Q2 2023 | Global Macro Outlook

Navigating turbulence

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The Fed's triple mandate

Events of the past quarter have strengthened our conviction on several of the team's core economic views.

- To be cautious about the risk-on price action in January given we had expected H1 to be bumpy
- The full impact of prior policy tightening has yet to filter through to the real economy
- A global recession is likely within the next 12 months
- Investors may need to reassess their belief that the U.S. Federal Reserve (Fed) will always come to the market's rescue

In our view, the macro backdrop will get worse before it gets better in the current global economic cycle, and investors should expect to experience higher and longer bouts of volatility through H123.

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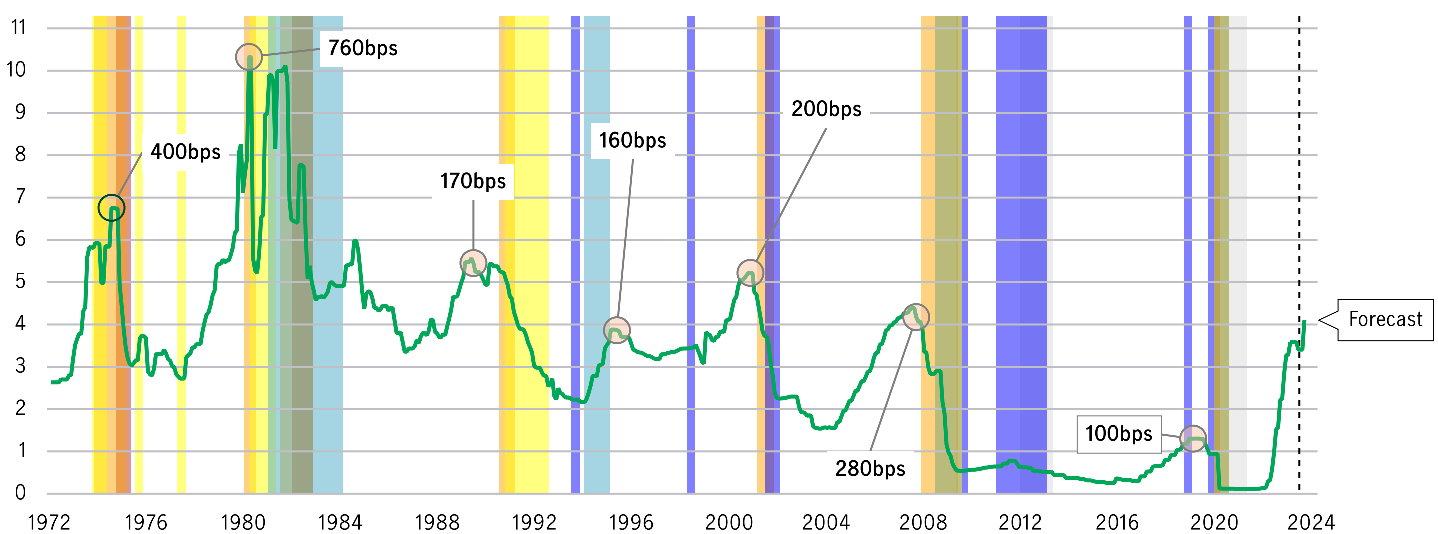
At this point, we believe it's crucial to reassess how we should be thinking about the Fed's approach to policymaking, especially in the context of the second biggest bank failure in U.S. history, which has raised doubts about the health of the U.S. banking system.

The most aggressive monetary tightening cycle in decades

The current tightening cycle in advanced economies is the most aggressive in decades, and while markets are now pricing in rate cuts, we think it's premature to anticipate an easing cycle just yet.

GDP-weighted developed-market policy rate (%)
Steep rises in policy rates typically correspond with historical episodes of recessions and systemic crises



Source: National central banks of advanced economies, Macrobond, Manulife Investment Management, as of March 23, 2023. GDP refers to gross domestic product. Bps refers to basis points. The shaded areas represent recessions and periods of systemic financial crisis around the world. Past performance does not guarantee future results.

Moving fast and breaking things

The old market adage is that central banks tend to hike rates until something breaks. Well, we're at a point where things appear to be breaking. The strain in global financial markets as a result of ongoing tightening in financial conditions and the marked deterioration in market liquidity across key asset classes have crossed important thresholds. This can be seen in recent episodes of extreme volatility in the gilts market, stresses in Mainland China's highly leveraged property sector, swings in South Korea's bond market (following a high-profile bond default), and, most recently, the loss of confidence in U.S. regional banks triggered by the closure of two tech-focused lenders in the second week of March.

The last event, in particular, led to a massive spike in volatility in the bond markets. For instance, yields on the two-year U.S. Treasury bill fell 102 basis points (bps) in the days following the bank closures. For context, this represented the largest move in yields since the week of Black Monday in 1987, surpassing declines seen when Lehman Brothers collapsed in 2008, the pandemic meltdown in 2021, and when the dot-com bubble burst in 2001.[1]

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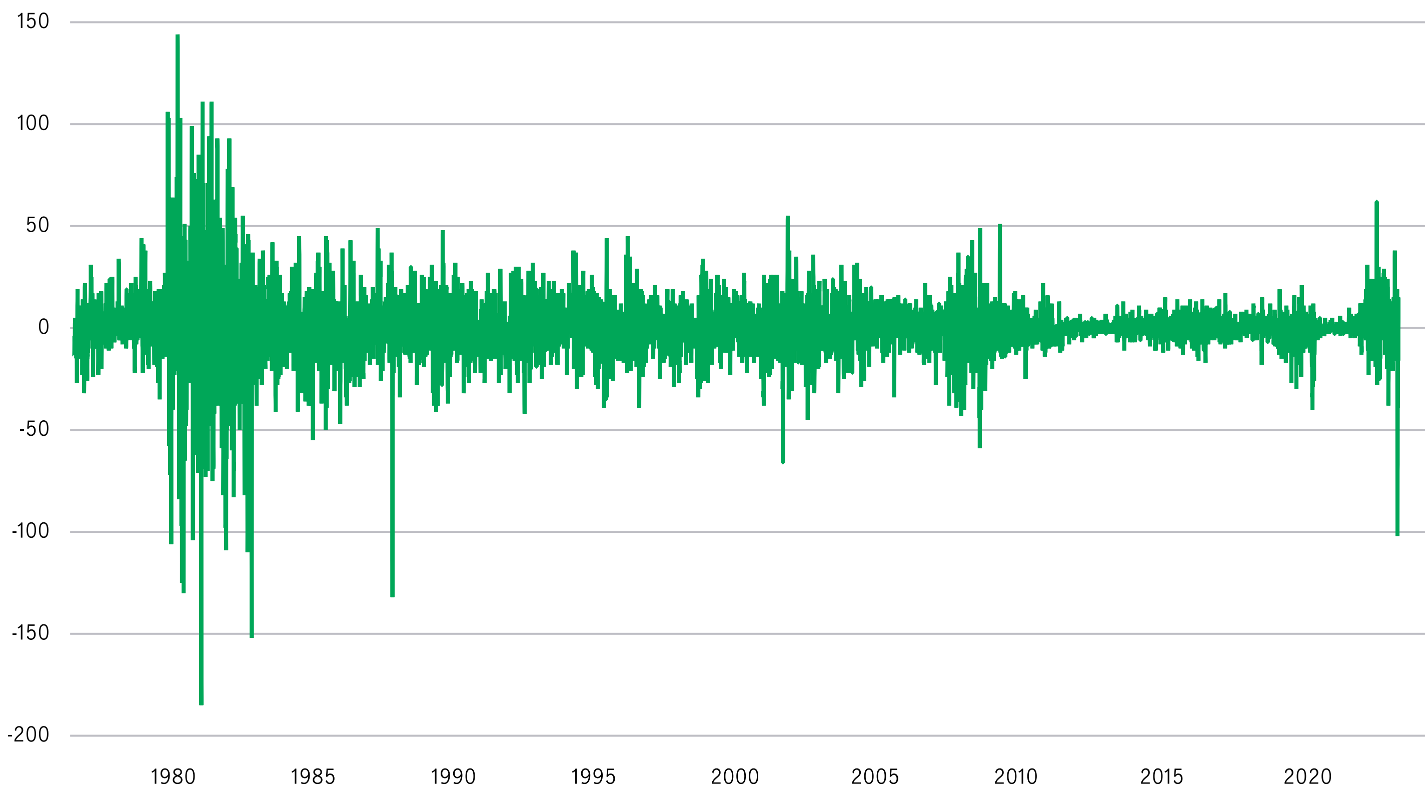
Change in two-year U.S. Treasury yield (bps)



Source: U.S. Department of the Treasury, Macrobond, Manulife Investment Management, as of March 23, 2023. Bps refers to basis points.

1 Bloomberg, as of March 23, 2023.

Unsurprisingly, as these events unfolded, markets changed their medium-term pricing of terminal federal funds rates. Over the course of three days, between March 10 and March 13, market pricing of terminal rates fell from 5.70% to 4.75%, before settling at 4.95% going into the March 22 Fed meeting.

In our view, the market's initial belief that trouble in the U.S. banking sector and mounting concerns about financial instability would dramatically change the Fed's thinking was misguided. That perspective hinges on two assumptions:

1. The idea that the Fed would need to combat financial stress by adjusting its interest-rate policy
2. The Fed would prefer to avoid financial stress at all costs

We take issue with both assumptions.

Balancing the Fed's *implied* triple mandate: the right tools for the right job

In assessing what could be construed as the Fed's appropriate monetary policy response to the ongoing malaise, we note that former Fed Chair Ben Bernanke said on many occasions that in order to achieve different policy objectives, central banks can and should use the right tool for the right job. In other words:

- **Monetary policy tools** should be used to manage the demand-side of an economy (e.g., interest rates in most advanced economies)
- **Macro-prudential tools** should be used to address wider systemic risks (e.g., loan-to-value restrictions in the mortgage market and core funding ratios for banks)
- **Micro-prudential tools** should be used to promote the stability of individual financial institutions (e.g., through capital requirements and disclosure)

Policy tools that central banks can tap into

Monetary policy	Policies relating to the management of money supply/interest rate to achieve macroeconomic objectives such as price stability, employment, growth, and/or liquidity
Macro-prudential policy	Policies introduced to limit the buildup of vulnerabilities within the financial system (i.e., systemic risk), with financial stability as its ultimate goal
Micro-prudential policy	Policies introduced to safeguard individual financial institutions from idiosyncratic risks and prevent them from excessive risk taking

Source: Manulife Investment Management, as of March 23, 2023.

Having different tools at their disposal enables central banks to be more flexible and formulate appropriate policies to support the economy, particularly in an environment in which the financial and business cycles are out of sync.

Indeed, the Fed demonstrated the breadth of its tool kit in March when it introduced the Bank Term Funding Program. At the same time, the U.S. Treasury, along with the Federal Deposit Insurance Corporation, pledged to make good on all deposits at the two lenders that were closed by regulators, including deposits that were uninsured. In policy terms, many would agree that these were highly surgical tools meant to address a specific risk in specific circumstances.

The actions taken by policymakers suggest that U.S. depositors may no longer need to fear a banking crisis. The announced measures imply that regulators could step in to resolve liquidity and solvency problems at banks with questionable risk management practices to eliminate the risk of cascading bank runs. But this ain't no free lunch: The inference here is that there will be increased regulation and oversight, which could translate into a cap on risk-taking activities and, potentially, lower profits. On the other hand, banks may also need to increase the interest they offer depositors to prevent deposit outflows—again, a development that could dent profit margins.

The way we see it, the regulators' response was substantially more effective than cutting interest rates, which wouldn't have cured the underlying problem and could have exacerbated other existing challenges.

Is the Fed increasingly comfortable with financial *instability*?

If this can indeed be read as the Fed's default approach to addressing banking crises, the market's going to need to adjust to the idea that central banks may be much more comfortable with financial instability than in the past. In addition, markets may also need to get used to the view that some level of financial stress—particularly when it's able to help alleviate some excesses—is a feature and *not* a bug of central bank thinking.

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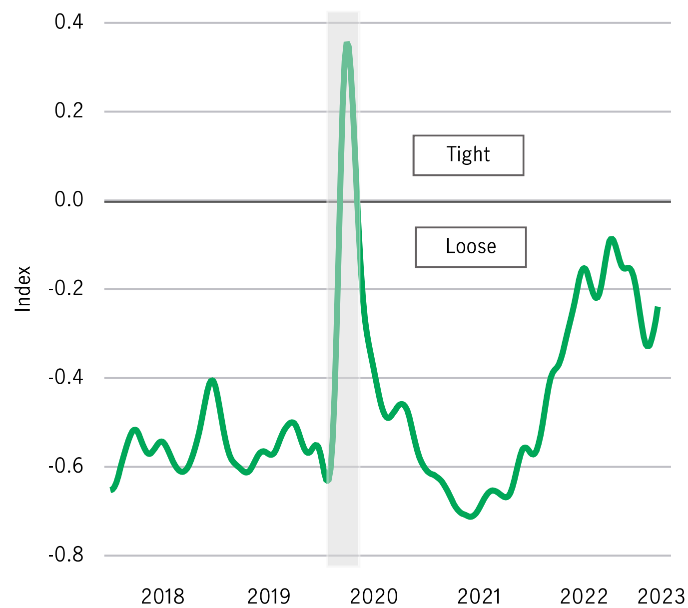
First, while pausing interest-rate hikes (or cutting rates) in response to financial instability might temporarily alleviate some immediate stress, it also risks reinvigorating the concept of the Fed put, which can inflate excesses. It's a phenomenon that crept in after the global financial crisis that likely contributed (in part, at least) to current policy dilemmas; in other words, trimming rates may solve a short-term problem but could well *exacerbate* a longer-term one.

Second, there remains a large gap between market expectations of what the Fed *will* do and what the Fed tells the market it *expects* to do.[1] This credibility gap poses a problem for any central bank since the expectations channel is an important transmission channel for monetary policy. In our view, this gap is largely a function of the market's belief that central banks are more likely than not to put a floor under the prices of financial assets. We think it's likely that the Fed will act to close the residual gap in expectations with more hawkish communication.

Third, Fed Chair Jerome Powell has repeatedly highlighted financial conditions as an important indicator to monitor. Since February, traditional market proxies for financial conditions in the United States have diverged from the Fed's own Financial Conditions Index (FCI). The widely used Goldman Sachs FCI shows that after a period of sustained tightening, financial conditions eased from September/October into January and have subsequently straddled neutral territory.

Goldman Sachs Financial Condition Index

Chicago Fed's Financial Conditions Index



Source: Goldman Sachs, Federal Reserve Bank of St. Louis, Macrobond, Manulife Investment Management, as of March 23, 2023. The gray area represents a recession. It is not possible to invest directly in an index.

The Fed may not be as dovish as it seems

Chair Powell appeared to validate this view in his post-March FOMC press conference. He noted that the recent banking turmoil was likely to tighten financial conditions in a way that was equivalent to a 25bps rate hike, and possibly even more than that. Yet the Fed's closely watched dot plot—contained within its quarterly summary of economic projections—remained largely unchanged relative to December, save for the median point for projected federal funds rates for 2024, which was revised *higher* by 12.5bps. Moreover, Mr. Powell noted several times at the press conference that interest-rate cuts aren't in the Fed's base case. As the team has noted previously, we may have moved closer to the end of the Fed's rate hiking cycle, but the central bank took pains to make clear that it retained the right to raise rates further if it deems fit. The option to raise interest rates remains on the table, and the idea of imminent rate cuts seems misplaced to us.

> "The option to raise interest rates remains on the table, and the idea of imminent rate cuts seems misplaced to us."

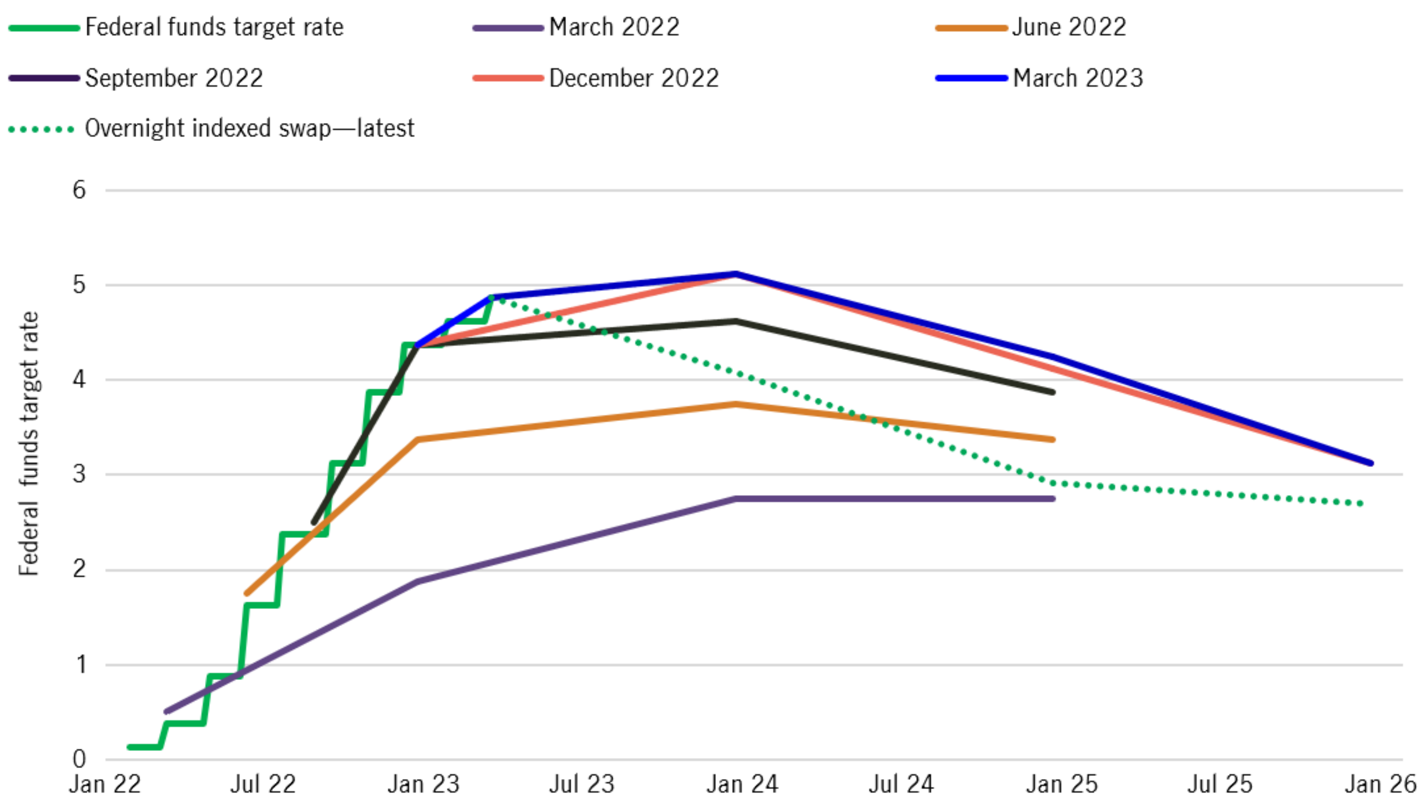
A new Fed normal?

Recent developments are pointing to the increased likelihood that the Fed could be more comfortable with the idea of financial volatility. We believe the central bank's recent surgical approach to instilling financial stability in the aftermath of the U.S. regional banks' fallout points to that. Understandably, that wouldn't be welcome news for markets, which would have to let go of their long-held assumption that the Fed will always step in to save the day. In our view, a reset in investors' mindset could be warranted.

From an investment perspective, we continue to focus on more defensive positioning and a risk-off bias. That, however, doesn't preclude other opportunities in the global macro environment, and our Q2 2023 outlook highlights several of them. That said, it does mean that market participants may have to dig deeper and be more selective as they absorb the implications of what could be the Fed's new decision-making function.

> "Recent developments are pointing to the increased likelihood that the Fed could be more comfortable with the idea of financial volatility."

Federal funds rate vs. the Fed's SEP dot plot projections (%)



Source: Bloomberg, U.S. Federal Reserve (Fed), Macrobond, Manulife Investment Management, as of March 23, 2023. SEP refers to the Fed's Summary of Economic Projections. An overnight index swap refers to a hedging contract in which a party agrees to exchange a payment with another party on a predetermined date based on the difference between a fixed interest rate and the overnight index rate, typically the federal funds rate. It's widely used as an indicator of where borrowing costs could head.

United States

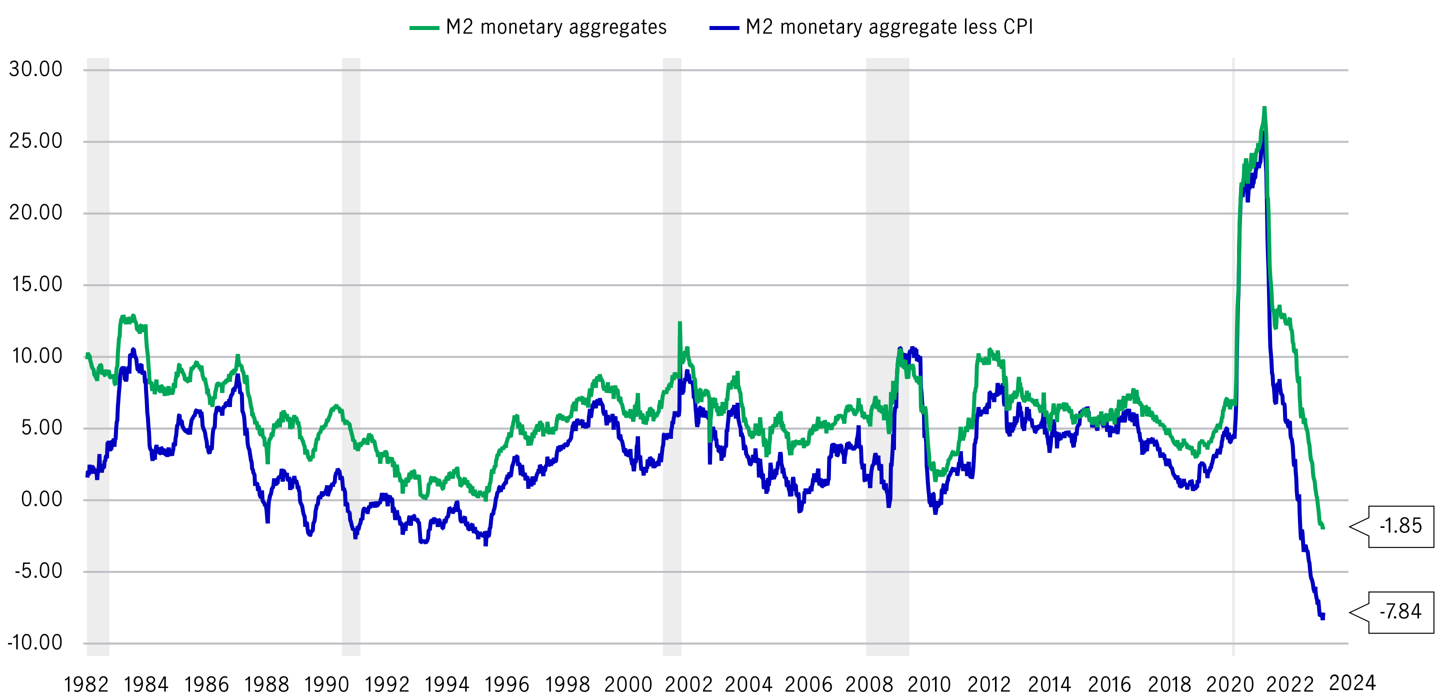
Big picture

There are few who question the likelihood of a U.S. recession in the coming months: Leading economic indicators ranging from money supply growth to the yield curve to business surveys and residential construction activity all point unambiguously in that direction. What *is* up for debate, however, is how *long* it will take to get there. So far, the U.S. consumer is holding up well and the labor market's still running hot; if neither slows down, it's difficult to make a strong case for any economic deterioration. At this stage, we believe the economy will slip into a recession around Q4 this year.

From a monetary policy perspective, we view the Fed's reaction function to inflation as being timeline based. Disinflation in goods—which we're seeing now—is, in our view, a precondition to pausing the current tightening cycle. Over a longer horizon, easing services inflation, which is linked to wage growth, is likely to be the hurdle for the Fed to clear to begin easing. To get to that point, a weaker labor market is likely required.

There are few who question the likelihood of a U.S. recession in the coming months, but the timeline for when we get there *is* subject to debate.

Money growth is at its weakest in decades, YoY (%)



Source: U.S. Federal Reserve, U.S. Bureau of Labor Statistics, Institute for Supply Management, Macrobond, Manulife Investment Management, as of March 9, 2023. M2 is a measure of money supply; it includes cash, savings deposits, and other forms of deposits that can be easily converted into cash. CPI refers to the 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. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

What we're watching

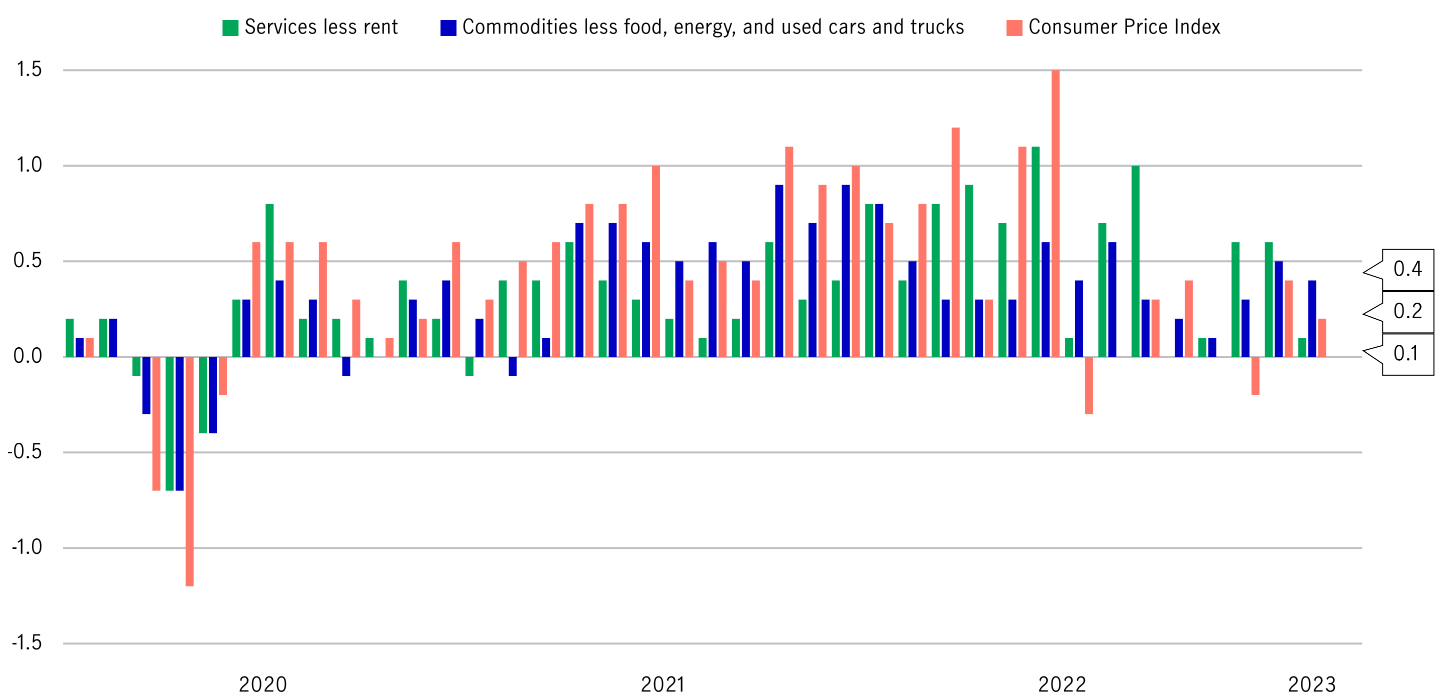
- **Inflation—**Inflation related to COVID-19 and Russia's invasion of Ukraine is receding; the Fed's focus is now likely to be on services inflation, excluding shelter, which is seen as the proxy that shows the effect that high wage growth can have on prices.
- **The labor market—**Given the relationship between services inflation and wage growth, a weaker labor market will likely need to surface before disinflation emerges. While the monthly nonfarm payrolls get most attention from investors, we're also focused on signs of softening demand: Indicators such as hours worked, jobless claims, and job leavers should provide a more holistic view.

  Debt ceiling—Although we doubt the debt ceiling will ultimately have a material impact on the economy, anxiety around the issue could lead to bouts of market volatility in the months ahead.

Key market views

- **Currencies and fixed income—**We believe that the price rally (decline in yields) in U.S. Treasuries in January 2023 reflected the markets' skepticism of the Fed's resolve to maintain a tight policy stance in the face of weakening economic data. Given that there are currently few concrete signs of a slowdown, we expect this debate to be reassessed as data deterioration becomes observable and markets start to reduce their expectation of how long the Fed pause might last, a development that could lead to a more sustained rally in government bonds. In terms of credit, we maintain that higher quality is prudent: The likelihood of a deteriorating economic environment could cause spreads to widen, especially for securities on the riskier end of the spectrum.
- **Equities—**We remain neutral to slightly defensive on this asset class on expectations that U.S. economic data will begin to weaken in the coming months.

Alternative measures of inflation are moving in the wrong direction—again, MoM (%)



Source: U.S. Bureau of Labor Statistics, Macrobond, Manulife Investment Management, as of March 9, 2023. MoM refers to month over month. It is not possible to invest directly into an index.

Canada

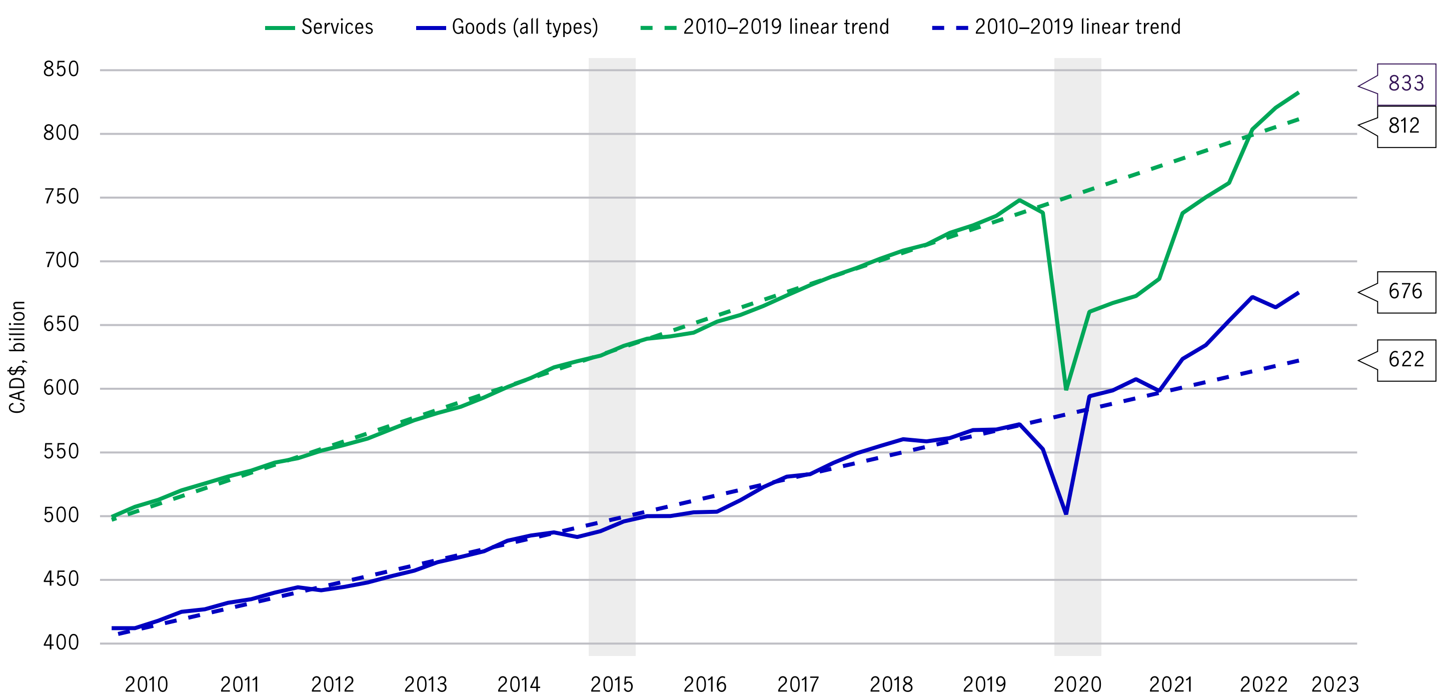
Big picture

The Canadian economy stalled in the fourth quarter of 2022 but has likely bounced back in the first quarter of this year. Household consumption, especially in the services sector, remains resilient despite high consumer prices and interest rates. Strong population growth due to migration inflow could support the labor market early in the year and underpin economic activity; however, we're seeing early signs that labor demand is rebalancing. For instance, job openings have declined by more than 280,000 (–27%) since May 2022.[1]

We continue to expect significant economic weakness toward the middle of 2023 as high interest rates weigh on households, particularly those that need to refinance their mortgages; business investment is also likely to decline. Inflation has moderated, but that's mainly due to lower energy prices and, to a lesser extent, durable goods. After hiking rates faster than most other central banks, the Bank of Canada (BoC) signaled a pause in its tightening cycle in January. We expect the BoC to remain on pause for the foreseeable future as the global economic outlook weakens and the Canadian housing sector continues to contract.

> "Strong population growth due to migration inflow could support the labor market early in the year and underpin economic activity; however, we're seeing early signs that labor demand is rebalancing."

Canadian household consumption is holding firm



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of March 7, 2023. The gray areas represent recessions.

1 Statistics Canada, as of March 7, 2023.

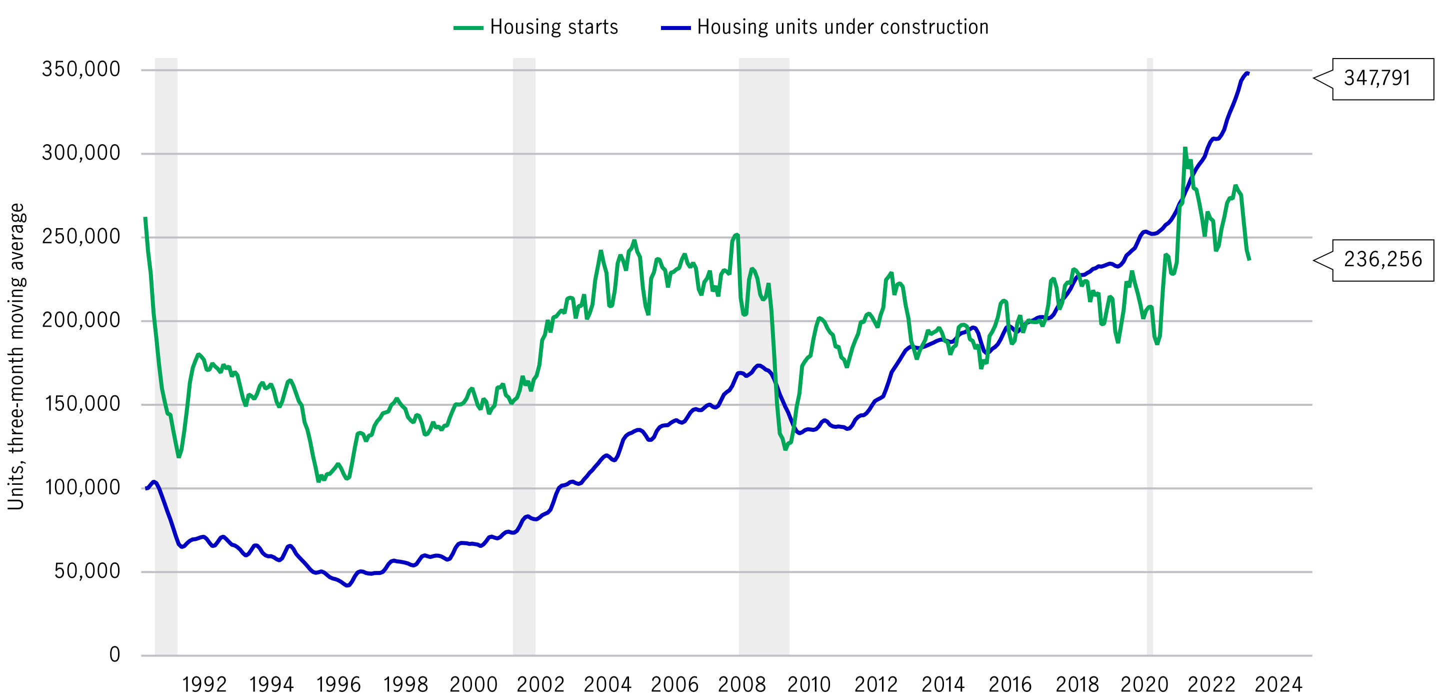
What we're watching

- **Housing activity—**The Canadian housing market continues to adjust to higher interest rates. In January, resale activity was down almost 50% relative to its March 2021 peak and national prices have declined around 7% relative to their peak in April 2022.[1] Meanwhile, construction activity has barely begun its decline as a record-level number of units remains under construction. The housing sector is expected to weigh on economic activity and households' net worth in the near term.
- **QT—**The BoC's balance sheet shrank by nearly CAD$100 billion in 2022[2] as it didn't reinvest proceeds from maturing assets on its balance sheet (mainly government bonds). Quantitative tightening (QT) is scheduled to continue throughout most of 2023, but we don't expect the BoC's balance sheet to decline to pre-COVID-19 levels. Since QT is seen as a tightening policy that complements rate hikes, the need to cut rates will likely entail ending the policy measure.

Key market views

- **Equities—**All sectors of the S&P/TSX Composite Index (TSX) are positive year to date,[3] but energy and financial stocks contributed the most to a small outperformance of the TSX relative to the S&P 500 Index. Going forward, we expect energy companies to continue to benefit from healthy cash flows; however, a looming recession could affect their bottom line if oil prices decline due to lower demand. Financial companies could also be affected as demand for mortgages declines as a result of the ongoing slowdown in the housing market. Overall, these factors could threaten the TSX's outperformance.
- **Currencies and fixed income—**The BoC has implemented a conditional pause on its rate hike cycle even as the Fed's dot plot creeps higher. Unsurprisingly, this has weighed on the Canadian dollar (CAD); however, in view of the still-elevated level of commodity prices, we remain constructive on the CAD in the medium term.

Housing starts have just started to decline even as units under construction hit a record high



Source: Canada Mortgage and Housing Corporation, Macrobond, Manulife Investment Management, as of March 7, 2023. The gray areas represent recessions.

2 Bank of Canada, as of March 7, 2023. **3** Bloomberg, as of March 7, 2023.

Euro area

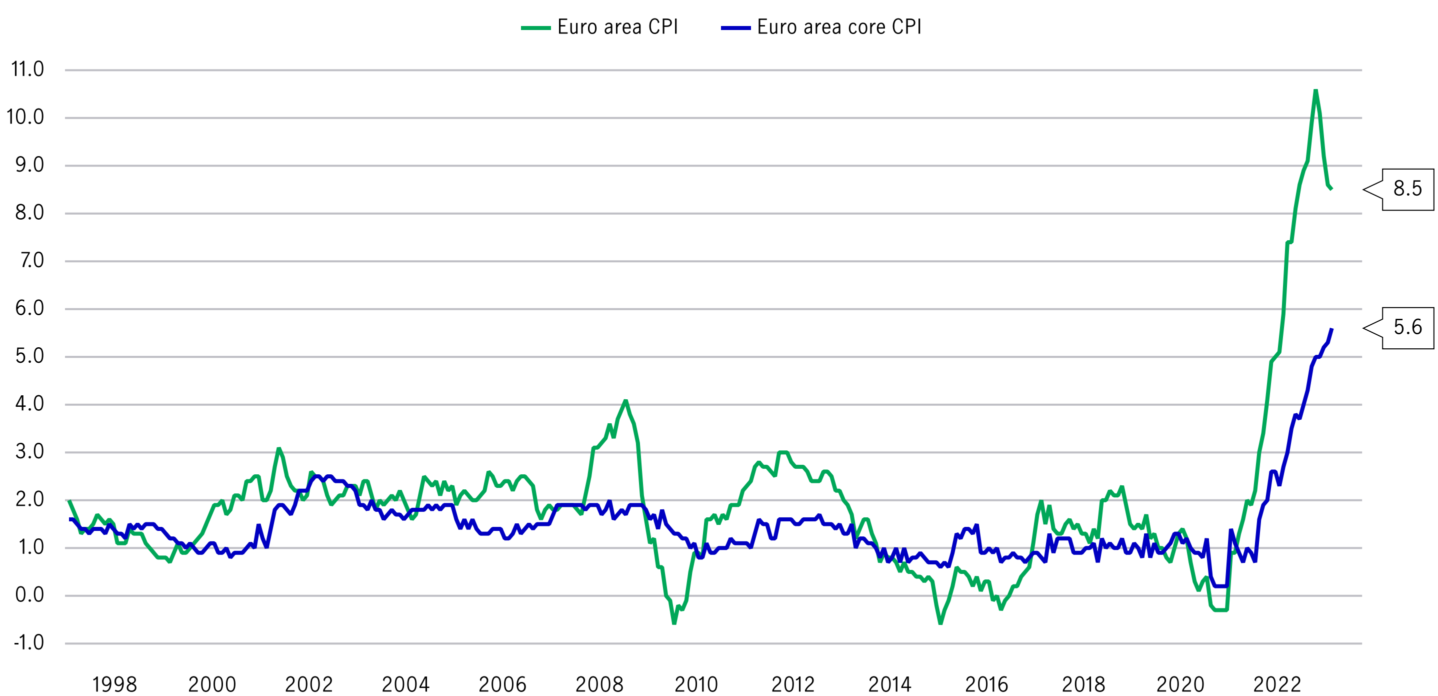
Big picture

Europe's economic outlook is improving on the back of a meaningful recovery in global growth expectations following Mainland China's reopening. Energy-related concerns have moderated, and leading sentiment indicators are pointing to a significant recovery in economic activity. Resilience in the services sector remains a concern for policymakers as the European Central Bank (ECB) maintains a focus on wage growth and inflation.

Price pressures are elevated with headline inflation holding well above the ECB's 2.0% target as core inflation continues to climb to fresh record highs. Rate expectations are rising, and market pricing of the ECB's terminal rate is pushing well above 4.0%.[1] That said, we think the outlook for relative central bank policy is offering meaningful fundamental support for the euro (EUR) and should pave the way for sustained upside for the currency, particularly against the U.S. dollar (USD). In our view, financial stability risks are rising as the ECB pushes forward with its plans for balance sheet reduction; however, European bond spreads remain contained.

"Price pressures are elevated with headline inflation holding well above the ECB's 2.0% target as core inflation continues to climb to fresh record highs."

Headline inflation in the euro area remains elevated and core inflation is near record highs, YoY (%)



Source: Eurostat, Macrobond, Manulife Investment Management, as of March 9, 2023. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year.

1 Bloomberg, as of March 9, 2023.

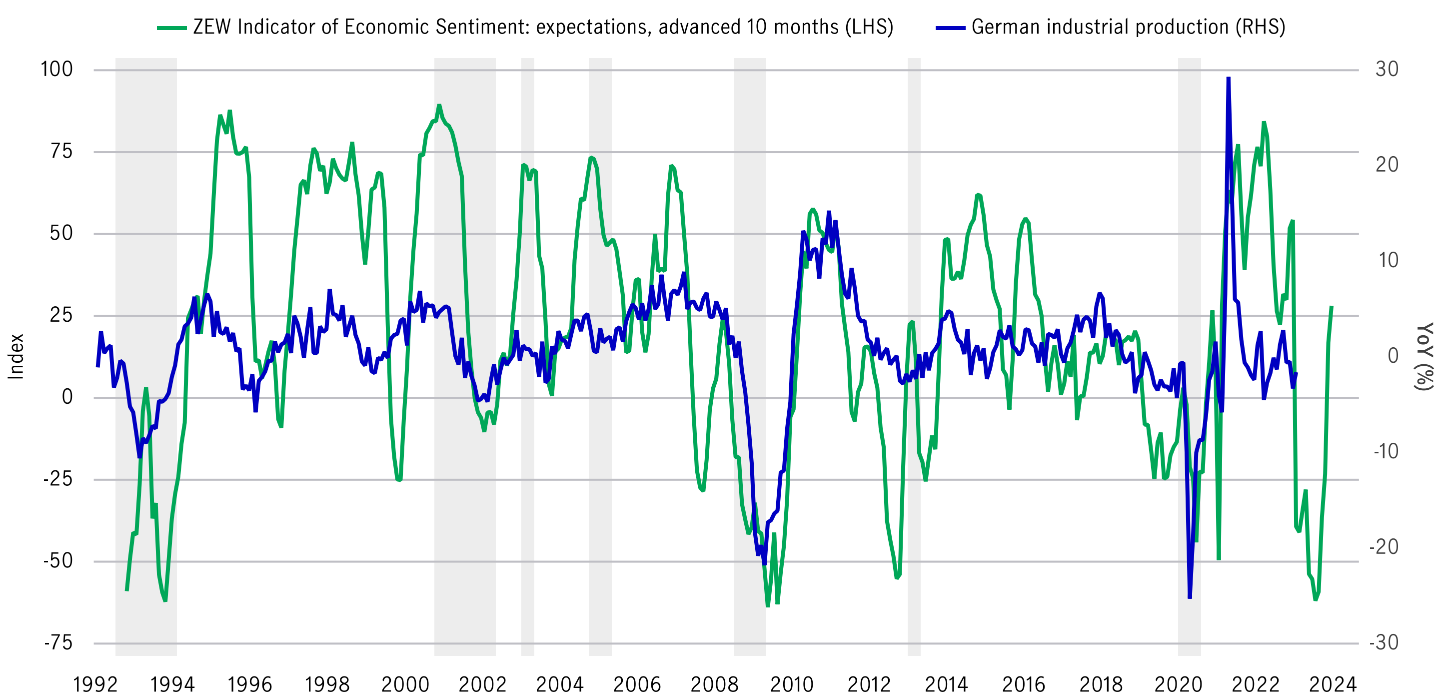
What we're watching

- **Euro area inflation—**Headline readings remain elevated and rising core inflation is a key concern for policymakers. Wage negotiations present an added risk for second-round effects.
- **Business sentiment—**Leading sentiment indicators hint at a meaningful recovery in industrial production following last year's Ukraine-related decline. In our view, the balance of risk implies further upside and an extension of recent gains.
- **ECB policy, European bond spreads, and financial stability risk—**We think the ECB's multipronged policy tightening plans pose a meaningful risk to financial stability as policymakers seek to deliver both higher rates and a smaller central bank balance sheet. Weaker euro area government bonds and financial institutions may struggle in an environment of tighter monetary policy and shrinking liquidity.

Key market views

- **Equities—**European equities are outperforming global benchmarks year to date and climbing to fresh highs following their impressive recovery from mid-2022 lows.[1] The trend appears to be gaining renewed momentum.
- **Currencies—**EUR/USD remains well supported by interest-rate differentials, and the fundamental outlook for the EUR remains constructive as market participants assess the potential policy path that other central banks may take as well as the ECB's dedication to continued tightening. Spreads favor continued upside for EUR/USD and a meaningful extension through recent highs around the psychologically important 1.10 level.

Leading sentiment indicators have shifted considerably and are favoring growth



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 9, 2023. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side. The gray areas represent recessions. It is not possible to invest directly in an index.

United Kingdom

Big picture

The United Kingdom's economic outlook is improving. High-frequency indicators of economic activity have been surprising to the upside, shifting positively in tandem with recent releases from both developed-market (DM) and emerging-market (EM) economies. Expectations of an economic contraction in 2023 have moderated and, in our view, the outlook for growth in 2024 is no longer deteriorating. Service sector resilience has been notable, and the labor market remains tight as the country's unemployment rate continues to hover just above multidecade lows.

That said, the resurgence in wage growth is a concern for policymakers as it makes the task of returning inflation back to target even more challenging, with measures of both headline and core Consumer Price Index at unacceptably elevated levels. Rate expectations for the Bank of England (BoE) are climbing, and the terminal rate is pushing toward 5% as markets have priced a series of 25bps rate hikes through June.[1] Political/geopolitical risk has fallen considerably as significant progress been made toward resolving U.K.-EU tensions around Northern Ireland.

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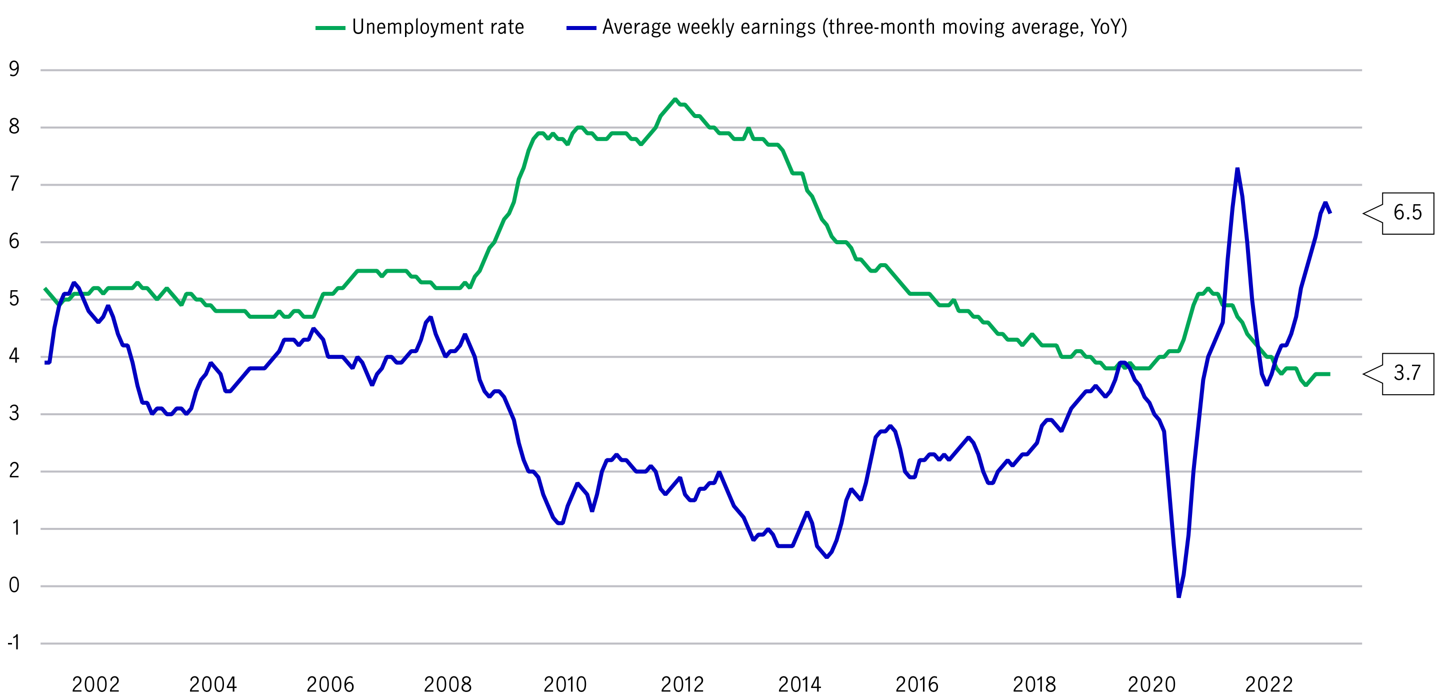
Wage growth is showing signs of reaccelerating as unemployment rate remains low (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 7, 2023. YoY refers to year over year.

1 Bloomberg, as of March 9, 2023.

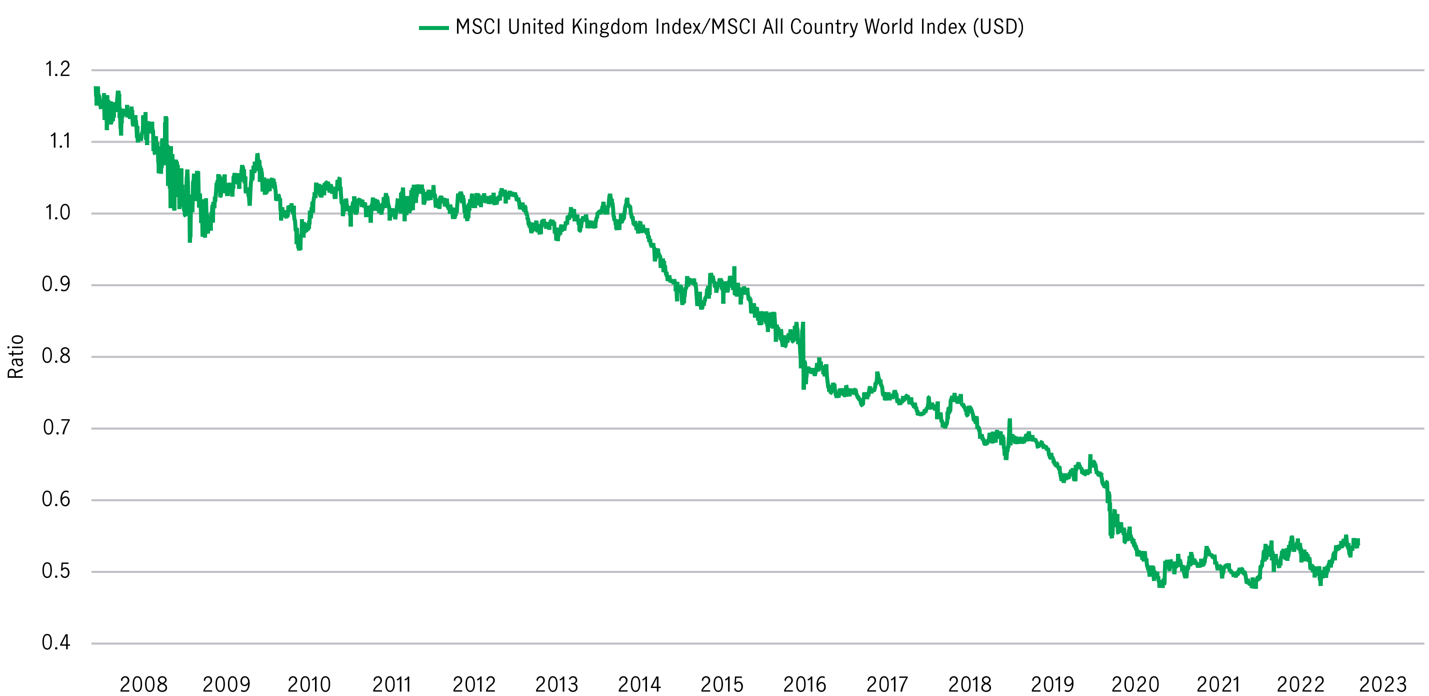
What we're watching

- **Labor market—**The evolution of employment data remains a core concern for policymakers as they assess the persistence of wage growth and its implications for services inflation. The data reveals a tight labor market, as reflected by the historically low unemployment rate, and a reacceleration in wage growth that hints at persistent labor demand.
- **BoE policy—**U.K. rate expectations have repriced in recent weeks on the back of perceived renewed hawkishness among BoE officials. This recent hawkish shift is important as it reveals a dynamism to the calibration of policy tightening in an environment of persistently elevated inflation.

Key market views

- **Currencies—**Pound sterling (GBP) has been holding up relatively well against the USD and the EUR. The BoE's dynamic stance is offering support to the currency as policymakers adjust to domestic data as well as developments in the outlook for global rate expectations. In our view, the balance of risk is tilted to the upside as we await a break of GBP/USD's recent trading range of between 1.18 and 1.25.
- **Equities—**U.K. equities continue to outperform their global peers and are managing to maintain gains versus global stock benchmarks. We expect this trend of outperformance that began in late 2020 to continue.

U.K. equities have managed to maintain gains vs. global stock benchmarks



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 13, 2023. USD refers to the U.S. dollar. It is not possible to invest directly in an index.

Asia-Pacific

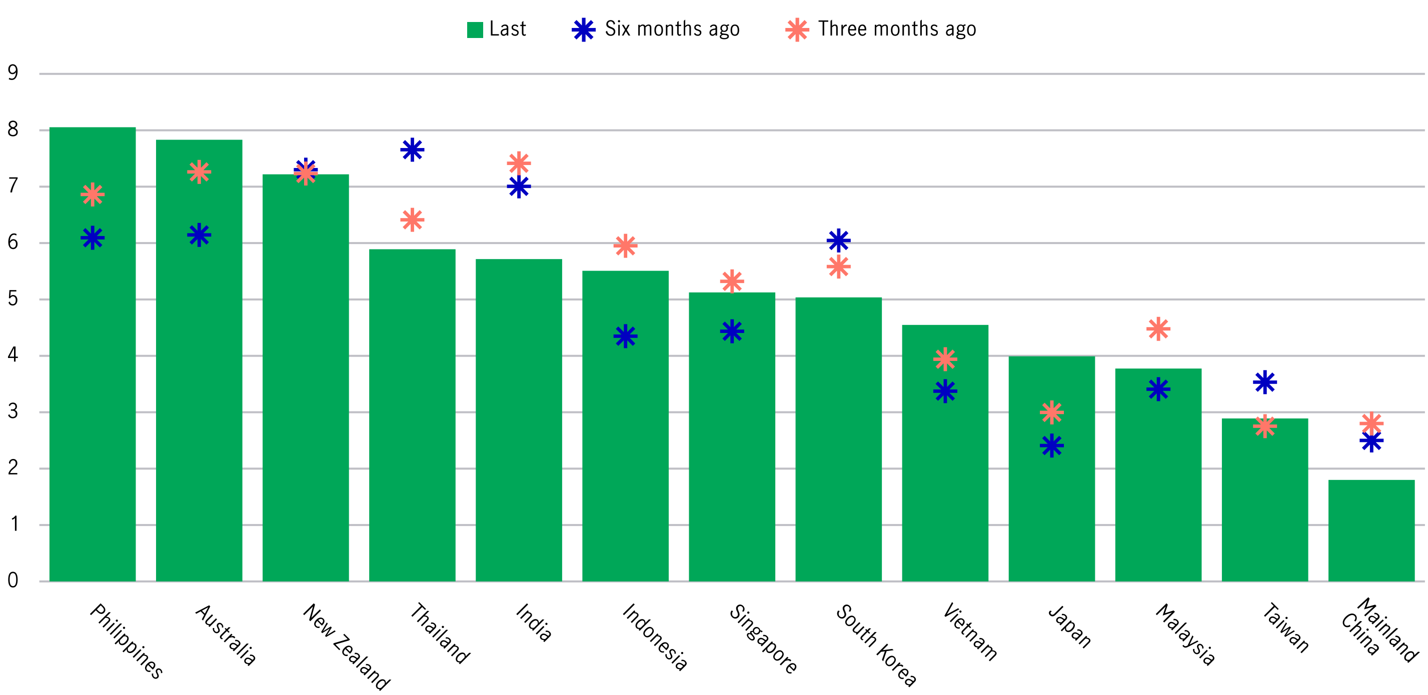
Big picture

Price pressures in emerging Asia appear to be easing with headline inflation starting to decline in many economies. As a result, central banks have started to slow the pace of monetary tightening: In January, Bank Negara Malaysia became the first major central bank in the region to pause, keeping rates at 2.75%. In February, Bank of Korea followed suit, pausing at 3.50%, as did Bank Indonesia at 5.75%. Elsewhere, Bank of Thailand raised rates in January by 25bps, to 1.50%; the Reserve Bank of India (RBI) hiked by 25bps, to 6.50%, in February; and Bangko Sentral ng Pilipinas went for a 50bps hike in February, pushing the country's policy rate to 6.00%.

We note, however, that policymakers are generally turning more dovish, barring a few exceptions. A drop in price pressures combined with a deteriorating outlook for growth will likely open the door for many of the region's central banks to bring their tightening cycles to a close in coming months. In our view, rate cuts in H2 will be contingent on a weaker USD and a further drop in food, fuel, and energy price inflation. A potential risk to that view relates to the fact that headline inflation readings can exaggerate the extent to which the inflation threat has diminished. Core inflation, which is a better measure of underlying price pressures, is still rising and is now at multi-year highs in many economies.

"Price pressures in emerging Asia appear to be easing with headline inflation starting to decline in many economies. As a result, central banks have started to slow the pace of monetary tightening."

CPI inflation over time, YoY (%)



Source: Macrobond, Manulife Investment Management, as of March 14, 2023. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year.

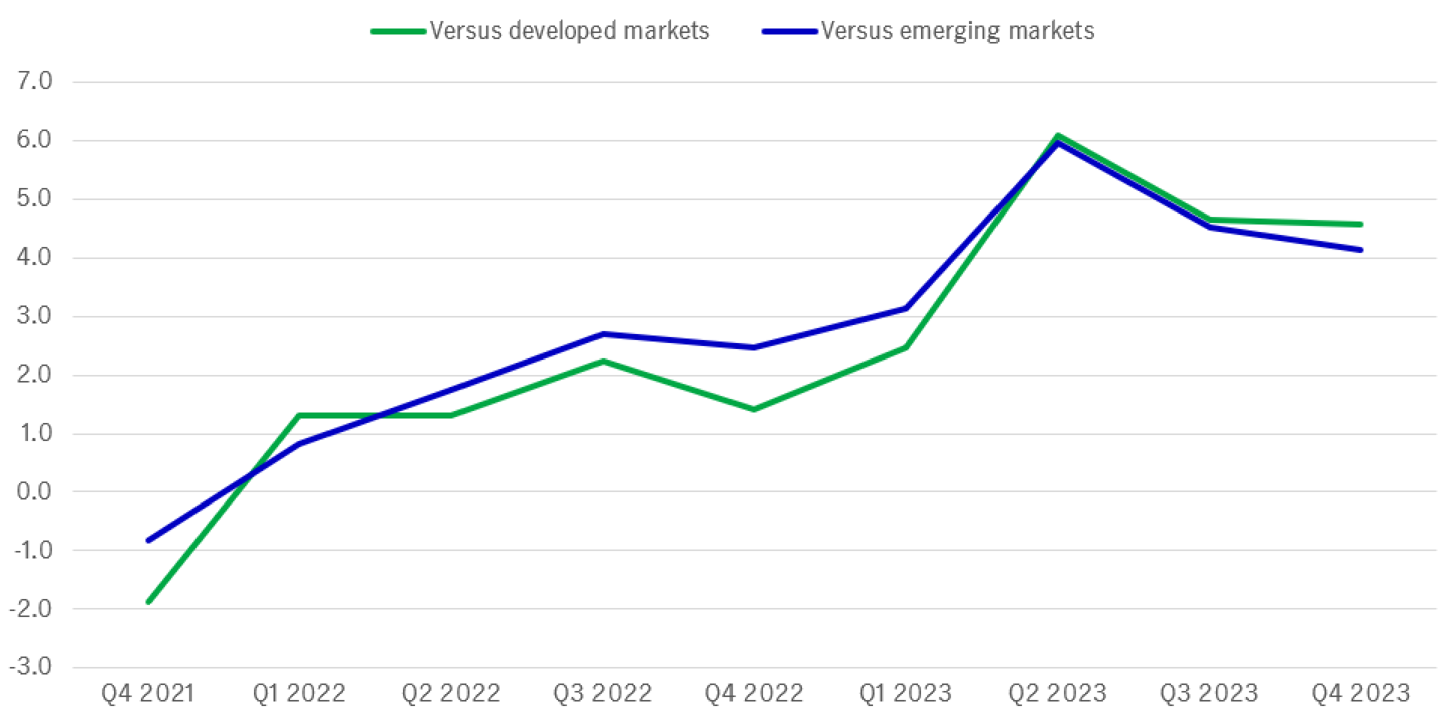
What we're watching

- **Asian export growth slowdown—**The ongoing inventory overhang in Northeast Asia and the weakening global demand for Asia's exports could extend for longer, negatively affecting economic growth.
- **Inflation—**While disinflation is broadening in earnest, inflation remains well above target for many, and central banks in the region may not rest easy until they see inflation back within target. For instance, India and the Philippines have recently faced inflation setbacks that may extend their respective tightening stance: CPI inflation in India fell to within the RBI's target range of 2.0% to 6.0% in December but has since crept higher again.[1] In the Philippines, headline inflation unexpectedly rose from 8.1% to 8.7% on a year-over-year (YoY) basis in January, well above market consensus of 7.6% YoY and also the highest annual rate since 2008.[2]

Key market views

- **Equities—**We're constructive on this asset class amid an expected widening in gross domestic product (GDP) growth differentials versus both DM and other regions within the EM universe and less worrying inflation levels; we believe central banks in the region are also likely to make a dovish pivot sooner. That said, the rising risk of a global recession implies higher volatility, continued weakness in global trade, and tighter USD funding, which suggest that an additional screen for relative strength in external liquidity metrics could be helpful. Our analysis shows that Indonesia and the Philippines screen well against liquidity risk.
- **Fixed income and currencies—**In our view, regional policymakers aren't likely to match the timing and scale of the Fed's tightening cycle. This suggests likely outperformance in regional bonds and underperformance in local currencies.

Consensus forecasts: Asia GDP growth differentials are expected to widen vs. DM and other EM economies (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 14, 2023. DM refers to developed markets. EM refers to emerging markets.

1 Ministry of Statistics and Programme Implementation, as of March 14, 2023. **2** Philippine Statistics Authority, as of March 7, 2023.

Mainland China

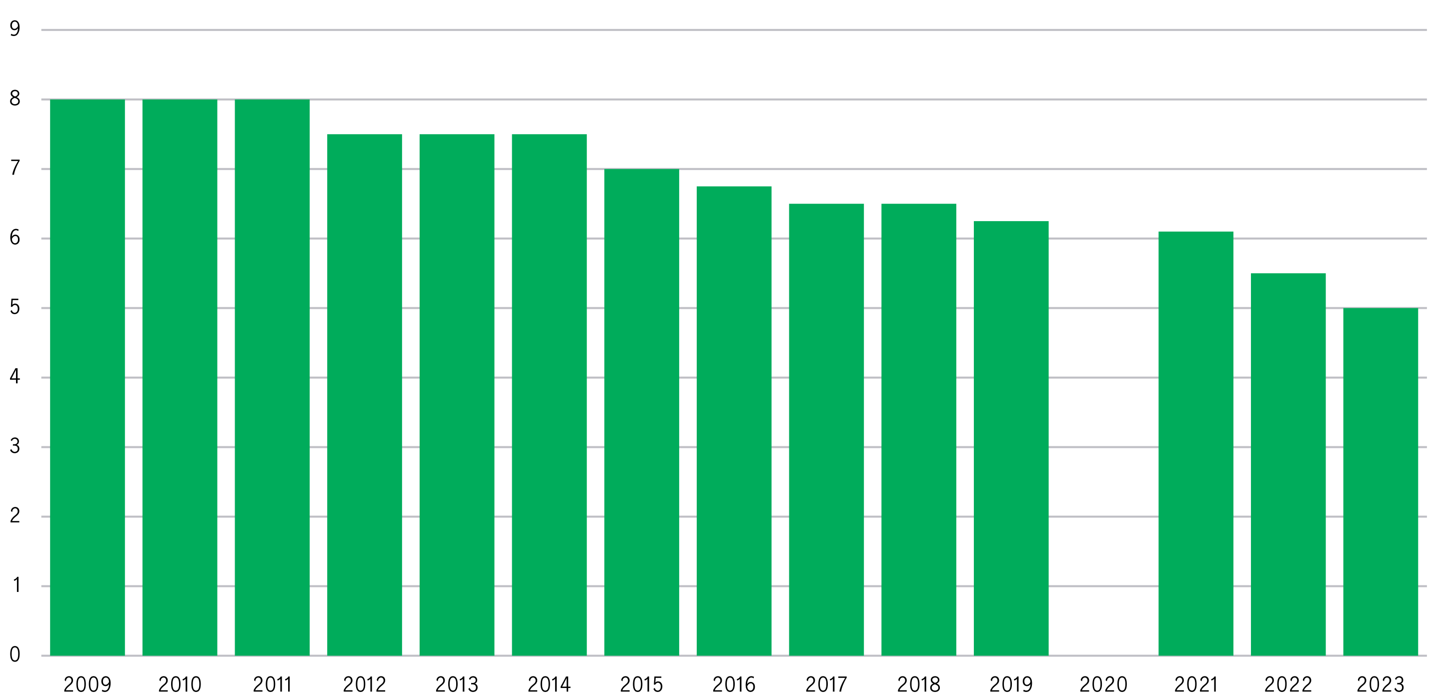
Big picture

The economic plans that were detailed at the recent National People's Congress (NPC) are more cautious and restrained than the market expected following what had been widely seen as pro-growth messaging ahead of the event. The government surprised with a lower GDP growth target of around 5.0% for this year, down from around 5.5% in 2022, and signaled that it's planning on providing less fiscal and monetary support in 2023. While this may suggest less upside to economic activity once the mechanical rebound from the easing of zero-COVID constraints has run its course, it could also mean that officials have more policy space to tackle structural problems and financial risks.

Key takeaways from the event include suggestions that the private sector could see some respite after the crackdowns we've seen in the past couple of years—boosting market confidence is now a priority, and the rights and interests of entrepreneurs will be protected. So far, there are few details regarding how those goals will be squared against the government's aim of improving income distribution and its role in pooling resources to boost science and technology.

"The government surprised with a lower GDP growth target of around 5.0% for this year, down from around 5.5% in 2022, and signaled that it's planning on providing less fiscal and monetary support in 2023."

Mainland China's official growth targets over time (%)



Source: Ministry of Finance, Macrobond, Manulife Investment Management, as of March 14, 2023. Midpoint is shown in years where a range has been targeted. The Chinese government decided against setting a target in 2020 due to the pandemic.

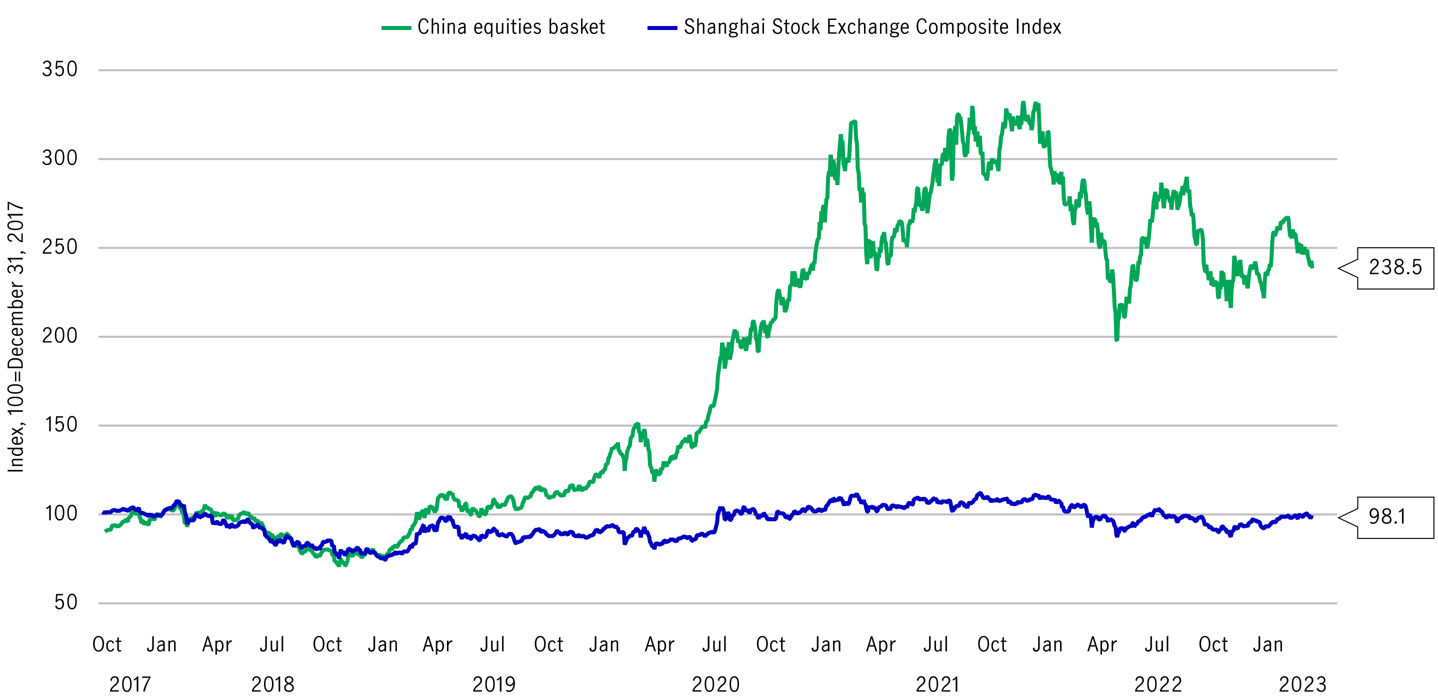
What we're watching

- **Property market—**While there may be less urgency to boost growth, it appears that highly leveraged property developers may still be under pressure to rein in debt. Notably, local governments appear not to be anticipating any increase in land sales this year—typically a crucial element of their budget.
- **Financial sector reforms—**In a speech on February 28, ahead of the NPC 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 the risk that the delisting of Chinese companies from U.S. exchanges could take place sooner than expected. Yet there remain selective strategic opportunities, and we continue to have a favorable view of 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 growth continues to disappoint and the People's Bank of China refrains from joining the global tightening cycle.

Selective strategic opportunities in Chinese equities



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 14, 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

Stubbornly high inflation led the RBI to hike its repo rate by a cumulative 225bps since April 2022[1] even as growth in passenger vehicle sales slumped (which is indicative of where the economy could be heading). This stark trade-off has contributed to a marked underperformance in Indian asset markets since October.

With core CPI inflation coming in at a sticky 6.10% YoY in February,[2] the RBI is likely to extend its tightening into Q2 with a hike in the repo rate of 25bps in April to 6.75%, assuming that the global macro outlook doesn't deteriorate rapidly. We expect the hiking cycle to end at that point and believe there may be scope for the Indian asset market to reverse some of the underperformance it endured in the past six months, since consensus expectation is that the economy will outperform its peers by a wide margin this year.[3]

Outside of cyclical factors, we remain bullish on India's structural prospects. Encouragingly, 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 should also benefit from the ongoing trade and investment diversification of supply chains.

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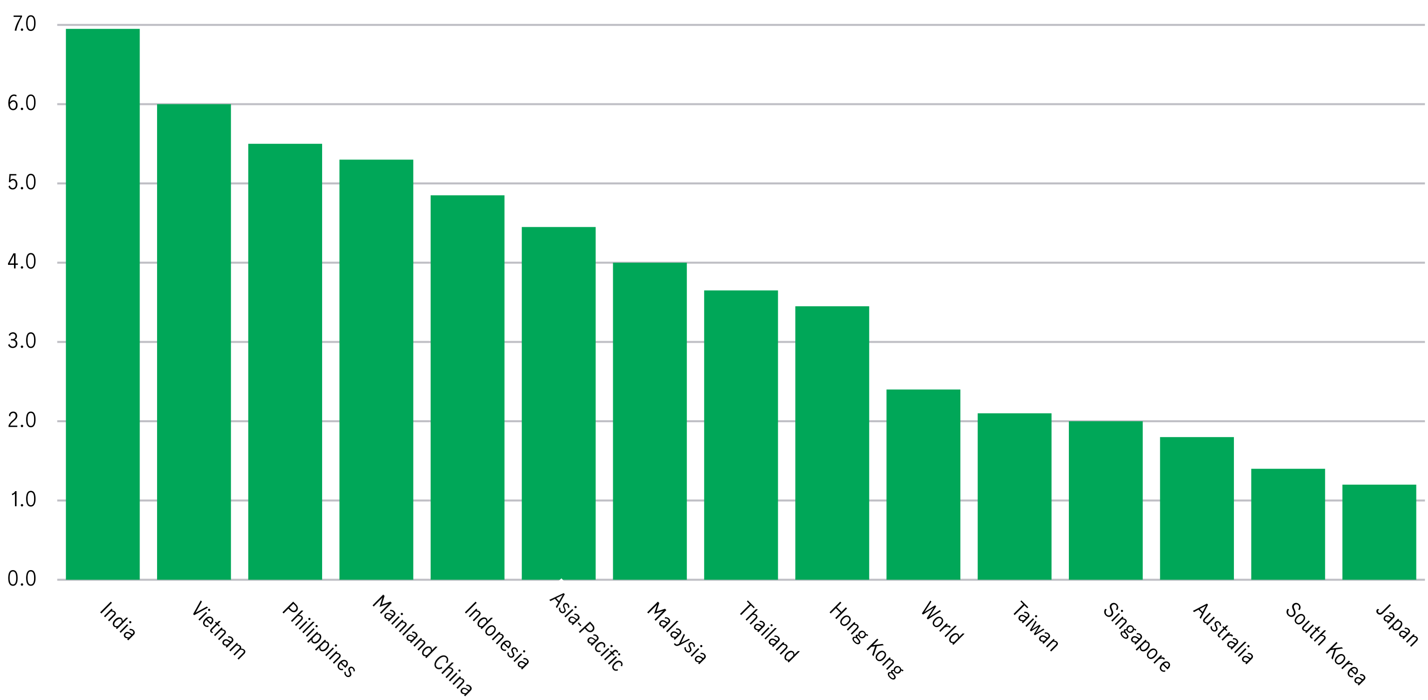
Consensus GDP forecasts for 2023, YoY (%)



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

1 Reserve Bank of India, as of March 14, 2023. **2** Ministry of Statistics and Programme Implementation, as of March 14, 2023. **3** Bloomberg, as of March 14, 2023.

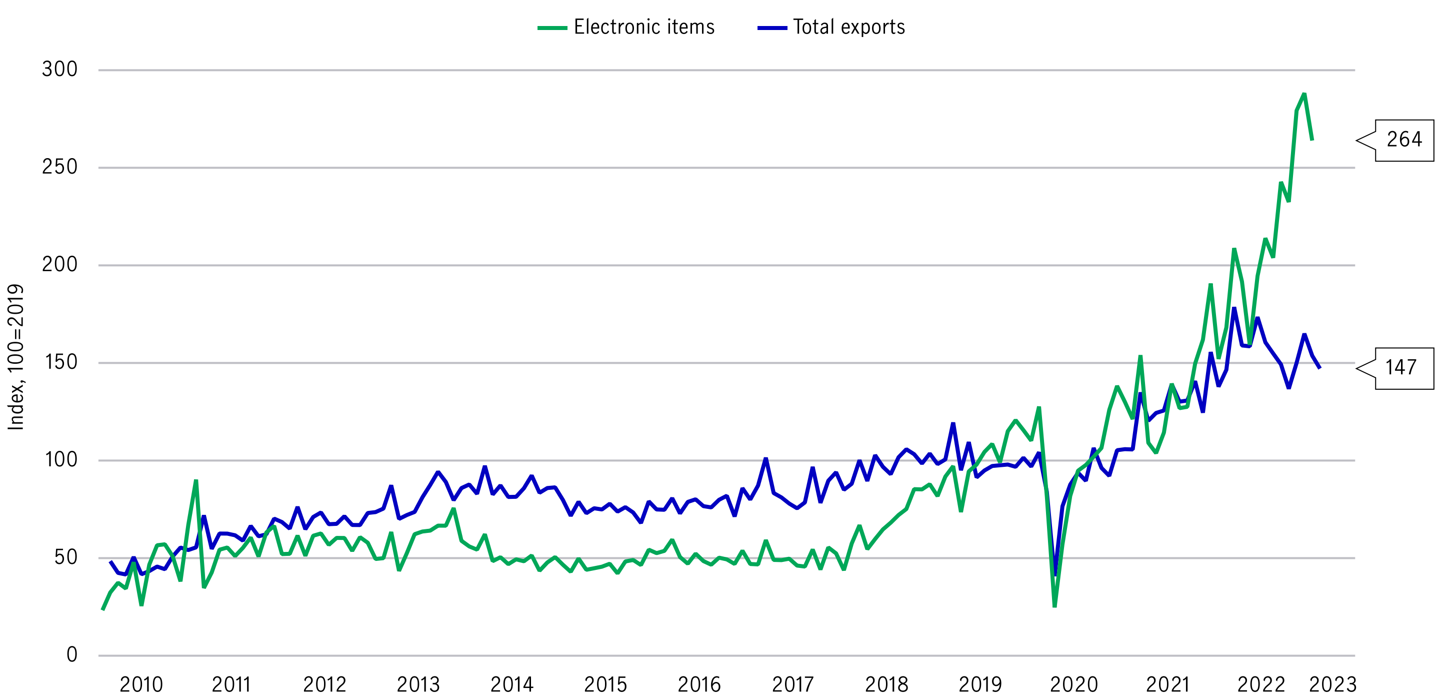
What we're watching

- **RBI policy and inflation—**Stickier inflation at elevated levels may compel the RBI to extend its tightening cycle and/or delay any expected easing. In our view, downside inflation risks could emanate from a sharp fall in wheat prices. Conversely, upside risks to food inflation can arise from a hot spring and possible El Niño conditions governing this year's monsoon season, which could affect crop harvests.
- **Buildout of a broader electronics ecosystem—** Apple's international operations have received clearance to expand into India, and construction on Vedanta Resources/Foxconn's semiconductors plant in Gujarat could begin imminently. These announcements reflect a growing trend that's mirrored in India's trade data, with electronics exports far outpacing the country's total export basket. It's certainly a development that's worth monitoring.

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.
- **Currencies and rates—**The RBI could have defended the Indian rupee from breaking above 83.0 against the USD in February. That said, the central bank's foreign currency reserve adequacy remains comfortable on key coverage metrics. In terms of rates, sticky inflation, expectations of an additional repo rate hike in April, increased bond sales in fiscal year 2023/2024, and a proposed plan to tax high-value insurance policies (which may limit demand from insurers) have weighed on the government bond market. We think it may take some time for the dust to settle.

Export of electronic items is booming



Source: Indian Ministry of Commerce and Industry, Ministry of Statistics and Programme Implementation, Macrobond, Manulife Investment Management, as of March 14, 2023.

Japan

Big picture

Market speculation of an imminent change to—or even abandonment of—Japan's yield curve control (YCC) framework has been relentless, with pressure from multiple angles, including the market, the inflation data, and how it might have swayed the public's perception of the government. Sentiment regarding bond market functioning remains at a historic low. Core CPI inflation rose to 4.2% YoY in January, more than double the Bank of Japan's (BoJ's) 2.0% target. Crucially, the surge in inflation appears to be weighing on Prime Minister Fumio Kishida's cabinet approval rating.

Despite these factors, we think it's premature to assume that the BoJ will be abandoning YCC. Specifically, inflation is likely to fall sharply in the coming months as government utility subsidies have kicked in since January. Price caps introduced to curb energy costs could shave roughly 1% from inflation. Meanwhile, indicators are far from suggesting that a wage inflation spiral is taking hold. Forward-looking indicators for the labor market are weakening, a development suggesting that base pay growth is unlikely to accelerate. Overall, wage growth isn't yet sustainably above the 3% rate the BoJ has argued is needed to achieve sustained inflation.

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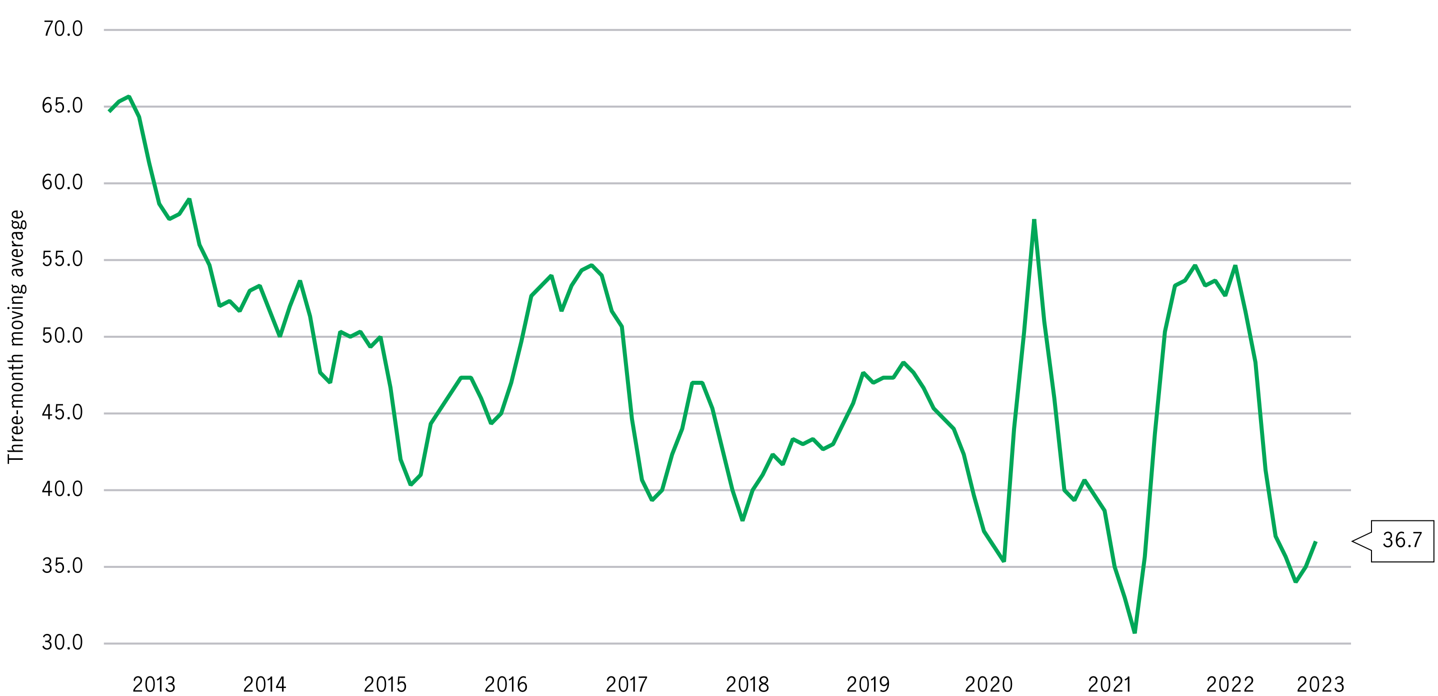
Approval ratings for Japan Prime Minister Fumio Kishida and his cabinet (%)



Source: NHK, Macrobond, Manulife Investment Management, as of March 14, 2023.

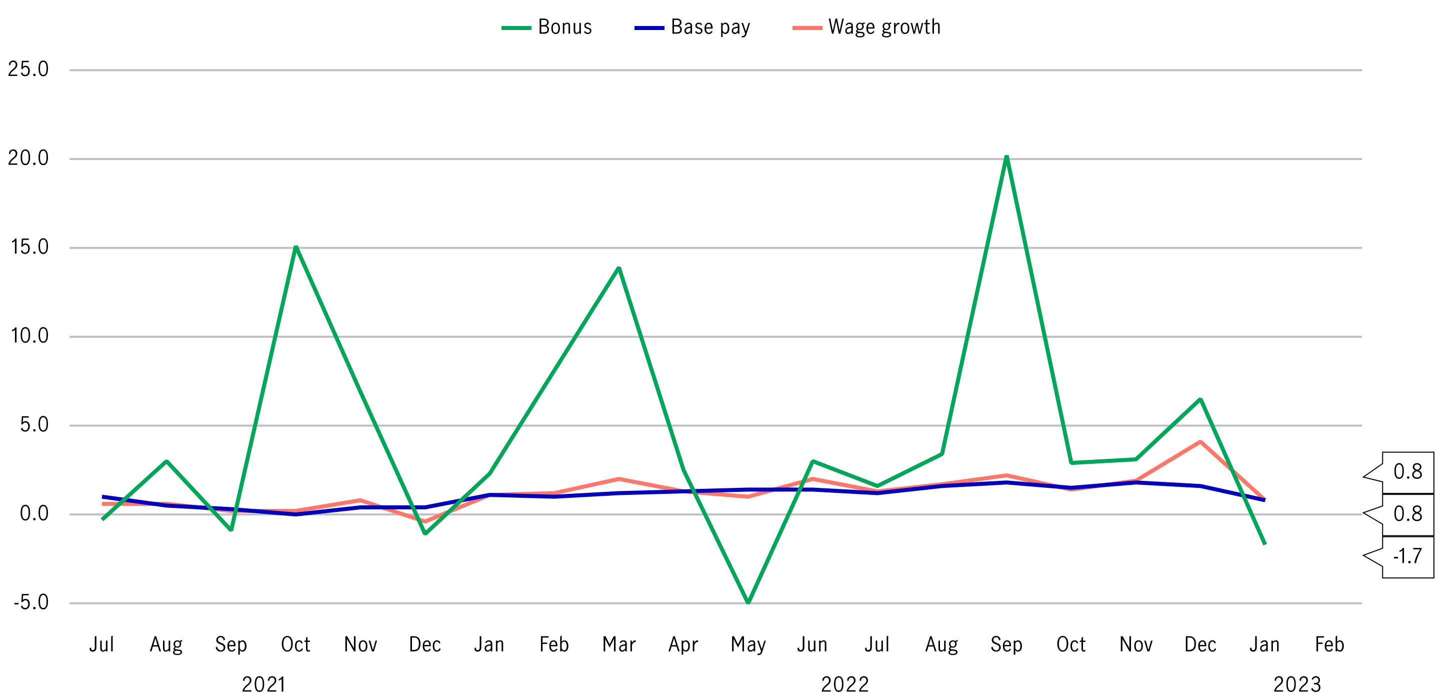
What we're watching

- **Wage growth—**The BoJ has stipulated that stronger wage growth is a precondition for policy normalization. The recent spike in wage growth appears temporary because it was largely due to a jump in volatile bonus payments, which climbed 7.6% YoY after a 3.1% YoY rise in November. Base pay has remained relatively steady at around 1.9%, well below CPI inflation of 4%+.[1]
- **New chief at the BoJ—**Incoming BoJ Governor Kazuo Ueda was present at the inception of the central bank's zero interest-rate policy in 1999 and quantitative easing program in 2001, and has been known to lean dovish. But he left the board in 2005 and hasn't played a prominent role in public policy debate since. As such, his policy bias isn't readily apparent. Markets will be scrutinizing any comments he makes for clues.

Key market views

- **Equities—**The MSCI Japan Index has been a relative outperformer versus global equities year to date.[1] 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 and those that are likely to benefit from reopening.
- **Currencies—**Consensus toward the Japanese yen (JPY) is bullish against the USD on expectations of tighter monetary policy from the BoJ in 2023. This isn't our base case. The JPY's volatility-adjusted yield is deeply prohibitive to strategic long JPY positions. The rise in Japanese government bond yields couldn't compete with global rates, and the gulf between market expectations and central BoJ policy guidance (to date) is—in our view—the perfect setup for heightened volatility through the early months of the BoJ leadership transition.

Large jump in wage growth in December was mostly due to a surge in bonus payments, YoY (%)



Source: Ministry of Health, Labour and Welfare, Japan; Macrobond; Manulife Investment Management, as of March 14, 2023. YoY refers to year over year.

1 Bloomberg, as of March 14, 2023.

Brazil

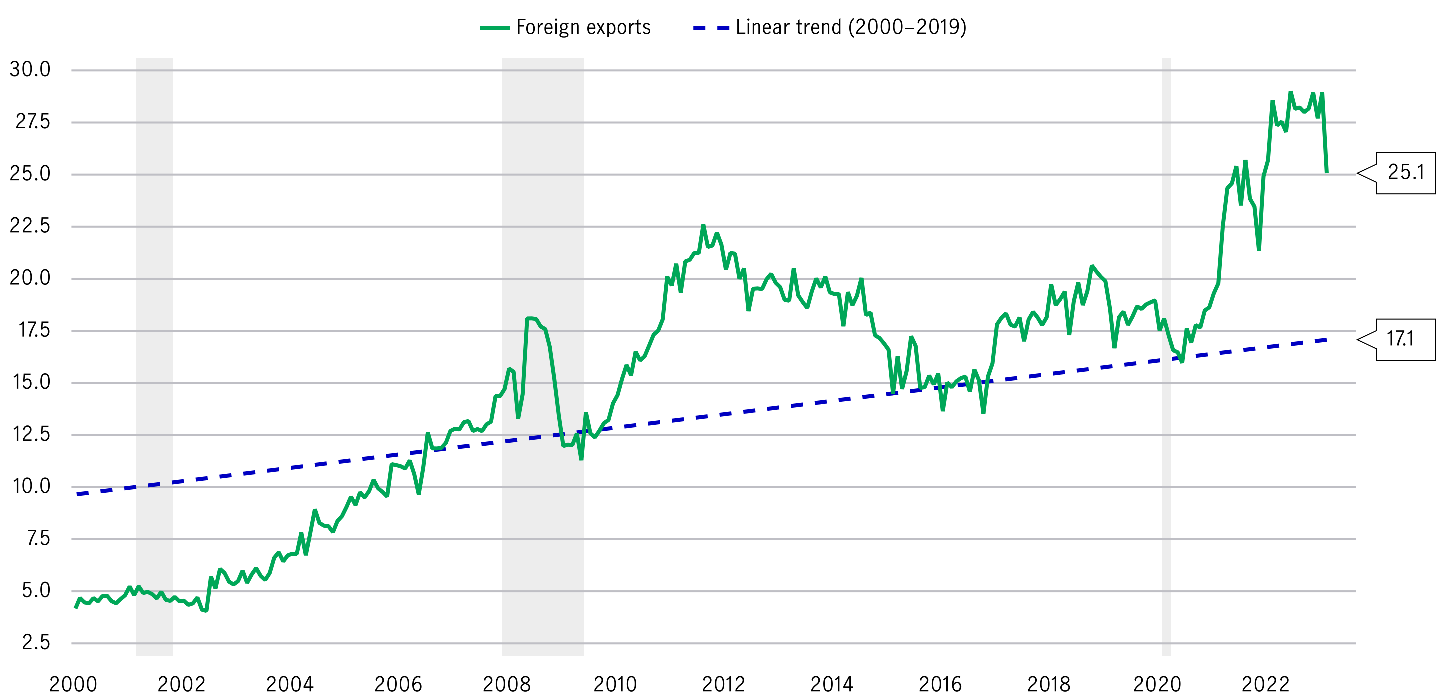
Big picture

The outlook for Brazil continues to moderate as the country absorbs the lagged effects of an aggressive tightening cycle, but we maintain a positive structural view of the economy. The employment backdrop is strong, acting as a tailwind to consumption, while above-trend export growth remains supportive thanks to continued tightness in the global resource markets.

That said, as various leading indicators soften (e.g., manufacturing new orders and capacity utilization rates), we expect Banco Central do Brasil (BCB) to leave its benchmark policy rate unchanged at 13.75% throughout Q2. In our view, the central bank will probably want to see more signs that inflation has abated and demand more clarity on the country's fiscal outlook before it will start cutting rates. In regard to Brazil's fiscal position, risks are tilted to the downside due to uncertainty around President Luiz Inácio Lula da Silva's plan, but we think the extent of market concerns may be overblown since political gridlock will likely put a cap on any major fiscal expansion that would lead to a material deterioration in the fiscal balances.

"The employment backdrop is strong, acting as a tailwind to consumption, while above-trend export growth remains supportive thanks to continued tightness in the global resource markets."

Brazil exports remain significantly above trend (USD, billion)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 9, 2023. USD refers to U.S. dollar. The gray areas represent recessions.

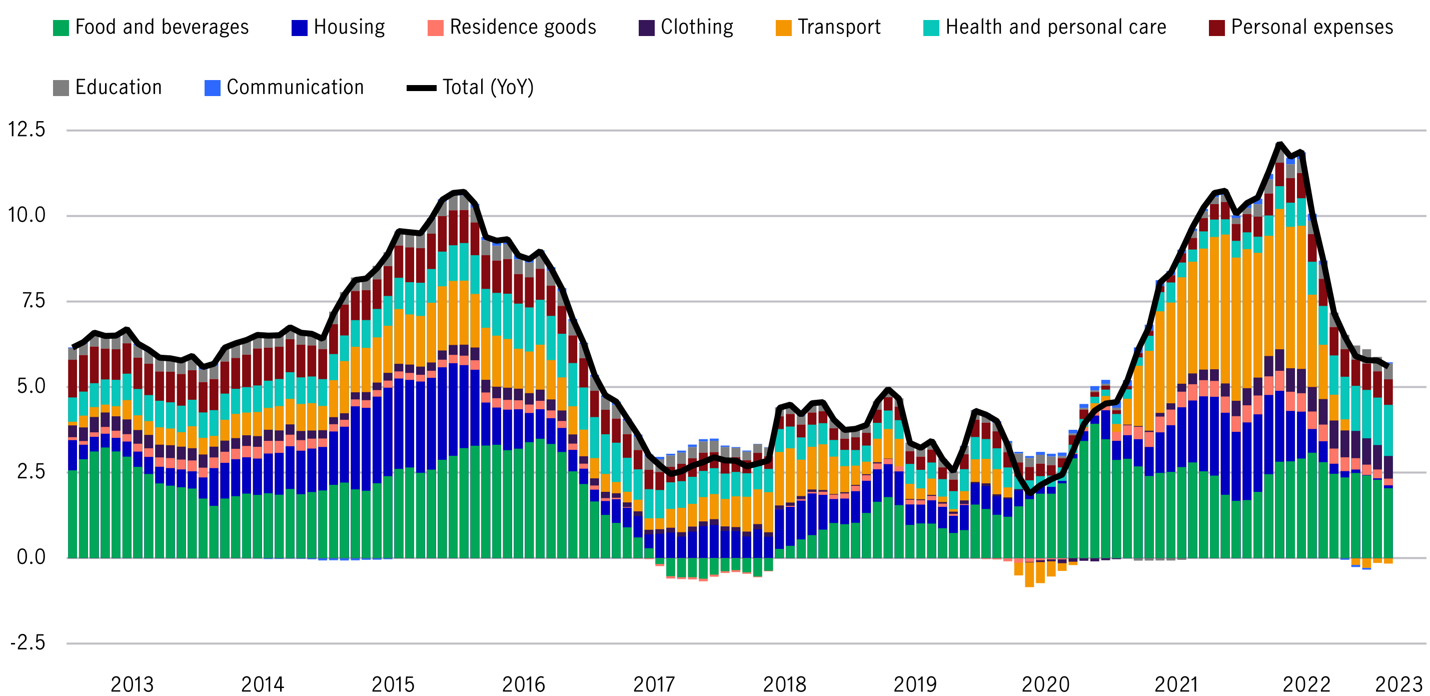
What we're watching

- **Inflation—**While inflation is trending toward the BCB's 2023 target of 3.25% (+/–1.25%), we acknowledge that much of the move lower was driven by the energy component. Since Brazilian inflation is dominated by global factors rather than domestic factors, BCB may be inclined to maintain the policy rate at the currently restrictive level for an extended period. This may have significant negative consequences for economic growth.
- **Capital flows—**Global demand for Brazilian assets remains a major driver of the Brazilian real. The currency continues to be primarily driven by global risk sentiment; as such, sudden and forceful swings in either direction are possible.

Key market views

- **Fixed income—**Real rates and the yield on Brazilian assets are among the highest in the world. With the BCB being one of the first central banks to start tightening globally, we also expect it to lead other central banks in cutting rates, which will likely be bullish for Brazil's sovereign yield curve. On the corporate front, liquidity remains high and our analysis shows that corporate fundamentals are stronger than they were prior to the pandemic.
- **Equities—**In the shorter term, the idiosyncratic political risk associated with key components of the MSCI Brazil Index (they carry the heaviest weight) could dominate price movements. From a longer-term perspective, both fundamentals and valuations appear remarkably strong: Metrics such as forward profit margins, dividend yields, and price-to-earnings metrics compare favorably against their EM and DM peers.

Brazil: contributions to inflation (%)



Source: Instituto Brasileiro de Geografia e Estatística, Macrobond, Manulife Investment Management, as of March 8, 2023. YoY refers to year over year.

Mexico

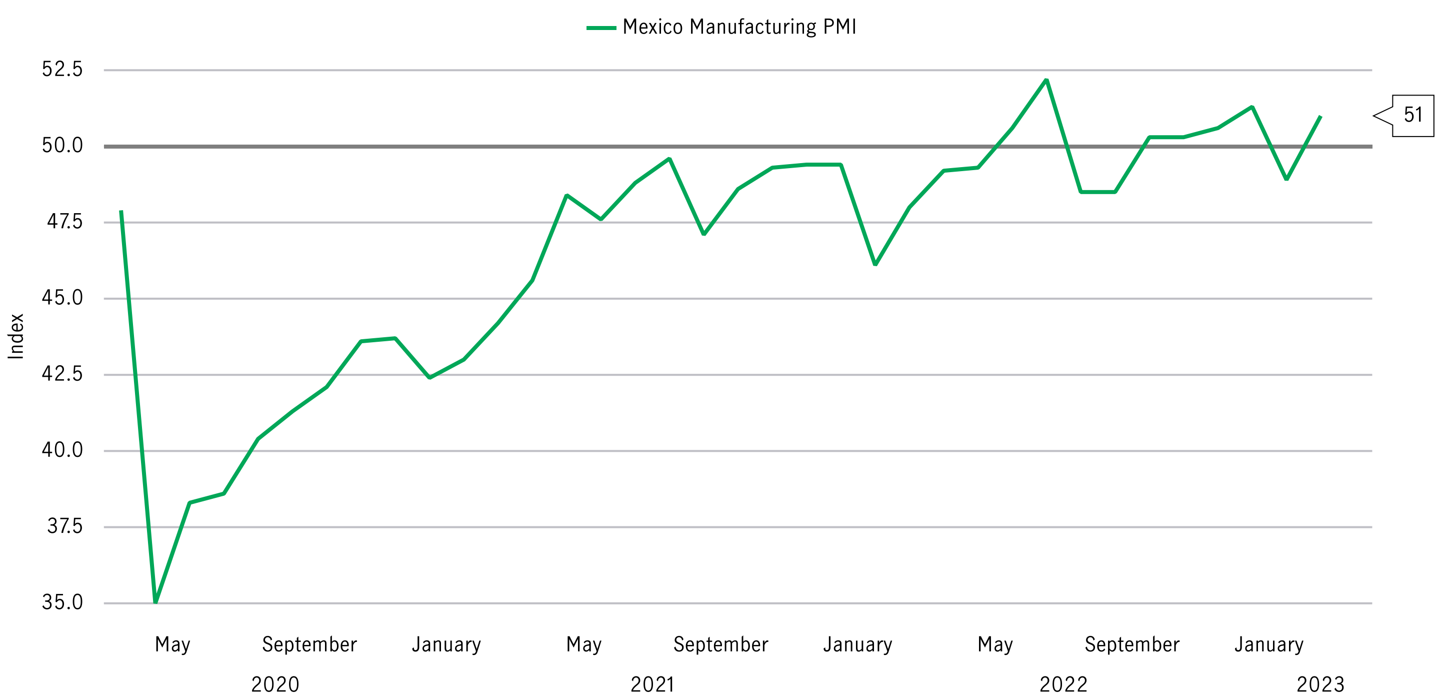
Big picture

Mexico's economic outlook appears increasingly challenged as the growth trajectory of its largest trading partner, the United States, weakens amid intensifying headwinds. Encouragingly, recent domestic data has hinted at considerable resilience in terms of both economic activity and inflation. Banxico's relatively hawkish stance has enabled the Mexican peso (MXN) to deliver a strong performance as policymakers seek to contain persistently elevated inflation.

Political developments remain an area of concern, but markets appear to have ignored recent attempts to reform the country's electoral process. Mexico remains an attractive destination for foreign direct investment—multinational corporations appear to be adjusting to geopolitical developments and the implications of the ongoing diversification of global supply chains. Mexican equities are holding up relatively well and have been trending higher versus global benchmarks since late 2021.

"Encouragingly, recent domestic data has hinted at considerable resilience in terms of both economic activity and inflation."

High-frequency measures of economic activity have hinted at considerable resilience



Source: Macrobond, Manulife Investment Management, as of March 9, 2023. PMI refers to Purchasing Managers' Index. A reading above 50 indicates expansion; a reading below 50 indicates contraction. It is not possible to invest directly in an index.

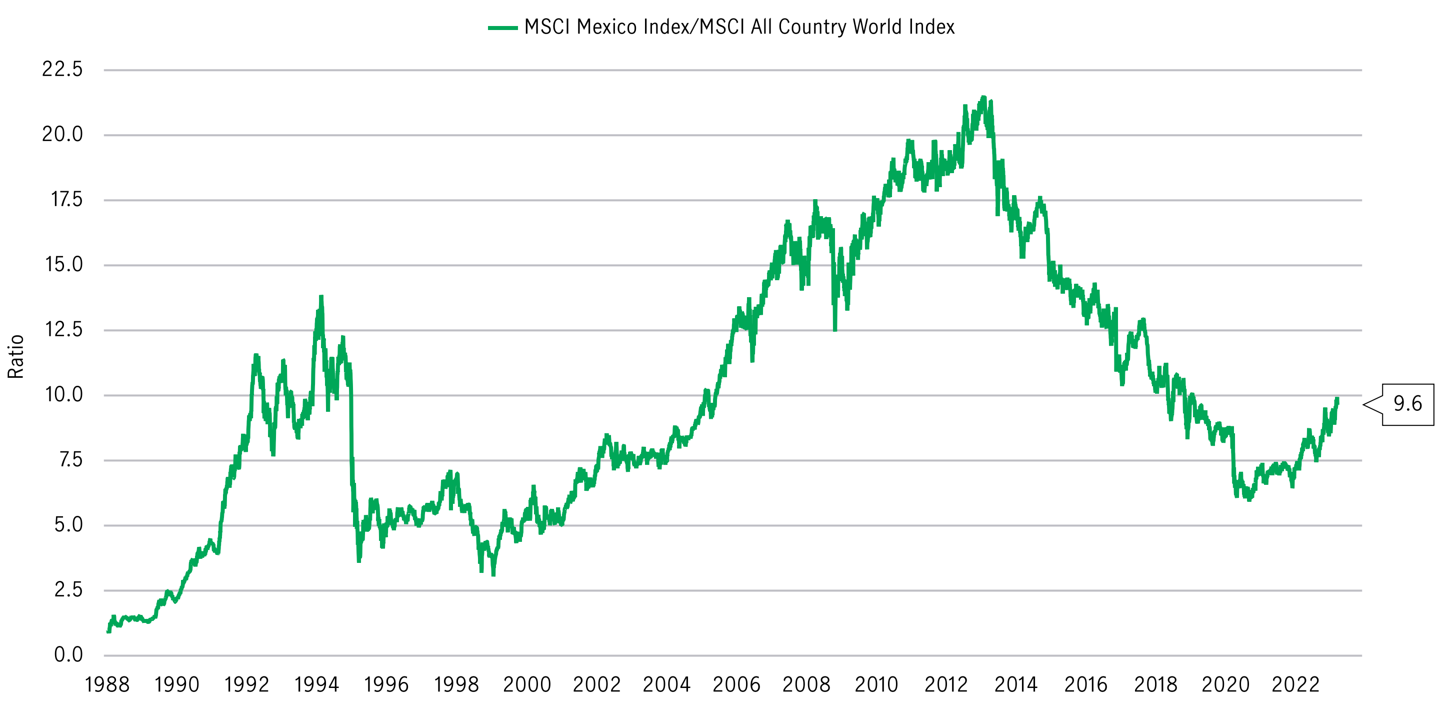
What we're watching

- **Domestic political developments—**President Andrés Manuel López Obrador's recent attempts to reform Mexico's electoral system have generated a considerable amount of pushback from opposition parties and the broader public. While market reaction has been limited so far, the issue is worth monitoring, particularly in the lead-up to the presidential election in 2024.
- **Foreign direct investment—**Mexico is an increasingly attractive destination for foreign direct investment as multinational corporations adjust their global supply chains amid an evolving geopolitical backdrop. The country is attracting high-profile names and should benefit from near-shoring trends as companies bring production closer to home.

Key market views

- **Currencies—**The MXN has been strengthening steadily over the past year thanks in part to Banxico's relatively hawkish policy stance. That said, the currency remains vulnerable to periods of heightened financial market volatility. We expect USD/MXN to trade between 18.00 and 20.00 in the coming months amid a period of consolidation.
- **Equities—**Mexican stocks continue to perform well relative to both EM and DM benchmark indexes. Mexico's relatively lower risk profile should allow for a continued period of outperformance as markets respond to geopolitical developments and an expected rise in growth differential between EM and DM.

Mexican equities are extending their trend of outperformance vs. global stock benchmarks



Source: Macrobond, Manulife Investment Management, as of March 14, 2023. It is not possible to invest directly in an index.

Manulife Investment Management

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