2022: TOWARDS THE BIG NORMALISATION

After last year's sudden, deep and a-typical recession, caused by the Covid-19 pandemic, this year has also been a-typical in several respects. Supply bottlenecks and supply disruption have been dominant themes throughout the year, acting as a headwind to growth, both directly but also indirectly, by causing a pick-up in inflation to levels not seen in decades. Under the assumption that the pandemic is gradually becoming less of an issue thanks to the vaccination levels, 2022 should see a normalisation in terms of growth, inflation and monetary policy.

In the advanced economies, we expect above potential growth in real GDP, with household spending underpinned by cheap financing conditions, a further improvement in the labour market and faster wage growth. Company investments should benefit from improved profitability, very attractive financing conditions, increased capacity utilization and a favourable demand outlook.

In the euro area, fiscal policy should also support growth with the Recovery and Resilience Facility playing a key role. Yet, growth should gradually slow down. The mechanical recovery in sectors that followed the lifting of the Covid-19-related restrictions, has run its course. Concern about the Omicron variant may lead to precautionary behaviour, weighing on certain household spending categories. Supply bottlenecks should continue to act as a drag on growth in the near term. In the US and the UK, fiscal policy may act as a headwind as well. Finally, in several countries, household surveys reflect a growing concern about elevated inflation, which is eroding real disposable income. This is particularly an issue for lower income households.

However, after surprising so much to the upside this year, inflation should decline in 2022. Base effects will play a role – the expected stabilization of oil prices should cause a decline in annual inflation in the course of the year – and supply bottlenecks should ease due to increased supply and somewhat slower demand growth. However, the underlying dynamics of inflation are upwards, with tight labour markets causing an acceleration of wage growth, which could push companies to increase their sales prices. In the US, companies are paying significantly higher wages to fill vacancies and, judging by labour shortages, wage growth should also accelerate in the euro area.

This implies that monetary policy will normalize as well, albeit with important differences in timing. In the US, the Federal Reserve has started to slow down the pace of monthly asset purchases. This tapering should be followed by several rate hikes, starting around the middle of next year, in order to cool down the economy and bring inflation back in line with the objective. This may end up leading to a more volatile market environment, considering that research shows that the federal funds rate is a key driver of the global financial cycle and investor risk appetite. In the euro area, monetary policy should remain very accommodative. The net purchases under the Pandemic Emergency Purchase Programme are expected to end in March 2022 but it will take more time for the conditions for hiking the policy rate to be met. We expect a first increase of the deposit rate in June 2023. The monetary divergence between the Fed and the ECB should cause a further strengthening of the dollar versus the euro.

More than ever, surprises could lead to an economic outcome that is different from what is currently expected. Potential upside surprises are the pandemic being brought fully under control and inflation declining more quickly than anticipated. The list of downside risks is longer: pandemic-related uncertainty could become endemic, supply disruption could continue, inflation could stay high for longer due to second round effects and concerns about rate hikes in the US could weigh on equity and corporate bond markets, thereby impacting confidence and the real economy.

UNITED STATES: CORE INFLATION

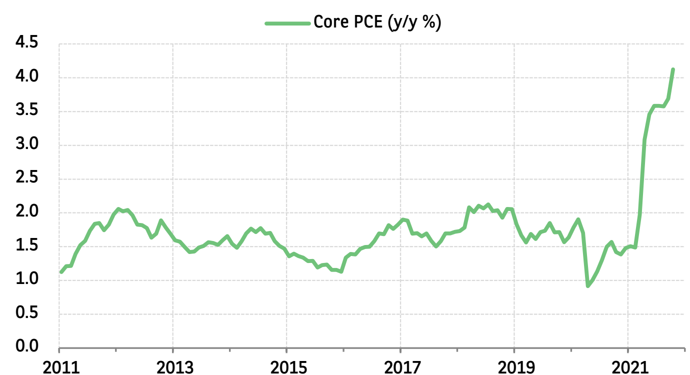

CHART 1 SOURCE: BEA, BNP PARIBAS

EUROZONE: CONSUMERS SURVEY

CHART 2 SOURCE: EUROPEAN COMMISSION SURVEYS, BNP PARIBAS

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