High Inflation and Slowing Growth

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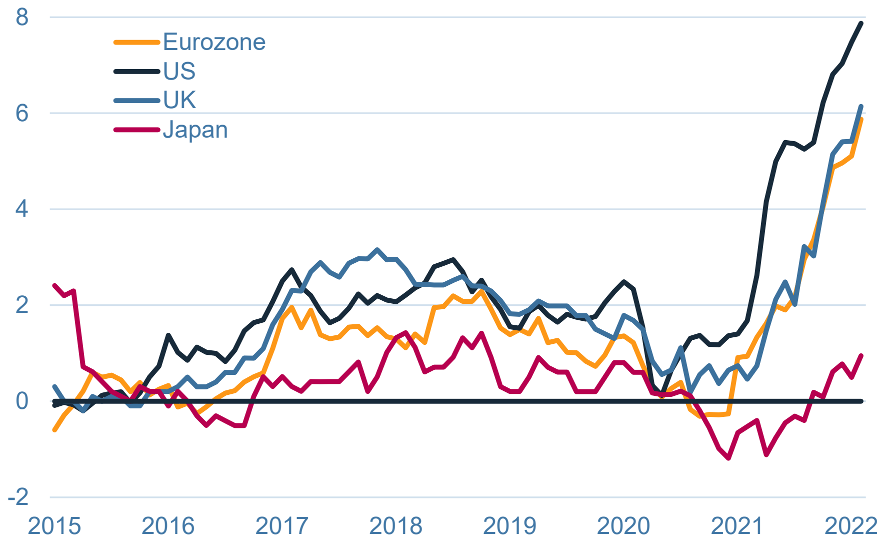
Inflation has climbed sharply in most economies

Consumer Prices

Percent change from 12 months earlier



Sources: US Bureau of Labor Statistics, Eurostat, UK Office for National Statistics, and Japanese Statistics Bureau via Macrobond

Therefore, many central banks are or will be tightening policy, which will represent a downward force on economic activity

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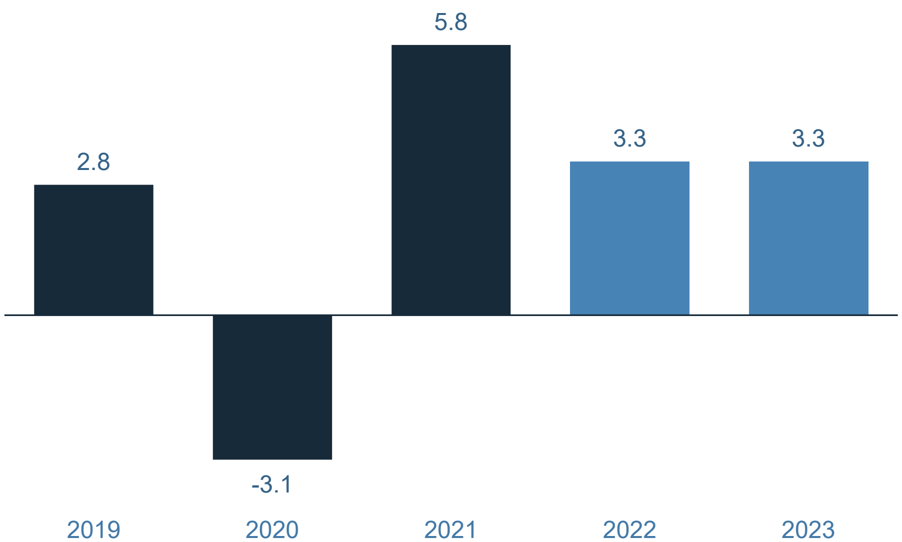
Global economic growth has stepped down markedly

Global Real GDP Growth
Percent change from previous year



Note: Purchasing power parity weights used to calculate global GDP
Sources: Consensus forecasts for 2019-2021; author's forecasts for 2022-2023

Growth has already slowed on a quarterly basis in many countries

Some common factors are bearing on the outlook for most countries

- Underlying momentum in demand for goods and services
- Setbacks from episodes of resurging COVID
- Disruptions from war in Ukraine, including higher prices for energy, food, and other commodities
- Highest inflation in decades, necessitating rapid transition from monetary support to neutral policy or beyond

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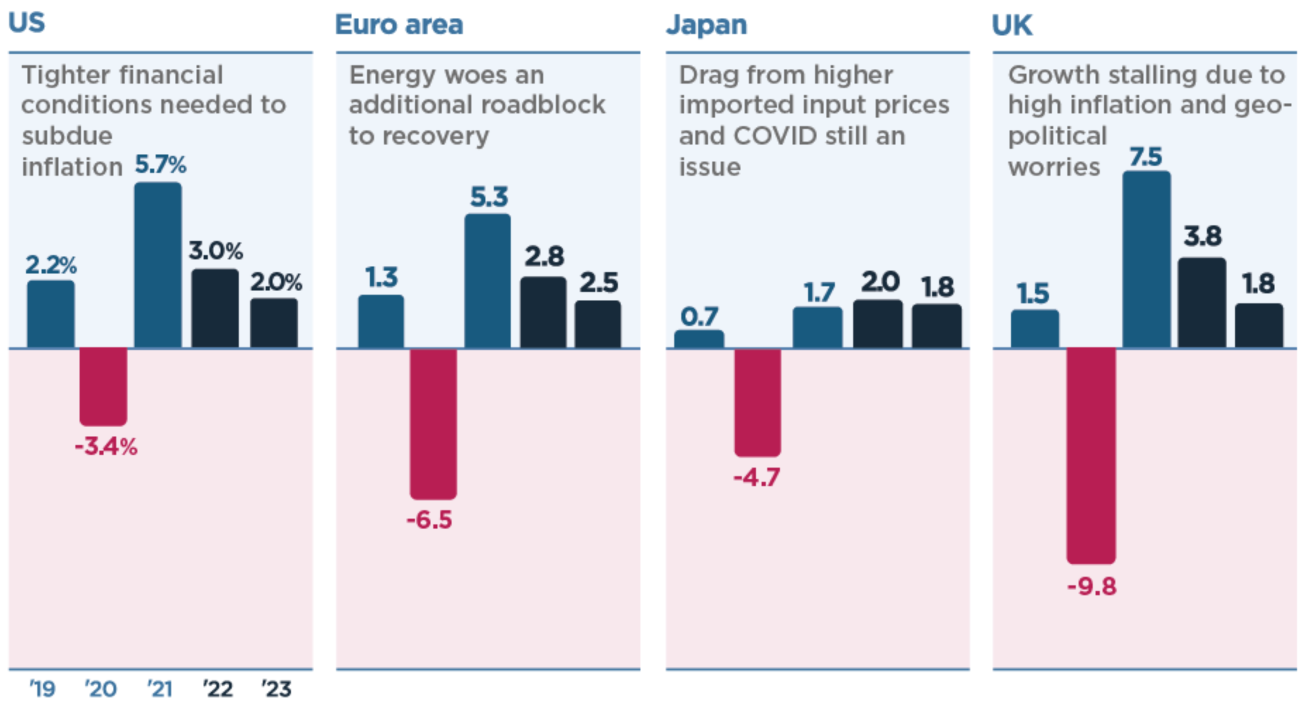
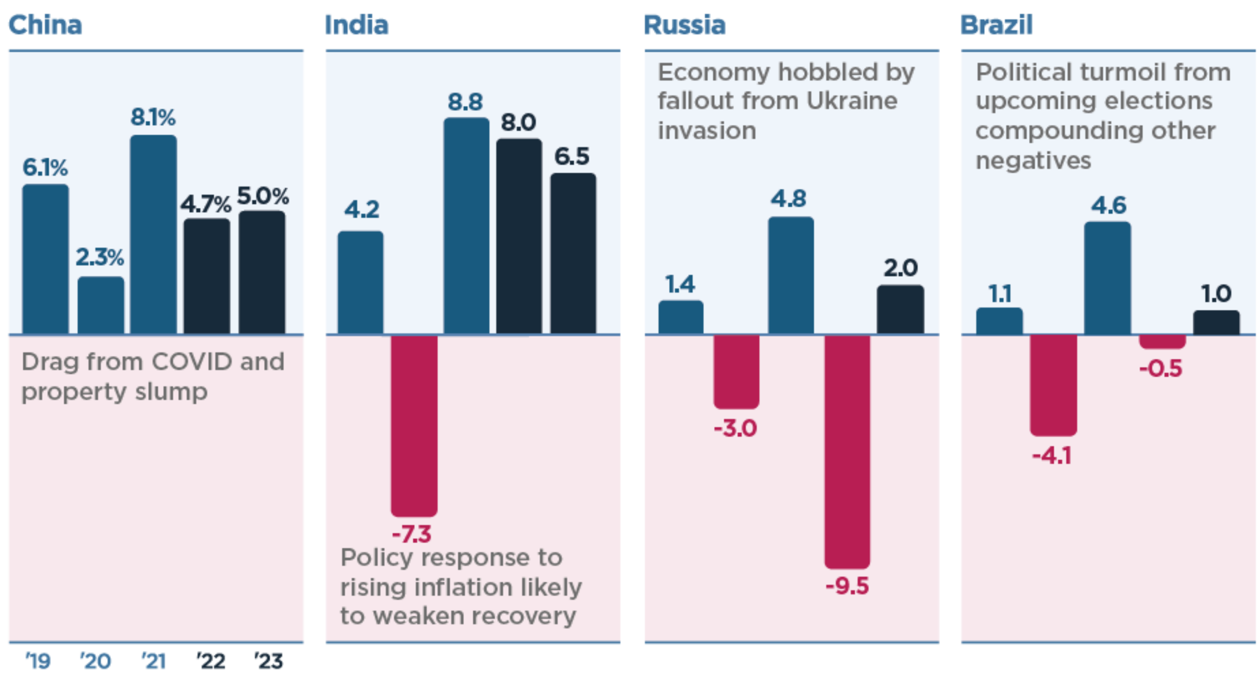
Growth slows across all advanced economies despite scope for further rebound in some



Sources: Consensus forecasts for 2019-2021; author's forecasts for 2022-2023.

Growth in emerging economies is diverging to a striking degree



Summary of the outlook for large economies

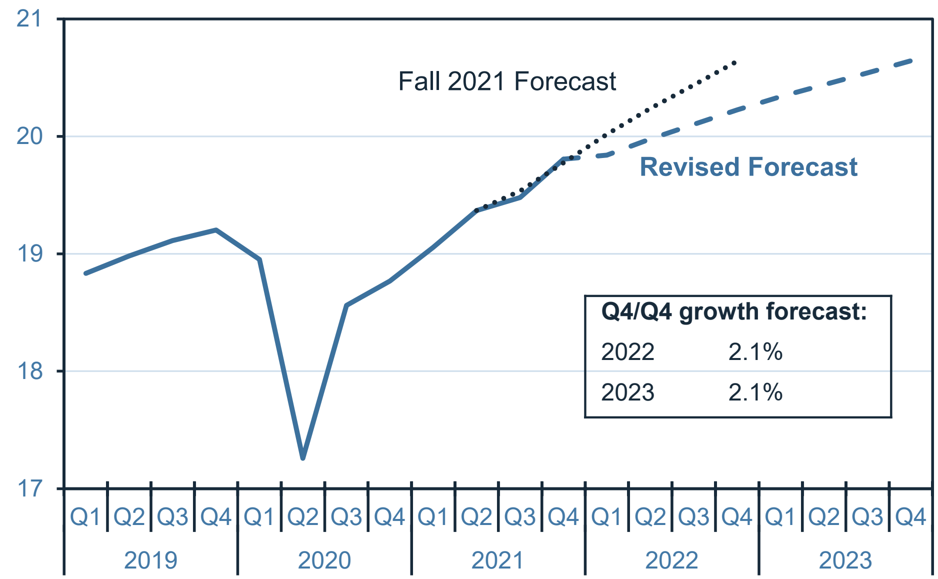
Real GDP Growth (Y/Y)	2020	2021	2022	2023
Global Output Growth	-3.1	5.8	3.3	3.3
United States	-3.4	5.7	3.0	2.0
Euro Area	-6.5	5.3	2.8	2.5
Japan	-4.7	1.7	2.0	1.8
Canada	-5.3	4.6	4.0	3.0
United Kingdom	-9.8	7.5	3.8	1.8
China	2.3	8.1	4.7	5.0
India	-7.3	8.8	8.0	6.5
Russia	-3.0	4.8	-9.5	2.0
Brazil	-4.1	4.6	-0.5	1.0
Mexico	-8.3	4.8	1.5	1.5

Source: Consensus forecasts for 2020-2021; author's forecasts for 2022-2023. Annual-average-over-annual-average growth rates. PPP weights.

The US GDP outlook is less robust than expected last fall

US Real GDP

Chained 2012 Dollars (Trillions)



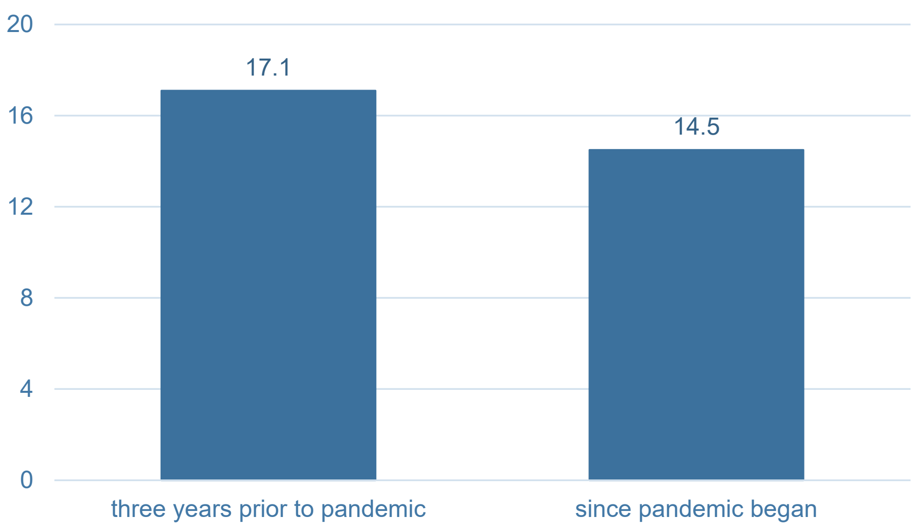
Source: US Bureau of Economic Analysis via FRED; author's forecast

Growth in GDP last year pushed the economy further beyond its short-run productive capacity than had been anticipated

Underlying demand remains strong at this point, but it will need to be restrained for inflation to moderate

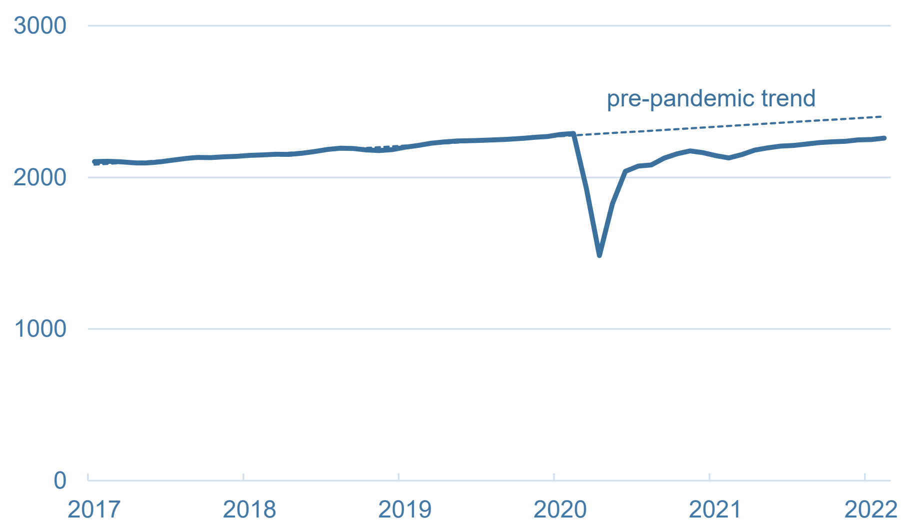
Demand is likely to be boosted by consumers making up for lost ground in some categories

Average New Light Motor Vehicle Sales
Millions (annual rate)



Source: US Bureau of Economic Analysis via FRED

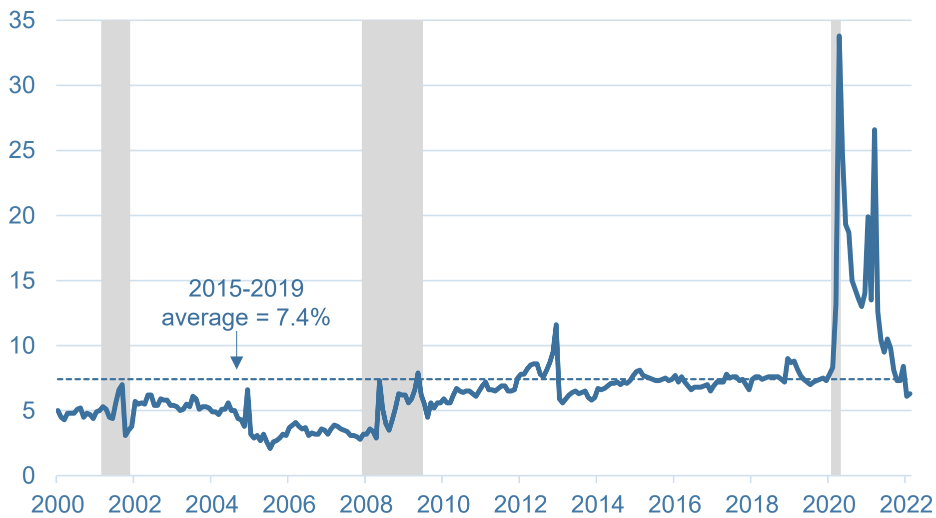
Real PCE Healthcare Services
Billions of chained (2020) dollars



Source: US Bureau of Economic Analysis

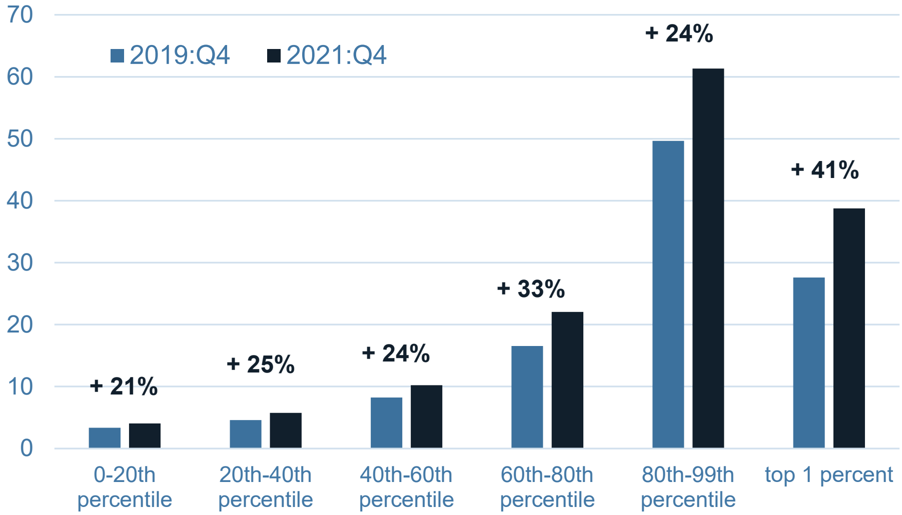
Accumulated savings during the pandemic will also boost demand across the distribution

Personal Saving Rate
Percent of disposable personal income



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

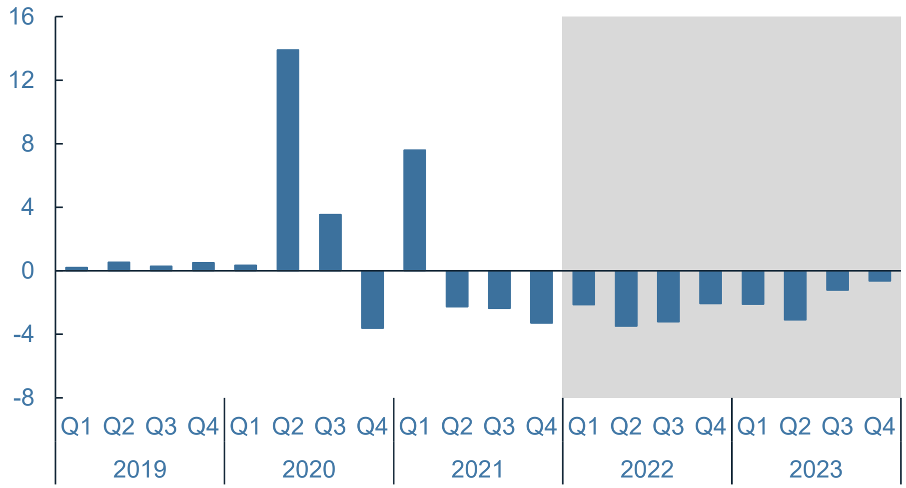
Aggregate Wealth by Income Percentile
Trillions



Source: Federal Reserve Distributional Financial Accounts; author's calculations

The waning of fiscal stimulus represents a drag on demand

Contribution of Fiscal Policy to Real GDP Growth
Percentage points



Note: Estimates do not include multipliers or monetary policy response
Source: Brookings Hutchins Center

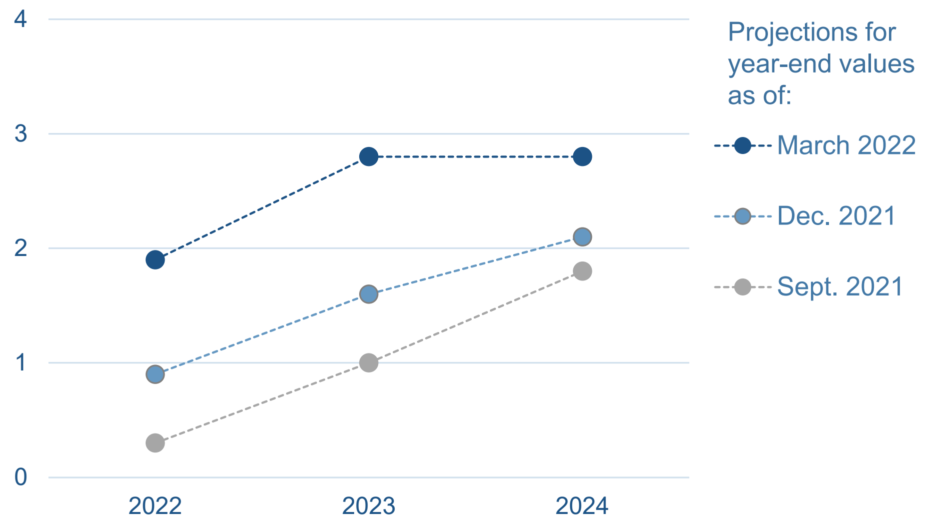
The normalization of fiscal policy generates some drag

(But remember that the earlier increases in government spending and reductions in taxes is what helped people build their substantial cushion of savings and also has contributed to many states and localities being flush with cash)

Demand will also be restrained by the removal of monetary accommodation

Median FOMC Projections for Federal Funds Rate

Percent



Source: Federal Reserve

Interest Rate on Two-Year Treasury Note

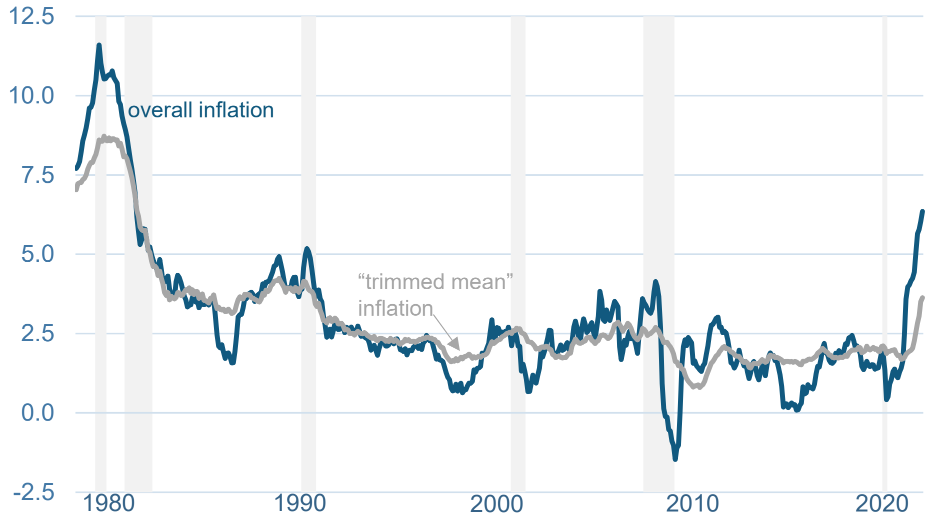
Percent

Source: Federal Reserve via FRED

The pace of funds rate increases will depend on the evolution of inflation

PCE Inflation

Percent change from 12 months earlier



Source: Federal Reserve Bank of Dallas and US Bureau of Economic Analysis via FRED

Overall inflation began to ramp up last March and has now surged to a level not seen since the early 1980s

Measures that exclude outsized changes remained subdued through the end of last summer but then began rising and have now also hit levels not seen in decades

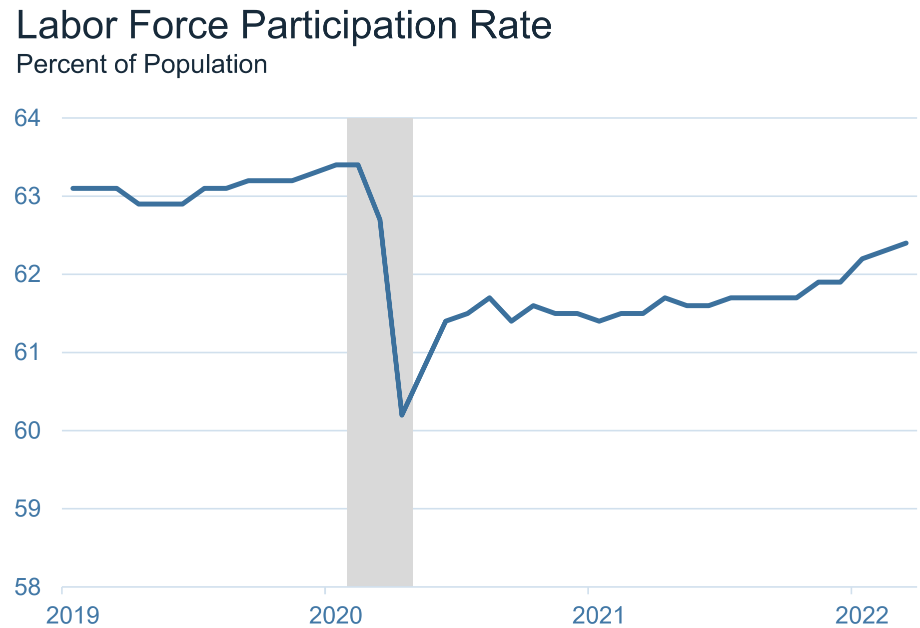
The path of inflation will depend primarily on three factors

Slack—the extent to which demand is below (or above) potential supply

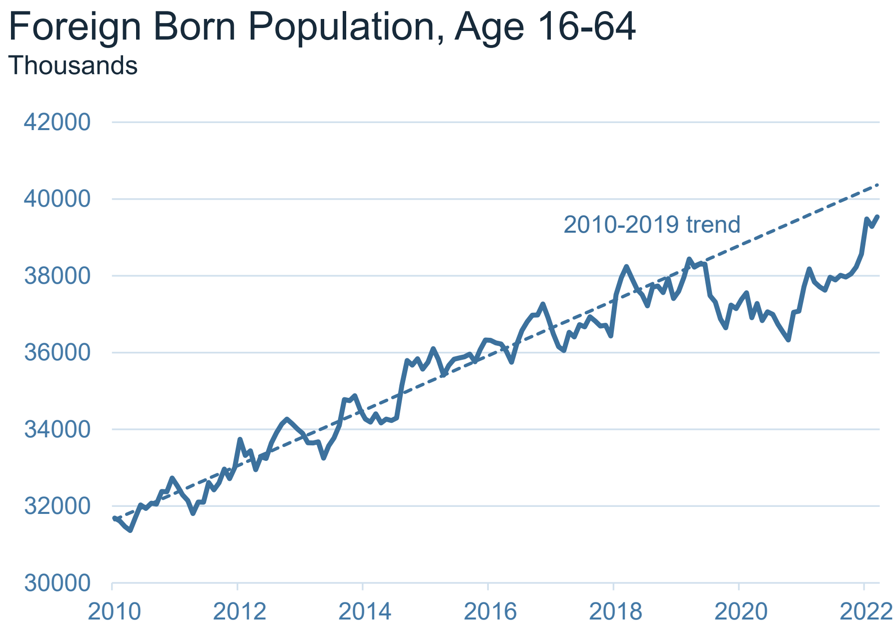
Supply shocks—for example, reductions in Russian oil exports and COVID-related shutdowns in China

Expected future inflation and past inflation

Rising labor supply will increase slack this year



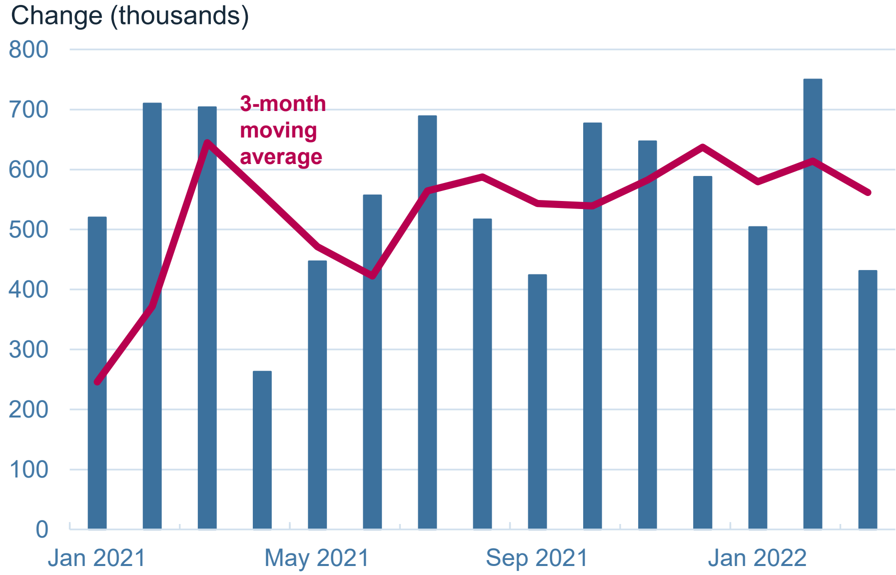
Source: US Bureau of Labor Statistics via FRED



Note: January changes incorporate annual adjustments to BLS population controls
Source: US Bureau of Labor Statistics

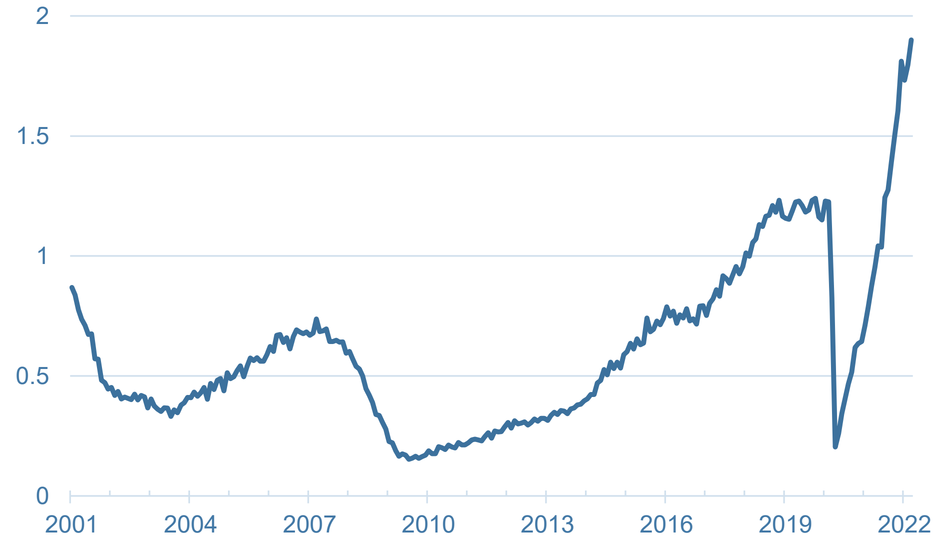
But labor demand shows no sign of slowing as yet

Nonfarm Payroll Employment



Source: US Bureau of Labor Statistics via FRED

Job Openings per Unemployed Worker



Note: Job openings for March 2022 are estimated based on Indeed Hiring Lab job postings.
Sources: US Bureau of Labor Statistics via Macrobond; Indeed Hiring Lab; author's calculations

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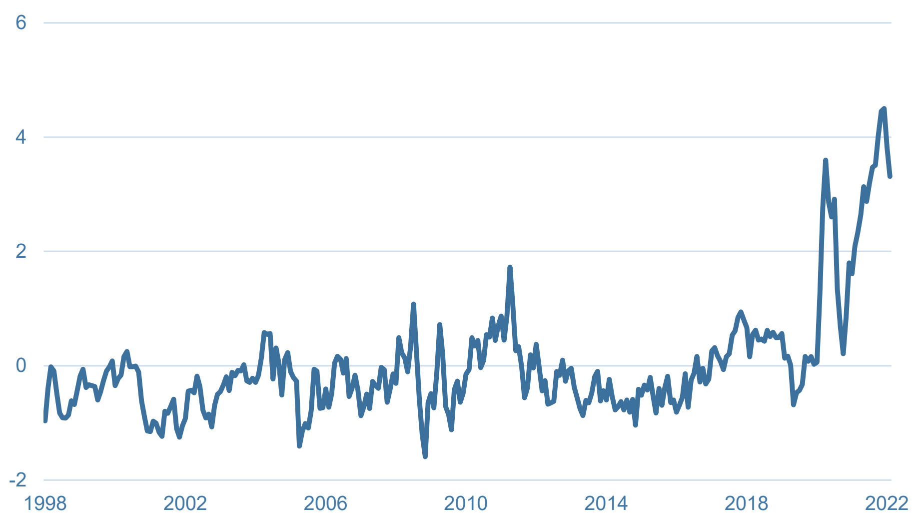
Some supply shocks may be abating, but new ones are arising

Global Supply Chain Pressure Index

Standard deviations from average value



Source: Federal Reserve Bank of New York

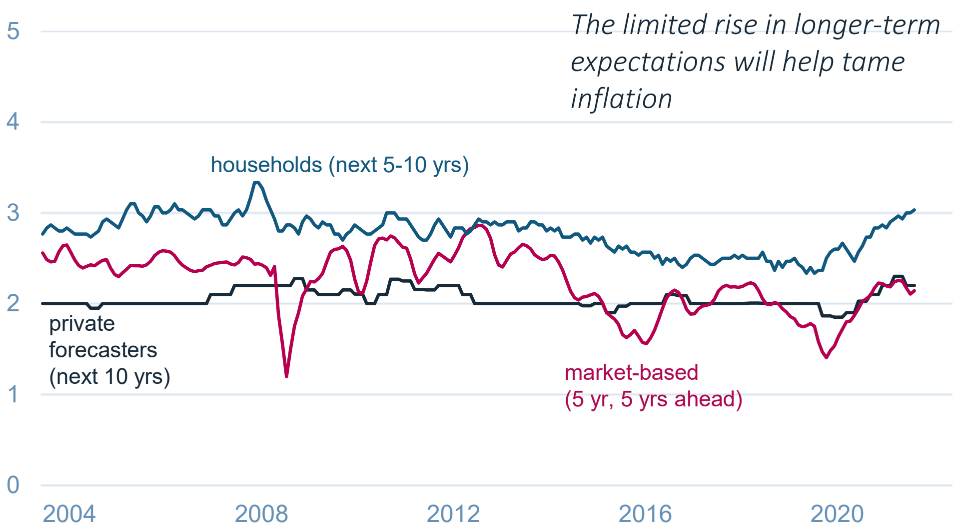
West Texas Intermediate Spot Price of Oil

Dollars per barrel

Source: US Energy Information Administration via FRED

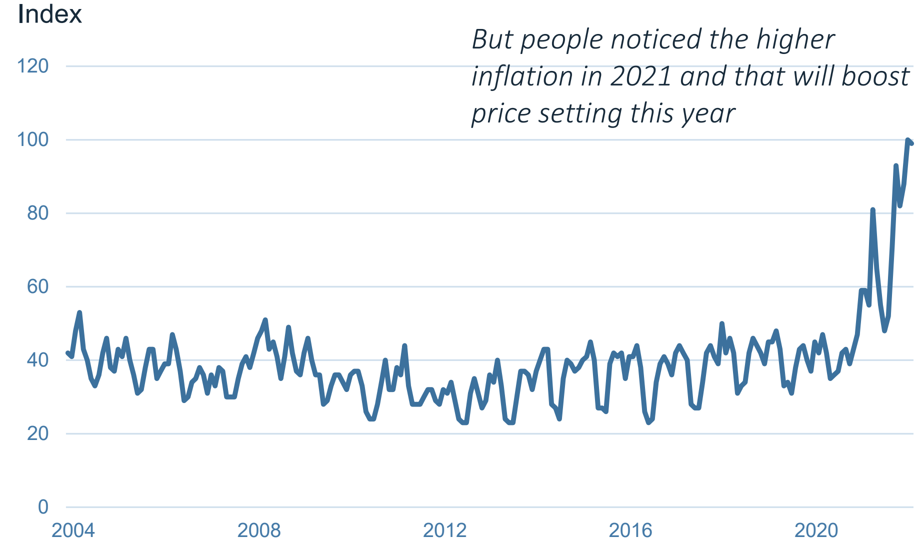
Inflation is heavily influenced by expectations and also by previous inflation

Long-term Inflation Expectations
Percent



Source: University of Michigan, Survey of Professional Forecasters, Federal Reserve Bank of St. Louis via FRED.

Monthly Google Searches for "Inflation"
Index

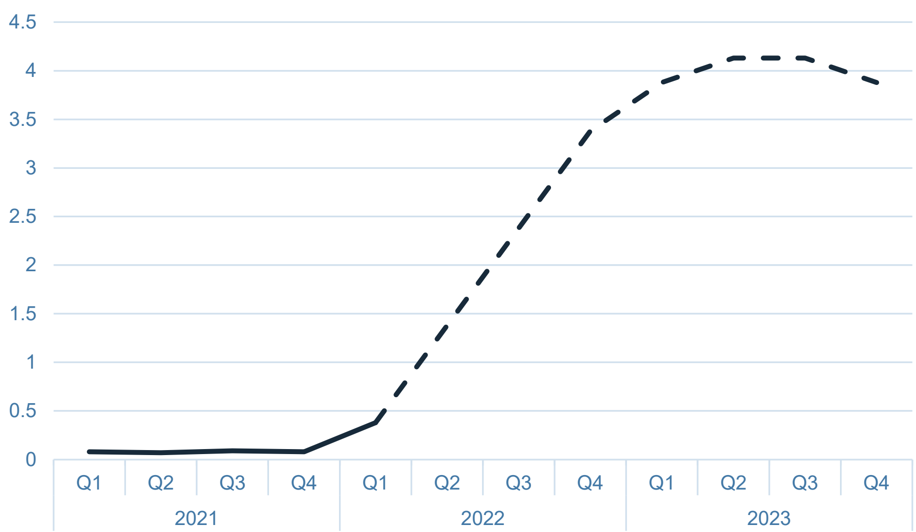


Note: Last data point is March 2022
Source: Google Trends

The Fed will likely need to raise rates aggressively to subdue inflation

Federal Funds Rate

Percent



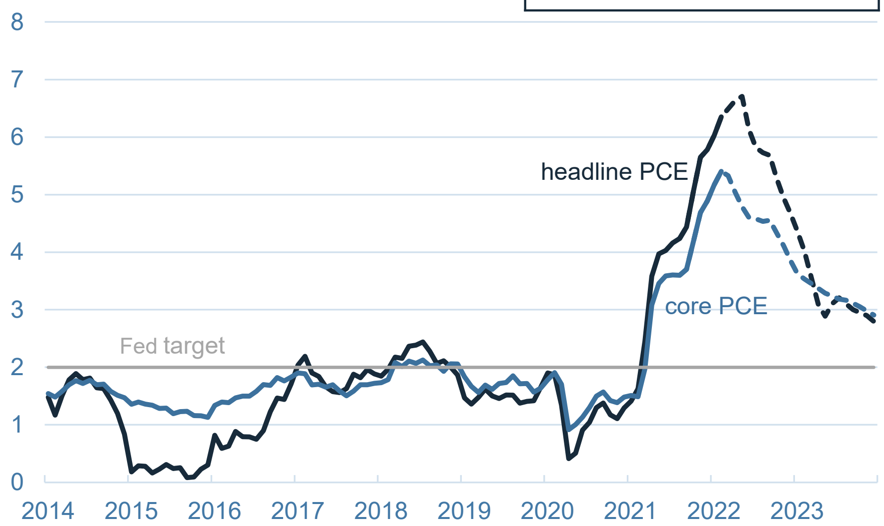
Note: Dashed line corresponds to forecast
Source: Federal Reserve via FRED and author's forecast

Consumer Prices

12-month percent change

Q4/Q4 forecasts:

	headline	core
2022	5.0%	2.9%
2023	4.1%	3.0%



Note: Dashed lines correspond to forecasts
Source: US Bureau of Economic Analysis via FRED and author's forecast

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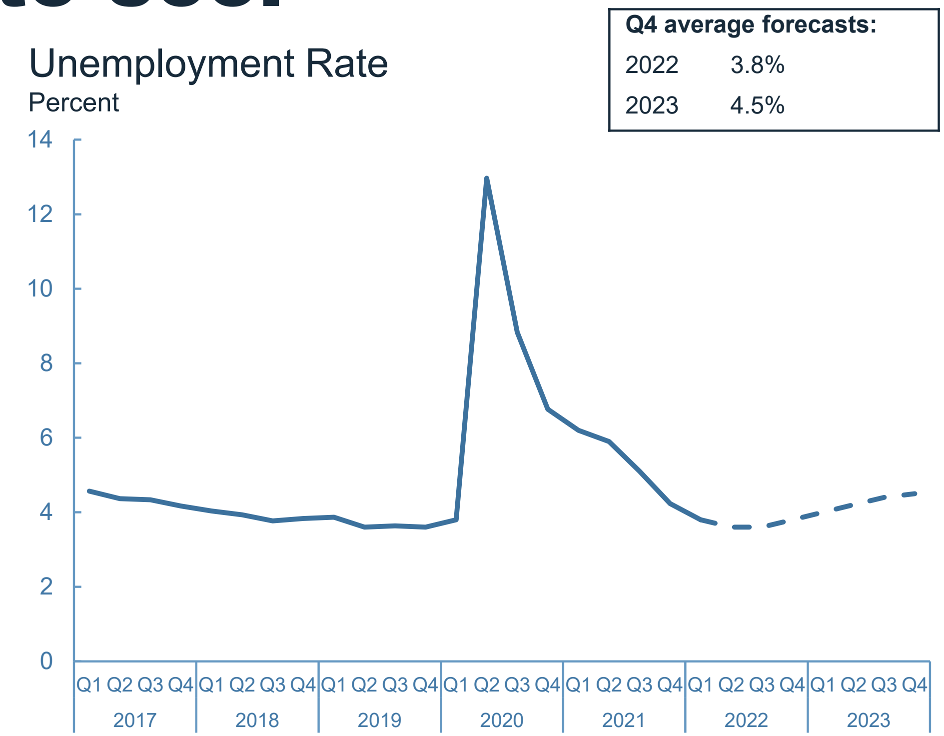
Fed tightening causes the labor market to cool



Note: Dashed line corresponds to forecast
Source: US Bureau of Labor Statistics via FRED and author's forecast

The unemployment rate rises to 4.5 percent in this forecast, about ½ percentage point above the natural rate

The job openings rate falls back close to traditional levels

(Inflation is also tempered by tighter monetary policy keeping long-term inflation expectations contained)

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Uncertainty is higher than usual and recession risks are elevated

Consider the following possible developments:

- Continued fighting in Ukraine pushes up global energy and food prices more than currently envisioned
- Inflation expectations move up and core inflation stays high
- The Fed responds by raising the funds rate much more than expected, and asset prices fall sharply
- Consumers worry more about risks and pull back on spending
- Rolling COVID shutdowns slow Chinese growth

Some combination of these factors could push the economy into recession by the end of this year

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