Visa Business and Economic Insights

Europe Annual Economic Outlook

Signs of a turnaround in the outlook tempered by global uncertainty

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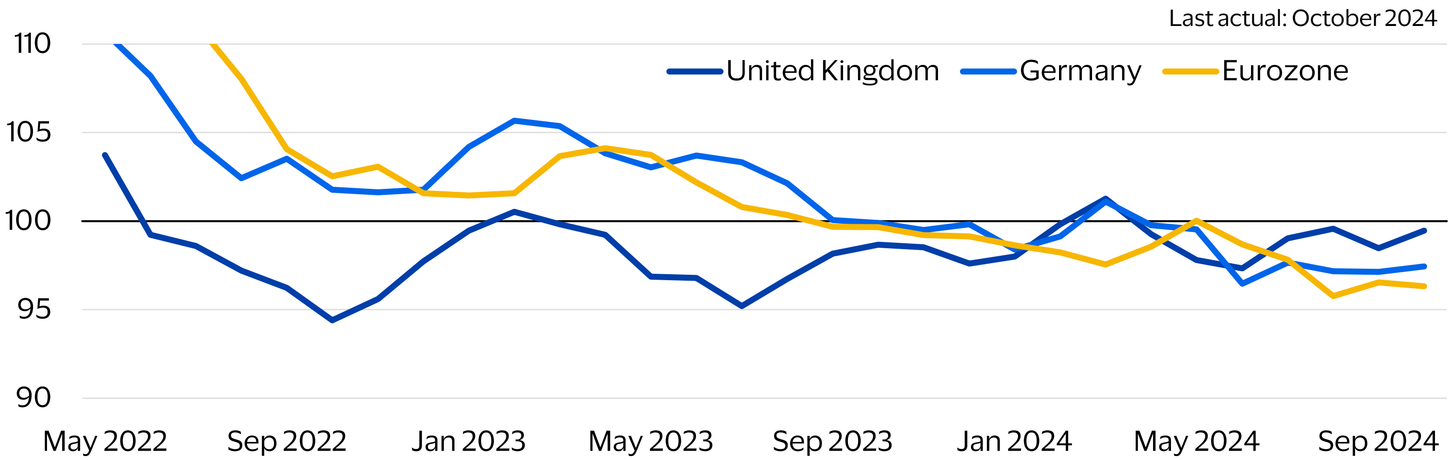
The outlook for 2025 is mixed, with reason for both optimism and concern. Resilient labour markets, falling inflation, and lower interest rates are encouraging factors that give us hope for a cyclical turnaround in the coming 12 months. On the other end, geopolitical instability, an uncertain outlook for global trade, and fragile fiscal conditions in several European countries are all moderating factors we are monitoring as potential headwinds to growth.

To understand the European economy's current trajectory, we reflect on the latter half of 2024. The recent disappointing performance of European consumer spending, as indicated by Visa's proprietary Spending Momentum Index (SMI), highlights the economic challenges faced in recent quarters. Despite what looked like favourable macroeconomic conditions, the European consumer gradually ran out of steam in the second half of the year. We believe this reflects the lingering effect of the surge in inflation and the resulting cost-of-living crisis in 2022-2023. This price jump compressed purchasing power and reduced household savings. Now, households are rebalancing their spending and rebuilding real savings, which is currently limiting economic growth. However, we are cautiously optimistic that this adjustment will lead to a gradual improvement in spending in 2025.

Key Points:

- Global uncertainty will weigh on growth
- Labour markets should remain resilient
- Spending momentum expected to gradually improve in 2025

Fig. 1: Visa Spending Momentum Index (SMI)
(Not seasonally adjusted, *≥100 = expansion, <100 = contraction; 3-month moving average)

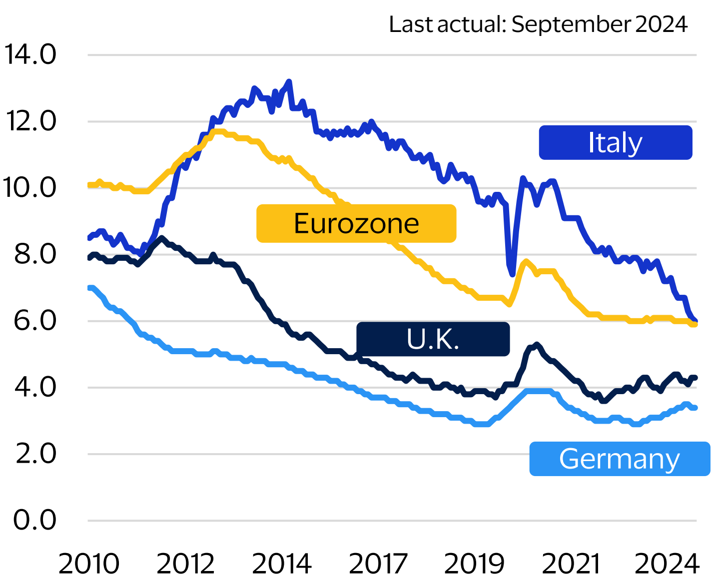


Source: Visa Spending Momentum Index

What factors will help Europe to regain momentum?

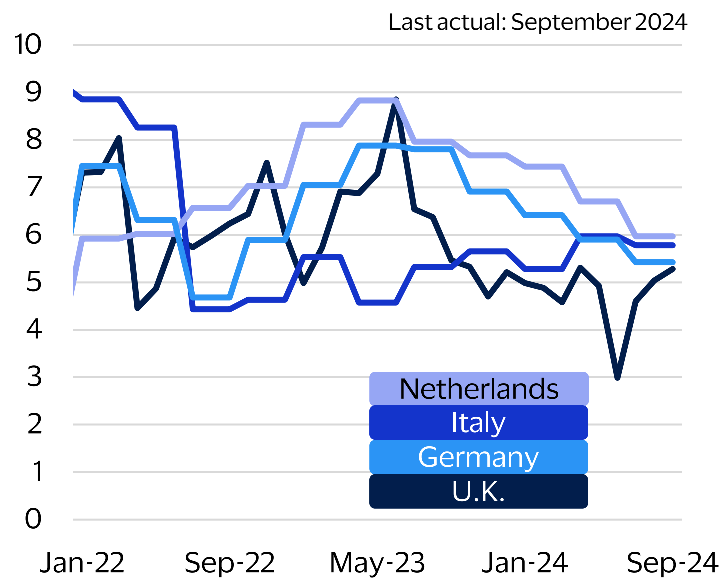
First, labour markets. The unemployment rate is at 6.3 percent in the Eurozone. In most countries, the jobless rates (6.1 percent in Italy, 3.5 percent in Germany, and 4 percent in the U.K.) remain quite low compared with recent years. Granted, in some countries labour markets deteriorated in 2024—the unemployment rates hit 8.7 percent in Sweden and 5.6 percent in Austria. But, by and large, labour market conditions remain favourable. The rise in wages and salaries, now growing at a moderate-to-robust pace, are a positive sign. In the Eurozone, wage growth is averaging 6.2 percent on a year-over-year basis, with Germany, Italy, and the Netherlands all in the same range, but the U.K. at a more modest 3.7 percent. These numbers reflect how compensation is gradually adjusting to the inflation shock that took place in 2022 and 2023. Which brings us to the second piece of encouraging news: Inflation is finally abating. In the Eurozone, consumer prices are up 1.7 percent compared to fall 2023. Inflation is at 2.1 percent in Germany, but in other countries of the bloc, such as France and Italy, it has fallen well below the 2 percent target set by the European Central Bank. Only in the U.K. have price increases remained elevated, at a rate of 2.6 percent relative to one year ago.

Fig. 2: Unemployment rates
(percent)



Sources: Haver Analytics: ONS, ISTAT, Statistisches Bundesamt, Eurostat

Fig. 3: Wage growth
(percent change, year ago)



Sources: Haver Analytics: ONS, ISTAT, Eurostat, Deutsche Bundesbank

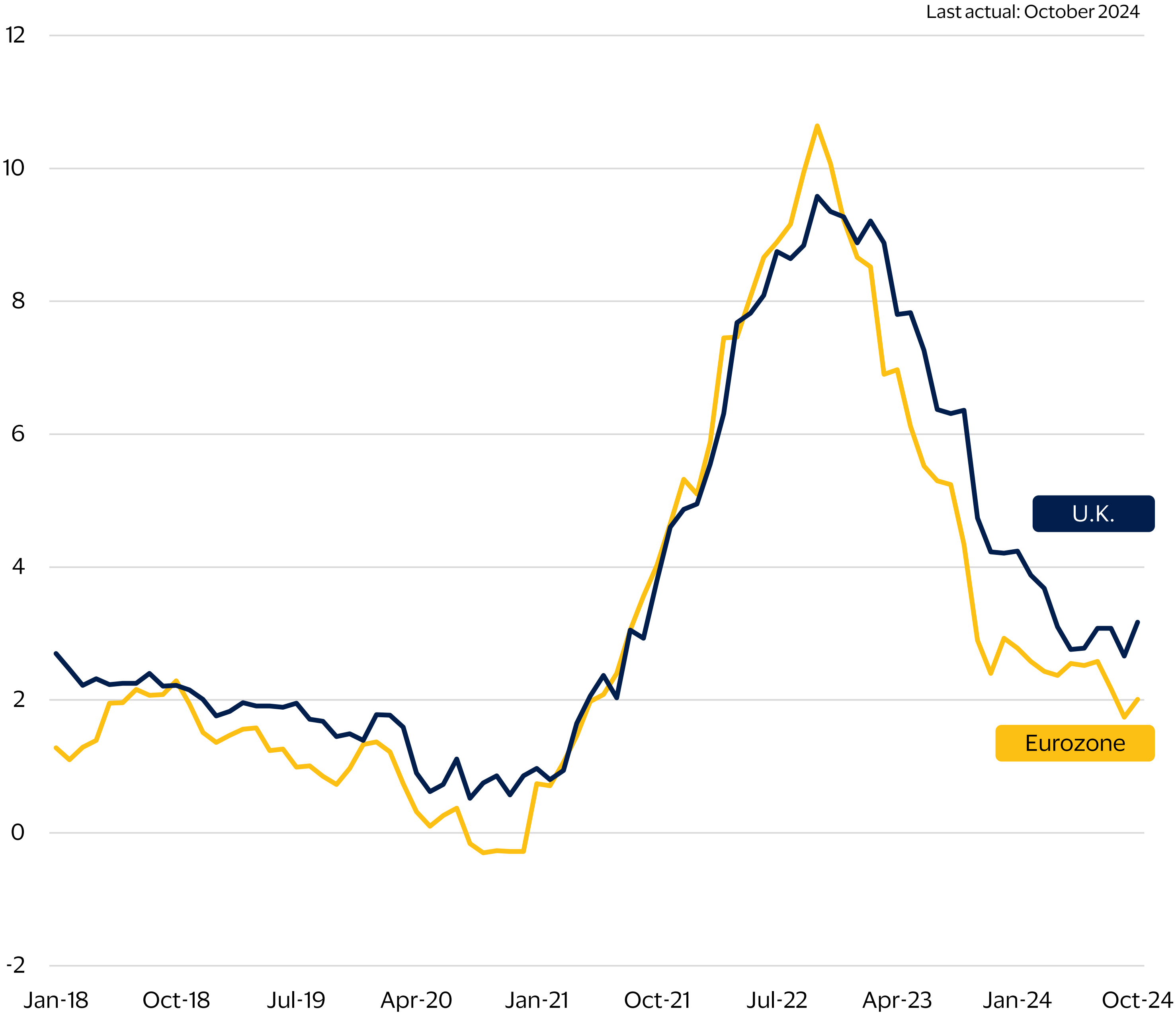
The combination of faster wage growth and decelerating inflation points to a progressive repair of real incomes across the continent. It is a trend we clearly welcome, even conceding that it may take some time to fully recover the ground lost in the last two years. Data also suggest that European households are rebuilding their stock of savings. In many countries, high inflation significantly reduced the real value of household bank deposits. Over the last few quarters, saving rates have been on the rise as growth in real income outpaces growth in consumer spending. In the short term, this is not helping spending, as demonstrated by the disappointing performance of the SMI. Over time, though, a positive differential between real income and real spending sets the conditions for a cyclical rebound in spending, which we are forecasting to begin in 2025.

Add to that the third positive development: Interest rates are slowly falling. Central banks have been cautious so far, a disappointment for those in financial markets expecting more aggressive rate cuts in 2024. But policy rates are coming down. The European Central Bank has delivered three rate cuts to a level of 3.25 percent, and the Bank of England cut rates twice to 3.75 percent. We expect the easing of financial conditions to remain slow and gradual throughout 2025, but eventually it will help revamp interest-sensitive sectors. Housing markets and small- to medium-sized businesses are most likely to benefit from easier access to credit and cheaper cost of financing.

These are the reasons why, on net, we are optimistic about economic healing in 2025 and beyond. But what are the risks to our relatively benign outlook for 2025?

Fig. 4: Inflation

(percent change, year ago)



Sources: Haver Analytics: Eurostat, ONS

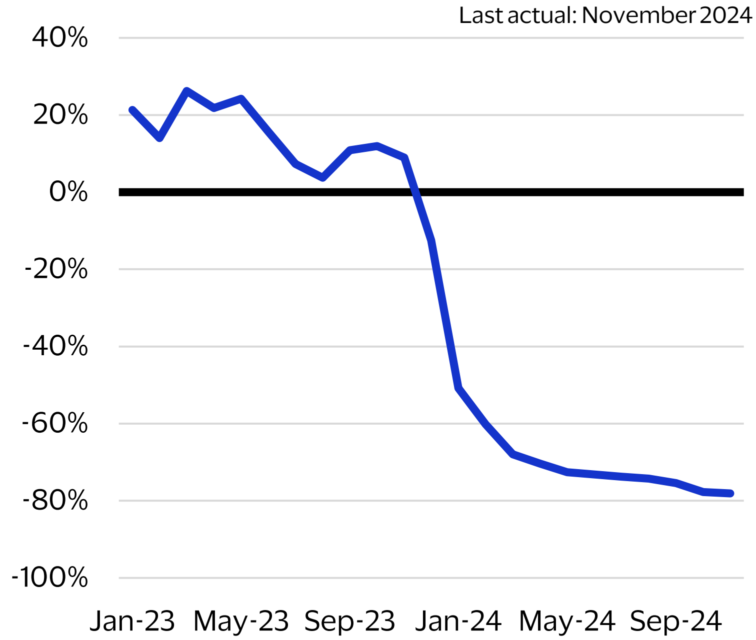
Downside risks abound

Let's begin with the energy markets. The geopolitical uncertainty in the Middle East is a significant concern. Fortunately, not all the regional turmoil has translated into an economic shock for Europe. Despite tensions rising in the Red Sea and an 80 percent drop in shipping traffic, there have not been extensive disruptions to European supply chains. However, shipping costs have increased and traffic with the Far East has become more problematic. Thankfully, these issues have not significantly impacted energy prices. A weaker-than-expected demand in advanced economies and robust supply from key Middle Eastern states, such as Saudi Arabia, have resulted in more favourable dynamics, defying worries about the deteriorating geopolitical context in the region. Looking ahead, we expect oil prices to remain in the range of $70 to $80 per barrel, barring any further deterioration in conditions on the ground.

The more problematic matter is trade. European growth is heavily dependent on external demand. Exports account for more than 50 percent of the European economy, as measured by gross domestic product (GDP). With a new administration in the U.S., it is broadly anticipated that the global economic climate will evolve in a direction less favourable to free trade, and tariffs may become part of the U.S. policy mix. Even ruling out the most extreme scenarios, which could be crippling for European manufacturing, the region will likely face some targeted tariffs that will disproportionately impact vulnerable industries such as automotive, machinery, and specialty foods. This poses a major risk for countries specializing in these sectors, such as northern Italy, Germany, and smaller countries closely tied to the supply chain networks of large European manufacturers.

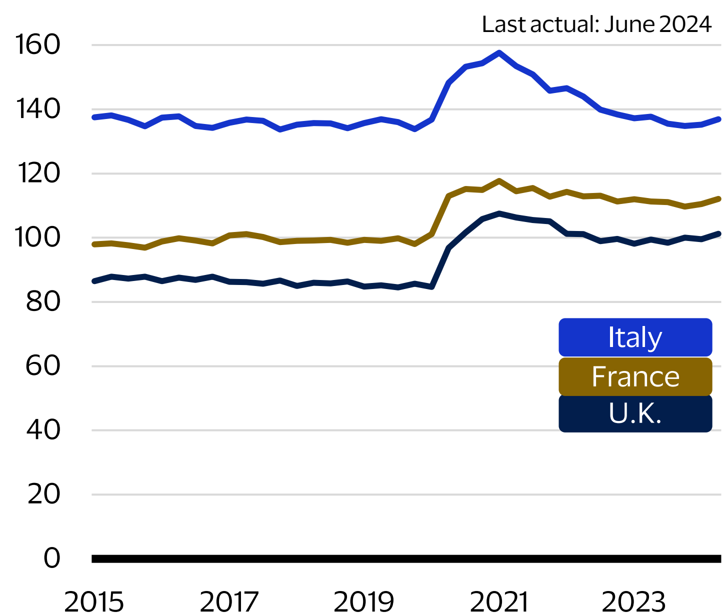
Our third concern is the sustainability of fiscal positions in Europe. Many countries are still grappling with the fiscal shock from the COVID pandemic. Debt, relative to the size of the economy, has risen in most countries, with the possible exception of Germany. The U.K. and France now find themselves in fiscal positions reminiscent of Italy and Spain years ago.

Fig. 5: Red Sea monthly average volume growth
(percent change, year ago)



Source: Visa Business and Economic Insights analysis of IMF-PortWatch data

Fig. 6: General government debt
(percent moving total GDP, NSA)



Sources: Haver Analytics: ISTAT, Banque de France, ONS

Moreover, most governments are spending more than they collect in tax revenues, resulting in elevated fiscal deficits. This structural hardening is likely to create headwinds for the region in the coming years. Europe needs to rebalance its productive structures, shifting away from a heavy reliance on exports. While new engines of growth have yet to be identified, investment will be essential to successfully address these structural transformations. Given the limited fiscal space available, it is hard to envision how governments can play a positive role in this transition.

Conclusions

So, what can we expect from European economies in 2025? We expect that global uncertainty will offset the gradual recovery of household balance sheets, ultimately weighing on growth. We now forecast growth to be between 1.0 percent and 1.5 percent in 2025. This is only a modest improvement compared to the estimated 0.8 percent GDP growth in 2024.

Overall, we do not foresee a surge in the unemployment rate or a dramatic deterioration in labour market conditions. However, it is likely that the number of jobless individuals will rise and wage growth will moderate somewhat. The fragile economic environment will help keep inflation in check, allowing central banks to continue easing interest rates and financial conditions.

All in all, the short-term balance of risks appears benign. What is more complicated is the medium-term outlook, which, in several cases, poses more structural challenges. In this regard, political and economic risks remain significant. With the new U.S. administration and March election in Germany, political developments could quickly lead to less favourable economic outcomes. As is often the case, political risks are a critical factor to watch when assessing the evolution of economic performance. Policymakers' choices will be fundamental to how Europe responds to the structural woes weighing on the economy.

Fig. 7: Macroeconomic forecasts for 2025
(percent change, year-on-year)

	GDP			Consumer prices			Personal consumption (nominal)		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
United States	2.9	2.8	2.1	4.1	3.0	3.2	6.4	5.2	4.8
United Kingdom	0.3	0.9	1.4	7.3	2.6	3.0	7.4	3.0	4.5
Eurozone	0.5	0.8	1.2	5.4	2.4	1.7	4.9	2.0	1.4
Germany	-0.1	-0.1	0.6	5.9	2.2	1.4	6.5	2.8	2.6
France	1.1	1.1	0.8	4.9	2.0	1.4	8.0	3.0	2.3
Italy	0.8	0.5	0.8	5.6	1.0	1.9	6.1	1.8	3.0
Spain	2.7	3.1	2.4	3.5	2.7	2.1	7.2	7.1	5.1
Poland	0.1	2.3	3.3	11.4	3.7	4.4	9.7	7.0	7.4
Romania	2.4	0.8	2.8	10.4	5.5	4.0	13.1	12.2	6.7
Sweden	0.0	0.6	2.4	8.5	2.8	1.5	4.3	3.1	3.6

Sources: Oxford Economics, VBEI

Accessibility notes

Figure 1: Line chart showing the 3-month moving average Visa Spending Momentum Index (SMI) for the United Kingdom, Germany and the Eurozone beginning in May 2022. The U.K. SMI ranges from 103.7 in May-2022 to 99.5 in Oct-2024, a low of 94.4 in October 2022, and a high of 103.7 in May-2022, the first reading of the series. Germany's SMI ranges from 110.7 in May-2022 to 97.4 in Oct-2024, a low of 96.5 in Jun-2024 and a high of 110.7 in May-2022. The Eurozone SMI ranges from 111.0 in May- 2022 to 96.3 in Oct-2024, a low of 95.8 in Aug-2024, and a high of 112.6 in June-2022.

Figure 2: Line chart showing the unemployment rate for Italy, the Eurozone, the U.K. and Germany. The Italian series ranges from 8.5% in Jan-2010 to 6.0% in Sept-2024, with a high of 13.2% in Nov-2014 and a low of 6.0% in Sept-2024. The Eurozone series ranges from 10.1% in Jan-2010 to 5.9% in Sept-2024, the lowest point of the series with a high of 11.7% in Jan-2013. The German series begins from a high of 7.0% in Jan-2010 to 3.4% in Sept-2024, with a low of 2.9% in Mar-2023. The U.K. series ranges from 7.9% in Jan-2010 to 4.3% in Sept-2024, and a high of 8.5% in Oct-2011 and a low of 3.6% in Jun-2022.

Figure 3: Line chart showing the year-on-year percent change in wages in the Netherlands, Italy, Germany and the U.K. The Netherlands series ranges from 5.9% in Jan-2022 to 6.0% in Sept-2024, and a high of 8.8% in Apr-2023 and a low of 5.9% in Jan-2022. The Italian series ranges from a high of 8.9% in Jan-2022 to 5.8% in Sept-2024 with a low of 4.4% in Jul-2022. The German series ranges from 7.5% in Jan-2022 to 5.4% in Sept-2024, and a low of 4.7% in Jul-2022 and a high of 7.9% in Apr-2023. The U.K. series ranges from 7.3% in Jan-2022 to 5.3% in Sept-2024, and a high of 8.9% in Jun-2023 and a low of 3.0% in Jun-2024.

Figure 4: Line chart showing the U.K.and Eurozone year-over-year (YoY) consumer price index. The U.K. series ranges from 2.7% in Jan-2018 to 3.2% in Oct-2024, a low of 0.5% in Aug-2020, and a high of 9.6% in Oct-2022. Eurozone inflation ranges from 1.3% in Jan-2018 to the last forecast of 2.0% in Oct-2024, a low of -0.3% in Oct-2020, and a high of 10.6% in Oct-2022.

Figure 5: Line chart showing the year-on-year growth in Red Sea traffic volume. The series ranges from 21% in Jan-2023 to a low of -78% in November 2024, and a high of 26% in Mar-2023.

Figure 6: Line chart showing General Government Debt as a percent of moving Gross Domestic Product for Italy, France and the U.K. The Italian series ranges from 137.5% in Q1 2015 to 136.9% in Q2 2024, a high of 157.6% in Q1 2021 and a low of 133.7% in Q4 2017. The French series ranges from 97.9% in Q1 2015 to 112.1% in Q2 2024, a low of 96.9% in Q4 2015 and a high of 117.7% in Q1 2021. The U.K. series ranges from 86.5% in Q1 2015 to 101.2% in Q2 2024, and a high of 107.5% in Q1 2021 and low of 84.5% in Q3 2019.

Forward Looking Statements

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