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 | Coping with uncertainty – again

As we kick off 2022, we should be ready for another very challenging year of substantial uncertainty with many questions to be answered. Is the pandemic near its end? Will supply chain disruptions be resolved? How high will inflation go and how long will it last?

The economy is currently managing through another COVID-19 winter, exacerbated by the rapid transmission of the omicron variant. Even with the experience of the past two years, there is no model that can predict how the economy responds to a pandemic. What we have learned is that each successive variant has slowed down the economy but that the degree of slowdown has been less. Omicron has driven COVID-19 cases to record highs and epidemiologists have been crunching data from the front lines as fast as it can be compiled to understand what the new variant means for the winter and beyond. Researchers have cranked out several potential scenarios for what the first months of 2022 may have in store. Even the most optimistic scenarios aren't exactly pleasing and with many people still unvaccinated some experts say this could be the deadliest phase of the pandemic yet. But while omicron is highly transmissible, its effects can be relatively mild for those who are fully vaccinated and broad-based lockdowns are not expected.

Supply chain disruptions are likely to persist well into 2022, partly because of the resurgence of COVID-19. Little is certain about omicron's impact on consumer demand, but people who stay at home because of the variant are more likely to spend their money on retail goods rather than services like dining out or in-person entertainment. That would put further pressure on inflation since supply chains are already overloaded across the globe. In addition, infections among port workers and truck drivers could become a speed bump to the supply chain progress underway.

Inflation started gradually and then came on strong, but clearly heated up during 2021 and has become a formidable factor facing the economy and especially consumers. Current inflation has many causes and neither demand nor supply alone is to blame. Instead, it is the result of a mix of forces. Prices fell precipitously in early 2020 with the initial pandemic-induced collapse of the economy. Then came government stimulus that helped induce demand, which quickly ran up against restricted supply and caused bottlenecks and shortages. As stimulus flowed through the economy and more businesses reopened, inflation continued into 2021, when it was fueled by the availability of vaccines that helped the economy further reopen. By the second quarter of 2021, consumer spending adjusted for inflation jumped at a 12 percent pace. What is ironic is that the monetary and fiscal policy that pulled the economy out of the recession has prompted unprecedented growth that is now undermined by accelerating prices.

Economists and policymakers have acknowledged that they don't know how high inflation will get or how long it will last, and such uncertainty adds to the probability that widespread inflation will, in fact, occur. That's because volatile prices can have a negative impact on the economy and worries about inflation can become a self-fulfilling prophecy. When prices are unanticipated and mixed with the impact of COVID-19, people are unable to adjust and protect their purchasing power. Likewise, the underlying conditions of supply and demand complicate business planning and investment decisions. If prices reflect rising demand for goods and services and workers believe prices will keep rising, they will demand higher wages — which will force employers to raise prices.

Researchers find that consumer beliefs about inflation are shaped by what they can see — extreme changes in grocery prices, especially goods purchased frequently such as milk and bread, for example — rather than government reports. Consequently, economists focus not only on actual inflation but inflation expectations. The Federal Reserve Bank of New York's Survey of Consumer Expectations follows how consumers expect overall inflation and prices for food, gas, housing and education to behave. Its most recent edition shows consumers expect prices to increase 6 percent over the next year but only 4 percent over the next three years. However, consumers conveyed increased uncertainty about future inflation.

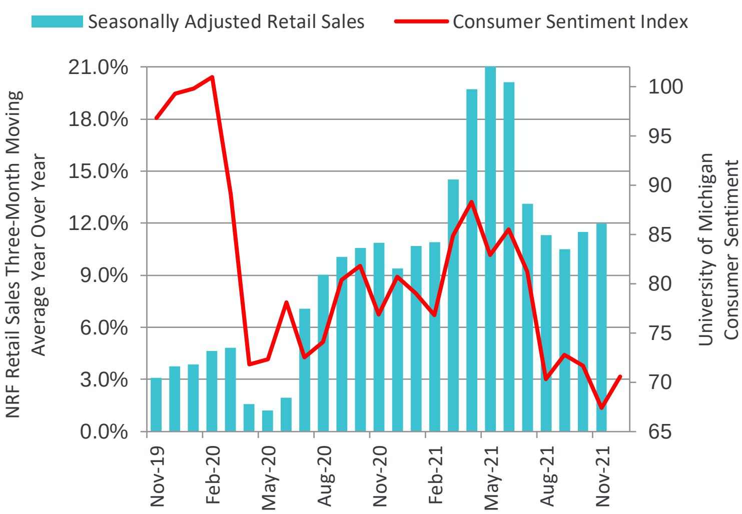
In December 2020, inflation as measured by the Personal Consumption Index registered only 1.3 percent, far beneath the Federal Reserve's long-run target of 2 percent. Nearly a year later in November 2021, the index posted 5.7 percent year-over-year growth, the most in nearly 40 years. Since December 2020, inflation has increased 4.4 percent and is likely to persist above 2 percent. So-called base effects, however, will play an important factor in the coming year: As we move further along, there should be lower year-over-year increases because the comparisons will be against already-high numbers in corresponding months of last year.

Conditions for continuing U.S. growth look favorable and the gradual removal of pandemic monetary policy accommodation has begun. The Fed has announced that it is speeding up plans to withdraw support from the economy and has set the stage to potentially raise interest rates several times this year. While this might make it more expensive to buy big-ticket items like a car or home, it would make it more attractive to save, thereby cooling off a portion of inflation over time.

Consumer spending propelled growth in 2021 and will continue to be a bright spot as 2022 unrolls. The current recession recovery cycle is very different from previous ones. Consumers have never been as wealthy as they are today. In fact, consumer wealth grew an additional 18.1 percent year-over-year in the third quarter, keeping well ahead of inflation. If there is one lesson we have learned it is not to underestimate the resilience of the consumer and, therefore, the U.S. economy. With stimulus programs in the rearview mirror, consumer income and spending will instead be fueled by job growth paired with wage gains going forward. That said, the omicron variant could cause households to crunch down. Fed Chairman Jerome Powell recently said "people are learning to live with it" but households have already changed their behavior. Theater performances and concerts are being canceled and universities are returning to remote teaching. Fortunately, we have a lot of tailwind in terms of job growth, spending and production as we turn the calendar to 2022.

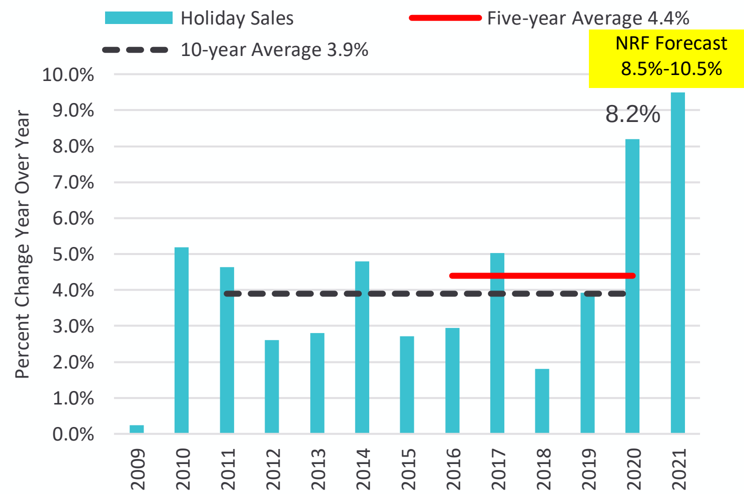
SALES AND SENTIMENT

Retail spending was strong in November, reflecting an uptick in trends from October. The continuing relative weakness in confidence continues to be disconnected relative to consumer spending fundamentals.



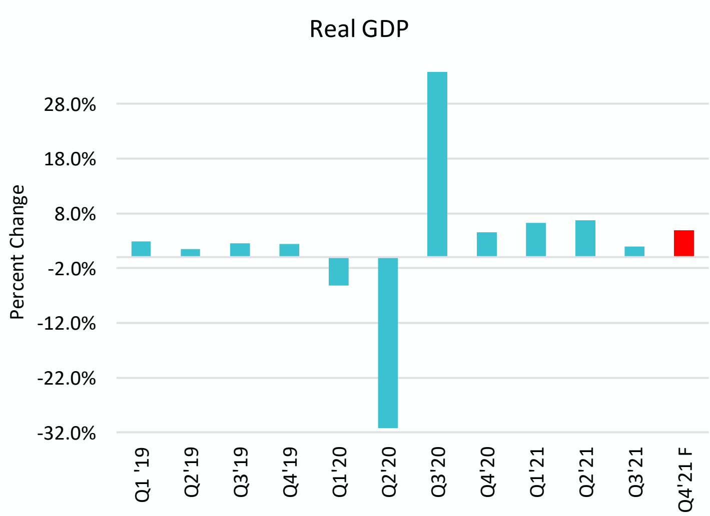
NRF HOLIDAY FORECAST

The holiday season appeared to be on track to meet or exceed NRF's 2021 holiday spending projection despite supply chain challenges, inflation and the omicron variant.



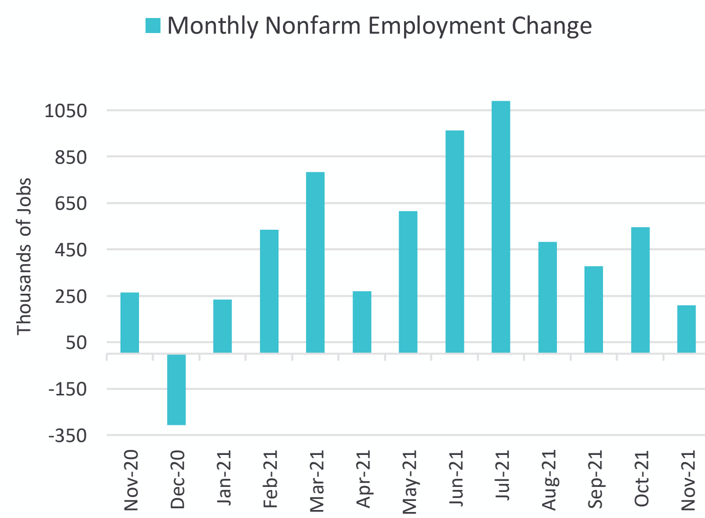
GROSS DOMESTIC PRODUCT

Real gross domestic product grew 2.3 percent in the third quarter of 2021 and is expected to rebound to 5 percent or better when fourth-quarter numbers become available.



EMPLOYMENT

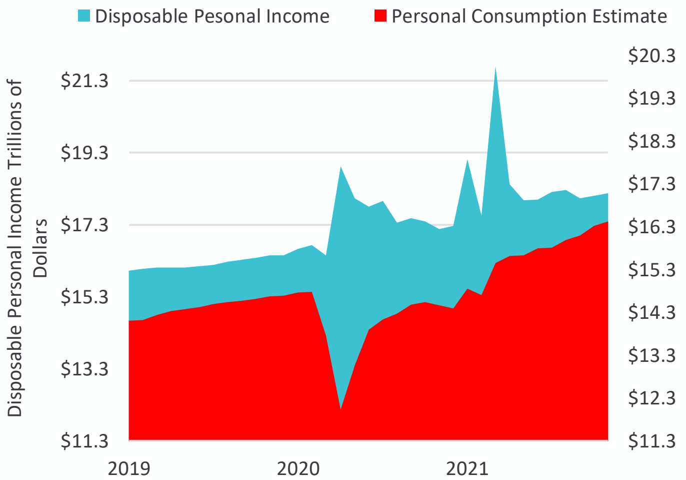
November payroll data again highlighted the roller coaster labor market ride created by the pandemic. Payrolls grew by 210,000 jobs but fell short of expectations.



NRF National Retail Federation

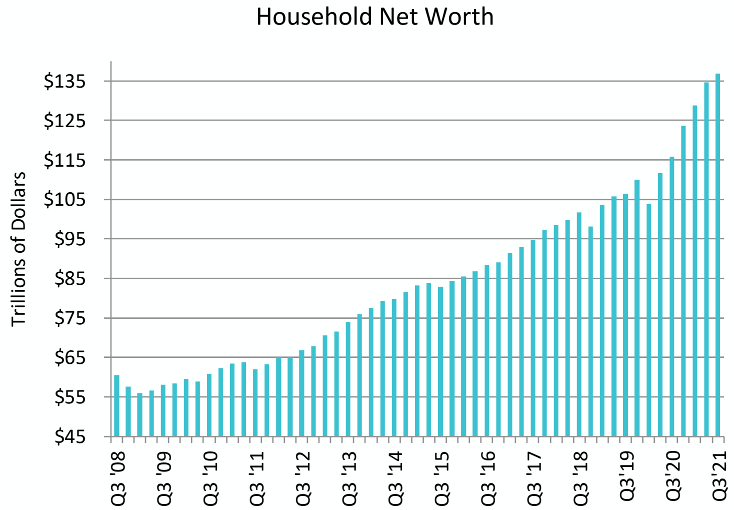
INCOME & EXPENDITURES

November disposable personal income increased 0.4 percent while personal consumption rose 0.6 percent. Income was up 5.8 percent and consumption up 13.5 percent year-over-year.



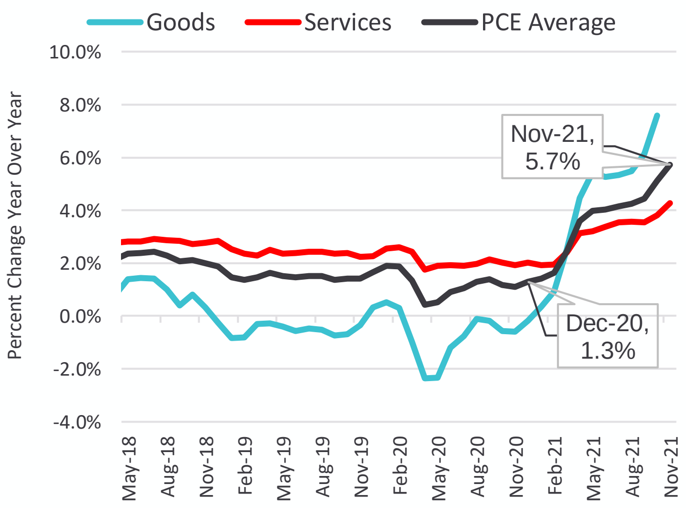
HOUSEHOLD WEALTH

Household wealth in the third quarter rose again, increasing $2.2 trillion. Year-over-year, wealth increased 18.1 percent after rising 20.7 percent in the second quarter



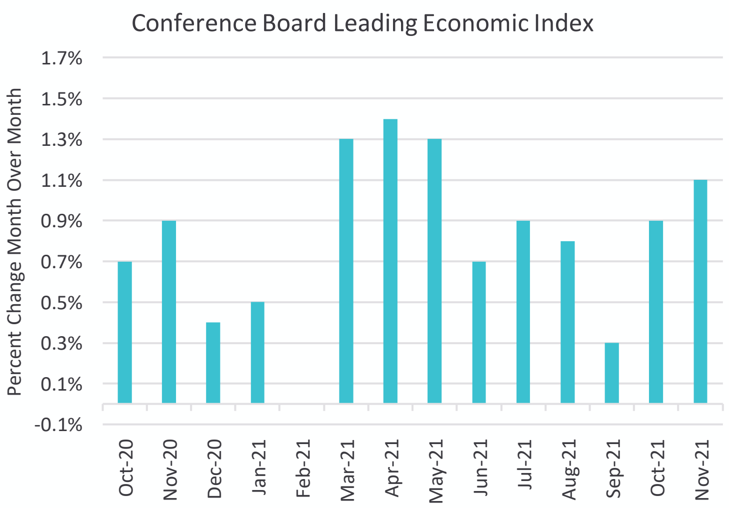
INFLATION

The PCE inflation index rose 0.6 percent in November, with 5.7 percent growth year-over-year, the most since July 1982. Inflation has increased 4.4 percent since December 2020 and is likely to remain elevated.



LEADING ECONOMIC INDEX

The Conference Board's Leading Economic Index climbed 1.1 percent. November's reading showed the economic recovery was on a healthy path and the largest improvement in six months.



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