AXA Investment Managers

26 October 2022

Investment Institute *Macroeconomics*

Monthly Investment Strategy

Tighter global financial conditions

Key points

- Monetary policy continues to tighten across the globe as inflation remains far too elevated and is broadening from headline to core measures.
- Economies continue to slow in the face of tightening conditions and deteriorating real incomes for corporates and households. The UK looks likely to be in recession from Q3, as do some Eurozone economies. The US may not see recession begin this year.
- The UK has seen the downfall of its Prime Minister after the latest market havoc. Italy's new government appears to have learnt from the UK's travails. China's Congress reiterated development as a priority. We await US midterms on 8 November.
- Financial markets across the globe cope with tightening financial conditions. Sharp rises in US real yields and the dollar are symptomatic. Credit and equity markets have seen material adjustments but may not be fully priced for expected recessions.

Global Macro Monthly

Tighter Global Financial Conditions

Global Macro Monthly Summary October 2022

David Page
Head of Macro Research
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The drift from economic orthodoxy

A persistent global transformation since the 2008 financial crisis has been the increasing divergence of political direction from economic orthodoxy. What began with ill-advised austerity amid demand-deficient balance sheet recessions spread out to include trade policy, tax cuts and support for state-sponsored enterprises as governments re-prioritised security, distribution and climate considerations while at the same time losing faith in what gains longer-term market disciplines had delivered. This divergence was widespread, obvious across the US, the Eurozone and UK, as well as impacting China and emerging markets.

Arguably, the UK underwent the greatest transformation. As one of the economies to outperform the most in the decades before the financial crisis, it was among the hardest hit during the financial collapse and its aftermath, leading its politicians to propose ever more ideological solutions to the economy's problems of falling investment and productivity growth. But what started with Brexit – an initiative that defied economic benefit – culminated recently in 'Trussonomics', a hope that unfunded tax cuts could bolster supply-side recovery. Markets had priced economic prospects lower in the wake of Brexit and lower still with the extreme implementation in the Northern Ireland Protocol. But recent events saw markets consider fiscal sustainability. This was enough to end the experiment abruptly, and the short careers of both Chancellor and Prime Minister. It has led to a revival of policy based on economic reality for now.

The UK's example may continue to steer other governments – a lesson in what to avoid. In this month's Global Macro Monthly we discuss how the new right-wing Italian coalition government – in part owing their rise to power from the lessons learned from the UK's Brexit debacle – has toned down its pre-election stance for fiscal easing.

We also examine the importance of China's latest National Party Congress and President's Xi Jinping's speech, focusing on its important reiteration of development as the key priority for China over the coming five years – albeit acknowledging a rising reference to "security".

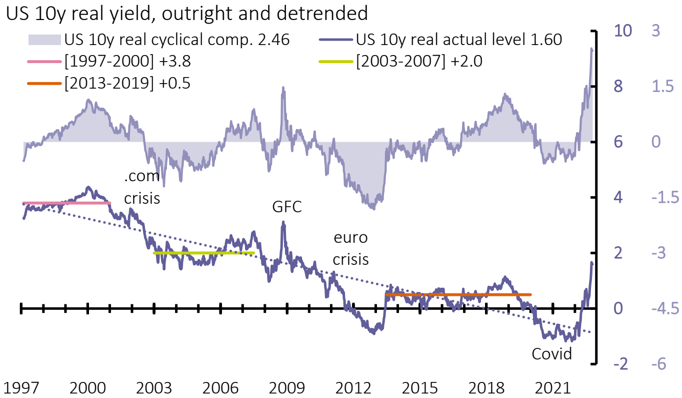
This month, we also preview the upcoming US midterms on 8 November. These will prove a pivotal next step in political developments that will determine who will run for President in 2024. But economically, we argue the impact is likely to be less dramatic. We also look at the unexpectedly close run-off Presidential elections in Brazil due at the end of this month, with broader Latin American economies seeing several noisy political developments.

Tighter global financial conditions

Beyond the political, the world faces a material tightening in global financial conditions. Central banks are being forced to continue to tighten policy in a bid to restore price stability as supply shocks, increasingly more domestic labour supply constraints than external supply chain-driven, keep inflation at far too elevated levels.

Exhibit 1: Symptoms of tighter global financial conditions

US 10y real yield, outright and detrended



Source: Bloomberg and AXA IM Research, Oct 2022

Our Theme of the Month focuses on the flux in financial markets. We consider the meteoric rise of the US dollar across the course of the year as symptomatic of this tightening in global financial conditions also obvious in the steep rise in US real yields (Exhibit 1). We see this being felt in every corner of financial markets across the world and expect these strains to persist until central banks can pivot in policy – something which now looks unlikely this year.

We look at individual asset markets arguing that credit markets have seen spreads widen to attractive levels but that they may not yet adequately reflect the recessions we consider likely. From an equity perspective we argue that valuations have fallen sharply, but with defensives' outperformance pointing to slower growth, the impact of slower earnings growth may still have to play out – albeit that on a longer-term investment horizon the probability of positive returns has improved.

Global Macro Monthly – US

David Page
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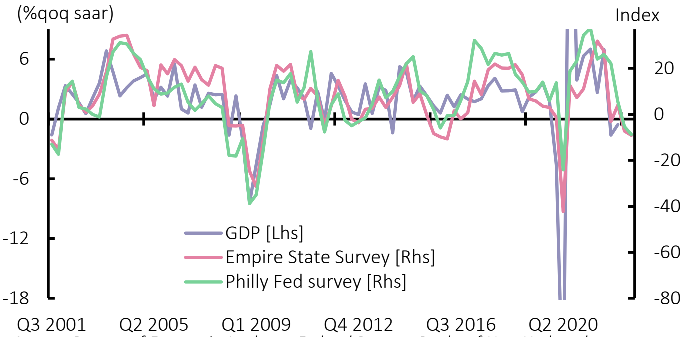
Fed forced to continue tightening

Another month has delivered yet another upside surprise to core inflation. September's annual rate rose to 6.6% – a new 40-year high – from 6.3% in August, as shelter, food, apparel, parts, medical costs and education all added to the monthly rise. Meanwhile, headline inflation eased to 8.2% from its 9.1% June peak on weaker oil prices. The minutes from September's Federal Reserve (Fed) meeting revealed that participants believed "inflation remained unacceptably high… and was declining more slowly than they had previously been anticipating". These developments were sufficient to dissuade us that the Fed would temper its pace of tightening as early as November. We have adjusted our view to forecast a 0.75% hike in November from 0.50% before (to 4.00%), a 0.50% hike (unchanged) in December. We now consider one further 0.25% hike to a peak of 4.75%, likely at the February meeting.

Exhibit 2: Survey data continue to weaken

US GDP growth and Fed surveys



Source: Bureau of Economic Analysys, Federal Reserve Banks of New York and Philadelphia and AXA IM Research, October 2022

Short-term economic data also suggests a firmer increase in Q3 GDP – we now consider a rise of around 2% annualised, double our previous view, with much of the shift coming from a greater adjustment in net trade – a more erratic item of growth which is also responsible for the contraction of activity in Q1. But falling gasoline prices over Q3 added to the momentum. This will not likely continue in Q4, though stronger momentum questions whether the economy will fall in Q4 – as we had considered, marking the start of a recession – something that could now be delayed until early next year. Accordingly, we adjust our GDP forecast to 1.8% (from 1.5%) for 2022 and to -0.2% (from -0.3%) for 2023 (consensus 1.7% and 0.4%).

We still forecast a mild recession. Survey evidence continues to deteriorate (Exhibit 2), although not yet in recession territory – as does the Conference Board's latest CEO confidence survey, which is at its lowest since the 2008-09 global financial crisis. Our own recession probability model is expected to rise to signal contraction as the Fed continues to deliver short-end rate increases. Moreover, we believe a rise in unemployment beyond the 0.5 percentage point historically consistent with recession will be necessary to deliver the easing in the labour market required to restore price stability.

Ultimately, the key driver of downturn will likely be the Fed's determination to restore price stability, combined with the lagged nature of its data and tools. The Fed has rightly focused on the importance of inflation expectations in times of elevated inflation. Although it recently clarified that it would not keep tightening policy at the current rate until inflation rates show "compelling evidence" of having slowed, we expect the Fed to be watching signs of a turn in the labour market for guidance of when it should relent in the pace of hikes. While this is backward-looking, the tools the Fed tightens with are forward-acting – monetary policy characterised as acting with "long and variable lags". This combination of backward-looking guidance and forward-acting tools creates the scope for over-tightening, particularly as the Fed has already tightened financial conditions in excess of usual practice.

Will midterms have much economic impact?

Midterm elections are upon us, with the vote on 8 November. Incumbent parties tend to fare poorly at midterms and President Joe Biden's low approval ratings make him an unlikely exception. Approvals have risen lately as the Supreme Court's abortion ruling and former President Donald Trump's interventions in key Republican primaries have shifted the odds in some key contests. Republicans look highly likely to gain a majority in the House, but the Senate looks to be tougher. The result will be pivotal for the next big political development, which will be to determine who runs for President in 2024.

Economically though, these elections may have less impact. Democrats are highly unlikely to retain the House *and* increase their majority in the Senate to 52 – to overcome the internal blocks from Governors Joe Manchin and Kyrsten Sinema – that would allow them to reinvigorate their 'Build Back Better' agenda. We will most likely see a divided government, which means political gridlock and no fresh fiscal developments for the next two years. This could be most costly if recession requires activation of discretionary fiscal stabilisers. Further, if the Republicans take both Houses of Congress, the risks of confrontation between Congress and the Executive branch will rise, with greater chances of government shutdowns and the risk of a debt ceiling stand-off.

Global Macro Monthly – Eurozone


François Cabau,
Senior Eurozone Economist
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Hugo Le Damany,
Eurozone Economist
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Rome is all ears to London's havoc

Brothers of Italy and its two right-wing coalition partners had pledged fiscal easing measures worth some 2%-4% of GDP ahead of their win at September's general election. Going hand in hand with the League's disappointing voting score, the recent UK mini-budget experiment, which generated market havoc, appears to have been a lesson that Prime Minister Georgia Meloni has absorbed to implement responsible, gradual policies on the economic front. The nomination of moderate Giancarlo Giorgetti as Finance Minister appears further evidence of this. This provides reassurance for relatively well-behaved long-term Italian government bond (BTP) markets in the weeks to come.

We nonetheless maintain our cautious bias for likely BTP-German Bund spread widening in the months and quarters to come, driven by medium-term public debt sustainability concerns in an environment of low nominal growth and high interest rates and a three-party coalition, which is anything but a coherent and stable grouping.

2023 budgets at risk of slippage

Large Eurozone country governments have presented their draft 2023 budgets, with the exception of Italy whose new government has just been formed. At odds with the unusually very explicit Eurogroup call to avoid generating additional inflation pressures via fiscal support, governments seem rather focused on political economy concerns (including social stability) planning on significant untargeted, permanent demand supporting measures which included caps on gas/electricity prices and fuel tax rebates.

Budgets also seem to have been built on optimistic growth forecasts, which imply downside risks for projected public deficits, especially if temporary measures need to be extended owing to prolonged energy crisis (Exhibit 3). Moreover, heterogenous measures and fiscal space across countries require enhanced coordination at the EU level to ensure a level playing field and avoid fragmentation. However, such coordination is progressing very slowly reflecting disagreement across member states on gas price caps "that would immediately limit episodes of excessive gas prices". A new mutualised facility seems very unlikely at this stage.

Exhibit 3: Optimistic 2023 public deficit forecasts, especially for France and Spain

	Germany	France	Spain
Government's 2023 public deficit forecast (2022), % of GDP	2 (3.25)	5 (5)	3.9 (5.0)
Government's 2023 GDP forecast, %	-0.4 (AXA IM: -1.5)	1.0 (AXA IM: 0.0)	2.1 (AXA IM: 0.6)

Source: Ministries of Finance and AXA IM Research, October 2022

While this new crisis has created incentives for coordination, the lack of progress so far raises further concerns that a lack of targeted response on short-term issues, and the lack of entrenched coordinated medium-term strategies will push the European Central Bank (ECB) further into a hawkish corner.

ECB: Further in its hawkish corner

Over the past month, ECB speeches have continued to come on the hawkish side, even from renowned doves such as Spain Governor Pablo Hernández de Cos (projecting a neutral rate of 2.25%-2.5%). While our call for a 75-basis-point rate hike is uncontentious for the upcoming Governing Council meeting and well-priced into the market, we think the risk is that the ECB's Deposit Facility Rate (DFR) is not only likely to go to 2% earlier than February but could rise even further.

Fiscal policy orientation is likely to bring additional fuel to the fire since the ECB is looking at "further dampening demand". Moreover, risks to the core inflation outlook are increasingly skewed to the upside, notably coming from services. Looking forward, various plans to cap households' energy bills next year would provide some relief for the headline Harmonised Index of Consumer Prices (HICP). However, non-targeted fiscal measures imply upside risks to core inflation – it may take more time than initially projected to decelerate from our baseline landing at 2.5% at end-2023.

Finally, resilient activity and core inflation surprises in the US also implies more than the anticipated hikes by the Federal Reserve, which in turn is likely to push the ECB's DFR higher to avoid further euro depreciation. On quantitative tightening, discussion is likely to continue until year-end, but (modest) action on the Asset Purchase Programme is unlikely before Q2 next year. At its October meeting, the ECB Governing Council is likely to address remuneration of excess reserves, especially those linked to the Targeted Long-Term Refinancing Operations.

AXA Investment Managers

26 October 2022

Global Macro Monthly – UK

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The death of 'Trussonomics'

Liz Truss resigned as Prime Minister after just 45 days in office - the shortest premiership in the country's history. She stepped down as Jeremy Hunt, her new Chancellor, undid almost all of the elements of her and previous Chancellor Kwasi Kwarteng's now infamous fiscal event which triggered weeks of political and market turmoil. Events that followed highlighted a loss of control of the most basic essentials of government and accelerated the inevitable. The party are seeking to appoint a successor rapidly, with the leadership contest set to be concluded by 28 October. Rishi Sunak, Penny Mordaunt and ex-PM Boris Johnson are currently seen as the frontrunners.

Despite the significant political implications of the PM's resignation, the economic impact has been contained by Chancellor Hunt, who has committed to delivering a more economically orthodox approach. His Budget is still expected to take place on 31 October. However, the medium-term outlook will still be determined by Conservative MPs' decision between centrists Sunak/Mordaunt or a return of the populist Johnson, with broader issues around the Northern Ireland Protocol and Brexit still to be addressed. We forecast growth of 4.2% and -0.7% this year and next, with risks to the downside amid fiscal tightening.

Rising prices also remain in the spotlight, with inflation rising back to a 40-year high of 10.1% in September and we expect it to climb further in October on rising energy prices. The shortening of the household energy price cap to six months could see inflation much higher in 2023. In our baseline we see inflation averaging 9% over this year and 5.6% in 2023. Currently gas futures suggest that if the regulatory price cap is reinstated energy prices could rise to around £4,000 in April, pushing inflation to 7.9% in 2023, but we suspect that further measures yet to be determined will have an impact here.

We expect a 75-basis point (bp) Bank Rate increase at the Bank of England's (BoE) next Monetary Policy Committee meeting on 3 November, with the tightening of the fiscal stance lessening the need for the BoE to deliver a larger hike. The BoE has confirmed it will commence gilt sales on 1 November, to avoid overlapping with the Budget. It will exclude longer-dated gilts, to reduce the risk that the tightening cuts across its previous intervention, to prevent disorderly moves in the long-dated gilt market.

Global Macro Monthly – Canada

David Page
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Macklem warns "more work to do"

The trade-off between restoring price stability and avoiding recession is coming into sharper relief. The latest Parliamentary Budget Office (PBO) Economic and Fiscal Outlook forecast growth of 3.1% for 2022 and 1.2% for 2023 – avoiding a recession. PBO Officer Yves Giroux suggested that, "assuming that the bank does not overshoot in its tightening,", we should see the "return to a more sustainable growth". The PBO also forecast that interest rates would reach 4.0% by end-2022, followed by a 0.25% cut by end-2023.

Yet inflation is cornering the Bank of Canada (BoC). Headline inflation remained elevated at 6.9% in September, although falling oil prices have led it lower from its 8.1% June peak. Core measures – though off their peak as well – were only a little lower. BoC Governor Tiff Macklem stated there was "more work to do" on rates, with the economy "clearly" still in excess demand, and that ultimately, high inflation was the "immediate" threat. He warned of a "narrow" path to a soft landing. Macklem's words pushed markets to re-price their outlook to 4.25% by year-end and consider a peak near 4.50%.

Falling employment suggested the first signs of an easing labour market. The latest BoC surveys showed a growing number of firms record that, with wage expectations falling to 4.9% over the coming 12 months, from 5.9% 3-months ago, yet the latest report showed employment rise and labour supply weaken. The surveys warned inflation expectations remained elevated – but longer-term measures are returning to pre-pandemic levels.

While we forecast a slower 0.50% hike in October (to 3.75%), we now forecast an additional 0.25% hike (to 4.00%) in December. Given labour supply uncertainty, we see a final hike to a 4.25% peak as a close call by year-end or early next year. This will impact our growth outlook. For now, we continue to forecast growth of 3.3% for this year, and 0.7% for next - narrowly avoiding recession (consensus is 3.2% and 0.8%). However, a higher rate peak would weigh more on our outlook with housing a key transmission mechanism. The National Housing Agency forecast a "modest recession" by year-end, with house prices set to fall 15% by mid-2023. Yet others have suggested the BoC may follow former Governor John Crow's late-1980 example, leading housing into a sharper fall and the economy into recession.

Global Macro Monthly – China

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'Development' remains the priority

The 20th National Congress of the Communist Party of China kicked off on Sunday 16 October. These Party Congresses – which take place once every five years to reshuffle the party leadership, change the constitution and amend the development direction of the nation – are the most consequential events in China's political cycle. This year's congress convenes at a time when China is confronting severe challenges at home and abroad. Investors looked to the Congress for answers to questions on how to exit from the rolling 'Zero-COVID' lockdowns, on the plan to revive the economy in the face of a deflating property bubble, and on management of the US-China relationship to prevent a further escalation of geopolitical tensions.

It may, therefore, be something of a disappointment to some that no specific policies were announced in President Xi's opening remarks. This, however, was not a surprise to us given that the Party Congress – being a high-level political event – has never been a platform for short-term policy deliberation. In contrast, the two-hour-long Political Report from Xi focused on long-term party objectives and development priorities in the coming decades. These long-term development themes will serve as the guiding principles for short-term policies, but to see how the latter will be formulated, we will likely have to wait for details at the Central Economic Work Conference in December and next year's National People's Congress.

Despite limited immediate implications, the Report is still an important document to be deciphered by long-term investors. To that end, it should come as a relief to many that the party leaders still consider economic development to be the top priority in building a modern and prosperous socialist China. In doing so, the Party vowed "unwavering support" to the private economy, continuing to pursue quality opening up, and letting the market play a "decisive role" in resource allocation. The fact that these phrases continued to feature prominently in Xi's speech suggests desire for policy continuity.

Aligned with the 'development first' doctrine was the emphasis on education, technology and human resources as fundamental drivers of China's advancement. After last year's crackdowns on the tutoring and technology sectors, the recognition by party leaders of the importance of these development inputs should be comforting to markets. We see this as supporting our view that the campaign-style crackdowns have broadly ended, and the implementation of existing regulations should be less punitive for markets going forward.

The importance of 'security' was elevated in this year's Report. A rapidly changing global environment has heightened China's security concerns over food, energy, technology, supply chains and national security. Xi emphasised the importance of securing the "rice bowls" in the hands of Chinese people, continuing the fight against climate change, expediting the development of home-grown technology, and building a modern military force capable of defending the country in a changing world.

The discussion over Taiwan attracted attention. On that, Xi said Beijing would devote its "utmost effort" and present "maximum sincerity" to pursue peaceful reunification but would never "commit to renounce the option of using force". The maintenance of this long-held stance – which dates back to former Chairman Mao Zedong's era – gives little indication of Beijing wanting to unilaterally change the status quo of the Taiwan strait.

A few other items are worth highlighting. On property, Xi did not mention "housing is for living, not speculation" (although this was included in the full Report). We do not see this as signalling a policy U-turn, but it does imply that incremental policy easing, which has helped to prevent an even bigger disaster in the housing market, will most likely continue. The Report also discussed the importance of building a multi-layer housing system as a long-term solution to the current predicament, consistent with our view.

The discussion on the Zero-Covid policy was backward-looking. Xi called the Zero-COVID strategy a success in protecting lives, and balancing pandemic prevention and economic growth. This echoed recent articles from the People's Daily – which called for the maintenance of the current strategy – dashing hopes for an imminent policy pivot. Our long-held view is that the name – Dynamic Zero-COVID Policy – is unlikely to change any time soon, but its implementation can be recalibrated further. With receding political uncertainty, there is a chance of a faster 'dynamic adjustment' to the approach after the Party Congress that prepares China for an eventual reopening in 2023.

Our overall impression of the Political Report is that, insofar as long-term goals are concerned, President Xi hit all the right notes of what the market was looking for. However, saying is one thing, and doing is another. Delivering the right speech at the 19th Party Congress in 2017 (covering many of the same development objectives) did not guarantee market-friendly actions over the five years that followed. Turning the right promises into the right actions will depend on many moving parts falling into place. Markets will now turn their attention to how the party puts its ambitious 'development first' blueprint to work, with President Xi at the helm for the third term.

Global Macro Monthly – Japan

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Junior Economist (G7),
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Further slide in the yen adds to speculation of policy change

Japan's accommodative monetary policy stance continues to stand out against the global trend and is contributing to further pressure on the yen. The currency fell to ¥150 against the dollar, its weakest level in 32 years. Shortly after this slide, the yen saw sharp moves the other way, with the yen surging to ¥145.6 against the dollar in the space of minutes, leading market participants to suspect the Finance Ministry once again stepped in to prop up the yen. Year-to-date, the yen has fallen by 23% against the dollar as the divergence between the policy stance of the Bank of Japan (BoJ) and other central banks, such as the Federal Reserve, continues to grow. The recent suspected foreign exchange intervention follows last month's, which the Ministry confirmed had cost ¥2.9tn ($19.7bn), and only temporarily reversed the slide in the yen.

The continued weakness in the yen is adding to speculation that the BoJ could be forced to abandon its current yield curve control (YCC) policy on 10-year Japanese Government Bonds (JGB). Ten-year yields rose 0.5 basis points over the upper limit to 0.255% on 19 October. The renewed pressure on JGBs saw the BoJ commence unscheduled bond purchases to contain the rise. We expect JGBs to continue to come under pressure as differences in monetary stance only widen but we don't expect to see the BoJ change tack.

The weakening currency is also adding to the imported inflation Japan faces, with prices rising by 3% in August. Japan's trade deficit has, however, widened over recent months, posting a ¥2tn deficit in September after hitting a record in August as energy import costs continued to take a large toll. Export gains may start to reverse this trend but slowing global demand could see the deficit high for the coming months.

Ahead of the BoJ's October Meeting, we continue to expect it will leave all monetary instruments unchanged, maintaining its accommodative stance. Recently speaking in parliament, BoJ Governor Haruhiko Kuroda continued to rule out countering the weak yen with a shift in monetary policy. Whilst inflation has moved above target, wage growth and domestically generated inflation remained subdued. The BoJ will want to see more evidence of rising wage growth before it begins tightening its accommodative monetary policy. The meeting will also be accompanied by the Bank's quarterly Outlook Report, with its projections for growth and inflation.

Global Macro Monthly – EM

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Emergency rate hikes versus accelerating rate cuts?

The diversity of the Emerging European region is already considerable. From the open economies in Central Europe including EU members like Poland, Hungary and the Czech Republic, to the world's biggest hydrocarbon producers such as the Russian Federation – and often the region in its widest terms includes Middle East countries as well. Then there are important food producers such as Ukraine, or deep domestic economies such as Turkey. But currently we are seeing incredibly divergent monetary policy paths despite most of the region having to fight high and/or accelerating inflation trends.

The Hungarian central bank delivered a package of measures this month, implementing emergency key interest rate hikes, while leaving the base rate unchanged. This unexpected decision came two weeks after the central bank announced the end of its tightening cycle, likely triggered by the accelerated weakening of the currency that followed. The forint has benefited from one of the largest single-day rallies in recent history following this decision but is still weak when compared to other currencies in the region. It remains to be seen whether these measures will be enough to restore the loss of policy credibility, at a time when the growth outlook looks set to deteriorate significantly and in a context of disagreement with the EU with risks to EU funding. Furthermore, Hungary – and more widely Central Europe – has been experiencing a rise in local demand for hard currency which will likely further exacerbate currency weakness given the current risk aversion.

At the opposite of the monetary policy spectrum, the Turkish central bank (CBT) has accelerated the pace of monetary easing with a 150 basis points (bps) rate cut delivered in October after two consecutive cuts of 100bps in August and September. The bank clearly indicated an additional cut of similar size to follow in November which would bring the policy rate to single-digit territory at 9%, as formulated recently by President Recep Tayyip Erdoğan, and where it is guided to stay thereafter. Policy rates have become meaningless for some time, as foreign exchange (FX) and credit conditions are being handled through the FX-protected Turkish lira deposit scheme, indirect FX sales by the CBT and banking sector regulations. Lower rates are likely to help state banks fund the government's targeted measures, ahead of elections next spring. Meanwhile the lira can at best pursue its slow depreciation, bearing the risk of more brutal adjustments.

Global Macro Monthly – Asia

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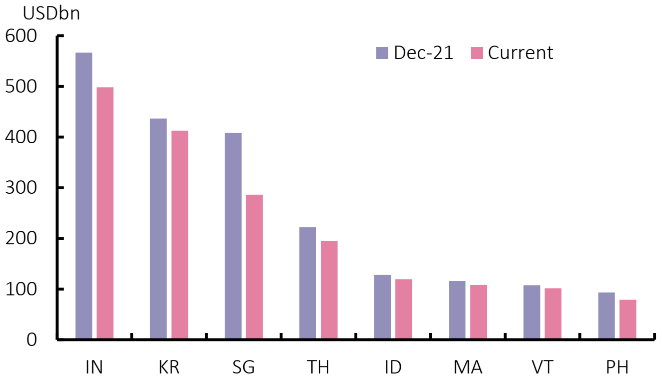
Asian foreign exchange reserves rapidly depleted

Asian economies remained under pressure during October amid external volatility. Foreign exchange (forex) reserves have seen sharp declines as policymakers in the region have attempted to arrest the collapse of currencies. While actual reserve levels still seem relatively healthy – compared to other emerging market economies – the pace of decline has been the most concerning. The last time such a rapid drop occurred was during the 2008 global financial crisis. For the eight major Asian economies (India, Indonesia, Malaysia, Singapore, Philippines, Korea, Thailand and Vietnam) total forex reserves declined over the first eight months of this year to US$1.9tn from US$2.2tn in December 2021 (Exhibit 4) – a 14% contraction.

Exhibit 4: Pace of forex reserve decline is concerning

Asian forex reserves compared to end-2021



Source: CEIC and AXA IM Research, 20 October 2022

A large portion of the reserve depletion is related to valuation and global issuance but the other significant portion is due to ammunition deployed by central banks to fend off currency depreciation pressures. Currencies of major Asian economies in the region have fallen by around 12% in October compared to December 2021. The Korean won has seen the most depreciation by far against the dollar, followed by the Philippine peso, the New Taiwan dollar and the Thai baht.

Looking ahead, the dollar's persistent strength coupled with the Federal Reserve's aggressive tightening stance means Asian central banks will likely remain in the current hiking cycle until at least year-end to ease currency depreciation pressures and would likely intervene further to alleviate financial market volatility concerns.

Global Macro Monthly – LatAm

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Political risks linger despite end to electoral cycle

Following a busy electoral calendar, only one election remains in 2022 but it is a critical one: The presidential runoff in Brazil, scheduled for 30 October. The first round was held on 2 October in which former President Lula da Silva came in first with 48.3% of the vote, against Jair Bolsonaro's 43.2%. Despite Lula's victory, there is a strong sense of disappointment on the left. The results were much narrower than expected and insufficient to win the election outright and avoid a runoff.

Only a few months ago, Lula's victory seemed like a foregone conclusion but Brazil's better-than-expected economic performance and declining inflation gave Bolsonaro a fighting chance. According to local pollster Poder360, Lula still has a four-point lead (48% vs. 44%) ahead of the runoff election. However, Bolsonaro's momentum and the high share of undecided voters (8%) could translate into a victory for the incumbent President. Regardless of the outcome, the next administration will have to deal with a very fragmented Congress, that will likely hinder any attempts at addressing Brazil's stagnant economy and difficult fiscal situation.

Other countries in the region are facing their own share of political noise despite no upcoming elections. In Peru, the ongoing political crisis shows no signs of abating. The attorney general filed a new constitutional complaint accusing President Pedro Castillo of alleged corruption. Congress must now examine the case and vote on whether to suspend him from office. Castillo had already survived two impeachment attempts after the opposition had failed to gather enough votes. However, through this legal route, Congress would only need 66 votes to oust the President instead of 87 (out of 130). As such, it seems increasingly unlikely the President will finish his term.

Meanwhile in Colombia and Chile, the recently elected leaders Gustavo Petro and Gabriel Boric are quickly losing popularity. The Chilean President's approval rating dropped to an all-time of 27%, down from 50% when he took office only seven months ago. The recent rejection of the new constitutional draft was a major blow to the President, who had been a big proponent of the document. In Colombia, the President saw his approval rating fall 10 points to 46% after just two months in office reflecting declining support for his left-leaning agenda. The peso has weakened 19% since Petro won the election in June.

Recommended asset allocation

Asset Allocation	Negative	Neutral	Positive
Key asset classes			
Equities	■		
Bonds			■ ▲
Commodities		■	
Cash		■ ▼	
Equities			
Developed			
Euro area	■		
UK		■	
Switzerland		■	
US		■ ▲	
Japan			■
Emerging & Sectors			
Emerging Markets		■	
Europe Cyclical/Value		■	
Euro Financials		■	
European Auto		■	
US Financials		■	
US Russell 2000		■	
Fixed Income			
Govies			
Euro core			■ ▲
Euro peripheral		■	
UK		■	
US		■	
Inflation			
US		■	
Euro		■	
Credit			
Euro IG		■	
US IG		■	
Euro HY		■	
US HY (short duration)			■ ▲
EM Debt			
EM bonds HC		■	

Legends: Negative | Neutral | Positive — Last change: ▲ Upgrade | ▼ Downgrade

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

Macro forecast summary

Real GDP growth (%)	2021	2022*		2023*	
		AXA IM	Consensus	AXA IM	Consensus
World	6.1	3.1		2.4	
Advanced economies	5.2	2.5		0.1	
US	5.7	1.8	1.7	-0.2	0.5
Euro area	5.4	3.0	2.9	-0.5	0.2
Germany	2.8	1.3	1.4	-1.5	-0.7
France	7.0	2.4	2.5	0.0	0.6
Italy	6.6	3.3	3.3	-0.6	0.3
Spain	5.1	4.7	4.3	0.6	1.6
Japan	1.6	1.5	1.5	1.7	1.5
UK	7.4	4.2	3.4	-0.7	-0.3
Switzerland	3.7	2.3	2.3	0.6	0.8
Canada	4.6	3.3	3.3	0.7	1.2
Emerging economies	6.7	3.6		3.9	
Asia	7.1	4.4		5.1	
China	8.1	3.6	3.3	5.2	5.0
South Korea	4.0	2.3	2.6	2.0	1.7
Rest of EM Asia	6.2	5.6		5.2	
LatAm	6.8	2.8		2.0	
Brazil	4.6	1.5	2.4	1.0	0.9
Mexico	4.8	1.7	2.0	1.3	1.3
EM Europe	6.5	-0.7		-0.2	
Russia	4.7	-6.0		-3.5	
Poland	5.7	4.8	4.1	0.9	1.4
Turkey	11.0	5.6	4.8	1.5	2.2
Other EMs	5.4	4.2		3.7	

Source: Datastream, IMF and AXA IM Macro Research – As of 25 October 2022

CPI Inflation (%)	2021	2022*		2023*	
		AXA IM	Consensus	AXA IM	Consensus
Advanced economies	3.2	7.2		4.7	
US	4.7	8.2	8.0	5.2	3.8
Euro area	2.6	8.1	8.2	5.5	5.4
China	0.9	2.1	2.3	2.3	2.3
Japan	-0.2	2.3	2.2	1.3	1.4
UK	2.6	9.0	9.2	5.6	7.0
Switzerland	0.6	2.8	2.9	2.0	2.0
Canada	3.4	6.9	6.9	4.3	3.6

Source: Datastream, IMF and AXA IM Macro Research – As of 25 October 2022

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	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		+1.5 (3.00-3.25)	+1.25 (4.25-4.50)	+0.25 (4.50-4.75)	unch (4.50-4.75)
Euro area - ECB	Dates	-0.50	21 July 8 Sep	27 Oct 15 Dec	2 Feb 16 Mar	4 May 15 Jun
	Rates		+1.5 (0.75)	+1.0 (1.75)	0.25 (2.00)	unch (2.00)
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	3 Feb 17 Mar	5 May 16 Jun
	Rates		+1.00 (2.25)	+1.25 (3.50)	+0.75 (4.25)	unch (4.25)

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

These projections are not necessarily reliable indicators of future results

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26 October 2022

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