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AZIMUT GLOBAL VIEW

03.03.25

Main Events

CHINA NPC
President Xi is set to unveil a highly anticipated stimulus plan at the upcoming National People's Congress

ECB MEETING
With a rate cut widely expected, investors will seek further insights into the ECB' s policy trajectory

US NFP
Investors will gauge the impact of the new Trump administration's initiatives on employment data

US CPI
Investors will evaluate the implications of trade-related measures on inflation

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
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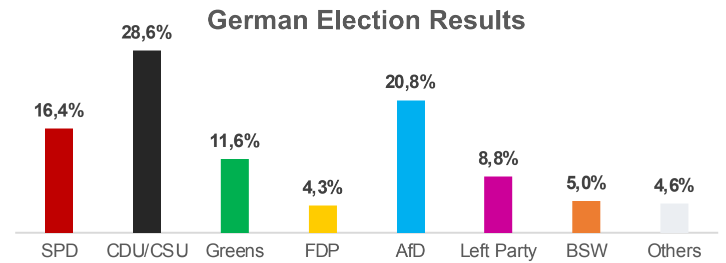
- Dublin
- Geneva
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

THE EUROPEAN DEFENSE DILEMMA

- **The conservative CDU/CSU coalition won the German federal election by a significant margin, paving the way for a "Grand Coalition" government with the SPD**
- **Fiscal policy is the key focus for the upcoming coalition talks, as CDU leader Merz is determined to secure additional defense spending**
- **A broader debate about independence from the US on security matters is sparking across Europe, fueling speculation about joint European borrowing**

According to preliminary official results, the conservative CDU/CSU coalition emerged as a winner from the German federal elections held on February 23rd, securing 28.6% of total votes. Other major parties performed broadly in line with pre-election polls: AfD garnered 20.6%, SPD 16.5%, and the Greens 11.8%. The standout surprise was the Left Party, which significantly outperformed expectations, obtaining 8.8% of preferences. Conversely, the FDP party, currently partaking in the ruling "traffic light" coalition, failed to meet the 5% threshold to enter the Bundestag, in a severe backlash for its leader Christian Lindner, penalized by the electorate for his responsibility in the collapse of the previous government.

This outcome supports CDU leader Friedrich Merz's candidature for the next Chancellor. Merz, who would lead a two-party coalition with the center-left SPD, signaled the willingness to expedite coalition negotiations, aiming for a high-level agreement by Easter—an ambitious timeline given Germany's historical precedent of lengthy coalition talks. The urgency reflects the country's pressing geopolitical and economic challenges.



Source: The Federal Returning Officer, Preliminary official result

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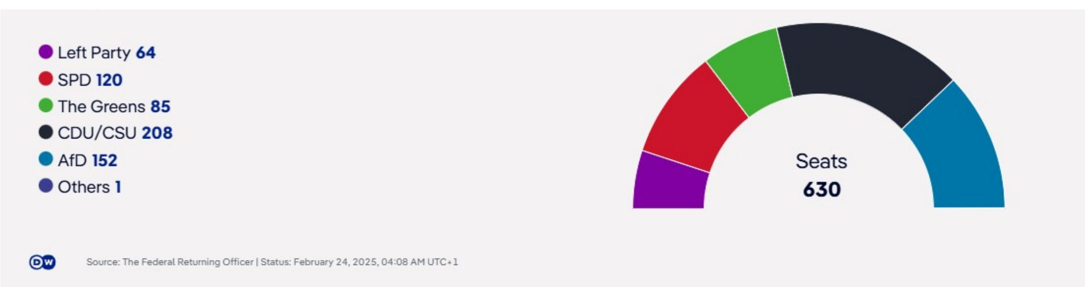
The outcome of Germany's federal election has drawn significant attention from investors, particularly regarding its implications for fiscal policy. In this regard, the new composition of the Bundestag should be broadly supportive for equities and risk assets in general, as the CDU-led coalition is expected to pursue a fiscally expansionary and pro-business stance. The CDU's policy platform outlines a range of measures aimed at stimulating economic growth, including tax reductions, lower electricity levies, streamlined regulatory processes and increased investment in critical infrastructure, with a strong emphasis on energy-related projects.

Importantly, the smaller number of members in the coalition – two in the current configuration compared to three in the previous one, which also included the Green Party – should pave the way for a more agile path toward legislation enactment. However, the strong showing by AfD and the Left Party—securing a combined 216 seats (over 33% of parliament)—creates significant hurdles for constitutional reforms requiring a two-thirds majority.

Bundestag Seats



This is particularly relevant with respect to a potential reform of the debt brake, a subject that has been attracting considerable focus over the last few months, on one hand given the need for additional spending to stabilize a sluggish economy in Germany and on the other to comply with new geopolitical order shaping up after the appointment of the new US administration.

This debt brake reform is unlikely to be pursued, as the Left Party supports relaxing the debt brake but opposes higher defense spending, while AfD favors increased defense budgets but rejects loosening fiscal constraints. This dynamic raises concerns about Merz's ability to deliver on his fiscal priorities without resorting to alternative mechanisms outside constitutional reforms.

Despite these challenges, Merz demonstrated his determination to boost Germany's defense capabilities and reduce reliance on U.S. military support. In a post-election press conference, Merz proposed leveraging the outgoing parliament's two-thirds majority (comprising CDU, SPD, and Greens) to finance a €200 billion (4.6% of GDP) special defense fund. This would supplement the existing €100 billion fund established in 2022, which is expected to be depleted by 2027.

The discussion gained further momentum as coalition talks intensified over the week following the election. Reportedly, the parties negotiating Germany's new government are considering two special funds worth up to €900 billion, almost 20% of GDP—a €400 billion vehicle dedicated to defense and another €400-500 billion focused on infrastructure investment.

Germany's defense spending debate is part of a broader European trend toward strategic autonomy in security matters. Since Donald Trump's inauguration, there has been growing momentum within Europe to reduce dependency on U.S. military support. Recent reports suggest that the European Union is exploring its most ambitious defense financing initiative since the Cold War, potentially mobilizing hundreds of billions of Euros through fiscal rule adjustments, repurposed funds, and even joint borrowing, a mechanism not employed since COVID-19 recovery efforts.

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Reportedly, the plan outlined by the European Commission will comprise three pillars:

- Allowing member states to increase spending by loosening fiscal rules, which, according to some officials, could help mobilize at least €160 billion. Discussions are focusing on excluding defense spending from deficit calculations, potentially amounting to between 1% and 2% of national GDP over two to four years.
- Easing investment constraints on the European Investment Bank, as the institution is currently not allowed to directly invest in military equipment unless it also has civilian applications;
- Enabling spending at the EU level through a new joint instrument. These funds would primarily be used for common projects in areas such as air defense, long-range strike capabilities, missiles, drones, and military-grade artificial intelligence.

Defense expenditures as a share of GDP, 2024 Estimates

Source: North Atlantic Treaty Organization, Bloomberg

Looking ahead, attention in Europe is likely to remain centered on discussions surrounding increased fiscal spending, particularly in Germany, as Friedrich Merz's push to secure approval for special budgetary funds ahead of the newly elected Bundestag's inaugural session is expected to accelerate negotiations. With the Bundestag constitutionally required to convene no later than 30 days after the election, Merz faces a March 25th deadline to finalize these additional spending measures.

In the U.S., investors will monitor closely economic data, as the initial policy measures of the Trump administration begin to influence forward-looking indicators and economic sentiment. Over the past few weeks, weaker-than-expected readings in retail sales, sentiment surveys, and GDP growth projections from the Atlanta Fed have raised concerns about the underlying momentum of the U.S. economy. In this context, the upcoming employment report will provide a critical barometer for determining whether these early policy actions are beginning to exert a tangible impact on hard economic data beyond sentiment-driven metrics.

Lastly, China's National People's Congress, the country's most significant annual political gathering, is set to begin on March 5th. Policymakers are widely anticipated to unveil measures aimed at achieving a growth target of approximately 5%, which should include raising the official budget deficit target to its highest level in over three decades, signaling a commitment to fiscal expansion. The move would inject trillions of yuan into the economy, underscoring Beijing's focus on stabilizing growth amid domestic and global headwinds.

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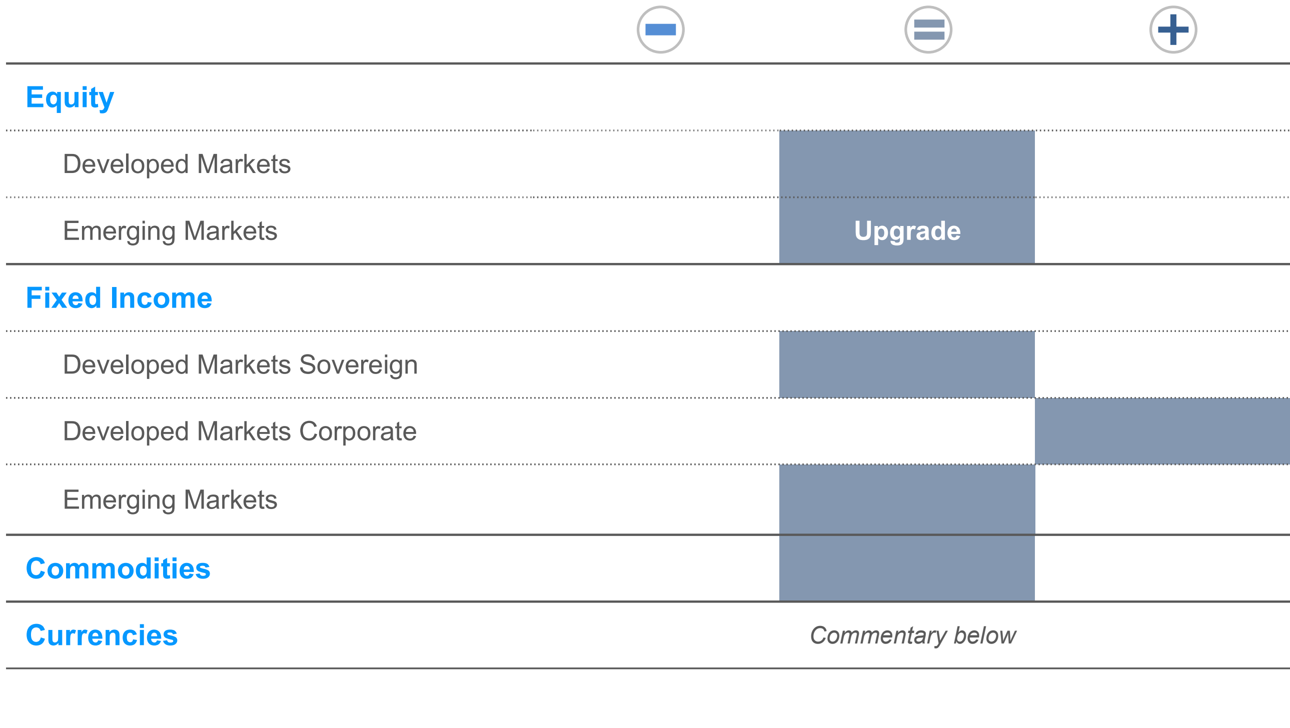
Asset Allocation View

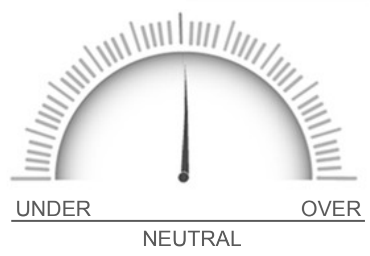


	UNDER	NEUTRAL	OVER
Equity			
Developed Markets			
Emerging Markets		Upgrade	
Fixed Income			
Developed Markets Sovereign			
Developed Markets Corporate			
Emerging Markets			
Commodities			
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

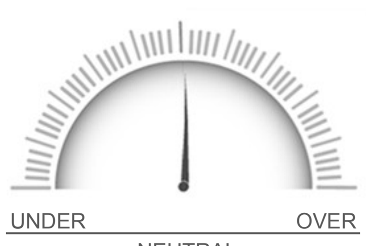
Developed Markets



We have maintained our **Neutral** recommendation on Developed Market Equities. The recent correction has cleared some of the excess of previous months, particularly in the U.S. markets and in technology stocks. At the same time, although there are no clear signs of an imminent slowdown in the U.S. economy, the Trump administration's constant threats of tariffs could unsettle the markets and further dampen the investor sentiment. On balance, we believe that unless hard data begins to deteriorate, it is preferable to maintain a neutral stance.

US	Europe	Japan

Emerging Markets



We have upgraded our recommendation on Emerging Market Equities back to **Neutral**. The upgrade is mainly driven by the expectation that the National People's Congress will approve concrete measures this week to stimulate the domestic economy. These are all the more necessary in light of Trump's announced tariffs, which are equal to 20% on all Chinese imports in addition to the pre-existing ones. If these measures are approved, the recovery of the Chinese market could extend, spreading to other sectors. Another factor that could support emerging markets is a potential weakening of the dollar. We remain more cautious about other emerging markets, where the impact of Trump's tariffs is expected to be much more severe than in developed countries.

Asia ex-Japan	EEMEA	LATAM

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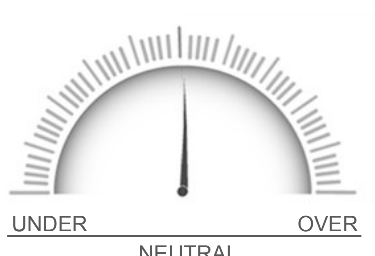
Fixed Income

Developed Markets Sovereign



We have maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. There is increased uncertainty regarding the direction of rates. On one hand, growing concerns about a potential slowdown caused by Trump's policies (such as cuts to public administration and the recessionary effects of tariffs) could lead to lower rates. On the other hand, inflation data consistently exceeding expectations—even before the effects of tariffs on prices become visible—could push rates higher. Additionally, the evolution of equity markets could also influence rates, given the recent return of a negative correlation between the two asset classes. We remain more constructive on the short and medium ends of the yield curve, while exercising growing caution on the long end.

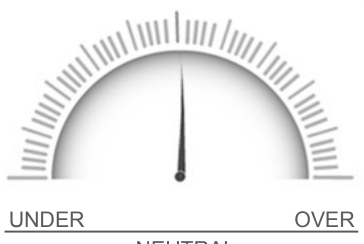
EU Core	EU Periphery	US Treasury	Japanese JGB

Developed Markets Corporate

We have kept our **Slightly Overweight** recommendation on Developed Markets Corporates. Trump's threats on tariffs should not have an impact on corporate bond spreads for the moment, at least until clear sign of a slowdown start to emerge. Therefore, the search for yield in the fixed income market will continue to favor the asset class. Within corporate bonds, we maintain a preference for investment-grade bonds over high-yield bonds that are hovering around all-time lows.

IG Europe	IG US	HY Europe	HY US

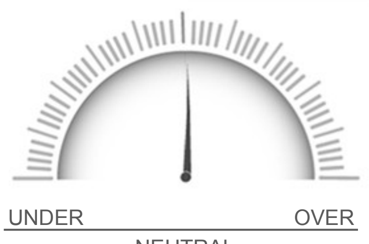
Emerging Markets



We have kept our **Neutral** recommendation for Emerging Market Bonds. The potential risks posed by tariff impositions from the Trump administration are mitigated by the relatively higher spreads that emerging market bonds currently offer compared to similarly rated corporate bonds in developed markets.

Local Currency	Hard Currency IG	Hard Currency HY

Commodities



We maintained our **Neutral** recommendation on Commodities. We remain positive on precious metals, which are in a bullish phase and could benefit from the uncertainties generated by Trump's unpredictable behavior, including the potential non-application of tariffs leading to a weaker dollar, and/or concerns over further fiscal slippage.

Precious	Energy	Industrial	Agricultural

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Currencies

The Committee downgraded the USD to **Underperform**. Several factors are contributing to the downgrade. The rate differential with other countries is narrowing, while the imposition of tariffs, the threat of mass layoffs in the public sector, and growing uncertainties caused by Trump's behavior could lead to a slowdown in the U.S. in the second half of the year. Additionally, Trump's confrontational stance towards the rest of the world could backfire, as foreign investors, who have been steadily investing in U.S. assets for decades, may fear retaliation. This could lead to a reversal of these flows if the rest of the world unites against the U.S.

As a consequence, the Committee also upgraded the Euro to **Outperform**. The favorable results of the German elections, the potential increase in fiscal spending in Germany and Europe—especially for defense—and the outperformance of EU markets since the beginning of the year could continue to support the Euro.

The view on the **Chinese Renminbi** remains **Neutral**, pending greater clarity about the decisions that will be taken at the National People's Congress this week.

The outlook for other **emerging market currencies** has also been upgrade to **Outperform**, mostly due to the expectation of a weaking dollar, which is usually bullish for emerging market currencies.

Euro	+	USD	−	CNY	=	Other EM	+

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