AXA Investment Managers

26 March 2025

Investment Institute Macroeconomics

Transatlantic Reversal?

Key points

- Trade-related uncertainty is already hurting confidence, including in the US, before the "real" impact of tariffs hits
- Unusual ideas in Washington on the global financial order are another source of uncertainty. There is a window of opportunity for "boring Europe" to step up on the Euro's international role
- Reverse peace dividend
- Higher yields ahead
- European stocks to benefit

Uncertainty hurts everybody

On 2 April, the US should release the next stages of their tariff plans, but Scott Bessent presented them as only the start of negotiations: trade uncertainty will remain high for months, with an immediate price to pay in terms of growth, both for the targets of the new tariffs and for the US itself, which will materialise before the "real effects" transiting through prices. Using estimates from 2018-2019, uncertainty alone could cost 2 to 4% of US business capex.

On the consumer side, Americans continue to be more depressed than what the "objective" state of the economy would suggest. This was true under Biden and remains true now. The post-election rebound in confidence was short-lived. We suspect the constant bombardment of news on tariffs is not helping. Sentiment matters: even when controlling for "hard" variables such as purchasing power or the unemployment rate, consumer confidence has a measurable impact on private consumption. It is unlikely to be powerful enough, at this stage, to precipitate the US into recession, but combined with lower equity prices and wait-and-see on capex, the significant US growth slowdown which we expected for 2026 could materialise faster.

Of course, trade uncertainty is another headwind for Europe. Still, in Germany and France, the source of the significant rise in overall economic policy uncertainty pre-dates trade war 2.0 and is more domestic (doubts on the growth model in Germany, political instability in France). The confirmation of Germany's new government success in decisively shifting the fiscal stance for the next 10 years, and in France the return of clearer political leadership in a context when defence and foreign affairs dominate, could offset some of the external headwinds.

Still, the sequence remains problematic: the tariffs are for today, defence spending is for tomorrow.

Unusual ideas in Washington add to uncertainty

An idea is circulating in Washington that financial flows into the US could be taxed to raise revenue and/or to depreciate the US dollar. A similar solution – taxing interest paid to non-residents on US bonds – was mentioned in an influential essay by Stephen Miran, Donald Trump's appointee as chairman of the Council of Economic Advisors, on the overhaul of the world monetary order, seen as working against US interests. This would raise the funding cost of the US government and would ultimately express a renunciation of the "exorbitant privilege" which for decades has allowed the US to pursue largely unconstrained fiscal policies thanks to the dollar status as the world's dominant reserve currency.

There is a precedent in the modern history of the US when the White House voluntarily, and by surprise, affected the US dollar status: the "Nixon shock" of August 1971, when the President suspended the convertibility to gold. While it was a political success for Richard Nixon in the short-term, it ended up exacerbating the US inflation problem. Equally, we do not think that renouncing the "exorbitant privilege" would serve the US economic interests in the long-run – the evidence that a dollar overvaluation has "hollowed out" US productive forces is scarce in our view – but these debates fuel a "mood music" in Washington which in any case is contributing to the ongoing correction of the USD.

"Boring" Europe is getting more attractive

There is no off-the-shelf solution to reshape the international monetary system should the dollar status erode. In 2010, the International Monetary Fund (IMF) worked on some ideas, but expanding the role of the Special Drawing Rights would not be straightforward. In any case, cooperative solutions would require a level of support for multilateralism which is – for now at least – missing in the US administration. The Euro area's preference for current account surpluses has for long impaired the Euro's capacity to play a major role in the international monetary system. The change of fiscal stance in Berlin may change this.

Still, that the Euro area is now moving towards a more "inward-driven" growth model – military spending replacing Chinese demand to support manufacturing, in a nutshell – is a necessary, but not sufficient conditions for the Euro to compete with the dollar as a reserve currency without harming itself. Protection of property rights is ensured in the European Union (EU), with a strong legal system and policy predictability is much higher right now than in the US. Liquidity and market depth however remain problems, given the fragmentation of the financial markets across national lines and the absence of a joint safe asset. This is precisely what the capital market union, and the prospect of joint issuance to fund defence could address. The road is still long for the euro – and decision-making in the EU institutions would probably need to change to reassure the rest of the world on its capacity to respond more quickly to crises, but we no longer deem it "unthinkable" that it could play a more central role in the international monetary system in the future.

Defence is the best form of sustainability

The fundamentals of Western society are built on the constructs of democratic political institutions and universal rights. Concepts such as sovereignty, equal representation, universal education, access to healthcare and a welfare net are enshrined in the model, even if funding and organisation differs from country to country. Over recent decades, governments have been able to take advantage of the post-Cold War "peace dividend". This has allowed greater spending on health, education, and social security. More recently, protecting society from climate change risks has seen higher spending. Attention, if not great amounts of money, has also been directed towards addressing inequalities and inclusion, particularly as societies have become more socially and culturally diverse. The cost of all this – against the backdrop of ageing societies – has exceeded the peace dividend – social spending has contributed to rising debt levels and investors have questioned fiscal sustainability.

In Europe, difficult choices need to be made. The apparent withdrawal of the US security guarantee will necessitate a reversal of the peace dividend. Defence spending needs to increase. Germany has announced a huge defence and infrastructure spending package. But Germany has the fiscal space to increase its debt-to-GDP ratio; other European Union countries do not but will spend more regardless to meet higher defence targets as a percentage of GDP. Hard choices could mean lower private income growth (because of increased taxation) and lower welfare spending. It will inevitably mean higher long-term borrowing costs, something which European government bond markets have already started to price in.

Markets anticipate huge political challenges ahead

Geopolitics is in flux, and it is too early to gauge whether there will be a sufficient public mandate for the hard choices ahead, especially if they mean increased taxation, higher interest rates, and reduced spending on welfare. Politicians are tasked with making the argument that to preserve the democratic model over the long term, defending it against escalating threats today is unavoidable. How this plays out is important for investors. If Germany's plan is really a game-changer, as some commentators have argued, then new investment opportunities will open for investors. Spending on European companies across the whole defence and security supply chain will increase. Again, markets have started to front run this with European equities significantly outperforming the US market since the start of 2025.

Trumponomics not being rewarded

Just over two months have passed since Donald Trump's inauguration, and a lot has already changed in terms of US policy, much of which has global implications. Tariffs will mean higher inflation and lower growth. The shift in geopolitical alliances will mean increased public spending on national defence in Europe and elsewhere. Globalisation as a theme was dealt a blow during the pandemic; US exceptionalism as a theme is starting to be tarnished by US policy making. This means businesses and investors need to adapt their own strategies. Recent data and surveys, as well as anecdotal evidence, all suggest more US companies are worried about the impact of tariffs on their input costs and whether they will be able to pass on higher prices. Consumers fear higher inflation, as highlighted in the recent University of Michigan consumer survey, and this comes despite Washington's argument that American consumers will not pay the tariffs. Hard data has started to soften and earnings expectations for listed companies are moving down. The real bear case for the US is that uncertainty affects spending which is reflected in further stock market losses. In turn these will impact personal financial wealth, and spending will be cut further. A recession can quickly unfold under such circumstances. Such a scenario would see the Federal Reserve (Fed) cutting interest rates by substantially more than is currently priced in.

Possible shifts in global flows

Other investment themes which could flow from the direction of current political and policy events include shifts in global allocation of equity and fixed income portfolios. For reasons already stated, the outlook for US equities has dimmed. In 2024, large-cap technology stocks helped deliver a 20% increase in the S&P500. That looks unlikely to be repeated this year as multiples on technology stocks have been cut. The emergence of competition in the field of artificial intelligence (AI) developments is playing a role here, but so is policy uncertainty. We still have a positive view on technology and AI as long-term investment themes, but there is no guarantee that only US companies will lead the way in terms of applications and democratisation of their use.

Foreign flows into US equities have been huge in recent years. Foreigners own almost 18% by value of listed corporate equities, according to the Fed's Flow of Funds data. If the "US exceptionalism" case for being overweight the US becomes tarnished, some of that money could reverse, or at the very least, net inflows could weaken. That suggests lower multiple premiums on US stocks relative to the rest of the world going forward. Keep in mind that the US has a large current account deficit which requires capital from the rest of the world to go into listed and private equity, Treasury bonds, corporate credit markets and real estate. A weaker dollar is inevitable if the rest of the world is less enthusiastic about owning US assets.

Europe should be a beneficiary of these shifts in global asset allocation. Higher public borrowing will change the savings and investment balance in the region, resulting in less capital outflows and more domestic investment. Part of that will be absorbed by bond markets through increased debt issuance. Improved fiscal stability in southern Europe should help those economies manage higher borrowing costs although France may face more challenges. Mutualisation of spending to boost Europe will help. For credit markets, closer financial integration seems inevitable as deeper capital markets will be needed to facilitate increased investment. This should benefit financials.

Equity markets are on the move in Europe. Defence and related stocks have performed well. Investors are shifting allocations to those companies and making the argument that "there is no sustainability without security". There will be broader growth impulses too, as Germany's plan is to increase spending not only on defence but on transport, energy, technology, and telecommunications. The industrial-military complex in Europe will be boosted. In the US, technology leadership in recent decades has been based on the US having a higher share of defence spending. There will be multiplier effects in terms of GDP spending, but also, potentially, in terms of productivity.

For now, Europe has better valuations than the US, and decent earnings growth that should be sustained in years to come, as well as a policy direction that is less unpredictable than in the US. The euro may not become the global reserve currency, but Europe can benefit from the US losing a little of its “exorbitant privileges”.

Download the full slide deck of our March Investment Strategy

26 March 2025

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

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

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AXA IM manages approximately €879 billion in assets*, of which €493 billion are categorised ESG-integrated, sustainable or impact. As an established player in responsible investing, we adopt a pragmatic approach with a view to provide long-term value to our clients, our employees and the broader economy.

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

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