Investment Institute Macroeconomics

Trade wars

Monthly Investment Strategy

AXA IM Macro Research

February 2025

Summary: February 2025

Theme of the month: Trade wars

- Any assessment that President Trump's second term would have less focus on tariffs has been overturned. While the US has only enacted additional 10ppt tariffs on China (raising the US average rate by around 1.5ppt), it deferred 25% tariffs on Canada and Mexico at least until March and scheduled broader 25% steel and aluminium tariffs from 12 March. Reciprocal tariffs are also being investigated in conjunction with a broader trade report due 1 April.
- There is much uncertainty as to the scale and scope of eventual tariffs. Exemptions were a regular feature of the last term, both as part of broader negotiations and to avoid the most damaging impacts on US production. These are likely again. However, the administration appears to have earmarked tariff revenue as part of an overall package to deliver material tax cuts despite elevated deficits. This suggests broad-based tariffs are still likely.
- Tariffs on China have been delivered faster, but so far not as far as expected. We consider further increases likely over coming months. Tariffs on Euro area trade also look likely, with reciprocal tariffs a threat for certain sectors, including cars and chemicals.

Macro update: Reacting to the new US administration

- President Trump has returned to office in a stream of activity. 70 Executive Orders, the start of deportations, a cavalier approach to commitments from the DOGE and tariffs have buffeted the US economy in the first month. So far, the economy remains solid and the Fed is in "no hurry" to ease policy.
- China has been the first to see tariff increases. It has retaliated in measured form. Separately the emergence of DeepSeek AI has offered the promise of private sector services lifting Chinese activity, something the government appears to be supporting. Chinese consumer spending remains subdued, with lower spending during the Lunar New Year holiday. Attention shifts to next month's NPC policy meeting.
- Eurozone activity was revised firmer and surveys have edged higher in the opening months of 2025. Still we expect a subdued pace of growth across 2025 (0.9%), now the consensus. Inflation remains subdued and wage growth points to further deceleration. We expect the ECB to continue with steady rate cuts through to 1.50% by year-end. German elections have delivered a new CDU/CSU leadership that hopes to form a coalition by the end of April.
- UK activity has picked-up in the last couple of months. The outlook for headline inflation is firmer for this year (we expect 3.3% average now), but we expect a loosening labour market to lead to an inflation undershoot next year. We expect three more BoE cuts this year to 3.75% and further in 2026.
- Japanese growth softened in Q4, but remained in excess of expectation, with consumer spending stable. Headline inflation reached 4%, but driven by food and energy. Nevertheless, wage growth looks persistent and we expect the BoJ to follow a January 0.25% hike with another in H2 this year.
- Emerging markets are each watching US trade policy developments. In Asia, this policy is combining US appeasement with attempts to bolster domestic resilience with increased fiscal spending. Central and Eastern Europe economies see weaker growth and some fiscal slippage, a dynamic exacerbated in both Hungary and Poland by impending elections. In Turkey, the risks of a growth acceleration risk reversing recent disinflation. In Latam, fiscal and monetary authorities face tensions. In Chile, authorities are working broadly in harmony; in Brazil, the central bank has tightened policy following fiscal easing, Colombia sees a delicate balance.

Central scenario

Summary – Key messages

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

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

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

Inflation

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

Monetary policy

Central bank easing to be constrained in some areas by inflationary US polices. Developed central banks to pursue more easing. Some EM's more constrained.

Fiscal policy

US deficits set to rise. Proposed European budget tightening likely eased in key countries. Markets increasingly vigilant.

Emerging Markets

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

FX

Dollar stays firm under uncertain Trump policy. Further gains possible as policies enacted in H1 2025, but a weaker US 2026 outlook should cap and reverse gains end-2025.

Rates

US term rates rise on new policy expectations, upside risks if fiscal doubts rise. European rates contained by more aggressive ECB policy rate easing.

Growth

Solid but slower US growth through 2025, headwinds mounting into 2026. Other economies face mounting headwinds, that US trade policy could worsen.

Alternative scenarios

Summary – Key messages

Entrenched supply shock

Probability
20%

What could be different?

- Full scale Trumponomics: protectionism, migration clampdown
- Geopolitical tensions escalate: Ukraine, Middle East and Indo-Pacific
- Inflation expectations rise, affecting wages and inflation persistence

What it means

- Growth weaker, employment slows, but inflation remains above targe
- Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Sovereign yields reprice higher
- Dollar remains elevated
- EM debt to come under pressure

A global boost

Probability
10%

What could be different?

- Productivity boost following investment rebound and structural post-pandemic adjustments, AI impact becomes visible
- De-regulation prompts more efficient government
- Ukraine settlement lowers short-term energy prices

What it means

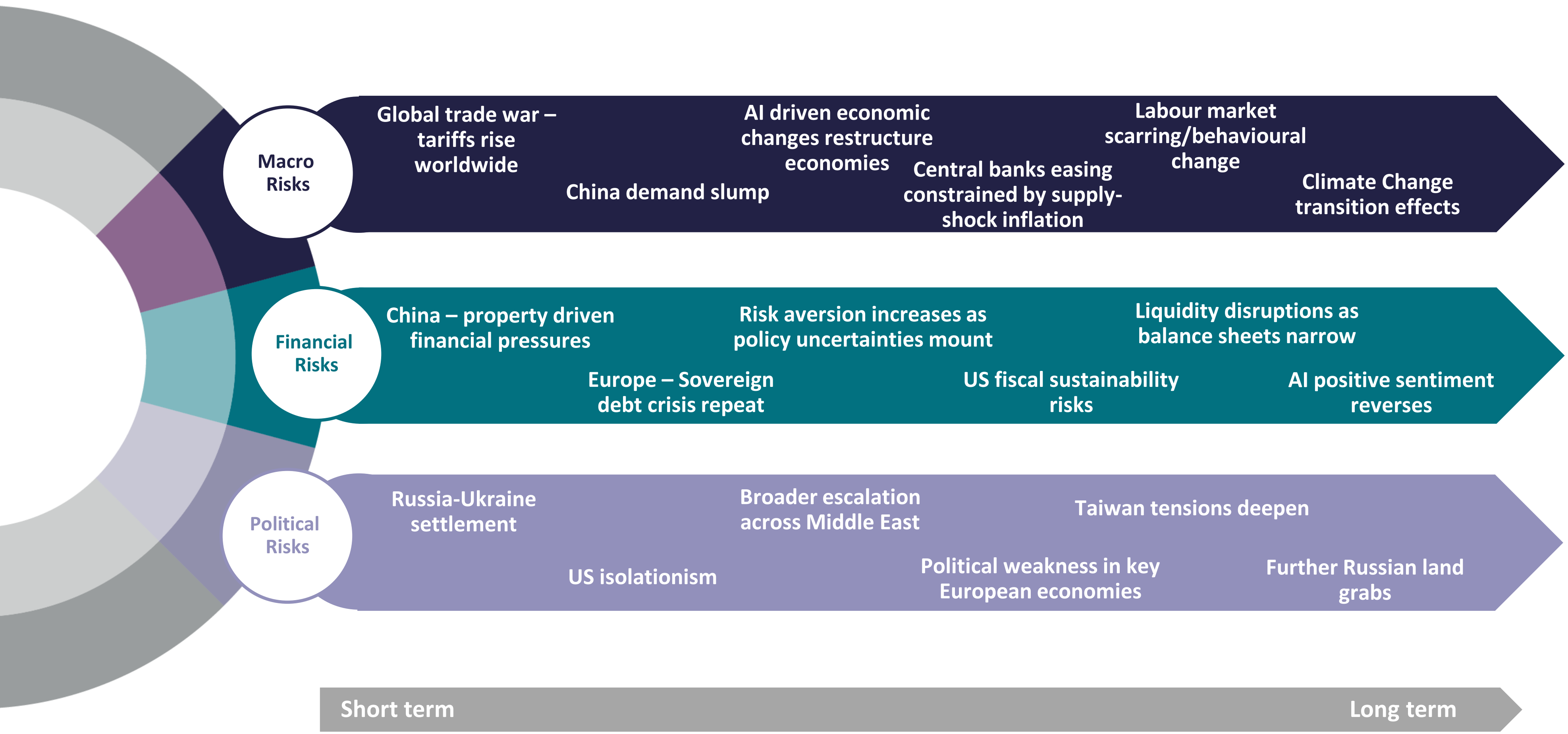
- Growth surprises on the upside in most regions
- Inflation fades more quickly towards and below central bank targets
- Monetary policy softens quicker than signalled

Market implications

- Risk-on environment, equities make further gains, growth retains lead over value
- UST softens, EUR strengthens
- Spreads grind tighter

RISk Radar

Summary – Key messages



Investment Managers

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Theme of the month

Tariff outlook remains uncertain

Trade wars

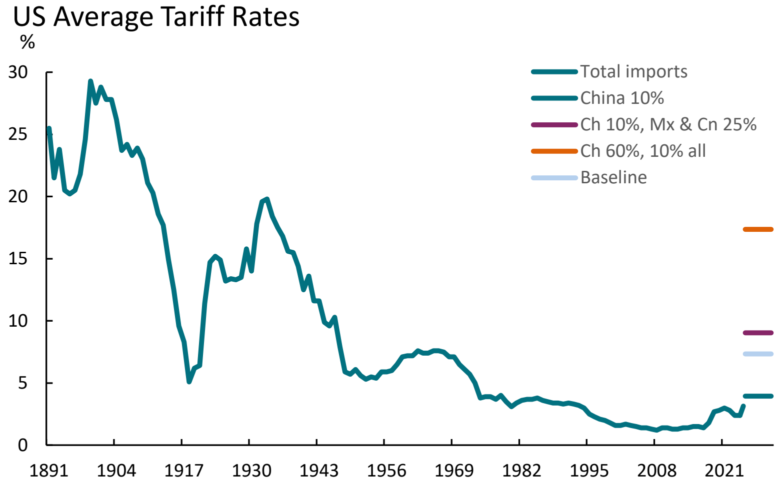
Tariff increases on China; Canada and Mexico last minute reprieve for now

- On 4 February, President Trump raised the tariff rate on all China's imports (approx. $525bn of goods) by 10ppt (to 31%). China immediately responded by announcing tariffs effective on 80 US products ($14bn of goods) from 10 February. These were the first shots fired in a renewed trade war. The US threatened 25% tariffs on both Canada and Mexico, also for 4 February, only to defer them for "at least 30 days" following last minute negotiations. It is unclear if this reflected concessions, or President Trump backed down from a policy that would have been highly disruptive to the North American manufacturing hub.

Policy uncertainty, not just outcomes, matter for activity

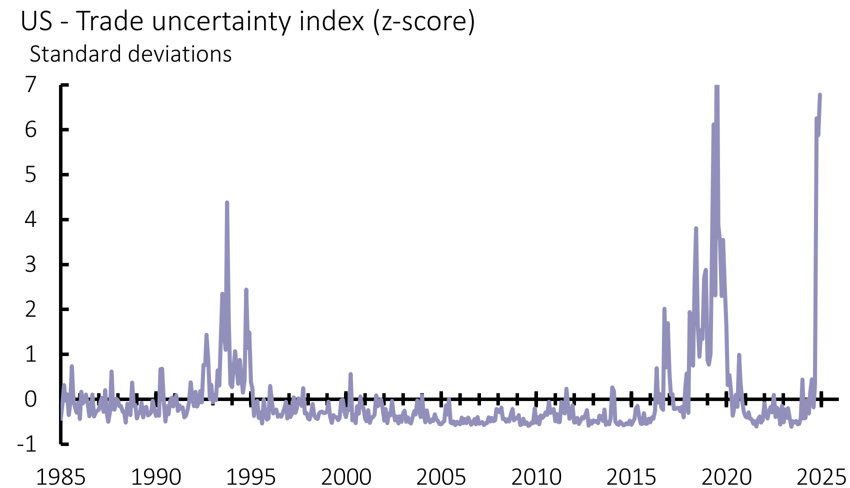
- Only time will tell if these deferrals will last. Or whether tariffs will broaden beyond the current countries. However, in the face of these unknowns trade policy uncertainty has soared to levels not seen since Trump's last term, something that is likely to impact investment and spending decisions.

Average US tariff levels and different scenarios



Source: Census Bureau, AXA IM Research, Feb 2025

US trade policy uncertainty



Source : Economic Policy Uncertainty and AXA IM Macro Research, February 2025

Steel and aluminium

Trade wars

Steel and aluminium tariffs

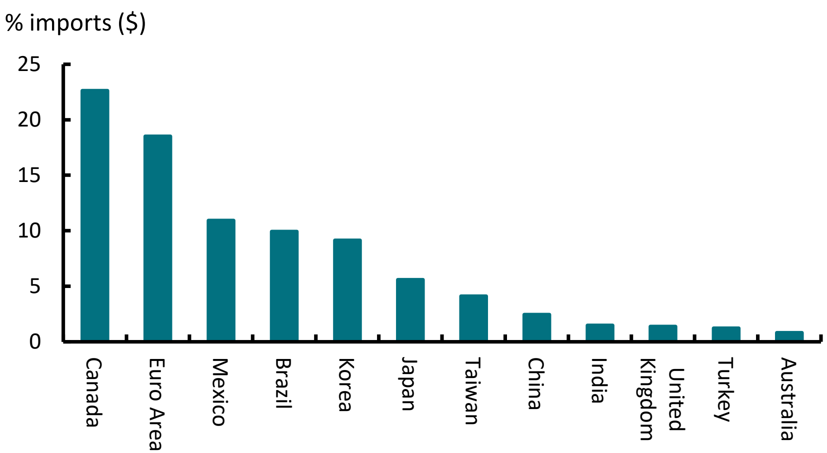
- President Trump has also announced 25% widespread tariffs on steel & aluminium, scheduled to take effect from 12 March, and warned they "may go higher". This echoed tariff increases from his first Presidency, reprising national security section 232 to deliver these tariffs through Executive Order. Countries are likely to retaliate, with the EU saying it will respond … if tariffs are enacted. In 2018, most studies showed that these tariff increases were wholly passed into US prices – we expect the same again.

Exemptions

- In 2018, the administration subsequently passed a wave of exemptions to the tariffs, as US industry reacted to the rising cost of imports. These are likely again. Trump has already suggested that Australia may be a special case. The UK's Chancellor Reeves has stated that she "strongly believe a deal can be done". Much uncertainty surrounds the eventual implementation of these tariffs.

Steel importers

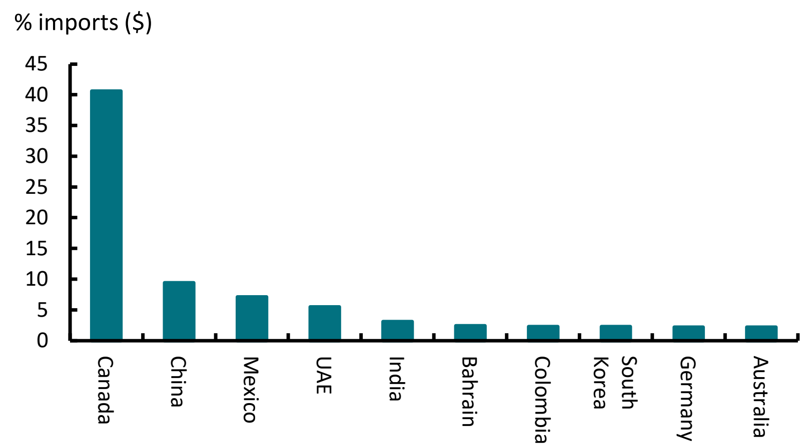
US steel impors by country (2024)



Source: Census Bureau, AXA IM Research, Feb 2025

Aluminium importers

US Aluminium imports by country



Source: Census bureau, Refinitiv, AXA IM Research, Feb 2025

Reciprocal tariffs – strategic not universal

Trade wars

International Emergency Economic Powers Act (IEEPA)

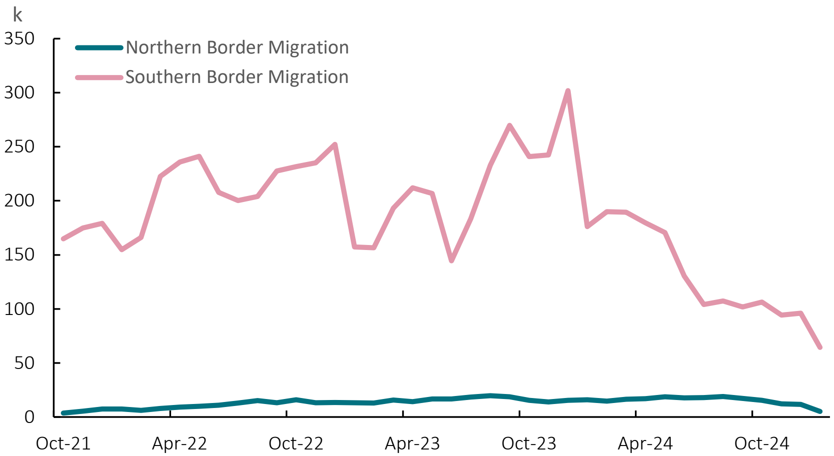
- The first round of tariffs was enacted by President Trump using IEEPA – a move justified by the 'emergency' at the Southern border and focused on migration and fentanyl imports. This was dubious for Canada, where migration is around 10% of that from Mexico and fentanyl seizures around 0.2% (NYT). But this facilitated an immediate response. Trump's inauguration day "America First Trade Policy" initiated a review into the causes of US trade deficits. Its first report is due 1 April. And Trump has more recently instructed these to follow a reciprocal tariffs pattern, compensating for other countries tariff and non-tariff barriers.

More strategic tariff policy to follow

- Trump's previous focus had been on 60% tariffs on China and a 10% universal tariff (which we had assumed excluded FTA members). But a strategic approach appears more likely and more closely aligns with a continued focus on US trade deficits: a list of the US's largest trading partner deficits defines much of Trump's ire, including for the Euro area.

Different orders of migration problem

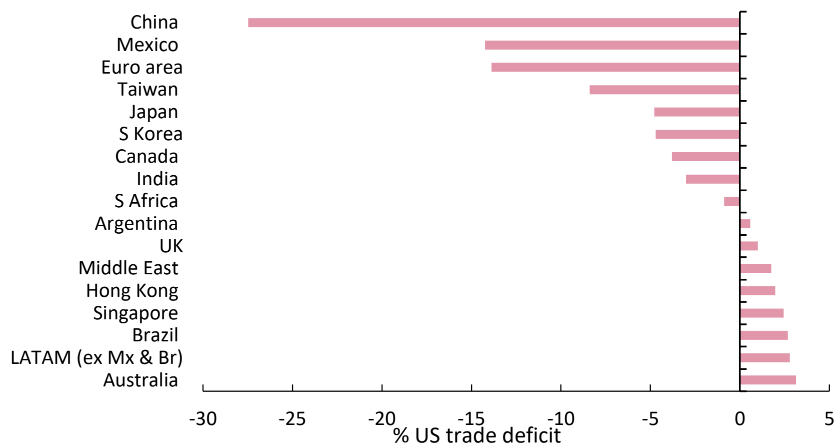
North and South US border migration



Source: US CBP, AXA IM Research, February 2025

Those contributing most to the US trade deficit

US bilateral trade Q3 2024 (% of total US deficit)



Source: Census bureau, Refinitiv, AXA IM Research, Feb 2025

A revenue motive

Trade wars

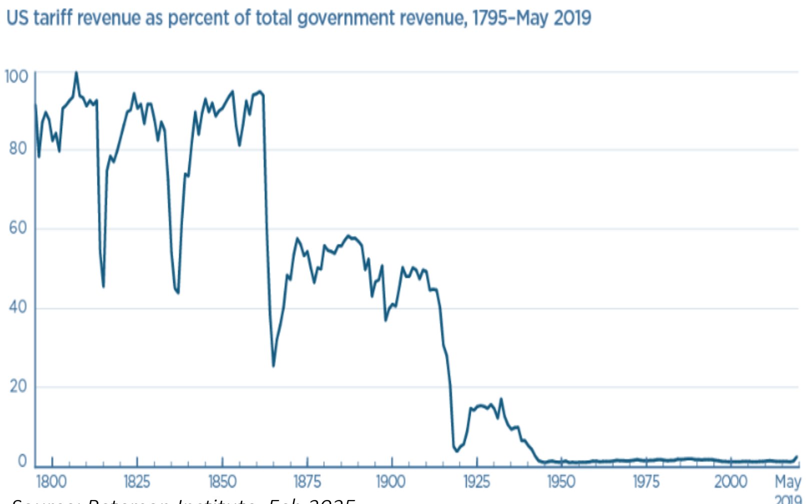
Revenue raising

- The administration continues to suggest that a key reason for tariffs is to raise revenue – harking back to a bygone era when tariff revenue exceeded income tax (pre-1920s). A large part of the shift in order of importance of tariff revenue for the US is the huge growth in domestic demand, relative to external trade over the past century. However, Trump has touted the creation of the External Revenue Service (ERS) in his inauguration speech.

An eye to tax cuts

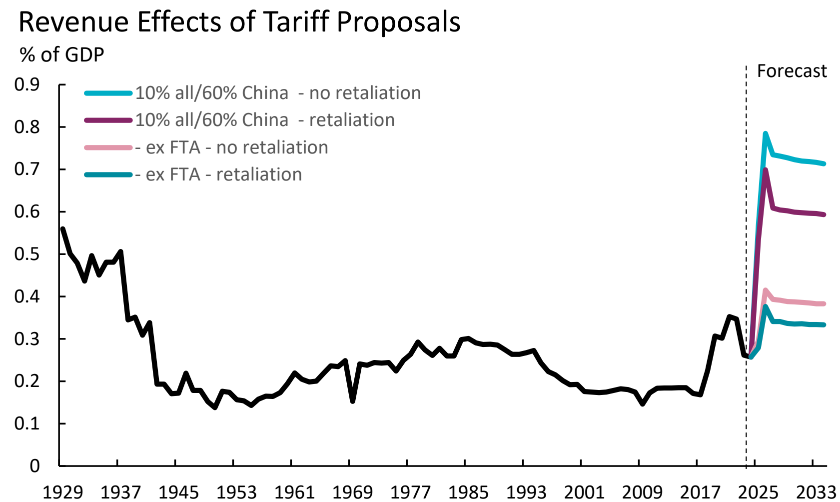
- Given Trump's references, we suspect the administration is ear-marking tariff revenue to facilitate proposed tax cuts. Trump has proposed a string of tax cuts including an extension of the TCJA household tax cuts beyond their scheduled expiry this year (1.3% of GDP) and corporate rate tax cuts (0.2%). With CBO deficit estimates at 6.4% of GDP in 2024 and to average 5.8% over the coming decade, the administration will likely require some pay-fors to convince some Republican deficit hawks.

US tariff revenue used to be a major source of income



Source: Peterson Institute, Feb 2025

Tariff increases proposed to plug budget holes



Source: Yale budget lab, Refinitiv Datastream, USITC, AXA IM Macro Researc, Febuary 2025

Macroeconomic impacts

Trade wars

A range of views on output

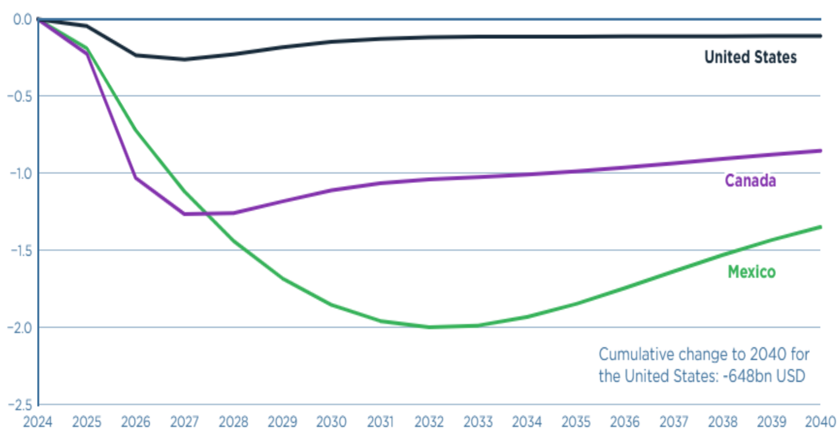
- Precise estimates of tariff impacts is difficult. Beyond 2018-19, advanced economies have generally witnessed easing, not rising trade barriers – so models assume symmetric reactions. Beyond having to estimate initial tariffs, assumptions have to be made for the degree of retaliation. The Peterson Institute estimated Canadian, Mexican and Chinese tariffs reducing US GDP by around 0.5% over the first two years. Alternate IMF estimates can be used to infer an impact of as much as 1.5ppt.

Similar uncertainty on inflation

- A similar uncertainty surrounds estimating the impact on inflation. Our baseline assumption remains a broadly 5ppt increase in the US's effective average tariff rate, compared with an estimated 15ppt impact if Trump were to deliver 60% on China and 10% elsewhere as threatened on campaign. Our baseline forecast would add around 0.5ppt to inflation at the peak around the turn of this year.

Estimated growth impact of tariff measures

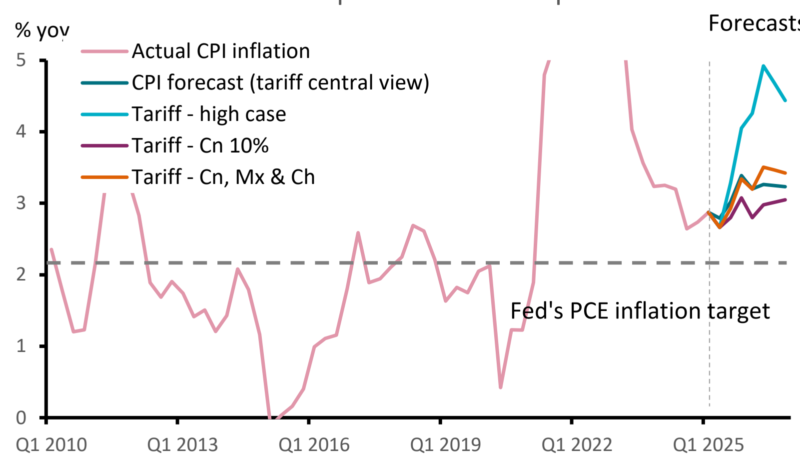
Estimated GDP impact of 25% Cn/Mx and 10% China tariffs



Source: Peterson Institute, Feb 2025

Estimated impact of different tariff scenarios on inflation

Headline CPI inflation and potential tariff impact



Source: Bureau of Labour Statistics (BLS) and AXA IM Research, Feb 2025

China taxed earlier, with more likely to come

Trade wars

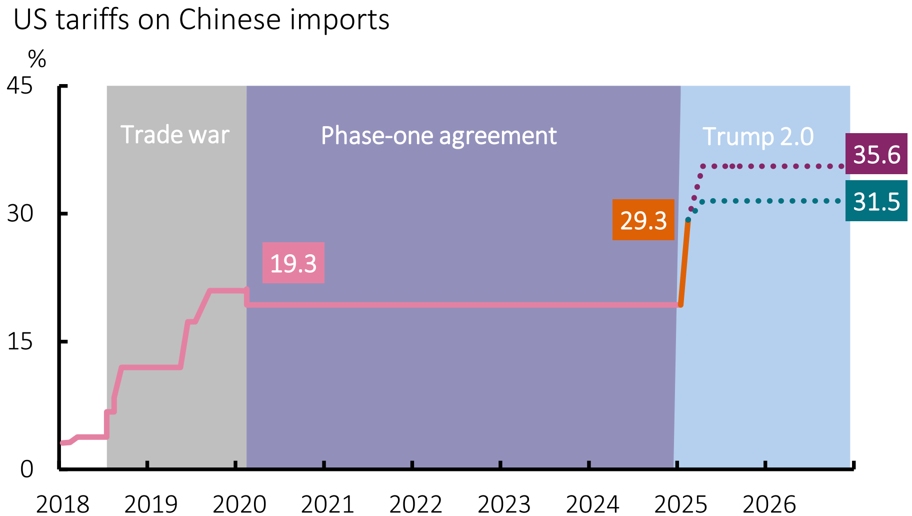
10% additional tariff only, but in February

- Trump's new tariff stance in this term has so far been less aggressive towards China than campaign rhetoric suggested, albeit arriving a little quicker. The newly imposed 10% additional tariff on all Chinese imports has raised the weighted average border tax on China to 29.3%.
- While this remains below our base case scenario, we still consider further tariffs likely to emerge in the coming months, particularly after the investigation report from the Office of the US Trade Representative in April.

US trade actions on rest of the world could have spillover effects on China

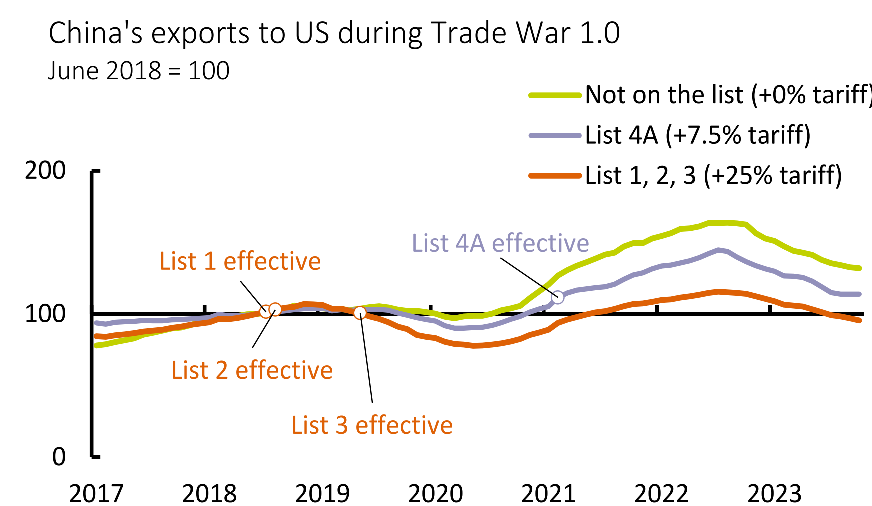
- Current US trade policy has also been broader and more disruptive to global trade. Others have also increased tariffs on China (S Korea, Indonesia) or are being coerced towards it (Mexico), which may broaden the impact further. However, the global rise of US tariffs may somewhat lessen the specific impact on Chinese imports, providing China with some breathing space.

Weighted average tariff levels in different scenarios



Source: Peterson Institute and AXA IM Research, February 2025

25% tariff rise deterred any growth of affected imports since enact



Source: Peterson Institute and AXA IM Research, February 2025

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The Eurozone has leverage it can exercise

Trade wars

Reciprocal tariffs not a major risk

- Looking at aggregated data, the gap between the US and EU average tariff rates is small, averaging an extra 0.7p on the EU side. Hence any reciprocal tariffs, based on equalising trade partners tariffs, would not at face value have a major impact on Eurozone activity. However, some sectors could be more impacted than others (cars, chemicals) but overall, we believe the impact is manageable, even more so if the EUR were to be depreciate against the USD.

Inclusion of 'non-tariff barriers' could be

- Donald Trump also suggested that additional US tariffs would account for non-tariff barriers. Where these are material in some economies, Trump also suggested that sovereign measures, including EU VAT, could be included in the calculation of reciprocal tariffs (despite the US having its own sales tax of around 7.5%). Adjusting for average VAT in Europe (around 20%) a tariff increases that included these could be more meaningful.

Tariff gap between the US and EU is small

Reciprocal tariffs

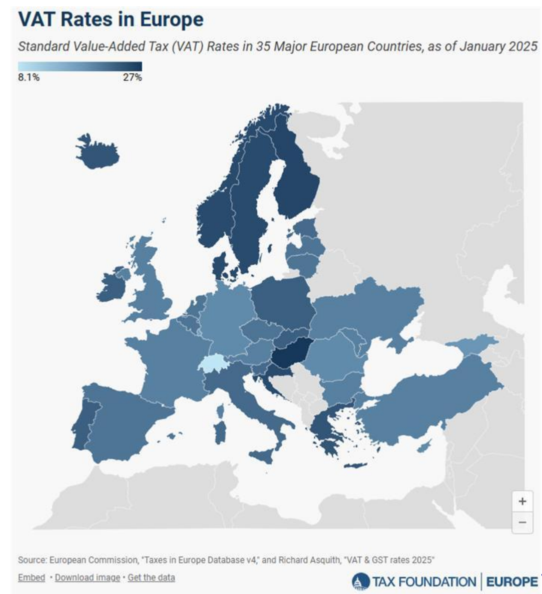
	Trade (EUR, bn)		US tariff (simple average)		US effective rate		
Products	Export (EU=>US)	Net (EU-US)	%	Gap (EU-US)	Duty free	%	Gap (EU-US)
Agri	7	-1	5.6	-1.7	46%	3.0	-1.0
Food	20	16	4.9	1.9	53%	2.3	0.6
Energy	16	-71	0.6	0.1	89%	0.0	0.2
Chemicals	55	16	3.0	1.9	21%	2.3	1.5
Pharma	91	47	0.4	-0.2	88%	0.0	-0.0
Textiles	21	15	6.8	-3.4	36%	4.3	-2.7
Materials	36	20	2.4	-0.3	52%	1.1	-0.1
Machinery	90	40	1.3	0.4	57%	0.5	0.7
Electrical	37	17	1.3	0.5	53%	0.6	0.4
Transport (excl. Aircraft)	66	52	2.7	4.1	47%	1.4	5.0
Aircraft	11	-9	0.1	4.1	96%	0.0	3.6
Optical	36	7	0.9	0.1	69%	0.3	0.1
Arms	2	0	1.3	0.7	62%	0.5	1.2
Miscellaneous	9	5	2.0	-0.4	56%	0.8	-0.1
Total	497	156	2.0	0.6	58%	1.0	0.7

Based on HS2 classification (97 groups)

Most exposed

Least exposed

VAT rate could be included in the calculation



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Macro outlook

Trump again

US

Trump hits the ground running

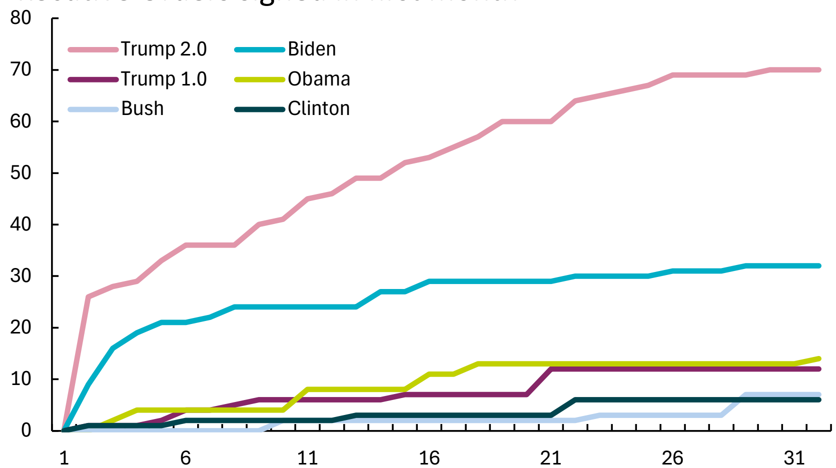
- The new administration has followed our expectation of hitting the ground running. Trump issued 70 Executive orders in his first month. Beyond the trade policy we have covered extensively, policy has pushed ahead with active deportations, a chaotic approach to cutting Federal spending, including aid suspensions that have been legally blocked, and attempts to reduce Federal employment as well as deregulation, particularly for tech, oil and gas.

Fiscal to follow

- Fiscal policy has been the only area that has been quieter, but that by necessity of involving Congress and legislation. Senate and House Republicans have differed in approach to delivering fiscal change, the former opting for a two-bill strategy to address the debt ceiling and tax cuts separately, the House for one grand bill. In either case, the administration will have to find revenue/spending cuts to part cover any proposed tax cuts to appease fiscal hawks.

New administration much more activist

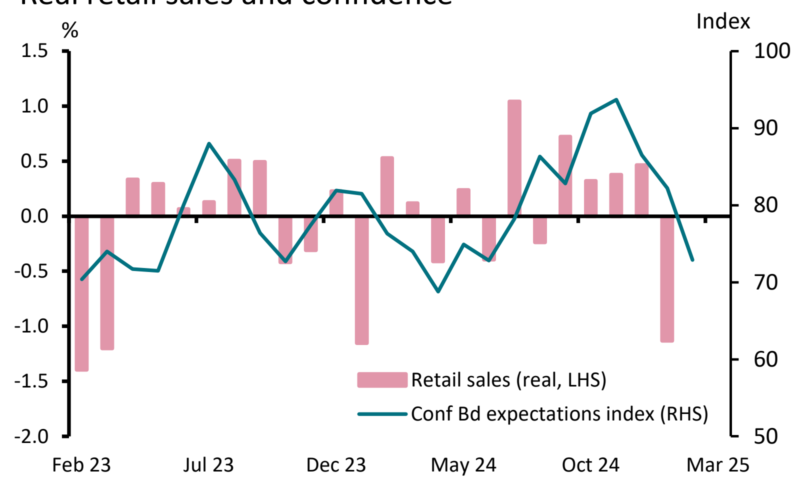
Executive Orders signed in first month



Source: Federal Register, AXA IM Research, February 2025

Consumer starts to Q1 on a more cautious footing

Real retail sales and confidence



Source: Census bureau, Conference Board, AXA IM Research, February 2025

Close on inflation, but not there yet

US

Inflation and labour market strength

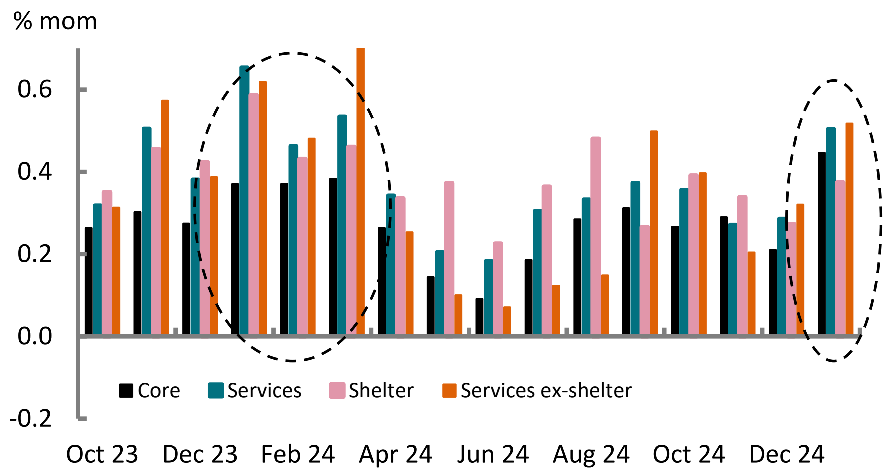
- Activity remains solid. 2024 delivered growth of 2.8% in line with our forecast. We expect growth to soften a little in 2025 to 2.3% (consensus has now risen to a similar 2.2%), but for Trump's unorthodox policy package to weigh on growth for 2026 when we estimate just 1.5% (2.0%). CPI inflation edged higher in January. We consider the services rise impacted by seasonality. We continue to expect inflation to be boosted by tariffs, forecasting an average 2.8% in 2025 and 3.2% in 2026 (cons 2.7% and 2.5%).

Fed in "no hurry" to ease policy

- January's decision to leave policy on hold was supplemented with guidance that the Fed was in "no hurry" to ease policy. Powell repeated this in testimony to Congress this month adding that the Fed was "close, but not there yet" on inflation. We expect administration policy to preclude rate cuts later this year. But expect softer growth to prompt easing in 2026, we forecast the FFR to end-2026 at 3.50%.

Rise in services inflation may reflect seasonal issue

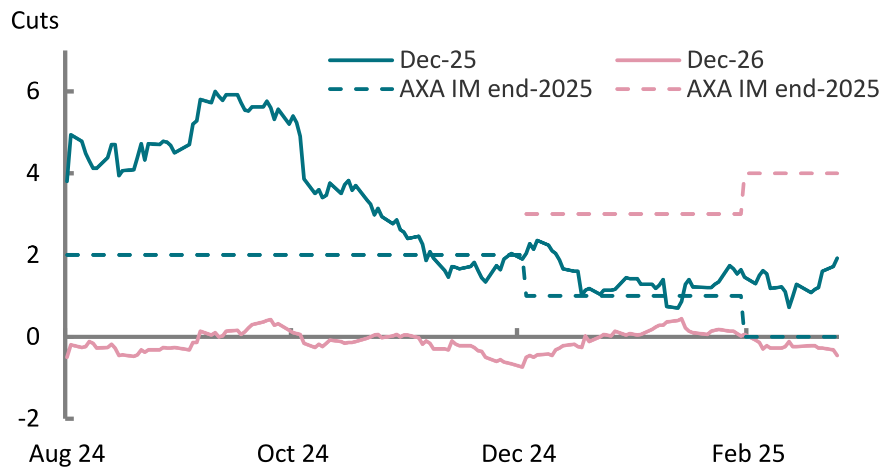
Recent movements in core and services inflation



Source: BLS and AXA IM Research, February 2025

Expected rate cuts for coming two years

Number of (0.25%) rate cuts priced by



Source: FRB, Bloomberg, AXA IM Research, February 2025

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Sluggish growth in Q4; slightly improving in 2025

Euro area

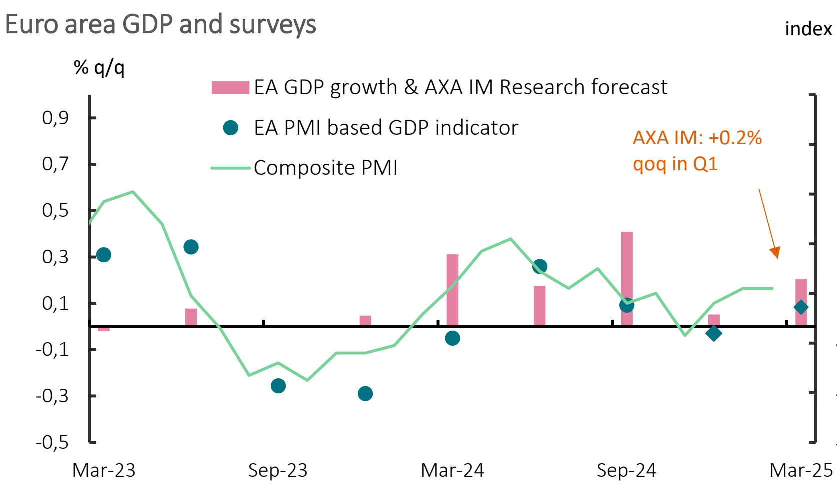
The Eurozone economy entered 2025 with a pinch of better news but remains weak

- Q4 GDP growth was modestly upgraded to 0.1% qoq, consistent with our initial forecast. Spain and Portugal outperformed (again), growing by an astonishing 0.8% and 1.5% respectively while the rest of the bloc performed poorly, contracting by -0.1%. Economic surveys are slightly better since January but are only consistent with GDP growing at best at +0.2% qoq. We maintain our subdued growth outlook through 2025 (0.9%), now in line with the downward revised consensus at 0.9%.

Geopolitical and trade risks loom large

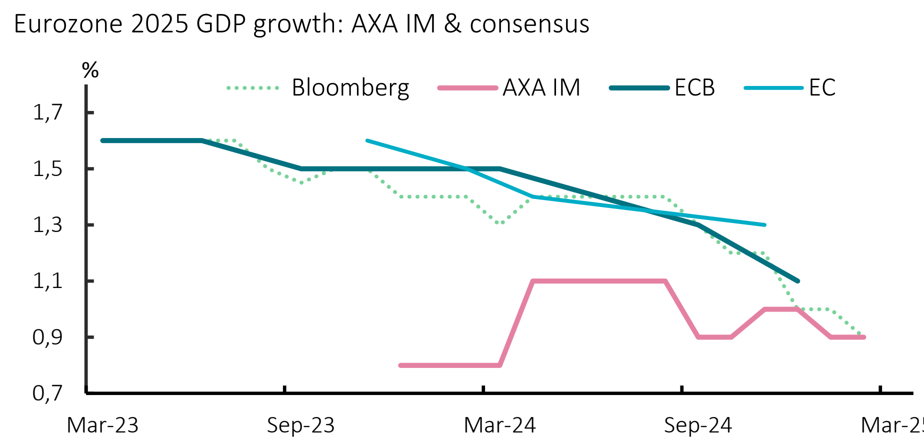
- Peace talks in the Russia-Ukraine conflict underline the need for caution. Any rebound in confidence would not necessarily translate into stronger consumption as we struggle to see Europe re-establishing an economic relationship with Russia. On tariffs, any decisions are unlikely before April. Reciprocal tariffs should have a limited impact, but inclusion of issues of broader sovereignty (i.e incl VAT) and retaliation would weigh further. Broader trade uncertainty likely to impact global trade reallocation and investment.

2025 PMIs consistent with small pick-up in Q1 25



Sources: Eurostat, PMIs, AXA IM Macro Research, as of February 2025

Consensus converging to our subdued outlook (0.9%)



Source: Bloomberg, AXA IM Research, ECB, European Commission, February 2025

European policies without surprises

Euro area

ECB : no major dissonance within the Governing Council for next meeting

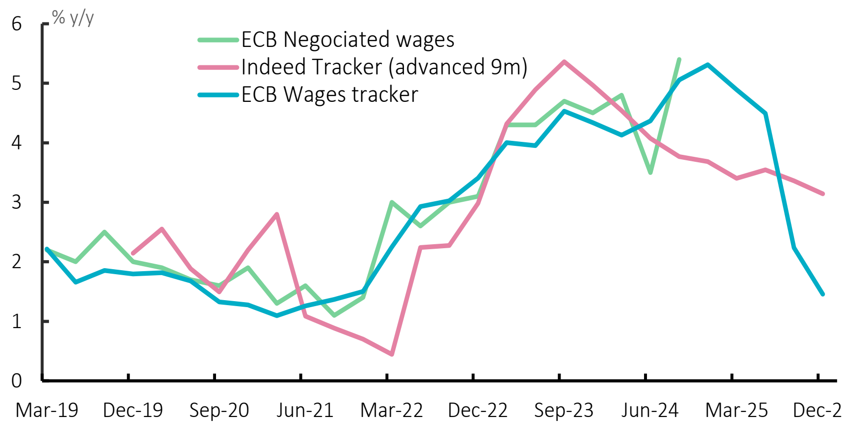
- Unlike in the US, where inflation surprised on the upside in January, Eurozone inflation came in below expectations at 2.4% yoy (2.7% for core inflation, unchanged from last month). Most recent ECB and Indeed wage trackers also point to further deceleration ahead. This should cement another 25bps rate cut at the next ECB meeting on 6 March and we forecast 1.50% by year-end.

German election: the CDU/CSU's come-back

- The CDU/CSU won the German election with 33% of the seats. It should be in a position to form a coalition with the SPD (19%). CDU leader Merz stressed that he would like to have a coalition agreement by the end of April. The AfD and Linke will have a blocking minority with 34% of the seats, the latter becomes a kingmaker. On the debt brake reform, the Linke has always opposed the rule so should support its removal. But it is resistant to military spending increases. The latter could be "bypassed" by going through EU joint funding.

Wages outlook to lead services inflation lower

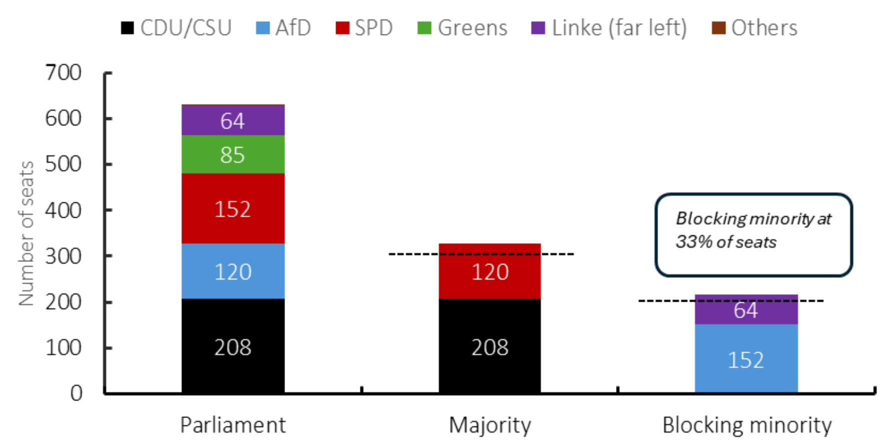
Euro area wages outlook



Sources: ECB, Indeed, AXA IM Research, as of February 2025

CDU/CSU – SPD should be the next coalition

German election results



Source: Politico, AXA IM Research, as of February 2025

Household demand to remain subdued

UK

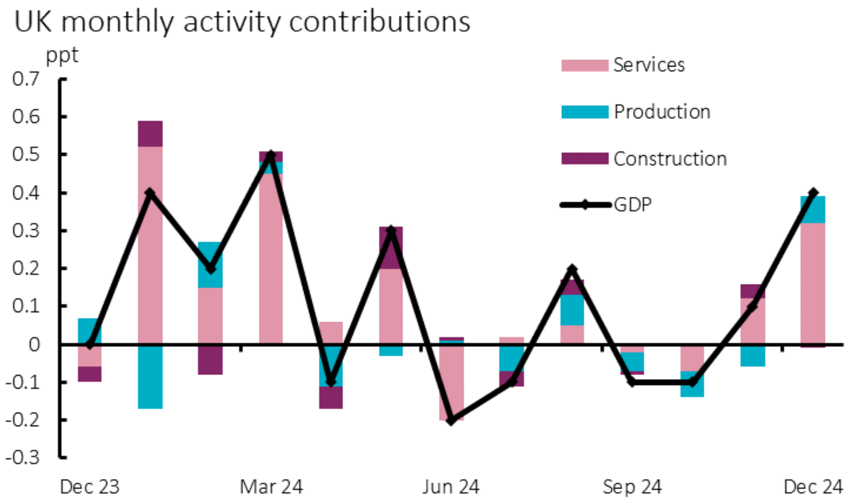
GDP rose in Q4, and further modest quarterly increases are likely…

- The economy beat expectations in Q4, rising by 0.1% quarter-on-quarter; a decline of equal measure was forecast. The beat boiled down to a 0.4% monthly rise in December reflecting strength in production and "white-collar services". Overall, growth came in at 0.9% in 2024.

…driven by the public sector

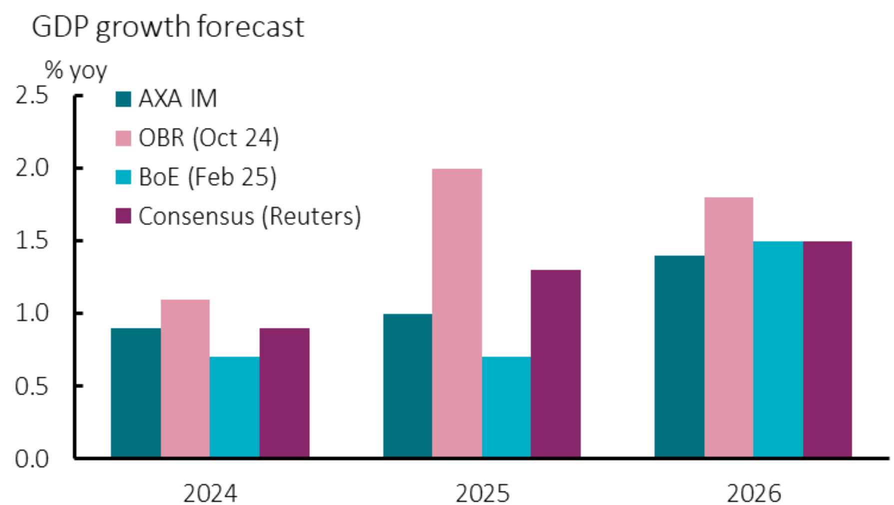
- We expect to see modest growth again this year, but as in Q4, that is likely to be largely due to the public sector. Growth on the household side will likely stay subdued, as rates remain restrictive, and sentiment stays weak as the labour market continues to soften. We see growth of 1.0% in 2025, well below the OBR's 2% expectation in the October Budget. As a result, Rachel Reeves will likely have to make some spending adjustments in her Budget to keep within the fiscal rules.

Monthly activity picked up in December



Source: National Statistics and AXA IM Research, February 2025

But we are much more downbeat than the OBR



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

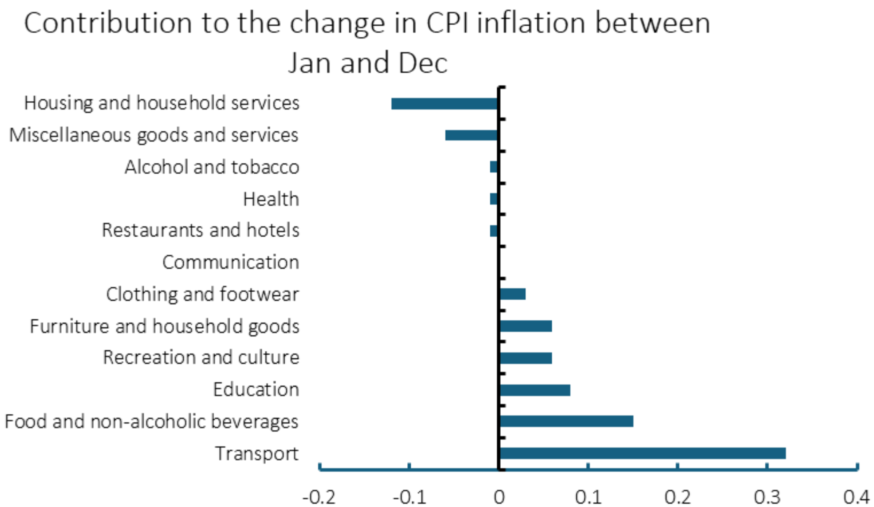
Near term inflationary pressure likely to abate next year

UK

MPC to look through near-term pressure; focus on medium-term downside risks

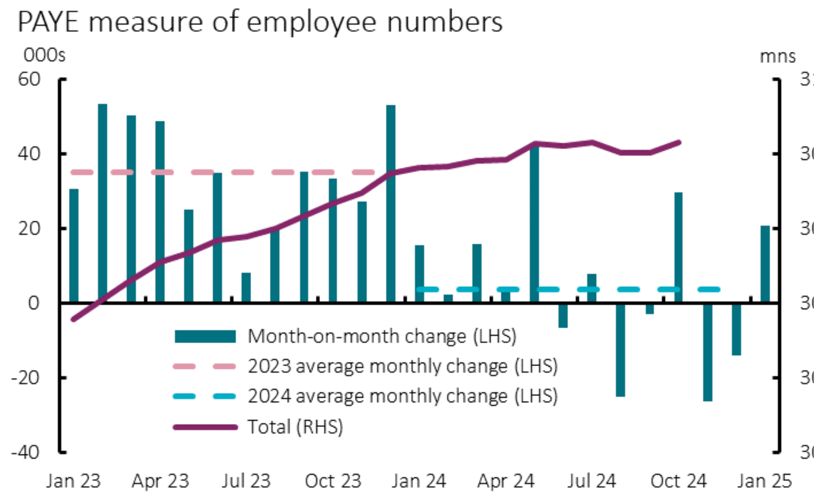
- January's inflation figures were mixed. Headline CPI inflation jumped to 3% – the highest in ten months – from 2.5%, above the BoE's 2.8% forecast. But that largely reflected upside surprises in food prices, which rose by 3.3%, from 2.0% and core goods, which rose to 1.6%, from 1.2%. Services inflation, by contrast, rose to 5.0% and undershot forecasts of 5.2%. With gas prices hitting two-year highs and surveys suggesting food inflation could rise back towards 4% this year, we have revised our inflation forecasts higher and now expect a peak of just over 3.5% by mid-year and an annual average of 3.3%.
- Further ahead, inflation will likely decelerate faster than the Bank expects, as a weak labour market and subdued private-sector demand reduces wage growth and limits firms' pricing power. Note that while the PAYE measure of employment rose by 21K in January, pretty much all of that was from the public sector. Private sector payrolls were down 0.5% on the three-month year-on-year measure; vacancies have continued to fall; and survey measures have weakened further, all suggesting labour market conditions are continuing to deteriorate. We continue to see three further cuts to Bank Rate this year and more easing in 2026.

Airfares and VAT on school fees boosted inflation in Jan



Sources: National Sources and AXA IM Research, February 2025

Labour market still soft, despite pick up in payrolls in Jan



Sources: National sources and AXA IM Research, February 2025

Positive surprise from Chinese tech begins Year of the Snake

China

AI industry shaken by the emergence of DeepSeek

- The emergence of one of the most powerful AI models, developed by an obscure Chinese company, sent shockwaves through the AI industry on the eve of the Lunar New Year. DeepSeek not only bolstered Chinese tech firms stock prices but, more importantly, caught Beijing's attention, as evidenced by a recent symposium where President Xi met with executives from leading technology and high-end manufacturing companies for the first time in seven years.

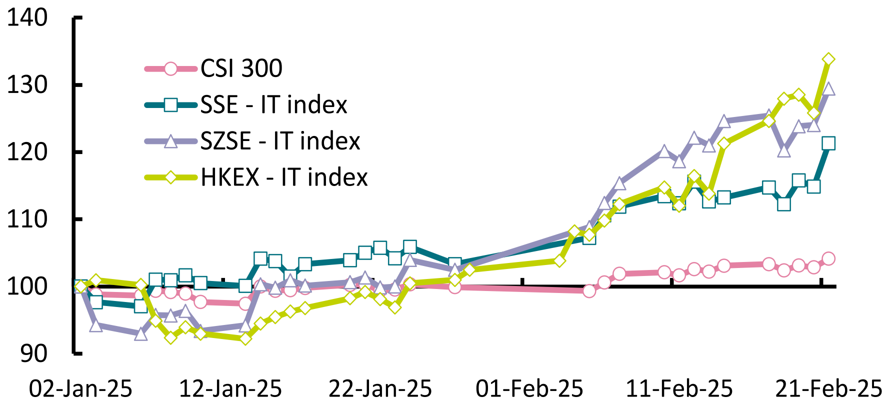
Consumer outlook remains less optimistic

- The performance of the tourism sector during the Lunar New Year holiday continued to indicate sluggish consumer demand. Although still experiencing positive growth, both tourist numbers and total tourism revenue have slowed significantly compared to the previous two years.

Some animal spirit seen in China IT equities

China - Stock index movement in 2025

Index, 02-Jan-25 = 100

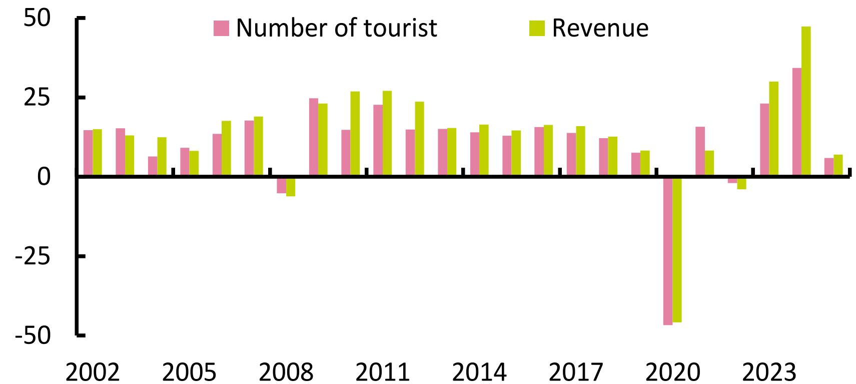


Source: CEIC and AXA IM Research, as of 21 February 2025

Latest holiday tourism spending decelerated materially

China - Lunar new year holiday tourism

%, yoy



Source: CEIC and AXA IM Research, February 2025

Risks on trade leaning to the downside

China

February saw quick initial US tariff rise

- US President Trump began his new term in the White House with a packed agenda, keeping tariffs at the forefront of his policy priorities. Despite seemingly adopting a relatively softer stance towards China, tariff increases came sooner than expected.
- We expect further US tariff increases over the coming months, particularly in April, when Trump is set to review investigation reports from the Office of the US Trade Representative.

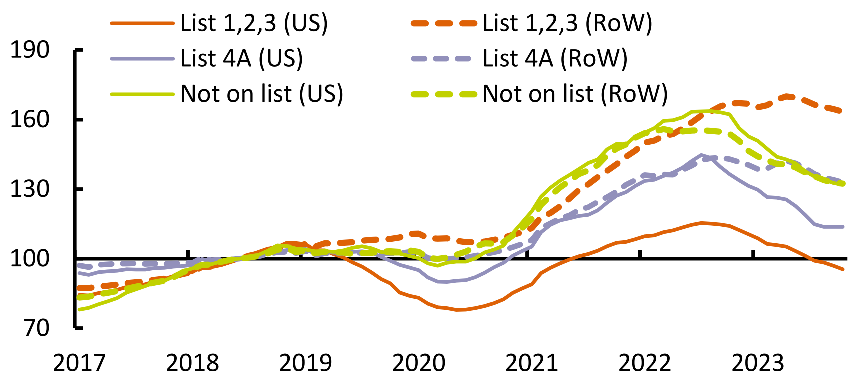
Upcoming National People's Congress to set crucial directions

- Alongside the GDP growth target for 2025, the March NPC is expected to unveil its fiscal stimulus package. Based on provincial GDP growth targets set by local governments, this year's national target is unlikely to be far from 2024's level. Meanwhile, we expect a modest increase in the fiscal package compared to last year. More crucially, the key factor will be how Beijing allocates its fiscal quota — a meaningful confidence boost could materialise if greater emphasis is placed on the household sector.

Less divergence expected if US tariff hikes worldwide

China - Impact of US tariff on China's exports in Trade War 1.0

Index, June 2018 = 100

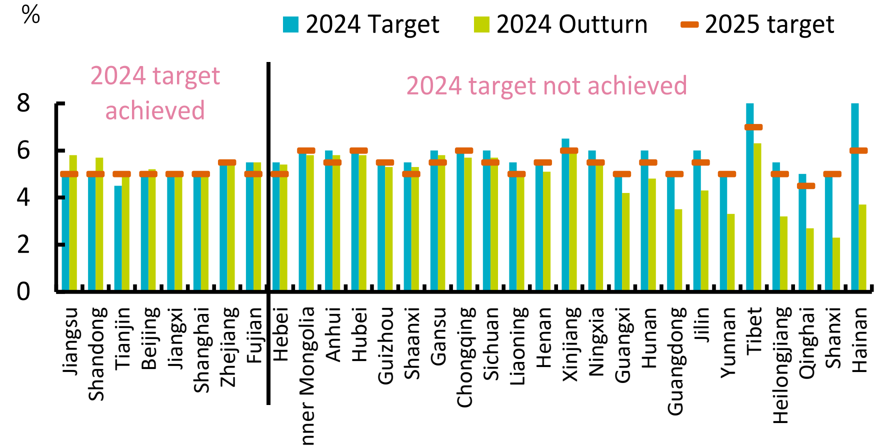


Note: Goods on List 1, 2, 3 subject to 25% additional tariff, while List 4A had 7.5%
Source: Peterson Institute and AXA IM Research, February 2025

Weighted average of GDP growth target reduced by 10bps to 5.3%

China - provincial GDP growth target and outturn

%



Source: CEIC and AXA IM Research, February 2025

Real incomes growth to keep growth buoyant

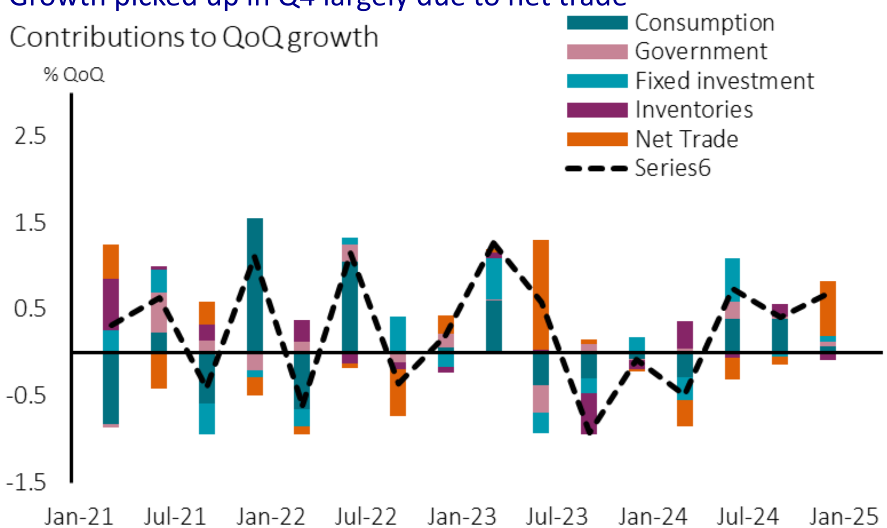
Japan

Moderate quarterly pace to continue through 2025

- Japan's Q4 GDP data provided further evidence that the Bank of Japan's (BoJ) expected virtuous wage/price spiral remains intact, with activity increasing by 2.8% on an annualised basis, well above the 1.1% rate expected. Private consumption continued to rise, as Japanese households made the most of stronger real income growth – real employee compensation rose to 6.3% annualised, from 1.4% in Q3. Some of that additional cash was likely saved as consumption growth slowed to 0.5%, from 3.0% in Q3.
- We expect GDP growth to remain solid throughout 2025, as rising real incomes pass through to spending; we expect growth of 1.3% across 2025. But global uncertainties suggest risks lie to the downside, with the impact of potential tariffs hitting demand in some of Japan's key export destinations.

Growth picked up in Q4 largely due to net trade

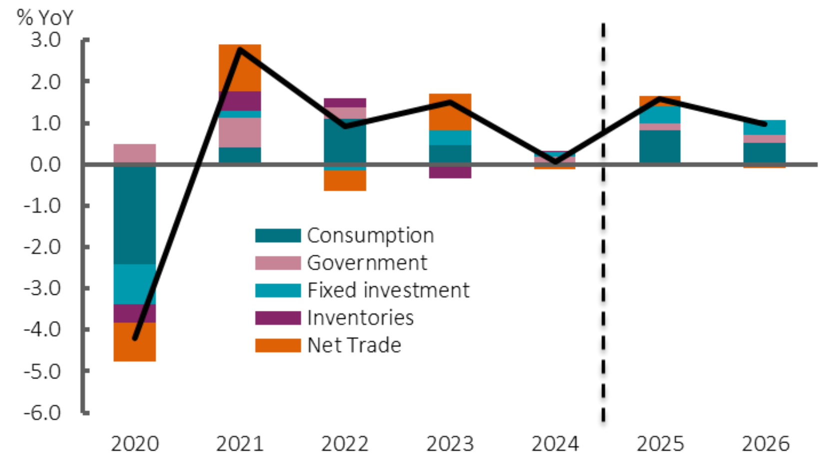
Contributions to QoQ growth



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

We expect modest quarterly increases across 2025

Japan: GDP growth contributions



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

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Bank of Japan to continue normalising policy in 2025

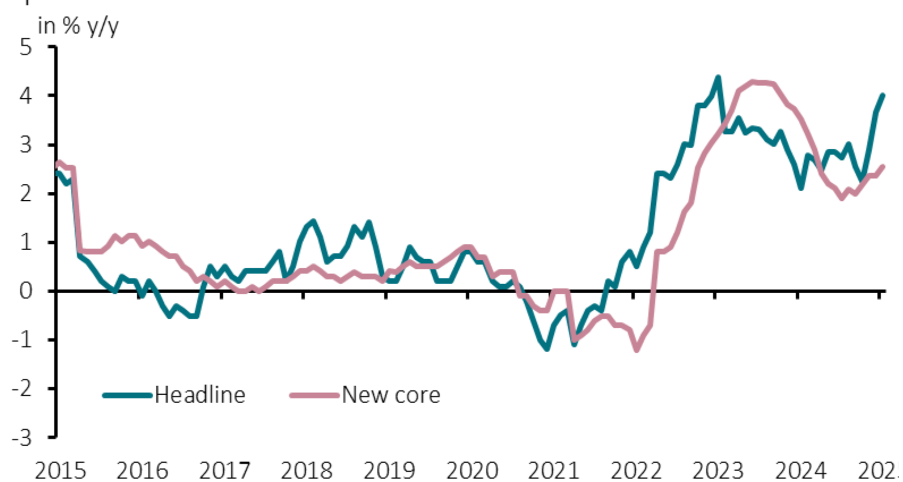
Japan

Growing evidence of virtuous wage/price spiral taking hold

- Headline CPI inflation rose to 4% in January, though that largely reflected energy and food prices. Measures of underlying inflation were more subdued, with core – excluding all food and energy – below the 2% target for the tenth month in a row. We expect underlying services inflation to pick up from April as services firms pass on higher labour and input costs to consumers.
- The Shunto wage negotiations should result in base pay increases of around 3%, which should help cement the wage/price spiral.
- The BoJ has appeared more confident in its outlook. The Bank hiked its key policy rate by 25bp in January, to around 0.50% – its highest level in 17 years. The Bank also revised up its inflation outlook and now expects headline and core CPI to average 2.4% and 2.1% in 2025, respectively. Looking ahead, if the Shunto wage negotiations lead to an agreement of an increase in base pay of around 3% as we expect, and the global backdrop remains relatively calm, we think the BoJ will feel confident to maintain the current pace of hikes and will push through another 25bp hike to 0.75% in the second half of the year.

Inflation is being driven higher by food and energy prices

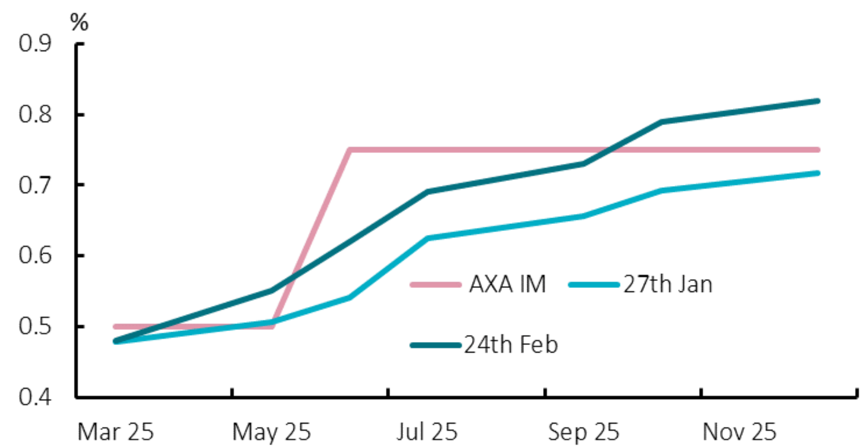
Japan CPI inflation



Source: National sources and AXA IM Research, February 2025

We expect a further 25bp hike in H2

Japan interest rate expectations



Source: Refinitiv and AXA IM Research, February 2025

Canadian economy is gathering momentum once more

Canada

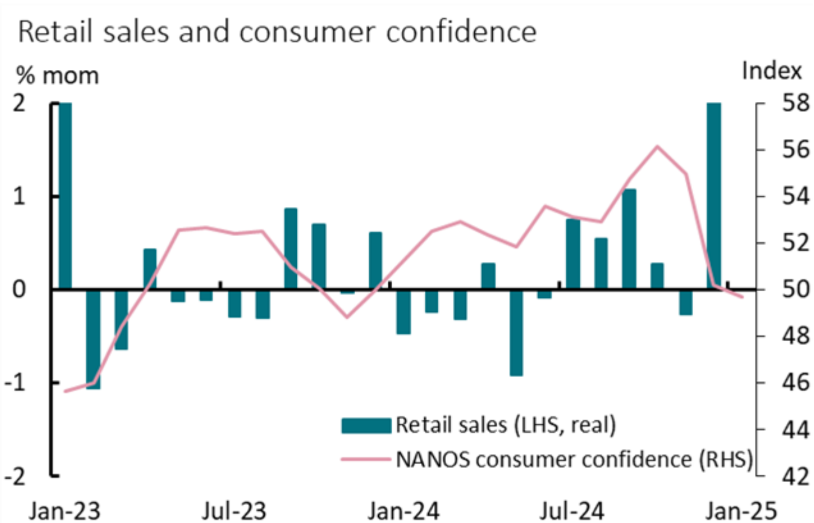
Weak confidence not translating to short-term spending decisions

- Canada's economy seems to be reviving. Despite a sharp drop in confidence as tariffs were announced, activity has improved. Retail sales reversed November's real fall to rise by 2.4% in December. This underpinned a preliminary estimated December GDP rise of 0.2%, which we expect to lead to a 1.8% annualised rise in Q4 GDP, delivering 2024 annual growth of 1.3%.

Longer term spending sensitive to market conditions, any slowdown limited by stronger employment

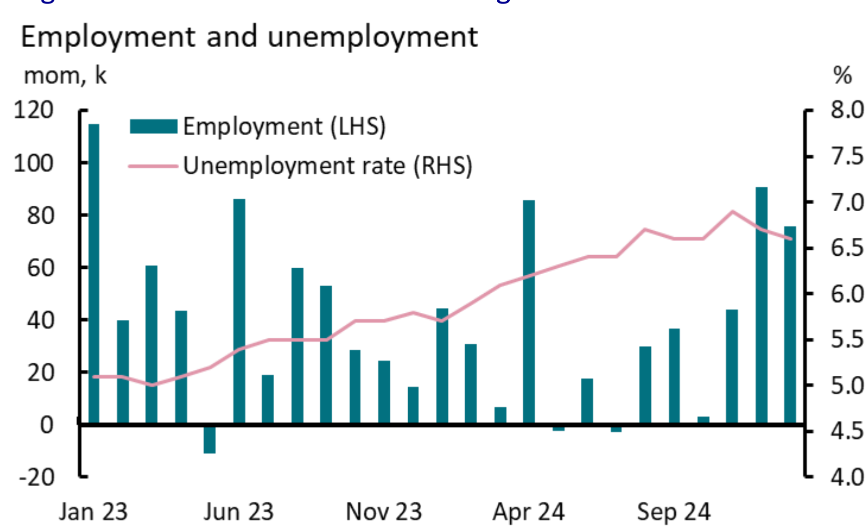
- The spending pick-up may reverse as short-term sales tax cuts expired this month. Long-term spending, including residential housing and business investment, may flag, largely due to elevated uncertainty and higher longer-term rates. Note the Canadian housing market is particularly sensitive to market rates given the average lending time being shorter than in the US.
- Any slowdown will be limited by a fairly strong labour market. Employment growth continues to rise solidly and unemployment fell to 6.6% in January – a six-month low.

Fall in confidence has not affected retail sales



Source: StatCan, Nanos and AXA IM Research, February 2025

Signs the labour market is rebounding



Source: StatCan and AXA IM Research, February 2025

Tariff uncertainty will weigh on growth in 2025

Canada

While tariffs are yet to be enacted, uncertainty is rife

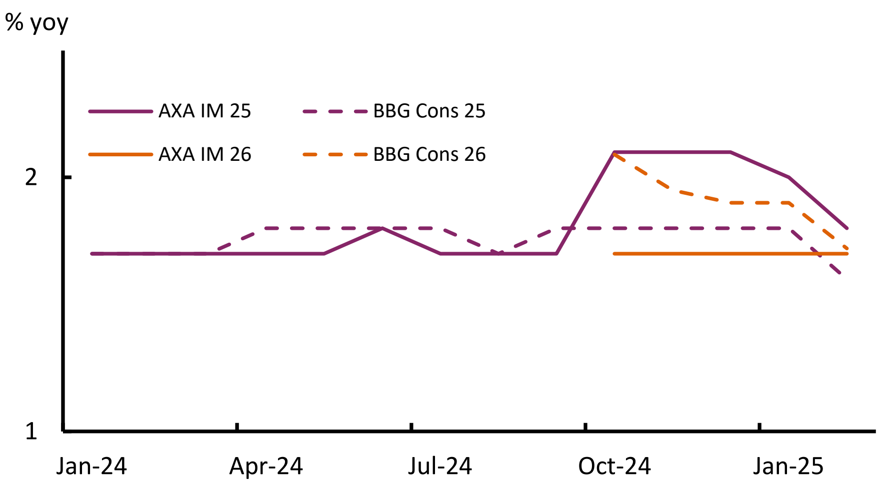
- The 25% tariffs enacted by the US on Canada were deferred for "at least 30 days", which likely reflects the US administration's acknowledgement of the damage it would do to its closely integrated industrial system. However, the 25% steel and aluminium tariffs, scheduled for 12 March, would also have a material impact, given that Canada constitutes 23% of US steel imports and 41% of aluminium imports. It's unclear if they will go ahead, in full or on time, but if enacted, the impact would be material.
- We continue to doubt the emergence of material tariffs on Canada, but the uncertainty will have an impact. We lowered our 2025 growth forecast to 1.8% (from 2.0%) but keep our 2026 outlook unchanged at 1.7%.

BoC will cut once more, acknowledge little to be done to offset potential tariffs

- The BoC slowed the pace of easing in January, cutting the policy rate by 0.25% to 3.00%. While Macklem has highlighted tariff damage, he has also explained that monetary policy could do little to offset it. We expect the BoC to cut rates once more this year in March to 2.75%. We then see a pause until H2 2026, when we forecast easing to 2.25%.

Consensus moves more in line with our forecasts

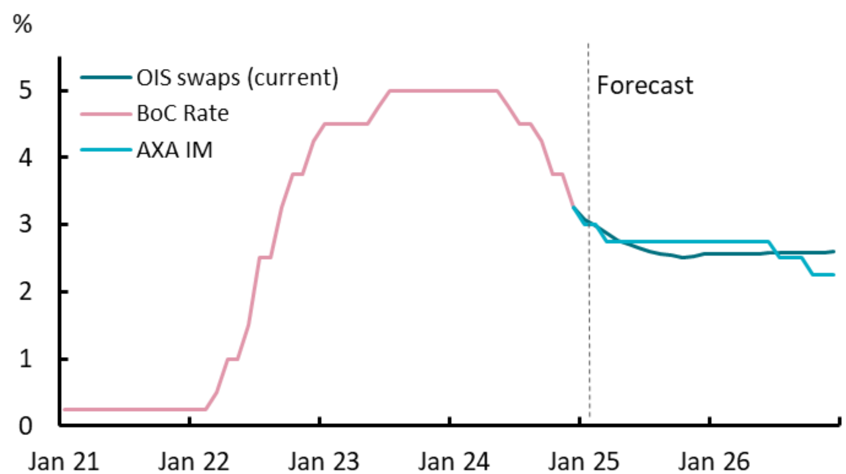
Evolution of GDP forecasts



Source: Bloomberg, AXA IM Research, February 2025

BoC to cut only once more, as uncertainty weighs

Bank of Canada overnight rate and outlook



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

Policymakers anxious over domestic weakness and looming US tariff hikes

EM Asia ex-China

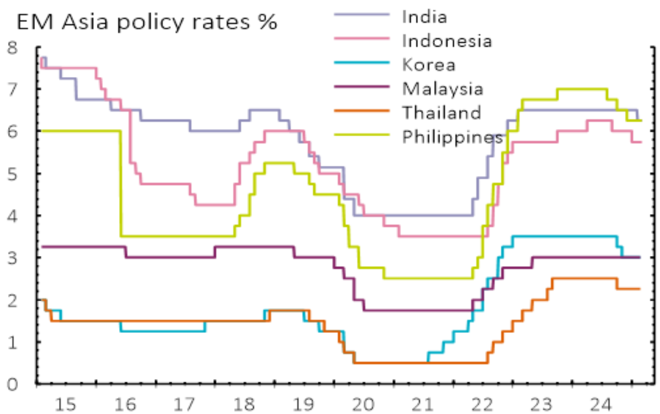
Fiscal measures to stimulate domestic demand, complementing monetary easing

- Alongside monetary easing underway, the need to shore up domestic resilience as Trump tariffs loom large is reflected in fiscal measures to stimulate demand. India's government has found space to boost consumption with cuts in income tax while still meeting the need for fiscal consolidation in its latest budget. Indonesia's President Subianto is demanding efficiency savings from government departments to enable him to fund flagship spending programmes, while South Korea's opposition-led National Assembly is pushing for a supplementary budget to prop up the economy hit by political turmoil.

Appeasing Trump to head off tariff hikes

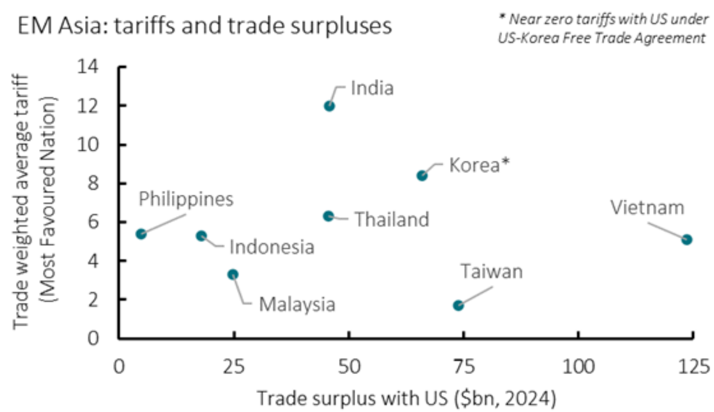
- The uncertainty over the timing and magnitude of US trade policy moves is unnerving the region's leaders. It is likely that the favoured initial strategy will be acquiescence. India's prime minister, Narendra Modi, appeared keen to appease Trump during talks at the White House in February, with an openness to cutting tariffs and buying more US energy. Taiwan's president, Lai Ching-te, has also recently pledged to invest more in the US and increase its imports from the US so as to reduce its trade surplus.

India's central bank has joined peers in cutting rates



Source: LSEG Datastream and AXA IM Research Feb 25

Vulnerability to US tariff hikes



Source: WTO, LSEG Datastream and AXA IM Research, February 2025

Different trade-offs between growth and financial stability

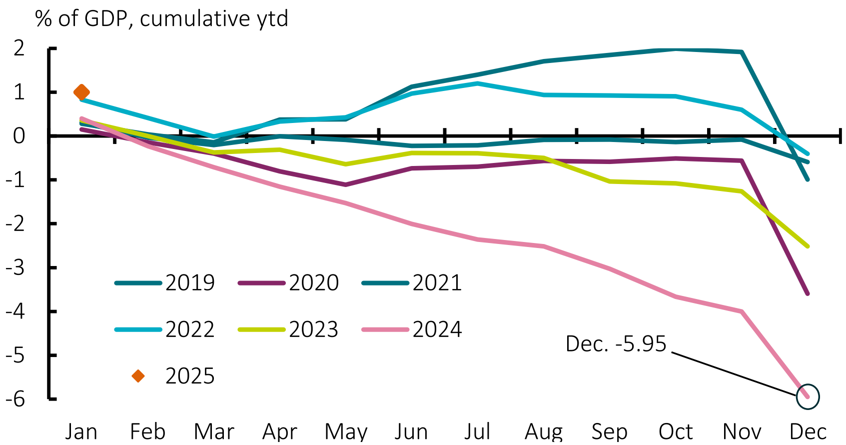
EMEA

Faster growth unlikely to dispel public finance concerns in Central Europe; slower growth needed in Turkey

- In Hungary, a slow growth recovery raises the odds of fiscal slippage after a tightening in 2024. Delayed recovery in household consumption amid a rise in inflation in Q1 2025 will not only weigh on VAT revenue but should encourage higher government spending, with opposition party Tisza taking the lead in polls ahead of 2026 elections (at 41%, a 4 ppt lead over Fidesz).
- In Poland, private consumption has been supported by an expansionary fiscal stance. Budget deficits will likely stay wide ahead of 2025 presidential and 2027 general elections, fuelled not only by military spending but also continued consumer support. An acceleration in private investment in 2025 helped by NGEU funds would be a positive development for growth sustainability.
- In Turkey, signs of growth re-accelerating at the turn of 2025, are worrisome. Reliance on real currency appreciation to curb inflation may backfire if stronger domestic demand feeds an import boom. High rates fuel an increase in external borrowing by the private sector. A contribution of fiscal policy to disinflation is needed to keep the rate cutting cycle on track.

Poland: Wider fiscal deficits support growth

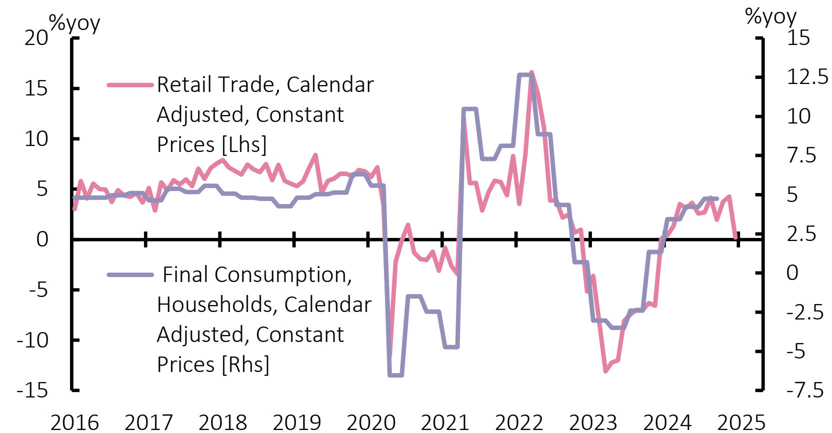
Poland - Central government budget balance



Source: Macrobond and AXA IM Research, February 2025

Weak momentum of retail sales in Hungary

Hungary - Consumption indicators



Source: Macrobond and AXA IM Research, February 2025

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A tricky relationship between fiscal and monetary policies

Latin America

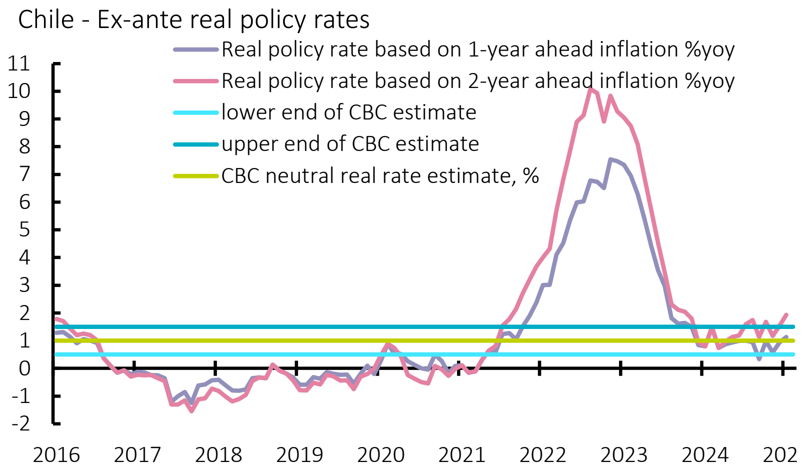
Cooperation between fiscal and monetary policy in Chile, confrontation in Brazil

- In Chile, the current neutral stance is appropriate as the small negative output gap closes in 2025. BCCh should look through the near-term supply shocks on inflation, namely electricity tariff increases, labour costs and past currency depreciation, in view of uneven domestic demand recovery. In Brazil, the monetary stance is restrictive but perhaps less than it seems with the fiscal risk premium raising the neutral rate. Beyond another 100bp hike in March, BCB's job is not done yet. Still the pace of tightening should slow in Q2 in view of a moderation in activity.

A middle path for central bank in Colombia

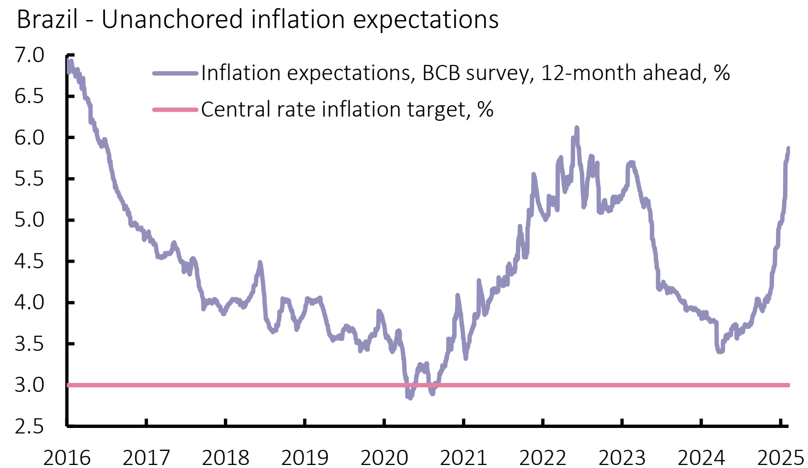
- The central bank unexpectedly paused in its easing cycle in January. Fiscal and external risks reflected in an uptick to inflation expectations (to 4%, the upper end of the target) explain its cautious reaction. Yet a measured pace of easing could resume in March, supported by a still negative output gap and a very restrictive monetary stance.

Chile: Policy rates within neutral territory



Source: Macrobond and AXA IM Research, February 2025

Still rising inflation expectations in Brazil, well above target



Source: Macrobond and AXA IM Research, February 2025

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2024*		2025*		2026*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2		3.2		2.9	
Advanced economies	1.6		1.7		1.4	
US	2.8	2.7	2.3	2.2	1.5	2.0
Euro area	0.7	0.8	0.9	1.0	1.2	1.4
Germany	-0.2	-0.1	0.2	0.4	0.9	1.3
France	1.1	1.1	0.6	0.7	0.9	1.3
Italy	0.5	0.5	0.3	0.7	0.7	1.0
Spain	3.3	3.0	2.9	2.3	2.5	1.7
Japan	0.1	-0.2	1.3	1.2	0.9	0.9
UK	0.9	0.9	1.0	1.2	1.4	1.5
Switzerland	1.6	1.4	1.5	1.3	1.4	1.6
Canada	1.3	1.2	1.8	1.7	1.7	2.1
Emerging economies	4.1		4.2		3.9	
China	5.0	5.0	4.5	4.4	4.1	4.2
Asia (excluding China)	5.2		5.0		4.9	
India	6.5	6.3	6.5	6.5	6.7	6.6
South Korea	2.1	2.2	1.5	1.8	1.5	2.2
Indonesia	5.0	5.0	5.1	5.0	4.9	5.1
LatAm	2.0		2.0		2.1	
Brazil	3.0	3.3	1.9	2.1	1.8	2.2
Mexico	1.3	1.5	0.6	1.1	1.0	2.0
EM Europe	3.1		2.1		2.2	
Russia	3.8	3.6	1.4	1.6	1.2	1.3
Poland	2.9	2.8	3.1	3.4	2.7	3.5
Turkey	2.8	2.9	2.6	2.5	3.4	3.6
Other EMs	2.8		4.0		3.8	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 26 February 2025
**Forecast*

AXA Investment Managers

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2024*		2025*		2026*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	2.6		2.5		2.4	
US	**2.9**	2.9	**2.8**	2.6	**3.2**	2.3
Euro area	**2.4**	2.4	**2.0**	2.0	**1.6**	2.0
China	**0.2**	0.2	**1.0**	1.3	**1.6**	1.6
Japan	**2.7**	2.5	**3.0**	2.0	**1.8**	1.7
UK	**2.5**	2.5	**3.3**	2.3	**2.3**	2.0
Switzerland	**1.1**	1.1	**0.8**	1.0	**1.0**	1.0
Canada	**2.4**	2.4	**1.7**	2.1	**1.9**	2.1

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 26 February 2025

**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
United States - Fed	Dates	4.50	18-19 Mar	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)	unch (4.50)	unch (4.50)	-0.25 (4.25)	-0.25 (4.00)	-0.25 (3.75)	-0.25 (3.50)
Euro area - ECB	Dates	2.75	06-mars	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		-0.25 (2.50)	-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	18-19 Mar	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)	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	20-mars	8 May 19 Jun	7 Aug 18 Sep	6 Nov 18 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		unch (4.50)	-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	3.00	12-mars	16 Apr 4 Jun	30 Jul 17 Sep	29 Oct 10 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		-0.25 (2.75)	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 26 February 2025

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Calendar of key events

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

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