Global Economic Outlook

November 2021

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Introduction

Inflationary uncertainty and uneven recoveries dominate the world's economic outlook.

2021 has been another turbulent, uncertain year and, at times, it can feel like the planet is facing a constant wave of challenges and threats. For the world's economists, predicting what lies ahead has never been tougher.

But there remains a place and purpose for forecasting and modeling. As the business world seeks to rebuild from the COVID-19 pandemic and adjusts to a planet more focused than ever on the climate crisis, looking ahead and identifying potential future risks and opportunities is essential.

KPMG's Global Economic Outlook offers that window into the world ahead. This year, Chief Economists from KPMG firms in a variety of countries, regions and territories have provided detailed insights into those obstacles and opportunities.

COVID-19 did not discriminate. Every nation on the planet was impacted by the pandemic, with seismic consequences for economic output. Government stimulus and support packages were rolled out in various shapes and forms as the world adjusted to a 'new reality'.

The pandemic may not be over, but the major economies are shifting their mindset and focusing increasingly on a long-term route to sustainable growth.

A major theme in this year's report is inflationary uncertainty. In almost all of the countries featured in KPMG's Global Economic Outlook, the risk of high inflation is a central feature. In the UK, political leaders are grappling with potentially crippling supply chain issues that are constraining production.

In Brazil, the main driver is a deeply uneven recovery, while in the US, consumer spending is helping to drive recovery, but labor shortages could halt any major progress.

There are exceptions. China was the first country affected by COVID-19, but it appears to be among the first to recover. Industrial production and exports are fueling a big return to pre-pandemic growth, but the global Asian powerhouse isn't immune to the effects of wider global economic uncertainty.

Meanwhile, in the Middle East, the Gulf Cooperation Council countries are reaping the rewards of near record-breaking oil prices, but any sudden change in the energy outlook could grind recovery in the region to a halt.

There is, sadly, no crystal ball in economics. We can't say for certain what lies ahead, but clear trends are beginning to emerge as the world itself surfaces from the pandemic and focuses on the potential risks and rewards of a more sustainable long-term recovery.

Please get in touch with any of the KPMG professionals quoted within the report for further information on your specific market.

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The global outlook: The economic costs of climate change[1]

Climate action is gaining impetus

Following the recent gathering of leaders in Glasgow for COP26, climate action continues to gain a significant impetus around the world. Since the 2015 Paris Agreement, countries and territories have intensified their climate actions and many have committed to reaching Net Zero Emissions (NZE) by 2050, meaning that any additional carbon emissions will be completely offset by carbon emissions withdrawn from the atmosphere.[2] However, as per the Paris Agreement, the timeframe to contain the maximum amount of emissions allowed to limit global warming to below 2°C (preferably 1.5°C) are quickly running out, as global warming continues at pace.

Rising temperatures

According to the National Oceanic and Atmospheric Administration & National Centers for Environmental Information, the increase in the global average temperature has been accelerating, with the average surface temperature rising by 0.14 degrees fahrenheit per decade since 1880 (chart 1). The rate of warming has also more than doubled since 1981, with the most extreme warming (darkest red, chart 2) observed in the northern high latitudes, and parts of Eurasia and the Middle East.

Global impact

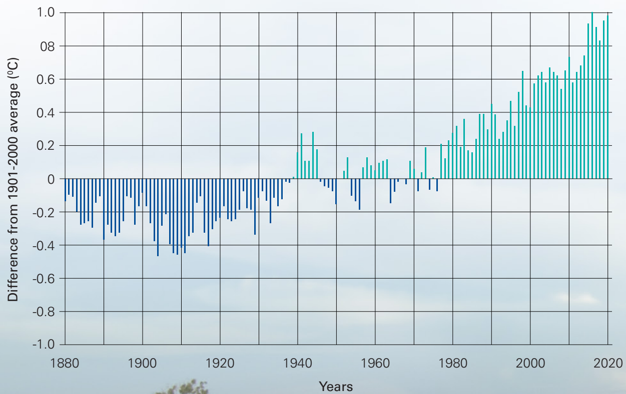
Rising global temperatures are already evidenced by the increased frequency of weather-related natural disasters, threatening both lives and livelihoods. For example, according to the World Meteorological Organization's (WMO) Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes (1970 – 2019), there were more than 11,000 reported disasters attributed to weather hazards globally during the 50-year period, with over 2 million deaths and US$3.6 trillion in losses cumulatively (chart 3).

Indeed, disasters related to weather, climate or water hazards have occurred every day for the past 50 years, on average killing 115 people and resulting in daily losses of US$202 million. As per the report, weather, climate and water hazards account for 50% of all disasters, 45% of all reported deaths and 74% of all reported economic losses.

According to Munich Re, in 2020 alone, global losses from natural disasters amounted to US$210 billion, of which only US$82 billion were insured. These events occurred across continents and included damages caused by hurricanes, wildfires, floods and droughts. The economic costs were in some cases recorded in billions of US dollars; for example, floods in Japan, hurricanes in the US and drought in Brazil.

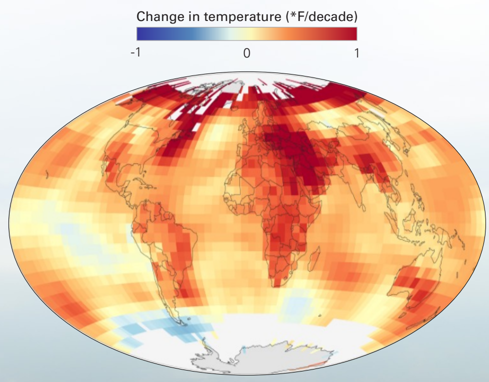
In terms of the economic losses incurred, there is demonstrable disparity observed, with emerging markets accounting for the highest number of uninsured losses in terms of the protection gap (chart 4).

Chart 1: **Global average surface temperature (1880-2020)**



Source: Snapshot from the National Oceanic and Atmospheric Administration & National Centers for Environmental Information.

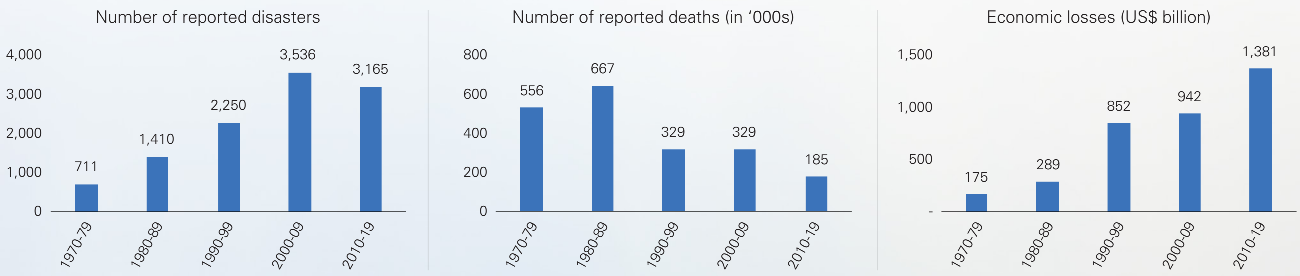
Chart 2: **Recent temperature trends (1990-2020)**



Source: Snapshot from National Oceanic and Atmospheric Administration & National Centers for Environmental Information.

[1] We have not included social and environmental costs in our analysis. We acknowledge that there are myriad factors that impact cost and incidence, including changes in forest management, building in flood zones, differential costs of rebuilding in developed versus emerging economies etc.
[2] IMF: 135 countries have committed to net zero by mid-century: https://blogs.imf.org/2021/10/31/not-yet-on-track-for-net-zero-climate-threats-demands-more-ambitious-global-action/.

Chart 3: **Reported disasters, reported deaths and economic losses**



Source: World Meteorological Organization Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes (1970 – 2019).

As per the WMO report, under the UN country classification, 71% of recorded disasters have occurred in developing economies, leading to 91% of recorded deaths associated with natural disasters (chart 4).[3] Without sizable and rapid reductions in carbon emissions, the frequency of intense disasters and volatile agricultural productivity are likely to become more common, with potentially catastrophic implications for emerging markets in the future.

The changes in climate will also have a significant impact on the global economy by the end of the century, with IMF estimates suggesting a global GDP impact of up to 13% relative to the baseline in the current policies scenario and a reduction of world real GDP per capita of more than 7% by 2100.[4] The importance of climate action becomes all the more critical as risks to ongoing development are increasing and economic growth continuing to erode natural capital, leading to increased water scarcity, floods, greater pollution, climate change and unrecoverable biodiversity loss.

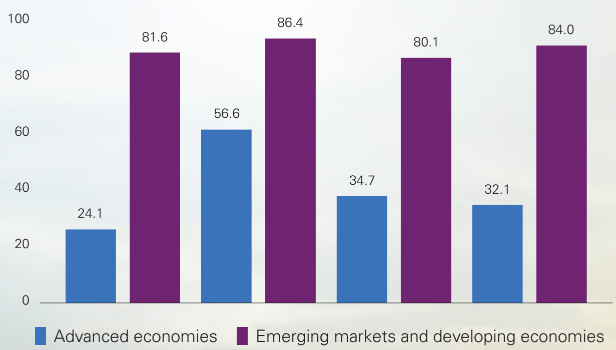
Future impact

Current projections demonstrate that the world remains on track for a dangerous global temperature rise, of at least 2.7°C this century, even if the goals under the Paris Agreement are met.[5] With no tangible and concrete policy responses, emissions would continue to rise and global temperatures could increase by an additional 2-5°C by the end of this century, imposing growing physical and economic damage across the world.

According to the latest UN Intergovernmental Panel on Climate Change (IPCC) Working Group I report, changes to the earth's climate are already being seen in every region and across the entire climate system.[6] Many of these observed climate change events will be unprecedented and some, such as the continued rise in sea levels, would be irreversible. The impact of these changes could lead to the following:

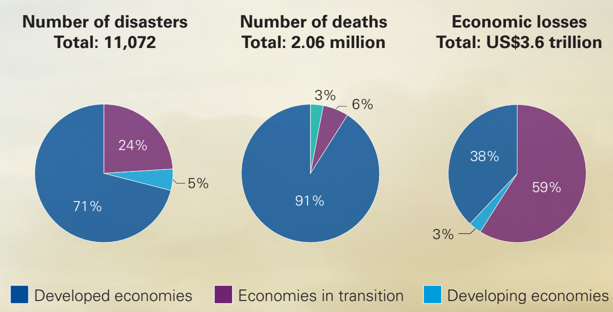
- Temperatures reaching 1.5°C above 1850-1900 levels by 2040 under all emission scenarios.
- In all climate scenarios assessed, the Arctic is likely to be completely ice-free during September at least once before 2050.

Chart 4: **Protection gap, 2009-2018 average**
Percentage



Source: IMF, GFSR April 2020; Protection gap is defined as the share of uninsured losses from disasters.

Chart 5: **Distribution of number of disasters, deaths and economic losses by United Nations country classification globally (1970–2019)**



Source: World Meteorological Organization Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes (1970 – 2019).

[3] World Meteorological Organization Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes: 1970 – 2019.
[4] NGFS Climate Scenarios for central banks and supervisors (June 2021); IMF Working Paper - Long-Term Macroeconomic Effects of Climate Change: A Cross-Country Analysis (October 2019).
[5] United Nations Environment Program, Emissions Gap Report 2021.
[6] Intergovernmental Panel on Climate Change, Working Group I Contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change: Summary for Policymakers.

- Even with warming contained at 1.5°C, increasing occurrences of extreme events "unprecedented in the historical record" are likely, including increases in fire weather in many regions across the globe.
- Extreme sea level events that previously occurred only once every century are projected to occur at least once a year at more than one-half of tidal gauge locations by 2100.

Mitigation and transition costs will be substantial

The changes needed to keep warming below 1.5˚C include a substantial reallocation of capital, which offer both unprecedented risks and opportunities. The International Energy Agency (IEA) estimates that getting countries on track for NZE requires an increase in annual investment in energy from over US$2 trillion globally on average over the last five years to almost US$5 trillion by 2030. The EIA expects such investment needs to reach US$4.5 trillion by 2050 (on the expectation that the cost of renewable energy technologies will continue to decline).[7]

The severe economic impacts and fiscal costs of COVID-19 will limit the ability of many developing countries to invest in both traditional economic recovery stimulus and climate action. The adaptation costs of climate change in developing economies could reach up to US$300 billion by 2030 and US$500 billion by 2050.[8] Besides, given the perceived slow pace of climate change, the broader adaptation, transition and mitigation financing gap is unlikely to narrow, with developing economies unlikely to rapidly switch to renewable sources due to a lack of immediate funding or incentives. The transition will be further complicated by the risk of stranded assets, which retain value in practice but would be inoperable due to, for example, regulations that limit use of coal power in generating electricity.

Hence, achieving these ambitious targets will require the following:

- COVID-19-induced fiscal measures have already constrained the budgets of many emerging and low-income countries. Developed countries and territories will need to substantially ramp up their financial support for developing countries to help reduce emissions and build resilience against climate impacts. The G20 countries continue to fall short of their existing commitment towards providing US$100 billion in annual funding to developing countries and territories (reaching only US$79.6 billion in 2019) to help them with climate adaptation, building resilience and new renewable energy-development.[9]
- The level of investment needed to secure NZE will involve redirecting existing capital towards clean energy technologies and substantially increasing the overall level of investment in energy. The majority of this investment is likely to come from private sources mobilized by public policies that should create incentives, set appropriate regulatory frameworks and reform energy taxes. There is already a big shift taking place among asset managers towards sustainable investments, with global green bond issuances also being accelerated – the stock of this category of bonds stood at US$269.5 billion in year 2020.[10] However, sustained long-term growth of the green bond market (and other asset categories) will require agreed taxonomies and common disclosure frameworks across countries' regulatory bodies and central banks, as well as support from international organizations.
- Data transparency, including the collection of data on public and private sector climate packages and measures, will be critical to achieving climate goals under NZE. This would help to enhance transparency around climate-positive investments and financing; countries (and firms), with their financial needs and goals presented in their climate pledges, would be able to track and monitor their progress in order to prove their green credentials for potential investors.
- Global carbon pricing has the potential to play a pivotal role in achieving NZE, as the system allows countries and industries to monitor and verify their carbon emissions. This also provides a price signal to redirect investment to low carbon technologies and energy efficiency.

The window of opportunity for containing global warming is closing and the associated costs will continue to rise rapidly. Natural disasters will continue to impede future economic growth prospects as it becomes increasingly costly to substitute physical capital for natural capital, and switching to renewable and environmentally-friendly resources will not necessarily follow a smooth trajectory. Without an urgent narrowing of policy and financing gaps, further delays in emission reduction targets beyond 2050 would only increase transition costs and put temperature goals beyond reach, thereby posing a threat to macroeconomic and financial stability going forward. These costs and impacts are likely to be felt to different degrees and through different routes in terms of developed economies vis-vis frontier and emerging markets.

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[7] IEA: Net Zero by 2050 Report, https://www.iea.org/reports/net-zero-by-2050.
[8] UNEP Adaptation Gap Report 2020.
[9] UN Climate Action Factsheet, https://www.un.org/sites/un2.un.org/files/fastfacts_finance.pdf.
[10] Climate Bonds Initiative, https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn.

United States: Consumer spending to power past Delta derail

Consumer spending is expected to shift gears toward services spending as the Delta wave moves into the rearview mirror.

Inflationary pressures are likely to ease but remain above target, potentially leading a more hawkish Federal Reserve (Fed) to raise rates in the second half of 2022.

High home prices will continue to curb housing demand, weighing on residential investment.

The US economy hit a speed bump in the third quarter of 2021 as the rise of the Delta variant slowed economic momentum. The pace of hiring in the service sector declined by 17% from the second to third quarter, and consumer sentiment dropped by nearly 15% from June to September. Even as the recovery slowed at the end of the summer, underlying economic fundamentals remain strong, and we anticipate a rebound in consumer spending and employment to drive above trend growth through next year.

While goods consumption will likely moderate, we anticipate continued progress on services consumption. This is propelled by three things; the anticipation of receding COVID threats, a reserve of excess savings, and a combination of jobs and wage gains that should provide sufficient income to propel consumption in 2022.

The spread of the Delta variant pushed the infection rate in September to its highest level since last winter, even as the share of the vaccinated public continued to rise, creating uncertainty as schools were set to return to in-person learning in September. The share of the public older than 12 with at least one dose is above 75%, and the Food and Drug Authority (FDA) approved vaccines for children between the age of 5-12 in early November.[11] This will help alleviate childcare issues for some parents, but health and childcare concerns are expected to persist in 2022, which will translate into a slower rebound in the labor force participation rate next year. A rebound in the rate of hiring intensifying wage pressures as anticipated is the tailwind that will allow household spending to grow between 2-2.5% in 2022.

[11] Centers for Disease Control and Prevention.

Table 1: **KPMG forecasts for the US**

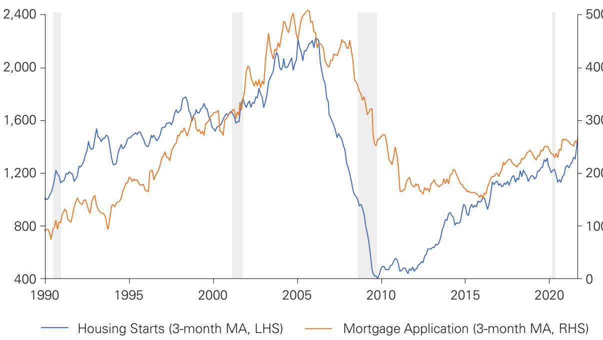
	2020	2021	2022
GDP	-3.4	5.5	4.4
Inflation	1.2	4.7	4.3
Unemployment rate	8.1	5.4	3.1

Source: Bureau of Economic Analysis (BEA), Bureau of Labor Statistics (BLS), KPMG analysis.
Note: GDP growth is shown for the full year. Inflation and unemployment rates are annual averages. Numbers are percentages.

Even as the receding Delta wave boosts employment, labor shortages are likely to persist in many in-person and high demand jobs, adding to wage pressures. Year-on-year (y-o-y) wage gains have been strong during the pandemic and have sustained a pace above 4%, recently causing average hourly wages to be 3.8% above the pre-pandemic trend.

The combination of wage and job growth is expected to yield an additional US$200 billion in spending power next year. Add to that another US$540 billion from a potential drawdown in savings, the savings rate is still 3.5% above its average during the last expansion, and consumer spending should remain elevated through next year despite price pressures on a variety of goods and services.

Chart 6: **Housing starts slow as mortgage boom eases**

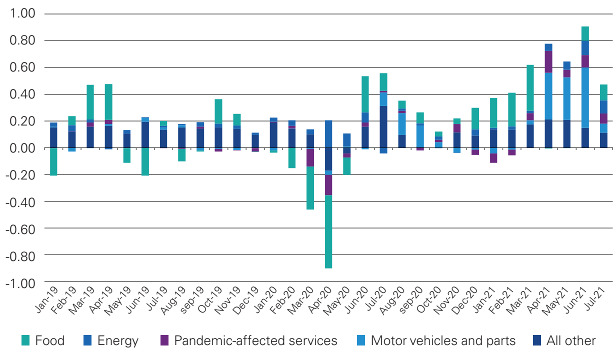


Source: Mortgage Bankers Association, U.S. Department of Commerce, KPMG Economics.

Despite rebounds in consumer spending and hiring, we expect activity in the housing market to continue contracting in 2022, as high prices weigh on housing demand and the Fed removes monetary policy support, lifting mortgage rates. A rise in home prices has far outstripped growth in average hourly earnings since the start of the pandemic, greatly reducing affordability. Recent housing data suggest that this has begun to weigh on residential investment; the pace of housing starts slowed in the second half and mortgage applications are also down almost 25% from their January high. Additionally, the decision by the Fed to begin tapering asset purchases is already tightening financial conditions in the real estate market, as evidenced by the near quarter point jump in the 30-year mortgage rate after the Federal Open Market Committee (FOMC) meeting in September. We anticipate that these factors should reduce residential investment by 4.8% next year.

The pandemic and its aftershocks are also dictating the path of inflation. Prices jumped in the second quarter as goods consumption continued at a strong pace, taking first half consumption to over a 19% annualized rate. A surge in demand for vehicles coupled with production shortfalls stemming from a global shortage of semiconductors, caused vehicles, coupled to accelerate further in the third quarter. In addition, the return of services demand caused the price of services such as airfare and auto rentals to experience strong monthly gains in first half of 2021. However, pandemic-related price pressures eased in the third quarter, partially owing to a contraction in consumer activity as the Delta variant spread. We expect consumer activity to shift from goods consumption to services consumption, while putting upward pressure on

Chart 7: **Pandemic-related inflation pressures are easing**
Contributions to headline CPI growth (percentage)



Source: Burea of Labor Statistics, KPMG Economics.

services prices. This, coupled with wage pressures that are likely to remain elevated due to a lag between the participation lost during the pandemic and what economists expect as the recovery ages is likely to keep inflation for 2022 near 3%, above the Fed's 2% target in 2022.

While monetary policymakers have publicly stated that the recent inflation spike is likely to be transitory, the composition of the rate-setting committee at the Fed will likely skew more hawkish next year. In addition, the median forecast by policymakers for the first rate increase recently came forward into 2022. These developments, and continued above-target inflationary pressures, make a rate increase in the second half of next year a possibility and a base case that we have factored into our forecasts.

Looking further out, elevated wage pressures and a high savings rate could fuel investments in productivity-enhancing technology, which would improve the productive capacity of the economy and lift potential GDP. To get there, monetary policy makers will need to navigate the long-term downward pressure on inflation from technology advancements and demographics versus what we anticipate will be persistent price and wage pressures in 2022. Waiting to raise rates could foster additional price pressures, but raising too soon could prematurely slow growth, further hindering the pace at which people return to the labor force, which would cause long-term damage to the growth rate. Despite the economic challenges that lie ahead, we anticipate above trend growth of slightly over 4%, with inflation over 4% as supply constraints persist. This combination of GDP and price growth should be supportive of continued elevated capital expenditure and should allow firms some pricing pressure that was absent in the last recovery.

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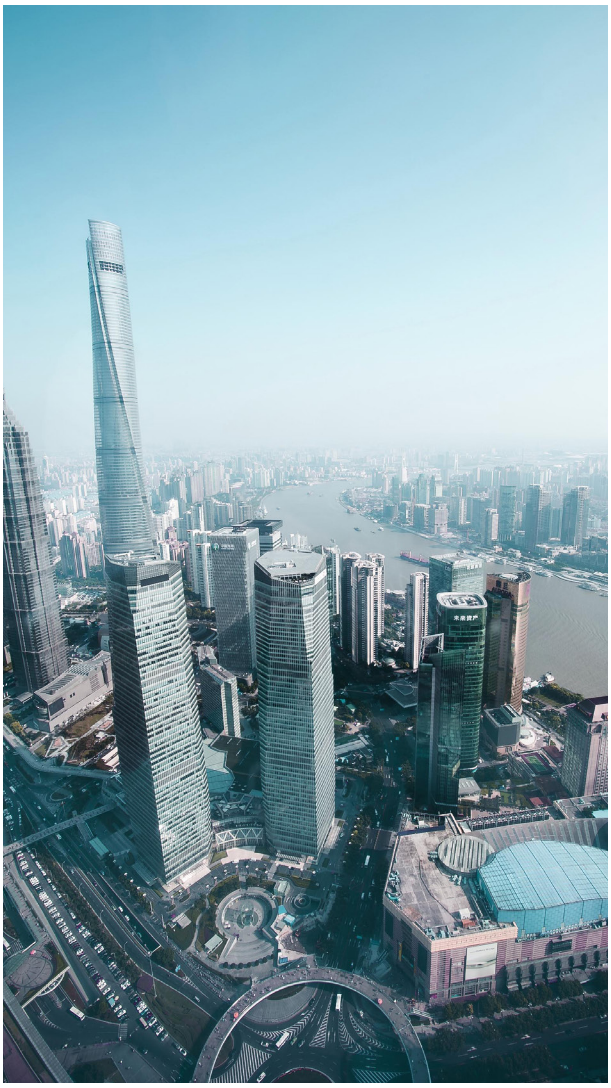
China: continued economic recovery

The Chinese economy continues to recover but the pace may moderate due to a higher base, regulatory adjustments, pandemic controls and the uncertainties of the global economy.

Industrial production and exports have been the main drivers for China's economic rebound, but consumption is expected to gain more traction in 2022.

Inflation has remained muted for consumers but has been rising on the production side.



China's economy continues to recover, growing by an average of 9.8% y-o-y in the first three quarters of 2021. This high growth rate was partly driven by a low base comparison due to the COVID-19 pandemic. The annualized average growth rate for 2019-2021, which removes the base effect, reduced from 5.5% in Q2 to 4.9% in Q3. The Chinese economy is expected to continue to rebound but the pace is likely to moderate due to the higher base, regulatory changes, sporadic but lingering COVID-19 cases and uncertainty within the global economic environment. Overall, mainland China's Real GDP should grow by 8.2% in 2021 and 5.5% in 2022.

Industrial production and exports have been the key drivers of China's economic rebound. Both continued to post strong growth in the first three quarters of 2021. Industrial production grew by 11.5% y-o-y and exports surged by 33%. However, the growth of industrial production has begun to moderate, thanks to rising commodity prices, supply chain disruptions and tightened regulations on carbon emissions. In addition, China's exports have remained strong due to rising demand from advanced economies and production disruptions in some developing markets due to new waves of COVID-19 cases taking hold. Looking ahead, China's exports are likely to continue to do well, but the growth rate may slow as the base for comparison is getting higher and demand in advanced economies is shifting more towards services.

In contrast to the strong growth of industrial production and exports, the recovery in consumption has lagged. Based on a survey by the People's Bank of China (PBoC), household confidence in incomes is recovering from a historical low in Q1 2020, during the height of the pandemic, but has not fully regained the levels seen during 2017–19. As a result, households are still cautious with consumption and have tended

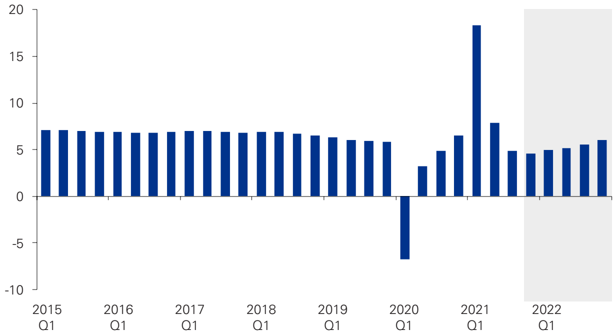
Table 2: **KPMG forecasts for China**

	2020	2021	2022
GDP	2.3	8.2	5.5
Inflation	2.5	0.9	2.3
Unemployment rate	5.6	5.1	5.0

Source: Wind, KPMG analysis.
Note: Average percentage change on previous calendar year except for the unemployment rate, which is the average annual rate. Inflation measure used is the CPI, and the unemployment measure is the surveyed unemployment rate.

to save more. Another challenge for the recovery in consumption is the lingering pandemic. COVID-19 has generally been under control across the country since last May, but there are still sporadic cases, especially those caused by the Delta variant. China has followed a zero-COVID strategy, which has been effective in controlling the spread of the virus but may also create challenges for the recovery of consumption in the near term. With a recovering economy and improving consumer sentiment, consumption growth is expected to gain more traction in 2022.

Chart 8: **China's economic recovery is expected to continue but the pace will likely moderate**
Percentage change, y-o-y



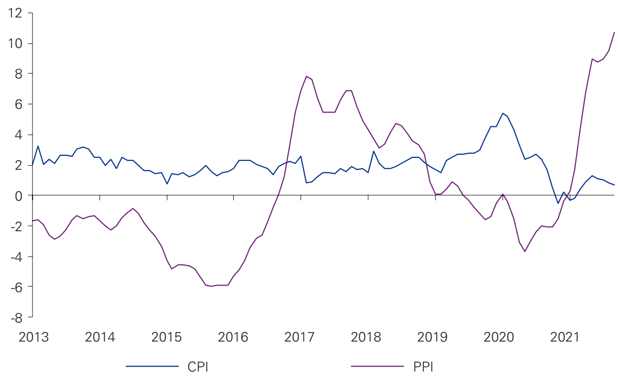
Source: China's National Bureau of Statistics, Wind, KPMG analysis.

China has introduced a series of tightening measures on the property market since the second half of 2020, such as controlling developers' debt levels, limiting banks' exposure to real estate loans and changing the method of land auctions. In October, the government also announced it would start pilot programs of collecting property tax in selected areas. The real estate market has slowed markedly, and new housing starts fell 4.5% in the nine months through September. Property investment growth is likely to further moderate in 2022.

Inflationary concerns are rising globally. Due to rising commodity prices and production caps in some sectors to reduce carbon emissions, producer prices in China have stayed at relatively high levels. The government has taken a series of measures to rein in commodity prices. In September, China released state petroleum reserves for the first time in history to ease oil prices. As supplies recover further, pressure on producer prises should moderate in 2022.

China's consumer price inflation (CPI) has been significantly affected by food price fluctuations over the past two years, which were largely driven by pork prices. With a recovery in the pork supply, food price inflation has come down and dropped 1.6% through September from a year ago. It has helped keep the overall CPI down. However, rising commodity prices, supply chain disruptions and efforts to cut carbon

Chart 9: **Consumer inflation has remained muted, but producer prices surged with rising commodity prices**
Price index, percentage y-o-y



Source: China's National Bureau of Statistics, Wind, KPMG analysis.

emissions have pushed up producer price inflation, surging in September by 10.7% y-o-y, to a record high in the data's 25-year history. Looking forward, some of the inflationary pressures on the production side may trickle through to consumers, but overall inflation should remain in check. The CPI is expected to grow 0.9% y-o-y in 2021 and 2.3% in 2022.

China's new urban employment increased by 10.45 million jobs in the nine months through September, completing 95% of the government's annual target (11 million). The surveyed unemployment rate came in at 4.9% in August, which is 0.6% lower than the government's target. The unemployment rate is expected to average 5.1% in 2021 and 5.0% in 2022.

The Hong Kong (SAR) economy remains on the recovery path, supported by an improving global economy and better pandemic controls. The economy grew by 7.6% y-o-y in Q2, following 7.9% growth in Q1. However, the recovery is still uneven, with the exports of goods staying robust but inbound tourism subdued. Retail sales continue to recover but are still below pre-recession levels. Meanwhile, the unemployment rate declined from its peak of 7.2% in February 2021 to 5% in July. Looking ahead, the global economic recovery should continue to support the rebound of Hong Kong's economy, with 4% growth in 2022.

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Japan: Economic growth likely to accelerate to above trend rates

A successful vaccination program, robust external demand and an easing of supply chain disruptions are expected to support an economic recovery.

Non-regular workers, who bore the brunt of the pandemic-induced labor market weakening, will likely benefit most from the economic upturn.

Despite high energy prices, headline inflation should remain low owing to long-standing deflationary forces and several recent government policy measures.

Table 3: **KPMG forecasts for Japan**

	2020	2021	2022
GDP	-4.6	2.3	3.1
Inflation	0.0	-0.2	1.1
Unemployment rate	2.8	2.9	2.5

Source: Cabinet Office, Ministry of Internal Affairs and Communications, KPMG analysis.
Note: Average percentage change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

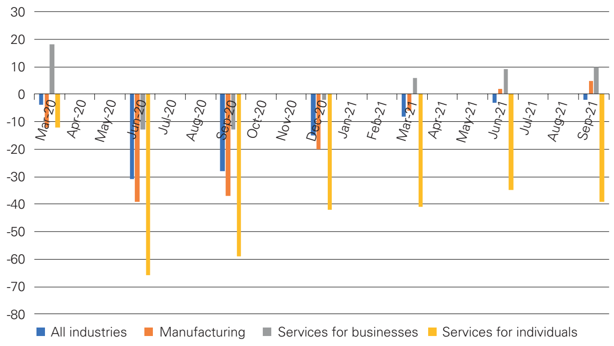
Domestic COVID-19 case numbers and those in the country's main trading partners, as well as supply chain bottlenecks (themselves related to trends in COVID-19 case numbers domestically and abroad) have determined the performance of Japan's economy thus far in 2021. According to the Cabinet Office, the annual growth rate recorded a contraction of 1.3% y-o-y in the first quarter of 2021 as pandemic containment measures offset improvements in production and exports during the same quarter. Correspondingly, as COVID-19 containment measures eased in the second quarter, real GDP expanded by 7.6% y-o-y.

The headline growth number in the second quarter was further supported by base effects; the economy contracted by 10.1% y-o-y in the same quarter of 2020, when the initial spread of the pandemic curtailed global economic activity. The economy was also supported by an upturn in demand for goods exports and domestic business investment, as well as a modest improvement in private consumption as face-to-face services sectors benefited from an easing of pandemic-related restrictions.

Headwinds remain as supply chain shocks continue to hinder manufacturing output. In particular, the automobile sector has continued to see supplies hindered by production (and transport) problems stemming from COVID-19-related disruptions in key overseas suppliers. Moreover, private consumption was undermined in August owing to a resurgence of COVID-19 cases, highlighting the risks to Japan's economy from further possible spikes in COVID-19 cases both domestically and abroad.

Nevertheless, high frequency data suggest a turnaround is underway. COVID-19 cases started to drop in September and October, and pandemic-related restrictions are being eased. This bodes well for a recovery in economic activity as broader pent-

Chart 10: **Tankan survey's Diffusion Index suggests mixed but positive momentum**
Percentage points



Note: Business Conditions (Diffusion Index of "Favorable" minus "Unfavorable" (for "All Enterprises").
Source: Bank of Japan.

up domestic demand combines with an improvement in face-to-face service activities. Together, these factors are expected to support a recovery in private consumption. Moreover, expected supply chain improvements should support an increased supply of durable goods that should also further bolster domestic consumption.

Export and other segments of the manufacturing sector, such as information technology goods and capital goods production, are already in recovery mode thanks to strong external demand. Together with fiscal stimulus measures currently passing through parliament and a continued tempered monetary policy, private investment is likely to accelerate into 2022.

The assumption of a positive economic outlook is supported by the Tankan Survey for September; the Diffusion Index for business conditions across all industries and enterprises showed continued improvement, with the manufacturing sector segment of the index being supported by components such as electrical machinery. On balance, real GDP growth is expected to accelerate from 2.3% y-o-y in 2021 to 3.1% in 2022.

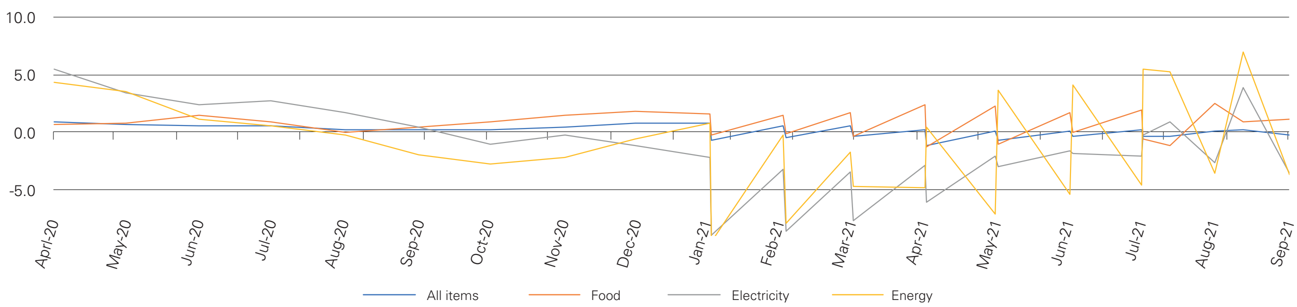
The broad economic upturn and the expected prevention of spikes in COVID-19 cases, largely the result of a successful domestic vaccination program, should support the labor market, particularly in the face-to-face services sector. The unemployment rate is expected to rise from an annual average of 2.8% in 2020 to 2.9% in 2021, before falling back to 2.5% in 2022 (close to pre-pandemic levels).

The positive impact is likely to be felt most among "non-regular workers," who are effectively contract employees and who have borne the brunt of the negative effects of pandemic containment measures. We note that the expected improvement in employment opportunities being centered on non-regular workers indicates the fact that the reaction function of employers in relation to full-time staff during pandemic-related lockdowns was to retain full-time staff. This reflects myriad factors that include structural worker shortages in many sectors, which makes employers reluctant to fire staff. Underlying improvements for labor overall will nevertheless support income growth and, related, consumer confidence.

The sharp fall-off in domestic and external demand (that widened the output gap) as a result of the pandemic reinforced Japan's long-standing deflationary trends in 2020, with annual average inflation standing at 0% in that year. This deflationary pressure has persisted, even as high international energy and other commodity prices have put upward pressure on both domestic consumer and producer prices, reflecting in part a government initiative that saw mobile phone operators cutting fees, as well as several other transitory deflationary measures. Indeed, owing to rising input costs, underlying price pressures have been rising. These are likely to feed through into the broader CPI in 2022. The deflationary impact of the reduction in mobile phone prices should also filter out next year, even as the output gap narrows.

Together, these factors are likely to push up domestic prices and see the rate of inflation rise by 1.1% in 2022, following a fall of 0.2% in 2021.

Chart 11: **Inflationary pressures will remain low**
Percentage change, y-o-y



Source: Bank of Japan.

India: Recovery expected to be driven by effective implementation of policy reforms and rapid vaccination roll-out

India's rapid administration of COVID-19 vaccines should support a recovery in economic growth.

The easing of pandemic-related restrictions and the associated economic recovery should also support a decline in the unemployment rate.

Government measures will likely contain headline consumer price inflation.

A rapid increase in vaccine coverage, a related ebbing of the second COVID-19 wave of infections, benign monetary and financial conditions, and buoyant external demand have together helped the economy to embark on a strong growth trajectory, barring some supply-side disruptions. Indeed, the economic outlook appears promising for India, with projected real GDP growth of around 9.3% in the 2021-22 fiscal year (running from April to March) and headline numbers bolstered by base effects.[12] In addition, domestic equity indices such as the SENSEX and NIFTY have been performing well in recent months, reflecting improvements in business and investor sentiment, strong retail and institutional inflows (amid improving earnings prospects), and a boom in initial public listings.

The economy more broadly is expected to be boosted by both urban and rural consumption. Urban demand is turning the corner, as corroborated by high frequency domestic indicators. Agriculture and allied activities should benefit from the good kharif sowing and harvest. A recovery in manufacturing and services sectors, including contact-intensive services, should get a boost from rising inoculation rates and a gradual, albeit still uncertain, normalization of the global supply chain network.

[12] International Monetary Fund, World Economic Outlook (October 2020).

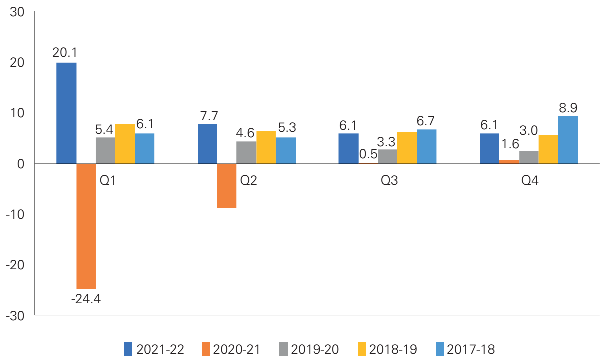
Table 4: **KPMG forecasts for India**

	2020	2021	2022
GDP	-7.3	9.3	7.9
Inflation	6.2	5.5	4.9
Unemployment rate	10.0	7.6	6.5

Source: Ministry of Statistics and Programme Implementation; Center for Monitoring Indian Economy; KPMG analysis.
Note: Fiscal year runs from April – March, for instance, 2020 spans April 2020 to March 2021. Real GDP numbers (at constant prices) based on fiscal year. Inflation rate and unemployment rate are on an annual average basis.

Policy reforms such as the Production Linked Incentive (PLI) schemes, National Monetization Pipeline (NMP) and the launch of PM Gati Shakti, amongst others, are expected to drive demand growth across the public and private sectors and create new jobs. In addition, amendments to insolvency laws and the provisioning of bad loans present a positive outlook in relation to the profitability of banks, as well as liquidity in the market more generally. These factors, along with a gradual improvement in the performance of contact-intensive service sectors, are leading to reduced unemployment rates, which according to the Center for Monitoring Indian Economy (CMIE) stood at 7.8% in October 2021, with the labor market expected to continue improving.[13]

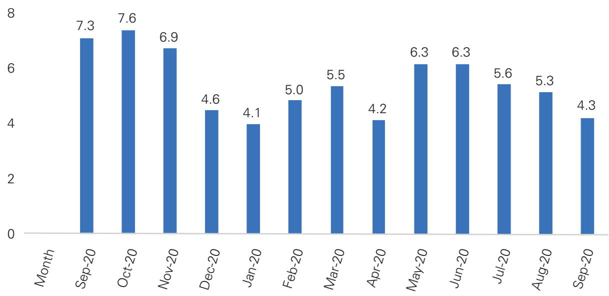
Chart 12: **Incremental GDP growth estimates indicate faster economic recovery in near term**
Growth rate of quarterly estimates of GDP at constant prices, percentage change, y-o-y



Source: Survey of Professional Forecasters; Reserve Bank of India; National Statistical Office.

Rising input costs originating from increases in metal and energy prices and a shortage of industrial components are two of the factors adding to inflationary pressures, which nevertheless currently remain in line with the Reserve Bank of India's (RBI) policy remit.[14]

Chart 13: **Government interventions and base effects should contain headline inflationary numbers**
CPI, percentage change, y-o-y



Source: Ministry of Statistics and Implementation.

The inflation rate for 2021 is expected to be around 5.5% (0.7 percentage points lower than 2020), with price pressures being contained by government interventions such as reductions in excise duty and value added tax (VAT) rates on fuel and reduced import duties on edible oil (to keep a check on retail inflation in the short-term). The inflation rate is expected to decelerate to 4.9% on 2022, largely in line with a further easing of supply side constraints. Backed by government support, the economy is likely to continue on its recovery path. However, escalations in geopolitical tensions, further surges in domestic COVID-19 cases, and inflationary risks posed by global supply-side disruptions are potential risks to expectations of a rapid economic expansion.

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[13] Unemployment in India, Center for Monitoring of the Indian Economy (CMIE).
[14] Minutes of the MPC meeting: balancing growth and inflation, Morgan Stanley research.

Eurozone: From summer tailwinds to winter headwinds

Accelerated vaccination campaigns have helped European economies reap the benefits of re-opening throughout the summer.

Rising inflation and supply chain bottlenecks pose a threat to the near-term outlook for households and businesses.

Filling up the political vacuum created by the recent general election in Germany will be crucial for the stability of the Eurozone.

A significant reopening of the economy over the summer, coupled with rising immunity to COVID-19, have supported a sharp recovery in business and consumer sentiment. The Eurozone economy is now 0.5% below its pre-pandemic level, which we expect to be exceeded by the end of 2021. Nonetheless, only a handful of member states, supported by relatively less stringent government policies, have so far reached their pre-pandemic peaks.

The Next Generation European Union (EU) program, worth over EUR800 billion, should help to ensure a more uniform recovery across the Eurozone over the next five years, through investment in research and innovation, climate transition and digital transformation.

The near-term outlook for the Eurozone will depend on the persistence of the current headwinds, including supply chain bottlenecks and rising inflation. Shortages of materials and labor have constrained growth in the manufacturing sector, while a fading summer rebound in activity has led to a slowdown in services. The supply pressures could take until the middle of next year to fully resolve, continuing to put upward pressure on prices.

Inflation was below 1% at the start of 2021, but increased to over 4% in October, reflecting higher energy prices and supply-side constraints. These factors are expected to moderate, putting downward pressure on inflation next year. We expect inflation to return towards the European Central Bank's (ECB) new symmetric target of 2% in 2022. Under its new monetary policy strategy, symmetry means that the Governing Council now considers negative and positive deviations from the target to be equally undesirable.

Table 5: **KPMG forecasts for the Eurozone**

	2020	2021	2022
GDP	-6.5	5.2	4.5
Inflation	0.3	2.4	2.0
Unemployment rate	7.9	7.8	7.4

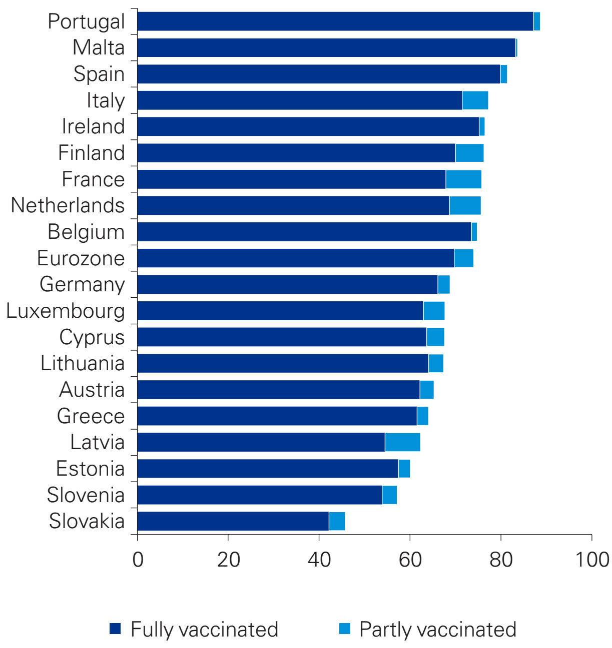
Source: Eurostat, KPMG analysis.
Note: Average percentage change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

The recent general election in Germany has contributed to a growing vacuum in the Eurozone's political leadership. Spain is now ruled by a minority government, the Netherlands is engaged in lengthy coalition talks, while France is heading into a presidential election campaign next year.

In Germany, the centre-left Social Democrats (SPD) are hoping to secure power after winning the highest number of votes in the general election in September. Coalition talks could conclude as early as December, providing a much-needed impetus to growth next year. Optimism among businesses has deteriorated over recent months, as supply chain bottlenecks that impede industrial production are expected to persist throughout the winter.

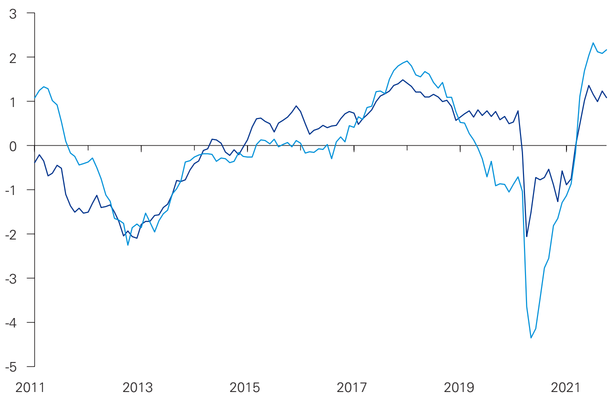
Having grown strongly in Q3 2021, we expect the French economy to exceed its pre-pandemic peak in the fourth quarter of this year. However, we note that consumer confidence has faltered, as households have become concerned with the impact of rising electricity and gas prices. With six months left before the presidential election, the government has announced a EUR100 grant to help low-income families with rising costs, although this will unlikely prevent growth from moderating.

Chart 14: **Vaccination programs have generally been robust (vaccination rates by dose per 1 November 2021)**
Share of the population (percentage)



Source: Our World in Data, KPMG analysis.

Chart 15: **Eurozone business and consumer confidence has been improving**
Deviation from the 2011-2019 avarage



Source: European Commission, KPMG analysis.

In Italy, the recovery has been led by investment, which is now over 5% above its pre-pandemic level, thanks in part to the government's plan to digitalize the public administration and the judicial system. Further ambitious reforms, including energy efficiency and training initiatives, will be facilitated by a total of EUR191.5 billion in grants and loans provided by the EU's Recovery and Resilience Facility over the next five years.

In the Netherlands, prolonged negotiations to form a coalition since the general election in March has meant that the caretaker government has been unable to introduce any meaningful reforms. Despite the political impasse, the Dutch economy has enjoyed strong growth so far this year, although the recent surge in domestic COVID-19 cases could cast a shadow on its near-term prospects. The outgoing government presented its Budget plans for 2022, with an allocation of EUR6.8 billion to climate actions.

In Spain, a gradual recovery in tourism has supported growth over the summer, but output still remains 6.6% below its pre-pandemic level. We expect the recovery to pick up pace next year, driven by progress in vaccination programs and a corresponding normalization of international travel.

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United Kingdom: Recovery in soft patch

A re-opening economy and successful vaccination program fuelled a rapid recovery through the second quarter of this year.

Ongoing supply chain issues and skill shortages are constraining production and slowing the pace of growth.

Upsurge in inflation is expected to persist until the end of 2022 amid gradual increases in base rates.

The recovery of the UK's economy is entering a delicate stage, with ongoing supply chain issues and skill shortages constraining production. While there are grounds for optimism around consumer and investment demand, the economy must now contend with a high, and potentially accelerating, inflation rate. There is also currently a level of uncertainty around the labor market due to the ending of the government's furlough scheme.

The initial boost that the successful vaccination program and re-opening of the economy brought fuelled a rapid recovery in the second quarter of 2021. However, a late summer surge in COVID-19 cases led to more cautious behaviour by consumers and stalled the recovery through July to September. Quarterly real GDP growth fell to 1.3% in Q3 of this year, from 5.5% in the previous quarter, with overall GDP growth now expected to reach 6.8% this year and 4.4% in 2022.

The outlook for consumer spending continues to be positive, as the £186 billion of excess savings accumulated since the start of the pandemic is at least partially expected to be spent over the coming months, driving an increase in overall consumption to 3.8% in 2021 and 7.2% in 2022. However, persistent higher inflation, and a rising tax burden could eat into the accumulated savings and household incomes and weaken the boost to consumption.

In the medium term, investment will be aided by the impact of a super-deduction allowance for capital investment on plant and machinery which is projected to expand by 4.9% in 2021 and 5.5% in 2022. The boost to demand for investment has taken longer than anticipated to impact GDP figures, with investment

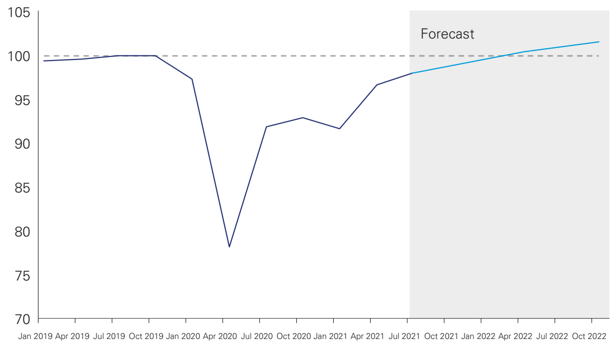
Table 6: **KPMG forecasts for the UK**

	2020	2021	2022
GDP	-9.7	6.8	4.4
Inflation	0.9	2.5	4.8
Unemployment rate	4.5	4.6	4.4

Source: Eurostat, KPMG analysis.
Note: Average percentage change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

contracting in the second quarter of 2021 even though the scheme was in place from the beginning of April 2021. Nevertheless, a steadier pandemic recovery and a return to normal business conditions should see firms taking advantage of the 130% corporate tax deduction against investment on plant and machinery offered by the UK government to bring forward their planned investments.

Chart 16: **UK GDP expected to return to pre-COVID level by early next year**
Index of real GDP (Q4 2019 = 100)

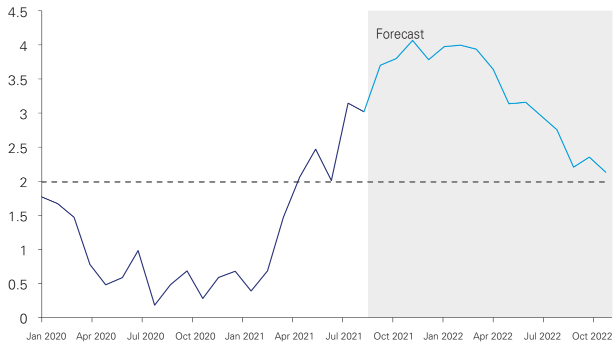


Sources: Office for National Statistics (UK), KPMG analysis.

The UK labor market is likely to see some deterioration before the end of 2021, after the ending of the government's furlough scheme in September 2021. This could lead to a brief increase in the rate of unemployment. This coincides with a significant rise in staff shortages, with a record number of vacancies – more than one million as was recorded in August 2021.

Inflation increased sharply in October 2021, to 4.2%, caused in part by the impact of supply chain shortages and the temporary measures enacted during the pandemic, which lowered the level of prices during 2020. The current upsurge of inflation is expected to continue into the first half of 2022, with average inflation reaching 2.5% in 2021 and 4.8% in 2022. We expect the first tightening by the Bank of England to take place in December 2021, taking the level of the policy interest rate to 0.25% and then to 0.75% by the end of 2022.

Chart 17: **After a surge this year, UK inflation is expected to moderate in 2022**
Percentage, change, y-o-y



Sources: Office for National Statistics (UK), KPMG analysis.

The October Budget and Spending review took advantage of the improvement in the economic outlook to raise planned government spending by an estimated 3% in real terms for the three years between 2021-22 and 2024-25. The added headroom may also allow the Chancellor to meet his rule of declining debt-to-GDP ratio within three years, which has been enshrined in the new fiscal mandate alongside goals to balance the current budget within a rolling three-year window and caps on investment and welfare spending. However, despite the many increases in spending, there were few announcements in the recent Budget on the longer-term challenges: especially on climate change and "levelling up," the so-called acceleration economic development of underperforming regions in the UK.

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Canada: Economy anticipated to weather housing slowdown

Growth in 2022 is expected to be driven by consumer spending, higher wages and a strong demand for labor, and possibly also constrained by these same factors.

While pandemic-induced inflation is likely to moderate and housing prices have started easing, labor force participation is at an all-time high and 50% of firms anticipate raising wages.

It will be the labor picture that will likely dictate when the Bank of Canada raises interest rates and if it has enough strength to raise them ahead of the US Federal Reserve.

The Canadian economy contracted in the second quarter at a seasonally-adjusted annualized rate (SAAR) of 1.1%, as residential investment and exports both declined by double-digits in response to cooling housing demand and pandemic-related trade disruptions. Canada was slower than other OECD countries to vaccinate its population and it maintained relatively high stringency into the third quarter, which held back growth in the first half of the year. Now that vaccination rates are over 77%, it is anticipated that factors such as solid wage growth and plans by Canadian firms to increase capital expenditure will be the main drivers of growth. Holding back growth will likely be ongoing labor shortages and limited capacity due to supply constraints.

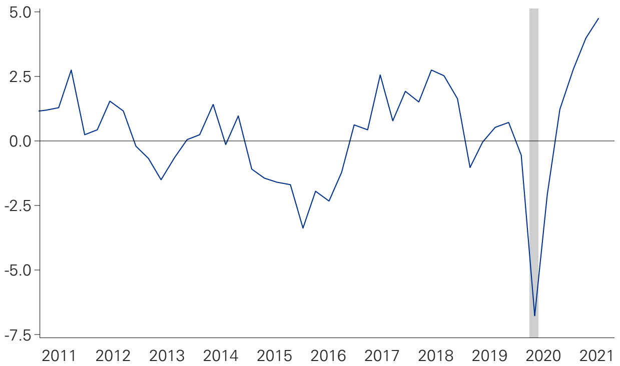
It is anticipated that Canada's largest challenge to growth in the coming years is having a sufficient labor force. Canada's labor force participation is at an all-time high (age 15 to 64 years). One reason for the higher labor force participation is that pandemic-related benefits were tied to being in the labor force, which kept more people attached to their employers. This high labor force participation has pushed up Canada's unemployment rate, which is ultimately a good sign and does suggest there is some slack remaining in the labor market. The third quarter Canada Business Outlook Survey from the Bank of Canada shows that, despite firms facing capacity constraints and labor shortages, business sentiment

Table 7: **KPMG forecasts for Canada**

	2020	2021	2022
GDP	-5.3	4.8	3.5
Inflation	0.7	4.6	3.8
Unemployment rate	9.6	7.5	6.0

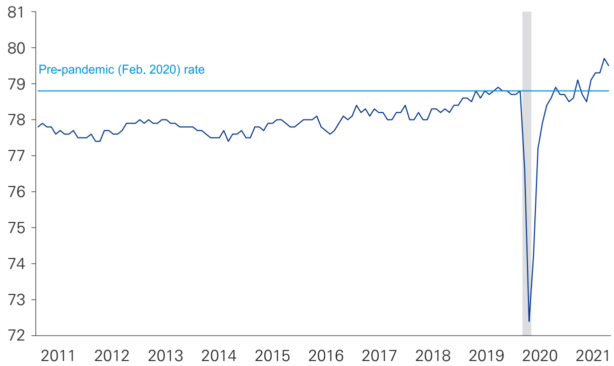
Source: Statistics Canada, KPMG analysis.
Note: GDP and the unemployment growth rates are annual averages. Inflation rate is the 12-month change at year-end. Numbers are percentages.

Chart 18: **Index of the Business Outlook Survey has turned sharply positive**
Index



Source: Statistics Canada; Haver Analytics, KPMG analysis.

Chart 19: **Prime age labor force participation rate (15-64 years) is in recovery mode**
Percentage



Source: Statistics Canada; Haver Analytics, KPMG analysis.

is above pre-pandemic levels. The two largest constraints to growth cited by firms are supply chain disruptions and labor shortages. However, as is happening elsewhere, this is prompting firms to increase capital expenditure, improve work processes and adjust workers' compensation. This suggests the two largest contributions to growth in 2022 are likely to be consumption due to higher wages and increased employment, as well as capital expenditure. The market expects three rate hikes in 2022, while it would not be surprising to see two hikes dependent on labor market health and the behavior of prices. If Canada raises rates too far ahead of the US, it will likely have currency appreciation to deal with.

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Brazil: High inflation could slow economic momentum

Fiscal stimulus helped to mitigate a contraction in economic activity last year.

Consumer spending should drive expansion, but inflation remains a threat to spending power should COVID-related price pressures continue.

Banco Central do Brasil has raised rates six times in 2021 to mitigate inflation and strengthen the Real and will keep raising rates until inflation reaches its target of 3.5%.

An uneven recovery has hindered Brazil's progress. The economy contracted in the second quarter of 2021 as a resurgence of COVID-19 infections slowed consumer spending and caused corporate investment to contract. However, growth is rebounding as the vaccinated population continues to increase, fostering a rebound in consumer spending, especially on services.

The strength of the rebound will depend on the pace of recovery in the labor market, and whether the central bank is successful in reducing inflationary pressures that are eroding real wages. The aggressive policy of the Banco Central do Brasil has already reduced future inflation expectations and it is likely they may make further progress in 2022.

While the economy has surpassed its pre-pandemic level of activity, the labor market is still short by around 3.5 million jobs. Additionally, the labor force participation rate is improving, but remains well below its pre-pandemic level, indicating that many workers remain on the sidelines. The continued improvement in the vaccination rate augurs well for continued strong employment gains in 2022 and we expect the unemployment rate to decline almost a full percentage point next year. However, persistently high inflation continues to erode real wages, creating a headwind on household spending.

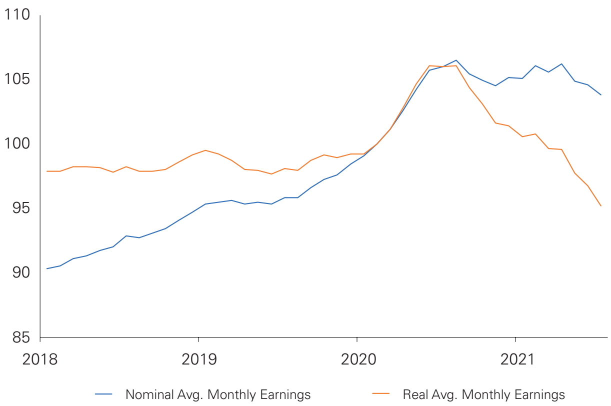
The Brazilian economy contracted less than other major Latin American economies during 2020, due in large part to the strong response by the central government, which deployed stimulus measures

Table 8: **KPMG forecasts for Brazil**

	2020	2021	2022
GDP	-4.1	5.0	3.3
Inflation	4.5	10.5	9.8
Unemployment rate	13.2	14.4	13.6

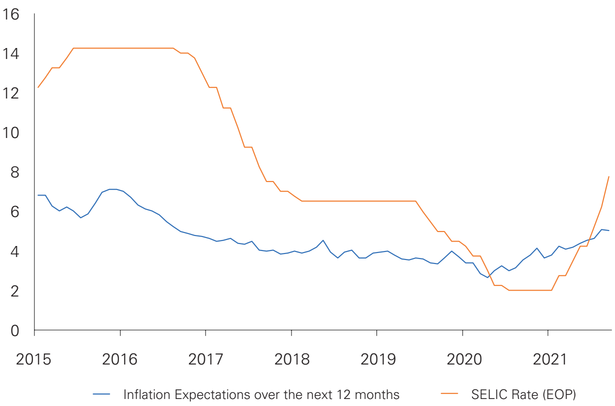
Source: Instituto Brasieiro de Geografia e Estatistica, IMF, KPMG analysis.
Note: GDP and unemployment growth rates are annual averages. Inflation rate is the 12-month change at year-end. Numbers are percentages.

Chart 20: **High inflation is eroding real wages**
Percentage



Source: Instituto Brasileiro de Geografia e Estatística, KPMG analysis.
Note: 3-months average indexed to February 2020.

Chart 21: **Inflation expectation continues to rise despite policy rate increase**
Percentage



Source: Banco Central do Brasil, KPMG analysis.

that added up to over 10% of GDP. However the central government may not have much fiscal policy space remaining. The public debt-to-GDP ratio has climbed to 59%, the highest level since 2003, and the Brazilian 10-year treasury rate climbed by more than 5 percentage points in 2021, reaching its highest level in three years. The central bank has also lifted the policy rate six times in 2021, raising borrowing costs and further eroding fiscal capacity. These developments pose a risk to the economic outlook as the central government is unlikely to step in with another round of double-digit fiscal stimuli should consumer spending remain weak.

The key to Brazil's inflation outlook lies in the credibility of the central bank and federal government; high credibility will help stabilize the currency, allowing inflation to come back to the central bank's target. Headline inflation is above 10% on a 12-month basis, and price increases are broad-based. The central bank has responded by aggressively raising rates, but the pace of monthly gains has picked up recently, signaling that inflationary pressures may still be firming, not easing. Additional rate increases are likely next year and should slow the rate of price growth, and we anticipate headline inflation may dip under 10% by the end of 2021. While that would still be its fastest pace since 2015, even a modest downtick should further slow inflation expectations, which only recently appear to have leveled off after a steady rise during the pandemic.

On balance, the Brazilian economy has surpassed its pre-pandemic level of activity, but a weak labor market and persistent inflationary pressures are risks to the expansion. The central bank may likely need to lift rates further to keep inflation expectations in check, but doing so too quickly, or misreading the economic landscape, could dramatically slow the Brazilian economy, just as the federal government runs out of room to help with additional spending.

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Saudi Arabia: Real GDP growth showing signs of a robust upturn

Broad-based real GDP growth recovery expected for 2021 and 2022 with the oil sector leading the way.

Effective COVID-19 containment measures have enabled a rapid re-opening of the economy and a continued reduction in unemployment.

Headline inflation will be contained by policy measures designed to limit domestic price pressures in key CPI basket components.

Table 9: **KPMG forecasts for Saudi Arabia**

	2020	2021	2022
GDP	-4.1	2.4	4.9
Inflation	3.4	3.1	2.2
Unemployment rate	7.7	6.5	6.3

Source: GASTAT, KPMG analysis.
Note: Average percentage change on previous year except for the unemployment rate, which is the annual rate taken from the Labour Force Survey and represents the rate for the total resident labor force. GDP represents real GDP growth at constant prices.

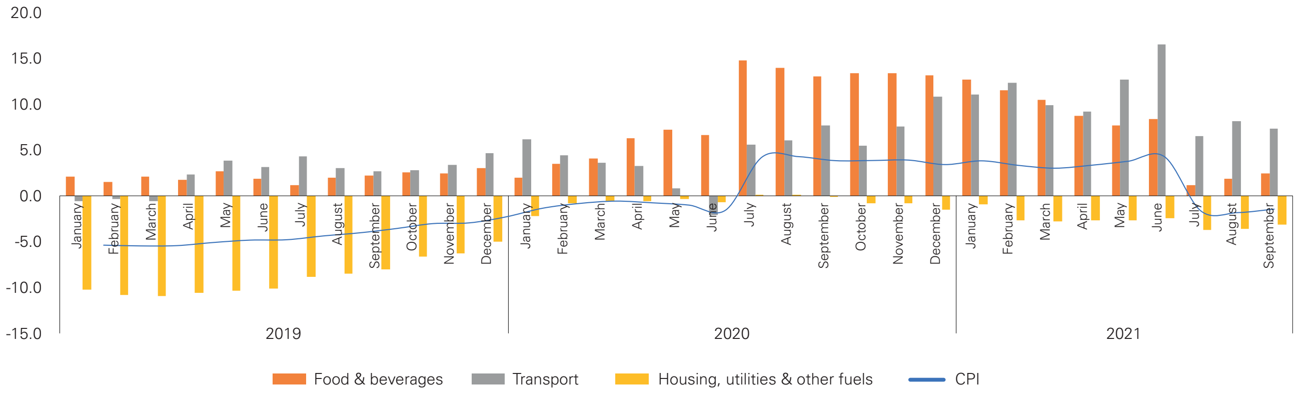
Real GDP in Saudi Arabia is expected to grow by an annual average of 2.4% y-o-y in 2021, following a contraction of 4.1% y-o-y in 2020. According to the General Authority for Statistics (GASTAT), real GDP contracted by 3% y-o-y in the first quarter of 2021. There was a broad-based pick-up of non-oil economic activity, with all the main components of non-oil GDP, barring transport, storage and communications, expanding. However, overall real GDP growth was curtailed by an 11.7% y-o-y contraction in the oil sector, as the government adhered to the oil production limits agreed by OPEC+.

Despite base effects supporting both non-oil and oil GDP in the second quarter of 2021 – pandemic-related restrictions in Saudi Arabia curtailed domestic demand in the second quarter of 2020, even as similar restrictions in Saudi Arabia's main trading partners weakened demand for its oil – the economy still grew by just 1.8% y-o-y.

Nevertheless, this overall GDP number masked a growing divergence between the oil and non-oil sectors. The oil sector still contracted by 6.9% y-o-y during the quarter, albeit at a slower pace, as the OPEC+ agreement continued to restrict oil output. At the same time, the non-oil sector recorded a robust y-o-y growth rate of 8.4%. The private sector continued to recover, with key components such as manufacturing, wholesale and retail trade, hospitality, transport and storage, and communications all recording double-digit y-o-y growth, amid a recovery in both domestic and external demand.

High-frequency data indicates that this broad-based pick-up in economic activity has gained momentum in the second half of 2021 and will continue to support non-oil GDP during 2022 overall, when total real GDP is expected to expand by a robust annual average rate of 4.9% y-o-y. A further easing of COVID-19 social-distancing measures should bolster the retail- and tourism-related sectors during the forecast period. Critical to the strong total real GDP outlook in 2022 is the continued reversal of related oil supply cuts. This is expected to result in an expansion of approximately 10% in the oil sector next year, following an expected annual y-o-y contraction in 2021. The expansion in oil output alongside high oil prices – according to the Economist Intelligence Unit, the price of the OPEC

Chart 22: **Government measures in the second half of 2021 have been pivotal in containing upward price pressures in the major CPI categories**
Percentage change, y-o-y



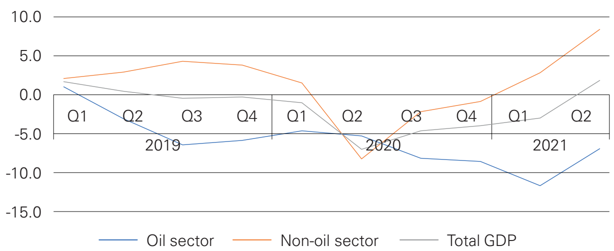
Source: GASTAT.

reference basket is expected to average US$67.4 per barrel (pb) in 2021 and US$73.8 pb in 2022, compared with an annual average of US$39.8 pb in 2020 – will bolster consumer and business confidence, as well as supporting government spending on mega-projects and Vision 2030 initiatives such as efforts to expand the Kingdom's industrial capacity and housing supply.

The economic contraction induced by COVID-19 and witnessed in the second quarter of 2020 saw the overall unemployment rate, defined as Saudi nationals plus foreign workers, rise from 5.7% in the first quarter of 2020 to 9% in the second quarter.

A rapid reopening of the economy from the latter part of 2020 resulted in the total unemployment rate falling to 6.6% by the second quarter of 2021 according to latest available figures, with both sub-components – the unemployment rate for the Saudi population and the unemployment rate for foreign workers – trending downwards. Indeed, the Saudi unemployment rate in the second quarter (11.3%) was lower than the level recorded in the first quarter of 2020 (11.8%), despite there being a rise in the number of Saudi citizens in work, suggesting that the falling unemployment rate in relation to the Saudi workforce has not been the result of a lower participation rate among this population. The total unemployment rate is expected to continue trending downwards during the remainder of 2021 and in 2022. However, the rate of deceleration may slow. The rapid turnaround in the labor market since the height of the COVID-19-related measures were in place

Chart 23: **The economic recovery is being led by the non-oil sector**
Percentage change, y-o-y



Source: GASTAT.

largely reflects the fact that Saudi Arabia was able to effectively contain cases and thus re-open the non-oil domestic economy rapidly in comparison to its peers. Thus, the rapid rehiring witnessed during the latter part of 2020 and 2021 is likely to decelerate. Overall, the annual average unemployment rate is expected to fall from 7.7% in 2020 to 6.5% in 2021 and to 6.3% in 2022.

Annual average inflation is expected to decelerate from 3.4% y-o-y to 3.1% and 2.2% in 2021 and 2022, respectively. The main driver behind Saudi Arabia's divergent inflationary path vis-à-vis its peers relates to an increase in value-added tax rate and customs duties that the authorities implemented in mid-2020. Year over year inflation during the second half of 2020 averaged 5.8% and 5.5% during the first half of 2021.

Correspondingly, base effects have contained price pressures in the second half of 2021 and should have a similar deflationary impact in the first half of 2022. Another factor containing headline inflation will stem from direct government measures. For example, sharp increases in the price of fuels for personal transport equipment in the first half of 2021 resulted in the authorities capping the price of this component at June 2021 levels, effective from July (with shortfalls faced by suppliers being paid for by the government). Finally, there are a few signs of labor markets failing to respond to the ongoing and continued pick-up in domestic economic activity.

However, the risk of upward price pressures is likely to remain. High international prices for a range of imports (whether directly through low supply or indirectly through the rising cost of international cargo transport) over the forecast period could drive import inflation higher than we currently envisage. Import inflation could also be transmitted through the fact that Saudi Arabia's currency is pegged against the US dollar; a weaker US dollar in the international foreign exchange rate would bring higher import inflation.

Kilbinder Dosanjh
Senior Economist, KPMG in Saudi Arabia

Middle East: Continued recovery into 2022 expected with the GCC bloc likely to lead

The Gulf Cooperation Council (GCC) is likely to lead the region's economic recovery, with high international oil prices helping to increase the bloc's resilience.

A decline in unemployment rates should be seen across the region.

Inflationary pressures in the GCC will remain contained, but other countries are likely to face greater difficulties in suppressing domestic price increases.

Gulf Cooperation Council

The GCC, whose membership is comprised of Saudi Arabia, the United Arab Emirates (UAE), Kuwait, Bahrain, Oman and Qatar, is benefitting from a steep increase in international fuel prices. Since collapsing during the initial months of the pandemic, international oil prices have been on an upward trend – by August 2021 they had reached levels last seen in October 2018 and currently stand at levels previously recorded in late 2014.

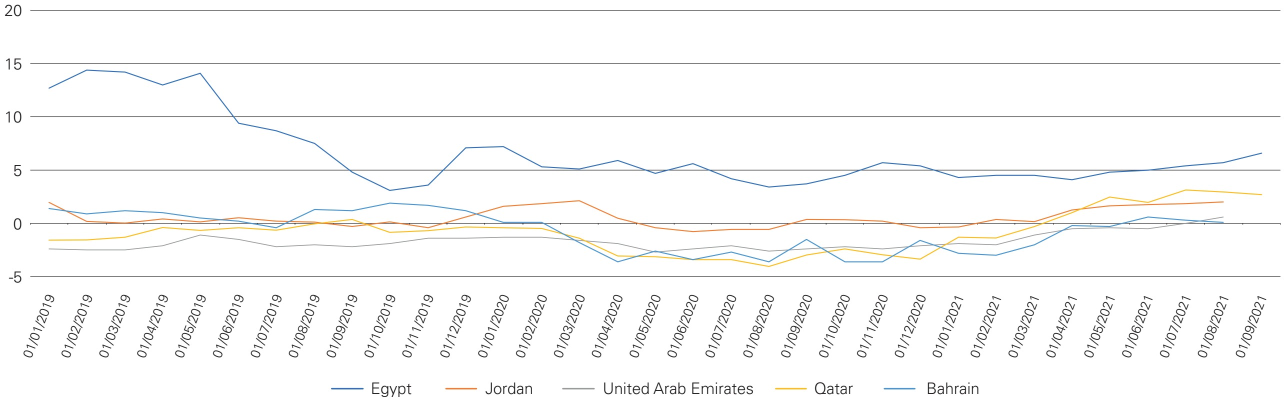
Oil revenues represent a key economic driver through multiple routes that include significant contributions to the fiscal and balance of payments accounts. Thus, rising prices have supported the ongoing economic recovery evident during much of 2021. The effective containment of COVID-19 cases, including through successful vaccination programs, has also enabled a direct, broad and relatively rapid domestic re-opening of GCC economies and supported the non-oil-based economy, particularly in terms of tourism in the UAE, and regional private consumption more generally.

OPEC+ oil production limits are gradually being reversed and this should further bolster the economic expansion across the group by supporting oil volume output even as international oil prices remain elevated. As a result, both the oil and non-oil sectors will be supportive of growth during the remainder of 2021 and in 2022.

Risks to this benign economic forecast remain, however. While the risk of COVID-19-related closures at the levels seen during the first year of the pandemic are unlikely to reoccur in the GCC's main trading partners – this reduces the risk of a sharp reversal in international demand for oil – any fall in oil demand even as OPEC+ continues to gradually increase oil supplies, could result in a fall in oil prices. This drop would result in a corresponding negative impact on the oil sector directly and indirectly through spillover effects, within the non-oil sector as well. Moreover, a resurgence in COVID-19 cases through new variants, either in non-GCC tourist markets or in the GCC bloc itself cannot be ruled out. Further domestic lockdowns and restrictions on cross-border travel would directly impact consumer demand and the sectors dependent on this expenditure component.

The bloc's substantial use of foreign labor limits the inflation risks relating to potential imbalances in the output gap. As a result, while a relatively rapid opening of GCC economies has seen unemployment rates generally fall since the height of pandemic-related containment measures (a trend that is expected to continue), labor supply shortages are unlikely.

Chart 24: **Selected countries: with some notable exceptions, inflationary pressures in the region have largely been contained in recent years**
Inflation, percentage change, y-o-y



Source: Haver; National statistical agencies.

Annual average inflation will generally remain benign during the remainder of 2021 and in 2022, even if high relative to historical levels as COVID-19 continues to disrupt supply chains (both in terms of production and transportation) across finished goods and commodities. In addition to labor market flexibility, effective supply chain management strategies and the existence of the exchange rate pegs of member countries, when combined, are unlikely to result in inflation numbers that concern the authorities.

Non-GCC

Non-GCC economies in the Middle East are diverse in terms of their economic growth potential and resilience to shocks, but collectively they under-perform their GCC counterparts. In general, many of these economies have weak fiscal and external balance sheets, volatile and weak economic growth rates and varying levels of political and/or social instability.

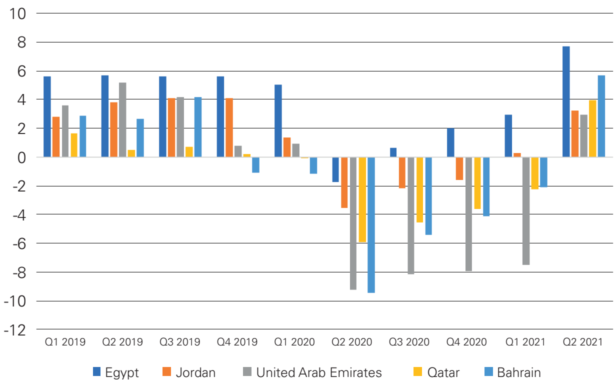
The pandemic has both highlighted and worsened existing structural weaknesses. The general improvement in economic performance during the forecast period will largely be driven by base effects – most of these countries witnessed significant economic contractions owing to the impact of pandemic-related containment measures both domestically and in their main trading partners (the latter reducing external demand). We assume that further lockdown measures for this grouping will be limited and that the continued reopening of economies will help drive unemployment rates down.

Over-burdened healthcare systems, institutional weaknesses and poor fiscal balance sheets mean that vaccination programs in these countries have generally been insufficient, leaving them vulnerable to further spikes of COVID-19 cases. Moreover, economic weakness has further undermined fiscal accounts, which in turn has further weakened the authorities' ability to provide stimulus and social support in the event of such spikes.

Economic weakness has also put many regional currencies under downward pressure even as international commodity prices have risen. As a result, import inflation is likely to feedthrough into domestic prices, with governments lacking the fiscal resources to offset rising costs through direct payments or subsidies.

On balance, while headline numbers for key economic variables are expected to continue to recover, underlying weaknesses have worsened since the pandemic started – both public and private sector balance sheets are now vulnerable to future crises.

Chart 25: **Selected countries; there are signs of economic recovery across the Middle East, but balance sheet repair is expected to be more rapid in the GCC**
Percentage change, y-o-y



Source: Haver; National statistical agencies.

Kilbinder Dosanjh
Senior Economist, KPMG in Saudi Arabia

Mexico: External developments expected to shape the outlook

Consumer spending is expected to drive strong growth in 2022, but vulnerabilities to key manufacturing exports will likely persist due to global chip shortages.

Global supply chain disruptions and currency depreciation have caused a runup in inflation and the central bank has responded with rate increases.

Should global trade disruptions continue to weigh on exports, the government may not be able to respond with stimulus.

The Mexican economy contracted in the third quarter as the pace of vehicle and retail sales both slowed, a sign that the late summer spike in infections weighed on consumer activity. Household spending and growth are expected to rebound as the vaccination rate continues to rise and the infection rate falls further. However, goods shortages stemming from persistent global supply chain disruptions are likely keep inflationary pressures elevated and weigh on key manufacturing and export sectors next year. The central bank will likely need to navigate these opposing forces by raising rates at a measured pace to avoid derailing the Mexican recovery as prices continue to climb.

Mexico was hit hard by the Delta variant, with cases reaching their peak in mid-August. After a short tightening of economic restrictions, conditions eased in early September. Consumer confidence improved at the end of the third quarter and the unemployment rate has continued to fall, suggesting that spending activity will improve at year-end. Recent business surveys are showing a rebound in reported hiring in both the manufacturing and non-manufacturing sectors, a further sign that the pace of employment gains should continue to improve. Additionally, the savings rate in the domestic economy is still nearly 9% above its pre-pandemic peak on a seasonally-adjusted basis. Remittances from the US have also continued to grow. All of this suggests that consumer spending should rebound if the virus remains under control.

Table 10: **KPMG forecasts for Mexico**

	2020	2021	2022
GDP	-8.3	4.5	4.0
Inflation	3.2	4.1	3.8
Unemployment rate	4.4	4.2	3.9

Source: Instituto Nacional de Estadística Geografía e Informatica, KPMG analysis.
Note: GDP and the unemployment growth rates are annual averages. Inflation rate is the 12-month change at year-end. Numbers are percentages.

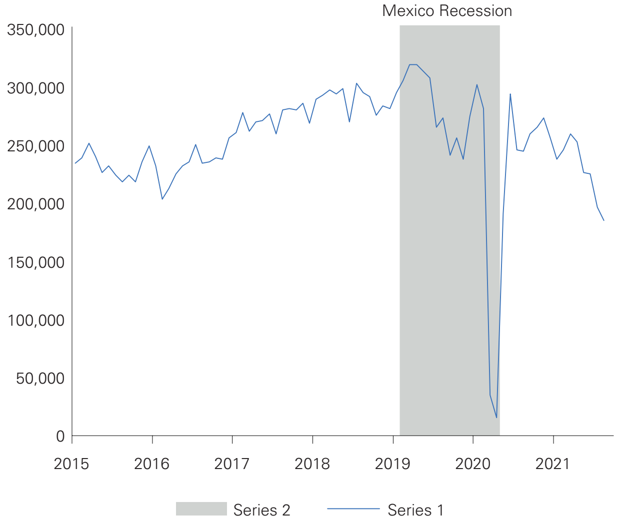
Exports are a significant driver of growth in the Mexican economy. Goods and services exports make up around 40% of GDP, and trade with the US comprises about 80% of total exports. The pandemic has disrupted global supply chains, which has slowed the recovery in exports. A global shortage of semiconductors caused Mexican automobile production to drop by 30% and vehicle exports have declined precipitously since May. Global trade is expected to rebound in 2022, but the semiconductor shortage is expected to persist, signaling a sluggish recovery for Mexican auto exports.

Should these external developments materially affect the outlook, the federal government, will be hard-pressed to respond with fiscal stimulus. Public sector debt as a share of GDP climbed 9 percentage points from 2019 to 2020, reaching 50% of GDP, the largest share since 1989. The central bank has been tightening financial conditions by raising the policy rate four times in 2021, to 5.00%, in an effort to stem rising inflationary pressures. This caused the 10-year Treasury rate to surpass its pre-pandemic level, raising borrowing costs for the central government.

Headline inflation is growing y-o-y core inflation has accelerated every month in 2021. The market expects the policy rate to rise to above 7.5% by the end of 2022. The last time the overnight rate reached that level was prior to the 2018 downturn, indicating the central bank should to be cautious when addressing inflationary pressures.

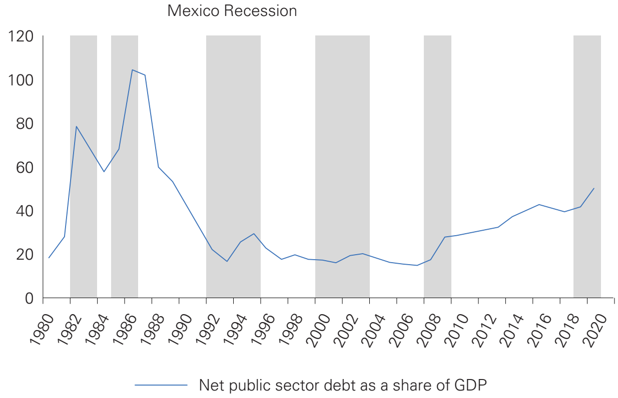
Pandemic-related supply shortages and price pressures are not yet in the rearview mirror and will likely take some time to resolve. How these dynamics play out and the strength of the US recovery are anticipated to dictate the path of monetary policy as the central bank maneuvers between persistent inflationary pressures and pandemic-related bottlenecks that are weighing on key sectors.

Chart 26: **Global trade disruptions have caused vehicle exports to plummet**
Units



Source: Instituto Nacional de Estadística Geografía e Informatica.

Chart 27: **Public sector debt jumped during the pandemic**
Percentage of GDP



Source: Secretaría de Hacienda y Credito Publico.

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Nigeria: Rising oil prices, production and fiscal expansion expected to support modest recovery

Nigeria's economic recovery is expected to remain modest but increasingly broad-based.

High unemployment and underemployment rates are expected to persist into 2022.

Inflation will likely remain heightened on the back of subsidy removal in the downstream oil and gas sector, with hikes in electricity tariffs and electoral spending.

The economy rebounded in Q2 2021, following a marginal y-o-y growth rate of 0.5% in Q1 2021. The recorded real GDP growth rate of 5% y-o-y in Q2 2021 was the fastest GDP quarterly growth rate witnessed since 2014, indicating that business and economic activities are heading back to pre-pandemic levels.

The oil sector, Nigeria's biggest fiscal revenue source, accounted for 7.4% of GDP in Q2 2021 and contracted by 12.7% y-o-y, following a 2.2% y-o-y contraction in Q1 2021. These contractions have largely impacted low oil production because of technical and operational issues that caused disruptions at key oil terminals. Nigeria's oil production stood at 1.61 million barrels per day (mbpd) in Q2 2021, compared with 1.72 mbpd in Q1 2021 and 1.81 mbpd in Q2 2021. However, positive oil price market forecasts, along with increases in oil production quotas by OPEC+ are expected to support oil revenue and volume growth in 2022.[15]

The non-oil sector, which contributed around 93% of GDP in Q2 2021 and recorded a strong growth rate of 5.4% y-o-y (compared with the 0.4% year on year growth rate recorded in Q1 2021), has been the main driver of the economic pick-up.

Growth is expected to be increasingly broad-based during the remainder of 2021 and in 2022. Agriculture, information, communications and technology (ICT) and manufacturing are expected to drive the expansion. The manufacturing sector's

Table 11: **KPMG forecasts for Nigeria**

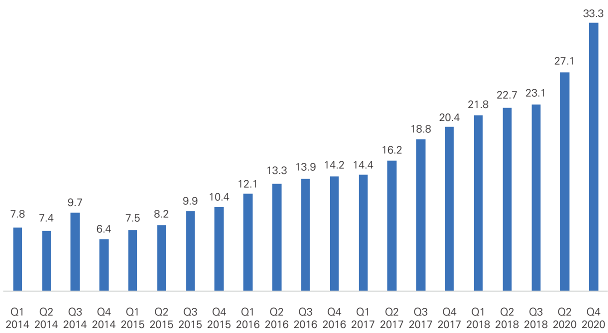
	2020	2021	2022
GDP	-1.9	2.4	3.2
Inflation	15.8	15.0	12.6
Unemployment rate	N/A	N/A	N/A

Source: NBS, IMF, World Bank, Rencap, BMI, NESG, SBG Securities, KPMG analysis.
Note: Forecasts are based on main scenario of slow recovery. Inflation is based on percentage y-o-y change of CPI.

[15] https://www.eia.gov/outlooks/steo/.

resilience will likely be boosted by the Central Bank of Nigeria, which is supporting key subsectors in manufacturing through intervention funds and foreign exchange supply (fiscal stimulus packages designed to support the manufacturing sector). The ICT sector will likely be supported by increased adoption of digitization and increasing use of data.

Chart 28: **The pandemic has accelerated a long-running trend of rising unemployment**
Percentage unemployment rate



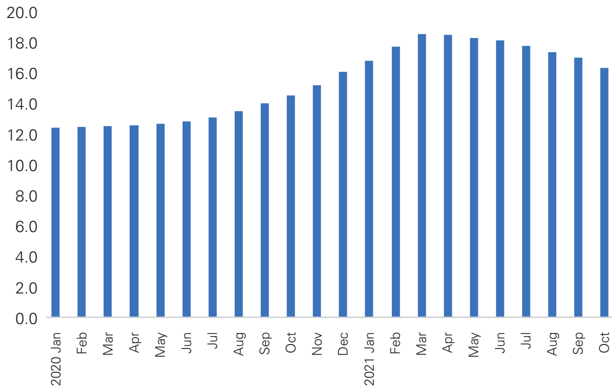
Source: National Bureau of Statistics.
Note: Break in series reflects insufficiant data.

Other sectors, including trade, real estate and financial services are also likely to support the economic expansion going forward, although rates of growth in these GDP components will be moderate. Also, the government has initiated broader expansionary policies, including spending on infrastructure, agriculture, and trade and investment, to accelerate the economic recovery. On balance, real GDP growth should accelerate from an annual average rate of 2.4% in 2021 to a still-modest 3.2% next year, with strengthening global oil demand, robust oil prices and a reversal of the negative impact of COVID-19 providing key pillars of economic support.

According to the National Bureau of Statistics, the unemployment rate in Nigeria continued its upward trend in Q4 2020, rising to 33.3% from 27.1% in Q2 2020, according to latest available data. This was expected as employment opportunities continued to be eroded by lockdown measures and a resultant weakness in business activity. While the government continues to drive employment creation initiatives, significant improvement in the unemployment rate is not expected in 2022.

Nigeria's inflation rate accelerated to 18.2% y-o-y in March 2021, from 15.6% y-o-y in December 2020, driven largely by higher food prices. However, the y-o-y rate tapered down to 16% in October 2021. The high level of inflation can be attributed to a combination of supply-side factors and related input shortages, including a disruption of agricultural

Chart 29: **Headline inflation is decelerating but remains high**
Percentage change, y-o-y



Source: National Bureau of Statistics.

activities caused by supply chain challenges, the lingering (and related) effects of COVID-19, an exchange rate depreciation, higher energy prices, and high global food prices more generally.

Inflation's recent downward trend is expected to continue during the remainder of 2021 and in 2022 due to base-year effects, but it will stay in double digits; annual average inflation will likely stand at 15% in 2021 and a still high 12.6% in 2022, driven by several factors. First, a likely further weakening of the Naira due to a drawdown and utilization of Nigeria's IMF Special Drawing Rights (SDR) allocation, and planned Eurobond issuance of US$16.2 billion approved in November 2021. Second, the deregulation of the downstream oil sector following the passage of the Petroleum Industry Act; the federal government plans to stop subsidy payments on crude oil by mid-2022. Third, expected hikes in electricity tariffs. Finally, there remain a variety of risks relating to further supply-side shocks across sectors, particularly in relation to further spikes in COVID-19 cases.

However, local refining activities could potentially lower the future inflation rate. The foreign exchange savings from local sourcing of refined petroleum products, value added from other derivatives of refined products and the non-oil sector positive effects on growth could all ease inflationary pressure.

Olugesun Zaccheaus
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KPMG in Nigeria

South Africa: In need of a growth mandate

Sustainable higher rates of long-term growth are expected to remain elusive.

Vaccine roll-out delays will limit the economy's ability to reach full capacity.

Inflation predicted to remain around the middle of the central bank's target range.

Since the democratically elected government took office in 1994, South Africa has had the challenge of being faced with a dual mandate. On the one hand, needing to focus on the long-term goal of economic growth and employment creation, while on the other hand, and because of its history, needing to also deliver a shorter-term goal of expanding the social wage/safety net for those that would have missed being absorbed into the economy. The short-term goal of expanding the social wage has generally dominated the government's agenda with a rollout and subsequent expansion of a social grant program to the point where more people receive a social grant than are employed. Such a strategy may work if economic growth is driving employment creation and the broadening of the tax base, but this has not been the case in South Africa, where the tax base has been reduced over time, resulting in increased pressure on the public sector balance sheet.

The pursuit of long-term economic growth and employment creation has not received much attention and has generally fluctuated along with global markets and commodity cycles. Between 2004 and 2008, the economy managed to grow at an annual average of 4.8% before contracting in 2009 due to the global financial crisis. Between 2010 and 2015, South Africa managed a more subdued 2.3% annual average growth, and since 2016 had only managed 0.9% average annual growth, not including the COVID-19 induced contraction of 2020.

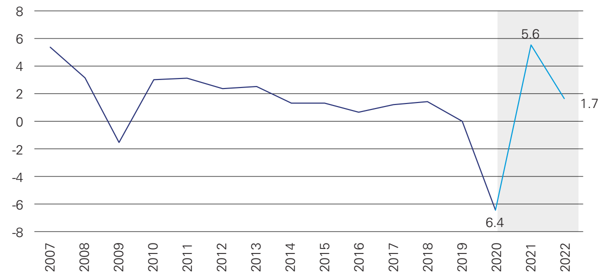
Real GDP is set to grow by 5.6% in 2021, led by contributions from the transport, storage and communication sector, growth in personal services as well as agriculture, mining, trade, catering and accommodation. However, much of this estimated growth is due to technical base effects following the contraction experienced in 2020, and concern remains that the economy returns once again to pre-COVID-19 growth rates of around 1% over the longer term. The forecast deceleration in 2022 is the result of several factors, the first of which relates to base effects. Moreover, the economy was struggling to grow prior to the pandemic due to a sustained period of lower investment and consumption spending caused by a reaction to a number of governance failures including policy uncertainty, corruption, aging infrastructure, the absence of growth stimulating policy interventions and a general lack of service delivery. An expected post COVID-19 reversion

Table 12: **KPMG forecasts for South Africa**

	2020	2021	2022
GDP	-6.4	5.6	1.7
Inflation	3.3	4.4	4.6
Unemployment rate	29.2	34.2	33.8

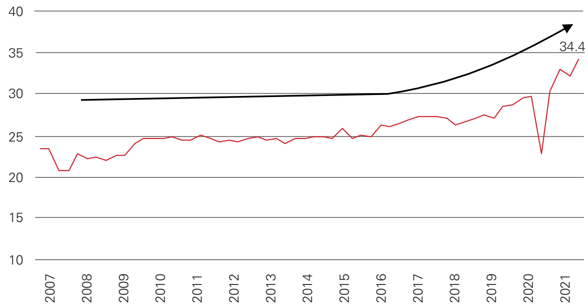
Source: Statistics South Africa, KPMG analysis.
Note: Average percentage change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

Chart 30: **Real GDP growth has recovered rapidly**
Percentage change, y-o-y



Source: Statistics South Africa, KPMG analysis.

Chart 31: **Labor market remains weak**
Percentage



Source: Statistics South Africa, KPMG analysis.

to the longer-term trend would mean the economy reverting back to that lower growth rate once more. Another reason for the expected lower growth would be the negative impact of the civil unrest experienced in two provinces in July, costing South Africa billions of Rand in damages and infrastructure losses that are likely to require an extended period of time to rebuild, if ever. Finally, the muted growth expectations, may also be caused by the shared international factors impacting domestic growth expectations including ongoing supply constraints and possible further economic restrictions at home or abroad brought about by the pandemic.

The expected rate of economic growth in 2021 and 2022 would not be sufficient to tangibly reduce the high unemployment rate of 34.4% currently being experienced in the country. A national strategic growth mandate would need to be implemented along with the eradication or reduction of domestic barriers to growth and doing business to attain an economic growth rate that would make noticeable inroads into unemployment.

While South Africa continues to slowly re-open its economy and the number of vaccinated people grows, inflationary pressures for 2021 and 2022 remain cost-push in nature as aggregate demand still lags below its potential level. The main drivers of forecast consumer inflation are local energy prices, including both fuel and electricity prices, as well as food prices. The increase in commodity prices, including oil, has meant rising imported fuel prices from the COVID-19 induced lows experienced in the first half of 2020. Energy supply and in particular electricity, remains an ongoing concern for South Africa. In addition, the remaining fleet of power stations is old with maintenance frequently required and costly to undertake. To fund this, the state-run power provider regularly requires additional tariff increases that underpin the increasing energy prices. Constrained aggregate demand combined with a general appreciation of the local currency on the back of commodity price increases and attractive domestic bond yields has nevertheless meant that the inflation rate is expected to remain contained within the central banks' target range of 3% to 6% over the forecast period 2021 and 2022.

Frank Blackmore
Senior Manager, KPMG in South Africa

Appendix: KPMG country forecasts

	GDP			Inflation			Unemployment		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
World	-3.3	5.8	4.5	2.0	3.6	3.7	7.0	5.9	5.0
US	-3.4	5.5	4.4	1.2	4.7	4.3	8.1	5.4	3.1
Canada	-5.3	4.8	3.5	0.7	4.6	3.8	9.6	7.5	6.0
Argentina	-9.9	7.4	2.3	36.1	49.5	46.4	11.6	10.0	9.2
Brazil	-4.1	5.0	3.3	4.5	10.5	9.8	13.2	14.4	13.6
Chile	-5.8	10.6	2.6	3.0	5.7	4.0	10.8	9.1	7.4
Mexico	-8.3	4.5	4.0	3.2	4.1	3.8	4.4	4.2	3.9
Colombia	-6.8	8.2	3.9	1.6	4.8	3.5	16.1	14.5	13.8
Peru	-11.1	10.7	3.2	2.0	5.5	3.2	13.0	8.7	6.5
Germany	-4.9	2.9	4.5	0.4	3.0	2.2	3.9	3.6	3.4
France	-8.0	6.7	3.9	0.5	2.0	1.6	8.0	8.0	7.9
Italy	-9.0	6.2	4.2	-0.1	1.7	1.7	9.3	9.6	9.5
Netherlands	-3.8	4.1	3.6	1.1	2.5	1.7	3.8	3.3	3.1
Spain	-10.8	4.7	6.4	-0.3	2.9	1.9	15.5	15.1	14.2
Eurozone	-6.5	5.2	4.5	0.3	2.4	2.0	7.9	7.8	7.4
Norway	-2.5	3.7	3.9	1.3	3.0	1.8	4.6	4.3	4.0
Sweden	-2.8	4.4	3.6	0.5	1.9	1.8	8.3	8.9	7.9
Switzerland	-2.4	3.5	3.1	-0.7	0.5	0.6	3.1	3.1	3.0
UK	-9.7	6.8	4.4	0.9	2.5	4.8	4.5	4.6	4.4
Poland	-2.8	5.2	5.1	3.4	4.6	4.4	3.2	3.5	3.2
Russia	-3.0	4.3	2.6	4.9	6.7	4.5	5.8	4.9	4.6
Turkey	1.8	8.8	3.5	12.3	17.5	14.6	13.1	12.2	11.0
Saudi Arabia	-4.1	2.4	4.9	3.4	3.1	2.2	7.7	6.5	6.3
China	2.3	8.2	5.5	2.5	0.9	2.3	5.6	5.1	5.0
Japan	-4.6	2.3	3.1	0.0	-0.2	1.1	2.8	2.9	2.5
India	-7.3	9.3	7.9	6.2	5.5	4.9	10.0	7.6	6.5
Indonesia	-2.1	3.3	5.1	2.0	1.7	2.8	7.1	6.6	6.0
Malaysia	-5.6	3.9	5.6	-1.1	2.4	1.9	4.5	4.7	4.5
Philippines	-9.6	4.0	6.8	2.6	4.3	3.3	10.4	7.8	6.8
Singapore	-5.4	6.5	4.2	-0.2	1.8	1.6	3.0	2.7	2.5
South Korea	-0.9	4.1	3.2	0.5	2.2	1.7	4.0	3.9	3.7
Nigeria	-1.9	2.4	3.2	15.8	15.0	12.6	N/A	N/A	N/A
South Africa	-6.4	5.6	1.7	3.3	4.4	4.6	29.2	34.2	33.8

Source: National statistical agencies, KPMG analysis.
Note: Average percentage change on previous calendar year except for unemployment rate, which is average annual rate.

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