

Q2 2022 | Global Macro Outlook

An unexpected turn of events

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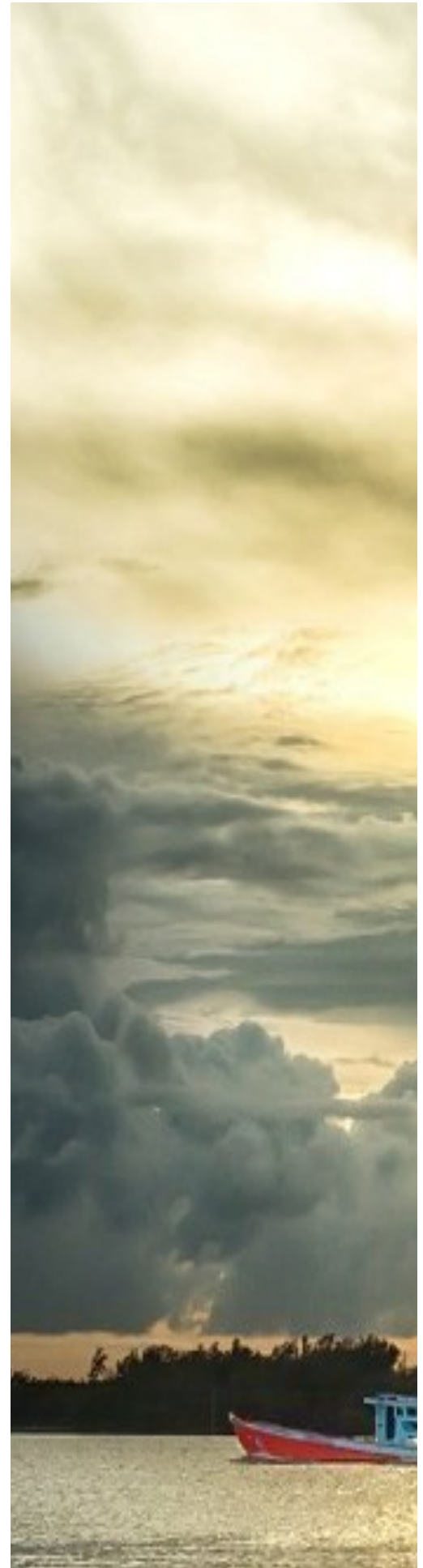
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Global overview

Big picture

What a start to 2022!

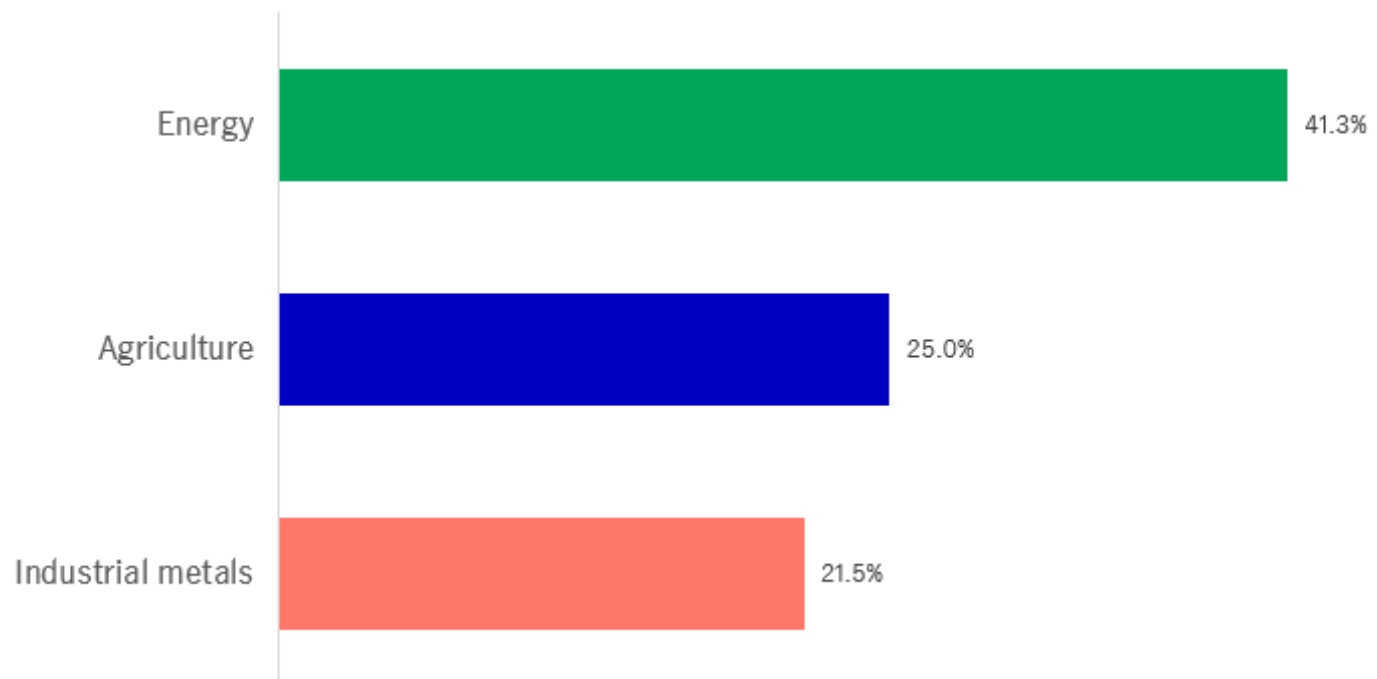
Just as we were looking to a return to some semblance of postpandemic normalcy, the Ukraine conflict and resulting geopolitical stress have further complicated the macro landscape for 2022.

As we've mentioned previously, the extended disruption to global supply chains and surge in commodity prices have amplified the dilemma facing major central banks: On the one hand, this will push headline inflation (and inflation expectations) even higher; on the other hand, it will amplify the squeeze on real incomes, economic activity, and core inflation further ahead. Tightening in this environment risks exacerbating the downside risks to economic growth. In our view, there's very little monetary policy in isolation can do to address cost-push inflation.

The best-performing markets year to date are energy (41.3%), agriculture (25.0%), and industrial metals (21.5%), reflecting the worsening global shortage after removing the supply from a critical producer such as Russia.

“Tightening in this environment risks exacerbating the downside risks to economic growth. In our view, there’s very little monetary policy in isolation can do to address cost-push inflation.”

Best-performing asset classes year to date



Source: Commodity Research Bureau, Macrobond, Manulife Investment Management, as of March 11, 2022.

By extension, equity markets leveraged to rising commodity prices, such as Indonesia, Canada, Australia, and Brazil, have outperformed. Precious metals, the U.S. dollar (USD), Chinese government bonds, and U.S. Treasury bills have also performed well relative to the weakness seen in other assets, reflecting their safe haven status.

At the other end of the spectrum, growth-oriented stocks and sectors that have a higher equity duration—Chinese equities; stock markets in the Europe, Middle East, and Africa regions—and Asia high-yield debt have underperformed, reflecting these markets' sensitivity to tighter global financial conditions and their respective trade, financial, and geopolitical linkages to the Ukraine crisis.

Cross-asset volatility remains elevated: Our composite measure of risk aversion indicates a difficult quarter ahead for risk assets, yet many central banks are pushing ahead with monetary policy normalization. Apart from the questionable efficacy of tightening into a negative global supply shock, this dynamic has important implications for global liquidity.

Global liquidity *growth* has slowed markedly—from a record 21.5% in March 2021 to 5.4% by mid-March 2022, the slowest rate since April 2020.¹ A declining global liquidity impulse is most relevant to emerging-market (EM) growth and earnings, but it also has broader relevance to risk assets.

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Global liquidity growth is falling significantly (YoY%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 14, 2022. YoY refers to year over year.

¹ Bloomberg, as of March 14, 2022.

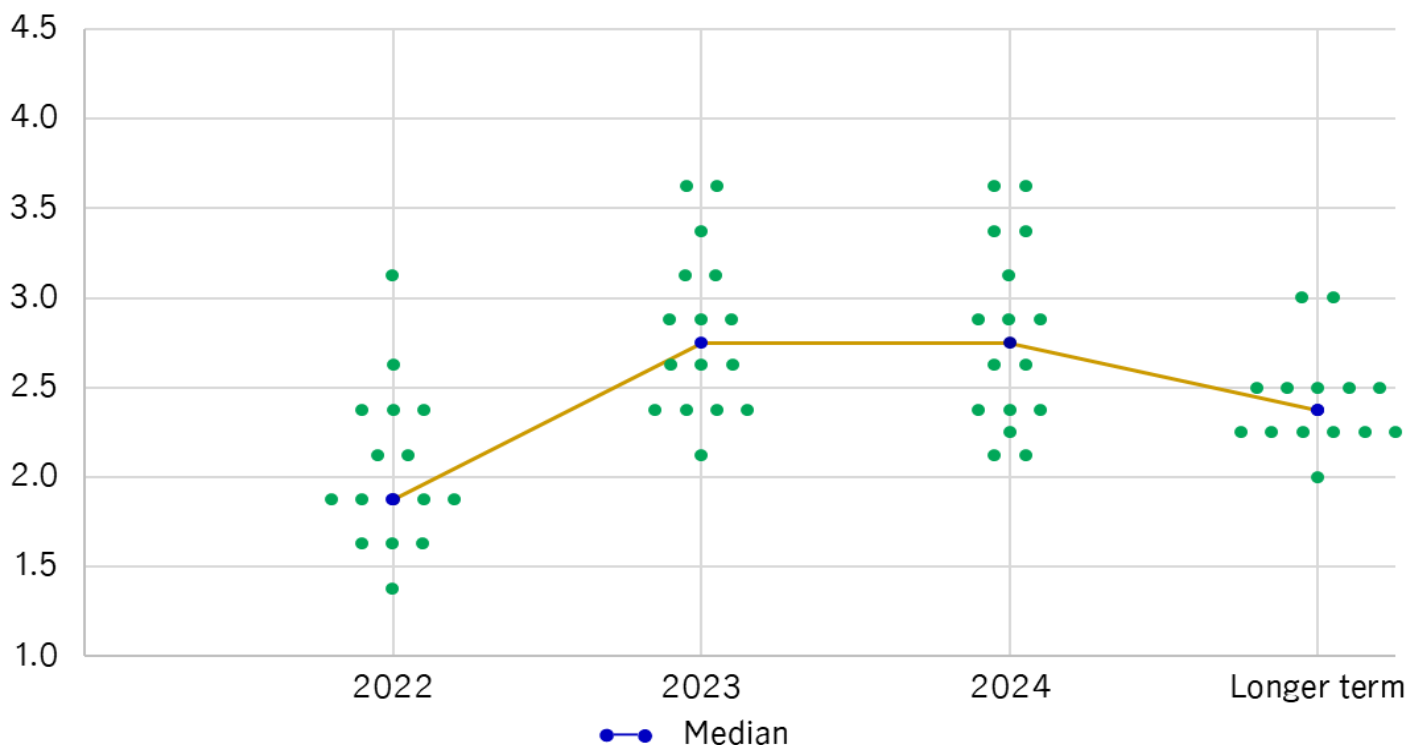
We're still of the view that policymakers' concerns over high inflation will ultimately give way to worries about slower growth. For this reason, we anticipate a dovish pivot from the U.S. Federal Reserve (Fed), likely in Q3, and believe the U.S. central bank's tightening cycle will fall short of the market's pricing in terms of its pace, magnitude, and duration.

Crucially, we think it's extremely likely that the next global stimulus phase will represent a significant departure from the playbook that investors have been conditioned to seeing since the global financial crisis. While the public policy response to every crisis in the past 15 years has been steeped in neoliberalism—broadly characterized by globalization, offshoring and free trade, limited role for the state in the economy, a structurally lower consumption share of GDP, and the hyperfinancialization of the global economy—the social and political appetite to repeat these policy prescriptions is incredibly limited at this juncture. Indeed, we're already seeing revolutionary shifts in the opposite direction.

Europe has awakened to the great power competition and, in a historic shift, Germany has announced plans to ramp up its [defense spending](#) and end its [reliance](#) on Russian energy in light of the crisis in Ukraine. Significant increases to defense spending are being adopted by governments across the world.

“We’re still of the view that policymakers’ concerns over high inflation will ultimately give way to worries about slower growth.”

The U.S. central bank's dot plot suggests Fed officials are on an aggressive hiking path (%)



Source: U.S. Federal Reserve, March 16, 2022. The median value represents the implied path of future interest-rate hikes. Fed refers to the U.S. Federal Reserve.

Meanwhile, Western solidarity around sanctions has been ramped up to previously unthinkable levels—key Russian banks have been [barred](#) from the global SWIFT system and major economies have introduced [restrictive measures](#) that will prevent the Central Bank of Russia from accessing its foreign reserves. Many Western banks and businesses are engaging in self-sanctioning, opting to avoid unsanctioned Russian entities out of fear that the official sanctions list might broaden at a later time.

These are profound changes, developments that have significantly accelerated the pace at which we're progressing toward an even more fragmented global economy. In fairness, this movement was already in place before the pandemic but has been catalyzed by Russia's invasion of Ukraine. Military conflicts change everything. As the politics change, economics will too, and financial markets—as history informs us—will follow.

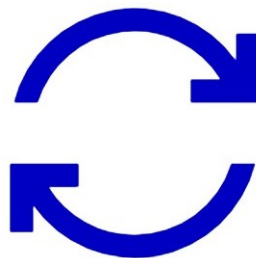
From a longer-term perspective, we continue to expect to gravitate toward a medium- to longer-term macro landscape in which governments will play even bigger roles in economies. Naturally, the extent of government involvement will vary greatly from economy to economy, and central banks are likely to come under increasing pressure to monetize government spending.

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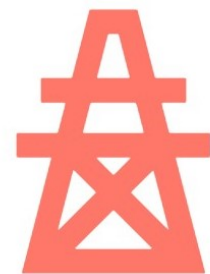
Key sanctions imposed on Russia



The G7 moved to block Russia's central bank from accessing reserves that it had deposited in their countries



Several key Russian banks have been excluded from the SWIFT system that underpins global financial transactions



The United States, Australia, and the United Kingdom announced plans to ban Russian oil imports

Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 14, 2022. The [Group of Seven](#) (G7) is an intergovernmental organization made up of the world's largest developed economies: France, Germany, Italy, Japan, the United States, the United Kingdom, and Canada.

Against that backdrop, key macro themes going forward will, in our view, include significant geopolitical upheaval, private sector deleveraging, reshoring and reindustrialization in developed markets/industrialization in EM, lower and flatter yield curves, increasingly negative real interest rates, competitive currency devaluations, more government regulation, and increasing protectionism/localization.

The strategic investment implications from this macro thesis remain a portfolio biased toward up-in-quality assets, U.S. equities and fixed income over other developed markets, and EM with less room or willingness to monetize deficits (e.g., the eurozone and China). Similarly, the thesis would favor the USD over high beta fiat currency. Sectorwise, critical industries benefiting from industrialization and rising living standards in both the United States and rest of the world should outperform; these include utilities, materials, and consumer staples. Finally, exposure to alternative assets (e.g., gold, residential real estate investment trusts, and crypto assets) as a form of protection from fiat devaluation may also make sense.

“The strategic investment implications from our macro thesis remain a portfolio biased toward up-in-quality assets, U.S. equities and fixed income over other developed markets, and EM with less room or willingness to monetize deficits.”

United States

Big picture

While the United States may be geographically removed from the Russia-Ukraine conflict, it won't be unscathed by the spillovers. Spiking commodity prices will only aggravate and extend the inflationary pressure that was expected to recede during the second quarter. Meanwhile, weaker confidence and supply chain disruptions should weigh on economic growth. Against this potentially stagflationary backdrop, the Fed is in the unenviable position of feeling compelled to tighten monetary policy despite questions surrounding the efficacy of such a move on stemming supply-side inflationary shocks, not to mention its potentially negative impact on growth. While business investment should remain healthy, the consumer outlook is much more delicate. Since consumer spending had been brought forward during the pandemic and confidence is flagging amid higher interest rates and market volatility, housing activity and discretionary spending could soften going forward. Employment, however, is likely to remain firm, which may provide some offset.

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CRB Raw Industrials Index: commodity prices have surged



Source: Commodity Research Bureau, Macrobond, Manulife Investment Management, as of March 11, 2022.

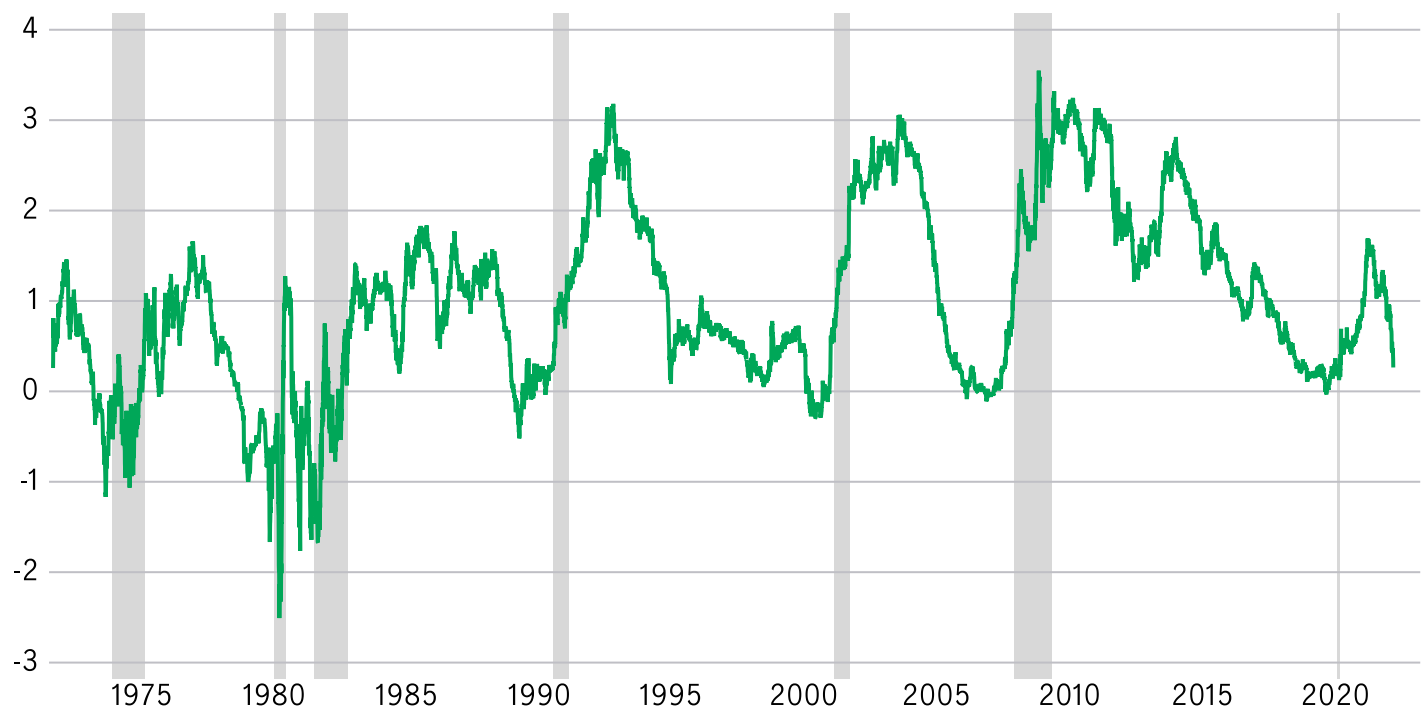
What we're watching

- **Inventories**—Sectors such as household materials and electronics have had a meaningful ramp-up that could lead to oversupply in some spaces; conversely, supplies in other sectors (e.g., autos and food) remain low. As such, a buildup would be welcome there.
- **Prices**—With key commodities spiking and more supply chain disruptions on the horizon, an inflection point has been pushed out indefinitely.
- **Monetary policy**—The Fed is in the uncomfortable position of tightening monetary policy during a growth slowdown. While this could imply a dovish pivot later in the year, it's contingent on either inflationary pressure moderating or negative growth shocks being pronounced enough to warrant maintaining an expansionary policy stance.

Key market views

- **Fixed income**—The 10-year/2-year yield curve is dangerously close to inverting, but we maintain that if we do get any sign that inflation might be easing, the Fed will tighten at a slower pace than the markets have anticipated.
- **Equities**—We expect market volatility to persist. Moving into spring, we foresee several factors that could translate into choppy equity market returns; most notably, the removal of liquidity, a possible slowdown in the housing and consumer space, and geopolitical events. All these factors point to a potentially choppy trading environment.

The U.S. 10-year/2-year yield curve is close to inverting (%)



Source: U.S. Federal Reserve, Macrobond, Manulife Investment Management, as of March 11, 2022. YoY refers to year over year. The gray areas represent recessions.

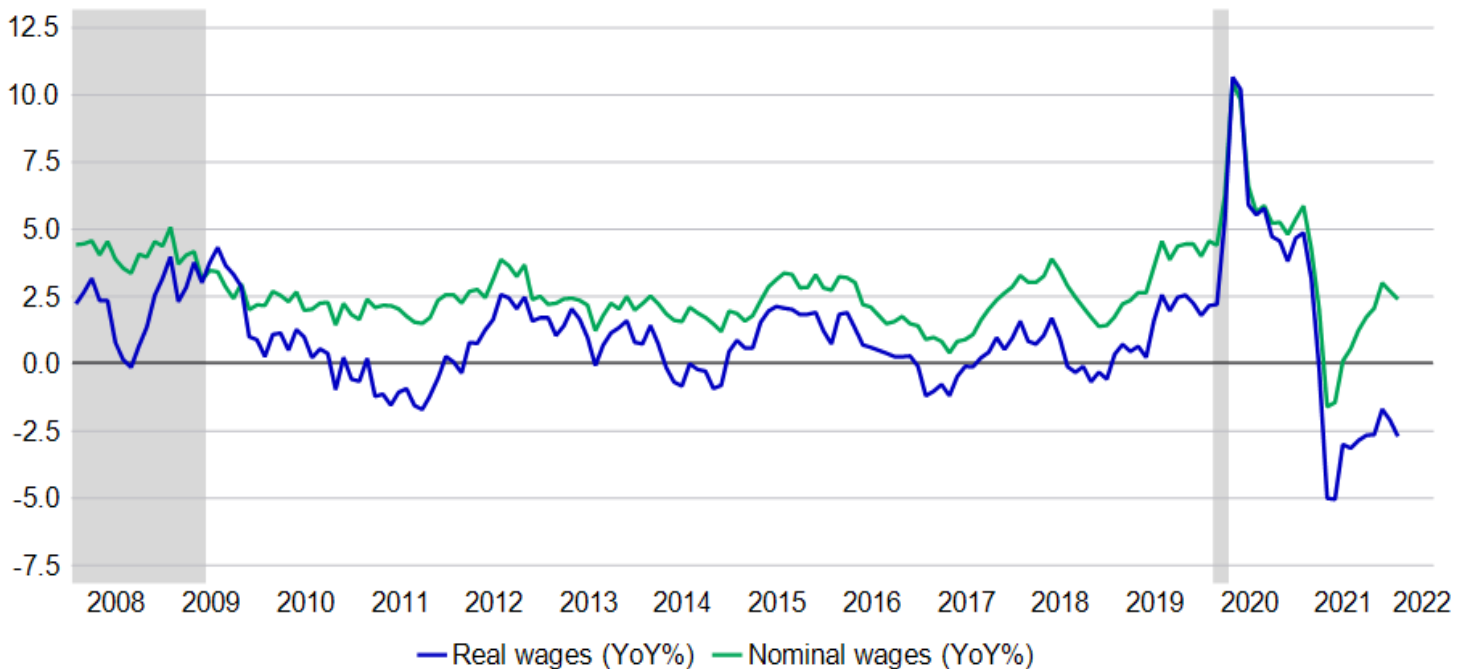
Canada

Big picture

Canada appears to have fully recovered from its COVID-19 recession in that excess slack, as measured by the output gap, has been absorbed and the labor market is now as strong as it was prepandemic. This has encouraged the Bank of Canada (BoC) to begin what's likely to be a series of rate hikes, with the first occurring on [March 2](#) and another likely to take place in the second quarter. That said, Canada's recovery is fragile: Government spending is being pulled back sharply, real wages are falling under the weight of inflation, and housing activity—the key driver of Canadian growth—is at risk of a pullback as interest rates rise and COVID-19 dissipates. Critically, Canada's domestic policy levers, both monetary and fiscal, are likely to have a limited impact on the globally driven headwinds to growth in the coming months, particularly in regard to inflation. Notably, while higher oil prices have historically helped to strengthen the Canadian dollar (CAD) and reduce inflation, the CAD has recently stayed weak due to other factors, thereby limiting the potential upsides that the economy might experience.

Canada's recovery is fragile: Government spending is being pulled back sharply, real wages are falling under the weight of inflation, and housing activity—the key driver of Canadian growth—is at risk of a pullback.

Canadian real wages are struggling: average hourly earnings adjusted for inflation are negative



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of March 10, 2022. YoY refers to year over year. The gray areas represent recessions.

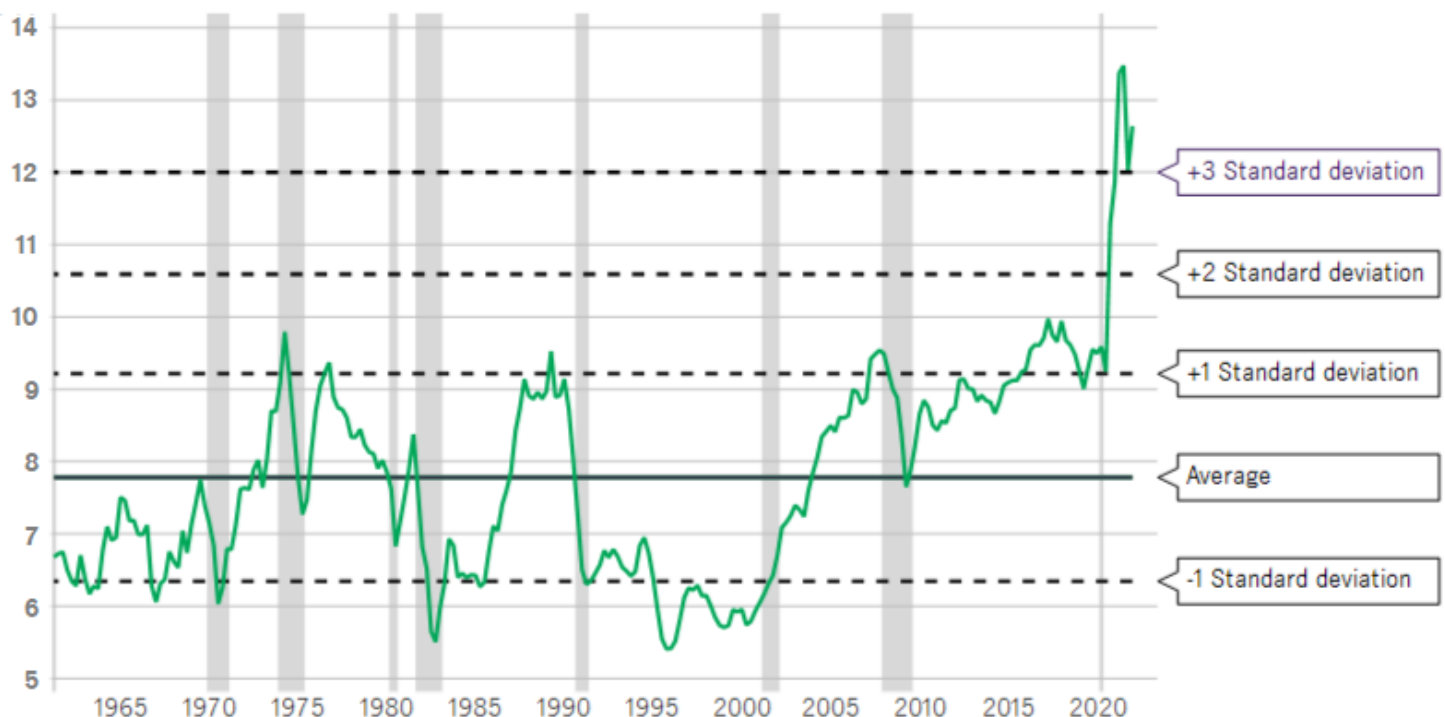
What we're watching

- **Interest rates**—Bond markets have priced in six rate hikes, which we believe is too aggressive given the headwinds that are likely to emerge in the coming quarters. We continue to expect to see three to four rate hikes this year, along with the introduction of quantitative tightening. In our view, given its particularly hawkish rhetoric, the BoC runs a significant risk of committing a policy mistake (by overtightening) relative to its peers.
- **Housing**—Housing activity may experience one last burst of activity in advance of more rate hikes, but we suspect momentum will slow in the coming months, particularly in major city centers. Problematically, Canada's reliance on housing has skyrocketed over the course of the pandemic. With little government support, an inflation-burdened consumer, and generally weak nonresidential investment spending, a slowdown in housing may feel particularly painful for aggregate growth.

Key market views

- **Currency**—We expect range-bound conditions to play out in the coming months as the crosscurrents of stronger oil prices (a tailwind) are roughly offset by the risk-off move toward a stronger USD. Our year-end target for USD/CAD remains at 1.25.
- **Equities**—Canada's stock market remains disconnected from the underlying macro economy and should do well in relative terms given its positive exposure to the commodities space and rising demand for materials. In our view, valuations also look attractive from a long-term perspective.
- **Fixed income**—We expect the Canadian yield curve to continue to flatten, driven by a central bank that seems focused on delivering rate hikes despite a medium-term growth outlook that looks increasingly disappointing.

Canadian residential investment (% of nominal GDP)



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of March 2022. Gray areas represent recessions. Standard deviation is a statistical measure of the mathematical distance from the mean or average value of a data set. The larger the standard deviation, the greater the deviation from the norm.

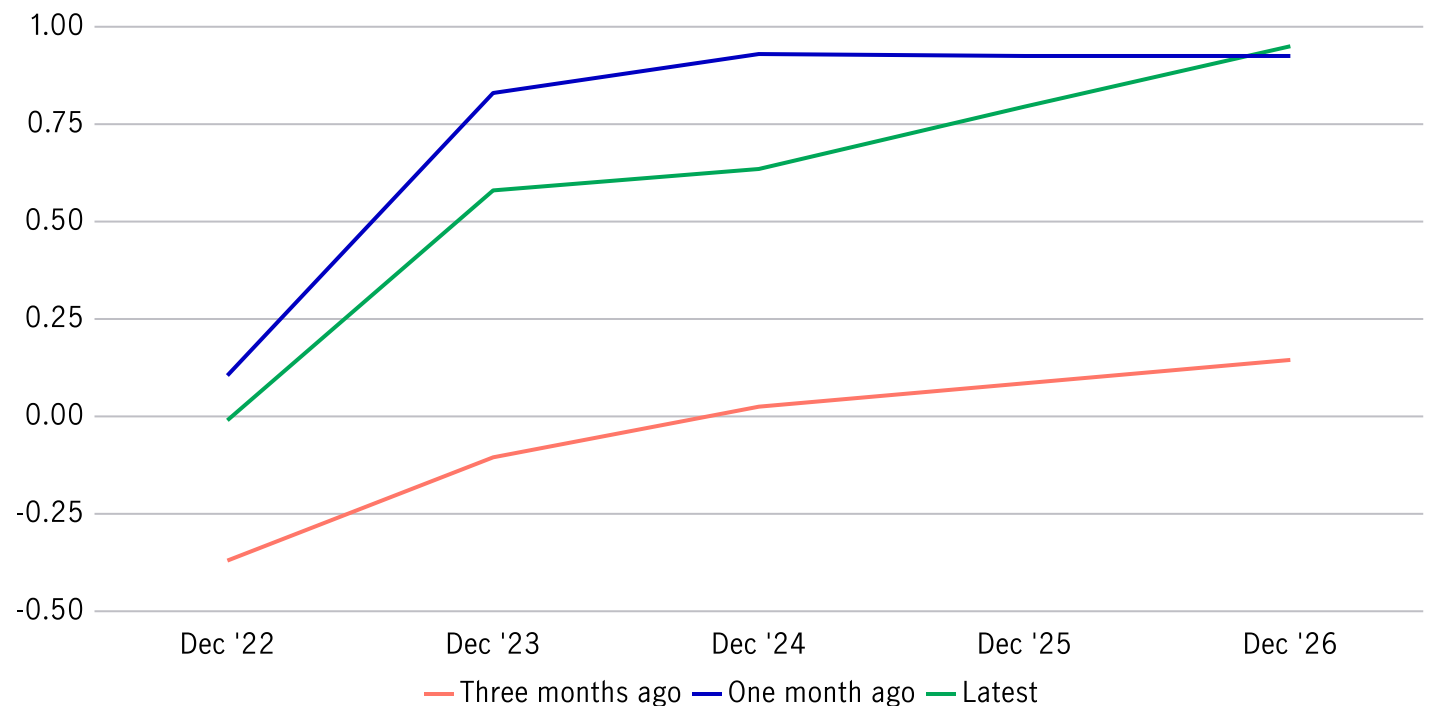
Euro area

Big picture

The significant increase in energy prices on the back of the conflict in Ukraine is delivering a crippling blow to the euro area's economic growth outlook. The market has reduced the pricing of near-term rate hikes despite [record high inflation](#) that's likely to continue through—at least—several quarters to come. The region's terms of trade have weakened significantly, and the outlook for consumption is deteriorating as higher energy costs erode discretionary income. Efforts by the region's governments to mitigate consumer burdens will carry fiscal consequences; however, these are likely to pale in comparison to plans for historic, collective investments across defense and energy. The European Central Bank's (ECB's) policy normalization is likely delayed, but not completely abandoned, and we see scope for greater flexibility on the timing of rate hikes versus tapering. Barring surprises, policymakers should find considerable reassurance in plans for new joint debt issuance among EU members as they build on the success of the Recovery Fund.

“The ECB’s policy normalization is likely delayed, but not completely abandoned, and we see scope for greater flexibility on the timing of rate hikes versus tapering.”

Markets (Euribor futures) repricing near-term rate hike path, but not the terminal rate (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 10, 2022. Euribor refers to Euro Interbank Offered Rate.

What we're watching

- **The persistence of the global energy shock**—The hit to euro area growth is estimated to be between 0.5% and 1.0% of GDP and is concentrated in key member states such as Germany and Italy. The deterioration in the terms of trade is significant given the region's energy dependence—[nearly 100% of petroleum products and 90% of gas](#) consumed in the euro area are imported.
- **ECB**—The ECB's emergence from negative interest rates will likely take a little longer as policymakers assess how the geopolitical conflict evolves, its impact on energy prices, and, ultimately, inflation levels: We see scope for a shallower, later lift-off in rate hikes. In regard to the ECB's balance sheet, we suspect that the central bank will still look to complete the tapering of its asset purchases by the end of 2022.

Key market views

- **Currency**—The euro (EUR) is expected to remain weak versus both the USD and the British pound (GBP), given the expected central bank policy divergence. In regard to EUR/USD, we see the potential for the pair to weaken toward the 1.05 level, but we remain skeptical about an extension to parity. Against the GBP, a retracement of the Brexit rally is taking place, and we anticipate the GBP to exhibit continued weakness, trading between 0.80 and the mid- to upper level of the 0.70s in coming quarters.
- **Fixed income**—The 10-year yield spread between the German bund and Italian long-term treasury bond (BTP) had been trending wider since September 2021, driven by expectations for ECB tightening. The latest narrowing confirms the existing correlation, and we anticipate a continued moderation toward the upper bound of the range we saw in 2021 as markets price in developments on the European fiscal front.

Scope for continued narrowing in 10-year bund/BTP yield spread (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 8, 2022. BTP refers to the Italian long-term treasury bond.

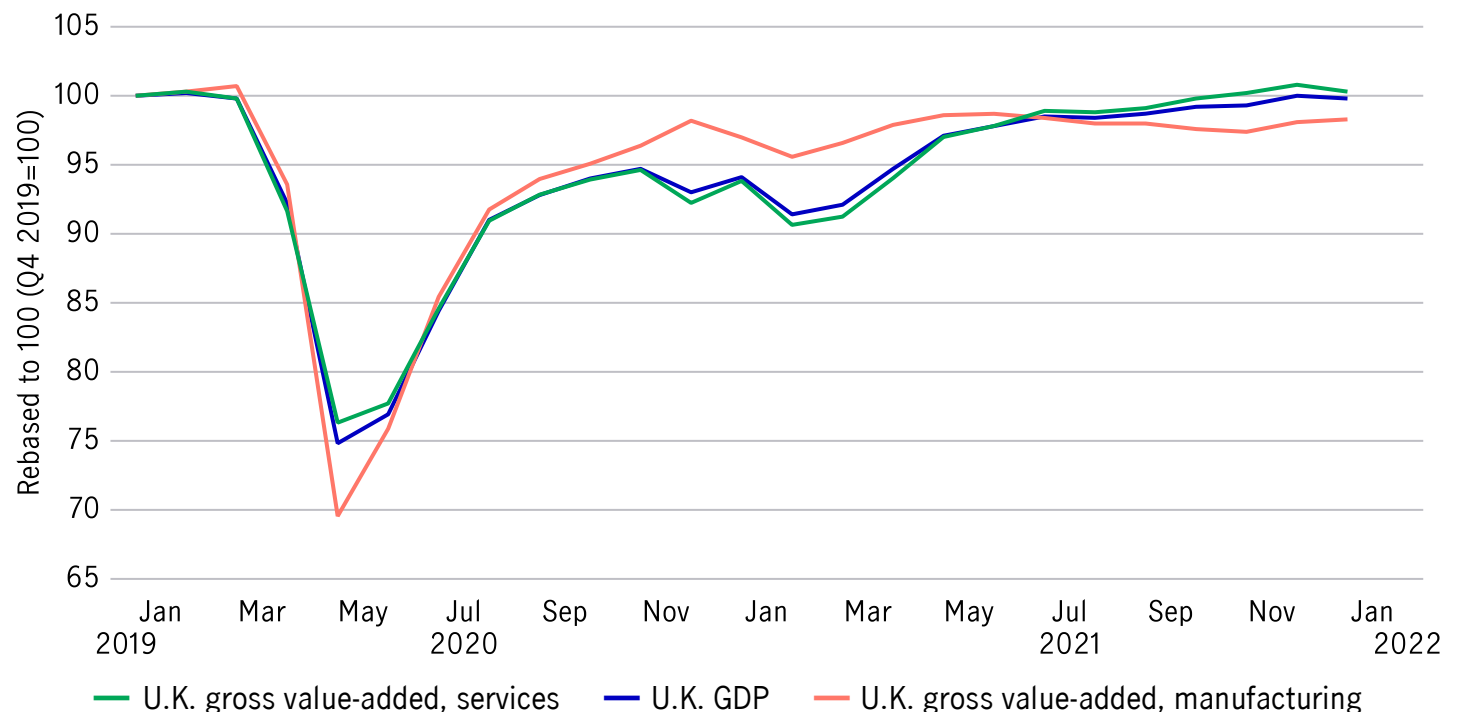
United Kingdom

Big picture

Headwinds to U.K. economic growth have intensified significantly in recent weeks. Geopolitical developments are a negative terms-of-trade shock that inflames existing inflationary pressures. We expect the Bank of England (BoE) to balance the trade-off between supporting growth and reining in inflation with a less aggressive rate hike path than currently priced. We foresee two additional hikes (bringing policy rates to 1%) by mid-2022 before a pause sets in. Although labor conditions are tight—and are likely to worsen—wage increases aren't keeping up with the steep rise in energy prices, which has the effect of eroding consumers' real income. The U.K. economy is heading into this challenging environment having just recovered to its prepandemic levels of economic activity in Q4 2021, with gains in government and services offsetting an incomplete recovery in manufacturing and goods.

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GDP recovered to its prepandemic level in Q4 2021



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 10, 2022.

What we're watching

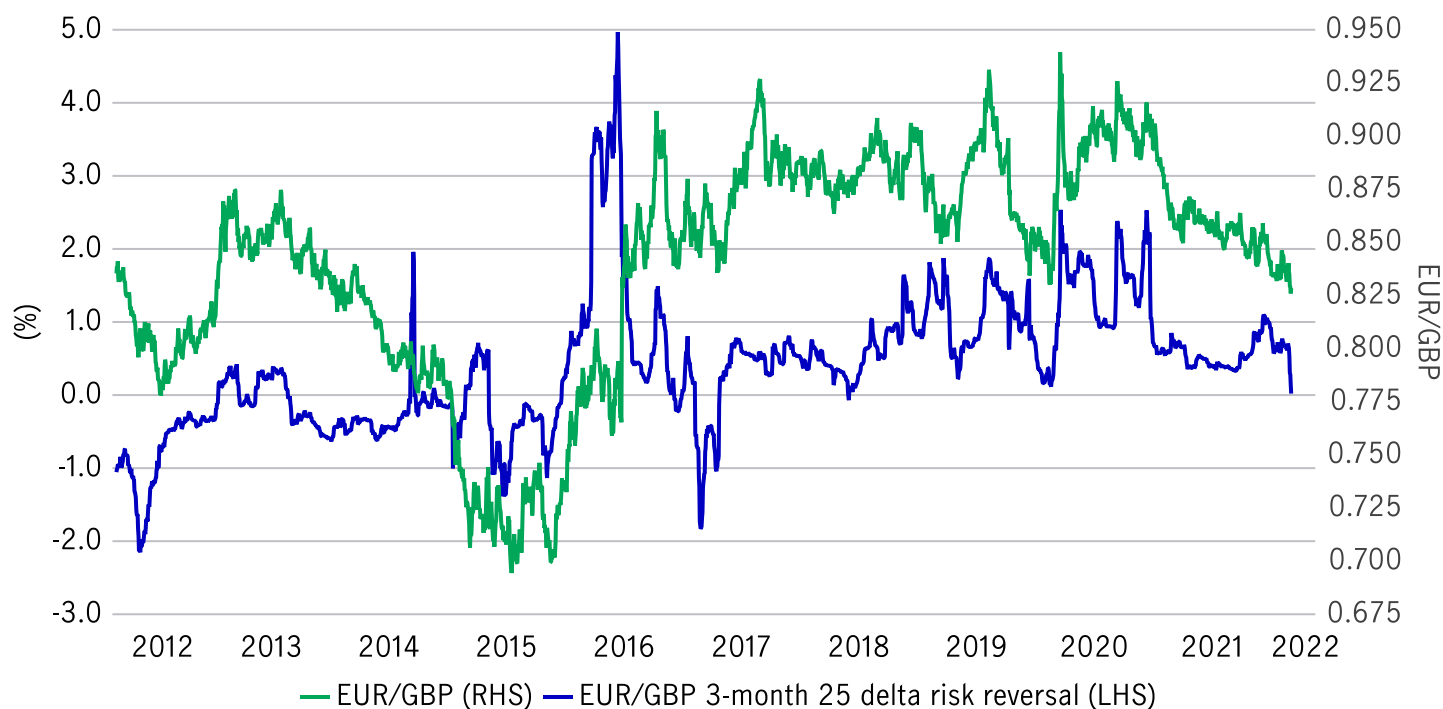
- The persistence of the global energy shock**—The United Kingdom is a net importer of energy—prepandemic, 35% of energy used in the country was imported. The recent surge in energy prices will weigh on GDP through trade and consumer spending, given the expected hit to households' real income. Consensus estimates of a 0.5% to 1.0% hit to GDP in 2022 and 2023 are likely to be adjusted higher.
- BoE**—Policymakers remain focused on normalization through rate hikes and quantitative tightening, given historically elevated levels of inflation. However, recent developments are likely to force a reassessment in terms of the total extent of tightening required in light of the significant deterioration in the outlook for economic growth. In our view, the BoE's policy path may inform the Fed's own thinking on policy normalization.

Key market views

Currency—The GBP has completely retraced its decline during the pandemic against the EUR with a push to levels last seen on the night of Brexit in 2016. From a monetary policy perspective, the BoE's expected path is likely to offer additional support to the GBP as the bank delivers on rate hikes and quantitative tightening while the ECB struggles to formulate an exit from ongoing quantitative easing.

The options market is also confirming a critical shift in the outlook for the currency pair, with a complete erosion in the premium for protection against EUR strength versus the GBP. Risk reversals (a widely used hedging strategy) may soon price a premium for protection against GBP strength versus the EUR.

EUR/GBP vs. risk reversals (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 8, 2022. The 25 delta put is the put whose strike has been chosen such that the delta is -25%. The greater the demand for an options contract, the greater its price and, therefore, the greater its implied volatility. LHS refers to left-hand side. RHS refers to right-hand side. EUR refers to the euro. GBP refers to the British pound.

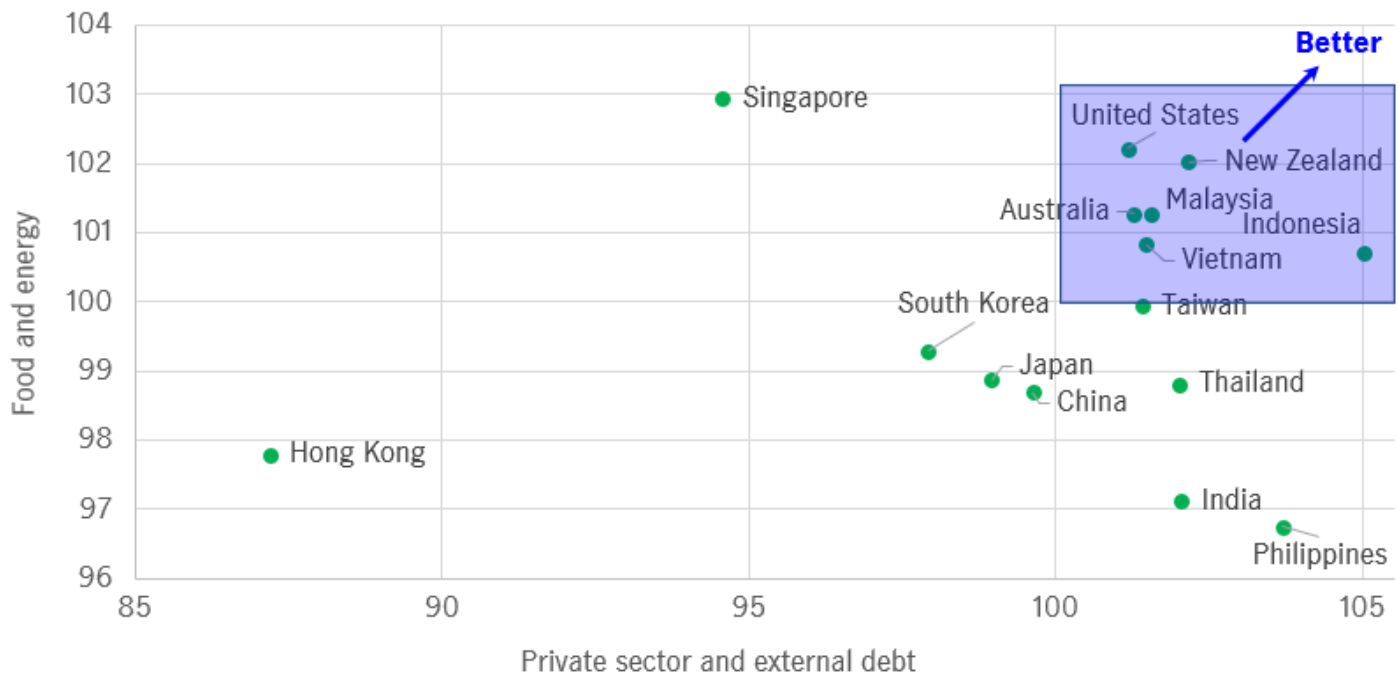
Asia-Pacific overview

Big picture

As a net food, materials, and energy importer, the Asia-Pacific region is vulnerable to the reduced supply—and spike—in the prices of these key strategic resource commodities owing to the conflict in Ukraine. However, we stress that the region isn't monolithic, and the impact across the region will be uneven. There are also larger spillover effects to consider: the potential for higher inflation and inflation expectations, whether an economy can rely on strong export growth to materially offset rising food and energy import prices and/or the policy space to withstand further deterioration in its fiscal position, and a potential liquidity/credit shock. When we screen for economies that are least vulnerable to these potential shocks, we find that Singapore, Malaysia, Australia, and New Zealand (NZ) are likely to be the biggest beneficiaries from rising prices. Meanwhile, Indonesia, the Philippines, NZ, and India appear least exposed to a potential liquidity shock. Balancing the simultaneous impact from these two shocks, our analysis suggests NZ, Malaysia, Indonesia, Australia, and Vietnam will be the relative macro outperformers among the economies that we follow.

We stress that the Asia-Pacific region isn't monolithic in nature, and the impact of the Russia-Ukraine conflict will be uneven across the region.

A screen for relative exposure to the potential shocks coming from the Ukraine crisis



Source: Bloomberg, Macrobond, Manulife Investment Management, as of November 26, 2021. Food and energy Z-scores are calculated based on net food and energy trade balance, the weight of food and energy in the Consumer Price Index basket, and budget balances. Private sector and external debt Z-scores are calculated based on foreign currency debt, private sector debt, and debt servicing costs.

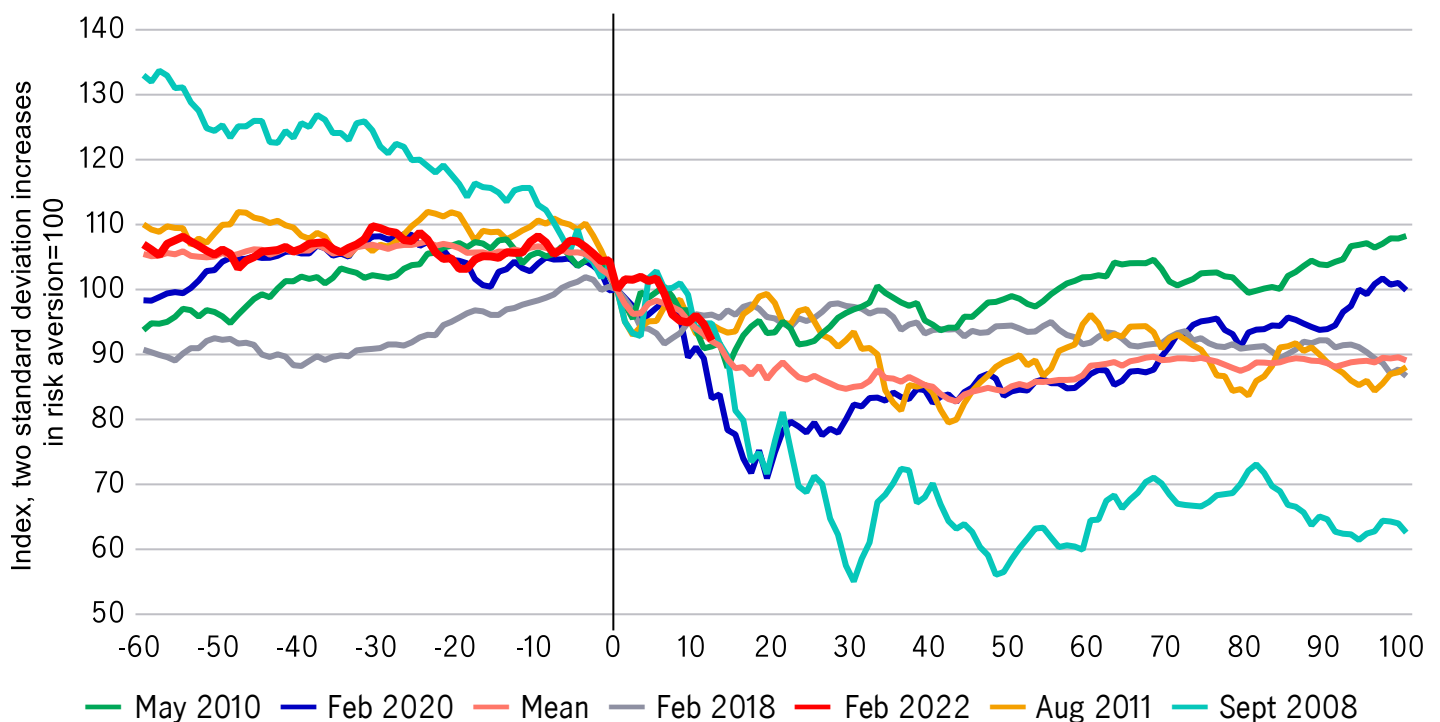
What we're watching

- **Global tightening in financial conditions**—Risk aversion across global asset markets has risen to more than two standard deviations above average levels. We looked at how global markets performed historically when this happened to get a sense of the risks should risk aversion remain elevated: The results point to weaker equity performance—with EM underperforming—a stronger USD, and lower 10-year U.S. Treasury yields.
- **Central banks**—A deep stagflationary shock is a nightmare scenario for central banks, which are ill-equipped to respond to supply-driven or cost-push inflation. Unsurprisingly, how the trade-off between inflation and growth is balanced will vary. EM central banks have the added complication of trying to preserve external stability and attracting capital flows.

Key market views

- **Equities**—Relative equity performance since Russia-Ukraine tensions flared has been consistent with our findings: Indonesia, Malaysia, Australia, Vietnam, and NZ have outperformed their regional peers.¹ That said, we remain mindful that an extended stagflationary environment, heightened geopolitical tensions, and the withdrawal of global liquidity aren't typically ingredients that make for a period of EM equity market outperformance.
- **Fixed income and currency**—Regional policymakers aren't likely to match the timing or scale of the Fed's tightening cycle. This suggests likely outperformance in regional bonds and underperformance in local currencies.

Historical performance of the MSCI EM Index when risk aversion increases by two standard deviations



Source: MSCI, Macrobond, Manulife Investment Management, as of March 10, 2022. Measures of volatility in equities, currencies, and spreads in corporate credit and emerging bond markets are aggregated into a composite index that measures overall market risk aversion. When the index is positive, risk aversion is accelerating and the markets are assumed to be risk averse, and vice versa. Standard deviation is a statistical measure of the mathematical distance from the mean or average value of a data set. The larger the standard deviation, the greater the deviation from the norm.

¹ Bloomberg, as of March 10, 2022.

China

Big picture

We continue to expect slower growth in China. The main challenges include ongoing disruptions in supply chains, particularly in strategic resource commodities; the rising economic costs of COVID-zero policies, which will continue to hold back efforts to rebalance the economy and focus on consumption-led growth; worsening developments in the property sector; and an upcoming slowdown in export growth as global consumption patterns are reoriented. China announced an official GDP growth target for 2022 at [5.5%](#), the lowest in decades. Within the government's [budget report](#) are suggestions that officials are expecting growth to be even weaker than the official target. We remain cautious about China's medium- and long-term economic growth prospects amid elevated debt levels, intense demographic challenges, and an increasingly zero-sum global economic environment. In our view, policy support remains modest and insufficient relative to previous easing cycles, particularly in light of the intensity of current economic headwinds.

“In our view, policy support remains modest and insufficient relative to previous easing cycles, particularly in light of the intensity of current economic headwinds.”

Chinese retail sales growth has fallen below the prepandemic rate



Source: National Bureau of Statistics, Macrobond, Manulife Investment Management, as of March 10, 2022. YoY refers to year over year. The black line represents the day on which the pandemic began to be covered by mainstream news organizations.

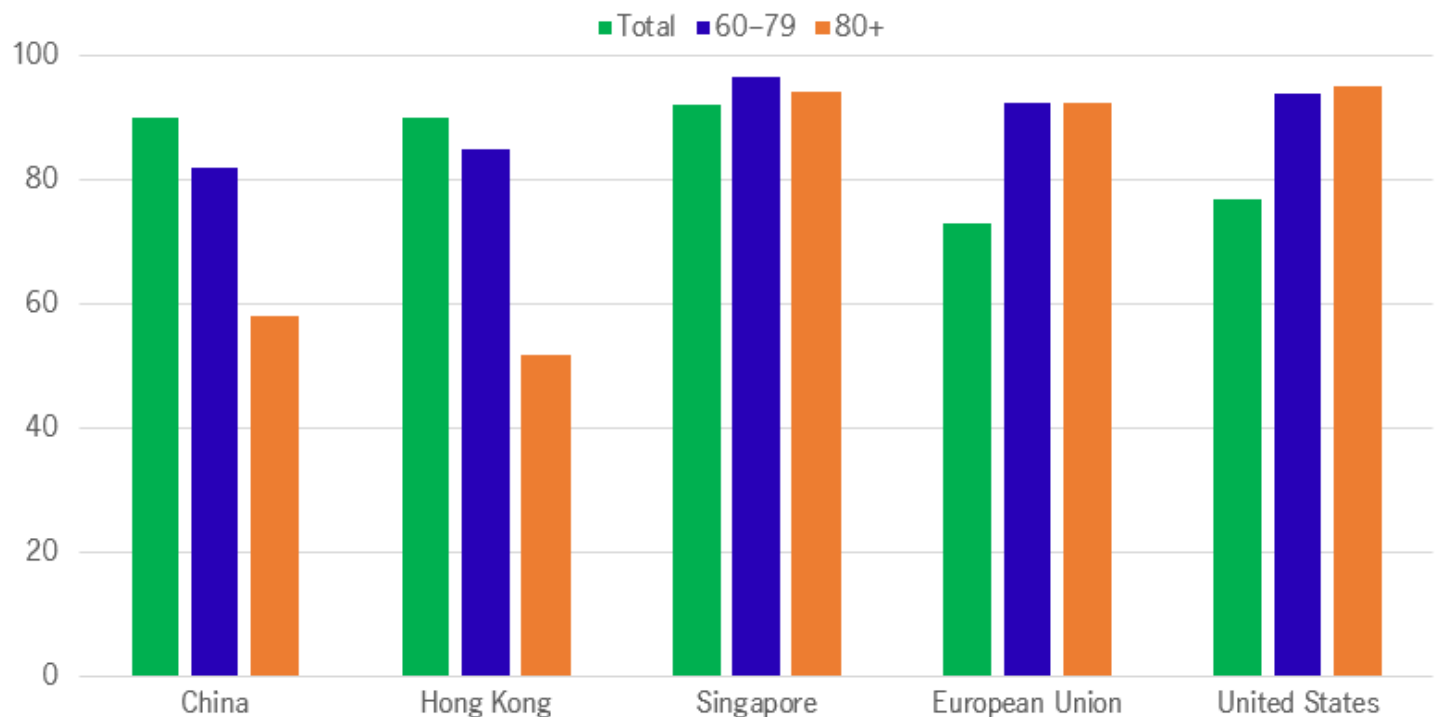
What we're watching

- **COVID-zero**—A key uncertainty pertaining to the economy continues to pertain to if or when China will pivot away from its COVID-zero policy measures. Experimental economic reopenings will likely be limited in scope until the leadership is confident that the associated healthcare costs will be manageable. In that regard, although China's overall vaccination rate is high, over 40% of its residents who are 80 years and older remain unvaccinated.
- **China's property sector**—The months of April and May represent a crucial period for the property sector—a rebound in sales will offer some near-term relief after what's been a persistent and worse-than-expected decline in the past six months.

Key market views

- **Equities**—Investor sentiment toward Chinese equities remains negative amid elevated regulatory risk and concerns that the asset class provides limited hedge against stagflation risk, given the composition of the MSCI China Index. We expect Chinese A-shares to outperform H-shares as the former group is relatively less likely to be exposed to intervention risk and more likely to benefit from domestic stimulus measures.
- **Fixed income**—Chinese government bonds typically outperform during periods of declining global liquidity, and we don't expect things to be different this time.

Share of age group that's received at least one dose of vaccination (%)



Source: Centers for Disease Control and Prevention, National Health Commission of the People's Republic of China, Hong Kong government, Singapore Ministry of Health, Manulife Investment Management, as of March 2, 2022.

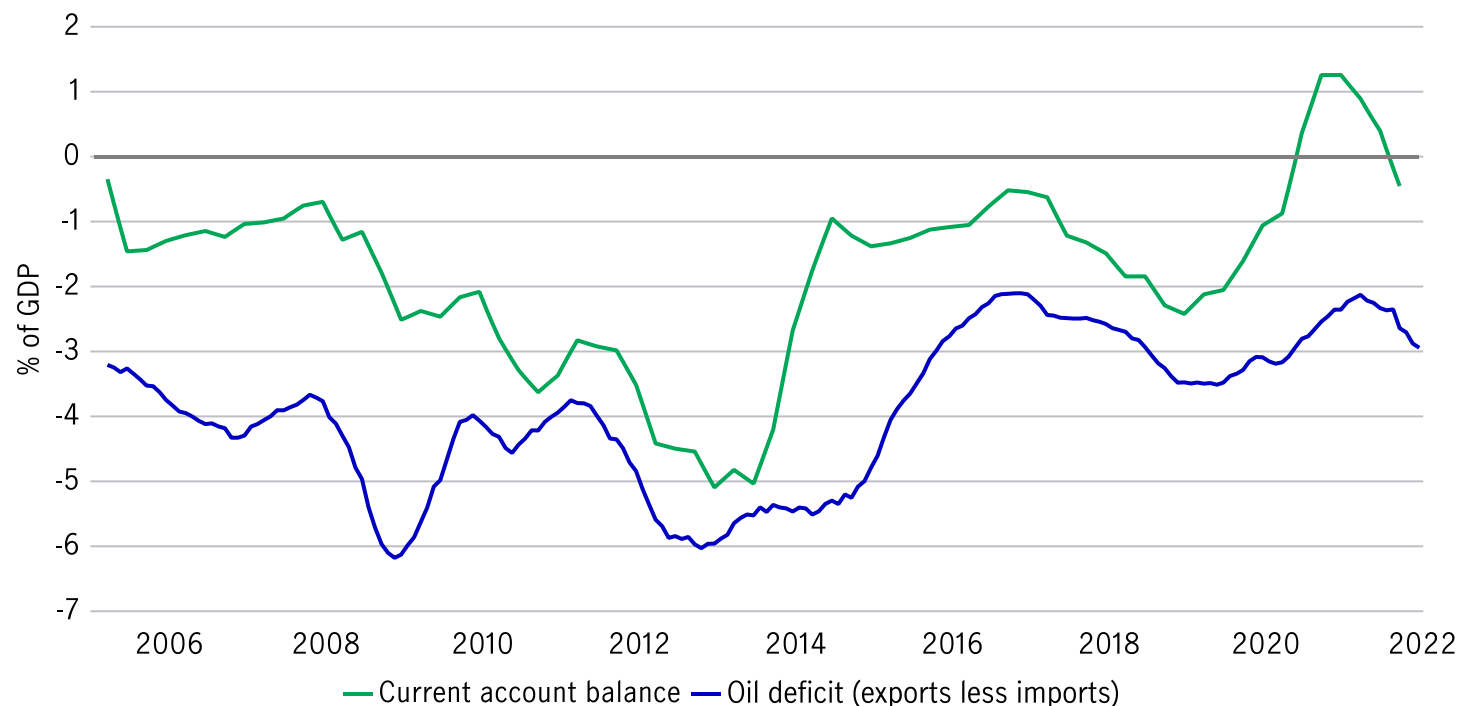
India

Big picture

The Indian economy was in the throes of recovering from the Omicron wave when financial market volatility arising from the conflict in Ukraine struck. Although India's direct trade and financial linkages with Russia and Ukraine are relatively insignificant, India is very much indirectly exposed as the country is a net commodity importer, particularly of energy, which, along with food items, represents over 50% of the Consumer Price Index (CPI) basket. In our view, India is one of the most vulnerable economies in the Asian region to higher food and energy prices. Net portfolio outflows from India's financial markets have picked up over recent weeks, and the Indian rupee dropped to a new record against the USD.¹ The Reserve Bank of India (RBI) maintained a dovish tone in February alongside an expansionary budget, but the inflationary backdrop is about to get far more challenging. We expect the RBI to continue further down the road of unconventional monetary policy, coordinating fiscal and monetary policy.

Although India's direct trade and financial linkages with Russia and Ukraine are relatively insignificant, India is very much indirectly exposed to the ongoing conflict.

India's external balance is heavily influenced by oil prices



Source: RBI, Indian Ministry of Commerce & Industry, ICE, Ministry of Statistics and Programme Implementation, Macrobond, Manulife Investment Management, as of March 8, 2022.

¹ Bloomberg, as of March 9, 2022.

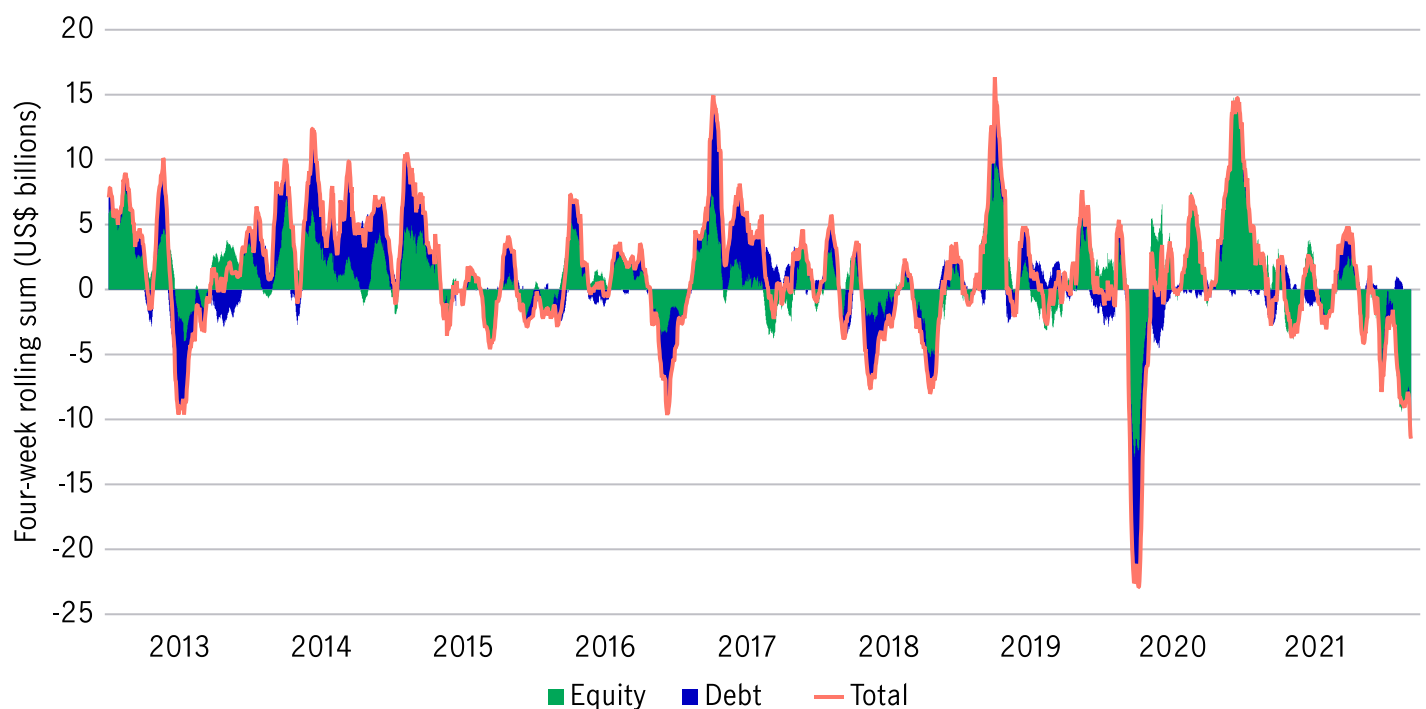
What we're watching

- **Extreme market movements**—Market volatility may cause the government to postpone the long-awaited initial public offering of the state-run Life Insurance Corporation. If so, the government will fall short of its asset sales target for fiscal year (FY) 21/22, exacerbating investor concerns over the country's twin deficits (current and fiscal balances).
- **Rising prices**—Headline CPI inflation jumped to a seven-month high of 6.0% in January and further acceleration seems likely, particularly as the government appears to be delaying price hikes ahead of major state elections, which will conclude in March. Inflation seems likely to rise above the 6% ceiling of the RBI's target.

Key market views

- **Equities**—The reemergence of twin deficits has catalyzed a significant underperformance in Indian markets, which we expect should partially unwind, particularly as valuations and investor positioning become more reasonable following the recent derating. The government's assumptions on GDP growth and the country's fiscal deficit were based on an average oil price of US\$70 to US\$75 a barrel in FY23 and that global supply chain disruptions would ease—this suggests we should see significant revisions ahead. That said, funding India's current account is a much less precarious exercise than in previous years. The country used to rely primarily on unstable foreign portfolio flows, which were highly sensitive to oil price fluctuations. Since 2014, external funding has shifted to foreign direct investment, which is more stable and less sensitive to oil price fluctuations.

Funding India's current account is less precarious than before



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 8, 2022.

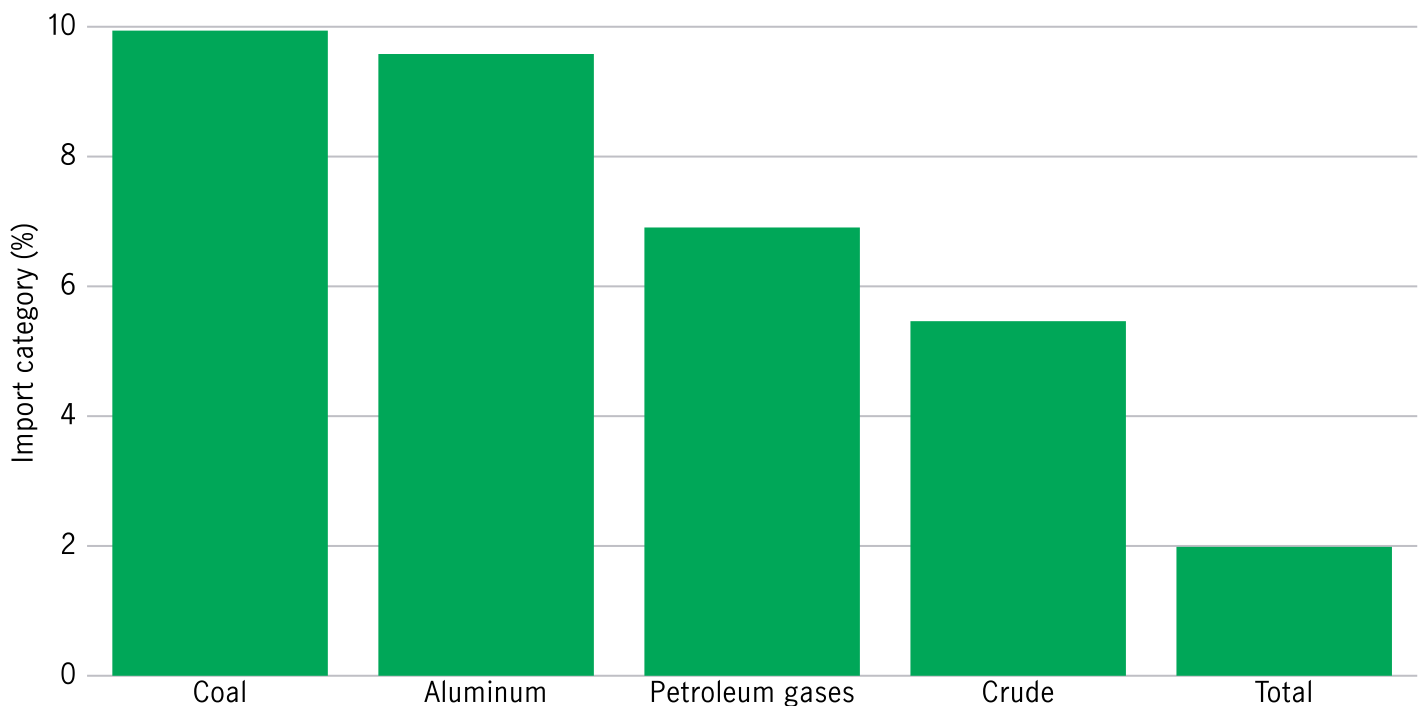
Japan

Big picture

With daily COVID-19 cases falling and the booster rollout advancing, Japan was poised for an imminent services consumption bounce before the Ukraine crisis erupted. The key vulnerability for Japan is that disruption to Russia's energy exports sends global energy prices much higher. Japan is the [world's largest liquified natural gas importer](#) and the [third-largest coal importer](#). Japan is secondarily exposed to the disruption in the supply—and spike in prices—of global metals and food. Around 10% of Japan's aluminum imports come from Russia; its auto sector is also dependent on palladium used in catalytic converters, of which Russia produces [40%](#) of the world's supply. Similarly, over 10% of Japanese imports are concentrated in foodstuffs. That said, we believe Japan is in a strong policy position to respond to the financial/economic shock thanks to consistent external and domestic private sector surpluses.

“With daily COVID-19 cases falling and the booster rollout advancing, Japan was poised for an imminent services consumption bounce before the Ukraine crisis erupted.”

Share of Japanese imports sourced from Russia



Source: UN Comtrade, United Nations Conference on Trade and Development Ministry of Finance (Japan), Macrobond, Manulife Investment Management, as of December 31, 2019.

What we're watching

- **JPY**—The Japanese yen (JPY) has been a surprising underperformer as the currency tends to attract flight-to-safety repatriation flows in times of crisis. It seems JPY selling is dominating on the back of the widening interest-rate differential between the United States and Japan, the country's dependence on energy imports, and its new [US\\$88 billion university fund](#) due to go live at the end of March. Should the JPY start to appreciate sharply, it would be a sign of broadening risk aversion in global markets.
- **CPI inflation**—The Bank of Japan's (BoJ's) trimmed mean measure of inflation accelerated in December at the fastest pace since 2008. At this rate, the BoJ's 2% target for CPI inflation could be in jeopardy, yet such a rate of inflation would pale in comparison to rates seen in the rest of the world.

Key market views

- **Equities**—The TOPIX has outperformed year to date but is still down ~12%¹ amid increased uncertainty from the withdrawal of global policy accommodation and rising risk aversion stemming from the Ukraine crisis. Valuations in Japanese equities have improved since mid-2021 but continue to look much cheaper than U.S. equities.
- **Rates**—Ten-year Japanese government bond yields have fallen back since the BoJ [defended](#) the upper limit of its $\pm 0.25\%$ tolerance band in February. Speculation is high that the central bank will switch its yield target from 10-year government bonds to 5-year bonds, but the benefits of doing so aren't immediately clear to us.

Valuation gap: MSCI Japan Index vs. MSCI USA Index (ratio)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 9, 2022.

¹ Bloomberg, as of March 9, 2022.

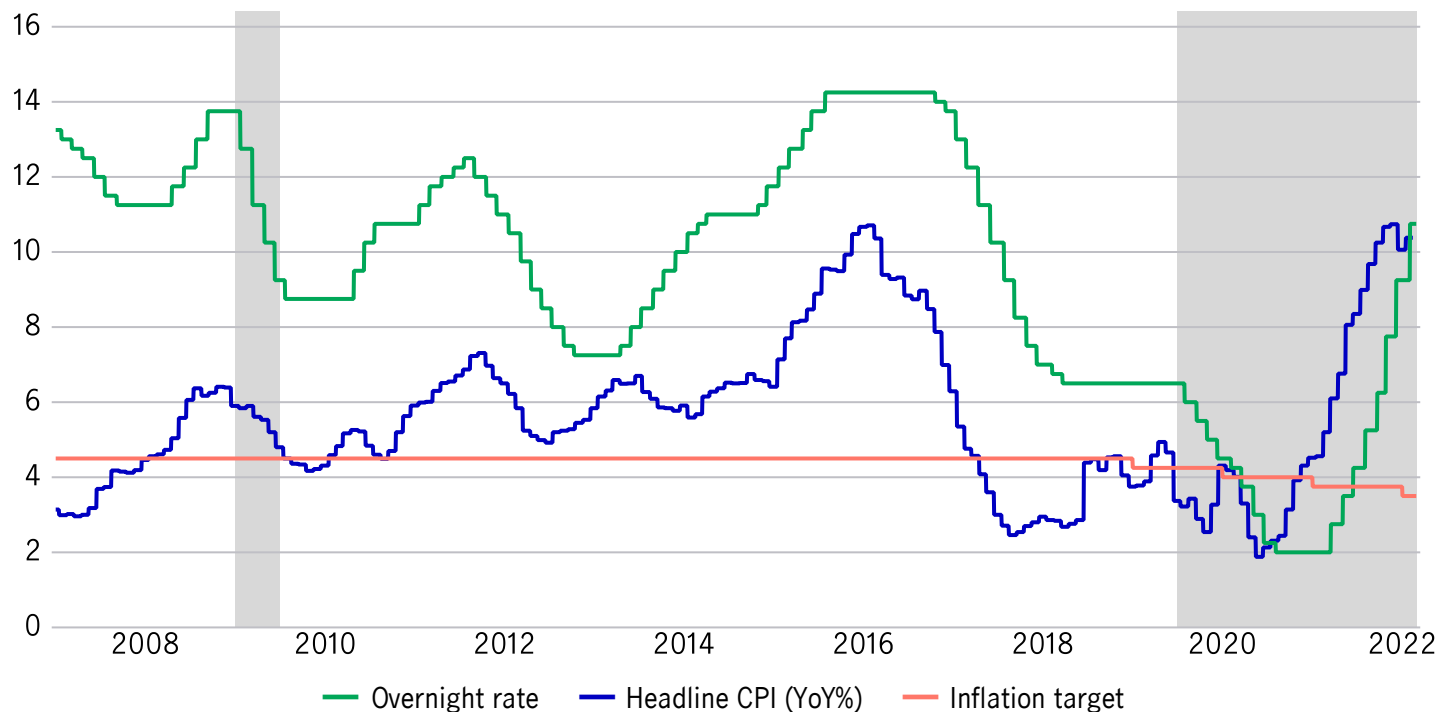
Brazil

Big picture

As Brazil moves past the pandemic, we expect the macro story to strengthen; economic growth should benefit from decelerating inflation and an improving fiscal landscape. The Russia-Ukraine conflict could benefit the commodity export-driven economy; however, potential supply shortages pose upside risk to inflation, particularly in the agriculture sector, which relies heavily on fertilizer imports from Russia. Banco Central do Brasil (BCB) will continue to search for signs that CPI inflation has peaked to encourage a less aggressive tightening cycle. Energy prices will be critical in that regard: We expect the rise in energy costs to take on additional significance as we approach the 2022 election in October. The BCB hiked its benchmark Selic rate from 2.00% to 9.25% last year in the most aggressive tightening cycle globally. Current market pricing suggests a much slower rate of tightening to 11.90% by the end of 2022.¹ In the global context, this may—ironically—provide investors with greater monetary policy certainty.

“As Brazil moves past the pandemic, we expect the macro story to strengthen; growth should benefit from declining inflation and an improving fiscal landscape.”

Hawkish BCB with above-target CPI inflation (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 9, 2022. BCB refers to Banco Centro do Brasil. CPI refers to Consumer Price Index. YoY refers to year over year. The gray areas represent recessions.

¹ Bloomberg, as of March 9, 2022.

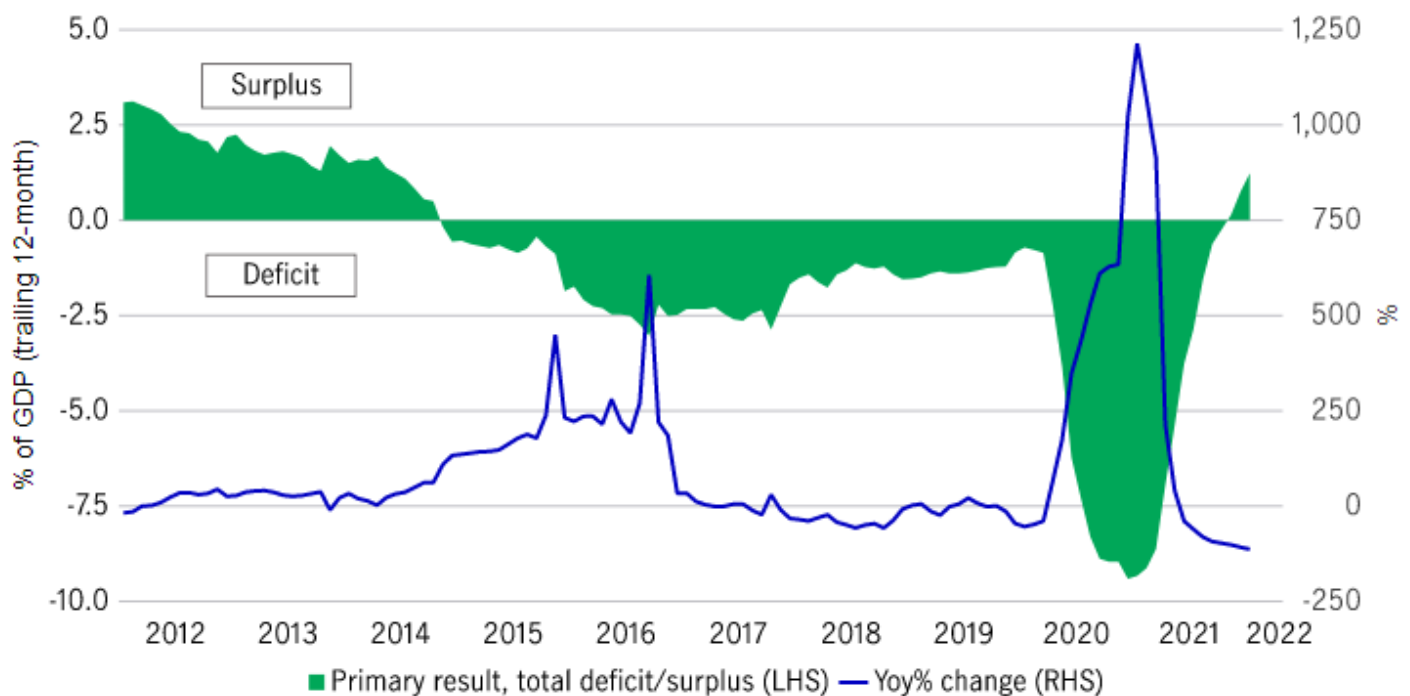
What we're watching

- **2022 elections**—The political discount applied to Brazilian assets continues to wane as markets seem to find comfort in former President Luiz Inácio Lula da Silva's advancement in the polls with a more centrist platform. Markets will be hyperfocused on Mr. Lula's proposed brand of fiscal austerity and commitment to the spending cap.
- **Flows and sentiment**—International demand for Brazilian assets remains a major driver of the Brazilian real (BRL). Its high carry has attracted global inflows to broadly underowned assets, as reflected in record net foreign inflows into Brazilian equities year to date.¹ Yet, given the market is primarily sentiment driven, the risk of forceful swings in either direction has the potential to quickly erode investors' upbeat attitude toward BRL-denominated assets.

Key market views

- **Equities**—Valuations are at attractive levels, and our analysis shows that the asset class's fundamentals are, broadly speaking, stronger than they were before the pandemic. We believe the MSCI Brazil Index will continue to benefit from global reopening and supply shortages of commodities, given the cyclical exposure of the index composition.
- **Currencies**—The BRL is the best-performing EM currency year to date, gaining ≈10% as of early March.¹ Terms of trade remain supportive, and geopolitical developments are providing an added lift as global investors reallocate within EM from troubled hotspots. Domestic risks also appear to have moderated significantly.

Brazil's consolidated public sector budget



Source: Banco Central do Brasil, Macrobond, Manulife Investment Management, as of March 9, 2022. LHS refers to left-hand side. RHS refers to right-hand side.

¹ Bloomberg, as of March 9, 2022.

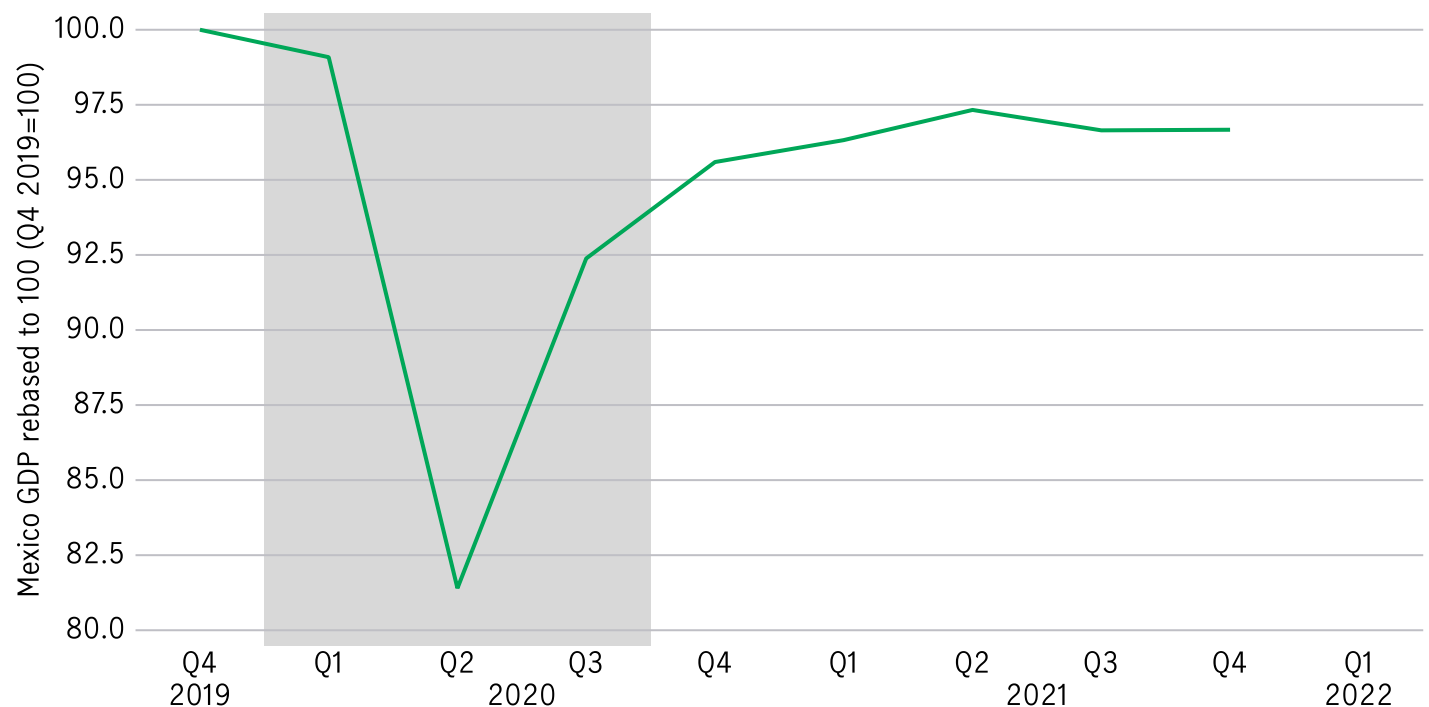
Mexico

Big picture

Mexico entered 2022 with a significant loss of economic momentum owing to inflation levels not seen in more than [two decades](#), heightened domestic political uncertainty, and a challenging global backdrop. Growth may have stalled, but the outlook for consumption is improving, with domestic demand set to benefit from reopening and, along with it, expected employment gains in the services industry. The outlook for manufacturing is closely tied to external demand and will hinge on the United States' much-anticipated inventory rebuild. Banco de México remains hawkish due to ongoing concerns around inflation expectations and global financial conditions. The pace of tightening has accelerated, and policymakers have shifted from 25 basis point (bps) hikes to 50bps increments, with speculation of possible 75bps hikes in the hopes of reining in more than 7% annual CPI inflation. Domestically, political uncertainty will remain elevated going into the April 10 referendum; however, Mexican equities have so far continued to perform well as Latin America is relatively well positioned in the current environment, which is characterized by higher food and energy prices.

“Growth may have stalled, but the outlook for consumption is improving with domestic demand set to benefit from reopening and, along with it, expected employment gains in the services industry.”

Mexico's GDP growth stalled in the second half of 2021



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 11, 2022. The gray area represents a recession.

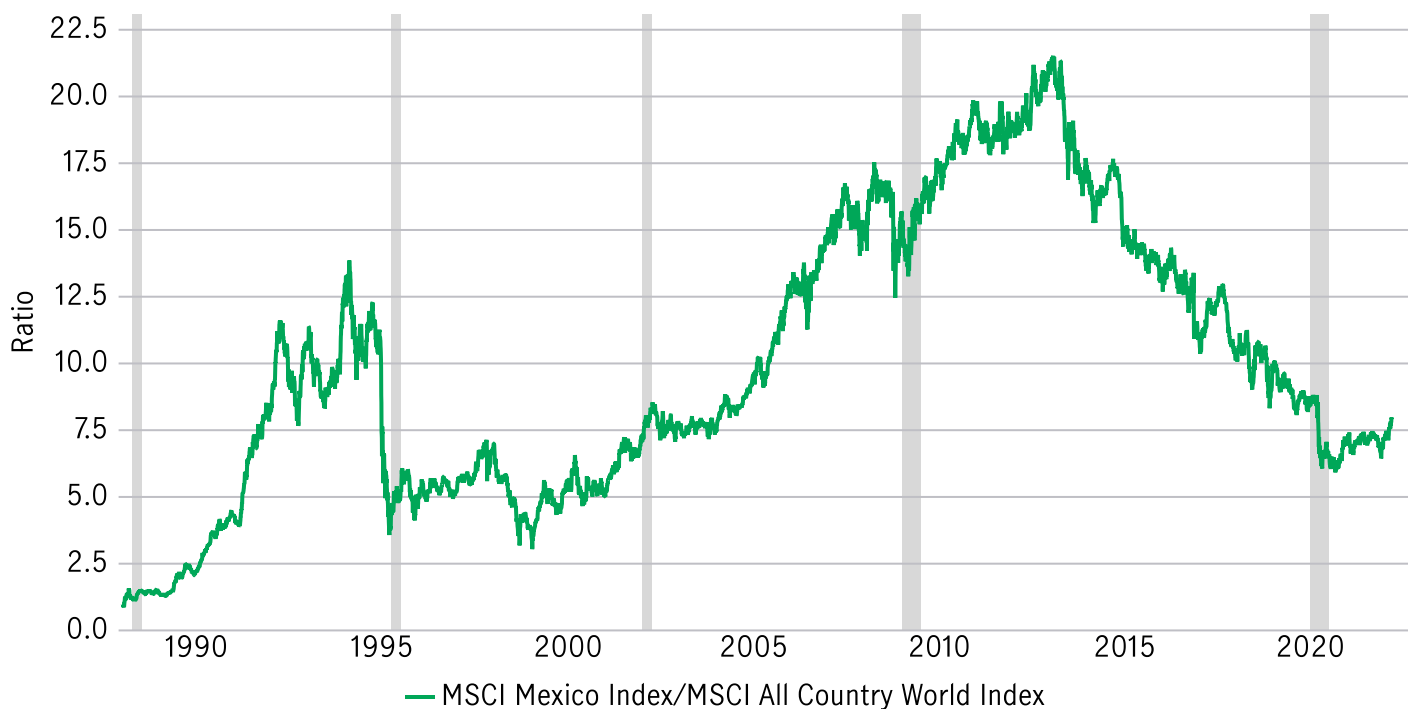
What we're watching

Domestic politics—The [presidential mandate referendum](#), proposed by President Andrés Manuel López Obrador (AMLO) and passed by the congress in August 2021, had initially been criticized by the opposition as a political charade to flaunt the president's impressive approval ratings (as well as a possible first step toward an unconstitutional extension of his term). Recent developments have [dented](#) AMLO's approval rating, adding a new dimension to political uncertainty. That said, should AMLO be forced to step down, a reversal in some of his policies—perceived as being counterreform in nature and increasingly antibusiness—would likely be welcomed by foreign investors.

Key market views

Equities—The MSCI Mexico Index recently outperformed the MSCI All Country World Index benchmark. Crucially, the index has broken above its post-COVID-19 recovery trading range. In our view, this reflects a broader investor rotation that could eventually lead to the index recouping a greater portion of the decline it chalked up between 2013 and 2020.

Mexican equities vs. world equities: still some way to go



Source: Banco de México, Macrobond, Manulife Investment Management, as of March 9, 2022. LHS refers to left-hand side. RHS refers to right-hand side. Gray areas represent recessions.

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