

US: MACROECONOMIC SCENARIO 2022

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

Author

THOMAS COSTERG
tcosterg@pictet.com

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 In a nutshell, while extraordinary fiscal and monetary support is being gradually withdrawn in the US, we think there are enough accumulated private savings to keep fuelling consumption and corporate investment.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)

US: MACROECONOMIC SCENARIO 2022

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

The US consumer has enough fuel in the tank

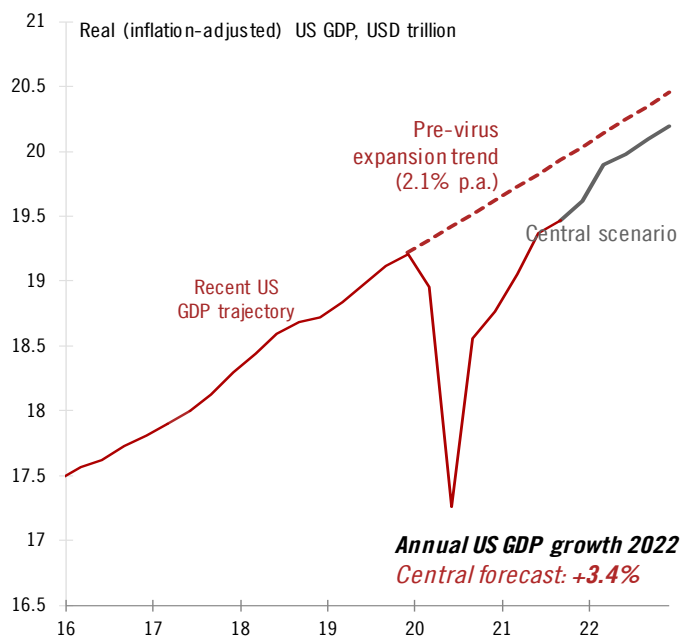
The macroeconomic picture for 2022 is more complicated than the one for 2021, as the monetary and as the fiscal and monetary floodgates begin to close. On the fiscal side, the Biden administration's stance on budget deficits has evolved towards less profligacy, and more towards boosting the supply side 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.

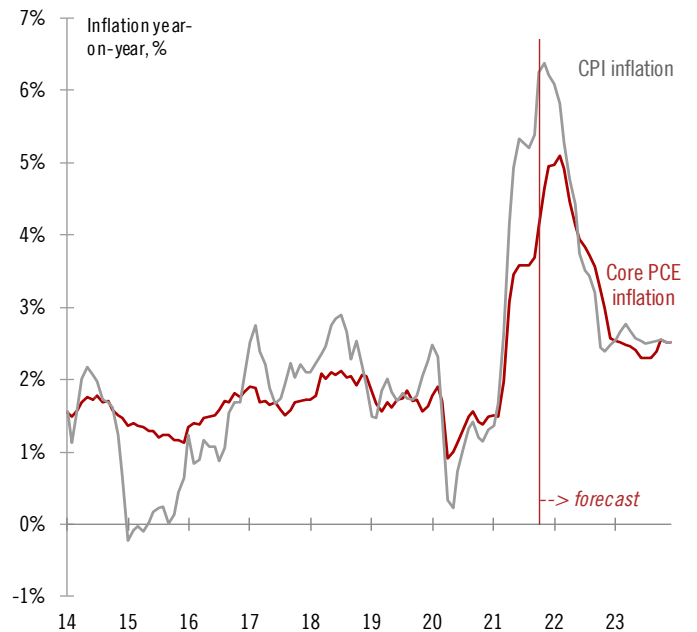
Bottom line: US fiscal policy will no longer be the stimulative force it was.

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)

US: MACROECONOMIC SCENARIO 2022

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

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.

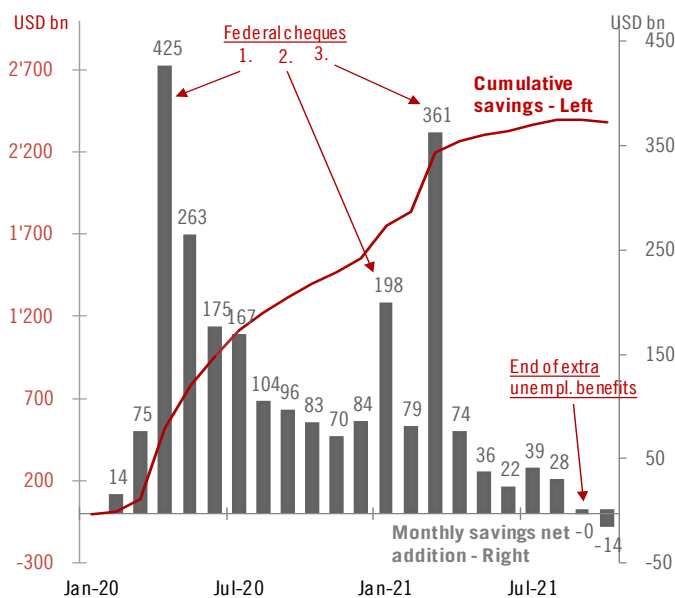
The good news is that **US households are still sitting on a high cushion of savings** which we estimate to be in the vicinity of USD2,500 bn. Data for October may indicate that consumers are starting to draw down their savings, a trend that could continue over the coming months.

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).

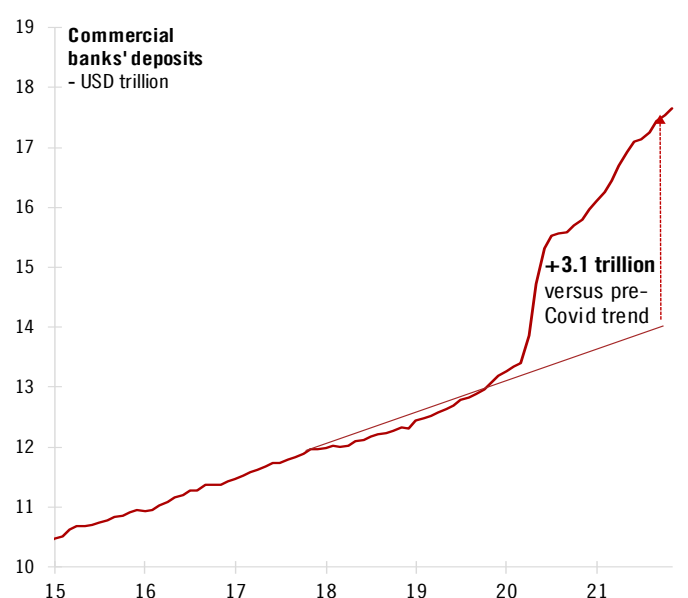
In our alternative, more positive scenario for the US economy, we could see consumers spending more of the windfall from rising home and equity prices. A big pick-up in spending on travel and leisure sparked by the fading of coronavirus concerns could also feed into this positive alternative scenario.

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

US: MACROECONOMIC SCENARIO 2022

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

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 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

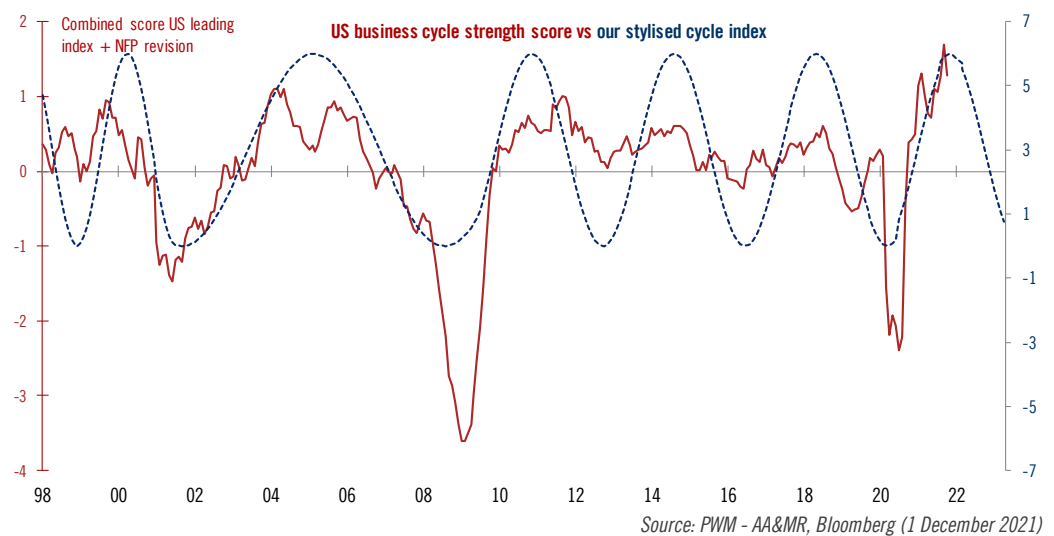
US: MACROECONOMIC SCENARIO 2022

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

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.

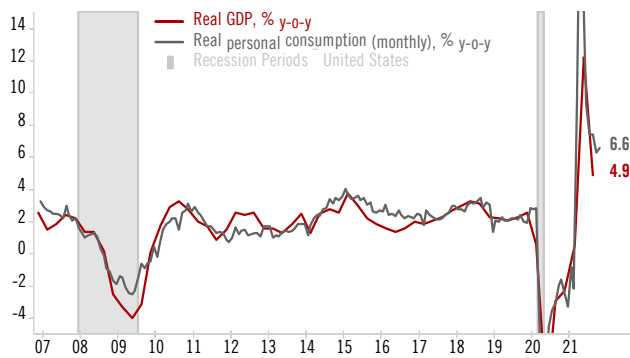
CHART 6: OUR US BUSINESS CYCLE SCORE INDICATES WE ARE NOW ENTERING PHASE 3 OUT OF 4



US: MACROECONOMIC SCENARIO 2022

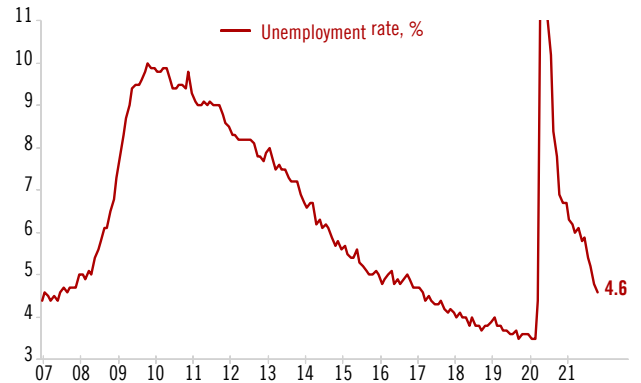
ENOUGH FUEL TO KEEP THE GROWTH ENGINE RUNNING, BUT AT A SLOWER PACE

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



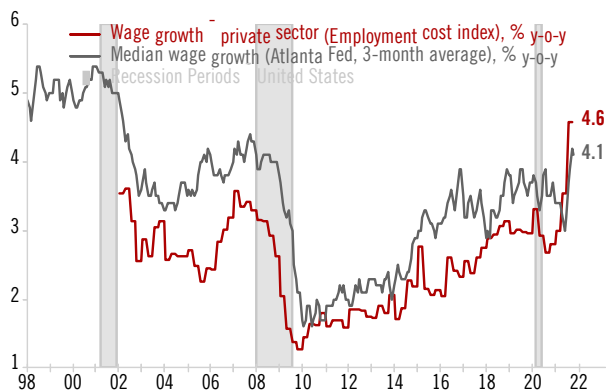
Source: Pictet WM – AA&MR, Factset

UNEMPLOYMENT RATE, %



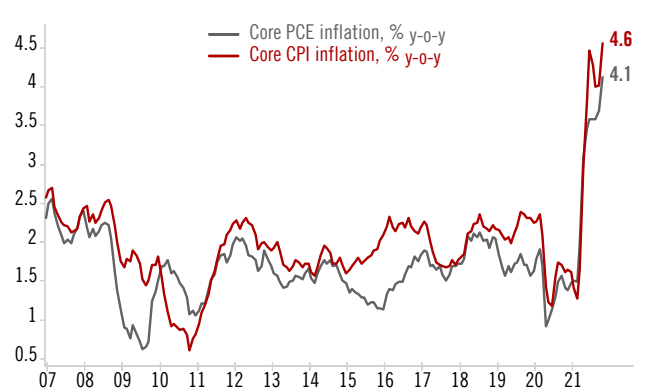
Source: Pictet WM – AA&MR, Factset

WAGE GROWTH INDICATORS, % Y-O-Y



Source: Pictet WM – AA&MR, Factset

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



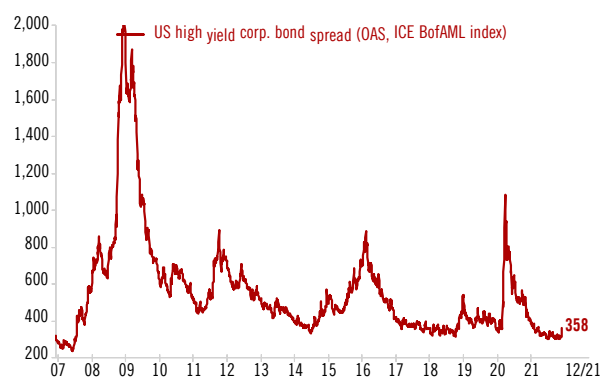
Source: Pictet WM – AA&MR, Factset

ISM BUSINESS SURVEYS



Source: Pictet WM – AA&MR, Factset

HIGH-YIELD CORPORATE BOND SPREAD, BASIS POINTS

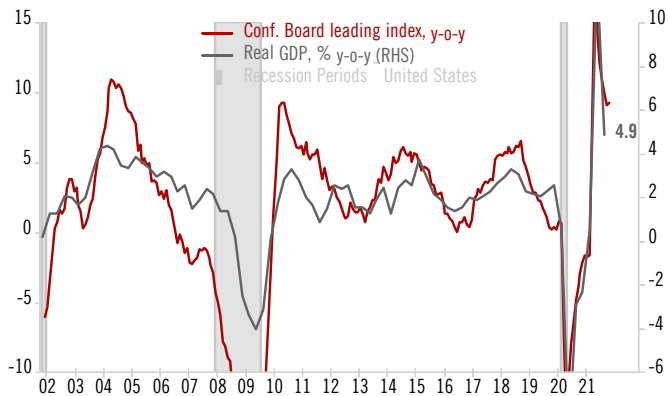


Source: Pictet WM – AA&MR, Factset (last close)

US: MACROECONOMIC SCENARIO 2022

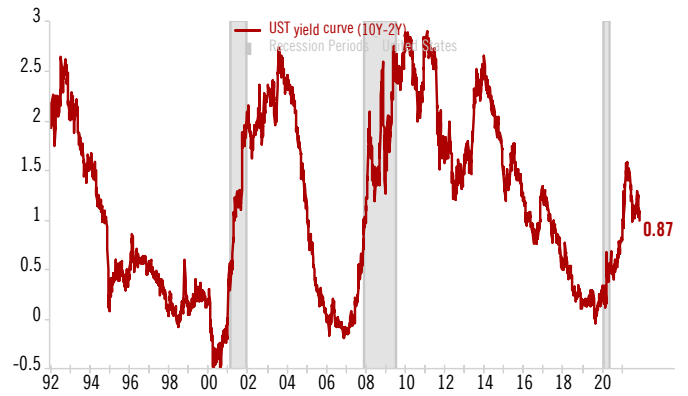
ENOUGH FUEL TO KEEP THE GROWTH ENGINE RUNNING, BUT AT A SLOWER PACE

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



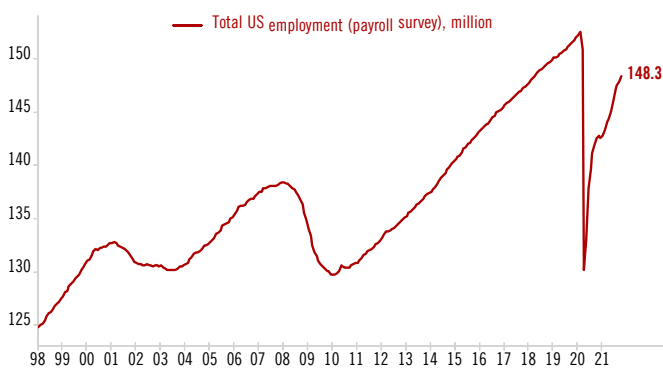
Source: PWM - AA&MR, Factset

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



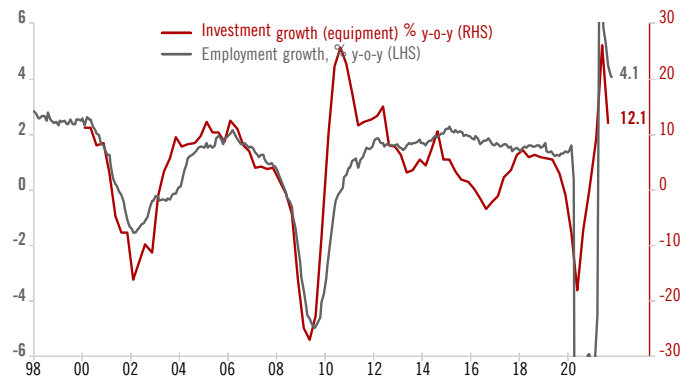
Source: PWM - AA&MR, Factset (last close)

TOTAL US EMPLOYMENT



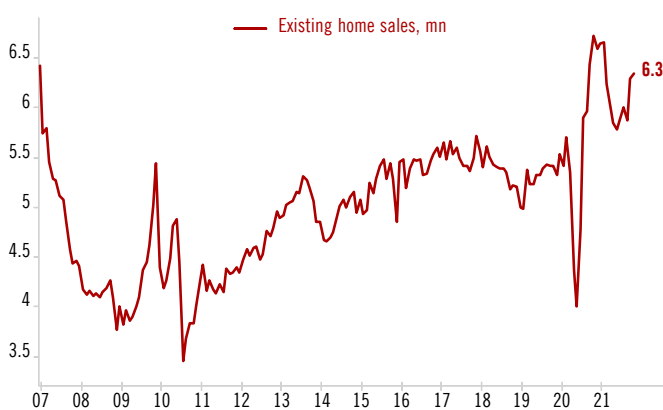
Source: PWM - AA&MR, Factset

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



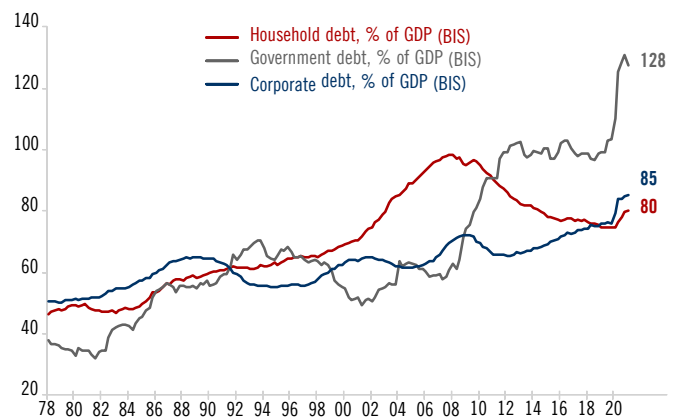
Source: PWM - AA&MR, Factset

EXISTING HOME SALES, MILLION UNITS (ANNUALISED)



Source: PWM - AA&MR, Factset

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



Source: PWM - AA&MR, Factset

DISCLAIMERS

Distributors: Banque Pictet & Cie SA, Route des Acacias 60, 1211 Geneva 73, Switzerland and Pictet & Cie (Europe) SA, 15A, avenue J. F. Kennedy, L-1855 Luxembourg/B.P. 687 L-2016 Luxembourg.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Pictet & Cie (Europe) SA is established in Luxembourg, authorized and regulated by the Luxembourg Financial Authority, Commission de Surveillance du Secteur Financier.

This marketing communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance. The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

This document is issued by Banque Pictet & Cie SA. This publication and its content may be cited provided that the source is indicated. All rights reserved. Copyright 2017.

Distributors: Bank Pictet & Cie (Asia) Ltd ("BPCAL") in Singapore and/or Banque Pictet & Cie SA, Hong Kong Branch ("Pictet HK Branch") in Hong Kong.

The information, tools and material presented in this document are provided for information purposes only and are not to be used or considered as an offer, an invitation to offer or solicitation to buy, sell or subscribe for any securities, commodities, derivatives, (in respect of Singapore only) futures, or other financial instruments (collectively referred to as "Investments") or to enter into any legal relations, nor as advice or recommendation with respect to any Investments. This document does not have regard to the specific investment objectives, financial situation and/or the particular needs of any recipient of this document. Investors should seek independent financial advice regarding the appropriateness of investing in any Investments or adopting any strategies discussed in this document, taking into account the specific investment objectives, financial situation or particular needs of the investor, before making a commitment to invest.

BPCAL/Pictet HK Branch has not taken any steps to ensure that the Investments referred to in this document are suitable for any particular investor and accepts no fiduciary duties to any investor in this regard, except as required by applicable laws and regulations. Furthermore, BPCAL/Pictet HK Branch makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment. Any investor interested in buying or making any Investment should conduct its own investigation and analysis of the Investment and consult with its own professional adviser(s) as to any Investment including the risks involved.

This document is not to be relied upon in substitution for the exercise of independent judgment. The value and income of any Investment mentioned in this document may fall as well rise. The market value may be affected by, amongst other things, changes in economic, financial, political factors, time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Furthermore, foreign currency rates of exchange may have a positive or adverse effect on the value, price or income of any Investment mentioned in this document. Accordingly, investors must be willing and able to assume all risks and may receive back less than originally invested.

Past performance should not be taken as an indication or guarantee of future performance and no representation or warranty, expressed or implied, is made by BPCAL/Pictet HK Branch regarding future performance.

This document does not constitute the investment policy of BPCAL/Pictet HK Branch, or an investment recommendation, and merely contains the different assumptions, views and analytical methods of the analysts who prepared them. Furthermore, the information, opinions and estimates expressed herein reflect a judgment at its original date of

publication and are subject to change without notice and without any obligation on BPCAL/Pictet HK Branch to update any of them. BPCAL/Pictet HK Branch may have issued or distributed other reports or documents that are inconsistent with, and reach different conclusions from, the information presented in this document.

While the information and opinions presented herein are from sources believed to be reliable, BPCAL/Pictet HK Branch is not able to, and do not make any representation or warranty as to its accuracy or completeness. Accordingly, BPCAL/Pictet HK Branch accepts no liability for loss arising from the use of or reliance on this document presented for information purposes only. BPCAL/Pictet HK Branch reserves the right to act upon or use any of the information in this document at any time, including before its publication herein.

BPCAL/Pictet HK Branch and its affiliates (or employees thereof) may or may not have long or short positions in, and buy or sell, or otherwise have interest in, any of the Investments mentioned herein, and may or may not have relationships with the issuers of or entities connected with Investments mentioned in this document. BPCAL/Pictet HK Branch and their affiliates (or employees thereof) may act inconsistently with the information and/or opinions presented in this document.

The information used to prepare this document and/or any part of such information, may have been provided or circulated to employees and/or one or more clients of BPCAL/Pictet HK Branch before this document was received by you and such information may have been acted upon by such recipients or by BPCAL/Pictet HK Branch.

This document is provided solely for the information of the intended recipient only and should not be reproduced, published, circulated, or disclosed in whole or in part to any other person without the prior written consent of BPCAL/Pictet HK Branch.

Singapore

This document is not directed to, or intended for distribution, publication to or use by, persons who are not accredited investors, expert investors or institutional investors as defined in section 4A of the Securities and Futures Act (Cap. 289 of Singapore) ("SFA") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject BPCAL and any of its affiliates or related corporations to any prospectus or registration requirements.

BPCAL is a wholesale bank regulated by the Monetary Authority of Singapore ("MAS") under the Banking Act Cap. 50 of Singapore, an exempt financial adviser under the Financial Advisers Act Cap. 110 of Singapore ("FAA") and an exempt capital markets licence holder under the SFA. Please contact BPCAL in Singapore in respect of any matters arising from, or in connection with this document.

Hong Kong

This document is not directed to, or intended for distribution, publication to or use by, persons who are not "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet HK Branch and any of its affiliates or related corporations to any prospectus or registration requirements. If you do not want Pictet HK Branch to use your personal information for marketing purposes, you can request Pictet HK Branch to stop doing so without incurring any charge to you.

In distributing investment products as agents for third party service providers, Pictet HK Branch is an agent of the third-party service provider, and the product is a product of the third-party service provider but not Pictet HK Branch. In respect of an eligible dispute (as defined in the Terms of Reference for the Financial Dispute Resolution Centre in relation to the Financial Dispute Resolution Scheme) arising between Pictet HK Branch and you out of the selling process or processing of the related transaction, Pictet HK Branch is required to enter into a Financial Dispute Resolution Scheme process with you; however any dispute over the contractual terms of the product should be resolved between directly the third party service provider and you.

Banque Pictet & Cie SA is a limited liability company incorporated Switzerland. It is an authorized institution within the meaning of the Banking Ordinance and a registered institution (CE No.: BMG891) under the SFO carrying on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities. The registered address of Pictet HK Branch is 9/F., Chater House, 8 Connaught Road Central, Hong Kong.

Warning: The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. Please contact Pictet HK Branch in Hong Kong in respect of any matters arising from, or in connection with this document.

Distributor: Pictet Bank & Trust Limited, where registered office is located at Building 1, Bayside Executive Park, West Bay Street & Blake Road, Nassau, New Providence, The Bahamas.

The document is not directed to, or intended for distribution or publication to or use by persons who are not Accredited Investors (as defined in the Securities Industry Regulations, 2012) and subject to the conditions set forth in the Securities Industry Regulations, 2012 or to any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet Bank & Trust Limited to any prospectus or registration requirements. Pictet Bank & Trust Limited is incorporated in The Bahamas with limited liability. It is a bank and trust company that is licensed in accordance with the Banks and Trust Companies' Regulation Act and is regulated by the Central Bank of The Bahamas. Additionally, Pictet Bank & Trust Limited is registered with the Securities Commission of The Bahamas as a Broker Dealer II and is approved to (i) Deal in Securities 1.(a) & (c); (ii) Arrange Deals in securities; (iii) Manage Securities; (iv) Advise on Securities.

Warning: The content of this document has not been reviewed by any regulatory authority in The Bahamas. You are, therefore, advised to exercise caution when processing the information contained herein. If you are in any doubt about any of the content of this document, you should obtain independent professional advice.