*2021 Economic Outlook: Problems, Yes, But Opportunities, Too*

*By Steven P. Lanza, Associate Professor-in-Residence, UConn Department of Economics*

We’ve lived through a year like no other in modern memory, one that has turned lives and economies upside down. But as we look forward to a new year where vaccines promise to begin to restore some normalcy, there will be much rebuilding ahead. That work will present both problems and opportunities for the world, the nation, and the state of Connecticut.

**The Global Economy**

Following growth in world output of 2.4% in 2019, the International Monetary Fund (IMF) projects that the global coronavirus epidemic will have slashed the value of world output by 4.4% in 2020. Assuming the widespread distribution of vaccines and therapeutics, along with continued fiscal and monetary policy support, output should expand by 5.2% in 2021, more than enough to restore output to pre-pandemic levels.

For the world’s advanced economies, including the United States and Western Europe, the prospects are not quite so rosy. The toll of the pandemic was likely greater—a 5.8% drop in output—and the rebound is expected to be less brisk—a 3.9% uptick in the new year. But in emerging markets and developing economies the picture is reversed: a 3.3% decline in output in 2020 followed by a 6.0% surge in 2021. The leader here is Mainland China, where the virus originated. A swift and severe lockdown allowed the country to check the spread of infection and to preserve a modicum of positive, 1.9%, growth for the year. China’s economy is expected to swell by more than 8% in 2021.

Global inflation is expected to remain tame although opposing forces will obscure the path that prices might follow. If the recovery releases pent-up consumer demand at a time that continued supply disruptions raise production costs, prices could veer upward. But if worries about health risks and job losses prompt consumers to save more, and if wage and salary growth skews to upper income groups with lower propensities to spend, prices could dip down.

On balance, relatively weak demand paired with considerable excess capacity in economies across the world is expected to contribute to subdued price pressure. In advanced economies, inflation will likely inch up to 1.6% in 2021, following a tepid 0.8% rise in 2020. Among emerging markets and developing economies, 5.0% inflation in 2020 will cool to 4.7% in 2021.

Unlike previous downturns which typically claim the most jobs in economies built on manufacturing, the global recession ushered in by COVID-19 has been costliest for service-based economies that rely on personal interaction in industries such as trade, hospitality, arts and entertainment. For some countries, like the tourism-dependent economies of Greece and Iceland, a full jobs recovery will likely await the complete containment of the virus. But the pandemic’s repercussions are likely to be transformational everywhere as resources are redeployed to accommodate permanent behavioral shifts toward remote working and online shopping.

**The U.S. Economy**

The Federal Reserve Bank of Philadelphia’s latest Survey of Professional Forecasters projects that the that when all is said and done, U.S. economic output will have contracted by 3.5% in 2020, but that it will rebound at a 4.1% rate in 2021. Both numbers are a bit more optimistic than those advanced by the IMF which puts the 2020 drop in U.S. output at 4.3% and the 2021 bounceback at 3.1%. These small differences have large implications: the Fed forecasters expect a full recovery of GDP in 2021, while for the IMF, that recovery is delayed until 2022.

As the U.S. economy slowed in 2020, inflation slipped to 1.3%, down from 1.8% in 2019. But as the expansion gains ground, Philadelphia Fed’s professional forecasters expect inflation to return to a pre-pandemic pace, averaging 2.0% in 2021. That’s slower than the IMF’s forecast of a 2.8% rise in U.S. prices but still consistent with the view that the forces allied in quickening the economy’s pace will gain the upper hand.

On the jobs front, the consensus among U.S. forecasters in the Philly Fed survey is that payrolls will advance at a monthly rate of 321,600 in 2021, or by 3.9 million for the year. Though nearly double the pace of payroll growth compared with the pre-COVID economic expansion, job gains of that magnitude won’t even cut the country’s remaining 10-million job deficit in half, so there will still be plenty of job recovery work to do in 2022.

Aggregate forecasts of job and output growth obscure the more complicated underlying dynamics associated with the recovery from the COVID recession. Analysts have proposed an alphabet soup of recovery descriptions—V-shaped, W-shaped, L-shaped, U-shaped—but the most unusual and this time most appropriate might be a K-shaped recovery. The left stem or stroke of the letter K represents the economy’s sudden and unprecedented descent into recession in March and April, and its equally sudden although only partial retracement of that vertical path upward as the economy partially reopened in the summer months. Now the economy is following two simultaneous but divergent paths. Some sectors are enjoying a fairly robust rebound: that’s the K’s ascending arm; but others are still lagging: that’s the K’s descending leg.

These diverging fortunes are, in some cases, simply accelerations of trends that were well established before the pandemic. Clearly, any activities that can shift from traditional workplaces to homes and be conducted remotely, have gained renewed advantage. While this has especially benefited highly skilled, high income workers who can telecommute some lower skilled occupations have been helped too (e.g. home-based customer service support). Similarly, online retailers have flourished, while traditional brick and mortar stores have languished. Thus, sectors focused on moving things, such as transportation and warehousing, have expanded, while those requiring personal contact, such as hospitality, tourism, and entertainment, have waned.

In other cases, diverging economic fortunes have firm roots in the unique medium of the pandemic. Recessions are typically hard on goods-producing industries (as consumers who are tight on cash postpone purchases of new durable items and get by awhile longer on their old ones) but go easy on service industries. The virus-induced shutdowns and quarantines, however, have upended the usual formula and shifted consumer buying patterns. We buy goods (gym equipment, food and beverages for meal preparation at home) rather than services (gym memberships and meals eaten out at restaurants). With people spending more time at home and mortgage rates at historic lows, residential real estate has flourished (to the delight of homeowners and the chagrin of new home buyers) while commercial real estate has suffered.

Whether and to what extent these divergences will narrow or resolve once the pandemic is over is hard to say. Near term, things may get worse as the virus surges in the cold weather and the vaccines are slow to roll out to the general public. Longer term, the bars and restaurants will reopen if patrons still have an appetite for them. But in many cases the success of the recovery will hinge on the ability of store clerks, Uber drivers and short-order cooks to become electricians, plumbers and software engineers.

**The Connecticut Economy**

As Connecticut’s COVID death toll soared in spring, the state lost a staggering 291,000 nonfarm jobs. Putting that number in perspective, it’s nearly twice the blow suffered in the early 1990s recession, more than four times the loss in the 2000 recession and fully 1 of every 6 jobs in the economy as of February. Remarkably, by year’s end, the state had reclaimed two-thirds of the jobs given up.

But the slowing pace of monthly employment growth suggests the easy part is over. Many who were temporarily laid off have been rehired, leaving those permanently let go still looking for work. The mounting surge of new infections across the country and across the state will impede that progress, but with vaccines now rolling out, 2021 will be a year of solid rebuilding.

On a year over year basis, Connecticut’s payrolls will have shrunk by over 110,000 jobs in 2020 with three sectors alone—accommodation and food services, retail trade, and health care—accounting for the majority of those losses. According to IHS Markit (formerly Global Insight, an economic forecasting organization) the state should add about 65,000 jobs in 2021, with most of the gains centered in those same hardest-hit industries, as life regains a greater semblance of normalcy.

In the state’s flagship industries—finance and insurance, and durable goods manufacturing (e.g. aerospace, shipbuilding)—where wages are high and jobs represent a larger share of the total than nationally, the job losses were far less severe: finance surrendered fewer than 3,000 jobs year-over-year, durable manufacturing fewer than 4,000. Even so, Connecticut will struggle to recoup these losses. IHS Markit projects that by the end of its 2023 forecast horizon the finance sector will make a recovery but manufacturing will still fall short.

The year 2023 will mark the return to 2019 employment levels in Connecticut, according to IHS Markit, thanks largely to anticipated growth in the state’s professional and business services sector, which includes a wide array of jobs in research, consulting, law, engineering, computer design and more.

With jobs returning, the unemployment rate will ease, continuing its descent from 2020's average level of over 7%, to less than 6% in 2021 and to below 4% by 2023. There may be more people affected by the downturn than shown in the official unemployment measure. In mid-2020 there were more than 350,000 workers claiming unemployment benefits including those receiving benefits under the Pandemic Unemployment Assistance program (PUA) - a program for the unemployed self-employed. The total including all programs fell to less than 200,000 by early November.

In terms of GDP, Connecticut’s recovery will come more quickly. IHS Markit estimates that 2020 will have sliced 3.7% from the state’s real gross product but a projected 4.1% rebound in 2021 will lift state output above pre-pandemic levels. State GDP growth will range between 2% and 3% in 2022 and 2023.

Ditto for wages and salaries. In IHS Markit’s assessment, wage and salary workers saw just a 0.9% drop in earnings in 2020 (though after accounting for inflation real earnings slipped more than 2%). But the rebound is expected to boost earnings by 6% in 2021, 4.7% in 2022, and 3.7% in 2023 with inflation remaining in check throughout the forecast period.

Reading the tea leaves for glimmers of a brighter future for Connecticut, one can divine at least a couple of possibilities. First, the state’s housing market is booming as virus-weary urbanites flee cities for the haven of Connecticut’s socially-distanced suburbs. According to data from William Pitt Sotheby's International Realty, Connecticut home sales swelled 18% in 2020 compared with 2019. The increase was particularly remarkable in the $400,000-plus price range where sales jumped 58%. Connecticut’s economy surged in the ‘60s and ‘70s during a similar urban exodus so even a modicum of renewed interest in our state as a place to live and work could do much to boost our fortunes.

Second, new business formations are at record levels in Connecticut according to data tracked by the Secretary of the State’s office. Even net starts, which subtracts businesses that shutter their doors, match their former peaks in the mid-2000s. Connecticut is a cradle of Yankee ingenuity, and has had a long history of innovation and of finding practical solutions to vexing problems. The historic surge in new businesses, no doubt born of the disruption arising from widespread job layoffs, nonetheless illustrates the ability of Nutmeggers to adapt to changing circumstances and to take their futures into their own hands. n