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Global economic growth appears to have ended 2024 on a solid footing. This positive momentum is expected to extend into 2025, as lower inflation will help to underpin domestic demand. However, widening sectoral divergence, persistent regional imbalances and, critically, the potential for significant shifts in US government policies after Trump's inauguration all cloud the outlook for how long the global economy will continue to expand at its current robust pace. Meanwhile, major CBs are expected to continue dialling back the restrictiveness of monetary policy, albeit cautiously, mindful of potential uncertainties and risks.

Macro Picture

USA: on a slightly above-trend growth path, while the disinflation process has stalled

EA: weak activity momentum; energy base effects are driving inflation higher

China: policy stimulus has not kicked in yet; deflationary pressures persist

Japan: wage growth data solidly above 2%, with signs of more to come in annual pay talks

CESEE: high frequency data point to improved growth performance in Q4 in key economies

Markets

FX: EUR/USD eyeing parity; USD/JPY higher as carry trade rebounds

Rates: higher on both sides of the Atlantic following strong macroeconomic data in US

EM: sovereign spreads remained at tight levels as US yields rose sharply

Credit: attention on macro data in US and Europe ahead of upcoming Fed, ECB meetings

Policy Outlook

USA: Fed expected to slow the pace of easing ahead as inflation risks are skewed to the upside

EA: stickly services inflation should keep the ECB on a cautious rate easing path

Japan: BoJ officials offer strong guidance that they will hike rates this month

CESEE: scenarios of high for longer rates in the US tap the brake on monetary easing

Key Downside Risks

DM & EM: economic fragmentation from additional trade tariffs; further escalation in regional conflicts; sharply higher commodity prices and market-based inflation expectations; monetary policy remains restrictive for longer; sharp repricing of risk in financial markets; climate related disasters

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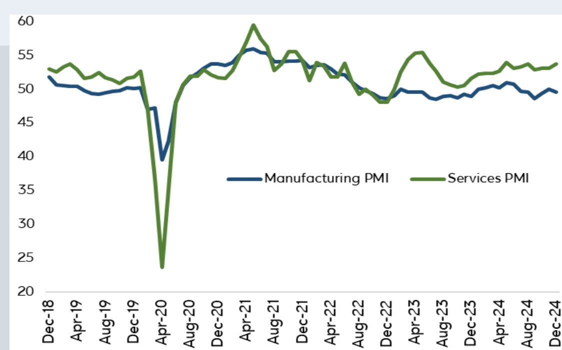
Macro Views

Trump's policy mix and uneven growth dynamics raise questions over whether positive momentum will be sustained; CBs to proceed cautiously in easing paths

The global economy appears to have ended 2024 on a solid footing, as shown by December's PMI surveys which posted a third consecutive modest increase in the composite index. Specifically, the index rose 0.2pts to a four-month high of 52.6, indicating an approximate global annual growth rate of 3.0%. Despite this positive signal and a gradual loosening in labour market conditions — though they are still relatively tight — the sectoral divergence observed in recent months intensified further in December. The services PMI, the key driver of global expansion, rose to a four-month high of 53.8, up from 53.1 in November, marking the 24th consecutive month above the 50-point expansion threshold. In contrast, the global manufacturing PMI fell back into contraction territory, dropping 0.4pts to 49.6, and remaining below 50 for five of the last six months. Alongside sectoral divergence, regional disparities among major economies persisted. The US retained its position as the leading global growth engine, with India and Spain also ranking among the top performers. China and Japan continued to show expansion, while the Eurozone remained sluggish.

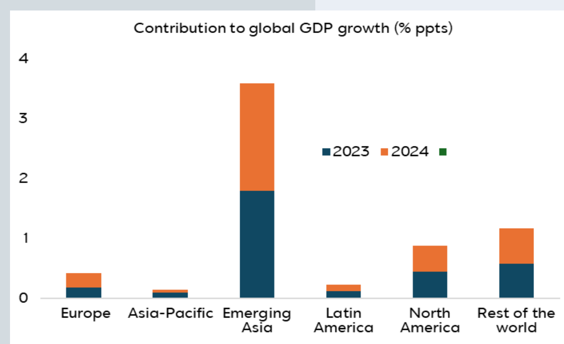
Figure 1: Sector divergence is intensifying



Source: Bloomberg, Eurobank Research

In 2025, global economic growth is projected to maintain its strong momentum, with GDP projected to expand by 3.0%YoY (Bloomberg consensus). This outlook is supported by the underlying resilience in domestic demand, offering a basis for cautious optimism. However, risks and uncertainties remain high, casting doubts over whether this positive growth momentum will be sustained. Uneven dynamics across sectors and regions persist, while challenges such as the potential escalation of geopolitical tensions and prolonged restrictive monetary policies by major central banks, point to downside risks. Additionally, just a few days before US President-elect Trump's inauguration on 20 January, potential significant shifts in administration policies add further uncertainty to the global economic outlook. However, attempting to predict their potential impact may prove futile, as this will depend heavily on the sequencing and the extent to which Trump's pre-election promised policies — including tariffs, taxes, immigration and deregulation — materialize.

Figure 2: Growth dynamics across regions remain uneven



Source: OECD, Eurobank Research

Meanwhile, outside the US, global inflation remains on a gradual declining trend, though rates are still above pre-pandemic levels. The OECD reported that headline inflation held steady at 4.5%YoY in November following four consecutive months of decline. Food inflation rose for the second straight month (+0.4pts to 4.3%YoY), while energy inflation moved into positive territory (+1.8pts to 1.2%YoY). These increases in food and energy inflation were partially offset by a slight decline in core inflation, which edged down to 4.9%YoY from 5.0%YoY in October, although it remained above the headline rate. Goods inflation has remained subdued, driven by easing supply disruptions and weaker demand. In contrast, services inflation, though gradually slowing, remains well above pre-pandemic levels, especially in countries with tight labour market conditions and stickier wage inflation. However, further moderation is anticipated as an expected shift in global demand away from services and back toward goods, alongside still restrictive monetary policies, are expected to ease labour market conditions further.

Against this backdrop, major central banks are expected to reduce policy restrictiveness further with the aim to bring interest rates closer to neutral. However, they are anticipated to proceed cautiously and some of them might keep all options open, mindful of potential uncertainties and risks.

Developed Economies

US: As President-elect Donald Trump's inauguration approaches on January 20, which is expected to bring greater clarity on his policy agenda, recent data reveals that healthy growth momentum continued into the final quarter of 2024. This is largely driven by household consumption which remains supported by a declining savings rate, solid household fundamentals and notable gains in real disposable personal income. Looking ahead, economic activity is expected to lose some momentum throughout 2025 as labour market conditions are forecasted to ease further. Additionally, tighter immigration policies and uncertainty about higher tariffs are expected to pose headwinds to GDP growth. However, this drag is anticipated to be partially offset by looser fiscal policy and regulation, allowing the economy to maintain slightly above-trend quarterly growth rates. Meanwhile, disinflation progress towards the Fed's 2% inflation target has stalled in recent months. Not surprisingly, at the December policy meeting the Fed signalled a slower pace of rate cuts ahead, likely due to growing concerns about inflation.

Euro area: GDP growth unexpectedly accelerated in Q3 2024, to 0.4%QoQ from an average of 0.25%QoQ in the first half of the year. However, incoming data for Q4 suggests a slower, yet still positive growth rate. As a result, full-year GDP growth for 2024 is projected to remain slightly below trend, hovering around 0.7-0.8%. Meanwhile, headline inflation rose in December, as anticipated, increasing by 0.2ppts to 2.4%YoY largely driven by energy base effects. Core inflation remained steady at 2.7%YoY for the fourth consecutive month, with a slight uptick in services inflation offset by a decline in core goods inflation. For Q4 overall, headline inflation averaged 2.2% and core inflation 2.7%, both 0.1ppts below the ECB's December staff projections. That said, the ECB could maintain a cautious approach to rate easing, with markets currently pricing in more than fully a 25bps rate cut at the January meeting, with an additional 70bps of easing anticipated by the end of Q3 2024.

Emerging Economies

EM: emerging markets have had a rough start to 2025. Key indices such as the MSCI EM equity index have dropped around 2%, with losses widening to nearly 10% since October 2024, when markets began factoring in the possibility of a Trump victory in the US elections. Similarly, the EM currency index has followed suit. In contrast, the MSCI World Equity index posted modest gains to begin the year. Market reactions are driven by concerns that the tariffs and tax cuts proposed under a second Trump administration could exacerbate inflationary pressures in an already strong US economy. This, in turn, could lead to higher US interest rates for a longer period, placing additional pressure on emerging market assets. In China, market signals are also raising alarms for policymakers. The country's sovereign bond market is reflecting growing deflationary pressures, with CPI growth slowing to 0.1% YoY in December from 0.2% YoY in November, marking the weakest pace since March 2024. The 10-year bond yield, a key indicator of growth and inflation expectations, fell to a record low of under 1.6% last week and has remained near that level. The outlook for China's economy has become more complex with the looming threat of higher US tariffs. However, what may pose a challenge for China could present an opportunity for other major emerging markets, such as India, to strengthen their position.

CESEE: as GDP flash estimates for Q4 2024 are expected in mid-February, attention has shifted to inflationary pressures, which have been building amid a changing global landscape, particularly following the re-election of President Trump in the US and the anticipated changes in his second term. In November, the Harmonized Index of Consumer Prices (HICP) rose across the CEE3 and Romania, with the exception of Poland. Inflationary pressures are largely attributed to rising gas and oil prices, along with the recent strengthening of the US dollar, which has put downward pressure on the region's currencies, including the Czech Koruna, Hungarian Forint, and Polish Zloty. Additionally, idiosyncratic factors, such as political instability in Romania — where presidential elections were annulled, sparking social unrest and protests — have also impacted sovereign bond markets. Along these lines, national central banks in the region have moderated their previously dovish stances.

Markets View

Foreign Exchange

EUR/USD: after reaching a more than two-year low of 1.0178 on January 13, the pair gained some ground, but still remained below 1.03. ECB officials highlight concerns over economic growth and the risk of undershooting the inflation target, while political uncertainty in Germany and France persists, keeping market sentiment cautious and bearish. A break below 1.01 could pave the way for a potential decline towards below parity. Support levels include 1.0111, 1.00 and 0.99 while resistance levels stand at 1.0324, 1.0476 and 1.0528. Implied volatility for 1M, 6M and 9M currently at 9.3675%, 8.365% and 8.08% respectively.

USD/JPY: higher at 158.87 on January 10, close to a breakout above 160, before retreating towards 155.50 thereafter, with JPY carry trade again in the spotlight. Support levels include 155.1924, 154.4086 and 153.6248 and resistance ones 160.0446, 160.8369 and 161.6292. Implied volatility for 1M, 6M and 9M currently at 10.9125%, 10.445% and 10.33% respectively.

Rates

EU: swap rates experienced notable shifts following a volatile month. The 5yr swap rate was trading at 250bps on January 14, rebounding from a low of 200bps in early December. The curve's slope has remained relatively stable, with the 5s-30s spread at -12bps, though it briefly tightened to -6bps. Looking ahead, we expect rates to decline gradually, as inflation has not yet stabilized at levels below the ECB's 2% target. Additionally, the Eurozone is facing a period of weak growth, particularly in Germany, where the manufacturing sector has significantly weakened.

US: swap rates have begun the year significantly higher. The 10yr swap rate was trading at 4.30% on January 14, up from 3.60% at the beginning of the year. The curve's inversion has also consolidated, close to -13bps but having reached a high of -4bps at the beginning of the month. We expect rates to remain at elevated levels given that the labour market re-mains robust, and inflation, while having moderated significantly from its peak, remains above the Fed 2% target.

Emerging Markets Sovereign Credit

The sharp rise in US yields from early December did not affect EM sovereign spreads with the EMBI Global Index tightening by 5bps to 296bps between the start of last month and January 14. In Central Europe, Serbia and Bulgaria continued their strong performance with the 10yr spreads over swaps tightening by 18bps and 17bps respectively. Romania on the other hand was the worst performer with political risk rising and Fitch revising its outlook from stable to negative but affirming the rating to BBB-. Hungary came to

the market with a new EUR 10yr and a new EUR 15yr Green bonds, while Moody's downgraded its outlook from stable to negative (Baa2 affirmed), but with no significant market impact. In LATAM, both Mexican and Chilean USD bonds were little changed in terms of spreads. In Asia, Indonesian EUR bonds performed relatively well from the end of November with the 9yr bond trading 11bps tighter as of January 14 at 116bps. We remain cautious on adding EM sovereign risk due to the imminent Trump policies and we think that politics and geopolitics will likely remain a near-term focus for markets.

Corporate Credit

December saw markets stumble, as the Fed pivoted in a more hawkish direction. It cut rates by 25bps on December 18, as largely expected, but only signalled 50bps of cuts for 2025, which was more hawkish than anticipated. That led to the biggest daily decline for the S&P 500 in almost 25 years. Meanwhile in Europe, the ECB cut rates again in December, but there was disappointment as it did not pivot towards a more dovish stance. Separately in France, the government of Michel Barnier fell, putting pressure on French assets. On a monthly basis, Stoxx 600 registered a -0.5% decline in December, alongside a 2.5% decline for the S&P 500. Moving on to the start of the year, the key market theme has been a US-led global bond sell-off. There have been quite a few headlines that collectively point in a more hawkish di-rection, including strong US labour market data, a rise in commodity prices (Brent crude +10% since early December) and expectations that tariff policies of the incoming Trump administration will be inflationary. Against this backdrop. European equities pared back a rebound earlier in the year, standing on marginally positive ground as of January 14 compared with the start of December. US equities have underperformed, with the S&P 500 -3.3% since the start of December, despite a 5.7% rise in large tech stocks.

In credit, both European and US synthetics widened between the start of December and January 14, with US HY underperforming vs. EU. Since the beginning of December, Main widened by +2bps while Xover closed +17bps wider (vs. CDX IG +4bps, CDX HY +26bps). Cash remained well supported in December but saw a softer performance in January. in line with the rates move. In EUR Corporate cash, IEAC is -1bp December-to-date, with IHYG -20bps during the same period, as January's weakness has so far been offset by stronger performance in December. Sector-wise, there have been no notable outperformers and underperformers among IG names. In High Yield, Snr Financials and Energy outperformed (c. -100bps each), while Technology lagged (+36bps). The European primary market saw fairly low activity in December (less than €10bn total issuance), but bond sales picked up in January, with combined issuance exceeding €140bn so far year-to-date.

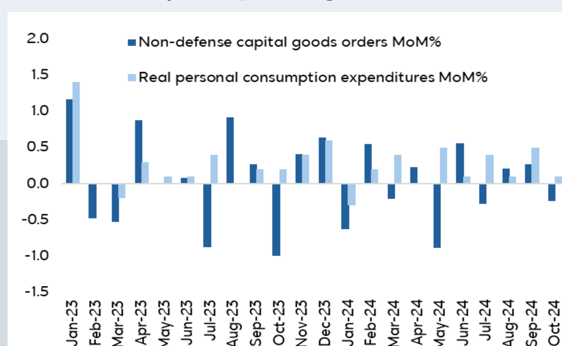
Attention has shifted to key inflation data in the US and Europe, ahead of the upcoming meetings from the Fed (January 29) and the ECB (January 30). The fourth-quarter earnings season kicks off this week in the US, with analysts seeing +7.3% growth for the S&P 500 EPS (vs. +9% in Q3), led by strong growth in semiconductors and a rebound in autos, which offset a decline in oil & gas earnings.

US

Growth slightly above trend as disinflation falters

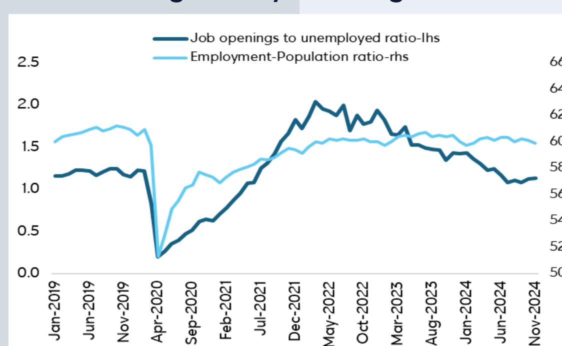
As President-elect Donald Trump's inauguration approaches on January 20, which is expected to bring greater clarity on his policy agenda, recent data reveals that healthy growth momentum continued into the final quarter of 2024. This is largely driven by real household spending which continued to perform strongly through November, rising by a higher-than-expected 0.3%MoM, aligning with the Q3 average, following a 0.1%MoM increase in October. November's acceleration was fuelled by the goods sector, which grew 0.7%MoM after a slight 0.1%MoM decline in the prior month, mirroring a solid performance in November's retail sales control group (+0.4%MoM). Household consumption remains supported by a declining savings rate (4.4% in November, down from a peak of c. 26% in early 2021), solid household fundamentals (net worth reached $189.7trn in Q3, an increase of $56trn or 42% from pre-pandemic levels) and notable gains in real disposable personal income, which rose 3.4% saar over the three month period that ended in November, compared to just 0.6% saar in the preceding three-month period ending in August. Market participants expect another above-trend GDP growth rate of 2.3% saar in Q4, though slightly slower than the upwardly revised final estimate of 3.1% saar in Q3, after factoring in weak November data for industrial production (-0.1%MoM), housing starts (-1.8%MoM) and the trade balance (deficit widened to $78.2bn). Looking ahead, economic activity is expected to lose some momentum throughout 2025 as labour market conditions are forecasted to ease further. Additionally, tighter immigration policies and uncertainty about higher tariffs are expected to pose headwinds to GDP growth. However, this drag is anticipated to be partially offset by looser fiscal policy and regulation, allowing the economy to maintain slightly above-trend quarterly growth rates. Meanwhile, disinflation progress towards the Fed's 2% inflation target has stalled in recent months. Core PCE stood at 2.5% saar in the three-month period ending in November, 0.2ppts higher than the rate in the preceding three-month period that ended in August, while inflation risks are skewed to the upside due to Trump's plans for more protectionist trade policy, tax cuts and stricter immigration rules. Not surprisingly, at the December policy meeting the Fed signalled a slower pace of rate cuts ahead, likely due to growing concerns about inflation, with markets currently pricing in just 32bps of easing in 2025.

Figure 3: Consumer spending remained on a solid trajectory through November



Source: BLS, Eurobank Research

Figure 4: Labour market conditions are gradually loosening



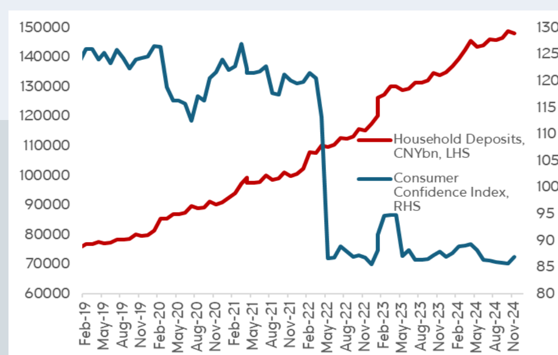
Source: BLS, St. Louis Fed, Eurobank Research

China

Rebooting consumption and navigating tariffs critical to the outlook

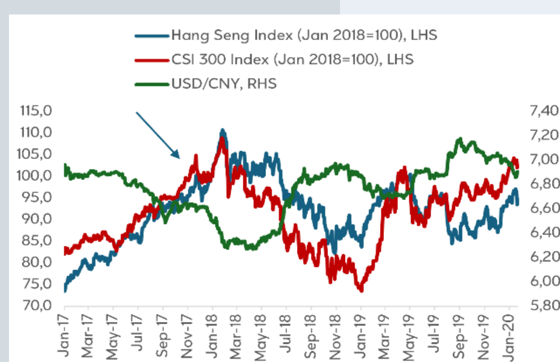
This year marks a significant milestone for China's "Made in China 2025" initiative, launched in 2015 to bolster the country's manufacturing sector amid rising international competition and increasing economic security concerns. Once heralded as an "economic miracle", China's growth has shown signs of slowing in recent years. According to the latest IMF projections through 2029, China's growth is expected to continue decelerating, although it will still outpace the G7 economies by more than twofold. The economy grew at an average rate of 4.8% in the first nine months of 2024, requiring a strong Q4 performance to meet the official 2024 target of "around 5%". While final Q4 GDP figures will be published on January 17, 2025, the overall economic performance for 2024 remains mixed. Despite initial policy hesitancy, Chinese policymakers are now fully committed to a broad set of measures aimed at steering the economy towards more sustainable growth. A key priority is addressing the supply-demand mismatch, particularly by restoring consumer confidence to stimulate private consumption. However, the effectiveness of these measures has yet to be seen. Indicatively, corporate profits for companies with revenues exceeding RMB 20 million ($2.7 million) fell by 4.7%YoY between January and November 2024, according to data from the National Bureau of Statistics. This decline exceeds the 4% drop in 2022, a year marked by pandemic lockdowns. In addition, China's sovereign bond market is signalling increasing deflationary pressures, with CPI growth edging down to 0.1%YoY in December from 0.2%YoY in November, marking the slowest pace since March 2024. The 10yr bond yield, a key indicator of growth and inflation expectations, fell to a record low of under 1.6% last week and has remained near that level. While recent export data showed a 10.7%YoY increase in December, driving the trade surplus to a record $1 trillion, this surge is likely due to companies frontloading purchases in anticipation of future tariffs, raising doubts about the sustainability of this performance in 2025. Overall, China's economic outlook is further complicated by the potential for a second Trump presidency, which could heighten trade tensions and exacerbate geopolitical uncertainty.

Figure 5: Weakening consumer confidence swelled household savings and hampered consumption ...



Source: Bloomberg, Eurobank Research

Figure 6: The 2018 trade war roiled Chinese financial markets. Are we heading towards a repeat?



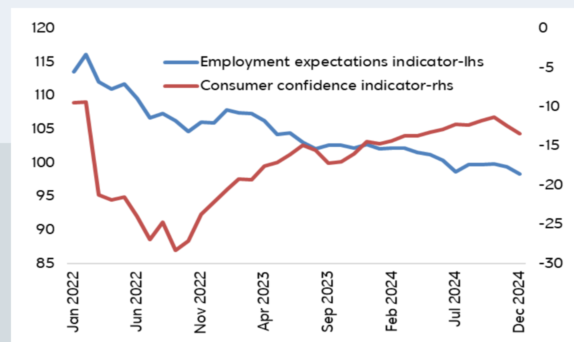
Source: Bloomberg, Eurobank Research

Euro area

Activity momentum weak; energy base effects drive inflation higher

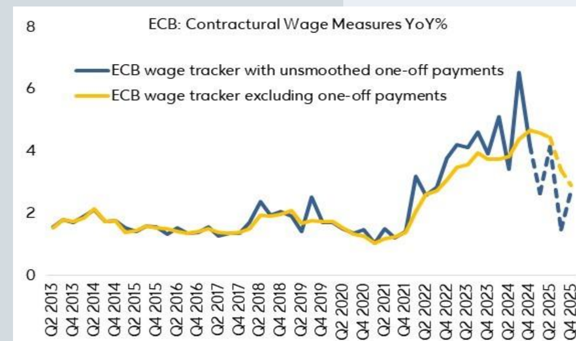
GDP growth unexpectedly accelerated in Q3 2024, to 0.4%QoQ from an average of 0.25%QoQ in the first half of the year. This increase was primarily driven by a 0.7%QoQ rise in household consumption, likely supported by France's economic boost from the Olympic Games. However, incoming data for Q4 suggests a slower, yet still positive growth rate. As a result, full-year GDP growth for 2024 is projected to remain slightly below trend, hovering around 0.7-0.8%. Supported by a rebound in services (+1.9pts to 51.4), the composite PMI rose 1.2pts to 49.5 in December, partially reversing November's 1.8pts decline. However, it remained below the 50-point threshold that separates contraction from expansion, with the Q4 average at 49.3, below Q3's 50.3. Adding to the weak outlook for Q4, economic sentiment unexpectedly weakened in December, falling to 93.7, its lowest level since early 2021, from 95.6 in November. Consumer confidence also declined for the second consecutive month, dropping 0.7pts to -14.5, raising concerns about the strength of a potential consumer spending recovery in the coming quarters, despite anticipated real income gains. The outlook for consumer spending remains fragile, as individuals grow concerned about short-term labour market conditions and the possibility of slowing wage growth (as indicated by the ECB's newly introduced "headline" wage tracker) amid declining company profits and sluggish economic activity. Hard data paints a mixed picture. Industrial production was broadly flat in October after three consecutive quarters of contraction, remaining 2.6% below pre-pandemic levels. Retail sales increased 0.1%MoM in November following a 0.5%MoM decline in October, on pace for a modestly positive Q4. Meanwhile, headline inflation rose in December, as anticipated, increasing by 0.2ppts to 2.4%YoY largely driven by energy base effects. Core inflation remained steady at 2.7%YoY for the fourth consecutive month, with a slight uptick in services inflation (0.1ppts to 4.0%YoY) offset by a decline in core goods inflation (-0.1ppts to 0.5%YoY). For Q4 overall, headline inflation averaged 2.2% and core inflation 2.7%, both 0.1ppts below the ECB's December staff projections. That said, the ECB could maintain a cautious approach to rate easing, with markets currently pricing in more than fully a 25bps rate cut at the January meeting, with an additional 70bps of easing anticipated by the end of Q3 2024.

Figure 7: Consumers start to worry about labour market conditions



Source: European Commission, Eurobank Research

Figure 8: Newly introduced ECB "headline" wage trackers point to weaker wage growth ahead



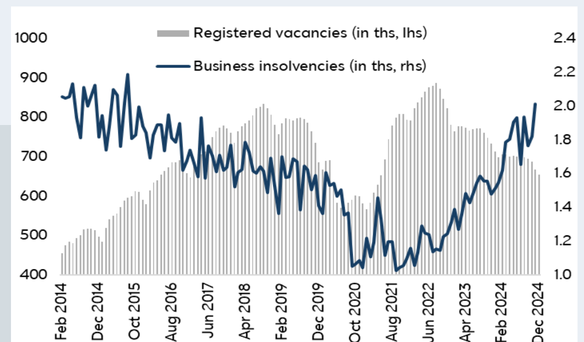
Source: Eurostat, Eurobank Research

Germany

Prolonged stagnation has ignited a debate over more expansionary fiscal policy

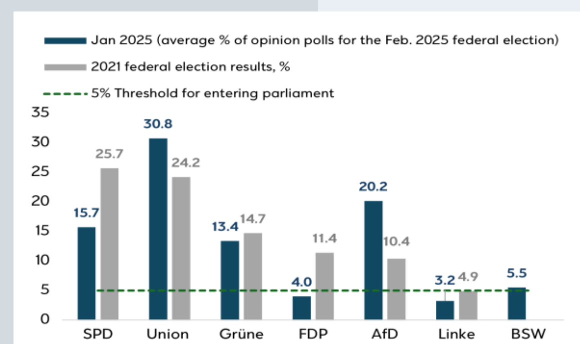
After recovering an average growth rate of 0% in the first three quarters of last year and achieving a mere 0.1% recovery compared to pre-pandemic levels, data for Q4 (e.g., IFO, PMIs, industrial orders, trade data) indicates ongoing stagnation. Projections for full year 2024 suggest another year of slight contraction. If that is the case, it would mark the first consecutive annual declines since 2002-2003, driven by a mix of structural challenges (aging population, labour shortages, reliance on exports, energy transition hurdles, declining industrial competitiveness and bureaucratic obstacles) and cyclical issues (economic slowdown in key trading partners, energy price shocks, weak domestic demand and geopolitical uncertainty). The prolonged stagnation has triggered a rise in company insolvencies and significant strain in the labour market. In October, Germany recorded 2,012 company insolvencies (+35.9%YoY), the first monthly figure above 2k since mid-2014, with the construction and retail sectors experiencing the highest number of insolvencies in 2024 so far. Unemployed also increased in December for the 24th consecutive month, albeit less than expected, to reach 2.807mn, leaving the unemployment rate steady at 6.1%. Job vacancies continued to decline, with around 654k registered in December, a decrease of nearly 59k compared to the same month the previous year. These challenges have reignited discussions over the need for a more expansionary fiscal policy to stimulate public investment, either in the form of amending the debt brake or a special off-budget fund for which the debt break does not apply (a two-thirds parliamentary majority is required). As German heads into a federal election on February 23, recent opinion polls indicate that no party is likely to secure an absolute majority. The centre-right CDU/CSU leads with c. 31%, followed by the AfD at c. 20%, the SDP in third place at c. 16% and the Greens in fourth at c. 13.5%. As things stand, two primarily coalition scenarios seem plausible: a grand coalition led by the CDU/CSU, alongside the SPD, or a black-and-green coalition with the Greens. The CDU/CSU manifesto says the party aims to "adhere" to the debt brake but leaves room for potential adjustments if circumstances warrant it, particularly for financing investments. Conversely, the SPD and the Greens prioritize increased government investment and openly advocate for relaxing the debt brake.

Figure 9: Stagnation has led to an increase in company insolvencies and a decrease in vacancies



Source: German Federal Statistics, Eurobank Research

Figure 10: CDU/CSU maintains strong lead in recent opinion polls



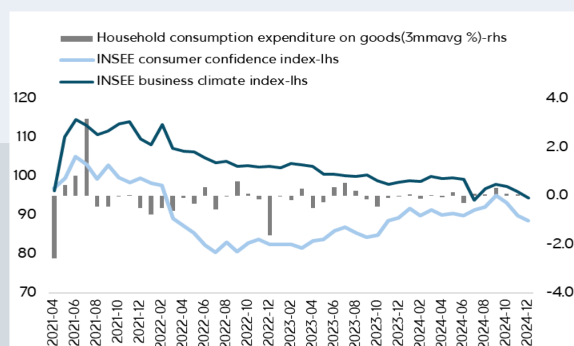
Source: Pollytix,Strategic, Eurobank Research

France

Political uncertainty has started to impact economic activity

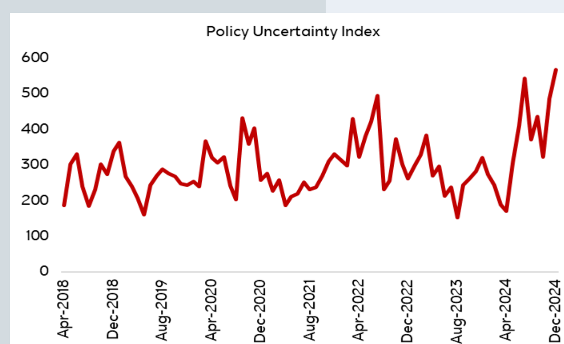
France's economic outlook remains clouded by persistent political and fiscal uncertainty, contributing to a slowdown in growth momentum. After a solid 0.4% QoQ GDP growth in Q3 2024, fuelled by a temporary boost from the Summer Olympics, and a modest average of 0.2%QoQ in H1, Q4 data suggests weaker performance. INSEE's business confidence index dropped in December for the third consecutive month, down by 1.7pts to 94.3, approaching the 2024 low recorded during the snap parliamentary elections in July. The INSEE confidence index also declined, reaching 88.6, its lowest level since late 2023 from November's 89.8. Moreover, hard data offers little grounds for optimism, with household consumption of goods expected to increase by only 0.1%QoQ in Q4, following a stronger 0.4%QoQ in the previous quarter. Overall, we forecast GDP to stagnate in Q4, bringing the annual growth rate for 2024 to 1.1%, before the economy slows to 0.7% in 2025, in contrast to the modest recovery expected for the Eurozone. Fiscal consolidation is likely to dampen public demand and hinder both consumer and business spending. Political uncertainty and tighter financial conditions (driven by higher OAT yields) are also anticipated to weigh on economic activity. Political and fiscal uncertainty is likely to persist for months, as the fragmentation of the National Assembly raises questions about whether the new government, led by François Bayrou, can offer more stability and effectiveness than the previous administration under Michel Barnier. One of the pressing issues is the 2025 budget. Discussions in the Senate are set to resume soon, with the goal of passing the budget by mid-February. However, approval may require political compromises, potentially including concessions to the far-right (e.g., proportional representation) or the moderate Left (e.g., by amending pension reforms). These compromises could increase the budget deficit beyond Barnier's original target of 5% of GDP, with forecasts for 2024 already reaching 6.1%. If Bayrou's government fails to secure the support of at least 289 MPs (the absolute majority threshold), it may resort to the controversial Article 49.3 procedure to pass the budget through. This could lead to fresh elections, further escalating political and fiscal risks, and potentially resulting in credit rating downgrades, all of which would compound the economic challenges facing France in 2025.

Figure 11: Data points to weakening growth momentum in Q4 ...



Source: INSEE, French Government, Eurobank Research

Figure 12: ... reflecting continued political and fiscal uncertainty

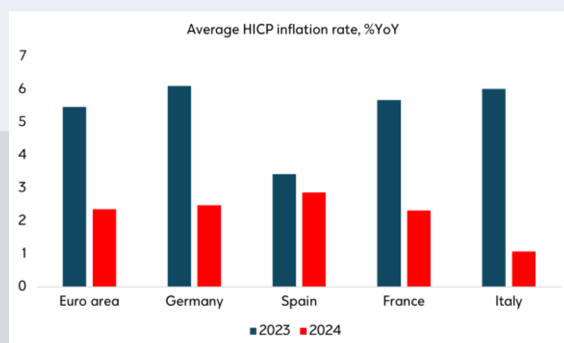


Source: Economic Policy Uncertainty, Eurobank Research

Italy

Low inflation shows country stands to benefit from more central bank easing

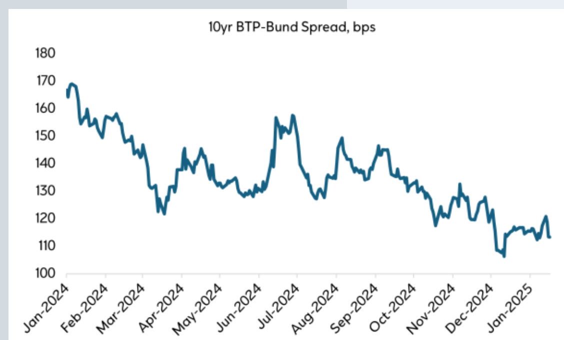
Figure 13: Price growth in 2024 was less than half that of other major eurozone economies



Source: Eurostat, Eurobank Research

Inflation unexpectedly slowed in December, a fitting way to close out a year in which price growth has stayed below the ECB's 2% target throughout. The headline index increased 1.5%YoY last month, unchanged from November's figure which was downwardly revised from 1.6%YoY. Core HICP also increased less than the central bank's target in December, rising 1.8%YoY compared with 2%YoY the month before. The latest data means that Italy's headline inflation rate slowed to an average of 1.1% last year – less than half the euro area average of 2.4% – from 6% in 2023. As the major euro-area economy with the lowest inflation rate, Italy would stand to benefit from continued further ECB monetary policy easing, especially since growth momentum stalled in the second half of 2024. GDP was unchanged on a quarterly basis in Q3, after expanding 0.2%QoQ in Q2. Business survey data show few signs of a pickup in momentum in Q4. The services PMI did move back above the 50 threshold separating expansion from contraction in December, increasing 1.5pts to 50.7, but the composite and manufacturing PMI readings both stayed below, with the latter still in a slump despite rising to 46.2 from 44.5 in November. Composite PMI increased 2pts to 49.7. Meanwhile, consumer confidence dipped 0.3pts to 96.3 in December. As a result, we forecast that FY 2024 GDP growth will come in at 0.5%, 0.2ppts lower than 2023. In contrast to the weak output data, Italy's labour market continues to look healthy. After dropping to its lowest rate recorded in Eurostat data going back to 1983 in October, the unemployment rate decreased another 0.1ppts in November to 5.7%. The combination of low inflation and tight labour markets points to a way out of the current slowdown, with consumption likely to increase as real earnings incomes improve – especially after the effects of easing monetary policy begin to transmit to the real economy. Retail sales rose 1.1%YoY in November, which was less than October's 2.6%YoY increase but still marked the second-highest gain since March 2024. Italy is also benefiting from its current relative political stability, which has meant that the yield spread of Italian government bonds over their German counterparts tightened last month despite a broader global sovereign bond selloff. The 10yr BTP-Bund spread reached a three-year low of 106bps on December 11. Since then it has increased 13bps to 119bps, but remains below where it was for most of 2024.

Figure 14: Political stability has driven down spreads despite sell-off in government bonds



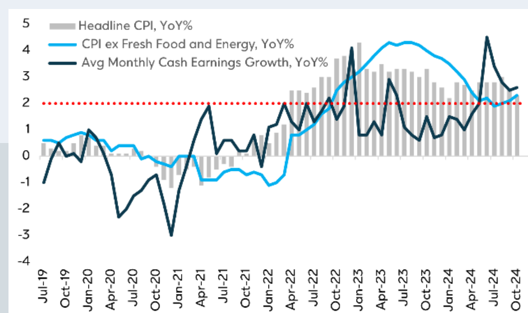
Source: Bloomberg, Eurobank Research

Japan

Latest Ueda comments suggest interest rate hike likely at this month's meeting

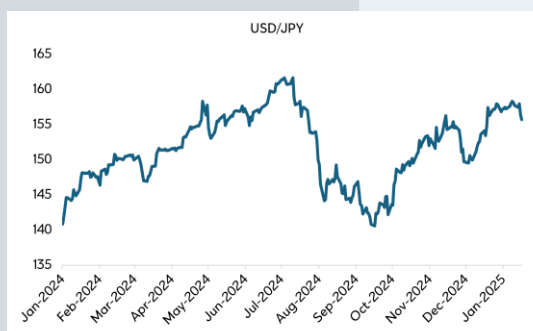
It is looking increasingly likely that the Bank of Japan will start the year with the third interest rate increase of the current cycle at its policy meeting on January 23-24. A hike has been in the pipeline for some months now, with the BoJ holding off at its December meeting as it monitored developments in domestic wage growth and in US economic policy under the incoming administration of President-elect Donald Trump. The latter of these considerations remains uncertain, and rate-hike expectations – as of January 15, futures markets implied a 73% probability of a 25bp increase in the policy rate to 0.5% this month – would fall quickly if Trump were to drop a surprise at his January 20 inauguration speech such as announcing specific tariffs on Japanese goods. Barring such a development, BoJ officials have signalled that there has been enough progress on wages for them to move. Labour cash earnings grew 3%YoY in November, 0.3ppts more than the consensus forecast and up from 2.2%YoY the month before. A separate gauge eliminating distortions from changes to the survey sample, which is preferred by the BoJ, rose 3.5%YoY from 2.8%YoY October. Moreover, the indications continue to be that unions and large Japanese corporations will negotiate salary increases at the annual *shunto* spring negotiations that will be similar in size to the 5.1% rise agreed last year. That increase was the biggest since 1991 and one of the main factors enabling the BoJ to end its unconventional monetary policy in March 2024. On the inflation front, headline CPI increased 0.6ppts to 2.9%YoY in November, with services-price inflation at 1.5%YoY, unchanged from October. Tokyo's CPI, seen as a leading indicator for nationwide trends, increased 0.3ppts to 3%YoY in December. Speaking after a meeting of regional bank executives on January 15, BoJ Governor Kazuo Ueda echoed comments by other central bank officials that rate hikes will be discussed at this month's meeting, also noting that at the BoJ regional branch managers' meeting earlier this month there was a lot of positive talk on the wage outlook. Aside from domestic wage developments and US economic policy, the yen's weakening against the dollar also figures in the central bank's interest rate calculus. The BoJ's decision to defer a rate hike at December's policy meeting is seen as one factor driving USD/JPY up to around 158 earlier this month, a level previously seen in July when Japanese authorities last intervened in the currency market.

Figure 15: BoJ officials have expressed confidence that wage growth will be sustained



Source: Bloomberg, Eurobank Research

Figure 16: The yen weakened after the central bank kept rates on hold in December



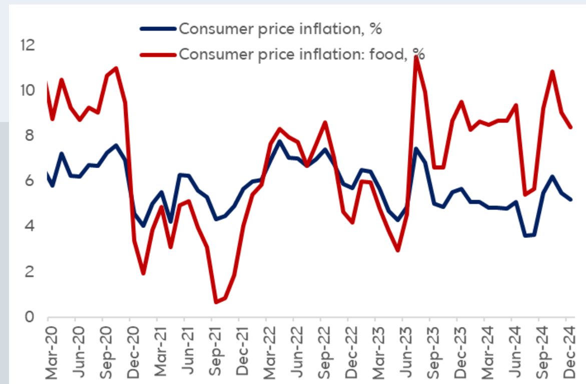
Source: Bloomberg, Eurobank Research

India

Growth now cooling, but country could be winner in global trade shake up

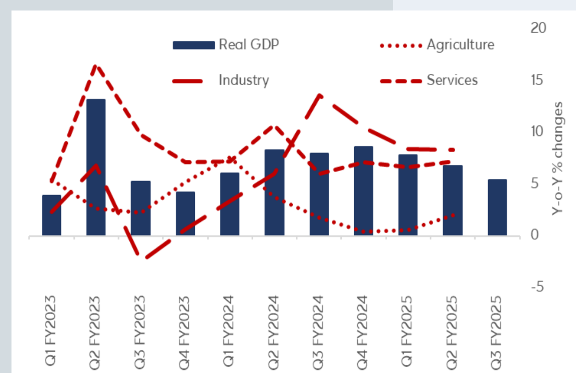
India's economy experienced a slowdown in the first three quarters of fiscal 2025 (the country's fiscal year runs from April 2024 to March 2025). Growth, which was 8.2% in fiscal 2024, decelerated gradually to 7.8%YoY in Q1, 6.7%YoY in Q2, and 5.4%YoY in Q3, bringing the average for the first nine months to 6.6%YoY. This slowdown, despite India being the world's fastest-growing major economy, can be attributed to several factors: softening consumer demand, sluggish private investment, and a pullback in government spending, a key driver in recent years. Moreover, India's goods exports have faced persistent challenges, with their global share remaining at just 2% in fiscal 2023, despite modest growth over the past decade due to the pandemic and rising geopolitical tensions. In early January, the Ministry of Statistics and Programme Implementation (MoSPI) released the "First Advanced Estimates" (FAEs) for fiscal 2025 GDP, forecasting 6.4% growth. This suggests a slight pickup in Q4 (January-March) growth to 5.7% YoY, compared to 5.4% YoY in Q3. This projection aligns with the Reserve Bank of India's (RBI) forecast of 6.6% in December, which was revised down from 7.2% previously. The RBI made this adjustment during its last Monetary Policy Committee (MPC) meeting, where it also kept the key policy rate (KPR) unchanged at 6.5%. With annual CPI readings cooling from 5.5%YoY in November to 5.2%YoY in December, there is room for an interest rate cut in the upcoming MPC meeting in February under new RBI Governor Sanjay Malhotra, who succeeded Shaktikanta Das after the latter's six years at helm of the bank. It is expected that the RBI will pivot towards a more dovish stance, prioritizing growth. A 25bps cut in Q1 2025 is likely, given the current repo rate's lead over the neutral rate, estimated by the RBI at 5.4%-5.9%. Concluding, India may find new opportunities to strengthen its trade relationship with the US, as the US seeks to reduce its economic dependence on China. Geopolitical uncertainties stem from the possibility that a second Trump term will end up existing global trade patterns, but India could emerge as one of the winners of such a reconfiguration, potentially boosting the country's economic growth.

Figure 17: Resurging inflationary pressures in fiscal 2025 ...



Source: OECD, Eurobank Research

Figure 18: ..have taken a toll on growth



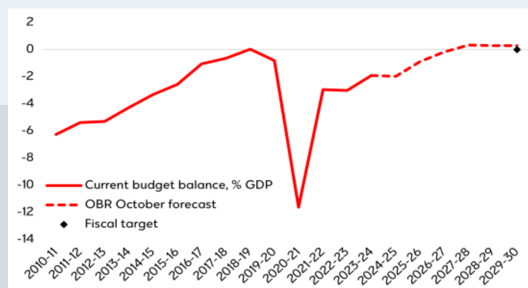
Source: OECD, Eurobank Research

UK

Government under pressure as rising bond yields throw off budget arithmetic

The government's budget maths has come under renewed focus as the selloff in sovereign bonds worldwide has hit the gilt market particularly hard. That's raised fears that the increase in the UK's borrowing costs will mean that the government will need to raise taxes or cut spending on public services even more than the measures it announced in October if it is to remain in compliance with its self-imposed fiscal rules. The yield in 10yr gilts closed as high as 4.89% on January 14, its highest since the global financial crisis in 2008 and an increase of more than 100bps since mid-September. However, the yield fell 16bps the following day after December's CPI print showed the inflation rate slowing 0.1ppts to 2.5%YoY, compared with consensus expectations that it would remain unchanged. The core CPI rate dropped 0.3ppts to 3.2%YoY, lower than the consensus forecast of 3.4%YoY. The respite for bonds was also fed by US CPI data for December coming in cooler than expected. The UK CPI release, together with comments on the same day by a Bank of England policy maker about the need to cut rates to prevent a hard landing, raised market expectations over the pace of monetary easing. As of January 15, futures markets were pricing in 56bps of cumulative easing this year, compared with just 28bps before the data release, while the market-implied probability of a rate cut at next month's BoE policy meeting increased to 90% from 64%. Despite the recent fall in government bonds and GBP/USD mostly emanating from economic and political developments in the US, critics of the government have latched onto it to attack its handling of the economy – at its extreme making comparisons with the market blowup in the autumn of 2022 during Liz Truss's brief premiership. That comparison seems exaggerated – back then, the yield on 10yr gilts rose more than 100bps in less than a week after the government announced a package of unfunded tax cuts, coinciding with a liquidity crunch for UK long-term pension funds. But the increase in borrowing costs has boxed Finance Minister Rachel Reeves into a corner as it jeopardises the chances of meeting the rule she adopted in October that the current budget balance should be in surplus in 2029-30. The key moment will come on March 26, when the Office for Budget Responsibility issues fiscal forecasts that will determine whether the government is in breach of that rule, which could leave the government needing to make politically difficult budget cuts.

Figure 19: The government does not have much headroom for meeting its fiscal target



Source: ONS, Eurobank Research

Figure 20: Gilt yields earlier this month rose to their highest since the GFC in 2008

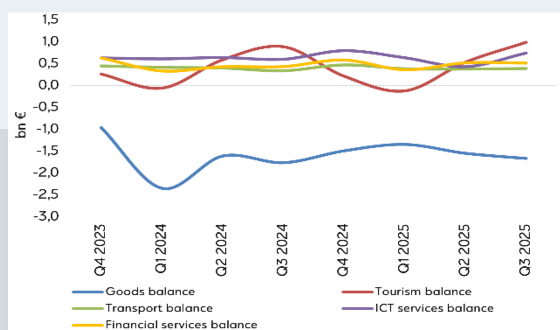
Source: Bloomberg, Eurobank Research

Cyprus

Investment potential from robust services exports - real estate at a multiyear high

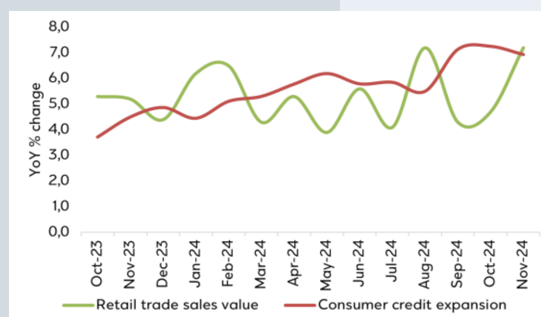
Recent trends in short-term indicators of economic activity remain tilted to the upside, suggesting that the strong growth momentum in Q1-Q3 2024 could persist into the final quarter. Despite inflation accelerating to 2.2%YoY in November from 1.6%YoY in September-October, retail volume rose 6.3%YoY, the most in 16 months, compared with 4.6%YoY in October. The surge in consumer demand is attributed to the decline in unemployment to 16-year lows, a small increase (+1.5%) in the salaries of civil servants and public sector pensioners from October onwards and a faster consumer credit expansion since September. There is no indication that this acceleration in household consumption in recent months has negatively impacted the goods trade balance. Although its deficit more than doubled in November (+113%YoY), this was largely driven by a sharp decline in exports (-50%YoY), related to base effects from exports of ships. This drag on the overall external balance could be offset by a higher surplus in services, which has been expanding throughout Q1-Q3 2024. Based on current account balance data, this improvement is supported by various sectors: ICT, financial services, tourism, transport. Amid protracted geopolitical tensions in the region and in Ukraine, which have dampened tourism, the upward trend in tourist arrivals continued in October-November (+9.1%YoY), leading also to a new all-time high (+1.0% from 2019 in January-November). In terms of investment, the foreseen in previous issues multiyear high in the number of real estate sales in 2024 was eventually achieved, as they rose by 1.5%, to their highest level since 2007. The stronger activity in the sector, with positive spillovers for construction, occurred despite a 10.1% decline in sales to foreign buyers and a new spike in residential prices by 5.3%YoY in Q1-Q3 2024. which both point to robust domestic demand in the real estate market. The acceleration of credit supply growth close to 2.0%YoY in July-November from on average 1.3%YoY in H1 2024, mainly due to more financing to businesses (+1.4%YoY), enhances the investment potential for Q4 2024 and 2025. Investment will also be supported by the disbursement of the second tranche of the RRF in November, almost two years after the first one. Given the solid upward dynamics in the components of private demand and mixed developments in the external balance, we keep our GDP growth forecast for 2024 unchanged to 3.7%, and project a small deceleration for 2025, to 3.4%.

Figure 21: Trade surpluses in tourism, ICT, financial services and transport more than offset the goods deficit



Source: Central Bank of Cyprus, Eurobank Research

Figure 22: Retail sales growth helped by faster consumer credit expansion



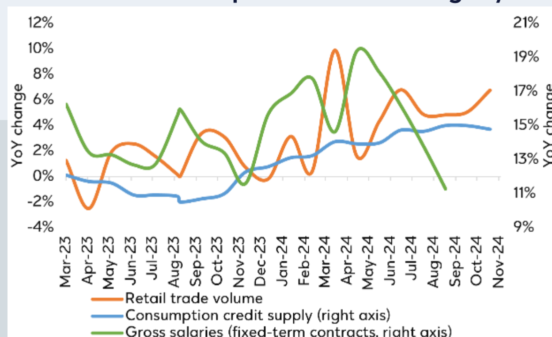
Source: Central Bank of Cyprus, CYSTAT, Eurobank Research

Bulgaria

Minority coalition government formed, with significant political challenges ahead

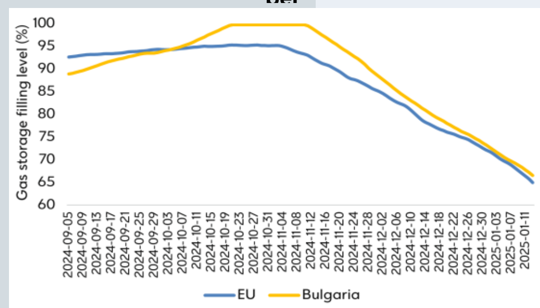
Negotiations for a coalition government since December bore fruit, with the first government formation mandate being fulfilled on the same date it was received by GERB, the party that finished first in October elections, as it had already reached an agreement with two parties (TISP, BSP) for a minority cabinet, backed in parliament by another party (ARF). The key question now is whether the political differences among these parties, which are significant on certain issues, can be overcome in order for the government to make the necessary decisions for the country's eurozone entry. An immediate challenge is the ratification of the 2025 state budget, which must ensure a fiscal deficit no higher than 3% of GDP. It is noted that the three parties involved in the new government had previously criticised the budget draft presented by the caretaker government. In early January, the MinFin announced the preliminary estimate of the 2024 budget deficit, at approximately BGN6.1bn, or 3% of GDP, which aligns with the maximum reference level for Bulgaria's eurozone accession. Turning to inflation developments, HICP inflation remained unchanged in November compared to the previous month, at 2.0%YoY, as food inflation accelerated, but was counterbalanced mainly by deflation in utilities, particularly natural gas. However, the gap between the 12-month average inflation in Bulgaria and the inflation reference value for eurozone entry narrowed to 0.4ppts from 0.7ppts in October, bringing the country closer to meeting the inflation criterion. The governor of the Bulgarian National Bank stated that the country will meet this criterion in the current month and that euro adoption could take place in January 2026, six months later than previously expected. Despite a halt in disinflation in September-November, retail trade volume expanded by 1.3%YoY in November, the same pace as in October and a five-month high, as consumer demand continues to be fuelled by a historically rapid consumer credit expansion (+14.2%YoY in Jan.-Nov.). Housing credit growth is even stronger (+24.7%YoY). However, the boost to construction activity in November (+1.8%YoY, 9-month high), was primarily driven by civil engineering works. Higher consumption weighed on the goods and services external balance, which in October posted the strongest annual deterioration in 2024 so far. Given these mixed developments, we are maintaining our GDP growth forecast for 2024 at 2.2%, while for 2025 a moderate acceleration in growth is projected (2.8%), driven by stronger momentum as Bulgaria approaches its eurozone entry.

Figure 23: Household consumption growth is more correlated with credit expansion than earnings dynamics



Source: Bulgarian National Bank, Bulgarian Statistical Institute, Eurobank Research

Figure 24: Faster-than-the-EU fall in gas reserves, with potential effects on disinflation, halted since December



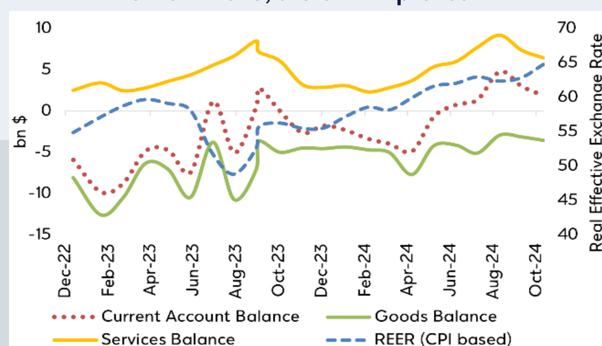
Source: Gas Infrastructure Europe, Eurobank Research

Turkey

Switch to monetary policy easing, although inflationary dynamics could rebound

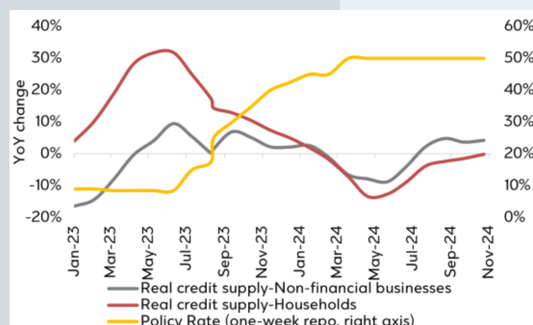
The central bank of Turkey (TCMB) implemented in December its first policy rate cut in 23 months, by 250bps, to 47.5%, in line with consensus expectations after disinflation gathered pace in November (inflation of 44.4%YoY, down from 47.1%YoY in October and 48.6%YoY in September). The TCMB attributed its decision to Q4 indicators suggesting that domestic demand growth is at disinflationary levels and will continue to decelerate. Inflation expectations and pricing behaviour were supportive of the inflation slowdown. However, the TCMB considers that both factors will continue posing risks to the disinflationary process. Looking ahead to 2025, some factors are expected to challenge the disinflationary trend in the short term, though they will also support consumer spending. These include the new increases in the minimum wage, the salaries of civil servants and pensions from January 1, by 30%, 11.54% and 15.75% respectively. Hikes in administered prices (e.g. utilities, water) and tax increases (e.g. +6% in the special levy on fuel since January) will also put upward pressure on prices and weigh on real household income growth. These effects, if they materialise, will likely push interest rates down more slowly than they went up, with implications for investment and household spending. Besides, real credit supply to businesses has remained positive since August (+4.2%YoY in November) and real credit contraction to households has nearly been eliminated (-0.1%YoY in the same month). The most significant drag on fixed capital formation in H2 2024 and into 2025 is expected from lower public investment, as reconstruction spending after the Feb-23 earthquakes has already fallen and is set to decline further (TRY584bn target in the 2025 budget, 43.3% below the respective target for 2024). The improvement in net exports in Q1-Q3 2024 continued in October, supported steadily by the goods balance. It occurred despite the continuous increase in the CPI-based real effective exchange rate in January-October 2024 (+10.1%YoY), due to stronger disinflation in Turkey's main trading partners (e.g., US, Germany, Italy). Provided that Turkey's inflationary pressures ease faster than those of its trading partners in 2025, net exports could improve further, offsetting some of the weaker domestic demand. These conflicting dynamics within key GDP components lead us to leave our growth forecast for 2024 unchanged (3.2%) and project a slowdown in 2025 (+2.5%).

Figure 25: Despite rising REER in 2024, which could decline in 2025, the CAB improved



Source: Central Bank of Turkey, Eurobank Research

Figure 26: Amid severe monetary tightening, real credit supply improved from Jul-24 onwards



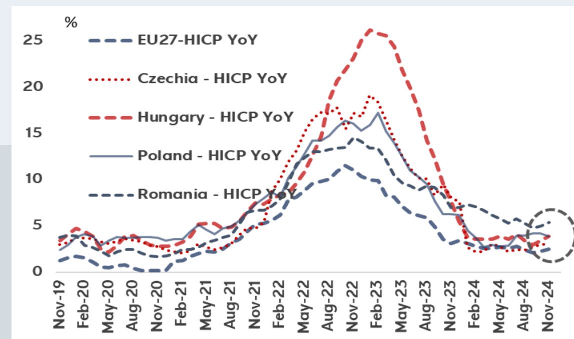
Source: Central Bank of Turkey, Eurobank Research

CESEE

Inflationary pressures and idiosyncratic risks

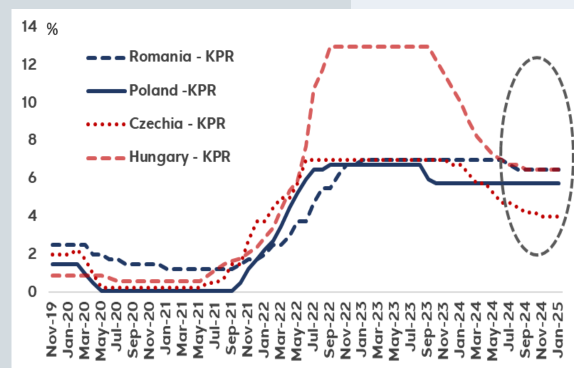
Q3 2024 GDP estimates for the CEE3 and Romania indicated a cooling of growth, with only Czechia showing an acceleration compared to the previous quarter, both on a quarterly and annual basis. However, slight improvements in industrial production and retail sales in Hungary and Poland in November, compared to Q3 averages, offer some optimism for a mild recovery in Q4. As GDP flash estimates for Q4 2024 are expected in mid-February, attention has shifted to inflationary pressures, which have been building amid a changing global landscape, particularly following the re-election of President Trump in the US and the anticipated changes in his second term. In November, the Harmonized Index of Consumer Prices (HICP) rose across the CEE3 and Romania, with the exception of Poland. In Czechia, HICP growth edged up slightly to 3.0%YoY in November, after bottoming out at 2.2YoY in February and March. In Hungary, after a low increase of 3.0%YoY, HICP growth climbed to 3.4%YoY in October and 3.9%YoY in November. Hungary's momentum of HICP growth below 5.0%YoY seen in September (4.8%YoY) could not be sustained, with subsequent increases of 5.0%YoY and 5.4%YoY in October and November, respectively. Inflationary pressures are largely attributed to rising gas and oil prices, along with the recent strengthening of the US dollar, which has put downward pressure on the region's currencies, including the Czech Koruna, Hungarian Forint, and Polish Zloty. Additionally, idiosyncratic factors, such as political instability in Romania — where presidential elections were annulled, sparking social unrest and protests — have also impacted sovereign bond markets. For example, Hungary's 10yr benchmark bond yield surged above 7% in mid-January, the highest in nine months. Given these inflationary pressures, local risks and the expectation that the US Federal Reserve will maintain interest rates high for a longer period to mitigate inflation risks, national central banks in the region have moderated their previously dovish stances.

Figure 27: Building price pressures, among other factors...



Source:Eurostat, Eurobank Research

Figure 28: ..tap the brake on interest rate cuts ...



Source: Central Bank of Czechia, Hungary, Poland & Romania, Eurobank Research

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2024e	2025f	2026f	2024e	2025f	2026f	2024e	2025f	2026f	2024e	2025f	2026f	2024e	2025f	2026f
World	3.2	3.0	3.0	5.8	3.6	3.2									
Advanced Economies															
USA	2.7	2.1	2.0	3.0	2.5	2.5	4.0	4.3	4.1	-3.6	-3.6	-3.5	-6.9	-6.4	-6.4
Eurozone	0.8	1.0	1.2	2.4	2.0	2.0	6.4	6.4	6.4	2.8	2.4	2.2	-3.1	-2.9	-2.8
Germany	-0.2	0.4	1.0	2.5	2.1	2.0	6.0	6.3	6.2	6.3	6.0	5.9	-2.0	-1.8	-1.5
France	1.1	0.7	1.1	2.3	1.5	1.8	7.5	7.7	7.6	-0.3	-0.2	-0.4	-6.1	-5.5	-5.0
Periphery															
Cyprus	3.7	3.4	3.0	2.2	1.7	1.5	4.9	4.3	4.0	-4.5	-4.0	-3.5	4.4	4.0	3.8
Italy	0.5	0.8	1.0	1.1	1.7	1.7	6.5	6.4	6.2	0.0	1.1	1.2	-4.0	-3.6	-3.0
Portugal	1.7	1.9	2.0	2.7	2.0	2.0	6.5	6.4	6.2	1.9	1.4	1.4	0.5	0.3	0.3
Spain	3.0	2.2	1.8	2.9	2.0	2.0	11.5	11.0	10.8	2.7	3.3	3.1	-3.1	-2.9	-2.6
UK	0.8	1.2	1.4	2.5	2.5	2.2	4.3	4.4	4.5	-2.8	-2.7	-2.7	-4.5	-3.7	-3.2
Japan	-0.2	1.2	0.9	2.6	2.1	1.8	2.5	2.4	2.4	4.5	4.2	4.0	-2.4	-3.7	-3.5
Emerging Economies															
BRIC															
Brazil	3.2	2.0	1.9	4.4	4.3	3.7	6.9	6.9	7.2	-2.4	-2.4	-2.3	-7.9	-8.3	-7.8
China	4.8	4.5	4.2	0.2	0.9	1.3	5.1	5.1	5.1	1.5	1.3	1.0	-5.0	-5.5	-5.7
India	6.8	6.9	6.8	4.8	4.2	4.0		N/A		-0.5	-0.7	-1.1	-8.2	-7.5	-7.0
Russia	3.7	1.5	1.4	8.3	7.3	4.9	2.6	2.7	3.1	2.9	2.6	2.6	-1.7	-1.2	-1.2
CESEE															
Bulgaria	2.2	2.8	3.2	2.6	2.0	2.4	4.4	4.1	3.7	0.2	0.2	0.6	-3.2	-2.9	-2.7
Turkey	3.2	2.5	3.5	60.0	30.7	18.7	8.8	8.4	8.0	-1.9	-1.4	-1.1	-4.3	-3.5	-2.9

Sources: European Commission, World Bank, IMF, OECD, Bureaus of National Statistics, Bloomberg, Eurobank Research

Eurobank Fixed Income Forecasts

	Current	March 2025	June 2025	September 2025	December 2025
USA					
Fed Funds Rate	4.25-4.5%	4.08-4.35%	3.81-4.05%	3.63-3.9%	3.53-3.8%
3m SOFR	4.29%	4.18%	3.87%	3.69%	3.57%
2yr Notes	4.3%	4.04%	3.9%	3.8%	3.74%
10yr Bonds	4.68%	4.27%	4.2%	4.18%	4.16%
Eurozone					
Refi Rate	3.15%	2.65%	2.2%	2.1%	2.05%
3m Euribor	2.75%	2.32%	1.96%	1.86%	1.85%
2yr Bunds	2.25%	1.91%	1.85%	1.84%	1.82%
10yr Bunds	2.58%	2.2%	2.2%	2.23%	2.27%
UK					
Repo Rate	4.75%	4.45%	4.15%	3.9%	3.7%
3m Sonia	4.54%	4.35%	4.03%	3.83%	3.79%
10-yr Gilt	4.73%	4.25%	4.16%	4.1%	4.07%
Switzerland					
3m Saron	0.34%	0.24%	0.11%	0.11%	0.11%
10-yr Bond	0.42%	0.30%	0.34%	0.39%	0.46%

Source: Bloomberg (market implied forecasts)

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