Economic Perspectives

UBB
Part of KBC Group

April 2025

Highlights

- On 2 April, Donald Trump dramatically escalated the ongoing trade war. He announced a 10% tariff on all imports (going into effect on 5 April). On top of that, several countries will be hit by reciprocal tariffs (going into effect on 9 April). The EU will face a 20% tariff in total, while China will face a 54% tariff in total. USMCA-compliant imports will notably be exempt from the reciprocal tariffs. Other products which will reportedly be exempt from these reciprocal tariffs are pharmaceutical products, semiconductors, lumber, copper, gold, and energy resources and select minerals not found in the US. However, given the volatile nature of US trade policy, the list of exemptions can change rapidly.

- Oil prices increased slightly in March to 74.7 USD per barrel. In early March, prices dipped as OPEC+ confirmed its plan of increasing production from April onwards. However, the breakdown of the Gaza ceasefire along with military escalations in Lebanon, Syria and Yemen pushed prices back up. European gas prices dropped in March by 9% to 40 EUR per MWh. The drop was mostly weather-related and happened despite unfavourable developments in the Ukraine peace negotiations. After the 2 April tariff announcements, energy prices dropped significantly.

- Germany's decision to amend its constitution to increase military and infrastructure spending, along with the EU's ReArm plan will exert an inflationary effect as it could exacerbate existing (but gradually easing) shortages of labour. We therefore upgrade both our 2025 and 2026 euro area inflation forecasts by 0.1 percentage points to 2.6% in both years. The upgrade comes despite the recent favourable inflation evolutions in the euro area. Headline inflation in the euro area declined from 2.3% to 2.2% in March, while core inflation declined from 2.6% to 2.4%.

- Increased military and infrastructure spending will boost euro area growth in the medium term. Especially the latter has an elevated multiplier, as it boosts productivity. We expect a more modest impact from increased military spending, as this type of spending risks crowding out other investments and consumption and/or has a smaller impact on overall productivity. Increased spending could also provide a necessary boost in economic confidence. These effects are expected to impact the medium-term growth outlook. In the near term, elevated uncertainty and increasing tariffs are likely to weigh on growth. We thus upgrade our 2025 forecast from 0.8% to 0.9% and our 2026 forecast from 1.0% to 1.2%.

- In contrast to US CPI inflation, PCE inflation was relatively strong in February. PCE inflation stayed constant at 2.5%, while core PCE inflation increased from 2.7% to 2.8%. Other inflation data were more favourable. Producer prices were unchanged in February month-on-month, while forward-looking indicators on rents and used cars and trucks were quite soft. Given the favourable February data and softening energy inflation, we downgrade our CPI inflation forecast from 3.4% to 3.2% for 2025 and from 3.0% to 2.9% in 2026.

- The US economy (and growth outlook) is being hit by tariff uncertainty. Consumption remains sluggish, while inventory growth is mild. Most notable are the recent large deficits in the goods trade balance (though this can be partly explained by large imports of monetary gold). Consumer confidence is also plunging, though producer confidence indicators and employment growth remain decent. We maintain our forecast of below-potential growth of 1.8% in both 2025 and 2026.

- The intensifying trade war has spurred the Chinese government into action. In March, the government unveiled a 30-point plan to boost consumption. This is a much-needed step to help achieve its 5% growth target. It will also help to stave off the risk of deflation, as CPI-inflation declined on a year-on-year basis in February. On growth, we upgrade our forecast for 2025 from 4.5% to 4.7% and for 2026 from 3.9% to 4.1%. On inflation, we downgrade our 2025 forecast from 0.8% to 0.6%, while upgrading it for 2026 from 1.7% to 1.9%.

- Tariff uncertainty is pushing the Fed to adopt a wait-and-see mode. It kept rates on hold in March, while upgrading its inflation forecast and downgrading its growth forecast. We expect this wait-and-see mode to continue in Q2 and only expect a rate cut in Q3, followed by another one in Q4. In contrast, we expect the ECB to keep its rate cutting cycle going by implementing another rate cut at the April meeting. That would be the last one of this cycle, according to our expectations.

Global Economy

American isolationism is spurring governments across the world into action. This is especially the case in Germany, where the lower US commitment to NATO triggered an unprecedented fiscal response. This consisted of an amendment of the German constitutional debt brake, allowing for increased infrastructure and military spending. This is a truly historic shift away from Germany's previously fiscal austerity stance. This change, in combination with the EU's ReArm plan, will boost European confidence and provide a welcome positive demand shock to Europe's sluggish economy. Moreover, on the supply side, the planned additional infrastructure investments in particular are also likely to raise European potential growth in the medium term. China is also reacting to US tariffs by providing a much-needed fiscal boost to support internal demand. The government recently unveiled a 30-point plan, allowing its economy to shift from a more export-led economy to a more consumption-led economy.

Back in the US, on 2 April, the so-called "Liberation Day", Donald Trump ramped up the trade war. He announced a 10% tariff on all imports (going into effect on 5 April). On top of that, several countries will be hit by reciprocal tariffs (going into effect on 9 April). Asian countries will be particularly hard hit. China faces a total 54% tariff (close to our working assumption of 60%), while India and Japan will face tariffs of 27% and 24% respectively. South-East Asian countries such as Cambodia, Laos and Vietnam face tariffs close to 50%. The EU will face a 20% tariff in total, while the UK faces no reciprocal tariffs. USMCA-compliant imports will notably be exempt from the reciprocal tariffs, making the hit on Canada and Mexico somewhat smaller than anticipated. Other products which will reportedly be exempt from these reciprocal tariffs are pharmaceutical products, semiconductors, lumber, copper, gold, and energy resources and select minerals not found in the US. However, given the volatile nature of US trade policy, the list of exemptions can change rapidly. Aluminium and steel products, automobiles, and auto components are also exempt, as they already face 25% tariffs. For now, we keep our working assumptions unchanged as we wait for negotiations and retaliation to play out. We see permanently higher tariffs as an upside risk for inflation and a downside risk for growth, however.

Energy markets overshadowed by geopolitical developments

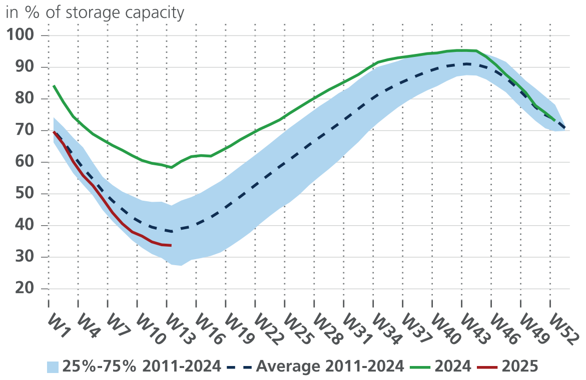
Oil prices remained broadly stable in March, reaching 74.7 USD per barrel end of March. Oil prices dipped in early March as OPEC+ confirmed its plan of increasing production from April onwards. It will increase production gradually and flexibly up to 2.2 million barrels per day over the next 18 months. However, geopolitical tensions in the Middle East pushed oil prices back up. Indeed, the end of the Gaza ceasefire along with Israeli military operations in Lebanon and Syria and US strikes on Houthi targets in Yemen, re-ignited fears of a wider Middle East conflict. That said, so far the reaction in the oil markets has been relatively mild, as the market is well supplied.

Gas prices dipped slightly in March (by 9% to 40 EUR per MWh). The decline happened despite unfavourable evolutions in the Ukraine peace negotiations. As Vladimir Putin refused to agree to a full ceasefire and is driving a hard bargain, betting markets now also see only 9% chance of Trump ending the war in his first 90 days as president. The fact that gas prices did decline was mostly weather-related. Continued mild winter weather conditions in Europe reduced gas consumption and limited withdrawals from EU gas reserves (see figure 1). Gas reserves still remain below historical averages, however.

German parliament passes historic fiscal package

On 18 March, the Bundestag (Germany's federal parliament) adopted the landmark fiscal package announced earlier. A few days later, on 21 March, the plan was also greenlighted by the Bundesrat (the legislative body that represents the 16 Länder). The country's constitutionally enshrined fiscal rules were amended as follows: (1) A new debt-financed infrastructure fund worth EUR 500 bn was created for a period of 12 years. The fund will be available for additional spending, i.e., investments in excess of a 'normal' investment rate of an estimated 10% of government spending. Of these EUR 500 bn, a EUR 100 bn will be earmarked for the disposal of states and local governments and another EUR 100 bn will be added to the existing Climate and Transformation Fund; (2) The constitutional debt brake rule was amended in the sense that any defence spending in excess of 1% of GDP is not taken into account when applying the debt brake; (3) From now on, the states (Länder) are allowed to run a deficit of 0.35% of structural GDP as well, as is already the case for the federal government.

Figure 1 - EU gas reserves
in % of storage capacity



Source: KBC Economics based on Gas Infrastructure Europe (GIE)

The plan signals a historic shift in fiscal policy and will dismantle decades of budgetary constraint in Europe's biggest economy. It will increase the fiscal capacity for the German general government by some 3% of GDP of fiscal spending, or higher depending on defence spending. The new fiscal capacity is composed as follows: (1) On the assumption that the EUR 500 bn investment fund will be spread over 12 years, this amounts to EUR 42 bn (i.e., about 1% of GDP) per year; (2) The extension of the structural deficit allowance to states brings the overall average deficit margin for the general government to 0.7% of GDP, adding 0.35% of GDP; (3) On the assumption that defence spending will increase from currently about 1.8% of GDP to 3.5% of GDP per year, this adds 1.7% of GDP to general government spending. Potentially 0.3% can be added to the general 'debt brake-relevant' budget and can lead to additional new government spending.

On top of the German plan, there is additional fiscal space for EU defence spending. On 19 March, the European Commission (EC) published its Joint White Paper for European Defence Readiness 2030, ahead of the EU Council meeting held on 20-21 March. The paper provides more details on the ReArm Europe plan (EUR 800 bn for defence investments, or 4.5% of EU GDP in total) announced earlier by EC President Ursula von der Leyen on 4 March. Amongst other things, it outlines concrete legal and practical aspects on the EU's new EUR 150 bn SAFE instrument ('Security Action For Europe', i.e. loans backed by the EU budget). With regard to what national governments could additionally generate on defence (a total estimated at EUR 650 bn), it was mentioned that countries wanting more fiscal space will be able to deviate from the EU budgetary rules for more than four years, through the national escape clauses in the SGP.

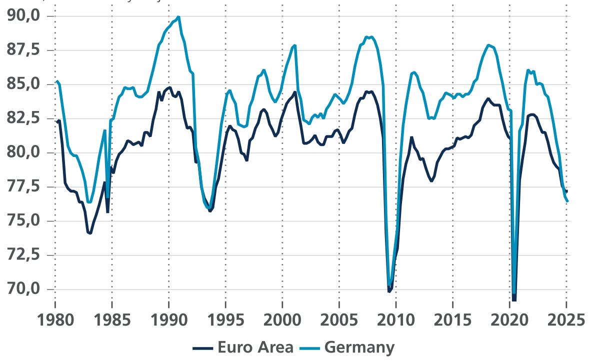
Economic impact for the euro area

Assessing the impact of Germany's reform and Europe's ReArm plan on GDP growth is not straightforward, as it not only depends on the amount spent but also on the so-called 'fiscal multiplier' (i.e., the change in GDP arising from a 1 euro increase in government expenditure). The latter varies according to what the additional money is spent on. Most studies see the multiplier for general infrastructure spending higher than the one for military spending, which is often pegged at (well) below 0.50. In practice, the size of the multiplier may vary because of various factors, e.g. whether or not countries finance the spending by cutting elsewhere, to what extent (defence) orders 'leak', i.e. go to imports, etc. Timing issues play an important role as well. Because of capacity and implementation constraints, it may take time for the additional spending on infrastructure and defence to take effect.

Our analysis suggests that the impact of both impulses on euro area growth will initially be slow and incremental over time. For Germany, the impact might come sooner and should overall be bigger in the end. In 2025, maximum half of the additional (more than) 3% spending in Germany (see above) is still plausible, due to the still ongoing government formation and implementation lags. However, to compensate as much as possible, defence procurements and infrastructure projects are likely to be frontloaded and fast-tracked in terms of planning approvals. In our updated scenario, we see a boost from the additional spending to German GDP growth of 0.1 percentage points in 2025 and 0.5 percentage points in 2026. For the euro area, we think spillovers from the German stimulus combined with extra military spending (both SAFE and at the national levels) could lift GDP growth up by 0.05 percentage points in 2025 and 0.2 percentage points in 2026. As a result, we changed the outlook for euro area growth to 0.9% in 2025 and 1.2% in 2026. The benefits from the stimulus are expected to last after 2026, with (hopefully) meaningful effects on medium-term potential growth as well.

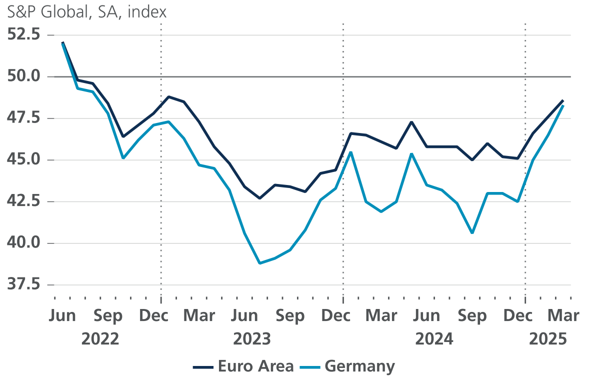
If fast and massive spending were applied to capacity-constrained manufacturing and building industries, this could also impact inflation. We think the inflationary pressures from the higher spending are likely to be relatively soft, however. Lower demand has forced industrial firms to keep capacity utilisation low in recent quarters. At just 77% in Q1 2025, the capacity utilisation rate in both Germany and the euro area is currently at levels previously only seen in crisis periods (see figure 2). With a still negative output gap, Germany in particular has room at the macro level before broader capacity constraints translate into wider inflationary pressures. All in all, we now see annual euro area inflation slightly (i.e., 0.1 percentage points) higher at 2.6% in both 2025 and 2026. Meanwhile, headline inflation in the euro area fell to 2.2% in March, from 2.3% in February. Core inflation, excluding energy, food and beverages, declined to 2.4%, continuing its downward trend.

Figure 2 - Capacity utilisation in manufacturing
in %, seasonnally adjusted



Source: KBC Economics based on Eurostat

Figure 3 - Manufacturing PMI
S&P Global, SA, index



Source: KBC Economics based on S&P Global

We acknowledge that the updated euro area scenario is still surrounded by significant uncertainty, with the biggest downside risk coming from the recently announced 20% tariffs on EU imports and potential retaliation. On the upside, the shift in German and EU policies could support euro area growth more than expected via the confidence channel. The latest sentiment indicators (e.g., the German ifo Business Climate Index as well as Manufacturing PMIs) already showed a cautious improvement for the manufacturing industry (see figure 3). That said, the latest survey was conducted before US President Trump announced 25% import tariffs on cars and car parts, which will hurt European car manufacturers. Meanwhile, services sentiment continued to deteriorate in March.

US tariffs and policy uncertainty weigh on US growth

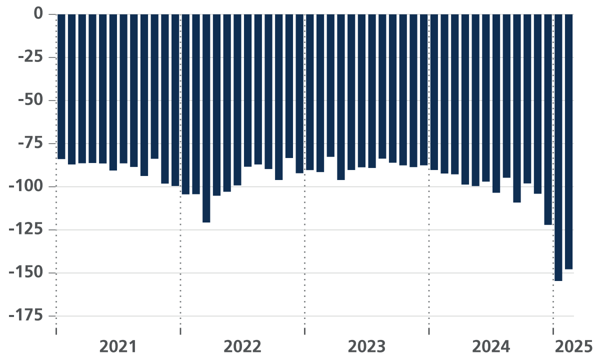
Tariff uncertainty is affecting the US economy. This is most clearly visible in trade data. For the second month in a row, the goods trade deficit was exceptionally large as imports surged in anticipation of higher tariffs. The goods trade deficit reached USD 148 bn in February, around 50% larger than pre-election levels (see figure 4). This larger deficit has a potential negative effect on GDP growth as it lowers the contribution of net exports. That said, this frontloading should typically be offset by higher inventory or consumption contributions. However, we see limited evidence of frontloading in inventory data (which have only grown at a very modest pace) or in consumption data. Real personal consumption expenditures increased by only 0.1% last month, following a downwardly revised 0.6% month-on-month decline in January. Services consumption declined, while the rebound in goods was very modest.

What could explain this discrepancy? Part of the answer lies in imports of gold. These totalled USD 30 bn in January (detailed figures not yet available for February) and are largely used for investment purposes (and thus filtered out of GDP data, while still in import data). Indeed, when taking this into account, our in-house nowcast jumps from around -1.5% quarter-on-quarter annualised to around 0.5%. The Atlanta Fed nowcast makes a similar jump when adjusting for these gold imports. Yet the discrepancy can also be partly explained by weakening momentum in consumer spending, as consumer confidence plunged since January (see figure 5). Many consumers cite economic policy uncertainty in the report.

Other confidence indicators were mixed. S&P Global Composite Index rebounded from a 51.6 low in January to 53.5 in February as service confidence increased, while manufacturing confidence decreased. However, the ISM Manufacturing and Non-Manufacturing indices both declined notably. The declines happened partly because of big decline in the Employment subindices. This stands in contrast with the latest labour market report. Non-farm payrolls increased by 228k last month, while unemployment only increased marginally (from 4.1% to 4.2%).

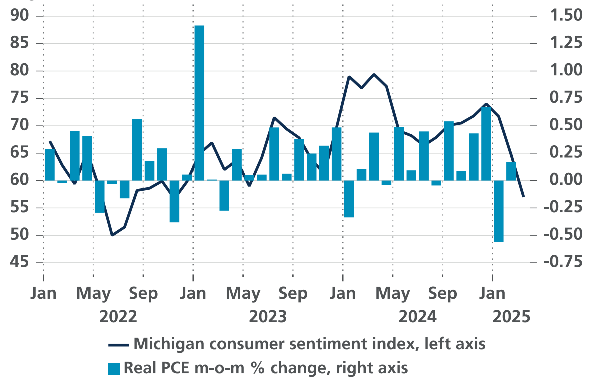
All this is broadly in line with our view of a weakening growth momentum. We thus maintain our forecast of below-potential growth of 1.8% in both 2025 and 2026. However, risks are tilted to the downside, given continued uncertainty about economic policy in general and trade policy in particular.

Figure 4 - US goods trade balance
in billion USD



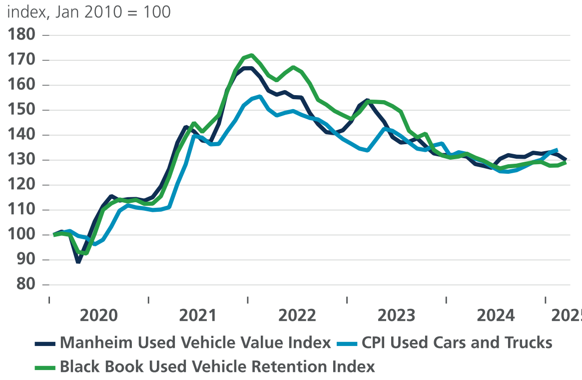
Source: KBC Economics based on USCB

Figure 5 - US consumption



Source: KBC Economics based on BEA, University of Michigan

Figure 6 - US used cars and trucks indicators



Source: KBC Economics based on Manheim Consulting, BLS, Black Book

Forward-looking inflation indicators cool in February

In contrast with the soft CPI inflation print, PCE inflation was firm in February. PCE inflation stayed constant at 2.5%, while core PCE inflation increased from 2.7% to 2.8%. The acceleration can be attributed to accelerating durable goods and services PCE inflation.

Other recent inflation data were relatively soft. Average hourly earnings increased by only 0.25% month-on-month in March, boding well for services inflation. Producer prices stayed flat in February, thanks to lower trade services and energy prices. The stagnation in producer prices followed two months of strong producer price increases. At 3.2%, year-on-year producer price inflation remains elevated, however.

Rental data suggested some softening of shelter inflation ahead, as the Zillow Observed Rent Index increased by only 0.27% last month. Forward-looking indicators for used car prices also moved in a favourable direction as the Manheim Index declined by 1.6% in March. This stands in contrast with used cars and trucks CPI prices, which have increased sharply in the latest releases (see figure 6) and are thus expected to moderate in the months ahead. All in all, given the favourable February data and moderating energy inflation, we downgrade our CPI inflation forecast from 3.4% to 3.2% for 2025 and from 3.0% to 2.9% in 2026. Despite this downgrade, our forecast remains above market expectations.

Chinese consumer plan boosts growth outlook but risks remain

The outlook for the Chinese economy has improved notably in the past month. The main reason behind this was the introduction by the government of a 30-point plan to "vigorously boost consumption" and "comprehensively expand domestic demand". The plan is a welcome addition to previous measures, including the trade-in program for consumer goods that was launched in 2024 and expanded in 2025. It also fits into the strategic announcement made at the Two Sessions a few week ago, that boosting consumption will be the top priority of the government going forward.

The new consumer plan not only focusses on near-term support but also aims to boost the consumption environment in a more structural way. This includes increasing household income and reducing financial burdens via enhanced social welfare. The list of proposed measures stretches across many different areas of the economy, like employment, digital services products, pensions, tourism, child and elderly care, the housing market, the financial sector and education. The plan contains few new details on how exactly spending will be increased but its extensiveness shows a greater determination to tackle China's consumption problem.

Since the publication of the plan, several local governments have come out with new measures to bring the plan into action. These are much-needed first steps but more will be needed to make the plan a success and push the economy back on the 5% growth track.

It remains to be seen how much of the plan will be implemented, how effective it will be in restoring confidence and if the expected boost to consumption will be enough to compensate for the fallout from trade tariffs. For now, we only slightly upgrade our growth forecast for 2025 from 4.5% to 4.7% and for 2026 from 3.9% to 4.1%. This growth forecast can be adjusted further in the coming months based on the evolution of the trade dispute with the US. In response to the latest US tariff increase, the Chinese government already announced a retaliatory 34% tariff on all US imports starting on 10 April. The waters between the two countries are deep but concessions following negotiations are not out of the question.

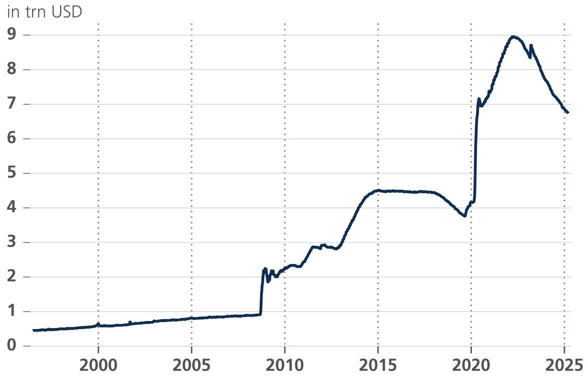
If successful, the consumer plan should also help to lift lacklustre inflation further away from negative territory. In February, CPI inflation dropped from 0.5% year-on-year in January to -0.7% year-on-year. The February reading might have been skewed to the downside by seasonal distortions but even without these disruptions, the number was still disappointing. It is clear that deflationary pressures are persisting in the economy. The 34% retaliatory tariff that the Chinese government announced, if effectively implemented, will create some upward price pressure. We have upgraded our inflation path for 2025 and 2026 based on the newly announced consumer plan but because of the very negative February reading, the overall average inflation forecast for 2025 has declined from 0.8% to 0.6%. For 2026, we upgrade our forecast from 1.7% to 1.9%.

ECB policy now 'meaningfully less restrictive'

In March, the ECB cut its policy rate by another 25 basis points to 2.50%. This brought it another step closer to the neutral interest rate level and thus the ECB is also nearing the end of its easing cycle. The ECB did stress that uncertainty is extraordinarily high, especially with regard to economic policy and, in particular, trade policy. Therefore, future ECB policy remains data-dependent and will be reconsidered from meeting to meeting without any 'precommitment' with respect to a particular interest rate path.

Based on the ECB's reference to the less restrictive nature of its policy and high uncertainty, we assume the ECB will cut its policy rate by 25 basis points to 2.25% one more time in April. At that level, the ECB is likely to end its easing cycle. In contrast, financial markets currently expect the ECB to make an additional rate cut in the second half of 2025, which would bring its deposit rate to a final level of 2%.

Figure 7 - Federal Reserve's balance sheet



Source: KBC Economics based on Fed

Fed takes a wait-and-see approach

At its policy meeting in March, the Fed left its policy rate unchanged at 4.375%. In his comments, Fed Chairman Powell highlighted following elements. First, the extreme uncertainty surrounding economic (trade) policy. Second, in their March forecasts (the 'dot plots'), the Fed governors again revised downwards their growth forecasts for 2025 and 2026, to 1.7% and 1.8% respectively, while raising again their inflation expectations (measured by the Fed's favourite measure, the core PCE), now to 2.8% for 2025. Although Powell said it was too early to back it up with 'hard' statistical data, he did assume that this stagflationary development was mainly driven by the ongoing trade tariff conflicts.

Lower growth and higher inflation offset each other in terms of their impact on the desirable path of policy rates, according to Powell. Moreover, according to the Fed, it is possible that the inflationary impact of those trade restrictions is limited to a one-off increase in the price level, and thus the resulting inflationary pressures are temporary. Hence, given the extremely high degree of uncertainty, the Fed will remain on the sidelines for a while. We assume that it will remain so in the second quarter of this year. In the third and fourth quarters, the Fed is likely to cut its policy rate by 25 basis points each time to 3.875% by the end of 2025. In early 2026, it will then probably bottom out at 3.625% after a final rate cut in this cycle. Our view for 2025 is broadly in line with market expectations, although with the important difference that the market expects the final bottom rate in this cycle to be lower (and later).

Fed slowly but surely gets closer to a more normal balance sheet size

Alongside its interest rate decision, the Fed again slowed the pace of normalising its balance sheet size (figure 7). It lowered the average monthly amount of non-reinvestment of Treasury bonds to USD 5 bn (from USD 25 bn) starting in April, while the average monthly run-off of government agency bonds and mortgage-backed securities remains unchanged at USD 35 bn. This asymmetry is in line with the Fed's goal of ultimately holding mostly government bonds in its portfolio. Fed Chairman Powell stressed that this decision is purely technical, and thus has no impact on monetary policy, nor on the target size of the Fed's balance sheet in the medium term. Only the duration of the path to the unchanged final target size would be

Figure 8 - Treasury General Account (TGA) balance with Federal Reserve Banks
in trn USD

Source: KBC Economics based on Fed

longer as a result.

This is the second time the Fed has slowed the pace of balance sheet reduction. The programme, launched in June 2022, was already slowed down a first time in June 2024. The Fed took its new decision in March 2025 as it observed increasing tightness in the money market, particularly a sudden and pronounced drop in deposits at the Fed from the Treasury General Account (TGA) (see figure 8). This could potentially pose a risk of short-term liquidity shortages for the Treasury and hence for the stability of the money market. Powell still labelled the reserves in the financial system as a whole as 'abundant', which is still more than the Fed's target of reaching a situation where reserves are only 'ample'. This is the reason why balance sheet normalisation, albeit at an admittedly reduced pace, is continuing.

Unchanged scenario for bond yields

Since mid-March, both German and US 10-year yields remained broadly unchanged, except for a slight decline over the past few days due to somewhat weaker US economic data, such as weaker-than-expected private consumption spending in February.

Against the background of an unchanged monetary policy forecast for the Fed and ECB, we also maintain our scenario for 10 year US and German bond yields. This forecast is largely based on the hypothesis that the underlying US business cycle remains resilient in the context of high and persistent policy uncertainty, and can thus avoid a 'hard landing'. We therefore expect the US 10 year bond yield not to fall further, but on the contrary to stabilise first, and then gradually return to 4.50% by the end of 2025. Since that corresponds to what we consider consistent with US economic 'fundamentals', US 10 year bond yields are likely to continue to hover around that level into 2026.

The rebound of German 10 year bond yields in early March to around 2.80% was driven by the structural change in German (and European) fiscal policy. Consequently, that rise will be sustainable. During 2026, there is still limited upside potential. After all, we assume that the recent decompression of the low term premium in the German 10 year bond yield is not yet complete. That decompression was largely due to the market expectation that the relative scarcity of German government bonds as a benchmark for the euro area will further decrease due to the increasing debt issuance by the German government.

Intra-EMU spreads remain subdued

Bond yield spreads between EMU sovereigns on the one hand and German government bonds on the other remained stable or even crumbled slightly recently. The main reasons remain higher German bond yields due to the unprecedented planned German fiscal stimulus and continued attempts by most EMU governments to consolidate their budgets in line with the requirements of European fiscal rules (SGP). Those efforts are somewhat tempered by the national 'escape clause' for defence spending, though. On the other hand, the option for the ECB to use its Transmission Protection Instrument (TPI) if necessary continues to exert a downward effect on sovereign yield spreads.

Belgium

Weakening sentiment

The heightened economic uncertainty increasingly weighs on sentiment of Belgian businesses. In March, the NBB barometer slipped to its lowest level since January 2024. All sectors surveyed, with the exception of trade, contributed to the fall of the indicator. The business-related services sector saw the most significant downturn in confidence, followed by manufacturing and construction. Consumer confidence dropped markedly as well in March, almost completely reversing the marked increase seen in the previous month (see figure BE1). The decline was due mainly to rising fears over unemployment, which had abated substantially in February following the announced reforms of the new federal government. Consumers' expectations concerning the general economic situation fell sharply too, reaching their lowest level since November 2022.

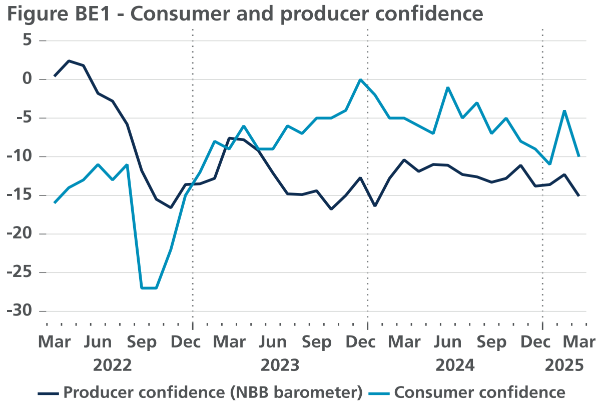
March's drop in Belgian survey-related data reflects current turbulent times, with concerns about US tariffs in particular deepening doubts over near-term recovery momentum. Growing caution among both businesses and consumers is also seen in the euro area as a whole, as both the EC's economic sentiment indicator (ESI) and consumer confidence indicator dipped further below their long-term averages in March. Country-level shifts were mixed, though. Belgium is among the group of countries, including also France and Italy, which experienced (sharp) declines in sentiment in March, while other countries, including Spain and Germany, reported (slight) improvements (see figure BE2). For Germany, the brighter mood, which is also visible in national indicators like the Ifo and ZEW, is undoubtedly due to the country's future looser fiscal policy (see text on the international economy).

Stimulus spillover

While tariffs complicate the near-term outlook for the Belgian economy, we think that the large European budgetary expansion may alter the economic prospects for 2026 and beyond. Spillovers from Germany's 'fiscal bazooka' to the Belgian economy in particular will likely be non-negligible. From the literature, we know that spillovers from bigger countries' fiscal policy are generally more positive for small open economies which share a land border and trade extensively with the country (see e.g. Beetsma et al., "Trade spill-overs of fiscal policy in the EU: a panel analysis", Economic Policy, Vol. 21, Issue 48, 2006, p. 640–687). Considerable additional defence spending by the Belgian government may provide an extra impulse to GDP growth, albeit somewhat less due to defence multipliers being relatively low.

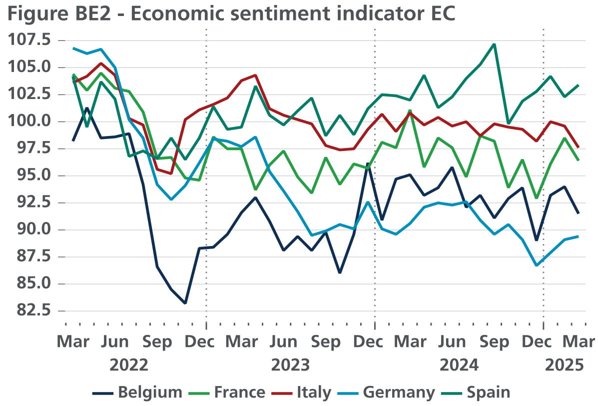
We roughly estimate the impact of the stimulus on Belgian economic activity at 0.8% of GDP, spread over several years. Due to implementation lags, it will likely take time before the extra spending may take effect. Hence, we currently stick to our cautious 0,7% growth forecast for 2025. Higher US import tariffs on European goods, which we already factored into the scenario early on, will weigh on Belgian growth. From 2026 onwards, the first effects from the stimulus will kick in and partially compensate for the tariff effect. In the light of this, we are revising

Figure BE1 - Consumer and producer confidence



Source: KBC Economics based on NBB

Figure BE2 - Economic sentiment indicator EC



Source: KBC Economics based on Eurostat

our growth forecast for 2026 upward by 0.2 percentage points to 1.1%. With this, the 2026 figure continues to be at the lower end of the range of forecasts made by other institutions. We see the biggest impact from the fiscal stimulus in the years beyond 2026, lifting up Belgian growth by an estimated 0.3 percentage points in both 2027 and 2028. Stronger growth is likely to result in a modest rise in inflation from 2026 on. We now forecast Belgian inflation of 1.8% in 2026, i.e. 0.1 percentage points higher than in our previous outlook.

The scenario continues to be subject to a high degree of uncertainty. Risks on the downside mostly pertain to the trade environment, with tariffs and trade policy uncertainty possibly derailing the Belgian economy more than expected. Likely, the US-imposed tariffs on all EU products imported into the US will not be reversed any time soon. Besides their direct trade impact, the negative effect on Belgian economic activity could eventually be bigger due to indirect effects such as a loss of confidence. On the upside, the expected big shift in EU and especially German policies could support growth more than expected via the confidence channel. After the recent weak performance, next month's NBB barometer may already shed some light on whether Belgian businesses see the fiscal turnaround as something positive rather than fearing the announced tariff hike.

Central and Eastern Europe

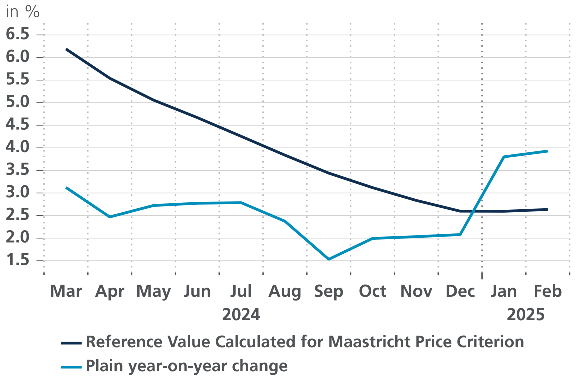
Eastern European economies are currently facing two opposing macroeconomic factors in the form of higher US-imposed tariffs and the looming EU fiscal expansion aimed at rearming member states. In both cases, we expect the impact of these external influences on the Eastern European economies we follow to be very limited. On the one hand, Eastern Europe's exposure to the US economy is relatively low, and on the other hand, the fiscal multiplier related to fiscal expansion aimed at increasing (German or domestic) military spending will be small in the case of Eastern Europe. Given that the above-mentioned effects can largely offset each other, we can stick to our conservative approach towards GDP revisions.

Turning to the key regional events in Eastern Europe that we consider important for the macroeconomic outlook, we would like to highlight the slightly hawkish stance during CNB and NBH meetings plus the recent developments in Bulgaria, which we believe have brought the country closer to meeting the convergence criteria and thus to joining the euro area in 2026.

Bulgaria's entry to the EMU

Let's start with Bulgaria, where the political situation has finally stabilised, leading to minor adjustments in our forecasts of the budget deficit and public debt as the country is preparing for entry into the euro area. The country has requested extraordinary Convergence Reports from the EC and the ECB. Parliament voted for a budget, aiming for a 3% deficit in 2025 with respective adjustment in the following years. As a result – in our view – Bulgaria would be able to meet fiscal convergence criteria.

Figure CEE1 - HICP inflation in Bulgaria



Source: KBC Economics based on Eurostat

However, the situation around meeting the inflation criterion looks more challenging (see figure CEE1). Following a clear convergence trend, Bulgaria's average annual inflation expectedly approached the Maastricht price criterion: the three best-performing countries of the EA plus 1.5 percentage point. Thus, in December 2024, inflation in Bulgaria was only 0.1 percentage point higher than the price stability criterion. However, in February, inflation in Bulgaria was already 0.1 percentage point lower than required by the Maastricht treaty.

However, inflation worsened, from 2.8% in December to 3.8% in January and 3.9% in February, due to the reinstatement in 2025 of the VAT rates for flour, bread and restaurants from 9% to 20% and the price increases of the Energy and Water Regulatory Commission – for household electricity by 8.4% and for gas by 8.0% in January for gas by an extra 3.0% in February. In addition, the country's alleged accession to the EMU strongly stimulates the housing market prices, due to the perception of the population that the current prices are still too low compared to the euro area countries.

Until February, these short-term effects practically did not affect the average annual inflation rate. Although, in our assessment, these are one-offs, they create some uncertainty about the punctual fulfilment of the price stability criterion in March and April (relevant for the Convergence Report). What is certain now is that a possible deviation would be small anyway. All in all, given the comprehensive nature of the convergency reports, such a small deviation itself would be hardly the stumbling block for the country's admission to the euro area.

Don't count on defence fiscal bazooka

Moving to the Czech economy, our GDP growth forecast for 2025 remains at 2.1%, but with risks skewed to the downside due to lacklustre external and investment demand. While hard data was rather weak, confidence indicators have been stable or even better.

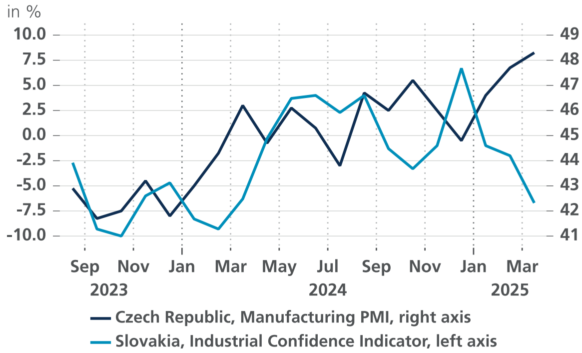
As far as the direct impact of the German fiscal stimulus on Czech GDP is concerned, we expect it to be very limited in the short term, with a small boost to medium-term growth forecasts. In this context, it is also worth noting that the Czech parliament recently agreed on the need to increase defence spending from the current level of around 2% of GDP to 3% of GDP by 2030. Given that higher defence spending will be import-intensive, the associated fiscal multiplier is likely to be low (estimates range from 0.3 to 0.9). Thus, we expect the additional defence spending to bring relatively little demand stimulus to the Czech economy in the coming years – in our view less than 0.1% of GDP per year.

Meanwhile, the CNB left official interest rates unchanged, maintaining a surprisingly hawkish stance due to inflation risks. The CNB expects inflation to stay in the upper part of the tolerance band (1-3%) in the first half of 2025, while CNB Governor Michl stressed the new budget injections into infrastructure and defence in Germany to be pro-inflationary. Let us add that we believe that the CNB has not yet said the last word and one standard 25 basis point rate cut will occur at the May meeting when the new staff forecast is available. A subsequent fine-tuning to 3.25% remains in play (although not our base scenario), assuming that price pressures recede faster and/or growth recovery is slower than we expect.

Regarding Hungary, the highlight was the NBH meeting. Even though the central bank left its base rate unchanged at 6.5%, the focus was on the press conference as it was the first one since Mihaly Varga became the new governor of the NBH and new staff forecasts were published as well. The latest inflation figures were above the inflation forecast of the central bank and Mihaly Varga highlighted that the inflation path this year was likely to be higher than earlier expected, so achieving the inflation target has been delayed. According to the new forecast the average inflation might be between 4.5-5.1% year-on-year in 2025 and 2.9-3.9% year-on-year in 2026, which means that the NBH may reach its inflation target only in the second half of 2026. The new NBH governor emphasised that there were broad upside risks in the inflation outlook. In this respect, it is worth noting that we had to revise up our inflation outlook for 2025 too, from 4.7% to 5.0% for 2025.

Hence, the new NBH chief stressed with a hawkish bias that a careful and patient approach to monetary policy remains necessary – not only because of upside inflation risks but also because of trade policy and geopolitical tensions (which can put unwarranted pressure on the forint). It means that the current NBH base rate could be maintained for an extended period. This communication

Figure CEE2 - Manufacturing confidence in Czech Republic and Slovakia



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

fits into the previous months messages of the NBH, so it confirms our view that there might only be another rate cut in Q3 and any base rate change will be highly dependent on the evolution of inflation in the coming quarters and on the actions done by the ECB and especially by the Fed. We still see a good chance for one or two rate cuts during the autumn, as we believe that inflation has already peaked in February and the Fed might cut the Fed funds rate in the second half of 2025, which could widen the manoeuvring space for the NBH.

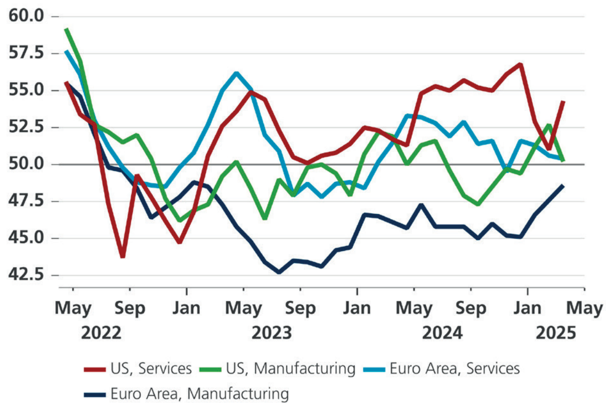
Finally, for Slovakia, the GDP growth forecast has been lowered to about 2% on average for the next three years. The downward revision stems from a deterioration in sentiment and expectations of households and firms (see figure CEE2). Another factor is the evolution of the dynamics and structure of GDP at the end of the year. Last, but not least, both households and firms signal concerns about the impact of the domestic consolidation package such as the looming transaction tax as well as uncertainty arising under high energy prices. Firms are also postponing private investment due to uncertainty and the absorption of EU funds, which has been slow. Moreover, given the high exposure of the Slovak economy to the automotive sector, the outlook might prove optimistic, if trade wars escalate further.

Figures

Real GDP
yearly change in %

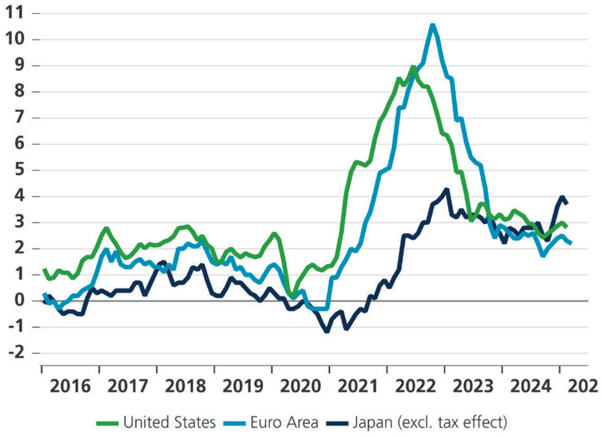
Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators
index, above 50 = expansion



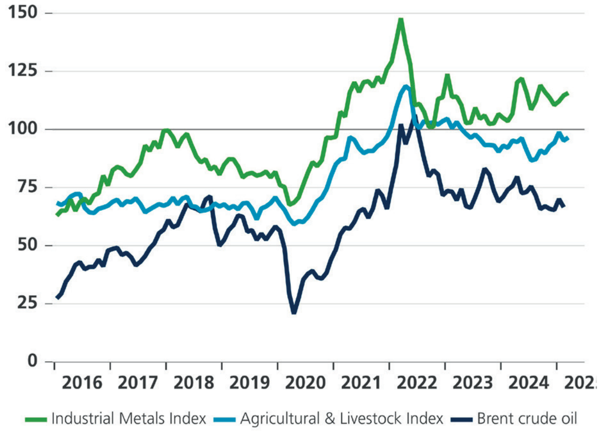
Source: KBC Economics based on S&P Global

Headline inflation
yearly change consumer price index, in %



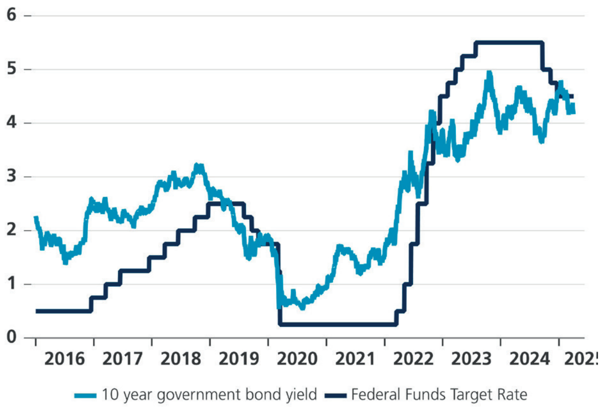
Source: KBC Economics based on Eurostat, SBJ, BLS

Commodity prices
index, January 2013=100, in USD



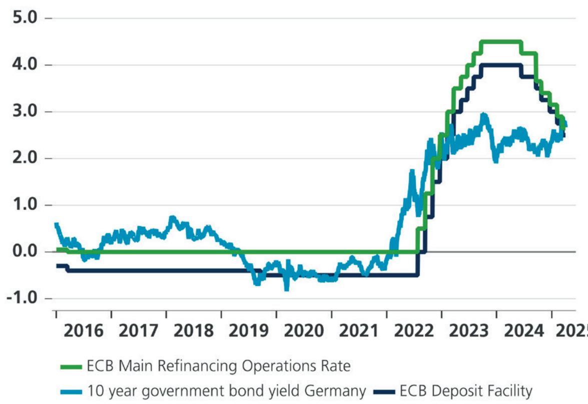
Source: KBC Economics based on World Bank, S&P Global

United States interest rates
in %



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

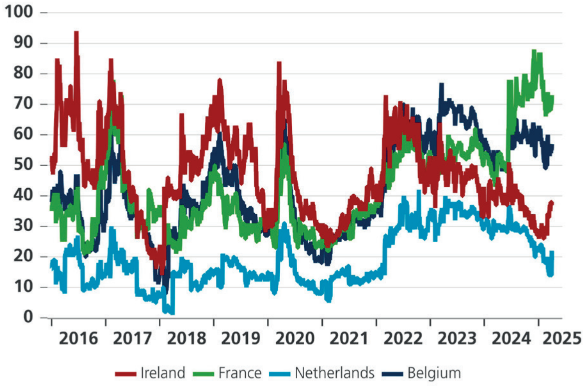
Euro area interest rates
in %



Source: KBC Economics based on Macrobond, ECB

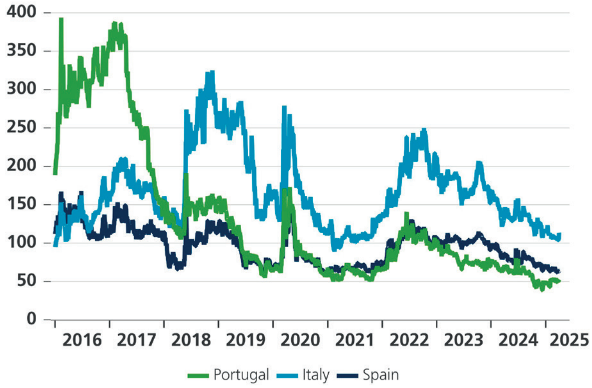
Figures

10 year government bond yield spreads to Germany
in basis points



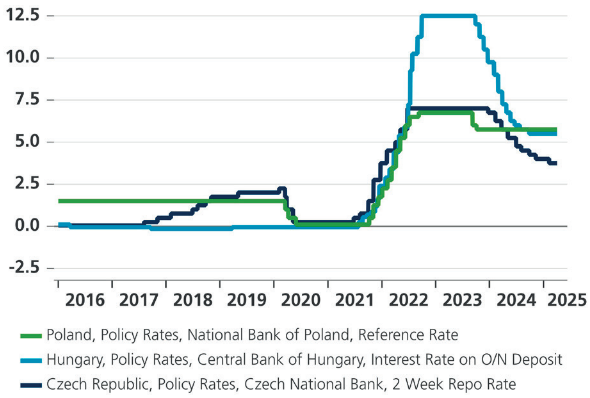
Source: KBC Economics based on Macrobond

10 year government bond yield spreads to Germany
in basis points



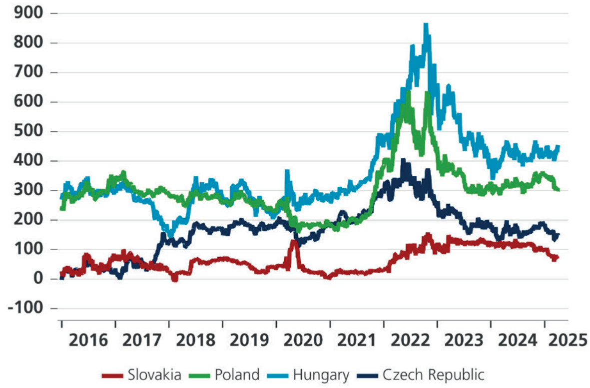
Source: KBC Economics based on Macrobond

Monetary policy rates Central Europe
in %



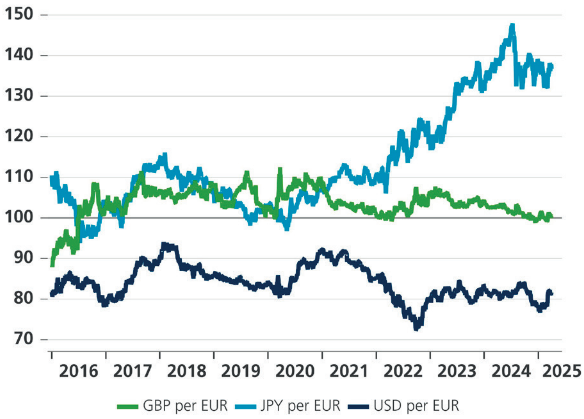
Source: KBC Economics based on CNB, MNB, NBP

10 year government bond yield spreads to Germany
in basis points



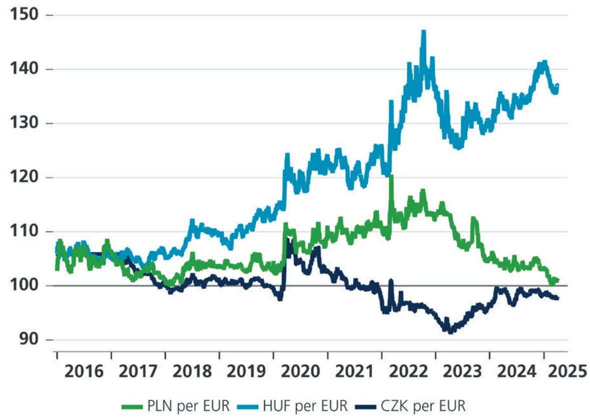
Source: KBC Economics based on Macrobond, AKK, Eurostat

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



Source: KBC Economics based on Macrobond

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



Source: KBC Economics based on Macrobond

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	0.9	1.2	2.4	2.6	2.6
	Germany	-0.2	0.2	1.4	2.5	2.9	2.8
	France	1.1	0.5	1.1	2.3	2.1	2.4
	Italy	0.5	0.4	0.7	1.2	2.0	2.2
	Spain	3.2	2.2	2.0	2.9	2.6	2.4
	Netherlands	0.9	1.6	1.2	3.2	3.7	3.5
	Belgium	1.0	0.7	1.1	4.3	3.2	1.8
	Ireland	1.2	4.0	4.0	1.4	2.2	2.1
	Slovakia	2.0	1.9	2.2	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	5.0	3.8
	Bulgaria	2.7	2.6	2.7	2.6	2.9	3.0
	Poland	2.8	3.4	3.5	3.6	4.5	2.9
	Romania	0.9	2.1	2.9	5.8	4.5	3.5
Rest of Europe	United Kingdom	1.1	0.9	1.2	2.3	3.1	2.4
	Sweden	0.9	1.8	2.5	2.0	0.9	1.8
	Norway (mainland)	0.6	1.6	1.6	2.9	2.5	2.1
	Switzerland	1.3	1.2	1.6	0.9	0.5	0.8
Emerging markets	China	5.0	4.7	4.1	0.2	0.6	1.9
	India*	6.2	6.3	6.5	4.7	4.2	4.6
	South Africa	0.6	1.6	1.9	4.4	4.1	4.5
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	3.2	2.9	3.5	58.5	32.6	20.9
	Brazil	3.4	1.6	2.1	4.4	5.2	4.4
Other advanced economies	United States	2.8	1.8	1.8	3.0	3.2	2.9
	Japan	0.1	1.2	0.9	2.7	2.8	1.8
	Australia	1.0	2.0	2.4	3.2	2.8	2.6
	New Zealand	-0.1	1.2	2.6	2.9	2.1	2.0
	Canada	1.5	1.3	1.2	2.3	2.3	2.0
*** fiscal year from April-March**						31/3/2025	

Policy rates (end of period, in %)		31/3/2025	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	4.50	4.50	4.25	4.00
	Switzerland	0.25	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	6.25	6.00	5.75
	South Africa	7.50	7.50	7.50	7.50	7.25
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	42.50	42.50	42.50	37.50	32.50
	Brazil	14.25	14.25	14.25	15.00	15.25
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	2.75	2.75	2.75	2.50	2.50

Outlook main economies in the world

10 year government bond yields (end of period, in %)		31/3/2025	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Euro area	Germany	2.73	2.73	2.80	2.80	2.80
	France	3.44	3.44	3.55	3.54	3.53
	Italy	3.86	3.86	3.90	3.88	3.86
	Spain	3.37	3.37	3.50	3.49	3.48
	Netherlands	2.95	2.95	3.00	3.00	3.00
	Belgium	3.29	3.29	3.40	3.39	3.38
	Ireland	3.11	3.11	3.10	3.10	3.10
	Slovakia	3.52	3.52	3.60	3.60	3.60
Central and Eastern Europe	Czech Republic	4.24	4.24	4.20	4.20	4.20
	Hungary	7.21	7.21	6.80	6.45	6.20
	Bulgaria*	3.85	3.85	3.80	3.80	3.80
	Poland	5.72	5.72	5.80	5.40	4.90
	Romania	7.48	7.48	7.55	7.55	7.55
Rest of Europe	United Kingdom	4.67	4.67	4.75	4.75	4.75
	Sweden	2.64	2.64	2.75	2.75	2.75
	Norway	4.01	4.01	4.15	4.15	4.15
	Switzerland	0.51	0.51	0.65	0.65	0.65
Emerging markets	China	1.81	1.81	1.90	1.95	2.05
	India	6.65	6.65	6.55	6.60	6.65
	South Africa	9.94	9.94	10.57	10.62	10.67
	Russia	13.93	Temporarily no forecast due to extreme uncertainty			
	Turkey	31.21	31.21	30.15	28.00	26.00
	Brazil	15.07	15.07	14.98	15.03	15.08
Other advanced economies	United States	4.23	4.23	4.35	4.40	4.50
	Japan	1.55	1.55	1.50	1.50	1.50
	Australia	4.42	4.42	4.50	4.55	4.65
	New Zealand	4.56	4.56	4.75	4.80	4.90
	Canada	3.00	3.00	3.15	3.20	3.30

***Caution: very illiquid market**

Exchange rates (end of period)	31/3/2025	Q1 2025	Q2 2025	Q3 2025	Q4 2025
USD per EUR	1.08	1.08	1.08	1.08	1.08
CZK per EUR	24.96	24.96	25.20	25.10	25.10
HUF per EUR	402.35	402.35	395.00	398.00	408.00
PLN per EUR	4.18	4.18	4.15	4.17	4.20
BGN per EUR	1.96	1.96	1.96	1.96	1.96
RON per EUR	4.98	4.98	5.03	5.07	5.08
GBP per EUR	0.84	0.84	0.85	0.86	0.87
SEK per EUR	10.85	10.85	10.80	10.75	10.75
NOK per EUR	11.41	11.41	11.50	11.50	11.50
CHF per EUR	0.95	0.95	0.94	0.94	0.94
BRL per USD	5.73	5.73	5.73	5.73	5.73
INR per USD	85.47	85.47	85.37	85.37	85.37
ZAR per USD	18.39	18.39	18.13	18.13	18.13
RUB per USD	84.75	Temporarily no forecast due to extreme uncertainty			
TRY per USD	37.93	37.93	38.01	38.84	40.53
RMB per USD	7.26	7.26	7.32	7.36	7.40
JPY per USD	149.57	149.57	148.00	147.00	145.00
USD per AUD	0.62	0.62	0.63	0.64	0.64
USD per NZD	0.57	0.57	0.57	0.57	0.58
CAD per USD	1.44	1.44	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	2.2
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	5.2	5.2
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		2.7	2.6	2.7
Inflation (average yearly change, harmonised CPI, in %)	3.7	5.0	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		-3.0	-3.0	-2.9
Gross public debt (in % of GDP)	73.8	73.5	73.0		23.6	26.8	29.0
Current account balance (in % of GDP)	1.5	1.3	1.0		0.2	0.0	-0.4
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	12.6	5.5	4.0		16.5	9.7	5.5

Outlook KBC markets - Belgium

National accounts (real yearly change, in %)	2024	2025	2026
Private consumption	2.0	2.1	1.5
Public consumption	3.7	0.5	0.5
Investment in fixed capital	1.0	1.1	2.8
Corporate investment	1.7	1.5	2.6
Public investment	7.0	1.4	5.6
Residential building investment	-4.8	-0.8	1.7
Final domestic demand (excl. changes in inventories)	2.1	1.4	1.6
Change in inventories (contribution to growth)	-1.1	-0.0	0.0
Exports of goods and services	-4.1	-2.1	0.5
Imports of goods and services	-4.2	-1.2	1.1
Gross domestic product (GDP), based on quarterly figures	1.0	0.7	1.1
Household disposable income	1.3	1.3	1.4
Household savings rate (% of disposable income)	13.5	12.9	13.0

Equilibrium indicators	2024	2025	2026
Inflation (average yearly change, in %)			
Consumer prices (harmonised CPI)	4.3	3.2	1.8
Health index (national CPI)	3.3	3.1	1.8
Labour market			
Domestic employment (yearly change, in '000, year end)	11.5	20.0	30.0
Unemployment rate (in % of labour force, end of year, Eurostat definition)	6.0	6.2	6.0
Public finances (in % of GDP, on unchanged policy)			
Overall balance	-4.6	-4.9	-4.5
Public debt	104.4	106.7	107.6
Current account balance (in % of GDP)	-0.2	-1.2	-1.3
House prices (average yearly change in %, existing and new dwellings, Eurostat definition)	3.2	3.0	3.0

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