



The Global Economy: A Cyclical Boom (with Risks)

Karen Dynan

Nonresident Senior Fellow

Peterson Institute for International Economics

Professor of the Practice

Harvard University Department of Economics

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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.

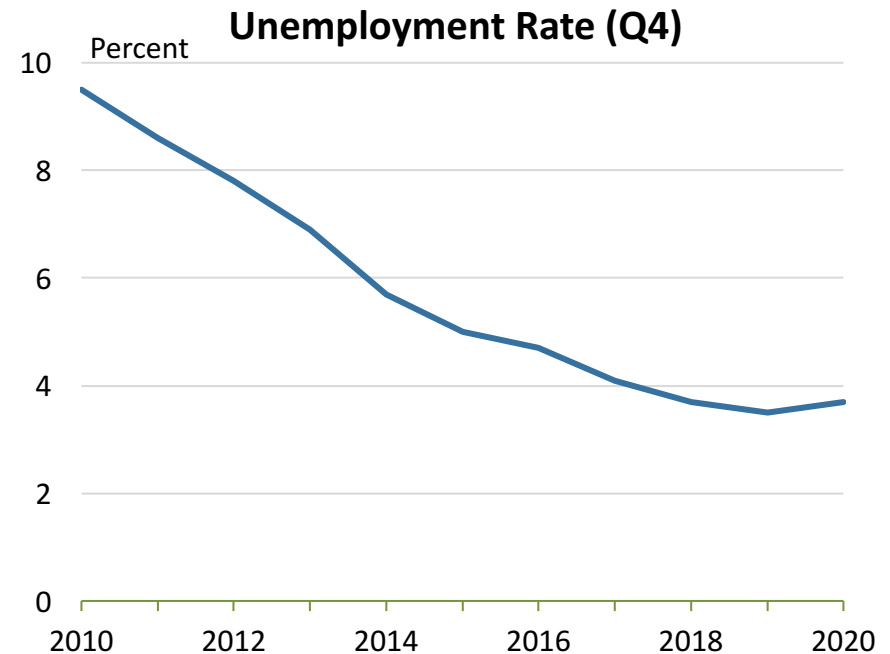
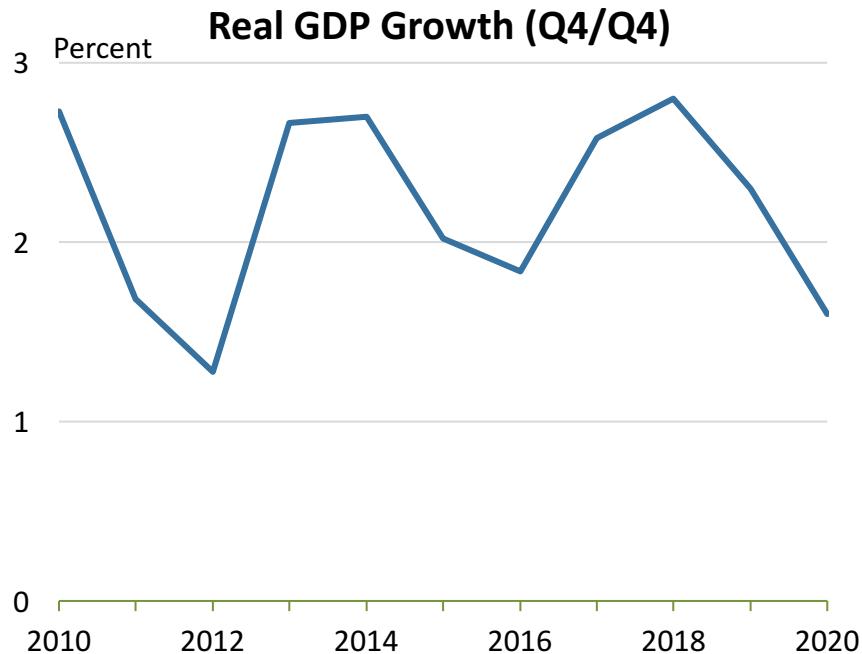
The global outlook: broad-based growth



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

Source: Consensus Forecasts for 2017, PIIE for 2018-2019. Annual-average-over-annual-average growth rates.

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

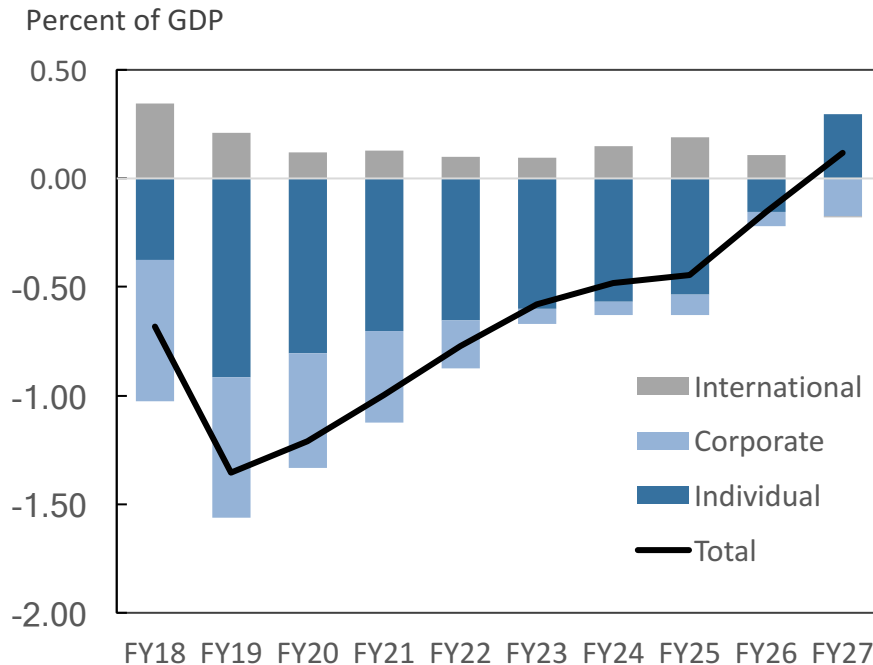


Forecast	2016	2017	2018	2019	2020
Real GDP Growth (Q4/Q4)	1.8	2.6	2.8	2.3	1.6
Unemployment (Q4)	4.7	4.1	3.7	3.5	3.7
PCE Price Inflation (Q4/Q4)	1.6	1.7	1.9	2.0	2.2
Core PCE Price Inflation (Q4/Q4)	1.9	1.5	1.9	2.0	2.2

Significant fiscal stimulus from tax reform

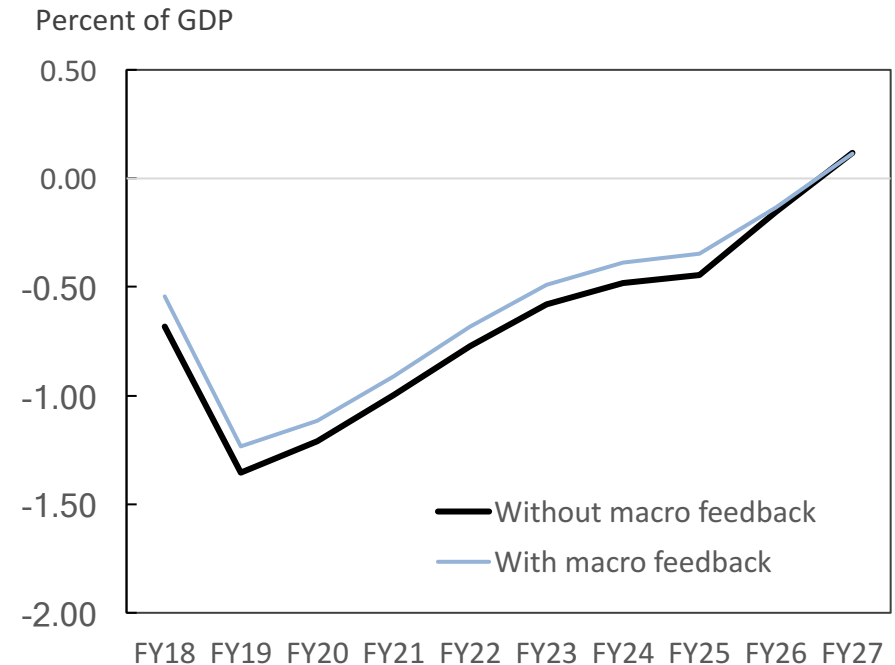


Change in Tax Payments from 2017 Tax Reform



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

Deficit Effects of Change of 2017 Tax Reform

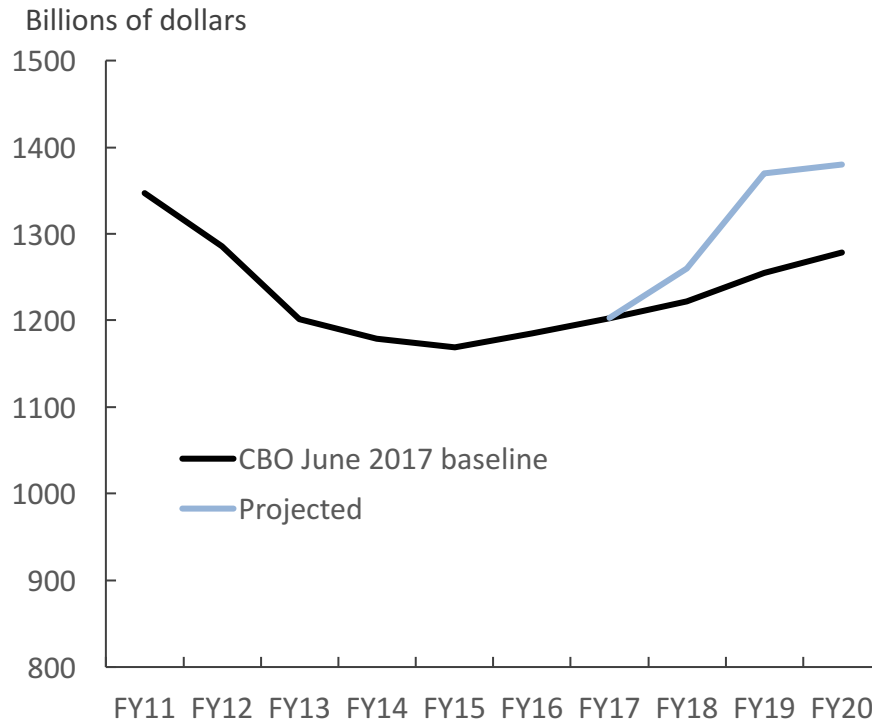


Source: Author's calculations based on Tax Policy Center, JCT and CBO data.

Significant fiscal stimulus from spending



Federal Discretionary Spending



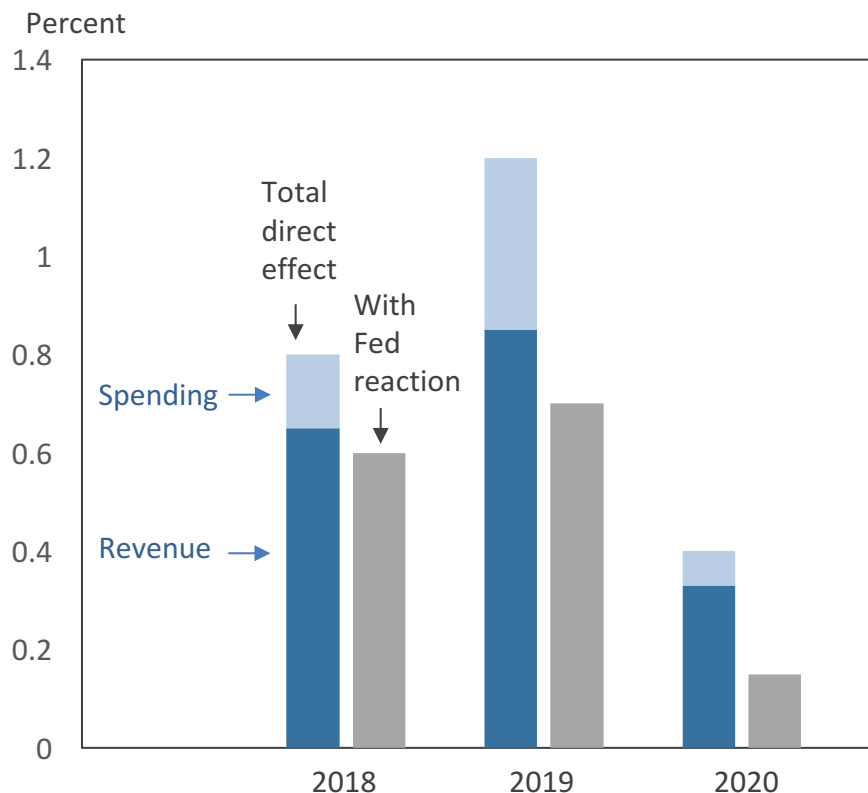
Source: CBO, author's calculations based on CBO information about BBA 2018 and assumptions about 2020.

- 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.)

Macroeconomic effects of fiscal stimulus



Effect of Fiscal Stimulus on Q4 Level of GDP



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

Effects on Economic Growth, All Else Equal

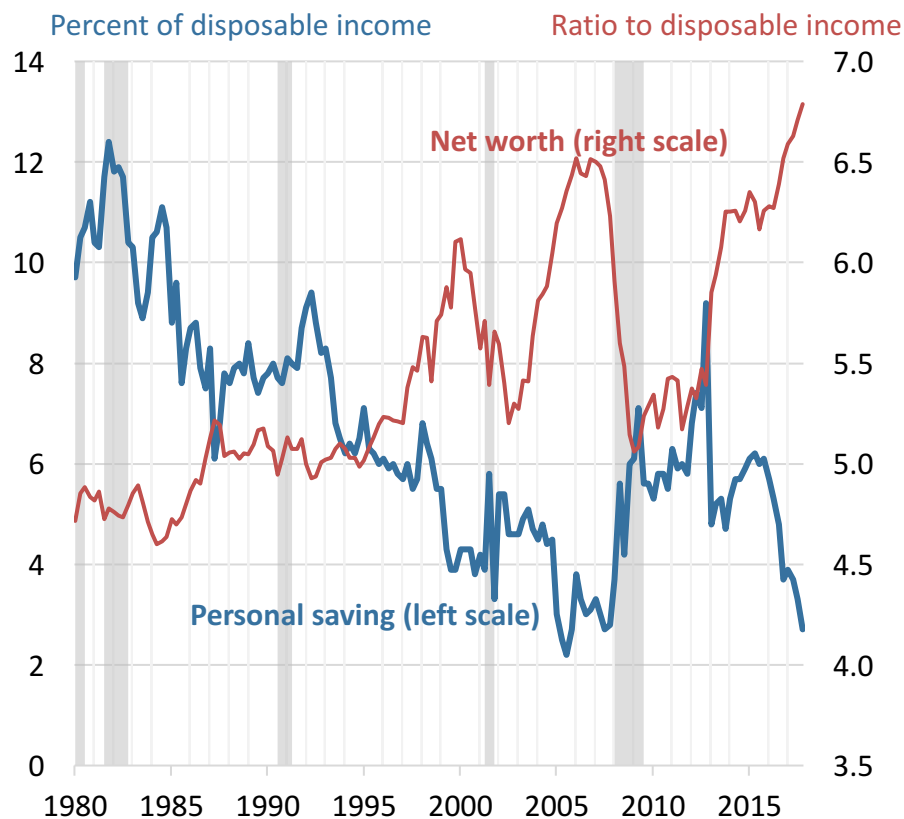
	Q4/Q4 real GDP growth	Annual avg. real GDP growth
2018	0.60	0.50
2019	0.10	0.40
2020	-0.55	-0.50

Source: Author's calculations. Effects include Fed reaction.

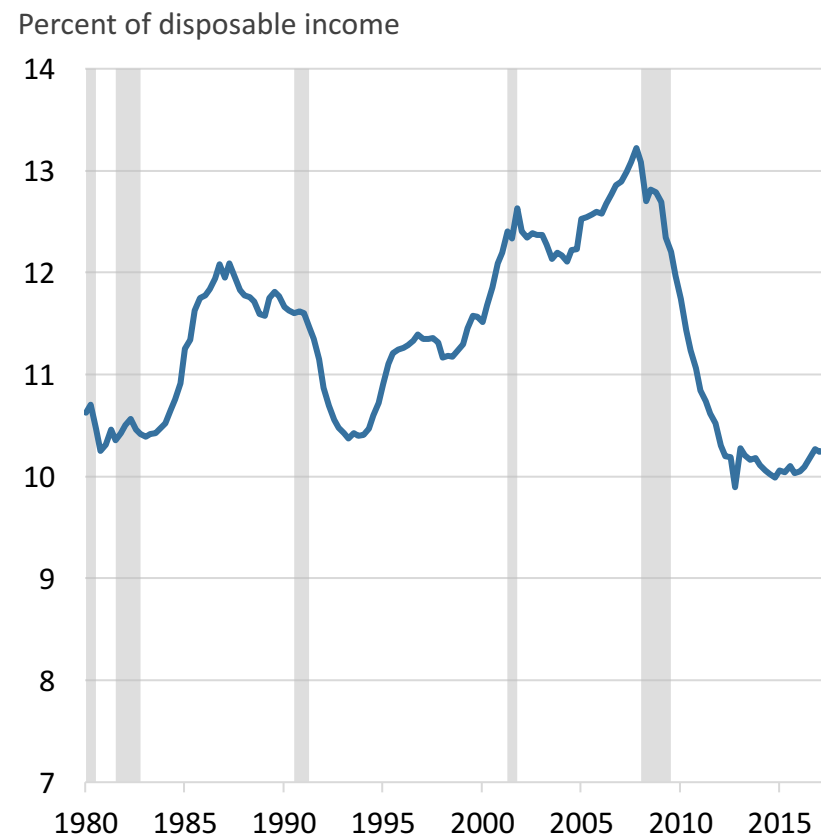
The personal saving rate is low but household balance sheets are in good shape



Personal Saving Rate and Net Worth



Household Debt Service

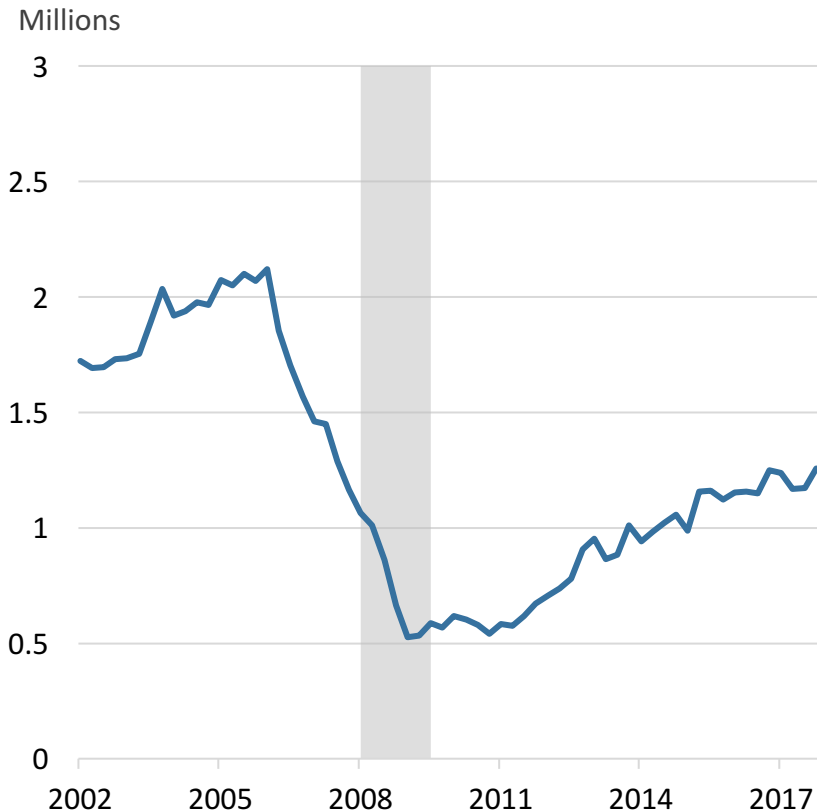


Sources: Federal Reserve and BEA.

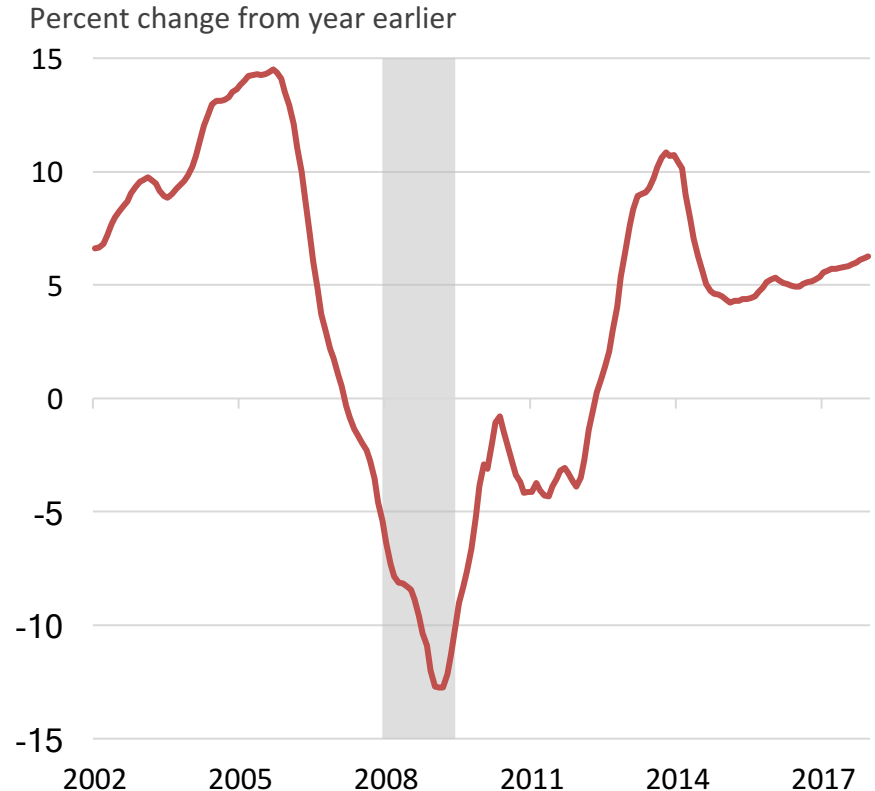
Gradual recovery in housing continues



Total Housing Starts



S&P / Case Shiller National Home Prices

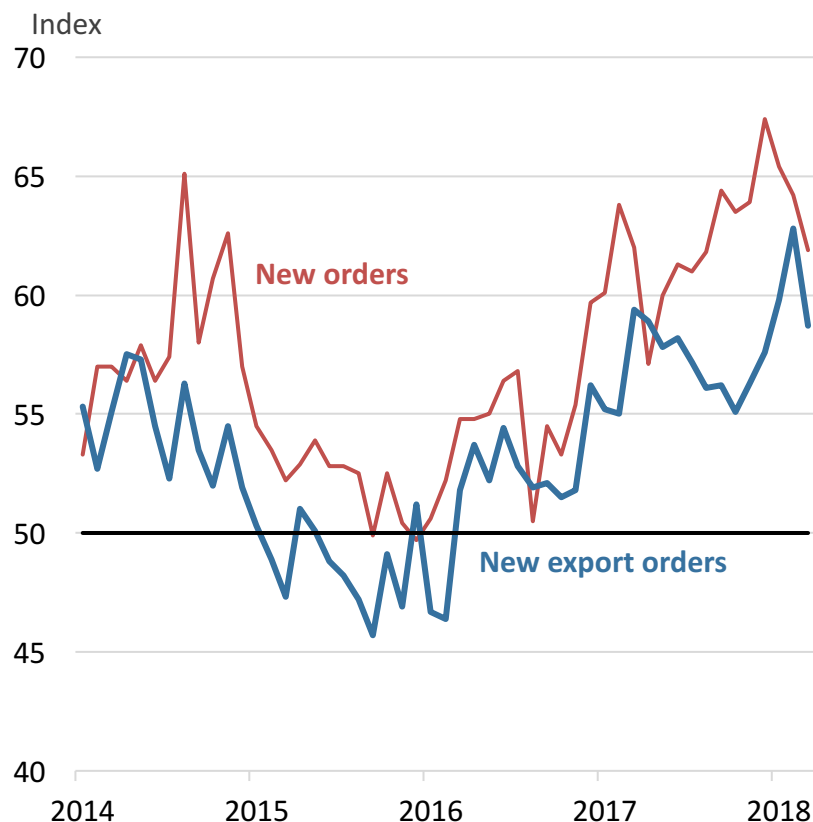


Sources: Census Bureau and S&P Dow Jones Indices LLC.

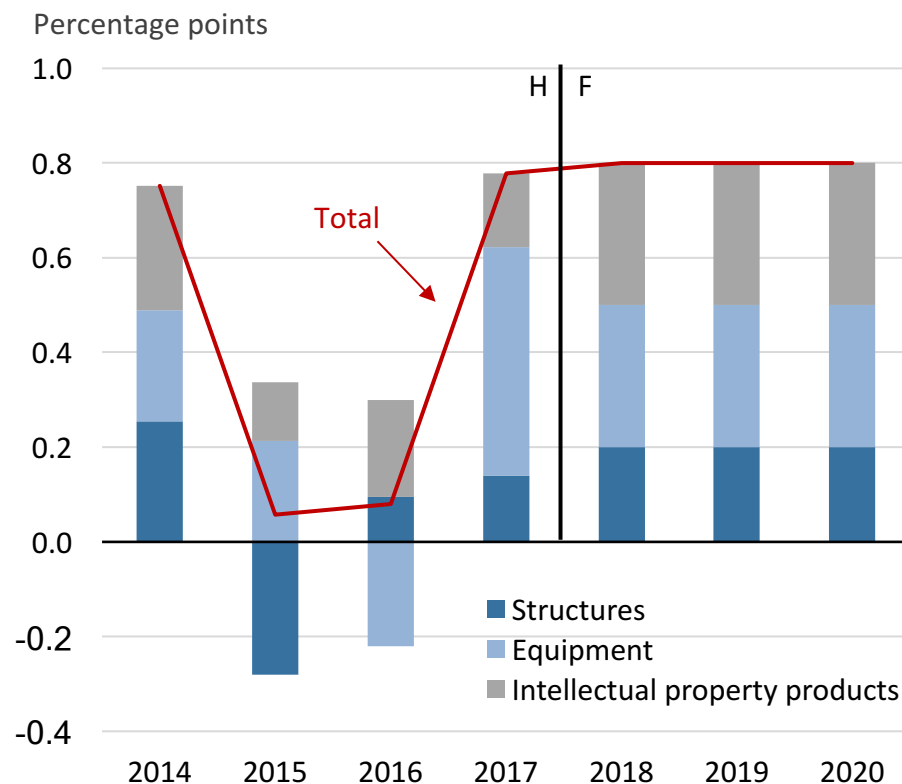
Momentum in business investment



ISM Manufacturing Indexes

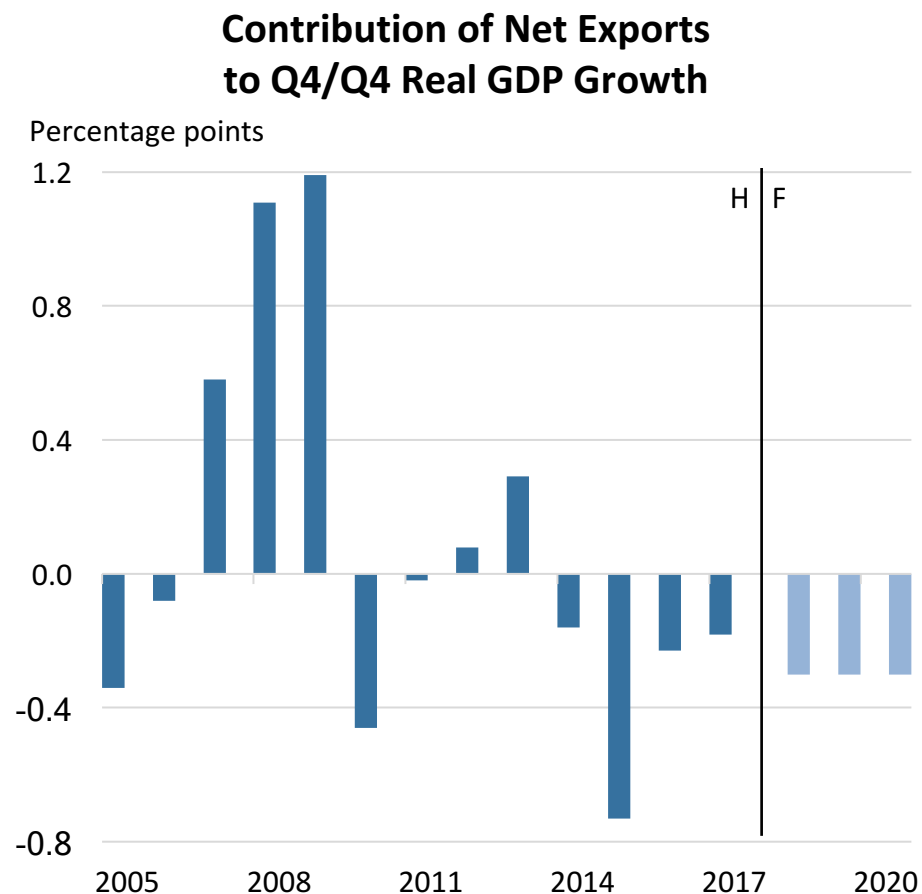
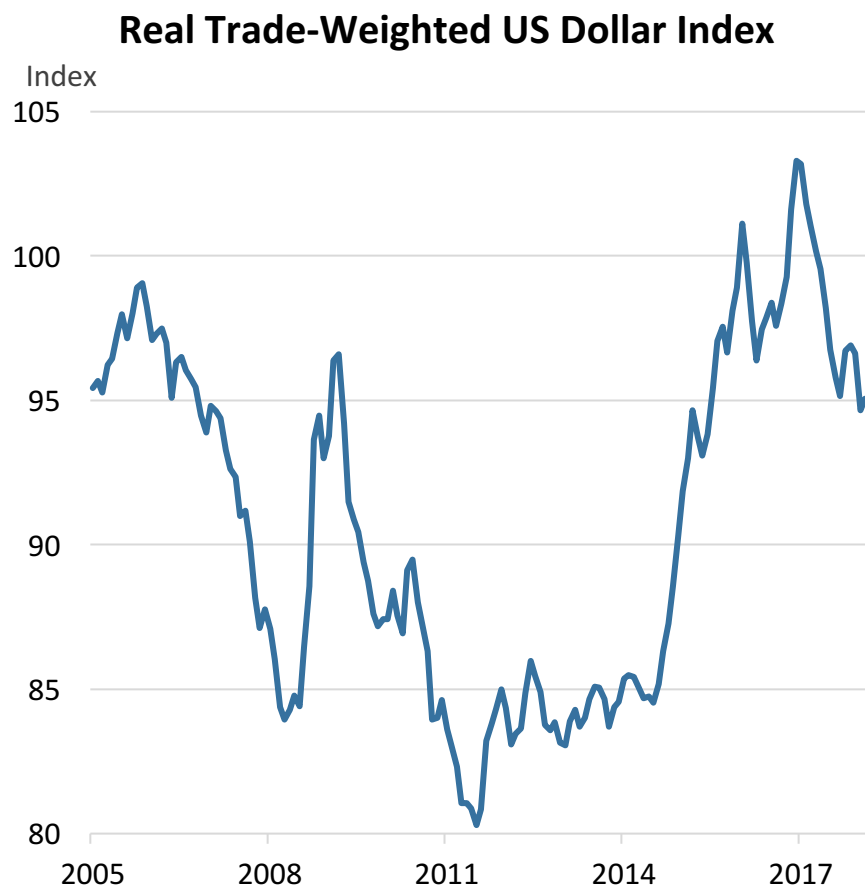


Contribution of Business Fixed Investment to Q4/Q4 Real GDP Growth



Sources: Institute for Supply Management, Commerce Department, author's projection.

Some drag from net exports

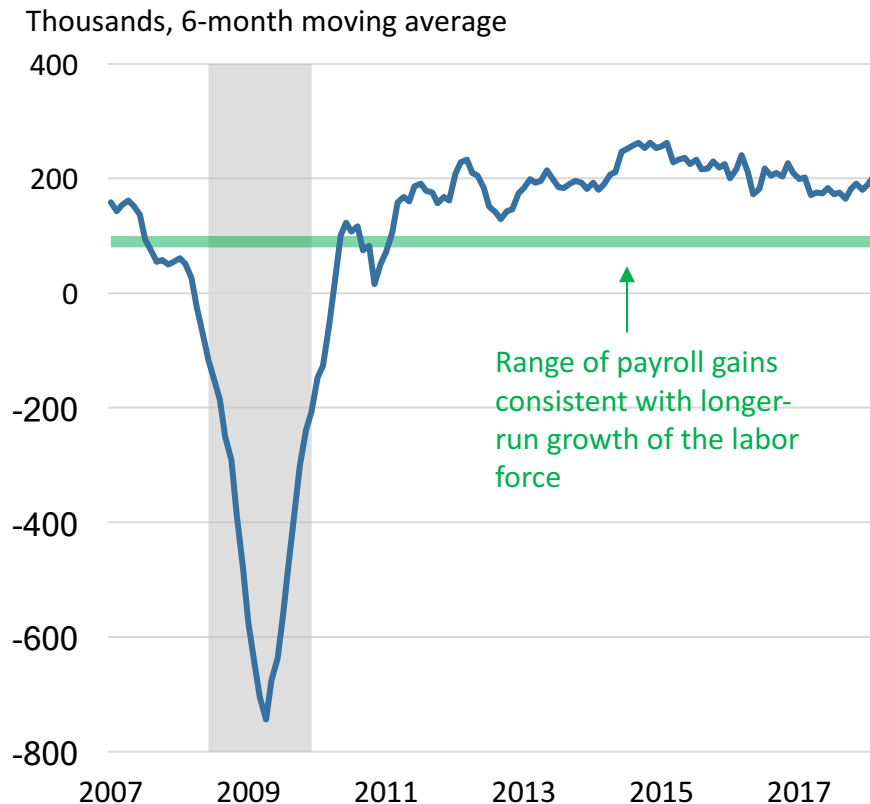


Source: Federal Reserve, BEA, author's forecast.

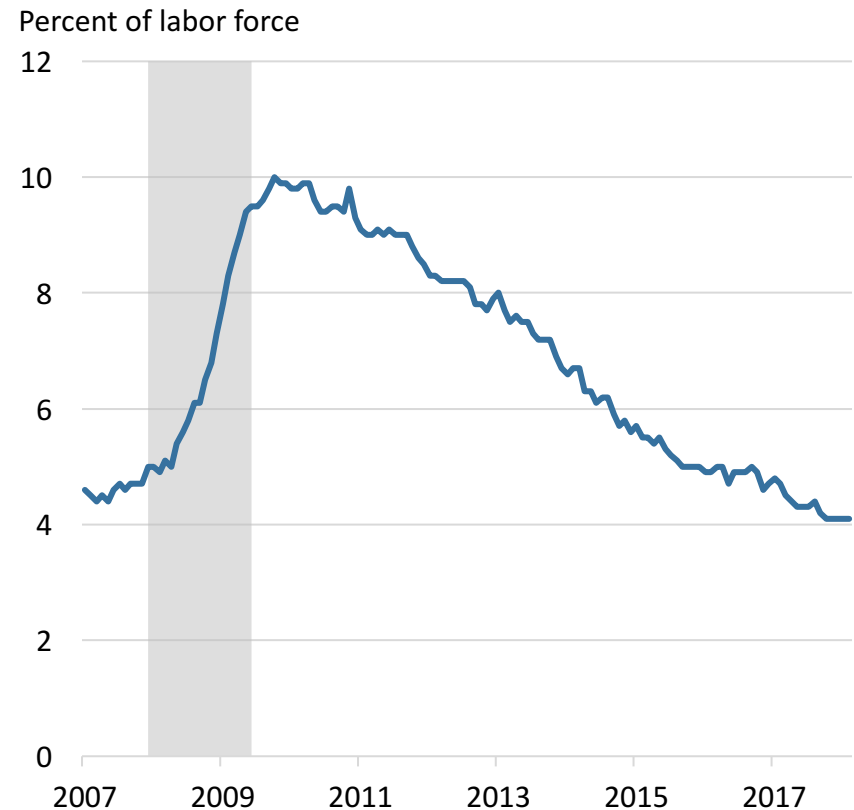
A tight labor market is getting tighter



Change in Nonfarm Payrolls

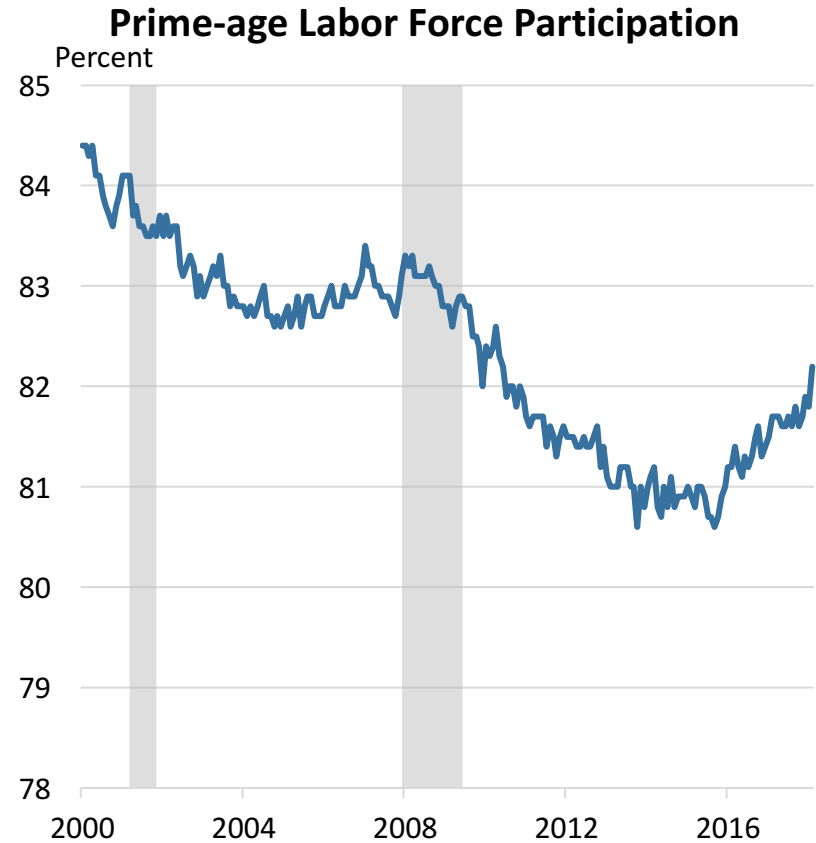
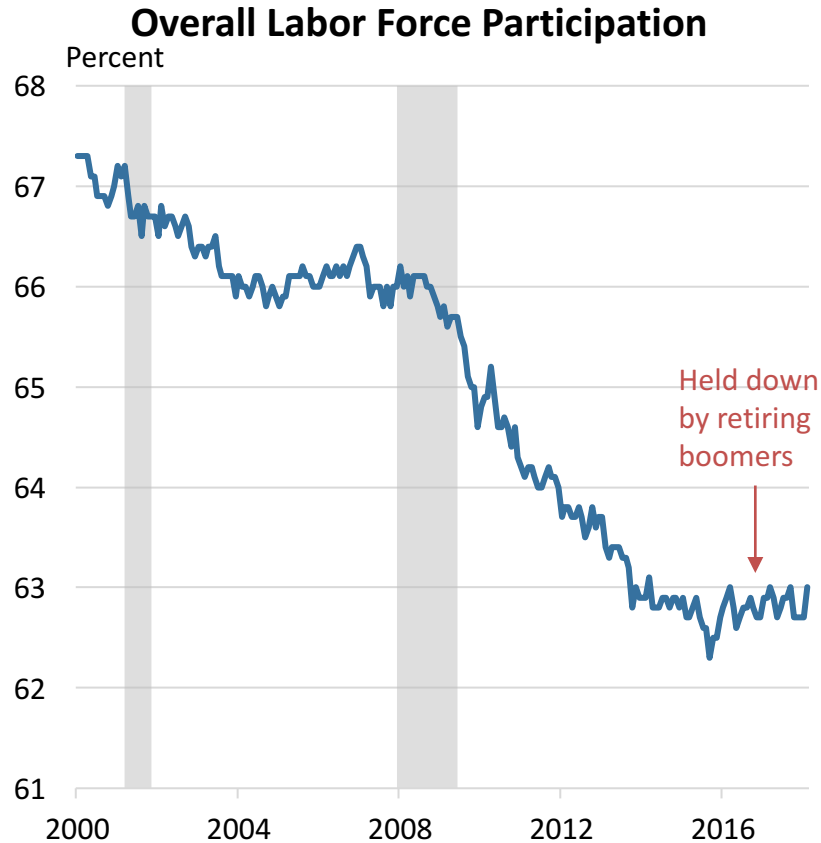


Unemployment Rate



Sources: Labor Department and author's calculations.

A little remaining slack in participation



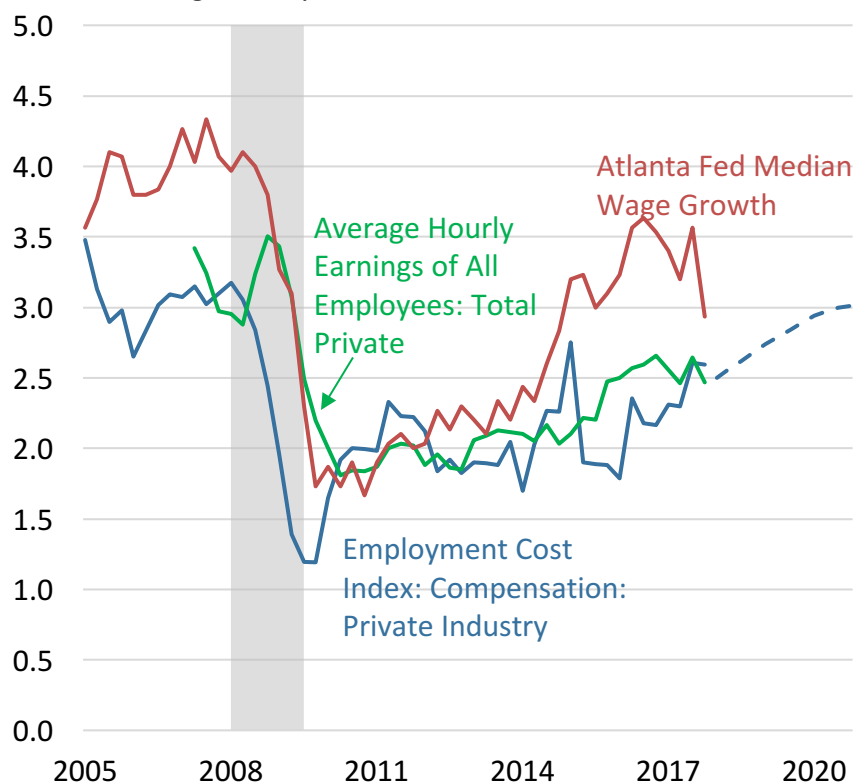
Source: Labor Department.

Wages have room to rise without putting much pressure on prices



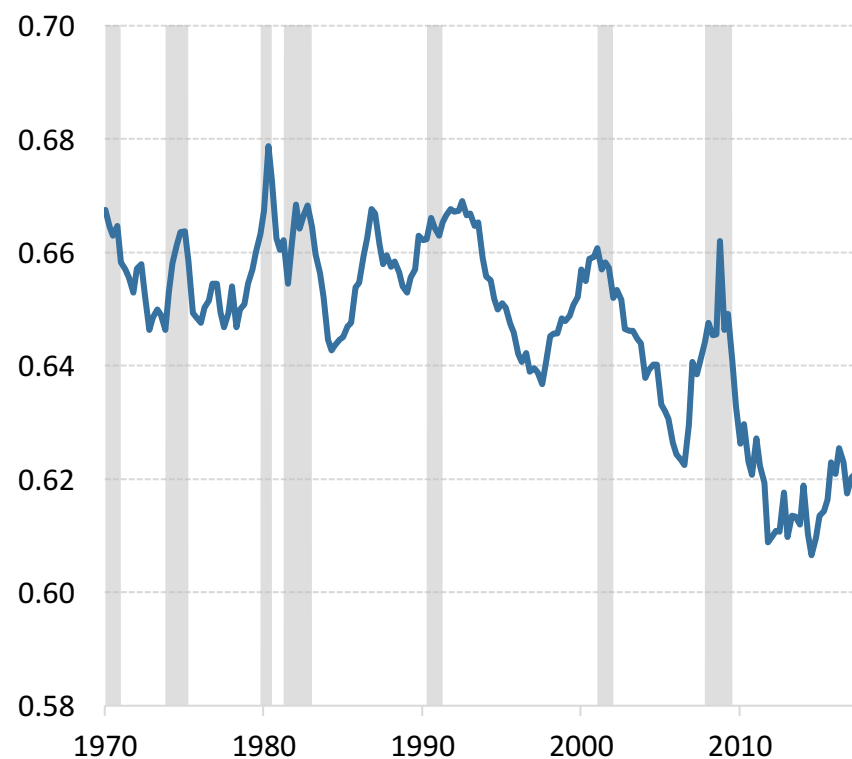
Labor Compensation

Percent change from year earlier



Labor Compensation as a Share of National Income

Percent



Note: Atlanta Fed indicator was calculated as a quarterly average of monthly data.

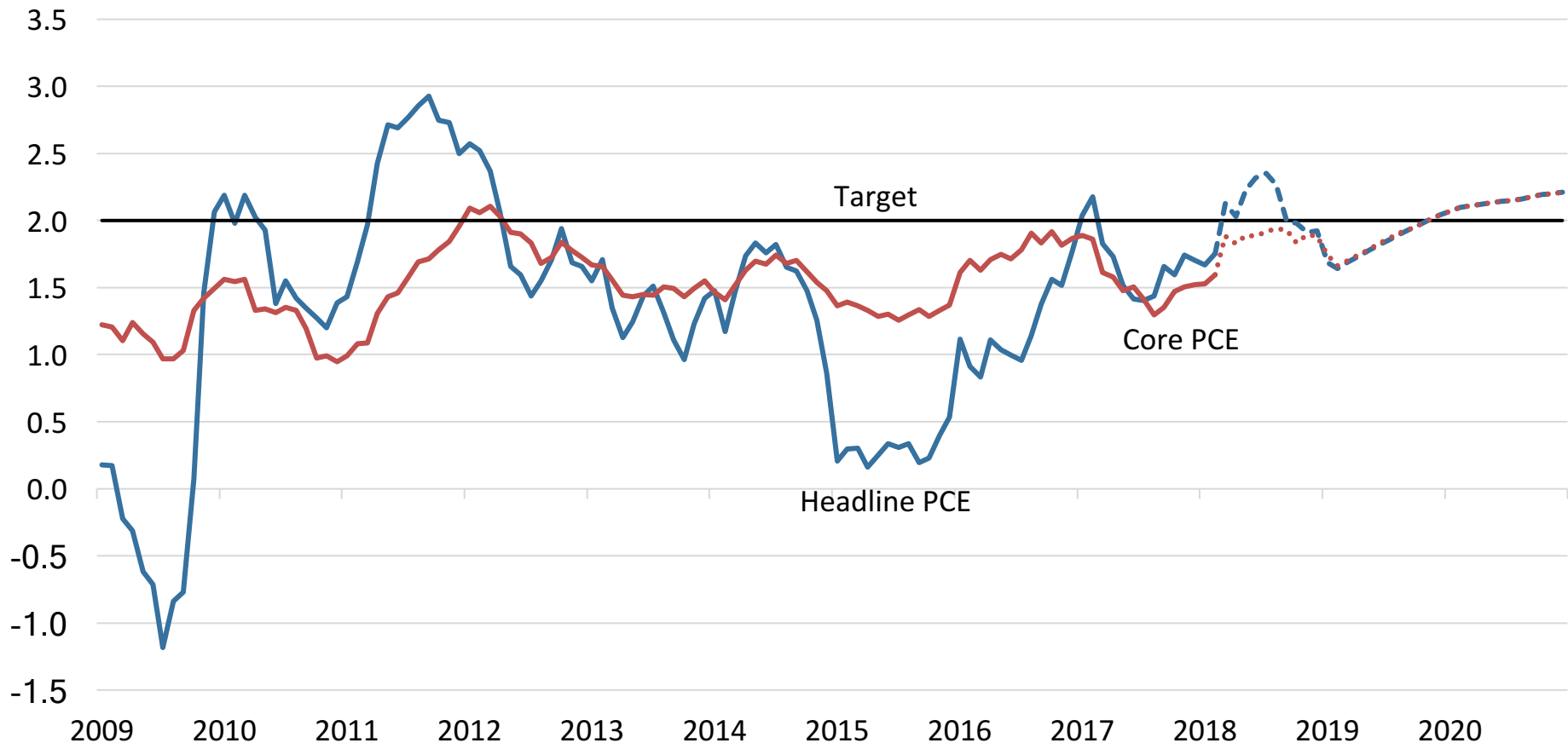
Sources: Labor Department, Federal Reserve Bank of Atlanta, BEA, author's forecast.

A slight overshooting of inflation is likely



Consumer Price Inflation

Percent change from 12 months earlier

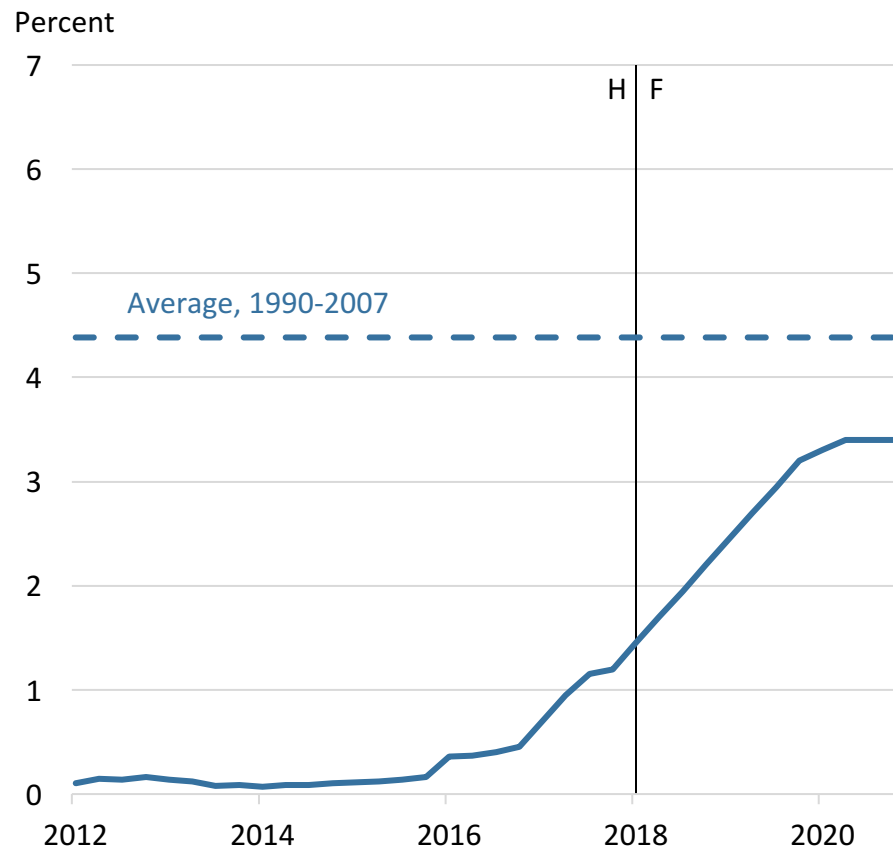


Sources: Commerce Department, author's forecast.

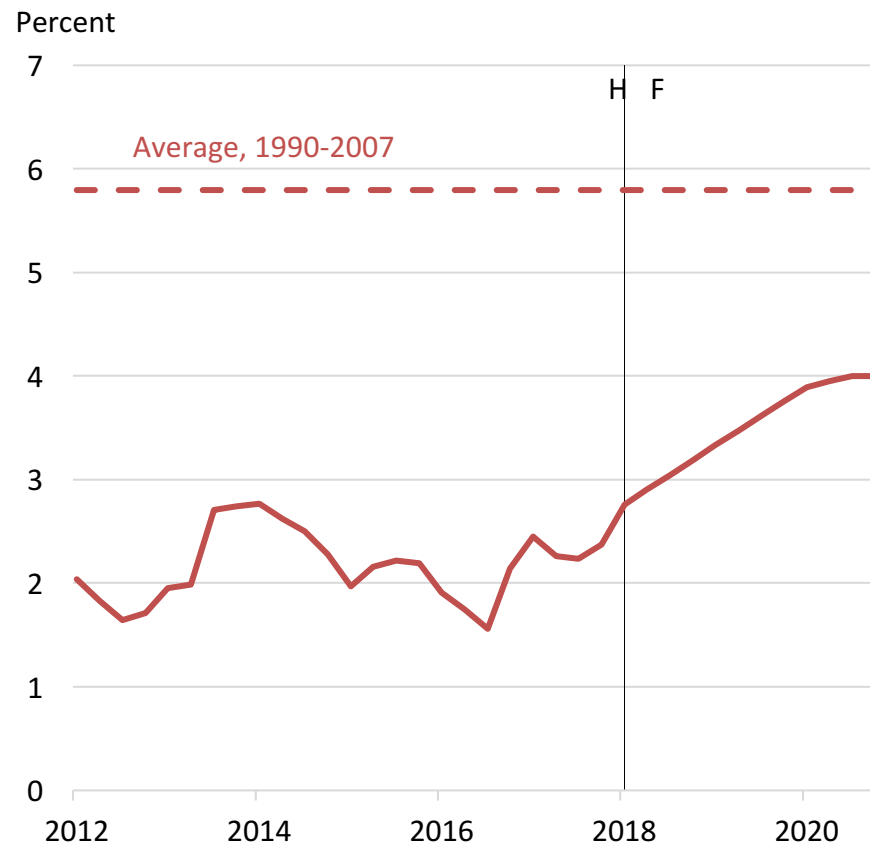
Gradual normalization of monetary policy, but rates will stay below historical averages



Effective Federal Funds Rate



10-Year Treasury Yield

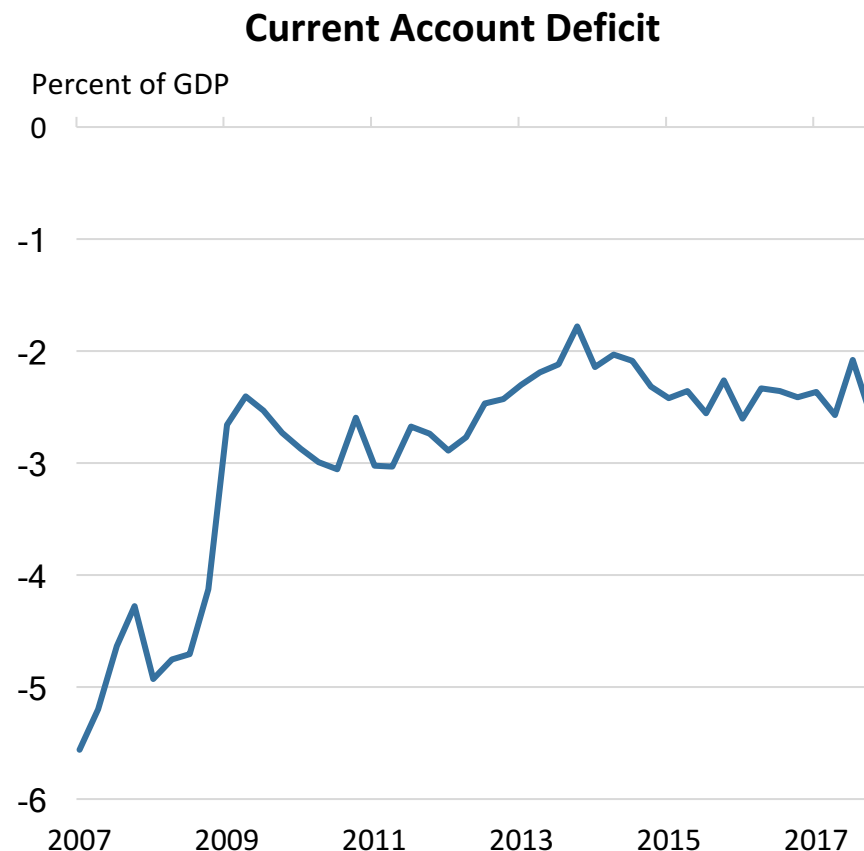


Sources: Federal Reserve, author's forecasts.

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.