Investment Managers

Investment Institute Macroeconomics

Faith in the system

Monthly Investment Strategy

AXA IM Research

March 2023

Summary: March 2023

Theme of the month: When will US rates peak ?

- The US has witnessed the failure of three banks, one the largest in US banking history. The outlook is highly uncertain and market sentiment febrile. Despite swift action by the authorities, further large scale precautionary shifts in deposit holdings risk further issues in US banking – and potentially overseas. Turmoil to date suggests some tightening in credit conditions weighing on activity and reducing the need for future policy tightening.
- Stronger and more resilient economic activity has left the labour market still tight and risks a slower decline in core inflation. We suggest that labour market trends should be set to shift over the coming two quarters, a development more consistent with the Fed being able to pause in policy hikes.
- While banking sector uncertainty leaves the outlook uncertain, we now expect the Fed to hike just one more time, but leave rates on hold until year-end.

Macro update: Banking developments capture headlines, but inflation persistence is a common threat

- Concerns about global banking impacted outlooks directly in many developed market economies or indirectly via risk sentiment and the dollar elsewhere.
- Developed Western economies share a trait of resilient economic activity and persistently tight labour markets. In most regions consumer spending recovered sharply in Q1 compared with signs of weakening in Q4. Seasonality problems might be at work.
- In this context, while headline inflation continues to fall back, it largely reflects declining energy prices – particularly compared to last year. Core measures of inflation, whatever their varied range, exhibit more stickiness associated with still tight labour markets. This is a common phenomenon across many EM.
- Central banks generally are caught between a desire to rein in stronger growth and persistent inflation, and concerns about the global banking sector.
- Japan is seeing some improvement in its inflation outlook (sustainably to the upside). This may allow the BoJ to adjust its policy over the coming quarters.

Investment Strategy: risk premia on high alert amid banking troubles

- FX: US banking issues have put an end to February's USD rebound. Amid this uncertainty, confidence in EUR may well strengthen. JPY should recover further later in H2 2023. Broader EUR strength may not translate to higher EURCHF. As hard landing risk undermines support for high beta currencies.
- Rates: Recent events suggest a likelihood of a deceleration in economic activity, persistent inflation and financial & banking stress. There is a considerable level of uncertainty attached to the policy mix. The decline in yields appears excessive in view of sticky inflation and ebbing risk aversion.
- Credit: Spreads have widened on banking issues in the US and Europe, consistent with elevated recession risk. The entry point in terms of credit yield remains attractive, but we think some caution is warranted in terms of the risk-reward in spreads; until we get more clarity on the banking sector's issues.
- Equities: The Banks-triggered sell-off has realigned the market with fundamentals. Despite the elevated growth pessimism priced in the market, defensive stocks have the potential to further outperform cyclicals in the US and in Europe. In this environment, Quality tends to deliver the most value.

Central scenario

Summary – Key messages

Our central scenario: Global economy to slow, bank concerns non-systemic.

We forecast global growth to slow to 2.7% in 2023 and 2024.

Headline inflation to slow, more resilient growth to keep core firmer. Central banks tighter for longer.

Inflation

Supply-chain pressures ease, energy and food base effects strong. Headline inflation to fall sharply in H1 2023. Core slower to fall as labour markets remain tight.

Monetary policy

Most central banks close to peak. Rate cuts unlikely for most in 2023. Banking turmoil adds uncertainty and could see quicker reversal in policy if worsens.

Fiscal policy

Europe has provided fiscal supports, but lower energy costs could see consolidation. US debt ceiling debate threatens spending cuts.

Growth

Growth beginning to slow more obviously. Mild recession expected in US, Europe could avoid for now. Tighter credit conditions to add to headwinds.

Emerging Markets

Inflation should ease across EM. Central banks close to peak, some add FX intervention. Global rate adjustments add to fragile finances

Rates

Term rates remain low relative to policy. Technicals may account for some of inversion, but growth concerns key.

FX

Banking concerns impact dollar. Divergent bank policy supports others, particularly euro and yen in H2 2023.

Credit

Spreads have started 2023 on a strong footing, perhaps underpricing recession risk even if balance sheets in good health. Some caution warranted.

Equities

Earnings expectations are key for 2023 returns. A strong start to the year may create complacency given ongoing central banks hawkishness and macro headwinds. Margin pressures on the horizon.

Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 25%	A global boost Probability 10%
What could be different?	- Banking turmoil escalates, credit conditions tighten. - Escalation in Ukraine conflict - COVID outbreaks spreads again: China and/or new mutations - Post-pandemic structural persist. Supply shocks last longer - Inflation expectations rise, affecting wages and persistence	- Geo-political tensions ease – peace in our time. - Labour market participation recovers, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments
What it means	- Growth weaker, employment could start to fall, but inflation remains elevated - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
Market implications	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	- Risk-on environment, equities make further gains, growth retains lead over value - UST softens, EUR strengthens - Spreads grind tighter

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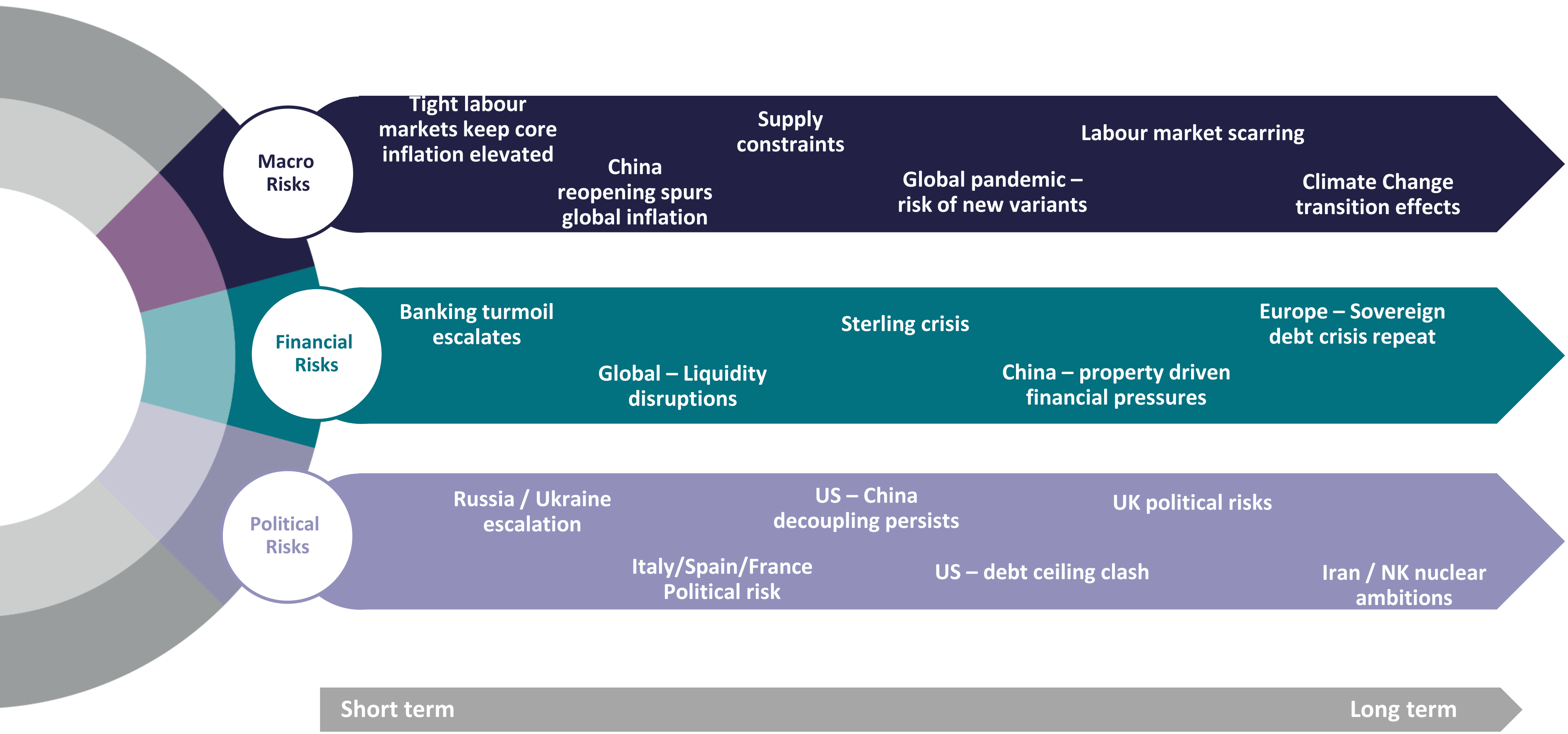
RISk Radar

Summary – Key messages



Contents

Theme of the Month

When will US rates peak?

A non-systemic financial collapse should have modest lingering impact

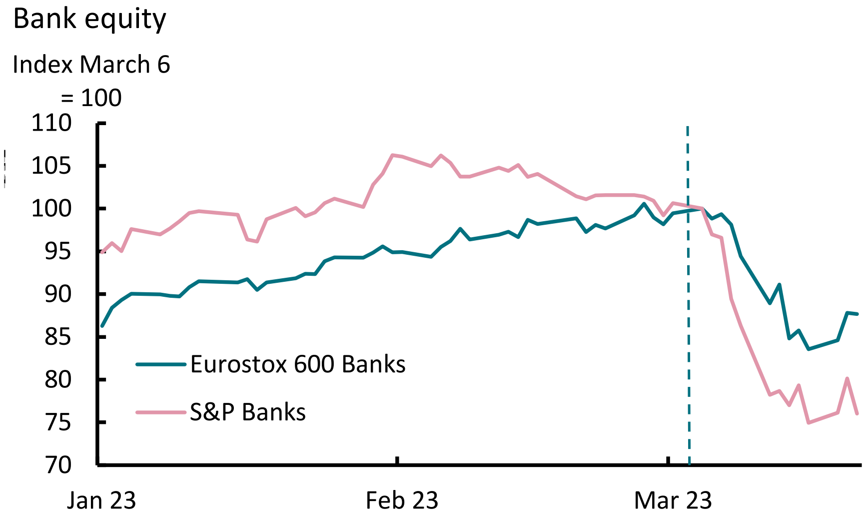
Largest bank collapses in history

- The collapse of Silicon Valley Bank (SVB) and Signature Bank were the first and third largest US bank wind-ups in history (Washington Mutual in 2008 is second), with Silvergate Bank also included. The FDIC used its Deposit Insurance Fund to avoid losses to depositors (and reassure depositors elsewhere to avoid any runs). The Fed enacted the Bank Term Funding Program to provide an alternative to crystalizing large marked-to-market losses for other banks, alongside Discount Window lending.

Systemic or not ?

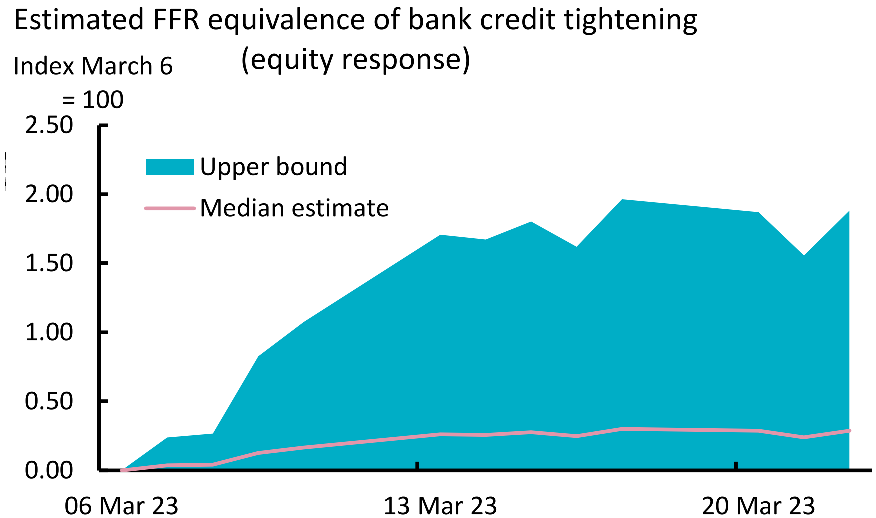
- It is difficult to immediately determine whether issues are systemic. The idiosyncratic client base and liability management of the failed banks suggests an idiosyncratic issue. However, Fed policy tightening, by design, creates pressure on the banking system and the NBER estimates losses of around $2trn in non-marked-to-market loans. On balance, we expect this not to be systemic. However, turmoil to date threatens a tightening in credit conditions, which will act as an additional headwind to activity. And with rates having risen so sharply, broader financial stability issues should see additional caution to future Fed policy tightening.

US bank equity underperforms Eurozone



Source: Bloomberg, AXA IM Research, Mar 2023

Estimated FFR equivalent impact of bank turmoil



Source: Bloomberg, AXA IM Research, Mar 2023

When will US rates peak?

Broader outlook for economy to turn

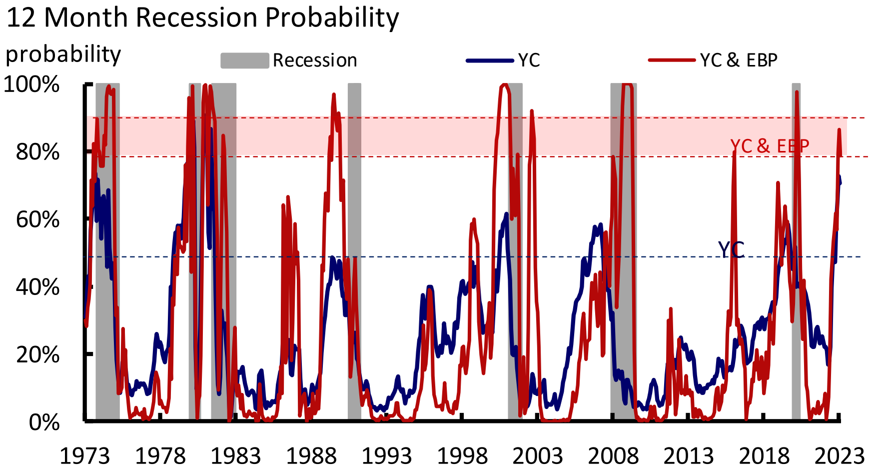
Recession model higher conviction

- Recessions are difficult to forecast bottom-up because of non-linear reactions.
- Our top-down recession model moved to signal greater recession conviction in the latest month. This was driven by greater 3m-10y curve inversion. A debate persists as to whether that relationship is casual or causal. If the former, arguments about balance sheet may distort, but if causal this is irrelevant. SLOOS pointed to a tightening in credit conditions consistent with a causal relationship. Increased financial instability suggests an acute version.

Credit conditions tighten

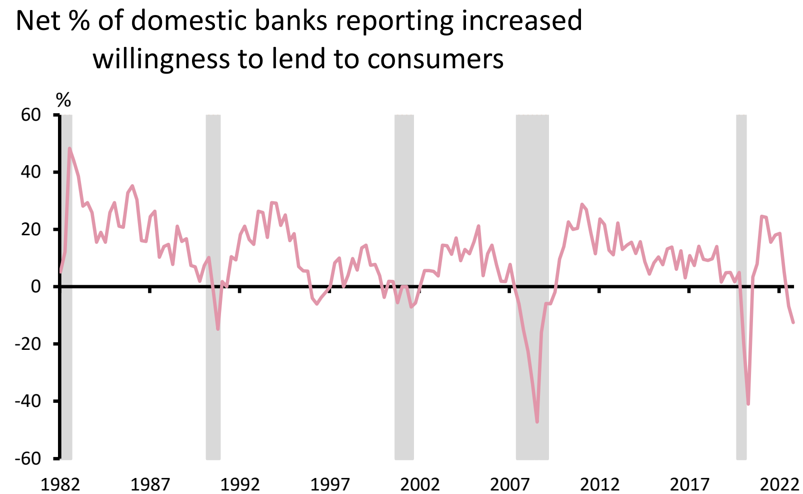
- A deterioration in bank lending to consumers has also historically occurred during most recessions. The Fed's Kashkari recently suggested that banking concerns brought the US "closer to recession".

Recession model shows conviction of downturn



Source: FRB, NBER, AXA IM Research, March 2023

Deteriorating bank willingness to lend to consumers



Source: FRB SLOOS, FRED, AXA IM Research, Mar 2023

When will US rates peak?

Robust employment growth should soften from Q2

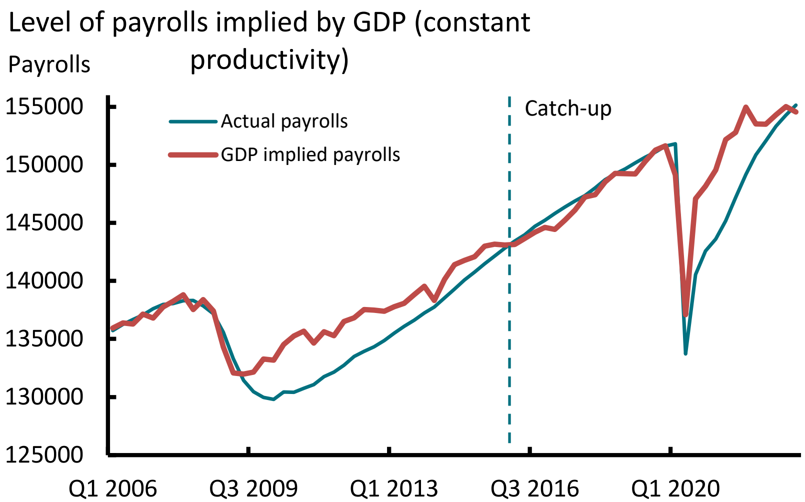
Post-recession jobs catch-up

- Employment growth is a function of underlying GDP growth. Over longer time frames the relationship changes with productivity. But over short-time frames – explicitly assuming constant productivity growth – we can estimate jobs required to meet. Employment has followed a familiar course: after recessions payroll growth lags the level of employment suggested by GDP. As the recovery persists, employment gains quicken to 'catch-up' the shortfall. Our estimates for jobs and GDP growth suggest that employment will have 'caught up' in Q1 2023, assuming productivity growth is unchanged from the previous cycle.

Employment growth slows after catch-up

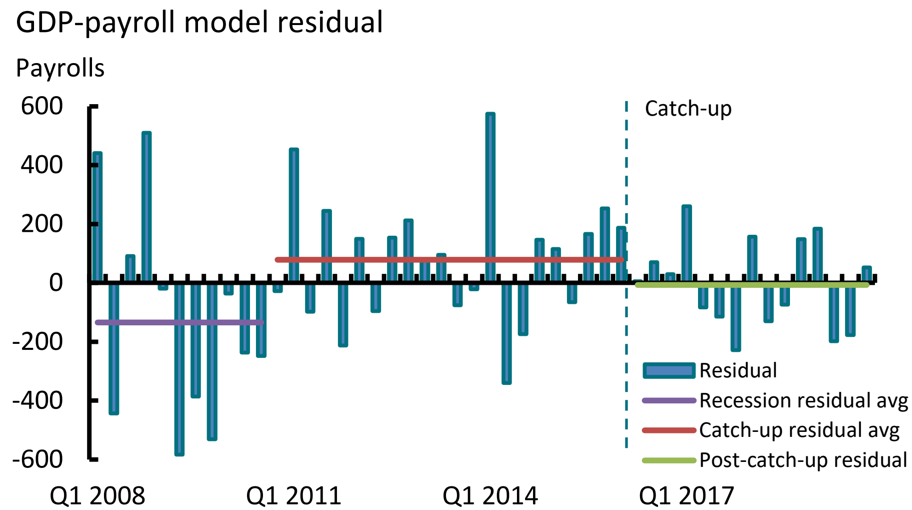
- After employment has 'caught-up', historically it has been better explained by GDP. After the GFC, employment growth fell by more than implied by GDP during the recession, by more than implied during the catch-up phase and in line with GDP after the catch-up phase. This suggests payrolls growth should soften from Q2 – again on the assumption of stable productivity growth.

Employment growth may finally have caught up



Source: BEA, BLS, AXA IM Research, Mar 2023

Payroll growth slows after 'catch-up'



Source: BLS, AXA IM Research, Mar 2023

When will US rates peak?

Usual monetary policy lags apply around mid-year

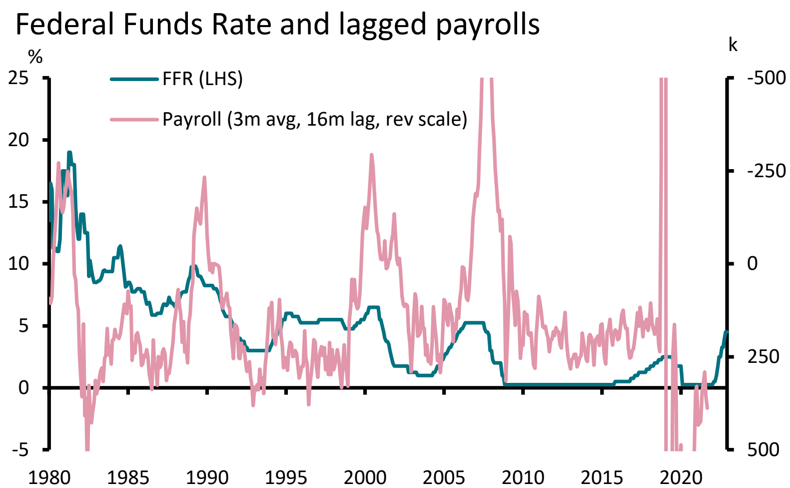
Usual lags now coming up

- Historically the labour market has tended to lag movements in the Fed Funds Rate by around 16m+ – with variation between cycles. With the Fed starting to tighten policy from March 2022, this would see a weakening emerging in H2 2023. This assumes that this cycle is similar, with the high level of vacancies still an uncertainty as to how much these represent pent up demand.

Seasonal uncertainties

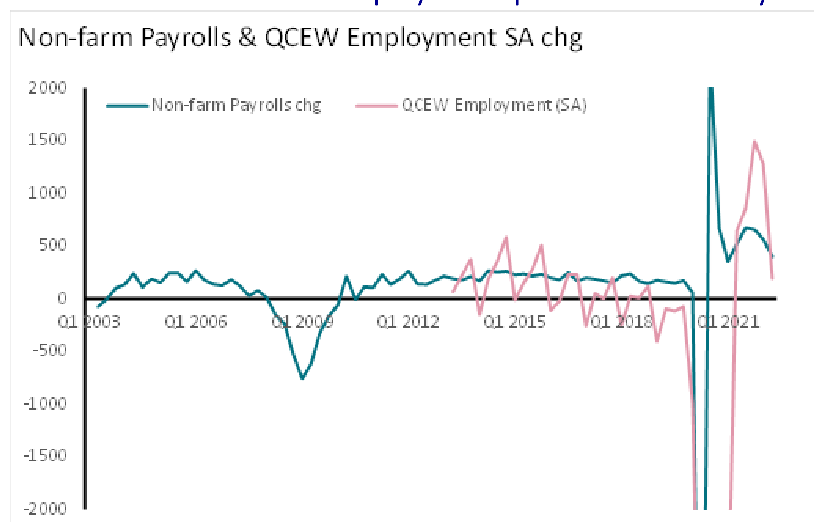
- There is also tentative evidence in the Quarterly Census of Employment and Wages (QCEW), which suggests that payroll growth has been much softer than recorded – questioning the tightness of the labour market. Other analysis has also questioned whether the pandemic has impacted the seasonals – if so these would start to unwind as we move though March.

The lagged impact of monetary policy on employment



Source: BLS, AXA IM Research, Mar 2023

Alternative measures of employment question seasonality



Source: Refinitiv, AXA IM Research, Mar 2023

When will US rates peak?

Additional turbulence after June: the debt ceiling

Debt ceiling .. again

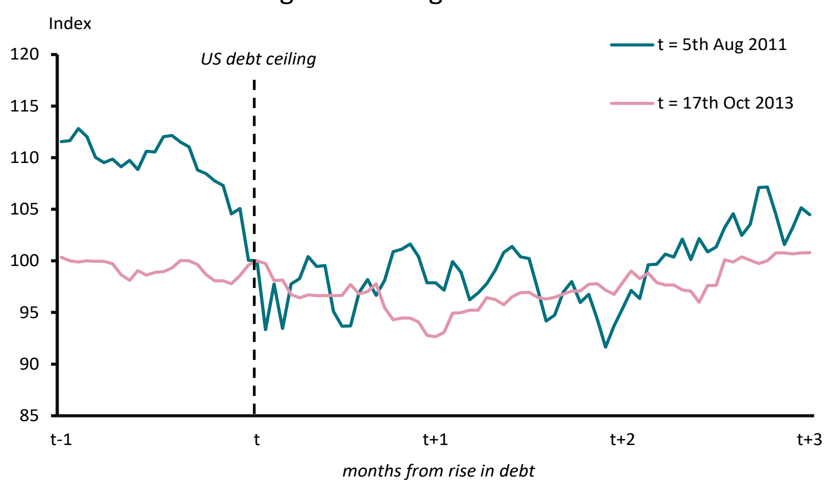
- The debt ceiling is once again being used as a tool by a faction of the Republican Party to extract spending cuts. Democrats believe they have learned from 2011 and will resist political pressure that they think hampered recovery. Republicans are being driven by a small minority – with leverage over House Speaker McCarthy. Estimates of X-date are uncertain, but around mid-August. Borrowing related to further banking sector developments could potentially have an impact on this timing. This is likely to come to a head before Congress goes into summer recess around end-July. The Fed meets 25-26 July.

Market reaction part of the solution

- It is unusual for a fully anticipated market event to have a significant impact. However, in this instance it appears market pain is likely to be necessary to provide the political cover necessary for compromise. As such, brinkmanship looks likely to be sufficient to justify market reaction before an expected resolution emerges. The S&P dropped 17% in 2011 and 7.5% around 2015 debt ceiling events.

Balance sheet unwind should progress smoothly

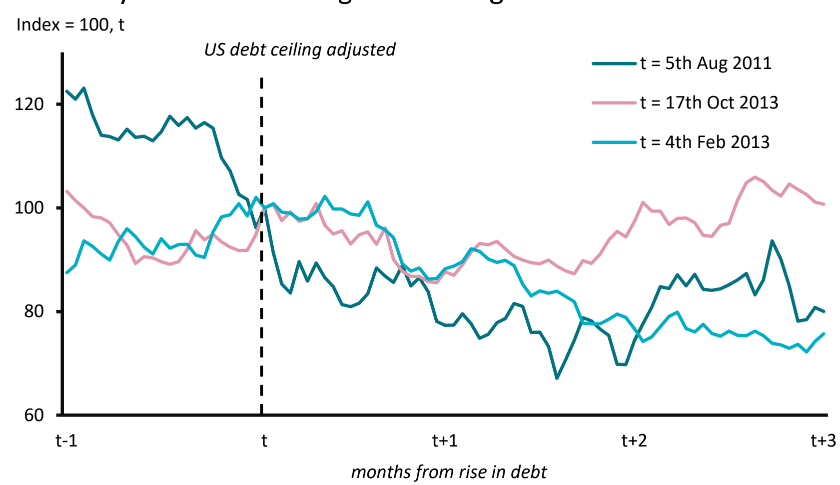
S&P 500 moves during debt ceiling crises



Source: FRB, AXA IM Research, Mar 2023

Liquidity has correlated with risk moves

US 10Y yield moves during debt ceiling crises



Source: FRB, AXA IM Research, Mar 2023

When will US rates peak?

One more hike and hold until year-end

Fed "some additional tightening"

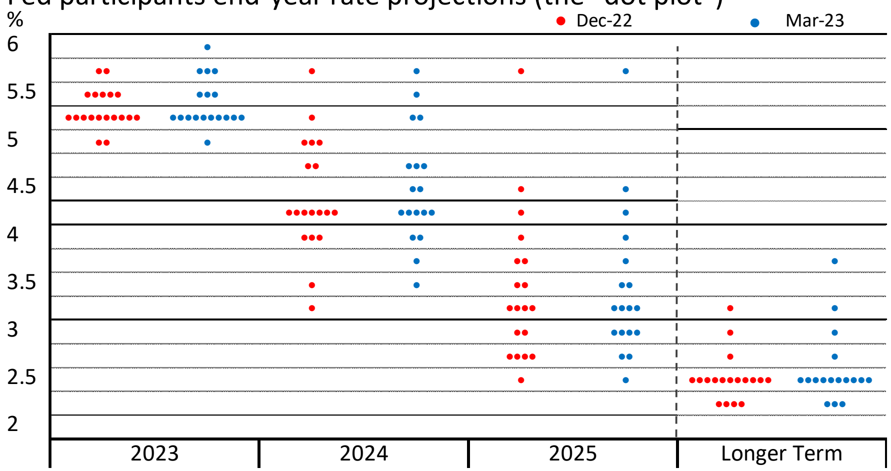
- The Fed's latest Summary of Economic Projections left the outlook for rates unchanged (in the median) from December at just one more hike, contrary to recent commentary that had suggested an increase in the expected rate peak. Fed Chair Powell stated that banking turmoil was now expected to tighten credit conditions, similar in fashion to rate hikes. He added that the outlook was highly uncertain and that the Fed would monitor the evolution of credit conditions versus expectations in setting future policy.

Market has different ideas

- To date, the market has taken a different outlook and currently prices the Fed to have peaked, while currently expecting three cuts to 4.00-4.25% by year-end. Whether this represents a base line expectation of a material worsening in the banking system; a mean expectation with increased downside risks; or a market taking out insurance against a worst-case scenario, the outlook has changed materially in less than one month and is materially different to our own and Fed expectations.

Balance sheet unwind should progress smoothly

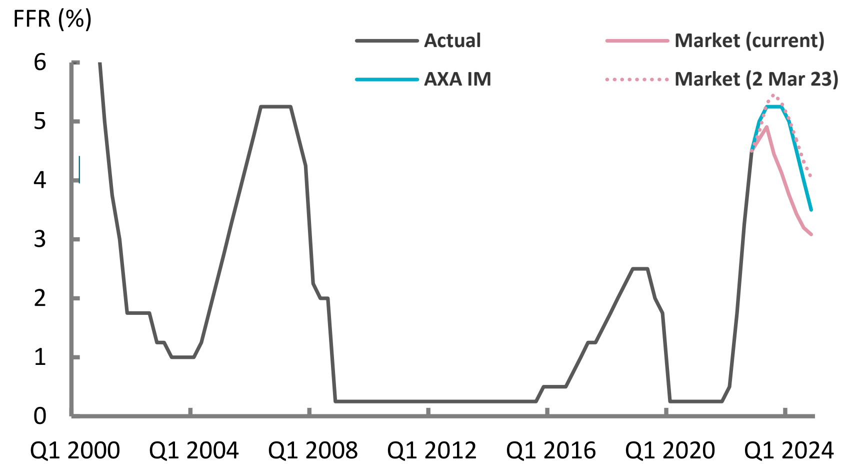
Fed participants end-year rate projections (the "dot plot")



Source: FRB, March 2023

Liquidity has correlated with risk moves

Fed Funds Rate and forecasts



Source: FRB, AXA IM Research, Mar 2023

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Macro outlook

Resilient economy

US

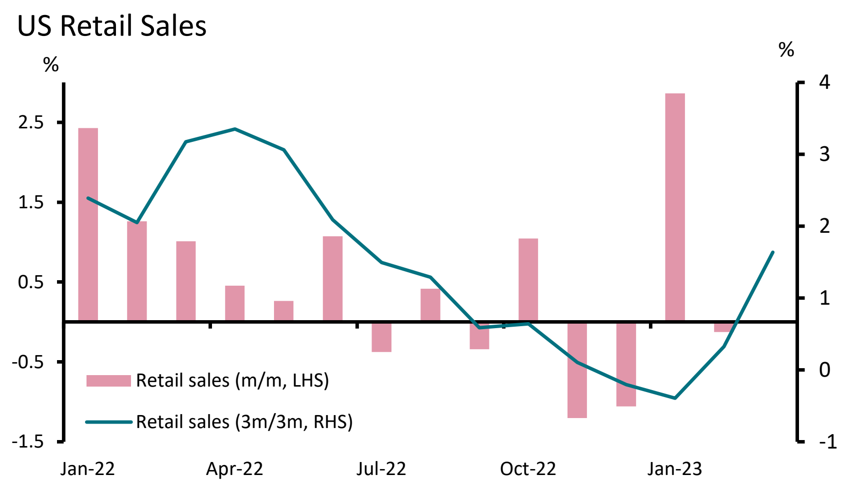
A stronger quarter's growth again

- Following a surprisingly solid Q4, Q1 shows signs of repeating the pattern. Strong retail sales in January barely retraced in February. Employment growth was also strong over the period, accelerating to a 3-monthly average expansion of 351k. We revise our outlook for Q1 GDP growth to 2.4% (saar), but the Atlanta GDPNow-tracker suggests 3.25%. Firmer short-term growth looks likely to see softer medium-term growth. However, we raise our 2023 GDP outlook to 1.0% (from 0.7%) and see 0.3% in 2024.

Inflation proves stickier

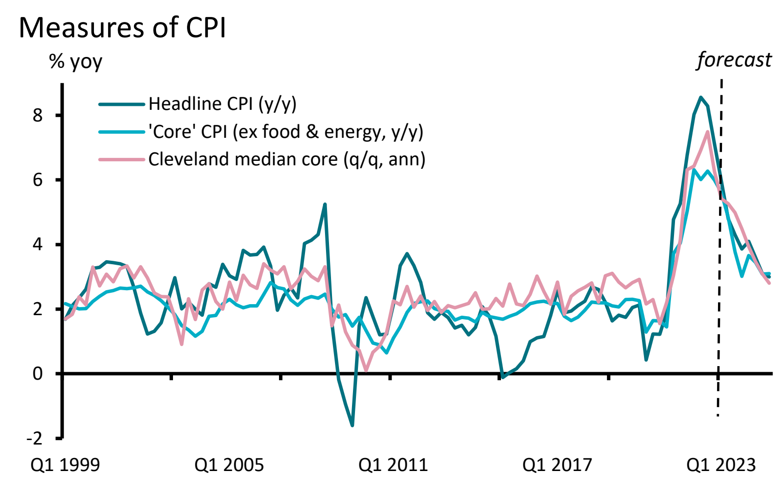
- Headline CPI inflation fell to 6.0% in February from 6.4% as energy prices continued to ease. However, excluding the volatile food and energy components, core inflation dipped marginally to 5.5% from 5.6% and broader measures of 'core', including the Cleveland median core measure confirmed sticky core inflation. This looks most likely to reflect a still tight labour market. We expect both measures to ease over the coming quarters, but dependent on a loosening labour market.

Retail sales surge into the New Year



Source: Refinitiv, AXA IM Research, March 2023

Core inflation remains sticky



Source: Refinitiv, Cleveland Federal Reserve, AXA IM Research, March 2023

Fed put on the horns of a dilemma

US

Labour market outperformance to come to an end

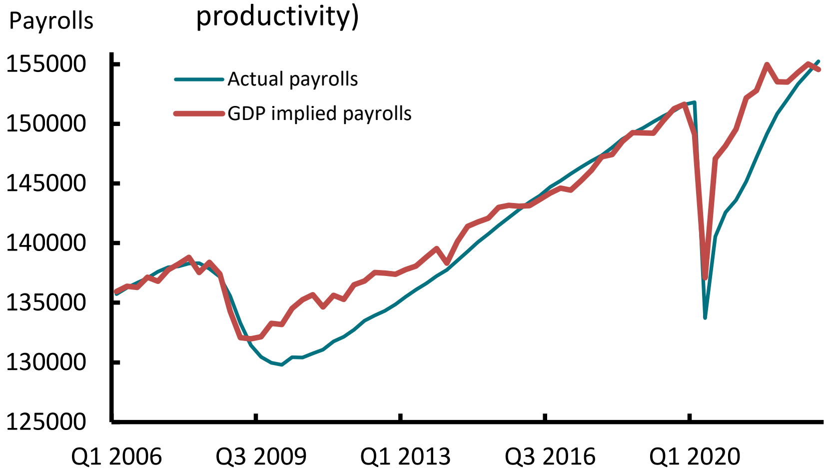
- Key to the outlook for activity and inflation will be the labour market dynamic – driving both household income growth and core inflation. We argue that employment growth has been through a post-recession 'catch-up' phase that should now have concluded. Moreover, we find that usual monetary policy lags of 15-18m should be about to impact on the labour market. As such, we expect labour market outperformance to fade over the coming quarters – reducing the pressure for higher rates.

Fed assumes tighter credit conditions will share the load

- The Fed left its policy rate outlook unchanged for December considering just one more hike – even as the market price three cuts before year-end. The Fed now believes that tighter credit conditions will have an equivalent effect as tighter monetary policy. It now assumes just one more hike one the assumption of the impact that emerging tighter credit conditions will have. But it accepts elevated uncertainty. We try to quantify the impact of banking turmoil on the rate outlook, also concluding a peak rate at 5.25%.

Period of payrolls 'catch-up' should be over

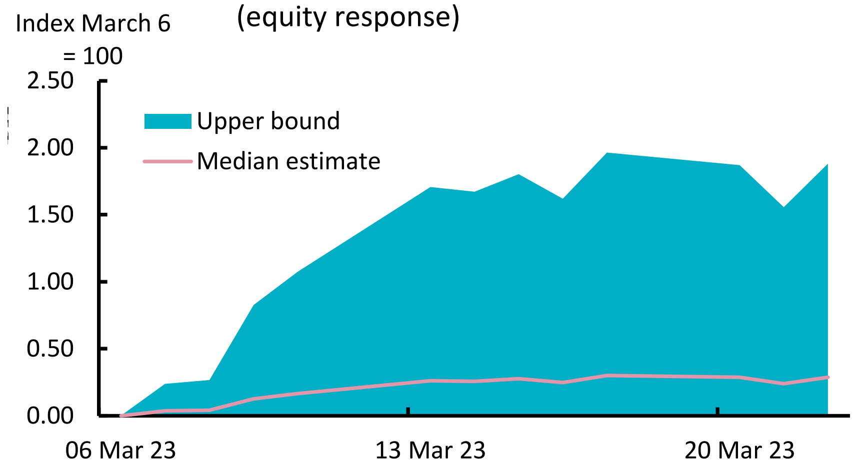
Level of payrolls implied by GDP (constant productivity)



Source: BLS, AXA IM Research, March 2023

Estimated equivalence of FFR tightening from banking turmoil

Estimated FFR equivalence of bank credit tightening (equity response)



Source: Bloomberg, Goldman Sachs, AXA IM Research, March 2023

Short-term growth upside risks while the dust settles

Euro area

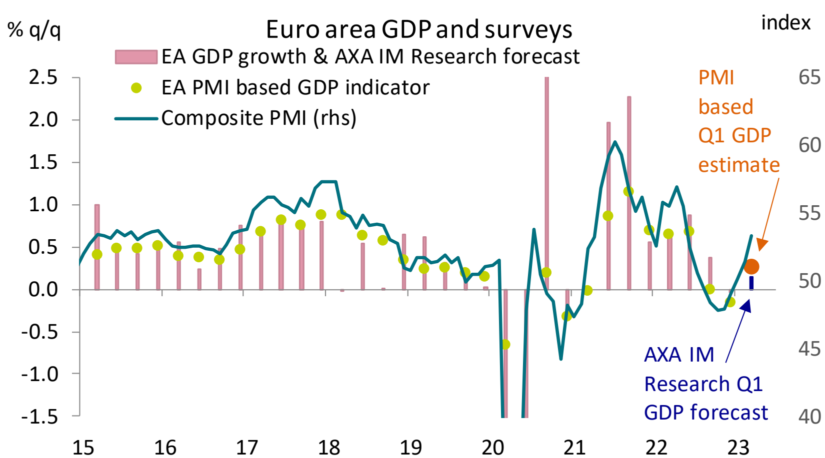
A cautious view on the growth outlook is still warranted

- Significant consumer purchasing power squeeze in H1, the lagged effects of monetary policy tightening and fiscal stance normalising towards neutral at best to be felt mainly in H2 and afterwards. Furthermore, dust is yet to settle from banking sector financial turmoil.
- March PMIs suggest upside risks to our 0.1% q/q Q1 euro area GDP growth forecast consistent with a flat print in Germany which may thus avoid two consecutive negative quarters
- We keep our conservative view on the economy projecting only a meagre growth path of 0.1% q/q on average every quarter this year, consistent with 0.7% average this year, and only 0.6% next (consensus forecasts 0.5% and 1.2%).

Core inflation dynamics are still skewed to the upside

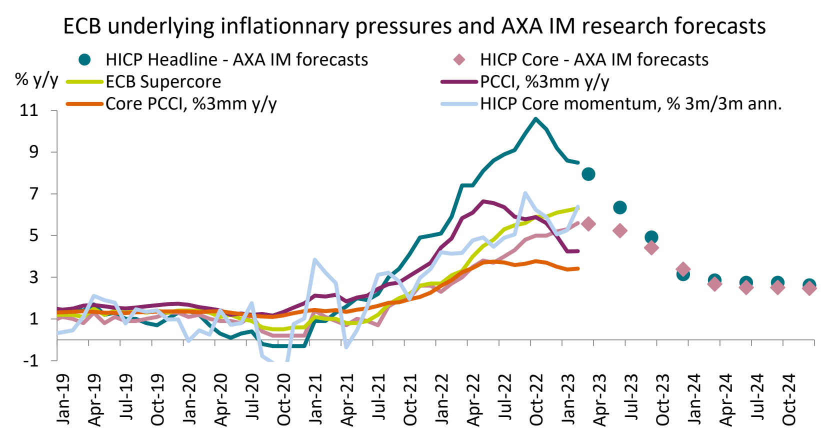
- It is not that the core inflation peak should be much higher, but it will likely take another several months before it engages a significant and persistent downward trend. We project euro area core inflation hovering between 5% and 5.8% y/y until July.

EA PMIs marked bounce point to short-term upside risks for growth



Source: Refinitiv, AXA IM Research, March 2023

Euro area underlying price pressures yet to turn decisively



Source: Eurostat, ECB, AXA IM Macro Research, as of March 2023. NB: PCCI stands for Peristent and Common Component of inflation

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ECB in a hawkish wait-and-see mode

Euro area

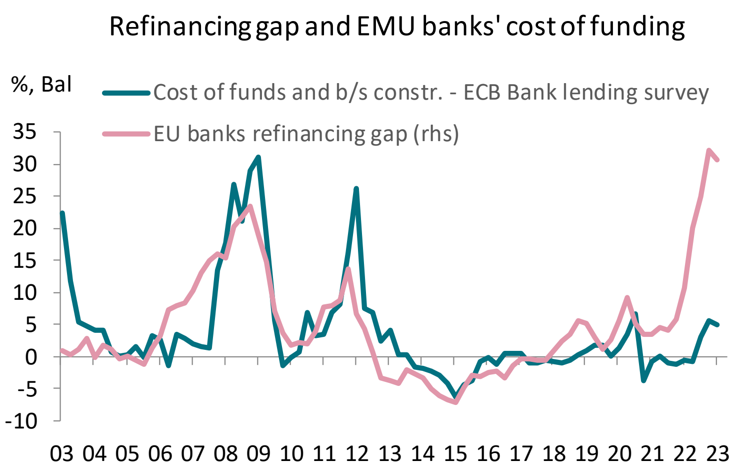
Bank's financial turmoil: A relevant market event, yet no big game changer (for now)

- Our in-house credit analyst team confirmed their upgraded outlook for the European banking sector, concurring with the reassuring signals made by ECB officials. Above and beyond daily moves in CDS's, equity prices, bank's refinancing cost, we will particularly pay attention to March's M3 data and the next ECB bank lending survey (both released on 2 May).
- While the banks' turmoil is unsurprisingly having little economic impact for now, we nonetheless think it will leave scars notably in terms of risk re-appreciation to filter through banks' funding costs, and in turn lending.

Our baseline foresees upside risks to 3.75% ECB terminal rate

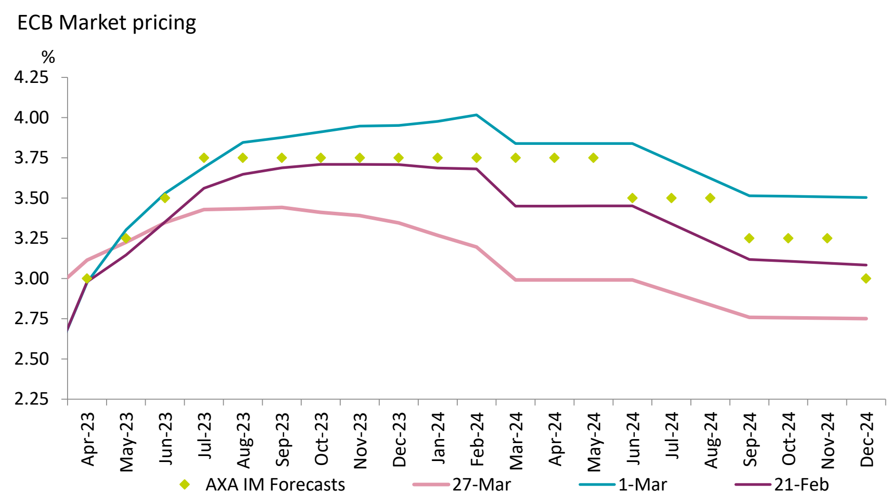
- All in, we now see the ECB hiking the depo rate by 25bps in May, June and July consistent with a terminal rate at 3.75%. We maintain our upside bias to this baseline notably for the next meeting. If the current shock takes longer to filter through, a 50bps hike remains a distinct possibility.

Macro data yet to catch up with market developments



Source: Bloomberg, ECB, AXA IM Research, March 2023

Massive short-end repricing



Source: Bloomberg, AXA IM Research, as of 27 March 2023

Indicators paint a mixed picture

UK

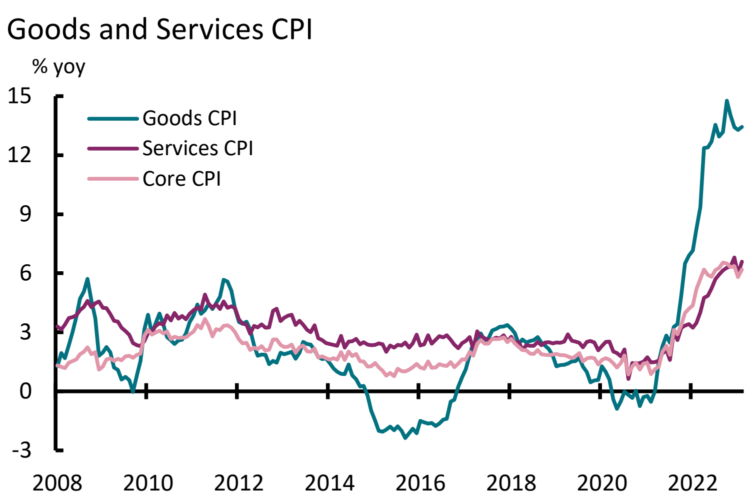
February CPI jumps unexpectedly

- Inflation surged unexpectedly in February, rising to 10.4% from 10.1% in January, driven by increases in clothing and food prices. Services and core inflation also picked up, reversing previous declines. The headline increase is unlikely to be sustained as energy price contributions drop out of the annual measure over the coming months, but we see some risk that core may remain elevated for longer.

Indicators suggest some improvement, but sentiment remains weak

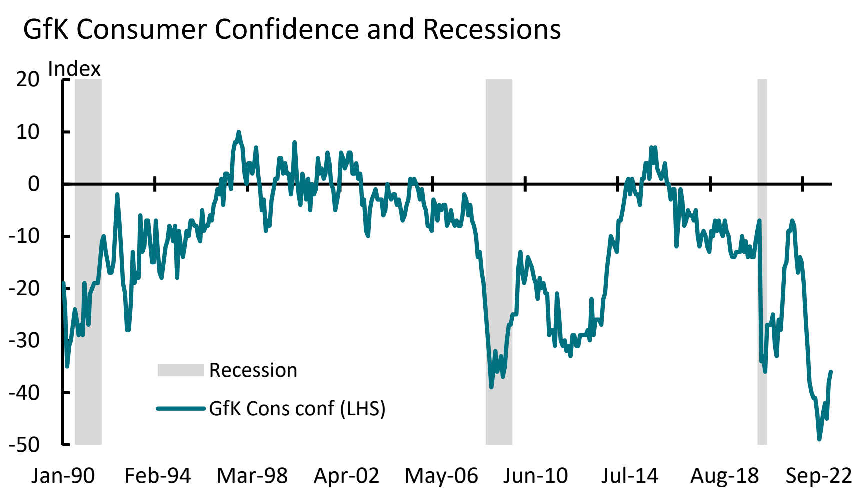
- Activity indicators suggest upside risks to our forecast of Q1 GDP growth at -0.1% q/q. PMIs have rebounded: the services PMI remains in expansionary territory and although manufacturing continues to struggle it is a more minor driver of UK GDP. Consumers have also shown signs of resilience. Retail sales rose by 1.2%mom in February on a January figure that was revised up to 0.9%mom from 0.5% before, bringing volumes back to pre-pandemic levels. But overall, the outlook remains weak and GfK consumer confidence is close to historic lows despite gradually improving.

Increases seen in headline, core and services



Source: ONS, AXA IM Research, March 2023

Consumer confidence remains close to all-time lows



Source: GfK, ONS, AXA IM Research, March 2023

BoE closes in on peak

UK

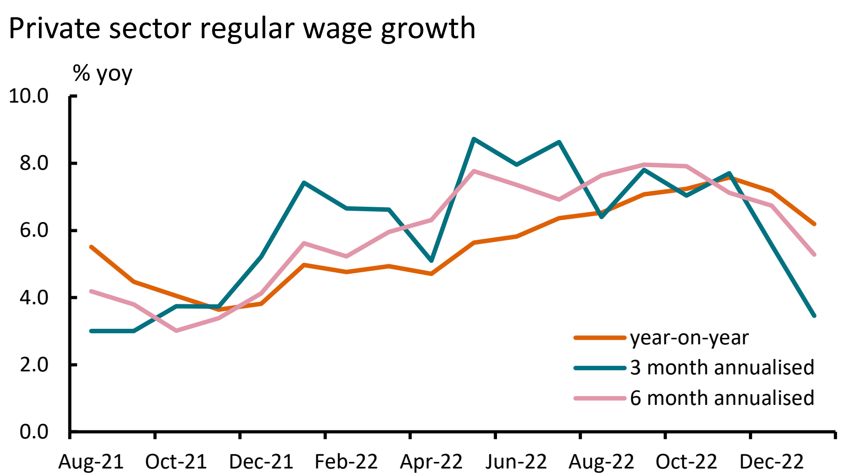
Wage growth slowing but stronger activity and broader labour market tightness a concern for MPC

- The wage outlook has improved, with growth starting to slow. Average growth in weekly earnings fell to 6% in February and Bank of England (BoE) Agents suggests 2023 settlements will stay around this level. Overall, the labour market remains tight: vacancies have eased in recent months but are still around two-thirds higher than pre-pandemic; and three-monthly employment growth remains firm at 65k in the latest reading.

One more and done

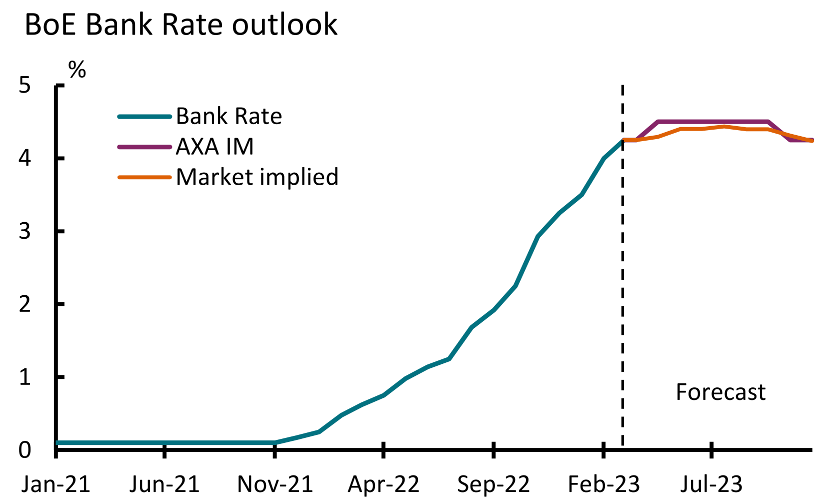
- The MPC hiked the Bank Rate by 0.25% to 4.25% in March, in line with our expectations. It considered the outlook for the UK banking system to be resilient. We raise our expectation for the Bank Rate, adding a further 25bp hike to 4.5% at the next meeting in May. The MPC remains wary of inflation persistence, and we think on this basis the labour market remaining tight in coming months, which suggests the appetite for tighter policy will remain. But further banking unrest could weigh on the outlook.

Wage growth slowing



Source: ONS, AXA IM Research, March 2023

Markets pricing in change of a 4.50% peak



Source: Refinitv, AXA IM Research, March 2023

Spring wage discussions look set to deliver biggest hike in 30 years

Japan

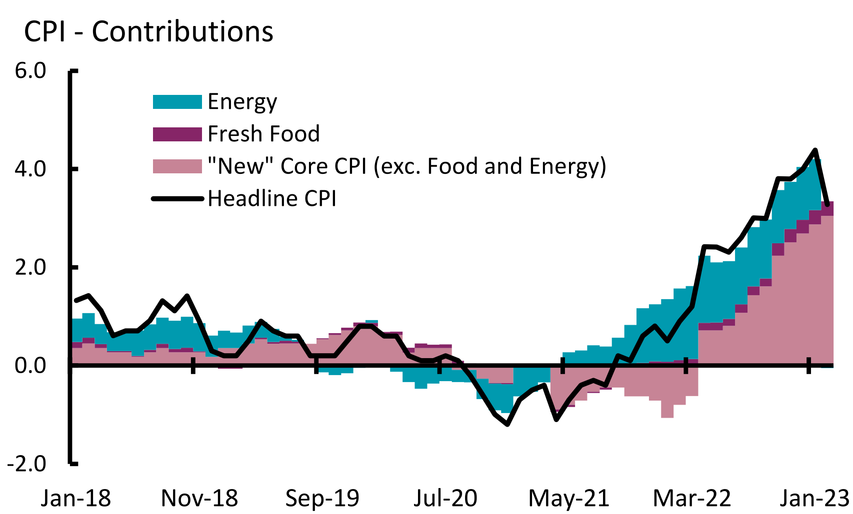
Headline falls, but core still on the rise

- Policy intervention has pushed headline CPI inflation down; CPI rose 3.3% in February down one ppt from January. This decline was driven by government measures to hold down household energy costs. In fact, BoJ core CPI (ex-fresh food and energy) continued to rise, picking up to 3.5% from 3.2% prior. Looking ahead, we expect CPI inflation to gradually lose momentum as contributions from food and energy increases fade.

Shunto wage gains 3.8%

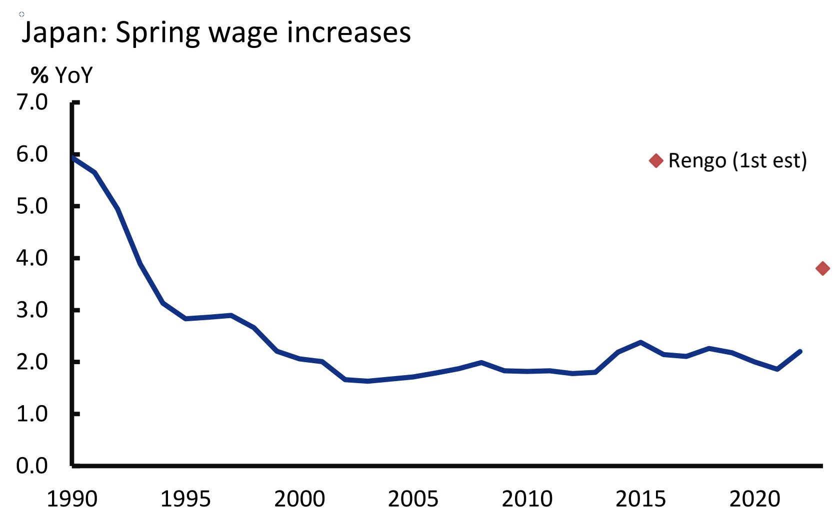
- On 17 March, the first-round results of the Shunto spring wage negotiations were released by Rengo. The results suggested an expected overall wage increase of 3.8% (2.3% in base pay) which would represent the biggest settlement in over 30 years. This came well above expectations for a 3% hike. Going ahead, we will focus on any revisions to the figures, as more unions report, and the distribution of the hikes, particularly across firms of different sizes.

Energy contribution pushes headline lower



Source: Refinitiv, AXA IM Research, March 2023

Spring wage negotiations set to deliver biggest hike in 30 years



Source: Rengo, Refinitiv, AXA IM Research, March 2023

BoJ look set to tweak YCC

Japan

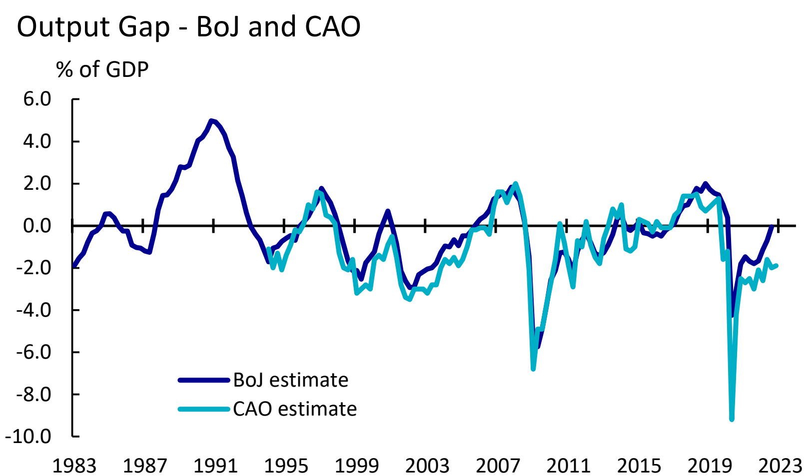
Strong wage prospects set scene for YCC tweak

- Given the improving wage and price dynamics and the assessment from the BoJ that the output gap is closing, we think the BoJ will take steps to exit YCC sooner than anticipated. We expect it to tweak YCC by July with a view to removing the policy altogether later this year. We expect it will reduce the tenor of its target to 5Y from 10Y as a further widening of the band around 10Y would do little to improve market functioning.

BoJ to remain cautious

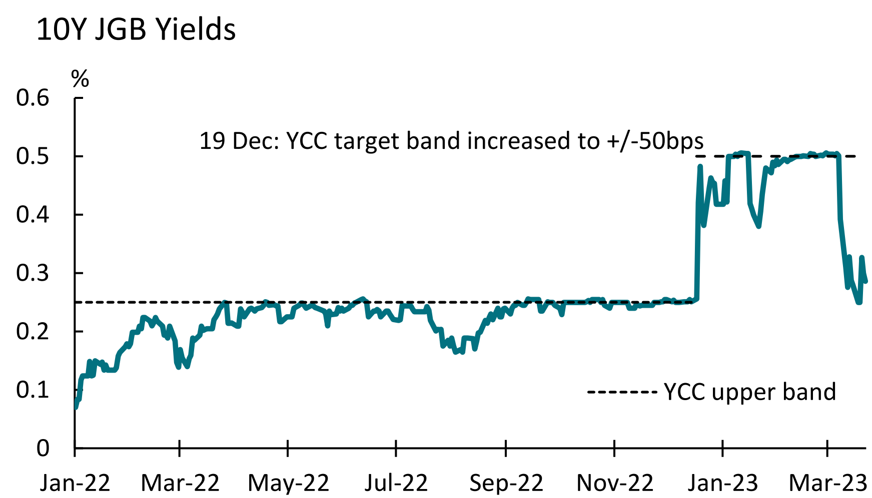
- Despite this, we still expect the BoJ to remain cautious, driven by considerations around weakening global growth and the potential for rapid yen appreciation, particularly in the more risk-averse environment triggered by banking concerns. We expect the removal of the negative interest rate policy to be delayed until 2024 as the BoJ will likely want to see further evidence of persistent improvement in price dynamics, including from the next spring wage negotiations, and see how the economy weathers the adjustment in YCC first.

Output gap closing



Source: Bank of Japan, Cabinet Office, AXA IM Research, March 2023

Recent rate moves provide relief to YCC



Source: Refinitiv, AXA IM Research, March 2023

AXA Investment Managers

Economic resilience persists

Canada

Economy quickens in Q1

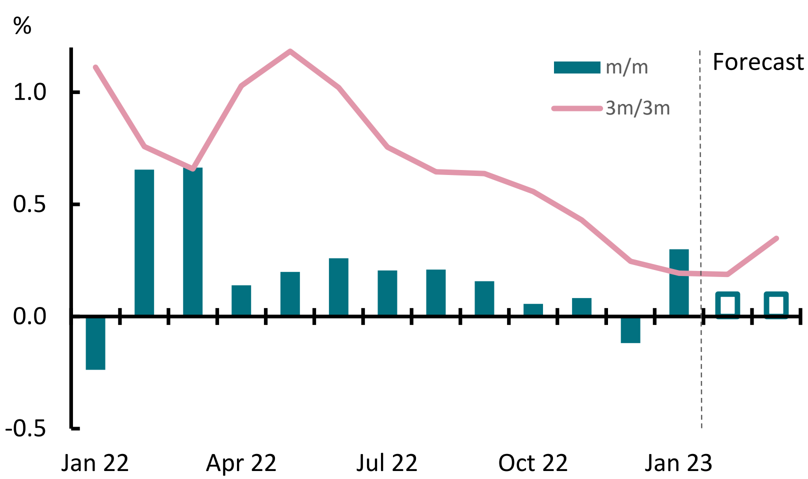
- Q4 GDP came in weaker than we expected at 0.0% q/q, but short-term factors weighed including a large inventory unwind and declines in business and residential investment. Household spending remained solid. An unexpected dip in December looks to be reversed by a 0.3% (preliminary) rise in January, threatening a quicker Q1 GDP overall. We continue to forecast GDP to expand by 1.0% in 2023 and just about avoid a recession. We forecast 1.0% in 2024. Consensus forecasts are for 0.7% and 1.5% respectively.

Headline falls – core remains sticky

- Headline inflation fell to 5.2% in February – down sharply on January's 5.9% on energy base effects. The BoC forecasts the headline rate slowing to around 3% by mid-year. However, core measures of inflation have remained more stubborn over the last few quarters. The slower adjustment in core inflation appears more directly associated with an ongoing tight labour market.

Canadian GDP appears to quicken in Q1

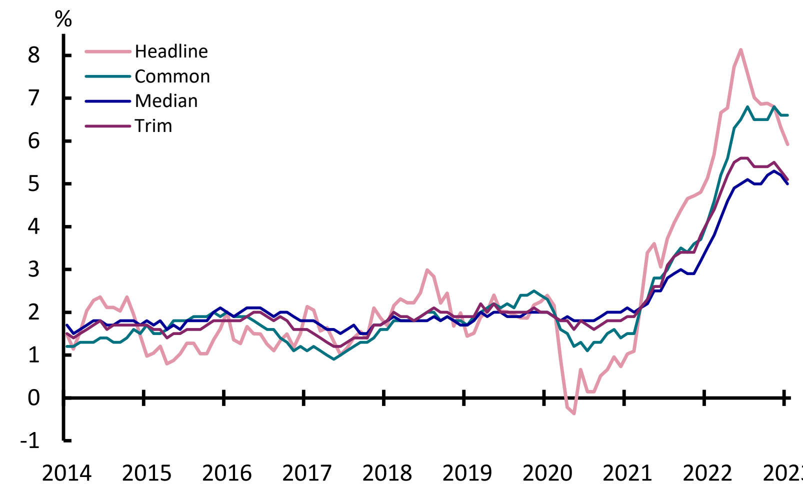
Canadian GDP



Source: CANSIM, AXA IM Research, March 2023

Headline inflation falls; core remains sticky

CPI measured variations



Source: CANSIM, AXA IM Research, March 2023

Bank concerns dominate market pricing

Canada

Few signs of labour market loosening

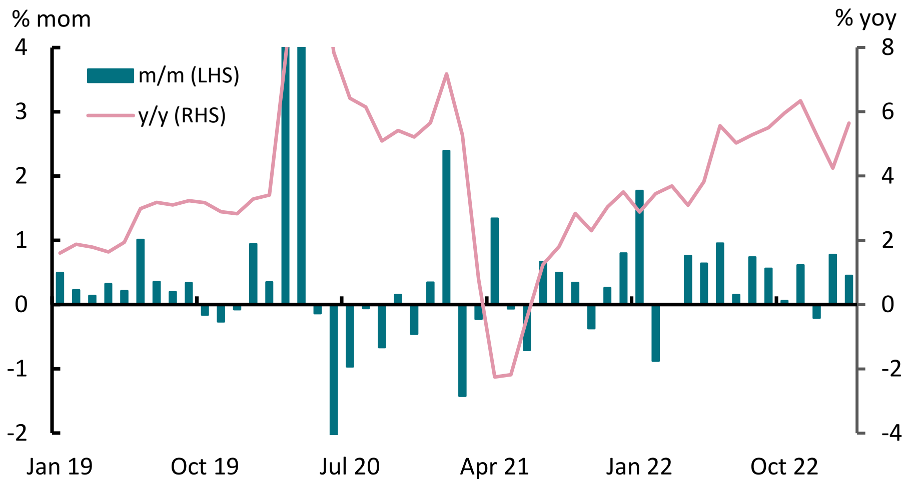
- Employment rose by a further 22k in February, slower than the 150k gain in January, but showing no signs of unwinding consistently strong private sector jobs growth. Unemployment remained close to multi-decade lows at 5.0% - it did not fall further because the labour supply also rose sharply and labour force participation rose back to 65.7%. Average earnings growth had shown some signs of softening in Q4, but strong monthly gains in January and February suggest reacceleration in Q1.

BoC outlook blurred by banking

- The BoC left rates unchanged at 4.50% in March – the first developed market central bank to pause. This pause to consider the lagged impact of policy tightening appeared prescient in the face of global banking concerns. However, the resilient economic data question whether the BoC's "conditional pause" is "restrictive enough". We continue to see the BoC on hold at 4.50%, but expect it to maintain this restrictive rate into 2024. In light of recent bank developments, markets now expect rate cuts in H2 2023.

Wage pressure continue to highlight tight labour market

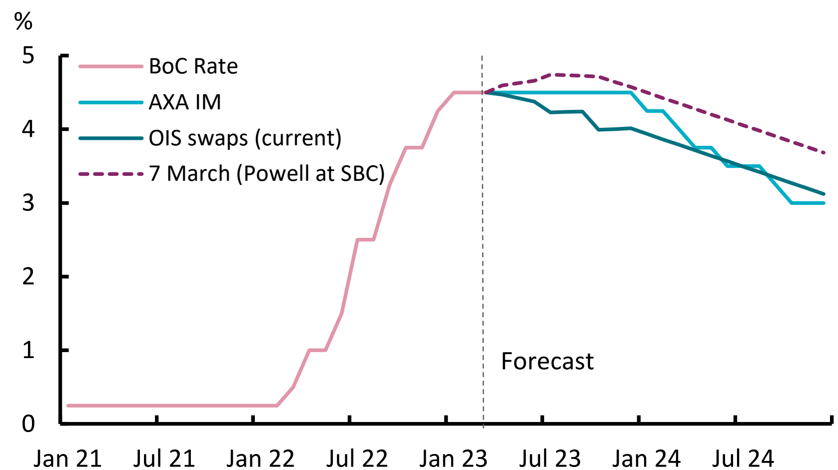
Average earnings



Source: CANSIM, AXA IM Research, March 2023

Banking concerns impact market pricing

Bank of Canada overnight rate and outlook



Source: Bloomberg, AXA IM Research, March 2023

Peak inflation reached, but disinflation path ahead may be difficult

Emerging Markets

Is Latin America finally seeing an end to inflation?

- Headline inflation in Colombia was stable at 13.3% in February after having increased without interruption since last May. As such, it seems that inflation has finally peaked in all major economies of the region (except Argentina and Venezuela). Yet, core inflation rose in Chile for a second month in a row, while food prices remain elevated in Peru due to massive protests and weather event.

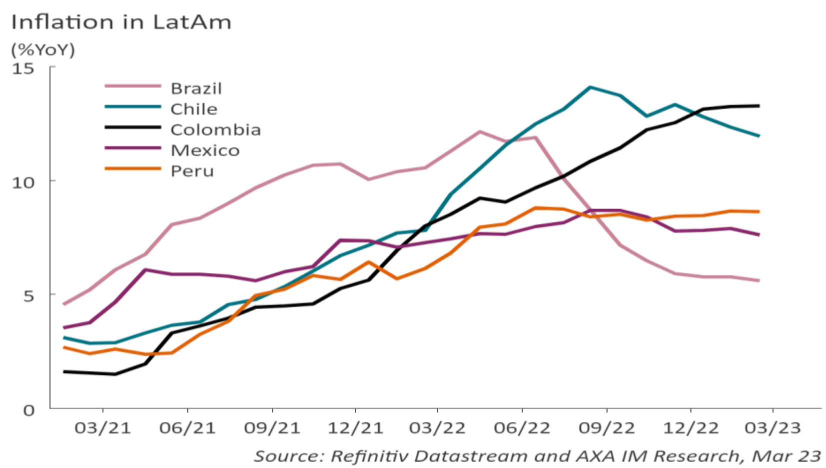
Inflationary pressures are easing, but food prices remain sticky in Asia

- Easing global energy prices contributed to declining inflation for Asia. For India and the Philippines, inflation declines have been challenged by still elevated food prices. Conversely, Thai inflation eased significantly on the back of food prices – services inflation is likely to rebound going ahead, despite a tepid recovery in the tourism sector.

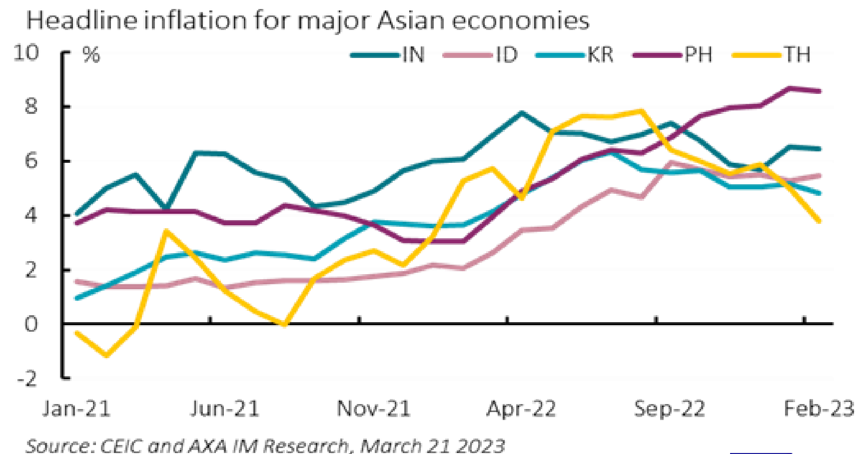
Headline inflation declined further in CEEMEA but core still tricky

- Inflation declined further from peaks in most of the countries in the region mostly driven by non-core prices (energy and food prices). Core inflation also moderated in the Czech Republic, Hungary, Turkey and Russia, but increased in Poland, Romania and South Africa suggesting a more moderate persistent path of inflation remains ahead.

LatAm: Columbia, last to have reached inflation peak?



Asia: inflation still elevated in India and the Philippines



Investment Managers

EM central banks remain vigilant

Emerging Markets

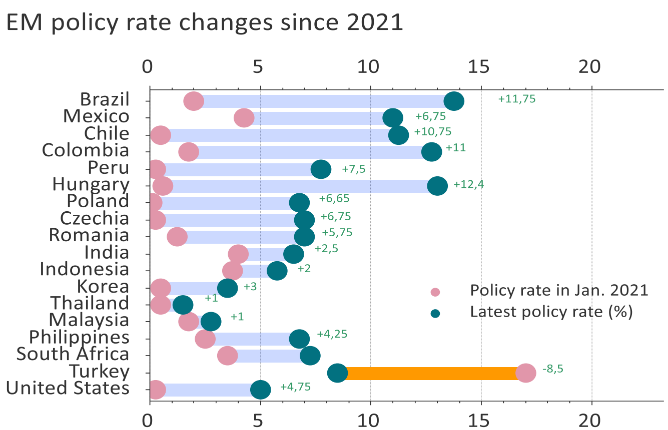
EM central banks are showing pragmatism in front of stubborn inflation…

- Signs of relative hawkishness emerged among various EM central banks: an unexpected hike in Taiwan, a less dovish pause in Brazil (markets were waiting for a policy pivot), no additional rate cut in Turkey, a higher-than-expected hike in Mexico, more tightening in the Philippines. These developments appeared to reflect caution over the slowing retreat in inflation (and happened before the recent banking concerns).

… and are assessing the effects of the past tightening on growth

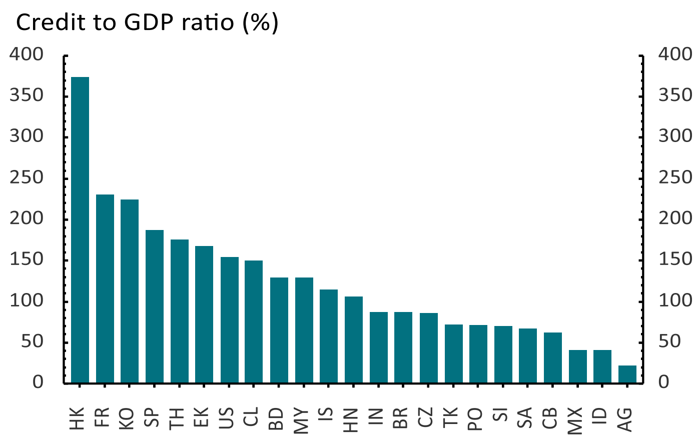
- While growth resilience has been rather impressive, signs of a slowdown are growing as higher interest rates filter into the rate-sensitive sectors of the economy. Construction and real estate sectors started to cool in several economies.
- However, policy transmission varies between countries, depending on banks' role in the financing of the economy, the structure of loans offered (fixed or variable) and, more broadly, the degree of indebtedness of each country – as credit-to-GDP ratios can vary from 224% for Korea to 40% for Mexico or Indonesia.

EM monetary policy tightening has run a long course…



Source: Refinitiv Datastream and AXA IM, March 24 2023

… but transmission to real economy (demand/inflation) can vary



Source: Refinitiv Datastream and AXA IM Research Q3 22

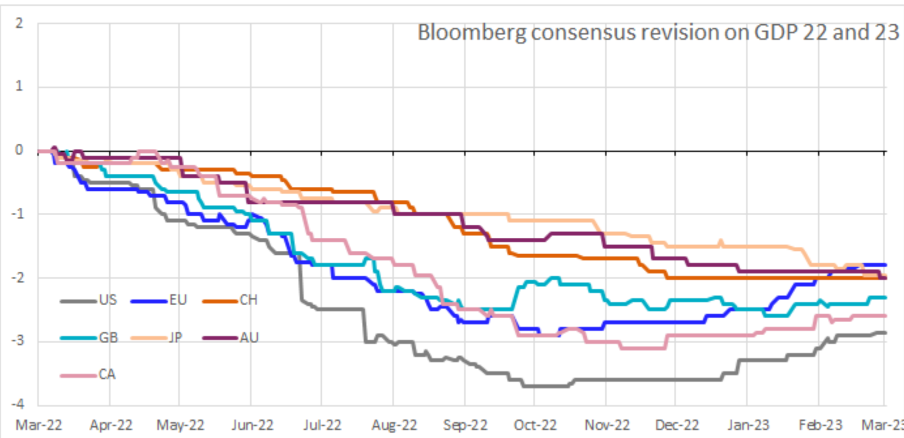
Investment Strategy

FX Strategy

Reduced visibility, but a clearer path for EUR

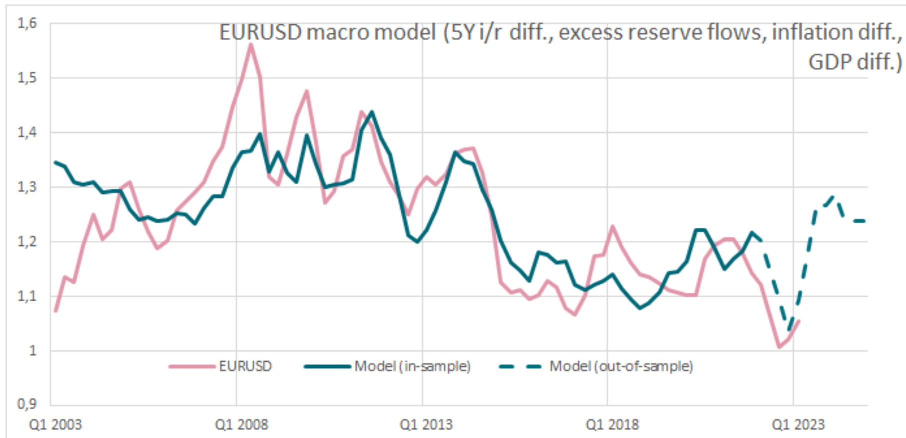
- US banking issues have put an end to February's USD rebound. Given the emerging frailties in US regional banks, the bar for further Fed tightening appears to be higher. But at the same time, USD could still strike back if inflation continues to prove sticky as US rates currently underprice this. As a hard landing risk has been repriced higher, this undermines recent support for high beta currencies.
- Amid this uncertainty, confidence in EUR may well strengthen. Rising core inflation in the Eurozone should keep the ECB on the hawkish side. An improving growth outlook and current account balance, along with China reopening are also supportive. The Eurozone economic cycle is younger, and the Fed is likely to turn dovish earlier than the ECB. Lastly, if US inflation surprises to the upside, ECB expectations are likely to follow the Fed's.
- JPY should recover further in H2 2023 as US inflation softens and the US rate outlook falls. Extra support could come from BoJ the removing Yield Curve Control, maybe in June. But the JPY may suffer a setback before then, given expensive carry and already dovish Fed pricing.
- CHF depreciated amid the Credit Suisse upheaval. But behind the noise, inflation has sharply rebounded in January, raising the risk of renewed intervention from SNB to defend the currency. So broader EUR strength may not translate to higher EURCHF this time.

EU growth outlook has recovered marterially



Source: Bloomberg and AXA IM Research, Mar 2023

Higher EU inflation/rates, ECB b/s unwind, point to EURUSD rebound



Source: Bloomberg and AXA IM Research, Mar 2023

Investment Strategy

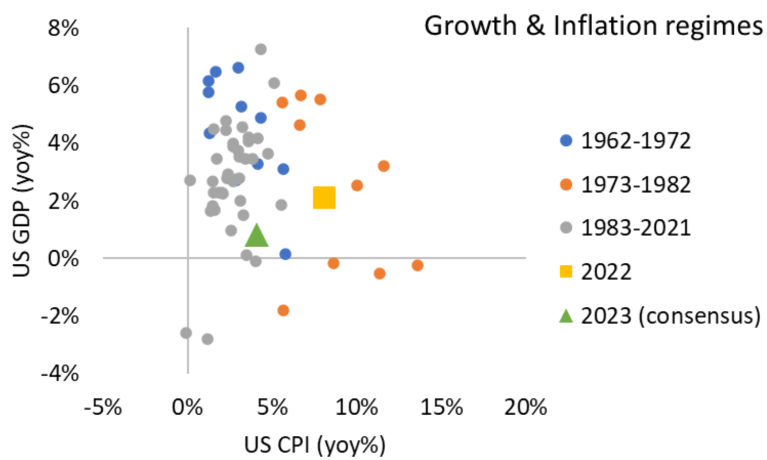
Rates: dealing with a potential policy trilemma

- Recent events suggest an increasing likelihood of a simultaneous deceleration in economic activity, persistent inflation and financial & banking stress. This matters because there is no 'policy playbook' to follow, as investors we have not experienced such a scenario in recent history. Essentially, we're talking about a blend of late 70s stagflation and late 80s S&L crisis. The former alone is very unlikely by itself, as in the past 60 years we've had few observations of negative annual GDP growth and faster than 5% price inflation.

- Under this tail risk scenario, there is a considerable level of uncertainty attached to the policy mix. Does monetary policy stay tight to fight off inflation? or does it ease off to prevent a protracted economic slowdown? And what about fiscal policy? - inflation expectations typically rise in response to expansionary budgets. Macroprudential policy is essential to the stability of the banking sector, but relies on liquidity metrics as well as credit controls, which may be in conflict with fiscal and monetary policy.

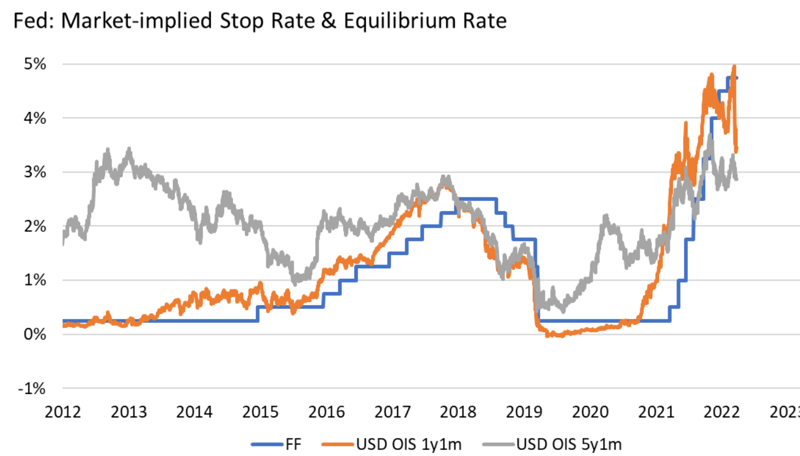
- The Fed seems to have reached a neutral/contractionary policy stance, which could be appropriate in case of an idiosyncratic shock in an otherwise inflationary scenario. Markets are pricing in aggressive rate cuts during the second half of 2023. While this re-pricing can be explained by very short rates positioning and safe haven flows, it appears excessive in view of sticky inflation and stabilising risk aversion.

Current growth/inflation regime more like the 1970-80s



Source: Bloomberg and AXA IM Research, Mar 2023

Market pricing implies that Fed cycle is nearing its end



Source: Bloomberg and AXA IM Research, Mar 2023

Investment Strategy

Credit: spreads on high alert amid banking troubles

- Spreads have widened in the past couple of weeks, on the back of the banking issues in US and Europe. This appears to be consistent with elevated recession risks, as banks are likely to become a lot more cautious, thus restricting their lending and precipitating a deceleration in economic activity.

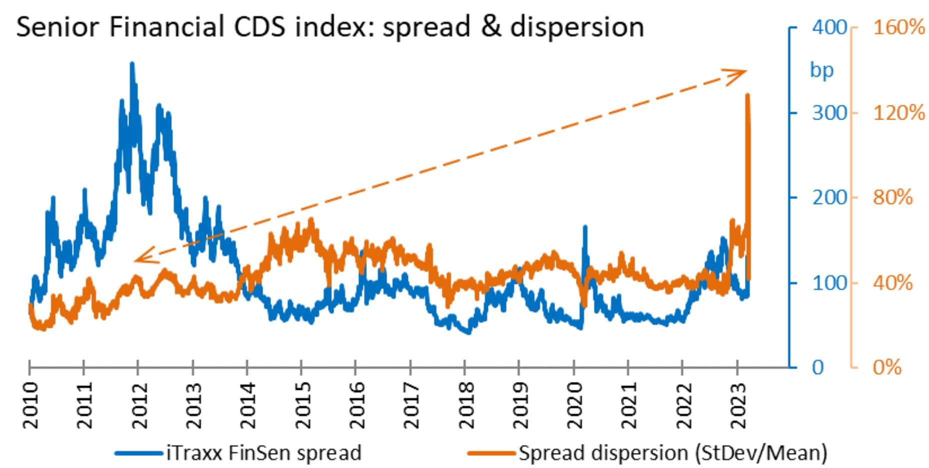
- The widening in spreads has pushed credit yields higher, but not to the point of making fresh highs compared to Oct 2022, because the decline in underlying govie yields has mostly offset the rise in spreads. The entry point in terms of credit yield remains attractive, yet we think that some caution is warranted in terms of the risk-reward in spreads, until we get more clarity on the banking sector's issues.

- As far as the issues amid European banks are concerned, we are encouraged by the fact that the reaction by CDS within the iTraxx Senior Financials CDS index has been typical of an idiosyncratic shock, inasmuch dispersion within the CDS basket first spiked and then collapsed, in contrast to the (systemic) eurozone crisis in 2011-12, when dispersion remained subdued (as CDS spreads widened in unison).

Lower govie yields have offset wider spreads, holding credit yields below their October highs

Source: ICE & AXA IM Research; Mar 2023

CDS spread reaction to Europe banks issues so far idiosyncratic



Source: IMS Markit, Bloomberg, AXA IM Research; Mar 2023

Investment Strategy

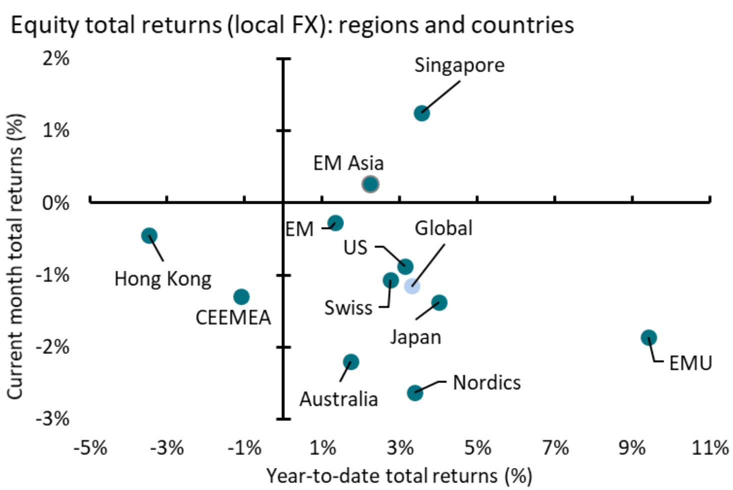
Equities: Quality's time amid the turmoil

- Most recent developments in the financial sector on both sides of the Atlantic have triggered a risk-off sentiment, bringing most global indices' performance to negative territory over the last month. At the time of writing, Singapore (+1.2%) and EM Asia (+0.3%) are the only two regions which have delivered positive returns, recovering from February's double digit negative figures. Sector wise, Telecom (+4.5%) and Tech (+4.3%) have led the pack, benefiting from their defensive and quality characteristics.

- Over the past three months, the market has exhibited a risk-off trend consistent with low inflation and economic activity and high (expected) unemployment rate. The Banks-triggered sell-off has realigned the market with fundamentals. Despite the elevated growth pessimism priced in the market, defensives stocks have potential to further outperform cyclicals in the US and in Europe.

- In this environment, Quality delivers the most value. We tend to favour quality investment strategies in general, but especially when macroeconomic fundamentals become headwinds for stock markets (high inflation, low growth), Quality is likely to offer the best excess returns in the asset class.

Equity markets around the world are in retreat



Markets sometimes look too far ahead into the future, before realising that near term macro risks may be looming

Source: MSCI, Refinitiv and AXA IM Research, March 2023

Key market calls

Our directional views across assets in key markets (3-month horizon)

CURRENCIES	weaker	neutral	stronger
Euro			●
Yen		●	
GBPEUR		●	

EQUITY	lower	neutral	higher
US equity	●		
EU equity		●	
EM equity		●	

RATES	higher	neutral	lower
US rates short	●		
US rates long		●	
EU rates short	●		
EU rates long	●		

CREDIT	wider	neutral	tighter
US IG		●	
EU IG			●
US HY		●	
EU HY			●

CURRENCIES

Banking troubles clouding central bank inflation fighting. Cyclical advantage in Europe & US centric banking concerns suggest EUR upside near term. Less so in JPY on BoJ inaction. Sterling caught between inflation pressures and growth concerns.

EQUITY

More constructive on Europe, due to growth resilience and appealing valuation, while we see an uptick in growth downside in the US. Profit margin pressures ahead point to further downside in profits' momentum. Not the best mix for stocks.

RATES

Market moves in rates remain extraordinary. Bar a full blown banking crisis, short end yield moves appear excessive. Long end yields better anchored by drop in peak policy rates and higher growth downside. Short end yields likely to rebound higher.

CREDIT

Spreads are caught in no man's land. Wider on banking troubles but not wide enough to compensate for recession risk. Banking risks more systemic in the US than in Europe. Tail risk for spreads more broadly is towards widening.

Source: AXA IM Core Investment Research, as of 27 March 2023

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Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2022*		2023*		2024*	
	AXA IM	Consensus	AXA IM	Consensus	AXA IM	Consensus
World	3.5		2.7		2.7	
Advanced economies	2.7		1.0		0.7	
US	2.1	1.9	1.0	0.7	0.3	1.1
Euro area	3.5	3.2	0.7	0.4	0.6	1.2
Germany	1.9	1.7	0.2	-0.1	0.6	1.4
France	2.6	2.5	0.6	0.4	0.6	1.2
Italy	3.8	3.7	0.6	0.4	0.5	1.0
Spain	5.5	4.5	1.3	1.2	0.9	1.9
Japan	1.6	1.5	1.7	1.1	1.3	1.1
UK	4.0	4.4	-0.3	-0.8	0.5	0.7
Switzerland	2.3	2.1	0.6	0.6	1.3	1.6
Canada	3.5	3.4	1.0	0.6	0.8	1.5
Emerging economies	3.9		3.7		3.8	
Asia	4.2		5.0		4.6	
China	3.0	3.1	5.3	5.2	5.0	5.1
South Korea	2.6	2.6	1.5	1.2	2.0	2.2
Rest of EM Asia	5.7		5.0		4.4	
LatAm	3.9		1.5		2.1	
Brazil	3.0	2.9	1.0	1.0	1.5	1.8
Mexico	3.1	2.9	1.2	1.1	1.8	1.8
EM Europe	1.6		0.0		2.2	
Russia	-2.1		-3.8		2.0	1.2
Poland	5.0	4.9	0.1	0.8	2.4	3.0
Turkey	5.6	5.1	0.5	2.2	1.4	2.4
Other EMs	4.8		3.0		3.4	

Source: Datastream, IMF and AXA IM Macro Research – As of 27 March 2023
*Forecast

AXA Investment Managers

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2022*		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	7.3		4.7		2.7	
US	8.0	8.1	4.5	3.9	3.2	2.5
Euro area	8.3	8.5	5.8	5.5	2.8	2.4
China	2.1	2.1	2.3	2.4	2.5	2.3
Japan	2.5	2.4	2.7	2.1	1.3	1.2
UK	9.1	9.0	5.8	6.7	2.2	2.9
Switzerland	2.8	2.9	2.0	2.2	1.3	1.2
Canada	6.8	6.8	3.8	3.7	2.7	2.3

Source: Datastream, IMF and AXA IM Macro Research – As of 27 March 2023

**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy
eting dates and expected changes (Rates in bp / QE in |

		Current	Q2-23	Q3-23	Q4-23
United States - Fed	Dates	5	2-3 May 13-14 Jun	25-26 Jul 19-20 Sep	31-1 Oct/Nov 12-13 Dec
	Rates		+0.5 (5.25)	unch (5.25)	unch (5.25)
Euro area - ECB	Dates	3.00	4 May 15 Jun	27 Jul 14 Sep	26 Oct 14 Dec
	Rates		+0.5 (3.5)	+0.25 (3.75)	unch (3.75)
Japan - BoJ	Dates	-0.10	27-28 Apr 15-16 Jun	27-28 Jul 21-22 Sep	30-31 Oct 18-19 Dec
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	4.25	11 May 22 Jun	3 Aug 21 Sep	2 Nov 14 Dec
	Rates		+0.25 (4.50)	unch (4.50)	-0.25 (4.25)

Source: AXA IM Macro Research - As of 27 March 2023

Calendar of 2023 events

	Dates	Events	Comments
April	02-Apr	Finland elections (National Parliament)	
	08-Apr	BoJ Governor Kuroda's term ends	
	13-Apr	Northern Ireland Assembly elections	Latest date if executive not formed
	24-Apr	BoE Meeting	Unchanged (4.25%)
	28-Apr	BoJ Meeting	Unchanged (-0.1%)
May	02-03 May	FOMC Meeting	+25bps (5.25%)
	04-May	ECB Meeting	+50bps (DFR=3.5%)
	04-May	UK local elections	
	07-May	Thailand general elections	
	11-May	BoE Meeting	Unchanged (4.25%)
	14-May	Germany (Federal state elections)	
	23-May	BoE Meeting	Unchanged (4.25%)
	28-May	Spain Regional elections	
June	Early June	US Earliest Treasury special measures could see debt ceiling impact	
	13-14 June	FOMC Meeting	Unchanged (5.25%)
	15-Jun	ECB Meeting	+25bps (3.75%)
	16-Jun	BoJ Meeting	Unchanged (-0.1%)
	18-Jun	Turkey presidential and parliamentary elections	
	29-30 June	EU Summit	
July	July	US Estimated resolution of the debt ceiling	
	July	Greece elections (National Parliament)	
September	Autumn 23	Poland presidential elections	
October	29-Oct	Argentina general elections	
December		Spain (National Parliament)	

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Latest publications

ECB Quantitate Tightening: Navigating a treacherous path

1 March 2023

February Global Macro Monthly – Economic cross currents and central bank re-pricing

23 February 2023

February Monthly OpEd – The end of the dovish pivot

23 February 2023

ESG dissection of European equities

2 February 2023

2023 emerging market elections: The who's who and the so what…

27 January 2023

January Global Macro Monthly – 2023 starts on a more positive note

25 January 2023

January Monthly OpEd – It feels better, but central banks on the lookout

25 January 2023

Outook 2023-2024 – Global slowdown to subdue inflation

1 December 2022

The unequal impact of inflation: How governments are responding

27 October 2022

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