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Macroeconomic Update

This note updates the macro narrative based on information and data that have become available since our most recent Credit Conditions round. At this juncture, there is no material change to our GDP growth forecasts, although we will continue to monitor developments closely.

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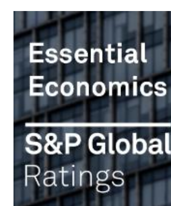

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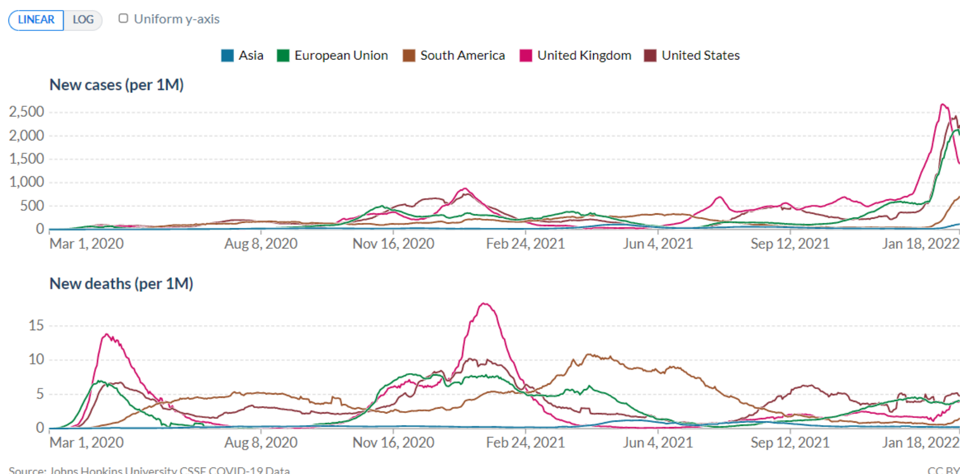
The Omicron variant of COVID-19 has spread quickly but its economic impact appears limited. The link from the virus to economic activity has been weakening throughout the pandemic as policymakers and economic agents adjust. Moreover, the Omicron variant is less lethal than earlier variants and appears to be shorter-lived. Cases are already declining in some areas.



The strong economic recovery continues apace, with some softening around the end of 2021. Global growth was picking up momentum in the last quarter of the year until Omicron struck. The most recent monthly indicators have softened, particularly in the services sector; however, manufacturing data remains strong. Our 2021 growth forecasts therefore remain broadly valid and given the short length of the Omicron wave our 2022 growth numbers appear valid as well.

COVID-19 induced output shocks have closed in the Big 3, although many EMs will see lasting damage. China regained its pre-COVID GDP level last year, but momentum is fading as the authorities struggle with property excesses and continue to adhere to a costly (in economic terms) zero-COVID policy. The US regained its pre-COVID GDP level in mid-2021 while most of Europe caught up in the fourth quarter. In contrast, many EMs remain below pre-COVID levels and will be on permanently lower output path post-COVID.

Labor markets are tighter, especially in the advanced economies. Unemployment in Europe and the US (and other advanced economies) is now near pre-pandemic rates. Importantly, Europe has re-started its labor market more smoothly and in a less inflationary way than the US, where labor market exits have been high. Across advanced markets the labor market recovery was aided by aggressive and (reasonably) well-targeted fiscal policy, a lesson learned from the global financial crisis. EM labor market developments have been mixed.

Inflation remains elevated with increasing evidence of demand-led pressures. The main macro development since the previous CCC round has been the persistence of inflation and the sharp shift in language from the US Federal Reserve. With US headline inflation at 7% (December) and the targeted PCE inflation at 5.7% (November) the Fed has concluded that policy accommodation should be withdrawn sooner than expected. We now expect net asset purchases by to end March 2022 and the Fed to raise rates by 25bps three times this year starting in May. Balance sheet normalization could start as early as in 2023.

Recent Fed actions will put pressure on other central banks to raise rates (further), mainly in EMs. This pressure will be asymmetric and will be largest in jurisdictions where US dollar debt is higher and where US dollar capital inflows are more sensitive to interest rate differentials. And vice versa. At the other end of the spectrum, demand driven inflation pressures in the Eurozone are largely absent (consumer spending is still weak) and inflation pressures remain less broad based than in the US and UK. As a result, the ECB remains on hold in 2022 and into 2023

Supply side driven inflation looks set to moderate this year. Oil prices, which rose sharply in 2021, should flatten out this year according to Platts, sharply reducing inflation from this source. Price rises related to supply chain disruptions appear to have peaked, based on data from Europe and LATAM. These pressures should continue to ease, albeit gradually, in 2022.

Looking ahead, we continue to see convergence to pre-pandemic GDP growth rates. 2021 was an exceptional year, with growth well above trend in most countries. But, as we have noted, levels matter as well given the shock of the pandemic; 2021 featured an accelerated return toward pre-COVID levels and paths. As those gaps are narrowed, growth should moderate toward trend. The ultimate sectoral composition of growth is unclear, but some changes now appear inevitable. Permanent changes include on-line versus in-person shopping, working from home versus in commercial real estate and the “greening” of behavior and production.

The risks to the baseline remain on the downside. On the pandemic front, our baseline assumes that the Omicron surge is short lived and that successive variants of the virus continue to be less virulent. On inflation front, the baseline assumption is that the oil market rebalances and geopolitical pressures ease. Both assumptions are subject to downside risk. With inflation remaining high, the risk of disorderly macro-credit reflation remains, but central banks (esp. the Fed) have largely converged to the market view of the need for more upfront policy action. Finally, the growth path for China remains cloudy in light of the crackdown on some private enterprises, the move toward self-sufficient, and the current, costly zero-COVID policy.

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