NRF National Retail Federation

MONTHLY

Economic Review

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The data for this report is released on a rolling schedule. The presented numbers are current as of publication and are subject to revision.

SYNOPSIS | A New Economic Expansion is Underway, But How Long Will It Last?

Coming up on two years since the end of the brief recession caused by the pandemic, we appear to be at the middle of the current economic cycle. The maturing economy remains in growth mode and there is good reason to expect it will soon approach normal trends. Despite ongoing challenges, we are clearly still in an expansion phase. The question is how long it will last as policymakers try to strike a delicate balance between encouraging growth and taming inflation.

Economic cycles go from expansion to contraction and then back again, with both phases usually taking place over a period of several years. From 1945 to 2019, the National Bureau of Economic Research defined 11 cycles lasting on average a bit longer than five and a half years. The most recent pre-pandemic cycle began in 2008-2009 and lasted about 12 years before it was ended by the 2020 recession.

Unlike the gradual pace of most economic cycles, COVID-19 brought such a shock to the economy that we experienced an amazingly squeezed mini-cycle in early 2020 — a quick, deep decline followed by a fast, steep recovery. Last year, the NBER said the recession sparked by the pandemic had ended in April 2020, just two months after it had begun in February 2020. That made it the shortest recession in U.S. history, even briefer than a six-month recession seen during the 1980s. The NBER traditionally defines a recession as a decline lasting “more than a few months.” But the bureau declared the 2020 downturn a recession despite its short length because there had been such an unprecedented magnitude of decline in employment and production and such broad reach across the entire economy.

Why does this matter? Understanding the expansion-recession-resurgence characteristics of an economic cycle helps point to appropriate policy paths. Our nation is currently in the process of policy normalization, and the key to extending the expansion is to balance growth, inflation and interest rates. Strong growth without inflation is the ideal scenario, but that is not the case today.

Clearly, this expansion is different from the last, and the policy approach will be different. Inflation is higher and may prove to be more persistent than expected, growth is well above trend, and the labor market is tight. When the Federal Reserve last began economic tightening by raising interest rates in December 2015, policy considerations were substantially different from those in play today. Gross domestic product growth was under 2 percent, inflation was under 1 percent and the unemployment rate was at 5 percent.

By contrast, GDP grew an impressive 6.9 percent in the fourth quarter of 2021, up from 2.3 percent in the third quarter. As a result, real GDP was up 5.7 percent for the year, the fastest growth for any calendar year since 1984. Unlike other periods of robust economic growth, 2021 was artificially boosted by massive government stimulus, particularly early in the year. Fourth-quarter household spending was slower than in the first half of the year but still accelerated. Omicron occurred late in the fourth quarter and was not a major restraint on growth, although it will be a temporary drag during the first quarter this year. Looking forward, the economy should be at or near full employment in the first quarter and inflation is expected to slow but still rise 3.6 percent. For all of 2022, I expect GDP to grow between 3 percent and 4 percent, still faster than the 2.3 percent annual pace during the previous expansion and the economy's long-term trend.

It has been over four months since federal stimulus in the form of temporary supplemental unemployment benefits ended, but the economy is still running hotter than it has in a long time. Monetary policy will be completely different in 2022 as the Fed shifts direction from accommodation to tightening. The economy is sturdy enough to stand on its own and can sustain itself toward a growth environment without the pandemic stimulus and monetary policy of the past two years. Excess liquidity growth has likely switched from a tailwind to a headwind in 2022 as increased spending and demand have led to inflation. But relief from inflation should come as the result of less accommodative monetary policy in the form of higher interest rates planned by the Fed for 2022.

Against this backdrop, it will be interesting to determine spending trends and what might stymie spending. It is important to keep in mind that in the past, the Fed has only tightened its policy when the economy was doing well, as it is today. It is not clear how Fed policy will develop and there will be indigestion as we adjust to new policies. But both businesses and households are fundamentally in good financial shape and COVID-19 is having less of an impact on economic activity despite its ongoing concern as a health issue.

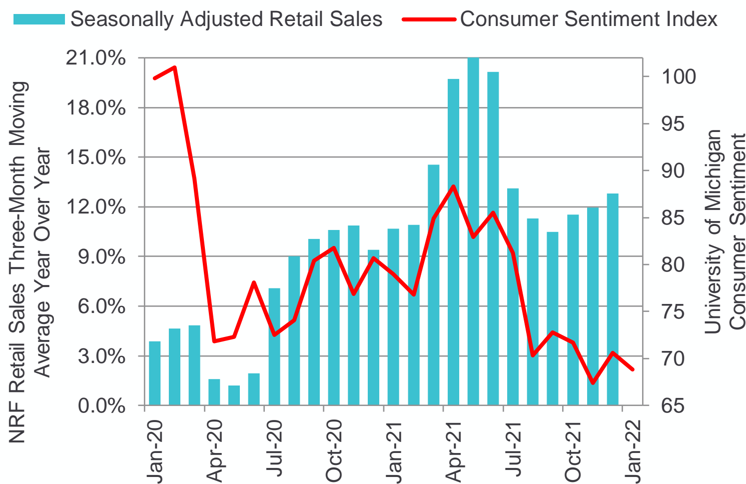
The Fed indicated just last week that it expects to begin raising its benchmark interest rates going forward, and there is plenty of room to raise rates without threatening the economy. The Fed's goal is to increase the cost of credit across the board. Higher interest rates will make car, student and home mortgage loans more expensive for consumers, and everyone will end up spending more on interest payments.

Nonetheless, households are poised to continue to spend due in part to the cash savings accrued during the pandemic. In addition to shopping, Americans are returning to pre-pandemic behavior like eating out, traveling and attending entertainment events, so more industries will be able to fully reopen and a good portion of those savings will return to the economy as COVID-19 dissipates. In turn, there will be a record number of jobs to fill, leading to higher wages and continued increases in consumer spending.

The Fed wants to be flexible in how and when it raises rates as it needs to be positioned to respond to a full range of circumstances. There are many risks we are keeping our eyes on, including inflation, taxes, interest rates, COVID-19 policies and more. With less fiscal support and the Fed combating inflation, 2022 could see considerable tightening of financial conditions that could conceivably shorten the economic cycle. The key is to bring inflation under control without artificially bringing on another contraction before its time.

SALES AND SENTIMENT

Retail spending was robust in the last quarter of 2021 and showed record gains. Meanwhile, consumer sentiment remained depressed and disconnected relative to consumer spending fundamentals.

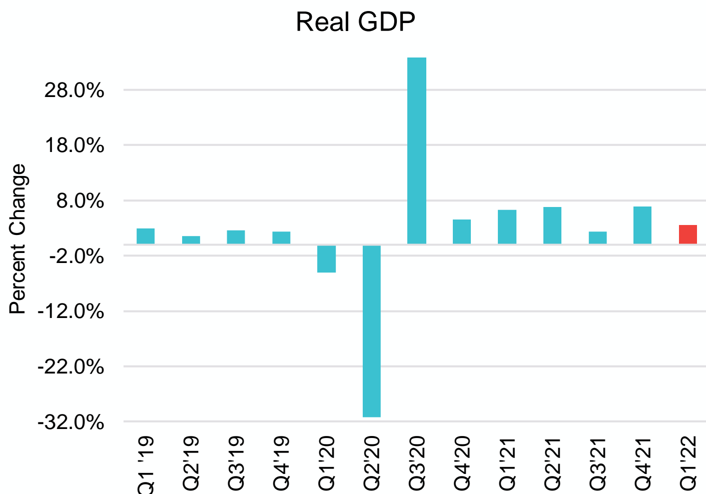


HOLIDAY SALES

Holiday season sales grew 14.1 percent, exceeding NRF's forecast and setting a record despite inflation and supply chain disruptions and the outbreak of the omicron variant.

GROSS DOMESTIC PRODUCT

Real gross domestic product grew an astounding 6.9 percent in the fourth quarter of 2021 but is expected to slow to 3.5 percent during the first quarter of 2022.



HOLIDAY HIRING

Holiday hiring exceeded NRF's forecast of between 500,000 and 650,000, reaching approximately 685,000 jobs.

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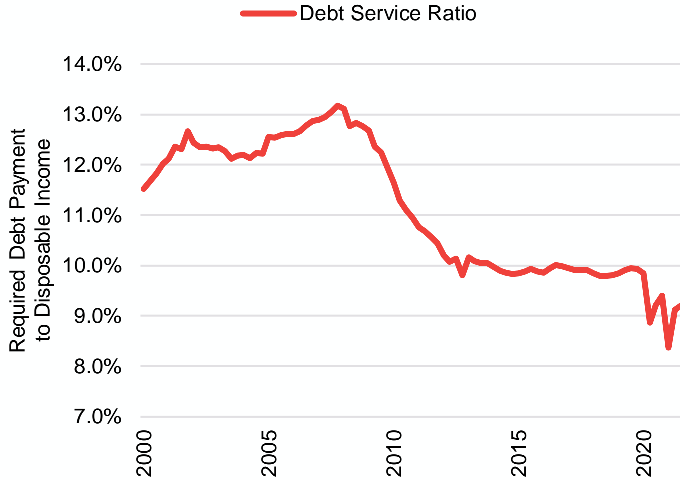
DEBT BURDEN

Debt burdens relative to income were at record lows before the pandemic but are even lower today. The third-quarter reading reaffirmed that household finances remained in good shape.

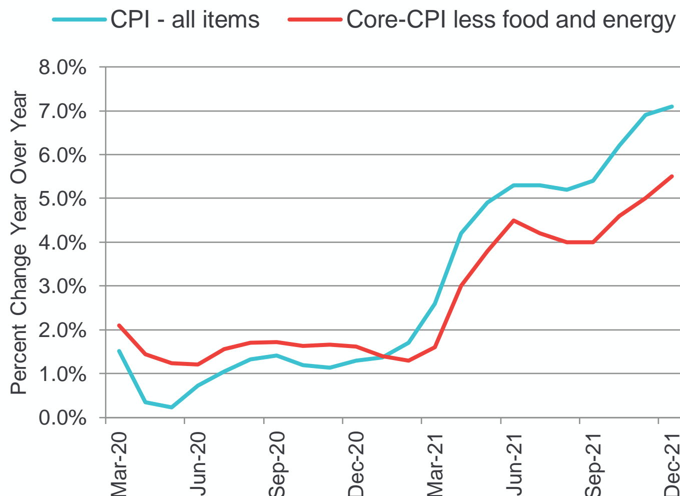


SUPPLY CHAIN

The New York Federal Reserve Bank's supply chain gauge suggests pressure remains high but may have peaked. Zero on the scale indicates average pressure while higher numbers show increased pressure.

INFLATION

December's 7 percent year-over-year increase in the Consumer Price Index was the largest in nearly 40 years. Strong price increases are expected for the next few months but should slow later this year.



LEADING ECONOMIC INDEX

The Conference Board's Leading Economic Index climbed 0.8 percent in December to 120.8 and was 10.2 percent higher than the beginning of 2021. Overall, the index is signaling growth over the next six months.

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