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Investment Institute Macroeconomics

Inflation divergence to drive monetary tensions

Monthly Investment Strategy

AXA IM Research

March 2024

Summary: March 2024

Theme of the month: Inflation divergence to drive monetary tensions

- The pandemic and subsequent policy reactions led to a synchronised surge and subsequent unwind in inflation rates in many international economies. Some global upside inflation risks have emerged, centred around Middle East conflicts. Otherwise, idiosyncratic developments are more likely to govern the outlook for inflation and hence central bank policy rates over the coming years.
- These include in the US positive supply dynamics that have allowed exceptional growth in recent quarters, even as targeted inflation fall back to 2.4%. Negative supply dynamics across the Eurozone that have kept Eurozone inflation above target (2.6%) despite near recessionary conditions. And a lagged disinflationary impact in the UK, which has seen its inflation to surprise to the downside in recent months.
- Looking further afield, higher inflation expectations and strong wage gains have helped the Bank of Japan deliver above target inflation for nearly the last two years – despite battling deflation for most of the past three decades. That battle may have passed to China where consumer prices have been falling in outright terms over recent months as economic recovery has failed to become self-fulfilling.
- Even across broad regions we note differences emerging, including in the relatively subdued inflation increases in EM Asia, which have resulted in a more modest cycle and central banks unlikely to ease before H2 2024 and EM Latin America, where a sharp rise in inflation was met with a swift tightening of monetary conditions, which has given way to widespread disinflation and relatively early rate cuts.

Macro update: Synchronised developed central bank outlook, emerging markets more diverse

- US inflation surprised to the firmer side at the start of 2024, but this may prove to be noise. There are some signs of weakening activity. Meanwhile the Fed continued to suggest that it would cut rates three times this year and slow the pace of balance sheet adjustment "fairly soon".
- Eurozone growth remains weak, particularly industrial, but there are some signs of services recovery, underpinned by recovering real wages. Disinflation has slowed, but the ECB remains on track to cut in June and three times this year. We remain wary of a deterioration in some public deficit outlooks.
- The UK looks to have emerged from recession in Q1. Yes, signs of labour market slack are emerging. Moreover, inflation continues to fall a little faster than expected. We bring forwards our expectations for a BoE cut to June (from August), and add two further cuts to H2 2025 (seeing 3.25% by year-end)
- China saw some improvement in exports and industrial activity at the start of 2024, but consumer spending remains subdued, not helped by continued property sector weakness. Credit growth slowed in the latest month and the PBoC left rates unchanged this month, although hinted at future RRR cuts.
- Japan's economy has avoided recession and inflation is gradually coming back towards target. But the BoJ hiked rates for the first time in 17 years, ending 8 years of negative rates as it became confident that inflation would be anchored around 2%.
- Emerging markets exhibit different trends across the regions. EM Asia has shown impressive growth, with inflation – not wild by global standards – coming off slowly. This is likely to see most central banks ease policy only in H2 (and Taiwan recently hiked policy). EM Latam is someway ahead with Mexico the last central bank to join the policy easing, but others cutting since 2023 and some accelerating the pace recently. CEE faces still high inflation, but weak growth that has led to some easing across the region already.

Central scenario

Summary – Key messages

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

Global growth expected to slow to 3.0% in 2024 and 3.1% in 2025.

Disinflation slower this year, spreading to core. Creates space for monetary policy easing, market expectations now aligned with our views.

Inflation

Headline disinflation likely to pause, geo-politics provides some upside risks. Core disinflation to broaden this year. Target rates more likely next.

Monetary policy

Central banks have peaked and move closer to easing restrictive policy, most to cut this year, several developed banks from mid-year. Balance sheet policy from Fed and ECB to come to fore around mid-year.

Fiscal policy

European rules require fiscal consolidation, but not too sharply for 2024. US Congressional politics delays further funding requests, long-term outlook in question.

Growth

Growth resilient in US, expected to slow but avoid recession. Eurozone and Japan avoid technical recession; UK to emerge from one in Q1. China sets ambitious target for 2024.

Emerging Markets

Inflation easing across EM, and several central banks underway with easing cycle

Rates

Policy rate re-pricing has driven term rates higher. Actual cuts should see yields lower by year-end, but structural drivers underpin key regions, making a return to post-GFC levels unlikely

FX

Dollar recovered on rates repricing, US fundamentals remain firm for now. BoJ action failed to spur yen. Watch risk currencies in event of geopolitical escalation.

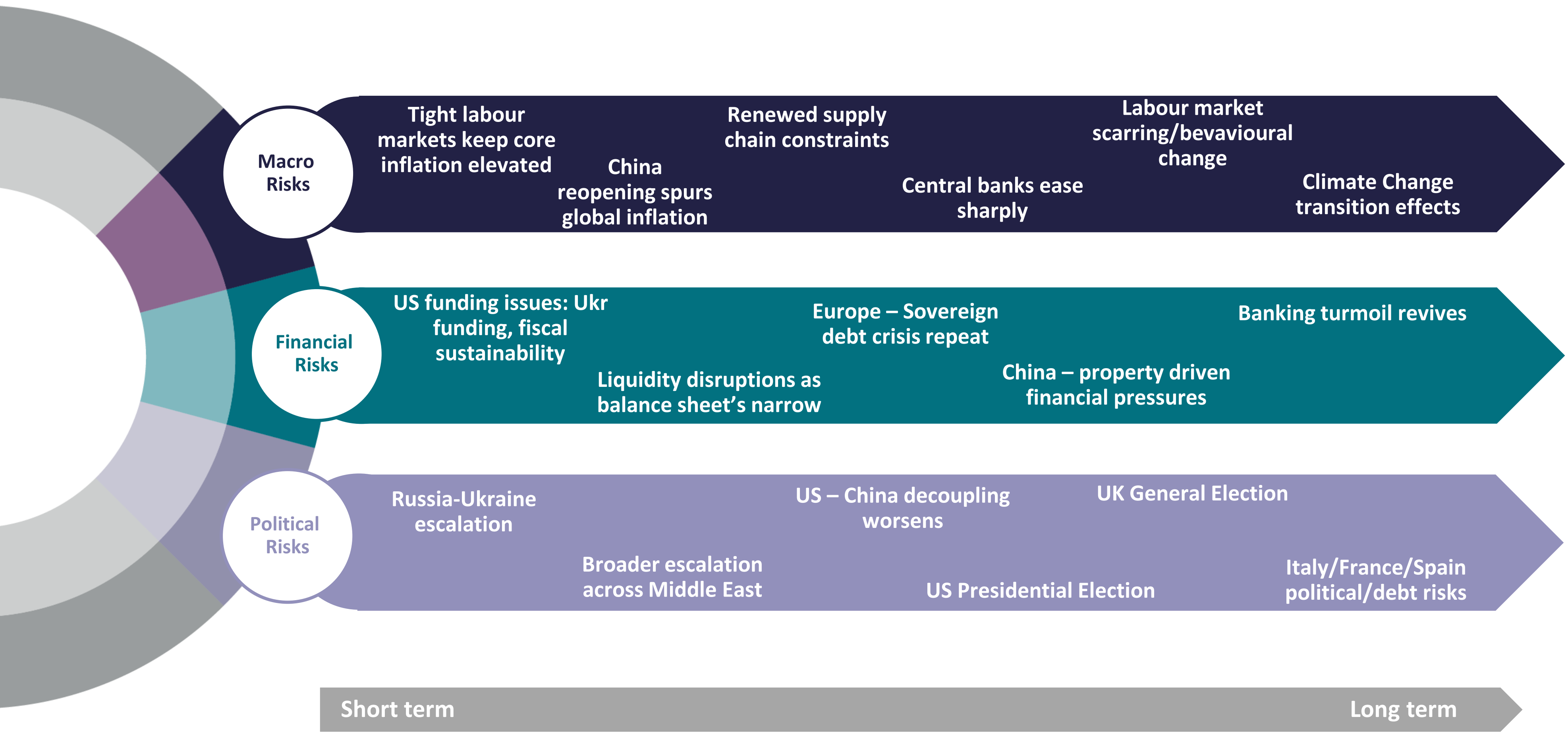
Alternative scenarios

Summary – Key messages

	Entrenched supply shock Probability 15%	**A global boost** Probability 20%
What could be different?	- Banking turmoil escalates, credit conditions tighten. - Escalation in Ukraine conflict or Middle East tensions - Post-pandemic structural adjustment continue. Supply shocks persist - Inflation expectations rise, affecting wages and persistence	- Geo-political tensions ease – peace in our time. - Labour market participation recovers, strong income growth and easing inflation pressures - Productivity boost following investment rebound and structural post-pandemic adjustments
What it means	- Growth weaker, employment could start to fall, but inflation remains elevated - Monetary policy ill-equipped to deal with supply shocks and financial instability, deteriorating inflation credibility forces still tighter policy in DMs	- 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

Inflation heterogeneity

Global shocks still a risk, but local divergence increasingly important

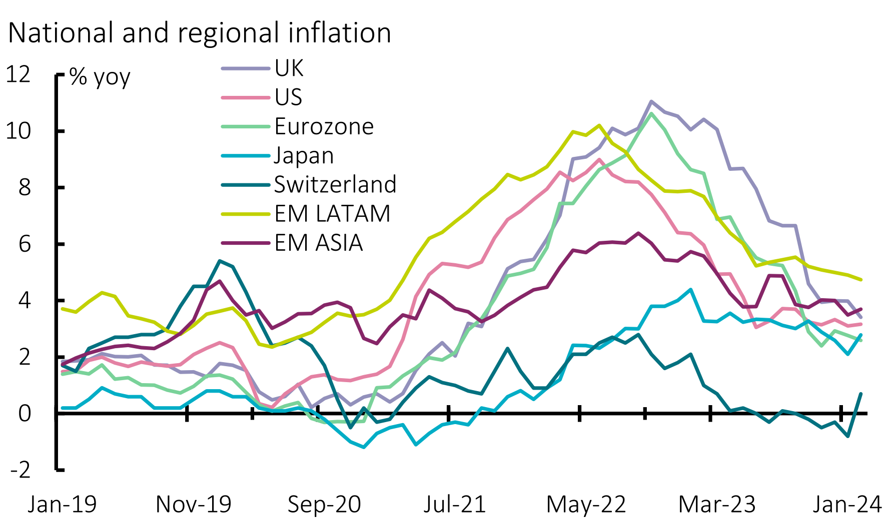
Global risks persist

- Middle East tensions and Houthi shipping attacks present upside inflation risks. The Fed's global supply chain index has risen recently as shipping has increasingly avoided Red Sea transit, which may impact core goods prices. Oil prices have also risen this year on factors including the Middle East, Russian refinery strikes and a revival in China's industry. Both present upside inflation risks

Divergence in inflation trends

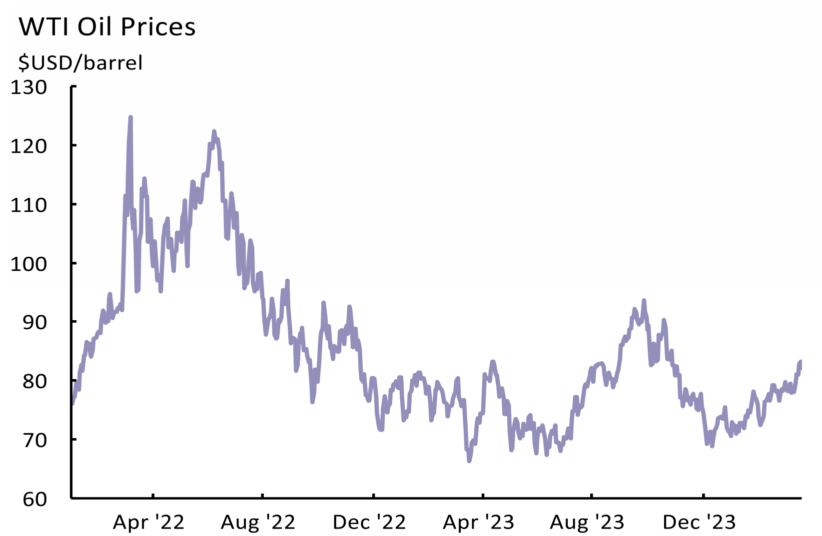
- After a period where global inflation was synchronised by the material supply-side shock associated with the pandemic and its unwind, inflation heterogeneity is now emerging. The US has seen accelerating services inflation – a symptom of domestic pressures; the Eurozone sees a similar dynamic despite much weaker growth; while in the UK we argue that what has seemed a UK inflation problem is simply a case of lagged disinflation. More broadly Japan may finally have overcome its decades long battle with deflation – although maintaining 2% inflation may still be a challenge. China is now battling deflation.

Inflation has been broadly synchronised to date



Source: BLS, Eurostat, ONS, JP Min Int Affairs, NBS, IMF and AXA IM Research, March 2024

Oil prices rise across 2024



Source: LSEG Datastream , AXA IM Research, 21/03/2024

Inflation heterogeneity

US inflation - exogenous disinflation fades, endogenous inflation rises

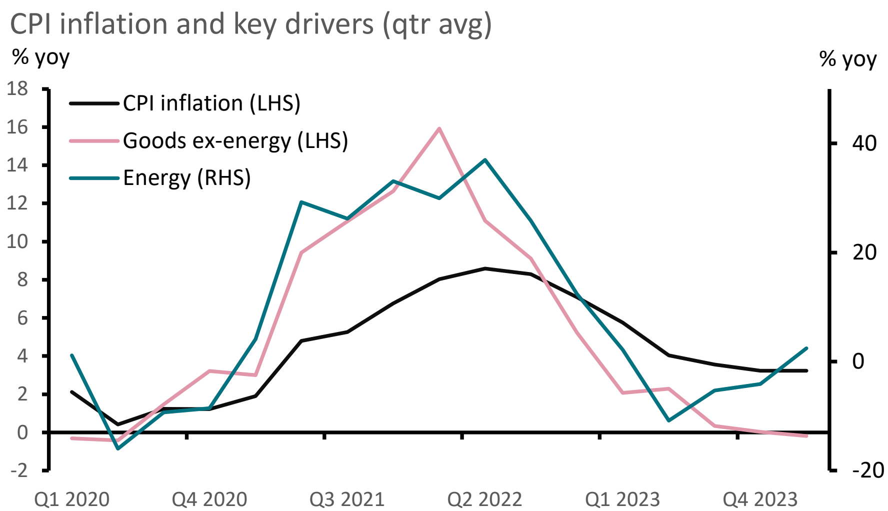
Disinflation from energy and goods prices has run its course

- US CPI inflation fell sharply from 9.1% in June 2022 to 3.0% in June 2023. Since then it has been stable and is currently at 3.2% (PCE inflation at 2.4%, close to the Fed's 2% target). The key drivers of US disinflation have been energy prices, where disinflation peaked mid last year and have risen since, and core goods inflation which has remained subdued. Neither was ever likely to maintain its peak disinflation and both face upside risks now. However, for inflation to return to target, we need to see disinflation in services.

Service sector inflation to soften

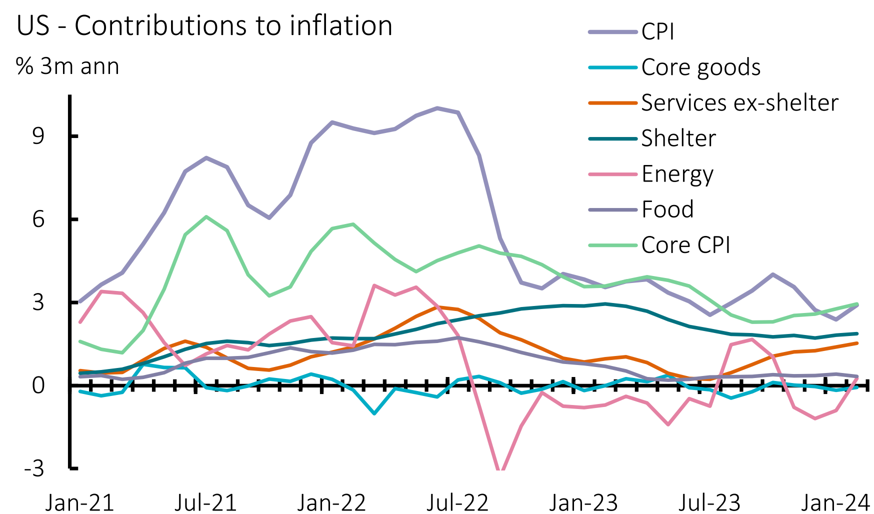
- This has not been the case to date, with services inflation broadly stable for the last six months. Looking ahead, we expect shelter inflation to start to slow, reflecting the lagged impact of falling rents seen over most of last year. The last 9 months has also seen accelerating services ex-shelter inflation, reflecting a still tight labour market and buoyant consumer spending. We expect a loosening in the former and softening in the latter to help dampen this inflation ahead.

Sharp disinflation driven by energy and core goods



Source: BLS, AXA IM Research, March 2024

Return to target requires service sector disinflation



Source: Bureau of Labor Statistics and AXA IM Research, March 2024

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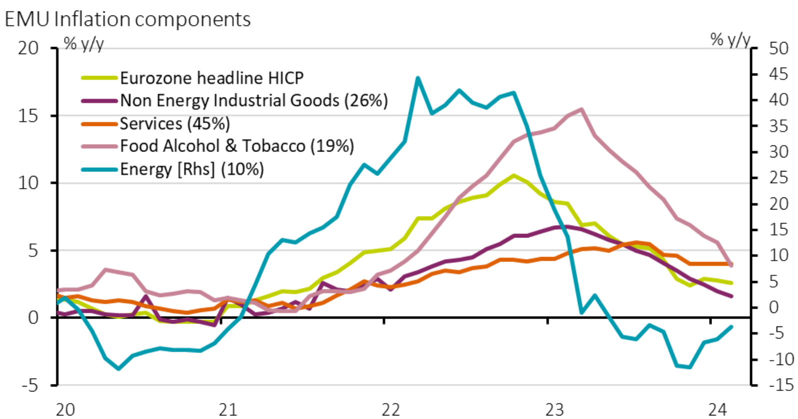
Inflation heterogeneity

Euro Area inflation – the stabilisation phase

Disinflation has not occurred everywhere and at the same pace

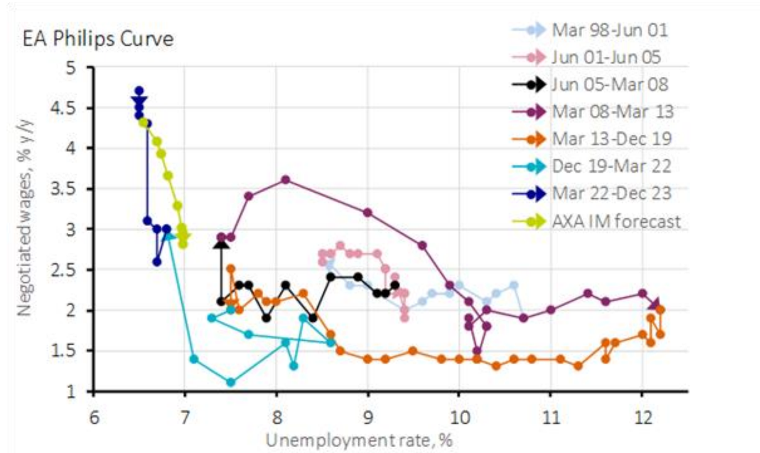
- Headline inflation is not far from the ECB's target (2.6% y/y in February) but underlying dynamics across components are heterogeneous. Negative base effects on food and goods inflation are still high after sharp price increases at the end of 2022/beginning of 2023. Those for energy are fading and are likely to be more neutral, if not slightly positive in the coming months.
- Services inflation remained at 4% y/y in February 2024, at the same level for four consecutive quarters. Historically, it is very well correlated with wage growth, which remains dynamic. Thus, the "domestic" disinflation process is slower. We forecast services inflation to gradually converge to 2.4% in Q4 2025.
- Risks: if a shock occurs on energy or the supply chain, inflation may rebound and stay "higher for longer" and could complicate the ECB's task of easing restrictive policy.

Services inflation yet to engage decisive downward path



Source: Eurostat, AXA IM Research, March 2024

Eurozone wage growth has likely peaked, though to remain above 4% in H1 24



Source: ECB, Eurostat, AXA IM Research, March 2024. NB: Line color reflect changing dynamics in unemployment rate

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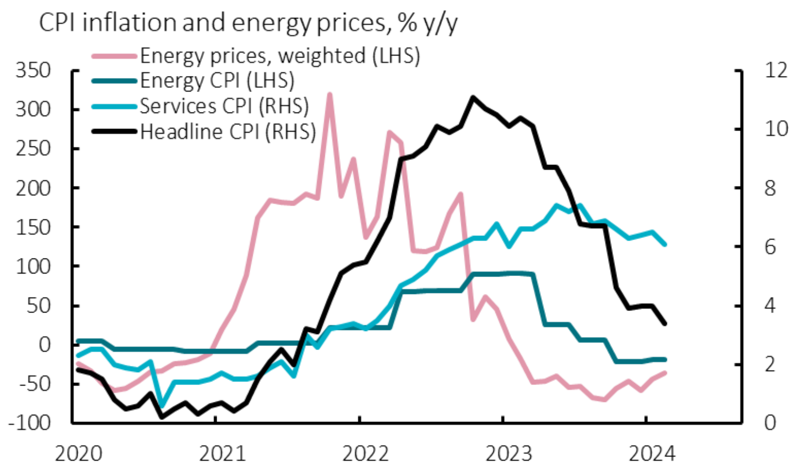
Inflation heterogeneity

UK inflation – from one inflation problem to another

The UK will shift from having one of the highest inflation rates to one of the lowest

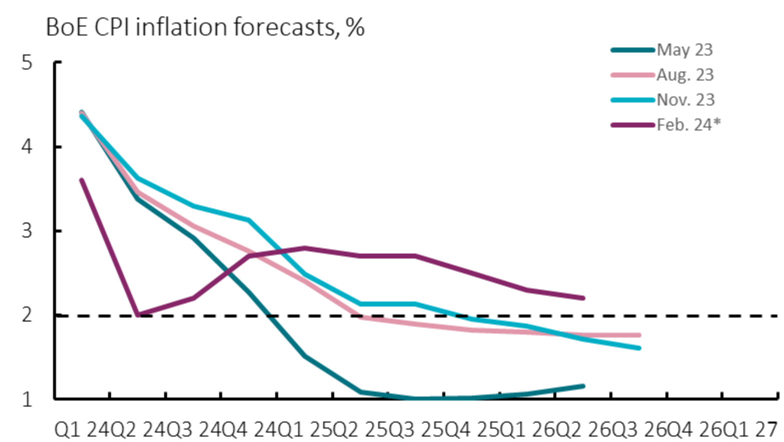
- UK CPI inflation came in just below expectations in February, dropping to 3.4%, from 4.0%, but was still far higher than in the Eurozone. Yet we do not believe that the UK has an inherent inflation problem. Rather, the UK inflation impulse lags because the of the delay of passthrough of wholesale energy prices to retail caused by Ofgem Energy Price Cap; this delayed inflation emerging and appears similar on the way down. We expect a further slowdown over the coming months with the headline rate likely to drop below 2% in April.
- By next year, the UK will likely face the opposite problem and we are increasingly focused on the risk of a persistent inflation undershoot of the 2% target from 2025. Indeed, services CPI inflation should already be moving swiftly back to the 3% rate we think is consistent with the BoE achieving its inflation mandate. But rising labour market slack and tighter fiscal policy looks set to cause a further slowdown. To our minds, the MPC has too much optimism built into its forecasts. We have pencilled in a further two cuts in 2025, bringing Bank Rate to 3.25% by year-end as a result.

Hit from energy was delayed due to the Ofgem Price Cap



Source: ONS, LSEG, AXA IM Research, March 2024

BoE CPI inflation forecasts likely will be revised down in '25



Source: BoE, AXA IM Research, March 2024

Inflation: Towards a higher inflation anchor

Japan

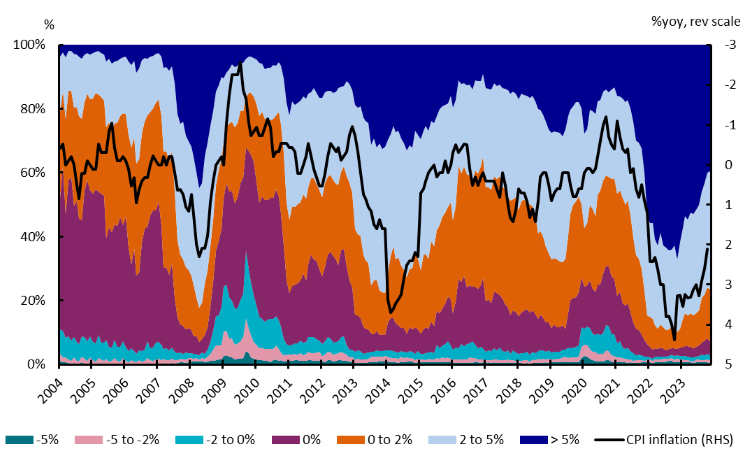
After decades battling deflation

- Disinflation is well underway from the peak in national inflation at the start of 2023, although it would have been quicker without yen weakness and the gradual reduction in energy subsidies. But inflation has still spent 22 consecutive months above the BoJ's 2% inflation target, which was in stark contrast to the average 0% between 1995 and 2021 (excluding the 2014 VAT hike). Long-term inflation expectations rose.

2% inflation target may still be a challenge

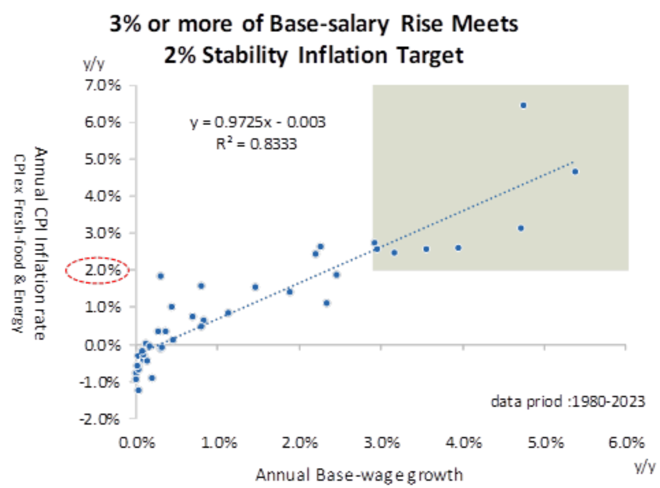
- The BoJ awaited strong wage growth to signal a virtuous wage price loop for the coming year to increasingly anchor expectations to its target. The recent 3.7% (base pay only) announced Rengo negotiations came above any estimates, confirming such a rise and resulting in the BoJ removing its negative interest rate – the first hike since 2007. Yet we suggest that while the risk of falling into deflation has receded, we maintain that achieving the BoJ's 2% target over the long-term looks hard to achieve

Inflation expectations rise structurally higher



Source: Cabinet Office, AXA IM Macro Research, March 2024

Inflation around target requires the exceptional to be the norm



Source: Ministry of Internal Affairs & Communication, AXA IM Macro Research, AXA IM Tokyo FI, March 2024

Inflation heterogeneity

China inflation – pork or not, weakness remains

Weak CPI inflation exaggerated by pork prices

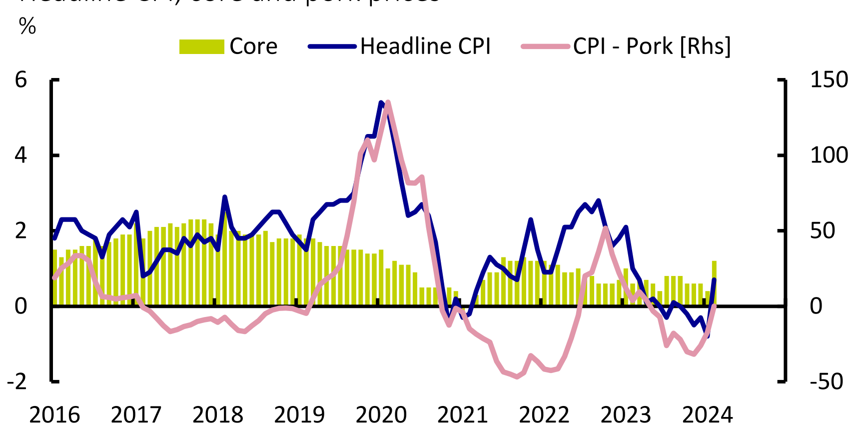
- In 2023, CPI recorded its weakest inflation since 2009. Over the year, fluctuations in pork prices have exacerbated subdued inflation, resulting in outright annual deflation in some months. Core inflation, excluding food prices in general, has been weak.

Persistent PPI deflation underscores weak output amid overvalued currency

- Despite a brief surge in exports in early 2021 and subsequent rapid PPI inflation, these trends quickly dissipated as global lockdowns ended. Overcapacity, sluggish domestic demand, and subdued exports have resulted in PPI remaining in deflationary territory since September 2022. Given the People's Bank of China's (PBoC) resistance to monetary stimulus, demand and exports have failed to revive and support for the yuan has added to prolonged PPI deflation.
- We expect a gradual recovery in both PPI and CPI over the next two years, accompanied by a narrowing gap between the two, as further stimulus lifts underlying activity. However, in the short term, risks persist in a near-deflationary environment.

Headline CPI inflation exacerbated by pork price fluctuation

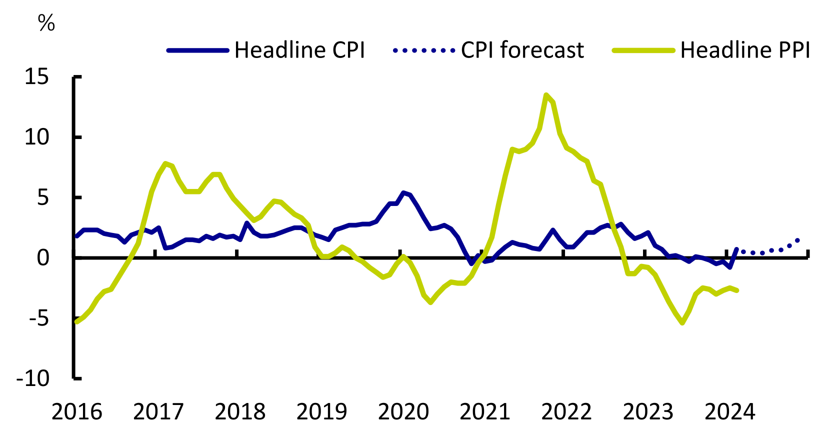
Headline CPI, core and pork prices



Source: CEIC and AXA IM Research, March 2024

Gap between PPI and CPI followed by persistent PPI deflation

Headline CPI and PPI



Source: CEIC and AXA IM Research, March 2024

Inflation heterogeneity

EM ex China inflation – disinflation well advanced

EM inflation has come off to levels close to CB's targets or target ranges, but the easy ride is rather behind

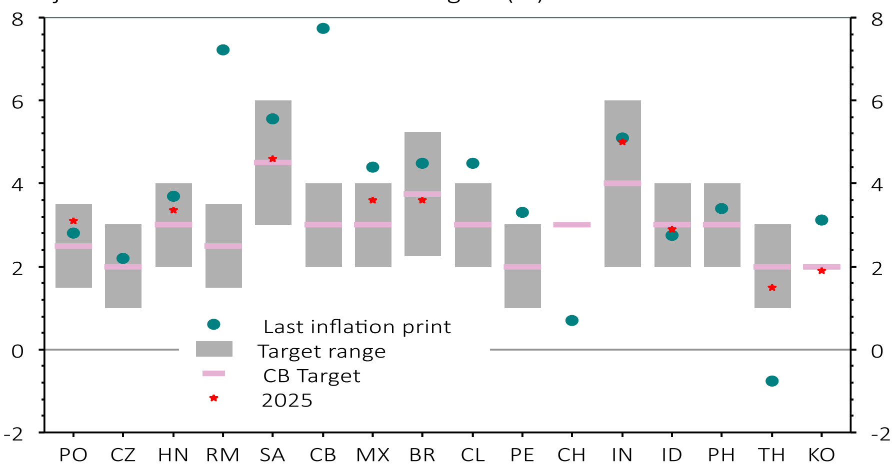
- Having peaked at around 10% in Latin America (mid-2022), 6% across EM Asia ex China (fall 2022) and more than 18% across Central Europe (early 2023), inflation has decisively started its descent. By February 2024, headline inflation had come back to central banks' targets or within their target bands. There are still outliers, such as Romania in CEE, Colombia in Latam and Turkey, but overall, all major components contributed to disinflation albeit that energy prices have done the heavy lifting.

Monetary policy easing is ongoing and will be paced by various metrics

- Having hiked rates earlier than DM, many EM central banks have already started easing. Brazil and Chile were among the first-movers last summer followed by Central Europe. Banxico is the latest big EM central bank to move, cutting by 0.25% this month. Yet Asian central banks appear in no rush to start easing: inflation has been kept in check via subsidies, but these now need to be faded (Taiwan recently tightened policy as electricity subsidies were removed). While positive real rates still point to further easing ahead, the evolution of the stickier services prices, FX moves, and fiscal policy will be key to gauge the pace of future policy cuts.

Inflation at CB targets or within bands in many countries

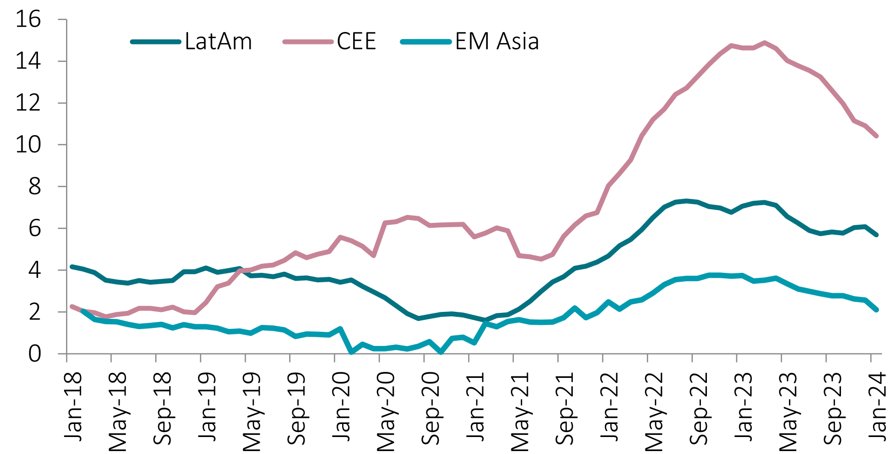
Major EM inflation rates and CB targets (%)



Source: LSEG Datastream, AXA IM Research 15/02/2024

Stickiness in services inflation grabs CB's attention

Services inflation by region (%yoy)



Source: LSEG, AXA IM Research, Jan 2024

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Macro outlook

Inflation firmer at start of year

US

Disinflation doubt

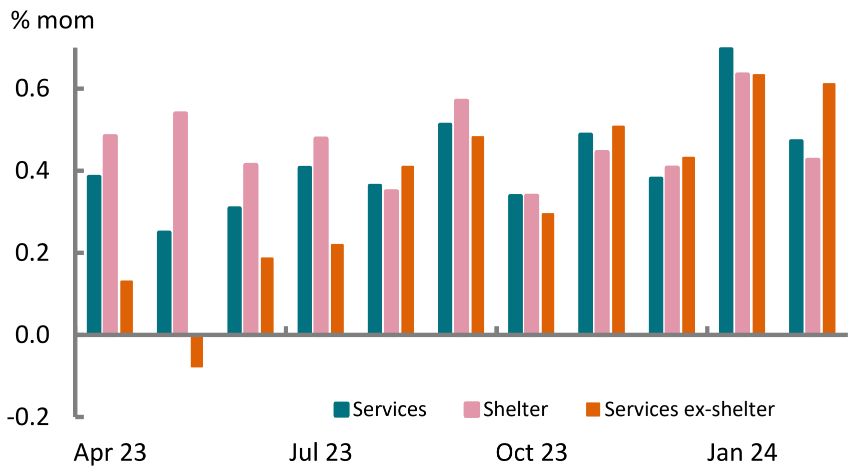
- February's inflation surprised again with monthly gains of 0.4% in both headline and core. Energy impacted headline rates, but the pick-up in services has been more concerning. Admittedly, shelter inflation resumed a softer pace after January's spike, services ex-shelter remained firm, but was in part driven by volatile airfares. We suspect this is more statistical noise than trend. Yet we expect inflation to remain stickier than consensus forecasting an average rate of 3.0% in 2024 and 2.5% in 2024 (consensus 2.8% and 2.4%)

A softening consumer

- There are some signs of a softening consumer. February's retail sales failed to rebound from a sharp January drop (the control group was flat after a 0.3% decline). Measures of consumer confidence have faded since year-end and the Beige Book reported some signs of softer spending activity. We expect this softness to persist after a robust H2 2023.

Firming in services inflation most watched

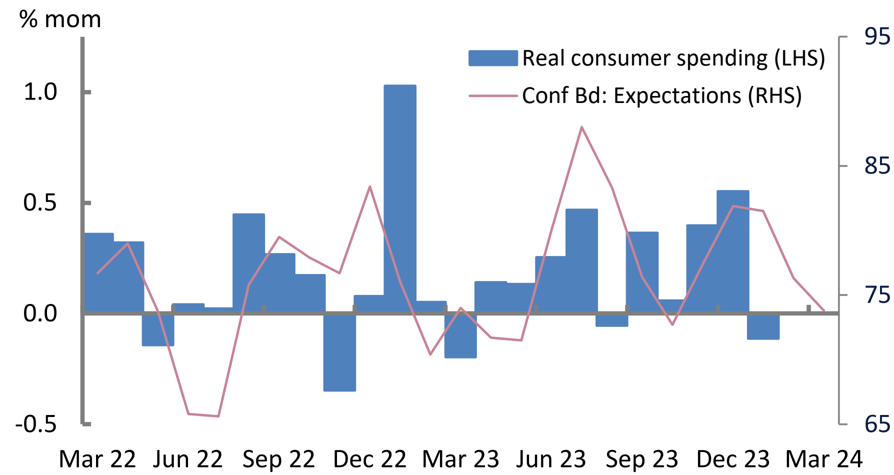
Services inflation, by major component



Source: BEA, AXA IM Research, March 2024

Consumer sentiment softens from year-end

Consumer spending and confidence



Source: BEA, Conference Board, AXA IM Research, March 2024

Fed maintains option for June easing

US

Broader activity softening

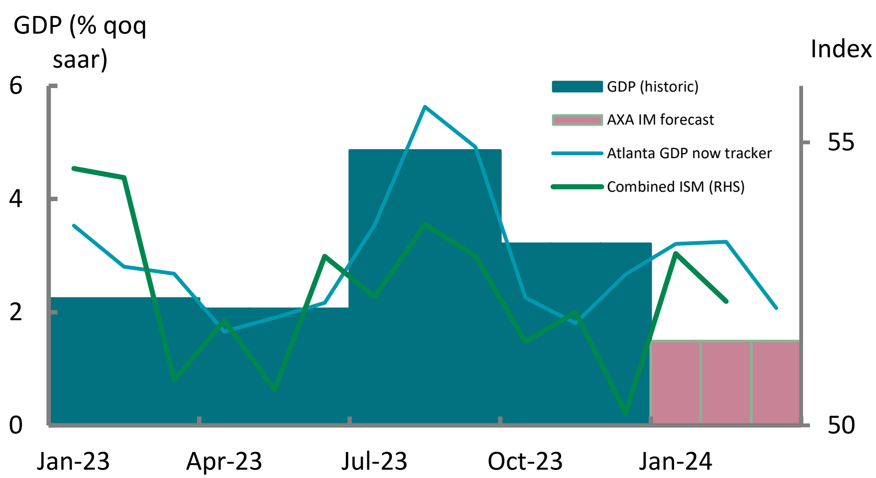
- While a softening in consumer spending is at the centre of our forecasts for a slowdown in growth over the coming quarters, we also note that services surveys appear to be on a softening trend for now. And the Atlanta Fed GDP tracker has slowed from suggesting Q1 GDP growth of 3.5% to currently suggesting 2.1%, closer to our own 1.5% forecast. Nevertheless we edge our 2024 forecast higher to 2.1% (from 2.0%) and forecast 1.5% for 2025 (consensus 2.1% and 1.7%)

Fed maintains three dots for 2024

- The Fed held its projection of three cuts for 2024 at the median in March's projections. Fed Chair Powell said the Committee required further evidence that inflation was sustainably returning to target before easing, but dismissed fears that recent inflation prints had derailed expectations for cuts this year. We forecast 4 cuts this year, starting in June, and 3 cuts next (to 3.75% by end-2025). This is now lower than Fed and market expectations. The Fed added it would announce a slower pace of QT "fairly soon".

Growth prospects continue to soften

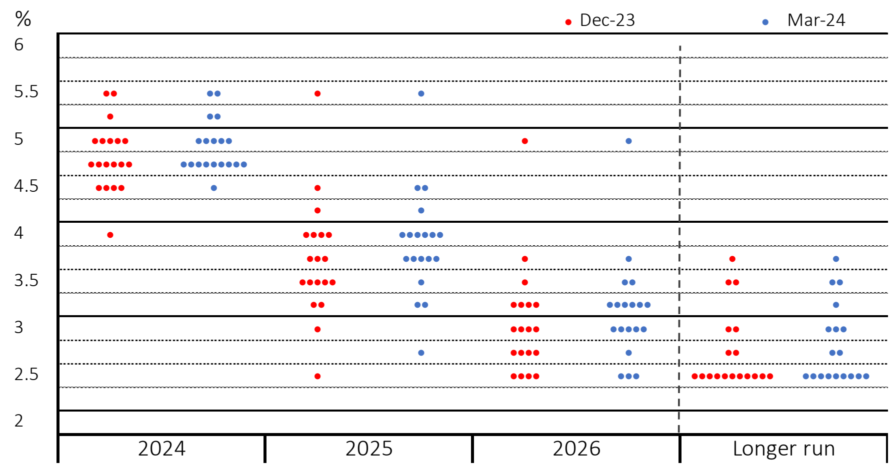
GDP growth and short term outlook



Source: BEA, ISM, Bloomberg, AXA IM Research, March 2024

Fed continues to see three cuts in 2024

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



Source: FRB, Mar 2024

Meagre growth outlook

Eurozone

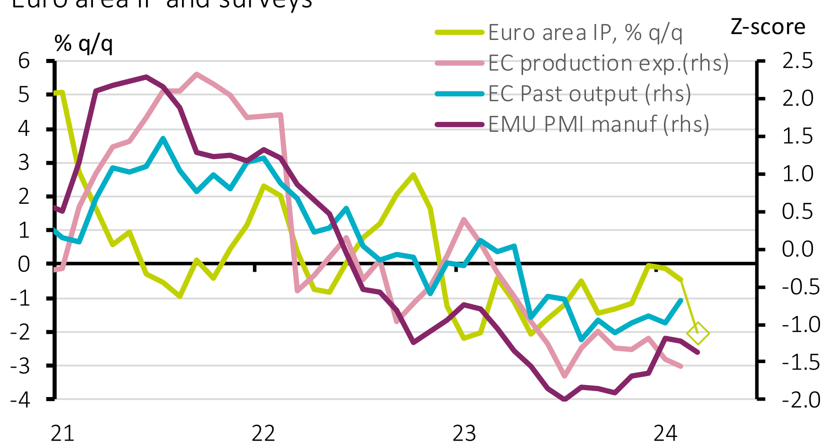
Manufacturing is stuck, services tentatively improving

- Euro area industrial production dropped markedly in January – significantly affected by Ireland. Q1 24 carry over is -2%. Meanwhile, surveys continue to suggest no imminent manufacturing growth rebound.
- Meanwhile, PMI services improved a little in March, but the overall PMI composite output remained slightly below the 50-breakeven concurring with limited growth pick-up. We see downside risks to our +0.1% q/q eurozone Q1 GDP forecast

Convergence to our long held below consensus forecast

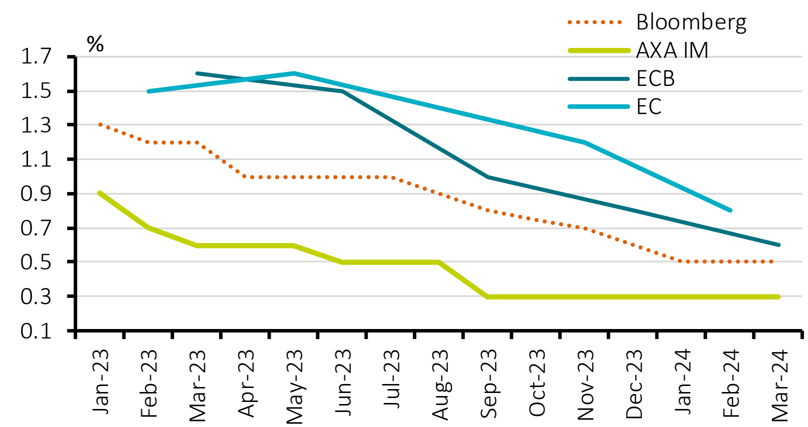
- The updated March ECB 2024 growth forecast (0.6%) converged further with the Bloomberg consensus (0.5%), closer to our long held anaemic growth forecast this year (0.3%)

Negative contribution from industrial output in Q1 24 likely



Source: Refinitiv, AXA IM Research, March 2024. NB: Diamond shows the Q1 24 carry-over

Converging on our below consensus growth view



Source: Bloomberg, AXA IM Research, ECB, European Commission, March 2024

Fiscal policy in focus

Eurozone

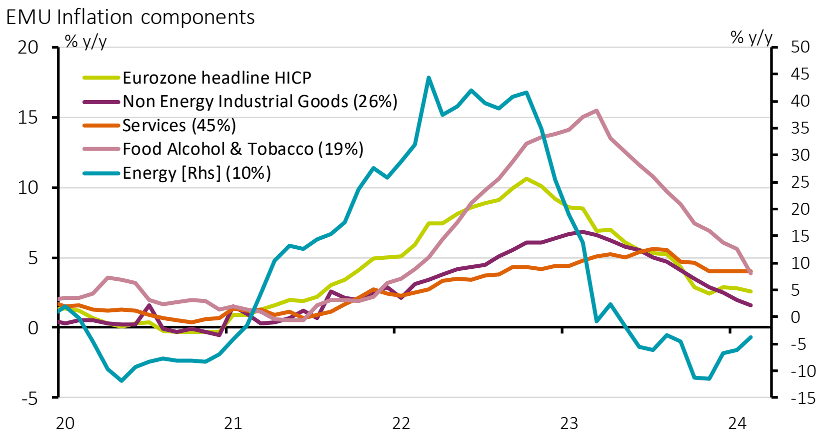
ECB: Rendez-vous in June

- At its March meeting, the ECB kept its policy stance unchanged, still concerned by "high domestic inflation" and needing to see more evidence of the underlying disinflation process. Services inflation is a key concern. We maintain our long held call of a 25bps rate cut at the June meeting – looking for three in total this year, the market now only marginally more aggressive at -90bps.

Watch for updated stability programmes in April

- We think the Italian government's optimistic 2024 growth forecast (1.2%, AXA IM: 0.3%) is likely to be revised lower, which would mean looking for €15-20bn of extra savings to keep this year's public deficit to GDP target realistic (4.3%). The French government could shift the entire fiscal trajectory: 2023 public deficit-to-GDP ratio came 0.6pp above target at 5.5%, this year's government growth forecast remains too optimistic (1%; AXA IM: 0.4%); Embedded 2025 fiscal trajectory already requires c.€20bn extra savings.

Sticky services inflation



Source: Eurostat, AXA IM Research, March 2024

Italy: Superbonus-led upward revision in past deficit again

Italian public finances

% of GDP		2022	2023	2024	2025	2026
Mar-24	Budget bal.	-8.6	-7.2	-	-	-
	Primary bal.	-4.3	-3.4	-	-	-
	Gvt gross debt	140.5	137.3	-	-	-
Sep-23	Budget bal.	-8.0	-5.3	-4.3	-3.6	-2.9
	Primary bal.	-3.8	-1.5	-0.2	0.7	1.6
	Gvt gross debt	141.7	140.2	140.1	139.9	139.6
Apr-23	Budget bal.	-8	-4.5	-3.7	-3	-2.5
	Primary bal.	-3.6	-0.8	0.3	1.2	2.0
	Gvt gross debt	144.4	142.1	141.4	140.9	140.4

Source: Italian Treasury

Economy rebounds at the start of 2024

UK

Likely out of recession

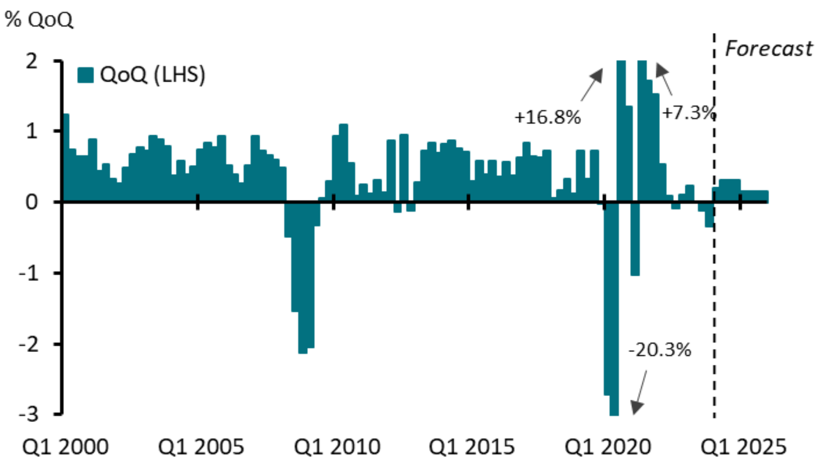
- The UK is probably no longer in recession; GDP rose by 0.2% m/m in January, after a 0.1% drop in December. Output was still down 0.1% in the three months to January, but further rebounds in 2024 look likely; the services PMI is above 50, RICS data points to a recovery in housing and consumer confidence is above its 2023 level. Real incomes look set to rise as wage growth outstrips inflation and tax cuts and benefit hikes kick in in the spring. The stronger consumer outlook has led us to revise up our growth forecast by 0.2pp in both 2024 and 2025, to 0.4% and 0.8% (consensus 0.3% and 1.1%).

Labour market slack developing slowly

- The latest labour market data show slack emerging; employment fell by 21K in the three months to January and the unemployment rate rose by 0.1pp to 3.9%. Admittedly, the MPC probably still aren't placing much weight on official figures, given the shortcomings of the LFS survey. But other indicators also suggest a looser labour market: vacancies fell for the 20th month in a row, redundancies remained above pre-Covid levels and survey data suggest recruitment difficulties are easing.

Gradual recovery likely this year

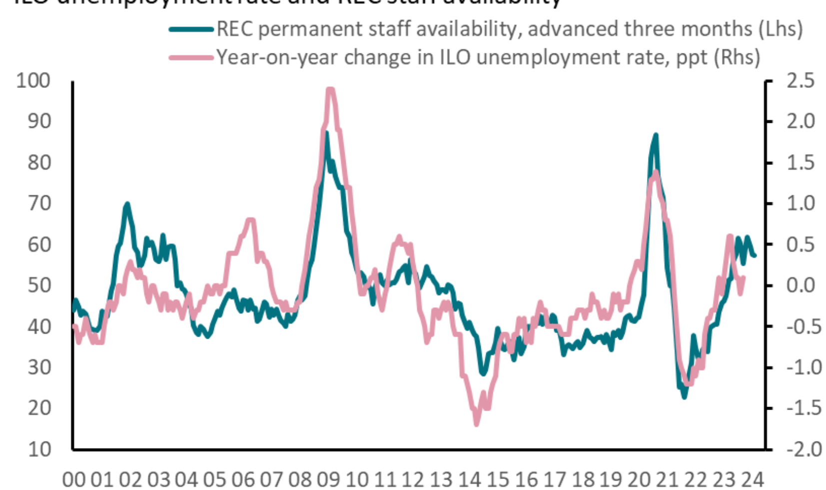
GDP growth forecasts



Source: National Statistics, AXA IM Research, March 2024

More labour market slack than LFS data suggest

ILO unemployment rate and REC staff availability



Source: REC, National statistics, AXA IM Research, March 2024

Slowing inflation to underpin rate cuts

UK

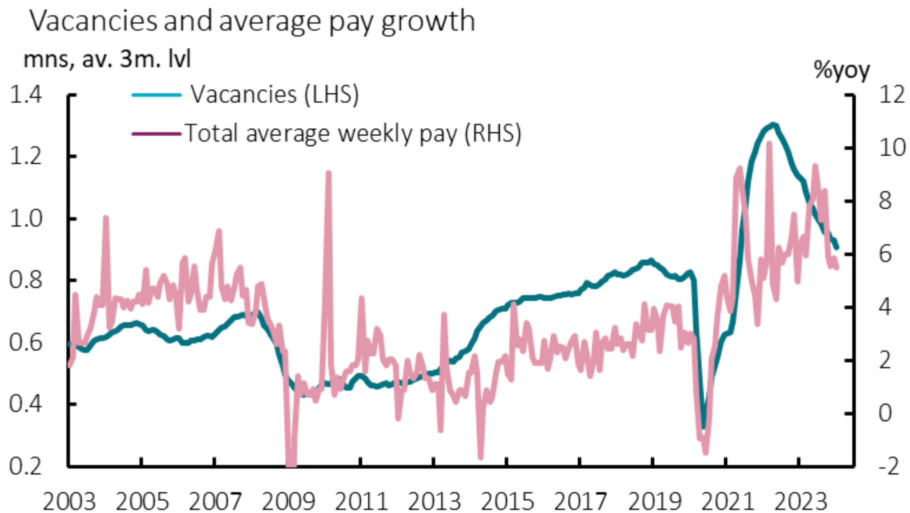
Wage growth and inflation will cool further

- Headline growth in ex-bonus AWE was below consensus in January, falling to 6.1%, from 6.2% (consensus 6.2%). We expect some upward pressure on wages in the spring, as low-wage employers push through pay increases on the back of a 9.8% rise in the NLW. But rising labour market slack suggests headline pay growth will grind lower. Inflation, meanwhile, also came in below consensus and BoE expectations for a fall to 3.5% in February, instead slowing to 3.4%, from 4% in January.

Bringing in our rate cut call to June

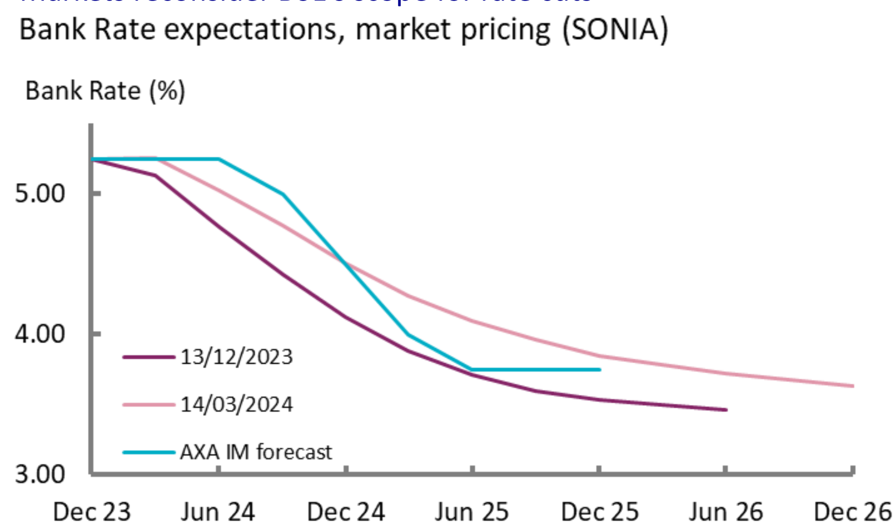
- As expected, the MPC voted to keep Bank Rate unchanged at 5.25% at March's meeting, but a dovish shift in the vote split (both Haskel and Mann voted with the majority, rather than pushing for a further 25bp hike) and in the minutes means we now think the first cut to Bank Rate will come in June, not August. We then expect two further cuts in September and November, leaving Bank Rate at 4.75% by year-end. With inflation looking as though it will undershoot the 2% target in 2025, we have added in two further rate cuts in the latter part of the year, leaving Bank Rate at 3.25% by year-end.

Wage growth should continue to slow



Source: National Sources, AXA IM Research, March 2024

Markets reconsider BoE's scope for rate cuts



Source: Bloomberg, AXA IM Research, March 2024

Private consumption still lags

China

New year celebration did not revive private consumption

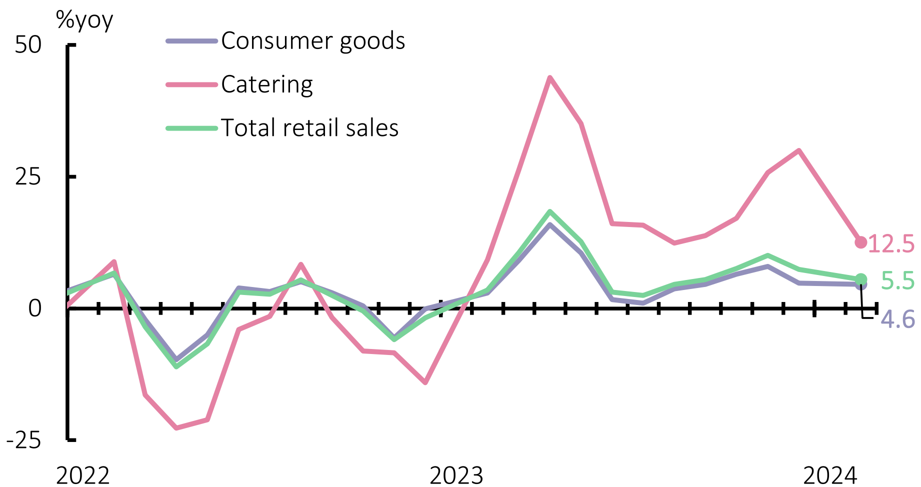
- Holiday travel during the Lunar New Year reached a record high since 2019, yet retail sales still lost momentum at the beginning of the year, reflecting a combination of strong base effects and ongoing subdued consumer confidence.

Property prices extended the trend decline

- Despite the supportive policy measures on both demand and supply sides, property prices declined further in February compared to a month before, across the primary and secondary markets. The downturn in the property sector is likely to extend into next year. Furthermore, without direct fiscal support to the consumer sector, the ongoing property price correction will continue weigh on consumer confidence and supress private consumption, adding disinflationary pressure to the economy.

A new year celebration without much consumption

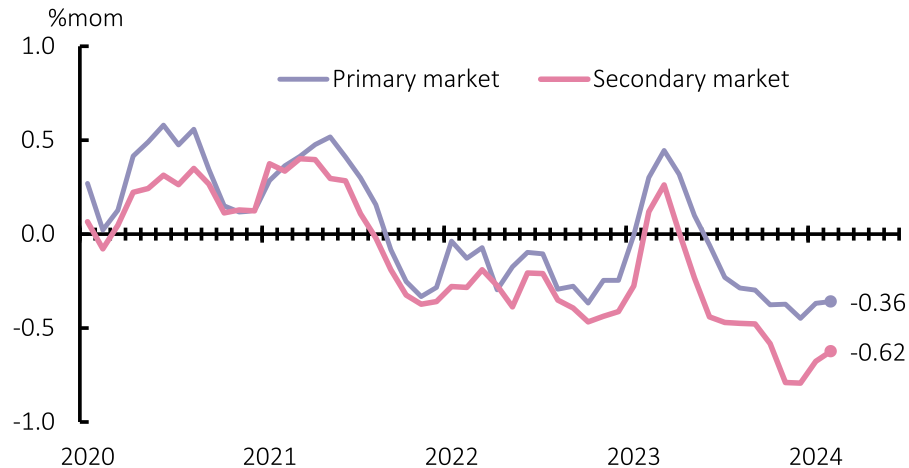
China - Retail sales



Source: CEIC and AXA IM Research, March 2024

Property price continued its decline in February

China - National average property price



Source: CEIC and AXA IM Research, March 2024

Investment Managers

Exports beat expectation, credit rebound short-lived

China

Exports had a great start of the year, signalling a recovery of external demand

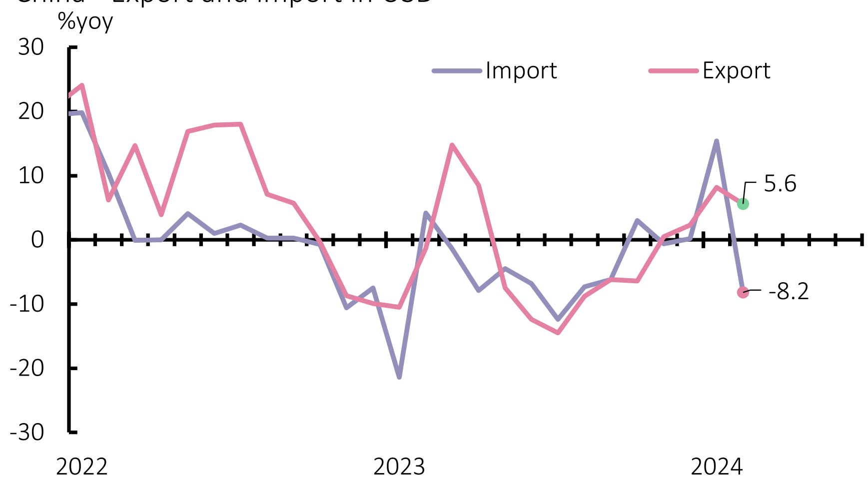
- Exports gained momentum at the beginning of the year, reaching the highest level since May 2023. This could be an early sign of external demand recovery. However, medium-term headwinds will persist, especially in a US election year with both Presidential candidates hawkish towards China.

Boom in credit faded quickly

- January saw a record-high total social financing (TSF) flow and the largest net issuance of corporate bonds in nearly two years. However, the latest data has shown that boom to be short-lived. Though a firm base effect exacerbated the decline on the single month, a decline of 12% for January and February combined highlights the slowing momentum in credit impulse. Although the PBoC kept the one-year medium-term lending facility rate unchanged at 2.5% on 15 Mar, the Governor confirmed during a press conference in the National People's Congress week, that a RRR cut is possible in the near future.

Early sign of recovery in trade

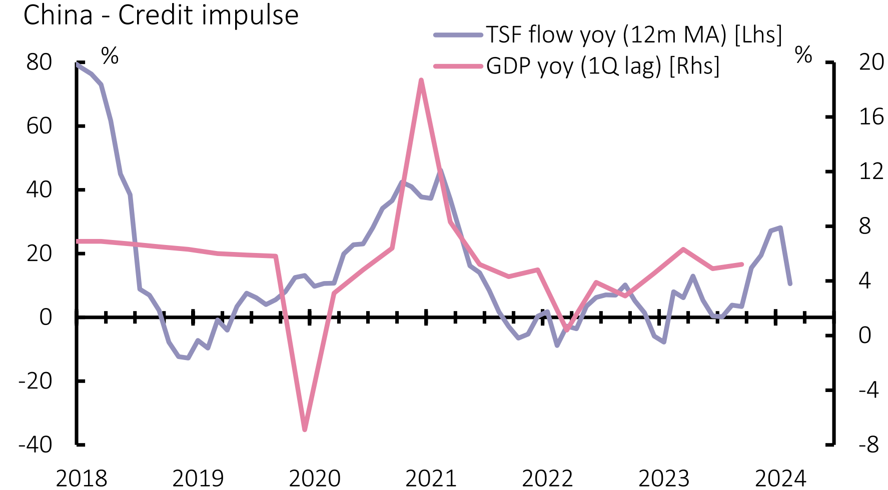
China - Export and import in USD



Source: CEIC and AXA IM Research, March 2024

Credit momentum ahead of LNY was short lived

China - Credit impulse



Source: CEIC and AXA IM Research, March 2024

The Bank of Japan did it

Japan

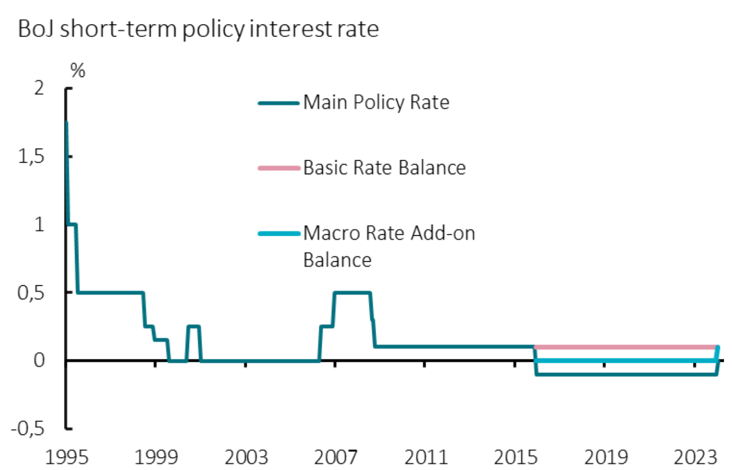
The Bank of Japan didn't want to miss the opportunity

- The BoJ finally ended 8 years of negative interest rate policy and abolished its yield curve control on 10-year JGB. The policy rate range is now between 0% and +0.1% (from -0.1%). The BoJ will continue to buy JGBs at a monthly pace of around ¥6trn, a similar pace to before. Its statement mentioned ad hoc and unlimited purchases at fixed interest rates in the event of a sharp increase in JGB yields, although BoJ Governor Ueda added that the ultimate plan was for market forces to set long-term rates.

Wages proved the trigger

- Since the autumn, the BoJ had conditioned this first step of policy normalisation on the outcome of wage negotiations and an improving economic outlook. The former exceeded any expectations, with union negotiated wages rising by 5.3% (3.7% for base pay, 1.6% depending on seniority), up 1.7 ppt from last year and only 0.6ppt below the trade unions' initial request. This is the largest increase since early 1990s.

End of Negative Interest Rate Policy (NIRP)



Source: Bank of Japan, AXA IM Research, March 2024

Historic wage negotiations

Source: Ministry of Health, Labour and Welfare, AXA IM, March 2024

The BoJ is after a virtuous wages/price loop

Japan

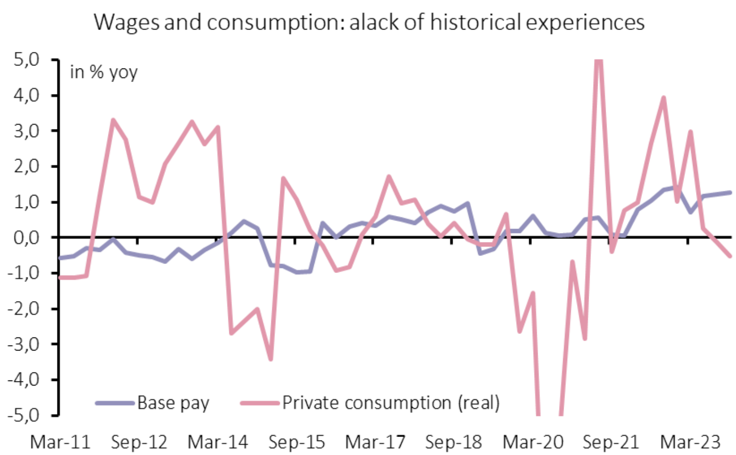
The rebound in consumer spending now eagerly awaited

- The BoJ believes that surging wages and continued disinflation should boost household real purchasing power. We also believe this will be the case, particularly in Q2 and Q3. However, we remain cautious about the impact, given the lack of historical experience over the last three decades with the risk that households choose not to consume all their new income, with different implications for activity.

The Bank of Japan remains wary

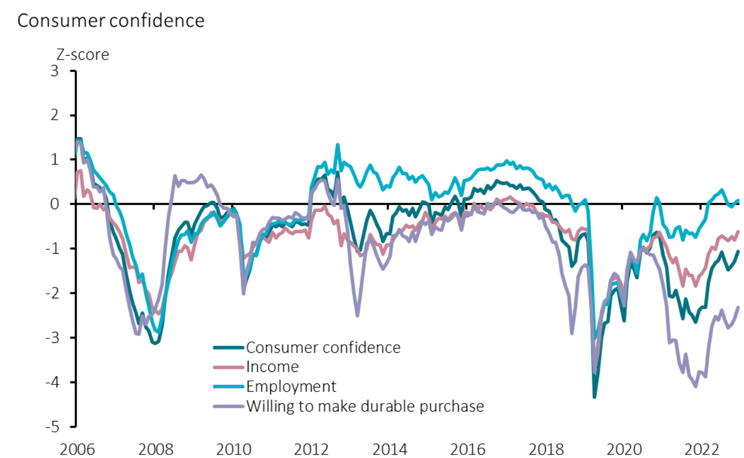
- The BoJ's next steps rely on the emergence of a virtuous wage/price loop evolving through higher consumption. If everything goes as planned, it should be able to make further small hikes to short-term interest rates: we forecast one more hike of 10bp by year-end and 20bp by end-2025. It should also start to look at reducing its balance sheet, but it is only likely to consider this towards the end of 2024, with implementation unlikely before 2025.

Converting higher wages into consumption boost …



Source: Cabinet Office, AXA IM Macro Research, as of March 2024

Consumer surveys bounced back recently, only "willing to make durable purchase" lagging



Source: Cabinet Office, AXA IM Macro Research, as of March 2024

GDP holding in

Canada

Growth just above zero

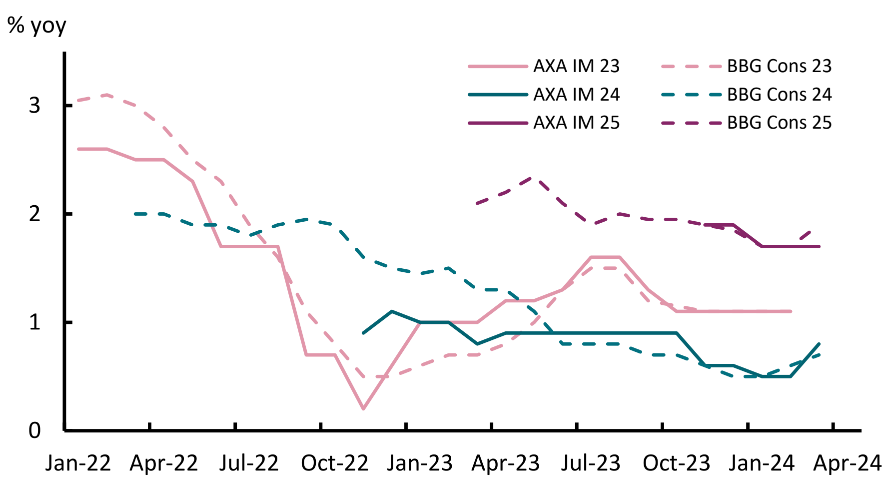
- Q4 GDP rose by 1.0% (annualised), broadly reflecting our expectation for a catch-up following a surprisingly soft (although upwardly revised) -0.5% in Q3. Growth recorded 1.1% for 2023 as a whole. The 'flash' estimate of January's GDP was a rise of 0.4%. We are sceptical of this, but acknowledge a stronger trend at the start of this year than we feared. We raise our forecast for this year to 0.8% (from 0.6%), leaving 2025 at 1.7% (consensus 0.7% and 1.9%, BoC 0.8% and 2.4%)

Headline disinflation to continue

- CPI inflation eased back to 2.8% in February, its lowest rate in 4 years. The headline rate looks set to ease by more over the coming quarters and may temporarily dip below 2% in Q3. However, we expect inflation to remain around 2.5% by year-end. We lower our inflation forecast to 2.3% (from 2.9%) this year and 2.2% (from 2.3%) next. Core measures of inflation also ticked lower, showing some improvement. However, progress in these core measures has been slow.

More confidence that economy to avoid contraction

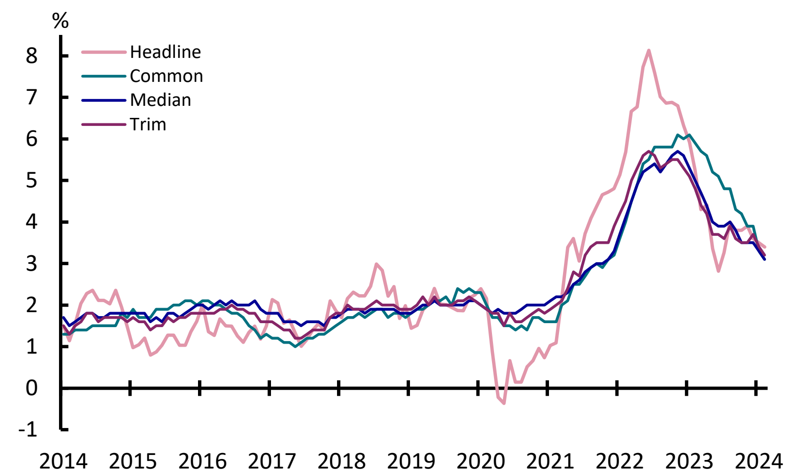
Evolution of GDP forecasts



Source: CANISM, Bloomberg, AXA IM Research, March 2024

Inflation at 4-year low, core progress still slow

CPI measured variations



Source: CANISM, AXA IM Research, March 2024

Domestic inflation pressures constrain BoC easing

Canada

Recent trends threaten inflation persistence

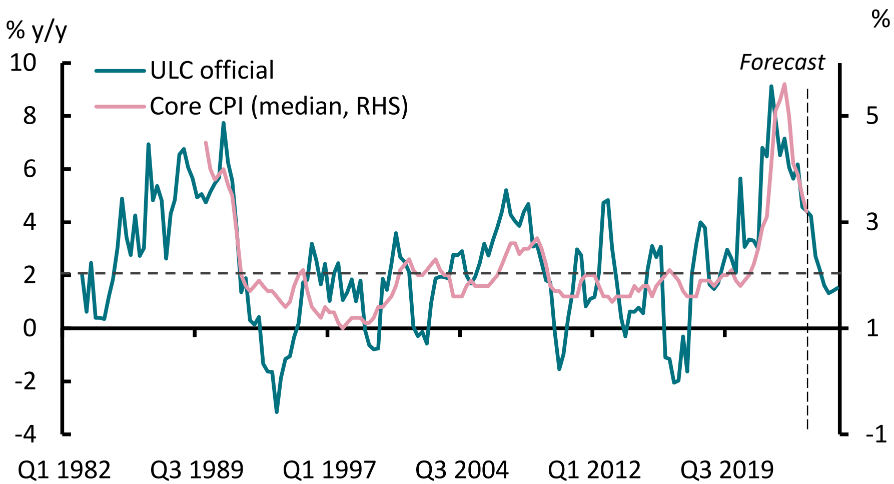
- The BoC remains concerned about the prospects for persistent underlying inflation, something that slow progress in core inflation will exacerbate. The BoC will also watch developments in unit labour costs (ULC). For now, these remain elevated at 4.6% (Q4 2023) – a rate previously associated with cyclical highs. Falling wage gains should soften this over the coming quarters, but ULC developments will also depend on productivity growth, which has been persistently weak and risks these remaining elevated.

BoC cautious to cut, learning on balance sheet

- With sluggish progress in core inflation we expect the BoC to remain cautious in easing policy and continue to forecast a July first easing (markets see 80% June), although our expectation for 3 cuts this year has now become consensus. We forecast a further 3 cuts next year to 3.50% by year end. Recent BoC comments updated the outlook for QT, suggesting an end to the policy could come a little later (in 2025), although a move to follow the Fed in slowing QT this year could see this later still.

Unit labour costs threaten inflation persistence for now

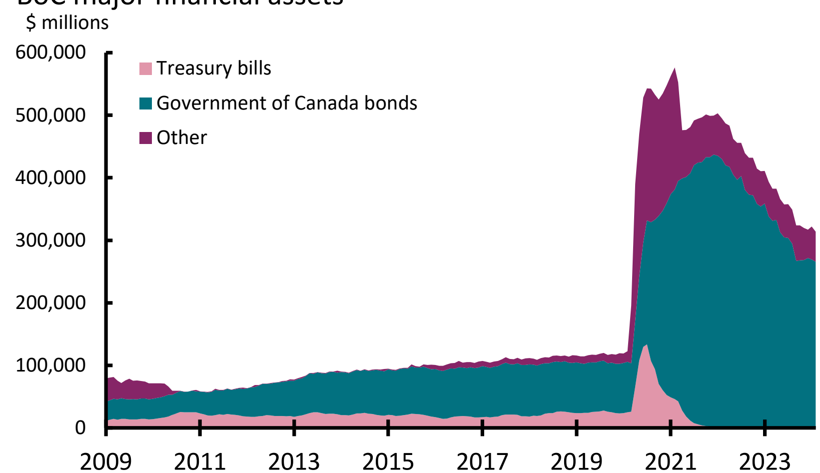
Core (median) CPI inflation and unit labour costs



Source: CANISM, AXA IM Research, March 2024

BoC considers outlook for balance sheet

BoC major financial assets



Source: Bloomberg, AXA IM Research, February 2024

Inflation is easing, but central bankers in no rush to cut rates

EM Asia ex-China

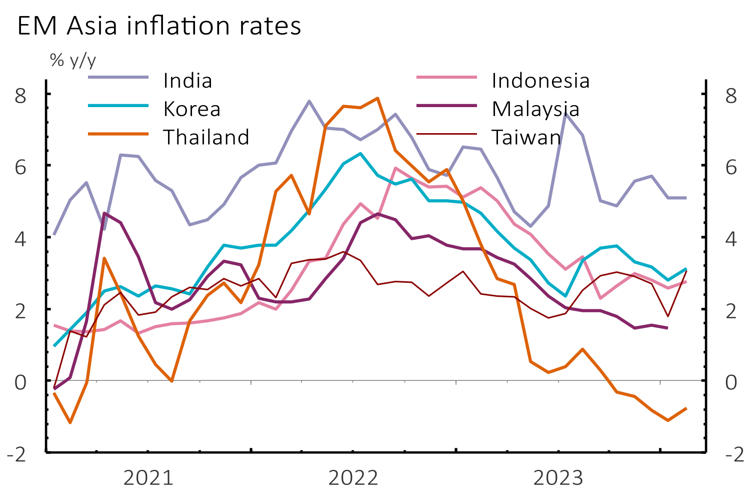
Impressive headline annual growth masks recent weakness

- Headline GDP growth across the region has been impressive. India's economy surged by 8.4% y/y in Q4, and Indonesia's GDP has also continued to grow solidly at 5.0%. However, on a quarterly basis, private consumption and investment across the region has been sluggish, reflecting the lagged impact of monetary tightening.

Inflation easing back to target, but concerns around volatility persist

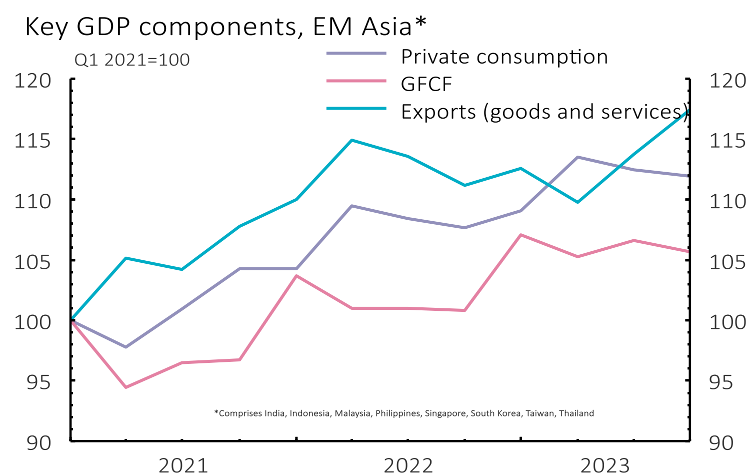
- Despite weak domestic demand recently, central bankers are not expected to rush to cut rates, as they will want to be convinced that price pressures are contained before loosening. The hikes in interest rates, although not as hefty as elsewhere, are doing their job; inflation has now fallen within target range in India, Indonesia, the Philippines and Vietnam.
- An additional consideration for central bankers is the potential inflationary impact of planned subsidies rationalisation. Taiwan's central bank raised its policy rate by 125 bps in March ahead of April's electricity price jump as subsidies were lifted.

Inflation trending downwards but further to go



Source: LSEG Datastream and AXA IM Research Feb 24

Export upturn offsetting sluggish domestic demand



Source: LSEG Datastream and AXA IM Research

A sense of hawkishness from central banks

EM Europe

Prudent forward guidance from CNB despite significant disinflation

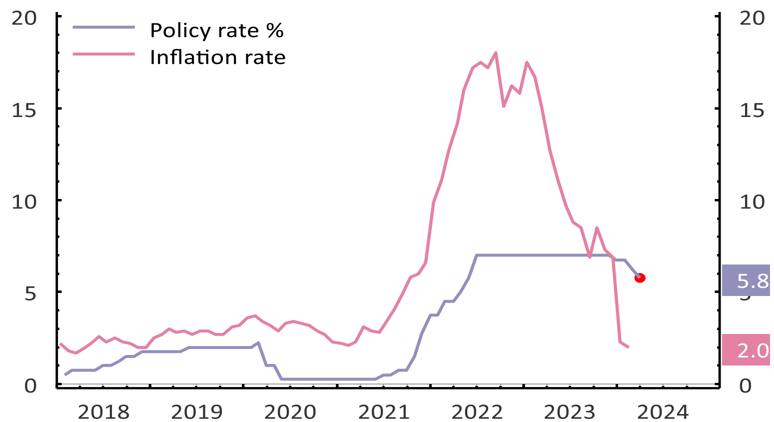
- Inflation has been coming down quite sharply in the Czech Republic, at 2% in February from its 18% peak reached more than a year ago. This prompted Czech National Bank (CNB) to start cutting rates as of last December. Headline inflation reached the CNB's target, but the Bank's forward guidance remained hawkish along the 50bp rate cut delivered in March, with concerns around sticky services inflation, around 7%, and recent FX weakness. We see ample scope for interest rates cuts with more data-driven adjustments in the pace of easing, expecting policy rate at 2.5% by end-2025.

A bold move from the Turkish central bank

- At 67.1% in Feb, inflation surprised again to the upside in Turkey triggering renewed de-anchoring of inflation expectations (44.2% expected by end-2023), accelerating TRY depreciation and a further fall in FX reserves. In response, the central bank hiked policy rates by a bold 500bp to 50% only days ahead of local elections, a testament to its current political independence. We do not expect further hikes, assuming fiscal policy becomes more restrictive after the upcoming elections. At present, we expect inflation to gradually fall during H2 and end the year at 45%, opening the door for monetary policy easing the following year.

CzechRep: scope for easing remains, but the pace will be data-dependent

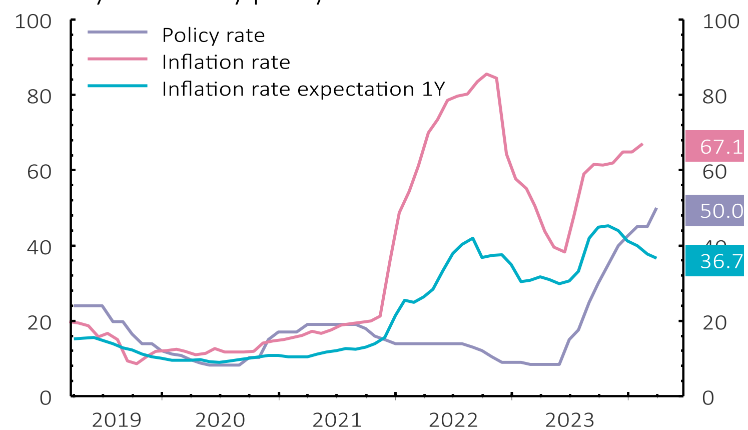
Czech policy rates vs inflation



Source: LSEG Datastream and AXA IM Research Mar 24

A proof of orthodox monetary policy in Turkey

Turkey: monetary policy and inflation



Source: LSEG Datastream and AXA IM Research Mar 24

Regional easing cycle continues

Latin America

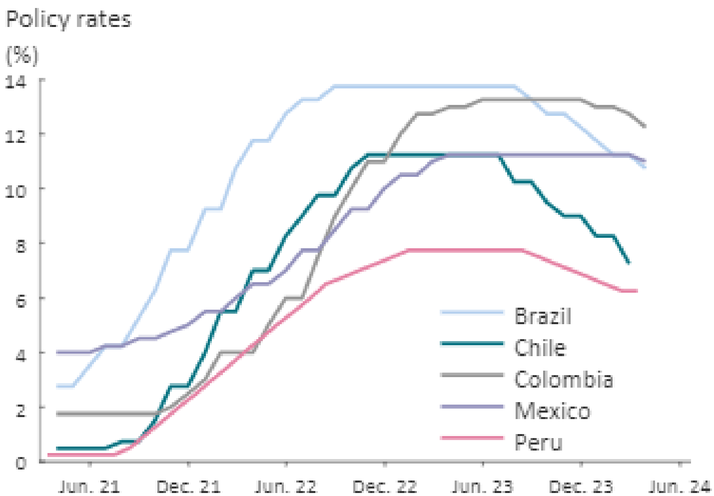
Mexico joins the club

- As widely expected, Mexico's central bank delivered its first rate cut since mid-2021, finally joining its regional peers which had started easing cycles last year: The decision to cut the key rate by 25bps to 11%. The bank's board did not provide any explicit forward guidance, instead stating that policy would remain data-dependent over the next meetings. As such, it seems that the central bank is open to pausing the easing cycle, if necessary.

Brazil stays on course, Colombia quickens the pace

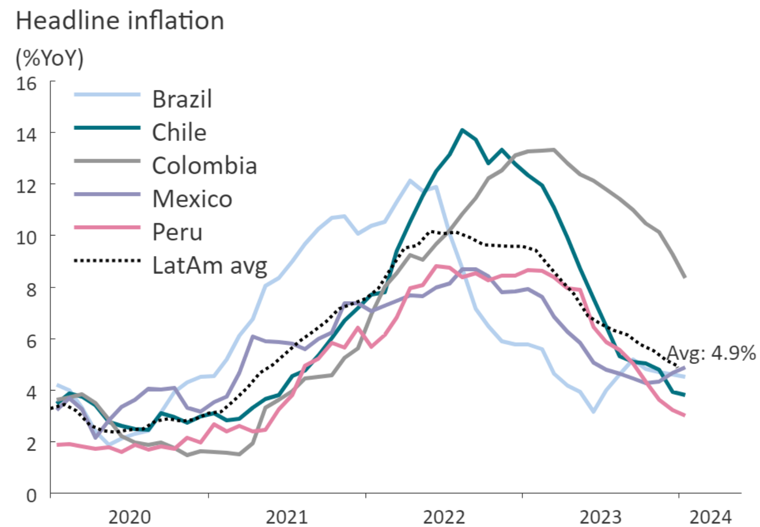
- Brazil continued its easing cycle by slashing its policy rate by 50bp for a sixth consecutive time to reach 10.75%. Looking ahead, the central bank hinted at a potential similar-sized cut at its next meeting in May, a departure from its previous indication of multiple cuts in upcoming meetings. Meanwhile, Colombia reduced its key rate by 50bps to 12.25%, following two preceding 25bps cuts in the current easing cycle

Mexico joins the regional easing cycle…



Source: LSEG Datastream and AXA IM Research, Mar 24

…as inflation continues to fall in the region



Source: LSEG Datastream and AXA IM Research, Feb 24

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2	3.0		3.1	
Advanced economies	1.7	1.3		1.2	
US	2.5	2.1	2.1	1.5	1.8
Euro area	0.5	0.3	0.5	0.8	1.5
Germany	-0.1	-0.1	0.3	0.7	1.5
France	0.9	0.4	0.7	0.7	1.3
Italy	1.0	0.3	0.5	0.6	1.2
Spain	2.5	1.6	1.5	1.3	1.9
Japan	1.9	1.2	0.7	1.0	1.0
UK	0.3	0.4	0.3	0.8	1.2
Switzerland	0.6	0.8	1.1	1.3	1.5
Canada	1.1	0.8	0.6	1.7	1.9
Emerging economies	4.1	4.0		4.2	
Asia	5.3	5.0	4.0	4.7	
China	5.2	4.6	4.6	4.2	4.4
South Korea	1.3	2.2	2.1	2.3	2.2
Rest of EM Asia	5.9	5.8		5.4	
LatAm	2.4	1.7		2.6	
Brazil	3.0	1.5	1.6	2.0	2.0
Mexico	3.2	2.2	2.2	2.1	2.2
EM Europe	2.6	2.5		2.6	
Russia	3.0	2.6	1.7	1.1	1.1
Poland	0.2	2.8	2.8	3.5	3.4
Turkey	4.3	2.0	2.2	3.6	3.2
Other EMs	1.9	2.8		4.6	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 26 March 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		2.2	
US	4.1	3.0	2.6	2.4	2.3
Euro area	5.5	2.5	2.3	2.1	2.1
China	0.2	1.1	0.9	2.0	1.9
Japan	3.2	2.2	2.3	1.6	1.5
UK	7.7	2.7	2.6	1.6	2.0
Switzerland	2.2	1.6	1.6	1.3	1.3
Canada	3.6	2.3	2.6	2.2	2.0

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 26 March 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	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	1 May 12 Jun	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec
	Rates		-0.25 (5.25)	-0.25 (5.00)	-0.50 (4.50)
Euro area - ECB	Dates	4.00	11 Apr 6 Jun	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	0 - 0.1	25-26 Apr 13-14 Jun	30-31 Jul 19-20 Sep	30-31 Oct 18-19 Dec
	Rates		unch (0-0.1)	unch (0-0.1)	+0.15 (0.15-0.25)
UK - BoE	Dates	5.25	9 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		-0.25 (5.00)	-0.25 (4.75)	-0.25 (4.50)
Canada - BoC	Dates	5.00	10 Apr 5 Jun	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		unch (5.00)	-0.25 (4.75)	-0.50 (4.25)

Source: AXA IM Macro Research - As of 26 March 2024

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Calendar of events

2024	Dates	Events	Comments
March	31-Mar	Ukraine Presidential election	
April		BoE Term Funding Scheme repayments begin	
		India General Elections	
	02-Apr	US: Connecticut, Delaware, New York, Rhode Island & Wisconsin Republican primaries	
	10-Apr	BoC meeting	unch (5.00%)
	11-Apr	ECB meeting	-25bps (3.75%)
	23-Apr	US: Pennsylvania Republican primaries	
	25-26 Apr	BoJ meeting	unch (0-0.1%)
	30-Apr	Post Brexit border full SPS checks on EU goods introduced	
	Late April	EU countries send their updated stability programmes (GDP & fiscal outlook) to the Commission	
	Spring	Commission will propose to EU Council to open Excessive Deficit Procedures	
May	01-May	FOMC meeting	-25bps (5.25%)
	07-May	US: Indiana Republican primaries	
	07-May	Reserve Bank of Australia (RBA) meeting	
	09-May	BoE meeting	unch (5.25%)
	14-May	US: Maryland, Nebraska & West Virginia Republican primaries	
	21-May	US: Kentucky & Oregon Republican primaries	
June	02-Jun	Mexico Presidential Election	
	04-Jun	US: Montana, New Jersey, New Mexico & South Dakota Republican primaries	
	05-Jun	BoC meeting	unch (5.00%)
	06-Jun	ECB meeting	-25bps (3.75%)
	09-Jun	European Parliament Election	
	09-Jun	Belgium Federal Elections	
	12-Jun	FOMC meeting	-25bps (5.25%)
	13-14 Jun	BoJ meeting	unch (0-0.1%)
	18-Jun	Reserve Bank of Australia (RBA) meeting	
	20-Jun	BoE meeting	-25bps (5.00%)
	27-28 Jun	European Council	
	30-Jun	BoE MPC member & Deputy Governor Ben Broadbent's term ends	
October	Before 24 Oct	Austria General Elections	
November	05-Nov	US Presidential Elections	

Investment Managers

Latest publications

February Global Macro Monthly - Policy Rules and Monetary Tools

28 February 2024

February Op-Ed - Exploring Exuberance

28 February 2024

Framing the ECB's rate cutting cycle

26 February 2024

January Global Macro Monthly - The great election year

24 January 2024

January Op-Ed - Cuts are coming – but the market needs to be more patient

24 January 2024

2024's elections around the world: The who's who and the so what…

23 January 2024

The key drivers of 10-year US Treasury yields

18 January 2024

Outlook 2024-25: Slowing mid-cycle, not crashing end-cycle

30 October 2023

October Global Macro Monthly -Geopolitics and yield add to macro uncertainty

25 October 2023

October Op-Ed – Bond pressure

25 October 2023

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