What's Next for the U.S. Economy?

Prospects for Growth, Jobs, and Inflation

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Outline for today’s talk

Where the U.S. economy is now

Key questions for 2022

Possible risks ahead
Where the U.S. economy is now
Real GDP has experienced an impressive recovery

GDP is now approaching its pre-pandemic trend

(For comparison, it took nearly a decade for the economy to normalize after the last recession)
Demand fundamentals are strong

Levels of wealth (of course) vary greatly by group

But all groups have seen significant financial gains since the pandemic started because of more saving and stock/home price appreciation.

Data from Federal Reserve
Demand has shifted to goods from services

**Consumer Spending on Goods**
Billions of 2012 dollars

**Consumer Spending on Services**
Billions of 2012 dollars

Data from BEA via FRED
Supply is not meeting demand because of bottlenecks and supply chain issues.

Cargo Ships Continue To Arrive, Just To End Up Waiting To Get Into Ports Of LA, Long Beach

Toyota cutting production in February due to semiconductor shortage

Toyoda will miss 9 million target for the fiscal year
Supply is not meeting demand because of worker shortages

About 2¼ million fewer people are in the labor force than prior to the pandemic because of the “Great Resignation” and other factors holding back would-be workers.

Data from BLS via FRED.
Amid strong demand and limited supply, inflation has jumped, reaching its highest level in four decades.

Data from BLS via FRED
Some components of inflation have seen particularly large increases.

The New York Times
Energy Prices Spike as Producers Worry Over Pandemic and Climate

By Clifford Krauss and Peter Envis
Published Oct. 4, 2021 | Updated Nov. 4, 2021

CPI Inflation for New and Used Cars
Percent change in prices from 12 months earlier

Data from BLS via FRED (here and here)
But inflation has also picked up more broadly.

Alternative Measures of CPI Inflation
Percent change from 12 months earlier

Measures of inflation that exclude the categories that are surging haven’t risen as much but are still well above their pre-pandemic norms.

Data from Cleveland Fed via FRED (here and here)
Key questions for 2022
Will demand remain strong in 2022?

Yes—very likely it will

Federal government support has dropped from heightened pandemic levels but …

Most households have considerable excess saving (as noted earlier)

State and local governments are flush with cash
Will bottlenecks and supply chain issues ease in 2022?

Probably although the easing may occur quite gradually

As one would expect—ports are clearing, semi-conductor production is increasing rapidly, and so on

But remember it’s a slow time of year for businesses, which may be making things appear better than they are

Things could get worse before they get better if China shuts down because of Omicron
Will people come back into the labor force in 2022? (I)

To some extent, as some of the contributing factors are unlikely to persist

Virus fears—should recede if Omicron is the last big wave

Financial buffers—likely to dwindle for workers who traditionally have little savings

Childcare shortage—workers in this sector should come back as wages rise
Will people come back into the labor force in 2022? (II)

But other factors suppressing the labor supply may be more permanent.

For example, older people have not returned at all (on net) to the labor force, suggesting many may have retired.

Data from Bureau of Labor Statistics.
Will people come back into the labor force in 2022? (III)

But other factors suppressing the labor supply may be more permanent.

Because of increased restrictions on immigration and travel, there are about 2 million fewer working-age people in the United States than if the pre-2020 trend had held up.
Will inflation decline in 2022? (I)

Probably—but it is unlikely to recede all the way back to the Fed’s goal of 2 percent

The demand-supply imbalance will take time to correct

Inflation expectations have risen—not as much as actual inflation but enough to get built into wage and price increases this year
Will inflation decline in 2022? (III)

3-Year Ahead Inflation Expectations

Interestingly, the people expecting the highest inflation are those who have lived through periods of high inflation in the past!

Data from Federal Reserve Bank of New York
What will the Federal Reserve do? (I)

Background: monetary policy has been very supportive of economic growth over the past two years

Federal Funds Rate
Percent

Federal Reserve Balance Sheet
Percent

the policy rate has stayed close to zero

Quantitative easing has expanded the balance sheet

Data from Federal Reserve via FRED
What will the Federal Reserve do? (II)

The days of supportive monetary policy are ending

This was made clear after the last meeting of the Federal Open Market Committee

And tightening may occur yet more rapidly if inflation stays high or rises further
Possible risks ahead
Risk 1—new virus variants

COVID-19 vaccine doses administered per 100 people, Jan 17, 2022
All doses, including boosters, are counted individually. As the same person may receive more than one dose, the number of doses per 100 people can be higher than 100.
Risk 2—a “hard landing” for the economy

With monetary policy tightening,

The **hope is that inflation will gradually recede** with the economic recovery somewhat slower than it otherwise would be.

But **we can’t rule out the possibility that financial markets will be surprised** by Fed action (particularly if it is more hawkish than currently expected)—leading to sharp declines in asset prices, sharp rises in private interest rates, abrupt capital outflows from lower-income countries and so on.
Risk 3—a different “black swan” event that unsettles financial markets

The 21st century has seen two black swans with the global financial crisis and the pandemic

Some argue that we have an “everything bubble” given the high levels of stock prices, home prices, commodity prices, crypto prices, etc.

We don’t know what’s next (a major cyber attack? a geopolitical disruption?) but it could deflate this bubble
Thank you!