2022 Predictions: Continuing volatility thwarts global recovery

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The global credit market outlook for 2022 embraces a variety of risk factors. By actively monitoring the most relevant macro market economic scenarios, one common theme is that the impact of inflation is a global reality. As the year came to a close, supply chain disruptions, higher energy prices and Omicron variant uncertainty contributed to the likelihood that the risk of high inflation will spill well into 2022. As a result, surprise rate hikes between the US UK and EU could occur in 2022 in response to worse than expected inflation trends.

Many governments will reduce spending and begin to withdraw from COVID-19 measures that were in place to curb economies for overheating. In the US, the wholesale price index rose 9.6% over the twelve-month period ending November 2021; the largest annualized increase since the data was first calculated in 2010. During the same period, consumer price inflation rose by 6.8%, a level not seen since June 1982, according to the Bureau of Labor Statistics. The consumer price index for processed goods alone jumped 26.5%, a startling increase not seen since year end 1974.

In response to inflationary pressures, government policymakers are taking steps to preserve market integrity and support recovery stability. As announced at its last policy meeting of 2021, the US Federal Reserve will raise rates sooner than projected with the expectation that the first of three incremental rates could occur by mid-year 2022. While Fed chairman Jerome Powell has indicated that the first increment will raise the benchmark interest rate to 0.9% from the current 0.3%, rates throughout 2022 will remain historically low, especially on an inflation-adjusted basis. The Fed's Pandemic Emergency Purchase Program will gradually subside by end of the first quarter of 2022. The European Central Bank, however, will likely maintain a conservatively dovish stance and keep their asset purchase initiative in place for at least 10 months, thereby holding interest rates at current levels for the year.

Overall global monetary policy direction is moving toward a tightening phase. The impact will reduce demand for riskier assets and liquidity in high-risk bonds or longer-term assets will diminish. With clearly defined policy direction by the Fed and ECB, financial markets can better manage expectations and adjust accordingly to avoid another market imbalance on a global scale like the 2016 'taper tantrum'.

Uncertainty surrounding other factors could derail the path to recovery in 2022, triggering a sudden shift in policy direction. As of year-end 2021, the Omicron variant emerged to be more potent than expected. As such, further government lockdowns would widen the supply-demand imbalance, causing global wholesale and subsequently consumer prices to rise. Rate increases to preemptively curb the spread of inflation would be inevitable. An abrupt tightening would pose a threat of default for those companies that rely on the corporate bond market. Unexpected rate hikes would cause a reversal in the flow of funds leading to an adverse chain reaction drying up liquidity in the international finance markets. Vulnerable countries would be faced with major currency devaluation and higher than optimal interest rates, thereby worsening domestic demand and leading to negative credit growth. Banking sectors that rely heavily on foreign funding would suffer balance sheet disparity linked to currency devaluations.

In 2022, there will be continuing strains on the supply chain. Many sectors, such as hospitality, tourism and transportation that suffered during the pandemic have been under-invested over the past several years, causing business shutdowns and permanent closures. Those that survived and were beginning to recover in mid-2021 are now facing new constraints and the threat of real recovery given the emergent surge in the Omicron variant.

With myriad unforeseen variables challenging governments and financial markets in 2022, high volatility across all industry sectors is likely for the foreseeable future. Many of the inflation-driving factors are likely to ease somewhat by end of 2022 as economies rebalance post-pandemic, assuming the recent Omicron threat does not turn back the clock with the resumption of severe government shutdown measures. As the impact of the 2020-2021 global pandemic was unpredictable, the global recovery is tracking an uncharted pattern presenting challenges for reliable predictions in the new year.