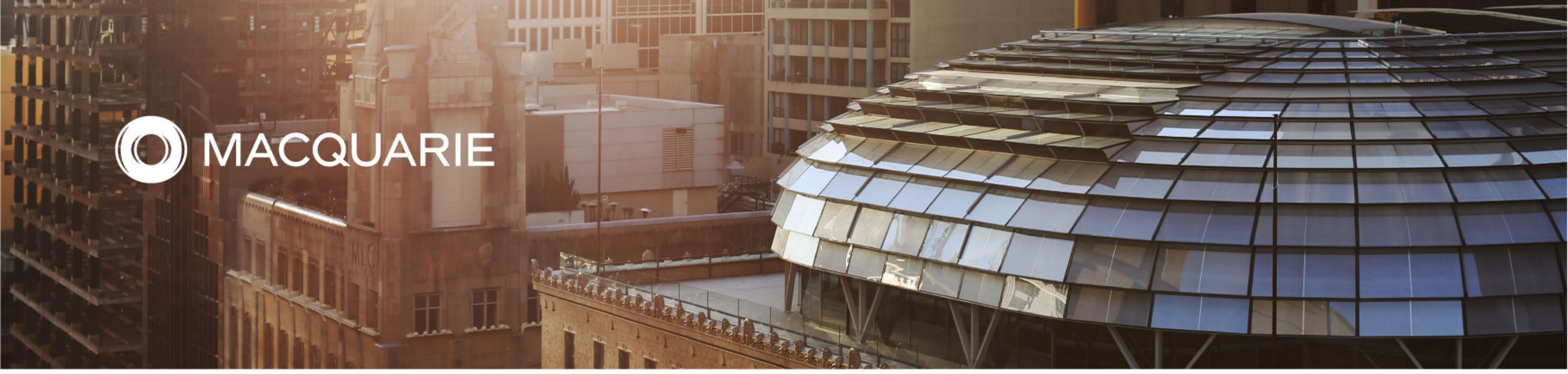



# Global Economic and Markets Outlook - June 2022

## Part 1 – Recession the price to pay for lower inflation

- Macquarie's Macro Strategy Team now expects most of the developed world (US, UK, Europe) to be in recession by 2023 as persistently high inflation forces interest rates into restrictive territory, ultimately resulting in slower growth and higher unemployment.

- Central banks are behind the curve and now need to do 'whatever it takes' to get inflation down. This will likely require a mild recession with unemployment increasing +2-3%. Macquarie's Macro Strategy Team expects aggressive 2H22 rate hikes which will take monetary policy into restrictive territory with large July rate hikes from both the Fed (+75bps) and RBA (+50bps), followed by further consecutive rates hikes through 2H22 and 1H23.

- Inflation is expected to peak during 2H22 at ~7-8% across the US, Europe and Australia before declining through 2023 and eventually returning to <3% in 2024.

- Australia is expected to avoid a recession (for now), but growth will slow materially with the cash rate expected to peak at 3.1% by May. Macquarie's Macro Strategy Team now expects national house prices to decline 15% peak to trough (previously 10%).

- The US 10-year bond yield has increased +175bps YTD resulting in one of the worst starts to the year for bonds on record. However, Macquarie's Macro Strategy Team believes the lion's share of this move has unfolded and expects the 10-year to peak at ~3.5%, only slightly above current levels, before declining to 2.0-2.5% in 2023 as the market prices in recession.

- Macquarie's Macro Strategy is bullish on the US dollar which should be supported by recession risks, risk-aversion and a widening yield advantage. The A$ is now expected to range trade at $0.65-0.70 over the next few years. Industrial commodities should come under pressure, despite structural tailwinds, as recession risks build.

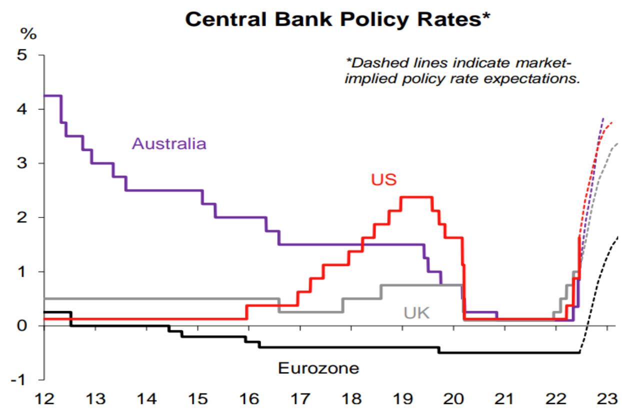
*This is a summary of a recent report from Macquarie's global macro team "Mid-Year Economic and Market Outlook: The End of "Modern Monetary Theory". We will provide a follow up 'part 2' report focused on Australia.*

### Deep in the 9th innings

The outlook for next year has soured materially as inflation has proved more persistent and elevated than previously expected. Macquarie's Macro Strategy Team now expects several of the major advanced economies (US, UK, Europe) to enter recession over the next 12-18 months, as strong inflation weighs on real incomes and sentiment, and as monetary policy moves from being highly accommodative to contractionary. China is expected to be the outlier due to 2H22 stimulus measures.

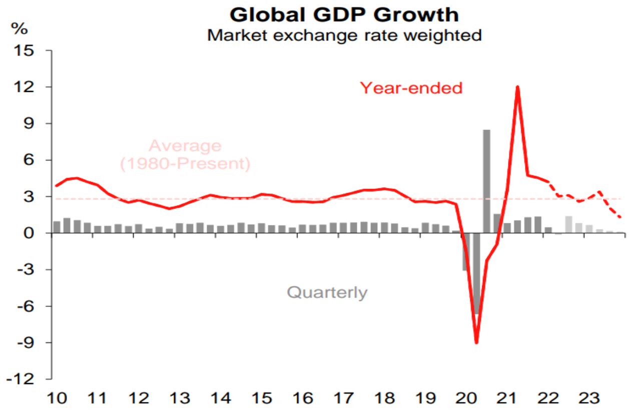
It has become clear that faced with a once-in-a-generation surge in inflation, most central banks will need to tighten policy until inflation is clearly slowing back towards target, which is likely to require an increase in unemployment rates of 2 or 3 percentage points. Put more simply, by waiting too late to act, central banks have backed themselves into a corner, with a mild recession now needed to put the inflation genie back into the bottle. If central banks fail to do "whatever it takes", we will be faced with a far worse outcome: 1970s style stagflation.

Central banks expected to aggressively tighten policy




Source: Macquarie Macro Strategy, June 2022

And with the Fed planning to reduce the size of its balance sheet by $95 bn per month from September, the risks of significant financial volatility and poor market liquidity will build as the year progresses, potentially forcing the Fed to pause at some stage.




Source: Macquarie Macro Strategy, June 2022

## Major economy outlooks

### United States – Recession 2023

Real GDP contracted in Q1 and appears to be tracking towards a weak Q2. Underlying real activity has been stronger, with final domestic demand tracking in the 2-2.5% range. Macquarie's Macro Strategy Team expect this pace to continue in 2H22.

Looking ahead to 2023, the outlook is less benign. The impact of the 2022 rate hike cycle should start to weigh on final demand. Housing investment is likely to become a more material drag, the consumer is likely to be less able to cope with the ongoing headwinds to real disposable income, and weakness in financial markets could lead to hesitation in the corporate sector to invest and hire. In Macquarie's Macro Strategy Team's baseline scenario, the combined impact of these forces pushes the US into a recession in 2023, with Q2 likely to be marked as its starting point.

### Eurozone – Stagflation

Macquarie's Macro Strategy Team expects the Eurozone to eke out modest growth near-term, supported by an easing in supply-chain constraints, a release of pent-up demand (following reopening in late Q1/early Q2) and fiscal measures (both the Recovery and Resilience Facility and recent policies to limit the effects of elevated energy prices on consumers and businesses).

However, heading into 2023, still-elevated energy prices, slower global growth, and tightening monetary conditions are expected to weigh further on activity, leading to a mild recession beginning early in the year. While there are risks to either side of this forecast, recent developments suggest risks are skewed towards an earlier recession.

### China – Lockdown-driven volatility

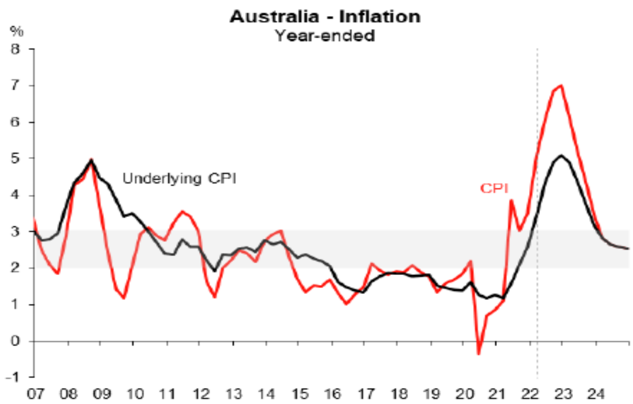
Macquarie's Macro Strategy Team expect China's economy to stage a robust recovery in 2H22, after the sharp slowdown in 2Q22 due to the lockdowns. In terms of policy support, Macquarie's Macro Strategy Team expect it to be conducted in two stages. The first stage would take place in the next month or two, when policymakers would implement the existing measures as quickly as possible, including the issuance of RMB3.65tn local government special bonds. The second stage would happen around the Politburo meeting in late July, when policymakers could roll out additional stimulus measures.

2Q22 could prove to be the low point for the property sector, which should see some improvement in 2H22 on the removal of lockdowns and more policy easing.

Regarding the zero COVID policy, policymakers have adopted regular mass PCR testing and quick lockdowns to avoid another long lockdown. That said, the COVID situation remains the key downside risk for China for the rest of this year.

### Australia – Resilient for now

Momentum in the Australian economy remains strong according to a range of high-frequency activity indicators. Nonetheless, the economy is clearly facing a myriad of capacity constraints. Demand is crashing up against tight supply across many parts of the economy and inflation is surging. High inflation will weigh on real income and demand growth and monetary policy tightening is happening earlier, and more aggressively, than what was envisaged earlier this year.




Source: ABS, Macquarie Macro Strategy, June 2022

Macquarie's Macro Strategy Team have therefore lowered their 2022 growth outlook to 3½% on a year-ended basis – this is still above 'potential' and is expected to result in the unemployment rate falling a little further from 3.9% currently. With higher unemployment necessary to help take the steam out of inflation, monetary policy will need to be tightened until growth slows below potential. As a result, Macquarie's global GDP growth forecasts

| % y/y | 2020a | 2021a | 2022f | 2023f |
|---|---|---|---|---|
| US | -3.4 | 5.7 | 2.3 | 1.0 |
| China | 2.2 | 8.1 | 5.0 | 5.0 |
| Eurozone | -6.5 | 5.3 | 2.8 | 0.0 |
| Japan | -4.6 | 1.7 | 1.4 | 1.1 |
| UK | -9.3 | 7.4 | 2.9 | -0.3 |
| Canada | -5.2 | 4.5 | 3.2 | -0.5 |
| Australia | -2.1 | 4.8 | 4.1 | 2.6 |
| New Zealand | -2.1 | 5.7 | 2.1 | 1.4 |
| Global (MER) | -3.5 | 6.0 | 3.2 | 2.4 |
| Global (PPP) | -3.4 | 6.2 | 3.5 | 2.7 |

Source: Macquarie Macro Strategy, June 2022

## Central banks

### Fed – Playing catch-up is hard to do

Macquarie's Macro Strategy Team expect the Fed will hike rates by a further 75bps in July, which would bring the policy rate to the median FOMC participant's estimate of neutral (2.25-2.5%). Following this, Macquarie's Macro Strategy Team expect a more gradual pace to be adopted, with 50bps likely in each of September and November and 25bps in December and January.

This would bring the fed funds rate into the 3.75-4.0% range – a level Macquarie's Macro Strategy Team believe will mark the peak for the cycle. Beyond early 2023, however, Macquarie's Macro Strategy Team expect the fed to begin cutting rates as the economy enters a mild recession and inflation momentum slows.

### ECB – The end of negative rates

Alongside persistent inflation surprises and a reassessment of the medium-term outlook, the ECB's policy stance has turned decidedly more hawkish in recent months. Macquarie's Macro Strategy Team now expect the ECB to hike by 150bps over the remainder of this year, with the deposit rate moving out of negative territory in September and reaching 1% by December – broadly in line with market pricing. However, in contrast to the several further hikes priced by the market, Macquarie's Macro Strategy Team expect a recession in early 2023 to force the ECB to reverse course, with policy rates ultimately ending the year lower, albeit not in negative territory.

### RBA – 180-degree turn

The backdrop of high inflation has seen a sharp change in the RBA's rhetoric, with Governor Lowe suddenly an inflation fighter. Macquarie's Macro Strategy Team expect the RBA Board to hike by 50bps in both July and August, followed by 25bps hikes for September, November and December, taking the cash rate to 2.60% by year-end.

Macquarie's Macro Strategy Team see the cash rate rising to 3.10% by May next year, with a key downside risk being the possibility that something "breaks" in the meantime. By late 2023, however, their expectation for much slower growth and sharply lower inflation should provide scope for the cash rate to be lowered – they have pencilled in 100bps of rate cuts by end-2024.

### Long-term rates – Is the 42-year downtrend over?

Long bonds have moved up sharply YTD with the US 10-year treasury yield rising ~175bps. This has captured the dramatic shift in market pricing towards a sharp and more aggressive rate hike cycle from the Fed. Macquarie's Macro Strategy Team believe the US 10-year yield should stabilize (quarter-end basis) at around 3.5% into early 2023. Looking into mid-2023, as the market begins to price in recession, Macquarie's Macro Strategy Team are forecasting eventual cuts from the FOMC, with the 10-year yield likely to decline again into the 2.0 to 2.5% range.

## Commodities

Commodity sectors' price performance has diverged over the past quarter, with industrial metals falling sharply due to China's lockdowns and precious metals giving back the gains which followed Russia's invasion of Ukraine, while energy markets have generally held up or made new highs.

So long as the US consumer proves resilient, commodity prices should hold firm through 2H22 on the back of China's infrastructure stimulus fuelled reopening. Nevertheless, high prices are incentivising supply growth from US shale oil to Indonesian nickel pig iron and once growth slows, with inflationary pressures and the associated monetary policy response taking their toll on industrial commodities consumption, prices are likely to face significant downward pressure. Even those winners from the energy transition, such as copper and aluminium, are unlikely to be able to escape the business cycle.

## FX – The US dollar is far from finished

The likelihood of a global recession by mid-2023 has Macquarie bullish on the US dollar over the next 12-months: falling equities, decelerating growth and general risk-aversion usually spark demand for dollars. The dollar's widening yield advantage should also help to keep it propped up in the meantime.

| | Quarterly | | | | | | | | | | | Yearly | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **GDP, % YoY** | **Jun-22** | **Sep-22** | **Dec-22** | **Mar-23** | **Jun-23** | **Sep-23** | **Dec-23** | **Mar-24** | **Jun-24** | **Sep-24** | **Dec-24** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **US** | 2.2 | 2.3 | 1.2 | 2.1 | 1.6 | 0.6 | (0.3) | (0.7) | 0.2 | 1.4 | 2.6 | (3.4) | 5.7 | 2.3 | 1.0 | 0.9 |
| **China** | 1.5 | 6.2 | 7.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 2.2 | 8.1 | 5.0 | 5.0 | 5.0 |
| **Eurozone** | 3.3 | 1.4 | 1.4 | 0.8 | 0.2 | (0.4) | (0.5) | (0.4) | 0.3 | 0.8 | 0.9 | (6.5) | 5.3 | 2.8 | 0.0 | 0.4 |
| **Japan** | 0.9 | 2.3 | 1.8 | 2.2 | 1.5 | 0.7 | 0.0 | (0.2) | (0.2) | 0.1 | 0.5 | (4.6) | 1.7 | 1.4 | 1.1 | 0.0 |
| **UK** | 2.3 | 1.3 | 0.0 | (0.6) | (0.1) | (0.4) | (0.1) | (0.1) | (0.0) | 0.6 | 0.8 | (9.3) | 7.4 | 2.9 | (0.3) | 0.3 |
| **Canada** | 4.3 | 3.5 | 2.3 | 1.7 | 0.6 | (1.2) | (2.8) | (3.2) | (2.5) | (0.4) | 1.6 | (5.2) | 4.5 | 3.2 | (0.5) | (1.1) |
| **Australia** | 3.4 | 6.2 | 3.4 | 3.3 | 2.9 | 2.4 | 1.7 | 1.4 | 1.2 | 1.5 | 1.8 | (2.1) | 4.8 | 4.1 | 2.6 | 1.5 |
| **New Zealand** | 0.3 | 4.8 | 2.2 | 2.6 | 1.4 | 0.9 | 0.6 | 0.6 | 0.9 | 1.5 | 2.0 | (2.1) | 5.7 | 2.1 | 1.4 | 1.3 |
| **Global (MER)** | 3.0 | 3.1 | 2.6 | 2.9 | 3.4 | 2.1 | 1.3 | 1.0 | 1.4 | 2.0 | 2.6 | (3.5) | 6.0 | 3.2 | 2.4 | 1.7 |
| **Global (PPP)** | 3.7 | 3.3 | 2.8 | 3.0 | 3.7 | 2.4 | 1.6 | 1.3 | 1.7 | 2.2 | 3.0 | (3.4) | 6.2 | 3.5 | 2.7 | 2.0 |

| **CPI, % YoY** | **Jun-22** | **Sep-22** | **Dec-22** | **Mar-23** | **Jun-23** | **Sep-23** | **Dec-23** | **Mar-24** | **Jun-24** | **Sep-24** | **Dec-24** | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **US (PCE)** | 6.4 | 6.5 | 5.7 | 4.8 | 3.7 | 3.0 | 2.7 | 1.9 | 1.2 | 1.0 | 1.0 | 1.2 | 3.9 | 6.2 | 3.5 | 1.3 |
| **China** | 2.2 | 2.8 | 3.5 | 2.3 | 2.6 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 0.9 | 2.4 | 2.5 | 2.5 |
| **Eurozone** | 7.9 | 7.9 | 6.9 | 5.0 | 2.5 | 2.0 | 1.9 | 1.8 | 1.6 | 1.7 | 1.8 | 0.3 | 2.6 | 7.2 | 2.8 | 1.7 |
| **Japan** | 2.5 | 2.4 | 2.4 | 1.9 | 1.1 | 0.9 | 0.6 | 0.6 | 0.6 | 0.8 | 1.1 | 0.0 | (0.2) | 2.0 | 1.1 | 0.7 |
| **UK** | 9.5 | 9.3 | 11.6 | 9.8 | 6.8 | 5.9 | 3.7 | 2.8 | 2.4 | 2.0 | 2.0 | 0.9 | 2.6 | 9.2 | 6.5 | 2.3 |
| **Canada** | 6.8 | 6.6 | 6.0 | 4.9 | 3.3 | 2.7 | 2.4 | 1.6 | 1.0 | 1.0 | 1.0 | 0.7 | 3.4 | 6.3 | 3.3 | 1.2 |
| **Australia** | 6.1 | 6.8 | 7.0 | 6.1 | 5.2 | 4.4 | 3.5 | 2.8 | 2.7 | 2.6 | 2.5 | 0.8 | 2.9 | 6.3 | 4.8 | 2.7 |
| **New Zealand** | 7.1 | 6.4 | 6.0 | 5.1 | 4.4 | 3.5 | 3.0 | 2.6 | 2.4 | 2.2 | 2.2 | 1.7 | 3.9 | 6.6 | 4.0 | 2.4 |

| **Policy Rate %** | **Jun-22** | **Sep-22** | **Dec-22** | **Mar-23** | **Jun-23** | **Sep-23** | **Dec-23** | **Mar-24** | **Jun-24** | **Sep-24** | **Dec-24** | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **US (Fed Funds rate)** | 1.63 | 2.88 | 3.63 | 3.88 | 3.63 | 3.13 | 2.13 | 0.38 | 0.38 | 0.38 | 0.63 | 0.13 | 0.13 | 3.63 | 2.13 | 0.63 |
| **China 1-yr MLF rate** | 2.85 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.95 | 2.95 | 2.75 | 2.75 | 2.75 |
| **Eurozone deposit rate** | (0.50) | 0.25 | 1.00 | 1.25 | 1.00 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | (0.50) | (0.50) | 1.00 | 0.50 | 0.75 |
| **Japan policy rate** | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) | (0.10) |
| **UK base rate** | 1.25 | 1.75 | 2.25 | 2.50 | 2.25 | 2.00 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 0.10 | 0.25 | 2.25 | 1.75 | 1.75 |
| **Canada overnight rate** | 1.50 | 2.75 | 3.25 | 3.25 | 3.00 | 2.25 | 0.50 | 0.25 | 0.25 | 0.25 | 0.50 | 0.25 | 0.25 | 3.25 | 0.50 | 0.50 |
| **RBA cash rate** | 0.85 | 2.10 | 2.60 | 2.85 | 3.10 | 3.10 | 2.60 | 2.60 | 2.35 | 2.10 | 2.10 | 0.10 | 0.10 | 2.60 | 2.60 | 2.10 |
| **RBNZ OCR** | 2.00 | 3.00 | 3.50 | 3.50 | 3.50 | 3.25 | 2.75 | 2.50 | 2.50 | 2.50 | 2.50 | 0.25 | 0.75 | 3.50 | 2.75 | 2.50 |

| **10-year yield %** | **Jun-22** | **Sep-22** | **Dec-22** | **Mar-23** | **Jun-23** | **Sep-23** | **Dec-23** | **Mar-24** | **Jun-24** | **Sep-24** | **Dec-24** | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **US** | 3.25 | 3.50 | 3.50 | 3.50 | 3.25 | 2.50 | 2.25 | 2.25 | 2.50 | 2.75 | 2.75 | 0.93 | 1.52 | 3.50 | 2.25 | 2.75 |
| **China** | 2.80 | 3.00 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.14 | 2.78 | 3.20 | 3.20 | 3.20 |
| **Germany** | 1.60 | 1.60 | 1.60 | 1.30 | 1.10 | 0.90 | 0.90 | 0.90 | 1.00 | 1.10 | 1.20 | (0.56) | (0.21) | 1.60 | 0.90 | 1.20 |
| **Japan** | 0.20 | 0.20 | 0.20 | 0.20 | 0.15 | 0.00 | 0.00 | 0.00 | 0.05 | 0.10 | 0.15 | 0.02 | 0.07 | 0.20 | 0.00 | 0.15 |
| **UK** | 1.75 | 1.95 | 2.05 | 2.25 | 2.05 | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 | 1.95 | 0.19 | 1.02 | 2.05 | 1.95 | 1.95 |
| **Canada** | 3.40 | 3.50 | 3.20 | 3.00 | 2.75 | 2.00 | 1.75 | 1.75 | 2.00 | 2.25 | 2.25 | 0.71 | 1.49 | 3.20 | 1.75 | 2.25 |
| **Australia** | 4.00 | 4.00 | 3.70 | 3.60 | 3.35 | 3.00 | 2.80 | 2.60 | 2.50 | 2.40 | 2.40 | 0.97 | 1.67 | 3.70 | 2.80 | 2.40 |
| **New Zealand** | 4.20 | 3.95 | 3.70 | 3.70 | 3.60 | 3.40 | 2.90 | 2.80 | 2.70 | 2.50 | 2.50 | 0.99 | 2.39 | 3.70 | 2.90 | 2.50 |

| **FX Rates** | **Jun-22** | **Sep-22** | **Dec-22** | **Mar-23** | **Jun-23** | **Sep-23** | **Dec-23** | **Mar-24** | **Jun-24** | **Sep-24** | **Dec-24** | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EUR USD** | 1.03 | 1.01 | 1.02 | 1.03 | 1.05 | 1.07 | 1.08 | 1.10 | 1.11 | 1.13 | 1.14 | 1.22 | 1.14 | 1.02 | 1.08 | 1.14 |
| **USD JPY** | 135.0 | 130.0 | 125.0 | 120.0 | 118.0 | 115.0 | 113.0 | 111.4 | 109.8 | 108.1 | 106.5 | 103.2 | 115.1 | 125.0 | 113.0 | 106.5 |
| **USD CNY** | 6.75 | 6.85 | 6.90 | 6.95 | 6.90 | 6.85 | 6.80 | 6.78 | 6.75 | 6.73 | 6.70 | 6.53 | 6.35 | 6.90 | 6.80 | 6.70 |
| **USD INR** | 78.5 | 79.5 | 80.0 | 80.0 | 79.5 | 78.5 | 77.5 | 77.6 | 77.6 | 77.7 | 77.8 | 73.0 | 74.5 | 80.0 | 77.5 | 77.8 |
| **GBP USD** | 1.22 | 1.18 | 1.15 | 1.17 | 1.21 | 1.23 | 1.25 | 1.27 | 1.29 | 1.31 | 1.33 | 1.37 | 1.35 | 1.15 | 1.25 | 1.33 |
| **USD CAD** | 1.27 | 1.29 | 1.31 | 1.33 | 1.34 | 1.35 | 1.37 | 1.37 | 1.38 | 1.38 | 1.38 | 1.27 | 1.26 | 1.31 | 1.37 | 1.38 |
| **AUD USD** | 0.70 | 0.69 | 0.67 | 0.65 | 0.64 | 0.67 | 0.69 | 0.69 | 0.69 | 0.69 | 0.70 | 0.77 | 0.73 | 0.67 | 0.69 | 0.70 |
| **NZDUSD** | 0.64 | 0.62 | 0.60 | 0.59 | 0.58 | 0.60 | 0.63 | 0.64 | 0.66 | 0.66 | 0.66 | 0.72 | 0.68 | 0.60 | 0.63 | 0.66 |

Source: Macquarie Macro Strategy, June 2022

**Macquarie WM Investment Strategy Team**

This report was finalised on 21 June 2022.

**Recommendation definitions (Macquarie Australia/New Zealand)**
**Outperform** – return >3% in excess of benchmark return
**Neutral** – return within 3% of benchmark return
**Underperform** – return >3% below benchmark return