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Global Monthly

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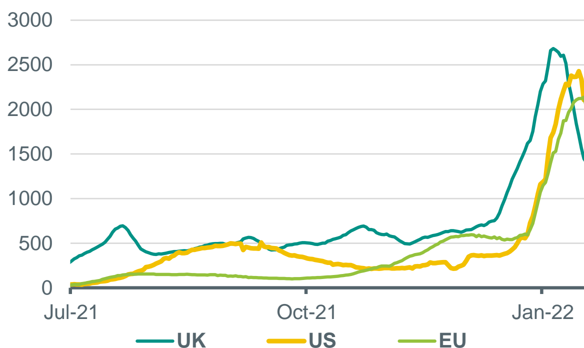
What if interest rates rise much more quickly?

- **We have made only modest downgrades to our growth forecasts on the back of the Omicron wave, but much bigger *upgrades* to our inflation forecasts**
- **Alongside surging wage growth in the US, this has led us to bring forward our expectation for Fed rate hikes to March – with the risk of an even steeper rise in rates**
- **We explore the impact of an alternative scenario, where the fed funds rate rises to as high as 4% next year: on the US economy, bond markets, as well as the potential spill-over effects to the eurozone**
- **Regional updates: Omicron has led to a significant loss of growth momentum in *the eurozone* and *the Netherlands*, but the economy should pick-up strongly again from Q2**
- **In *the US*, cooling goods consumption is coming too late to shift inflation dynamics**
- **Monetary policy is being eased in *China*, as the authorities grapple to contain Omicron**

Global View: Inflation is becoming a bigger problem – what if interest rates surge in response?

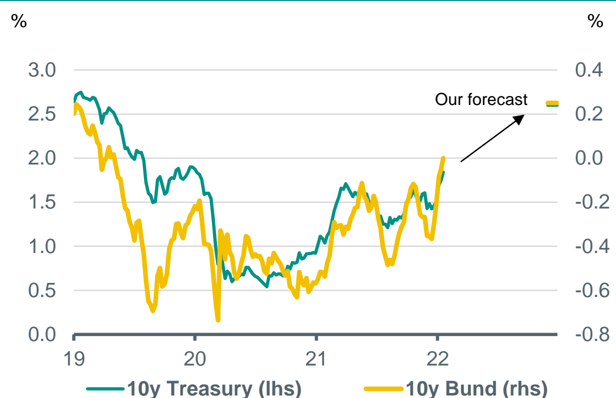
With infection waves looking to have peaked in major advanced economies, and the few countries that reimposed restrictions starting to loosen them once again, the spread of the Omicron variant has proven to be more benign in its impact on the economy than feared. This month, we have made relatively modest near-term downgrades to our growth forecasts, chiefly on the back of a delay in the services recovery and in the resolution of supply-side bottlenecks. At the same time, we have made much bigger upgrades to inflation forecasts, particularly in the US and the eurozone. Indeed, the effect of Omicron on the policy outlook has, if anything, been to strengthen the case for an earlier tightening in monetary policy. As such, we have again brought forward our expectation for the start of rate rises in the US. We continue to expect the ECB to chart a very different course than that of the US Fed – with ECB rate hikes still perhaps years away – but the eurozone will not be immune to rate rises in the US. We have already seen the beginnings of this, with 10y bund yields last week symbolically breaking back into positive territory for the first time since May 2019. In this month's *Global View*, as well as giving updates on how Omicron has altered our view on the outlook, we will explore how markets and economies would respond to a potentially much steeper rise in interest rates than we currently have in our base case.

Omicron wave looks to be peaking…



Source: Our World in Data, ABN AMRO Group Economics

…while bond yields have begun their ascent higher



Source: Bloomberg, ABN AMRO Group Economics

Omicron impact: Growth downgrades; inflation upgrades; bringing forward interest rate rises
In growth terms, the main impact of Omicron has been to delay the services recovery. For the most part, this has come on the back of voluntary consumer caution, with visitor traffic to retail and recreation establishments falling back in most countries. For some eurozone countries (notably the Netherlands and Austria) and a number of cities in China, there were even outright lockdowns for a time. In the eurozone and China, we have lowered our 2022 GDP growth forecasts 0.2pp to 3.7% and 5.1% respectively. But with the recovery pushed further out, this has the effect of lifting our 2023 growth forecasts, to 2.6% and 5.3% respectively. For the US, we have made a slightly bigger downgrade to 2022 growth – to 3.8% from 4.1% previously – but keep our 2023 forecast unchanged at 2.3%. Similar to the eurozone and China, the services recovery will pushed further out, though the positive effect of this on 2023 growth will be offset by weaker government spending following the failure of Biden's Build Back Better plan, and the pass-through of Fed rate hikes.

Indeed, we have made much bigger changes to our inflation projections, partly on the back of Omicron, and in the US specifically, partly because inflationary pressures have broadened and become more durable. The effect of Omicron on inflation is chiefly in the delayed easing of supply-side bottlenecks. In advanced economies, increased worker absences for isolation reasons are putting renewed strains on already stretched workforces. In China, the government's zero-covid policy has led to renewed local lockdowns (that said, the latest PPI data from China suggests some modest easing in price pressures for now). Indeed, while the Omicron wave looks to have peaked in advanced economies, the situation in China is radically different, and the possibility of broader lockdowns in China to contain the spread of Omicron remains a major risk to the outlook, both for growth (to the downside) and inflation (to the upside).

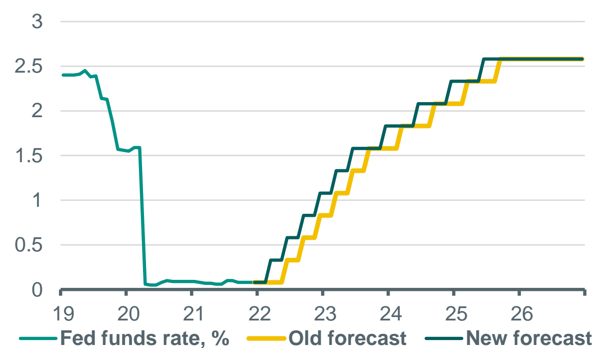
Bottlenecks taking longer to resolve

Semiconductor gap between order and delivery, weeks

Source: Refinitiv, ABN AMRO Group Economics

Fed now likely to start raising rates in March

%



Source: Refinitiv, ABN AMRO Group Economics

In the US, continued upside surprises to inflation have led us to bring forward our expectation for the first Fed rate hike to March, from June previously. We now expect inflation to average 4.6% in 2022 in the US, up from 3.9% in our December projection. This is on the back of elevated pipeline pressures from producer prices, but more importantly – and more durably – from the labour market. With unemployment now sitting below the level consistent with full employment at 3.9%, wage growth accelerated further in December, to 6.1% on a 3m annualised basis – double the pre-pandemic average of c.3%. Elevated inflation and a tight labour market are proving to be a potent cocktail in the US, and have significantly raised the risk of a prolonged wage-price spiral.

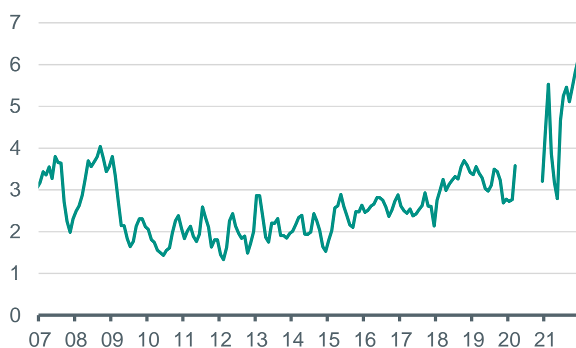
To be clear, the picture in the eurozone continues to differ substantially. While we have also raised our 2022 inflation projection here, to 2.5% from 1.7% previously, this is chiefly on the back of more sustained goods and **energy price inflation**. Inflationary pressures stemming from the domestic demand side remain absent in the eurozone, with the volume of private consumption still around 2.5% below pre-pandemic levels as of Q3 last year, whereas in the US it was 3.6% above pre-pandemic levels. Moreover, structural rigidities – such as the prevalence of multi-year, collectively negotiated wage agreements – continue to keep a lid on near-term wage growth, despite labour market tightness in countries such as the Netherlands and Germany. Even the recent jump in inflation is likely to have only modest upward effects on wage growth, with indexation regimes applying to a small minority of workers. As such, despite our forecast upgrade, our base case

continues to be for inflation to fall back to below the ECB's 2% target by end-2022. Given these differences, we expect a much earlier and steeper rise in interest rates in the US than in the eurozone. For the US, we now expect four interest rate rises this year, up from three previously, and a further three rate hikes next year. This will bring the fed funds rate back to the pre-pandemic target range of 1.5-1.75% by mid-2023. For the ECB, while **recent commentary** from Governing Council members signal greater vigilance over inflation, we continue to think rate hikes on our forecast horizon (to end-2023) are unlikely.

Still, as we flagged in our Global Outlook last month, the eurozone is significantly impacted by spill-overs from the US inflation problem, and this will intensify as the year progresses. Moving in tandem with US Treasury yields, Bund yields have already risen more quickly than our forecasts, and given the earlier start to Fed rate hikes, we now expect Bund yields to rise to 0.25% by end-2022, up from our previous expectation of 0%. Rising rates naturally put a dampener on growth through various channels, from housing to business investment. These effects will be masked during the post-pandemic recovery phase, but will weigh on growth in the longer run.

US wage growth is surging

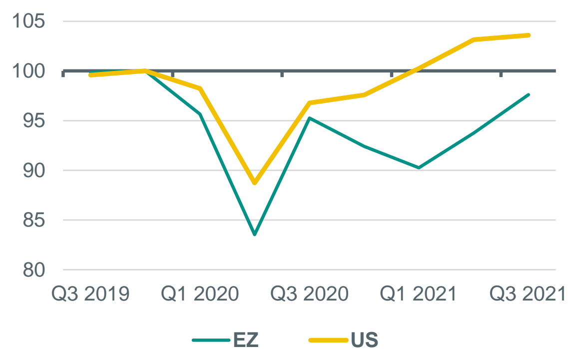
US average hourly earnings, % 3m/3m annualised



Source: Refinitiv, ABN AMRO Group Economics
Note: Data around first lockdown removed due to compositional distortions

Significant EZ-US divergence in demand side pressure

Private consumption, 100 = Q4 19



Source: Refinitiv, ABN AMRO Group Economics

But what if interest rates have to rise a lot more?

While we have again brought forward our expectation for the start of Fed rate hikes, even this more aggressive profile is conditioned on inflation falling back significantly over the coming year, albeit settling above the Fed's 2% target. But what if inflation doesn't fall back, or falls back by less than we expect? We think the Fed would respond much more aggressively in this scenario. This would involve raising rates at more than double the pace of our base case, and peaking as high as 4% by end-2023 – well above the estimated nominal neutral rate of c.2.5% (see chart on next page).

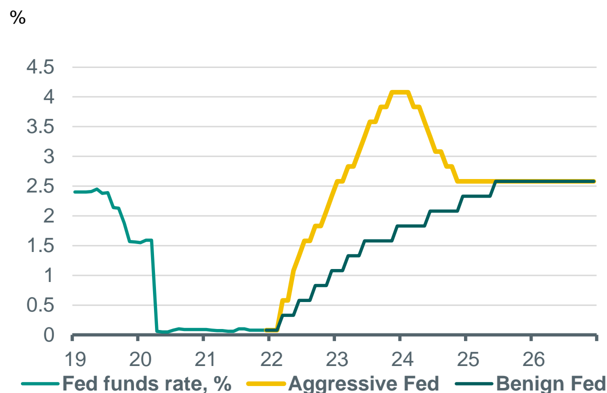
The first round impact of this would be to trigger a massive (and probably quite sudden) tightening of financial conditions. The 10y Treasury yield – which typically peaks at around the eventual peak of the fed funds rate – could surge to as high as 4% by the second half of this year. Our estimates suggest that, at a 4% 10y Treasury yield, equity markets would be due a severe correction, with credit spreads also likely jumping sharply. Such a shock to financial conditions would naturally be a big hit to the economy, via numerous channels. The housing market – which turned red-hot through the pandemic – would likely see a correction lower on the back of surging mortgage rates. Many business investments would be rendered unviable by higher interest rates. And the fall in equity markets would have a major negative wealth effect. The net effect of all of this would indeed be to bring inflation back down, but with the unfortunate side effect of a significantly weaker economy – and perhaps a US recession by later this year. The Fed could slow the pace of rate hikes if this looks to be inducing a *severe* recession, but with its priority to tackle inflation, **the bar for this would be much higher**.

Spill-over to the eurozone would be even bigger in this scenario

As with our base case, there are significant spill-over effects to the eurozone and indeed the global economy. Weaker demand from a slowing (if not contracting) US economy, alongside a hit to EM growth (see **Question 4 from our Outlook**), would be one major spill-over, though a weaker US economy could actually provide some relief to buckling supply chains,

with excess goods consumption having compounded these difficulties over the past year. A much more negative spill-over is likely to be via financial conditions, both from surging bond yields and weak equity markets. We are likely to see such market moves mirrored in Europe, albeit on a smaller scale. For bund yields, we would see an even bigger jump than in our base case, to around 1.25%. This would be the highest yields have been since 2014, when the ECB first embarked on its asset purchase programme. Given the very different macroeconomic environment in the eurozone, the ECB would likely push back against this surge in bond yields by stepping up asset purchases, while risk aversion stemming from global falls in equity markets would also support demand for safe havens such as Bunds. This would ultimately bring yields down to a still-elevated level of around 0.8%.

The Fed may have to hike much more aggressively…



Source: Refinitiv, ABN AMRO Group Economics

…which would trigger a far bigger surge in bond yields

Source: Refinitiv, ABN AMRO Group Economics

A further offsetting factor would be a weaker euro, which would be weighed by an even larger gap between US and eurozone bond yields. Even in our base case, we expect EUR/USD to fall to 1.05 by end-2022, and to parity by end-2023. In this more aggressive Fed scenario, we would expect this move lower in EUR/USD to be hastened, although this effect could be later blunted as markets price in a bigger hit to the US economy from surging rates. A weaker euro would boost eurozone export competitiveness, offsetting some of the dampening effect on activity of higher interest rates and the expected slowdown of global growth and world trade in this scenario. While the tightening of financial conditions would therefore not be as big in the eurozone as in the US, it would still lower economic growth, likely to close to zero as compared to the above-trend growth we expect in our base case.

The Netherlands: How could surging yields affect the housing market and the broader economy?

While not our base, it is worth considering how the above-described alternative scenario of steeper US interest rate rises might spill over to the Dutch housing market and business investment.

A prolonged period of declining interest rates in combination with lack of supply have pushed up real estate prices. House prices in particular have surged during the pandemic. Households' exposure to an inflation shock runs primarily via mortgage interest rates. Firstly, increased mortgage rates could pose a risk for domestic demand as increased mortgage rates lead to higher monthly payments. As the majority of Dutch households have long term fixed rates mortgages, the number of households exposed is rather small. Secondly, higher mortgage rates could trigger a price correction as higher mortgage rates constrain lending capacity and dampen investor demand. Commercial real estate (CRE) prices could in similar fashion see a correction as well. What would be the impact of such a correction? The house price corrections in the wake of the financial crisis led to negative equity problems prompting households to cut expenses. Dutch consumers are particularly exposed to this problem, given their lack of liquid assets as savings are locked up in mandatory pension funds. However, since the financial crisis things have changed. Back then home owners mostly relied on interest only loans. Nowadays, home buyers rely primarily on annuity loans as interest relief is restricted to redeeming loans. Moreover, recent price rises have been so strong, that the majority of households is shielded, even in the event of a substantial price correction. The group most at risk of price corrections are first time buyers that recently bought a house at an elevated LTV rate.

Another channel through which tighter financial conditions could hurt the Dutch economy is business investment. While in general Dutch firms showcased resilience throughout the pandemic, they will still be affected by a rise in rates. The prime macroeconomic effect will run via a reduction in business investment. Despite Dutch firms' preference for internal financing, we expect financial tightening to put further downward pressure on investment, which already has a bleak outlook in 2022 due to constraining factors caused by supply-side bottlenecks and lack of qualified personnel. That said, overall the Dutch corporate sector is resilient; indeed, non-financial debt as share of GDP dropped below pre-pandemic levels in the third quarter of 2021.

Eurozone: Low growth-high inflation mix will not last

Aline Schuiling – Senior Economist | aline.schuiling@nl.abnamro.com

- **Economic activity slowed in the final months of 2021 and in early 2022**
- **Inflation has risen to record-high levels in the final months of 2021. It will probably remain elevated during the first half of 2022, but should drop sharply lower in the final months of the year**
- **GDP growth is expected to rebound sharply in Q2-Q3 and, subsequently, settle above the trend rate**

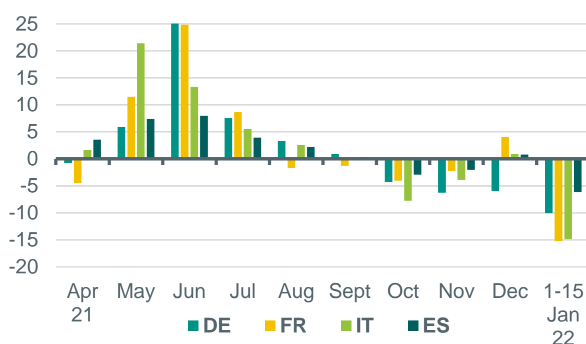
The eurozone economy lost momentum in the final months of 2021 and at the start of 2022. High frequency data gauging consumption of services (e.g. Google Mobility data for visits to retail and recreation) dropped in the final weeks of 2021 and in the first weeks of 2022 (see graph), while the services sector PMI and consumer sentiment fell in December. The rapid spread of the Omicron variant has resulted in new social distancing measures in a large number of countries, partial lockdowns (e.g. lockdowns for the non-vaccinated) in others, and even a total lockdown in the Netherlands. Services sector activity will likely remain depressed in the first few months of 2022. The slowdown in services activity is expected to be largely compensated by growth in industry, as indictors for activity in the eurozone industrial sector suggest ongoing robust growth in Q4 and Q1. Nevertheless, global supply side disruptions have remained an impediment to industrial production, particularly in the vehicle industry. For instance, output in Germany's vehicle sector, which is seriously limited by shortages of materials and/or equipment, was about 25% below pre-pandemic levels by the end of 2021, whereas the gap for Germany's total industry was around 6% lower, and the eurozone total was slightly above pre-pandemic levels.

All in all, we expect eurozone GDP to be roughly stagnant in 2021Q4 and to grow modestly in 2022Q1. We have lowered our earlier forecasts of 0.7% q/q for each quarter. However, we have simultaneously raised our forecasts for 2022 Q2-Q3, as we expect Omicron-related disturbances to services sector activity to wane in the course of 2022Q1, and global supply chain problems to gradually ease. We expect GDP growth to remain somewhat above the trend rate in the final quarter of this year and in 2023.

Inflation jumped higher in the final months of 2021, reaching 5.0% in December, up from 3.4% in September. The main reason for the rise was a further jump in energy price inflation (see graph), but food prices and core inflation also contributed. A further breakdown in components shows that services inflation has been boosted by a recovery in services related to holidays, which should normalise in the course of this year. Core goods price inflation seems to have been fuelled by rises in factory goods inflation, reflecting sharply higher commodity price inflation and supply-chain bottlenecks. We have raised our forecast for inflation in the first half of 2022, mainly because we expect the rise in global goods prices to be more persistent than we estimated previously. Still, inflation should decline in the second half of this year, and will probably fall to below the ECB target of 2% in the final months of 2022, when base effects will result in a sharp decline in energy inflation and the impact of supply bottlenecks will have eased. At the same time, wage growth at the eurozone level is still subdued, and should be largely compensated by rises in labour productivity.

Omicron has reduced services sector activity

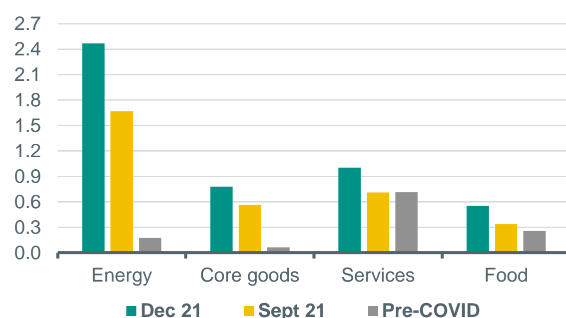
Google Mobility Trends: Visits to retail and recreation, monthly change



Source: Our World in Data, ABN AMRO Group Economics

Inflation and contribution of main components

Contribution to annual inflation, ppts yoy



Source: Refinitiv, ABN AMRO Group Economics

The Netherlands: Omicron and inflation weighing on growth

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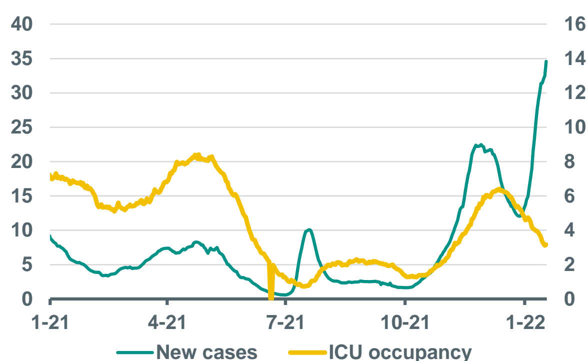
- **Omicron and elevated inflation expectations are weighing on consumer confidence**
- **Spending plans by the government will be constrained by the chronic labour shortage**

When the Omicron variant started to spread in December 2021, the Netherlands already struggled with overburdened ICUs. Almost 60% of the ICU capacity was already used by covid-19 patients, whereas the average in the Eurozone stood at around 20%. This has caused the government to announce a pre-emptive lockdown on 18 December 2021. However, the rate at which Omicron leads to ICU admittances has been lower than expected, and so some restrictions were lifted last weekend such as on sports activities and non-essential shopping. Despite this easing, the remaining restrictions will depress consumer spending in the first quarter of 2022, albeit less than during the last lockdown (see graph on the right below).

Omicron breaks link between cases and ICU-occupancy

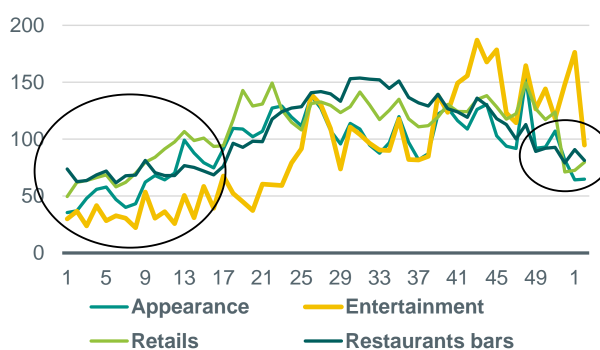
Total confirmed cases per 1,000,000 people



Source: ABN AMRO, Our World in Data

Impact current lockdown less than previous lockdown

AAB Transaction data, index base year = 2019



Source: ABN AMRO

Consumer confidence deteriorated for the third month in a row in December

With this drop, consumer confidence is almost back at its all-time low from the spring of 2020. This is likely not only attributable to covid-19, but also to the sharp rise in inflation (CPI: 5.7%, core 2.2% in December). According to the CBS, 55% of the consumers described the price increases of the past year as 'sharp', the highest percentage since the beginning of the time series in 2017. This is confirmed by survey data from the European Commission. To the question 'By comparison with the past 12 months, how do you expect consumer prices will develop in the next 12 months?' 32% answered a more rapid increase, while 41% thought inflation will increase at the same rate. Only 27% thought prices would fall at a slower rate or decrease.

The uncertainty resulting from the ongoing threat of the virus and high inflation, will continue to depress growth. We expect all restrictions to be lifted at the end of February, which will be followed be a renewed impulse to spending, as consumers catch-up on some of the lost spending of the lockdown. In our projections, we expect GDP to grow by 2.8% in 2022 (after 4.3% in 2021).

Last month, the Dutch government finally reached a coalition agreement

This agreement includes new fiscal measures to support education, the housing shortage and free childcare. In addition, EUR 60 billion was allocated to multi-year green funds. The plans could also increase the growth potential of the Dutch economy, as more funds are dedicated to research, development and education. Most plans will be rolled-out during the course of 2023, and the agreement will therefore have little to no effect on growth in 2022. In addition, the Netherlands Bureau for Economic Policy Analysis (CPB) said that promises for generous spending may not be feasible in light of the significant labour shortages. The unemployment rate dropped to 2.7 percent in November 2021 from 2.9 percent in the previous month – the lowest figure since the survey began in 2003. Moreover, an increase in labour demand in the public sector could crowd out labour supply in the private sector.

US: Cooling goods consumption too late to shift inflation

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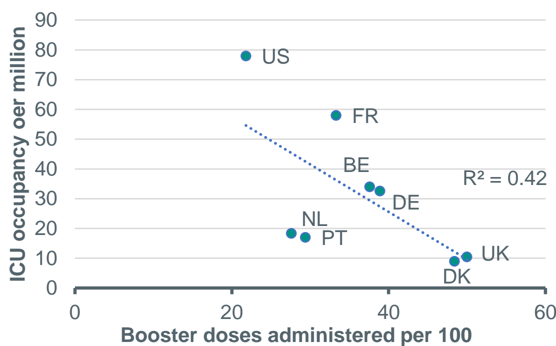
- **Slow booster uptake has meant the US is being particularly hard hit by Omicron**
- **Goods consumption appears to be cooling, but inflation is increasingly driven by the labour market**
- **This will keep pressure on the Fed to continue its radical hawkish pivot**

The US is being particularly hard hit by the Omicron wave. A comparatively sluggish uptake of booster shots has compounded an already low vaccination rate, and as a result, hospitalisations and more importantly ICU occupancy resulting from Omicron infections has actually surpassed that seen in previous waves. This stands in contrast to the experience of many European countries, where rates of ICU admission have been significantly lower than in previous pandemic waves. While any notion of restrictions on activity has become political anathema in the US – despite the enormous pressure on healthcare systems – citizens have nonetheless taken it upon themselves to reduce social contact, with high frequency data showing a clear drop-off in pandemic-sensitive air travel and restaurant dining sectors. All told, activity in these sectors fell by about 10% in the first weeks of January compared to the December average. While case numbers look to be peaking now, the delay to the services recovery – in combination with additional supply-side disruptions – led us to lower our 2022 growth forecast by 0.3pp to 3.8% (see Global View for more).

Slow booster uptake; surging ICU occupancy

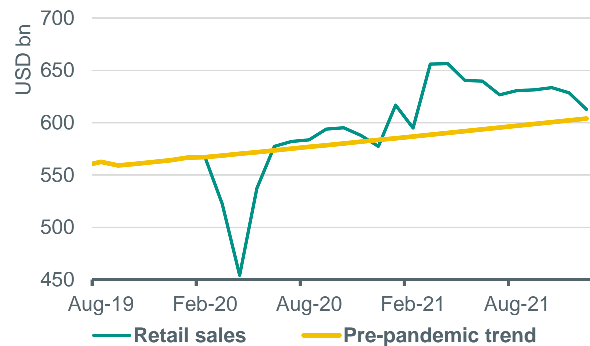
ICU occupancy as at 17 Jan; Booster uptake as at 1 Jan



Source: Refinitiv, ABN AMRO Group Economics

Goods consumption cooled in December

Real retail sales, USD bn



Source: Refinitiv, ABN AMRO Group Economics

At the same time, nominal retail sales fell by 2.1% in December, with the real fall likely somewhere nearer to 2.6% given current elevated inflation readings. While volume data has yet to be released, we estimate real retail sales are now running at just 1.5pp above the pre-pandemic trend, a significant decline from the 5-10pp in excess consumption seen for much of 2021, and the smallest gap with trend since February (just prior to the final round of stimulus checks). While a welcome development, given the contribution excess goods consumption has made to the surge in inflation this year, it has likely come too late to shift broader inflationary dynamics, which have since become self-reinforcing via the ultra-tight labour market. In December, wage growth momentum accelerated further, to 6.1% 3m/3m annualised (see chart on p3) while other measures such as the quit rate and vacancies remain historically elevated. Already services – particularly housing – has become a bigger contributor to inflation in recent months, and it is likely that even as goods inflation declines, strong wage growth will fuel a further pick-up in services inflation as the year progresses. The net effect is that inflation should still come down significantly this year, but we expect core inflation to settle at a level well above the Fed's target, in the 2.5-3% range.

All of this is keeping pressure on the Fed to continue radically pivoting in a more hawkish direction, and we saw further evidence of that in recent weeks, with many officials openly advocating for a March rate hike. The balance sheet is also increasingly seen as a potential tool to tighten policy, should rate hikes alone fail to cool inflationary pressures. The December FOMC minutes signalled a likely quicker unwind of the balance sheet compared to the previous quantitative tightening episode, and comments from hawks such as Mester even hinted that outright sales of Treasuries might be considered ("won't take anything off the table regarding balance sheet reduction"). Our base case is that, soon after lift-off in March, the Fed will begin allowing the balance sheet to slowly unwind, gradually picking up the pace to $60bn per month. However, given the degree of inflationary pressure, the risk is for the Fed to move even more aggressively.

China: Policy easing continues as Omicron drag builds

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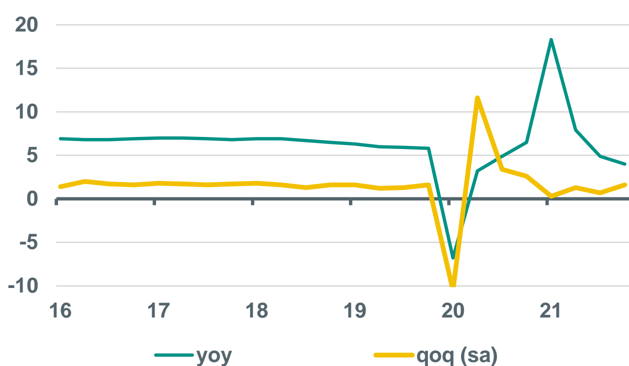
- **Qoq growth picked up in Q4, but yoy growth reached the lowest pace since first half of 2020**
- **Near-term growth forecasts revised down on pandemic risks/Omicron**
- **Mini rate cuts and other policy easing continues, as 'stability' is Beijing's buzzword for 2022**

Full-year annual growth in 2021 came in at an above-trend pace of 8.1%, driven by the base effect from the initial covid-19 shock in early 2020. However, sequential growth was much less impressive last year. In line with our expectations, quarterly growth picked up in Q4, to 1.6% qoq (Q3 revised up to 0.7%). This recovery was production-led, helped by the fading of supply-side disturbances stemming from a power crunch and strict covid-19 policies over the summer. That said, annual growth in Q4 fell to 4.0% yoy, the weakest pace since 1H-2020, with drags from real estate and the pandemic persisting. We have cut our near-term growth forecasts on pandemic risks/Omicron. The impact thereof on full-year growth for 2022 is offset by some 'payback' later this year, and by a further policy shift from financial de-risking to (piecemeal) easing. We have cut our 2022 growth forecast marginally to 5.1% (from 5.3%), and raised our 2023 forecast to 5.3% (from 5.2%).

Omicron puts China's strict covid-19 policies to the test

Drags from pandemic flare-ups and the highly contagious Omicron variant combined with China's strict covid-19 policies continue to build, with uncertainty remaining high. We have seen local lockdowns (Xi'an's city-wide lockdown was due to a Delta outbreak), and a tightening of restrictions in the run-up to the Chinese New Year period and the Beijing Winter Olympics. In late 2021, China's covid-19 policy seems to have shifted somewhat from 'aim for zero cases' to 'quickly contain local outbreaks'. Further Omicron outbreaks could put this decentralised approach to the test and lead to more widespread lockdowns and even tighter restrictions. As indicated in our 2022 China Outlook, Omicron reduces the likelihood that China will ease its covid-19 policy soon. Meanwhile, related supply disturbances (some temporary production cuts, rising port congestion) adds to bottlenecks in global supply chains. At the same time, an Omicron-related delay in the rotation in global demand back to services may be beneficial for Chinese exports, which have continued to outperform during the pandemic.

Qoq growth firms in Q4, yoy growth drops to 1.5 year low



Source: Bloomberg

Inflationary pressures eased in late 2021

Source: Refinitiv, Bloomberg

Mini rate cuts and other policy easing continue, as 'stability' is Beijing's buzzword for 2022

With drags from Omicron and real estate persisting and CPI inflation remaining below target, China's (piecemeal) easing approach continues, in line with our expectations. Since December, the PBoC has cut the reserve requirement ratio (RRR) for banks by 50bp, and lowered several of its policy rates in one or more mini steps. The 1-year loan prime rate (LPR) was lowered by 15bp in two steps, to 3.70%, and the 5-year LPR by 5bp, to 4.60%. The medium-term lending rate was cut by 10bp, to 2.85%, and the 7-day reverse repo rate by 10bp, to 2.10%. We expect piecemeal monetary easing to continue in the coming months, with another 50bp reduction in bank RRRs and further mini cuts in policy rates. We also expect more fiscal support in the form of targeted tax cuts for households and firms, and easier financing conditions for local governments. Regarding real estate, we have seen some easing of policies over the past months and expect further steps going forward.

Key views on a page

We expect the post-pandemic recovery to continue in 2022, with above trend growth to resume in the eurozone, the US and China following the current Omicron-induced soft patch. However, uncertainty over the economic outlook is now arguably the highest it has been since the start of the pandemic in early 2020. While economic growth has been strong, as economies have largely opened up, the supply-side has struggled to keep up with resurgent demand, with the consequence being inflation. This has brought forward the likely timing of interest rate rises in the US, with the Fed expected to begin raising rates in March. While we do not expect the ECB to follow, given the very different macroeconomic circumstances in the eurozone, this will have global spill-over effects over the coming year, pushing bond yields higher and ultimately dampening growth.

Macro	Central Banks & Markets
Eurozone – The economy has entered a soft patch. Supply side bottlenecks and record-high (energy price) inflation are restraining growth in industry and reducing real incomes. In addition, a new coronavirus wave has hit the region. We expect GDP to have been stagnant in 2021Q4 and grow modestly in 2022Q1. Following this soft patch, growth is expected to rebound sharply and remain above trend, supported by fiscal and monetary policy and solid employment growth. Inflation is likely to stay elevated in the first months of 2022 but should gradually decline during the year, ending up below the ECB target in 2023. We do not expect wage growth to accelerate sharply.	**ECB** – A slowdown in the central bank's net asset purchases is on the cards. The wind down of purchases under the PEPP will not be offset by a temporary increase in the APP pace (to EUR 40 billion in Q2 and EUR 30 billion in Q3). Beyond that, the ECB will run net purchases at EUR 20bn until shortly before it starts raising the key ECB interest rates. We expect policy rates to remain unchanged through our forecasting horizon, given that the central bank is projecting that inflation will moderately undershoot its goal all the way through 2024. The tone of Governing Council officials has turned more hawkish though due to near term upside risks to its inflation goal.
Netherlands – Despite new lockdown measures in late December, annual growth in 2021 is still expected to come out at 4.4%. However, looking ahead, we have downgraded our growth expectations for 2022 from 3.8% to 2.8% due to these new restrictions. Indeed, we expect restrictions to be in place for a large part of Q1, which will depress consumption. Constraints to growth stemming from the notoriously tight labour market and supply bottlenecks will weigh more heavily as the economy closes the gap with trend growth. Inflation is expected to average at 3.5% in 2022, with upward pressure from energy and supply bottlenecks gradually fading in the coming year.	**Fed** – Given persistently elevated inflation in the US, and upside risks to the outlook, we now expect the Fed to begin hiking rates in March, and to hike rates four times this year, with three further hikes in 2023. This would take the target range of the fed funds rate back to the pre-pandemic level of 1.5-1.75% by mid-2023. The risk continues to be for an even steeper path of rate hikes. Shortly after lift-off, we expect the Fed to begin unwinding its balance sheet in late Q2, initially at a gradual pace, but eventually for this to run at $60bn per month. There is a significant risk that the Fed reduces the balance sheet at a much faster pace, potentially using it as a tool in its fight against inflation.
US – The economy grew strongly in 2021, and above trend growth should continue in 2022. However, unexpected tightness in the labour market is putting additional upward pressure on inflation, with wage growth surging in recent months, and with the recovery in labour supply less than we previously expected. The spread of Omicron is – if anything – intensifying those risks. While we expect above-trend growth to continue in 2022, we expect growth to slow to below-trend rates in 2023, on a combination of fading post-pandemic catch-up effects, weaker government spending following the failure of Biden's Build Back Better plan, and tighter monetary policy.	**Bond yields** – Given that we forecast the Fed funds rate to be at its eventual peak of around 2.50-2.75% by end 2025, we expect longer term yields will move higher in 2022, with the 10y US Treasury yield settling at around 2.6% at year-end. In previous cycles, the 10y US Treasury yield also settled around the eventual peak in the Fed funds rate, although well ahead of that time. Once we move closer to the first rate hike, which we have pencilled in for mid-2022, we expect the US Treasury curve to bear flatten. The rise in US Treasury yields will also put further upward pressure on their European counterparts, despite the ECB keeping its policy rates on hold.
China – Qoq growth picked up in Q4, with supply bottle-necks from a power crunch and covid-19 policy fading. However, yoy growth reached the lowest pace in 1.5 year, with drags from real estate and the pandemic remaining. We have cut our near-term growth forecasts on pandemic risks/Omicron. Omicron is putting China's strict covid-19 policy to the test in the run-up to the Lunar New Year and the Winter Olympics, with lockdowns/tighter restrictions adding to supply bottlenecks. With drags from Omicron and real estate, remaining and CPI inflation below target, we expect (piecemeal) monetary and fiscal easing to continue and real estate policies to be relaxed further.	**FX/EURUSD** – We expect more weakness in EUR/USD. The key driver will be a significant policy divergence between the Fed and the ECB over the coming years. We now expect that the Fed will begin hiking interest rates in March 2022 and to hike four times in 2022. We believe that the ECB is facing a different set of macroeconomic circumstances than faced by the US central bank. The ECB has also explicitly ruled out a rate hike in 2022 and has hinted that it could well be "on hold" for much longer. Our forecast for EUR/USD at year-end 2022 is 1.05 and 1.00 for year-end 2023.

Main economic/financial forecasts									
GDP growth (% yoy)	**2020**	**2021e**	**2022e**	**2023e**	**Inflation (%)**	**2020**	**2021**	**2022e**	**2023e**
United States	-3.4	5.5	3.8	2.3	United States	1.2	4.7	4.6	2.1
Eurozone	-6.5	5.1	3.7	2.6	Eurozone	0.2	2.6	2.5	1.3
Japan	-4.5	1.9	3.1	1.5	Japan	0.0	-0.2	1.0	0.7
United Kingdkom	-9.4	6.9	5.2	2.1	United Kingdkom	0.9	2.6	4.3	1.9
China	2.2	8.1	5.1	5.3	China	2.5	0.9	2.5	2.0
Netherlands	-3.8	4.3	2.8	2.7	Netherlands	1.1	2.8	3.5	1.9
Policy rate	**21/01/2022**	**+3M**	**2022e**	**2023e**	**10Y interest rate**	**21/01/2022**	**+3M**	**2022e**	**2023e**
Federal Reserve	0.25	0.50	1.25	2.00	US Treasury	1.75	1.85	2.60	2.60
European Central Bank	-0.50	-0.50	-0.50	-0.50	German Bund	-0.06	0.05	0.25	0.35
Bank of Japan	-0.10	-0.10	-0.10	-0.10	Japanese gov. bonds	0.12	0.10	0.13	0.20
Bank of England	0.25	0.50	0.75	1.25	UK gilts	1.17	1.35	1.65	2.00
People's Bank of China	3.70	3.60	3.60	3.60					
Natural resources	**21/01/2022**	**+3M**	**2022e**	**2023e**	**Currencies**	**21/01/2022**	**+3M**	**2022e**	**2023e**
Brent - Oil USD/barrel	87.9	85	75	75	EUR/USD	1.13	1.09	1.05	1.00
WTI - Oil USD/barrel	85.1	82	72	72	USD/JPY	113.7	120	124	130
Henry Hub - Gas USD/mn	4.00	4.50	3.50	3.50	GBP/USD	1.36	1.36	1.33	1.30
TTF - Gas EUR/MWh*	44.5	50	35	25	EUR/GBP	0.84	0.80	0.79	0.77
Gold - USD/oz	1,835	1,700	1,500	1,300	USD/CNY	6.34	6.30	6.20	6.15

Source: Refinitiv, Bloomberg, ABN AMRO Group Economics

* Brent, WTI, Henry Hub: active month contract; TTF: next calender year

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