CUSTOMER TREASURY SERVICES

# Economist's Weekly Market View

Tuesday, 7th December 2021

## *Clouded Outlook*

There has been a marked increase in volatility on financial markets in recent weeks, with sharp movements even on an intra-day basis, becoming increasingly common across all asset classes. Investors are desperate for some certainty, but the economic outlook is getting cloudier by the day, resulting in big swings back and forth on markets. This is contributing to a general risk-off tone to trading as markets start to wind down for the year.

In this regard, the OECD last week published its latest semi-annual Economic Outlook. The global economy has seen a much stronger than expected recovery this year, with output, trade, employment and incomes all rebounding. The OECD's central forecast is that the global recovery will continue, with further good growth forecast for the world economy in 2022-23, as it copes better with the pandemic and macroeconomic policies remain supportive of activity.

However, that's where the good news ends. The OECD points to striking imbalances in the economic recovery, both within and across countries, in labour markets, and in the gulf that has opened up between supply and demand. These imbalances are adding to the high level of uncertainty around the outlook for the global economy, with more downside than upside risks.

There are far more questions than answers when it come to the likely path of the pandemic, the ongoing disruption and bottlenecks in supply chains, unexpected labour market shortages, as well as the future path of inflation and monetary policy. Central banks are also now diverging in their approach in how they should respond to the sharp rise in inflation this year, adding to the uncertainty in markets.

The emergence of the worrying Omicron variant of the coronavirus only adds to uncertainty and downside risks facing the world economy. There is little known yet about this new variant, but there are clear concerns about increased transmissibility and that vaccines may be less effective against it. The short-term implications are clearly negative for growth. Restrictions on travel have already been imposed, and reduced social distancing and interaction seem inevitable as case numbers rise, regardless of whether authorities tighten restrictions further or not.

Indeed, many countries had already re-imposed some restrictions to counteract rising Covid case numbers of the Delta variant. The impact on inflation is less clear. Oil prices are down by about 20% from their recent peak, but the new variant could see disruptions to supply chains and production persist for an even longer period of time.

The lessons learned this year, though, are in danger of being lost sight of in this sea of uncertainty and risk aversion. Both economies and financial markets have become better able to cope with the pandemic, most notably during the lockdowns imposed in the opening months of 2021. The recovery in labour markets has been particularly impressive. Corporate and household balance sheets are in a very robust state. There is also still a large amount of pent-up demand in economies, which should provide fuel for the recovery.

Vaccines have also proved effective in combating severe Covid illness, though, they may require tweaking to counter new variants. One other lesson from this year, though, is that the production and deployment of vaccines needs to be ramped up globally in 2022. Until this is achieved, the economic recovery will remain at risk and laced with uncertainty.

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