Investment Managers

Investment Institute Macroeconomics

Global reaction

Monthly Investment Strategy

AXA IM Macro Research

March 2025

Summary: March 2025

Theme of the month: EU defence

- Europe has responded to the US's apparent shift in direction over support to Ukraine and for wider European security. The EU has announced an "EU ReArm" policy. This lifts restrictions on national borrowing, easing triggers for excessive deficit proceedings, for defence spending. This is expected to provide around €650bn in defence spending over the coming four years. EU loans will make up a further €150bn. These estimates appear toppish.
- The EU's new defence spending plans aim to reduce decades of relative underinvestment, particularly compared with the US, which has maintained a minimum 1.5% of GDP spending excess over the EU. Even now 7 EMU members do not meet their NATO obligations, including Italy and Spain. The EU only achieved a 2% average last year, helped by large increases from the Baltics, Finland and Poland ie those with more direct Russian exposure.
- Insofar as spending is to provide immediate help to Ukraine, this boost will largely fall on imports – 80% of EU spending since the start of the Ukraine war has been imported, 63% from the US. This will have a limited boost to EU growth. The plan is designed to restart a domestic defence industry. Over the medium term, if defence spending rises to 3.5% of GDP as planned and based on conservative multiplier metrics, defence spending could add around 0.5ppt to Eurozone growth.

Macro update: Global aftershocks from tectonic US shifts

- US policy uncertainty is having a negative impact on the economy. Despite a rebound from a weak January, sentiment has weakened, not least as equity markets correct. Underlying growth appears solid for now, but should fade. We forecast GDP growth to average 2.1% this year, but slow to 1.5% next. Risks to growth appeared to contribute to the Federal Reserve downplaying any inflation risk. Yet we still see the Fed deferring rate cuts until later this year.
- The European response to the US has been sharp, although the net adjustment (inc tariffs, uncertainty and higher yields) has led us to reduce our growth outlook for 2025 to 0.8% (unch) and left 2026 unch (1.2%). We do consider prospects for a material boost (c 0.5ppt) over the medium-term. But short-term expect the ECB to continue to ease to 2% by mid-year and 1.5% by end.
- China also moved forward with supportive fiscal policy (adding 2.1% of GDP) to support an ambitious growth target of "around 5%" for this year. reengagement with private enterprise should help, but weak consumer spending – despite reorientation of support – is likely to see growth miss its target this year. We forecast growth of 4.5%. We also lower our inflation outlook to 0.5% and 0.8% for this year and next.
- Canada has seen the biggest impact from tariffs, sentiment indices falling sharply. New PM Carney has announced an election for 28 April, where his Liberal party now enjoy a small lead in the polls having overturned a 25pt deficit.
- Mexico is also threatened by tariffs, pressure which adds to a number of domestic adjustments for the new government. In broader EM, many countries grapple with the uncertainty that US trade and broader security problems bring. Those that have their own problems are more exposed and we highlight Indonesia, where fiscal finessing has caused market concerns, and Korea, which continues to cope with its own constitutional crisis. We also flag Turkey, which has taken this opportunity to make another foray into authoritarianism.
- Japanese developments appear consistent to the BoJ tightening monetary policy again in July.
- The UK continues to face a difficult public finances backdrop.

Central scenario

Summary – Key messages

Our central scenario: Global economy reshapes to new US policies.

Global growth expected 3.2% in 2025, to slow to 2.9% in 2026.

New US policies to have global impact, depending on scale of implementation. Divergence expected in key economies.

Inflation

Upside inflation risks for US on policy initiatives and rising inflation expectations – spillovers to rest of world through currency impact. Core disinflation to broaden, but stickiness in services persists.

Monetary policy

Expected changes in US trade policy to lead most developed central banks to pursue more easing. Some EM's more constrained. Fed likely to defer easing.

Fiscal policy

Expansive. Germany leads in fiscal expansion of infra and defence, but broader EU defence increase. China lifts borrowing to spur growth. US deficits likely to rise for tax cuts. Markets increasingly vigilant.

Emerging Markets

External pressures, including tighter financial conditions, rise. Require wise use of fiscal and monetary policy. Some have more space than others.

FX

Dollar retraces from 40-year highs (real, TW) as exceptionalism expectation fades. Short-term gains possible, but policy response elsewhere to see further pull back into 2026.

Rates

European yields rise on fiscal expansion. US yields fall on growth fears, but fiscal concerns may reemerge. Japanese yields trend higher in normalisation. China yields bounce of lows.

Growth

US growth fears overdone, but headwinds mounting. Other economies face drag from US trade policy as domestic policies become supportive.

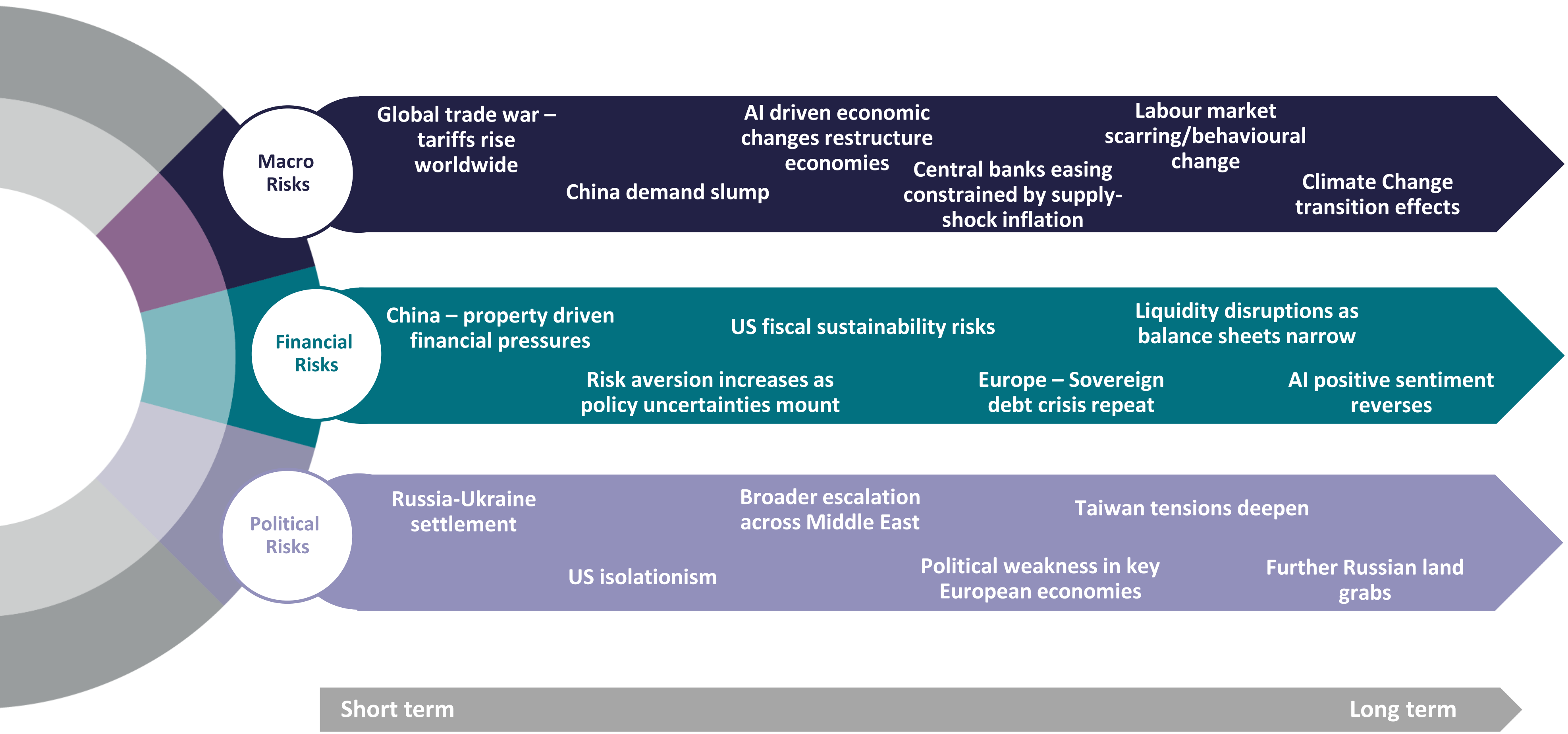
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 20%	**A global boost** Probability 10%
What could be different?	- Full scale Trumponomics: protectionism, migration clampdown - Geopolitical tensions escalate: Ukraine, Middle East and Indo-Pacific - Inflation expectations rise, affecting wages and inflation persistence	- Productivity boost following investment rebound and structural post-pandemic adjustments, AI impact becomes visible - De-regulation prompts more efficient government - Ukraine settlement lowers short-term energy prices
What it means	- Growth weaker, employment slows, but inflation remains above targe - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
Market implications	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	- Risk-on environment, equities make further gains, growth retains lead over value - UST softens, EUR strengthens - Spreads grind tighter

RISk Radar

Summary – Key messages



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Theme of the month

A new direction – EU ReArm

EU Defence

High national contributions

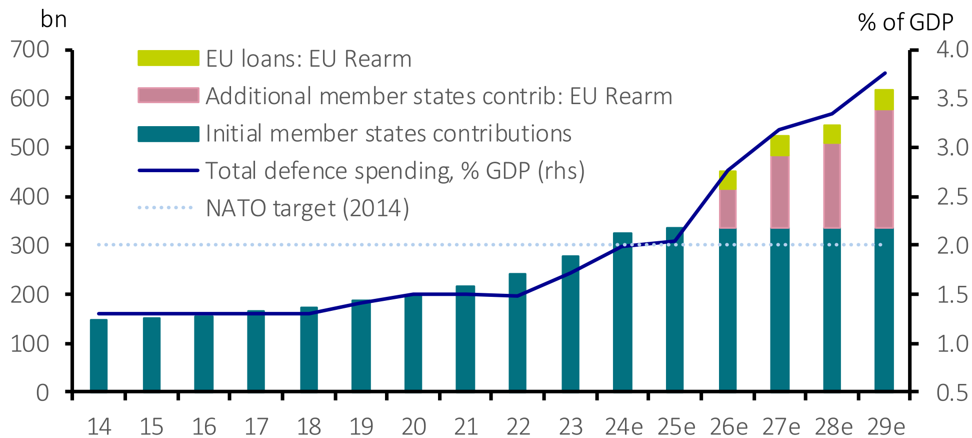
- The EC President's new defence package "EU ReArm" is based on increased defence spending for the countries that have the fiscal space, thanks to the easing of the national escape clause which avoids triggering the excessive deficit procedure.
- Based on voluntary contributions, the EC expects extra spending of around EUR650bn over the next four years, quite possibly on the optimistic side.

Small EU funding contributions

- A new instrument providing loans worth a total EUR150bn is to be created, allowing (cheaper) spending in pan-European domains (e.g. air and missile defence, drones, cyber…) with the aim to transfer these to Ukraine in the short-run.
- Reallocating unspent EU budget: c.EUR60bn worth of cohesion funds is yet to be disbursed.

A targeted meaningful EU defence spending effort…

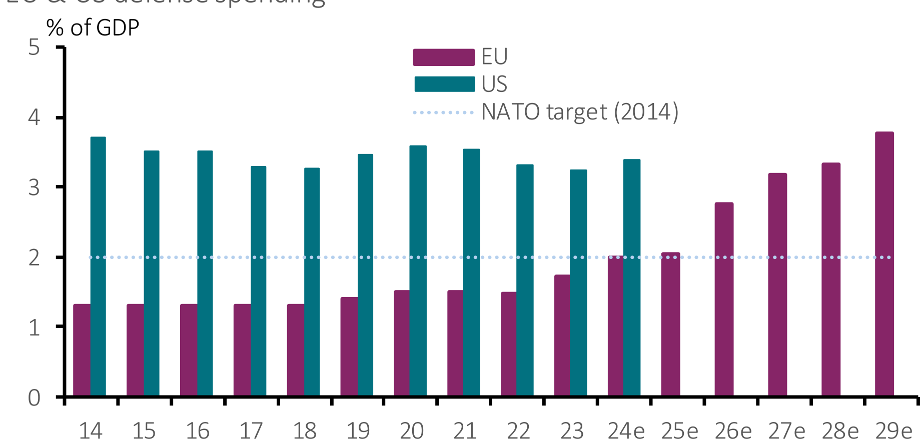
Targeted EU defense spending



Source: EC, NATO, World Bank, AXA IM Research, March 2025

…to eventually catch up with the US

EU & US defense spending



Source: EC, NATO, World Bank, AXA IM Research, March 2025

AXA Investment Managers

Where did the EU stand? Far behind

EU Defence

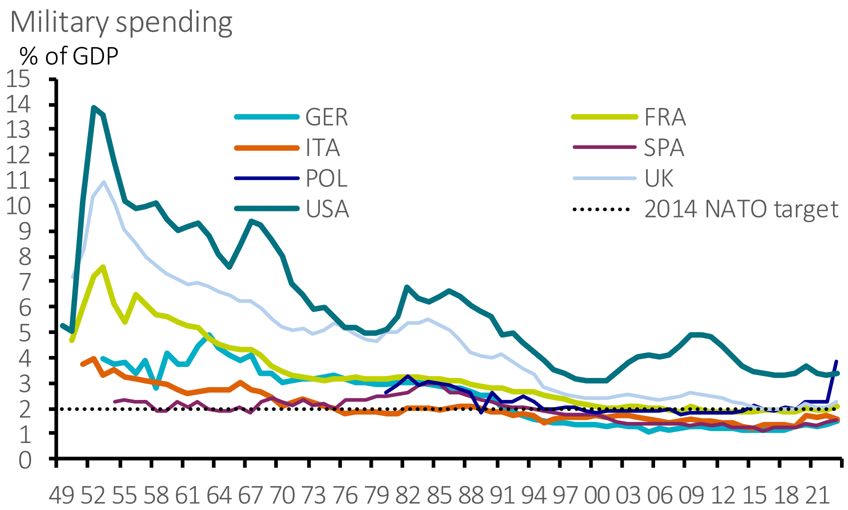
EU piece dividend

- The US-EU military expenditure gap has remained above 1.5% of GDP since 1960, although recent US deceleration saw this close to historical lows in 2024. The EU as a whole has consistently undershot its 2014 NATO target until last year.

A well-diversified picture within EMU

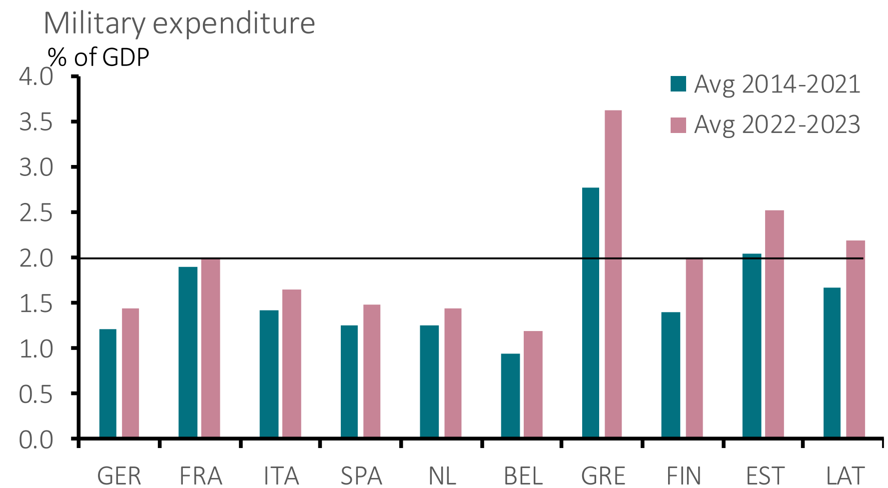
- Still, 7 out of 23 EU NATO members are expected to miss their 2% defence spending threshold in 2024.
- Despite the fact that some countries geographically close to Russia have been spending more (Baltic countries, Finland, Poland), it is fair to say that EMU countries greatly lag in both physical and human capital

The EU peace dividend



Source: SIPRI, AXA IM Research, March 2025

Discrepancies across EMU, Italy and Spain far below NATO threshold



Source: SIPRI, AXA IM Research, March 2025

A lot to catch up

EU Defence

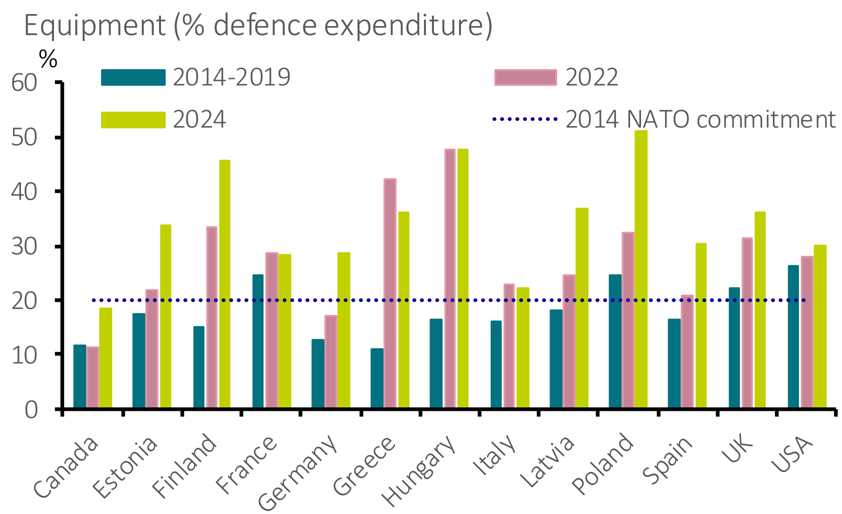
Charging up on equipment

- Despite a recent pick-up since the Russia-Ukraine conflict, EMU countries have yet to catch up with decades of under-investment implying significant lag in terms physical and human capital, but also efficient (and reliable) transnational supply chains within and across products.

Not all defence spending is equipment

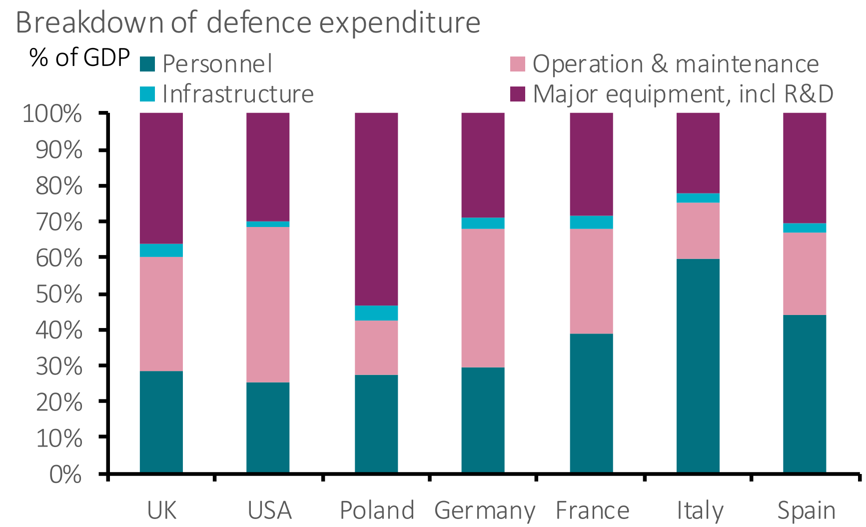
- Euro area defence expenditure is seemingly biased towards personnel. A reorientation towards investment is key to improved long-term prospects

Most European NATO members were under-investing before 2022



Source: NATO, AXA IM Research, March 2025

Defence spending heavily skewed towards personnel spending



Source: NATO, AXA IM Research, March 2025

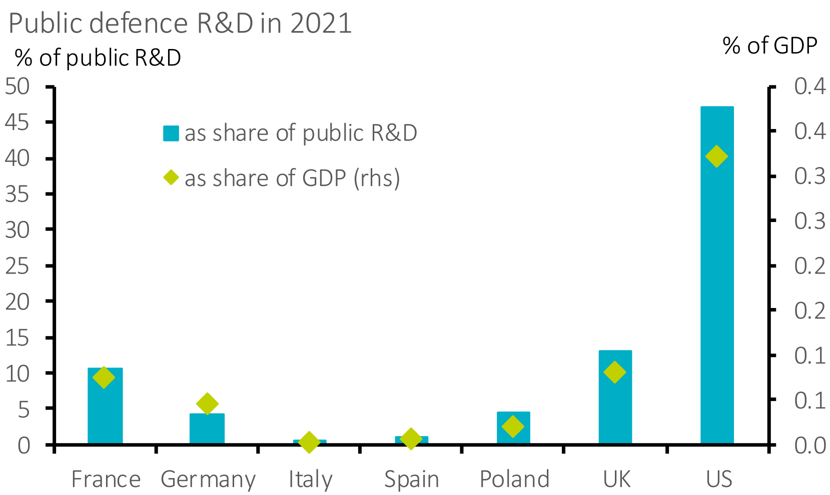
An ecosystem to (re)build within the EU

EU Defence

Changing gear will take time

- Underinvestment for decades means limited size, lagging R&D, and thus high reliance on the US
  - Only 8 EU firms among the top-50 listed world players of the aerospace defence sector
  - Nearly 80% of around €250bn of defence acquisition made by EU countries since the start of the Ukraine war was made outside of the EU, with the US alone representing 63%.
- CEO of Airbus: “What Europe needs to do is first come together and create programmes at scale, second spend more money, and third buy from (pooled resources in) Europe”

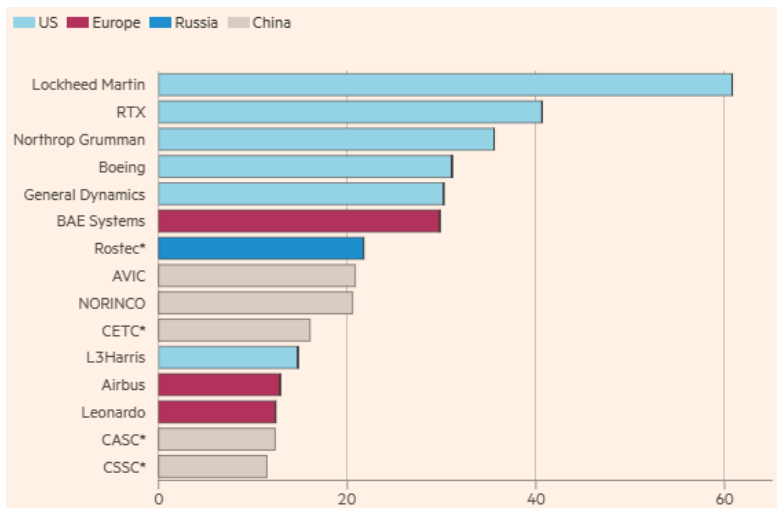
EMU Public defence spending R&D largely lags the US



Source: OECD, Barclays Research, March 2025

Embryonic defence in Europe

Top arms-producing companies globally by arms revenue, 2023 ($bn)



Source: FT, AXA IM Research, March 2025

The (possible) growth impact

EU Defence

Large caveats to bear in mind

- Economic literature gives very uncertain result on the relationship between defence spending and GDP growth, its direction of causality.
- Lack of industrial capacity (infrastructure, personnel) and Ukraine's urgent needs, likely means extra spending would mainly boost imports in the short-term, implying very small multiplier. It should increase gradually though this depends on investment frontloading and crucially member states' ability to ramp up spending.

Our tentative baseline

- Under conservative multiplier assumptions and highly depending on euro area defence spending to effectively increase to 3.5% of GDP by 2030, this could add 0.5% of GDP by then

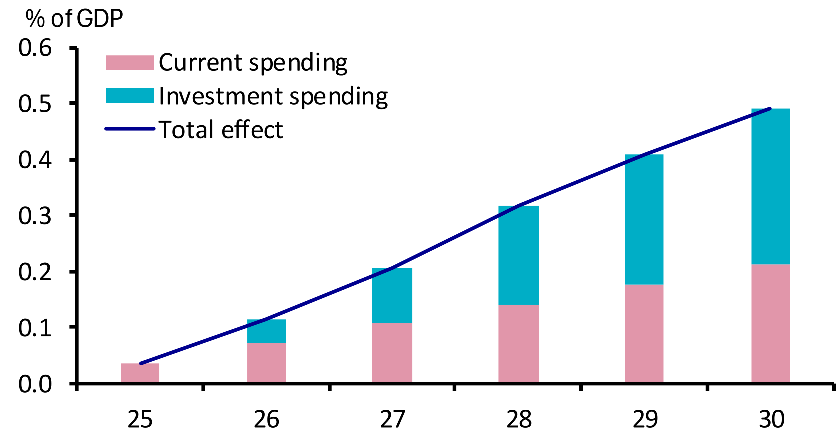
Empirical findings of the nexus defence expenditure - growth in advanced economies

Authors	Effects on growth
Nincic and Cusack (1979); Ahmed (1986); Atesoglu and Mueller (1990); MacNair et al. (1995); Landau (1996); Atesoglu, (2002;2009); Cuaresma and Reitschuler (2003); Dunne and Nikolaidou (2001a ; 2005); Bremmer and Kesselring (2007); Lee and Chen (2007); Kollias et al (2007); Pieroni, d'Agostino and Lorusso, (2008); Yilgör et al. (2012); Ando (2018) ; Daddi et al. (2019); Lobont et al. (2019) ;Canbay et al. (2021);	Positive
Szymanski's (1973); Cappelen, et al (1984); Ward and Davis (1992); Landau (1996); Antonakis (1997); Bremmer and Kesselring (2007); Chang et al. (2014); Dunne and Nikolaidou (2001a and b) ; Cuaresma and Reitschuler (2003); Ocal and Brauer(2007); Mylonidis, (2008); Chang et al. (2011); Dunne and Nikolaidou (2012)Hou and Chen (2014); Canbay et al. (2021); Paparas et al. (2016);	Negative
Mintz and Huang (1990;1991); Heo (2000;2010); Dunne and Nikolaidou (2001a); Kollias et al. (2004b); Smith and Tuttle, (2008) Dunne and Nikolaidou (2012); Kollias and Paleologou (2013); Chang et al. (2014); Kollias and Paleologou (2016); Canbay et al. (2021)	Neutral

Source: European Commission, April 2024

Limited gains to GDP growth from increased defence spending

Possible growth impulse from increased defense spending if EC commitments are respected



Source: NATO, AXA IM Research, March 2025

Macro outlook

A Trump dump ?

US

Hard data rebounds, but sentiment weakens further

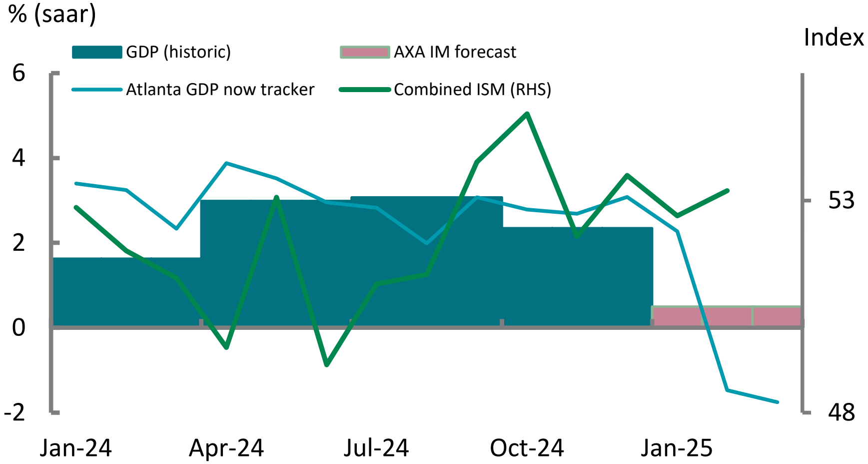
- A weak start to Q1 compounded fears of sharp slowdown. Recent weeks have seen a rebound in activity: retail sales (control) rose by 1.0% after a 1.0% fall; durable goods rose 3.1%; manufacturing was up 0.9%; and housing starts surged 11.1%. This suggested the start of Q1 saw an unwind from consumer strength in Q4, exacerbated by weather-disruption. However, Michigan's consumer sentiment fell again in March, raising concerns of a more persistent slowdown and a second-round impact from equity weakness.

Q1 GDP outlook weakens sharply

- Disruption at the start of the quarter should lower Q1 GDP, sharply when compounded by import front-loading. We forecast consumer spending to slow to 1% annualised, but total GDP could be lower based on the import/inventory balance and any weakness in investment. Yet the underlying pace of activity appears still solid and we pencil in some rebound in Q2. We forecast GDP growth of 2.1% in 2025 and 1.5% in 2026 (consensus 2.2% and 2.0%).

Q1 GDP slowdown – a one-off or just the start?

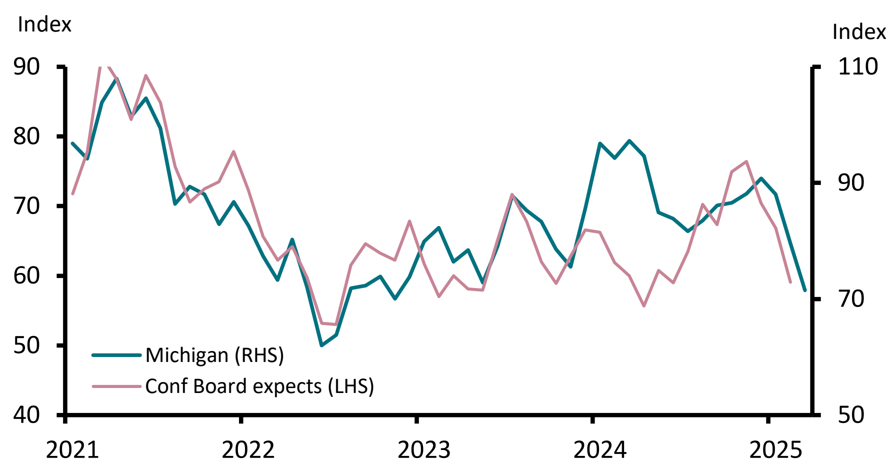
GDP growth and short term outlook



Source: BEA, ISM, FRBA, AXA IM Research, March 2025

Michigan consumer sentiment falls further in March

Measures of consumer confidence



Source: Michigan University, Conference Board, AXA IM Research, March 2025

Fed downplays inflation nervousness

US

Inflation pressures mount

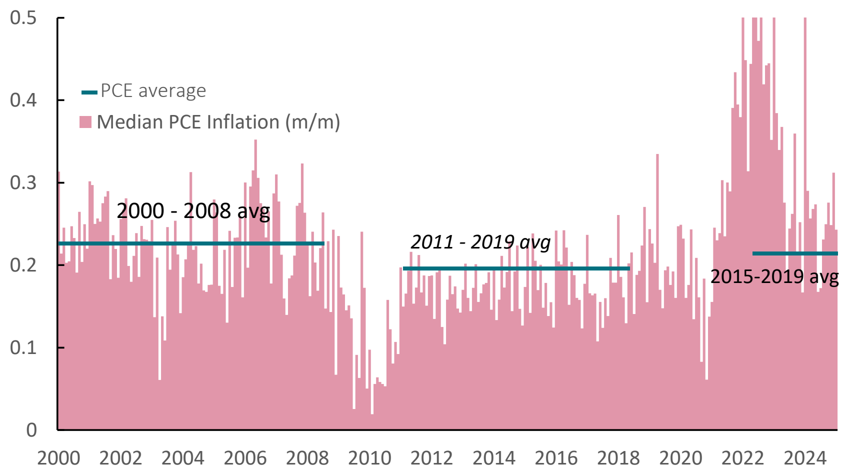
- February's CPI and PPI inflation came in below expectations, following January strength. Components that reflect PCE inflation – and a 0.4% rise in import prices – suggest successive firm PCE inflation for the first time since early 2024 and sticky inflation. Expectations are also rising, broadly in the short term for consumers and businesses, less so longer term, although Michigan recorded a 32-year high. Short-run expectations risk driving wage demands higher in the face of upcoming tariff price shocks.

Fed in "no hurry" to ease policy

- The Fed left policy unchanged in March. Despite market relief that Fed Chair Powell downplayed inflation risks and the Fed's median rate forecasts remained unchanged, the 'dot plot' showed a drift higher in the distribution of participants forecasts. We expect the Fed to triage the economy before cutting rates: risk of recession, deteriorating labour market, progress on inflation. We expect none of these criteria over coming months and expect the Fed to defer rate cuts until end-year.

Median PCE inflation remains sticky

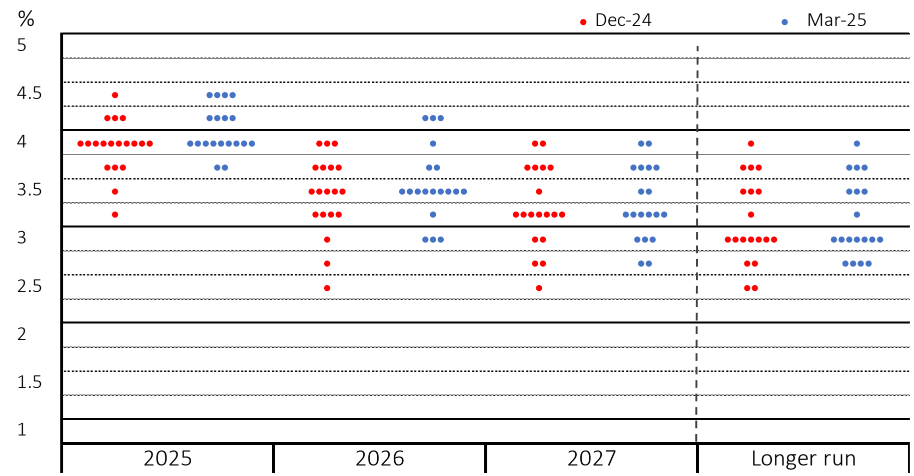
Median measure of PCE Inflation



Source: Federal Reserve Bank of Cleveland, AXA IM Research, Mar 2025

Feds rate forecasts drift higher

Fed participants end-year rate projections (the "dot plot")



Source: FRB, Mar 2025

Darkest before the dawn

Euro area

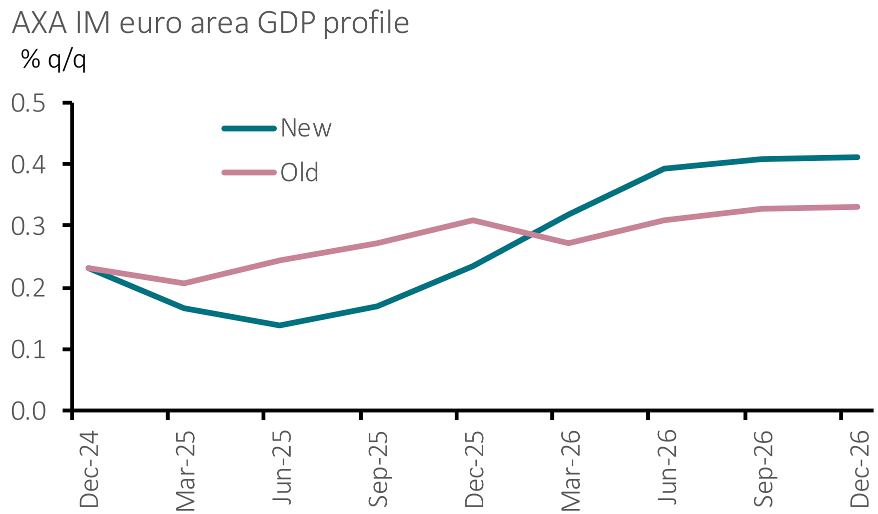
Imminent growth downside

- We downgrade our euro area GDP growth projection to 0.8% (-0.1pp) accounting for upcoming higher-than-expected US tariffs as well as a drag on activity from higher (trade) uncertainty. For 2026, we continue to expect 1.2%, with a weaker 2025 carry-over offset by stronger sequential growth mainly stemming from the German fiscal bazooka.

Increased US tariffs and uncertainty loom

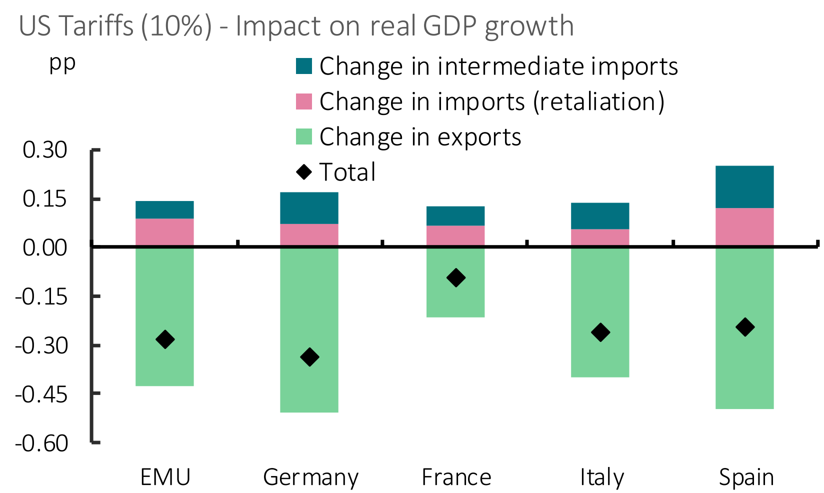
- Following aggressive rhetoric displayed by President Trump against the EU, we have raised our assumptions on tariffs and now consider US tariffs on EU goods would reach 10% (instead of 5%) from April, with the EU likely to impose moderate retaliation (5%).
- Increased policy uncertainty together with tighter financing conditions adds to our short-term growth concerns.

More growth headwinds this year; domestic impulse next



Source: Eurostat, AXA IM Research, March 2025

Higher US tariffs to slow euro area growth



Source: Eurostat, AXA IM Macro Research, March 2025

Unchanged dovish ECB view

Euro area

Fiscal push to hit later

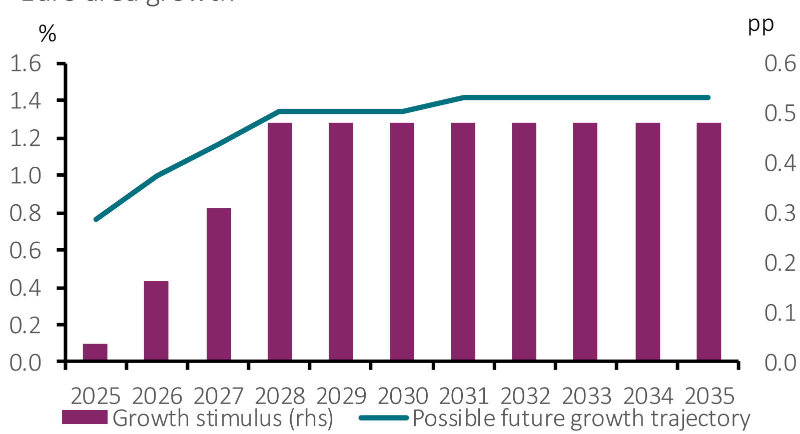
- While certainly a positive response following the US's apparently new geopolitical direction, we are not convinced the new EU Rearm Facility is an immediate game changer from a growth perspective. However, we are much more upbeat about the new German infrastructure plans which may almost triple German potential growth in the medium term to 1.5-1.75%, doing the heavy lifting in raising euro area growth prospects by c. 50bps. But for our forecast horizon, uplift is only likely to emerge from H2 26.

ECB: cautious, gradual, dovish bias to dominate

- Facing more imminent downside risks to growth, we maintain our dovish forecast expecting the ECB to keep back-to-back rate cuts to 2% before moving to quarterly forecast meetings, ending the year with a depo rate at 1.5%, standing below market's expectations for just two cuts to 2%.

Towards upgraded euro area medium term growth

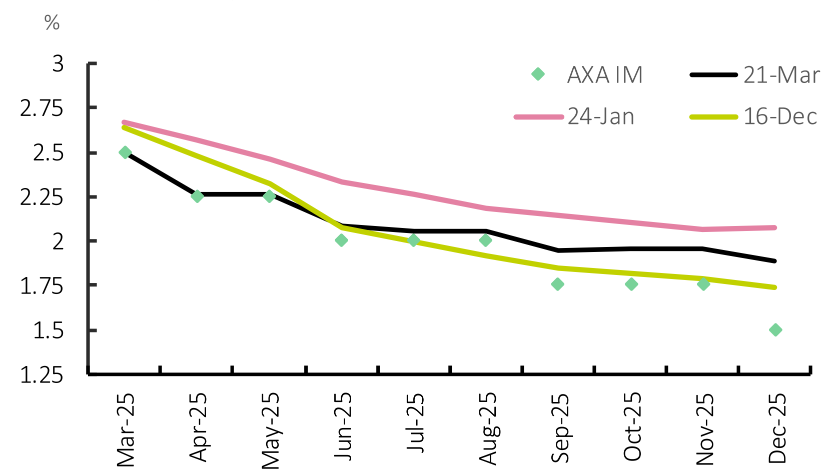
Euro area growth



Source: AXA IM Research, March 2025

We maintain our below market expectation ECB view

ECB market pricing and AXA IM forecasts



Source: AXA IM Macro Research, as of March 2025

A (conservative) framework for future growth

Germany

Unprecedented fiscal easing likely leading to a regime change…

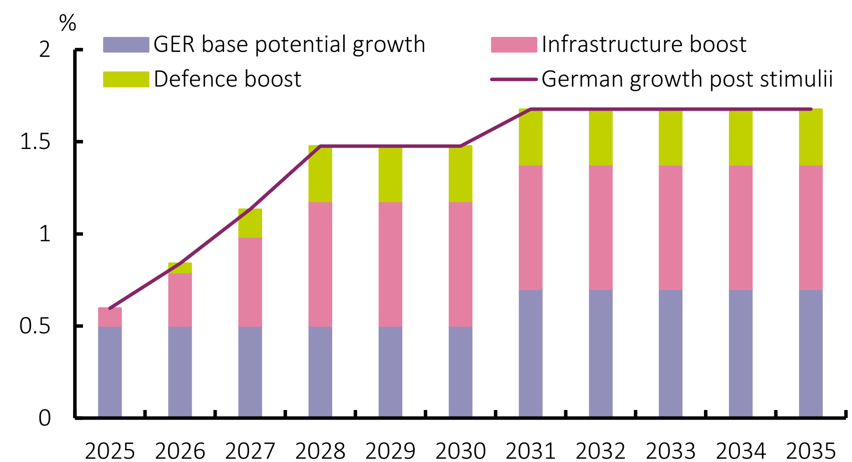
- Germany used the current seating in Parliament to change its constitution, pushing through an historic fiscal package of infrastructure spending: 11.6% of GDP over 12 years, which could generate c.1ppt additional yearly growth; defence spending to be excluded from national debt brake rule above 1% of GDP; Landers allowed to have deficit at 0.35% of GDP (instead of 0%).
- German potential growth could rise from 0.5% to 1.5-1.75% over the medium-term

… near-term outlook to change slowly, what to watch ..

- Public investment typically takes a while before feeding through, likely even longer in the case of defence. Very limited unused defence capacity, constraints on personnel, materials and (high) import content would mechanically (highly) reduce any GDP impulse in the short-term. A challenging trade environment is also likely to remain a drag.
- Though mindful of the (non-linear) impact of a confidence boost may have.

German growth: a likely regime change

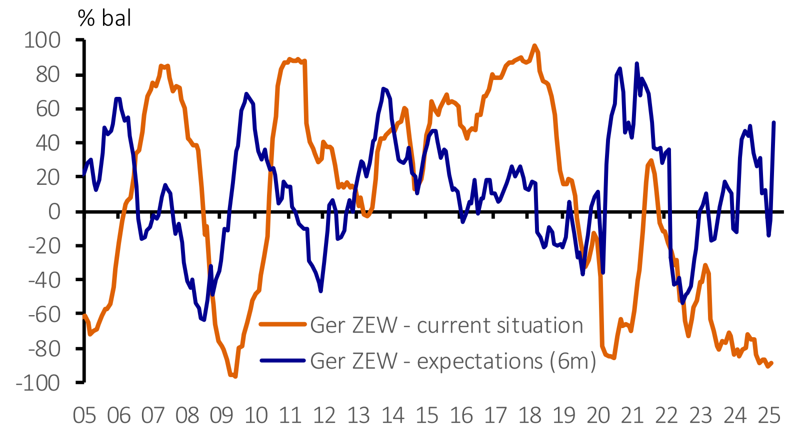
German GDP growth



Source: European Commission and AXA IM Research, March 2025

But one that takes time to materialise

German ZEW



Source: Refinitiv, AXA IM Research, March 2025

Momentum remains sluggish

UK

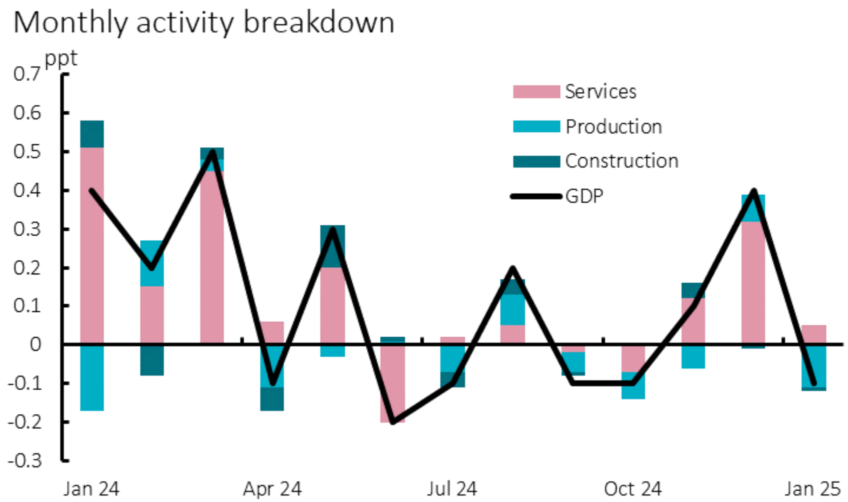
Monthly activity data showed a renewed decline in Jan

- Momentum in the UK economy remains sluggish. The unexpected 0.4% month-on-month increase in activity in December now looks like an outlier, given the 0.1% decline on the month in January. This downside surprise led us to revise down our forecast for Q1 to 0.2% – broadly in line with the message from the PMI – leaving growth across the year as a whole at around 0.9%, a tad above the BoE's forecast, 0.7%.

Higher inflation outlook, but still below BoE's forecast

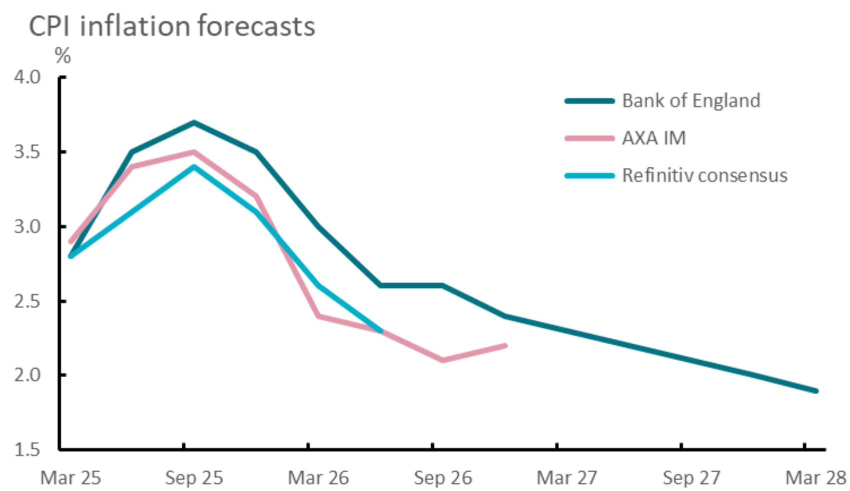
- Headline CPI inflation was punchy in January, rising to a 10-month high of 3.0%, from 2.5%. But at 3.7%, core CPI was broadly in line with expectations, while services inflation was 20bps below. Over the coming months there will be a few administrative and tax changes, such as changes to rail fares, vehicle duty and alcohol duties and utilities bills, including energy and water, are also due to rise. Underlying price pressures, however, will continue to ease as a softer labour market underpins a material slowdown in wage growth and demand remains weak.

Growth momentum remains weak



Source: National Statistics and AXA IM Research, March 2025

CPI inflation to peak around 3.5%



Source: National Statistics, BoE, OBR and AXA IM Research, March 2025

Bank of England to stick to gradual path

UK

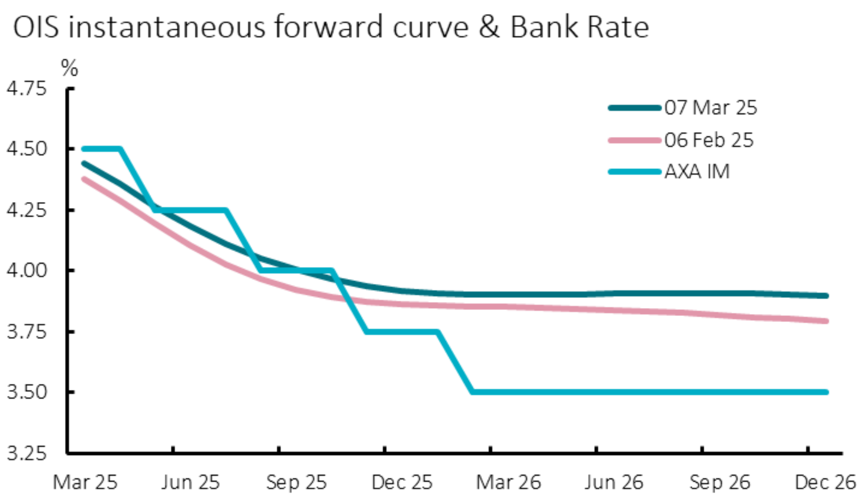
MPC to look through near-term pressure

- As expected, the MPC kept Bank Rate unchanged at 4.50% at March's meeting, with 8 out of 9 members agreeing and forward guidance unchanged, stating "gradual and careful approach to further withdrawal of monetary policy restraint". The MPC did, admittedly, sound more cautious on the impact of higher inflation expectations on wage growth and the balance of UK supply or demand constraints. But given our view that a weaker labour market will underpin further disinflation, we see three further cuts this year, leaving Bank Rate at 3.75% by year end.

Chancellor forced to push through spending cuts at spring fiscal event

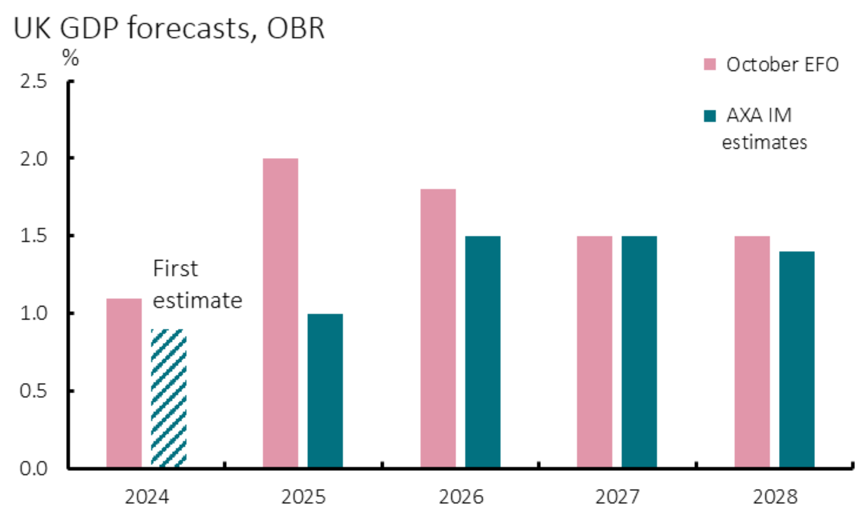
- The near-£10bn headroom the Chancellor had in her October Budget has gone. To February, the deficit was £20bn worse than the OBR forecast, we also expect OBR to revise its near-term growth forecasts, reducing tax revenues, and borrowing costs are higher. As a result, the government looks set to announce spending cuts up to around £30bn at the spring fiscal event, including £5bn from welfare spending. The Chancellor will likely shrink the spending envelope available in the Spending Review later this spring.

Three cuts still on the cards this year



Sources: National Sources and AXA IM Research, March 2025

OBR to revise down near-term growth forecast; tax revenues to drop



Sources: National sources, The OBR, and AXA IM Research, March 2025

Fiscal expansion announced with ambitious growth target

China

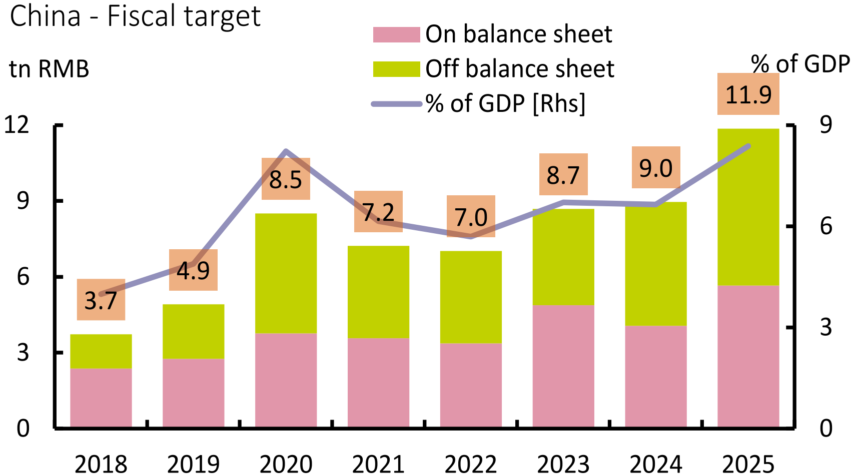
Increased fiscal spending may still fall short of ambitious growth target needs

- This year's National People's Congress unveiled a fiscal plan worth RMB 11.9tn, structured through expansions in both on- and off-balance-sheet budgets.
- The growth target remains unchanged at "around 5%" since 2023, though achieving it appears increasingly challenging.

Emerging risks under scrutiny

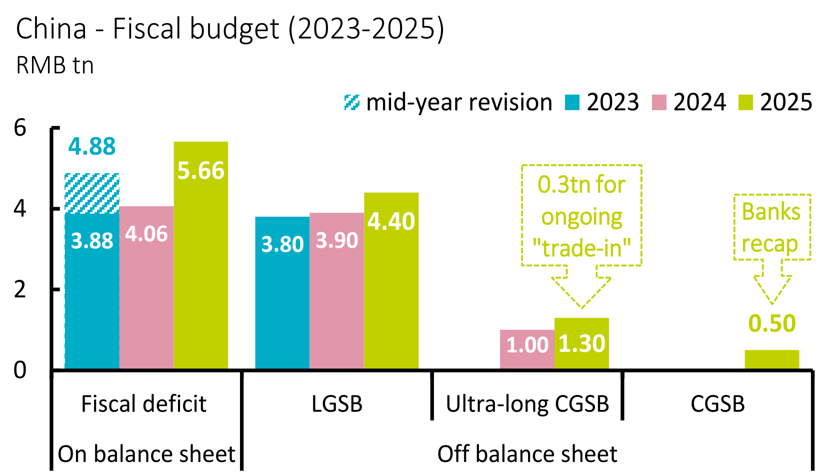
- Beyond the larger budget size, the funding sources and budget allocation suggest that Beijing is closely monitoring emerging risks in the banking sector and distressed local governments.
- Central government is shouldering the funding of more than half of the fiscal package—the largest share since 2018. Special bonds have been assigned to recapitalise major banks, aiming to reduce systemic risks and create room for future monetary easing.

Fiscal expansion equally split between on- and off-balance-sheet



Source: CEIC and AXA IM Research, March 2025

Govt bond to support banks, property market and consumers



Source: CEIC, Government work reports, and AXA IM Research, March 2025

Weaker and slower response from consumers to be offset by stronger investment

China

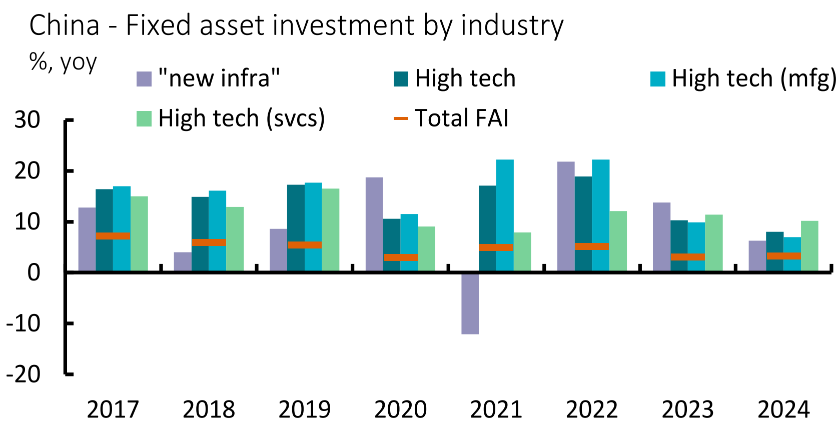
Private businesses receive renewed support

- The breakthrough in AI, followed by a rare meeting with the top leadership and a strong focus during the NPC, has given China's private sector a much-needed boost not seen in years. This growing momentum is expected to drive up investment in AI and high-tech sectors, projected to reach approximately 0.4% of GDP in 2025.

Weak consumer confidence yet to recover despite significant policy shift

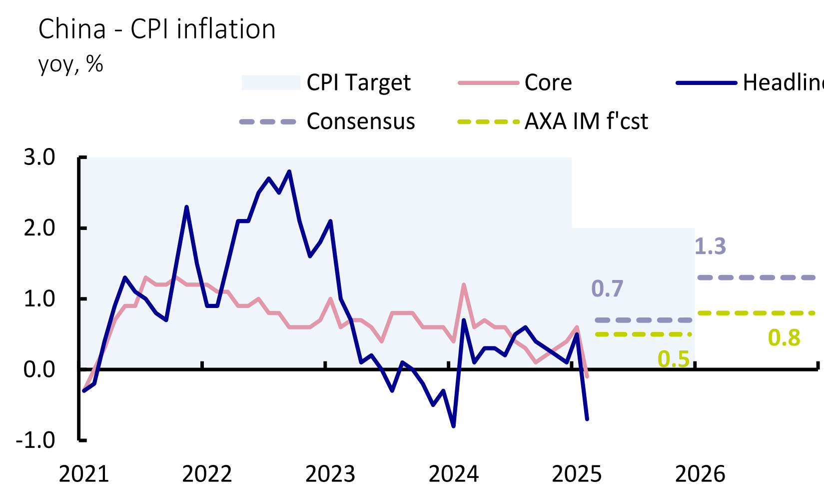
- The trade-in programme has created a surge in sales of eligible goods, yet spending beyond these areas remains weak. Households squeezed by lower incomes and declining wealth await tangible financial improvement before resuming spending, lowering recovery prospect for this year. The trade-in initiative has also led to lower prices of eligible goods, pressing on inflation.
- Balancing stronger investment with a slower recovery and more moderate rebound in consumption, we maintain our GDP growth forecast at 4.5% for 2025 and 4.1% for 2026, while lowering inflation projections to 0.5% for 2025 and 0.8% for 2026.

Investment in emerging sectors largely outperforms headline FAI



Note: "new infra" refers to information transmission, soferware and IT services.
Source: CEIC and AXA IM Research, March 2025

Downward-revised forecast expecting longer recovery in prices



Source: CEIC, Bloomberg and AXA IM Research, March 2025

Investment Managers

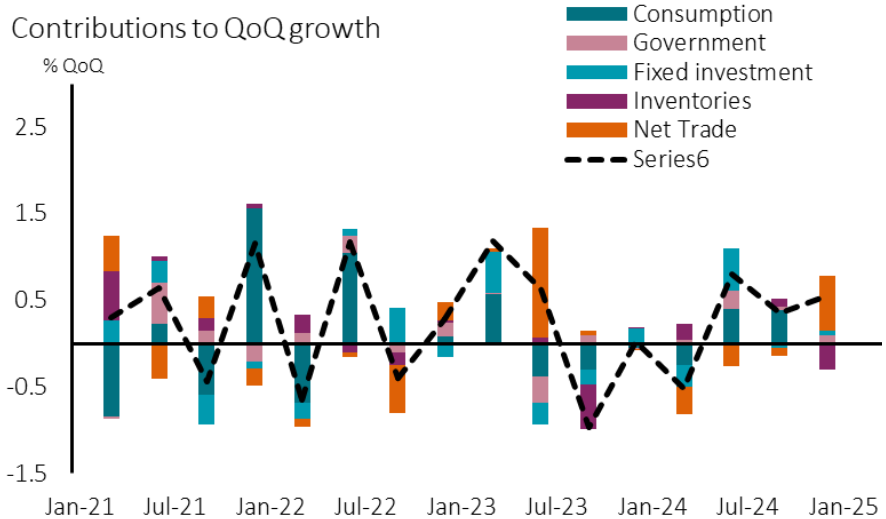
Real incomes growth to keep growth buoyant

Japan

Moderate quarterly pace expected through 2025

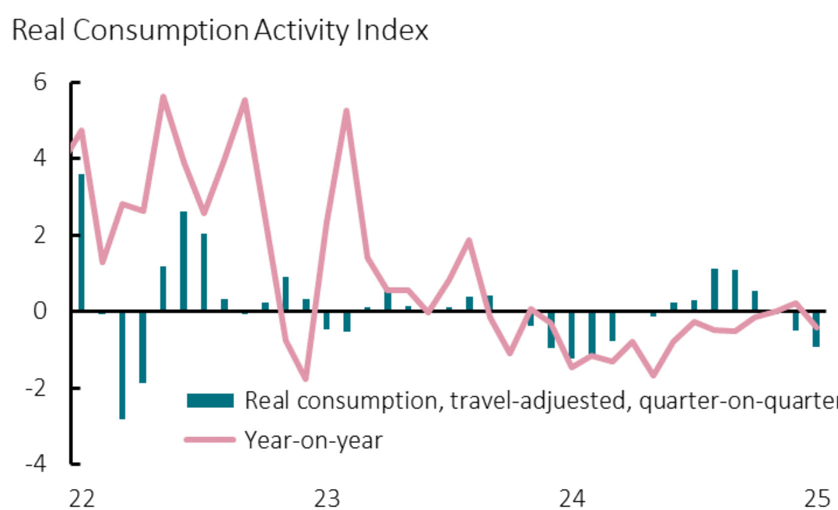
- Japan's Q4 GDP data provided further evidence that the Bank of Japan's (BoJ) expected virtuous wage/price spiral remains intact, with activity increasing by 2.2% on an annualised basis, well above the 1.1% rate expected.
- Admittedly, private consumption was unchanged, despite Japanese households seeing stronger real income growth suggesting households saved additional cash. And the BoJ's consumption activity index has weakened, suggesting ongoing caution against a backdrop of growing global pressures.
- Nonetheless, we expect GDP growth to remain solid throughout 2025. We think capex will continue to rise, as businesses continue to invest technology amid the backdrop of a declining labour pool. Rising real incomes will eventually start to pass through to spending; we expect growth of 1.3% across 2025.

Growth remained solid in Q4, driven by net trade



Source: National sources and AXA IM Macro Research, March 2025

Signs that private consumption is weakening, though



Source: National sources and AXA IM Macro Research, March 2025

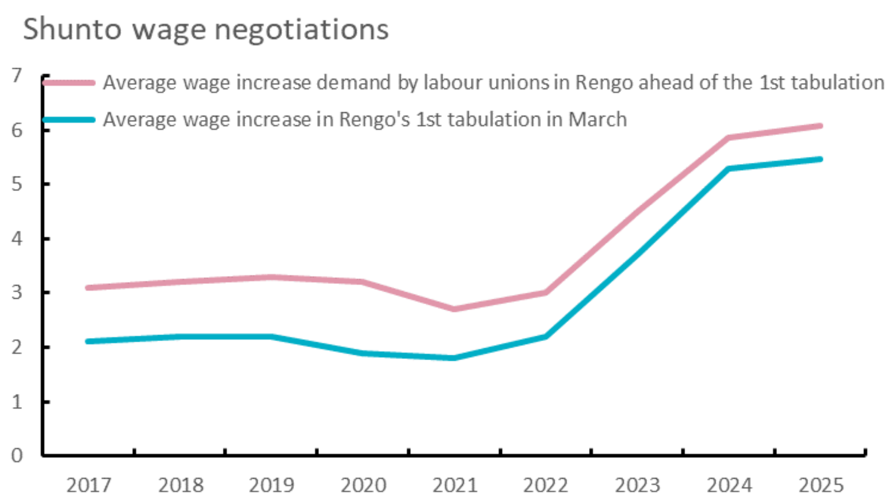
Bank of Japan to continue normalising policy in 2025

Japan

Growing evidence of virtuous wage/price spiral taking hold

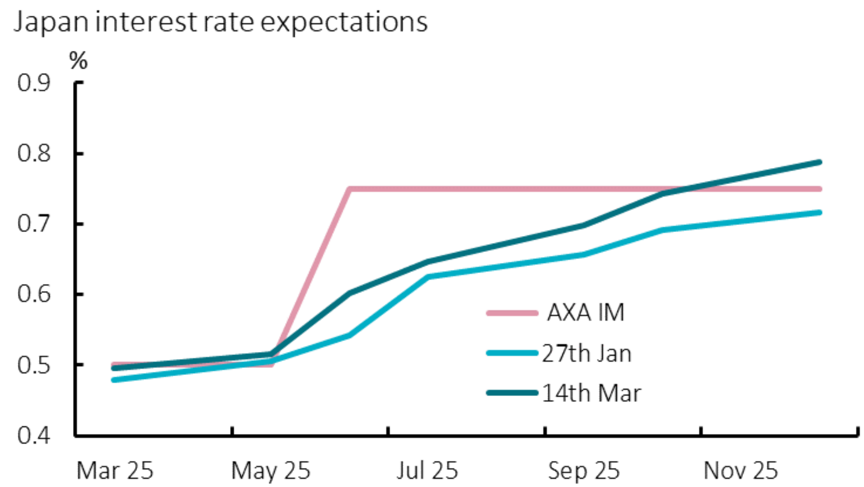
- Labour shortages seem to be driving a structural shift in wages, adding weight to expectations that the wage/price spiral has taken hold, and that inflation will likely hover around the 2% target over the medium term. The first round of the Shunto wage negotiations resulted in an average annual wage increase of 5.46% in 2025, compared to 5.1% in 2024. Base pay – which has a closer relationship with the official figures – rose by 3.84%; we expect year-on-year pay growth to reach a peak of around 3.7%.
- As expected, the BoJ voted unanimously to maintain the uncollateralised overnight call rate at around 0.50% in March. No new hawkish phrases were added to the accompanying statement, despite strong pay settlements, with the BoJ reiterating its commitment to gradually increasing the policy rate if the economy evolves as expected. It still expects growth to outpace potential over the coming quarters. The BoJ noted that global uncertainties remain a key risk; US trade policy should settle down after the summer, which would remove one source of uncertainty. We continue to see one more rate hike this year to around 0.75% in July, in line with the current pace of hiking.

Strong outcome from wage negotiations



Source: RENGO and AXA IM Research, March 2025

We expect a further 25bp hike in H2



Source: Refinitiv and AXA IM Research, March 2025

Canadian recovery curtailed by tariffs

Canada

Economic activity had been recovering well

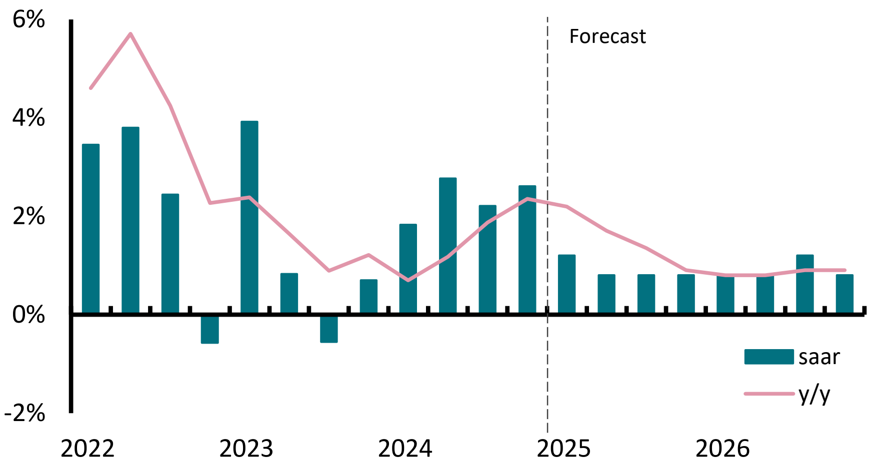
- Real retail were still 1.4% higher than November, despite a 1.1% drop in January. This underpinned a 0.2% rise in GDP in December and a 0.3% 'flash' estimate in January. Q4 GDP rose by a robust 2.6% annualised, leaving 2024 up 1.5% overall. Q1 looks likely to be a still solid 1.6%. However, a marked tariff impact is already obvious in survey data and looks to slow growth materially in this year and next. For now, we lower our GDP forecasts to 1.5% and 0.9% (from 1.8% and 1.7%), but will fine-tune as tariffs adjust.

Tariffs present major shock to Canadian economy

- Implementation of US tariffs on Canada has been erratic and is likely to remain so. At the time of writing, they stand at 25% on exports to the US that do not qualify for the USMCA (including steel and aluminium). We estimate this to be around a 14ppt weighted average tariff rise on Canada. Canada exported 76% of its goods and services to the US in 2024, or 25% of total GDP. Canada has retaliated with 25% tariffs on CAD30bn of goods, with a further CAD125bn to be applied if US tariffs persist.

Canada has shown signs of recovery

GDP Growth and outlook



Source: StatCan and AXA IM Research, March 2025

Tariff impact looks set to hit hard

CFIB Business Barometer

Source: CFIB, Nanos, March 2025

Institutions react to tariff attack

Canada

Bank of Canada to cut cautiously quicker

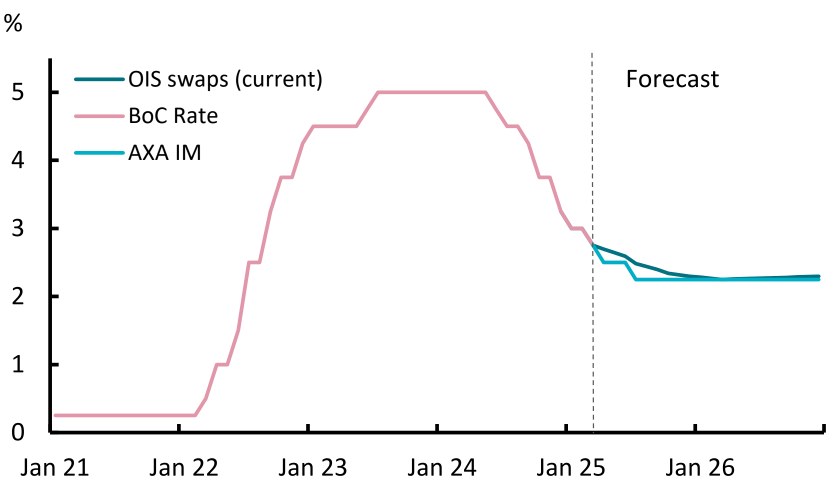
- The BoC cut its policy rate to 2.75% in March. It warned it could not "offset the impact of a trade war" and must focus on preventing a price level adjustment from translating to ongoing inflation. A trade shock is both demand and supply shock, complicating the appropriate response. However, the asymmetry of US tariffs to Canadian retaliation should be net disinflationary over the medium term. We now see two 0.25% cuts in April and July, bringing the policy rate to 2.25% in 2025, from 2026.

Prime Minister Carney and an election

- Mark Carney won the Liberal leadership election with 86% of the votes in the first round. He became prime minister on 14 March. As Parliament re-opened, Carney called for an early General Election on 28 April. The opposition Conservatives led in the polls by 25ppt at the start of the year. The Liberals currently lead at the time of writing, with the Liberal Party consolidating votes from other parties. At the time of writing, a guaranteed Conservative win three months ago now hangs in the balance.

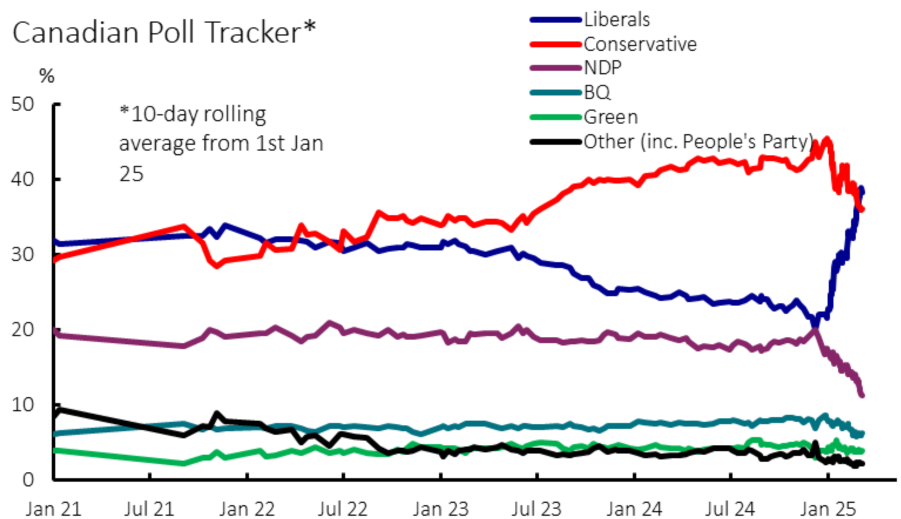
Bank of Canada

Bank of Canada overnight rate and outlook



Source: BoC, Bloomberg and AXA IM Research, March 2025

Liberals surge in the polls – but tight race with Conservatives



Source: BoC, Bloomberg and AXA IM Research, March 2025

Amid heightened global uncertainty, this is not a good time for homegrown crises

EM Asia ex-China

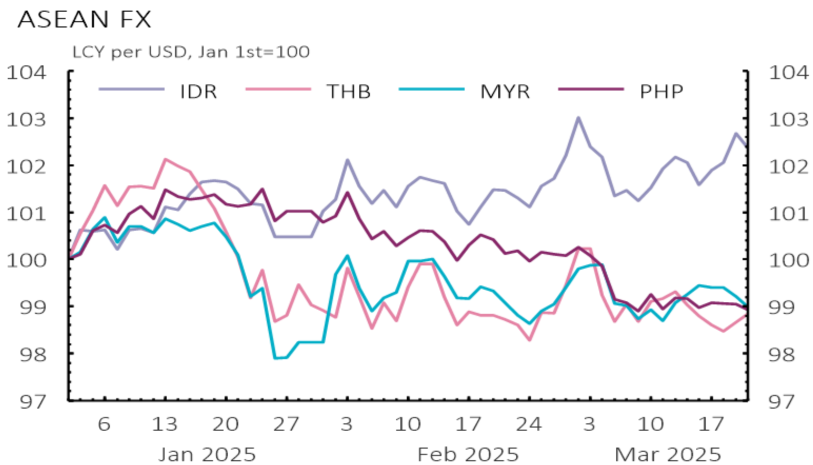
Indonesia's economy is holding up relatively well, but investors unnerved by fiscal issues

- President Prabowo Subianto has undone much of Indonesia's recent reputation for sound fiscal management, contributing to the currency's slide this year and the March 18th equity market collapse. With revenue plummeting in Jan-Feb (down 21% y/y), there is now a greater risk that it will fail to adhere to its fiscal rules that cap annual deficits at 3% of GDP. A potential sharp rise in off-budget spending under Prabowo's new sovereign wealth fund (with limited oversight) is also concerning.

Political crisis drags on in South Korea, with no favourable outcome

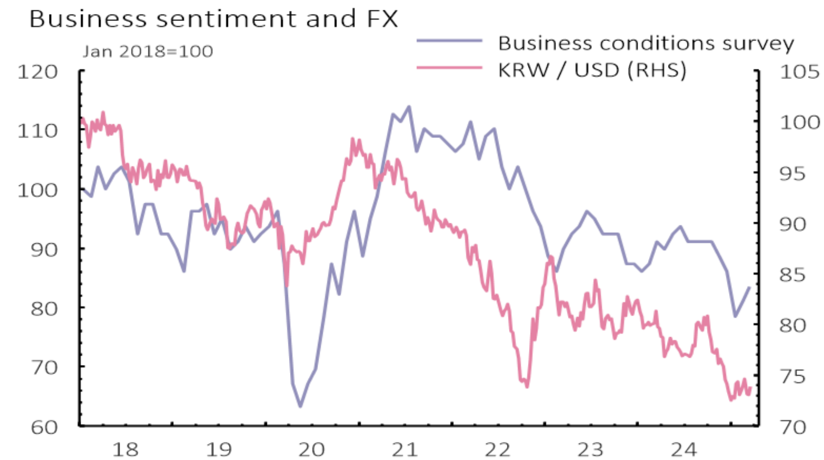
- The Constitutional Court (at the time of writing) had yet to reach a verdict on President Yoon's impeachment case over his failed bid to invoke martial law in December. If impeached, an election would be held within 60 days. This would be highly contentious, and during the campaign period there would be limited political capacity to challenge or respond to US tariff hikes. If Yoon is reinstated, the ensuing political deadlock – the opposition controls the legislature - would make it difficult to pass a supplementary budget and confidence-boosting measures.

Indonesia's currency underperforms peers



Source: LSEG Datastream and AXA IM Research 20/03/2025

Confidence and currency still fragile in Korea



Source: LSEG Datastream and AXA IM Research Mar 25

Exposure to US tariffs, reliance on German demand

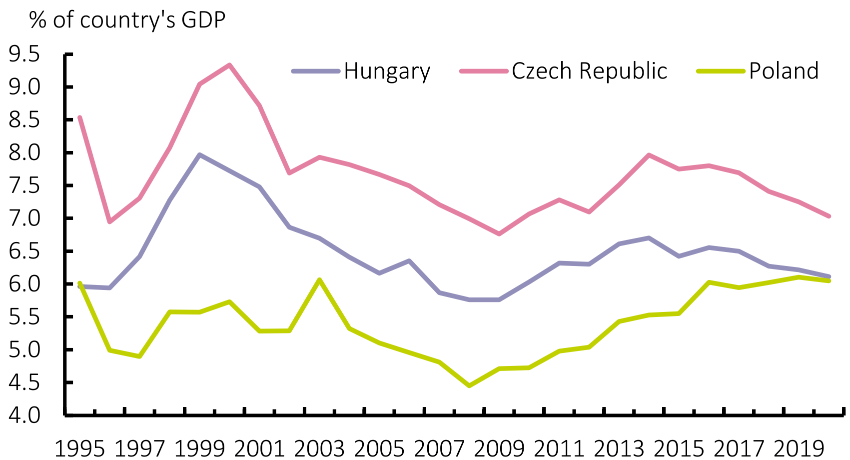
Central Europe

Tariff risks in the short term to be offset by higher demand from Germany over the medium term

- Hungary, the Czech Republic or Poland are highly exposed to tariff risks from the US, both ‘reciprocal tariffs’ due on April 2nd or tariffs on specific sectors, among them the auto sector. But their direct vulnerability is limited as the domestic value-added content of their exports to the US is small.
- Central European (CE) economies are instead vulnerable to the indirect impact of US tariffs via German demand. We see a similar balance of risks to growth in the region than in Germany: downside risks in 2025, upside risks from 2026.
- Increased fiscal leeway could cushion growth in CE. EU countries will be able to activate a national escape clause over the next 4 years, allowing them to deviate from their expenditure path to increase defence spending vs. 2021 with a limit of 1.5% of GDP per year. Hungary and Poland would benefit most.

Central Europe: Reliant on German demand

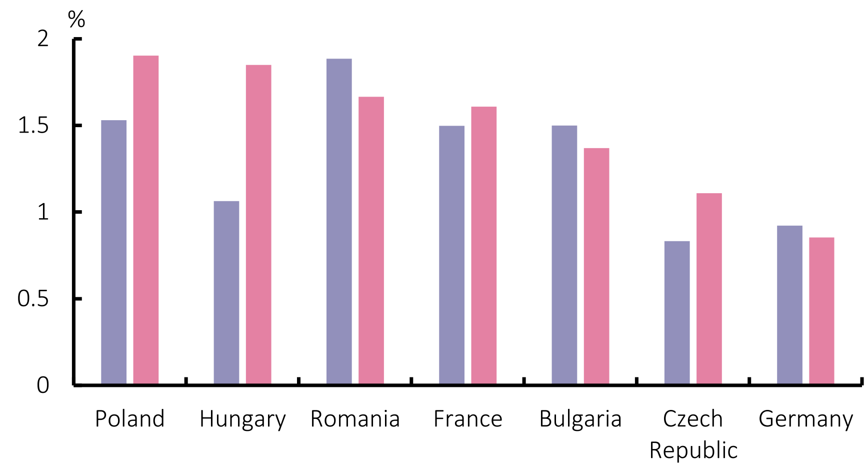
Exports of value added to Germany



Source: Macrobond, OECD and AXA IM Research, March 2025

Hungary and Poland leading the increase in military spending

ESA2010 military defence spending, % of GDP



Source: Macrobond, Eurostat and AXA IM Research, March 2025

Growth and budget under pressure

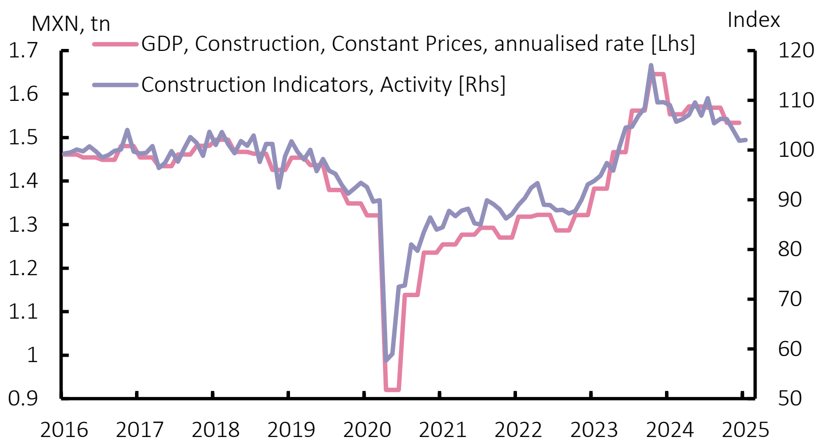
Mexico

Domestic and external headwinds to growth

- The economy faces a perfect storm, with a large fiscal tightening under way, constitutional reforms (including the judicial system reform) negatively impacting the business environment, and external headwinds building with US slowdown and risk of punitive tariffs from the US. Preliminary data for Q1 to another quarterly contraction after GDP fell by 0.6% n Q4 and GDP growth could be close to zero in 2025 assuming no additional US tariffs are imposed on April 2nd.
- In a risk scenario, a permanent increase in US tariffs by 25% as threatened by Trump would likely tip the economy into a severe downturn. A 25% increase in US tariffs with retaliation from Mexico would have a negative impact on its GDP of 0.4 ppt in 2025, 1.3 ppts in 2026 and a peak impact of 3.4 ppts by 2032-33 according to PIIE estimates.
- The 2025 budget, which seeks to reduce the general government deficit to 3.9% of GDP from 5.9% in 2024, is based on GDP growth between 2 and 3%. The negative chain effects between weaker growth and fiscal underperformance are likely to intensify.

Construction activity points to a drag on GDP in Q1

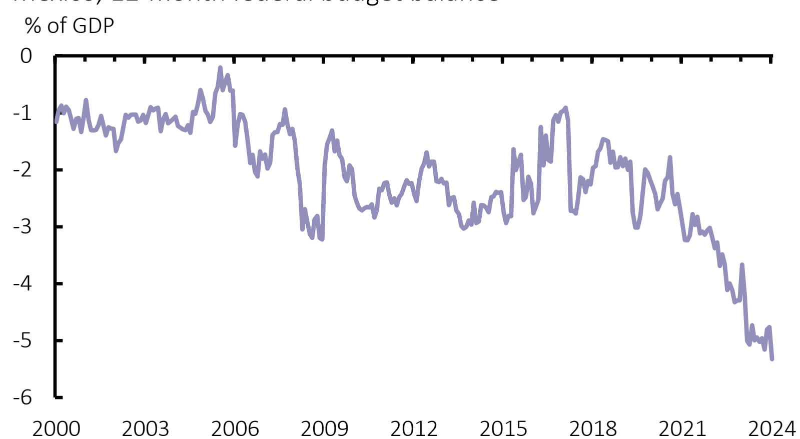
Mexico - Construction detracting from GDP growth



Source: Macrobond and AXA IM Research, March 2025

The challenge of reducing wide fiscal deficits in a slowdown

Mexico, 12-month federal budget balance



Source: Macrobond and AXA IM Research, March 2025

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2024	2025*		2026*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.3	3.2		2.9	
Advanced economies	1.6	1.5		1.4	
US	2.8	2.1	2.2	1.5	2.0
Euro area	0.9	0.8	0.9	1.2	1.4
Germany	-0.2	0.1	0.3	1.0	1.3
France	1.1	0.4	0.7	0.9	1.3
Italy	0.5	0.2	0.7	0.7	1.0
Spain	3.2	2.9	2.4	2.5	1.7
Japan	0.1	1.3	1.2	0.9	0.9
UK	0.9	0.9	1.1	1.4	1.5
Switzerland	1.3	1.2	1.2	1.8	1.6
Canada	1.3	1.5	1.5	0.9	2.1
Emerging economies	4.2	4.2		3.9	
China	5.0	4.5	4.5	4.1	4.2
Asia (excluding China)	5.4	5.0		4.9	
India	6.7	6.5	6.5	6.7	6.6
South Korea	2.1	1.5	1.7	1.5	2.2
Indonesia	5.0	5.1	5.0	4.9	5.1
LatAm	2.2	2.0		2.1	
Brazil	3.4	1.9	2.1	1.8	2.2
Mexico	1.5	0.6	0.9	1.0	2.0
EM Europe	3.2	2.1		2.2	
Russia	3.8	1.4	1.7	1.2	1.3
Poland	2.9	3.1	3.5	2.7	3.5
Turkey	3.2	3.0	2.6	3.4	3.6
Other EMs	2.8	4.0		3.8	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 25 March 2025
**Forecast*

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2024		2025*		2026*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	2.6		2.7		2.4	
US	2.9		3.0	2.7	3.2	2.3
Euro area	2.4		2.1	2.0	1.6	2.0
China	0.2		0.5	1.3	0.8	1.6
Japan	2.7		3.0	2.0	1.8	1.7
UK	2.5		3.3	2.3	2.3	2.0
Switzerland	1.1		0.4	1.0	0.9	1.0
Canada	2.4		2.4	2.1	2.2	2.1

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 25 March 2025

**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
United States - Fed	Dates	4.50	6-7 May 17-18 Jun	29-30 Jul 16-17 Sep	28-29 Oct 9-10 Dec	27-28 Jan 17-18 Mar	28-29 Apr 16-17 Jun	28-29 Jul 15-16 Sep	27-28 Oct 8-9 Dec
	Rates		unch (4.50)	unch (4.50)	-0.25 (4.25)	-0.25 (4.00`)	-0.25 (3.75)	-0.25 (3.50)	unch (3.50)
Euro area - ECB	Dates	2.50	17 Apr 5 Jun	24 Jul 11 Sep	30 Oct 18 Sep	5 Feb 19 Mar	30 Apr 11 Jun	23 Jul 10 Sep	29 Oct 17 Dec
	Rates		-0.50 (2.00)	-0.25 (1.75)	-0.25 (1.50)	unch (1.50)	unch (1.50)	unch (1.50)	unch (1.50)
Japan - BoJ	Dates	0.50	30 Apr - 1 May 16-17 Jun	30-31 Jul 18-19 Sep	29-30 Oct 18-19 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		unch (0.50)	+0.25 (0.75)	unch (0.75)	unch (0.75)	unch (0.75)	unch (0.75)	unch (0.75)
UK - BoE	Dates	4.50	8 May 19 Jun	7 Aug 18 Sep	6 Nov 18 Dec	5 Feb 19 Mar	30 Apr 18 Jun	30 Jul 17 Sep	5 Nov 17 Dec
	Rates		-0.25 (4.25)	-0.25 (4.00)	-0.25 (3.75)	-0.25 (3.50)	unch (3.50)	unch (3.50)	unch (3.50)
Canada - BoC	Dates	2.75	16 Apr 4 Jun	30 Jul 17 Sep	29 Oct 10 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		unch (2.75)	unch (2.75)	unch (2.75)	unch (2.75)	unch (2.75)	-0.25 (2.50)	-0.25 (2.25)

Source: AXA IM Macro Research - As of 25 March 2025

Calendar of key events

2025	Dates	Events
March	26-Mar	UK Spring Statement
	27-Mar	Global Trade Conference
	31-Mar	Pause on US/ EU steel & aluminium tariffs expires
April	1-Apr	Florida special election for House seat to replace Rep. Waltz
	17-Apr	ECB meeting
	25-27 Apr	World Bank Spring meeting
	28-Apr	Canada General Election
	30-Apr	Republican target for final budget reconciliation bill
	30-Apr	Deadline for 2025 fiscal appropriations
	30-Apr - 1-May	BoJ meeting
May	1-May	UK local elections
	6-7 May	FOMC meeting
	8-May	BoE meeting
	18-May	Poland presidential elections
June	4-Jun	BoC meeting
	5-Jun	ECB meeting
	15-17 Jun	G7 Leaders' Summit
	16-17 Jun	BoJ meeting
	17-18 Jun	FOMC meeting
	19-Jun	BoE meeting
	24-25 Jun	North Atlantic Treaty Organization (NATO) Summit
July	27-Jul	Japanese House of Councillors election
September	9-Sep	UN General assembly
October	17-19 Oct	World Bank annual meeting
	20-Oct	Canada federal elections
	30-Oct	End of FY2025
November	5-Nov	US Mid term elections
	10-21 Nov	Brazil host COP30
	22-23 Nov	G20 Summit
December	31-Dec	Temporary provisions of Tax Cuts &Jobs Act expire
2026	**Dates**	**Events**
February	5-Feb	New START Nuclear Treaty Expires
March	Mar	France Municipal elections
May	15-May	Powell term as Fed Chair expires
July	1-Jul	First review of USMCA
November	3-Nov	US midterm elections

Latest publications

February Op-ed - Are we already past "peak Trump"?

27 February 2025

February Global Macro Monthly - Trade war

27 February 2025

Understanding the fiscal drivers of French sovereign bond yields

20 February 2025

German election preview: Aiming at a grand reset

13 February 2025

January Op-ed - Macro Roller Coaster

29 January 2025

January Global Macro Monthly - A new Golden age

29 January 2025

2025's elections around the world: The who's who and the so what…

23 January 2025

Outlook 2025-2026: Trump-starting the global economy

04 December 2024

October Op-Ed – Meeting in the middle

23 October 2024

October Monthly Investment Strategy – A far reaching US election

23 October 2024

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