

2022: The year of the consumer

By Lachlan Hughes

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The global economy is on track to grow above trend in 2022, as consumerism bounces back big.

In many parts of the world, including Australia and the United States, consumer balance sheets are in good shape.

With a huge amount of stimulus swirling around the economy, demand for goods and services is high and will climb higher in 2022 as people emerge from COVID-19 restrictions ready to spend on things like luxury goods, cars, travel and entertainment.

While some sectors stand to partake in this nascent demand more than others, the broader economy will benefit.

However, supply chain problems represent a key threat to stability and growth. Logistical systems are an amazingly complex maze of global labour, production, transport and storage but these are also fragile. COVID-19 continues to cause labour shortages, production problems and shipping delays.

The impact of this can be seen and felt in everyday life, with products increasingly out of stock, deliveries taking much longer, and shops and cafes closed over the Christmas period due to staff shortages as many workers contracted Omicron.

Globally, this demand and supply dynamic is pushing up the cost of goods and services, causing inflation to heat up. In December, the US consumer price index – the most common measure of inflation – recorded its highest annual increase (6.7 per cent) since 1982. A spike in inflation due to the rising cost of goods and services is not new and has historically led to fears about economic stagnation.

However, inflation should cool off as supply and demand bottlenecks dissipate in the second half of 2022. Furthermore, technology-led productivity gains should help keep a lid on inflation.

The year 2022 is expected to see a significant uplift in productivity, as those forced out of the labour force due to COVID-19 re-enter while the acceptance of flexible working conditions enables others previously excluded for reasons such as disability, geography and child-minding responsibilities to find suitable work.

While rising productivity, inflation and interest rates have historically been precursors to wage inflation, companies have been slow to introduce salary increases, despite many posting record profits in 2021.

Wages have generally not kept up with the pace of inflation, although a tight labour market and signs of the “Great Resignation” is forcing companies to fight to attract and retain talent.

Lower paid jobs are more likely to experience wage growth.

Over the next five to 10 years, productivity gains will be underpinned by technology enhancements in areas like artificial intelligence, robotics and automation.

This will help manage inflation, with Microsoft chief executive officer Satya Nadella describing digital technology as a “deflationary force in an inflationary economy” at the group’s quarterly earnings call in November 2021.

According to Mr Nadella, businesses of every size can improve productivity and the affordability of their products and services by “building tech intensity”.

Over the medium term, this should support real wage growth.

Uncertainty abounds, return to quality

After a strong equities market rally in 2021, concerns about a bubble in the benchmark are growing. Benchmark companies hit hard by COVID-19 during 2020 experienced a strong recovery in the past year, driven by earnings growth.

Index investors rode the wave in 2021, buoyed by a 94 per cent increase in earnings in the MSCI World Index.

However, this year earnings growth is forecast to fall to single digits.

Under such conditions, index funds and other large, diversified fund managers will struggle to outperform.

While many investors are still on risk-on mode looking for lower quality companies with greater potential to grow rapidly, conditions in 2022 are likely to favour active value managers who can pick the best businesses within the benchmark.

It is difficult to predict which investment style will be rewarded at any given time, however, if – as anticipated – 2022 sees a flight to quality, investors who remain in the quality orbit will be strongly positioned to outperform over the longer term and benefit when markets change.

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