26 June 2025

Investment Institute Macroeconomics

Fiscal anchors

Key points

- Intense air strikes between Iran and Israel and the US subsequent intervention has brought back geopolitics – through an oil price spike, as another layer of uncertainty for global growth.
- Monetary policy is pretty much pinned, either by supply shock to yet show in the data (the Fed), uncertainty (all of them), and/or the zero lower bound (the SNB).
- This implies that much of upcoming market action is to revolve around fiscal policy. We remain very cautious on the path forward for the US, but also in the UK and France. We are more comfortable with the situation in Japan, and even more so in Germany.
- Colombia, Romania, Poland, and Thailand are the emerging countries where key fiscal risks lie.
- Trade truce between the US and China limits growth downside risk, persistent deflation is an ongoing concern.

Global Macro Monthly

Fiscal anchors

Global Macro Monthly Summary June 2025

Francois Cabau
Senior Economist
Macro Research

Geopolitical tensions rachet up risks to growth

Following Israel's large-scale strike on Iran on 13 June, tensions escalated quickly between the two countries. On 22 June the US took the unprecedented step of bombing Iran's nuclear facilities. Given so far limited response from Iran, oil prices have eased from their peak and are, at the time of writing, only 7% higher than in the middle of May, from 20%) thanks to a – possibly fragile – ceasefire. Yet, tension in the Middle East could always flare up again, constituting another downside risk to global growth.

Prominent geopolitical risks also include a re-intensification of the Russia-Ukraine conflict as US peace efforts to date have gone nowhere. Yet, trade uncertainty has receded with a de-escalation of the US-China trade war following talks in London. Yet, the level of uncertainty remains daunting, especially after 9 July, when the reciprocal tariffs 90-day pause could elapse. A continuation of the talks – at least with the EU – beyond 9 July is likely and suggests the US would rather avoid unilateral action but this also means that European producers will have to endure further uncertainty on their US exports.

Following a large upside revision to Eurozone Q1 GDP growth (from 0.3% to 0.6% on a quarterly basis), we have made slight changes to our growth forecasts, moving some of the anticipated weakness from Q3 into Q2. Heavier trade frontloading will make the growth path more volatile, and the bloc will now only flirt with recession. We maintain our below-consensus view that 2026 growth is likely to be lower than 2025, at 0.6% and 0.9% respectively.

Monetary policy under (heavy) constraints

The Federal Reserve (Fed) maintained its policy rate at 4.25%-4.50% on 18 June. The Federal Open Market Committee (FOMC) struck a hawkish note in its forecast revisions reflecting their concerns about the looming supply shocks in the US economy (tariffs and immigration crackdown). The median projection for the Fed Funds Rate (FFR) was revised up for next year, with only 30 basis points (bps) worth of cuts against 50bps projected in March, and 20bps in 2027 against 30bps in March. We find it striking that in the last year of the forecasting horizon, the FFR would remain 40bps above the committee's estimate for the long-run level (3.0%).

At the other end of the spectrum of developed market central banks, the Swiss National Bank cut its main policy rate by 25bps to 0%, as anticipated, though maintained a reluctance to go into negative territory again. This suggests that more currency intervention may be on the way.

Currently, all central banks face a very high level of uncertainty. This environment contributed to a somewhat dovish Bank of England meeting in June, where rates were left unchanged at a still-high level (4.25%), but a higher-than-expected level of dissent between its Monetary Policy Committee illustrates the difficulty in navigating the current backdrop. Meanwhile, the latest European Central Bank meeting was on the hawkish side: now that rates are back to 2% – a level widely viewed as the neutral rate – the bar for further cuts is high.

All eyes on fiscal

After some bond market pressure in the US, UK and Japan over the recent weeks, there has been some respite – though we do not think the root causes have disappeared. Our *Theme of the month* delves into the specifics.

In the US, the 'One, Big Beautiful Bill' is now being debated in the Senate, with a vote eyed for early July. Given that Republicans hold a majority in the upper house, the Bill's main thrust is likely to remain intact, although it may undergo some potentially small changes, particularly on section 899 relating to additional taxes on foreign investors and companies. We remain concerned about US public debt sustainability, with markets likely to respond (again).

A difficult growth path for France and the UK is likely to further constrain government choices while emerging markets, such as Romania, Poland, Colombia and Thailand should be closely monitored.

By contrast, we continue to think Japan's fiscal situation is not quite as fragile as it first appears. Germany has significant fiscal policy headroom and has stated clear intentions to use it. We do not expect this to be a gamechanger in the short run, given that funds will take time to be deployed, and the economic outlook remains overshadowed by external downside risks, along with the government only just about finalising its 2025 budget. However, we have turned more buoyant with regards to medium-term prospects.

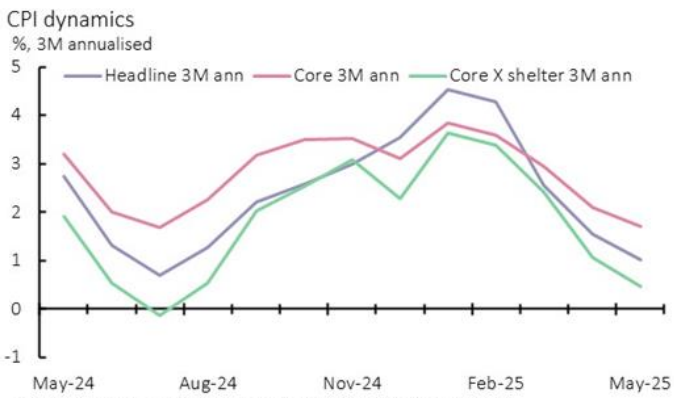
Global Macro Monthly – US

Gilles Moec
AXA Group Chief Economist and AXA IM Head of Research
Macro Research

Not showing up (yet)

For now, US consumer prices are still not showing any tangible sign of being impacted by the tariffs. The US headline Consumer Price Index (CPI) print for May came out in line with expectations, at 2.4% year-on-year (yoy), barely accelerating from April's 2.3%, but core inflation was below consensus, stabilising at 2.8%yoy while the market was projecting a slight rise (2.9%). We want to vary the vantage point by focusing on the latest developments, looking at the three-month annualised change. The picture then gets positively rosy. Headline fell to 1.0%, continuing the brisk descending trend which had started last winter, while core CPI fell below 2.0% for the first time since last summer. Excluding shelter, which is the Federal Reserve (Fed)'s favourite gauge of price pressure at the moment, core was particularly weak, at 0.5% (Exhibit 1). In the current circumstances, when tariffs are the most obvious source of tension, the first concerning signs of pass-through should emerge in core goods prices (that is the internationally tradable component of the consumer basket). This is not yet happening: on a three-month annualised basis, the price of goods excluding food and energy fell again in negative territory in May, while core services posted an innocuous, and decelerating, 2.3% gain.

Exhibit 1: Disinflation continues, for now



Source: Bureau of Labor Statistics and AXA IM Research, June 2025

Were it not for the looming tariff shock, we would be tempted to borrow from Christine Lagarde's statements at the June press conference to characterise the US: this monetary policy cycle is closing. The post-Covid reopening inflation shock is absorbed, and the central banks have reason to congratulate themselves on their deft management of the last, momentous five years. They delivered disinflation gradually but ultimately within a reasonable time frame, without triggering a recession, after having saved the global economy's bacon in 2020 with massive, pre-emptive support. With the benefit of insight, grumblings on whether they changed course and opted for restriction quickly enough are largely inconsequential in our opinion.

Still, of course, central bankers can never fully rest, and success on yesterday's mission does not preclude an equally deft dealing with the trade war. Tariffs will hurt. Import prices shocks are usually unpredictable – rising energy and commodity prices in response to geopolitical disturbances are perfect examples. But as the trade war had been telegraphed for months, businesses could prepare and adjust their inventory behaviour. Massive imports fuelling equally massive inventory building in Q1 to beat the tariffs currently help wholesalers and retailers to delay the transmission of the shock to their final consumers. As inventories gradually deplete, the pass-through should show its ugly head.

The first trade war with China (2018-2019) was different: until quite late into the dispute, US stakeholders failed to adjust their behaviour despite clear warnings from the US administration, the consensus of the time being that a last-minute deal would emerge. The US Trade Representative issued on 3 April 2018 the first list of Chinese products hit by 25% tariffs (applicable to USD50bn worth of imports), enforced only on 6 July. While press reports at the time pointed to US businesses speeding up their orders, seasonally adjusted Census Bureau data show that US imports from China fell in April 2018 (-3.9%mom) and May (-1.4%). It is only the second wave of US tariffs (announced in the late summer) which triggered some measurable reaction (imports from China rose by 4.9%mom in September 2018). A Fed staff study from May 2025, drawing on the 2018-2020 experience, concluded that the tariffs were passed to consumers "within 2 months". Given the better level of preparation this time, the pass-through may take a bit longer.

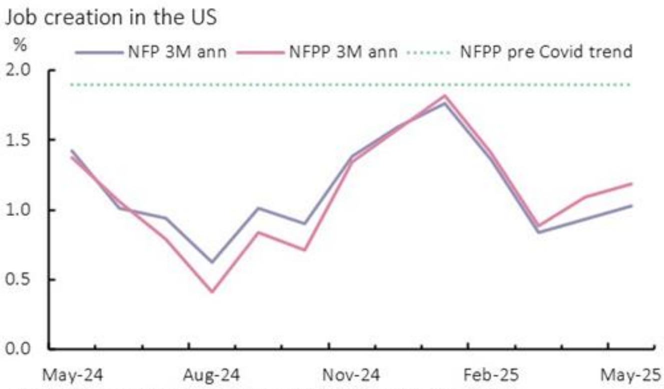
Fed even less in a hurry to cut

This is how the Fed seems to be looking at the current picture. The analysis of the US economy Fed Chair Jay Powell has offered at the June press conference was very much skewed, in our opinion, towards elevated concern over the looming inflation shock. He acknowledged that so far, aggregate consumer prices do not indicate much pass-through from tariffs, but he also indicated that this was likely the result of precautionary behaviour by producers and retailers, and the central bank is definitely bracing itself for the shock to materialise in the coming months.

The resilience of the labour market is clearly keeping the Fed away from providing "pre-emptive cuts". The Employment

Report came out better than expected in May, with non-farm payroll at +139K (market consensus at +126k) according to the Establishment Survey. Despite downward revisions to previous months, and cuts to federal employment, job creation is still decent – +1.0% on a 3-month annualized basis, against 0.9% in April. While the employment gains are markedly below the pre-Covid trend (1.9% on average between 2010 and 2019), this is still a very, very soft landing: the slowdown in job creation reflected by the Establishment Survey continues to be contained. True, payrolls are less strong than last winter, when they were within touching distance from the pre-Covid trend (1.8% in the three months to January), but the current pace according to the Establishment Survey is close to what was observed in the middle of 2024 (Exhibit 2). May's unemployment rate was unchanged at 4.2%. Meanwhile, the recent tentatively softening trend in pay per hour stopped in May, with hourly wages hitting 3.8% on a three-month annualised basis.

Exhibit 2: Job creation is still decent



Source: Bureau of Labor Statistics and AXA IM Research, June 2025

The new forecasts of the Fed sent, on balance, a hawkish message. The Federal Open Market Committee's (FOMC) median forecast for GDP was revised down for 2025 and 2026. The change for this year, from 1.7% in March to 1.4% can be partly explained by the carry-over effect from the (artificially) negative print for Q1, but GDP growth is now projected slightly below trend growth next year, at 1.6%, against 1.8% in March. Yet, this slower economy – itself probably triggered by the tariff-induced price shock – would not fully take care of inflationary pressure: the forecast for core Personal Consumption Expenditures (PCE) was revised up from 2.2% to 2.4% in 2026 and, crucially, the FOMC is not sure it can be brought completely back to target in 2027, hitting 2.1% at the end of the horizon, from 2.0% in March. While the FOMC's median projection for Fed Funds has not changed for this year (two cuts), we mentioned in our preview on Monday that it is more 2026 and 2027 which would be of interest in this batch of forecasts. There, the message is hawkish: the median projection for Fed Funds was revised up for next year, with only 30bps worth of cuts against 50 in the March batch, and 20bps in 2027 against 30 in March. We find it striking that in the last year of the forecasting horizon, Fed Funds would remain 40bps above the committee's estimate for the long-run level (3.0%). In other words, the FOMC does not seem to contemplate the need to bring the policy stance into accommodative territory, even quite late after the tariff shock.

In terms of distribution of opinions within the FOMC, it seems that "team transitory" – those, such as Governor Christopher Waller, who argue that it is more likely than not that the tariffs won't trigger a persistent inflation drift – are still a relatively small minority: only five members see Fed Funds below 3% in 2027, unchanged from March. Conversely, the group in favour of maintaining a wait-and-see attitude for long, not planning to cut at all in 2025, is getting stronger (seven members in June against four in March).

The September meeting will be key, as Jay Powell mentioned that they are expecting to get more clarity on the tariff pass-through within the summer. Two cuts by year-end – remaining the FOMC's, and the market's baseline (46bps priced in, without much change as Jay Powell was talking) is still probably the likeliest path, but a proper softening in the economy will need to materialise in the second half the year to get us there.

Runaway fiscal policy

The Congressional Budget Office (CBO) confirmed the early assessments by academic centres just after the release of the "Beautiful Budget Bill" voted by the House of Representatives: even with the help of the tariff revenues, the bill would lift the deficit by USD2.4tn over the coming decade. A key issue of course is the extent to which the tax cuts will lift GDP and help keep US public finances sustainable. The CBO's "dynamic estimate", taking on board the macroeconomic effects, conclude to an increase in the public debt ratio of 7.1% of GDP over 10 years: while GDP would indeed grow faster than in the baseline by 0.5% per annum on average, the "snowballing effect" stemming from higher interest rates weighing on an already high stock of debt would more than offset the improvement in the primary deficit. Hopes are now on the possibility that the Senate would amend the text in a more prudent direction, but the discussion there is not necessarily supportive of that view.

In such a configuration, the resilience in US long-term interest rates is understandable. While the probability of the most extreme scenarios has significantly diminished – on tariffs, but also on the threats on the Fed's independence as the Supreme Court has made it plain that the Fed chair cannot be dismissed before the end of their term – a risk premium is now embedded in US assets. It also shows in the disconnect between the interest rate differential between the US and the Euro area and the euro exchange rate.

26 June 2025

Global Macro Monthly – Eurozone


François Cabau,
Senior Eurozone Economist
Macro Research


Hugo Le Damany,
Eurozone Economist
Macro Research

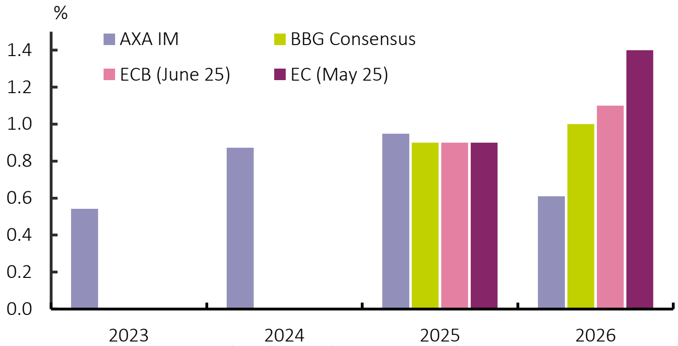
Unsatisfying underlying growth momentum

In Q1, GDP growth in the Eurozone was revised up to 0.6% on a quarterly basis in the final estimate (from 0.3%) on the back of superior growth, two and three-times stronger than initially estimated in Germany and Ireland, at 0.4% and 9.7% respectively. Ireland made up 50% of Eurozone Q1 growth – despite a weight of only 4% – boosted by very large net trade and investment contributions.

But the expenditure and industry breakdown of the Q1 peformance (mainly chemicals and pharmaceuticals) points to a Q2 reversal, losing the boost of activity frontloading ahead of increased US tariffs. This was already apparent in April's data – industrial production and exports fell back to January/February levels. This reinforces our cautious reading of business surveys which have displayed counter-intuitive relative strength in manufacturing, against dipping services.

Exhibit 3: We remain conservative on Eurozone growth

Eurozone Annual GDP forecast



Source: ECB, Datastream, Bloomberg and AXA IM Research, June 2025

Our revised projected growth profile now looks more volatile, as we bring forward some of the weakness we expected in the second half of the year. We now project GDP to contract by 0.2% in Q2 (from 0.0%) before a flat reading in Q3 (from -0.2%) but dipping again by 0.1% in Q4 (from -0.2%). The Eurozone area would be just about flirting with a recession – our previous projection was consistent with the canonical definition of a recession (two consecutive quarters of GDP contraction). As such we maintain our cautious, below consensus forecast (Exhibit 3). For 2026, we believe GDP growth should reach +0.6%; + 0.1 percentage points (ppt) above our previous estimate and below 2025's +0.9%, (up from 0.7% previously). A proper rebound would only occur in the first half of 2026.

Revised ECB rate path but dovish bias remains

In line with our long-held call, the European Central Bank (ECB) cut its deposit rate to 2% in June. Amid continued very high uncertainty, the bank maintained its data dependent and meeting-by-meeting approach.

ECB President Christine Lagarde struck a surprisingly hawkish tone during the press conference, stating the ECB's deposit rate is now "well positioned", suggesting that the ECB would no longer resort to back-to-back cuts, and putting the very continuation of the path to proper accommodation in question This came at odds with notable downside revisions to growth and inflation with risks still very much skewed to the downside for the former.

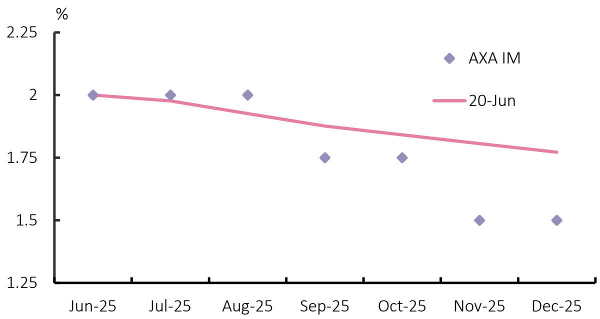
Besides, we find ECB's revised baseline underpinned by optimistic assumptions on both tariffs (staying at 10%, below current levels), and the German fiscal boost kicking in quickly, spurring growth to a fast 0.3%-0.4% quarterlty rate as early as Q4 2025.

All in all, we think the bar for continuing back-to-back rate cuts has moved significantly higher, pending more news on the tariff front – US officials have indicated a US-EU trade deal by the 9 July deadline is unlikely. In light of the ECB's communication, and slightly better data than expected, we now only foresee two more rate cuts – in September and December, taking the deposit rate to 1.5% by year-end. We maintain our dovish bias against market expectations (Exhibit 4).

Given the underlying weakness of the economy, any re-escalation in the Middle East triggering renewed pressure on energy prices may further deter growth prospects. At this stage, however, we are not too concerned about a renewed supply shock which suddenly send inflation expectations soaring.

Exhibit 4: We keep our dovish bias

ECB market pricing and AXA IM forecasts



Source: Bloomberg and AXA IM Macro Research, as of June 2025

26 June 2025

Global Macro Monthly – UK

Gabriella Dickens
Economist (G7)
Macro Research

Q1 strength unlikely to last

GDP growth surprised to the upside in Q1, rising by 0.7% on the quarter. But evidence suggests that some of that growth was due to activity being brought forward ahead of President Donald Trump's 'Liberation Day' as well as various tax changes, including increased car sales ahead of the Vehicle Excise Duty (VED) change and house purchases ahead of the Stamp Duty tax break changes. Indeed, the latest data showed a 0.3% month-on-month decline in April while retail sales were down a chunky 2.7% in May. We see growth flatlining in Q2, below the Bank of England's (BoE) forecast.

Consumer Price Index (CPI) inflation, meanwhile, edged down to 3.4% in May, from 3.5% in April. But the official data miscalculated the impact of April's VED change, meaning the headline number would have been 10 basis points (bps) lower had this error not occurred. The headline rate was, therefore, technically unchanged from April. But there were signs that the underlying disinflation story remained intact. Core inflation was in line with expectations, falling to 3.5% from 3.8% in April, while services inflation dropped back sharply to 4.7% from 5.4%. So far, at least, there are few signs that businesses have been able to pass on the statutory pay increases to prices. For now, we expect to see underlying CPI inflation edging lower over the coming months, albeit with some bumps in the road, as a weaker labour market underpins a more material slowdown in wage growth and sluggish demand limits firms' ability to pass on higher costs. Note the Pay As You Earn (PAYE) measure of employment dropped by a whopping 109K in May, though this likely will be revised higher, and survey data suggests slack is continuing to widen.

The BoE voted to keep Bank Rate unchanged at 4.25% this month, but the vote split was more dovish than expected, with three of the nine members – Swati Dhingra, Dave Ramsden and Alan Taylor – voting in favour of a further 25bp cut. The BoE also continued to refer to its "gradual and careful" approach which in our eyes indicates a desire to stick to the current quarterly pace of cuts. The Monetary Policy Committee also noted that while it remained sensitive to higher oil prices amid the growing conflict in the Middle East, geopolitical factors did not play a significant role in its June decision, indicating it is happy to look through near-term volatility if evidence continues to show growing slack in the domestic economy. We continue to expect Bank Rate to fall to 3.75% by year end, broadly in line with market expectations.

Global Macro Monthly – Canada

Gabriella Dickens
G7 Economist
Macro Research

We still see further BoC rate cuts this year

Canada GDP surprised to the upside in Q1, rising by 2.2% quarter-on-quarter annualised, surpassing the Bank of Canada's (BoC) forecast, 1.8%. This was largely driven by a jump in exports – up 6.7% – as US demand surged prior to US President Donald Trump's 'Liberation Day'. Inventories also rose, adding 1.4 percentage points (ppt) to the headline rate. Consumption growth, by contrast, slowed to 1.2% in the face of growing uncertainty, after a strong 5% rise in Q4. Capex also fell outright by 3.1%, due to an 11.0% drop in residential investment on lower resale activity. Looking ahead, we expect growth to fall outright in Q2, as the boost from front-loading reverses, and then to remain subdued in the second half of the year, due to spillovers from a US slowdown and a pause in investment activity in the face of uncertainty. We see growth of 1.4% this year and 0.5% next.

The unemployment rate rose to nearly a four-year high of 7.0% in May, up from 6.9% in April. The increase largely reflected a rise in supply, with net employment up by a modest 8.8K. The firms most exposed to US tariffs adjusted hiring strategies, though, with net employment in the manufacturing sector down 12.2K. We think the unemployment rate will continue to edge higher over the course of the year, as demand eases. Underlying inflationary pressures picked up more than expected in April, with the trimmed mean measure rising to 3.1%, from 2.8%. But growing slack in the labour market and weak demand will likely offset the initial upward impact of tariffs on inflation.

As expected, the BoC kept its key policy rate unchanged at 2.75% at its June meeting, as it waits to see further evidence on the impact of US trade policy. The BoC highlighted high levels of uncertainty, despite Trump rolling back on some of the more severe tariff measures and appearing more open to trade negotiations. We continue to see two further rate cuts this year, leaving the key policy rate at 2.25% by year end. While underlying inflationary pressures are currently firmer than expected, we believe the downward impact on growth from tariff uncertainty and the corresponding increase of slack looks set to be stronger and more persistent than any upward pressure on costs, particularly given the recent uptick in unemployment.

26 June 2025

Global Macro Monthly – China

Yingrui Wang
Economist (China)
Macro Research

Trade negotiations even out some downside risks

Earlier in June, Washington and Beijing held their second round of trade negotiations in London. According to the limited details revealed, the primary focus was on easing the rare earth export restrictions, which China had introduced as part of its countermeasures to the US's reciprocal tariffs in April. Moreover, neither side changed its tariff regime after the latest talks — the effective US tariff has been reduced to 51.1% from April's peak of 134.7%, according to The Peterson Institute for International Economics[1]. While this is still over 30 percentage points above the pre-2025 level, it is closer to our base case scenario.

The tariff truce has reduced downside risks to economic growth, which in our view will defer the urgency for additional fiscal support until Q4 at the earliest. We maintain our view and continue to expect below-target growth of 4.3% in 2025 and 4.0% in 2026.

The impact of the tariff truce agreed in early May has not yet appeared in the trade data — China's shipments to the US declined again by 35%. That said, high-frequency trackers suggest a rebound in containership volumes to the US in the first half of June.

In aggregate, China's exports have held up well so far, rising by 6% year-to-date as of May, supported by front-loaded demand and transshipment via Association of Southeast Asian Nations (ASEAN) countries. However, as trade uncertainties persist, exports will likely continue to face headwinds in the months ahead.

The performance of the Chinese yuan against the dollar has been firmer than expected late last year. It has lost less than 2% against the greenback since Donald Trump's January inauguration. Yet, against the China Foreign Exchange Trade System (CFETS) currency basket, the yuan has depreciated by over 5%, which may have helped boost exports to neighbouring regions, especially as an increasing share of trade is being settled in renminbi.

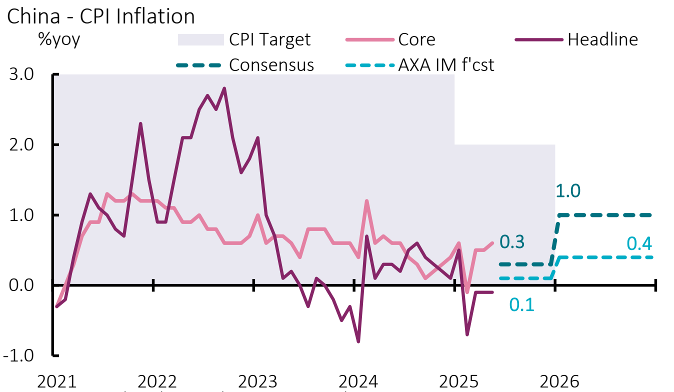
Looking ahead, China will likely continue to enhance its trade links with non-US regions, while gradually reducing reliance on exports by reviving domestic demand.

Consumers rebound but deflation lingers

Domestically, China's retail sales accelerated modestly in May, yet inflation remained in contraction for the fourth consecutive month. Several catalysts supported consumer spending in May, including the ongoing government-led trade-in programme; the Labour Day holiday; and early promotions for the '618' shopping festival. However, the seemingly strong sales growth was achieved with retailers cutting prices, contributing to the persistent deflationary pressure across the economy.

Moreover, the current strength in retail sales is predominantly driven by one-off measures that triggered front-loaded demand. Spending momentum is likely to fade once future demand has been pulled forward — unless there is a material improvement in household income and wealth prospects. This would put further pressure on inflation in the coming months. As a result, we have revised our CPI inflation forecast down to 0.1% in 2025 and 0.4% in 2026, from 0.4% and 0.6% respectively (Exhibit 5).

Exhibit 5: CPI inflation to stay barely above the borderline



Source: CEIC, Bloomberg and AXA IM Research, June 2025

In our view, the near-deflation Consumer Price Index (CPI) readings are unlikely to be sufficient to prompt another policy rate cut. After the 10 basis-point (bp) reduction in May, we do not expect further cuts this year, as the central bank remains concerned about net interest margin compression and the overall stability of the banking system. Instead, we expect to see targeted loan repricing — for example on mortgage and small and medium-sized enterprise loans — alongside a likely 50bp cut to the reserve requirement ratio in the coming months to maintain ample system liquidity.

[1] Using the trade numbers in 2017 (i.e. before the first trade war in 2018). Another popular estimate is from The Budget Lab at Yale, which estimates the US effective tariff on China has reduced to 27.9% from the peak of 105.2% in April.

Global Macro Monthly – Japan

Gabriella Dickens,
G7 Economist
Macro Research

Still one more hike on the horizon

The second estimate of Japan Q1 GDP was revised up to an annualised quarter-on-quarter fall of 0.2% from the initial estimate of -0.7%. But while personal consumption increased slightly to 0.5% from 0.2%, most of the upward revision reflected an increase in inventories, likely due to activity being brought forward ahead of US President Donald Trump's 'Liberation Day'. Looking ahead, therefore, we expect only a modest rebound in Q2, as a sustained increase in personal consumption – due to elevated wage growth – is offset by a drop in autos exports to the US, a reversal in support from inventories and weaker investment as businesses weigh up the tariff impact. Note too that the latest business surveys have edged lower. On balance, we expect growth of 1.0% this year.

The latest evidence suggests that, despite geopolitical concerns, the virtuous wage/price spiral remains broadly intact, with growing acceptance among the population that modest inflation is needed to keep wages rising sustainably over the long term. In addition, structural changes – including the ageing population and depleting labour pool – should keep wage growth elevated compared to the previous couple of decades. There is also growing evidence that businesses are passing rising costs on to consumers. Indeed, the latest Consumer Price Index (CPI) data showed the May core inflation reading jumping to more than a two-year high of 3.7%, from 3.5%, while the Bank of Japan's (BoJ) so-called "Model 1" estimate of underlying inflation is approaching 2%.

The BoJ voted unanimously to leave its key policy rate unchanged at 0.5% in June. It also stuck to the forecasts laid out in its most recent Quarterly Report, which predicted a near-term slowdown in activity due to the imposition of US tariffs and a drop back in core inflation in 2026. Nonetheless, domestic dynamics remained favourable, with underlying inflation expected to return to the 2% target by the end of the forecast horizon. Stronger-than-expected CPI inflation in May, combined with elevated inflation expectations, mean we continue to see one more 25 basis-point hike this year to 0.75%, before the Bank is forced to keep rates unchanged through 2026. Meanwhile, the government will reduce bond issuance at the long end of the curve in response to weakening demand from investors. The revised plan shows a 1.8 trillion yen drop in issuance of super-long-dated government bonds.

Global Macro Monthly – EMEA

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

Fiscal policy and the political cycle: Persistent ties

When faced with fiscal deterioration in Central Europe, investors' ability to look through political cycles is being tested. Romania has just come out of an extended election cycle in 2024-2025 and the prospect of a 2027 general election in Poland may already impact fiscal policy next year.

In Poland, the government's rapid rise in spending ahead of May's presidential elections is unlikely to be reversed soon. Increased social transfers and heavy military spending widened the deficit to 2.9% of GDP in the first five months of 2025 compared to 1.4% in the same period in 2024. With the election outcome signalling that PiS could return to power in 2027, the appetite for reducing social spending is minimal. Meanwhile, potential tax increases could be vetoed by the president. Wide budget deficits of 6%-6.5% of GDP are likely to stay in 2026-2027. With European Union (EU) funds both from the Multiannual Financial Framework (MFF) and the Recovery and Resilience Facility (RRF) totalling close to €30bn in 2025 (3% of GDP), EU support is likely to keep investors patient. The European Commission (EC) is still unlikely to interrupt the release of RRF funds to Poland even if Prime Minister Donald Tusk cannot immediately deliver on the judiciary reform due to presidential obstruction.

In Romania the political situation continues to interfere with the fiscal outlook. May's market-friendly presidential election outcome and the formation of a new pro-EU government are necessary but insufficient conditions for lowering fiscal risks. A large and frontloaded fiscal tightening is needed as the deficit is on course to reach over 9% of GDP in 2025. How broad the support of the new government is across political parties will be key to limit execution risks when it comes to deep and unpopular fiscal tightening. Reining in pension spending, increasing VAT and the personal income tax are all necessary fiscal measures that require political capital. Despite likely patience from the EC, access to EU funds may not provide enough reassurance to investors. Romania is unlikely to receive more than €5bn to €6bn (1.5% of GDP) both from EU MFF and RRF this year, given earlier delays in securing RRF tranches. That leaves both the financing of the fiscal and current account deficits (-9% of GDP as well) precarious. With the Romanian leu significantly overvalued, the post-election macro adjustment is likely to require a sizeable currency depreciation alongside large fiscal tightening.

Global Macro Monthly – LatAm

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

Fiscal results: Where you are in the cycle matters

LatAm's public debt concerns are not new but fiscal performance across countries has taken diverging routes, especially given their different stages in the business cycle.

Brazil has recorded one of the largest improvements in the region so far, with the public sector deficit narrowing to 7.7% of GDP in the 12 months to April 2025 (from -9.3% a year ago). But the economy also recorded a large positive output gap as indicated by a record low unemployment rate and persistent underlying inflationary pressures. The deficit reduction has been driven by buoyant revenue helped by a high level of activity and primary expenditure restraint. On the latter, as Brazil only had a budget for 2025 in April, delayed spending execution has been helpful. While that is bound to reverse, the government spending freeze announced in May suggests some discipline will be maintained in the remainder of 2025. However, risks are building for the 2026 budget due by end-August, as Congress is reluctant to adopt tax hikes needed to fund spending increases ahead of 2026 elections. A reform of the fiscal framework post-elections will be needed, including de-indexation of social transfers from the minimum wage, if Brazil is to regain fiscal credibility over the medium term.

In contrast, Mexico's fiscal improvement this year withstands scrutiny. The deficit narrowed by 1.2 percentage points of GDP in the first four months of 2025 compared to the same period of 2024 to reach 0.6% of GDP. That happened even as private consumption and fixed investment contracted in Q1. Despite weak activity and lower oil revenue, tax collection was robust, thanks to an increase in the VAT base to cover digital platforms. While sluggish growth is a risk to revenue in the rest of 2025, Mexico now has buffers. It has also demonstrated its commitment to fiscal consolidation, with spending cuts, mostly capex. The fiscal anchor is in place, even if Mexico still needs to broaden its tax base and tackle rigid public expenditure to stabilise its debt ratio over the medium to long term.

In Colombia, immediate and future fiscal risks have flared up, despite growth recovery. Higher primary spending and a large revenue undershoot are projected to take the deficit to 7.1% of GDP this year. With fiscal rules now suspended for the next three years, there is no plan to cut spending ahead of 2026's elections and the deficit reduction planned in 2026 relies on a tax package (1.1% of GDP) which is unlikely to be voted for. Restoring the fiscal anchor will have to wait after elections.

Global Macro Monthly – EM Asia

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

Monetary easing giving way to fiscal stimulus

Central banks still have room for further policy easing but the bulk of rate cutting in the current easing cycle has been carried out. Heightened geopolitical risks and the potential for sustained higher oil prices will also prompt renewed caution given the varying risks to currencies and inflation. In India, the 50 basis-point (bp) cut on 6 June means "monetary policy is (now) left with very limited space to support growth," according to the central bank. South Korea's Monetary Policy Board voted unanimously for a 25bp cut in late May, but the meeting's minutes showed members calling for careful assessment of domestic and external risks before considering further cuts. Indonesia's central bank kept rates unchanged on 18 June due to "still high global uncertainty", but it will continue to monitor the potential for further cuts to support growth.

Fiscal support will also be forthcoming in most markets as governments try to stimulate demand, and this may also influence the timing and extent of any further rate cuts. South Korea's new president is advancing his campaign promises of a substantial fiscal stimulus package, primarily focusing on cash handouts and debt restructuring. With a supplementary budget featuring KRW20.2tn (US$14.7bn) in additional spending and covering an expected revenue shortfall of KRW10.3tn, the new administration is targeting a managed fiscal deficit of 4.2% of GDP (up from an initial target of 2.8% and 3.3% after the first supplementary budget). Government debt, though still manageable, is set to rise to 49% of GDP from 47.4% in 2024.

Indonesia has introduced a US$1.5bn economic support package for June-July, with discounted travel costs and the provision of food aid and cash payments to low-income workers. However, the limited scale and short-term nature of the package may restrict its overall impact on growth. A more pressing need is to get spending back on track now that the budget reallocation process under President Prabowo's "efficiency savings" drive has been completed; disruption to spending meant the government ran a deficit of just 0.09% of GDP between January and April. In contrast, Thailand's government risks running a larger deficit than planned. In the first seven months of the fiscal year, its deficit reached nearly 90% of the annual target (excluding carried-over spending), reflecting a revenue shortfall and higher expenditure. A large fiscal stimulus package now seems unlikely; instead, the government will reallocate funds from its digital wallet cash handout scheme to other projects to drive growth.

Macro forecast summary

Real GDP growth (%)	2024	2025*		2026*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.3	2.6		2.4	
Advanced economies	1.7	1.1		0.7	
US	2.8	1.2	1.4	0.5	1.7
Euro area	0.9	0.9	0.9	0.6	1.2
Germany	-0.2	0.0	0.1	0.3	1.3
France	1.1	0.3	0.6	0.6	1.0
Italy	0.5	0.6	0.5	0.7	0.8
Spain	3.2	2.3	2.5	1.9	1.9
Japan	0.1	0.8	1.0	0.9	0.7
UK	1.1	0.9	0.7	1.1	1.1
Switzerland	1.3	1.1	1.1	1.2	1.5
Canada	1.5	1.4	1.0	0.5	0.8
Emerging economies	4.2	3.5		3.4	
China	5.0	4.3	4.5	4.0	4.2
Asia (excluding China)	5.4	4.5		4.6	
India	6.9	6.5	6.3	6.1	6.5
South Korea	2.0	0.5	1.3	1.7	1.9
Indonesia	5.0	4.5	4.9	4.9	5.0
LatAm	2.4	1.8		2.0	
Brazil	3.4	1.9	1.9	1.8	1.7
Mexico	1.5	0.0	0.2	0.8	1.4
EM Europe	3.3	2.1		2.0	
Russia	4.1	1.5	1.7	0.9	1.2
Poland	2.9	2.8	3.3	2.9	3.2
Turkey	3.2	3.0	2.9	3.4	3.4
Other EMs	2.8	3.2		3.7	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 25 June 2025
**Forecast*

CPI Inflation (%)	2024	2025*		2026*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	2.7	2.7		2.4	
US	3.0	3.2	3.2	3.2	2.3
Euro area	2.4	2.0	2.0	1.6	2.0
China	0.2	0.1	1.3	0.4	1.6
Japan	2.7	2.9	2.0	1.5	1.7
UK	2.5	3.3	2.3	2.0	2.0
Switzerland	1.1	0.2	1.0	0.5	1.0
Canada	2.4	2.4	2.1	2.5	2.1

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 25 June 2025
**Forecast*

These projections are not necessarily reliable indicators of future results

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Forecast summary

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
United States - Fed	Dates	4.50	29-30 Jul 16-17 Sep	28-29 Oct 9-10 Dec	27-28 Jan 17-18 Mar	28-29 Apr 16-17 Jun	28-29 Jul 15-16 Sep	27-28 Oct 8-9 Dec
	Rates		unch (4.50)	-0.50 (4.00)	-0.50 (3.50)	-0.25 (3.25)	unch (3.25)	unch (3.25)
Euro area - ECB	Dates	2.00	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 (1.75)	-0.25 (1.50)	unch (1.50)	unch (1.50)	unch (1.50)	unch (1.50)
Japan - BoJ	Dates	0.50	30-31 Jul 18-19 Sep	29-30 Oct 18-19 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		+0.25 (0.75)	unch (0.75)	unch (0.75)	unch (0.75)	unch (0.75)	unch (0.75)
UK - BoE	Dates	4.25	7 Aug 18 Sep	6 Nov 18 Dec	5 Feb 19 Mar	30 Apr 18 Jun	30 Jul 17 Sep	5 Nov 17 Dec
	Rates		-0.25 (4.00)	-0.25 (3.75)	-0.25 (3.50)	unch (3.50)	unch (3.50)	unch (3.50)
Canada - BoC	Dates	2.75	30 Jul 17 Sep	29 Oct 10 Dec	Jan Mar	May June	Jul Sep	Oct Dec
	Rates		-0.25 (2.50)	unch (2.50)	-0.25 (2.25)	unch (2.25)	unch (2.25)	unch (2.25)

Source: AXA IM Macro Research - As of 25 June 2025

These projections are not necessarily reliable indicators of future results

Download the full slide deck of our June Investment Strategy

26 June 2025

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

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

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AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
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