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24 May 2022
Research & Strategy Insights

Good medicine tastes bitter

Global Macro Monthly

Key points

- Inflation is prevalent across international economies. It appears close to a peak in many economies, but further energy price gains and supply disruptions risk further increases and a slower reversal than previously hoped.
- In many cases, higher inflation is associated with tight labour markets – often tighter than before the pandemic. An easing here is required to restore price stability.
- Yet early signs of slowdown are emerging. China's COVID policy makes it a special case. More generally, interest-rate sensitive sectors like housing, or price sensitive sectors like consumers are starting to soften. But this is not universal and some regions still see solid growth.
- This has created a near universal set of conditions for tighter monetary policy with most central banks tightening or continuing to tighten policy. The BoJ and PBoC are amongst the largest exceptions.
- Yet these are difficult conditions for markets. Central banks desires for now appears geared to yet further tightening of financial conditions.

Global Macro Monthly

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Good medicine **tastes bitter**

Global Macro Monthly Summary May 2022

David Page,
Senior Economist,
Macro Research – Core Investments

Inflation nears peak in many regions

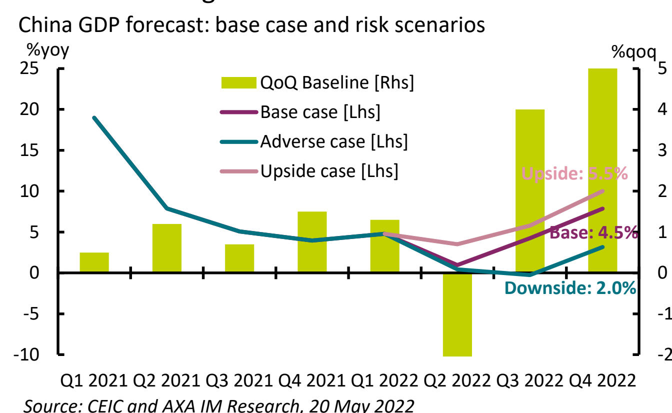
Inflation is a ubiquitous worldwide concern. While we are hopeful it has peaked in the US and UK, and is close to it in the Eurozone, Canada and many Latin America economies, risks still abound. Energy prices have surged since the start of the Ukraine war, but we had feared worse. Over the coming months, gas supply interruptions related to payments for Russian gas and a strong China rebound in the second half of 2022 could add to energy price pressures. Longer term, gas prices could rise further when we head into winter. Meanwhile, China's latest COVID-19 difficulties are likely to add to further supply disruption, something that will slow the pace of inflation retrenchment this year. In most regions we have revised our inflation forecasts modestly higher.

While global supply conditions have delivered the greater part of the international inflation surge, countries with tight domestic labour markets are some of those most worried by the prospect of shifting inflation expectations. Several now see unemployment close to, or below, pre-pandemic levels. Yet in the post-COVID-19 world, many economies are undergoing structural realignments, which has likely lifted their natural rates of unemployment. That being the case, labour markets globally are even tighter than a simple comparison of pre-and post-pandemic joblessness would suggest. This is consistent with the higher vacancy rates and elevated wage growth prevalent in many economies.

Amidst this inflation angst, there are signs of slowdown in several economies. The case of China is quite specific and our May Monthly Investment Strategy goes into some detail about the repercussions of managing China's Zero-Covid policy and its growth implications. We forecast a below-consensus 4.5% this year, but recognise risks skewed to the downside to our outlook (Exhibit 1). Developed economies that have tightened policy rates are beginning to see tentative signs of reaction, interest rate-sensitive housing is weakening in the US and Canada, while the UK posted a GDP contraction in March. Yet these signs remain tentative and are not shared globally – indeed we are hard-pressed to identify any signs of deceleration in Central and Eastern Europe, so far at least.

This backdrop creates a near universal set of conditions for tighter monetary policy. The Federal Reserve, the European Central Bank, the Bank of England and Bank of Canada, and central banks in Latin America, Asia and Central and Eastern Europe (CEE) are all likely to tighten policy, in most cases further, over the coming months. Only in the CEE is this running into some political opposition. In several cases, and certainly across Europe, tighter monetary policy is being made more likely as governments use public spending to cushion some of the energy income shock to domestic households. It is a testimony to current market conditions that some have even considered that the Bank of Japan could tighten policy – although Governor Kuroda has been swift to dismiss this. Only the People's Bank of China is likely to ease policy as part of a broader stimulus package to ease pressure on the weakening economy – and even it is cautious about the implications for the yuan.

Exhibit 1: China growth risks skewed to downside



Source: CEIC and AXA IM Research, 20 May 2022

But this is not a conducive environment for financial markets. Many regions require tighter financial conditions to slow growth and ease labour market pressures. An outlook of slower growth, high inflation and tighter policy is challenging for risk assets. Financial conditions have tightened a lot already – consistent with weaker equity markets and wider spreads. Yet for now central banks appear to be driving those conditions tighter still. As and when this has the desired impact of slowing activity, monetary authorities will likely ease up. But for now, this appear to be some way away.

Global Macro Monthly – US

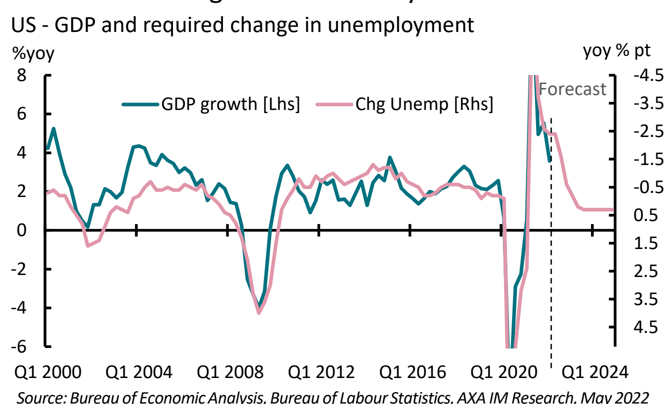
David Page,
Head of Macroeconomic Research,
Macro Research – Core Investments

The narrow runway for a "softish" landing

Federal Reserve Chair Powell has just been confirmed for a second term in office; by the end of this term, he may wish he hadn't been. Inflation dipped to 8.3% in April, down from March's 8.5% and underlining our expectation that 8.5% will be the peak of the inflation cycle. However, with energy price uncertainty persisting, we move our annual average forecast higher to 7.6% (from 7.0%) and still expect inflation to be around 6% by year-end.

Inflation is too high for the Fed, the American people and the President. At May's meeting of the rate-setting Federal Open Market Committee, Powell made direct representation to the US public, explaining that the Fed would restore price stability. To that end, the Fed announced a 50bp rate hike (the first since May 2001) and the start of quantitative tightening (QT) in June – both of which we had expected – and added that two further 50bp hikes in June and July were currently being considered. This was a faster tightening than we had expected and we raise our end-year Fed Funds Rate (FFR) target to 2.75% from 2.50%.

Exhibit 2: Slower growth necessary to ease inflation



Source: Bureau of Economic Analysis, Bureau of Labour Statistics, AXA IM Research, May 2022

To restore price stability, beyond concerns about Ukraine-war-disrupted energy markets and supply chain issues in COVID-19-hit China, the Fed will have to address the labour market, which Powell described as too tight. Indeed, unemployment fell to 3.6% in April – just above the pre-pandemic low of 3.5%. However, with some degree of structural post-pandemic realignment in the US economy, it is likely that the natural rate of unemployment has risen, meaning that the current rate of unemployment signifies an even tighter labour market. This would be consistent with record levels of vacancies – two-thirds more than the 2016-19 average – and elevated wage gains: The Q1 employment cost index rose at its fastest in over 30 years.

A slower labour market would require a slower economy (Exhibit 2) and the Fed's quicker policy tightening has generated a tightening in financial conditions that should deliver this. The challenge is to deliver enough deceleration to quell inflation pressures, without tipping the economy into a long recession. This is not an easy balance and the Fed's track record over the decades points to more recessions than soft landings. Powell has stated that he sees a "good chance" of a "soft-ish" landing, but added that restoring price stability was likely to "include some pain". Markets discuss a "growth recession" – a slowdown that causes a rise in unemployment but maintains positive expansion.

Financial markets have begun to consider the prospect of recession, something that has contributed to the sharp tightening in financial conditions since the end of March. Indeed, recent tightening has left conditions close to the point that has historically caused the Fed to reduce that pressure. Partly this has reflected market expectations that the FFR would rise to 3.25% or higher next year, although expectations have retreated to 2.75% for this year with one, perhaps two, more hikes priced for next.

Consensus forecasts still consider growth of 2.7% this year and 2.1% next. After an earlier-than-expected drop in quarterly growth in Q1, we lower our growth outlook to 2.5% for this year and 1.4% for next (from 2.8% and 1.6%). This should be below the US' potential rate and consistent with a gentle rise in unemployment. In turn, this should be consistent with an easing in inflation pressures, although how quickly inflation falls will also be a product of external developments and how inflation expectations evolve domestically. It is not clear to us how growth at consensus rates will alleviate labour market tightness.

The difficulty for the Fed will be in achieving such precision. This has not been regularly achieved in "normal" times. There are also additional structural uncertainties, including pent-up labour demand to support employment even as economic activity softens, excess savings that should cushion spending despite the income squeeze, and the impact that the balance sheet adjustment (QT) will have on markets. These factors add further difficulties into the assessment of the scale of monetary policy tightening required to achieve such a carefully calibrated slowdown. Amidst uncertainty, the Fed has a choice: To err on the side of too little slowing and persistent inflation; or too much slowing and a tipping point to recession. For now, the Fed appears skewed to the latter, resulting in financial market caution. However, if signs of labour market and price growth deceleration emerge as we expect in the second half of this year, the Fed should first slow and then pause its pace of rate hikes by year-end, pulling up short of recession.

Global Macro Monthly – Eurozone

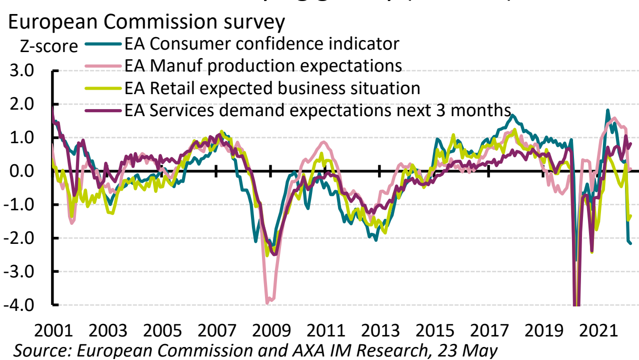
François Cabau and Hugo Le Damany,
Economists,
Macro Research – Core Investments

Downbeat activity narrative to dominate

Eurozone GDP grew by 0.3%qoq in Q1, the same pace as in Q4. The data was affected by measures to suppress the Omicron wave and to a lesser extent by the initial consequences from the Ukraine conflict, both evident in a large drop in private consumption in France and Spain.

We keep our below-consensus GDP forecast at 2.1% and 1.2% for this year and next. Good momentum in services (Exhibit 3), supported by the reopening of contact-intensive activities, suggests, material upside risks to our projected dip in Q2. This would more than offset a sharp drop in retail and industrial confidence – the latter affected by a marked fall in China activity creating demand and supply-side concerns. We think that such support to growth is likely to be short-lived and is unlikely to offset a record real income squeeze, high economic uncertainty and tightening financing conditions globally. All in all, risks of an activity contraction in H2 22 remain material, supporting our unchanged narrative. Macro uncertainty remains very high with a number of large shocks occurring simultaneously, including on supply chains.

Exhibit 3: Services defying gravity (for now)



Source: European Commission and AXA IM Research, 23 May

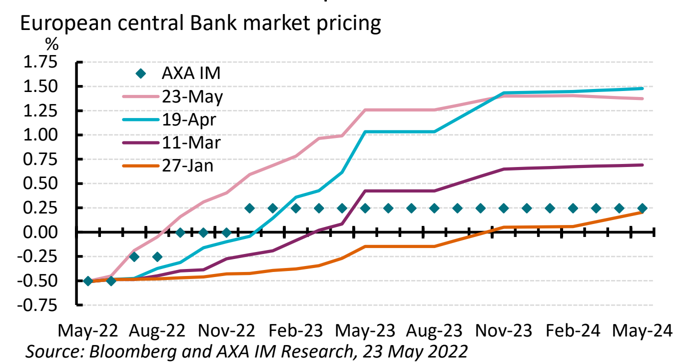
We have updated our inflation forecasts for this year and next to 6.6% and 2.4% (from 6.1% and 2.1%), considering the recent rebound in oil prices, pass-through to food prices as well as the extension of pump price rebates in Italy and capped gas prices for electricity production in Spain.

ECB: Hike to zero in 2022 and pause

Continued upside inflation surprises (mainly on core and expectations) and resilience in the economy (services) has seen ECB Governing Council members turn increasingly hawkish since the April meeting, seemingly finding an early consensus for a July rate lift-off. We have reflected this by bringing forward our expected two rate hikes of 25 basis points (bps) to July and September (from December and March). We think the apparent haste is in response to a window of opportunity to remove unconventional policy accommodation, amidst inflation edging down to 2% from above in the medium term. We maintain that our subdued, below consensus, growth outlook is likely to generate a pause of ECB rate hikes after reaching zero on the deposit rate. We therefore push back against markets' expectations for a spate of hikes – 4 in 2022 and 3 in 2023 (Exhibit 4).

Dealing with financial fragmentation is likely to remain challenging for the ECB Governing Council. We continue to think it will act reactively rather than proactively. Decisions are likely to be guided by three elements: The level of sovereign spreads/tightened financing conditions; the pace of deterioration/volatility; and the cause of market pressure. While more details are unlikely before the summer, we think that 2023 budget discussions in September/October, as well as preparations for Italy's general elections next spring, may generate additional market pressures, bringing the ECB closer to clarifying its thinking.

Exhibit 4: ECB to hike and pause



Source: Bloomberg and AXA IM Research, 23 May 2022

All round political tensions

Uncertainty remains ahead of French Parliament elections[1] (12-19 June), all the more so after an evolution in the political landscape that has more or less united the left (socialists, greens, communists, radicals) behind Jean-Luc Mélenchon. Polls point towards President Emmanuel Macron's party maintaining an absolute majority in the lower house.

Energy and defence topics will likely be more politically charged ahead of the 30-31 May EU Heads of States meeting. Several countries have been pushing back on oil sanctions against Russia, threatening the EU unity seen to date. Sweden and Finland formally applying to join NATO may broaden tensions with Russia and could escalate (economic) retaliation beyond Finland's electricity supply cut on 14 May.

[1] Cabau, F. and Le Damany, H., "French elections: Wait until Summer", AXA IM Research Insights, 5 April 2022

Global Macro Monthly – UK

Modupe Adegbembo,
Junior Economist,
Macro Research – Core Investments

Rising inflation puts the BoE in spotlight

The UK government criticised the Bank of England (BoE) for not preventing price rises after inflation hit a 40-year high of 9% in May. Markets had expected a 9.1% increase, but the downside surprise mattered little as inflation inched towards double digits. Rises in energy prices due to the upward adjustment of the industry regulators price cap accounted for the bulk of the increase, with other service sectors also contributing. As a result, we have raised our inflation outlook to 7.6% for 2022 and 3.6% for 2023, up from 7.3% and 3.5%, respectively (versus a consensus of 7.6% and 3.9%).

Recent GDP data has provided some tentative signs of activity slowing as the economy unexpectedly contracted by 0.1% in March. GDP growth may fall into negative territory in Q2 with a weak consumption backdrop and the additional June bank holiday shifting activity into Q3. We expect GDP growth of 3.8% for 2022 but raise our 2023 outlook to 0.9% from 0.6% (versus a consensus of 3.8% and 1.4%).

The labour market has continued to tighten and business hiring intentions remain strong. Unemployment in the three months to March fell to 3.7% – a 50-year low – and for the first time since records began there are fewer unemployed than there are vacancies in the economy. This is partly due to a smaller workforce than before the pandemic, and a return of some of those who have exited the workforce would be vital to easing pressure in the labour market.

Following May's Monetary Policy Committee meeting and Monetary Policy Report, markets repriced their rate expectations as the BoE signalled the economy was close to recession under market rates. However, recent strong labour market data and high headline inflation have seen much of this anticipated tightening return. We expect fewer hikes than the market; we believe the BoE will hike in June and August, bringing interest rates to 1.5%, short of the 2% by year-end expected by markets.

Amidst the uncertain economic outlook, political developments around Brexit remain at the forefront. The UK government has announced a bill which will be introduced to overturn areas of the Northern Ireland (NI) protocol after the Democratic Unionist Party (DUP) blocked the formation of a power-sharing executive. The legislation is most likely a negotiating tactic with the EU and an attempt to placate the DUP. However, the risk remains that the UK government will enact the legislation, potentially triggering a trade war with the EU.

Global Macro Monthly – Japan

Hugo Le Damany,
Economist,
Macro Research – Core Investments

COVID-19 scars are slowly healing

Preliminary estimates saw Q1 GDP contract after suffering from COVID-19 restrictions at the start of the year but surprised on the upside to fall by 'only' -0.2% quarter-on-quarter (qoq). Private consumption was flat qoq, more robust than anticipated, helped by booming services spending in March. Private fixed investment rose by 0.5%, a bit weaker than expected, while exports rose but remain constrained by bottlenecks. Despite some resilient data, Japan is going to be exposed to China's weakness and pressure on purchasing power over the coming quarters.

Tokyo's headline Consumer Price Index rose by 2.5% year-on-year (yoy) in April, boosted by another rise in energy and food prices. Nationwide prices should mimic Tokyo's index and reach 2.5%– the first time they have exceeded the Bank of Japan's (BoJ) inflation target since 2015. We believe that volatile components will build up some pressure on core inflation and could reach 1% in the summer (without considering the possibility of the "Go to" campaign restarting). For the time being, we do not believe that inflation will derail private consumption, as Japanese households hold excess savings of about 4% of GDP while the government has just agreed on a supplementary budget to be submitted to the Diet ($21bn, or 0.5% of GDP). It will include one-off ¥50,000 ($380) cash pay-outs per child for low-income families and subsidies to fuel wholesalers.

All this considered, there is a tiny upside risk to our Japanese GDP forecast of 1.8% for this year. However, our GDP profile remains unchanged with an acceleration phase in Q2, led by the service sector, and growth still above trend in Q3.

The Bank of Japan remains firm

BoJ Governor Kuroda reiterated the central bank's dovish stance, stating: "Easy policy needs to be maintained to boost the medium- to long-term inflation expectations and support economic activity, and tighten the labour market to cause wage hikes that would boost tolerance of higher prices". BoJ Executive Director Shinichi Uchida added there was no plan to widen the target tolerance band, as such action would be "tantamount to an interest rate hike". Kuroda also acknowledged that rapid yen depreciation is undesirable, but the BoJ was not targeting any yen level. For one month, the dollar/yen pair has stabilised around 130, probably reflecting some uncertainties around whether the US Federal Reserve can deliver what is priced into markets.

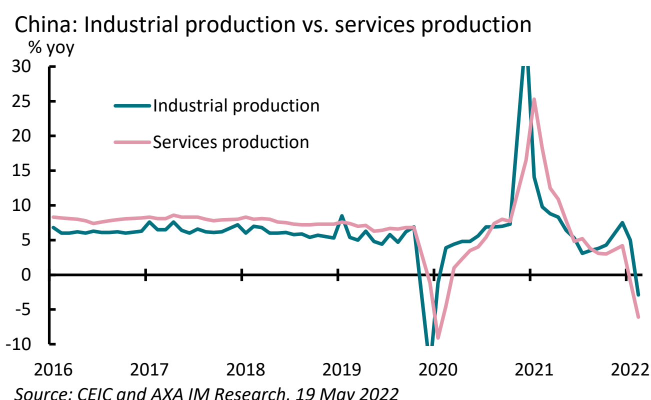
Global Macro Monthly – China

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

COVID-19 containment takes a heavy toll

April data revealed the paralysing effect of the strict COVID-19 restrictions imposed on the economy as China battled the worst outbreak of the virus since the onset of the pandemic. All activity metrics nosedived as Shanghai went into a full lockdown, sending ripple effects across the neighbouring provinces, which together account for the bulk of the nation's manufacturing, logistics and supply chain ecosystem. From production to demand, and logistics to credit disbursement, the economy was under severe pressure to a degree not seen since Q1 2020 (Exhibit 5). Benchmarking the current shock against the initial COVID-19 wave, we estimate the growth decline is currently around 30% of the early 2020 impact, consistent with our below-consensus Q2 GDP forecast of -3.0% quarter-on-quarter.

Exhibit 5: Omicron flare-up causes a double dip



Source: CEIC and AXA IM Research, 19 May 2022

The COVID-19-induced lockdown brought widespread pain to the economy. On the demand side, consumption weakened sharply in April, with retail sales falling for the second consecutive month, by 11.1% year-on-year (yoy). Spending on services – restaurants and catering – was hit particularly hard by tighter restrictions that limited eating out and disruptions to the delivery system curtailing online orders. Falling sales of large-ticket items – such as appliances and furniture – were exacerbated by collapsing house turnover, while plunging auto sales (-32%yoy) were also in part due to supply chain disruptions impeding product delivery. All weakness can be traced, one way or another, to the strict implementation of the 'Zero Covid' policy.

Besides the COVID-19 impact, the worsening labour market has also contributed to the consumption woes. We think Beijing will likely take particular note of the continuous climb of the unemployment rate to 6.1% – only a touch below the record high of 6.2% in February 2020. Worsening job market conditions could be a source of both economic malaise and social discontent and add urgency for Beijing to step up its policy response to stabilise the economy.

The supply side did not fare any better. Rapidly falling demand, together with production halts, saw industrial output growth contract 7.1% month-on-month and 2.9%yoy. Production of autos, electronics and other high-end manufacturing products weakened as the production base in the Yangtze River Delta region was struck by the virus flare-up. Although operations have gradually resumed in Shanghai under closed-loop management, the actual production capacity of firms remains significantly below normal levels. This will likely keep a lid on the sequential growth recovery in May.

The investment picture grew bleaker too. Real estate activity remained in deep contraction, despite policy easing at local levels and falling mortgage borrowing costs. What is concerning is that manufacturing investment also started to weaken, due to deteriorating business confidence and softer external demand.

But the biggest surprise was the deceleration in infrastructure investment growth. This was despite Beijing pledging an 'all-out' effort to support activity and local governments expediting special bond sales. We think April was likely a temporary setback. Given that infrastructure investment has become one of the few areas which policy easing can still reach while many other transmission channels are impaired by COVID-19 lockdowns, Beijing has to rely on it to get its stimulus into the real economy. We see a rebound in investment growth as likely in the coming months.

Overall, April data confirmed that COVID-19 has well and truly taken centre stage as the dominant driver of the economy. So much so that one cannot form a credible growth outlook on the Chinese economy without first having a view on how the virus situation – and Beijing's response to it – will evolve. Our base case assumes that the authorities will gradually move away from an excessive reliance on lockdowns to a set of less draconian policies – involving targeted containment, production bubbles, rapid testing, and vaccination – even though the overall name of the strategy, 'Dynamic Zero Covid', will stay the same. There are some signs that such a policy recalibration is already underway, in Shanghai (under closed-loop operation) and Beijing (with rapid testing and targeted containment). These are moves in the right direction, but much more is needed to refine the approach to make it compatible with a growing economy.

While April data is in line with our Q2 GDP forecast, we see, on balance, downside risks to our assumed growth recovery in the second half of the year.

Global Macro Monthly – Canada

David Page,
Head of Macro Research,
Core Investments

BoC to work harder, but some impact visible

Recent releases show Canada continues to expand briskly, with inflation overheating, adding further pressure onto the Bank of Canada (BoC) to tighten policy quickly. GDP surged in February (up 1.1% on the month) and the preliminary estimate for Q1 is a strong 1.4%, more than our forecast and leading us to raise our 2022 growth outlook to 3.9% (from 3.3%, consensus 4.1%). Unemployment dropped to a record low of 5.2% – with records dating back to the 1970s. Annual inflation rose to 6.8% in April – its highest since January 1991 – and core to 4.2%, its steepest since 1990, driven by food and shelter costs. Despite some signs of supply pressures easing with a surge in March imports, global tensions look set to keep inflation elevated over the rest of 2022 and we have edged our inflation forecast higher to 6.2% (from 5.9%) this year and 3.4% (3.2%) for 2023 (consensus 5.6% and 2.6%).

Given the backdrop, pressure has mounted for the BoC to tighten further. New Conservative Party leader Pierre Poilievre criticised the BoC, suggesting he would replace Governor Macklem. Macklem admitted the Bank had misjudged the potential strength of inflation and he would act “as forcefully as needed” to restore price stability. This likely paves the way for another 0.50% rate hike at the BoC’s next meeting in June, taking rates to 1.50%.

With inflation set to remain high, we now think the BoC will continue to front-load rate hikes. We expect a further 0.50% rise in July, before slowing to 0.25% hikes for the rest of 2022. On balance, we have raised our year-end forecast to 2.75% (from 2.50%). This is short of the 3.00% market outlook and we consider this to be the peak in the rate cycle, where markets consider a further increase next year.

The top will depend on the tightness of domestic conditions. April’s unemployment dip owed more to stagnant labour supply than jobs growth; employment rose by just 15k, the smallest in a year – barring January’s COVID-19-related fall – but it also appeared to reflect rising cases in April. However, interest rate-sensitive sectors of the economy are reacting – housing sales fell by 12.5% in April, albeit from elevated levels. Housing is estimated to have accounted for 20% of GDP growth last year and residential investment now accounts for 10% of GDP, exceeding business investment. A slowdown in this market will weigh on broader activity and explain BoC communication that it will likely pause when policy is returned to neutral – estimated between 2% and 3%).

Global Macro Monthly – EM

Irina Topa-Serry,
Senior Economist (Emerging Markets),
Macro Research – Core Investments

Stronger inflation, policy issues?

Central and Eastern Europe’s inflation spike is showing no respite. April saw annual rates rising and surprising once again on the upside – reaching 13.8% in Romania, 13.2% in the Czech Republic, 12.4% in Poland and 9.4% in Hungary where food and energy prices are almost capped. Core inflation is accelerating – in double-digit territory in the Czech Republic (12.8%) – and above the headline measure in Hungary (10.3%). April’s figures show broad-based inflationary pressures with double-digit price growth observed in both goods and services. Despite recent policy rates hikes – a cumulative 515 basis points (bps) for Poland, 480bps for Hungary and 550bps for the Czech Republic since lift-off – mounting second-round effects and de-anchoring inflation expectations are increasingly visible. The economic environment of buoyant wage growth and expansionary fiscal policy is keeping consumption robust and there are calls for more decisive monetary tightening throughout the region for higher peak rates.

However, there are several concerns. First, the Polish central bank delivered a smaller-than-expected 75bp rate hike to 5.25% for the policy rate in May, at odds with the government's introduction of a mortgage holiday of one month per quarter in 2022 and 2023, which will reduce the strength of the monetary policy transmission mechanism and its estimated equivalent to a 150bp easing. Hungary’s central bank raised its base rate by 100bps to 5.4%, but the tone has turned more dovish when inflation has started to surprise significantly to the upside again. There is no clear plan to consolidate the budget, especially in the absence of removing energy subsidies; the current account deficit is widening and the relationship with the EU is worsening, leaving little hope to see an unlocking of NextGenerationEU funds this year. Finally, the Czech President recently confirmed the appointment of Aleš Michl, one of the most dovish board members, as the next governor of the Czech National Bank, while criticising its hiking pace. There is a high chance of seeing a more aggressive approach from the current board on rates and currency interventions, ahead of the reshuffle of the board, which may carry its own set of surprises and the start of the Governor’s mandate on 1 July.

Despite those hurdles, we believe inflation will not leave many options for policymakers in the short run, other than to deliver more hikes. We expect policy rates to peak somewhere during Q3 at 8% in Poland and Hungary, and 7.5% in the Czech Republic.

Global Macro Monthly – EM Asia

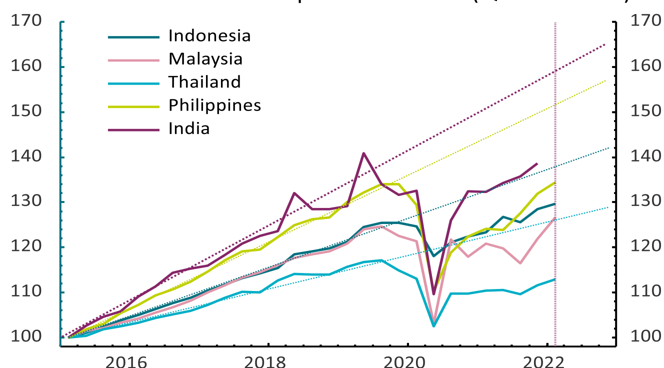
Irina Topa-Serry,
Senior Economist (Emerging Markets),
Macro Research – Core Investments

A stronger than expected start to 2022

Asia's Q1 GDP data has so far come with positive surprises, pushing our annual GDP growth forecasts up, even as we remain wary of a worsening of the global backdrop over the coming months. On a quarter-on-quarter basis, growth was expected to slow from the strong rebound in Q4 (the Delta virus wave hit the region in Q3 2021), but the slowdown proved much more limited than expected: +1% in Indonesia, +1.1% in Thailand, +1.8% in the Philippines and +3.9% in Malaysia. Domestic demand strength was noticeable, with private consumption, investment and imports strongly rising. Thailand remains somewhat in retreat, supported by the external sector, but it should benefit from a better tourism season. Bar any additional COVID-19 wave, there is still pent-up demand in the region as most countries have not yet recouped with the pre-pandemic growth trend (Exhibit 6).

Exhibit 6: GDP growth continues to recover

GDP index in EM Asia and pre-Covid trend (Q4 2015=100)



Source: Refinitiv Datastream and AXA IM Research Q1 22

Asia has lagged Latin America and Central Europe in many aspects – starting with a slower reopening post-COVID-19 which translated into 2021's subdued growth recoveries. The pace of monetary policy normalisation has also been slower in Asia. Inflation pressures were more modest too but there has been a clear sense of acceleration in recent months, above central banks' comfort zones. Policymakers have started reducing their accommodative stances, with India, Malaysia and the Philippines raising rates in May. We expect Indonesia and Thailand to start hiking policy rates in the second half of 2022 by a total of 100 basis points (bps) and 25bps respectively, with risks skewed for more front-loading.

Global Macro Monthly – LatAm

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

Not quite done yet

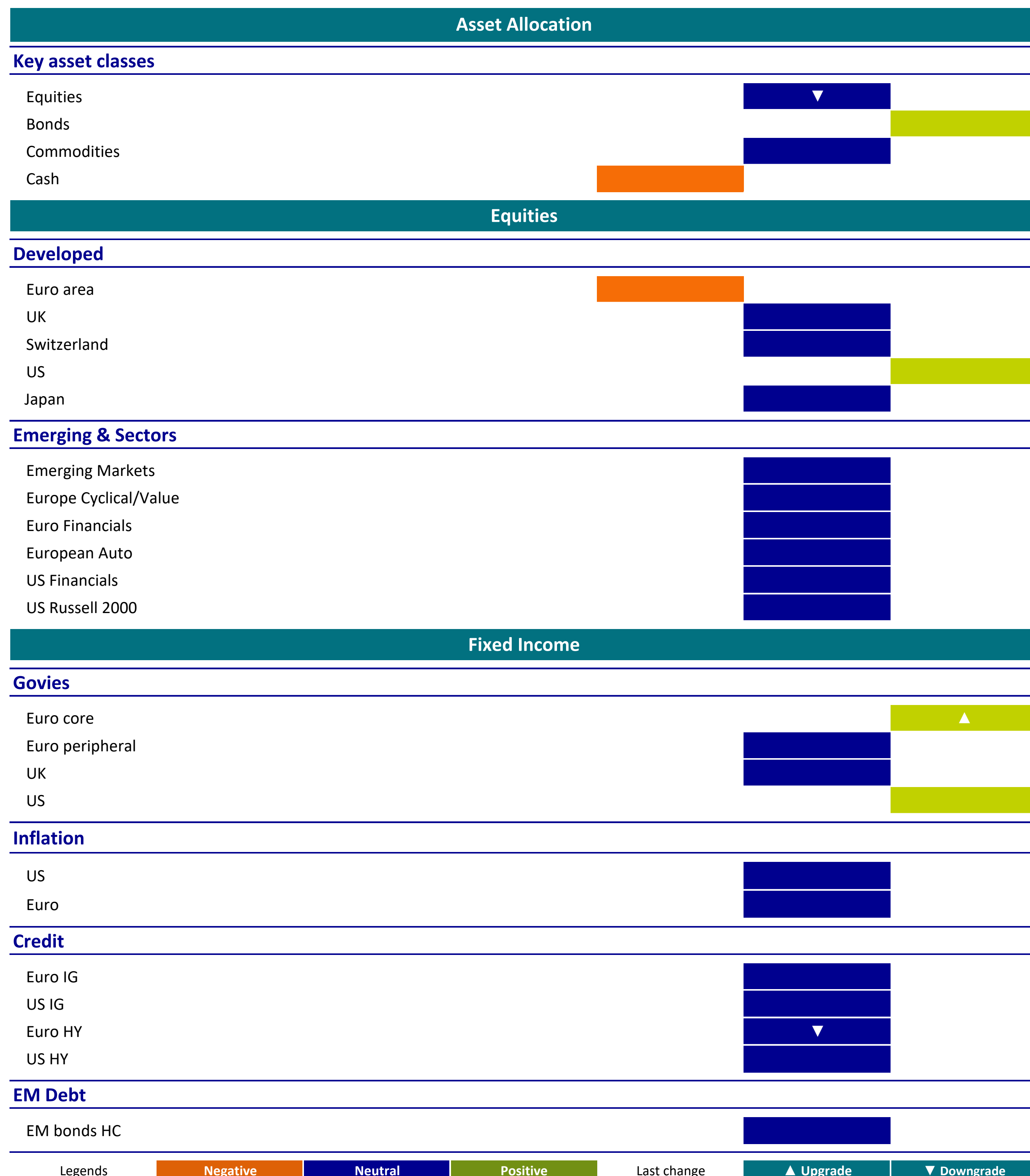
Unabated inflation continues to force Latin American monetary authorities to extend the ongoing tightening cycle. Just in the last month, all major central banks raised interest rates and, in some cases, adopted a more hawkish stance. Fresh energy and food price pressures driven by Russia's invasion of Ukraine have taken inflation to heights not seen since the early 2000s. Average inflation across Brazil, Chile, Colombia, Mexico, and Peru is now running at 9.5% year-on-year. Likewise, average core inflation reached 5% in April, showing that high food and energy prices are already seeping into other goods. However, inflation would be much higher if it were not for tax cuts on gasoline and food prices implemented by the different governments in the region.

Brazil, Chile, and Colombia delivered the largest hikes. In Brazil, the central bank boosted its policy rate by 100bps to 12.75% and warned that it will continue tightening to anchor inflation expectations. Despite already hiking 925bps since it started its cycle, consumer prices in Brazil accelerated to 12.1% in March, the highest among the major economies. In Chile, the central bank made a hawkish pivot in its last meeting, raising rates by 125bps, above market consensus of a 100bp hike, and significantly toughened its language in its policy statement. Unlike its previous meeting, the bank omitted any mention of an end to the cycle and did not offer clues regarding the size of future hikes. Colombia also displayed a more hawkish tone in its last policy decision. The move to lift rates by 100bps to 6% was split in a four-to-three vote, with the minority group calling for a larger 150bp hike.

Peru and Mexico opted for smaller raises, consistent with their comparatively lower inflation rates. Peru continued to use a gradual approach to tame inflation and hiked by 50bps for the ninth consecutive time, thus taking its key rate to 5%. Similarly, Mexico raised rates by 50bps to 7%. While the decision was anticipated by markets, the board adopted a more hawkish tone. One member voted for a 75bp hike, and in its statement, the central bank highlighted that it could take more forceful measures if the outlook deteriorates.

While we still expect tightening in most countries to conclude between June and September, worsening inflation conditions or a more aggressive Federal Reserve could justify a possible extension of the cycle and undermine the region's ongoing recovery.

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		■	
EM Debt			
EM bonds HC		■	

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

Source: AXA IM Macro Research – As of 23 May 2022

Macro forecast summary

Real GDP growth (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	-3.1	6.1		3.2		3.0	
Advanced economies	-5.0	5.1		2.5		1.5	
US	-3.4	5.5	5.6	2.5	3.2	1.4	2.2
Euro area	-6.7	5.4	5.1	2.1	2.8	1.2	2.3
Germany	-4.9	2.8	2.7	1.2	2.2	1.7	2.5
France	-8.0	7.0	6.6	2.7	3.1	1.0	1.8
Italy	-9.0	6.5	6.3	2.3	2.7	0.6	1.9
Spain	-10.8	5.0	4.7	3.5	4.6	1.6	3.3
Japan	-4.9	1.7	1.8	1.8	2.1	2.1	1.8
UK	-10.0	7.2	7.0	3.8	3.9	0.9	1.4
Switzerland	-2.5	3.5	3.5	2.0	2.6	1.3	1.8
Canada	-5.2	4.4	4.6	3.9	3.9	2.3	2.8
Emerging economies	-1.9	6.7		3.6		4.0	
Asia	-0.7	7.1		4.8		5.1	
China	2.2	8.1	8.0	4.5	4.9	5.2	5.1
South Korea	-0.9	4.0	4.0	2.0	2.8	2.0	2.5
Rest of EM Asia	-4.2	6.2		5.5		5.2	
LatAm	-7.0	6.8		2.6		2.6	
Brazil	-3.9	4.6	4.7	0.9	0.6	1.9	1.5
Mexico	-8.2	4.8	5.6	2.4	1.7	2.2	2.2
EM Europe	-2.0	6.5		-0.2		1.0	
Russia	-2.7	4.7		-7.0		-3.0	
Poland	-2.5	5.7	5.3	4.2	3.9	3.3	3.4
Turkey	1.8	11.0	9.9	3.9	2.1	3.4	2.7
Other EMs	-2.5	5.4		3.0		3.0	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 May 2022   * Forecast

CPI Inflation (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	0.7	3.2		6.4		3.0	
US	1.2	4.7	4.6	7.6	7.0	4.0	3.2
Eurozone	0.3	2.6	2.5	6.6	6.5	2.4	2.4
Japan	0.0	-0.2	-0.2	2.2	1.6	1.0	1.0
UK	0.9	2.6	2.5	7.6	7.2	3.5	3.9
Switzerland	-0.7	0.5	0.5	2.0	2.0	1.0	0.9
Canada	0.7	3.4	3.4	6.2	5.2	3.4	2.5

Source: Datastream, IMF and AXA IM Macro Research – As of 23 May 2022   * Forecast

These projections are not necessarily reliable indicators of future results

Forecast summary

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)						
		Current	Q2-22	Q3-22	Q4-22	Q1-23
United States - Fed	Dates	0.75-1.00	3-4 May 14-15 June	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec	Jan Mar
	Rates		+1.00 (1.25-1.50)	+0.75 (2.00-2.25)	+0.5 (2.50-2.75)	unch(2.50-2.75)
Euro area - ECB	Dates	-0.50	14 April 9 June	21 July 8 Sep	27 Oct 15 Dec	Feb Mar
	Rates		unch (-0.50)	+0.5(0.00)	unch (0.00)	unch(0.00)
Japan - BoJ	Dates	-0.10	27-28 April 16-17 June	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec	Jan Mar
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch(-0.10)
UK - BoE	Dates	1.00	5 May 16 June	4 Aug 15 Sep	3 Nov 15 Dec	Feb Mar
	Rates		+0.5 (1.25)	+0.25 (1.50)	unch (1.50)	unch(1.50)

Source: AXA IM Macro Research - As of 23 May 2022

These projections are not necessarily reliable indicators of future results

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