26 March 2025

Investment Institute *Macroeconomics*

Monthly Investment Strategy

Global reaction

Key points

- Even as US policy uncertainty mounts, global economies start to respond.
- The German government changed its constitution and has initiated a large fiscal stimulus in defence and infrastructure. The EU has initiated an €800bn rearmament programme. These are historic changes.
- China increased fiscal spending to support an ambitious "around 5%" growth target for this year, despite risks from US trade policy and domestic correction.
- Canada's economic outlook will deteriorate quickly from US tariffs. New PM Carney called an election for 28 April.
- Emerging markets join developed in growth uncertainty. Indonesia and Korea both face additional concerns. Turkey renews foray into authoritarianism.
- Central banks and financial markets cautiously await tariff announcements expected in April.

Global Macro Monthly

Global reaction

Global Macro Monthly Summary March 2025

David Page
Head of Macro Research

Equal and opposite reactions

Stock markets are not the best representation of a nation's fortunes but changes can be instructive and unlike measures of GDP they are forward-looking. It is thus illustrative that over the last month, since the new US administration stepped up its tariff policies, the US S&P500 equity index fell by 10% (currently down 7.5%). Over that period other countries have responded to the new direction of US policy. Uppermost in our mind is the European reaction but China announced further domestic stimulus to address its own outlook. The Euro Stoxx and China's CSI 300 index are down less than 1%.

Europe has so far seen the greatest reaction. While the European Union (EU) faces an uncertain future with further US tariffs expected in April, it has responded to the shifting geopolitical backdrop. Germany's new Chancellor Friedrich Merz acted boldly to enact a change to the country's debt brake even before its new Parliament sat. Germany will create a €500bn infrastructure fund for the coming decade and remove defence spending from its fiscal rules. This is an historic shift in German fiscal policy to manage the altered geopolitical realities of US security uncertainties. It has been matched by an EU-wide facility of €150bn of EU funds for defence, with a waiver to national governments for deficit constraints with regards defence.

It is unclear how much and how quickly governments will increase defence spending. It is likely to be a function of how quickly defence production capacity can increase within the EU (and those in EU defence pacts). But this looks set to be a material driver of growth over the medium term. Admittedly, the latest Summit highlighted problems for the EU in filling the US void. EU leaders were unable to progress €5bn worth of aid for ammunition to Ukraine and debated who would represent the EU at peace negotiations in which it is not yet a party. Another meeting is scheduled in Paris over the coming days. Democracies can take longer to affect change than autocracies, but they have other strengths.

The Eurozone's economic outlook is mixed. Despite fiscal expansion, we see a minimal net impact on our growth outlook: we lowered our 2025 GDP outlook to 0.8% (from 0.9%) and leave 2026 unchanged at 1.2%. This reflects an expected greater impact of tariffs, the deferred fiscal boost and higher yields. But over the longer-term Eurozone growth could rise by around 0.5 percentage points (ppt).

China also responded to increased external pressure. Its latest National People's Congress saw it set an ambitious growth target of "around 5%" for this year. To deliver this it announced a 2.1% of GDP increase in its total annual debt limit to provide a household and business sector boost. Overall, given the weak pace of consumption, we fear this will be insufficient to spur quick recovery and suggest actual growth will fall short of its target. However, the authorities appear to be embracing private sector enterprise, which should provide a bigger boost in business investment than previously hoped.

Canada has perhaps seen the biggest disruption from US policy to date. A recent business barometer collapsed to a record low, below readings recorded during the financial crisis and pandemic. The central bank is easing policy and looks set to continue careful stimulus, even as it keeps medium-term inflation expectations anchored. But Canada's biggest shift may be political. Newly elected party leader Mark Carney became Prime Minister on 14 March and has called a General Election for 28 April. Where his party stood over 20 points behind in the polls three months ago, they are now only 5 points behind. A win for Carney hangs in the balance and with it a potential pivot to Europe for trade and security alliances. On the other side of the US border, Mexico faces a perfect storm that sees the economy face the risk of recession, compounded by the threat of tariffs. However, Mexico has responded strongly to US demands – border security has been increased, collaboration surrounding drug cartels increased and Mexico has even proposed tariffs on China.

Country reactions are not limited to the above. Many are adjusting policy to reflect the short-term risks of US tariffs, the apparent shift in its security relationships and the broader geopolitical change. As we wrote before the election, these geopolitical shifts are highly unpredictable and may manifest in subtle ways on the macroeconomic landscape. One might argue that even Turkey's latest foray into autocratic rule – President Erdoğan arrested Istanbul mayor and opposition leader Ekrem İmamoğlu – and its impact on the Turkish lira is a side effect of geopolitical developments that have seen Turkish regional importance grow. The EU has provided scant criticism of these developments so far. Moreover, US developments are set to continue and likely get worse over the coming quarters. This will likely result in more direct headwinds to growth for many countries and a continued cost of uncertainty to all.

Investment Managers

26 March 2025

Global Macro Monthly – US

David Page
Head of Macro Research

Hard data, soft data

The new US administration has not relented from implementing unorthodox policy. Tariffs were raised again on China (another 10ppts) and to 25% on Canada and Mexico, albeit only to non-USMCA compliant goods, as well as 25% on global steel and aluminium. Another round of reciprocal and sectoral tariffs are expected at the start of April. Federal worker layoffs (and in some cases re-hirings) have continued, with estimates of a 25k reduction in workers to mid-March. The US has also continued deportations, despite in one reported instance contradicting a court ruling.

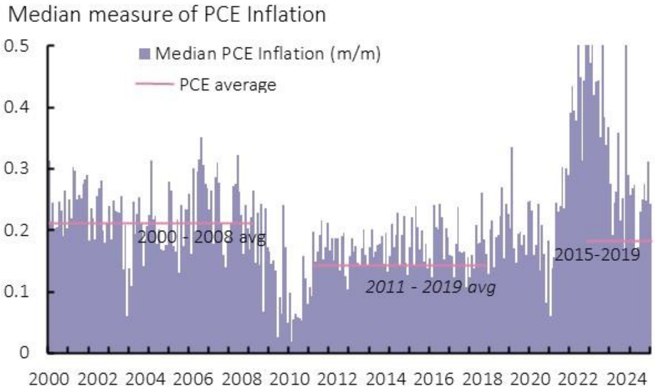
The economic impact is so far difficult to gauge. After January's sharp drop in retail sales, February enjoyed a rebound – particularly in the 'control group' that most closely aligns with monthly consumption – which rose by 1.0% following a 1.0% drop in January. Other areas also appeared to recover – durable goods rose 3.1% in January, albeit mainly in transport orders; manufacturing increased 0.9% in February; and housing starts bounced by 11.2% on the month. Survey evidence also corroborated firmer activity in February, with the ISM services index rising. However, other surveys have softened, including Michigan's consumer sentiment for March while the Atlanta Federal Reserve (Fed)'s GDP tracker currently suggests Q1 GDP will shrink 1.8%.

We draw several conclusions from this mixed evidence. Q1 GDP looks set to be soft – we forecast around 0.5% (annualised). However, only part of this reflects softening consumer spending (we estimate 1.0% in Q1), with that exaggerated by an unwind of a strong Q4 and weather disruption. Growth also looks to be impacted by accelerated imports intended to get ahead of tariff increases, with the final figure dependent on the degree of inventory build. GDP should rebound in Q2. On balance, we see growth as volatile, but fundamentally solid. However, we now expect the deceleration in growth a quarter sooner, due to quicker policy implementation than forecast. We forecast GDP growth of 2.1% this year and 1.5% next (consensus 2.2% and 2.0%).

By contrast, while February's Consumer Price Index (CPI) and Producer Price Index (PPI) inflation data eased, components that add to Personal Consumption Expenditures (PCE) inflation were more elevated, particularly following the 0.4% increase in import prices. We expect February's PCE inflation to rise by another 0.3% which would be the firmest two-monthly inflation rise since early 2024 – suggesting price stickiness (Exhibit 1).

Moreover, surveys show inflation expectations rising. Admittedly, the New York Fed's 12-month consumer survey only inched higher to 3.1% in February, but the Michigan University one-year outlook leapt to 4.9% – its highest since 2022; the 5-10-year measure rose to 3.9% – its highest since 1993 – and the Atlanta Fed business inflation expectations survey rose to 2.5% in March. Higher short-term inflation expectations risk bolstering wage growth.

Exhibit 1: PCE inflation – no further progress towards target



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

Fed downplays inflation for now

Against these developments, the Fed's decision to leave policy unchanged in March was clear: there have been signs of softening activity, but the labour market remains robust, PCE prices are not showing further disinflation, and some measures of inflation expectations have risen sharply. With policy uncertainty high, the Fed's case to be in "no hurry" for further easing was well justified – and widely expected. The quarterly update of medium-term projections perhaps gave more away – growth was revised lower and inflation higher, albeit modestly for now. The Fed left its rate outlook unchanged, with two cuts this year and next, and one in 2027. Fed Chair Jerome Powell suggested that the forecasts owed a lot to inertia in the face of uncertainty. However, the distribution of forecasts drifted higher, particularly for this year and next.

Over the coming months, we expect the Fed to triage the economy along the following lines: is the economy likely to slow sharply towards recession? Is there any deterioration in the labour market? Is there more progress on inflation towards target? For now, we suggest Q1 will see slower growth but consider fears of a recession overdone. Powell described the economy as "healthy". We also expect the unemployment rate to remain stable, not least with labour supply being squeezed by falls in migration. The Fed currently projects unemployment to rise to 4.4% from 4.1%. Meanwhile, inflation remains sticky, and expectations are rising. We expect the Fed to defer rate cuts beyond the market's current expectations (June) and only deliver the first cut by year-end, forecasting 3.50% by end-2026.

Global Macro Monthly – Eurozone

François Cabau,
Senior Eurozone Economist
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Hugo Le Damany,
Eurozone Economist
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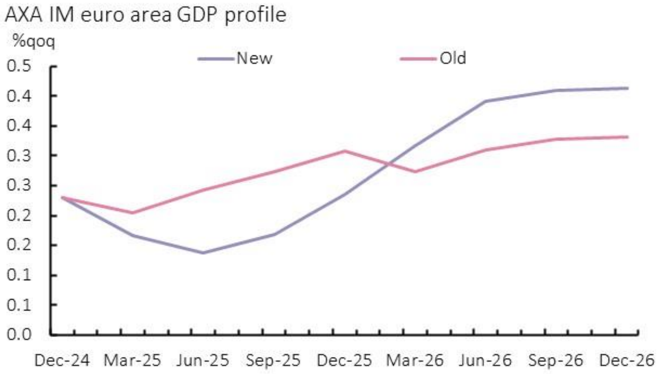
Darkest before the dawn

We have downgraded our Eurozone GDP growth projection to 0.8% (-0.1 percentage point, ppt) to account for upcoming higher-than-expected US tariffs as well as a drag on activity from higher uncertainty. For 2026, we continue to expect 1.2%, with a weaker 2025 carry-over made up by stronger sequential growth mainly stemming from the German fiscal bazooka (Exhibit 2).

Exhibit 2: Two-step Eurozone GDP growth revision



Source: Eurostat and AXA IM Research, March 2025

Increased US tariffs and uncertainty loom

In response to US President Donald Trump's aggressive rhetoric towards the European Union (EU), we have updated our tariff assumptions, now expecting 10% (instead of 5%) from April, with a moderate 5% retaliation from the EU. The net cumulative impact of these changes reduces our Eurozone GDP growth forecast by around 0.1ppt, with the greatest impact expected this year. Among major countries, Germany is the most exposed, followed by Italy.

Overall policy uncertainty – over and above US trade policy itself – has increased further since we updated our forecasts last November. Using country sensitivities from European Commission (EC) research[1], France and Italy look to be most affected, further impacting Eurozone momentum with a likely maximum impact towards the end of 2025. We also note the additional headwind of higher Eurozone bond yields.

German bazooka passed

The incoming German CDU/CSU – SPD government coalition went fast and big, using the current Bundestag seat split to make three key changes to the German constitution. It passed a bill setting up a new infrastructure (off budget) fund, worth €500bn (11.6% of GDP) to be spent over 12 years; states will be allowed a deficit of 0.35% of GDP (the same as at the federal level, from 0% previously); and all defence spending above 1% of GDP will be excluded from the debt brake rule. As such, Germany will be free from both national and EU fiscal rules.

ReArm Europe: Mostly from member states

As part of its ReArm Europe initiative, set out on 19 March with a much-awaited EC white paper, the EU Council has agreed to exempt defence spending (up to 1.5% of GDP) from EU fiscal rules for countries keen to trigger their national escape clause.

The European Commission has estimated a total €800bn increase in defence spending over the next four years, suggesting around €650bn would come from increased national issuance via this national escape clause. The EU will also set up a new facility, Security Action for Europe (SAFE) to distribute up to €150bn worth of loans – backed by EU borrowing – that will limit national issuance, and at a lower cost for many member states. However, initial intentions reported in the press for France, Italy and Spain were underwhelming. In this regard, updated stability programmes to be published next month will be key.

While certainly a positive response following the US's shift on global security, we are not convinced the new EU ReArm facility is an immediate game-changer from a growth perspective. However, we are much more positive about the new German infrastructure plans which may almost triple its potential growth in the medium term to 1.5%-1.75% – this will help raise Eurozone growth prospects by around 50 basis points. But for our forecast horizon, the uplift is likely to emerge from the second half of 2026 (Exhibit 2).

Unchanged ECB baseline

Facing more imminent downside risks to growth, we maintain our dovish forecast. We expect the European Central Bank to keep back-to-back rate cuts to 2% before moving to cutting at its quarterly forecast meetings, ending the year with a deposit rate at 1.5%, below market expectations for just two cuts to 2%. The upcoming decision on US tariffs will be key in shaping the short-term rate outlook, with the fiscal push unlikely to move the dial much before 2026.

[1] European Commission, the cost of uncertainty – new estimates, 15 November 2024

Global Macro Monthly – UK

Gabriella Dickens
Economist (G7)
Macro Research

Bank of England to look through near term pressures

UK economic momentum remains sluggish. The unexpected 0.4% month-on-month increase in December activity looks like an outlier, given the 0.1% decline in January. This decline has led us to lower our forecast for Q1 to 0.2% – broadly in line with the message from the most recent Purchasing Managers' Index – leaving growth across 2025 as a whole at around 0.9%, a tad above the Bank of England's (BoE) 0.7% forecast.

Headline Consumer Price Index (CPI) inflation was punchy in January, rising to a 10-month high of 3.0%, from 2.5%. But at 3.7%, core CPI came in broadly in line with expectations, while services CPI inflation came in 20 basis points (bps) below. Over the coming months there will be several one-off level changes to the price basket, such as changes to rail fares, vehicle duty and alcohol duties. Utilities bills, including energy and water, are also due to rise.

We think underlying price pressures will continue to ease, though, as a softer labour market underpins a material slowdown in wage growth and demand remains weak. Note the Pay-As-You-Earn (PAYE) measure of employee numbers dropped by 9K on a quarter-on-quarter basis in the February, and survey measures point to further weakness ahead. At the same time, private sector earnings excluding bonuses rose by 0.2% on the month, a tad below the average January monthly change across the 2010s (0.4%) suggesting easing momentum. And the His Majesty's Revenue and Customs (HMRC) median pay data was down 0.4% in February, with the headline growth rate dropping to an annual 5.0%, from 6.0% in January.

March's BoE meeting was largely uneventful. As expected, it kept the Bank Rate unchanged at 4.50%, with eight of the nine members agreeing and forward guidance was unchanged, stating "gradual and careful approach to further withdrawal of monetary policy restraint". The BoE 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. Meanwhile, the government looks set to announce spending cuts potentially to the tune of £30bn at the spring fiscal event, including £5bn from welfare spending. We think the Chancellor will shrink the spending envelope available in the Spending Review later this spring, impacting spending in future years and but not the immediate growth outlook.

Global Macro Monthly – Canada

David Page
Head of Macro Research

Trade war will damage economy

The Canadian economy has shown signs of recovery, but US tariffs are a major shock. Implementation has been erratic, but we estimate tariffs on Canada have increased by a weighted average of around 14 percentage points (ppt) at the time of writing. Meanwhile, Canada announced 25% retaliatory tariffs on CAD155bn of goods, with CAD30bn from 4 March and the remainder to be applied if US tariffs persist. Some 76% of Canada's exports are to the US (25% of GDP), and while the impact is hard to judge it will be large. The Bank of Canada (BoC) published a scenario that estimated a 4ppt drop in output adding 1.6ppt to inflation over three years. Current tariffs are smaller, but meaningful.

End-of-year growth was robust, with retail sales driving a 2.6% annualised growth boost in Q4 and 1.5% for 2024 as a whole. January's flash estimate recorded a further 0.3% rise and though GDP should soften, we forecast Q1 growth of 1.6%. However, consumer confidence has fallen to a two-year low and business confidence to its lowest on record (since 2001). We have sharply lowered our forecasts for the coming quarters, while the firmer end-2024 leaves our 2025 forecast at 1.5% (from 1.8%). We see a more substantial drop in 2026 to 0.9%, assuming tariffs persist.

The BoC reduced its policy rate by 0.25% to 2.75% in March, as we forecast. Governor Tiff Macklem explained that "policy cannot offset the impact of a trade war. What it can and must do is ensure that higher prices do not lead to ongoing inflation". The lopsided impact of tariffs versus retaliation suggests a net demand shock – the impact on exports and confidence outweighing the various cost increases. We therefore expect further cautious easing by the BoC, while continuing to anchor inflation expectations. We expect it to ease in April and July and to leave rates at 2.25% through 2026, depending on the scale and persistence of tariffs.

The political backdrop has moved as swiftly. Mark Carney won the Liberal party leadership contest, was sworn in as Prime Minister and called an election for 28 April. The Liberals were over 20 points behind in the polls three months ago, several polls now see them enjoying a small lead, with the Liberals taking some votes from the Conservatives, but more from the New Democratic Party and Bloc Québécois. The election now looks in the balance.

Global Macro Monthly – China

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Economist (China)
Macro Research

Fresh domestic policy amid tariff uncertainty

March is typically a pivotal month for China's economy. This is not only when the National People's Congress unveils the annual budget but also the first chance to recalibrate China's annual outlook as it resumes data releases following the two-month gap over Chinese New Year. However, this year has been especially eventful, with widespread US tariffs reshaping global dynamics and posing additional risks to China's growth.

Developments within the economy have been somewhat positive. The newly announced fiscal budget aligns with expectations, featuring an expansion of RMB2.9tn or 2.1% of GDP, supporting the GDP growth target to stay ambitiously at "around 5%". Beijing's policy stance has shifted towards what we expected last year, placing greater emphasis on the private sector and households – a long-awaited adjustment (Exhibit 3).

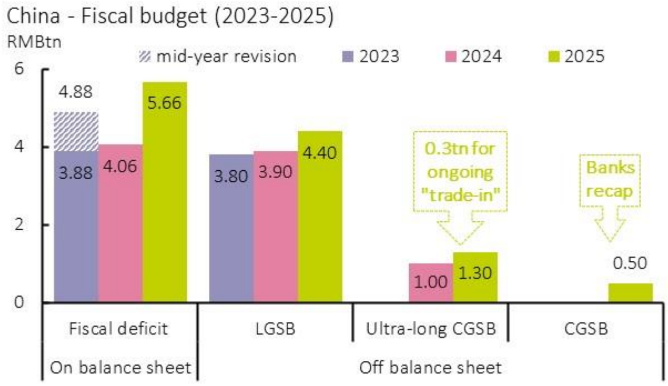
Continuing last year's trade-in programme with an additional RMB300bn quota in 2025 has boosted sales of eligible goods, yet it has imposed a short-term disinflationary effect, as producers lowered prices to meet the subsidy requirements. The impact on retail sales is likely to be temporary, given most qualifying items are big-ticket durable goods, which may lead to weaker future demand. Other measures – such as promoting income growth, enhancing childcare benefits, and stabilising the property market – are intended to provide more fundamental support. However, consumer confidence has been eroded by prolonged weak income growth and declining asset values. Households appear hesitant to increase spending until they see tangible and sustained improvements in financial conditions. Hence, only gradual recovery and more moderate rebound in consumption are expected this year.

For these reasons we have revised down our inflation forecasts to 0.5% for 2025 and 0.8% for 2026. However, our 2025 GDP forecast is unchanged at 4.5%, below Beijing's official growth target, as stronger investment by privately owned companies in AI and high-tech sectors should offset a weaker consumer.

This year's fiscal plan also addresses emerging risks in the banking sector and local government finances. Central government is taking more than half of the near-RMB12tn fiscal quota for 2025, the highest ratio since 2018, in an effort to ease financial pressures at the local government level. The planned RMB500bn funding for large bank recapitalisations should help mitigate systemic risks in the banking sector as it navigates ongoing challenges posed by the property downturn and plausibly prepares them for further monetary policy easing.

Domestic challenges have yet to improve fundamentally, but recent policy moves have given rise to hopes for a brighter outlook and a more balanced long-term development trajectory. That said, the road to a full recovery will take time, and much depends on the effectiveness of policy implementation and developments overseas.

Exhibit 3: A modestly larger fiscal package in 2025



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

China faced another round of US tariffs in March, with an additional 10% levy coming into effect, pushing the weighted average US border tax to nearly 40%. Further US action is widely anticipated in April following the United States Trade Representative (USTR) report, alongside a subsequent, potential trade negotiation.

We still expect US tariffs to stabilise below the 60% mark which US President Donald Trump previously threatened, while the overall economic impact on China will also depend on broader US trade policies – if Washington adopts a harsher stance towards other trading partners, the impact on China may be mitigated as its import prices may not rise as much relative to others. Our base case assumes China's GDP growth in 2025 will be impacted by less than one percentage point due to escalating trade tensions.

A consequence of the additional tariffs is likely to be depreciation pressure on the Chinese yuan. We forecast it will weaken to around 7.5 yuan per dollar by year end, although upside risks come from the People's Bank of China's (PBoC) likely stronger daily fixes to manage the pace of depreciation and prevent capital flight. Avoiding Trump's potential dissatisfaction with yuan depreciation may also be a factor and may already be restraining the PBoC's monetary response.

China's domestic challenges remain more pressing than external ones. With a more supportive policy environment emerging, the conditions for a fundamental economic recovery may finally be taking shape.

Global Macro Monthly – Japan

Gabriella Dickens,
G7 Economist
Macro Research

One further hike on the horizon

The second estimate for Q4 GDP growth showed an increase of 2.2% on an annualised basis, well above the 1.1% expected. Admittedly, private consumption was unchanged, despite Japanese households seeing stronger real income growth, suggesting households saved the additional cash. In addition, the Bank of Japan's (BoJ) consumption activity index has weakened, pointing to ongoing caution against a backdrop of growing global pressures. But we still expect growth to remain solid throughout 2025. We think capital expenditure will continue to rise, as businesses continue to invest in technology amid the backdrop of a declining labour pool. Rising real incomes should eventually start to pass through to spending; we expect GDP growth of 1.3% across 2025.

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, well above the 4.92% expected by analysts. The upside surprise largely came from small and medium-sized enterprises with settlements equal to 5.09%, compared to 4.42% in 2024. Base pay – which has a closer relationship with the official wage growth figures – rose by 3.84%. As a result, we expect year-on-year pay growth to reach a peak of around 3.7%. But the big picture is that growing labour shortages appear to be driving a structural shift in wages, adding weight to the BoJ's expectations that the wage/price spiral will take hold, and that inflation will likely hover around the 2% target over the medium term.

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 continues to develop in line with their thinking. It still expects growth to outpace potential over the coming quarters, driven by a growing recovery in private consumption as wage growth remains strong, policy accommodative and growth moderates overseas. The BoJ did note 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.

Global Macro Monthly – EMEA

Claire Dissaux,
Senior Sovereign Credit Analyst (Emerging Markets)
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Exposed to US tariffs, reliant on German demand

Central Europe (CE) is facing US tariff risks, via both the reciprocal tariffs due on 2 April and those targeting specific sectors, including automotive makers. With the US assessing 'reciprocity' by comparing not just tariffs, and non-tariff barriers, but also VAT rates, EU countries such as Hungary, the Czech Republic or Poland are highly exposed. CE economies are also exposed to tariffs on the automotive sector, which represents between 5% and 10% of their GDP. But their direct vulnerability to US tariffs is limited. The domestic value-added content of their exports to the US is small: 2.8% of GDP in Hungary, 2.1% of GDP in Poland and 1.7% in the Czech Republic. CE economies are instead highly integrated in value chains across the EU, particularly Germany and via car production. Tariff-related shifts in value chains could negatively impact foreign direct investment (FDI) in CE. Net FDI inflows to Hungary and Poland are significant (1.3% and 1.5% of GDP in 2024), but their reduction would not be an external constraint given a current account in balance in Poland and a surplus in Hungary.

The indirect impact of US tariffs via German demand would thus matter most for CE. In domestic value-added terms, the region's exposure to German demand is high at 6% of GDP for Poland, 6.1% for Hungary and 7% for the Czech Republic. For the latter two, which are the most sensitive to German demand, we see a similar balance of risks to Germany: lower in the near term, but higher from 2026.

The region should therefore benefit from increased fiscal expansion across the EU. It should also enjoy increased fiscal leeway. EU countries will be able to activate a national escape clause over the next four years, allowing them to deviate from their expenditure path to increase defence spending versus 2021 with a limit of 1.5% of GDP per year. Hungary and Poland, which as of 2023 had increased their military spending in ESA2010[2] terms most since 2021, would benefit most. The additional flexibility would be 0.8% of GDP for Hungary and 0.4% for Poland. With Poland running large primary deficits, easing pressure on fiscal consolidation should be welcome news, provided a credible path is maintained and caps bond yields. Domestic demand-driven growth in Poland, supported by expansionary fiscal policy, is set to continue, with GDP growth seen above 3% this year.

[2] European system of national and regional accounts

Global Macro Monthly – LatAm

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Mexico: Growth and budgetary pressures

Mexico's economy is facing a perfect storm. Large fiscal tightening is under way, as is the implementation of constitutional reforms (including for the judicial system) which are negatively impacting the business environment. External headwinds from a US slowdown are building, and then there is the risk of punitive US tariffs and associated pressures to weaken links with China. Activity weakened sharply in the second half of 2024, with the construction and public investment booms ending after Mexico's presidential election. Preliminary Q1 data – PMI surveys and industrial output – point to another quarterly contraction after GDP fell by 0.6% in Q4. If a technical recession materialised in Q1, GDP growth would likely be close to zero in 2025 (0.1% vs. our 0.6% forecast, assuming no additional US tariffs are imposed), with Q1 the trough in activity in our baseline. While persistent trade uncertainty weighs on private investment and fiscal tightening curbs public investment, the recent consumption weakness may be temporary, given support from wage increases, remittances, disinflation and resilient sentiment.

Yet in a risk scenario, the threatened permanent 25% increase in US tariffs would likely tip the economy into a severe downturn. Currently only non-USMCA compliant goods are subject to a 25% tariff, which is estimated to affect 5%-10% of exports while further US decisions on tariffs have been postponed to 2 April. A 25% increase in US tariffs on Mexico followed by retaliation from Mexico would have a 0.4 percentage point (ppt) negative impact on its GDP in 2025, 1.3ppt in 2026 and a peak impact of 3.4ppt by 2032-2033, according to Peterson Institute estimates.

The negative chain effects between weaker growth and fiscal underperformance are likely to intensify, even in our base case scenario. The 2025 budget, which aims to reduce the deficit to 3.9% of GDP from 5.9% in 2024, is based on GDP growth of between 2% and 3%. Much lower growth would mean the government is unlikely to achieve its revenue target despite the Mexican peso being 10% weaker to the US dollar than assumed for end-2025. Without the prospect of a much-needed tax reform given the reliance on oil and a low tax base, adjustment was supposed to go through spending cuts. But with rigid expenditure given the rise in social spending and the interest rate burden over the past decade, outsized cuts in investment and other discretionary expenditure are needed to reduce the deficit, which would reinforce the downside risks on growth.

Global Macro Monthly – EM Asia

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Now is not the time for homegrown crises

Facing the imminent prospect of US tariffs hikes from April, the region's policymakers have their work cut out to support growth and avoid excessive financial market volatility. Central bankers have recently proved to be adept at this balancing act, cautiously easing their policy stance and being more measured in their market intervention when necessary. A steady hand is also required on the fiscal side to maintain a level of predictability and avoid unnerving investors.

Indonesia's central bank has broadly kept to its mandate, but the new president, Prabowo Subianto, has undone much of the country's reputation for sound fiscal management, and this has been a contributing factor in the currency's slide this year and the 18 March equity market collapse. His abandonment of a budgeted VAT increase, and since the start of this year, pursuit of an "efficiency" drive to free up funds for his populist welfare programmes have fuelled concerns. The efficiency savings, along with a rerouting of state-owned enterprise dividends, will also go towards raising $20bn (1.3% of GDP) in seed capital for a new sovereign wealth fund under the President's control; this has raised concerns over a rise in off-budget spending with limited oversight. The country's well-respected finance minister, Sri Mulyani Indrawati, denied resignation rumours and has asserted that the government is sticking to this year's deficit target of 2.5% of GDP. However, with the dismal revenue performance in January-February (down 21% year-on-year), there is now a greater risk that it will fail to adhere to its fiscal rules that cap annual deficits at 3% of GDP.

With tough US trade negotiations on the horizon for most in the region, this is not the time for domestic political frailty. In South Korea, at the time of writing, the Constitutional Court had yet to reach a verdict on the impeachment case against the president, Yoon Suk Yeol. If Yoon is impeached, a presidential election will be held within 60 days. Given the widening political divide since Yoon's failed effort to invoke martial law in December, the election will be highly contentious, and during the campaign period there will be limited political capacity to challenge or respond to US tariff hikes. However, if Yoon is reinstated, the ensuing political deadlock – the opposition controls the legislature – will likely prevent the timely passage of a supplementary budget and broader measures required to shore up investor confidence.

Macro forecast summary

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*

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*

These projections are not necessarily reliable indicators of future results

Forecast summary

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

These projections are not necessarily reliable indicators of future results

Download the full slide deck of our March Investment Strategy

26 March 2025

Our Research is available online: www.axa-im.com/investment-institute

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**All figures, as at end of December 2024*

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