High Inflation and Slowing Growth

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April 12, 2022
Spring 2022 Global Economic Prospects Event

1750 Massachusetts Avenue, NW | Washington, DC 20036 | www.piie.com
Inflation has climbed sharply in most economies

Therefore, many central banks are or will be tightening policy, which will represent a downward force on economic activity.
Global economic growth has stepped down markedly

Growth has already slowed on a quarterly basis in many countries

Note: Purchasing power parity weights used to calculate global GDP
Sources: Consensus forecasts for 2019-2021; author’s forecasts for 2022-2023
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
Growth slows across all advanced economies despite scope for further rebound in some

**US**
- Tighter financial conditions needed to subdue inflation
- Consensus forecasts: 2.2%, 3.0%, 2.0%
- Author's forecasts: 5.7%
- Growth: -3.4% in 2019, 1.3% in 2020, 2.8% in 2021, 2.5% in 2022, 1.8% in 2023

**Euro area**
- Energy woes an additional roadblock to recovery
- Consensus forecasts: 1.3%, 5.3%, 2.8%
- Author's forecasts: 2.5%
- Growth: -6.5% in 2019, 0.7% in 2020, 1.7% in 2021, 2.0% in 2022, 1.8% in 2023

**Japan**
- Drag from higher imported input prices and COVID still an issue
- Consensus forecasts: 0.7%, 1.7%, 2.0%
- Author's forecasts: 1.8%
- Growth: -4.7% in 2019, 1.5% in 2020, 3.8% in 2021, 1.8% in 2022

**UK**
- Growth stalling due to high inflation and geopolitical worries
- Consensus forecasts: 1.5%, 3.8%, 1.8%
- Author's forecasts: 7.5%
- Growth: -9.8% in 2019, 1.5% in 2020, 3.8% in 2021, 1.8% in 2022

Growth in emerging economies is diverging to a striking degree

China:
- Drag from COVID and property slump
  - 2019: 6.1%
  - 2020: 2.3%
  - 2021: 4.7%
  - 2022: 5.0%
  - 2023: 8.1%

India:
- Policy response to rising inflation likely to weaken recovery
  - 2019: 4.2
  - 2020: 8.8
  - 2021: 8.0
  - 2022: 6.5
  - 2023: 2.0

Russia:
- Economy hobbled by fallout from Ukraine invasion
  - 2019: 1.4
  - 2020: -3.0
  - 2021: 4.8
  - 2022: -9.5
  - 2023: 2.0

Brazil:
- Political turmoil from upcoming elections compounding other negatives
  - 2019: 1.1
  - 2020: -4.1
  - 2021: 4.6
  - 2022: -0.5
  - 2023: 1.0

## Summary of the outlook for large economies

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

The US GDP outlook is less robust than expected last fall

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.

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

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Three years prior to pandemic</td>
<td>17.1</td>
</tr>
<tr>
<td>Since pandemic began</td>
<td>14.5</td>
</tr>
</tbody>
</table>

Real PCE Healthcare Services
Billions of chained (2020) dollars

Source: US Bureau of Economic Analysis via FRED
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

**Aggregate Wealth by Income Percentile**
Trillions

Source: US Bureau of Economic Analysis via FRED; author's calculations
Source: Federal Reserve Distributional Financial Accounts; author's calculations
The waning of fiscal stimulus represents a drag on demand

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

Interest Rate on Two-Year Treasury Note

Source: Federal Reserve

Source: Federal Reserve via FRED
The pace of funds rate increases will depend on the evolution of inflation

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.

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

Labor Force Participation Rate
Percent of Population

Foreign Born Population, Age 16-64
Thousands


Note: January changes incorporate annual adjustments to BLS population controls
But labor demand shows no sign of slowing as yet

Nonfarm Payroll Employment
Change (thousands)

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

Global Supply Chain Pressure Index
Standard deviations from average value

West Texas Intermediate Spot Price of Oil
Dollars per barrel

Source: Federal Reserve Bank of New York
Source: US Energy Information Administration via FRED
Inflation is heavily influenced by expectations and also by previous inflation

**Long-term Inflation Expectations**

Percent

- **households (next 5-10 yrs)**
- **private forecasters (next 10 yrs)**
- **market-based (5 yr, 5 yrs ahead)**

The limited rise in longer-term expectations will help tame inflation

**Monthly Google Searches for "Inflation"**

Index

But people noticed the higher inflation in 2021 and that will boost price setting this year

Note: Last data point is March 2022
Source: Google Trends
The Fed will likely need to raise rates aggressively to subdue inflation

<table>
<thead>
<tr>
<th>Q4/Q4 forecasts:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>2022</td>
</tr>
<tr>
<td>2023</td>
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</table>

**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

Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4
2021 2022 2023

Note: Dashed lines correspond to forecasts
Source: US Bureau of Economic Analysis via FRED and author’s forecast
Fed tightening causes the labor market to cool

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.)

Note: Dashed line corresponds to forecast.
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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