Investment Managers

Investment Institute Macroeconomics

Where we are in the cycle – and the super-cycle

Monthly Investment Strategy

AXA IM Research

September 2023

Summary: September 2023

Theme of the month: Generative AI in the context of previous supercycles

- The emergence of generative AI has accelerated expectations of the technical feasibility of AI. We consider this in the context of the five great waves of technology, beginning with the Industrial Revolution in the 18th century. Previous waves have lasted around 50 years, following similar patterns.
- AI, as other great technological revolutions, promises to boost productivity growth. Studies show significant gains on a micro level and we expect a macro level lift, although this will be dependent on the scale of displaced labour and what it moves on to.
- The outlook for economic developments is uncertain and will depend on social and institutional responses. Technology has historically created more jobs than its destroyed, but we highlight greater uncertainty with the impact of AI. Productivity gains should dampen inflation, but this will also depend on the level of competition. GDP should be firmer, but labour displacement risks stagnation. Neutral rates should rise with firmer growth and stronger investment.

Macro update: Where we are in the cycle?

- Growth has proven more resilient in the US and while we expect a softening to year-end, we no longer expect recession. China has also moved to secure its "around 5%" growth target for this year – although further stimulus is needed to support next year's outlook. Emerging Markets have generally also outperformed expectations in H1 2023, with CEE a laggard. Europe's outlook is weaker: the Eurozone looks set to contract in Q3 and we cannot rule out recession in H2. The UK outlook is also subdued, with recession also a risk here.
- Headline inflation declines look to have stabilised for now with some upside risks emerging as oil prices rise. Core disinflation should, however, spread in most economies over the rest of H2 2023. But tight labour markets still threaten inflation persistence.
- Central banks increasingly appear to have peaked. The ECB in line with expectations and the BoE a little ahead. More uncertainty surrounds the Fed and we expect one more hike from the BoC. Some EM central banks are already easing policy.
- Politics will begin to play an important role. Over the coming month Poland and Argentina both go to the polls with uncertain outcomes. Japan appears to be shaping up for an early, snap elections. And that is before next year's European, US and UK elections.

Investment Strategy: risky assets still in a constructive mood

- Rates: The final stages of the central bank hiking cycles is causing some pain in bond markets as economic resilience has dampened expectations for longer-term rate cuts, while more technical factors, including a reconsideration of future term premia and fiscal issues are adding to concerns.
- Equities: Global equities have recorded a slightly negative performance (-0.8%) over the last month driven by a de-rating in reaction to higher real rates. The "higher for longer" should benefit value/short duration stock. Leading indicators suggest an EPS rebound by year-end.
- Credit: Spreads are exhibiting resilience as levels have tightened in reaction to higher bond interest rates. Refinancing conditions are tight but the maturity structure is not front loaded. However, cautiousness should remain as rising defaults and lending tightening headwind are growing.
- FX: The dollar has continued to rise, supported by the rebound in real interest rates. In addition, the resilience of the US economy coupled with the recovery in commodity prices is adding weight to the dollar's bull case. The euro seems to be taking a breather, despite being positioned for the long term.

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Central scenario

Summary – Key messages

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

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

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

Inflation

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

Monetary policy

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

Fiscal policy

Europe has provided fiscal support, but consolidation increasingly the outlook for 2024. US debt ceiling resolution leaves longer-run outlook unsustainable.

Growth

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

Emerging Markets

Inflation easing across EM. Central banks have started to cut rates. Global rate adjustments add to fragile finances

Rates

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

FX

Dollar has gained on resilient economy – risks ahead. BoJ action would spur yen gains, but appears distant. Sterling has been overpriced on rate outlook, some softening underway.

Credit

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

Equities

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

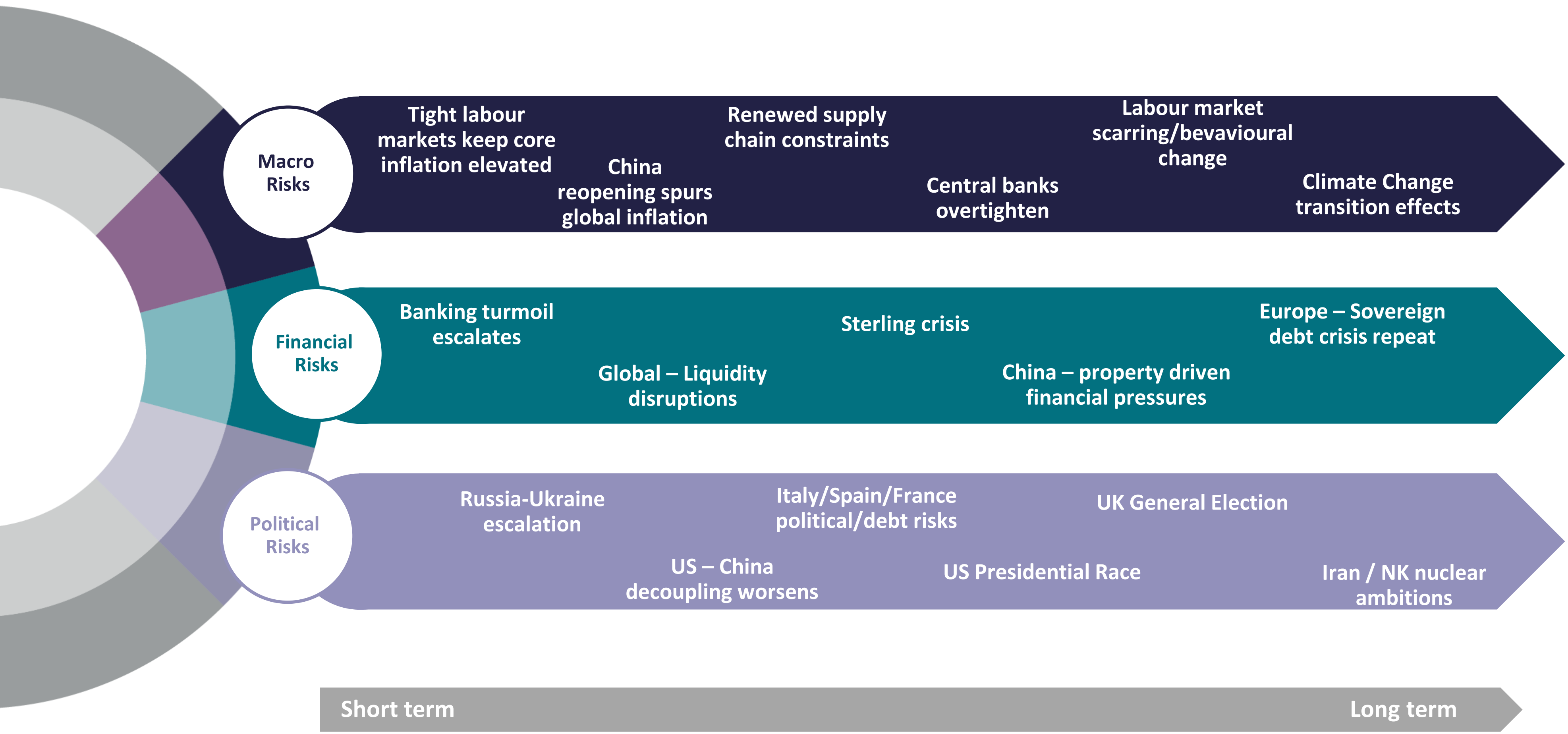
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 20%		A global boost Probability 20%
	- Banking turmoil escalates, credit conditions tighten. - Escalation in Ukraine conflict - COVID outbreaks spreads again: China and/or new mutations - Post-pandemic structural persist. Supply shocks last longer - Inflation expectations rise, affecting wages and persistence	What could be different?	- Geo-political tensions ease – peace in our time. - Labour market participation recovers, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments
	- Growth weaker, employment could start to fall, but inflation remains elevated - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	What it means	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	Market implications	- Risk-on environment, equities make further gains, growth retains lead over value - UST softens, EUR strengthens - Spreads grind tighter

RISk Radar

Summary – Key messages



Contents

Theme of the Month

Generative AI in the context of previous supercycles

A history of previous technological waves and supercycles

Five great waves of technological advance

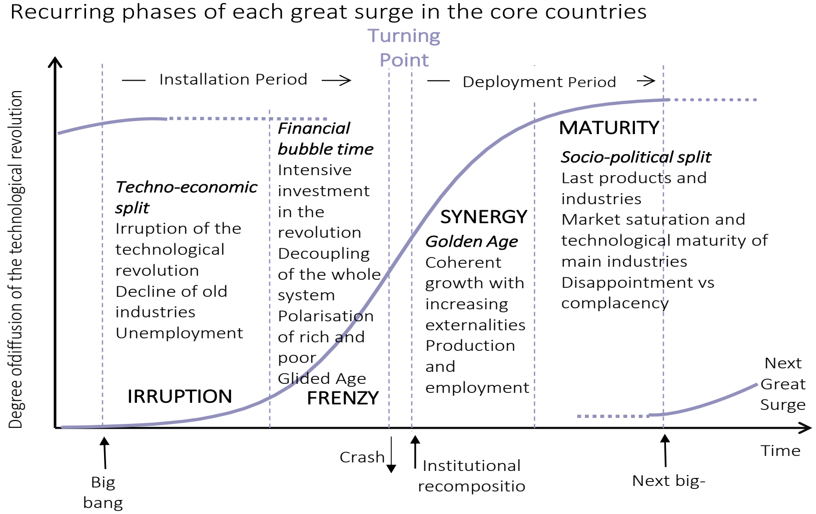
- We consider AI in the context of previous technological waves. Historically there have been five waves of technological development since the Industrial Revolution in the 1700s, also including the age of steam and railways, steel and heavy engineering, cars and mass production and IT and the digital age. Each wave has broadly unfolded over 50 years, a timetable driven more by socio-institutional factors than techno-economic.

Each wave has followed a similar, stylised evolution

- Each historic wave has followed a broadly similar – stylised – pattern. Each wave has started – irrupted – during the maturity phase of the previous wave. It has been followed by a frenzy phase where capital chases new opportunity, until resulting booms have given way to financial busts. Such turning points have often resulted in a resetting of regulations and societal norms to act as guardrails to the economy. This has typically ushered in a golden age. Finally a maturity phase emerges where growth rates slow.

The stylised evolution of a technological wave

Recurring phases of each great surge in the core countries



Source: Perez, C."Technological revolutions and Financial Capital, 2002 and AXA IM Research

Previous technological waves or supercycles

Approximate dates of the insallation and deployment periods of each great surge of development

GREAT SURGE	Tecnological revolution / Core country	INSTALLATION: Irruption	INSTALLATION: Frenzy	Turning Point	DEPLOYMENT: Synergy	DEPLOYMENT: Maturity
1st	**The Industrial Revolution** *Britain*	1771	1770s and early 1980s	late 1780s and early 1790s	1793-1797	1798-1812	1813-1829
2nd	**Age of Steam and Railways** *Britain (spreading to continent and USA)*	1829	1830s	1840s	1848-1850	1850-1857	1857-1873
3rd	**Age of Steel, Electricity and Heavy Engineering** *USA and Germany overtaking Britain*	1875	1875-1884	1884-1893	1893-1895	1895-1907	1908-1918*
4th	**Age of Oil, Automobiles and Mass Production** *USA (spreading to Europe)*	1908	1908-1920*	1920-1929	*Europe:* 1929-1933 *USA:* 1929-1943	1943-1959	1960-1974*
5th	**Age of Information and Telecommunications** *USA (spreading to Europe and Asia)*	1971	1871-1987*	1987-2001	2001-??	20??	

↑ Big bang   Crash ↓   ↑ Institutional recomposition

* Observe phase overlaps between successive surges

Source: Perez, C."Technological revolutions and Financial Capital", 2002 and AXA IM Research

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Generative AI in the context of previous supercycles

The irruption of the AI wave

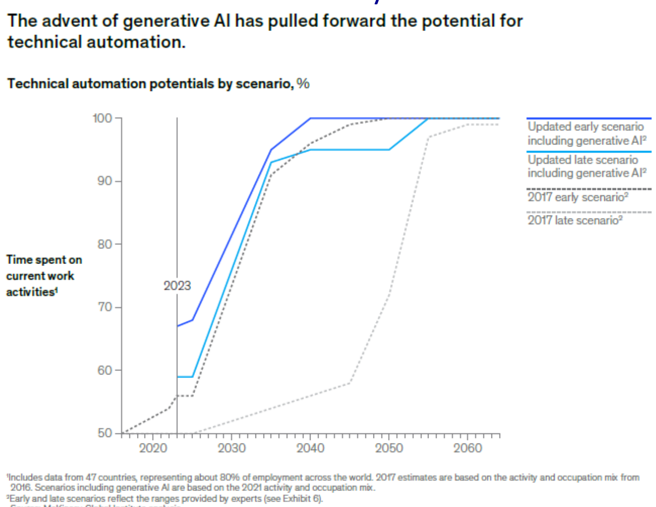
Generative AI accelerates expectations

- The advent of generative AI has led to a significant reappraisal of the technical feasibility of automating current human work activities. In the wake of generative AI, McKinsey changed its 2017 estimate for when machines would be able to do 70% of all human activities from between 2029-2049 (22 years to the midpoint) to now expecting this between 2025-2028 (4 years).

Characteristics of irruption of a new wave

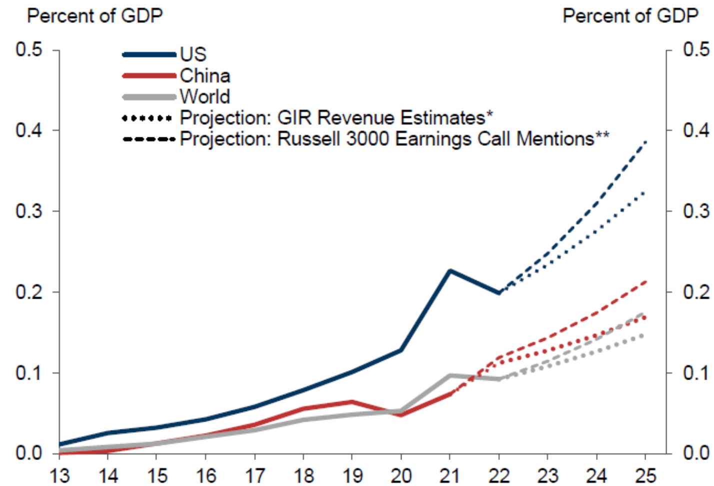
- Company reports are increasingly citing AI developments, with >16% now mentioning AI in company calls from <1% 8 years ago. Investment appears to be matching this with a broad range of reports of the growing amounts that companies are investing in AI. Goldman Sachs estimates rising AI investment based on company reports and revenue estimates.
- This combination of technological feasibility and increased investment is characteristic of the irruption of a new technology wave.

AI boosts technical feasibility estimates



Source: McKinsey & Co, 2023

Private share of AI investment and estimated outlook



Source: Goldman Sachs, July 2023

Generative AI in the context of previous supercycles

Productivity at the heart of technological advance

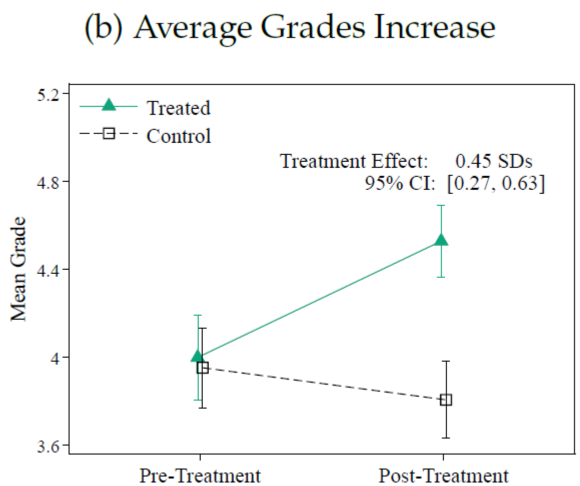
Academic papers point to micro productivity gains

- Academic studies have conducted controlled experiments introducing AI to various workplace-style experiments. One found a significant improvement (reduction) in customer call resolution times. Another showed marked improvement in grade score averages in writing tests. At a micro level, AI supplementing human labour appears to provide a marked boost to productivity, primarily by bringing all workers closer to the best-in-class workers in a group.

The macro impact remains more uncertain

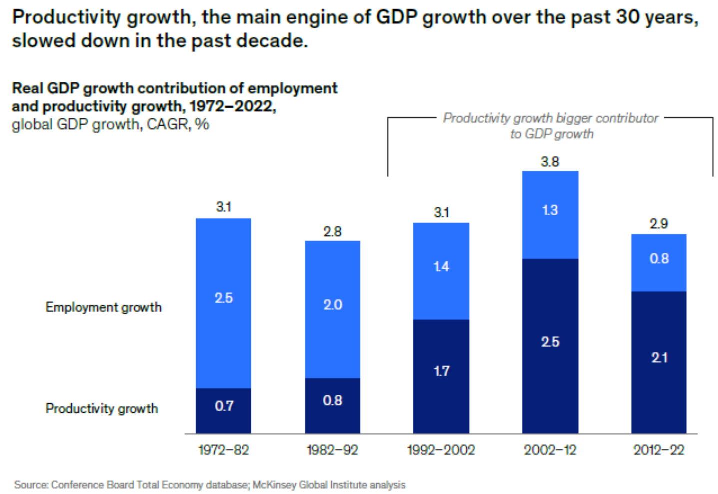
- The micro boost to productivity offers the hopes of a significant boost to economy-wide GDP – a material positive supply shock. However, this assumes either no labour displacement, or that displaced labour can find similarly productive work. It is not clear that either assumption will prove valid, challenging any assumption of an overall lift to productivity.

Academic work shows evidence AI productivity enhancement



Source: Noy and Zhang (2023)

A total economy productivity boost would support growth



Source: Conference Board, McKinsey & Co, 2023

Generative AI in the context of previous supercycles

Tentative economic outlooks: unemployment and inflation

Technology has *ultimately* created jobs

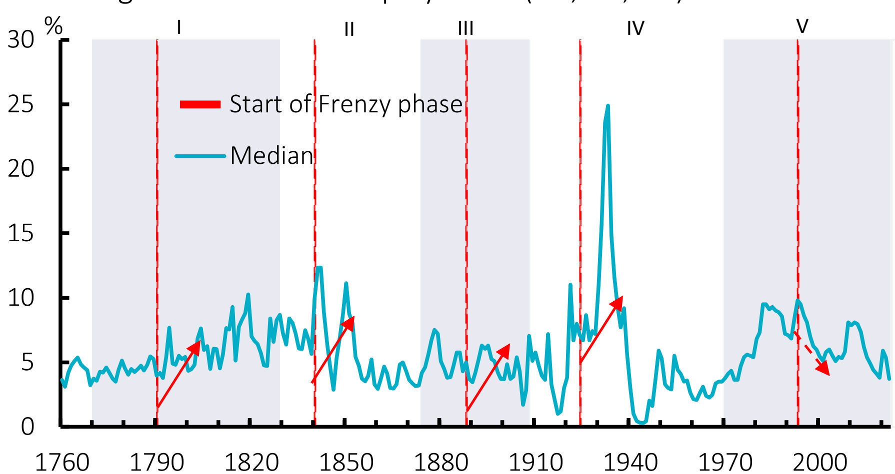
- Historically technology has helped create more jobs than it has destroyed, including in the new industries that have emerged. However, this has typically only been true over the longer-term. The frenzied second phase of new waves has typically been consistent with increases in unemployment that have lasted for around a decade. Moreover, AI will increasingly substitute for intelligence, not just muscle, reducing the scope for human involvement in a wider range of activities.

Inflation a product of supply shocks and competition

- If AI is a productivity enhancing supply shock, it should be associated with downward pressure in prices. Yet the institutional context will be important. Some of the current AI developers are tech giants who own vast networks which accrue more gains the larger the networks. This might suggest that AI emerges in the hands of a few oligopolistic firms that fuel profit growth, not reduce prices. This would likely be further enhanced if AI emerges quickly, in the hands of a few developers. A slower emergence would likely be consistent with many developers, increasing competition and adding to the prospect of disinflationary pressure.

Unemployment stable in prior waves, but gains during frenzy phase

G7 - Long-run median unemployment (UK, US, Ge)

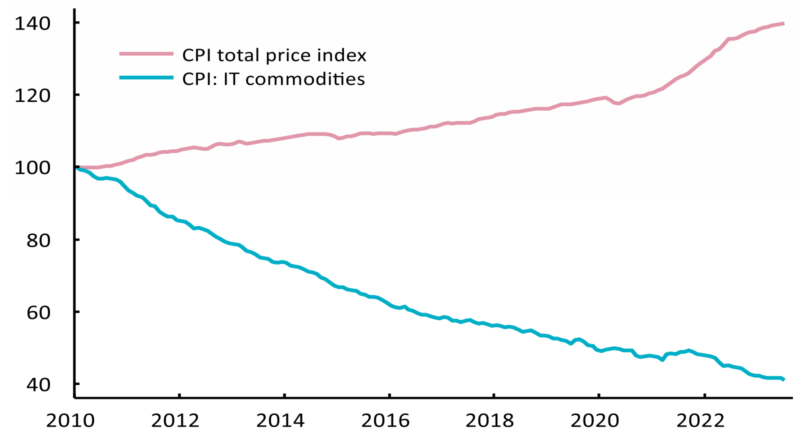


Source: Bank of England, Federal Reserve Bank of St Louis, Social Science Open Access Repository (SSOAR) & AXA IM Research, September 2023

New technology waves create two-speed price pressures

Broad consumer price level and price of IT commodities

Index 2010 = 100



Source: LSEG Datastream , AXA IM Research, 11/09/2023

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Generative AI in the context of previous supercycles

Tentative economic outlooks: GDP growth and interest rates

GDP growth a function of broader social impacts

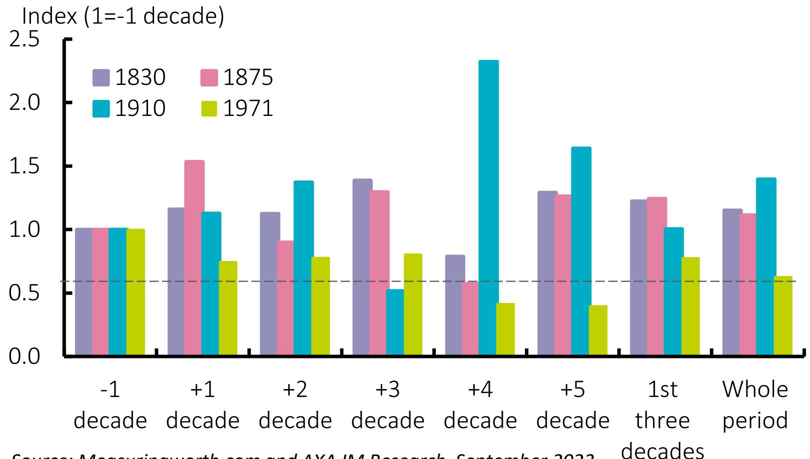
- As above, a positive supply shock should be consistent with higher potential growth rates and on average firmer growth. This was true in the US of the steam & railway and steel & engineering waves over the first three decades and whole periods. However, the Great Depression meant the autos & mass production wave only lifted growth over the whole period (WWII onwards), while the IT wave underperformed growth (where productivity was overwhelmed by demographics and slowing educational growth).

AI structurally supportive of rates, but outcome depends on combination of factors

- For interest rates we consider the structural and the cyclical separately. Structurally, faster productivity growth, boosting trend growth, should raise the neutral rate, r*, although this was not obvious in the 1990s IT boom. Moreover, a significant increase in ex ante investment should also raise r*. Cyclically, central bank rates relative to r*, will depend on demand growth. Positive growth would see rates rise with r*, but a demand deficiency, which could follow a rise in unemployment, could drive rates below r*.

Relative performance of US GDP during previous waves

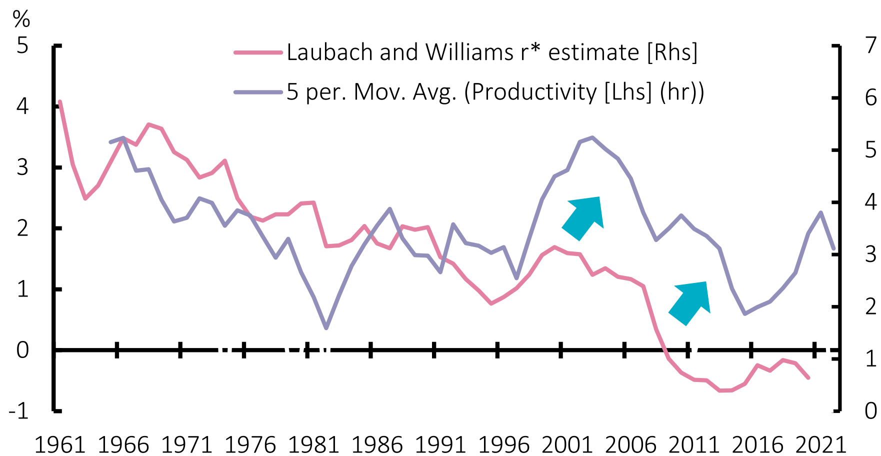
Average 10-year US GDP growth after technological revolution



Source: Measuringworth.com and AXA IM Research, September 2023

Neutral rates should be supported by new technology wave

Estimated R* and 5y MA US productivity (output/hr)



Source: Federal Bank of New York, Bureau of Economic Analysis and AXA IM Research, Sept-2023

Macro outlook

Consumer resilience to end

US

A summer of consumer resilience

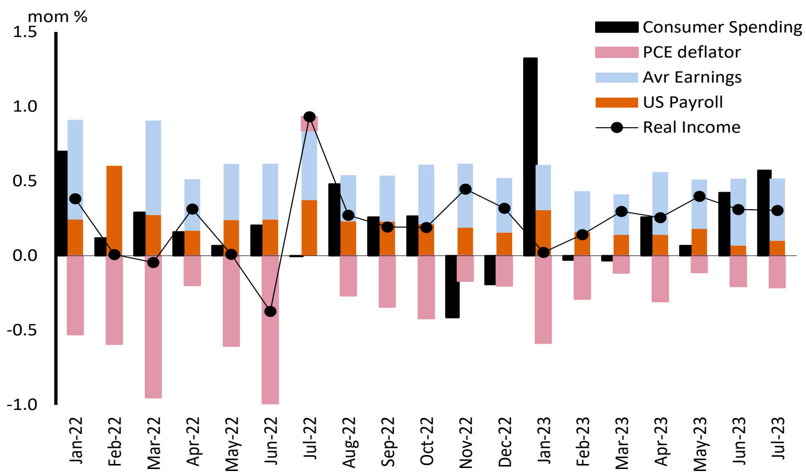
- Consumer spending surged in July, rising by 0.8% m/m. Excited talk of Taylor Swift concerts and Barbenheimer fuelled expectations of strong spending. But the rise in July was driven by a steep fall in the savings rate to 3.5% from 4.8% in May. August's retail sales surprised to the upside, but headline sales were driven by rising gasoline values. The 'control' measure rose by just 0.1%, with July revised down to 0.7% from 1.0%. The consumer has been more solid than we expected. We think it will slow from here.

Real incomes, dwindling savings and student debt payments

- The consumer faces a tough year-end. Nominal income growth looks set to slow as employment and wage growth slow. Moreover, inflation fell from 6.5% to 3.0% in H1; H2 now looks set to see a rise from 3% to 4% as oil prices boost gasoline costs. Real income growth will be slower in H2 than H1. Additionally, we believe that excess savings are all but exhausted and the saving rate should rise to 5% over coming quarters. Finally, student loan repayments resume from September. The precise balance of these factors is uncertain, but we forecast a Q4 contraction and a softer 2024 in general.

Key drivers of real incomes set to slow in H2

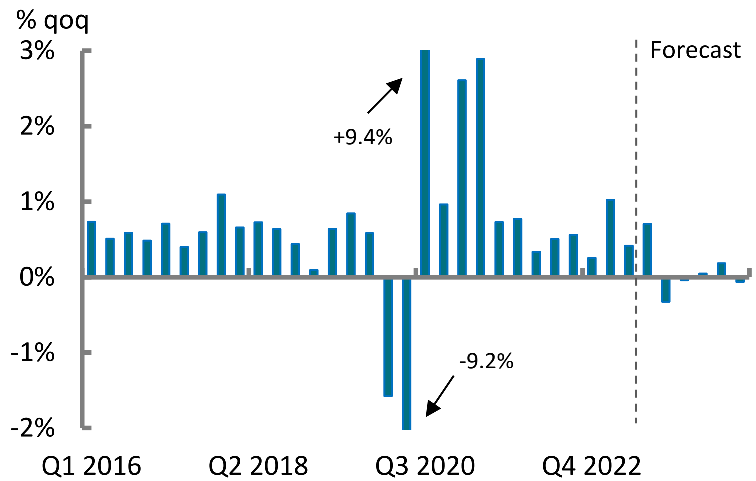
US Monthly Pattern: Real Income & Consumer spending



Source: BEA, AXA IM Research, Sept 2023

Forecast Q4 contraction in household spending and softer 2024

Household spending growth



Source: BEA, AXA IM Research, Sept 2023

But risks rise in favour of a soft landing

US

Yet growth outlook strengthening

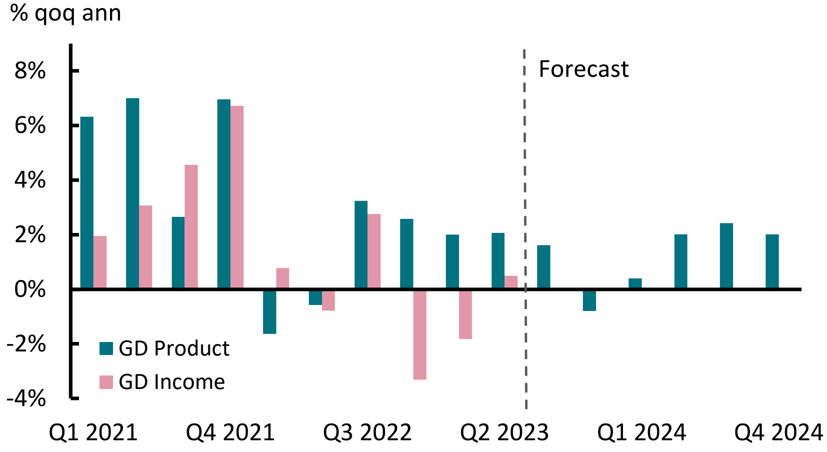
- Despite our expectation of a softening in consumer spending, we now raise our outlook for other areas of the economy, particularly investment spending and plausibly manufacturing into 2024. This now looks likely to limit overall contraction in GDP to just one quarter (despite the recession in GDI terms), in line with the "asynchronous deceleration" scenario we flagged earlier in the year. We now forecast 2023 GDP growth at 1.9% and 2024 at 1.1%, with just one quarter's contraction in Q4 not constituting a recession.

Fed done, but maintains optionality for now

- The Fed left the Fed Funds Rate on hold at 5.50% in September. Fed participants on balance continued to forecast a further hike this year – now either in November or December. There was also an upward shift in rate expectations for future years by 0.50% for each year – an expected slower pace of cuts. Given the resilience in the economy – and our new view that the US just avoids recession – we have also reduced the expected number of cuts for next year, now seeing 3 cuts from June to 4.75% by year-end.

Just one quarter's contraction does not equal recession

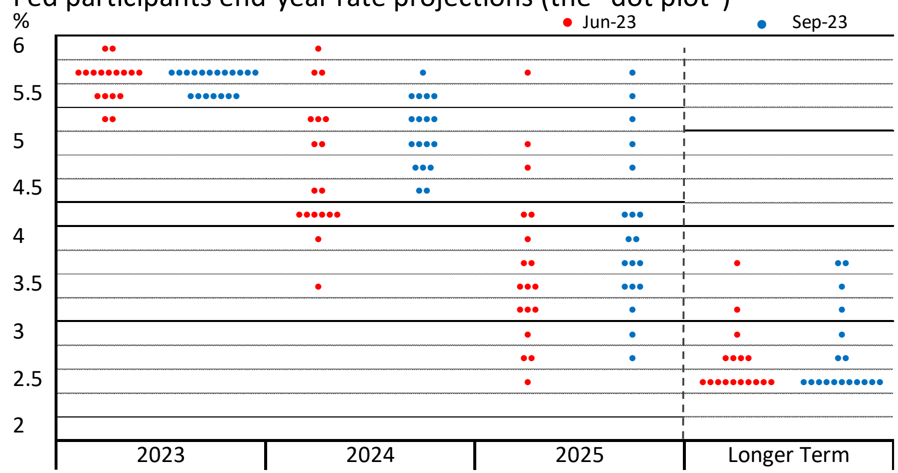
Different measures of economic activity



Source: BEA, AXA IM Research, Sept 2023

Dot plot – retaining optionality

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



Source: FRB, Sept 2023

On a (supply constrained) tightrope

Euro area

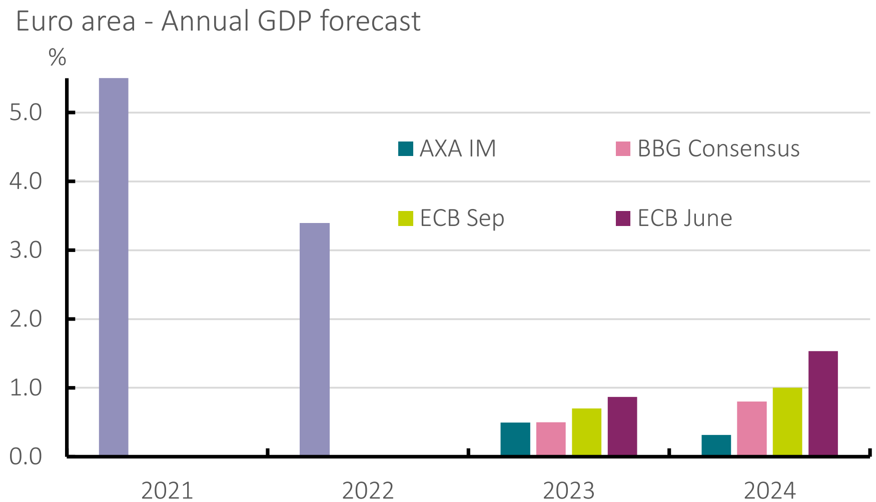
Anaemic growth to continue (at best)

- Eurozone Q2 GDP growth was revised down 0.2pp to 0.1% q/q, in line with our initial expectations confirming our stagflation scenario. Early data suggest euro area activity is likely to contract in Q3. We cannot rule out a recession in H2 23.
- All in, we have made limited revisions to our outlook projecting eurozone economy to grow by 0.5% and 0.3% this year and next (from 0.4% and 0.5%), remaining significantly below consensus.

Source of the shock matters

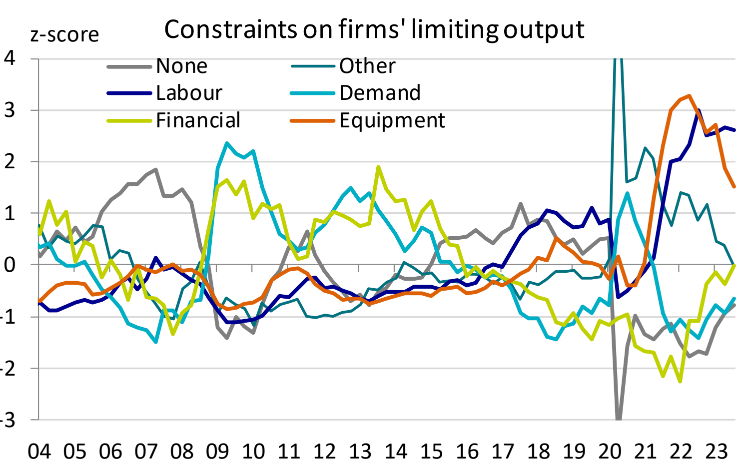
- Demand is visibly affected. We think that supply factors (energy prices, supply chain disruption, hiring difficulty, low productivity) should not be overlooked. An economy constrained by supply could combine mediocre growth and still above ECB target price pressures.

We maintain our, below consensus, anaemic growth outlook



Source: ECB, Datastream, Bloomberg and AXA IM Research, September 2023

Supply constraints remain important



Source: EC, AXA IM Research, September 2023

ECB: Focus to turn on balance sheet

Euro area

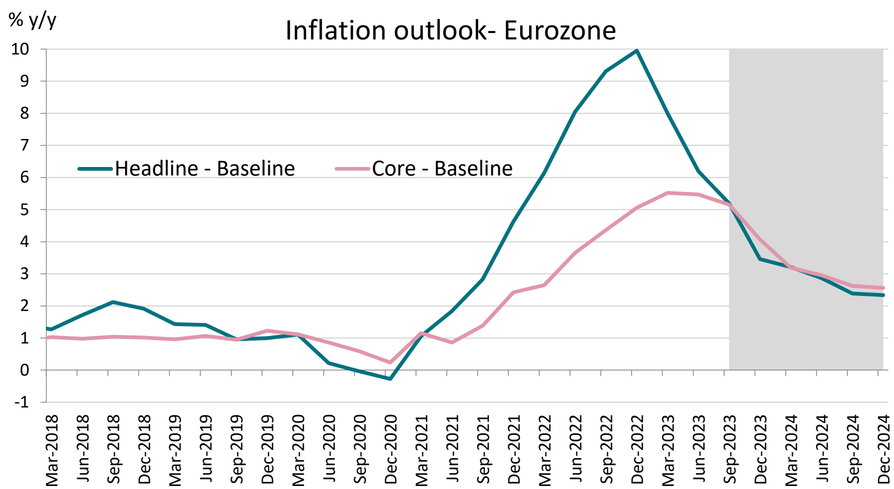
A (last) +25bps hike in September

- ECB Governing Council (GC) decided to hike its depo rate by 25bps to 4.0% in September, in line with our expectations while consensus and markets expected no hike. We foresee no more changes to ECB's policy rates before the summer 2024.
- We think policy discussion is going to shift to the ECB's balance sheet, most likely on changes to the PEPP reinvestment policy (before December 2024). We think discussions will start soon, but a decision is only likely in December at the earliest.

Fiscal: Tough times ahead

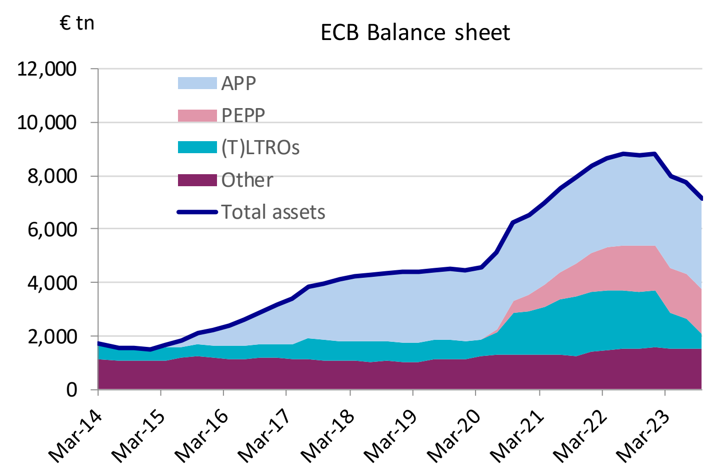
- Short and medium-term fiscal outlooks are to come to the forefront with the presentation of 2024 budgets across the euro area – due to be sent to the Commission by mid-October.
- Meanwhile, caretaker governments in Spain and the Netherlands do not bode well for an agreement on future euro area fiscal rules. The market is likely to be sensitive to a continuation of old, light-escalation rules and to the credibility of countries' related budgetary paths.

Headline and core to soft land in sync



Source: Eurostat, AXA IM Research, September 2023

ECB balance sheet to come into focus



Source: ECB, AXA IM Research, September 2023

Slowing signs

UK

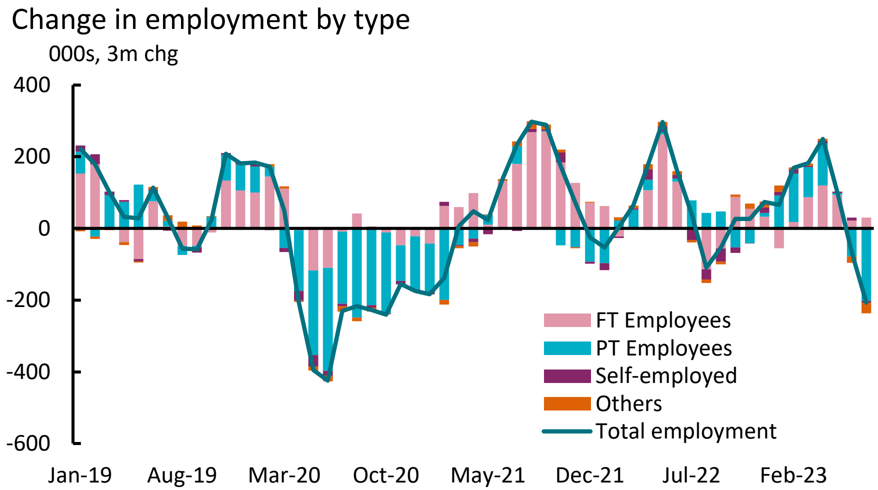
Activity indicators weakening

- Growth indicators have weakened considerably. September's flash composite PMI fell to 46.8- its lowest since January 2021. GDP growth in July fell sharply by 0.5%. Some contributory factors such as wet weather and industrial action that affected July could recover in the coming months. We forecast growth of 0.2% in Q3 with risks skewed to the downside.

Nascent signs of easing in BoE's inflation persistence indicators

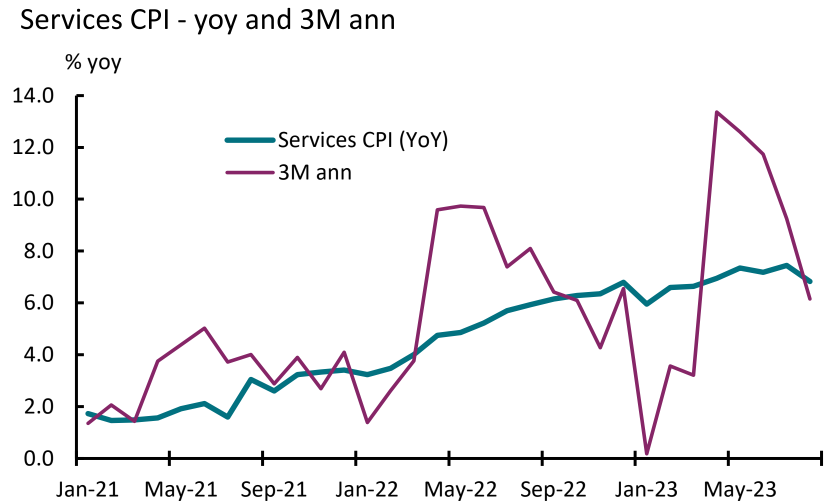
- Inflation eased unexpected in August to 6.8% from 6.9% in July, despite the rise in fuel prices and alcohol duty. These impacts were outweighed by a slowing in core inflation to 6.2% from 6.8%, notably with services inflation slowing.
- The labour market has continued to show signs of loosening, but wages remain elevated. Employment fell by 207k but was almost entirely driven by self-employment. Indicators of hiring remain weak, leading us to expect further falls in employment. However, private sector annual regular pay rose to 8.1% - although the monthly rise was only 0.2%, perhaps suggesting a turning point.

Employment drop seen this quarter driven by self-employment



Source: ONS, AXA IM Research, September 2023

Services CPI eased to 6.8% with move driven by volatile components



Source: ONS, AXA IM Research, September 2023

BoE surprise hold at 5.25% marks uncertain peak

UK

BoE surprise hold at 5.25% in knife-edge decision

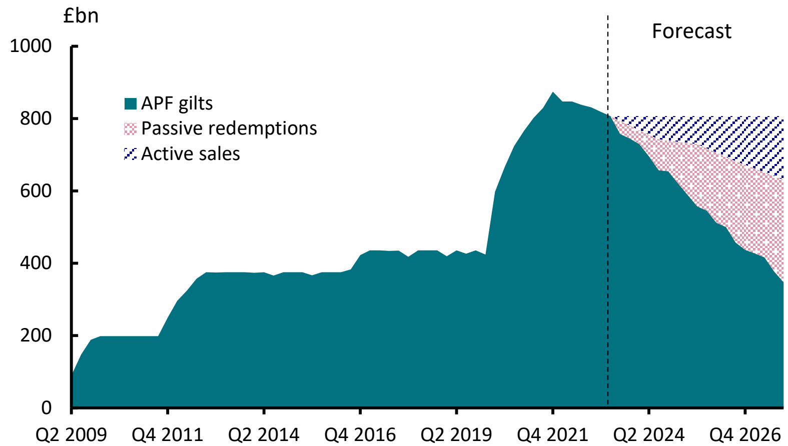
- The BoE held Bank Rate at 5.25% in a 'finely balanced' 5-4 decision. This was below our and consensus' expectations of a 25bp hike. The fall in August's services inflation, BoE Agent's intelligence and advanced sight of services PMI showing that economic activity was slowing and a dismissal of official wage figures all shifted sentiment from August's upside inflation concerns.
- The BoE also decided to increase the pace of APF unwind over the next year to £100bn from £80bn prior. The BoE is set to keep the pace of active sales broadly steady with the pace of unwind of maturing gilts rising to £50bn next year, from £35bn last.

Peak or pause?

- The BoE next meets on 2 November. The policy decision will come alongside updated economic projections. We forecast the BoE to remain on hold, but risks of an additional hike persist. Further out, there is a threat of weaker growth next year as lagged impacts of monetary tightening emerge. We continue to expect the BoE to cut rates in H2 2024, pencilling in two 25bp cuts to 4.75% by end-2024.

Pace of QT to rise to £100bn

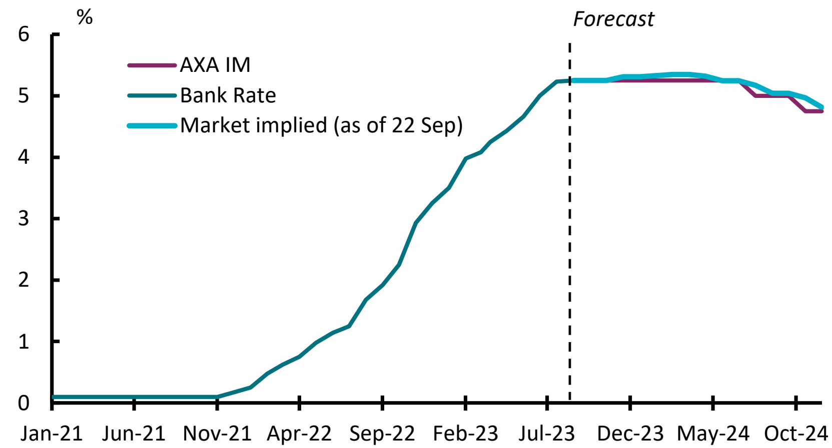
BoE APF gilt holdings



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

Markets converge on our view of cuts over 2024

BoE Bank Rate outlook



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

A silver lining emerges

China

Policy supports rolls out in August, lifts sentiment

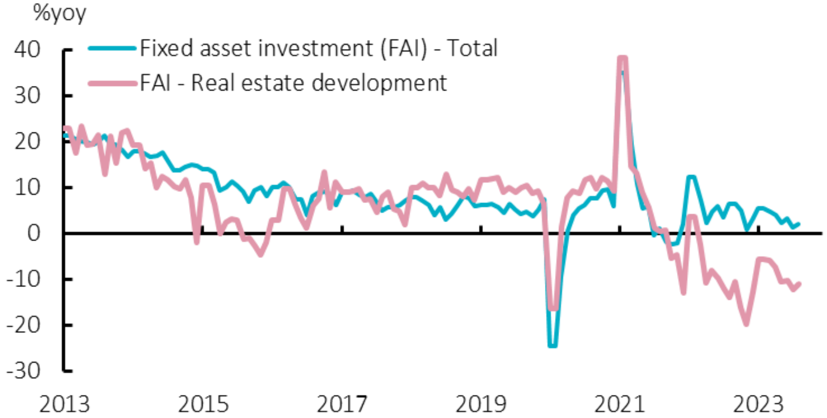
- Multiple rate cuts, taxes and stamp duty reductions and an expedited issuance of local government special bonds (LGSB) have been announced. Most importantly, much-needed property easing measures were announced on 31 August.
- This episode of policy response has made the "around 5%" annual growth target for 2023 more achievable. However, to avoid the economic softness carrying into 2024, further policy support will likely be necessary.

RMB 613bn LGSB will be issued by end-September, spent by end-October

- Typically, previous stimulus has helped drive investment in infrastructure spending and 'urban village' renovation projects and we expect similar this time.
- This should help the construction industry compensate for losses from the property sector.

Investment ticked up slightly, real estate lags

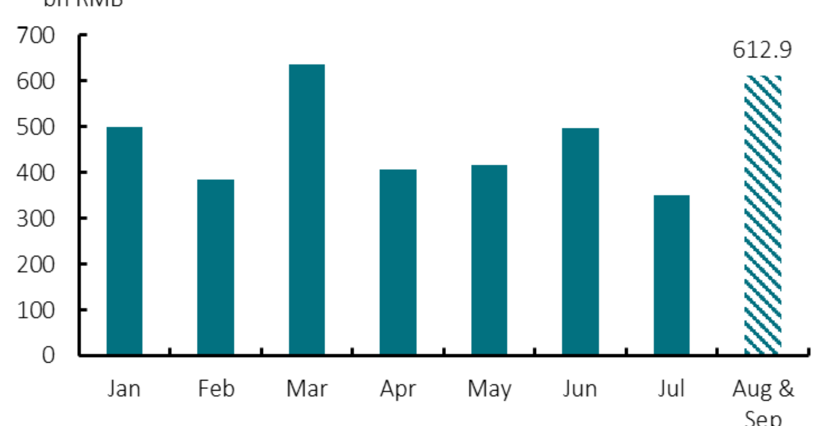
China - Total FAI and Real estate FAI



Source: LSEG Datastream, AXA IM Research, September 2023

Expedited LGSB issuance will boost investment in coming months

China - 2023 LGSB issuance



Source: LSEG Datastream, AXA IM Research, September 2023

Deflation overturned for now, risks remain

China

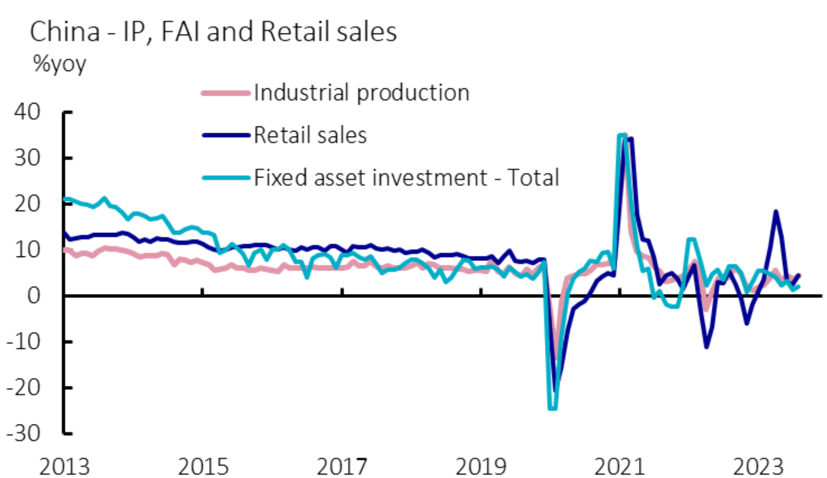
August data recovers from lows, real estate requires more time

- Improvements were posted in August's industrial production (IP), fixed asset investment (FAI), and retail sales.
- Weekly data showed significant acceleration in top-tier city housing sales after recent policy announcements, but this was not enough to address the nationwide downturn. More time is needed to see whether announced policy supports will be sufficient.

CPI inflation reversed July's deflation

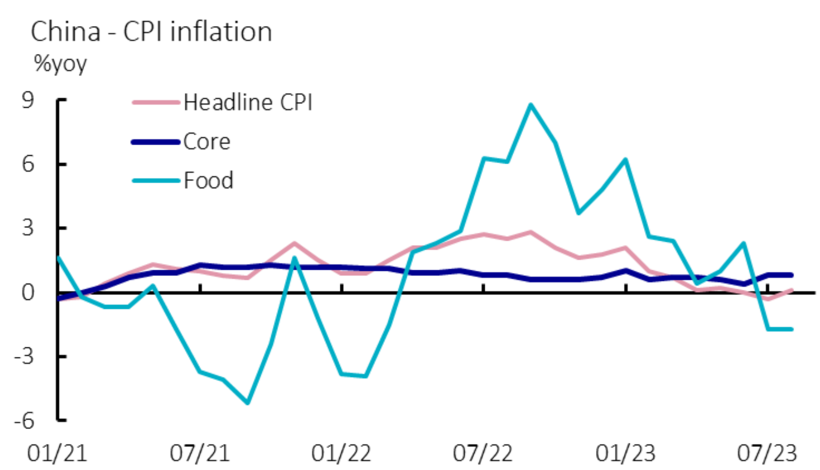
- In July, China's headline CPI inflation fell into negative territory (-0.3% year-on-year) – making the deflationary headwinds real.
- Due to price corrections in fuel and food, August's annual CPI returned to positive, if barely at +0.1%. From January to the end of August, headline CPI has averaged +0.5% and there is not much of 2023 left to see it rise far from here. Looking into 2024, we expect inflation to remain weak, but positive.

August activity lifts off July lows



Source: LSEG Datastream, AXA IM Research, September 2023

CPI turned positive in August, after deflationary July



Source: LSEG Datastream, AXA IM Research, September 2023

Growth remains on track as price pressures continue to broaden

Japan

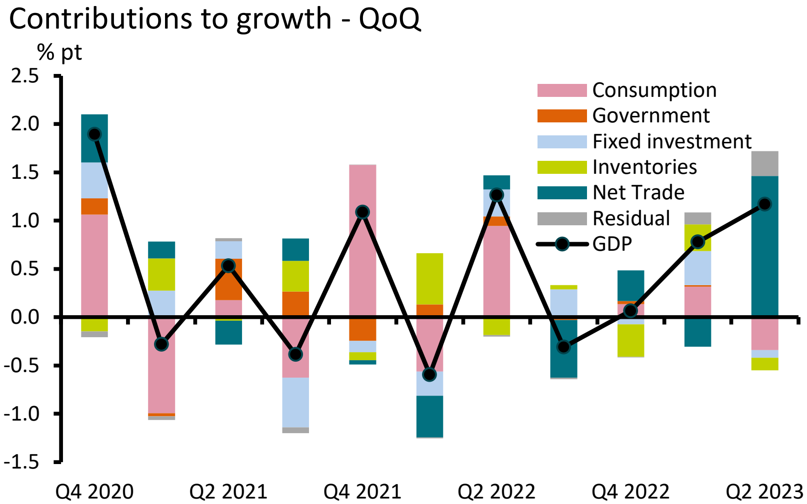
Strong Q2 growth masks consumption weakness

- Japan's GDP recovery continues, though it appears that high inflation is weighing on consumption. Q2 GDP rose by a strong 1.2% on the quarter but consumption was weak, falling by 0.6%. The overall strength of GDP was driven by improvement in Japan's net trade position with exports picking up and imports falling, contributing 1.9ppts to GDP. The increase in exports was driven by a pickup in auto exports and inbound tourism supporting services.

Inflation remains elevated, adding to hopes of sustainable inflation

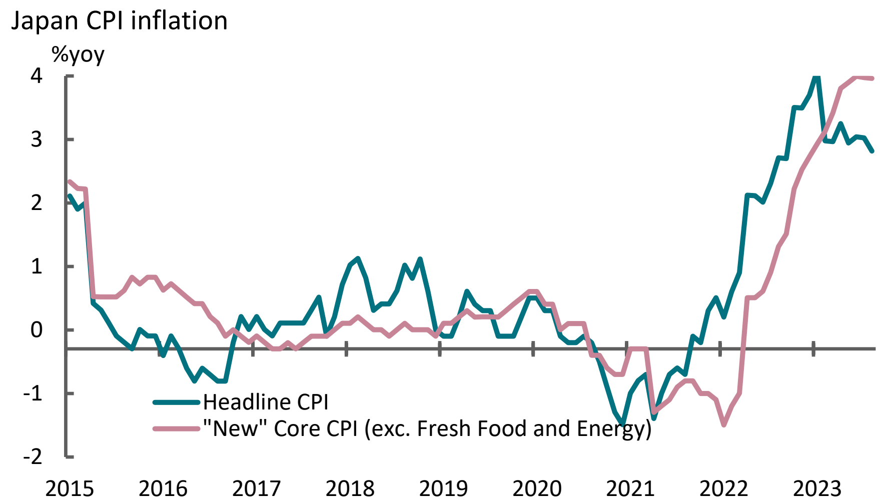
- CPI inflation eased marginally to 3.2% in September from 3.3%. The BoJ's preferred core measure (excluding fresh food and energy) remained at 4.3%. The outlook for Japanese inflation remains uncertain, but we expect it to gradually lose momentum as contributions from food and energy fade, but believe such inflation will likely prove stickier than during past periods. The resilience of corporate profits, which could underpin firms abilities to deliver wage hikes next spring, adds to our view.

Q2 growth strong, but domestic demand components weaker



Source: Statistics Bureau of Japan, AXA IM Research, September 2023

Core inflation showing little sign of slowing



Source: Refinitiv , AXA IM Research, September 2023

BoJ remains on hold, resisting calls to shift guidance

Japan

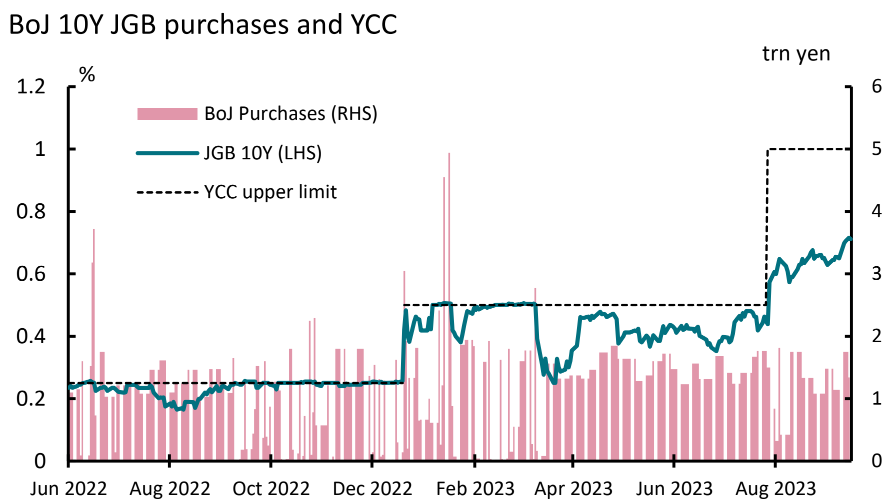
September MPM on hold despite hawkish hints

- In its September meeting, the Bank of Japan (BoJ) left all policy tools, including its yield curve control (YCC) unchanged. This came in line with our expectations. There had been some speculation that the BoJ would adjust its dovish guidance following a step up in hawkish communications from BoJ officials, notably Governor Ueda indicated that YCC could be removed before next year's spring wage negotiations. However, the BoJ chose to maintain its forward guidance which states that the BoJ "will patiently continue with monetary easing" and "will not hesitate to take additional easing measures if necessary".

Cabinet reshuffle sets stage for snap election

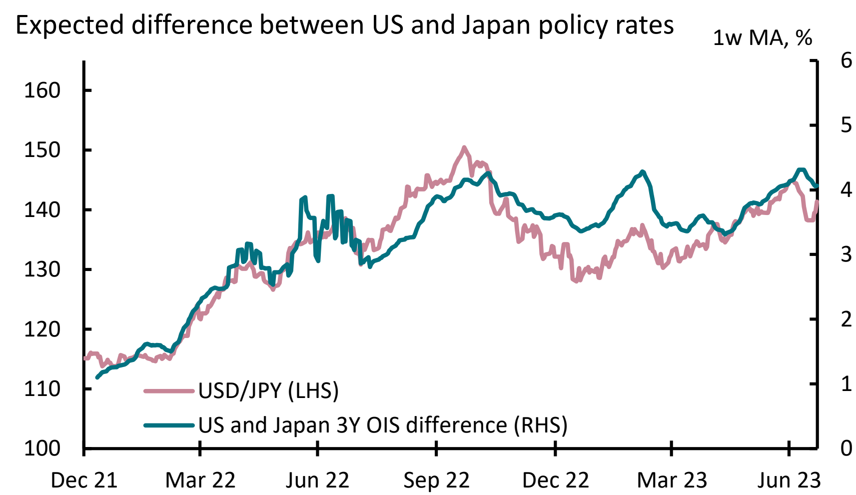
- Risks of a snap election of Japan's lower house have also risen. PM Kishida reshuffled his Cabinet and the LDP leadership and is preparing to introduce new fiscal stimulus. These appear attempts to boost approval ratings ahead of a snap election. Elections of Japan's lower house are not due until 2025, but Kishida faces internal LDP leadership elections in September 2024 and may want to secure domestic support ahead of this. This could come as soon as 22 October, as by-elections are already scheduled for then. If Kishida's approval ratings fail to rise, December could be the next opportunity for a snap election.

Yields remain well below the BoJ's new 1% ceiling



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

Hawkish comments have done little to prevent the yen's slide



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

Investment Managers

A softening in activity and the labour market

Canada

Activity softens – Q2 erratically weak

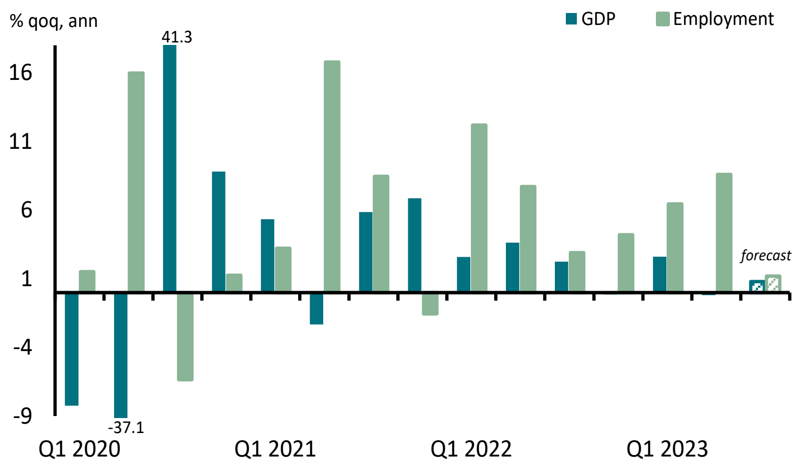
- The BoC forecast growth of 1.8% and 1.2% for 2023 and 2024 respectively, including 1.5% (annualised) growth in Q2 and Q3. We warned this looked too aggressive and Q2 GDP contracted by 0.2%, although this was likely exacerbated by wildfires and strikes. We expect softness from consumer spending, residential investment and an unwind of Q2's strong structures investment. We lower our forecast (back) to 1.3% for 2023 and remain at 0.9% for 2024, compared with consensus 1.4% and 0.8%.

Labour market softening, but slowly and wage growth still high

- Unemployment has risen from a near historic low of 5.0% in April to a 19-month high of 5.5% in August, despite some reduction in participation, suggesting a slackening. Indeed employment growth has slowed to average 20k increases over recent months. However, employment growth still exceeds broader GDP growth, suggesting continued productivity declines. And wage growth has re-accelerated in recent months to leave the 3m-annualised growth rate at 4.7% and its highest pace this year.

Activity slows faster than labour market

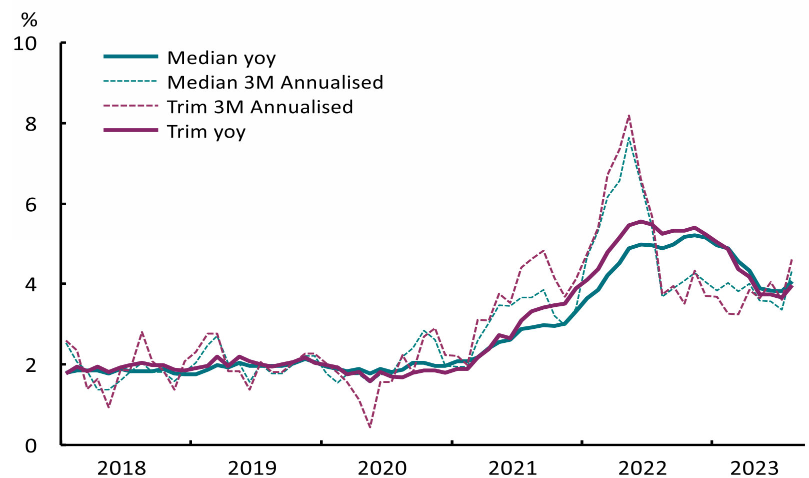
Change in growth and employment



Source: Refinitiv, AXA IM Research, Sep 2023

Core CPI displays unconvincing disinflation

Median and Trim of Core Inflation



Source: LSEG Datastream , AXA IM Research, 20/09/2023

Raising BoC forecasts in face of inflation persistence

Canada

Inflation persistence

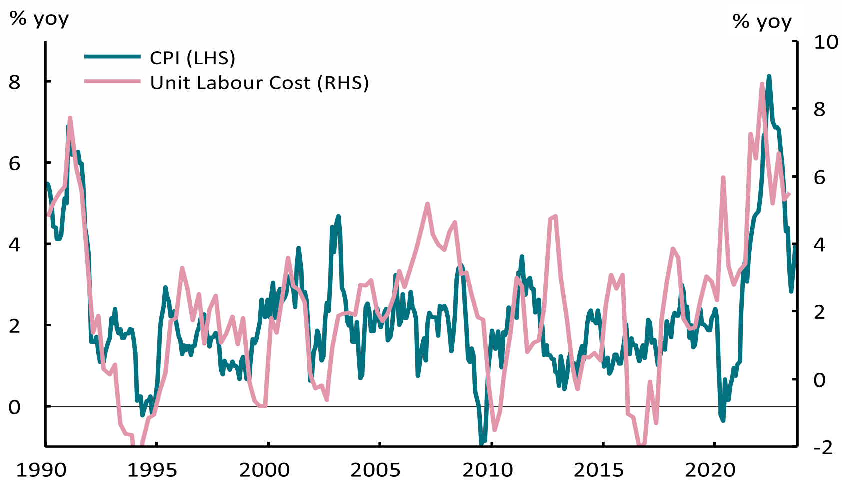
- Headline CPI inflation rose to 4.0% in August. This partly reflected the rise in oil prices feeding into gasoline costs. Yet core inflation also rose, the median to 4.1% y/y from 3.9%. Against a backdrop where loosening in the labour market has not yet fed through to wage growth and weak productivity growth exacerbates this inflationary pressure in terms of unit labour costs, we are wary of persistent inflation pressure. We raise our CPI forecast to average 4.2% and 3.0% this year and next (consensus 3.8% and 2.4%).

BoC – raising the forecast again

- The BoC held policy unchanged at 5.00% in September, balancing nascent signs of slowing activity and a slackening labour market with still elevated wage growth. The BoC explicitly warned that it was worried about inflation "persistence", while recognising the lagged effects of policy tightening. The re-acceleration in wage growth and pick-up in core inflation will, we think, feed this concern and add to arguments for a further hike to 5.25% in October. We expect two cuts to 4.75% in H2 2024 (July and October).

Drop in headline should impact core

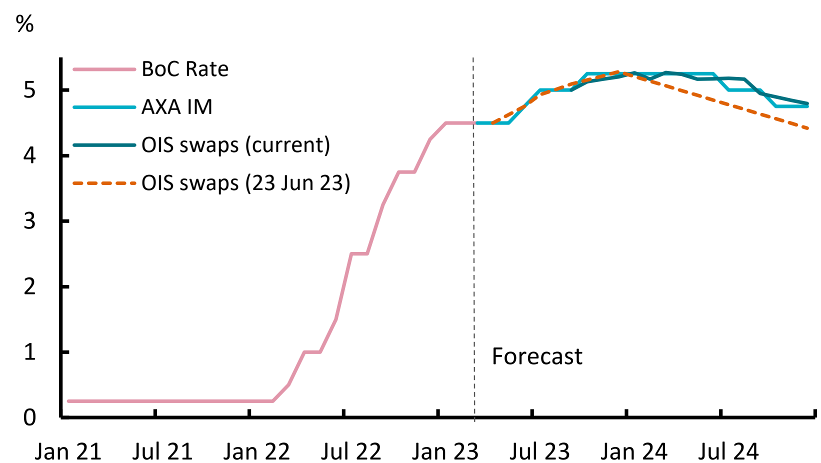
Unit Labour Costs and Headline CPI



Source: LSEG Datastream , AXA IM Research, 20/09/2023

BoC expected to keep policy higher for longer

Bank of Canada overnight rate and outlook



Source: BoC, Bloomberg, AXA IM Research, Sept 2023

Despite multiple headwinds, EM growth resilient

Emerging Markets

Emerging markets proved resilient despite headwinds

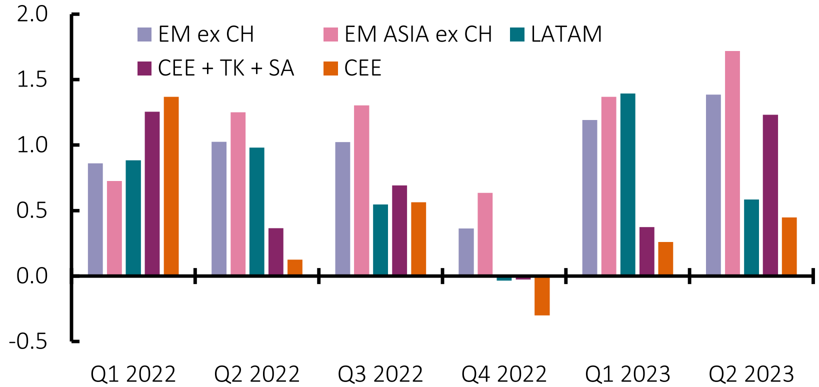
- Against a difficult backdrop of weak China growth, tighter global and domestic financial conditions, a tense geopolitical environment, including the ongoing war in Ukraine and high inflation, activity in emerging markets remained surprisingly resilient. Q1 and Q2 GDP data showed strong readings in Asia, but also in some Latin American countries. CEE is slowly reviving but remained weak overall.

Moving into the end of the year, we see growth momentum shifting gears among the different regions.

- We expect softer growth in Latin America as past monetary tightening filters through the economy. Meanwhile, private consumption in Central Europe is expected to pick up on the back of improving real disposable incomes as disinflation progresses. Asian economies will be sensitive to China. All in all, the strong H1 2023 leads to mechanical upgrades of full year 2023 average GDP growth estimates in many EM countries and regions

Undeniably, a strong first half for EM growth

Regional GDP growth (% qoq)

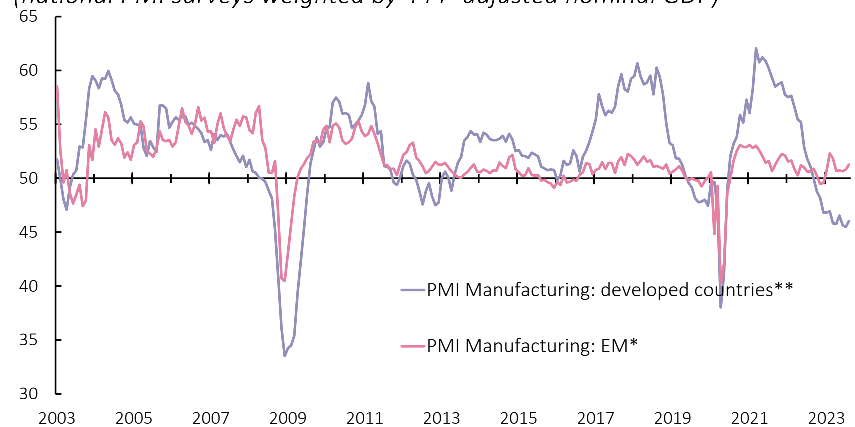


Source: LSEG, AXA IM, GDP-PPP weighted using Korea, Taiwan, India, Indonesia, Phillippines, Thailand, Malaysia, Brazil, Mexico, Chile, Colombia, Peru, Turkey, South Africa, Poland, Czechia, Hungary, Romania, Q2 2023

Relative manufacturing resilience versus developed markets

Global PMI indices

(national PMI surveys weighted by PPP-adjusted nominal GDP)



Source: Purchasing Managers Indices (PMI) and AXA IM, September 2023

** Poland, Mexico, Chile, South Africa, Russia, China, India, Brazil, Turkey, Hungary, Czech*

*** US, Euro area, Japan, UK, Australia, Canada, Sweden, Switzerland*

Investment Managers

October elections preview: Poland and Argentina

Emerging Markets

In Poland, the incumbent PiS is seeking a third consecutive mandate. Beware of (more) trouble with the EU!

- After 8 years in power, the populist PiS-led coalition has seen weakening public support, yet they remain the favourite in the upcoming election. But polls point to a stalemate as incumbent and opposition coalitions look likely to fail to reach a majority in the Lower House.
- We expect fiscal slippage in 2023 after an acceleration in populist measures in the run up to elections. But 2024 fiscal consolidation is also likely to be slower given election spending pledges by all parties. This could put Poland under the excessive deficit procedure within the EU, an additional tension on top of the rule-of-law issue still blocking the disbursement of EU funds.

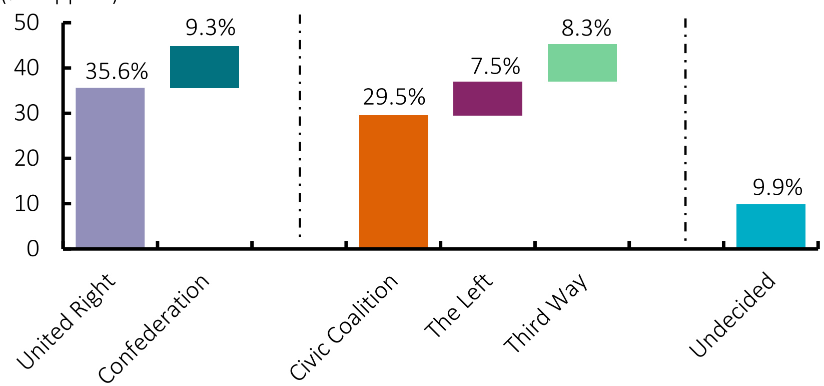
In Argentina a libertarian political outsider leads the polls for the upcoming elections amid economic turmoil

- Argentina's elections on October 22, featuring candidates Patricia Bullrich, Sergio Massa, and Javier Milei, are a pivotal moment for the nation's future, given its challenges such as high inflation, balance of payments pressures, and an ongoing IMF program.
- Milei, with 34% support in the polls, leads the race, introducing an element of unpredictability with his blend of libertarian economics and conservative social stances. Milei's main proposal revolves around dollarization which raises significant feasibility concerns. The elections are likely to move to a 2nd round, with Milei expected to face Massa, the ruling party's candidate.

Poland: polls point to stalemate

Polish Parliamentary polls and potential coalitions

(% support)

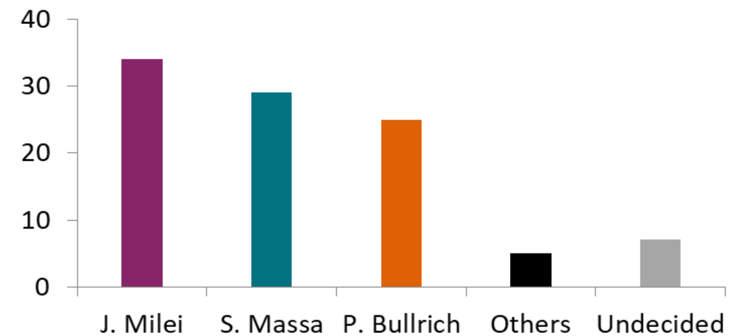


Source: multiple opinion polls among which IPSOS, IBRiS, IBSP, CBOS etc and AXA IM Research, September 2023

Argentina: Political outsider holds the lead

Argentina 2023 elections - Voter support

(%)



Source: Opina Argentina & AXA IM Research, September 2023

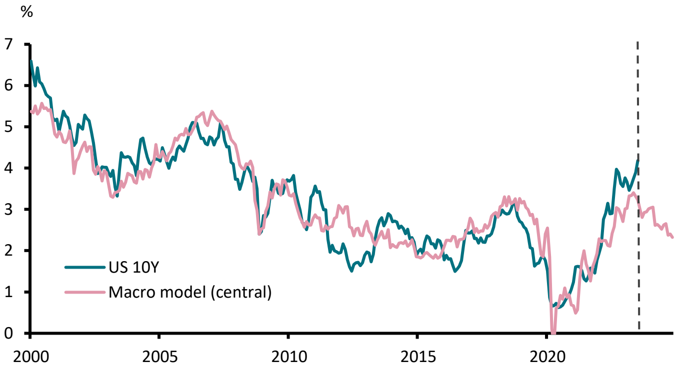
Investment Strategy

Investment strategy

Macro driven yield models: US and Germany

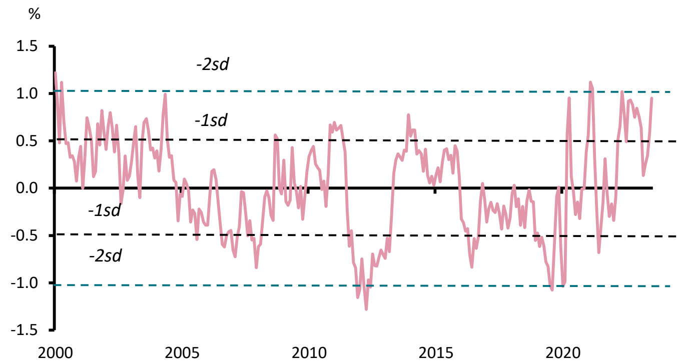
Model points to yield drop as Fed peaks and inflation falls

US 10Y Treasury yields and basic macro model



Model residual at extreme levels

Model Residual and std error bands



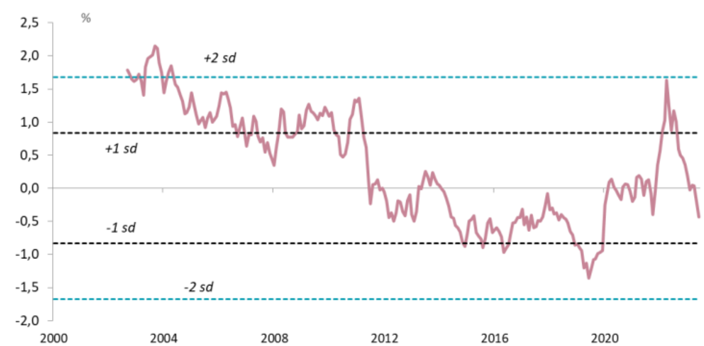
Bund model points to easing driven by inflation

German 10Y yields and basic macro model

Source: Refinitiv, AXA IM Research, September 2023

Model residuals not far from being balanced

Model residual



Source: Refinitiv, AXA IM Research, September 2023

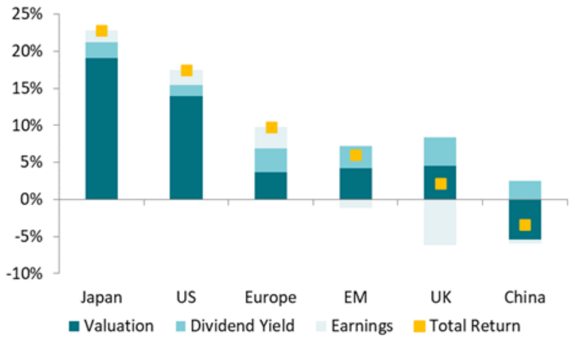
Models are derived from purely macro variables, specifically central bank policy rates, core inflation, central bank bond holdings, net bond issuance and manufacturing surveys. Model forecasts project our macro forecasts for these variables. Forecasts do not include contributions from valuations, sentiment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

Investment strategy

Equity outlook

Valuations have driven performance year-to-date…

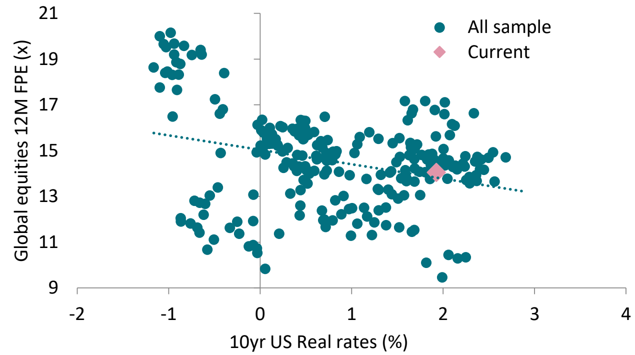
Global Equity - Total return composition by regions



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

But globally, valuations appear fairly priced

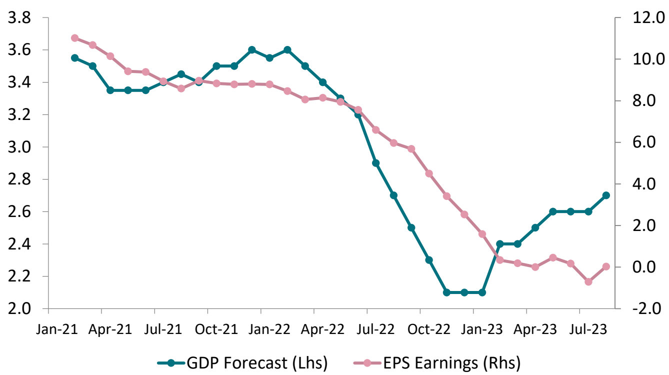
Global equities Forward PE and real rates



Last 20 years

EPS growth outlook is subdued for 2023 …

Global - 2023 GDP and EPS growth forecasts



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

but could be better next year

CEO Business confidence and 12M Trailing EPS growth

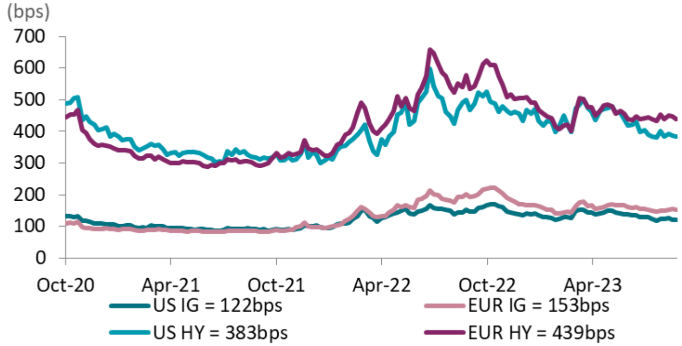
Source: The Conference Board, MSCI and AXA IM Research, September 2023

Investment strategy

Credit markets

Credit spreads remain stable

Regional credit spreads



Source: ICE and AXA IM Research, September 2023

While the outlook is gloomy

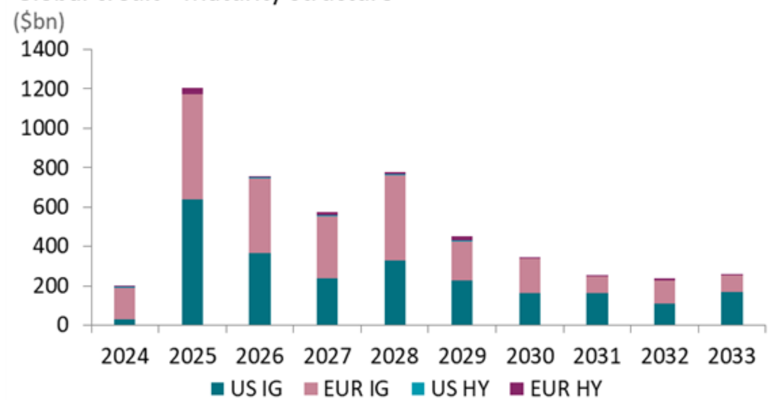
Refinancing scheme is tough…

Global IG - Coupon vs Yield

Source: ICE and AXA IM Research, September 2023

but there's no rush

Global credit - Maturity structure



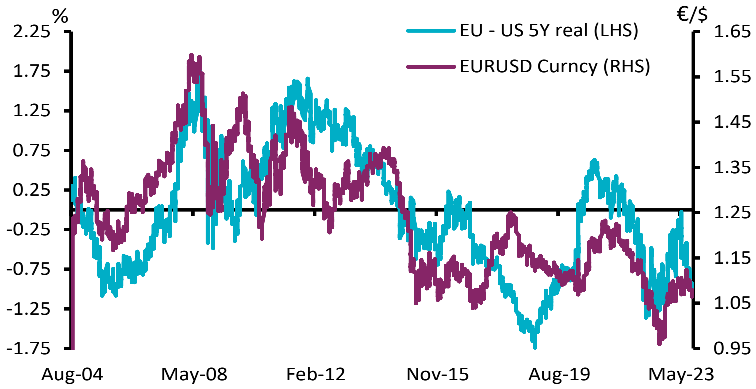
Source: Bloomberg and AXA IM Research, September 2023

Investment strategy

FX

Longer-term real yields support dollar outlook

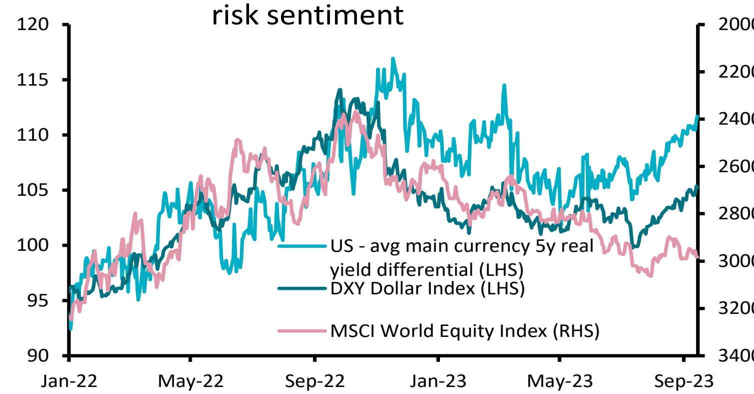
EURUSD and 5Y real rates differential



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

Even amidst global-risk questions

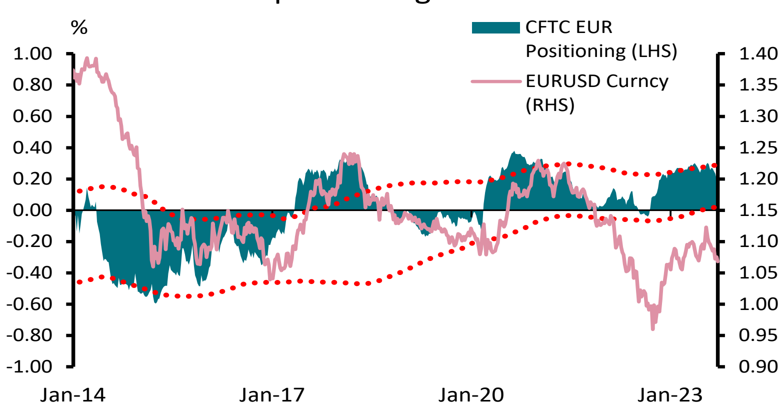
Broad dollar index, 5Y real differential and risk sentiment



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

Euro appears soft despite long positioning

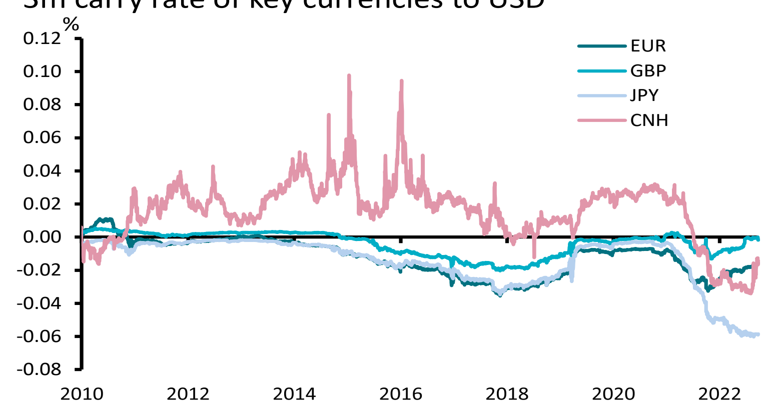
EURUSD and CFTC positioning



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

Carry continue to support the dollar

3m carry rate of key currencies to USD

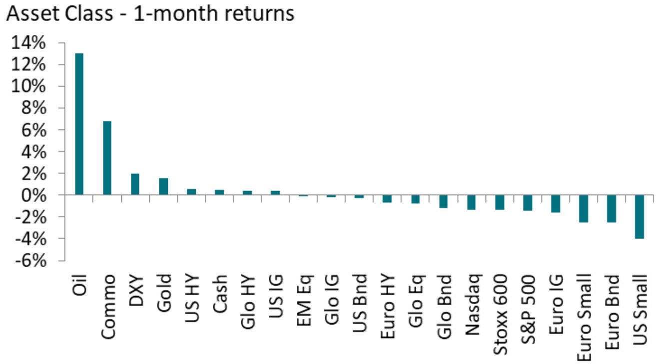


Source: Refinitiv, Bloomberg, AXA IM Research, Sep 2023

Investment strategy

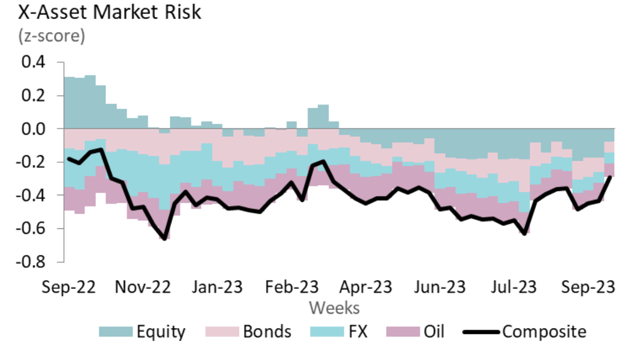
Cross asset

Oil has outshone other asset class



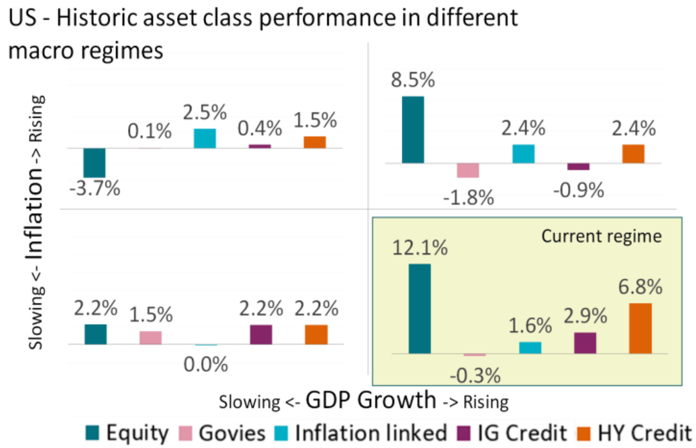
Source: Refinitiv and AXA IM Research, September 2023

Market implied risk has remained low, but is slowly increasing



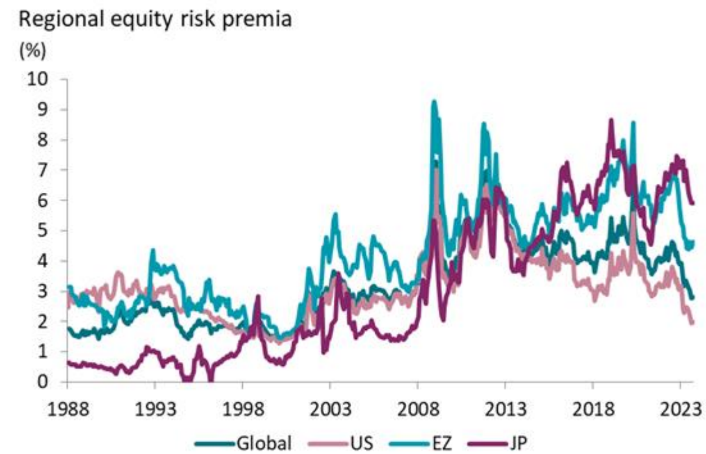
Source: Bloomberg and AXA IM Research, September 2023, Composite average of implied vol z score

Currently in equity supportive territory



Source: Refinitiv and AXA IM Research, September 2023

ERP have declined globally



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

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

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.5		2.9		2.7	
Advanced economies	2.7		1.4		0.8	
US	2.1	2.1	1.9	1.9	1.1	0.6
Euro area	3.6	3.2	0.5	0.6	0.3	0.8
Germany	1.8	1.8	-0.3	-0.3	0.3	0.9
France	2.5	2.5	0.7	0.7	0.3	0.9
Italy	3.7	3.7	0.7	1.0	0.1	0.7
Spain	5.5	5.5	2.2	2.1	0.6	1.4
Japan	1.0	1.0	1.9	1.4	0.9	1.0
UK	4.1	4.1	0.5	0.2	0.2	0.4
Switzerland	2.1	2.1	0.7	0.7	1.0	1.4
Canada	3.4	3.4	1.4	1.5	0.9	0.8
Emerging economies	4.0		3.9		3.8	
Asia	4.4		5.0		4.4	4.0
China	3.0	3.0	5.0	5.3	4.5	4.7
South Korea	2.6	2.6	1.4	1.2	2.4	2.1
Rest of EM Asia	6.3		5.4		4.4	
LatAm	3.9		2.2		2.3	
Brazil	2.9	2.9	2.9	2.2	1.1	1.5
Mexico	3.0	3.0	2.5	2.7	1.9	1.7
EM Europe	0.9		1.3		2.4	
Russia	-2.1		1.5		1.3	1.2
Poland	5.1	4.9	0.0	0.9	3.5	2.7
Turkey	5.6	5.6	2.1	2.6	3.1	2.0
Other EMs	4.8		2.8		3.8	

Source: Datastream, IMF and AXA IM Macro Research – As of 26 September 2023

**Forecast*

Investment Managers

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2022		2023*		2024*	
	AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**7.4**		**4.8**		**2.8**	
US	**8.0**	8.0	**4.3**	4.1	**3.0**	2.6
Euro area	**8.4**	8.5	**5.7**	5.5	**2.9**	2.5
China	**1.9**	2.0	**1.0**	0.8	**2.0**	2.0
Japan	**2.5**	2.5	**3.0**	3.0	**1.5**	1.7
UK	**9.1**	9.1	**7.5**	7.3	**2.8**	3.0
Switzerland	**2.8**	2.8	**2.4**	2.3	**1.5**	1.5
Canada	**6.8**	6.8	**4.2**	3.6	**3.0**	2.3

Source: Datastream, IMF and AXA IM Macro Research – As of 26 September 2023
**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q4-23	Q1-24
United States - Fed	Dates	5.50	31-1 Oct/Nov 12-13 Dec	30-31 Jan 19-20 Mar
	Rates		unch (5.50)	unch (5.50)
Euro area - ECB	Dates	4.00	26 Oct 14 Dec	25 Jan 7 Mar
	Rates		unch (4.00)	unch (4.00)
Japan - BoJ	Dates	-0.10	30-31 Oct 18-19 Dec	22-23 Jan 18-19 Mar
	Rates		unch (-0.10)	unch (-0.10)
UK - BoE	Dates	5.25	2 Nov 14 Dec	1 Feb 21 Mar
	Rates		unch (5.25)	unch (5.25)
Canada - BoC	Dates	5.00	25 Oct 6 Dec	24 Jan 6 Mar
	Rates		0.25 (5.25)	unch (5.25)

Source: AXA IM Macro Research - As of 26 Sep 2023

Calendar of events

2023	Dates	Events	Comments
October	01-oct	US Risk of government shutdown	
	15-oct	Polish general elections	
	15-oct	Deadline to submit EA 2024 draft budgets to the European Commission	
	20-oct	UK Sovereign rating reviews (S&P, Moodys)	
	22-oct	Argentina general elections	
	25-oct	BoC meeting	+25bps (5.25%)
	26-oct	ECB meeting	unch (4.00%)
	31-oct	BoJ meeting	unch (-0.10%)
November	01-nov	FOMC meeting	unch (5.50%)
	02-nov	BoE meeting	unch (5.25%)
	22-nov	UK Autumn Statement	
December	01-déc	UK Sovereign rating review (Fitch)	
	06-déc	BoC meeting	+25bps (5.25%)
	13-déc	FOMC meeting	unch (5.50%)
	14-déc	ECB meeting	unch (4.00%)
	14-déc	BoE meeting	unch (5.25%)
	19-déc	BoJ meeting	unch (-0.10%)
2024	**Dates**	**Events**	**Comments**
January	24-janv	BoC meeting	unch (5.25%)
	25-janv	ECB meeting	unch (4.00%)
	31-janv	FOMC meeting	unch (5.50%)
February	01-févr	BoE meeting	unch (5.25%)
March	06-mars	BoC meeting	unch (5.25%)
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