Economic Perspectives

March 2025

Highlights

- The global trade war is intensifying rapidly while its future course remains highly uncertain. On 5 March, the US implemented a 25% blanket tariff on imports from Mexico and Canada. A one-month partial reprieve was announced on 6 March. Alongside, the US again increased tariffs on imports from China by 10 percentage points. The EU is facing a 25% tariff threat, which could be implemented in April, while also a threat of tariff reciprocation lingers on. That said, the tariffs might still be negotiated downwards. We now assume a 25% blanket tariff on imports from Mexico and Canada. We maintain for now our working assumption of an eventual 60% blanket tariff on imports from China and a 10% blanket tariff on imports from other nations.

- The prospect of a potential Ukraine ceasefire or peace deal and potential sanctions relief put downward pressure on energy prices in February. This is particularly the case for gas prices which declined by 15% last month to 44 EUR per MWh (also thanks to a relaxation of refill schedules). Oil prices declined by 3.9% to 73 USD per barrel in February in anticipation of possible sanction relief. That said, many obstacles still stand in the way of a peace agreement.

- Euro area inflation declined from 2.5% to 2.4% in February. The decline was primarily caused by declining energy prices. Food price and core goods inflation increased. Encouragingly, services inflation declined somewhat, as wage evolutions were relatively favourable, bringing down core inflation from 2.7% to 2.6%. In the medium term, potential EU tariffs and retaliation, along with increased fiscal impulses (defence and/or infrastructure spending) could push up inflation. All in all, we maintain our 2.5% inflation forecast for both 2025 and 2026.

- US inflation softened in February as headline inflation declined from 3.0% to 2.8%, while core inflation declined from 3.3% to 3.1%. Inflationary pressures decreased across all major categories. That said, we expect this softening in inflationary pressure to be temporary as inflation expectations remain elevated and price components in business surveys indicate higher prices ahead. As the trade war is intensifying rapidly, we upgrade our 2025 inflation forecast from 3.3% to 3.4%, while maintaining our 3.0% 2026 forecast.

- The euro area economy is facing several risks. On the downside, a full-fledged EU-US trade war could weigh on exports, consumption and investments. On the upside, Germany's debt brake reform and the European Commission's 'ReArm Europe' plan could provide a welcome, much-needed, stimulus boost to the euro area's sluggish economy. We upgrade our 2025 forecast from 0.7% to 0.8% (as a result of higher Q4 2024 growth figures), while maintaining our 1.0% growth forecast for 2026 for now. Overall, risks to our medium term growth forecasts are strongly tilted to the upside and depend on the timing and intensity of future fiscal stimulus.

- US growth indicators have weakened significantly lately, as overall economic uncertainty and tariffs are negatively affecting the wider economy. Consumption fell in January, while the trade goods deficit widened dramatically and construction spending declined. Sentiment indicators also weakened notably, both for consumers and producers. In the labour market, job growth was moderate, while the unemployment rate increased and the participation rate decreased. We downgrade our US growth forecast for 2025 from 2.3% to 1.8%, while maintaining our 1.8% 2026 forecast.

- Though the National People's Congress set an ambitious 5% growth target in the Annual 'Two Sessions' meeting, the Chinese economy continues to face structural growth risks. An intensifying US-China trade war is likely to hurt its export-dependent economy. Domestic demand remains weak and bogged down by the still ongoing, slow-grinding real estate crisis. In this context, China's 4% deficit target and other announced stimulus measures seem too timid to reach the growth target. We thus lower our 2025 forecast from 4.7% to 4.5%, while maintaining our 3.9% growth forecast for 2026.

- Global bond markets remain macro-sensitive and displayed extreme bouts of price volatility. In the US, weaker economic data brought US Treasury yields down. Meanwhile, in anticipation of higher military and infrastructure spending, German Bund yields spiked. In the euro area, the ECB adjusted to this new reality and said rates have become meaningfully less restrictive, suggesting that the rate-cutting cycle might be ending soon. We now expect only one more ECB rate cut this year. Meanwhile, Fed Chair Jerome Powell tried to downplay US growth concerns in his latest remarks. We still expect only two Fed rate cuts this year.

Global Economy

Economic uncertainty, particularly trade uncertainty, is hurting the global economy. On 5 March, President Trump imposed a 25% tariff on imports from Mexico and Canada into the US. Only Canadian oil energy products would face a lower levy of 'only' 10%, as Canada accounts for around 60% of US crude imports. Canada retaliated, imposing 25% tariffs on 108 billion USD worth of American goods. In a move reflecting the whimsical nature of this trade war, the US offered a one month reprieve to all USMCA-compliant imports a day later.

Alongside, the US again increased tariffs on imports from China by 10 percentage points on 4 March. This raise came on top of a 10 percentage points raise in tariffs already implemented in February. China responded by imposing 10 to 15% tariffs on agricultural goods such as soy beans, wheat and pig meat. It also imposed trade and investment restrictions on 25 US companies.

The EU has not been spared from Trump's tariff threats. Trump threatened 25% tariffs on imports from the EU to be imposed from April onwards. That said, it was unclear whether this would be a blanket tariff or a tariff on specific sectors, such as the automobile sector. Negotiations might also bring these tariff levels down. For now, we maintain our working assumption of a 10% blanket tariff on imports from the EU.

On top of this, President Trump signed a presidential memorandum on 13 February to develop a plan to levy reciprocal tariffs from April onwards. Currently, under World Trade Organisation rules, countries must levy the same import tax on a given good, no matter its origin. Donald Trump wants to replace this with a system where US tariffs would match the tariffs the US faces in other countries. This would not only be complex and cause

Figure 1 - Odds Trump ends Ukraine War by First 90 Days

Source: KBC Economics based on Polymarket

a big administrative burden, but also likely raise the average tariff on US imports.

All in all, we now assume a 25% blanket tariff on imports from Mexico and Canada (instead of 10%). Aside from that we maintain for now our working assumption of an eventual 60% blanket tariff on imports from China and a 10% blanket tariff on imports from other nations.

The ongoing trade war will have a stagflationary effect. This is especially the case for the US, where the trade deficit widened and consumption declined, while inflation expectations drastically increased. The trade war could also delay the recovery in the euro area, where confidence indicators remain broadly flat (at low levels). That said, increased (military-related) deficit spending could provide a necessary boost to its economy. China is also likely to face serious difficulties to reach its newly announced 5% growth target. Its recently announced deficit spending seems too timid to reach this target.

Energy prices decline in February

Ukraine peace negotiations loom large over energy markets. Following the release by Russia of an American prisoner, Marc Fogel, Donald Trump spoke by phone to Vladimir Putin to start negotiations on a possible peace agreement. US and Russian delegations later met in Riyadh to improve bilateral relations and negotiate on end to the Ukraine war. The US already seems to have made important concessions to Russia. Indeed, in a recent speech to NATO, the US defense secretary, Pete Hegseth, said it was "unrealistic" for Ukraine to return to its international borders and indicated that Ukraine would not be admitted by NATO. Still, several obstacles stand in the way of a peace agreement. Russia doesn't seem to have made any meaningful concessions thus far. Furthermore, Ukraine-US diplomatic relations have worsened significantly, in the wake of President Zelensky's visit to the White House and his tense exchange with Donald Trump and JD Vance. The diplomatic relations improved recently as the US and Ukraine recently agreed on a ceasefire proposal (Russia has yet to respond). Betting markets now see an increased chance of a comprehensive peace deal happening soon (see figure 1).

If a peace deal were to occur and sanctions on Russia would be lifted, energy prices would decrease. This would especially be the case for European natural gas prices. Current European gas prices remain more than twice as high as pre-war levels. Tellingly, European gas prices declined 6.9% on 13 February, the day after the Trump-Putin phone call. Over the month of February, European gas prices declined by 15% to 44 EUR per MWh. That said, softer weather conditions (and a relaxation of refill requirement schedules) also put downward pressures on European gas prices last month.

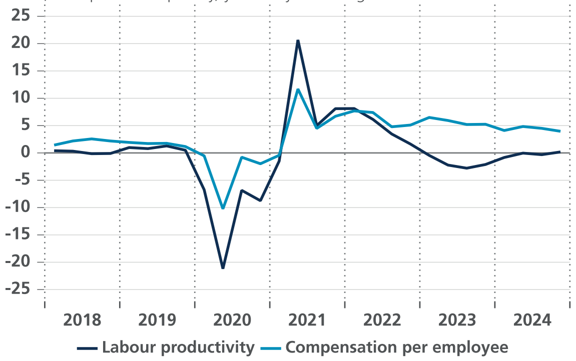
Oil prices could also decline if sanctions were lifted. Urals prices traded at an average 66 USD per barrel in January, well below Brent prices. That said, Russia has been able to redirect more of its oil production to non-Western nations than its gas production. Its crude oil production has been relatively stable in recent years. Consequently, oil prices have declined by 3.9% in February to 73 USD per barrel. Worsening economic sentiment, especially in the US, also weighed on oil prices. As OPEC+ announced it will proceed with its plan to increase oil production from April onwards, oil prices declined further in early March.

Gradual inflation decline in euro area

In the euro area, both headline and core inflation fell by 0.1 percentage points to 2.4% and 2.6% respectively in February. Food price inflation picked up from 2.3% in January to 2.7% in February, while energy price inflation moderated from 1.9% to 0.2%.

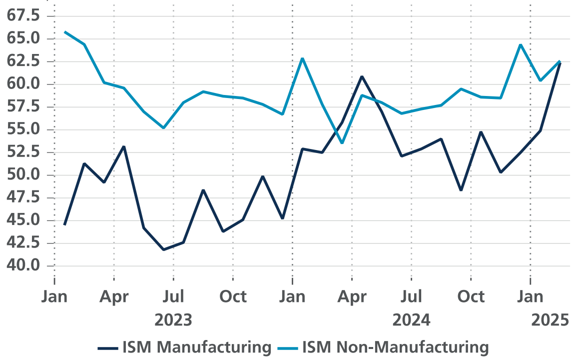
The course of core inflation is in line with our expectation, which is a very gradual cooling, especially of services inflation. At 3.7%, it is still well above the ECB's 2% target for headline inflation. In fact, the short-term momentum of services inflation (month-on-month) appear to be accelerating somewhat again in recent months, even

Figure 2 - Euro area services: productivity and wage cost
trade, transport & hospitality, year-on-year change in %



Source: KBC Economics based on ECB, Eurostat

Figure 3 - Price components in business surveys
index, SA



Source: KBC Economics based on ISM

when seasonal factors are excluded. (For the impact of seasonal and base effects on inflation trends, see: KBC Economic Briefs, 27 February 2025).

However, we assume that this movement will not continue. Indeed, key drivers of services inflation are moving in the right direction. The wage growth rate slows and productivity growth strengthens, albeit moderately (see figure 2), reducing pressure on services prices. This is also reflected in the price expectations of entrepreneurs in the services sector, which had increased slightly in the last months of 2024, but recently fell again. All this supports the view that services inflation may gradually cool further.

On the other hand, we keep in mind the possible impact of retaliatory tariff hikes by the EU if, as expected, the trade war would escalate. Such measures combined with possible additional German and European fiscal stimulus may prevent a sustainable decline in (core) inflation in the near term, although it remains guesswork how this will play out. For the time being, therefore, we maintain our forecast of average euro area inflation of 2.5% in both 2025 and 2026.

US inflation pressures soften in February

US inflationary pressures were mild in February as headline inflation declined from 3.0% to 2.8%, while core inflation declined from 3.3% to 3.1%. Both headline and core prices increased by only 0.2% last month.

Inflationary pressures were soft across all major categories. Energy prices only increased slightly as a big drop in gasoline prices was compensated by increases in other categories such as electricity. Food inflation was also mild, as food at home prices were unchanged last month. This is despite another double-digit increase in the price of eggs.

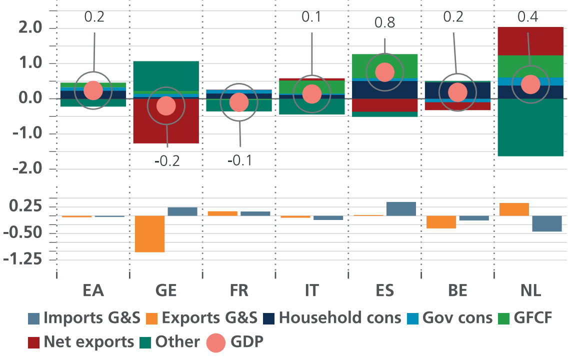
Core goods prices also increased by 0.2% month-on-month. This is a softer pace than last month, but higher than the negative average readings we saw last year. The increase was primarily driven by higher apparel prices and used cars and trucks prices. Forward-looking indicators indicated softer readings for the latter category.

As forward-looking indicators implied, shelter prices softened, increasing by 0.3% month-on-month. Core service prices (ex. shelter) also increased at the same pace. Though this softer increase was partly a result of a big drop in the volatile airline fares component, while other more sticky service components such as education and communication increased at a mild pace. A softer increase in average hourly earnings (0.3% month-on-month) also bodes well for services inflation.

Though this softer inflation print is certainly good news, we still expect inflation to accelerate again in the coming months. Consumer inflation expectations increased lately in all major surveys. Inflation expectations implied by inflation swaps expect inflation to remain at an elevated 3% in the next 12 months. Price indices in business surveys also increased markedly in February, indicating higher prices ahead (see figure 3). Furthermore, as we now assume higher tariffs on imports from Mexico and Canada (leading to higher goods inflation), we upgrade our US inflation forecast for 2025 from 3.3% to 3.4%, while maintaining our 3.0% forecast for 2026.

Figure 4 - Growth composition of real GDP in Q4 2024

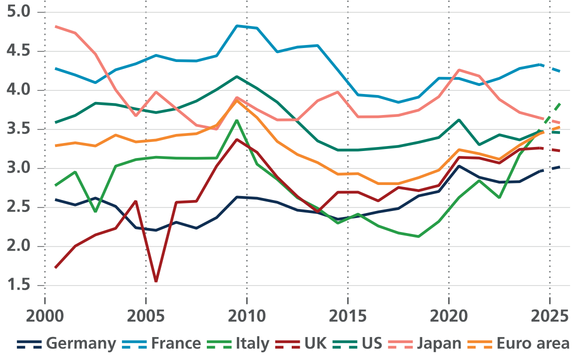
contribution (in ppts) to QoQ real GDP growth (in %)



Source: KBC Economics based on Eurostat

Figure 5 - Government gross fixed capital formation

% of GDP (2024 & 2025 are EC forecasts)



Source: KBC Economics based on DG ECFIN

Europe on the eve of a new era

The euro area's initial estimate of real GDP growth in Q4 2024 was raised slightly from 0.0% to first 0.1% and then 0.2% (versus the previous quarter). This ended up being slightly better than our initial forecast of 0.1%. The new figure brings the annual average growth rate of real GDP in 2024 to 0.8%, 0.1 percentage points higher than expected. The composition according to spending components shows that private consumption made a growth contribution of 0.2 percentage points and government consumption and investment contributed 0.1 percentage points each. Inventory reduction contributed negatively to growth for 0.2 percentage points, while net exports were neutral. However, the latter was solely due to the impact of the volatile Irish economy. Excluding Ireland, the growth contribution of net exports was -0.4 percentage points, mainly due to the sharp decline in German (net) exports (see figure 4). The growth contribution of investment would have been slightly higher (0.2 percentage points) if the Irish economy is excluded, as the Netherlands, Spain and Italy made relatively large investment growth contributions.

However, the most important news for European economies in recent weeks came not from traditional economic indicators, but from the monumental reversal of expected fiscal policy. While we are still waiting for clarity on the brewing US-EU trade disputes, the vote at the United Nations General Assembly and the contentious meeting between Presidents Trump and Zelensky, among other things, made it crystal clear that Europe has been catapulted into a new regime and that it must urgently and substantially strengthen its defence capabilities. In response, Friedrich Merz, the incoming new German Chancellor, is likely to get a drastic reversal of German fiscal policy approved by the outgoing German parliament. The de facto removal of the constitutional debt brake on defence spending would henceforth allow a whatever-it-takes approach to national defence in Germany. At the same time, the creation of a 10-year debt-financed fund amounting to almost 12% of GDP and the possibility of limited debt financing (amounting to 0.35% of GDP) by the German Länder would allow Germany to eliminate its significant public investment backlog (see figure 5).

Meanwhile, the hastily convened Summit of European Heads of State and Government approved the ReArmEU plan proposed by European Commission President Von der Leyen. Among other things, it would create a new EUR 150 billion facility for loans to finance defence spending by member states. In addition, Member States could ask to apply, through the national escape clause of the Stability and Growth Pact, more flexible fiscal rules for their defence spending, in principle as far as their debt position allows.

Undoubtedly, the geopolitical repositioning of Europe and the policy reversal in Germany will potentially have far-reaching economic consequences. However, it is currently difficult to estimate to what extent and at what speed this will be implemented. After all, most plans are still embryonic and the implementation challenges are not negligible. In the short term, the most likely positive effects on economic growth (but possibly also inflationary effects) will still be tempered to a large extent by the negative impact of expected trade conflicts and high uncertainty. However, if successfully implemented, the plans could boost economic growth in the medium and long term, not only from a cyclical point of view but also in terms of growth potential, especially in Germany. But it is, for the moment, very early to quantify any of this.

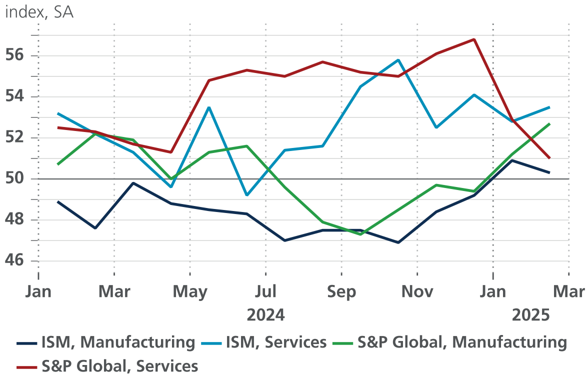
Since in our outlook we already take into account, on the one hand, a dampening growth effect of trade conflicts and, on the other, a more growth-enhancing policy of a new German government from the second half of 2025 and especially in 2026, we keep our growth forecasts unchanged for the time being. That is, the euro area economy will continue to drag on at a subpar growth rate of below 1% for some time. We only expect a pick-up in growth towards year end and during 2026. However, due to the larger-than-expected spillover from 2024 to 2025, we have raised the expected figure for average real GDP growth in 2025 from 0.7% to 0.8%. We maintain our growth forecast for 2026 at 1.0% for now.

The US economy weakens suddenly

Elevated uncertainty and tariffs are already hurting the US economy. This was most directly visible in recent trade data. The goods and services trade deficit increased by 34% in January due to a big increase in imports (likely in anticipation of higher tariffs). Tariffs also seem to impact the housing market. The National Association of Home Builders sentiment declined from 47 to 42 in February. Notably, responses collected after the February tariff announcements were 8 percentage points lower than the ones collected before, as 7% of residential construction materials are imported. Other housing indicators also weakened. New single-family housing starts fell 8% in January, while existing home sales fell by 5%. Residential construction spending declined by 0.4% in January (non-residential construction remained flat).

Most worrying of all is the sudden weakness in consumption. Real consumer spending fell by 0.5% in January. Though half of the decline can be attributed to motor vehicle spending (which bounced back in February), other less volatile categories were also notably weak. Real service spending declined by 0.1% last month. Consumer confidence also dropped drastically in the last two months. Other confidence indicators were also softish. Business confidence indicators moved in different directions (see figure 6). Especially the sharp decline in the S&P Services PMI was notable. Tariffs were mentioned regularly in the survey reports.

Figure 6 - US PMI Business confidence indicators



Source: KBC Economics based on ISM, S&P Global

Labour market indicators are also pointing to some softness. Non-farm payrolls increased by 151k last month, a mild rebound versus January. Private sector job gains were 140k, in line with the average of the prior six months. However, government jobs increased by only 11k (versus 44k in January), possibly as a consequence of the ongoing cuts initiated by Elon Musk's DOGE program. The unemployment rate ticked up from 4.0% to 4.1%, while the participation rate declined significantly (from 62.6% to 62.4%). Disappointingly, average weekly hours worked remained at 34.1. Most concerning was the large increase in people working part time for economic reasons (+460k versus last month), which is indicative of lower labour demand. Given the weaker recent economic data, we materially downgrade our US growth forecast for 2025 from 2.3% to 1.8%, while maintaining our 1.8% 2026 forecast.

Additional tariffs overshadow Chinese Two Sessions

At the beginning of the year, China traditionally hosts the Two Sessions, the country's most important annual political gathering in the country. For about two weeks, delegates from the National People's Congress (NPC), China's highest legislature, and members of the National Committee of the Chinese People's Political Consultative Conference (CPPCC), China's highest political advisory body, sit together to vote on important laws and to approve government appointments and the budget. In addition, the Two Sessions are often used to make important announcements that provide insight into the government's policy direction.

This year's Two Sessions took place in a context of increased trade tensions with the US. These concerns come on top of the major structural problems the Chinese economy has been facing for several years, including unfavourable demographics, weak consumer demand, a real estate crisis and large local government debts. President Trump, since taking office in late January, has twice raised tariffs on imports from China by 10 percentage points each. In retaliation to the most recent increase, China raised import tariffs on several US agricultural products. Moreover, the country also put some major US companies on its list of untrustworthy entities, preventing them from trading with China and from making additional investments in the country.

It is doubtful that the current tariffs will be the end of the US-China trade war. For now, China's retaliatory measures are still relatively limited and targeted but if the US were to go further in restricting trade relations, stronger countermeasures could still be in the cards. An important event in this context is the outcome of the investigation into US trade relations that President Trump commissioned upon taking office. Based on this investigation, Trump intends to decide if new trade measures need to be issued against China.

One speech that was watched with great interest at the beginning of the Two Sessions was that of Premier Li Qiang, presenting the growth target for 2025. Just like the past two years, the target was set at "around 5%". This target is very ambitious, especially because of the deteriorating trade environment and disappointing domestic demand. China still seems to believe that it will be able to sufficiently boost the economy through monetary and fiscal policy. For the latter, it puts forward a central government deficit projection of 4% of GDP, a 1 percentage point increase over last year's deficit. It also announced some specific fiscal stimulus measures, including 300 billion yuan subsidies for consumer goods programs and 4.4 trillion yuan for infrastructure spending. Overall, the announced stimulus measures were less generous than expected. It is therefore highly uncertain whether they will be enough to push GDP growth toward 5%. Based on the (for now) disappointing fiscal measures and increased trade tariffs, we lower our growth outlook for 2025 by 0.2 percentage points, to 4.5%. We leave the expected growth rate for 2026 unchanged at 3.9%. The inflation outlook was revised upward for 2025 (by 0.1 percentage points to 0.8%) because of the Chinese government's retaliatory tariffs, which make the import of a selection of goods from the US more expensive.

Bond yields diverge sharply

In line with the diverging business expectations for the US and the euro area, US and German bond yields also decoupled. US 10-year yields fell to around 4.30% on rising growth pessimism, while German 10-year yields rose sharply to around 2.80% on the back of the future German government's expansionary budget plans. This opposite movement was also visible in real interest rates (i.e., adjusted for inflation expectations).

The unprecedented magnitude of the rise in German interest rates is also a consequence of German interest rates being at artificially low levels for quite some time. Real interest rates were only marginally positive during that period, unlike US real rates. Consequently, the sharp rise in German interest rates in just a few days is driven by a decompression of the artificially low term premium. That low term premium was itself caused by a relative scarcity of low-risk German government securities due to the dogmatically conservative fiscal policy so far. Following the recent rise in interest rates, we expect this decompression to continue moderately into 2026, allowing German 10-year yields to reach 2.85% by the end of 2026.

On balance, the 10-year interest rate differential between the US and Germany fell sharply to around 145 basis points. That narrowed interest rate differential in turn caused the USD to depreciate sharply to around 1.08 USD per EUR.

Fed in wait-and-see mode

Against the backdrop of higher inflation expectations and downside growth risks in the US, we keep our expectations for Fed policy unchanged. Markets assume that the Fed will cut its interest rate three times in 2025 to support the business cycle. However, we think this is unlikely as underlying inflationary pressures remain present, especially if announced tariff hikes take effect. We therefore confirm our expectation that the Fed will hold its wait-and-see stance in the first half of the year, before cutting its policy rate by 25 basis points in both the third and fourth quarter, to 3.875%. We expect the Fed then to cut its policy rate one more time by 25 basis points in spring 2026 to the bottom level in this cycle of 3.625%. That view is consistent with the recent communication by Fed Chairman Powell following the US labour market report for February to (try to) reassure sceptical financial markets. He stated that the Fed is in no hurry to cut its interest rates further for now.

Meanwhile, the Fed's balance sheet normalisation continues, reducing excess reserves in the financial system. To avoid dangers of short-term liquidity shortages, the Fed may decide in one of its next policy meetings to slow the pace of balance sheet reduction further, or even stop that process altogether.

ECB policy rate closer to neutral

The ECB, on the other hand, is likely to cut its policy rate one last time by 25 basis points to 2.25% in the course of the second quarter. Following the rate cut in March, the central bank indicated that interest rates have now become meaningfully less restrictive. On that basis, we expect a policy rate of 2.25% to be the bottom in this rate-cutting cycle. The ECB may also be guided in this consideration by the likely unprecedented fiscal stimulus in Germany and the euro area. As mentioned above, this has already pushed up real German bond yields, and it is plausible that this will also be the case for real short-term interest rates (r*). A higher bottom level in this rate cycle is therefore likely.

Intra-EMU spreads remarkably stable

Sovereign yield spreads within the EMU remained remarkably stable against the backdrop of sharply higher German benchmark yields. Political risk in countries such as Belgium decreased following the formation of the new government and the prospect of a fully-fledged budget by 2025. The European Commission's application of the Stability and Growth Pact rules is also likely to be more lenient following recent geopolitical developments. As a result, we confirm our view that intra-EMU spreads are currently at or even past their peak and that they could further decline somewhat during 2025 and 2026.

Bulgaria one step further on its way to EMU

In the same context, the new Bulgarian government stated that Bulgaria's entry into the euro area is a top policy priority. The conclusions of the ad hoc convergence reports by the European Commission and the ECB should be available by the middle of this year. We expect these opinions to be positive, with Bulgaria adopting the euro in January 2026.

Central and Eastern Europe

Soft investment so far does not weigh significantly on CEE labour markets

Although the most recent GDP figures have confirmed cautious acceleration of the growth momentum in the CEE region, investment activity and foreign demand remain rather weak. While quarter-on-quarter real GDP growth in the fourth quarter was 0.5% in Hungary, 0.7% in the Czech Republic and 1.3% in Poland, the gross capital formation (approximated by the sum of investments and inventories) declined in all three countries, including Poland, where investment activity has been growing relatively fast over the past two years.

Overall, the rather weak investment environment, which has been associated with the underperformance of the manufacturing sector, especially in the Czech Republic and Hungary, has not led to any dramatic cooling on the labour market. The harmonised unemployment rate stayed nearly unchanged in the Czech Republic (2.6%) and Hungary (4.2%), while it even decreased in Poland (2.7%) (see figure CEE1).

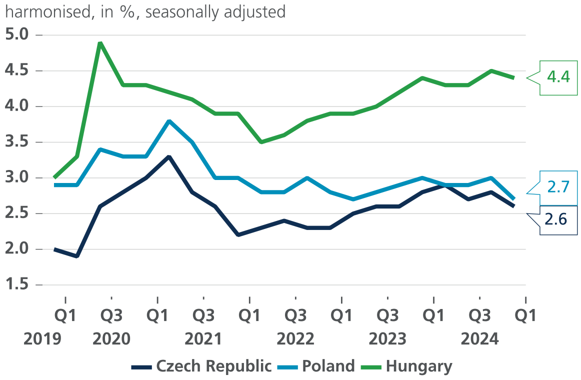
Nevertheless looking specifically at the manufacturing employment together with the registered unemployment data, one can notice some visible cooling off, especially in the Czech Republic. The number of manufacturing jobs has been declining steadily over the last one and a half year and compared to 2019, it is approximately 2% lower in Poland, 3% lower in Hungary and 7% lower in the Czech Republic (see figure CEE2).

Other sectors have been able to offset the reduction of the manufacturing jobs so far, but this does not have to be the case forever. Looking specifically at national registered unemployment data (which may better capture certain turning points in comparison with harmonised Eurostat surveys), the registered unemployment rate has recently increased more significantly, especially in the Czech Republic to 4.3% (0.3 percentage points higher year-on-year and the highest level since February 2021). The gap between the harmonised unemployment and the national registered unemployment has increased somewhat, also in Poland.

Looking ahead, we do not forecast further major cooling on the CEE labour markets, but rather a stabilisation going hand in hand with a stabilisation of the investment environment. The current weak investment environment can be partly attributed to the nervousness stemming from the trade tensions after the election of Donald Trump. According to our recent analysis, we believe Hungary and Slovakia are especially vulnerable towards potential US tariffs on the automotive industry. This uncertainty can probably persist for some time, but should not limit the “necessary” investment activity in the region forever. Secondly, regulatory uncertainty in the automotive sector could have led to a delay of investments in the CEE region. Until recently, the production of combustion engines was mandated to be severely limited already in 2025. Now, the EU's Competitiveness Compass seems to introduce a more flexible approach. This will allow the maximum permitted emissions from new cars sold to be measured against average emissions in the years 2025-2026-2027, rather than in each year separately. This change could offer more "breathing space" for

Figure CEE1 - Unemployement rate in CEE

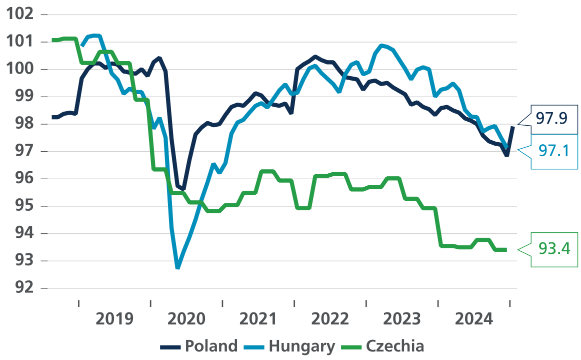
harmonised, in %, seasonally adjusted



Source: KBC Economics based on Eurostat, MoLSA, MPIPS, HCSO, CZSO

Figure CEE2 - Employment in manufacturing

2019 = 100



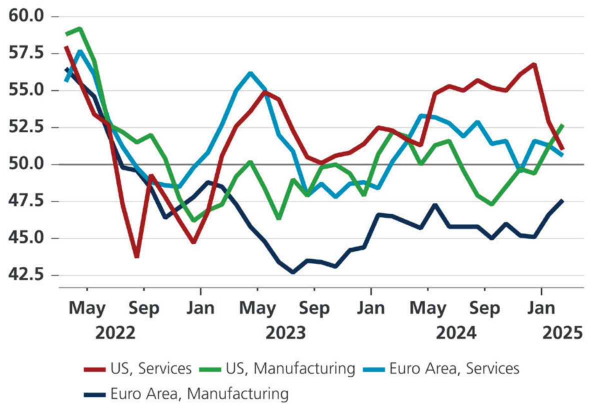
Source: KBC Economics based on GUS, HCSO, CZSO combustion-engine oriented automotive in the CEE region to manage its transition to net zero by 2035 and it can potentially support investment activity. And last but not least, the approaching deadline for the implementation of Recovery and resilience fund projects together with major fiscal plans of the German government could be supportive for the regional investments in 2026 and 2027 as well. If that is the case, we believe also the labour force in the manufacturing sector should stabilise across the CEE.

Figures

Real GDP
yearly change in %

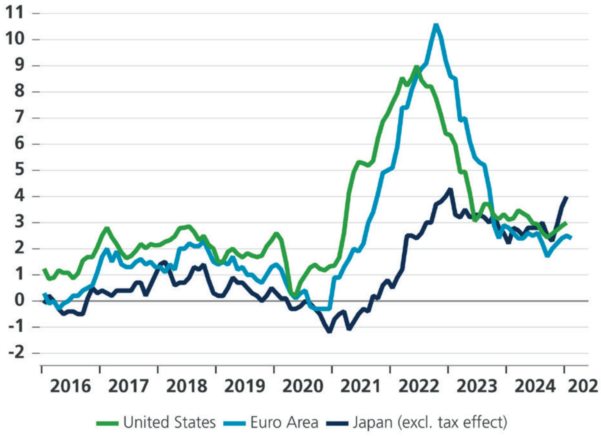
Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators
index, above 50 = expansion



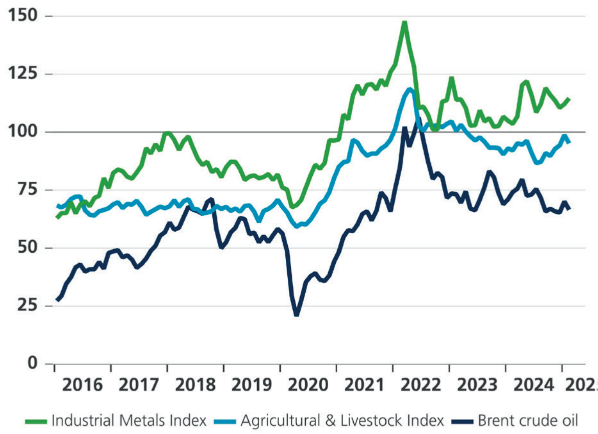
Source: KBC Economics based on S&P Global

Headline inflation
yearly change consumer price index, in %



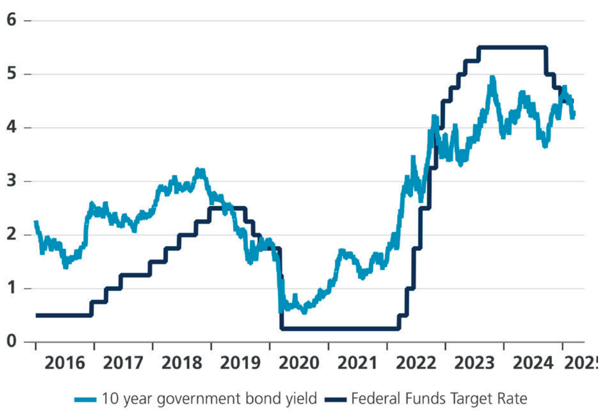
Source: KBC Economics based on Eurostat. SBJ. BLS

Commodity prices
index, January 2013=100, in USD



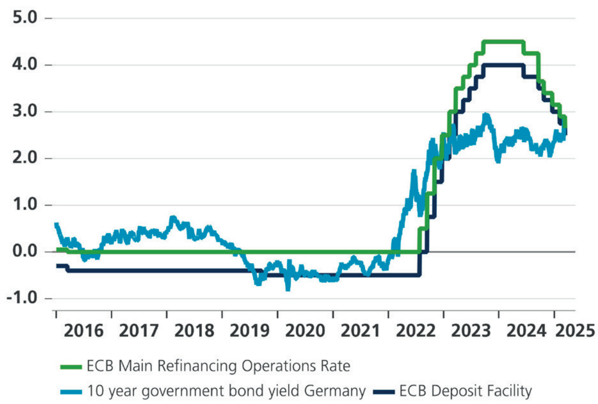
Source: KBC Economics based on World Bank, S&P Global

United States interest rates
in %



Source: KBC Economics based on Fed, U.S. Treasury

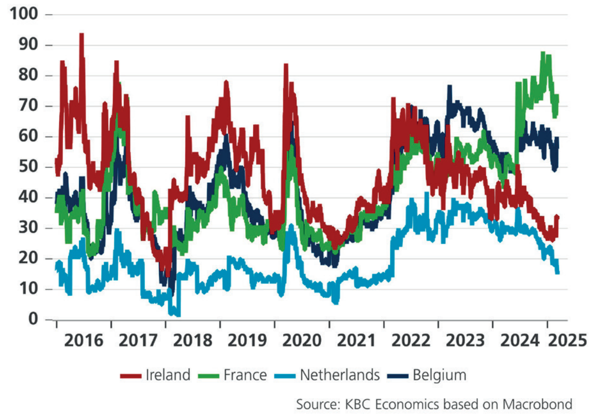
Euro area interest rates
in %



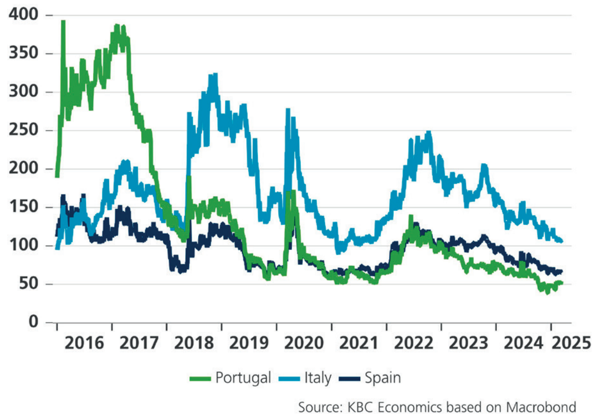
Source: KBC Economics based on Macrobond, ECB

Figures

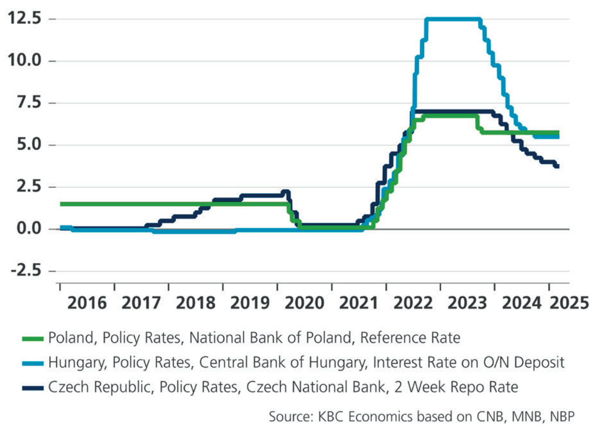
10 year government bond yield spreads to Germany
in basis points



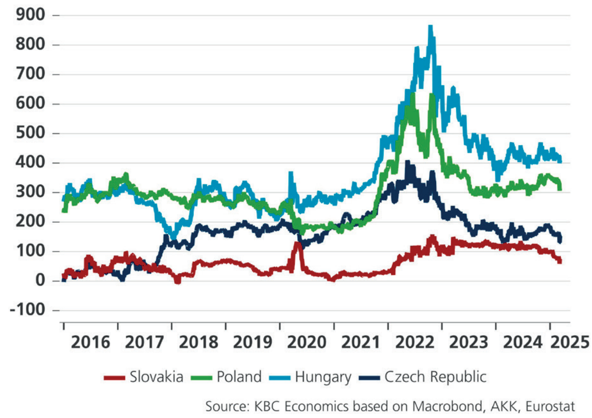
10 year government bond yield spreads to Germany
in basis points



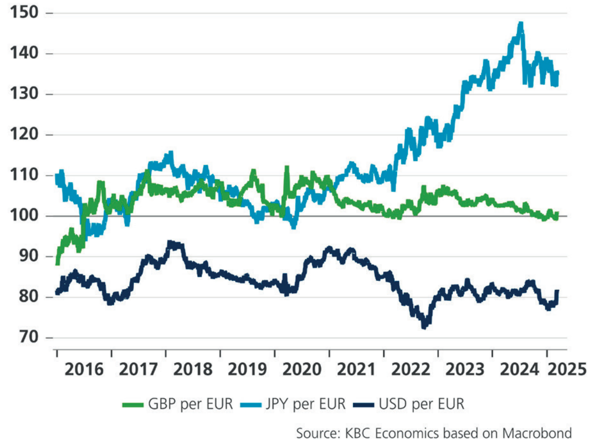
Monetary policy rates Central Europe
in %



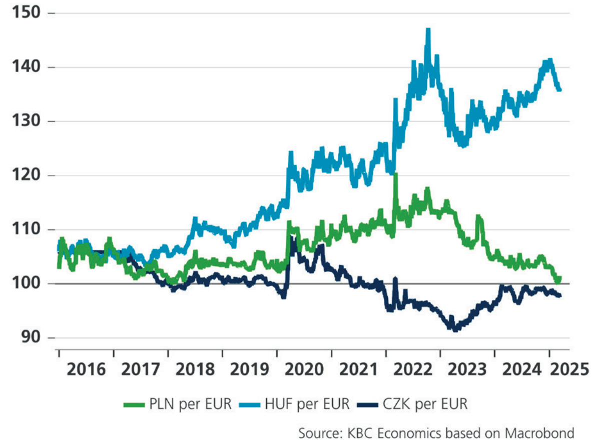
10 year government bond yield spreads to Germany
in basis points



Exchange rates
index, January 2013=100, increase = stronger EUR



Exchange rates
index, January 2013=100, increase = stronger EUR



Outlook main economies in the world

		Real GDP growth (period average, based on quarterly figures, in %)			Inflation (period average, in %)		
		2024	2025	2026	2024	2025	2026
Euro area	Euro area	0.8	0.8	1.0	2.4	2.5	2.5
	Germany	-0.2	0.1	0.9	2.5	2.8	2.7
	France	1.1	0.5	1.0	2.3	2.0	2.3
	Italy	0.5	0.4	0.5	1.2	1.9	2.1
	Spain	3.2	2.2	1.8	2.9	2.5	2.3
	Netherlands	0.9	1.6	1.0	3.2	3.6	3.4
	Belgium	1.0	0.7	0.9	4.3	3.2	1.7
	Ireland	0.3	4.2	4.5	1.4	1.7	2.0
	Slovakia	2.0	1.9	2.5	3.2	4.1	3.0
Central and Eastern Europe	Czech Republic	1.0	2.1	2.3	2.7	2.4	2.4
	Hungary	0.6	2.0	3.6	3.7	4.7	3.8
	Bulgaria	2.6	2.1	2.4	2.6	2.9	3.0
	Poland	2.8	3.3	3.3	3.6	4.3	2.7
	Romania	0.9	2.1	2.9	5.8	4.5	3.5
Rest of Europe	United Kingdom	0.9	1.1	1.3	2.3	2.8	2.4
	Sweden	0.9	1.7	2.4	2.0	0.9	1.8
	Norway (mainland)	0.6	1.6	1.7	2.9	2.5	2.1
	Switzerland	1.3	1.2	1.6	0.9	0.5	0.8
Emerging markets	China	5.0	4.5	3.9	0.2	0.8	1.7
	India*	6.2	6.3	6.5	4.7	4.3	4.5
	South Africa	0.6	1.6	1.9	4.4	4.0	4.5
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	3.2	2.6	3.6	58.5	32.5	20.6
	Brazil	3.4	1.9	2.1	4.4	4.6	4.4
Other advanced economies	United States	2.8	1.8	1.8	3.0	3.4	3.0
	Japan	0.1	1.2	0.9	2.7	2.6	1.8
	Australia	1.0	2.0	2.4	3.2	2.8	2.6
	New Zealand	-0.4	1.2	2.6	2.9	2.1	2.0
	Canada	1.5	1.5	1.7	2.3	2.1	2.1
*** fiscal year from April-March**						7/3/2025	

Policy rates (end of period, in %)						
		7/3/2025	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Euro area	Euro area (refi rate)	2.65	2.65	2.40	2.40	2.40
	Euro area (depo rate)	2.50	2.50	2.25	2.25	2.25
Central and Eastern Europe	Czech Republic	3.75	3.75	3.50	3.50	3.50
	Hungary	6.50	6.50	6.50	6.25	6.00
	Bulgaria	-				
	Poland	5.75	5.75	5.75	5.50	4.75
	Romania	6.50	6.50	6.25	6.00	5.75
Rest of Europe	United Kingdom	4.50	4.50	4.25	4.00	4.00
	Sweden	2.25	2.25	2.25	2.25	2.25
	Norway	4.50	4.25	4.00	3.75	3.75
	Switzerland	0.50	0.25	0.25	0.25	0.25
Emerging markets	China (7-day r. repo)	1.50	1.50	1.40	1.30	1.20
	India	6.25	6.25	6.00	6.00	5.75
	South Africa	7.50	7.50	7.50	7.25	7.25
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	42.50	42.50	37.50	32.50	29.75
	Brazil	13.25	14.25	15.00	15.50	15.50
Other advanced economies	United States (mid-target range)	4.375	4.375	4.375	4.125	3.875
	Japan	0.50	0.50	0.50	0.75	0.75
	Australia	4.10	4.10	3.85	3.85	3.85
	New Zealand	3.75	3.75	3.25	3.25	3.25
	Canada	3.00	3.00	3.00	2.75	2.75

Outlook main economies in the world

10 year government bond yields (end of period, in %)		7/3/2025	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Euro area	Germany	2.80	2.80	2.80	2.80	2.80
	France	3.52	3.55	3.55	3.54	3.53
	Italy	3.87	3.90	3.90	3.88	3.86
	Spain	3.46	3.50	3.50	3.49	3.48
	Netherlands	2.95	3.00	3.00	3.00	3.00
	Belgium	3.36	3.40	3.40	3.39	3.38
	Ireland	3.06	3.10	3.10	3.10	3.10
	Slovakia	3.66	3.60	3.60	3.60	3.60
Central and Eastern Europe	Czech Republic	4.41	4.20	4.20	4.20	4.20
	Hungary	7.01	6.80	6.50	6.30	6.10
	Bulgaria*	3.85	4.20	4.20	4.15	4.10
	Poland	5.99	5.80	5.80	5.40	4.90
	Romania	7.60	7.50	7.50	7.50	7.60
Rest of Europe	United Kingdom	4.67	4.70	4.70	4.70	4.70
	Sweden	2.54	2.55	2.55	2.55	2.55
	Norway	3.99	3.95	3.95	3.95	3.95
	Switzerland	0.72	0.65	0.65	0.65	0.65
Emerging markets	China	1.76	1.80	1.85	1.90	2.00
	India	6.69	6.70	6.75	6.80	6.90
	South Africa	10.55	10.60	10.65	10.70	10.80
	Russia	15.13	Temporarily no forecast due to extreme uncertainty			
	Turkey	25.81	26.00	24.00	24.00	22.50
	Brazil	15.03	15.10	15.15	15.20	15.30
Other advanced economies	United States	4.26	4.30	4.35	4.40	4.50
	Japan	1.50	1.50	1.50	1.50	1.50
	Australia	4.41	4.45	4.50	4.55	4.65
	New Zealand	4.66	4.70	4.75	4.80	4.90
	Canada	3.04	3.10	3.15	3.20	3.30

***Caution: very illiquid market**

Exchange rates (end of period)	7/3/2025	Q1 2025	Q2 2025	Q3 2025	Q4 2025
USD per EUR	1.09	1.07	1.06	1.06	1.06
CZK per EUR	25.01	25.10	25.20	25.10	25.10
HUF per EUR	399.09	398.00	395.00	398.00	408.00
PLN per EUR	4.17	4.20	4.15	4.17	4.20
BGN per EUR	1.96	1.96	1.96	1.96	1.96
RON per EUR	4.98	5.00	5.03	5.07	5.08
GBP per EUR	0.84	0.84	0.85	0.86	0.87
SEK per EUR	10.96	11.00	11.00	11.00	11.00
NOK per EUR	11.77	11.65	11.65	11.65	11.65
CHF per EUR	0.95	0.94	0.94	0.94	0.94
BRL per USD	5.77	5.80	5.82	5.82	5.82
INR per USD	86.94	87.53	87.94	87.94	87.94
ZAR per USD	18.13	18.24	18.33	18.33	18.33
RUB per USD	88.90	Temporarily no forecast due to extreme uncertainty			
TRY per USD	36.44	36.93	38.64	39.81	40.70
RMB per USD	7.23	7.28	7.32	7.36	7.40
JPY per USD	147.71	148.00	148.00	147.00	145.00
USD per AUD	0.63	0.63	0.63	0.64	0.64
USD per NZD	0.57	0.57	0.57	0.57	0.58
CAD per USD	1.43	1.43	1.43	1.43	1.43

Outlook KBC markets - Central and Eastern Europe

	Czech Republic			Slovakia		
	2024	2025	2026	2024	2025	2026
Real GDP (average yearly change, based on quarterly figures, in %)	1.0	2.1	2.3	2.0	1.9	2.5
Inflation (average yearly change, harmonised CPI, in %)	2.7	2.4	2.4	3.2	4.1	3.0
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	2.6	3.2	3.1	5.1	5.5	5.5
Government budget balance (in % of GDP)	-2.8	-2.1	-1.9	-5.8	-4.9	-4.5
Gross public debt (in % of GDP)	43.3	44.3	44.7	58.2	59.5	60.8
Current account balance (in % of GDP)	1.8	0.3	0.5	-2.0	-2.8	-2.5
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	4.5	5.4	3.5	3.0	3.0	3.5

	Hungary			Bulgaria		
	2024	2025	2026	2024	2025	2026
Real GDP (average yearly change, based on quarterly figures, in %)	0.6	2.0	3.6	2.6	2.1	2.4
Inflation (average yearly change, harmonised CPI, in %)	3.7	4.7	3.8	2.6	2.9	3.0
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	4.4	4.3	3.9	4.0	3.9	3.8
Government budget balance (in % of GDP)	-4.8	-4.4	-4.2	-2.9	-3.0	-3.0
Gross public debt (in % of GDP)	73.8	73.5	73.0	24.3	26.8	28.0
Current account balance (in % of GDP)	1.5	1.3	1.0	-0.7	-0.9	-1.0
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	12.6	5.5	4.0	15.1	9.7	3.5

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