

February 24, 2025

# Weekly Investment Insights



*German stocks started the week with a boost as investors welcomed the conservatives' victory in the national elections. The hope now is that the conservatives will be able to form a coalition quickly. Protracted talks will delay long-awaited and necessary measures such as budget reforms and spending increases to revive Europe's largest economy.*

## WEEKLY HIGHLIGHTS

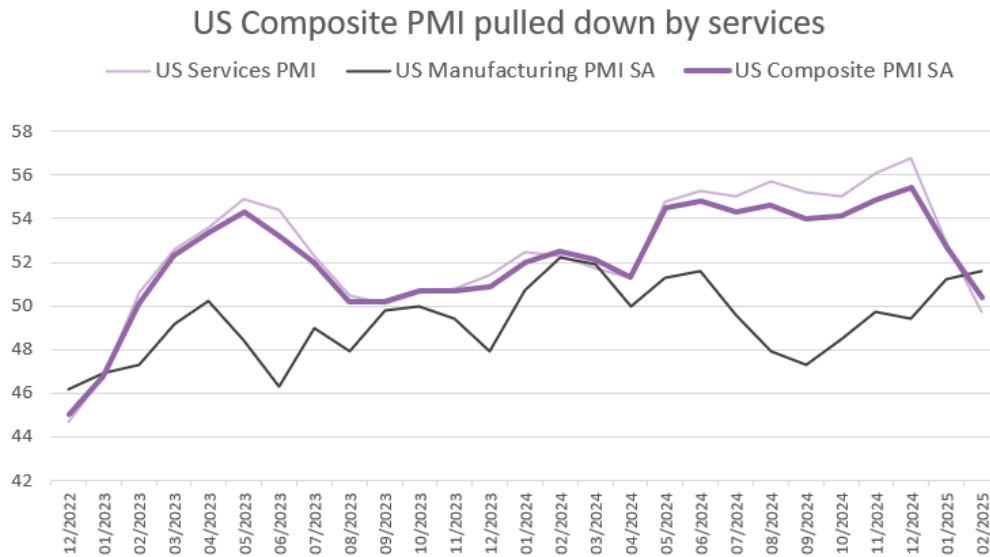
### US Services sector contracts for the first time in over two years

According to Friday's flash PMIs, the US composite PMI fell to 50.4 in February from 52.7 in January due to a contraction in the services sector. In February, the services PMI fell to 49.7, well below expectations, from 52.9 in the previous month. The services sector moved into contraction territory as new orders approached stagnation due to political uncertainty. The spending cuts and potentially inflationary policies of President Trump's administration, combined with concerns over tariffs and geopolitical uncertainty, caused the optimism index to fall to its lowest level in five months.

The manufacturing PMI rose to 51.6 in February from 51.2 in the previous month, suggesting

optimism for a recovery in the sector. Factory output grew at the fastest pace in almost a year, while the drag from falling input stocks eased. However, new orders slowed, and employment growth almost came to a standstill.

It is increasingly evident that [trade] policy uncertainty is causing concern not only for businesses around the world, but also at home. We explore this topic more in our latest BILBoard, [now online](#).

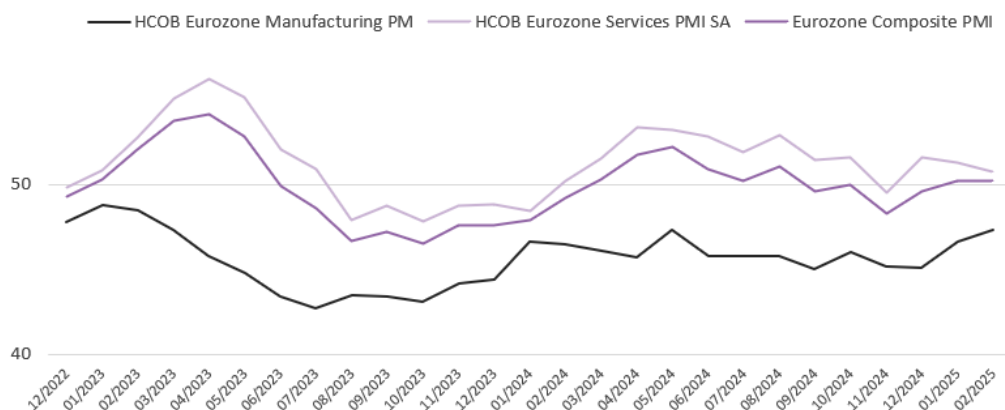


Source: Bloomberg, BIL

### Eurozone composite PMI stabilises as services soften

The Eurozone PMIs saw the industrial downturn, which has lasted over two years, ease further. The Manufacturing PMI increased to 47.3 in February, from 46.6. While this is still below 50, considered the line between contraction and expansion, it provides some hope that the situation is at least bottoming out. From there, it is difficult to foresee a major rebound for the time being. New business continued to fall and there was a marked reduction in manufacturing workforce numbers. Eurozone manufacturers continued to lower their purchasing activity, in response to weak customer demand – and that reduction was marked, despite being the weakest for two-and-a-half years.

## Eurozone Composite PMI stabilises



Source: Bloomberg, BIL

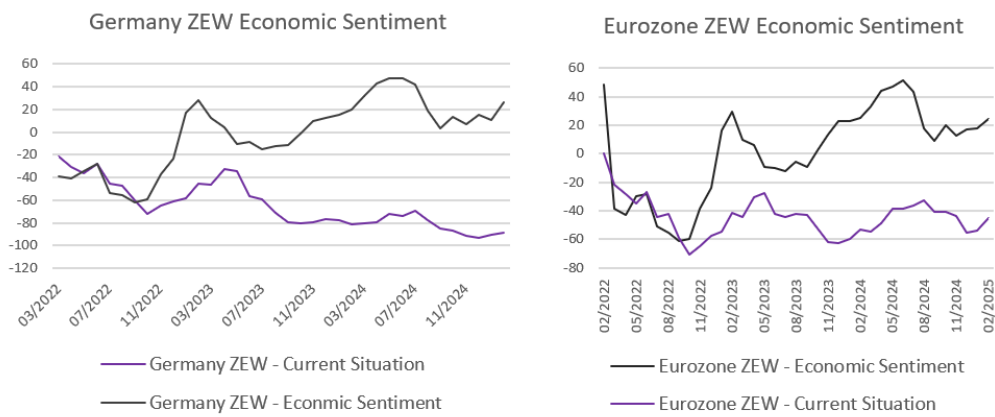
Meanwhile, the Services PMI fell to its lowest level in three months. New business declined for the first time in three months, though employment saw a slight increase. Input cost inflation remained elevated, while output prices continued to rise substantially.

A major detractor was France where the Services PMI dropped to 44.5 in February, versus 48.9 expected, with new orders falling at one of the fastest rates in five years. With demand in decline, companies' pricing power is being eroded at a time when input costs are rising sharply. Service providers let go workers at the fastest pace since August 2020. Overall, it seems that Bayrou's achievement in passing a budget is seen as more of a temporary success rather than being something that will bring long-term stability; he still lacks a majority in Parliament and could be ousted by the opposition at any time. France's manufacturing PMI improved marginally, from 45 to 45.5.

### Financial professionals grew more optimistic on Germany ahead of elections

Ahead of Sunday's general election, the ZEW Indicator of Economic Sentiment for Germany surged 15.7 points to +26, surpassing market expectations of +20 and reaching its highest level since July 2024. The survey is based on the opinions of 350 experts, including financial professionals and analysts.

Sentiment was boosted by hopes for a new German government capable of action and expected growth in private consumption over the next six months. The frontrunner, Merz, promised to rekindle growth by reducing taxes, regulation and social handouts. It was also noted that ECB rate cuts are boosting the outlook for construction sector.



Source: Bloomberg, BIL

Looking at the indicator for the Eurozone as a whole, it rose 6.2 points to 24.2, the highest in seven months. 58% of surveyed analysts expected no change in economic activity, 33.1% saw an improvement and 8.9% anticipated a deceleration.

As of late, markets appear to be taking a glass-half-full view when it comes to Europe. Prospects of a US-brokered peace deal in Ukraine are adding to optimism, while the Trump administration's shift towards more targeted tariffs as opposed to blanket levies, is also helping. Household confidence in the bloc is also slowly improving on the belief that the ECB will continue cutting rates this year (the European Commission's consumer confidence indicator registered -13.6 in February, the highest in four months).

## Germany's auto industry and Trump's trade tariffs

After contracting for the second year in a row in 2024, the German economy began 2025 with another threat looming on the horizon - US trade tariffs. While we still await more details on what the new trade policy based on "reciprocity" will look like, even the fear of tariffs could weigh on economies around the world. Last week, Trump specifically stated that cars, chips and pharma were in his sights.

Germany is particularly vulnerable to potential tariffs given its export-driven economy. The Bundesbank estimates that GDP growth could fall 1.5% below the baseline scenario as a result of changes in US trade policy.

Trump's threat to impose tariffs "in the neighbourhood of 25%" on cars imported from the EU, up from the current 2.5%, is especially worrying. The German car industry has struggled in recent years with high energy costs, low demand and increased competition from China. As the largest importer of German cars, any change in demand from the US could be another blow to an already struggling sector. Germany is also more at risk than other European countries, with

24% of Germany's non-EU car exports going to the US, compared with just 6% and 5% respectively for Spain and France.

Car makers have long been the crown jewel of German industry. However, in recent years, the car industry has lost momentum, with the number of cars produced in Germany having fallen from 5.6 million in 2017 to 4.1 million in 2023.

One thing that has put carmakers under particular pressure is the transition to electric vehicles (EVs). The decision to phase out petrol and diesel cars over the next decade has forced carmakers to invest heavily in the EV transition, and although battery EVs accounted for 13.6% of new car registrations in the EU in 2024, demand has not grown as quickly as initially expected. Some major German carmakers have recently announced that they will renew focus and continue to invest in combustion engines to keep up with demand.

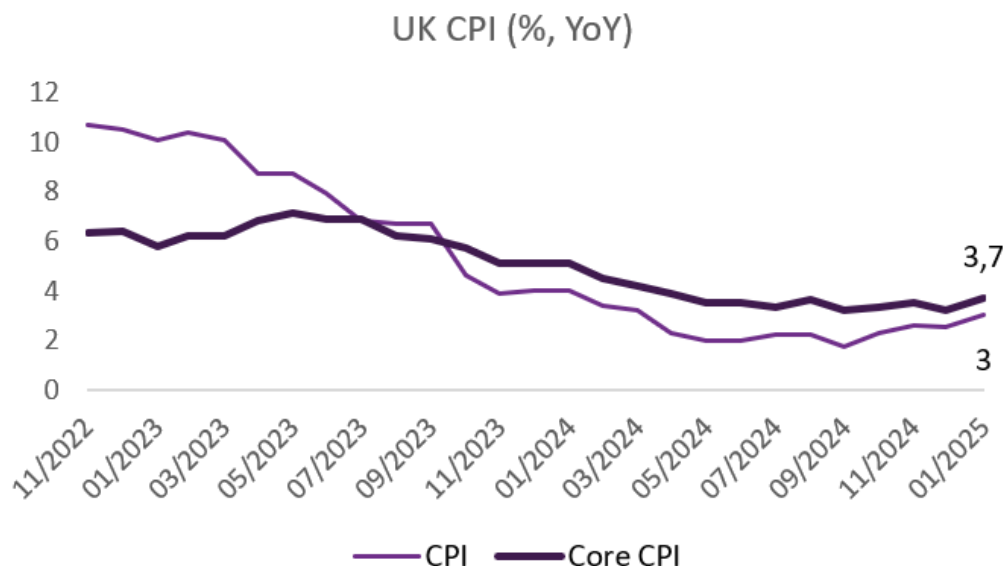
This year is likely to be another difficult year for German car makers, as they strive to adapt to changing market demands, while also trying to navigate the flood of announcements coming from the Oval Office.

## **UK inflation rises more than expected in January**

Inflation in the UK hit a 10-month high in January, rising to 3% year-on-year from 2.5%. According to the ONS, the rise was driven by a smaller-than-usual fall in air fares in January and a rise in fuel prices. Food costs rose and private school fees increased following the introduction of VAT charges. Core inflation, which excludes volatile categories, rose to 3.7% from 3.2%.

Services inflation, which is closely monitored by the Bank of England (BoE) when deciding whether or not to cut interest rates, also rose to 5% from 4.4%. This, combined with last week's strong wage growth figures, complicates matters for the BoE.

When the BoE cut interest rates to 4.5% at the beginning of February, it also revised its inflation forecasts, predicting that inflation will peak at 3.7% this year and only return to the BoE's target of 2% at the end of 2027. With the increase in employer taxes and the new minimum wage coming into effect in April, underlying cost pressures could intensify. Weaker growth forecasts combined with high inflation point to the risk of a stagflation scenario, which would make the BoE's task of using monetary policy to support growth and keep inflation low even more difficult.



Source: Bloomberg, BIL

Sterling briefly strengthened against the dollar on the release, before retreating again.

On the consumption side, however, consumers were more optimistic at the start of the year. Retail sales rose by a stronger-than-expected 1.7% month-on-month in January, the first month-on-month increase since August last year. Growth was driven by a sharp rise in food sales, offsetting falls in non-food, clothing and footwear, household goods and car fuel sales.

The GfK consumer confidence index also rose in February, up 2 points to -20, reflecting slightly more optimism among households about their personal finances and the wider economic outlook. The interest rate cut has certainly helped, but concerns about sluggish economic growth and persistent inflation remain.

### UK PMIs show companies cutting jobs ahead of tax rises

According to Friday's flash PMIs, UK companies are continuing to shed staff at the fastest pace in more than four years ahead of tax rises coming into place in April as per the Autumn Budget. The composite PMI edged down slightly to 50.5 in February from 50.6 the previous month, as growth in the services sector (51.1 in February from 50.8) failed to fully offset a fall in manufacturing activity (46.4 in February from 48.3). Employment continued its decline of previous months, falling from 45.3 to 43.5, the lowest level since November 2020.

The contraction in manufacturing was the sharpest since December 2023, and the fourth consecutive month of falling output. The services sector grew more than expected, as expectations for business activity rose slightly, despite concerns about the wider economic environment and geopolitical uncertainty.

This latest release continues to paint a challenging picture for the UK economic outlook, with more headwinds than tailwinds for the time being.

## Calendar for the week ahead

**Monday** – Germany IFO Business Climate. Eurozone Inflation (Final, January).

**Tuesday** – US House Price Index, **Conference Board Consumer Confidence**. Eurozone Negotiated Wage Growth.

**Wednesday** – Germany and France Consumer Confidence. US New Home Sales and Building Permits.

**Thursday** – France PPI. **Eurozone** M3 Money Supply and **Economic Sentiment**. Spain Inflation (Preliminary, February). US GDP Growth (Q4, 2<sup>nd</sup> estimate), Durable Goods Orders, Pending Home Sales.

**Friday** – Japan Industrial Production and Inflation. Germany Retail Sales and Unemployment. UK House Prices. Germany and Italy Inflation (Preliminary, February). **US PCE Inflation, Personal Income and Spending** (January). ECB Consumer Inflation Expectations.

**Saturday** – China NBS PMI (February).

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