

Analysts

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Basic Information

GDP (share of world
GDP in PPP, %) 11.5

**Value added by
economic activity**

Agricultural, fishing,
forestry (%) 1.7

Industry, including
constructions (%) 24.1

Services, including
non-market services
(%) 74.2

Unemployment Rate
(%) 6.4

**General Government
(% of GDP)**

Surplus/deficit -3.1

Gross debt 87.1

Revenue 46.4

Expenditure 49.5

External (% of GDP)

Exports of Goods
and Services 28.4

Imports of Goods
and Services 24.9

Current Account
Balance 2.7

Source: ECB 2024

Overview of European Union
Introduction

The European Union is a political and economic union of 27 individual countries, built around the free movement of goods, services, people and capital. The Euro area refers to the 21 EU countries who share the same currency (the euro) and monetary policy (Czechia, Denmark, Hungary, Poland, Romania, Sweden do not use the euro and hence have their own monetary policy that is still coordinated with the ECB). As a union of many different countries, vast regional disparities exist in Europe's economy. Monetary Policy is centralised in the euro area via the European Central Bank (ECB) but fiscal policy is determined by individual governments. Different from national budgets, the EU also runs multi-year budgets and programs that focus on investment themes, industrial policy, green transitional and cohesion funding.

In terms of its share of global GDP, it is the world's third-largest economy, after the United States and China. Like other highly developed economies, the service sector has the largest share of total output, followed by industrials, while the share of agriculture, fishing and forestry is relatively small. Finance services are well-developed in the euro area, where companies have a greater reliance on bank lending than in the United States.

Trade in goods accounts for about two thirds of total euro area external trade, while services make up the remaining third. In the euro area's extra-area trade in goods (Trading Economics), the main imports are machinery and transport equipment (34%), followed by other manufactured goods (25%), mineral fuels/lubricants (15%), and chemicals (13%); the largest import partners are China (17%) and the United States (9%). Exports are led by machinery and transport equipment (38%), chemicals (21%), manufactured goods (24%), and food/drinks/tobacco (8%), with the main export partners being the United States (15%), the United Kingdom (10%), and China (8%). For services, the import/export breakdown is broadly similar, with Information and Communications Technology being the largest category, followed by other business services and transportation.

Chart info

Figure 1: Key EU Forecast Figures (Dec 2025)

Table 1

Growth and inflation projections for the euro area

(annual percentage changes, revisions in percentage points)

	December 2025					Revisions vs September 2025		
	2024	2025	2026	2027	2028	2025	2026	2027
Real GDP	0.9	1.4	1.2	1.4	1.4	0.2	0.2	0.1
HICP	2.4	2.1	1.9	1.8	2.0	0.0	0.2	-0.1
HICP excluding energy and food	2.8	2.4	2.2	1.9	2.0	0.0	0.3	0.1

Source: European Central Bank

European Central Bank

The ECB's primary objective is to maintain price stability in the euro area, targeting an inflation rate of 2% over the medium term: the ECB views inflation symmetrically, where positive and negative deviations from 2% are considered equally undesirable. Inflation is measured by the Harmonised Index of Consumer Prices. The decision-making body comprises of all six members of the ECB's Executive Board and the 20 governors of the euro area national central banks. Voting rights for governors operate under a monthly rotation system: governors from the five largest economies (Germany, France, Italy, Spain and the Netherlands) share four voting rights, while the remaining governors share 11 voting rights. The Governing Council meets every six weeks to make monetary policy decisions, following a data-dependent, meeting by meeting approach informed by ECB staff macroeconomic projections, inflation outlook, financial market data. Macroeconomic projections include information related to economic growth, inflation, wages, unemployment and trade and are released four times a year in March, June, September and December.

Balance of Payments

There are 2 types of BoP data reported: euro area (ECB) and EU (Eurostat). The euro area data, which accounts for transactions between euro area residents and non-residents (excludes intra-euro area flows) are more relevant for markets because it links more directly to cross-border capital flows.

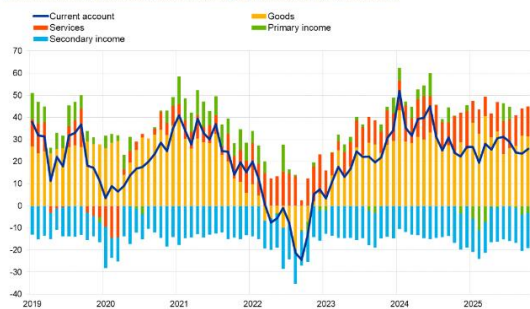
The euro area often runs a large current account surplus at the aggregate level, driven by strong exports in goods and services. Primary income tends to fluctuate but recent trends show larger deficits due to lower returns on direct investment income while secondary income consistently shows deficits due to net transfers to the rest of the world. At the member-state level, current accounts are heterogeneous: in Q2 2025, Germany, Ireland, Spain and the Netherlands had the largest surpluses while the largest deficits were in France, Italy, Romania, Belgium and Greece. The euro area's largest bilateral current account surplus was with the United Kingdom (€198 billion) and the largest deficit was with China (€134 billion). While persistent current account surplus indicates strong export competitiveness and external financial health, large surpluses can also signal weak domestic demand.

Throughout 2025, the euro area current account surplus has been narrowing: in the four quarters to August 2025, the Euro area reported a €303 billion surplus, down €404 billion the year before. Factors include the primary income switching to a deficit and secondary income deficits widening.

As a net importer of energy, the euro area's external balance is highly sensitive to energy dynamics. In the first half of 2025, the euro area had higher energy import prices compared to the same period in 2024 partly due to supply disruptions from the halt of Russian gas transit via Ukraine, increased imports of Liquefied

Figure 3: Euro area current account balance

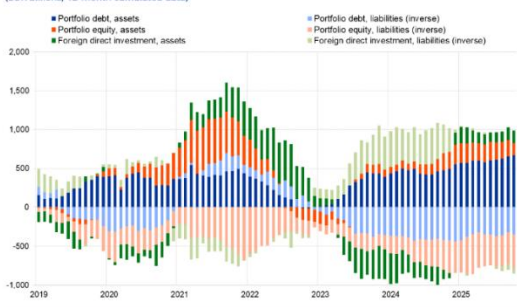
(EUR billions unless otherwise indicated; working day and seasonally adjusted data)



Source: ECB

Figure 4: Selected items of the euro area financial account

(EUR billions; 12-month cumulated data)



Source: ECB.
Notes: For assets, a positive (negative) number indicates net purchases (sales) of non-euro area instruments by euro area investors. For liabilities, a positive (negative) number indicates net sales (purchases) of euro area instruments by non-euro area investors.

Source: ECB

Natural Gas (LNG), and colder weather conditions. This tends to worsen the goods trade balance, and all else equal, narrows the current account surplus. Recently, the euro area's energy deficit has been improving, helping to drive trade resilience.

In the 12 months to Sep 2025, ECB data shows large two-way portfolio flows where euro area residents increased net purchases of non-euro area equity (€213 billion) and non-euro area debt (€655 billion), while non-residents' net purchases of euro area equity rose to €410 billion. Sustained foreign buying of euro area debt is typically supportive for core EUR duration at the margin, while aggressive recycling of surplus abroad by euro area residents can be a mild EUR headwind, all else equal.

As of Q2 2025, euro area's International Investment Position (IIP) was positive, with significant net assets of around 1.43 trillion euros (9.3% of GDP), indicating a net creditor position. This signifies a strong external financial position and reduces its vulnerability to external funding shocks.

Euro Area Macro Overview

Figure 11: GDP growth rates over the previous quarter

% change, based on seasonally adjusted data

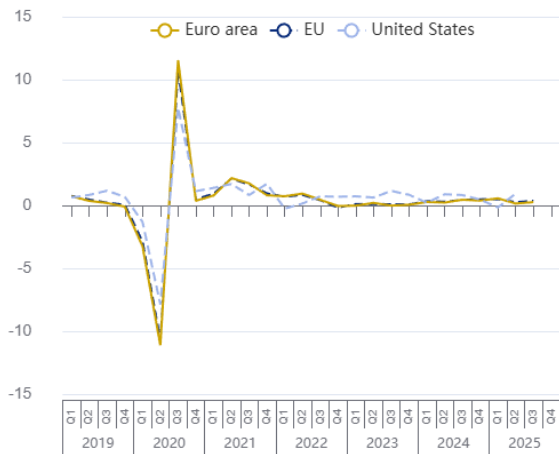


Figure 14: Labour productivity levels

Real GDP per hour worked, USD PPP-adjusted, five-year moving average

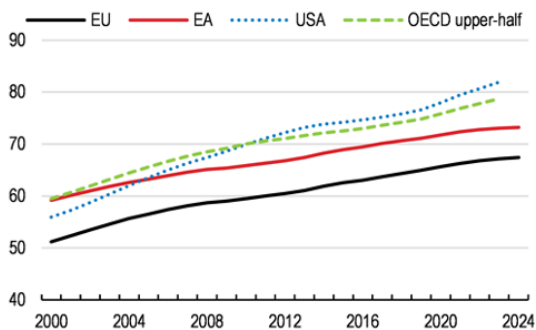


Figure 15: Contributions to labour productivity growth in the EU (percentage points)

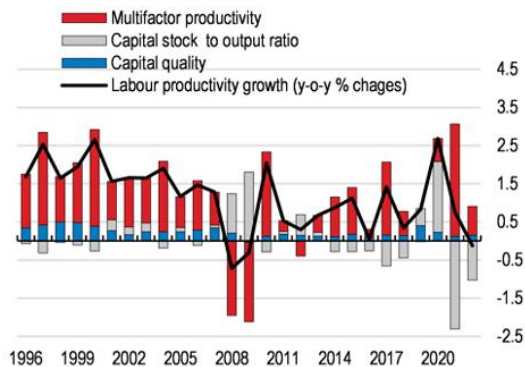
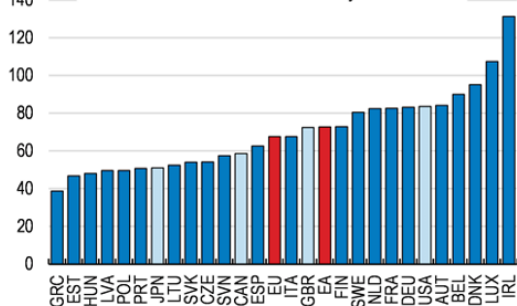


Figure 16: Labour productivity level by country

Real GDP per hour worked, USD PPP-adjusted, 2024 or latest available year



Over the past six months, the euro area has continued to operate in a modest-growth, cautious policy regime. Disinflation has progressed meaningfully toward target and reduced acute crisis risk, but it has not been sufficient to unlock a broad re-acceleration in underlying economic activity. Real GDP is projected to grow around 1.4% in 2025 according to the latest Euro system staff macroeconomic projections, reflecting a combination of better-than-expected data outcomes, reduced trade policy uncertainty, stronger foreign demand, and lower energy prices. The labour market has remained resilient with unemployment near historic lows and real incomes supporting consumption, but investment activity and external demand remain subdued under persistent uncertainty. This combination has kept the macroeconomic environment characterized by limited momentum and asymmetric downside risks, with policy space still constrained by inflation dynamics and financial stability considerations.

Economic Health

Economic activity in the euro area has exhibited modest expansion through the past six months. Output is positive but remains uneven across sectors, with services generally outperforming manufacturing. The OECD and other international institutions report that recent quarterly growth has been positive though modest (around 0.2–0.3% q-o-q), and domestic demand, particularly consumption supported by real income growth, continues to be the primary driver of overall activity.

Private investments see recovery through improved financial conditions and public investments receiving support in 2026 by the Recovery and Resilience Facility Funds. However, investments are still restricted, reflecting elevated uncertainty and financing conditions that are still restrictive relative to long-run norms.

Labour market conditions continue to support the broader economy. Unemployment has remained close to historic lows and wage growth is projected to ease gradually, helping underpin moderate consumption. At the same time, some surveys show slowing employment and wage momentum, suggesting the labour market is normalizing rather than accelerating, consistent with only modest support to aggregate demand.

Overall, economic momentum is positive but subdued. The combination of steady consumption, weak investment, and sluggish external demand points toward expansion that is neither robust nor recessionary, but vulnerable to adverse shocks.

Growth and Structural Competitiveness

Cyclically, the euro area appears to be in a weak but stable growth phase. Manufacturing remains soft, and while inventories and exports provide occasional temporary uplifts, underlying demand

Figure 17: Labour productivity growth by country

Average y-o-y % changes, 2000-2023/24

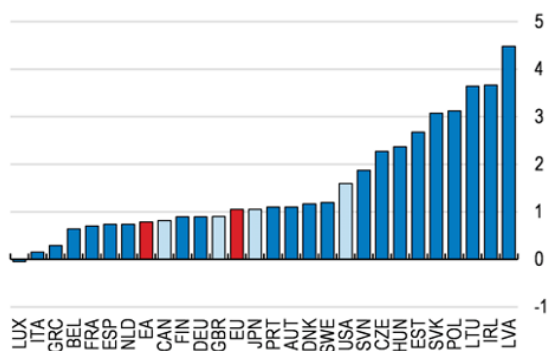
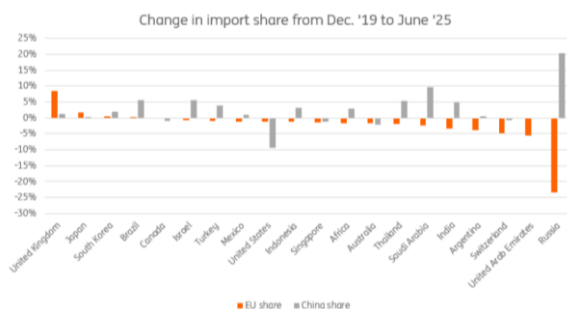


Figure 18: Fall in EU share on imports in other countries



Source: IMF Dots, ING Research Calculations

growth has not broadened significantly. Official projections reflect this, forecasting continued modest expansion in 2026 and beyond as domestic demand supports activity and global conditions improve only gradually.

Structural issues weigh on competitiveness over the medium term. Energy costs in Europe remain higher than in some competing regions, reflecting structural exposure to imports and policy-driven climate transition costs. These pressures weigh particularly on energy-intensive sectors. Productivity growth has lagged in several member states, dampening potential growth, and OECD analyses emphasize the need for further structural reforms to enhance market integration, reduce regulatory burdens, and strengthen capital markets to support investment.

Additionally, global industrial competition remains intense, particularly in high-tech and export-oriented sectors. While the euro area maintains strengths in advanced manufacturing such as precision engineering and advanced automotive and mobility technologies, rapid expansion of capacity in China and targeted industrial subsidies in the United States contribute to competitive pressures that amplify the region's structural headwinds. These dynamics suggest that even if cyclical conditions improve, structural constraints will continue to cap the pace of growth relative to some peers without significant policy or institutional reforms.

Fiscal Policy

Fiscal policy in the euro area is shifting toward a neutral stance after years of exceptional crisis support. According to EU Commission forecasts, deficits are expected to remain modestly below 3½ % of GDP in 2025, and the overall fiscal stance is projected to be broadly neutral. The introduction of new fiscal governance rules and the reinstatement of national mid-term budgetary frameworks have led several countries to prioritize consolidation once temporary support measures have expired.

At the same time, public investment through EU-level mechanisms such as the Recovery and Resilience Facility continues to support growth in strategic areas, including infrastructure, digitalization, and green transition priorities. However, the combination of neutral fiscal policy and ongoing structural headwinds means that fiscal support is unlikely to provide a strong counter-cyclical boost in the event of a significant downturn. Over the past six months, Italian and Spanish sovereign spreads versus Bunds have remained range-bound to tighter, despite a neutral fiscal impulse and ongoing consolidation, suggesting that markets have become more confident in the credibility of national fiscal frameworks under the reformed EU rules. Financial markets have responded to these dynamics with generally tighter sovereign spreads for some peripheral economies, reflecting improved fiscal credibility in

July 24 2025 ECB Meeting:

The ECB left its key interest rates unchanged at the existing level (deposit facility 2.00%, main refinancing 2.15%, marginal lending 2.40%).

This was the first meeting after the June cut (in early June, the ECB cut all policy rates by 25 bp). Markets and policymakers indicated a wait-and-see stance, reflecting uncertainty about inflation path, global growth, and trade tensions.

October 30 2025 ECB Meeting:

The ECB again kept all three key interest rates unchanged. Deposit facility: 2.00%. Main refinancing: 2.15%. Marginal lending: 2.40%

Inflation was reported as near the ECB's 2% medium-term target. The Governing Council maintained that future decisions would remain data-dependent, not pre-committed to a particular path. The ECB emphasized resilience in the Eurozone economy despite global uncertainties.

December 18 2025 ECB Meeting:

For a fourth consecutive meeting, the ECB held rates unchanged at the same levels as in October. Deposit facility: 2.00%. Main refinancing: 2.15%. Marginal lending: 2.40%.

The ECB's staff projections showed inflation expected to average around ~2% in the medium term, though the outlook included risks. The Governing Council reiterated a meeting-by-meeting, data-dependent approach rather than committing to future cuts or hikes. Asset purchase portfolio adjustments continued as part of policy normalization.

countries like Spain and Italy, while others face more fiscal scrutiny amidst rate-cut uncertainties.

Monetary Policy

The European Central Bank has maintained a cautious, data-dependent monetary stance over the past six months. After a series of rate reductions earlier in the year, the Governing Council has kept key policy rates unchanged in recent meetings, reflecting a balance between headline inflation that is close to the ECB's medium-term target and persistent core inflation pressures, particularly in services.

Inflation projections from the ECB indicate a continued moderation from 2.1% in 2025 toward target levels in subsequent years, but services inflation and wage growth remain considerations that constrain the scope for deeper or more rapid rate cuts.

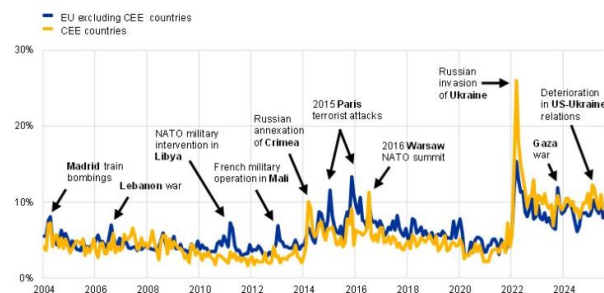
The ECB's reaction function has shifted from a focus on combating high inflation toward anchoring expectations and supporting growth were consistent with price stability. However, policy is constrained by concerns about financial fragmentation and the need to maintain credibility after the years of high inflation episodes. Market pricing reflects a relatively shallow easing path rather than aggressive cuts, with expectations that rates will remain above very low levels for an extended period.

Geopolitical Events and Risks

Geopolitical developments have influenced the euro area mainly through risk premia and uncertainty channels rather than direct, large-scale economic shocks in the last six months. Trade tensions involving the United States and key trading partners have contributed to volatility in global demand and investment decisions, while ongoing conflicts such as Russia's war in Ukraine continue to underpin energy security concerns. These risks elevate the uncertainty premium on European assets and keep risk expectations elevated among investors.

Energy security, although structurally improved since the energy price shocks of 2022–2023, remains an underlying vulnerability. Europe's reliance on external energy sources and the associated higher cost structure relative to some regions continues to feed cost pressures for industry and households. Geopolitical pressures have also underscored the importance of diversified supply chains

Figure 18: Geopolitical Uncertainty Index of EU

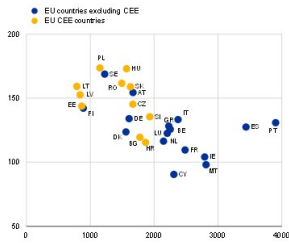


Source: ECB

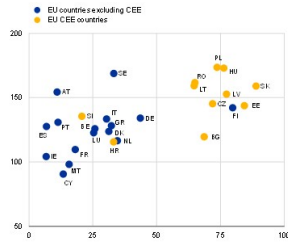
Figure 19: Regional exposure and energy reliance of EU

(panel a: x-axis: distance of the capital to Moscow in km; y-axis: average geopolitical risk indicator since Feb. 2022; panel b: x-axis: pre-war oil and gas dependence on Russia as a %; y-axis: average GRI since Feb. 2022)

a) Proximity to the Ukraine war



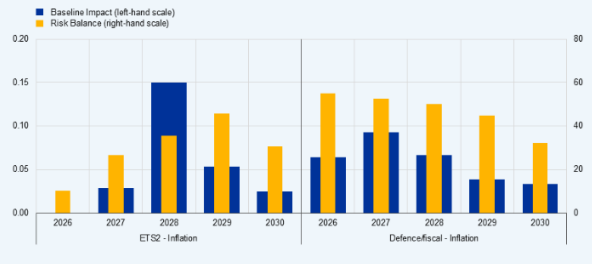
b) Pre-war dependence on Russian energy



Source: ECB

Figure 20: Estimated Impact of defence/fiscal spending on inflation

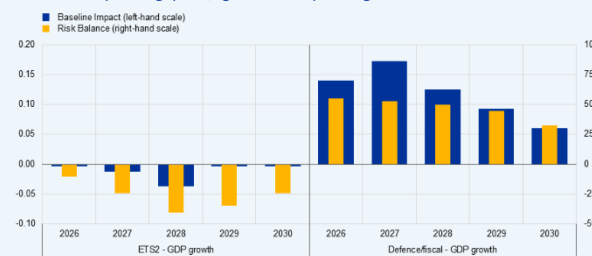
a) Impact of ETS2 and defence/fiscal spending on inflation
(left-hand scale: percentage points; right-hand scale: percentages)



Source: ECB

Figure 21: Estimated impact of defence/fiscal spending on real GDP growth

b) Impact of ETS2 and defence/fiscal spending on real GDP growth
(left-hand scale: percentage points; right-hand scale: percentages)



Source: ECB

and accelerated policy discussions on strategic autonomy and resilience.

Regime Assessment, Risks, and Potential Shifts

Taken together, the euro area remains in a modest-growth, cautious policy regime. Disinflation has brought inflation closer to target and reduced immediate crisis risk, but growth momentum is limited and structural headwinds remain potent. Downside risks include further global trade disruptions, geopolitical shocks, or confidence effects from fiscal or policy uncertainty, which continue to dominate the risk landscape. Upside scenarios depend on sustained improvements in global demand, successful implementation of structural reforms, and a gradual strengthening of investment dynamics that could broaden growth beyond its current, narrowly-based drivers.

Looking into 2026

ECB: “In a Good Place”

ECB President Christine Lagarde has continued to hint at the central bank's lack of urgency to act during her press conference following the December monetary policy meeting. She stated that the current interest rate policy is in a "good position."

The ECB has paused rate cuts in the second half of 2025, which itself suggests that a large downside to inflation and growth expectations is needed to justify another cut. Furthermore, the latest staff forecasts indicate that inflation will moderately reach its target over the next three years: Headline inflation is expected at 1.9% in 2026, 1.8% in 2027 and 2.0% in 2028. The slight upward revision to the 2026 forecast is the result of a slower than expected drop in services inflation, while the 2027 drop will be the result of the delayed implementation of the second phase of the EU's Emissions Trading System. Eurozone GDP growth is expected to come in at 1.2% in 2026, 1.4% in 2027 and 1.4% in 2028.

With inflation expected at or slightly below 2%, as well as growth expected at around potential, the ECB is unlikely to change its policy stance in the short term, either to the upside or downside. If there are changes in 2026, they are most likely to be rate hikes towards the end of 2026 or early 2027.

Growth slow but resilient

The ECB indicated that the eurozone economy has proved more resilient than expected in 2025, even as trade restrictions weigh on global activity: the ECB revised forecasts growth of 1.4% upwards.

Eurozone’s economy is expected to maintain a steady pace of growth in 2026, with the strongest acceleration expected in Germany and Southern Europe.

Key drivers of economic activity in 2026 include German infrastructure and NATO defence spending (5% of GDP by 2035, Current: 2.76%), digital transformation, a gradual recovery in household consumption growth and lower interest rates.

Germany’s expansive fiscal policy is likely to boost growth and have positive regional spillover effects, particularly in Central and Eastern Europe.

Low inflation, a falling unemployment rate, rising disposable income and a gradual moderation of household savings should support a recovery in household spending. However, the consumer recovery remains fragile, and wage growth is likely to slow in 2026, so a full recovery in household consumption to pre-pandemic growth rates in 2026 is not expected.

Downside risks to GDP growth in 2026 include higher energy costs, fiscal spending taking longer to materialise, and fiscal tightening in some countries, including France and Spain, limiting the impact of German loosening. Underlying structural issues, such as increased competition from China and a shift to electric vehicles will continue to weigh on the economy. US tariffs may also hit euro area exports in 2026 more than expected.

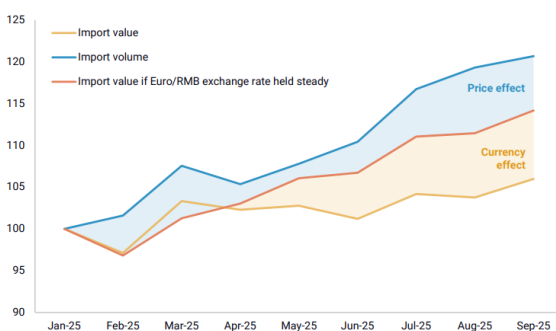
China shock; depreciation of the yuan against the euro

The renminbi (RMB) is managed against a basket of currencies, with the US dollar carrying the largest weight (estimated at around 22%). In practice, the PBOC has been relatively passive in resisting RMB depreciation against the USD. Combined with persistent deflationary pressures in China, driven by excess industrial capacity and weak domestic demand, this has led to a sustained weakening of the RMB in real terms.

As a result, the RMB has depreciated significantly against the euro (around 8.2% in nominal terms), improving the price competitiveness of Chinese exports to Europe while simultaneously depressing European exports to China. In the near term, these deflationary pressures are unlikely to ease: measures aimed at countering producer price deflation have become less effective, implying that weakness in the real exchange rate is likely to persist.

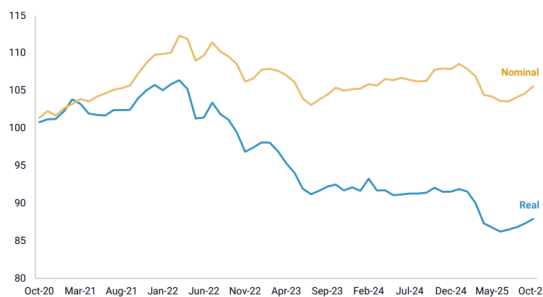
The combination of falling Chinese export prices and a weaker RMB relative to the euro has driven a rapid increase in EU import volumes from China, largely at the expense of European producers that struggle to compete on price. Since the beginning of 2025, currency effects are estimated to account for roughly half of the widening gap between EU import volumes from China and their corresponding import values. In Q3 2025, EU import values from China increased by just 0.2% year-on-year, while import volumes rose by 7%. Over the same period, EU export values to China

Figure 22: Index of EU import value and estimated import value from China if euro/RMB exchange rate had held at Dec 2024 rate



Source: Eurostat

Figure 23: China BIS Real and Nominal Exchange Rate Index, Oct 2020 – Oct 2025



Source: Bank for International Settlements

Figure 24: EUR-CNY exchange rate (scale inverted)



Source: Bloomberg, Rhodium Group Calculations

Figure 25: Real Effective Exchange Rate of USA, China and Euro area



declined by 6%, reflecting weak Chinese demand and increasingly unfavorable relative prices for European exporters.

This dynamic also undermines the effectiveness of EU trade defence instruments such as tariffs and anti-dumping duties. Declines in euro-denominated import prices can outpace the implementation and revision of such measures, which often take years to review and adjust. In practice, import price declines have already offset the impact of duties in three out of seven trade defence cases enforced by the European Commission in 2023 and 2024 (excluding electric vehicles).

Looking ahead, the persistence of a weak RMB, ongoing deflation, and excess capacity in China is likely to continue posing significant challenges to EU competitiveness both globally and domestically. The implications for European industry, employment, and growth are substantial. This is particularly detrimental for the EU, given its export-oriented economic model and structurally large current account surplus.

Germany

Political

After the last government's collapse and months of stalemate, Germany has elected its new government with new coalition and conservative Friedrich Merz as the new Chancellor in May 2025. The new coalition consists of the CDU, CSU and SPD, which only have a narrow majority of 328 seats out of the total 630 seats. Despite forming a government together, significant ideological differences persist, such as on fiscal policy and the debt brake, where CDU/CSU advocates for strict adherence and the SPD advocates for more flexibility. The main opposition party is now the far right Alternative für Deutschland (AfD), who advocates for the closure of Germany's borders, mass deportation of migrants, end weapons supply to Ukraine and reopen ties with Russia. Recently, Merz has expressed alarm about the "very critical" state of parts of the German economy and indicated that the government's main priority in 2026 will be to restore Germany's economic growth through large-scale public spending and increased investment in defence and infrastructure.

Economy

Germany has been an export-oriented economy with a deep integration into global industrial supply chains and a focus on high-end manufacturing exports. Since 2017, its growth has faced numerous structural headwinds. These include

1. Germany's reliance on global trade, which has become more protectionist in the recent years.

Since the start of the year, the share of German exports to the US has dropped to some 9.5% this year, from 10.5% last year. At the same time, the share of exports to China has dropped further to 5%, from almost 6% last year and almost 8% in the years before the Covid-19 pandemic.

2. High energy prices disadvantage Germany's industrial economy

Historically, Germany has been a consumer of cheap Russian gas, allowing its energy-intensive industries to stay competitive globally. After the Russian invasion of Ukraine in 2022, Germany now faces the problem of higher and more volatile power prices and LNG dependence.

3. Skilled labour shortage, especially in technology sectors
4. Heavy reliance on traditional industries like auto manufacturing and underinvestment in technology-related growth industries that are less prone to trade tensions
5. Excessive regulations and inefficient public administration

Industrial Power Price

The German government has agreed to introduce an “industrial electricity price” starting in 2026. The target price is to be 5 cents per kilowatt-hour (kWh), the minimum price consistent with EU state aid guidelines. This implies a meaningful reduction: according to the Federal Network Agency, the current electricity price for industrial companies with concessions (i.e., large consumers) is currently around 10 cents per kWh. The subsidy will be applied to half of electricity consumption and be in place for three years until 2028 and likely cost between EUR 3 and 5 bn over this period, funded from the Climate and Transformation Fund.

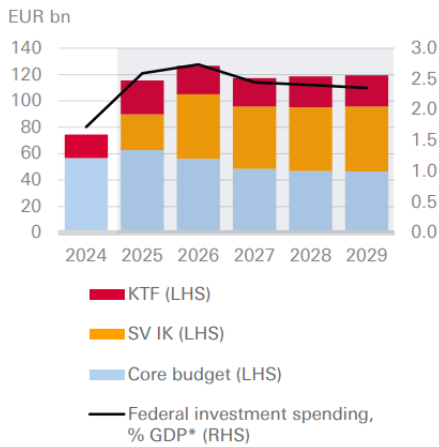
This helps to address the problem of Germany's high electrical prices compared to international competitors, helping to defend industrial competitiveness but there remain concerns about the short limitation period and the limitations of only subsidising half the consumption, dampening cost relief.

Germany Fiscal Expansion

Germany's fiscal expansion is centered around its 2025-2029 Medium-Term Fiscal Plan, and the March 2025 constitutional reform, which includes 3 significant changes: A new €500 billion infrastructure investment fund; an exemption from Germany's “debt brake” rule on defence spending above 1% of GDP; and a rise in the net borrowing cap for federal states from 0% to 0.35% of GDP. The infrastructure fund is intended to finance new projects in the fields of transport, healthcare, energy, education, research and digitalisation over 12 years.

The debt brake relaxation would enable massive, debt-financed spending. External analysts (DB) estimate that, if implemented as planned, federal debt could increase by an estimated EUR 850 bn

Figure 26: Germany's federal investment spending plans



Source: Deutsche Bank Research

Figure 27: Germany's 2026 Government Expenditure of GDP



Source: German Finance Ministry DBP 2026 and AllianzGI E&S

Figure 28: France's Exports

Machinery, Nuclear Reactors, Boilers	11%	Pharmaceutical Products	6.0%	Mineral Fuels, Oils, Distillation Products	4.4%	Essential Oils, Perfumes, Cosmetics, Toiletries	4.3%	Plastics	3.7%	Beverages, Spirits and Vinegar	3.4%
Vehicles Other Than Railway, Tramway	8.6%	Pearls, Precious Stones, Metals, Coins	3.3%	Organic Chemicals	2.0%	Articles of Iron or Steel	1.4%	Dairy Products, Eggs, Honey, Edible Products	1.4%	Articles of Apparel, Not Knit or Crocheted	1.3%
Electrical, Electronic Equipment	7.3%	Optical, Photo, Technical, Medical Apparatus	2.8%	Aluminum	1.1%	Ironware, Castings and Blanks	1.0%	Articles of Apparel, Knit or Crocheted	0.93%	Ships, Boats and Other Floating Structures	1.3%
Aircraft, ...	6.2%	Miscellaneous Chemical Products	2.2%	Rubbers	1.1%	Iron and Steel	1.1%	Articles of Apparel, Not Knit or Crocheted	0.85%	Meat and Edible Meat	0.65%
TRADING	6.2%	Iron and Steel	2.2%	Articles of Leather, Apparel Out-Fittings, Travel Good	1.0%	Articles of Apparel, Knit or Crocheted	1.0%	Articles of Apparel, Knit or Crocheted	0.57%	Meat and Edible Meat	0.65%

Source: TradingEconomics

until 2029. The current major spending phase is planned through until 2029, with the largest rate of increase and stimulus effect expected to build from 2026 to 2028.

Fiscal expansion is certainly delayed in 2025 as the ramp-up in defence and public investment is proceeding more slowly than the government anticipated. However, starting in 2026, the fiscal stimulus will build up, causing the deficit to widen visibly. The government plans to widen the budget deficit to 4.75% of GDP in 2026, implying a 1.75% structural widening. The largest component of the spending increase is social transfers (ie healthcare spending), while defence spending and public investment account for a smaller proportion of the widening. The focus on healthcare explains the relatively low multiplier the government appears to be assuming: GDP growth to accelerate only to 1% in 2026. The consensus among economists surveyed by Bloomberg is about 0.8% rate of growth. Concerns include the speed and execution of the fiscal package, which is expected to lag to the later half of the year, given Germany's recent track record of underdelivering on budgeted investments.

France

France's economy contains a significant presence of both private and state-owned enterprises. Key sectors include manufacturing (Automation, aerospace and luxury goods), services (tourism and finance) and a robust agriculture sector specializing in wine and dairy products.

France is a founding member of the eurozone, adapting the euro as its currency. The country has an influential control over shaping EU policy as described by the France-Germany political axis as the bloc's most important driving force. President Macron has called for EU enlargement into southern and eastern Europe in alignment with his personal wishes of a closer EU integration and strategic independence from foreign powers. Under President Macron, the French economy has been liberalized through a lesser rigid market, with tax cuts and a revamped unemployment insurance.

Over the past year, France has experienced extreme political instability. Multiple prime ministers have changed, or governments have nearly collapsed due to parliamentary deadlocks, especially around budgets. The government struggled to pass the 2026 budget on time, creating uncertainty and emergency legislation. Confidence in state institutions has plummeted with fewer than 30 % of French adults trusting the national government, and a majority feel the economy is worsening. Gallup quotes: trust in the national government has dropped 13 percentage points to 29% in 2025, while confidence in the honesty of elections has fallen by the same margin to 51%. Confidence in the judicial system has slipped nine points to 50%, and trust in financial institutions has fallen eight points to 42%, reversing years of steady gains. No other European Union

country has seen a bigger average drop in confidence across these four institutions in 2025 than France.

Economy

France's economy expanded by 0.5% quarter-on-quarter in Q3 2025, accelerating from 0.3% in the previous quarter and confirming preliminary estimates. This marks the sharpest quarterly expansion since Q2 2023, supported by firm domestic demand and a rebound in exports. Exports jumped 3.2% after 0.3%, driven by a strong recovery in transport equipment (+13.4%), while imports rose at a softer pace of 1.3% after 1.5%. As a result, net trade contributed +0.6 points to growth. Meanwhile, household consumption increased 0.1%, unchanged from Q2, as lower food spending (-1.0% after +1.5%) was offset by a rebound in energy demand (+1.3% after -2.3%) and slight growth in services (+0.1%). Fixed investment rose 0.5% after stagnating, supported by stronger information and communication (+1.7%) and capital goods (+1.7%).

Government consumption remained steady at +0.5%. On an annual basis, GDP expanded 0.9%, up from 0.7% in Q2, marking the strongest growth in a year.

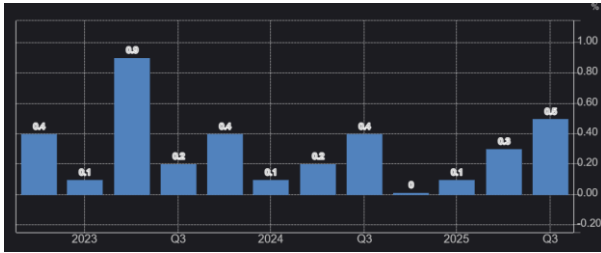
Politics

Under President Macron, the French economy has been liberalized, with the labour market made less rigid, taxes cut, and unemployment insurance revamped. However, the changes have also provoked a backlash among large sectors of the population and generated significant social unrest. Some of the most high-profile protests were the "Yellow Vest" movement in 2018 and 2019, and the [strikes over pension reform in 2023](#). Moreover, this wave of liberalization appeared to reach an end after Macron's party lost dozens of seats in parliament in the July 2024 snap elections. This turmoil has undermined investor and consumer confidence, directly weighing on growth, investment decisions, and business planning.

The [public debt](#) ratio is among the highest in the EU at well over 100% of GDP, posing a risk to fiscal stability. Moreover, public resistance to structural reforms is high, often resulting in widespread protests that hamper economic activity. Additionally, regional disparities in economic development and integration of immigrant populations into the labour market remain ongoing challenges. Finally, the fragmented parliament, with the leftist, centrist and right-of-centre blocs all holding a similar seat share, hinders policymaking.

France's deficit and debt levels are high: public debt around 117 % of GDP, with deficits above EU thresholds ($\approx 5\%$ versus EU's 3% guideline). Political inability to pass decisive budgets contributes to market anxiety; the Bank of France warns deficits above 5% would push France into a "danger zone" for lenders. Austerity-oriented centrists trying to cut spending and reduce deficits and Left- and far-left factions resisting cuts to social spending and pushing for protections on wages/pensions, result in delays in structural

Figure 29: France's GDP Annual Growth



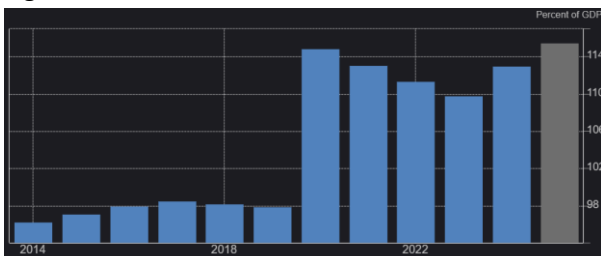
Source: INSEE France

Figure 30: The Yellow Vest Protests



Source: www.france24.com

Figure 31: France's Fiscal Deficit



Source: INSEE France

Figure 32: 2025 AI Action Summit in France



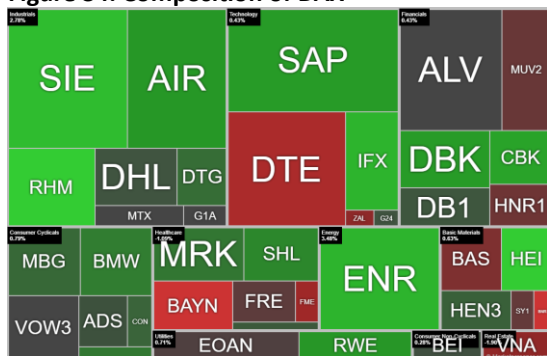
Source: Elysee.fr

Figure 33: Composition of CAC 40



Source: MarketScreener

Figure 34: Composition of DAX



Source: MarketScreener

Figure 35: France Exports of articles of leather, animal gut, harness, travel good to China

reforms.

Labour

France records more deaths than births in 2025 for the first time post-WWII, indicating aging demographics which increase long-term expenditure on health and pensions.

Separately, France successfully hosted the 2025 AI Action Summit, co-chaired by President Macron and India's PM Modi, drawing investment pledges of ~€109 billion for AI and tech development, placing France in a strong position in AI and high-tech sectors, Emerging industries and Global research partnerships, potentially strengthening their labour force, offsetting stagnation in traditional sectors.

Trade Idea (Short CAC 40/Long DAX)

We favour a relative outperformance of Germany over France over a 1–3-month horizon, expressed via a short CAC 40 / long DAX pair trade.

CAC 40 is heavily weighted towards Luxury (LVMH, Kering), consumer discretionary and Global brands exposed to China demand. DAX has greater weight in Industrials, Capital goods, Autos, Chemicals and Export manufacturing.

As global growth slows and China demand remains uneven, luxury demand sensitivity poses downside risk to the CAC, while DAX constituents are more leveraged to Global industrial capex cycle, supply chain normalization and the stabilization in manufacturing PMIs. If China stimulus underwhelms or global discretionary spending softens, CAC earnings revisions could deteriorate faster than DAX.

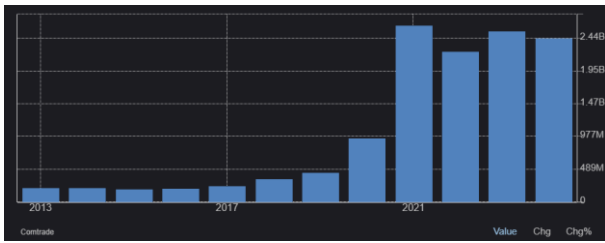
Germany, despite recessionary headlines, is more sensitive to global trade recovery, more leveraged to industrial reacceleration and better positioned for fiscal-led infrastructure spending.

France's growth profile is however more domestically consumption-driven, more exposed to margin compression in premium goods and vulnerable to luxury demand normalization. If global growth stabilizes without a strong China rebound, German cyclicals may outperform French defensives/luxury.

Recent outperformance of CAC relative to DAX has widened valuation spreads:

- CAC trading at elevated multiples due to luxury premium
- DAX trading at discounted cyclicals valuations

A compression of this valuation premium supports a mean reversion trade in favour of DAX.



Source: Trading Economics

Figure 36: CAC40



Source: Trading Economics

Catalysts:

1. Weak China retail sales / property data
 → Luxury demand concerns
 → CAC underperformance
2. German PMI stabilization
 → Industrial recovery narrative
 → DAX bid
3. Earnings revisions
 → Luxury guidance downgrades
 → Upward revisions in industrial exporters
4. Risk-off scenario
 → Pair trade remains partially market neutral (beta hedged)

Using current indicative levels:

- Sell CAC 40 at 7,420
- Buy DAX at 18,200

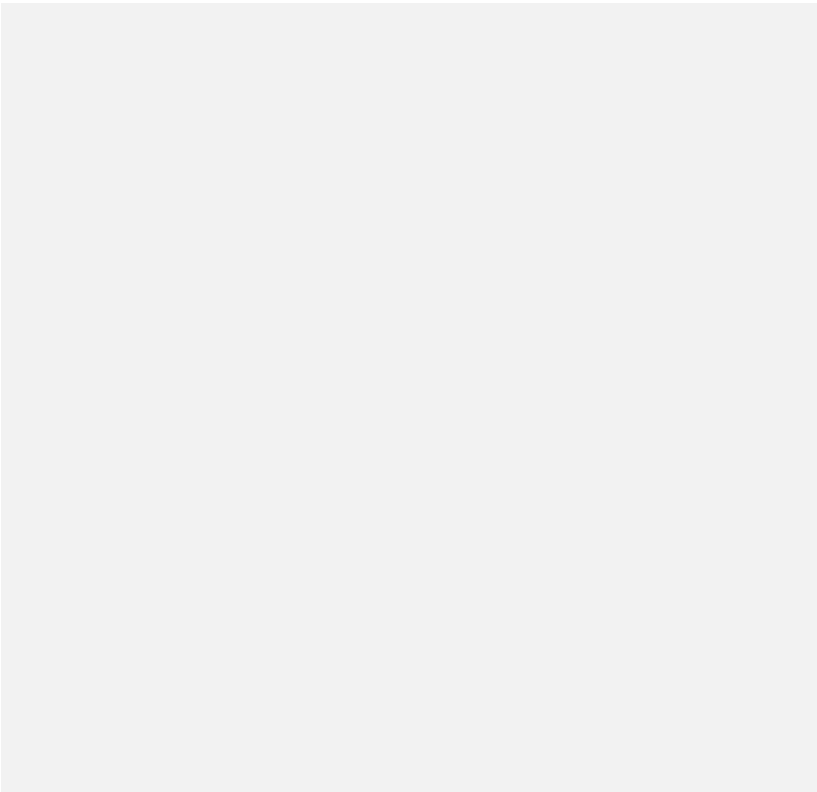
(Execution should be size adjusted for volatility weighting.)

Take Profit (Spread Compression Target):
 Target DAX/CAC ratio expansion equivalent to:

- CAC: 7,100
- DAX: 18,500

Stop Loss:

- CAC: 7,650
- DAX: 17,900
- Target spread expansion: ~4–5%
- Stop spread compression: ~2–2.5%
- Risk-to-Reward ≈ 1:2



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