Quarterly Macro Report – 1st Quarter 2025

The global business cycle remains out of synch. While China and Europe are struggling, the US continues to grow at a healthy pace. Inflation continues to be stubbornly too high.

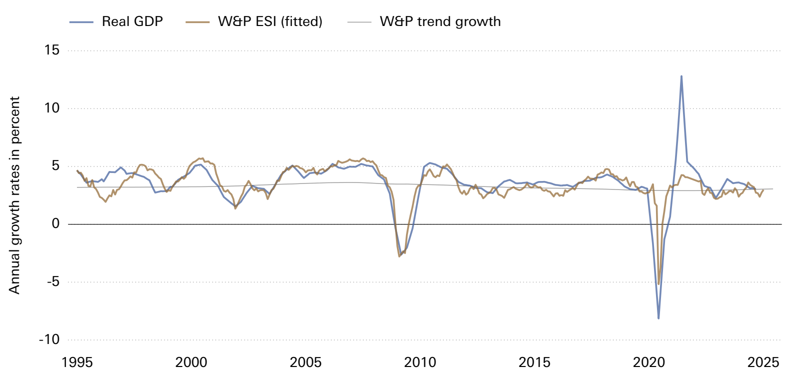
The world economy continues to present a complex picture. On one hand, the global goods cycle remains sluggish. Despite adjustments for overconsumption of goods during the post-Covid expansion, industrial production has yet to rebound. Consequently, industrial sentiment remains gloomy, and countries with significant industrial sectors, like China and Germany, are struggling to regain growth momentum. On the other hand, global demand for services remains robust, preventing most countries from slipping into outright recession or supporting growth as in the service-heavy US economy.

Low long-term interest rates have supported growth...

In this environment, low capital market interest rates have played a crucial role in bolstering demand. For industrial economies, this has meant that real estate investments remain attractive, and construction activities are relatively inexpensive to finance. Consumers have also benefitted from low debt financing costs and high asset prices.

However, this is now threatened by the recent stubbornness of inflation to recede further. Contrary to consensus expectations, both the US and Europe have experienced stagnation in core inflation and increases in total inflation numbers in recent months. The primary culprit remains high wage growth, which in some countries is the result of a catch-up move following unexpectedly high inflation post-Covid. In many Western countries, this also reflects the combined impact of deteriorating demographics and, more importantly, changed work attitudes within the labor force. Increasingly, employees are seeking to work fewer hours and days, a shift in preferences that could lead to significant wage pressures for some time.

Fig. 1: Economic sentiment in the industrialised countries



Economic sentiment in industrialised countries remains cautious but has gained a little momentum in recent months. Still, corporations expect to see less growth than has materialized so far. Thus, a small set-back could make a big difference in their willingness to invest.

Source: LSEG, Wellershoff & Partners

...but recent increases threaten the global cycle.

The persistence of stubborn inflation raises questions about whether central banks have cut interest rates too early or too quickly. The markets seem to have started to respond to this worry by scaling back expectations for rate cuts and by increasing capital market rates, which now start to threaten some of the supporting factors for global growth. During the coming months, we will have to watch in particular construction activity in the US to get a better understanding as to how fast growth there will decelerate.

“Inflation should have declined significantly in Europe, which is teetering on the brink of a recession.”

Still, we should not over-dramatize this situation. Weaker demand will eventually dampen inflationary pressures, and the rise in capital markets is thus self-limiting. However, the consequences for financial markets could still be significant, at least in the short term. As markets often overlook, it is the capital market rates, not the money market rates, that are relevant for valuations.

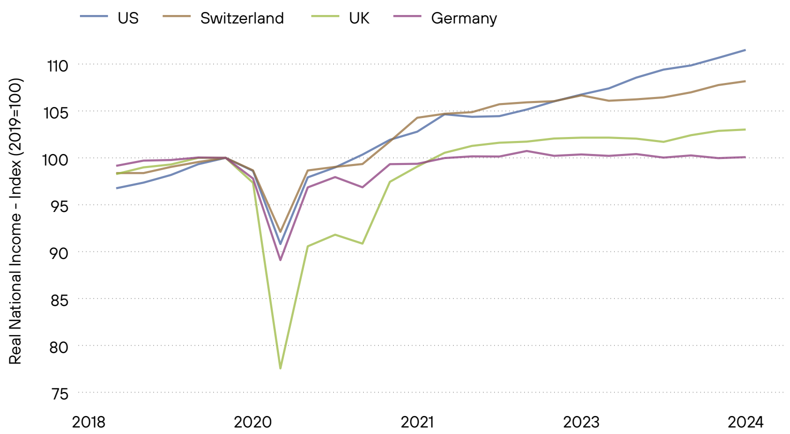
Furthermore, we should not forget that in major economies like China and the US fiscal policy will be rather supportive for growth. Both economies should see rising deficits this year, which will support domestic demand. We thus remain constructively optimistic about the economic outlook, although this is contingent on recent political developments not escalating. The inauguration of President Trump as well as his initial political actions will provide some clues about what to expect in terms of trade policies from the US. Here, too, we remain optimistic that it is in the best interest of all countries involved to facilitate a benign development.

Table 1: Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	**2024*E***	**2025*E***	**2024*E***	**2025*E***	**Q1 2025**	**y/y 01/2025**
USA	1.8	2.8	2.4	2.5	2.5	4.50	2.2
Eurozone	1.1	0.8	1.3	2.4	2.4	3.00	1.8
UK	1.7	0.9	1.7	2.6	2.8	4.75	0.6
Switzerland	1.3	1.3	1.5	1.1	0.8	0.50	–1.1
Japan	1.1	–0.3	1.3	2.6	1.9	0.25	1.4
China	4.5	4.3	4.5	0.5	1.0	4.35	–3.7
Brazil	1.4	1.5	1.5	3.5	3.2	12.25	8.9
India	5.0	5.8	5.5	4.5	4.2	6.50	9.4
Russia	1.0	1.5	1.0	6.2	4.5	21.00	1.4
World	3.0	2.8	3.1	4.2	3.8	–	–

Source: LSEG, Wellershoff & Partners

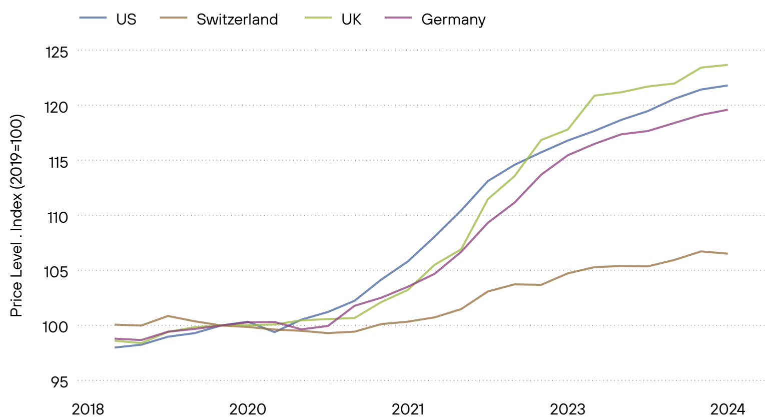
Fig. 2: National income since Covid



Levels of national income (GDP) have seen quite some divergence since Covid. While the US and Switzerland have provided rising prosperity, the UK and Germany have struggled to make any progress in recent years.

Source: Federal Reserve Bank of St. Louis, Wellershoff & Partners

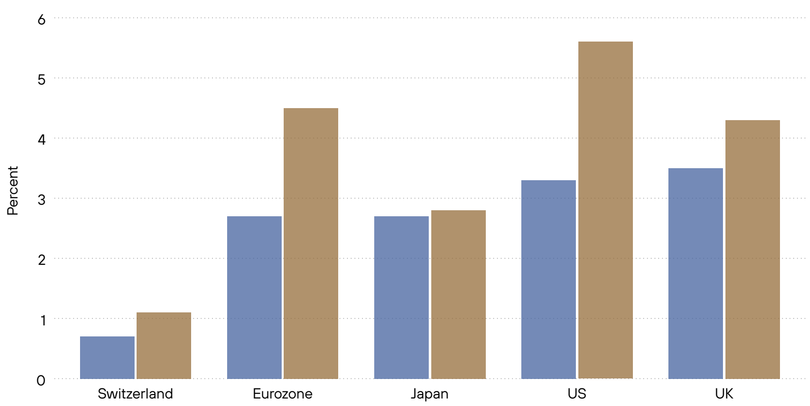
Fig. 3: Consumer prices since Covid



Levels of consumer prices have risen sharply in Europe and the US since Covid. On average households have to pay 20 percent higher prices for their standard basket of consumption. Only Switzerland has provided true price stability over this period. This is the main reason for the strength of the Swiss Franc.

Source: OECD, Wellershoff & Partners

Fig. 4: Core and wage inflation



Inflation has been not only an issue in recent years, it seems that inflation will continue to remain an issue. In most industrialised economies inflation is well above its target level. At the same time, wage inflation is even higher, which means that companies will face the bitter choice to either lose on the margins or to raise prices even further.

Source: Federal Reserve Bank of St. Louis, Wellershoff & Partners

Capital Market

Renewed concerns about inflation have pushed long-term interest rates higher over the past quarter. Inflation has proved to be persistent worldwide, with core inflation rates remaining well above central bank targets. In the U.S., this has led to a sharp rise in the yield on 10-year government bonds, increasing from around 3.6% in September to 4.6% at the end of the year.

Yield curve inversions have moderated in recent months, reflecting adjustments in market expectations. In the United States, short-term interest rates decreased by 50 basis points, while long-term rates rose by 80 basis points. By contrast, in the euro area, long-term rates rose more modestly, resulting in a yield curve that remains inverted, reflecting ongoing challenges in the region's economic outlook.

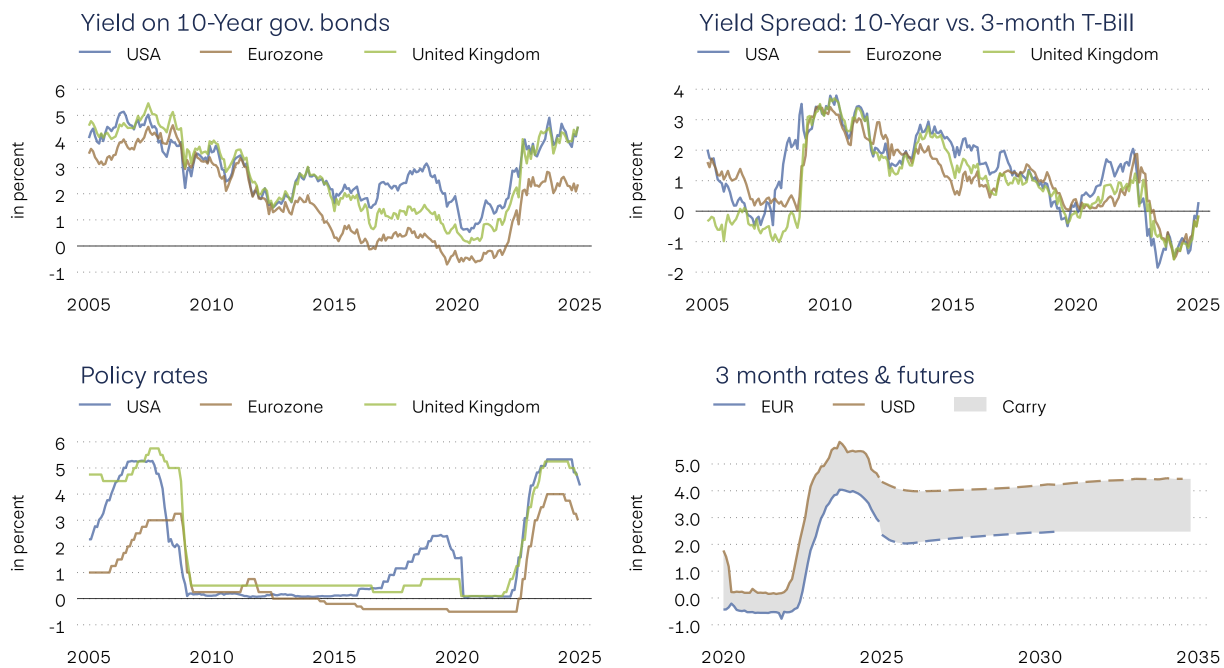
> "Markets are counting on inflation remaining elevated, driving global long-term yields higher."

Divergence in rate outlook persists. As widely expected, the Federal Reserve lowered their federal funds target rate by 25 basis points at its mid-December meeting but signaled a more cautious approach going forward. The Fed emphasized its reluctance to cut rates too quickly, citing potential inflationary risks associated with the Trump administration's proposed trade tariffs. This led to a significant repricing of rate cut expectations for 2025, with market participants now anticipating one to two fewer rate cuts than previously expected.

In the eurozone, the path of monetary easing is expected to remain more accommodating than in the U.S. Ongoing political instability and a subdued economic growth outlook continue to weigh on market sentiment. As a result, markets have priced in a full percentage point of European Central Bank (ECB) rate cuts by 2025, despite inflation remaining stubbornly high.

In summary, the past quarter has shown a shift in the yield curve with market participants adapting to persistent inflationary pressures. Consequently, long-term capital market rates remain elevated.

Fig. 5: Money market and capital market interest rates



Source: LSEG, Wellershoff & Partners

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