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# Development of the Eurozone – positives partly already priced in

Market Comment, July/August 2025

**Since the beginning of the year, Eurozone equities have enjoyed an upturn that has exceeded the expectations of the market consensus. This is primarily thanks to the lifting of the debt brake in Germany and planned investment spending on defence and infrastructure in the European Union. However, the economic data coming out of the Eurozone has also stabilised recently. Further improvements are anticipated, as indicated by higher European equity valuations. Key factors for economic growth in the Eurozone going forwards will now likely include the final outcome of the US tariff hikes against Europe, the development of private consumption and structural improvements.**

Much has happened in the Eurozone in recent months. This is true not only on the political stage, but also at an economic level. Economic growth has improved compared to earlier periods. For example, GDP in the first quarter of 2025 grew by +0.4% compared to the previous quarter, up from 0.2%, and even showed an improvement of +1.5% relative to the prior year. Private consumption as measured by the retail sector recently increased by +1.3% viewed on a year-by-year basis, marking a considerable improvement compared to the near-zero growth seen a year ago.

Looking ahead, the reform of German fiscal policy could generate additional growth. While the abandonment of the so-called debt-brake will increase government debt, which could push up government bond yields, it will also provide additional economic stimulus. In the short term, i.e. in 2025, the positive contribution to German economic growth may still be modest, but from 2026 onwards, additional annual GDP growth of around 0.5% in Germany and around an additional 0.2% for the Eurozone seems plausible. This is thanks to the combination of higher public spending on military equipment in the EU and infrastructure investments in Germany. Although the increase in the Eurozone's military spending is likely to be lower in the short term than Germany's infrastructure spending, which is planned to amount to EUR 500 billion,

EU military spending is still expected to rise in the medium to long term.

The clearly visible outperformance posted by industrial stocks in Europe over recent months, especially by defence and military stocks, therefore comes as no surprise, as these should benefit in particular from the planned investments. The improvement in the economic data of the Eurozone's industrial sector is thus also understandable. This applies first of all to the "soft economic data", i.e. survey results from companies in the manufacturing industry regarding their expectations for future orders. On the other hand, however, an improvement in the so-called "hard data" on production activity, i.e. in the real economy, can now also be observed in Europe.

**“Inflation in the Eurozone has benefited in recent months from the stronger euro against the US dollar.”**

Gérard Piasko, Chief Investment Officer

Nevertheless, caution is warranted, as the final extent of the US tariff increases on the European Union is still not set in stone and the information landscape in this regard remains subject to change. The increase in the valuation of equities in the Eurozone, and in Germany in particular since the beginning of the year, also shows that much of the expected improvements in corporate earnings has already been priced into the equity markets. There are still structural problems and uncertainties in the automotive sector, which is important for some European countries, not least due to the extremely aggressive Chinese competition for electric cars. The importance of the euro exchange rate must also be noted. Should the euro become too strong, especially against the US dollar or Asian currencies, it could dampen the momentum of EU exports.

Inflation, on the other hand, has benefited in recent months from the stronger euro against the greenback, as

well as from falling energy prices, especially declining oil prices. This is allowing the European Central Bank to continue lowering key interest rates. However, some members of the European Central Bank are warning against cutting interest rates too quickly, as they first want to observe the impact of the change in US trade policy.

Conclusion: following the stabilisation of economic data in the first and second quarters, a further economic improvement in the Eurozone over the remainder of the year would not come as a surprise, provided that US tariff increases do not prove to be excessive. In this respect, a certain degree of economic uncertainty remains for the time being – as well as in the relationship between Euro-

pean countries and China. This shows that while not everything in Europe will keep reaching for the sky, a partial recovery in relative valuations compared to US equities is understandable.

Gérard Piasko

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