Investment Institute Macroeconomics

Monthly Investment Strategy

Where we are in the cycle – and the supercycle

Key points

- The summer has seen further reevaluation of where key economies are in the current economic cycle.
- The US has seen ongoing resilience and we no longer expect recession, but a slowdown threatens Q4. The Fed has likely peaked at 5.50%, but markets are unsure.
- The Eurozone economy appears to be slowing more quickly and we expect a drop in Q3 GDP, although no recession. The ECB has likely peaked at 4.00%.
- China may be past its nadir, with output data rising in August and the authorities enacting a range of stimuli. But broader uncertainty over housing and banks continues to weigh over the medium-term outlook.
- We also consider the supercycle, considering the emergence of generative AI as a contender to form the next technological wave of development. We consider the outlook in the context of historical technology waves.

Global Macro Monthly

27 September 2023

Where we are in the cycle – and the supercycle

Global Macro Monthly Summary September 2023

David Page
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Reappraising the cyclical outlook

The post-COVID period has revealed structural adjustments and imbalances that have made judging cyclical variations in major economies difficult. This is an ongoing issue, and there was a further shift in expectations this summer for many major economies and a reappraisal of the relevant phase in the economic cycle.

The US is at the forefront of this – before the summer markets were judging whether a soft landing or recession was most likely (we had forecast the latter). However, a further period of economic resilience – charged by persistent strong consumer spending – has changed the debate to that of a soft, or indeed, no landing. We contest the no landing scenario. Consumer real income gains will be slower in H2; excess savings should be exhausted, requiring a rise from current low saving rates; and the economy faces several additional headwinds before year-end, including the prospect of a government shutdown. All this is likely to slow the economy, and we see the likelihood of Q4 contraction. Yet we recognize greater economic resilience and now no longer forecast recession, despite risks persisting in that regard. Moreover, we believe the Federal Reserve (Fed) requires a period of soft growth and a looser labor market to achieve its inflation mandate. The question is not a soft or no landing but how high the Fed has to take rates to ensure touchdown.

The Eurozone is also undergoing reappraisal. Considered to be lagging the US rate cycle before the summer, continued deterioration in soft and hard data warns of contraction and even recession in H2 2023 (not our central scenario). This has led markets to conclude that the ECB has reached peak rates before it is confident of such an assessment for the Fed. We agree on the ECB outlook, but the path ahead is unclear. Inflation remains elevated, particularly core. Moreover, while we consider a sluggish (though positive) growth outlook, we are not as convinced about the inflationary implications. Much of the headwind to Eurozone activity reflects supply constraints, not just weaker demand. As such, almost stagnant activity can remain consistent with inflation that remains over target.

China perhaps provides the biggest uncertainties. A buoyant post-pandemic start to the year deteriorated from the spring and activity data weakened further into July, while the authorities appeared to flounder in terms of how to counter such developments. August was more positive: output data firmed, and the authorities announced a raft of measures – some more likely to be impactful than others – to try and underpin activity and meet this year's "around 5%" growth target. Yet, this job does not look complete. The reduction in mortgage rates will provide a relief for households, but perhaps increases stress on the banking system. Moreover, expedited local government issuance will support growth this year but at the expense of activity early next year. More stimulus is likely necessary to secure a stable growth outlook consistent with avoiding growing deflationary concerns. Yet China also faces large structural imbalances, including in its property and banking systems, that threaten cyclical dynamics – this will require deft navigation by the monetary and fiscal authorities.

Against this backdrop oil prices have risen; historically a sign of strengthening activity. Indeed, the fading of US recession fears has lifted demand expectations, underpinning prices. However, supply has played a role here too. Output cuts by Russia and Saudi Arabia have pushed markets into deficit and driven prices higher. Intriguingly, within this we monitor the turnaround in Dubai-Brent oil spreads. Traditionally, these have been a gauge of Asian oil demand and continued increases here may indicate a quickening in activity in this part of the world.

From cycle to supercycle: The advent of AI

Our Theme of the Month summarizes our longer-term consideration of the impact artificial intelligence (AI) poses for the global economy[1]. Generative AI's emergence offers the prospect of a general-purpose tech that could echo the five previous great waves of technological revolution we have seen over the past three centuries. We introduce the debates to be considered around AI's impact on productivity and the economy – which we characterize as positive, but still with risks – the labor market, where we envisage disruption, and inflation – which remains uncertain for now. We also set the AI revolution in the context of previous technological revolutions, concluding that if AI follows previous patterns, investment should soar over the coming decade – presenting a marked potential opportunity.

[1] Page, D., "The macro impact of Generative AI : Learning from previous tech revolutions", AXA IM Research, 25 September 2023

Global Macro Monthly – US

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A resilient consumer Summer

Before the summer, markets debated whether the US was facing a soft landing or a recession; we were forecasting the latter. After firmer-than-expected Q2 GDP, activity over the summer accelerated with consumer spending rising sharply by 0.8% in July. The current Atlanta Fed GDPNow tracker suggests growth of 4.9% in Q3. The debate now appears to be focused on whether the US faces a soft landing or no landing.

Following strong average consumer spending in the first seven months of the year, we expect a deceleration for the rest of 2023. Nominal income growth should soften as employment growth has slowed relative to H1 and wage growth decelerates. Real incomes should slow further as the disinflationary tailwind fades and could even reverse as higher oil prices raise gasoline costs. Excess savings helped fuel July's spending, taking the saving rate to 3.5% but by our calculations should be all but exhausted. We expect the saving rate to rise towards 5% next year, further reducing purchasing power. The resumption of student debt repayments this month should further crimp incomes. In all we expect consumption growth to slow and forecast an outright contraction in Q4.

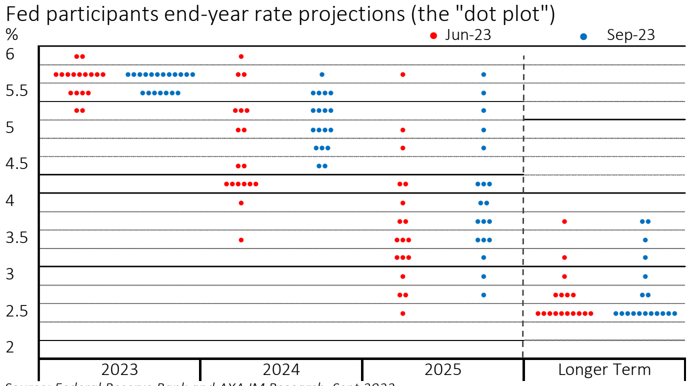
Combined with a further modest unwind in inventory and slower net trade, this fall in consumer spending could prompt an outright contraction in GDP in Q4, a risk exacerbated by a number of one-off factors including government shutdown, the auto-workers strike, and higher energy prices. However, other areas of the economy appear to be bottoming out or even strengthening. We forecast residential investment to deliver an only modest headwind over the coming quarters, inventory correction to be complete by year-end, and we raise our investment outlook, believing there is evidence of a quicker structural improvement in investment from the CHIPS and Inflation Reduction Acts stimuli than we expected. This suggests GDP growth is likely to start 2024 weak but positive. This is consistent with our risk scenario of a desynchronized slowdown, and we no longer forecast recession. We have raised our near-term growth forecast to 1.9% for 2023 and 1.2% for 2024 (consensus 2.0% and 0.9%). However, recession risks have not disappeared. Yield curve inversion, tight credit conditions and the expected labor market loosening all still suggest recession. We see growth risks as two-sided.

Fed retains optionality in dot plot

Headline inflation rose to 3.7% in August from 3.0% in June. July's rise was partly due to adverse base effects, but August's reflected higher gasoline costs. We had forecast headline inflation to remain around 3% over H2 2023 – and much of 2024. With oil now firmer, it looks set to end the year closer to 4%. However, core inflation has softened – to 4.3% from a 6.6% peak 10-months earlier. We expect core disinflation to spread over H2 and into 2024, perhaps more so if gasoline increases impact spending. Inflation expectation surveys have slowed to 1-year (5-10 years) and 2½ year (1-year) lows.

Exhibit 1: Fed revises rate outlook

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



Source: Federal Reserve Bank and AXA IM Research, Sept 2023

The Federal Reserve (Fed) left the Fed Funds Rate (FFR) at 5.25-5.50% in September, in line with our expectations. We believe the Fed has reached its peak rate and will now hope to manage policy restrictiveness via expectations of how long it will leave rates at these levels. However, the Fed has not said this, instead showing a median expectation for one further rate hike this year (Exhibit 1). We believe this retains the optionality of a further rate hike, but not necessarily the desire. However, the Fed also raised its outlook for end-2024 and end-2025 rates by 50bps for each, while those considering a higher long-run FFR also increased. These moves in expectations of term rates have helped drive US Treasury yields higher, with 10-year yields setting a new 16-year high in recent days.

A final consideration is the risk of a government shutdown on 1 October. At the time of writing, the outlook for this is highly uncertain. While moderate Republicans are keen to avoid being blamed for a shutdown ahead of next year's election, an ultra-conservative faction in the House of Representatives is relishing this prospect. This has made House speaker Kevin McCarthy's already weak position trickier and as yet he has been unable to pass a Republican-backed bill to avert a shutdown, let alone something that is likely to meet Senate approval. A government shutdown is estimated to shave 0.2ppt (annualised) from growth for each week it persists.

27 September 2023

Global Macro Monthly – Canada

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BoC reacts to more resilient economy

Resilient activity led the Bank of Canada (BoC) to raise its forecast for 2023 GDP growth to 1.8% in July. We warned this looked excessive and Q2 contracted by 0.2% (annualized) – likely impacted by strikes and devastating wildfires. A Q3 rebound is likely but slower household spending, softer residential investment and an unwind of a favorable Q2 business investment boost should see Q3 fall short of the BoC's 1.5% forecast. Statistics Canada suggested July's output was flat. This likely motivated the BoC's latest assessment that the economy had entered "a period of weaker growth". We have lowered our growth forecasts for 2023 to 1.3% (from 1.6%) and kept 2024's at 0.9% (consensus 1.4% and 0.8%).

Weaker activity has helped slow employment growth to an average 20k/month over the past four months. Unemployment rose to 5.5%, a 19-month high, from the near-historic low of 5.0% in April to 5.5% even as participation eased, suggesting increasing slack. Yet wage growth has re-accelerated after signs of softening into the summer; the 3m annualized rate is now at 4.7%, its fastest pace this year. With weak productivity growth, unit labor costs remain elevated at 5.5% in Q2.

This is troubling for the CPI outlook. Headline inflation rose to 4.0% in August from 3.3% in July – a rise exacerbated by base effects – but also up 0.4% in monthly terms as rising oil prices impacted gasoline. Core inflation measures also rose, the annual median and trim measures rising to 4.1% (up 0.2ppt) and 3.9% (0.3ppt) respectively with the 3m annualized median rate now at 4.4%. We have raised our headline inflation forecast to average 4.2% and 3.0% in 2023 and 2024 (consensus 3.8% and 2.4%).

The BoC faces a trade-off: Balancing signs that policy is restrictive enough to slow economic activity and loosen the labor market but not yet having a clear impact on wage growth, nor core inflation. The BoC "remains concerned about the persistence of underlying inflationary pressures and is prepared to increase the policy interest rate further if needed". However, it also noted the "lagged effects of monetary policy". On balance, with wage, unit labor costs and inflation all picking up again, we now expect the BoC to raise rates one more time to 5.25% in October – a Monetary Policy Report meeting. Beyond that we expect it to keep policy at this restrictive pace until the middle of next year, but then forecast cuts in the second half to 4.75% by end-2024.

Global Macro Monthly – EM

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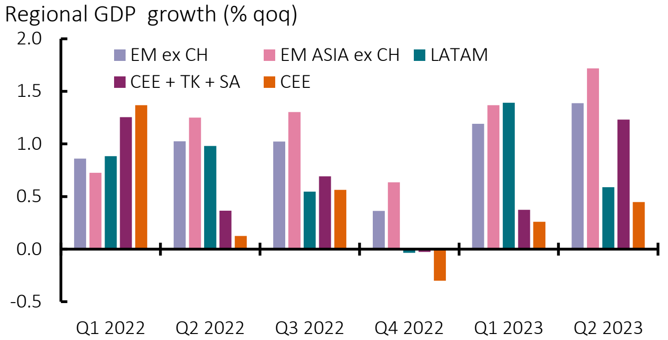
Resilience

Despite multiple challenges – China's slowing economy; the Ukraine war; the subsequent surge in energy and food prices; rising interest rates, and a stronger US dollar – emerging economies have remained surprisingly resilient. In Q2, Brazil once again recorded strong GDP expansion as the services sector kept up the momentum, after a record-high grain harvest in Q1. The services sector also remained a robust support to India's Q2 GDP. Turkey's economy has been stimulated by pre-election spending, and South Africa's by a rebound in private sector investments, while Mexico enjoyed rather broad-based growth momentum. Less positively, in Thailand, election-related uncertainty spilled over into weaker investment. Central Europe has also remained weak overall but with more mixed readings. Latin America was also hurt by GDP contracting in Chile, Colombia, and Peru during Q2. Yet domestic demand in Chile expanded after five consecutive quarters of falls, Peru was hit by heavy rainfalls and Colombia's GDP contraction came after strong Q1 expansion (Exhibit 4).

Exhibit 4: Resilient growth in emerging markets



Source: LSEG, AXA IM, GDP-PPP weighted using Korea, Taiwan, India, Indonesia, Phillippines, Thailand, Malaysia, Brazil, Mexico, Chile, Colombia, Peru, Turkey, South Africa, Poland, Czechia, Hungary, Romania, Q2 2023

Moving towards year-end, we see growth momentum shifting gears between the different regions. We expect softer growth in Latin America as monetary tightening filters through the economy. Meanwhile, private consumption in Central Europe is expected to pick up on the back of improving real disposable income as disinflation progresses. Asian economies will be sensitive to China. All in all, 2023's strong first half leads to mechanical upgrades of full-year 2023 average GDP growth estimates in many emerging market countries and regions.

27 September 2023

Global Macro Monthly – Argentina

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A political shift in Argentina?

Argentina is currently facing several economic challenges - high inflation, balance of payments pressures, and the burden of an ongoing International Monetary Fund (IMF) program. The country is set to hold general elections on 22 October with several candidates vying for the coveted presidential position.

One prominent candidate is Patricia Bullrich, representing the Juntos por el Cambio party, the political faction founded by former President Mauricio Macri. The incumbent government candidate is Sergio Massa, while Javier Milei, a self-described "anarcho-capitalist," has garnered significant attention. Argentina's economic fragility, coupled with its IMF program, means the elections are a critical turning point.

The IMF recently completed its fifth and sixth reviews of Argentina's Extended Fund Facility program, releasing approximately US$7.5bn in disbursements of the $44bn program to support the nation's economy. However, Argentina has faced challenges in meeting targets due to a historic drought and policy setbacks, necessitating waivers of non-observance.

Milei's surprising performance in August's primaries (known locally as PASO), where he secured roughly 30% of the votes, has shaken up the political landscape. Milei's unconventional style, blending libertarian economic views with conservative social stances, has made it difficult to label him definitively. He emphasizes challenging the status quo and has outlined a comprehensive economic plan, including eliminating currency controls, dollarizing the economy, privatizing state-owned enterprises, reducing public spending, and streamlining the government.

Despite Milei's popularity, his policy proposals raise questions about feasibility and their potential economic impact. Furthermore, the elections remain highly uncertain, with Milei currently favored in the first-round vote. His victory could signal a desire among Argentines for a fresh approach to the country's economic woes, but the path forward remains complex, given the country's deep-seated economic challenges. As Argentina approaches its political elections, economic stability, IMF cooperation, and the direction of its future leadership will be key in determining the nation's economic trajectory.

Macro forecast summary

Real GDP growth (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.5		2.9		2.7	
Advanced economies	2.7		1.4		0.8	
US	2.1	2.1	1.9	1.9	1.1	0.6
Euro area	3.6	3.2	0.5	0.6	0.3	0.8
Germany	1.8	1.8	-0.3	-0.3	0.3	0.9
France	2.5	2.5	0.7	0.7	0.3	0.9
Italy	3.7	3.7	0.7	1.0	0.1	0.7
Spain	5.5	5.5	2.2	2.1	0.6	1.4
Japan	1.0	1.0	1.9	1.4	0.9	1.0
UK	4.1	4.1	0.5	0.2	0.2	0.4
Switzerland	2.1	2.1	0.7	0.7	1.0	1.4
Canada	3.4	3.4	1.4	1.5	0.9	0.8
Emerging economies	4.0		3.9		3.8	
Asia	4.4		5.0		4.4	4.0
China	3.0	3.0	5.0	5.3	4.5	4.7
South Korea	2.6	2.6	1.4	1.2	2.4	2.1
Rest of EM Asia	6.3		5.4		4.4	
LatAm	3.9		2.2		2.3	
Brazil	2.9	2.9	2.9	2.2	1.1	1.5
Mexico	3.0	3.0	2.5	2.7	1.9	1.7
EM Europe	0.9		1.3		2.4	
Russia	-2.1		1.5		1.3	1.2
Poland	5.1	4.9	0.0	0.9	3.5	2.7
Turkey	5.6	5.6	2.1	2.6	3.1	2.0
Other EMs	4.8		2.8		3.8	

Source: Datastream, IMF and AXA IM Macro Research – As of 26 September 2023
**Forecast*

CPI Inflation (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	7.4		4.8		2.8	
US	8.0	8.0	4.3	4.1	3.0	2.6
Euro area	8.4	8.5	5.7	5.5	2.9	2.5
China	1.9	2.0	1.0	0.8	2.0	2.0
Japan	2.5	2.5	3.0	3.0	1.5	1.7
UK	9.1	9.1	7.5	7.3	2.8	3.0
Switzerland	2.8	2.8	2.4	2.3	1.5	1.5
Canada	6.8	6.8	4.2	3.6	3.0	2.3

Source: Datastream, IMF and AXA IM Macro Research – As of 26 September 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	Q4-23	Q1-24
United States - Fed	Dates	5.50	31-1 Oct/Nov 12-13 Dec	30-31 Jan 19-20 Mar
	Rates		unch (5.50)	unch (5.50)
Euro area - ECB	Dates	4.00	26 Oct 14 Dec	25 Jan 7 Mar
	Rates		unch (4.00)	unch (4.00)
Japan - BoJ	Dates	-0.10	30-31 Oct 18-19 Dec	22-23 Jan 18-19 Mar
	Rates		unch (-0.10)	unch (-0.10)
UK - BoE	Dates	5.25	2 Nov 14 Dec	1 Feb 21 Mar
	Rates		unch (5.25)	unch (5.25)
Canada - BoC	Dates	5.00	25 Oct 6 Dec	24 Jan 6 Mar
	Rates		0.25 (5.25)	unch (5.25)

Source: AXA IM Macro Research - As of 26 September 2023

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