Crystal ball
What can we expect in 2022?

Whenever we talk to investors and asset managers at the beginning of a year, they almost always expect a difficult twelve months ahead of them. Although this year might be different, one thing is absolutely certain: 2022 is not going to be as easy as 2021 when central banks flooded the markets with liquidity and governments opened their wallets for extra spending. In 2022, there are more questions than answers.

The central banks

The shift in monetary policy, especially that of the Federal Reserve, is quite clear: all buying programs will cease and up to three interest rate hikes can be expected during 2022.

This is hardly surprising, given that inflation in the US has reached 7%. The Federal Reserve can no longer ignore macroeconomic data and has therefore had to signal a change in its monetary policy.

The ECB, on the other hand, seems much more reluctant to change its monetary policy, despite rising regional inflation. However, if EU inflation remains high in combination with higher interest rates in the US, the ECB might be forced to adapt its policy accordingly, although it is unlikely that the ECB will be so aggressive as to force inflation below its target of 2%.

Traditional asset classes

For the traditional asset classes, 2022 will most likely be much more difficult than 2021.

If and when central banks stop buying bonds (and maybe offload some bonds), this will cause changes in yields on both government as well as credit bonds. Yields will most likely increase and credit spreads widen.

This leaves the equity markets in an interesting position. With higher yields, especially on credit bonds, the discounting of future earnings will be quite different from a "zero" interest rate environment. Stocks are generally quite expensive now and could incur significant losses when the central banks start tightening monetary policy and the fiscal stimulants from COVID-driven spending policies run out of steam.

Equity investors have a very fundamental question they need to answer: How big a correction in the equity markets is the central banks willing to accept? And how valuable is the central bank put in 2022?

COVID-19, Omicron, and the next variant

While Omicron is probably not the end of COVID-19, there is hope that future variants will be increasingly less severe.

More waves can come, but the world is beginning to learn to live with the virus, and while some restrictions can be really annoying there are likely to be fewer of them going forward.

Government policies will and have moved away from total lockdowns, which brought the economies to an almost complete standstill. As a consequence, the impact on GDP and employment will be much smaller in the future.

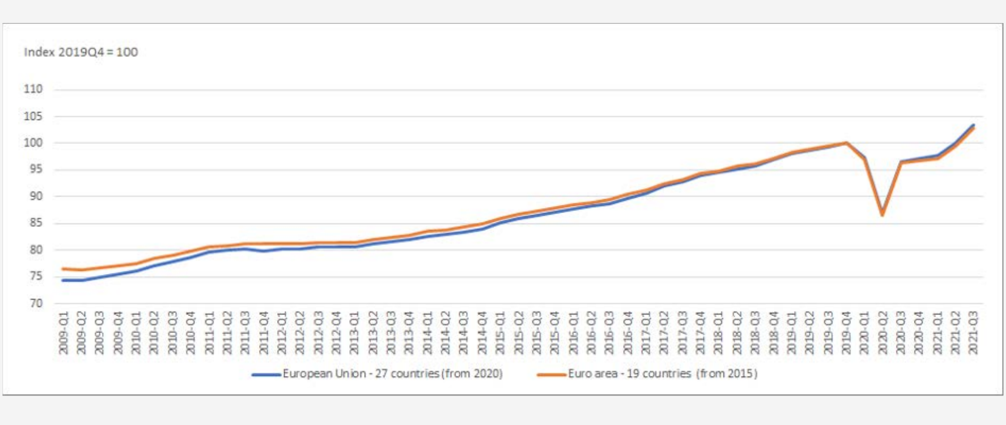
Economic conditions – EU now compared with pre-COVID

While there are still many restrictions and sectors that are partly closed down, the overall economic picture is not as bad as many would have expected.

Low interest rates, plenty of liquidity, and additional public spending have brought nominal GDP back on track.

As seen from Figure 1 (below), EU nominal GDP took a severe hit in Q2 2020, then rebounded during the last two quarters of that year, but this did not become a fully V-shaped recovery due to the second and third waves of the COVID-19.

Figure 1 - EU nominal GDP seasonally adjusted compared with 2019 Q4



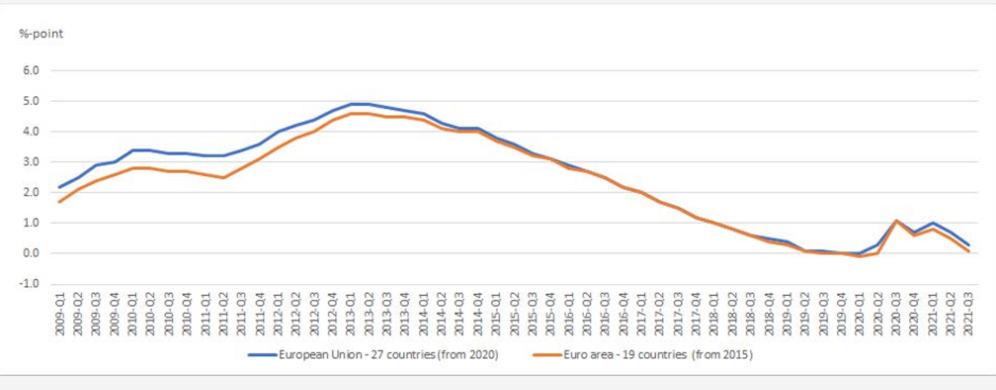
However, already in Q2 or Q3 of 2021 nominal GDP was back on its long-term trend and this will most likely be seen to have continued or even improved when GDP numbers for Q4 2021 are published.

While Nominal GDP is back on track, volumes (GDP in fixed prices) will probably also be back on track if the figures for Q4 2021 and Q1 2022 are as we expect.

With GDP in both nominal and volume terms back to long-term growth trends, ECB will find it difficult to argue for a continuation of its current monetary stance while inflation rises to levels not seen in decades.

Furthermore, the speedy recovery can also be seen in unemployment rates all over the EU. During Q1 and Q2 2020, unemployment rates increased by approximately 1%-point (see Figure 2, below). It is very interesting, that the unemployment levels in the EU are now basically at the same level they were at before the COVID-19 pandemic.

Figure 2 - EU unemployment rate compared with 2019 Q4



Continuing the expansive monetary and fiscal policy do not seem to be justified for much longer. Economic growth is back on track.

Alternative lending

With GDP growing briskly, the demand for credit will only increase. In general, high GDP growth combined with low unemployment rates is good news for alternative lending when invested in a diversified portfolio of loans.

Borrowers will be optimistic and loans will be easier to repay with an expanding economy.

Furthermore, if credit spreads increase alongside tightening monetary policy, it might indicate that reinvestment rates could be higher in 2022 than towards the end of 2021.

This view has been confirmed in our discussions with several market participants, who expect a significant increase in alternative lending volumes in 2022.

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