AXA Investment Managers

Investment Institute Macroeconomics

Geopolitics and yields add to macro uncertainty

Monthly Investment Strategy

AXA IM Research

October 2023

Summary: October 2023

Theme of the month: Decomposing higher for longer

- Economic resilience has seen markets increasingly discount the prospect of a US recession, with implications for rate expectations over the next few years. Moreover, signs of significant investment spending have fuelled expectations that longer-term neutral rates may also have risen. Both have served to raise 10-year interest rate expectations at a time when expectations around the peak Fed Funds Rate have been broadly stable.
- More technical aspects also appear at work. Specifically, we focus on the prospect that term premia – the additional return investors have required to lock in returns for longer-periods – should be a more prominent feature as the Fed continues to unwind its quantitative easing.
- Macro explanations only go so far in explaining rising Treasury yields. Our expectation for a turn in the Fed policy cycle and a further softening in core CPI inflation should see yields ease over coming quarters. However, US exceptionalism is for now meaning that elevated yields are supporting the US dollar.

Macro update: US resilience causes turbulence elsewhere

- We revise our US outlook higher as consumer spending remained solid through Q3, despite expectations of weakness ahead. We think the Fed has peaked, but rate cuts are likely a ways off, we forecast only around mid-next year. However, rising yields are creating pressures in other regions.
- Despite an economy apparently in stagnation and a more obvious peak from the ECB, Eurozone yields continue to rise, though not as quickly as US Treasuries. This adds to fiscal concerns, not least with Italy and France delaying the resumption of sub-3% deficits. Overall yields add to fiscal challenges.
- Emerging markets are also buffeted by rising yields (and weaker) currencies reducing central banks dovishness and even leading to a hike in Indonesia. Disinflation has become bumpier, with energy and food increases impacting headline rates. Core disinflation appears to remain on track.

Investment Strategy: risky assets still in a constructive mood

- Rates: The final stages of the central bank hiking cycles is causing some pain in bond markets as economic resilience has dampened expectations for longer-term rate cuts, while more technical factors, including a reconsideration of future term premia and fiscal issues are adding to concerns.
- Equities: Imbalances in valuation and fundamentals suggest that the downturn could become more pronounced, and the results season could provide a further headwind.
- Credit: Spreads are exhibiting resilience as levels have tightened in reaction to higher bond interest rates. Refinancing conditions are tight but the maturity structure is not front loaded. However, cautiousness should remain as rising defaults and lending tightening headwind are growing.
- FX: The dollar has retraced this month, even as long-term real rates continue to rise as markets contemplate whether financial conditions are tightening too quickly. The euro has recovered somewhat, while the yen remains squashed to the ¥150 limit where markets fear BoJ intervention.

Central scenario

Summary – Key messages

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

We forecast global growth to slow to 2.9% in 2023 and 2.7% in 2024.

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

Inflation

Headline inflation stabilizing, with oil providing some upside risks. Core disinflation to broaden over H2. Inflation persistence is now key risk.

Monetary policy

Most central banks now appear at peak, with some uncertainty over Fed. DM rate cuts likely only from mid-2024.

Fiscal policy

Europe has provided fiscal support, but consolidation increasingly the outlook for 2024. US Congressional politics delays further funding requests.

Emerging Markets

Inflation easing across EM, but higher yields and weaker currencies dampen dovish momentum while global rate adjustments add to fragile finances

FX

Dollar has gained on resilient economy – risks ahead. BoJ action would spur yen, but appears distant. Sterling has softened on rate outlook reappraisal.

Equities

Multiple expansion continues to drive performance across regions. Earnings continue to suffer, but their contribution should be beneficial again as from the end of the year.

Credit

Spreads continue to be expensive – and have even narrowed because of bond sell-offs. This resilience can be explained by supportive fundamentals, but the outlook points toward widening.

Rates

Rising expectations of term rates has underpinned 10-year yields, even as central bank peaks emerge. Likely at peak yields.

Growth

Growth resilient in US, expected to slow but avoid recession. Growth slow in Europe. Credit conditions add to headwinds.

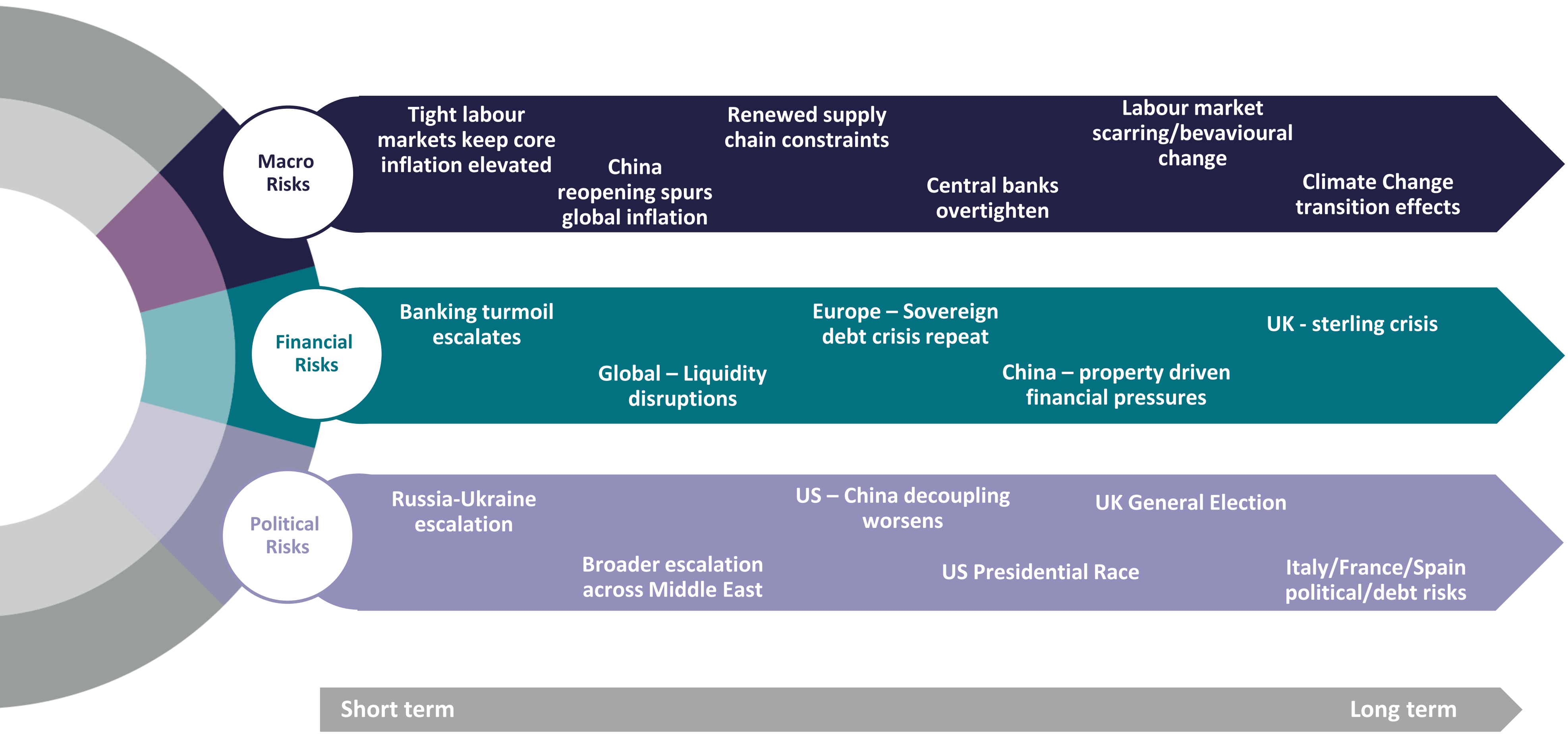
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 20%		A global boost Probability 20%
	- Banking turmoil escalates, credit conditions tighten. - Escalation in Ukraine conflict or Middle East tensions - COVID outbreaks spreads again: China and/or new mutations - Post-pandemic structural persist. Supply shocks last longer - Inflation expectations rise, affecting wages and persistence	What could be different?	- 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
	- 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	What it means	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	Market implications	- 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

Decomposing higher for longer

Cyclical peak

Fed signals close to peak

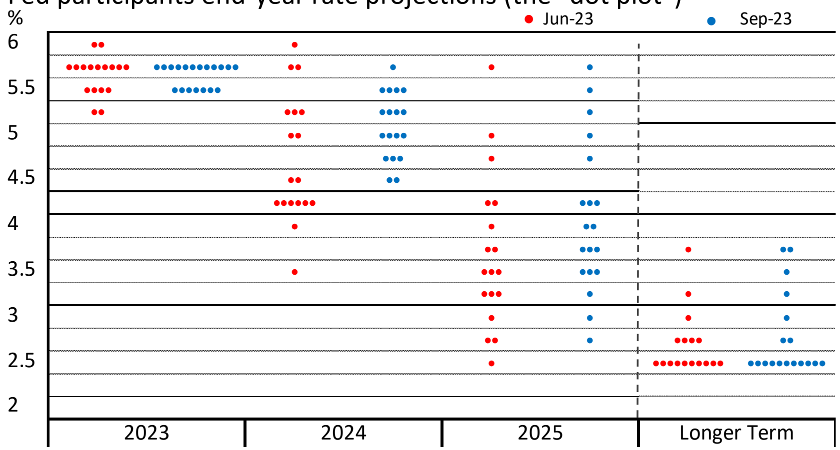
- September's FOMC meeting saw a majority of participants (12-7) project one more rate hike by year-end to 5.75% (upper bound). Since then a strong payrolls print and pick-up in ex-shelter core services CPI inflation have added to reasons to tighten. But a sharp tightening in financial conditions, as US 10-year yields have risen, has led a number of Fed speakers to explain that this is a reason not to hike in November. We continue to forecast the Fed at a peak at 5.5% and current market pricing sees <50% chance of any further hikes from here.

10y UST yields have historically peaked around same time as Fed

- Historically 10-year US Treasury yields have reached a local peak at or a little before the peak in the Fed policy rate cycle.

FOMC dots point to one more hike, commentary more dovish

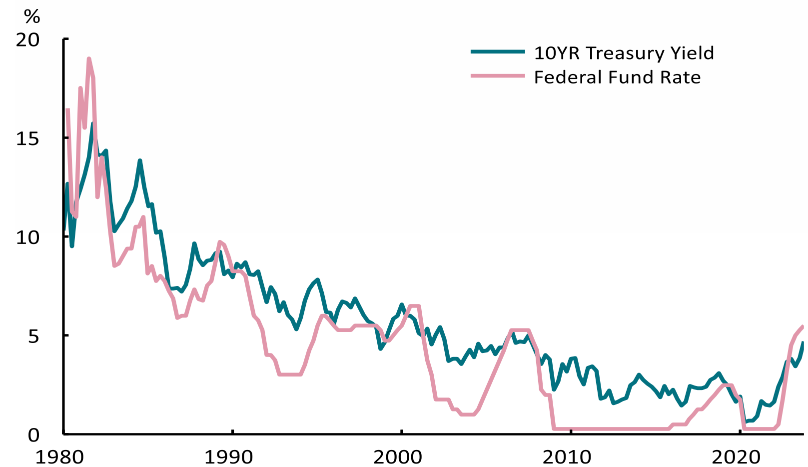
Fed participants end-year rate projections (the "dot plot")



Source: FRB, Sept 2023

Yields and FFR cycle tend to peak together

FFR and US 10YR Treasury



Source: LSEG Datastream , AXA IM Research, 05/10/2023

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Decomposing higher for longer

Fading hopes of rate cuts

Soft-landing expectations fade rate cut expectations

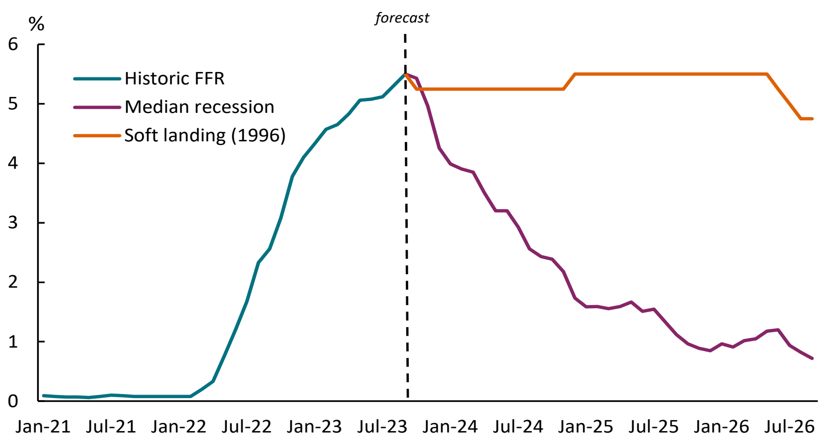
- As market expectations of a US recession have softened (we have revised our own outlook), expectations for rate cuts have faded. Recessions have typically led the Fed to cut the Fed Funds Rate sharply; the only recent example of a soft-landing (1995) saw rates broadly steady over the next 3 years.

Fading rate cuts lift expectations for future years

- Less than 6-months ago markets expected rate cuts to begin by end-2023. Over the past 4 months, while expectations of peak rates have been broadly constant, expectations for end-2024 and 2025 have risen markedly, by around 150bps and 100bps respectively. In terms of the impact on term rate expectations this has had more of an impact than shifts in peak rate expectations.

Rate outcomes in different macro scenarios

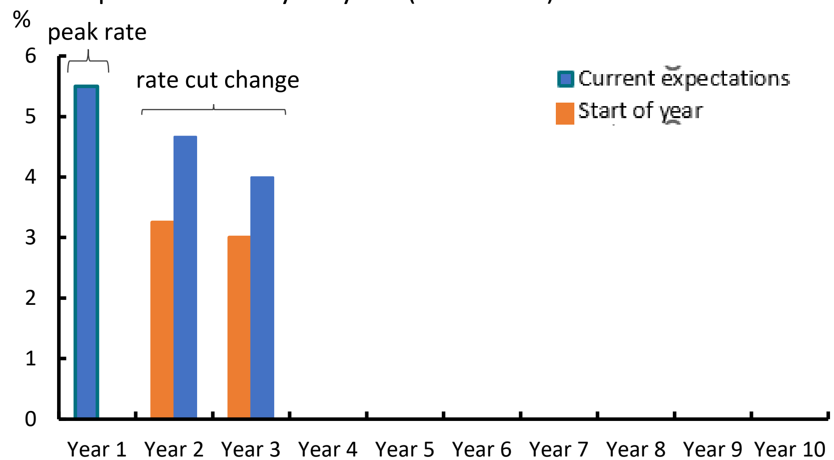
US Recession Fed Fund Rate



Source: FRB, AXA IM Research, Oct 2023

Rate expectations have shifted more further out than for peak

Decomposition of 10-year yield (illustrative)



Source: AXA IM Research, Oct 2023

Decomposing higher for longer

Broader increase in rate expectations

Building an investment boom

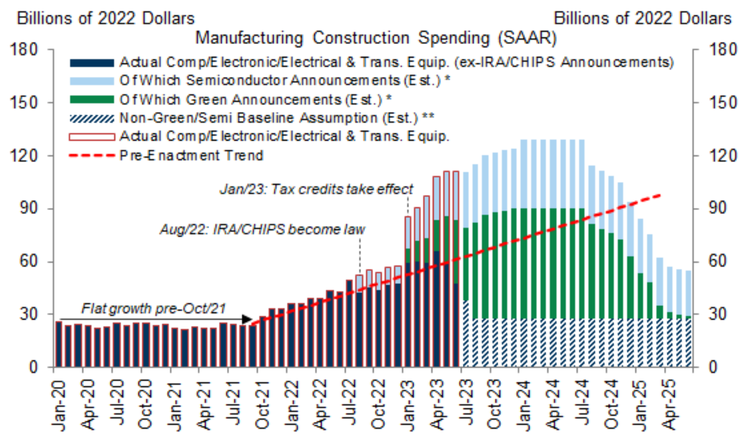
- The US government has provided incentives for structural investment in the form of the CHIPS Act and the Inflation Reduction Act. While there had been a modest post-pandemic increase in corporate announcements for increased investment, these picked-up more significantly after the associated tax credits took effect. This has also taken place against a backdrop where AI innovation has attracted additional investment spending.

Higher planned investment should boost rates

- Basic economic models suggest that a rise in planned investment should be consistent with a rise in interest rates. Indeed, this is the reverse effect of the rise in planned savings – ex-Fed Chair Bernanke's "savings glut" – that was widely attributed to having contributed to depressing interest rates in recent decades.

Company announcements suggest marked rise in investment

Exhibit 1: Company Announcements Imply Manufacturing Construction Spending Should Edg

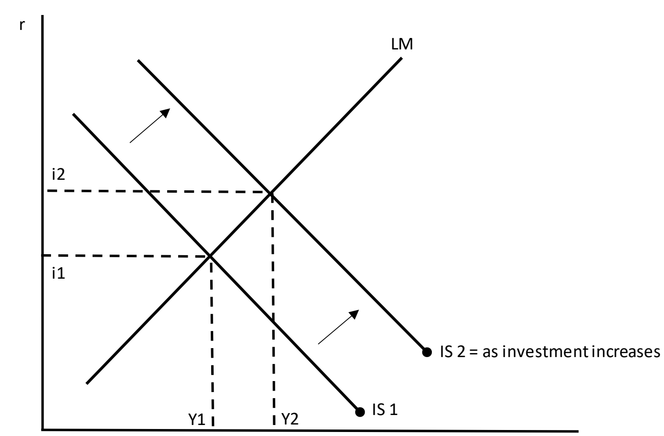


*Estimates reflect only current announcements, rather than a forecast of future announcements.
**Baseline assumes gradual return the average observed over the 3 years prior to enactment.

Source: Census Bureau, Jack Conness, Company data, Goldman Sachs Global Investment Research

Higher ex-ante investment to boost rates (the reverse of higher ex ante saving)

A basic IS-LM model



Source: AXA IM Research, Oct 2023

Decomposing higher for longer

Rising longer term rate expectations

Rising r*

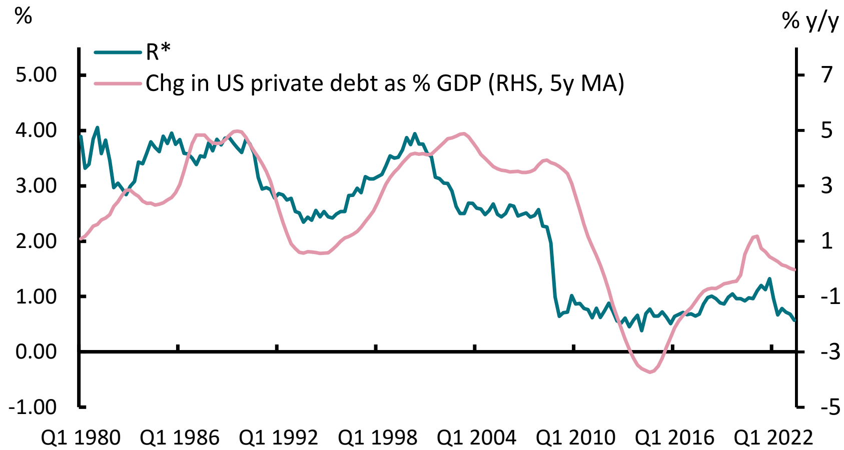
- More specifically there are a number of arguments pointing to higher longer-term neutral rates. Rising investment should help lift productivity and trend growth, all else being equal contributing to a higher neutral rate; moreover, some of the constraints that weighed on the neutral rate after the GFC, including falling borrowing rates and decreased risk appetite should also be consistent with a higher level of r*.

An increase in long-term rate expectations

- Despite the fact that r* is an unobservable variable and difficult to pin down in real time, a growing *perception* that longer-term neutral rates are rising would also add to upward pressure on term rates.

Rising US private debt also points to higher r*

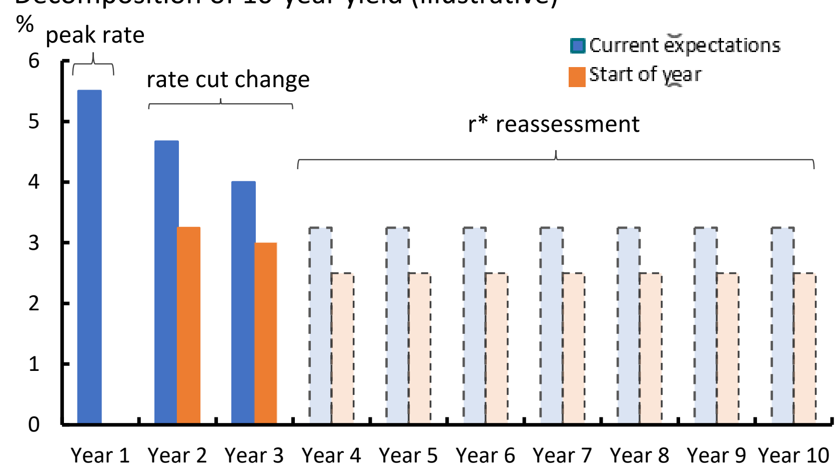
R* and change in US Private Debt % GDP



Source: FRB, AXA IM Research, Oct 2023

Beyond peak, rate expectations rise over broad maturity

Decomposition of 10-year yield (illustrative)



Source: AXA IM Research, Oct 2023

Decomposing higher for longer

The return of term premia

The cyclical

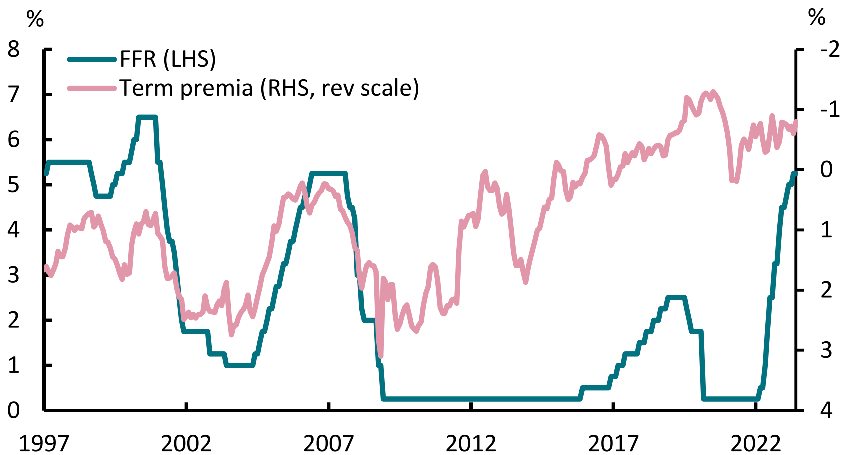
- Term premia is the additional compensation investors have required to take the risk of fixing returns for longer-periods. It is therefore cyclical, with historically less compensation required when rates appear near the top of the cycle and more when rates are lower. Based on this assessment, we would expect term premium demand to be relatively low with the Fed broadly expected to be at or near the peak in the cycle.

And the structural

- Since the GFC, term premium has been systematically reduced by the Fed's creation of excess reserves via QE. This has served to structurally reduce term premia over the last 15 years. However, as the Federal Reserve gradually drains these excess reserves through quantitative tightening, this structural reduction of term premia should fade. In the short-term, the impact of the Fed's QT has been impacted by large flows in and out of the overnight reverse repo facility, impacting the amount of excess reserves over and above the Fed's withdrawal of its asset holdings.

Compensation for rate risk is a function of the current cycle

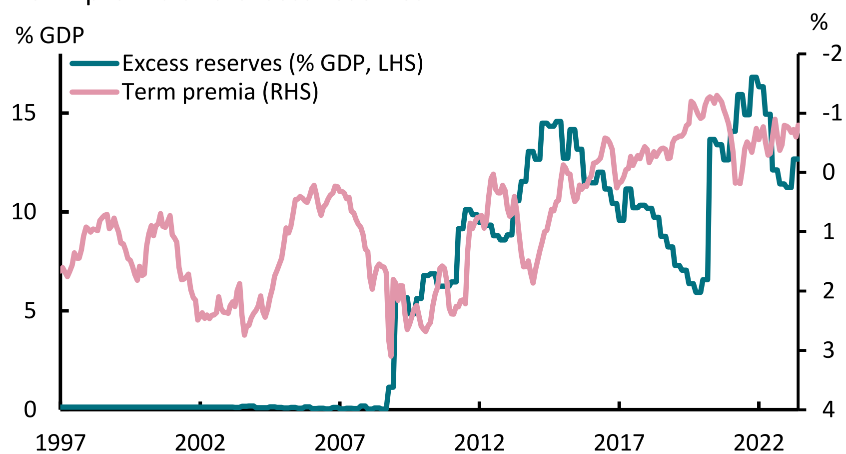
FFR and term premia



Source: FRB, Bloomberg, AXA IM Research, Oct 2023

QE compressed term premia; QT should usher in its return

Term premia and excess reserves



Source: FRB, Bloomberg, AXA IM Research, Oct 2023

Decomposing higher for longer

The implications of a higher-for-longer outlook

Macro explanations only go so far

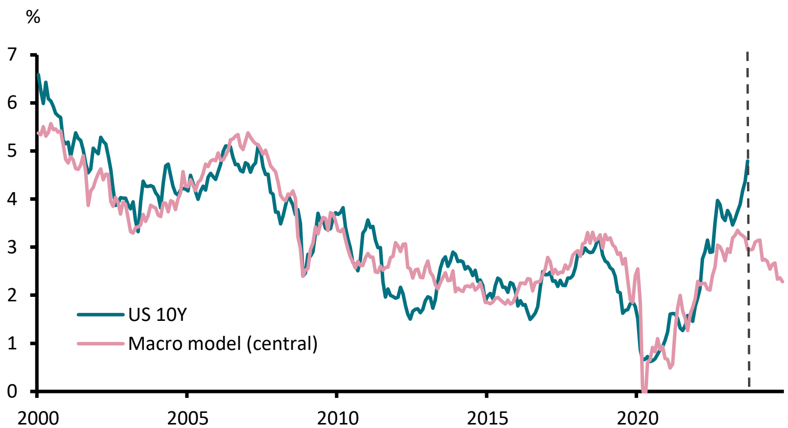
- Our decomposition of macro explanations for higher yields only goes so far in explaining current yields. Indeed specifically, our simple macro model not only points to lower levels of yields looking ahead (broadly anticipating a peak in the FFR and eventual easing and a softening in core inflation), but also fails to capture all of the upside to current yields. We believe that current technical factors are also affecting current Treasury yields.

US exceptionalism

- The rise in US yields has had echoes in other sovereign debt markets, but insofar as few other economies currently match the US in terms of economic resilience or investment spending, US Treasuries have underperformed most other sovereign markets – yields have risen by more. This has helped underpin US dollar strength.

Simple macromodel fails to capture all of recent yield upside

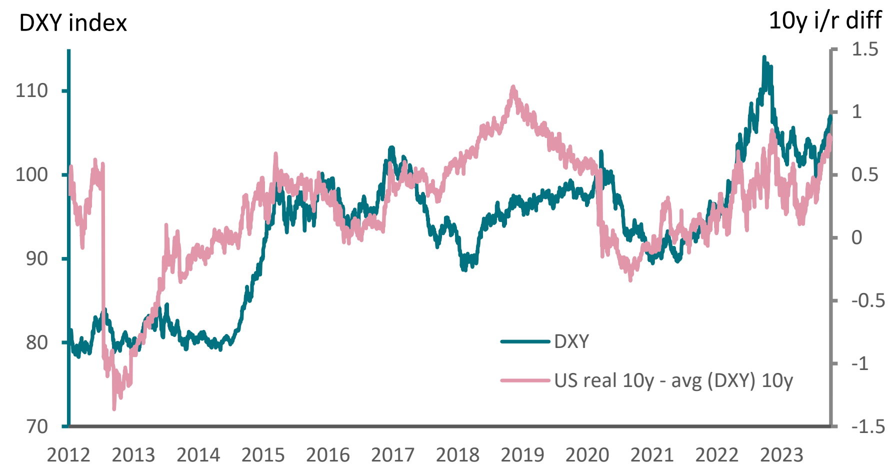
US 10Y Treasury yields and basic macro model



Source: Refinitiv, AXA IM Research, Oct 2023

Stronger US yields support US dollar

$ DXY index vs 10y real rates differential



Source: BEA, AXA IM Research, Oct 2023

Macro outlook

Economy approaching a turn, but upside risks

US

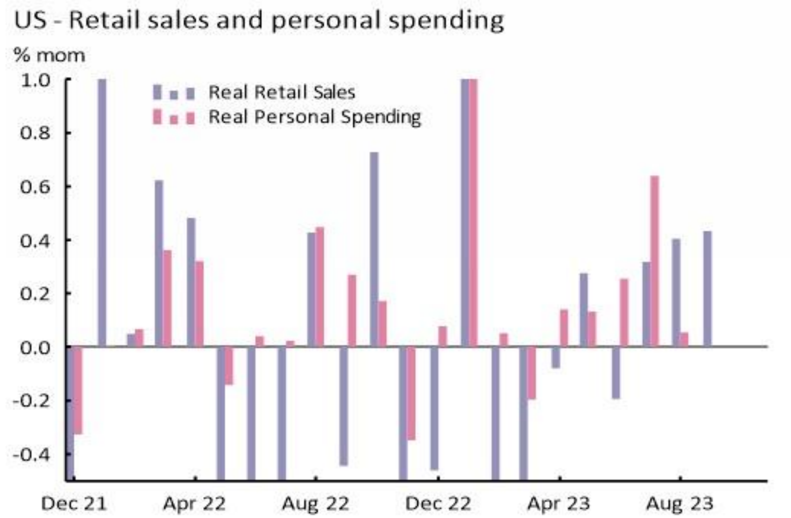
A turn in consumer spending?

- September's retail sales posted a surprising solid rise in real terms, contradicting a retracement in consumer sentiment surveys that have unwound early summer strength, and defying higher gasoline costs. We believe household incomes will come under more pressure in Q4 with the resumption of student loan repayments, but await to see if that translates to weaker spending, reduced saving or increased borrowing. We forecast a slowdown in consumer spending in Q4, but no longer a fall. We no longer forecast recession and raise our estimate of GDP growth to 2.2% in 2023 and 1.4% in 2024 (from 1.9% and 1.1%, consensus 2.1% and 1.0%).

Upside risks

- Yet recent data has stressed upside risks to our outlook. The Atlanta GDPNow tracker suggests growth in excess of 5%; payrolls posted 336k job gains in September, with employment growth rising in Q3 compared (up an average 266k vs 201k). And our forecast for weaker consumer spending is based on the view that weaker incomes translate to reduced spending, not increased borrowing.

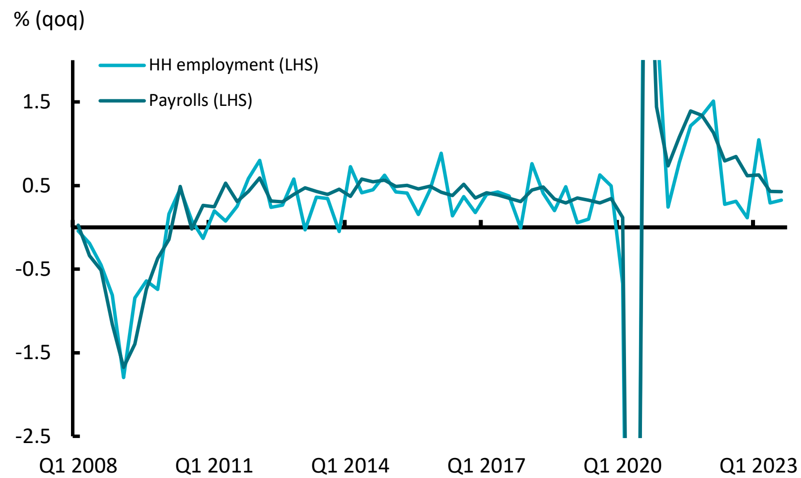
Real spending stays solid in Q3, should weaken across Q4



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

Measure of employment rise into Q3

Measures of employment growth



Source: BLS, AXA IM Research, Oct 2023

Softer data to dissuade Fed

US

Disinflation stalls in September

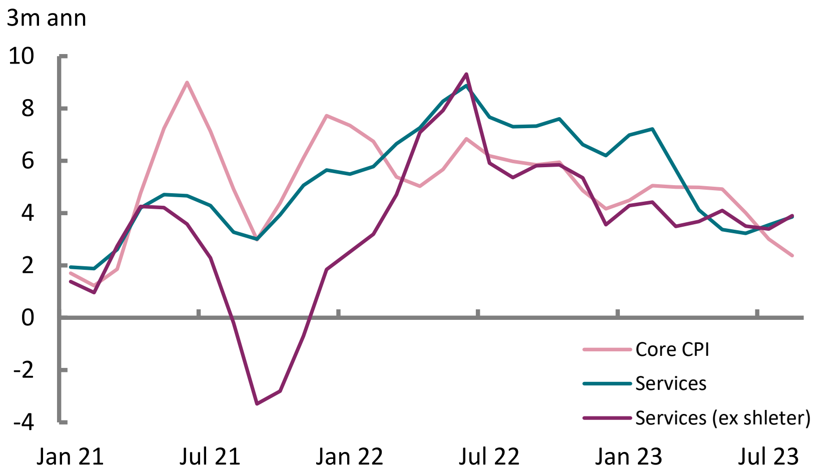
- Headline disinflation has stalled in recent months, the rise in oil prices adding to gasoline costs in August and September and the annual CPI rate remained at 3.7% in each month. Core inflation fell back to 2-year lows of 4.1%, however, a breakdown of recent trends shows that both services and services ex-shelter inflation – the latter a key focus of the Federal Reserve - picked up in recent months. We forecast headline inflation to average 4.3% and 2.8% this year and next (consensus 4.2% and 2.7%)

Weakening data to dissuade of December hike

- FOMC minutes echoed September's Summary Projections suggesting that a (small) majority envisaged one further rate hike this year, but that the Committee was data dependent. Recent Fed commentary has added that tighter financial conditions reduce the need for further policy hikes. We think this message, before the purdah period ahead of the November meeting, rules out a hike here. By December, we expect softer economic data. We believe that the Fed has peaked at 5.50%. We forecast the Fed to start gently easing policy in H2 2024 to 4.75% by year-end.

Sticky services inflation slows core disinflation

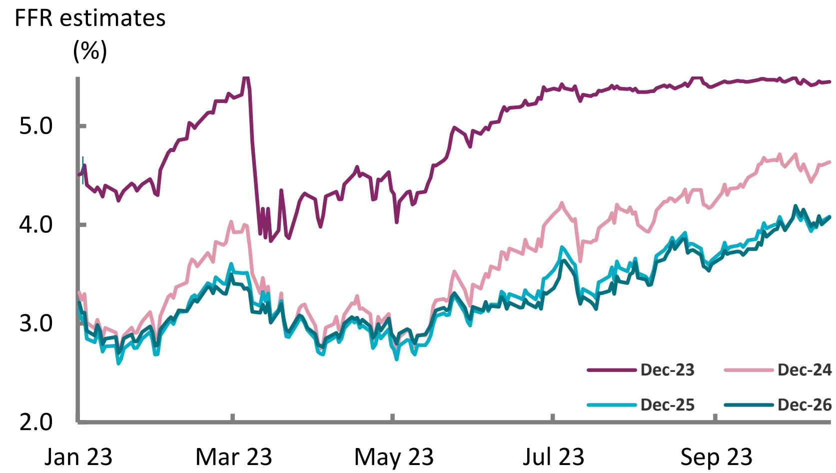
Components of core inflation



Source: BLS, AXA IM Research, Oct 2023

Markets consider not higher, but high-for-longer

Market rates for year-ends



Source: Bloomberg, AXA IM Research, Oct 2023

An invitation for (further) market differentiation

Euro area

Late deficit adjustments

- Several items are worrying in Italy's budget. First, optimistic growth (1.4%; AXA IM: 0.1%; consensus: 0.6%). Second, achieving a sub-3% deficit delayed by one year to 2026, and thus a risk of the Commission applying excessive deficit procedures.
- Third, there is virtually no improvement in public debt trajectory over the course of the forecast. France's multi-annual path presents some similarities, leaving no room for manoeuvre.

Market discipline applies

- In a context of higher global rates, led by the US, Italian spreads have increased to 200bps. Crucially, absolute 10y yields are flirting with 5%, much higher than already optimistic nominal growth projected slightly above 3.0%, making a very challenging debt stabilising hypothesis in the medium term. For more see our in depth research.
- Critical elements to monitor: Agreement of credible fiscal rules by EU Heads of States – unlikely before year-end; and Italian NGEU implementation getting back on track.

Minimum fiscal efforts in Italy…

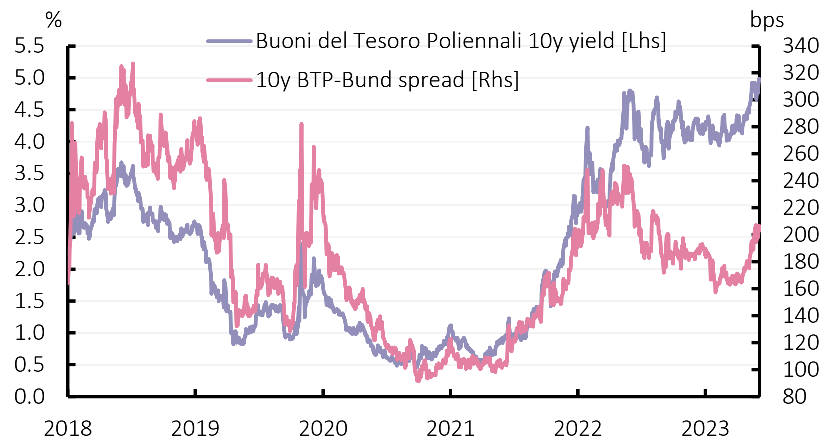
Italian NADEF (Sep 2023)

	2022	2023	2024	2025	2026
Budget bal. (% of GDP)	-8.0	-5.3	-4.3	-3.6	-2.9
Primary bal. (% of GDP)	-3.8	-1.5	-0.2	0.7	1.6
Gvt gross debt (% of GDP)	141.7	140.2	140.1	139.9	139.6
Real GDP growth, % y/y	3.7	0.8	1.2	1.4	1.0
GDP deflator, % y/y	3.0	4.5	2.9	2.1	2.1

Source: Italian Treasury

…against uncomfortable market dynamics

Selected Italian bond market metrics



Source: Refinitiv and AXA IM Research, October 2023

Investment Managers

ECB: Tasked to keep it together (again)

Euro area

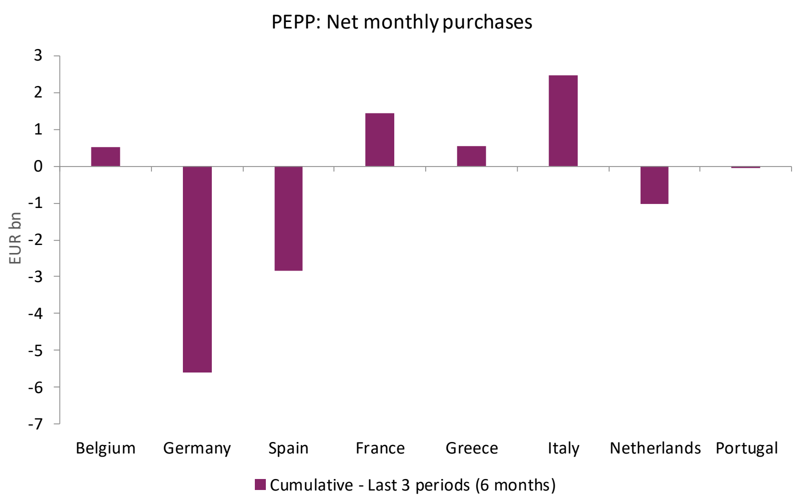
A decision-free October ECB meeting

- We do not think the ECB is likely to act swiftly on its first line of defence against financial fragmentation – the PEPP holdings - amidst tense budget discussions, limited fiscal rule visibility, issues with bond portfolio losses, and uncertain geopolitics.
- While minimum reserve requirement are widely discussed in newswires, we think this is unlikely to be turned into an active monetary policy tool and should really wait for a comprehensive review of ECB's excess reserve management due next spring.

TPI: Ever higher bar

- Given where things stand, it is not clear EU fiscal rules and debt sustainability eligibility criteria would be validated.
- Furthermore, the proportionality assessment was designed in relation with the ECB reaching its primary objective, now much closer

Italy has been a net beneficiary of PEPP reinvestment flexibility



Source: ECB, AXA IM Research, October 2023

ECB TPI three step activation process

TPI three-step activation process	**Steps in detail**	**Comment**
Whether TPI are justified	Countering unwarranted, disorderly market dynamics that pose <u>a serious threat to the transmission of monetary policy</u> across the euro area	Levels and pace matter, not justified by fundamentals
Evaluate TPI eligibility criteria	<u>- Compliance with the EU fiscal framework</u> <u>- Public debt sustainability</u> - Absence of severe macro-imbalances - Sound and sustainable macro policies	Excessive Deficit Procedure in 2024 - High bond yields make public debt stabilisation hypothesis more challenging, especially amid optimistic short and medium-term growth assumed by governments.
Proportionality assessment	TPI purchases are proportionate to the achievement of <u>the ECB's primary objective</u>	The ECB is now much closer on achieving its primary objective than in July 2022

Source: ECB, AXA IM Research, October 2023

Easing signs

UK

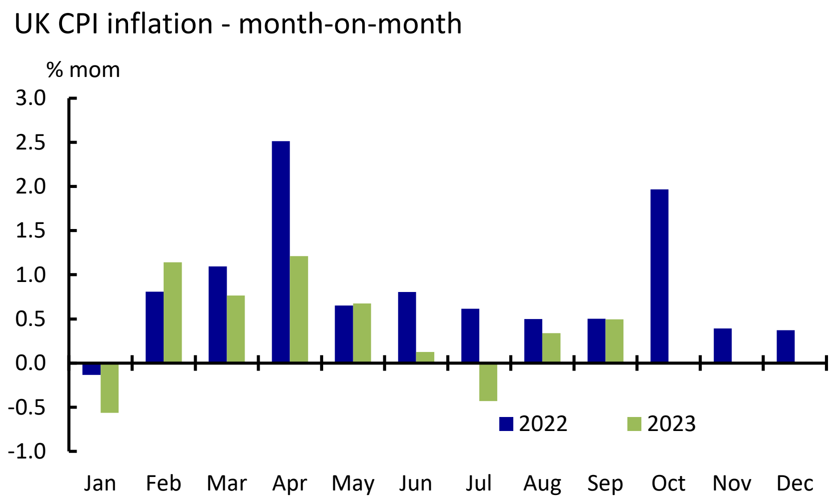
Inflation held at 6.7% in September ahead of large utility drop in October

- September's 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 goods inflation to continue to drive deflation over the coming months, with inflation to fall sharply in October to 4.7%, driven by a decline in energy prices.

Indicators continue to point towards stagnation

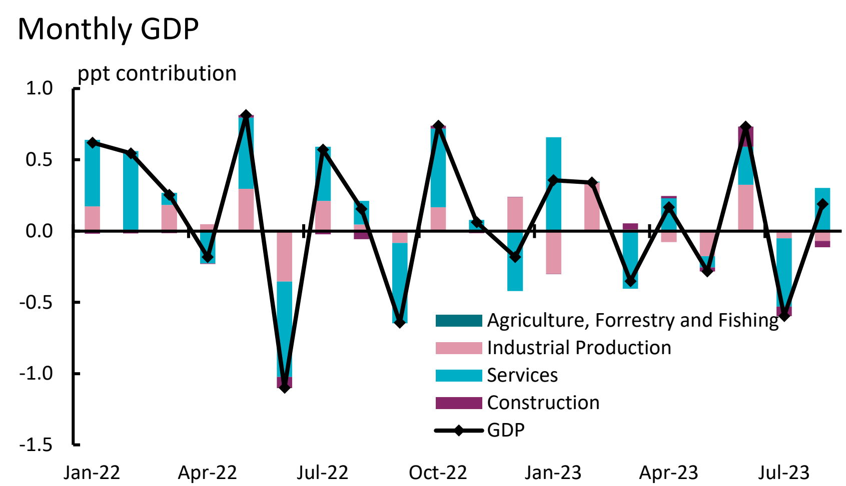
- Monthly GDP rose by 0.2% on the month in August following a (revised) 0.6% fall in July. Output was driven by resilience in professional services and an unwind of the strike impact in education. Survey data remains lacklustre; PMIs don't point to as sharp a fall as September's flash estimates (48.5 for the composite versus 46.8 flash) but are consistent with continued stagnation. GfK consumer confidence dropped sharply in October to -30 from -20 and retail sales dropped sharply in September by 0.9% despite improved weather.

Large CPI drop expected in October



Source: ONS, AXA IM Research, October 2023

Services drove 0.2% pick-up in August growth



Source: ONS, AXA IM Research, October 2023

Slowing data points to BoE hold in November

UK

Labour market data increasingly fuzzy

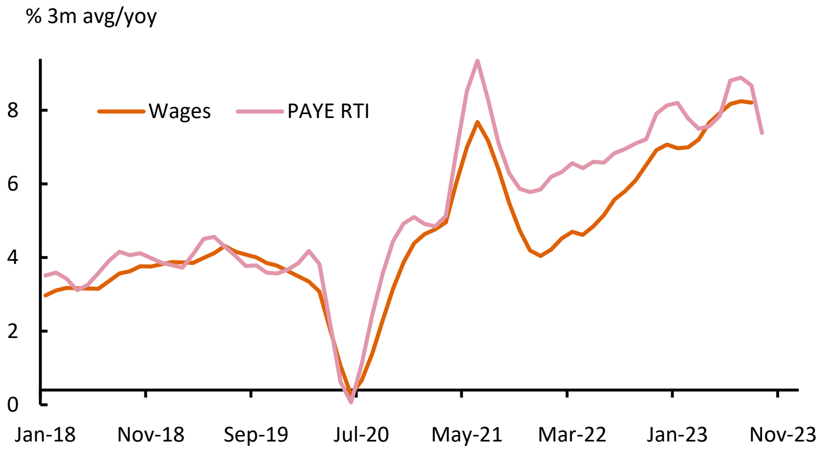
- The labour market has showed early signs of loosening, but recent events have cast uncertainty over the reliability of these data. The ONS delayed publication of October's Labour Force Survey by a week due to low response rates. This follows the BoE's assertion that wage data were difficult to reconcile with other measures, including HMRC payrolls and BoE Agent's intelligence, which show softer pay growth around 6.5%. AWE (ex bonuses) remained at 7.8% (yoy), but slowed to 5.3% (3m annualised).

BoE pause looks likely as MPC speakers focus on emerging weakness in growth

- The BoE's MPC meets on 2 November when it will also update economic projections. September's surprise hold was a close decision, but data continue 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%. 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.

Average weekly earnings not falling as fast as other measures

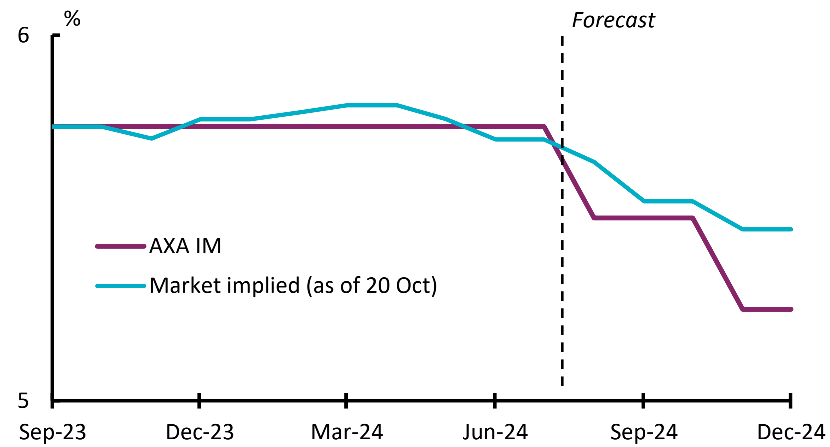
Regular wages and PAYE/Indeed wage data



Source: ONS, BoE, AXA IM Research, October 2023

Markets converge on our view of cuts over 2024

BoE Bank Rate outlook



Source: Refinitv, BoE, AXA IM Research, October 2023

Economy on track to the target

China

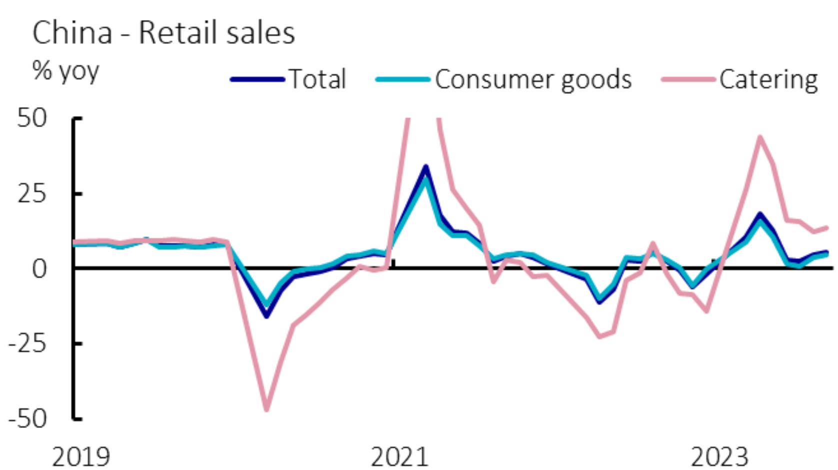
Stronger-than-expect Q3 GDP well positioned the economy to meet "around 5%" target

- 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 contributed to lift the economy from its mid-year trough.

Divergence within retail sales persists

- Small but rewarding expenditures, such as catering and restaurant spending were preferred over big-ticket purchases, underlining continued cautiousness among consumers.
- As the labour market continues to improve and the property market stabilises, consumer confidence is likely to advance further in the coming months.

Retail sales picked up, led by catering and restaurant spending



Source: CEIC, AXA IM Research, October 2023

While more people travelled, less were spent

Note: 8-day golden week: when Mid-autumn and national day fall together
Source: Ministry of culture and tourism, AXA IM Research, Oct 2023

Gloomy picture in property market to stay

China

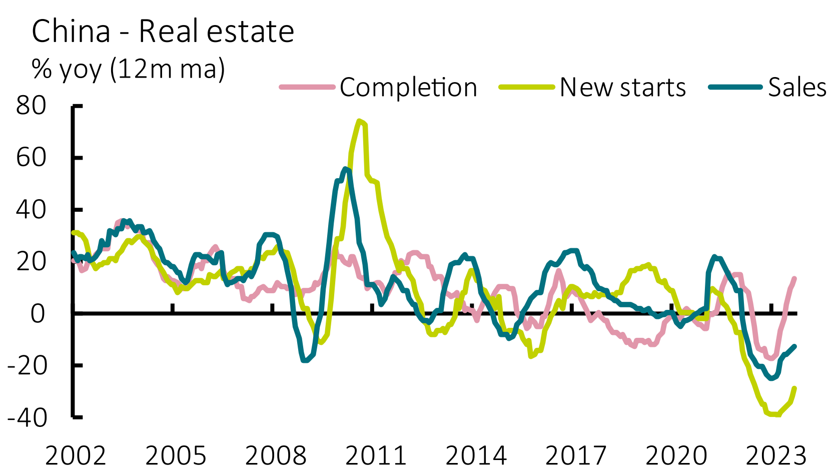
Resilience in completion, while other fronts remained subdued

- Floor space completion, that has been backed by policies from Beijing stayed resilient in September, but property sales, investment and new starts were still on the decline.

Housing prices stabilised, albeit some seasonal fluctuation

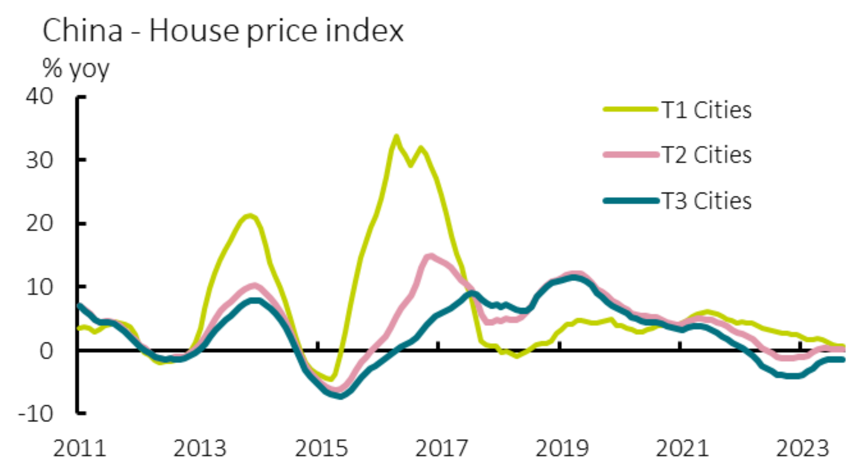
- Housing prices fell at their fastest pace on the month in a year in September. However, in annual terms, prices in Tier 1 and tier 2 cities started to stabilise, with some lags in tier 3 cities, due to years of oversupplies.
- It remains to be seen whether Beijing has done enough with recent stimulus 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 property continues to remain weak.

Completion stayed strong



Source: LSEG Datastream, AXA IM Research, October 2023

Housing prices started to stabilise, while tier 3 cities lagging



Source: CEIC, AXA IM Research, October 2023

Growth remains on track as price pressures continue to broaden

Japan

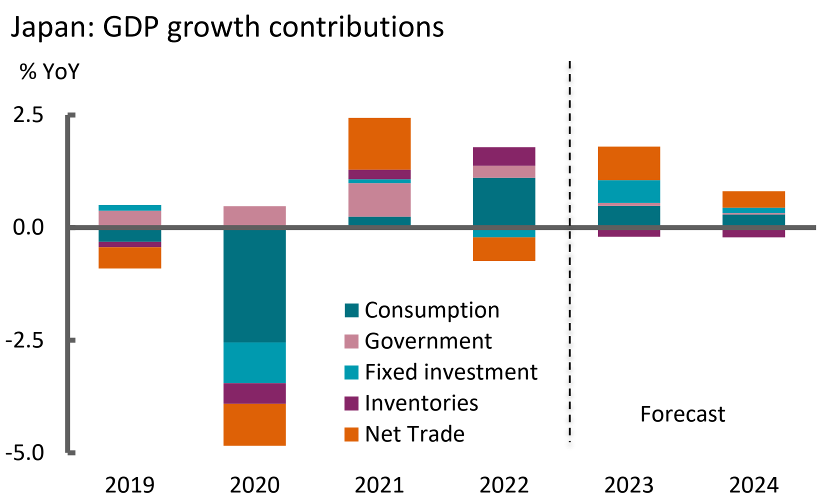
Growth continues, but pace of recovery likely to slow

- 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%).

Inflation remains elevated, adding to hopes of sustainable inflation

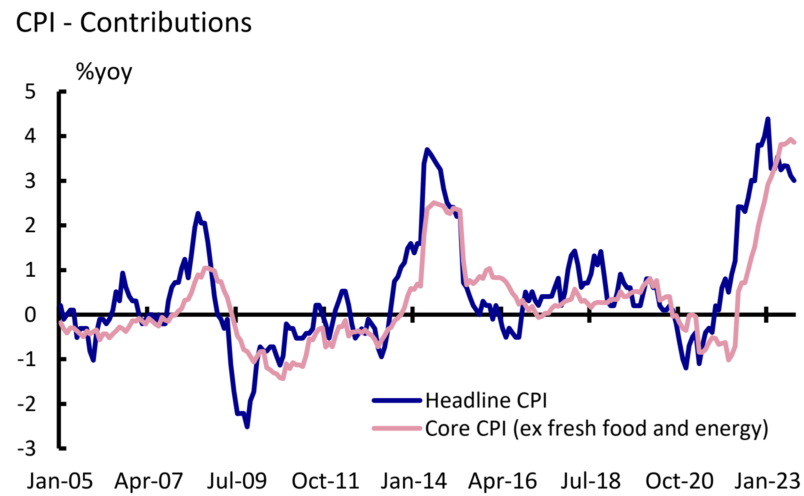
- CPI inflation eased marginally to 3% in September from 3.2%. The BoJ's preferred core measure (excluding fresh food and energy) eased to 4.2% from 4.3%. The outlook for Japanese inflation remains uncertain, but we expect it to gradually lose momentum as contributions from food and energy fade, but believe such inflation will likely prove stickier than during past periods. Wage dynamics continue to improve, with Rengo, Japan's largest labour union indicating they will seek wage hikes of at least 5% in upcoming spring wage negotiations.

GDP Recovery to continue



Source: Refinitiv, AXA IM Research, October 2023

Core inflation showing little sign of slowing



Source: Refinitiv , AXA IM Research, October 2023

BoJ to stay put as government prepares stimulus

Japan

October MPM likely to see significant upgrade to inflation forecasts

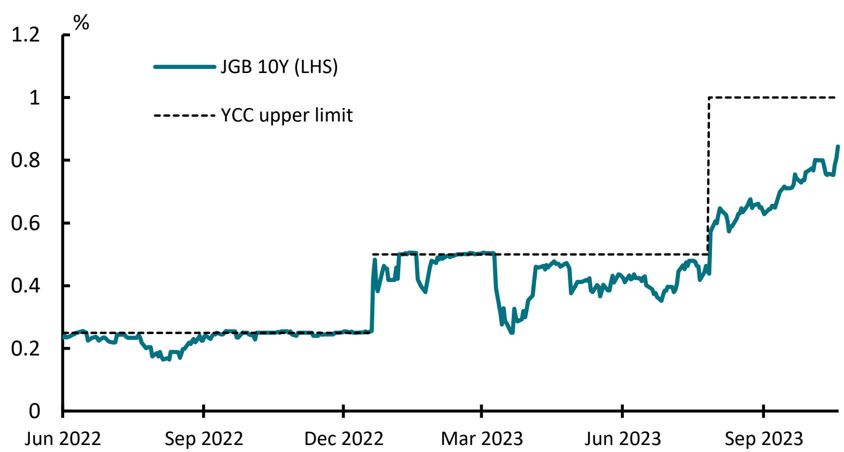
- The BoJ next meets on 30-31 October. This meeting will include the publication of its quarterly economic forecasts. Updated inflation forecasts will be closely watched - we expect the BoJ to raise its core inflation (excluding fresh food) forecasts for fiscal year 2023 and 2024, previously at 2.5% and 1.9%. 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 policy tools on hold here.

Stimulus expected by end-October

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

Yields have pushed higher, now trading around 0.84%

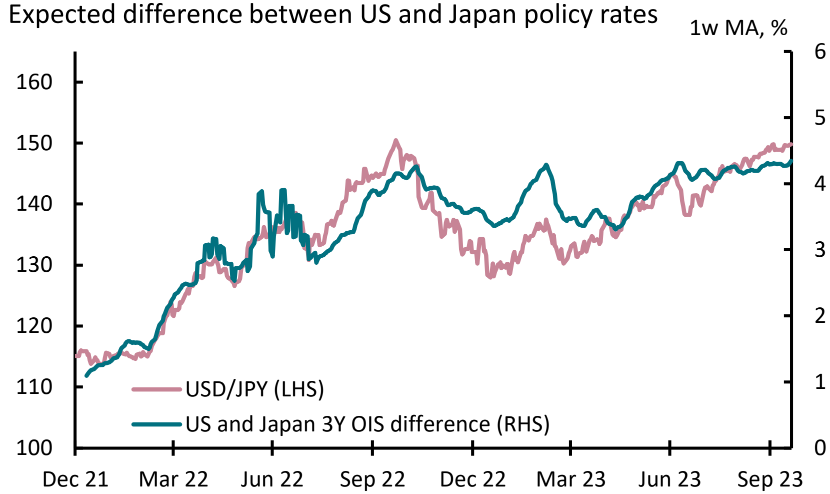
BoJ 10Y JGB purchases and YCC



Source: BoJ, Refinitiv, AXA IM Research, October 2023

Yen has continued to slide

Expected difference between US and Japan policy rates



Source: Refinitiv, BoJ, AXA IM Research, October 2023

Growth slow, but is it enough?

Canada

Economy to narrowly avoid recession, before 2024 pick-up

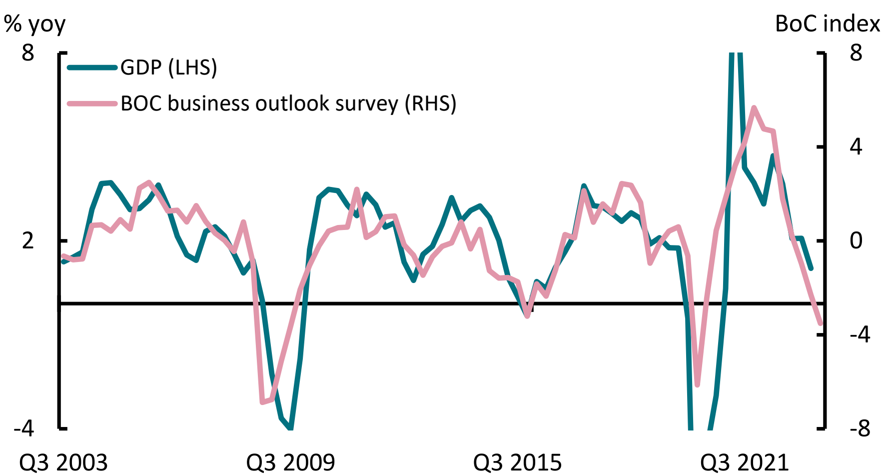
- Following Q2's contraction we forecast GDP to rise by a soft 0.4% (ann) in Q3, narrowly avoiding contraction with a final quarter around flat. Higher mortgage rates are seeing mortgage costs comprise a rising share of household incomes, which should weigh on spending, although exports and investment are proving more resilient. We lower our 2023 growth forecast to 1.1% (from 1.3%), but leave 2024 unchanged at 0.9% (consensus 1.2% and 0.7%).

Supply-driven slowdown?

- Recent data question Canada's trend growth rate. While strong migration has boosted potential growth, persistent contraction in productivity has weakened it. We see risks that potential growth could fall below the BoC's estimated 1-3.2% range over the coming three years, suggesting slower growth may not see sufficient disinflation. The slowdown to date has seen some easing in the labour market, but current pay growth remains in excess of rates consistent with the inflation target and accelerated in Q3.

Business sentiment continues to deteriorate

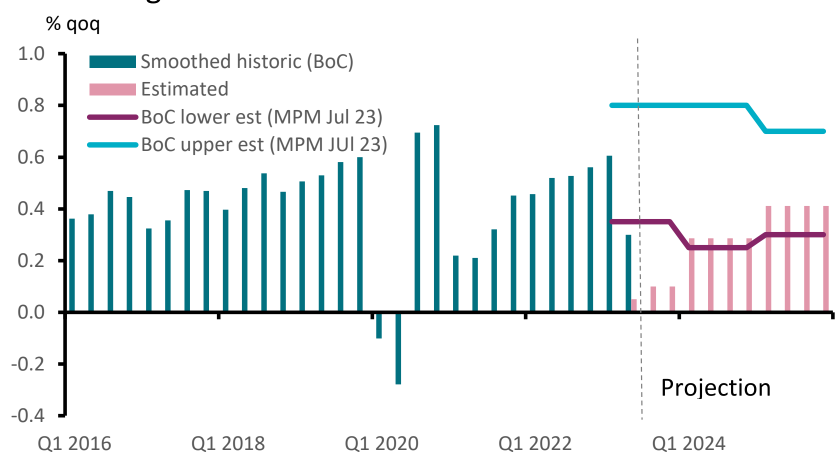
GDP and business survey



Source: CANISM, BoC, AXA IM Research, Oct 2023

Risks that potential growth could be lower than forecast

Potential growth rate



Source: CANISM, BoC, AXA IM Research, Oct 2023

Investment Managers

BoC balances two-sided risks

Canada

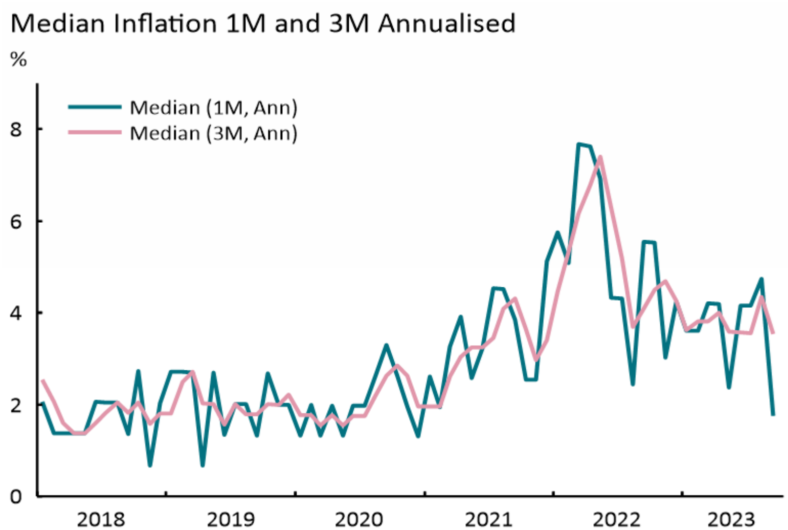
Persistence

- September's headline inflation rate eased to 3.8% despite rising gasoline prices and a weak base effect from last year. We envisage headline inflation closing this year a little higher before disinflation resumes next year. We forecast inflation to average 4.2% in 2023 and 3.1% in 2024 (consensus 3.9% and 2.5%). Core measures have remained stickier, but the latest month reversed recent gains. Broad stability over the last year reflects a still tight labour market and threatens inflation persistence.

Rate call volatility reflects nature of tight calls

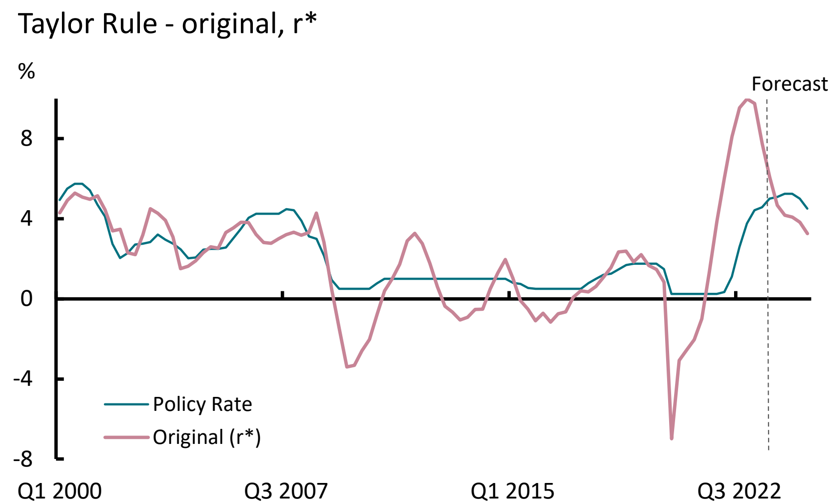
- The BoC is clearly balancing risks of overtightening against concerns of inflation persistence. Recent data are likely to have raised concerns over the former and we reverse our call for a final hike to 5.25%, certainly in October, but likely in December as well. Thereafter, a resumption of headline and core disinflation, as well as stagnant activity across H2 should lay the groundwork for easier policy, but only, we think, from H2 2024, when we forecast cuts back to 4.50% by year-end.

Recent trends in core inflation add to persistence angst



Source: LSEG Datastream , AXA IM Research, 17/10/2023

Longer-term policy rules signal a change in direction ahead



Source: CANISM, BoC, AXA IM Research, Oct 2023

It feels less dovish…

Emerging Markets

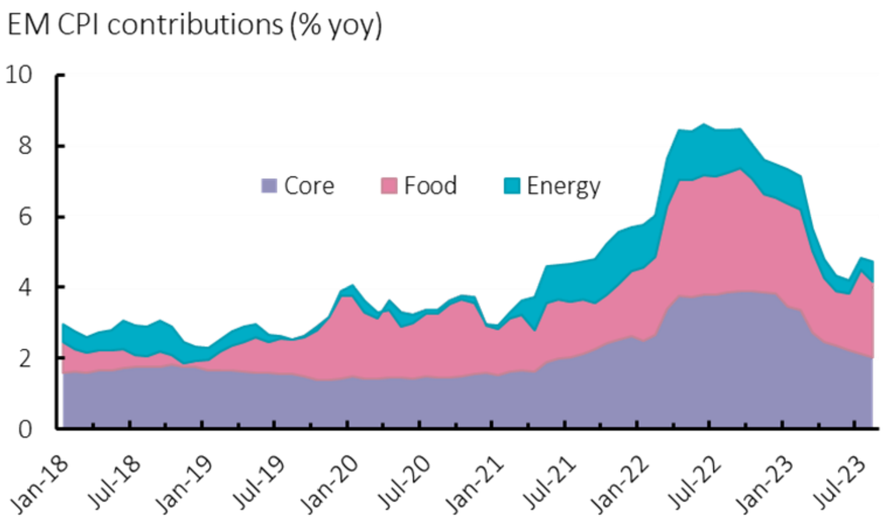
Disinflation continues but course becomes bumpier

- After a steep fall in inflation since mid-2022 as falling energy and food prices inflation reversed, there seems to be less strong momentum ahead. Inflation has even picked up lately in several countries, such as Brazil, Korea or the Philippines, although most of this was due to food and energy (sometimes on the back of lifting subsidies), while core inflation still remains well oriented. We expect slower disinflation in 2024, particularly in Asia, while CEE still benefits from strong momentum into this year-end.

Central banks become less dovish in the face of higher US yields and weaker currencies

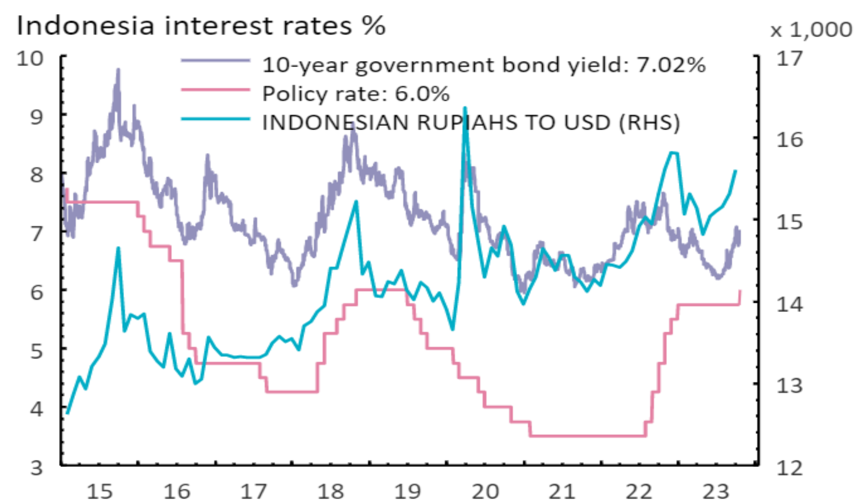
- Recent currency weakness (with the notable exception of PLN post-elections in Poland) is also a matter of concern on the path of disinflation. Additionally, higher US yields exert pressures on central banks and limit their dovish stances. Unexpectedly, Bank of Indonesia hiked policy rates in October after 7 months being on hold, a sign that the level of the currency does matter.

Disinflation path encounters some hurdles



Source: LSEG, AXA IM Research, October 2023
**EM ex-China proxy ie 18 countries GDP-PPP weighted = Brazil, Chile, Colombia, Czechia, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Philippines, Poland, Romania, Russia, South Africa, South Korea, Taiwan, Thailand*

An unexpected hike, in Indonesia



Source: LSEG Datastream and AXA IM Research 18/10/2023

AXA Investment Managers

Populism is not a fate… for Poland and Ecuador

Emerging Markets

Poland: opposition coalition likely to form government ending 8 years of populism

- A historical high turnout at polls granted the 3 opposition parties a majority in parliament, although protracted government formation should follow. We expect an improvement in the country's relationship with the EU, and more broadly, but we do not expect immediate EU funds' disbursements. Fiscal policy is likely to stay accommodative and Poland will likely enter the EDP under EU rules. A stronger PLN could help disinflation into 2024.

Ecuador: Correismo's 2nd consecutive defeat likely offers temporary respite from populist policies

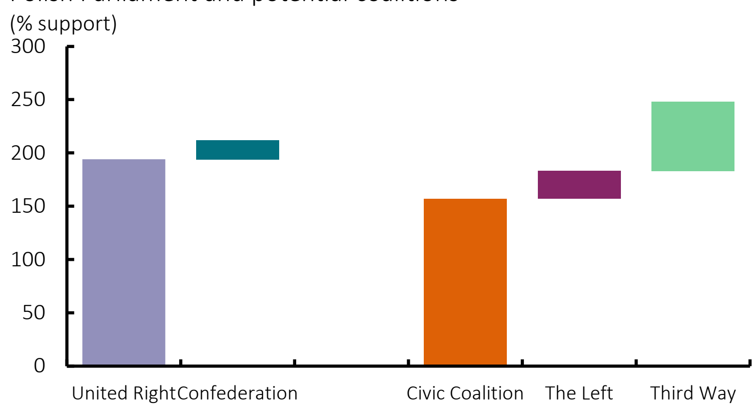
- Daniel Noboa, the centre-right candidate, has secured Ecuador's presidency, defeating Luisa Gonzalez, the *correista* candidate for the remaining 18 months of the presidential term. Despite challenging political conditions, Noboa's interim government will likely offer a temporary respite from the threat of a return to fiscally imprudent populist policies in Ecuador.

Argentina's presidential runoff: Massa, the ruling party's nominee, vs. political outsider Milei

- Sergio Massa achieved a surprising victory in the first round of Argentina's presidential elections with 36% of the vote. Javier Milei came in second with 30% of the support. As a result, Massa and Milei will compete in a runoff scheduled for November 19th. Polls suggest a victory for Milei but only by a small margin. In this context, it will be crucial for the libertarian candidate to capture Patricia Bullrich's votes.

Poland: opposition coalition won

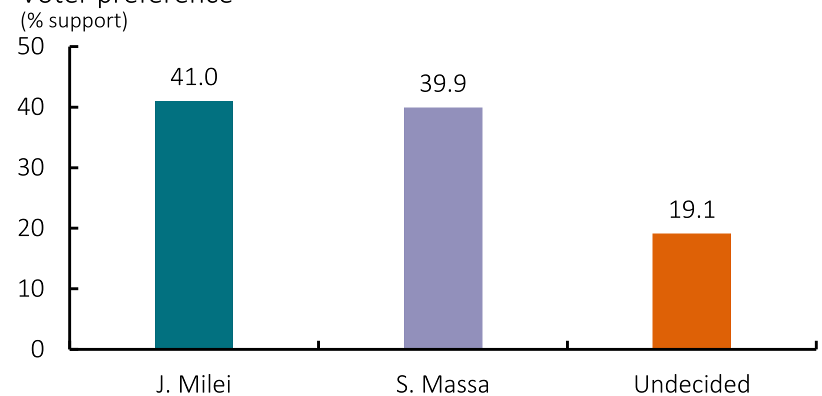
Polish Parliament and potential coalitions



Source: Election Commission & AXA IM Research, October 2023

Argentina: Political outsider holds the lead

Voter preference



Source: Opina Argentina & AXA IM Research, October 2023

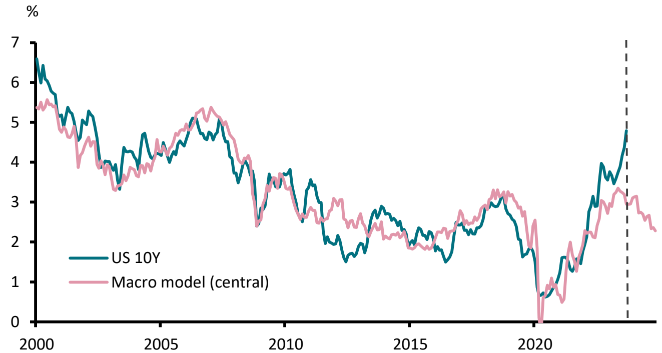
Investment Strategy

Investment strategy

Macro driven yield models: US and Germany

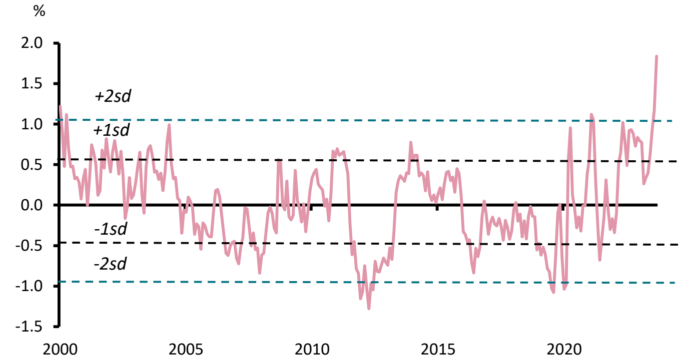
Model points to yield drop as Fed peaks and inflation falls

US 10Y Treasury yields and basic macro model



Model residual at extreme levels

Model Residual and std error bands



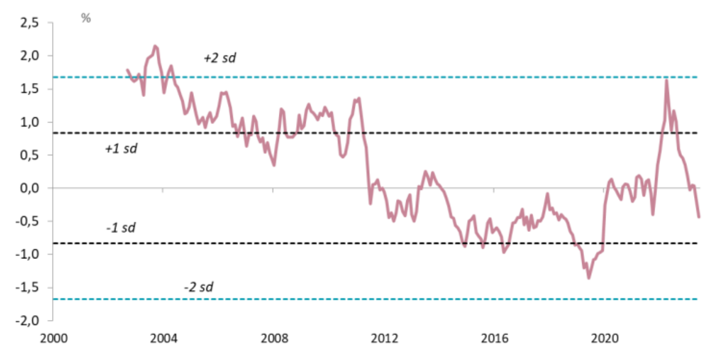
Bund model points to easing driven by inflation

German 10Y yields and basic macro model

Source: Refinitiv, AXA IM Research, September 2023

Model residuals not far from being balanced

Model residual



Source: Refinitiv, AXA IM Research, September 2023

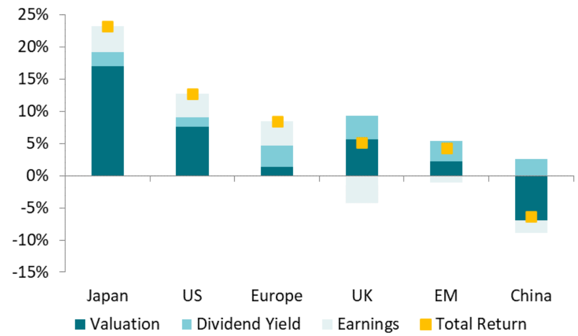
Models are derived from purely macro variables, specifically central bank policy rates, core inflation, central bank bond holdings, net bond issuance and manufacturing surveys. Model forecasts project our macro forecasts for these variables. Forecasts do not include contributions from valuations, sentiment and technical factors and should not be considered market forecasts.

Investment strategy

Equity outlook

Europe exhibits the most fundamental driven positive return

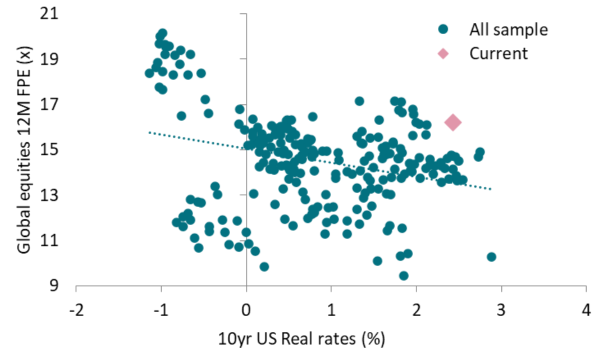
Global - YTD Total return composition by regions



Source: MSCI and AXA IM Research, October 2023, in Local terms

Global market is expensive relative to historical standards

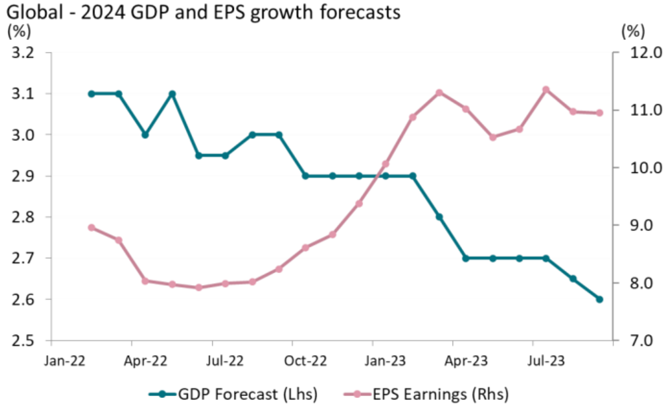
Global equities Forward PE and real rates



Source: MSCI and AXA IM Research, October 2023, over the last 20 years

EPS optimism is a risk for already rich multiples…

Global - 2024 GDP and EPS growth forecasts



Source: Bloomberg, IBES and AXA IM Research, October 2023

as fundamentals point toward more muted EPS growth

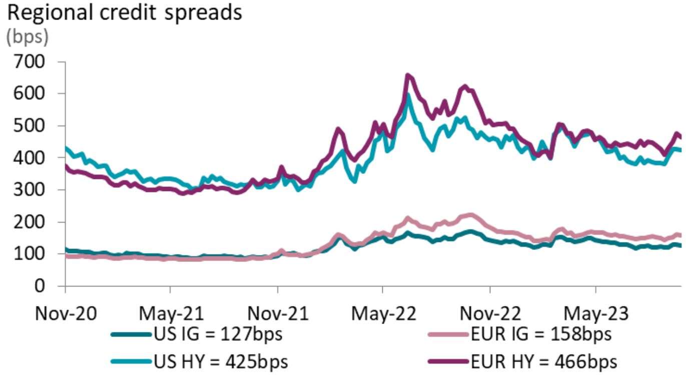
CEO Business confidence and 12M Trailing EPS growth

Source: The Conference Board, MSCI and AXA IM Research, October 2023

Investment strategy

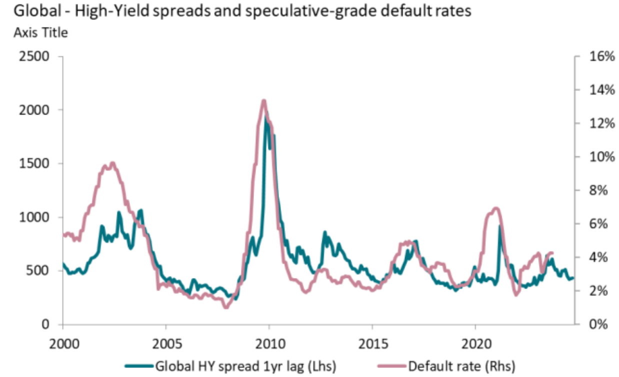
Credit markets

HY spreads uptick is marginal



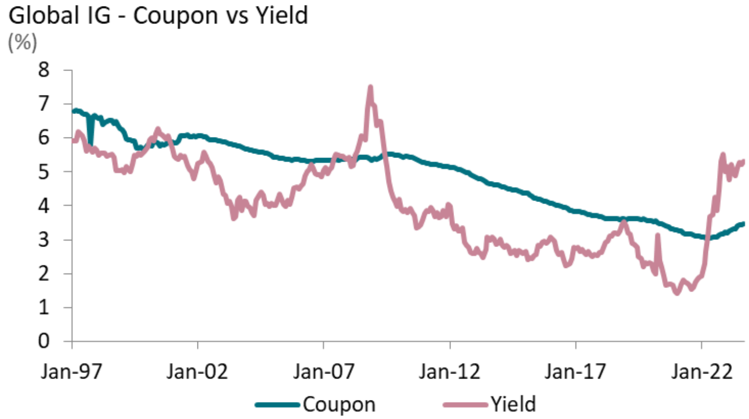
Source: ICE and AXA IM Research, October 2023

While current level suggest default rate stabilization



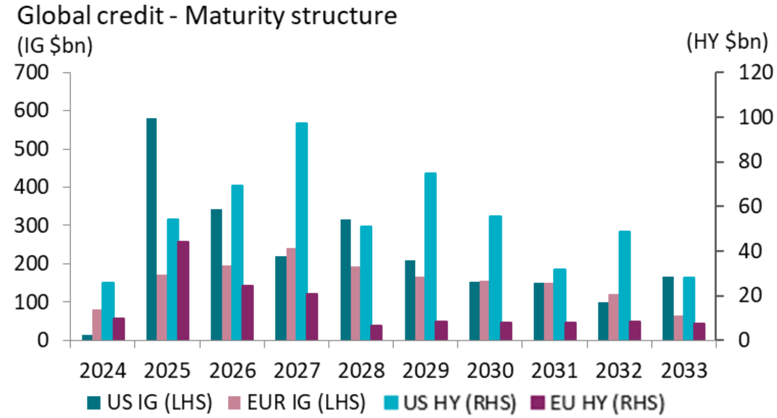
Source: ICE, Moody's and AXA IM Research, October 2023

The refinancing gap remains an issue…



Source: ICE and AXA IM Research, October 2023

But the maturity wall nuance this issue

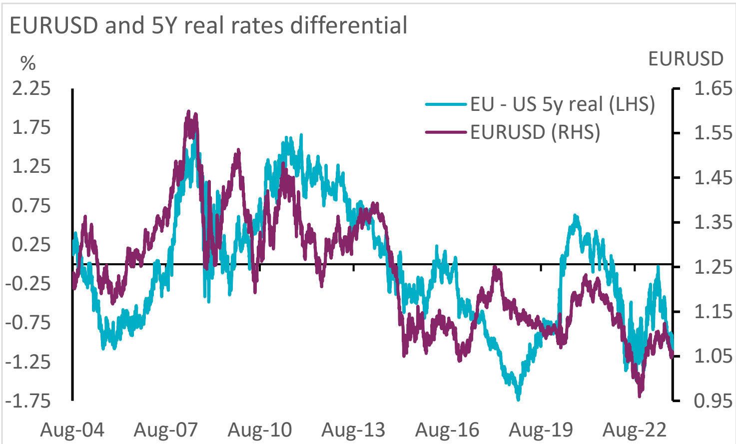


Source: Bloomberg and AXA IM Research, October 2023

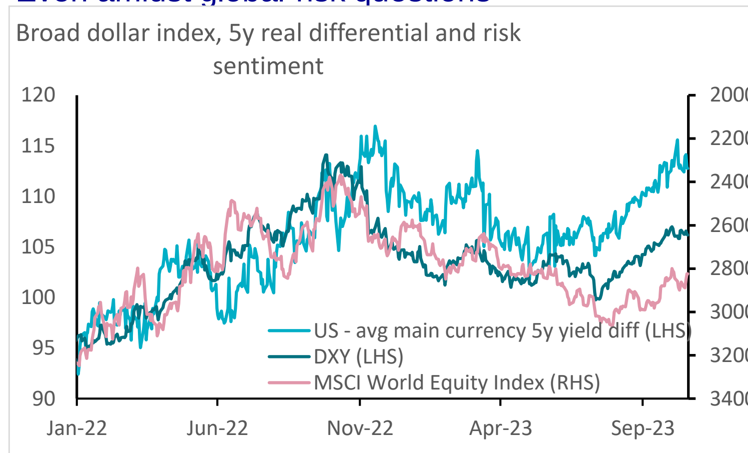
Investment strategy

FX

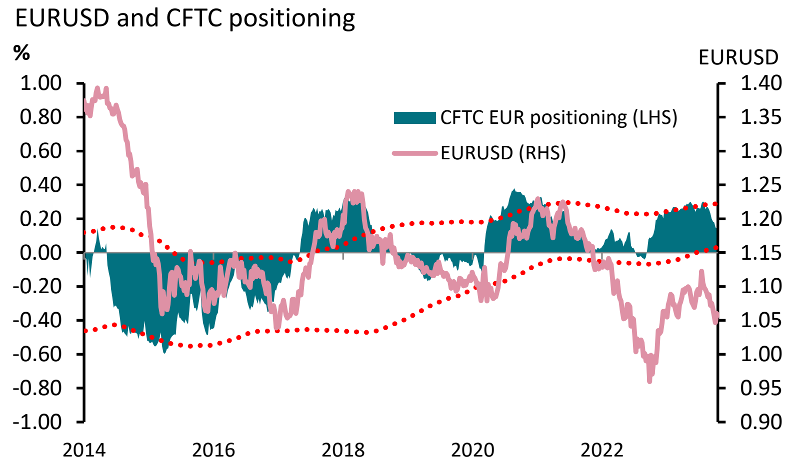
Longer-term real yields support dollar outlook



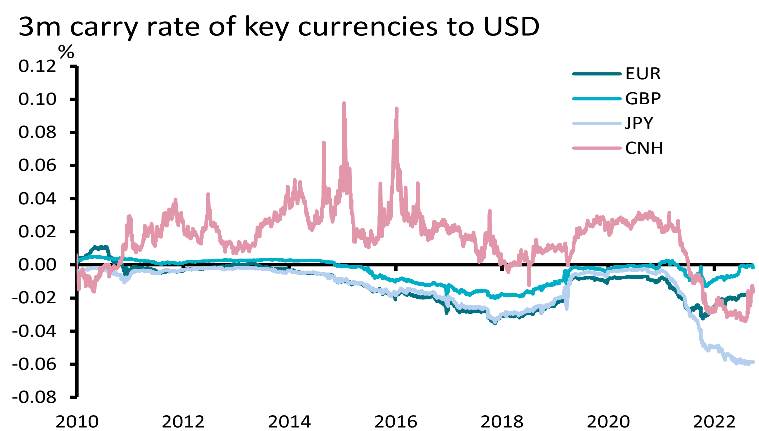
Even amidst global-risk questions



Euro appears soft despite long positioning



Carry continues to support the dollar

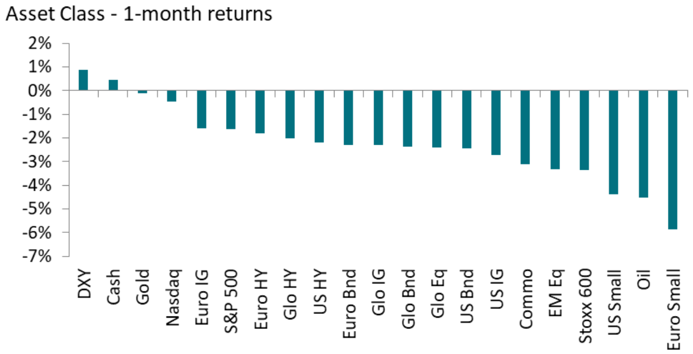


Source: Refinitiv, Bloomberg, AXA IM Research, Sep 2023

Investment strategy

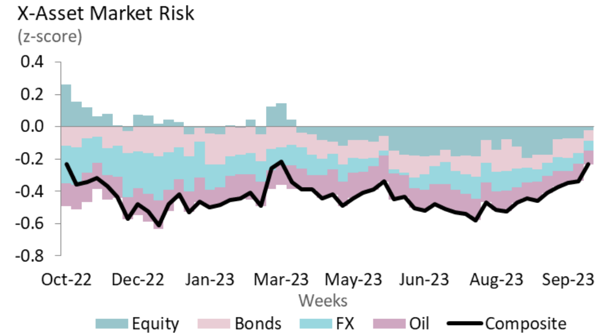
Cross asset

Dollars, cash and gold: the risk off trinity



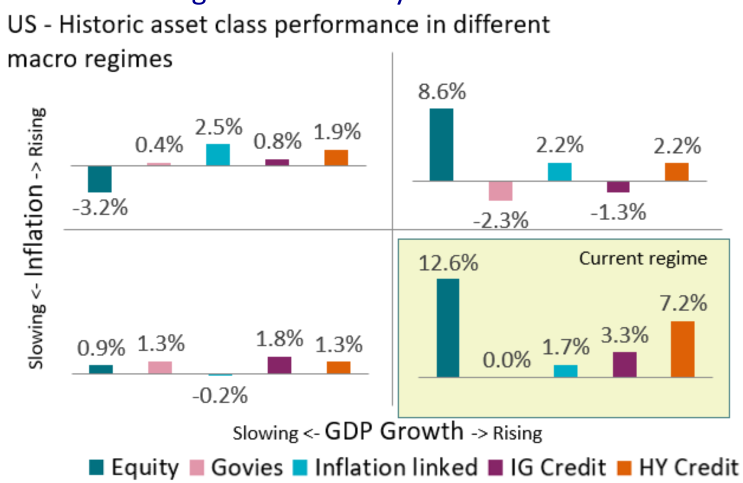
Source: Refinitiv and AXA IM Research, October 2023

Unsurprisingly, risk keeps its upward momentum driven by equity vol



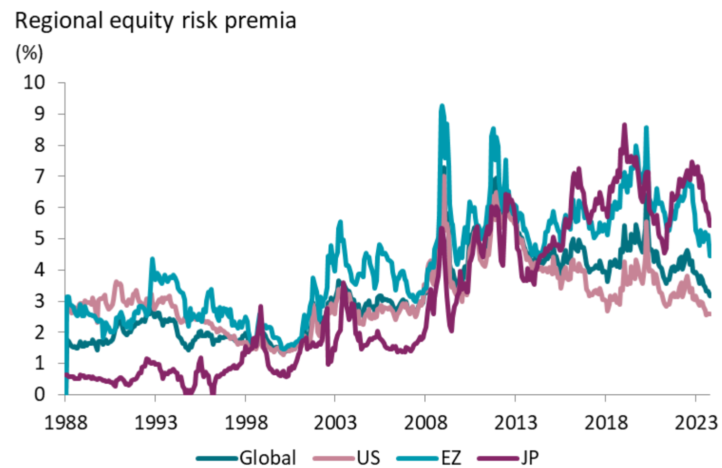
Source: Bloomberg and AXA IM Research, October 2023, Composite average of implied vol z score

The current regime favors risky asset classes…



Source: Refinitiv and AXA IM Research, October 2023

And equity markets remain attractive



Source: Absolute Strategy Research and AXA IM Research, October 2023

The historic asset class performance chart provides historic performance since 1988 of different US assets in different macroeconomic regimes: accelerating/decelerating growth; accelerating/decelerating inflation, relative to their performance over the whole period. We highlight the current macro regime.

Forecasts & Calendar

Macro forecast summary

Forecasts

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*

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	7.4		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*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	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		unch (5.50)	unch (5.50)	-0.25 (5.25)	-0.25 (5.00)	-0.25 (4.75)
Euro area - ECB	Dates	4.00	26 Oct 14 Dec	25 Jan 7 Mar	11 Apr 6 Jun	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		unch (4.00)	unch (4.00)	-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	-0.10	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)	+0.10 (0.00)	unch (0.00)	unch (0.00)
UK - BoE	Dates	5.25	2 Nov 14 Dec	1 Feb 21 Mar	9 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (5.25)	unch (5.25)	unch (5.25)	-0.25 (5.00)	-0.50 (4.75)
Canada - BoC	Dates	5.00	25 Oct 6 Dec	24 Jan 6 Mar	10 Apr 5 Jun	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		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 Oct 2023

Investment Managers

Calendar of events

2023	Dates	Events	Comments
October	25-Oct	BoC meeting	unch (5.00%)
	26-Oct	ECB meeting	unch (4.00%)
	31-Oct	BoJ meeting	unch (-0.10%)
November	01-Nov	FOMC meeting	unch (5.50%)
	02-Nov	BoE meeting	unch (5.25%)
	17-Nov	US budget extension expires, risk of shutdown	
	22-Nov	UK Autumn Statement	
December	01-Dec	UK Sovereign rating review (Fitch)	
	06-Dec	BoC meeting	unch (5.00%)
	13-Dec	FOMC meeting	unch (5.50%)
	14-Dec	ECB meeting	unch (4.00%)
	14-Dec	BoE meeting	unch (5.25%)
	19-Dec	BoJ meeting	unch (-0.10%)
2024	**Dates**	**Events**	**Comments**
January	24-Jan	BoC meeting	unch (5.00%)
	25-Jan	ECB meeting	unch (4.00%)
	31-Jan	FOMC meeting	unch (5.50%)
February	01-Feb	BoE meeting	unch (5.25%)
March	06-Mar	BoC meeting	unch (5.00%)
	07-Mar	ECB meeting	unch (4.00%)
	20-Mar	FOMC meeting	unch (5.50%)
	21-Mar	BoE meeting	unch (5.25%)

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