AXA Investment Managers

27 July 2022

Monthly Investment Strategy

Temperature keeps on rising for central banks

Key points

- Inflation continues to rise higher in multiple jurisdictions, hitting 40-year highs in the US, UK and Canada.
- Central banks are reacting to higher inflation and the threat to expectations with quicker and bigger rate hikes.
- The ECB joined the party with a surprise 50bps increases and introduced the Transmission Protection Instrument to minimize monetary policy fragmentation.
- The ECB's task is made harder with political uncertainty again in Italy and risks to gas supply from Russia.
- The Fed continues to tighten aggressively but looks unlikely to follow the BoC's lead in raising by 100bps.
- Fed guidance from here will be tricky, as it needs financial conditions to remain tight to restore price stability but not tighten much further and induce recession.
- This threatens the more constructive risk asset outlook.

Global Macro Monthly

Temperature keeps on rising for central banks

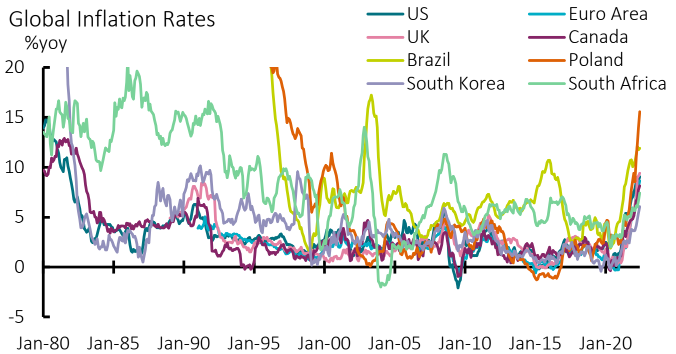
Global Macro Monthly Summary July 2022

David Page
Head of Macro Research
Macro Research – Core Investments

Inflation backs central banks against wall

Inflation has continued to set new records – reaching 40-year highs in the US, UK and Canada and a fresh high in the Eurozone. This was also true across many emerging markets (EM) including Turkey, Brazil, Mexico, South Africa, South Korea, and Poland. Our Monthly Investment Strategy *Theme of the Month* focuses on EM inflation (Exhibit 1). But with inflation elevated almost everywhere, most central banks are now focused on anchoring inflation expectations and trying to restore price stability.

Exhibit 1: Inflation rates in key countries (not done)



Source: Bureau of Labor Statistics, Eurostat, Statistics Canada, Organisation for Economic Co-operation and Development and AXA IM Research, 22 July 2022

The European Central Bank (ECB) was the most notable joiner to the fight against inflation this month, raising its key policy rates by a surprising 50 basis points (bps) while at the same time outlining a new tool – the Transmission Protection Instrument – designed to "counter unwarranted, disorderly market dynamics." Key aspects of the mechanism remain discretionary, but the ECB's ex-ante unlimited commitment illustrates its focus on avoiding fragmentation of monetary policy across the region and its intention to deliver further monetary tightening – we expect a further 125bps of tightening before year-end.

The ECB's task is made all the more difficult by politics and geo-politics. The collapse of the Italian coalition government under Mario Draghi and elections scheduled for September 25th have increased political risks for Italy that threaten not just the widening in Italian bond spreads that the ECB wishes to avoid, but for reasons that it would not wish to prevent. Europe is also considering the prospect of an even deeper supply shock. The return of gas flows in the key Nord Stream 1 pipeline last week eased some tensions. But the resumption of flows to just 40% of capacity highlights the risk of more severe gas shortages over the winter months that could induce a deep recession.

The Federal Reserve (Fed) hiked rates by 75bps in June as it contended not only with rising inflation, but an apparent jump in long-term inflation expectations. This combination also appeared to affect the Bank of Canada (BoC) that hiked rates by 100bps this month – its largest for 25 years and the largest developed central bank move yet. This led to speculation that the Fed might match the BoC's move. We see this as unlikely, as inflation expectations have more than reversed the previous month's spike and signs of softening US activity start to mount. While we continue to expect growth in Q2 GDP, the outlook for US recession before year-end is becoming more balanced, even before considering a worst-case gas shut-off in Europe.

Amid this central bank activity, we expect the Bank of England (BoE) to deliver a 50bp hike in August, despite our outlook for contraction in Q2 GDP. Rising inflation, risks to expectations, and a still tight labor market are likely to lead the BoE to quicken its tightening pace, despite continuing to warn of slowdown ahead. Only the Bank of Japan (BoJ) remains steadfast in its commitment to accommodative policy. With Japanese core inflation just 1.0%, 30 years of flirting with deflation and concerns of global recession, this is not unreasonable.

Yet this very activity is leading markets to consider 'peak hawkishness'. Markets price most economies – the Eurozone and Scandinavian key exceptions – with rates peaking over the next six months and being lower six months on. Faltering US consumer growth, expected UK contraction, declining Canadian output, and Eurozone weakening is testimony to how close many economies will be to recession as inflation continues to rise. Again, this is even before we consider risks from Russia or a re-emergence of COVID-19 in China or elsewhere.

BoC Governor Tiff Macklem claimed front-loading rate hikes was associated with "soft landings." Anchored inflation expectations should reduce the cost of restoring price stability. But, we believe there is no tested playbook for this and higher inflation only makes this more challenging. We worry that easier financial conditions may be premature. Fed Chair Jerome Powell's difficult July press conference will be all the more challenging as he sets out to maintain tight financial conditions as recession risks grow – a troubling outlook for risk assets.

Global Macro Monthly – US

David Page
Head of Macro Research
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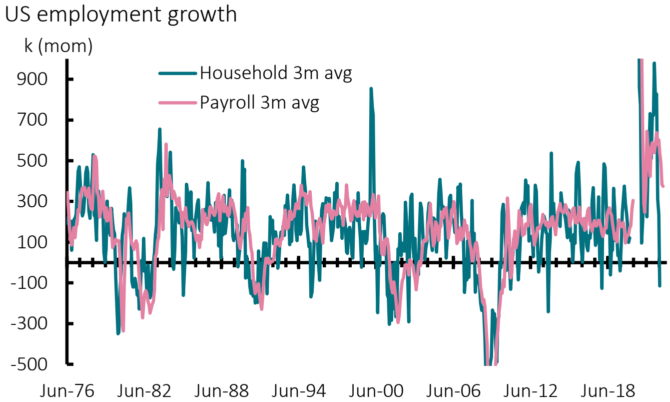
Setting policy for the summer

Inflation continues to post new records, surprisingly rising to 9.1% in June. Energy again contributed to the upside: Motor fuel costs rose 10% on the month and household energy 5%. Declines in oil and natural gas prices since mid-June should ease energy pressures over coming months. However, an acceleration of housing-related inflation to 1%, with owner equivalent rents up 0.7% is a concern. This is a large component of the overall basket and reflects strength in the labor market. Inflation could edge higher over the summer, but if housing gains persist, inflation may soften albeit modestly to year-end. We raise our forecasts to 8.4% for 2022 and 4.5% 2023 (from 7.8% and 4.5%), consensus sees 8.0% and 3.5%.

Inflation's continued rise gives the Federal Reserve (Fed) little room to maneuver. In June, Fed Chair Jerome Powell said he required "compelling evidence" that inflation was falling – clearly not the case in July. Despite signs of the softening economy, which we had thought would push the Fed to a smaller hike, we now expect 75bps in July. Admittedly, signs of weaker activity and a reversal in long-term inflation expectations to 2.8% should dissuade the Fed from following the Bank of Canada's 100bp example. However, Powell faces a difficult press conference. He has to suggest no let-up in the Fed's bid to restore price stability, but not deliver another tightening in financial conditions which could tip the economy into recession.

Indeed, the prospect of a US recession has escalated over the past month. GDP in Q1 was revised up insignificantly to -1.6% (annualized) from -1.5%, but the composition of growth was changed more materially. Consumption growth was reduced to 1.8% (from 3.1%), while April's consumer spending was revised lower to a monthly 0.6% from 0.9% and May rose by just 0.2%. Consumer spending in Q2 now looks set to rise by just 1% (annualized). Moreover, the slowdown in inventory build in Q1, which had contributed to the initial drop in total output, was revised higher. This mechanically reduces the outlook for Q2. We forecast GDP growth of 1% for Q2 but note that the Atlanta Fed GDPNow tracker is currently suggesting -1.6%. Even with positive growth expected in Q2, we forecast growth all but stagnating over H2 2022, eroded further by high prices weakening real income growth. On balance, we expect positive growth in the final quarters of 2022. However, we lowered our growth forecasts to 1.9% for 2022 and 0.8% for 2023. Consensus has fallen to 2.1% and 1.3%. We currently see the prospect of recession as very finely balanced.

Exhibit 2: First signs of a deteriorating labor market



Sources: Bureau of Labor Statistics and AXA IM Macro Research, 21 July 2022

Some argue that the economy is already in recession. The labor market provides the strongest arguments against. The Sahm effect – that a 0.5ppt rise in unemployment in a year is a good indication of recession – does not indicate recession. Unemployment is stable at 3.6%, nor is this exceptionally being driven by falling labor supply, which was also the case in 2001. Further, payroll growth has averaged gains of 375k per month across Q2 – far higher than before previous recessions. While both refute the idea of recession now, we do note signs of deterioration. Jobless claims have continued to trend higher from their March lows. Historically, this precedes a rise in unemployment by around 3-4 quarters. Moreover, while payroll growth has been robust, the household measure of employment has fallen by 116k over the same period (Exhibit 2). The two measures differ due to seasonality, new businesses, and measures of self-employed and multiple job holders. The latter is more volatile but contains valuable information – particularly at turning points.

Contrary to recent years, government policy has had little impact on the broader economy, but this may change. The long-awaited Build Back Better (BBB) package appears to have collapsed with Democrat Senator Joe Manchin refusing to support President Joe Biden's efforts on clean energy investment. Instead, a much-reduced bill focused on lowering prescription drug prices and extending Affordable Care Act subsidies beyond year-end appears all that will be delivered. Reduced drug pricing may combine with separate action to remove some Trump-era tariffs on consumer-facing Chinese products to modestly lower inflation. Moreover, the Senate is proceeding with legislation for a $52bn incentive scheme for US semiconductor production. While a long-term project, this could raise potential growth and ease supply-chain risks, both reducing price pressures over the long run. Finally, there is some expectation that President Biden could declare a Climate Emergency, something that would grant executive powers to reduce carbon emissions and boost clean energy investment.

Global Macro Monthly – Eurozone

François Cabau,
Senior Eurozone Economist
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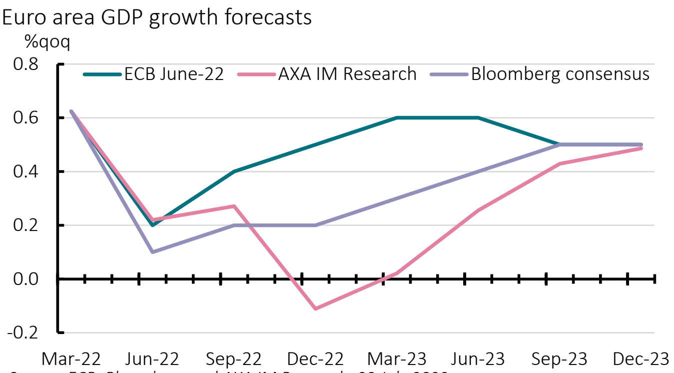
Hugo Le Damany,
Eurozone Economist
Macro Research – Core Investments

Growth and inflation outlook increasingly diverging

Eurozone GDP growth is slowing. Flash consumer confidence dropped to a new all-time low in July, while the flash PMI composite output fell by another 2.6 points to 49.4 in July, consistent with output contraction. Key is that momentum in the services sector is quickly fading and is no longer able to offset manufacturing troubles. Forward-looking indicators point to further weakness. This suggests downside risk to our below-consensus forecast which sees GDP contraction in Q4 (Exhibit 3). The latest indicators suggest this could materialize as soon as Q3. In our early June forecast update, we thought a strong tourist season and recovery in China would keep GDP growth in positive territory during the summer months.

Exhibit 3: GDP could contract as early as Q3



Source: ECB, Bloomberg and AXA IM Research, 23 July 2022

Russian gas supply remains a key risk. Flows have resumed in the Nord Stream 1 pipeline after the maintenance period. This has reduced the prospect of imminent supply disruptions but conveys little information for possible risks ahead. The mild GDP contraction we forecast could morph into a full-blown crisis if there are gas supply-interruptions where liquefied natural gas (LNG) is unable to buffer the economic impact. In such a scenario, the International Monetary Fund believes EU GDP would fall by more than 2%.

Inflationary pressures remain hot. Eurozone final harmonized consumer price indices (HICP) came out at 8.6% in June, up 0.5ppt led by food and energy (circa +0.3 ppt each). Without the introduction of a temporary €9 ticket in public transport in Germany (until the end of August), core inflation would have reach 4% instead of 3.7%. We forecast inflation to remain very elevated during the summer (8.6%-8.9%), before edging down from October.

In the short term, a buoyant tourism season is expected to raise inflation further, but goods prices are expected to soften as bottlenecks are easing and demand has already shown signs of weakness. This is expected to spill over to services after the summer. On energy, fuel prices dipped on recession fears, but we believe supply issues will persist. Electricity and gas prices are expected to remain volatile and at high levels, as Russia has every incentive to maintain pressure. As such, we envisage higher final gas and electricity prices paid by consumers in 2023. If energy prices remain elevated, food prices are likely to stay high for longer. These pressures are also likely to influence future wage negotiations, leading to somewhat higher inflationary pressure in 2023. Overall, we upgrade our inflation forecast to 7.6% in 2022 (+0.2ppt) and 3.5% in 2023 (+0.4ppt). The latest Survey of Professional Forecasters now stands at 2.2% (+0.1ppt) over the long term, fueling the European Central Bank (ECB) hawkishness.

ECB: Bold moves in July but unclear path ahead

The ECB Governing Council surprised markets by hiking all three policy rates by 50bps in July, bringing the deposit and refinancing rate to 0% and 0.5% respectively, evidently worried about the inflation outlook. Doves likely agreed to an additional +25bps to achieve a unanimous decision on the Transmission Protection Instrument (TPI), reinforcing the announcement effect, and a *sine qua non* condition for this and possible future large rate hikes.

Rate forward guidance was completely removed, moving to a meeting-by-meeting approach driven by data dependence. We keep our forecast of +50bps in September but see the deposit rate ending the year at 1.25%. Risks to coming meetings are for smaller increases, based on rising growth concerns. Faster normalization would come if Russia cut gas supply.

Agreement on TPI was a big achievement but was undersold during the press conference. Follow-up speeches from council members, especially hawks, will be key to ascertain the ECB's readiness to act. However, we do not think it will apply to Italy before a new government is in place, with further stress possible for Italian government bonds.

Following a two-step resignation process by Prime Minister Mario Draghi, Italy's President Matarella dissolved the Parliament, triggering snap elections. These will be held on September 25th. Polls currently put a coalition between Fratelli d'Italia (FdI), Lega, and Forza Italia in prime position to rule the country, headed by FdI leader Georgia Meloni, but careful monitoring of their respective electoral platforms will be key to judge possible future policy orientation as a coalition.

Global Macro Monthly – UK

Modupe Adegbembo
Junior Economist (G7)
Macro Research – Core Investments

‘Forceful’ action from the BoE on the horizon

The race to become next leader of the Conservative Party turns towards party members with ex-Chancellor Rishi Sunak and Foreign Secretary Liz Truss facing the final ballot. Taxation has been a dividing line between candidates, with Sunak favouring fiscal conservatism and seeing inflation fall before making tax cuts and Truss arguing for immediate cuts to boost the economy – which would have implications for the Bank Rate. The results are due on September 5th, with one poll suggesting Truss has a 24-point lead, which Sunak may struggle to close over the next four weeks of televised debates and hustings.

Prices continue to rise, impacting consumption and challenging the growth outlook. In June, inflation rose to 9.4% – a new 40-year high. Rising gas prices are likely to increase the Ofgem utility price cap by around 50% in October, pushing inflation above 10% in the autumn. We now expect inflation to average 8.7% this year and 4.8% next (consensus 8.5% and 5.0%).

Growth in Q2 and Q3 will be impacted by the bank holiday adjustment, shifting activity across quarters – we expect GDP to record -0.3% and 0.6%, respectively. The outlook for Q4 hangs in the balance; we have penciled in growth of 0.25%, but volatile energy prices and the threat of a Russian gas shut-off could see a further decline. We continue to forecast growth at 3.7% this year and 0.9% next (consensus 3.4% and 0.6%).

Labor market data remain robust. Employment grew by 296,000 in the three months to May – the largest jump since the August 2021 COVID-19 rebound. More timely indicators suggest employment growth is set to cool, with official HMRC payrolls and the Recruitment and Employment Confederation (REC) survey suggesting the pace of growth slowed in June. Wage growth remains buoyant with regular wages (excluding bonuses) up 4.6% on the year, well above the circa 3% we see as in line with the Bank of England’s (BoE) 2% inflation target.

We expect recent labor market data to lead the BoE to hike rates by 50 basis points in August. This call is finely balanced, but we see this data, alongside more hawkish comments from Governor Andrew Bailey and broader international central bank increases, making a larger hike more likely. We expect the Monetary Policy Committee to hike by 25bps in September and November, then pausing with the Bank Rate at 2.25% as slack begins to emerge in the economy.

Global Macro Monthly – Canada

David Page
Head of Macro Research
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Bank of Canada peak hawkishness

The Bank of Canada (BoC) takes the prize for the biggest developed market interest rate hike to date. In July, it raised its overnight lending rate by 100bps to 2.50%. We had argued that with inflation having risen to 7.7% in May and the Fed hiking by 75bps in June that it would have to tighten by more than the 50bps it delivered in June. But the sharpest rise since 1998 was a surprise for us and markets.

The BoC’s hike left policy squarely within its estimate of the neutral range (2-3%). With inflation expected to rise further, albeit recording a softer than expected 8.1% in June, Governor Tiff Macklem suggested additional hikes to the top of that range or slightly above the restrictive rate were likely appropriate. However, he also described the scale of increase as “very unusual.” We doubt the BoC will raise rates by 100bps again, but we raised our end-year rate forecast to 3.50% (from 3.25%), assuming hikes of 50bps in September and two 25bps moves in October and December.

While inflation concerns drove the BoC to such a sharp adjustment, we think growth concerns will mean slower tightening from here. The BoC lowered its GDP forecasts in July to 3.5% and 1.7% for 2022 and 2023, from 4.2% and 3.2%. This was below consensus forecasts of 3.8% and 2.3% but exactly in line with our view. Consensus forecasts have since softened to 3.7% and 1.9%. We consider risks to the downside to our own forecasts. May recorded a monthly drop in GDP; housing market activity appears to be falling – albeit from elevated levels and the labor market posted a 43k payrolls contraction in June – its first since the COVID-19 affected January – albeit that this was mostly part-time workers and unemployment set a new record low of 4.9%.

Macklem argued that “front-loading” tightening “tended to be associated with soft landings”, the BoC’s ultimate goal. While we agree anchoring inflation expectations with decisive policy moves should be consistent with minimizing the economic cost of restoring price stability, we consider the characterization of “associations” with soft landings as a stretch. The risk of such large adjustments is they alter other expectations – such as the future outlook for policy and this can lead to more abrupt changes in activity. With Canada facing external risks to its outlook – namely potential recessions in the US and Europe, our expectation is the BoC’s tightening will be done by year-end.

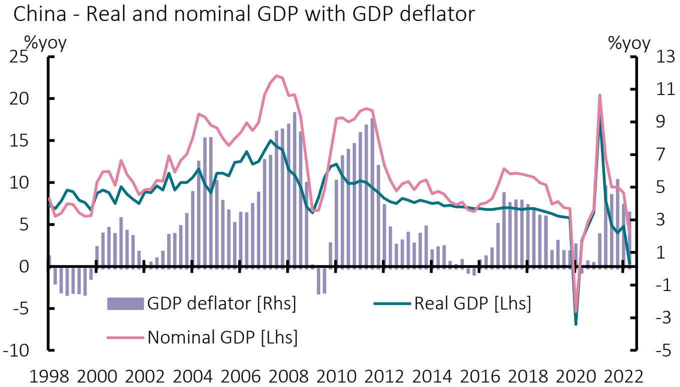
Global Macro Monthly – China

Aidan Yao
Senior Economist (China)
Macro Research – Core Investments

Recovery off to a good start…

China's second quarter GDP grew by 0.4%, in line with our forecast, but weaker than market expectations. While narrowly avoiding a contraction on a year-on-year basis, sequential growth clearly reflected the brutal hit from the two-month lockdown in Shanghai. The 2.6% quarterly decline was the second GDP contraction since the start of the pandemic. Nominal GDP growth also fell sharply to 3.9% from 8.9%, exacerbated by a softer GDP deflator (Exhibit 4).

Exhibit 4: Growth slows sharply on COVID-19 lockdown



Source: CEIC and AXA IM Research, 20 July 2022

The miss on Q2 GDP reflected the market's underestimation of the lockdown impact earlier in the quarter, but the post-lockdown recovery has surprised mostly on the upside. June activity data showed the recovery gained further momentum, building on the tentative improvement in May. The supply side of the economy continued to lead the recovery on easing COVID-19 controls. Industrial output growth rebounded to 3.9% on broad-base gains across manufacturing, mining, and utility sectors. The easing of supply-chain and logistic bottlenecks enabled firms to fill backlog orders and clear overseas shipments. The latter helped to keep export growth up despite slowing demand from China's major trading partners. However, we think this strength is transient, and the sector will eventually succumb to weaker global demand.

Green shoots also broadened in the domestic economy. Growth in fixed asset investment accelerated in June, and this time, the gain was no longer driven by only infrastructure activity. Manufacturing investment also posted decent gains, up 9.9%, rising to a 3-month high, thanks to improved demand and credit growth. Even the housing market showed some signs of life. Growth in house sales improved thanks to pent-up demand in major cities, but construction activity remained depressed, with many cash-strapped developers now struggling to complete projects.

Retail sales growth rebounded to 3.1%, from -6.7% in May, making it the biggest upside surprise in the monthly data. Strong auto and appliance sales were supported by policy easing helping to unleash pent-up demand, although rising prices were behind the near doubling of spending on gas and related products. Overall, goods sales continued to lead the recovery, while the year-on-year decline in services activity also narrowed, to -4% from -21% in May.

The labor market data showed a mixed picture. While the total unemployment rate fell for the second month to 5.5%, youth unemployment climbed to a new high. Both consumption and the labor market are far from their normal state – despite the latest improvement – making a strong case for continued policy nurturing.

… but the path ahead remains bumpy

Looking further ahead, however, dark clouds are gathering on the horizon again. The recent COVID-19 flare-up – involving the more infectious subvariants – will pose a critical test on Beijing's ability to control the pandemic without resorting to draconian lockdowns. In addition, the momentum of the housing market is fading again after a brief rebound in June. Recent news has revealed that some homebuyers have stopped servicing their mortgages on pre-sold properties that have passed delivery dates. If this becomes widespread, the housing market woes could spread to the banking system via an increase in non-performing loans. We think the situation is manageable as it currently stands given the stuffiest reserve and profit buffers of banks against potential debt write-downs, but Beijing still needs to act fast to guard against wider contagion risks.

Overall, now is not the time for complacency. Beijing needs to keep its feet firmly on the pedal to ensure the recovery does not falter heading into the Party Congress. Calls for additional policy easing are gaining volume, and Beijing cannot afford to disappoint. We see additional fiscal easing – most likely in the form of frontloading next year's special bond quota – supplemented by targeted monetary easing, to keep the economy humming in the second half of the year. The risks are large but broadly balanced around our 3.6% forecast for the year. This is not to deny that the recent developments have surprised mostly to the downside, with the COVID-19 resurgence the most concerning of all.

Global Macro Monthly – Japan

Modupe Adegbembo
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Bank of Japan holds its ground

Japan's daily COVID-19 cases rose to a record high this week as 180,000 were recorded. Despite the increase, the government reiterated it had no plans to reimpose movement restrictions. Even so, public caution is likely to rise. Short-term economic indicators slowed, reflecting the impact of the resurgence in cases. The services flash Purchasing Managers' Index estimate for July declined 2.8 points on the month to 51.2. The sustained spike in COVID-19 infections represents a downside risk to services growth over the coming months.

In the second quarter, Japanese exports climbed to a record high, but this strength was outweighed by increased energy imports causing the trade deficit to widen further. The risk that Japan's trade position worsens remains, but we expect the drag on growth from net imports to decline over the coming quarters as China's reopening boosts external demand. The impact of rising inflation is weighing on consumers and real wages fell by 1.8% on the year in May. Currency weakness is likely to keep the cost of imported goods elevated and while the government's intervention to cap gasoline prices is likely to prevent inflation rising above 3%, we expect consumption to remain weak this year.

In July the Bank of Japan (BoJ) reaffirmed its commitment to accommodative policy and kept all tools unchanged, despite raising its inflation forecast to 2.3% for the year ending in March. Governor Haruhiko Kuroda remarked that the BoJ has "no intention at all of raising rates under the yield curve control framework" and added that it has "no intention at all of expanding the 0.25% range on either side of the yield target." The BoJ remains concerned that a premature tightening could jeopardize economic recovery and the long-term convergence of inflation towards its target. Some had suggested recent weakness in the yen could see the BoJ begin to shift, but Kuroda argued that limited monetary tightening would do little to support the falling yen as other central banks embark on more aggressive tightening paths.

We acknowledge the pressure on 10-year Japanese government bonds as they continue to trade close to the 0.25% upper limit and the yen continues to depreciate but see a low probability of any change in policy in the coming months. Rising inflation expectations could give the BoJ some scope to begin normalising over the longer term, but we are far from this now.

Global Macro Monthly – EM

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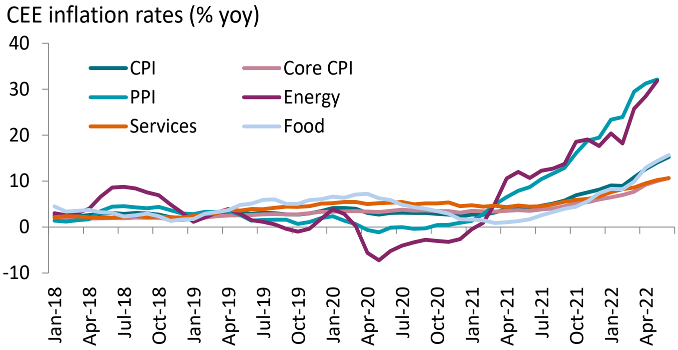
From global to domestic factors pressuring inflation

Inflation continues to rise across Central Europe. The June reports showed annual price increases of 17.2% in the Czech Republic, 15.5% in Poland, 15.1% in Romania, and 11.7% in Hungary. But these understate the real extent of the pressure. Hungary implemented a fuel price cap and is heavily regulating utility prices. Poland introduced an 'anti-inflation shield' – reducing or eliminating VAT on items across the board and subtracting a hefty three to five percentage points from annual inflation rates.

Exhibit 5: A broadening of inflation drivers



Source: Refinitiv Datastream, AXA IM, June 2022

Food and energy prices continue to exert upward pressures on consumer prices, and although these items remain the primary inflation drivers, there is a broadening towards more domestically driven Consumer Price Index components (Exhibit 5), illustrated by rising core inflation rates to 13.8% in Hungary, 9.1% in Poland, and 8.2% in the Czech Republic. Inflation expectations have also risen, pressuring central banks to further tighten policy. Despite policy rates having been raised by 640 basis points in Poland, 715bps in Hungary, and 675bps in the Czech Republic so far, currencies have depreciated against the euro, which in turn will increase imported inflation looking ahead. The Hungarian forint is the most affected in the region, having lost 17% against the euro from February to early July (-12% to 19 July). This is partly a reflection of a strong US dollar and tighter global financial conditions, but more specifically, it reflects the region's high economic dependence on Russian gas which is impacting external accounts. The IMF estimates that a possible Russian gas supply cut-off would be a significant threat to the economic outlook in the region with output likely contracting by between one and five ppt.

27 July 2022

Global Macro Monthly – Asia

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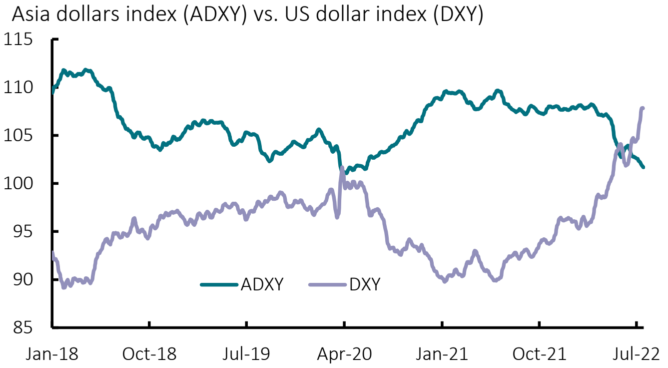
Pressures on Asian currencies remain

With the US dollar rising to a record high, Asian currencies have lost further ground. The ADXY index declined by another 2% compared to early June (Exhibit 6). South Korea's won has been the region's worst performing currency this year, dropping to a level not seen since 2009. Meanwhile, the New Taiwan dollar, Philippine peso, and Thai baht have all endured sizeable declines. Looking ahead, foreign exchange pressures will likely persist, reflecting several headwinds: Deteriorating external balances, portfolio outflows and a comparatively modest hiking cycle by regional central banks versus the Federal Reserve.

Exhibit 6: Mounting foreign exchange pressures in Asia



Source: Bloomberg and AXA IM Research, 20 July 2022

Asian central banks have so far been more reserved in terms of interest rate rises. Indonesia, Thailand, and Vietnam have yet to begin hiking rates. Despite this, Asian central banks have increasingly started to join the hiking bandwagon on the back of surging energy and food prices. Recently, two surprise central bank meetings caught the market off-guard. Singapore's central bank re-centered the mid-point of its policy bands in an inter-meeting adjustment, while also rising its inflation rate forecast. The Philippines, also in an off-cycle move, rose the policy rate by 75bps, in part reflecting stubborn price pressures and widening trade deficits.

Inflationary pressures continue in the region with most already at multi-year highs. In addition, with the broad US dollar strength, Asian central banks will likely intervene more to smooth the currency depreciation against the dollar. We continue to expect rate hikes throughout this year and in 2023. For the ones that have not yet started, we expect them to do so by Q4 2022.

Global Macro Monthly – LatAm

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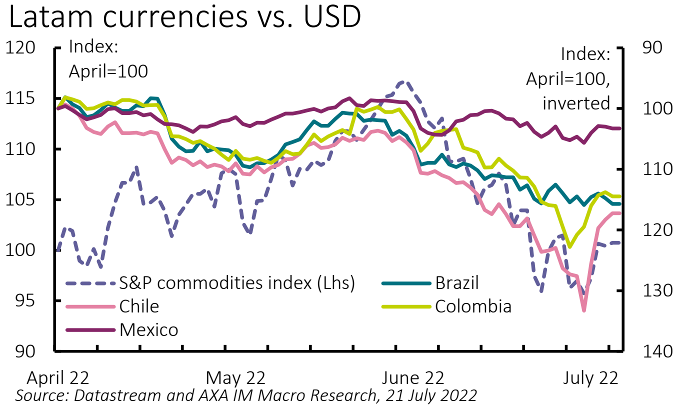
FX interventions to the rescue?

Latin American currencies were among the world's best performers in the first half of 2022, fueled by a surge in global prices for the region's commodities. However, these have tumbled in the last few months due to lower commodity prices and higher demand for the US dollar amid growing fears of a global recession. Three Latin American currencies are among the top five worst performing emerging market (EM) currencies in the last three months. The Brazilian real has led the decline depreciating 14.4% against the dollar since April, followed by the Chilean peso (-13.7%), and the Colombian peso (-13.4%) (Exhibit 7).

While the foreign exchange (FX) pass-through effect is much lower now than in previous decades, the recent depreciation has reignited concerns. Inflation in the region is already at its highest since the early 1990s despite a mature hiking cycle. In this context, central banks could start to consider FX market interventions to curb additional inflationary pressures coming from currency weakness. In fact, the Chilean central bank announced it would intervene in the FX market with $25bn. In contrast, Colombia's central bank governor recently stated that trying to fight the currency's drop would be futile and expensive. Nonetheless, the bank had intervened in FX markets in 2020 amid a similar peso drop.

Exhibit 7: Commodity prices and FX weakness



Source: Datastream and AXA IM Macro Research, 21 July 2022

Mexico is the exception to this trend. It is the second-best performer in EM in the last three months. The currency's high yield and liquidity makes it popular among carry traders. However, the peso's strength could unravel in the case of a US recession, given the country's dependence on US demand.

Sample asset allocation

Source: AXA IM Macro Research – As of 25 July 2022

The information presented should not be considered a recommendation to purchase or sell any security or class of securities.

Macro forecast summary

Real GDP growth (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	-3.1	6.1		3.1		2.8	
Advanced economies	-5.0	5.1		2.4		1.1	
US	-3.4	5.5	5.6	1.9	2.6	0.8	1.8
Euro area	-6.4	5.3	5.1	2.8	2.8	0.7	2.0
Germany	-4.6	2.9	2.7	1.5	1.8	0.7	2.1
France	-8.0	6.8	6.6	2.3	2.5	0.8	1.6
Italy	-9.0	6.6	6.3	2.7	2.6	0.2	1.7
Spain	-10.8	5.1	4.7	4.2	4.3	0.6	3.0
Japan	-4.9	1.7	1.8	1.6	1.7	1.9	1.9
UK	-10.0	7.2	7.0	3.7	3.5	0.9	0.8
Switzerland	-2.5	3.5	3.5	2.5	2.5	1.0	1.6
Canada	-5.2	4.4	4.5	3.5	3.7	1.7	2.3
Emerging economies	-1.9	6.7		3.5		3.9	
Asia	-0.7	7.0		4.3		5.0	
China	2.2	8.1	8.0	3.6	4.3	5.2	5.2
South Korea	-0.9	4.1	4.0	1.5	2.7	1.6	2.3
Rest of EM Asia	-4.2	6.1		5.5		5.2	
LatAm	-7.0	6.8		2.6		1.9	
Brazil	-3.9	4.6	4.7	1.4	1.3	0.5	1.1
Mexico	-8.2	4.8	5.6	1.5	1.8	1.5	2.0
EM Europe	-2.0	6.7		-0.8		0.4	
Russia	-2.7	4.7		-6.0		-3.5	
Poland	-2.5	6.0	5.3	6.0	4.9	2.0	2.7
Turkey	1.6	11.5	9.9	4.6	3.0	2.0	2.4
Other EMs	-2.5	5.4		4.2		3.7	

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

CPI Inflation (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	0.7	3.2		7.1		3.6	
US	1.2	4.7	4.6	8.4	7.7	4.5	3.6
Euro area	0.3	2.6	2.5	7.6	7.2	3.5	3.2
China	2.5	0.9	0.9	2.1	2.2	2.3	2.3
Japan	0.0	-0.2	-0.2	2.2	1.9	1.0	1.2
UK	0.9	2.6	2.5	8.7	8.5	4.8	5.2
Switzerland	-0.7	0.5	0.5	2.0	2.3	1.0	1.2
Canada	0.7	3.4	3.4	7.0	6.3	3.4	3.1

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

These projections are not necessarily reliable indicators of future results

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Forecast summary

Central bank policy						
		Meeting dates and expected changes (Rates in bp / QE in bn)				
		Current	Q3-22	Q4-22	Q1-23	Q2-23
United States - Fed	Dates	1.50-1.75	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec	31-1 Jan/Feb 21-22 Mar	2-3 May 13-14 Jun
	Rates		+1.25 (2.75-3.00)	+0.25 (3.00-3.25)	unch (3.00-3.25)	unch (3.00-3.25)
Euro area - ECB	Dates	-0.50	21 July 8 Sep	27 Oct 15 Dec	2 Feb 16 Mar	4 May 15 Jun
	Rates		+1.00 (0.50)	+0.75 (1.25)	unch (1.25)	unch (1.25)
Japan - BoJ	Dates	-0.10	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec	Jan Mar	May Jun
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	1.00	4 Aug 15 Sep	3 Nov 15 Dec	Feb Mar	May Jun
	Rates		+0.75 (2.00)	+0.25 (2.25)	unch (2.25)	unch (2.25)

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

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