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 | Inflation Continues to Weigh on 2022 Economy

The first whiff of the inflation we're seeing today came in April 2021, when the Bureau of Economic Analysis reported that personal consumption had suddenly jumped by 3.6 percent over the year before. That was more than double the rate at the beginning of the year and the strongest growth in 13 years. The jump was notably high, of course, because the comparison was against weak spending during the Spring 2020 government-ordered shutdowns of most of the economy. By comparison, inflation had been at only 0.4 percent year-over-year in April 2020. We are now at a similar pivot point for much the same reason. Given the unusually high level of consumer spending at this time last year, year-over-year comparisons should be less dramatic – though still strong – as new inflation numbers come out over the next few months. Furthermore, extraordinary and expansionary fiscal and monetary policies from the government that combined with pandemic-induced supply issues to cause high inflation are coming to an end. However, the conflict in Ukraine and Chinese coronavirus lockdowns have now taken center stage, causing higher energy, food and commodity costs. Adding to the mix and potentially compounding those disruptions is the recent surge in the BA.2 mutation of COVID-19.

The BEA's Personal Consumption Expenditures Index is the Federal Reserve's preferred measure of consumer inflation, and eventually soared to 6 percent by the end of last year and 6.6 percent this March, the highest level in decades. And even as year-over comparisons become less stark, the median forecast by the Fed for the end of 2022 is now 4.3 percent, up from 2.6 percent forecast in December 2021.

Surging inflation is the driving factor behind the central bank's current tightening of monetary policy. After raising rates by one-quarter of a percentage point in March, members of the Fed's Federal Open Market Committee plan more increases and expect the federal funds rates to reach 1.875 percent by the end of the year.

This tightening will continue through 2023 and is expected to hit a range of 2.5 to 2.75 percent, the highest mark since March 2008 during the Great Recession. How much and how fast the Fed raises rates will, of course, depend on how the economy performs in the months ahead. While policymakers would like to raise interest rates gradually, more aggressive action may be needed and appears to be the direction that will be taken. The Fed is far behind the price inflation curve, and there is a need to raise interest rates by a greater degree and more often than under customary practices.

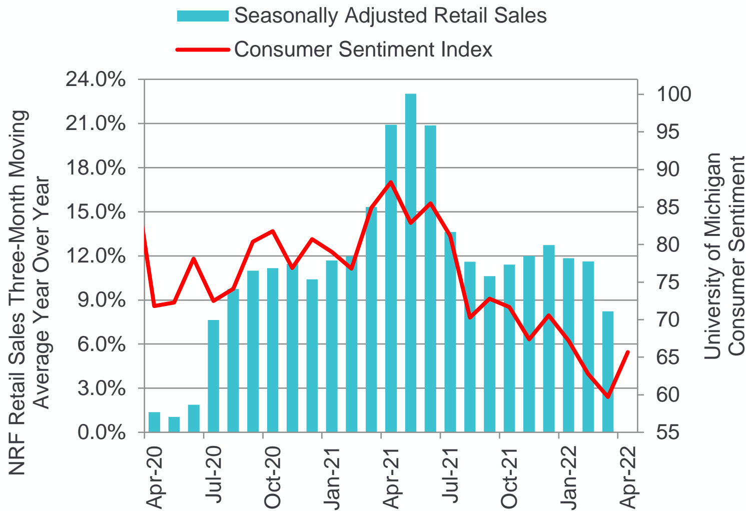
The Fed's alarm over inflation has extended to its balance sheet as well. The Fed more than doubled its asset holdings to about $9 trillion as it made monthly bond purchases to help stabilize markets during the pandemic. The assets are made up mostly of government-backed securities and mortgage-backed securities issued by Fannie Mae and Freddie Mac. Likely beginning this month, the Fed will start reducing its holdings to slowly remove the monetary stimulus it has been providing to the economy. The reduction in holdings will likely impact long-term interest rates through its effect on bond markets. As the Fed reduces holdings, the Treasury Department will need to issue a similar amount of new securities as the old securities mature, depending on other investors to buy them. Typically, when more bonds are supplied to the market, prices fall and yields go higher to attract investors.

The sustainability of the current economic recovery continues to be dependent on the U.S. consumer since 70 percent of the strength of the economy is the result of consumer spending. Because of that, inflation is a risk to economic growth via the household sector. While consumer sentiment remains at pessimistic levels driven by inflation worries, consumers have nonetheless kept up their spending habits. Headlines about inflation and the Russian invasion of Ukraine reinforce negative views on the economy but improved household finances remain steady. Spending for retail purchases was healthy in March and was evidence that consumers have a willingness to spend. Meanwhile, their ability to spend is supported by job growth, wage gains and wealth accumulated during the pandemic, while their financial obligations relative to income are low.

The rise in inflation was caused by neither demand nor supply alone but rather by the two interacting at the same time. Demand for goods and services rebounded more quickly than supply and the labor shortage and rising transportation prices have exacerbated inflationary pressures. The Fed is facing a tough problem. Its playbook for tightening of monetary policy can exert pressure on demand. It doesn't have a direct ability, however, to influence the supply side by producing more gas or oil, planting fields of needed crops or manufacturing microchips. Nonetheless, the Fed's tightening has kicked off a new cycle of adjustment and the outlook for interest rates has consequences for consumers and businesses alike. Higher rates will determine payments on household mortgages and car loans, on corporate debt and on government debt. There is a growing list of uncertainties, and the risks are mounting. But underlying strength and momentum from both the consumer and business sectors are likely to continue to offset a modest slowdown and should leave the economy bustling forward this year.

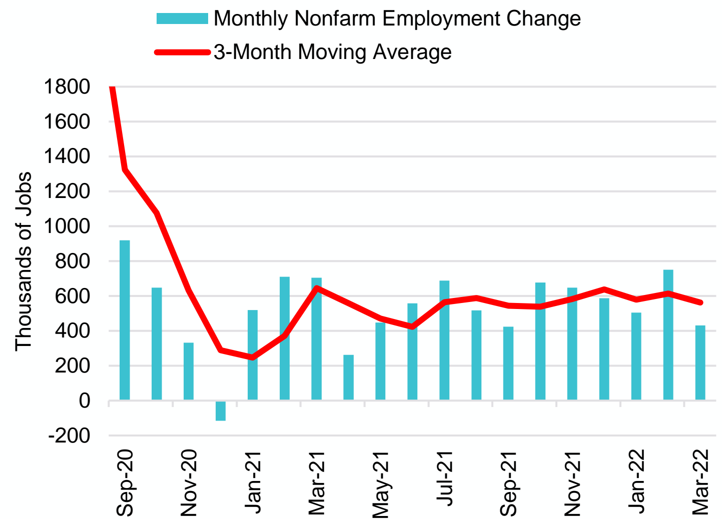
SALES AND SENTIMENT

Consumer sentiment remains relatively week despite an increase in mid-April. Nonetheless, retail sales remain in great shape even as inflation has edged higher.



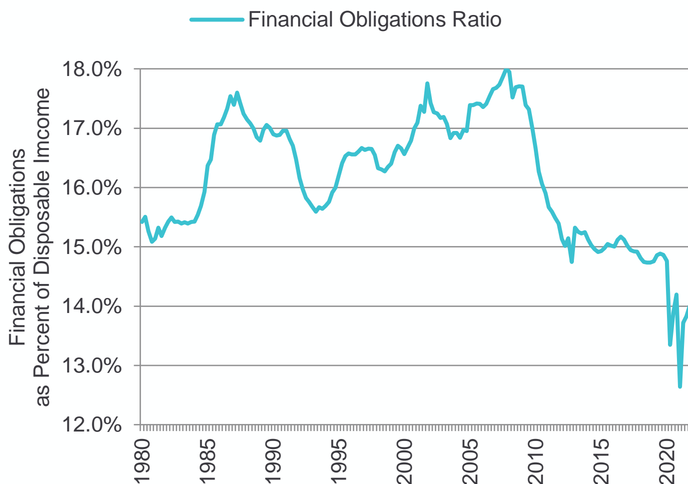
LABOR MARKET

The labor market is healthy as the pandemic continues to ebb. Employment increased by 431,000 jobs in February, bringing the current three-month average to 562,000.



FINANCIAL OBLIGATIONS

Household financial obligations relative to income were at record lows prior to the pandemic and remained low at the end of 2021. These include payments for loans, rents, auto insurance and property taxes.

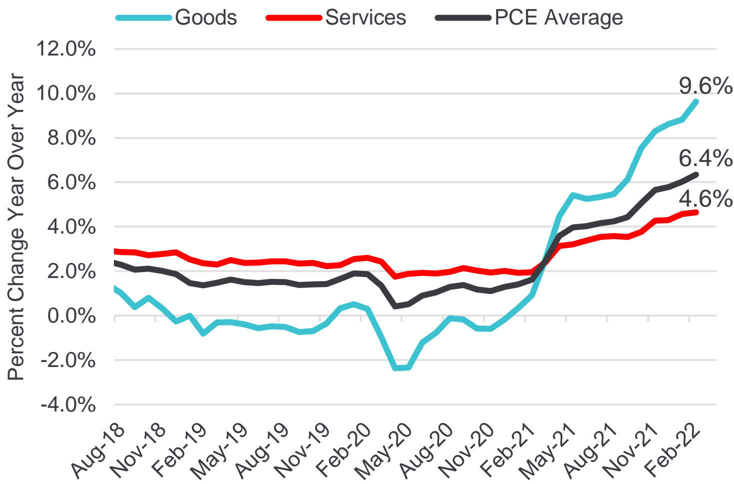


SUPPLY CHAIN PRESSURE

The New York Federal Reserve Bank's supply chain gauge points to an easing in global pressures since December. Zero on the scale indicates average pressure while higher numbers show increased pressure.

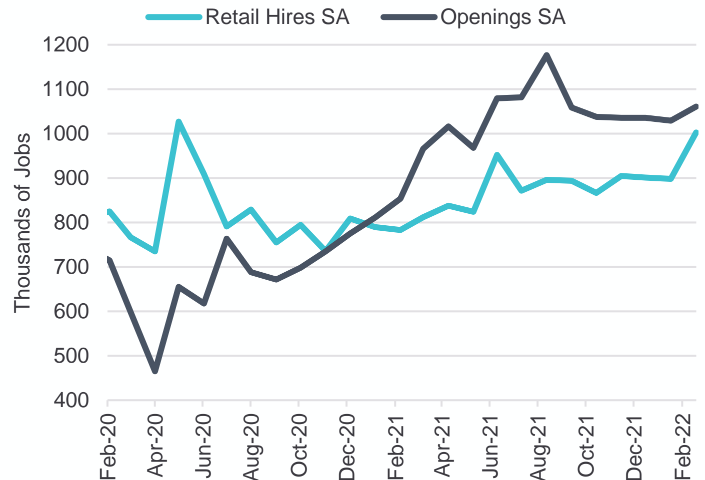
PERSONAL CONSUMPTION

The Personal Consumption Expenditures Price Index was up 6.4 percent year over year as of February. Inflation certainly was not transitory as was expected a year ago.



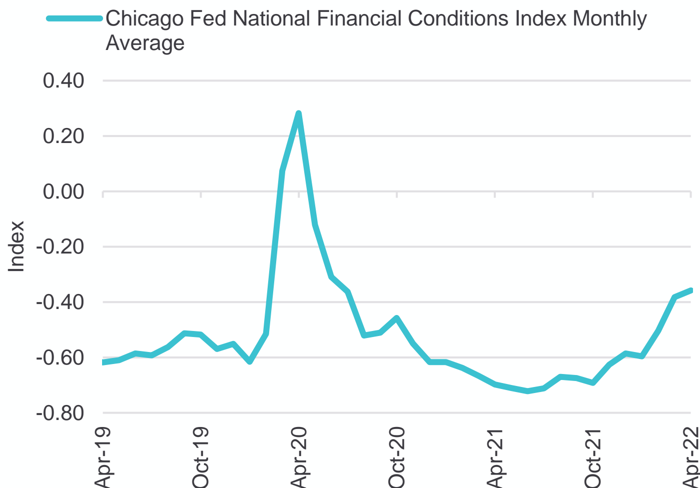
RETAIL EMPLOYMENT

Retailers have had 1 million job openings each month since June 2021 but were only able to hire an average of 910,000. The gap between openings and hires closed slightly at the end of February.



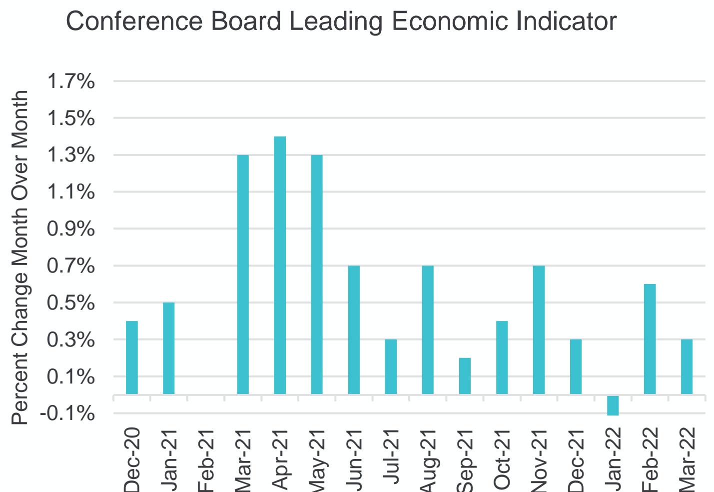
FINANCIAL CONDITIONS

The Chicago Fed's National Financial Conditions Index measure of U.S. financial conditions remains below average but is rising. A zero value equates to historical average levels of financial risk, credit and leverage.



LEADING ECONOMIC INDEX

The Conference Board's Leading Economic Index for March was slightly lower than February's but was still a positive sign for economic growth throughout 2022.



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