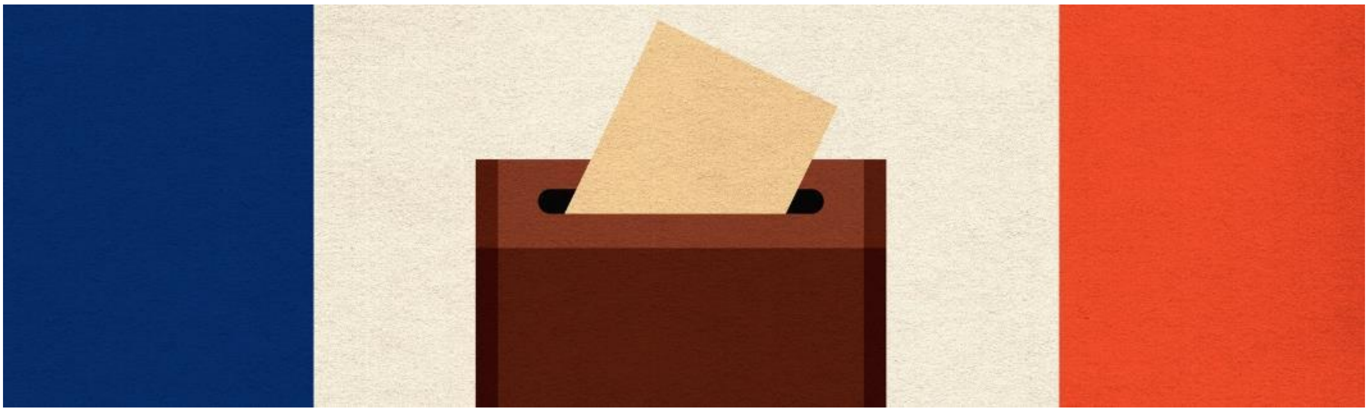
Macron encore

Global Macro Monthly



Key points

- The Ukraine war continues. Energy markets have been relatively cushioned, but commodity prices are elevated and supply-chain disruption has risen. This is an issue for European economies, but is impacting economies across the globe, with Asian central banks increasingly tightening
- The worsening inflation outlook has seen central bank expectations re-price higher. In the US, markets now see rates at 2.75% by year-end and 3.25% next. We expect a marked growth deceleration to moderate expectations, but regional labour market developments will be critical.
- China's Covid outbreak adds to risks. China growth slowed markedly in March – before the Shanghai lockdown. We expect a fall in Q2 GDP and lower our full-year growth forecast. This suggests demand headwinds for the rest of the world, but also risks further supply disruption.
- This is a toxic combination of factors and has led the International Monetary Fund to lower its global forecasts to 3.6% for 2022 and 2023. Our own outlook is for a weaker 3.0% and 2.9%.

Global Macro Monthly

Investment Strategy

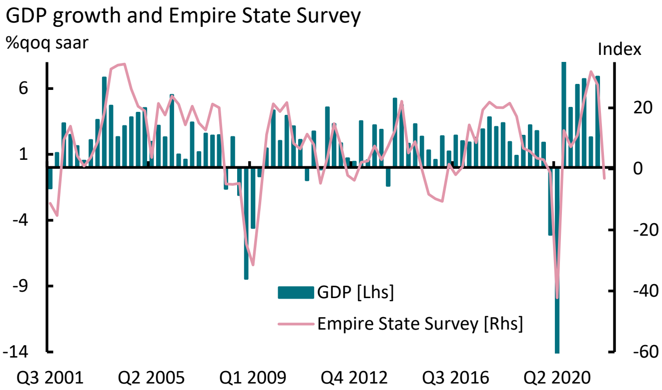
Global Macro Monthly – US

David Page,
Head of Macroeconomic Research,
Macro Research – Core Investments

Growth volatility and the Federal Reserve (Fed)

US growth is set to slow: Having exceeded 6% (annualised) for three quarters in 2021, this should be uncontentious, but the scale of slowdown is up for debate (Exhibit 1). Q1 GDP is due 28 April. We continue to forecast a marked deceleration to 1.5% from 6.9% in Q4, modestly above the 1.0% consensus and closer to the 1.3% indicated by the Atlanta Fed now-tracker. The larger components look relatively stable: Household spending should rise a touch (to 3.2% from 2.5%) and investment should slow (to 1.2% from 2.7%) as we expect a fall in residential investment. GDP growth looks set to be impacted by a sharp drop in export volumes (unwinding Q4's surprise gain). Inventory will prove the wildcard.

Exhibit 1: Growth set to slow



Source: Philadelphia Federal Reserve Board, Bureau of Economic Analysis and AXA IM Research, April 2022

Beyond Q1, GDP components point to subdued growth. Consumption will continue to reflect falling real incomes, offset by excess savings whose behaviour is difficult to predict. Investment should accelerate into 2023, but remain subdued this year with elevated uncertainty, energy and labour costs all weighing, while residential investment looks set for a prolonged normalisation after robust gains.

Inventory is an inherently volatile component. Business inventory growth has been phenomenal, posting gains of 2.2% (qoq) in Q3 2021, 3.7% in Q4 and an expected 4.7% in Q1 2022. The average quarterly rise in 2016-2019 was 0.7%. Inventory contributed 2.1 and 5.3ppt (annualised) to growth in Q3 and Q4 last year. This pace of growth won't continue and because of the unusual way inventory is accounted for in GDP[1] it will have a meaningful impact on GDP growth. On our forecasts for a modest slowing, inventory looks set to weigh on growth over the remainder of the year. If inventory unwinds faster, this adjustment would be sharper. Either way, one quarter of negative growth cannot be ruled out. We continue to forecast GDP growth of 2.8% this year and 1.6% next (consensus 3.2% and 2.1%).

Inflation – labour market – policy

Headline inflation reached 8.5% in March – a level we consider to be around the peak. Yet it is likely to take several months before inflation falls meaningfully and we now forecast it averaging 7.0% this year (from 6.8%) and 3.8% (unchanged) next, compared to consensus of 6.9% and 3.0%. Breakeven inflation expectations (5y5y) have risen recently and now exceed the 2.4-2.5% range we consider consistent with the Federal Reserve's (Fed) inflation target for the first time since 2014. The Ukraine war and China's COVID-19 outbreak threaten further supply disruption and present upside risks. Yet we continue to believe the Fed will be more focused on domestic pressures as it gauges a policy response.

Slower GDP growth should ease the tight labour market. Employment growth averaged 560k/month throughout 2021 and in Q1. This pace is explained by 6%+ GDP growth, but slower headline growth should also slow employment growth. Vacancies will be important. If these represent pent-up labour demand, strong job growth could continue even as the economy slows. However, if vacancies start to be withdrawn, employment growth will slow. Coupled with an expected further improvement in labour supply, this should stabilise unemployment, albeit around all-time lows of 3.4%.

It is the slowdown in the labour market, rather than the broader economy, that will be critical for the Fed. Fed Funds Rate (FFR) expectations have risen sharply – up a further 50bps from last month's meeting – now expected to reach 2.75% by year-end and to peak around 3.25% in 2023. Our forecast remains for less, although recent communication has seen us front-load our hike expectations to two 50bp moves in May and June and 25bp hikes for the rest of the year, raising the FFR to 2.50% by year-end – in line with the Fed's view of neutral. Moreover, with oil prices less elevated than we expected, we also reinstate a further increase to 2.75% in March next year, although consider this final hike in the balance, with signs of a faster easing in the labour market likely to render it unnecessary. The behaviour of excess saving, the scale of inventory unwind, the degree of pent-up labour demand, the persistence of inflation and the uncertain pass-through of policy to financial conditions are all uncertainties that make it difficult to judge the eventual scale of tightening required. This is why the Fed will continue to be "humble and nimble" as it monitors economic data over the coming quarters.

[1] It is the change in inventory that contributes to GDP and therefore the change in the change that impacts growth.

Global Macro Monthly – Eurozone

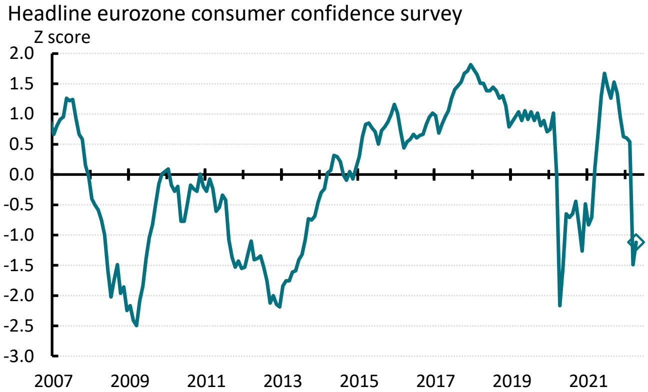
François Cabau and Hugo Le Damany,
Economists,
Macro Research – Core Investments

Consumers feeling the heat

Eurozone consumers have been feeling the brunt of the economic ramifications of the Ukraine crisis. Consumer confidence dived in March, only inching higher in April (Exhibit 2). Annual consumer inflation reached an all-time high at 7.4%yoy in March, mainly spurred by energy which contributed 4.4 percentage points (ppt) while core prices contributed 2ppt and food alcohol tobacco just 1ppt. Meanwhile, April's flash Purchasing Managers' Indices and national surveys show the lifting of pandemic-related restrictions have supported a rise in services activity, more than offsetting the fall in manufacturing confidence and highlighting the overall surprising resilience of the economy.

While this suggests upside risks to our projected average flat growth in Q2-Q3, we point to early indications of increased precautionary household savings and weaker-than-expected momentum in China, both likely to weigh on growth prospects.

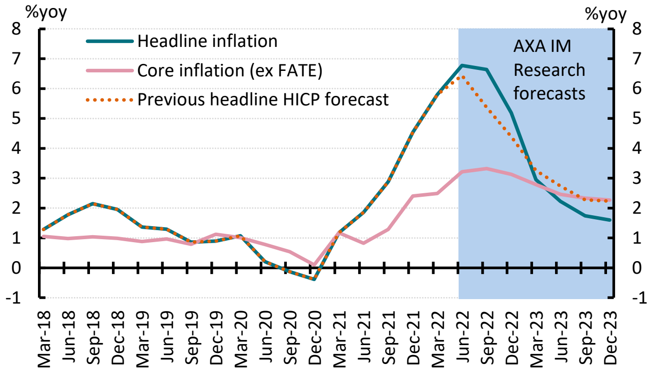
Exhibit 2: Eurozone consumer confidence stabilising at low level in April



Source: European Commission, AXA IM Macro Research, 27 April 2022. Note: Diamond refers to April data

Including the latest developments in energy prices, and enhanced food price inflation modelling, we now project Eurozone headline inflation to average 6.1% (+0.7ppt from our previous forecast) and 2.1% (-0.4ppt) this year and next. Our forecast for core inflation is unchanged at 3% and 2.5% (Exhibit 3). Owing to the differentiated fiscal responses, we continue to expect significant discrepancies within the Eurozone, with France and Spain at opposite ends of the growth spectrum – and with the former likely to yield a better performance than the latter.

Exhibit 3: High headline inflation for longer



Source: Eurostat and AXA IM Macro Research, 27 April 2022

ECB: Inflation concern, increased hawkish tone

At its April Governing Council (GC) meeting, the European Central Bank (ECB) pressed on with the hawkish rhetoric, evidently nervous about the inflation outlook impacting inflation expectations. The survey of professional forecasters sees inflation at 2.1% in the long run and market expectations have reached new highs.

We think the ECB will finish its Asset Purchase Programme (APP) at the end of Q2. Amended forward guidance that rate hikes would only follow "sometime after" still means a hike is likely before the end of 2022. Our baseline continues to envisage two 25 basis point (bp) deposit rate hikes to zero in December and March, and another in December 2023. But lift-off in September is a distinct possibility, given the resilience of the economy.

Meanwhile, the GC kept its broad commitment to a financial fragmentation tool, implying the design and deployment of a new tool above and beyond the APP and Pandemic Emergency Purchase Programme (PEPP) reinvestments. We think a new tool is likely to share features from previous programmes such as Securities Markets Programme (SMP), Outright Monetary Transactions (OMT), and PEPP.

France: Uncertain parliamentary elections ahead

President Emmanuel Macron has been re-elected for a five-year term, winning 58.5% of votes cast, slightly better than expected by polls but weaker than in 2017 (66%).

We continue to see high uncertainty for the 12-19 June parliamentary elections. These are vital in determining the ability of the re-elected President to act. While an opposition-led parliament is unlikely, ad-hoc political compromise may be needed, complicating policy making. Meanwhile, we will closely watch the formation of the first government to take place before 13 May (for more details, see our *comprehensive note*).

Global Macro Monthly – UK

Modupe Adegbembo,
Junior Economist,
Macro Research – Core Investments

Inflation set to reach 9% in April

Inflation continues to surprise to the upside with the conflict in Ukraine exacerbating the already challenging outlook for prices. Inflation rose to 7% in March with prices rising in most sectors as the spread of inflation appears to be broadening, a development which may unsettle the Monetary Policy Committee (MPC). Inflation is on track to reach a peak of around 9% in April driven by utility price rises. We have raised our inflation outlook to 7.3% for 2022 and 3.5% for 2023, up from 6.8% and 3.4%, respectively (consensus 7.0% and 3.3%).

We expect growth to begin to slow materially as the real income squeeze impacts households – some measures point to the worst real income fall on record. And unlike many European states, the UK is not offsetting much of this shock with fiscal policy. Rising prices will weigh on activity, further impacted by falling confidence, tighter financial conditions, and weaker external demand. We forecast GDP growth of 3.8% for 2022 and lower 2023 to 0.6% from 0.7% (consensus 3.8% and 1.7%).

The labour market remains tight but may begin to run out of steam as demand cools over 2022. Employment is well above pre-pandemic levels and unemployment in the three months to February fell to 3.8%, below the 4% seen just before the pandemic. This was also driven by more workers exiting the workforce as employment has remained steady. Payrolls data saw a small rise of 35,000 in March – the smallest increase since February 2021.

In May, we expect the Bank of England (BoE) to hike rates again to 1%. It will also publish updated economic forecasts which we expect to show a material slowdown in UK growth based on market rates and a worsening inflation outlook because of the war in Ukraine. This is likely to be a turning point for markets and may trigger a repricing of market rate expectations. At present, we forecast one further rise to 1.25% in June, with the BoE then likely to pause its hiking cycle as growth slows. However, this peak would be far less than the 2% markets currently forecast for end-2022. We then expect the BoE to cut rates to 1% next year.

UK local and Northern Ireland Assembly elections will be held on 5 May. Recent polls suggest Sinn Féin lead in NI elections ahead of the DUP who previously led the Assembly. UK local elections will frame the next stage of the 'partygate' scandal. Both the Prime Minister and Chancellor received police fines for breaking lockdown laws. A committee will now conduct an investigation into whether the PM knowingly misled Parliament in December. His future will be determined by the outcome of both events.

Global Macro Monthly – Japan

Hugo Le Damany,
Economist,
Macro Research – Core Investments

Mixed economic environment in Japan

April's flash manufacturing Purchasing Managers' Index (PMI) came in at 53.4, a 0.7 drop. Due to the Ukraine crisis and lockdowns in China, the output, new orders and employment indices were all lower, while delivery times increased. In contrast, the services PMI was up 1.1 at 50.5, benefiting from a normalisation in some sectors after the end of COVID-19 restrictions, despite higher inflationary pressure.

The Consumer Price Index (CPI) rose to 1.2% in March but should cross 2% in April for the first time since 2015 as the impact of the large cut in mobile phone charges last year drops out and second-round effects from higher energy prices emerge. On the supply side, domestic manufacturers are facing surging energy prices and yen depreciation is raising the risk of a higher pass-through of costs to prices. Consequently, we have adjusted our CPI forecast to 2.2% this year, up from 2%.

Interestingly, 52% of households believe inflation is currently above 5%. Discrepancies between observed and perceived inflation have always been high but rarely on this scale. This is likely to dampen private consumption, despite new government stimulus expected soon (around 1% of GDP). Accordingly, we have revised our GDP forecast down to 1.8% for 2022 (from 2.5%) but expect 2.1% in 2023, up from 1.8%.

The yen fell to a two-decade low against the dollar at ¥129. The huge advantage a cheap – yen has provided Japan in the past is less prevalent– Japan imports 90% of its energy needs so the import price increase hurt households and companies which are unable to pass on costs. Additionally, Japanese exporters have partially outsourced production, so the competitive advantage of a weaker yen is waning.

Another headache with yen depreciation

The correlation between the US/Japanese expected rate differential and yen depreciation is obvious, pressuring the Bank of Japan (BoJ). But it has stuck to its policy and has recently increased net purchases to defend its 10-year target at +0.25%. We believe the BoJ will keep the status quo at next week's policy meeting, arguing that insufficient core inflationary pressure and an incomplete recovery require further support. This provides it with a unique opportunity to overshoot its inflation target and possibly re-anchor inflation expectations higher. Also, the probability that the Federal Reserve under-delivers what is currently priced is high, which should ease pressure on the yen somewhat.

Global Macro Monthly – China

Aidan Yao,
Economist (China),
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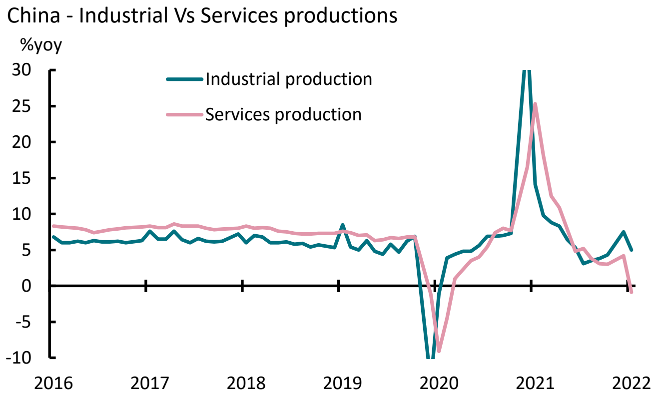
COVID-19 flare-up takes a heavy economic toll

The Chinese economy grew 4.8% year-on-year (yoy) in the first quarter (Q1), stronger than the market expectation of 4.2%. Secondary industry output growth accelerated to 5.8%, the primary sector also saw firmer activity, but services growth slowed notably to 4%, hit hard by the two Omicron outbreaks since the start of the year.

However, the stronger GDP reading will likely do little to ease the market's concerns about the economy. For a start, Q1 GDP was bolstered by surprisingly strong January-February data, which was difficult to reconcile with third-party information. Moreover, GDP presents a backward-looking view of the economy, which has dramatically changed with the current Omicron outbreak.

In contrast to the quarterly GDP release, the March monthly data did a better job of tracking the economy amidst the outbreak. As expected, sequential growth eased across the board, and in some cases, sharply relative to prior months (Exhibit 4). Industrial output growth cooled to 5% on the back of softer activity in manufacturing and utility sectors. While high-end manufacturing stayed resilient before the Shanghai lockdown started, auto output contracted by almost 5% following the production halt in Jilin.

Exhibit 4: COVID-19 takes a toll on the economy



Source: CEIC and AXA IM Macro Research, 18 March 2022

Investment growth came off the boil in March, falling to 7.1% from 12.2% at the start of the year. Infrastructure investment was again the bright spot, with increased fiscal support nudging growth to just over 10%yoy. In contrast, manufacturing capex softened due to an easing in domestic and external demand. Real estate investment growth contracted, unsurprisingly, despite policy easing by local governments and falling mortgage rates. The latest COVID-19 lockdowns may have exacerbated the impact on housing investment, keeping prospective buyers out of the market.

The biggest impact of COVID-19 restrictions was on consumer spending. Retail sales nosedived, contracting 3.5% in March, the worst fall since the onset of the pandemic. Services sales bore the brunt of the shock, with catering growth slumping 16.4%yoy. Removing the price effect, real sales grew by only 1.3% in the quarter, the weakest in two years. Apart from the impact of virus controls, consumer spending was also weighed on by rising unemployment rates and easing income growth. Signs that the labour market has finally started to crack will add to reasons why Beijing needs to act fast to stabilise the economy.

Urgent policy changes needed to rescue growth

The March data clearly shows an economy in distress, but April will likely be even worse as the Shanghai lockdown sends shockwaves through production networks and logistics supply chains**.** The vicious Omicron outbreak, combined with China's zero-COVID policy, is taking a hefty toll on the economy and society, risking an echo of Q1 2020.

To stop the economic slide, we think Beijing urgently needs to adjust two sets of policies. The first is its COVID strategy – the sustainability of which has been called into question by mounting economic costs and social discontent lately. We think that developments over the past month will force Beijing to move away from its current approach – which relies on strict administrative controls – to a strategy that puts more emphasis on vaccines, self-testing, and treating the vulnerable. We do not expect this to be 'living with COVID' straightaway due to public health and political considerations, but a middle-of-the-road approach – between 'zero COVID' and 'living with COVID' – is likely, even if the overall name of the strategy stays the same. With this, Beijing effectively tips the balance of costs of fighting COVID-19 from the economy more towards public health. Hence, managing the risks of rising infections and hospitalisation will be key to ensure its success.

Beyond changes to the COVID-19 strategy, more macro policy supports are also needed to revive growth. The pace of policy easing has quickened lately, but the measures announced to date still fall far short of what we think is needed to put a floor under the economy. The recent reserve requirement ratio (RRR) cut, for example, was smaller than expected due to the People's Bank of China (PBoC)'s concerns about inflation and the Fed's tightening. Such policy caution, combined with a more severe COVID-19 shock, has markedly worsened the economic outlook relative to our prior expectations. We have therefore lowered our 2022 growth forecast to 4.5%, below the consensus projection at 5%. Importantly, the revised view assumes the urgent policy adjustments described above. Failure to deliver them could see growth fall further towards, or below, 4% for this year.

Global Macro Monthly – Canada

David Page,
Head of Macro Research,
Core Investments

BoC accelerates hikes into tight domestic market

Inflation materially overshot expectations in March, rising to 6.7% on the year. Prices continue to be lifted by tight labour market conditions and external factors – notably in March the surge in energy prices. The Ukraine war increases the risk of lingering supply issues and elevated energy prices, which are both likely to delay a material retracement, even if we consider inflation close to a peak. Moreover, external supply disruptions, including from COVID-19 outbreaks in China, remain a further upside risk. We forecast inflation to average 5.9% and 3.2% for this year and next (consensus 4.9% and 2.5%).

The labour market appears tight. Employment growth has been strong and the unemployment rate has fallen to a record low of 5.3%, albeit exacerbated by not-fully-recovered participation and persistently weak productivity growth. Employment growth has, though, slowed in recent quarters, a trend we see continuing. Unemployment also looks set to fall further and we forecast it below 5% by year-end, then stabilising. This should see wage growth peak in H2 2022 and soften into 2023 but remain elevated.

Decelerating employment growth and still-elevated inflation should combine to deliver a marked slowdown in real income growth. In turn, this should slow consumer spending growth to 4.2% this year – cushioned somewhat by savings – and to 2.9% next as those savings begin to be exhausted. External demand is also likely to weigh on growth, in part from the impact of the Ukraine war, but also from a more material softening in US activity. We see GDP growth of 3.3% in 2022 and 2.5% in 2023, below the 3.9% and 2.8% consensus view.

External supply pressures, tight domestic conditions and elevated inflation have led the Bank of Canada (BoC) to accelerate policy tightening. Following March's 25bp initial rate hike, the BoC raised its rate by 50bps to 1.00% in April. It also announced that from 25 April it would allow a full run-off of its government bond holdings. This will result in around 40% of its bonds maturing over the next two years. The BoC also adjusted where it sees the neutral range, up by 25bps to 2-3%. We expect the BoC to continue front-loading monetary tightening, including another 50bp rate hike in June, and raise our year-end forecast to 2.50%. Our expectation of slower growth and a sharper labour market slowdown should see the BoC stop below the 3.00% market expectation, and we see the BoC on hold in 2023. Risks to this outlook are to the upside.

Global Macro Monthly – EM

Irina Topa-Serry,
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Macro Research – Core Investments

Signs and reactions since the start of the war

Since the start of the Russian military invasion of Ukraine, Central and Eastern Europe (CEE) has understandably been the most affected region. Governments are handling an unprecedented wave of refugees from Ukraine, consumer confidence is collapsing – particularly visible in the Czech Republic's latest survey – and manufacturing purchasing Managers' Indices point to weaker industrial activity ahead (with the notable exception of Hungary). At the same time, inflation has accelerated further, in double-digit territory for most countries in the region on the back of a renewed energy price shock. Central banks have stepped up the pace of monetary policy tightening with 100 basis point (bp) hikes in Poland and Hungary and 50bp hikes in the Czech Republic and Romania. More are to be expected. Governments are trying to limit the pass-through of higher world prices to domestic consumers. Poland's Anti-Inflation Shield is one of the most extensive programmes in Europe with measures likely to bring Poles savings of nearly 25bn zloty.

Continuity post-elections: Trouble ahead?

General elections held on 3 April in both Hungary and Serbia showed incumbent leaders and parties confirm their respective dominant positions, meaning no changes to be expected in their respective political positioning. In Hungary, the Fidesz-KDNP coalition will stay in power for a fourth consecutive term. While a victory for Fidesz and for PM Viktor Orban was widely expected, the scale of the victory is more surprising, with Fidesz garnering over 50% of the popular vote, beyond their score in 2018 elections, thus retaining its super majority in Parliament. Tensions with the European Union (EU) overrule-of-law infringements remain vivid: The EU launched an official procedure over financing conditionality that could eventually jeopardise transfers from the EU budget (€34.4bn) and the NextGenerationEU financial aid package (€7.2bn) to Hungary, worth 22.3% and 4.7% of GDP respectively and with non-negligeable effects on long-term growth prospects.

In Serbia, incumbent President Aleksandar Vučić convincingly won his next term in the first round and the Serbian Progressive Party (SNS) retained its dominant position, albeit with weaker results compared to the 2016 elections – the last time the opposition participated. Serbia refuses to join international sanctions on Russia, has no intention of joining the North Atlantic Treaty Organization (NATO) and most recently hinted that it may reconsider its planned goal of joining the EU.

Global Macro Monthly – EM Asia

Shirley Shen,
Economist (Emerging Asia),
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Central banks collectively make a hawkish shift

Soaring commodity prices on heightened geopolitical tensions have prompted many Asian central banks to recalibrate monetary policy. Both the Bank of Korea (BoK) and Monetary Authority of Singapore (MAS) tightened more aggressively than consensus expectation. The BoK raised the policy rate by 25 basis points to 1.5%, delivering its fourth hike since the COVID-19 outbreak. Meanwhile, MAS announced its first dual tightening since April 2010, marking the central bank's third policy tightening move since October last year. Both the mid-point and slope of Singapore Dollar Nominal Effective Exchange Rate (S$NEER) were raised, allowing for a faster pace of Singapore dollar appreciation.

The Reserve Bank of India (RBI) also took a first step in policy normalisation. Although the RBI retained an accommodative policy stance by keeping the repo and reverse repo rates unchanged at 4% and 3.35% respectively, it introduced a standing deposit facility at 3.75%. This will serve as the floor of the policy rate corridor and confirms our call for a June hike. Malaysia and the Philippines central banks also appear to be moving closer to the exit from current easy policy settings. We maintain our baseline for a 25bp hike in May for Bank Negara Malaysia and the Bangko Sentral ng Pilipinas.

Other banks in the region, notably Bank Indonesia (BI), Bank Negara Malaysia (BNM), and Bank of Thailand (BoT) remain on hold. Being the only two net commodity exporters in the region, inflationary pressures in Indonesia and Malaysia have been largely under control. In addition, compared to their peers, the rupiah has seen little depreciation whereas the ringgit appreciated. Therefore, neither BI nor BNM are in a hurry to raise rates immediately. The BoT's latest decision to remain on hold was also widely expected on the back of a weak growth recovery. We expect a total 100bp hike for BI, 50bp for BNM, and 25bp for BoT in the second half of 2022.

The highlights from central bank meetings were the forecast revisions, reflecting recent developments including a surge in global commodity prices. Many have already upgraded their inflation projections significantly and downgraded the 2022 growth forecasts on rising risks and economic headwinds – the characteristics of a severe supply shock. Overall, although some central banks may not be in a rush to hike yet, we are increasingly seeing signs of them moving closer to lift-off.

Global Macro Monthly – LatAm

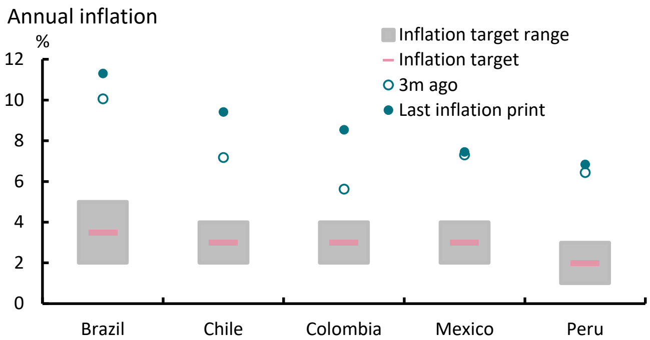
Luis Lopez Vivas,
Economist (Latin America),
Macro Research – Core Investments

Feeling the heat

Despite a mature hiking cycle, and respite from better terms of trade and currency strength, Latin American central banks continue to face unremitting inflation (Exhibit 5). March inflation was above consensus expectations in all major countries in the region (particularly Brazil and Chile) driven by higher energy and food prices. Year-on-year inflation in Brazil reached 11.3%, 0.3 percentage points above market expectations. Annual inflation in Chile increased to 9.4% in March versus 8.7% expected. These continuous upside surprises over the last few months are starting to undermine central banks' ability to anchor inflation expectations, which implies more hiking vis-à-vis recent forward guidance.

However, it is important to highlight that over half of the region's current annual inflation rate (9.3%) is explained by rising food and energy costs. For instance, energy inflation is now running at an incredible 30.9% and food inflation reached 11.1%. Meanwhile, core inflation sits at 7.4%. In this sense, there is relatively little that monetary policy can do to deal with external shocks such as global supply bottlenecks and higher commodity prices as a result of the ongoing war in Ukraine. This reality has prompted local governments to start implementing other measures to fight inflation.

Exhibit 5: Rising inflation



Source: Datastream and AXA IM Macro Research, 25 April 2022

For example, most countries in the region have reduced taxes on fuel and import tariffs. Countries like Chile and Colombia have announced new cash transfer programs to help low-income households. Price controls are being discussed in Mexico but so far have not been implemented. While these policies could temporarily help mitigate the impacts of inflation, they will put more stress on the already strained public coffers. Therefore, it will be crucial for governments to dismantle these measures once the current surge in inflation is over to ensure long-term fiscal sustainability.

Investment Strategy – Cross assets

Greg Venizelos,
Credit Strategist,
Research – Core Investment

Duration beckons as bears awaken

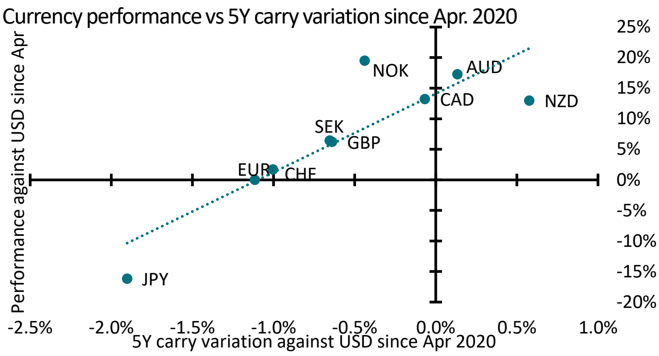
Investors continue to endure challenging markets as concerns about monetary tightening, inflation and growth dominate. Central bankers are hawkish, inflation is ubiquitous and consumer confidence has weakened. But equally, jobs are plentiful, wages are growing and companies are earning. Fixed income offers opportunity, once we accept inflation will eat away at returns near-term. Building some duration in portfolios is a way to potentially hedge against a more significant reaction in equities if growth falters into 2023.

Investment Strategy – FX

Romain Cabasson,
Head of Solution Portfolio Management,
Multi-Assets – Core Investments

The monetary policy divergence steamroller

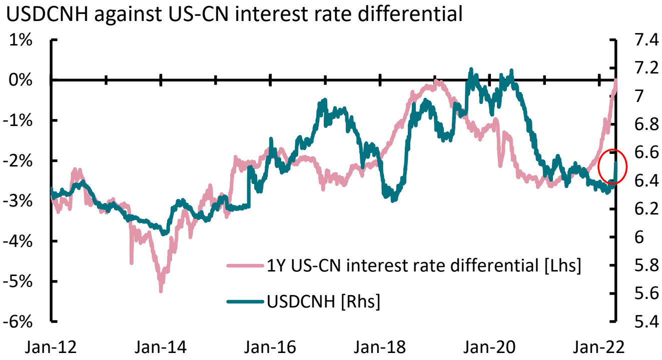
Exhibit 6: Policy hike expectations key currency driver



Source: Bloomberg and AXA IM Research, April 2022

The sharp inflation repricing caused by the Ukraine war continues and with it an even sharper repricing of monetary policy expectations. The Federal Reserve is leading, as higher energy prices are adding to already tight labour markets. But expectations for most central banks have followed and relative monetary policy normalisation continues to be the main driver of currencies (Exhibit 6). This is reflected the yen's year-to-date fall as markets are pricing no change in Bank of Japan policy, given its recent rhetoric. Japan is an outlier in G10 inflation (remains soft) and higher energy prices are challenging imports. Further rises in global inflation could weaken the yen more. Equally it should rebound if global inflation starts to soften, especially if domestic inflation rises and the BoJ needs to adjust its policy.

Exhibit 7: USDCNH also starting to react to policy divergence



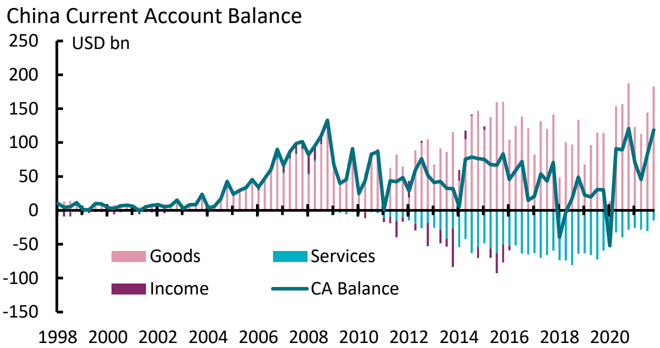
Source: Bloomberg and AXA IM Research, April 2022

The repricing of ECB policy has been remarkable, offsetting some of the pressure on the euro. The policy gap between the Fed and ECB seems fair, even if both expectations look excessive. ECB expectations look overdone, given more subdued labour market pressures, a worse growth outlook and downside risks if Russia sanctions escalate. Bank of England expectations look even more fragile, putting sterling at risk. Brexit disruptions are exacerbating inflation pressures but also threaten growth and trade. The stance of both the Bank of Canada and Norges Bank stance is credible as both Canada and Norway enjoy higher oil and gas revenues. The krone rebound can continue, given a sharp drop beforehand.

… smashed yen, heading for yuan

The People's Bank of China seems to be diverging from the Fed – it needs to increase accommodation due to the real estate deleveraging, new lockdowns and lower global growth. Yet while carry is anticipated to be lower, the yuan has barely reacted (Exhibit 8). The renminbi has gained a lot of support since COVID-19 thanks to strong China exports and low outbound tourism. But exports may start to peak as developed economies shift consumption from goods to services and China's zero-Covid policy creates disruption in domestic production. Capital flows have been supportive for the renminbi, but rising uncertainty is now weighing on emerging market inflows more broadly.

Exhibit 8: Covid crisis has boosted China Current Account surplus



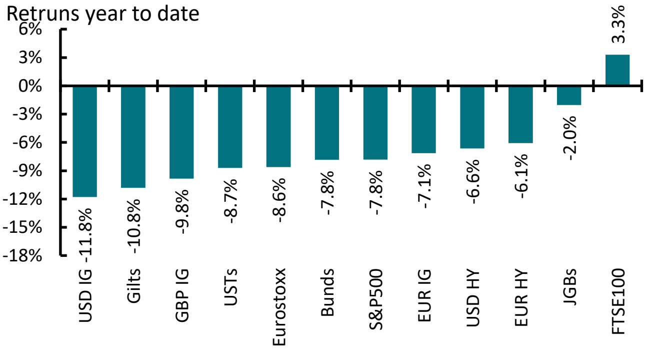
Source: Bloomberg and AXA IM Research, April 2022

Investment Strategy – Rates

Gregory Venizelos
Credit & Macro Strategist
Research – Core Investments

Returns drawdown: Shock and awe

Exhibit 9: Double-digit falls in long duration markets

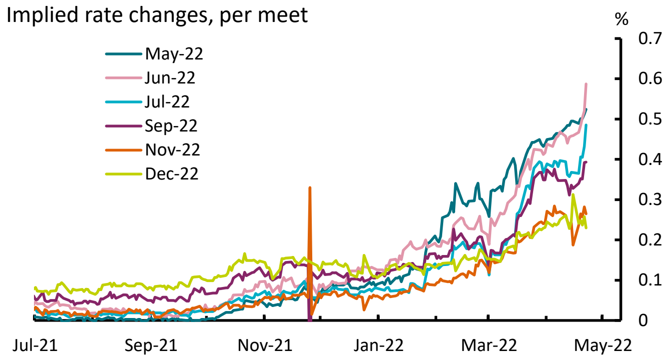


Source: InterContinental Exchange (ICE), Bloomberg and AXA IM Research, 25 April 2022

The inexorable rise in global yields in the first quarter of 2022 has continued in April, making the already dire fixed income returns in Q1 even worse. Double-digit drawdowns year-to-date in long duration markets like USD investment grade (IG), Gilts and sterling IG have become a stark reality for investors (Exhibit 9). By contrast, shorter duration markets have held up better – albeit well into negative territory – but have suffered smaller drawdowns than equity markets.

Rate hike expectations: A boil of hawks

Exhibit 10: Fed rate hike calls accelerated in April

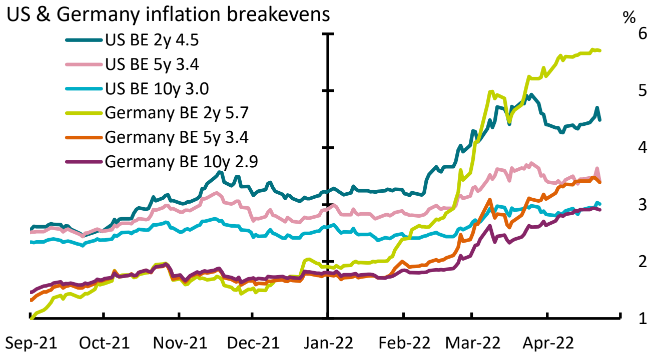


Source: Bloomberg and AXA IM research, 25 April 2022

The relentless hawkish repricing of central bank expectations has been a key driver in the rise in global yields, pushing real yields and term premia higher (especially in the US) while inflation expectations have continued to rise. With six meetings remaining for the Federal Reserve this year, the current market pricing implies a 50-basis-point (bp) rate hike in each of the next three meetings, a 25bp hike in each of the last two meetings, and an 80:20 probability blend of a 50bp:25bp hike at the September meeting (Exhibit 10). ECB expectations have shifted as well, with the market now pricing the equivalent of eight hikes of 10bp over the remaining five meetings in 2022, starting as early as July.

Inflation repricing: Stockholm syndrome

Exhibit 11: German inflation pricing exceeds US after Russia invasion

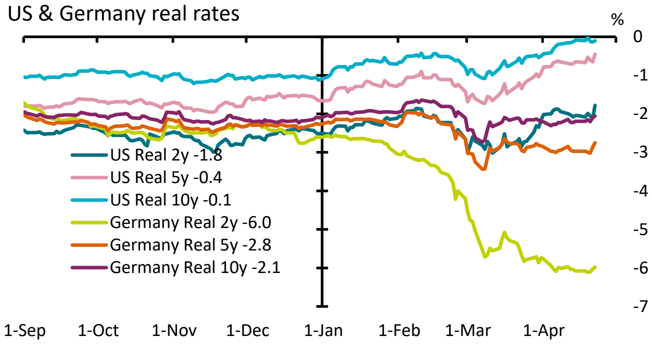


Source: Bloomberg and AXA IM research, 25 April 2022

The Ukraine war has exacerbated inflation pressures in Europe. Germany inflation breakevens, for example, have now matched if not exceeded those in the US – at least at the short end of the curve (Exhibit 11). This has contributed to the escalation of ECB rate expectations. Equity markets, however, have not reacted too adversely to the latest rise in inflation/policy rate expectations. It may be that investors have come to terms with elevated inflation in the medium term: Companies may be able to mitigate some of the impact on earnings; stocks offer a relative safe-haven amid the damage in fixed income returns; and central banks may not fully fulfil the hawkish expiations as a slowdown in growth unfolds into the second half of the year.

Real rates on the rise

Exhibit 12: US real rates have moved higher since Mar



Source: Bloomberg and AXA IM research, 25 April 2022

The hawkish repricing of the Fed has driven US real yields higher, with the 10-year tenor now threating to break above zero (Exhibit 12). Rising real rates are a risk to equities, which have traded down in the past three sessions. Together with spread widening, a warning sign of deteriorating financial conditions which could compel the Fed to dial back its hawkishness.

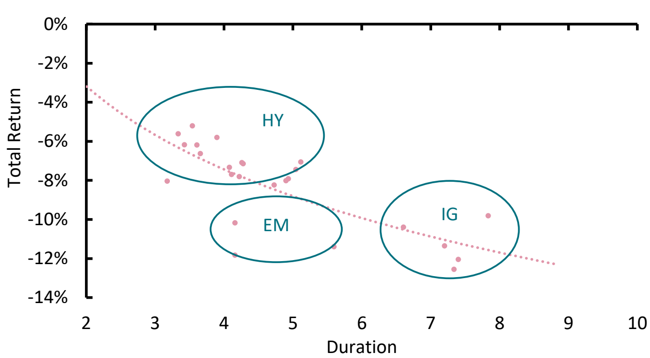
Investment Strategy – Credit

Gregory Venizelos
Credit Strategist
Research – Core Investments

Negative returns across the board

At best, credit investors have suffered negative losses of 5% year to date (Exhibit 13). The drawdowns across credit indices have ranged from -5.2% (euro single-B) to -12.6% (USD BBB), with duration the key driver (3.5 years for euro single-B versus 7.3 for US dollar BBB), aside from emerging market indices which have been affected by the China property bust, COVID-19 slowdown and the war in Ukraine. Historically, large drawdowns tend to be followed by a recovery in returns. The recent spread widening also suggests excess returns over 12 months could be positive. Yet, duration is set to continue to bedevil returns until we reach a peak in hawkish expectations vis-à-vis central bank monetary policy. We therefore continue to prefer high yield (HY) spread risk over investment grade (IG), the latter being more exposed to duration risk.

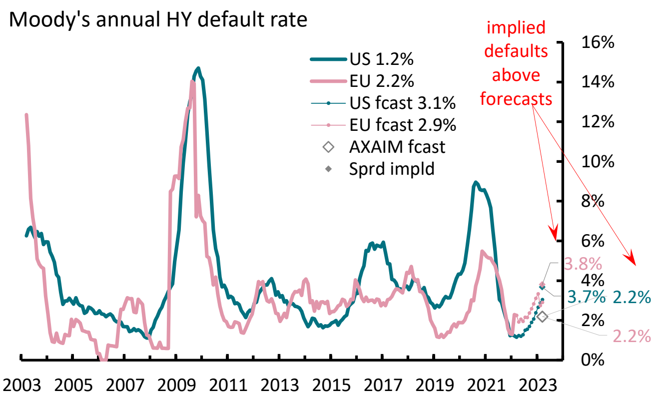
Exhibit 13: Losses of 5-13%– duration dominant factor



Source: Bloomberg and AXA IM Research, 25 April 2022

Defaults backdrop still rather benign

Exhibit 14: Default expectations have risen modestly but we may have more to go

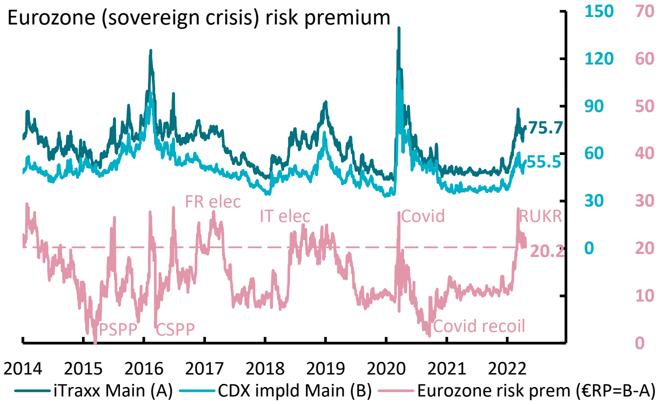


Source: Bloomberg and AXA IM Research, 25 April 2022

The default backdrop remains supportive of our preference for HY, although rising macro risks merit some prudence. Default expectations have ticked up but remain in benign territory, below their historic averages and below what is implied by spreads (Exhibit 14). Some deterioration ahead is likely, but not to the degree of wiping out HY excess spreads. Indeed, while bank lending standards in the Eurozone are set to tighten over the next three months, a low bond distress ratio is offsetting part of the impact of lending standards on defaults.

Eurozone risk premia

Exhibit 15: Eurozone risk premium retraced after hitting post euro sovereign crisis highs



Source: Bloomberg and AXA IM Research, 25 April 2022

One consequence from the Ukraine crisis has been the notable underperformance in euro risk premia against G7 peers. Upon the invasion, our Eurozone risk premium indicator spiked to its post-sovereign crisis highs (Exhibit 15) and has only partially retraced since. Further normalisation in this metric is unlikely to materialise before we move towards some resolution to the war and a relief in energy pressures for Europe. Furthermore, we have seen notable dispersion within euro risk premia, with credit and the periphery having repriced wider versus core and semi-core risk. Our Principal component analysis (PCA) analysis flags BTPs (Italy debt) and Xover (HY credit) as cheap by 16 and 21 basis points respectively (Exhibit 16).

Exhibit 16: PCA analysis flags BTPs and Xover as cheap amid euro risk premia

Euro risk PCA RV [2010-date]

21-Apr-22	Spot	Residual	Z-score
Bund ASW	72.0	-1.3	-1.6
EGB sprd	54.0	-8.8	-1.8
BTP-Bund	165.9	16.3	1.8
iTrx FinSen	87.3	-1.1	-0.2
iTrx NonFin	75.9	6.3	1.3
iTrx Xover	372.8	21.2	0.7

Source: InterContinental Exchange (ICE), Bloomberg and AXA IM Research, 25 April 2022

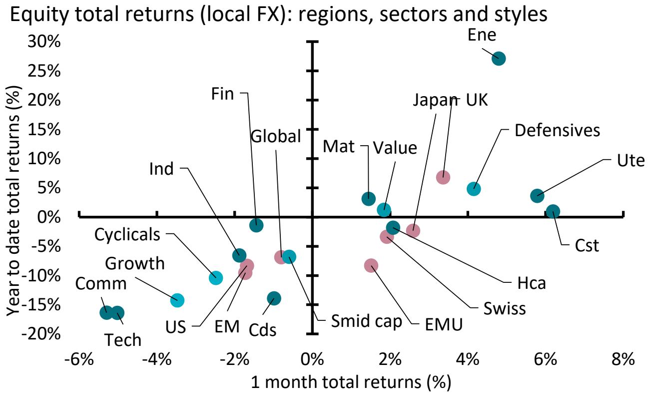
Investment Strategy – Equity

Emmanuel Makonga,
Investment Strategist,
Research – Core Investments

Hardly better

The current landscape remains tricky for equities given the backdrop of waning growth and rising inflation. Global equities declined by 0.8% over the past month (Exhibit 1). Regionally, the UK is the only positive country year-to-date (+3.4%). Energy (+4.8%) outpaced the other sectors once again thanks to elevated commodity prices while the defensive factor (+4.2%) keeps delivering in this uncertain macroeconomic regime.

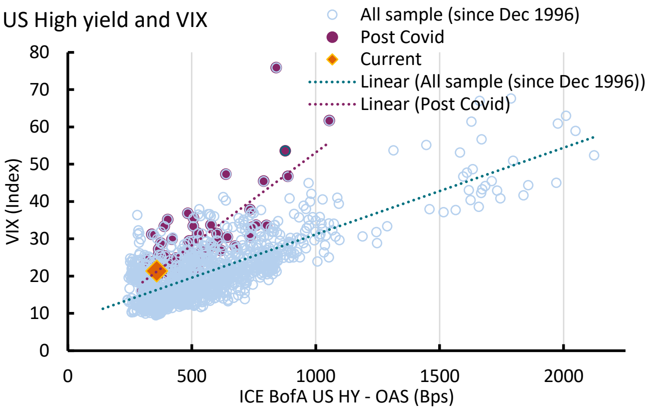
Exhibit 17: A month following first quarter trends



Source: Datastream and AXA IM Research, 25 April 2022

Implied equity market risk appears consistent across assets. Pre-COVID-19, the current levels of volatility measure the VIX would have appeared elevated relative to the US high-yield (HY) bond spread; yet structural factors have shifted this relationship and post-pandemic, a VIX index score hovering around 20 now appears fairly valued relative to US HY, with energy prices putting downward pressure on HY spreads.

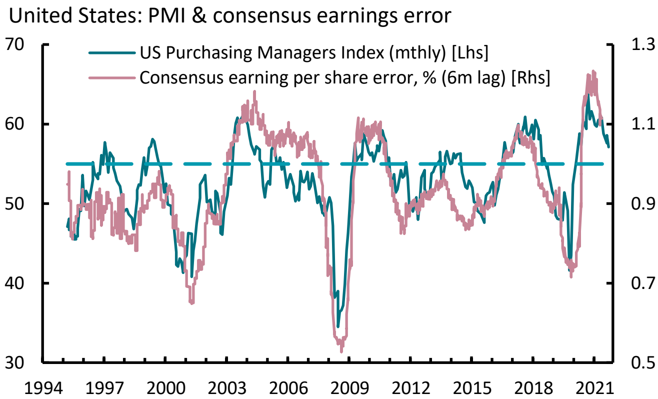
Exhibit 18: VIX relative value looks fair spot not shown



Source: CBOE, ICE and AXA IM Research, 25 April 2022

After focusing on earnings momentum last month, we now consider earnings growth levels. The earnings season has started and at the time of writing sales (+1.1%) and earnings (+7.2%) surprises are positive for the one-fifth of S&P500 companies that have reported so far. This is not necessarily surprising given the headwinds if we consider the point in the cycle – judged by the US ISM manufacturing survey (Exhibit 3). This suggests that we should be seeing positive surprises this quarter across the board – though the trend points towards deteriorating momentum for the rest of the year.

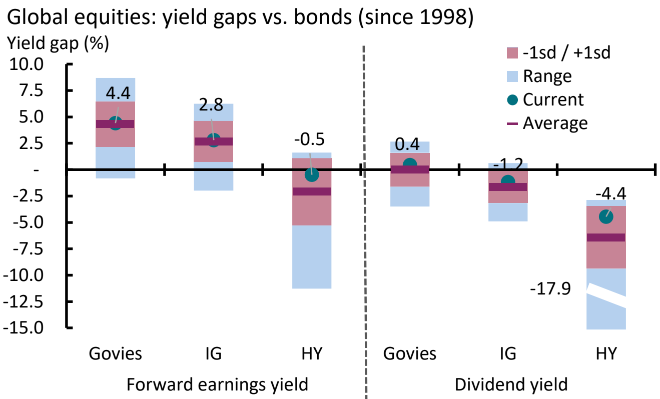
Exhibit 19: A little more respite for earnings growth



Source: ISM, IBES and AXA IM Research, 25 April 2022

This month, the notable rise in US 10-year real yields (+40 basis points), reaching zero for the first-time post COVID-19, could prove to be a catalyst for equity outflows into fixed-income as relative valuations have moved towards par (Exhibit 4).

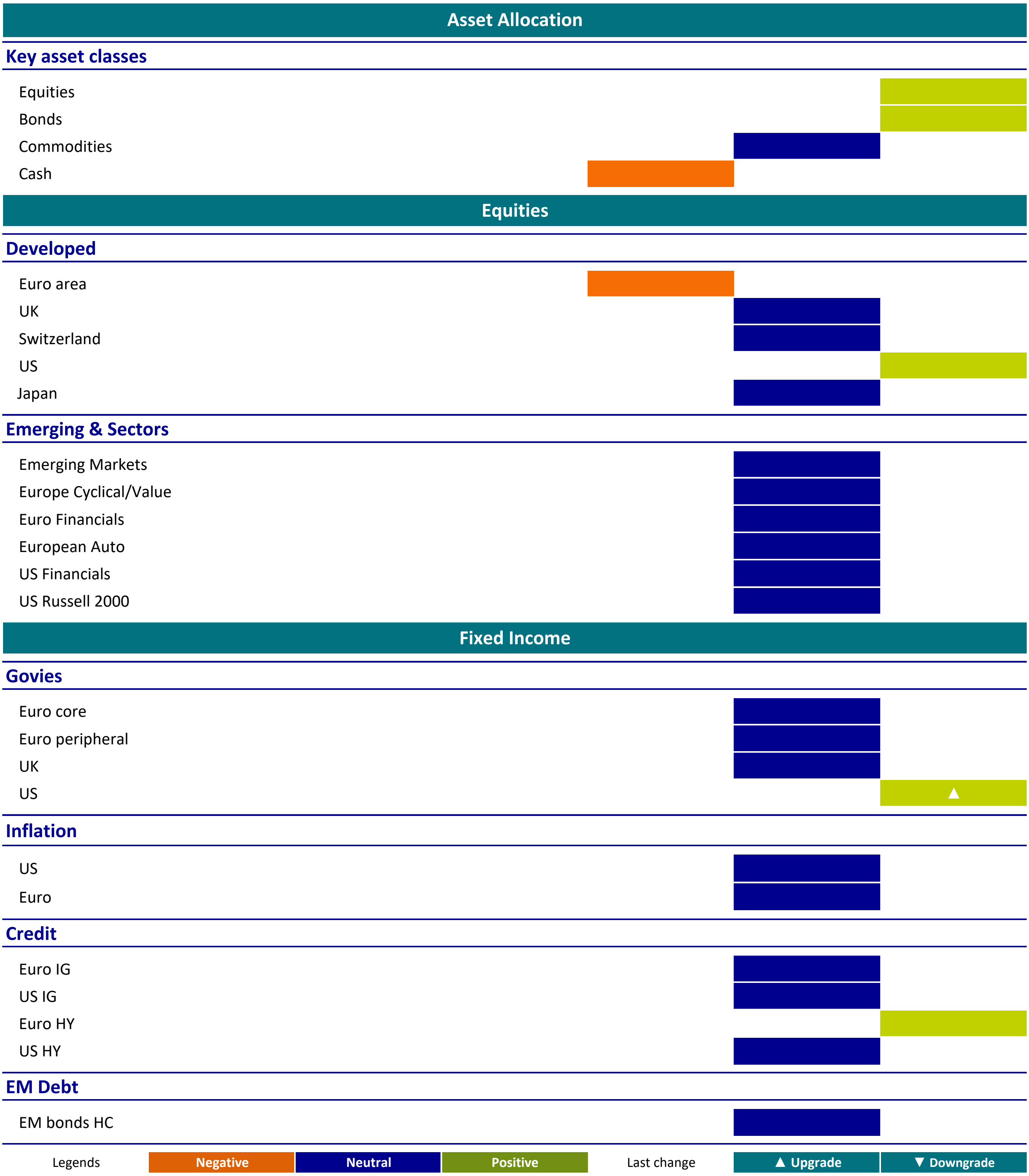
Exhibit 20: "TINA" more and more frothy



Source: MSCI, ICE and AXA IM Research, 25 April 2022
TINA = 'There is no alternative' – a phrase which references the perceived favourability of stocks while bond yields are low

The macro backdrop remains challenging as galloping inflation eats away at consumers and starts to impact sentiment. This adds to global growth concerns for 2022 in the wake of Omicron outbreaks in China and the Ukraine war. Some signs of policy easing are appearing in China. In this context, our equity allocation remains constructive, and we still favour utilities renewables and 'digital payment' themes.

Recommended asset allocation



Source: AXA IM Macro Research – As of 26 April 2022

Macro forecast summary

Real GDP growth (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	**-3.1**	**5.4**		**3.0**		**2.9**	
Advanced economies	**-5.0**	**3.4**		**1.9**		**1.2**	
US	**-3.4**	**5.5**	5.6	**2.8**	3.3	**1.6**	2.4
EMU-4	**-7.4**	**5.0**		**2.2**		**1.2**	
Germany	**-4.9**	**2.8**	2.7	**1.2**	2.4	**1.7**	2.6
France	**-8.0**	**7.0**	6.6	**2.7**	3.3	**1.0**	1.7
Italy	**-9.0**	**6.5**	6.3	**2.3**	3.4	**0.6**	2.0
Spain	**-10.8**	**5.0**	4.7	**3.5**	5.1	**1.6**	3.4
Japan	**-4.9**	**1.7**	1.8	**1.8**	2.3	**2.1**	1.8
UK	**-10.0**	**7.2**	7.0	**3.8**	3.9	**0.6**	1.6
Switzerland	**-2.5**	**3.5**	3.5	**2.0**	2.7	**1.3**	1.7
Canada	**-5.2**	**4.4**	4.6	**3.3**	3.8	**2.5**	2.9
Emerging economies	**-1.9**	**6.6**		**3.6**		**4.0**	
Asia	**-0.7**	**6.8**		**4.8**		**5.1**	
China	**2.2**	**7.9**	8.0	**4.5**	5.0	**5.2**	5.2
South Korea	**-0.9**	**4.0**	4.0	**2.0**	3.0	**2.0**	2.6
Rest of EM Asia	**-4.2**	**5.9**		**5.5**		**5.2**	
LatAm	**-7.0**	**6.9**		**2.6**		**2.6**	
Brazil	**-3.9**	**4.8**	4.7	**0.9**	0.5	**1.9**	1.6
Mexico	**-8.5**	**4.8**	5.6	**2.4**	1.9	**2.2**	2.3
EM Europe	**-2.0**	**6.7**		**-0.2**		**1.0**	
Russia	**-2.7**	**4.7**		**-7.0**		**-3.0**	
Poland	**-2.5**	**5.8**	5.3	**4.2**	4.0	**3.3**	3.5
Turkey	**1.8**	**11.5**	9.9	**3.9**	2.3	**3.4**	2.9
Other EMs	**-2.5**	**5.4**		**3.0**		**3.0**	

Source: Datastream, IMF and AXA IM Macro Research – As of 25 April 2022 * Forecast

CPI Inflation (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0.7**	**3.2**		**5.9**		**2.8**	
US	**1.2**	**4.7**	4.6	**7.0**	6.6	**3.8**	3.0
Eurozone	**0.3**	**2.6**	2.5	**6.1**	5.7	**2.1**	2.1
Japan	**0.0**	**-0.2**	-0.2	**2.2**	1.4	**1.0**	0.9
UK	**0.9**	**2.6**	2.5	**7.3**	6.7	**3.5**	3.6
Switzerland	**-0.7**	**0.5**	0.5	**2.0**	1.8	**1.0**	0.7
Canada	**0.7**	**3.4**	3.4	**5.9**	5.1	**3.2**	2.6

Source: Datastream, IMF and AXA IM Macro Research – As of 25 April 2022 * Forecast

These projections are not necessarily reliable indicators of future results

Forecast summary

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q1-22	Q2-22	Q3-22	Q4-22
United States - Fed	Dates	0-0.25	25-26 Jan 15-16 Mar	3-4 May 14-15 June	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec
	Rates		+0.25 (0.25-0.5)	+0.50 (1.25-1.50)	+0.25 (1.75-2.00)	+0.25 (2.25-2.50)
Euro area - ECB	Dates	-0.50	03 Feb 10 Mar	14 April 9 June	21 July 8 Sep	27 Oct 15 Dec
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	+0.25 (-0.25)
Japan - BoJ	Dates	-0.10	17-18 Jan 17-18 Mar	27-28 April 16-17 June	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.75	3 Feb 17 Mar	5 May 16 June	4 Aug 15 Sep	3 Nov 15 Dec
	Rates		+0.5(0.75)	+0.5 (1.25)	unch (1.25)	unch (1.25)

Source: AXA IM Macro Research - As of 25 April 2022

These projections are not necessarily reliable indicators of future results

Download the full slide deck of our April Investment Strategy

Our Research is available on line:

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