AXA Investment Managers

Investment Institute Macroeconomics

Governments extend influence over outlooks

Monthly Investment Strategy

AXA IM Research

May 2024

Summary: May 2024

Theme of the month: Can the US investment upsurge last?

- US investment spending appears to have defied its historic accelerator role. Investment appears to have behaved more acyclically and we consider whether it has been boosted by successive policies to boost investment spending.
- Looking at deviations from usual cyclical patterns, equipment spending and particularly information and software spending appears to be particularly subdued. However, investment in structures, particularly in the manufacturing and other sectors has risen sharply. This is confirmed by increases in construction spending, particularly in the computing, electrical and electronic sector. This is consistent with spending related to the CHIPS Act.
- Foreign direct investment (FDI) has also increased into the US since the pandemic. While this could be for a number of reasons, it is likely in part in response to fiscal incentives. 75% of the FDI increases have been driven by Europe (Eurozone and UK).
- The upcoming election may not change this backdrop materially. This is obvious if President Biden gets another term. But even President Trump may not repeal these Acts as much as Republican rhetoric may suggest: the Acts have boosted security and competitiveness; are popular; and provide most tax credit benefits in Republican states. We expect more amendment to the current framework rather than outright repeal.

Macro update: Sticky inflation, more cautious policy easing and elections

- Common themes echo around international economies: growth started the year firmer; services inflation has remained stickier; and central banks are being more cautious in starting or continuing their pace of easing.
- In the US, April's inflation softened after Q1 upside surprises that served to delay the likelihood of Fed easing. Yet broader signs of softening are emerging across the economy and we watch labour market developments closely. We forecast the Fed to cut rates in September and December this year.
- Eurozone GDP growth surprised at 0.3% in Q1, although construction boosts in Germany and Italy look unlikely to last and a softer pace is likely for the rest of the year. Inflation fell back to 2.4%, but services disinflation disappointed. The ECB looks set to cut rates by 0.25% in June and twice more this year.
- UK GDP growth rose by 0.6% in Q1, but should soften in Q2. While inflation fell to 2.3%, services inflation remained high at 5.9%. We have pushed back our BoE rate cut expectation to August and see a further cut in November. PM Sunak called an election for 4 July, sooner than the Autumn vote expected.
- China posted a mixed April – industrial output rose further, boosted by SoE investment, while consumer spending continued to soften. House prices also fell further and the authorities introduced additional support measures. Initial market enthusiasm was dampened by doubts over the size of the package.
- Japan bucked the trend with Q1 GDP contracting. Core, core inflation softened, which should support broader spending ahead. The BoJ must balance its outlook with a weak currency, inflation forecast on target and growth contracting. We expect only modest policy tightening over coming quarters.
- Emerging markets have seen a better start to the year, particularly in CEE, where growth has been slower, and EM Asia, where the pace of growth converged. Policy easing has slowed in Latam, although remains ongoing. It is set to begin later in the year across most of EM Asia. Key elections look large with India, Mexico and South Africa all due in the coming weeks.

Central scenario

Summary – Key messages

Our central scenario: Global economy softens, disinflation slows.

Global growth expected to slow to 3.2% in 2024 and 3.1% in 2025.

Disinflation slower this year, spreading to core. Creates space for monetary policy easing, Fed doubts have global spillover.

Inflation

Headline close to targets again in many economies. Core disinflation to broaden this year but stickiness apparent in services. Target rates more likely next.

Monetary policy

Central banks move closer to easing restrictive policy, but slower disinflation delaying delivery. Balance sheet policy from Fed and ECB to come to fore around mid-year.

Fiscal policy

European rules require fiscal consolidation, focus to sharpen in Sept/Oct. US longer term outlook now an election issue

Emerging Markets

Inflation easing across EM. Several central banks underway with easing cycle but becoming more cautious as strong dollar impacts.

FX

Dollar softens on easier CPI and broader data softening. BoJ action failed to spur yen. Watch risk currencies in event of geopolitical escalation.

Rates

Delayed delivery of easier policy lifts term rates higher. Actual cuts should see yields lower. Re-weighting of slowdown probabilities could lower rate outlook into summer.

Growth

Growth started 2024 on firmer footing in most economies, but likely to settle into softer pace for rest of year. Consumers supported by real disposable income growth.

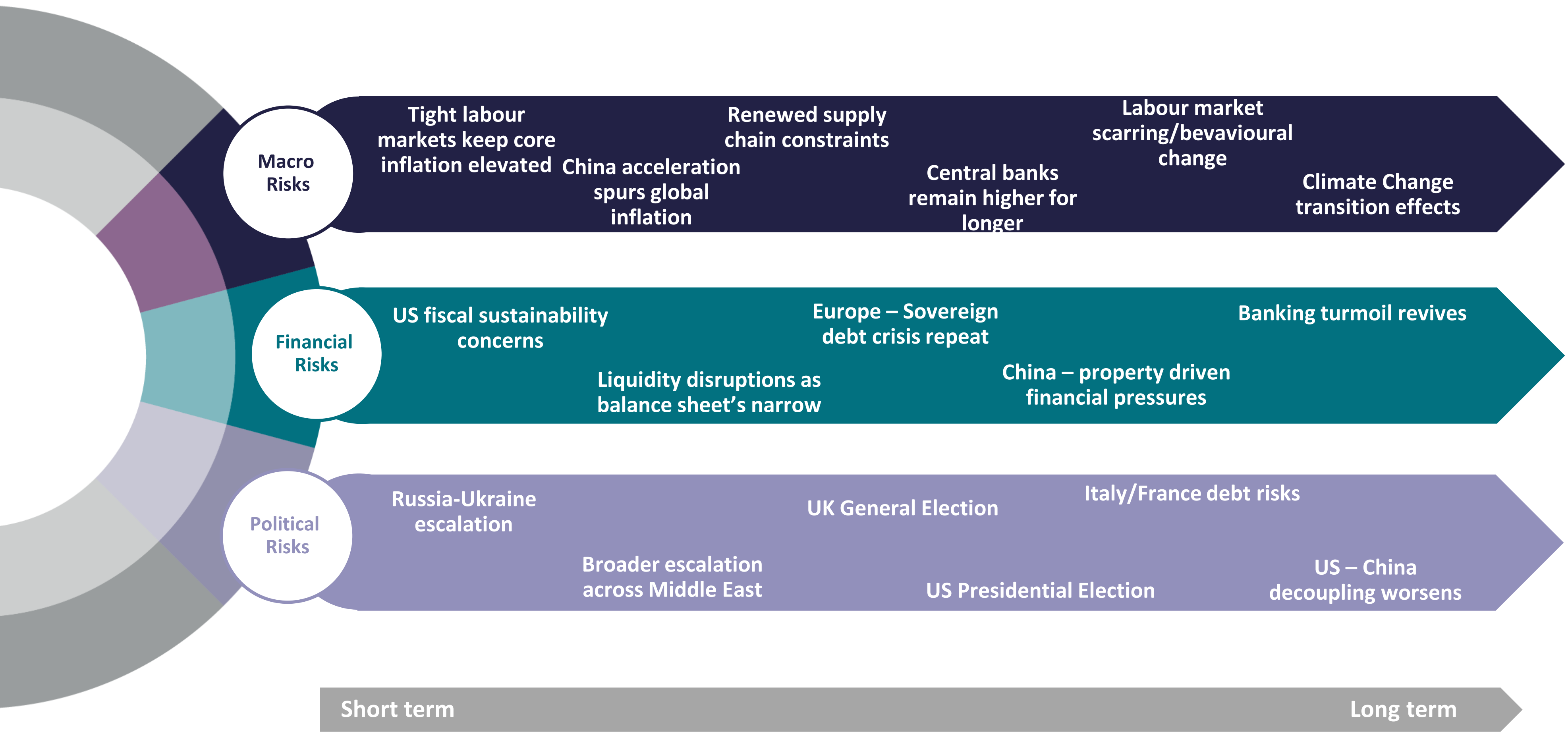
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 15%	**A global boost** Probability 20%
What could be different?	- Banking turmoil escalates, credit conditions tighten. - Geopolitical tension escalate: Ukraine, Middle East and Indo-Pacific - Inflation expectations rise, affecting wages and persistence	- Geo-political tensions ease – peace in our time. - Labour market participation recovers/migration strong, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments, AI impact becomes visible
What it means	- Growth weaker, employment falls back, 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



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Theme of the Month

Can the US investment upsurge last ?

Investment receives a boost

Investment's acyclical behaviour

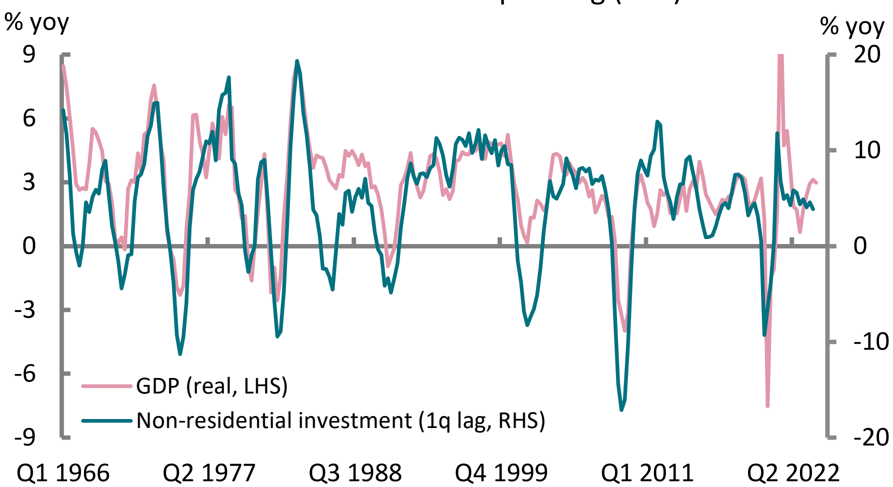
- Investment spending has historically been an accelerator of the underlying activity trend, typically buoyant during robust periods of growth and retracing sharply during downswings. There has also been a clear historic relationship between the pace of investment spending and the interest rate cycle. This time investment spending appears to be being pulled in different directions

The Biden investment boost

- The Biden administration has passed 3 pieces of legislation providing a $1.5tn public boost to investment spending (over a decade)
  - Infrastructure Investment and Jobs Act (Nov 2021), $550bn boost to infrastructure over 5 years
  - CHIPS Act (July 2022), $52bn over five years to provide incentives for semi-conductor manufacture
  - Inflation reduction Act (August 2022) $891bn in spending commitments ($783bn clean energy) at cost of $237bn

Investment usually an accelerator of underlying activity

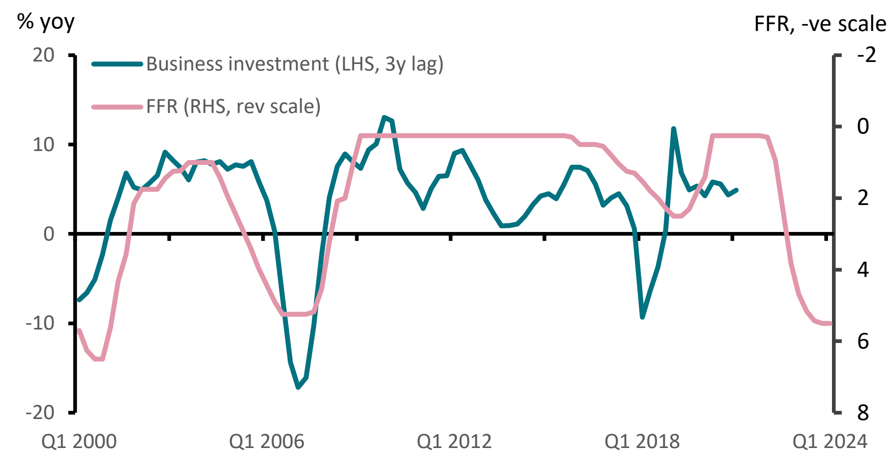
GDP and non-residential investment spending (real)



Source: BEA, AXA IM Research, May 2024

Investment spending and the interest rate cycle

Lagged cycle response of business investment



Source: BEA, FRB, AXA IM Research, May 2024

Can the US investment upsurge last ?

Gauging the impact

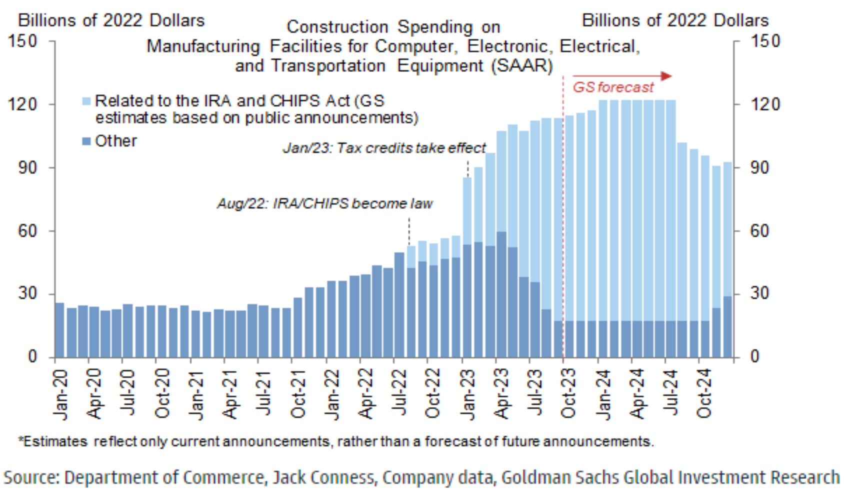
Corporate investment intentions boosted by legislation

- These 3 laws came in between 2021 and 2022 and investment can have long lead times. The initial ‘impact’ of these policies was to see a large increase in corporate investment intention announcements.

Measuring the actual investment

- More recently and as time has passed since the enactment of the policies, we have been able to see the impact on actual investment spending. The difficulty is disaggregating the behaviour of investment from what we would usually expect to be happening in the economy. To do this we measure the deviation of investment from usual cyclical behaviour and present on a standardised basis across different sectors.

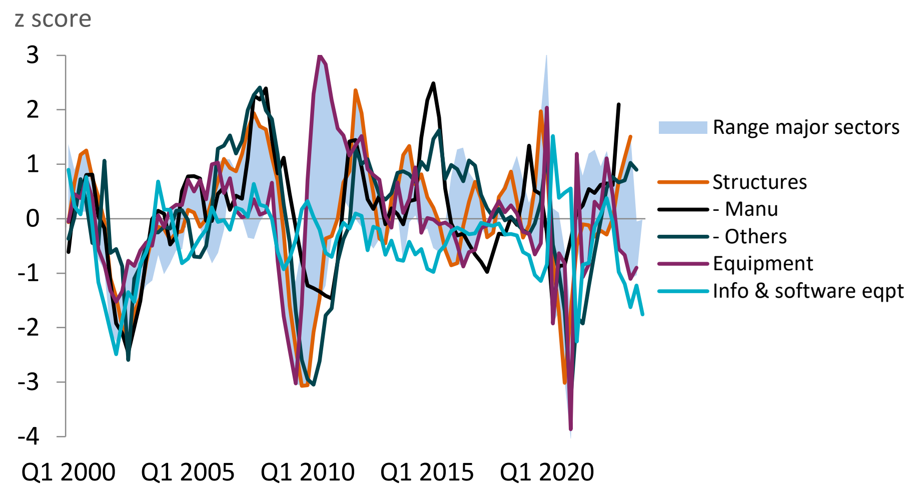
Announced investment intentions



Source: Goldman Sachs, October 2023

Investment deviation by sector

Deviation from cyclical norm (z-score)



Source: BEA, AXA IM Research, May 2024

Can the US investment upsurge last ?

Investment rises in manufacturing structures

Key trends: structures investment rising, equipment spending weak

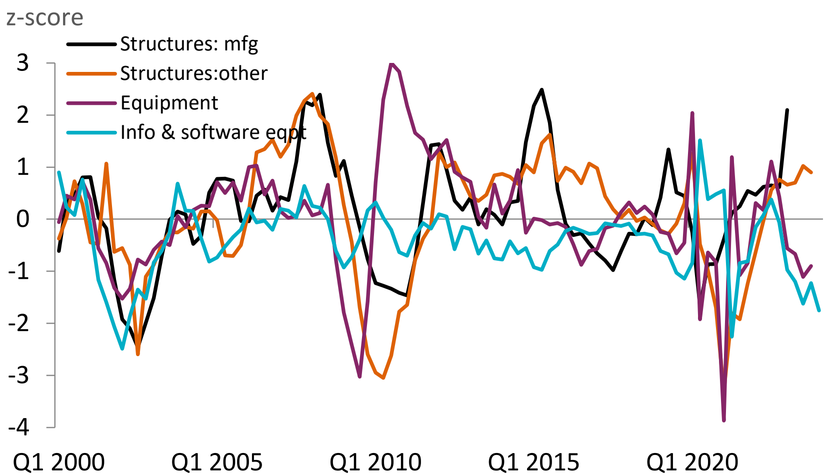
- Focusing on the key trends, we note that information and software equipment appears to be underperforming given broader economic activity. However, investment in structures has risen sharply, particularly in manufacturing structures (and other structures) which is consistent with a response to the policy initiatives.

Construction output echoes investment in structures

- Construction output echoes these investment in structures findings. Construction has risen sharply (in real terms) driven by manufacturing in the computing, electrical and electronic space, an area directly stimulated by the CHIPS Act, which is consistent with a series of anecdotal reports of companies investing in response (TMSC, Intel, Micron, Qualcomm and Global Foundries)

Investment spending in manufacturing structures surges

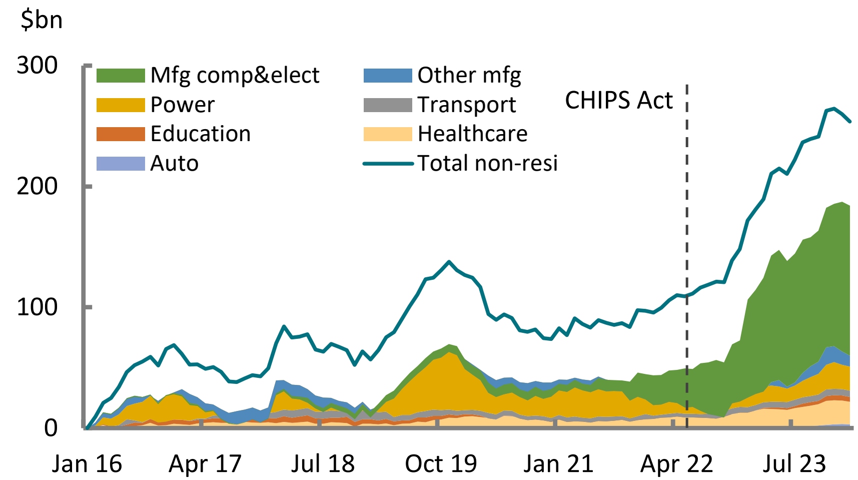
Deviation from cyclical norm (z-score)



Source: BEA, AXA IM Research, May 2024

Construction output in computer & electronic manufacture rises

Real non-resi construction gains by sector from 2016



Source: US Census Dept, BEA, AXA IM Research, May 2024

Can the US investment upsurge last ?

Build it, fill it ?

Structures and equipment investment affected by common factors

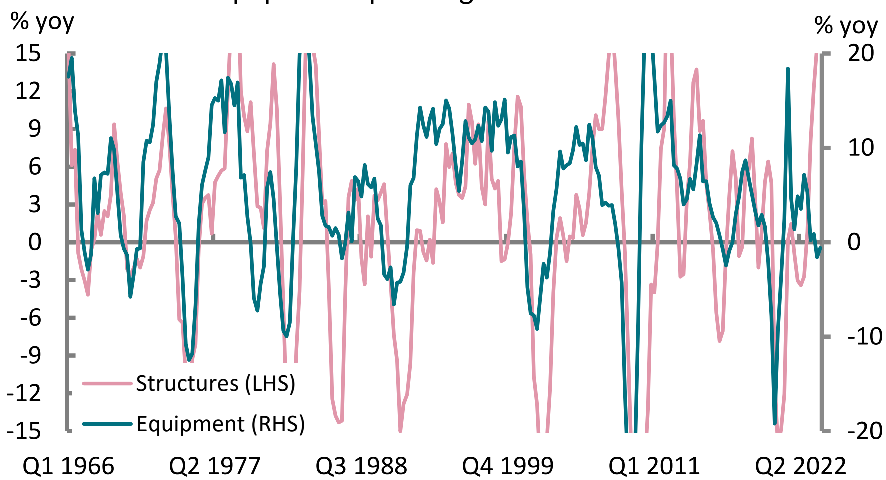
- We argue that if the first phase of a new investment wave has been to boost investment in structures, that a second wave should follow as structures are completed and require filling with capital equipment. This is not obvious in headline measures of investment in the two sectors, likely because investment overall is dominated by common factors: the outlook for economic activity and interest rates. The shorter lead times in equipment investment versus structures likely explains why equipment investment starts to shift modestly ahead of structures investment.

Adjusting for cyclicality, suggests tailwind for equipment investment

- Once we correct for the common factors issue – again looking at cyclical deviation – what's left suggests more of a relationship between the two, particularly in the industrial sector. The sharp pick-up in investment in manufacturing structures does thus suggest a tailwind to equipment investment over the coming years.

Investment spending driven by common factors

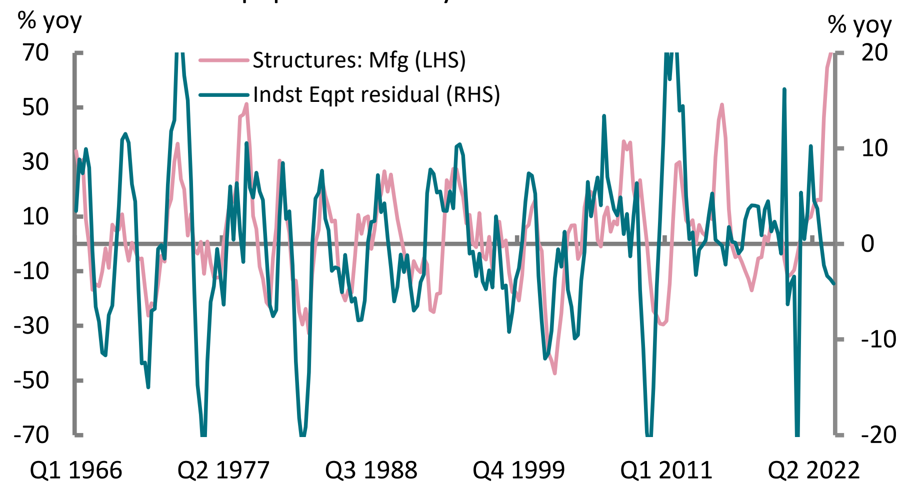
Structures and equipment spending



Source: BEA, AXA IM Research, May 2024

Structures and equipment do appear correlated in industrial sector

Structures and equipment non-cyclcial residuals



Source: BEA, AXA IM Research, May 2024

Can the US investment upsurge last ?

Investment from overseas

US inward foreign direct investment increases, but multiple factors can explain why

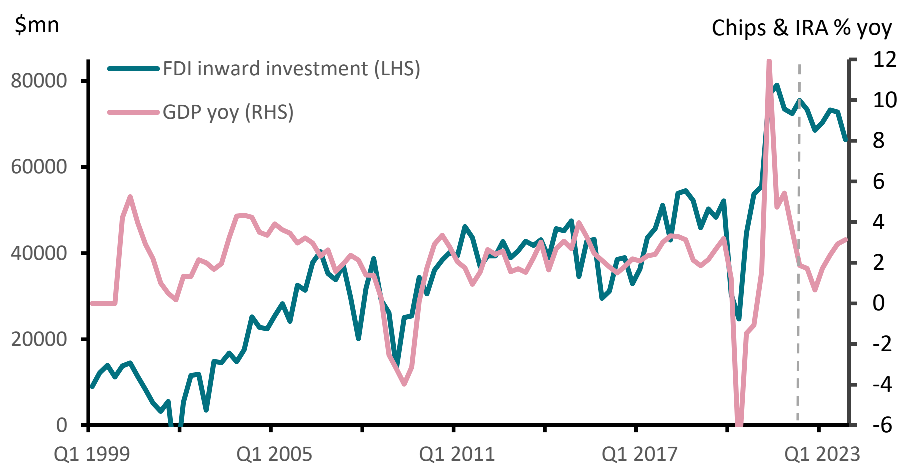
- US inward FDI started to rise from 2017, but has surged since the pandemic. Multiple factors could explain this including rising trade and geo-political tensions and an increased focus on supply-chain security. Indeed, the immediate rise in FDI in 2021 is likely to be a catch-up after the sharp drop in FDI at the time of the pandemic. But FDI has remained much firmer since, something that could well reflect overseas investment in the US attracted by fiscal incentives.

FDI makes unusual increases across a broad range of sectors

- It is difficult to ascertain intentions for FDI investment. When we focus only on unusual deviation from cyclical norms, the FDI increase has occurred across a broad range of sectors - many that fall outside of those that we would expect to have benefitted from the investment stimulus policies.

US inward FDI shifts higher post-pandemic

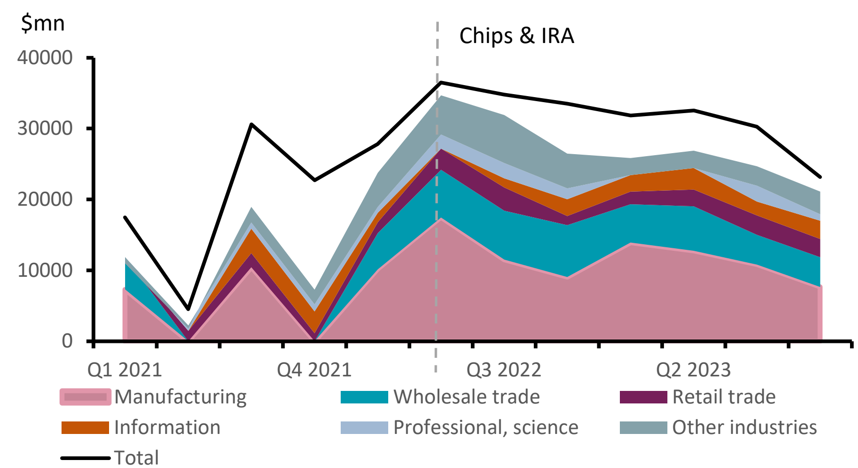
Foreign direct investment and US activity



Source: BEA, AXA IM Research, May 2024

Unusual FDI gains across a broad range of sectors

2std dev increases in residual



Source: BEA, AXA IM Research, May 2024

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Can the US investment upsurge last ?

Europe leads investment

Policy associated sectors account for half of FDI pick-up

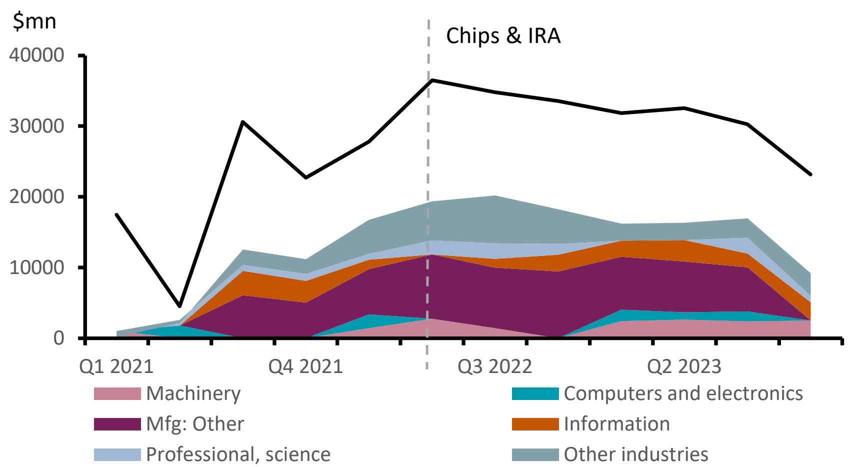
- However, FDI has also risen sharply in sectors that we would expect to have been boosted by the investment policies. We estimate that around a half of the sharp pick-up in FDI flows has been in these sectors

Breakdown of countries investing

- Considering who is behind this FDI increase we can see a number of actors, but three quarters of the investment increase is from Europe (54% Eurozone and 22% UK). A further 10% of the rise is accounted for by Japan and Canada. Mexico, India and South Korea account for 3-5% and other APC for 20%. (Figures do not sum to 100% as we exclude countries that have seen a reduction in inward FDI, including China)

Significant increases in sectors targeted by CHIPS/IRA

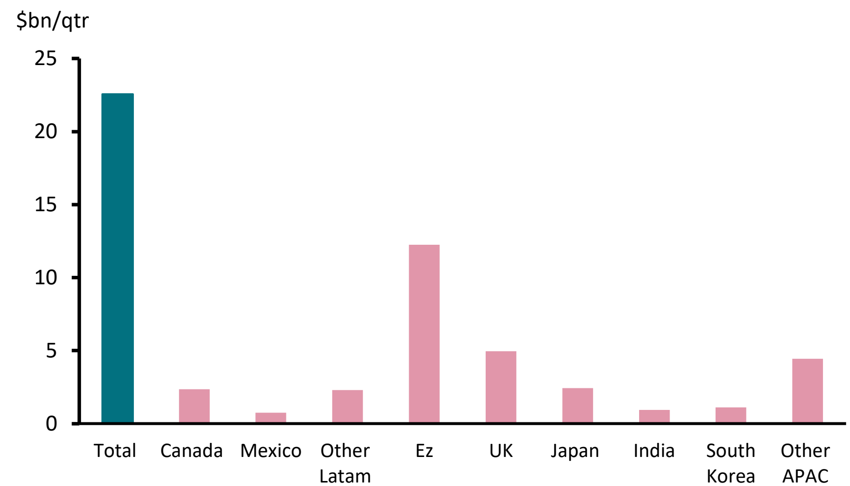
2std dev increases in CHIPS/IRA sectors



Source: BEA, AXA IM Research, May 2024

Europe leads the way in inward investment to US

Average FDI increase (2022-23/2018-19)



Source: BEA, AXA IM Research, Apr 2024

Can the US investment upsurge last ?

Will the Election change this?

President Biden or Trump

- We consider whether the outcome of November's election will change the outlook for investment? We suggest that President Biden is unlikely to change the policies that he instigated, but is unlikely to be in a position to supplement them. The outlook for President Trump is less clear with a lot of Republican rhetoric against particularly the IRA Act.

Less risk of repeal than considered?

- Despite vociferous opposition to IRA and some of the other stimulus measures, we would not expect a second-term Trump Presidency to repeal most of the measures. First, these policies have broadly been popular – like the Affordable Care Act before, this might rein in any desire for repeal. The policies have also boosted the economy's competitiveness and security, both likely important to a more protectionist regime. Finally, analysis suggests that most tax credits will be paid in Republican states. We do expect some repurposing of tax credits, see a risk of amendment to Foreign Entity of Concern Rule and see the repeal of some specific components, for example the IRA's increased funding of IRS.

Many of the IRA projects are in Republican States ..

Exhibit 1: Clean Power Project Pipeline by State

Source: American Clean Power Association

.. Which will receive most of the tax credits

Exhibit 2: Clean Energy Facility Manufacturing Map

Source: American Clean Power Association

Macro outlook

Focus to switch from inflation stickiness

US

Inflation myopia

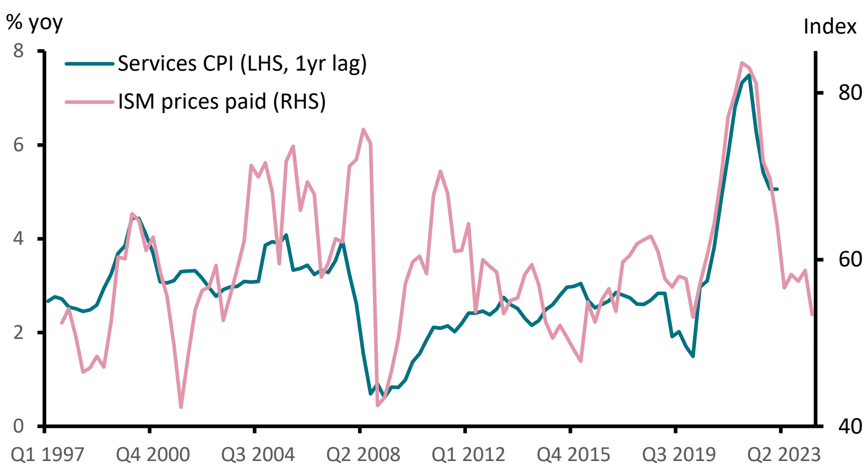
- Headline inflation eased to an annual 3.4% in April, core to 3.6% – a 3-year low. The recent rise in ex-shelter services inflation eased, April's monthly pace rising by just 0.2% from 0.8% in March. One month is insufficient to ring the 'all clear' for the outlook, but longer-term surveys are consistent with a more material easing in services inflation, which we expect to reflect easing shelter inflation, but helped by no deterioration in broader services. We forecast inflation to average 3.3% in 2024 and 2.5% in 2025.

Risk of an employment scare

- Payrolls rose by 175k in April – its softest in six months, but intrinsically solid. Forward-looking surveys point to a further deceleration ahead, which could include a negative headline print over the summer. Historically, payrolls move from solid to negative quickly during a recession and a negative print would unnerve markets and serve to lift recession probability assessments. We do not expect a recession, but such a scare will refocus markets from lagging inflation to forward-looking price developments.

Outlook for services disinflation to pick-up

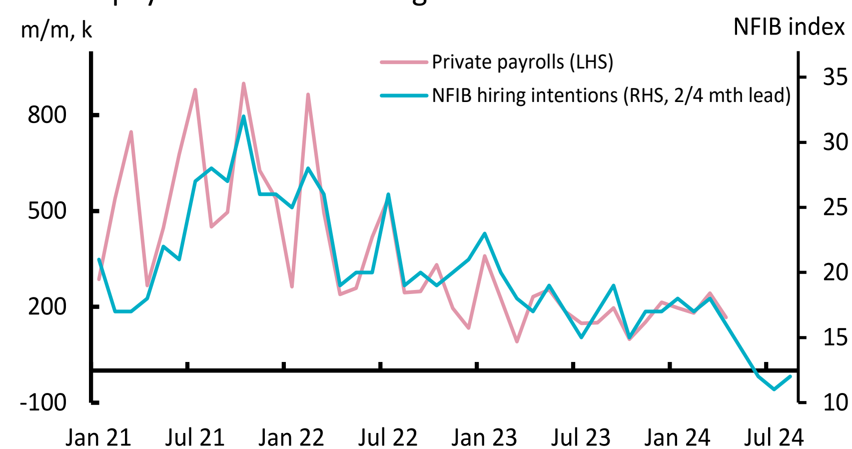
Services CPI and Non-mfg ISM prices paid



Source: BLS, AXA IM Research, May 2024

Payroll employment to slip off firm track

Private payrolls and NFIB hiring intentions



NB Chart adjusts NFIB index lead from 2 to 4 mths Sep 22

Source: BLS, AXA IM Research, May 2024

Soft-landing likely, but markets to fear worse?

US

Consumer slowdown to enable soft-landing

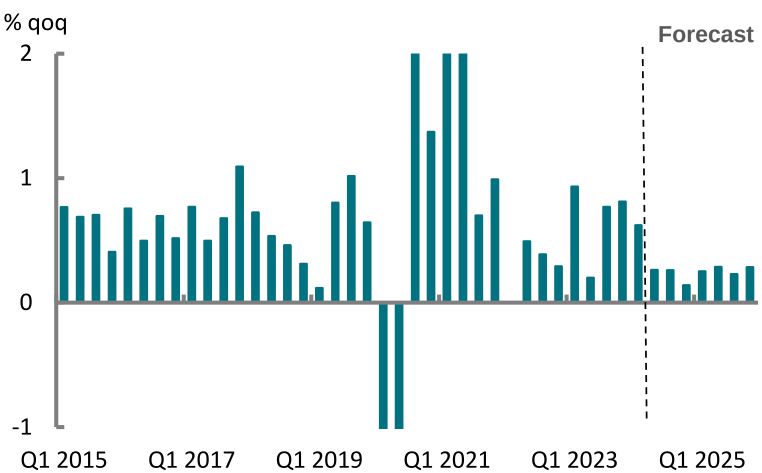
- More broadly signs are emerging of a consumer slowdown that we have long anticipated. We currently expect the combination of slower real employment income growth, increased tax payments and a rising saving rate to slow consumption growth relative to a solid previous year or so. This should see the economy slow to a below trend pace, consistent with a soft-landing. We forecast GDP growth of 2.4% this year and 1.6% next (consensus 2.4% and 1.7%).

Markets could see larger swing in rate outlook

- Slower CPI and a more widespread softening in data had helped markets refocus on 2 cuts this year (although this is not fully priced) and three next (to 4.00-4.25%). We forecast two this year – September and December – and four next (to 3.75-4.00%). However, we are wary that a bout of labour-market-inspired nervousness could see markets price the risk of more cuts than this, both this year and next, before evidence of achieving a soft-landing becomes clearer.

Consumer looks ready to soften from robust pace

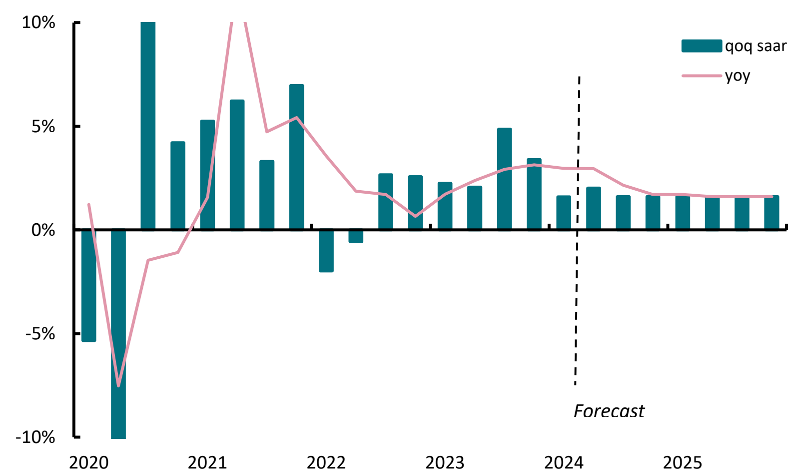
Consumer spending growth



Source: BEA, AXA IM Research, May 2024

GDP growth on track for a soft landing

US GDP growth



Source: BEA, AXA IM Research, May 2024

Finally, a positive surprise on growth

Eurozone

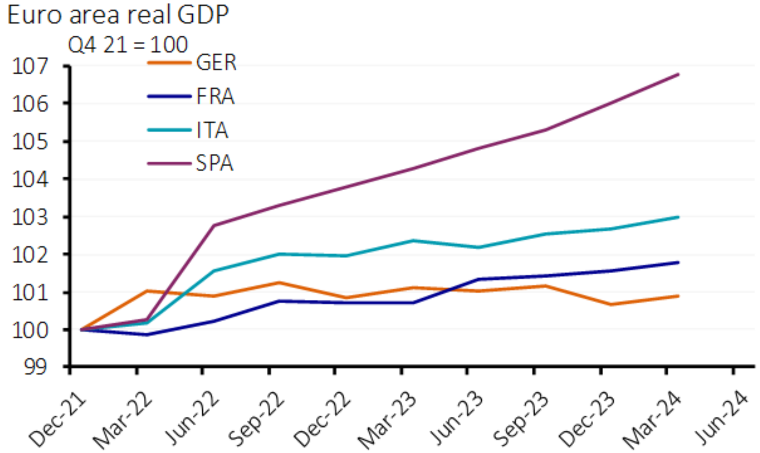
Preliminary estimate of euro area Q1 GDP strong at +0.3% qoq

- Once again there was a strong divergence across countries with Spain and Portugal rising by +0.7% while Germany and France had softer GDP growth of +0.2% each. We have only incomplete country breakdowns, but it seems that tourism spending in peripherals and construction in Germany and Italy were key contributors (on mild weather and the Superbonus). Domestic demand was entrenched in positive territory in France and Spain but was softer in Germany and Italy, but which still posted positive net exports.

Slower Q2 as growth convergences to a sustainable path

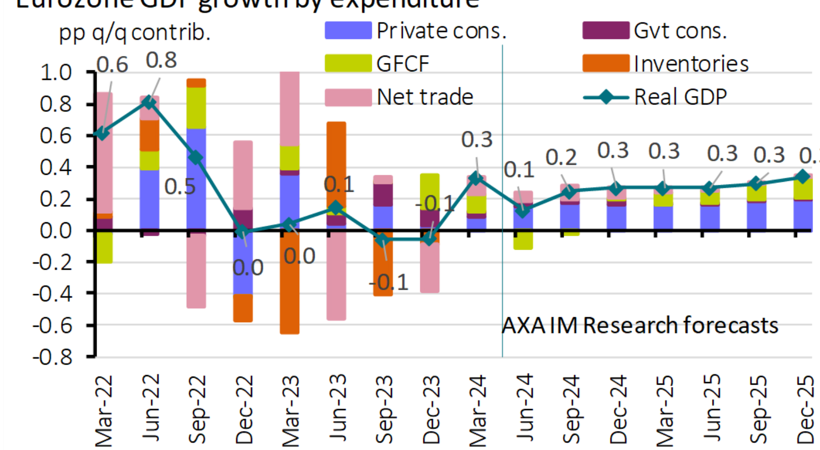
- PMIs in May signaled another expansion for services (flat at 53.3) and some improvement in the manufacturing sector to 47.4 as well. That remains consistent with our view of gradual recovery, mostly driven by private consumption. But we pencil in a deceleration in Q2 GDP growth to +0.1% and +0.2% in Q3, due to the normalization of exceptional contributions from construction in Germany and in Italy. Despite this, we revise up our forecasts to +0.6% in 2024 and +1.1% in 2025 (+0.3 percentage point each)

Divergence keeps growing



Source: Eurostat, Refinitiv, AXA IM Research, May 2024

Private consumption and net trade is the cocktail of 2024



Source: Eurostat, AXA IM Research, May 2024

The ECB faces uncertainty beyond June

Eurozone

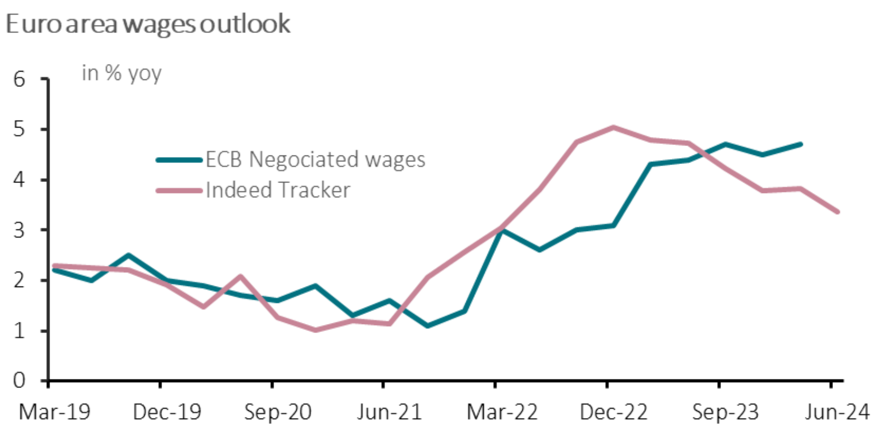
Uncertainty hangs over ECB rate outlook beyond June

- Employment grew again at +0.3% qoq, matching GDP growth. That suggests flat productivity on the quarter but still 2 pt below the Q4 2019 level. Q1 ECB negotiated wages came at an annual 4.7%, above forecast, although largely due to delayed wage settlements in Germany. Relatedly, we (and the market) were surprised by the resilience of services inflation.
- In the near term, our long-standing call of a 25bp rate cut by the ECB in June stands. Beyond June, we forecast two more cuts (Sep & Dec), but need further services disinflation and deceleration in official wages (as proxied by Indeed wages tracker).

European elections: a large centrist coalition still the baseline

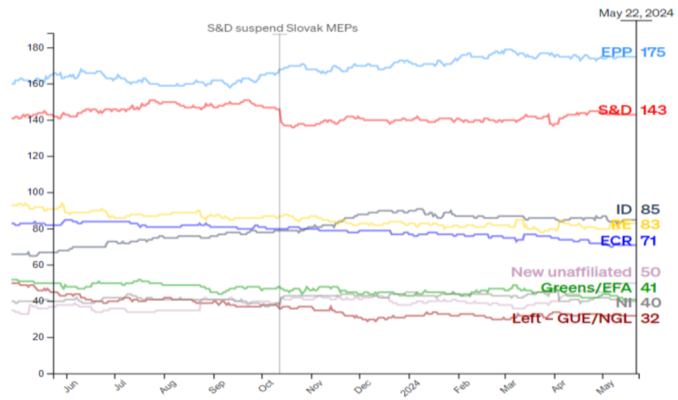
- We do not consider these a major event for financial markets as economic governance lies more with the Commission and European Council, while the Parliament enacts laws and influences the agenda. Despite a breakthrough of far-right party Identity and Democracy, it seems the European People's Party (center-right) should renew a large centrist and pro-European coalition.

Indeed, wages Tracker still point to deceleration ahead



Sources: ECB, Indeed, AXA IM Research, as of May 2024

The center right EPP is still largely leading the polls



Source: Poll of Polls, Politico, as of May 22,2024

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Recovery to continue, but at more gradual pace

UK

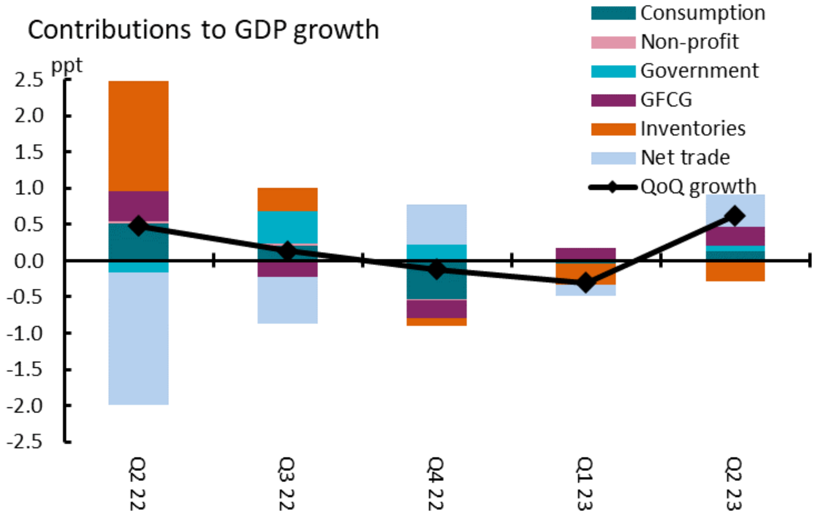
Strong rebound following recession in H2 23

- The UK bounced back strongly from the technical recession in the latter part of 2023, with GDP rising by a chunky 0.6% quarter-on-quarter in Q1. However, net trade accounted for around two-thirds of that rise and looks likely not to be repeated next quarter (is also prone to large revisions), so there is a chance this number is revised down. But we expect a softer rise in Q2 – an expectation compounded by weak retail sales growth at the start of the quarter.

Recovery should continue, momentum to ease

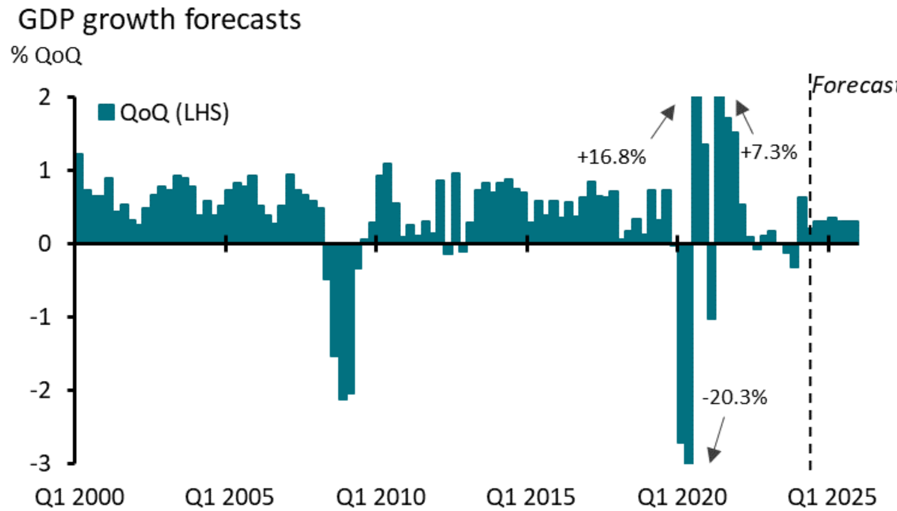
- Nonetheless, we expect the recovery to continue over the remainder of the year. Private consumption – which rose by 0.2%qoq – looks set to pick up as rising confidence spurs households to spend any additional cash from rising real incomes, rather than save. And government spending looks set to normalise as strike action eases. We expect growth to slow to around 0.2% in Q2 and then hover around 0.3% in Q3 and Q4. As a result, we have revised up our forecast for 2024 to 0.7%, from 0.4% previously

GDP rebounded strongly in Q1…



Source: National Statistics, AXA IM Research, May 2024

… and should continue to increase at around a 0.3% qoq pace



Source: National Statistics, AXA IM Research, May 2024

August rate cut, summer election

UK

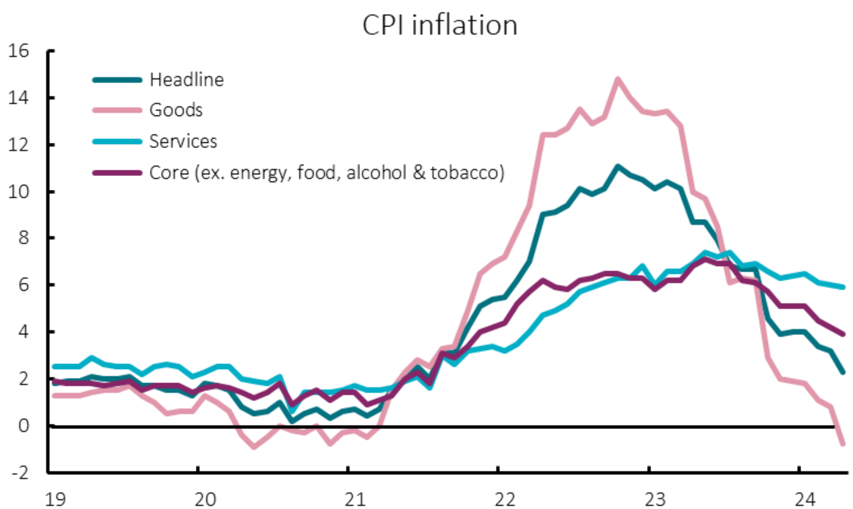
We have changed our rate call to August, from June

- The Monetary Policy Committee (MPC), meanwhile, kept the Bank Rate unchanged at 5.25% in May, as expected, but the vote split shifted further in favour of the doves, with Ramsden joining Dhingra in voting for a cut. The new CPI forecasts also signalled the MPC expect to cut Bank Rate this year, with the headline rate at 1.9% in two years' time, compared to 2.3% in the February report. This suggested the first cut could come as early as June, but more recently the stickiness of services inflation in April has reduced the chances of that. We push our expected June cut (back) to August, and expect one further cut in November.

Rishi Sunak calls a summer election

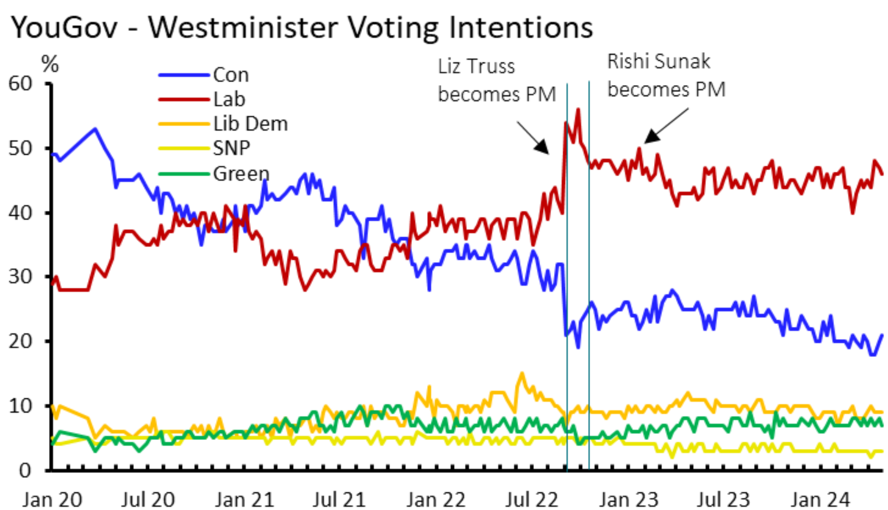
- Rishi Sunak surprised with the announcement that the next General Election will be held on 4 July, not in the autumn as expected. According to polls, a Labour government is the probable outcome; the party has held a 20-point lead over the past year or so. A comfortable majority would likely result in tighter fiscal policy next year, due to the fragility of the public finances, but some loosening in the second half of the parliament is on the cards. Reduced political instability would support growth.

Services inflation is proving sticky



Source: National Sources, AXA IM Research, May 2024

Labour have held a chunky lead in the polls for well over a year



Source: YouGov, AXA IM Research, May 2024

Unbalanced growth with industrial output excelling

China

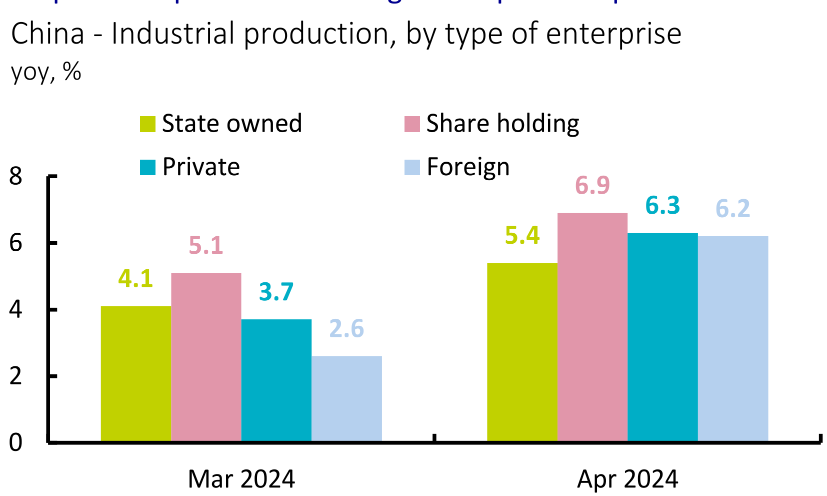
Robust industrial output in April thanks to strong investment earlier this year

- Industrial output exceeded expectations. The significant progress made by private and foreign enterprises could revive private investment in the coming months, which has been subdued due to the gloomy outlook. However, the strong industrial output can be attributed to resilient manufacturing capex investment led by state-owned enterprises earlier this year.

Unbalanced growth worsened as consumption dragged

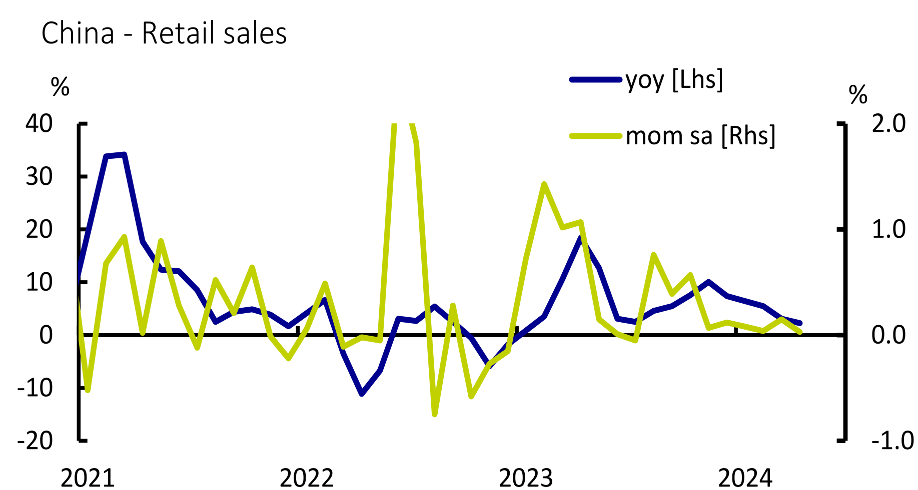
- The recovery in retail sales, a broad measure of private consumption, has been bumpy. The further deceleration in the latest data highlighted ongoing weakness. On the brighter side, more policy focus and improving labour market conditions could boost consumption meaningfully in the future, although it may take time.

Output from private and foreign enterprises improved



Source: CEIC and AXA IM Research, May 2024

Consumption stayed on a bumpy ride



Source: CEIC and AXA IM Research, May 2024

Extended property downturn triggers more support

China

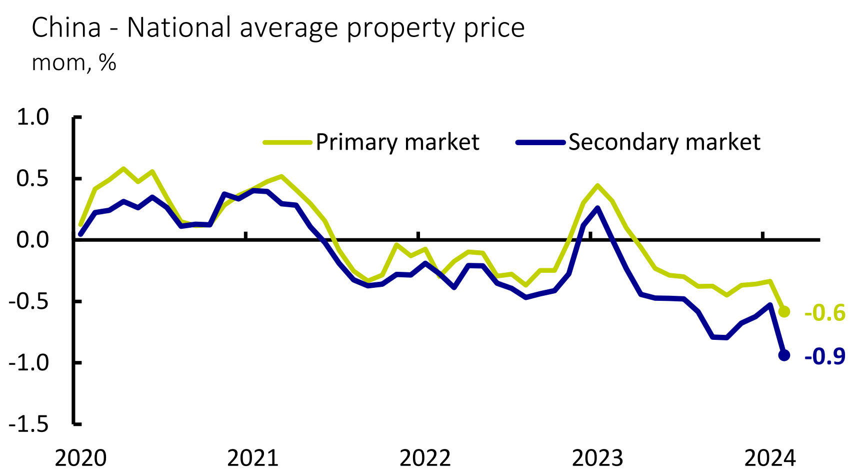
More efforts to stabilise the decline in the property market

- April saw further declines in property prices, both new and existing. Following this, Beijing announced more policy supports on the demand side, and called for direct intervention for local governments to purchase housing inventories. China's central bank also took action, providing funding to facilitate the purchases. The initial positive market reaction, evident by a rally in property equities was short-lived, as the scale of the rescue package appeared inadequate compared to the size of inventory.

Recovery in exports bolstered the rebound in April reading, yet the future remains uncertain

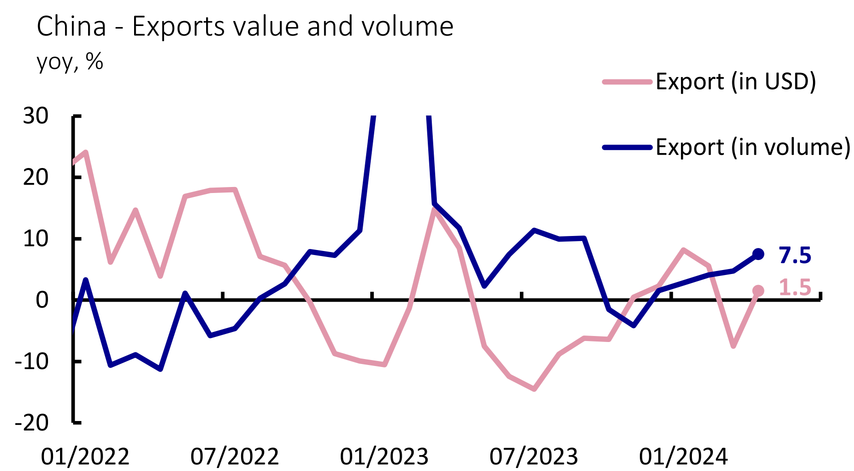
- Thanks to the more buoyant external environment and base effects, export values bounced in April. However, the US announced tariff hikes on c. $18bn of Chinese, mainly high-tech, goods. At only 4% of Chinese exports to the US (and a smaller proportion of total US imports) this was largely symbolic ahead of election. However, the long-term implications could be profound if other western allies adopt similar moves and if this normalises the debate domestically. Prolonged trade tensions could jeopardise China's long-term development strategy, which relies on high-tech manufacturing and export.

Property decline deepened while more support announced



Source: CEIC and AXA IM Research, May 2024

Export value bounced back



Source: CEIC and AXA IM Research, May 2024

Bank of Japan sounding more confident

Japan

Policy was unchanged at April's meeting…

- The Bank of Japan (BoJ) kept the policy interest rate at 0-0.1% at its April meeting and stated that it would continue to conduct purchases of Japanese government bonds (JGBs), commercial paper and corporate bonds. It did, however, remove the part of the statement pertaining to the exact amount of JGB purchases and has since reduced purchases of bonds with five to ten years left to maturity to ¥425bn, from ¥475bn. The yield on a 10-year JGB has risen to 0.975%, a 10-year high, amid speculation the BoJ will continue to reduce purchases across different maturities.

But the BoJ is more confident in the inflation outlook

- The board, meanwhile, revised up its forecast for CPI inflation ex. fresh food by 40bps in fiscal 2024, and by 10bp in fiscal 2025 due to expectations the output gap will improve and that longer-term inflation expectations will rise as the "virtuous cycle between wages and prices continues to intensify". Core, core estimates remain anchored at 1.9% in line with the BoJ's target.

Bank of Japan revised up outlook for CPI inflation ex. fresh food

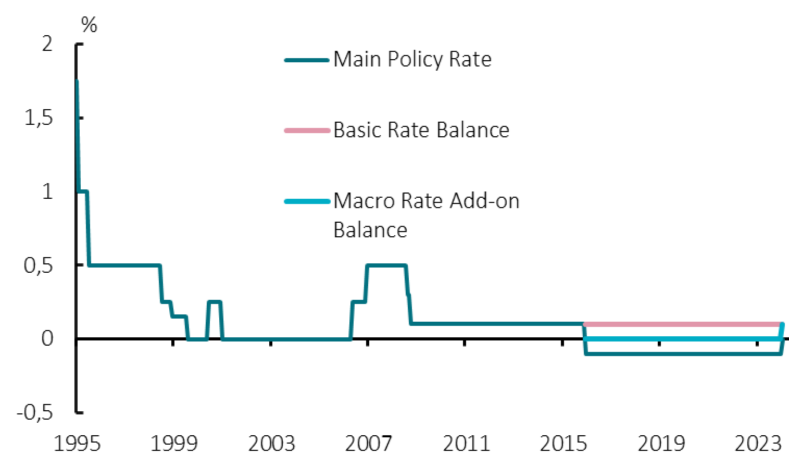
	Fiscal 2023	Fiscal 2024	Fiscal 2025
Real GDP	1.3 (1.8)	0.8 (1.2)	1.0 (1.0)
CPI (less fresh food)	2.8 (2.8)	2.8 (2.4)	1.9 (1.8)
CPI (less fresh food and energy)	3.9 (3.8)	1.9 (1.9)	1.9 (1.9)

* *Actual (Jan 24 Forecast)*

Source: Refinitiv, AXA IM Research, May 2024

Further hikes look likely; we expect two 10bp increases in Q3 and Q4

BoJ short-term policy interest rate



Source: Bank of Japan, AXA IM, May 2024

GDP is in the doldrums, so we remain cautious

Japan

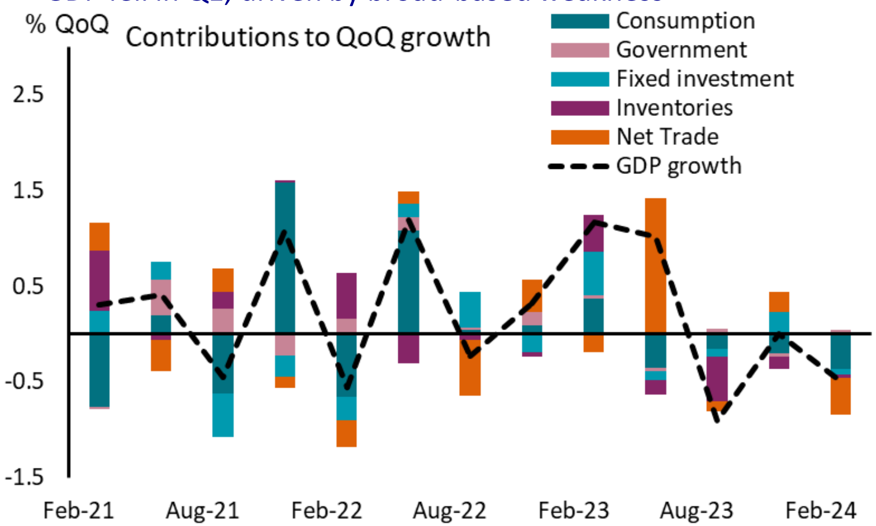
GDP dropped in Q1, no engines of growth to show

- GDP data for Q1 showed a renewed decline, with activity falling by 2% annualised, below the consensus for a 1.5% drop. That partly reflected several one-off factors, including the temporary shutdown at auto producers at the start of the year. But the weakness was broad-based, with both capex and private consumption declining. Governor Ueda emphasized a patient approach to waiting for an acceleration in the underlying inflation rate, accompanied by wage growth and domestic demand, so this suggests an imminent change in short term policy rates is unlikely.

The outlook is more upbeat, but we doubt the BoJ will hike aggressively

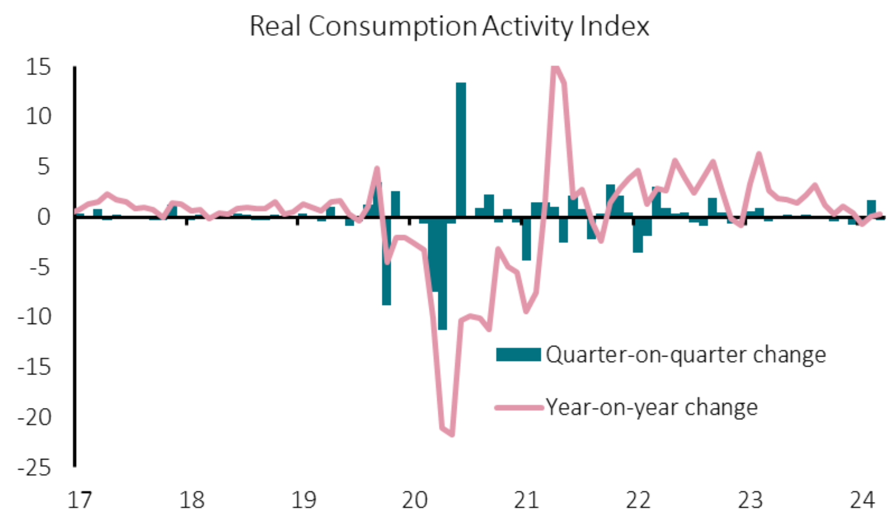
- A rebound from Q2, however, looks likely, as rising real incomes boost private consumption and as a weaker yen boosts exports. As a result, we now expect two 10bp hikes to the short-term policy rate in Q3 and Q4 and then two further 10bp hikes in H125. We also think the BoJ will start to discuss officially reducing its JGB purchases this year.

GDP fell in Q1, driven by broad-based weakness



Source: Cabinet Office, AXA IM Macro Research, May 2024

Consumption should rebound in Q2, as real wages start to rise



Source: Bank of Japan, AXA IM Macro Research, April 2024

Ebb and flow of Canadian releases

Canada

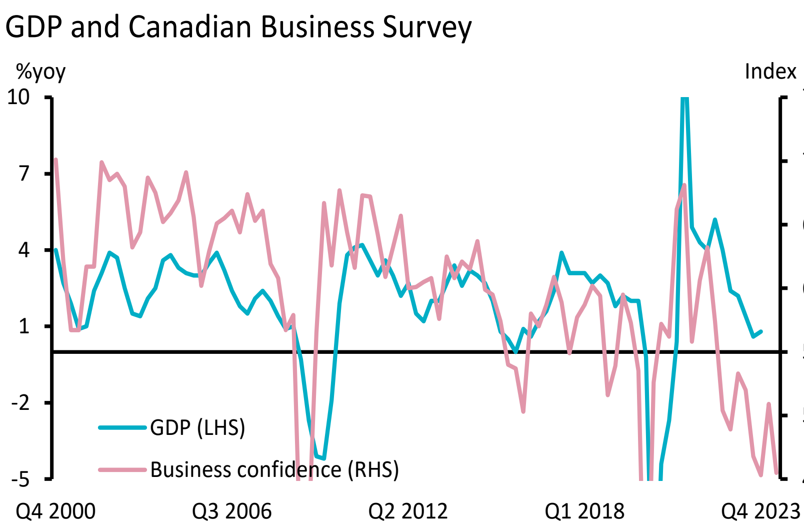
Growth not quite so buoyant

- We have been sceptical of the strength in Canadian GDP at the start of the year. Sure enough, preliminary estimates of 0.6% in January and 0.4% in February were revised lower to 0.5% and 0.2% respectively and flat for March. We forecast Q1 GDP growth up 2.4% (saar) versus the BoC's 2.8%. We leave our annual forecasts unchanged at 1.2% for this year and 1.7% for next versus consensus estimates of 1.0% and 1.8% and a BoC outlook of 1.5% and 2.2% respectively.

Mixed evidence from the labour market

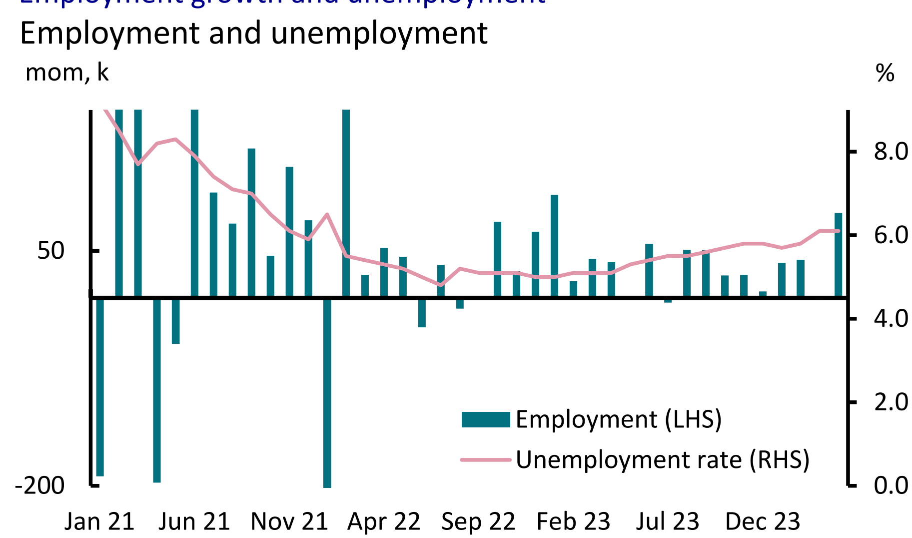
- Following the first dip in employment for 8 months in March, it bounced by 90k in April, leaving the year-to-date average increase at 42k, exceeding the average annual pace of 2022 and 2023. Yet at the same time unemployment remained unchanged at 6.1% a joint 27-month high. Robust labour supply growth, in part driven by high migration, has driven the discrepancy.

CAD GDP growth and business sentiment



Source: AXA IM Research, May 2024

Employment growth and unemployment



Source: CANISM, AXA IM Research, May 2024

BoC poised but patient

Canada

Wage growth grumbles on

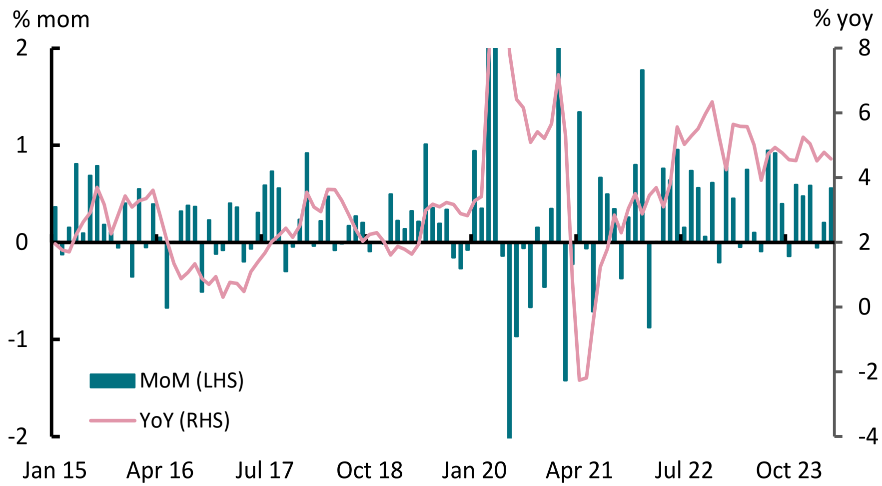
- With improving signs of underlying inflation – median core CPI inflation fell to 2.6% a 3-year low – the BoC will focus on the inflationary aspects of the labour market. Having softened in February and March, monthly wage inflation resumed a robust pace of 0.6% – leaving the annual rate of wage growth far in excess of the pre-COVID trend. We forecast wage growth to soften in H2 2024, but we suspect the BoC will want to see more evidence of this before easing policy

BoC clears path for it first cut

- The BoC's April meeting appeared to clear the path for rate cuts leaving it fully data dependent. We continue to forecast the first easing in July, alongside further signs of wage disinflation, but this is a close call with some expecting a June easing. Beyond the first cut we now expect the BoC to ease policy more quickly than markets forecasting 3 cuts this year (to 4.25%) and three cuts next year to 3.5%.

Wages pick up again in April

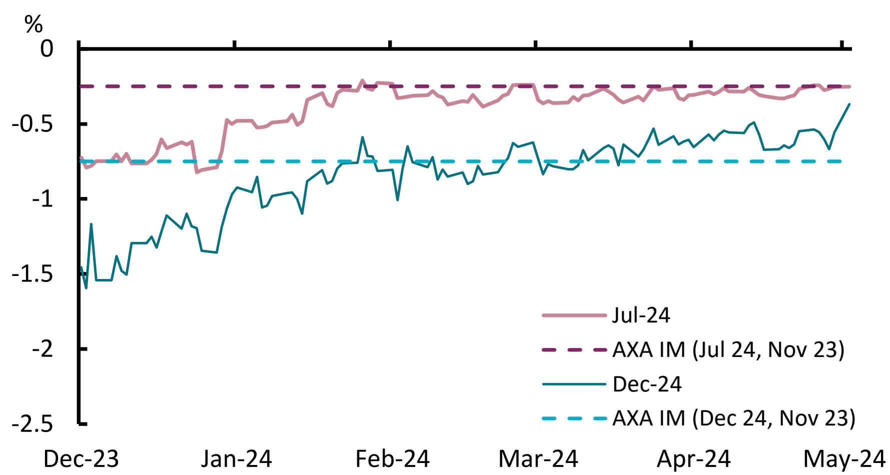
Average earnings



Source: CANISM, AXA IM Research, May 2024

Markets volatile against our consistent call

Evoultion of market rate cut views



Source: Bloomberg, AXA IM Research, May 2024

EM Asia's Q1 economic performance – same, but different

EM Asia ex-China

A short-lived convergence in growth rates

- The region's major economies had a steady start to 2024, with a rare convergence in seasonally-adjusted quarterly GDP growth in Q1. Malaysia and Indonesia posted growth of 1.4%, slightly ahead of the Korea and the Philippines (1.3%) and Thailand (1.1%). However, an analysis of GDP expenditure components shows that they have not been performing uniformly.
- There are similarities in private consumption trends; growth has stayed positive despite high interest rates, with government subsidies to varying degrees still shielding households from high food and fuel prices. However, investment saw a more mixed performance, with an expansion of 2.8% in Malaysia and 1.5% in South Korea, but -3.1% in Thailand. The external sector has been similarly divergent, particularly when assessing the contribution to growth.
- The clustering of quarterly GDP growth in Q1 is not expected to be repeated in coming quarters, not least because the outlook for consumption still hinges on the timing of interest rate cuts and the unwinding of subsidies. Nevertheless, the outlook for the region is broadly positive. Tourism is expected to continue to recover, and the upturn in the tech cycle (currently centred on Korea and Taiwan's high-end semiconductors) will generate positive spillovers to other export-oriented economies in the region. This in turn could support an improvement in investment, particularly in markets benefiting from China+1 investment strategies.

Currencies under pressure

Elevated oil

Q1 2024 started on a good foot

EM Europe

Q1 GDP flash estimates point to a good start of the year

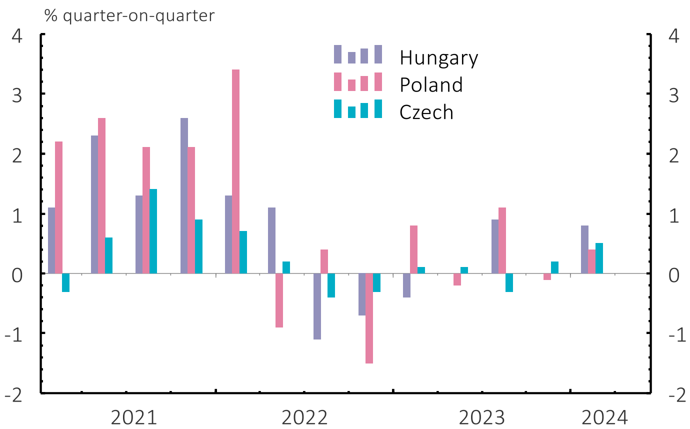
- In quarterly terms, Q1 GDP accelerated by +0.4% in Poland, +0.5% in the Czech Republic and +0.8% in Hungary, surprising to the upside with the notable exception of Poland where extreme volatility in quarterly GDP growth profile since 2022 is usual. We suspect the main driver behind the sequential growth acceleration was private consumption, with real household incomes supported by ongoing disinflation. Investment is likely to become a growth driver in 2025 as EU funds absorption increases and the eurozone economy accelerates. We foresee GDP weighted growth in CEE-3 accelerating to 2.1% this year from -0.1% in 2023 (3.4% in 2025).

Central banks become more cautious, but still scope for easing ahead

- Disinflation is well underway as supply side shocks recede. As we move into H2 2024, we expect a choppier inflation profile. Still, positive real rates and the start of the ECB easing cycle should allow for additional rate cuts.

Growth accelerated across CEE in Q1 2024

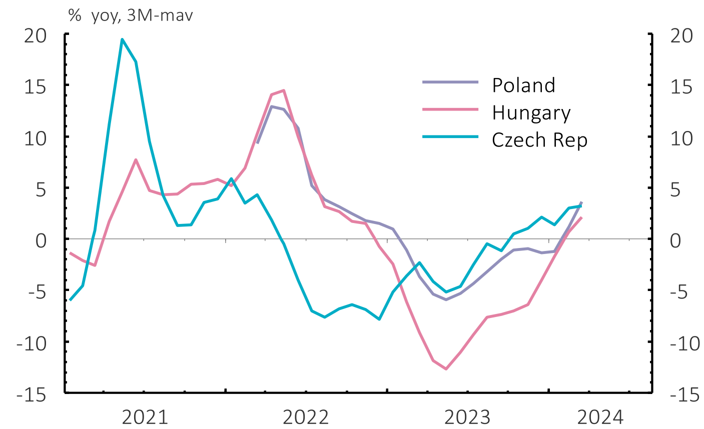
EM Europe GDP growth



Source: LSEG Datastream and AXA IM Research Q1 24

Private consumption in the driving seat

CEE: retail sales growth



Source: LSEG Datastream and AXA IM Research Mar 24

A more cautious easing cycle and general elections in Mexico

Latin America

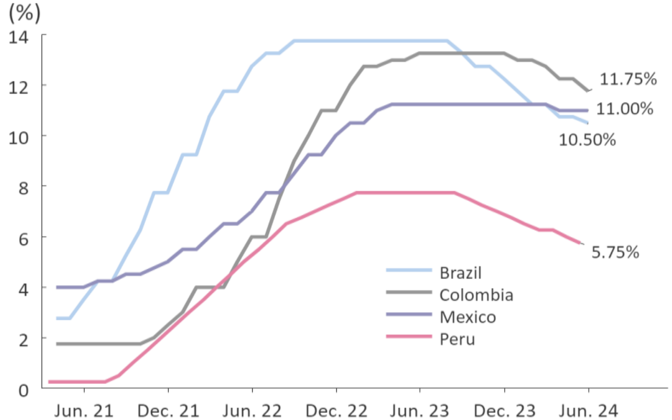
Central banks ease off the pedal in Latin America

- Global financial conditions have tightened, leading regional central banks to adopt a more cautious stance in their ongoing easing cycles. Brazil's central bank reduced the policy rate by 25bps to 10.50%, slowing its easing pace from the previous 50bp cuts. Similarly, Colombia cut rates by 50bps to 11.75% but refrained from a larger 75bp cuts do to tighter external financial conditions and a better growth outlook. Meanwhile, Mexico's central bank decided to hold the policy rate at 11%, eschewing sequential cuts as it expressed concerns over persistent services inflation.

Mexico will hold general elections on June 2

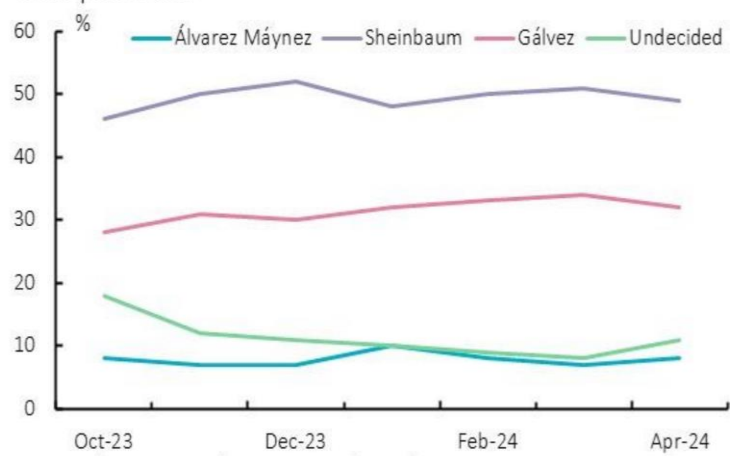
- Claudia Sheinbaum of the ruling Morena party is slated to become Mexico's first female president. A Sheinbaum presidency is expected to continue president AMLO's policies, which include higher social spending, fiscal rectitude (despite a recent increase in government spending), and continued state control over the energy sector. Despite her likely victory, Sheinbaum will face challenges such as a lack of a supermajority in Congress, an ailing energy sector, and the upcoming USMCA review in 2026.
-

A slower easing cycle going forward



Source: LSEG Datastream and AXA IM Research, May 24

Sheinbaum leads the race by a wide margin



Source: El Financiero and AXA IM Research, April 2024

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2	3.2		3.2	
Advanced economies	1.7	1.5		1.4	
US	2.5	2.4	2.3	1.6	1.8
Euro area	0.5	0.6	0.5	1.1	1.5
Germany	0.0	0.0	0.1	0.9	1.5
France	0.9	0.8	0.7	1.0	1.3
Italy	1.0	0.7	0.7	0.7	1.2
Spain	2.5	2.4	1.7	2.1	1.9
Japan	1.9	1.2	0.6	1.0	1.0
UK	0.3	0.7	0.3	1.2	1.2
Switzerland	0.8	0.8	1.2	1.3	1.5
Canada	1.1	1.2	0.9	1.7	1.9
Emerging economies	4.2	4.1		4.2	
Asia	5.3	5.2	4.0	4.7	
China	5.2	5.0	4.7	4.2	4.4
South Korea	1.3	2.3	2.1	2.3	2.2
Rest of EM Asia	5.9	5.6		5.6	
LatAm	2.3	1.8		2.6	
Brazil	2.9	1.6	1.8	2.0	2.0
Mexico	3.3	2.2	2.2	2.1	2.2
EM Europe	3.0	3.0		2.9	
Russia	3.6	3.2	2.3	1.8	1.1
Poland	0.2	2.8	2.9	3.5	3.4
Turkey	4.3	3.0	2.5	3.6	3.2
Other EMs	2.2	2.9		4.2	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 30 May 2024
**Forecast*

Investment Managers

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		2.3	
US	4.1	3.3	2.9	2.5	2.3
Euro area	5.5	2.5	2.3	2.2	2.1
China	0.2	0.6	0.8	1.6	1.9
Japan	3.3	2.2	2.4	1.6	1.5
UK	7.3	2.4	2.5	1.8	2.0
Switzerland	2.1	1.6	1.3	1.3	1.3
Canada	3.9	2.6	2.5	2.6	2.0

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 30 May 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	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	12 June	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec
	Rates		unch (5.50)	-0.25 (5.25)	-0.25 (5.00)
Euro area - ECB	Dates	4.00	6 June	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	0 - 0.1	13-14 June	30-31 Jul 19-20 Sep	30-31 Oct 18-19 Dec
	Rates		unch (0-0.1)	+0.10 (0.1-0.2)	+0.10 (0.2-0.3)
UK - BoE	Dates	5.25	20 June	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (5.25)	-0.25 (5.00)	-0.25 (4.75)
Canada - BoC	Dates	5.00	5 June	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		unch (5.00)	-0.25 (4.75)	-0.50 (4.25)

Source: AXA IM Macro Research - As of 30 May 2024

Calendar of events

2024	Dates	Events	Comments
June	02-Jun	Mexico Presidential Election	
	04-Jun	India General Election Results	
	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%)
	09-Jun	European Parliament Election	
	09-Jun	Belgium Federal Elections	
	12-Jun	FOMC meeting	unch (5.50%)
	13-15 Jun	G7 meeting, Italy	
	13-14 Jun	BoJ meeting	unch (0-0.1%)
	18-Jun	Reserve Bank of Australia (RBA) meeting	
	20-Jun	BoE meeting	unch (5.25%)
	27-Jun	1st US TV debate	
	27-28 Jun	European Council	
	30-Jun	BoE MPC member & Deputy Governor Ben Broadbent's term ends	
July	04-Jul	UK General Elections	
	18-Jul	ECB meeting	unch (3.75%)
	24-Jul	BoC meeting	unch (5.00%)
	30-31 Jul	BoJ meeting	unch (0-0.1%)
	30-31 Jul	FOMC meeting	unch (5.50%)
August	01-Aug	BoE meeting	-25bps (5.00%)
September	04-Sep	BoC meeting	-25bps (4.75%)
	06-Sep	Italy: Macro assumptions for 2025 draft budget	
	10-Sep	2nd US TV debate	
	12-Sep	ECB meeting	-25bps (3.50%)
	17-18 Sep	FOMC meeting	-25bps (5.25%)
	19-Sep	BoE meeting	unch (5.00%)
	19-20 Sep	BoJ meeting	unch(0-0.1%)
	25-Sep	France government to present draft 2025 budget	
October	Before 24 Oct	Austria General Elections	
November	05-Nov	US Presidential Elections	

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