

Monthly Investment Strategy



Ahead after the first half...

Key points

- Economic growth proved more resilient than expected, particularly in North America. While also true in Europe, recent eurozone activity has surprised to the downside.
- Inflation has continued to fall across developed and emerging economies, driven by energy, food, and in some cases, stronger domestic currencies. Core disinflation has been slower to emerge, reflecting tight labor markets in some cases but weak productivity growth in others.
- Resistant core inflation has kept developed central banks on the front foot: the Fed, ECB, and BoE all expected to hike further. Elsewhere, peaks are emerging. Some first-mover EMs are considering easier policy this year.
- Markets have made significant recovery from 2022 losses. The second half outlook will depend on whether growth and inflation continue their benign courses. We suggest a more challenging close to the year.

Global Macro Monthly

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Ahead after the first half...

Global Macro Monthly Summary July 2023



David Page
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A broad easing of inflation concerns

Our Theme of the Month focuses on a broad review of market developments across the first half of this year. This has been characterized by economies that have performed more resiliently than expected so far and, despite headline disinflation, have exhibited a stickiness in core measures. In turn, this has seen many central banks continuing to tighten monetary policy to restore price stability. This has provided a headwind to markets, but performance has been solid.

As we move into the second half of 2023, there are growing signs that markets' perceptions of inflation risks are starting to fade, impacting central bank rate outlooks. Headline inflation has fallen sharply. In the US, inflation fell to 3.0% in June, from a peak of 9.1% a year before. It was lower in Canada at 2.8%, with eurozone headline inflation also falling sharply to 5.5%. Emerging markets (EM) have seen the same trend, and several economies' inflation rates are now at or below target levels. In many cases, the fall in inflation is occurring faster than its rise – in the US it took 15 months for inflation to rise from 2.6% to 9.1%, but only 12 for it to fall back to 3.0%.

Much of the coincidental fall in headline inflation reflects energy prices, combining outright easing with the "transitory" component of the annual price shock. Core inflation has been stickier and remains more elevated than headline, particularly in the eurozone, UK, and Canada where there is questionable momentum in core disinflation. These economies share concerns over productivity growth, in turn keeping unit labor costs elevated, and their central banks have remained amongst the most cautious. Meanwhile, stickier core prices are falling in most areas. In the US, June's price falls were well dispersed, if the larger impacts were still from food and energy. The same was true for lagging UK disinflation. Moreover, there is no hard and fast distinction between headline and core measures, with sharp falls in the former leading to disinflation in the latter.

The latest releases have also had an impact on future inflation perceptions. 5-year/5-year breakeven inflation rates have retreated from highs across the eurozone and the UK, easing in the US – although longer-term survey-based expectations edged higher in the latest US releases. Broader market

sentiment can also be judged by expectations for central banks. Federal Reserve (Fed) rate expectations have eased since employment surveys posted a falsely strong impression of US jobs growth in July, while UK peak rate expectations eased 60bps over the same period, a quarter of that in the two days after the latest CPI release.

Central banks will avoid complacency. The latest data follows years of upward inflation surprises, and in the main, banks will require more tangible evidence of ingrained disinflation before relaxing entirely. The Fed and ECB both appear to have clearly committed to 25bp hikes in July. The Bank of England (BoE) looks likely to follow suit in August (easing inflation expectations reduces the chances of another 50bp increase). Thereafter, policymakers enter a more uncertain phase. We expect the ECB and BoE to hike again in September, the former suggesting this is more open to debate than we had considered. The Bank of Canada (BoC) is a close call, but on balance, we think it is at a peak. We expect the Fed to fall short of delivering the second of June's forecast hikes. Instead, we think authorities will settle for a phase of policy restrictiveness by keeping rates elevated for longer, rather than hiking further, although risks for further increases remain.

A broader question is whether central banks will have tightened too much by the end of the cycle. Insofar as we only now see a growing widespread acceptance that inflation pressures might be abating, this likely justifies policy tightening to date. But only time will tell whether expected peaks will deliver inflation at policy targets over the coming years. We suggest that with central banks necessarily gauging policy on inflation expectations and backward-looking data, some degree of overtightening is almost inevitable. The BoE's own central forecasts point to inflation locked well below target (around 1%) from mid-next year; the Fed expects a mild recession around the turn of this year. A slew of data over the coming weeks will leave us in a better position to judge underlying economic strength across H2, particularly after the summer.

This, in turn, is likely to prompt a rate easing cycle. We are closely watching EM central banks that were swift to start the tightening cycle and could loosen policy this year – in Latin America, Chile, Brazil, Peru, and Colombia and in Central and Eastern Europe, the Czech Republic. For developed economies, we see this as a story for next year, looking for the Fed to cut rates in March, the BoC in April, BoE in May, and ECB in June. The easing is likely to be gentle compared to the tightening, and we envisage it continuing through 2025.

Global Macro Monthly – US

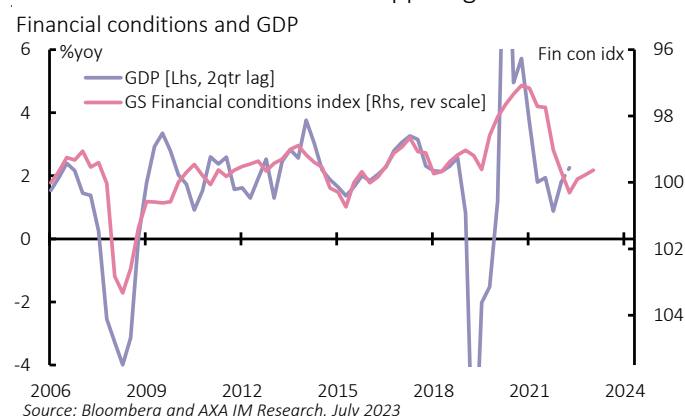


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Momentum and buffers

We are publishing before the first official estimate of Q2 GDP is released, but at the time of writing, the Atlanta GDP tracker suggests 2.4% growth (annualized) – a little more than trend – and the consensus forecast is for growth of 1.8%. Our own view is this should be a little softer at 1.4%, reflecting a material deceleration in consumer spending to just over 1% (from 4.2% in Q1), although the precise data will reflect the vagaries of the more erratic net trade and inventory contributions. Importantly though, the economy is still expanding, the expected recession is still ahead of us, and there are some signs of a strengthening in activity.

Exhibit 1: Financial conditions support growth outlook



Several factors have driven a more upbeat assessment. Housing starts have firmed, and even after June's sharp 8% drop, they are still 6.5% ahead. However, the broad trend in housing is reflected by the fall in the far bigger existing home sales (June down 3.3%). Investment intentions rose in many of June's surveys, although preliminary evidence for July has seen this reverse. And the recent easing in financial conditions is consistent with growth remaining around 2%, something that we acknowledge is a renewed tailwind to growth (Exhibit 1). Moreover, the labor market – while clearly now slowing – is still resilient with payrolls rising in excess of 200k in trend terms. Accordingly, with pay remaining elevated and inflation having retreated, real disposable income growth is likely to be firmer over the coming quarters, reducing the contraction in consumer spending that we had expected.

In broad terms, the top-down signals of yield curve inversion and tighter credit conditions still suggest a recession is likely over the coming quarters. However, we will need to see the erratic components of Q2's GDP to judge whether output will drop in Q3 – as we currently expect – or whether this expectation will once again be deferred, in line with the Federal Reserve's (Fed) current view of recession only in Q4 2023 and Q1 2024. The persistent uncertainty of excess saving in both household and corporate sectors goes a long way to explain the delayed onset of recession so far and continues to overhang our outlook for the future. For now, we forecast GDP growth of 1.4% and 0.6% – a shift from 1.0% and 1.1% previously, reflecting the further delaying of expected weakness (consensus 1.3% and 0.7%).

Inflation progress to secure the Fed

Inflation during June dropped to an annual rate of 3.0% – a substantial improvement from the peak a year before at 9.1% – and faster disinflation than the previous cycle (it took inflation 15 months to climb from 2.6% to 9.1%, and only 12 to retreat a similar distance). The Fed will not be complacent about the outlook. Most of the improvement reflects the (transitory) adjustment of energy, with food and shelter prices adding to disinflation this month. Core inflation remained elevated at 4.8%, and market (5-year-5-year breakevens) and long-term consumer expectations have edged higher recently. Moreover, despite the sharp disinflation in 2023, headline inflation looks likely now to be anchored around the 3% mark for the rest of this year. However, with June reflecting a broad dispersion of disinflation and our expectation of ongoing improvement in core measures, there is now clear evidence that restrictive policy is reining in price rises. The outstanding question for the Fed is how much more it needs to do to return inflation to target over the next 12 to 18 months.

The Fed left the Fed Funds Rate (FFR) unchanged at 5-5.25% at its June monetary policy meeting – the first pause since March 2022 after 500bps of tightening. However, Chair Jerome Powell described June's hiatus as a "skip," and the Committee forecasts two more hikes by year-end. We have been in little doubt since that the Fed intended to tighten policy again in July. However, we believe the ongoing softening in the economy and the broadening disinflation should be consistent with the Fed leaving rates on hold. Markets consider the Fed switching to an alternative meeting pattern, pricing the greatest risk of a further hike in November. But, by November, we expect material evidence of economic deceleration will see the market considering when in 2024 the Fed will ease. For now, we expect the first cut in March 2024 seeing the FFR close 2024 at 4.00%. We reiterate our expectation is for only a mild recession and do not expect the Fed to ease aggressively as it did during the past three cycles, with our forecast for easing to gradually continue into 2025. However, further resilience in the economic data could see the Fed leaving policy on hold for longer.

Global Macro Monthly – Canada



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BoC reacts to more resilient economy

Firm Q1 GDP growth of 3.1% (annualized) and a surprise catch-up in employment in June (up 60k, with full-time work up 110k) added to the Bank of Canada's (BoC) concerns that the economy remained in excess demand for longer than expected. The balance of policy has leaned towards not having done enough, rather than too much. The BoC raised rates again by 0.25% in July to 5.0% and said it was "prepared to go further."

Underpinning the central bank's assessment was a more upbeat view of GDP, with growth revised up to 1.8% for 2023 from 1.4% 3 months ago. We are more cautious and see growth softer than the 1.5% (annualized) the BoC estimates in Q2 and Q3, leaving our forecast at 1.6% for 2023 (also up from 1.4%) and 0.9% for 2024 (compared to the BoC's 1.2%). This reflects a softening in consumer spending – evident in lackluster retail sales volume growth; an unwind in the Q1 net trade boost, and caution on the business investment front.

Significant uncertainties surround the outlook. We expect a US recession in H2 2023 to dampen activity, but as discussed elsewhere, this remains uncertain. Canadian household excess savings contributed to the Q1 boost to consumer spending – the saving rate dropped to 2.9%. It remains uncertain how this will underpin spending in the immediate future. Finally, immigration is boosting demand – but also supply. Despite the rise in June's employment, unemployment rose to 5.4% – a 16-month high. Such an easing in the labor market should soften inflation. However, the BoC noted immigration was boosting inflation in some sectors, while alleviating it in others. In June, core CPI measures rose further. We forecast headline inflation to average 3.9% and 2.8% in 2023 and 2024, stickier than the BoC's 3.7% and 2.5%.

We see the BoC's latest hike as its last. It is considering the lagged impact of previous tightening as mortgage rates reset over the coming years. Moreover, although warning that it was "prepared to go further," the BoC added it didn't "want to do more than necessary." Given economic and policy surprises in recent months, we are cognizant of ongoing upside risks to our 5% peak outlook but concur with current market pricing of a less than 50% likelihood over the coming months. If our more cautious outlook for growth emerges, we think the BoC will likely begin to gently ease policy from next spring, but now see rates closing 2024 at a still-restrictive 4.25%.

Global Macro Monthly – Colombia



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Positive momentum in Colombia... will it last?

In recent months, Colombia has witnessed several positive developments in both its economic and political landscapes, signaling encouraging trends for the country's near-term future. While challenges persist, numerous indicators reflect progress in key areas.

Despite concerns about inflation and tight financial conditions, economic activity demonstrated resilience in Q1 2023, with growth accelerating to 3.0% year-on-year, surpassing market expectations. The increase was mainly driven by private consumption and net exports. However, recent high-frequency indicators suggest a slowdown has commenced. Consequently, we anticipate the Colombian economy to decelerate to 1.7% this year, down from 7.3% last.

Meanwhile, Colombia's macroeconomic imbalances have started to correct. Annual inflation has fallen for three consecutive months thanks to lower food prices while producer price inflation is already in negative territory, suggesting further disinflation in the coming months. The current account deficit has also been improving on the back of a lower trade deficit. Though the deficit remains high at 4.2% of GDP, foreign direct investment inflows now fully finance the deficit, contributing to a more stable external position.

The fiscal side saw some progress as well, with the government's fiscal deficit improving in recent quarters, although it remains elevated at 4.8% of GDP. The primary balance hovers close to zero. However, the impact of Congress approving additional resources for this year's budget, leading to increased spending, warrants close monitoring.

In the political arena, risks have diminished significantly due to President Gustavo Petro's compromised ability to pass radical reforms. His disapproval rate reached 60%, and conflicts with Congress have resulted in the fracturing of the government's coalition. A recent scandal involving alleged wiretapping and illegal campaign funding has further complicated Petro's governing conditions and led to a rally in Colombian assets.

Despite the recent positive developments, challenges remain for Colombia's future, including how to reactivate growth next year in the absence of high oil prices and how to preserve political stability in the face of declining support for Petro.

Macro forecast summary

Real GDP growth (%)	2022		2023*		2024*	
	AXA IM	Consensus	AXA IM	Consensus	AXA IM	Consensus
World	3.4		2.8		2.7	
Advanced economies	2.7		1.1		0.7	
US	2.1	2.1	1.4	1.3	0.6	0.5
Euro area	3.6	3.2	0.4	0.6	0.5	0.9
Germany	1.8	1.8	-0.5	-0.2	0.3	1.1
France	2.6	2.6	0.6	0.6	0.5	0.9
Italy	3.7	3.8	1.2	1.0	0.4	0.8
Spain	5.5	5.5	2.2	1.8	1.0	1.5
Japan	1.1	1.0	1.3	1.1	1.3	1.0
UK	4.0	4.0	0.2	0.1	0.3	0.8
Switzerland	2.1	2.1	0.7	0.7	1.0	1.4
Canada	3.4	3.4	1.4	1.2	0.9	1.0
Emerging economies	3.9		3.9		3.9	
Asia	4.3		5.0		4.6	4.0
China	3.0	3.0	5.3	5.7	5.0	4.9
South Korea	2.6	2.6	1.5	1.1	2.0	2.1
Rest of EM Asia	6.0		5.0		4.4	
LatAm	4.0		2.1		2.3	
Brazil	2.9	2.9	1.9	1.2	1.3	1.6
Mexico	3.1	3.1	2.3	1.8	1.9	1.7
EM Europe	0.9		1.5		2.3	
Russia	-2.1		1.7		1.3	1.3
Poland	4.9	4.9	1.0	0.7	2.9	3.1
Turkey	5.6	5.6	2.1	2.2	3.1	2.6
Other EMs	4.9		3.1		3.7	

Source: Datastream, IMF and AXA IM Macro Research – As of 24 July 2023

*Forecast

CPI Inflation (%)	2022		2023*		2024*	
	AXA IM	Consensus	AXA IM	Consensus	AXA IM	Consensus
Advanced economies	7.4		4.6		2.6	
US	8.0	8.0	4.0	4.1	2.8	2.6
Euro area	8.4	8.5	5.5	5.4	2.7	2.4
China	1.9	2.0	1.0	1.3	2.0	2.3
Japan	2.5	2.5	2.7	2.8	1.5	1.5
UK	9.1	9.1	7.3	7.3	2.5	3.2
Switzerland	2.8	2.8	2.4	2.4	1.5	1.4
Canada	6.8	6.8	3.9	3.7	2.8	2.3

Source: Datastream, IMF and AXA IM Macro Research – As of 24 July 2023

*Forecast

These projections are not necessarily reliable indicators of future results

Forecast summary

Central bank policy

Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q3-23	Q4-23	Q1-24
United States - Fed	Dates		25-26 Jul	31-1 Oct/Nov	30-31 Jan
		5.25	19-20 Sep	12-13 Dec	19-20 Mar
	Rates		+0.25 (5.50)	unch (5.50)	-0.25 (5.25)
Euro area - ECB	Dates		27 Jul	26 Oct	25 Jan
		3.50	14 Sep	14 Dec	7 Mar
	Rates		+0.50 (4.00)	unch (4.00)	unch (4.00)
Japan - BoJ	Dates		27-28 Jul	30-31 Oct	Jan
		-0.10	21-22 Sep	18-19 Dec	Mar
	Rates		unch (-0.10%)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates		3 Aug	2 Nov	1 Feb
		5.00	21 Sep	14 Dec	21 Mar
	Rates		+0.50 (5.50)	unch (5.50)	unch (5.50)
Canada - BoC	Dates		06-sept	25 Oct	Jan
		5.00		6 Dec	Mar
	Rates		unch (5.00)	unch (5.00)	unch (5.00)

Source: AXA IM Macro Research - As of 24 July 2023

These projections are not necessarily reliable indicators of future results

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