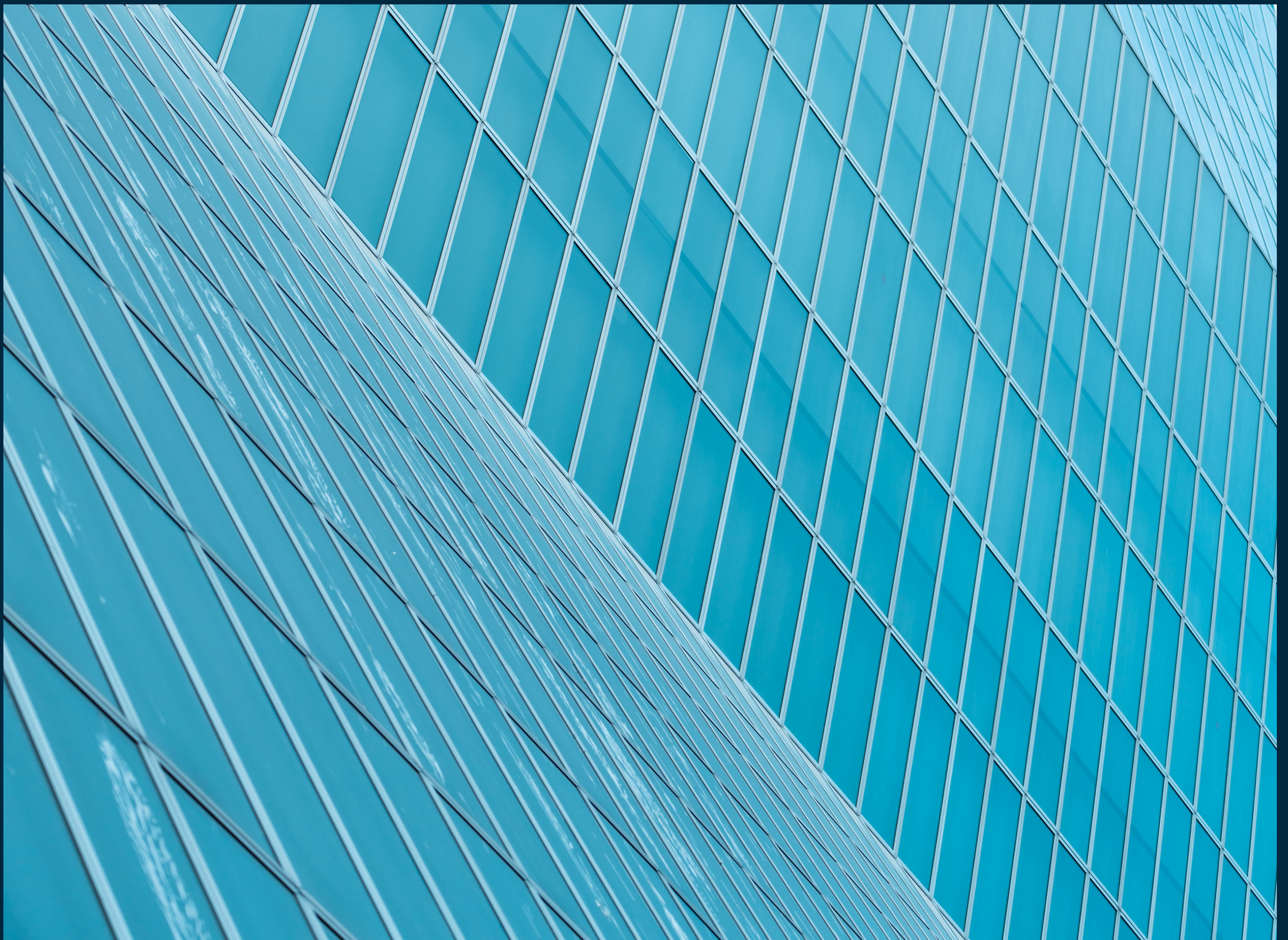
Piermont

Macroeconomic Outlook

H1 2025



Contents

Introduction & Key Economic Indicators 3

Global Economic Outlook 4

Global Economy 5

US 7

Eurozone 8

China 9

Key Conclusion 10

Key Economic Indicators

The Global Economy: on track for strong but uneven growth, a cautionary approach to continued rate cuts throughout the new year, and significant government fiscal policy announcements in the US, UK, and Eurozone.

01

The U.S. Economy continued to signal strength and resilience throughout the last half of 2024. Gross domestic product rose 2.8%, led by consumers, businesses. US economic growth accelerated by more than forecasted in the second quarter, illustrating demand is holding up under the weight of higher borrowing costs. Although we are complimentary to the Fed for gaining towards a win against inflation, we stand we want to underscore that we continue to expect it to center at a higher resting rate in coming years. Our reasoning includes US election results impacts, demographically driven labor scarcity, heightened geopolitics, fragmenting supply chains, and an at-times messy energy transition. As we detail further below, we still expect the 'new normal' is 2.5% core inflation, vs. 1.5% pre-pandemic. i.e., elevated inflation, but not elevated enough to keep the Fed from continued easing as growth slows over the coming quarters. By contrast, we expect the ECB to continue to cut Eurozone rates as started back in August 2024 by 25 basis point cuts on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will be decreased to 3.00%, 3.15%, and 3.40% respectively, with effect from December 18, 2024.

02

Our forecasts for real economic growth are practically unchanged from our 2024 H2 report. However, compared to a month ago, we've revised up our US GDP growth forecast for 2025 by 0.1 pts to 2.6% and expect a further bout of healthy growth over the following two years. Our China growth forecasts for 2025 and to a lesser extent 2026 have also edged higher. The US Gross Domestic Product (GDP) rose 2.8% in 2024, and we continue to anticipate global growth to slow to around 3.2 percent in 2025, well below the historical (2000–19) average of 3.8 percent. We expect robust near-term consumer driven growth in North America, Japan, and parts of Europe.

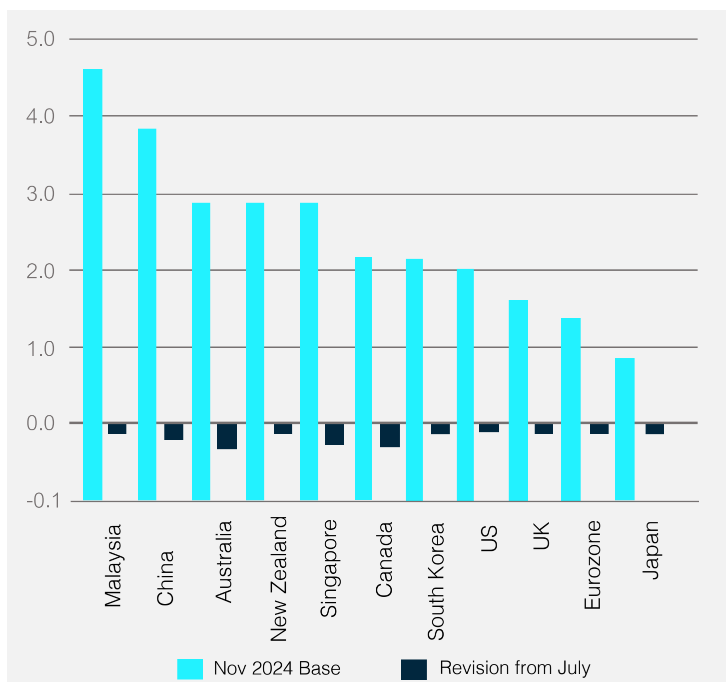
03

We expect global inflation will cool from an average pace of 4.30% in 2024 and 3.5% in 2025. Inflation is expected to decline faster in advanced economies and approach central bank targets throughout 2025 as persistent services inflation gradually dissipates while core inflation stickiness remains a key feature of the outlook across emerging markets. Easing supply constraints, reduced labor shortages, lower energy prices and moderating demand growth are expected to keep inflation in check, even if risks are tilted to the upside. Central banks are expected to ease monetary policy gradually as disinflation continues apace. Still, with risks to the inflation outlook tilted to the upside, policymakers are likely to take the "escalator on the way down," easing policy in a measured way.

The H1 global economic outlook calls for steady but desynchronized growth and gradually looser monetary policy, with growth this year and next holding steady at 3.2 percent.

Figure 1 shows our GDP growth forecasts remain, for the most part, largely unchanged. We identify that the Asia Pacific economies continue to show high potential for stronger growth over developed Western economies. The US has the highest gross government debt of any G7 country, at an estimated $36.19 trillion as of December 18, 2024. This is an increase from the $33.17 trillion in debt at the end of 2023. Japan has current forecast of slowest economic growth with the government currently spending around half of its total tax revenue on servicing its massive debt. Japan's government debt to GDP ratio end of 2024 was is estimated to be 268%. Our analysts project Japan's government debt to GDP ratio is expected to reach 272% by the end of 2025. Growth has also softened in Australia as sticky inflation has dampened consumer sentiment. The UK is faring slightly better as regular wage growth grew by 5.2% in real terms, while total pay grew by 1.6%, term August-October 2024.

Figure 1: Percentage of YoY GDP Growth 2025-2029

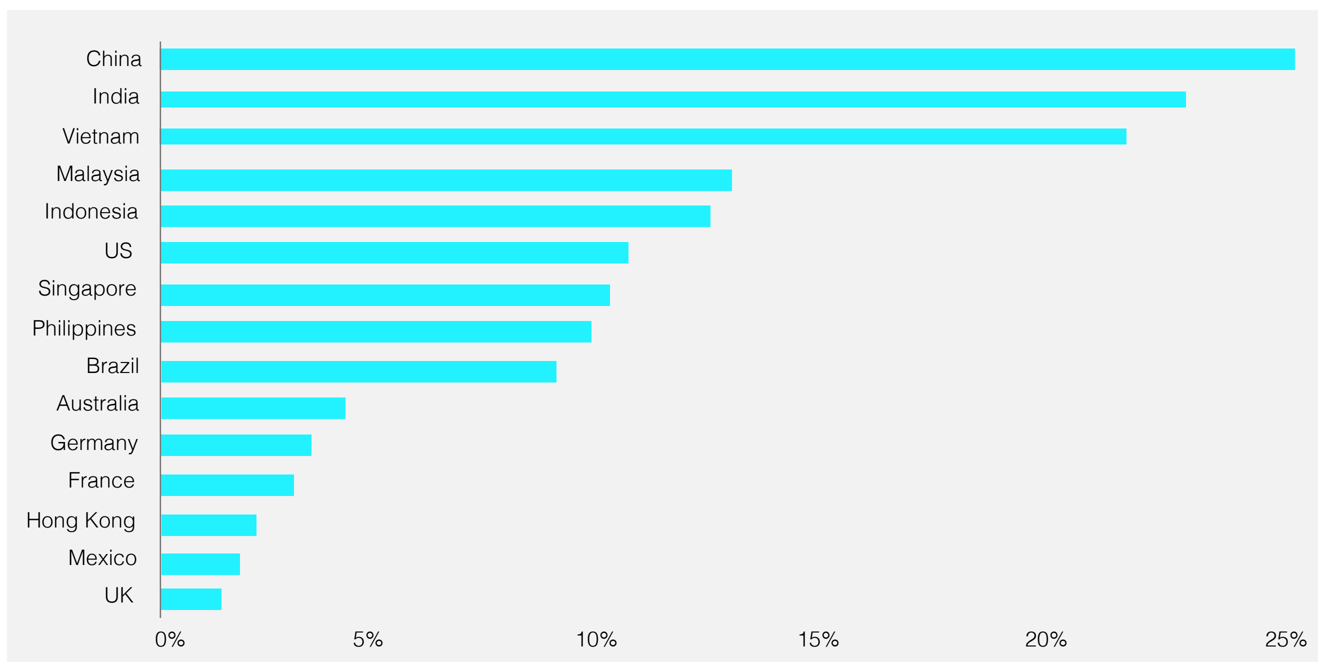


Source: Oxford Economics Forecasting and Piermont.

Global Economy

Within the US, post election data suggests that the Trump White House will inherit a robust economic expansion continuous from the past eight years — although inflation remains above the Federal Reserve's 2% target and there have been some indications of softening in the labor market with US and global consumer prices currently remaining elevated. Early signs point to a further modest acceleration into year-end model, which aimed to estimate GDP in real time, putting US growth at even faster 3.2% rate for Q1. The UK Economy slid Into stagnation in Q4 2024, with economists being right, as they expected the UK to book stagnation or at best anemic growth in the year's final months, suggesting the economy will expand weakly for the year as a whole. Entering the new year, France continues to have a debt problem which could impact GDP per capita growth, but the European Union in aggregate does not. Due to increased policy uncertainty, risks to the global outlook are skewed downward. Unexpected spikes in financial market volatility, like those that occurred in early last August, could make things more difficult financially and hinder growth and investment, particularly in developing nations where significant short-term external financing requirements could lead to capital flight and debt problems. Given China's significant role in international trade, a deeper or longer-than-expected contraction in the country's real estate market, particularly if it results in financial instability, could erode consumer confidence and have detrimental effects on the entire world. On the positive side of the ledger, we are living in a period of remarkable social progress. We now have more concrete proof that artificial intelligence will bring about another positive turning point in the technology/productivity cycle, and in many emerging economies, both GDP per capita and life expectancy are increasing quickly.

Figure 2: Change in GDP Per Capita, 2019 – 2024 %. This GDP per capita indicator provides information on economic growth and income levels from 2019, International US$. Data as of June1, 2024

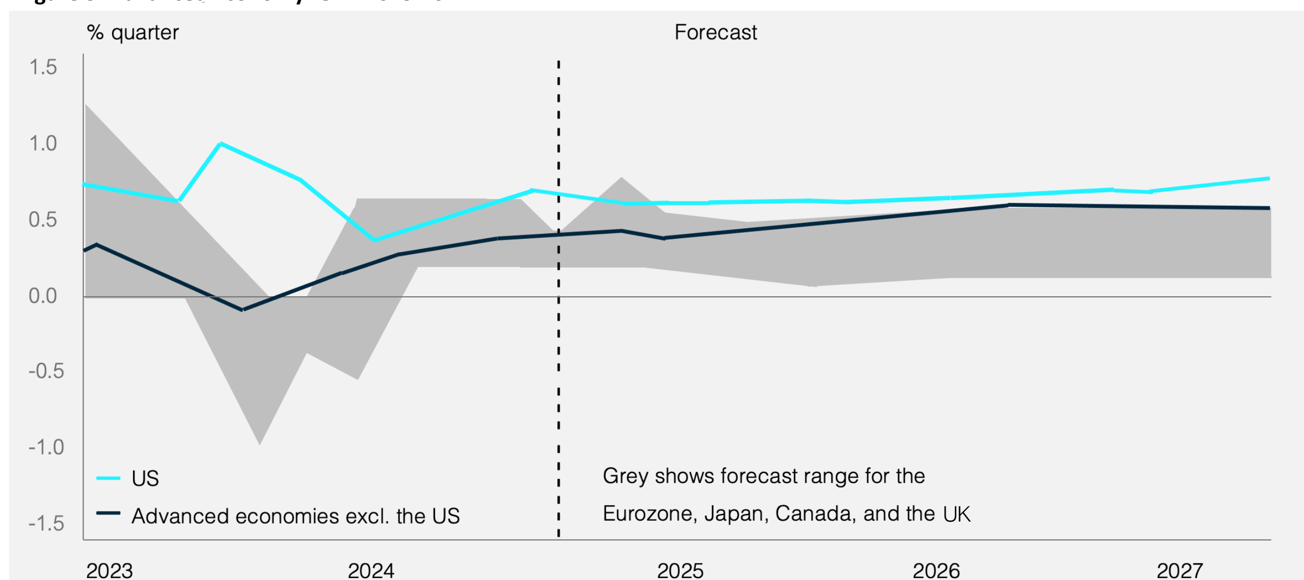


Source: IMF, KKR Global Macro & Asset Allocation analysis, Oxford Economics, Bloomberg, and Piermont Analytics.

Global growth is highly likely to hold steady this year, but beneath the surface the new US administration and China's struggles are set to usher in a new, more mercantilist era for the global economy. Trade disruption, volatility in prices, trade tariffs, and a new policy mix will determine the winners and losers this year.

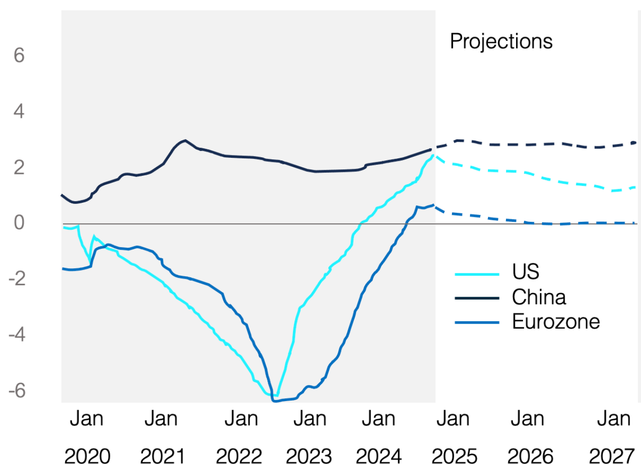
A new and uncertain policy mix as fiscal and trade policy – not monetary – take center stage. Although monetary policy is often the focus of market attention, over the past year or two it has been fiscal policy that has been the major driver of growth surprises. We expect that to continue. Policy rate cuts won't provide much of a boost to growth this year. Crucially, however, we stress that although higher tariffs generally reduce GDP overall, including through headwinds to real consumer spending, capital expenditures, and usually exports as well, there are significant counterbalances to take into account, such as lower import volumes and somewhat easier fiscal policy, since tariff revenue will probably be used to finance tax cuts. According to our best estimate, new tariffs will reduce U.S. GDP by a total of 40 basis points by year-end 2025.

Figure 3: Advanced Economy: GDP 2023-2027



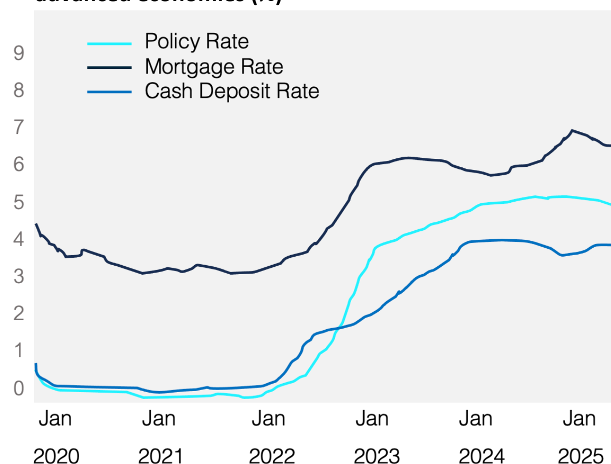
Source: Oxford Economics, Piermont Analytics.

Figure 4: Real policy rate in major economies (%)



Source: IMF, Piermont Analytics.

Figure 5: Median bank lending and deposit rates across advanced economies (%)

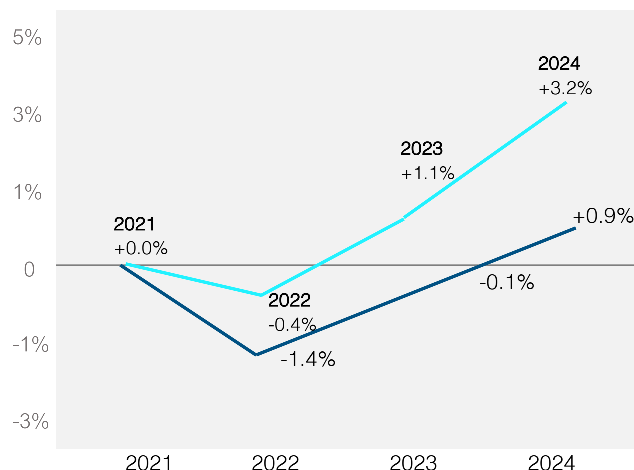


Source: IMF, Piermont Analytics.

US GDP

The US economy is set to outperform other advanced economies this year, according to our above-consensus view on growth. Beneath the surface, five key themes will dominate the narrative as the year unfolds. Increased productivity growth is not a quick fix. Regardless of the new administration's plans, previous immigration will continue to boost labor force growth, maintaining the economy's short-term potential speed limit high. The investment boom isn't over – this year's strong expansion in actual business equipment spending will be supported by company fundamentals. Fiscal dominance writ large - The idea of fiscal dominance will take a different turn in the coming year as the Federal Reserve's capacity to control inflation won't be dominated by the trade and fiscal policies of the Trump administration. Instead, it will make the central bank a price taker when it comes to trade and fiscal policy. Before adjusting monetary policy theory, the Fed will wait for the implementation of fiscal policy, which will receive greater attention than monetary policy. An already advantageous environment for US consumer spending and investment could be supported in the near term by the possibility of looser fiscal policy and regulatory changes. Even though we anticipate that real family income growth in the US would be slower in 2025 than in 2024, this slowing should be minimal because of a little acceleration of employment growth. Additionally, compared to other advanced countries, households' real earnings will continue to grow more rapidly. Thus, as the boost from Chinese investment wanes amid the economy's ongoing challenges, US consumers will continue to be a significant source of growth for the global economy.

Figure 6: Cumulative Income vs. Inflation Growth Since 2021

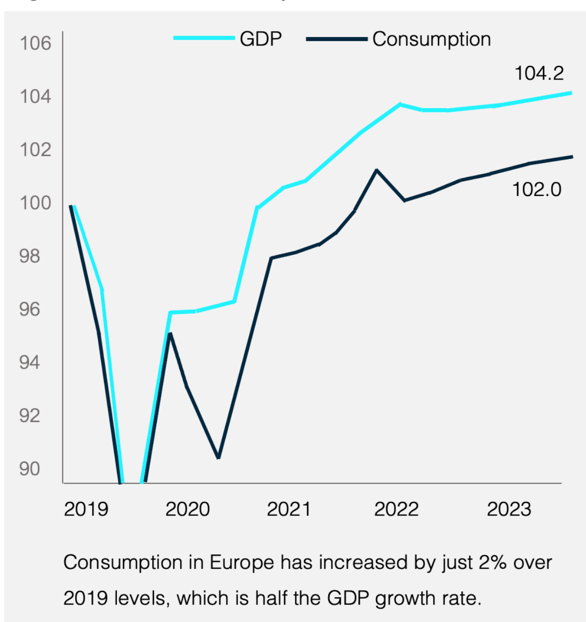


Source: Oxford Economics, Piermont Analytics.

Despite the potential economic danger posed by tariffs, we are actually raising our 2025 GDP forecast by a small margin to 2.5% from 2.3%, which places us much above the 2025 consensus (now at 2.1%). We predict 2% growth in 2026, which is consistent with the consensus. Our quantitative analytics, which do not account for the effect of tariff policy, are even more optimistic at +2.9%, despite the fact that our 2025 fundamental projection is +40 basis points above consensus. In particular, omitting tariffs, our models predict that robust wealth effects and a wide availability of credit will support GDP in 2025–2026, with a slight drag from the effect of high mortgage rates on housing market activity. However, we stress that there are significant counterbalances to take into account, such as lower import volumes and somewhat more lenient fiscal policy, even though higher tariffs do normally reduce GDP overall, notably through headwinds to real consumer spending, capital expenditures, and usually exports as well. Crucially, President Trump demonstrated throughout his first term that he could strategically employ tariffs to improve the United States' negotiation position with other countries, lessen trade imbalances, and accomplish security goals. In a world like this, tariffs are frequently a short-term solution. Additionally, Trump 1.0 cleverly demonstrated that the United States could successfully implement tariffs in industries where alternative products were accessible from foreign markets.

Eurozone GDP

Figure 7: Eurozone consumption vs. GDP since Q4 2019



Source: Eurostar, KKR, Piermont Analytics.

In collaboration with KKR, Goldman Sachs, and MSCI, we are forecasting GDP growth of 0.8% and 1.2% in 2025 and 2026, which is 40 basis points and 10 basis points below consensus, respectively, in comparison to the 0.8% growth in 2024. This ongoing below-trend growth at the Eurozone level conceals a growing gap between the more resilient services and tourism-driven periphery of Spain and Portugal and the slow manufacturing and export-driven core of Germany (30% of Eurozone GDP), which is further exacerbated by the overhang of US tariffs. We anticipate that the eurozone economy will face further difficulties in 2025. First, the imposition of tariffs by President-elect Trump is anticipated to have a substantial negative impact on growth, with increased trade policy uncertainty accounting for a large portion of the drag. Furthermore, persistent structural challenges in the manufacturing sector, such as high energy prices and Chinese competition, are likely to exacerbate the adverse trade effects. Third, we anticipate continued Euro area fiscal consolidation, and that ongoing structural headwinds in the manufacturing sector will amplify the adverse trade effects. Although energy prices have significantly decreased from their peak, gas prices in Europe are still significantly higher than those in the US and above pre-2022 levels. In the meantime, China has become a major rival to the production of goods in Europe, significantly increasing its market share in sectors where costs have gone up. Consequently, we anticipate a persistent structural obstacle to the industrial recovery in the upcoming year, especially in Germany. Policymakers at the European Central Bank made their fourth and final rate cut of 2024 mid-December. Markets priced in another 25-basis-points cut when the ECB's Governing Council makes its first policy decision of the year, according to overnight index swap data. We predict that the unemployment rate will increase this year and reach 6.7% by early 2026 due to our muted growth outlook. By 2025 Q4, we predict that wage growth will have slowed to 3.2% as the labor market softens and pay catch-up is finished. Since the summer, underlying inflation has started to decline again, and by the end of 2025, we expect headline and core inflation to sustainably return to 2%, driven by a further cooling of services inflation. Overall, we project core inflation to hover around three percent in 2025–2026 before settling closer to 2.5 percent over the long run.

There will also be a lot of financial and political risks this year. A change of government in Germany increases the likelihood of a fiscal expansion, but before 2026, we anticipate that the Conservatives will only support a small number of additional fiscal measures that have minimal effects on growth. France will make a strong effort to reduce the deficit, but after July 2025, there may be another legislative election and substantial fiscal deterioration. The government of Italy is probably going to adhere to its aggressive budgetary goals, which will give BTPs a favorable environment. Spain's debt ratio is still declining, despite the fact that the flooding in Valencia is likely to result in a bigger deficit than anticipated.

China GDP

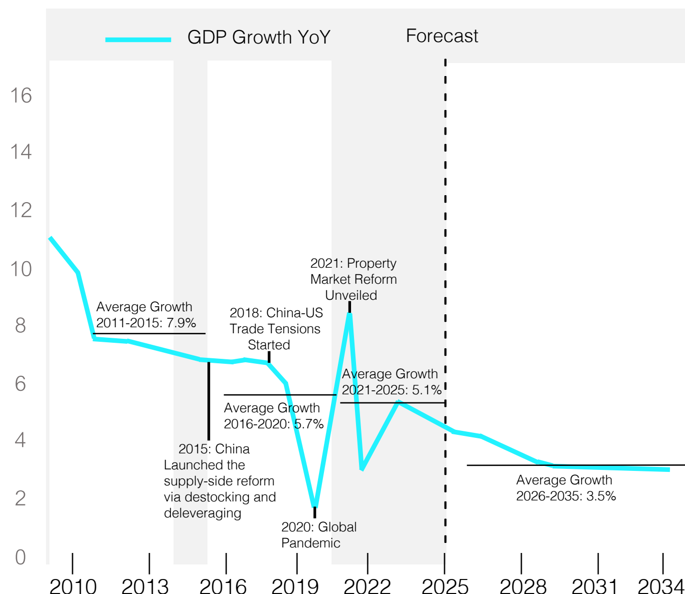
China's economy is expected to expand at a slower pace in 2025 as the government's stimulus plan helps to partially offset the effects of possible US tariffs. It is anticipated that real GDP growth will slow to 4.5% this year from 4.9% in 2024. According to our projection, the incoming Trump administration will raise the effective tariff rate on Chinese goods by 20 percentage points, which would have a 0.7 percentage point negative impact on China's real GDP in 2025. In order to mitigate the effects of tariffs, the prediction also expects that Chinese officials will implement new stimulus.

The only bright light in the Chinese economy this year has been robust exports, which have accounted for 70% of the anticipated headline real GDP growth of 4.9%. The growth of total exports is expected to slow dramatically in the face of much higher US tariffs, even though Chinese exporters may continue to increase their market share in emerging-market nations. Next year, exports' share of real GDP growth could significantly decline. Strong pricing competitiveness and possible currency depreciation would likely contribute to a moderate growth in Chinese exports to non-US nations in 2025, which account for over 85% of China's total exports. Compared to this year, we predicted that China's total products export volume would remain unchanged in 2024, after increasing by 13% last year. China deflationary risks are the biggest concern. We have lowered our headline inflation projection to 0.4% for 2025 because we are still worried that China can enter a deflationary spiral. This is marginally higher than the 0.2% forecast for 2024, which is mostly due to an anticipated increase in food prices. However, it is anticipated that in 2025, core inflation—which provides a more accurate indicator of the domestic demand-supply balance—will slightly decline to 0.01% YoY. In fact, China's GDP deflator has stayed in negative territory for six straight quarters.

China's resilience will be tested in 2025–2026 by both internal and external factors, either to provide a large dose of policy offset or to accept a notably lower headline real GDP growth.

The producer price index, on the other hand, has been declining for 26 months in a row and is more susceptible to changes in domestic prices than the CPI. Asset values are still under pressure to decline, especially in the equity and real estate markets. Although the People's Bank of China (PBoC) is dedicated to reflating the economy through policy rate reductions, these actions have been limited. Additionally, the central bank's balance sheet expansion, which is a vital tool for bringing liquidity into the economy, has slowed to 35% of GDP, down from 38% during the pandemic and far below the pre-Covid level of more than 40%. This cautious strategy emphasizes how difficult it is to provide enough monetary stimulation.

Figure 8: China's GDP growth path over time



Source: Oxford Economics Forecasting and Piermont Analytics.

Key Conclusions

The trends we observe in numerous areas give us hope for the future as we look to the future. To put it another way, we see the glass half full even in the face of increased uncertainty. For instance, at Credit, we believe that absolute rate levels are more important than many investors currently believe. As a result, even while we are concerned about credit spreads overall, we believe that higher nominal GDP in the future will be a significant tailwind for reducing defaults and downgrades in the current cycle, particularly in comparison to the low growth, low inflation environment that characterized the pre-COVID era. On the equity side of the equation, however, we anticipate higher nominal EPS growth in 2025, particularly in the United States. Within Equities, we strongly favor stories about corporate reform (think Japan), domestic consumption (think the US and India), and/or service-based nations (think Spain). Additionally, we think that market breadth across the majority of global equity indexes will benefit from a broadening of earnings, particularly in the United States. Within Investment Asset Management Firms, the focus for 2025 is on financial flows that are backed by tangible assets, such those in asset-based finance, real estate, and infrastructure. Our summary by economies are as follows:

Infrastructure and real estate equity are examples of real assets that appear appealing	Large-cap US Equity returns are likely to be lower	Fixed income returns should be higher on a go-forward basis
Our outlook for Japan's GDP growth this year is one percent, down from the previous estimate of 1.2%	The potential for a trade war 2.0 poses significant downward pressure on China's exports and growth	China has been shifting its policy priorities towards minimizing risk and promoting growth
Eurozone growth to continue at its current sub-trend clip	Spain and the United Kingdom are partially protected from the challenges posed by global trade	Consumption in Europe has increased by just 2% from 2019 levels, or half the GDP growth rate

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