4 December 2024

Investment Institute *Macroeconomics*

Outlook 2025-2026

Trump-starting the global economy

Key points

- Global growth looks set to continue its 2024 pace of 3.2% in 2025, before easing in 2026 to 2.9%
- Trump's policies will determine the US outlook, but are uncertain for now. On balance these look set to weigh on growth in 2026. China is likely to need ongoing stimulus to deliver a managed decline. Eurozone activity should improve, but US trade tensions would be a risk. And Emerging economies (EM) will also be vulnerable.
- Inflation is likely to be impacted by US policies, restricting the Fed's space to ease. This could slow the pace of disinflation more broadly and in EMs – also slowing monetary easing. European inflation looks set to fall further and we expect the ECB to cut rates below neutral next year.
- Broader risks will surround geopolitical developments, including developments in Ukraine, the Middle East and with China.

From the Macro Research team

With contributions from:
Chris Iggo – AXA IM Core Investments CIO

4 December 2024

Table of contents

Macro outlook 2025 – Divergence 3
By Gilles Moëc

Investment Strategy Outlook – Shifts in the balance of risk and return 5
By Chris Iggo

Summary – Trump-starting the global economy 7
By David Page

US – Second Term Trump 9
By David Page

Eurozone – Slowly taking off 11
By François Cabau & Hugo Le Damany

UK – Gradual easing in 2025 but lags will keep BoE cutting in 2026 13
By Gabrielle Dickens

Canada – reducing spare capacity 14
By David Page

Japan – Further hikes on the cards in 2025, but 2026 will mark the end 15
By Gabriella Dickens

China – Consumers key to breaking the deadlock 16
By Yingrui Wang

Emerging Markets – Resilience to be tested 18
By Irina Topa-Serry, Claire Dissaux and Danny Richards

Forecast summary 23

Calendar of events 2025 24

Abbreviation glossary 25

Macro outlook 2025 – Divergence


Gilles Moec
AXA Group Chief Economist
And Head of AXA IM Research

Key points

- Underlying growth, monetary and fiscal policy diverging across the main economic regions.
- The “discount rate” to apply on Donald Trump’s platform is key.

Three sources of divergence

2025 may be characterised by divergence across the world’s main economic regions, around three dimensions: underlying growth, fiscal policy, and monetary policy.

Let’s start with growth. We expect GDP to gain 2.3% in the US next year, above consensus. We would be tempted to say it also exceeds potential – often estimated at c.175% - but the resilience of the US economy probably also reflects a rise in the country’s potential. Successful investment choices by US corporations 10 years ago, accelerating spending on software and R&D, may explain the uptick in productivity which has outlived the pandemic. Participation rates have rebounded, hitting their highest level since the early 2010s, which, combined with strong immigration, is lifting labour supply.

The stronger US trend contrasts with China’s difficulties. The country is in the midst of a real estate correction. Experience accumulated across many such episodes across the globe suggests that slumps in residential investment last years. Given China’s poor demographic prospects, and the fact that the catch-up in terms of housing standards has been largely completed, counting on a recovery any time soon is illusory, in our view. At peak, residential capex may have underpinned nearly 1/5 of Chinese growth. With this engine switched off, it is unclear how China could repeat this year’s official target of “around” 5% GDP growth (we expect 4.5% next year). More fundamentally, China is meeting the limits of its capital-intensive growth model. Directing more of the productivity gains to real wages, rather than to profits and competitiveness, would go a long way towards moving the country towards a consumer-based model which, at some point in their development, all mature economies today transitioned to. Yet, for now Beijing continues to focus on its “productive quality” strategy which rests on allocating more capital to export-driven strategic sectors, such as cars, at a time when protectionism is increasingly holding sway at the global level. The Chinese slowdown is mostly structural, not cyclical.

The Euro area is likely to maintain a mediocre growth pace in 2025. We expect GDP gains of 1.0%, below consensus. While nominal wages continue to outperform inflation, the resulting real gains – unlike in the US – tend to be saved rather than consumed. Generic uncertainty probably explains this pattern. Political instability plays a role in this in France. In Germany, the general weakness to a large extent reflects structural shortcomings. While the brunt of the energy price shock is behind us, German industry is still struggling to normalise, with signs of activity relocation, and a difficulty to adapt to new demand patterns, for instance in the car industry. The outperforming cases cannot be easily replicated: Spain continues to do well, but this owes to a steep improvement in supply conditions, with massive immigration flows, notably from Latin America. Across the Euro area, productivity continues to stall which, combined with mediocre labour supply growth – outside Spain – and hesitant corporate investment suggest that potential growth probably needs to be revised down from its usual estimate at c.1.2%.

Ill-distributed fiscal stimulus

The US does not need further fiscal stimulus. Beyond its structural prowess, its cyclical position remains sound. The rise in the unemployment rate – now consistent with the “Sahm rule” according to which a rise of more than 0.5 pp relative to trough over the previous 12 months reliably predicts a recession – is of course a concern but “this time it may be different”. Indeed, employment growth remains decent, a stark difference with previous instances in which the “Sahm point” had been hit. The uptick in the unemployment rate mostly reflects better labour supply conditions.

Yet, Donald Trump’s platform is consistent with a further drift in the fiscal deficit of 2% of GDP in the years ahead, from an already problematic baseline at c.6% of GDP. Some of his measures would not necessarily move the dial much in terms of short-term growth dynamics. Taken in isolation, prolonging the 2017 tax cuts would simply keep the fiscal stance unchanged. The cut in the corporate tax rate from 21% to 15% would likely have a limited immediate effect on business spending. Yet, exempting social security benefits from income tax across the board would free up income equivalent to c.0.4% of GDP to some households will a high propensity to spend. Combined with deregulation – notably in the field of energy investment – this could continue to fuel a “feelgood effect” lifting equity prices, indirectly supporting consumer spending.

Conversely, in Europe, the fiscal stance is turning restrictive. Based on the budget plans for the three largest economies of the Euro area, 2025 would be the steepest net fiscal tightening since 2012, at nearly 1% of GDP. This will add to the general softness of aggregate demand. True, political difficulties in France may dampen the initial adjustment plans, but we think that any significant drift would be "punished" by a further widening of the sovereign yield spread. Germany could and should use its fiscal firepower to deal with some of its structural issues. The terms of the debate seem to be changing over there. The leader of the Centre-Right – who according to the polls is likely to become the next Chancellor after the early elections scheduled for late February 2025 – has indicated his openness to some reform of the "debt brake". It is however a qualified openness and building a coalition – let alone reach the two-thirds majority in parliament needed to change these constitutional rules – will be tough. We would not expect a significant loosening of Germany fiscal policy to come before the second half of next year, if at all.

China seems to be contemplating a wider use of stimulative policies, but the room there is tight: public debt in China already exceeds 100% of GDP. Measures aimed at shoring up financial stability should not be confused with stimulus "proper". The extra bond issuance allowed to local authorities in the autumn of 2024 is a way to "officialise" hidden debt – the exposure to the real estate sector via local governments' special vehicles – but will not directly lift ordinary spending.

Monetary policy divergence

Monetary policy, as often, will be the "valve of adjustment" which will balance those contradicting forces. In the US, we expect the Fed's ongoing "restriction removal process" to be stopped out well into restrictive territory early in 2025 (Fed Funds cutting only once in 2025 at 4.25%) by renewed inflationary pressure. On top of the usual impact of a fiscal push on prices, the Fed will need to take on board the rise in trade tariffs touted by the new administration. The announced crackdown on immigration – with even mass deportations of immigrants already in the US workforce – would probably re-start wage pressure. Even if we do not expect the hike in customs duties or action on immigration to be as radical as what has been presented during the campaign, even a moderate version would probably prevent a further convergence to the central bank's inflation target against a background of still lingering endogenous pressure (services prices still have not normalised).

Symmetrically, we think the ECB will have to move more decisively into accommodative territory given the weak economic conditions – exacerbated by the impact of US tariffs on European exports – in a context of net fiscal tightening. We expect the terminal level for the depo rate to land at 1.5%, 50bps below the consensus estimate of the neutral rate in the Euro area. The widening of the transatlantic policy differential would fuel a further decline in the euro towards parity, which would offset some of the impact of the US tariffs.

Despite clear signs that deflation is a major risk in China, the PBOC is often hesitant to take radical decisions. The deterioration of Chinese banks' interest margin in a context of monetary loosening is a cause for concern at the central bank, since it impairs the accumulation of profit buffers which help absorb mounting non-performing loans. A natural adjustment avenue though would be to allow a significant depreciation of the Renminbi. While offsetting a 60% US tariff would entail a magnitude of depreciation which would probably trigger financial stability risks for China itself, allowing the Renminbi to weaken relative to the euro and other key "non-dollar" currencies could help Chinese exporters replace their lost market shares in the US with new ones in the rest of the world.

How far is too far?

A key uncertainty in our scenario is the extent to which Donald Trump will deliver on his fiscal and trade platform. The nomination of Scott Bessent – a pragmatist – as Treasury Secretary and the choice of the Republican Senators of a moderate, John Thune, as their leader could be indications that a significant discount rate should be applied to the campaign version of Trumpnomics.

Yet, even under a "moderate version", we expect US growth to slow down in 2026 (1.5%), falling below potential: supply-side constraints combined with restrictive monetary conditions would ultimately prove too much to bear, especially since we believe overall financial conditions could get tighter as the bond market would react adversely to the additional fiscal drift. Once the slowdown comes, the Fed would be in position to resume cutting, which would improve financial conditions for emerging countries, but only after going through a difficult patch in 2025, between lower Chinese demand and disappointing capital flows.

How governments outside the US develop their own macroeconomic strategy while they embark on "surviving Trump" will of course be key. Trade war escalation is ultimately in no-one's interest – especially not for regions such as Europe and China which are more reliant on outside traction than the US. Designing strategies which will lift potential growth would be a better approach. Yet, another source of uncertainty lies in the interplay between the US macroeconomic stance and geopolitical risks. The US growing energy autonomy makes Washington increasingly tempted to tolerate further escalation in the Middle-East. Beijing could respond to tariffs by getting even more assertive towards Taiwan.

Investment Strategy Outlook – Shifts in the balance of risk and return

Chris Iggo
Chair of the AXA IM Investment Institute
and CIO of AXA IM Core

Key points

- Continued growth favours equities and credit
- Need to assess policy impact on earnings
- A tariff war will be difficult for exporters
- Technology stocks should continue to lead
- But US equity performance could broaden on any deregulation push
- A shallower rate path for the US is not bad for bond investors
- Best risk-adjusted returns likely remain with short-duration credit-focused strategies

Supportive market backdrop but with new risks

US President-elect Donald Trump's radical policy agenda has created some financial market uncertainty, in terms of the outlook for investment returns. Nevertheless, we believe the central macroeconomic outlook remains favourable for bonds and equities. Growth, stable inflation and lower interest rates should support markets. But investment decisions need to consider cashflow resilience and valuations, given policy risks and broader concerns. For now, we don't expect a recession in 2025 which should help deliver positive equity returns, while credit markets should provide attractive income opportunities.

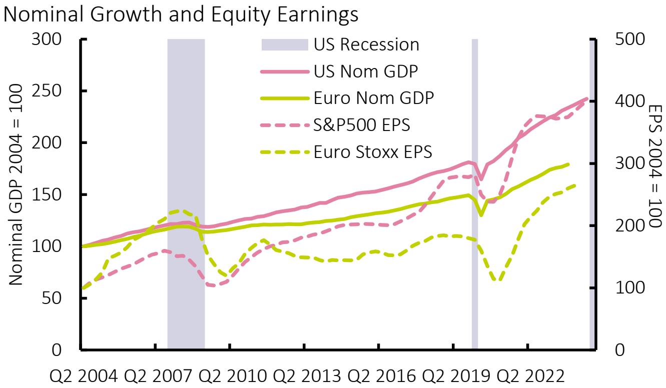
US policy agenda should be equity positive

Trump's agenda creates a potentially positive growth impetus. Lower corporate taxes and deregulation should support equity markets. The extension of earlier income tax cuts and positive real income growth will underpin consumption. Despite the new administration's expected preference for oil and gas production over subsidies for renewable energy, investment in the green transition will remain a major theme – at least outside of the US. Forecasts of significant increases in electricity consumption – driven by the technology sector and China's power demand – will promote further integration of solar and wind energy assets into power networks. Investment opportunities in sectors such as electrical components, equipment and renewable energy production continue to be an option for a sustainably focused equity approach.

Earnings momentum will be a key driver

Equity returns have historically been positive outside of periods of US recession, with an average 12-month total return of around 15%, compared to a mean return of -6% during recessions (as identified by the National Bureau for Economic Research). After solid earnings growth in 2024, the consensus forecast for 2025 is for around 13% growth in earnings per share for the S&P 500. Much of this will continue to be driven by the technology sector with there being no evidence of any softening in demand for artificial intelligence (AI) related technologies. In 2024, close to half the growth in the entire market's earnings per share came from the US's information technology and communications sectors. Policy may stimulate stronger earnings growth in areas such as financials and energy although the impact of potential tariffs is unknown for other industries. Overall, however, US equities are likely to retain their leadership position. Small-cap equities could also benefit from lower taxes and interest rates with upgrades to earnings expectations already having been seen (Exhibit **1**).

Exhibit 1: Nominal growth should support earnings



Source: LSEG Workspace Datastream; I/B/E/S and AXA IM, 20 November 2024

Mixed outlook outside US borders

Elsewhere the outlook is mixed. China appears likely to continue rolling out policies designed to stimulate domestic demand. This should be positive for Chinese equities, but any improvement needs to be judged against the potential negative growth impact from US tariffs. A global trade war is not helpful for companies relying on exports, and performance between domestic stocks and exporters could diverge significantly. This may not be something confined to China if Trump does go ahead with tariffs targeted at many countries. Emerging market equities may find this a more difficult backdrop with a less benign US interest rate outlook and a stronger dollar also being headwinds.

Europe's growth outlook is subdued, although equities could get some support from lower interest rates and the improvement in real incomes via lower inflation. European stocks benefit from more attractive valuations than in the US, and they boast a higher dividend yield. But expected earnings growth is only about half that forecast for the US. Interest rate-sensitive and consumer-focused sectors should continue to perform well, with some potential upside for industrials – provided the global industrial cycle shows signs of an upturn and if the worst fears of a trade war do not materialise.

Lower interest rates are good for bonds

The baseline for fixed income markets is defined by interest rate expectations. The US's potential policy mix has some upside inflationary risks. Moreover, inflation in some economies is settling slightly above central bank targets. Market-based expectations of terminal rates (neutral policy targets) have moved higher in recent months as a result. However, this is not bad for bond investors. The prevailing level of yields in developed bond markets provides the basis for robust income returns, which should remain above inflation.

Short duration strategies remain attractive

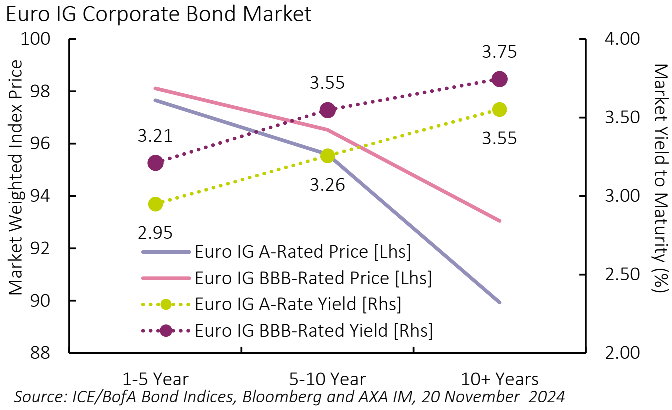
There are risks around longer-term interest rates coming from policy uncertainty and the profile of government debt in many countries. This has already led to a cheapening of longer-term government bonds on a relative value basis, when compared to the interest rate swap curve. For some investors, this could provide opportunities to move out of longer-term corporate debt into government bonds, particularly for institutional investors that have an interest rate swap benchmark.

However, for short and intermediate maturities, the bond market looks healthy. We see yields as fairly valued given the interest rate outlook – so much so that investors are unlikely to experience similar duration shocks to those seen in 2022 and 2023. On the credit side, despite spreads being tight, the additional return and the continued healthy state of corporate balance sheets underpins the attractiveness of both investment grade and high yield bonds. Of course, investor sentiment towards credit will be subject to the uncertain evolution of policy and geopolitical risks but on a risk-adjusted return basis, credit is attractive. This is especially the case for short-duration strategies. We continue to see US high yield, a short-duration asset class, delivering healthy returns.

Europe vs. the US

Our forecasts allow for greater monetary easing in Europe than in the US, reflecting softer growth. Thus, European fixed income investors may see total returns boosted by some decline in bond yields. Additionally, the relative picture should continue to support a strong dollar. For non-dollar investors, on a currency hedged basis, European fixed income looks more attractive especially as we continue to see opportunities in the credit markets (Exhibit 2).

Exhibit 2: Opportunities in Euro IG Credit



Source: ICE/BofA Bond Indices, Bloomberg and AXA IM, 20 November 2024

Risk premiums

Global economic expansion – while likely to ease in 2025 – will underpin corporate earnings and support returns from equity and credit markets. However, valuations are a concern. This is particularly the case in the US where equity multiples and credit spreads have reduced risk premiums. The simple US equity risk premium has turned negative on some measures. Any indication that radical policy making could disrupt corporate profits could impact US equity multiples, hitting total returns in the process. Given the level of yields, bonds should provide some offset to any decline in equity valuations.

Credit spreads are also tight, however. This does reflect healthy demand for credit assets which itself is a function of strong fundamentals. But again, any threat to the macroeconomic outlook could push credit risk premiums higher and reduce the excess returns from corporate bonds.

Investors will need to be flexible in 2025. The benign soft landing and lower rates story helped returns in 2024. Yet, as the year closed policy and geopolitical risks came back into focus. Tariffs, concerns about government bond supply, and trade or commodity disruptions due to geopolitical developments are threats to discounted cashflows and therefore current valuations.

Cash returns will ease further as rate cuts continue but income should remain the focus in bond markets and compounding returns from short-duration exposure in credit and high yield remains a favoured strategy. A US growth focus in equities is also seen as core with upside coming from thematic sectors like automation, the green transition and the broader continued strong investment in technology and AI.

Summary – Trump-starting the global economy

David Page
Head of Macro Research
AXA IM Macro Research

Key points

- US and China policy uncertainty weighs over outlook
- We judge Trump's policy package to weigh on US growth, but only in 2026, but to lift inflation
- China's economy is fragile. US tariffs would be a blow. Ongoing stimulus should achieve a managed decline
- Eurozone growth should slowly revive. But political weakness remains a risk in the face of shocks
- Emerging markets will have to use domestic policy wisely to navigate external headwinds
- Geopolitical risks appear elevated

Two major policy uncertainties drive global outlook

Two major policy uncertainties lie at the heart of the global outlook for 2025 and 2026. The first is the extent that US President-elect Donald Trump translates campaign promises into policy. Our view is that he will not fully deliver what he suggested on tariff increases, migrant deportations or fiscal loosening. However, we anticipate enough delivery to materially impact US growth as these policies bite into 2026.

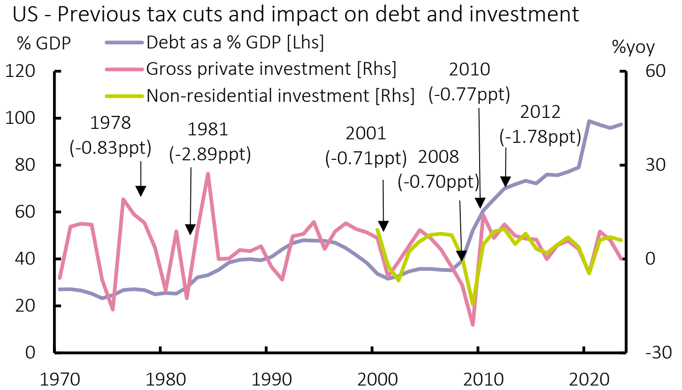
The second is how successful China will be in providing stimulus to bolster domestic – particularly household – demand as the economy appears close to a major debt-deflation trap as its property market collapses, impacting local governments and the banking system. Our assumption is of ongoing support, sufficient to deliver a managed deceleration in growth over the coming two years. But these assumptions for the world's two largest economies will govern the dynamics of the rest of the global economy, as domestic policies adjust to navigate these uncertain, but largely negative, external developments.

Softening US and China growth will dominate

Trump's re-election has substituted policy uncertainty for political uncertainty. Markets have reacted to this as a growth-positive outcome, but our own assessment is that fiscal measures are likely to be costly, but provide little boost (Exhibit 3). Deregulation might provide a noteworthy boost to fossil fuel production but is likely to be less obvious in other sectors, and at best delayed with regards to broader government efficiencies. We also think it is complacent to assume limited implementation of supply shocks, namely immigration and tariff policies. Trump has a mandate to deliver these policies and cabinet picks that include hawkish appointees or those associated with Project 2025 suggest a more focused delivery than during his first term. We forecast solid growth in 2025 at 2.3% (from an expected 2.8% this year), but slowing to a below consensus 1.5% in 2026, while inflation looks set to remain at 3.2% in 2026, reducing the Fed's space to ease.

Beyond economic policy, we focus on geopolitical risks. The new US administration has suggested a resolution of the Ukraine war, which we interpret as enforced settlement with Russia; a return to "maximum pressure" on Iran, which could impact Middle Eastern alliances; and dialling up trade pressure on China. These threaten to remove key foundations of the current, fragile geopolitical balance and result in a shift to a new equilibrium. We do not know what such a new equilibrium will look like, but we expect the uncertainty associated with transition to further impact growth.

Exhibit 3: US policies unlikely to lift growth



Source: Tax Foundation, CBO, BEA and AXA IM Macro Research, December 2024

China has been Trump's focus with 60% tariffs. Yet China faces its own domestic issues. Its property market crisis – with prices down 15% from the peak in 2021 and 5ppt in 2024 alone – looks set to continue despite recent stimulus. This is weighing on consumer spending, as property represents households' largest source of investment, and fiscal stimulus/credit creation as China's entangled local government and regional banking system are also impacted by the property downturn. China faces material challenges to avoid a generation-defining debt-deflation trap. Although we do not expect a full 60% tariff on China, we still foresee an economic impact of around 0.5ppt. We expect a range of measures, including further fiscal stimulus and pressure on state-owned enterprises, to boost the household sector in 2025. This should deliver a managed slowdown in China – rather than a severe downturn – and we forecast growth of 4.5% in 2025 (from 4.9% this year) and 4.1% in 2026. But this depends on delivery of a narrow policy path as the government grapples with unfamiliar headwinds from market forces; risks are skewed to a worse outcome.

Emerging market resilience tested again

Both will have major impacts on the world's other economies, but none more so than on emerging markets (EMs), particularly EMs in Asia and Latin America. Many EMs have large exposures to China and its domestic and export producing activities will feed through to raw material and intermediate goods demand. However, where many have been benefitting from the US's export diversification from China, a new Trump regime may be more focused on associated rising trade surpluses and target additional countries more specifically.

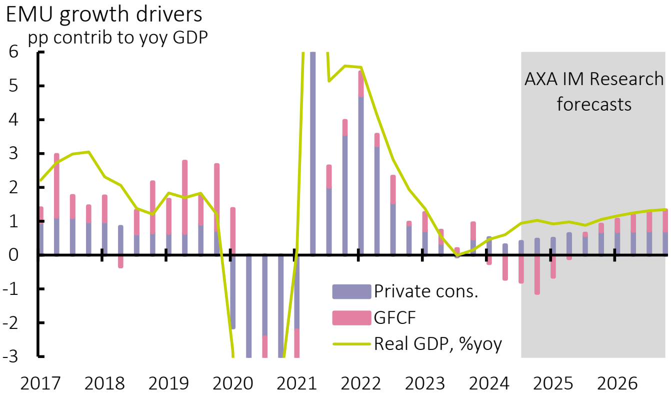
Emerging markets will have to adapt policies wisely to manage domestic demand in the face of external headwinds. Monetary policy space remains for further easing, with real rates still elevated in several EMs. However, policies that keep US rates and the dollar higher would reduce the scope for EM easing. Moreover, EM fiscal space remains constricted with primary deficits widening further from pre-pandemic levels in 2024. Policy will be most effective where monetary and fiscal policies work together. EMs should display resilience, but few are likely to lift long-term growth with structural reforms.

Countries with relatively large domestic sectors, including India and Indonesia, look best placed to deliver solid expansion – the latter one of the few with fiscal space to loosen if conditions worsen. Those that have corrected economic imbalances should catch up by 2026, including Turkey, Argentina and Colombia. South Africa, Egypt and Nigeria look well placed to benefit from structural reforms. But Brazil's outlook has seen debt sustainability concerns trigger an unwelcome monetary policy reaction. Mexico may also face difficulties with fiscal austerity at a time when constitutional reforms and US trade protectionism already dampen the outlook.

Europe: Economic stability, political challenges

For the Eurozone, recent weakness looks likely to slowly reverse, despite risks posed by the external environment. Inflation's return to target has lifted real disposable income growth, underpinning an acceleration in consumer spending, despite a marked rise in household saving rates. This should continue. We are still sceptical of a material recovery in investment (Exhibit 4). However, the evolution of growth headwinds from supply constraints to demand deficiency has increased scope for the ECB to boost activity. It has cut rates and we see this continuing to 1.5% by end-2025. This should bolster growth, which we forecast to rise to 1.0% in 2025 (from 0.8%) and 1.3% in 2026 as investment begins to respond to lower rates. This outlook remains vulnerable to a more broad-based trade war.

Exhibit 4: Eurozone domestic demand recovery despite risks



Sources: Eurostat and AXA IM Macro Research, November 2024

Yet weak governments pose a potential risk. In Germany, elections will be held in February instead of September. But even the probable return of a grand coalition looks unlikely to deliver a major turn in fiscal policy, despite the substantial need for long-term investment. France may suffer further political uncertainty with its government likely to face fresh challenges next year. Nor can we rule out elections in Spain. Weak governments are likely to result in slippage from the relatively sharp fiscal tightening planned for next year. They will hamper the EU response to any US tariffs and would impede reaction to any geopolitical developments involving Ukraine or beyond.

The UK should be politically more stable and credible than in recent years. We forecast a pick-up in growth to 1.5% in 2025 (from 0.9%) and 1.4% in 2026. This should reflect ongoing household real disposable income growth and a loosening in fiscal policy next year, although the latter will fade in 2026. After a brave Budget, the UK's public finances again risk deteriorating if growth fails to match bold expectations, requiring further tax increases, spending cuts and/or borrowing increases. Political stability may begin to attract foreign capital, an effect suggested by the currency this year. But as an open economy, the UK shares the risks of wider Europe from a broader trade war and geopolitical developments.

The global economic outlook is thus poised on the uncertain prospect of policy developments in Washington and Beijing. Our forecasts suggest overall global growth will remain at 3.2% in 2025, but softening to 2.8% in 2026. Next year, excluding China, global growth will be on a par with the post-global financial crisis (2012-2019) pace of activity, although this looks set to slow in 2026 with a more material slowdown in the US and some broader softening through EM. Yet there is a risk that this slowdown reflects renewed structural adjustment – notably from US supply adjustments – meaning, at least for the forecast horizon, relatively muted scope for policy easing and the prospect for relatively elevated term rates.

US – Second Term Trump

David Page
Head of Macro Research
AXA IM Macro Research

Key points

- Trump's election win opens a new chapter; for now policy uncertainty replaces political uncertainty
- We question the growth boost of Trump's policies and forecast GDP growth of 2.8% this year, 2.3% next and 1.5% for 2026
- But inflation looks set to rise. We forecast 2.9% in 2024, 2.8% in 2025 and 3.2% in 2026
- This will limit the Fed's easing space. We expect a pause in cuts at 4.25% in March but resuming in the second half of 2026 to 3.50% as growth slows

A new chapter

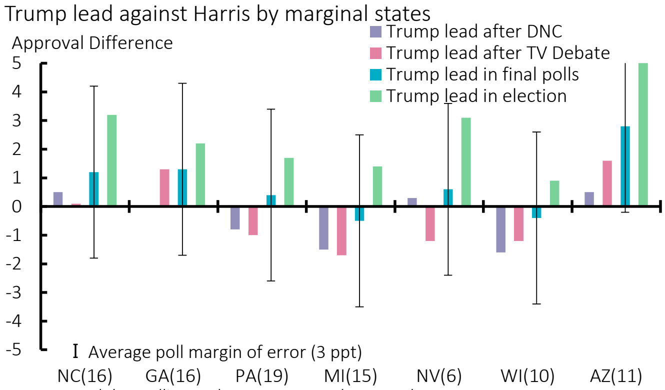
The US expanded by 2.8% annualised in Q3 2024 with consumption seeing a strong 3.7% rise. Although this followed weak headline expansion in Q1, due to dips in consumer and government spending as well as exports, Q2 was a robust 3.0% and 2024 as a whole looks set to deliver growth of 2.8%. However, despite growth's robust pace, CPI inflation fell to 2.6% in October, around the pace consistent with the Federal Reserve's (Fed) 2% PCE inflation target and marginally lower than we had anticipated last year (we forecast 2.9% for 2024 now, compared with 3.2% one year ago).

This combination of stronger growth and softer inflation largely reflected improving supply conditions: global supply chain tensions eased; labour market efficiencies improved, with vacancies falling more than unemployment has risen; and the labour supply increased, primarily from strong immigration. This has allowed the Fed to ease policy more quickly than expected and we expect one further 0.25% policy rate cut before year-end to leave the Fed Funds target at 4.25-4.50% as the Fed appears on track to delivering a soft landing.

Policy uncertainty replaces political uncertainty

If 2024 has played out a combination of recent years' economic shocks and the Fed's policy management, the coming years look more likely to be driven by the new administration's policy direction. November's election will return former President Donald Trump to the White House in 2025, with majorities in both houses of Congress. This was the result we expected[1], although the final outcome was less close than polls suggested (Exhibit 5). This avoided prolonged election outcome uncertainty but substituted political uncertainty for policy uncertainty. Trump campaigned on policies of fiscal easing and deregulation, which should support growth, but he also campaigned for tighter migration restrictions, trade tariff increases and made several geopolitical statements, which could all have a materially detrimental impact on the growth outlook. Yet for now there is significant uncertainty about the scale of implementation, with the immediate market reaction playing down some of the more growth-restricting policies.

Exhibit 5: Trump's win clearer than polls suggested



Source: RealClearPolling and AXA IM Research, November 2024

We are cautious of the growth outlook. Trump's signature fiscal easing is likely to include a $4bn+ cost to extend the 2017 household tax cuts due to expire at the end of 2025. While the expiry would present a marked fiscal cliff, extending them merely maintains the status quo – it is not a stimulus. Corporate tax cuts to 15% (from 21%) would be different but even these are only small at 0.2% of GDP and previous tax cuts have rarely been shown to boost investment. Deregulation might prove more of a boost, particularly in gas production. But more broadly deregulation, which might extend to tech, AI and banking, typically provides moderate tailwinds, rather than one-off boosts. Even if the proposed Department of Government Efficiency does lift productivity (rather than just cut spending), this is unlikely to materialise in the first two years.

More fundamentally, further immigration restrictions and deportations would constitute a supply shock – limiting, or reversing labour supply growth – as would tariffs. Both are to

[1] Page, D., "US 2024 Presidential Election Preview: Trump faces new adversary", AXA IM Macro Research, 26 July 2024.

be implemented to an uncertain scale but both would reduce US trend growth rates and boost inflation.
Two further uncertainties could also impair growth. While a full Budget is far from being prepared, the scale of tax cuts suggested is likely to see the deficit rise from its already elevated pace of around 6% of GDP per annum over the next 10 years. The Congressional Budget Office (CBO) currently estimates US debt exceeding 120% of GDP by 2034 and this could rise closer to 130% after Trump's policies. This risks markets driving yields higher to incorporate a credit premium over coming years, with key risks if CBO deficits deteriorate further and the Treasury increases coupon issuance. Any such rise in yields would be a further headwind.

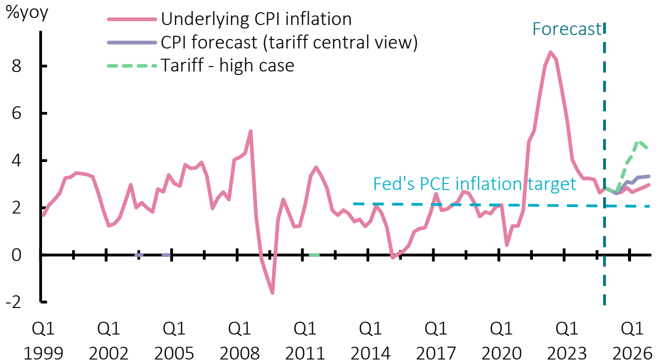
We are also mindful of geopolitical developments. Changing policies for Ukraine, the Middle East and increased economic tensions with China could topple the current, delicate geopolitical balance. We could not tell what new equilibrium might emerge but we are mindful that financial markets are rarely keen on uncertainty surrounding such transitions, something which may also dampen the growth outlook.

Growth to slow, inflation to rise

Our forecast is that with US activity enjoying solid momentum for now and a further loosening in financial conditions – in part in response to Trump's win – the economy should post another solid year in 2025 and we forecast growth of 2.3%. However, as we expect the new administration to introduce growth restraining policies soon after inauguration, we expect growth to slow markedly across 2026, to leave annual growth at 1.5%, and annualised H2 2026 growth slower still.

Exhibit 6: Inflation forecast to rise above target

Headline CPI inflation and potential tariff impact



Source: BLS, PIIE and AXA IM Macro Research, November 2024

Amid policy uncertainties, risks to our forecasts are two-sided. Growth could be supported beyond our expectations by a government efficiency drive, or a deregulatory spur to activity. But we do not assume full implementation of Trump's supply shocks, which could impact the economy more. We are also wary of a rebalancing of geopolitical risks and the impact on financial conditions and growth.

While there is much debate over the growth outlook, we see fewer reservations over the outlook for inflation. The combination of boosting demand conditions and simultaneously restricting supply seems inevitable to deliver higher inflation. The question is again one of extent, given uncertainties surrounding the scale of policy implementation. The Peterson Institute estimates[2] if Trump delivered the full extent of his campaign rhetoric, inflation could rise by up to 7ppt in 2025. We do not expect full implementation – although concede uncertainty. We also consider dollar strength as likely to dampen the inflation impact at the margin, as may increased oil and gas supply by lowering energy prices. We forecast inflation to edge lower to 2.8% on average in 2025 but forecast 3.2% for 2026 (Exhibit 6). These forecasts are consistent with the Fed's PCE inflation target measure remaining above target over the coming years.

Less space for monetary policy easing

We consider these developments likely to restrict the Fed's space for monetary loosening, certainly relative to its September projections that saw the median (upper bound) Fed Funds forecast at 3.50% by end-2025 and 3.00% by end-2026. Indeed, we consider the Fed's aggressive initial policy easing to have reflected a rebalancing of risks, trading off reduced downside growth/upside unemployment risks now for modestly above target inflation in the future. We still expect the Fed to ease policy to 4.50% by end-2024, but then consider just one more cut in 2025 to 4.25% in March, before supply shock policies raise the Fed's inflation outlook. Longer term, based on our assessment that growth will start to slow in 2026, we expect the Fed to cut rates to 3.50% by end-2026. However, our expectation for the near term is for government policy to limit the Fed's easing cycle. We also expect the Fed to end its quantitative tightening programme in the latter half of 2025.

There are wider concerns over the Fed's independence under Trump. Both the President and Vice President-elect have suggested the President should have some say over policy. But recently Trump has said he does not want to mandate Fed actions but simply wants the right to comment on them. Trump has also suggested he would let Fed Chair Jerome Powell serve his term until 15 May 2026. This should allay concerns that Trump would remove Powell – something we suggest is legally trickier than it sounds. However, the Fed may still feel Trump's ire if it ends its easing cycle in response to government policy.

[2] McKibbin, W., Hogan, M. and Noland, M., "The international economic implications of a second Trump Presidency", Peterson Institute for International Economics, Sept 2024.

4 December 2024

Eurozone – Slowly taking off


François Cabau,
Senior Economist (Euro Area)
Macro Research – Core Investments


Hugo Le Damany,
Economist (Euro Area)
Macro Research – Core Investments

Key points

- We project Eurozone GDP to grow by 1.0% in 2025 after 0.8% this year with a modest improvement in 2026 to 1.3%. But downside risks prevail
- We forecast the bloc's inflation to undershoot the ECB's target for most of 2025-2026
- We expect the ECB to take an accommodative stance, cutting its deposit rate to 1.5% by the end of 2025, possibly sooner
- Political (and policy) uncertainty remains high in several member states. Germany holds snap elections on 23 February 2025, although we do not see this as a likely game-changer

Modest growth acceleration with downside risks

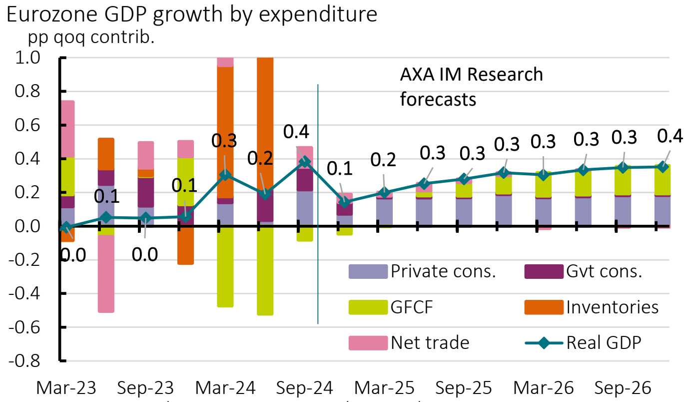
We expect the Eurozone's protracted economic rebound to continue and given Q3's stronger-than-expected performance we have revised our 2024 growth forecast up to 0.8% (up 0.1 percentage points). But beyond this, we maintain our below-consensus stance, projecting GDP growth at 1.0% in 2025 and 1.3% in 2026 (Bloomberg consensus: 1.2% and 1.4%). Our outlook is unchanged, anticipating expansion to recover slowly, led by private consumption in 2025, while investment should eventually make a firmer contribution in 2026.

Negotiated wage growth has exceeded inflation since Q3 2023, implying real purchasing power gains. However, the household saving rate has also been trending higher, culminating at 15.7% in Q2 2024, and acting as a brake to private consumption growth. Although we expect real wage growth to decelerate, we also anticipate some normalisation of the saving rate, implying a moderate but persistent pickup in consumer spending (Exhibit 7). However, the unprecedented recent savings behaviour makes it inherently difficult to forecast the timing and magnitude of such an acceleration.

We anticipate that investment will gently restart from the second half of 2025, following a year of progressive relaxation of monetary policy restrictiveness – and likely outright monetary easing to come – more than offsetting a reduced drag from profit margins.

Risks to our Eurozone growth forecasts are skewed to the downside. Trade policy and geopolitical uncertainty are running high after the US elections outcome. These come at a time when European political decisiveness is in question with several countries run by fragile coalitions. Notably, Germany is set to hold a general election on 23 February 2025, while snap elections in France and Spain cannot be ruled out. Increased political and economic uncertainty may imply that persistent manufacturing woes could spill over to services, leading to a quicker and more meaningful correction in the unemployment rate, projected to average 6.6% and 6.8% in 2025 and 2026 after 6.4% in 2024.

Exhibit 7: Modest euro area growth acceleration foreseen



Source: Eurostat and AXA IM Macro Research, November 2024

Inflation to stabilise below ECB's target

Headline inflation markedly eased in 2024 and should average 2.3%, down from 5.5% in 2023. We see a continued shift from better supply conditions to weaker demand continuing to affect price dynamics. Due to this weak domestic demand outlook, we project inflation to stabilise at 1.9% in 2025 and 1.7% in 2026, below the European Central Bank's (ECB) 2% target.

Eurozone core inflation should continue to edge down, to 2.1% in 2025 and 1.9% in 2026, from 2.8% this year. Though decelerating, we see services prices remaining the main inflation driver. By contrast, we foresee a pick-up of goods inflation pushing higher to 1.1% in 2025 and 1.3% in 2026 from 0.9% this year. We also expect food inflation to stabilise at its current level of around 3%, while the contribution from energy is expected to be slightly negative as market price futures continue to point to a weaker outlook. Such dynamics are likely to be only partially offset by the further expiry of energy crisis government support measures.

Towards an accommodative monetary policy stance

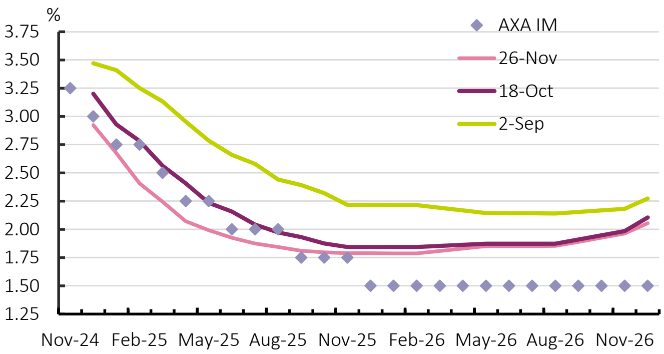
Our Eurozone sequential 2025 growth forecast (0.27% quarter-on-quarter on average) remains below estimates of potential growth (0.33%). Coupled with an undershoot of the ECB's inflation target for most of 2025, there is an obvious case for a continued unwinding of the central bank's restrictive stance. We continue to expect back-to-back 25-basis-point deposit rate cuts to reach 2.0% by next June, close to the vicinity of neutral rate territory.

Our projected path for 2026 sees a modest acceleration to potential growth, consistent with a continued undershooting of inflation (1.7%). This should push the ECB towards an accommodative policy stance. We expect it will cut twice in the second half of 2025, bringing the deposit rate to 1.5%, below current market pricing (Exhibit 8). Given the downside risks to growth, we think this could come sooner than end-2025, with the ECB forced into more accommodative territory.

There are two reasons that are likely to make the ECB more proactive in its policy response. First, compared with past years, weak Eurozone growth has rebalanced from supply to demand factors, on which the ECB can have more bearing via changes in its interest rate policy. Second, during the move towards a more accommodative stance, ECB risk management may encourage aggressive action to avoid being eventually pushed into extra-ordinary measures, including negative interest rates and/or quantitative easing.

Exhibit 8: ECB to cut deposit rate to 1.5%

ECB market pricing



Source: Bloomberg and AXA IM Macro Research, November 2024

Despite minor funding pressures arising, we do not think that the ECB is likely to alter the pace of balance sheet reduction, with excess liquidity projected to land at around €2.5tn by end-2026, still well above pre-pandemic levels. That said, we will watch for further details on the long-term aspects of the ECB's operational review, including prospects for long-term liquidity injections and structural bond portfolios.

Fiscal policy: France to remain in the spotlight

The Eurozone's stretched public finances will remain in focus across the bloc. However, for the first time in four years, countries have submitted budget plans following the application of (revised) EU rules after four years of suspension.

Nevertheless, we doubt the Eurozone's fiscal stance will be as restrictive as suggested in these plans – Germany's general election should offer an example of this. Moreover, several member states' budgets have been built on optimistic growth assumptions, likely leading to slippage versus targets, notably France – the European Commission's autumn forecasts concur. Finally, Italy and Spain are scheduled to receive increased amounts of Recovery and Resilience Facility funds next year.

Furthermore, France and Italy's public debt-to-GDP ratios are rising due to delayed deficit reduction, reflecting a challenging planned adjustment for the former while still accounting for the 'superbonus' tax credit for the latter. This highlights the vulnerability of these two countries – and the Eurozone as a whole – in case these downside risks to growth materialise.

Politics: No momentum to address key issues

German Chancellor Olaf Scholz ended the country's traffic-light coalition, calling for a snap election on 23 February 2025 – nine months ahead of schedule. Current polls show a likely CDU/CSU and SPD coalition return, although it is uncertain whether they will have enough votes to muster an outright majority in Parliament. It is not our base case scenario that Germany's fiscal stance turns accommodative – a two-thirds Parliamentary majority required to overturn the debt brake rule looks prohibitive – rather, we envisage a slightly less restrictive stance. In sum, these elections are unlikely to prove a game changer for domestic, nor European, prospects.

Fragile government coalitions also exist in France and Spain; such that we cannot rule out snap elections in either over the next couple of years. These developments also emphasise the weakness to the new European Commission.

This puts Europe in a weak political and policy position when facing the renewed economic challenges, it's likely to encounter from a new Donald Trump US presidency. Tariff hikes, domestic or global, could add to longstanding economic challenges including demographics, competitiveness and low productivity growth. Weak governments in key capitals could also increase the challenge of effective responses to arising geopolitical issues, of which Ukraine may be uppermost for Europe, but may also include the Middle East and climate change challenges.

UK – Gradual easing in 2025 but lags will keep BoE cutting in 2026

Gabriella Dickens,
G7 Economist
Macro Research

Key points

- Growth looks set to accelerate into 2025 as monetary and fiscal policies ease. But the recovery in household consumption will be muted, as saving remains high
- The Budget's tax increases will keep inflation above target across the forecast horizon. But a softer labour market will push wage growth lower
- Stronger-than-expected growth and inflation reinforce our view that rates will be cut gradually. We look for a 25-basis point cut each quarter

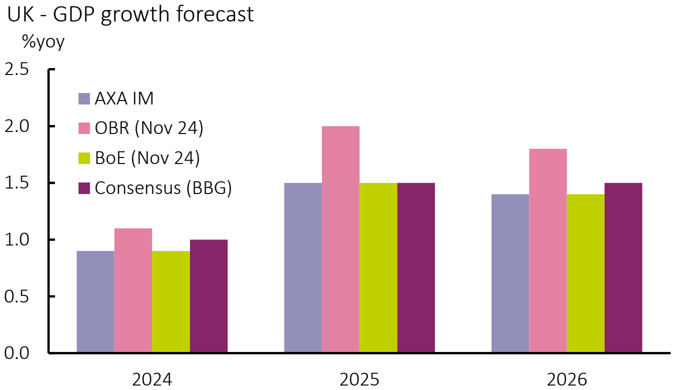
The UK economy recovered strongly in the first half of 2024 after a technical recession in late 2023. But momentum fell back to trend in the second half of the year, as exceptionalism faded, uncertainty rose in the run-up to the Budget and yields rose. We see growth accelerating into 2025, largely on the back of policy support with the Budget underpinning around a 4% rise in government consumption next year. In contrast, the recovery in household spending looks set to remain sluggish, with the saving rate likely to remain well above pre-pandemic norms. Unlike the Office for Budget Responsibility (OBR), we see few reasons to expect a marked acceleration in spending, with the Budget re-enforcing our view the Bank of England (BoE) will reduce interest rates only gradually. This, along with the hike in employer National Insurance contributions (NICs), is likely to weigh on wage growth and employment. A degree of scarring is probably also keeping households cautious, given the size of the shocks experienced since the turn of the decade.

We see growth rising to 1.5% in 2025, well below the OBR's 2.0% forecast (Exhibit 9). Further ahead, with public spending growth easing in 2026 and private spending likely to offset only part of that, we expect growth to slow to 1.4%. If growth comes in below the OBR's forecasts, as we anticipate, the government is likely to be forced to increase either borrowing or taxes again in 2026, to cover the shortfall in tax receipts.

The recent surge in net migration will ease in 2025 and 2026, due to stricter policies, causing labour supply growth to ease. But labour demand will be modest at best; private sector firms already have enough staff to respond to a modest pick-up in demand, as the tight labour market reduced staff turnover recently. We see the unemployment rate rising to 4.5% by end-2025 and 4.6% by end-2026. As such, wage growth looks set to slow; we look for growth of 3.7% in 2025 and 3.3% in 2026. Note the 6.7% National Living Wage hike in spring 2025 will have a marginal impact as low-pay firms, such as Amazon and most major supermarkets, already pay above the National Living Wage and are less likely to pass on the full hike than in 2024, given the softer labour market.

CPI inflation, meanwhile, fell back to target midway through 2024 but a smaller drag from energy prices pushed it back up in October, and we see it rising to 2.5% by year-end. The headline rate will likely remain around this level throughout 2025, averaging 2.5% for the year. Tax changes outlined in the recent Budget – including the VAT on school fees and alcohol and tobacco duties – should add around 10 basis points (bp) to the outlook, while indirect impacts from the additional fiscal announcements, possibly including the pass through from higher employer NICS, will add to price pressures. We see inflation slowing to 2.2% in 2026, as the impact from the Budget eases and labour market conditions continue to soften, pushing down on wage growth and possibly profit margins.

Exhibit 9: We think the OBR is too optimistic on growth



Source: ONS, BoE, OBR and AXA IM Macro Research, November 2024

The BoE cut its key policy rate at its August and November meetings, leaving Bank Rate at 4.75%. We think it will maintain this pace of easing throughout 2025, in line with its belief the UK economy requires a degree of economic slack to normalise pay and price-setting dynamics fully. Stronger-than-expected growth and inflation following the Budget and uncertainty surrounding how firms will handle the rise in employer NICs – firms could either raise prices, limit wage hikes, reduce employment or absorb the costs – means the BoE is keen to take time to see how these factors play out.

On balance, we forecast four 25bp cuts in 2025 – one per quarter – leaving Bank Rate at 3.75% by year end. In 2026, modest consumption growth will likely lead to excess supply opening up earlier than the BoE anticipates, exacerbated by our expectation of a material slowdown in the US. As a result, we think there is scope for additional cuts in 2026, whereas the market has Bank Rate broadly flat from the end of next year; we look for one additional cut in Q1, leaving Bank Rate at 3.5%.

Canada – reducing spare capacity

David Page
Head of Macro Research
AXA IM Macro Research

Key points

- 2024 growth appears to have slowed to 1.1% and CPI inflation to 2%. The BoC cut rates towards neutral
- In 2025, BoC cuts should boost consumer spending with US growth helping GDP quicken to 2.1%
- Excess capacity should narrow as potential growth also slows and we expect the BoC to leave policy at 2.25% from March despite inflation forecast at 1.7%
- Growth in 2026 is likely to be impacted by a US slowdown; we forecast growth of 1.7% and the BoC resuming rate cuts to 2.25% by year-end

Canada's GDP looks set to rise by 1.1% in 2024, in line with our view since April but quicker than forecast a year ago. Inflation has fallen faster with the headline at 2.0% and the core median rate at 2.4% – above target but much closer than we expected a year ago. This allowed the Bank of Canada (BoC) to ease policy faster than expected; it is forecast to end 2024 with a final 0.50% cut in its policy rate to 3.25%, 100 basis points (bp) more than we anticipated a year ago. The BoC estimates an output gap that reached 1.3% of GDP by mid-2024 as subdued growth fell short of a potential rate it estimates between 2.1-2.8%. It sees this adding disinflationary pressure. The BoC has been easing policy closer to neutral (estimated 1.75-2.75%) to close the gap and anchor inflation around target (Exhibit 10).

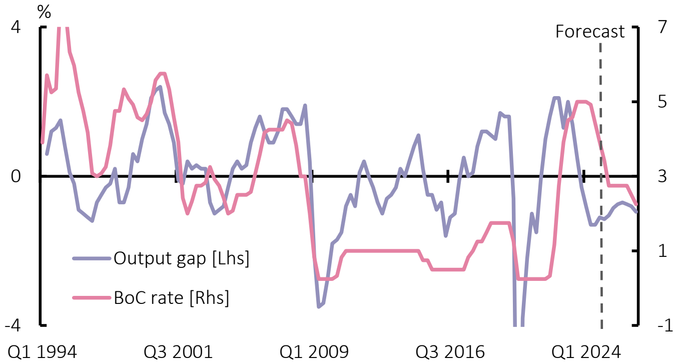
A number of factors should help narrow the output gap across 2025. First, we forecast growth to accelerate next year. There is some evidence the fast pace of BoC easing has underpinned a revival in consumer confidence and started to firm retail activity. Indeed, with the fading impact of the mortgage rate increase into 2025, the BoC's cuts should soften the mortgage conditions headwind, while more subdued inflation should firm real disposable income growth. We remain cautious about business and residential investment outlooks. Yet we now forecast GDP growth accelerating to 2.1% in 2025.

This would not close the output gap alone but the BoC estimated a slowdown in potential growth to 1.1-2.4% in 2025 as temporary migrant workers fall and a more recent restriction to target 1.1m total migration between 2025-2027 should slow it further. Alongside our own weaker productivity estimates, these suggest potential growth towards the lower end of the BoC's range, indicating less excess supply and tempering cuts.

Inflation has fallen faster than we forecast reflecting globally familiar combinations of improved supply conditions, labour matching and energy markets. Inflation is on track to average 2.4% in 2024, but we expect this to fall further into next year, to average 1.7%, before rising to 1.9% in 2026.

Exhibit 10: BoC policy governed by output gap assessment

Output gap and BoC policy rate



Source: BoC, StatCan, Refinitiv and AXA IM Macro Research, November 2024

As such we expect the BoC's enthusiasm for policy cuts to fade early next year. We forecast the BoC to slow cuts to a 0.25% clip in early and expect it to stop cutting at the upper end of its neutral rate assessment – at 2.75% in March – as it recognises improvement in activity following its prompt easing, wary of the lags in monetary policy.

External developments are likely to be key, none more so than the US elections. The new US administration is likely to see a series of measures that further restrict the BoC's space to ease policy further. US tariffs, which we expect to exclude Canada, should further boost spillovers of persistent solid US GDP growth into 2025. Moreover, a weaker Canadian dollar – currently around 20-year lows – should limit BoC divergence from the Federal Reserve.

Canada also faces its own election. While Prime Minister Justin Trudeau's minority Liberal government could fall earlier, an election must be held by October 2025. Current polling suggests right-of-centre Conservatives led by Pierre Poilievre would emerge as the new government. Parties have not published manifestos but concerns about social spending would make a shift in the tax and spend balance likely, which could add headwinds to the 2026 growth outlook.

We expect growth momentum to soften in 2026, largely on the back of a slowing US economy and we forecast Canadian GDP growth of 1.7%. An externally led slowdown, with the economy still exhibiting spare capacity is likely to prompt the BoC to resume easing and we expect the policy rate to close 2026 at 2.25%.

Japan – Further hikes on the cards in 2025, but 2026 will mark the end

Gabriella Dickens,
G7 Economist
Macro Research

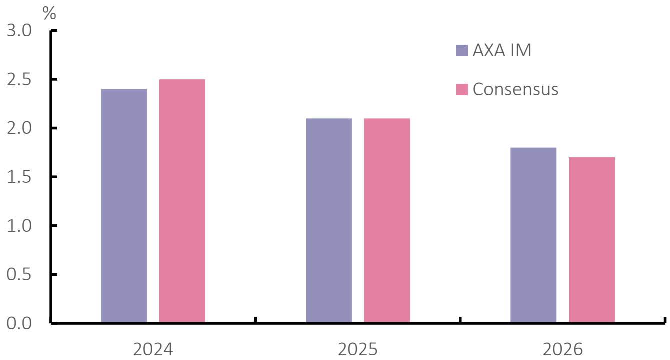
Key points

- Japan appears to have turned a corner on deflation: the virtuous wage/price spiral has taken hold this year and inflation expectations have risen
- Growth should accelerate in 2025, as a fiscal injection and increased higher income tax thresholds bites. However, household spending will remain limited by ongoing consumer caution
- The BoJ will likely hike twice more by end-2025 to 0.75%, but then be forced to halt policy normalisation through 2026, as both growth and inflation ease

Japan appears to have closed the door on deflation in 2024, with a virtuous wage/price spiral appearing to take hold. Indeed, the 2024 Shunto wage negotiations resulted in a 3.6% increase in base pay and a 5.17% rise in total pay, well above the average of the previous 10 years – 0.9% and 2.6%, respectively. Businesses also showed they were willing to pass on higher costs. While the headline inflation rate bumped about throughout the year due to the removal and reimposition of energy subsidies, the underlying inflation rate – which excludes fresh food and energy – is on course to average 2.4% this year (Exhibit 11). Prices in the labour-intensive services basket also showed signs of picking up.

Exhibit 11: Deflation in the rearview mirror

Japanese CPI inflation ex. fresh food and energy



Sources: Bloomberg and AXA IM Macro Research, November 2024

A similar result likely will emerge next year, with Rengo – the key union – setting its target for total pay at 5% for large firms and "over 6%" for small and medium businesses. While the slowdown in inflation across 2024 means the risks lay to the downside for this settlement, we see scope for a structural rise in wages over the coming years. Dwindling labour supply amid an ageing population should increase bargaining power, while rising inflation expectations among households and businesses should pave the way for larger pay rises in the coming years. We look for a rise in base pay of around 3% in 2025 and 2026. With wage gains staying elevated, growth above trend and the yen staying around the ¥150-mark, underlying inflation looks set to average 2.1% next year. More generally, though, estimates suggest that consistent 3% pay rises each year – feasible given labour supply constraints are unlikely to abate soon – are probably consistent with underlying inflation of just below 2%. Combined with expectations of an appreciating yen in 2026, this means CPI inflation excluding fresh food and energy will likely ease to a little below target at 1.8% in 2026.

Japan's economy is on course to decline by 0.3% over 2024 as a whole. Factory shutdowns in the auto sector due to concerns over safety signoffs weighed heavily on Q1 growth and inventories and net trade knocked 0.2 percentage points (ppt) and 0.6ppt off quarterly growth in Q2 and Q3, respectively. After a weak start, household spending has started to ramp up, helped by a rebound in real incomes, while strong growth in corporate profits has supported an increase in capex.

Looking ahead, the new government's ¥39tn fiscal package will underpin just around a 0.6% increase in government expenditure in 2025. The expected income tax threshold increase and minimum wage should support a further modest recovery in private consumption. Note, though, that growth in household spending will be limited by weak confidence; at least some of the real income increase will most likely be saved. A further increase in profits, meanwhile, as nominal GDP growth remains on an upward path, and the growing need to invest in technology to replace a declining workforce will keep investment ticking over. Yet, our expectation of a material slowdown in the US in 2026 would hit net trade, while higher borrowing costs would lead to a slowdown in private investment and consumption. We look for growth of 1.1% in 2025, before slowing to 0.9% in 2026.

With the virtuous wage/price spiral broadly embedded and growth slightly above trend in 2025, we expect the Bank of Japan (BoJ) to maintain its policy normalisation path, with 25 basis point hikes in December this year and September 2025, after Upper House elections in July. But we think the BoJ will be forced to halt policy normalisation there. With tariffs and reduced labour supply expected to lead to a material slowdown in the US in 2026 and the Federal Reserve beginning to ease policy again, pressure on the yen looks set to reverse, putting downward pressure on inflation in the medium term, while slowing growth will muddy the domestic picture. We think the BoJ will maintain its key policy rate at 0.75% throughout 2026.

4 December 2024

China – Consumers key to breaking the deadlock

Yingrui Wang
Economist (China)
AXA IM Macro Research

Key points

- China is set to hit its 2024 growth target of "around 5%" at 4.9%, despite a bumpy year
- A managed economic slowdown is expected over the next two years, supported by stimulus measures to address a weak labour market and falling property prices. Rising external risks, particularly from the US, may also weigh on the economy
- We project growth of 4.5% in 2025 and 4.1% in 2026, with a gradual reflationary trend, seeing average CPI inflation at 1.0% and 1.6% respectively

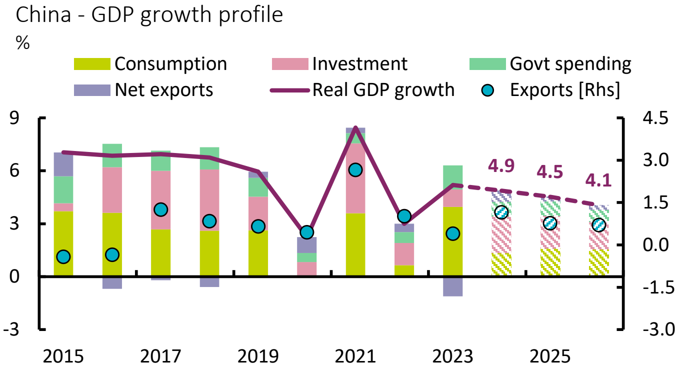
Another bumpy journey to target

For China, achieving its annual economic growth target remains the central performance measure for officials at all levels. The economy was well on track to meet 2024's goal of "around 5%" by the end of the first half of 2024, largely due to robust momentum from state-led investment. However, this positive trajectory was disrupted as local governments, perhaps overconfident from initial progress, or constrained by mounting debt pressures, slowed investment at the start of the third quarter. This decision triggered a broad-based economic slowdown. In response, Beijing reiterated its commitment to the growth target, and the central bank implemented stronger-than-expected monetary easing measures in late September. As a result, the economy now seems poised to meet this year's growth objective.

Looking back, 2024's bumpy path evokes a sense of *déjà vu*. The post-pandemic reopening boost provided a strong start to growth in the first half of 2023. Yet, policy support fell short of sustaining that momentum as the reopening effect waned. To stabilise growth, Beijing was compelled to unleash additional stimulus in October, including a rare mid-year budget adjustment that benefitted infrastructure investment. Ultimately, the economy managed to achieve its target, expanding by 5.2%.

Many of the economic obstacles faced in 2024 carried over from 2023 and have since deepened further. To avoid a more material slowdown as domestic obstacles and external pressures look set to mount, China will remain heavily reliant on policy support. We foresee an ongoing need for additional fiscal stimulus and a shift in focus for its delivery – from production to consumer demand-centric. Assuming this, we predict a managed economic slowdown is ahead for China's economy, forecasting growth of 4.5% in 2025 and 4.1% in 2026 (Exhibit 12). However, with Donald Trump's return to the White House amplifying external risks and an already fragile domestic economy, a debt-deflation trap leading to a generational downturn could be perilously close if upcoming stimulus measures are delayed or misdirected.

Exhibit 12: Growth profile of China's economy



Source: CEIC and AXA IM Research, November 2024

Troubled consumers drag on the economy

Chinese consumers continued to struggle in 2024, as the triple impact of declining wealth, stagnating incomes and limited policy support underpinned entrenched pessimism.

Property prices continued their unprecedented adjustment, with average home values falling by 15% from their peak in the summer of 2021 – five percentage points (ppt) in 2024 – approximately a third of the total correction we estimated[3]. The shrinking value of property assets – where Chinese households have historically concentrated most of their wealth – has placed significant strains on domestic consumers. This compounded the fading post-pandemic reopening momentum in the labour market, further dampening consumer spending. Although headline unemployment figures indicated a mild improvement from 2023 levels, they provide limited insights into broader labour market dynamics. Wage growth throughout 2024 was particularly lacklustre. Following divergent trends in 2023, 2024 saw even lower-income earners face stalling wages. The pervasive slowdown in wage growth,

[3] Wang, Y., "Brick by Brick: Unravelling China's property Puzzle", AXA IM Research, May 2024

combined with a pessimistic income outlook has led consumers to become increasingly cautious in their spending habits.

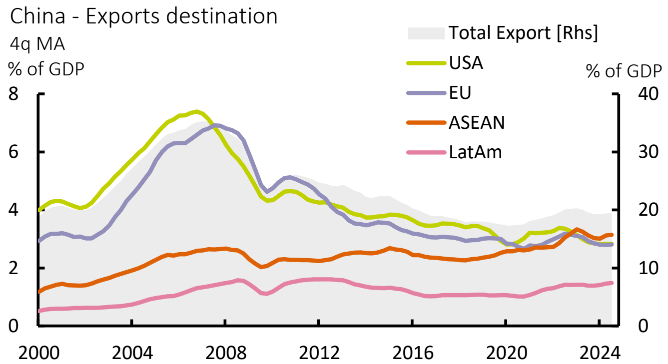
Moreover, Beijing's policy focuses on largely overlooked household demand for much of the year. It was not until Q3 2024 that the government began to acknowledge subdued household spending and rising deflationary risks, though substantial quantitative measures were still lacking. As a result, a robust recovery in domestic demand is yet to emerge, as reflected in persistently low consumer confidence levels.

Stronger headwinds from abroad

By contrast, Chinese exports have maintained a good momentum, particularly since the second quarter of this year. This in part stemmed from front-loading demand, as foreign importers sought to avoid potential higher tariffs on Chinese goods as the US, the European Union, Canada and Indonesia all raised tariffs on Chinese goods in 2024. However, Trump's return to the White House once again threatens a more hostile external environment for China.

We do not anticipate Trump's proposed 60% blanket tariff on Chinese imports being fully implemented. During his 2016 campaign, despite his calls for a 45% tariff on Chinese goods, only 37% of the claim was ultimately enacted. The resulting decline in China's exports to the US cut China's GDP growth by 0.6ppt, including the partial offset from currency devaluation – the Chinese yuan depreciated 5.2% against the US dollar. In Trump's second term, we foresee a similar materialisation rate for the tariff policy relative to his campaign rhetoric. This would suggest a comparable tariff rise to that seen in the 2018-2020 period, with a similar impact on China's GDP, assuming similar currency adjustment behaviours.

Exhibit 13: Trade diversion underway



Source: CEIC and AXA IM Research, Novemeber 2024

China has diverted its exports to other markets outside the US (Exhibit 13), and its integration into key global supply chains has deepened compared to 2018. These factors should offer some buffer against future potential US-China trade disruptions. It is worth noting the US's broader trade policies with other countries could also have implications for China's exports—harsher US trade stances globally may somewhat mitigate Chinese goods' loss of competitiveness. Overall, we estimate that Trump's anticipated trade policies will shave 0.3-0.5ppt off China's GDP, although a large degree of uncertainty surrounds these projections.

Domestic spending may be the last resort

China's investment-driven and export-supported growth model, which was instrumental in the nation's remarkable growth over the past three decades, has long been a cornerstone of its economic policy. However, the conditions that once underpinned this success have shifted significantly. Although the recently announced RMB 10trn multi-year debt swap programme aims to alleviate mounting local government debt pressures[4], returns on investment have diminished, constraining their ability to sustain expansion. Moreover, the golden era of infrastructure growth has slowed, reflecting the plateauing of urbanisation and a cooling housing market. While exports have transitioned to higher-value, technologically advanced goods, escalating trade tensions and shifting geopolitical dynamics present growing obstacles.

This places greater emphasis on China's households, which hold substantial growth potential due to one of the world's highest saving rates. With the right policies to revive the labour market and stabilise the property sector, a portion of these savings could be unlocked, albeit rebalancing the economy to a consumption-driven growth will take time. Beyond recent challenges, the elevated savings rate stems from an incomplete and limited social safety net, underscoring the critical need for structural reforms. Implementing such reforms could take decades, and it remains uncertain whether the government is willing to undertake such a transformative agenda.

We consider a revival of domestic demand through household-focused stimulus as the most viable path to achieving a managed slowdown and avoiding a pernicious economic downturn. The National People's Congress meeting in March next year looks the most likely juncture for additional stimulus. In the interim, authorities may also encourage state-owned enterprises to support employment and promote better wage growth. It would not only help facilitate a gradual slowdown in China's economic growth over the coming years but could also underpin a modest rebound in consumer prices. Alongside the support from a weaker yuan, we forecast inflation to rise from near deflation this year to 1.0% in 2025 and 1.6% in 2026.

[4] Wang, Y., "Bonds, Bridges, and Burdens: China's Local Government Debt in Focus", AXA IM Research, October 2024

Emerging Markets – Resilience to be tested

Irina Topa-Serry,
Senior Economist (Emerging Markets),
AXA IM Macro Research

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

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

Key points

- Emerging market growth steadied in 2024 while inflationary pressures were broadly contained
- The external environment presents major challenges, given the outlook for greater US protectionism and China's continued slowdown
- Top-line growth forecasts show the 2025-2026 expansion rate below trend with risks weighted to the downside
- Consumer demand is likely to be resilient but investment could be hit by global trade uncertainty. Further monetary easing to support demand is likely to be constrained in some economies
- There is little fiscal space owing to recent slippages and still elevated interest rate burdens in most emerging markets

Emerging markets (EMs) likely face a deteriorating external environment in 2025-2026, which will further test their resilience. EMs withstood a series of shocks over the past five years - the pandemic, an inflationary surge and 2022's terms-of-trade shock (higher energy and food prices). The prospect of greater US trade protectionism during Donald Trump's second term, as well as continued challenges facing China's policymakers in reviving their sluggish economy, present downside risks to EM economic growth. We see risks on the downside for oil prices – reflecting increased supply, Trump's deregulation agenda and global growth deceleration – but geopolitical tail risks in the Middle East could trigger a temporary spike in oil prices. Trump has pledged to end the Ukraine war but the terms of a resolution could have consequences for security arrangements for EM Europe, requiring an expansion in defence spending at a time when debt ratios and interest rate payments are elevated.

Against this backdrop, policymakers across EMs will continue to need to deliberate over decisions that prepare for, or react to, changes beyond their control, while adjusting monetary and fiscal policy to support domestic demand without risking a reacceleration in inflation or generating fiscal crises.

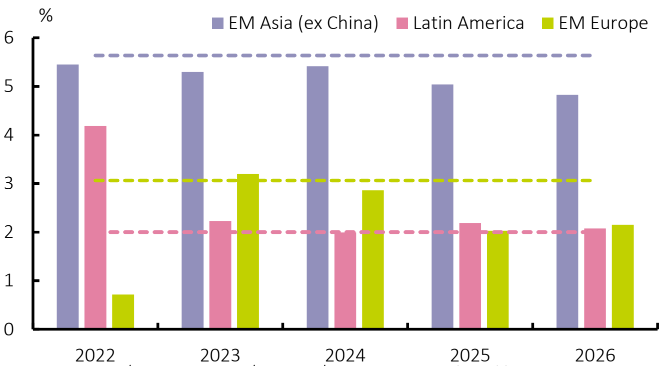
Numerous new governments have been formed over the past year across EMs and this provides the opportunity for meaningful reform agendas to be implemented. But success in driving up investment will be as much about avoiding policy mistakes as it will be about delivering structural reforms to improve competitiveness and productivity.

Back on an even keel but choppy waters ahead

EMs have enjoyed broad success in terms of getting economic growth back on trend in the past year while containing inflation. However, the EM growth path could yet shift dramatically off course as external headwinds ramp up.

Exhibit 14: Growth outlook

Real GDP growth



Source: IMF and AXA IM Research, November 2024 **dotted lines 2010-19 average*

The top-line forecast for growth in 2025-2026 reflects an expectation that the pace of expansion in EMs will maintain a degree of resilience in the face of external challenges (Exhibit 14). This will mostly be reliant on private consumption growth, with recent cuts in interest rates and sizeable real income gains (reflecting disinflation and resilient labour markets) providing some scope for increased spending in 2025. However, room for further monetary easing or fiscal loosening is limited. Investment growth will be hindered by heightened uncertainty over US trade policy. Although it may take time for tariffs to be enforced and the direct impact to the registered, the indirect impact on investment will be evident heading into 2025, as plans are potentially delayed or put on hold until a clearer picture emerges on Trump's policies.

Our central scenario is one of US tariffs being introduced at around one-third of the promised magnitude of 60% on China and 10% on all other imports. But even at this level, higher tariffs will weigh heavily on EM export performance, with the larger open economies struggling to expand at trend level – with risks of a broader trade war. The larger domestic-oriented economies, such as India and Indonesia, should fare better but any major disruption to global trade and capital markets will still have an impact.

There will be idiosyncrasies that will generate positive growth outcomes in some markets, offsetting weakness elsewhere. Argentina, for example, could post growth of close to 5% a year in 2025-2026 as its economy recovers from the contraction recorded in the past two years, provided the stabilisation programme is not derailed. Colombia's GDP growth is also expected to accelerate from 2024's lows as its domestic demand heals thanks to an easing from very tight domestic financial conditions. That will prop up the regional average, despite anticipation of growth deceleration in Brazil and Mexico. Turkey's economic growth is also set to pick up in 2026 on the basis that the benefits of the current orthodox monetary policy will be reaped, with massive interest rate cuts expected in 2025 underpinning a rebound in growth in 2026.

EMs caught in tariff crossfire

Trump's resounding success in the US presidential election gives him a solid platform to deliver on his "America First" policies by hiking tariffs as soon as he takes office. China will face the brunt of this protectionism, with 60% tariffs threatened, but a proposed blanket 10% tariff on all US imports would have a far-reaching impact on EMs. However, higher tariffs on China's goods could potentially benefit its competitors, particularly manufacturers in EM Asia that have struggled to compete with China on price. Yet any benefit will depend on the extent of the likely yuan depreciation.

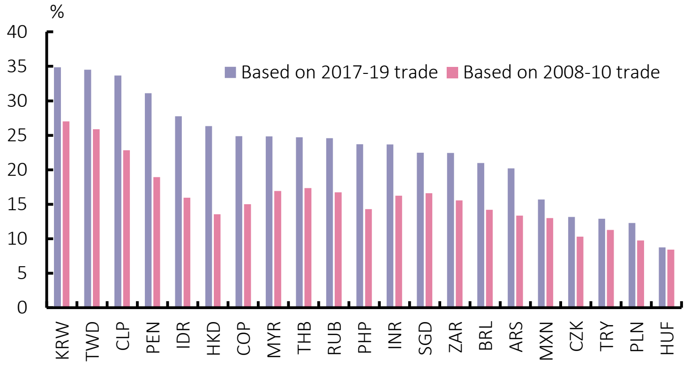
Although China's significance as an export destination for EMs has been limited recently by weak domestic demand, China still accounts for a large share of many EM exports, such as for Chile (39% of its exports in 2023), Brazil (31%) and Indonesia (22%). Much of this comprises commodities and raw materials as well as intermediate goods that ultimately feed into Chinese industrial production and manufacturing exports. Thus, any constraints on China's exports will negatively hit EM suppliers.

To compensate for any shrinkage in US demand following a potential hike in tariffs, Chinese exporters could redirect these goods to other markets. Fearing a surge in low-cost Chinese imports undermining the competitiveness of domestic suppliers, EMs could attempt to erect new, or raise existing, trade barriers to China. Indonesia has already taken such steps. But this risks retaliatory measures from China, which accounts for a relatively large share of EM imports and increasing foreign direct investment (FDI) flows into South-East Asia.

With the prospect of further yuan devaluation compounding these potential changes in EM-China trade dynamics, EM currencies are also likely to come under broader pressure, which would increase the vulnerability of those reliant on imports or with significant US dollar debt. The yuan now accounts for a much greater weight in the currency baskets for EMs' effective exchange rate indices (Exhibit 15).

Exhibit 15: Increasing vulnerability to yuan movements

Effective exchange rates, CNY weighting



Source: BIS and AXA IM Macro Research, November 2024

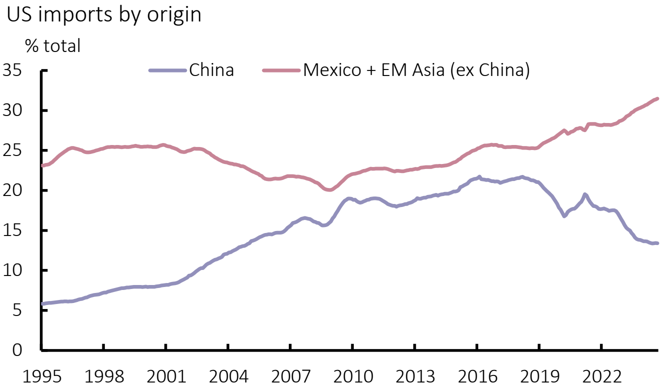
Supply chain rewiring supports investment in EM

Since the start of the US-China trade war during Trump's first term, there has been a major reconfiguration in supply chains delivering goods to the US. In early 2018, China accounted for close to 22% of US imports, but by mid-2024 its share had dropped to 13% (Exhibit 16). Other EMs have replaced China, notably South-East Asian markets, such as Vietnam and Malaysia, as well as Mexico. Other factors have also been at play, but a key contribution to this shift has been the rerouting of Chinese goods via these other markets. Initially, this may have taken the form of minimal additional processing by manufacturers and traders in these markets, but more recently the supply chain rewiring also reflects a shift of Chinese manufacturing capacity into these markets. This has also been taking place in EM Europe, where China's investment in electric vehicle (EV) manufacturing in Hungary, for example, has come at a time of EU tariff hikes. Moreover, an increase in total FDI to South-East Asia and Latin America, while that to China has fallen, is a broad indicator of how investment has shifted away from China to EMs as part of 'China+1' strategies. This could find renewed impetus with Trump's plan to hike tariffs on exports out of China.

However, there will be a wariness in US trade policy cracking down on any circumvention of its tariffs. This has already been the case under President Joe Biden. In August 2023, a US Department of Commerce inquiry found Chinese producers were shipping solar products through South-East Asian markets for minor processing to avoid paying anti-dumping and countervailing duties.

Trump may not concern himself with such inquiries before imposing hefty penalties. When campaigning, he stated he would impose a 100% tariff on Chinese-produced EVs from Mexico, despite the US-Mexico-Canada Agreement (USMCA) trade deal. The USMCA is up for review in July 2026, and this will no doubt have a focus on dealing with China's investment in Mexico. Ahead of this, Trump will likely use threats of tariffs and a tougher trade deal to secure a favourable outcome for his administration on its China and immigration policies.

Exhibit 16: EMs taking a greater share of the US market



Source: LSEG Datastream and AXA IM Macro Research, Nov 2024

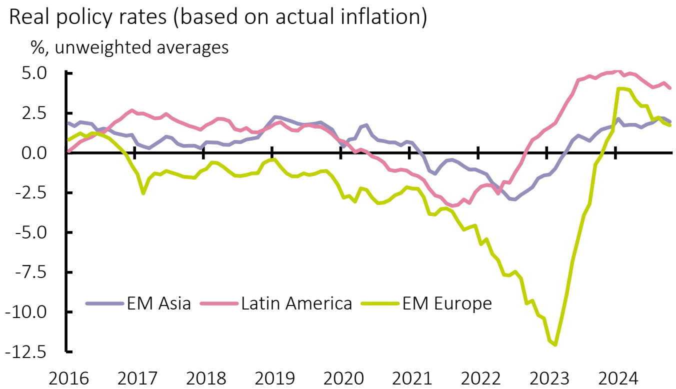
Others that have seen trade surpluses with the US widen in recent years also face the risk of a protectionist response from Trump. This is most pronounced for South Korea and Taiwan, which continue to drive technology exports, with strong demand for semiconductors as investment in artificial intelligence (AI) continues on an upward trend. There is also a security element to US relations with Taiwan and Korea. A harbinger of more complicated US-Taiwan relations was Trump's comments in July that Taiwan should pay the US for protection from China, while also bemoaning Taiwan's dominance in the global semiconductor trade. Meanwhile in his first term, Trump accused South Korea of free-riding on US security support (in relation to North Korea) and renegotiated the Korea-US Free Trade Agreement.

EM central banks more cautious on rate cutting

Irrespective of the US election outcome, EMs were already facing the prospect of a slowdown in the US, Eurozone and China. Following Trump's election victory, our central scenario sees US growth slow to 2.3% in 2025 and 1.5% in 2026 from 2.8% in 2024, while China's GDP growth is forecast to decelerate to 4.5% and 4.1% respectively in 2025 and 2026, from 4.8% in 2024. The Eurozone will likely remain sluggish, with growth rising to just over 1% in 2025-2026. Given this weak external environment, EM domestic demand will need a boost. Private consumption growth has stayed above pre-pandemic rates for most EMs but its contribution to overall GDP growth across EMs has been falling back steadily from the post-pandemic recovery highs. Given the weaker external environment, the challenges for policymakers will be to utilise fiscal and monetary tools to deliver support for their domestic economies without risking renewed inflationary pressure or worsening fiscal positions to the point of raising investor concerns over debt-servicing risks.

With inflation generally falling back to – or closer to – target, most EM central banks have been cutting rates (with the notable exception of Brazil) and easing cycles are now well underway. Yet real rates based on short-run inflation expectations still stand well above estimated neutral rates in countries such as Mexico, Colombia, Brazil, South Africa, Hungary, Peru and the Czech Republic. The 'last mile' on inflation may still prove difficult for some key EMs in Latin America and Europe given sticky services inflation. But a less restrictive monetary policy stance is likely given slowing growth and inflation across most EMs (Exhibit 17).

Exhibit 17: Real policy rates still relatively high[5]



Source: LSEG Datastream and AXA IM Macro Research, November 2024

But EM central banks will also be mindful of financial stability risks, including fiscal risks (which have led Brazil's central bank to embark on a tightening cycle) and external risks. The inflationary impact of Trump's tax, trade and immigration policies will make the Federal Reserve more cautious in cutting rates in 2025 and the US dollar remain strong. In turn, elevated US yields and a strong US dollar may delay monetary policy easing in EMs and keep the policy stance restrictive for longer. India is likely to be one of the last of the major EMs globally to start easing monetary policy as domestic demand proves resilient. The Reserve Bank of India's decision at its October meeting to shift its liquidity stance to neutral from "removal of accommodation" foreshadows an eventual rate cut, but we

[5] EM Asia – Korea, Taiwan, India, Indonesia, Malaysia, Thailand, Philippines; Latin America – Mexico, Brazil, Colombia, Chile, Peru; EM Europe – Poland, Czech Republic, Hungary

expect it to stay focused on getting inflation down sustainably within target, which could mean a shallow rate cutting cycle.

Limited scope for fiscal loosening

Fiscal space is limited across EMs, with government debt ratios and borrowing costs having risen over recent years. At worst, attempts to deliver measures to stimulate demand may backfire, as wider deficits trigger debt sustainability concerns and force higher rates, with negative effects on growth and debt servicing capacity. As developments in Brazil highlight, the future path of monetary and fiscal policy is intertwined, with fiscal activism in Brazil driving up inflation expectations, leading an inflation-targeting central bank to hike rates. Similarly, in Mexico, the space for the central bank to continue its so far gradual monetary easing is contingent on the government's success in bringing down its deficit. Mexico's new government has planned to reduce the deficit to 3.9% of GDP in 2025, from an estimated 5.9% in 2024 but this is based on optimistic forecasts for growth and oil production.

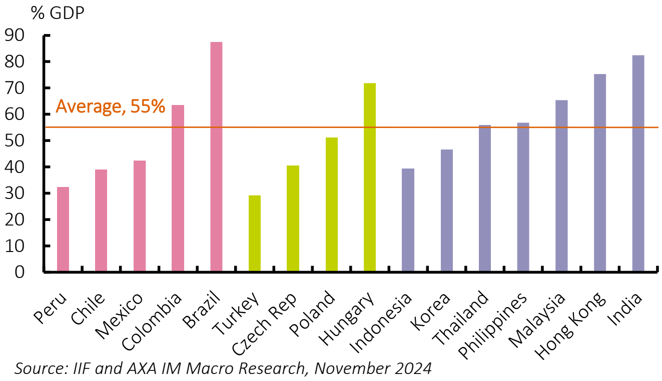
With fiscal consolidation delayed, EMs have failed to regain fiscal space. This year was another disappointing period for fiscal discipline across EMs. The International Monetary Fund's (IMF) recent *Fiscal Monitor* shows the cyclically-adjusted general government primary deficit for EMs in 2024 widened further by 0.1% to 3.6% of GDP, well above the 2.7% deficit in 2019. Rather than being primed to deliver fiscal support, EMs overall are focused on fiscal tightening in 2025 and 2026 to restore credibility. This is notable for Mexico and Turkey, where a large fiscal consolidation effort is expected. In Turkey, tolerance for lower growth will be key if macroeconomic stability is to be preserved, as fiscal policy needs to cooperate with monetary policy to achieve a sustained reduction in inflation. In Mexico, the planned fiscal tightening, mostly through spending cuts, will weigh on domestic demand and growth at a time of a deteriorating external environment.

India's deficit is on a gradual reduction path, but the combination of high government debt (82% of GDP as of mid-2024) and a wide deficit places it alongside Brazil as among the most debt-constrained large EMs (Exhibit 18). This may be less of a concern for India given its outlook for high nominal GDP growth, but Brazil is heading into a more challenging period. Although trend growth has improved, a marked improvement in Brazil's primary fiscal position is necessary to start reducing its debt burden, an outcome that is challenging given the fast growth in mandatory expenses.

Thailand is one of the few EMs that has already planned to run a wider deficit in 2025, with the cyclically adjusted deficit set to increase to 3.9% of GDP in 2025 from 2.5% in 2024, according to the IMF. The Thai economy has been particularly weak since the pandemic, and the Prime Minister, Paetongtarn Shinawatra, who came to office in August 2024, is pushing through a spending programme featuring cash handouts to try to drive up consumption. Although Thailand's government debt-to-GDP is not excessive (56% as of mid-2024), household debt is among the highest of EMs at 91% of GDP, which may limit the impact of fiscal stimulus.

Exhibit 18: Lack of fiscal space most evident in India and Brazil

Government debt, Q2 2024



Source: IIF and AXA IM Macro Research, November 2024

Structural reforms bring rewards

Structural reform has not been high on the policy agenda since the pandemic, and given the forthcoming expansion in US protectionism, EM policymaking will continue to be impacted by external developments and changes beyond countries' control. However, with only a small number of elections taking place in 2025-2026, and many new governments receiving new or extended multi-year mandates in 2024, there is scope for meaningful reform with a longer-term view.

A few 'reform stories' have developed over the course of 2024 and are likely to bolster growth dynamics over time. The new government in South Africa is undertaking energy and logistics reforms, set to improve the supply side of the economy and raise its trend growth. Egypt has embarked on a structural reform agenda, which includes subsidy reductions, tax reform, privatisation and a more flexible foreign exchange regime, aimed at combining macro and fiscal stabilisation with higher growth. In Nigeria, subsidy reform and a more flexible foreign exchange regime implemented by President Bola Tinubu's administration since 2023 have started to bear fruit. In Argentina, President Javier Milei has liberalised product markets and implemented a sharp spending-based fiscal consolidation, which, together with a foreign exchange anchor, has driven a massive reduction in inflation and set the stage for activity to recover.

Reforms that started in the late 1990s have contributed to some of the EM resilience of recent years, with central bank independence, financial market openness and exchange rate flexibility providing key buffers. But some of the more challenging, and potentially unpopular reforms, notably in terms of land, labour markets and tax, have been left on the back burner. For example, India has struggled to attract higher levels of FDI in recent years, which in part reflects the broad challenges that persist when doing business in India (despite recent liberalisation efforts and corporate tax cuts), as well as a failure to proceed with agriculture and land reforms. However, markets that have made progress have mostly been rewarded. In Brazil, for example, the IMF has revised higher its trend growth to 2.5% from 2%, partly on the back of the past fiscal reform to simplify the sales tax system and the 2016 labour market reform.

Growth prospects in EMs are also reliant on stable political environments or at least an avoidance of moves that destabilise or create uncertainty. Hungary has made no progress this year in unblocking EU funds that are still withheld owing to concerns over the rule of law. Relations between Hungary and the EU remain contentious. The prime minister, Viktor Orbán, has been in power since 2010 and will not face the electorate again until April 2026, but recent opinion polls showed a new centre-right party, Tisza, had overtaken Orbán's Fidesz, raising the risk of Orbán stepping up hardline anti-EU rhetoric. Hungary's current recession is the result of weak demand from Germany, specialisation in the automotive sector and tight macroeconomics policies. However, weak governance that has prolonged the standoff with the EU has prevented Hungary from funding public investment and taking advantage of growth opportunities in areas such as the green economy.

In Latin America, Mexican President Claudia Sheinbaum, who won a landslide victory in the June 2024 elections, is proceeding with her predecessor's judicial reforms (allowing judges to be elected by popular vote) and other constitutional reforms. These could dent the attraction of Mexico for foreign investment, jeopardise its 'nearshoring' potential and add to uncertainty in the scheduled USMCA review in 2026.

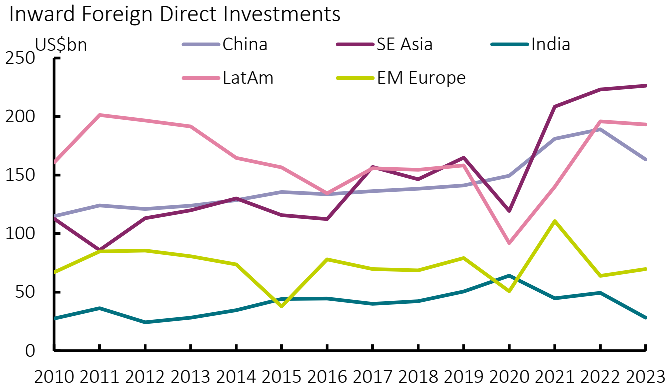
Reasons to be cheerful

A one-size-fits-all approach to assessing the outlook for EMs risks over-simplification but while few EMs will avoid the negative consequences of the worsening external environment, domestic demand resilience has improved and overall growth will broadly stay the course (albeit at a below trend rate for most EMs). There is clear downside risk in the event of Trump going all-out on his trade protection threats, or a broader trade war, but there are also still upside risks for EMs if his campaign pledges turn out to be little more than initial bargaining chips or if China makes progress in reflating its economy.

Among the positive EM growth stories is India, with its economy becoming more resilient over the past decade, and with Narendra Modi securing another five years in office in the 2024 elections, current investment-promoting policies should continue. This, combined with India's growing consumer market, should keep annual growth above 6%. Indonesia is also primed for continued growth of around 5% a year. In terms of its fiscal dynamics (low deficit and low debt), Indonesia's new government under Prabowo Subianto is relatively well-placed to take steps to support the economy, and spending on infrastructure and industrial policies aimed at driving up domestic value-add will continue.

Elsewhere in Asia, Korea and Taiwan have benefited from the boom in AI investment, with sales from their advanced semiconductor manufacturers driving a strong recovery in technology exports. While non-technology exports appear to be losing momentum, investment in AI is set to persist over the medium-term horizon, and this will have positive spillovers to technology manufacturers across the region.

Exhibit 19: Rising FDI in Southeast (SE) Asia



Source: UNCTAD and AXA IM Macro Research, November 2024

There is also the potential for continued growth in EM FDI (Exhibit 19), as manufacturers continue to shift supply chains away from China to avoid potential future US and EU protectionist measures. Although this will draw the attention of the Trump administration (and the EU) if Chinese firms are involved, the more competitive EMs could thrive as supply chains continue to be reconfigured. Those less so will be encouraged to embark on pressing but challenging reforms to attract FDI.

Although not yet a positive growth story, Argentina's 'shock therapy' reform agenda aims to unleash 'animal spirits' in the economy. Milei's initial package was diluted given his party's limited power in the legislature, but he has implemented structural reforms, including deregulation and labour market reform. Argentina will hold mid-term parliamentary elections in October 2025, which could provide a stronger footing for Milei to push forward with his reforms amid popular support that has remained surprisingly resilient so far.

Forecast summary

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	2.6	2.3	1.8	1.5	2.0
Euro area	0.8	0.7	1.0	1.2	1.3	1.4
Germany	-0.2	0.0	0.3	0.7	1.0	1.3
France	1.1	1.1	0.7	1.0	1.0	1.3
Italy	0.5	0.8	0.4	0.9	0.8	1.0
Spain	3.1	2.7	2.8	2.0	2.5	1.7
Japan	-0.3	0.0	1.1	1.2	0.9	0.9
UK	0.9	1.0	1.5	1.3	1.4	1.5
Switzerland	1.6	1.4	1.5	1.5	1.4	1.6
Canada	1.1	1.1	2.1	1.7	1.7	2.1
Emerging economies	4.1		4.2		3.9	
China	4.9	4.8	4.5	4.4	4.1	4.2
Asia (excluding China)	5.4		5.0		4.8	
India	6.9	6.8	6.6	6.6	6.5	6.6
South Korea	2.2	2.4	1.7	2.1	1.3	2.2
Indonesia	5.1	5.0	5.0	5.0	4.9	5.1
LatAm	2.0		2.2		2.1	
Brazil	3.0	2.9	1.9	2.0	1.8	2.2
Mexico	1.4	1.5	1.2	1.3	1.0	2.0
EM Europe	2.9		2.0		2.2	
Russia	3.6	3.5	1.3	1.6	1.2	1.3
Poland	2.5	3.1	3.1	3.7	2.7	3.5
Turkey	2.4	3.1	2.6	2.7	3.4	3.6
Other EMs	2.7		4.0		3.8	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 27 November 2024
**Forecast*

CPI Inflation (%)	2024*		2025*		2026*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	2.6		2.4		2.4	
US	2.9	2.9	2.8	2.2	3.2	2.3
Euro area	2.4	2.4	1.9	2.0	1.7	2.0
China	0.3	0.5	1.0	1.3	1.6	1.6
Japan	2.4	2.5	2.1	2.0	1.8	1.7
UK	2.5	2.5	2.5	2.3	2.2	2.0
Switzerland	1.2	1.2	1.2	1.0	1.4	1.0
Canada	2.4	2.5	1.7	2.1	1.9	2.1

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 27 November 2024
**Forecast*

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

		Current	Q4-24	H1-25	H2-25	H1-26	H2-26
United States - Fed	Dates	4.75	18-déc	29 Jan, 19 Mar 7 May, 18 Jun	30 Jul, 17 Sep, 29 Oct, 10 Dec	28 Jan, 18 Mar, 29 Apr, 17 Jun	29 Jul, 16 Sep, 28 Oct, 9 Dec
	Rates		-0.25 (4.50)	-0.25 (4.25)	unch (4.25)	-0.25 (4.00)	-0.50 (3.50)
Euro area - ECB	Dates	3.25	12-déc	30 Jan, 6 Mar, 17 Apr, 5 Jun	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 (3.00)	-1.00 (2.00)	-0.50 (1.50)	unch (1.50)	unch (1.50)
Japan - BoJ	Dates	0.25	19-déc	24 Jan, 19 Mar, 1 May, 17 Jun	31 Jul, 19 Sep 30 Oct, 19 Dec	Jan, Mar, May, June	Jul, Sep, Oct, Dec
	Rates		+0.25 (0.50)	unch (0.50)	+0.25 (0.75)	unch (0.75)	unch (0.75)
UK - BoE	Dates	4.75	19-déc	6 Feb, 20 Mar, 8 May, 19 Jun	7 Aug, 18 Sep, 6 Nov, 18 Dec	Jan, Mar, May, June	Jul, Sep, Oct, Dec
	Rates		unch (4.75)	-0.50 (4.25)	-0.50 (3.75)	-0.25 (3.50)	unch (3.50)
Canada - BoC	Dates	3..75	11-déc	29 Jan, 12 Mar, 16 Apr, 4 Jun	30 Jul, 17 Sep, 29 Oct, 10 Dec	Jan, Mar, May, June	Jul, Sep, Oct, Dec
	Rates		-0.50 (3.25)	-0.50 (2.75)	unch (2.75)	unch (2.75)	-0.50 (2.25)

Source: AXA IM Macro Research - As of 27 November 2024

Calendar of events 2025

2025	Dates	Events
January	1-Jan	US Debt limit suspension ends
	3-Jan	119th US Congress convences
	6-Jan	US Congress counts electoral votes
	20-Jan	US Presidential inauguration
February	10-11 Feb	AI Action Summit
	23-Feb	Germany federal elections
March	27-Mar	Global Trade Conference
April	25-27 Apr	World Bank Spring meeting
May	May	UK local elections
	May	Scottish Parliament elections
June	Jun	Poland presidential elections
	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
	20-Oct	US midterm elections
November	Nov	Brazil host COP30
2026	**Dates**	**Events**
February	5-Feb	New START Nuclear Treaty Expires
March	Mar	France Municipal elections
April	Apr	Legislative elections in Hungary
	16-19 Apr	World Bank Spring Meeting
May	1-May	Vietnam elections expected by this date
	15-May	Powell term as Fed Chair expires
June	22-26 Jun	International Economic Association World Congress 2026
July	1-Jul	First review of USMCA
October	Oct	Brazil elections
	16-18 Oct	World Bank Annual meeting
November	3-Nov	US midterm elections

Abbreviation glossary

1Q23	first quarter of 2023
1H23	first half of 2023
[Lhs]	left hand scale (graph)
[Rhs]	right hand scale (graph)
a.r.	annualised rate
ARS	Argentina Peso
AUD	Australian dollar
BEA	US Bureau of Economic Analysis
BIS	Bank for International Settlements
BLS	Bureau of Labor Statistics
bn	billion
BoC	Bank of Canada
BoE	Bank of England
BofA	Bank of America
BoJ	Bank of Japan
bp(s)	basis point(s)
BRL	Brazil Real
CAD	Canadian dollar
CBO	Congressional Budget Office
CEE	Central and Eastern Europe
CEEMEA	Central and Eastern Europe/Middle East/Africa
CHF	Swiss franc
CLP	Chili Peso
COP	Colombia Peso
CPI	Consumer price index
CZK	Czech Krona
DFR	Deposit facility rate
DM	Developed market
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EM(s)	Emerging market(s)
EMU	European Monetary Union
EPS	Earnings per share
ERP	Equity risk premium
ESM	European Stability Mechanism
ETF	Exchange-Traded fund
EU	European Union
EUR/€	Euro
Fed	US Federal Reserve
FFR	Fed fund rate
FOMC	Federal Open Market Committee
FRB	Federal Reserve Bank
FY	Fiscal Year
GBP/£	Pound Sterling
GDP	Gross Domestic Product
GFC	Global Financial Crisis
HKD	Hong Kong dollar
HUF	Hungary Forint
HY	High Yield
ICE	InterContinental Exchange
IDR	Indonesia Rupiah
IG	Investment Grade
IIF	Institute of International Finance
INSEE	French National Institute of Statistics and Economic Studies
IMF	International Monetary Fund
INR	India Rupee
ISM	Institute of Supply Management
JGB	Japanese Government Bonds
JPY/¥	Yen
LatAm	Latin America
mom	month on month
MPC	Monetary Policy Committee
MXN	Mexico Peso
MYR	Malaysia Ringgit
n.s/a	non-seasonally adjusted
NBER	National Bureau of Economic Research
NPL	non-performing loans
NOK	Norwegian krone
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
P/B	price-to-book ratio
P/E	price/earnings
PBoC	People Bank of China
PCE	personal consumption expenses
PEG	price/earnings to growth
PEN	Peru Nuevo Sol
PHP	Philippines Peso
PLN	Poland Zloty
PMI	Purchasing Manager Index
pp	percentage point
PPI	Producer price index
PPP	purchasing power parity
QE	Quantitative easing
qoq	quarter on quarter
RMB	China Renminbi (yuan)
RUB	Russia Rouble
s/a	seasonally adjusted
SGD	Singapore Dollar
SKW	South Korea Won
SWF	Sovereign Wealth fund
THB	Thailand Baht
TRY	Turkish New Lira
TWD	Taiwan Dollar
tn	trillion
UN	United Nations
UNCTAD	United Nations Trade and Development
USD/$	US dollar
yoy	year on year
ytd	year to date
WTO	World Trade Organisation
ZAR	South Africa Rand

4 December 2024

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

About AXA Investment Managers

AXA Investment Managers (AXA IM) is a leading global asset manager offering a diverse range of global investment opportunities in both alternative and traditional asset classes. Through our products we aim to diversify and grow portfolios, while delivering long-term investment performance and value for clients.

AXA IM manages approximately €859 billion in assets*, and has €480 billion of ESG-integrated, sustainable or impact assets**. Our purpose is to act for human progress by investing for what matters. As a responsible asset manager, we are committed to integrating ESG principles across our business, from stock selection to our corporate actions and culture.

Part of the AXA Group, a worldwide leader in insurance and asset management, AXA IM employs over 2,800 employees and operates from 23 offices in 18 countries globally**.

*As at the end of June 2024, including non-consolidated entities.
** As at the end of December 2023.

Visit our website: http://www.axa-im.com
Follow us on Twitter: @AXAIM & @AXAIM_UK
Follow us on LinkedIn: https://www.linkedin.com/company/axa-investment-managers
Visit our media centre: www.axa-im.com/en/media-centre

AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
Registered with the Nanterre Trade and Companies Register under number 393 051 826