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 | Despite Two Quarters of Downturn, a Recession Does Not Appear Likely – At Least Not Yet

NRF began 2022 with the expectation that the U.S. economy would continue to see solid growth, but it is now clear that the world has changed. Assumptions made early in the year have not lived up to expectations and the economy is facing unprecedented trends that could not be anticipated, many of them related to the volatility caused by COVID-19 and then compounded by the war in Ukraine. The economy is complex, the data is imperfect, and we cannot account for all of the interactions, particularly in economic growth, inflation and monetary policy. Like sailing, projections require constant adjustment to changing winds and hazards, and the economy is clearly navigating challenging headwinds that leave us far from a safe port. While stimulus checks, fiscal policy and monetary policy that stimulated demand are behind us, we are still dealing with supply chain disruptions that have made it difficult to meet that demand and have combined with pandemic stimulus and Russia's war against its neighbor to cause the red-hot inflation seen today.

NRF's forecast for 2022 was constructive about the U.S. economy and retail sales. Notwithstanding that a number of unknowns existed, economic growth was expected to be at an unexciting-but-solid annual pace in the 3 percent range. Balancing growth with inflation, geopolitical uncertainty and policy variability has been a challenge to all decision-makers since then. At this point, we are seeing impediments that are causing growth to slow, but NRF remains constructive in our outlook and still expects the economy to continue to grow.

Economic growth in 2022 is at a pivot point. The economy contracted at an annual rate of 1.6 percent in the first quarter, followed by 0.9 percent in the second quarter. These back-to-back contractions have heightened fear of a recession, but while the economy has lost momentum heading into the second half of the year, economic data is not yet consistent with a typical recession.

Private final sales to domestic purchasers, a measurement that focuses on consumer and business spending, remained in positive territory in the first six months, up 3 percent in the first quarter and flat in the second quarter. Other indicators including employment, retail sales, income and industrial production have slowed but none have been in contraction territory yet. Clearly, demand has slowed, but the slowdown is entirely a result of towering inflation.

We noted in our 2022 forecast that there would continue to be dislocations due to persistent inflationary pressures. Today, inflation is both sky high and on everyone's mind. June's Consumer Price Index certainly punctuated that fact by rising 9.1 percent year-over-year, an acceleration from May's 8.6 percent and among the strongest growth since the 1980s. Many of the forces contributing to inflation will not be unwound soon but we are seeing some potential relief as commodity and oil prices decline. Currently, inflation is well above the Federal Reserve's comfort zone, and shorter-term inflation expectations are high although longer-term expectations appear better anchored. Moreover, inflation forecasts continue to be highly uncertain and supply constraints will factor into the second half of the year.

There is no doubt that we are caught in a data puzzle, and putting the pieces together is even more difficult because monetary policy has sailed into unchartered waters. The policies adopted by the Fed in the past two years were historically unprecedented and there is little experience gauging their impact on the economy. The Fed is caught between an economic rock and a monetary policy hard place: As the central bank attempts to adjust monetary policy, it faces the dangers of continued inflation if it doesn't do enough and a recession if it goes too far. Consumer reaction to interest rate hikes is hardly immediate or predictable, making it impossible to judge the effect of the Fed's actions in real time and quickly correct any oversteering. History is not in the Fed's favor as there have been eight recessions in the last 11 cycles of economic tightening. Like many, we didn't imagine the Fed would need to take such aggressive actions to confront inflation.

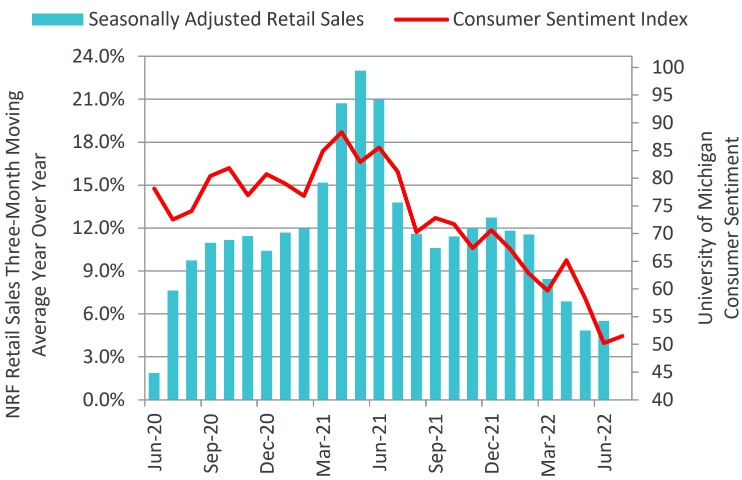
Given these developments, we have adjusted several levers in the framework behind our outlook. We have lowered our forecast for real growth of gross domestic product to 2 percent, down from about 3.5 percent. Likewise, we have increased our estimates for inflation. The Personal Consumption Expenditures Price Index, the Fed's favored measure of inflation, is expected to average 6.2 percent for 2022, nearly two percentage points higher than assumed in our initial projection. The savings rate is projected to fall further as consumers dip into their pandemic-era savings to pay for high food and energy prices along with discretionary spending such as travel, entertainment and hospitality. We have also incorporated changes to historical retail sales data released in late April, when the U.S. Census Bureau revised monthly data for January 2013 through March 2022. With those revisions, 2021 retail sales as defined by NRF – which exclude automobile dealers, gasoline stations and restaurants to focus on core retail – totaled $4.61 trillion. That was notably stronger than the earlier report of $4.58 trillion, an increase of 0.7 percent.

Nonetheless, we have not changed our belief that 2022 retail sales will grow by a sustainable range of 6 percent to 8 percent over 2021. The driver of the U.S. economy is the consumer and spending has been fueled by the stronger-than-ever labor market. A critical issue that would signal the onset of a recession would be a significant backtracking in employment but there is little sign of broad job losses. At 3.6 percent as of June, unemployment is nearly half a percentage point lower than the beginning of the year and only a hair above the 50-year pre-pandemic low of 3.5 percent in January 2020. Payrolls grew at an average monthly rate of 539,000 in the first quarter and 375,000 in the second quarter. Meanwhile, spending has slowed but has not been stopped by inflation. In fact, NRF's calculation showed retail sales were up 7 percent year-over-year for the first six months of the year.

At this juncture, the key concern remains inflation and the Fed's policy moves to contain it. It is up to the National Bureau of Economic Research to officially declare a recession. And the bureau, which defines a recession as a significant decline in activity spread across the economy and not confined to one sector, moves cautiously, typically waiting weeks if not months to decide whether a downturn has met that definition. In the meantime, our view is that while the economy is functioning at a slower pace it is likely to avoid a recession this year. Despite ongoing uncertainties, we believe the underlying strength of the economy is strong enough to deal with inflation and keep a recession at bay – or short-lived even if we are wrong.

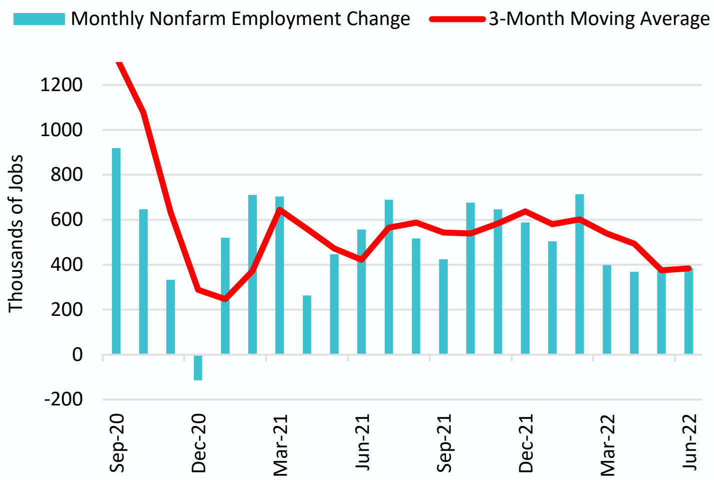
SALES AND SENTIMENT

June retail sales rebounded strongly from May's disappointing performance. Consumer sentiment index inched up a little in July from its record low set in June.



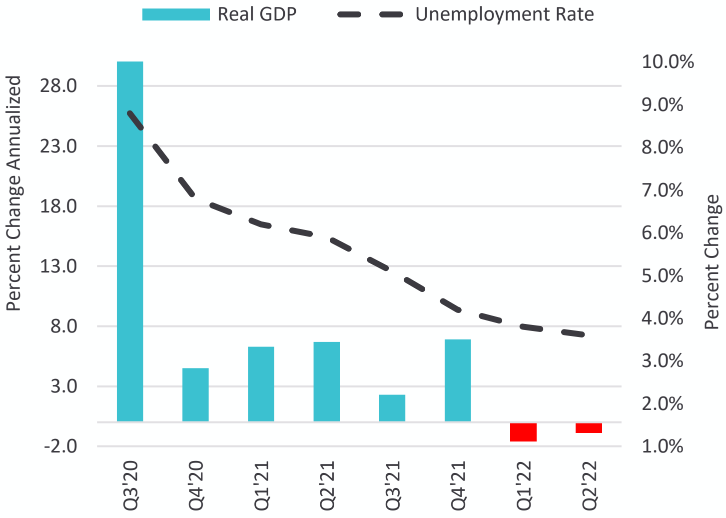
LABOR MARKET

The labor market maintained its strength in June. Payroll gains totaled 372,000, almost identical to the previous two months. Payroll gains averaged 375,000 a month in the latest three-month period.



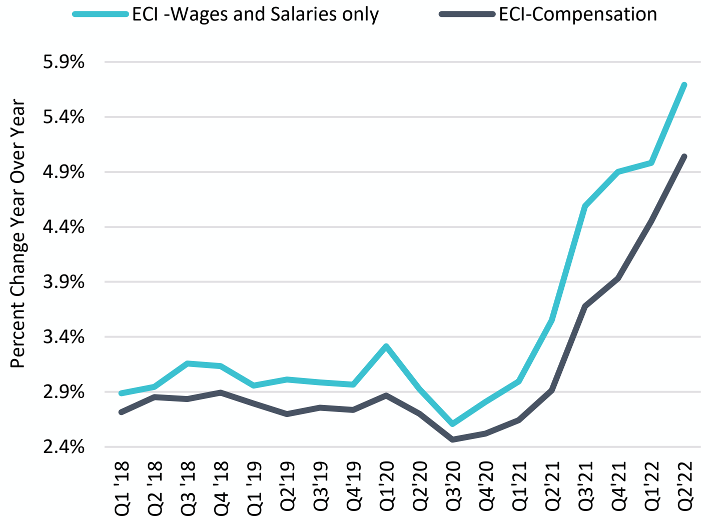
REAL GDP & UNEMPLOYMENT

Real GDP has fallen for two consecutive quarters in 2022, but it seems inaccurate to consider the first half of the year a recession. Unemployment is only a hair above the 50-year pre-pandemic low of 3.5 percent.



EMPLOYMENT COST INDEX

The labor market remained uncommonly tight through midyear, putting pressure on wages and overall compensation. It buttresses aggressive interest rate increases by the Federal Reserve.



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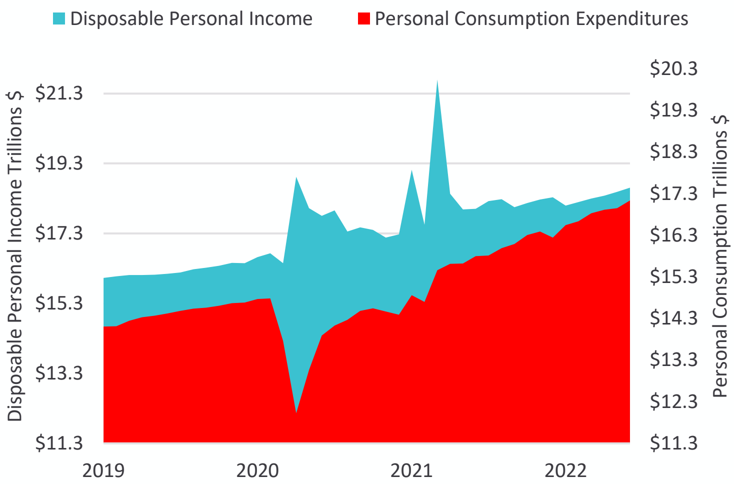
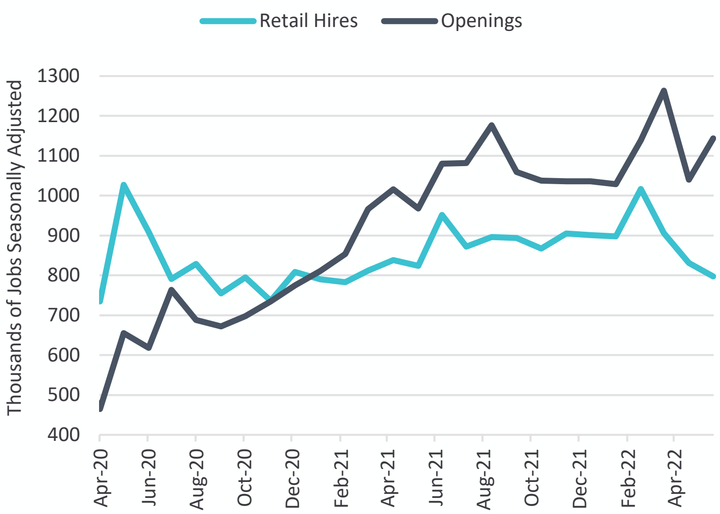
DISPOSABLE INCOME

Disposable personal income (income after taxes) increased 0.7 percent in June and was up 3.3 percent from a year ago. Personal consumption rose 1.1 percent and is up 8.4 percent in the past year.



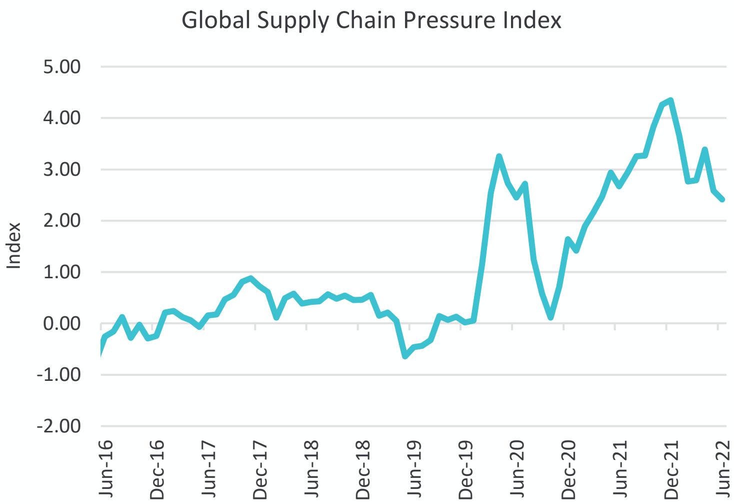
RETAIL EMPLOYMENT

Retailers had 1.1 million job openings in May but were able to hire only 797,000 workers. June's unemployment rate for the retail sector was 4.4 percent – the lowest so far this year.



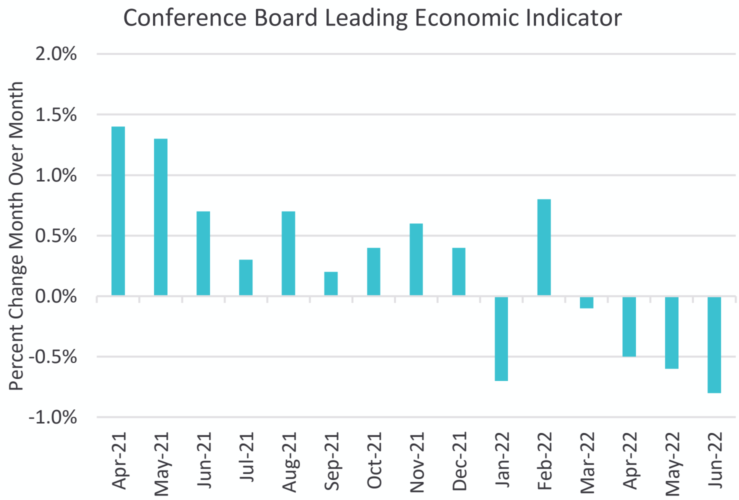
SUPPLY CHAIN

Supply chain pressures including both transportation and manufacturing declined in June, according to the New York Fed's Global Supply Chain Pressure Index.



LEADING ECONOMIC INDEX

The Conference Board's Leading Economic Index decreased for the fourth consecutive month in June, pointing to near-term weaker economic activity.



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