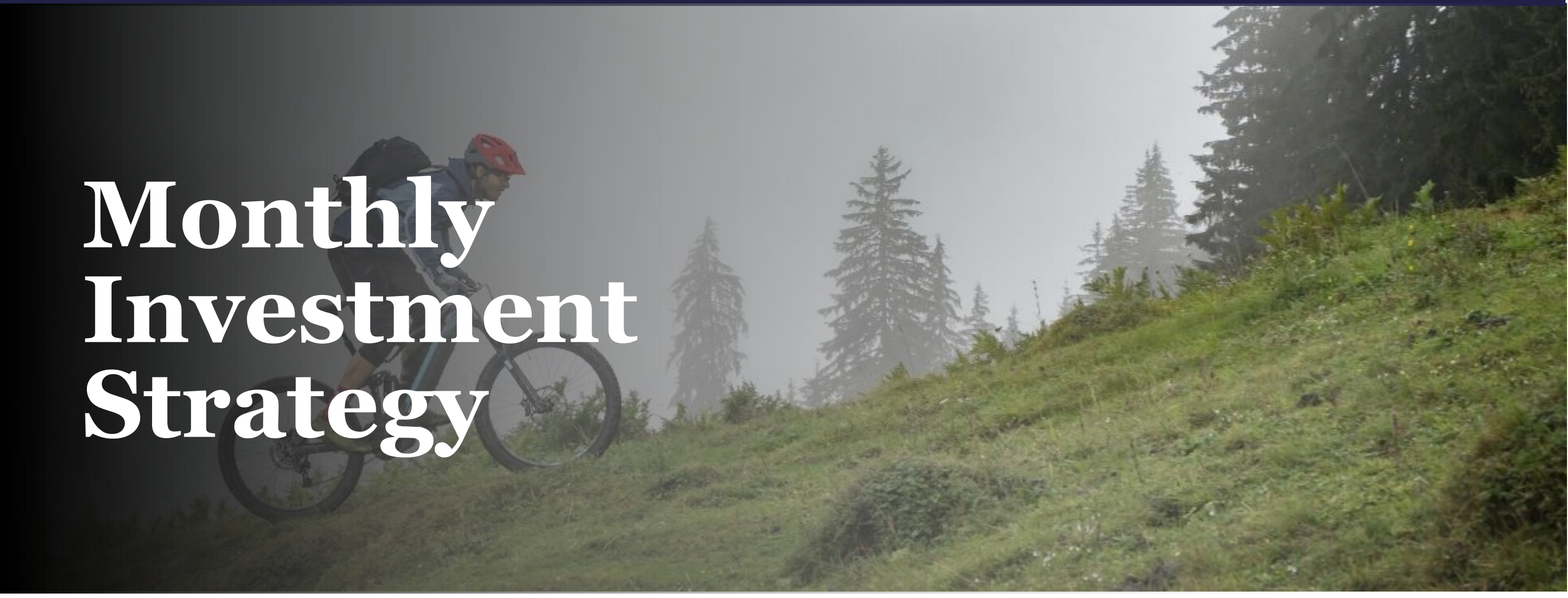
25 October 2023

Investment Institute Macroeconomics



Monthly Investment Strategy

Geopolitics and yield add to macro uncertainty

Key points

- Terrorist attacks in Israel and retaliation in Gaza has created the threat of a humanitarian crisis, with risks of regional conflict escalation. Market reaction has been cautious to date, but risks are obvious.
- Meanwhile global bond yields continue to rise, driven by a rise in US Treasuries. Technical features appear to be compounding this rise, including the re-emergence of term premium as quantitative tightening continues.
- Yet macro drivers of yields are also compelling, particularly in the US where consumer resilience and solid investment has lifted future interest rate expectations.
- China posted stronger Q3 GDP growth, with consumer activity recovering. This likely secures this year's growth target, yet property remains a risk and ongoing momentum next year requires more stimulus.
- Eurozone growth prospects remain more stagnant, but fiscal concerns dominate as the budget process and higher yields challenge certain governments.

Global Macro Monthly

Geopolitics and yields add to macro uncertainty

Global Macro Monthly Summary October 2023

David Page
Head of Macro Research
Macro Research – Core Investments

Geopolitics and surging yields threaten outlook

The terrorist attacks on Israel and retaliatory strikes in Gaza have created the latest humanitarian crisis and risk a broader regional conflagration. Political leaders have engaged to dampen the escalation potential, including US, German and UK Premier visits and the deployment of two US aircraft carrier groups. Whether this helps avoid a broader conflict remains to be seen. Already the normalisation of relations between Saudi Arabia and Israel has paused. The outlook is far from predictable. Market reaction and the spillover to the global economy has so far been limited with modest oil price gains, little disturbance in stocks and scant obvious safe-haven support for bonds. For now, we monitor events, but the risks are obvious.

In the absence of a major geopolitical reversal of trends, the prevailing dynamic remains the surge in global bond yields, led by US Treasuries. This month's Theme of the Month looks to decompose this rise, focusing on the macro drivers. But technical features are also in play. One such feature appears to be the return of term premia – the additional return investors require to compensate for locking into long-term returns. These were quashed during the expansion of quantitative easing but as central banks – and the Federal Reserve (Fed) specifically – unwind this with quantitative tightening, these premia should add to rate outlooks in the coming years.

Yet macro drivers for higher yields are also compelling, particularly in the US, where consumers continue to defy softening expectations. We forecast a reduction in household income in Q4 reflecting slower real disposable income growth, an exhaustion of excess savings for most income groups and the resumption of student loan repayments. We expect this to weaken spending, but after September's retail strength, we no longer expect consumption to fall in Q4, while there is a risk that further savings declines or rising borrowing shelters spending from falling incomes for longer.

Alongside consumer resilience we see improving investment, which together have reduced the chances of a hard landing. We still expect Fed tightening to slow activity consistent with returning inflation to target but now see this after a period of softer, not falling growth – a fabled 'soft landing'. As this view becomes more widespread, forecasts for interest rate cuts have faded – lifting term rates even as expectations for the Fed's peak rate have barely changed. Moreover, increased investment spending has raised perceptions that the neutral rate has risen, further boosting longer-term rates.

Globally, the macro picture is more mixed. China reported Q3 GDP growth of 1.3% on the quarter in Q3 – above expectations. Yet revisions to previous quarters included a downgrade to Q2's growth to 0.5% from 0.8%, reducing the overshoot in levels' terms. Yet there are signs of a turn in activity from a mid-year nadir with the latest data suggesting improvement in consumer activity. This increases our confidence that China will achieve its 2023 target but maintaining momentum for 2024 will likely require additional stimulus.

The Eurozone outlook is more downbeat. We expect a fall in Q3 GDP across the bloc as a whole but see it avoiding recession as a sharper drop in headline inflation boosts real incomes, supporting spending. Yet divergence is taking place. The more industrially focused Germany and Italy are experiencing greater headwinds than France and Spain. We believe the European Central Bank (ECB) has reached a policy rate peak at 4.00%, but will increasingly focus on balance sheet policy, with risks of exacerbating debt sustainability concerns.

The Eurozone is in the process of finalising next year's budget outlooks, something made more difficult by the stalled agreement on new EU rules. Italy and France stand out with proposals that delay reducing deficits below 3% of GDP until 2026 and 2027 respectively. Rising yields add to concerns about fiscal sustainability. Italy's 10-year bond spread over Germany now exceeds 200 basis-points, presenting the Italian government with a challenging 5% 10-year yield with which to finance its large debt. Italy is not alone in facing such pressures. This is an additional explanation for higher US yields.

Several outstanding political developments may also impact the global outlook. Continued disfunction of the US Congress, as the majority Republican party fails to elect a new House speaker, threatens government shutdown in November. Argentina's recent election also risks economic turbulence. More positively, Poland's elections pave the way for a government more aligned with broader EU values, which could unblock important EU investment funds. Meanwhile Ecuador's election looks to have prevented the return of the previous populist leader.

Global Macro Monthly – US

David Page
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Consumer keeps on rolling for now

September's retail sales rose by a surprisingly strong 0.7% on the month in value terms, the control group up 0.6% with upward revisions to August. Real retail sales continued to rise (Exhibit 1), although we await personal spending data to confirm if this was true for broader consumption. This defied a reversal in consumer sentiment, which surged to a 1½ year high in July from May but unwound by September.

Exhibit 1: Persistently strong consumer spending

Source: LSEG Datastream , AXA IM Research, 20/10/2023

This persistent strength follows strong summer spending, despite a headwind from gasoline costs. We continue to expect household income to come under pressure from the resumption of student loan repayments this month. Q4 should mark a softening in consumer spending but we now see this as around flat – compared to a fall – something that also assumes neither ongoing recourse to excess saving, nor increased borrowing supplementing spending.

Softer consumption should mark the final phase of an asynchronous slowdown that started with sharp falls in residential investment in the second half of 2022. However, as other economic sectors are unlikely to drop sharply from here (housing and inventory) or should start to firm (investment and manufacturing) we have already dropped our outlook for recession. We now see US GDP firmer, up 2.2% in 2023 and 1.4% in 2024. Yet upside risks persist. The Atlanta Fed GDPNow tracker suggests Q3 growth exceeded 5% (annualised); the latest labour report showed a 336k jobs gain, consistent with firmer GDP, and our outlook for softer consumption assumes weaker incomes will reduce spending, not raise borrowing.

Consumer Price Index (CPI) disinflation also stalled in September, the annual rate remaining at 3.7% as CPI rose by 0.4% on the month, buoyed by a further oil-inspired rise in gasoline. This should unwind in October, assuming oil prices remain steady. Core inflation, excluding food and energy, fell further to 4.1% – its lowest in two years. This drop was driven by core goods prices; services inflation eased to 5.2%, but the more recent trend suggests services disinflation also stalled, underpinned by services ex-shelter. We expect a more definitive easing in services ex-shelter inflation across Q4, but a persistently tight labour market poses a continued risk.

Fed at or near peak amid broader uncertainty

September's Federal Reserve (Fed) minutes reiterated that a small majority of members (12 vs. 7) still expect one more rate hike this year. We remain unconvinced, with Fed Chair Jerome Powell stressing data-dependency and more recent Fed commentary before the next meeting's purdah period acknowledging broader tightening in financial conditions reduces the need for further policy tightening. This highlights the circularity of the Fed-market influence on financial conditions, which are currently at one-year highs according to some metrics. It also appeared to signal a reluctance to tighten policy at the next meeting (1 November), a message the market has heeded pricing a 10% chance of a hike. We believe weaker data will dissuade the Fed from raising the Fed Funds Rate in December and see 5.50% as the policy peak. However, ongoing consumer resilience makes this a genuinely closer call. We forecast three rate cuts for the second half of 2024, with rates at 4.75% by year-end.

Politics remains an area of outstanding risk for the US economy. Having avoided a government shutdown at the end of September, House Speaker Kevin McCarthy was ousted from his position by four members of his own party. The House struggles to appoint a successor, the next nominee garnering only 113 votes of support and sufficient holdouts to see him drop his bid. Second-placed contender Jordan is currently failing to secure sufficient votes. The House is in uncharted territory with the current Speaker pro tempore possessing limited powers, thus stopping Congress resolving longer-term government spending, threatening a shutdown when the current extension expires on 17 November. This occurs before the Republican Primary season starts early next year in Ohio and before next year's Presidential race. As well as threatening a government shutdown and exposing the significant shortcomings in US governance, it will also hold up funding for the Ukraine war and potentially any additional support the US may offer Israel as recent terror attacks have raised additional potential headwinds from global geo-political developments.

Global Macro Monthly – Eurozone

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An invitation for (further) market differentiation

The combination of anaemic real growth prospects – some countries were underperforming already in Q2 – limited fiscal consolidation ambitions enshrined in 2024 budgets and pressure from rising global bond yields have brought increased investor scrutiny to the public finances outlook, especially for highly-indebted economies.

Italy is likely to remain a key market focus. While the construction 'Superbonus' tax credit is unlikely to mean any further increases to the public deficit, there could be disappointments to optimistic 2024 growth forecasts – while Italy's Government projects 1.4%, we expect 0.1% against a Bloomberg consensus of 0.6%. Despite decent efforts to improve its primary balance, the government has deferred lowering its budget deficit to below 3% by one year to 2026. All in, the above-3% nominal GDP growth projected is consistent with just a 0.6 percentage point drop to 139.6% in Italy's public debt-to-GDP ratio between 2023 and 2026.

With the 10-year Italian government bond yield flirting with 5%, it is of little surprise that the spread against German Bunds has widened to slightly above 200 basis points (Exhibit 2). The market has stopped short of testing higher levels for now – but this narrative is only just starting to unfold. Going forward, we highlight two critical elements to monitor: first, the ability of European heads of state to agree on a set of credible fiscal rules – which we see as unlikely before the end of the year; and second, whether the implementation of the Italian Recovery and Resilience Plan can get back on track. As we argued in our recent paper on Eurozone public debt sustainability[1], highly-indebted countries should take advantage of still-high nominal GDP growth and act. High(er) rates for longer means that this window of opportunity may close faster than thought.

Eurozone countries are focusing on their own issues: France is refraining from an ambitious fiscal strategy, gripped by a split Parliament, the German government coalition is speaking with increasingly divergent voices, while Spain is looking to break away from indecisive snap general elections. This is an invitation for further market differentiation.

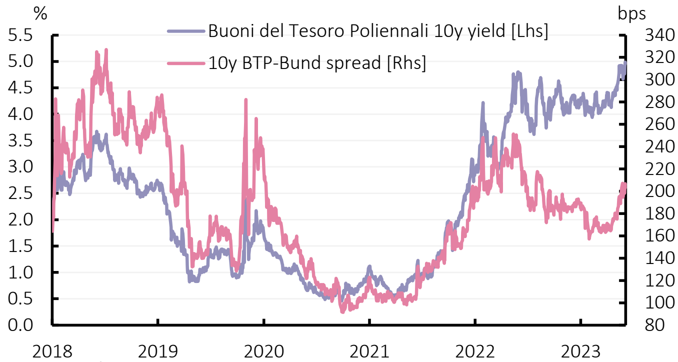
ECB: Tasked to keep it together (again)

All of the above puts the European Central Bank (ECB) in a difficult position. Despite renewed calls by hawkish board members to speed up balance sheet normalisation, we expect a decision on Pandemic Emergency Purchase Programme reinvestment in December at the earliest. It would appear unwise for the ECB to act more swiftly on its first line of defence against financial fragmentation amid tense budget discussions, limited visibility of fiscal rules, materialising bond portfolio losses and uncertain geopolitics, while economic data since September's meeting has been scarce. While minimum reserve requirement discussions are making headlines, we think this is unlikely to become an active monetary policy tool and wait for a comprehensive review of the ECB's operational reserve management, due next spring. We think October's meeting will likely be decision-free.

Increased tensions on yields and spreads also bring the ECB's second line of defence against fragmentation back into focus: The Transmission Protection Instrument (TPI). While the bar for implementation was high to start with, we think it is now likely even higher. TPI activation not only relies on impaired policy transmission (indicators) and eligibility criteria but also a proportionality assessment with regards "to the achievement of the ECB's primary objective". Greater confidence in reaching the inflation target in a timely manner, by maintaining interest rates at high levels, also reduces the likelihood (or increases the bar) for TPI activation.

Exhibit 2: Italian yields (not spreads) reaching new highs

Selected Italian bond market metrics



Source: Refinitiv and AXA IM Research, October 2023

[1] Cabau, F., "Eurozone public debt sustainability: Make hay while the sun shines", AXA IM Research, 31 July 2023

Global Macro Monthly – UK

Modupe Adegbembo
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Slowing data points to BoE hold in November

September's Consumer Price Index (CPI) inflation remained at 6.7% - defying market expectations of an easing to 6.6%. Inflation was unchanged on the month as lower food and furniture inflation were offset by an uptick in the contribution from motor fuels, restaurants and hotels. Overall, goods inflation has slowed considerably but momentum in services remains strong, with services CPI rising to 6.9% from 6.8% in August. We expect inflation to fall sharply in October to 4.7%, driven by a decline in energy prices.

The labour market has showed early signs of loosening but recent events have cast uncertainty over the reliability of these data. The Office for National Statistics delayed publication of the October Labour Force Survey by a week (to 24 October) due to sampling issues with low response rates. This follows the Bank of England's (BoE) assertion in its last rate decision that Average Weekly Earnings (AWE) data were difficult to reconcile with other inflation in pay, such as HM Revenue and Customs (HMRC) payrolls and BoE Agent's intelligence, which pointed to pay increasing around 6.5%. The wage data published in October, without the usual employment data, showed AWE (excluding bonuses) remained at 7.8% in annual terms in August, but the three-month annualised rate slowed to 5.3%.

Monthly GDP rose by 0.2% on the month in August following a (revised) 0.6% fall in July. Output was driven by resilience in professional services and an unwind of the strike impact in education. Survey data remained lacklustre; Purchasing Managers' Indices don't point to as sharp a fall as September's flash estimates (48.5 for the composite versus 46.8 flash) but are consistent with continued stagnation. We now expect Q3 GDP growth of 0.1%, down from 0.2% previously. This compares to the BoE's 0.4% projection published in August.

The BoE's Monetary Policy Committee (MPC) meets on 2 November when it will also update economic projections. September's surprise hold was a close decision, but data continues to track below the BoE's August expectations and speeches by MPC members have placed more emphasis on emerging weakness in growth. We forecast policy to remain unchanged and see Bank Rate at a peak at 5.25%. Lagged impacts of current tightening are likely to continue to emerge and we expect the BoE to begin to unwind some of these hikes, but only in the second half of 2024, forecasting 4.75% by end-2024.

Global Macro Monthly – Canada

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Inflation persistence spurs BoC on

This year's strong start was undone by a fall in Q2 GDP – exacerbated by strikes and wildfires. Q3 data is due at the end of November but with July's output estimated to be flat and 0.1% in August, Q3 looks on track for modest growth. We expect households to remain under pressure, with mortgage costs accounting for a larger share of income. However, export growth has outperformed and investment spending remained resilient. Canada should narrowly avoid recession, before seeing firmer quarterly growth from Q1 2024. We have lowered our 2023 growth outlook to 1.1%, from 1.3%, leaving 2024 unchanged at 0.9%.

Headline inflation fell in September to 3.8% despite firmer oil prices and we expect it to end 2023 a little firmer before disinflation resumes next year. Core inflation has proved stickier but the latest reading eased and the 3m-annualised median core rate fell below 4%. A softening in employment growth and easing in earnings growth should temper core price pressures but core inflation trends have been persistent over the last year. We forecast inflation to average 4.2% this year and 3.1% next.

Structural uncertainties complicate the outlook. Canada has raised migration targets to address skill shortages, adding over 400k again in 2022, boosting labour supply. But productivity has consistently fallen since the pandemic. These factors have opposite effects on potential growth. The Bank of Canada (BoC) estimates a broad range for potential growth from 1.0-3.2%. We see risks to the lower end, suggesting softer GDP growth may not deliver sufficient disinflation.

The BoC continues to trade-off risks of over-tightening and inflation persistence. Last month, the labour market's surprising strength, wage acceleration and a rise in core inflation led us to up our forecast to one more rate hike. Over the course of this month, the continued fall in the BoC outlook survey, the drop in core Consumer Price Index (CPI) pressures and the emergence of geopolitical tensions all suggest more caution. We drop our call for a further hike in October. December remains a risk but our expectation that lagged tightening will increasingly impact the economy suggests the more time elapses, the less likely further hikes become. We expect the BoC to leave policy unchanged at 5.00% and cut rates from next July to 4.50% by year-end.

Global Macro Monthly – China

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Economy on track but challenges ahead

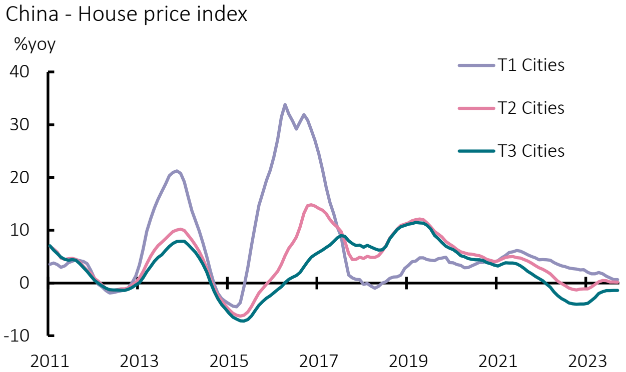
The better-than-expected Q3 GDP reading has left China's economy well-placed to meet its growth target of "around 5%" for 2023. Supportive measures announced in August have slowly but evidently started to restore sentiment. Consumption became the main driver of growth in Q3, but firmer investment also helped lift the economy from its mid-year trough. The property sector remained a drag on the economy, and this will likely be the case for a while. As the focus shifts to next year, challenges are becoming clearer. Headwinds surround weak prices, weak sentiment, local government indebtedness and the ongoing property sector malaise. How and when Beijing can address these issues will be crucial for the economy over the coming years.

The economy advanced by 1.3% quarter-on-quarter in Q3, surprising the market on the upside, although it partly reflected a series of revisions to the last six quarters' GDP growth rates, including the Q2 downgrade (to 0.5%, from 0.8% in the first release). Positive news came from retail sales, though the ongoing divergence between consumer goods and services underlined continued cautiousness among consumers – big ticket purchases stayed muted compared to catering and restaurant spending, as consumers leaned towards small but rewarding expenditures. A similar story was shown during the eight-day 'Golden Week' holiday. The number of tourists and tourism revenue (in nominal terms) rose back to 2019 levels but spending per capita (in nominal terms) was still below the 2019 level. As the labour market continues to improve and the property market stabilises, consumer confidence is likely to advance further in the coming months.

Another bright spot in September came from the manufacturing sector. Manufacturing output sustained a faster pace compared to other industrial sectors in September. It was led by production of metal smelting, automobiles and electrics. Investment in manufacturing continued to gain momentum in September, partly due to an increase in industrial profits – which turned positive for the first time this year in August – together with the recovery in domestic demand. Benefiting from the value chain upgrade, investment in electrical machinery and equipment manufacturing, automobile and computer and communications equipment has maintained double-digit growth to the end of Q3. As more policy supports are expected for future manufacturing upgrades, strong manufacturing investment is likely to stay. However, risks of overcapacity would increase if investment were to persist against a backdrop of ongoing softer demand, which would lead to low investment returns and rising inventory.

However, the gloom engulfing the property market clouded September and is unlikely to change anytime soon. Supportive measures announced in August have started to have some impact in stabilising the sector. Housing prices have stabilised over recent months in annual terms, albeit with lags in tier three cities (Exhibit 3), where there have been years of oversupply. However, house prices fell at their fastest pace on the month in a year in September. Floor space completion, which has been backed by policies from Beijing, stayed resilient over the month, but property sales, investment and new starts were still in decline. It remains to be seen whether Beijing has done enough to stabilise the property market adjustment, which in any case would appear to take some time to arrive. Further targeted stimulus will be likely over the coming months if the sector continues to remain weak.

Exhibit 3: Housing prices in tier three cities still lag



Source: CEIC and AXA IM Research, October 2023

Deflationary headwinds were renewed in September with headline annual CPI inflation slowing to 0.0% year-on-year. Excluding the double-digit decline in pork prices, and weaker food prices in general, core inflation registered 0.8%, maintaining the same rate since July. The holiday spending during Golden week is likely to lift CPI in October from the month before, but it will not be enough to overcome weakness in prices for the year overall.

The authorities in Beijing have a busy schedule in the last few months of this year. Several meetings – October's Politburo meeting, the third Plenum of the Chinese Communist Party (October), and the Central Economic Work Conference (November or December) – have historically focused on the economy. Policies announced in these meetings are likely to be imperative and pivotal for the economy in 2024 and beyond. Currently, we expect the economy to grow by 5.3% year-on-year in 2023, following a stronger Q3, before a slightly weaker 2024 with 4.5% growth.

Global Macro Monthly – Japan

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BoJ to stay put as government prepares stimulus

Political focus has turned to fiscal stimulus as a 2023 election looks less likely. The chances of a snap election in Japan's lower house over the coming months have fallen as Prime Minister Fumio Kishida's Cabinet reshuffle last month failed to provide a boost to his leadership ratings. The government is now focused on the introduction of a supplementary budget, expected by the end of the month. Details of this package have begun to emerge and it looks likely to include support for key sectors, such as semiconductors, and provide additional funding for households squeezed by inflation. The total package is expected to be worth between ¥20tn and ¥30tn (around 3.6%-5.4% of GDP).

Recovery remains underway in Japan but there are increasing signs the pace of growth is shifting lower. Domestic spending remained firm in September after rebounding strongly over the summer. However, recent survey data has softened; the current and outlook components of September's Economy Watchers Survey index fell again to 49.9 and 49.5 respectively. Sentiment worsened in all sub-sectors except food and beverages and fell particularly sharply for retail and services. We currently forecast GDP growth of 1.9% in 2023 and 0.8% in 2024 (consensus 1.7% and 1.0%).

The Bank of Japan (BoJ) next meets on 30-31 October. This meeting will also include the publication of its quarterly economic forecasts. The updated inflation forecasts will be closely watched - we expect the BoJ to upgrade its core inflation (excluding fresh food) forecasts for fiscal year 2023 and 2024, which were previously at 2.5% and 1.9%, respectively. However, we expect more minimal changes to its longer-term forecasts as uncertainty remains over the sustainability of the current inflation rise. We expect the BoJ to leave all its policy tools on hold at this meeting. Some speculate it may remove its yield curve control (YCC) altogether but we suspect the BoJ will not make further adjustments until it is ready to begin normalising policy.

An end to Japan's negative interest rate policy (NIRP) is likely further away. Additional evidence of wage growth is likely necessary for the BoJ to hike rates confidently without concerns of stifling a nascent, sustainable recovery in inflation. We forecast an end to NIRP and YCC in spring 2024 in our base case but monitor rising risks of a possible earlier move.

Global Macro Monthly – EM

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Populism: *quo vadis*?

Populism is not a new phenomenon but in recent years has appeared to gain significant traction. A deeper suspicion of the prevailing establishment has taken hold and populists (whether leaning right or left) have been increasingly successful in developing countries, with the likes of Viktor Orbán in Hungary, Recep Tayyip Erdoğan in Turkey, Narendra Modi in India, Jair Bolsonaro – then Luiz Inácio Lula da Silva in Brazil – and Andrés Manuel Lopez Obrador in Mexico. More recently, the populist pro-Russia party led by former Prime Minister Robert Fico has won Slovakia's parliamentary elections.

Yet recent results suggest rising populism is not a default outcome. Polish people went to the polls on 14 October[2] to elect the members of Parliament amid a very tense environment, with the incumbent anti-EU populist Law and Justice (PiS) party attempting to stay in power for a third consecutive term. Official results confirmed that opposition coalition parties were able to secure the majority in the lower house. Donald Tusk may become the next Prime Minister. If so, he will have the difficult task of restoring independence to the media and judicial institutions – both undermined during the past eight years under PiS that put Poland in a 'rule of law' conflict with the EU, affecting the disbursement of EU funds.

Ecuador also avoided a populist outcome with Luisa González's defeat in the October presidential elections. Centre-right Daniel Noboa becomes the interim President, keeping the left-wing Citizen Revolution Movement (known as Correistas) away for the next two years. This ends the political instability that has been a drag on the economy for years, although Noboa's lack of track record and the challenges that his government will face remain areas of concern.

During the first round of Argentina's presidential election, Economy Minister Sergio Massa achieved a surprising victory, securing 36% of the vote. Javier Milei came in second with 30% of the support. As a result, Massa and Milei will compete in the runoff scheduled for 19 November. Notably, Milei could still emerge as the victor in the runoff by garnering the votes of Patricia Bullrich, who obtained 23% of the initial vote.

[2] Topa-Serry, I., "Poles to the polls, at a crossroad", AXA IM Research, 28 September 2023

Global Macro Monthly – India

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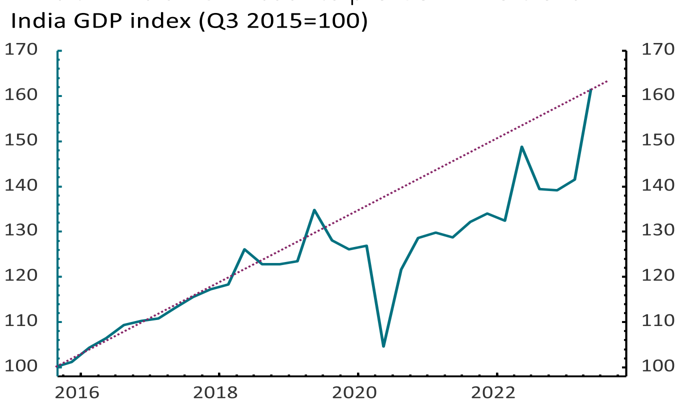
Indian economy continues to shine

The Indian economy appears to be roaring ahead, almost unscathed by the current struggling global environment (Exhibit 4). With GDP growth at 7.8% year-on-year in Q2, India appears to be the world's fastest-growing major economy. Many have criticised the quality and accuracy of the figures provided by the country's national statistics office – given the significant discrepancy between expenditure and the income-based calculated GDP every quarter. But it is fair to say that India has just about reached pre-pandemic trend levels, but its recovery has proven uneven across the economy.

Exhibit 4: Indian GDP back to pre-COVID-19 trend



Source: LSEG Datastream and AXA IM Research Q2 23

Yet confidence appears high among both corporates and consumers. The credit cycle has picked up steam following an extended period of weakness. Government spending continues to support economic activity and will likely remain a growth engine ahead of 2024's elections, but private investment is still lagging. On the external front, services exports remain buoyant and despite higher oil prices, the current account deficit was below 2% of GDP in Q2 2023. September CPI inflation showed a marked slowdown to 5% driven by an easing across food, fuel and core inflation, back within the tolerance band of the central bank (2%-6%). The moderation in core inflation (4.5% year-on-year) should provide enough comfort for the Reserve Bank of India to keep policy interest rates unchanged for some time (at 6.5% since February 2023), a restrictive monetary stance that should ensure the convergence to its 4% inflation target.

Global Macro Monthly – Mexico

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Mexico's surprising strength

In a period when many major economies in Latin America are experiencing a slowdown amid tight financial conditions, Mexico's economic activity stands out as a beacon of resilience, consistently surpassing expectations. Mexico's GDP grew 0.9% quarter-on-quarter in Q2, exceeding consensus forecasts. Additionally, leading indicators for Q3 signal continued economic strength, with retail sales and industrial production both maintaining impressive year-on-year growth rates of around 5%.

Several factors are contributing to Mexico's economic vitality. Notably, the US's robust economic performance has generated positive spill-over effects, including higher demand for Mexican vehicles, increased remittances and a surge in US tourists. On the domestic front, the construction sector is gaining momentum, driven by accelerated government spending on critical infrastructure projects. As a result of these dynamics, we anticipate that Mexico's economy will expand by 3.3% this year and 2.0% in 2024.

There is also encouraging news on inflation. Headline inflation has continued its downward trajectory, reaching a year-on-year rate of 4.5% in September. Mexico's strong economic performance and decelerating inflation align with the notion of a soft landing scenario. Nevertheless, it appears unlikely that the Bank of Mexico (Banxico) will initiate an easing cycle soon, in contrast to other major central banks in the region, such as those in Brazil, Chile and Peru.

The minutes from Banxico's September policy meeting conveyed a notably hawkish tone. Concerns revolve around the possibility of a slower convergence to the inflation target in the coming months, as well as apprehensions regarding the government's expansionary 2024 budget, which could bolster aggregate demand in the upcoming year.

In politics, the ruling party Morena has selected former Mexico City Mayor Claudia Sheinbaum as its candidate for the 2024 Presidential elections. Sheinbaum is a close ally of President Andrés Manuel López Obrador and represents a continuation of his social agenda. López Obrador's popularity and Morena's hold on most governorships gives Sheinbaum a significant advantage.

Macro forecast summary

Real GDP growth (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.5		3.0		2.7	
Advanced economies	2.6		1.5		1.0	
US	**2.1**	2.1	**2.2**	2.1	**1.4**	0.8
Euro area	**3.5**	3.2	**0.5**	0.5	**0.3**	0.7
Germany	**1.8**	1.8	**-0.3**	-0.4	**0.3**	0.6
France	**2.5**	2.5	**0.7**	0.8	**0.3**	0.8
Italy	**3.7**	3.7	**0.7**	0.8	**0.1**	0.7
Spain	**5.8**	5.5	**2.5**	2.2	**0.7**	1.4
Japan	**1.0**	1.0	**1.9**	1.8	**0.9**	0.9
UK	**4.1**	4.1	**0.5**	0.3	**0.2**	0.4
Switzerland	**2.7**	2.1	**0.7**	0.8	**1.0**	1.3
Canada	**3.4**	3.4	**1.1**	1.3	**0.9**	0.7
Emerging economies	4.1		3.8		3.7	
Asia	4.4		4.9		4.4	4.0
China	**3.0**	3.0	**5.0**	5.0	**4.5**	4.5
South Korea	**2.6**	2.6	**1.4**	1.1	**2.2**	2.0
Rest of EM Asia	**6.2**		**5.2**		**4.4**	
LatAm	4.1		2.3		2.2	
Brazil	**2.9**	2.9	**2.9**	2.9	**1.2**	1.6
Mexico	**3.9**	3.9	**3.3**	2.9	**2.0**	1.8
EM Europe	0.9		1.7		2.2	
Russia	**-2.1**		**2.2**		**1.1**	1.3
Poland	**5.1**	4.9	**-0.1**	0.5	**2.6**	2.6
Turkey	**5.5**	5.6	**2.1**	3.4	**3.1**	2.0
Other EMs	5.1		2.4		3.5	

Source: Datastream, IMF and AXA IM Macro Research – As of 24 October 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**	2.5
Euro area	**8.4**	8.5	**5.7**	5.5	**2.9**	2.5
China	**1.9**	2.0	**1.0**	0.7	**2.0**	1.8
Japan	**2.5**	2.5	**3.0**	3.1	**1.5**	2.0
UK	**9.1**	9.1	**7.5**	7.4	**2.8**	3.1
Switzerland	**2.8**	2.8	**2.4**	2.3	**1.5**	1.6
Canada	**6.8**	6.8	**4.1**	3.8	**3.2**	2.5

Source: Datastream, IMF and AXA IM Macro Research – As of 24 October 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	Q3-22	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	26-27 July 20-21 Sep	31-1 Oct/Nov 12-13 Dec	30-31 Jan 19-20 Mar	30-1 Apr/May 11-12 Jun	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec
	Rates		+1.5 (3.00-3.25)	unch (5.50)	unch (5.50)	-0.25 (5.25)	-0.25 (5.00)	-0.25 (4.75)
Euro area - ECB	Dates	4.00	21 July 8 Sep	26 Oct 14 Dec	25 Jan 7 Mar	11 Apr 6 Jun	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		+1.5 (0.75)	unch (4.00)	unch (4.00)	-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	-0.10	20-21 July 21-22 Sep	30-31 Oct 18-19 Dec	22-23 Jan 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)	unch (-0.10)	unch (-0.10)	+0.10 (0.00)	unch (0.00)	unch (0.00)
UK - BoE	Dates	5.25	4 Aug 15 Sep	2 Nov 14 Dec	1 Feb 21 Mar	9 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		+1.00 (2.25)	unch (5.25)	unch (5.25)	unch (5.25)	-0.25 (5.00)	-0.50 (4.75)
Canada - BoC	Dates	5.00	4 Aug 15 Sep	25 Oct 6 Dec	24 Jan 6 Mar	10 Apr 5 Jun	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		+1.00 (2.25)	unch (5.00)	unch (5.00)	unch (5.00)	-0.25 (4.75)	-0.25 (4.50)

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

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