Investment Managers

Investment Institute Macroeconomics

2023 starts on a more positive note

Monthly Investment Strategy

AXA IM Research

January 2023

Summary: January 2023

Theme of the month: Surprises for 2023 so far

- The broad contours of 2023 remain consistent with our outlook from the end of last year: global growth looks set to slow, inflation will fall back sharply and central banks will reach a peak this year. However, a number of surprises have had an impact on our outlook.
- Energy markets have been more benign than we had expected. A mild northern hemisphere winter helped natural gas prices, particularly in Europe remain low as consumption was reduced. This also helped subdue oil prices, as did broader concern around global demand.
- The global growth outlook does not look so bleak. Europe has benefited from reduced energy costs and a sharp contraction appears to have given way to a shallow recession at worst. China's accelerated removal of its Zero-COVID policy has boosted the outlook for growth this year. And the US appears to have closed 2022 with more solid momentum, even if we remain of the view that a mild recession remains likely in 2023.
- Firmer global growth is likely to underpin core inflation, even as headline inflation retreats quickly across H1 2023. This is likely to see central banks have to remain more hawkish. We do not expect a Fed cut this year. The ECB outlook is rising sharply. Even the BoJ surprisingly adjusted its yield curve control.

Macro update: Stronger growth, more hawkish central banks

- The US economy is set to decelerate this year – we think to mild recession. This should ease the labour market and soften core inflation back towards the Fed's mandate in 2024. We forecast a peak Fed rate at 5% and rate cuts delayed until 2024. But risks currently appear skewed to a higher peak.
- Eurozone activity could even avoid recession. However, stronger growth will underpin labour market resilience and threatens core inflation persistence. The ECB has already shifted its rate peak outlook materially, and we forecast at least 3.25% by May – the risks are for a sooner, higher peak.
- China's near term growth outlook is uncertain amidst a COVID spread that could be exacerbated by the New Year. However, the removal of restrictions should boost GDP going into the Spring, supplemented with other policy boosts from Beijing. We see risks to our 5% GDP forecast to the upside.
- Japanese inflation and market dysfunction have seen the BoJ adjust its monetary policy and markets expect more to follow. The Bank of England and Bank of Canada both look likely to reach peak rates in the coming weeks.

Investment Strategy: strong start by assets but a macro 'chill' may be looming

- FX: Global growth outlook has significantly improved into 2023 against a continuous softening of US inflation, which is calling for more USD weakness. Softening of inflation abroad and the possibility of a policy shift at BoJ, both should push JPY to recover further from its 2022 policy driven weakness.
- Rates: Despite the Fed being consistently hawkish, markets have priced a substantial change in monetary policy after the first half of 2023. But the 'stickier' parts of inflation have to show signs of rolling over before investors are confident that central bank hiking gets close to its cyclical peak.
- Credit: spread tightening year to date has been a reflection of reduced investor pessimism. This trend may run a bit further, but we take the prudent view that spread compression will be limited going forward. Key macro headwinds are still in place and valuations have narrowed substantially since Q3 2022.
- Equities: The outperformance of cyclicals relative to defensive stocks in recent weeks suggests that the level of activity should pick up. We think this is somewhat premature, as restrictive monetary policy remains in place and its full impact on economic activity may yet to be felt.

Central scenario

Summary – Key messages

Our central scenario: Global economy to slow, sharp recessions avoided.

We forecast global growth to slow to 2.3% and 2.8% in 2023 and 2024.

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

Inflation

Supply-chain pressures ease, energy and food base effects strong. Headline inflation to fall sharply over H1 2023. Core slow to fall.

Monetary policy

Most central banks close to peak as headline inflation and inflation expectations soften. Rate cuts unlikely for most in 2023. PBoC and BoJ major exceptions.

Growth

Growth beginning to slow more obviously. Mild recessions expected in US, Europe could avoid for now.

Fiscal policy

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

Emerging Markets

Inflation easing across EM. Central banks close to peak, some add FX intervention. Global rate adjustment adds to fragile finances

Rates

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

FX

Dollar continues to weaken amidst Fed rate cut bets. Weaker risk outlook would support dollar. Divergent bank policy supports others, particularly euro and yen.

Credit

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

Equities

Earnings expectations are key for 2023 returns. Strong start to the year may create complacency gi ven ongoing central banks hawkishness and macro headwinds.

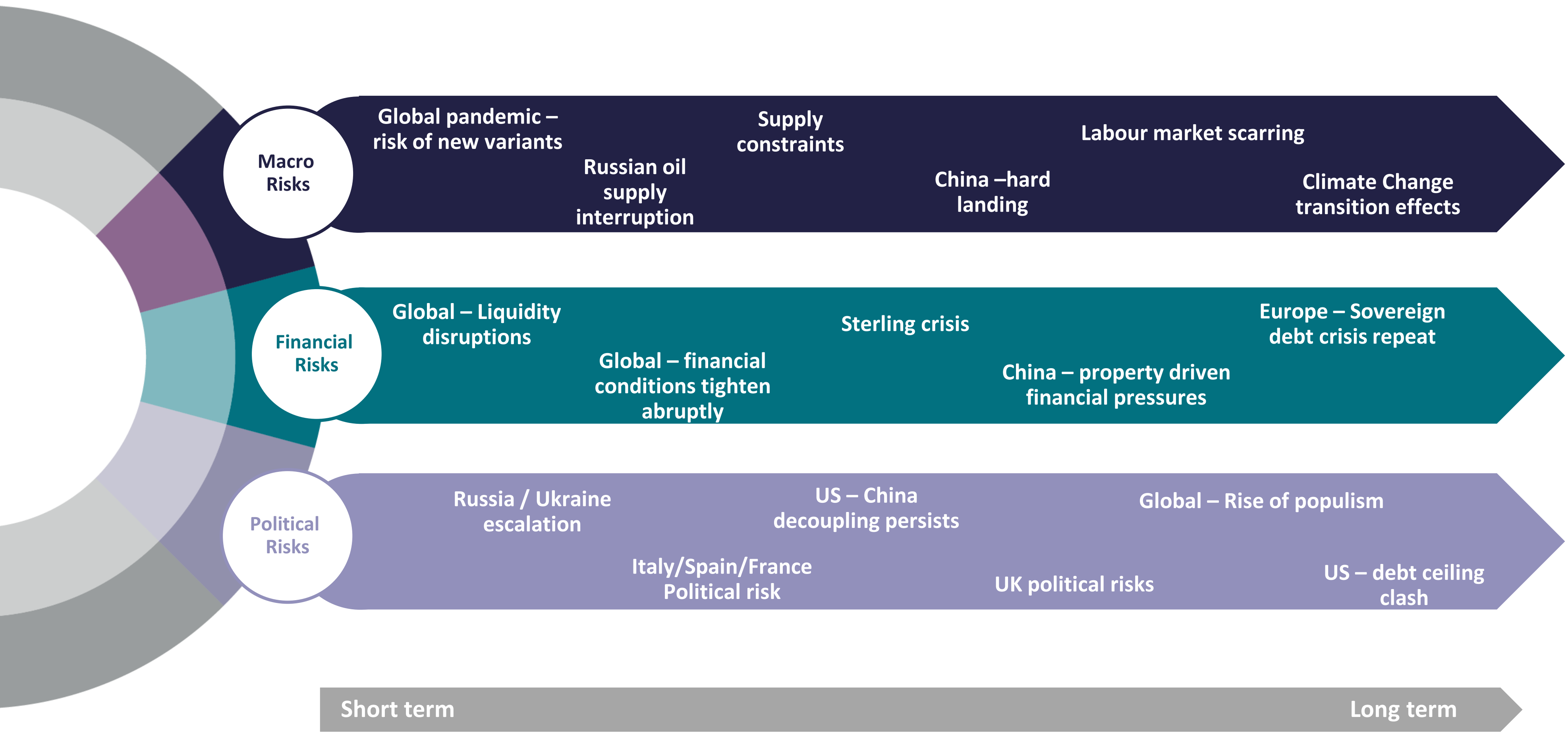
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 15%	**A global boost** Probability 15%
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	- 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, deteriorating inflation credibility forces still tighter monetary 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

RISk Radar

Summary – Key messages



Contents

Theme of the Month

Surprises for 2023 so far

Energy complex has been more benign

A mild winter has cushioned gas use

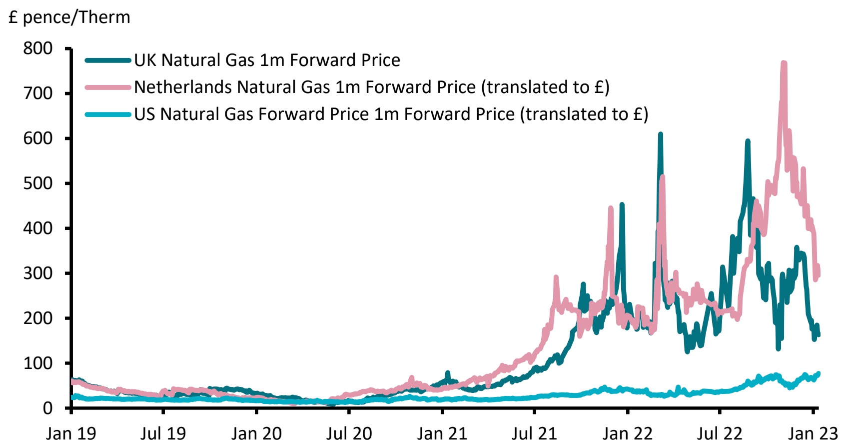
- Gas prices have tumbled from the peaks at the back end of last year. A mild Northern hemisphere winter, excluding some sharp cold snaps in the US and Europe, has reduced gas consumption and allowed for storage rebuilds even during the winter. From a European perspective, this has reduced the severity of the expected gas squeeze on industry. It should also reduce constraints over the summer months as the Eurozone replenishes storage going into Winter 2023/24.

Oil price has been more benign

- We had expected energy market stress over the winter to include elevated oil prices. In the event, concerns about demand – including from Chinese disruption and global recession concerns – combined with mild temperatures to soften the impact. Looking ahead, however, we are concerned that the European ban on refined products, the re-opening of the Chinese economy and the increasing complexity of global oil supply will lead to renewed oil price pressures, particularly from H2 2023.

Mild weather see gas prices drop

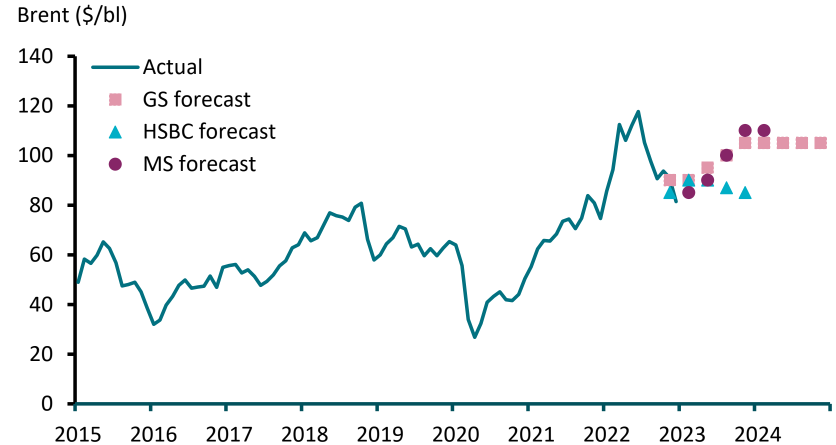
Natural Gas Prices UK, US and Netherlands



Source: Bloomberg, AXA IM Research, January 2023

Demand concerns weigh on current oil price, but could reverse

Oil Price Outlook



Source: Bloomberg, AXA IM Research, January 2023

AXA Investment Managers

Surprises for 2023 so far

Euro area growth resilience continues

Short-term upside growth surprise

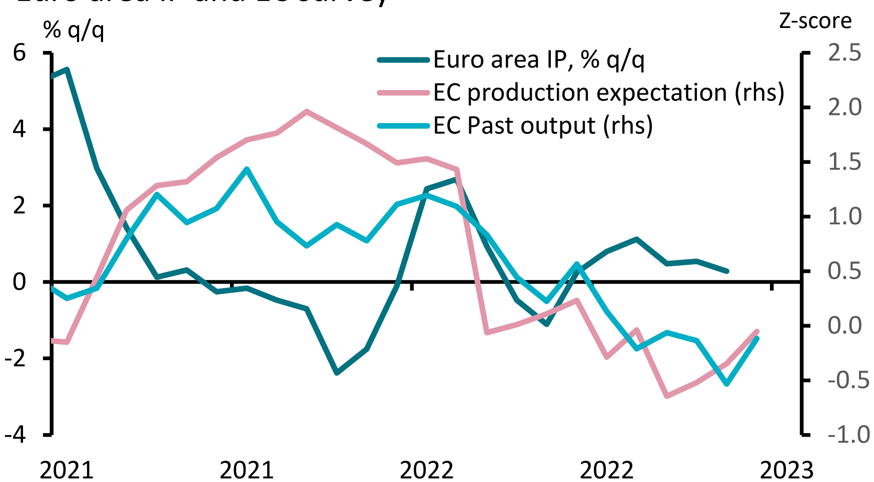
- Favourable developments with regards to energy consumption, soothing supply chains defying surveys (over)pessimism and support for consumption implies that the euro area is likely to experience a shallow and short-lived recession at worst. Germany GDP was flat in Q4.

Yet still hard to argue for a rosy outlook

- Better than expected activity is a net positive for labour market tightness and with wage inflation pressures, meaning the risk skew for the policy rate outlook is to the upside, so is the case for long-dated bond yields.
- Although we acknowledge surveys over-pessimism, profit expectations still do not look bright.
- Furthermore, less acute energy prices mean that fiscal policies can shift more towards a consolidation mode.

Euro area industrial production defied surveys (over) pessimism

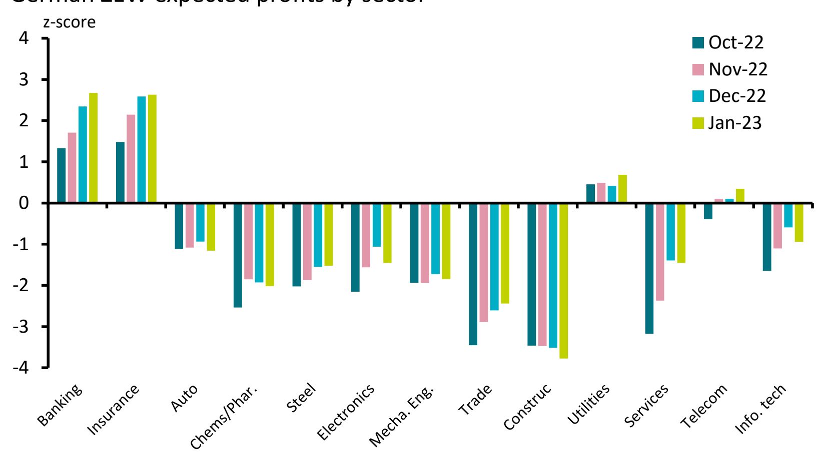
Euro area IP and EC survey



Source: Refinitiv, AXA IM Research, January 2023

Yet profit expectations still depressed by and large

German ZEW expected profits by sector



Note: Survey question survey is in the medium term (6 months), the profit situation of German companies in the following sectors will improve/not change/worsen/no estimate

Source: Refinitiv, AXA IM Research, January 2023

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Surprises for 2023 so far

US more momentum, more recession

US appears to have closed 2022 with strong momentum

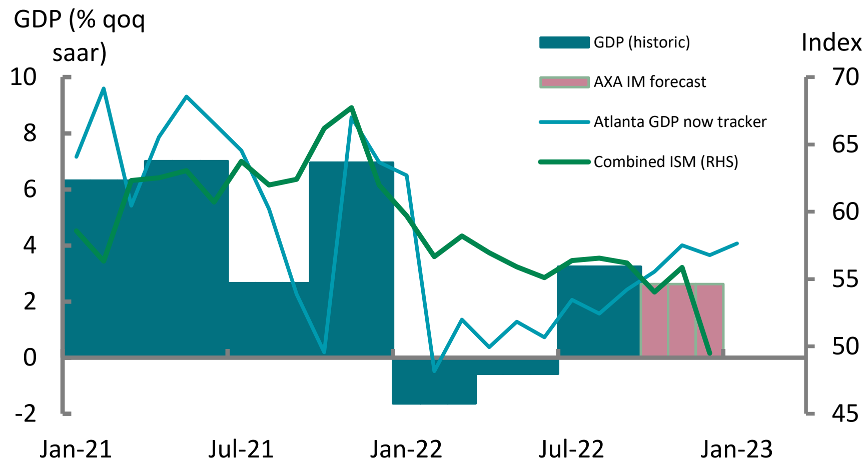
- At the time of writing we await the publication of the first estimates of Q4 GDP from the US (26 Jan). However, the Federal Reserve GDP now trackers points to a robust quarter of around 3.5% (saar). This is underpinned by a robust outlook for consumer spending, in turn underpinned by lower gas prices and a more aggressive use of household saving. We do not expect GDP to be quite this strong – forecasting 2.6% - but the US certainly appears to have closed the year on a firmer note than we had expected.

Recession warnings begin to grow louder

- At the same time recession warnings grow louder. Our own recession model now signals the likelihood of recession over the coming 12 months. More recently, survey data in recent weeks have retreated sharply to levels more associated with recession. We are wary of reading too much into one month's reading – particularly with the extreme weather witnessed in late December. But there is some consistency with these more forward-looking indicators.

Now trackers point to strong final quarter

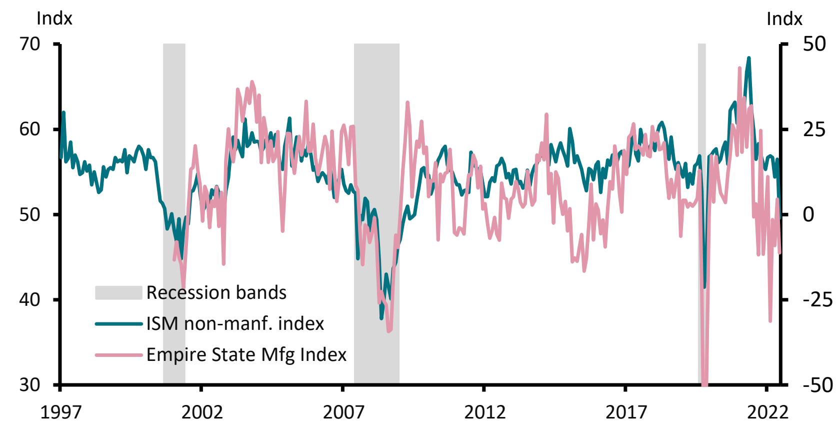
GDP growth and short term outlook



Source: FRBA, BEA, ISM, AXA IM Research, January 2023

Surveys fall back to more recessionary levels

ISM non-manufacturers & Empire State mfg index



Source: FRBNY, ISM, AXA IM Research, January 2023

Surprises for 2023 so far

From Zero-COVID to Zero-Restriction

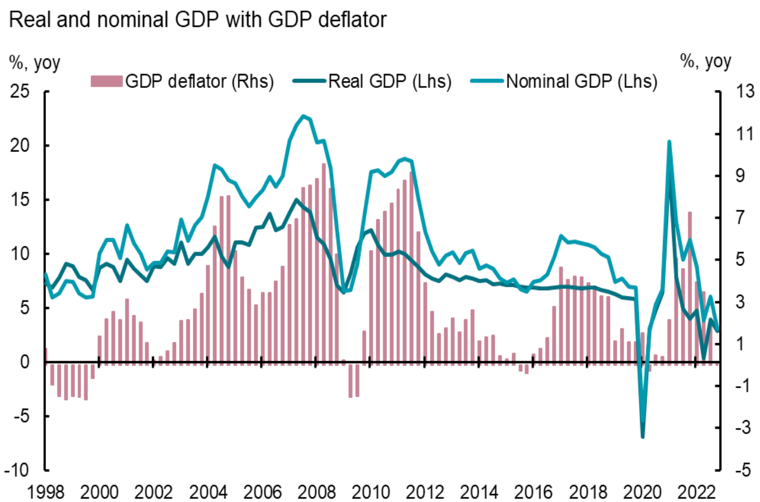
A sprint to exit

- Despite correctly predicting the direction and start of the COVID policy shift, we, like everyone else, were shocked by the speed and scale of changes in the past two months. Instead of pursuing a step-by-step gradual reopening, Beijing has decided to skip any medical preparations, and jumped straight to dismantling the Zero-COVID policy by the start of 2023. The sudden policy shift has caught the public by surprise, with surging COVID cases putting stress on the health system and society at large

Faster reopening darkens the present, but brightens the future

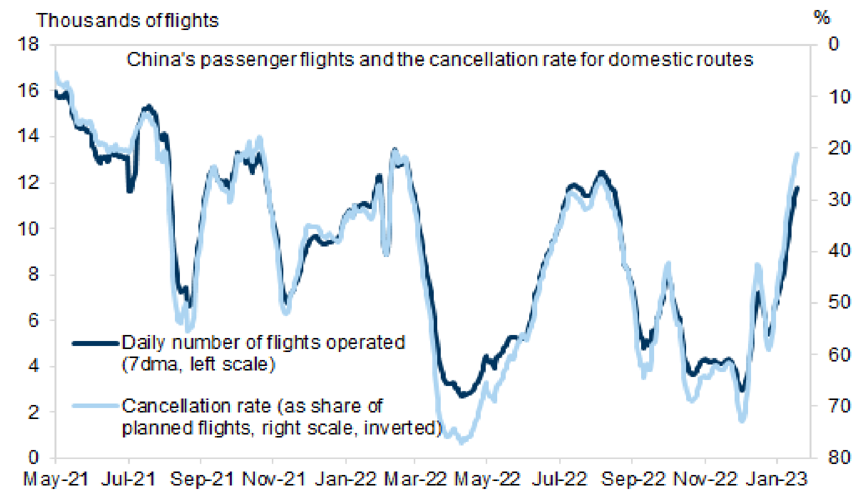
- The economy has suffered from a ‘reopening shock’. Official data paint a bleak picture, with the economy barely escaping an outright contraction in Q4. Full year economic growth for 2022 collapsed to 3%, the second lowest in more than 40 years. However, optimism has grown since the policy pivot as markets look past the near-term struggles and discount the future recovery. This optimism is reinforced by high-frequency mobility data, which shows the economy may have already turned the corner

Economy suffers from a ‘reopening shock’



Source: CEIC, AXA IM Research, January 2023

Mobility conditions improve after the policy shift



Source: GS, WIND, AXA IM Research, January 2023

Surprises for 2023 so far

BoJ surprises markets widening YCC

Market dysfunction forces the BoJ's hand

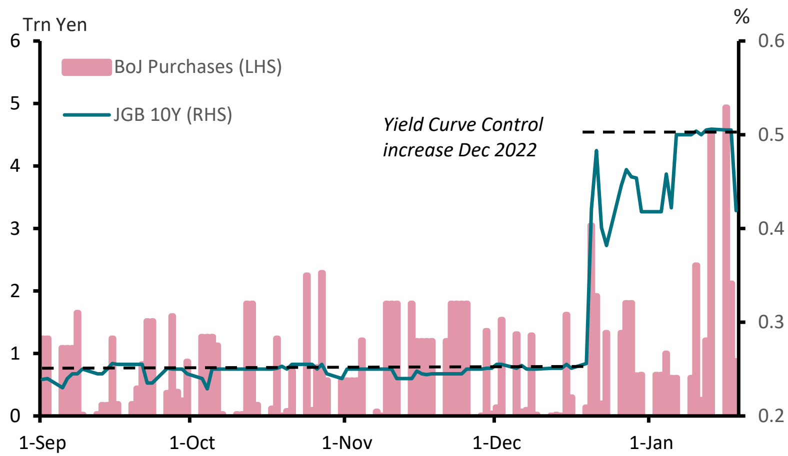
- The BoJ surprised markets at the turn of the new year in December by expanding the tolerance bands around the yield curve control (YCC) to +/-50bps from 25bps. The move was driven by growing market dysfunction, with the BoJ forced to make large purchases to keep 10y JGBs within their upper limit. The move was designed to make YCC more sustainable, but has only fuelled Market expectations for further tweaks to YCC.

Expectations for further policy change unlikely to fade

- In the January MPM the BoJ made no change to YCC and strengthened additional funding to defend the target. With inflation rising and a new BoJ Governor to be in place in April, we expect market expectations of a move to remain over this year. At present we expect the BoJ to remove YCC in 2024, but think the decision could be taken earlier as a New Governor will be in place from April and wage growth settlements could come in higher than forecast.

Asset purchases topped 5% of GDP in December

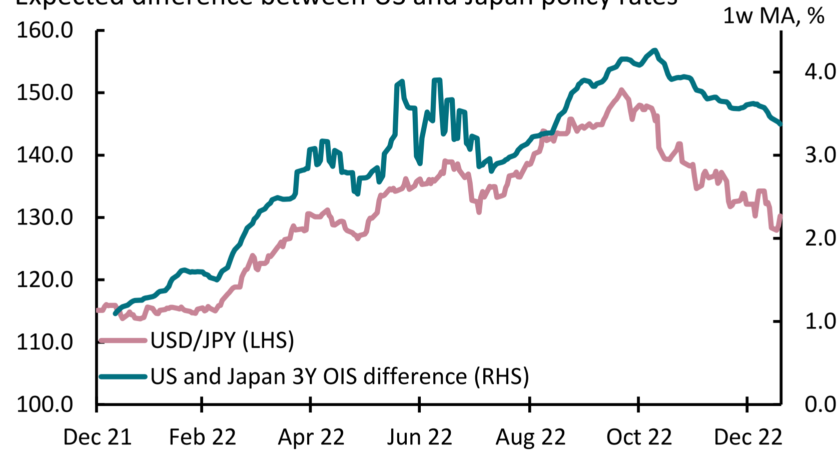
BoJ Asset Purchases



Source: BoJ, AXA IM Research, January 2023

Expected difference in policy has eased from Oct highs

Expected difference between US and Japan policy rates



Source: BoJ, AXA IM Research, January 2023

Macro outlook

Recession signals rise, timing uncertain

US

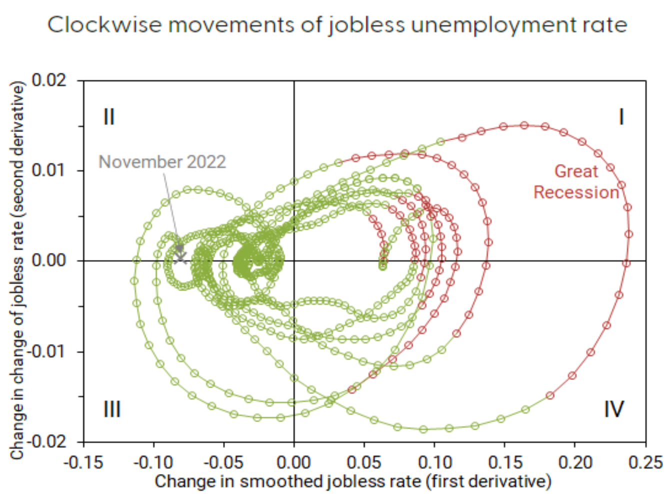
More indicators warn of recession

- We began to forecast a US recession from mid-2022. However, more recently the economy has started to provide confirmatory signals that a recession is likely this year: Our own recession probability model has moved into signalling recession over the next 12 months; broad unemployment forecasts suggest a rise historically consistent with recession; and recent surveys have fallen to recession consistent levels.

Uncertain timing and growth outlook

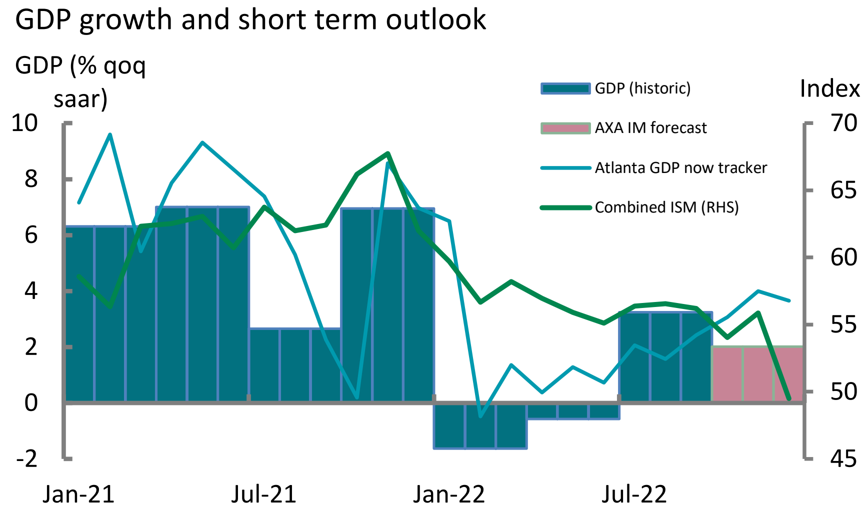
- The timing of any downturn remains uncertain. The labour market suggests a later downturn than our forecast contraction in H1 and GDP now trackers signal a firm close to 2022, stronger momentum that could suggest more resilience – we await the pace and composition of Q4 GDP. For now, we raise our 2022 growth outlook to 2.1% (from 1.9%). A delayed contraction could raise the 2023 outlook to around 0.5% (from -0.2%), but lower 2024 to 0.5% (from 0.9%). Consensus forecasts now envisage 1.9%, 0.4% and 1.3%.

Recession clock moves minutes to midnight



Source: FRB, January 2023

Stronger momentum could suggest delayed contraction



Source: BEA, FRBA, ISM, AXA IM Research, January 2023

Fed concerned about persistent inflation

US

Headline inflation falls quickly, but hard yards ahead

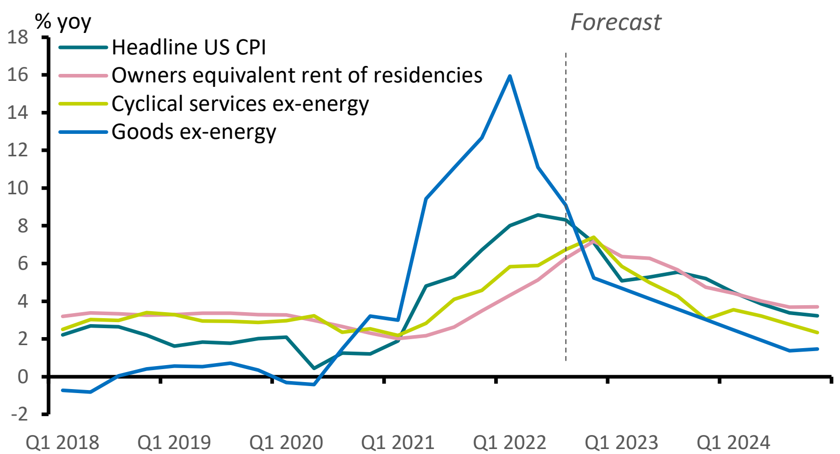
- Headline inflation fell to 6.5% in December, from 9.1% in June. With large energy and goods price base effects over H1 2023, we expect further declines over the coming months even as gasoline falls end. Core CPI inflation also fell back to 5.7% from the 6.6% high in September. However, shelter and services inflation remained elevated. These are likely to persist, slowing the pace of disinflation from H2 this year. We forecast inflation to average 4.9% this year and 3.2% in 2024 (consensus 3.9% and 2.5%).

Fed's messaging is clear, but will it change?

- The Fed is clear in its message. The Fed sees the risks of persistent services inflation while the labour market remains tight, a labour market that is imbalanced and the need for persistent tight policy. This translated into a policy outlook that sees a peak in rates above 5%, and cuts only starting in 2024. We see a rate peak of 5% and forecast 125bps of easing only in 2024. Yet the market remembers last December's outlook – expecting a 1% policy rate for end-2022. The market forecasts 50bps of cuts this year.

Inflation to fall sharply in H1, slowly thereafter

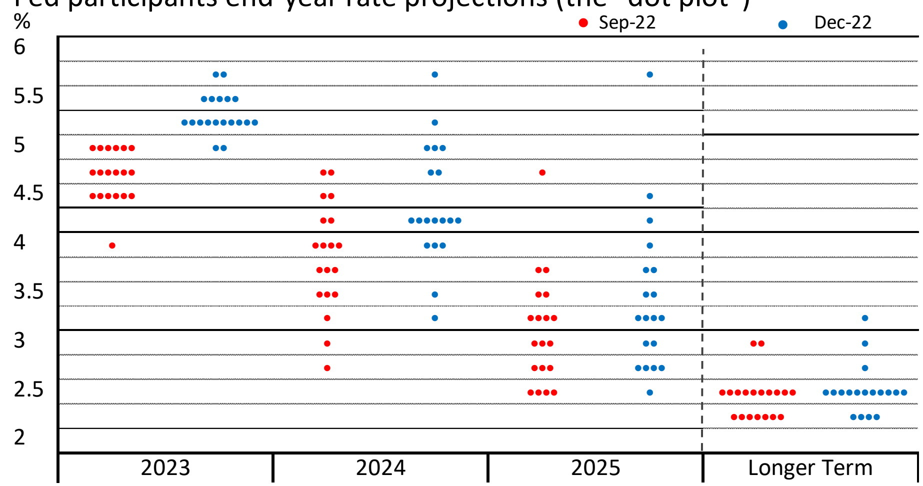
Headline CPI, goods, services and shelter inflation



Source: BLS, AXA IM Research, January 2023

Fed messaging clear

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



Source: FRB, December 2022

A shallow, short-lived, recession at worst

Euro area

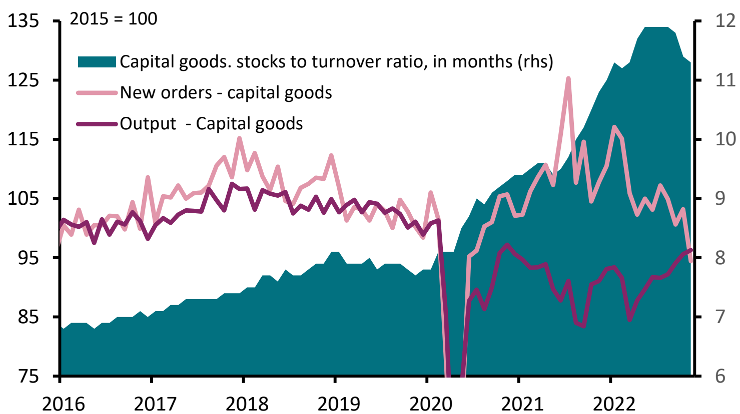
Both soft and hard euro area activity indicators have consistently surprised to the upside since last November consistent with the fact that the euro area may endure a short-lived, shallow recession at worst. In fact, we cannot rule out that it could avoid a contraction of activity altogether, against our initial expectation of a cumulative 1.0% GDP contraction between Q4 22- Q1 23.

Three key factors at the heart of much better-than-expected economy performance

- **Energy:** Very mild temperature, energy efficiency consumption gains, use of alternative sources of energy consistent with gas storage c.20ppt above typical.
- **Offsetting dynamics across industrial sectors:** Auto (and other chip related sectors) output have offset drop in energy intensive sector – the latter benefitting from much lower prices.
- **Labour market and fiscal measures support to demand:** Peak momentum employment growth is behind us, yet still strong in the context of weak growth and much affected business and consumer confidence.

Normalising supply chains offsetting energy intensive output drop

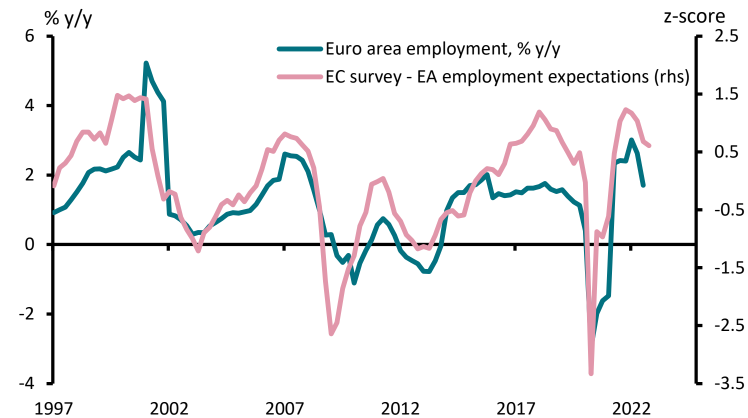
Germany manufacturing sector



Source: Refinitiv, AXA IM Research, January 2023

Strong labour market defies slump in business and consumer confidence

Euro area employment



Source: Refinitiv, AXA IM Research, January 2023

All is pointing towards a (more) hawkish ECB

Euro area

From "bad" to "good" inflation?

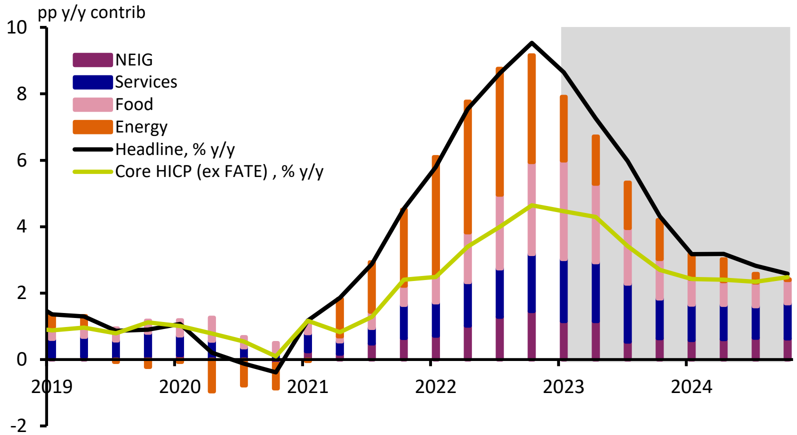
- The ECB is likely to be unfazed by slowing headline inflation, while it is driven by volatile factors and headline inflation remains very far from the target. Latest developments imply that risks to our outlook are more balanced.
- Our core forecasts are unchanged, projecting a slow normalisation, landing slightly north of 2% by the end of our forecast horizon. A better-than-expected growth outlook keeps wage developments crucial, though this time through demand-push, rather than an external supply shock.

Upside skew on rates outlook

- Subtly edging towards demand-push inflation, easing financial conditions are key ingredients for an (even more) aggressive narrative from the ECB. Well known doves now striking hawkish tones are a case in point.
- In the wake of December's ECB meeting, we flagged that depo rate could go as high as 3.50% by June. Not only could this materialise sooner (e.g. May), but the risk to the peak rate is also on the upside, even as market pricing has rallied since the beginning of the year.

Latest developments support our gradual core inflation landing

Euro area headline and core inflation

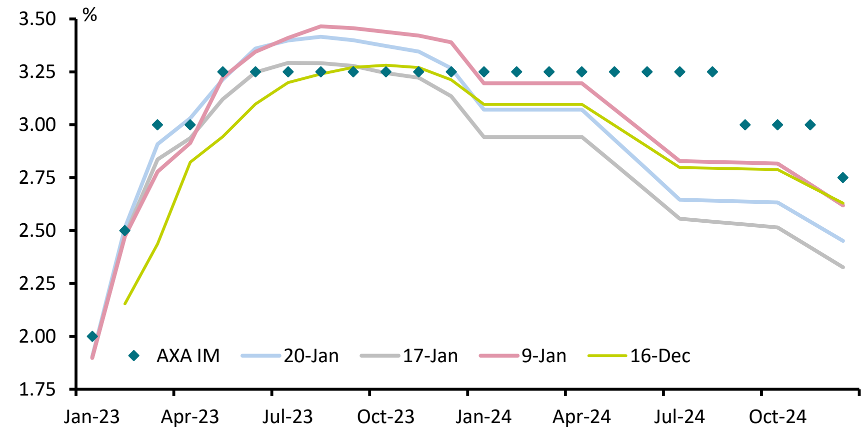


NB: FATE stands for Food, Alcohol, Tobacco,

Source: Eurostat, AXA IM Research, January 2023

Market rally at odds with fundamentals and ECB communication

ECB market pricing



Source: Bloomberg, AXA IM Research, January 2023

Stronger GDP contrasts with weaker activity indicators

UK

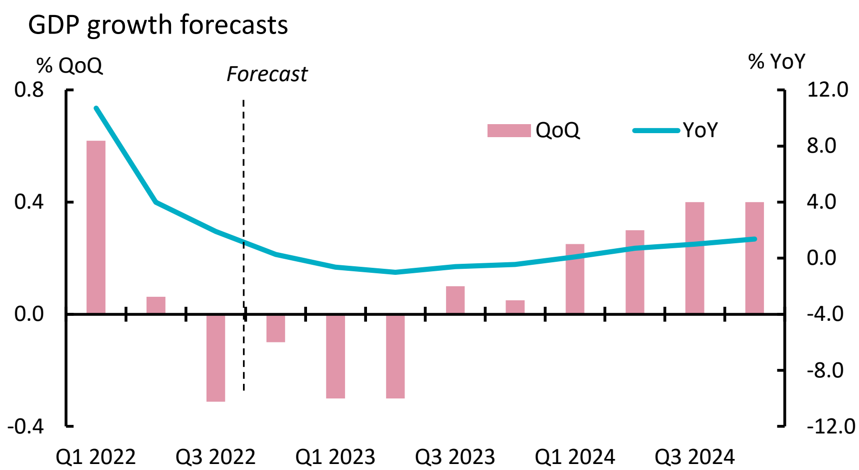
November's surprise growth makes 2022 recession more uncertain

- November's GDP figures surprised on the upside, with output up by 0.1% on the month compared to expectations of -0.2%. This follows October's 0.5% rise and means the UK could avoid a technical recession in 2022. However, other indicators remain weak: retail sales fell sharply in December (-1% mom), consumer confidence dipped further and strikes are likely to have impacted other areas of consumer spending. On balance, we still fourth quarter contraction of -0.1% after -0.3% in Q3 and recession underway.

Brexit rolls into 2023

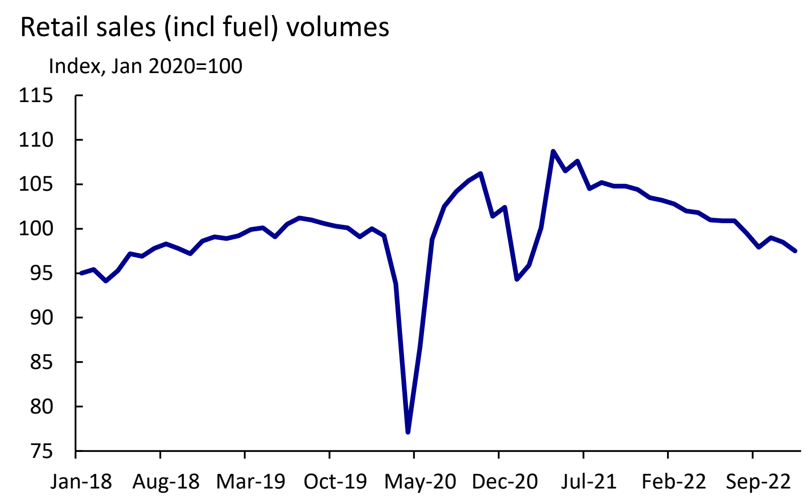
- There has been a marked change in negotiations on the Northern Ireland (NI) protocol with some hopes that the deadlocks could be addressed. That was signalled by an initial agreement on sharing data as part of the Protocol talks and PM Sunak is rumoured to be softening opposition to some degree of ECJ involvement. The government hopes to break the political impasse in NI and is allowing a six-week window to decide whether to call fresh elections.

Q4 GDP now expected as modest contraction



Source: ONS, AXA IM Research, January 2023

Retail sales continue downward path



Source: ONS, AXA IM Research, January 2023

BoE to hike by 50bp as services inflation and wages remain elevated

UK

Falls in headline inflation driven by goods, services still on the rise

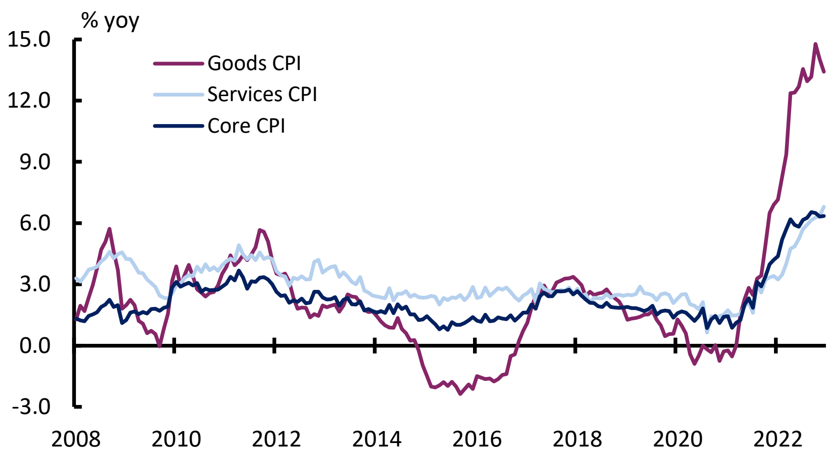
- Inflation continues to ease from October's peak, falling to 10.5% in December. The recent decline in wholesale gas prices could see energy prices fall below the government's £3,000 cap in the second half of 2023, lowering our outlook further. But this is likely to bring only so much comfort to the BoE as core inflation remains high. Falls in core goods prices are being offset by considerable rises in services inflation. The labour market also remains tight and wage growth continues to push higher.

BoE set to hike by 50bp in the face of rising signs of underlying inflation

- The MPC faces an economy that appears more resilient than it had anticipated, even as it is expected to fall into recession, with signs of more persistent inflationary pressures. We expect the MPC to hike by 50 bp at its February meeting. Following this, we expect another increase in March by 25bp, leaving the Bank Rate at 4.25% which we think will prove the peak. We think the Bank will begin unwinding these hikes as the labour market adjustment continues, pencilling in the first cut in Q4 2023 to 4%.

Core remains high driven by rising services

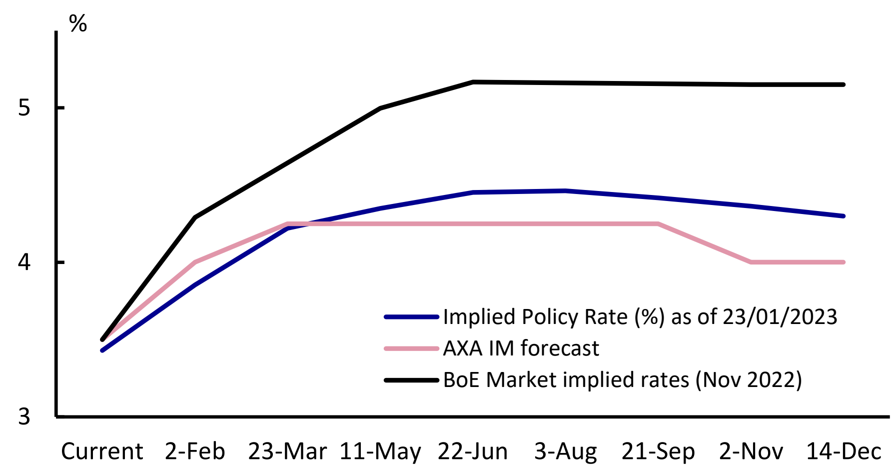
Goods and Services CPI



Source: ONS, AXA IM Research, January 2023

We expect rates to peak slightly lower than markets

Market implied Policy Rate



Source: Bank of England, Refinitv, AXA IM Research, January 2023

Post-reopening pain, but optimism ahead

China

A dreadful end to 2022

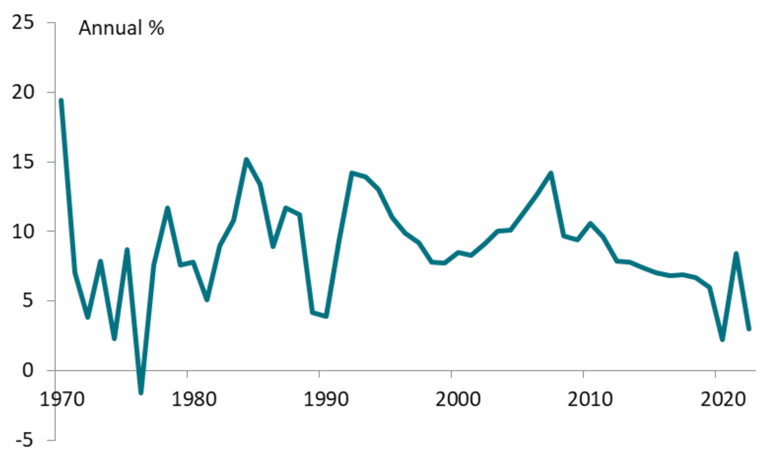
- Official data showed acute stress in the economy as it endured the transition from Zero COVID to living with COVID. GDP growth ground to a halt in the fourth quarter of 2022, with full year growth collapsing to 3%, the second lowest in more than four decades. Despite the lack of official COVID infection data, anecdotal evidence suggests the virus has ripped through the country at an extremely fast pace. The society and economy are living their darkest days since the pandemic started 3 years ago

But brighter days ahead

- However, high-frequency and forward-looking data offer hope. Traffic congestion, subway ridership, freight volumes and house sales all bottomed in late December led by cities that had already passed the peak COVID wave. At the current run rate, estimates suggest that the country as a whole could pass peak infections by late-Jan or early-Feb. These help to reinforce the market's optimism that China is facing a transient shock and a recovery is just around the corner

2022 records second lowest growth since the 1970s

China annual GDP growth



Source: CEIC, AXA IM Research, January 23

Mobility recovers from mid-December

Source: GS, WIND, AXA IM Research, January 23

Investment Managers

Balance of growth risks shifts to the upside

China

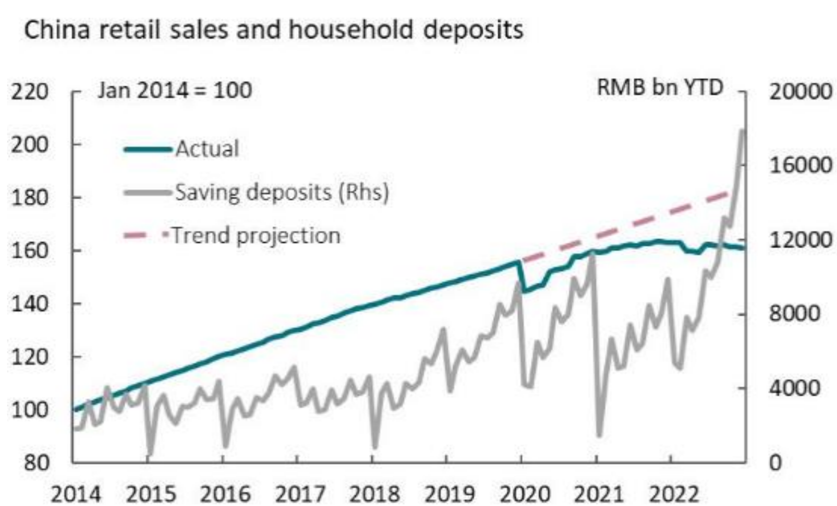
Consumption and services to lead the recovery

- The upcoming recovery is expected to be led by consumption and services activities, which have been hit hard by the rolling lockdowns. Households' deposits at banks have increased by trillions of RMB since the start of the pandemic and looks set to be unleashed to support spending once the economy reopens and confidence returns. Many services industries, including tourism, offline entertainment and restaurants, are also starting to see signs of demand recovery.

Risks balanced to the upside

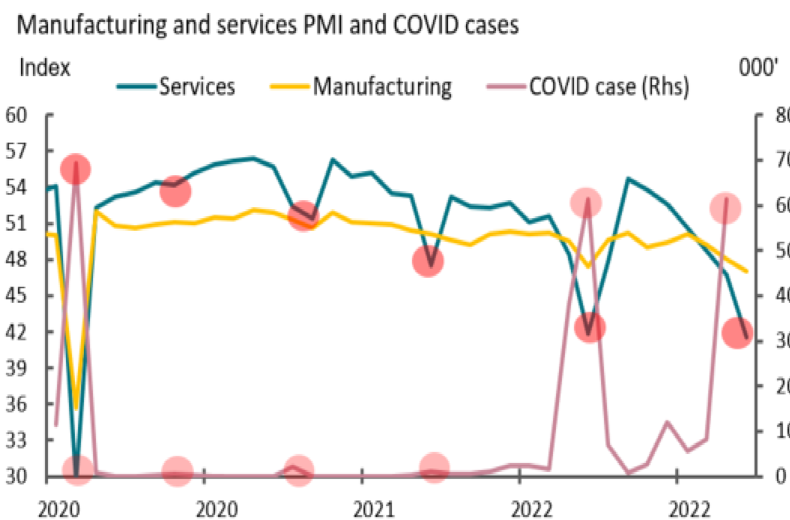
- The faster than expected reopening presents some upside risks to our 5% growth forecast for this year. Policy easing could also surprise positively if Beijing heeds the market's call to step up stimulus for consumption. On the flipside, the spread of COVID in rural China bears watching as a large enough social shock could have economic ramifications. Further out, a more pertinent downside risk is consumption not recovering as briskly as forecast if the labor market recovery disappoints and/or our estimate of excess savings proves too optimistic. On balance, we see risks are now biased to the upside of our forecast

Households cut spending and started to save



Source: CEIC, AXA IM Research, January 23

Services activity to recover more strongly



Source: CEIC, AXA IM Research, January 23

Inflation reaches a new 41-year high

Japan

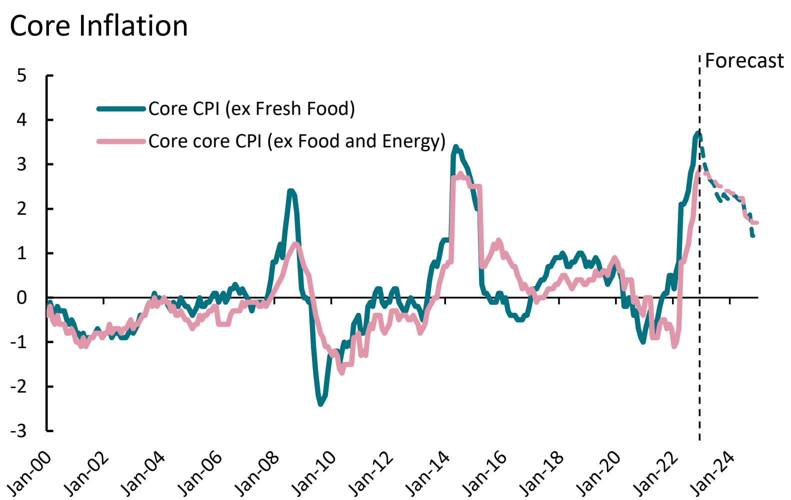
Inflation rises further in December

- Inflation continued to edge higher, keeping pressure on the BoJ. Excluding fresh food and energy, ‘core, core’ Consumer Price Index (CPI) inflation rose to 3% in December - well above the 2% target and the headline measure rose to 4% the highest for 41 years. We expect to see inflation fall from H2 2023, particularly as energy falls from the headline index, though evidence that firms are more willing to pass on price increases to their customers could see inflation remain more buoyant.

Inflation to decline from H2 2023 as underlying measures remain subdued

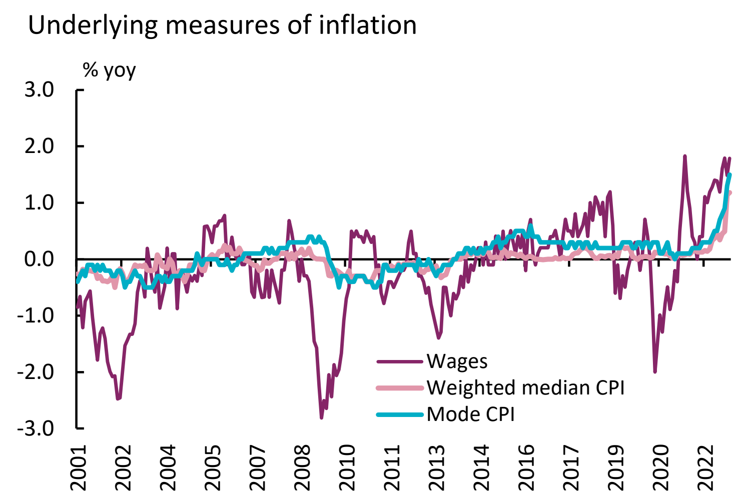
- Japan’s price dynamics have tended to exhibit downward rigidities with firms unwilling to pass on price increases to customers and muted wage increases. Despite the rise in inflation driven by higher food prices and a weak yen, domestic pressures remain subdued, underlying the BoJ’s commitment to maintaining its accommodative stance. Wages rose by 2.1% yoy in November – well below the c.3% growth we’d see as consistent with the Bank’s target.

Core CPI has risen considerably but to decline in H2 2023



Source: Refinitiv, AXA IM Research, January 2023

Wages and alternative CPI measures remain subdued



Source: Refinitiv, AXA IM Research, January 2023

Further changes to YCC policy likely later than markets anticipate

Japan

New BoJ Governor and wage negotiations critical to timing of end of YCC

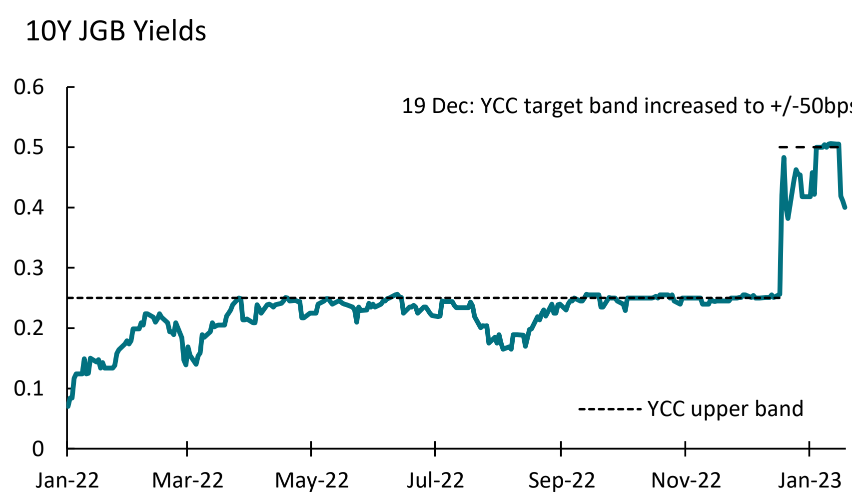
- At its January meeting the BoJ kept policy unchanged - including the +/-50 bp band around its 0% 10-year JGB target. Market expectations for a further tweak to the YCC had grown considerably since it's surprise band widening in December following market dysfunction.
- In our view, the timing of future policy changes will hinge on two key factors: The outcome of spring wage negotiations and the new BoJ leader. Unions have already indicated they will bargain for higher settlements than before, and an indication of the outcome will become clearer from mid-March. Current Deputy Governor Masayoshi Amamiya and former Deputy Governors Hiroshi Nakaso and Hirohide Yamaguchi are seen as most likely replacement BoJ Governor candidates, but each offers a potentially different path for BoJ policy.
- In our base case we expect the BoJ to end YCC in 2024. We think the new leadership will delay any change until they can be sure that inflationary pressures have risen sustainably, but the risk of an earlier move remains high.

Key dates upcoming

Key dates for BoJ outlook	
Govt to Present Next BoJ Governor Candidate to Diet	Feb 10
Last Monetary Policy Meeting under Governor Kuroda	Mar 9-10
End of term of Dept Governors (Amamiya and Wakatabe)	Mar 19
Results of Spring Wage Negotiations Start to be Released	Mid Mar
End of Governor Kuroda's term	Apr 8
First Monetary Policy Meeting under New BoJ Governor	Apr 27-28
Tally of wage negotiations released	Mid May

Source: AXA IM Research, January 2023

JGB yields fall back following BoJ dovish surprise to markets



Source: Refinitiv, AXA IM Research, January 2023

Inflationary pressures persist into year end

Canada

Fall in inflation to begin in earnest in 2023

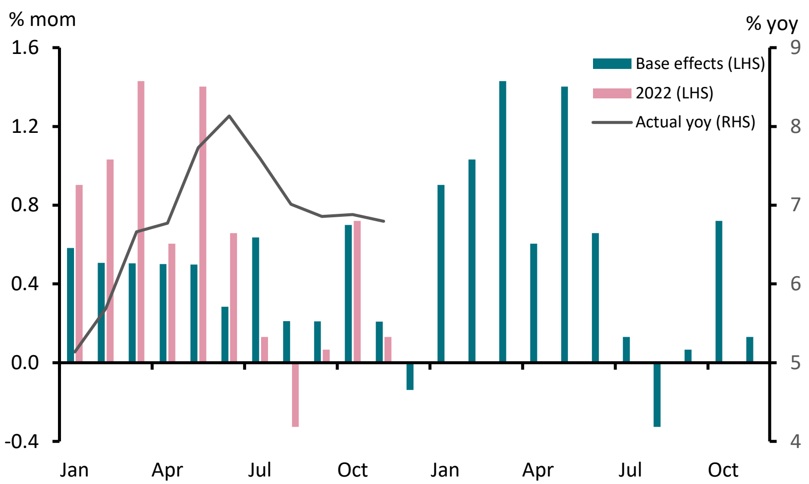
- Inflation closed 2022 at 6.3%. This was down from the peak rate of 8.1% in June, and softer than the broadly flat August to November rates. This reflects the pattern of base effects with inflation only starting to rise sharply in Canada in 2022. This will change across H1 2023, where base effects are large and the headline rate is set to fall back sharply. We forecast inflation to average 4.3% and 2.4% in 2023 and 2024, a little above the consensus 3.9% and 2.2%.

Labour market tightens into year end

- The labour market posted another strong reading in December, employment rising by 104k following the large 108k rise in October. Taking the quarter as a whole, employment growth has risen by 222k – the strongest increases outside the 2020-21 pandemic rebounds. This employment strength has contributed to a fall in unemployment back to 5.0% and a 6 month low. The labour market remains tight and wage growth persists at 5.2%. This looks to underpin further tightening by the Bank of Canada.

Base effects explain sticky inflation

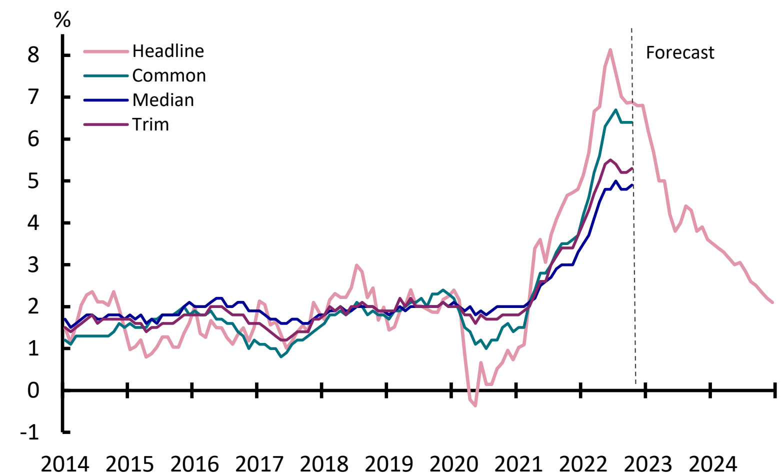
Base effects and impact on annual inflation rate



Source: CANSIM, AXA IM Research, January 2023

And point to a sharp retracement

CPI measured variations



Source: CANSIM, AXA IM Research, January 2023

Inflation fall should see BoC ease policy in 2024

Canada

GDP closes 2022 stronger, set to soften

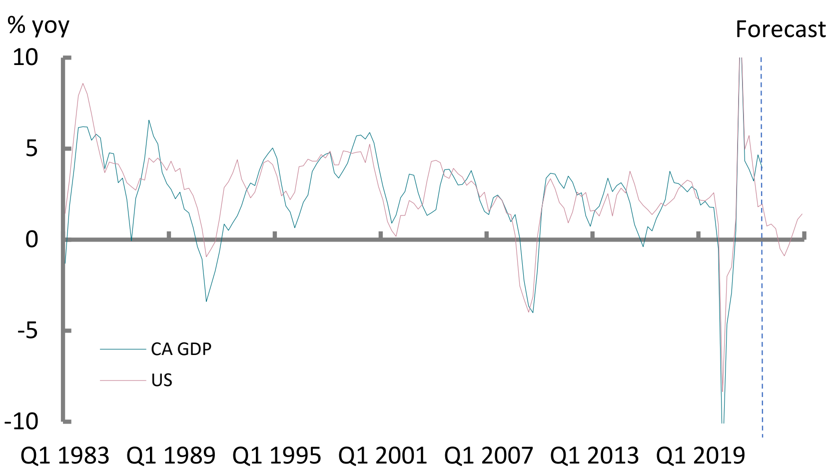
- Ahead of the release of Q4 GDP, monthly data suggest a stronger end to the year. Exports likely bolstered domestic spending reflecting surprisingly resilient global growth, particularly in the US and Eurozone. The outlook is still for deceleration this year, albeit that firmer momentum may delay this softening. A firmer Q4 expectation sees us raise our 2022 forecast to 3.5% (from 3.3%), 2023 to 1% (from 0.6%) but lower 2024 to 1% (from 1.1%). Consensus forecasts are for 3.5% and 0.5% respectively.

BoC – one more hike

- The Bank of Canada hiked rates by 50bps to 4.25% in December, more hawkish than we had forecast and seemingly vindicated by subsequent labour market data. With momentum a little firmer, we continue to look for a further 0.25% hike in January to 4.50% but consider this will be the peak. The Bank looks for a stalling economy, inflation should start to fall visibly, and the housing market is undergoing severe adjustment. Nevertheless, further labour market surprises would add upside risks to that outlook.

Canadian economy set to slow

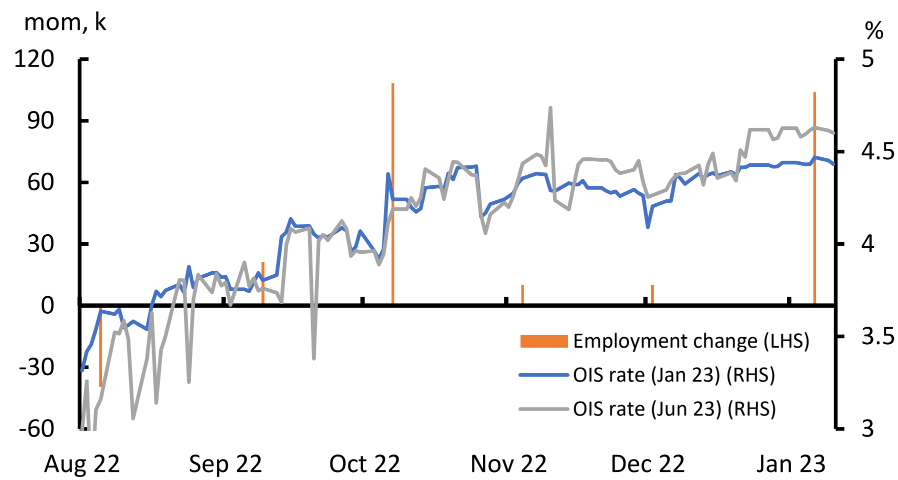
US and Canadian GDP growth



Source: CANSIM, BEA, AXA IM Research, January 2023

Rate market becomes less sensitive to labour market

Employment changes and rate expectations



Source: CANISM, Bloomberg, AXA IM Research, January 2023

Disinflation started in EM

Emerging Markets

Food and energy prices help EM inflation pass its peak

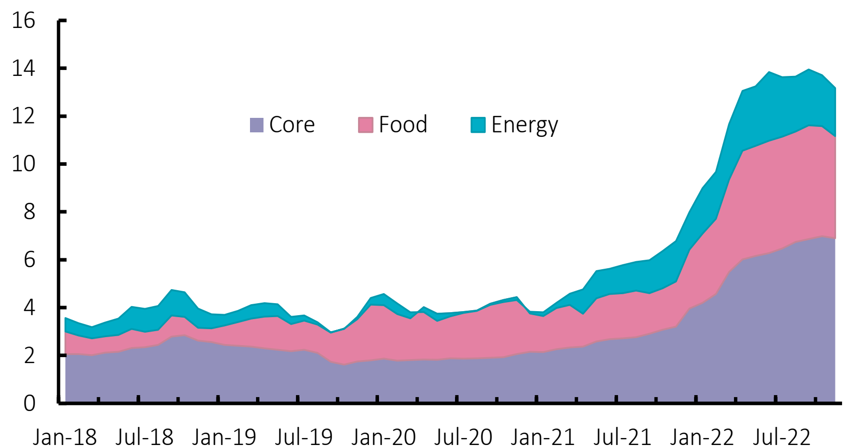
- In line with global trends, food and energy inflation have started to fade in emerging markets.
- Energy disinflation is particularly stark in Latin America, where year-on-year energy inflation was running below 1% for the region overall back in November. This was likely helped by the strong currency performance in the region which accelerated the global fall in energy prices when translated in local currencies.

Core inflation is more stubborn, particularly in Central and Eastern Europe

- Core inflation appears somewhat stickier for now, but the good news is that the EM GDP-weighted average core inflation proxy looks to have plateaued. Here we consider the 19 EM ex-China countries.
- One region where core inflation appears noticeably more stubborn than elsewhere is Central Europe (CEE), with Asia similar although to a lesser extent (and for sure a much more subdued absolute level), where core inflation continued to accelerate up to last November (available data for all).

EM: *en route* for lower headline inflation rates

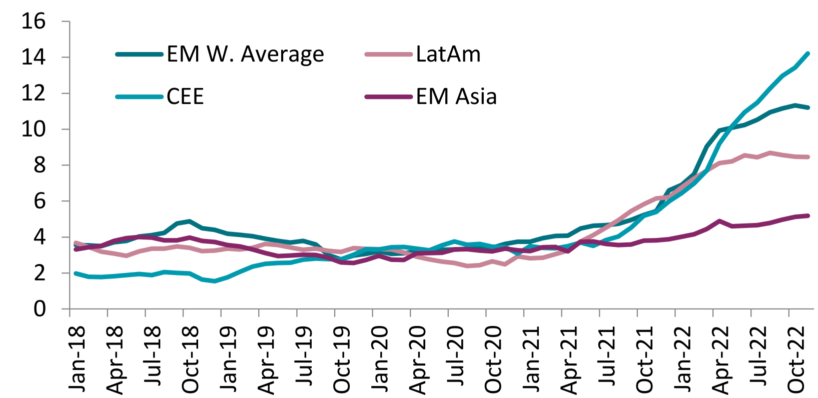
EM CPI contributions (% yoy)



Source: Bloomberg, Refinitiv Datastream and AXA IM Research, as of Nov 2022

Core inflation will be trickier to nail down quickly

Core inflation by region (%YoY)



Source: Eikon Refinitiv, AXA IM Research, Nov 2022

Disinflation may come later and prove longer to settle in Central Europe

Emerging Markets

Evidence of price pressure diffusion in core components in CEE

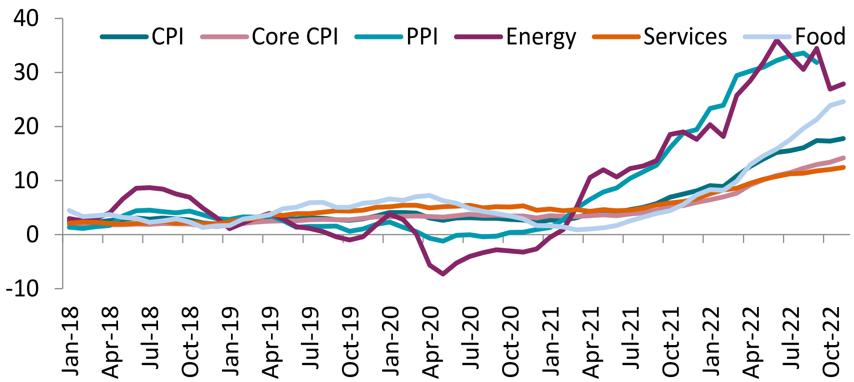
- Double-digit inflation and sticky core inflation are common traits in CEE. Producer prices are still running above 20% yoy (36% in Hungary) although rates have been coming down since last Fall. In Hungary, core inflation tracks headline almost perfectly, both having accelerated above 24% yoy in December.

Inflation to peak in Q1 but the pace of disinflation remains uncertain

- As governments in the region begin to unwind some of the measures introduced last year to protect households from the inflation spike, a more visible disinflationary path may emerge after the Spring in CEE. Underlying pressure remains as wage claims are likely to remain strong in the context of structural supply shortages in the labour market, inflation expectations appear unanchored and fiscal support ahead of elections will likely remain in Poland. Inflation will not converge towards target in 2023-2024, pressuring central banks for a 'tighter-for-longer' monetary policy stance.

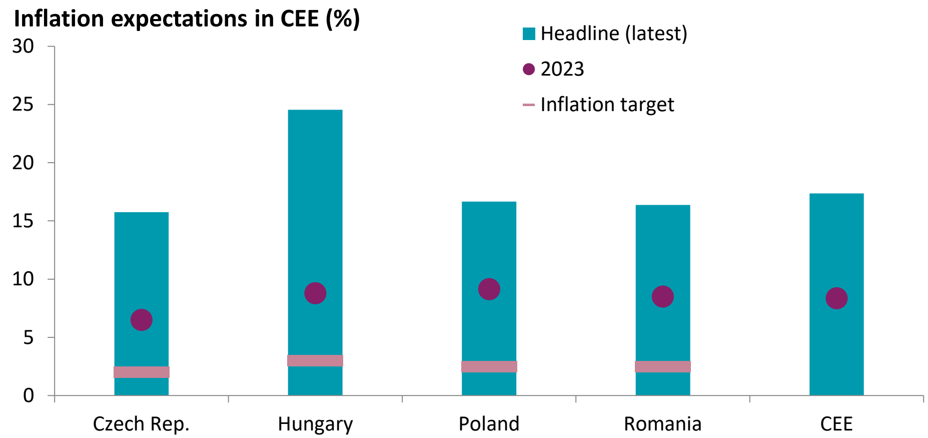
Bar energy prices, no sign of retreat in CEE inflation metrics

CEE: inflation measures



Source: Eikon Refinitiv, AXA IM Research, Nov 2022

Inflation to remain above targets for some time



Source: Bloomberg, Reuters Eikon, AXA IM Research, Dec 2022

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Negative on Equities

#1

Earnings deteriorating as economic activity decelerates while persistent inflation pressuring central banks to slow growth further

#2

China reopening to support Emerging Economies.
Higher carry with spreads at attractive levels for EM debt.

Positive Emerging Market equities and debt

#3

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

Neutral Investment Grade

#4

Markets increasingly concerned by the rising risk of recession, but still pricing rate cuts in the second half of 2023, which creates some space for disappointment

Neutral on Government Bonds

Source: AXA IM as at 25/01/2023

Investment Strategy

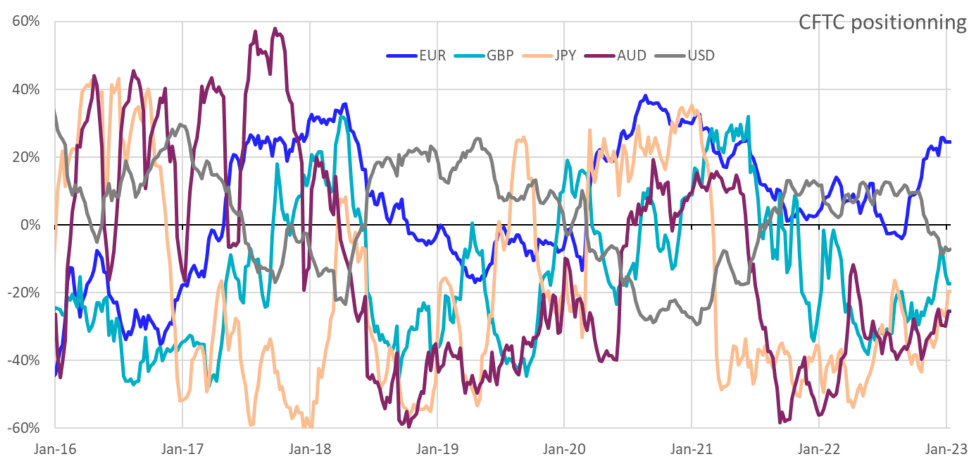
Currencies: USD folds, JPY's turn

- The global growth outlook has significantly improved into 2023 against a continuous softening of US inflation, which is calling for more USD weakness. Ditto a China reopening much faster than anticipated and the prospect of energy rationing in EU retreating. The Fed might want tighter financial conditions, but in order to forgo rate cut expectations, markets need more confidence that we are heading for a soft landing; a bullish macro scenario that might actually be even more USD-negative.

- Softening of inflation overseas and the possibility of a policy shift from the BoJ should both push JPY to recover further from its 2022 policy divergence driven weakness. The BoJ has already surprised with a YCC adjustment in December. But as it increases its JGB purchases against rising domestic inflation, the idea of further adjustments is gaining credibility, with a new governor to be announced shortly.

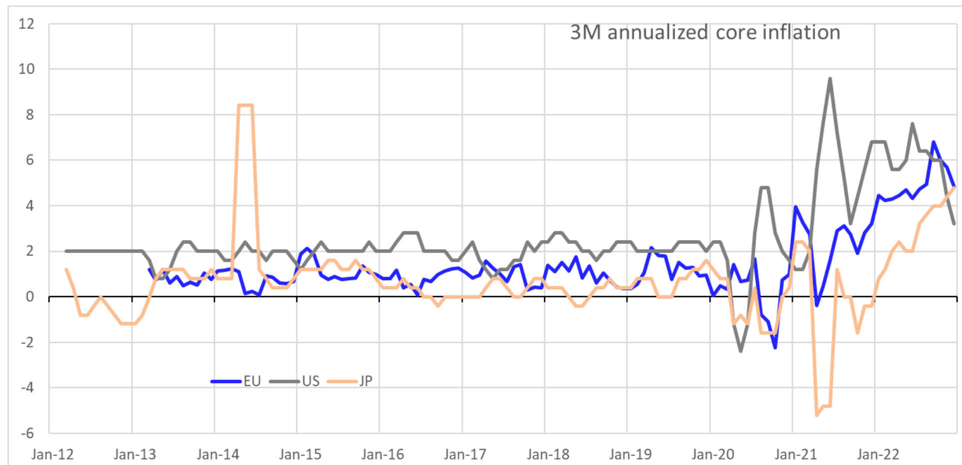
- AUD should also benefit from the better risk sentiment. Australia recently reached a trade surplus that should be further boosted by China's reopening and a thawing of relations. The RBA is more prudent, but with a better outlook on domestic growth. The EUR has also benefited, but value and positioning look less appealing, while energy challenges continue to cast a medium-term shadow.

USD shorts, JPY longs and AUD longs not stretched



Source: Bloomberg and AXA IM Research, Jan 2023

Inflation rising in Japan and softening elsewhere



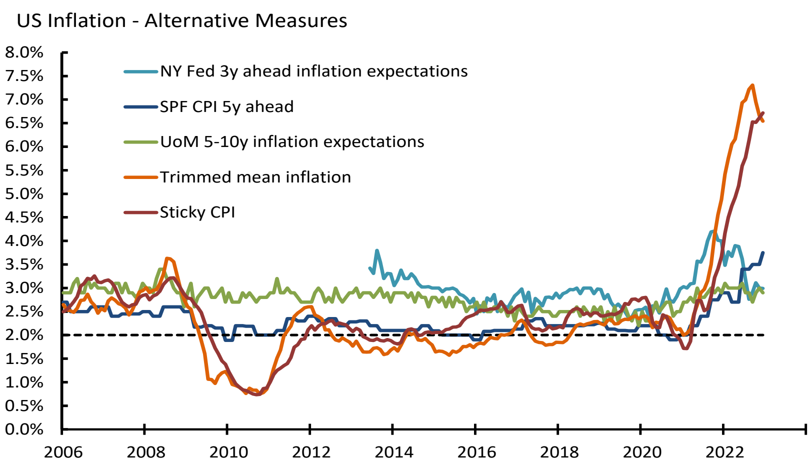
Source: Bloomberg and AXA IM Research, Jan 2023

Investment Strategy

Rates: the central banks' unfinished business

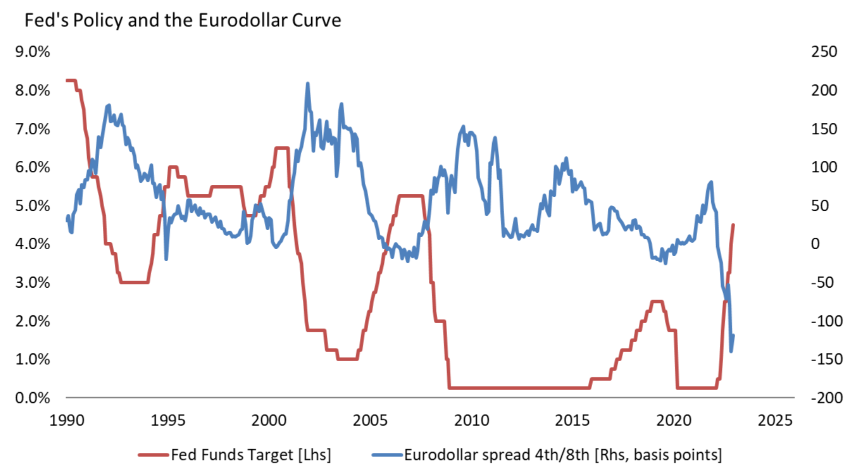
- Despite the Fed's consistently hawkish commentary, markets have started pricing a substantial change in monetary policy stance after the first half of 2023. While US macro data more broadly have started showing signs of weakness, employment data remain resilient at a time when labour market slack is a necessary condition for the Fed to start changing tack.
- Measures of US inflation, while having moderated from their 2022 highs, continue to point at persistent pressures. The 'stickier' part of inflation measures would have to show signs of rolling over before investors are more confident that central bank hiking gets close to their cyclical peak.
- China's Covid reopening has been bumpy, given the low level of vaccination especially in the elderly population. If, however, these reopening hiccups prove to be only transitory headwinds, the uptick in demand is likely to start putting upward pressure on commodity markets, and potentially adding to inflation risks afresh down the road.

Some inflation measure remain sticky



Source: AXA IM, Bloomberg

Markets are pricing an easing in Fe policy after H1 2023



Source: AXA IM, Bloomberg

Investment Strategy

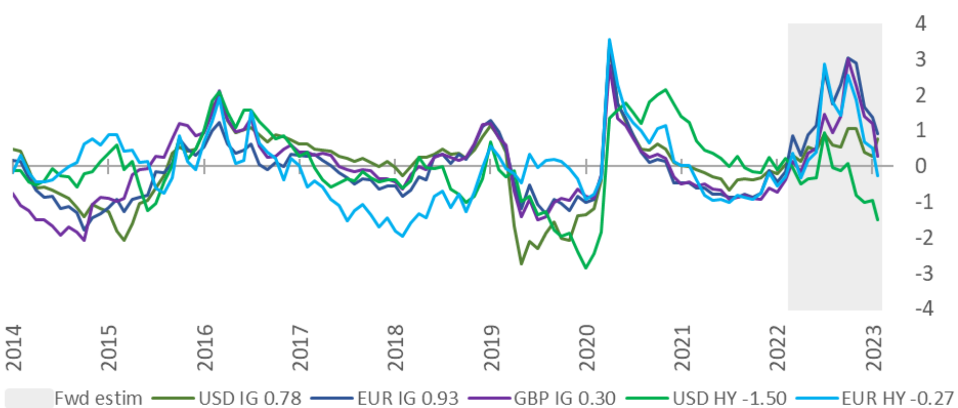
Credit: an optimistic start to 2023 but caution still warranted

- Credit markets have seen a strong start to the year, with investment grade (IG) markets up 2.5-4% and high yield (HY) markets up by over 3% year to date. Spread levels have tightened by between 6-10%. Companies (and governments) have taken advantage of the benign market conditions to come to the market. New bond issuance has been very substantial, in euro markets up by almost 40% over the same period last year. This is helping companies address refinancing needs in a timely manner, before any potential recession risks materialise.

- The tightening trend year to date has been a fair reflection of reduced investor pessimism. While this trend may run a bit further, we take the prudent view that further spread compression will be limited going forward. Key macro headwinds are still in place and valuations have narrowed substantially since Q3 2022. EUR IG screens the cheapest at 1 sigma cheap, while USD HY screens the richest at -1.5 sigma. Still, thinking of credit as a carry trade remains valid, as credit yield levels continue to offer an attractive entry point.

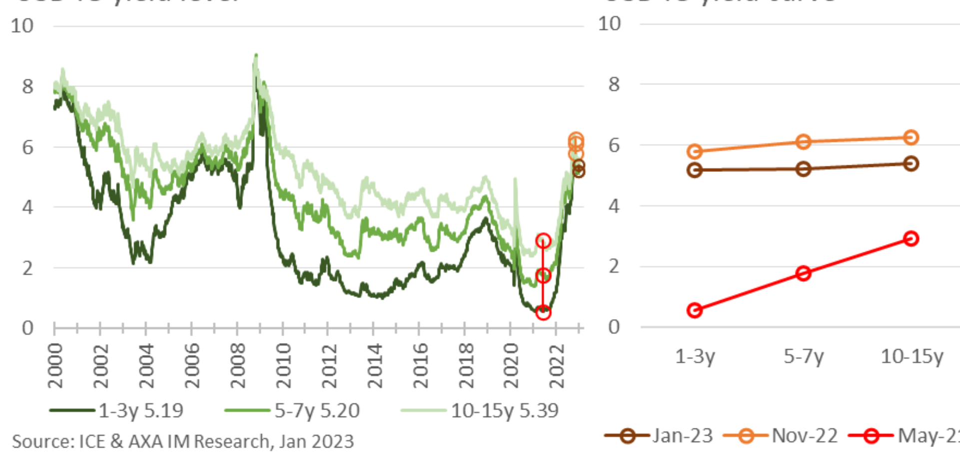
- Credit yield curves are currently very flat, given the underlying inverted government bond curves. This offers the opportunity to pick up historically very attractive carry at the short end of the curve, which also offers protection from duration risk, a useful trait given the ongoing inflation uncertainty and the associated central bank policy reaction.

Valuations have narrowed materially since Q3 2022



Source: Fed, ECB, ICE & AXA IM Research, Jan 2023

USD IG yield term structure flat as a pancake



Source: ICE & AXA IM Research, Jan 2023

AXA Investment Managers

Investment Strategy

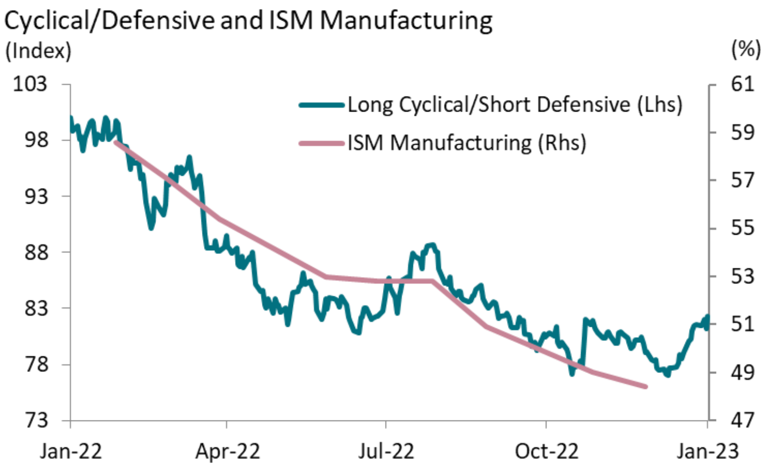
Equities: beware of risks of complacency

- As the year begins, equity markets seek to erase the bad year of 2023 by posting positive performance. China (+13.8%) is ahead of the pack, supported by the reassessment of its pandemic policy. China reopening has also been a boost for European equities (+8.4%) given Europe’s material exports to China. We also note that this year's top performers are last year's losers, with a double-digit gap in Europe and the US.

- The market seems to be somewhat ahead of the economic environment. The outperformance of cyclicals relative to defensive stocks in recent weeks would suggest that the level of activity, e.g. as observed by ISM Manufacturing, should pick up from current lows. We think this is premature and even if some economic optimism might be justified, as restrictive monetary policy remains in place and its impact on economic activity may be yet to be felt.

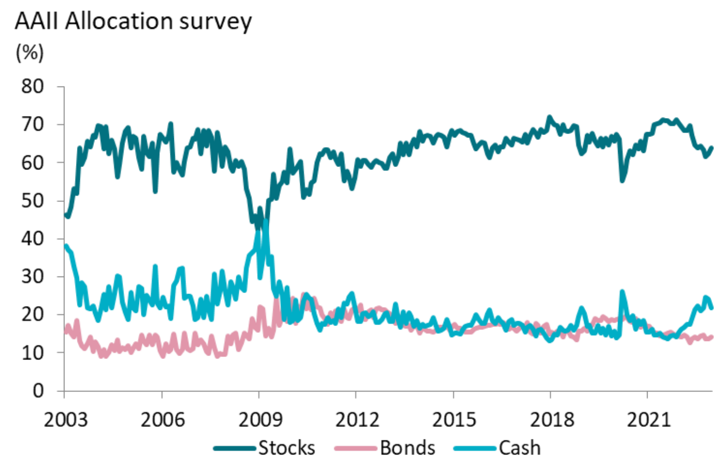
- In the US, retail investors seem comfortable with the idea of starting to reallocate their cash into equities. But we would not overread this this signal as investors have over the past year steadily reduced their historically high equity positions back to a historical average. Furthermore, the equity risk premium is still low in the post-GFC era and does not suggest an attractive entry point for the asset class yet.

The market is already pricing a cyclical recovery …



Source: MSCI, ISM and AXA IM Research, January 2023

… and cash holdings are being re-allocated back into equity



Source: AAII and AXA IM Research, January 2023

AXA Investment Managers

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 short duration HY		▼	
EM Debt			
EM Bonds HC			▲

Legend ● **Negative** ● **Neutral** ● **Positive** **Change** ▲ **Upgrade** ▼ **Downgrade**

Source: AXA IM as at 25/01/2023

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2022*		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2		2.3		2.8	
Advanced economies	2.6		0.3		1.0	
US	2.1	1.9	0.1	0.2	0.8	
Euro area	3.2	3.2	-0.2	-0.1	0.9	
Germany	1.7	1.7	-0.6	-0.7	0.8	
France	2.4	2.5	0.0	0.1	0.8	
Italy	3.6	3.7	0.0	-0.1	0.6	
Spain	4.5	4.5	0.3	0.8	1.3	
Japan	1.6	1.5	1.7	1.3	1.3	
UK	4.1	4.4	-0.7	-1.0	0.8	
Switzerland	2.3	2.1	0.6	0.5	1.3	
Canada	3.5	3.4	1.0	0.4	1.0	
Emerging economies	3.6		3.5		3.8	
Asia	4.1		4.8		4.5	
China	3.0	3.1	5.0	4.5	4.8	
South Korea	2.3	2.6	1.5	1.3	2.0	
Rest of EM Asia	5.5		4.9		4.4	
LatAm	3.5		1.7		2.4	
Brazil	2.7	2.9	1.0	1.0	2.0	
Mexico	2.2	2.8	1.0	1.1	2.0	
EM Europe	0.5		-0.9		2.1	
Russia	-3.0		-3.8		2.0	
Poland	4.4	4.8	0.1	0.8	2.4	
Turkey	5.9	5.2	0.5	2.2	1.4	
Other EMs	4.5		3.6		3.6	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 January 2023

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		5.0		2.8	
US	**8.0**	8.1	**4.9**	4.1	**3.2**	
Euro area	**8.4**	8.5	**5.8**	6.3	**2.8**	
China	**2.1**	2.1	**2.3**	2.4	**2.5**	
Japan	**2.5**	2.4	**2.7**	1.8	**1.5**	
UK	**9.1**	9.0	**7.2**	7.3	**2.3**	
Switzerland	**2.8**	2.9	**2.0**	2.3	**1.3**	
Canada	**6.8**	6.8	**4.3**	3.8	**2.4**	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 January 2023

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q1-23	Q2-23	Q3-23	Q4-23
United States - Fed	Dates	4.50	31-1 Jan/Feb 21-22 Mar	2-3 May 13-14 Jun	25-26 Jul 19-20 Sep	31-1 Oct/Nov 12-13 Dec
	Rates		+0.5 (4.75-5.00)	unch (5.00)	unch (5.00)	unch (5.00)
Euro area - ECB	Dates	2.00	2 Feb 16 Mar	4 May 15 Jun	27 Jul 14 Sep	26 Oct 14 Dec
	Rates		+1.0 (3.00)	+0.25 (3.25)	unch (3.25)	unch (3.25)
Japan - BoJ	Dates	-0.10	9-10 Mar	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)	unch (-0.10)
UK - BoE	Dates	3.50	2 Feb 23 Mar	11 May 22 Jun	3 Aug 21 Sep	2 Nov 14 Dec
	Rates		+0.75 (4.25)	unch (4.25)	unch (4.25)	-0.25 (4.00)

Source: AXA IM Macro Research - As of 23 January 2023

Calendar of 2023 events

	Dates	Events	Comments
January	Q1 2023	China Second Plenary Session of the 20th CPC Congress	
February	01-Feb	FOMC Meeting	+0.25% (4.50%-4.75%)
	02-Feb	BoE Meeting	+50bps (4.00%)
	02-Feb	ECB Meeting	+50bps (DFR= 2.50%)
	25-Feb	Nigeria general election	
March	March	National People's Congress	
	10-Mar	BoJ Meeting	Unchanged (-0.1%)
	16-Mar	ECB Meeting	+50bps (DFR=3.00%)
	21-22 Mar	FOMC Meeting	+0.25% (4.75%-5.00%)
	23-Mar	BoE Meeting	+25bps (4.25%)
	23-24 Mar	EU Summit	
April	02-Apr	Finland elections (National Parliament)	
	08-Apr	BoJ Governor Kuroda's term ends	
	13-Apr	Northern Ireland Assembly elections	Latest date if executive not formed
	24-Apr	BoE Meeting	Unchanged (-0.1%)
	28-Apr	BoJ Meeting	Unchanged (4.25%)
May	04-May	ECB Meeting	Unchanged (3.25%)
	04-May	UK local elections	
	07-May	Thailand general elections	
	11-May	BoE Meeting	Unchanged (4.25%)
	14-May	Germany (Federal state elections)	
	23-May	BoE Meeting	Unchanged (4.25%)
	28-May	Spain Regional elections	
June	Early June	US Earliest Treasury special measures could see debt ceiling impact	
	13-14 June	FOMC Meeting	
	15-Jun	ECB Meeting	Unchanged (3.25%)
	16-Jun	BoJ Meeting	Unchanged (-0.1%)
	18-Jun	Turkey presidential and parliamentary elections	
	29-30 June	EU Summit	
July	July	US Estimated resolution of the debt ceiling	
	July	Greece elections (National Parliament)	
September	Autumn 23	Poland presidential elections	
October	29-Oct	Argentina general elections	
December		Spain (National Parliament)	

Latest publications

Outook 2023-2024 – Global slowdown to subdue inflation

1 December 2022

The unequal impact of inflation: How governments are responding

27 October 2022

October Global Macro Monthly – Tighter global financial conditions

26 October 2022

October Monthly OpEd – How far is too far?

26 October 2022

The economic impact of a Russian gas cut-off

30 September 2022

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

28 September 2022

September Monthly OpEd – Dollar reigns supreme

28 September 2022

Brazil's Presidential Election: Familiar names for an uncertain future

27 September 2022

Asia's decarbonisation potential

14 September 2022

The outlook for China against US or European recession

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UK Conservative party leadership elections: The battle to be the next PM

31 August 2022

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