The Global Economy: A Cyclical Boom (with Risks)

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Why is the near-term outlook strong?

Monetary policy is accommodative and financial conditions are supportive.

Fiscal policy is stimulative.

Confidence is high.

But:

Protectionist policies are spreading.

The risk of significant overshooting has increased.
## The global outlook: broad-based growth

<table>
<thead>
<tr>
<th>Real GDP Growth (Y/Y)</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Global Output Growth (PPP weights)</strong></td>
<td>3.7</td>
<td>3.8</td>
<td>3.9</td>
</tr>
<tr>
<td>US: a fiscal bump</td>
<td>2.3</td>
<td>2.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Euro Area: above-trend gains</td>
<td>2.5</td>
<td>2.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Japan: growth continues</td>
<td>1.7</td>
<td>1.3</td>
<td>1.2</td>
</tr>
<tr>
<td>UK: modest growth</td>
<td>1.7</td>
<td>1.4</td>
<td>1.3</td>
</tr>
<tr>
<td>China: gradual slowdown</td>
<td>6.9</td>
<td>6.4</td>
<td>6.4</td>
</tr>
<tr>
<td>India: picking up</td>
<td>6.7</td>
<td>7.4</td>
<td>7.5</td>
</tr>
<tr>
<td>Russia: recovery underway</td>
<td>1.5</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Brazil: modest upturn</td>
<td>1.0</td>
<td>2.0</td>
<td>2.1</td>
</tr>
</tbody>
</table>

The U.S. (modal case): A cyclical boom

### Real GDP Growth (Q4/Q4)

<table>
<thead>
<tr>
<th>Year</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (Q4/Q4)</td>
<td>1.8</td>
<td>2.6</td>
<td>2.8</td>
<td>2.3</td>
<td>1.6</td>
</tr>
</tbody>
</table>

### Unemployment Rate (Q4)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (Q4/Q4)</td>
<td>4.7</td>
<td>4.1</td>
<td>3.7</td>
<td>3.5</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Unemployment (Q4)</td>
<td>1.6</td>
<td>1.7</td>
<td>1.9</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
</tr>
<tr>
<td>PCE Price Inflation (Q4/Q4)</td>
<td>1.9</td>
<td>1.5</td>
<td>1.9</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
</tr>
</tbody>
</table>
Significant fiscal stimulus from tax reform

Change in Tax Payments from 2017 Tax Reform

Deficit Effects of Change of 2017 Tax Reform

Source: Author's calculations based on JCT and CBO data.

Source: Author's calculations based on Tax Policy Center, JCT and CBO data.
Significant fiscal stimulus from spending

- Caps on discretionary appropriations were increased by $143B in FY 2018 and $153B in FY 2019.

- The additional spending will occur with lags.

- Caps for 2020 have not been increased but almost certainly will be later.

- (Discretionary spending will still be smaller relative to GDP than in almost any year since at least the early 1960s.)

Federal Discretionary Spending

Source: CBO, author's calculations based on CBO information about BBA 2018 and assumptions about 2020.
Macroeconomic effects of fiscal stimulus

Effect of Fiscal Stimulus on Q4 Level of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Spending</th>
<th>Revenue</th>
<th>Total direct effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: Author's calculations. Effects are relative to counterfactual where fiscal policy is neutral for GDP.

Effects on Economic Growth, All Else Equal

<table>
<thead>
<tr>
<th>Year</th>
<th>Q4/Q4 real GDP growth</th>
<th>Annual avg. real GDP growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>0.60</td>
<td>0.50</td>
</tr>
<tr>
<td>2019</td>
<td>0.10</td>
<td>0.40</td>
</tr>
<tr>
<td>2020</td>
<td>-0.55</td>
<td>-0.50</td>
</tr>
</tbody>
</table>

Source: Author’s calculations. Effects include Fed reaction.
The personal saving rate is low but household balance sheets are in good shape.

**Personal Saving Rate and Net Worth**
- Percent of disposable income
- Ratio to disposable income

**Net worth (right scale)**
- Personal saving (left scale)

**Household Debt Service**
- Percent of disposable income

Sources: Federal Reserve and BEA.
Gradual recovery in housing continues

Total Housing Starts

S&P / Case Shiller National Home Prices

Sources: Census Bureau and S&P Dow Jones Indices LLC.
Momentum in business investment

ISM Manufacturing Indexes

New orders

New export orders

Contribution of Business Fixed Investment to Q4/Q4 Real GDP Growth

Sources: Institute for Supply Management, Commerce Department, author’s projection.
Some drag from net exports

Source: Federal Reserve, BEA, author’s forecast.
A tight labor market is getting tighter

Sources: Labor Department and author’s calculations.

**Change in Nonfarm Payrolls**

Thousands, 6-month moving average

**Unemployment Rate**

Percent of labor force

Range of payroll gains consistent with longer-run growth of the labor force
A little remaining slack in participation

Overall Labor Force Participation

Prime-age Labor Force Participation

Held down by retiring boomers

Source: Labor Department.
Wages have room to rise without putting much pressure on prices

Note: Atlanta Fed indicator was calculated as a quarterly average of monthly data.
Sources: Labor Department, Federal Reserve Bank of Atlanta, BEA, author’s forecast.
A slight overshooting of inflation is likely

Consumer Price Inflation

Percent change from 12 months earlier

Sources: Commerce Department, author’s forecast.
Gradual normalization of monetary policy, but rates will stay below historical averages

Effective Federal Funds Rate

10-Year Treasury Yield

Sources: Federal Reserve, author’s forecasts.
Risk 1: More protectionism

- So far we have seen only trade skirmishes, not trade wars.
- But, one risk is that the U.S. takes more protectionist steps … because the current account deficit does not improve or because it “sells well” with the base.
- Another risk is that other countries get fed up with the U.S. and put more retaliatory measures in place.
Risk 2: Chance of significant overshooting has increased

- The most likely case is that GDP will rise a bit above potential and that inflation will modestly overshoot its target => will require a period of “cooling off” in 2020 and 2021.
- In the post-war period, the unemployment rate has never risen by a material amount without the economy entering recession.
  - But those were also periods when the Fed raised rates to address already high inflation or the economy suffered some other shock.
- While it’s not a foregone conclusion that the correction will be tough, we are in uncharted territory.