21 May 2025

Investment Institute Macroeconomics

Monthly Investment Strategy

Joseki in international trade

Key points

- Markets buoyed by further tariff easing, but tariff level has increased sharply and trade deals are unlikely to restore status quo ante. US fiscal bill may cause further market jitters as Moodys sovereign downgrade suggests.
- Tariffs have caused GDP volatility with first US contraction in three years in Q1. Underlying growth strong in Q1, but this to fade and we forecast mild US recession.
- Elsewhere tariffs have added to upside in GDP, although again likely temporary. We expect deceleration in global activity in H2, with mild recession in Eurozone.
- Countries look set to offset weakening with domestic policy. ECB and BoE likely to ease more than markets price, BoC to continue easing. PBoC to add liquidity boosts from now and BoJ to hike once more this year.
- Fiscal policy also used. Underway in Eurozone. Though China now to see less urgency. Several EM continue to ease fiscal policy, with or without the required space.

Global Macro Monthly

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21 May 2025

Joseki in international trade

Global Macro Monthly Summary May 2025

David Page
Head of Macro Research

Global trade policies remain in flux

Risk sentiment has surged with the successive reversals of US tariffs. Some of this likely reflects shifts within the US administration, notably Treasury Secretary Scott Bessent's rising influence – never a tariff advocate. Yet the world's reaction likely sparked this move. In April we described the financial market's reaction. However, different economies' reactions have been important – none more so than China.

China firmly retaliated, leading to a spiralling in tariffs between the two nations, but the impact on China at first glance was not catastrophic. Exports to the US fell by 21% in April but overall exports rose by 8.1% with offsetting boosts particularly to Association of Southeast Asian Nations (ASEAN) countries and the Eurozone. This, and supply restrictions of rare earth to the US appear to have led the US to reverse its punitive tariff levels on China, now up 30% under this administration, even before a trade deal has been struck.

China's strategy differed from other countries which hunkered down to negotiations with the US. The UK struck the first 'trade deal', albeit thin in nature. But after this, the UK only removed tariffs on steel and aluminium exports; other categories remained at 10% (including for lowered car export quotas) up from 3.8% in 2024. Other countries will likely gauge the relative merits of these approaches. Japan has already appeared more belligerent in negotiations, refusing to accept ongoing 25% tariffs on its auto sector. European Union (EU) reaction will be interesting. A 10% tariff on the EU was towards our risk case scenario at the end of 2024 and we think would be sufficient to generate a mild Eurozone recession. It would also likely prompt EU retaliation – on ice during negotiations.

Broader economic responses emerge

As the world digests US tariffs settling around 16%, up from 2.4% in 2024, the economic outlook will depend on different countries' responses. The Eurozone is among the most noteworthy. The surge in fiscal support – a reaction more to the geopolitical than trade environment – appears a gamechanger. However, an expected impressive boost to German potential growth over the coming years may not be reflected more broadly with other countries more constrained. Neither French nor Italian governments are looking to take advantage of low-cost EU loans for defence spending against a backdrop of elevated deficits, something to be further flagged in the upcoming European Commission deficit forecasts. The European Central Bank (ECB) will balance the near-term outlook for a mild recession in H2, suggesting the need for below neutral rate policy, against the longer-term prospect of fiscal-fuelled growth.

China continues to balance risks from external headwinds with its own domestic developments via policy stimulus. The recent yuan strengthening (dollar weakening) to above (below) Trump-election levels provided the People's Bank of China with opportunity to deliver monetary easing: a 10bp policy rate cut, 50bp reserve requirement ratio reduction and liquidity injection and 25bp key mortgage rate cut will all bolster demand. That said, the recent reverse in extreme tariffs may temper any additional fiscal stimulus. We still see China likely to miss its near 5% annual growth target this year. Our *Theme of the Month* conveys some of the structural adjustments taking place in China's labour market. But the urgency for policy stimulus has likely eased.

This balance of domestic policy support relative to external headwinds is the key theme across economies. In Asia, a US trade deal and fiscal policy will be uppermost for South Korea's new president after June's election; Thailand looks set to provide further fiscal support; in the Philippines further fiscal slippage will also boost domestic demand. In Latin America these developments will be exacerbated by oil price moves, with mixed effects for balance of payments and government budgets for countries in the region. For now, central and eastern European countries are more anchored via the EU – local politics continue to dominate, particularly in Romania.

Increasing local policy support will help support global growth. However, weaker Q1 US GDP and our forecast now for a mild US recession sees global growth at a soft 2.6% and 2.4% this year and next. A US contraction in H2 2025 is likely to lead to Federal Reserve rate cuts from September and a gradual recovery in growth through next year. However, the global reaction will help determine asset markets' reactions. Intrinsic strengths will underpin US activity, including likely productivity gains from tech sectors and huge domestic resources. We also see little chance of the US dollar losing reserve currency status over any credible timeline. However, the recent decoupling of dollar and risk movements does suggest a change in international investor behaviour. And a reduction in global asset allocation could be further accelerated if US fiscal concerns re-emerge with the upcoming fiscal bill.

Global Macro Monthly – US

David Page
Head of Macro Research

The Grand Old Donald Trump

President Donald Trump unleashed a barrage of tariffs on 2 April, marching levies up to levels not seen since the early 1900s. The extreme market reaction – suggesting an unwinding of US holdings – saw the policy reversed a mere week later. On 12 May the US de-escalated further, ending punitive post-retaliation tariffs on China, as its supplies to the US fell sharply, including in rare earth minerals, marching levies down again.

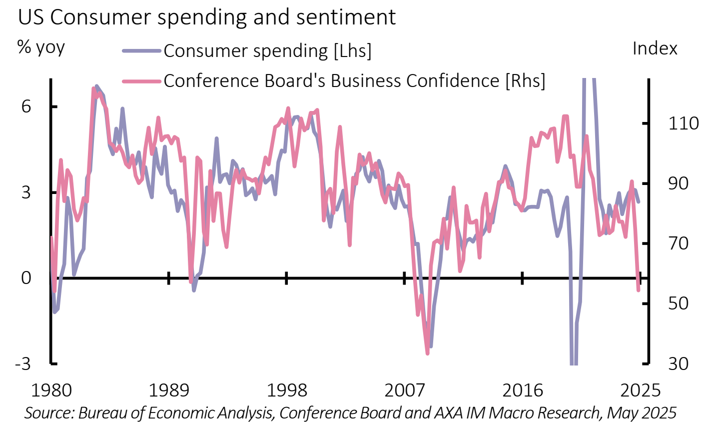
Despite optimism, likely reflecting the increasing influence of Treasury Secretary Scott Bessent – never a tariff advocate – over the more trade-hawkish elements of the administration, this up and down narrative misses the point: the announced US average tariff rate is still 17.8% – down from a high of 26% – but markedly higher than 2.4% in 2024. The UK, the first country to negotiate a trade deal, still faces tariffs – post-deal – of 10% on most sectors barring the important steel and aluminium carve out – not particularly a 'special relationship'.

Models estimating the tariff impacts and associated uncertainty suggest a wide range of possibilities, qualitatively lowering growth and rising prices, but quantitatively diverse. There is no precedent for such a large trade shock to a major developed economy in modern history (even the Brexit impact was obscured by COVID-19). The impact will be compounded by a plunge in inward migration, likely to slow US labour supply – reversing the tailwind that fuelled exceptional growth and falling inflation in recent years.

Yet data is only starting to reflect the impact. Q1 GDP fell by an annualised 0.3%, the first decline in three years. This did reflect tariffs albeit via a surge in buying to beat the hikes. Imports rose by an annualised 51%, net trade stripped 5.5ppt off headline growth, even as inventory lifted it by 2.2%. Underlying growth was supported by firmer-than-expected household spending. The timing is uncertain but we expect this effect to reverse in Q2 – imports halting after the pre-tariff surge – and likely to boost headline growth in Q2. However, consumer sentiment has collapsed – never lower outside of recessions (Exhibit 1); investment, strong in Q1, is likely to be on hold amid trade uncertainty and there are early warnings of a weakening labour market. Such a slowdown in underlying growth looks likely to persist into H2 2025 and result in headline deceleration. For now, we pencil in modest contraction in H2 2025 – a mild recession – but uncertainty remains high.

Exhibit 1: Sentiment never lower outside recessions

US Consumer spending and sentiment



Source: Bureau of Economic Analysis, Conference Board and AXA IM Macro Research, May 2025

Inflation is likely to rise – April recorded lower headline inflation at 2.3% (core remained at 2.8%). The scaling back of tariffs should reduce the boost but we still forecast inflation rising to 3.5% in Q4, to average 3.2% this year and next.

The Federal Reserve (Fed) recognises this outlook as a risk to both its mandates, a situation its Chair Powell described as "challenging". However, he remained adamant it was not the current situation and now was not a time to be pre-emptive. Indeed, with ongoing policy uncertainty, we recognise the Fed's desire to wait for more clarity in policy and impact. However, if these risks materialise as we expect, the Fed will assess which mandate deviation is most extreme and which it expects to be more persistent. We believe it will consider the tariff-price shock as temporary – although not without risks with inflation expectations rising. However, a growth shock threatens a more persistent divergence in its employment mandate. A growth slowdown on the scale we envisage is likely to lead the Fed to ease. On balance, we expect sufficient evidence of weaker activity to see it start easing in September and cut successively to 3.75% by end-year and to 3% by mid-2026.

This would challenge the current equity rebound, which has recovered start-of-year losses. It should also boost the outlook for US Treasuries, although we remain cautious that progress of the fiscal bill – something Bessent has suggested by 4 July – may unsettle markets by raising the deficit from already elevated levels, something that led to Moody's downgrading the US credit rating to Aa1 from Aaa. But the US dollar reaction may be the most telling. Though we believe discussions of the end of the greenback's reserve currency status are overdone, the unusual positive correlation between risk and the dollar – present since September, but more apparent during the latest sell-off – suggests a recent unwind of unhedged equity positions. The equity rebound has not lifted the dollar, suggesting domestic reinvestment or now hedged investments. Either would suggest overseas investors have become more cautious about the US.

Investment Managers

21 May 2025

Global Macro Monthly – Eurozone

François Cabau,
Senior Eurozone Economist
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Macro Research

Growth upside surprise likely behind us

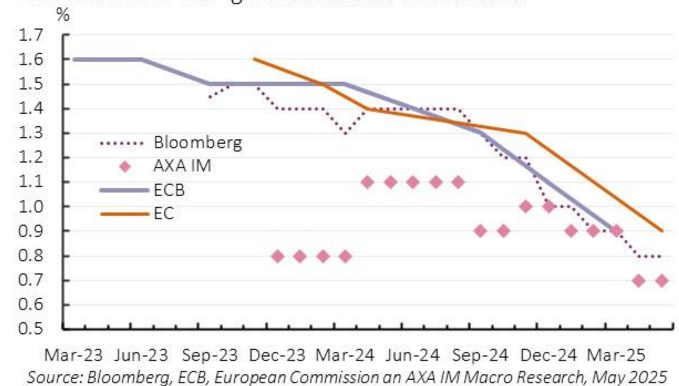
Eurozone Q1 GDP growth was revised down to 0.3% quarter on quarter, a -0.1 percentage points (ppt) drop, in line with our initial above-consensus forecast. Although details are scarce, the data was once again heavily distorted by Ireland (0.1ppt) and likely boosted by trade frontloading. Consistent with this, industrial production rose by 2.2% in Q1 – the strongest quarterly outturn since the global financial crisis bar the pandemic – although manufacturing confidence has remained in the doldrums. Meanwhile, details for France and Spain showed weakening domestic demand momentum.

Forward-looking indicators have been mixed at best. Very short-term manufacturing activity may continue to benefit from the tariff pause, and as firms may be wary of upcoming supply chain issues. Meanwhile, service activity surveys – both short and long-term – are unequivocally softer. This is consistent with consumer confidence edging lower in April, led by a fall in the general economic outlook in the next 12 months.

US-EU trade discussions have yet to make any progress. The European Commission (EC) has drawn up a list of goods for possible retaliatory tariffs (up to €100bn), though very much favours a conciliatory tone to lower tariffs rather than a tit-for-tat approach. While we acknowledge upside risks stemming from the latest US-China tariff agreement, we keep our baseline unchanged, projecting Eurozone growth to average 0.7% and 0.5% this year and next, including a small recession in the second half of 2025 – materially lower than the EC's (0.9/1.4%), or the Bloomberg consensus: (0.8/1.1%, Exhibit 2).While we agree with the EC's spring forecast that Q2 GDP growth is likely to be flat, we disagree that growth could restart as soon as Q3, reaching 0.3% on a quarterly basis in Q4.

Core inflation pressures are likely to soften further along with moderate labour market easing – we forecast the unemployment rate to average 7.0% in 2026 from 6.5% this year. Persistent euro appreciation and lower commodity prices are also likely to dampen inflation pressures. All in all, we project Eurozone core pressures to ease to 2.4% and 1.8% (EC forecast: 2.4%/1.9%) this year and next, while headline inflation should average 2.0% and 1.7% (EC: 2.1%/1.7%). As such, we put little weight into the three and one-tenth increases in one year and three years' ahead inflation expectations shown in the European Central Bank (ECB)'s March consumer expectations survey – before the April tariff showdown – to 2.9% and 2.5% respectively.

Exhibit 2: We remain conservative on Eurozone growth



Source: Bloomberg, ECB, European Commission an AXA IM Macro Research, May 2025

ECB's path all but certain

ECB Executive Board member Isabel Schnabel delivered a hawkish speech on 10 May calling for "keeping interest rates near their current levels" in neutral territory. With the positive news from the US/China, markets now expect the deposit rate to reach 1.68% by year-end. We nonetheless note that a June 25 basis point (bp) rate cut is still priced with about 90% probability in line with our long-held scenario.

While the latest developments have boosted optimism – as underlined by risky assets' performance – we do not think that such a hawkish tone is warranted, given the weak underlying macro situation, the lack of obvious (persistent) inflation pressures, and the ongoing uncertainty. In fact, hawkish Belgium central bank governor Pierre Wunsch said in an interview that "the ECB may have to cut rates below 2%". We think the June ECB meeting will likely strike a much more cautious and open tone about the future path of monetary policy. Our baseline remains for cuts to bring the policy rate into accommodative territory to 1% by year-end.

Portugal's snap general election broadly reiterated the previous balance of power. The incumbent conservative party Democratic Alliance won, slightly improving its score by 3.4ppt to 32.1%, gaining nine more seats, though it needs to form another minority government. Meanwhile, far-right party Chega gained further momentum, coming in second place – receiving an equal number of parliamentary seats as the Socialist Party at 58, but gaining eight seats while the Socialists lost 20. Although policy making will remain difficult, this is unlikely to alter Portugal's excellent macroeconomic backdrop which should allow it to further reduce public indebtedness over the course of the forecast horizon.

21 May 2025

Global Macro Monthly – UK

Gabriella Dickens
Economist (G7)
Macro Research

Q1 strength unlikely to last

GDP growth surprised in Q1, increasing by 0.7% on the quarter, above expectations for a 0.6% rise. In part, that likely reflects activity brought forward ahead of US tariff and UK business tax changes, with manufacturing output up 0.8% and export volumes up 3.5% after three consecutive declines. But services activity rose by 0.7% and capital expenditure by a chunky 6%. Looking ahead, we think Q1 growth will mark the peak; surveys fell in April, sentiment remains weak and real incomes growth is set to grind to a halt in the second half of 2025, as wage settlements fall and inflation picks up. We see 0.9% growth this year, with the quarterly pace slowing to a standstill mid-year.

The labour market is showing further signs of deterioration, driven by the private sector. The Pay-As-You-Earn (PAYE) measure of employees fell by 33K in the month to April, following a 47K drop in March. That left the three-monthly pace down 0.2%, with private sector employment down 0.4%. The Labour Force Survey (LFS) unemployment rate rose to 4.5% in March, from 4.4%, but the survey is still inadequate; we think the true picture could be around 30 basis points (bps) higher. Pay growth, meanwhile, is still high, despite the increase in slack. Total pay rose by 5.5% in March, with private sector wages up 5.6%. But underlying settlements data is weaker than the official figures suggest with pay growth likely falling below 4% by year-end, underpinning a slowdown in domestic inflationary pressures.

As expected, in May, the Bank of England (BoE) cut the Bank Rate by 25bps to 4.25% from 4.50%. But both the vote split and policy guidance were more hawkish than most anticipated, with two members voting for no change and a "gradual and cautious" approach still outlined. The Bank's forecasts were marginally dovish though, with inflation falling back to the 2% target by Q1 2027 – four quarters earlier than expected in February – and then holding steady at 1.9% in two and three-years' time respectively, compared to 2.3% and 1.9%. The BoE also saw a greater amount of slack opening up, in part due to a faster deterioration in the labour market. On balance, its current forecasts are broadly in line with our call for two more rate cuts this year and then two next, leaving the Bank Rate at 3.25% at end-2026, around 25bps more than currently pencilled in by markets. But given the downside risks, we are increasingly focussed on the risk the Bank starts to move more quickly than we currently expect, with back-to-back cuts looking more and more likely in Q4.

Global Macro Monthly – Canada

Gabriella Dickens
G7 Economist
Macro Research

Weakness remains, likely sparking BoC cuts

The latest data suggests uncertainty over US trade policy continued to weigh on Canadian activity in April, despite coming out of the so-called 'Liberation Day' relatively unscathed. Indeed, the composite Purchasing Managers' Index (PMI) remained well below the 50.0 mark, despite edging up to 42.0, from 41.7 and the IPSOS measure of consumer confidence decreased to 47.7, from 48.2 in March, its lowest reading since July 2024.

Admittedly, the US government has appeared more open to trade deals over the past couple of weeks, having altered tariffs on autos and steel with the UK and lowering additional tariffs on China back to 30%, which could limit some of the downside risks. But even if further deals are negotiated, tariffs are still far higher than before, consistent with a slowdown in global growth. We had always expected a row back on US tariffs and had baked it into our forecasts, so we continue to expect growth of 1.6% in 2025 and 0.6% in 2026, with quarterly growth grinding to a halt in Q3.

The latest labour market data was mixed but continues to paint a gloomy picture on balance. Employment increased by 7.4K, slightly higher than the 5.0K pencilled in by markets but not enough to make up for the 32.6K drop in March. Note too that the jobs were created in the public sector, which probably partly reflects additional hiring in the run up to the election that may reverse in May. In addition, the increase in jobs was offset by an increase in the workforce, leaving the unemployment rate at its November high of 6.9%, from 6.8%.

At April's Bank of Canada (BoC) meeting, Governor Tiff Macklem highlighted that the high level of uncertainty meant the Bank would once again be placing more weight on the near-term data, stating it would be less "forward-looking than usual" so these developments boost our confidence that the BoC will continue to loosen policy this year. And while we expect Consumer Price Index (CPI) inflation to rise over the coming quarters, as retaliatory tariffs boost import costs, ultimately the opening of slack in the economy as growth slows looks set to be stronger and more persistent than any upward pressure on costs. The BoC will likely cut twice more this year, leaving the policy rate at 2.25% by year-end. Further ahead, if US tariff pressure relents, there is scope for the BoC to restore the key policy rate back to its current level as private consumption recovers.

Global Macro Monthly – China

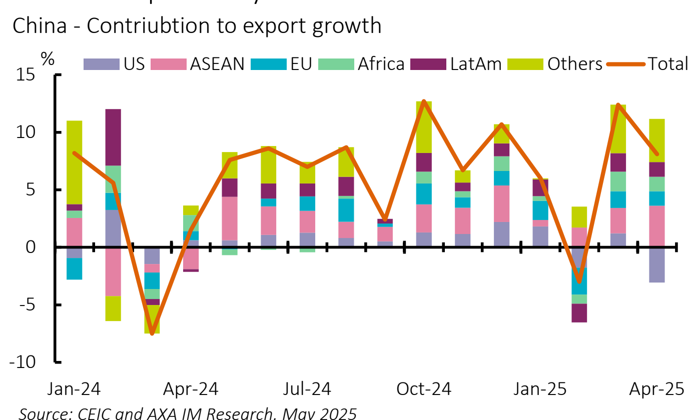
Yingrui Wang
Economist (China)
Macro Research

Preliminary trade deal exceeds expectations

The US and China reached a preliminary trade deal, marking a notable de-escalation in bilateral tensions. The outcome appears more constructive than anticipated, with both sides agreeing to substantially reduce newly introduced tariffs to 10%, down from the post-"Liberation Day" 145% (US) and 125% (China). Including President Donald Trump's 20% "fentanyl tariff" imposed in February, US border taxes on Chinese imports now stand 30% higher than pre-2025 levels of 11%. Additionally, the US has cut the tariff on small 'de minimis' packages from China to 54%, partially reversing the decision to close that loophole with a 120% tariff effective 2 May. In total, the effective increase in weighted average US tariffs on Chinese goods now stands at around 30%, closer to our expectations at the start of the year of 16%.

We anticipate additional progress, particularly on the fentanyl tariff, given the shared interest Beijing and Washington have in combatting illegal drug trafficking. Rather than maintaining elevated blanket tariffs, we expect a return to a more targeted regime akin to the Phase One agreement of Trump's first term, which identified target purchases for China, primarily in US manufactured goods, agricultural and energy products.

Exhibit 3: Exports stay resilient amid trade diversion



Source: CEIC and AXA IM Research, May 2025

As noted by US Treasury Secretary Scott Bessent, the new deal aims to narrow the US trade deficit, echoing objectives outlined in 2018. The original Phase One agreement, implemented in February 2020, was largely derailed by the pandemic; however, the current administration may be more determined to enforce Chinese purchases of US goods, which could prove more effective in achieving trade goals while minimising collateral damage economically.

Despite a substantial tariff hike in April, China's total exports held up well: exports to the US fell sharply by 21%, shaving three percentage points off total export growth (Exhibit 3); but nearly one-fifth of Chinese exports were shipped to ASEAN countries in April (+20.8%), surpassing both the US and European Union to become China's largest export market – a sign that trade diversion is underway.

While trade tensions are easing, the economic impact of April's peak tariffs is starting to materialise. Purchasing Managers' Index surveys show a softening in both manufacturing and services activity, reflecting heightened concerns over job security and order books. Credit demand, which had shown tentative signs of improvement earlier in the year, reversed in April. Retail sales growth also moderated, pointing to a dent in consumer sentiment.

On a more positive note, the sharp appreciation of the Chinese yuan in early May – largely driven by a carry trade unwind – has created additional policy space for the central bank. The People's Bank of China (PBoC) responded with long-awaited easing measures: cutting the reserve requirement ratio (RRR) by 50 basis points (bps) and the policy rate by 10bps. Notably for households, the PBoC lowered the mortgage rate on the Housing Provident Fund for first-time buyers by 25bps to 2.6%, which is estimated to save households RMB20bn annually in interest payments.

The less dovish-than-expected policy rate cut aligns with the subtle shift in tone in the PBoC's Q1 monetary policy report. While still calling its stance "moderately loose", it emphasised the need to support the real economy while safeguarding the financial system. This implies a preference for keeping net interest margins relatively stable, which in turn may limit scope for further rate cuts. Additionally, it replaced "interest rate policy" with quantity-based tools – such as medium-term lending facility loans and relending/rediscounting – on its list of preferred policy instruments. We interpret this as a signal that further policy rate cuts are unlikely this year. Instead, targeted reductions in loan pricing and further RRR cuts are expected to be the main easing levers. We maintain our forecast for another 50bp RRR cut later in 2025.

The recent improvement in trade relations, coupled with renewed policy easing, reduces the downside growth risk and should stabilise the economic outlook in the coming months. As trade adjusts, pressures on the domestic economy should ease, which in turn should reduce the urgency for additional fiscal stimulus under Beijing's consideration in April. On balance, we maintain our GDP growth forecast at 4.3% for 2025 – still below Beijing's growth target – and 4.0% for 2026.

21 May 2025

Global Macro Monthly – Japan

Gabriella Dickens,
G7 Economist
Macro Research

Still one more hike on the horizon

Japan's Q1 GDP fell by 0.7% quarter-on-quarter annualised, the first negative print in four quarters and below analysts' expectations for a 0.3% drop. But the breakdown was more reassuring. Domestic private consumption rose by 3.5%, with household spending remaining in positive territory, despite the rocky start implied by the Bank of Japan's (BoJ) Consumption Activity Index and household spending data, while capex was up by 5.8%. This was offset by a drop in net trade, with exports down 2.3% quarter-on-quarter annualised, as services exports plunged by 12.8%. Notably, goods exports continued to rise, perhaps as some business was brought forward ahead of Donald Trump's so-called 'Liberation Day'. Looking ahead, we think growth should recover in Q2, before slowing again in the second half on the year, largely due to a weaker US. We have revised down our GDP forecast for 2025 to 0.8%, from 1.1%.

Domestic dynamics are still moving in the right direction, with growing acceptance among the population that modest inflation is needed to keep wages rising sustainably over the long term. Inflation expectations have risen modestly, with the BoJ's trimmed mean measure up at 2.2% in March, compared to an average of 2% in 2024, while the fifth tabulation of the Shunto wage negotiations showed a 3.75% rise in base pay, above the BoJ's 3% threshold which it estimates will keep inflation consistently at the 2% target. The ageing population and depleting labour pool should keep wage growth elevated compared to the previous couple of decades.

The BoJ voted unanimously to maintain its key policy rate at around 0.50% at its May meeting. This was widely expected, with the accompanying forecast changes always likely to garner more interest. The BoJ pushed back its expectations for Consumer Price Index (CPI) inflation to return consistently to the Bank's 2% target, in what some perceive as a dovish shift. But it still has faith that the virtuous wage/price spiral remains broadly intact, and therefore is likely to continue its tentative policy normalisation, albeit more cautiously than before. Indeed, the BoJ expressed strong caution about the possibility of downward pressure on both growth and inflation in the near term due to the impact of trade negotiations following the US announcement of reciprocal tariffs. We continue to see one hike this year to 0.75%, before an elongated pause throughout 2026, as the world grapples with a US slowdown.

Global Macro Monthly – EMEA

Claire Dissaux,
Senior Sovereign Credit Analyst (Emerging Markets)
Macro Research

When global and domestic factors need to align

In Central Europe, the environment has become more conducive to monetary easing, thanks to lower oil prices and stronger currencies. US tariffs should be disinflationary if the European Union (EU) continues to hold off retaliation. Trade diversion, with an increase in Chinese exports to the EU, will also cut inflation. Chinese imports have risen to 12% of the total in the Czech Republic, 9% in Hungary and Poland and 7% in Romania.

Domestic conditions will be decisive for policy and have turned more benign as softer labour markets begin to erode the sticky services inflation seen over the last three years. Wage inflation has softened in Poland (to 7.7% year-on-year) and Hungary (9.0%), pointing to further slowing in services inflation (from 6.4% and 8.6% respectively), though well above targets. Softer wages in Poland were a key factor in the central bank's April shift from a hawkish stance to guidance for a cumulative 100 basis-point (bp) cut this year with 50bps delivered on 7 May. In contrast, Hungary's central bank has yet to change its hawkish rhetoric. Worse, in Romania, where disinflation had only been imported, downward currency pressures have emerged in the wake of the first round of its presidential election.

Fiscal policy and the election cycle will also shape monetary policy. Poland's annualised year-to-date deficit widened to -2.1% of GDP ahead of the presidential election in May from -0.7% in March 2024. While the election of Civic Platform's Rafał Trzaskowski would help the government reform agenda, the extent of his lead will affect its ability to implement fiscal consolidation. With Prime Minister Donald Tusk's popularity low, the presidential election is seen as a referendum on his government and signal whether the Law and Justice (PiS) party can return to power in 2027. In Hungary, budget discipline has been stronger than anticipated, despite the lead of opposition party Tisza in polls ahead of 2026 elections (the annualised deficit in Q1 was unchanged vs. Q1 2024 at -3% of GDP), pointing to delayed but bigger rate cuts in the second half of the year. In Romania, a large fiscal tightening after the deficit reached an annualised 9.5% of GDP in Q1 is the key for macroeconomic stability. With the election of centrist Nicuşor Dan as President, a new government can likely move fast on that front, with a hard landing in growth ahead.

Global Macro Monthly – LatAm

Claire Dissaux,
Senior Sovereign Credit Analyst (Emerging Markets)
Macro Research

Oil: A differentiated impact across the region

While lower oil prices reinforce disinflation across the region, albeit to varying degrees given country-specific subsidies, the drop will have a differentiated impact on fiscal and external accounts. The balance-of-payment strength of oil importers such as Chile or Peru will be reinforced. For Mexico, a net oil importer, risks are concentrated on the fiscal side. But for Brazil and Colombia both their budget positions and external accounts will be negatively affected.

In Colombia, lower oil prices could widen the budget deficit by close to 0.3 percentage points (ppt) of GDP this year. With the cumulative deficit tracking 8% of GDP in Q1, mostly due to a rise in government primary spending, the focus firmly remains on corrective fiscal measures. Medium-term fiscal plans due in June will be scrutinised for spending cuts. But restoring fiscal credibility may have to wait for the 2026 presidential election, which remains wide open but could prove a game changer as the very low popularity of President Gustavo Petro should prove a high hurdle for a leftist candidate. Domestic headwinds will likely continue to outweigh external risks. With the current account deficit contained at 2.3% of GDP and fully covered by foreign direct investment, the year-to-date decline in oil prices, which would add 0.3ppt of GDP to the deficit, should not jeopardise external stability.

In Brazil, a growing oil exporter – and with the budget reliant on oil company Petrobras – we estimate that the year-to-date decline in oil prices will result in a 0.3ppt of GDP hit to the current account balance, with a similar negative impact on its budget balance. The current account deficit has already widened to 3.2% of GDP in the year to March 2025, the widest since 2019. External balance strength no longer offsets public debt sustainability concerns as private savings have fallen, amid a tight labour market, expansionary fiscal policy and weak transmission of monetary policy (with the new 'payroll credit' the latest example). The impact from lower oil prices on the budget would require policy action, with the public sector deficit close to 8% of GDP. Meanwhile, the central bank added lower oil prices to the downside risks to inflation in its May statement when it slowed the pace of tightening to 50 basis points. Yet far from sending an all-clear signal for the central bank to end its tightening cycle, lower oil prices could prevent further normalisation of Brazil's country risk premium, which has constrained monetary policy by keeping inflation expectations well above target.

Global Macro Monthly – EM Asia

Danny Richards,
Economist (Asia Emerging Markets),
Macro Research

Fiscal support in the offing as growth prospects dim

In South Korea, after the 3 June election, a new president will take office with two priorities: assessing the need for a new fiscal stimulus package and finalising a US trade deal. The economy shrank in Q1 amid weak domestic demand, and lawmakers have already approved a supplementary budget of KRW13.8tn (0.5% of GDP) focused on boosting consumption and supporting small businesses. This could push the fiscal deficit (excluding social security funds) to 3.3% of GDP, up from the 2025 budget target of 2.8%, and central government debt to 48.5% of GDP. South Korea has more fiscal space than others in the region and is not constrained by fiscal rules (recent proposals for such rules have centred on a debt ceiling of 60% of GDP). With the Democratic Party's Lee Jae-myung favoured to win the election, a more expansionary fiscal stance is likely. The need, and size, for this will partly depend on the outcome of US tariff talks, to be concluded after the election.

The Thai government is also proposing additional fiscal support for its flagging economy. The finance minister said THB500bn (2.6% of GDP) will be needed to boost consumption and investment to offset external headwinds that prompted downward revisions to the growth outlook – the International Monetary Fund (IMF) now sees 2025 growth at 1.8%, from 2.9% previously. However, Thailand has relatively little space for fiscal largesse; with an expansionary budget for the current fiscal year, including cash handouts under the digital wallet scheme, the deficit was set to widen to 3.6% of GDP (from 2.2% last year) and public debt to 64.7% of GDP. Any additional stimulus would push debt closer to 70% of GDP, a ceiling under fiscal rules that was raised from 60% in 2021. Citing risks to economic growth and fiscal pressures, rating agency Moody's has revised its outlook on Thailand's sovereign credit rating to negative.

The Philippines' government will struggle to adhere to its fiscal consolidation goals this year. Government consumption rose 19% year-on-year in Q1, the fastest expansion since the start of the pandemic, including pre-midterm election spending. Following this frontloading, there could be a drop off in spending in Q2. However, given the weak Q1 GDP outturn and signs of a disappointing outcome in the mid-term elections for President Ferdinand Marcos Jr., whose picks for the Senate won fewer seats than expected, there is a growing risk of fiscal slippage as the government is likely to favour growth-supporting policies over the prudence needed to bring the deficit down to the target of 5.3% of GDP.

Macro forecast summary

Real GDP growth (%)	2024	2025*		2026*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.3	2.6		2.4	
Advanced economies	1.6	1.1		0.6	
US	2.8	1.2	1.4	0.5	1.7
Euro area	0.9	0.7	0.9	0.5	1.2
Germany	-0.2	-0.2	0.1	0.2	1.3
France	1.1	0.4	0.6	0.6	1.0
Italy	0.5	0.3	0.5	0.2	0.8
Spain	3.2	2.4	2.5	2.0	1.9
Japan	0.1	0.8	1.0	0.9	0.7
UK	0.9	0.9	0.7	1.1	1.1
Switzerland	1.3	0.7	1.1	1.0	1.5
Canada	1.3	1.6	1.0	0.6	0.8
Emerging economies	4.2	3.4		3.4	
China	5.0	4.3	4.5	4.0	4.2
Asia (excluding China)	5.4	4.4		4.6	
India	6.7	6.3	6.3	6.1	6.5
South Korea	2.1	0.4	1.3	2.0	1.9
Indonesia	5.0	4.5	4.9	4.9	5.0
LatAm	2.4	1.8		2.0	
Brazil	3.4	1.9	1.9	1.8	1.7
Mexico	1.5	0.0	0.2	0.8	1.4
EM Europe	3.3	2.1		2.0	
Russia	4.1	1.5	1.7	0.9	1.2
Poland	2.9	2.8	3.3	2.9	3.2
Turkey	3.2	3.0	2.9	3.4	3.4
Other EMs	2.8	3.2		3.7	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 21 May 2025
**Forecast*

CPI Inflation (%)	2024	2025*		2026*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	2.6	2.7		2.4	
US	2.9	3.2	3.2	3.2	2.3
Euro area	2.4	2.0	2.0	1.7	2.0
China	0.2	0.4	1.3	0.6	1.6
Japan	2.7	2.9	2.0	1.5	1.7
UK	2.5	3.2	2.3	2.0	2.0
Switzerland	1.1	0.2	1.0	0.5	1.0
Canada	2.4	2.4	2.1	2.6	2.1

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 21 May 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	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)	-0.25 (4.25)	-0.50 (3.75)	-0.50 (3.25)	-0.25 (3.00)	unch (3.00)	unch (3.00)
Euro area - ECB	Dates	2.25	05-juin	24 Jul 11 Sep	30 Oct 18 Dec	5 Feb 19 Mar	30 Apr 11 Jun	23 Jul 10 Sep	29 Oct 17 Dec
	Rates		-0.25 (2.00)	-0.50 (1.50)	-0.50 (1.00)	unch (1.00)	unch (1.00)	+0.25 (1.25)	+0.25 (1.50)
Japan - BoJ	Dates	0.50	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	4.25	19-juin	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		unch (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	04-juin	30 Jul 17 Sep	29 Oct 10 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		unch (2.75)	-0.25 (2.50)	unch (2.50)	-0.25 (2.25)	unch (2.25)	unch (2.25)	unch (2.25)

Source: AXA IM Macro Research - As of 21 May 2025

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Download the full slide deck of our May Investment Strategy

21 May 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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