



 **Manulife** Investment Management

**Q3 2023 | Global Macro Outlook**

# The long and winding road

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# Table of *contents*

Global overview	<a href="#"><u>3</u></a>
<b>North America</b>	
United States	<a href="#"><u>9</u></a>
Canada	<a href="#"><u>11</u></a>
<b>Europe</b>	
Euro area	<a href="#"><u>13</u></a>
United Kingdom	<a href="#"><u>15</u></a>
<b>Asia-Pacific</b>	
Asia-Pacific	<a href="#"><u>17</u></a>
Mainland China	<a href="#"><u>19</u></a>
India	<a href="#"><u>21</u></a>
Japan	<a href="#"><u>23</u></a>
<b>Latin America</b>	
Brazil	<a href="#"><u>25</u></a>
Mexico	<a href="#"><u>27</u></a>

# The long and winding road

## Key takeaways

- **Recession postponed, not canceled**—Despite the aggressive policy tightening we've seen so far, economic activity in developed economies proved to be more resilient than expected amid a strong rebound in the services sector.
- **Inflation is still too sticky at uncomfortable levels**—While headline inflation is easing, core inflation remains stubbornly high, and it isn't just due to services inflation: Goods inflation is inflecting higher after a period of decline.
- **We believe central bank policy easing will be more gradual than consensus expectations**—From the Bank of Canada to the Reserve Bank of Australia to Bank Negara Malaysia to the U.S. Federal Reserve, central banks around the world are proving to be more hawkish than expected.
- **Shifting geopolitics and the need for a new markets playbook**—There are signs that we're entering a new global regime, requiring a rethink of how risk assets respond to changes in the macro backdrop.

“From the Bank of Canada to the Reserve Bank of Australia to Bank Negara Malaysia to the U.S. Federal Reserve, central banks around the world are proving to be more hawkish than expected.”

## Recession postponed, but it's not time to pop the champagne just yet

Data year to date suggests that developed economies had a better start to the year than expected. At the time of writing, only the eurozone and New Zealand have slipped into recession (as defined by two consecutive quarters of negative growth).<sup>1</sup> But don't pop the champagne just yet: We see this as a case of recession postponed rather than canceled. We highlight three factors that have unexpectedly underpinned economic activity.

### Stronger than expected: three factors that have supported economic growth

1



A significant easing in financial conditions

2



Continued drawdown of excess savings

3



Rotation of spending from goods to services

Source: Manulife Investment Management, as of June 7, 2023. For illustrative purposes only.

<sup>1</sup> Bloomberg, as of June 15, 2023.

### 1 A significant easing in financial conditions

Data from the [U.S. Federal Reserve](#) (Fed) shows that financial conditions remain looser than average given current levels of economic growth and inflation. Crucially, financial conditions are looser than before March’s banking turmoil *and* in March 2022, when the Fed started tightening.

### 2 Continued drawdown of excess savings

According to [the Fed](#), pandemic-related fiscal support allowed U.S. consumers to accumulate excess savings—in nominal terms—of around US\$2.1 trillion through August 2021. Conversely, cumulative drawdowns, which have been supporting household spending, reached US\$1.6 trillion as of March 2023.

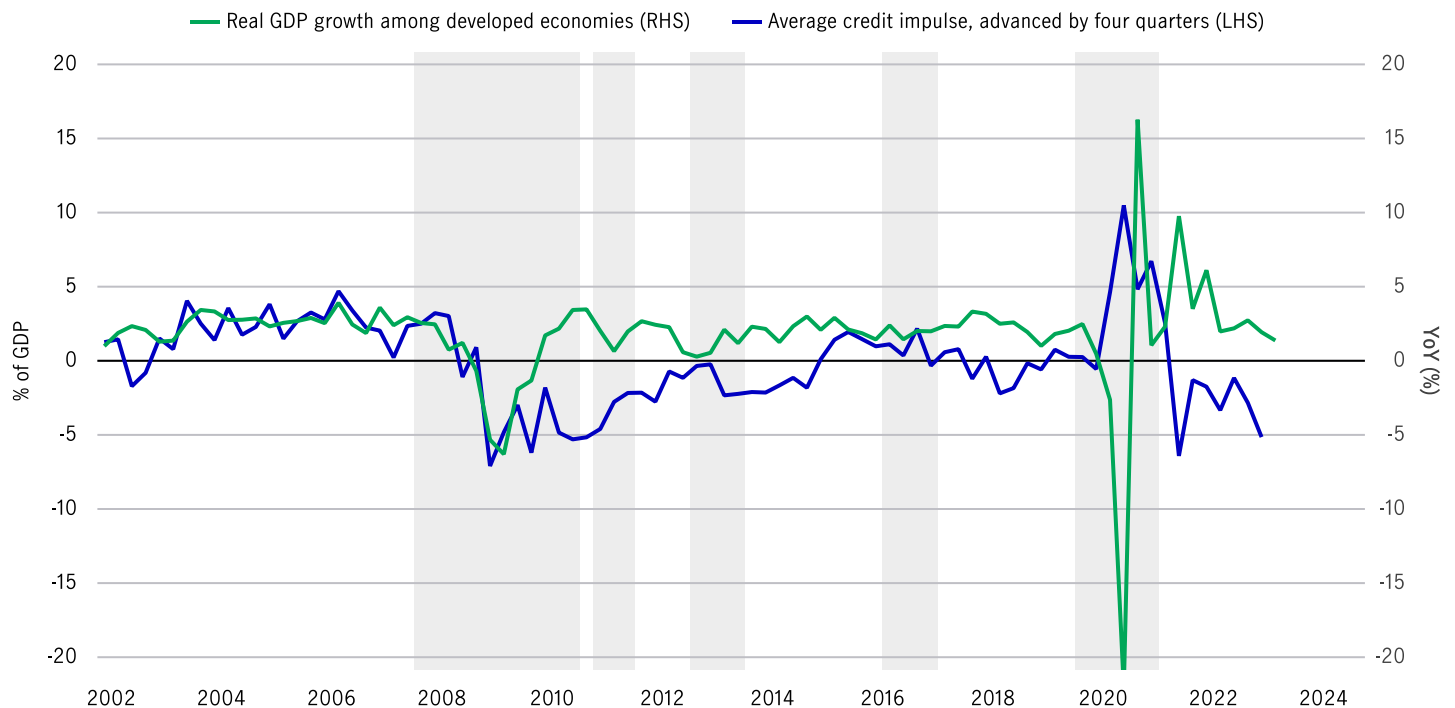
### 3 Rotation of spending from goods to services

During the pandemic, demand for services (e.g., restaurant, theaters, and travel) suffered

disproportionately relative to demand for consumer goods such as televisions, furniture, and home-improvement-related items. When the economy reopened, pent-up demand was unleashed and consumption patterns rotated from goods to services, thanks in part to fiscal support. That said, expenditure on services in the United States in real terms has returned to long-term trend while inflation-adjusted consumer spending on goods remains well above long-term trend.<sup>1</sup>

In our view, these tailwinds should dissipate as the lagged effects of monetary tightening filter through and the savings buffer that consumers have accumulated is run down. Indeed, the tightening of credit conditions and the slowdown in lending—developments that can be seen in the latest data from the United States, the eurozone, and the United Kingdom—suggest that we’ve so far managed to delay the impending recession as opposed to averting it altogether.

## Credit impulse to private sector and GDP growth in developed markets



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 1, 2023. GDP refers to gross domestic product. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side. The gray areas represent recessions.

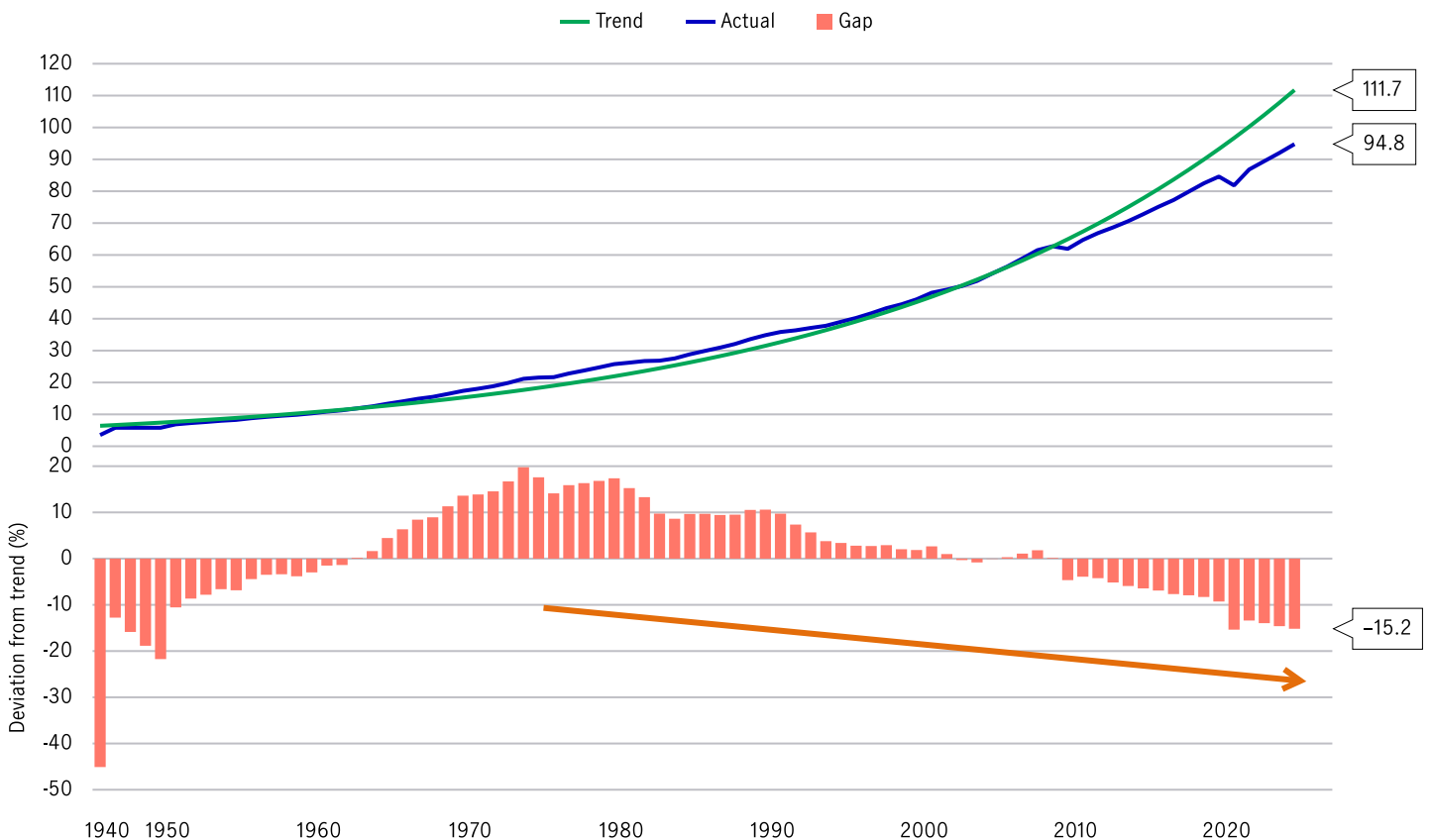
## Recession or no recession: moving beyond binary discourse

*Whether a recession actually takes place is far less relevant than how long we could be stuck in a period of below-trend GDP growth.*

Precision in forecasting where and when recessions will happen can be extremely difficult; however, as we've argued previously, *whether* a recession actually takes place is far less relevant than *how long* we could be stuck in a period of below-trend GDP growth. It's also worth noting that recessions can have an uneven effect across geographies and sectors.

The consensus view is that global growth will come in at around 2.5% this year and next.<sup>1</sup> It's difficult to see this as anything but a rather lackluster performance but, crucially, it's significantly below 3%—a threshold<sup>2</sup> that, if breached, could herald a global recession. For context, if consensus forecasts are correct, it means that global GDP growth would come in 15.2% below trend, a scenario last seen during the pandemic in 2020 and, before that, in the 1940s.

### Mind the gap: the difference between real-world GDP growth and trend growth is widening



Source: World Bank, Eurostat, Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, U.S. Federal Reserve, SingStat, Bank for International Settlement, Macrobond, Manulife Investment Management, as of June 1, 2023. Consensus forecasts are used for the years 2023 and 2024.

<sup>2</sup> "World Economic Outlook, 2008: Housing and the Business Cycle," International Monetary Fund, April 9, 2008.

## Inflation remains too sticky for comfort

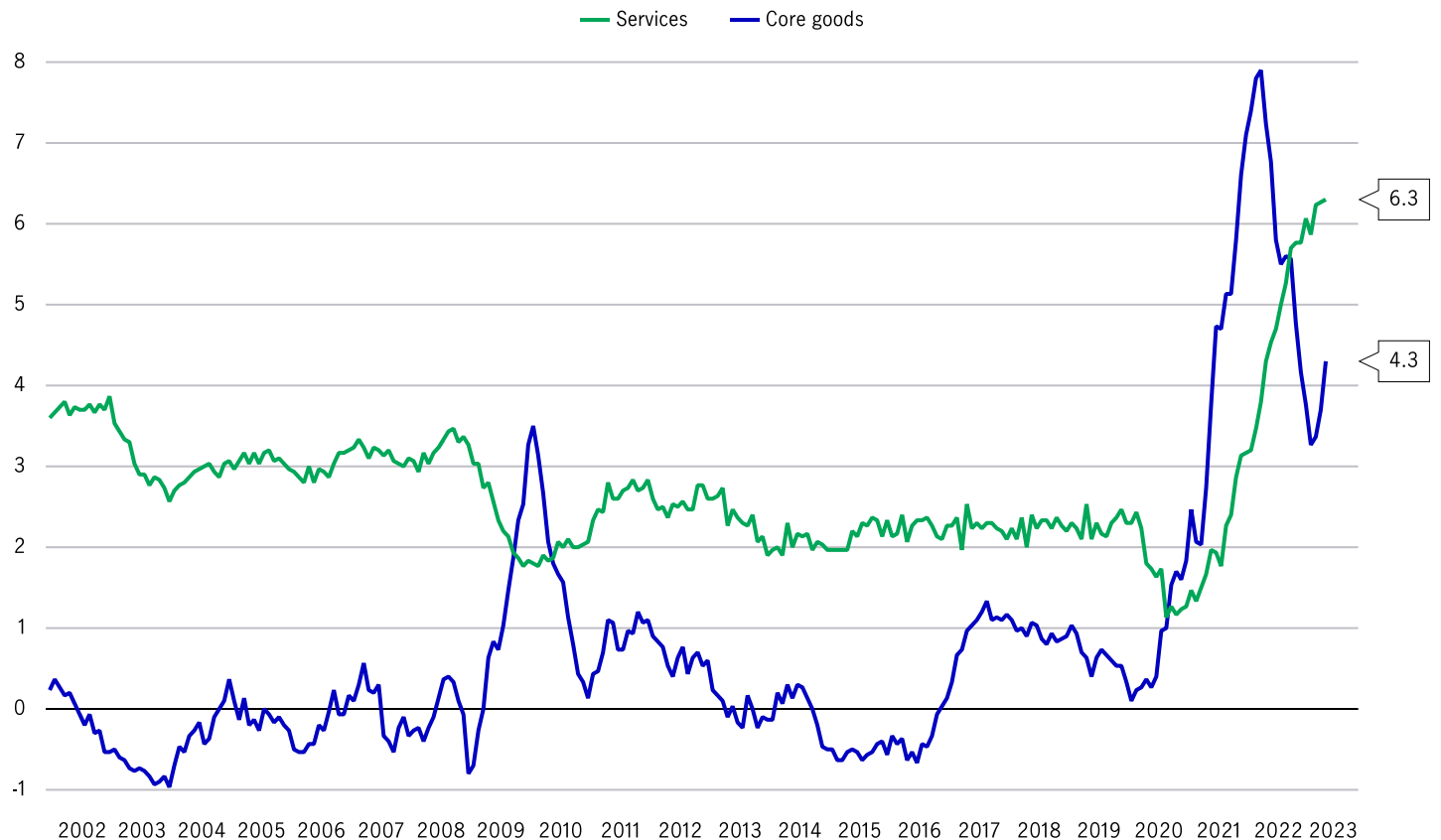
A steep run-up in goods prices was the main cause behind the surge in inflation over the past 2.5 years. From energy to food to shipping, many of the factors that drove inflation higher in 2021 and 2022 have eased considerably this year.

However, core inflation remains stubbornly high—an outcome of strong income growth and the resilience of economic activity, among other factors—pointing to intensifying upside risks to inflation in services driven by tight labor supply.

The latest data showed a renewed spike in core inflation in the United States and the United Kingdom and a fresh record (high) in [the eurozone](#). While the rise in core inflation has more to do with higher prices in services as opposed to goods, the price momentum in core goods inflation appears to be inflecting higher again as favorable base effects<sup>3</sup> are largely behind us.

**“Core inflation remains stubbornly high ... pointing to intensifying upside risks to inflation in services driven by tight labor supply.”**

Average core goods and services inflation in advanced economies, YoY (%)



Source: U.S. Bureau of Labor Statistics, Office for National Statistics, Eurostat, Statistics Canada, Statistics Bureau (Japan), Macrobond, Manulife Investment Management, as of June 1, 2023. GDP refers to gross domestic product. YoY refers to year over year.

<sup>3</sup> Although the pace in price rises in goods slowed in the months leading up to January 2023, this had been largely a result of base effects. For instance, one year ago, crude oil and wheat prices jumped nearly 60% on a year-over-year basis; they’re now about 20% and 45% lower, respectively. There is a limit to how much further the prices of critical commodity prices can fall going forward.

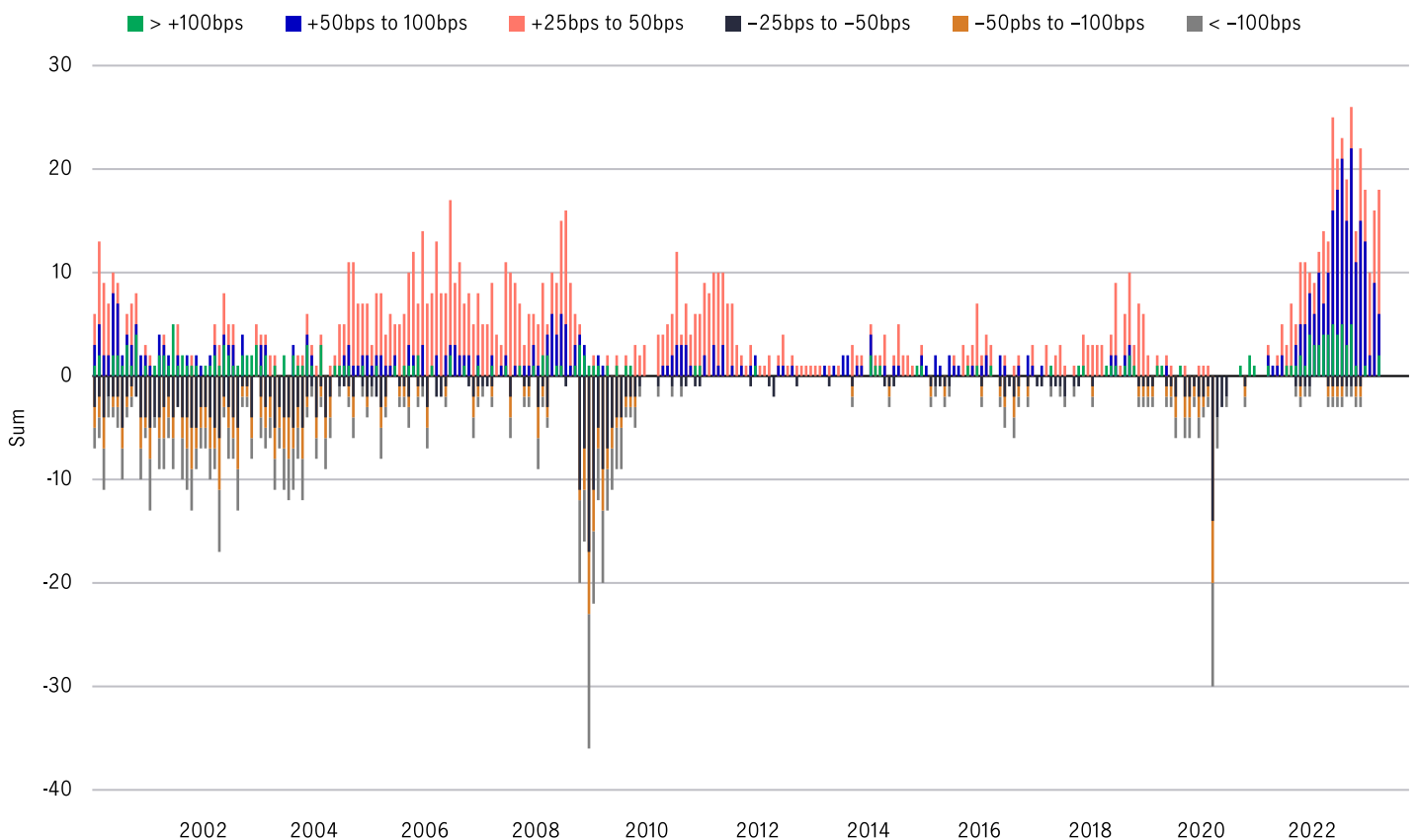
## Why interest rates are likely to stay higher for longer

Persistent price pressures have forced central banks around the world to extend their respective tightening cycles; however, they're proving to be more hawkish than the market had hoped. In parts of Asia, policy pauses have been followed by further tightening, contrary to the market's all-too-simple linear pricing model of tightening followed by pausing followed by easing followed by risk-on. It's a model that—so far—has failed in this cycle. In our view, markets have adopted a pricing model appropriate for the last 20 to 30 years, but it's no longer appropriate today.

We like to think of central banks as apolitical, independent agents but, in practice, it's difficult to completely separate monetary policy from the political developments of the day. For better or worse, central banks do not and cannot operate in a vacuum. Indeed, the dominant political ideology in the West over the last 20 to 30 years, which informed policy, allocation of resources, and financial markets was neoliberalism—one of many forms of a political economy.

But that's ending: In our view, we're entering a new regime.

### Number of central banks hiking rates by 50bps or more are still near record levels



Source: Bank for International Settlements, Macrobond, Manulife Investment Management, as of June 5, 2023. Bps refers to basis points.

## An evolving geopolitical backdrop

This shift in ideology was flagged in April by two key speeches, one from European Central Bank (ECB) President Christine Lagarde and the other from U.S. National Security Advisor Jake Sullivan.

In her speech "[Central banks in a fragmenting world](#)," Ms. Lagarde noted that competing global trading blocs are emerging and the ECB's analysis suggests that if global value chains were to fragment along geopolitical lines, global Consumer Price Indexes could rise by between 5% in the short run to 1% in the long run; she also warned against repeating the 1970's mistake of not hiking sufficiently in the face of persistent supply shocks. Ms. Lagarde went on to say that monetary policy must work with fiscal and structural policies to remove supply constraints, implying a need to deploy targeted stimulus to the supply side alongside higher rates.

**In our view, the market is premature in its pricing of dovish pivots from global central banks, both in terms of timing and magnitude.**

**The IMF warned that a rise in geopolitical tensions among what it called "partner countries" could lead to an abrupt reversal in cross-border capital flow.**

Meanwhile, Mr. Sullivan pushed back on the notion that free markets are best at allocating capital in his speech "[Renewing American Economic Leadership](#)." Notably, a new policy path was required to fend off emerging geopolitical and socioeconomic risks. He highlighted the need to identify and boost "specific sectors that are foundational to economic growth, strategic from a national security perspective, and where private industry on its own isn't poised to make the investments needed to secure our national ambitions."

If we were to take these two influential leaders at their words, the implications of what they've said are enormous. Our interpretation is that both leaders are signaling that Western governments have reweighed their priorities and will be allocating capital toward rebuilding domestic industrial capacity, narrowing the U.S. current account deficit, lifting labor's share of income, and actively using capital to defend hegemony. In other words, they're no longer pursuing neoliberalism. In our view, this change in regime will reinforce a zero-sum game global environment that will heighten geopolitical tensions.

The International Monetary Fund (IMF) also picked up on these developments. In a [recent publication](#), the IMF warned that a rise in geopolitical tensions among what it called "partner countries" could lead to an abrupt reversal in cross-border capital flow. Unsurprisingly, such a development would affect emerging-market and developing economies more than their developed peers and could potentially morph into macro financial stability risks. Specifically, the IMF noted that "greater financial fragmentation stemming from geopolitical tensions could also exacerbate macro-financial volatility in the longer term by reducing international risk diversification opportunities in the face of adverse domestic and external shocks."

To be forewarned is to be forearmed. We continue to believe:

- 1 The market is premature in its pricing of dovish pivots from central banks, both in terms of timing and magnitude.
- 2 There's a risk that even if the Fed pauses in the coming months, the next move could be more tightening, not easing.
- 3 Markets need to reassess the central bank put for asset prices.



# United States

## Big picture

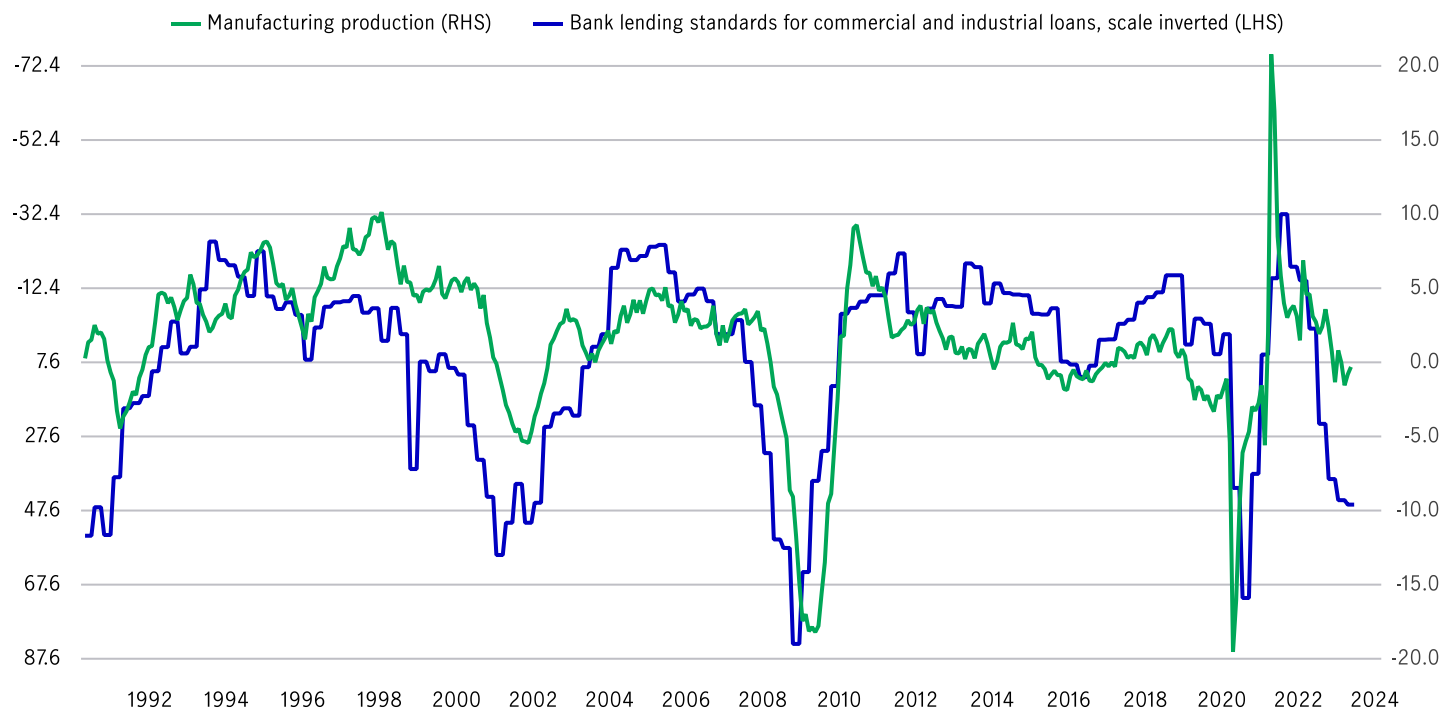
The magnitude of tightening in both monetary policy and lending standards strongly suggests that we'll see recessionary conditions in the United States. What's considerably less clear is *when* we'll see them.

Nascent signs of slack are showing up in the labor market, but conditions are still tight. This dynamic is supportive of consumption, which represents about [70% of U.S. GDP](#), and would potentially extend the business cycle; without weakening economic growth and employment, there's no incentive for the Fed to begin easing.

The employment picture is also central to what the Fed would do going forward in another way: Over the medium term, a tight labor market is typically associated with persistent strength in wage inflation. This trend is likely to add to inflationary pressures, supporting the view that incremental policy tightening by the Fed could be needed and that there could be a longer pause at peak rates than the bond markets are pricing in.

**“The magnitude of tightening in both monetary policy and lending standards strongly suggests that we’ll see recessionary conditions in the United States. What’s considerably less clear is *when* we’ll see them.”**

### Tightening credit conditions mean slower industrial production, YoY (%)



Source: U.S. Federal Reserve, Macrobond, Manulife Investment Management, as of June 16, 2023. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

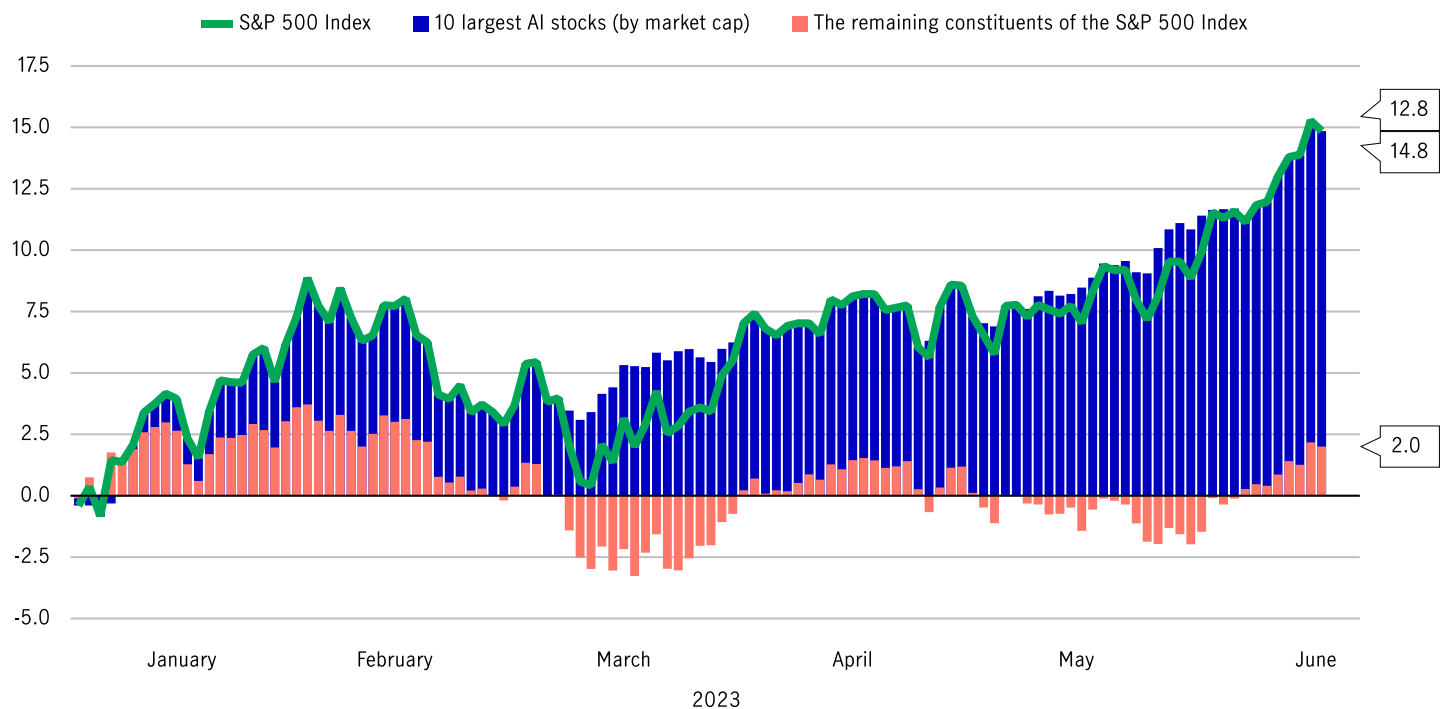
## What we're watching

- **Labor market slack**—Given the effect that labor market tightness has on the Fed's rate decisions, we remain on the lookout for signs that employee leverage is weakening. To that end, hours worked are normalizing and quit rates are slowing, indicating less demand for labor at the margin.
- **How the Fed interprets the more stubborn components of inflation**—Some components of inflation have shown signs of disinflation, while others remain firmly entrenched at higher levels. As the Fed transitions away from hiking at every meeting, a key determinant in the length of any upcoming Fed pause or, more fundamentally, the direction of travel for future rate decisions, will likely be the rate-setting committee's willingness to look past inflation components that remain elevated (e.g., housing, used cars, food prices, and the link between wage growth and inflation).

## Key market views

- **Fixed income**—We expect shorter-dated securities to be more volatile as expectations around monetary policy evolve, but we think longer-dated securities could remain rangebound at higher levels until there are clear signs of economic deterioration. While credit is providing attractive yields and, in certain cases, offers the potential for capital appreciation, we've adopted a conservative stance toward this asset class amid a deteriorating macroeconomic backdrop.
- **Equities**—While markets have largely been subdued outside of the artificial intelligence space, there are signs of improving dynamics within the S&P 500 Index. Over a one-year horizon, we remain neutral to slightly defensive; however, we acknowledge that over shorter periods—especially if it becomes clear that the threat of a recession is diminished—we could see risk-on moves in the stock market.

### Stocks related to AI have been a significant driver of market returns this year (%)



Source: S&P Global, Macrobond, Manulife Investment Management, as of June 16, 2023. AI refers to artificial intelligence. It is not possible to invest directly in an index.

# Canada

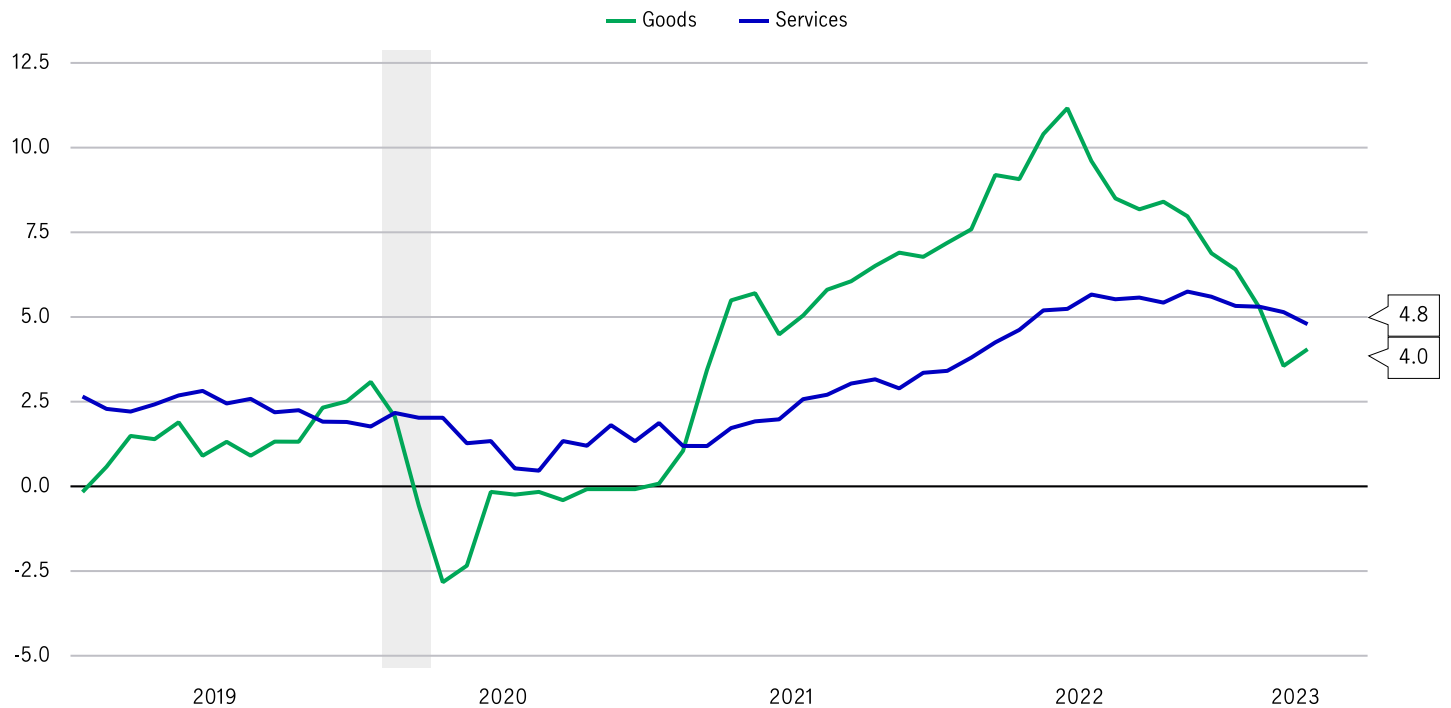
## Big picture

The Canadian economy shows no sign of a slowdown. Rampant household consumption and debt accumulation have already led to a rise in consumer insolvencies, which is a worrying trend. Strong population growth as a result of migration continues to support the labor market, although there are early signs that hours worked—and therefore general economic activity—are slowing.

Despite the elevated interest-rate environment, the housing market is rebounding. While the number of new listings keeps falling, a tight labor market and solid family formation continue to underpin housing demand, ultimately eroding housing affordability. Sticky inflation prompted the Bank of Canada (BoC) to resume its [interest-rate hike cycle](#) in June, and further tightening seems likely in the coming months. Indeed, goods inflation has picked up again recently while disinflation in services categories continues at a sluggish pace. We continue to anticipate a moderate economic contraction in Canada in the second half of 2023.

**“Sticky inflation prompted the BoC to resume its interest-rate hike cycle in June, and further tightening seems likely in the coming months.”**

Canadian household consumption is holding firm, YoY (%)



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of June 9, 2023. The gray area represents a recession.

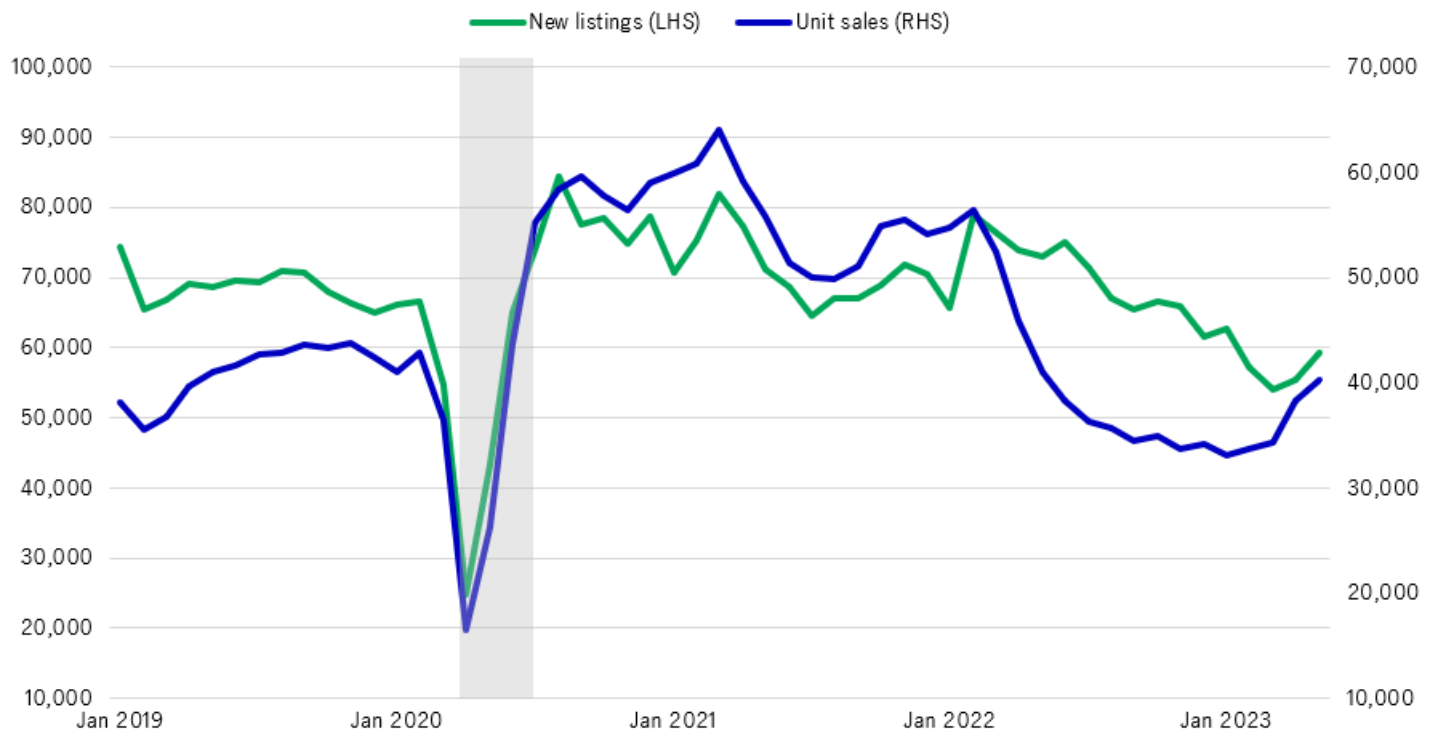
## What we're watching

**Housing activity**—Residential investment continues to act as a drag on economic growth by limiting new construction in a chronically undersupplied housing market, placing additional upward pressure on house prices. Meanwhile, the strain of rising mortgage interest costs on indebted households increases financial stability risks. Data published in May showed that refinancing activity fell by more than 32%<sup>4</sup> in the second half of 2022. With the BoC possibly looking to hike further, and the growing likelihood that interest rates could stay higher for longer, the risk of broader financial distress in 2024 and 2025, in our view, has risen.

## Key market views

- **Equities**—Canadian banks, which represent the largest sector of the S&P/TSX Composite Index, have overperformed their U.S. counterparts in the wake of regional banking stress earlier this year. That said, Canadian financial firms could see weaker demand for loans due to the ongoing slowdown in the housing market.
- **Currencies and fixed income**—The interest-rate differential between Canadian government bonds and their U.S. counterparts widened over the past quarter, lifting the Canadian dollar (CAD) to its highest level versus the U.S. dollar (USD) since February.<sup>5</sup> We think the differential will stabilize in the near term, leading to a period of consolidation for the CAD.

### Home sales are rebounding while new listings of properties for sale keep sliding



Source: Canadian Real Estate Association, Macrobond, Manulife Investment Management, as of June 9, 2023. The gray area represents a recession. LHS refers to left-hand side. RHS refers to right-hand side.

<sup>4</sup> Canada Mortgage and Housing Corporation, May 2023. <sup>5</sup> Bloomberg, as of June 9, 2023.

# Euro area

## Big picture

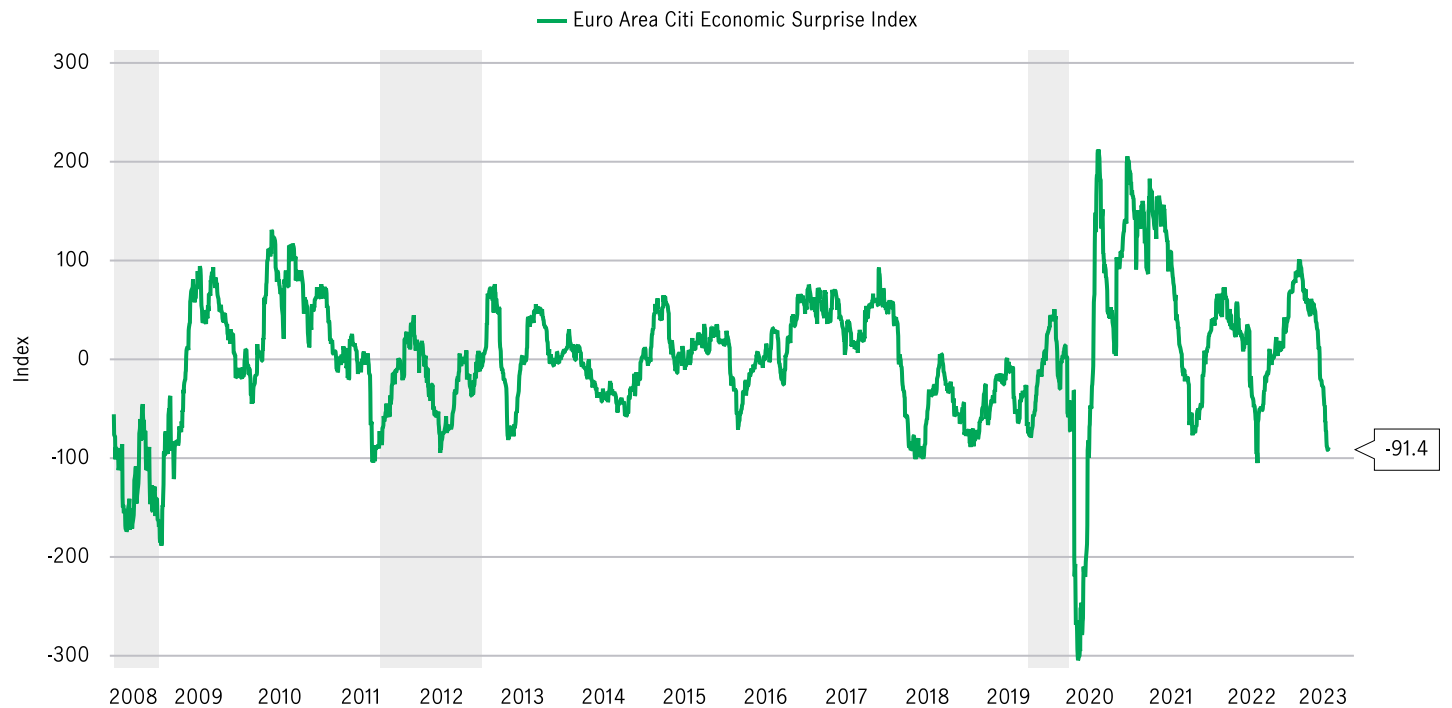
The pervasive sense of optimism around the market outlook for Europe earlier in the year has faded along with dimming prospects for global growth. This is due in part to a more muted-than-hoped-for Chinese reopening, which has affected global trade—a problematic development for Europe given the Continent’s relative exposure to manufacturing production and trade.

Inflation also remains a challenge: Headline figures are improving, but wage negotiations whose outcomes could have lingering effects on inflationary pressure remain a point of concern. Against this unappealing backdrop, it would appear as though the ECB is cornered into keeping policy rates higher for longer even as it ramps up quantitative tightening.

[Far right wins in local elections in Spain](#) have triggered a national election in July, which could raise investor concerns. One source of support to growth could come from Germany, where the payment of inflation bonuses from June 2023 could provide a short-term boost to consumption.

**Against an unappealing backdrop of persistently high inflation, the ECB could be forced to keep rates higher for longer despite dimming growth prospects.**

### Euro area economic data has disappointed



Source: Citi, Macrobond, Manulife Investment Management, as of June 12, 2023. The gray areas represent recessions. It is not possible to invest directly in an index.

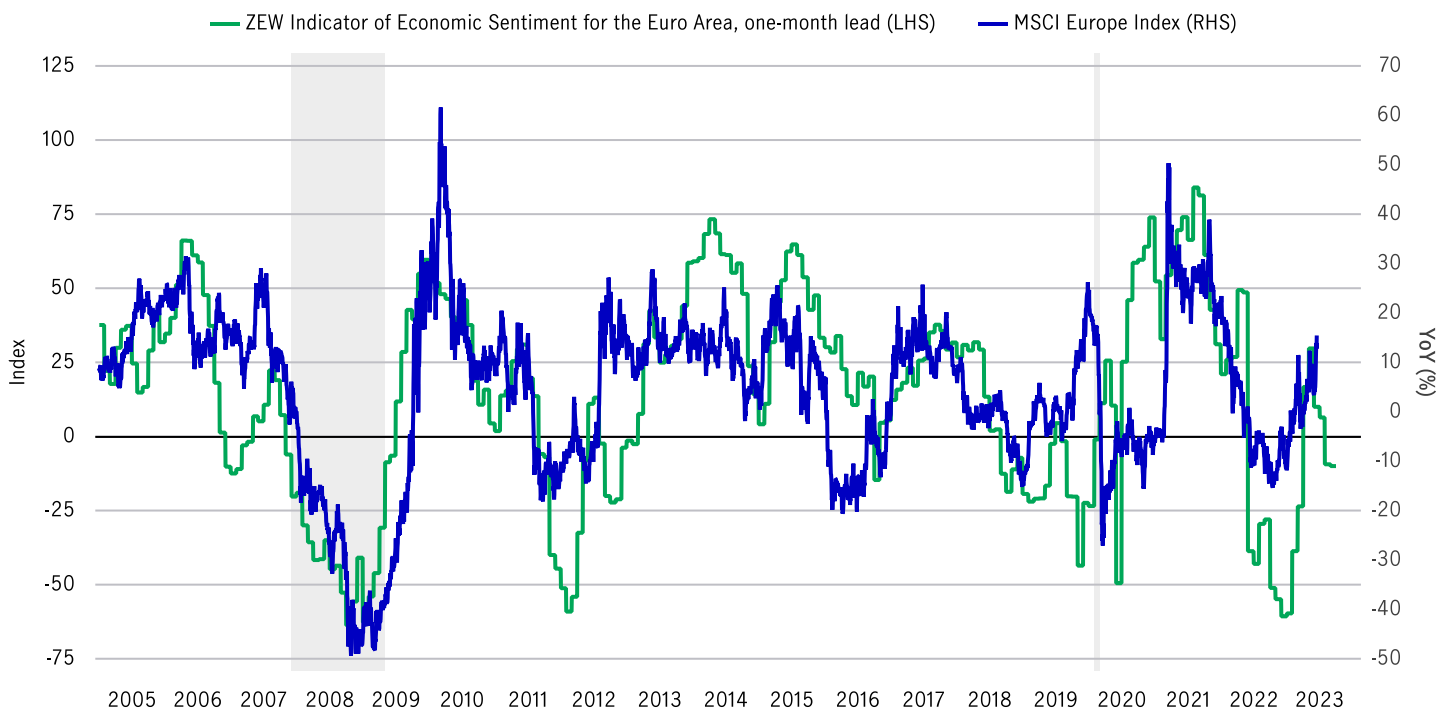
## What we're watching

- **Global trade**—This is a critical component of Europe’s manufacturing-intensive economy. Mainland China’s underwhelming reopening and the lack of sustained economic momentum have led to downside surprises in the broad macro data.
- **Wage deals**—Wage-setting negotiations with key unions are a key risk to Europe’s inflation outlook: Unlike COVID-19 and conflict-related distortions, adverse outcomes could feed through to more persistent inflationary pressure and force the ECB into a restrictive policy stance for longer.
- **Climate**—Droughts in recent years have wreaked havoc on key German distribution lines, and the outlook for this winter will also be critical in framing anxiety around energy shortages on the Continent.

## Key market views

- **Equities**—The region outperformed global equities for a six-month period as fears about a probable energy crisis receded. Optimism associated with Mainland China’s reopening and fiscal stimulus also provided sources of upside that weren’t available elsewhere. Unfortunately, these tailwinds have all become headwinds—we see the potential for downside risk for European equities at this point.
- **Fixed income**—Europe’s inflation risks remain skewed to the upside, likely requiring the ECB to keep rates higher for longer.

### Eurozone weakness typically represents a headwind for European equities



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 14, 2023. The gray areas represent recessions. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side. It is not possible to invest directly in an index.

# United Kingdom

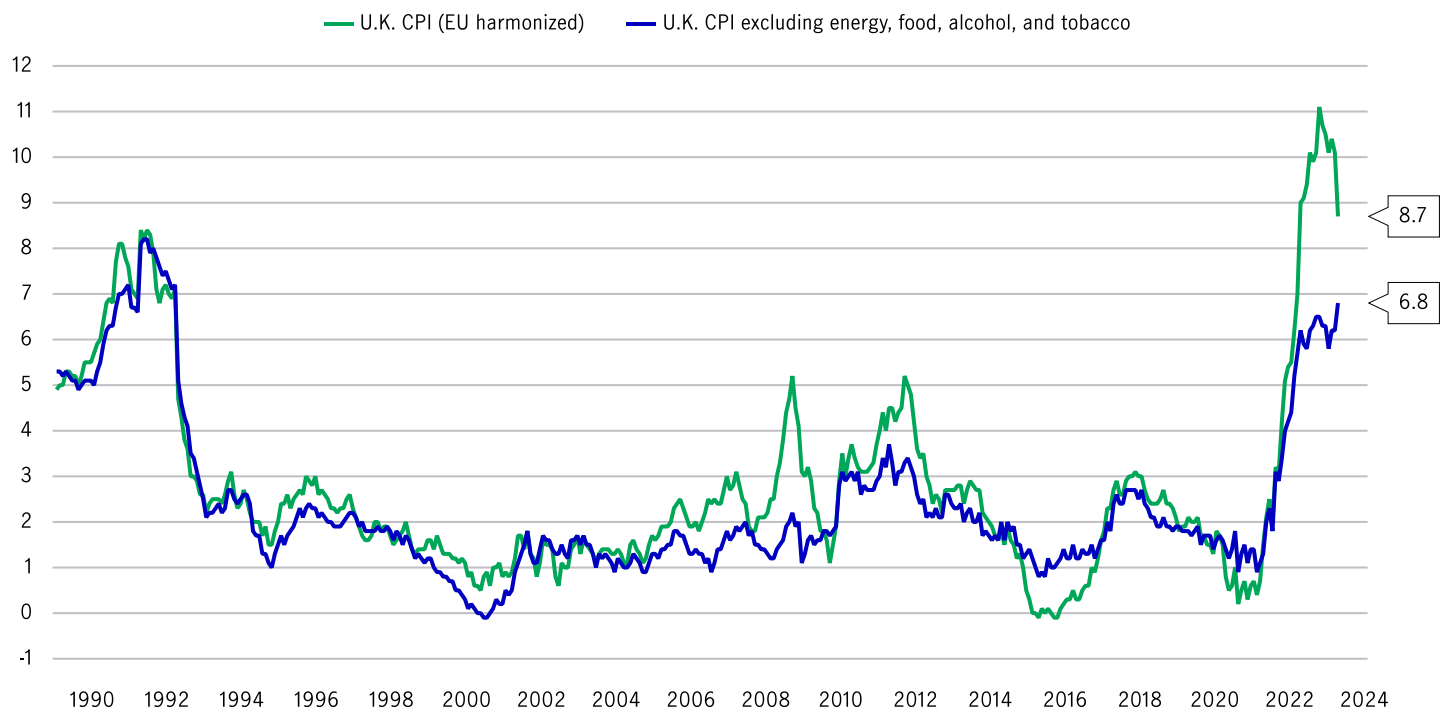
## Big picture

Inflation remains top priority for policymakers in the United Kingdom. Unlike other regions, core inflation is still accelerating in the country, which has caused expectations for the Bank of England’s (BoE’s) terminal rate to ratchet higher. So far, the lagged effects of tighter monetary policy have yet to bite, but consumption and residential investment growth is likely to face additional headwinds in the coming months.

Further darkening the picture is softening international trade, where volumes are ebbing in concert with the slowdown in global activity. Following the U.K. market’s dramatic response to the announcement of an expansive stimulus package last year, it seems unlikely that fiscal policy will be a material source of support to the economy.

**Core inflation is still accelerating in the country, which has caused expectations for the BoE’s terminal rate to move higher.**

### Underlying (core) measures of inflation are climbing to fresh highs, YoY (%)



Source: Citi, Macrobond, Manulife Investment Management, as of June 12, 2023. CPI refers to the Consumer Price Index. EU refers to the European Union. YoY refers to year over year.

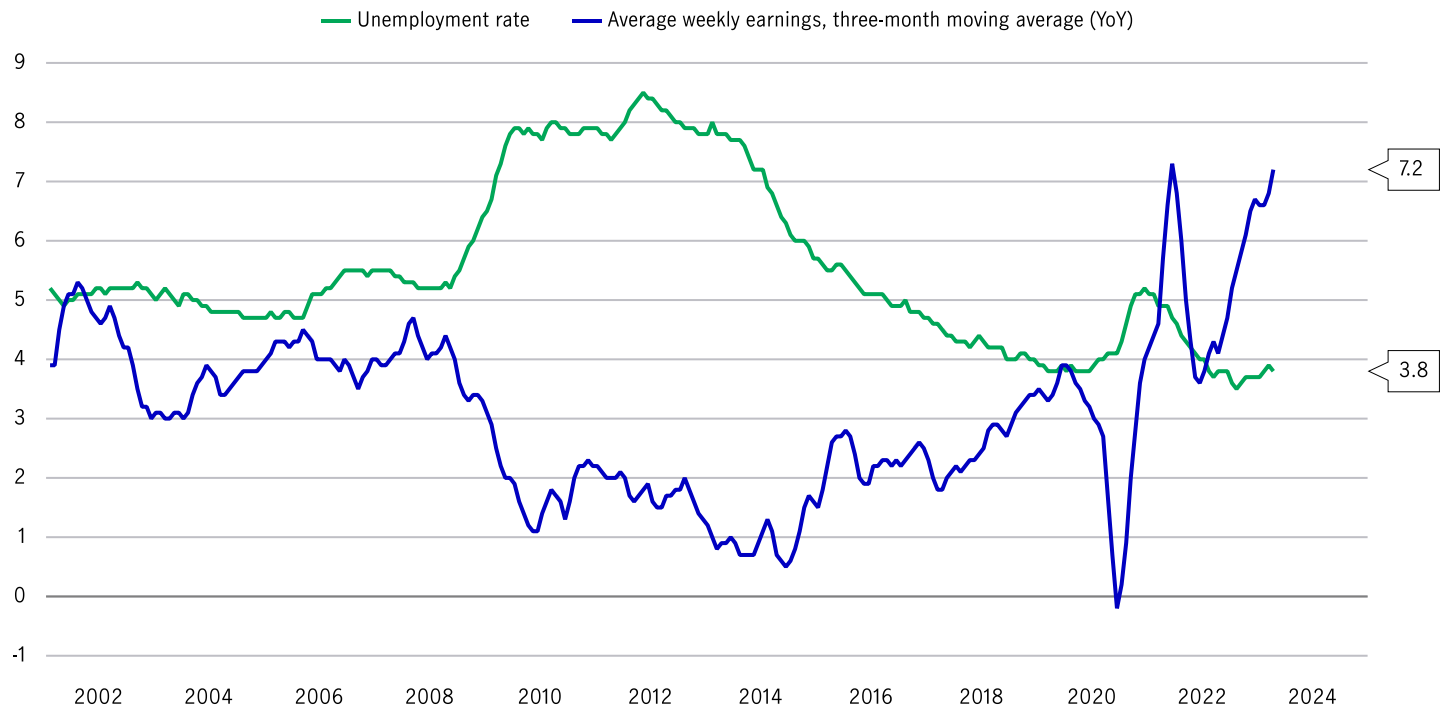
## What we're watching

- **Inflation**—The persistence of core inflation, which has climbed to fresh highs,<sup>6</sup> is a concern to investors and policymakers alike. While headline inflation is well off its highs, the rate at which it's easing has been a lot slower than hoped for as falling energy costs have been offset by persistently high food prices.
- **Employment**—Tentative signs of slack are emerging: Unemployment has increased modestly from multidecade lows; however, the stunning recovery in wage growth suggests that medium-term inflationary pressures are still a potential source of concern.

## Key market views

- **Fixed income**—Expectations for peak BoE policy rates are back to highs seen in Q3 last year. The market has priced in a terminal rate of 5.75% by the end of this year, with minimal expectations of a rate cut before Q3/Q4 of 2024.<sup>6</sup>
- **Currencies**—A similar pace of monetary tightening has left the pound sterling (GBP) roughly stable against the USD, but we'd note that the GBP is appreciating against the euro on the back of relative interest-rate and inflation dynamics.
- **Equities**—We have a neutral view of U.K. equities. Potentially favorable currency movements could support sales and earnings, and the FTSE 100 Index is inexpensive relative to history. However, the index looks expensive relative to peers, and exposure to international revenue against a slowing global backdrop warrants caution.

### The labor market is displaying preliminary signs of easing with a rise in unemployment rate



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 14, 2023. YoY refers to year over year.

<sup>6</sup> Bloomberg, as of June 14, 2023.



# Asia-Pacific

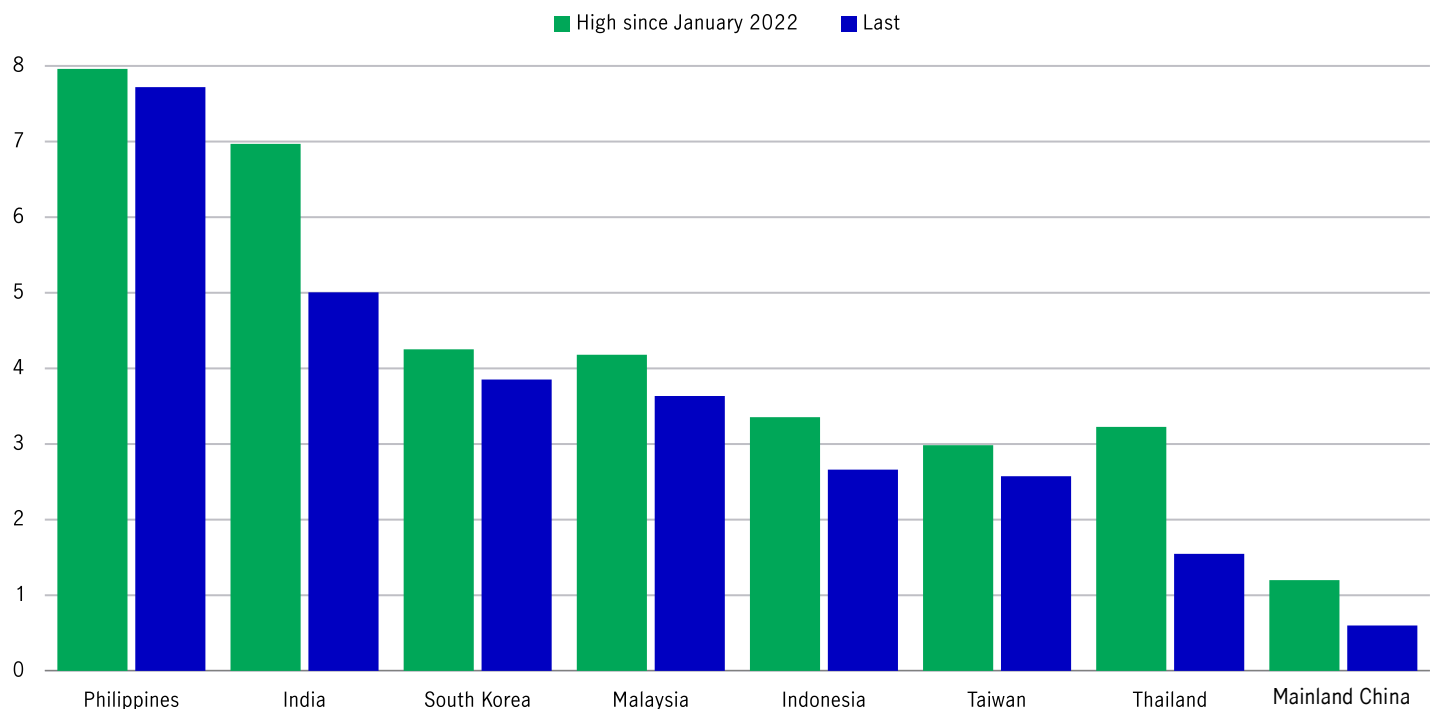
## Big picture

Despite falling price pressures, central banks in the region have been surprising the market with their hawkishness. [Bank Negara Malaysia](#) raised interest rates by a further 25 basis points (bps) to 3.25%. Since pausing in April, the [Reserve Bank of Australia](#) has hiked at its two subsequent meetings for a total of 50bps, bringing rates to 4.10%. Meanwhile, the [Bank of Korea](#) and the [Reserve Bank of India](#) (RBI) delivered hawkish pauses at 3.5% and 6.5%, respectively, pushing back against the possibility of early interest-rate cuts, and the [Bank of Thailand](#) hiked its policy rate by 25bps to 2.00%, judging that further policy normalization is still appropriate.

We had anticipated that slowing growth and inflationary pressures would open the door for many of the region’s central banks to bring their tightening cycles to a close. Our observation, however, is subject to the condition that core inflation, which is a better measure of underlying price pressures, is declining in a reasonable timeframe. So far, data shows that core inflation is easing very slowly and remains well above average in almost every economy in the region. Recent developments indicate that the anticipated timing of dovish pivots has been delayed.

**Core inflation is easing only very slowly and remains well above average in almost every economy in the region.**

### CPI inflation remains uncomfortably high, YoY (%)



Source: China National Bureau of Statistics; India’s Ministry of Statistics and Programme Implementation; Statistics Indonesia; Department of Statistics Malaysia; Statistics Korea; Thailand Bureau of Trade and Economic Indices; Taiwan Directorate-General of Budget, Accounting and Statistics; Philippine Statistics Authority; Macrobond; Manulife Investment Management, as of June 9, 2023. CPI refers to Consumer Price Index. The Consumer Price Index (CPI) tracks the average change of prices over time by urban consumers for a market basket of goods and services. YoY refers to year over year. It is not possible to invest directly in an index.

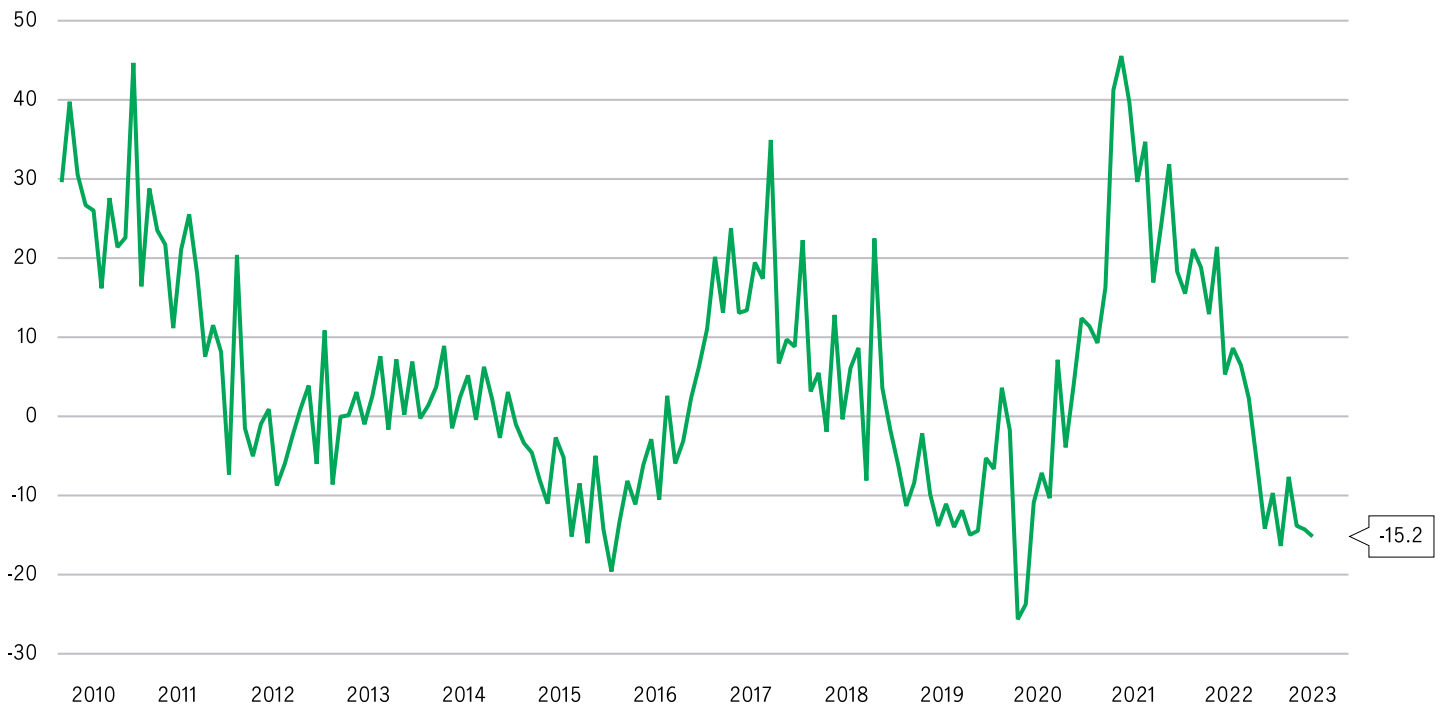
## What we're watching

- **Asian export**—Exports remain weak, but we'll be on the lookout for evidence of a bottoming out. Weak external demand and elevated inventory levels have weighed on manufacturing output in Asia. We're paying particular attention to developments in South Korea where headline exports extended their decline in May, plunging 15.2% year over year (YoY), in line with the contraction in headline manufacturing Purchasing Managers' Index (PMI), which came in at 48.4 in May.<sup>6</sup>
- **Inflation**—While disinflation is broadening in earnest, inflation remains well above target for many economies, and central banks in the region may not rest easy until they see inflation back within target and sustained softening in core inflation. Core inflation is above 2.5% YoY in almost all economies we follow.<sup>6</sup>

## Key market views

- **Equities**—We're constructive on this asset class amid expected widening in GDP growth differentials versus both developed markets (DM) and other regions within the emerging-market (EM) universe and less worrying inflation levels. Central banks in the region are also likely to make a dovish pivot sooner. That said, the rising risk of a global recession unfolding implies higher volatility, continued weakness in global trade, and tighter USD funding, which suggests that an additional screen for relative strength in external liquidity metrics could be helpful.
- **Fixed income and currencies**—In our view, regional policymakers aren't likely to match the timing nor the scale of the Fed's tightening cycle. This suggests likely outperformance in regional bonds and underperformance in local currencies.

South Korean export growth yet to inflect higher, YoY (%)



Source: Korea Customs Service; Korea's Ministry of Trade, Industry and Energy; Macrobond; Manulife Investment Management, as of June 9, 2023. YoY refers to year over year.

# Mainland China

## Big picture

Most indicators of cyclical activity revealed an economic slowdown in May and early June, consistent with the contraction in the official manufacturing PMI survey. Most significantly, weakening credit momentum and property sales indicate that the reopening rebound is fading.

We've argued that in order for the cyclical rebound to strengthen beyond the mechanical boost, a sustained recovery in household consumption and property sales would be required; however, there's been limited evidence of either so far. Consumption indicators remain below prepandemic levels and growth rates.<sup>5</sup> Meanwhile, property construction remains an important drag on the economy, with sales and construction activity remaining weak. For now, markets are eagerly expecting Beijing to lend a helping hand.

To date, the government has appeared reluctant to deliver broad-based easing. With the 2023 GDP growth target of "around 5.0%" easily achievable—thanks to base effects—and policymaker concern over the threat to financial stability of an excessive debt buildup, we continue expecting limited policy stimulus.

**A sustained recovery in household consumption and property sales would be needed for the cyclical rebound to strengthen beyond the mechanical boost, but there's limited evidence of either so far.**

### Mainland China's economic data has surprised to the downside in recent months



Source: Citibank, Macrobond, Manulife Investment Management, as of June 9, 2023. The Citigroup Economic Surprise Index (CESI) tracks whether a core set of economic data series has been coming in under expectations, at expectations, or over expectations. It is not possible to invest directly in an index.

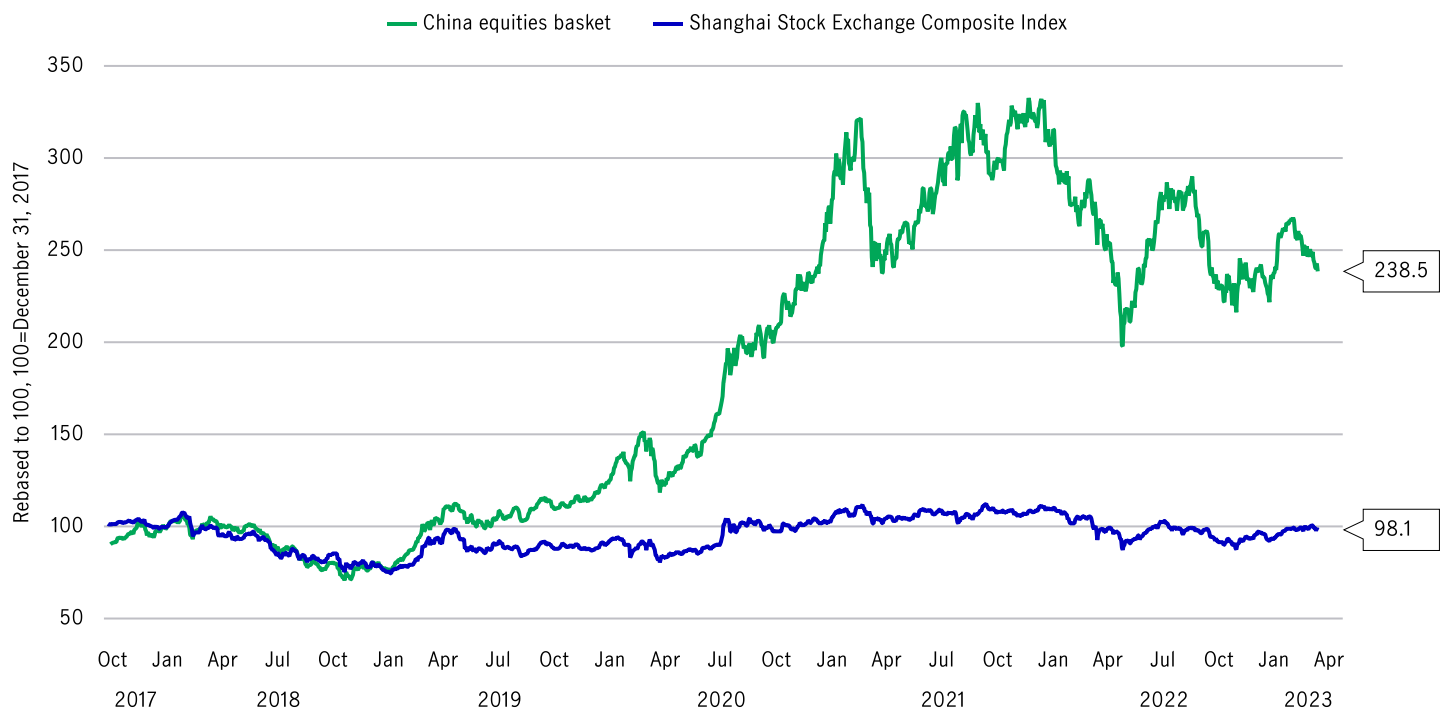
## What we're watching

- **Refinancing pressures**—While there may be less urgency to boost growth, it appears that highly leveraged property developers and local governments may come under increasing refinancing pressures in a deteriorating credit environment.
- **Financials sector reform**—In a speech on February 28, ahead of the National Party Congress legislative session, Chinese President Xi Jinping said that the ruling party would roll out plans for “[deepening structural reform](#)” in the financials sector. This has sparked concerns that the sector could soon face regulatory crackdowns similar to those seen in the technology and education sectors. Markets will likely respond positively if such risks aren't crystalized.

## Key market views

- **Equities**—A stagflationary global economic backdrop remains particularly challenging for Chinese equities; we're also mindful of an escalation in geopolitical risks. That said, there remain selective strategic opportunities, and we continue to favor equities leveraged to the renewable energy sector, the digital economy, high-value global manufacturing, advanced technology, and consumption upgrade.
- **Fixed income**—We expect Chinese government bond yields to fall further as economic growth continues to trail lofty expectations and the People's Bank of China refrains from joining the global tightening cycle.

### There could be selective strategic opportunities in Chinese equities



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 9, 2023. The basket of Chinese equities referenced in the chart comprises Chinese firms with exposure to renewable energy, innovation, and consumption. It is not possible to invest directly in an index.

# India

## Big picture

The RBI kept its policy rate at [6.5%](#) for a second meeting but surprised the market with its hawkishness. Even as the RBI lowered its inflation forecast, the bank remained concerned about upside risks stemming from increased government [support](#) for agricultural crops announced on June 7 and the likelihood that El Niño could [affect the monsoon season](#). If this were to happen, India could experience below-normal rainfall and severe droughts, affecting crop performance and possibly fueling broader food price inflation.

On the nonfood side, the bank’s rate-setting committee acknowledged that crude oil prices have eased but conceded much of this was due to base effects and that domestic prices remain elevated. On the flip side, the RBI does have some breathing room, as the Indian economy is holding up much better than expected. GDP growth accelerated from 4.5% YoY to 6.1% YoY in Q1.<sup>7</sup> What’s more, higher frequency activity data such as the PMI surveys have pointed to robust growth in both the manufacturing and services sector in recent months. The strength of the data so far this year has led markets to revise their 2023 GDP growth forecasts higher.

**In our view, the RBI does have some breathing room, as the Indian economy is holding up much better than expected.**

Consensus forecasts for Indian GDP growth in 2023—upward revisions begin in earnest, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 9, 2023. GDP refers to gross domestic product. YoY refers to year over year.

<sup>7</sup> India’s Ministry of Statistics and Programme Implementation, as of June 12, 2023.

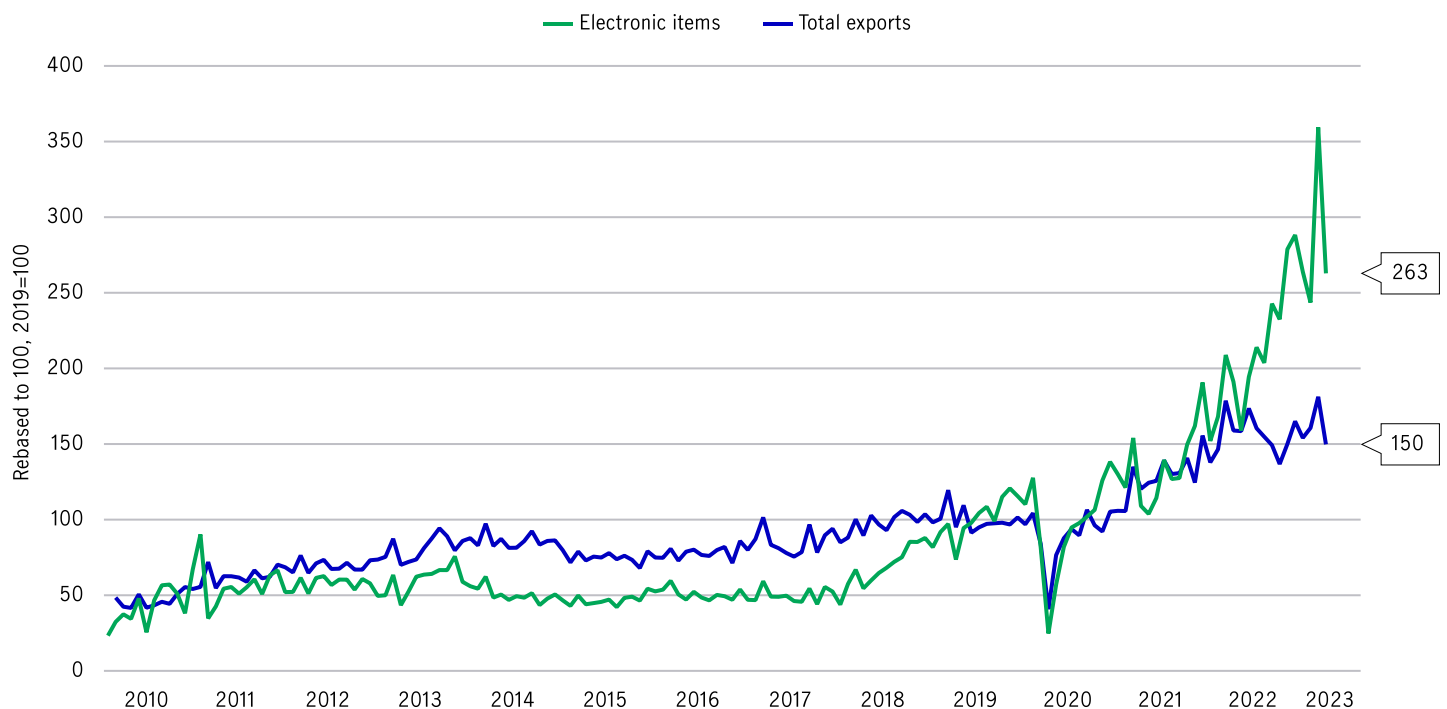
## What we're watching

- **RBI policy and inflation**—Stickier inflation at elevated rates may compel the RBI to extend its tightening cycle and/or delay any expected easing.
- **Buildout of broader electronics ecosystem**—At least two global tech manufacturers have shifted part of their operations into the country. Recent trends in India's trade data underline these emerging developments, with electronics exports far outpacing the total export basket.

## Key market views

- **Equities**—In our view, the backdrop remains fundamentally positive, and we expect to see Indian equities outperform on a relative basis within the region; the consensus view is that the Indian economy will outperform its peers by a wide margin this year.<sup>6</sup> Away from cyclical factors, we remain bullish on India's structural prospects. The Indian government continues to pursue reforms to improve the ease of doing business in the country, and we've seen some deleveraging in regard to corporate balance sheets. Finally, the economy may also benefit from the ongoing trade and investment diversification of supply chains.
- **Currencies**—In our view, the Indian rupee remains a bright spot among Asian currencies given its low volatility and high carry.

### India: export of electronic items is booming



Source: India's Ministry of Commerce and Industry, India's Ministry of Statistics and Programme Implementation, Macrobond, Manulife Investment Management, as of June 9, 2023.

# Japan

## Big picture

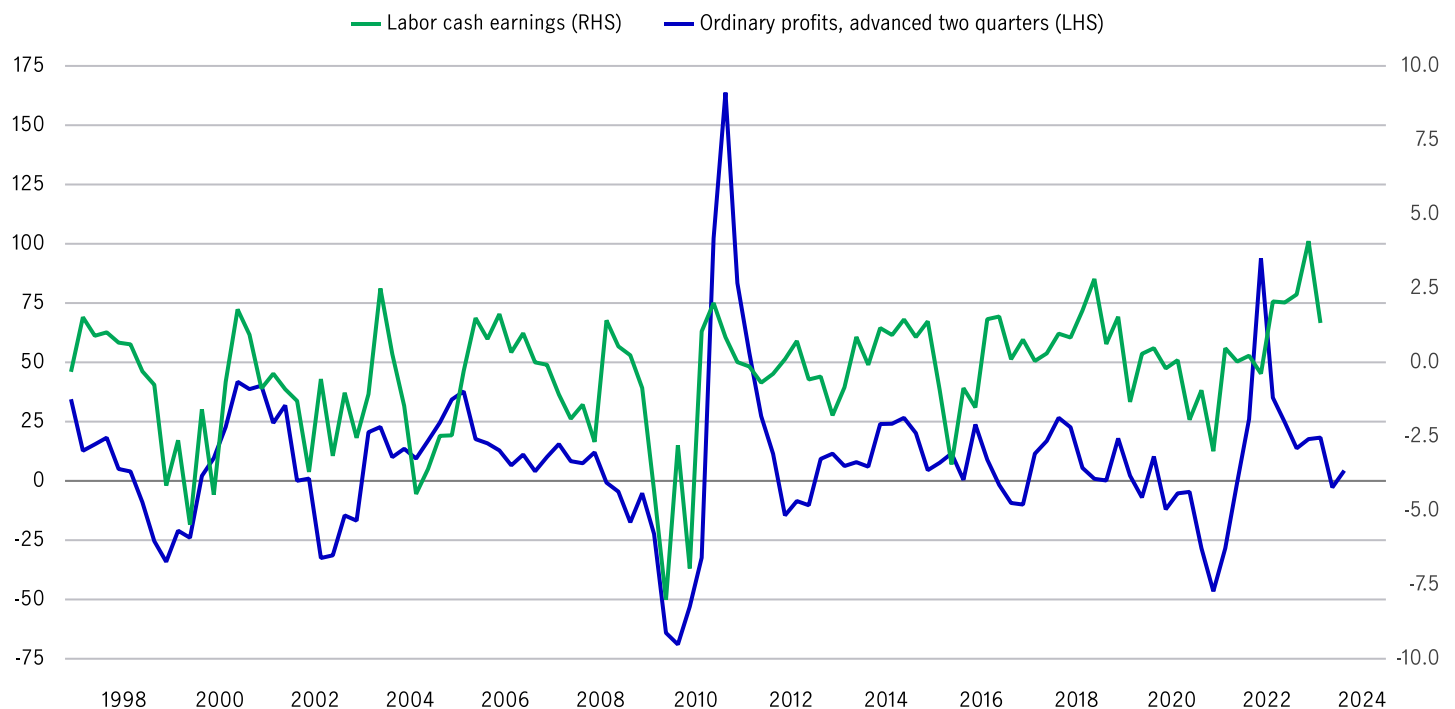
Our dovish expectations for the Bank of Japan (BoJ) were affirmed by Kazuo Ueda’s early speeches as the bank’s governor. He’s been much more cautious about potential tightening than the market had previously thought and highlighted that the risk of inflation slowing below the BoJ’s target was a greater risk than the risk of it overshooting.

The precondition for BoJ tightening is for wage growth to be sustained at a level where it’s able to support inflation at or above the bank’s 2% target; specifically, the bank has stated that [wage growth needs to be sustained at 3%](#) to maintain inflation at or above its 2% target. The latest signs aren’t encouraging.

Wage growth hit 4.1% in December but [has crashed to around 1%](#) since the year began. Shrinking bonuses played a large part in that decline, but regular pay growth also slowed, settling around 1%, compared with the average of 1.3% in the second half of last year.<sup>6</sup> Firms no longer enjoy the supernormal profits fueled by the weak Japanese yen (JPY) last year and are less willing to raise pay now. Indeed, ordinary profits fell in annual terms for the first time in two years in Q4 2022, suggesting that wages may follow suit.

“Our dovish expectations for the BoJ were affirmed by Kazuo Ueda’s early speeches as the bank’s governor. He’s been much more cautious about potential tightening than the market had previously thought.”

### Ordinary profits vs. labor cash earnings, YoY (%)



Source: Japan’s Ministry of Finance; Ministry of Health, Labour and Welfare of Japan; Macrobond; Manulife Investment Management, as of June 9, 2023. LHS refers to left-hand side. RHS refers to right-hand side. YoY refers to year over year.

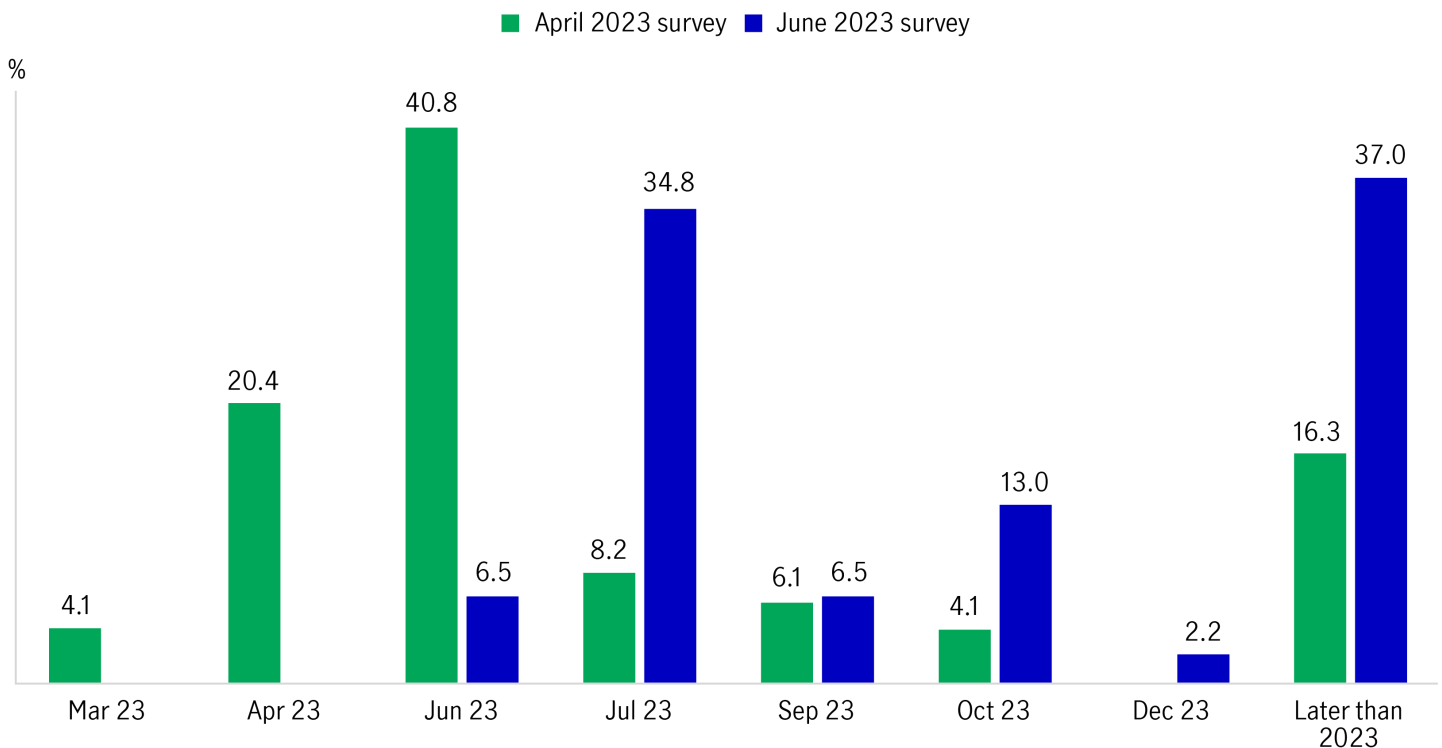
## What we're watching

- **Wage growth**—The BoJ has stipulated that stronger wage growth is a precondition for policy normalization.
- **BoJ**—The market has pushed back its forecasts for the timing of policy adjustments after Governor Ueda’s repeated signaling of the continued need for monetary stimulus. Still, we can’t rule out the chance of an adjustment to the BoJ’s yield curve control program, such as a shift from targeting the yield on the 10-year Japanese government bond to the yield on shorter-maturity tenors.

## Key market views

- **Equities**—The MSCI Japan Index has been an outperformer year to date.<sup>6</sup> Looser monetary and fiscal conditions have supported positive earnings revisions in stark contrast to much of the rest of the world. As we head into a more challenging macro environment, we have a preference for stocks with more defensive qualities.
- **Currencies**—Consensus is bearish USD/JPY on expectations of tighter monetary policy in 2023. This isn’t our base case. The JPY’s volatility-adjusted yield is deeply prohibitive to strategic long JPY positions. In our view, the rise in Japan government bond yields can’t compete with global rates and the gulf between market expectations. As a result, we believe Japanese investors will maintain their preference for unhedged foreign bonds.

### Responses to survey question: when will the BoJ tighten its main policy settings?



Source: Bloomberg; Macrobond; Manulife Investment Management, as of June 15, 2023. BoJ refers to Bank of Japan.



# Brazil

## Big picture

The Brazilian economy is moderating, but many cyclical indicators continue to show resilience. General economic activity and consumption are supported by a robust labor market and cooling price pressures.

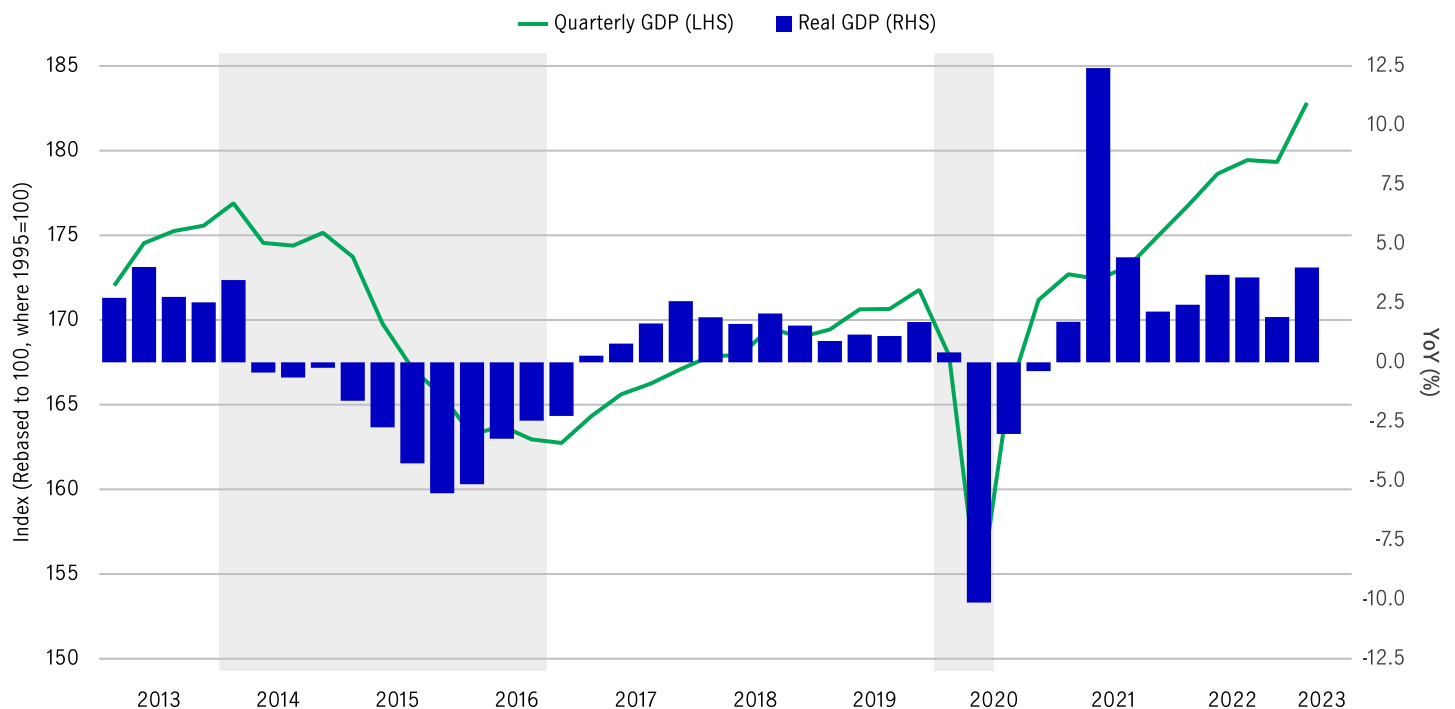
Agriculture has been a key driver of expansion in the supply side of the economy, and we expect this to continue given the tightness in global resource markets. Decelerating inflation should lead to a more accommodative monetary policy stance from the Banco Central do Brasil (BCB) by the end of Q3.

Concerns over fiscal largesse have subsided on the approval of the government’s new fiscal [framework](#) in May 2023. Constructive developments on the foreign investment front involving Mainland China and [Europe](#) across a range of Brazilian industries support our positive structural thesis on Brazil.

The country’s clean energy industry is also attracting international attention and is constructive in an environment of resource scarcity. We continue to monitor Brazil’s international relations and the trade implications arising from U.S./China tensions.

“Constructive developments on the foreign investment front involving Mainland China and Europe across a range of Brazilian industries support our positive structural thesis on Brazil.”

### Brazil: GDP growth continues to expand



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 9, 2023. GDP refers to gross domestic product. The gray areas represent recessions. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

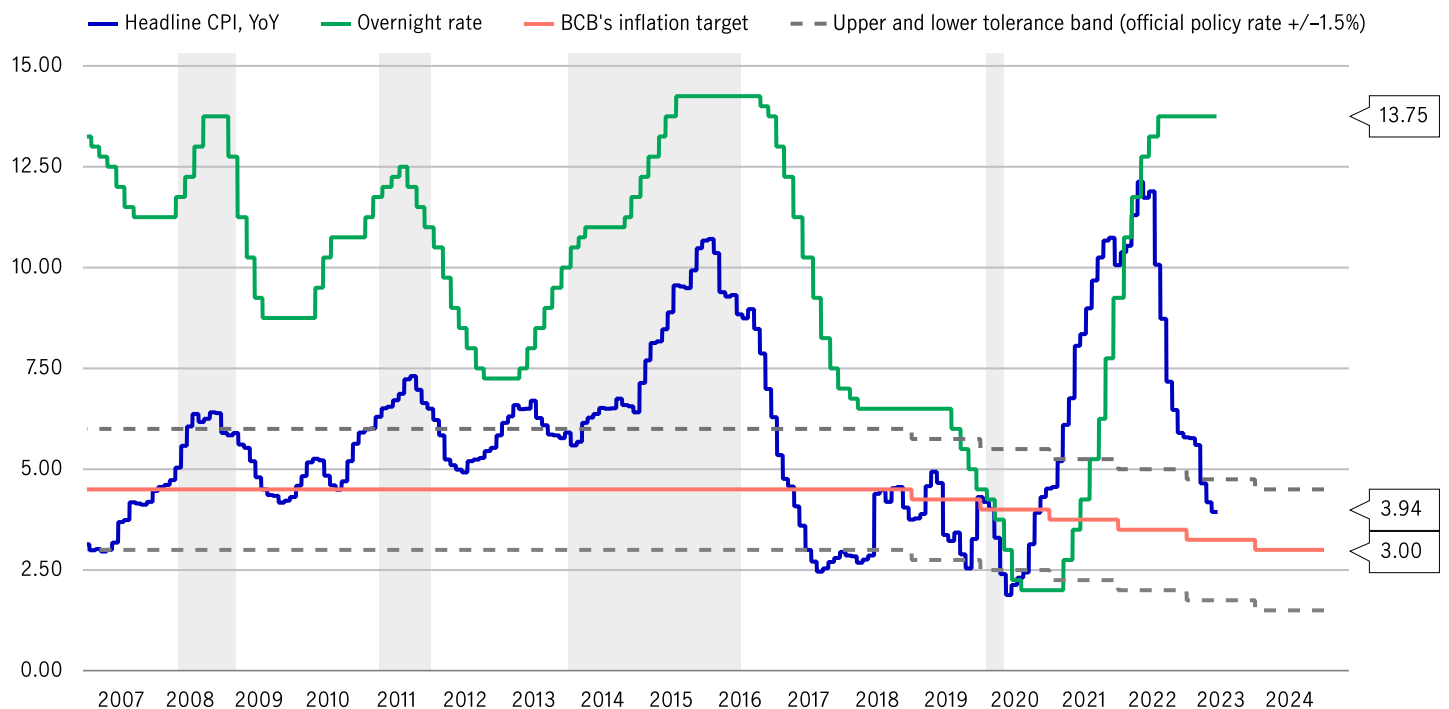
## What we're watching

- Politics and fiscal policy**—These two factors continue to drive global investor sentiment and capital flows into Brazil. The government's new fiscal framework should benefit low-income earners and keep the fiscal target in place. That said, we note that the country's overall fiscal dynamic remains fluid and a significant tax reform will be the government focus in H2, which could drive sentiment in either direction.
- Monetary policy**—Annual inflation has slowed from a peak of 12% in April 2022 to the current level under 4%, which falls within the BCB's target inflation band of 3.25% (+/-1.5%). We see a high probability of a rate cut in either August or September. A marginally more accommodative monetary policy stance should alleviate the fiscal drag and consumer strain—a function of high interest rates.

## Key market views

- Fixed income**—Real rates and carry in Brazil are among the highest globally relative to both DM and EM. With the BCB being one of the first global central banks to engage in its tightening cycle, we expect it to also lead other central banks in rate cuts, which would be bullish for the sovereign yield curve. On the corporate front, fundamentals such as debt coverage ratios are stronger than they were prior to the pandemic.
- Equities**—In the shorter term, some of the main constituents of the MSCI Brazil Index could be exposed to idiosyncratic political risks, which is likely to dominate price movement. From a longer-term perspective, both fundamentals and valuations are remarkably strong. Forward profit margins and dividend yields, along with price-to-earning metrics, compare favorably against their EM and DM peers.

**Brazil: inflation is within the BCB's target band (%)**



Source: Instituto Brasileiro de Geografia e Estatística, Macrobond, Manulife Investment Management, as of June 9, 2023. BCB refers to Banco Central do Brasil. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

# Mexico

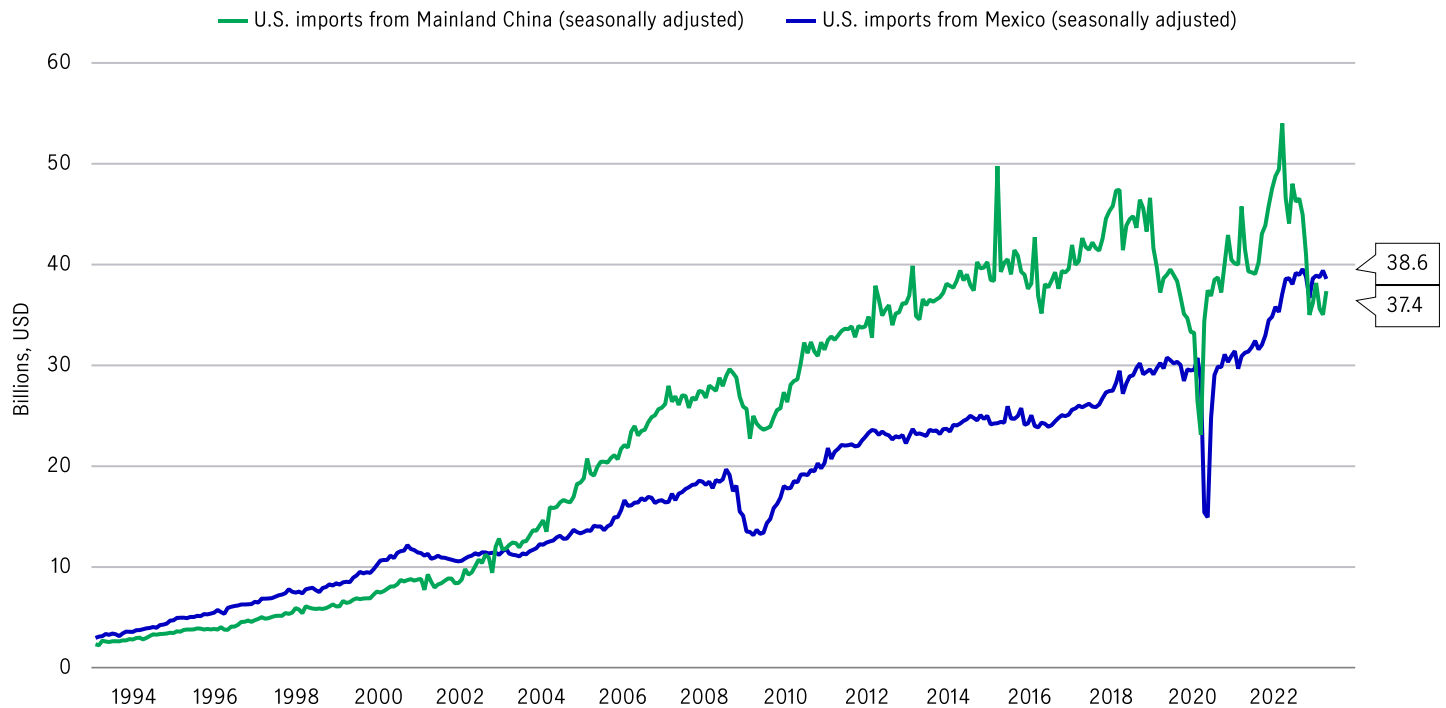
## Big picture

Despite a more modest outlook, Mexico remains one of the more attractive regions globally. While a slowdown in trade with the United States has represented a headwind growth, the country should continue to benefit from the diversification of global supply chains. The value of monthly Mexican exports to the United States has recently [surpassed](#) that of Mainland China.

As with most countries, consumption growth has slowed as a result of tighter monetary policy, but fiscal policy has so far provided a source of support. Moderating inflationary pressures have allowed Banxico to pause its monetary policy tightening cycle, leaving its overnight policy rate at 11.25%. The relatively higher yield on offer and favorable macro picture versus peers have driven a strong appreciation in the Mexican peso (MXN), which recently hit multi-year highs against the USD.

**Mexico should continue to benefit from the diversification of global supply chains.**

### Mexico has surpassed Mainland China in monthly exports to the United States



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 14, 2023. USD refers to U.S. dollars.

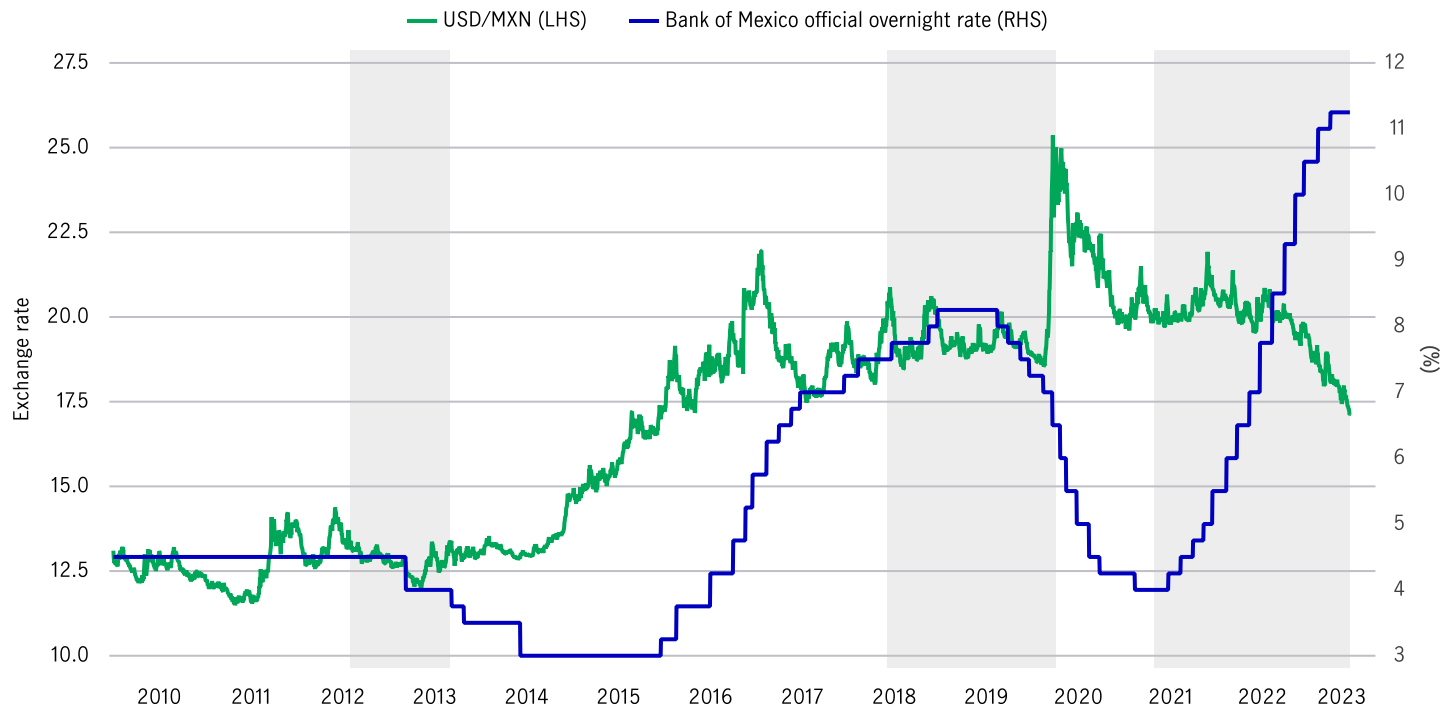
## What we're watching

- **Nearshoring/friend-shoring**—A realignment in global supply chains toward more closely allied nations could be a source of upside for Mexico, even against a backdrop of weakening trade, with potential benefits coming in the form of trade and capital investment. Somewhat marring this development is intensifying organized crime, which could be viewed as a potential [roadblock to foreign investment](#).
- **Policy direction**—Reduced inflationary pressure has allowed Banxico to pause its tightening cycle. What's more, changes to March's [Monetary Policy Statement](#) appeared consistent with the peak rates theme, with references to inflation declining more than expected and language around further hikes removed.

## Key market views

- **Currencies**—The shift in policy stance and the accompanying move in interest-rate differentials may prompt a period of consolidation for MXN after its impressive rally.
- **Equities**—In our view, Mexican equities' recent run of relative outperformance could persist. Foreign investors are attracted to the country's improving risk profile and relatively healthy macro backdrop; however, that needs to be balanced against relatively rich valuations—Mexican stocks are expensive relative to their Latin American peers.

### The MXN and Mexico's overnight rate



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 14, 2023. USD refers to the U.S. dollar. MXN refers to the Mexican peso. The gray areas represent recessions. LHS refers to left-hand side. RHS refers to right-hand side.

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