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Economic Recovery Continues—with Complications

Karen Dynan

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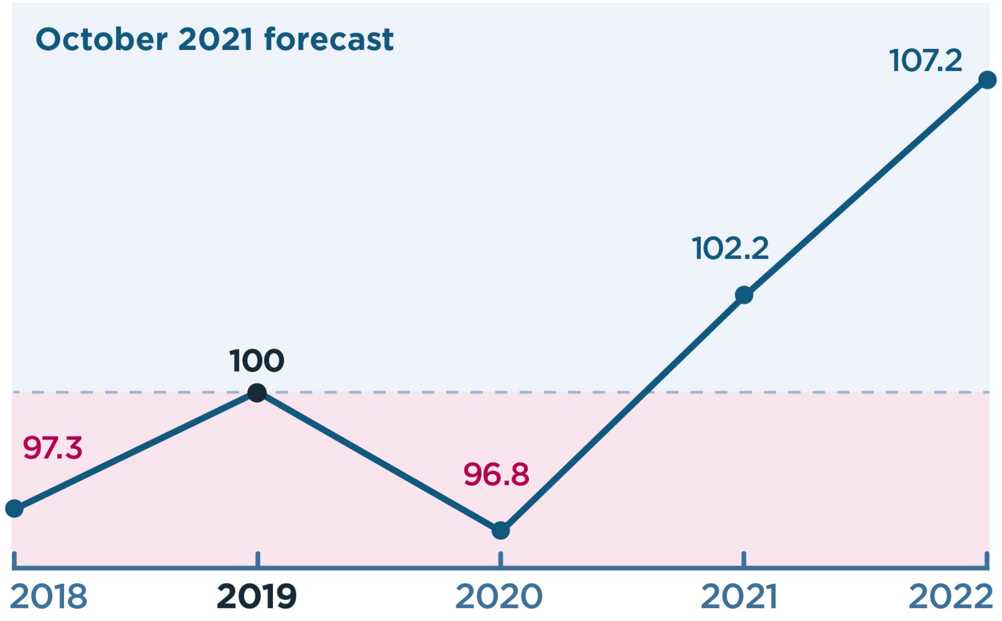
Global GDP has surpassed its earlier high and is poised to advance again in 2022

Global real GDP, 2018–2022 (index, 2019=100)

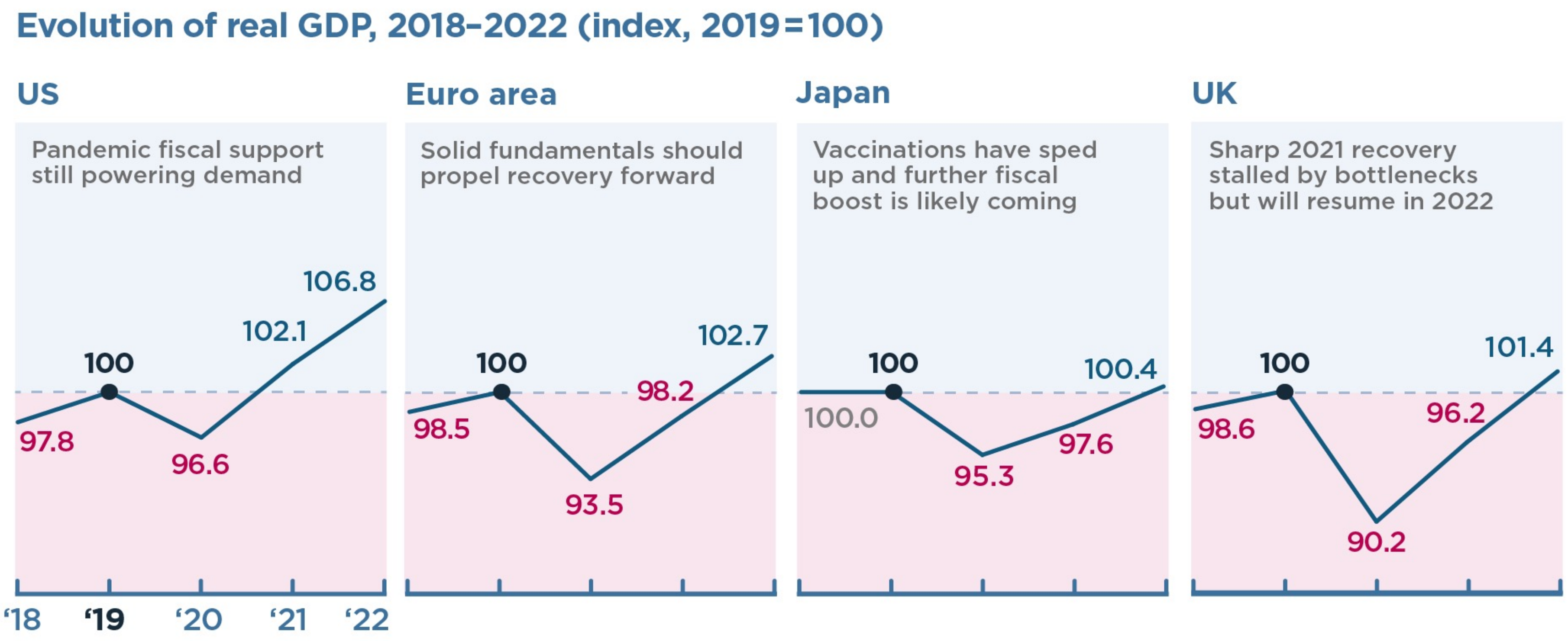


Note: Purchasing power parity weights used to calculate global GDP.

Sources: Consensus forecasts for 2018–2020; PIIE for 2021–2022.

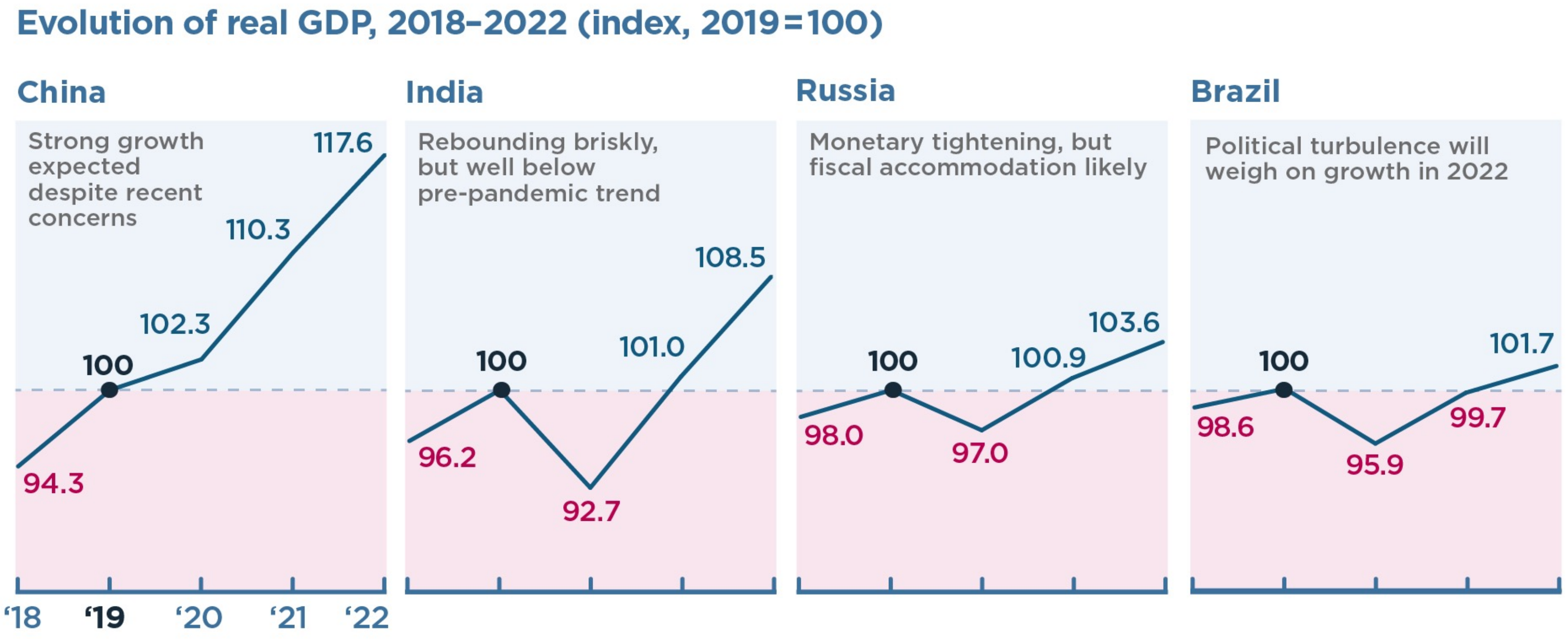
Strong demand has pulled the global economy ahead and should continue to do so—even though the Delta variant and other obstacles are damping the outlook relative to the hopes of early summer

The US continues to lead among the large advanced economies



Sources: Consensus forecasts for 2018–2020; PIIE for 2021–2022.

Large emerging economies are rebounding at very different rates



Sources: Consensus forecasts for 2018–2020; PIIE for 2021–2022.

Summary of the outlook for large economies

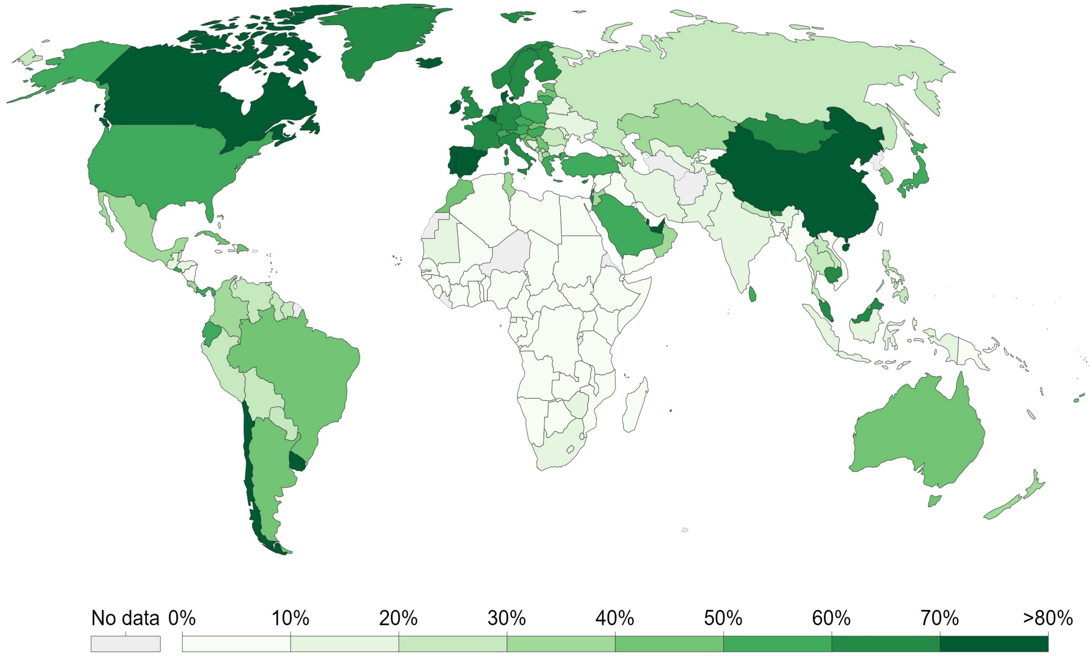
Real GDP Growth (Y/Y)	2020	2021	2022
Global Output Growth	-3.2	5.6	4.9
United States	-3.4	5.7	4.6
Euro Area	-6.5	5.0	4.6
Japan	-4.7	2.4	2.9
United Kingdom	-9.8	6.6	5.5
China	2.3	7.8	6.6
India	-7.3	8.9	7.5
Russia	-3.0	4.0	2.7
Brazil	-4.1	4.0	2.0

Source: Consensus Forecasts for 2020; author's forecasts for 2021-2022. Annual-average-over-annual-average growth rates. PPP weights.

More broadly, recoveries will differ depending on vaccine access

Fully Vaccinated Against COVID-19

Share of population



Source: Our World in Data (as of September 28, or latest available data)

- Vaccination rates in most of Africa and a number of other countries remain extremely low, exposing those countries to continued pandemic fallout and risk
- In addition, many of these countries have limited financial capacity to provide fiscal support

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Recent developments have surprised in three related ways

Many countries (even those with vaccine access) have struggled with the Delta variant

The reopening of economies has faced significant headwinds:

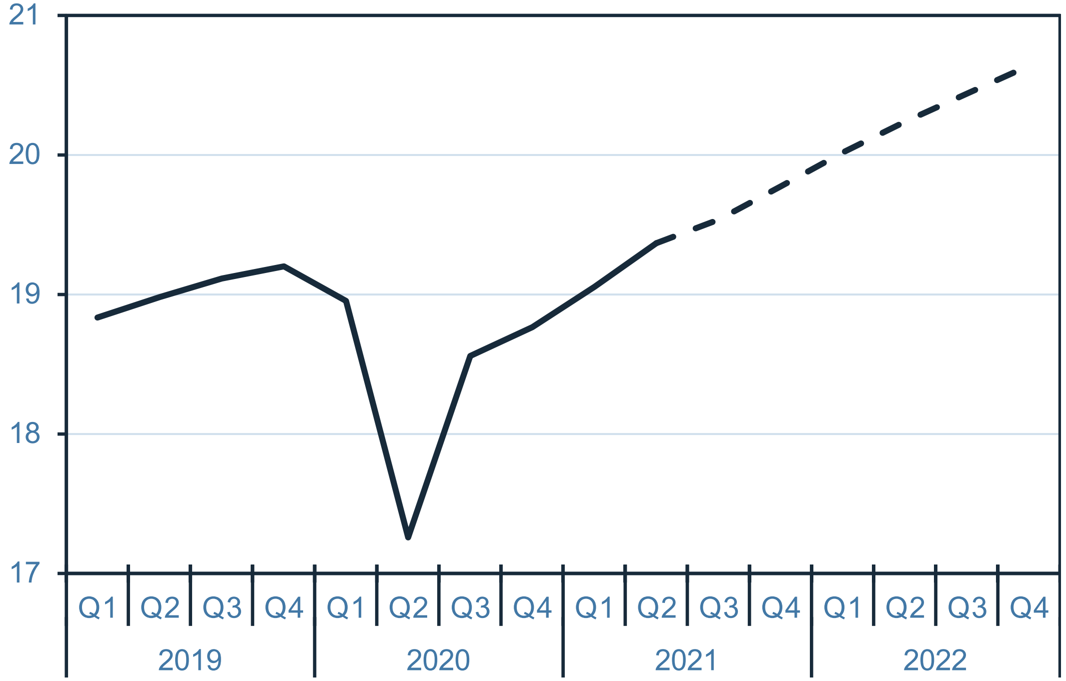
- Supply chain breakdowns and bottlenecks have been weighing on production
- Some would-be workers have been reluctant to come off the sidelines

These frictions and pent-up demand have pushed up inflation significantly—in the United States, 12-month core PCE inflation is 3.6 percent

After a Q3 lull, US GDP growth will average 4.5 percent through the end of next year

US Real GDP

Chained 2012 Dollars (Trillions)

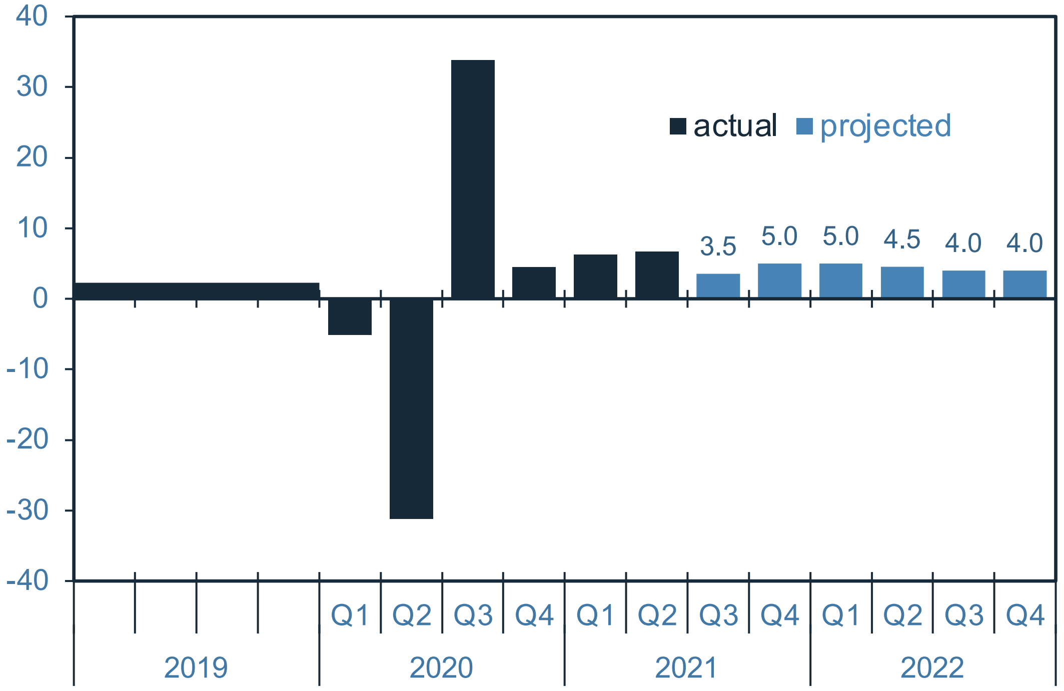


Note: Dashed segment is forecast

Source: US Bureau of Economic Analysis; FRED; author's forecast

US Real GDP Growth

Percent change, annual rate



Source: US Bureau of Economic Analysis; FRED; author's forecast

5 key economic factors will shape the outlook in the US (and many other countries)

- Whether households have the financial capacity to keep spending
- When supply chain problems and bottlenecks will fade
- How labor force participation and the demand for workers will evolve
- What course fiscal policy will take
- How inflation expectations, wage pressures, and monetary policy play out

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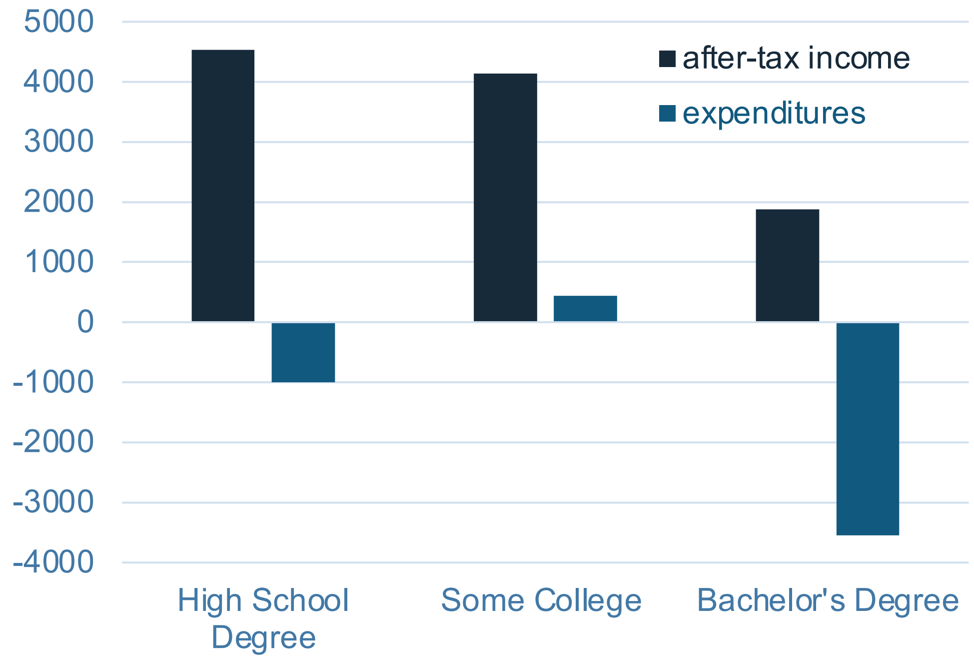
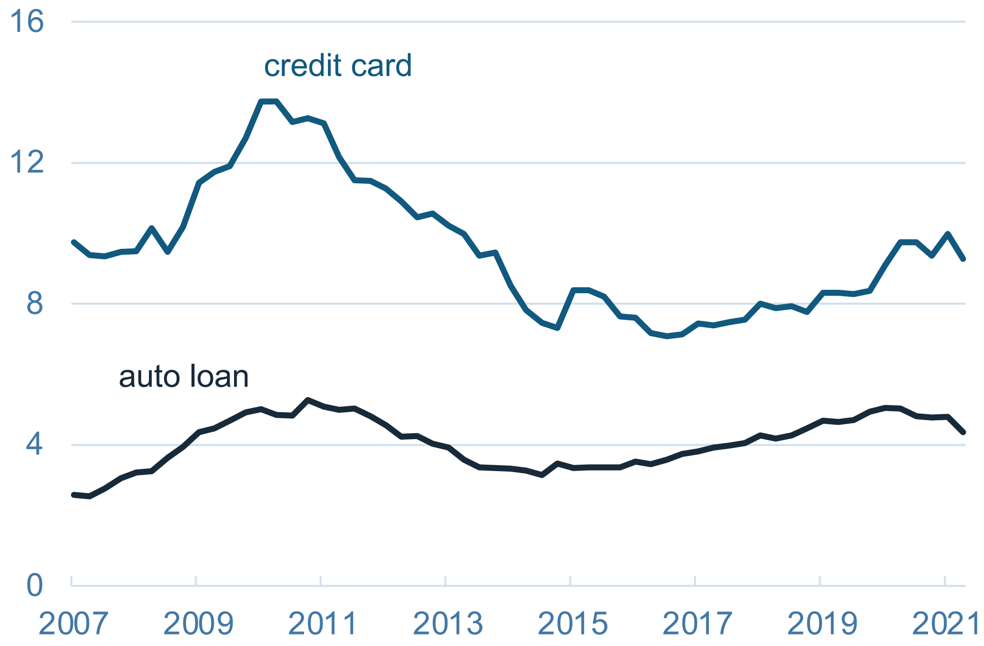
Pandemic income support bolstered household finances, even at the low end

Change in Income and Expenditures, 2019-2020
Current dollars



Source: US Bureau of Labor Statistics Consumer Expenditure Surveys

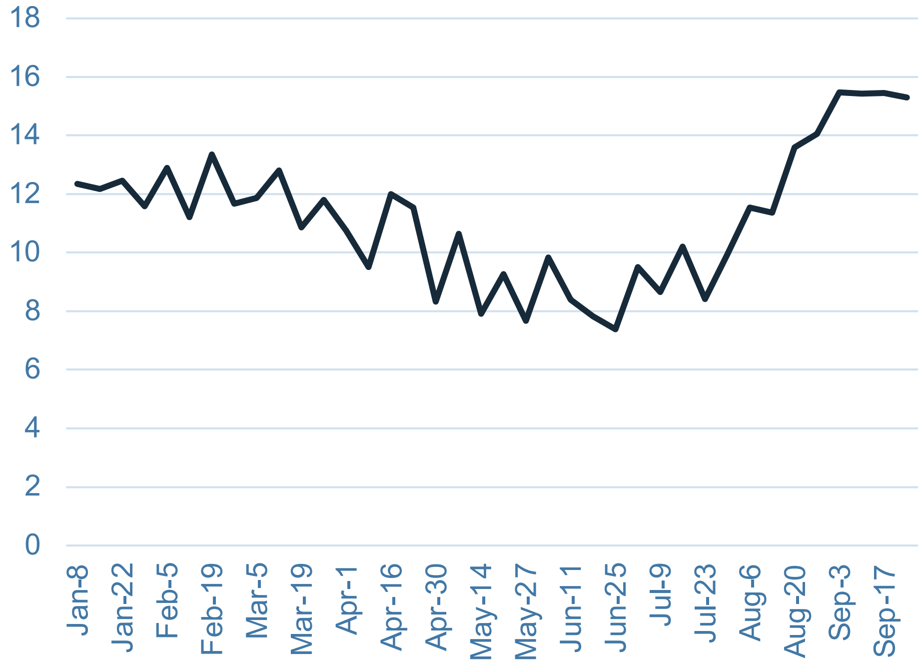
90+ Days Delinquent by Loan Type
Percent of balance



Source: New York Fed Consumer Credit Panel/Equifax

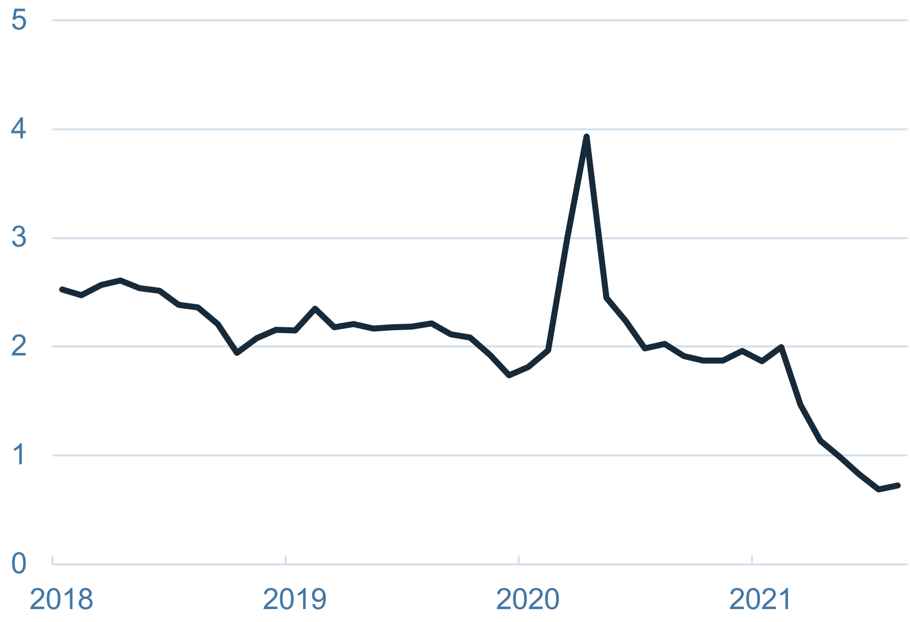
Bottlenecks and supply chain problems are not dissipating yet

Port of Los Angeles Days at Anchor and Berth
Weekly averages for 2021



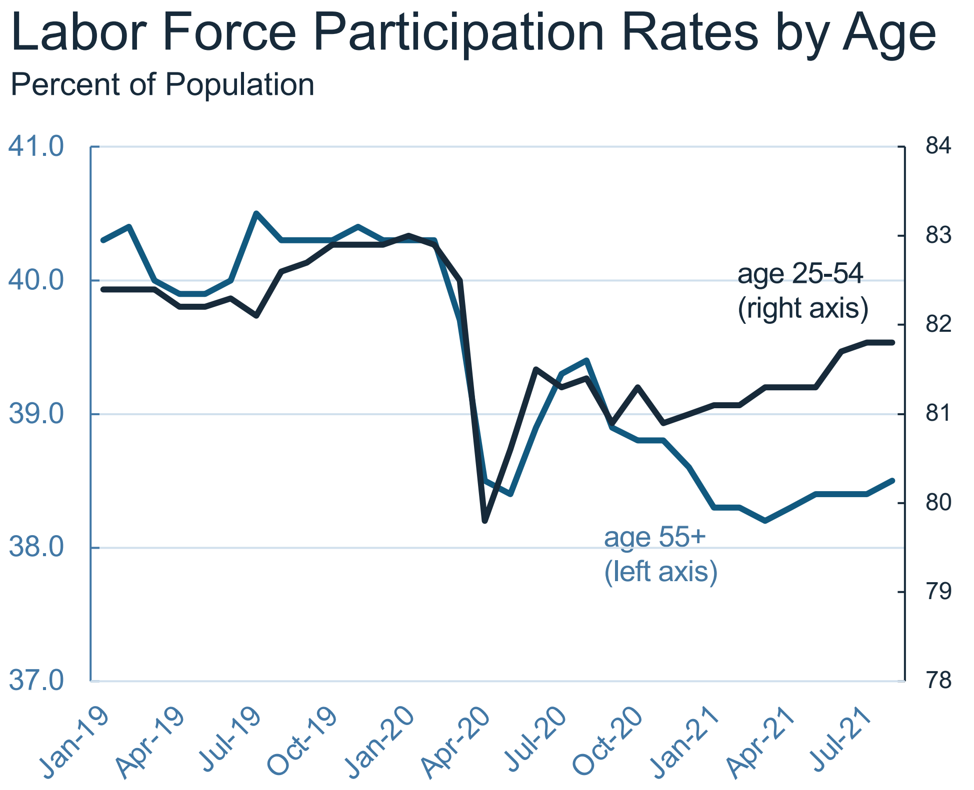
Source: Port of Los Angeles

Inventory-to-Sales Ratio for Domestic Autos



Source: US Bureau of Economic Analysis

Hesitation of would-be workers is holding down the supply of labor



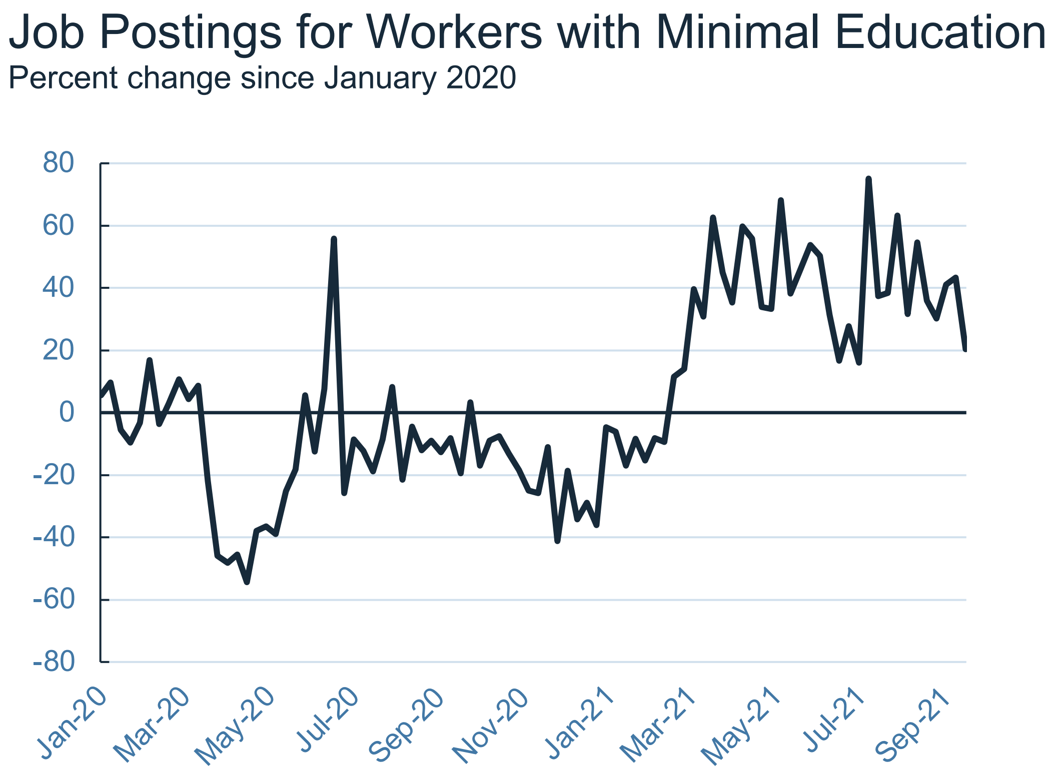
Source: US Department of Labor

Contributing factors likely include:

- Fear of the virus
- Unpleasant working conditions related to the pandemic
- Accumulated savings from fiscal support and strong asset price growth

These factors will mostly fade for working-age adults but less so for older adults who have 401(k) windfalls

Labor demand is strong for less-skilled workers—but will it persist?



Source: Burning Glass Technologies via Tracktherecovery.org

- Job postings for minimally skilled workers have been running well above their pre-pandemic level
- Looking ahead, restructuring, sectoral shifts, and an acceleration of automation spurred by the pandemic will hinder the recovery of low-skilled jobs—but the extent is still unclear

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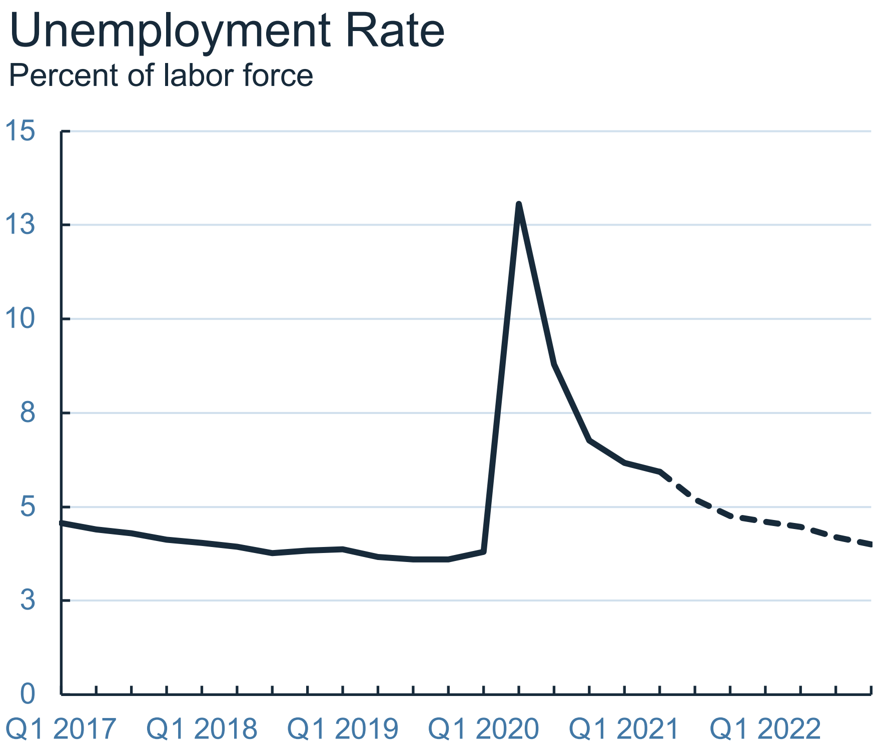
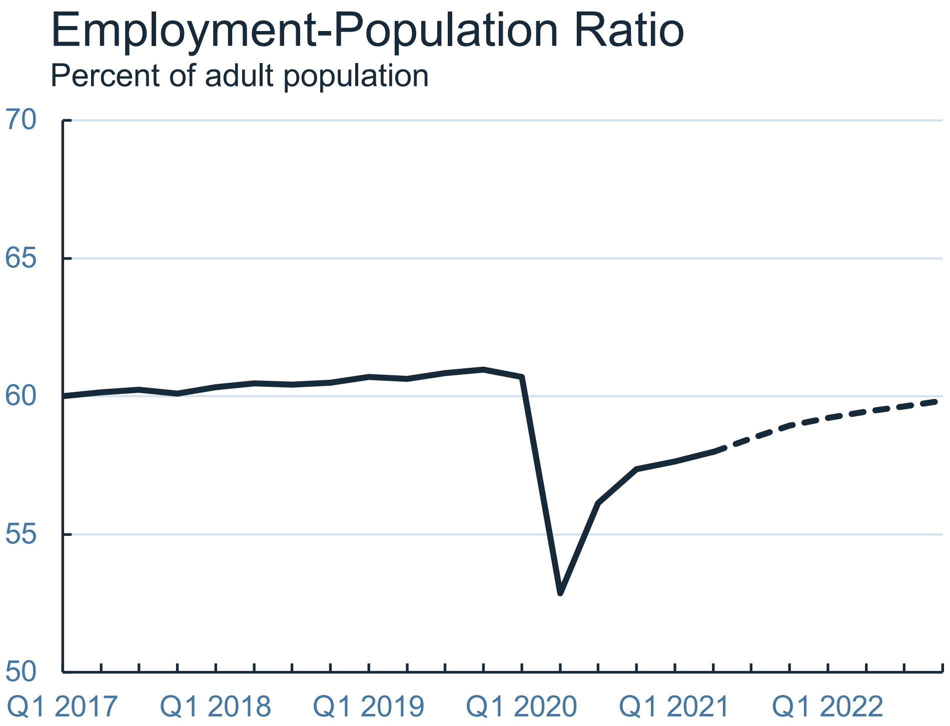
The unemployment rate will fall below 5% this year and to 4% by the end of 2022



Note: Dashed segment is forecast
Source: US Bureau of Labor Statistics; FRED; author's forecast



Note: Dashed segment is forecast
Source: US Bureau of Labor Statistics; FRED; author's forecasts

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Outcome of US fiscal debate will have limited impact on macroeconomy over next 2 years

Assuming that the debt limit is raised soon (as seems very likely)

Big spending increases are being discussed, but:

- the final numbers will be much smaller
- there will be a partial tax offset
- the amounts will be spent over 10 years (albeit front-loaded)

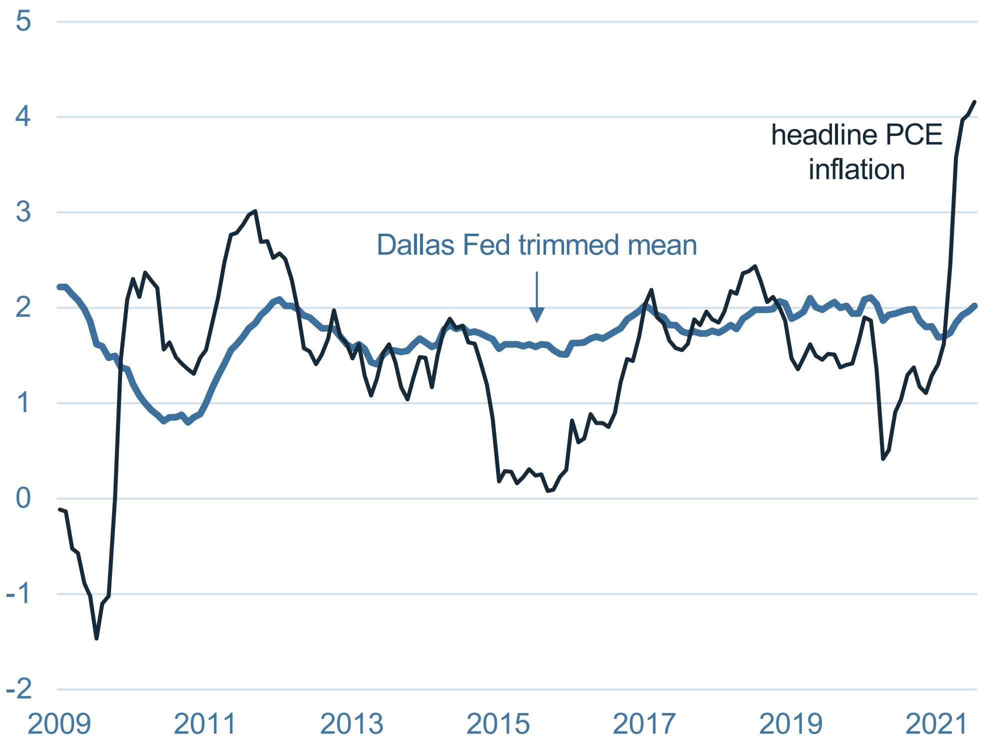
The forecast assumes $150 billion in net new stimulus (with a big confidence band), offsetting some of the drag from the waning of earlier stimulus

Over the longer run, concerns about inequality and dislocations could lead to more policies that prioritize equity over efficiency and restrict international trade

Some good news, some bad news on inflation

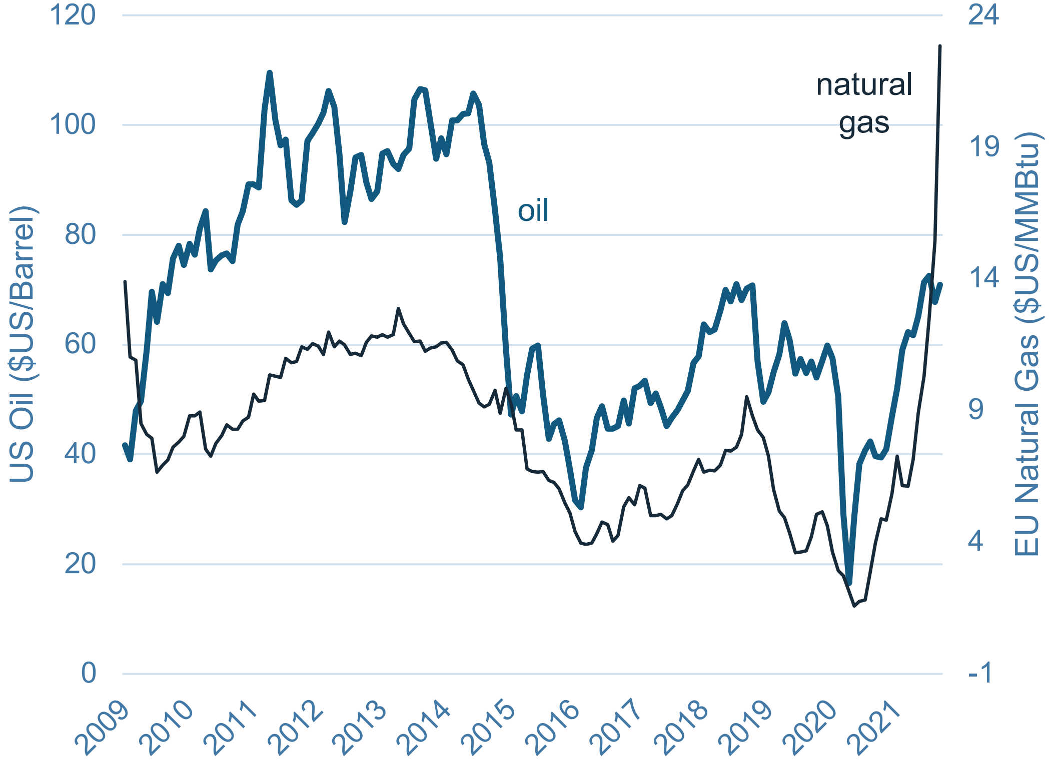
PCE Inflation

Percent change from 12 months earlier



Source: Federal Reserve Bank of Dallas; US Bureau of Economic Analysis

Oil and EU Natural Gas Prices

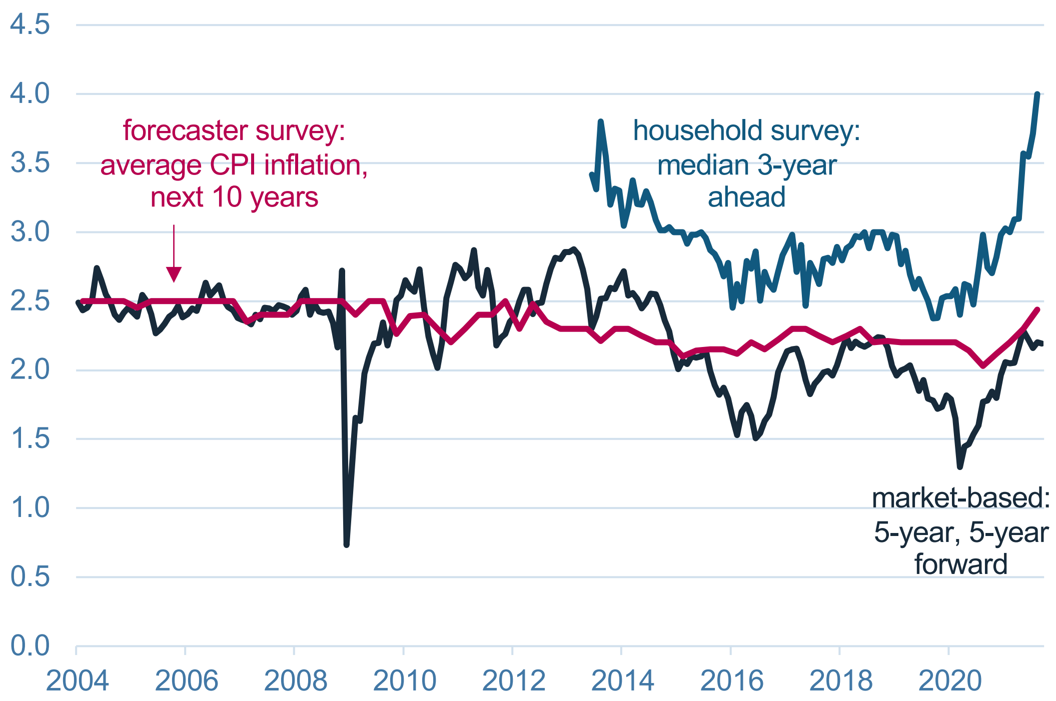


Source: US Energy Information Administration; World Bank
Notes: September value for oil series is an estimate based on daily data through 9/27; Natural gas series ends in September

Measures of expected inflation and wage growth do not (yet) signal sustained high inflation

Expected Inflation

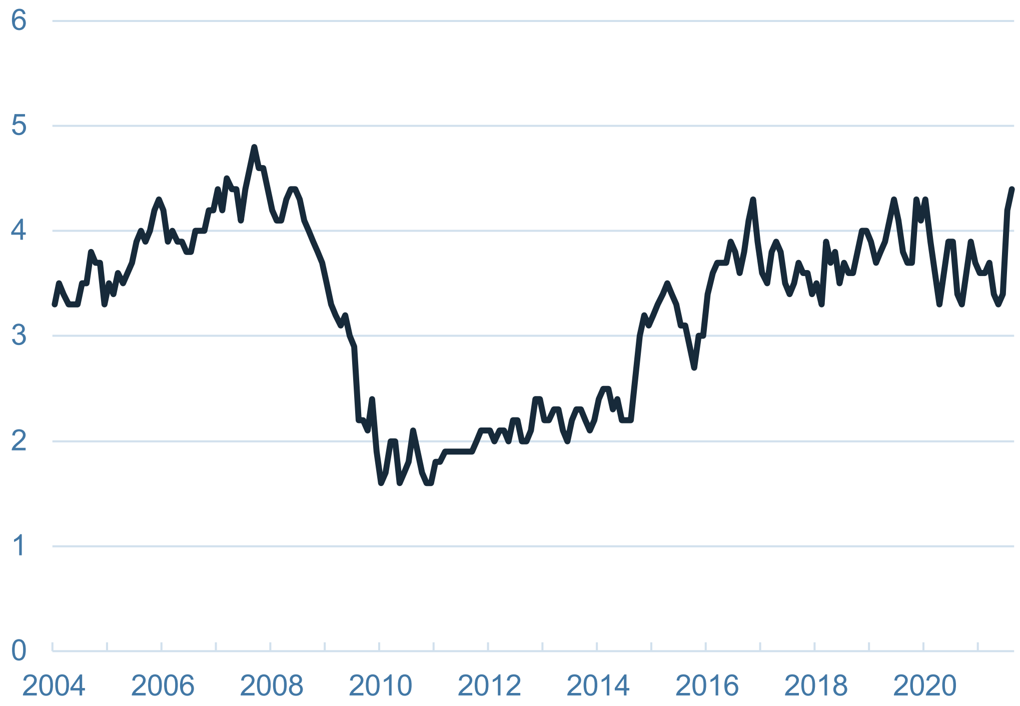
Percent



Sources: Federal Reserve Bank of Philadelphia; Federal Reserve Bank of St. Louis; Federal Reserve Bank of New York

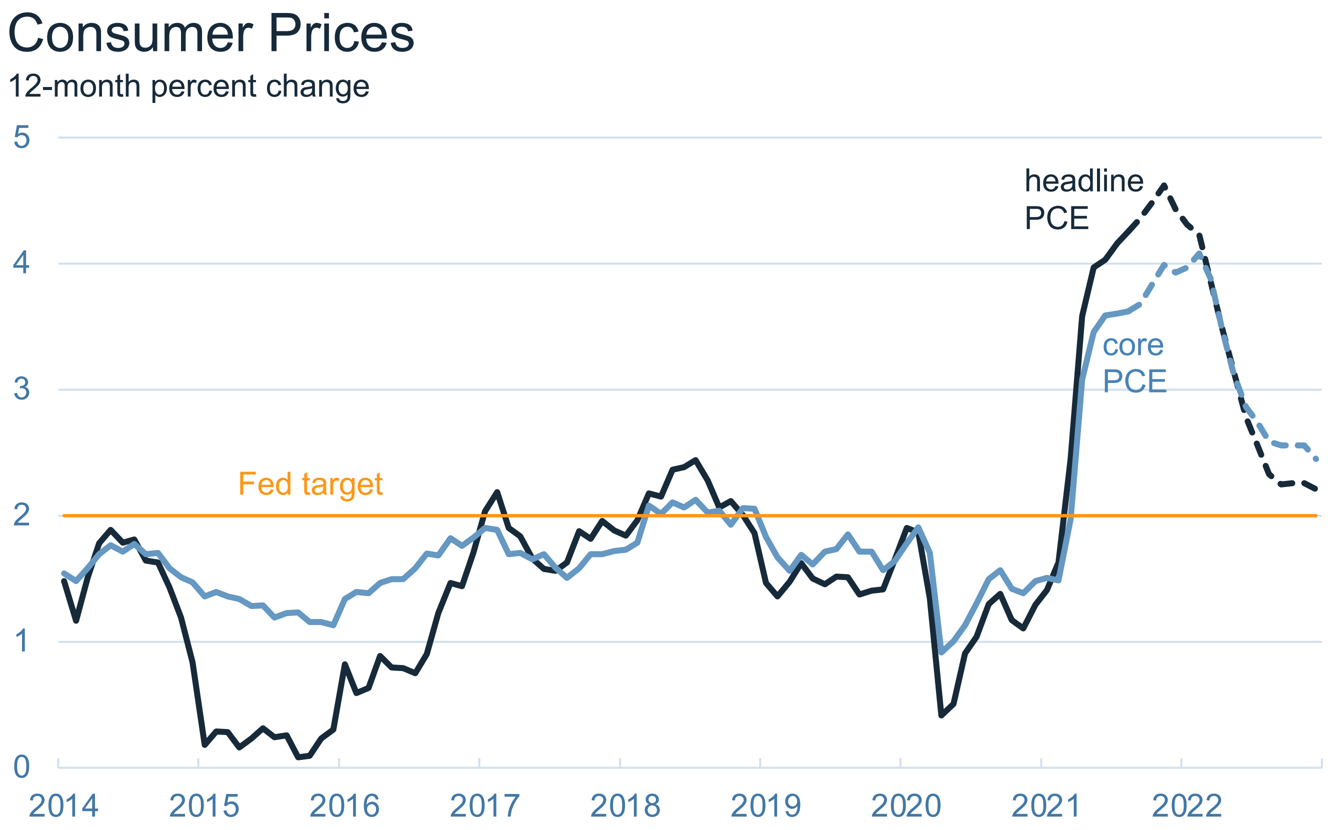
Atlanta Fed Wage Growth Tracker

Percent



Source: Federal Reserve Bank of Atlanta

US inflation should fall into the mid-2s by late next year



Source: US Bureau of Economic Analysis; author’s forecasts

The Federal Reserve will probably begin raising the funds rate in 2022

With inflation likely to be higher than the current FOMC consensus, policy tightening is likely to be a little more aggressive as well:

- Tapering of asset purchases to begin in November and finish by mid-2022
- One rate increase in 2022 and three or more in 2023

An important risk is that markets could be surprised by the extent of policy tightening—particularly if the Fed has to pivot more abruptly—and the "everything bubble" deflates, perhaps suddenly

Even in the absence of a surprise, higher rates might be problematic for EMDEs with high levels of debt

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The bottom line: continued economic recovery but with bumps and risks

There are no similar episodes in recent history to guide us, but my best guesses:

- Demand for goods and services will remain strong despite Delta headwinds
- Supply chain problems and bottlenecks will ebb slowly through 2022
- Most of the working-age population will re-enter the labor market, but restructuring, sectoral shifts, and automation will drag out the jobs recovery
- Inflation will moderate to the mid-2s in the US by late next year

Still, much could go wrong, including new virus variants, further supply shocks, and disruptions to financial markets caused by central bank tightening or other factors

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