Germany flouts – self-imposed fiscal taboos

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N°787
10 March 2025

Financial markets are enduring a period of instability, overshadowed by trade tensions and wide-ranging economic measures.

Trade war brewing

The US has moved to impose customs duties of 25% on imports from Mexico and Canada, plus 20% on imports from China, although there has since been a temporary carve-out for goods covered by the North American trade agreement until 2 April. These measures have caused significant disruption to global supply chains and are one of the factors stoking inflation. In response, Canada has applied tit-for-tat tariffs on a specific range of American goods, while China is taxing American farming products. The end result has been more uncertainty in the markets.

As each country tries to outdo the others with their tariffs, some sector rotation has been witnessed. The automotive sector is benefiting from the one-month reprieve in tariffs, which is temporarily mitigating the negative repercussions on what is a strategic segment for the US economy.

In China, the government is forecasting continued growth of 5%, supported by fresh fiscal stimulus. Emphasis has been placed on galvanising consumers and technological innovation, particularly in the field of AI, although the precise details have yet to be worked out. The trade war with the US remains a decisive factor in just how extensive the measures will be.

In the US, despite some resilience by the ISM manufacturing and services indices, economic indicators are showing signs of losing momentum. The trade deficit, which stands at USD 131.4 billion based on latest numbers (up 34% month-on-month and doubling year-on-year), reflects an increase in imports, as a direct consequence of anticipated customs duties. This raises concerns about possible stagflation – that fatal mix of persistent inflation and stagnant economic growth. The jobs market is also slowing, partly due to the uncertainty surrounding the implementation of the radical new economic policies.

Europe intent on making war, not love

Here in Europe, Germany has announced the creation of a special EUR 500 billion fund to finance defence, modernise infrastructure and make the country more competitive on the global scene. But this measure, which marks a reversal of the traditional tight grip on debt, requires the adoption of a constitutional reform, which will depend on achieving a political consensus involving the CSU/SDU coalition, the SPD and potentially the Greens. Changes to the constitution require a qualified majority in order to pass in the Bundesrat. At the same time, the European Commission has unveiled an ambitious project to rearm Europe by allocating EUR 800 billion to strengthen collective defences and support Ukraine, following the withdrawal of US aid.

Last week the ECB continued monetary easing by cutting its benchmark policy rate to 2.50%, at the same time revising its inflation forecasts. Public spending in Europe has potential to stimulate growth, but customs duties could rekindle inflation, leaving the future rate trend in interest territory.

Against this backdrop, equity market volatility has increased significantly, oscillating between periods of panic and rallies. The US 10-year yield ended the week at 4.30% while the return on the German Bund jumped to 2.80%. The S&P 500 shed 0.65% over the week, Nasdaq was down 1.10% and the Stoxx Europe 600 1.74%.

Swiss Market Index (SMI)

Momentum is weakening but remains relatively strong. Some consolidation was seen towards 12900 last week, but overall the foundations seem solid enough to fuel retracement to all-time highs.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.88	0.95	13'076.68	5'468.41	23'008.94	8'120.80	8'679.88	5'770.20	18'196.22	36'887.17	1'128.55
Trend	↓	→	↑	→	↑	→	→	↓	↓	↓	→
YTD	-3.03%	1.45%	12.72%	11.69%	15.59%	10.03%	6.20%	-1.89%	-5.77%	-7.54%	4.93%

(values from the Friday preceding publication)

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