Executive Perspectives

Growing but Slowing—Planning for the World Economy in 2022

October 2021

BCG Executive Perspectives

IN THIS DOCUMENT

GROWING BUT SLOWING

As executives turn to planning the year ahead, they face a growing but slowing global economy. Although stimulus is fading, **consumers are well placed to carry the expansion forward**. But leaders must also navigate risks that—while contained for the macroeconomy as a whole—can threaten individual sectors and firms.

In planning the next chapter, leaders should start with a macro view in mind and **translate that systematically to their markets, situations, and strategies.**

KEY MACRO TRENDS COMPANIES MUST CONSIDER

Fiscal policy and vaccines have underpinned a successful global rebound, though with **varying degrees of structural scarring**. As stimulus retreats and the growth bounce fades, households can tap booming labor markets as well as strong savings and balance sheets to pick up where policy makers left off. While the economic recovery is slowing, the **growth context is strong for 2022** and the Delta variant has shifted growth out, not down.

US DEEP DIVE | FACTOR IN US DYNAMICS AND RISKS

At the frontier of the global recovery, the US is the first to navigate risks related to the strong rebound. **Bottlenecks in labor markets** will take more time to ease and even when they do, wage pressures will continue, necessitating that firms invest in productivity growth. **Product market bottlenecks** will also persist as demand overshoot will keep straining productive capacity and inflict intense localized pain. **Inflationary pressures** will continue in the first half of 2022 but are less likely to be structural. **The retreat of monetary policy** will likely be slow, but policy errors remain the greatest risk of potential volatility to markets and the economy.

Source: BCG

Planning season: 12 priorities emerging from macroeconomic trends

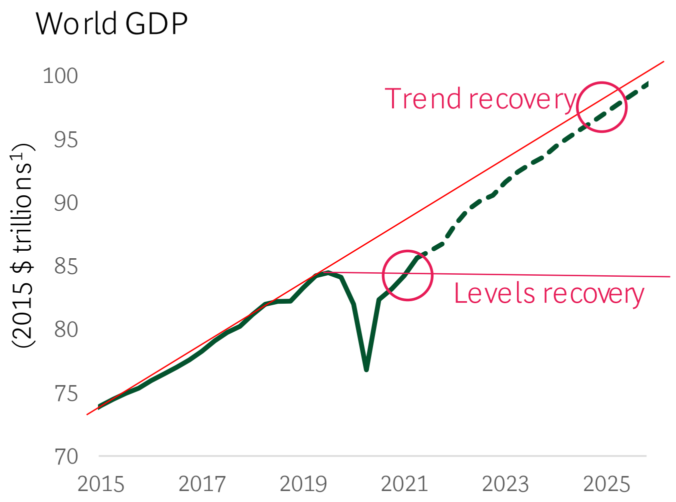
Insights from the US economy

Six macro trends in 2022	Considerations when planning for 2022	Context pages
Growth slowdown	1 Prepare for **growing but slowing** macro outlook, as many economies return to **tight conditions** 2 Account for multiple growth dynamics as **varying degrees of structural scarring** materialize	4-5
Consumer-led recovery going forward	3 Focus on drivers behind **consumers' ability to sustain recovery as** fiscal stimulus retreats 4 Assess **demand shifts** and the drivers and sustainability of **consumption overshoots**	6-8
Labor market bottlenecks	5 Expect **acute bottlenecks to ease** as intense "scramble" to rehire workers lessens 6 Protect margins with **productivity-enhancing investments** as wage pressures will persist	10-12
Product market bottlenecks	7 Monitor economy's inventory dynamics to **separate macro stress from intense localized pain** 8 Invest in **supply chain resilience** to continue recovering and prepare for future disruptions	13
Inflationary pressures	9 Understand and monitor the **drivers of cyclical vs. structural inflation** to assess risks 10 Do not conflate temporary pricing power with **persistent pricing power** and act accordingly	14-16
Monetary policy and rates	11 Plan for **soft and orderly exit** from ultra-low policy rates but **risk of faster pace of tightening** 12 Consider the risk of **volatility** as policy errors have potential to upset markets and even the cycle	17

Source: BCG

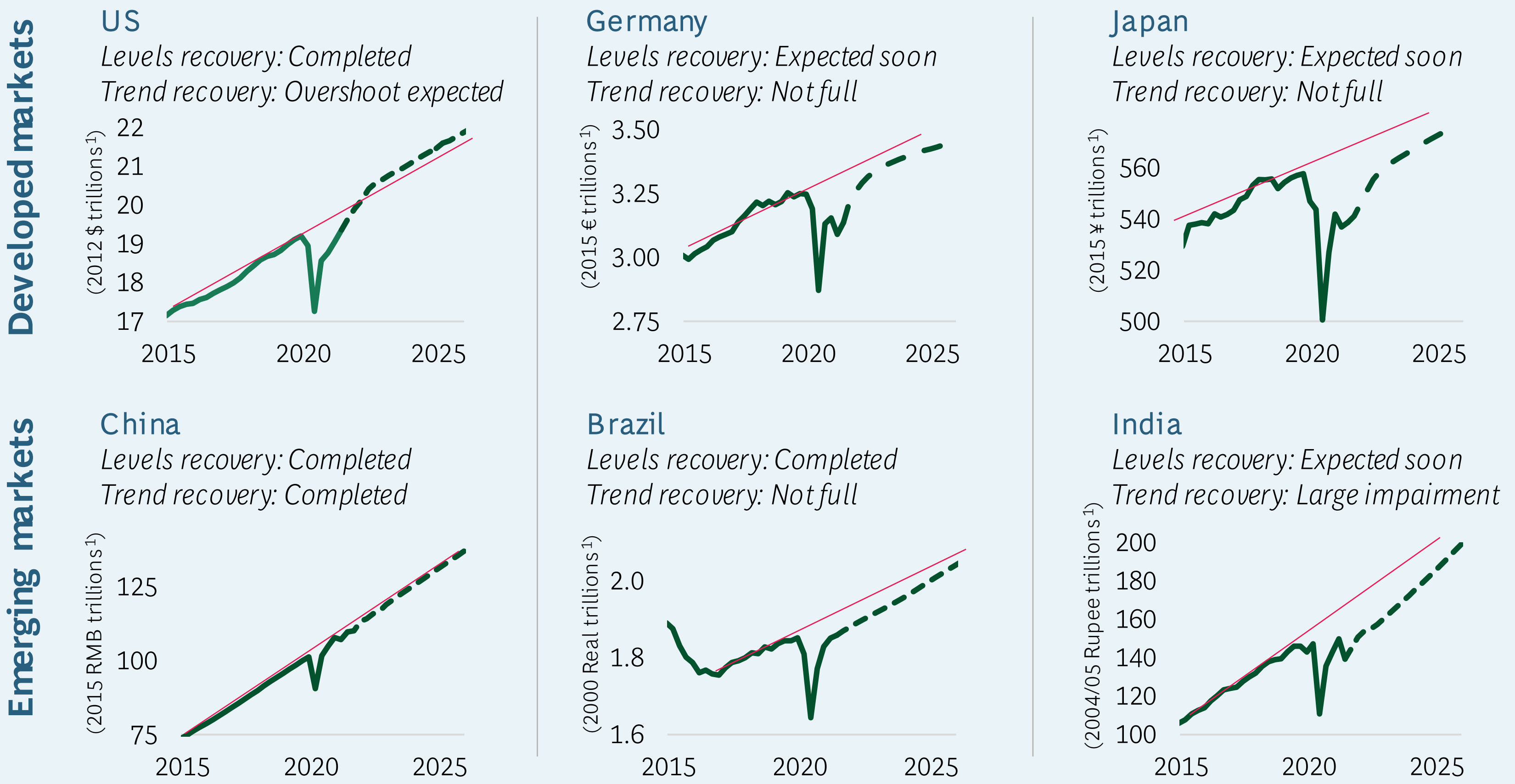
1 A fast and strong global recovery—with varying degrees of structural scarring and an expected growth slowdown in 2022

Global economy has rebounded strongly since the depths…



Global economy has made a "levels recovery" (back to 2019 output levels) but will take **more time to return to pre-COVID trend** (i.e., structural scarring)

…with levels recovery within sight everywhere, but trend recovery has wider distribution (structural scarring) in emerging markets

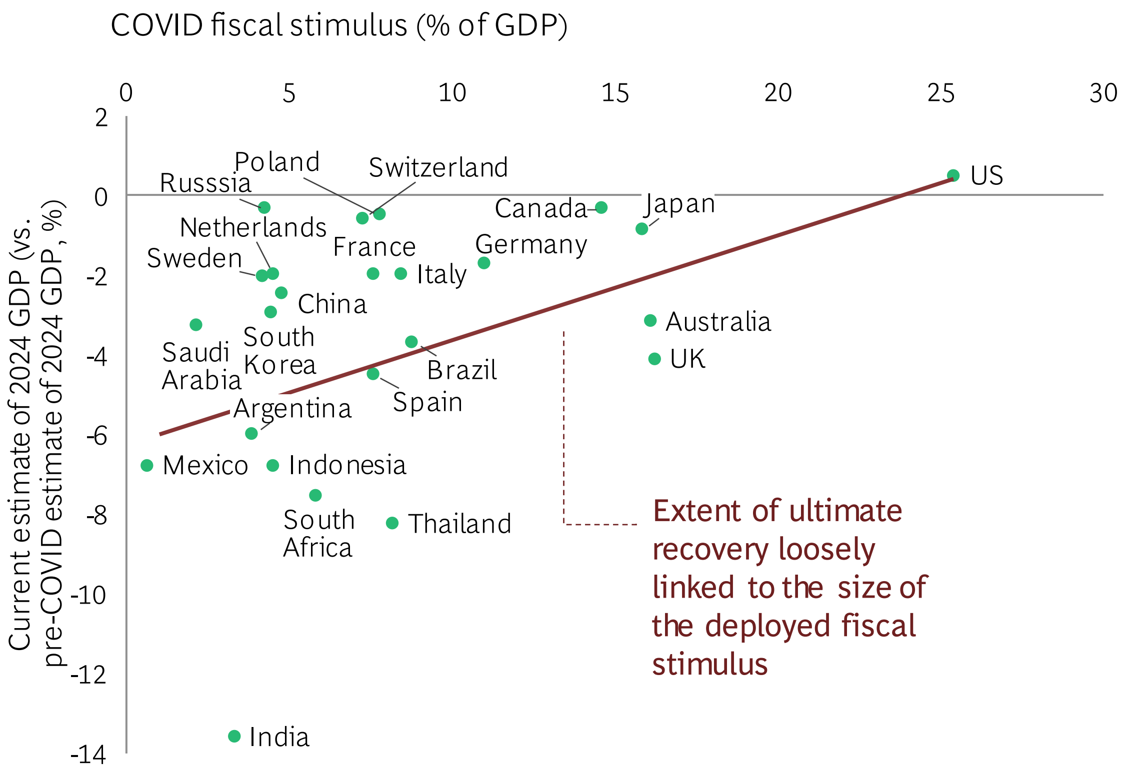


Growth slowdown in 2022 built into V-shapes, returning many economies to a 2019-like growth environment

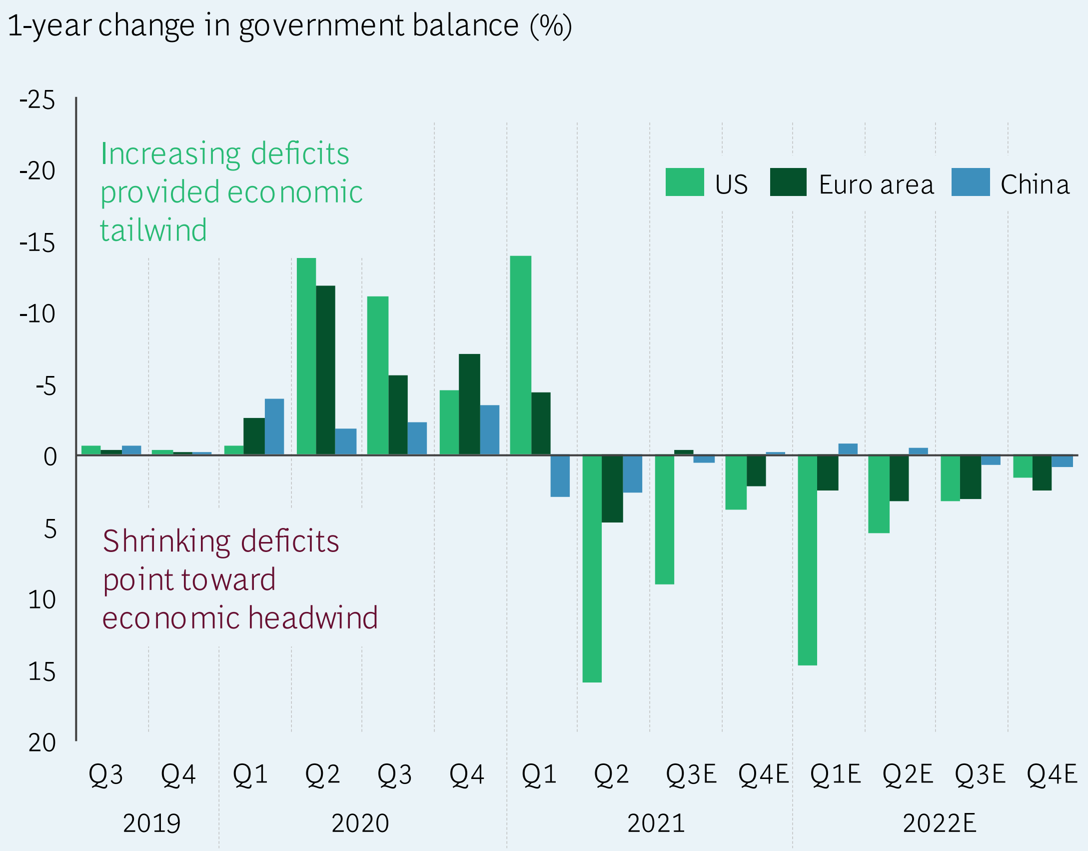
1. SAAR (Seasonally adjusted annual rate); Source: Oxford Economics, BCG

Stimulative fiscal policy, which successfully contained structural damage, is now (appropriately) in retreat around the world

Fiscal stimulus successfully limited structural damage...[1]



...but now flips from being tailwind to headwind (as it is expected to fade in 2022)

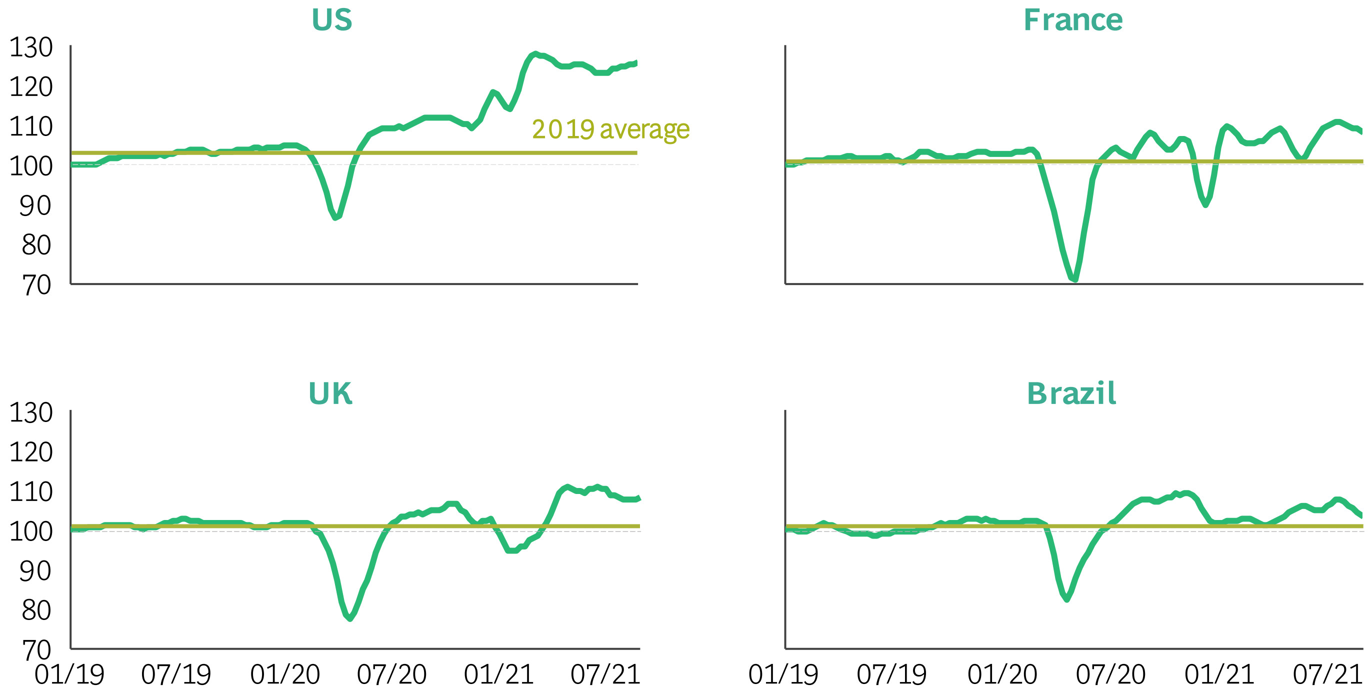


1. Sample G20 + Netherlands, Poland, Sweden, Switzerland, Spain; Turkey is left out due to data issues/reliability
Source: IMF, Oxford Economics, BCG

1 Recoveries throughout the world in 2021 are currently in a "risky window" of handoff from policy makers to consumers

Retail sales have overshot, initially supported by stimulus, but lately have been maintained by the consumer

Retail sales (Index = 100 for 01/2019)



Currently retail sales in the US are more than 25% higher compared with the beginning of 2019, translating into more than an **extra $100 billion** in sales per month

The rest of the post-COVID expansion depends even more on **consumers' ability to carry it forward**

The household sector is well positioned to sustain demand—and is even able to push demand higher

Note: Retail sales in value terms (i.e., nominal). Due to difference in country definition, retail sales are best used looking across time within a country rather than across countries, so compare the green vs. yellow lines.
Source: BEA, Office for National Statistics, Ist Nat de la Statistique et des Etudes Economiques, Russian - European Centre for Economic Policy/Haver Analytics, BCG

1 Consumers in strong position to sustain expansion due to booming labor markets, large savings, and record wealth

Strong job opportunities lift consumer outlook in many countries

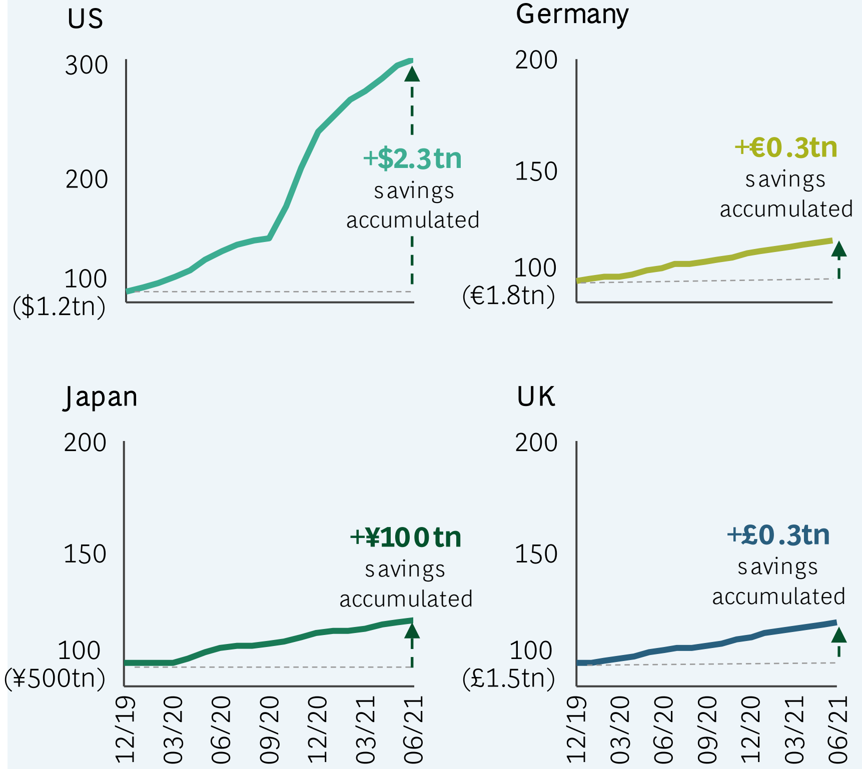
~55% Of US respondents say there are **plentiful jobs** in the market (**highest** since 2000-2001)

55%+ Of UK hospitality businesses view **staff availability as a constraint** on growth

13 wks. Is median duration to find a job in **Australia, down from 27 weeks** last year

Households have accumulated trillions in savings during pandemic

Household checking deposit
(indexed to 12/19 values = 100)



Wealth growth across nations

$18.6tn Increase in financial wealth in the **US**

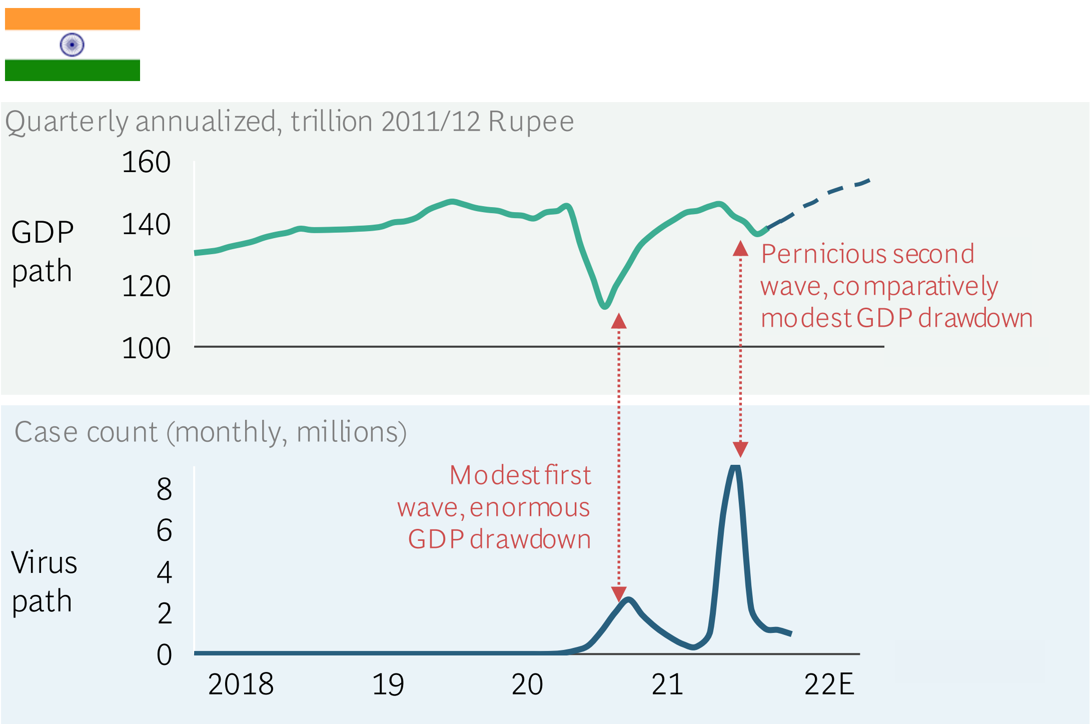
€0.67tn Increase in financial wealth in **Germany**

¥91.3tn Increase in financial wealth in **Japan**

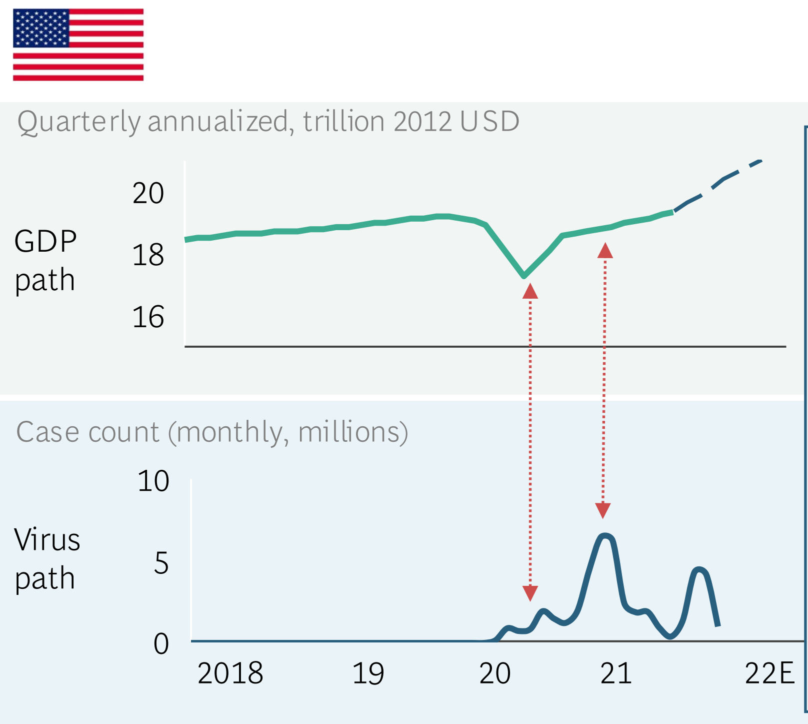
Note: rounded numbers
Sources: Conference Board, Federal Reserve Board, Bank of Japan, Deutsche Bundesbank, UK Office for National Statistics, Australian Bureau of Statistics, BCG

1 Economies have also begun to "decouple" from the virus, meaning that COVID case surges likely to shift recovery and growth out but not down

Economies have largely decoupled from virus trajectory – in India, larger second wave drove smaller drawdown



In the US, the spike in Delta COVID cases changed growth expectations – pushing it out, not down



Delta surge shifted growth expectations **out but not down**

- Surge in cases **moderated growth estimates** in second half of 2021
- …but also contributed to **rising estimates in all quarters of 2022**

Sources: Bloomberg, Federal Reserve Economic Data, Johns Hopkins Our World in Data, Projections from Oxford Economics, BCG

2

US deep dive | Overall healthy outlook for 2022, with need to navigate four risks of the 2022 macroeconomic environment

Important to consider US economic outlook in your 2022 planning:

US economy at frontier of rebounding global economy: US stimulus has led the world and delivered a faster and stronger rebound than in most other economies. It also means that the US is the first to experience bottlenecks in labor and product markets associated with a strong consumption overshoot - dynamics that are growing around the world

US centrality to global system: US dynamics matter not only because of weight of US economy in global system but also for financial and monetary policy spillovers to the rest of the world

In the US, consumer spending will support a healthy outlook for 2022, with expected growth still above (long-term) trends. Although risks are likely to ease, need to monitor and manage four areas:

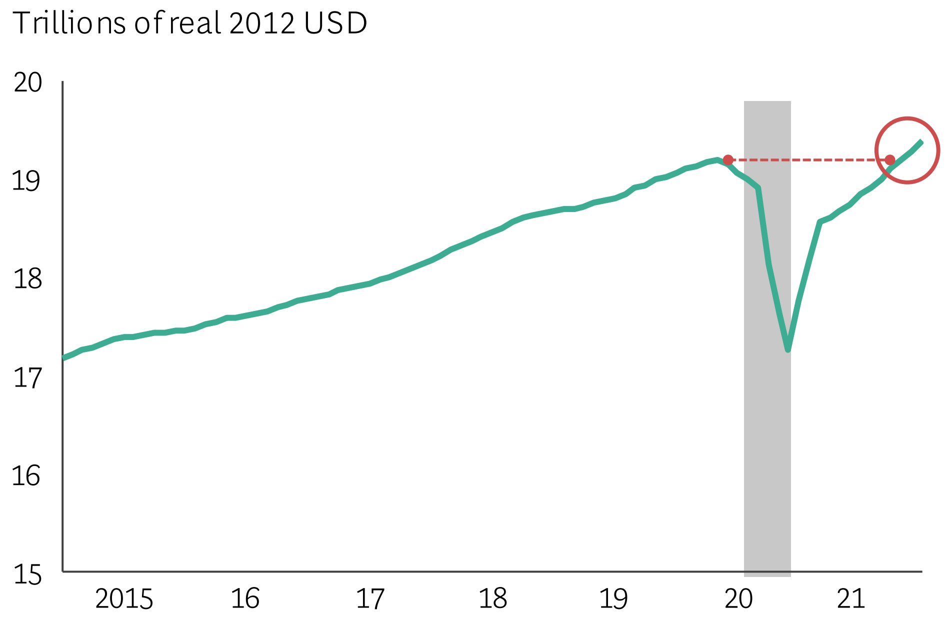
1. Labor market bottlenecks
2. Product market bottlenecks
3. Inflationary pressures
4. Monetary policy normalization

Source: BCG

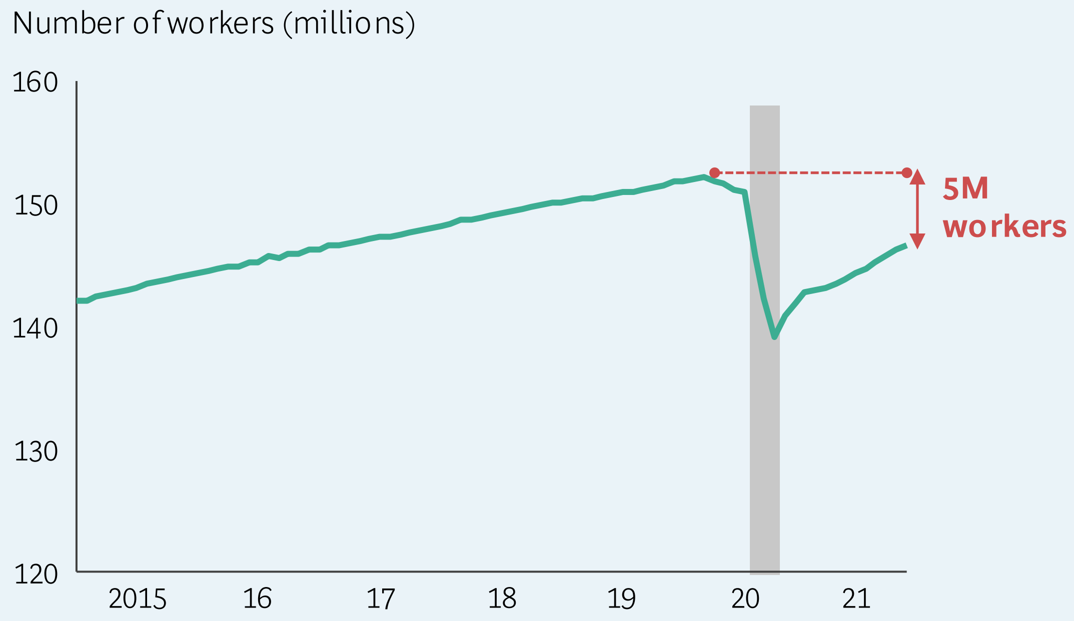
2.1
2.2

Bottlenecks in labor and product markets will take time to ease—with different rates of normalization of demand and supply

US economy operates above pre-COVID levels



... but with 5 million fewer workers



Such a fast divergence is impossible without causing bottlenecks across the economy

Source: BEA, BLS, BCG

Labor bottlenecks: Labor demand in the US is still below pre-COVID levels—hiring difficulties and wage growth driven more by speed of hiring

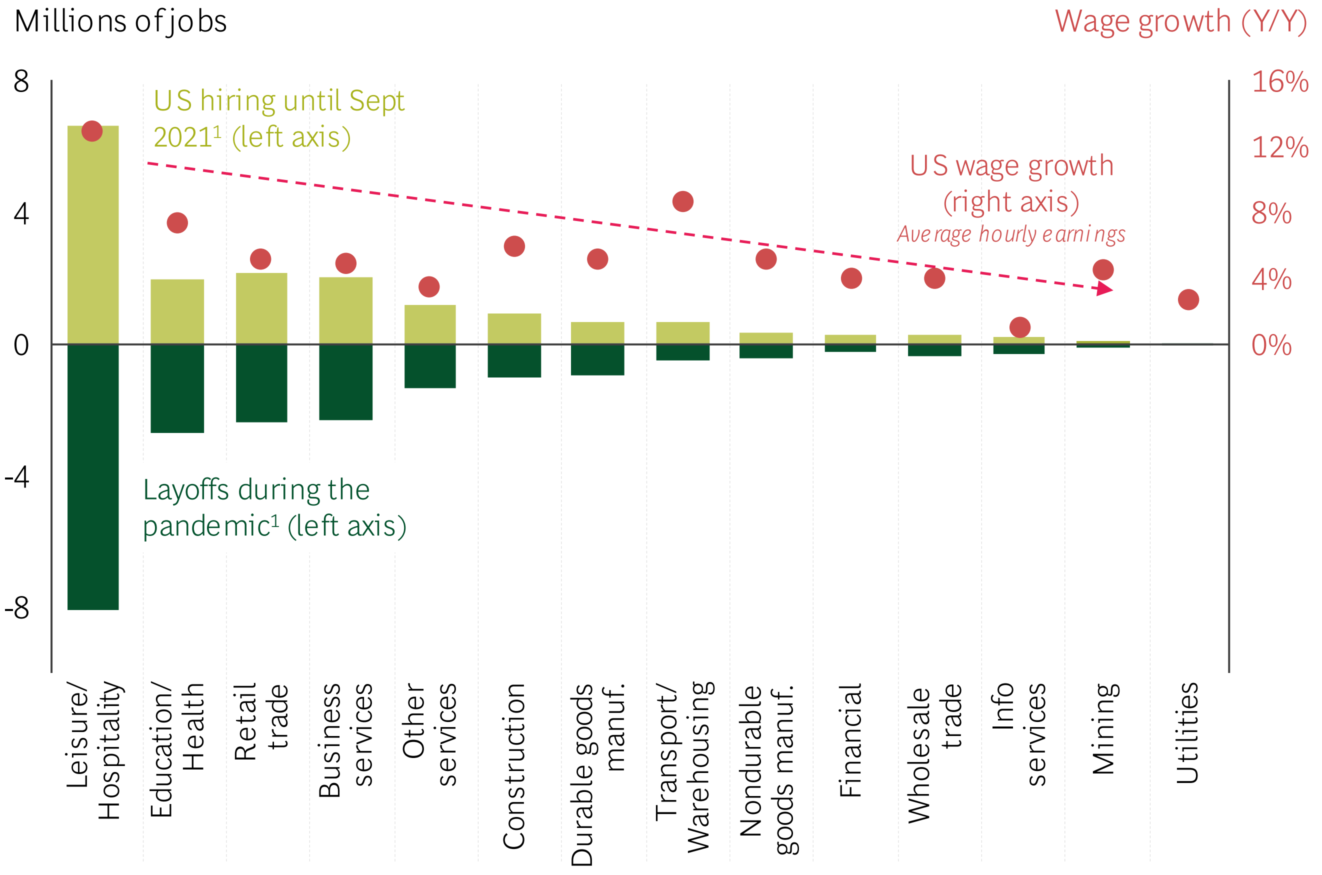
Total labor demand remains below pre-COVID levels…

22 million workers let go during the pandemic in just 2 months

17 million have been **hired back** over a much longer period[2]

Even if all the **new open positions (~4 million)** were filled today, payrolls (total labor demand) would still be below pre-COVID levels

… but those who fired in a big way have scrambled to hire workers back in a big way—and have had to pay much higher wages

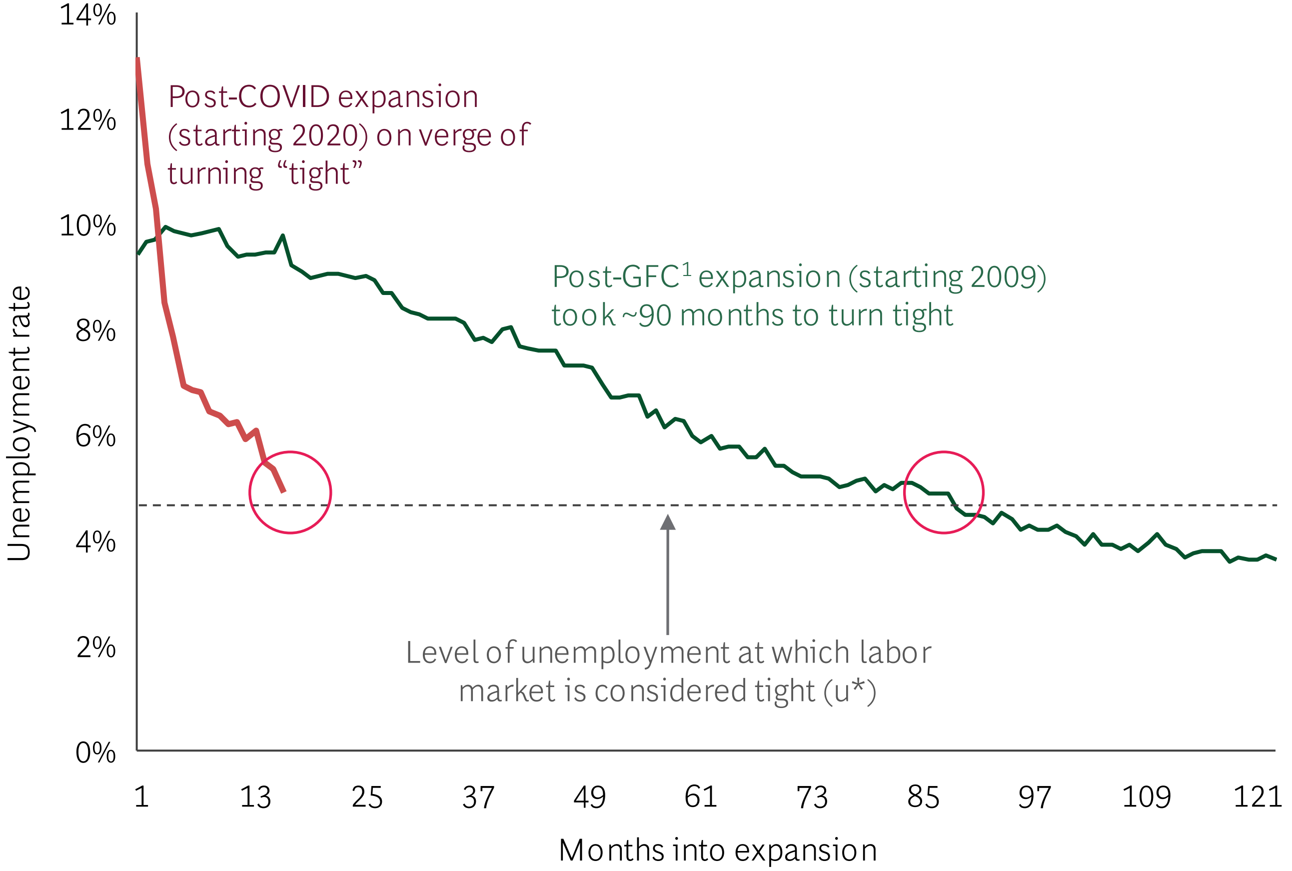


1. "Layoff" difference between 2020/2021 minimum and Dec 2019; "hiring" change between minimum and Sept 2021. 2. Note: even under the best of circumstances, it takes more time to hire than to fire. Source: BLS, BCG

2.1

Real wage pressures will persist as the US labor market quickly returns to tightness, necessitating a strategic response by firms to protect margins

US post-COVID cycle returning to tightness in record time...



1. Dark green curve shows global financial crisis of 2008/2009
Note: u* at Mar 2017
Source: NBER, BLS, CBO, BCG

...necessitates planning for persistent wage pressures

While hiring difficulties will likely ease, the **labor market will not return to the easy condition** that lasted for most of the previous cycle—it will remain tight

Wage growth will put **cyclical pressure on margins**—firms forced to absorb or offset with greater productivity growth

Passing through to consumers not possible for every company, all the time—risk of loss of market share

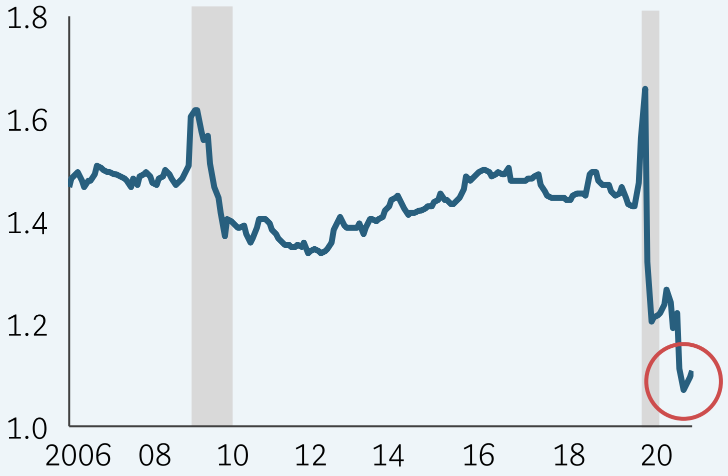
Tight cycles, when labor is less available, tend to **spur capital investment** and lift productivity growth cyclically

2.2

In US product markets, many firms also struggle to meet demand and experience disrupted supply chains, largely due to high goods consumption

Inventory-to-sales ratios are low…

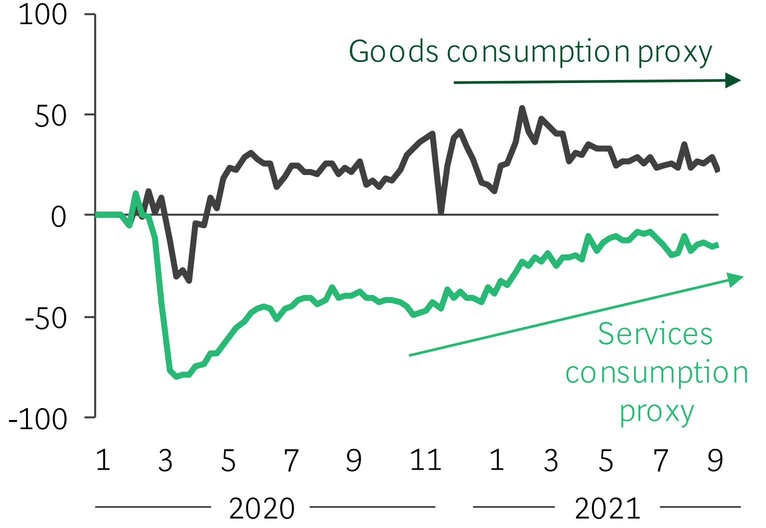
Retail inventory-to-sales ratio



…largely driven by high goods consumption…

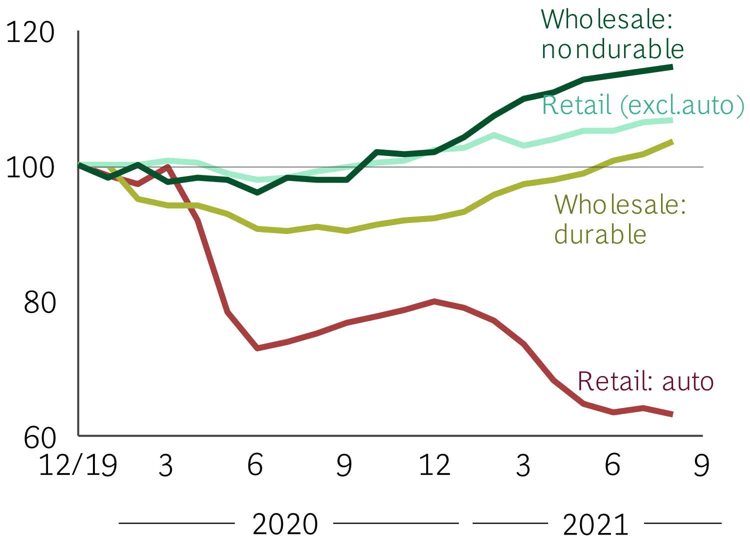
High goods consumption persists even as vaccines and easing restrictions allow services to come back

Goods and service consumption (relative to baseline)



…while inventories are mostly stable, though many painful exceptions persist

Inventory (100 = 12/2019)



Strong rebound in demand exacerbates localized bottlenecks in supply chains which have been strained by pandemic-related production interruptions creating acute pain for some

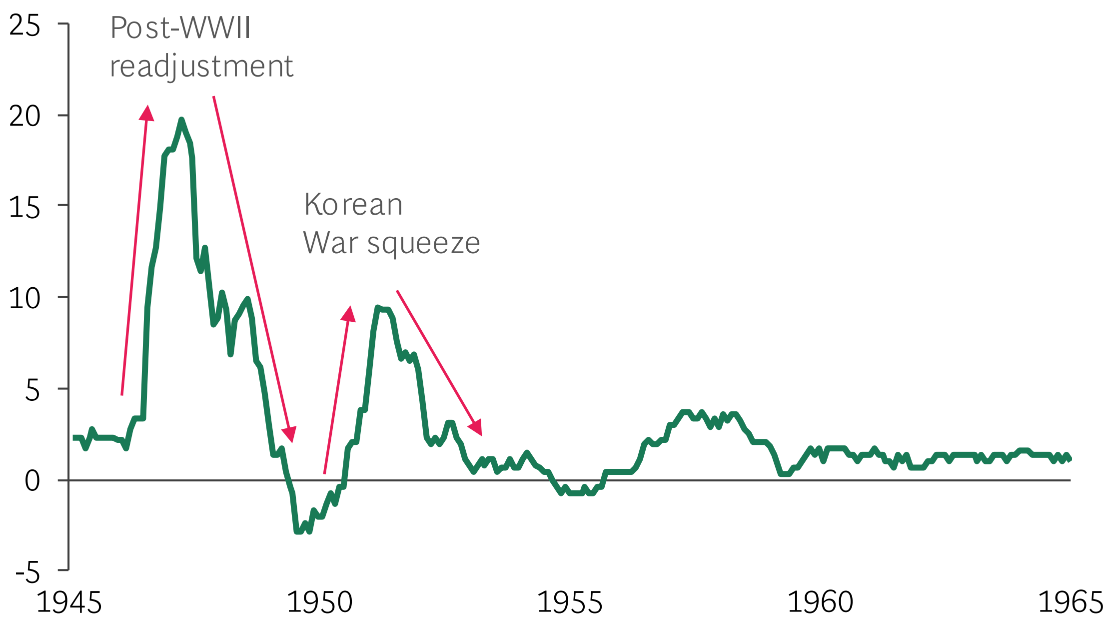
Source: Census, BEA, NBER, BCG

2.3

Inflation: Key question for 2022 is whether inflation is a transitory spike or a structural inflection

Transitory inflation spike (post-WWII bottlenecks): Driven by reopening and bottlenecked consumer economy

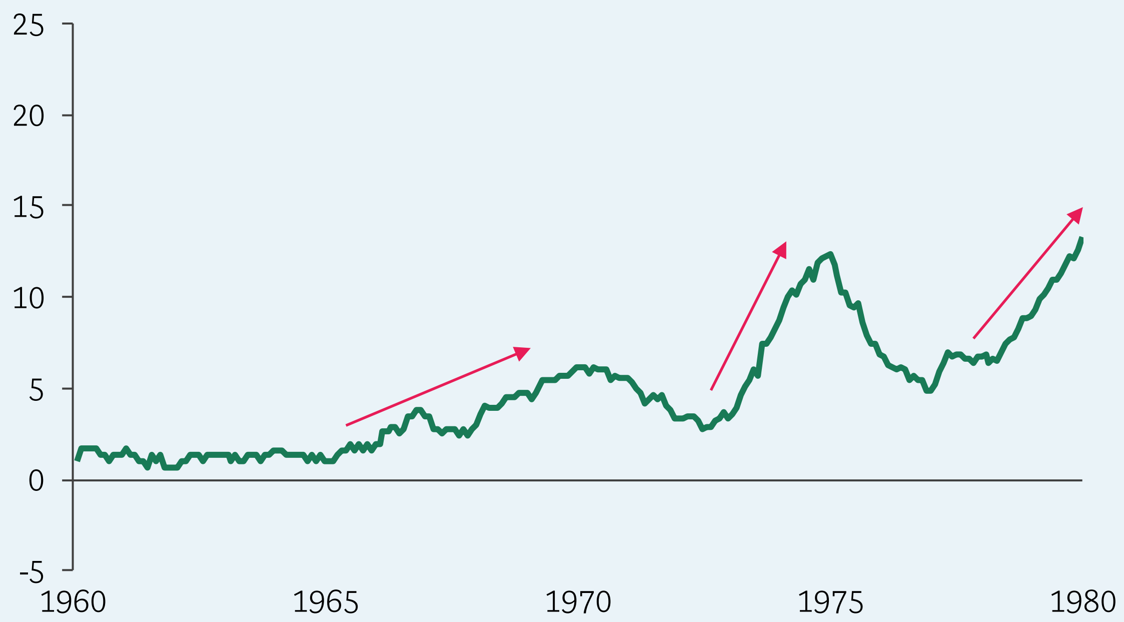
Headline inflation (Y/Y)



Analogy highlights transient pressures related to systemic bottlenecks and consumption surge
Movement is up and down but not a structural inflection

Structural regime inflection (60s-70s): Years of tight economy and sustained policy errors permanently shifted inflation up

Headline inflation % (Y/Y)



Analogy highlights slow-motion breaking of inflation regime related to tightness and policy errors
Movement is up and up with ever-higher lows

Source: BLS, BCG

2.3 If month-over-month inflation remains contained, the first opportunity for year-over-year decline is April 2022, given base effects. Will it happen?

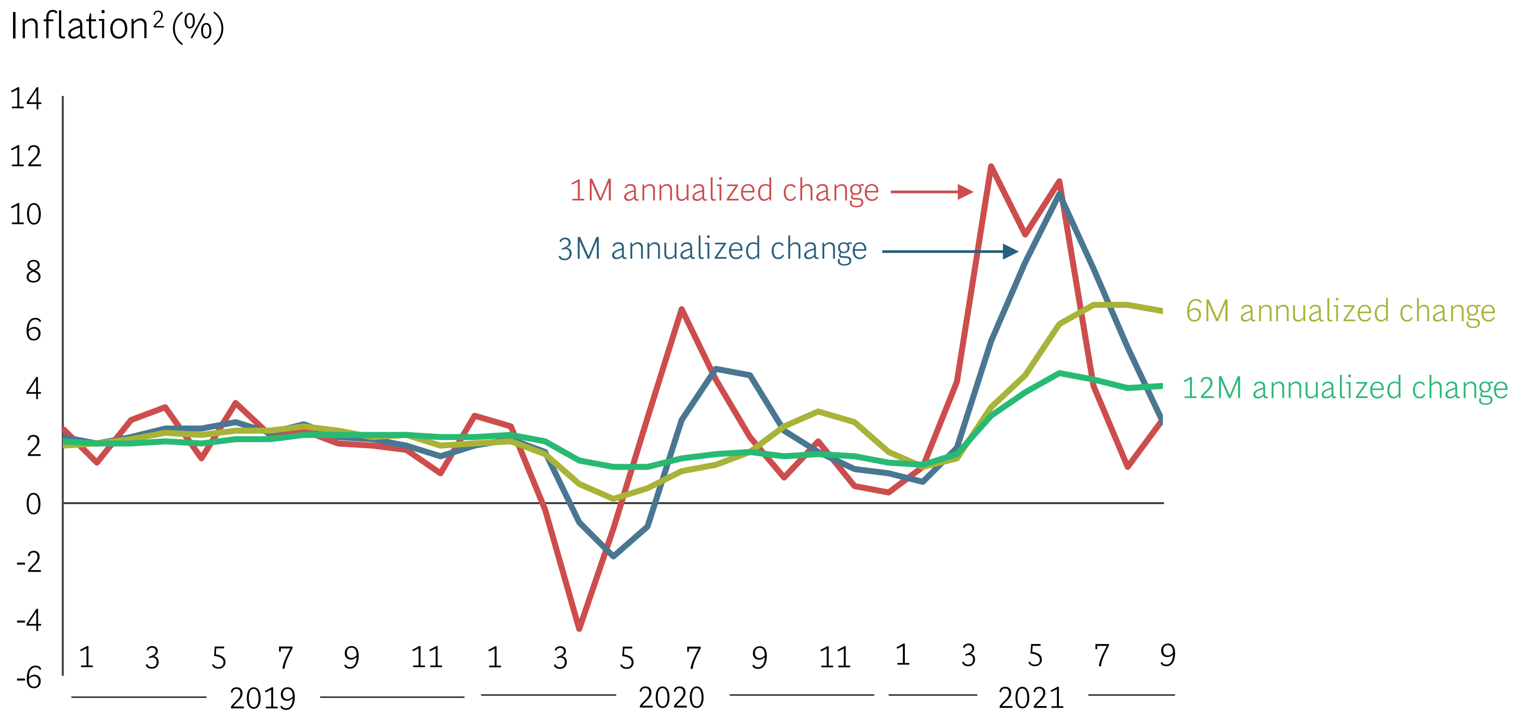
Know the mechanics and drivers of each inflation print

Month-over-month inflation has been contained, highlighting that year-on-year prints are driven by base effects[1]

Year-over-year prints must stay high until at least April and May of 2022, which is the first opportunity to roll out of high base effects of April and May of current year

If month-over-month remains at current levels until then, year over year inflation would fall by May 2022

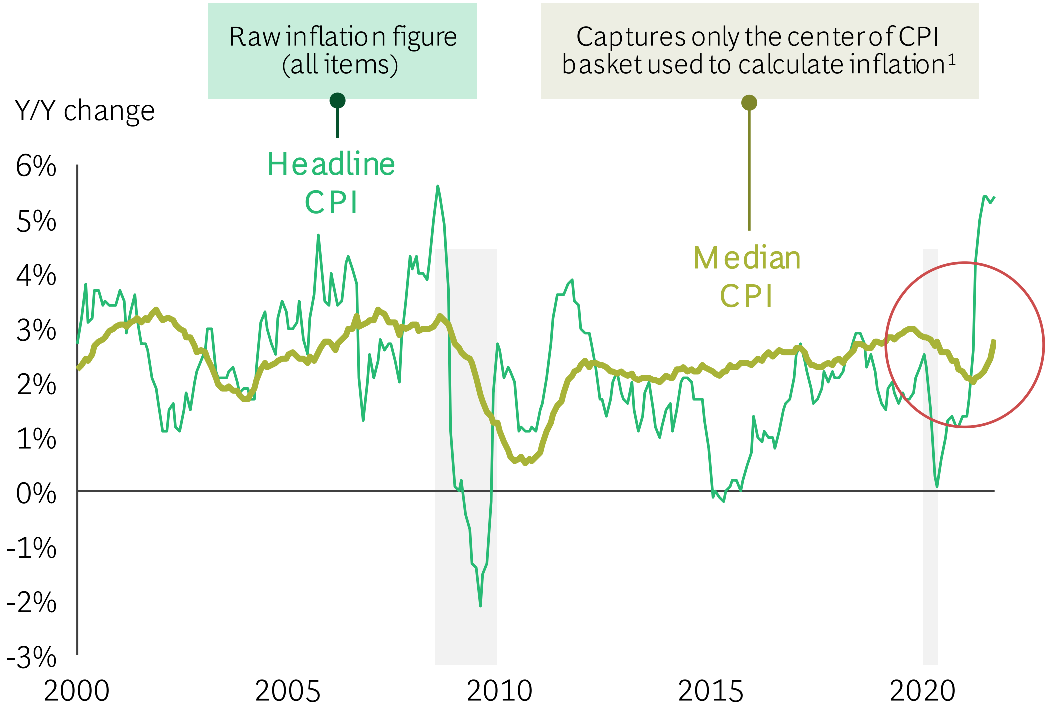
Y/Y elevated but M/M not—focus on month-over-month evolution



1. Base effect refers to the impact of the corresponding "base" or period of the previous year on current growth estimates (e.g., during 2020 low core CPI); 2. Based on Core CPI
Source: BLS, BCG

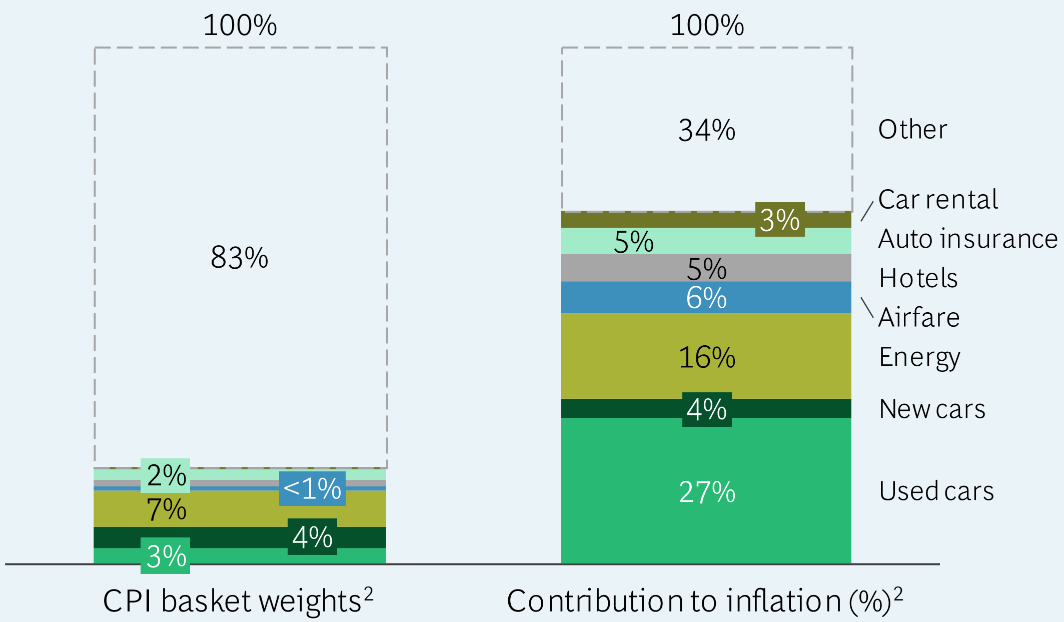
2.3 Evidence of broad-based inflation continues to be scant as a small number of items—not the whole price basket—are driving inflation prints

Broad-based measure (median inflation) not spiking higher, despite surges in headline inflation...



...caused by a few reopening-related consumption categories

Two-thirds of inflation driven by **COVID-sensitive sectors** that account for ~**17%** of the CPI basket

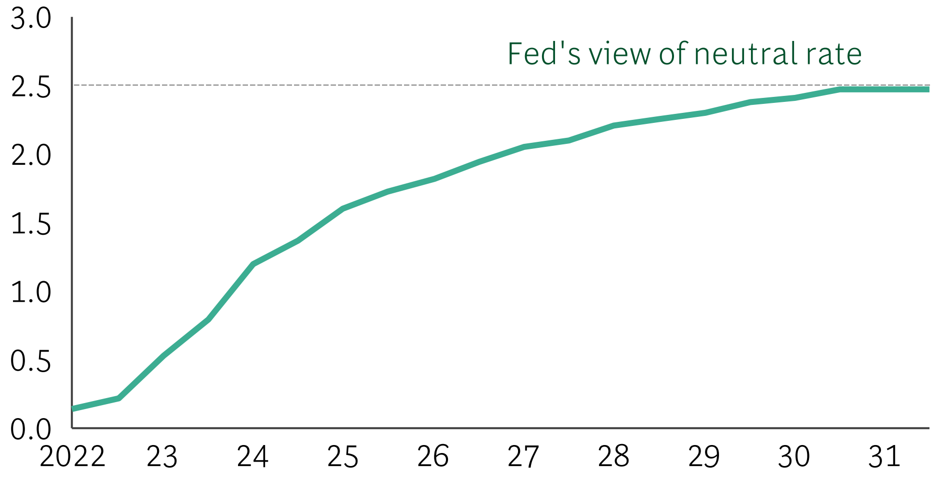


1. The median CPI excludes all price changes except for the one in the center of the distribution of price changes, where the price changes are ranked from lowest to highest (or most negative to most positive); 2. Average March, April, May 2020;
Source: Bloomberg, BLS, Federal Reserve Bank of Cleveland, BCG.

2.4 Policy should normalize in an orderly way—but if inflation starts to look structural, policy makers would tighten faster to prevent a structural break

Monetary policy is set to tighten - but very gradually

Market-implied path of policy interest rate (%)



Market pricing of the Fed's rate path does not exhibit expectation of spiraling inflation

Source: Federal Reserve Board, Bloomberg, BCG

If the Fed turns out to be wrong about transitory inflation, it will need to tighten policy faster, which would upset markets and could even risk the cycle

Soft and gradual exit from ultra-low rates expected by market and Fed as inflation thought to be transitory

If **inflation proves not to be transitory,** the pace of tightening will quicken to contain the risk of a structural break of inflation regime

This would rapidly tighten financial conditions and disrupt financial markets, threatening the economic expansion

Risk of **"policy error" is up**—could either be to tighten too soon or too much (triggering recession) or policy inaction (risk of regime break)

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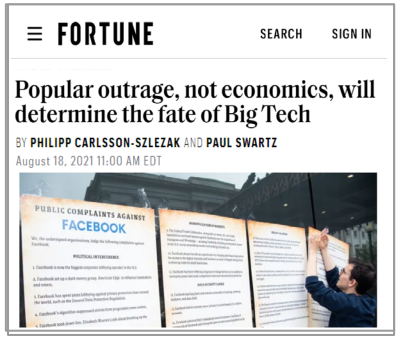
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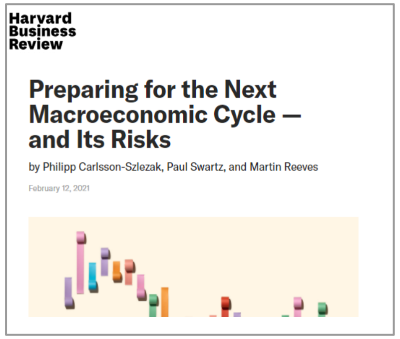
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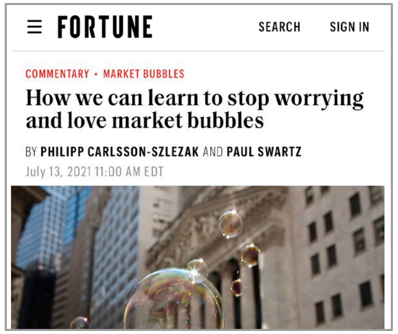
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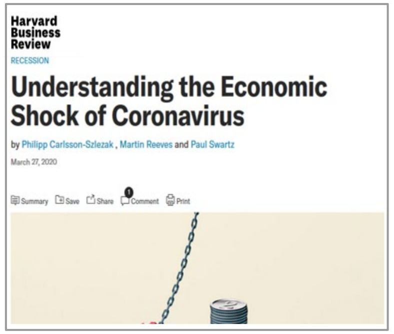
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