PICTET WEALTH MANAGEMENT
ASSET ALLOCATION & MACRO RESEARCH
02 December 2021

# US: MACROECONOMIC SCENARIO 2022

## ENOUGH FUEL TO KEEP THE GROWTH ENGINE RUNNING, BUT AT A SLOWER PACE

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### SUMMARY


- In a nutshell, while extraordinary fiscal and monetary support is being gradually withdrawn in the US, we think there are enough accumulated private savings to keep fuelling consumption and corporate investment. The US economy will likely experience a soft landing after a solid rebound in 2021, with growth still above its long-term 'potential' rate of 1.9% next year.
- Our 2022 GDP growth forecast is 3.4%, down from 5.4% expected in 2021 (it was -3.4% in 2020).
- Among the upside risks is an accelerated running down of savings, potentially in tandem with a sharp boom in credit, and spending linked to the wealth effect created by the rising house and equity prices.
- The main downside risks include potentially more aggressive variants of the coronavirus. Unexpectedly large monetary tightening by the Fed is another risk. Also, current bottlenecks could hide some 'over-ordering' that risks being unwound suddenly when logjams ease. Geopolitics (and especially the still-tense US-China relationship) could also upend business confidence.
- Inflation is likely to stay high in the near term due to ongoing supply-chain bottlenecks, high commodity prices and robust consumer spending on goods, but we expect it to decline gradually. We still do not expect a 'wage-driven' inflation spiral *à la* 1970s, but this remains an upside risk. Year-on-year median wage growth of 5.5% would set off alarm bells: in October, the rate was 4.1%.
- Our average 2022 CPI inflation forecast is 3.9%, down from 4.6% expected in 2021. Our core PCE inflation (stripping out food and energy prices) forecast is 3.9%, up from 3.3% expected in 2021.
- Our US stylised business-cycle analysis concludes that we are entering the phase 3 out of 4 of a mini-cycle that started in Q2 2020. While we do not expect a sharp imminent slowdown in US growth, financial conditions will be key next year.


CHART 1: US MACROECONOMIC FORECASTS

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021F | 2022F | 2023F |
|---|---|---|---|---|---|---|---|---|---|
| GDP growth | 2.7 | 1.7 | 2.3 | 2.9 | 2.3 | -3.4 | 5.4 | 3.4 | 2.1 |
| Unemployment rate (end-period) | 5.3 | 4.9 | 4.3 | 3.9 | 3.7 | 6.7 | 4.8 | 3.7 | 3.5 |
| CPI inflation | 0.1 | 1.3 | 2.1 | 2.5 | 1.8 | 1.2 | 4.6 | 3.9 | 2.6 |
| Core PCE inflation | 1.3 | 1.6 | 1.6 | 2.0 | 1.6 | 1.4 | 3.3 | 3.9 | 2.5 |
| Fed funds rate (top rate), end-period | 0.50 | 0.75 | 1.50 | 2.50 | 1.75 | 0.25 | 0.25 | 0.875 | 1.375 |

*First hike June 2022*

Source: Pictet WM – AA&MR, Bloomberg

*Source: PWM - AA&MR, Bloomberg (2 December 2021)*



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## The US consumer has enough fuel in the tank

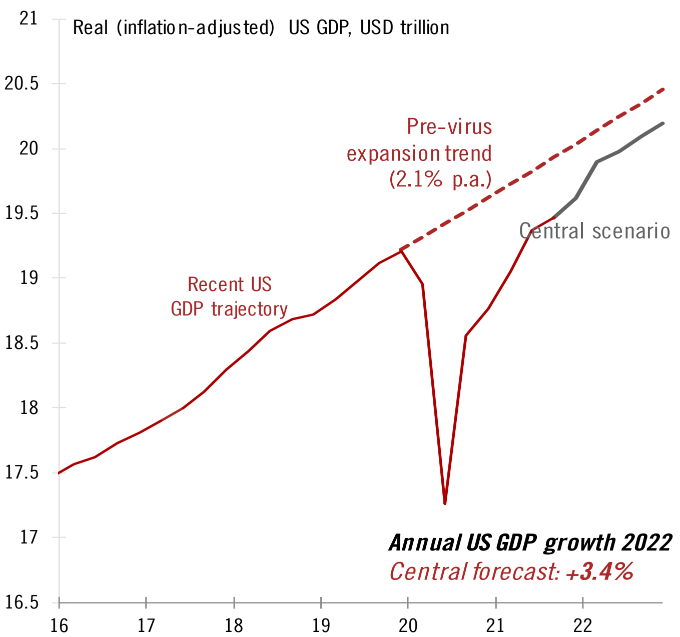
**The macroeconomic picture for2022 is more complicated than the one for 2021, as the monetary and as the fiscal and monetary floodgates begin to close**. On the fiscal side, the Biden administration's stance on budget deficits has evolved towards less profligacy, and more towards boosting the supply side of the economy rather than the demand side.

This means less support for households and more focus on long-term projects, particularly social/green projects). Extraordinary federal unemployment benefits ended in September 2021. And the last special cheques to help deal with the effects of the pandemic were sent to households in March 2021. Meanwhile, there is more discussion on funding fiscal packages through tax hikes rather than through increasing the budget deficit.

The latest USD 1 trillion physical infrastructure package (of which around USD500 bn is actually new spending) mostly relies on unused funds from pandemic-era programmes. President Biden's USD 1.75 trn 'Build Back Better' bill (also referred to as the 'Human Infrastructure' package) is currently stuck in Senate due to wrangling about which taxes to hike, and also because of fears it may continue to boost household demand excessively (thus fuelling inflation). We ultimately expect the bill to pass, but it will be a close call and there is a strong risk it will be diluted. 'Build Back Better is mostly to be paid for by higher taxes on multinational corporates and wealthy individuals.

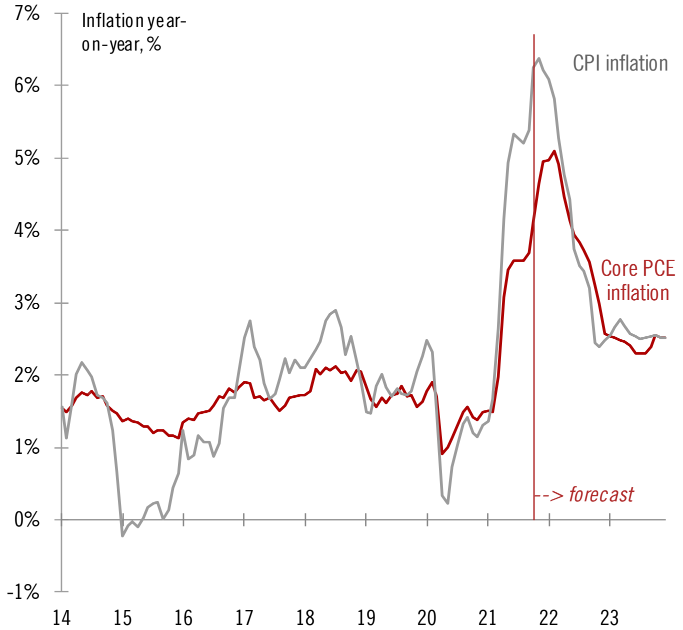
Bottom line: US **fiscal policy will no longer the stimulative force it was.**

CHART 2: OUR 2022 REAL GROWTH FORECAST IS +3.4%




Source: PWM - AA&MR, Bloomberg (2 December 2021)

CHART 3: OUR 2022 AVERAGE CORE PCE INFLATION FORECAST IS +3.9%




Source: PWM - AA&MR, Bloomberg (2 December 2021)

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On the monetary side, the Fed is set to wind down its monthly bond purchases in the first half of 2022 *(see below)*, while five rate hikes are likely from the current zero-lower bound until end-2023.

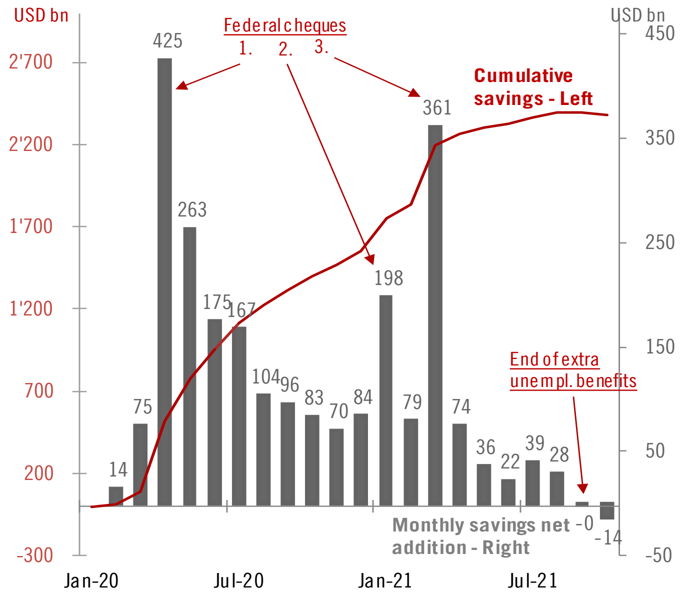
The good news is that **US households are still sitting on a high cushion of savings** which we estimate to be in the vicinity of USD2,500 bn. Data for October may indicate that consumers are starting to draw down their savings, a trend that could continue over the coming months.

At this stage, we would tend to ignore the recent erosion in consumer sentiment surveys, which likely echo the sharp rise in consumer prices but may not necessarily be a leading indicator of future spending. Depending on how the virus situation evolves *(see below)*, we continue to see a rotation in **spending from goods to services.**

Our 2022 GDP forecast of 3.4% is below current market consensus of 3.9%, but above the US economy's potential long-term growth trend, estimated at 1.9% (see our annual *Horizon* publication about long-term forecasts).

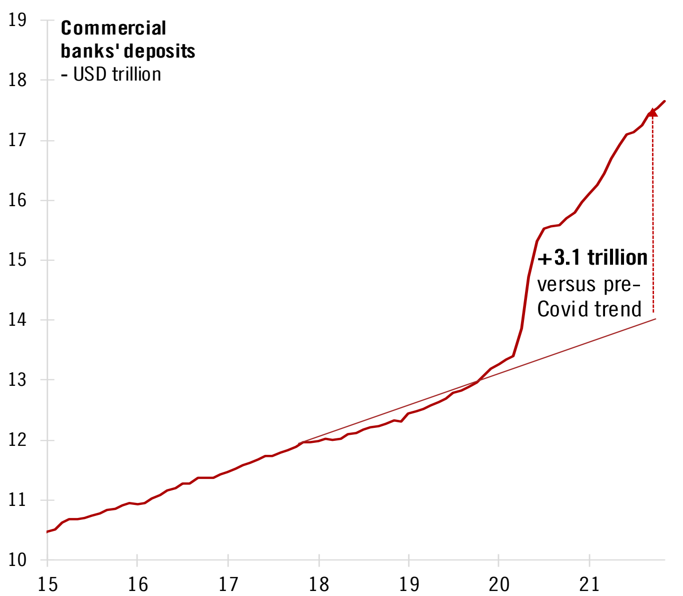
In our alternative, more positive scenario for the US economy, we could see consumers spending more of the windfall from rising home and equity prices.  A big pick-up in spending on travel and leisure sparked by the fading of coronavirus concerns could also feed into this positive alternative scenario.

CHART 4: HOUSEHOLD SAVINGS COULD BE (FINALLY!) DEPLOYED IN 2022




Source: PWM - AA&MR, Bloomberg (Dec. 2021)

CHART 5: BANK DEPOSITS HAVE SURGED SINCE THE COVID19 SHOCK




Source: PWM - AA&MR, Bloomberg (Dec. 2021)

We also have a negative scenario. Among the downside risks, one is that current supply-chain bottlenecks are masking 'over-ordering' by manufacturing companies (a risk also referred to as the **'bullwhip effect'**), with a chance that the inventory build-up goes into reverse when logjams ease. Separately, business sentiment could be affected by any deterioration in the complicated US-China relationship. President Biden has not overturned tariffs on Chinese imports inherited from the Trump administration, even though the two countries seem to have found common ground on things like tackling climate change.

While information was limited at time of writing, there are three main aspects of the Omicron virus variant that will need monitoring for their economic consequences: first, the authorities' appetite (likely declining) for restricting social and economic life; second, the health measures taken to deal with the variant (vaccination rates are already high but uneven in the US, and new treatments may come to market soon); and third, the potential budgetary reaction (Omicron may lead to some renewed loosening on the fiscal stance especially if a growth slowdown becomes an issue ahead of the **midterm elections in November 2022**).

Regarding inflation, we forecast core PCE inflation (which excludes food and energy prices, and which is a better reflection of 'demand push' inflation) averaging 3.9% in 2022, up from 3.3% in 2021. But we think price rises will slow in the second half of 2022 and in 2023, when we expect core PCE inflation will be 2.5%. Core inflation currently mostly reflects supply-chain bottlenecks (particularly visible in used car prices) but also the sharp rebound in demand in 2021, especially for physical goods. **Rents could remain firm**, supporting inflation throughout 2022, which is why our estimate of core PCE next year is above the current Bloomberg consensus of 3.0%.

**We do not think we are entering an inflation spiral *à la* 1970s**, with accelerating wage growth feeding into consumer prices. But the risk exists, especially given signs of tightness in the US labour market due to structural reasons such as mass retirement of baby boomers, but also the drop in immigration caused by the pandemic. We also wonder whether societal changes may be at play in the US labour market, including shifting attitude to work. One could also add the potential negative impact of the mass 'gamification' of financial markets (and crypto assets) by individual investors.

### US business cycle: We are probably in phase 3 out of 4 of the mini-cycle

From a cycle perspective, we believe the we are entering the second half of a four-stage mini cycle that started in March 2020. We do not expect an imminent recession, but financial conditions will determine how long this mini cycle endures

Among the main cycle-related indicators we watch, two indicators suggest underlying cycle vigour: the (positive) difference between gross domestic income and gross domestic product and the (positive) trend in macro data revisions, and especially employment data revisions. In addition, corporate profits are still very robust, especially as a share of US GDP. Nevertheless, high wage growth and increasing unit labour costs together with the erosion in the Conference Board's leading index indicate the cycle is now past its primes. This is corroborated by **evidence the ISM new orders sub index has started to slide** (its cycle peak was at 68.0 in March 2021).

### Federal Reserve: We expect modest tightening in 2022

Our Federal Reserve outlook will be discussed in a separate piece. In a nutshell, we expect **QE tapering to accelerate** as the Fed becomes increasingly worried about the **upside inflation risks**. This could clear the way for a 25bp rate hike at the June 2022 Fed policy meeting. We expect three rate hikes in total in 2022, and by December 2022 the fed

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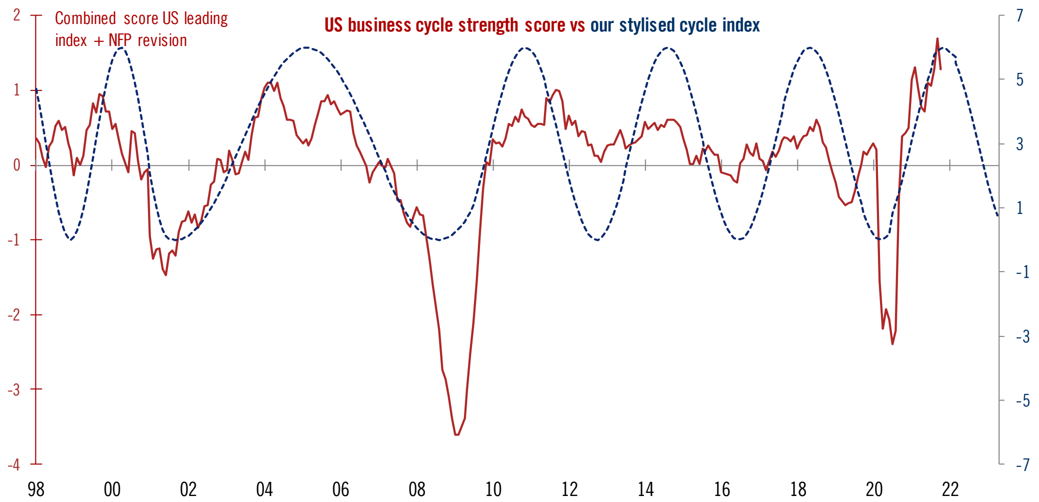
funds target rate could top 0.875%. This forecast compares with 2.5 rate hikes in 2022 being priced in by money market futures, as of 2 December 2021.

We expect two additional rate hikes in 2023 and then a long pause. The Fed will likely keep its base rates below the rate of inflation over the long run as it continues *implicitly* to try to prolong the business cycle amid high federal and private debt burdens.

CHART 6: OUR US BUSINESS CYCLE SCORE INDICATES WE ARE NOW ENTERING PHASE 3 OUT OF 4




*Source: PWM - AA&MR, Bloomberg (1 December 2021)*

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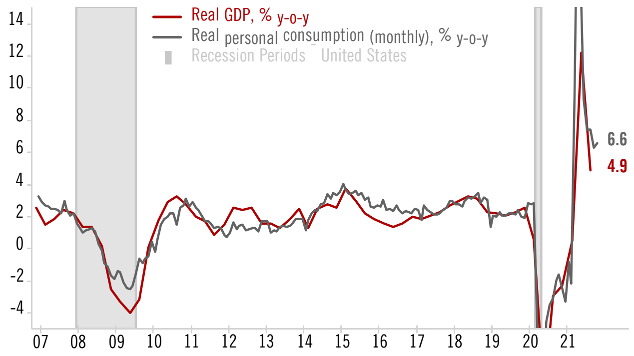
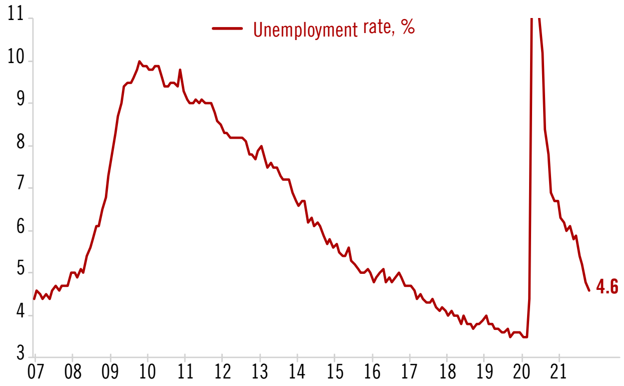
### REAL GDP AND PRIVATE CONSUMPTION GROWTH, % Y-O-Y



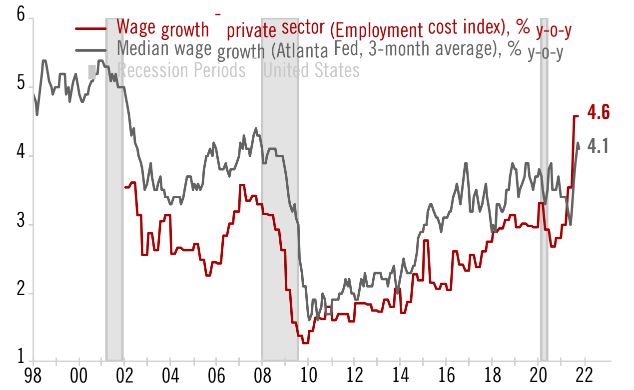

*Source: Pictet WM – AA&MR, Factset*

### UNEMPLOYMENT RATE, %



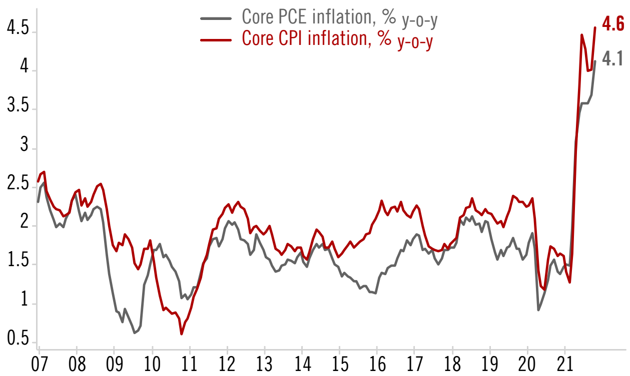

*Source: Pictet WM – AA&MR, Factset*

### WAGE GROWTH INDICATORS, % Y-O-Y



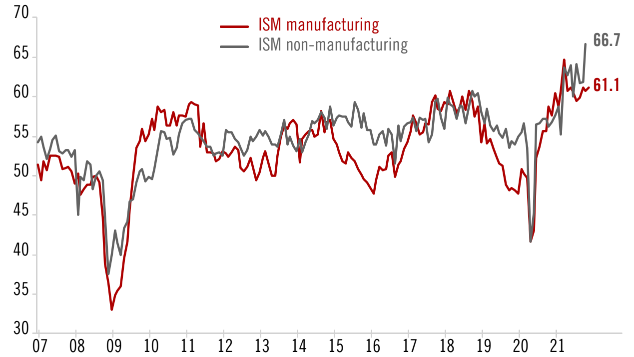

*Source: Pictet WM – AA&MR, Factset*

### CORE INFLATION (PCE AND CPI), % Y-O-Y



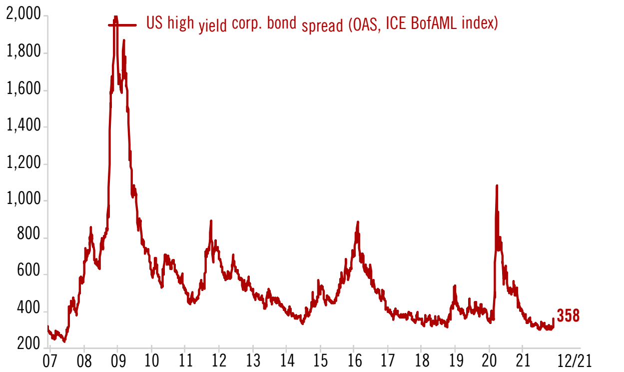

*Source: Pictet WM – AA&MR, Factset*

### ISM BUSINESS SURVEYS




*Source: Pictet WM – AA&MR, Factset*

### HIGH-YIELD CORPORATE BOND SPREAD, BASIS POINTS




*Source: Pictet WM – AA&MR, Factset (last close)*

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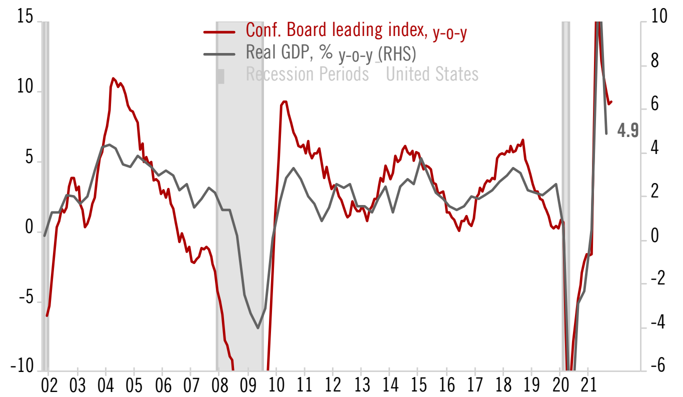
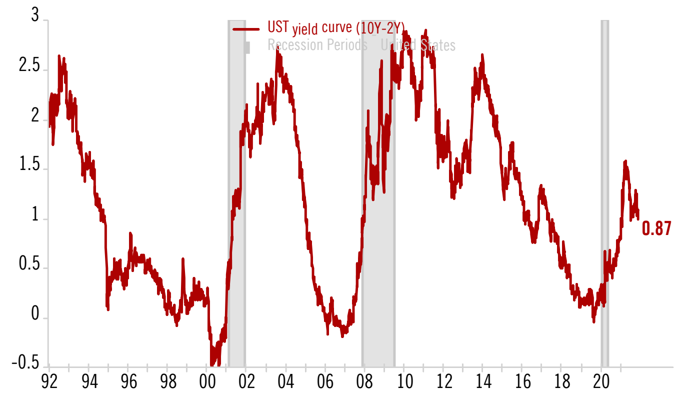
### CONF. BOARD LEADING INDEX, % Y-O-Y VS GDP GROWTH, % Y-O-Y



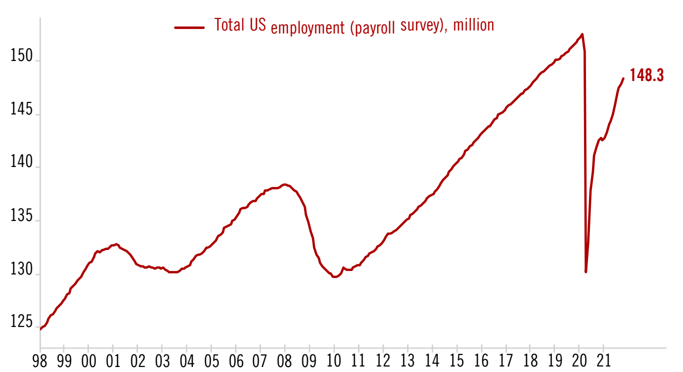

*Source: PWM - AA&MR, Factset*

### US YIELD CURVE SPREAD (10-YEAR YIELD MINUS 2-YEAR YIELD)



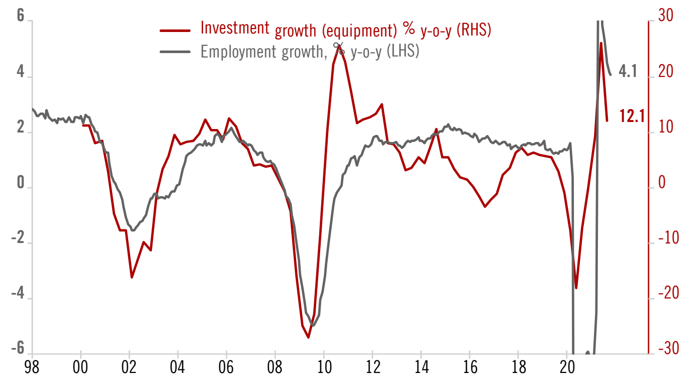

*Source: PWM - AA&MR, Factset (last close)*

### TOTAL US EMPLOYMENT




*Source: PWM - AA&MR, Factset*

### US INVESTMENT (EQUIPMENT) VS EMPLOYMENT GROWTH, % Y-O-Y

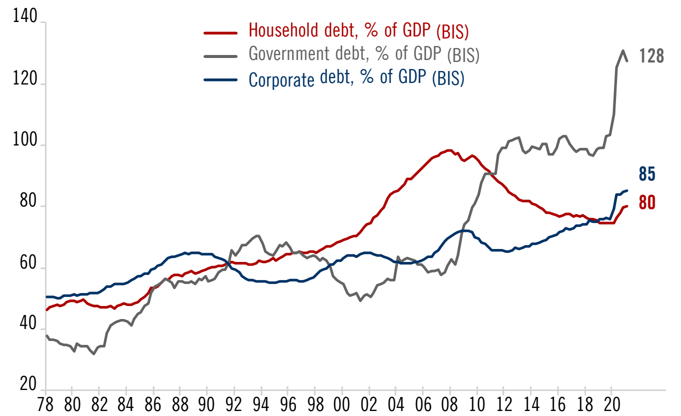



*Source: PWM - AA&MR, Factset*

### EXISTING HOME SALES, MILLION UNITS (ANNUALISED)


*Source: PWM - AA&MR, Factset*

### DEBT RATIOS (HOUSEHOLD, CORPORATE, GOVERNMENT), % OF GDP




*Source: PWM - AA&MR, Factset*

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