January Market Outlook

Canada: New health restrictions may weaken employment data for January after December's strong report that saw the unemployment rate come down to 5.9%, with hiring strong in the manufacturing and construction industries. This is consistent with October's GDP report last month, which showed a strong rebound in manufactured goods production. Activity may also be hampered by supply disruptions following December's flooding in BC. These should prove to be delaying factors for Canada's economic rebound and not seen as structural impediments to growth. Economists are predicting a 4.0% increase in GDP for 2022, which may be guided higher should this delay cause 2021 growth to come in below expectations of 4.6%.

United States: Daily new COVID-19 cases have spiked and are now averaging over 500,000 per day, although some believe that early, hard-hit cities like New York City may be reaching peak levels. Vaccine and booster hesitancy remains high and, even with the suspected lesser severity of Omicron infections, the sheer number of cases is posing challenges for some hospital systems, especially those serving unvaccinated communities. The December jobs report sent mixed messages, with the survey of employers (payroll jobs) suggesting weaker-than-expected jobs growth and still strong wage increases while the survey of households (unemployment rate) gave a stronger employment picture. Minutes from the Federal Reserve's December meeting raised expectations that it could begin not just to hike interest rates, but also to reduce the size of its balance sheet sooner than anticipated.

Europe: Despite a surge of COVID-19 cases across Europe, investors seem to feel more optimistic about the eventual growth recovery in 2022 for the region. As in previous waves of the virus, the UK appears to be between two to three weeks ahead of EU countries in terms of case count. As cases appear to be peaking, and in some areas, declining in the UK, markets will be hoping for a return to more normalised activity during 1H22. December manufacturing indicators have showed Germany being hit hardest by the restrictions in movement and congregation, and the regional PMI fell to 58.0 from 58.4. France remains more resilient but may decline in January with more draconian measures being introduced. At the same time, inflation hit an historic high of 5.0% last month, causing some concern from the ECB, though officials continue to stress we are likely at or near a peak in the current inflationary cycle. Business inventories are also rising as new orders weaken, suggesting inflationary pressures may subside relatively soon.

Asia: The RCEP trade agreement between 15 Asia-pacific nations went into effect on 1 January, which should be a long-term structural positive for the region. Business conditions in Japan should continue to improve into 2022 following firm manufacturing and service sector indicators through December. COVID-19 waves remain a key risk throughout the region for economic activity. China will see lockdowns in several areas in January in order to contain the spread of the virus before next month's Winter Olympics; there may be a further cut in the medium-term lending facility rate by up to 10 basis points (bps) should the property sector continue to languish. India is suffering a third wave of the virus, though hospitalisations and fatalities appear moderate and the economic impact is expected to be milder than the second wave. In a further sign that supply chain bottlenecks are easing, recent manufacturing indicators in South Korea have grown strongly on export orders for autos and semiconductors. Indonesia banned the export of thermal coal for January to ease local supply concerns, though the investment climate remains constructive with lower inflation and improved local liquidity.

Emerging Markets ex Asia In the face of spiraling inflation, Brazil's central bank increased rates 150 bps in December and indicated a similar move for the February meeting despite coincident high unemployment. The key export sector in Mexico remains moribund due to lack of container availability, transport bottlenecks, and raw material shortages, which will hamper GDP growth in 1H22. Chile's new leftist president Gabriel Boric may end up not being as market-negative as assumed and should reduce social unrest. As the Omicron variant case count has declined steeply, so activity is rebounding in South Africa, which bodes well for local markets. Russia finds itself embroiled in another neighbouring country again after sending around 3,000 troops into Kazakhstan in a "counter-terrorist" operation; this may lessen speculation of an invasion of Ukraine in the near term, but sanctions remain a key market risk. Middle Eastern markets continue to trade in line with the energy prices, having a firm end to the year and looking well supported into 2022.

Commodities: OPEC+ have agreed to raise monthly output as previously telegraphed to the market, though with crude inventories 8% below the five-year average and a lack of spare capacity, prices look well supported in the recent move back above $80/barrel for the Brent crude contract. Although European natural gas prices came off highs in December as US LNG exports were diverted to

Europe; we could see further upside pressure (vs the North American equivalent) due to shortages of Russian-supplied gas and competition from Asia for LNG. Industrial metals prices remain rangebound, lacking a clear driver of demand and ongoing concerns about the activity outlook in the Chinese real estate sector. There is similar lacklustre price action in agricultural commodities, though soybean futures are moving higher as dry soil conditions in Brazil are expected to negatively impact harvests. Gold prices have been hitting resistance around the $1,800/oz level as rising interest rates provide a headwind, despite a deterioration in the outlook for global inflation.

Currencies: Stability in the trade-weighted US dollar has been a recent feature, though the US rate outlook will be critical for the next step - with a bias to strength given increasing calls for running down the Fed's balance sheet and rate increase expectations being revised up to four 25-bp hikes in 2022. The Canadian dollar looks set to continue firming from around 1.26 (per US dollar) on the back of firmer energy prices and an improved current account. Other energy exporters are likely to be supported (barring political stresses in the case of the ruble). The euro seems stuck in a €1.12-1.15/$1 range for now, with value buyers unlikely to support unless it breaks down towards 1.10/$1. The Japanese yen looks oversold at ¥116/ $1, particularly if local activity growth returns on the back of a more stimulatory budget.

Views are as of 7 January 2022