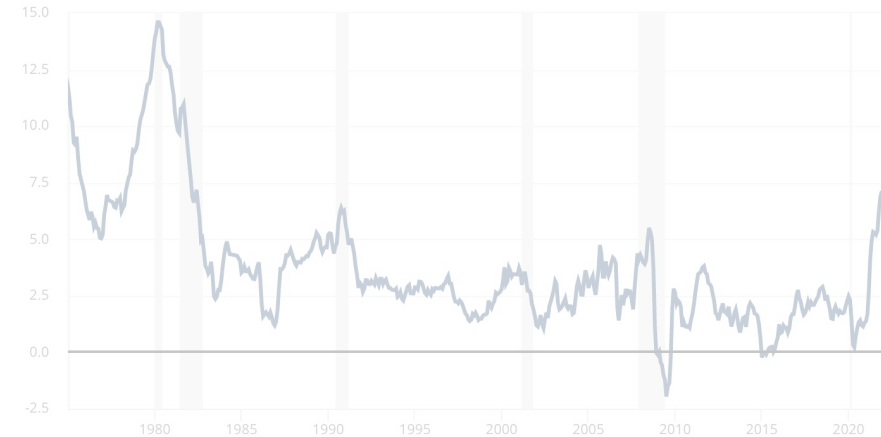


What's Next for the U.S. Economy?

Prospects for Growth, Jobs, and Inflation



Karen Dynan

Harvard University

Presentation for
Retired Men's Association of Greenwich
January 19, 2022

Outline for today's talk

Where the U.S. economy is now

Key questions for 2022

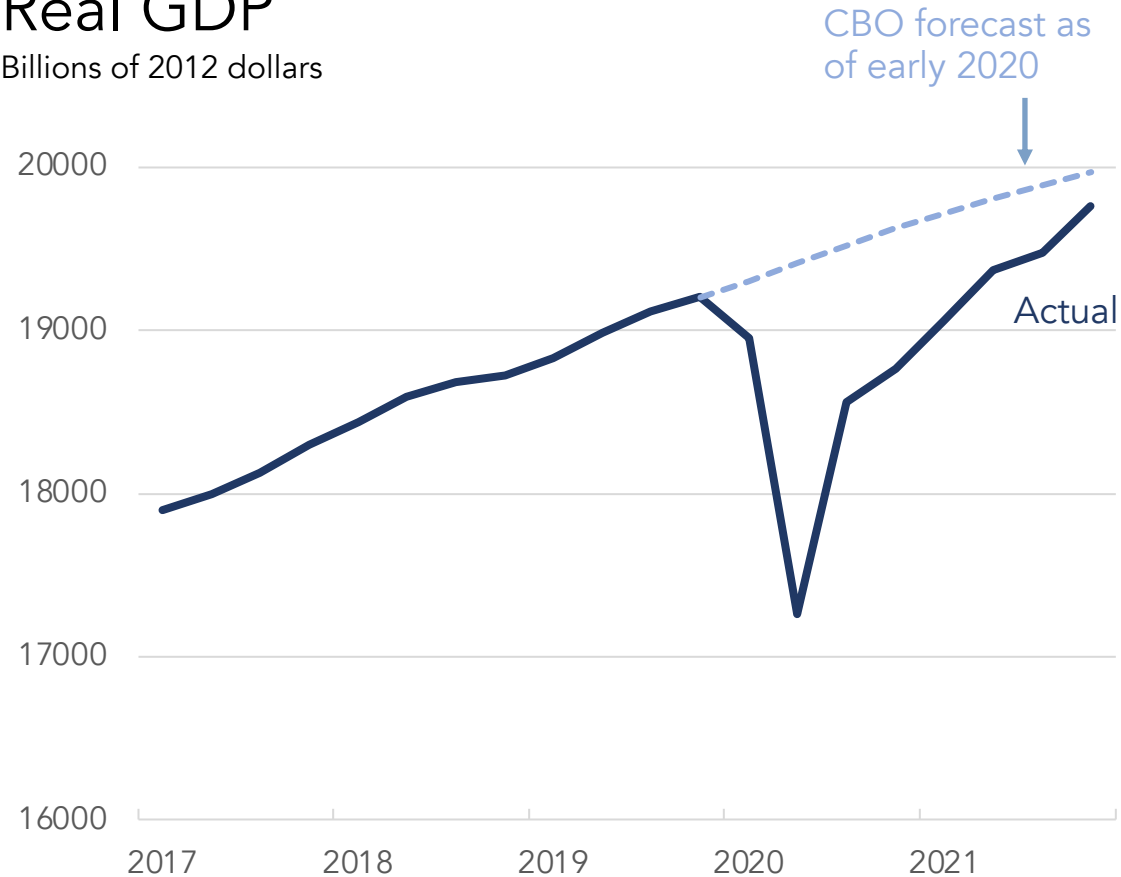
Possible risks ahead

Where the U.S. economy is now

Real GDP has experienced an impressive recovery

Real GDP

Billions of 2012 dollars



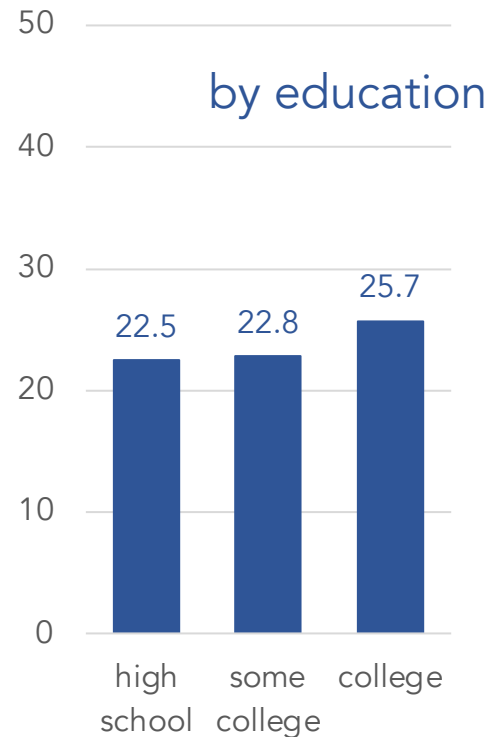
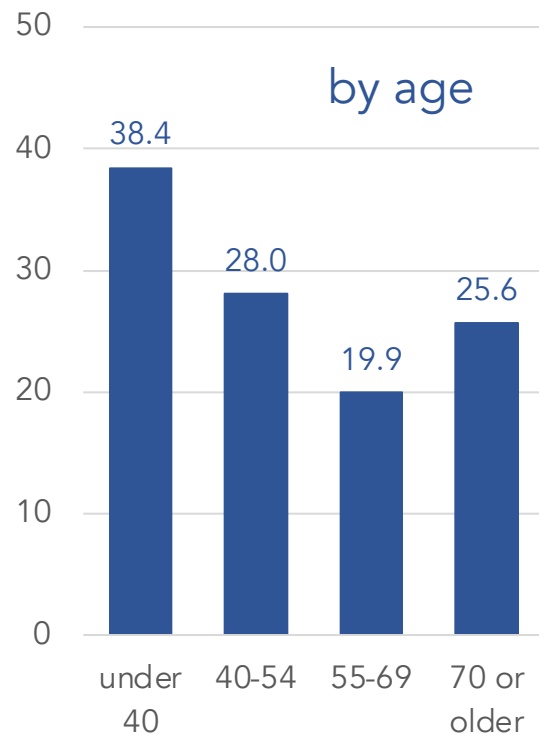
Data from BEA via [FRED](#) (assuming GDP grew 6% in 2021:Q4) and [CBO](#);

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

Percent Change in Wealth since 2019:Q4



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

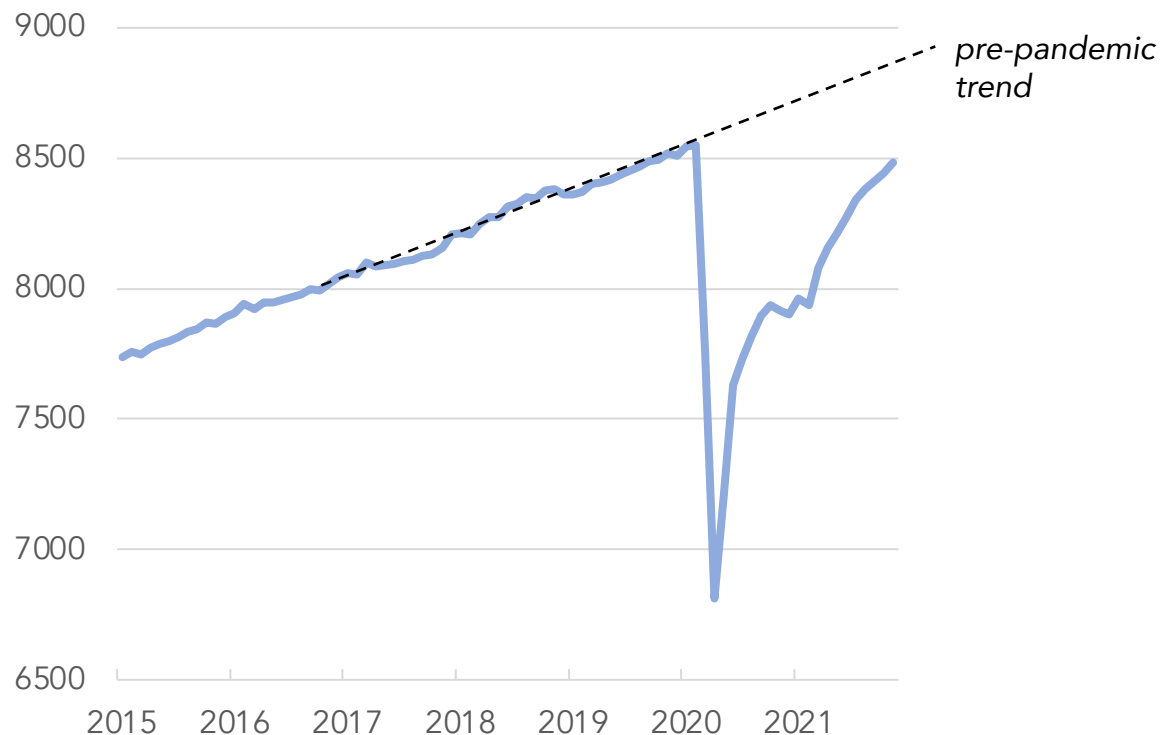
Billions of 2012 dollars



Data from BEA via [FRED](#)

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



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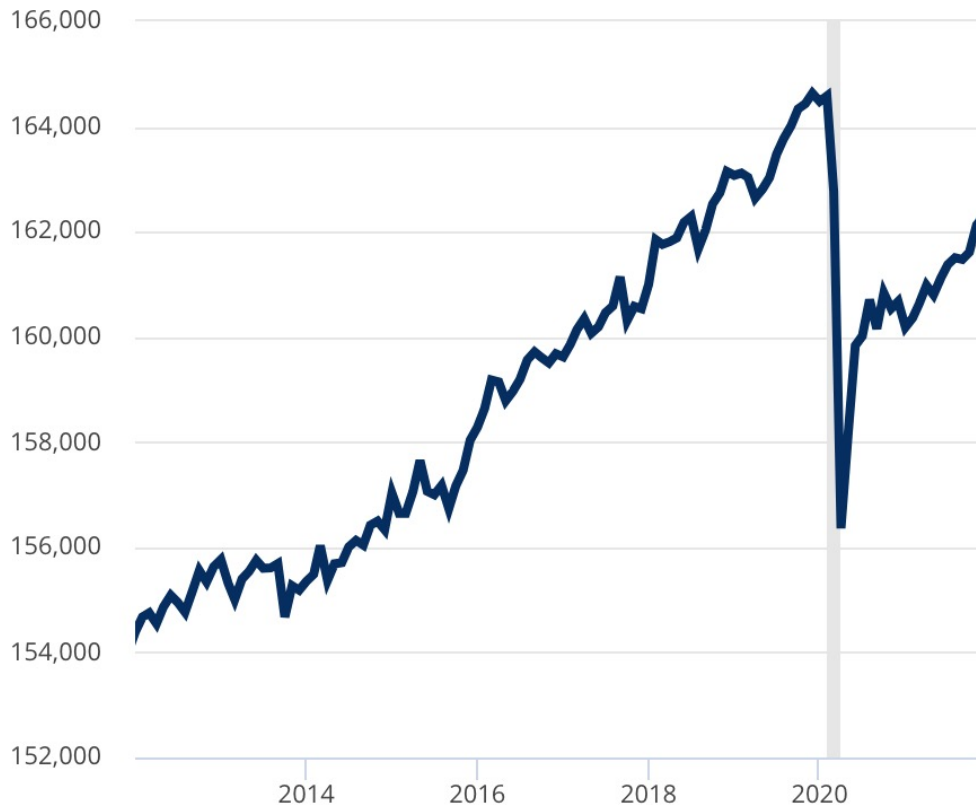
TOYOTA · Published 2 hours ago

Toyota cutting production in February due to semiconductor shortage

Toyota will miss 9 million target for the fiscal year

Supply is not meeting demand because of **worker shortages**

Civilian Labor Force
Thousands



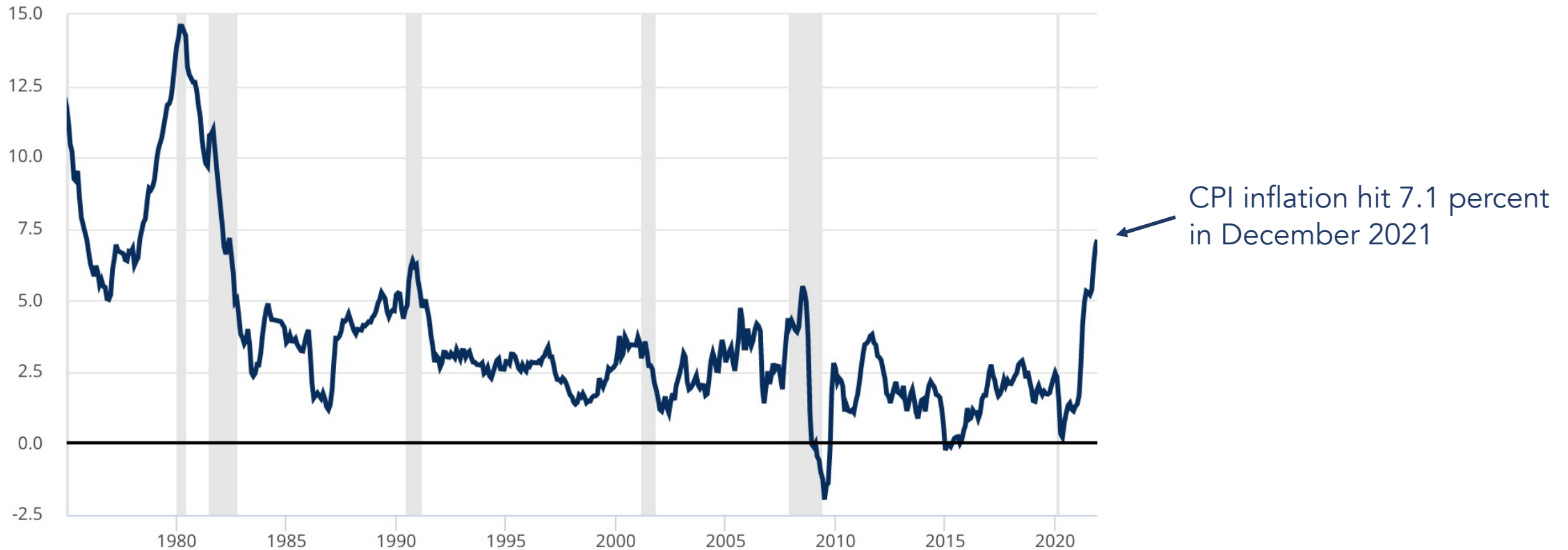
Data from BLS via [FRED](#)

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

Amid strong demand and limited supply, **inflation has jumped**, reaching its highest level in four decades

CPI Inflation

Percent change in prices from 12 months earlier



Data from BLS via [FRED](#)

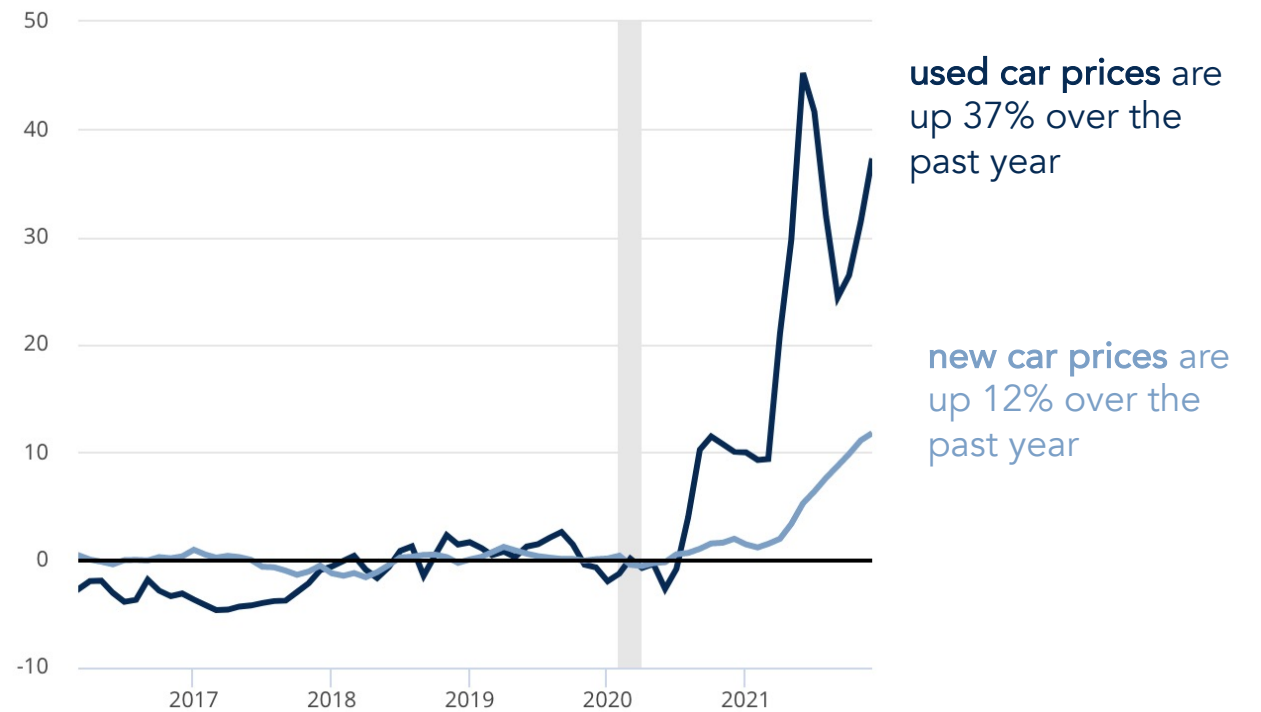
Some components of inflation have seen particularly large increases

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



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

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

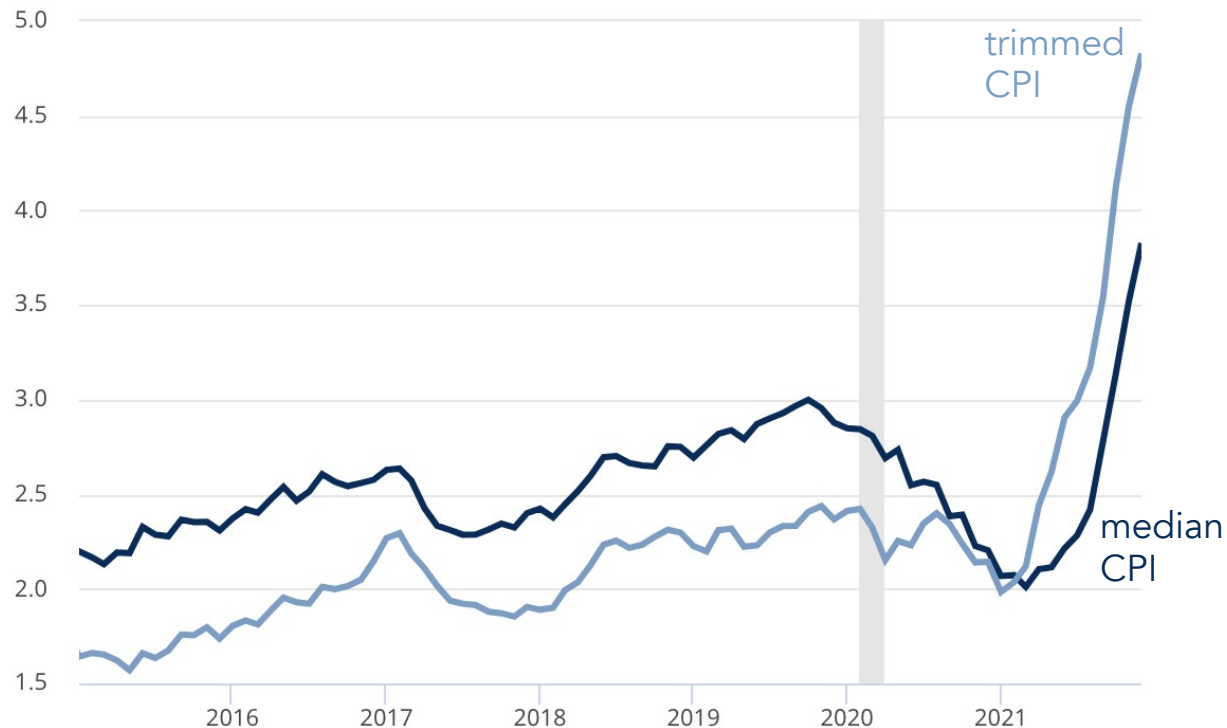


Data from BLS via FRED ([here](#) and [here](#))

But inflation has also picked up more broadly

Alternative Measures of CPI Inflation

Percent change from 12 months earlier



Data from Cleveland Fed via FRED ([here](#) and [here](#))

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

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

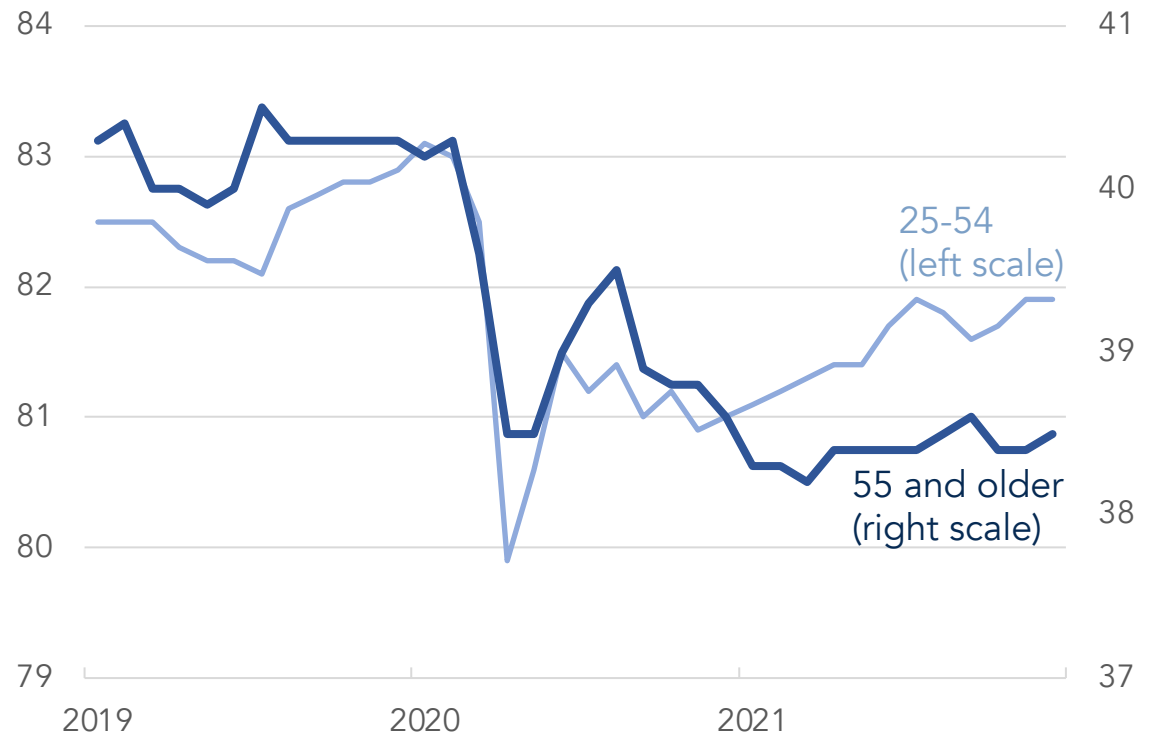
Childcare shortage—workers in this sector should come back as wages rise

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

Labor Force Participation by Age
Percent of population



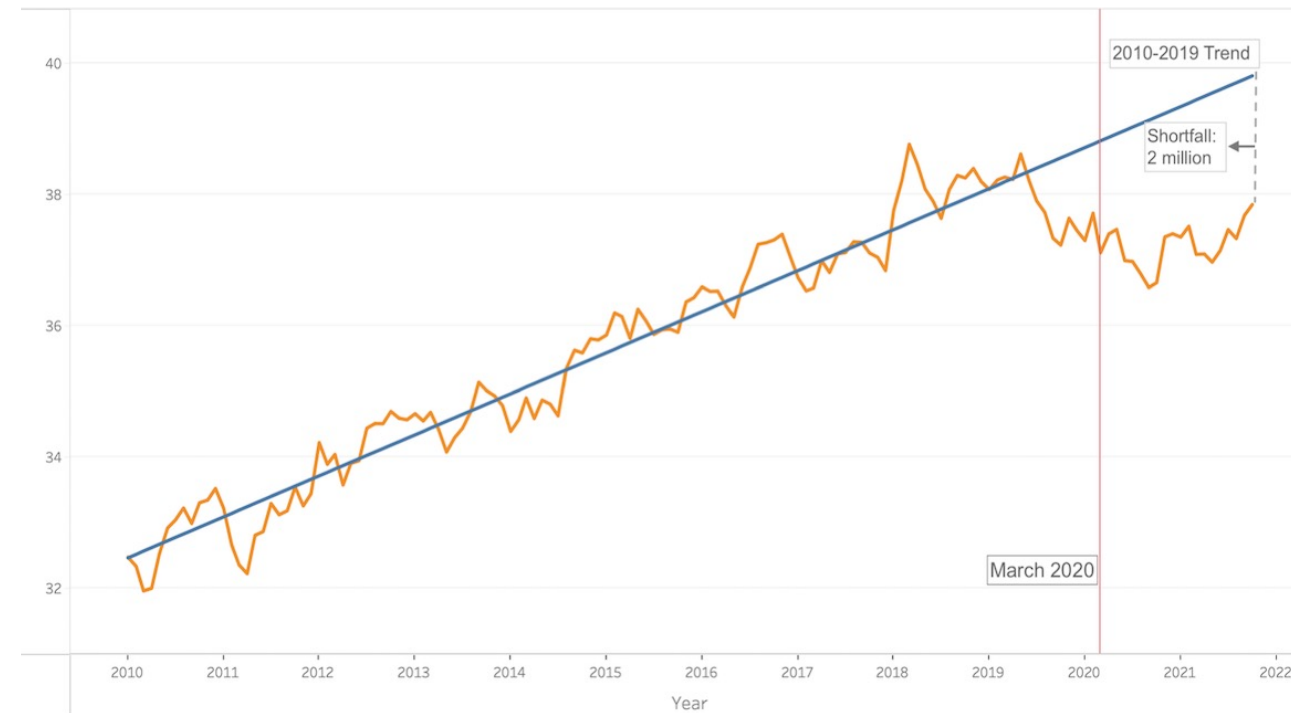
Data from [Bureau of Labor Statistics](#)

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

Working-age Foreign Born Population
Millions



Screenshot from [EconoFact](#)

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

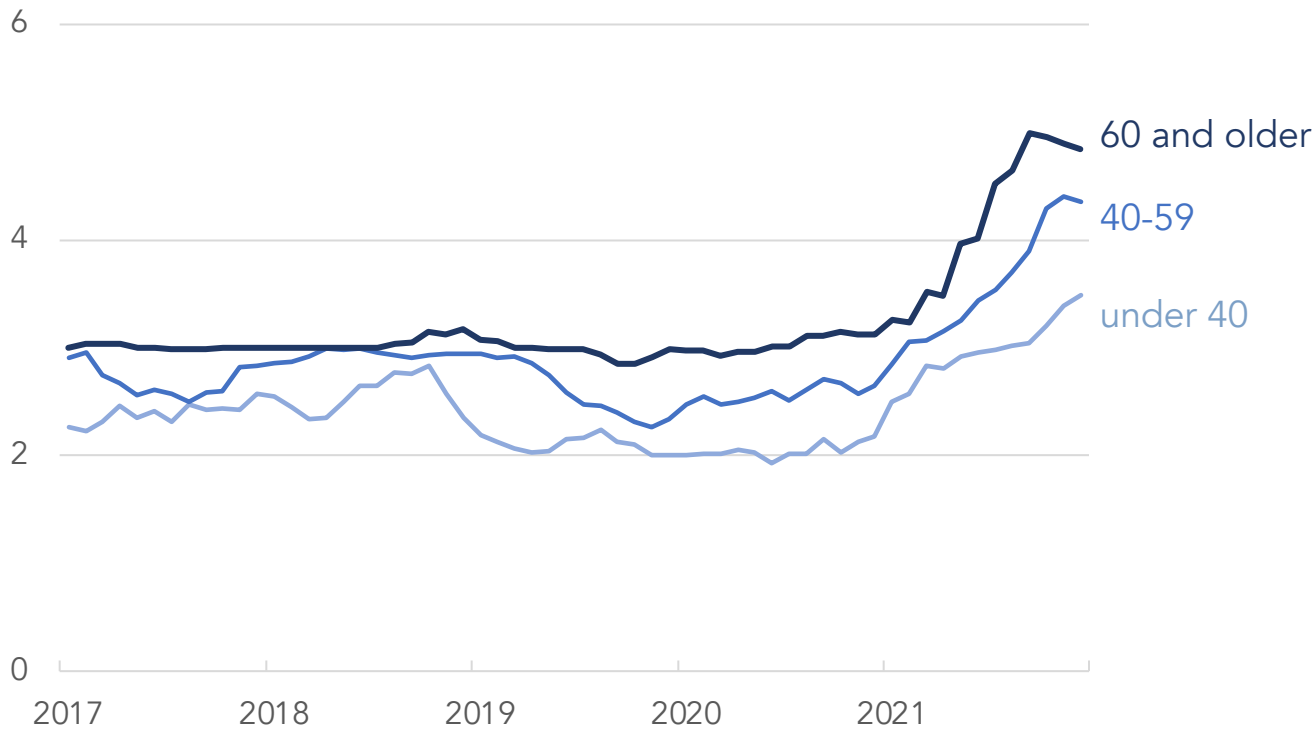
The demand-supply **imbalance will take time to correct**

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

Percent change



Data from [Federal Reserve Bank of New York](#)

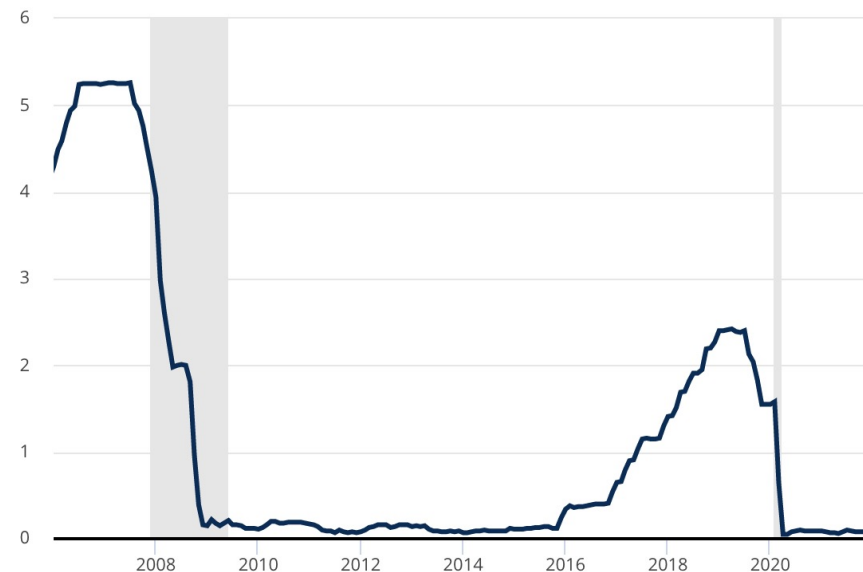
Interestingly, the people expecting the highest inflation are those who have lived through periods of high inflation in the past!

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

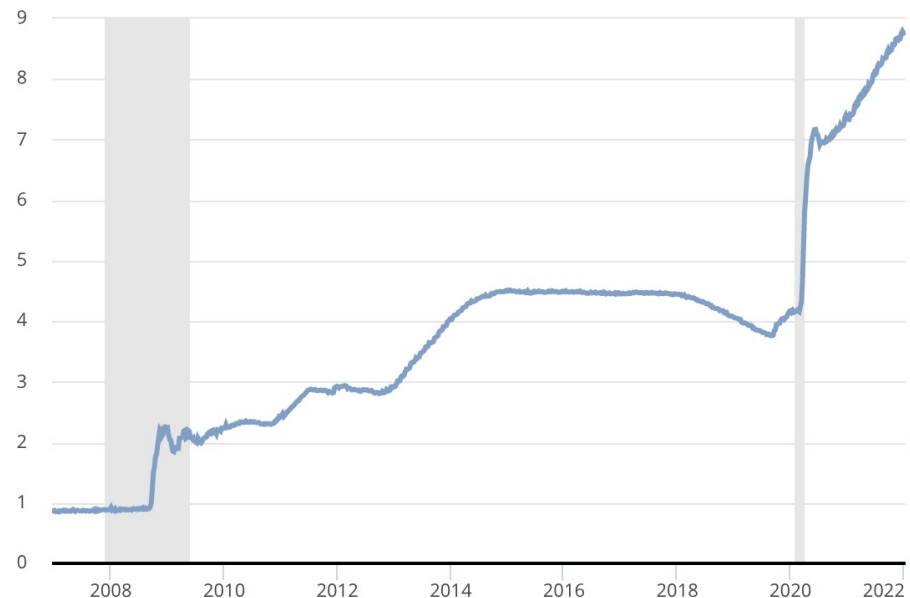
Percent



the policy rate has stayed close to zero

Federal Reserve Balance Sheet

Percent



Quantitative easing has expanded the balance sheet

Data from Federal Reserve via [FRED](#)


Data from the 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**







FEDERAL RESERVE

Fed will aggressively dial back its bond buying, sees three rate hikes next year

PUBLISHED WED, DEC 15 2021-2:01 PM EST | UPDATED WED, DEC 15 2021-6:28 PM EST

 **Jeff Cox**
@JEFF.COX.7528
@JEFFCOXCNBCCOM

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Possible risks ahead

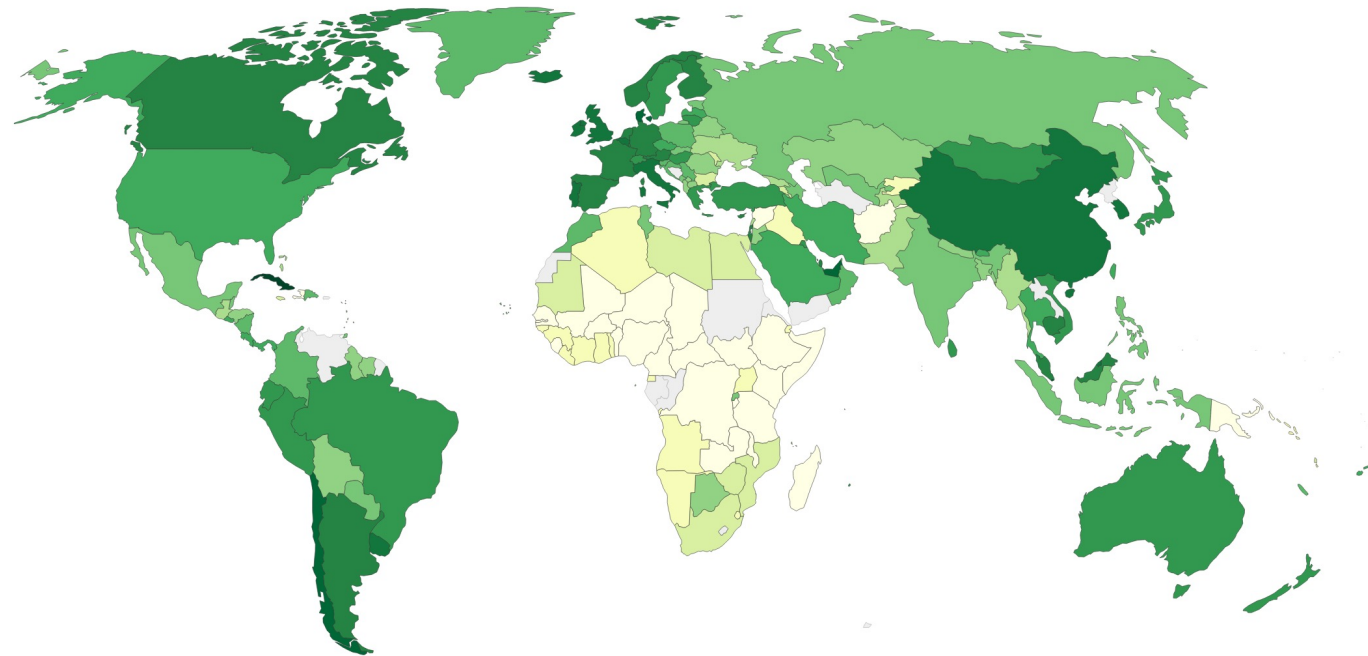
Risk 1—new virus variants

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.



World



Screenshot from [Our World in Data](https://ourworldindata.org/covid-vaccines)

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



photo from
[Wikimedia Commons](#)

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!