

Global Economy Watch

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Predictions for 2022: Reaping the benefits of a “high-pressure” economy

As we usher in the new year, our clients and the wider business community will be refreshing their business plans in the hope that the year ahead is less eventful than the last. To help provide some clarity, in this edition of the Global Economy Watch, PwC takes a look at what 2022 might have in store for the global economy.

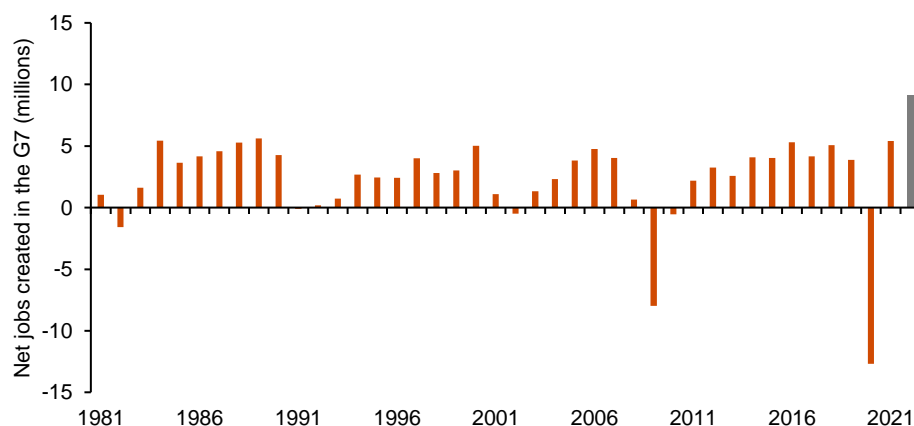
At risk of sounding like a broken record, we remind our readers that the new variant of COVID-19, Omicron, introduces a huge level of short-term uncertainty to our outlook. The predictions in this paper, as well as our gross domestic product (GDP) and inflation projections, are based on our assumption that Omicron’s economic impact will be limited and that the current set of booster vaccines, or indeed those that are likely to be introduced at the end of Quarter 1 / beginning of Quarter 2, provide adequate protection against serious illness. We should get more clarity on this in the next few weeks, and it is possible that this assumption does not hold. We therefore also outline the shape of a plausible downside scenario in the Box on the next page.

Here, we set out some key themes and predictions for 2022 in our base case scenario.

Chinese economy bigger than the European Union (EU): In our base case scenario, we expect the world economy to grow by around 4.5% next year in market exchange rates, which is significantly above the longer-term average real GDP growth. We expect that the US, China and EU will continue to remain the three largest economic blocks for years to come. There will, however, be some subtle changes within these economies. For example, we expect 2022 will be the first year where the output of the Chinese economy will overtake that of the European Union (EU) and will continue to persist in the medium-term. Focusing on emerging economies, IMF projections show India could become a US\$3 trillion economy, reaching a similar level as the combined output of the ASEAN-5 (Indonesia, Malaysia, the Philippines, Singapore and Thailand). The Sub-Saharan African economies are collectively poised to be a US\$2 trillion economy.¹

Almost 10 million jobs created in the G7: The Group of Seven (G7) are projected to continue to create jobs at a rapid pace—in our base scenario we estimate these economies could create at least nine million jobs which is the highest figure since at least the 1980s. To set the context, this would mean that a total of 14-15 million jobs will have been created in the G7 two years after extraordinary policy action, such as furlough schemes, was taken to run “high pressure” economies in response to the pandemic (see Figure 1). A closer look at our analysis shows that this picture will be somewhat disjointed as it is only the US and Canada that will have managed to exceed their pre-crisis employment levels. Despite this, we think that a ‘hot’ labour market will mean that employers will continue to experiment with newer, innovative ways to retain existing staff and attract newer ones—we dub this phenomenon as the rise of the ‘flexible employer’.

Fig 1: Projected net new jobs created in the G7 in 2022



Source: PwC analysis of IMF data. Last datapoint is an estimate for 2022.

¹ IMF, World Economic Outlook, October 2021

² Hutchins Center Fiscal Impact Measure, December 2021

³ International Energy Agency, Renewables 2021

Predictions for 2022

Rise of the 'flexible employer': A hot labour market means that workers will have more bargaining power. We don't necessarily expect this to translate into sustainably higher nominal wage growth (or indeed a wage-price spiral similar to that experienced in the UK in the 1970s). In fact, adjusting for the effects of the pandemic (compositional issues, distortions from government schemes and base effects) we have seen that the latest nominal wage growth data is more in keeping with historic levels, particularly in the Eurozone and the UK.

What we do expect though is employers to adapt to the high competition for workers experimenting with ways to attract and retain staff by making themselves stand out as 'flexible employers'. For example, we have begun to see employers offer four day working weeks, hybrid working arrangements, and better non-financial benefits. We expect to see more of these type of trends particularly in the services sector and the knowledge-based sectors.

Economies will enter a monetary policy tightening cycle: We expect tighter financial conditions as central banks in advanced economies hike their policy rates and cut back on their quantitative easing programmes. This process has already started in the US and the UK but effects of the Omicron variant might delay this by a few months. We expect that the Eurozone will continue its accommodative monetary stance as its core inflation rate, excluding changes in indirect taxes, is unlikely to breach its 2% target in 2022.

This won't spell trouble for most emerging markets. Unlike in 2013, most of the larger emerging economies (Brazil, South Africa etc) have been preparing for "lift off" in the US by raising their central bank rates. The exception to this is Turkey, which has decided not to follow the example of other emerging economies, leading to economic turmoil.

Shift from 'just in time' to 'just in case': We expect supply chain pressures to dissipate. We've already seen evidence of this happening in the last few months of 2021 and expect this to continue. By the second half of 2022, this trend will pull down headline inflation via relatively low durable prices. This could give central banks some breathing space to potentially delay future rate hikes particularly if their economies face additional headwinds (due to unexpected epidemiological changes, for example).

The case for developing 'strategic autonomy' in a variety of areas ranging from semi-conductors, to artificial intelligence and car battery manufacturing will continue to gather momentum, particularly in the EU which is an open large economy. This will help build resilience in corporates, even though it could have a short-term negative hit on profit margins. Our historic scenario analysis on reshoring some 'strategic' sectors of economic activity shows that this could be a US\$136 bn to US \$272 bn (in 2019 constant prices) opportunity for the G7 countries, but could lead to sub-optimal economic outcomes, particularly if the 'strategic' sectors draw up labour from other more productive sectors of the economy.

Reversal of roles between the US and EU in fiscal policy: In the US, for the first time since the beginning of the pandemic, the Hutchins Centre expects fiscal policy to drag economic growth by around 2 percentage points (pp) in 2022.² This drag could be larger if the Build Back Better programme is delayed or downsized.

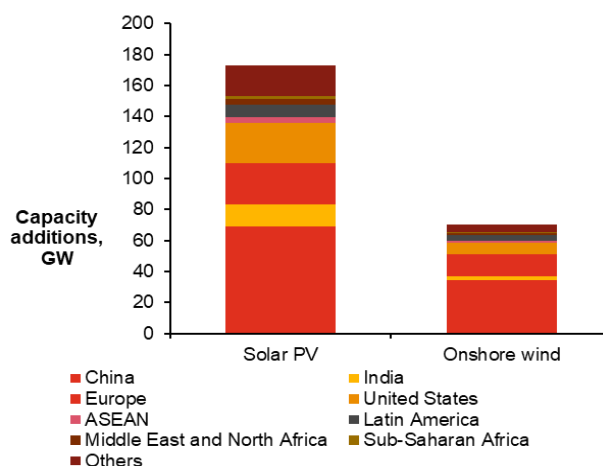
Meanwhile in the EU, which is governed by a set of fiscal rules, the story is different as fiscal policy is expected to add between 0.5pp to 1pp to economic growth in 2022. This reversal reflects the suspension of EU fiscal rules until probably 2023 which we expect will be revised to acknowledge the more activist role fiscal authorities will have to play to meet the bloc's legally binding target of net zero greenhouse gases by 2050.

A third of global electricity could come from renewable sources in 2022 as coal consumption continues to decline: 2022 is likely to be another record breaking year for renewable energy, as falling prices and global momentum from COP26 drive renewable sources to account for over 30% of total electricity generation globally.³

Capacity projections suggest new renewable capacity will increase by 295 gigawatts (GW), the biggest ever for the second year in a row.³ Solar and wind will account for most of this growth, particularly in the US and China. This will facilitate the clean energy transition, following new commitments made at COP26 to phase out coal and end international public support for unabated fossil fuel energy by end 2022.

We expect the discussion on renewables to start to shift to storage and transmission systems, which are a key component of making electricity grids more resilient.

Fig 2: Expected capacity additions by country, 2022



Source: International Energy Agency, PwC analysis

Commodity prices expected to remain steady but geopolitics could derail this: The rapid growth in energy prices, and natural gas in particular, in 2021 is expected to ease over the first half of 2022 based on future prices. However, this assumes no major geopolitical developments, which are a key driver of short-term prices of natural gas, particularly in Europe which has limited energy-related commodities.

Box 1: A plausible downside scenario for the global economy in 2022

Due to the short-term uncertainty the Omicron variant has introduced, here we outline a potential downside scenario for the global economy

Base case

Epidemiological assumptions

- Omicron becomes the dominant variant of COVID-19 in Q1 in most Northern Hemisphere economies. There is a significant spike recorded in the number of COVID cases with some strain on health systems.
- Booster vaccines are highly effective at preventing hospitalisation from Omicron. Emphasis on production and distribution of vaccines. Omicron specific vaccines ready by end of Q1 2022 / beginning of Q2 2022.
- Additional non-pharmaceutical measures put in place to stop the spread of the variant but these do not significantly impede economic activity.
- Omicron spreads further afield but does not cause widespread disruption.

Real GDP growth

- Some slowdown in economic activity in Q1 2022. However, this is clawed back by faster growth in the subsequent quarters of 2022.

Inflation

- Demand and supply mismatches gradually dissipate after Q2 2022, easing price pressure on goods prices.
- Oil and energy related commodity prices remain on average stable.
- Headline inflation rates in the G7 on a downward trend in the second half of 2022.

Downside scenario

- Omicron becomes the dominant variant of COVID-19 in Q1 in most Northern Hemisphere economies. There is a very high spike in the number of COVID cases recorded in Q1/Q2 2022 in a very short period of time, overwhelming health systems.
- Current vaccines do not provide adequate protection from Omicron. Omicron specific vaccines launched at the end of Q1 2022 / beginning Q2 2022 which provide adequate protection against hospitalisation from Omicron.
- A wider suite of non-pharmaceutical measures put in place to stop the spread of the variant some of which hinder activity in specific sectors (including in education, retail, hospitality and entertainment).
- Omicron spreads further afield and causes some disruption.

- Significant slowdown or potential contraction in economic activity for some Northern hemisphere economies in Q1 2022.
- In this scenario, we expect global GDP growth to be reduced by approximately 50 basis points compared to the base case.

- Demand and supply mismatches continue even after Q2 2022, putting upward pressure on goods prices.
- However, energy prices are under less pressure due to less demand and more stringent rules which impeded economic activity.
- Headline inflation rates higher compared to the base case scenario as supply-chain shortage price effect dominates the decrease in energy prices.

Projections: January 2022

	Share of 2020 world GDP		Real GDP growth (%)					Consumer Price Inflation (%)				
	PPP	MER	2020	2021e	2022p	2023p	2024-2027p	2020	2021e	2022p	2023p	2024-2027p
Global (Market Exchange Rate ("MER"))		100.0%	-3.1	5.9	4.5	3.1	2.6	1.8	3.2	3.1	2.5	2.3
Global (Purchasing Power Parity ("PPP") rate)	100.0%		-3.0	6.2	4.7	3.4	3.1	2.5	3.7	3.6	3.0	2.6
G7	31.1%	45.5%	-4.8	5.2	4.2	2.1	1.4	0.8	3.0	3.0	2.1	2.0
E7	36.9%	27.4%	-0.2	7.6	5.2	4.7	4.6	3.4	3.4	3.4	3.2	2.7
United States	15.8%	24.6%	-3.4	5.9	4.4	2.3	1.7	1.2	4.2	3.9	2.6	2.5
China	18.3%	17.5%	2.3	8.2	5.5	5.2	5.1	2.4	1.1	2.0	2.2	2.0
Japan	4.0%	5.9%	-4.6	2.2	2.8	1.2	0.6	0.0	-0.3	0.6	0.7	0.9
United Kingdom	2.2%	3.2%	-9.8	6.8	5.0	2.0	1.5	0.9	2.3	3.4	2.2	2.0
Eurozone	10.3%	13.1%	-6.5	5.1	4.4	2.2	1.4	0.3	2.3	2.0	1.5	1.6
France	2.3%	3.1%	-8.0	6.4	3.9	1.9	1.4	0.5	1.9	1.9	1.3	1.3
Germany	3.4%	4.5%	-4.6	2.9	4.4	2.0	1.2	0.4	3.0	2.1	1.8	1.8
Greece	0.2%	0.2%	-8.2	7.1	4.3	2.7	1.5	-1.3	0.3	1.2	1.3	1.8
Ireland	0.4%	0.5%	5.9	13.7	4.0	3.9	2.9	-0.5	2.0	2.3	1.8	2.0
Italy	1.9%	2.2%	-8.9	6.0	4.2	2.1	1.0	-0.1	1.7	2.0	1.4	1.3
Netherlands	0.8%	1.1%	-3.8	4.1	3.3	2.0	1.7	1.1	2.2	2.3	1.8	1.9
Spain	1.4%	1.5%	-10.8	5.7	6.3	3.2	1.7	-0.3	2.5	2.1	1.4	1.7
Poland	1.0%	0.7%	-2.7	5.2	5.0	3.4	3.0	3.4	4.7	4.5	3.1	3.0
Russia	3.1%	1.7%	-3.0	3.9	3.0	1.7	1.7	3.4	8.3	4.9	4.5	4.0
Turkey	1.9%	0.8%	1.8	9.1	3.2	3.6	4.0	12.3	19.4	22.5	17.2	8.5
Australia	1.0%	1.6%	-2.4	3.8	3.8	2.8	2.6	0.9	2.5	2.3	2.2	2.4
India	6.8%	3.1%	-7.3	9.5	8.1	6.0	6.2	6.2	5.6	5.0	4.3	4.0
Indonesia	2.5%	1.2%	-2.1	3.4	5.3	5.7	5.4	2.0	1.8	2.9	3.1	3.0
South Korea	1.8%	1.9%	-0.9	4.1	3.1	2.7	2.8	0.5	2.2	1.8	1.6	1.9
Brazil	2.4%	1.7%	-4.1	5.0	1.6	2.0	2.1	3.2	9.9	5.2	3.5	3.2
Canada	1.4%	1.9%	-5.3	5.3	4.3	2.7	1.5	0.7	3.2	3.0	2.0	2.1
Mexico	1.8%	1.3%	-8.3	6.0	3.4	2.4	2.0	3.4	6.1	3.9	3.1	3.0
South Africa	0.6%	0.4%	-6.4	4.9	2.3	1.5	1.3	3.3	4.3	4.5	4.5	4.5
Nigeria	0.8%	0.5%	-1.8	2.6	2.8	2.6	2.5	13.2	16.8	13.2	11.8	11.6
Saudi Arabia	1.2%	0.8%	-4.1	2.6	5.1	2.8	3.0	3.4	3.1	2.2	2.0	2.0

e: Estimate, p: Projection

Sources: PwC UK and global analysis, national statistical authorities, EIKON from Refinitiv, IMF, Consensus Economics and the OECD.

Our projections are a weighted average of projections from the OECD, IMF and Consensus Economics. They also incorporate inputs from select teams across the PwC network. 'MER' refers to market exchange rates and 'PPP' is purchasing power parity. All inflation projections refer to the Consumer Price Index (CPI) unless otherwise stated. The table above form our main scenario projections and are therefore subject to considerable uncertainties. PwC recommends that our clients look at a range of alternative scenarios particularly for economies where there may be a high degree of volatility and uncertainty.

Interest rate outlook of major economies

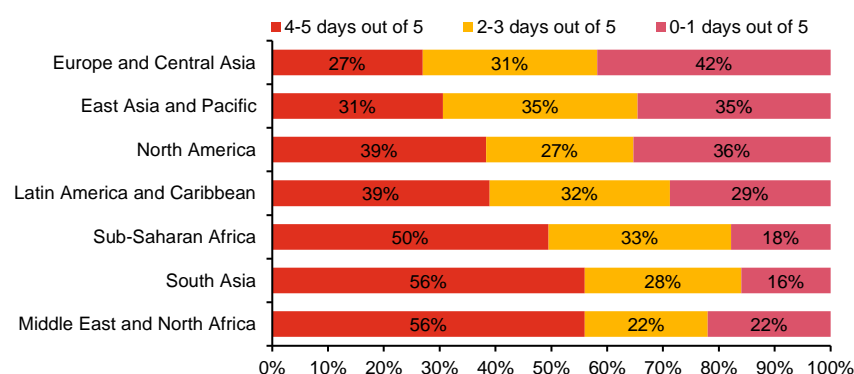
	Current rate (Last change)	PwC Expectation	Next meeting
US Federal Reserve	0.00-0.25% (March 2020)	Gradual increase in rates over 2022	January 25-26
European Central Bank	0.00% (September 2019)	No increase for foreseeable future	February 2
Bank of England	0.25% (December 2021)	Gradual increase in rates over 2022	February 3

Chart of the month

The chart shows the average number of days that workers across the world want to work from home once the pandemic is over and all restrictions have been lifted. On average, a third of people around the world want to work 2-3 days out of five with hybrid working arrangements.

This survey evidence demonstrates that while few workers want to give up the flexibility they have gained over the pandemic, the preferred number of days can vary considerably across countries. In particular, we see a higher preference for less working from home reported in higher income countries.

Figure 3: How many days per week would you prefer working from home once the pandemic is over and all restrictions have been lifted?



Sources: Ipsos, World Economic Forum, PwC analysis based on averaging of unweighted results
Note: Percentages may not sum to 100% due to rounding

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