



PGIM

GLOBAL ASSET MANAGEMENT

EUROPEAN OUTLOOK 2025

AN OPPORTUNITY FORGED IN CRISIS?

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including possible loss of capital.

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INTRODUCTION

Entering 2025, the economic landscapes of Europe and the United States present contrasting narratives for investors. The consensus view of “U.S. exceptionalism” leading global economic growth is well entrenched. In contrast, Europe is set for a year of sub-par growth, with projections under 1%, reflecting structural challenges and global trade dynamics. Additionally, the re-election of U.S. President Donald Trump brings the potential imposition of tariffs on European exports, a risk for Europe’s export-driven economies.

The region faces a pivotal year. The publications of the Enrico Letta and the Mario Draghi reports in 2024 provided European policymakers with comprehensive manuals on how to successfully navigate these structural challenges. Moreover, peripheral eurozone economies are outperforming their core eurozone economic counterparts. With a war raging at the bloc’s doorstep, Brussels will have to forge a political consensus to

enact some of these proposals and capitalise on several transformative opportunities that could reshape its economic landscape and drive long-term prosperity for the bloc.

Against this backdrop, we asked experts from our business affiliates for their independent quick takes on the outlook for the European economy and markets.



PGIM FIXED INCOME



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QUICK TAKE

- Biggest risk facing the eurozone is a recession, stagflation also a concern.
- Economic resurgence in the periphery is an opportunity.

The outlook for the European economy is constructive. Economic growth remains sluggish but inflation has declined markedly. Labour markets are resilient while inflation-adjusted incomes have recovered from the recent energy shock. Our view remains that there are going to be gradual interest rate cuts going ahead. The European Central Bank is likely to cut benchmark interest rates by 100 basis points this year after a similar magnitude of policy easing in 2024.

However, the biggest risk facing the eurozone is a potential recession. Europe faces a 'perfect storm' of cyclical and structural headwinds. While interest rates

are heading lower, they remain in restrictive territory. Moreover, the risk of escalating trade conflicts with the U.S. could undermine growth.

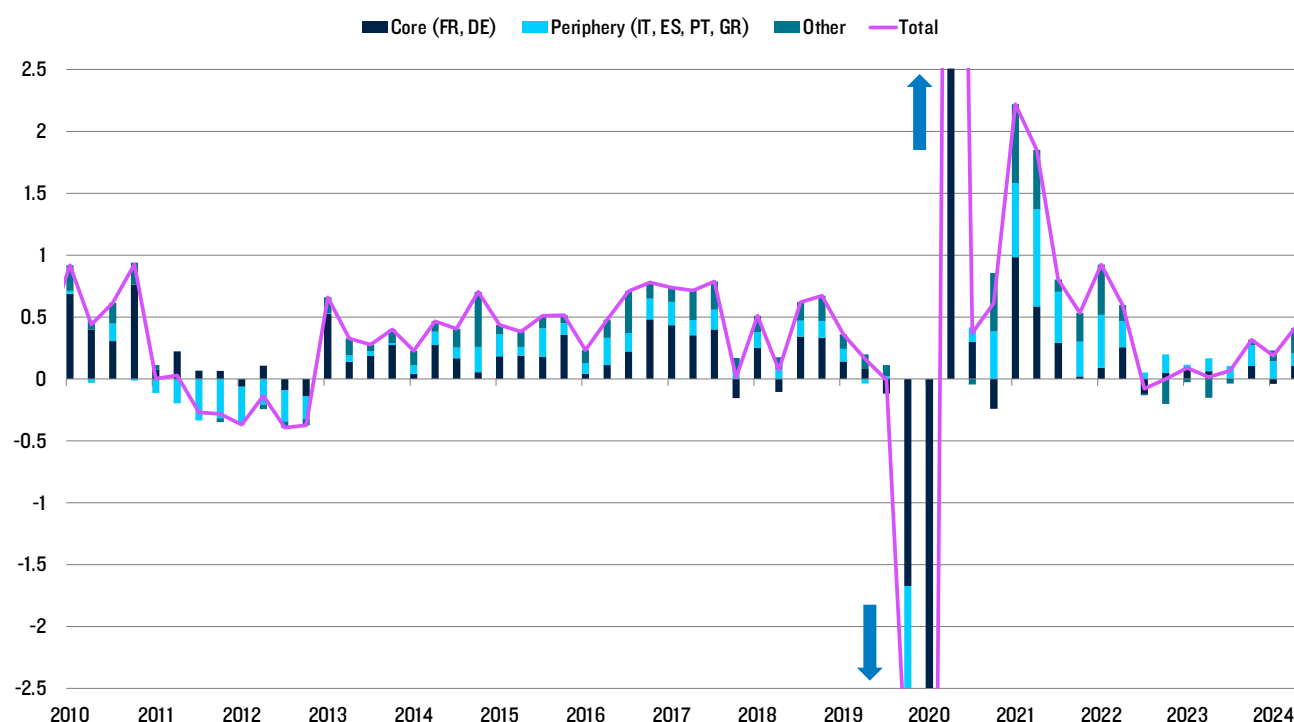
The EU is a much more open economic region than either the U.S. or China, with a total trade share of close to 45% of GDP, compared to around 35% and 25% for China and the U.S., respectively.¹ Given the importance of trade to the EU economy, the impact of higher tariffs imposed by its largest trading partner would be severe. These headwinds could exacerbate job losses and hit investor sentiment.

A lesser, but notable concern is the risk of stagflation which could dampen investor confidence. Recent

inflation spikes in Germany and France indicate this risk warrants attention.

Economic diversity across the eurozone, however, offers some mitigation for these pressures. Peripheral economies, including Spain, Portugal and Greece, are witnessing growth rates that, in some instances, rival the U.S. Projections for these economies are being revised upwards, with accompanying rating upgrades. Bond yield spreads between peripheral and core eurozone government debt could tighten further.

Euro Area Quarterly GDP Growth Contributions



Source: Eurostat.

¹ PGIM Fixed Income. (Sept 2024) *Five Risks U.S. Tariffs Pose to EU Competitiveness*. <https://www.pgim.com/fixed-income/blog/five-risks-us-tariffs-pose-eu-competitiveness> (Accessed January 2025).



PGIM REAL ESTATE



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QUICK TAKE

- Total returns in Europe set to improve further due to stable yields and rental growth.
- Liquidity set to rise in 2025 as interest rates fall further and investor sentiment rebounds.

Headline real estate values edged upwards in the second half of 2024 on the back of stable valuation yields and steady occupier market performance. The outlook is for returns to improve further in 2025, supported by declining interest rates and positive income growth.

With inflation moving within target ranges, the European Central Bank (ECB) has been able to decisively embark on its easing cycle. While transaction volumes remain low, investor intention surveys point to a pick-up in deal activity across the next few quarters on the back of a general uptick in sentiment.

Income growth is set to be a key driver of real estate returns over the next few years unlike the last economic cycle when property yields tightened significantly. However, as liquidity improves, there is some additional upside from yields trending slightly lower from today's levels and boosting values. A resilient rental growth

outlook is supported by a limited supply environment and improving productivity with city- and submarket-specific factors are shifting into focus, such as elevated space affordability.

Investment opportunities are also becoming more broad-based, even in sectors which have seen significant headwinds such as retail and office, where improved affordability and low supply are boosting rental growth potential. The living sectors are benefiting from strong structural tailwinds linked to the basic need of shelter and rising rental demand on the back of high housing costs, while logistics and data centres are supported by space demand coming from the ongoing trend of digitalisation. There are tactical opportunities too,

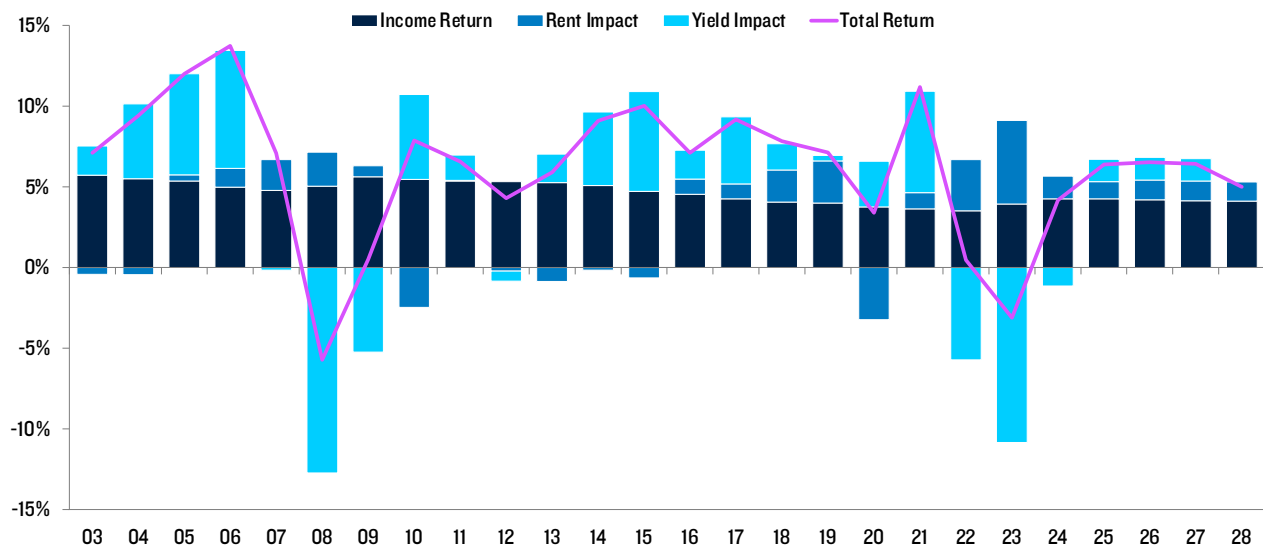
capitalising on a growing funding gap and short-term cyclical drivers, such as rising tourism demand.

However, risks remain elevated. While the outlook has improved, economic growth is still sluggish, capital inflows to real estate remain low, and the value recovery is yet to get meaningfully underway.

Still, markets linked to the rebound in international tourism offer the potential for improving retail sector fundamentals and the prospect of rising hotel revenues. More broadly, the main driver of capital value growth is rising rents, reflecting expectations of improving economic growth and ongoing low supply growth in the coming years.

Returns Are Back in Positive Territory and Improving

MSCI Europe Annual Property Index, Unlevered All Property Total Returns (% p.a.)



Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: MSCI, Cushman & Wakefield, PMA, CBRE, PGIM Real Estate. As of November 2024.



PGIM QUANTITATIVE SOLUTIONS



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QUICK TAKE

- Reasonable equity valuations (in line with 20-year averages) boost case for strategic exposure.
- Potential opportunity for Eurozone economies to break the shackles of weak productivity growth.

The war in Ukraine has upended industries that were dependent on cheaper sources of energy, especially from Russia. While hopes are growing for a settlement in the Ukraine-Russia conflict, other trends such as rise of Chinese brands in the auto sector are having an impact on major European industries. For example, Chinese electric vehicle brands in Europe have risen to 21% of all cars sold in the EU in 2023. Trade negotiations between the EU and China are ongoing, and there is uncertainty about a further escalation and potential retaliatory measures by China.

Eurozone economies also tend to suffer from structural headwinds such as less flexible labour markets and score

lower on measures of the ease of doing business, which tends to be associated with slower productivity growth.

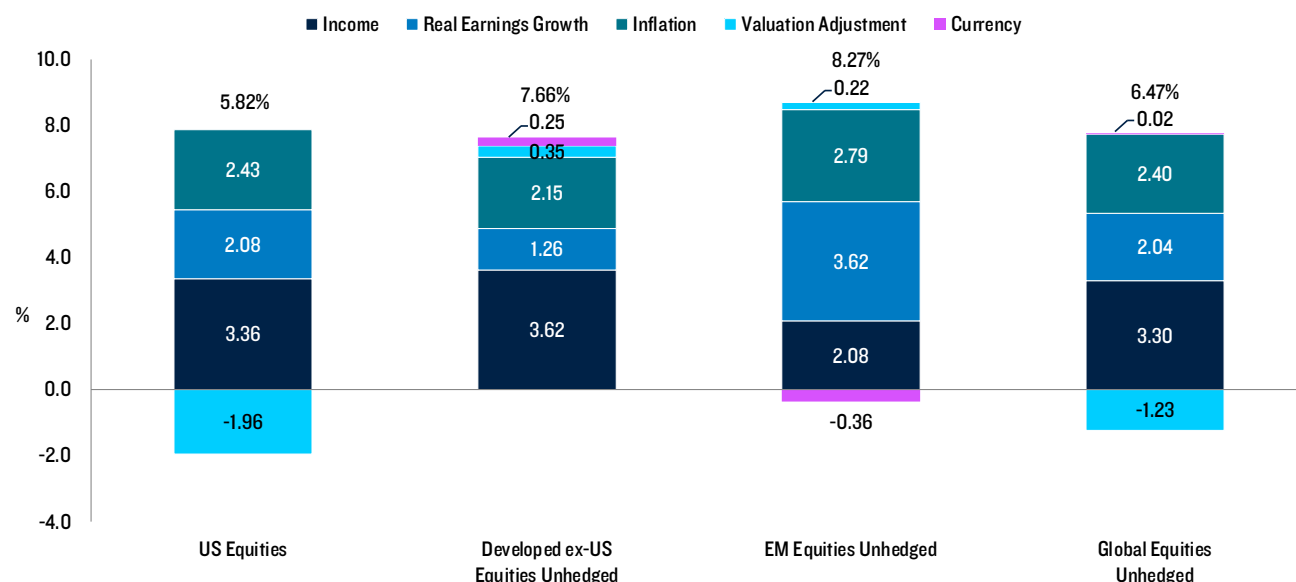
These, along with the headwinds mentioned above, are likely to keep European corporates on the backfoot compared to their developed markets counterparts over 2025. Efforts to jump start competitiveness are promising, but less likely to bear fruit in the near term.

Within our global multi asset portfolios, we still prefer US stocks over other developed market equities as well as emerging markets stocks on a tactical basis. Despite these near-term challenges, European stocks

have attractive long term expected returns¹, especially relative to US equities. These returns are driven more by attractive valuations rather than earnings outlooks which are relatively softer.

On a stand-alone basis European valuations are not too expensive, trading in line with the last twenty-year average based on forward earnings multiples. Overall, European equities should be considered as a key strategic exposure within broadly diversified portfolios.

Decomposition of Global Equity Return Forecasts



Source: PGIM Quantitative Solutions as of 30-Sep-2024. For illustrative purposes only. Forecasts may not be achieved and are not a guarantee or reliable indicator of future results.

¹ PGIM Quantitative Solutions. (Nov 2024). *2024 Q4 Capital Market Assumptions*. <https://www.pgimquantitativesolutions.com/outlook/2024-q4-capital-market-assumptions> (Accessed December 2024).



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QUICK TAKE

- Investor sentiment more positive towards Europe vs UK, infrastructure transactions in focus.
- Illiquidity premium in private assets is reasonable compared to public markets

The outlook for mergers and acquisitions activity in 2025 remains subdued though dealmaking may rebound if economic conditions improve. Companies are eager to invest despite the broader uncertain macroeconomic backdrop. If market conditions become more supportive, then sponsors will start recycling assets and that will kickstart a virtuous cycle of increased funding and lending activity.

The private lending market is relatively more stable. At a broad level, corporate balance sheets in the investment grade space are resilient. Moreover, borrowers continue to expect that interest rates are headed lower that could be act as a tailwind for lending activity. Another advantage of a slightly subdued outlook is companies who might have been planning to execute a large transaction via a syndicated deal or visiting the public market, might end up with a smaller issuance tranche via the private lending space.

Geographically speaking, investor sentiment towards Europe is relatively more positive compared to the UK, mainly due to the political changes and subsequent fiscal policy. European lenders are aggressive in the private credit lending space with Italian and Spanish banks providing stiff competition. Infrastructure related funding remains a key focus for policymakers,

driven by government spending plans.

A big theme playing out in private credit in Europe is the progressive shift from a bank funding to a non-bank funding model. In Europe, we are starting to see the trend of companies wanting access to more longer term capital. The structural growth driver for that trend remains intact in Europe and this shift is likely to accelerate thanks to regulatory changes. The other big driver encouraging the shift towards private lending is the lacklustre performance of the public bond and equity markets. For example, the IPO market in the UK has been outpaced by its global counterparts in recent years. In comparison, the illiquidity premium harvested by investors relative to public assets remains reasonable fuelling that shift. The overall activity for 2024 was robust with a tilt towards higher yields and riskier credit quality transactions.

JENNISON ASSOCIATES



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QUICK TAKE

- Europe is underexposed to the high growth companies compared to the U.S.
- Weakening Chinese consumer confidence is a headwind.

Over the last decade, European equity markets have significantly lagged the MSCI All Country World Index, with the majority of that underperformance emanating from the strong returns in the U.S. market over that period. Europe seems to have missed the big waves of innovation and disruption that have helped to power the recent gains in the U.S. stock market.

Framed another way, Europe is underexposed to the high growth companies that have become a defining feature of the U.S. market. While that may be beneficial in a year like 2022 when European markets outperformed their global counterparts during

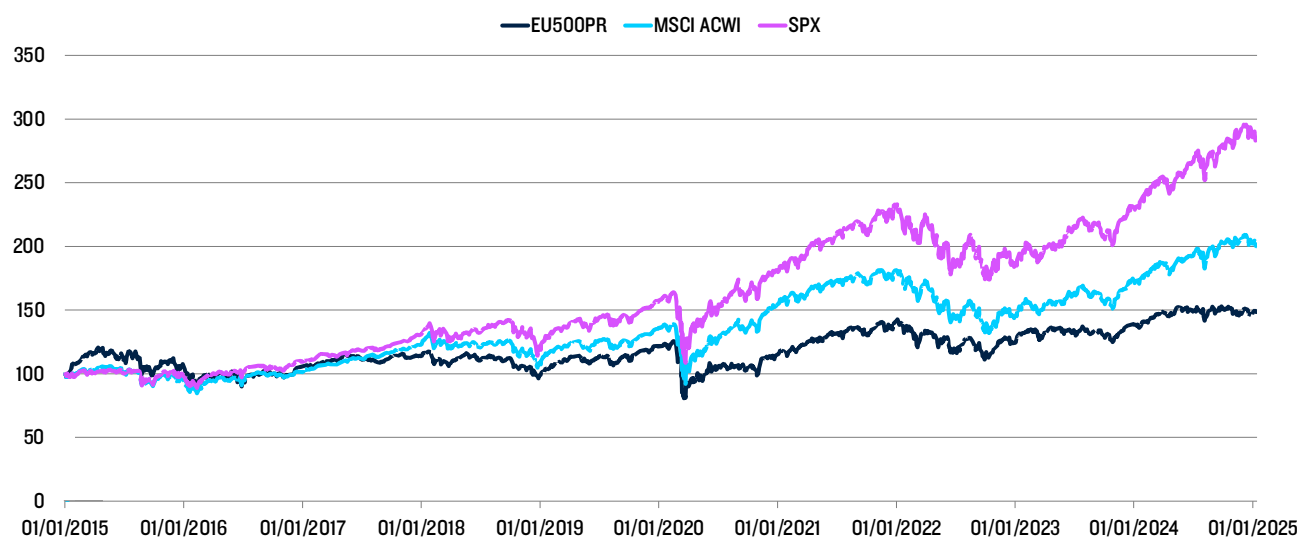
a global market selloff as growth companies suffered severe multiple compressions, the bigger question for investors remain, how many companies with a trillion-dollar market capitalisation are European?

The outlook in 2025 has not changed. With key events ahead, starting with German elections in February, it seems likely that investors in European equities may have to be content with yet another year of modest returns, or work even harder to uncover areas of the market that can show some secular growth.

While Chinese equities have rallied after the government announced new stimulus measures to boost the economy and this may happen again, we think that reigniting consumer confidence sustainably in the world's second-largest economy is going to prove much harder than market expectations. We maintain our cautious outlook on the Chinese economy and markets and doubt Beijing's ability to provide a demand boost for European corporates.

U.S. "Exceptionalism" in the equity markets

U.S. equities outperform European, World stocks.



Source: Bloomberg.

CONCLUSION

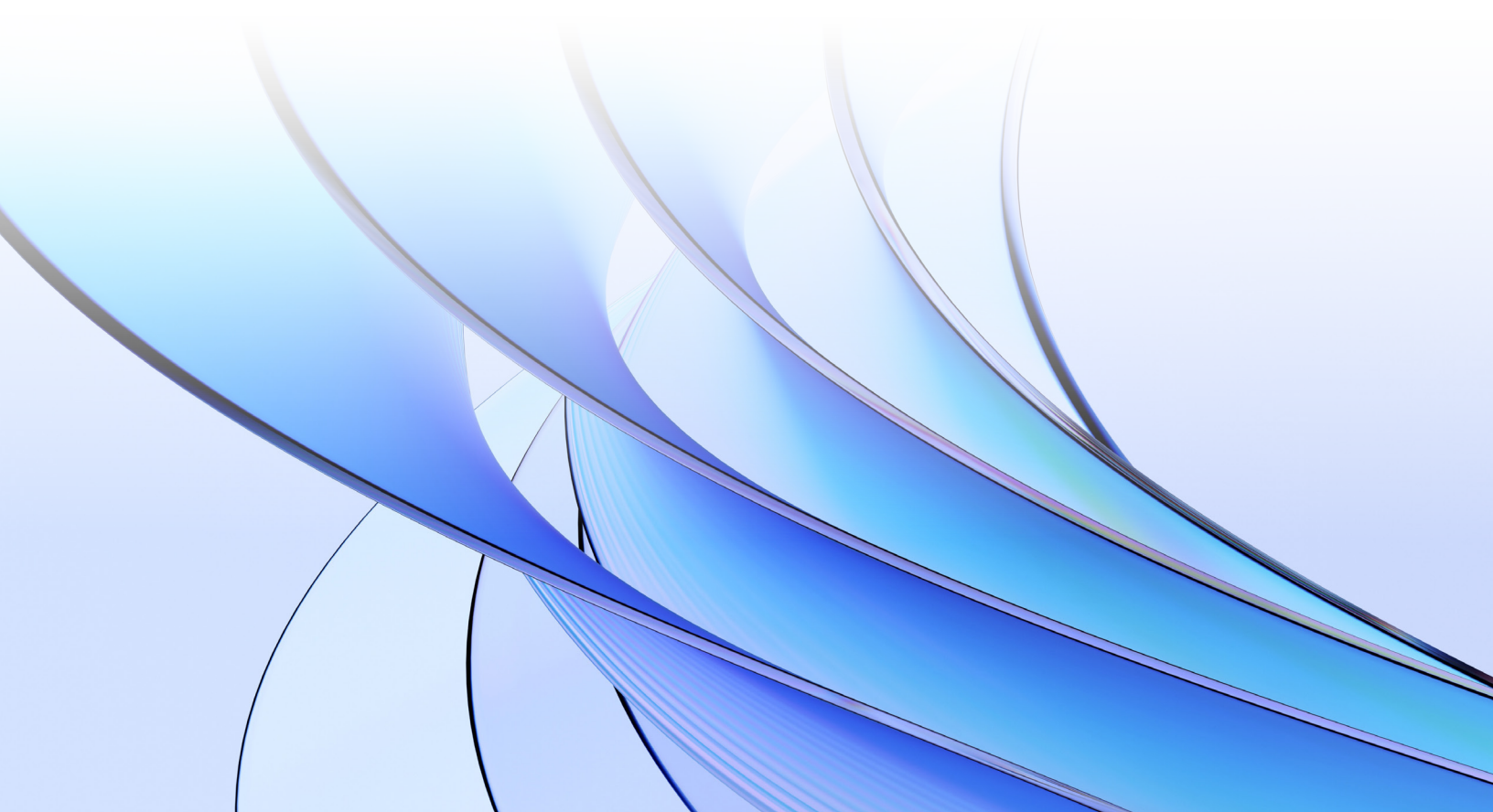


The contrasting narrative for the U.S. and Europe is well rehearsed: recent U.S. growth has been robust, supported by success in technologies where Europe has struggled to build industrial scale; the potential impact of tariffs by the incoming U.S. administration on the open trading economies of Europe could be severe; and the crucial economies of France and Germany are struggling to form the stable governments that are a pre-requisite for necessary policy change.

But the familiarity of this narrative also means that it is priced into markets. There are many ways in which the new U.S. administration could encounter road bumps as it seeks the delivery of its radical agenda.

On the other hand, potential reasons for optimism in Europe get less airtime: inflation and interest rates are projected to come down in the coming year in Europe; the economies of peripheral Europe have been

performing strongly; and blueprints for navigating Europe's structural challenges have been crafted. So while we have no doubt that global geopolitical storms have ample capacity to hurt Europe in 2025, we believe that there are opportunities for investors at current market levels, and that European policymakers have a significant opportunity to deliver an upside surprise if they prove willing and able to deliver meaningful progress in reworking the continent's economic architecture.



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