6/1.8
	0855	Feb Unemployment Rate	6.2	6.2
	1300	Feb CPI (MoM%/YoY%)	0.5/2.2	-0.2/2.3
France	0745	Q4 GDP 2nd Est. (QoQ%/YoY%)	-/-	-0.1/0.7
	0745	Feb CPI (MoM%/YoY%)	-/-	-0.1/1.4
Italy	1000	Feb CPI (MoM%/YoY%)	-/-	0.6/1.5
Canada	1330	Q4 GDP (QoQ%/YoY%)	-/-	0.3/1.5
Sweden	0700	Q4 GDP 2nd Est. (QoQ%/YoY%)	-/-	0.2/1.1
Portugal	0930	Feb CPI (YoY%)	-	2.5
	1100	Q4 GDP 2nd Est. (QoQ%/YoY%)	-/-	1.5/2.7

Source: Refinitiv, ING

Key events in EMEA next week

Country	Time (GMT)	Data/event	ING	Prev.
		Monday 24 February		
Poland	0900	Jan Retail Sales (YoY%)	2	1.9
	1300	Jan M3 Money Supply (YoY%)	8.8	9.3
Croatia	1000	Jan CPI (YoY%)	3.6	3.4
		Tuesday 25 February		
Poland	1139	Jan Unemployment Rate	5.4	5.1
Hungary	0730	Dec Average Gross Wages (YoY%)	11.1	11.9
	1300	Interest Rate Decision	6.50	6.50
Czech Rep	0800	Jan PPI (MoM%/YoY%)	0.8/1.2	0.6/2.8
		Wednesday 26 February		
Russia	1600	Jan Industrial Output (YoY%)	5.2	8.2
Hungary	0730	Dec Trade Balance Final	387	387
		Thursday 27 February		
Turkey	0700	Jan Trade Balance	-7.7	-8.78
Poland	0900	Q4 GDP 2nd Est. (QoQ%/YoY%)	-/-	1.3/3.2
Hungary	0730	Jan Unemployment Rate	4.6	4.4
Croatia	1000	Q4 GDP (YoY%)	2.8	3.9
		Friday 28 February		
Turkey	0700	Q4 GDP (YoY%)	2	2.1
	0700	Jan Unemployment Rate	-	8.5
Czech Rep	0800	Q4 GDP 2nd Est. (QoQ%/YoY%)	0.5/1.6	0.5/1.6

Source: Refinitiv, ING

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