

Outside of the box: What to look out for in 2025?

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The year 2024 has been full of changes and challenges that are likely to spur more of the same in 2025. This year brought political uncertainties around the globe that fuelled market turbulence, with central banks swinging from rapid hikes to subsequent cuts in interest rates. After such a year full of challenges and change, what should investors look out for next year? These are the five topics to watch.

1) A new world order with new priorities

After the European elections in June, the newly appointed European Commission has set priorities that look quite different from those of the previous one. While the Covid response and the Green Deal were the main priorities for 2019-2024, the European Union (EU) strategic agenda for the next five years focuses on a free and democratic, strong, and secure, and prosperous, and competitive Europe. This includes working on European security and defence, Europe's competitiveness and deepening the single market.

We are living in a different world, full of geoeconomic tensions, two wars at Europe's borders, and sluggish competitiveness that is leaving Europe lagging behind the United States (US) and China. Mario Draghi describes this very well in his latest report. Since 2002, the gross domestic product (GDP) gap between the EU and the US, measured at 2015 prices, has almost doubled to 30% in 2023, primarily due to lower productivity in the EU ^[1]. Draghi calls for an additional EUR750 to EUR800 billion in investments per year to help revert the situation, 80% likely to be financed by the private sector and 20% by the public sector.

In his "Much More Than a Market" report^[2], Enrico Letta dives deeper into details and gives concrete examples on how to finance these needs, from the EU budget and

European Investment Bank (EIB) project lending to putting in place a European Stability Mechanism (ESM) precautionary credit line to help its Members finance defence and security expenditures.

Given that the priorities and money flows will be different, every investor globally will need to closely watch the EU's new direction and new financial opportunities in 2025.

2) From billions to trillions - the money to finance Europe's priorities

In March 2024, bonds issued by the European Commission, the EIB, and the ESM and its predecessor the European Financial Stability Facility (EFSF), so-called European safe assets, crossed the EUR1 trillion mark for the first time in history^[3].

Financing public goods through European institutions might help countries that need to consolidate their public finances to make room for investment and to protect themselves against future shocks. The ESM, for example, borrows on the market at cheaper rates than 16 out of the 20 euro area countries, and its financing costs are below the GDP-weighted average of the euro area's financing costs (Figure 1).

Figure 1: ESM borrows at cheap rates

(Euro area 10-year yield levels, in %)

Note: Euro area weighted GDP is the GDP-weighted average of 10-year yield levels across euro area countries.

Source: Bloomberg Finance L.P.

The new priorities lend themselves to being considered European public goods and could therefore be publicly financed. Using the percentage that Mario Draghi suggests would amount to about EUR160 billion annually or EUR800 billion over five years.

Global investors should watch whether European policymakers can agree on how to collectively finance these new strategic priorities.

3) Markets change eagerly and rapidly

After the fastest interest rate hike cycle in the last half century, most central banks around the world have cut rates. And markets are expecting more in 2025 (Figure 2). At the same time, the second Donald Trump administration and the prospect of a tariff war being potentially inflationary, could mean delaying further cuts or even reversing.

Figure 2: From fastest hiking cycle to the first cuts

(%)

Source: HSBC

We have seen some interesting shifts in our investor base the last couple of years. 2024 has been particularly significant. Asian investors took up almost a quarter of ESM/EFSF bonds, their biggest participation since 2011 (Figure 3) and four times more than in 2022. Asian investors seem to be showing an increased interest in euro-denominated assets.

Figure 3: Asian investors interest in ESM/EFSF bonds on the rise

(% of ESM/EFSF issued bonds allocated to Asia)

Source: ESM calculations

There has also been an increased interest in EFSF/ESM bonds from central banks globally. In 2024, more than a third of our bonds - namely 36% - were bought by central banks, sovereign wealth funds, and official institutions (Figure 4). Again, the highest level since 2011. This shows trust in the euro area economy, the euro as a currency, and the willingness to diversify investments into triple-A rated European safe assets.

With more volatility and unpredictability in the market, we can expect more diversification in 2025. The euro is the second currency in the world, after the US dollar. We see more reserve managers diversifying to ensure they are hedged in a risk-prone world.

Figure 4: Central banks buying more ESM/EFSF bonds

(% of ESM/EFSF issued bonds allocated to central banks, government and sovereign wealth funds)

Source: ESM calculations

4) Electronic trading and AI technology

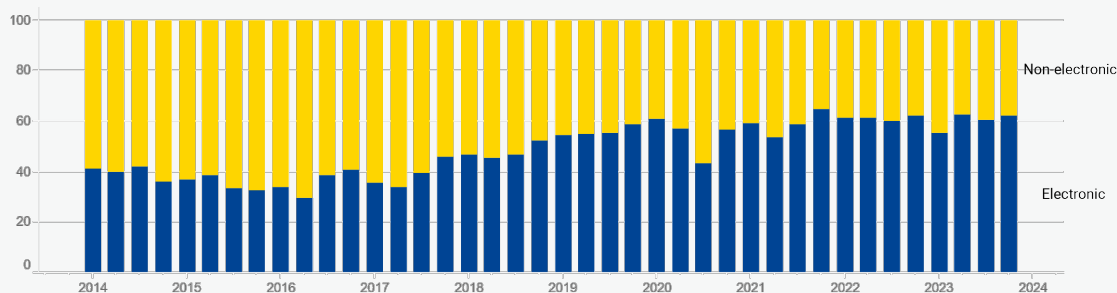
Technological advancements have revolutionised the capital markets industry and will remain topics for investors to watch moving forward.

[Electronic trading in EFSF/ESM bonds](#) has increased from 40% to 60% over the past decade (to 55% to 80% in number of trades), see figure 5.

Figure 5: Electronic trading on the rise

Electronic versus non-electronic trading activity in ESM/EFSF bonds

(% share of volumes traded in secondary markets)



Volumes are in terms of bond face value.

Source: ESM

Even in volatile markets, investors continue to trade electronically, and more high-risk trades have shifted to electronic platforms. A balance between voice and electronic

trading increases resilience during stress events. Artificial intelligence (AI) will also be worth tracking in 2025. The US and China already lead in venture capital investment in AI, with the US around seven times more and China nearly doubling such investments compared to Europe. To stay competitive, [Europe must create an environment where AI companies can thrive](#) with access to well-developed capital markets supporting large funding rounds.

5) ESG is maturing, but must remain in focus

With 2024 on course to being the hottest year on record, climate change is a fact and mitigating its risks must remain a priority. Environmental, social, and governance (ESG) topics need to be integrated more into businesses and countries' strategies.

For example, increases in global temperatures have a direct impact on tourism in Europe. Warmer winters, intensifying droughts, and extreme weather events can discourage tourism but also endanger natural attractions and increase operational costs. Adaptation and mitigation will require billions of euros every year. Where to get this financing from was the main discussion at the 29th United Nations Climate Change Conference in Baku in November. Given the significant role for the private sector in financing climate change, further enhancing the financial integration in the EU would be beneficial. [Completing the banking union and progress with the capital markets union are key in this](#) .

The euro has been the currency of choice for future-oriented issuers and investors in ESG, followed by the dollar. This is a trend that is set to continue in 2025, and might even grow if the US reduces ESG efforts under its new administration.

Challenges and opportunities

The changing geopolitical world is an opportunity for Europe to seize the moment to deepen integration, especially on defence, security, competitiveness, and deepening the single market.

At the same time, green investment and sustainability must remain priorities. Moving from idealism to integrating ESG into business strategies will help companies lay the groundwork for long-term resilience and attract new investors.

Markets will be searching for a new norm, after the changing interest rate environment over the last two years, at a time when AI and technology will be pushing innovation further, also in capital markets.

Uncertainty and change might be the words that come to mind when looking forward to 2025, but the new year and the renewed set-up of the EU strategic agenda is also an opportunity to make a positive difference for Europe.

Further reading

[Electronic trading - a boost to ESM bond market resilience.](#)

[Europe's AI leadership: key priorities.](#)

[How banking union and capital markets union can help Europe finance the climate change challenge](#) .

Acknowledgements

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Footnotes

[1] [Mario Draghi, "The future of European competitiveness", Part A, 2024.](#)

[2] [Enrico Letta, More Than a Market, 2024](#)

[3] [Celebrate that European safe assets have joined the EUR1tn club](#)