Economics

Special Commentary — January 21, 2021

The Economic Outlook: What Could Possibly Go Wrong?

Part I: Introduction to the Series

Summary

The U.S. economy went on a roller-coaster ride in 2020 due to the COVID pandemic. Looking forward, we expect that U.S. economic growth should strengthen significantly later this year as vaccines become widely deployed, which should allow the economy to fully re-open. But the history of economic forecasting is replete with examples of projections that went sharply awry. In a series of reports that we plan to publish in coming weeks, we hope to shed some light on risks, other than the uncertain trajectory of the pandemic, that the U.S. economy could face in the next year or two.

Economist(s)

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Economic Growth in Most Economies Should Bounce Back Sharply in 2021

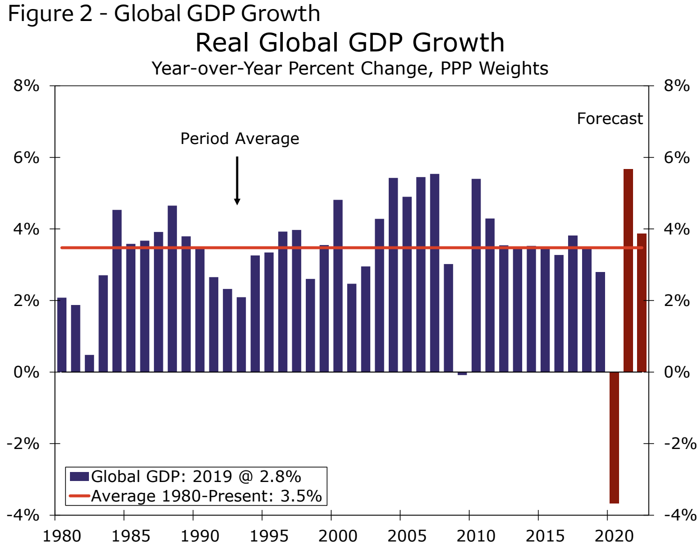
Real GDP in the United States experienced a roller coaster ride in 2020 (Figure 1). The economy essentially ground to a halt in the second quarter - real GDP nosedived at an annualized rate of 31.4% - as the pandemic took hold in the United States. But growth came roaring back in the third quarter as restrictions were relaxed and the economy re-opened. Economic activity decelerated sharply in Q4, but we project that real GDP growth remained positive at roughly 4%.

Looking into 2021, we forecast that GDP growth will remain slow in the first part of the year due largely to renewed restrictions that many local officials have re-imposed due to the renewed surge in COVID cases. But as an increasing number of individuals receive vaccines, restrictions should start to ease and the battered service sector should return to some semblance of "normal." We forecast that pent-up demand for postponed spending on services (e.g., restaurant dining, personal travel, etc.) will lead real GDP to grow at an annualized rate in excess of 7% in the second half of the year relative to the first half. We also forecast that the economy will continue to expand at an above-trend rate of 4.8% in 2022.

Figure 1 - U.S. GDP Growth

Source: U.S. Department of Commerce and Wells Fargo Securities

Figure 2 - Global GDP Growth



Source: International Monetary Fund and Wells Fargo Securities

Most other foreign economies experienced similar dynamics in their GDP growth rates. That is, most foreign economies suffered steep declines in GDP in Q2-2020 with subsequent strong rates of growth in the third quarter. We estimate that global GDP contracted 3.7% in 2020, by far the sharpest decline in at least 40 years (Figure 2). But economic activity in most foreign economies should also accelerate considerably later this year as those economies re-open due to the widespread deployment of vaccines that we anticipate. The pandemic originated in China, but the country has been successful, at least relative to most other major economies, in subsequently keeping it suppressed. We forecast that the Chinese economy will grow roughly 9% in 2021, and we look for real GDP in the Eurozone and the United Kingdom, which both contracted considerably in 2020, to grow 3.2% and 2.4% respectively this year. In sum, we look for the global economy to expand nearly 6% in 2021, following its sharp contraction last year.

But What Could Go Wrong?

Obviously, the economic bounce-back that we forecast for 2021 could be delayed even longer if the deployment of vaccines proceeds at a slower-than-expected pace and/or a more virulent strain of the virus appears. But are there risks aside from COVID that could cause the U.S. economy to significantly under-perform our expectations over the coming year or two?

In a series of reports that we plan to publish in coming weeks, we intend to address a number of risks that the economy could potentially experience in the foreseeable future. We will begin our series by analyzing whether inflation, which has long been dormant, could make a meaningful comeback this year and next. If it does, market-determined interest rates could snap significantly higher and profit margins could potentially be squeezed. Other potential risks that we will cover in the series include fiscal deficits and debt in the United States, the debt-servicing abilities of American households, and risks related to commercial and residential real estate in the United States. We will also address the potential for premature fiscal tightening in the United States and in major foreign economies, which could lead to significantly slower global economic growth than we currently forecast, and we will analyze the potential for a debt crisis in China.

To reiterate, our base case forecast looks for U.S. real GDP to grow at an above-trend rate of 4.6% this year and at an even stronger rate of 4.8% in 2022. These projections are more robust than the consensus view, but most forecasters look for above-trend U.S. economic growth in both 2021 and 2022 as well. Specifically, the Blue Chip panel of economic forecasters looks for 4.2% real GDP in the United States in 2021 and 3.4% in 2022. But the history of economic forecasting is replete with examples of projections that went sharply awry, because of developments that were in some cases unknowable in advance (e.g., the OPEC oil boycott in 1973-74) or in other cases were caused by evident imbalance in the economy (i.e., the housing bubble in the early years of the 20th century). What are the potential risks to the economic outlook to which readers should be cognizant? We hope to shed some light on that question in this forthcoming series of reports.

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