

»Global Macro Environment: Outlook for 2022

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CIO outlook 2022: “Goldilocks light”

Globally we are seeing a sustained period of solid economic growth and generous money supply from central banks. Inflation rates and inflation expectations are likely to come down again in the medium term after their latest increase. We thus find ourselves in an ongoing “Goldilocks light” scenario. We rate the risk of stagflation as low.

Economic outlook

In the US, we expect the economic recovery to continue in 2022 as well, with the help of positive feedback loops from a number of favourable factors: the labour market is steadily improving, property prices are rising, private households have high cash holdings with consequent potential for consumption, monetary policy remains loose (despite tapering of asset purchases by the central bank), and national infrastructure and social welfare packages are in place.

In the eurozone, too, we expect growth in the coming quarters to improve once more due to very similar factors as in the US after a setback in the first half of the year caused by lockdown measures. However, the fresh wave of Covid-19 that is currently underway is dampening growth. Europe is more export-oriented than the US, and is thus benefitting particularly strongly from the global economic recovery.

The real estate crisis in China seems to be under control, but will probably weaken Chinese growth for a prolonged period, and is thus also having a slight dampening and deflationary effect on a global level. However, the Chinese government and the central bank have a smart crisis management system in place with appropriate monetary easing. This should prevent the crisis from escalating. All in all, we therefore do not expect stagflation either in China or globally for the time being.

In addition, despite the fact that Covid-19 case numbers are on the rise again worldwide, the pandemic should be brought under control in the medium term. In particular, the imminent availability of new drugs should help to prevent hospitals from becoming overwhelmed.

Owing to the positive growth factors mentioned above, we expect a temporarily strong trend towards higher inflation rates in both the US and Europe. However, a reduction in asset purchasing by the Fed and the ECB is the first step towards stemming inflationary forces and, in particular, inflation expectations as well. With the easing of base effects, we expect a calming on this front next year after the present uptick. However, inflationary forces that cannot be underestimated are at play in the medium and long term as well, and these are likely to keep inflation above the central banks’ targeted 2% for a prolonged period.

In Europe, the sharp increases in gas and crude oil prices, and the fact that monetary policy is still more expansionary than the Fed’s, have weakened the euro, thereby increasing medium-term inflationary pressure. However, there are signs of this situation normalising in the medium term if energy prices correct downwards – which we expect them to do – thus providing support to the euro.

Environment for financial markets favourable for now

Both in the US and the eurozone, a combination of economic recovery, a policy of fiscal stimulus (e.g. US infrastructure programme) and loose monetary policy is at play. This should ensure a healthy reflation of the financial system until well into next year. However, fiscal and monetary stimulus is waning, while inflation risk is growing. Despite that, equity and credit markets remain in a balanced “Goldilocks light” scenario. However, given high valuations, rising inflation and the fact that the system is more sensitive to rising interest rates, we only expect limited upside potential. Central banks are performing a difficult balancing act between sufficient stimulus and timely inflation control. As such, the possibility of future policy error or untimely adjustments cannot be ruled out. However, for now, the situation is under control worldwide.

Sharp rises in public debt, a booming economy, high potential for consumption, wage pressure and higher inflation will lead to potential upward pressure on long-term interest rates globally in the coming quarters. As such, we believe that sovereign bonds and cash offer relatively unattractive prospects in the year ahead. Also, due to its high dependence on exports, Europe will benefit to a greater extent from the global upturn. For that reason, the difference in long-term interest rates between Europe and the US is likely to diminish in the medium term. With a probability of more than 50%, a hike in the short-term key rate in the US is expected as soon as next year. In Europe, market expectations for a hike by the end of 2023 are rising, although the ECB has not come out with an official confirmation yet. These increases will help dampen inflation expectations, and thus also the rise in interest rates at the long end.

There is a dichotomy in the development of the US dollar at the moment. It is holding firm against the euro (and other European currencies) but is weaker against the Chinese yuan. We are thus seeing a pronounced weakness in the euro at present. One of the main reasons for this is likely to be the sharp rises in natural gas and crude oil prices, as mentioned above. Unlike the US, Europe has to pay for most of its energy imports in US dollars and Russian roubles. However, we expect the situation to return to normal in the medium term. In particular, a large US trade deficit points towards the likelihood of a lower US dollar, including against the euro. In very general terms, if the US dollar fell again, this would also help many emerging markets to keep their own monetary policy loose and not have to raise interest rates too much.

Chart: Retail sales in the US remain high and are shoring up the economy (year-on-year comparisons)



Source: Trading Economics/US Census Bureau

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