Manulife Investment Management

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A *difficult* climb ahead

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Global overview: summary

Macro anchors that could shape risk markets in the coming months

1 Slowing growth in China

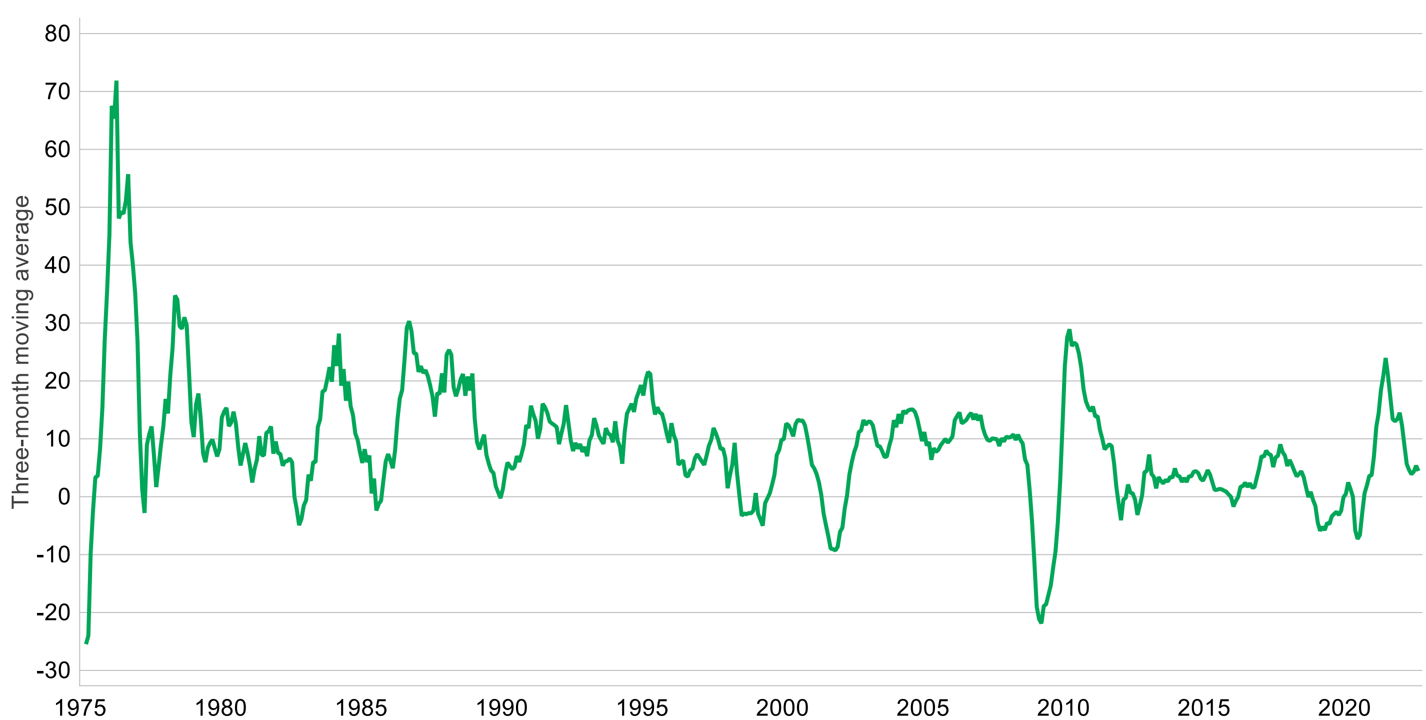
We continue to have concerns about China's economy. The economic costs of the country's dynamic zero-COVID policy mount as the fear of additional large-scale lockdowns persists. This could signify further disruptions to supply even as China's property sector continues to deteriorate. Slowing global growth would also likely mean a reduction in global appetite for Chinese exports. These are all nonnegligible headwinds to growth. Crucially, policy support remains underwhelming relative to the scale of the economic challenges that the economy faces.

Slowing Chinese growth is also likely to weigh on the outlook of regional economies in Asia, which are already dealing with an inventory overhang and the effects of a synchronized global growth shock.

That said, the gradual resumption of economic activities in recent months after the Omicron outbreak may help provide an offset for economies in South and Southeast Asia. Consumer Price Index (CPI) inflation in these parts of Asia is showing nascent signs of easing, which may give central banks in the region an opportunity to moderate their respective tightening cycles in the coming months.

"Slowing Chinese growth is also likely to weigh on the outlook of regional economies in Asia, which are already dealing with an inventory overhang and the effects of a synchronized global growth shock."

Growth in Asia's annual export volume is slowing sharply, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year.

2 Inflationary pressures should ease, but inflation is likely to remain elevated

Inflationary pressures should unwind gradually over the coming months, but they're likely to remain at elevated levels through the rest of 2022 and into next year. We expect headline CPI readings to begin to diverge from Core CPI readings: Food and energy prices are likely to remain high, but more interest-rate-sensitive items should begin to display signs of disinflation. We expect inflation to have materially decelerated by the middle of 2023 on the back of base effects kicking in, an expected buildup in excess inventories in non-auto retail goods, and the alleviation of supply chain disruptions.

> "That said, we believe the Fed, the BoC, and other major central banks will begin cutting rates in Q3 2023, a view that's consistent with current market pricing."

3 Central bank tightening as a headwind to growth

Global central bank tightening in both developed markets and emerging markets will contribute to deteriorating global liquidity conditions and act as a headwind to growth. While we initially expected central banks to shift their focus from tamping down inflation to addressing growth-related concerns later this year as economic data worsened, obstinately high inflation readings gave most central banks little choice but to continue raising rates despite slowing growth, thereby amplifying recessionary dynamics.

That said, we believe the U.S. Federal Reserve (Fed), the Bank of Canada (BoC), and other major central banks will begin cutting rates in Q3 2023, a view that's consistent with current market pricing. The brewing energy crisis in Europe has cast a dark shadow over the region's outlook—talks of preemptive gas rationing in the winter months are a reflection of how severe things can get on the Continent.

Tightening financial conditions

The full impact of central bank policies can typically only be fully felt in the real economy after a lag of between 12 and 18 months. Beyond central bank tightening that's already in the pipeline, there are several developments that also have an impact on the global liquidity picture:

- **Quantitative tightening—**The Fed has accelerated the pace at which it's shrinking its balance sheet beginning September 2022, from US$47.5 billion a month to US$95.0 billion a month.
- **Europe's energy crisis—**The energy crisis has heightened concerns of hidden financial stress on the Continent as surging energy prices have prompted requests for stricter collateral requirements in the energy market.
- **Negative feedback loop—**Tighter U.S. dollar (USD) liquidity is creating a self-reinforcing feedback loop of USD strength. In September, global financial conditions hit their tightest level since April 2020.

A challenging few months ahead

In our view, the prognosis is clear: We're entering a challenging period for risk markets, in the short term at least. The broader geopolitical environment doesn't help, as two important events—the Chinese Communist Party Congress in October and the U.S. mid-term elections in late 2022—will no doubt dominate market chatter. In times like these, it's important to consider enhancing portfolio resilience. While it's true that opportunities can emerge in times of uncertainty and volatility, it's just as important for investors to cut through the white noise in the near term and train their goals on the longer term.

1 Bloomberg, as of September 26, 2022.

Global Macro Outlook contains detailed commentary on key markets such as the United States, Canada, China, the euro zone, Japan, and India, among others. To access the full 28-page report, please visit https://www.manulifeim.com/institutional/global/en/global-macro-outlook.

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A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange-trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other preexisting political, social, and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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