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MACROECONOMIC ASSUMPTIONS

The new old normal: Moderate growth but a little more inflation

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IN BRIEF

- For the first time in many years, we raise our long-term inflation projections across a range of economies, detecting a different inflationary dynamic: Post-recession, output gaps are closing quickly; meanwhile, stimulative fiscal and monetary policies are working in partnership.
- Our global growth forecast sees upside risks from technology and greater labor force participation, yet countering headwinds abound: stalled globalization; a less immigration-friendly atmosphere; the long-expected, gradual slowing of Chinese growth; and continuing weak demographics globally.
- We shave our global real growth forecast slightly, to 2.2%, for our set of economies. Developed market (DM) nominal growth edges up, reflecting a small downgrade to real GDP and the uplift in our inflation forecast.
- Emerging market growth edges down in both real and nominal terms, reflecting cuts to the China and India real GDP forecasts.
- We raise our trend growth expectations in several DM economies, despite a year of powerful growth since the 2021 edition.

The financial crisis of the late 2000s cast a decade-long shadow over the global economy. An extended period of household and public sector deleveraging leaned against growth, which was already under pressure from weakening demographics. Meanwhile, large-scale spare capacity helped keep inflation persistently low, and even highly accommodative monetary policies failed to generate much lift.

Still, the economic cycle survived for more than 10 years – and might have lasted longer had the coronavirus pandemic not struck. The long-term implications of this latest shock will reveal themselves only over time, but some changes seem apparent a year into the new expansion.

Most obviously, we detect a somewhat different inflationary dynamic: Economies have closed output gaps much more quickly this time, with fiscal and monetary policies now working in partnership. For the first time in many years, we have raised our long-term inflation projections, and now see less risk of persistent deflationary pressures. The growth picture seems less clear. We can imagine upside risks from technological change and efforts to boost labor force participation. But the global economy may also encounter new headwinds, such as stalled globalization and, importantly for the U.S., restrictions on immigration. Moreover, population growth continues slowing inexorably, as does growth in China.

GLOBAL GROWTH: UPSIDE RISK, BUT DEMOGRAPHICS STILL WEIGH ON PROJECTIONS

We continue to project modest real GDP growth by historical standards for our sample of countries and, in aggregate, shave our trend forecasts slightly. We have lifted our growth forecasts for several economies, countered by downgrades to a few heavyweights: the U.S., China and India. We thus expect 2.2% real GDP growth for our set of economies over the next 10 to 15 years, vs. 2.9% from 2010 to 2020 and 2.7% from 2000 to 2020 (**EXHIBIT 1**).

Our 2022 assumptions anticipate slower real GDP growth globally, mostly because last year's cyclical bonuses have been removed, and somewhat higher inflation

EXHIBIT 1: 2022 LONG-TERM CAPITAL MARKET MACROECONOMIC ASSUMPTIONS (%, ANNUAL AVERAGE)

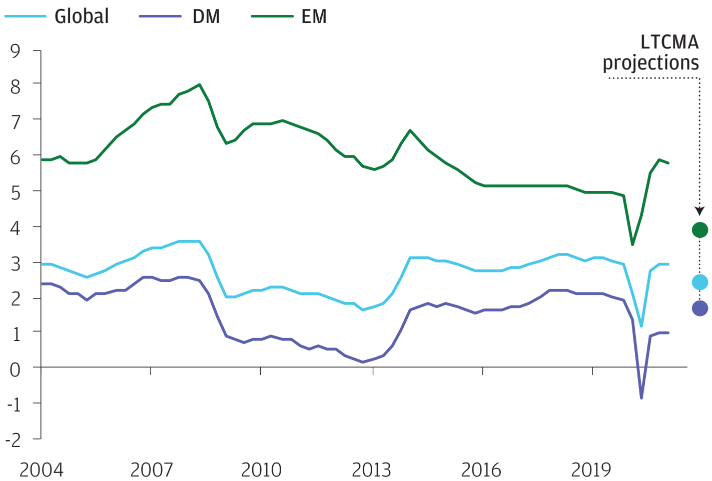
	REAL GDP				INFLATION		
	2022	2021	Change (trend only)	Change (cyclical + trend)	2022	2021	Change
DEVELOPED MARKETS	1.5	1.6	0.0	-0.1	1.8	1.6	0.2
United States	1.7	1.8	-0.1	-0.1	2.3	2.0	0.3
Euro area	1.2	1.3	0.1	-0.1	1.5	1.3	0.2
Japan	0.7	1.0	0.0	-0.3	0.7	0.7	0.0
United Kingdom	1.4	1.6	0.2	-0.2	2.2	2.0	0.2
Canada	1.6	1.7	0.1	-0.1	1.9	1.8	0.1
Australia	2.2	2.4	0.0	-0.2	2.2	2.3	-0.1
Sweden	1.8	2.0	0.1	-0.2	1.8	1.6	0.2
Switzerland	1.4	1.5	0.2	-0.1	0.6	0.5	0.1
EMERGING MARKETS	3.7	3.9	-0.2	-0.2	3.3	3.3	0.0
China	4.2	4.4	-0.2	-0.2	2.5	2.5	0.0
India	6.0	6.9	-0.5	-0.9	4.5	5.0	-0.5
Russia	0.8	1.1	-0.1	-0.3	5.0	5.3	-0.3
Brazil	2.0	2.4	-0.3	-0.4	4.3	4.3	0.0
Korea	2.0	2.1	0.1	-0.1	2.0	1.8	0.2
Taiwan	1.7	1.6	0.1	0.1	1.1	1.0	0.1
Mexico	2.2	2.5	0.0	-0.3	3.7	3.7	0.0
South Africa	2.2	2.5	0.0	-0.3	5.3	5.3	0.0
Turkey	3.1	3.1	0.1	0.0	12.0	8.5	3.5
GLOBAL	2.2	2.4	-0.1	-0.2	2.4	2.2	0.2

Source: J.P. Morgan Asset Management; estimates as of September 30, 2021. Previous year's real GDP forecasts shown include cyclical bonuses. Given depressed post-shock starting points, in last year's edition we added cyclical bonuses to our 2021 trend growth projections. This year, our 2022 forecasting returns to trend rates alone. In comparing 2021 with 2022 trend rates here, we do not use last year's rate-plus-cyclical-bonus figure but only the trend rate.

We believe aggregate developed market (DM) growth, which we forecast at 1.5%, will run fairly close to its historical track record. But China's ongoing deceleration pulls down the emerging market (EM) aggregate: We pencil in 3.7%, compared with 6.0% during the 20 years ended in 2020 (**EXHIBIT 2**).

We expect DM real GDP growth fairly close to its historical norm, but EM growth is lower than in the past 20 years

EXHIBIT 2: REAL GDP GROWTH HISTORY AND PROJECTIONS (% Y/Y, 5-YEAR AVERAGE)



Source: Haver, J.P. Morgan Asset Management; data and estimates as of September 30, 2021.

In late 2020, the world was just beginning its rebound from the steep economic contraction wrought by the coronavirus pandemic. Reflecting depressed starting points, we added cyclical bonuses to our estimated trend growth rates in the last edition of our Long-Term Capital Market Assumptions (LTCMAs). For this edition, with recoveries now well advanced and output gaps largely closed, we remove those bonuses from our growth projections.

The last edition also considered several possible long-term implications of the pandemic, including a reversal of globalization and the de-densification of living and working arrangements. A year on, we see limited evidence that these changes will have material effects on potential growth.

Accelerating total factor productivity; faster growth in labor supply

What might prove longer lasting is some influence from two other recent developments. First, the pandemic shock appears to have catalyzed business adoption of new technologies. Total factor productivity (TFP) growth – over the long run, mostly a proxy for technological change – grew disappointingly slowly during the prior expansion. Just before the recession, though, it showed tentative signs of a pickup.

We think a renewed focus on incorporating digitization, communication tools and other advances into the capital stock and work practices may be accelerating TFP.

Second, monetary policymakers' attempts to run economies hot in the years before the pandemic seemed to bear fruit in increased labor market participation. As central banks, led by the Federal Reserve, incorporate full employment goals more explicitly into their frameworks, and as fiscal policy takes a more activist turn, we may see faster growth in the labor supply than demographics would suggest. Technology may help on this front, too, as flexible work arrangements facilitate greater employment of women in particular.

We have nudged up our assumption for DM TFP growth by 0.1 percentage point (ppt), to 0.7%, largely in a nod to the somewhat speculative technology adoption story. The move also reflects optimism about the euro area, which looks set to avoid the damaging fiscal contraction initiated there in the early 2010s in response to creditworthiness concerns. The European Union's Next Generation fund is now set to invest in digitization, clean energy and other (possibly productivity-enhancing) projects.

As usual, we forecast a slightly faster pace of TFP growth in emerging markets: 0.8%, which slips down 0.1ppt from last year, mostly because of China. Our TFP projections for Korea and Taiwan rise, in accord with the DM numbers.

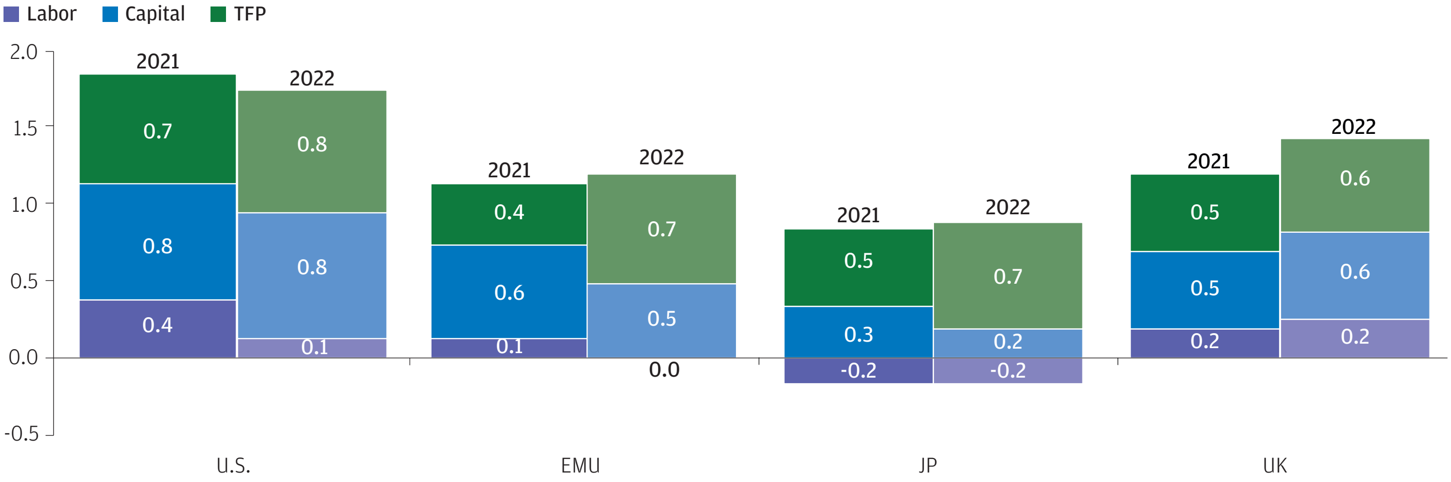
The reality of weak demographics

The reality of weak demographics continues to weigh on the prospects for DM and EM economies' growth. Our framework regards the labor force, the capital stock and TFP as the ingredients in the recipe for long-term growth. Shrinkage in the DM prime-age population during our forecast period thus represents a significant constraint. Greater participation by senior citizens, and possibly women and the previously marginalized, should provide some offset, but we still expect the DM workforce to grow only 0.1% annually, down from 0.3% in last year's forecasts. EM demographics do not look much better, due largely to aging societies in China, Korea and Taiwan. Ongoing urbanization in China will help, but we still see EM employment growing at a modest 0.6% pace.

Finally, the modest net modifications in the labor force and TFP lead to broad stability in our capital stock forecasts. Broadly, we relate the growth of the capital stock to the expansion of the workforce and TFP, observing that economies generally grow in a balanced way, with the capital stock holding fairly steady relative to GDP.

Better productivity growth offsets weaker demographics in trend real GDP forecast

EXHIBIT 3: CONTRIBUTIONS TO DM REAL GDP GROWTH



Source: J.P. Morgan Asset Management; estimates as of September 30, 2021. Contributions do not include the cyclical bonuses incorporated into 2021 LTCMA real GDP forecasts.

U.S. trend growth forecast declines slightly; some other DM forecasts rise

Accelerating TFP growth proved insufficient to head off a small decline in our U.S. trend growth forecast, now at 1.7%, compared with 1.8% last year (**EXHIBIT 3**). Relatively favorable demographics have given the U.S. a significant advantage vs. other DM economies, but a more restrictive immigration atmosphere should damage that source of strength. We correspondingly reduce our U.S. labor force growth forecast, to 0.3% from 0.6%, reflecting both weaker immigration and a higher starting point for labor force participation a year into the recovery.

By contrast, our economic trend growth numbers have moved up 0.1ppt–0.2ppt in several other DM economies, reflecting a combination of the TFP and labor force stories. We have raised our UK trend growth forecast by 0.2ppt, to 1.4%, expecting that disruptions related to the Brexit process will ease early in our forecast period and noting that immigration from outside the European Union is compensating for fewer EU arrivals. We hold our Australia projection steady at 2.2% for another year – our highest DM forecast.

In emerging markets, we lower our China trend growth forecast, to 4.2% from 4.4%. We have long suggested that China's growth rate will glide lower as the economy continues to converge toward DM status, leaving less room for catch-up; this year's change represents such an adjustment. Although our India growth forecast still tops the emerging markets, we cut it for a second straight year, to 6.0% from 6.5%, in light of disappointing progress on structural reforms and a likely persistent overhang from a weakened financial sector. Russia's dependence on the energy sector motivated a downgrade. Concerns about policy instability in Brazil led to a 0.3ppt cut, to 2.0%. By contrast, the Korea and Taiwan forecasts edged up, thanks to our optimism on TFP.

GLOBAL INFLATION LIKELY TO STICK

In broad terms, global inflation has been falling since the 1970s. In the developed world, powerful long-term economic forces have suppressed inflation, and these forces have been supplemented in emerging markets by more responsible central bank policies. Global inflation has also generally fallen during recessions, and inflation pressures receded further after the global financial crisis (GFC). However, after the COVID-19 recession, we expect aggressive fiscal policy and a faster recovery to carve out a somewhat stronger path for inflation globally over the next 10 to 15 years.

Globally aggregated measures of inflation have generally declined. However, any such measure tends to be distorted by a few nations with very high inflation. Perhaps a cleaner measure is that of the 22 countries for which we provide forecasts, decade-over-decade inflation declined in the 1990s in 18 economies, dropped in the 2000s in 20 economies and fell in the 2010s in 16 economies.

Forces suppressing inflation

A number of long-term forces have contributed to lower inflation (**EXHIBIT 4**). First, information technology has tended to increase the competitiveness of all markets by empowering both consumer and wholesale buyers. Second, while income inequality across nations has lessened in recent decades, it has increased within nations. This has tended to reduce the demand for goods and services and increase the demand for financial assets, boosting asset prices while restraining consumer inflation. Third, increased globalization has allowed consumers, generally in rich countries, to take advantage of lower labor costs in poorer nations. To some extent, this is illustrated by the rise in the value of global exports and imports – from 27% of global GDP in 1970 to 61% by 2008.[1]

Some slow-moving forces seem likely to create more upward pressure in the future

EXHIBIT 4: LONG-TERM INFLUENCES ON U.S. INFLATION

	IMPACT ON U.S. INFLATION	
Economic forces	Last global expansion (2008–19)	Next 10–15 years
Income distribution	-	+
Globalization	-	?
Dollar	-	+
Fiscal policy	-	+
Online markets & information availability	- -	- -
Energy spikes	+	0
Union membership	-	-
ESG	0	+

Source: J.P. Morgan Asset Management; forecasts and assumptions as of September 30, 2021.

Also reducing global inflation: Oil prices, a trigger of higher inflation in the 1970s and periodically since then, have recently traded in a narrower range, partly because of the advent of shale oil, supplies of which can respond quickly to changes in demand. Declining union power has also tended to reduce inflation. More recently, although monetary policy has been loose for some time, it has proved ineffective at boosting inflation after the GFC, in part because it worked at cross-purposes from austere fiscal policies.

Finally, information technology and productivity-enhancing investments in artificial intelligence and robotics put downward pressure on inflation in the long run.

Forces supporting inflation

Since the pandemic recession, many headwinds to inflation have diminished while new tailwinds have materialized.

Political populism and the need to combat the pandemic's economic impacts have encouraged many governments to adopt far more aggressive fiscal stimulus. This is likely to prove more potent than the monetary stimulus of the last decade, in part because much of it is directed toward helping lower and middle income consumers, who have a greater marginal propensity to spend. Globalization has also stalled, due to greater protectionism and an increasing share of services, which are less tradable, in global GDP. Between 2008 and 2019, the value of exports and imports fell from 61% to 58% of global GDP.

Politics may also contribute to higher wage growth, reflected in higher minimum wages and more generous unemployment benefits. A focus on battling climate change could have the same effect if it includes carbon taxes rather than only green technology, especially considering the global economy's likely continued reliance on fossil fuels for at least the next decade.

On balance, our long-term inflation outlook is a little higher this year, as some of the inflation manifesting itself in the late stages of the COVID-19 pandemic is proving a little stickier than the central banks expected.

[1] World Bank and OECD national accounts data files, 2020.

REGIONAL INFLATION HIGHLIGHTS: WARMER OUTLOOK IN DM ECONOMIES

Twice in this still-young century, the global economy has experienced deep recessions and recoveries that unfolded in synchronous fashion. Because of a common business cycle, there is less divergence in the global inflation outlook than has often been the case.

THE U.S.: The U.S. still continues to broadly lead the developed world in expected inflation, and we increase our 2022 long-run U.S. inflation forecast, from 2.0% to 2.3%. This reflects an expectation that aggressive fiscal policy and easy monetary policy in an economy with stronger wage growth and inflation expectations will enable the Federal Reserve to meet its long-run goal of 2% consumption deflator inflation while modestly exceeding this target in the short run.[2]

THE EUROZONE AND UK: In the eurozone, we expect somewhat higher long-run inflation and forecast 1.5%, compared with 1.3% last year. This reflects some coordinated fiscal stimulus, although not on the same scale as in the U.S., plus some costs for environmental, social and governance (ESG) policies that are likely to be more impactful in the eurozone. We boost our UK inflation estimate, from 2.0% to 2.2%, assuming a little more economic dynamism and more aggressive fiscal policy than in continental Europe.

JAPAN: We continue to expect inflation in Japan to severely undershoot the Bank of Japan's 2% goal, forecasting an unchanged 0.7% rate. Japan's aging population will likely limit economic growth, while its already massive government debt should curtail its ability to implement significant fiscal stimulus.

Emerging market inflation

Central bank credibility is even more important for emerging markets to achieve desired inflation outcomes.

CHINA: We expect 2.5% inflation in the long run, unchanged from last year's edition. Plenty of forces could push Chinese inflation higher, but the government is acutely aware of the need to prevent financial or economic bubbles, and it appears willing to adopt more restrictive monetary and fiscal policies than in the U.S. or Europe to keep inflation under control.

INDIA, MEXICO AND BRAZIL: We have cut our forecast of Indian inflation, from 5.0% to 4.5%. This partly reflects a slower economic growth path going forward than we expected a year ago. We continue to believe that inflation will exceed central bank targets in Mexico and Brazil, and leave our forecasts unchanged, at 3.7% and 4.3%, respectively.

RUSSIA AND TURKEY: We believe central bank credibility may be moving in opposite directions in these economies. Consequently, we reduce our forecast for Russian inflation, to 5.0%, and increase Turkey's, to 12.0%.

[2] The LTCMAs project CPI inflation; our 2.3% CPI forecast over the next 10 to 15 years likely equates to roughly a 2.1% consumption deflator inflation rate.

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