Investment Managers

Investment Institute Macroeconomics

One crazy summer

Monthly Investment Strategy

AXA IM Research

July 2024

Summary: July 2024

Theme of the month: A toolkit for investing in EM

- The US, China (and to a lesser extent Europe) have become strong factors behind the EM growth outlook. The US outlook, pivoting into easier global financial conditions, should boost the EM growth outlook. China's weaker growth outlook is more of a challenge.
- Yet the US (and Europe) have typically boosted EM gross exports, but not so much domestic value-added (DVA) growth, whereas China's activity has been more resource related, which has underpinned DVA. Increasingly intra-EM, ex-China trade, so called South-South trade, has been an increasing factor.
- EMs have engaged in significant institutional reform in recent decades, including free-floating exchange rates, central bank independence and inflation targeting. In the main this has increased their resilience to fluctuating global financial conditions and their attractiveness to long-term investors.
- The confluence of global shocks, the pandemic, Russia's Ukraine invasion and the accompanying global inflation shock have undermined investor confidence and EMs have suffered an unusually long period of portfolio outflows, particularly in debt markets. We are hopeful that the next three years will not be so pernicious.
- But there are always risks. A protectionist US after a possible Trump win would impact trade flows for some (but boost those for others) and tighten global financial conditions. AI risks diverting capital flows, although could bring productivity gains. Climate change is a real challenge for many EMs.

Macro update: Politics dominates central bank easing

- Politics continues to play an outsized role in economies. In the US, politics has moved quickly from June's TV debate: one-failed assassination attempt on Trump and Biden stepping down has changed the face of the US election, we consider Trump as favourite versus assumed nominee-elect Harris. US activity appears to have softened in H1 and inflation slowed again in June. We see the Fed on track to cut rates twice this year, but now consider two cuts next.
- France's election, which generated financial market uncertainty, delivered a result that has avoided the extreme outcomes, but has left the French state without political direction. All while France needs a budget to repair its fiscal shortfall. More broadly, activity remains under pressure with German output weak. The ECB left rates on hold in July, describing its next meeting as "wide open". We continue to suggest two more cuts this year, September/December.
- The UK General Election delivered a Labour government with strong majority, but the weakest public finances since the 1950s. A rebound in GDP growth continues and we raise our full-year outlook, but the labour market continues to soften. We still forecast an August BoE rate cut, but this will be tight.
- China saw its Third Plenum pass without fanfare, swiftly followed by an unexpected PBoC rate easing. Q2 GDP growth was weak. Although full-year growth remains on track to deliver the 5% growth target, the economy is becoming unbalanced with risks of demand-deficiency becoming entrenched.
- Growth also remains weak in Japan, particularly in consumption – although rising real wages should lift this into Q2. Core disinflation appears to have ended, which should underpin cautious rate increases from the Bank of Japan, later this quarter and in Q4.
- Emerging markets continue to see central banks in the main tread carefully. Despite easier inflation in CEE, central banks appear on hold. This is all the more so in Latam, where fiscal issues are seeing some speculation of hikes (we see them on hold), while in EM Asia a pick-up in trade volumes appears narrowly focused on AI-related chip flows.

Central scenario

Summary – Key messages

Our central scenario: Global economy stabilises, disinflation slows.

Global growth expected to slow to 3.2% in 2024 and 3.1% in 2025.

Disinflation slower this year, spreading to core. Monetary policy easing underway. Political risks into year end and for 2025.

Inflation

Headline close to targets in many economies. Core disinflation to broaden this year but stickiness in services; target rates more likely next year.

Monetary policy

Central banks tip into easing restrictive policy, Fed shifts to position for September. Balance sheet policy from ECB and BoJ to come to the fore from mid-year.

Fiscal policy

European rules require fiscal consolidation, elections sharpen focus. EU budget submissions in Sept/Oct. US fiscal doubts now central to the election outlook.

Emerging Markets

Inflation easing slowly across EM. Central bank easing cycle becomes more cautious as strong dollar weighs. Some see fiscal slippage.

FX

Dollar softens into Fed easing, exacerbated by recovering European politics and Japanese intervention. Dollar rebound expected into year-end on election result.

Rates

Term rates drift lower as confidence in Fed easing grows. But doubts grow over longer-term outlook following US election.

Growth

Growth started 2024 on firmer footing in most economies, but likely to settle into softer pace for rest of year. Consumers supported by real disposable income growth.

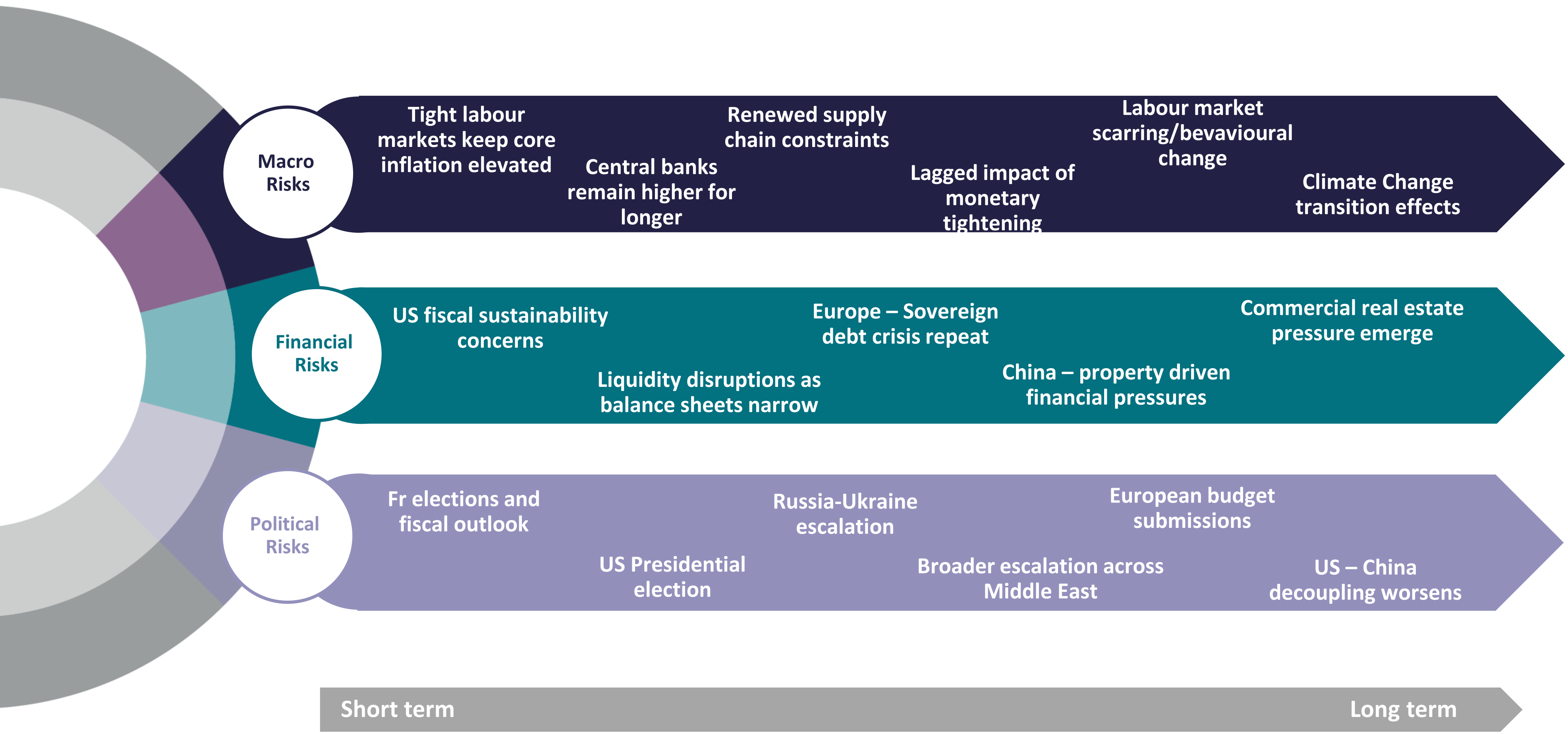
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 20%	A global boost Probability 20%
What could be different?	- Trumponomics: protectionism, migration clampdown - Geopolitical tensions escalate: Ukraine, Middle East and Indo-Pacific - Inflation expectations rise, affecting wages and persistence	- Labour market participation recovers/migration strong, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments, AI impact becomes visible
What it means	- Growth weaker, employment slows, but inflation remains elevated - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	- Growth surprises on the upside in most regions - Inflation fades more quickly towards and below central bank targets - Monetary policy softens quicker than signalled
Market implications	- Risk appetite deteriorates / equities sell off / credit widens - Sovereign yields reprice higher - Dollar remains elevated - EM debt to come under pressure	- Risk-on environment, equities make further gains, growth retains lead over value - UST softens, EUR strengthens - Spreads grind tighter

RISk Radar

Summary – Key messages



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Theme of the Month

A toolkit for investing in EM

External factors: US and China

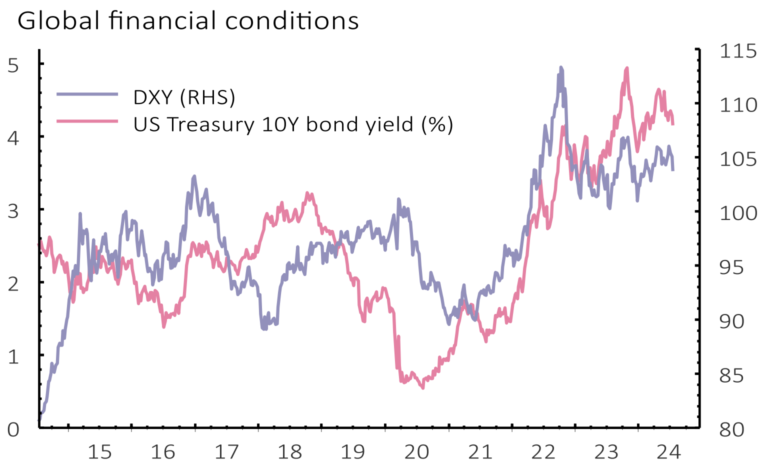
Global financial conditions, particularly US Treasury yields and the US dollar, impact EM

- Financial conditions in advanced economies, and particularly the US, affect capital flows to EMs, particularly countries running current account deficits. There is a risk that net capital inflows decline, or even become net outflows, if the risk-adjusted return on lending to EMs becomes less attractive when yields in advanced economies are high/rising.
- If former President Trump the wins next US Presidential elections, our baseline, we expect upward pressure on US yields and the dollar in the short term. US trade policy will need to be assessed country-by-country as to assess its potential winners and losers.

China's growth model supported EM commodity exporters and Asia's regional development

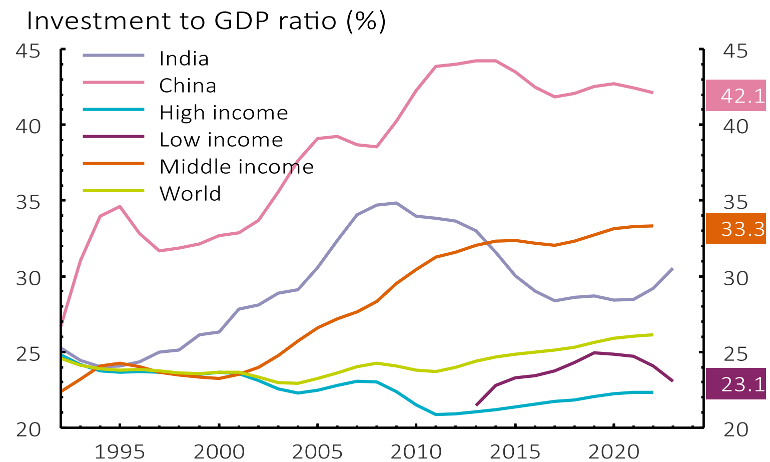
- China's investment/export-driven growth model has shaped the EM landscape over the past decades. It has defined the rapid growth of Asia's region, which has become embedded in its manufacturing supply chains. But it has also supported EM commodity producers given the strong metals-intensity of China's growth. A rebalancing of its economic model towards a more consumer-oriented one would impact commodity producers in EMs in the longer run.

Global financial conditions into US elections



Source: LSEG Datastream and AXA IM Research 18/07/2024

China's investment-led growth model



Source: LSEG Datastream and AXA IM Research 23

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A toolkit for investing in EM

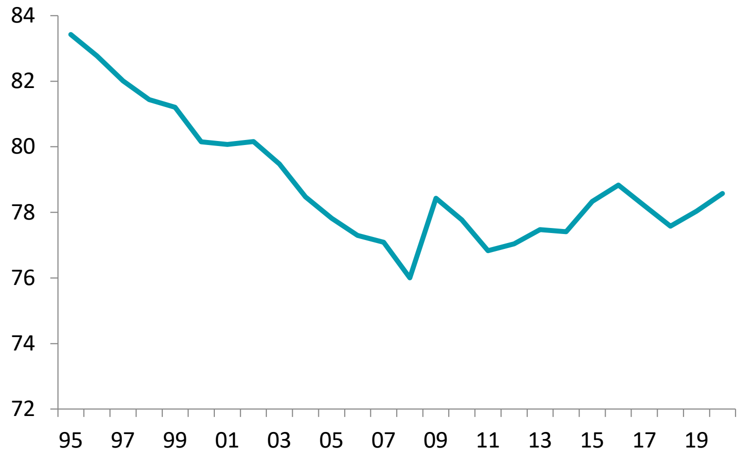
EM domestic factors: exports vs. domestic value added

The rise of China and the South-South trade

- The growth of global value chains has made production more fragmented and trade flows more complicated to measure and trace. Exports data fail to capture the complexities of these modern supply chains and the value added by different countries throughout the production process. We examine domestic value added (DVA) of exports via the OECD's TiVA database. The ratio of DVA to gross exports had been steadily declining until the GFC along increased participation in global value chains.
- Indeed, over the past decades, China has dramatically increased its influence, becoming a primary trade partner for numerous EM countries and is almost as important now as the US. Examining what drives DVA vs exports through two types of regressions across 29 EM countries, we found that China, on average, has a larger impact on DVA growth (primarily importing commodities) while US has a greater effect on export growth (consuming more manufactured products).
- Notably, the EM region itself exerts a larger effect on DVA growth than either China or the US, underscoring the increasing significance of South-South trade.

Increased EM participation in the global value chains

Domestic value added as % of gross exports

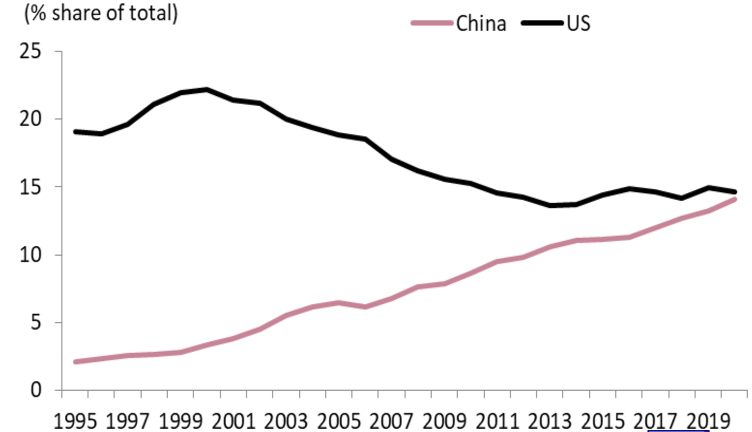


Source: OECD & AXA Investment Managers, July 2024

China's growing relevance

EM domestic value added by destination

(% share of total)



Source: OECD & AXA Investment Managers, July 2024

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A toolkit for investing in EM

Increased EM institutional resilience

EMs have exhibited greater resilience to shifts in global financing conditions during tightening cycles

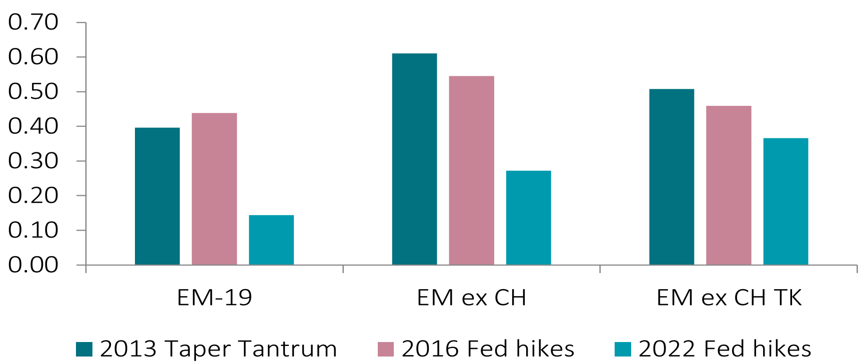
- We find that EM local currency government bonds sensitivity to US 10-year Treasury yield has weakened through the past Fed hikes episodes. Yet, the impact varies across EMs and is shaped by idiosyncratic macro-financial vulnerabilities and monetary policy actions at the national level.

Reduced macro-financial vulnerability in EMs

- EM local bond markets have quadrupled in size since 2010 and doubled in the past seven years to end-2022. This is a result of a process of financial market and capital flows liberalisation, the development of market infrastructure and regulation, and establishing domestic institutional investors with longer lending appetites, such as domestic pension and insurance companies.
- The overall institutional framework has evolved and become more resilient as countries have adopted flexible exchange rate regimes and chosen central bank independence and inflation targeting to anchor inflation expectations, lowering the inflation risk premia and making longer-term borrowing in local currency feasible.

A greater resilience to Fed hikes…

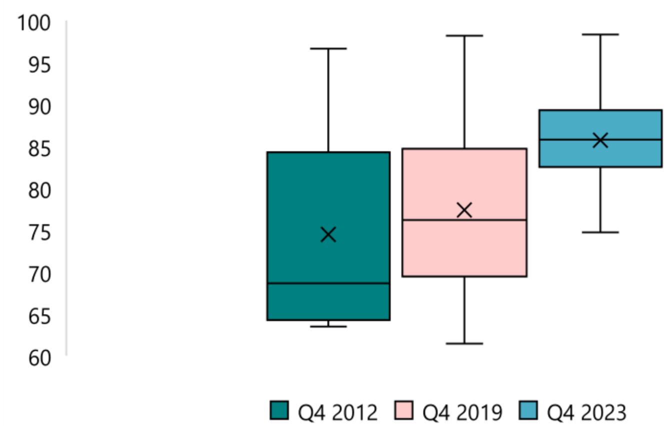
Changes to 10-year Local Currency Gov. bond yield sensitivity to 10-year US Treasury (coefficient)



Source: LSEG Datastream, AXA IM Research, July 2024

… as domestic institutional investors developed

Domestic institutions holding local debt in major EM (%)



Source: IIF, AXA IM Research, Q4 2023
**Brazil, India, Mexico, Indonesia, Malaysia, South Africa, Thailand, Poland; circa 80% of outstanding major local currency government bonds*

A toolkit for investing in EM

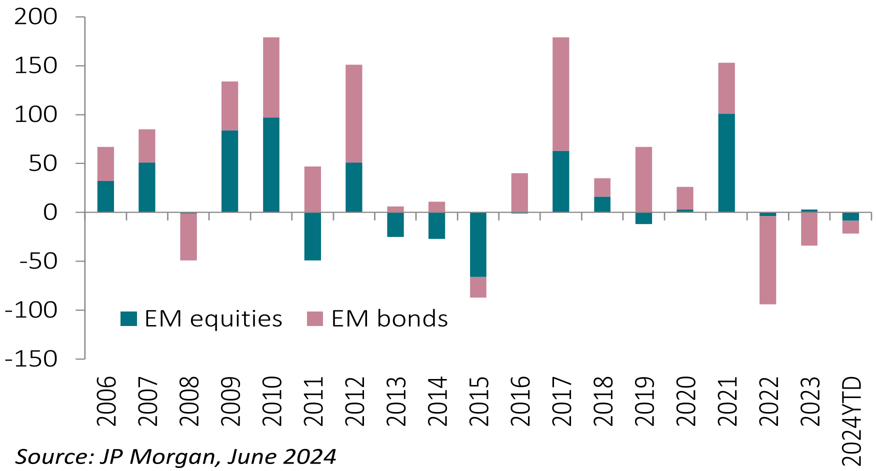
Non-resident outflows

Non-resident investors have shown no appetite for EM assets for three years in a row

- The series of risk-off events since the Covid-19 pandemic has dented investors' confidence in EM. After strong inflows in 2021, minor outflows were recorded in the EM equities space, while strong outflows have continued in fixed-income markets for an unusually long period of time.
- As global central banks have raised interest rates to fight inflation sparked by supply-side shocks, the refinancing ability of indebted emerging markets has been tested. Several low income and highly indebted countries dependent on external financing saw their access to market financing cut; defaults and restructurings followed. These events have been a deterrent, pushing portfolio flows away from EM. Since then, private or multilateral sector support has been provided, but in many cases have included domestic policy shifts and reforms to improve the sovereign fundaments of these countries.
- In a context of higher US interest rates and a strong dollar, investors have seen indeed higher returns with lower risk than before in US financial markets.

Non-resident portfolio outflows for the third year in a row…

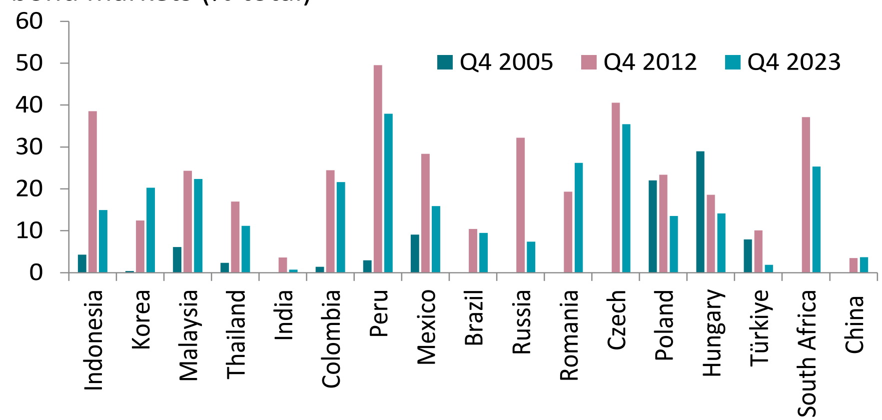
Non-resident portfolio flows (bn US$)



Source: JP Morgan, June 2024

… through reduced participation in EM local sovereign bonds

Foreign participation in local currency government bond markets (% total)



Source: IIF, AXA IM Research, Q4 2023

A toolkit for investing in EM

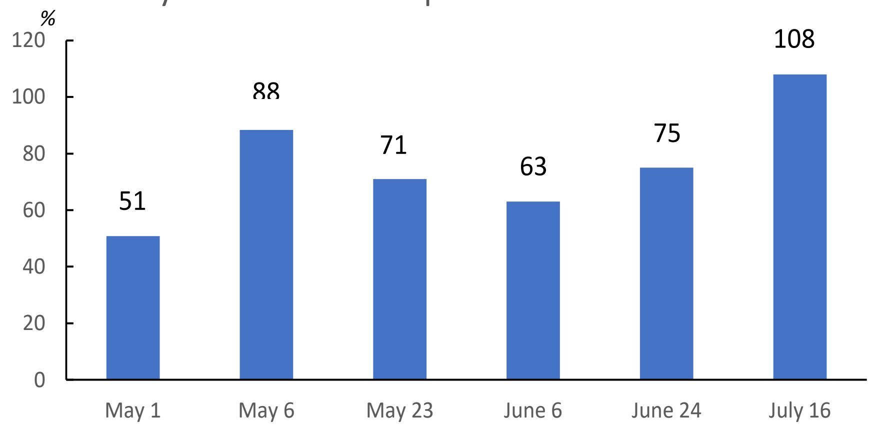
Reasons to consider investing in EM, in the short run

There are reasons to believe that we may be getting closer to an end of these portfolio outflows…

- Events that sparked investor risk aversion, including pandemic and wars have been extreme. It is perhaps not too bold a hope, that the coming years, while uncertain, will not deliver a similar scale of geopolitical concerns.
- Moreover, as the US economy seems to be responding to monetary policy tightening and a rather orderly soft landing appears to be emerging as we speak, allowing the Fed to begin to ease monetary policy restrictiveness, which in turn should ease the pressure from a dollar that remains around historically strong levels. A Trump election remains a threat into 2025.
- More fundamentally, idiosyncratic issues have been mostly addressed of late and EM markets are likely to operate in a more benign environment. As always, vulnerabilities exist and can be mapped, but many of the very problematic situations seem to have been resolved. As an illustration, more than 70% of EM rating actions by global international rating agencies have been in a positive direction this year when including improved outlook changes.

An easing in monetary policy restrictiveness in September

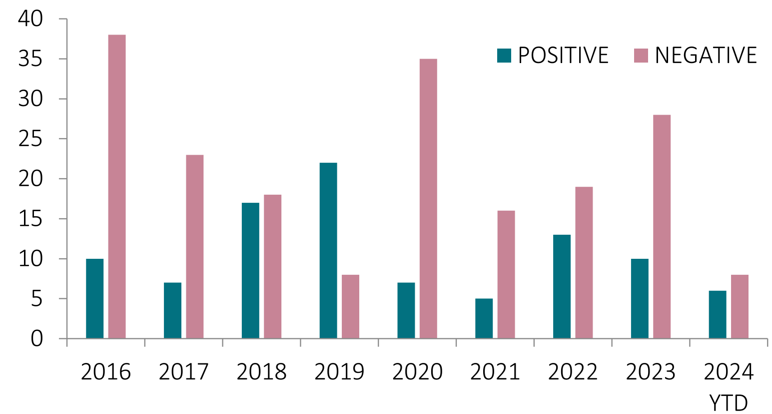
Probability of a Fed cut in September 2024



Source: Bloomberg, AXA IM Research, as of 16 July

EM rating actions

Cumulative rating changes *



Source: Bloomberg, AXA IM Research, July 2024
** 47 countries, 3 rating agencies*

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A toolkit for investing in EM

Reasons to consider investing in EM, in the longer run

Getting exposure to growth

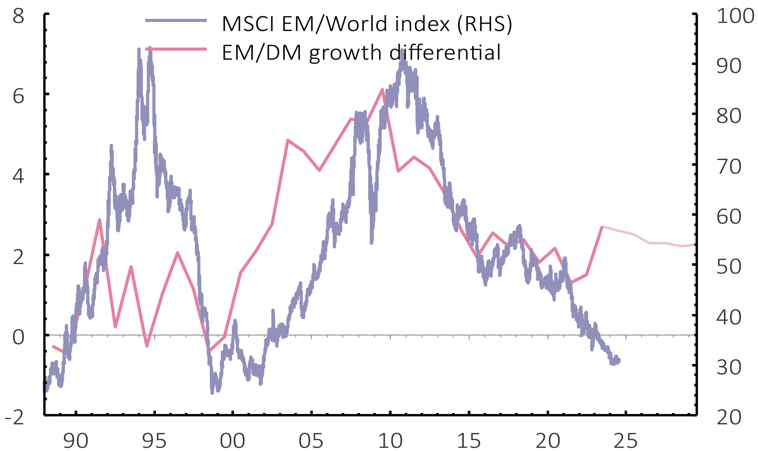
- Getting exposure to emerging markets (EM) allows investors to benefit from their long-term growth advantage. In the more medium term, we forecast GDP growth in emerging markets at 4.2% in 2024 and 2025; this is almost three times that of the developed world, in spite of an expected slowdown of China.

Getting exposure to the new global middle class in EM

- EM demographic edge builds the longer-term structural case for investing in emerging markets. EMs will soon account for 90% of the world's population. Two-thirds of the global middle-class is expected to be living in emerging markets by 2050.

EM/DM GDP growth differential is supportive

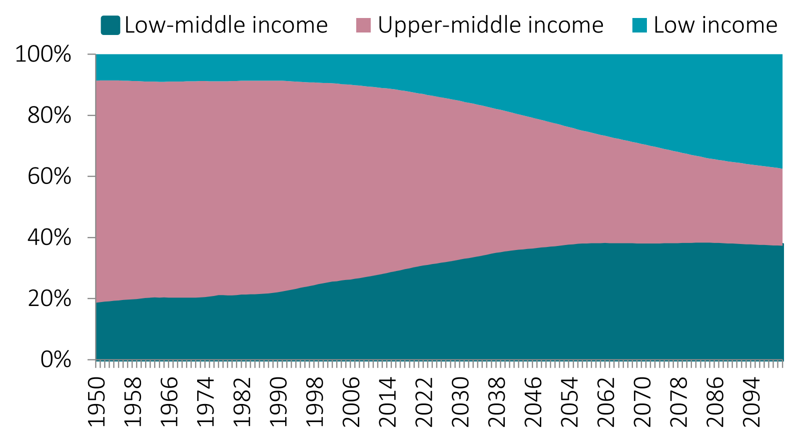
EM/DM relative growth and equity performance



Source: LSEG Datastream and AXA IM Research 17/07/2024

Grasping EM demographic edge

Share of EM's working age population



Source: LSEG, World Bank, AXA IM Research, March 2023

A toolkit for investing in EM

Never plain sailing

US elections: implications of a Trump win

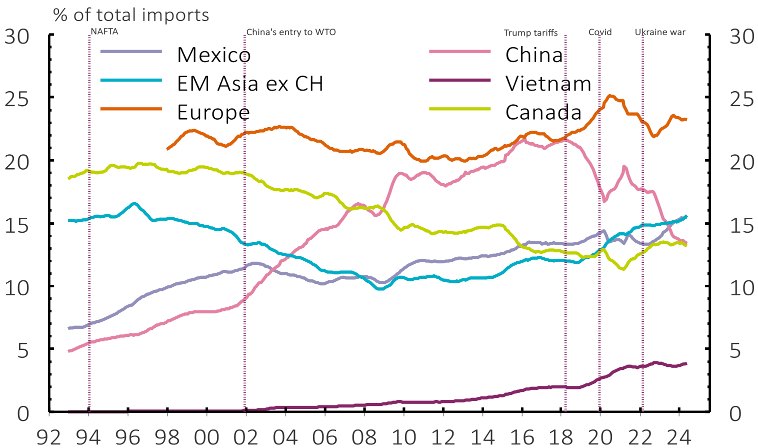
- If the US adopts a more protectionist approach following a Trump election victory, this would directly harm export demand in Mexico, China and other Asian countries, but would boost friend-shoring trends, in turn benefitting more US-aligned countries. Trump's agenda would likely reverse nascent declines in US yields and the dollar, at least in the near term. Countries with weak debt affordability, large interest payments as a share of revenue, are more vulnerable (ie Bahrain, Egypt, Nigeria, Pakistan).

Artificial Intelligence (AI) and climate change: threats and opportunities

- Tech could bridge critical gaps in EM in healthcare/education/government policies and improve productivity by boosting automation. However, AI threatens the competitive edge of countries relying cheap services provisions. AI also threatens to divert capital inflows to AI centres, from EMs.
- Climate change disproportionately threatens EMs, both directly through changing living conditions and through unaffordable transition costs. In the shorter run, pay attention to the exposure of many EMs to the nascent commodities boom, metals like copper (Chile/Peru) and nickel (Indonesia/Philippines) needed for clean energy and electric vehicle infrastructure.

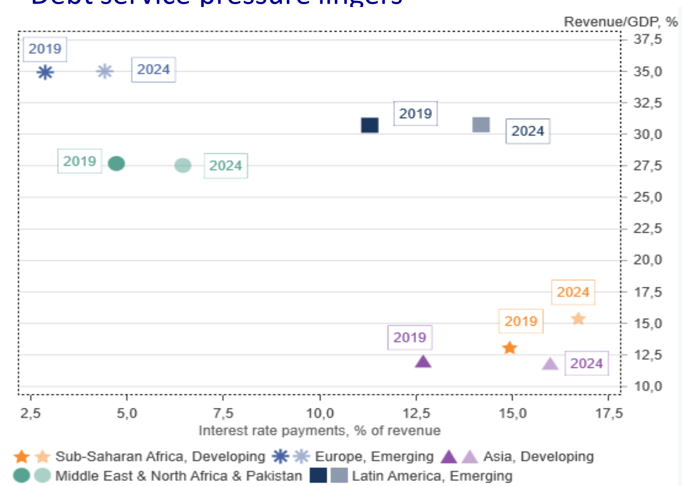
Debt service pressure lingers

US imports by origin (12m MAV)



Source: LSEG Datastream and AXA IM Research May 24

Debt service pressure lingers



Source: Macrobond and AXA IM Research, June 2024

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Macro outlook

Balance emerges

US

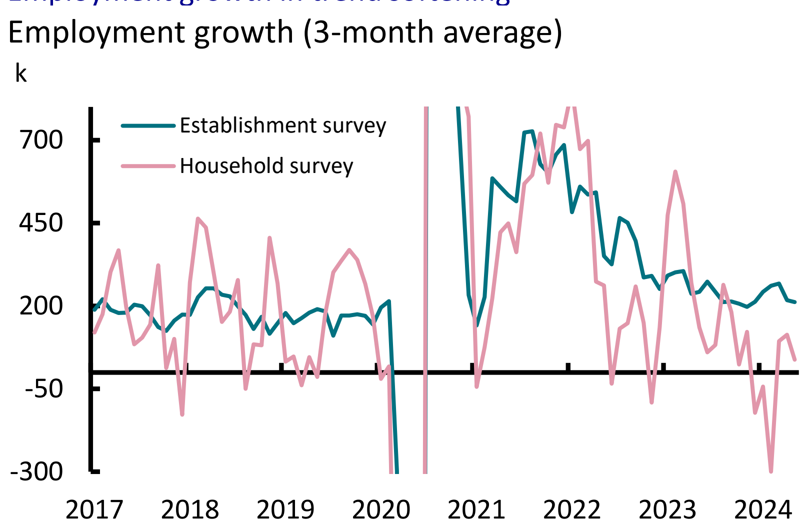
Labour market described as balanced

- Fed Chair Powell described the labour market as balanced in his semi-annual address to Congress and we concur. Despite a still firm 206k increase in June's payrolls, recent months have been revised lower by over 50k from first estimates, while household employment is slowing. Unemployment has risen to a 2½ year high of 4.1%, continuing claims are rising and vacancies falling. And annual average earnings have slowed to 3.9% (3.6% 3m ann), a pace consistent with the Fed's inflation target.

May's inflation "good", June's better.

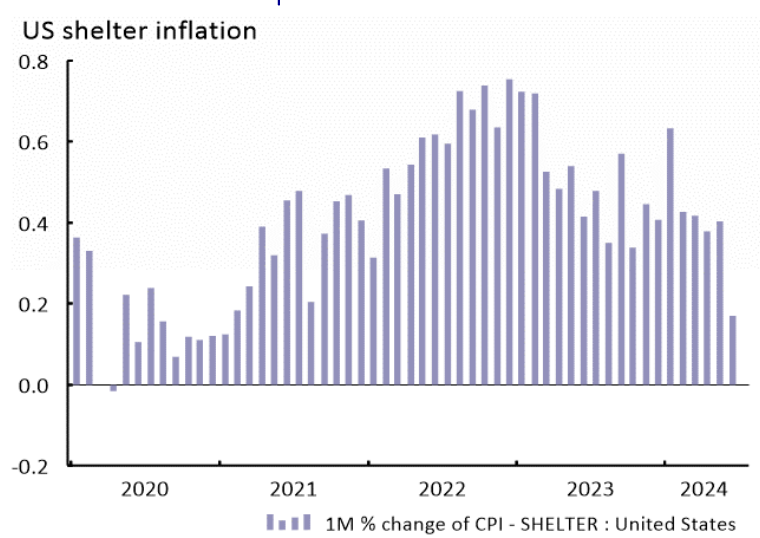
- Inflation surprised again in June, -0.1% on the month. While falling gasoline prices flattered, core only rose by 0.1% with services up just 0.12%. This reflected another weak 0.04% rise in ex-shelter services, suggesting broad-based softness. But shelter inflation also softened to just 0.17% from the average 0.45% of the past 15 months, finally reflecting the lagged impact of falling new rents. Having slowed, this weaker pace of shelter inflation should persist. We forecast inflation to average 3.1% in 2024 and 2.5% in 2025.

Employment growth in trend softening



Source: BLS, AXA IM Research, July 2024

Shelter inflation steps lower



Source: LSEG Datastream , AXA IM Research, 18/07/2024

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Fed near-term focus sharpens, medium-term slips

US

Biden drops out, Trump moves into poll position

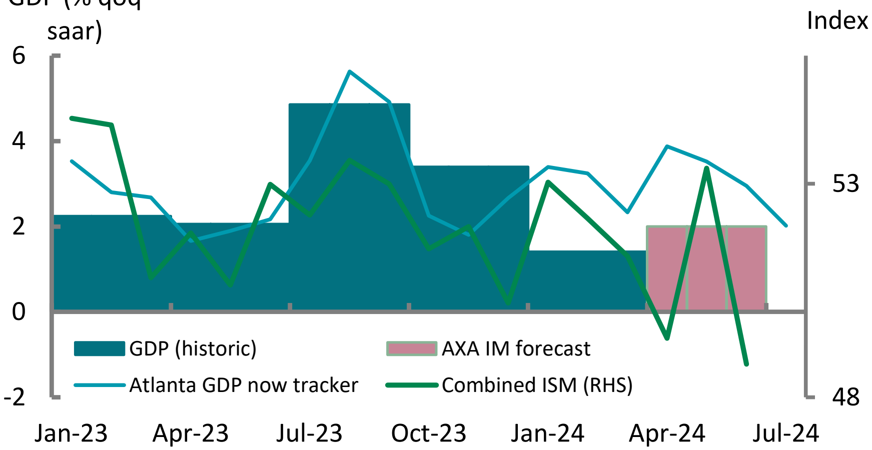
- President Biden performed poorly at the TV debate and has ended his re-election campaign instead, endorsing Vice President Kamala Harris. By contrast, after a failed assassination attempt, Trump appointed JD Vance as running mate at the Republican Convention. Harris makes the outcome more uncertain, but we still consider Trump as favourite to win in November. But his economic agenda of tax cuts, tariffs and border closure threatens first inflation, then an economic shock.

Fed ready to begin easing in September

- Recent Fed members have described the latest inflation figures being closer to what it needs for cuts and the labour market is still softening. However, a surprise boost in June's activity belies any concern of a sharper slowdown. Speculation of more than two rate cuts looks excessive with financial conditions reaching their loosest since 2022. We forecast cuts in September and December. But the Fed's scope to ease policy next year looks set to be crimped by Trumponomics, and we now suggest just two cuts next year.

Pace of economic activity appears to be slackening

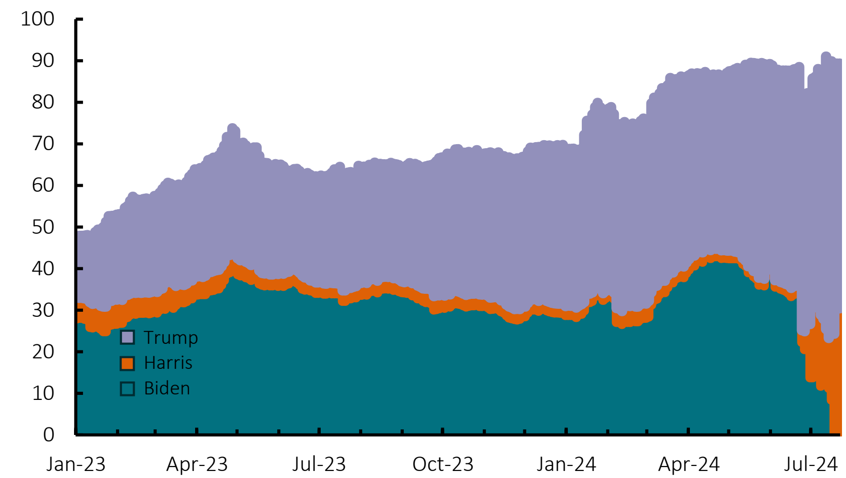
GDP growth and short term outlook



Source: BEA, FRBA, ISM, AXA IM Research, July 2024

Trump improves position in marginal seats post TV-debate

Biden, Harris and Trump betting probabilities



Source: RCP and AXA IM Research, July 2024

Another highly political July

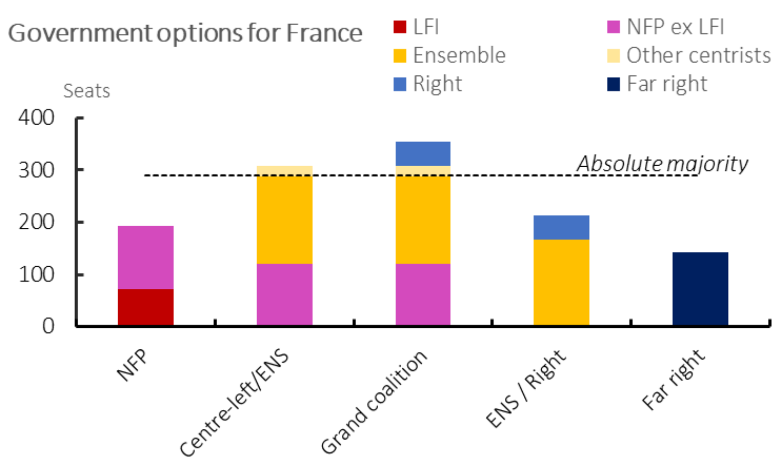
Eurozone

Macron’s clarification back-fired

- Results: left-wing coalition NFP (193 seats), Ensemble and allies (166 seats), the far right (142 seats) and the right (47 seats).
- It is the NFP coalition’s responsibility to propose a nominee for Prime Minister, but it has failed to agree on one so far. They need the centrist bloc to form a stable government, but the latter (and President Macron) have already ruled out working with the LFI. That means either the NFP splits, or rules under permanent threat of a no confidence vote.
- An alternative could be a left-centrist coalition that could gather an absolute majority, but it would not be a smooth process for adopting laws. A grand coalition seems even less likely with both traditional parties’ manifestos tilted towards far right and far left. Macron may finally decide to appoint a technocratic government to run the country. But this is unlikely to be a permanent solution, potentially leading to another snap election in a year’s time.

Von der Leyen confirmed for a second term

No easy alliances



Source: Assemblee nationale, AXA IM Macro research, as of July 2024

The European Commission’s policy priorities for 2024-2029

Von der Leyen’s speech	2024-2029 objectives
Green Deal	Pragmatism on the current Green deal; new clean industrial deal to be presented within 100 days; enshrining the 90% emission reduction target for 2040; cheaper energy will be achieved under renewables
Competitiveness	New EU commission VP focus on reducing bureaucracy, revamping the SME and competitiveness issues, focus on capital market union to better mobilize private savings. Proposal for a successor of NGEU with a "European Competitiveness Fund"
Defence & Security	supporting Ukraine; no suggestion of common funding but a focus on creating a single market for defence; strengthening Europol
Immigration	Strenthening Frontex against illegal immigration
Housing	European affordable housing plan

Source: European Commission, VdL’s speech, AXA IM Research, July 2024

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The ECB is "wide open" for September

Eurozone

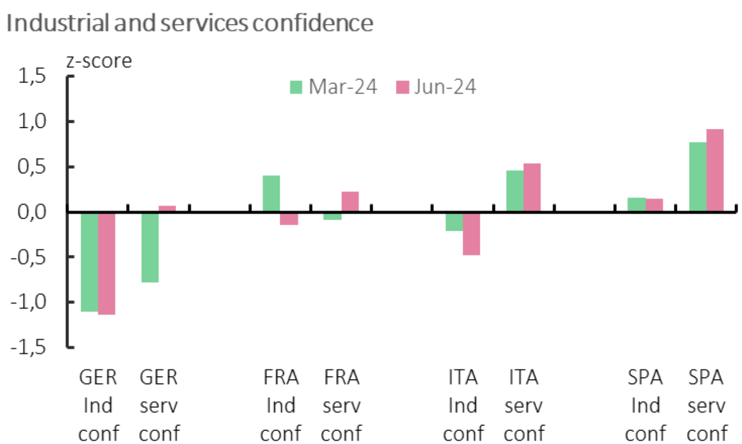
Is the economic recovery already fading?

- June's surveys were mixed. French political turmoil is having some impact on the domestic economy, but only on expectation components for now. Germany is struggling, despite more upbeat data since the beginning of the year suggesting improvement. Industrial production fell 2.5% in May and is still around 8% below its pre-pandemic level – weak even despite some distortions due to the timing of public holidays. Italy and Spain are doing better and remain well oriented, particularly for services.

ECB: dovish comments, noncommittal for September

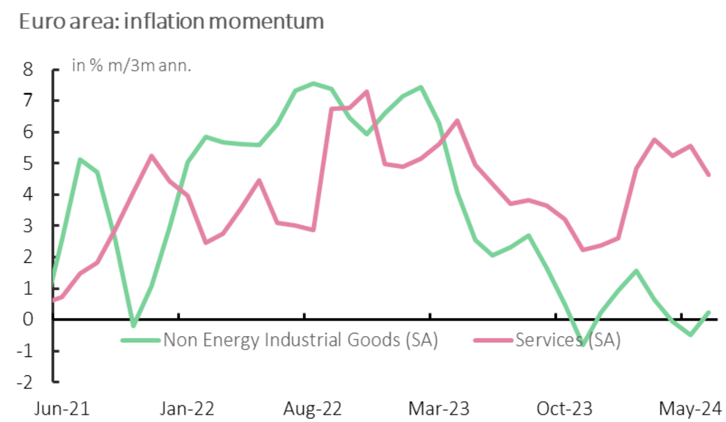
- Headline inflation is not far from 2% but services inflation is still at 4.1% yoy, labour market tightness and insufficient proof of wage deceleration, remain arguments against a rapid normalization of interest rates.
- But we still believe the ECB will cut interest rates in September as the ECB's seasonally adjusted inflation measure showed a more marked deceleration in June; the ECB admitted GDP growth is likely to be weaker than in Q1 (+0.3% qoq), having expected +0.4% (AXA IM: +0.1%); and several ECB governors have endorsed two cuts this year.

Core versus peripheral countries: two cruising speeds



Source: European Commission and AXA IM Research, July 2024

Easing in services inflation momentum



Source: ECB, AXA IM Macro Research, as of July 2024

Recovery to continue in H2

UK

Quarterly growth to remain solid in Q2

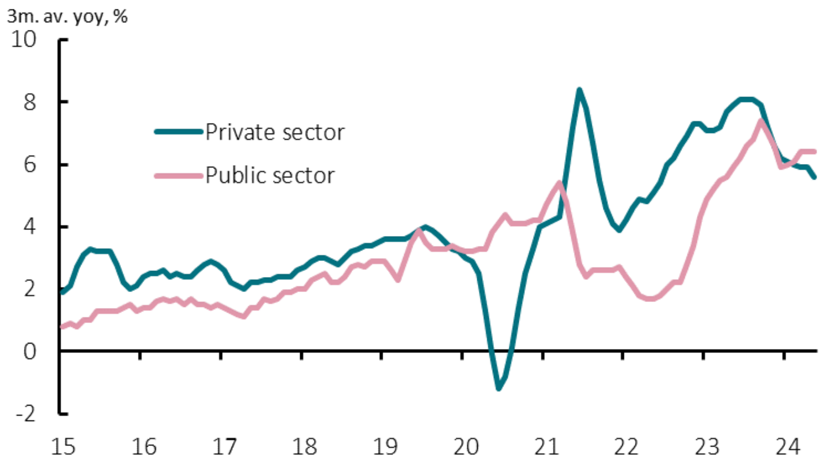
- Activity continued to rebound in Q2. While monthly GDP data showed no change in April, as the wetter-than-usual weather weighed on the retail and construction sectors, it rose by an above-consensus 0.4% month-on-month in May. We have revised up our Q2 GDP forecast to 0.5% quarter-on-quarter, from 0.3%, pushing up the annual growth rate to 1.1%% in 2024, from 0.8%.

Services inflation sticky, but signs wage growth is now starting to ease

- Headline CPI inflation remained at the 2% target in June but that masked the ongoing stickiness of services inflation. The latter was unchanged at 5.7%, well above the Bank of England's expectations laid out in the May Monetary Policy Report of 5.1%.
- The latest labour market data, meanwhile, suggest further evidence of growing labour market slack and easing wage growth. Average weekly earnings growth, excluding bonuses fell to 5.7% in May – the lowest since September 2022 – from 6% in April, while private sector regular earnings – the Bank of England's preferred measure – fell to under a 2-year low of 5.6% from 5.9%.

Private sector wage growth has started to drop more decisively

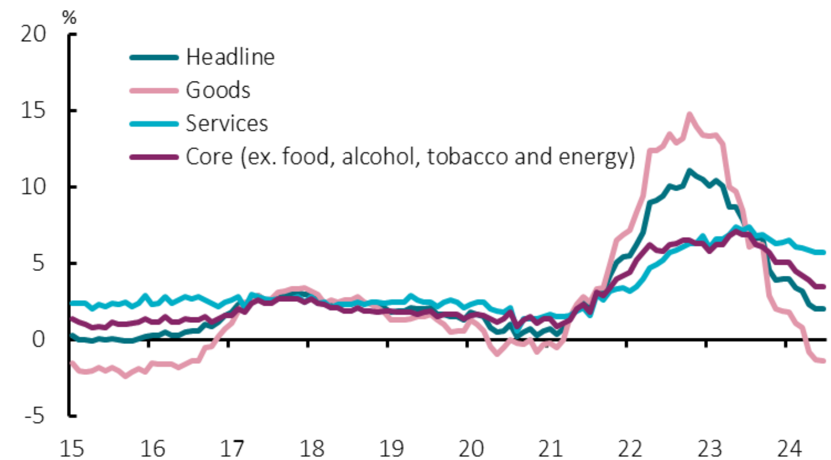
Average weekly earnings, excluding bonuses



Source: National Statistics and AXA IM Research, July 2024

Services inflation is sticky, but should start to tick down

CPI inflation



Source: National Statistics and AXA IM Research, July 2024

August Bank of England meeting is “live”

UK

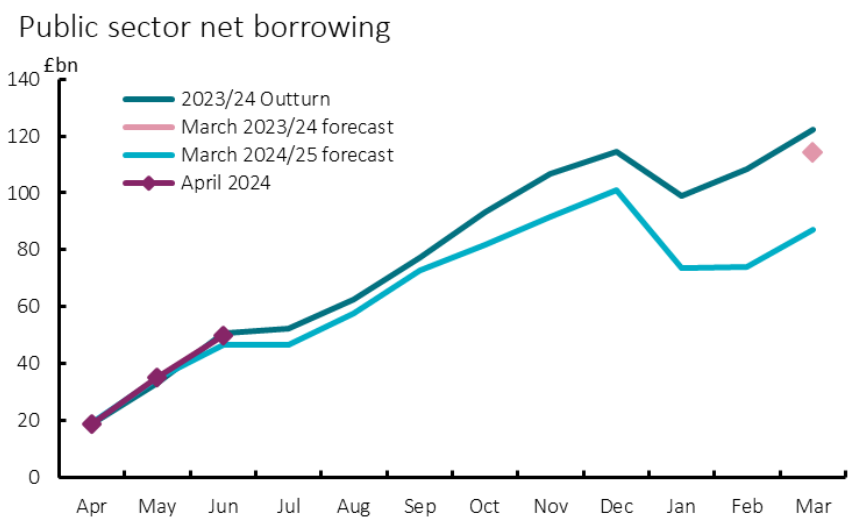
We continue to think the Bank will cut in August, but the decision is on a knife-edge

- On balance, we think the recent data will be just enough to tip the scales in favour of a 25bp cut at August’s meeting, but it will be very close. We look for a vote split of 5:4. We then expect one further cut in November, leaving Bank Rate at 4.75% by year end.

Large labour majority, but fragile public finances a constraint

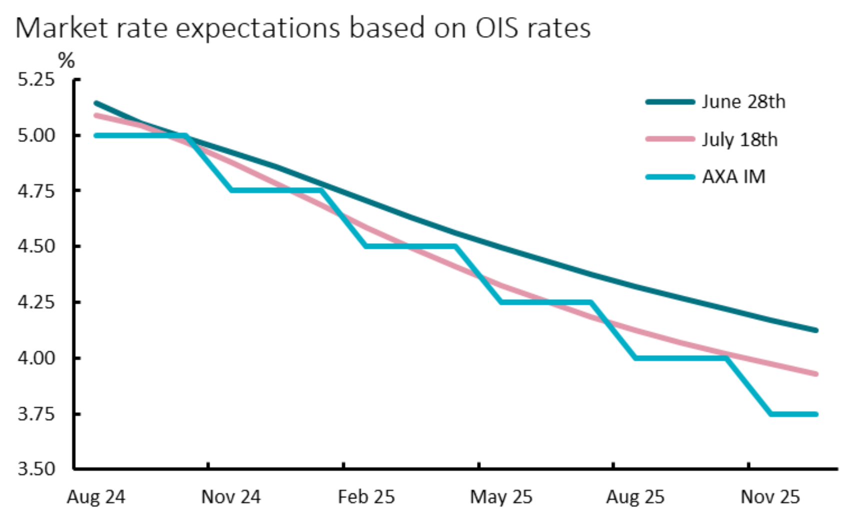
- Labour won a whopping 411 seats at the 2024 General Election, leaving the party with a majority of 172 seats. So far, the new government has provided few surprises in terms of policy, including in the King’s Speech. But we think the fragile public finances – including the combination of high public debt, high interest rates and modest growth – will force the party to outline further tax increases in the Autumn Budget, that looks set to take place early-October.
- The latest public finances data show that public sector net borrowing over the financial year so far overshot the OBR forecast by over £3bn.

Public finances remain fragile



Sources: National Sources, the OBR and AXA IM Research, July 2024

Bank Rate will fall more than markets expect, despite downward shift



Sources: Bank of England and AXA IM Research, July 2024

Disappointing Q2 GDP underscores consumer pessimism

China

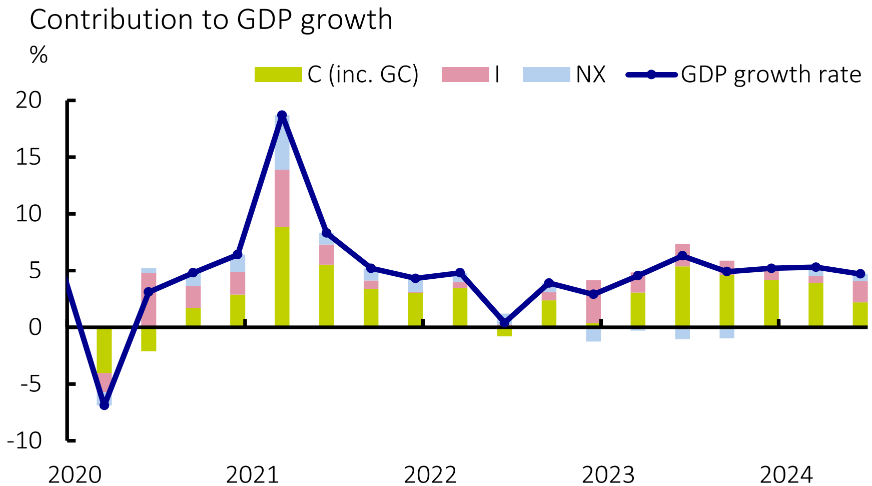
Q2 growth less than half pace in Q1, reduced domestic demand

- China's economy decelerated significantly in Q2, with GDP growth slowing to 0.7% quarterly, less than half the pace of Q1's 1.5%. This followed a strong start to 2024, driven by state-led investment and resilient industrial production, particularly from the manufacturing sector. However, these growth engines weakened in Q2, the main weakness emerged from the household sector.

Imbalance entrenched despite growth remaining on target

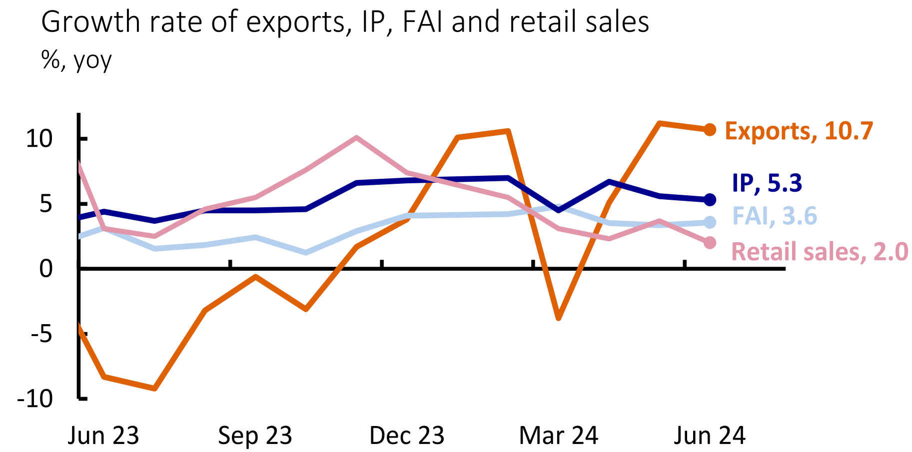
- China's economy managed to grow by 5.0% in the first half of 2024, staying on track to achieve the annual growth target. However, the output gap continued to widen, with demand lagging and adding pressure on deflation. An improving environment in the West has helped China's exports recover, and recent US and EU tariff hikes have triggered some front-loading of demand, keeping China's exports afloat for now. However, the average price of China's exports has been contracting, highlighting the issue of overproduction (or overcapacity) in the economy.

Contribution from consumption fell back in Q2



Source: CEIC and AXA IM Research, July 2024

Some upside consumer surprises, but generally subdued



Note: Exports in RMB; IP: industrial production; FAI: fixed asset investment
Source: CEIC and AXA IM Research, July 2024

Policy attention misplaced

China

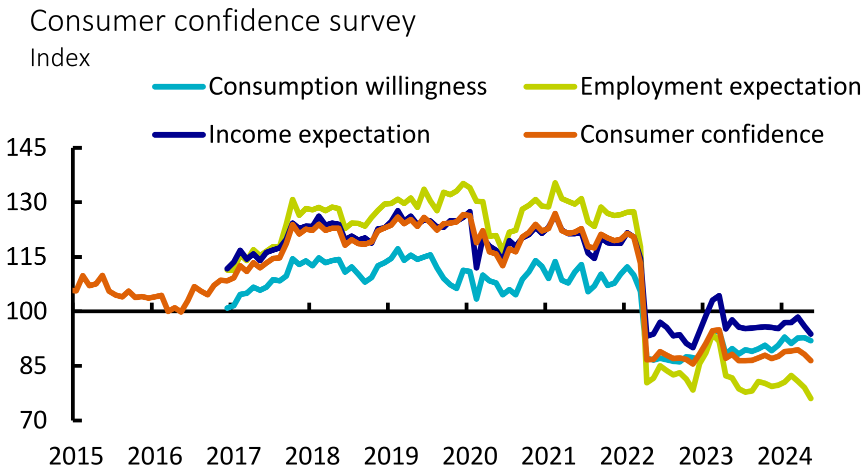
Labour market boost may be more effective in reviving domestic demand

- Record low employment expectations and recent declines in overall consumer confidence and income expectations point to the labour market as the key to weak consumer demand, with changes in employment and wages having a direct influence on consumption. Elsewhere the decline in property prices has provided a negative wealth effect, also weighing on confidence. To date China's focus on infrastructure and investment stimulus has failed to spill over to support the consumer. However, a recent further, surprise 10bp easing in short-term lending rates provides some further movement in this direction.

Third Plenum reiterates growth target, focus on long-term structural planning

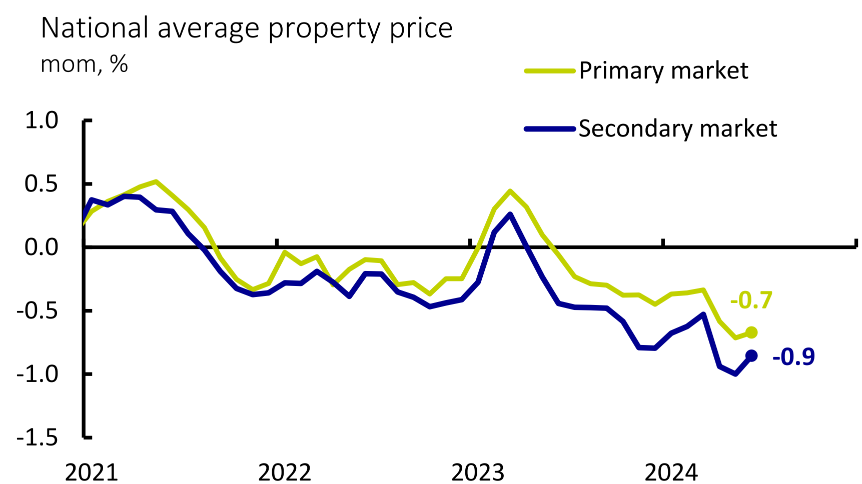
- Key priorities included supply chain self-sufficiency, technological innovation, and a green transition. Fiscal reforms were also promoted, potentially reclassifying tax incomes between central and local governments to ease financial pressures on local administrations

Pessimism mounting again among consumers



Source: CEIC and AXA IM Research, July 2024

Rescue plan in mid-May is yet to bear fruit



Source: CEIC and AXA IM Research, July 2024

Cautious, given growth weakness

Japan

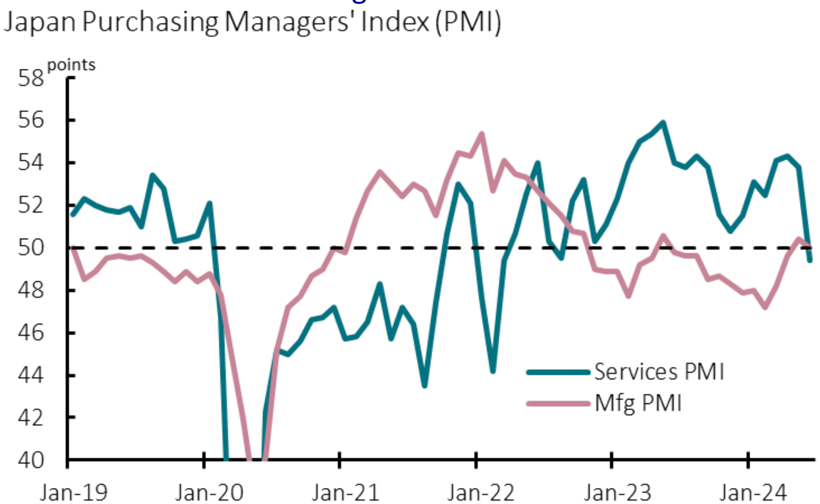
Growth was probably stagnant in Q2

- Economic activity appears to have been fairly stagnant in Q2, particularly in services. Indeed, the Bank of Japan (BoJ) Tankan Survey showed that business conditions at large non-manufacturers slipped to +33, from +34, the first decline in four years. In addition, the services PMI fell to over a two-year low of 49.4 in June, from 53.8 in May, with the final estimate revised down from the flash reading.

The outlook is slightly more upbeat, as rising real incomes boost consumption

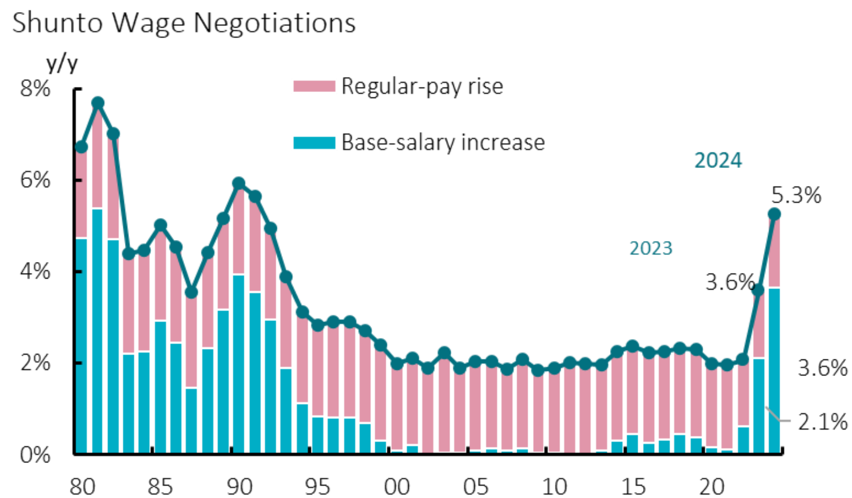
- The positive outcome of the Shunto wage negotiations, however, suggests that the virtuous wage/price spiral the BoJ are looking for should gather momentum in the second half of the year. Indeed, stronger wages means pay growth will start to outpace CPI inflation meaningfully, lifting real incomes and boosting consumption in the process. This should enable firms to pass on higher labour costs. Note, though, that households will probably allocate some of the increase to boost savings buffers.

Services PMI has taken a leg down



Source: S&P Global and AXA IM Macro Research, July 2024

Strong wage growth should help to boost consumption gradually



Source: Rengo and AXA IM Macro Research, July 2024

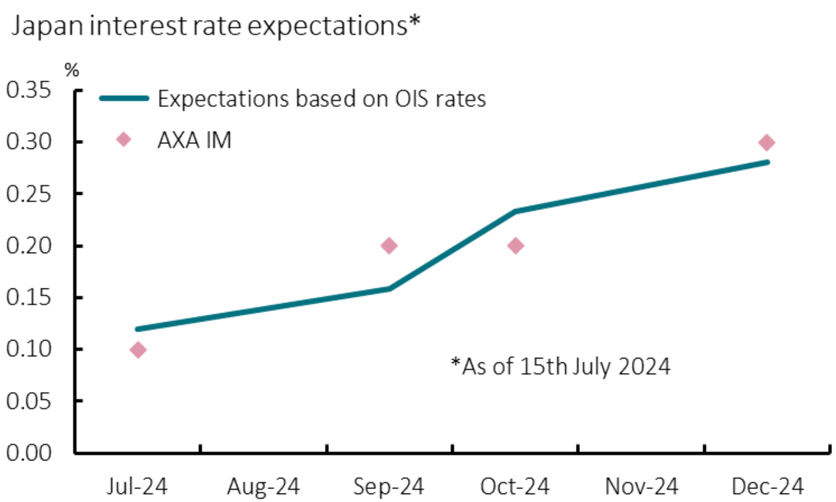
Bank of Japan to taper bond purchases

Japan

Bank of Japan to see impact of bond purchase tapering before hiking policy rates

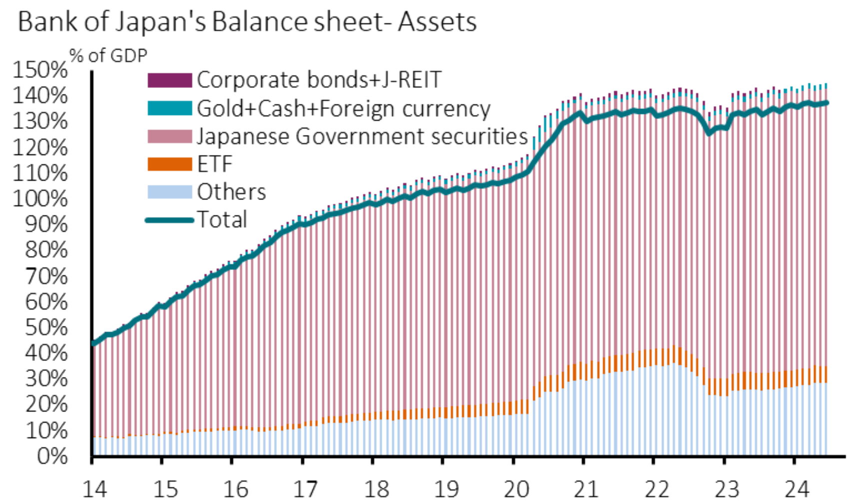
- CPI inflation held steady at 2.8% in June, but the “new core” measure, which excludes fresh food and energy ticked up to 2.2%, from 2.1%, tentatively suggesting the gradual decline of the past nine months may be bottoming out. We expect underlying inflation to hover around 2% over the remainder of the year, as businesses start to pass on higher costs to consumers and the weaker yen causes price rises in durable goods to accelerate. Note the headline rate is likely to dip between August and October, as energy subsidies return.
- On balance, we continue to think the Bank will push ahead with two further 10bp hikes this year, in Q3 and Q4, respectively. We think September looks more likely than July, with the Board probably wanting to see the impact of reducing its JGB purchases – it outlined in June that it would lay out the plan for tapering at July’s meeting – on the financial market before making any further adjustments to the policy interest rates.

Markets broadly there on rate hikes



Source: Refinitiv and AXA IM Research, July 2024

BoJ plans to taper its massive bond purchase programme



Source: Bank of Japan and AXA IM Research, July 2024

Evidence of excess supply emerges

Canada

Labour market loosening

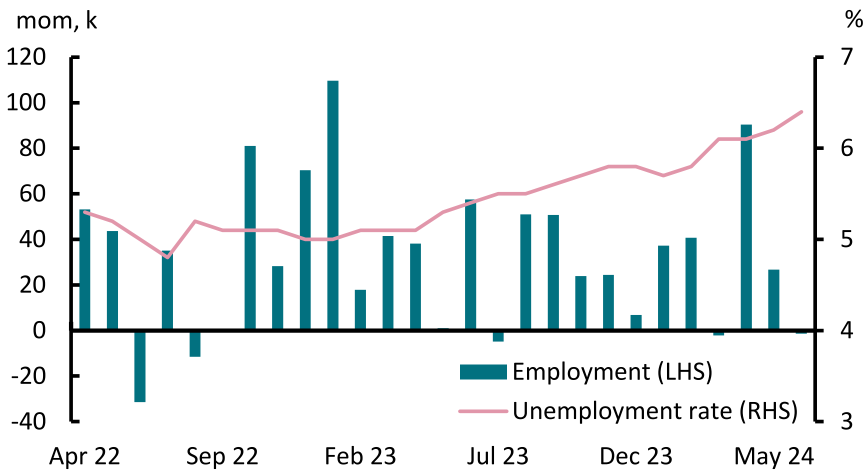
- Employment growth fell by 1k in June but has averaged around 40k over the quarter as a whole – a solid pace. Unemployment has however risen to 6.4% – a 2½ year high, with labour supply outstripping jobs growth in every month bar two since 2023. Average earnings growth is yet to obviously soften, although large base effects over coming months are unlikely to be repeated this year, which would lead to some deceleration. Productivity appears to have continued to fall in Q2.

Inflation continues to slow

- Headline inflation fell back to 2.7% in June, the median core inflation rate to 2.6% – a joint three year low. We expect inflation to average 2.6% for this year but remain at that pace next year with a weaker dollar and still elevated unit labour costs weighing on the outlook.

Labour market eases despite solid employment gains

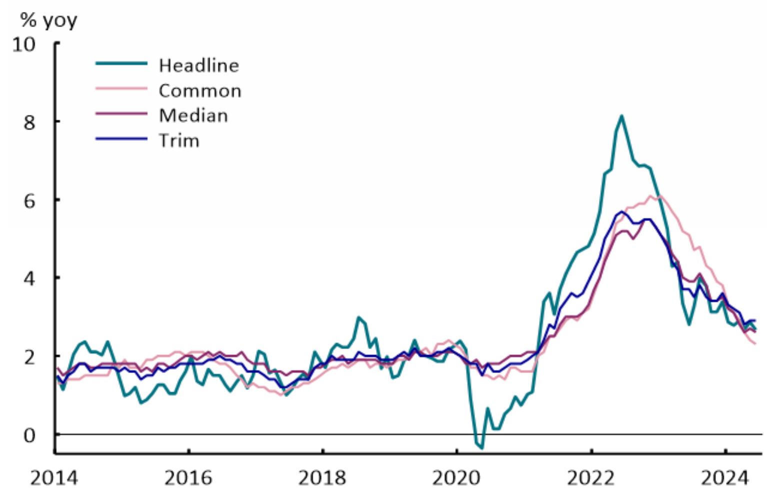
Employment and unemployment



Source: CANISM and AXA IM Research, July 2024

Inflation and core continue to soften

CPI measured variations



Source: LSEG Datastream , AXA IM Research, 19/07/2024

Investment Managers

BoC to follow gradual path

Canada

Export outlook in the balance

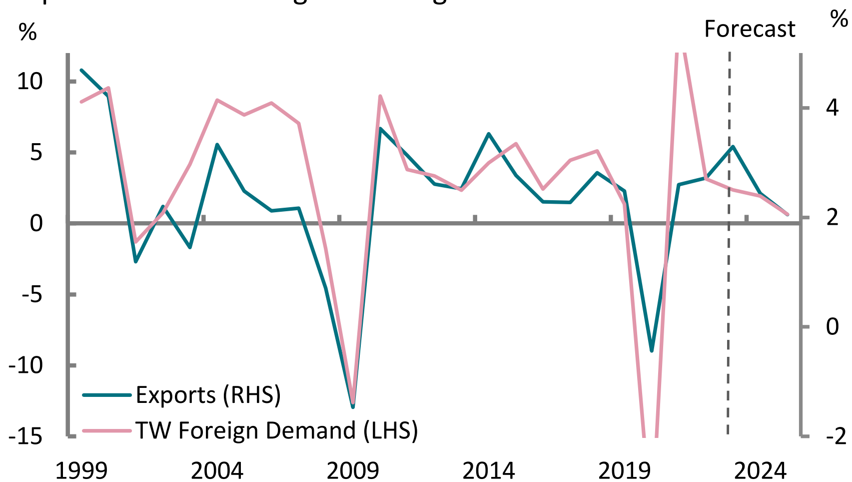
- One of the drivers of Canadian growth outperformance has been net trade, with the economy benefitting from a terms of trade boost after the Russian invasion of Ukraine and export growth exceeding broader external demand gains. This would likely fade over the coming years. However, a re-elected US President Trump will have an impact on Canada's trade backdrop: exclusion from proposed 10% tariffs on the rest of the world would prove a boost, inclusion a marked hit with an impact on GDP growth.

BoC to lock in gradual easing path

- The BoC cut rates by 0.25% in June to 4.75% and we expect a further cut in July with the Bank gradually easing monetary policy in line with the evolution of its economic projections. The emergence of gradual signs of excess supply in the economy should underpin the move, but the risk will be of a delay until September, to avoid the appearance of too hasty an easing. We forecast one more cut in October. But only two cuts in H1 2025, leaving policy mildly restrictive at 3.50% by year-end.

Export outlook dependent on Trump tariff policy

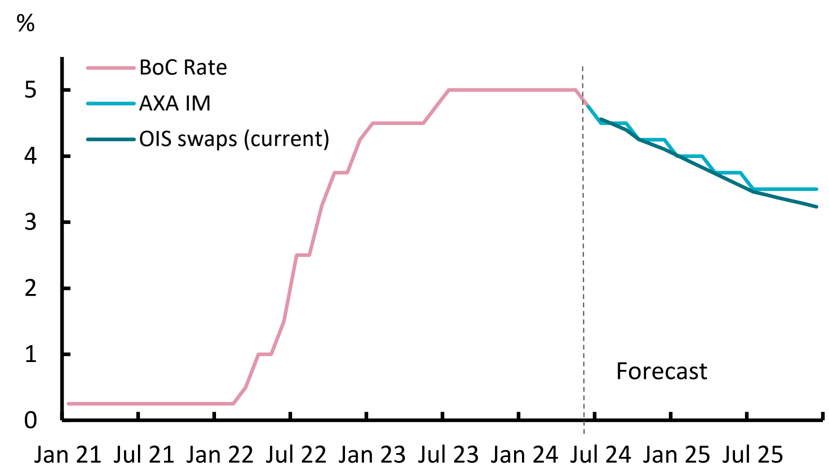
Exports and trade-weighted foreign demand



Source: BoC, CANISM and AXA IM Research, July 2024

BoC to continue gradual easing

Bank of Canada overnight rate and outlook



Source: BoC, Bloomberg and AXA IM Research, July 2024

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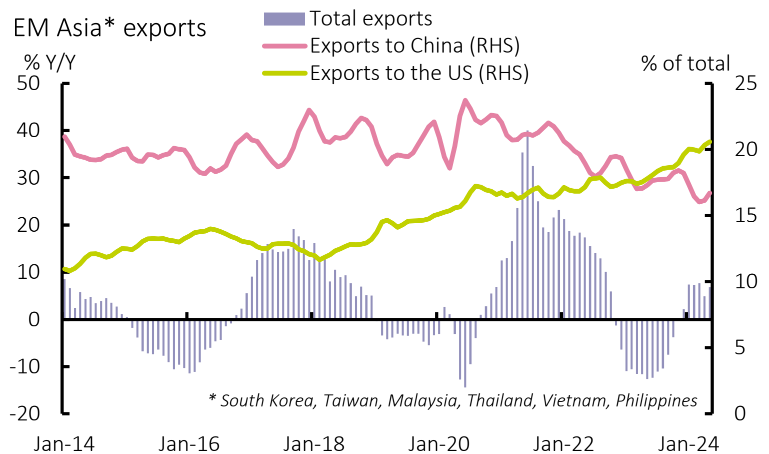
Exports recovering, outlook uncertain

EM Asia ex-China

A narrow-based recovery, complicated by potential hiking of tariffs on Chinese trade

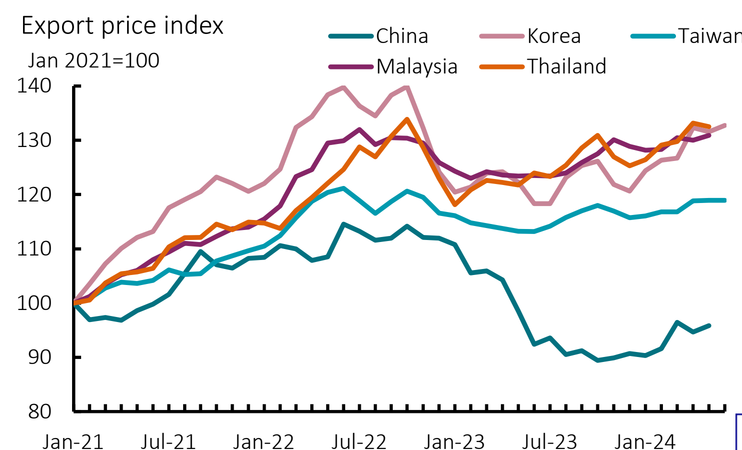
- From the lows of 2023 an export recovery is underway across EM Asia, but export values have yet to return to the 2022 highs, and there are doubts over the strength and sustainability of the current upturn. The drivers of the recovery are narrow, linked to AI-related investments and demand for advanced chips. South Korea and Taiwan, the bellwethers of trade in such technology, have recorded sharp growth in their chips exports.
- Leading indicators suggest the short-term outlook for the region's export recovery is still positive. However, the picture is mixed looking further ahead, given the precarious nature of the recovery, which could be derailed by faltering demand, a slowdown in the pace of AI investment growth or further US sanctions. China has also become a weaker demand source to its trade partners.
- Another worrying trend for EM Asia exporters is that China as a trading rival has been more price competitive recently based on export prices (although EM Asia's currencies have been weaker). China's competitiveness could be blunted by potential hikes in US tariffs on China's exports, and this could be a boon for exporters across EM Asia. There have already been indications of this, with the region gaining a larger share of the US market at the expense of China. But China has not completely lost out, given its involvement in complex supply chains for goods that are exported to the US, or the diversion of Chinese exports via third party markets. If US tariffs are widened to cover such trade, EM Asia's gains could be limited.

Exports recovering, with US taking a larger share than China



Source: LSEG Datastream and AXA IM Research, July 2024

China more price competitive



Source: LSEG Datastream and AXA IM Research, July 2024

Dovish inflation, hawkish central banks

EM Europe

Headline inflation continues to surprise to the downside

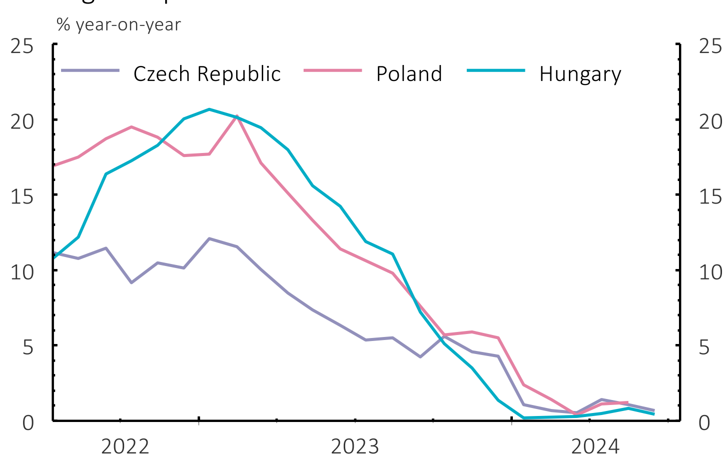
- Inflation figures surprised to the downside across CEE for a second month in a row in June: CPI rose only marginally in Poland to 2.6%yoy, slowed to 3.7% in Hungary from 4% in May, and fell back to the 2% target in the Czech Republic.
- From the external side, gas prices are now only a fraction of their peak levels, food commodity prices have also broadly weakened, while oil prices are now around the middle of their past two-year range. Goods inflation has been running below central bank targets since the start of the year across the region, to very depressed levels

But central banks' tone remain hawkish

- Policymakers remain nonetheless concerned about the stickiness of services inflation. The current sharp improvement in real wage growth and the subsequent domestic demand resumption may put upward pressure on core inflation metrics in the second half of the year and remain the focus of monetary policy calibration. Real policy rates remain strongly positive but in an increasingly complex global political environment.

Goods inflation runs low…

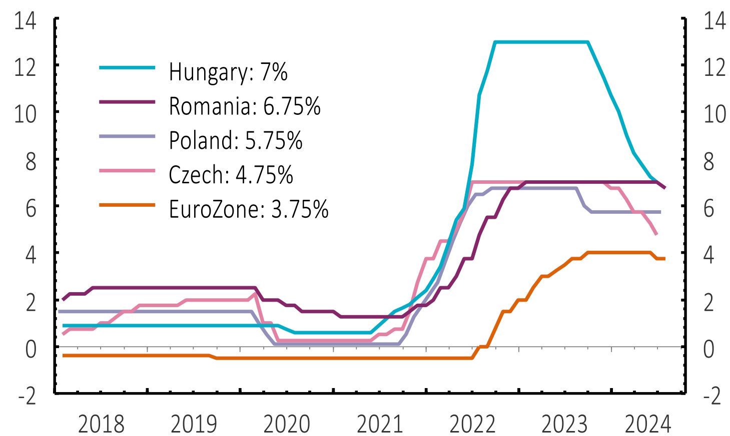
CEE: goods price inflation



Source: LSEG Datastream and AXA IM Research Jun 24

… but CBs focus on services prices stickiness

CEE CB policy rates (%), Jul 24



Source: LSEG Datastream and AXA IM Research Jul 24

Headline volatility, core stability

Latin America

Weather-related inflation volatility

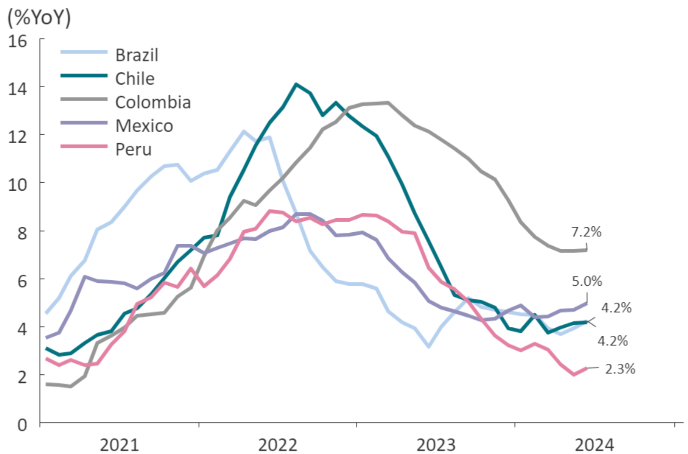
- June's year-on-year inflation data revealed mixed outcomes across the region, significantly impacted by weather events, particularly in Brazil and Mexico. In Brazil, inflation accelerated to 4.2% due to floods in the south, which drove up food prices. Similarly, in Mexico, El Niño's impact led to higher food prices, pushing inflation to 5.0%. The peso's depreciation further contributed to rising prices. Inflation also increased in Chile, rising to 4.2%, and in Peru, reaching 2.3%. Meanwhile, it remained stable in Colombia at 7.2%, the highest rate in the region.

Core remains under control

- Despite fluctuations in headline inflation, core prices across Latin America have remained relatively stable and close to target, with the exception of Colombia, the region's laggard. In June, core inflation declined in Brazil (3.6%), Chile (2.8%), and Mexico (4.1%). It remained unchanged in Colombia (6.5%) and Peru (2.9%). However, recent foreign exchange volatility and fiscal uncertainties will require central banks to remain cautious.

Disinflation's last mile proves difficult

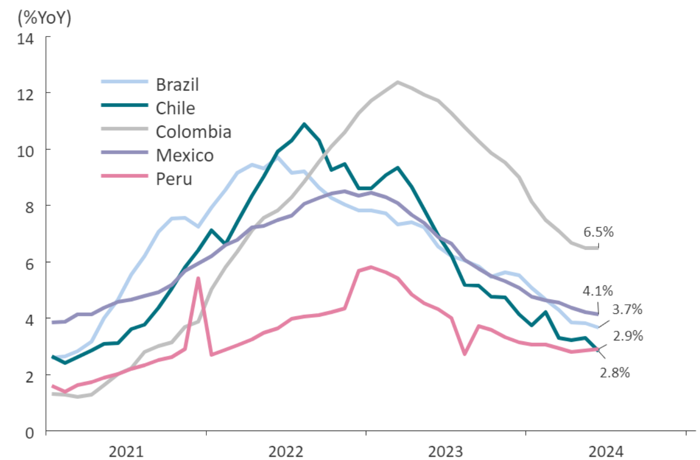
Headline inflation



Source: LSEG Datastream and AXA IM Research, Jul 24

Core prices remain stable

Core inflation



Source: LSEG Datastreamand AXA IM Research, Jul 24

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Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2	3.2		3.1	
Advanced economies	1.7	1.4		1.4	
US	2.5	2.3	2.3	1.6	1.8
Euro area	0.6	0.6	0.7	1.1	1.5
Germany	0.0	0.1	0.2	0.9	1.5
France	1.1	0.9	0.9	1.0	1.3
Italy	1.0	0.7	0.8	0.7	1.2
Spain	2.5	2.5	2.1	2.1	1.9
Japan	1.9	0.6	0.3	1.1	1.0
UK	0.3	1.1	0.6	1.1	1.2
Switzerland	0.8	1.2	1.3	1.3	1.5
Canada	1.1	1.2	1.0	1.7	1.9
Emerging economies	4.2	4.2		4.1	
China	5.2	5.0	5.0	4.2	4.4
Asia (excluding China)	5.3	5.3		5.3	
India	7.7	6.8	6.8	6.5	6.7
South Korea	1.4	2.5	2.5	2.6	2.2
Indonesia	5.0	5.1	5.0	5.1	5.1
LatAm	2.3	2.0		2.5	
Brazil	2.9	2.2	2.0	1.9	2.0
Mexico	3.2	2.2	2.1	1.4	2.2
EM Europe	3.0	3.1		2.7	
Russia	3.6	3.2	3.1	1.5	1.1
Poland	0.2	2.8	2.9	3.5	3.4
Turkey	4.3	3.0	3.3	3.6	3.2
Other EMs	2.4	3.0		3.9	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 23 July 2024
**Forecast*

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	4.7	2.7		2.3	
US	4.1	3.1	3.2	2.5	2.3
Euro area	5.5	2.5	2.4	2.1	2.1
China	0.2	0.6	0.6	1.6	1.9
Japan	3.3	2.5	2.6	1.9	1.5
UK	7.3	2.4	2.6	1.8	2.0
Switzerland	2.1	1.3	1.3	1.3	1.3
Canada	3.9	2.6	2.5	2.6	2.0

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 23 July 2024
**Forecast*

Central banks' policy: meeting dates and expected changes

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
United States - Fed	Dates	5.50	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec	Jan Mar	Apr Jun	Jul Sep	Oct Dec
	Rates		-0.25 (5.25)	-0.25 (5.00)	-0.25 (4.75)	unch (4.75)	-0.25 (4.50)	unch (4.50)
Euro area - ECB	Dates	3.75	12-Sep	17 Oct 12 Dec	30 Jan 6 Mar	17 Apr 5 Jun	24 Jul 11 Sep	30 Oct 18 Sep
	Rates		-0.25 (3.50)	-0.25 (3.25)	-0.25 (3.00)	-0.25 (2.75)	unch (2.75)	unch (2.75)
Japan - BoJ	Dates	0 - 0.1	30-31 Jul 19-20 Sep	30-31 Oct 18-19 Dec	Jan Mar	Apr Jun	Jul Sep	Oct Dec
	Rates		+0.10 (0.1-0.2)	+0.10 (0.2-0.3)	+0.10 (0.3-0.4)	+0.10 (0.4-0.5)	unch (0.4-0.5)	unch (0.4-0.5)
UK - BoE	Dates	5.25	1 Aug 19 Sep	7 Nov 19 Dec	6 Feb 20 Mar	8 May 19 Jun	7 Aug 18 Sep	6 Nov 18 Dec
	Rates		-0.25 (5.00)	-0.25 (4.75)	-0.25 (4.50)	-0.25 (4.25)	-0.25 (4.00)	-0.25 (3.75)
Canada - BoC	Dates	4.75	24 Jul 4 Sep	23 Oct 11 Dec	Jan Mar	Apr Jun	Jul Sep	Oct Dec
	Rates		-0.25 (4.50)	-0.25 (4.25)	-0.25 (4.00)	-0.25 (3.75)	-0.25 (3.5)	unch (3.5)

Source: AXA IM Macro Research - As of 23 July 2024

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Calendar of events

2024	Dates	Events	Comments
July	24-Jul	BoC meeting	-25bps (4.50%)
	30-31 Jul	BoJ meeting	unch (0-0.1%)
	30-31 Jul	FOMC meeting	unch (5.50%)
August	01-Aug	BoE meeting	-25bps (5.00%)
	19-22 Aug	US: Democrat Convention	
	22-24 Aug	Fed's Jackson Hole symposium	
September	04-Sep	BoC meeting	-25bps (4.75%)
	06-Sep	Italy: Macro assumptions for 2025 draft budget	
	10-Sep	2nd US TV debate	
	12-Sep	ECB meeting	-25bps (3.50%)
	17-18 Sep	FOMC meeting	-25bps (5.25%)
	19-Sep	BoE meeting	unch (5.00%)
	19-20 Sep	BoJ meeting	+10bps (0.1%-0.2%)
	25-Sep	France government to present draft 2025 budget	
October	17-Oct	ECB meeting	unch (3.50%)
	23-Oct	BoC meeting	-25bps (4.25%)
	Before 24 Oct	Austria General Elections	
	30-31 Oct	BoJ meeting	unch (0.1%-0.2%)
November	05-Nov	US Presidential Elections	
	6-7 Nov	FOMC meeting	unch (5.25%)
	07-Nov	BoE meeting	-25bps (4.75%)
December	11-Dec	BoC meeting	unch (4.25%)
	12-Dec	ECB meeting	-25bps (3.25%)
	17-18 Dec	FOMC meeting	-25bps (5.00%)
	18-19 Dec	BoJ meeting	+10 bps (0.2%-0.3%)
	19-Dec	BoE meeting	unch (4.75%)

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