

COMMENTARY



**Global
Macroeconomic
Outlook**

2022



Marakon
Management Consulting at
Charles River Associates

BRIEFING CONTEXT

In this Briefing

- Global macroeconomic outlook in light of recent financial, scientific, geopolitical and economic developments
- Key risks to monitor that could destabilise the global recovery
- Deep dive on UK economy and expected trajectory and challenges

Why it is Important?

What does this mean for you and your company—what is the emerging new normal and how can you get front-footed to take advantage?

Forward-looking executives are closely monitoring the macroeconomic environment to:

- Rebase internal financial forecasts to get more accurate estimates
- Reassess output and product portfolio to optimize for supply constraints and customer demands
- Build capabilities to address inflation, supply chain snags and labour force dynamics
- Rethink financial framework, rebalancing trade-offs between growth, returns and risk
- Recalculate cost of capital and implications for economic profit and valuation

KEY MESSAGES

Global recovery is expected to continue in 2022, although at a slower pace; some challenges will exert a drag...

An overheated economy, with inflation's extent and duration dependent on four factors...

1. The extent to which bottlenecks in supply chains begin to ease
2. Pace of labour market loosening as absent workers return
3. Severity of Central Banks' responses
4. Household spending power and its impact on consumer demand

As COVID-19 continues to present new variants, the pandemic is far from over...

The threat of renewed disruption from a new strain remains ever-present, especially as the benefits of vaccination are unequally distributed

Other challenges will also need to be carefully monitored...

- Weakened state of public finances and implications for taxation
- Balancing the energy transition with its immediate economic impact and climate change
- Ongoing geopolitical uncertainty and impact on global economics, energy prices and refugee situation
- Lingering structural issues with the Chinese economy and implications for the global economy

Volatility and downward pressure in the capital markets following 2 years of dramatic US outperformance...

- Indices enter correction territory in the first month of 2022 with investors weighing on inflationary threat and increasingly assertive Central Banks
- Crypto remains an unknown quantity, with some central banks pushing forward on their own Digital Currencies

In this global context, the UK's strong vaccination track record has underpinned its recovery, but challenges remain

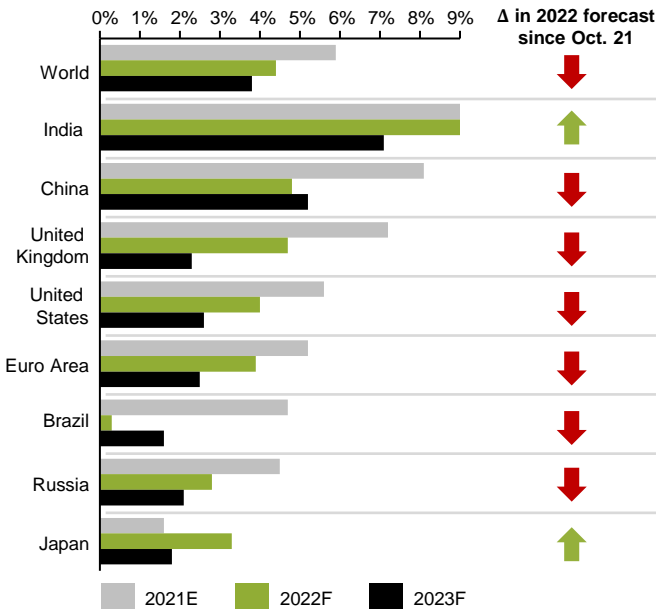
- Labour markets have remained stable but at a significant cost to the government
- Amidst rising inflation and increasing taxes, the UK faces a cost-of-living crisis that may dent its recovery
- Although out of focus, Brexit will continue to exert a long-term drag on the UK economy

GLOBAL GROWTH EXPECTED TO MODERATE...

Advanced and vaccinated economies expected to surge ahead, but at a slower pace than 2021 as they converge to pre-pandemic trends. Meanwhile, developing economies face a longer, slower recovery

Global recovery continues but at a slower pace

Real GDP growth
% YoY, Jan 2022 IMF Forecast

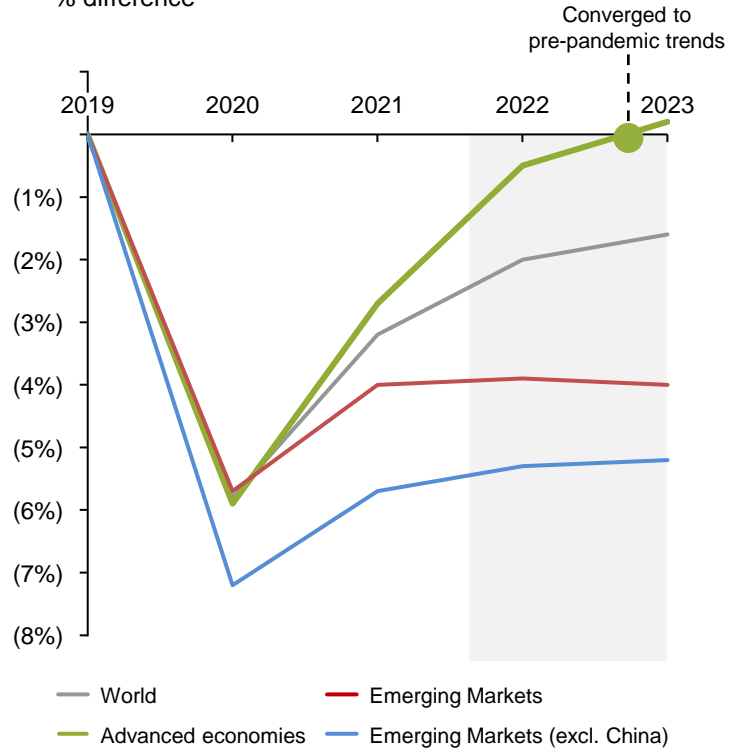


Sources: IMF, World Bank

...as inequality between countries widens

Deviation of output from pre-pandemic trends

% difference

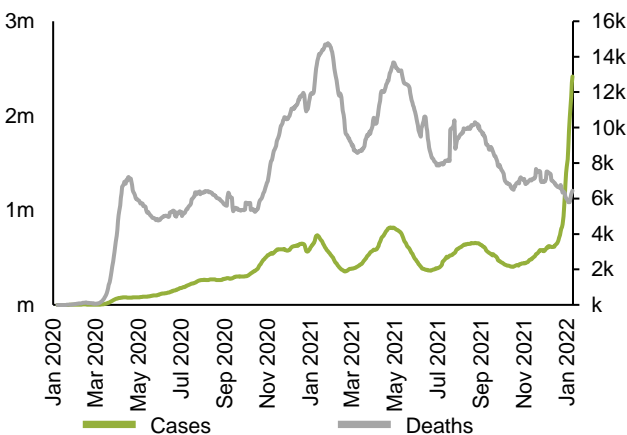


...WITH COVID-19, AS AN ONGOING BUT DIMINISHED THREAT

The pandemic is far from over, though vaccines and improved treatments in the developed world have facilitated some degree of normalcy, however, a new variant could severely derail recoveries

Vaccines weakened link from cases to deaths

COVID-19 new cases vs. deaths
7-day moving avg.

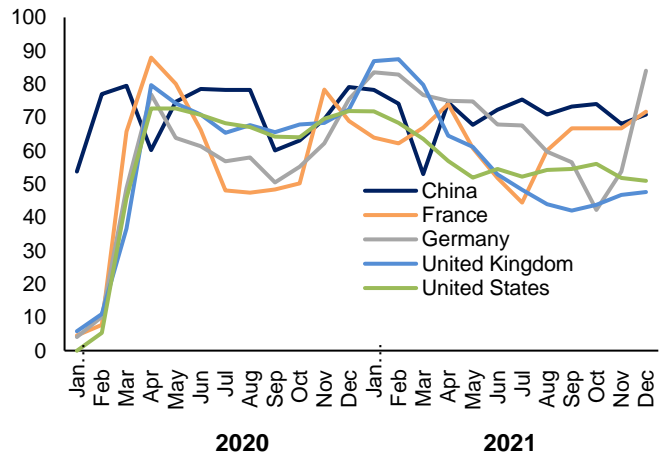


Sources: WHO, Oxford Blavatnik School of Government

...allowing countries to take different approaches

Government restrictions

Oxford Stringency Index (0-100), monthly avg.



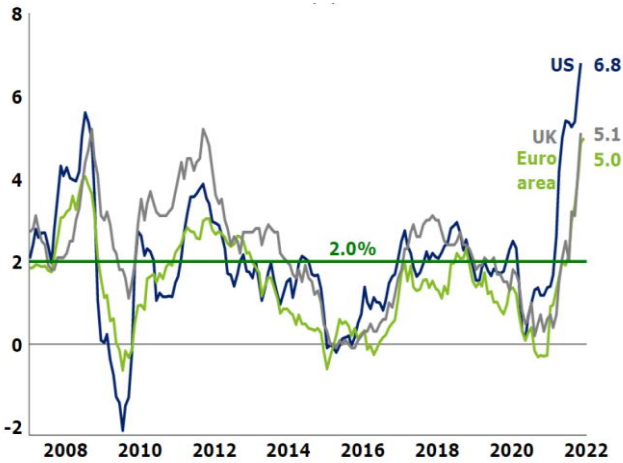
INFLATION HAS RETURNED, WITH BREVITY DETERMINED BY...

The mismatch between rampant spending and snarled up supply chains has led to a surge in prices of goods globally but so far this has not materially shifted medium-term expectations

Inflation has surged to record highs globally

Consumer price inflation

% YoY

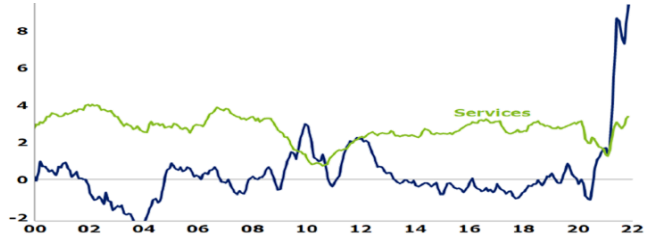


Sources: Refinitiv DataStream, Deloitte

...but has been broadly confined to goods

US inflation: goods vs. services

% YoY



...and medium-term expectations are stable

Inflation expectations

5Y-5Y forward rates, %



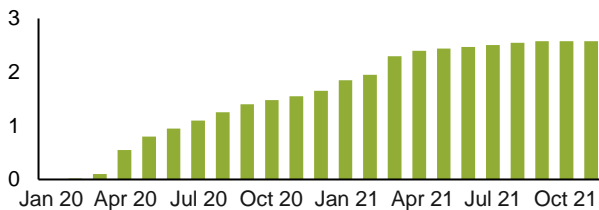
...ROBUST BUT SLOWING CONSUMER DEMAND...

Strong consumer balance sheets driven by rising savings ratios and fiscal stimulus increased demand for goods, however, distribution is highly unequal and demand will moderate with end of income support

Built-up household wealth will support demand...

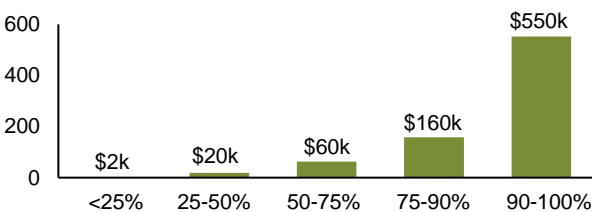
US households' cumulative excess savings

US\$ tn



Estimated increase in US median wealth by percentile

US\$ k, 2019 – 2021 Q2

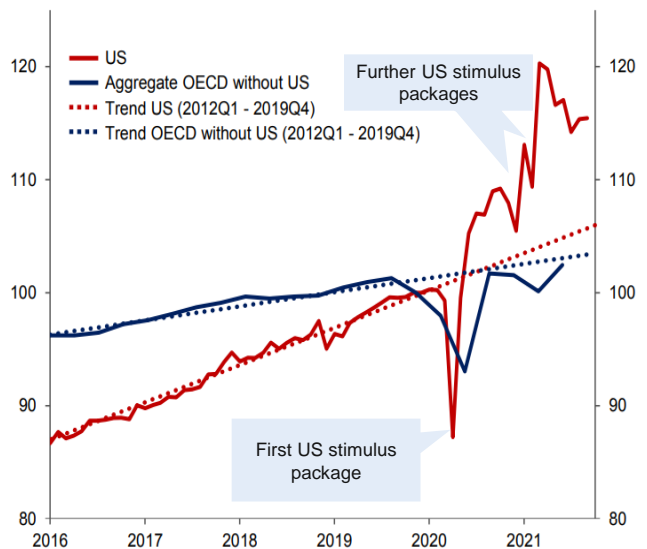


Sources: BEA, Moody's, Goldman Sachs, FT

...but an adjustment is likely when fiscal support ends

Real goods expenditure

Index, 2019 Q4 = 100



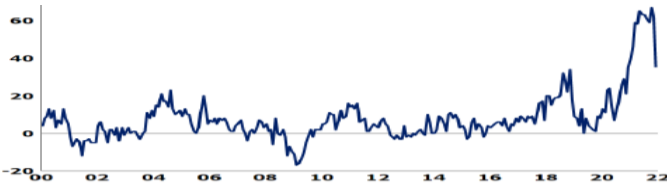
...UNSNARLING SUPPLY CHAINS...

Persistent supply bottlenecks have acted as a major drag on the global recovery and created the conditions for soaring inflation but there are early signs that the worst may have passed

Diminishing risk of COVID-driven shocks globally

US manufacturing vendor lead time

Richmond Fed manufacturing business survey



Risk of new Covid-driven shocks from Asia to global goods supply

Red = high; orange = moderate; green = low

	2020				2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
China	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red
Japan	Red	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green
Australia	Red	Red	Red	Red	Red	Red	Red	Red	Yellow	Yellow	Yellow	Green
Singapore	Red	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green
Philippines	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red	Yellow	Yellow
Malaysia	Red	Red	Red	Red	Red	Red	Red	Red	Yellow	Green	Green	Green
Thailand	Red	Red	Red	Red	Red	Red	Red	Red	Yellow	Yellow	Green	Green
South Korea	Red	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green
Taiwan	Red	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green

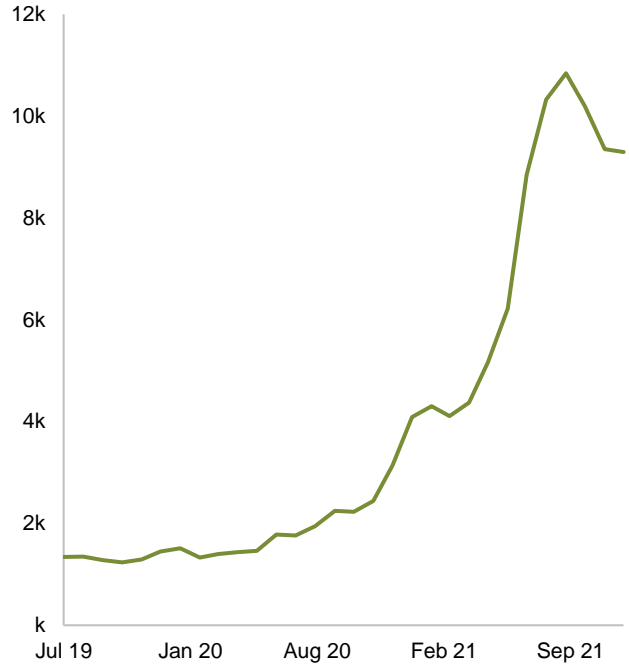
Impact of increased vaccination rates and relaxation of government policies reducing threats to supply chains from plant and port shutdowns

Sources: Goldman Sachs, Freightos, Richmond Fed, Deloitte

...and shipping costs may have peaked

Global container freight rate index

Freight rate in US\$



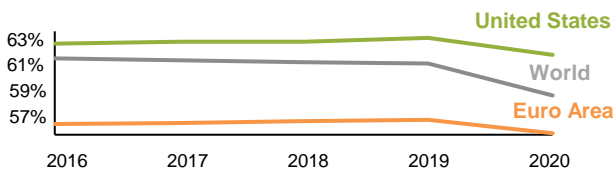
...LABOUR MARKETS LOOSENING...

COVID-19 and governments' fiscal responses have caused major distortions in the global labour force, creating artificially tight markets despite significant slack. Labour force reentry is likely to ease this.

The young and low-skilled have left labour markets

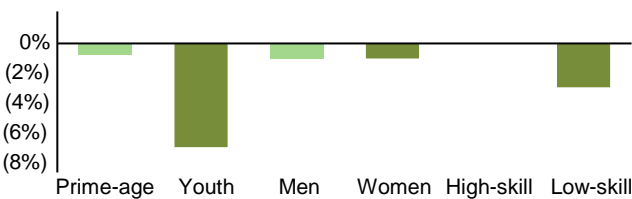
Labour force participation rate

% of total population aged 15+, modelled ILO est.



Change in labor force participation rate, advanced economies

Average % Δ from 2019 Q4 – 2021 Q1



Sources: World Bank, IMF

...but reasons to believe that some will return

Transitory factors

- Reduced fiscal stimulus increasing incentives for individuals to return
- Reduced COVID-19 health risks encouraging return to work
- Policy focus returns to payroll participation from preventing unemployment
- Reduced excess household savings increasing urgency for new income

Structural changes

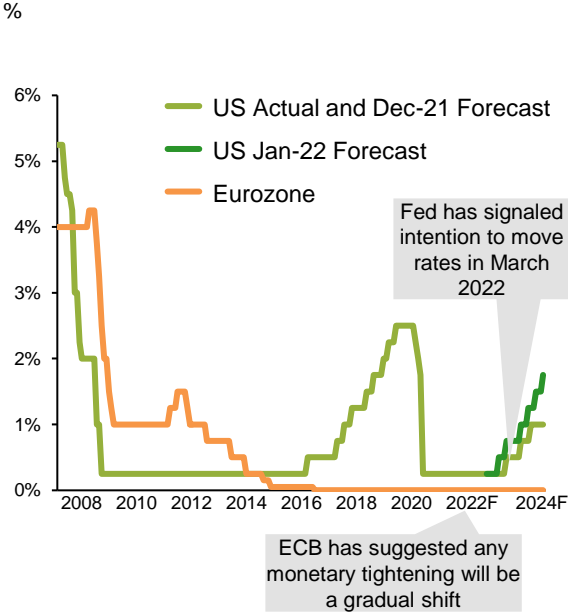
- Automation creating structurally lower demand for low-skilled workers
- Shifting mindsets as employees demand more from their jobs – working conditions and personal fulfillment
- Demographic changes with increasing share of population aged 65 and older
- Increasing educational attainment delays younger members of the labor force starting careers

...AND THE RESPONSE OF CENTRAL BANKS.

The Fed has signaled its intent to move rates by March with balance sheet reduction to follow, but as recent events demonstrate, Central Banks face difficult trade-offs around contributing to market turmoil

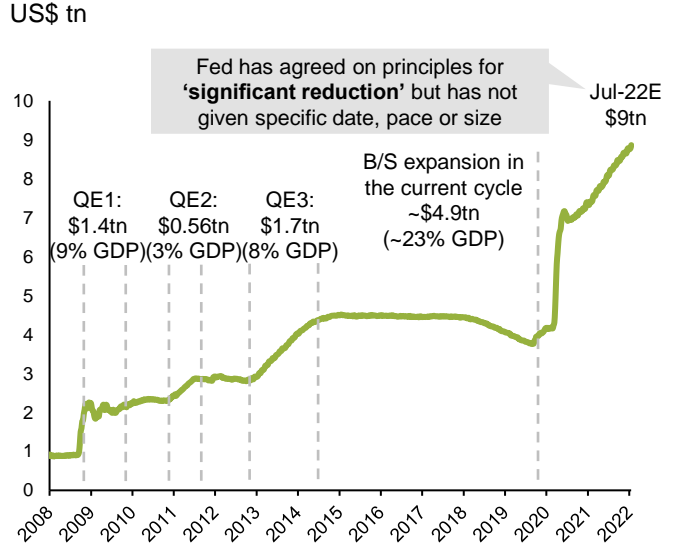
Rates set to rise, despite questions over extent

Policy interest rates



...uncertainty remains over balance sheet unwind

Federal Reserve balance sheet



Sources: Fitch Ratings, Federal Reserve, Bloomberg

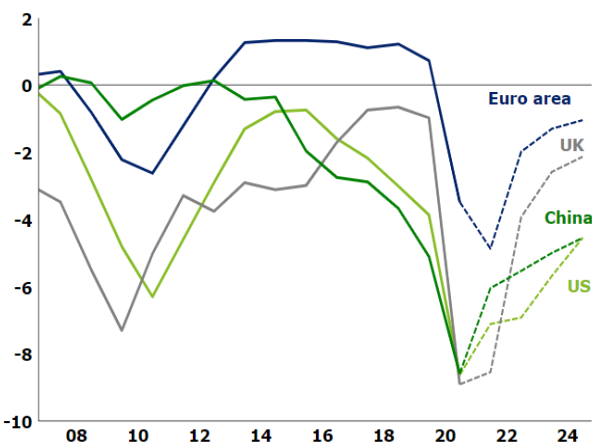
GLOBAL DEBT BURDEN REMAINS A PRESSING CONCERN...

The surge in global debt amplifies global vulnerabilities to changes in financing conditions and creates a difficult balancing act for governments concerned about rising inflation and fragile recoveries

Governments have spent big over the pandemic

Fiscal balances

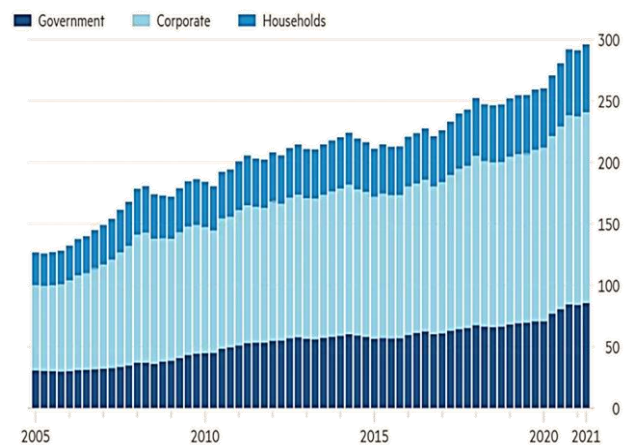
Cyclically adjusted primary balance (% potential GDP)



...contributing to a massive global debt pile

Global debt, by sector

US\$ tn



Sources: IMF, Institute of International Finance, Refinitiv DataStream, Deloitte, FT

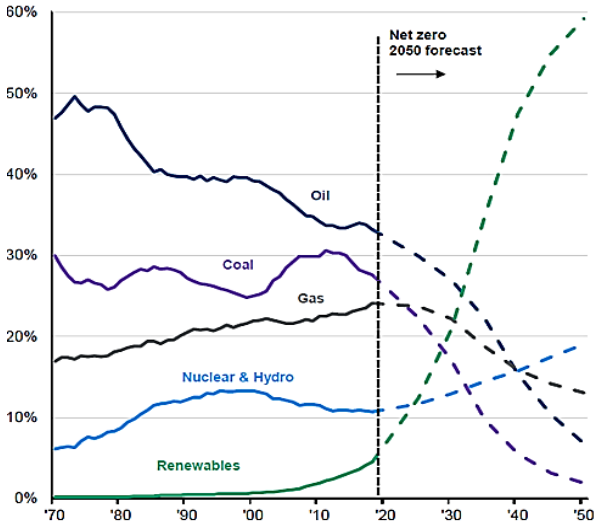
...WHILE THE ENERGY TRANSITION NEEDS TO PRESS ON

The energy transition is slowly gathering pace but continued political wrangling at COP27 and the costs of transition may create uncertainty despite the economic impacts of failure coming into focus

The changes required are radical

Global energy mix

% of primary energy consumption



Sources: JPMorgan Asset Management, ABN AMRO, BP Energy Outlook 2020

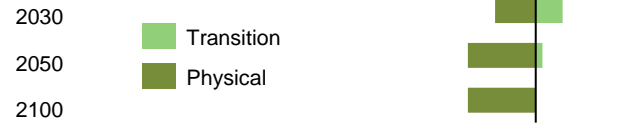
...and expected costs of inaction are substantial

GDP impact relative to trend

% change in GDP

Scenario 1: Net Zero 2050

(14%) (12%) (10%) (8%) (6%) (4%) (2%) 0% +2%



Scenario 2: Delayed Transition



Scenario 3: Current Course and Speed



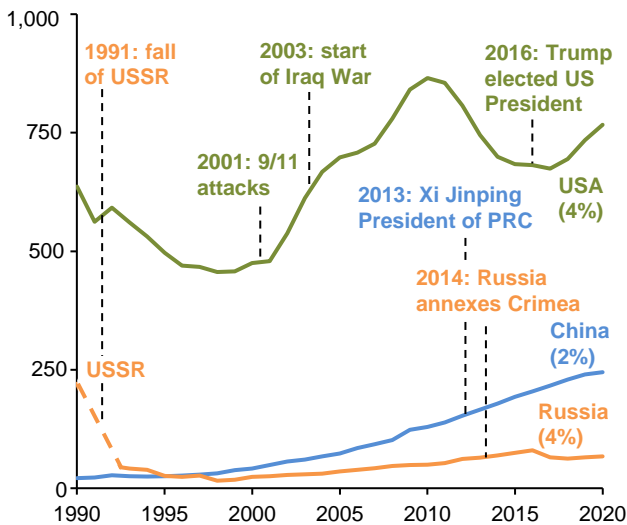
GEOPOLITICS COULD KNOCK RECOVERY OFF COURSE...

Worsening Sino-American relations and Russian threats to Ukraine could contribute to continued geopolitical turbulence with significant implications for investor and consumer confidence

Uncertainty breeding instability...

Military expenditure

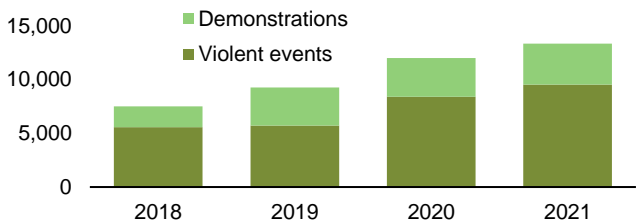
US\$ bn, constant 2019 prices



Sources: SIPRI, World Bank

.....with many potential flare points

Number of reported events



Ones to watch

- **Russia – Ukraine:** as Russian troops mass, invasion increasingly looks both 'imminent and inevitable'
- **US – China Strategic Competition:** risk of China taking military action to accelerate reunification with Taiwan or more forceful behavior in South China sea
- **Gulf Tensions:** US negotiations to rejoin Iran nuclear deal falter as Iran edges towards nuclear capability
- **North Korea:** potential resumption of nuclear-weapons testing amid 'hostile' U.S. policy

...AND CHINA MAY SHIFT FROM THE ENGINE OF GROWTH TO A DRAG.

China's economy, historically a major driver of global GDP, is expected to be weighed down by zero-Covid policy and regulatory tightening with heavy reliance on real estate and debt creating near-term risks

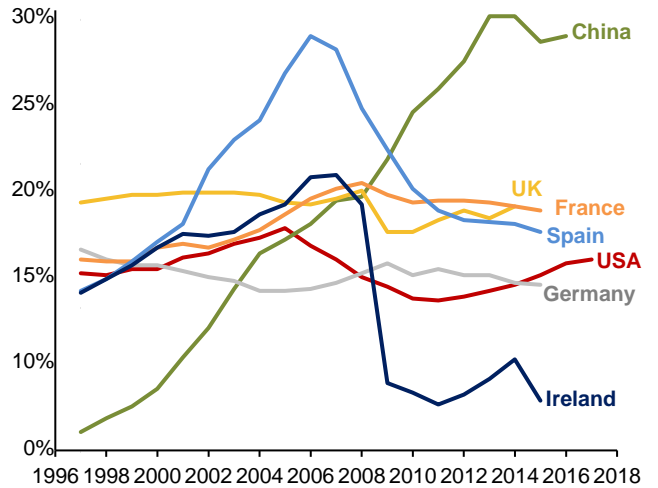
Growth trajectory slowing since 2010

Annual GDP growth
% YoY



...with potential for a more catastrophic slow-down

Impact of real estate-related activities on GDP
% by country



Sources: IMF, UNCTAD, US Department of the Treasury, World Bank, Rogoff and Yang (2021)

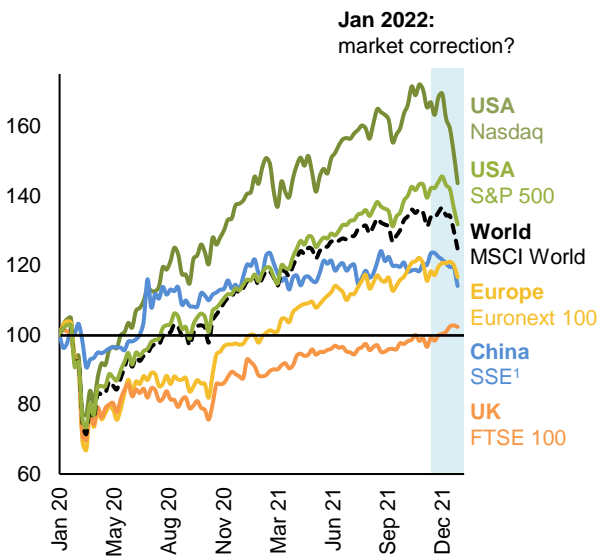
AFTER A STRONG 2021, MARKETS HAVE HAD A ROCKY START...

After two years of dramatic US outperformance, markets have started 2022 in correction territory as investors' concerns around inflation and Central Bank assertiveness have created significant volatility

US has consistently outperformed others

Global equity performance

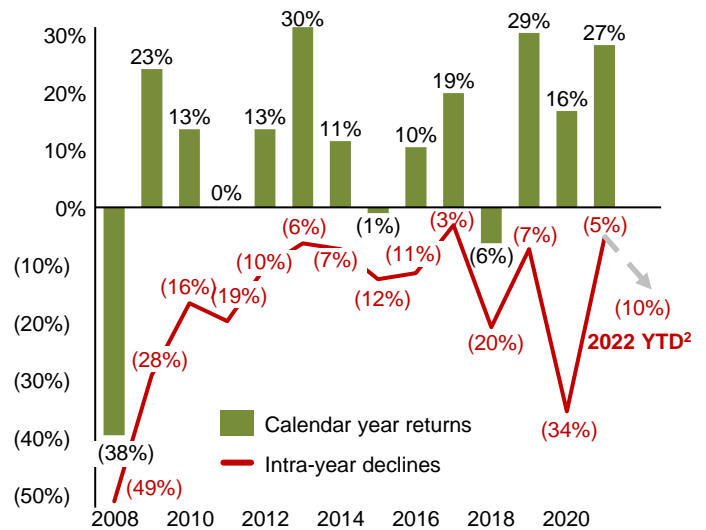
Value of US \$100 invested Jan 30th 2020



....but volatility has returned to markets

Annual returns and intra-year declines

S&P 500 intra-year decline vs. calendar year returns



Note: 1. Shanghai Stock Exchange. 2. Decline from 03/01/2022 to 28/01/2022. Source: CAPIQ, JPMorgan Asset Management, Marakon Analysis

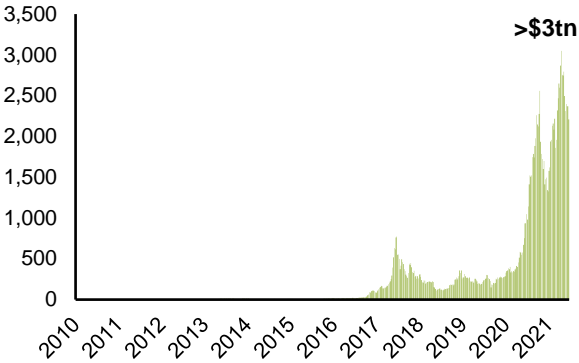
...WITH CRYPTO AS THE UNKNOWN UNKNOWN?

As the crypto-sphere expands, governments have become increasingly wary of its potentially destabilizing effects, but Central Banks have recognised the potential of a digital-only currency

Explosion in the size of crypto as an asset pool

Market capitalization of crypto assets

US\$ bn



\$340tn
Real Estate



\$120tn
Equities



\$11tn
Gold



\$3tn
UK GDP

...met with differing responses by governments

Some have banned or proposed bans

- Egypt, Iraq, Qatar, Oman, Morocco, Algeria, Bangladesh and China have all banned cryptocurrencies
- While Russia and India have proposed a ban

...while some are willing to tolerate

- US refuses to recognize it as legal tender, but Tesla has recently allowed merchandise to be bought using Dogecoin
- UK government has sought to strengthen regulation around its sale, citing misleading promotional information

...with several Central Banks co-opting the technology.

- The Fed, the BoE and the People's Bank of China have all indicated interest in developing a digital currency
- e-Yuan expected to be launched nationally as early as 2022

Sources: Bloomberg, World Bank, Statista

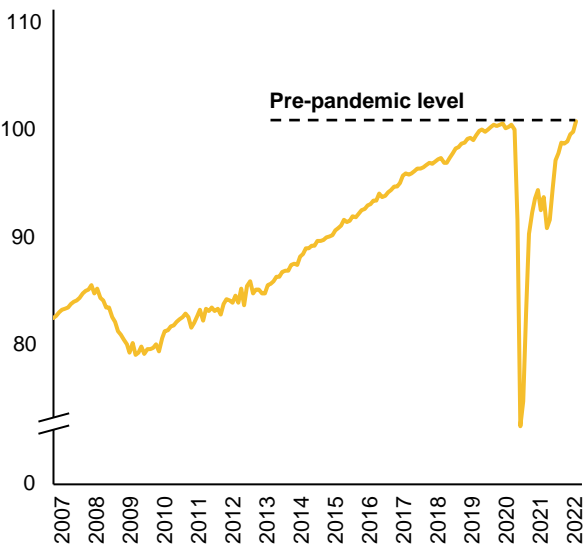
IN THIS GLOBAL CONTEXT...THE UK HAS RECOVERED WELL...

Having been hit hard by the initial economic disruption, the UK economy is recovering, having enjoyed a successful vaccination campaign and (less successfully) hard-won natural immunity

GDP recently returned to pre-pandemic levels

Monthly GDP

GDP index (Nov. 2019 = 100)

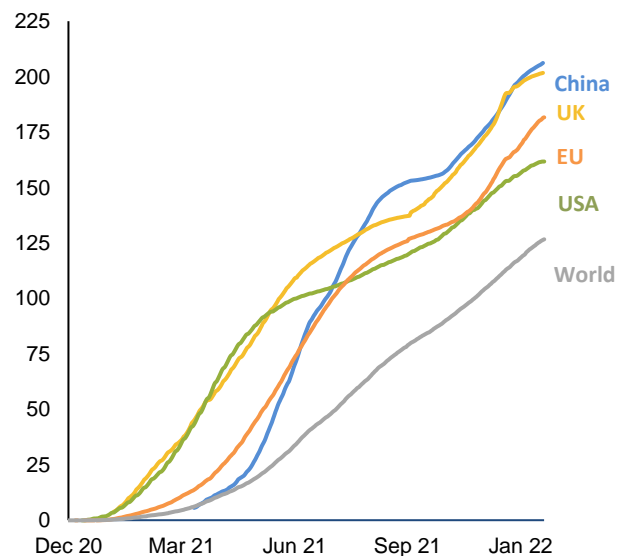


Sources: ONS, Our World in Data

....supported by a leading vaccination campaign

Vaccine doses administered

Cumulative doses administered per 100 residents



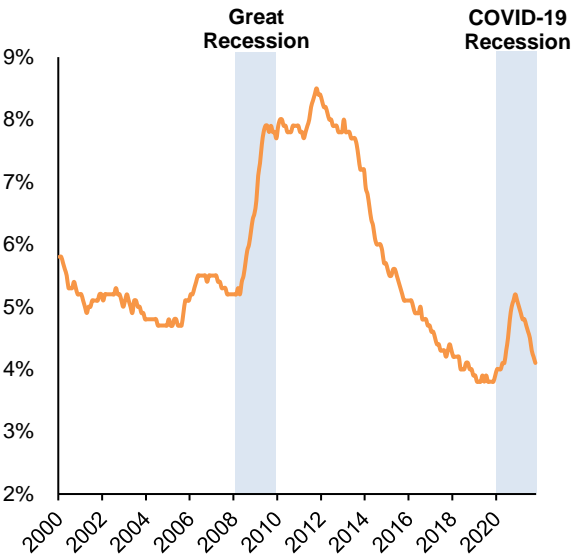
...WHILE THE LABOUR MARKET HAS REMAINED STABLE, IF TIGHT...

Unemployment remained at historic lows despite the pandemic with the government stepping in through the generous allocation of Job Retention and Income Support Schemes

Unemployment nearing record lows...

Unemployment rate

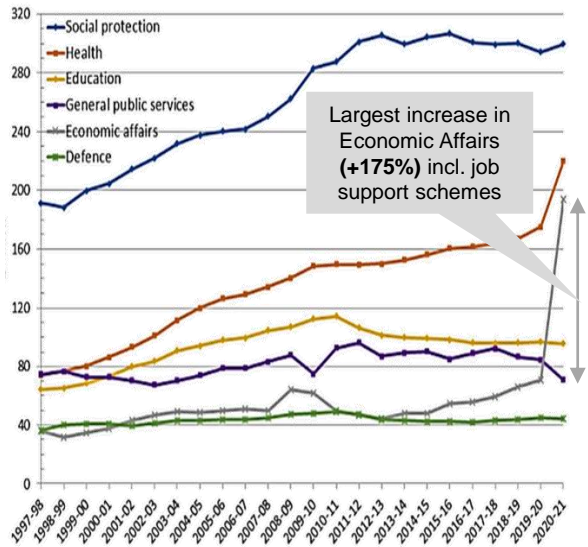
%, Aged 16+, seasonally adjusted



Sources: ONS, UK HM Treasury

...with jobs preserved by massive fiscal expansion

Real terms trends in UK Public Spending £bn

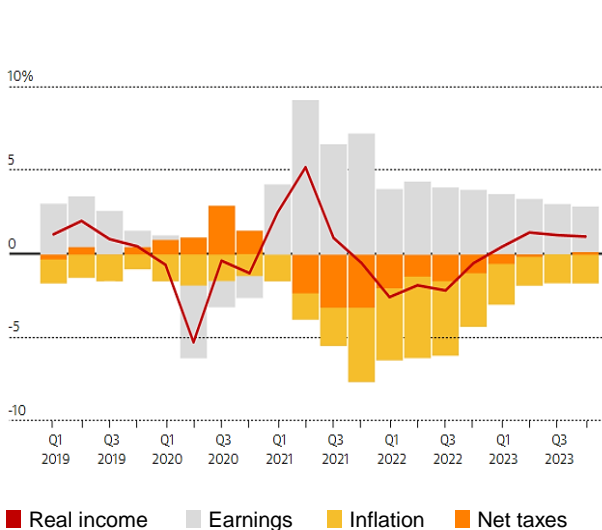


... BUT THE COST-OF-LIVING CRISIS WILL DAMPEN RECOVERY...

The UK starts 2022 in anticipation of significant tax hikes through national insurance, real-term cuts to benefits and high inflation likely to constrain consumer spending

Taxes and inflation will weigh on spending

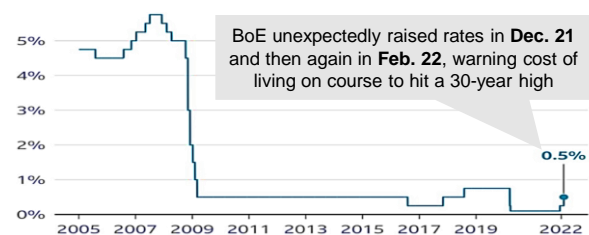
Contributions to real household income growth %



Sources: HSBC, ABN AMRO, Bank of England

...even if a hawkish BoE limits full effects

Bank of England policy rates



Inflation

CPI YoY %, Forecast = BoE estimate under different policy rate scenarios



...AS WILL THE HANGOVER OF 'TAKING BACK CONTROL'.

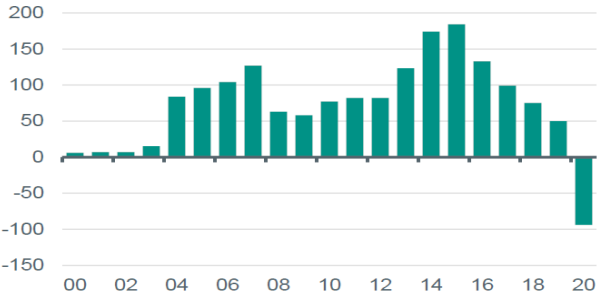
Although its effects so far have been masked by the economic disruption of the pandemic, Brexit is likely to exert a continued drag on the UK economy

Contributing to tight labour market and skills-gaps...

....and exerting a long-term drag on growth

Net flow of EU migrants

1,000s



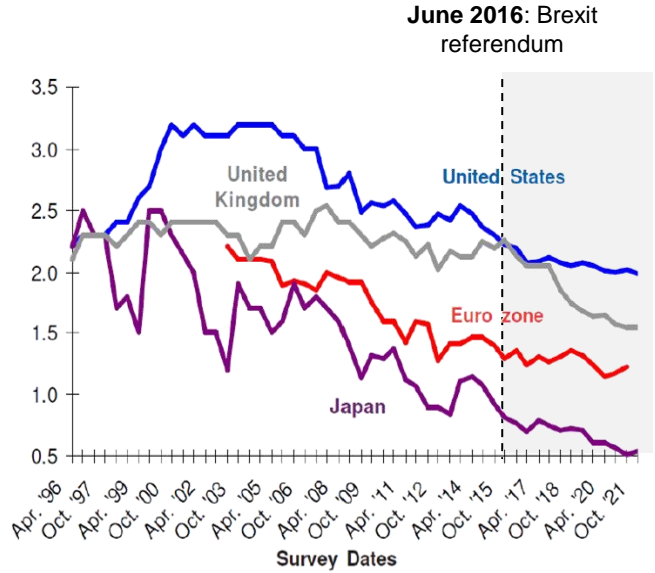
Unemployed people per job vacancy



Sources: ABN AMRO, Refinitiv DataStream, ONS, Deloitte

Long-term 6–10-year GDP forecasts

% change over previous year



QUESTIONS YOU MAY BE ASKING

1. What capabilities do I need to build in an inflationary market e.g., price negotiation? How should I determine that my company's short-term price increases are fair?
2. How can I best achieve supply chain resiliency amid disruption? How can I best prepare to minimize my company's exposure to supply chain disruptions and build visibility over key risks?
3. As the leader of a financial institution, how can I ensure my business is able to take advantage of the rising interest rate environment?
4. In the context of globally tight labour markets, how do I ensure that I retain and attract the best talent? What actions can I take to improve the employer-employee relationship and how can I entice people back into the workforce and onto my team?
5. How should I manage the energy transition in my company in a way that balances short-term financial costs with long-term economic costs of climate inaction? How do I navigate regulatory changes, advances in technology, and a step-change in investor demands and consumer preferences?
6. How should I alter my Financial Framework in light of the revised outlook to suitably trade off growth, risk and returns? E.g., how should I prioritize re-investing in the business vs. returning cash to shareholders?
7. Do I have a clear point of view on my company's cost of equity and WACC in light of this revised macroeconomic context?

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ABOUT MARAKON

Marakon is a strategy and organizational advisory firm with the experience and track record of helping CEOs and their leadership teams deliver sustainable profitable growth. We get hired when our client's ambitions are high, the path to get there is not clear (or taking too long) and lasting capabilities are as important as immediate impact.

We help clients achieve their ambitions for sustainable profitable growth through:

- Stronger strategies and advantaged execution based on:
 - a. A better understanding of what drives client economics and value
 - b. Insight into changing industry dynamics and the context in which clients need to succeed
- A stronger management framework to generate better ideas and link decisions and actions to value
- A stronger organization with a more focused top management agenda and well-aligned resources
- A more confident and effective leadership team that's focused, decisive, and strategic

We have a joint team delivery approach where client ownership and engagement is paramount. Partners are highly engaged in the work product and supported by strong analytical and industry relevant capability. We work as advisers and catalysts in close, trust-based relationships with top management teams.

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