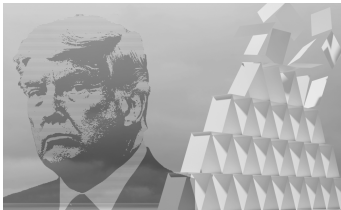


ING Monthly: Top Trumps and the global economy's House of Cards

Experiencing Trump's second term in office is akin to navigating the twists and turns of a political thriller like House of Cards

In this bundle



Top Trumps: the global economy's House of Cards

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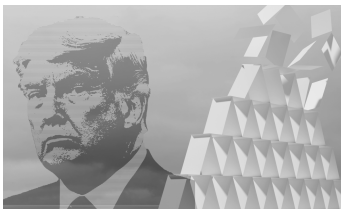


United States

Tariffs and other stuff pushing rates around

Tariffs are a complicated story, and could force rates down initially – but cumulatively they'll end up higher

By Padhraic Garvey, CFA



ING Monthly: Top Trumps and the global economy's House of Cards

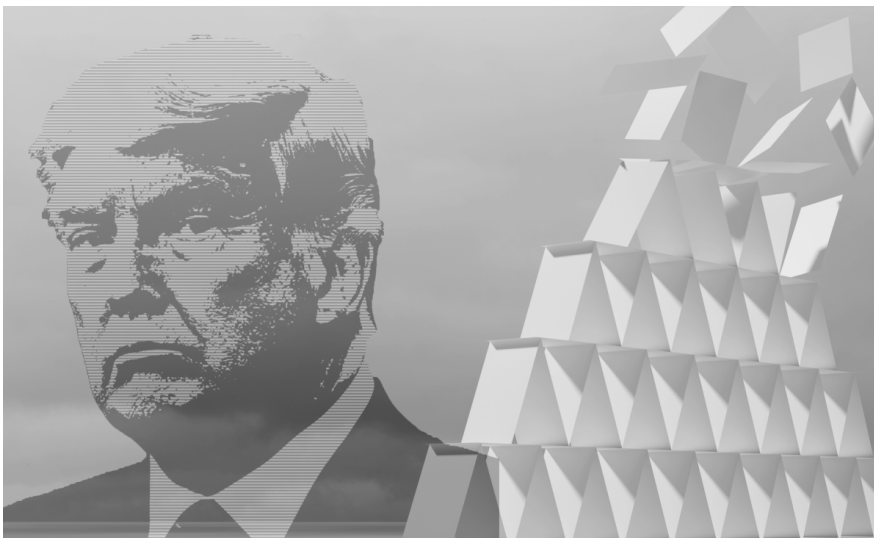
ING's February Economic Outlook focuses on Trump's second presidency and its impact on the global economy

By Carsten Brzeski

Article | 6 February 2025

Top Trumps: the global economy's House of Cards

The year has barely started and we are learning the hard way what Donald Trump's second term in office means for markets, analysts and global policymakers. It's like living through an episode of the political thriller, House of Cards



A throwback to the 'good' old days

Besides working extra hours and producing tons of analysis with a lifespan of only a few hours, the second Trump era seems to mean unpredictability, uncertainty and high volatility. The last few days were like a throwback to when I binged on 'House of Cards'. Each new move feels like a strategic power play, leaving the world in suspense and constantly on edge. One moment, you're in the middle of a political storm, and the next, there's a surprising twist that changes everything. The rest of the world is left trying to keep up with the unpredictable plot.

Admittedly, it is not entirely unpredictable, as the pattern emerging this week is very similar to the one we saw around 2018. It usually starts with some grand announcement, followed by an executive order to show seriousness, and then we wait to see if negotiations work or whether financial markets revolt. So, nothing new?

All the world's a stage

I'm not so sure. Even if the first round of tariff tensions ended like a storm that dissipated into a

gentle breeze, tariffs, to some, are not only the most beautiful word in the dictionary but, apparently, a powerful foreign policy instrument. In short, the last few days only marked stage one of Donald Trump's trade policies. Call it the "fentanyl phase", in which tariffs were only used to bring other countries to the table to deliver domestic policy successes in the fight against drugs and illegal immigration.

Stage two could then be called the "revenues and economics phase", in which trade policies will be used to finance domestic tax cuts. This is why we stick to our underlying assumption that, come April, the US administration will also threaten Europe with tariffs. And although, economically, the EU is larger and more powerful than Canada or Mexico, I doubt whether Europeans can work together to build a solid and coherent line of defence against overly aggressive US trade policies. Agreeing on retaliation tariff measures falls under the responsibility of the European Commission, but agreeing on any new European purchases of certain US products, be it LNG, military or agricultural goods, requires unity amongst European countries and governments. And that's something that rarely happens.

You couldn't make it up

Talking about European governments, don't forget that there is more in the world than Trump and tariffs. In two weeks from now, Europe will see a crucial vote: the German snap elections. For a long time, German politics have been a beacon of stability in Europe, but this has changed. Betting on the result, or even on which parties will form the next government, is something of a fool's game, not least because of the impact of the far-right AfD. It's polling well, which just goes to show that Germany has finally become a more 'normal' European country in the sense that populists are gaining ground here, too. And while the prospect of the AfD joining the government still looks a step too far right now, small changes in the results can have a major impact.

So, these elections and the posturing from Washington and beyond are rapidly shaping a new world order, which will determine not just Germany's future but also that of the European Union.

I admit it: I'm a political junkie, and I watch far too many TV series with seemingly outlandish plots and conspiracy theories. So, are the best Hollywood scripts no match for the real world of 2025? To quote from the original House of Cards series, *you might very well think that; I couldn't possibly comment...*

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Trump's whirlwind leaves the world breathless

US President Donald Trump is revelling in his return to the role of 'Dealmaker in Chief' as he pushes ahead with his low tax, light-touch, regulation-led growth agenda. Nonetheless, immigration controls, trade tariffs and government spending cuts pose challenges for the economy while re-shoring and regulatory changes will take time to gain traction



Quick out the blocks

President Trump's first few weeks in power have been a whirlwind of activity as he looks to push through with his promises of tax and spending cuts, trade tariffs, immigration controls and regulatory reforms. The sense that this policy mix would boost growth, but heighten the risk of more prolonged above-target inflation readings still holds, although views on the scale of the impact continue to evolve. So where do we stand right now?

Trump's policy thrust

Immigration: The President pledged to crack down on illegal immigration and his threat of tariffs has yielded a significant response from the Canadian and Mexican governments who are beefing

up security at their US borders. Deportations have been increasing, but the primary way this is set to impact the economy is by deterring people from attempting to enter the US. In an environment of falling numbers of American-born workers, this may mean labour supply is constrained in some key sectors including construction, agriculture and leisure and hospitality. This could push up pay rates and prices.

Regulation: Trump believes that by halting and reversing a “regulatory onslaught” he can unshackle the economy and unleash growth. The most apparent way he is doing this is by making it easier to obtain permits for oil and gas exploration – “drill, baby, drill”. However, the Dallas Fed reports that the “breakeven” cost for shale producers in the Permian basin is \$65/bbl when oil prices are little more than \$70/bbl, so there is little financial incentive to drill right now.

Tariffs: The perception that countries have been taking advantage of the US, costing jobs and damaging the social fabric of America runs deep in this administration. Tariffs will make domestic manufacturers more competitive in the local market, but those with international supply chains will face higher costs while US exporters will fear reprisals from foreign nations.

The bigger threat is to consumer demand, which has been the main engine of US growth. The value of US manufacturing output (\$2.85tr full-year 2023) is less than the value of the goods imported into the US (\$3.1tr in 2023), meaning that manufacturing output would need to double in size to remove the need for imports. This is unfeasible within the next decade, let alone the next few months. If/when tariffs are applied, the squeeze on spending power will be substantial even if businesses absorb some of the costs in their profit margins. The burden will fall disproportionately on low-income households who spend more of their income on physical goods relative to higher-income households who spend more on services and experiences, which aren’t subject to tariffs.

Taxes: His primary goal is to extend his 2017 tax cuts, which expire at the end of this year. This should pass easily, but it will be very costly and contribute to an ongoing deterioration in government finances over the next decade. Remember though an extension will not boost household spending power – it merely maintains the status quo. Consequently, he wants to go further and has stated that tariffs incentivise manufacturing reshoring, but they also provide revenue that can fund tax cuts elsewhere. Among his proposals to eliminate taxes on tips, social security benefits, and overtime pay, the one concerning tips is the most likely to pass, as it is the least expensive and enjoys bipartisan support.

Government spending: Trump’s aspiration of cutting government spending by \$2tr is ambitious, but more than two million employees have been offered voluntary redundancy while plans to shut the US Agency for International Aid (USAID) show clear intent to carry through. However, to deliver the scale of cuts to spending that would put US government finances on a stable footing would require the trimming of government entitlement programmes surrounding health and social security. Congress will be immensely reluctant to sanction that.

Too far, too fast?

Combining these factors we see near-term strength in economic activity continuing. Robust consumer demand remains the main theme with evidence suggesting many households have started bringing forward spending to avoid tariffs. The jobs market remains solid while manufacturing appears to be recovering after languishing for the past couple of years.

Nonetheless, the rise in Treasury yields has pushed mortgage rates higher while credit card and

auto loan borrowing costs have failed to drop despite 100bp of Federal Reserve interest rate cuts. Higher government borrowing costs remain a key call for us with tariffs keeping inflation more elevated and fiscal sustainability fears fuelling investor demand for higher returns for the risks they face. Dollar strength is also a headwind, making exports less competitive in international markets.

In the second half of 2025, tariffs look set to erode spending power, and with tax cuts not materialising before 2026 and government spending being cut immediately, we expect to see cooler growth. The will-they-won't-they nature of the tariff strategy and the lack of clarity on which countries are impacted, what carve-outs there may be and what the tariff rate will be is going to leave US manufacturers uncertain about what to do. This lack of clarity may hinder investment and hiring until more certainty is provided.

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Trump's trade tariffs: exploring the potential actions his administration could take

President Trump invoked the International Emergency Economic Powers Act (IEEPA) on 1 February, citing illicit drug flows as a national emergency to justify tariffs. But that is just one of the many possibilities the administration has to apply tariffs. How might China and Europe respond?



US President Trump signs executive order in the Oval Office

President Trump invokes IEEPA to announce new tariffs

Late on 1 February, US President Donald Trump signed three executive orders announcing new unilateral tariffs on Canada, Mexico, and China. While the tariffs on Mexico and Canada will be delayed by a month and will potentially never see the light of the day, 10% on imports from China are still on the cards.

In order to conduct this first unilateral tariff strike, Trump invoked the International Emergency Economic Powers Act ([IEEPA](#)), which authorises the President to regulate imports during a national emergency declared under the National Emergencies Act (NEA). In all three cases, he cited the flow of illicit drugs as the cause for proclaiming a national emergency.

What about other possibilities to invoke tariffs? Section 201, 301 and 232

Although this hefty tariff action has drawn attention over the last couple of days, don't forget that a comprehensive investigation into US trade relationships is still outstanding and due on 1 April. During Trump's first presidency, we discovered various legal avenues for imposing tariffs on a range of products under US law. For his tariff strategy at that time, Trump relied on two key laws, invoking three specific sections:

Trade Act of 1974:

- **Section 201 tariffs:** Used to provide temporary relief to US industries affected by import surges. Under [Section 201](#) of the Trade Act of 1974, the United States International Trade Commission (USITC) investigates whether imports are causing serious injury to domestic industries. If the investigation concludes affirmatively, the USITC recommends relief measures to the president. The USITC has 120 to 150 days from receiving a petition to determine the impact of imports and must submit its report, including any relief recommendations, to the president within 180 days.
- **Section 301 tariffs:** Used to address unfair trade practices and enforce US rights under trade agreements. Under [Section 301](#) of the Trade Act of 1974, the United States Representative (USTR) investigates and consults with the private sector, conducts public hearings, and engages in consultations with the targeted foreign government to address unfair trade practices. The USTR must decide whether to initiate an investigation within 45 days of receiving a petition and make its final determinations within 12 months of starting the investigation. The president then has 90 days to decide on the appropriate action. If the president approves tariffs, they are implemented within 30 days of the decision.

Trade Expansion Act of 1962:

- **Section 232 tariffs:** Used to protect national security by adjusting imports. Under [Section 232](#) of the Trade Expansion Act of 1962, the Secretary of Commerce, in consultation with the Secretary of Defence and other relevant agencies, assesses the national security implications of imports. The Department of Commerce has 270 days to complete the investigation and prepare a report. The president then has 90 days to review the report, decide whether to agree with its findings, and determine the appropriate course of action.

As the use of these trade laws requires thorough investigations, it took roughly a year into Trump's first presidency before tariffs were actually implemented.

Exploring more tariff options for US administration: Section 122 and 338

But these are not the only choices that a US administration has. For example, under Section 122 of the Trade Act of 1974, and Section 338 of the Tariff Act of 1930, tariffs could theoretically be implemented relatively quickly.

Trade Act of 1974:

- **Section 122 tariffs:** Used to help correct serious imbalances in the country's international

payments. Under [Section 122](#) of the Trade Act of 1974, the president can impose tariffs of up to 15% or quotas on all imports for up to 150 days to address balance-of-payments deficits. Extending tariffs beyond 150 days requires Congressional approval.

However, using tariffs under Section 122 would contradict the administration's goals of sustainable economic strengthening and revenue generation, as these tariffs would only be in force for 150 days. While this approach might create a dramatic entrance, it lacks long-term impact.

Tariff Act of 1930:

- **Section 338 tariffs:** Used to tackle discrimination against US commerce. Under [Section 338](#) of the Tariff Act of 1930, the president can impose new or additional duties on imports from a foreign country of up to 50% or exclude its products from importation if the foreign country imposes unreasonable charges or discriminates against US commerce. These duties take effect 30 days after the proclamation and do not explicitly require consultation with any department.

Regarding Section 338, bypassing departmental consultations could still lead to legal challenges. Additionally, justifying tariffs under this section will very likely contradict WTO rules.

Given the vast legal framework of the US and its trade policies, we wouldn't be surprised if the Trump administration created a new law to justify additional tariffs.

Beyond tariffs: the hidden power in trade policies

Although most attention is directed towards tariffs, trade policies extend well beyond these. Export/import restrictions, quotas, subsidies, anti-dumping duties, countervailing duties, import licenses, and regulations can all be used to restrict or complicate trade. While tariffs undoubtedly attract the most attention, export bans can have more far-reaching consequences for a country, especially if that country is critically reliant on a product. Export bans can disrupt global supply chains, create shortages, and significantly impact industries reliant on those exports. During the Covid-19 pandemic, for example, export bans on vaccines profoundly impacted global health.

Inga Fechner

How could China and Europe react to US tariffs?

The events since 1 February have made it clear that the threat of tariffs, like the sword of Damocles, will loom over the global economy for the next four years. Even if there are moments of relief, tariffs are far from off the table. A temporary deal does not eliminate the risk of new tariff conflicts flaring up. Here are some thoughts on how China and Europe might react.

China: Early retaliation, a path to de-escalation and potential for further escalation

China's initial response to the first 10% tariff hike could be characterised as relatively muted in its immediate impact, but also featuring a thinly veiled warning shot to the US as we fast approach a vital crossroads for US-China relations with top-level talks expected to occur at any time in the

coming days.

After tariffs came into effect on 4 February, China responded with some retaliatory tariffs of its own. Our initial look at the categories suggests that the impacted products will be something in the range of US\$15-17bn of products or something in the range of 10-12% of total imports from the US. Specifically, the retaliatory tariffs announced were:

- 15% tariff on coal (\$1.5bn imported in first 11 months of 2014) and LNG imports (\$1.6bn in 11M24)
- 10% tariff on crude oil (\$6.0bn in 11M24), agricultural machinery (\$108mn in 11M24), large displacement engine vehicles, and pickup truck imports (\$6.1bn of road vehicles imported in 11M24, not all will be subject to tariffs).

Additionally, while not an official part of the response, China also announced an antitrust probe into Google, and added PVH Group (parent company of Calvin Klein) and Illumina Inc. to the unreliable entities list, which opens them up for potential restrictions and sanctions. These moves won't have an immediate impact but could be interpreted as a thinly veiled threat that China will hit back against US corporate interests if negotiations go poorly.

The early response does not preclude an agreement being struck on the fentanyl issues – there's still room to de-escalate at this stage, and China's tariffs set to take effect on 10 February clearly are designed to accommodate such a possibility.

Given China's exports of chemicals to Mexico and Canada hold a negligible weight in its exports, the fentanyl issue is one where China and the US could find it relatively easier to find room for cooperation. Other than the fentanyl issue, the other catalysts in the coming months include the investigation into China's purchases under the Phase One Trade Deal, and the ongoing TikTok sale negotiations.

Our [previous report](#) discusses China's purchase agreement in more depth, but the key takeaways are that China did not come close to meeting the purchase targets of an additional \$200bn from 2017 levels, though there were also extenuating circumstances such as the pandemic, and later on export controls from the US. The outcome will likely depend on whether the US seeks a new commitment to ramp up these purchases again or prefers an excuse to increase tariffs.

As far as the TikTok sale goes, Trump's 75-day moratorium on the TikTok ban is set to expire in early April, which makes that a key window to watch. It remains possible that the fate of TikTok could play a role in the tariff picture.

Amid all the talk about China de-risking in the US, it's worth highlighting that this process works both ways. China at this point is less reliant on US suppliers and customers than it has been in the past, and has been preparing for the possibility of a second trade war for some time. We do feel that if pushed into a corner, China's retaliation could be stronger than what most expect, but we have yet to reach this stage for now.

It's worth noting that China in 2025 is likely to be more receptive toward addressing long-standing Western criticisms of its trade surplus and market access, as it seeks to boost the role of domestic demand in its economy, and as it aims to woo foreign investors back to its markets. There remains a path to de-escalation and cooperation, but this path looks narrow.

Lynn Song

Europe: EU prepares for possible retaliation as Trump administration eyes tariffs

The European Union has not (yet) been subject to the US administration's tariff announcements. However, Trump has regularly publicly criticised the EU for running trade surpluses with the US. Looking at the US bilateral trade balances, the country runs the third largest bilateral trade deficit with Germany, after China and Mexico. Given the swiftness with which the Trump administration implements election promises, it is hard to see how the EU could escape the tariff dance. Trump has already [initiated a comprehensive investigation](#) into US trade relationships. A report of this investigation is due on 1 April 2025. A crucial moment for the EU.

However, it won't take until April before the EU feels the economic pain of US tariffs. Given that many European (car) manufacturers have production facilities for the US market in Mexico, as part of the near-shoring and derisking strategy of the last four years, US tariffs on Mexico will also harm Europe.

There is little known how the EU would react to US tariffs on European goods. During the last Trump administration, the EU first reacted with direct retaliation on US tariffs on European aluminium and steel and was later able to prevent a tariff escalation by threatening to impose tariffs on Levi's jeans and Jack Daniels. Also, the EU promised the US administration it would purchase more US LNG and soybeans. A similar strategy looks possible this time around. The EU could, for example, offer to buy more US LNG or military equipment. However, the overarching question remains how transactional President Trump's approach to tariffs in his second term in office will be.

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Global central banks are treading carefully

The Fed is cautious, and so is the Bank of Japan. The ECB seems determined to keep cutting and the Bank of England might be tempted to speed up its rate reduction pace later in the year



The US Federal Reserve

After 100bp of interest rate cuts in the latter part of 2024, the Fed held policy steady in January and suggested it was in no hurry to cut again. The recent developments surrounding tariffs are likely to keep it that way through the first half of 2025. We expect stronger near-term consumer demand as households bring forward spending on big-ticket items to avoid tariffs, together with the risk of more elevated inflation over the medium term.

Weaker consumer demand is likely in the second half of the year, assuming tariffs materialise and squeeze household spending power. Proposed tax cuts on overtime pay, tips and social security payments will not provide financial relief until 2026, if at all – we are not confident they will be passed by Congress as currently proposed.

US business supply chains will be tested and exporters will be hurt by retaliatory tariffs from trade partners. Risk assets also appear vulnerable to a more stressed growth environment. A cooling jobs market adds to the belief that the Fed may 'look through' near-term inflation and cut rates twice in the second half of this year. What happens next is highly uncertain, but assuming a gradual de-

escalation of tensions that sees tariffs being removed, we are forecasting one further rate cut in early 2026.

The European Central Bank

The latest data once again confirmed that the ECB is currently looking at a mild version of stagflationary tendencies: continued sluggishness of the economy and accelerating inflation. Still, the ECB seems to be looking through this temporary acceleration of inflation and sounds determined to continue cutting rates. The desire to stay ahead of the curve – also in light of potential incoming economic worries for the eurozone stemming from the US administration – remains a compelling reason to return interest rates to neutral.

According to the ECB's logic, the Bank will have to bring interest rates to where market expectations were in December in order to deliver the December forecasts' outcome. This would imply cutting rates by a total of another 75bp. Otherwise, inflation would undershoot and growth underperform. This means that another 25bp rate cut at the March meeting is almost a done deal. But this is not where we see the ECB stopping. Instead, a further weakening of the eurozone growth outlook will force it to cut interest rates to at least 2% by the summer.

The Bank of England

Markets are pricing between three and four rate cuts this year, up from less than 30 basis points in total back in mid-January. The path of least resistance for the Bank is to keep cutting rates once per quarter, and that's what we currently expect until rates bottom out at 3.25% next year. There is still a chance that the BoE will move faster, given that the jobs market is looking shaky, particularly with big tax hikes coming in for businesses in April. Wage growth should gradually fall this year, while services inflation is likely to show a lot more progress by the spring; it's set to fall below 4% in the second quarter, and progress is likely to look even better if you exclude volatile/less relevant items.

December's meeting, which saw three out of nine committee members dissent in favour of a more immediate rate cut, hints that the balance of opinion at the Bank is slowly shifting in a less hawkish direction. Still, for now, our base case is for cuts in May, August and November.

The Bank of Japan

The Bank of Japan raised its target rate in January. Unlike last July's unexpected hike, this one was relatively well-telegraphed, with messages from top BoJ officials a few weeks before the meeting. Later, the Summary of Opinions suggested that further hikes were on the way. The market is currently pricing in another hike in July given the BoJ's cautious approach, but we believe that if Shunto's results are as strong as last year's – that's the annual round of wage negotiations – an earlier hike in May is possible.

Core inflation is expected to remain above 2% for most of this year, while growth should improve thanks to healthy wage increases and consumption. The latest labour cash earnings rose the highest since 1997, with an almost 3% steady growth of base payment. The biggest risk factor should be Trump's trade policy towards Japan, but so far, Trump's arrow hasn't yet targeted Japanese firms. It seems like the BoJ would like to reduce the market volatility risk, so the markets will be listening closely to messages from BoJ officials and whether it drops any hints about the rate hike prior to the meeting. We have also raised the BoJ's terminal rate from 1.00% to 1.25%

based on recent data outcomes and the BoJ's latest quarterly outlook revision, and we expect two more hikes in 2025 (May and October), and a 25bp hike in 2026.

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Energy markets shaken by tariff talk and sanctions

Energy prices have had a volatile start to the year driven by a combination of sanction and tariff risks, along with colder weather. While the floor for energy markets is likely higher than originally expected, we still see prices trading lower from current levels



Energy markets have been quite volatile so far this year

Oil stuck between tariff and sanction risk

Oil prices have had a volatile start to the year with the market coming into 2025 with the expectation of a fairly comfortable oil balance. However, demand through the winter has been stronger than expected due to colder weather, while sanction and tariff risks have left the outlook more uncertain.

The sanction risks facing the oil market are predominantly coming from Russia and Iran. Before President Biden left office, he tightened sanctions on the Russian energy sector. The aim of sanctioning a large proportion of Russia's shadow tanker fleet was to reduce Russian energy revenues by forcing Russian crude prices below the G-7 price cap. The uncertainty over the impact saw buyers of Russian oil looking for alternatives, and that provided support to the Middle East physical market. However, until now, seaborne crude oil exports from Russia appear to be continuing with little disruption. The potential supply impact from these sanctions could be as much as 700k b/d, which would be enough to erase the global oil surplus we forecast for this year.

The other sanction risk is related to Iran. President Trump recently signed a directive to increase economic pressure on the country by strictly enforcing sanctions, which does put a large amount of oil supply at risk, possibly as much as 1m b/d.

President Trump has already made it clear that he wants OPEC to increase output. If he is successful in convincing the group to do that, it would help offset any potential losses from Russia and/or Iran. However, convincing OPEC may prove difficult, particularly considering that Saudi Arabia has a fiscal breakeven oil price of above \$90/bbl.

The supply risks facing the market due to sanctions mean that the floor for oil prices is probably a little higher than we had expected coming into this year. However, much will depend on how trade relations progress. A tougher stance from the US on trade will be a concern for global growth.

Storage concerns prop up European gas prices

European gas prices have been fairly strong so far this year. TTF has traded to its highest levels since October 2023 on the back of storage concerns. Stronger gas demand from the power generation sector, stronger heating demand, and the loss of Russian pipeline flows through Ukraine mean that storage is falling at a quicker-than-expected pace.

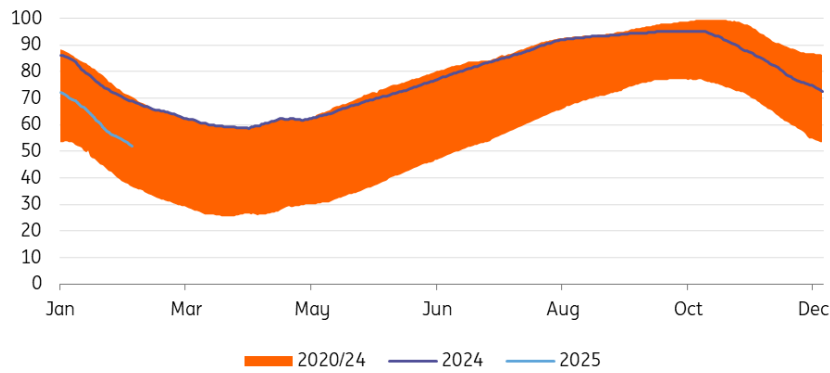
EU storage ended January at a little under 54% full, still above the European Commission's intermediary target of 50%; however, it was below last year's level of 70% full and the 5-year average of almost 61%. The region will get through this winter with few issues but will face a larger task of refilling storage through the injection season. Our numbers suggest we would need to see a 17bcm YoY increase in net injections through the summer to hit the Commission's storage target. Also complicating matters is that the TTF forward curve does not incentivise storing gas for the 25/26 winter, with summer 2025 prices trading at a premium to winter 25/26 prices. Therefore, there has been increasing talk that governments may look to subsidise refills to ensure that the EU hits its storage target of 90% by 1 November.

The price spread between TTF and Asian spot LNG means that LNG cargoes should continue to be redirected towards Europe. The forward curves suggest this should continue through much of the summer, which should ensure adequate gas supply for Europe. This year, we should also continue to see the ramping up of new LNG export capacity, predominantly from the US.

Russian LNG was also affected by sanctions announced by the US, which included sanctioning operational LNG projects in Russia for the first time. However, the two projects recently sanctioned make up only a very small share of Russia's LNG export capacity.

Given that Europe faces a bigger job in refilling storage for next winter, it suggests that the floor for the market is higher than we originally thought. However, we also believe the upside in the market is capped. Gas prices are trading at levels where it makes more economic sense for the power generation sector to switch from gas to coal, even when you consider the rally in European carbon prices. Furthermore, the investment fund long in TTF seems fairly stretched and, so the appetite for speculators to increase their position significantly more (in the absence of a fresh bullish catalyst) is likely limited.

EU gas storage falling quicker than expected (% full)



Source: GIE, ING Research

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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

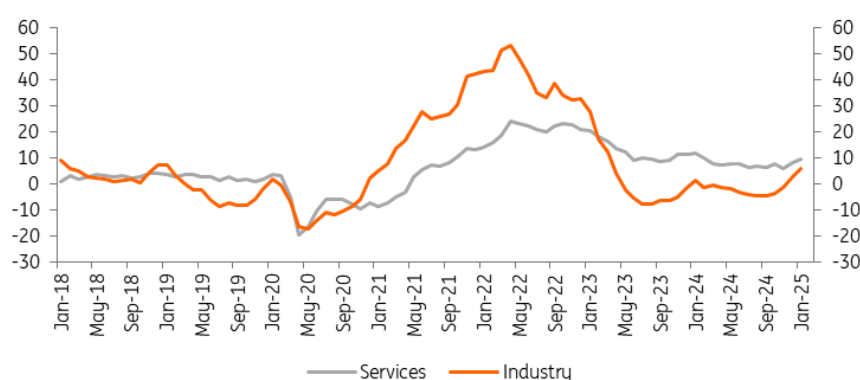
high that the US will impose tariffs on the EU in the second quarter. The EU will likely react with specific retaliations while trying to appease Trump with promises of more LNG and weapons purchases. One thing is certain: more uncertainty. This might weigh on business investment. We anticipate that 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.

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The UK Treasury's tax and spend tightrope

UK Chancellor Rachel Reeves has little choice but to scale back spending plans when she presents her Spring Statement in March. But faced with weaker growth forecasts and investors that are more alive to the UK's fiscal challenges, the Treasury may be forced to raise taxes again in the autumn



UK Chancellor Rachel Reeves faces some tough choices ahead of her Spring Statement in March

The government has run out of fiscal 'headroom'

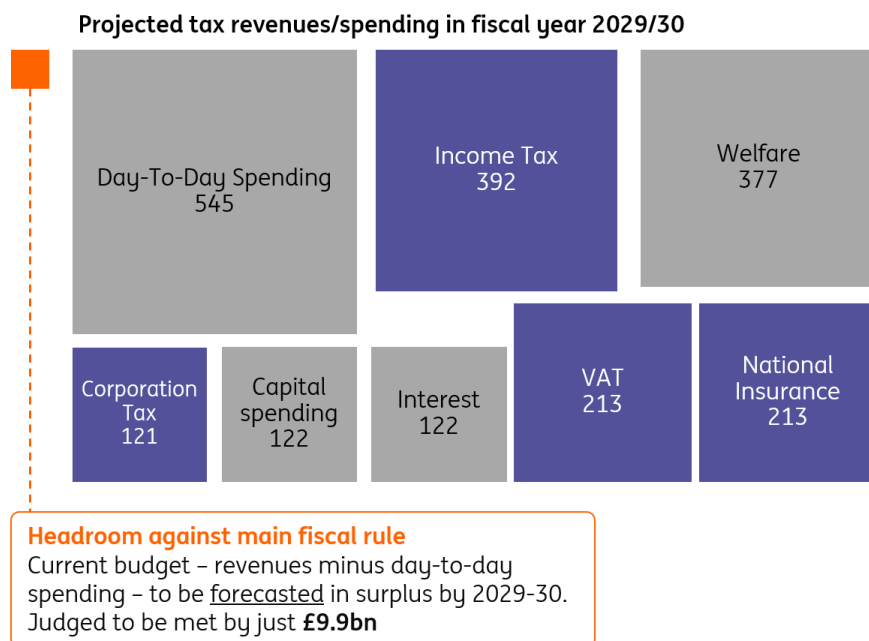
Not for the first time, the UK started 2025 in the headlines for all the wrong reasons. Britain bore the brunt of last month's global bond sell-off, thrusting Chancellor Rachel Reeves back into the limelight ahead of her Spring Statement in March.

At issue is her inaugural budget from last October, which saw big tax hikes coupled with considerably larger spending increases. Back then the Treasury left itself with very little room for manoeuvre under its fiscal rules, rules which by historical standards, are not particularly restrictive. Though UK markets have calmed since mid-January, we think that all of the modest £9.9bn fiscal 'headroom' – money that is left over once the fiscal rules are met – will have been eradicated by higher debt-interest forecasts.

On paper, that's not as troublesome as it sounds. £10bn here or there are not earth-shattering numbers in the context of more than a trillion pounds worth of spending/taxation. Remember too that the UK's fiscal rules do not mandate fiscal surpluses today, but instead concern project levels in 2029/30. That means the Treasury can – and often has – relied upon the promise of future spending cuts to make the numbers add up while avoiding pain for households and government departments today.

But this is a risky strategy. January's sell-off showed that investors are alive to the UK's fiscal challenges. Regardless of how the Treasury makes the fiscal rules work, the simple fact is that the UK is headed toward 4% fiscal deficits and circa £300bn borrowing needs over the next financial year.

£9.9bn fiscal 'headroom' is not much



Source: Office for Budget Responsibility, ING

Further tax hikes are likely in the autumn

The Chancellor will hope that her recent Growth Strategy will encourage the Office for Budget Responsibility (OBR) – the government's independent forecaster and arbiter of the fiscal rules – to upgrade (or at least not downgrade) its GDP forecasts. That would give the Treasury more breathing space and limit the need for painful tax or spending measures. But the long-term nature of that strategy, which included some major infrastructure projects, means the OBR may be reluctant to make substantive changes to its numbers.

The bigger issue is that the OBR's 2025 growth forecast – pitched at 2% – looks wildly optimistic in light of a weaker run of data and mounting economic headwinds. While the jury's still out on the government's tax hike on employers, the impact looks more likely to manifest itself in lower hiring rather than higher prices for consumers. Employment, excluding government-dominated sectors, fell by almost one percentage point in 2024, while vacancy rates in most sectors are comfortably below pre-Covid averages.

Weaker growth, higher market rates and relatively limited scope to credibly trim public spending

projections suggest further tax hikes are inevitable in the autumn. A more fragile jobs market and the prospect of better news on services inflation in the spring should also help cement a gradual string of rate cuts from the Bank of England this year.

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Chinese economy hits 2024 growth target, but storm clouds are gathering

Strong December data pushed 2024 growth to the target level, but 2025 is off to a weak start as PMI softens and tariffs loom



China hit its 5% growth target in 2024

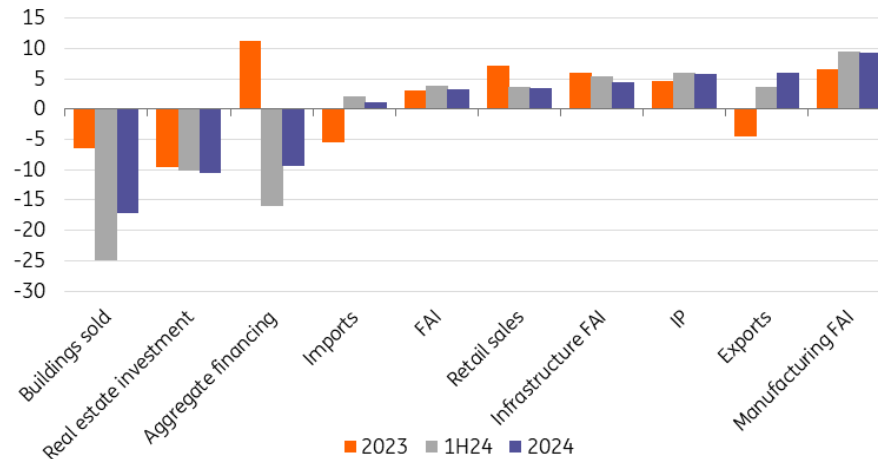
Mission accomplished on 2024 growth target as growth drivers shift

Data published over the past month confirmed that the Chinese economy grew by 5.0% year-on-year in 2024, which was exactly in line with its growth target of around 5%. China's fourth quarter 2024 GDP surged to 5.4% year-on-year, up from 4.6% YoY in 3Q24, marking the highest level of the year, and the fastest YoY growth of any quarter since 2Q23, benefiting from an adjustment in the GDP calculation methodology to better reflect the rental market.

Last year featured a fairly significant shift in terms of growth drivers. In 2023, consumption momentum was relatively solid thanks to a wave of “revenge consumption” after the pandemic restrictions were lifted, but fell off significantly in 2024 as sentiment reached new all-time lows amid widespread pay freezes and pay cuts and the continued slide in property values. At the same time, the continued pressure on local governments led to lacklustre investment growth. As a result, the main growth driver last year was actually from external demand, with a pickup in exports and a recovery in manufacturing.

External demand became an increasingly important growth driver in 2024

%YoY, ytd



Source: CEIC, ING

Early warning signs cloud the 2025 outlook

With Trump's return signalling a new era of tariffs and protectionism, external demand is expected to weaken, heightening the need to boost domestic demand. Trump's initial actions against China include announcing an additional 10% tariff on Chinese exports. Following the suspension of tariffs on other countries, upcoming bilateral talks will be crucial in determining whether the situation with China improves or deteriorates.

While we will not get China's key activity data until March as the January-February data is released together to minimise the impact of Lunar New Year-related distortions, the data we have seen so far suggests that 2025 is off to a relatively weak start.

China's official PMI unexpectedly fell to 49.1 in January, breaking a three-month expansion streak. Subindices weakened across the board, but there was a particularly glaring drop in new export orders which fell to a 13-month low last month, suggesting that the export frontloading ahead of tariffs ended in January.

China's first response to tariffs: muted but with a thinly veiled threat

Following the failure to reach a last-minute deal to prevent tariffs, China announced several retaliatory measures after the US implemented a 10% tariff on 4 February.

On top of the earlier announcement that China would be filing a complaint with the World Trade Organisation, the retaliatory measures included tariffs on what should be something in the range of US\$14-17bn of products or something in the range of 10% of total imports from the US. Specifically, the retaliatory tariffs announced were:

- 15% tariff on coal (US\$1.5bn imported in first 11 months of 2024) and LNG imports (\$1.6bn in 11M24)

- 10% tariff on crude oil (\$6.0bn in 11M24), agricultural machinery (\$108mn in 11M24), large displacement engine vehicles, and pickup truck imports (\$6.1bn of road vehicles imported in 11M24, not all will be subject to tariffs).

Additionally, while not an official part of the response, China also announced an antitrust probe into Google, and added the PVH Group (the parent company of Calvin Klein) and Illumina Inc. to the unreliable entities list, which opens them up for potential restrictions and sanctions. These won't have an immediate impact but could be interpreted as a thinly veiled threat that China will hit back against US conglomerates instead of just token tariffs on commodities if negotiations go poorly.

We feel that this combination of measures shows China is taking care not to flip the proverbial table but also to show it has cards to hit back at real US economic interests if talks sour. We feel like policymakers still hope to reach some sort of a deal – we have argued that the fentanyl issue is an area where it should be relatively easier to reach an agreement on. There should be more formal talks on this topic in the coming days.

Moving forward, there are three big issues for China and the US; the fentanyl issue, China's purchase agreement under the Phase One Trade Deal, and the potential upcoming TikTok sale, all of which have some room for cooperation but are also subject to high risk of negotiation breakdowns.

We think that if pushed into a corner, China's retaliation could be stronger than what most expect, but we haven't reached that point yet. [The path to avoiding a more destructive trade war remains a narrow one.](#)

With the external environment looking difficult to navigate, for China's economic outlook, we believe the domestic response is actually more important. So far this year, China has announced expansion of equipment renewal subsidies and trade-in policies to support domestic demand. We expect monetary policy easing to resume in the coming weeks and months, with one rate and one RRR cut forecasted for 1Q25. All eyes now turn to China's Two Sessions starting on 5 March, where this year's growth target will signal how much support is likely to come through this year. We expect policymakers to run back last year's "around 5%" growth target in a show of confidence.

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Asian central banks cut rates to mitigate growth risks

Due to uncertainty surrounding tariffs and external demand, Asian central banks are becoming more cautious about the domestic growth outlook, leading to pre-emptive rate cuts. This also indicates that they might be increasingly open to currency depreciation to bolster growth



Asia: growth considerations drive monetary policy decisions

Recent monetary policy decisions in Asia highlight the challenges that Asian central banks face in balancing risks to growth amid rising uncertainty on global trade. The Monetary Authority of Singapore eased monetary policy for the first time in almost five years by reducing the slope of the S\$NEER policy band “slightly”, driven by a faster-than-expected fall in core inflation below 2% on a sustainable basis and as growth concerns from trade policy uncertainty took centre stage. The strong growth and inflation picture that the economy witnessed in 2024 has turned sharply and we expect GDP growth in Singapore to slow down in the second half of this year, driven by slower global and export growth. We expect the trading range of SGD NEER to drift lower in 2025 driven by slower growth and inflation.

Bank of Indonesia cut rates unexpectedly despite IDR being a currency that is highly sensitive to rate differentials and where FX considerations have a higher weight in the monetary policy reaction function compared to other countries. These moves suggest that Asian central banks

might be getting more open to currency depreciation to support growth.

Two countries in the region that are yet to embark on the rate-cutting cycle are Malaysia and Australia. While their respective currencies have borne the brunt of USD strength, growth in both countries has held up relatively well. Malaysia's strong recovery, advantages from supply chain diversification, and low inflation influenced the Central Bank of Malaysia's decision to maintain its rate pause in January, even as central banks globally shift towards easing.

In Australia, the market is pricing in the first rate cut by the Reserve Bank of Australia (RBA) in February. While this is in line with our view and we place a 60% probability on it, we think the decision to cut or pause will be a close one, hence it's not a done deal. Key to our thinking is that wage pressures have eased more than expected and household consumption growth has been weaker than anticipated, which should give RBA comfort to ease. However, the unemployment rate is still below the central bank's target, which could result in more uncertainty on the pace and timing of rate cuts.

South Korea: domestic uncertainty eases, but weak growth expected

Following the brief declaration of martial law in South Korea and the December plane crash, market sentiment has stabilised. Activity data indicates that the negative impact of these events was mainly felt in consumption and construction, while manufacturing and equipment investment saw solid growth, largely driven by external demand. However, this growth is primarily concentrated in semiconductors and automobiles, which are likely to be targeted by tariffs from the Trump administration.

We still think semiconductors will be the least affected as there is no substitute in the market, but automobiles are likely to be hit hard. With external conditions likely to deteriorate while domestic recovery remains sluggish, we expect the Bank of Korea to provide liquidity to the market and ease monetary conditions to support growth throughout the year. The government is trying to stimulate the economy through early fiscal spending, but the long-awaited supplementary budget has been slower than expected due to a lack of consensus between the ruling and opposition parties. We expect GDP to grow by 1.3% YoY in 2025, with risks skewed to the downside.

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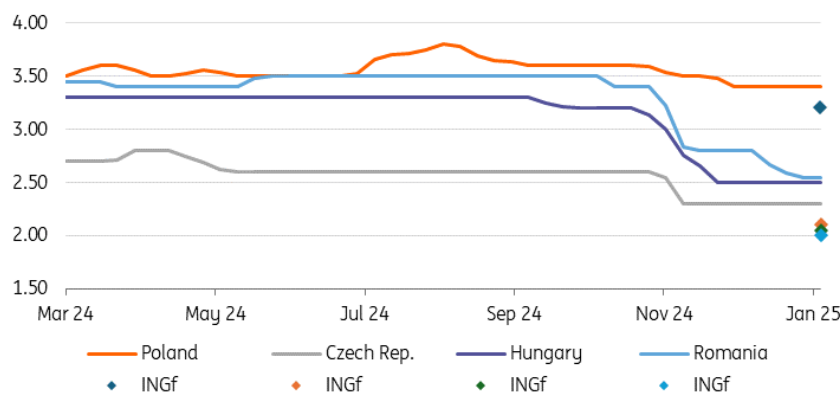
CEE: Awaiting a full economic recovery

Economic growth last year was disappointing across much of the CEE region, and we expect a similar story this year. Its recovery should continue, but we think it'll be weaker than market consensus assumes. Risks point clearly to the downside from this point, and further disinflation is complicated. Central banks in CEE no longer have much room for rate cuts



Poland was the only CEE country whose economic performance didn't disappoint against initial expectations for 2024 growth prospects

Consensus forecasts for 2025 GDP growth (%)



Poland: Economic growth outshines CEE peers

December's monthly data and the preliminary estimate for 2024 GDP suggest that the Polish economy resumed its recovery in the fourth quarter of last year after a weaker third quarter. Retail sales also resumed growth after a soft third quarter. We see some improvement in the infrastructure part of the construction sector as the new cycle of public investment unfolds, driven by the EU's Recovery and Resilience Facility (RFF) and Cohesion funds. The manufacturing sector, however, is stagnating on a year-on-year basis. Some export sectors continue to grow, while others have stalled. We also see mixed signals from industries that could benefit from a recovery in public investment.

We estimate that GDP grew by around 3.5% YoY in the final quarter of 2024, compared to 2.7% YoY in the third quarter. As the main driver of GDP, consumption grew by a strong 3.5% YoY – but spending was less dynamic than in the first half of 2024. Investment activity remained muted (around 0.0% YoY), especially in the private sector, and continued to decline. The negative contribution of net exports reached 1.1 percentage points, reflecting stagnation in both Germany and the euro area.

Economic growth last year was close to 3%, broadly in line with forecasts made a year earlier. Poland was the only CEE country whose economic performance did not disappoint against initial expectations for 2024 growth prospects. Elsewhere in the region, growth was a third (Czech Republic) or even two-thirds (Hungary, Romania) slower than expected (against consensus a year ago). The overall economic picture – together with a hawkish policy stance from the National Bank of Poland (NBP) – should allow the Polish zloty to remain strong, or even to strengthen further than we had expected. The outlook for the PLN also depends on developments regarding the war in Ukraine and the actions of the new US presidential administration in this regard. There are early signs that President Donald Trump is now inclined to take a more positive approach to the region than statements made during his presidential campaign had suggested.

The NBP is expected to keep interest rates on hold at 5.75% in February. Since the January meeting, we've seen solid economic growth data and no news on inflation. We expect that, when asked what a firmer PLN means for the outlook, NBP Governor Adam Glapiński will emphasise Poland's floating exchange rate. The NBP only intervenes when currency moves are deemed excessive. Recent comments from the Monetary Policy Council's Ludwik Kotecki suggest that rate cuts will be delayed until the July meeting at the earliest, when the new projections will be published. We see room for 50-100bp of easing, although a stronger currency and the improved inflation outlook would call for a 100bp scenario, especially if the European Central Bank (ECB) continues to ease.

Czech Republic: Underperforming industry a threat as final rates get closer

The Czech economic rebound is on track, and we think it's set to gain traction this year. The continued real wage growth will provide enough support to household budgets to carry on with solid spending. In contrast, industry remains under pressure due to havoc in European automotive sector, with its main trading partners (such as Germany) seemingly unable to reach the bottom.

The manufacturing base faces rising costs – be it wage bills or materials – which act as a drag on profit margins. Such a situation poses a risk to the willingness and ability of firms to maintain

robust wage increases. The protracted underperformance in manufacturing has implied continuous layoffs over the past quarters, only partially offset by a rebound in construction. The mounting uncertainty and gradually deteriorating labour market conditions have been recognised by households, which could curtail consumption for precautionary reasons in the second quarter.

Inflation is set to slow down in January, but both the headline and core rate are expected to remain above the inflation target throughout this year. Moreover, some inflationary risks have emerged that will feed through to consumer prices, such as accelerating prices of agricultural products and recovering prices in the residential market. So, food prices and imputed rents represent an upward risk to inflation.

We still see some space for further monetary easing – but it is limited, with real interest rates likely to drift below 1% by mid-year. We don't see the Czech National Bank (CNB) willing to get close to the zero-bound in terms of real rates. We therefore see 3.25% as the final destination for the base rate, which would be reached in a cautious cut-pause-cut fine-tuning approach in the summer. The more potent interest rate differential toward the European Central Bank (ECB) and better economic performance across the eurozone will support the domestic currency over the coming quarters.

Hungary: Moving in the wrong direction

The market consensus on the GDP outlook for 2025 is slowly but surely moving lower, especially after the weak GDP growth seen in the fourth quarter of 2024. With only 0.5% quarter-on-quarter growth, the carry-over effect will be virtually zero. This makes the government's target of 3.4% growth this year much harder to achieve. Hungary would need four quarters of strong growth (at least an average of 1.325% QoQ) to achieve this. With all the local and global headwinds, we still see 2% GDP growth as the base case. And there are plenty of headwinds. Consumer and business confidence are both moving in the wrong direction, reducing the potential for a quick and strong turnaround in the economy. Trump's tariffs will be the icing on the cake for a country that is deeply integrated into global value chains. We haven't seen any confirmation of tariffs on the EU as of yet and so hope remains that those will be delayed.

Speaking of indicators moving in the wrong direction, we can also point to inflation. Underlying inflation indicators, like core inflation and sticky price inflation, both ticked up in December. Price expectations for retail sales and services also jumped higher, as did perceived inflation and household inflation expectations. We therefore revise our average inflation forecast for 2025 up to 4.5%. And while the unemployment rate surprised with a decline at the end of the year, this is more due to the combination of shrinking labour supply and a lack of demand for labour. In such an environment, the risk of a negative feedback loop for further weakness in consumer and business confidence increases.

Global uncertainty and FX and interest rate volatility are additional factors – alongside inflation developments – that justify the National Bank of Hungary's caution. While we stick to our latest base case of a total of 75bp of back-loaded easing in 2025, we admit that the probability of this happening decreases sharply as the likelihood of a flat policy rate of 6.50% increases. In this environment, we see little point in chasing a rally for the forint here as EUR/USD is likely to continue its slide, which in turn should put some pressure back on EM currencies in general. We see EUR/HUF peaking at around 420 this year.

Romania: A challenging fiscal and external picture fuels the upside risks for rates

We expect domestic demand to have remained firm over the last quarter of 2024. That said, the structural need for imports should have continued to weigh on growth. For 2024, we expect GDP growth at 0.7%. For 2025, we have recently adjusted our full-year GDP growth forecast from 2.1% to 1.6% due to little prospect of structural improvements in the trade deficit, the potential need for an even higher tax burden down the line, and the upside pressures on interest rates stemming from global trade unrest. On the other hand, consumer demand should remain robust, and productivity improvements from the Schengen ascension and new infrastructure developments should provide some tailwinds ahead.

On the monetary policy front, the National Bank of Romania (NBR) left rates on hold at its January meeting. We think that the current external environment will convince policymakers to hold fire until the July meeting at the earliest, given the rising premiums necessary to compensate Romania's macro imbalances at the current juncture in global trade and financial markets. For 2025, we foresee a total of 50bp of rate cuts, taking the key rate to 6.00%, with risks mildly to the upside.

On the fiscal front, the 2024 budget deficit stood at 8.6% of GDP. At this stage, we continue to expect a correction to 7.0% in 2025, with risks tilted to the upside again. The government coalition elaborated an investment-driven budget for 2025, which counts on solid EU funds absorption. So far, some early signs and measures point to the fact that fixing fiscal issues through more moderate spending and better tax collection is indeed a priority for officials. Risks to the outlook stem from scenarios of weaker-than-expected consumption and tougher financing conditions.

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Germany election preview: how to make the economy great again

The German economy currently faces many problems. The three most pressing structural economic issues are energy, the changing role of China, and deteriorating competitiveness due to decade-long underinvestment. Here's what we think needs to be done to tackle these issues



Campaign posters in Düsseldorf, Germany

In just over two weeks, the German elections will be behind us. We'll have the results of these crucial elections, which are significant not only for Germany but for Europe as a whole. However, we are unlikely to know the composition of the next German government and its policy priorities. Let's dive into what needs to be done to make the German economy great again, what the main political parties have to offer, and what could happen after the elections.

How to make the German economy great again – some ideas

The election campaign has entered the final stretch. Several television debates over the next few weeks and strategic voting can still significantly impact the final election results. The two main topics dominating the election campaign are the economy and, increasingly, immigration.

The German economy currently faces many problems. The three most pressing structural

economic issues are energy, the changing role of China, and deteriorating competitiveness due to decade-long underinvestment. Here's what we think needs to be done to solve or at least tackle these issues.

Energy

Germany's energy sources are renewables and coal. For the sake of the green transition and energy autonomy, the move toward renewable energies needs to continue. However, there are currently two main problems associated with the full shift towards renewables: network problems and insufficient storage capacities to offset periods with no wind or sun, as well as the costs. Consequently, Germany needs to step up investment in renewables and innovation as well as present a better way to accompany this transition by ensuring secure and stable energy imports, subsidising energy prices to ensure stable prices, and/or rethinking nuclear power plants.

China

China's changing role in the global economy, from a welcome destination for German exports to a fierce competitor in both Chinese and global markets, will be hard to tackle. An obvious route for Germany could be via protectionism at the European level. A subsidy race against China would be lost from the start. A more disruptive way to deal with the China factor could be to completely focus on new sectors that are not prone to Chinese competition. This would require a complete overhaul of the economy or at least industry, in other words: Schumpeterian creative disruption.

Competitiveness

Closely linked to the 'China factor' is Germany's deterioration in international competitiveness, a result of chronic underinvestment by both the public and private sectors over the last decade. To restore competitiveness, Germany needs an investment offensive, reduction of red tape, and structural reforms.

Increasing investment is not only about higher public investments. To revive private investments, the next government will have to provide typical public goods, i.e., a functioning conventional and digital infrastructure as well as education at the highest standards. This will not be possible without stepping up public investments. Further incentives to support private investments should include tax cuts and faster depreciation of certain corporate investments. Finally, to effectively tackle red tape, investment in e-government seem unavoidable.

Additionally, two important economic issues related to competitiveness are defence and pensions. Regarding defence, the new US administration is another argument in favour of stepping up defence spending. The irony is that higher defence spending could eventually also help the domestic industry, as over the last years, the largest part of European defence spending went to the US. However, given Germany's history, the question is whether Germany and the rest of Europe would like to see Germany spending up to 5% of GDP per year on its military. A better option would be to follow the idea of a European Defense Fund.

Turning to pensions, Germany's pay-as-you-go system and the projected increase of the old-age dependency ratio from currently some 30% to 50% over the next 25 years require significant structural changes, with options ranging from higher retirement ages to higher contributions, capital market-funded additional pensions, and incentives for individual long-term capital market-based savings.

Sacrificing the Holy Schuldenbremse?

Ah, the debt brake! Looking at the long list of policies needed to make the German economy great again, it is impossible to see any substantial overhaul happening without higher public spending. Just to make up for the underinvestment of the last decade, Germany would need to invest around 1.5% of GDP every year for the next 10 years.

Of course, there will always be room to cut some public expenditures, but finding the fiscal space for all the required policies exclusively in austerity looks like a mission impossible. Therefore, the next government will have to agree on looser fiscal policies, be it via changes to the constitutional debt brake or via special funds, if it wants to achieve a real overhaul of the economy.

From the past, we know that election programmes often look like wish lists or declarations of intention rather than clear proposals cast in stone. The election programmes of the four parties that are most likely to participate in the next government in whatever combination (CDU, SPD, Greens, and FDP) show clear differences in how to tackle the main economic problems.

Energy

All four parties intend to invest more in renewable energy, some more than others. At the same time, however, the SPD and Greens plan to lower energy prices (hinting at subsidies), while the CDU and FDP want to reopen nuclear power plants and invest in micro-nuclear reactors.

China

China is featured in all party programmes, being mentioned approximately 10 times in each. While China is significant in terms of derisking and foreign policy, no party integrates a response to China's transition with specific policy proposals.

Competitiveness

As expected, the economy plays an important role in all party programmes. All four parties plan to reduce income taxes. However, while the CDU and FDP are also in favour of corporate tax cuts, the SPD and Greens are proposing subsidies for corporate investments. All four parties plan to reduce bureaucracy and stimulate innovation; the 'how' often remains unclear.

Debt brake

When it comes to financing their plans, most parties remain vague. The German research institute 'Institut der deutschen Wirtschaft' (IW) estimated that the proposals could cost between 30bn euros (SPD) to 138bn euros (FDP). While the SPD and Greens want to finance investments with a 100bn euro fund, the CDU and FDP hope for higher economic growth over the next few years and want to stick to the current constitutional debt brake.

The far-right AfD is currently the second-strongest political party in Germany. However, due to some parts of the party's questionable assessment of Germany's Nazi history, it seems unlikely that the AfD could become part of the next government. In terms of economic policies, the party follows a conservative liberal approach of cutting taxes, increasing investments, returning to nuclear power plants and restarting trade with Russia. The AfD also wants to stick to the debt brake, leading to an even larger funding gap, according to the above-mentioned assessment by

IW. Also, proposals such as Germany leaving the monetary union and an end to the EU currently do not make the AfD a realistic coalition partner.

Better, but not good enough

Taking all these proposals together, Germany has an almost stereotypical election campaign when it comes to the economy. Centre-left parties are in favour of debt-funded investments, while the centre-right parties hope for the positive effects of deregulation on growth to finance tax cuts. At the same time, it is becoming increasingly clear that even in a best-case scenario with reforms and investments, any new government will not try to overhaul the old economic business model but rather try to rejuvenate the old one. Less red tape, some tax cuts to stimulate spending and investments, possibly attempts to lower energy costs and infrastructure investment – all of which feature in any European economist's wish list, and a growth booster for the economy, at least temporarily.

Whether these measures will really be sufficient in competing against China and the US is a completely different question. What Germany would get after the elections is a refurbished model of its economy – clearly better than the old one with cracks, battery failures, and very few gadgets, but also not a shiny, sparkling new model that makes the competition speechless.

What do the polls say?

So, who will be responsible for the refurbishment? Two weeks before the elections, the CDU and Friedrich Merz are still leading in the polls, with slightly above 30% of the votes, while the AfD stands second on some 20%. The SPD currently stands at 16% and the Greens at 14%, while the “conservative-left” Sahra Wagenknecht Alliance (BSW), FDP, and left-wing Die Linke are predicted to score 5%, 4%, and 4% respectively.

Remember that the German election system is complicated as it is a hybrid election system in which voters cast one ballot for a candidate representing a constituency and a second for a particular party's list of candidates in a federal state. Only parties that win 5% of the second vote can enter parliament. However, parties that win at least three constituency seats ('Direktmandat') will still be entitled to seats in parliament even if the national vote for the party is below 5%. As there is another party, Freie Wähler (Free Voters), in Bavaria which could also clear the 5% hurdle or get three constituency seats, the next assembly could consist of between four and eight parties. This makes any prediction of the distribution of seats (and majorities) extremely difficult.

To complicate things further, after the murder of a two-year-old boy in Aschaffenburg, the political debate has shifted away from the economy to immigration and the question of how to deal with the AfD. The CDU's leading candidate, Friedrich Merz, presented a law-and-order plan that he would implement on the first day in office, brought a motion into parliament which was backed by the AfD and unsuccessfully tried to bring in a law asking for stricter immigration. These moves have sparked a discussion on whether or not the CDU might be tempted to work together with the AfD after the elections – something the CDU publicly strictly rules out. However, the tone and content of the debate will make it almost impossible for the CDU to form a coalition with the Greens. Currently, a coalition with the SPD would not break over stricter immigration laws, but no one knows how the SPD will position itself after the elections. In case of a severe defeat, it is hard to see how Olaf Scholz would still lead the SPD. Whether such an event would then lead to the party's shift towards the political right or left remains uncertain.

All in all, and returning to the starting question of how to make the German economy great again, a majority for either SPD and Greens or CDU and FDP would bring the highest level of policy certainty, though with very different priorities. Such a two-party coalition would probably avoid the permanent in-house quarrels the current government had. However, it looks unlikely that the German voter will give such clear guidance. In fact, it increasingly looks like the German elections will be over two weeks from now, but finding the next German government will take much longer.

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FX: Learning to live with volatility

It has been a rollercoaster start to the year in FX markets as investors have struggled to build baseline views for Trump's tariff plans.

Currently, the dollar is under a little pressure on the view that tariffs could be more transactional than ideological and that some of the worst-case outcomes may not materialise after all



Trump's tariff threats are the big story for FX markets this year

Tariffs are the big story for FX markets this year. They can demand a risk premium of 4-5% in currencies on the receiving end of those tariff threats – an amount that can dwarf the impact of adjustments in interest rate differentials. This latter theme had dominated FX markets up until October last year.

As above, the return of the tariff threat into the second quarter should give the dollar another boost across the board. Having previously assumed in our EUR/USD profile that maximum tariff pressure would be something for the end of 2025, bringing that peak pressure forward a couple of quarters means we now see EUR/USD trading down to parity earlier.

We see no reason for a quick bounceback in EUR/USD over the summer. But EUR/USD is already around 5% undervalued on some of our medium-term models and any dip below parity is unlikely to be sustained this year.

We are also seeing a clear rise in realised volatility and that may well be the trend for the first half

of this year. Trump has a strategy of keeping his opponents guessing, and given FX is one of the most efficient markets in the world, frequent changes in tariff assumptions are leading to unsettled conditions.

However, the Trump 1.0 tariff experience from March 2018 to August 2019 showed that FX markets did learn to live with this new environment. Realised volatility fell through 2019 even as tariffs continued to be raised. This could potentially mean more settled conditions later this year – barring any geopolitical shock.

The Fed's real, broad trade-weighted dollar



Source: US Federal Reserve

The one slight concern we have to an otherwise conviction call that the dollar stays strong is that US corporate earnings start to suffer on FX headwinds and Washington tries to take action.

Yet wanting a weaker dollar is inconsistent with the administration's trade, immigration and tax policies. And occasional social media complaints over a strong dollar – or more likely complaints against undervalued currencies of trading partners – only look likely to add to volatility rather than turning the strong dollar trend.

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Tariffs and other stuff pushing rates around

So far, deals made to help avoid tariffs are deemed good for risk exposure and growth, and result in upward pressure on yields. The reverse holds true when tariff threats are deemed a real and present danger. But don't assume that these simple correlations will hold as a constant – in the end, an environment of material tariffs should force yields higher



Tariffs are a complicated story, and could force rates down initially – but we think they'll cumulatively end up higher

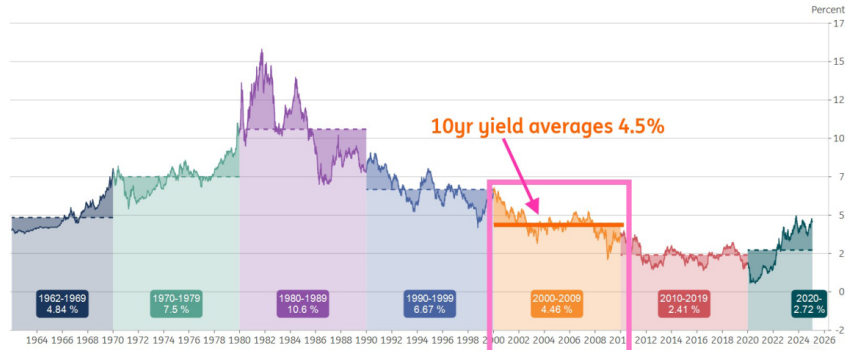
The 4.5% area for the 10yr Treasury yield is broadly neutral, and poised

The US 10yr Treasury yield at 4.5% is flat to our [estimate of neutrality](#). It feels from here it's likely to trade in a 50bp range around that – effectively 4.25% to 4.75%. And breaks above or below these extremes would result in practically inevitable tests of either one of 4% or 5%. Structurally, and as a call for 2025, we maintain the view that a trek towards 5% is most likely. We've already hit 5% in this cycle, some three months after the Federal Reserve had peaked (July 2023), before easing back down to below 4%. The initiation of Fed cuts (September 2024) coincided with a rise back up towards 5% (stopped short at 4.8%). And here we are now back down at 4.5% and poised

for the next big move.

We think 4.5% for the US 10yr is and area of neutrality

As seen in the noughties (when inflation averaged 2.5% and the funds rate averaged 3%)



Source: Macrobond

Right now, there is a drag lower on a narrative that adds tariffs to eurozone angst

In the very near term, the pressure is biased toward a break lower in yields. The angst story out of Europe is a pull factor that cannot be ignored. The prospect of the European Central Bank cutting rates on an ongoing basis in the coming number of months is one that should drag longer rates lower, or at least keep them under wraps. In the eurozone, the ECB is aiming to get deposit rates down to 1.75%. That's below the 2% area that we deem to be neutral. In contrast, the Federal Reserve is not expected to cut the funds rate down to its area of neutrality (the 3% area). The funds rate is likely to end the rate cutting cycle at closer to 4% than 3%.

In the end, The ECB depo rate ends up lower than neutral, while the Fed funds rate lands above

The rationale for the ECB landing below neutrality while the US lands above largely centres on relative fundamentals. Germany continues to act as a drag in the eurozone – and typically when Germany is not working, the eurozone is in trouble. On top of that, the US tariff bullets being aimed at Europe are the last thing that the eurozone needs – partly as they would be rebuffed by counter-tariff, so everyone loses. But the contrast between the two regions is stark as US growth remains more lively, and the Trump administration has stimulus at its core at practically any cost. That, plus an already bloated US fiscal deficit, rationalises why the Fed will stop cutting at well above the 3% neutral area.

Ultimately, the tariff story is a painful one with a notable price-rise tint – in the end hurting Treasuries

It also rationalises why the US 10yr yield, even if pulled lower initially, will ultimately be prone to re-testing higher again. We think it will get back up to the 5% area, and if we're right, we'd suggest it lands in the 5% to 5.5% area. This is not necessarily a call for the here and now. It's a call for the coming number of months, and in fact it could be something more for later in the year. By that time, US tariffs will begin to actually show up on CPI readings, and tax cuts will finally be through

Congress for execution from 2026. And if the fiscal deficit remains untamed, the route into the 5% to 5.5% range will look that bit less of a dramatic call.

This likely drags the 10yr Bund yield back up to the 2.5+% area, coinciding with a steepening process on both the US and eurozone curves, and ultimately with even wider longer-dated spreads between US and eurozone rates. What could change this is a failure in the sequencing above that forces the US 10yr above 5% in the first place.

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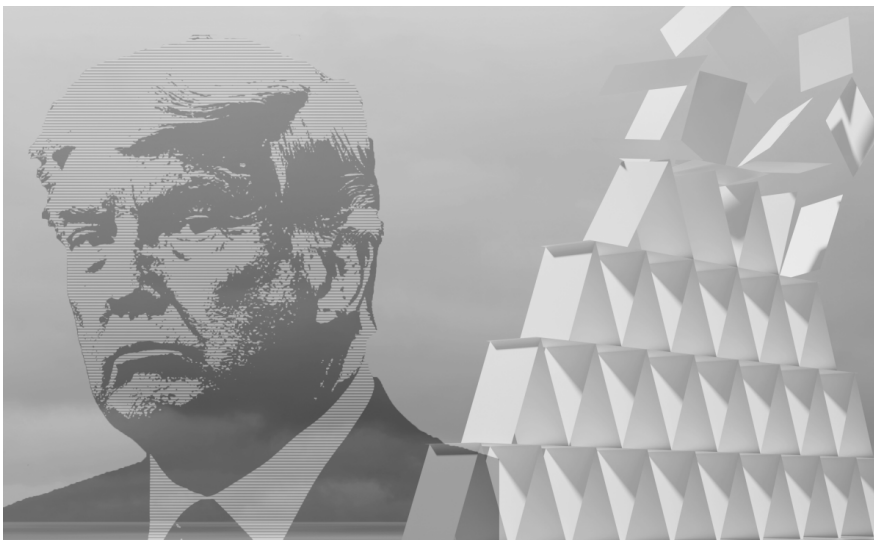
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Report | 6 February 2025

ING Monthly: Top Trumps and the global economy's House of Cards

ING's February Economic Outlook focuses on Trump's second presidency and its impact on the global economy



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