AXA Investment Managers

Investment Institute Macroeconomics

Central banks gauge lagged effects

Monthly Investment Strategy

AXA IM Research

April 2023

Summary: March 2023

Theme of the month: BoJ policy update – a question of when, not if

- Global inflationary pressures have spilled onto Japanese shores. Headline inflation reached 4.3% in January and now stands at 3.2%. Recent union wage negotiations suggest broader wage pressures across the economy consistent with some persistence to the latest rise in headline inflation.
- The Bank of Japan has combated deflation for decades, in 2016 introducing super-accommodative policy including a negative interest rate (-0.1%) and yield curve control (YCC), anchoring 10-year yields to 0% (with a gradually increasing tolerance band) to raise inflation sustainably to a 2% target.
- Now, rising inflation and expectations and some market dysfunctionality question ongoing super-accommodative policy. New Governor Ueda looks likely to gradually adjust the BoJ's policy course. We expect cautious steps to include a change to the YCC in the coming months.

Macro update: Bank concerns fade, central banks judge whether inflation peaking or persistent

- Market concerns about global banking have faded, but key surveys gauging the impact on credit conditions are awaited and will impact policy outlooks.
- Headline inflation appears to be peaking across developed and emerging economies. Core inflation appears stickier in most regions, even if most – including the Eurozone - appears to have passed its peak. This persistence, especially coupled with tight labour markets, is adding to central bank concerns.
- The Bank of Canada announced a "conditional pause" (while several EM central banks, including India and Indonesia, have reached less explicit outcomes). We forecast the Fed and Bank of England to hike once more. The ECB looks set to tighten into Q3. Even the BoJ appears to be preparing to adjust policy.
- Higher rates will also cause problems for sovereign issuers. The impending US debt ceiling and separate proposed reforms to Brazilian fiscal rules have deeper roots. However, rising borrowing costs could see several sovereign issuers facing more challenging conditions over the coming years.

Investment Strategy: risk premia waiting for policy lagged effects to land

- FX: 'Peak USD' narrative has room to run, and a higher hard-landing risk has raised the bar on further Fed tightening. JPY should recover further in the second half of the year on the back of this. EUR has more upside potential and indeed the US rates rebound in Apr has not suppressed the EURUSD.
- Rates: Markets expect the FOMC to initiate a fairly aggressive rate cutting cycle immediately after a final 25bp hike at the May meeting. Given the extent of rate cuts priced into the curve, it is reasonable to expect a substantial correction in fixed income markets, should the market's dovish expectations correct.
- Credit: Credit markets have weathered the banking troubles well enough to post positive returns. There has predictably been a strong divergence between banks and non-financial corporates. The downside to this resilience is that spread risk-reward is currently not attractive enough given the recession risks.
- Equities: Early bird earnings reports have been better than expected. EPS have declined since last year despite positive sales which benefit from price effects, as profit margin pressure due to wage growth is likely to persist. Cyclicals' earnings support expected in 2023 poses a downside risk in a recession.

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

Headline inflation is falling sharply in H1 2023. Core response slower to fall as labour markets remain tight. Inflation persistence is now the key risk.

Monetary policy

Most central banks close to peak. Rate cuts unlikely for most in 2023. Banking concerns fade, but could still lead to a quicker reversal in policy if worsen.

Growth

Growth continues to prove more resilient. Mild recession expected in US with weaker Q2. Europe started year stronger, but at unsustainable pace. Tighter credit conditions to add to headwinds.

Fiscal policy

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

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

Bank concerns did not boost USD, debt ceiling could see repeat. Euro could make further gains, as could Yen in H2 2023.

Credit

Spreads have sailed through the March bank troubles and are again underpricing recession risks even if balance sheets are in good health. Some caution warranted.

Equities

Earnings expectations are key for 2023 returns. A strong start to the year may create complacency amid central banks hawkishness and macro headwinds. Margin pressures at play due to wages.

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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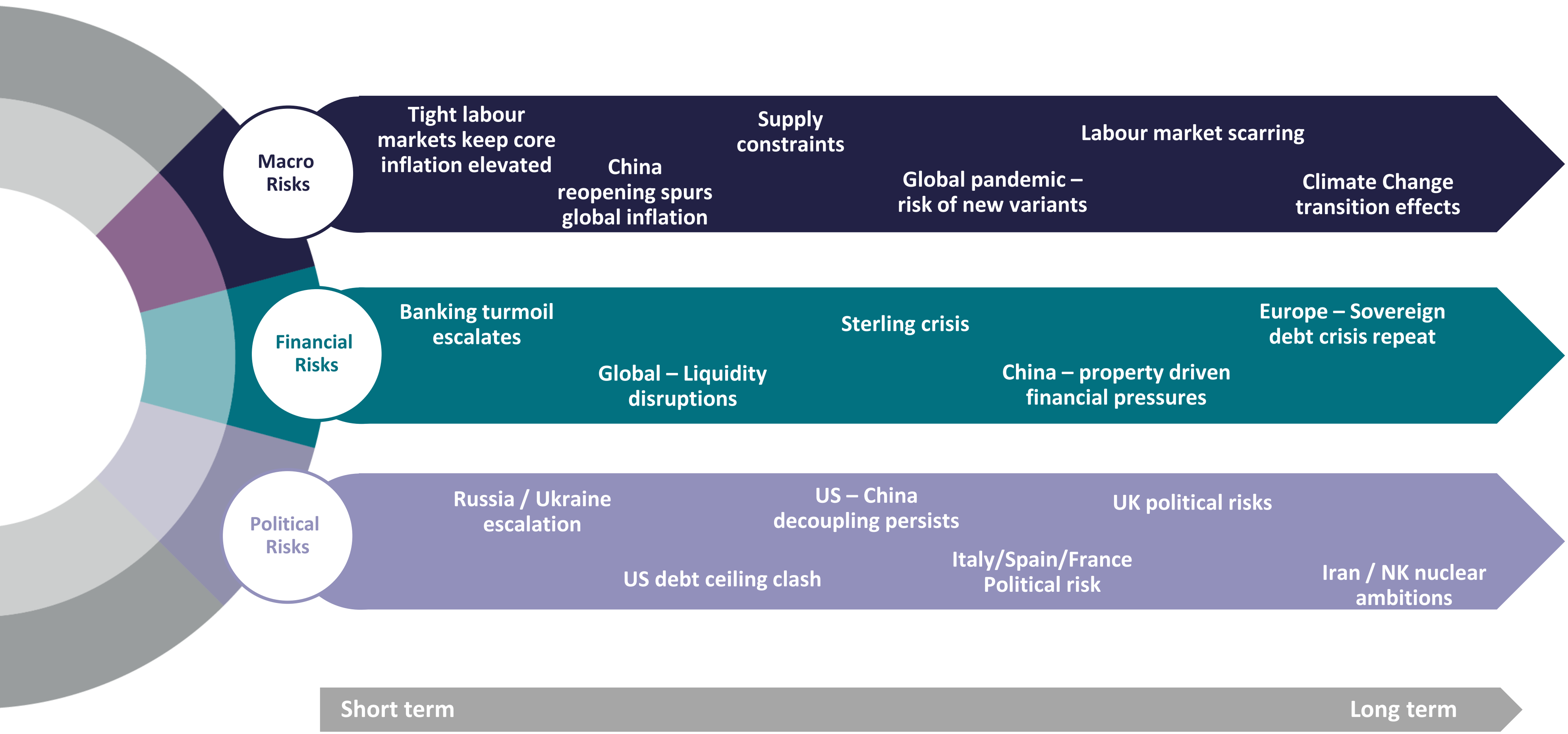
RISk Radar

Summary – Key messages



Contents

Theme of the Month

BoJ Policy update: A question of when, not if

The end of a decades-long battle with deflation?

Prices have risen considerably driven by energy, food and a weak yen

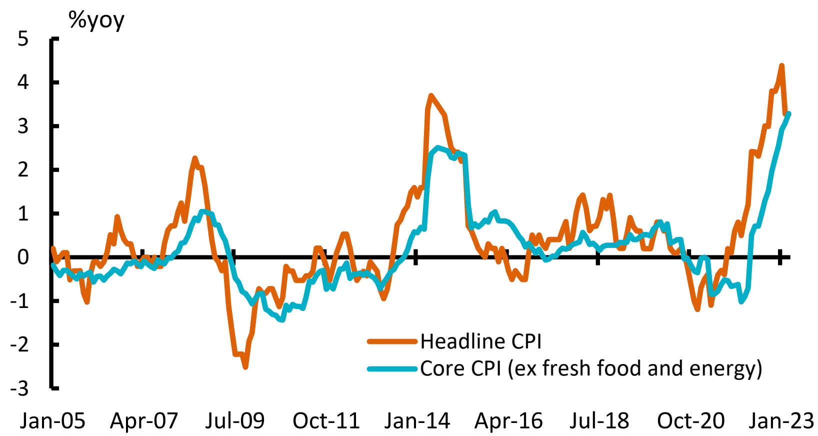
- Over the past 12 months, Japan's inflation rate rose to 4.3% from 0.9%, and is currently at 3.2% – a material rise for a country that has battled with deflation for decades.
- Rises in global energy costs and other goods have been key drivers, but the backdrop has been exacerbated by a weakening yen, which slumped to a 32-year low against the US dollar in the wake of a widening monetary policy gap between Japan and other developed markets.

Inflation rising, but how sustainable is it?

- Yet signs that inflation will remain above target are weaker. Services inflation reached only 1.3% in February 2023. While improving wages indicate that inflationary pressures should persist, given Japan's history of prolonged deflation, we remain cautious in assuming such a future development is certain.

Inflation has risen considerably

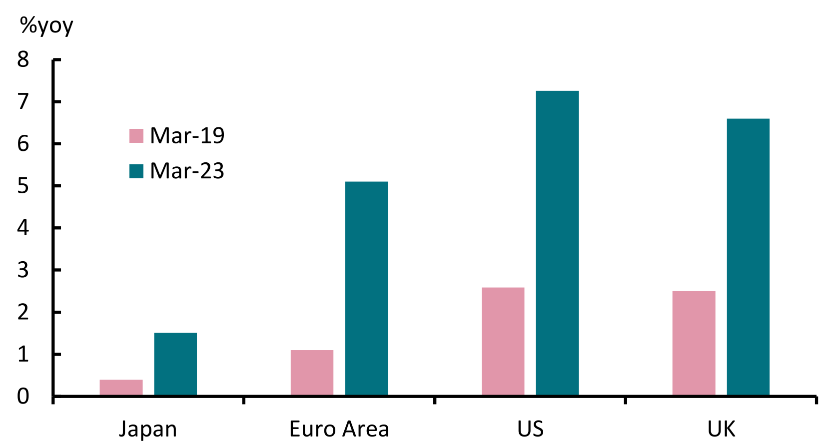
CPI - Contributions



Source: Statistics Bureau of Japan (SBJ), Refinitv, AXA IM Research, April 2023

Data suggest little risk inflation to remain above target

Services CPI inflation - March 2019 and 2023



Source: SBJ, Eurostat, BLS, ONS, AXA IM Research, April 2023

BoJ Policy update: A question of when, not if

Wages – a key missing piece in the puzzle

Higher wage growth needed for sustainable inflation

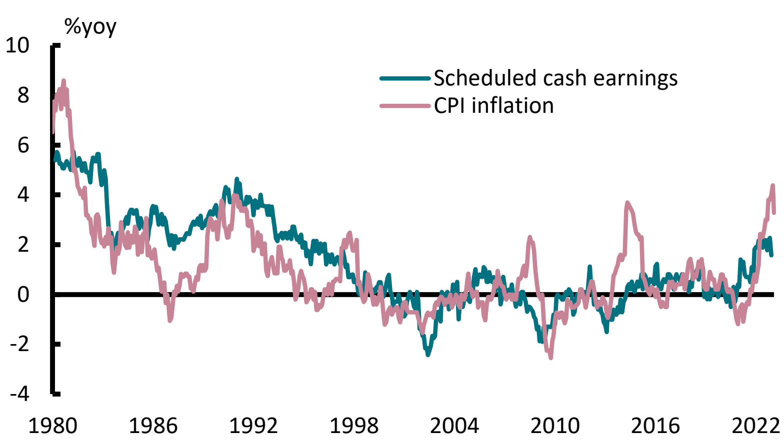
- Higher wage growth is seen as a prerequisite for returning inflation to the BoJ's 2% target on a sustained basis, reflecting the close relationship between nominal wage growth and prices over longer periods of time. Faster nominal wage growth supports faster nominal consumption growth which in turn builds domestic inflationary pressure in the economy.

Shunto spring wage negotiations for FY23 an important step

- Shunto refers to Japan's annual spring wage discussions between unions and employers. While these cover only around 16% of the workforce directly, but act as a key barometer for the pace of wage increases throughout the wider economy.
- The latest data from Japanese Trade Union Confederation (RENGO) point to a 3.7% increase in total wages, of which 2.3% is base pay the most relevant indicator for broader cash earnings.

Wage inflation feed through to broader CPI inflation

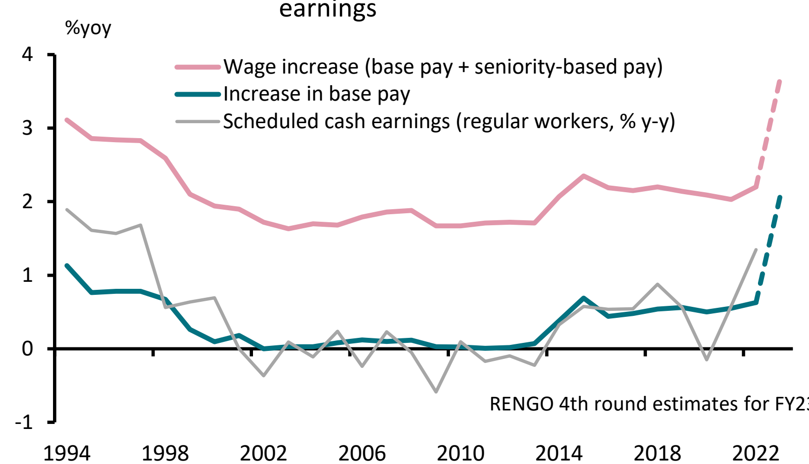
Japan: Inflation and wages



Source: SBJ, Ministry of Health, Labour and Welfare (MHLW), AXA IM Research, April 2023

Spring wage settlements point to historic rises

Annual wage negotiation increase and scheduled cash earnings



Source: RENGO, MHLW, AXA IM Research, April 2023

BoJ Policy update: A question of when, not if

BoJ's policy of YCC has been under pressure

BoJ's accommodative policy of Yield Curve Control and negative interest rates

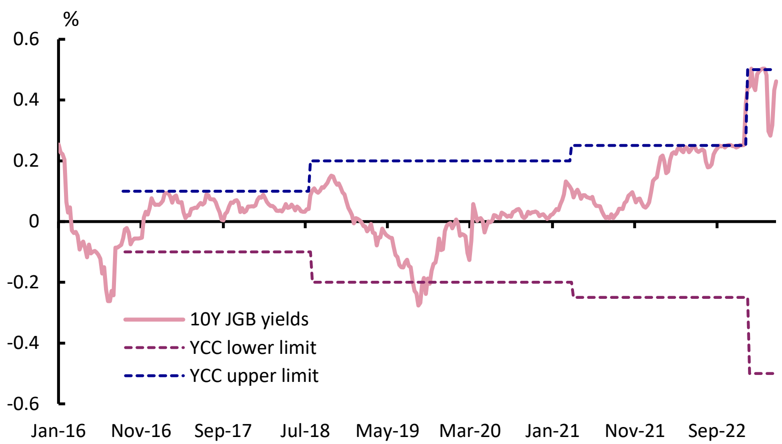
- In January 2016, the BoJ introduced a negative interest rate policy, cutting the Call Rate to -0.1%. In September 2016, yield curve control (YCC) was introduced initially with the intent of steepening the yield curve. The policy sees the BoJ commit to unlimited JGB purchases aimed at maintaining 10-year JGB yields at 0% with a tolerance band that was initially set at +/-10 bp. The band around YCC has been progressively widened, now standing at +/-50bp since the BoJ's adjustment in December 2022.

Pressure on policy stemming from improving dynamics and deterioration in market functioning

- Expectations have risen for the BoJ to adjust monetary policy from here, particularly its YCC. These have been driven by economic fundamentals, both the rising short-term inflation outlook and the risk of increased inflation persistence, underpinned by improving wage dynamics. Considerations of the side effects of the current BoJ policy in terms of market functioning are also driving the debate.

YCC has evolved over time

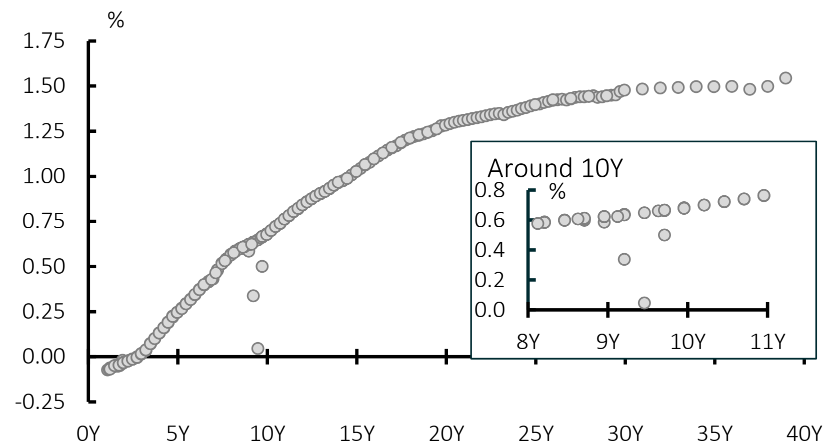
10Y JGB yields and yield curve control



Source: Refinitiv, Bank of Japan, AXA IM Research, April 2023

Yield curve distortions around 10-year JGBs

JGB yield curve as of 9 Mar 2023 - March BoJ MPM



Source: Japan Security Dealers Association, AXA IM Research, April 2023

BoJ Policy update: A question of when, not if

New BoJ leadership to provide a new direction

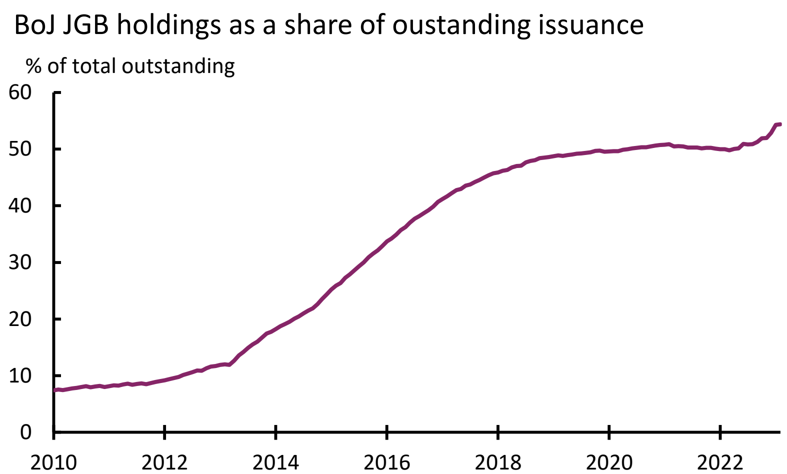
New leadership, new direction

- Kazuo Ueda, an economist and expert on Japanese monetary policy, replaced Haruhiko Kuroda as Governor of the Bank of Japan on 8 April. Ueda's first meeting at the helm of the BoJ will be on 27-28 April. We think the fresh slate provided by the change of leadership, alongside improved pricing dynamics, is likely to trigger a gradual change in approach.

Change in policy by July

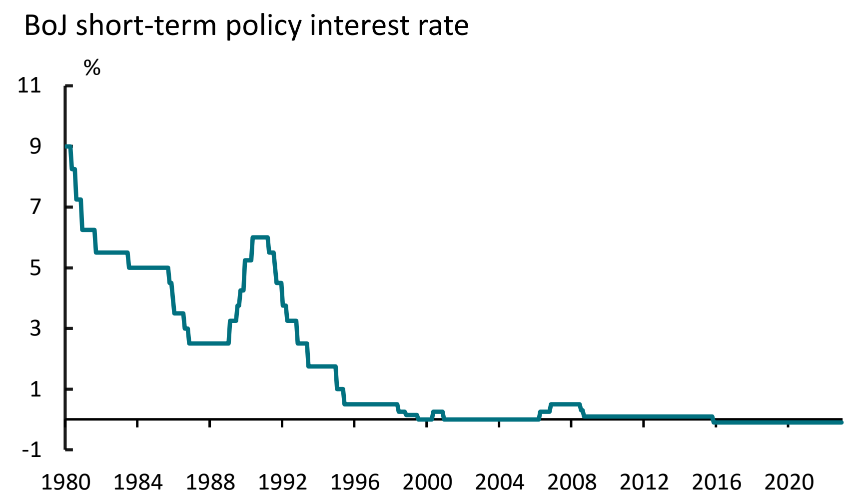
- We think the BoJ will begin to exit its ultra-easy policy in three gradual steps:
  - First, we expect the BoJ to announce a comprehensive monetary policy review.
  - Second, we think the BoJ will begin by making its YCC policy more flexible, most likely by July as an interim step before scrapping the policy. Currently the BoJ targets 10-year yields we think it will move to target 5-year yields.
  - Third, we anticipate the removal of the negative interest rate policy to be delayed until 2024

BoJ holds most outstanding JGB issues



Source: BoJ, Refinitv , AXA IM Research, April 2023

Policy rate has remained close to zero for over 20 years



Source: BoJ, Refinitiv, AXA IM Research, April 2023

BoJ Policy update: A question of when, not if

Steady as she goes

Uncertainty clouds the outlook – BoJ will be wary of rapid tightening

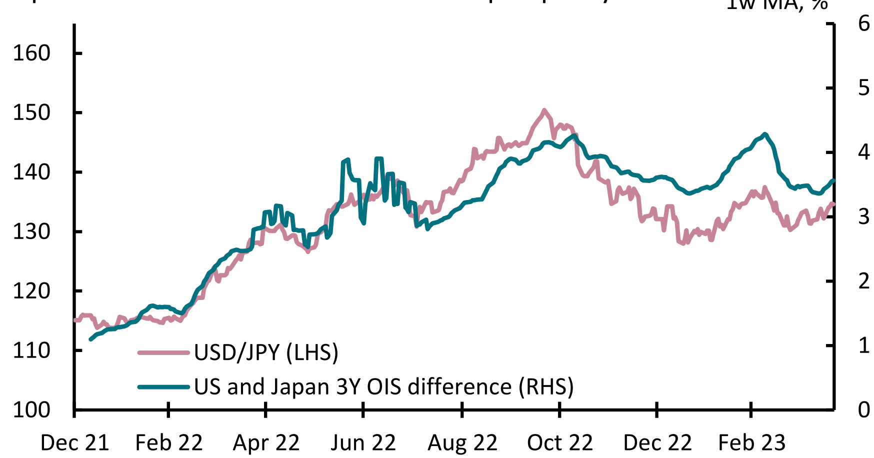
- The yen has already gained on expectations of a change in BoJ policy and would rise further if confirmed. Rapid yen appreciation could slow Japan's fragile recovery and reintroduce disinflationary pressures at a time when prices are just beginning to rise.
- Furthermore, we forecast weak global growth and the prospect of slowing external demand, which should add to hesitancy around any rapid policy change.

How fast do pricing behaviors change?

- Prices in Japan have exhibited downward nominal rigidities. Household price expectations have shifted higher as spot inflation has increased. However, these expectations have closely followed actual inflation in previous episodes, quickly unwinding after inflation begins to fall back. This experience and the risks of inflation expectations declining will likely add to the BoJ's step-by-step approach, pausing to see the impact of changes and the evolution of price dynamics before making further steps.

Prospect of rapid yen appreciation will keep BoJ nervous

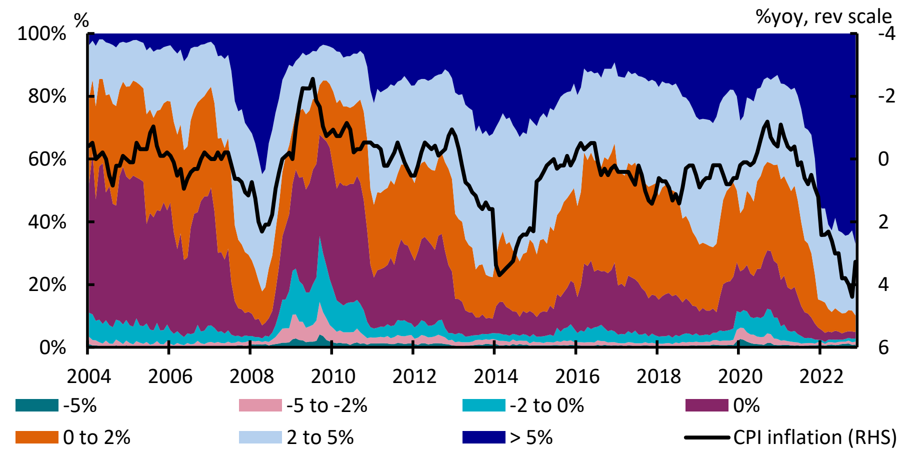
Expected difference between US and Japan policy rates



Source: Refinitiv, AXA IM Research, April 2023

Expectations shifting – but historic shifts have not endured

Inflation and household price expectations



Source: BoJ, SBJ, Refinitiv, AXA IM Research, April 2023

Macro outlook

Resilient economy

US

Banking concerns fade for now

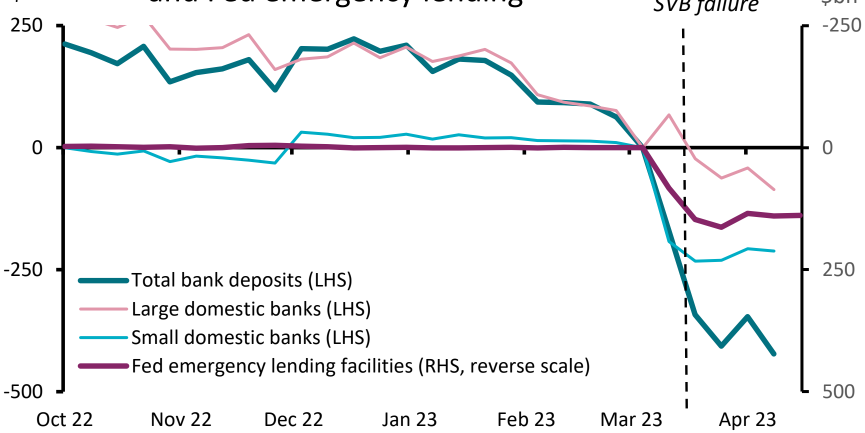
- Just over a month from the US bank failures, fears over banking have receded somewhat. Deposits have stabilised, albeit $422bn below their pre-SVB level and still falling in the latest week. The Fed's emergency support to the banking system has not grown for 3 weeks. But US bank equities are still 20% lower (compared to 8% in Europe). The upcoming Senior Loan Officers Survey will detail changes in credit conditions and lending and help gauge the impact on the broader economy and implications for monetary policy.

A strong start to the year, but Q2 to weaken

- We await Q1 GDP, but now-tracking estimates a solid 2%+ (saar), albeit with downside risks from inventory. The breakdown of this growth will shape the outlook for Q2, with monthly consumption raising the risks of a fall in consumption in Q2. We estimate a weaker Q2, which could be negative, before contraction in H2 and a mild recession. We forecast GDP growth averaging 1.1% in 2023 and 0.3% in 2024, a weaker outlook than the consensus 1.1% and 1.0%.

Banking sector outflows start to stabilise

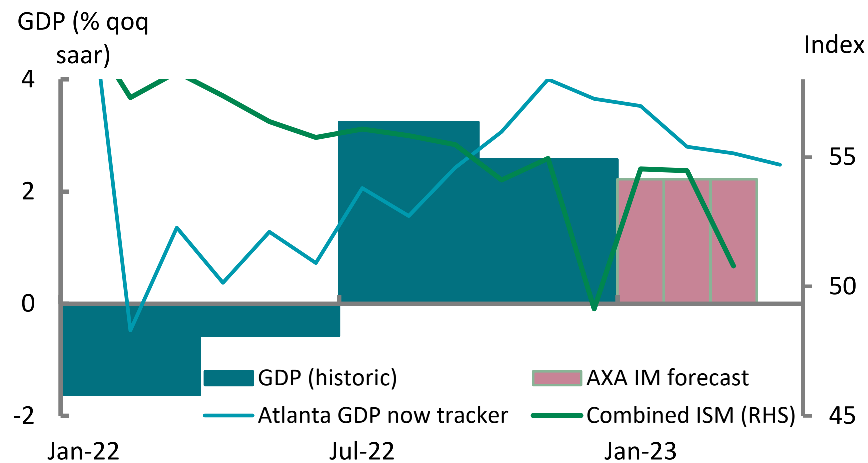
Cumulative change in commercial bank deposits and Fed emergency lending



Source: FRB, AXA IM Research, April 2023
**Note: Cumulative change from SVB failure*

Q1 GDP set for firm rise despite headwinds

GDP growth and short term outlook



Source: BEA, FRB Atlanta, ISM, AXA IM Research, April 2023

Non-market forces to add to summer volatility

US

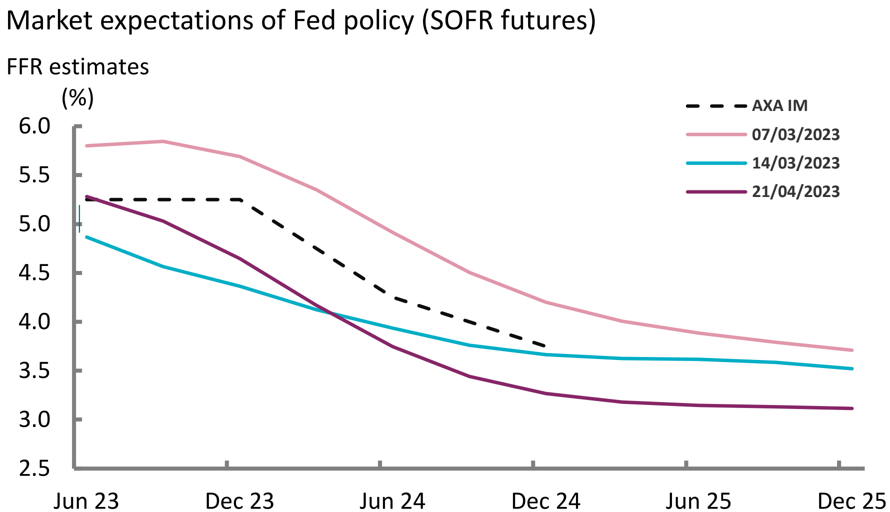
Fed shapes for “one and done”; debate focuses on pace of easing

- Despite significant uncertainty over recent weeks, Fed members ahead of a purdah period before May’s meeting suggested a further hike in FFR to 5.25% on 3 May, in line with our forecast. Market expectations for rate cuts by year-end to 3.75% (upper range) have now risen to 4.75%. We continue to see cuts delayed until 2024. However, next year does appear to be a year of policy easing, with our forecast that rates close 2024 at 3.75%, likely with further to fall beyond that.

Debt ceiling moves up the agenda

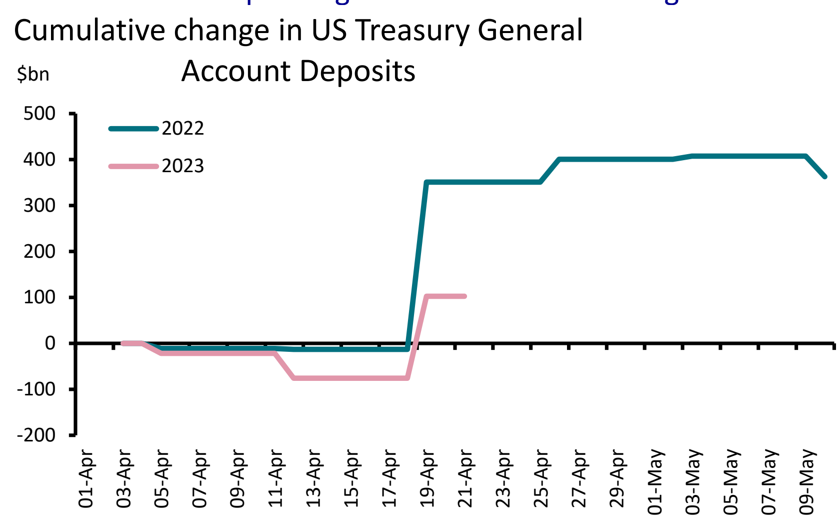
- House Republicans made the first moves towards passing a bill to raise the debt ceiling ($1.5trn), but on the condition of material spending cuts ($4.5trn over ten years) that are unlikely to progress the debt ceiling resolution. April is an important month with tax receipts building government cash reserves that will determine when it runs out of cash. The government’s cash account at the Fed (TGA) is set to rise over coming days and should see the X-date for end-July. A shortfall in receipts could bring this to start-June.

Market rate outlook (SOFR contracts)



Source: Bloomberg, AXA IM Research, April 2023

Government cash pile to grow ahead of debt ceiling showdown



Source: FRB, AXA IM Research, April 2023

In doubt (large) Q1 GDP growth rebound has legs

Euro area

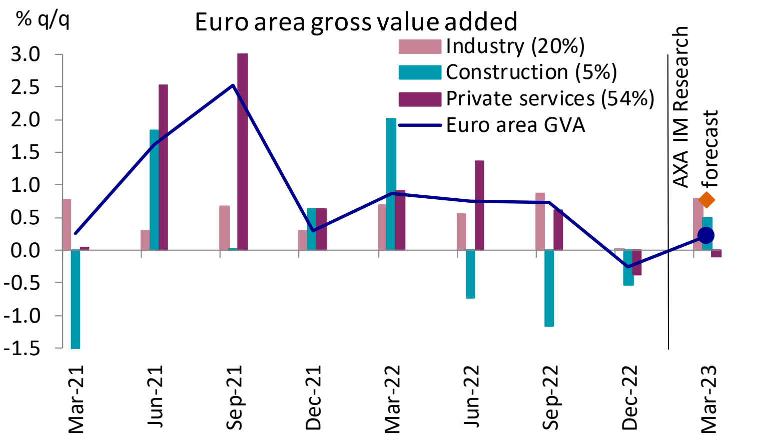
Large upside risks to Q1 GDP growth

- Latest indicators continue to display buoyant eurozone real activity. Meaningful rebounds in industrial and construction output early this year are likely to explain the bulk of Q1 growth acceleration from a flat Q4 GDP.
- We think euro area Q1 GDP may well surprise again to the upside. Based on the output approach, a jump of up to 0.7% q/q growth cannot be ruled out.

Is this headline growth pace sustainable?

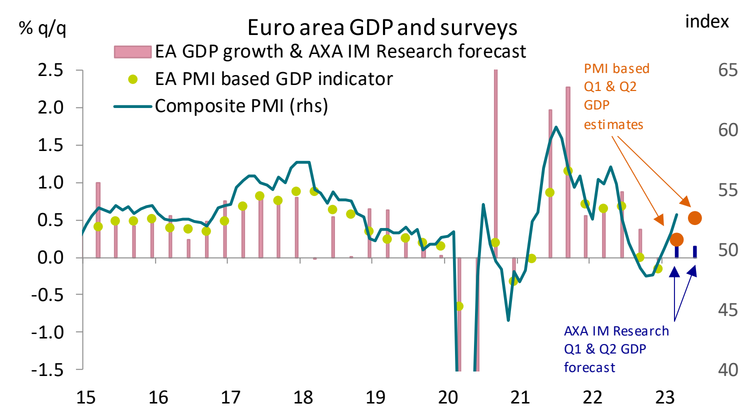
- We think Q1 GDP will be mainly driven by net exports and to some extent by investment. Private consumption is likely to remain in the doldrums. Initial analysis will be driven by preliminary reports from France and Spain.
- A large share of the Q1 GDP rebound is likely to be short-term in nature. Fiscal policy has been highly supportive and the energy terms of trade shock is now reversing. Considering debt sustainability-related concerns, this implies an at best neutral fiscal stance in the quarters to come. We are also still very much in the early days (time and level wise) of monetary policy tightening with full effects yet to come through. In total, we do not believe the expected pace of Q1 GDP growth will prove sustainable.

EA Q1 GDP – A meaningful rebound is on the cards



Source: Refinitiv, AXA IM Research, April 2023. NB: Number in parenthesis corresponds to sector weight in gross value added (GVA). Orange diamond represents extent of upside risks to our Q1 GDP baseline forecast.

Services lifting the entire economy



Source: Refinitiv, AXA IM Research, April 2023. NB: Q2 PMI GDP estimate based on April data only while Q1 is based on January to March data

ECB hawkish compromise to remain

Euro area

Data dependence to remain at the forefront

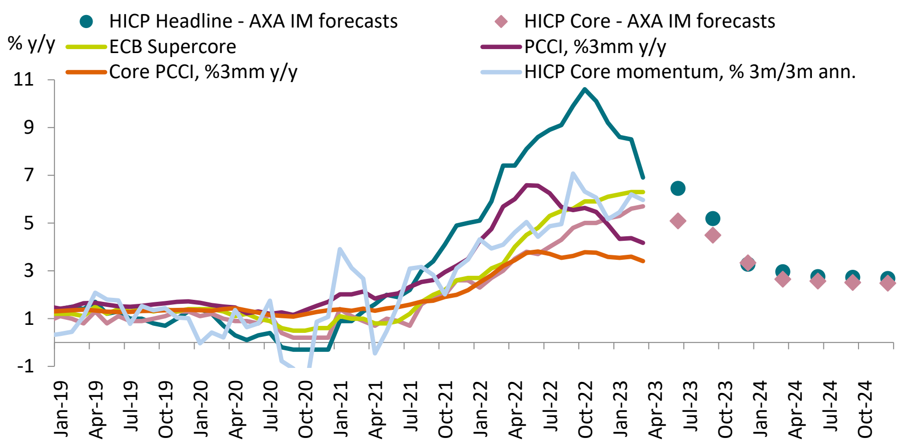
- While market banking sector concerns have eased, key data are yet to be published ahead of 4 May ECB GC meeting. On 2 May, March M3 data, and Q2 bank lending survey will be critical in informing whether commercial banks have translated increased funding costs/uncertainty in lending conditions or plan to do so. Flash April HICP and Q1 GDP will also be critical.

Our baseline is unchanged with upside risks to 3.75% ECB terminal rate

- Several underlying inflation measures have edged down in March. This is consistent with our core inflation forecast that the peak is most likely behind us, but the road to 2% convergence is still far away. The latest developments on the wage front concur.
- A hawkish 25bps hike seems in order at the May meeting (50bps cannot be entirely ruled out), slowing the pace from 50bps but coupled with a guidance of still more "ground to cover" on the rate front, and that the pace of APP reinvestment is likely to further slow after June. Risks to our view that the ECB will stop at 3.75% in July remains to the upside.

Very early signs of underlying inflation easing

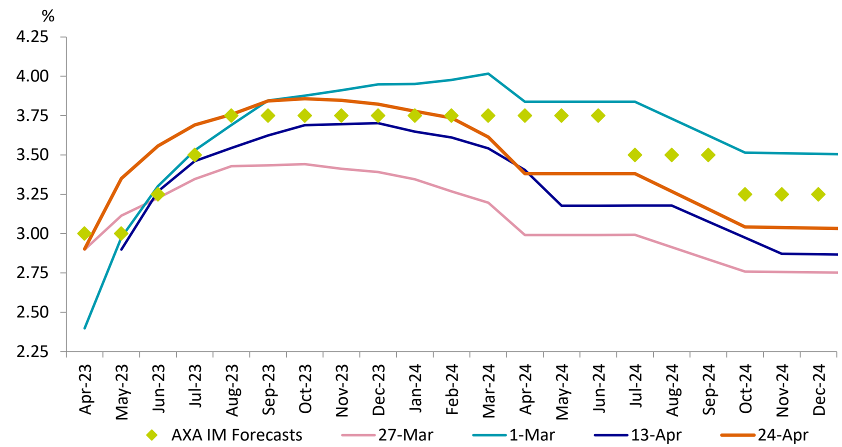
ECB underlying inflationnary pressures and AXA IM research forecasts



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

Short-end rates broadly reconverged to pre-banking sector turmoil

ECB Market pricing



Source: Bloomberg, AXA IM Research, as of 24 April 2023

Signs point to greater inflationary pressures

UK

Growth prospects brighter with a technical recession likely to be avoided

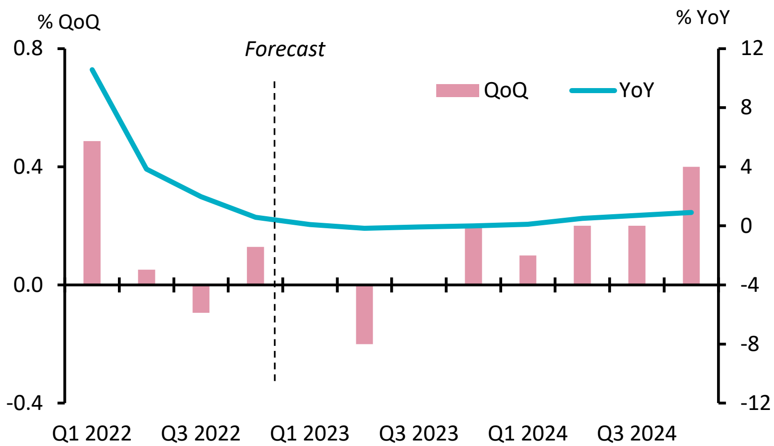
- Recent indicators point to more underlying strength in UK activity. Flash PMIs for April pointed to the fastest rate of expansion for a year, but this masks a growing divergence between sectors. Manufacturing output continues to slow, whilst improvements in services are driving the rebound in PMIs. Following flat monthly GDP growth in February, we revised our view for growth this year, now expecting GDP growth of 0% this year (up from -0.3% prior) and 0.5% in 2024.

Inflation remains stubbornly high

- CPI inflation eased to 10.1% in March from 10.4% in February driven by base effects in energy, but increases in food and recreation goods and services kept headline inflation elevated coming in 30bp above consensus forecasts. Inflation is likely to fall back sharply in April by around 2ppts as increases in household energy prices seen last year drop out of the annual comparison, but the path of core inflation is likely to be more sticky. We forecast CPI inflation to average 6.6% in 2023 and 2.4% in 2024.

Growth hovering around zero this year, before a 2024 pickup

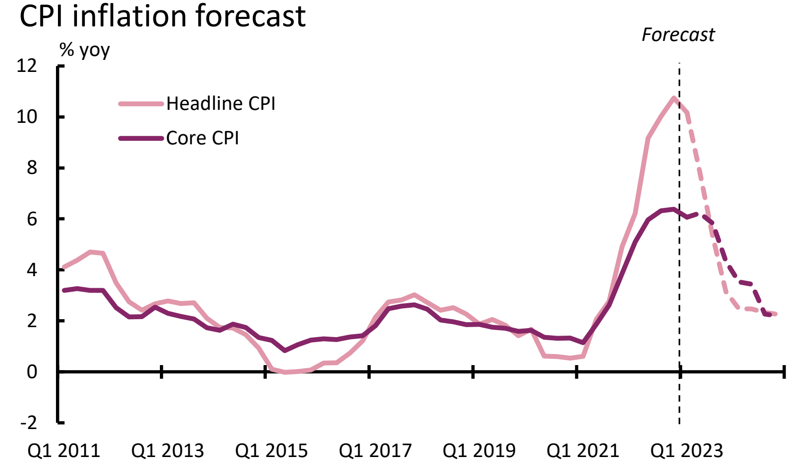
GDP growth forecasts



Source: ONS, AXA IM Research, April 2023

Sharp falls in headline approach

CPI inflation forecast



Source: ONS, AXA IM Research, April 2023

Rising wages, high prices set scene for May hike

UK

Pick up in private sector wages

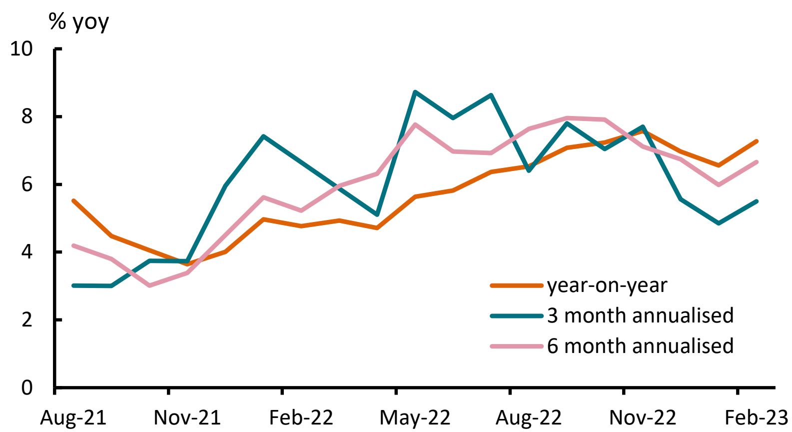
- The labour market also remains tight. Recent labour market data saw unemployment rise marginally to 3.8% as inactivity declined. However, private sector pay, which the MPC have focused on as an indicator of inflation persistence rose sharply in February following months of gradual moderation. Private sector pay rose to 7.3% yoy in February 2023, up from 6.6% in January.

May hike, markets question whether this will be enough

- Recent labour market and inflation data add to our conviction for our call that the BoE will hike rates by 25bp in May. Following the data, markets are questioning whether the BoE may be forced to go further and see rates rising to just below 5% by end-2023. We think that the upcoming sharp drops in inflation will give the BoE the space to pause hiking Bank Rate at 4.50%. However, we think continued strength in wages could warrant further action from the BoE.

A pick up in wages

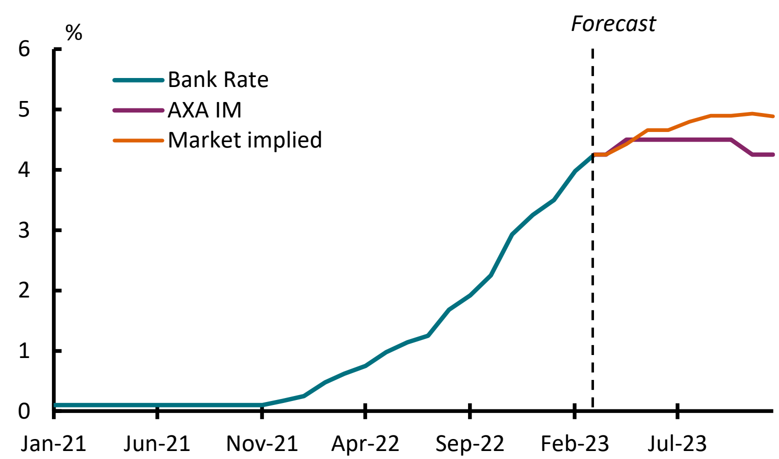
Private sector regular wage growth



Source: ONS, AXA IM Research, April 2023

Market expectations of rate rises have risen

BoE Bank Rate outlook



Source: Refinitv, AXA IM Research, April 2023

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

Japan

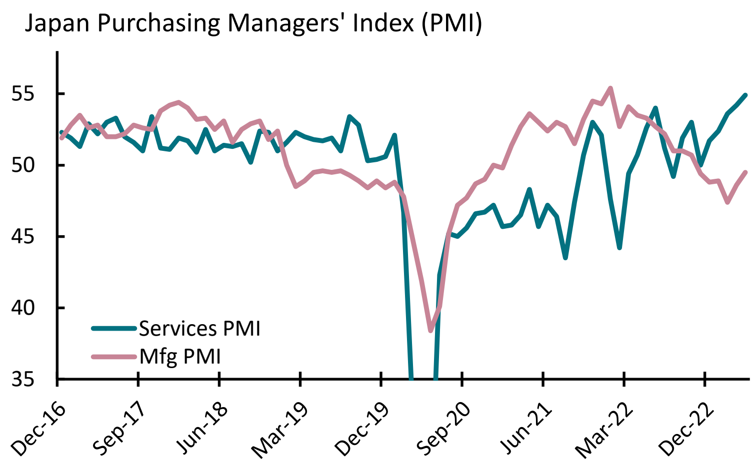
Recovery in growth remains underway

- Services PMI is stabilising at highs, suggesting that consumption will remain robust into Q2. Manufacturing has struggled, but the recent data suggests a recovery in manufacturing sentiment. Whilst the PMI has only a loose relationship with overall GDP growth, the improvement in the measure points to continued growth momentum as the economy continues its recovery.

Headline falls, core continues to pick up

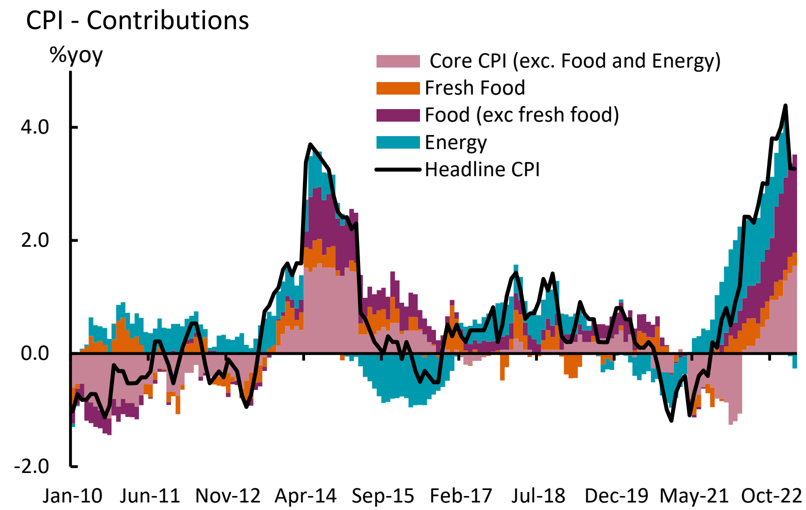
- Headline inflation continues to moderate as base effects weigh, but measures of underlying inflation are still rising. The Consumer Price Index eased to 3.2% in March from 3.1%, but the BoJ's preferred measure of core, excluding fresh food and energy, rose to 3.8% — a 0.3 percentage point increase on the month.

PMIs signal strength in growth momentum



Source: Refinitiv, AXA IM Research, April 2023

Energy weighs on headline but core still rising



Source: Refinitiv, AXA IM Research, April 2023

BoJ looks set to tweak YCC, but not just yet

Japan

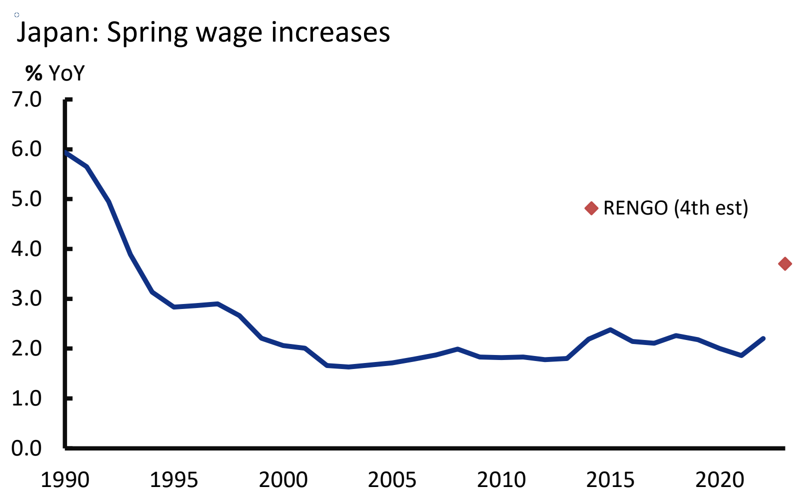
Ueda's first BoJ meeting approaches

- Market focus is once again turning to the Bank of Japan (BoJ) as the long-awaited first meeting under the new governor approaches. Kazuo Ueda's first meeting at the helm of the BoJ will take place on 27-28 April – to be held alongside the publication of updated BoJ forecasts in its Outlook Report. Whilst we cannot rule out a surprise move to tweak yield curve control (YCC) as soon as next week, we do not expect changes to all BoJ policy tools

BoJ to remain cautious

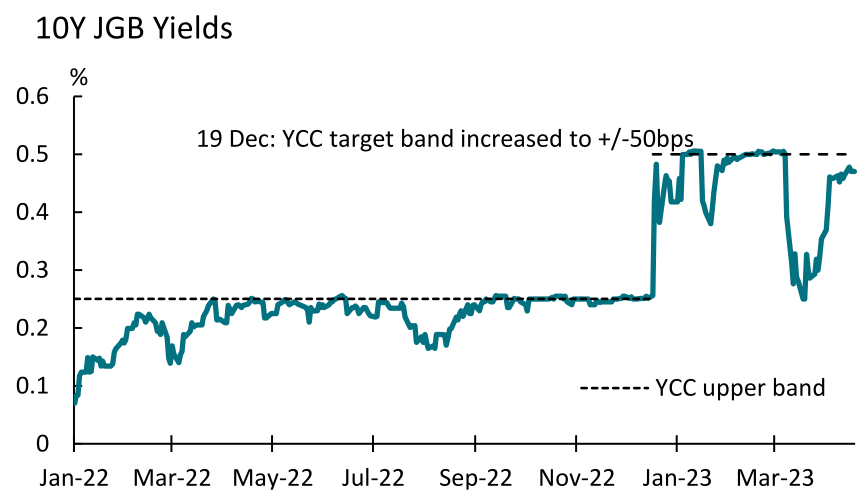
- Despite this, we still expect the BoJ to remain cautious, driven by considerations around weakening global growth and the potential for rapid yen appreciation, particularly in the more risk-averse environment triggered by banking concerns. We expect the removal of the negative interest rate policy 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.

Spring wage settlements average 3.7%



Source: RENGO, AXA IM Research, April 2023

JGB yields remained below the cap in the run-up to April BoJ MPM



Source: Refinitiv, AXA IM Research, April 2023

Solid start to fade

Canada

Incomes boost lifts consumer spending in Q1

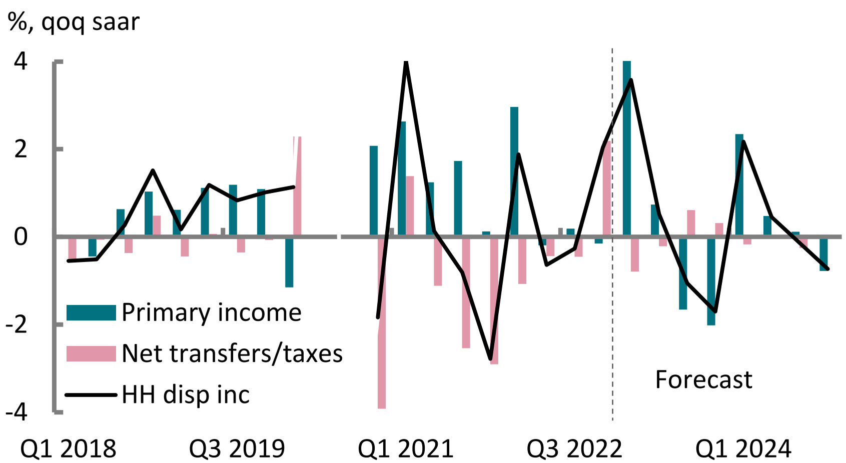
- After stagnating in Q4, monthly GDP started 2023 stronger, underpinned by stronger consumer spending. Tax credits and pension boosts lifted incomes in Q4, while employment income will be supportive across Q1. We expect Q1 GDP to rise by 2.8% (saar).

Buoyancy to reverse and skirt recession

- The consumer strength looks set to fade as the impact of higher interest rates increasingly feeds through to mortgage payments, albeit that retained excess savings may act as a buffer. Investment spending and net trade should also soften. We forecast growth softening in Q2 and contracting in Q3, although on balance we expect the economy to avoid an outright recession. We forecast growth of 1.2% and 0.9% in 2023 and 2024. This is a more delayed slowdown than the consensus outlook for 0.7% and 1.3%.

Household incomes support solid consumer start to 2023

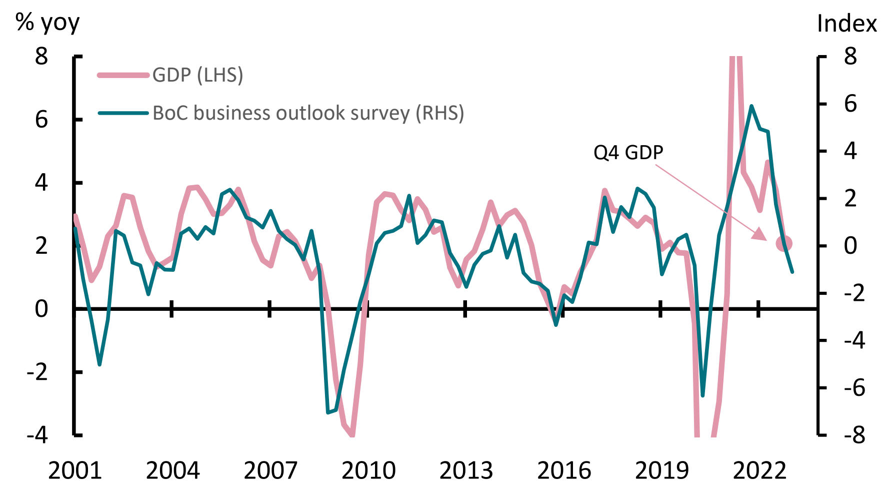
Components of household income (real)



Source: CANSIM, AXA IM Research, April 2023

Business surveys point to slower outlook

BoC business outlook survey and GDP



Source: CANSIM, BoC, AXA IM Research, April 2023

Lagged tightening effects dominate despite strong labour market

Canada

Tight labour market keeps core inflation elevated

- Headline inflation fell back to 4.3% in March – in line with our forecasts – and down nearly 4ppt from the 8.1% peak in June. Median 'core' prices also retreated more this month, though at 4.6% the annual rate is still only 0.7ppt lower than peak. We forecast inflation averaging 3.8% and 2.7% this year and next, firmer than consensus expectations for 3.7% and 2.2%. A still tight labour market leaves us cautious about how quickly core inflation will ease over the coming quarters.

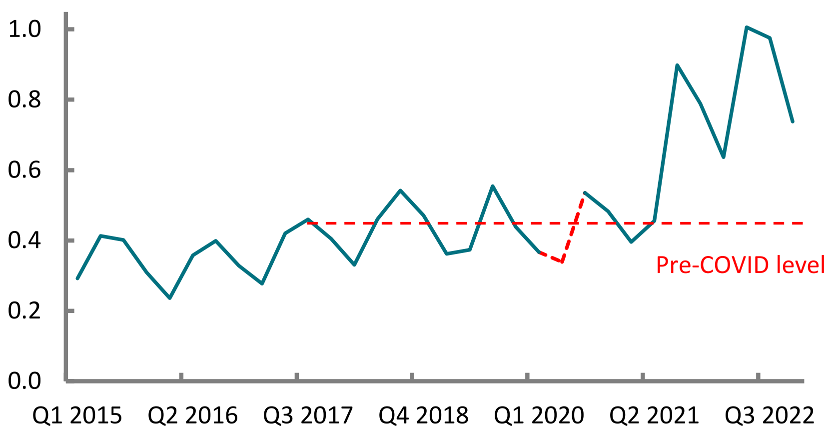
BoC considers policy lags

- The BoC raised rates through 2022 eyeing high inflation and a tight labour market. This year, its focus appears to have shifted to the lagged impact of that tightening, even as employment growth remains strong. In January it announced a "conditional pause" and has left policy unchanged at the last two meetings. In April, it estimated that tightening would increasingly weigh on households. We believe the BoC to have peaked at 4.50% and forecast cuts only from January 2024 to 3.00% by year-end.

Labour market tightness keeping core inflation elevated

Vacancies

% unemp

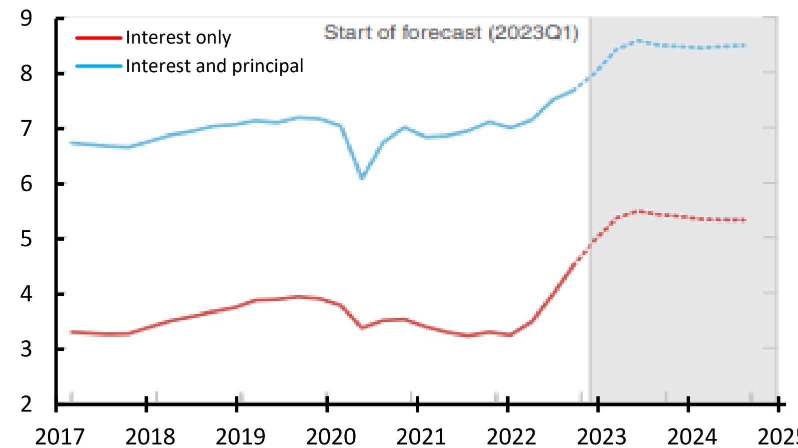


Source: CANISM, AXA IM Research, April 2023
NB Dotted line reflects interpolation of vacancies not published Q2 & Q3 2020

BoC mulls lagged impact of tightening

Mortgage costs are expected to rise

% disposable income before payment of interest



Source: BoC MPR, CANSIM, April 2023

Peak inflation and peak policy rates

Emerging Markets

EM disinflation confirmed… almost everywhere

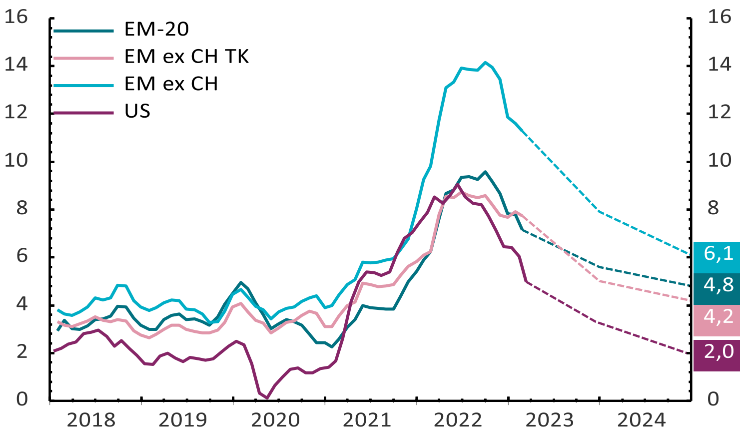
- Inflation rates passed the peak in EM and disinflation advances at various speeds among countries. Energy inflation has stopped driving inflation higher. Food inflation remains more of a challenge, due to domestic developments (as illustrated by South African CPI recently). Core inflation has equally peaked, although it is stickier in Hungary and Poland for now.

First signs of dovishness?

- Hungarian central bank MNB deputy Vargas announced a cut in the upper bound of the interest rate corridor to 20% (from currently 25%) which is to converge in time towards the base rate (13%) on the back of lower growth that should start impacting the inflation profile, if the currency allows for such an adjustment.
- Indian RBI bank which has kept policy rates unchanged in April at 6.5%, at odds with expectations of an additional last hike. This may well be the peak policy rate of the cycle despite the RBI hinting at only a pause – as March inflation was already within the central bank's target range (below 6%), and RBI has revised down its inflation expectations.

EM disinflation path

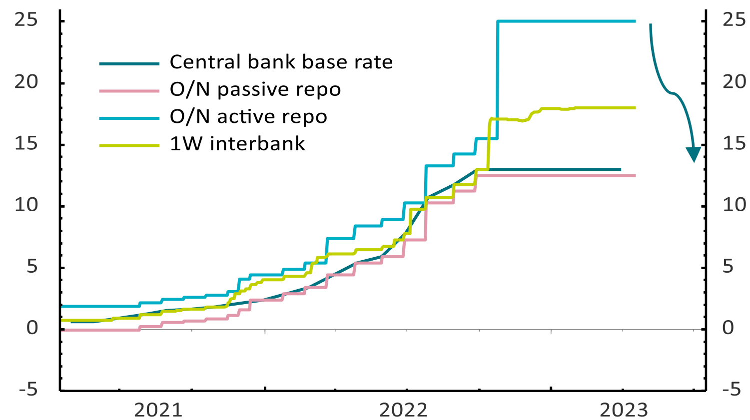
Inflation rates and consensus expectations



Source: Refinitiv Datastream and AXA IM Research févr. 23

Hungary: towards monetary policy orthodoxy

Hungary policy rates (%)



Source: Refinitiv Datastream and AXA IM Research mars 23

Brazil's new fiscal framework

Emerging Markets

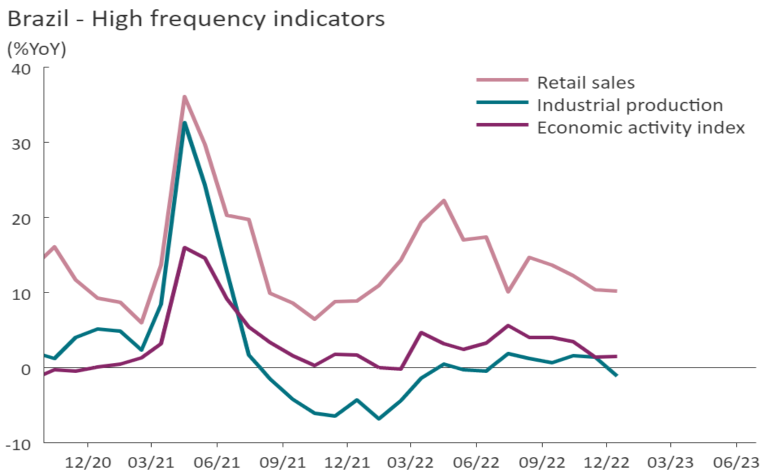
The new plan

- The government recently presented its new fiscal framework (30 March) to replace the old fiscal rule that constrained real expenditure growth to zero. Instead, the new framework includes: i) real primary expenditure limited to 70% of revenue growth of the prior year, with a floor of 0.6% and ceiling of 2.5% (yoy); ii) new primary balance targets, which would reach -0.5% of GDP and improve gradually until reaching 1.0% by 2026.

A focus on revenues

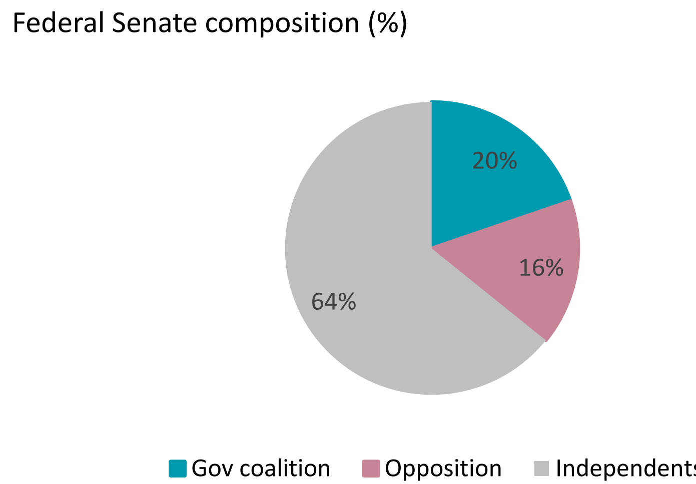
- While the plan was relatively well received by markets, the new framework is too contingent on boosting revenues rather than containing spending. Moreover, details are still missing on enforceability mechanisms. As such, there could be the risk of additional spending without higher revenues, particularly as the economy decelerates. So far, the plan only specifies that real primary expenditure would be constrained by 50% of revenue growth if the government fails to meet its target in the previous year. The plan will likely change as the government negotiates its approval in Congress, where it holds a minority.

Increasing pressure to boost spending as the economy cools



Source: Refinitiv Datastream, IBGE and AXA IM Research, Mar 23

Plans likely to change as it navigates the Federal Senate



Source: AXA IM Research

Investment Strategy

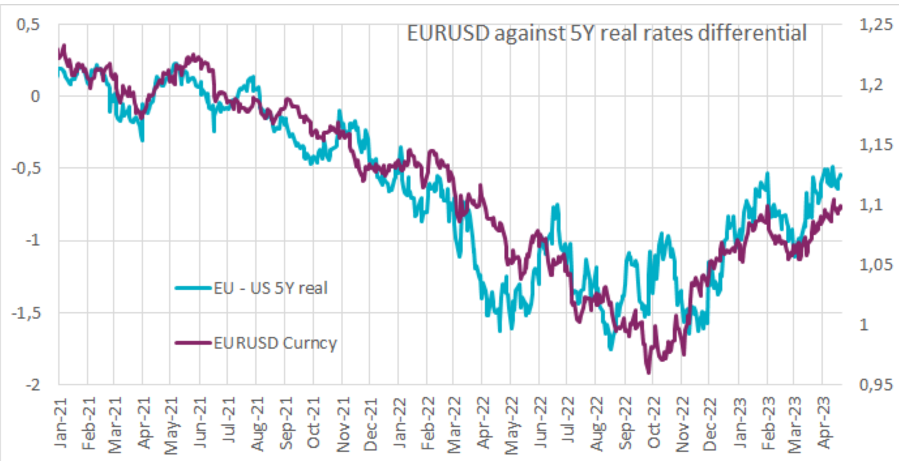
Investment Managers

Investment Strategy

FX: Desynchronisation – a chance for EURUSD to break higher

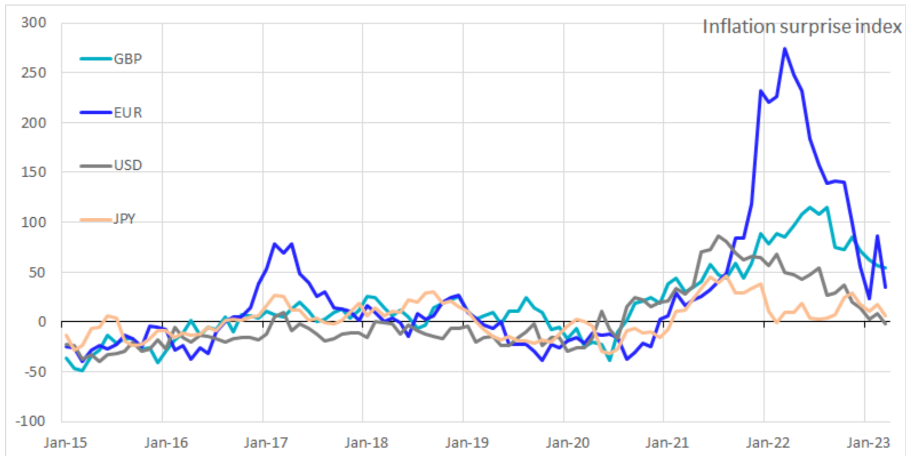
- USD failed to strengthen on the back of the banks' troubles. One could have expected the higher recession fears and perception of systemic risk to trigger supportive haven flows. On the contrary, USD weakened, reflecting the late cycle position of US economy and the frailties of US regional banks. Upcoming US debt ceiling turmoil might follow a similar template, highlighting US specific issues. 'Peak USD' narrative has room to run, and a higher hard-landing risk has raised the bar on further Fed tightening while domestic data continues to soften.
- JPY should recover further in H2 2023on the back of this and expected BoJ adjustment. Yet in the short term we see some weakening risk: JPY carry is expensive, expectations on the Fed are perhaps too dovish, and we do not expect BoJ to adjust its policy before June.
- EUR has more upside potential and the US rates rebound in Apr has not suppressed the EURUSD. The EU economic cycle is younger as growth expectations and domestic demand rebound from the energy crisis and inflation pressures are rising, e.g. German wage negotiations. China reopening adds upside risks. The ECB can remain confidently more hawkish. A strong EU equity market and finally high yielding rates from EUR assets might push for further catch up in capital allocation towards EU assets. Current account flows have also recovered into positive territory.

EURUSD is lagging real rates differential



Source: Bloomberg and AXA IM Research, Apr 2023

Inflation continues to surprise to the upside in Europe



Source: Bloomberg and AXA IM Research, Apr 2023

Investment Strategy

Rates: Market placing all its eggs in one (dovish) basket

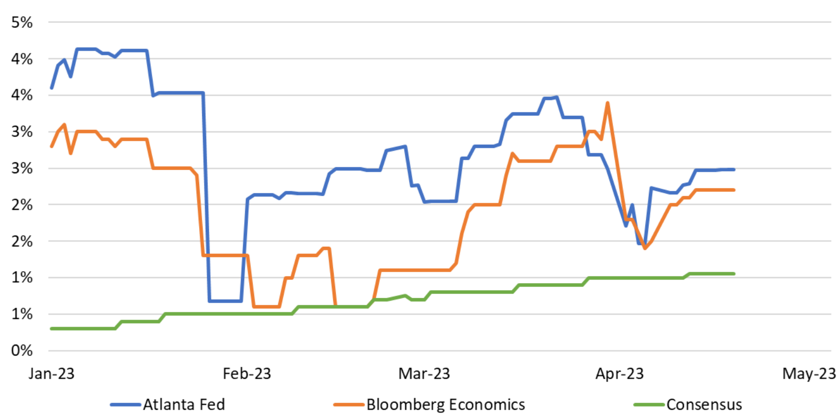
- Markets expect the FOMC to initiate a fairly aggressive rate cutting cycle immediately after a final 25bp hike at the May meeting. The SOFR-curve has been inverted for a while, as if a recession were imminent. However, after almost 12 months of inversion, macro projections – both real time as well as consensus forecasts – do not venture beyond a cyclical slowdown.

- The obvious question is then: Why is the market putting all its eggs in one basket? Why stick to a view that has not materialised so far and which does not seem to be an imminent risk? Why focus on a low-probability scenario and not blending in also the priors of a moderate growth (rather than just a recession) scenario?

- Given the extent of rate cuts priced into the curve, it is reasonable to expect a substantial correction in fixed income markets, should the market's dovish policy anticipations normalise somewhat. In fact, a 'one and done' (an then pause for a while rather than cut) Fed scenario might be enough to reprice the money markets curve.

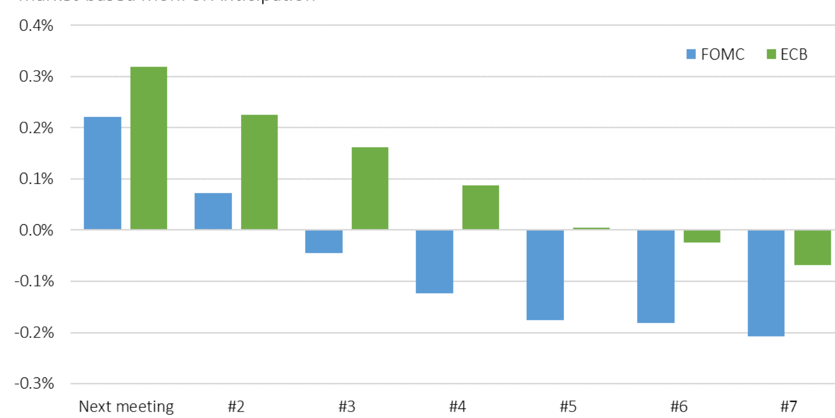
- The picture is different in Frankfurt, where the ECB is still dealing with rather sticky inflation as well as with a hiking cycle that has started too late, mainly as a direct result of the "transitory inflation" view that has been only recently revised within the GC.

GDP measures don not suggest imminent recession



Source: Bloomberg, AXA IM Research; Apr 2023

Central bank policy expectations too dovish in the US



Source: Bloomberg, AXA IM Research; Apr 2023

Investment Managers

Investment Strategy

Credit: spreads have weathered banking troubles but lack risk-reward appeal

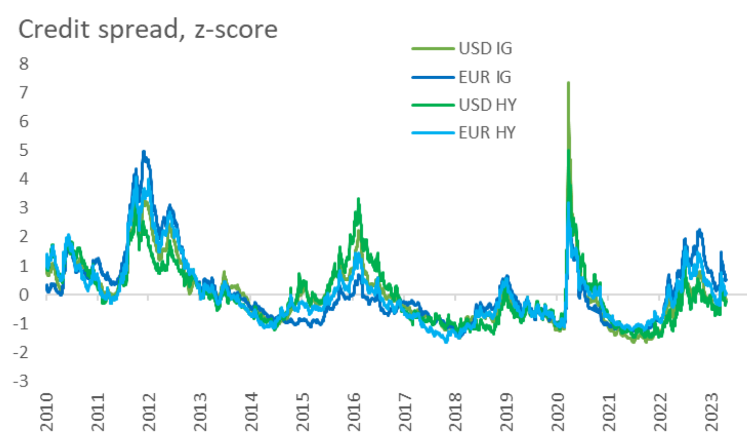
- Credit markets have weathered the banking troubles well enough to post positive returns. Spreads are currently wider than in early March, but the widening has been more than offset by the decline in underlying government bond yields. This has brought credit yields lower and has thus protected total returns. All-in credit yields remain very attractive historically, however.
- There has predictably been a strong divergence between banks and non-financial corporates, with the 10-15bp widening in investment grade (IG) benchmarks driven by the 20-35bp widening in bank spreads, while corporate spreads have widened by only 5-6bp. The downside to the resilience in spreads is that spread premia currently are not ample enough given the recession risk ahead.
- USD IG at 135bp is less than half the spread level that is historically associated with zero GDP growth year on year. EUR IG at 155bp likewise, is still some distance from a zero GDP growth spread level that is in the low to mid 200s. Spreads don't screen cheap from a mean reversion perspective either. Current levels are historically consistent with flat spreads over 3M and mildly wider spreads over 12M.

Credit markets have weathered the banking troubles well

	Market	Spread				Yield				Return
		06-Mar	21-Apr	PCH	DCH, bp	06-Mar	21-Apr	PCH	DCH, %	PCH
#1	USD IG	124	137	10.5%	**13**	5.59	5.25	-6.0%	**-0.33**	2.5%
#2	EUR IG	144	155	7.6%	**11**	4.37	4.18	-4.5%	**-0.20**	1.5%
#3	USD HY	397	446	12.3%	**49**	8.35	8.26	-1.1%	**-0.09**	0.9%
#4	EUR HY	401	454	13.2%	**53**	7.02	7.22	2.7%	**0.19**	-0.2%
–										
#5	USD Banks	115	151	31.3%	**36**	5.67	5.52	-2.7%	**-0.15**	1.3%
#6	EUR Banks	146	167	14.4%	**21**	4.42	4.33	-2.1%	**-0.09**	1.0%
#7	USD Corps	124	130	4.8%	**6**	5.52	5.12	-7.3%	**-0.40**	3.0%
#8	EUR Corps	136	141	3.7%	**5**	4.29	4.02	-6.4%	**-0.27**	1.8%

Source: Bloomberg, ICE, AXA IM Research; Apr 2023

Spreads approximately at mid-range historically



Source: Bloomberg, ICE, AXA IM Research; Apr 2023

Investment Strategy

Equities: Ready, steady, no

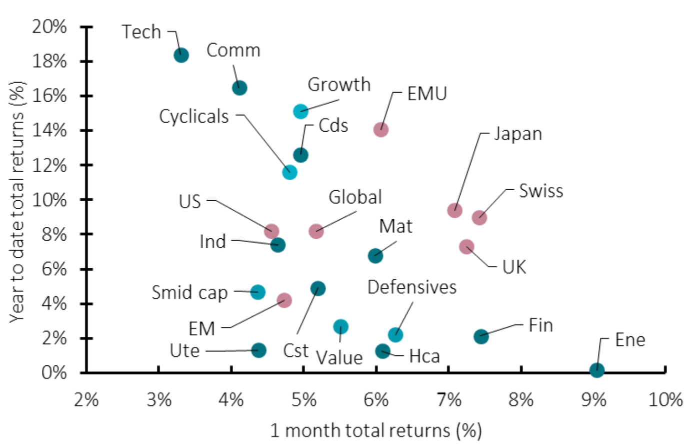
- The laggards have made up some ground - Switzerland (+7.4% on the month) is leading the way, following the Credit Suisse takeover in March, and the Swiss equity index has recovered its losses. Then, the UK (+7.3%) and Japan (+7.1%) round off the podium in line with the good performance of Value (+5.5%). Sector wise, Financials (+7.4%) regained the drop in March while Tech (+3.3%) underperformed the rest, although it remains the leader since the beginning of the year (+18.4%). The last three months' market pattern continues to be in line with an environment of low inflation and economic activity and high unemployment.

- Early birds earnings reporting has been better than expected. At the time of writing, just under 20% of S&P500 and 10% of STOXX 600 companies have reported, and these have generally been above expectations, albeit below average. EPS have declined since last year despite positive sales which benefit from price effects. The downward trend in margins driven by strong wage growth should persist.

- Finally, we believe that 2023 earnings are at risk of being lowered as the core of this year's earnings growth comes from cyclicals and in the case of a downturn this contribution should evaporate bringing the total figure at least below the -5% annual growth. In this case, we believe that the market valuation level is still too expensive.

The comeback of the laggards

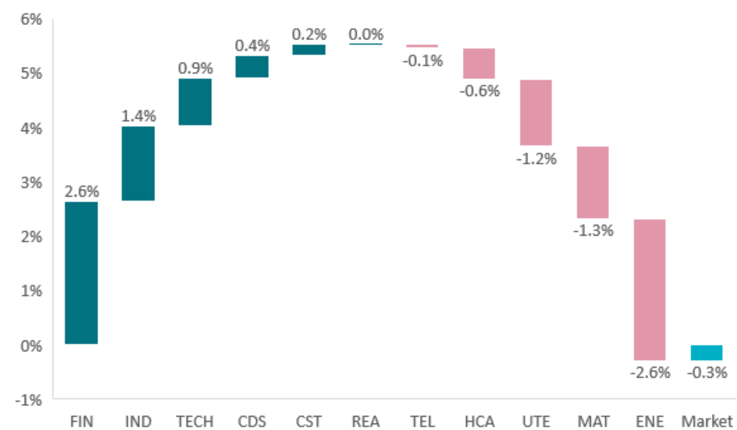
Equity total returns (local FX): regions, sectors and styles



Source: MSCI and AXA IM Research, April 2023

Cyclical and recession do not mix, do they?

Global equities: 2023 earnings growth contribution



Source: IBES and AXA IM Research, April 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

Peak dollar narrative has room to run as higher hard landing odds raise bar for further Fed hikes. EUR has more upside potential and ditto for JPY but in the second half of the year. If BoE does not fulfil what priced by markets; GBP can weaken.

EQUITY

Earnings expectations are key for 2023 returns. A strong start to the year may create complacency as central banks still hawkish & macro risks. Margin pressures already at play mainly due to wage growth. China rebound momentum underpins EM.

RATES

Rates volatility remains elevated while market expectations for central banks may be too dovish, raising the risk of a market correction. Further banks headlines more of a risk for the US, implying more rebound potential higher for EU yields.

CREDIT

Spreads have sailed through the March bank troubles and are again underpricing recession risks even if balance sheets are in good health. Some caution warranted given the unappealing risk reward although yield levels still attractive.

Source: AXA IM Core Investment Research, as of 24 Apr 2023

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.4		2.7		2.7	
Advanced economies	2.7		1.0		0.7	
US	2.1	2.1	1.0	1.0	0.3	0.9
Euro area	3.6	3.2	0.7	0.6	0.6	1.1
Germany	1.8	1.8	0.2	0.0	0.6	1.3
France	2.6	2.6	0.6	0.5	0.6	1.1
Italy	3.7	3.8	0.6	0.6	0.5	1.1
Spain	5.5	5.5	1.3	1.3	0.9	1.8
Japan	1.1	1.0	1.7	1.0	1.3	1.1
UK	4.0	4.0	0.0	-0.5	0.5	0.7
Switzerland	2.1	2.1	0.6	0.7	1.3	1.6
Canada	3.4	3.4	1.2	0.6	0.9	1.4
Emerging economies	3.9		3.8		3.8	
Asia	4.3		5.0		4.6	
China	3.0	3.0	5.3	5.3	5.0	5.2
South Korea	2.6	2.6	1.5	1.1	2.0	2.2
Rest of EM Asia	6.0		5.0		4.4	
LatAm	4.0		1.5		2.3	
Brazil	2.9	3.0	1.0	1.0	1.5	1.7
Mexico	3.1	3.0	1.2	1.3	1.8	1.9
EM Europe	0.9		0.9		1.8	
Russia	-2.1		1.7		1.3	1.3
Poland	4.9	4.9	0.1	0.8	2.4	3.0
Turkey	5.6	5.1	0.5	2.1	1.4	2.8
Other EMs	4.9		3.1		3.7	

Source: Datastream, IMF and AXA IM Macro Research – As of 26 April 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	7.4		4.8		2.7	
US	8.0	8.0	4.5	4.2	3.1	2.6
Euro area	8.4	8.5	5.7	5.6	2.8	2.4
China	2.1	2.0	2.3	2.3	2.5	2.4
Japan	2.5	2.5	2.7	2.3	1.3	1.3
UK	9.1	9.1	6.6	6.4	2.4	2.9
Switzerland	2.8	2.8	2.0	2.5	1.3	1.4
Canada	6.8	6.8	3.8	3.7	2.7	2.3

Source: Datastream, IMF and AXA IM Macro Research – As of 26 April 2023

**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		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		+0.25 (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 24 April 2023

Calendar of 2023 events

	Dates	Events	Comments
April	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 (England)	
	07-May	Thailand general elections	
	11-May	BoE Meeting	+25bps (4.50%)
	14-May	Germany (Federal state elections)	
	18-May	UK local elections (Northern Ireland)	
	28-May	Spain Regional elections	
June	Early Jun	US Earliest Treasury special measures could see debt ceiling impact	
	13-14 Jun	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	
	22-Jun	BoE Meeting	Unchanged (4.50%)
	29-30 Jun	European Council Summit	
July	Jul	Greece elections (National Parliament)	
	Late Jul	US Estimated resolution of the debt ceiling	
August	Late Aug	Federal Reserve's Central Bank Symposium Jackson Hole	
September	Autumn 23	Poland presidential elections	
October	29-Oct	Argentina general elections	
December		Spain (National Parliament)	

Latest publications

Bank of Japan policy update: A question of when, not if

11 April 2023

March Global Macro Monthly – Faith in the system

29 March 2023

March Monthly OpEd – Accelerated monetary tightening pass-through

23 February 2023

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

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