Investment Managers

Investment Institute Macroeconomics

Policy rules and monetary tools

Monthly Investment Strategy

AXA IM Research

February 2024

Summary: February 2024

Theme of the month: Framing the ECB's rate cutting cycle

- A formal analysis of market expectations through the recent rate tightening cycle suggests that these have been poor predictors of eventual ECB policy, with best results only 2-3 weeks before the meeting. We are cautious of similarly poor performance in future cycles.
- With a combined waning of exogenous inflation shocks and a reining in of fiscal support, we expect the ECB to embark on a rate-cutting cycle this year. We use traditional monetary policy rules (Taylor and Orphanides-Wieland) to frame the outlook for such a cycle.
- Taylor Rules point to deep rate cuts, both in the short-term and over our two-year forecast horizon. OW rules, which academically perform better in short-run forecasts, suggest a more cautious outlook to rate cuts. We interpret the latter as supporting our outlook for a June first cut, while the former present downside risks to our outlook for 125bps by end-2025. Yet both confirm a regime change from the post-Eurozone Debt crisis period.
- Structural changes to the Eurozone economy provide the biggest threat to these assessments, with survey data continuing to suggest negative (if waning) supply-side impacts. This questions the build-up of spare capacity (an output gap) across the Eurozone, a key factor in Taylor rule assessments.
- The adoption of new fiscal rules provides additional uncertainty as new rules may change the balance of monetary-fiscal support in the upcoming cycle.

Macro update: US remains key exception to softer growth

- US growth remained strong in Q4 2023 and despite weaker retail sales growth in January, still suggests firm activity in Q1. We continue to see headwinds to growth and forecast softening, but this is not obvious in most surveys or hard data for now.
- The Eurozone avoided recession with growth flat in Q4 2023. GDP should rise as real disposable income growth picks-up and the latest services surveys have shown improvement. But manufacturing activity has been weak and surveys have weakened further.
- The UK fell into technical recession in Q4. This was as we expected and it should bounce back in Q1 – albeit with growth still around zero; Japan also fell into recession, which we did not expect, with survey evidence suggesting that a pick-up may be delayed until Q2.
- China weakness also continues a theme, with recent stock market weakness echoing concerns. However, concerted fiscal support from last year has seen credit growth accelerate, while recent accelerated monetary easing suggests more pre-emptive policy. New Year travel exceeded pre-COVID levels.
- Emerging markets have shown mixed trends. Despite Chinese weakness, broader Asian economies have seen continued solid growth. However, in Central and Eastern Europe, activity has softened, particularly in manufacturing and construction sectors.
- Despite varying growth trends, inflation continues to broadly ease in most economies. We expect a stickier period to emerge in several economies over the coming quarters, with some upside risks emanating from the continuing conflict in the Middle East.
- We continue to envisage developed central banks easing policy from broadly around mid-year. Our forecasts are unchanged, but market expectations have shifted materially to broadly align views in most instances. Emerging market central banks have largely already started easing policy, but as inflation falls back in line with central bank targets over 2024, this should allow further easing to continue.

Central scenario

Summary – Key messages

Our central scenario: Global economy to slow, bank concerns non-systemic.

Global growth expected to slow to 2.9% in 2024 and 3.1% in 2024.

Disinflation slower this year, spreading to core. Creates space for monetary policy easing, market expectations now aligned with our views.

Inflation

Headline disinflation likely to pause, with geo-politics providing some upside risks. Core disinflation to broaden this year. Target rates more likely next.

Monetary policy

Central banks now peaked, most to cut this year, developed central banks likely from mid-year. Balance sheet policy from Fed and ECB to come to fore around mid-year.

Fiscal policy

European rules require fiscal consolidation, but not too sharply for 2024. US Congressional politics delays further funding requests, long-term outlook in question.

Emerging Markets

Inflation easing across EM, and several central banks underway with easing cycle

FX

Dollar recovered on rates repricing, US fundamentals remain firm for now. BoJ action still needed to spur yen. Watch risk currencies in event of geopolitical escalation.

Rates

Policy rate re-pricing has driven term rates higher. Actual cuts should see yields lower by year-end, but structural drivers underpin key regions, making a return to post-GFC levels unlikely

Growth

Growth resilient in US, expected to slow but avoid recession. Eurozone avoids technical recession; UK and Japan do not. China hits target but risks remain.

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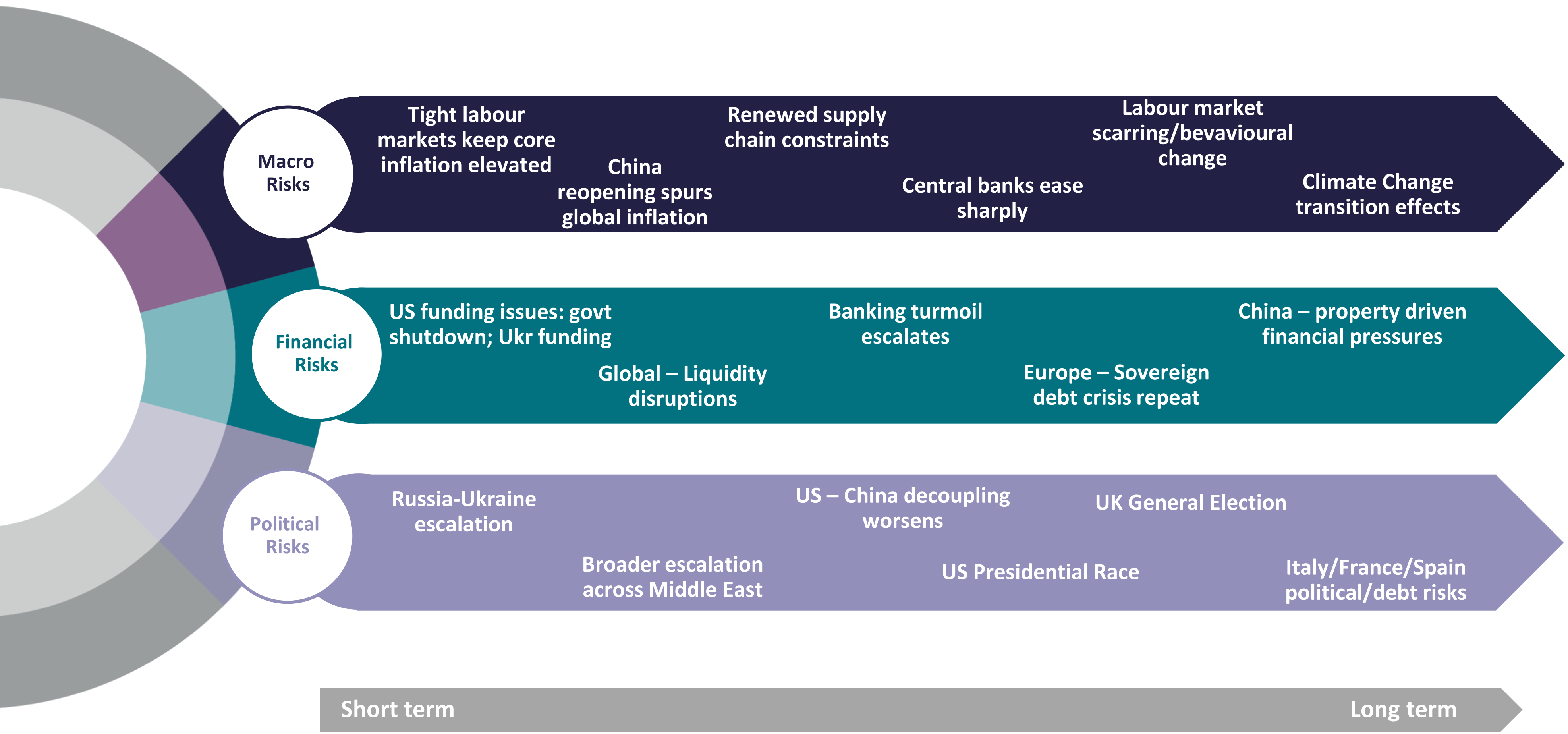
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 25%	**A global boost** Probability 15%
What could be different?	- Banking turmoil escalates, credit conditions tighten. - Escalation in Ukraine conflict or Middle East tensions - Post-pandemic structural adjustment persists. Supply shocks persist - Inflation expectations rise, affecting wages and persistence	- Geo-political tensions ease – peace in our time. - Labour market participation recovers, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments
What it means	- Growth weaker, employment could start to fall, but inflation remains elevated - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
Market implications	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	- Risk-on environment, equities make further gains, growth retains lead over value - UST softens, EUR strengthens - Spreads grind tighter

RISk Radar

Summary – Key messages



Contents

Theme of the Month

Investment Managers

Framing the ECB's rate cutting cycle

Taking stock of market expectations

Market expectation have been poor predictors

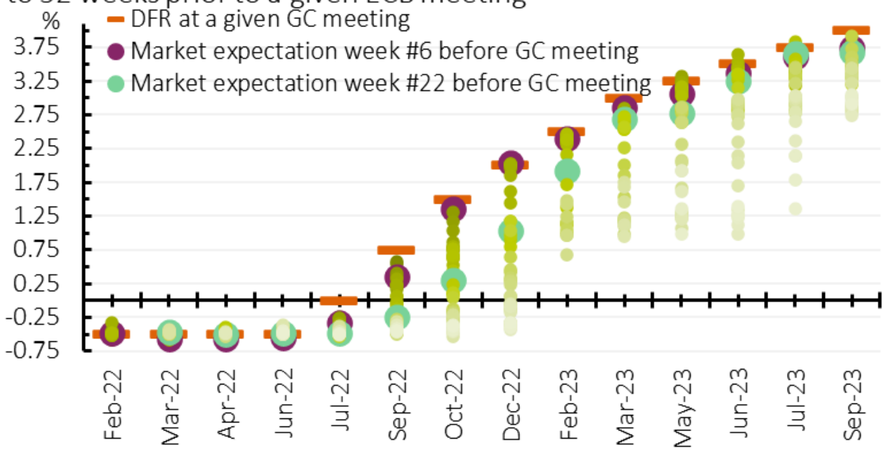
- Market expectations have been poor predictors, consistently undershooting ECB rate decisions throughout the past hiking cycle
- The reduced standard deviation in the forecast error of an ECB decision from an early peak suggests a mutual learning process. We contend that ahead of any formal communication of the cutting cycle, market expectations contain little valid information.

Reliable pricing comes only two to three weeks prior to the meeting

- Unsurprisingly, the closer to a rate decision on average, the better the forecast. This suggests the market is incorporating the most recent economic and financial data, as well as ECB communication. However, the best forecasts have come only between the second and third week prior to the meeting. This emphasises that market pricing any earlier has not been a reliable guide to what the ECB will actually do and should be taken with great caution

Market rate expectations persistently undershoot

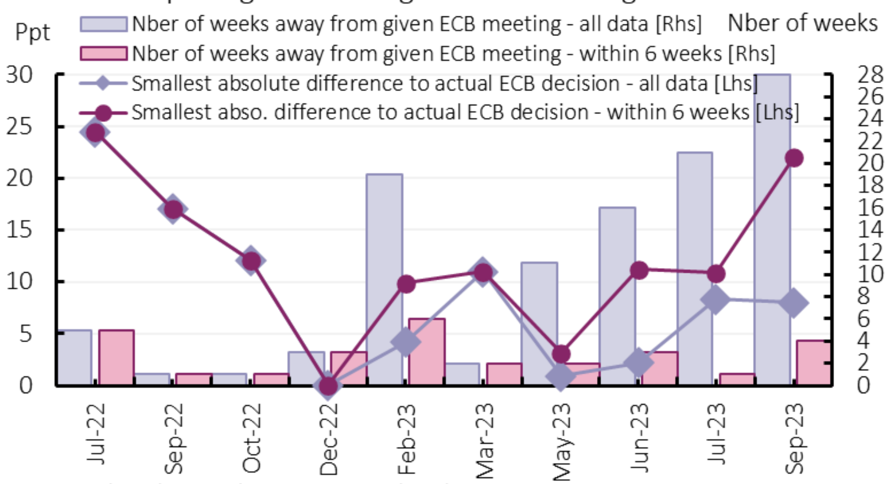
ECB rate decision and market expectation vintages up to 52 weeks prior to a given ECB meeting



Source: Bloomberg and AXA IM Research, February 2024

Expectations only a good guide close to meetings

Best market pricing ahead of a given ECB meeting



Source: Bloomberg and AXA IM Research, February 2024

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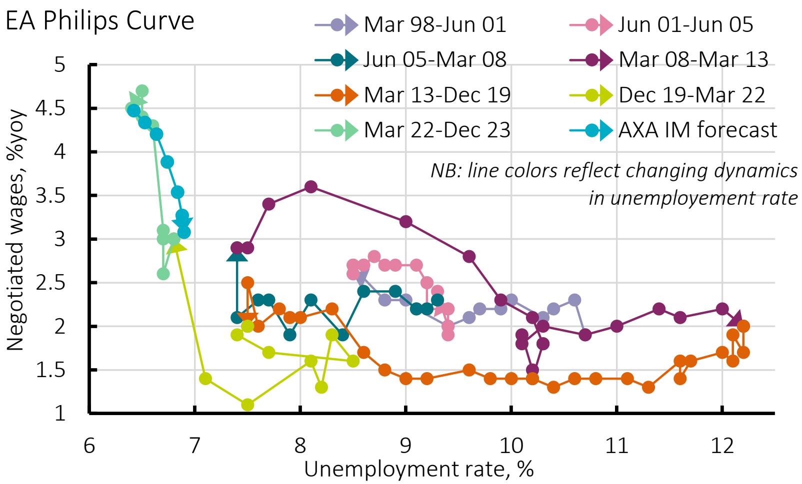
Framing the ECB's rate cutting cycle

Towards more normal policy times

Waning sources of the shock

- Industrial producer prices are in deflation. What is more, manufacturing producer prices (excluding energy) have been in slight deflationary territory on a three-month rolling basis on average since May 2023
- Tight labour markets are seemingly generating little endogenous wage pressures, suggesting a steep(er) Phillips curve – the inverse relationship between inflation and unemployment – with wage growth at historically high levels mainly responding to the inflation shock rather than to labour market tightness, at least so far
- Fiscal policy played a crucial role in absorbing the COVID-19 and inflation shocks. It is also set to normalise, with two caveats, that fiscal support will not be withdrawn at full speed and the removal of fiscal support can generate transitorily higher inflation

Waning inflation and mild labour market loosening consistent with (fast) wage growth deceleration



Source: ECB, Euronext and AXA IM Research, February 2024

France: withdrawing fiscal support, albeit slowly

France fiscal support measures					
In % of GDP	2020	2021	2022	2023	2024
Measures to support the economy during COVID - Maastricht accounting	2.5	2.2	0.5	0.1	0.0
Recovery plan net of EU financing - national accounting	0.1	0.3	0.3	0.2	0.1
Measures to fight inflation shock	-	0.2	1.6	1.3	0.5

Source: Rapport économique, social et financier 2024 de la Direction générale du Trésor français and AXA IM Research, October 2023

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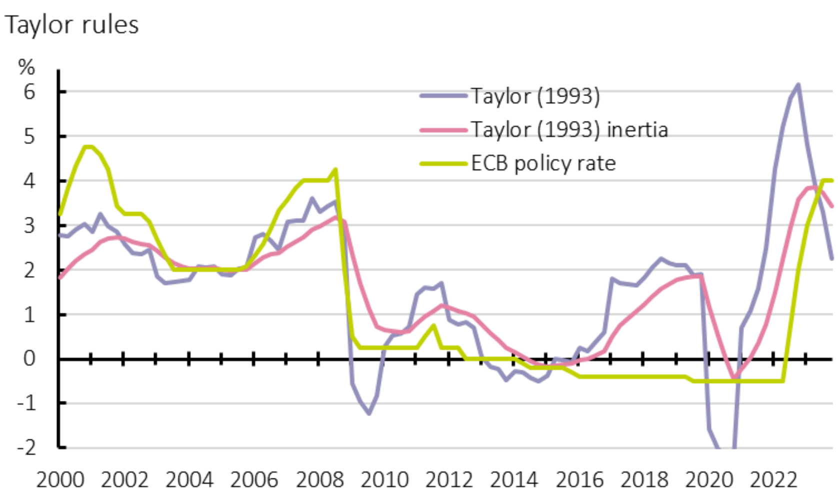
Framing the ECB's rate cutting cycle

Playing by the rules?

Backtesting monetary policy rules

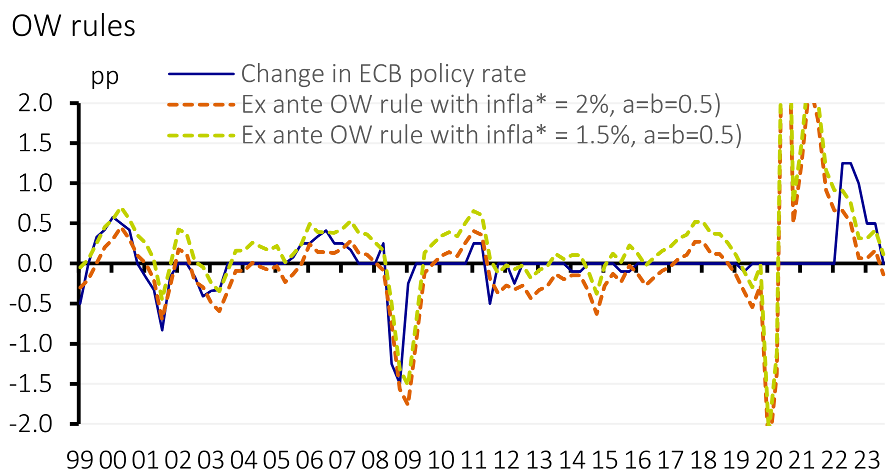
- During the most recent monetary policy tightening, both the Taylor and Orphanides-Wieland (OW) rules suggest the ECB should have started tightening earlier – in 2021 rather than 2022
- The Taylor rule suggests that the ECB has now caught up with prescribed levels of interest rates
- Academic studies have shown that the OW rule has performed better in very short-term forecasts, while the Taylor measure tends to work better over a one-to-two-year horizon

Backtesting the Taylor Rule(s)



Source: Refinitv and AXA IM Research, February 2024

...and the Orphanides-Wieland rules



Source: Refinitiv, AXA IM Research, February 2024

Framing the ECB's rate cutting cycle

Playing by the rules – the results

Policy rule specifications and assumptions provide wildly different outcomes

- Focusing on the short-term outlook, policy rules suggest some upside to our – and market's – baseline forecast of a 25bp rate cut in June
- The Taylor rule argues in favour of an aggressive rate cutting cycle. This is driven by a rapidly increasing negative output gap However, the significant uncertainty around the scale of large (negative) supply shocks makes us cautious of this assessment. Thus, we cautiously acknowledge the indication of possible downside risks to our baseline of 125bp worth of cuts until end-2025
- Even with the aggressively lower projections of the Taylor rules, these are consistent with nominal rates remaining firmly anchored in positive territory, in turn confirming a regime shift from the Eurozone sovereign debt crisis
- We find it difficult to draw definite and clear conclusions from such simple policy rules. The ECB is likely to maintain a more holistic approach encompassing more theoretically robust models as well as risk management perspectives

Results from multiple policy rate rules

Eurozone multiple policy rate rules				
In percentage points	Dec 23 - June 24	Dec 23 - Dec 24	Dec 23 - Jun 25	Dec 23 - Dec 25
Taylor (1993)	-193	-220	-260	-281
Taylor (1993) inertia	-69	-123	-169	-208
Taylor (1993) inertia, fwd	-90	-158	-202	-230
OW fwd	-13	-30	-30	-30
Estimated OW fwd	7	-2	-2	-2
Estimated OW, fwd asym	7	-5	-5	-5
Estimated OW, fwd credibility loss	20	13	14	15

Source: AXA IM Research, February 2024

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Framing the ECB's rate cutting cycle

Broader caveats

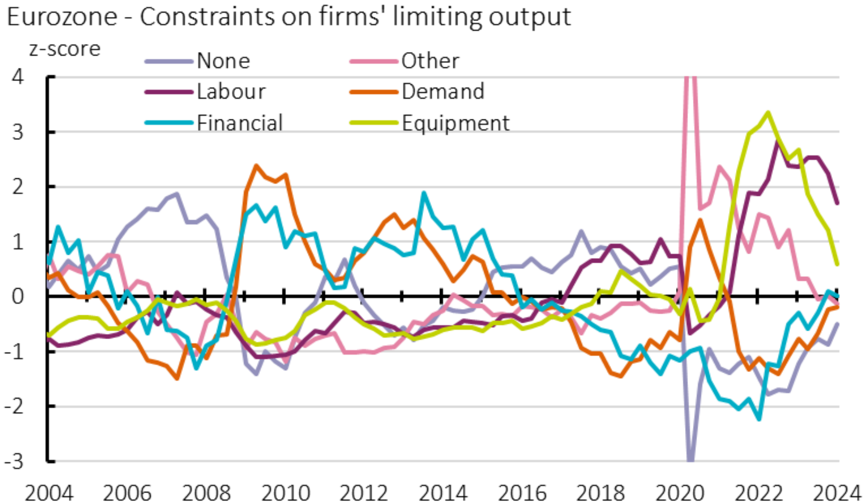
Maintain focus on supply side developments

- The Eurozone is facing multiple supply transition challenges. The EC's quarterly survey on constraints faced by companies in limiting their output shows demand issues are on the rise, but supply factors, though receding, continue to constitute meaningful constraints across all sectors. These add to our doubts of an increasingly negative output gap implied in our Taylor rule calculations
- A tight labour market also questions the size of the output gap. If the output gap was more consistent with the expected outlook for unemployment, it would reduce the Taylor rule suggested cuts by around 50bp by the end of our forecast horizon

New fiscal rules could alter policy balance

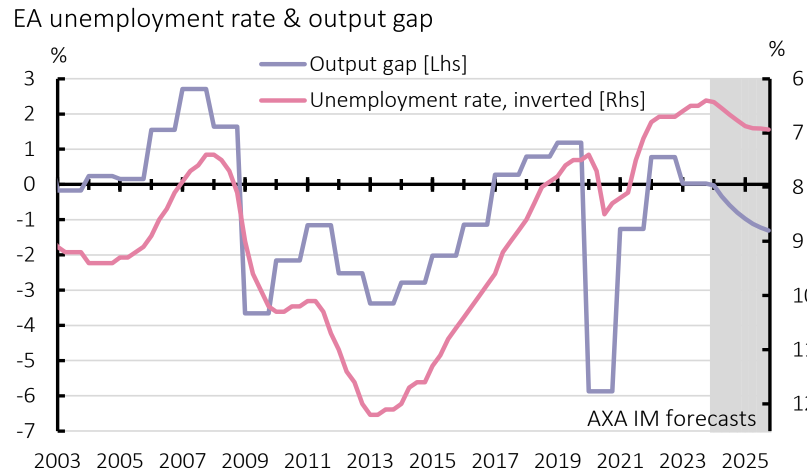
- Fiscal policy should be closely monitored since it is one of the key tools to address the aforementioned supply issues
- The new fiscal framework gives governments more leeway to lean against the business cycle. But we are yet to be convinced about any improved enforceability of these rules, which makes us doubt that countries' economic policies will respect the new guidelines

Supply factors by no means have disappeared



Source: European Council and AXA IM Research, February 2024

Unemployment rate suggests less slack than output gap



Source: Eurostat, European Council and AXA IM Research, February 2024

Source: Eurostat, EC, AXA IM Research, February 2024

Macro outlook

Watching for a slowdown

US

First signs of growth softening ?

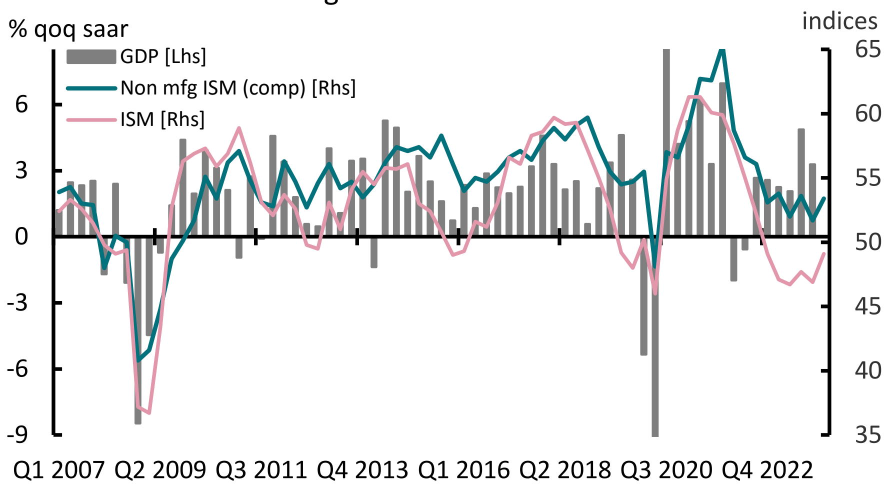
- US Q4 GDP came in at a strong 3.3% (annualised) following Q3's 4.9%. Such a pace defied a range of surveys. However, the latest retail sales report recorded sales starting the year in more subdued fashion (headline -0.8% m/m). This in turn slowed the Atlanta GDP now tracker, but which still forecasts Q1 GDP growth of 2.9%.

Longer-term headwinds should be impacting

- Slower income growth, a rising tax contribution and an increasing saving rate should all slow consumer growth over the coming quarters. The impact of policy tightening should also be increasingly evident, albeit there is some suggestion that this is not impacting corporate interest costs as expected. However, strong labour supply growth, rising productivity growth and plausibly a higher neutral rate might in part explain current growth resilience. We raise our quarterly profile slightly for 2024, but soften 2025. The sharply stronger close to 2023 also helps lift our GDP outlook for 2024 to 2.0% (from 1.4%), we lower 2025 to 1.5% (from 1.6%)

Survey evidence points to softer activity

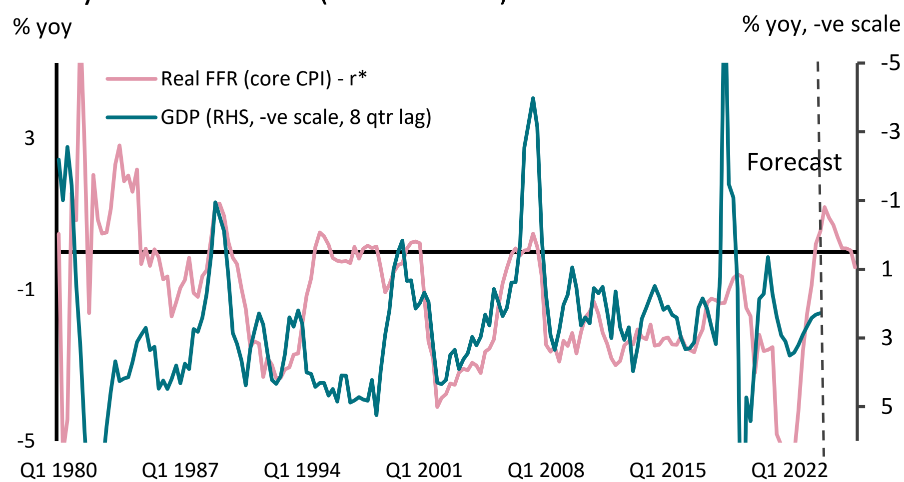
US ISM indices and GDP growth



Source: BEA, ISM, AXA IM Research, Feb 2024

Policy headwinds not yet slowing growth

Policy restrictiveness (real FFR - r*) and GDP



Source: BEA, BLS, FRB, AXA IM Research, Feb 2024

Adjusting Fed outlook

US

Falling inflation despite strong GDP should allow faster easing

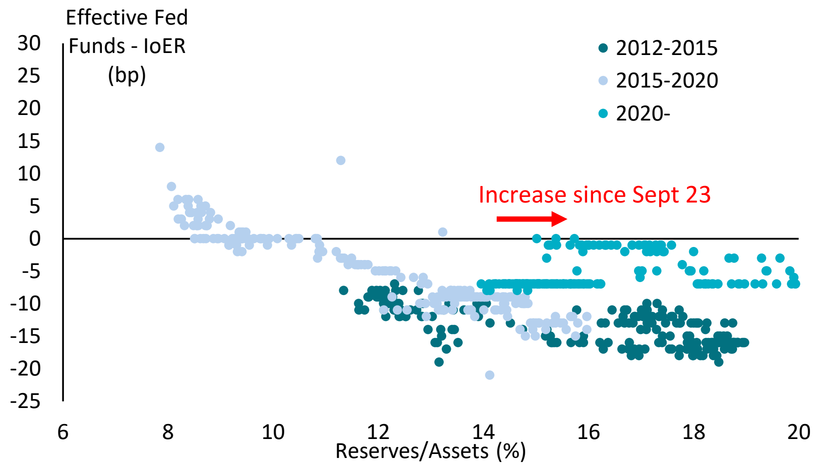
- CPI inflation fell to 3.1% in January (core 3.9%), despite strong growth in H2 2023. We see stickier disinflation over coming quarters and particularly watch services inflation. However, we continue to expect the Fed to cut rates from June and now see the FFR at 4.50% by year-end and 3.75% by end-2025 as supply improvement has reduced the need for more persistent restrictive policy. We also expect some balance sheet policy adjustment from mid-year. The Fed will gauge short-term rate spreads to fine-tune policy.

Increased focus on November's election

- Former President Trump continues to dominate primaries and looks well on track for the Republican nomination. President Biden appears weakened by a series of gaffes and a politically charged DoJ report referring to his "poor memory". This has added to a Democrat polling deficit. Polls remain flaky this far out and Biden should benefit from an improved economic outlook on our outlook. But markets are increasingly beginning to consider the implications of November's elections.

Fed to monitor price of reserves to gauge QT

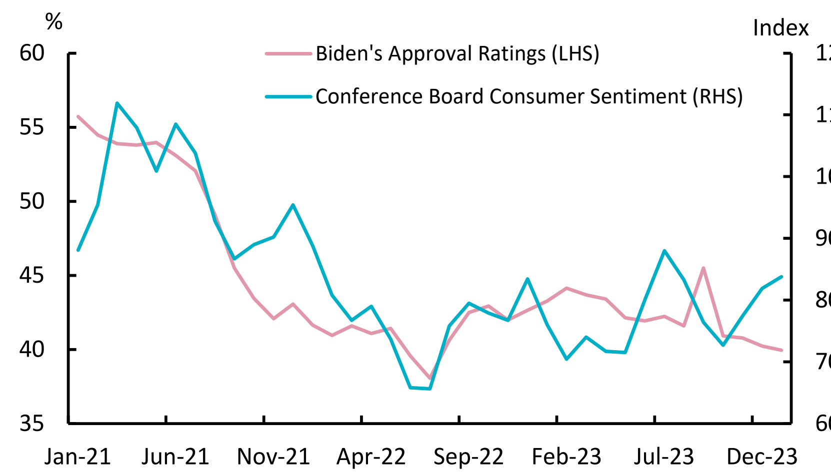
Reserves demand



Source: Bloomberg, FRB, AXA IM Research, Feb 2024

Biden should benefit from rising consumer confidence

Biden's approval ratings & consumer sentiment



Source: Conference Board, Real Clear Politics, Feb 2024

Lack of activity momentum to continue

Euro area

No GDP growth, but rising employment

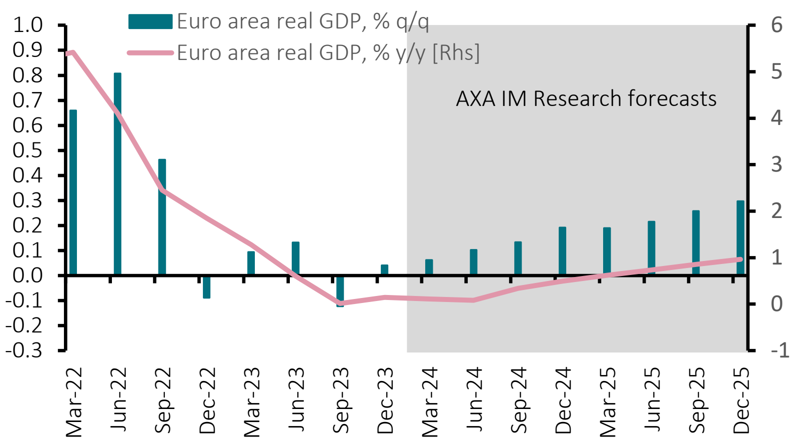
- Preliminary estimates released by Eurostat showed GDP flat in Q4 (0.0% qoq). Economic dynamism is substantially better in Spain (+0.6% qoq), slightly better in Italy (+0.2%), neutral in France (0%) and stays weak in Germany (-0.3%).
- More surprisingly, employment continues to resist economic headwinds and posted a rise of +0.3% qoq. This means productivity growth has declined again. We still expect a recovery in productivity over the coming quarters as employment should stabilize at a high level while economic activity should gradually pick up.

High frequency data do not point to any material improvement yet

- We see only tentative signs of rebound in the manufacturing sector since the beginning of the year (German truck-tolls in +2.3% m/m in January), but German industrial output has not risen since April and the preliminary February manufacturing PMI dropped to 42.3 (down 3.2pt), (wider Eurozone to 46.1 (-0.5p)). Services surveys have improved somewhat.

Meagre GDP growth to continue

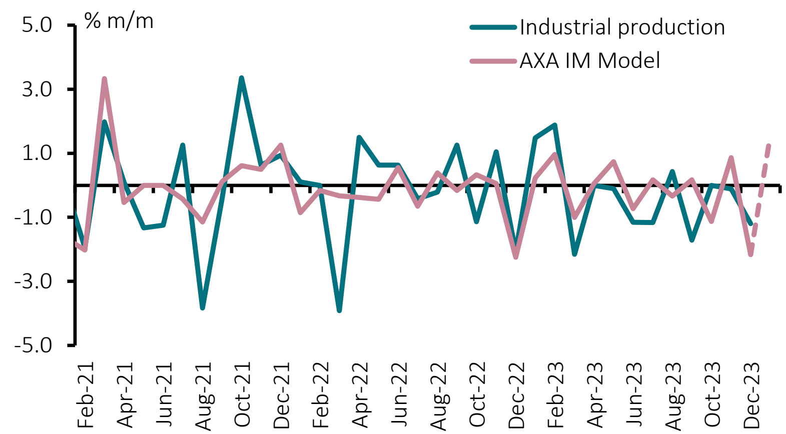
Euro area GDP growth



Source: Eurostat, AXA IM Research, Feb 2024

German truck toll signal improvement yet to be seen in wider data

Germany : Industrial production



Source: Destatis, Bundesbank, AXA IM Research, Feb 2024

ECB: a little more patience

Euro area

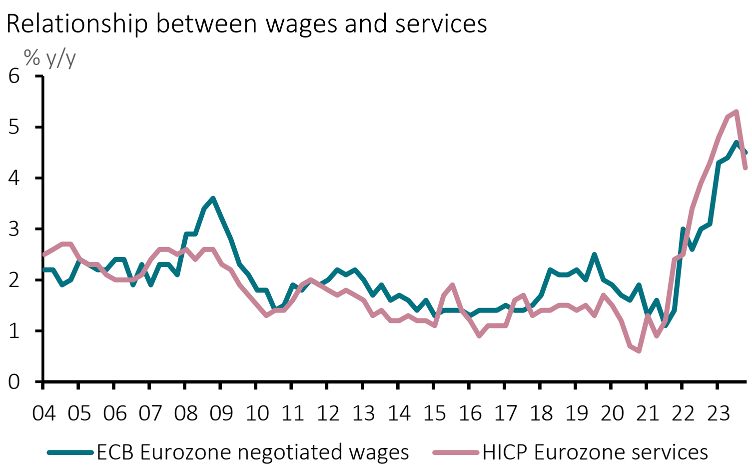
Sticky patch expected for disinflation

- Inflation is easing with the annual headline falling to 2.8% in January. Due to the risks surrounding this print (high turnover in prices, some tax rebates ended, HICP weights changes), it is quite reassuring. Looking into the major inflation components, services prices remain sticky at 4% (for three months in a row). Services inflation should ease in the coming months, but will likely be gradual, giving inertia to further declines in the headline rate.
- On wages, the ECB negotiated data for Q4 came at 4.5% yoy, declining by 0.2pp from Q3. As expected, negotiated wages are gradually easing but remain firm. High frequency data, such as the Indeed Wages tracker, point to a smaller rebound in wages in January at the euro area level (4.1%; +0.2ppt from December 2023).

Inflation and wages in line with ECB expectations

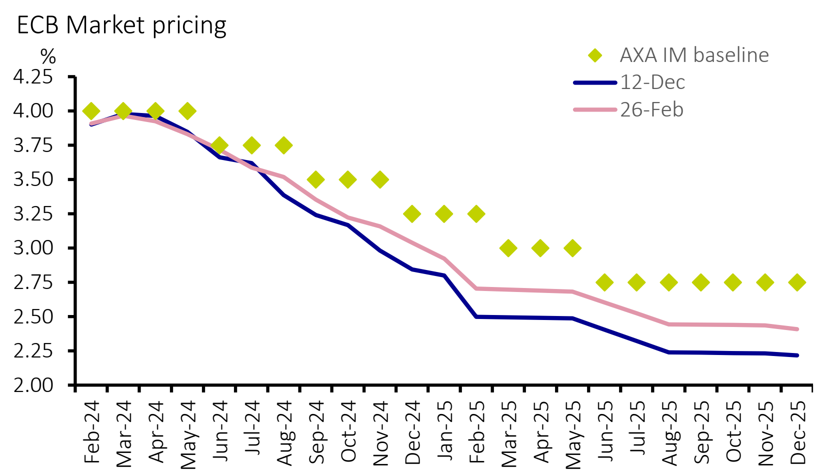
- Accordingly, recent speeches have not materially changed. The ECB remains concerned by elevated wages and sticky services inflation. Data remain key for future decisions. We continue to believe the ECB will wait until June to begin a rate cutting cycle (3 in total in 2024, 2 in 2025). Risks are skewed to an earlier cut (April) owing to persistent disappointment on the growth front.

The ECB needs to see services inflation easing further



Source: ECB, Eurostat, AXA IM Research, as of Feb 2024

ECB market rate cut pricing has significantly eased



Source: Bloomberg, AXA IM Research, as 26 of Feb 2024

Economy contracts in H2 2023

UK

Back in (mild) recession

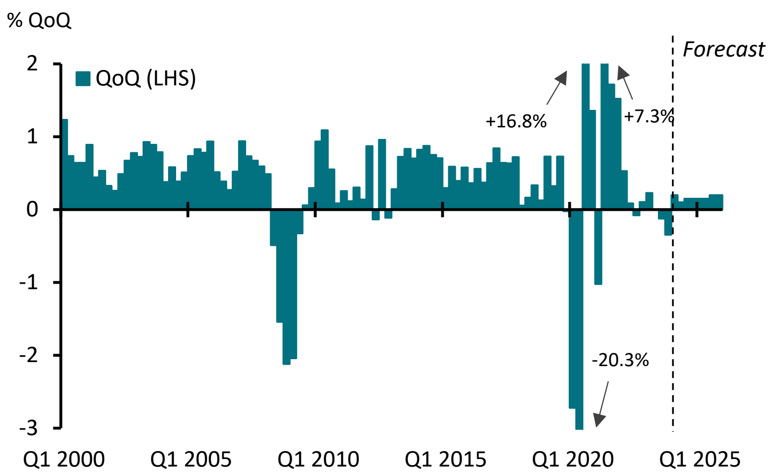
- Q4 GDP fell by a sharper than expected 0.3%, not helped by a 2.9% plunge in exports. Following the 0.1% Q3 contraction, the economy was in recession for the first time since the pandemic and before that the GFC. That said, there is evidence of an improvement for 2024: manufacturing has risen by 0.8% m/m in both of the last two months of 2023, the services PMI is rising, RICS suggests an improving housing market and consumer sentiment is rising. We raise our outlook for Q1 growth to 0.2% and leave our forecasts unchanged for 2024 and 2025 at 0.2% and 0.6% (consensus 0.4% and 1.2%)

Unemployment suggests tighter labour market

- The latest labour market figures show a 0.5ppt point drop in unemployment in the last five months to 3.8% in December. This is the sharpest 5m fall in unemployment in nearly a decade and occurred during a recession. Admittedly falling activity rates explain some of this anomaly. However, we have our doubts about these official statistics that suggest a tightening labour market.

Back in (mild) recession

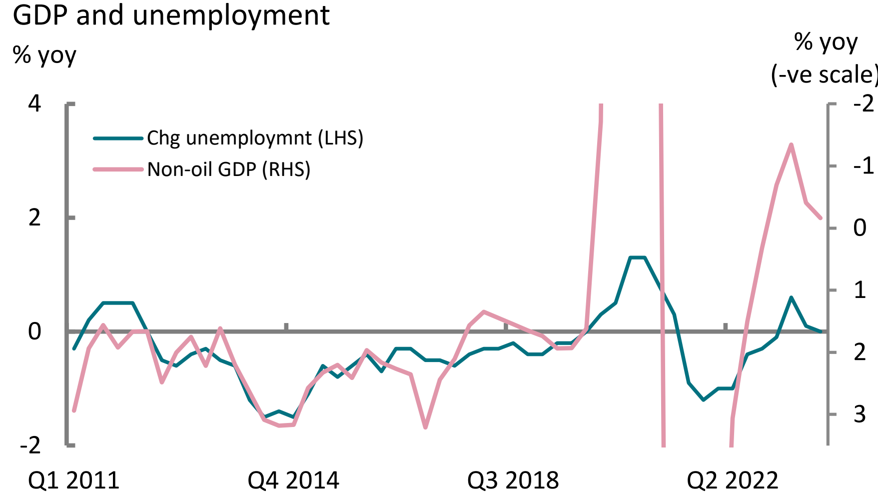
GDP growth forecasts



Source: National Statistics, AXA IM Research, February 2024

Growth suggests a marked worsening in unemployment

GDP and unemployment



Source: National statistics, AXA IM Research, February 2024

Focusing on easier policy

UK

Evidence of a looser labour market

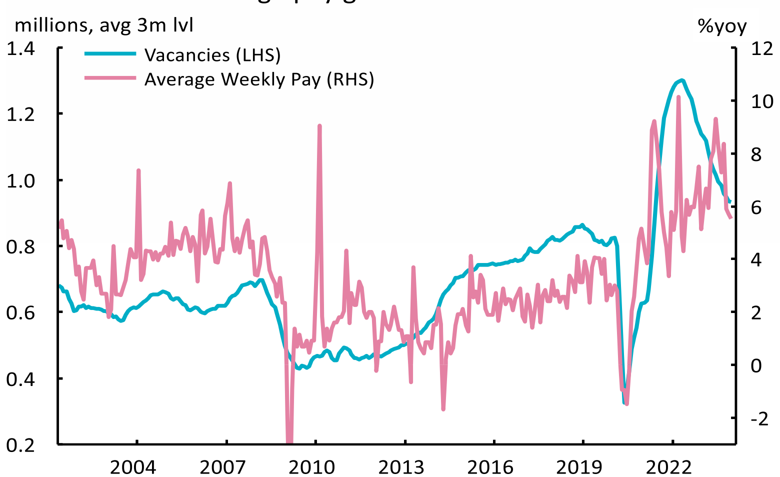
- If the unemployment rate suggests a tighter labour market, other indicators point more conclusively to loosening. Vacancies have fallen back sharply from their pandemic peak. Historically drops in vacancies have coincided with deceleration in pay growth. This has not been as obvious in the current phase, but pay growth has slowed materially recently (albeit revised higher in November) and we expect further deceleration to come. Inflation remained at 4.0% in January (5.1% core).

BoE shifts cut considerations to when not if

- The Bank of England was split 3 ways over its decision to leave policy unchanged at 5.25% in February. The MPC stated that most considered it a case of when rates will be cut, not if. With growth expected to accelerate in Q1, we expect the MPC to want to see the March Budget and spring wage negotiations before easing. It will have both by June, but we expect it to present a cut in the context of August's economic projections. A June cut is a risk. We forecast Bank Rate at 4.50% end-2024 and 3.75% mid-2025.

Broader labour market measures suggest loosening

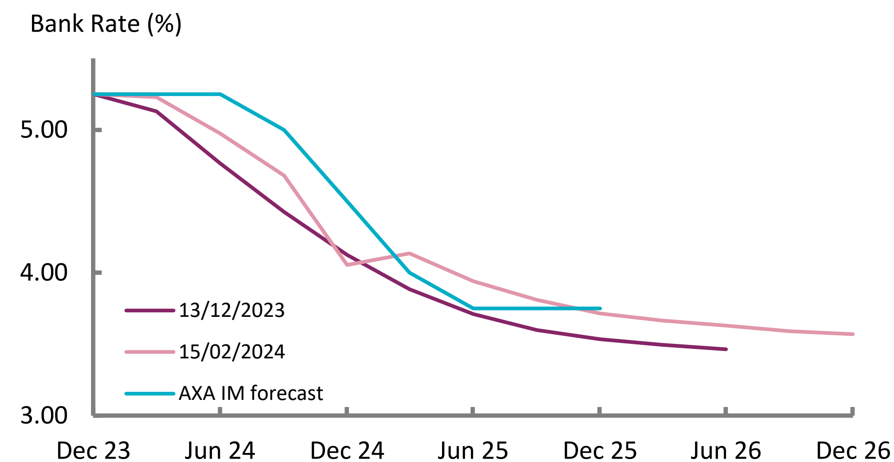
Vacancies and average pay growth



Source: LSEG Datastream , AXA IM Research, 15/02/2024

Markets reconsider BoE's scope for rate cuts

Bank Rate expectations, market pricing (SONIA)



Source: Bloomberg, AXA IM Research, February 2024

Stock market underperformed while New Year traffic exceeded pre-pandemic era

China

Stock market under spotlight before Lunar New Year

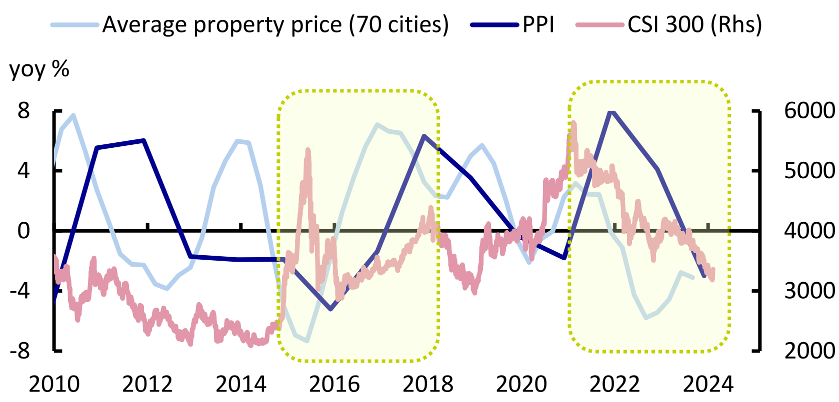
- The blue-chip index CSI 300 reached a five-year low ahead of the Lunar New Year holiday break despite rescue efforts by the authorities, reflecting entrenched pessimism about China's economic outlook.
- Drawing parallels with the 2015 stock market turbulence, equities then stabilised after the property downturn and persistent producer price index (PPI) deflation had ended, suggesting that rescue efforts now could prove challenging and protracted.

Holiday traffic exceeded pre-pandemic era

- Ahead of the new year of the Dragon holiday, railway passenger traffic saw flow came back to 2020 level, before the country went into a strict lockdown. Post new year's day travel, mainly represented by leisure holiday travel, reached its highest level in the past 5 years. We await data releases to see how much of this travel was translated into stronger consumer spending and any restoration in confidence.

Déjà vu in China's stock market

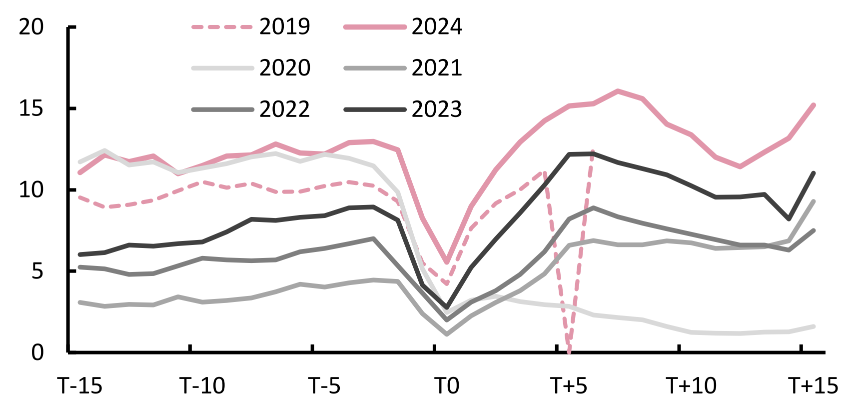
Stock market index, property price and producer price index



Source: CEIC, BIS, AXA IM Research, Feb 2024

Railway traffic exceeds pre-pandemic level

Railway passenger traffic 15 days before and after LNY
Person- time mn



Source: CEIC, AXA IM Research, Feb 2024

Prices stay while policy accommodation grows

China

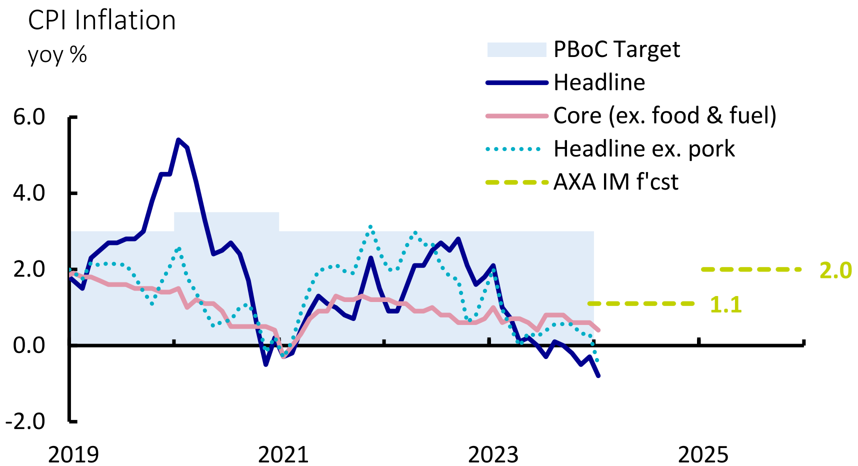
Prices continued softness into new year

- Although featuring stronger seasonality at this time of year, the January headline CPI still appeared 0.2 percentage points lower than the five-year average of monthly gains prior to a Lunar New Year. High-frequency data indicate suggest some pickup in February on the back of more favourable base effects. However, more meaningful price recovery is needed.

Credit responds to policy support, Beijing turns proactive after holiday break

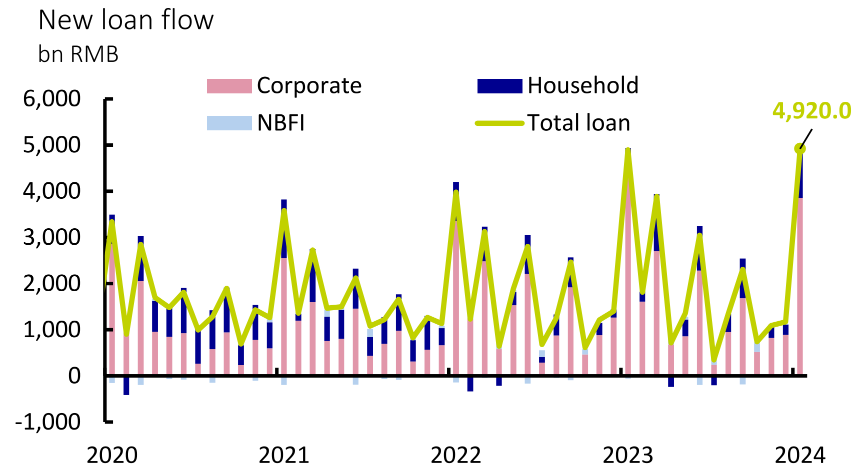
- Credit demand in January exceeded expectations, with a record-high total social financing flow and the largest net issuance of corporate bonds in nearly two years. This is seen as a reflection of recent policy measures, namely the RMB 1trn more fiscal deficit and RMB 500bn net injection through Pledged Supplementary Lending.
- The PBoC surprised the market on 20 February with its largest ever 5-year LPR cut of 25bps to 3.95% (1-year LPR was left unchanged at 3.45%). The real impact of this cut will take time to materialise, but it will help boost sentiment and stabilise the stock market ahead of the National People's Congress in March.

Seasonality dragged down already soft prices



Source: CEIC, AXA IM Research, Feb 2024

Credit gained momentum ahead of Lunar New Year



Source: CEIC, AXA IM Research, Feb 2024

GDP: a fallen hope

Japan

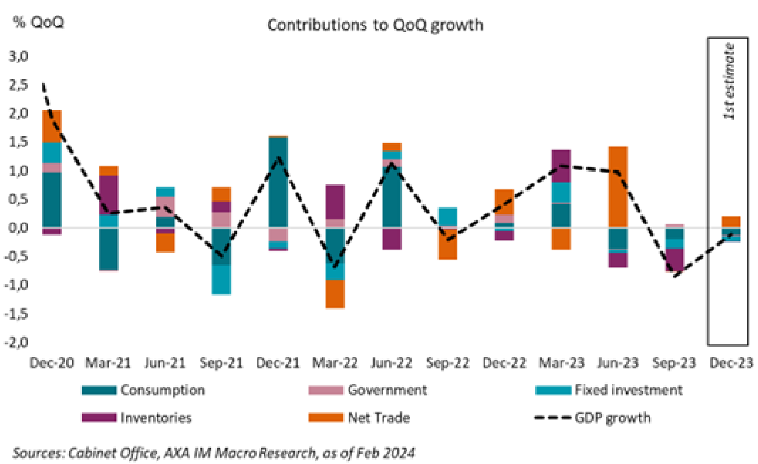
GDP surprised again on the downside

- The Japanese economy is still in the doldrums, highlighted by another fall in GDP growth during the fourth quarter (-0.1% on he quarter, after -0.8% in Q3). Almost all components were in negative territories. Private consumption came at -0.2%, the third successive decline. Investment was also weak, from housing (-1%), capex and public investment (-0.2%). Net exports have been positive, but were supported by a strong one-off gain from intellectual property which should reverse in Q1.

Wait for second quarter for a proper rebound

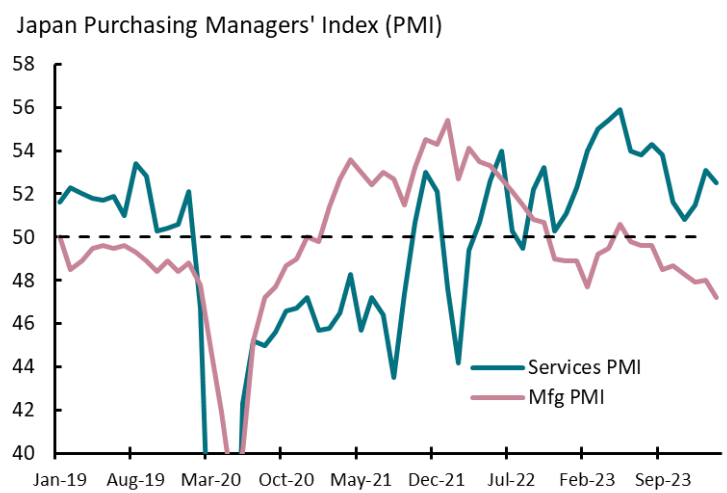
- Economic activity appears to remain weak in Q1, as highlighted by February flash PMIs for both manufacturing and services sectors, reaching respectively 47.2 (-0.8p) and 52.5 (-0.6p). We now only expect a pick-up in economic activity from Q2 when households will benefit from gains in real purchasing power.

Private consumption declines for third quarters in a row



Source: Bank of Japan, AXA IM Research, February 2024

A continuing divergence between services sector and manufacturing



Source: Bloomberg, AXA IM Research, February 2024

Bank of Japan seems ready to push the button

Japan

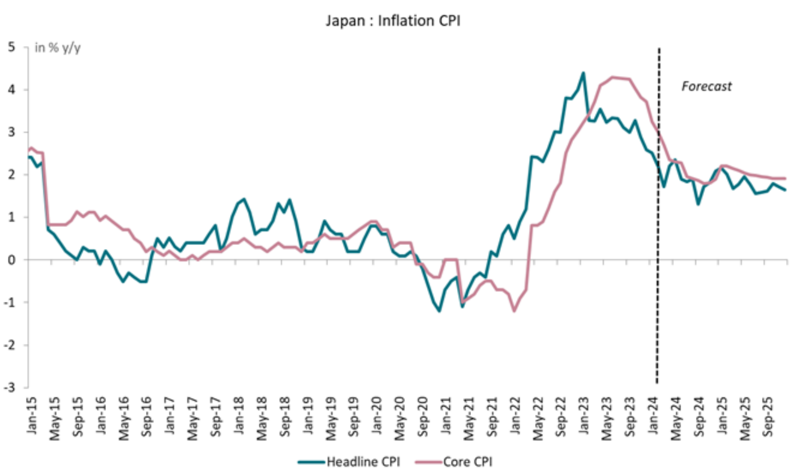
Inflation continues to fall but should stabilize in coming months

- Leading Tokyo CPI inflation fell again to 1.6% yoy (-0.8 point from December). But such deceleration may not occur again soon. We expect some stabilization around these level over the coming months as several energy subsides likely come to an end, probably from around the new fiscal year (April) and wage negotiations prove more generous than usual this year, which should boost private consumption

Bank of Japan Governor sticks to January communication

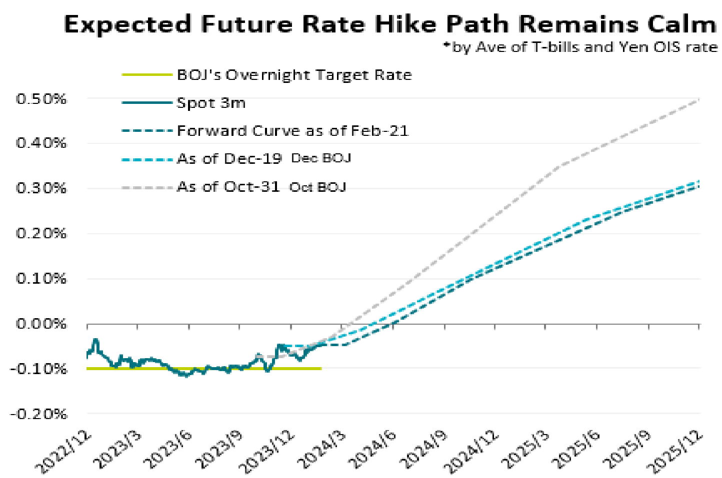
- Despite weak growth, Governor Ueda stated he kept faith in future purchasing power gains and a virtuous cycle in inflation.
- Three weeks ago, Deputy Governor Uchida, a slightly dovish member, also stated that "*even if the Bank were to terminate the negative interest rate policy, it is hard to imagine a path in which it would then keep raising the interest rate rapidly*".
- We read those statements as the BoJ endorsing a small hike, most likely in April (+10 bps). Next move may wait Q4 2024 (+10bps).

A last fall in inflation before stabilising



Source: Ministry of Internal Affairs & Communication, Japan, AXA IM Macro Research, as of Feb 2024

First rate hike fully-priced for April (+10 bps)



Source: Bloomberg, AXA IM Tokyo FI team, as of February 2024

Activity to stagnate before rebound into 2025

Canada

Growth hovers around zero

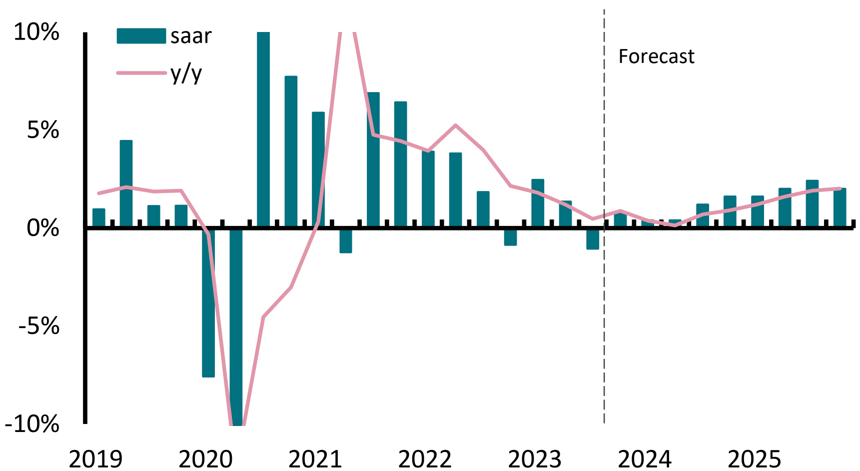
- Q3 GDP growth surprised to the downside (-1.1% annualised). However, monthly data suggests Q4 GDP could make up the difference (we forecast +0.8%) to deliver 2023 growth at 1.1% overall.

Activity to rise later in year

- For 2024, we are wary of the lagged policy transmission effect of previous BoC tightening. However, strong tailwinds from a robust H2 2023 from the US and a modestly firmer outlook should support Canadian growth. We also note a number of domestic indicators have posted improvement since Q4. We forecast two weak quarters of growth in H1, 0.5% (annualised) in each, before expecting a gradual reacceleration. Canada's commitment to strong, inward migration is also set to be a tailwind to growth. We forecast GDP growth of 0.5% in 2024 and 1.7% in 2025 (consensus 0.5% and 1.7%).

GDP likely bounces around stall speed before late-year pick-up

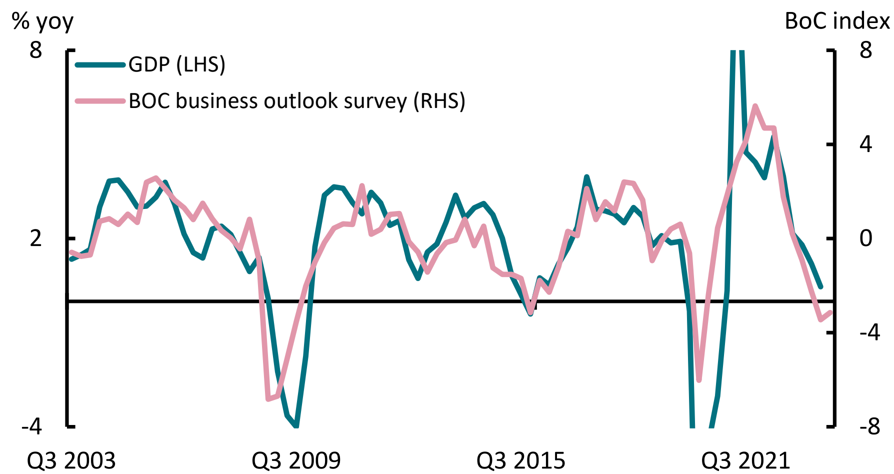
GDP Growth and outlook



Source: CANISM, AXA IM Research, Feb 2024

Business survey hints at stabilisation

GDP and business survey



Source: CANISM, BoC, AXA IM Research, Feb 2024

Domestic inflation pressures constrain BoC easing

Canada

Recent trends suggest inflation persistence

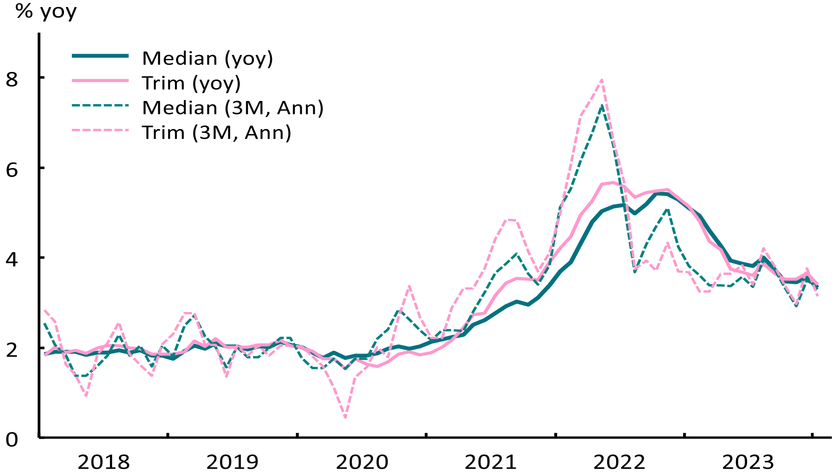
- Headline inflation has eased and January recorded inflation at 2.9% - the lowest recorded since June, but persistently since March 2021. However, core measures of inflation have remained stuck around 3.5%. This stickiness suggests some risk of inflation persistence, particularly as services components are increasingly recording growth in excess 3%. We forecast further disinflation this year, but with a forecast average of 2.9% in 2024 and 2.3% in 2025, this remains above consensus for 2.5% and 2.1% .

Inflation concerns see BoC slower to cut

- We continue to expect weak activity and rising spare capacity to be consistent with BoC rate cuts this year. However, with inflation risks rising, core inflation elevated and domestic inflation pressures high, the BoC looks set to hold current restrictive levels for some time. Markets see a 75% chance of a first cut in June. Our own view remains for July, while we acknowledge risks of June. Fed timing will be important. Once the BoC starts, we think it will ease substantially and forecast rates at 4.25% by year-end and 3.50% by mid-2025.

Recent trends in core inflation suggest persistence threat

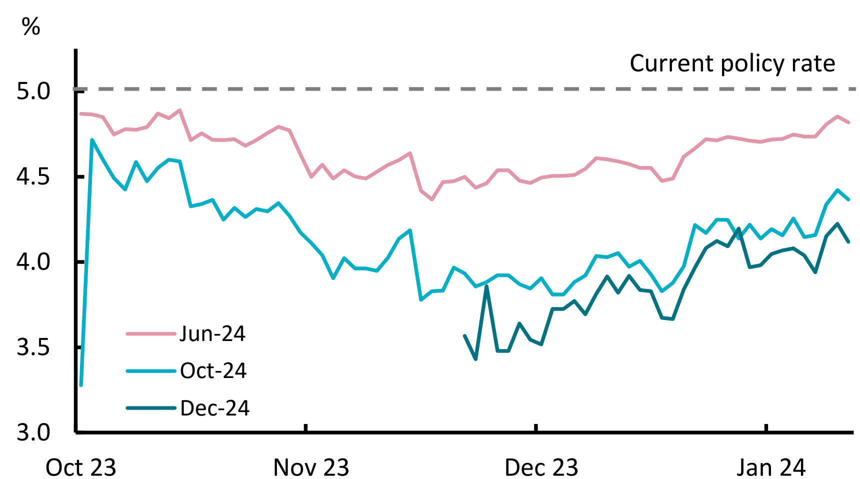
Median Inflation (annual and 3M annualised)



Source: LSEG Datastream , AXA IM Research, 25/02/2024

Market expectation for BoC loosening have slipped

Market rate expectations



Source: Bloomberg, AXA IM Research, Feb 2024

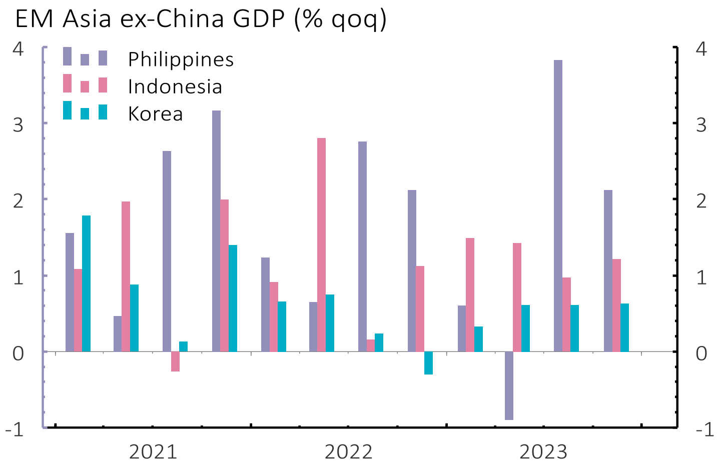
Most Asian economies still roaring ahead

Asia ex-China

Q4 2023 GDP remained robust

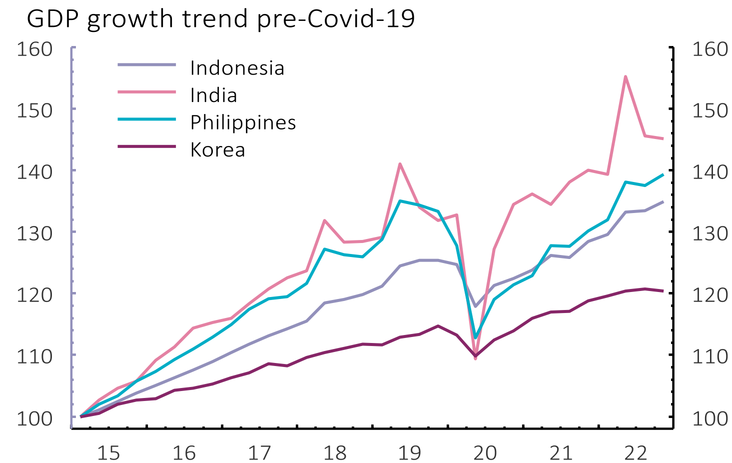
- Indonesia GDP was up 0.5% qoq after 1.6% in Q3, supported by private consumption given strong pre-election spending. Growth averaged 5% in Indonesia in 2023 and is likely to accelerate in 2024 on the back of a better investment backdrop after elections.
- GDP increased by 2.1% qoq in Q4 from 3.3% in Q3 in the Philippines, bringing the 2023 average growth to 5.6%, at the top range of Asian countries right behind India which is expected to grow by closer to 6.5-7%.
- Korea's GDP posted +0.6% qoq for the third quarter in a row supported by export recovery, likely to continue into 2024. Korean GDP is expected to accelerate to 2.2% in 2024, from an average of 1.4% last year.
- In Taiwan, Q4 GDP growth came largely above expectations at +2.1% qoq after 1.9% in Q3, driven by a surge in net exports as imports were impacted by weakness in domestic demand.

Still tepid growth in Asia into the year-end



Source: LSEG Datastream and AXA IM Research Q4 23

Growth has generally not yet recovered pre-Covid trend



Source: LSEG Datastream and AXA IM Research Q4 23

Activity ended 2023 on a weak note

Central Europe

Q4 2023 GDP releases show weakness across the board

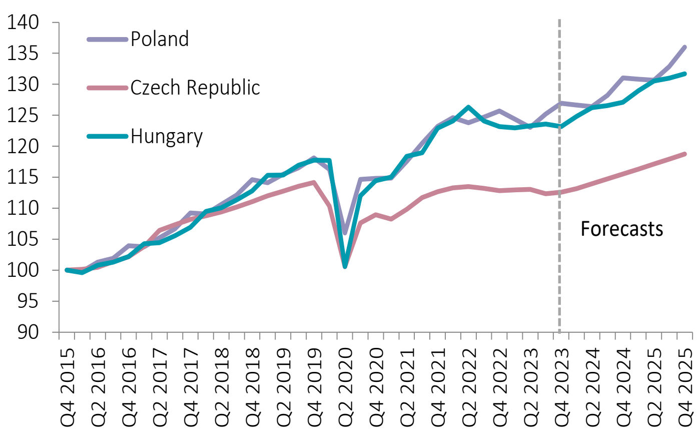
- The best outcome was reported in the Czech Republic with GDP having progressed by +0.2% qoq (after a 0.3% contraction in the previous quarter). Growth came in flat in both Poland and Hungary, after respectively +1.1% and +0.8% in Q3. Growth stood at -0.2% yoy in the Czech Republic, 0% in Hungary and +1% in Poland in Q4. Weak manufacturing and construction sectors have weighed into year-end, as well as consumer spending, save in the Czech Republic where there is suggestion of a consumer revival.
- Annual 2023 growth registered a meagre 0.2% in Poland, having contracted by 0.4% in the Czech Republic and by 0.9% in Hungary.

Expecting growth to rebound in 2024

- In spite of weak end-year momentum we keep our 2024 growth projections unchanged (1.4% for the Czech Republic, 2.8% in Poland and Hungary) on the back of possible positive spill overs on growth from a faster absorption of EU funds in Poland and Hungary. We continue to expect a supportive backdrop for the consumer on the back of positive real wage growth.
- .

Growth remained weak at the end of 2023…

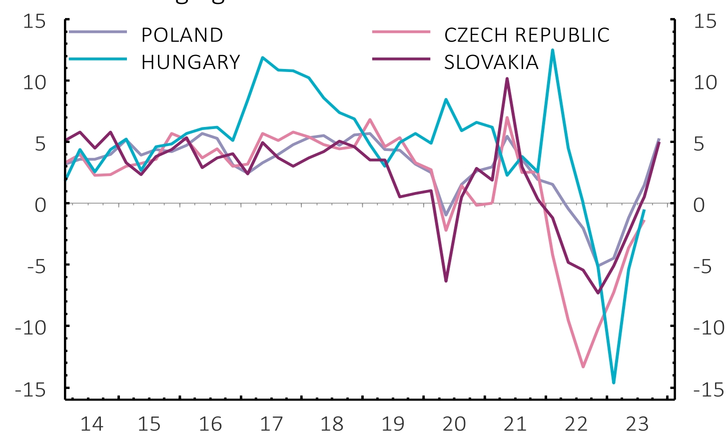
GDP index in Central Europe (Q4 2015 = 100)



Source: LSEG Datastream and AXA IM Research, Q4 2023

… but is expected to rebound in 2024 thanks to the consumer

CEE: real wage growth %



Source: LSEG Datastream and AXA IM Research Dec 23

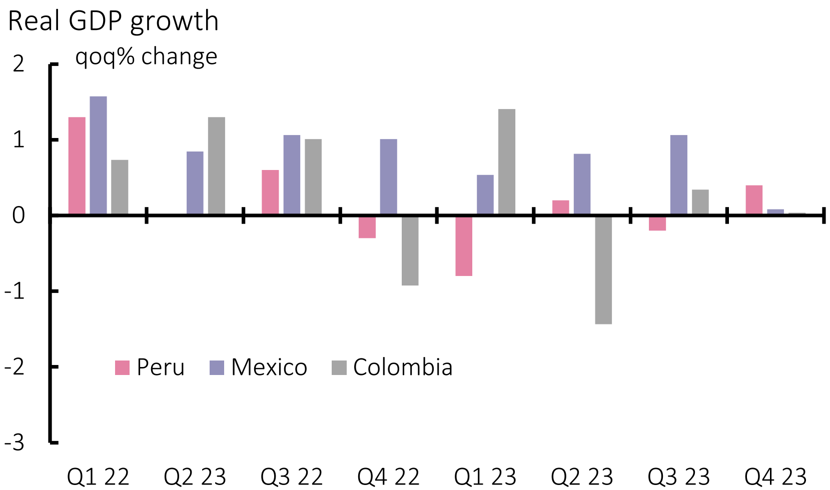
LatAm growth tapers off in Q4 as inflation continues to fall

Latin America

Weak GDP figures in Q4

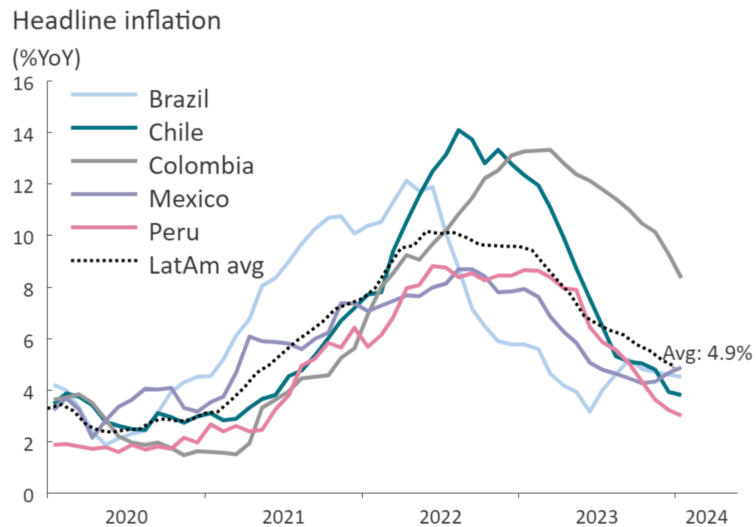
- Growth in Mexico decelerated to 0.1% qoq in Q4- the worst reading since Q3 2021. The economy's weak footing and relatively low inflation should allow Banxico to deliver its first cut in March. Growth was flat (0.0% qoq) in Colombia, dragged down by falling investment, reflecting tight monetary policy. Meanwhile, economic activity gained steam in Peru (+0.4 qoq). Despite the quarterly uptick, Peru contracted 0.6% over the course of last year, marking its first annual downturn in 25 years (excluding 2020) as it grappled with a series of negative shocks including political turmoil, extreme weather and high interest rates.
- On a brighter note, the region continues to progress in disinflation. In January, annual LatAm inflation dropped to 4.9%, down from 5.1% in December. Chile (3.2%) and Peru (3.0%) have brought inflation within their central banks' target bands, while Brazil (4.5%) is expected to converge in the coming months. Notable exceptions persist in Colombia (8.3%), the last country in the region to tighten monetary policy last year and Mexico (4.9%), where inflation has risen for three consecutive months due to elevated food prices. However, these pressures are anticipated to diminish as weather conditions improve.

Growth on a weak footing in Q4



Source: LSEG Datastream and AXA IM Research, February 2024

Inflation continues to fall in the region



Source: LSEG Datastream and AXA IM Research, Feb 24

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2023*		2024*		2025*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.1		2.9		3.1	
Advanced economies	1.6		1.2		1.2	
US	**2.5**	2.4	**2.0**	1.4	**1.5**	1.8
Euro area	**0.5**	0.5	**0.3**	0.5	**0.8**	1.5
Germany	**-0.1**	-0.3	**-0.1**	0.3	**0.7**	1.5
France	**0.9**	0.9	**0.4**	0.7	**0.8**	1.3
Italy	**0.7**	0.7	**0.3**	0.5	**0.6**	1.2
Spain	**2.5**	2.4	**1.6**	1.3	**1.3**	1.9
Japan	**1.9**	1.7	**1.2**	0.8	**1.0**	1.0
UK	**0.3**	0.5	**0.2**	0.2	**0.6**	1.2
Switzerland	**0.6**	0.8	**0.8**	1.2	**1.3**	1.5
Canada	**1.1**	1.1	**0.5**	0.4	**1.7**	1.9
Emerging economies	3.9		3.9		4.2	
Asia	5.1		4.9	4.0	4.7	
China	**5.2**	5.2	**4.5**	4.6	**4.2**	4.4
South Korea	**1.4**	1.3	**2.2**	2.1	**2.3**	2.2
Rest of EM Asia	**5.3**		**5.7**		**5.4**	
LatAm	2.4		1.6		3.0	
Brazil	**3.0**	3.0	**1.4**	1.6	**2.4**	2.0
Mexico	**3.2**	3.3	**2.2**	2.2	**2.9**	2.2
EM Europe	2.6		2.5		2.6	
Russia	**3.0**	2.7	**2.6**	1.7	**1.1**	1.1
Poland	**0.2**	0.4	**2.8**	2.8	**3.5**	3.4
Turkey	**4.3**	3.9	**2.0**	2.2	**3.6**	3.2
Other EMs	1.9		2.8		4.6	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 27 February 2024

**Forecast*

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	4.7	2.8		2.2	
US	4.1	3.0	2.6	2.5	2.3
Euro area	5.5	2.5	2.2	2.1	2.1
China	0.2	1.1	1.2	2.0	1.9
Japan	3.2	2.2	2.2	1.6	1.5
UK	7.7	3.1	2.6	1.8	2.0
Switzerland	2.2	1.6	1.6	1.3	1.3
Canada	3.6	2.9	2.5	2.3	2.0

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 27 February 2024
**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q1-24	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	20-Mar	1 May 12 Jun	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec
	Rates		unch (5.50)	-0.25 (5.25)	-0.25 (5.00)	-0.50 (4.50)
Euro area - ECB	Dates	4.00	7-Mar	11 Apr 6 Jun	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		unch (4.00)	-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	-0.10	18-19 Mar	25-26 Apr 13-14 Jun	30-31 Jul 19-20 Sep	30-31 Oct 18-19 Dec
	Rates		unch (-0.10)	+0.10 (0.00)	unch (0.00)	unch (0.00)
UK - BoE	Dates	5.25	21-Mar	9 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (5.25)	unch (5.25)	-0.25 (5.00)	-0.50 (4.50)
Canada - BoC	Dates	5.00	6-Mar	10 Apr 5 Jun	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		unch (5.00)	unch (5.00)	-0.25 (4.75)	-0.50 (4.25)

Source: AXA IM Macro Research - As of 27 February 2024

AXA Investment Managers

Calendar of events

2024	Dates	Events	Comments
March		UK Chancellor Jeremy Hunt delievers Spring Budget	
	01-Mar	Latest split deadline for US government funding agreement	
	02-Mar	US: Idaho & Missouri Republican primaries	
	03-Mar	US: Washington DC Republican primaries	
	04-Mar	US: North Dakota Republican primaries	
	05-Mar	US Super Tuesday	
	06-Mar	BoC meeting	unch (5.00%)
	07-Mar	ECB meeting	unch (4.00%)
	08-Mar	Latest split deadline for US government funding agreement	
	10-Mar	Portugal General Elections	
	12-Mar	US: Georgia, Hawaii, Mississippi & Washington Republican primaries	
	17-Mar	Russia Presidential Elections	
	18-19 Mar	BoJ meeting	unch (-0.10%)
	19-Mar	Reserve Bank of Australia (RBA) meeting	
	19-Mar	US: Arizona, Florida, Illinois, Kansas & Ohio Republican primaries	
	20-Mar	FOMC meeting	unch (5.50%)
	21-Mar	BoE meeting	unch (5.25%)
	21-22 Mar	European Council	
	23-Mar	US: Louisiana Republican primaries	
	31-Mar	Ukraine Presidential election	
April		BoE Term Funding Scheme repayments begin	
		India General Elections	
	02-Apr	US: Connecticut, Delaware, New York, Rhode Island & Wisconsin Republican primaries	
	10-Apr	BoC meeting	unch (5.00%)
	11-Apr	ECB meeting	-25bps (3.75%)
	23-Apr	US: Pennsylvania Republican primaries	
	25-26 Apr	BoJ meeting	+10bps (0.00%)
	30-Apr	Post Brexit border full SPS checks on EU goods introduced	
	Late April	EU countries send their updated stability programmes (GDP & fiscal outlook) to the Commission	
	Spring	Commission will propose to EU Council to open Excessive Deficit Procedures	
May	01-May	FOMC meeting	-25bps (5.25%)
	07-May	US: Indiana Republican primaries	
	07-May	Reserve Bank of Australia (RBA) meeting	
	09-May	BoE meeting	unch (5.25%)
	14-May	US: Maryland, Nebraska & West Virginia Republican primaries	
	21-May	US: Kentucky & Oregon Republican primaries	
June	02-Jun	Mexico Presidential Election	
	04-Jun	US: Montana, New Jersey, New Mexico & South Dakota Republican primaries	
	05-Jun	BoC meeting	unch (5.00%)
	06-Jun	ECB meeting	-25bps (3.75%)
	6-9 Jun	European Parliament Election	
	09-Jun	Belgium Federal Elections	
	12-Jun	FOMC meeting	-25bps (5.25%)
	13-14 Jun	BoJ meeting	+10bps (0.00%)
	18-Jun	Reserve Bank of Australia (RBA) meeting	
	20-Jun	BoE meeting	unch (5.25%)
	27-28 Jun	European Council	
	30-Jun	BoE MPC member & Deputy Governor Ben Broadbent's term ends	
September	25-Sep	Germany General Elections	
October	Before 24 Oct	Austria General Elections	

Latest publications

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26 February 2024

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28 September 2023

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