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 | Efforts to tame inflation could test the U.S. economy

With changes underway that focus on taming inflation without splintering the economy, the nation's economic system is in the process of being rebalanced in ways that are testing its resilience. The economy contracted in the first quarter and the question is whether succeeding quarters will show strength or weakness. This is an extraordinary period with unprecedented factors that include inflation at a 40-year high, uncertainty over the war in Ukraine, supply chain disruptions and the Federal Reserve raising interest rates. There's good reason why businesses, consumers and policymakers alike all feel uneasy.

The Fed raised interest rates by half a percentage point in early May and said it would begin paring its holdings of Treasury bills, bonds and notes along with other government securities. Inflation has been alarmingly higher and longer-lasting than the Fed expected, and the twin moves are designed to curb its growth. "Inflation is much too high," Chairman Jerome Powell said at a news conference announcing the actions. "We understand the hardship it is causing, and we are moving expeditiously to bring it back down."

The Fed has a tricky job on its hands. Increased interest rates will mean higher borrowing costs across the economy at the same time higher prices keep eroding the purchasing power of the U.S. consumer. But the central bank needs to act in order to prevent inflation from being baked into the economy and to reduce the risk that expectations of inflation will become unanchored. While the rate of inflation expected by consumers in the near term has moved up, expectations for the long term remain subdued. It is important to understand that the forces contributing to inflation cannot be quickly unwound and that it is difficult to tell how monetary policy will impact the economy. The Nobel economist Milton Friedman argued that monetary policy acts with a long and variable lag time and can sometimes aggravate rather than ameliorate economic fluctuations

Though many people fear an extreme cooling off of the economy, there is not an overwhelming amount of evidence to support such predictions. For this year as a whole, the Blue Chip Economic Indicators survey of economists currently projects that gross domestic product will climb 2.6 percent, slightly less than the April forecast of 3.2 percent. For 2023, growth is expected to be 2.1 percent. After expanding at an average pace of 5.7 percent last year, the U.S. economy contracted by 1.5 percent in the first quarter of 2022. While that was the first quarterly decline since the second quarter of 2020, there is less reason for concern than the figure suggests. Both consumer and business spending were solid, with consumer spending up at a 3.1 percent pace and business investment up at a 9.2 percent annual rate. GDP was pulled into the negative as international trade became a major drag on growth, with inventories and government spending also contributing negatively.

In general, the data suggests that we remain in an ongoing expansion. Nonetheless, understanding changes in payroll, retail sales and prices will be tricky in the next few months, with the contours of the economic outlook dependent on the pace of consumer spending.

The labor market is a powerful support for consumer spending, and recent strong hiring and increases in average wages suggest that the momentum of domestic demand remains sturdy. A positive sign is the historically tight labor market, which has experienced rapid job growth despite economic uncertainties and anxious markets. Payrolls increased by 428,000 jobs in April, marking the 12th straight month of gains above 400,000. Meanwhile, the unemployment rate remained at 3.6 percent, a kernel above the 50-year low of 3.5 percent recorded in February 2020 just before pandemic lockdowns sent the economy into a tailspin. In addition, the Employment Cost Index showed wages rising 5 percent compared with the first quarter of 2021. That was the highest reading in nearly two decades, but unfortunately not enough to keep up with inflation. And while initial claims for unemployment insurance are low, they have edged up in recent months — a possible signal of a turning point in the pace of the economy and employment if the trend continues.

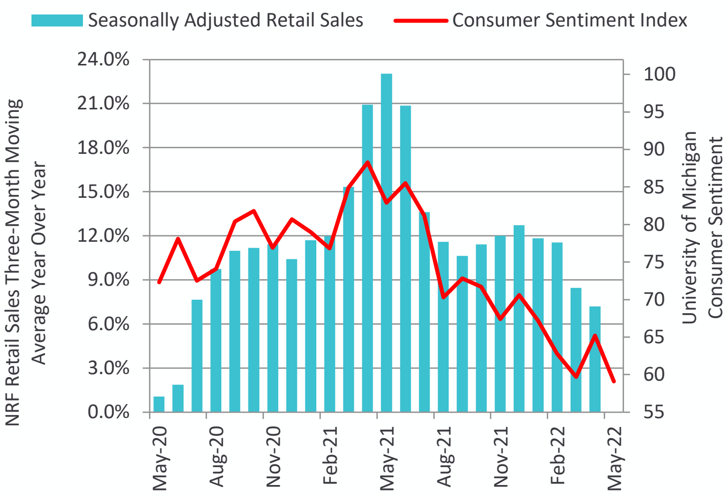
Even though consumers are pinched by inflation, April retail sales rose at a solid pace even compared with the Commerce Department’s upward revision of March figures. NRF’s calculation of retail sales — which excludes automobile dealers, gasoline stations and restaurants to focus on core retail — showed April was up 0.9 percent seasonally adjusted from March and up 6.4 percent unadjusted year over year. In March, sales were up 1 percent month over month and up 3.9 percent year over year. On a three-month moving average, retail sales were up 7.1 percent unadjusted year over year as of April.

We are watching closely to see if consumer spending can continue to hold up in the face of inflation. Households have kept up their spending habits, but their buying is shifting away from the pandemic-era focus on goods toward services as people re-engage with activities they had cut back on. Data indicates that pent-up demand from the pandemic continues to be unbridled. S&P Global Economics' U.S. real-time economic trackers show out-of-the-house “mobility” in retail and recreation was only 11 percent below the pre-pandemic trend through mid-April. Other measures such as the number of diners at restaurants, air traffic and hotel occupancy rates are close to their 2019 rates, but the recent pickup in new COVID-19 cases may dampen these activities as we head into summer.

For now, the economy looks sturdy but there is rising uncertainty, with questions ranging from the outcome of the Russia-Ukraine conflict to the impact of China’s lockdowns on the supply chain to whether the Fed can aggressively slow inflation without stalling economic growth. Hopefully, the next several months will provide the answers.

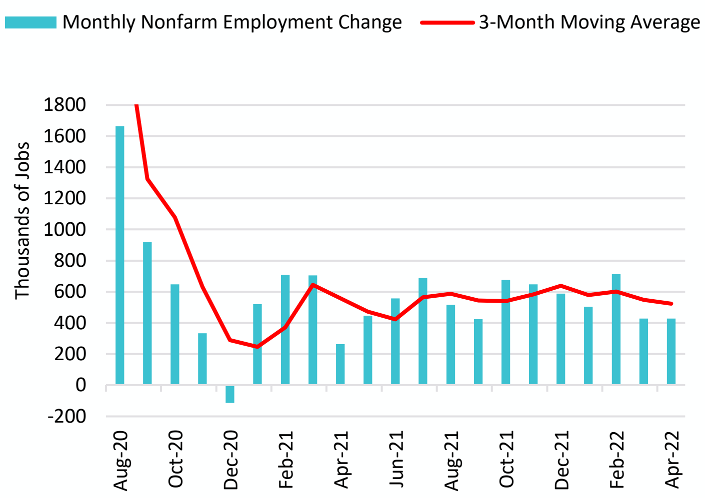
SALES AND SENTIMENT

May's reversal in consumer sentiment does not warrant an immediate concern. Retail sales continue to grow as expected at a slower-but-healthy pace.



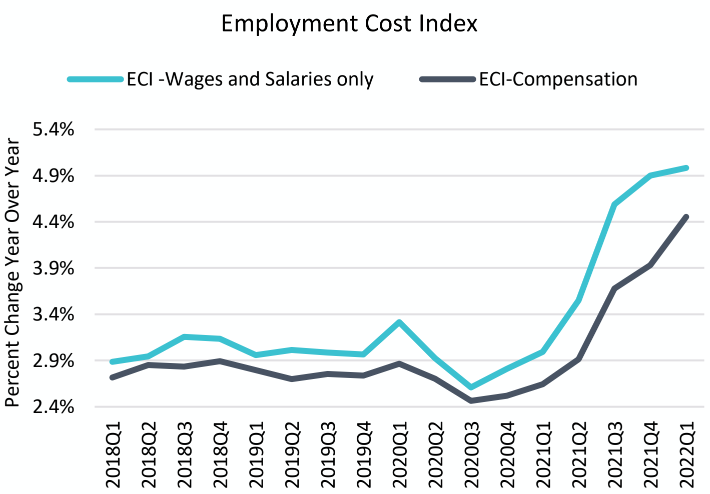
LABOR MARKET

The economy added 428,000 jobs in April, equal to March and better than expected. Payroll gains averaged 523,000 during the latest three-month period.



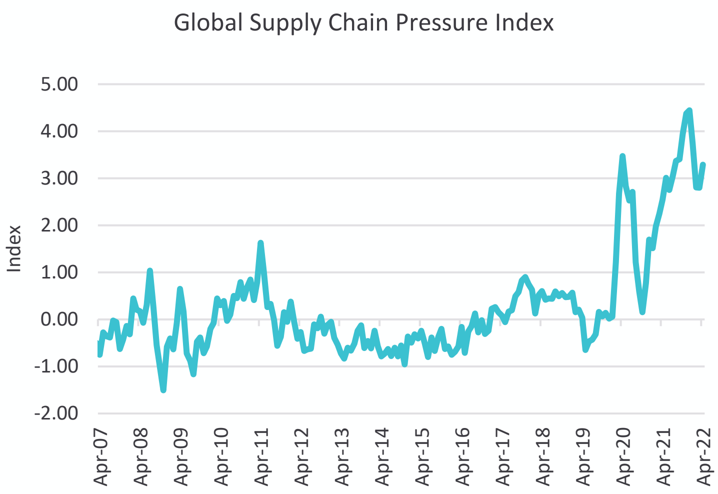
EMPLOYMENT COST

The first-quarter Employment Cost Index for private workers rose an impressive 5 percent on a year-over-year basis. The index underlines the risk of wages accelerating and the Fed's need to tighten monetary policy.



SUPPLY CHAIN PRESSURE

Supply chain disruptions continue, according to the New York Fed's Global Supply Chain Pressure Index. Given current geopolitical issues, further strains could develop.



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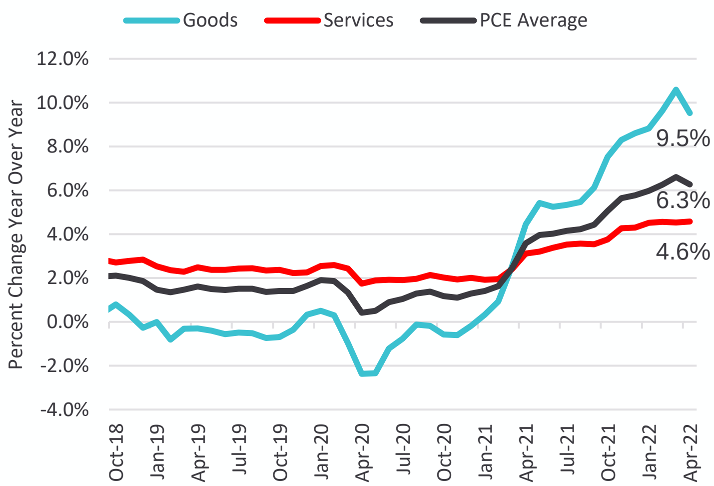
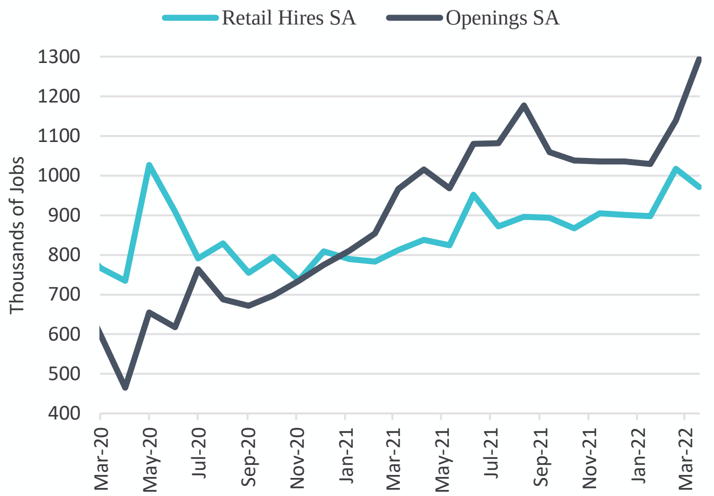
PCE PRICE INDEXES

There were encouraging signs in April as both the overall Personal Consumption Expenditures Price Index and the index for goods declined. The data could signal that price pressures have peaked.



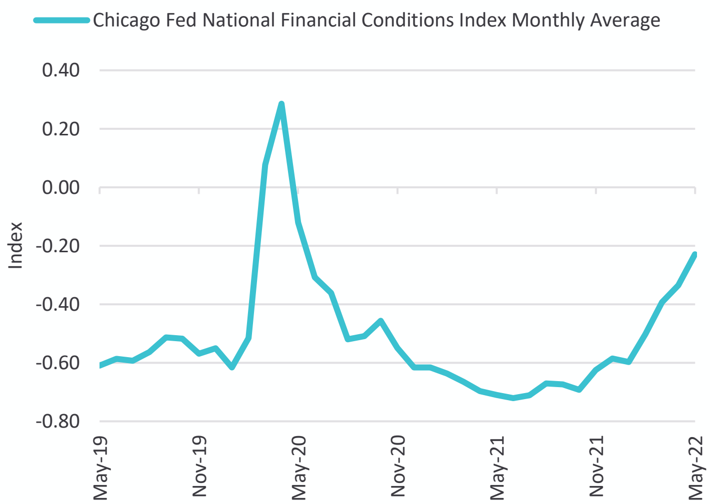
RETAIL EMPLOYMENT

The number of available retail jobs reached a new high with 1.3 million openings at the end of March but retailers were able to fill only 971,000.



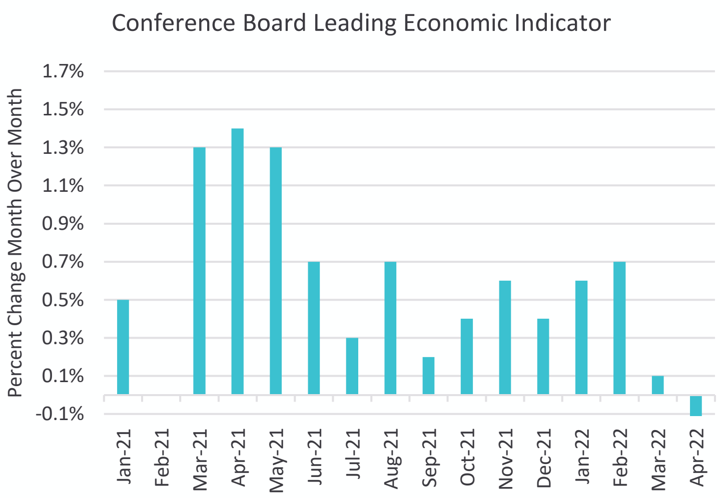
FINANCIAL CONDITIONS

The Chicago Fed's National Financial Conditions Index reflects the availability of funding in the economy. The index suggests financial conditions tightened again but are below the historical average.



LEADING ECONOMIC INDEX

The Conference Board's Leading Economic Index declined in April, a potential sign of slower economic growth. The drop reflects dwindling consumer expectations and eroding business confidence.



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