

Analysts

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Basic Information

Real GDP (USD Tn)	16.9 (2024)
M2 (USD Tn)	15.7 (Mar-25)
CPI	128 (Apr-25)
PPI	126.4 (Mar-25)
Con. Confidence	-15.2 (May-25)
Currency	Euro (EUR)

Source: Trading Economics

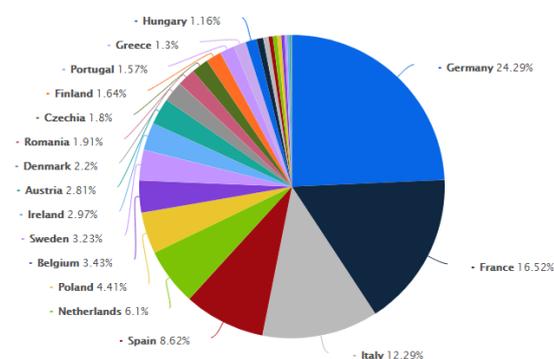
Chart info

Figure 1: Key EU Forecast Figures

Key figures			
GDP	Inflation	Deficit	Unemployment
EU:	EU:	EU:	EU:
2024: 1.0%	2024: 2.6%	2024: -3.2%	2024: 5.9%
2025: 1.1%	2025: 2.3%	2025: -3.3%	2025: 5.9%
2026: 1.5%	2026: 1.9%	2026: -3.4%	2026: 5.7%
Euro area:	Euro area:	Euro area:	Euro area:
2024: 0.9%	2024: 2.4%	2024: -3.1%	2024: 6.4%
2025: 0.9%	2025: 2.1%	2025: -3.2%	2025: 6.3%
2026: 1.4%	2026: 1.7%	2026: -3.3%	2026: 6.1%

Source: European Commission

Figure 2. Contribution to EU GDP, 2023



Source: Eurostat

Overview of European Union

- The European Union (EU) is a political and economic partnership consisting of 27 European countries. 20 of the 27 EU members utilise the Euro as their official currency. These 20 countries make up a subset of the EU, which is known as the Eurozone or Euro area (its official name). The Euro is the world's second reserve currency. Notable countries that are not part of the EU are the UK, Switzerland and Norway.
- The Central Bank of the EU is the European Central Bank (ECB), which has been chaired by Christine Lagarde since 2019. The ECB, as part of the bigger Eurosystem, is tasked with ensuring price stability by managing and implementing a single monetary policy across the Eurozone, as well as by managing foreign reserves. The ECB looks to the Harmonised Index of Consumer Prices (HICP) for inflation readings, with a target of 2%. The primary monetary policy instrument of the ECB are its three key policy interest rates at which commercial banks can borrow from or deposit with the ECB: the main refinancing operations (MRO) rate, the deposit facility rate and the marginal lending facility rate.
- The European Commission is a legislative body that develops policies, laws, and funding programmes for all 27 members of the EU. Ursula von der Leyen has held the presidency of the Commission since 2019.
- The Services sector is the growth engine of the EU, making up 64.7% of GDP, composing the likes of industries like R&D, business professional & technical services, transport, travel and ICT. Manufacturing is the secondary driver of growth in the European economy, making up 23.8 of GDP with its main export products being machinery & equipment, pharmaceutical products, and motor vehicles. Agriculture makes up merely 1.5%.
- The 3 main economies within the EU – Germany, France, Italy (Fig 2), which each contribute 24.3%, 16.5% and 12.3% to EU GDP respectively. This focus of this report will therefore be on these 3 countries.
- The main trading partners of the EU are primarily the U.S., the UK, China and Switzerland. The U.S. takes the pole position as the EU's biggest export partner, followed by the UK and China. The EU imports most from China, followed by the U.S.
- The economic recovery story stalled in 2024, where the eurozone's GDP grew at a disappointing +0.7%. The rebound was expected to surface in 2025, but persistent

macroeconomic uncertainty have once again stalled optimistic targets from materialising.

Summary of events in the past 6 months

Tariff Policy: A Calm Before the Storm

- U.S. President Donald Trump implemented a 90-day tariff pause from April 9 on various trading partners, including the EU, who will still be subjected to a baseline 10% U.S. import tariff during this period. This is in addition to Trump's prior 25% levies on metals (steel & aluminium) and cars on all imports including those from the EU.
- The EU has since responded and paused its retaliatory 25% tariffs on €21bn of U.S. Goods for 90 days as well. While Trump's metals & cars tariff are still in place, the European Commission appears unwilling to escalate trade tensions and are focused on working towards a trade deal.
- Nonetheless, if a trade deal cannot be made, expect a financial Armageddon to surface. President Trump has threatened to impose unilateral tariffs of 50% on EU goods on June 1. Prior to this, European Commission chief Ursula von der Leyen has indicated willingness to retaliate with a "bazooka", targeting American Big Tech & services firms and limiting their access to public procurement contracts in Europe, in addition to a resumption of the initial 25% retaliatory tariffs. Retaliatory tariffs of greater magnitude are expected given Trump's proposed tariff level that surprised to the upside.

Geopolitical Events: Adding Fuel to the Fire

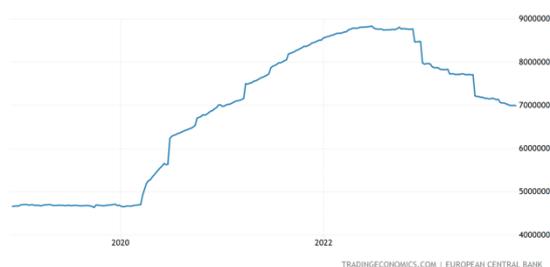
- The ongoing Russia-Ukraine war does not seem to be dying down anytime soon. Many EU members such as Sweden, Spain, France and Poland are expected to commit more to defence, greater than the current target of 2% of GDP. Germany's Merz has also unveiled a €3B Ukraine aid following reforms to the debt brake policy, while European Commission President von der Leyen continues to shore up support for Ukraine with the €800 billion ReArm Europe Plan.
- Russia's actions, including a unilateral 3-day ceasefire from May 9, comes from a position of strength, not weakness. The date coincides with the 80th anniversary of Soviet victory over Nazi Germany, allowing Putin to ensure a smooth military parade where he is expected to host high-ranking foreign leaders. Russia has not yielded despite threats of "crushing new sanctions" from the EU on May 10. Putin has no intention of returning any seized, occupied or Ukrainian land it claims to annex; rather, he is asking for more.
- The U.S.-Ukraine Minerals deal have also affirmed U.S.' commitment to defending and reconstructing Ukraine. Signed on April 30, the deal involves the establishment of a jointly managed U.S.-Ukraine Reconstruction Investment Fund. Ukraine will contribute 50% of revenues from the exploitation of new minerals, oil and gas projects. The U.S will also make

Figure 3: ECB Policy Rate



Source: Refinitiv Datastream

Figure 4: ECB Balance Sheet Size



Source: Trading Economics

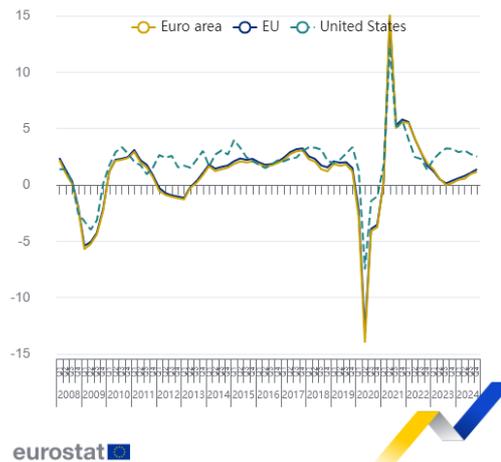
capital contributions, which includes the dollar value of military support rendered to Ukraine.

- Following the deal, President Trump restarted military support to Ukraine, approving US\$50mn in weapons sales to Ukraine. The deal effectively quells fears of Trump conceding several key peace terms advanced by Ukraine through an economic alignment of both countries.

European Union

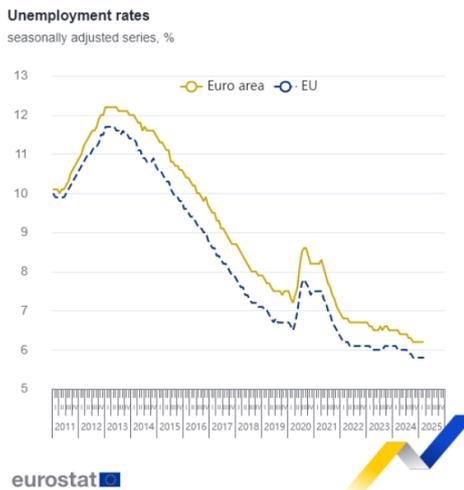
Figure 6: GDP Growth rates, YoY

GDP growth rates over the same quarter of the previous year
% change, based on seasonally adjusted data



eurostat
Source: Eurostat

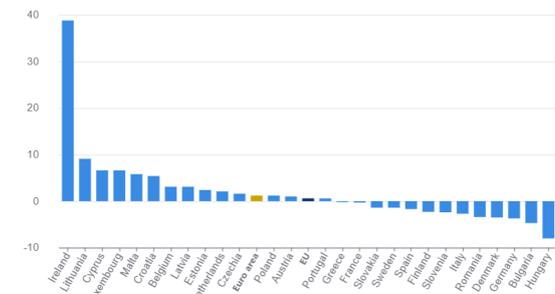
Figure 7: Eurozone unemployment rates, seasonally adjusted



eurostat
Source: Eurostat

Figure 8: Industrial Production in February 2025

Industrial production in February 2025
% change compared with February 2024



Source: Eurostat

Modest Growth, Easing Inflation, but Persistent Uncertainty

The European Union's economic recovery in early 2025 has been modest. According to Eurostat, EU real GDP expanded by **+0.4% QoQ** in Q1 2025 (vs. +0.2% in Q4 2024), a slight pickup from earlier quarters. On an annual basis, the euro area's GDP grew by **+1.2%**, marking the strongest performance since the first quarter of 2023. Nonetheless, the growth is expected to be transitory, fuelled by anticipatory purchases ahead of impending U.S. tariffs.

Industrial production showed weak signs of recovery at the start of 2025: in February, EU industrial output rose **+1.1% MoM**, reversing earlier weakness of **+0.1%** in January. Nevertheless, the statistics appear skewed – the rise in industrial output was powered by Ireland's meteoric **+38.8% growth** in industrial production, fuelled by pharmaceuticals. Major EU economic powerhouses like Germany, France and Italy declining in industrial production has sparked worries of an economic slowdown.

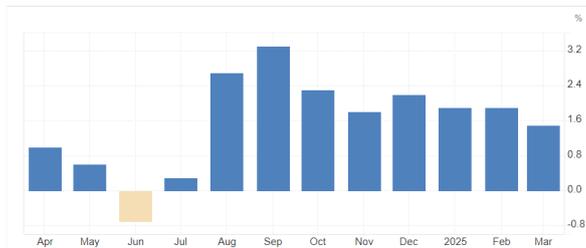
Retail spending has displayed a noticeable buzz of pessimism. Eurozone retail sales rose **+1.5% YoY** in March (vs. 1.9% in the previous month), which fell short of market expectations of 1.9%. This is the weakest pace of expansion since July 2024, with the downward trajectory in retail sales expected to be sustained by greater macroeconomic uncertainty escalated by Trump's April 2 "Liberation Day" tariffs.

Inflation across the Eurozone has eased significantly and remains stable. As of April, Harmonised CPI inflation stood at **+2.2% YoY**. Energy prices have sharply retreated, down **-3.5% MoM**, alleviating one of the biggest inflationary pressures. However, services inflation remains stubborn, rising to elevated levels of **+3.9% YoY**. Overall, the relatively low and stable inflationary environment enabled the ECB to cut policy rates by 25 basis points in April. ECB staff projections suggest inflation will average around 2.3% in 2025, gradually moving toward the 2% target by 2027.

The labour market across the EU has shown resilience, continuing its steady decline in unemployment since the pandemic highs of 2021. The EU unemployment rate remains stable at **+5.8%** in March 2025, down from **+6.0%** a year earlier. In the euro area, unemployment has also held steady at **+6.2%** YoY. Compared to the average euro area unemployment rate of 9.22% over the past 30 years, current conditions point to an overheated labour market. Such an occurrence is a double-edged sword: while supporting consumption and economic growth, they risk sustaining upward wage pressures, complicating the full normalisation of inflation via a wage-price spiral.

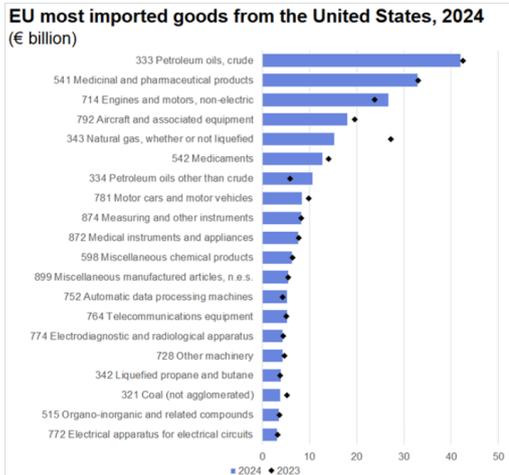
Confidence indicators, however, have softened noticeably in early 2025. The European Commission's consumer confidence index (DG ECFIN's flash estimate) dipped further into negative

Figure 9: Euro area retail sales, YoY



Source: Trading Economics

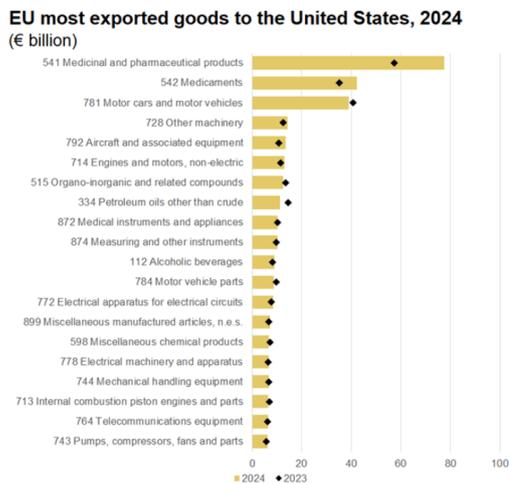
Figure 8: EU most imported goods from US by sector, 2024



Source:

Eurostat

Figure 9: EU most exported goods to US by sector, 2024



Source: Eurostat

territory for the 2nd month in a row, reaching **-16.7 (euro area) and -16.0 (EU) in April**, an 18-month low. Business sentiment surveys similarly suggest that firms remain cautious about investment, citing concerns over geopolitical instability, potential new trade barriers, and financial market volatility. Such uncertainties are likely to persist until market participants gain greater clarity on the Trump “Liberation Day” tariffs.

Trade remains a risk factor. OECD reports highlight that “higher trade barriers in several G20 economies” are already starting to dampen EU export growth. In particular, looming threats of renewed U.S. tariffs on European goods — including steel, aluminium, and automobiles — pose a significant risk to export-driven economies within the EU.

For the near term, we foresee greater economic hurdles. Combined with front-loaded purchases on goods before Trump’s “Liberation Day” tariffs, consumers and businesses are likely to pull back on spending amid volatility, relieving inflationary pressures. However, such relief is short-lived, and inflation may escalate in the coming months as the fate of the EU’s inflation story hinges upon a trade deal with the U.S. Economic growth may grind to a halt, given that U.S. was the largest partner for EU exports of goods (20.6%), and the second largest partner for EU imports of goods (13.7%). In particular, Germany will bear the brunt of tariff-induced woes given its significant exposure to the U.S. tariffs on automobiles. The 4-year trend of declining unemployment finds itself at a potential reversal point, as firms may engage in cost cutting efforts by trimming jobs amid market turmoil.

Looking ahead, most major institutions predict tepid EU growth for the remainder of 2025. The OECD expects **+1.0% EU GDP growth**, citing domestic consumption as the primary driver, while investment and net exports are likely to stay weak. ECB forecasts have been revised downwards to 0.9% for 2025, 1.2% for 2026 and 1.4% for 2027. The ECB has also projected for the bulk of negative tariff impacts to materialise in 2025 and 2026, supporting a near-term bear case for the Eurozone. Fiscal policies remain broadly neutral, with no major stimulus expected across the bloc. Some national governments, such as Germany’s, are planning infrastructure investments, but implementation remains slow, and its effects are expected to materialise only next year.

European Central Bank

Summary of Policy Rate Decisions

January 2025 ECB Meeting

- The ECB cut rates by another 25 bps, aligning with expectations as the disinflation process continues to unfold steadily. Most underlying inflation indicators suggested price pressure were easing, with inflation on track to return to the 2% target within the year.

Figure 10: EU Imports of goods from US by country, 2024

EU imports of goods from the United States, 2024		
	€ million	% of the United States in extra EU imports
Germany	68 968	15.2
Netherlands	68 166	15.7
France	44 075	17.5
Belgium	31 401	17.6
Italy	25 889	10.8
Spain	24 160	12.5
Ireland	21 257	27.6
Poland	12 125	10.6
Sweden	6 512	11.3
Denmark	5 915	15.7
Austria	4 802	11.3
Czechia	3 486	5.7
Finland	2 593	12.0
Portugal	2 415	8.8
Greece	2 161	5.3
Hungary	1 664	4.2
Lithuania	1 614	12.4
Romania	1 314	3.7
Slovenia	1 218	2.7
Croatia	785	8.1
Slovakia	766	3.6
Luxembourg	601	31.4
Bulgaria	419	2.0
Estonia	311	9.5
Malta	280	9.2
Cyprus	245	4.9
Latvia	242	6.3

Source:

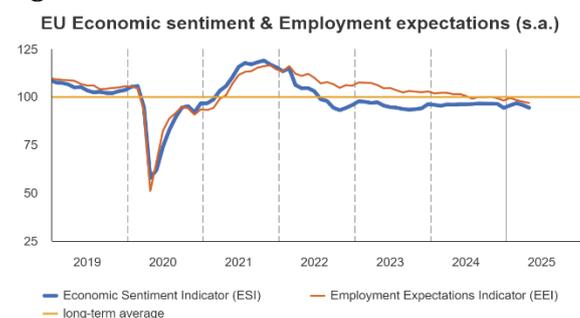
Eurostat

Figure 11: EU exports of goods to US by country, 2024

Source: Eurostat

EU exports of goods to the United States, 2024		
	€ million	% of the United States in extra EU exports
Germany	161 215	22.7
Ireland	72 085	53.7
Italy	64 759	21.2
France	47 064	17.2
Netherlands	43 430	16.5
Belgium	32 958	20.2
Spain	18 179	12.3
Austria	18 218	25.7
Sweden	15 811	19.1
Poland	11 634	12.7
Denmark	8 522	15.3
Finland	6 972	23.0
Czechia	6 580	13.1
Portugal	5 318	23.2
Hungary	5 008	15.2
Slovakia	4 478	18.9
Greece	2 412	10.7
Romania	2 284	8.8
Lithuania	1 847	15.2
Bulgaria	1 082	7.0
Slovenia	941	2.9
Croatia	805	9.7
Estonia	714	15.0
Latvia	531	9.2
Luxembourg	423	14.5
Malta	268	15.3
Cyprus	53	1.9

Figure 8: EU Economic sentiments



Source: European Commission services

- Domestic inflation remained high due to lingering wage-price adjustments, but wage growth showed signs of moderation and corporate profits cushioned by the impact.
- Despite a stagnating economy and weak confidence in Q4 2024, improving real incomes and fading restrictive effects of prior hikes were expected to revive demand. The ECB reaffirmed its data-dependent stance.
- Markets remained cautious, and despite lower borrowing costs, financing conditions remained tight as maturing loans were still repriced higher. Growth in firm credit picked up slightly.

March 2025 ECB Meeting

- The ECB delivered another 25 bps cut, bringing the deposit rate to 2.50%. Updated staff projections saw headline inflation at 2.3% for 2025, revised up due to energy dynamics, but longer-term expectations remained anchored near target.
- Core inflation projections stood at 2.2% in 2025, gradually easing to 1.9% by 2027, with most underlying metrics pointing to a return to 2%. Wage growth continued to moderate, and profit margins were buffering its inflationary effects.
- Monetary policy was meaningfully less restrictive, with improved loan affordability, though overall lending remained subdued. Growth forecasts were trimmed due to export weakness and trade policy uncertainty, with 2025 GDP now seen at 0.9%.

April 2025 ECB Meeting

- The ECB cut rates by another 25 bps to 2.25%, maintaining a dovish posture amid mounting global trade tensions and rising uncertainty. March inflation prints showed easing in both headline and core measures, with services inflation notably cooling.
- Underlying inflation remained on track to return to the 2% medium-term target. Wage pressures continued to moderate, and profits helped absorb cost increases.
- However, the ECB flagged deteriorating growth prospects as volatility in global markets and investor caution weighed on financing conditions.
- While economic resilience had improved, the adverse trade environment posed downside risks.

Projection of Rate Cuts and Analysis

The ECB lowered its 2025 growth prediction to 0.9%, its 6th consecutive reduction, with many expecting lower lows in the next updated forecast in June. It has warned on deteriorating growth outlook due to rising trade tensions when it cut interest rates to 2.25%.

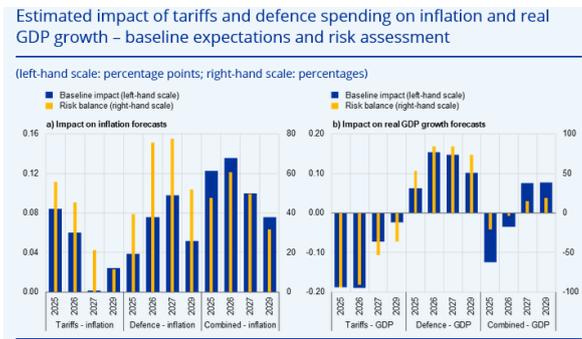
It is widely expected for the ECB to further its dovish policy agenda to support the slowing growth in the EU, further fuelled by uncertainty over the Trump administration's tariffs. Swap

Figure 9: Survey of Professional Forecasters (SPF) for Q2, 2025

	Survey horizon			Longer term ¹⁾
	2025	2026	2027	
HICP Inflation				
Q2 2025 SPF	2.2	2.0	2.0	2.0
Previous SPF (Q1 2025)	2.1	1.9	2.0	2.0
ECB staff macroeconomic projections (March 2025)	2.3	1.9	2.0	-
Consensus Economics (April 2025)	2.2	1.9	1.9	2.0
<i>Memo: HICP Inflation excluding energy, food, alcohol and tobacco</i>				
Q2 2025 SPF	2.3	2.1	2.1	2.0
Previous SPF (Q1 2025)	2.2	2.0	2.0	1.9
ECB staff macroeconomic projections (March 2025)	2.2	2.0	1.9	-
Consensus Economics (April 2025)	2.3	2.0	-	-
Real GDP growth				
Q2 2025 SPF	0.9	1.2	1.4	1.3
Previous SPF (Q1 2025)	1.0	1.3	1.3	1.3
ECB staff macroeconomic projections (March 2025)	0.9	1.2	1.3	-
Consensus Economics (April 2025)	0.9	1.2	1.5	1.4
Unemployment rate²⁾				
Q2 2025 SPF	6.3	6.3	6.3	6.2
Previous SPF (Q1 2025)	6.5	6.4	6.3	6.3
ECB staff macroeconomic projections (March 2025)	6.3	6.3	6.2	-
Consensus Economics (April 2025)	6.4	6.4	-	-

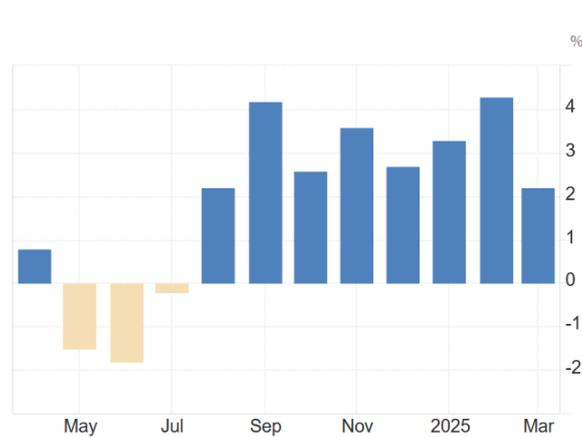
Source: ECB

Figure 10: Projection of tariff impacts



Source: ECB

Figure X: Germany Retail Sales, YoY



Source: Destatis, Trading Economics

market traders are pricing in an 85% probability of rate cut in June.

Germany

Hopes for a Turnaround Has Been Trumped

Germany's economy has lagged its peers once again. It contracted modestly in 2024 (-0.2% YoY) for the second straight year. While the eurozone's largest economy grew by +0.2% QoQ in Q1 2025, GDP still fell by -0.2% on an annual basis, reflecting that Germany is still in an economic slump. The weak rebound was supported by easing inflation and lower borrowing costs, which helped boost domestic demand. Business and consumer confidence also improved marginally, driven by optimism surrounding the successful conclusion of coalition talks and the formation of a stable government—factors that helped offset ongoing concerns over volatile U.S. tariff policies.

However, Germany is still dragged down by weak external demand, marking the 7th consecutive quarter of contraction. Exports have been the Achilles' heel: Industrial production in Germany fell -1.3% MoM in February, driven by weakness in the construction and food industry. On a yearly basis, industrial activity fell by -4%, following a -1.6% drop in January. While bright spots like retail sales and household consumption have held up amidst the backdrop, these factors alone are insufficient in reversing Germany's persistent contraction, bogged down by severe structural limits proposed by the debt brake policy.

Inflation in Germany is moderating. HICP inflation fell in April to +2.2% YoY (vs. 2.3% in March) as energy prices eased sharply. Wage growth has remained relatively strong, but core inflation is receding. The Bundesbank notes that lower oil prices and a stronger euro helped slow headline inflation in March.

The German labour market remains unusually strong. Unemployment is near historic lows (about 3½% in early 2025) and employment stable. In fact, youth unemployment is among the EU's lowest (Germany ~6.3%). Business sentiment, however, has been gloomy. The Ifo Business Climate Index was just 85.1 in January 2025 (still historically low), reflecting widespread caution. Firms cite policy uncertainty – both about the upcoming German election and global developments – as weighing on confidence.

Looking forward under a new chancellor, growth is expected to be only modest. The OECD forecasts +0.7% GDP growth in 2025 (after stagnation in 2024), while Reuters notes some forecasters see about +0.7%–0.8%. Germany's underperformance reflects structural headwinds: weak exports, high energy costs, and tight fiscal policy. Political upheaval adds further uncertainty: early 2025 elections and a government turnaround mean planned reforms (on infrastructure and investment) have been delayed. Notably, the incoming government has earmarked a large multi-year

infrastructure program (€500 billion) to boost demand, but it remains to be seen how quickly this will take effect.

A critical tail risk is the fate of transatlantic trade ties. Both the OECD and Bundesbank warn that any new U.S. tariffs would hit Germany hard. The Bundesbank specifically notes that anticipated U.S. tariffs already caused a one-time jump in exports (especially to the U.S.) in early 2025, and that without such effects exports may soon retreat.

Reuters reports that President Trump has explicitly threatened to re-impose tariffs on EU goods. German industry (especially autos and machinery) depends heavily on access to the U.S. market, so renewed tariffs could significantly dent output.

Outlook and Risks – In sum, Germany faces a cautious recovery. The Bundesbank expects only slight output growth in Q1 2025, with a possible setback in Q2.

Inflation should continue to ease, given the recent disinflation trend. The tight labour market will support domestic demand, but external demand is likely to remain weak. Key uncertainties – the policies of the new government and any shift in U.S. trade policy – will determine the near-term trajectory. Economically, Germany is entering 2025 much as it ended 2024: with low growth, moderate inflation, and many open questions about the path ahead.

France

Growth and Economic Activity

France's economic growth has essentially flatlined entering 2025. After a -0.1% contraction in Q4 2024, GDP eked out +0.1% QoQ in Q1 2025, according to INSEE's preliminary data. This weak start undershot expectations and highlights the turbulence facing the euro zone's second-largest economy.

The meagre Q1 uptick was driven entirely by inventory accumulation, which contributed +0.5 percentage points to growth (notably stock-building in chemicals, pharmaceuticals, and agri-food). Domestic demand was stagnant – household consumption was flat, as a cutback in car purchase incentives dragged auto sales lower, and business investment dipped by 0.1%. Net exports were a significant drag, subtracting about -0.4pp from Q1 GDP, with exports falling 0.7% even after the one-time delivery of a new cruise ship.

The slight growth that did occur came largely from firms rebuilding inventories, masking underlying weakness in demand. Finance officials maintain the government's full-year 2025 growth forecast at 0.7%, revised down from 0.9% previously. They still hope to reach this modest target, but private economists warn the outlook has darkened considerably due to external shocks. Indeed, the escalating trade war launched by the United States in early 2025 is seen as a major threat: Prime Minister François Bayrou

cautioned that U.S. tariffs could shave over 0.5 percentage points off France's GDP growth going forward.

Business surveys already show worsening conditions – the composite PMI fell to 47.3 in April, marking an eighth consecutive month of contracting private-sector activity. Notably, services activity has deteriorated sharply (services PMI 46.8 in April, new business at its weakest since late 2020), reflecting weak consumer demand and a pullback in client spending.

Manufacturing fared slightly better: while the headline manufacturing PMI remained below 50 (at 48.2), output stabilized (production sub-index ticked above 50 for the first time in nearly three years), suggesting the industrial sector's slump may be bottoming out. Overall, however, confidence is fragile – order books have thinned and future expectations hit a 5-year low. With growth likely to stay around zero in the first half of 2025, France appears headed for another year of only slight GDP expansion (around 0.6–0.7%) barring a turnaround.

Inflation and Monetary Policy

Inflation in France has decelerated dramatically in early 2025, easing pressure on households and policy makers. Headline consumer price inflation fell to 0.9% year-on-year in March and April 2025 on a harmonised basis – a far cry from the elevated rates seen in 2022–2023. April's 0.9% annual inflation was even a touch above the initial estimate (0.8%), but essentially flat from the prior month, confirming that price stability has largely returned.

Core inflation (ex-energy and food) is also contained (hovering around 2% YoY), as energy prices and import costs have normalized and domestic price pressures eased. Companies report input cost inflation at its slowest pace in years and even some discounting of output prices amid slack demand.

With the disinflation process well on track across the euro area, the European Central Bank has shifted to a dovish stance. The ECB began cutting rates in late 2024 and continued into 2025 – by April 2025 the deposit rate stood at 2.25% (down from 3.75% at the peak). Lower borrowing costs should eventually support credit conditions in France, although monetary policy remains somewhat restrictive in real terms.

The Bank of France expects inflation to remain around 1% throughout 2025, below the eurozone average, helped by government measures (such as earlier caps on energy bills) and the euro's relative strength. The flipside of very low inflation is that real wage growth has turned positive, which could bolster consumer spending capacity later in the year. However, for now the boost is offset by pessimism and higher precautionary saving amid uncertainty.

Fiscal Situation and Public Debt

France's public finances remain strained, though there was a slight upside surprise in last year's outcome. The budget deficit for 2024 came in at 5.8% of GDP, larger than 2023's 5.4% but narrower than the 6.0% the government had feared. This reflected revenue shortfalls and high spending (including energy subsidies) that drove the deficit to one of the highest in the EU.

The government's 2025 budget aims to trim the deficit to 5.4% of GDP as a first step toward fiscal repair, though that target assumes some spending restraint and a rebound in tax receipts. Achieving it will be challenging if growth undershoots. Indeed, budget officials froze €5 billion of expenditures in April to help meet the deficit goal amid slowing growth and trade-war uncertainty.

Finance Minister Eric Lombard insists France will stick to its consolidation path and avoid excessive slippage. However, he has ruled out drastic austerity measures (no major tax hikes or deep spending cuts for now) and hinted the deficit target could loosen slightly if the U.S. tariff conflict seriously hits the economy.

Alarmed by France's high deficits and rising debt trajectory, the IMF in its May review urged a "sustained budgetary squeeze" over the coming years. France's public debt has climbed to ~113% of GDP as of 2024 and is set to keep rising without further fiscal efforts. Ratings agencies and EU authorities are closely watching Paris: Moody's was scheduled to update its outlook in late April, reflecting investor scrutiny of France's fiscal credibility.

President Macron's government has pledged to bring the deficit below the EU's 3% limit by 2029, a very gradual adjustment. Meeting that requires about €40 billion in savings by 2026 (to hit an interim deficit target of 4.6% of GDP). The challenge is compounded by a divided National Assembly that makes passing budget cuts difficult (see Political Developments below). In short, France's fiscal room for manoeuvre is minimal – the country must balance supporting growth in the near term with convincing markets it has a credible medium-term debt-reduction plan. Public debt interest costs are also rising due to past rate hikes, adding pressure.

On a positive note, France continues to benefit from investor confidence (low borrowing yields) for now, and the ECB's tools like the Transmission Protection Instrument stand by to prevent unwarranted bond market turmoil. But sustaining this confidence will require tangible fiscal consolidation progress once the economy improves.

Sectoral Performance and External Trade

Most sectors of the French economy are experiencing soft or negative growth in early 2025, with notable divergence

between manufacturing and services. Industrial output shows tentative signs of stabilization after a prolonged slump: manufacturing production received a one-off boost from the delivery of a large cruise ship in Q1 and the PMI output index indicates the factory sector may be near turning a corner.

Some exporters are seeing order volumes level off, helped by improved supply chains and a less volatile energy market. However, manufacturing PMI remains in contractionary territory and new orders – especially from abroad – are weak, so any industrial recovery is fragile.

The services sector, traditionally the engine of French growth, has unexpectedly become a drag. As noted, services PMI plunged to 46.8 in April, reflecting declines in hospitality, transportation, and business services activity. High-frequency data suggest consumer-facing services are struggling: retail sales have been flat, and the post-COVID rebound in travel spending has faded.

Households remain cautious, as confidence surveys indicate concerns about jobs and the impact of the trade conflict. Consumer spending overall was unchanged in Q1, and within that, essentials like food held up but discretionary categories (e.g. auto sales) fell after subsidy cuts. Construction is another weak spot – rising interest rates through 2024 dampened housing investment, and construction output has yet to recover, with the Bank of France reporting the sector “losing momentum” this quarter.

On the external front, France’s trade performance has been underwhelming. Exports declined in Q1 2025 (–0.7%), weighed down by cooling global demand and the initial impact of U.S. tariffs. Import growth (+0.4% in Q1) outpaced exports, resulting in net trade reducing GDP.

Key export industries like aerospace and luxury goods are facing headwinds: aircraft deliveries are slowing after last year’s surge, and Chinese demand for luxury products remains soft. The U.S. tariff announcement in April – a blanket 20% duty on EU imports proposed by the Trump administration – has cast a pall over export-oriented manufacturers.

While those tariffs were temporarily suspended for 90 days as of mid-April, the threat alone has led French firms to postpone some export orders and seek alternative markets. The government insists the impact of the U.S. trade measures will be “moderate” on France and fall harder on the U.S., but private sector sentiment is undeniably hit.

On the positive side, foreign direct investment (FDI) into France is surging, reflecting confidence in France’s long-term prospects and the government’s pro-business initiatives. In May, President Macron hosted the annual “Choose France” summit at Versailles, securing a record €20 billion in new foreign investment commitments.

These deals span high-tech and industrial sectors – for example, U.S. logistics giant Prologis announced a €6.4 billion expansion of warehouses and data centers in France, Amazon pledged €300 million for new facilities, UK-based fintech Revolut is investing €1 billion and seeking a French banking license, and Spain’s Cellnex will put in €2.5 billion for telecom infrastructure.

An additional €20.8 billion is slated for AI-related projects as part of France’s strategy to lead in artificial intelligence. These investments – the largest ever from a single summit – should bolster sectors like tech, logistics, and green industry in coming years, partially offsetting weaker domestic demand. They are a testament to France’s attractiveness (stable infrastructure, skilled workforce) even amid short-term turbulence.

In summary, France’s sectoral picture is one of broad weakness with a few bright spots: manufacturing contraction is slowing and big-ticket foreign investments offer hope, but services and consumer-oriented sectors are under pressure from waning demand and trade uncertainty.

Political and Policy Developments

France’s political landscape in 2025 is marked by governance challenges and policy continuity, following significant shifts in late 2024. President Emmanuel Macron, midway through his final term, faced a snap legislative election in 2024 that resulted in a highly fragmented National Assembly. The outcome compelled Macron to replace his prime minister and seek a broad centrist coalition. He appointed François Bayrou as Prime Minister, heading a centrist minority government.

Bayrou’s administration must navigate a parliament where no single bloc holds a majority – a scenario that has made reform efforts delicate. The government survives by building ad-hoc alliances: crucially, it depends on Socialist Party lawmakers to pass budgets and legislation, while fending off no-confidence votes from both the far left and far right. This precarious balance has two implications.

First, major structural reforms are largely on hold. Macron’s previous signature reform – raising the pension age to 64 – was enacted in 2023 amid protests, but further controversial measures (labor or welfare cuts, tax hikes) have been shelved given the political risk. Bayrou has explicitly ruled out harsh austerity, opting instead for small spending adjustments and efficiency gains.

Second, fiscal discipline is being pursued cautiously, as noted earlier – the government is trying to trim the deficit without drastic actions, which likely means slow progress. Still, there is some alignment across moderate parties on the need to restore stability to public finances; as the IMF noted, France will need a “*credible and well-designed*” package of spending rationalizations and better targeted social benefits. Bayrou has echoed this priority, stating that reining in public spending is

“the priority and our compass” as budget planning for 2026 begins. We can expect extensive negotiations through 2025 on finding €40 billion in budget savings by 2026 – a task made harder by the minority government’s weak mandate.

On other fronts, the government’s focus is on managing external challenges. The sudden U.S. trade war measures have prompted France to work closely with EU partners and the UK to formulate a united response. Macron has taken a lead in advocating a firm but measured stance, arguing that a tariff escalation is in no one’s interest while preparing safeguard measures for French industries if needed.

France is also navigating the energy transition and industrial policy: 2025 will see the implementation of France’s Green Industry Act and EU’s Net-Zero Industry initiatives, aiming to channel investment (including FDI mentioned above) into clean tech and reduce reliance on imports in strategic sectors.

In foreign policy, France formally remains committed to supporting Ukraine (with no major change in stance in 2025) and is recalibrating its China strategy along EU lines (seeking “de-risking” rather than decoupling – e.g. screening Chinese investments in sensitive sectors while still encouraging trade). In sum, France’s political situation is one of constrained governance – the current leadership is maintaining policy continuity (pro-EU, pro-investment, gradual fiscal tightening) but lacks the political capital for bold new reforms. This status quo is likely to persist until the next scheduled elections (2027), barring any new political realignment. The near-term agenda will thus be dominated by crisis management (responding to the trade war and any economic slowdown) and incremental measures to guide the economy through what Finance Minister Lombard admits is “a turbulent year”.

Italy

Growth and Economic Activity

Italy’s economy showed resilience at the start of 2025, outperforming some of its larger EU peers, but overall growth remains subdued. GDP grew by +0.3% QoQ in Q1 2025, a notch above consensus forecasts and stronger than France or Germany in the same quarter. This follows an upwardly revised +0.2% expansion in Q4 2024, meaning Italy managed to avoid recession through the end of 2024 despite a stagnation in the middle of last year. On a yearly basis, Q1 GDP was up 0.6% YoY, and Italy’s full-year growth for 2024 is now estimated at 0.7% (matching 2023’s pace).

The drivers of Italy’s better-than-expected Q1 performance were largely domestic. Preliminary data from ISTAT point to positive domestic demand offsetting weakness in trade. Consumer spending and government expenditure provided support, thanks in part to falling inflation boosting households’ real incomes. Industry and agriculture expanded output in Q1, while the services sector was flat. Businesses

likely drew down inventories or saw a stabilization in manufacturing, given that industrial production contributed to growth after contracting last year.

Net exports, however, weighed on growth, as Italy faced softer external demand: trade flows subtracted from Q1 GDP (similar to the pattern in France) amid sluggish exports of machinery and textiles and higher import volumes. In essence, Italy's economy is trudging forward slowly, with domestic activity just robust enough to compensate for external drags.

The slightly stronger start to 2025 prompted some optimism in Rome – Economy Minister Giancarlo Giorgetti noted Italy “*performed better than other European countries*” in Q1. However, both government and independent forecasters have become more cautious about the rest of 2025. In April, Italy's government halved its 2025 growth forecast to 0.6% (from a 1.2% assumption made last autumn), acknowledging the much darker outlook due to U.S. trade policy uncertainty. The Bank of Italy projects only +0.5% growth in 2025 (and the IMF a mere +0.4%), reflecting expected fallout from tariffs and weaker investment. Those downgrades incorporate the estimate that Trump's tariff measures could shave more than 0.5 percentage points off Italian growth cumulatively from 2025 to 2027 – a significant hit for an economy already near stall speed. On a quarterly trajectory, growth may slow in Q2 and Q3 as the trade shock filters through.

Nonetheless, some recent indicators suggest Italy might maintain modest momentum: the composite PMI jumped to 52.1 in April, the highest in nearly a year, indicating private-sector output is expanding moderately. This improvement was driven by services (details below) and hints that Q2 GDP could see another slight uptick (the Bank of Italy expects at least a positive but small growth in Q2). For the full year 2025, most analysts now foresee Italian GDP growth in the 0.5%–0.8% range, a downgrade from earlier hopes of ~1%+ but still avoiding recession barring a severe trade war escalation.

It is worth noting that Italy's medium-term growth remains anemic – the economy has essentially grown ~0.7% annually in 2023–24, and potential growth is low due to decades-long structural issues. The government hopes that effective use of EU recovery funds (see below) and pro-investment reforms will gradually lift this trajectory, but in the immediate term the focus is on weathering external shocks and preventing stagnation from reasserting itself in 2025.

Inflation and Monetary Policy

Italy, like the rest of the euro area, has seen a sharp decline in inflation to near-target levels. Headline HICP inflation was ~2.1% year-on-year in April 2025, unchanged from March. This is a dramatic comedown from the high inflation of 2022. Italy's national CPI (NIC) similarly showed 2.0% inflation in April.

While headline inflation is stable around 2%, there was a slight uptick in core inflation – core HICP rose to 2.2% YoY in April (from 1.9% in March) as some underlying price pressures in services persist. However, broadly price growth has moderated significantly, aided by lower energy costs, the fading of supply bottlenecks, and tighter monetary conditions in 2023.

The inflation mix in Italy now features very low goods inflation (even some deflation in consumer durables) and only modest services inflation, though food prices remain somewhat elevated. Importantly, inflation expectations are well anchored; with the ECB easing policy (rate cuts in Q1/Q2 2025), borrowing costs are expected to gradually fall, reducing the cost-push pressure on businesses.

The ECB's rate cuts – bringing the deposit rate down to 2.25% by spring – will slowly feed through to Italy's credit market. Italian banks had tightened lending markedly in 2023, but credit conditions should improve later in 2025, supporting investment and durable goods consumption. The Bank of Italy's latest outlook sees HICP inflation averaging 1.6% in 2025, essentially at the ECB's target, and staying around 1.5% in 2026.

In the near term, Italian consumers are getting relief from inflation: real wages have started rising as nominal wage growth (around 3-4%) now outpaces prices, something not seen since before the pandemic. This real income growth underpinned consumer spending in Q1 and could continue if confidence holds.

Energy prices – a key swing factor for Italy – are significantly below last year's levels, thanks to a mild winter and diversified gas supplies, keeping utility bills manageable and industry input costs down. Overall, Italy has entered a phase of price stability, a welcome development for policymakers after the price surge of previous years.

The challenge now is to prevent inflation from undershooting too far (Italy's inflation is slightly below the euro-area average) and instead achieve a “soft landing” around 2%. The ECB's cautious approach – pausing or even reversing rate cuts if core inflation re-accelerates – provides some assurance. For now, Italy's inflation dynamics are favorable: low inflation is boosting purchasing power and enabling looser monetary conditions, which together should provide a modest stimulus to the economy in the second half of 2025.

Public Debt and Fiscal Plans

Italy continues to walk a fiscal tightrope, juggling the euro zone's second-highest debt load with commitments to budget discipline and growth-friendly policies. In April, Prime Minister Giorgia Meloni's government approved the 2025 Economic and Financial Document (DEF) outlining a revised fiscal path.

Crucially, despite cutting growth forecasts, Italy pledged to keep its budget deficit under control and not let it widen further. The

2025 deficit is now targeted at 3.3% of GDP, unchanged from the previous goal (and only slightly above the estimated ~3.0–3.2% deficit for 2024). For 2026, the government reaffirmed a deficit target of 2.8%, which would bring Italy below the EU’s 3% ceiling by that year.

Maintaining these targets in a lower-growth scenario will be difficult, but the political will to avoid fiscal slippage is strong, given Italy’s history of market scrutiny. In fact, as growth prospects dimmed, Rome identified additional savings: ministers froze some discretionary spending and planned asset sales to raise revenues.

The Treasury announced plans to sell nearly €20 billion in state assets by 2027, equivalent to ~0.8% of GDP. This includes a modest €2 billion (0.1% of GDP) in asset sales in 2025, rising in later years. Economy Minister Giorgetti confirmed the government will press ahead with previously announced privatizations, albeit cautiously due to turbulent markets amid U.S. tariff fears.

Among the candidates: the state’s remaining stakes in Monte dei Paschi di Siena bank and energy major Eni – indeed over €4 billion was already raised since 2022 by selling shares in those entities – and a plan to divest up to 14% of Poste Italiane, which could fetch ~€3 billion. These moves aim to trim public debt at the margin and signal reform intent.

Italy’s public debt, however, is so large that it will take sustained primary budget surpluses and growth to put it on a firm downward path. Debt stood at 135.3% of GDP in 2024 and is now projected to edge up to 136.6% in 2025 given the weaker growth outlook.

The DEF sees debt peaking around ~137.5% in 2026 before inching down, but essentially debt will remain ~135–137% of GDP for the next few years. This ratio, while high, is slightly improved from the 155% peak hit after COVID, thanks to nominal GDP growth in 2021–22.

Italy benefits from a still relatively long average debt maturity and ECB tools deterring unwarranted spreads, and tellingly the Italy–Germany bond yield spread narrowed to a 4-year low recently as markets perceive Meloni’s policies as relatively prudent.

The government is also aided by the suspension (and forthcoming reform) of EU fiscal rules, which gives it flexibility until 2024 – after which Italy will operate under a revamped Stability Pact likely requiring steady debt reduction. The Meloni government has so far balanced fiscal prudence with its policy agenda: for 2024 it passed a budget with a slightly higher deficit than initially agreed with the EU (after incorporating a costly pension and flat-tax promise), but in 2025 it appears determined not to further widen the fiscal gap despite growth “crumbling”. In public remarks, officials emphasize Italy’s

commitment to fiscal credibility, knowing investor sentiment can shift quickly.

In summary, Italy's fiscal plan for 2025–2026 is to hold the line on deficits and stabilize debt, using one-off measures like asset sales and assuming the absence of new fiscal shocks. The risk is that if growth undershoots (e.g. due to a full-blown trade war or failure to execute EU-funded projects), debt could start rising more sharply, forcing painful adjustments. For now, though, Italy has bought itself time and moderate goodwill in Brussels by setting a 2026 deficit below 3%. Achieving these targets will require strict spending control and successful implementation of its recovery plan projects to stimulate growth.

Sectoral Trends and External Trade

Sectoral performance in Italy is mixed in early 2025, with strength in services contrasting with a protracted manufacturing downturn that may finally be bottoming out. Services have emerged as a growth engine: the services PMI reached 52.9 in April, rising for five consecutive months. Robust new business in sectors like tourism, transport, and business services drove the fastest services expansion since 2022.

Italy's important tourism industry continues to recover – early 2025 saw strong booking numbers, and the country expects another good summer season, which should benefit hospitality and related services. Consumer services (retail, dining) are also seeing a boost from improved household finances as inflation abates.

Meanwhile, manufacturing in Italy remains in contraction but shows clear signs of improvement. April marked the 13th straight month of sub-50 PMI for manufacturing, yet the decline has slowed markedly. The manufacturing PMI climbed to 49 in May (flash estimate), near the threshold of growth, indicating that the sector's year-long recession is close to ending. Output is stabilizing as order inflows stop shrinking at the rapid pace seen in 2024. According to HCOB survey data, manufacturing output has “practically stopped shrinking” by April, and backlogs of work have levelled off for the first time in over two years (suggesting factories have caught up with orders).

Key Italian industries like machinery, automotive, and fashion are adapting to weaker external demand by tapping domestic orders and intra-EU markets. Still, challenges persist: export orders remained soft, and profit margins are squeezed in some manufacturing segments due to past input cost spikes.

Construction is another lagging sector – higher interest rates previously dampened building activity, though there are pockets of strength (public infrastructure projects funded by the EU). Notably, agriculture provided a rare bright spot, expanding output in Q1, aided by favorable weather and export demand for food products.

On the external trade front, Italy's export momentum has faltered in late 2024 and early 2025. Exports are essentially flat to slightly down year-on-year, with weakness concentrated in extra-EU trade. The United States' tariff measures pose a significant headwind: Italy's exports to the U.S. (which include machinery, luxury goods, and foods like cheese and wine) are now subject to uncertainty and potential double-digit tariffs.

The Bank of Italy warned that Italian exports will be "strongly affected" by the U.S. tariffs, projecting virtually zero export growth in 2025. This is a stark change from the recovery of 2021–22 when exports boomed. To mitigate the impact, Italian trade officials are eyeing diversification – e.g. expanding trade with the Middle East, Latin America, and within Europe. The recent depreciation of the euro (from its 2024 highs) might also help price-competitiveness abroad.

Imports into Italy have been relatively robust (imports rose in Q1 while exports dipped), partly due to resilient domestic demand for consumer and capital goods and inventory rebuilds as supply chains normalize. The net result is that net exports have turned into a slight drag on Italy's GDP, after being a growth driver in previous years.

Another notable shift in Italy's external economic relations is its stance toward China's Belt and Road Initiative (BRI). In late 2023, Italy formally withdrew from the BRI agreement, becoming the only G7 country to do so. While this withdrawal was driven by disappointment in the BRI's meager benefits and strategic realignment with EU allies, it has had *minimal immediate impact* on trade flows.

Italy continues to trade actively with China, but is now pursuing a "soft reset" of China relations – seeking investment and export opportunities outside the BRI framework. Italian companies remain engaged in China, but the government is more closely screening Chinese investments at home (e.g. in ports or telecom) in line with EU security guidelines.

In terms of foreign investment activity, Italy is seeing select significant deals that could shape certain sectors. A prime example is in aviation: Germany's Lufthansa agreed to acquire a 41% stake in ITA Airways (Italy's state-owned successor to Alitalia) for €325 million, a deal finalized in January 2025. This partial privatization integrates ITA into Lufthansa's network, aiming to improve the Italian airline's fortunes and potentially leading to full ownership in the future. It represents a vote of confidence by a major foreign airline in Italy's market and will inject capital and know-how into Italy's air transport sector.

Outside of such headline deals, overall FDI into Italy has been lukewarm compared to France – investor surveys cite concerns about Italy's bureaucracy and medium-term growth, though interest exists in segments like energy, luxury goods, and automotive (especially in electric vehicle supply chains).

The Italian government is working to attract investment through tax incentives and by leveraging the EU recovery plan funds to modernize infrastructure and digital networks. Indeed, effective use of EU funds is a critical “sectoral” story: these investments target areas like green energy, rail and broadband, and innovation hubs.

However, Italy has struggled with delays in deploying EU Recovery and Resilience Facility (RRF) funds. By end-2024, Italy had only spent ~€53.5 billion of the €191 billion available (under 30%), and many project tenders remained incomplete. The government in early 2025 has been renegotiating certain RRF milestones with Brussels and passed decrees to accelerate project spending.

These funds were originally expected to add over 2 percentage points to GDP across 2022–2024, but due to delays their actual growth impact has been much lower – only an estimated +0.7pp in 2024 instead of +2.1pp. This shortfall partly explains why Italy’s growth has underwhelmed despite the stimulus available.

Closing this implementation gap is vital: if Italy can catch up on RRF project execution in 2025–26, it could provide a much-needed boost to construction, industrial equipment demand, and job creation. The government insists it will not forfeit any EU funds and is consolidating oversight to ensure better coordination. Successful deployment of these investments would improve Italy’s long-term productive capacity (e.g. upgraded ports, renewable energy installations, digitalization of businesses) and raise its growth potential.

In summary, Italy’s sectoral outlook presents a cautious optimism: the service sector is driving what little growth there is, manufacturing is on the mend but facing external shock waves, and public investment via EU funds could be a game-changer if bottlenecks are resolved. The external sector is the main source of concern, given trade tensions and Italy’s reliance on exports of industrial goods. The upcoming months will test Italy’s ability to pivot its trade and sustain domestic service momentum in the face of global headwinds.

Political and Policy Developments

In contrast to the political shake-up in France, Italy’s political scene has been relatively stable through early 2025. Prime Minister Giorgia Meloni, in office since late 2022, continues to lead a right-wing coalition (Brothers of Italy, League, and Forza Italia) with a solid majority in Parliament. There have been no major elections or changes in government since the 2024 European Parliament elections (where Meloni’s party performed strongly).

This stability has allowed the government to focus on policy execution rather than political survival. Meloni’s administration has trodden a somewhat moderate line in economic management, seeking to reassure investors and European

partners that it is fiscally responsible and pro-EU (in contrast to some past populist governments). For instance, Meloni worked with the European Commission in late 2024 to revise Italy's recovery plan and avoid any confrontation over budget rules. The government's decision to stick to EU deficit limits for 2025 and 2026 and its cooperation with Brussels on RRF funds demonstrate a pragmatic approach that has calmed markets.

That said, policy priorities remain influenced by the right-wing agenda: in the 2024 budget, the government cut taxes for middle-income earners and extended support for families (consistent with its pro-natalist stance), while also tightening eligibility for the "Citizens' Income" poverty benefit (now replaced by a more limited scheme). These measures were popular with Meloni's base but had to be balanced with fiscal constraints.

Looking ahead, Meloni has voiced intent to pursue a comprehensive tax reform (moving towards a flatter tax structure) and bureaucratic simplification to improve Italy's business climate, but meaningful progress has been slow.

Internationally, Italy's foreign policy under Meloni in early 2025 is a balancing act. On one hand, Meloni aligns with NATO and EU positions – staunchly supporting Ukraine against Russian aggression and maintaining sanctions on Russia, and aligning with EU partners on critical issues. On the other hand, she is cultivating a distinct profile: for example, positioning Italy as a potential "bridge" in transatlantic relations.

Notably, with the return of Donald Trump to the White House, Meloni has kept communication channels open; Italian diplomats have tried to mediate or at least soften the impacts of U.S. tariffs, given Italy's exposure (Italy's approach is to engage and seek exemptions where possible, while backing EU retaliatory measures if absolutely needed).

Domestically, Meloni's firm stance on issues like immigration continues – early 2025 saw Italy pressing the EU for more support on Mediterranean migrant flows, even briefly sparring with France over migrant arrivals (though this did not escalate significantly). No significant new legislation has been passed in 2025 on sensitive issues like judicial reform or constitutional changes (e.g. Meloni's proposal to move towards a presidential system remains under discussion but without broad consensus, it's on the back burner).

The government's parliamentary majority ensures political stability, but also means Meloni owns the outcome of Italy's economic performance. Her poll ratings have dipped slightly as growth disappoints, but she remains the most popular party leader and faces a weak opposition (the center-left is fragmented and the Five Star Movement has lost momentum). As such, the political risk in Italy is relatively low in the near term – there is little threat of government collapse or snap elections.

This gives Meloni an opportunity to focus on administrative efficiency (e.g. fixing the RRF fund delays) and incremental reforms. One emerging foreign policy shift was Italy's withdrawal from the Belt and Road Initiative in late 2023, which took effect in 2024; by 2025 Italy is trying to maintain cordial ties with China outside the BRI framework.

Rome has also been an advocate for a new EU fiscal framework that allows growth-friendly investments – Italy is supportive of the EU's ongoing fiscal rules reform, which as of spring 2025 is nearing conclusion and is expected to grant member states like Italy somewhat more flexibility in reducing debt over a longer horizon.

In summary, Italy's political environment in early 2025 is characterized by continuity and cautious governance. Meloni's government is stable and has broadly maintained Italy's policy direction: pro-NATO, anchored in the EU but asserting Italy's interests firmly, and domestically pursuing conservative social policies paired with moderately expansionary economics (within fiscal limits). The key political challenges ahead will be managing the economic fallout of the trade war (ensuring affected industries are supported) and demonstrating tangible improvements in areas like public investment and bureaucratic reform, which have long plagued Italy. Successful navigation of these issues would bolster Italy's economic outlook and Meloni's standing; failure or a significant downturn could revive Eurosceptic and populist tensions.

For now, however, Italy enjoys a rare period of political calm by its historical standards – an asset in confronting the economic headwinds of 2025.

Trade Idea (Short EURUSD)

Narrative

The euro is under increasing pressure amid deteriorating macroeconomic conditions across the eurozone, political instability in key member states, and growing divergence between ECB and Fed policy trajectories. France and Germany, the euro area's largest economies, are stagnating. France's GDP was effectively flat in Q1 2025, driven largely by inventory accumulation rather than underlying demand, while Germany continues to struggle under a contraction in both manufacturing and services. The ECB, acknowledging the breadth of economic softness, has adopted a firmly dovish stance, cutting rates by a cumulative 150 basis points since September 2024 and leaving open the possibility of further easing. Inflation across the bloc has eased more quickly than expected, particularly in France, where harmonised CPI now sits below 1%—well under the ECB's medium-term target.

Meanwhile, the U.S. economy remains more resilient, with inflation still above target and the Fed signalling a slower, more cautious rate-cutting cycle. The Fed's reluctance to aggressively loosen policy—especially in the face of fresh supply-side

pressures from U.S. trade policy—contrasts starkly with the ECB's accommodative pivot. The growing yield differential between U.S. and European assets, especially at the front end, has tilted relative interest rate expectations firmly in the dollar's favour.

Compounding these structural challenges are renewed political and fiscal concerns, particularly in France. The appointment of Prime Minister François Bayrou has not resolved the impasse in a fractured National Assembly, leaving the government reliant on informal alliances to pass legislation. France's deficit remains among the eurozone's largest at 5.8% of GDP, and while modest budget freezes have been enacted, there is little evidence of the structural consolidation needed to reassure markets. The IMF has issued explicit warnings about France's debt trajectory, and rating agencies have flagged the risk of future downgrades. The spectre of fiscal fragmentation, particularly if France begins to trade more like a "peripheral" economy, casts a long shadow over euro stability.

Catalysts

The near-term outlook for EURUSD is likely to be shaped by a series of bearish catalysts. First, eurozone growth remains tepid at best. Survey data from April confirms that private-sector activity continues to contract, particularly in services—a marked departure from their historical role as a stabilising force during manufacturing downturns. With domestic demand flatlining, business investment falling, and exports weakening in response to global trade frictions, the risk of a euro area recession is rising.

Second, the ECB's dovish trajectory shows no sign of reversal. Even as headline inflation approaches target levels, core inflation trends and macro data warrant caution. The ECB has signalled a data-dependent, meeting-by-meeting approach to policy, but markets are already pricing in at least one further cut by the end of 2025. With nominal policy rates below the Fed's and real rates trending negative in countries like France, the carry profile increasingly favours short EURUSD positioning.

Third, political risk is becoming more material. France's precarious fiscal position is under increasing scrutiny, and the minority government's ability to push through necessary but unpopular spending cuts remains in doubt. The prospect of further ratings pressure from Moody's or S&P is non-negligible and would heighten euro vulnerability in sovereign debt markets.

Lastly, the risk of a renewed U.S.-EU trade conflict looms large. Though the Biden administration has temporarily suspended its proposed 20% blanket tariff on EU goods, the risk of implementation remains. For France, heavily exposed in sectors like luxury, aerospace, and autos, such a move would sharply worsen both sentiment and the external balance. Even the anticipation of these tariffs has already begun to chill export orders and dampen business confidence.

Key Risks

Despite the weight of macroeconomic and political evidence favouring euro downside, several factors could pose risks to the bearish thesis. A sharp deterioration in U.S. economic data—particularly labour market indicators or forward-looking inflation prints—could force the Fed into a more aggressive easing cycle. Should this occur, interest rate differentials could narrow abruptly, placing upward pressure on EURUSD.

Furthermore, a political breakthrough in France or across the eurozone could catalyse renewed investor optimism. For example, if Bayrou's government manages to pass a credible fiscal consolidation package or EU-level coordination delivers stronger investment stimulus, the euro could benefit from a repricing of political risk.

Finally, any unforeseen event that triggers a rapid deterioration in dollar sentiment—such as a U.S. debt ceiling crisis, geopolitical event, or an overly hawkish Fed misstep—could unwind dollar longs and support the euro in the short term. However, in the absence of such tail events, the underlying dynamics remain decisively euro-negative.

Conclusion

Against this backdrop, we recommend initiating a short EURUSD position at 1.0880, targeting a move down to 1.0550 over a one- to three-month horizon. This level coincides with key support observed earlier in the year and reflects a reasonable adjustment to renewed euro area weakness. A stop-loss at 1.1020 is set to contain upside risks related to U.S. data or dovish Fed repricing. The trade offers a compelling risk-reward ratio of approximately 1:2.4 and aligns with both macro fundamentals and market positioning. While sentiment may fluctuate on near-term data releases, the euro faces a combination of structural headwinds, policy divergence, and idiosyncratic risks that, in our view, favour downside continuation through mid-2025.

Entry Level: 1.0880

Take Profit: 1.0550

Stop Loss: 1.1020

Risk-Reward Ratio: ~1:2.4

Time Horizon: 1–3 months

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Basic Information

GDP	3.84 Trillion USD
M2	3120664 GBP Million
CPI	136
PPI	137
Con. Confidence	-23 points
Unemployment	4.5%
Bank Rate	4.25%
Net Debt-to-GDP	95.1%
Currency	Pound Sterling (GBP)

Source: IMF, ONS, GfK Consumer Confidence

Figure 1: GDP Quarterly Growth



Source: CEIC

Figure 2: CPI and CPI Growth(Y/Y)

Overview of the United Kingdom

- The United Kingdom comprises England, Scotland, Wales, and Northern Ireland, using the pound Sterling (GBP) as its national currency. As the sixth-largest economy in the world, the UK recorded a GDP of approximately 3.84 trillion USD in 2024, according to IMF estimates. The economy is driven mainly by its services sector, which accounted for around 80% of GDP in 2024, according to the Office for National Statistics (ONS).
- Beyond services, manufacturing contributed about 9% of GDP in 2024, with key segments including aerospace, pharmaceuticals, aluminium, timber products, and textiles.
- Trade plays a significant role in the UK economy, with exports and imports contributing to 34% and 35% of GDP, respectively. The top five trading partners are the United States, Germany, Netherlands, France, and China. In 2024, the UK ran a trade deficit of £97 billion with the EU, while recording a trade surplus of £65 billion with non-EU countries.
- The UK is a member of international organisations including the G7, G20, NATO, OECD, and WTO. The country has active free trade agreements with several major economies, such as the EU, Australia, New Zealand, Japan, Singapore, and South Korea. Despite its exit from the EU, the UK remains economically intertwined with the European continent and has engaged deeper with Indo-Pacific trade frameworks, including membership in CPTPP.
- The current fiscal situation of the UK faces a big shortfall. The UK government's debt is at its highest level since the 1960s, with government borrowing reaching £151.9 billion in FY24/25, beating OBR forecasts. While the budget deficit could be financed by the sale of government bonds (Gilts), the new Labour government led by Keir Starmer is seeking to cut down the budget deficit level, together with making technical changes to the way debt is measured, which will allow it to fund extra investment without breaching fiscal rules.

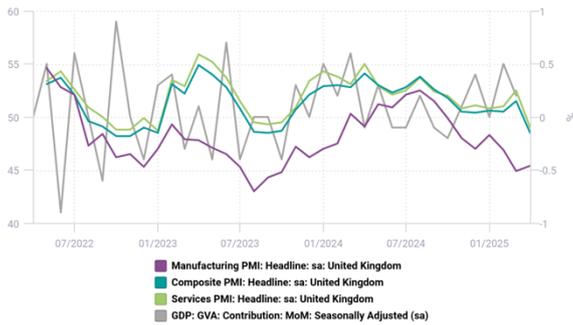
Summary of Events in the Past 6 Months

- UK's economic output showed signs of resilience towards the end of 2024, with GDP growing 0.1% Q/Q in Q4, driven by a robust December in the services sector. For the full year, GDP grew by 1.1%, up from 0.4% in 2023, although investment fell sharply in Q4 amid policy uncertainty. The BoE and OBR have both revised down their 2025 growth forecasts to 0.75% and 1% respectively, reflecting persistent headwinds and soft household spending



Source: CEIC

Figure 3: PMI and GDP Growth(M/M)



Source: CEIC

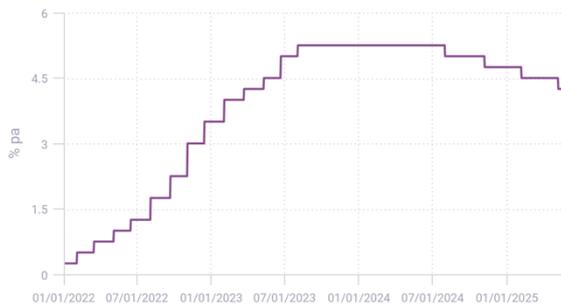
Figure 4: GBP is the best performing G10 currency against USD in 2024



Source: CEIC

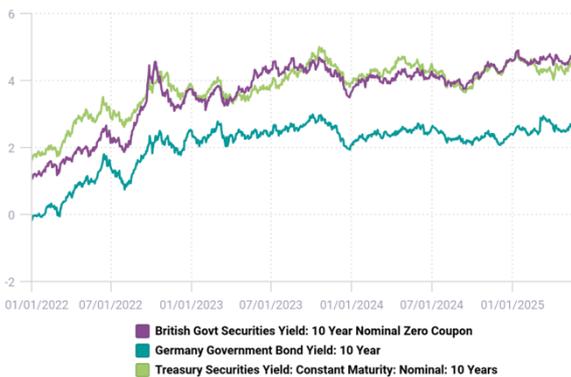
- Annual inflation cooled steadily over the past half-year, with CPI easing from 2.8% in February to 2.6% in March. The disinflation has been broad-based, with softening in clothing, airfares, and hospitality prices. However, service inflation remains sticky due to strong wage growth, and April's rise in energy bills (+6.4%) has sparked concerns of a temporary rebound in headline inflation later in 2025. The OBR expects average CPI to stay above 3% through this year
- With inflation trending towards 2% target, the BoE began its easing cycle cautiously. After two 25bps cuts in August and November last year, the Bank Rate was further trimmed to 4.5% in February 2025 and 4.25% in May. Despite soft data, Governor Bailey reiterated that further rate cuts will be "gradual and careful". Notably, the May decision saw two MPC members vote against the cut, underscoring a cautious tone in policy guidance
- After 14 years of Conservative rule, the Labour Party won a majority in the July 2024 general election. Prime Minister Keir Starmer and Chancellor Rachel Reeves came into power with the UK facing record-high debt levels. In the Autumn Budget, Reeves pledged to rebuild public services and announced targeted tax hikes, notably in employer National Insurance. The expansionary stance lifted growth temporarily, but in March 2025, the Spring Statement reversed course as the OBR halved its growth forecast and raised borrowing projections. Reeves responded with fiscal tightening, cutting planned spending and announcing £4.8 billion in welfare savings to restore a safety margin in public finances.
- GBP ended 2024 as the best-performing G10 currency against the USD, despite falling 1.4% over the year. The pound was initially supported by UK economic resilience and political clarity following the Labour victory in July. However, the pound weakened in Q4 as the dollar strengthened sharply following Trump's election win. Into 2025, Sterling has rebounded steadily, underpinned by stabilising UK data and softening US rate expectations, gaining 6.31% YTD and last trading at 1.3306 as of 11 May, near the top end of its 52-week range of 1.2100 - 1.3444.

Figure 5: BoE's Bank Rate



Source: BoE

Figure 6: Differential between UK, US, and Germany 10y Government Bond Yields (%)



Source: CEIC

Figure 7: Unemployment Rate



Source: CEIC

BOE's Key Measures: Walking the Tightrope

Cautious Easing Amid Structural Frictions

BoE kept Bank Rate below 1% for much of the post-Brexit and pandemic period to support the economy through successive shocks. But the inflation surge following Russia's invasion of Ukraine in 2022 forced the Bank into an aggressive tightening cycle, with the Bank Rate peaking at 5.25% by August 2023.

As inflation pressures gradually eased into 2H24, BoE entered a cautious easing cycle. It delivered two 25bps cuts in August and November 2024, followed by a third cut to 4.5% in February 2025, and most recently a fourth to 4.25% at the May meeting. That decision, however, saw a narrow 5-4 vote split on the MPC, with two members preferring to hold and two calling for a deeper 50bps cut. Underlining uncertainty over the pace of normalisation.

Although headline CPI has fallen sharply to 2.6% in March, services inflation and wage growth remain elevated. The May statement noted that pay growth is moderating but still strong, and inflation is expected to rise again temporarily in the second half of 2025, peaking at around 3.5% in Q3 before returning to target in 2026. BoE's guidance maintains that "policy will need to remain restrictive for sufficiently long until the risks to inflation returning sustainably to 2% have dissipated."

The recalibration of rate cuts remains complicated by structural labour market frictions. Despite signs of a softening job market, wage pressures are still high, particularly in the services sector. The shortage of available labour, linked to NHS backlogs, post-Brexit migration rules, and long-term sickness, continues to cap the economy's supply potential and keeps underlying inflation sticky. At the same time, US trade tariffs are expected to weigh on UK growth in the near term.

BoE is therefore navigating a narrow path. A premature easing could risk inflation persistence, while holding rates too high for too long may tighten financial conditions just as growth slows. Current market pricing points to a terminal rate of around 3.5% by year-end, though if downside risks to demand materialise, further cuts may be warranted.

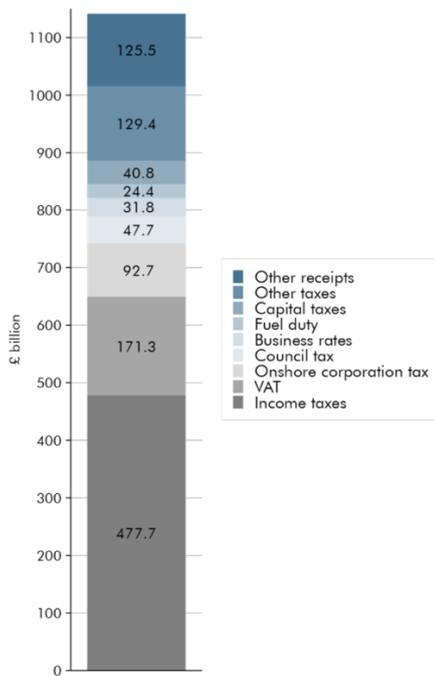
Domestic Developments: First Budget delivered to deal with structural pressures and budget woes

Labour Market: Loosening, but wage growth remains elevated

The UK labour market is showing clearer signs of cooling. The unemployment rate ticked up to 4.4% in the Dec to Feb 2025 period, and redundancies have risen from pandemic lows. Vacancies have fallen below pre-COVID levels, and early payroll data shows a net drop of 78,000 employees in March, the largest monthly decline since the early 2020 shock. Still, the market remains tight by historical standards, especially in key service sectors.

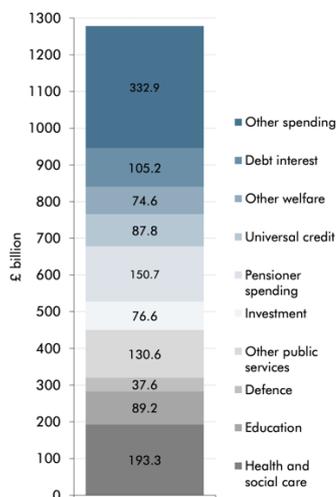
Wage growth has not yet fully adjusted to the softer conditions. Average weekly earnings rose 5.9% Y/Y in the three months to February, keeping real wages positive but also sustaining service-sector inflation. The rise in employer National Insurance and the

Figure 8: 2024-25 Sources of public sector receipts



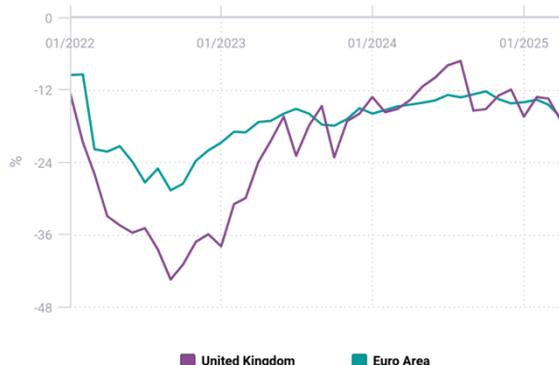
Source: OBR

Figure 9: 2024-25 Public sector spending forecast



Source: OBR

Figure 10: Consumer Confidence Indicator



Source: CEIC

nearly 7% hike in the minimum wage in April added to cost pressures. Many firms, particularly in manufacturing and retail, have responded by cutting staff or freezing hiring. Meanwhile, efforts to raise workforce participation, including those affected by long-term illness and NHS waitlists, are progressing slowly, reinforcing structural constraints on labour supply.

Inflation: Cooling down trend but risks of rebound remain

After falling steadily in late 2024, inflation appears to have stabilised around 2.6% in early 2025. The decline has been broad-based, with easing prices in clothing, airfares, and hospitality. Still, sticky services inflation and recent policy-driven cost increases are raising concerns of a temporary resurgence.

April’s energy bill cap adjustment added 6.4% to regulated tariffs, and the start of the new fiscal year brought further cost-of-living pressures from council tax hikes and adjustments to motor fuel and vehicle excise duties. While real wage growth has turned positive, it is largely being absorbed by these rising essentials, squeezing discretionary spending. The OBR expects CPI to average 3.2% in 2025, above the BoE’s target, but moderating further into 2026.

Growth and Confidence: Fragile and uneven

UK GDP grew 0.1% in Q1 2025, continuing the sluggish trend seen at the end of last year. The economy narrowly avoided recession in Q4 2024, buoyed by strong December services output and inventory accumulation. Growth in the first half of 2024 had been notably stronger, with GDP expanding 0.7% in Q1 and 0.5% in Q2, the fastest pace since late 2021. However, back-to-back monthly contractions in September and October (-0.1% m/m) raised recession concerns, as output in construction and manufacturing fell amid fiscal uncertainty and external trade disruptions. Business investment also contracted 3.2% in Q4, and early 2025 data suggest firms remain cautious. Consumer spending is similarly soft, with retail volumes falling again in March after a brief bounce in January.

Business confidence remains subdued. While the BoE’s gradual rate cuts and the government’s Spring Statement helped ease financial conditions, sentiment is still cautious. Many firms are deferring capital spending, citing rising labour costs, tax pressures, and soft demand. According to the BoE’s Decision Maker Panel, 54% of firms said they would respond to higher costs by reducing employment, while an equal proportion planned to raise prices. 38% expected to lower wages, underscoring the cost burden introduced in the Autumn Budget.

The Autumn Budget’s expansionary stance provided a short-term lift, but its longer-term effects have been mixed. Public investment announcements supported sentiment, but higher employer taxes have dragged on hiring and profit expectations. The subsequent Spring Statement in March 2025 marked a partial reversal, with Reeves announcing £4.8 billion in welfare cuts and trimmed spending plans to restore fiscal headroom.

Table 1: Tax Adjustment in the Autumn Budget

Measure	Details
Employers' National Insurance Contributions (NICs)	Increase from 13.8% to 15% on salaries above £5,000, effective April 2025.
Capital Gains Tax	Rates increased to 18% (from 10%) for basic rate taxpayers and 24% (from 20%) for higher rate taxpayers, effective immediately.
Inheritance Tax	Introduction of tax on pensions from April 2027; agricultural property relief capped at £1 million from April 2026.
Stamp Duty	Surcharge on second homes increased from 3% to 5%, effective 2025.
Vaping Tax	New tax introduced on vaping products.
Fuel Duty	Frozen for an additional year.
Alcohol Duty	Duty on draught drinks reduced by 1p; other alcohol duties increased.
Non-Domiciled Tax Regime	Ending in 2025.

Table 2: Public Spending Initiatives in the Autumn Budget

Sector	Investment	Details
Healthcare	£22.6 billion (day-to-day) and £3.1 billion (capital) over this year and next year	Largest real-terms growth in NHS spending outside of COVID-19 since 2010.
Education	£6.7 billion capital investment next year	19% real-terms increase; includes £1.4 billion to rebuild over 500 schools.
Housing	£5 billion in 2025–26	Focus on enhancing affordable housing availability.
Green Hydrogen Projects	Funding for 11 new projects	Among the first commercial-scale projects globally.
Defense	£2.5 billion additional spending	To bolster national security.
Transport	£650 million for local transport; £550 million for road maintenance	Includes funding to fill 1 million potholes.

International Developments: De-escalation provides relief but global weakness persists

Eurozone stagnation remains a drag

Economic momentum across the Eurozone remains weak. Germany entered a technical recession while French output contracted in late 2024. Although recent industrial data showed signs of stabilisation, particularly in Germany's capital goods segment, the broader recovery remains uneven. Soft consumer spending and political uncertainty continue to weigh on investor sentiment across the bloc. With UK exports to the EU comprising nearly half of total exports, soft external demand remains a key downside risk to UK trade.

The ECB's rate cuts in April have modestly eased conditions, but the underlying demand softness is likely to persist through mid-2025. UK manufacturers have flagged deteriorating sentiment from European buyers, reflected in weak new export orders across PMI readings since March.

Trade tensions ease but uncertainty remains

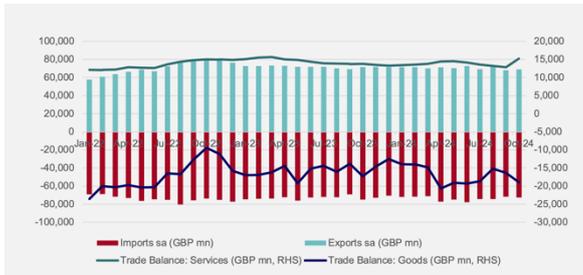
Global risk sentiment improved following a 90-day suspension of new tariffs between the US and China after talks in Switzerland. As part of the agreement, the US reduced tariffs on Chinese goods from 145% to

Figure 11: GBP/EUR and GBP/USD



Source: TradingView

Figure 12: Trade Balance



Source: CEIC

30%, while China cut its tariffs on US products from 125% to 10%. This move followed earlier signs of softening, including the partial rollback of US tariffs on UK steel and auto exports.

The direct impact of US tariffs on the UK remains limited, as UK exports to the US are predominantly services. However, the broader impact of global trade tensions, particularly on supply chains and investor sentiment, had already begun to weigh on UK business confidence. While the truce has reduced some near-term pressure on trade costs and market volatility, UK exporters remain cautious given the temporary nature of the pause and the fragility of global trade volumes.

China and emerging Asia: Slow recovery, low inflation tailwind

China's recovery remains uneven. While policymakers have responded with targeted easing measures, including a surprise RRR cut and lower repo rates, the pace of new stimulus has slowed following the trade deal. UK exposure to China, particularly in sectors like luxury goods, automotive and higher education remains sensitive to changes in Chinese consumer demand. Meanwhile, falling Chinese export prices have helped to ease UK import costs. In broader EM Asia, currencies have rebounded slightly, but growth remains below trend.

GBP: Supportive fundamentals amid global divergence

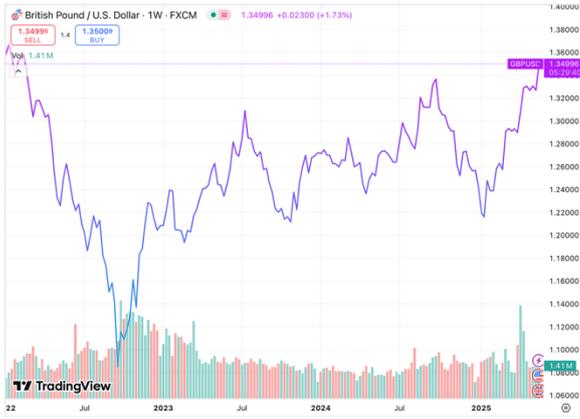
Sterling has held up well in 2025, outperforming most G10 peers as markets reassess the pace of monetary easing across major economies. The BoE's more gradual approach to rate cuts, compared to the ECB and SNB, has provided consistent support for GBP, particularly against the euro and Swiss franc. The pound has also benefited from easing global trade tensions and more constructive UK-US and UK-EU relations, which have helped improve investor confidence around the UK's external outlook.

Against the dollar, sterling recently tested multi-year highs, lifted by broad USD softness and a shift in capital flows away from the US. This was further supported by steady demand for UK assets, with high Gilt yields continuing to attract inflows despite ongoing volatility.

That said, GBP remains vulnerable to external risks. While the UK has largely avoided the direct fallout from recent tariff disputes, some manufacturing sectors particularly autos and pharmaceuticals, still face exposure. Meanwhile, fiscal pressures and high public borrowing could complicate the BoE's ability to stay measured, especially if inflation proves stickier than expected.

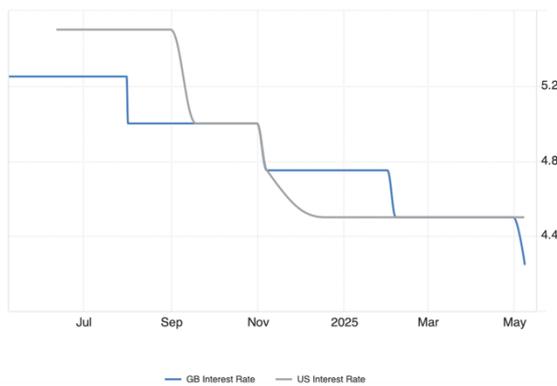
Overall, sterling is expected to stay resilient in the near term, with rate differentials and stable domestic sentiment offering relative support. But with global markets closely watching US fiscal policy, Fed guidance and broader shifts in risk appetite, periods of volatility are likely to persist.

Figure 13: GBPUSD Currency Pair



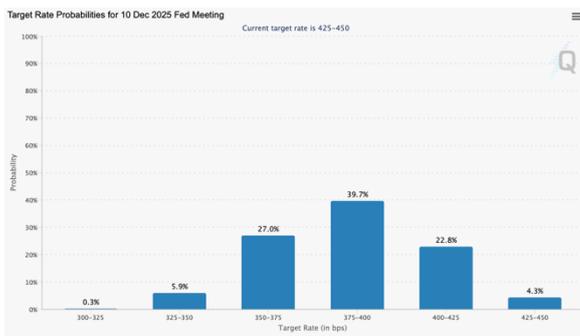
Source: TradingView

Figure 14: Interest Rate Differential between UK & US



Source: Trading Economics

Figure 15: Fed Fund Futures



Source: CME FedWatch

Trade Idea: Long GBPUSD

The BoE has adopted a more cautious monetary policy stance following a surprise upside inflation print in April. The latest CPI figure came in at 3.5% YoY, up from 2.6% in March, with services inflation rising to 5.4%, well above the BoE's internal forecast. Markets are currently expecting two more cuts, bringing Bank Rate to 3.75% by end 2025. Notably, the BoE's cut in May was accompanied by a split 5-4 vote, with two members voting for no change. Hence, I believe the BoE will slow the pace of cuts, likely delivering only zero to one cut for the remainder of the year.

BoE Governor Andrew Bailey has reiterated that policy is not on a preset path, and future decisions will depend heavily on incoming data. With wage growth still running around 6% YoY and retail sales rising 1.2% MoM in April, the domestic economy appears more resilient than previously expected. Meanwhile, the US Federal Reserve, which held rates steady at its recent May FOMC meeting, continues to signal a wait-and-see stance, with markets currently pricing in two cuts in 2025.

The diverging monetary paths are supportive of sterling. The Fed is expected to cut up to two more times in 2025, whereas the BoE may only deliver one cut or pause altogether, if services inflation remains elevated. Moreover, with GBP/USD breaking above 1.345, the pound has reached levels not seen since early 2022, supported by both relative yield differentials and a more constructive fiscal and trade narrative, including recent UK-US and UK-EU trade realignments. As of now, real UK yields remain among the highest in the G10, bolstering demand for GBP from both a carry and valuation perspective.

Catalysts

A key catalyst will be upcoming UK CPI and wage data releases ahead of the BoE's August meeting. If inflation moderates without a collapse in employment or wages, the BoE is likely to delay further easing, reinforcing the yield premium in favour of GBP.

Additionally, if the Fed signals a clearer rate cut timeline at its upcoming FOMC meeting, while the BoE maintains its "gradual and careful" stance, the policy divergence will widen. This would likely attract further capital inflows into the UK and offer scope for GBP/USD to appreciate toward the 1.38-1.40 range.

Technical

GBP/USD is currently trading around 1.3497 (as of 23 May 2025). The RSI stands at 64.22, indicating bullish momentum but not yet overbought. The price sits comfortably above the 20-day and 50-day moving averages, reflecting a well-established uptrend. The pair recently broke through a long-term resistance at 1.34, which may now act as a key support level going forward.

Trade

Entry: 1.3497
Take Profit: 1.3970
Stop Loss: 1.3190
Reward Risk Ratio: 1.54

Analyst

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Basic Information

Real GDP 209.76B

(Q4-24)(CHF)

Balance of Trade 5.3B

(Mar-25) (CHF)

CPI (Mar-25) 107.46

PPI (Mar-25) 106.83

Unemployment 2.8%

Rate (Apr-25)

Manufacturing PMI 45.8

(Apr-25)

Stock Index Swiss Market Index
(SMI)

Currency Schweizerfranken/
Swiss Franc (CHF)

Source: Trading Economics

Chart info

Figure 1: Switzerland GDP

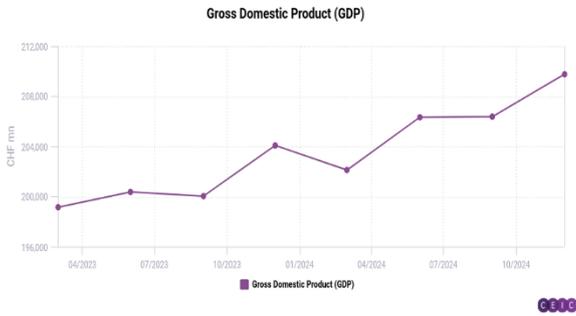
Overview of Switzerland

- Switzerland, officially known as the Swiss Confederation, is a landlocked, mountainous country located in central Europe. Known for its stunning landscapes, it is bordered by Germany, France, Italy, Austria and Liechtenstein. Despite its centrality in Europe, Switzerland is not part of the European Union (EU), albeit its economy is highly integrated with the EU. Switzerland is currently ranked 20th in the world by GDP, holding 0.4% of the share of the World GDP and ranked 2nd in the world by GDP per capita.
- Switzerland's geopolitical stance is characterized by its long-standing policy of **neutrality**. This is reaffirmed even in recent conflicts, such as the war in Ukraine. While Switzerland joined EU sanctions against Russia, it has maintained its neutral stance by not joining military alliances like NATO. The Swiss population strongly supports this position of neutrality, with over 90% of the population backing this position in a 2023 poll.

Summary of Events in the Past 6 Months

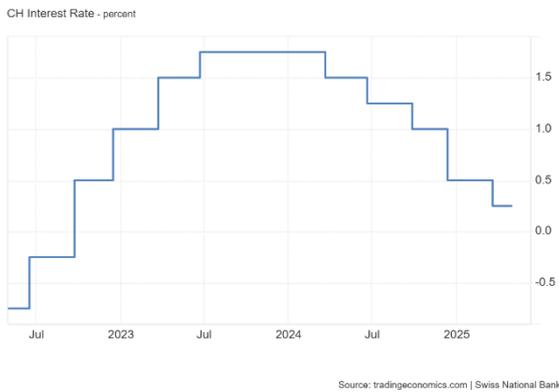
Fiscal Policy

- The Swiss Federal Parliament accepted the budget for 2025 on 12 December 2024. Included in the budget is higher military spending, reductions in farm subsidies, and significant cuts to international aid. Additionally, the planned increase in state pensions, referred to as an extra 13th month, will commence in 2026 as scheduled. The budgeted expenditure for 2025 is 86.3 billion, a 0.7% increase (0.7 billion) compared to the 2024 budget.
- In March 2025, the Swiss Confederation released their projections for Switzerland's GDP. They expect the GDP to grow by 1.4% and 1.6% (adjusted for sporting events) in 2025 and 2026 respectively. This is a downward revision from the projected December forecast at 1.5% and 1.7% respectively. This revision was announced in preparation for US's announcement of its global reciprocal tariffs.
- From the *Statement of Financial Performance* ended 2024, published on 3 March 2025, the Switzerland economy ended on a fiscal surplus of 2.1 billion CHF in 2024. The net debt for fiscal 2024 also decreased to 141.4 billion CHF, bringing the net debt ratio down to 17.2% in 2024.



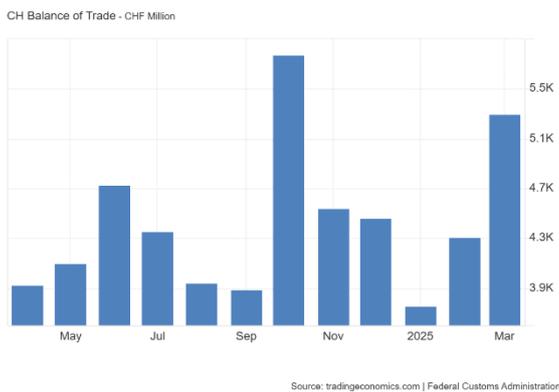
Source: CEIC Data

Figure 2: Switzerland Interest Rates (%)



Source: Trading Economics

Figure 3: Switzerland's Balance of Trade (CHF Million)



Source: Trading Economics

Figure 4: Switzerland's Economic Partners

- The Swiss Federal Council announced that it will again increase the standard VAT by 0.7 percentage points from 8.1% to 8.8% in 2026 in order to fund extra pension payments that would cost around 4.2 billion CHF in 2026.

Monetary Policy

- The Swiss National Bank (SNB) announced an interest rate cut of 25 basis points on March 20 from 0.5% to 0.25% (Figure 2). This cut brings the policy rate to its lowest since September 2022, prior to when the global economy experienced a period of high inflation. We can expect more rate cuts to come given the deflationary pressures that have persisted since May 2024. With deflationary pressures continuing to persist, exacerbated by the strengthening of the CHF, we can expect more cuts to come especially with inflation rates already hitting 0% for April of 2025.

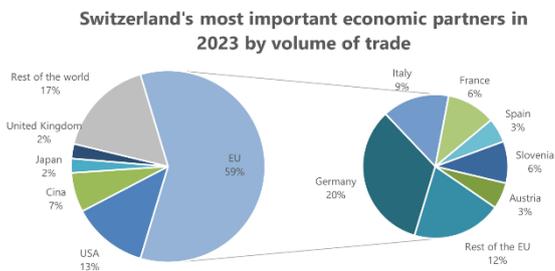
- The interest rate cut could result in the weakening of the CHF, but the strength of the CHF continues to persist given its traditional 'safe haven' status in these tumultuous times.

Geopolitical Events

- With the ongoing Ukraine-Russia conflict that has now lasted for about 3 years and 2 months, Switzerland is reconsidering its stance on neutrality. The Swiss Department of Defense presented a series of recommendations on 29 August 2024 which included recommendations such as increasing military budget to 1% of GDP by 2030, relaxing its ban on re-export of Swiss weapons to certain countries and aligning the policy of neutrality more closely with the UN Charter. A meeting between a Swiss delegate and NATO's Support and Procurement Agency (NSPA) also occurred on 28 August 2024 in Luxembourg, with one of the meeting's goals to assess potential synergies for cooperation between the country and the agency. While there might be increase cooperation with the EU and NATO, it is unlikely that Switzerland will become a member of NATO. While Switzerland might have imposed EU sanctions on Russia, its position of neutrality remains strong with 78% of respondents, to a survey by Ipsos, still in favour of neutrality by the country.

- Since Trump's election in November 2024, Switzerland has quietly hosted US and Russian participants in Switzerland for unofficial discussions about the Ukraine war.

- In light of the ongoing Ukraine-Russian conflict, Switzerland has invested 220 million CHF to refurbish and update its existing

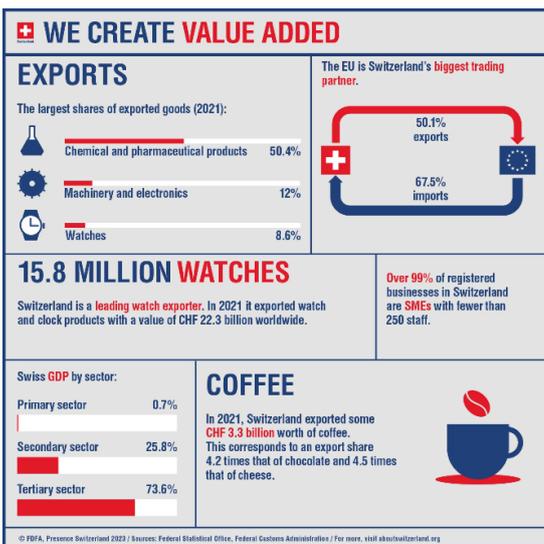


Source: Switzerland's Federal Department of Foreign Affairs (FDFA)

network of nuclear shelters. This is fueled by a law passed in 1963 which ensures that there is a bunker spot for each Swiss resident.

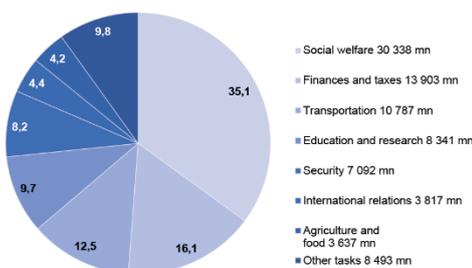
- On 2 April 2025, Trump announced his 'reciprocal tariffs' plan where he introduced a 10% baseline tariffs on imports from all countries and a higher tariff rate for countries running a trade surplus with the U.S. . Switzerland, being one of those countries running a trade surplus with the U.S., was hence, slammed with a 31% tariff rate. Largely hit sectors in the Switzerland economy include the Swiss watch industry, machinery industry, medical technology industry and Swiss food products (Figure 20). The reciprocal tariffs have since been reduced to 10% and put on a pause from 9 April 2025. This pause will last for 90 days until 31 July 2025.

Figure 5: Switzerland's Sector Breakdown



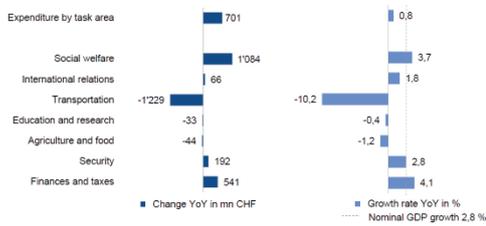
Source: Swiss Confederation, 2024

Figure 6: Switzerland Budget Breakdown 2025



Source: FFA

Figure 7: Switzerland 2025 Expenditure by Task Area



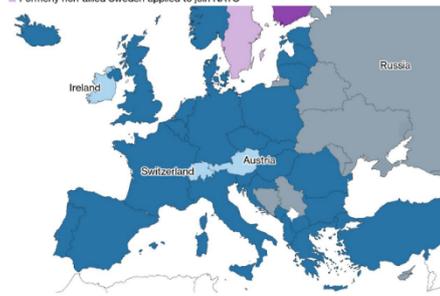
Source: FFA

Figure 8: Switzerland's Neutrality in Europe

Faced With Aggression, Europe Ditches Neutrality

The only remaining countries are far away from Russia

- NATO members
- Neutral countries
- Formerly non-allied Finland joined NATO this year
- Formerly non-allied Sweden applied to join NATO



Sources: NATO, Bloomberg

Bloomberg

Source:

Bloomberg

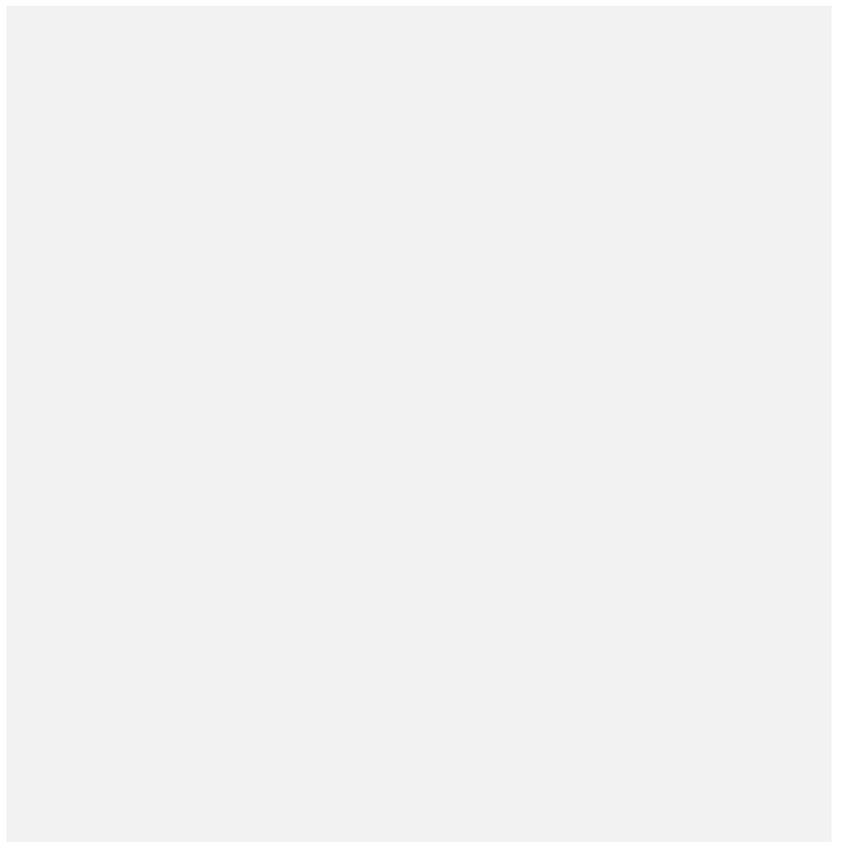
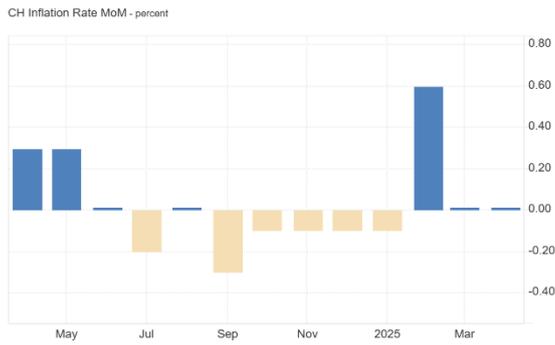


Figure 9: CHF/EUR Currency Pair



Source: TradingView

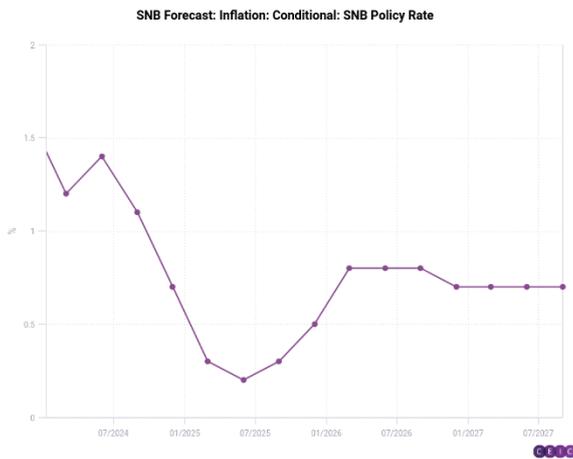
Figure 10: Switzerland's Inflation Rate MOM



Source: tradingeconomics.com | Swiss Federal Statistical Office

Source: Trading Economics

Figure 11: Switzerland Inflation Expectations



Source: CEIC Data

Switzerland Economy

The Swiss Economy can be divided into 3 sectors, namely: "Landwirtschaft" (agriculture), "Industrie, Gewerbe und Handwerk" (Industry, Trade and Handcraft) and "Dienstleistungen" (Services). They are known as the Primary, Secondary and Tertiary sector respectively (Figure 5).

Less than 10% of the population is employed in the primary sector and about 40% of the population is employed in the secondary sector. More than 50% of the population is employed in the tertiary sector. In 2023, approximately 74% of the Swiss GDP is generated by the tertiary sector and 25% by secondary sector. The primary sector contributes to less than 1%. Switzerland's biggest trading partner is the EU. Around 67% of Swiss imports come from the EU and 50% of Swiss exports are to EU countries (Figure 5).

Switzerland's Annual GDP growth rate decreased to 1.2% in 4Q2024, falling from the 1.3% growth in Q3 (Figure 13). Overall, Switzerland's GDP grew by 1.3% in 2024 (Figure 12). This growth is higher than the 0.7% growth in 2023 (Figure 12) and was largely driven by domestic demand from private consumption. Switzerland's GDP is expected to continue growing to 1.4% and 1.6% in 2025 and 2026 respectively.

Switzerland's prosperity largely stems from its banking, insurance, and tourism sectors, along with the export of high-end goods, pharmaceuticals, precision instruments, and medical technology.

Domestic Developments

Inflation

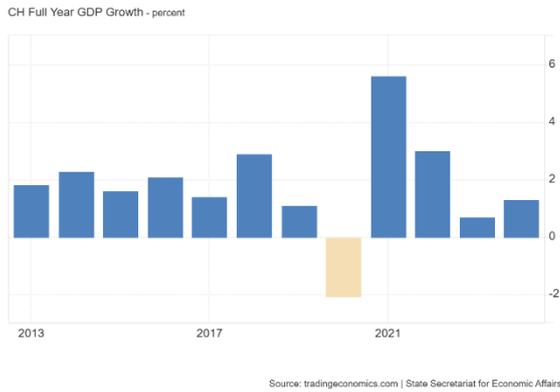
Like many other countries in the world, the Swiss National Bank (SNB) aims to maintain a 2% inflation rate year-on-year. However, Switzerland is at risk of slipping into a deflationary position with April 2025 recording a flat inflation rate of 0%.

This deflationary trend is largely due to the strengthening of the Swiss Franc. Since the start of June 2024, the Swiss Franc has appreciated strongly against the Euro. With 2/3 of all imports coming into Switzerland coming from the EU, this has caused goods imported into Switzerland from the EU becoming much cheaper.

Globally, countries are facing inflation due to the rising price of oil, gas and coal, driven by geopolitical tensions. However, unlike other countries that are reliant on traditional forms of energy, Switzerland primarily relies on hydropower and nuclear power to meet its electricity demands. In 2021, hydropower accounted for 61.5% of the electricity production, while nearly 29% came from nuclear power. With global conflicts pushing up oil prices, Switzerland will be less likely to experience increase in prices due to rising energy cost.

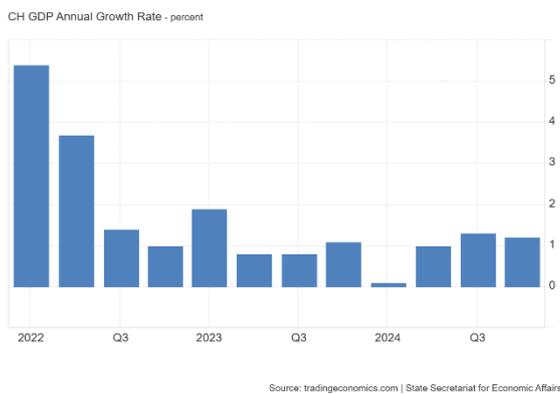
Another contributing factor to global inflation – rising agricultural prices – has a limited impact in Switzerland as well. This is due to the high import duties on agricultural goods, averaging nearly 43%, compared to just 12.6% in the EU. Import duties vary based on whether the agricultural product is produced in Switzerland. High

Figure 12: Switzerland Full Year GDP Growth



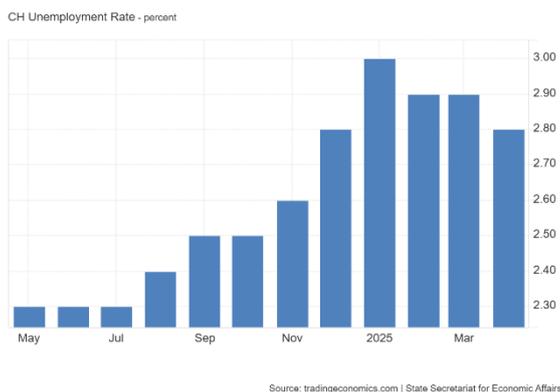
Source: TradingEconomics

Figure 13: Switzerland GDP Annual Growth Rate



Source: Trading Economics

Figure 14: Switzerland Unemployment Rate



Source: Trading Economics

tariffs are imposed on domestically produced goods. This high level of production for Swiss agricultural products means that food prices in Switzerland are largely insulated from global market fluctuations, so rising global prices have less effect on domestic prices.

With the strong Swiss Franc and reduced economic activity due to the looming threat of the U.S. tariffs, we should expect for inflation rates to possibly dip into negative territories in the months to come.

Interest Rates

Following the strong global inflationary pressures due to the COVID-19 pandemic, the SNB was quick to adopt a dovish stance and was one of the first countries to cut domestic interest rates given the well-mitigated imported inflationary pressures circumvented by the strong Swiss Franc.

In response to the current threat of deflation, the SNB reduced interest rates by 25-basis point cut on 20 March 2025. This brings the domestic interest rate to just 0.25% (Figure 2). This is the lowest since September 2022.

Switzerland's deflationary pressures are exacerbated by 2 events, Trump's reciprocal tariffs as well as the strong Swiss franc. With the next rate cut decision to be made on 19 June 2025, it is difficult to estimate whether SNB will wait until after 31 July 2025 (Trump's Tariff updates) to decide on lowering interest rates to 0%. However, the street is expecting the cut to happen.

SNB's Chairman, Martin Schlegel, has committed on 6 May 2025 that the SNB is ready to bring down interest rates to the negative territories, if necessary, with his comment "but if we have to do it, the negative rates, we're certainly prepared to do it again".

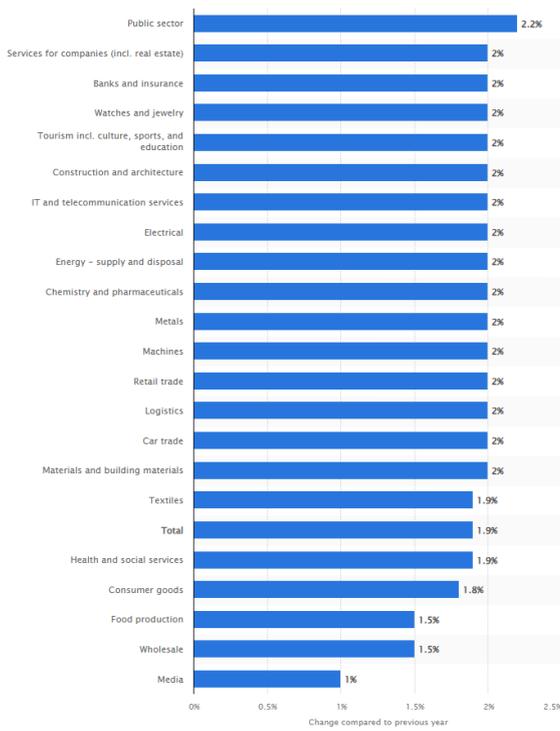
Unemployment & Wages

The unemployment rate in Switzerland decreased by 0.1% in April 2025 to 2.8% after two consecutive months of unemployment rate being steady at 2.9% (Figure 14). The unemployment rate, adjusted for seasonal factors, was also reported at 2.8%.

However, Switzerland could experience increase in unemployment in the months to come due to the Trump tariffs. In the beginning of April 2025, Swissmem (the association for Switzerland's mechanical and electrical engineering industries and related technology-oriented sectors) has requested for the Swiss government to allow for more worked to be put on state-subsidised shortened working hours. Even before the tariffs were introduced on 2 April, about one-third of the 1,300 companies in the Swissmechanic mechanical engineering lobby group had also already cut staff hours. The KOF Swiss Economic Institute (a leading research institute in ETH Zurich that focuses on analysing and forecasting the Swiss economy) has also previously estimated that unemployment could peak at 3% in 2025, though this projection has not been updated since the tariffs were announced.

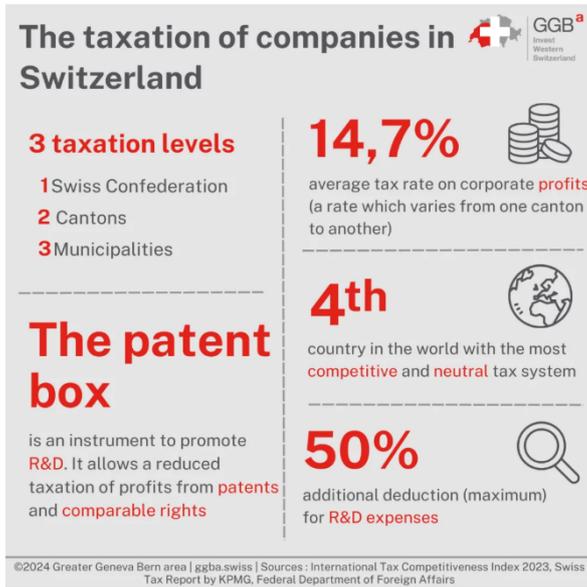
In 2024, nominal wages grew by 1.8%, while real wages increased by 0.7%. Among the 24 economic branches, 23 saw nominal wage growth, with the sole exception being Administrative and Auxiliary Activities. However, only 19 branches recorded real wage growth. The

Figure 15: Wage Increment Across Sectors



Source: Statista

Figure 16: Taxation of Companies in Switzerland



Source: Greater Geneva Bern area

highest real wage increase of 4.9% was observed in the Manufacture of Rubber and Plastics Products and Other Products from Non-Metallic Minerals sector, while the IT and Other Information Services sector experienced the lowest growth of 0.2%.

Economy Characteristics

Tax Haven

A tax haven is defined as a country or independent area where taxes are levied at a low rate. Switzerland’s identity as a tax haven stems from its Federal Act on Banks and Savings Banks introduced in 1934 where the law does not recognise tax evasion and allows the country to take in any individual with the intention to underreport assets. On top of that, the Swiss Banking system is known for its secrecy with managing the finances of wealthy account holders.

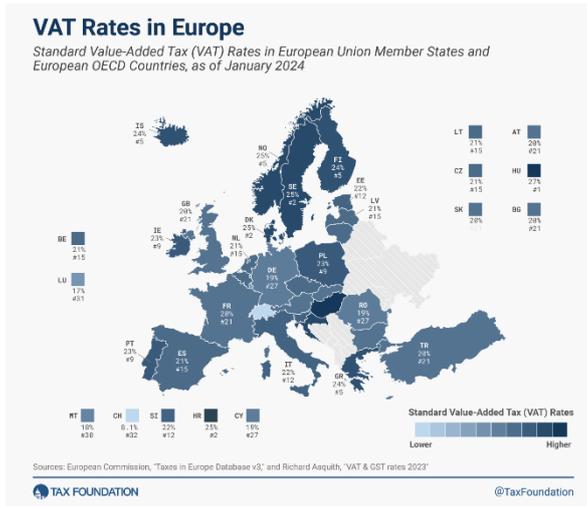
Switzerland’s tax system is structured by the country’s three tiers of government – Federal, Cantonal and Municipal. The federal tax law in Switzerland is consistent across the entire country, but each of the 26 cantons has its own distinct laws for cantonal taxes. Municipal taxes are calculated as a percentage of the cantonal taxes. The highest federal income tax rate is 11.5%. The various cantonal and municipal taxes are also levied at progressive rates, with a maximum combined cantonal and municipal rate of approximately 36%. In addition, cantonal and municipal net wealth taxes are levied.

For foreign individuals whose wealth is in Switzerland, they have the option to pay a low, lump-sum on the wealth they hold in Switzerland. Also known as expenditure-based taxation, this form of taxation is for “foreign nationals who are domiciled in Switzerland but are not gainfully employed here”. The tax is determined based on the total annual living expenses incurred by taxpayers both in Switzerland and abroad for themselves and their dependents.

For corporations in Switzerland, they pay a tax on net profit, with no federal capital gain tax. The federal tax rate is 8.5% of net profit, and the tax paid is deductible, possibly lowering the effective tax rate. To avoid multiple taxation, profits from domestic and foreign subsidiaries distributed to Swiss corporations and cooperatives are indirectly exempt. This participation deduction applies to entities with at least a 10% stake in share capital or profits and reserves, or a capital interest worth at least CHF 1 million. The net profit tax is reduced based on the proportion of net revenue from these financial interests to total net profit.

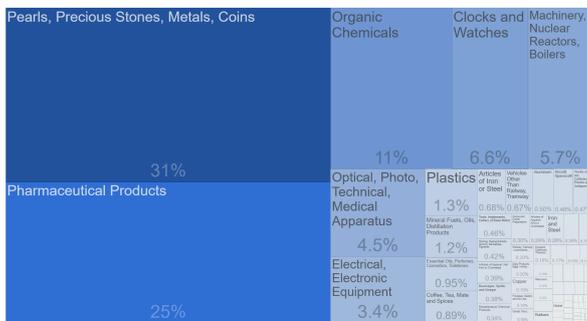
Currently, Switzerland has the lowest Value-Added Tax (VAT) rates in Europe at 8.1% for most cases. For the hotel and serviced accommodation sector the VAT is lower at 3.8% while ordinary consumer goods are subjected to an even lower rate at 2.6%. VAT is borne by the final consumer of the goods. However, the VAT is set to hike by 0.7 percentage points in order to fund an increase in pensions for the elderly, taking effect from 2026. These extra pension payments are projected to cost around 4.2 billion CHF in 2026.

Figure 17: VAT Rates in Europe



Source: Tax Foundation

Figure 18: Switzerland Exports by Category (2024)



Source: TradingEconomics

Figure 19: Top 10 Switzerland Exports by Category (2024)

Product	Value
Pearls, Precious Stones, Metals, Coins	\$136.47B
Pharmaceutical Products	\$110.44B
Organic Chemicals	\$47.21B
Clocks and Watches	\$29.53B
Machinery, Nuclear Reactors, Boilers	\$25.25B
Optical, Photo, Technical, Medical Apparatus	\$20.02B
Electrical, Electronic Equipment	\$15.09B
Plastics	\$5.93B
Mineral Fuels, Oils, Distillation Products	\$5.29B
Essential Oils, Perfumes, Cosmetics, Toiletries	\$4.24B

Source: TradingEconomics

Figure 20: Top 10 United States Imports from Switzerland (2024)

Product	Value
Pharmaceutical Products	\$19.01B
Pearls, Precious Stones, Metals, Coins	\$14.84B
Clocks and Watches	\$6.47B

Swiss National Bank

The Swiss National Bank (SNB) witnessed a handover of leadership from previous Chairman Thomas Jordans to the current Chairman, Martin Schlegel on 1 October 2024. Thomas Jordans has been the SNB Chairman since April 2012.

In his speech after the announcement of his promotion, Schlegel emphasised his dedication to the central bank’s goal of maintaining price stability, which is defined as keeping the inflation rate between 0-2%. The appointment of Schlegel is deemed by economist as a safe choice by SNB, given that Schlegel spent his entire career at the SNB. “It means it will be the same governance as before, with no major changes to monetary policy design or communication,” said Nikolay Markov, an economist at Swiss Private Bank Pictet.

Prior to his promotion, Schlegel served as the Vice President of the Governing Board of SNB and oversaw the management of Department II in Bern.

Following his promotion, Schlegel first challenge is likely having to balance the existing monetary policy to mitigate the risk of deflation against the strength of the Swiss Franc.

The Strength of the Swiss Franc and The Carry Trade

Given the recent announcement by SNB to lower interest rates to 0.25%, Switzerland now has the lowest domestic interest rate globally, with Japan at 25-basis points more. Carry Trade involves borrowing a low-interest rate currency to invest in a higher-yielding asset abroad. With SNB’s current dovish stance to first deal with the deflationary pressures, it is unlikely that we will experience a medium-term upward revision of interest rates. As such, the CHF carry trade is a viable option and is unlikely to unwind like the JPY carry trade in 2024.

With the global economy threatened by emerging geopolitical conflicts and tariffs imposed by the U.S., we can expect that the demand for the ‘safe haven’ Swiss Franc to continue to persist throughout the year, hence, driving up its value. However, we might witness the SNB intervening in the market to temper with the Swiss Franc’s strong appreciation aiming to mitigate the immediate problem of deflationary pressures stemming from the strong Swiss Franc.

Switzerland & The Trump Tariffs

Out of the top 5 Switzerland exports by category in 2024, (1) Pearls, Precious Stones, Metals, Coins, (2) Pharmaceutical Products, (3) Organic Chemicals, (4) Clocks and Watches and (5) Machinery, Nuclear Reactors, Boilers (Figure 19), the percentage of each category exported to the U.S. were, 10.9%, 17.2%, 9.7%, 21.9% and 14.9% respectively. With 17% of the total Switzerland exports to the U.S. in 2024, U.S. being Switzerland’s biggest importer, highlights the severity of the tariffs placed on Switzerland products entering the U.S. . Under Trump’s administration, Switzerland imports were slapped with a 31% import tariff on 2 April and was subsequently lowered to 10% on 5 April.

It is likely that the Swiss Administration will negotiate to lower the tariffs, evident from the previous attempt by Guy Pramelin, Swiss

Optical, Photo, Technical, Medical Apparatus	\$4.61B
Organic Chemicals	\$4.59B
Machinery, Nuclear Reactors, Boilers	\$3.75B
Commodities not specified according to kind	\$3.50B
Electrical, Electronic Equipment	\$1.73B
Coffee, Tea, Mate and Spices	\$1.19B
Aircraft, spacecraft	\$968.98M

Source: TradingEconomics

Economic Affairs Minister, where he visited Washington in March 2025 to plead Switzerland's case after Switzerland was out on the list of countries being examined for unfair trade practices. During his press conference some of the statements he made include "We have abolished industrial tariffs. That means almost 99% of goods from the U.S. that come to Switzerland do so without customs duties. Probably other countries have that", "We are a strong investor ... and we want to invest more" (Switzerland was the sixth biggest foreign investor in the U.S., and Swiss companies employed around 400,000 people in the U.S.), "The high-level political discussions will come afterwards". These statements highlight the potential negotiations that will come through between the Trump Administration and the Swiss Administration and we can potentially expect possible cuts to the tariffs placed on Switzerland imports which will prove beneficial for Switzerland's export economy. As of now, the biggest export to the U.S., Pharmaceutical Products, do not have import tariffs placed on them by the U.S. .

Figure 21: USDCHF Currency Pair



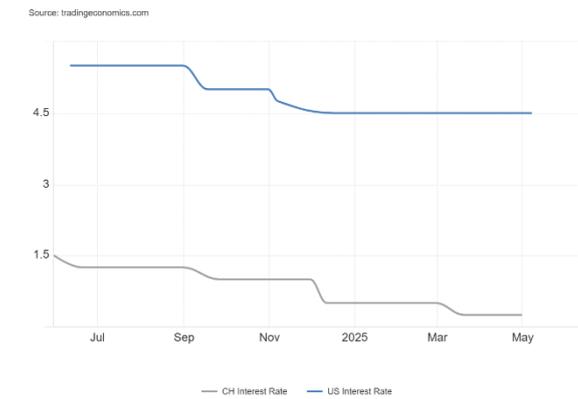
Source: TradingView

Figure 22: USDCHF Currency Pair



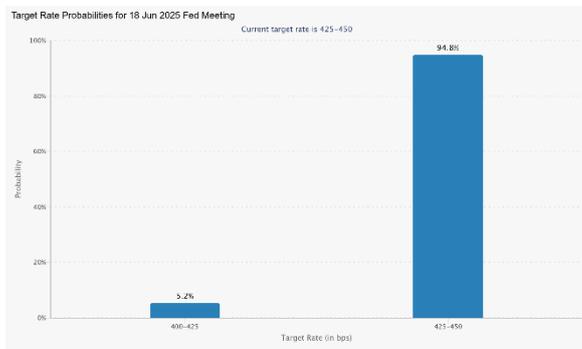
Source: TradingView

Figure 23: Interest Rate Differential between Switzerland & United States



Source: Trading Economics

Figure 24: Target Fed Fund Rate for 18 June 2025



Source: CME Group

Trade Idea: Long USDCHF

Narrative

Currently, the biggest concern on SNB's plate is the deflationary pressures driven by the strong Swiss Franc. The SNB has since cut interest rates from 50 basis points to 25 basis points on March 20, 2025, with the next possible cut scheduled to be on 19 June 2025. The decision will be made before the end of the 90 days pause on the Trump reciprocal tariffs. With inflation rate as of April currently at 0% and strength of the Swiss Franc continuing to persist with global investors continuing to seek 'safe haven' assets amidst the global uncertainty, it is unlikely that we will see inflation move into the positive before 19 June 2025.

Further, given SNB's Chairman, Martin Schlegel's commitment to lower interest rates to the negative, if executed, we will start to see an outflow of assets from the country as holding the Swiss Franc as a 'safe haven' asset no longer offers return. Martin Schlegel has even stated that SNB will engage with currency manipulation to bring inflationary pressures back up, if necessary.

On the other hand, the U.S. has recorded 2 consecutive months where inflation rates were lower than expected at 2.4% and 2.3% for March and April respectively. In the recent Federal Reserve meeting on 7 May 2025, Federal Reserve Chairman, Jerome Powell has also stated that Fed Fund rates will remain at 4.5% not because of shifts in inflationary expectations but rather driven by increased real rates. With much global uncertainty in today's economy, we can expect that real rates will continue to remain elevated for the months to come and it is unlikely for the Federal Reserve to lower interest rates during the next Federal Reserve meeting on 18 June 2025 before there is any decision made by Trump's administration towards the end of the 90 days pause on reciprocal tariffs which will end on 31 July 2025. The market is currently pricing in that Fed Fund rates will remain unchanged after the meeting on 18 June 2025 (Figure 24).

Catalyst

A potential catalyst would be for the Trump administration to retract their reciprocal tariffs before or on the end of the 90 days tariff pause. With the uncertainty of the tariffs alleviated, we could expect an increase in capital inflow back into the U.S. markets and hence an increase in the demand for the dollar.

Further, if SNB cuts rates further, there will be a greater interest rate differential between the two countries, a further reason to long USDCHF (Figure 23).

Technical

The USD/CHF pair is currently trading at **0.82894** (22 May 2025). RSI is currently at **44.19** with the price of the currency pair in the lower band of the Bollinger Bands with an upward trend of crossing the 20 days moving-average. RSI is currently showing an overall upward momentum in the USDCHF currency pair (Figure 21). Lastly, MACD is currently still moving above the signal line, signalling a continued bullish stance (Figure 22).

Trade

Entry: 0.82894

Take Profit: 0.84171

Stop Loss: 0.82043

Reward Risk Ratio: 1.5

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