Flash Economics

N° 28
March 18, 2025

Why are European stock markets doing well when the news is bad for the eurozone economy?

When considering the outlook for growth, industrial production, employment, the risk of tariffs on exports to the United States, and business investment, we see that all the news is bad for the eurozone economy, and the economies of Germany, France and Italy.

Yet the European stock market indices have risen sharply since the start of the year (between the beginning of January and the middle of March, the Euro Stoxx 50 has gained 10.9%, the DAX 40 14.8%, the CAC 40 9.1%, the FTSE MIB 12.4% and the IBEX 35 11.4%), while the S&P has fallen by 6.6%, also since the start of the year, in the United States.

This contradiction between the trend in European stock market indices and Europe's economic situation can be explained:

- Not by the trend in long-term interest rates (mid-March, the 10-year rate on German public debt was 2.86%, whereas it was 2.36% at the start of 2025);
- Possibly by the return of capital previously invested in the United States (the euro appreciated from 1.018 to 1.09 against the dollar between the beginning of January and mid-March 2025);
- By the decline in the perception of political instability in Europe (the 10-year OAT-Bund spread narrowed from 86 basis points at the beginning of January 2025 to 69 basis points in mid-March 2025; the BTP-Bund spread narrowed from 116 basis points at the beginning of January 2025 to 106 basis points in mid-March 2025);
- By the correction of the valuation gap between US and European equities, which investors view as excessive;
- By the weight of the banking sector in the European equity market;
- By the sharp rise in the market prices of companies manufacturing military equipment.

The possibility of peace in Ukraine and a normalisation of relations between Europe and Russia, perhaps involving the resumption of Russian gas imports into Europe, which is being mooted by some, seems very doubtful.

All in all, however, one must remain wary: the economic news for Europe will not be good, which could break the upward trend in European stock market indices.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus

Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

European stock market indices have risen significantly faster than US stock market indices in the recent period

Charts 1a/b compare the performance of the European stock market indices (Euro Stoxx 50, CAC 40, DAX 40, FTSE MIB, IBEX 35) with that of the S&P500 index, showing that the European stock market indices have risen significantly faster than the US indices, particularly since the beginning of 2025.

Chart 1A
Stock market indices (01.01.2024 = 100)

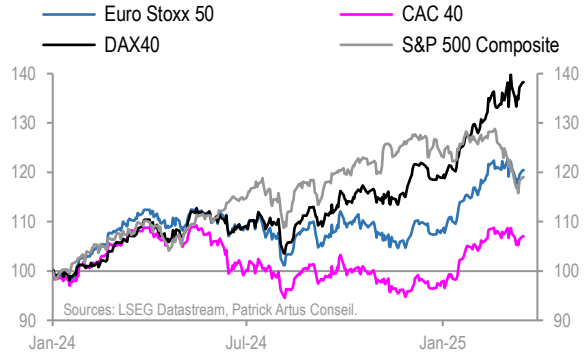
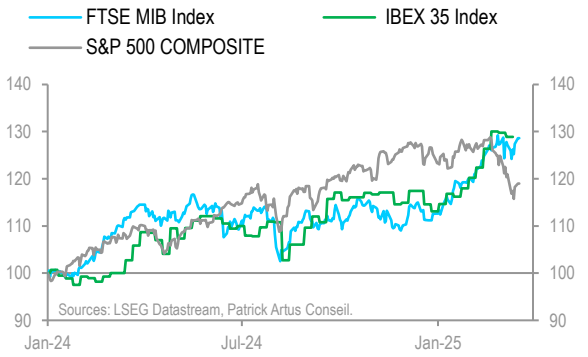


Chart 1B
Stock market indices (01.01.2024 = 100)

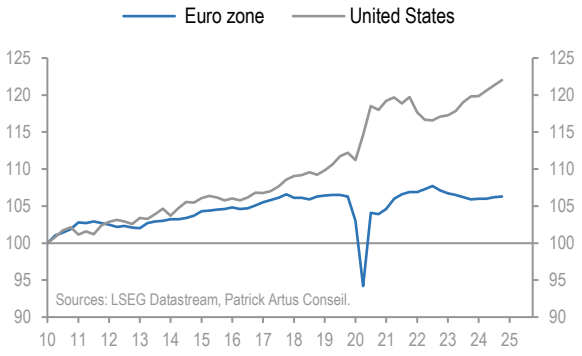


Yet the euro zone economy is in trouble

The outperformance of the European stock markets relative to the US stock market is surprising, given the difficulties the euro zone economy is facing:

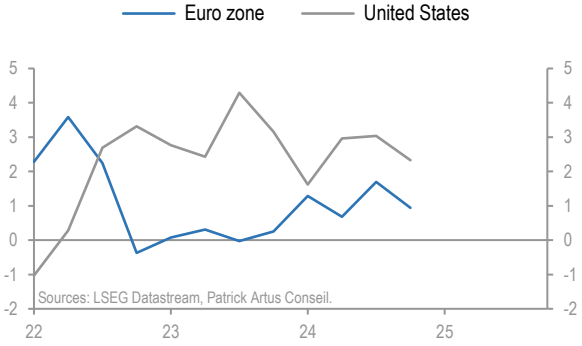
- A stagnating labour productivity (Chart 2);

Chart 2
Productivity per head (2010.Q1 = 100)



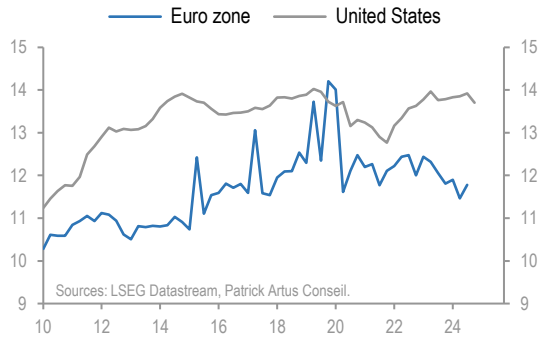
- Weak growth (Chart 3), which has led to a 60% rise in business insolvencies in the euro zone between the beginning of 2022 and the end of 2024;

Chart 3
Real GDP (Q/Q as %, annualised)



- A decline in the rate of business investment (Chart 4);

Chart 4
Investment of corporations
(in value terms, as % of nominal GDP)



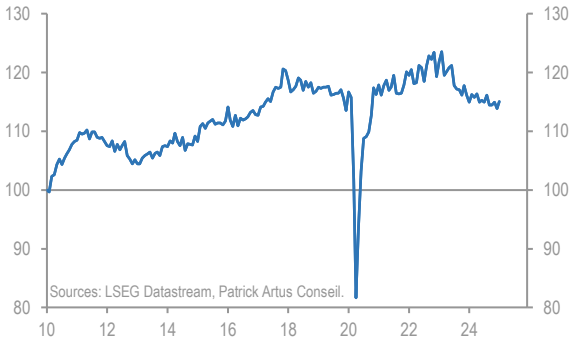
- A decline in exports (Chart 5);

Chart 5
Euro zone: Exports of goods and services
(monthly, EUR bn)



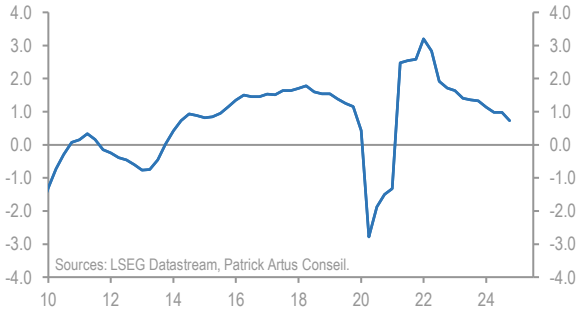
- A decline in manufacturing output (Chart 6).

Chart 6
Euro zone: Manufacturing production (2010.M1 = 100)



The outlook for employment (Chart 7) is unfavourable, with numerous announcements of job cuts, and overall, the situation in the euro zone could deteriorate further as the Trump administration is set to impose tariffs on European exports (particularly cars) to the United States.

Chart 7
Euro zone: Employment (Y/Y as %)



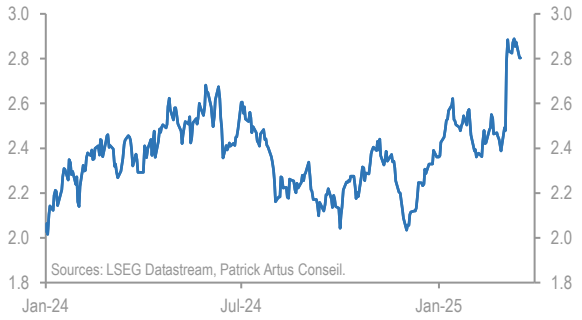
How can one explain the contrast between the performance of the stock market indices and the economic situation in the euro zone?

There is a stark contrast between **the good performance of the euro zone stock market indices and the poor state of the euro zone economy**.

How can this contrast be explained?

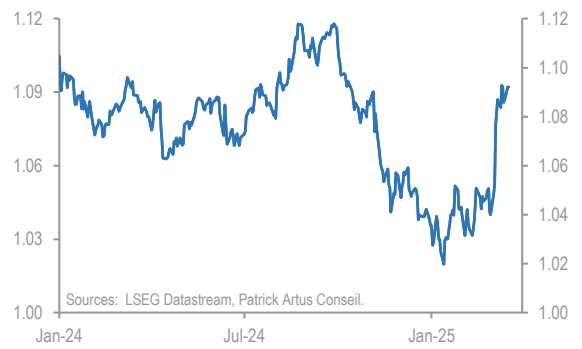
- Long-term interest rates have risen in the euro zone since the beginning of January (Chart 8), so the rise in stock market indices cannot be attributed to the drop in long-term interest rates.

Chart 8
Germany: Interest rate on 10-year government bonds
(as %)



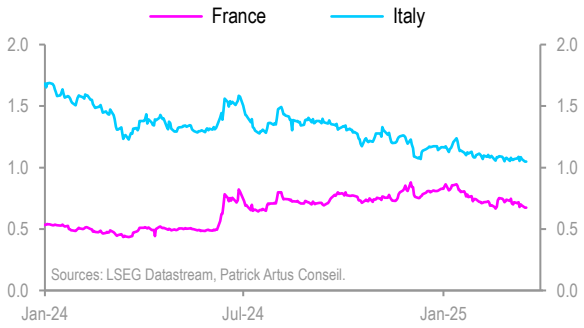
- It is possible that **capital has returned from the United States to the euro zone**, as seemingly shown by the euro's recovery against the dollar since the beginning of 2025 (Chart 9).

Chart 9
Euro/dollar exchange rate (EUR 1 = USD...)



- There has **been a decline in the perception of political risk** in some euro zone countries (France, Italy), as shown by the narrowing of these countries' long-term interest rate spreads vis-à-vis Germany (**Chart 10**).

Chart 10
Yield spread on country's 10-year government bonds against Germany (as % point)



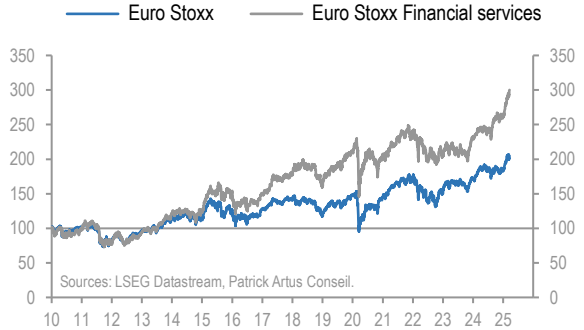
- It is simply possible that **the valuation gap between US and European equities is considered excessive** (**Chart 11**), leading investors to increase the share of European equities in their portfolios despite the poor economic situation in the euro zone.

Chart 11
Forward P/E ratio



- One possible explanation is **the sizeable weight of the banking (financial) sector in the European stock market** (18%) following the recovery of the financial sector stock indices (**Chart 12**).

Chart 12
Stock market indices: Euro Stoxx and Euro Stoxx financial services (01.01.2010 = 100)



- Another explanation is **the sharp rise in the stock market indices tracking companies manufacturing military equipment**: since the start of the year, for example, Dassault Aviation has risen by 57%, Safran by 26%, Rheinmetall by 127% and Thales and Leonardo by 81%.

- Finally, the argument put forward by some that the war in Ukraine is coming to an end and that economic relations between Europe and Russia will normalise (perhaps implying a resumption of imports of Russian natural gas into Europe) seems completely unrealistic.

Summary: whatever the relevant explanation for the sharp rise in European stock market indices, one needs to remain cautious

The strong rise in European stock market indices, particularly since the start of 2025, may be due to the return of capital from the United States to Europe, a reaction by investors to the valuation gap between US and European equities, a reduction in the perception of political risk in France and Italy, and the good stock market performance of banks and the defence sector.

Whatever the cause of this strong performance by European equities, investors should remain cautious because the economic news for the euro zone (growth, investment, employment, exports, corporate failures, etc.) will remain poor.

Disclaimer

Ossiam, a subsidiary of Natixis Investment Managers, is a French asset manager authorized by the Autorité des Marchés Financiers (Agreement No. GP-10000016). Although information contained herein is from sources believed to be reliable, Ossiam makes no representation or warranty regarding the accuracy of any information of which it is not the source. The information presented in this document is based on market data at a given moment and may change from time to time. This material has been prepared solely for informational purposes only and it is not intended to be and should not be considered as an offer, or a solicitation of an offer, or an invitation or a personal recommendation to buy or sell participating shares in any Ossiam Fund, or any security or financial instrument, or to participate in any investment strategy, directly or indirectly. It is intended for use only by those recipients to whom it is made directly available by Ossiam. Ossiam will not treat recipients of this material as its clients by virtue of their receiving this material. All performance information set forth herein is based on historical data and, in some cases, hypothetical data, and may reflect certain assumptions with respect to fees, expenses, taxes, capital charges, allocations and other factors that affect the computation of the returns. Past performance does not predict future returns. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. Ossiam assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from, an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. This information contained herein is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Ossiam to any registration requirements in these jurisdictions. This material may not be distributed, published, or reproduced, in whole or in part.