The US Hands the Fiscal Baton to Germany and China

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

April
2025

Fiscal policy is a powerful tool to steer economic growth, by influencing aggregate demand, investment, and economic activity. It contributed to the anemic growth rate in the post-financial-crisis years, as fiscal austerity was in vogue. It contributed to rapid economic recovery from the Covid pandemic, as fiscal policy came to the rescue. It is not an exaggeration to say that the ebb and flow of fiscal policy has been perhaps the most decisive determinant of macro outcomes for the past 20 years, and beyond. Even the dominance of monetary policy in periods such as the post-financial-crisis years resulted from the *absence* of fiscal support.

Everywhere we have witnessed a strong fiscal impulse, growth and outperformance have been the result, as one would expect. Even in Europe, where fiscal prudence has reigned supreme for decades, we have seen the fruits of targeted fiscal policy in recent years. For instance, the NextGenerationEU fund significantly boosted economies such as Italy and Spain with substantial financial support post-Covid, allowing them to record strong GDP growth following decades of stagnation. In contrast, Germany, has been in a state of self-imposed fiscal restraint and has been sliding in and out of recession, as discussed in more detail below.

In the US, the fiscal thrust has been the stealth driver of economic growth post-Covid. We've witnessed the most significant expansion of the fiscal deficit in over five decades, helping to counterbalance and soften the impact of monetary tightening. This contrasts sharply with Germany's and China's fiscal restraint. The US fiscal excess is now dropping off, transitioning from substantial fiscal expansion to mild contraction due to President Trump's deficit reduction efforts. While reducing fiscal spending will not be easy, as many items are rigid (e.g., only one-third of fiscal spending is nondiscretionary), the direction is clearly toward cutting costs. Meanwhile, raising taxes is currently off the table, but an extension of the tax cuts from Trump's first term is likely. This combination suggests that there will be an attempt to compress the fiscal deficit, which is likely to be a headwind to future growth. We expect a near-term slowdown followed by a gradual upturn in 2026, driven by higher-quality companies that are differentiators in AI, productivity, and innovation.

In contrast, Germany's fiscal policy has entered a new era, driven by the realization that while the US is likely to remain an ally, it will no longer be its primary line of defense. Germany's approval of a €500 billion spending package marks a historic departure from its post-crisis austerity, characterized by the constitutionally codified debt brake. This new program includes substantial infrastructure and defense spending, projected to exceed 1% of GDP, alongside increased state borrowing. The fiscal paradigm shift is expected to significantly improve Germany's economic outlook. While the initial improvement may be modest, with a 0.1% increase in GDP expected in 2025, more substantial growth of one to two percentage points is expected in 2026 and beyond.

This higher run rate of Germany's growth is projected to boost euro area GDP by 20 to 30 basis points. The European Commission has also eased fiscal regulations to allow for the exemption of defense spending up to 1.5% of GDP, amounting to €800 billion in defense investments across member states, and made available €150 billion of loan financing. However, the broader European fiscal landscape remains fragmented, with many countries cautious about increasing spending due to limited fiscal space. We therefore emphasize that it is mostly a German fiscal shift, rather than a European one.

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

China is also ramping up its fiscal support with an injection of RMB 2 trillion, equivalent to 1.1% of GDP, primarily targeting technology sectors such as AI and autonomous driving. The top five tech companies in China are set to double their capital expenditures on AI compared to last year, reaching approximately RMB 400 billion. However, concerns persist in the property sector, with limited clarity on addressing housing inventory issues. While the government aims to bolster consumption with an additional RMB 750 billion, these measures are perceived as modest and not fully aligned with market expectations.

The global fiscal landscape is poised for significant shifts: the US is expected to scale back its fiscal expansion, while Europe, and Germany in particular, is preparing for stronger growth beyond 2026 with increased fiscal spending. Meanwhile, China too is incrementally boosting its fiscal support, particularly through higher investment in AI, though not to the extent seen in Europe. US growth will be driven more by the private sector, powered by innovation and (eventually) a more business-friendly environment once trade uncertainties resolve. Overall, we see a different global fiscal mix, but a continuation of the "high nominal world" of higher growth, inflation, investment, and yields, powered by fiscal policy.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 3.00 (unchanged)

Sentiment and risks have shifted to the downside as ongoing uncertainty over tariffs and DOGE combine with a US administration exhibiting greater-than-expected tolerance for weaker economic outcomes. Soft data highlights risks around a moderation in economic activity, while hard data remains more constructive. Nowcasting models suggest a more substantial slowing in the US economy but appear to be driven by temporary factors, such as a spike in gold imports. The 12-month outlook will depend on how long policy uncertainty lasts and whether the weakening in sentiment starts to materially affect the economy. Additionally, the timing of tax cuts and deregulation may also provide some support in the second half. In the near term, the US exceptionalism theme is fading but our base case remains a "Soft Landing."

A worrisome indicator is the slump in the University of Michigan's measure of consumer sentiment, which has fallen from 74 in December to 57.9 in March. At the same time, consumers' views on the direction of prices have become unanchored across time horizons, with the school's five-year inflation expectations rising to 3.9% in March from 3.3% at the start of 2025; the New York Fed inflation expectations indicator has risen more moderately.

While soft data is giving amber warning signs over future expectations, the current economic situation remains resilient. Labor market indicators are not yet signaling weakening, with JOLTS and Indeed New Job Postings remaining stable, while initial jobless claims have fallen back from their spike at the end of February. These indicators allay some of the recent concerns around layoffs and spending cuts by DOGE, with the Challenger, Gray & Christmas job cuts measure jumping to 172,000 in February from 50,000 in January. Similarly, February retail sales were mixed but the underlying trend remains resilient, with the control group rising 1% month over month, suggesting that January's concerns were largely unbased, with the weak print driven by weather and payback from the fourth quarter. However, risks are increasing amid weakening sentiment and the fact that consumption continues to be skewed toward the top 10% of households, which account for 50% of spending in the US currently. Over a 12-month period, consumption is expected to slow as labor market growth softens and tariffs reduce real incomes.

Europe has seen a substantial shift in fiscal policy, particularly in Germany, raising structural growth outlooks over the long term. Near-term risks related to tariffs and uncertainty, however, will dampen prospects for European growth over the next few months. While spending announcements are positive, questions remain around how much of spending will materialize, whether it will be spent within Europe, and what the multipliers will be. Over the medium to long term, we think the US exceptionalism theme will reemerge given European-US differences in energy costs, AI, and tech sector investment.

Rates

Gunter Seeger
Portfolio Manager, Developed Markets Investment Grade

CS 4.00 (+0.50)

We are closer to a top in rates than a bottom, for several reasons. First, the Federal Reserve has given the administration everything on its wish list: two rate cuts in 2025 based on dot-plot forecasts; a reduction in quantitative tightening from $25 billion in US Treasuries to $5 billion; and verbal support from Chair Powell in the form of labeling tariff inflation as "transitory" and defending the president by saying "the last time we had tariffs, it was not inflationary."

Among other reasons is the approval of deficit spending at $2 trillion (8% of GDP) as part of the recently passed debt-ceiling resolution. Overseas, Europe and especially Germany will be doubling deficit spending over the next 10 years to build manufacturing plants and military hardware facilities. Europe will buy nothing from the US, sourcing the expansion from EU members and causing inflation. We have argued that the threat of expanding wars holds down yield curves in a flight to quality. If peace is achieved in Eastern Europe and the Middle East, rates will move higher. Finally, Trump loves tariffs and will use them extensively over his term.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

CS 3.50 (unchanged)

Risk sentiment has shifted decidedly toward a negative stance as the economic outlook deteriorates on the back of US policy actions. Tariffs, rather than being simply a negotiation tool, appear to be an entrenched philosophical stance that will weigh on future growth while raising short-term inflation. As noted last month, jobs reliant on US government spending have been a primary driver of employment growth in recent years; they will reverse in the second half of the year. Recession probabilities have increased significantly, but from ultra-low levels to still-moderate levels. On the positive side, Germany's shift toward fiscal stimulus, coupled with Europe's increased defense spending, will help stem the current economic malaise. The Fed's signaling a somewhat dovish tone by maintaining its rate cut forecast and reducing its balance sheet tapering also is a positive.

Strategists have substantially revised their credit spread forecasts to bearish levels. Spread valuations have pulled back from recent ultra-tight levels to a more fair-value range, but the near-term path is likely to be wider, particularly with forthcoming reciprocal tariff announcements.

Last month, we shifted toward a more defensive positioning recommendation with respect to quality. We maintain this view but would trend more neutral again should spread differentials decompress further. While recession probabilities have increased, credit fundamentals are strong heading into this environment, and a recession, if any, will be mild given low starting unemployment and the Fed's significant dry powder. We would also look to add European credit exposure should spreads there widen further on tariff announcements.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 2.75 (-0.25)

A US growth scare driven by tariff uncertainty and sticky inflation have created a "stagflation lite" theme that has already weakened the US dollar across the board. In combination with a seismic shift in German fiscal spending that opens the door to much higher German deficits and a higher European Central Bank (ECB) terminal rate, the two-year US Treasury/bunds rate differential collapsed and led to a sharp bounce in the euro/US dollar relationship, pushing it just above 1.0900. While the US dollar moved into April on the backfoot, current US dollar levels may provide an opportunity to rebuild long US dollar positions, as the euro/dollar value is already at the higher end of our revised 12-month forecast range of 1.0500-1.1000.

We maintain a clear bias toward our "soft landing" scenario over a 12-month timeframe. We view the deterioration in US consumer sentiment and survey data as a strong test of the underlying growth credentials in the short term as decision-making by consumers and businesses has been halted by policy uncertainty. Consequently, we have shifted our short-term view to softer growth (not a downturn) and reduced the weight in "trend/higher for longer," viewing risks as more balanced over 12 months around a soft landing. We believe the Fed will remain focused on its dual mandate and likely stay on hold for some time amid sticky inflation and the need for more evidence in the hard economic data before pulling the trigger on renewed monetary policy easing.

Germany's U-turn on fiscal spending on infrastructure and defense led us to revise higher our 12-month German bund forecast to 2.75% from 2.00%. While we cannot rule out an overshooting in bund yields in the short term, we still await a better picture of the impact that tariffs and German spending's multiplier effects will have on European growth. We expect to see an increase in potential growth in Germany from the fiscal boost, but that may be more of a 2026 story. Above all, we have highlighted the need to reevaluate potential growth trends in the US too amid the underlying AI and productivity impetus.

Emerging Markets Fixed Income

Alfonso De la Torre
Sovereign Analyst

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 3.00 (-0.25)

The domestic macro environment for most emerging markets (EMs) continues to be favorable, with the improving fundamental trend remaining intact. These fundamental improvements are reflected in the number of sovereign credit rating upgrades, with 2024 being the best year for upgrades since 2011. As we go forward, the number and aggregate index weight of upgrade candidates – which include several potential rising stars, including Oman, Serbia, and Azerbaijan – far outweigh downgrade candidates.

EM spreads remain sensitive to US dynamics and have widened in line with a recent deterioration in US risk sentiment. That said, overall spread levels are not too far from recent tights, consistent with strong local drivers such as improving fiscal outlooks, significant reserve levels, and stronger policy frameworks. While rising risks around tariffs will be harmful for some EMs, and near-term trade uncertainty will weigh on growth and investment, countries in any country-specific trade, tariff, aid, or budget support headlights look to be developing a playbook to navigate these headlines swiftly. We also highlight that the EM-DM growth differential in 2025 is not only positive but also accelerating despite the expected structural slowdown in China.

In the sovereign space, the first two months of the year have been busy for primary markets, with some US$77 billion issued, most of it corresponding to investment grade (IG) names. For scale, this is around 40% of our total issuance expectations for the year. In total, while we expect gross issuance to be similar to last year, net supply will be lower, in line with improving fiscal dynamics and more EM sovereigns shifting a growing share of their overall debt to local currency as domestic capital markets develop further.

In the corporate space, fourth-quarter 2024 results have been broadly as expected. We have seen positive beats in consumer goods, metals and mining, and financials, while utilities, industrials, and Colombia oil and gas have missed on the margin. Our current credit trend matrix reflects this, with 15% positives and 11% negatives. The positive skew is more evident in high yield (HY), with 23% positives and 17% negatives, while in IG the split is 11% positives and 8% negatives. Primary activity slowed in February to $33 billion, which has been easily absorbed with the scheduled cash flows of $34 billion. Including the unscheduled cash flows, the net financing for the month turned negative, to -$12 billion. The net financing for the year moved lower, to $6 billion. March, typically a quiet month for supply, saw $16 billion of deals through roughly mid-month. With modest scheduled cash flows of $27.6 billion, we expected net negative financing for the month. In the month's primary deals, we were still seeing healthy book coverage ratios and ongoing demand from the crossover community, which remains supportive.

Any new US tariff announcements will be a headwind, but likely a manageable one. Barring exceptional cases (such as Mexico), threatened trade action in the EM space largely entails reciprocal tariffs, which would raise existing US duties to match those applied by other countries. From that standpoint, the impact is likely to be limited. Not only are there 16 countries where tariffs are zero due to free-trade agreements, but for most of the others, the trade-weighted tariff increase will be less than 10 percentage points and affect 20% or less of total exports.

Multi-Asset

Peter Hu, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.50 (unchanged)

Trump 2.0 has presented itself as a blend of populist reflationary policies and business-friendly supply-side disinflationary measures. For financial markets, a key concern is how well these divergent approaches will be balanced. So far, tariffs have been paced to allow for some relief for Europe and emerging markets. However, business confidence in the US, especially among small businesses, has declined slightly after an initial post-election surge. The dip is due to uncertainty about government policies, which may cause companies to hesitate in hiring and investing. Unexpectedly, the administration has also introduced aggressive plans to reduce government spending. While this move has eased previous fears of unsustainable government debt, the abrupt and unpredictable nature of these cuts has created uncertainty among consumers.

On the global stage, geopolitical tensions have increased. However, this has pushed European countries to become more decisive in expanding their military capabilities. We expect this period of uncertainty to peak in the first half of the year. Afterward, the private sector in the US is likely to play a bigger role in driving the economy, while the eurozone could finally experience economic growth after its sluggish recovery from Covid-19. We are expecting technological advancements to lead to higher productivity and better returns on investments, with slowly normalized inflation and interest rates. Given the remaining uncertainties, we are taking a cautious approach and maintaining a moderate level of risk in our investments, with a bias toward adding risk on dips.

Global Equity

John Song, CFA
Global Equities Analyst

CS 3.00 (unchanged)

Market volatility remains driven by trade tensions, inflation concerns, foreign policy developments, DOGE actions, and a relatively disappointing earnings season. While expectations of improving earnings momentum persist, the market's recovery from its lows has been slower than anticipated, with business and consumer uncertainty weighing on sentiment.

We continue to see a rotation into safety, with value and defensive names benefiting, though we believe fundamentals for those companies remain unchanged. More recently, investor interest has shifted toward European equities, driven by fiscal policy announcements that have bolstered European industrials and defense contractors.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

US tariffs and Ukraine-Russia peace proposals have dominated recent headlines in global EM (GEM). Fourth-quarter earnings have been very mixed, and every sector saw meaningful misses and beats. Consensus earnings estimates for 2025 in GEM have been reduced by 1.8%, and those for 2026 by 1.9%. While the drops are not large in magnitude, the direction points to some profit pressure.

In China, AI-related optimism remains supportive of stocks in that space. Domestic loader and excavator shipments grew by 30% year over year, which was better than expected, as the government looks to accelerate infrastructure works. Jewelry sales recovered over the last two months, which gives an indication of a bottoming in sluggish retail sales, but early Lunar New Year sales could add some distortion. In India, after a 22% fall in the MSCI India Index, investors are beginning to look for relative bargains. Indonesia has seen strong consumer demand year to date, but the outlook is unclear, as the government's budget reallocation could dampen short-term purchasing power.

Latin America has gone through a relatively quiet period politically. The market has focused on the remainder of the quarterly reporting, which was positive for consumer and materials stocks but light for banks, oil and gas, and capital goods stocks.

As of this writing, the market awaits the US-Russia and US-Ukraine meeting in Riyadh. Germany's new budget is raising risk premia in Europe. Turkey's renewed instability is causing a large market sell-off. On the portfolio level, we favor consumer discretionary in India and Brazil, chip manufacturers in Korea and Taiwan, and European industrials. We favor profit-taking in Chinese platforms that had a big AI-driven run.

Quantitative Research

Qian Yang
Fixed Income
Quantitative Strategist

Our US Conviction Score retreated toward neutral, mostly due to curve flattening of 11 basis points. The credit spread widened by three basis points.

Global credit forecasts worsen and continue to be negative, relatively favoring developed markets over emerging markets. In developed markets, the model favors banking and brokerage and dislikes utilities, basic industry, and electrics. In emerging markets, the model likes financials and dislikes transportation, metals and mining, and utilities.

Our global rates model forecasts lower yield for Oceania and the UK and higher yields for Japan and most European countries. The model forecasts a flatter curve for New Zealand, Japan, Greece, and Sweden and globally steeper curves for North America and most European countries.

The rates view expressed in our G10 Model portfolio is neutral to slightly overweight global duration. It is overweight France, Oceania, and Italy and underweight the US, Germany, and Japan. Along the curve, it is overweight six-month, 10-year, and 20-year durations and underweight two-year, five-year, and 30-year durations.

All market data, spreads, and index returns are sourced from Bloomberg as of 24 March 2025.

About PineBridge Investments

pinebridge.com

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 December 2024, the firm managed US$190.3 billion across global asset classes for sophisticated investors around the world.

MULTI-ASSET | FIXED INCOME | EQUITIES | ALTERNATIVES

Disclosure Statement
PineBridge Investments is a group of international companies that provides investment advice and markets asset management products and services to clients around the world. PineBridge Investments is a registered trademark proprietary to PineBridge Investments IP Holding Company Limited.

Readership: This document is intended solely for the addressee(s) and may not be redistributed without the prior permission of PineBridge Investments. Its content may be confidential, proprietary, and/or trade secret information. PineBridge Investments and its subsidiaries are not responsible for any unlawful distribution of this document to any third parties, in whole or in part.

Opinions: Any opinions expressed in this document represent the views of the manager, are valid only as of the date indicated, and are subject to change without notice. There can be no guarantee that any of the opinions expressed in this document or any underlying position will be maintained at the time of this presentation or thereafter. We are not soliciting or recommending any action based on this material.

Risk Warning: All investments involve risk, including possible loss of principal. If applicable, the offering document should be read for further details including the risk factors. Our investment management services relate to a variety of investments, each of which can fluctuate in value. The investment risks vary between different types of instruments. In making an investment decision, prospective investors must rely on their own examination of the merits and risks involved.

Performance Notes: Past performance is not indicative of future results. There can be no assurance that any investment objective will be met. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. PineBridge Investments often uses benchmarks for the purpose of comparison of results. Benchmarks are used for illustrative purposes only, and any such references should not be understood to mean there would necessarily be a correlation between investment returns of any investment and any benchmark. Any referenced benchmark does not reflect fees and expenses associated with the active management of an investment. PineBridge Investments may, from time to time, show the efficacy of its strategies or communicate general industry views via modeling. Such methods are intended to show only an expected range of possible investment outcomes, and should not be viewed as a guide to future performance. There is no assurance that any returns can be achieved, that the strategy will be successful or profitable for any investor, or that any industry views will come to pass. Actual investors may experience different results.

Information is unaudited unless otherwise indicated, and any information from third-party sources is believed to be reliable, but PineBridge Investments cannot guarantee its accuracy or completeness. All information is sourced from PineBridge Investments unless otherwise noted.

This document and the information contained herein does not constitute and is not intended to constitute an offer of securities or provision of financial advice and accordingly should not be construed as such.

The securities and any other products or services referenced in this document may not be licensed in all jurisdictions, and unless otherwise indicated, no regulator or government authority has reviewed this document or the merits of the products and services referenced herein. This document and the information contained herein has been made available in accordance with the restrictions and/or limitations implemented by any applicable laws and regulations. This document is directed at and intended for institutional and qualified investors (as such term is defined in each jurisdiction in which the security is marketed). Before acting on any information in this document, prospective investors should inform themselves of and observe all applicable laws, rules and regulations of any relevant jurisdictions and obtain independent advice if required.

Where applicable, the Manager may determine to terminate any arrangements made for marketing the Shares in one or more jurisdictions in accordance with the AIFM Directive and UCITS Directive respectively, as may be amended from time to time. Investors and potential investors can obtain a summary of investor rights and information on access to collective redress mechanisms at www.pinebridge.com/investorrights.

Certain Geographic Disclosures:

Australia: PineBridge Investments LLC is exempt from the requirement to hold an Australian financial services license under the Corporations Act 2001 (Cth) in respect of the financial services it provides to wholesale clients, and is not licensed to provide financial services to individual investors or retail clients. Nothing herein constitutes an offer or solicitation to anyone in or outside Australia where such offer or solicitation is not authorised or to whom it is unlawful. This information is not directed to any person to whom its publication or availability is restricted.

Hong Kong: The issuer of this document is PineBridge Investments Asia Limited, a company incorporated in Bermuda with limited liability, licensed and regulated by the Securities and Futures Commission (SFC). This document has not been reviewed by the SFC. PineBridge Investments Asia Limited is registered as a Class A Registered Person with the Bermuda Monetary Authority pursuant to the Investment Business Act 2003 (as amended).

Malaysia: PineBridge Investments Malaysia Sdn Bhd is licensed and regulated by Securities Commission of Malaysia (SC). This material is not reviewed or endorsed by the SC.

Singapore: PineBridge Investments Singapore Limited is licensed and regulated by the Monetary Authority of Singapore (MAS). In Singapore, this material may not be suitable to a retail investor. This advertisement or publication has not been reviewed by the MAS.

Taiwan: PineBridge Investments Management Taiwan Ltd. Is licensed and regulated by Securities and Futures Bureau of Taiwan (SFB). In Taiwan, this material may not be suitable to investors and is not reviewed or endorsed by the SFB.

Last updated 15 January 2025. For additional legal and regulatory disclosures including other cross border information, please refer to https://www.pinebridge.com/en/regulatory-disclosure.