AXA Investment Managers

205 – 4 December 2023

Investment Institute Macroeconomics

Vox Populi

- COP 28 is taking place against a background of emerging "decarbonation backlash". Taking stock of the latest wave of the EIB's Climate Survey, we explore citizens' level of climate awareness and policy preferences.
- Another good inflation print in the Euro area makes markets even more impatient.

While we do not expect a breakthrough at COP28 allowing a swift adjustment towards a decarbonation path consistent with the Paris Agreement targets, we take the opportunity of the current focus on the UAE conference to take stock of citizens' attitudes towards climate change and policy preferences as they are reflected in the European Investment Bank's Climate Survey. Contrary to a popular opinion there does not seem to be any gap left between Europeans and Americans when it comes to considering climate change as a crucial issue. Across the Atlantic, the same percentage of respondents (39%) mention it as one of the three major challenges facing their countries in the coming years. Possibly counter-intuitively, it seems that climate sensitivity might have eroded somewhat in Europe over the last few years whereas it has remained unchanged in the US.

Europeans come out as more worried than Americans, Chinese or Indians on the economic consequences of the fight against climate change, with more concerns about its impact on employment, income, or social equality. They are also more circumspect about carbon taxes. We suspect a lot of this has to do with the fact that, relative to other constituencies, Europeans already pay significant environmentally related taxes. The European public already deals with some of the costs of decarbonation, while other constituencies have so far been largely spared. We think the Carbon Border Adjustment Mechanism, with the right narrative, may help to prevent a brewing political backlash.

While COP is in full swing, the market is fixated on the prospects of a quick reversal in the monetary policy stance and welcomed more good news on the price front. November inflation in the Euro area surprised again to the downside. The market pricing is getting extreme, in our view, with the first ECB cut now seen at the end of Q1 2024. While we agree a lot of what is the November CPI print is encouraging, we stick to the point we made last week: while from a "normative" point of view plausible macro scenarios would suggest quick and substantial cuts in 2024, we maintain our baseline to June for the first move. Messages from the ECB cannot be ignored.

Climate change and citizens' preferences

The Global Stocktake prepared by the United Nations (UN) ahead COP28 makes it plain that strong action is needed to set the decarbonation path in line with the targets set by the Paris Agreement. Expectations are limited though for the impact of the conference in the United Arab Emirates (UAE) (see the paper by our colleague Virginie Derue here). We want here to focus on the fact that **COP28 is taking place against a background of emerging "decarbonation backlash"**. Despite the obvious positive effect that the Inflation Reduction Act – in truth a decarbonation investment initiative - is having on short-term growth dynamics in the United States (US), Donald Trump has stated that he would dismantle it should he come back to the White House. In the United Kingdom (UK), the government is pushing back the mandatory shift to electric vehicles and is reopening oil drilling in the North Sea. The consensus is stronger in the European Union but even there, cracks are appearing. There, as Tony Barber from the Financial Times highlighted last week, the backlash is not limited to populists, since for instance the representatives in the European Parliament of Poland's Civic Forum, Donald Tusk's mainstream party have a poor voting record when it comes to the green agenda (see the source data in this report by Climate Action Network).

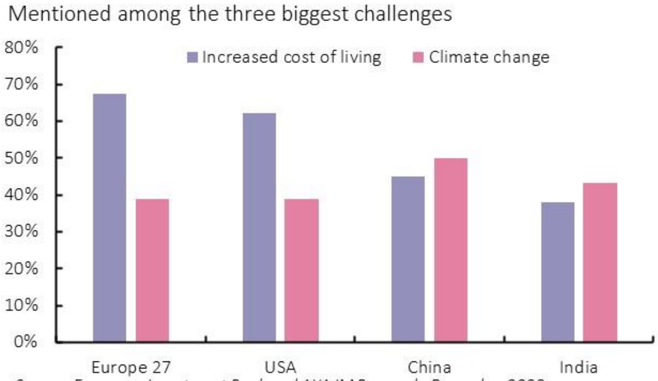
In the short history of climate change mitigation, there are already examples of countries which completely reversed their policy stance. The Australian government introduced in 2012 a carbon tax of AUD23 per ton of CO2 levied on around 260 industrial emitters. For reference, then the price of a ton of CO2 in the European Union (EU) was as low as EUR3.3 (c. AUD5.0 at the time). The impact on Australia's carbon emissions was visible within a year – falling to its lowest level in 8 years. The electricity generation mix shifted abruptly, with the share of hydropower rising steeply to the detriment of coal. Yet, the new majority emerging from the 2013 elections abolished the tax in 2014. Between then and 2019 (before Covid took global emissions down) Australia's annual CO2 emissions have risen by 4.2% - a rare occurrence among developed nations.

The government of the time was well aware of the potential politically toxic consequences of its tax. The carbon tax was not introduced to raise new *net* revenue and the shock to household purchasing power was offset by a decline in income tax (in practice by raising the tax-free threshold). Polls suggest discontent with the tax had ebbed by the time the election took place. Acrimonious leadership changes had affected the image of the incumbent Labour party, which may have played a bigger role in the centre-right victory. Yet, the carbon tax – which repeal ranked prominently in the opposition's electoral manifesto – was at the heart of the campaign. Australia's example suggests that support for decarbonation should not be taken for granted even in places where the issue has been uncontroversial so far (until 2009 the Australian centre-right was in principle in favour of a carbon tax). **Understanding citizens' preferences – in particular their willingness to sacrifice purchasing power to the fight against climate change - is therefore key.**

The European Investment Bank (link here) has been conducting public opinion surveys on this matter for several years in the EU, the US and China (adding India in the most recent waves). Contrary to a popular opinion, at least according to the latest survey conducted in August and September 2023, **there does not seem to be any gap left between Europeans and Americans when it comes to considering climate change as a major issue.** The same percentage (39%) of respondents across the Atlantic mention it among the three main challenges facing their countries in the coming years (see Exhibit 1). In fact, **possibly counter-intuitively, it seems that climate sensitivity might have eroded somewhat in Europe over the last few years**. Climate change was mentioned by 47% of EU respondents in the 2019 wave. Not such decline was observed in the US (it was already 39% there in 2019).

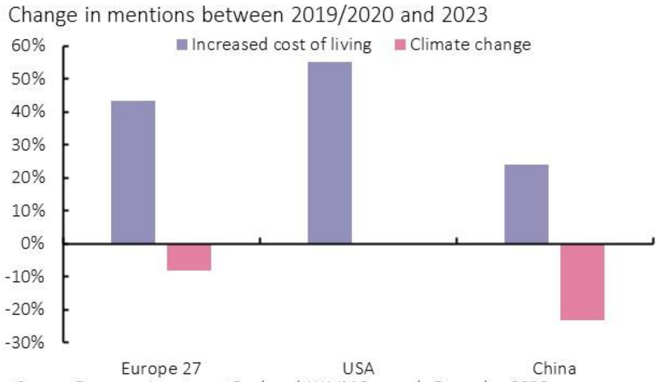
Note however that unfortunately the questionnaire is not kept constant, with new questions appearing in the successive waves, which may distort the comparison over time. In particular, "environmental degradation" is now a possible choice (mentioned by 22% of Europeans), which was not the case in 2019, and it may be that respondents conflate climate issues with the broader environmental theme. However, the addition of this new environmental question has not changed the percentage of those mentioning climate change in the US.

Exhibit 1 – Competition from purchasing power issues



Source: European Investment Bank and AXA IM Research, December 2023

Exhibit 2 – Climate change concern more resilient in the US

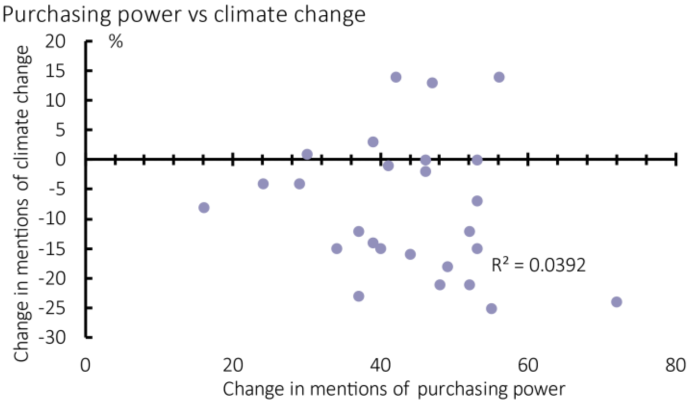


Source: European Investment Bank and AXA IM Research, December 2023

A natural expectation would be that the pandemic and the subsequent inflation shock have shifted priorities. Purchasing power issues were mentioned by only 24% of European respondents in 2019. This rose to 68% in 2023. This would reflect a run of the mill "end of the world vs end of the month" trade-off. But again, the same pattern could not be found in the US, since the rise in purchasing power concerns was very similar across the Atlantic but without a decline in salience of climate change. Conversely, climate change concerns lost a lot of traction in China, although there the surge in purchasing power issues was the smallest (see Exhibit 2).

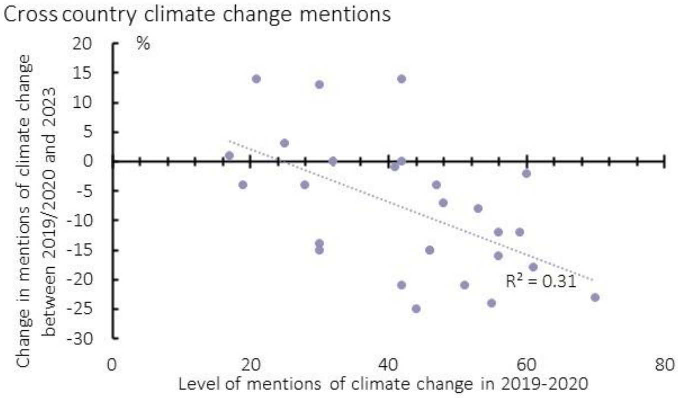
Inferring causation from opinion surveys is a dangerous endeavour, but we can go a step further and use the country-by-country European Investment Bank (EIB) data to check for any correlation between the change in purchasing power sensitivity and focus on climate change. Exhibit 3 suggests that no such correlation can be established. **Countries where the purchasing power issue surged the most were not necessarily where climate change sensitivity declined the most**. Where we however find some (limited) negative correlation is between the level of climate awareness in 2019 and the change over the following four years (see Exhibit 4). In other words, there is some catch-up in countries which initially were lagging (it's particularly true for small Eastern European nations) which does not offset some erosion in the most advanced nations. The standard deviation across countries has diminished by 1 percentage point between the two waves which we have analysed, even if the broad East/West divide, the latter part of the EU remaining more focused on climate change, is still here (45% of respondents in France mention climate change, 30% in Poland and 19% in Hungary).

Exhibit 3 – No correlation with purchasing power concerns



Source: European Investment Bank and AXA IM Research, December 2023

Exhibit 4 – Some erosion in "climate aware" countries

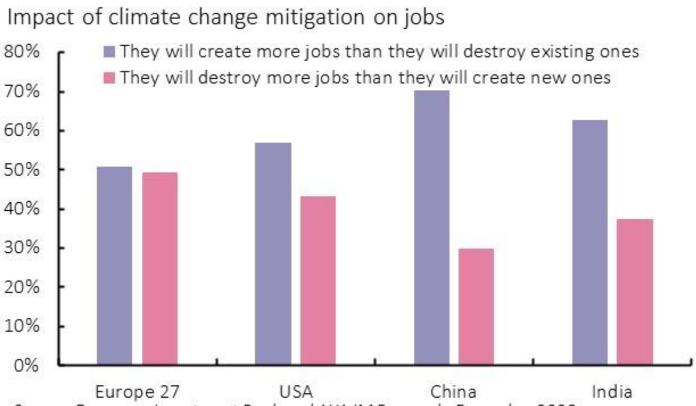


Source: European Investment Bank and AXA IM Research, December 2023

It would however be too strong to conclude that climate awareness is resolutely fading in Europe. The score in the 2023 survey still puts the issue very high relative to themes which seem to quantitatively loom as large or larger in the public debate. While climate change is now only the second most mentioned issue, the gap relative to the third one (income inequality) still stands at a quite respectable 11 points. "Large scale migration" is mentioned as one of the three top issues facing their country by 25% of the EU27 respondents, 14 points below climate change. Note also that if the level of climate change awareness in the population is now similar between the US and the EU, it is less politically polarised in the latter. In the EU, the distance between the respondents mentioning climate change who classify themselves on the far left and those on the far right stands at 15 points (47% versus 33%). In the US, the distance on this metric between those declaring themselves "very liberal" and "very conservative" (the equivalent extremes in the EIB survey) stands at 24 points (55% versus 31%).

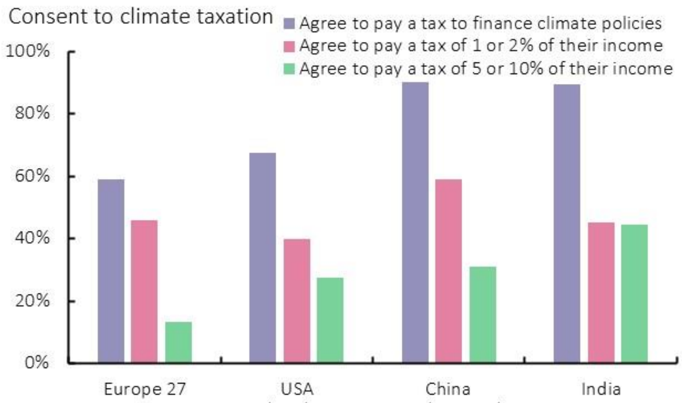
Yet, what we also find striking in the EIB survey is that **Europeans come out as more worried than Americans, Chinese or Indians on the *economic consequences* of the fight against climate change**. Indeed, there is only a tiny majority of European respondents who consider that the transition will create more jobs than it will destroy. Respondents in the other constituencies take a sunnier view (see Exhibit 5) and the same pattern emerges when the question covers income prospects. So, where Americans, Chinese and Indians see the net zero transformation as an economic opportunity, Europeans are more circumspect. Europeans are also doubtful of the capacity to reconcile the fight against climate change with preserving equality (only 38% of them are confident their governments can pull it off, against 57% of Americans, 93% of Chinese and 88% of Indian respondents).

Exhibit 5 – Europeans in two minds about the economic consequences of climate change mitigation…



Source: European Investment Bank and AXA IM Research, December 2023

Exhibit 6 – … and less enthusiastic about carbon tax



Source: European Investment Bank and AXA IM Research, December 2023

This general wariness is also reflected in their readiness to pay environmental tax (see Exhibit 6). While a majority of respondents from the EU27 are ready to pay some carbon tax, the margin is wider in the US, China and India, and Europeans are the least open to a level carbon-related taxation which dent their income to the tune of 5 to 10%.

This is probably counter-intuitive given the general higher consent to taxation found in Europe relative to the US. We suspect a lot of this has to do with the fact that, relative to other constituencies, Europeans *already* pay a significant share of their income in various environmentally related tax. The Organisation for Economic Cooperation and Development (OECD) has been doing a great work at compiling, in a harmonised way, those different levies across member states. The message is straightforward: **in 2021, the receipts of tax related to climate change mitigation stood at 1.6% of GDP in Germany and 1.4% in France against only 0.4% in the US**. Habitual readers of Macrocast are used to your humble servant's rants at the US "all carrot/no sticks" approach to decarbonation. **In Europe, the public already deals with some of the costs of decarbonation, while citizens in other constituencies have so far been largely spared**. This may explain the difference in outlook on the economic pain the transition will ultimately inflict.

These developments on the state of public opinion in various constituencies gets us back to a familiar concern when it comes to climate change mitigation: the difficulty to coordinate across regions when **disagreements over burden sharing abound**. The dominant narrative in developing nations is that mature economies, as they are factually responsible for most of the historical depletion of the planet's carbon budget, should accept massive transfers of financial resources to the South which is now being requested to growth their economy without recourse to the same carbon-intensive technologies deployed in the North during their own expansion. However, public opinion in Europe – which for now supports the principle of such transfer by a clear 60/40 majority according to the EIB survey - may increasingly focus on the fact that carbon emissions have been falling in their countries, sometimes quickly, while they continue to rise significantly in the South. As an example, In France, greenhouse gas emissions have fallen by 12.5% from peak in 2010 to 2019, twice as fast as in the US, while over the same period they rose by 26.7% in China and 24% in India according to Climate Watch. We could easily see a politically attractive discourse emerging around the fact that Europeans effectively pay to decarbonise while others are not making corresponding efforts, to the point that mitigation is essentially doomed.

Such presentation is of course at least partly a fallacy because measuring Greenhouse Gas (GHGs) at the point of emission does not take into consideration what is "crystallised" in imports. Again using France as an example, a 2020 report by the High Council on Climate Change concluded in 2020 that the country's imported emissions were 70% higher than its domestic emissions (see here the link to the report). The Carbon Border Adjustment Mechanism (CBAM) now gradually implemented in the EU (the first reporting period for importers ends on 31 January 2024, with the first actual payments coming due in 2026) will help deal – partly – with the issue.

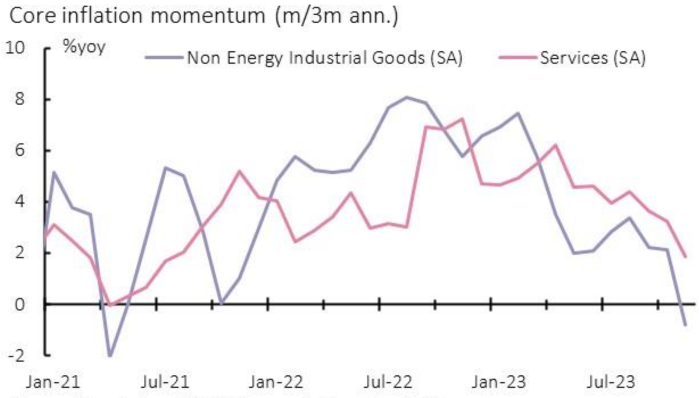
The narrative around the CBAM will be key, from the point of view of its long-term acceptance by the population. Indeed, a well-established conclusion of economic theory is that ultimately, the price of a customs' duty is ultimately always paid by the consumer in the importing country. From this point of view, the CBAM is not going to make European citizens better off. The net effect on employment is also ambiguous, since some domestic carbon-intensive producers will see their free carbon emission allowances, which so far had allowed them to avoid much of the impact of the European carbon trading system, phased out. However, at least it provides a strong incentive for non-European producers to reduce their carbon emissions, or for non-European governments to introduce their own version of the carbon tax. This could create a sense among European citizens that their domestic policies are geared towards burden sharing and that, in exchange for some dent to their purchasing power, they can collectively make a difference to *global* carbon emissions, which from a climate change mitigation point of view is really what matters.

European disinflation confirmed – with more pain ahead

While COP is in full swing, the market is fixated on the prospects of a quick reversal in the monetary policy stance and welcomed more good news on the price front**. In November inflation in the Euro area surprised again to the downside last week**. Headline fell from 2.9%yoy to 2.4% while the market consensus collated by Bloomberg was counting on a much more subdued decline (2.7%). What's more, the bulk of the surprise came from core, which fell from 4.2% to 3.6% (3.9% expected). The deceleration in core consumer prices is broad based, with none of the divergence observed in the US between manufactured goods' prices and services. In the Euro area, both sub-components are going in the right direction (see Exhibit 7) and even services inflation has now fallen below 2% annualised for the first time since July 2021.

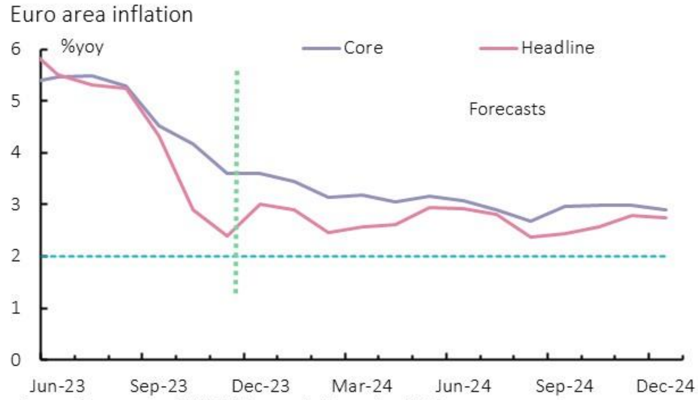
Now, while this release has triggered another downside revision in the market's pricing of the ECB trajectory next year (nearly two rate cuts are now priced in for the spring of 2024, with a first one now expected for March), **we may have to brace ourselves for some less spectacularly encouraging Consumer Price Index (CPI) readings in the months ahead.** The expiry in December 2023 of one of the "energy price shield" measures set up in December 2022 in Germany will mechanically push the year-on-year change up, and more generally, the powerful base effects from energy and food prices which have helped take inflation readings in recent months will fade. Progressing into 2024 the overall price trajectory, absent more shocks on energy and food, will become more dependent on core. We think we can safely assume manufactured goods prices will remain under control – supply lines have been restored, deflation or zero-inflation looks entrenched in China, the world's biggest manufacturer, and the euro has stopped depreciating – the key question is whether the current subdued pace of services prices can be maintained.

Exhibit 7 – Downward convergence



Source: Eurostat and AXA IM Research, November 2023

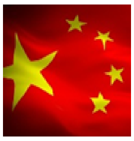
Exhibit 8 – Not quite 2% in 2024 yet



Source: Eurostat and AXA IM Research, November 2023

Such rosy scenario would entail that the ongoing rise in labour costs does not transmit to retail prices. We think evidence is accumulating across most of the Euro area that wage growth is now past its peak. The impact on prices of the looming deceleration in wages – already tangible in real time indicators such as the Indeed survey – may however be blunted by adverse developments on the productivity front. Indeed, productivity per head in mid-2023 was still 1% below its pre-pandemic level and is only marginally better in hourly terms. That gets us back to our concern over labour market prospects. "Proper" disinflation cannot be achieved in the Euro area without a significant deterioration of employment restoring some measure of productivity gains. The process has recently started – we have already commented in Macrocast the rise in unemployment in France and Germany – but it is still contained. In our baseline in which the Euro area flirts with recession without fully falling into it, with accordingly only limited rise in unemployment inflation would remain above the ECB target throughout 2024 (see Exhibit 8).

In such configuration, seeing the ECB cutting at the end of Q1 already would be far-fetched in our view. We agree that the March 2024 forecast might indicate some firmer confidence in Frankfurt that inflation is fast getting back under control, but we continue to think that such turnaround in more likely for June 2024. We note that even Yannis Stournaras, who was the first member of the Governing Council to openly discuss cutting rates in mid-2024, explicitly stated last week that the market pricing April was too optimistic. We stick to the points we made last week. While from a "normative" point of view plausible macro scenarios would suggest quick and substantial cuts in 2024, we think we need to take on board the ECB's "narrative inertia": changing the policy discourse often takes time, even when the data move. **In the meantime, the market may have to focus on the balance sheet aspects of the ECB's policy making.** Christine Lagarde's explicit warning about the central bank possibly revisiting their current forward guidance on reinvesting Pandemic Emergency Purchase Programme (PEPP) (today intended to last until December 2024) should act as a reminder that the ECB might not be in a very "market friendly" mood at the moment. We will discuss this next week ahead of the next Governing Council.

Country/Region	What we focused on last week	What we will focus on in next weeks
	• GDP (Q3) revised higher to 5.2% (saar), investment firmer, but consumption lower and inventory higher • PCE inflation (Oct) 3.0%; 3.5% core (from 3.4%; 3.7%) • Spending (Oct) slowed to 0.2% from 0.7% in Sept. • Beige Book slowdown recorded in most areas • Chicago PMI (Nov) jumped to 55.8 – 18m high • Continuing jobless claims reached 2-yr high	• Fed in purdah ahead of next week's meeting • Labour market report (Nov) closely watched after weak report in October • JOLTS survey (Oct) further drop in vacancy rate • Services ISM (Nov) signs of improvement • Consumer sentiment (Dec, p) and inflation expect's • Consumer credit (Oct) any increase to fund spending
	• EMU Inflation (Nov) came below expectations at 2.4%yoy (-0.5pp). Energy base effects have been strong but stable. Core inflation (svcs and neig) led the decline. It seems items related to tourism are weak (to be confirmed with final release mid dec.) • Nov EC sentiment slightly improved in both mfg and svc sector. Price expectations continue to fall	• Sentix index (Dec) • Industrial production in Fr and Ge • EMU retail sales (Oct) after strong heterogeneity across countries: Fr: -0.9%mom, Ge: +1.1% • EMU final employment and GDP figures (Q3)
	• BoE lending (Oct) mort apps ticked higher to 47.4k, but overall mtg lending fell again -£0.1bn • Ntwd HPI (Nov) +0.2%mom, third successive monthly rise, -2.0%yoy • BRC shop price index (Nov) 4.3% from 5.2%	• Services PMI (Dec, f) rose to 50.5 from 49.5 in prel • BRC retail sales monitor (Nov) first guidance for month, retail sales have fallen 3 of last 4 months • KPMG/RECS (Nov) increased focus with adjustments in official labour market data
	• Industrial production (Oct) rose by 1%mom (after +0.5%mom in Sep) • Retail sales (Oct) was very weak at 4.2%yoy after 5.8% in Sep., implying a large correction • Labour market remains tight with Urate down to 2.5% (-0.1pp), while jobs/applicant ratio is flat at 1.3	• CPI Tokyo (Nov) • Final PMIS (Nov) • Reuters Tankan Non-Mfg index (Dec) • Household spending (Oct) to confirm weak retail sales • GDP revision (Q3) after a strong downward surprise
	• Industrial profit (Oct) declined to 2.7%yoy (Sep: 11.9%) • NBS PMI Mfg (Nov) dropped marginally to 49.4 (Oct: 49.5); Non-Mfg (Nov) edged down to 50.2 (Oct: 50.6); Composite PMI (Nov) decreased to 50.4 (Oct: 50.7) • Caixin Mfg PMI (Nov) rose to 50.7 (Oct: 49.5), beating market expectation of 49.8.	• Tue (5 Dec): Caixin PMI Service (Nov) • Thu (7 Dec): Exports & Imports (Nov) • Thu (7 Dec): FX reverses (Nov) • Sat (9 Dec): CPI & PPI (Nov)
	• CB: Korea (3.5%) & Thailand (2.5%) stood on hold • Annual inflation (Oct) fell in Poland (6.5%). It rose in Indonesia (2.9%) • Q3 GDP (%yoy) lost steam in India (7.6%) while it accelerated in Turkey (5.9%). Growth remained steady in Taiwan at 2.3% • Industrial production decelerated in Korea (1.1%) & Russia (5.3%)	• CB: India (6.5%) & Poland (5.75%) are expected to stay on hold • Q3 GDP data in Brazil, Romania & South Africa • Nov CPI: Chile, Colombia, Mexico, Hungary, Indonesia, Korea, Philippines, Taiwan & Turkey • October industrial production in Hungary

Upcoming events	US:	Mon: Durable goods orders (Oct), Factory orders (Oct); Tue: Services PMI (Nov), ISM non-manf index (Nov), JOLTS Job Openings (Oct); Wed: ADP emp change (Nov), Non-farm productivity (Q3), Trade balance (Oct), Unit labour costs (Q3); Thu: Weekly jobless claims (2 Dec), Federal reserve issues Quarterly Financial Accounts; Fri: Non-farm payrolls (Nov), Unemp (Nov), Michigan consumer sentiment & inflation expectations (Dec)
	Euro Area:	Tue: EA Composite PMI (Nov), EA,Ge,Fr,It,Sp Services PMI (Nov), EA PPI (Oct), Fr,Sp Industrial production (Oct); Wed: EA Retail sales (Oct), Ge New manf orders (Oct); Thu: EA GDP (Q3), Ge,It Industrial production (Oct)
	UK:	Tue: BRC Retail sales (Nov), SMMT new car registrations (Nov), Services PMI (Nov); Wed: Constructions PMI (Nov), BoE publishes Financial Stability Report
	Japan:	Thu: Leading index (Oct), GDP (Q3), Trade balance (Oct); Fri: Economy Watchers Survey (Nov)
	China:	Tue: Caixin Services PMI (Nov); Thu: Exports & Imports (Nov), Trade balance (Nov); Sat: CPI (Nov)

Our Research is available online: www.axa-im.com/investment-institute

About AXA Investment Managers

AXA Investment Managers (AXA IM) is a responsible asset manager, actively investing for the long-term to help its clients, its people and the world to prosper. Our high conviction approach enables us to uncover what we believe to be the best global investment opportunities across alternative and traditional asset classes, managing approximately €840* billion in assets as at the end of June 2023.

AXA IM is a leading investor in green, social and sustainable markets, managing €489 billion of ESG-integrated, sustainable and impact assets as at the end of December 2022. We are committed to reaching net zero greenhouse gas emissions by 2050 across all our assets, and integrating ESG principles into our business, from stock selection to our corporate actions and culture. Our goal is to provide clients with a true value responsible investment solution, while driving meaningful change for society and the environment.

At end of December 2022, AXA IM employs over 2,600 employees around the world, operates out of 24 offices across 18 countries and is part of the AXA Group, a worldwide leader in insurance and asset management.

** Includes the contribution from Architas and AXA IM Prime, net of intercompany elimination.*

Visit our website: http://www.axa-im.com
Follow us on Twitter: @AXAIM & @AXAIM_UK
Follow us on LinkedIn: https://www.linkedin.com/company/axa-investment-managers
Visit our media centre: www.axa-im.com/en/media-centre

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities.

It has been established on the basis of data, projections, forecasts, anticipations and hypothesis which are subjective. Its analysis and conclusions are the expression of an opinion, based on available data at a specific date.

All information in this document is established on data made public by official providers of economic and market statistics. AXA Investment Managers disclaims any and all liability relating to a decision based on or for reliance on this document. All exhibits included in this document, unless stated otherwise, are as of the publication date of this document.

Furthermore, due to the subjective nature of these opinions and analysis, these data, projections, forecasts, anticipations, hypothesis, etc. are not necessary used or followed by AXA IM's portfolio management teams or its affiliates, who may act based on their own opinions. Any reproduction of this information, in whole or in part is, unless otherwise authorised by AXA IM, prohibited.

Issued in the UK by AXA Investment Managers UK Limited, which is authorised and regulated by the Financial Conduct Authority in the UK. Registered in England and Wales No: 01431068. Registered Office: 22 Bishopsgate London EC2N 4BQ.

In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.

© AXA Investment Managers 2023. All rights reserved