

Making Sense of the Bottleneck Economy

To BCG's network around the world,

As I've mentioned in the past, when the economy is in the headlines, I find it incredibly helpful to check in with our chief economist at BCG, Philipp Carlsson-Szlezak, for his latest thoughts. I've shared with you Philipp's astute insights about inflation and the global growth outlook. In my latest conversation with him, we talked about bottlenecks in the US economy—a trend already going global—and the outlook for labor and product markets. I'm so pleased to be able to pass along some of Philipp's thinking here—a longer read than usual, but I found his thoughts super interesting.

Since the pandemic-induced shocks of 18 months ago, the US economy has bounced back, beating all expectations. But in an economy producing more than it was before COVID-19, with 5 million fewer workers, it's no surprise that stress is pervasive. Today, companies are scrambling to hire workers and struggling to prevent disruptions in supply chains from curtailing production. Because the US deployed extraordinary pandemic-relief stimulus, it's the first economy to face bottlenecks. But they're showing up in other parts of the world now too, and will be increasingly common.

Is this stress a temporary or permanent feature of the post-COVID expansion globally? According to Philipp, the answer lies in looking at supply and demand for labor and products.

What's Really Going On in the US Labor Market?

If companies are complaining that they can't fill job openings, that might suggest that demand is simply too high. But that's a misguided approach. Total demand for

labor is actually not back to pre-COVID levels, a fact that would be true even if all new openings were filled right now. Instead, labor market stress is due to two factors:

First, speed. Hiring is simply harder and slower than firing. Letting go of more than 22 million workers in two months was, however painful, generally not a complex task. Hiring back that number in even twice that time is not plausible. So it's no coincidence that hospitality, which laid off the most workers, is now struggling the most to hire workers back, having to aggressively hike salaries to get them. That sector's spike in wage growth is driven more by the scramble to hire than it is by the number of job openings. Once the hiring backlog eases, so should the pressures.

Second, labor supply is normalizing on its own slow timeline. As the pandemic spread, 8 million workers left the labor force. Many started to return as the job market improved and vaccines became available, but those with care responsibilities—primarily the middle-aged—have not returned at the same rate. While many kids are back in school in person, Delta's shadow and vaccine mandates have thrown a wrench into the story of a strong labor supply return this fall.

Wage Pressures Will Persist

Though the worst labor bottlenecks should ease, likely by the middle of next year, the labor market will remain tight, and wages will continue to grow in real terms. This is in stark contrast to the last cycle, when firms got used to abundant labor supply and flat wages in real terms for much of the ten-year expansion.

But with the post-COVID cycle starting with tight labor market conditions, wage pressures will be a persistent feature for the rest of the expansion. To avoid absorbing wage pressures in their margins, companies will have to offset them by fostering [productivity growth](#). US firms typically respond to tight labor markets with greater capital investment—one reason there should be a [tailwind](#) to productivity growth in the coming years.

Product Markets Are Snarled by Demand Overshoot

Filling jobs is not the only headache. There are daily headlines about companies struggling to meet demand for their products because of snarled supply chains, perhaps most notably in autos. Has demand outstripped productive capacity (a shortage) or is supply just out of sorts (a bottleneck)?

Very strong demand is the bigger story here. Retail sales are over 20% above the 2019 average level and will likely stay high as households fueling this boom enjoy

strong wage gains, large piles of savings, and record net wealth—even at the bottom of the wealth distribution. They are able and likely to [sustain this consumption boom](#), even if COVID has altered the composition of demand.

It's this demand boom—more than inadequate supply—that has pushed down inventory-to-sales ratios across the economy. In fact, inventories themselves are mostly growing or stable, suggesting that, in aggregate, production is keeping up with consumption. There are notable exceptions—again, most significantly in the auto industry. The aggregates hide the sharp pain that single missing components can create for companies and products, pain that will likely persist well into 2022 and beyond for some.

But the most agile firms will also see opportunities to capture market share in a strong economic expansion. And the gyrations in product markets are unlikely to threaten that expansion. In fact, the aggregate response to the bottlenecks—investment in capacity and restocking of inventories—could be a tailwind to at least some post-COVID economies around the world.

Please see below for related content from Philipp and team, who regularly publish insights on the economy in some of the world's leading business journals. If you're interested, [click here](#) to add your name to his distribution list.

Until next week,

A handwritten signature in black ink, appearing to read "Rich", with a stylized flourish at the end.

Rich Lesser
Global Chair

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