Quarterly Macro Report - 1st Quarter 2022

The Omicron variant was a reminder that the coronavirus will likely be on our minds for years to come - however, its economic impact is becoming smaller and smaller. The main question for 2022 is whether the overheating tendencies in the global economy will continue – or whether last year's recovery rally will be followed by a great void. For the time being, overheating seems to be the bigger risk.

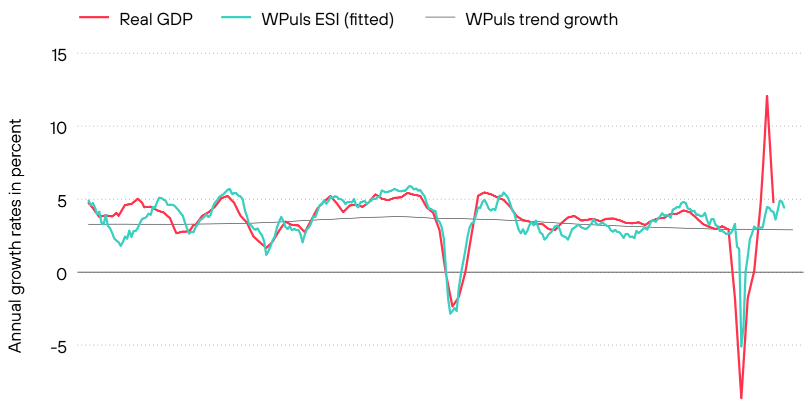
The appearance of the Omicron variant last November was a reminder that the coronavirus has not yet admitted defeat. However, thanks to the seasonality of the virus, it seems probable that the economic impact will be limited in time and scope.

The big question for 2022 is thus rather the following: Do we have to continue to expect high inflation rates, because the economy continues to overheat - bringing central banks under pressure to react more quickly than initially estimated and potentially causing significant headwinds for financial markets? Or will the combination of tighter monetary and fiscal policy, a normalization of consumer demand, and greatly expanded capacity provide for a hangover after last year`s catch-up party? Or will - that would be the ideal case - economic growth rates normalize gently, allowing central banks to adjust their support policies just as gently while financial markets will hardly be disturbed in their optimism?

For the time being, the leading indicators continue to point towards a positive development of the global economy. As a result, the current bottlenecks on the US labor market could tighten further. Already, wages are rising, which is reflected in the inflation rate. In December, US inflation accelerated to 7 percent, a level last reached at the end of the high-inflation phase of the 1970s. Rising wages and housing costs indicate that inflation will remain well above the central bank target of 2 percent in 2022.

Inflation risks do not only exist in the USA. In December, inflation in the euro zone also accelerated. With a rise in core inflation by 2.6 percent and service inflation by 2.7 percent, inflation pres-

Fig. 1: Omicron dampens economic outlook only in the short term



The Omicron variant is weighing on the economic growth in the short term. However, it should not greatly impact the economic outlook over the next 6 months. Growth rates should remain above trend, only limited by increasing bottlenecks in the labor markets.

Source: Refinitiv, WPuls

sures in Europe are increasingly broadly based and thus challenging the narrative of the alleged «temporary nature» of the price increases. Amongst the European member states, however, major differences persist: In Portugal, the overall inflation rate registered at 2.7 percent in December, while in Spain it was at 6.5 percent.

Federal Reserve acknowledges inflation risks
With inflation at 7 percent, the US central bank Federal Reserve has finally acknowledged reality and announced its intentions towards a more rigorous approach. Already before Christmas last year the Fed communicated a more rapid reduction to its bond-buying-program, thus ending it by the end of March. At the same time, the members of the decision-making body (FOMC) expect three interest rate increases of 0.25 percentage points each by the end of 2022. Considering the strong words spoken by Fed president Jay Powell regarding inflation risks, the exit plan remains surprisingly cautious overall. Current actions are thus strangely at odds with communications. Why is the Fed still buying bonds when the economy is in danger of overheating? And will three small interest rate steps by 2022 be enough to cool down an overheated economy? Probably not.

On its part, the European Central Bank (ECB) remains reluctant to acknowledge the inflation risks until now. However, given the increasing bottlenecks in the labor market also in Europe, higher wages could keep inflation high and force the ECB to act.

Current Fed actions are strangely at odds with communications.

More support from China`s authorities?
China`s economy has been battered by the pandemic, turbulences on the real estate market and an energy crisis. At the same time, the Chinese authorities have so far been reluctant to support the economy. Lending has remained modest. The energy crisis seems to have been overcome, but the zero-covid strategy and the deliberate cooling of the real estate sector are still weighing on the economy in 2022. The bright spot continues to be the high demand from abroad, driving exports to record highs.

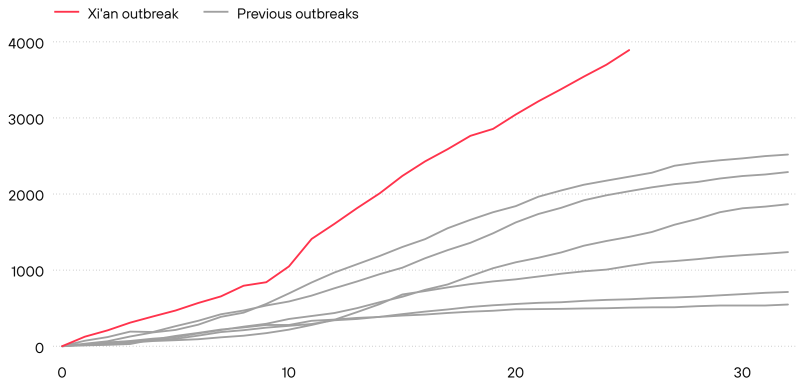
Table 1: Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M2
	Trend	2021*F*	2022*F*	2021*F*	2022*F*	Q4 2021	2021
USA	1.6	5.8	3.4	4.5	5.2	0.25	15.3
Eurozone	1.0	5.5	3.3	2.5	4.3	-0.50	10.0
UK	1.6	7.6	4.5	2.5	4.0	0.25	10.0
Switzerland	1.4	3.7	2.7	0.5	1.2	-0.75	4.7
Japan	1.0	1.7	2.1	0.0	0.7	-0.10	6.9
China	4.5	8.5	5.2	1.3	2.3	4.35	3.5
Brazil	1.1	5.1	1.3	7.9	7.5	9.25	-1.3
India	5.0	10.8	9.6	5.5	6.5	4.00	12.8
Russia	1.0	5.9	2.6	5.8	5.0	8.50	13.7
World	2.9	5.5	4.0	4.4	4.7	-	6.4

Source: Refinitiv, WPuls

Fig. 2: China with Covid deadlock

Cumulated positive cases since start of the outbreak

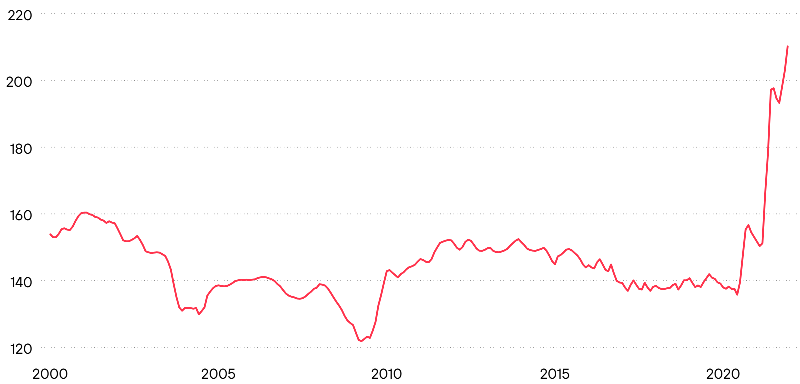


Source: Our World in Data, WPuls

Despite the lockdown of Xi'an, a city of 13 million people, the spread of the virus has not yet been stopped. According to the official narrative, the outbreak in Xi'an is still caused by the delta variant. The highly contagious Omicron variant is thus likely to pose even greater challenges. Some shift away from the zero-covid strategy after the Olympics is becoming more likely. Global inflationary pressures could rise further due to production bottlenecks.

Fig. 3: Prices of used cars in the USA skyrocket

Indexed price of used cars in the US

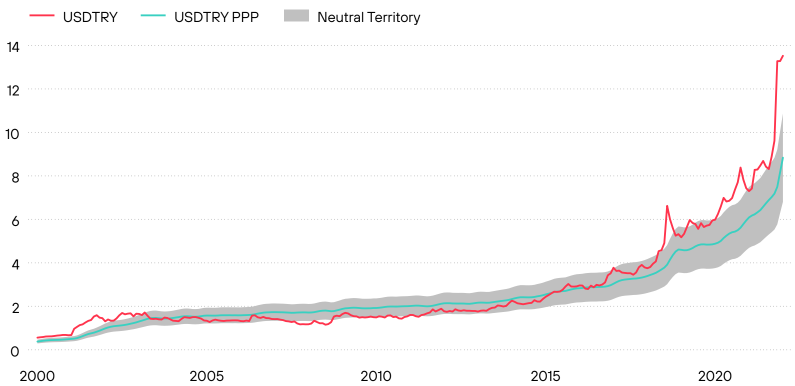


Source: Refinitiv, WPuls

US inflation rates reached 7 percent at the end of 2021. Among the drivers were used cars. The production of cars was especially hampered in 2021 by the shortage of semiconductors. At the same time, plenty of savings led American consumers to spend their money. As no repetition of the price increase can be expected in 2022, this part of the inflation pressure will decrease. However, higher wages and living costs will keep US inflation rates high.

Fig. 4: Turkish Lira in free fall

Exchange rate US-Dollar versus Turkish Lira, including Purchase Power Parity



Source: Refinitiv, WPuls

In the past year, the Turkish lira has lost almost 50 percent of its value. As a result, inflation broke through the 36 percent mark in December. Nevertheless, President Erdogan maintains his stance that high interest rates fuel inflation and thus must be avoided. This led to the resignation of the finance minister while the central bank bowed to Erdogan`s demands, lowering the key interest rate again to 14 percent. It also resumed its currency market interventions.

Foreign Exchange

While 2021 was marked by strong movements on the financial markets, currency markets – with exceptions such as the Turkish Lira – were surprisingly calm. Among the winners last year was the US dollar, increasing more than 5 percent against a basket of major currencies. However, also the Swiss franc has continued its nominal appreciation. Due to the persistently low inflation in Switzerland, the fair exchange rate has appreciated even further against most currencies. The Euro on the other hand has weakened over the course of 2021 both against the US dollar and the Swiss franc.

> The Brazilian central bank responded with seven interest rate hikes in 2021.

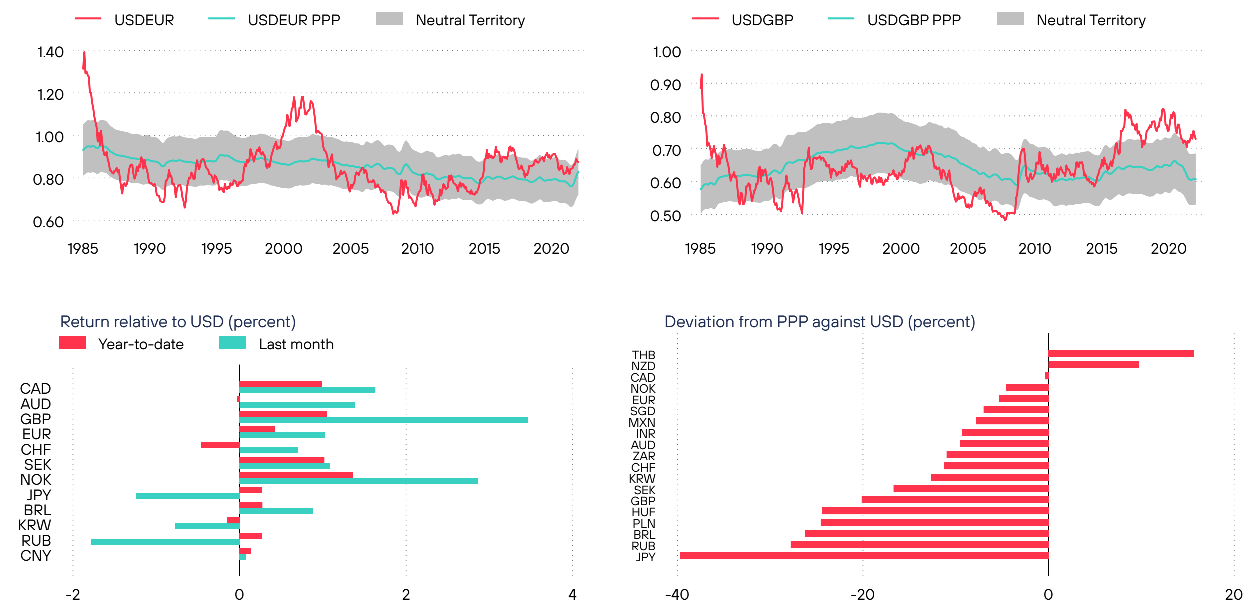
Brazil inflation taking off

Brazil`s economy remains on shaky ground. Most recently, poor weather conditions caused a sharp rise in energy prices, further fueling the already heightened price momentum. In 2021, inflation has almost tripled, registering double digits since September. The central bank responded with seven interest rate hikes in 2021 raising rates to 9.25 percent. This seems to have given support to the Brazilian Real, which experienced a significant devaluation in the first year of the pandemic. In 2021 however it stabilized around 5.5 against the US dollar, albeit with volatile swings.

Russian Ruble with difficulties

Despite high commodity prices, the Russian economy is still struggling. In the course of 2021, inflation has picked up significantly, approaching double digits. With unemployment at 4.3 percent – the lowest level since 2019 – the Russian central bank decided to have enough leeway to fight price pressures with yet another rate hike to 7.5 percent. In comparison, at the beginning of 2021, the key interest rate was still at 4.25 percent. Geopolitical dynamite is lurking on the Ukrainian border: Russia recently began to increase its military capacities in the border regions. This has exacerbated military tensions with the U.S., which has been supporting Ukraine`s territorial independence. The Russian Ruble has displayed a lot of volatility throughout 2021 but has not further lost value.

Fig. 5: FX performance and valuations



Source: Refinitiv, WPuls

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