AXA Investment Managers

Investment Institute Macroeconomics

Summer passes, winter's coming

Monthly Investment Strategy

AXA IM Research

September 2022

Summary: September 2022

Theme of the month: The energy market shock

- Russia has been able to cut gas supplies to Europe in response to economic sanctions as gas revenues form a smaller part of its total energy revenues and overall prices have risen.
- Europe is vulnerable to this supply interruption. However, swift action from European governments has reduced consumption (Germany by 20%, Italy closer to 8%) and rebuilt storage ahead of the winter. Germany is still likely to require additional restrictions (rationing) over the winter as are some CEE economies. Italy is close, but France and Spain should have sufficient supplies. The UK should also be self-sufficient given its LNG import terminals.
- The US has increased LNG exports to Europe by around 17bcm on the year over H1 2022, although an explosion at a terminal might constrain exports a little more in the second half. Longer-term, the US has the resource and plans to materially increase its energy exports. However, this will be a medium to longer term plan, with difficulties arising from appetites for long-term contracts.

Macro update: Temperatures keep on rising for central banks

- European economies face a tough winter. We lower our Eurozone growth outlook to include a more distinct contraction in Q4 this year and Q1 next. We forecast a modest rebound thereafter, but a gas storage rebuild, and tight policy will prevent the level of growth rebounding to current levels by end 2023. The UK is also likely to fall into recession, despite a huge fiscal easing announced that has undermined confidence in UK markets.
- US news is mixed. The short-term drop in gasoline prices appears to be boosting Q3 activity. Falling real incomes, corporate profits, high inventory and tighter financial conditions still look set to push the US into a mild recession. Moreover, the Fed signalled higher rates into 2023. We expect a softer labour market to see the Fed peak at 4.25%, but without compelling evidence of slowdown it will move further.
- China has suffered recurrent setbacks from COVID, despite evidence suggesting a more muted reaction this time. Moreover, the authorities are merely ringfencing the housing market adjustment. We lower our growth outlook for 2022 to 3%. The upcoming Party Congress will help define the 2023 outlook
- CEE remains dominated by the energy crunch facing the rest of Europe and we lower our forecasts sharply here. Asian economies have benefitted from lower inflation to date. Latam has not, but significant policy tightening in several economies may leave policy close to the peak in several economies.

Investment strategy: risky assets under pressure amid fresh wave of central bank hawkish repricing

- FX: USD to remain supported by the stronger US cyclical position, robust real yields and/or bouts of risk aversion. Pressure on the euro and sterling to continue and CNH should also keep trending lower. By contrast, the CHF might do better in Europe and the AUD might outperform high beta currencies.
- Rates: The jump in yields in September has been particularity brutal, compounding the worst drawdown in returns in decades. A rolling over in spot inflation levels now appears as a necessary condition for policy expectations and thus longer-term yields to stabilise.
- Credit: Credit has suffered too in the latest bout of risk aversion; bad, but not as bad as govie bonds. HY markets continue to offer attractive an entry point in both spread and yield terms, but a worsening macro backdrop merits prudence and dictates careful credit selection.
- Equity: The momentum of global equities has shifted since the end of August, following hawkish rhetoric by central bankers at the Jackson Hole symposium. Europe earnings growth forecasts for 2023 are holding up but GDP growth forecasts do not justify such expected levels of earnings.

Central scenario

Summary – Key messages

Monetary policy

Most central banks continue to tighten as inflation high and concerns of inflation expectations rise. Slowing activity to alter this outlook around turn of year. PBoC and BoJ major exceptions.

Inflation

Supply-chain pressures ease, but energy and domestic pressures persist. Headline inflation pressures near peaks, but slow to fall next year.

Fiscal policy

Europe adding to fiscal supports to ameliorate cost-of-living. More material step-up if gas supply interruption occurs. US deadlocked in Congress.

Growth

Growth beginning to slow more obviously. Recessions expected in Europe and US. Gas interruption to result in severe slowdown over winter.

Our central scenario:

Tighter financial conditions and energy inspired inflation shock to see recession in Europe and the US.

We forecast global growth to rise by 3.1% and 2.4% in 2022 and 2023.

Economic slowdown amidst supply pressures and tighter monetary policy. Inflation slow to fall in 2023.

Emerging Markets

Inflation rising across EM. Central banks hike more, some add FX intervention. Some fiscal response add to fragile finances

Rates

Rates push higher as Fed struggles to rein in economy. Technicals may account for some of inversion, but broadly reflects growth concerns.

FX

Dollar continues to fresh peaks and appears extreme. Risk outlook key to support. Sterling collapses following new government stimulus.

Credit

Volatile spreads in 2022 on central bank and geopolitics, but spreads now wide by standards of last decade.

Equities

Earnings expectations are getting shakier due to inflation & downside risks to growth. Despite already adjustment to date, risks still to downside.

Alternative scenarios

Summary – Key messages

Entrenched supply shock ***(probability 35%)***

What could be different?

- Escalation in Ukraine conflict
- Russian oil supply interruption into European winter
- COVID outbreaks spreads again: China and/or new mutations
- Post-pandemic structural persist. Supply shocks last longer
- Inflation expectations rise, affecting wages and persistence

What it means

- Growth weaker, employment could start to fall, but inflation remains elevated
- Monetary policy ill-equipped to deal with supply shocks, deteriorating inflation credibility forces still tighter monetary policy in DMs

Market implications

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

A global boost ***(probability 10%)***

What could be different?

- 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

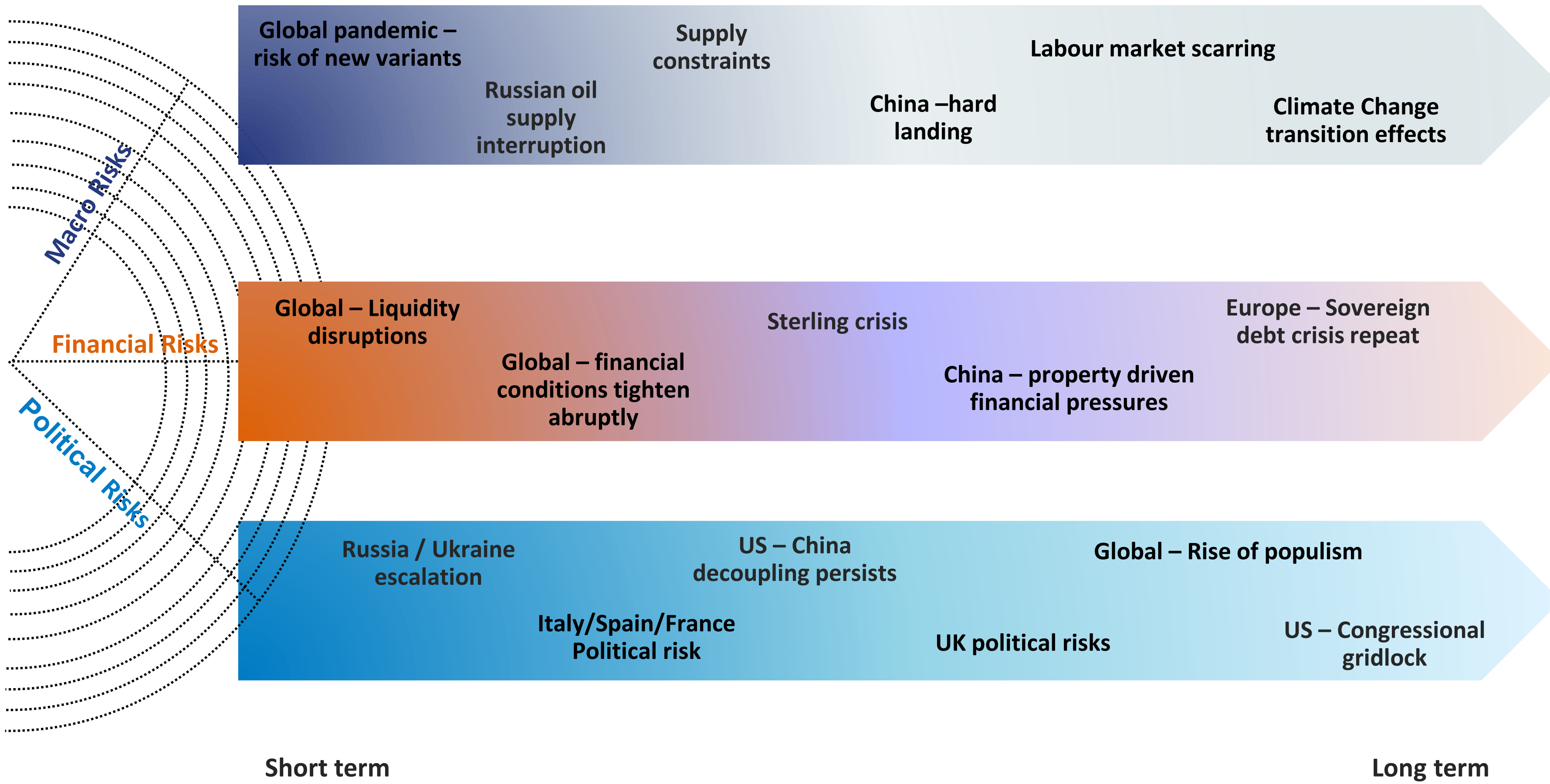
- Growth surprises on the upside in most regions
- Inflation fades more quickly towards and below central bank targets
- Monetary policy proves more patient than expectations

Market implications

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

RISk Radar

Summary – Key messages



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Theme of the month

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Russia turns off the taps

The energy market shock

Russian invasion sparks gas shut off

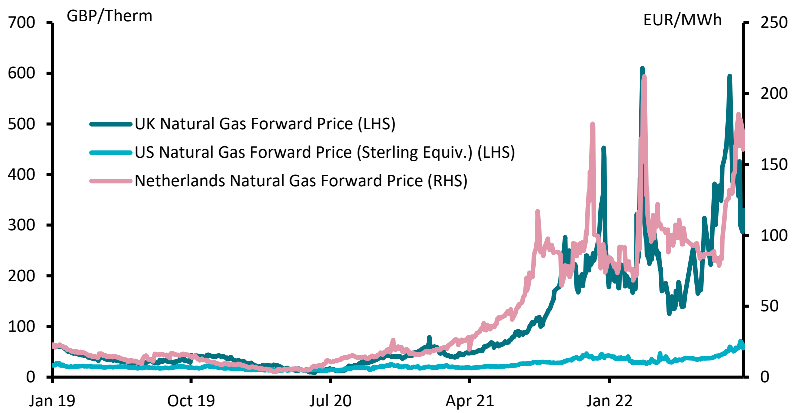
- Russia provided 50% of European energy imports (50bcm) before the Russian invasion of Ukraine. While the EU is working towards energy embargoes on Russian oil and coal, it did not target Russian gas. Instead Russia has cut European gas supplies (barring a small amount to Italy).

Russia can afford gas shut off, not oil

- Russia is in a position to stop gas supplies to Europe as revenues are relatively small compared with oil revenues. Gas provided Russia with $23bn revenues in 2021, 3.5% of total government revenues. Moreover, rising oil and gas prices have softened the revenue impact of falling volumes. Oil provided $100bn and the impact of oil embargoes/price caps will be more critical to Russia

Gas prices rise sharply as Russia cuts supply

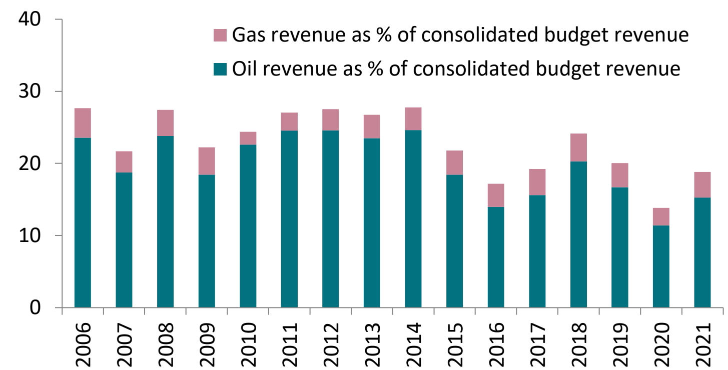
Natural Gas Prices UK, US and Netherlands



Source: Bloomberg, AXA IM Research, September 2022

Gas revenues a relatively small part of Russia finance, oil is more

Russia: oil and gas revenue in consolidated budget



Source: Federal Treasury of Russia, AXA IM Research, Sept. 2022

European dependence

The energy market shock

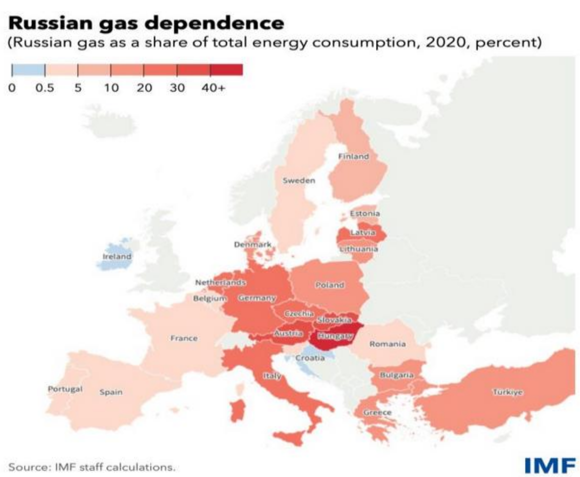
European gas dependence

- The lure of cheap and accessible energy has proven too much for most of Russia's close neighbours. Russia supplies significant amounts of energy flows to European economies. 70% of German gas consumption comes from Russian supply. This has left the economies – and their industries – particularly vulnerable to an interruption in supply.

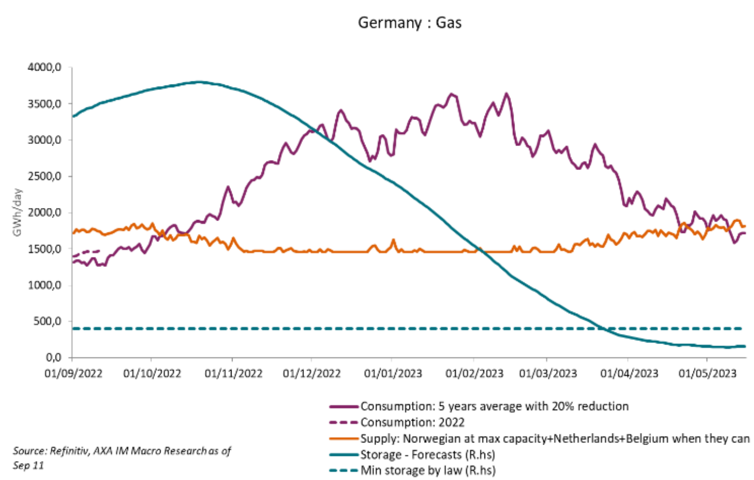
Germany's shortfall

- Yet European authorities have been swift to react. Germany is already enacting gas consumption cuts of 20%, comprised of efficiency savings, demand reduction and rationing. Italy has reduced consumption by around 8% - a little short of the required 10%. More restrictions – including forced restrictions or rationing - may be needed depending on severity of winter and how quickly floating LNG terminals can be installed

Europe vulnerable to Russian gas supply



Gas flows and storage in Germany



Source: Refinitiv, AXA IM Macro Research as of Sep 11

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Counting the days

The energy market shock

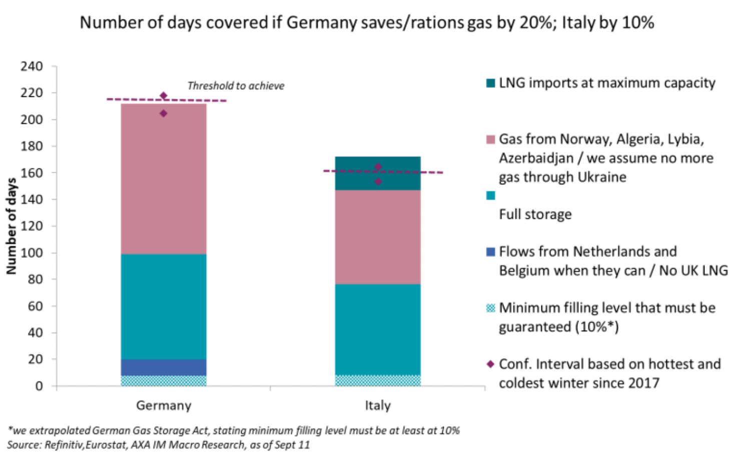
Can Eurozone economies survive the winter

- Based on estimated gas flows and average daily winter consumption, we estimate how many days consumption individual economies can make through the winter. We estimate Germany will have 195 days until mid-March, around 20 days short of the usual winter period. Italy is estimated at 170 days, until end-April and should get beyond mid-April's 'breakeven' day. France and Spain both have larger margins.

CEE dependence could add to German woe

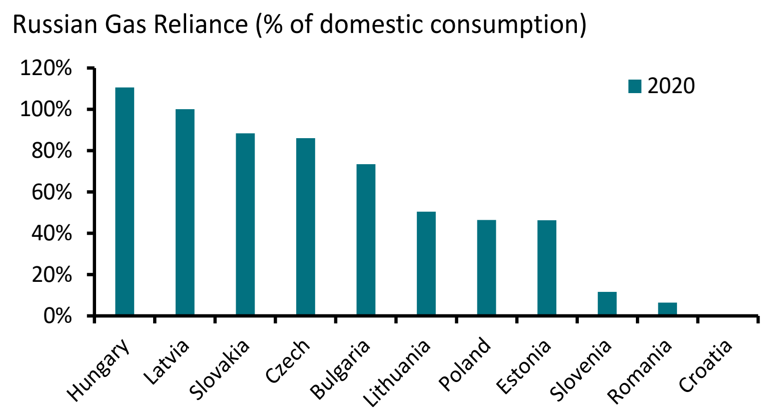
- Hungary, Slovakia and Czech Republic also face significant challenges to replace large dependence on Russian energy, with obvious alternative suppliers already under pressure. These are key part of German manufacturing supply chain and could add to German companies' supply constraints

Converting to average days



Source: AXA IM Research, September 2022

Central and Easter European Exposure



Source: IEA, AXA IM Research, 2020

UK self sufficient barring bad winter

The energy market shock

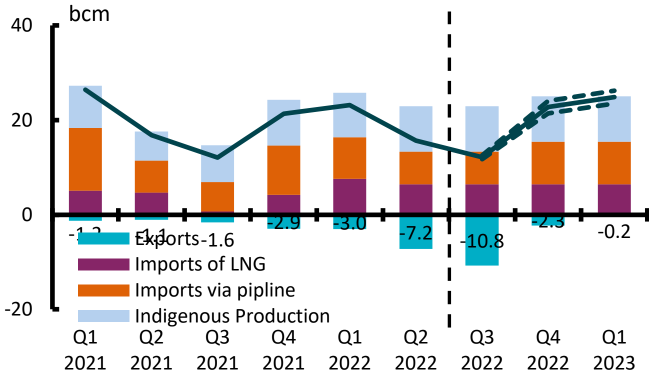
UK consumes most of its total supply over the winter

- The UK has been able to re-export excess LNG to Europe to help it fill European storage ahead of winter during the summer (low demand) months. Historically the UK has imported gas from Europe over the winter, but this was a cost decision. UK LNG supply should fulfil its demand over the winter (barring a severe winter). However, UK exports will likely slow, but could continue through a mild winter

High LNG capacity, low storage

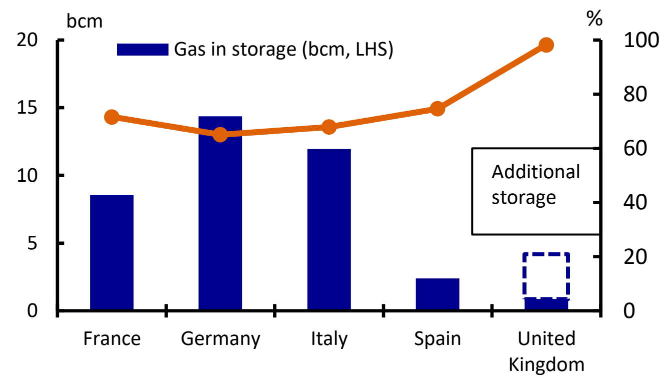
- The UK's high LNG import capacity has seen it maintain relatively low storage facilities (as Spain). The UK plans to increase storage by 5 bcm by re-opening the Rough storage facility. This would take storage to around 20 days and would raise UK's margin of self-sufficiency beyond a severe winter

UK gas supply should meet demand over winter months



Source: AXA IM Research, September 2022

Low gas storage reflects large LNG import capacity



Source: AXA IM Research, September 2022

Long-term energy supplier

The energy market shock

US LNG exports to Europe soared

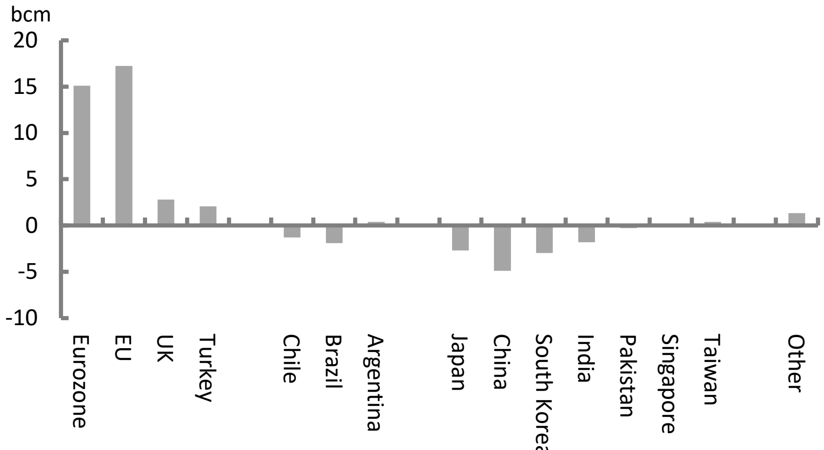
- The US has made good on early promises to increase LNG supply to Europe. Over the first half of 2022, LNG exports have increased by over 17bcm compared to the previous year. Subdued Asia demand for LNG has facilitated re-shipping some of these flows. AN explosion at an LNG terminal will see less export in H2.

Long-term energy supply capacity, but incentive

- The US has planning permission (and hence plans) to double LNG export capacity over the coming decade. The production of natural gas has been limited by supply-chain and labour shortages, as well as Federal planning law and investor appetite for expansion. However, even if natural gas extraction increases at one-third the pace of 2017-19 it would be sufficient to double the supply to the domestic market (of previous 17 years) and add 20bcm/annum for export

US LNG commitments large

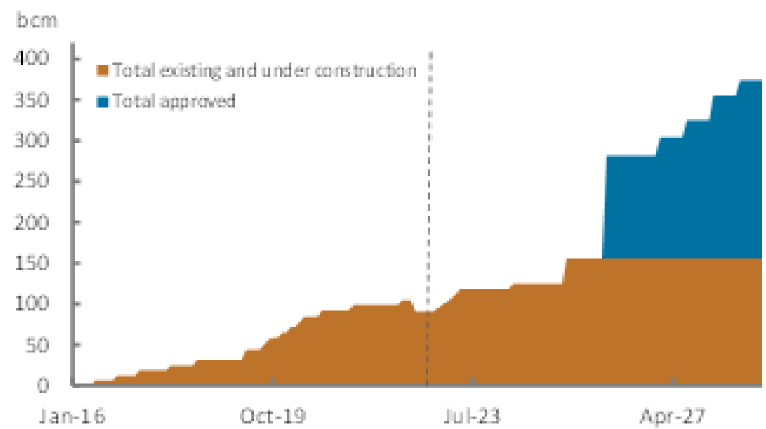
Exports by destination (chg Jan-Jun 2021 to 2022)



Source: EIA, AXA IM Research, September 2022

Lacklustre response from US oil & gas to date

US LNG export annual capacity



Source: EIA, AXA IM Research, September 2022

Macro outlook

Slower economic activity to feed into labour market

US

Gasoline provides boost

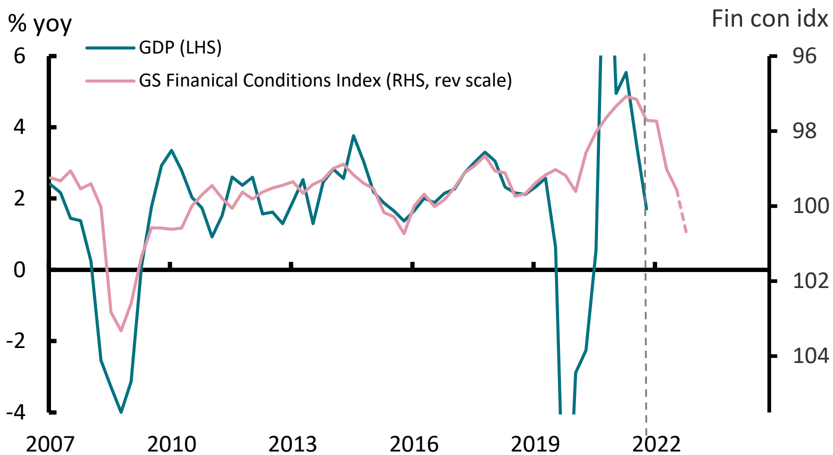
- After contractions in Q1 and Q2, we expect to see a rise in Q3 GDP (0.8% annualised). Short-term indicators appear to be being buoyed by falling gasoline prices. We forecast a contraction in Q4, although if oil prices continue to fall (rather than rise), this may be postponed to next year. Falling real incomes, corporate profits, high inventory and tighter financial conditions should weigh on growth over the coming quarters. We forecast growth of 1.4% and -0.4% this year and next (consensus 1.6% and 0.9%).

Labour market resilience

- Despite two quarters of contraction the labour market is showing only the first tentative signs of easing, and even then payrolls growth has been elevated. We expect slower economic activity to continue to soften the labour market over the coming months, although believe high levels of vacancies – pent up demand for labour – is dampening the pass through for now. Assuming modest supply recovery, we see unemployment rise to 4.4% next year and 4.7% in 2024.

Financial conditions point to further GDP deceleration

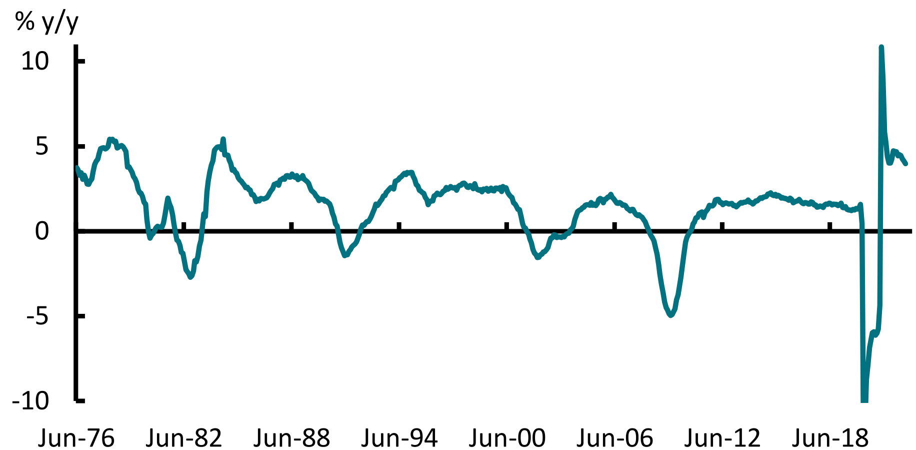
Financial conditions and GDP



Source: BEA, Goldman Sachs, AXA IM Research, Sep 2022

US employment growth remains robust

US employment growth



Source: BLS, AXA IM Research, September 2022

Fed to keep tightening until "compelling evidence" to stop

US

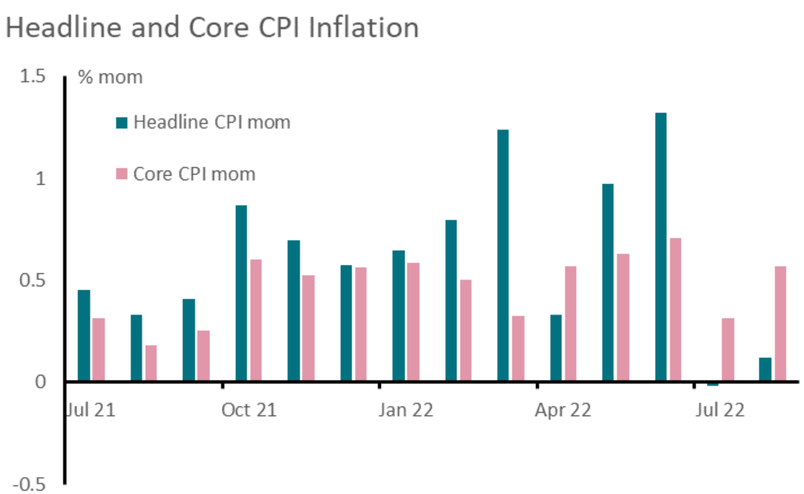
Summer surprise in prices

- August's headline inflation dropped to 8.3%, but core prices rose unexpectedly to 6.3% from 5.9%, with the monthly increase up 0.6%. On the month as well as persistently robust shelter prices a raft of other prices rose, including previously under pressure apparel and other goods. We expect some softening (on the month) in September, but our outlook for inflation is for it to fall back somewhat more slowly than markets expect. We forecast inflation at 8.2% and 5.2% this year and next (consensus 8.0% and 3.7%).

Fed points to tighter policy

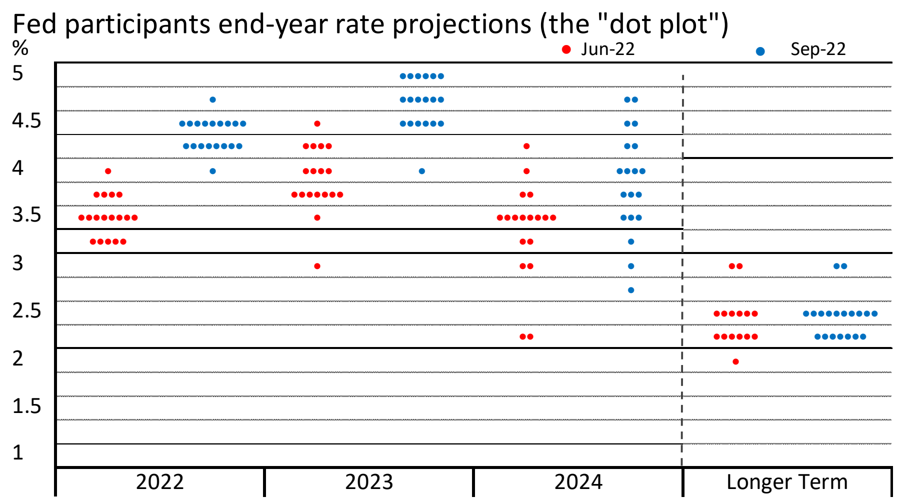
- While there had been some tentative signs of easing labour market conditions, August's inflation we think spurred the Fed to a 75bp hike, taking rates to 3.25%. The Fed also raised its end-year rate projections to 4.4% (from 3.4% in June) and 4.6% (from 3.8%). This was even higher than market pricing and contributed to a further tightening in financial conditions. If the labour market slows as we expect, we forecast two more 50bps rate hikes taking policy to 4.25% by year-end. If it does not the Fed will continue to hike.

Core CPI inflation pressures rise in August



Source: BLS, AXA IM Research, September 2022

Fed signals to continue tightening until the job's done



Source: FRB, September 2022

Gas rationing leading to recession

Eurozone

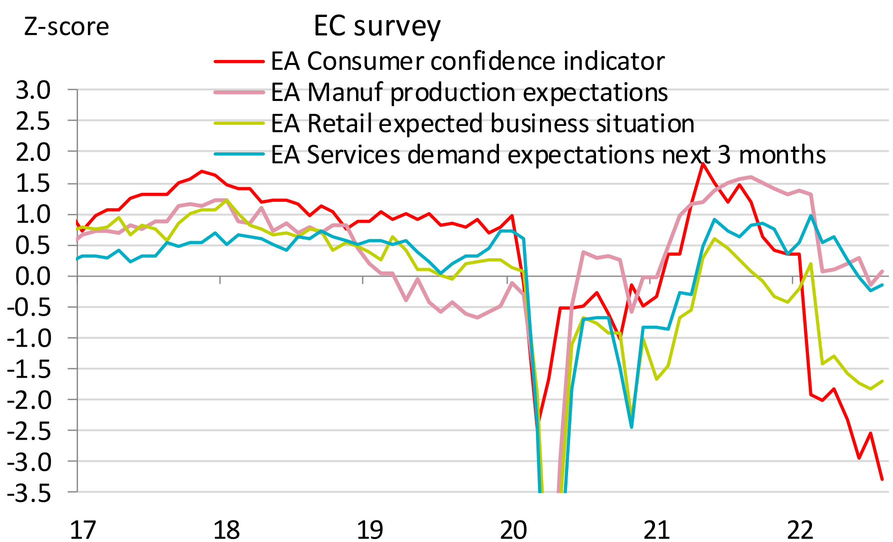
Tough winter ahead

- We have moved our baseline outlook to a recession, projecting a cumulative 1.6% Eurozone GDP contraction between Q4 2022 and Q1 2023 – from a mild contraction in Q4. Necessary gas rationing during the winter at least in Germany and Italy is the main driver of the deeper retreat – with supply woes dominating the outlook despite soothing global supply chains, affecting all sectors of the economy.

…protracted recovery ahead

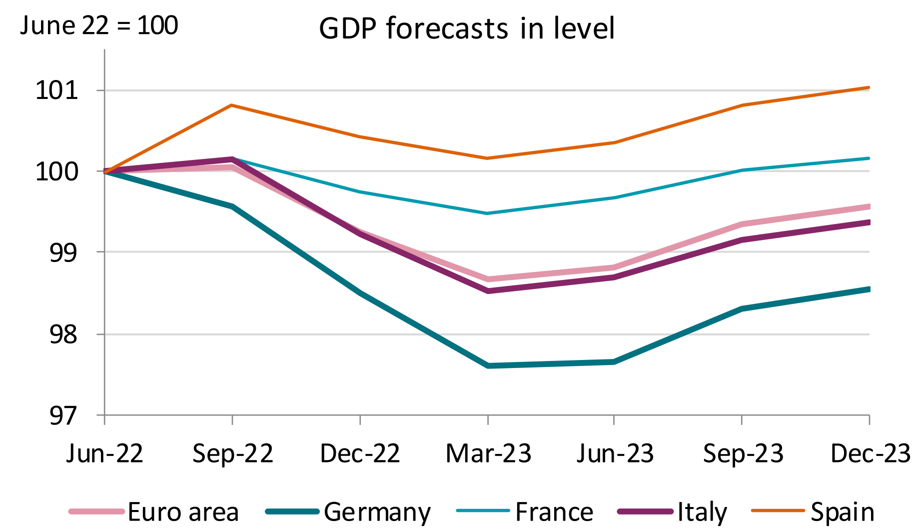
- Countries will emerge with very low gas storage levels, requiring continued efforts to replenish stocks ahead of the following winter. The policy mix is also likely to be much tighter than post-COVID-19, with inflation still high. We project the level of euro area GDP to be lower than it is now at the end of our forecast horizon. We continue to see risks skewed to the downside.

Services: defying gravity is hard



Source: European Commission, AXA IM Research, September 2022

Euro area GDP level unlikely to recover by end-2023



Source: Eurostat, AXA IM Research, September 2022

ECB: Heading to upper-end of neutral

Eurozone

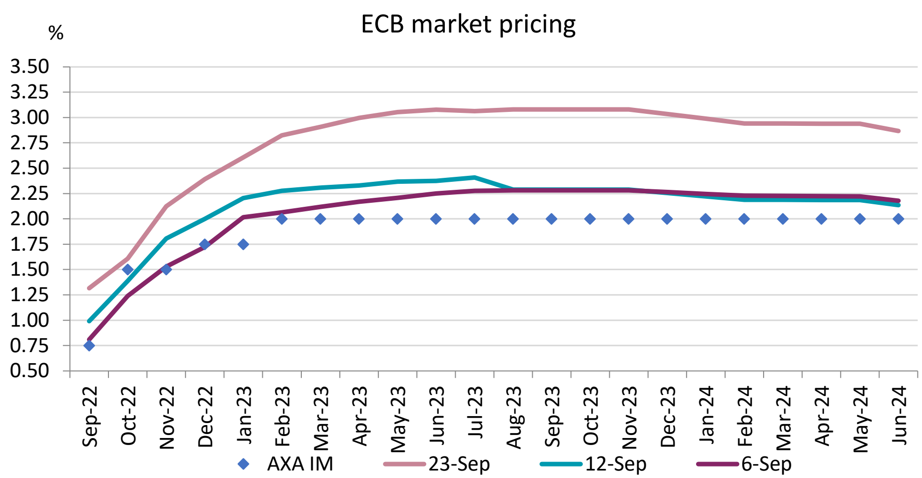
Projecting Deposit Rate at 2.0% by early 2023

- Frontloading ECB interest rate increases looks set to continue. We expect the ECB to hike its deposit facility rate (DFR) by another +75bps to 1.5% in October, wary about inflation being "far too high above target" for too long and risking an unanchoring of inflation expectations, even as wage developments remain moderate. Given the latter, and our expected material output drop - not in ECB's baseline - we forecast a more moderate +25bps in December and February bringing the DFR to 2%.

Risks for rates rising further – mind policy (mis)coordination

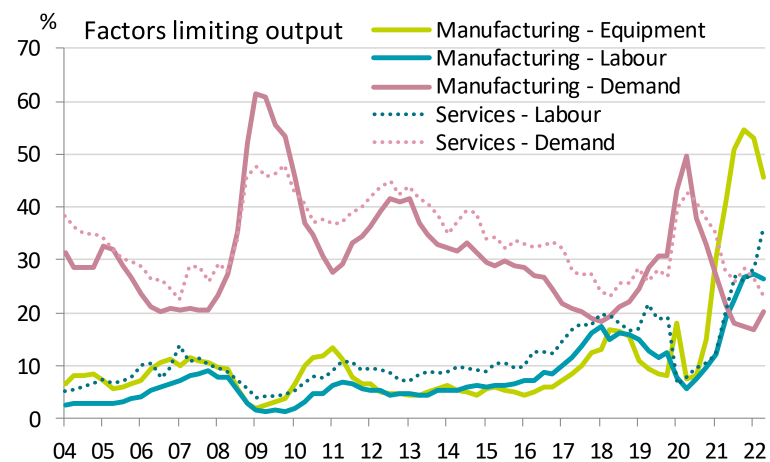
- The ECB Governing Council argues explicitly in favour of "further dampening demand" while President Christine Lagarde reiterated her mantra from Sintra that persistent supply shocks would be consistent higher rates not lower.
- Market expectations have increased substantially, staying at around 3.0% from mid-2023, reflecting US rate expectations. Despite this repricing, the euro reached a new 2022 low and these exchange rate concerns could also justify hiking rates faster higher.
- Additional fiscal policy response could further fuel additional inflation pressures.

Market firmly pricing ECB in restrictive territory



Source: Bloomberg, AXA IM Research, as of 23 September

Eurozone supply woes means rates higher not lower



Source: European Commission, AXA IM Research, September 2022

Government sets out Growth plan and energy bills support package

UK

Chancellor sets out 'Growth Plan'

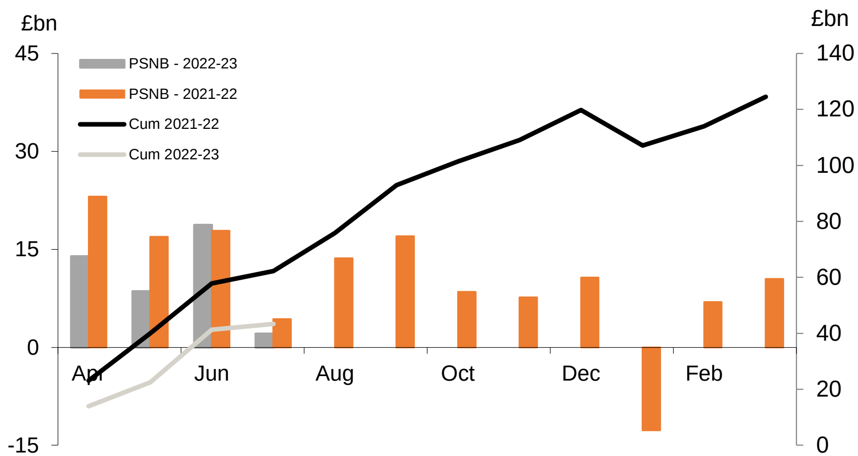
- The Chancellor outlined plans to drive the UK economy into a "new-era" and raise underlying trend growth to 2.5%. The polices included large tax cuts and micro measures to incentivize investment. Official estimates of the Growth Plan (excluding energy bills support) is expected to cost £160bn over the next five years (c6% of GDP).

Energy price guarantee sees inflation capped

- Earlier this month, the Government had set out their energy bills support package. The package is forecasts to cost c£60bn over this financial year alone (six months) and we estimate this could rise to £150bn over the total period. This caps household energy costs at £2,500 and business energy costs are set to be frozen for six months. The cap in energy prices takes 3 ppts off our expected peak of inflation. We now see inflation rising to 10.6% in October compared to 13.6% in January 2023 before.

Public borrowing set to rise

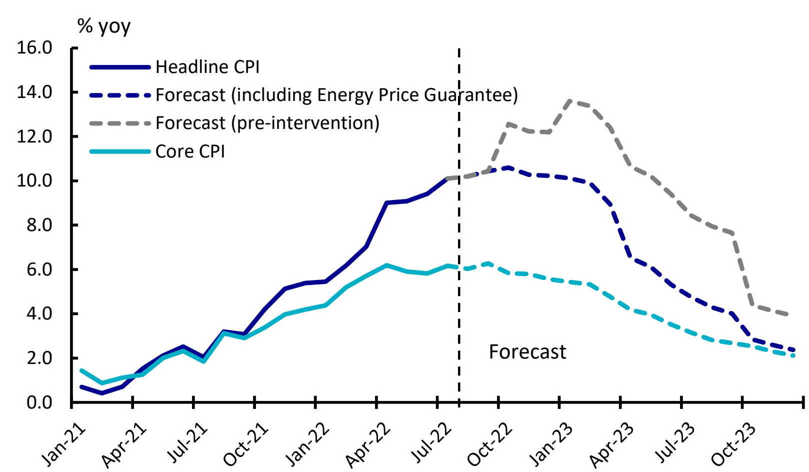
PSNB current run rate



Source: ONS, AXA IM Research, September 2022

Near term peak of inflation down by 3pts

UK CPI inflation forecasts



Source: ONS, AXA IM Research, September 2022

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Markets fear Tory growth plan

UK

Pound's slide to add to BoE concerns

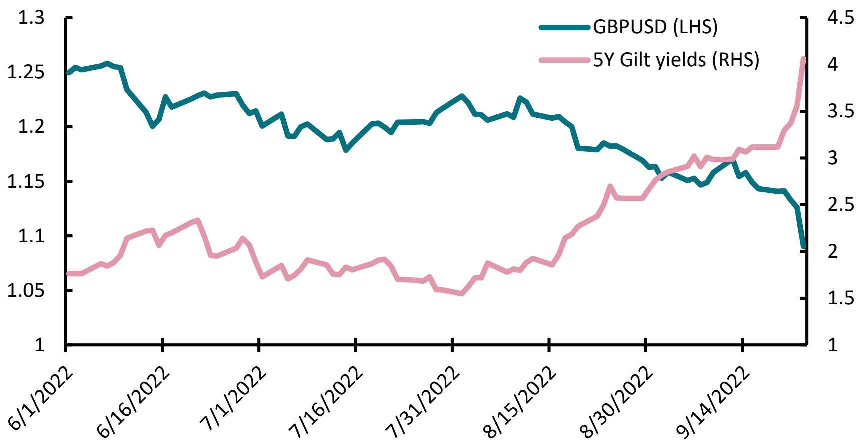
- The pound fell to an all time low of $1.035 to the US dollar. Even before this, we had expected the pound's weakness to weigh more on BoE decision making. The Chancellor added to market pressure over the weekend by stating that there was "more to come". Speculation has grown that the Bank of England may be forced into an intermeeting hike. It is not obvious that such a development would quell market fears, but we expect further communication from the BoE and government, over coming days.

Markets now see rates above 6% next year

- Market pricing of rates has shifted significantly and now price Bank Rate above 6% by Summer 2023. We now expect rates to reach 4.00% early next year compared to 3.50% prior. We expect the BoE to hike Bank Rate by 75 basis points (bp) in November, but a continued slide in the pound could see them do more. In addition to expecting the BoE to move by 75bp in November, we now expect a 50bp hike in December and 25bp in February and March.

Selloff of UK assets continues

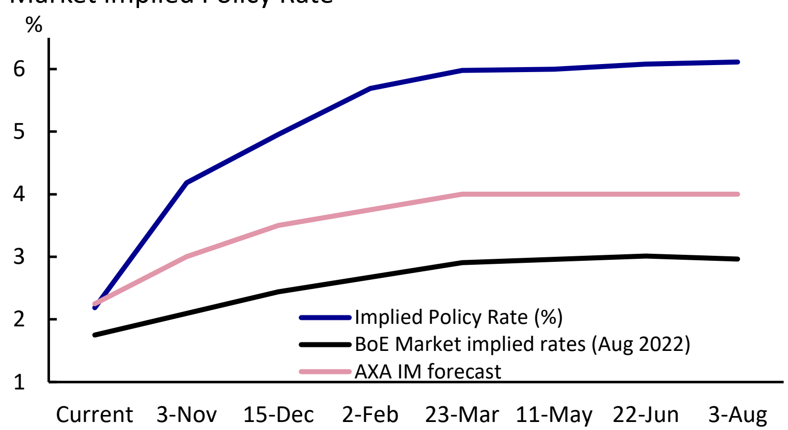
GBPUSD and Gilt yields



Source: Refinitv, AXA IM Research, September 2022

Markets now see Bank Rate at 6%

Market implied Policy Rate



Source: Bloomberg, BoE, AXA IM Research, September 2022

Economy recovers in August, but momentum may not last

China

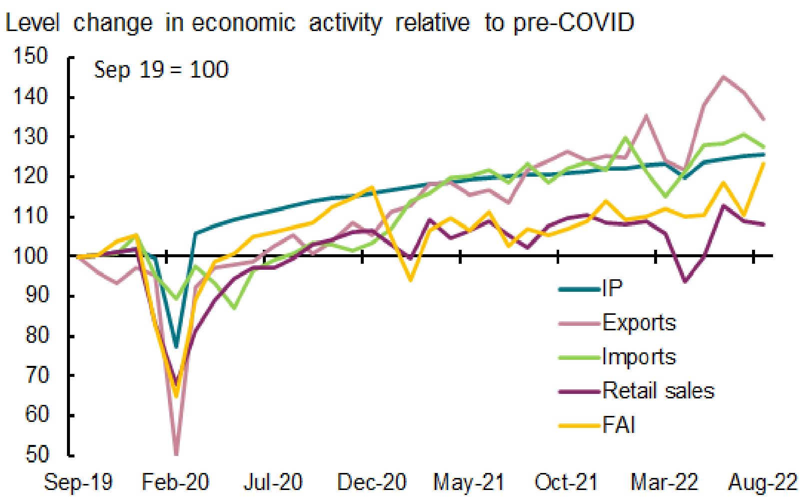
Economy taken on a rollercoaster ride by COVID

- Shanghai's lockdown dealt a heavy blow to the Chinese economy. GDP sunk 2.6% sequentially in Q2, and yoy growth fell to 0.4% the lowest since early 2020. As Shanghai and surrounding provinces exited COVID controls, growth stabilized in May and rebounded in June. However, dark clouds have gathered again since July with Omicron making a comeback

Recovery in August may not last

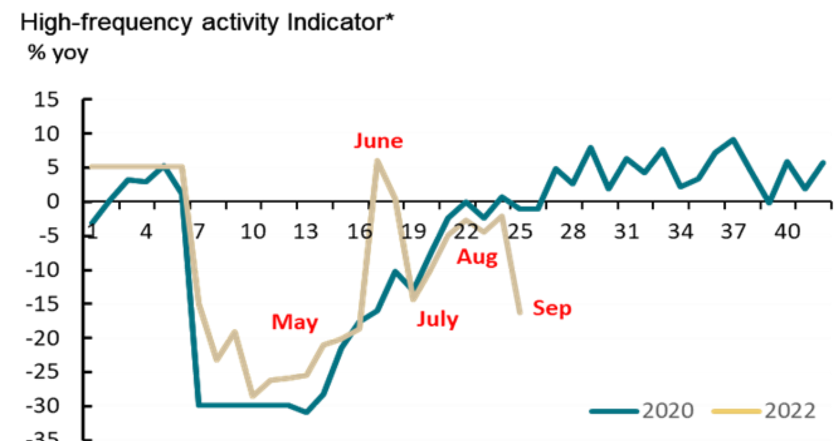
- The August data surprisingly showed sequential growth improved across many parts of the economy. Major activity indicators beat market expectations, with investment and retail sales growth nearly doubling from July. Some of this strength could be transitory – the strong power production in response to an unusually hot summer is one example. Moreover, COVID-related restrictions have tightened since September and extreme weather has prompted some regions to ration power usage. These call the sustainability of the recovery beyond August into question

Domestic demand picks up while exports falter



Source: CEIC, AXA IM Research, Sep 22

Economy taken on a wild ride by COVID



* Incl. steel production, cargo throughput, property sales, auto sales, truck freight, traffic congestion and subway ride

Source: UBS, WIND, AXA IM Research, Sep 22

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COVID remains the biggest hurdle to recovery

China

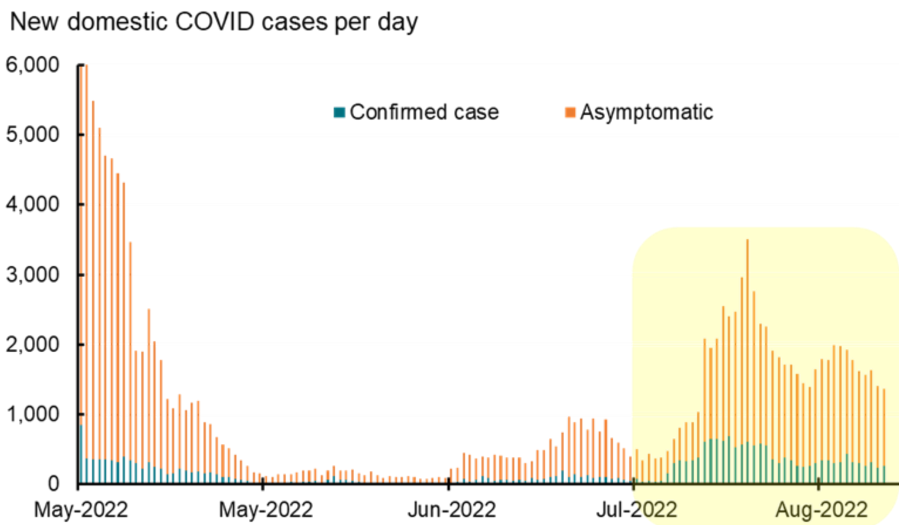
Another COVID wave haunts the economy

- The recent COVID flare-up is a cause for concern. Even though case numbers are low relative to April-May, they are more wide-spread than the last wave. While refraining from another Shanghai-style lockdown, local governments are not taking any chances ahead of the Party Congress and have restarted tightening social and mobility restrictions. With a few major cities now engaging in various form of COVID controls, this will hurt the recovery and risk plunging the economy into a double-dip

Recalibrating COVID response helps but not enough to save the economy

- Despite the wider spread of infections, the degree of lockdown has not been as severe as seen in April-May. This is consistent with our view of a more lenient management of the "dynamic zero-COVID" policy. Hence, compared to Shanghai a few months, the current practice should help to mitigate, albeit not eliminate, the impact of the outbreak. Beijing has also responded to the mortgage boycott issue but fell short of rescuing the troubled developers. With time running out to revive growth, we have cut our full year growth forecast again to 3% from 3.6%, below the consensus at 3.5%

Another COVID wave puts recovery at risk



Source: CEIC, AXA IM Research, Sep 22

Beijing finetunes COVID response by avoiding a Shanghai-style lockdown

Source: GS, AXA IM Research, Sep 22

Rising CPI in the spotlight

Japan

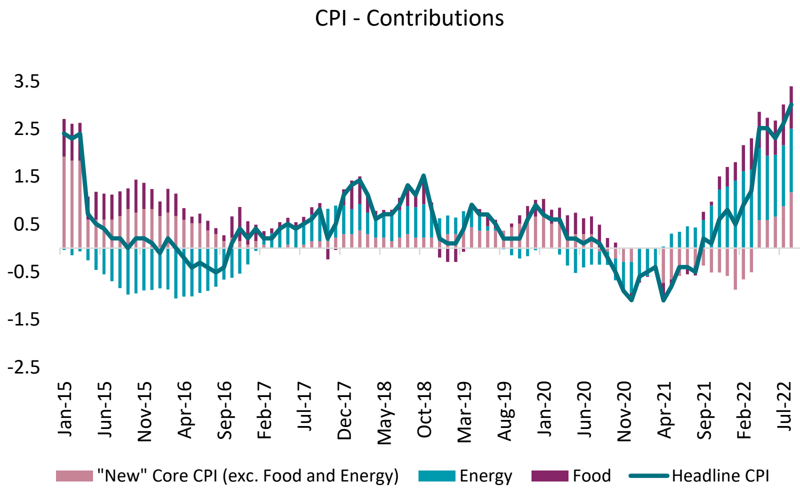
Headline CPI reaches highest rate since 1999

- Inflation rose by 3% y/y in August following a 2.6% rise in July. This marks the highest rate since December 1999 excluding the impact of consumption tax hikes. Prices are likely to continue to rise at a robust pace as energy and imported food costs continue to rise. Amidst rising inflation and declining real incomes, PM Kashida ordered Ministers to begin putting together a fresh stimulus package to support households and businesses.

Growth continues to pick up, but destruction caused by Typhoon Nanmadool could weigh

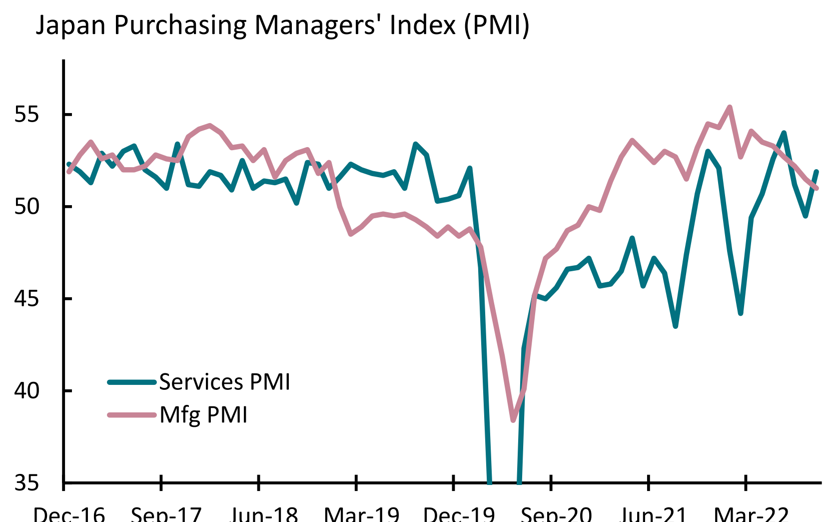
- GDP increased by 0.5% q/q in Q2 and we expect the recovery to continue into Q3 penciling in growth of 0.4% with PMIs rebounding following a decline in COVID concerns. Headwinds to growth remain. Weakening global demand will see growth begin to moderate. Japan has also faced the powerful Typhoon Nanmadool, the strongest typhoon to hit Japan the country since 2000. Despite the scale of damage and disruption caused, the it appears to have caused less economic damage than previous typhoons.

Inflation pushes to 3% in August



Source: Refinitv, AXA IM Research, September 22

PMIs bounceback as COVID concerns abate



Source: IHS Markit, AXA IM Research, September 22

FX Intervention sees pressure on yen abate

Japan

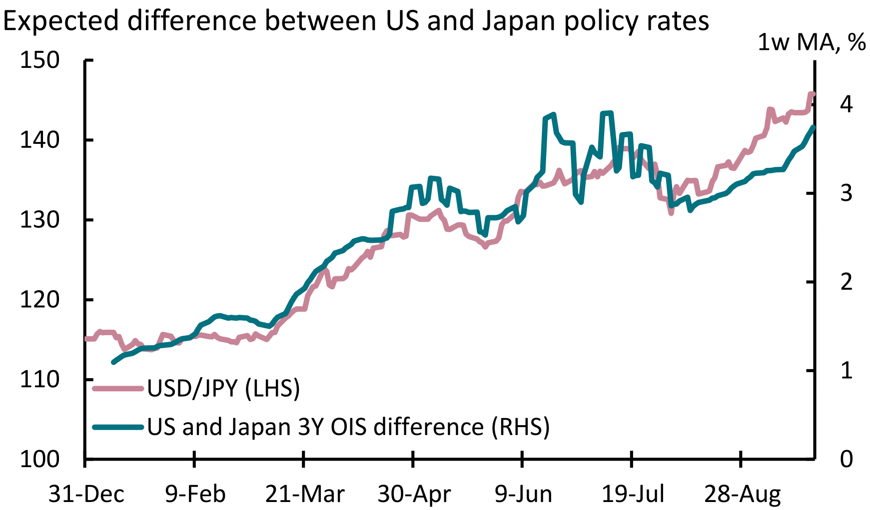
Yen slide prompts FX intervention

- The increasing divergence between Japanese monetary easing and tightening conditions in most other developed markets has seen the yen face continued pressure, with the currency declining by 20% year to date over the year so far. This slide has pushed Japan's Ministry of Finance (MoF) to intervene in FX markets to support the yen for the first time since 1998. Following the intervention, the yen rose from lows of ¥145.8 to the US dollar. The move is likely to provide only temporary reprieve relief to the currency as divergence the Bank of Japan (BoJ)'s policy stance and the Federal Reserve – and other central banks – grows further.

Governor Kuroda remains steadfast in easing

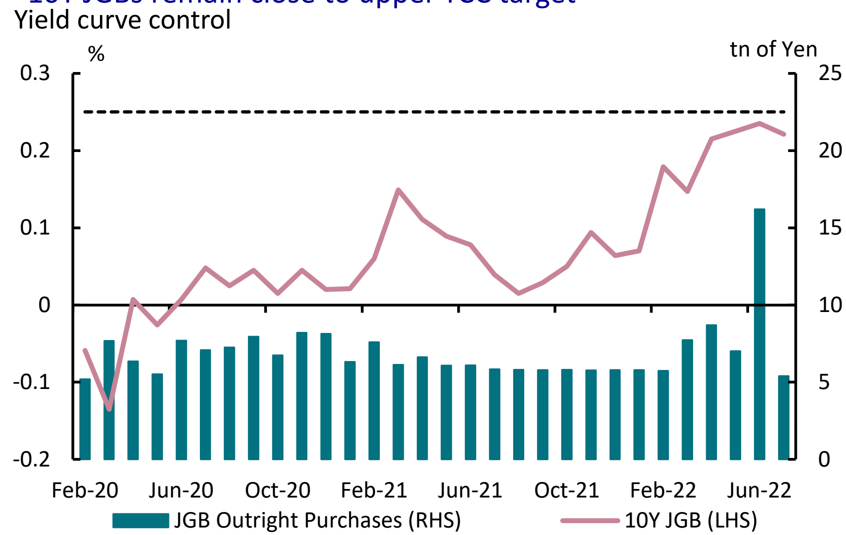
- At its recent meeting, the BoJ reaffirmed its commitment to accommodative policy and kept all policy measures unchanged. There was some adjustment to its COVID-19 support package, with the BoJ taking the decision to phase out its COVID support for business. Governor Haruhiko Kuroda reaffirmed his commitment to maintaining the current easing stance and made clear that he did not intend the BOJ to follow the path of moving away from negative interest rates that has been taken by other central banks.

The yen has extended its declines against the dollar



Source: Refinitiv, AXA IM Research, September 22

10Y JGBs remain close to upper YCC target



Source: Bank of Japan, Refinitv, AXA IM Research, September 22

Is the economy beginning to soften?

Canada

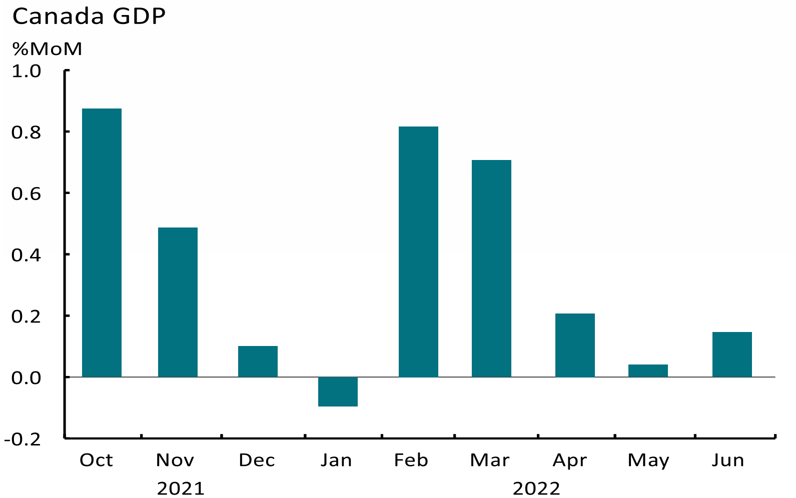
Strong first half to fade

- Canada posted strong growth of 3.1% and 3.3% (annualised) in the first two quarters of this year. Yet monthly numbers show this centred around a post-COVID bounce in Q1. Mechanically this will see a much weaker Q3, not least if a 2.5% fall in retail sales in July translates to a dip in monthly output. We forecast 1.2% growth in Q3 and something closer to stagnation by year-end, leaving growth at 3.3% for 2022 and 0.7% for 2023. 3.3% is now consensus, but we are below the 1.1% outlook for next year.

First signs of loosening labour market

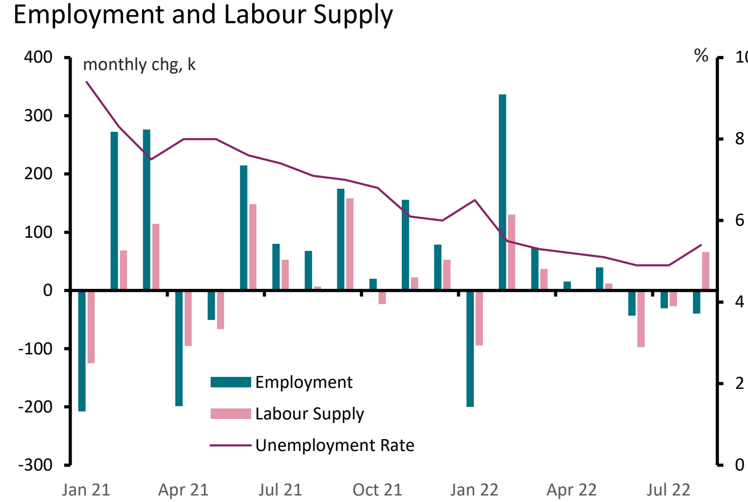
- The unemployment rate has fallen to record lows. Yet weaker growth has seen employment fall in the last three months (to August). Still faster declines in labour supply saw unemployment reach 4.9%, before a rise in supply in August saw it rebound to 5.4%. Broader questions remain over Canadian labour supply, but for now we forecast a modest rise. This should outpace all but stagnant job growth over the coming quarters and see unemployment gently rise to 5.7% by year-end and 6.5% by end-2023.

Canada's Feb/Mar boost disguises softer trend



Source: CANISM, Refinitiv, AXA IM Research, September 2022

Unemployment rises as labour supply recovers



Source: CANISM, AXA IM Research, September 2022

BoC peak coming into sight

Canada

CPI turns, but a long way to go

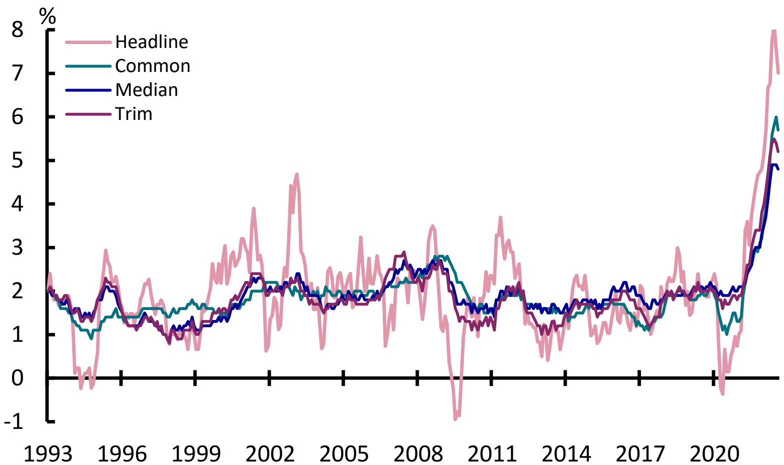
- Headline inflation fell to 7.0% in August, from 7.6%. Most of the decline reflected a fall in energy prices. However, different measures of core inflation all declined somewhat as well. Inflation has a long way to fall to move back in line with the BoC's target. However, we lower our forecast for this year to 6.8% and pencil in 4.3% for next (consensus 7.0% and 3.4%).

BoC "assessing how much higher .. to go"

- The BoC hiked rates by 75bps in September, delivering 175bps of tightening to take Bank Rate to 3.25% since stating that it was "prepared to act forcefully". In September, it changed guidance to say it was "assessing how much higher interest rates need to go". With economic activity appearing to soften and the labour market to loosen, we expect the BoC to hike by 50bps in October, but suggest that could be its last hike (at 3.75%), although we acknowledge the risk of a further 25bps in December to peak at 4.00% in line with market consensus.

CPI inflation dips on energy, but more broadly

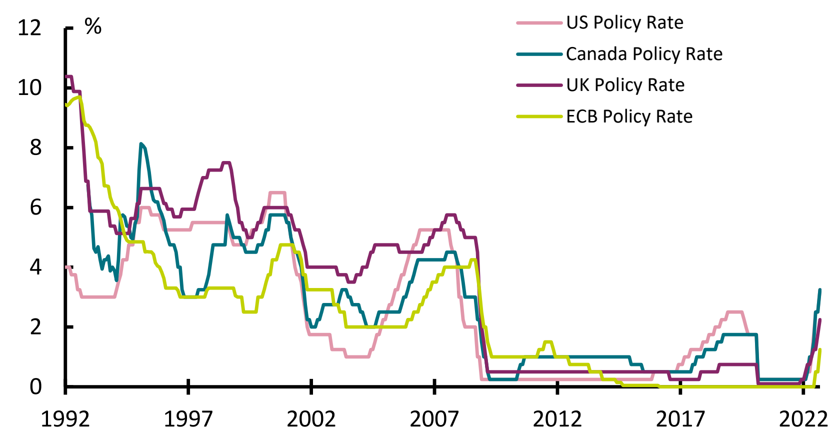
CPI measured variations



Source: CANISM, AXA IM Research, September 2022

BoC's 'frontloading' sees it lead the pack

CA, UK, US & ECB Policy Rates



Source: Refinitiv, CANISM, ECB, BoE, AXA IM Research, September 2022

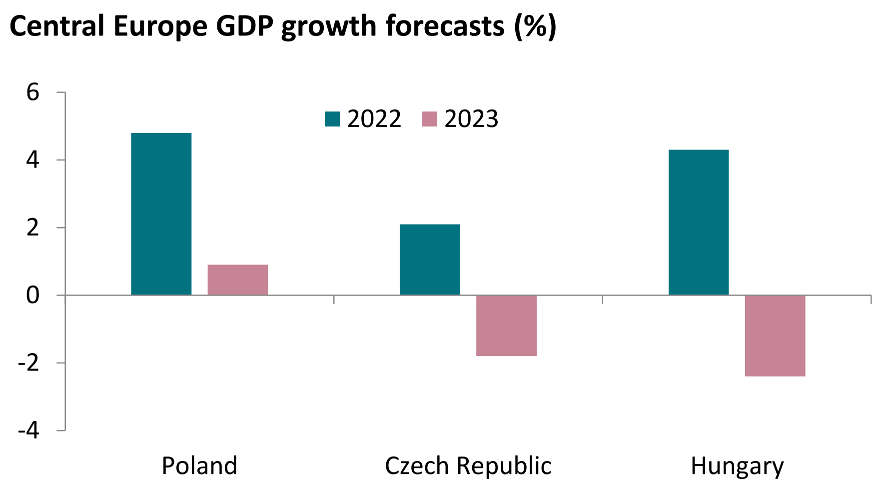
Central Europe : heading into a "cold" winter

Emerging Markets

Particularly reliant on Russian gas, recession on cards in the wake of Russian gas supply shutdown

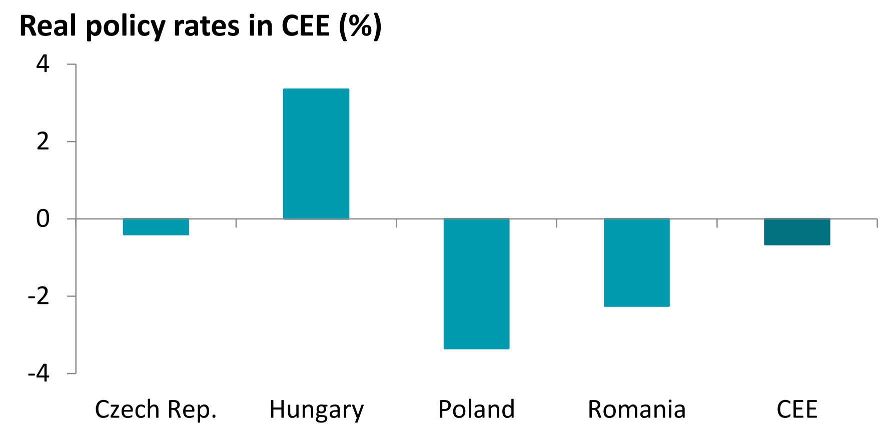
- Landlocked Hungary or the Czech Republic will be directly affected by gas shortages as well as second round effects coming from the weakening economic activity in Germany, their largest trading partner. We have trimmed our GDP growth forecasts by 4ppt of GDP cumulatively affecting Q4 2022 and Q1 2023 projections, implying GDP contraction by 2.4% and 1.8% respectively in 2023. Poland is less gas intensive, with a greater reliance on coal; we expect GDP growth of +0.9% for 2023 overall.
- Central banks have been hiking interest rates for some time now, but most countries still show negative policy rates (using Bloomberg consensus 2023 inflation expectations). With the ECB appearing more hawkish of late, this buffer versus Europe is likely to be insufficient.

Trimming growth outlook on recession expectations



Source: Eikon Reuters, AXA IM Research, Sept. 2022

Still mostly negative real rates across CEE



Source: Bloomberg, Eikon DS, AXA IM Research, Sept. 2022 (using 2023 consensus inflation expectations)

Some signs of rates peaking in Latam

Emerging Markets

Headline CPI numbers continue to trend upwards, though some seems to have peaked

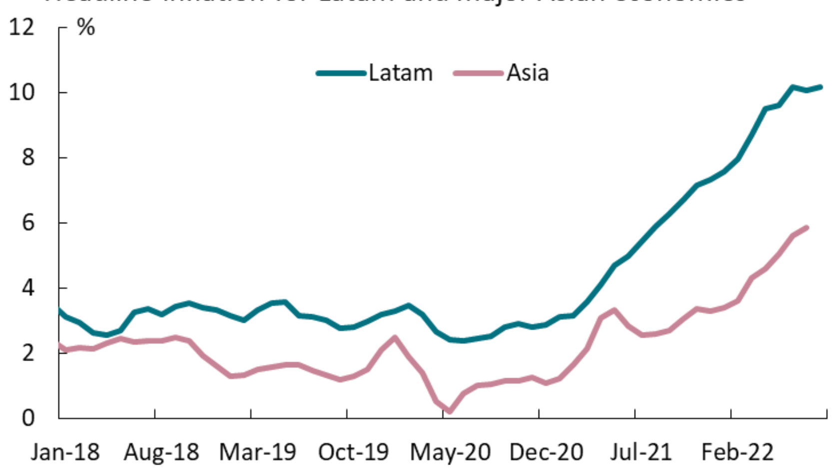
- Since December 2021, headline inflation figures across Asia have accelerated by between 120bps (MA) to 570bps (TH). Compared to other parts of EM and rest of the world, inflationary pressure in Asia seem to be relatively well maintained as governments in the region have implemented measures (from energy to food and fertilizer subsidies) to help contain prices. In Latam, while inflation has been rising much faster, it seems to have peaked in some economies such as Peru and Brazil, hinting at the prospective end of their respective hiking cycles .

Latam's busy electoral calendar is coming to an end

- Colombians recently elected left-wing Gustavo Petro as president. The new leader plans to overhaul the tax code and the pension system to allow for more social spending. In contrast, voters in Chile rejected the new constitutional draft that would have given the state a larger role in the economy. Brazil's upcoming general elections (Oct 2) will be the region's last important election. Former president Lula da Silva commands a comfortable lead over its main rival incumbent, president Jair Bolsonaro.

Governments are under pressure to respond to rising prices

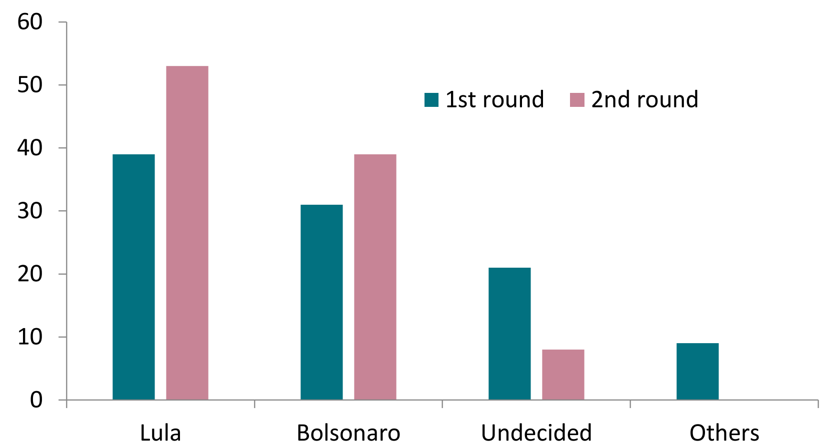
Headline inflation for Latam and major Asian economies



Source: Datastream, CEIC, AXA IM Research, September 2022

General elections will take place in Brazil on 2 October

Brazilian elections: voter preference (%)



Source: Datafolha and AXA IM Research, September 2022.

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

#1
Economic activity rapidly decelerating while persistent inflation pressuring central banks to slow growth further

Negative on Equites

#2
Valuations have improved following recent spread widening albeit not attractive enough to warrant being overweight

Neutral on Investment Grade Credit

#3
Central banks hiking cycle priced in, limiting bond yield upside. But inflation has not yet peaked

Neutral Sovereign Bonds

#4
Pricing at levels consistent with positive returns over medium term. However, default expectations should further increase as activity decelerates

Neutral on High Yield Credit

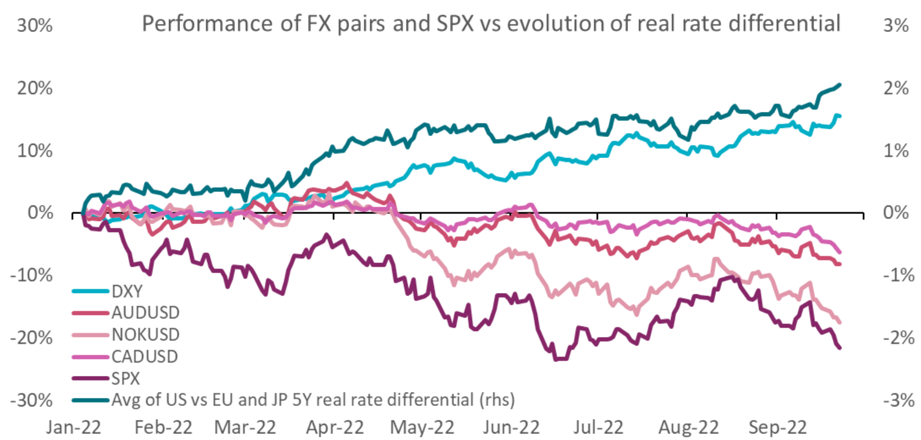
Source: AXA IM as at 23/09/2022

FX Strategy

Hopes for a peak in USD strength have been dashed

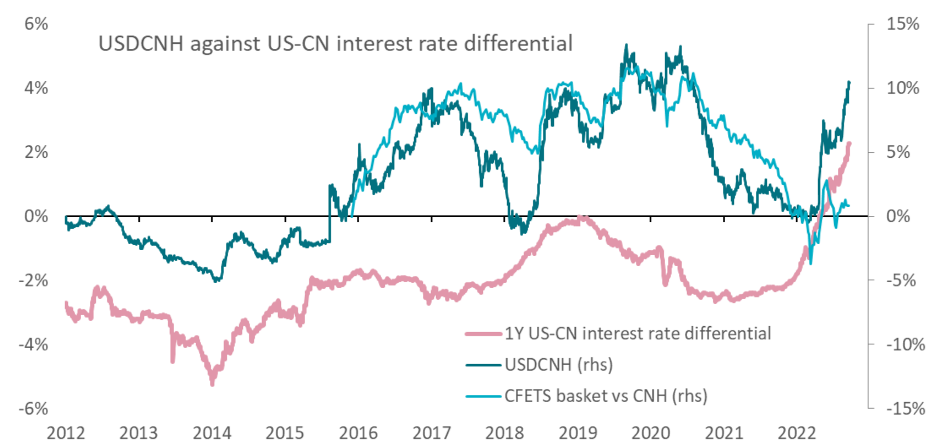
- USD to remain supported by the stronger US cyclical position and/or bouts of risk aversion. US real rates look more robust.
- Pressure on EUR & GBP to continue. Escalating energy crisis has further downgraded European growth outlook, erasing EU current account surplus and deteriorating UK's deficit. Weak EU export demand by China and Brexit disruptions. High inflation means cheaper fair value.
- CNH should also keep trending lower. China Zero Covid policy continues to disrupt production and the PBOC needs to stay accommodative to counter this and the real estate deleveraging. Lower global goods demand should weaken China's trade balance.
- CHF might do better in Europe. Switzerland growth looks better due to lower energy dependency and energy intensive industry. SNB is now accepting CHF strength to tame rising imported inflation.
- AUD might outperform high beta currencies, supported by an extremely tight labour market, amid more resilient domestic growth and consumption. Gas exports are also taking over from iron ore prices in generating further budget and trade balance surpluses.

Real rates support USD in G4 & risk sentiment drives high beta ccy



Source: Bloomberg and AXA IM Research, Sept 2022

USDCNH can rise further as PBOC divergence from the Fed widens



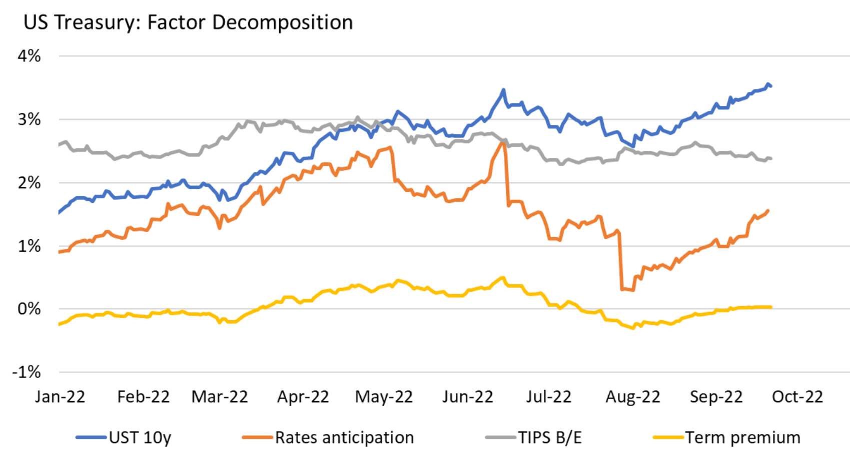
Source: Bloomberg and AXA IM Research, Sept 2022

Rates Strategy

Inflation remains a key driver for both policy-makers and markets

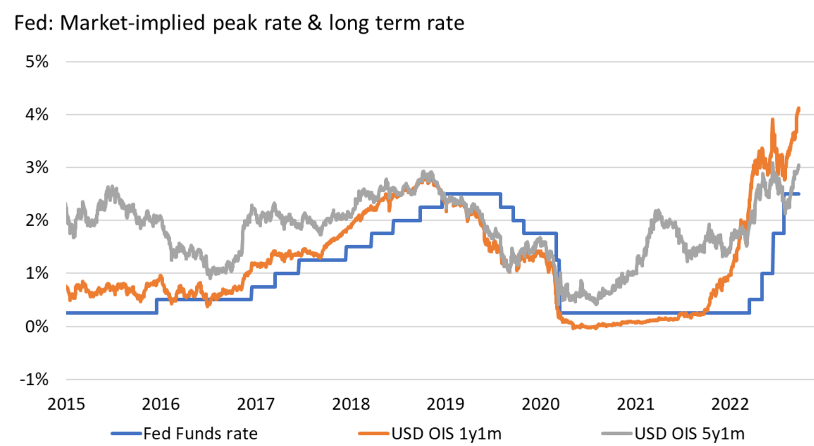
- US Treasury yields, UK Gilt yields and global bond yields in general have posted new highs for this year, mainly driven by central bank policy expectations. The moves in mid September have been particularity brutal, compounding the worst drawdown in returns in decades.
- Longer term breakeven inflation in the US has traded rangebound below 2.5% since July, despite the fact that spot inflation prints have kept surprising on the upside. A rolling over in spot inflation levels now appears a necessary condition for policy expectations and thus longer term yields to stabilise.
- Interestingly, both the cyclical peak Fed policy rate (1y1m) and the equilibrium Fed policy rate (5y1m) have drifted higher since the summer, perhaps signalling a degree of uncertainty with regards to central bank policy effectiveness in taming near inflation pressures.

Fed policy expectations continue to drive US Treasury yields higher



Source: Bloomberg & AXA IM Research, Sep 2022

Market implied policy expectations have drifted higher since summer



Source: Bloomberg & AXA IM Research, Sep 2022

Credit Strategy

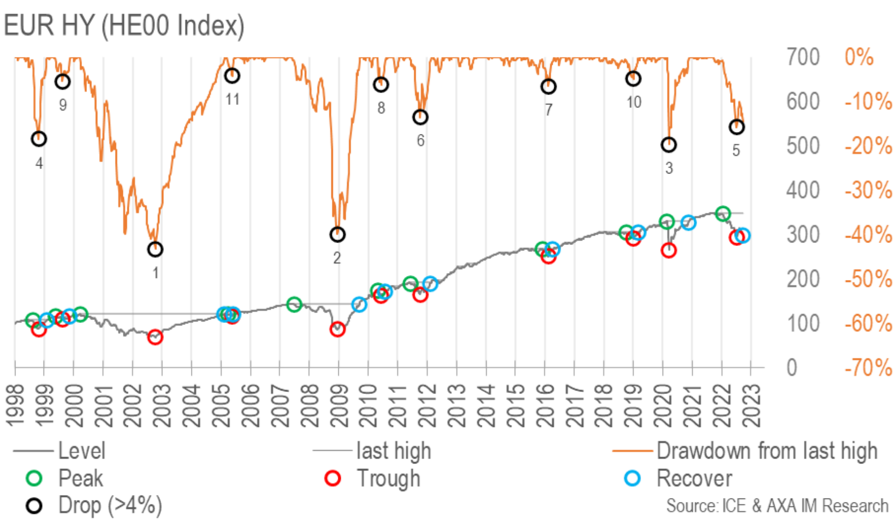
Credit has suffered too in the latest bout of risk aversion bad not as bad as govie bonds

- The latest deterioration in risk appetite has reversed the rebound in credit returns in July. Yet the relative resilience in spreads has kept the 2022 performance drawdown from making new lows, in contrast to what has happened in government bond markets. So while key bond markets have lost anything from a quarter to a third of their market value from their peak, HY credit losses have been in 'teen' figures.

- HY markets continue to offer attractive entry points in both spread and yield terms, but a worsening macro backdrop merits prudence and dictates careful credit selection. Indeed, as default predictors have deteriorated, the gap between spread implied defaults and forecast default has narrowed. Excess spreads net of expected default losses remain positive but not as generous as earlier in the year.

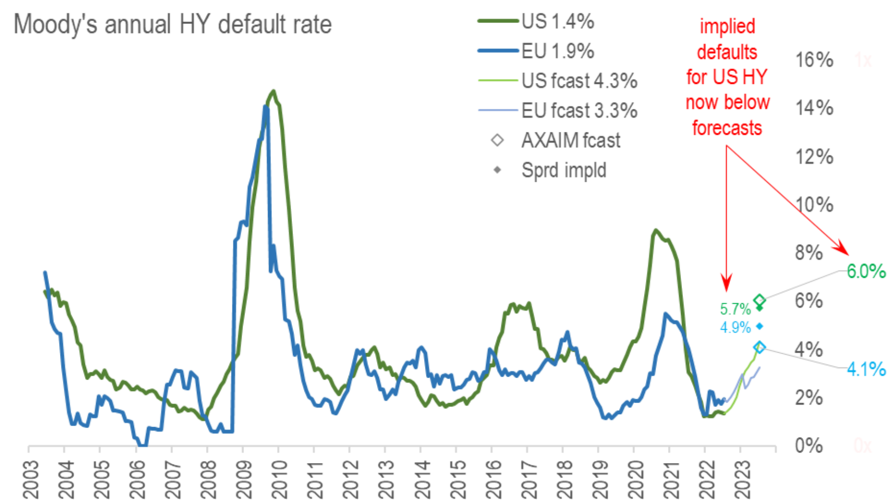
- In relative terms, European credit continues to screen cheaper than US credit, but the potentially profitable normalisation trade of long Europe vs the US is not likely to get underway before more clarity on the energy risks for European growth.

2022 has seen the 5th worst drawdown in EUR HY since 1998



Source: ICE & AXA IM Research

Default valuations have started to narrow as macro backdrop worsens



Source: Moody's, ICE & AXA IM Research

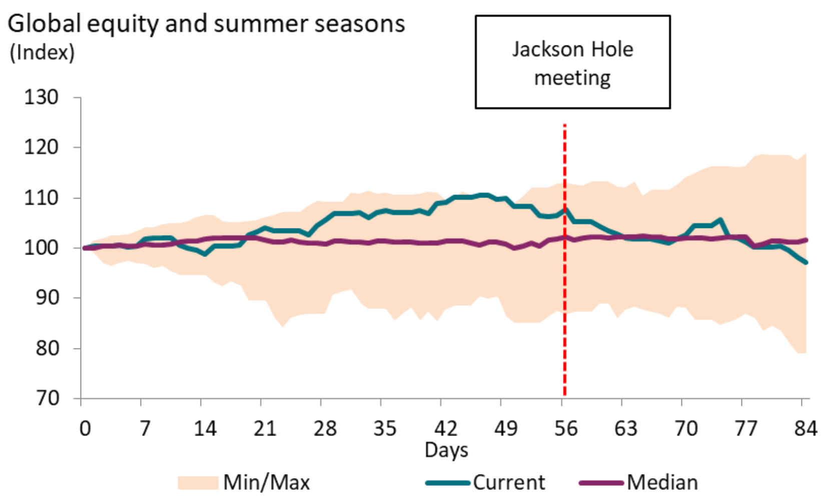
Equity Strategy

Temperature drop at all levels, summer is over

- The momentum of global equities has shifted since the end of August, following hawkish rhetoric by central bankers at the Jackson Hole symposium. Over the past month, world stocks have fallen -7.7%, with the decline of the 'long duration' Growth factor by -10% accounting for most of this. Growth concerns have also weighed on cyclical stocks (-9.1%), which have been struggling this year (-23.4%). In this environment, the energy sector (-2.4%) remains the most resilient, benefiting from a tight commodities market, while defensive stocks (-5.5%) have also fared better as fears of recession in upcoming quarters have escalated.

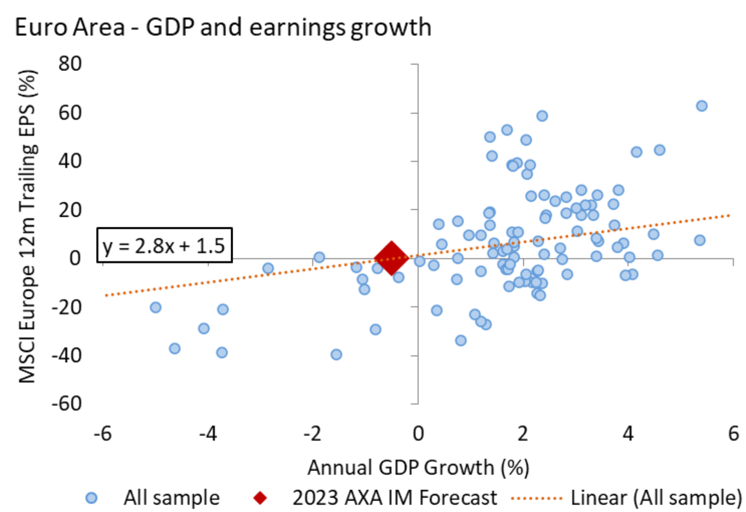
- Surprisingly, Europe earnings growth forecasts for 2023 are holding up. Revisions over the past 3 months are still positive (+1.9%) despite being negative for US (-3%) and emerging markets (-2.1%). Even if a weaker currency supports these revisions (about 60% of European equity sales are made abroad), it should not erase the impact of the expected global economic slowdown, especially in Europe. GDP growth forecasts do not justify the expected levels of earnings next year. Embedding our European GDP growth forecast for 2023, next year's earnings growth is expected to hover around zero. Quarters with negative annual growth tend to be associated with negative earnings growth.

Jackson Hole, a turning point for risky assets



Source: MSCI and AXA IM Research

In Europe, the consensus remains too optimistic for 2023



Source: Eurostat, IBES and AXA IM Research

Asset allocation stance

Positioning across and within asset classes

Asset Allocation

Key asset classes			
Equities	■		
Bonds		■	
Commodities		■	
Cash			■

Equities

Developed			
Euro area	■		
UK		■	
Switzerland		■	
US	■		
Japan			▲

Emerging & Equity Sectors			
Emerging Markets		■	
Europe Cyclical/Value		■	
Euro Financials		■	
European Autos		■	
US Financials		■	
US Russell 2000		■	

Fixed Income

Govies			
Euro core		■	
Euro peripheral		■	
UK		■	
US		■	

Inflation Break-even			
US		■	
Euro		■	

Credit			
Euro IG		■	
US IG		■	
Euro HY		■	
US HY		■	

EM Debt			
EM Bonds HC		■	

Legend Negative | Neutral | Positive

Change ▲ Upgrade | ▼ Downgrade

Source: AXA IM as at 23/09/2022

AXA Investment Managers

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2021	2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	6.1	3.1		2.4	
Advanced economies	5.1	2.2		0.1	
US	5.5	1.4	1.7	-0.4	0.7
Euro area	5.2	3.0	2.8	-0.5	0.9
Germany	2.6	1.3	1.5	-1.5	0.7
France	6.8	2.4	2.4	0.0	1.2
Italy	6.6	3.3	3.0	-0.6	1.1
Spain	5.1	4.7	4.3	0.6	2.3
Japan	1.7	1.5	1.4	1.7	1.6
UK	7.2	3.4	3.4	-0.2	0.1
Switzerland	3.5	2.3	2.5	0.6	1.2
Canada	4.4	3.3	3.5	0.7	1.5
Emerging economies	6.7	3.6		3.9	
Asia	7.0	4.4		5.1	
China	8.1	3.6	3.7	5.2	5.4
South Korea	4.1	2.3	2.6	2.0	1.9
Rest of EM Asia	6.1	5.6		5.2	
LatAm	6.8	2.8		2.0	
Brazil	4.6	1.5	1.8	1.0	0.8
Mexico	4.8	1.7	1.9	1.3	1.6
EM Europe	6.7	-0.7		-0.2	
Russia	4.7	-6.0		-3.5	
Poland	6.0	4.8	4.8	0.9	2.3
Turkey	11.5	5.6	3.7	1.5	2.3
Other EMs	5.4	4.2		3.7	

Source: Datastream, IMF and AXA IM Macro Research – As of 27 September 2022

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2021	2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	3.2	7.2		4.7	
US	4.7	8.2	8.1	5.2	3.8
Euro area	2.6	8.1	7.8	5.5	4.1
China	0.9	2.1	2.4	2.3	2.5
Japan	-0.2	2.3	2.0	1.3	1.4
UK	2.6	9.0	8.6	5.6	5.6
Switzerland	0.5	2.8	2.7	2.0	1.6
Canada	3.4	6.8	7.0	4.3	3.5

Source: Datastream, IMF and AXA IM Macro Research – As of 27 September 2022

Central banks' policy: meeting dates and expected changes

Central bank policy		Meeting dates and expected changes (Rates in bp / QE in bn)				
		Current	Q3-22	Q4-22	Q1-23	Q2-23
United States - Fed	Dates	1.50-1.75	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec	31-1 Jan/Feb 21-22 Mar	2-3 May 13-14 Jun
	Rates		+1.5 (3.00-3.25)	+1.0 (4.00-4.25)	unch (4.00-4.25)	unch (4.00-4.25)
Euro area - ECB	Dates	-0.50	21 July 8 Sep	27 Oct 15 Dec	2 Feb 16 Mar	4 May 15 Jun
	Rates		+1.5 (0.75)	+1.0 (1.75)	0.25 (2.00)	unch (2.00)
Japan - BoJ	Dates	-0.10	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec	Jan Mar	May Jun
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	1.00	4 Aug 15 Sep	3 Nov 15 Dec	Feb Mar	May Jun
	Rates		+1.00 (2.25)	+1.25 (3.50)	+0.5 (4.00)	unch (2.50)

Source: AXA IM Macro Research - As of 27 September 2022

Calendar of 2022 events

2022	Date	Event	Comments
	Q3-Q4 2022	Chilean Constitutional Referendum	
September	25 September	Italian Elections	
	30 September	Possible U.S. Government Shutdown	
October	October	China's 20th National Congress- President Xi to be re-elected (expected)	
	2 October	Brazil General Elections	
	30 October	Brazil Presidential Elections (second round)	
November	2 November	FOMC meeting	
	3 November	UK Monetary Policy Report & MPC Summary and minutes	
	8 November	US Midterm Elections	
December	14 December	FOMC meeting	
	15 December	MPC Summary and minutes	

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27 September 2022

Asia's decarbonisation potential

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The outlook for China against US or European recession

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28 July 2022

July Global Macro Monthly – Temperature keeps on rising for central banks

27 July 2022

July Monthly OpEd – Signs of recession accumulating, but is it fully in the price?

27 July 2022

Equity market compass in the Fed's hiking trail

11 July 2022

June Global Macro Monthly – A summer of discontent

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Investment Managers

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