Weekly Economic Brief

14 March 2025 | Principal Economist's View

The global economy is not just the United States

Germany embarks on a dramatic shift in fiscal policy

With further US tariffs coming on-line during the week, this time the 25% tariffs on steel and aluminium imports, it is easy to get swept away by the rapid shake-up of the global trading system emanating from Washington. However, it is important not to conflate the US economy with the global economy.

Yes, the US remains the world's largest economy (based on 2024 market exchange rates), accounting for around 27% of global GDP. But together, the European Union (18% of global US$ GDP) and China (17% of global US$ GDP) comprise a larger share. While headwinds from the US continue to build, last week we saw Chinese and European policymakers announce more supportive fiscal policy settings.

The news from China's National People's Congress was largely as expected. China's 2025 real GDP growth target was unveiled at 'around 5%' the same as seen in 2024, and the official budget deficit target was increased from 3% of GDP in 2024 to 4% of GDP in 2025. Total government bond net issuance (including special government bonds) will be stepped up from a target of RMB 9 trillion in 2024 to RMB 11.9 trillion of GDP in 2025, an increase worth around 1.8% of GDP. Although we remain sceptical that authorities will hit their 2025 growth target given both the property market and tariff headwinds facing China, the stimulus measures will help underpin activity and we retain our forecast for real GDP growth to average around a 4½% pace in 2025.

More importantly for the global economy have been signs of a fundamental change in fiscal policy in the EU and Germany. The EU is clearly responding to the shifting geopolitical environment caused by the new US administration and the freezing of US military aid to the Ukraine. The European Commission has unveiled an €800 billion plan to boost defence spending over the next four years and activate an 'escape clause' so that it doesn't fall foul of EU budget rules. Boosting EU defence spending will not only allow the region to be less reliant on US security support, but will also help stimulate the economy, with the plan worth around 1.1% of annual EU GDP.

An even more seismic shift is occurring in Germany following the recent national elections. New Chancellor-elect Friedrich Merz has unveiled a plan to reform the constitutional debt brake – a rule that has ensured prudent fiscal policy settings in Germany by limiting the structural budget deficit to 0.35% of GDP, but that has constrained the ability of the government to stimulate the economy and respond to the shifting geopolitical environment.

Under the German fiscal plan, defence spending in excess of 1% of GDP will be exempt from the debt break rule. With defence spending in 2024 around 2% of GDP, this reform will provide immediate fiscal space worth 1% of GDP that can be used to fund increased spending or tax cuts elsewhere in the economy. The fiscal boost is likely to build over time, with Germany expected to gradually increase defence spending towards 3% of GDP. The Chancellor-elect has also outlined a new €500 billion infrastructure fund to be spent over the next decade (1.2% of GDP p.a.) and proposed to increase state government borrowing caps from 0% to 0.35% of GDP.

These more stimulatory fiscal settings from Germany will drive a much-needed turnaround after the economy contracted modestly in 2023 and 2024. The proposals are being rushed through the outgoing German parliament, with the composition of the new parliament, including the far-right AfD and The Left, likely to block the two-thirds majority required to pass the debt brake and infrastructure fund legislation.

While the disruption caused by President Trump is causing a rapid shift in international trading relationships, it is also galvanising other countries to increase defence spending and pursue more stimulatory domestic fiscal policies. Although these shifts will not offset the headwinds from the US, they should help provide an important partial counterbalance for global economic growth over 2025 and 2026.

Table 1: Financial market movements: 6 - 13 March 2025

EQUITY INDEX	LEVEL	CHANGE	10-YR GOVERNMENT BOND	YIELD	CHANGE	FOREIGN EXCHANGE	RATE	CHANGE
S&P 500	5,521.5	-3.8%	US	4.27%	-1.0 bps	US Dollar Index (DXY)	103.83	-0.2%
Nikkei 225	36,790.0	-2.4%	Japan	1.55%	0.6 bps	USD-JPY	147.81	-0.1%
FTSE 100	8,542.6	-1.6%	UK	4.68%	1.7 bps	GBP-USD	1.295	0.5%
DAX	22,567.1	-3.6%	Germany	2.86%	2.2 bps	EUR-USD	1.085	0.6%
S&P/ASX 200	7,749.1	-4.3%	Australia	4.42%	-6.5 bps	AUD-USD	0.629	-0.8%

Source: Bloomberg

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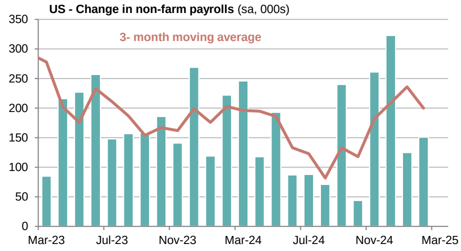
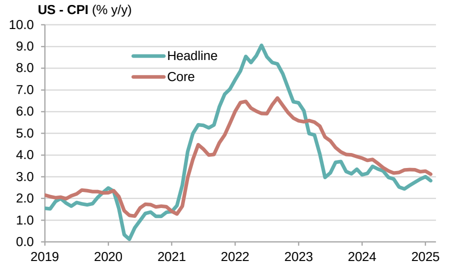
Economic update by region

United States/Canada

US labour market remains robust

- The February labour market print was solid, with non-farm payrolls increasing by 151k over the month. While federal government payrolls did fall 10k over the month, the majority of the layoffs from the Department of Government Efficiency's push to downsize the federal bureaucracy are expected to appear in the March print. The unemployment rate ticked up from 4.0% in January to 4.1% in February.
- After a picking up significantly during January, the CPI was far more benign in February. Over the month, headline CPI rose 0.2% (down from 0.5% in January), while core CPI also rose 0.2% (down from 0.4% in January). The year-ended rate of headline inflation declined from 3% to 2.8% in February, while core inflation moderated from 3.3% to 3.1%.
- The Governing Council of the Bank of Canada (BOC) chose at its March meeting to cut its policy rate by 25bps to 2.75%. The Council indicated that an easing of monetary policy was justified as inflation had returned to near the Bank's 2% target and that the heightened uncertainty from the potential trade war with the US was threatening the economic recovery. The BOC did not give guidance as to how they would respond to a trade war noting that there were both downside risks to inflation from a negative growth shock and upside risks from higher costs.

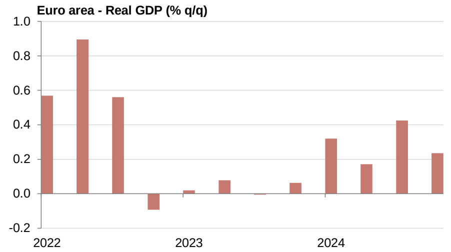




Euro area/United Kingdom

Euro area GDP revised up again

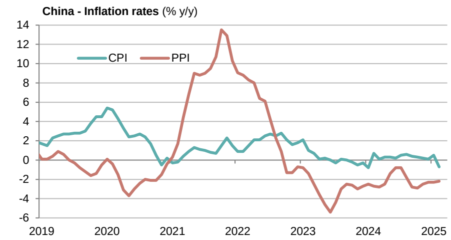
- Euro area real GDP growth for the December quarter was revised up from 0.1% to 0.2%.



China/Japan

China's consumer prices return to deflation

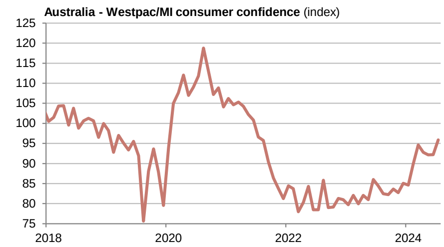
- China's year-ended rate of headline inflation moved down from 0.5% in January to -0.7% in February. This size of the shift into deflation was primarily due to differences in timing between lunar new year celebrations in 2024 and 2025. While this effect may have exacerbated the February outturn, the average over January and February has fallen into deflationary territory at -0.1%. The producer price inflation rate was little changed in February and remained solidly in deflationary territory (-2.2% from -2.3%).
- Japanese real GDP growth for the December quarter was revised down from 2.8% to 2.2% on a quarterly annualised basis (qsaar).



Australia/New Zealand

Australian consumer confidence improves in wake of rate cut

- The Westpac/MI consumer sentiment index rose 3.7 index points over March to a level of 95.9. While the index remains in pessimistic territory this is its highest level since March 2022. The February interest rate cut combined with easing cost of living pressures have improved consumers' outlook.
- The NAB business confidence index fell 6.1 index points in February to a level of -1.5, reversing January's rise and returning the index to below the long-term average. Capacity utilisation edged down by 0.1 points to 81.9 in February continuing its trend of slow decline since it peaked at 86 in July 2022.



Sources: Refinitiv, QIC