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 | Economy remains durable – not recessionary – in early 2023

The World Health Organization says the pandemic is over, and the U.S. government has ended its declaration of a public health emergency. But that doesn't mean the economic challenges brought on by COVID-19 are over. For the past year, the Federal Reserve has been trying to bring rampant inflation under control by raising interest rates. The effort has yet to reach its goal, and results from the first quarter show taming inflation without tipping the nation into a recession remains a formidable challenge.

The U.S. economy remained in gear and continued to grow during the first quarter, with gross domestic product expanding at a modest 1.1% annual rate, according to the federal Bureau of Economic Analysis. That was slower than the average 3% growth in the previous two quarters and consistent with the Federal Reserve's anticipation of subdued real GDP growth and softening in the labor market as the result of higher interest rates. Even with that, most components of GDP, including consumer spending, exports and government purchases, grew at a healthy pace. A slowdown in GDP is normally seen as a negative, but in the current context is key to controlling inflation.

Notably, the deceleration primarily reflected a substantial downturn in private inventories and a slowdown in nonresidential fixed investment. Businesses drawing down on inventories was a huge drag on GDP growth, clipping off what otherwise could have been an additional 2.26% increase, the largest amount in two years. Firms may have attempted to reduce inventories to more normal pre-pandemic levels while still having the option to step up production should demand arise. And lower inventories mean fewer unsold goods on store shelves if a recession does come, preventing a deeper and longer-lasting downturn.

Fortunately, the economic data is not consistent with a typical recession. Private final sales to domestic purchasers, which exclude inventories and imports and are a good indicator of underlying growth, increased 2.9% after zero growth in the fourth quarter. And consumer spending – which typically accounts for two-thirds of GDP and has an outsized effect on the pace of the economy – was the highlight of the GDP report, growing at a 3.7% annual rate during the first quarter compared with the fourth quarter's meager 1%. Most household spending came from durable goods, which increased 6.5% compared with the previous quarter's 0.1%, while spending on services rose 2.3% following 1.6% growth in the previous quarter. It is not surprising that Americans are still spending. Consumer spending is closely related to consumer income and disposable personal income grew rapidly in the quarter, increasing at an annual rate of 8.4%.

Meanwhile, the Census Bureau revised monthly retail sales estimates in April, showing slower growth in the first quarter than initially reported. NRF's calculation of retail sales – which excludes automobile dealers, gasoline stations and restaurants to focus on core retail – is based on Census data and consequently fell from 6% year-over-year growth for the quarter to a much slower 5.4%. The revision also affected NRF's annual retail sales numbers, with our estimates lowered for three of the last five years while two years were adjusted upward. That left retail sales for 2022 up a full percentage point at 8% growth rather than 7%.

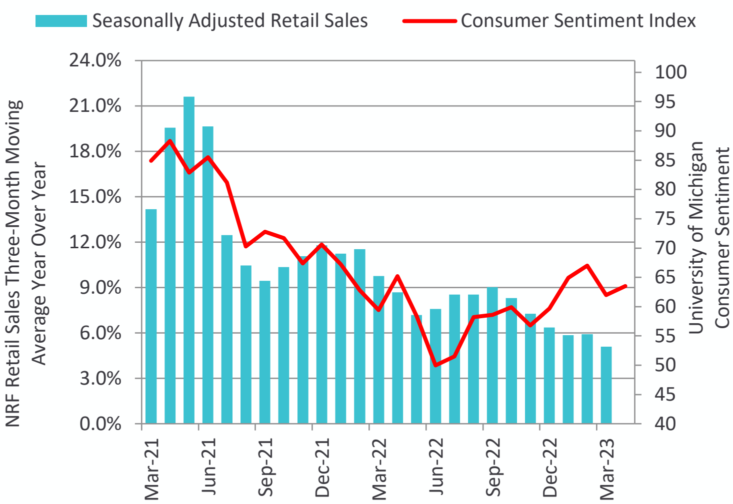
Inflation as tracked by the Personal Consumption Expenditures Price Index – the Fed's preferred measure – was 4.9% year over year in the first quarter. That was down from 5.7% in the fourth quarter and far below the 6.4% seen a year earlier. The core PCE index, which excludes volatile food and energy prices, was at 4.7%. Nonetheless, inflation is still well above the Fed's 2% target.

The labor market remains tight and continues to be a surprise. Despite higher interest rates, April employment numbers were all better than expected, with a net jobs gain of 253,000, a year-over-year wage increase of 4.4%, and the unemployment rate of 3.4% tying January for the lowest level in more than 50 years. While initial worker filings for unemployment rose by 13,000 to 242,000 in the week ending April 29, continuing claims fell 38,000 the week before to 1.8 million, the lowest level since April 1. The Employment Cost Index showed private manufacturing wages and salaries were up 4.9% in the first quarter, down from 5.1% growth in the prior quarter. Wage growth needs to slow to about 3.5% to be consistent with the Fed's inflation target.

As expected, the Fed last week raised the federal funds rate another quarter-point, a 10th consecutive increase that brought the upper bound to 5.25%. Chairman Jerome Powell said general sentiment on the Fed's Federal Open Market Committee favors a pause, but that the panel is not yet ready to commit. If the Fed is going to end its economic tightening, the big questions are how it will know when to stop and then how soon after that should it begin to trim rates. In announcing the increase, the Fed clearly stated that "tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring and inflation" even though "the extent of these effects remains uncertain." That is consistent with our views on the risks to the 2023 economic outlook. But in the bad-news-is-good-news world of trying to control inflation, that may be exactly the result that is needed. The key is finding a way to control or manage the uncertainty.

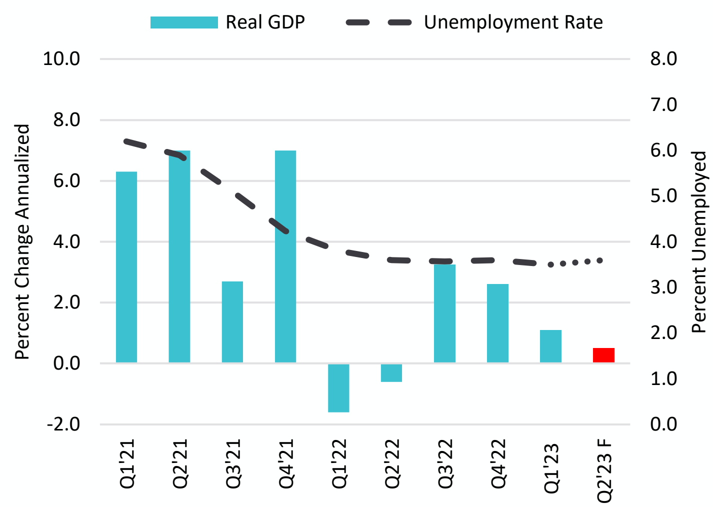
SALES AND SENTIMENT

The pace of retail spending growth decelerated in the first three months of 2023 but still showed strength. Consumer sentiment improved modestly but remained deeply in recessionary territory.



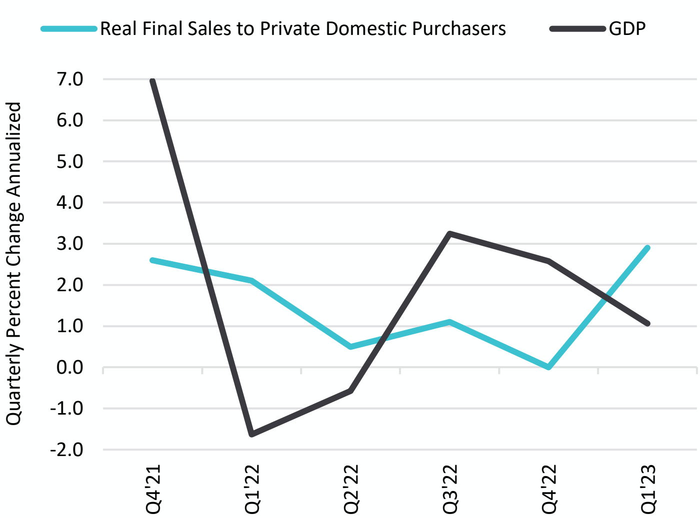
REAL GDP & UNEMPLOYMENT

GDP growth showed a slowdown from 2.6% to 1.1% in the first quarter but the slowdown was not sufficient to lessen inflationary pressures.



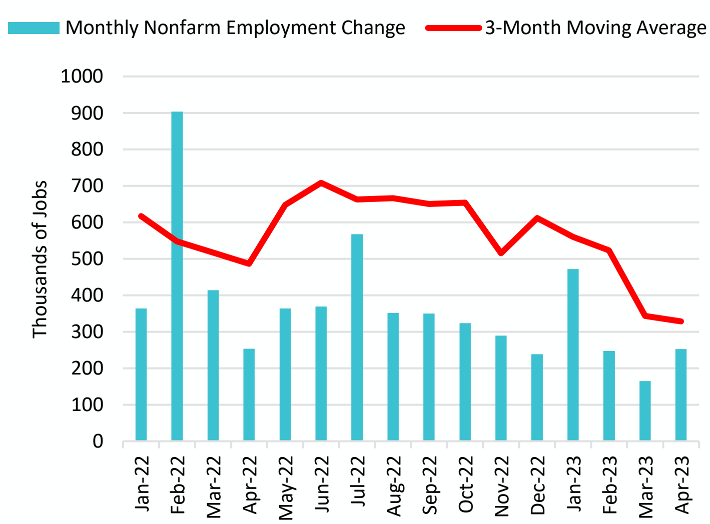
REAL FINAL SALES

There was a healthy pace to real final sales to domestic purchasers (excluding net exports and inventories) during the first quarter, underpinning economic activity and primarily driven by consumer spending.



EMPLOYMENT

The economy created a better-than-expected 253,000 jobs in April. Job growth has averaged 222,000 over the last three months, the weakest since January 2021.



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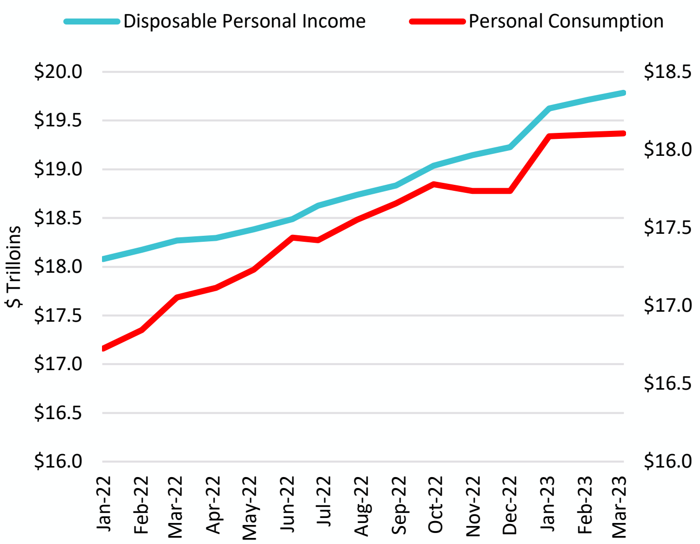
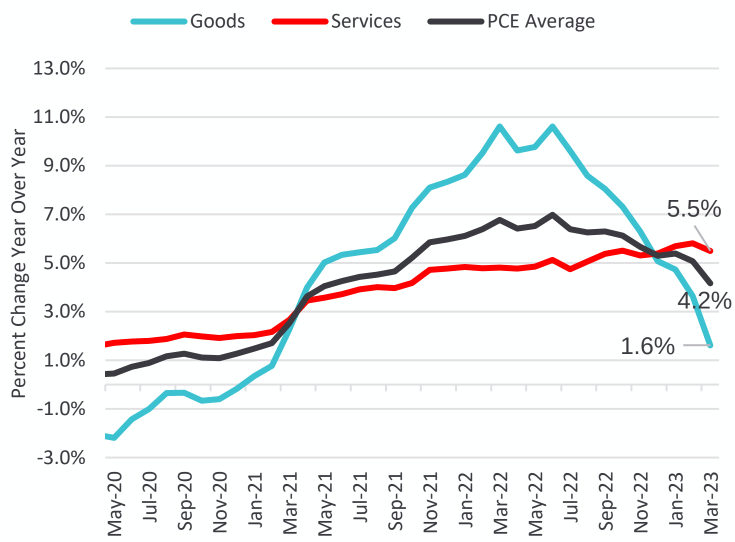
INCOME & CONSUMPTION

Growth in disposable personal income generated from job and wage gains has supported consumers' willingness and ability to spend.



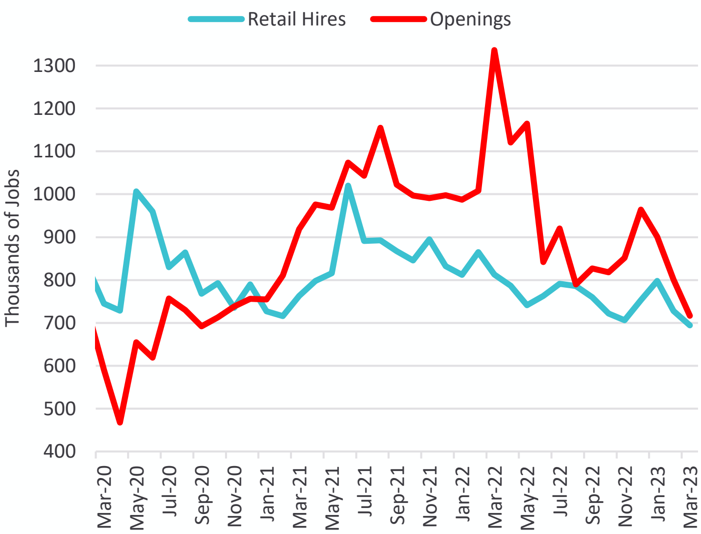
INFLATION

Overall inflation remains high. The PCE Price Index for March was up 4.2% year over year but the pace of inflation is slowing, led by lower goods prices.



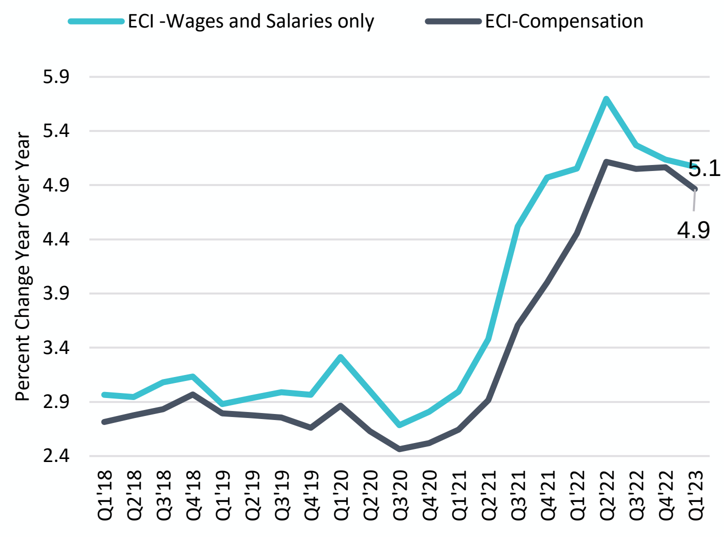
RETAIL LABOR MARKET

The labor market is exceptionally tight. While both retail job openings and hires fell in March, the number of unemployed retail workers fell from 744,000 in March to 593,000 in April – the second lowest since late 2019.



EMPLOYMENT COST INDEX

The Employment Cost Index, which provides an accurate picture of both wages and compensation, clearly shows elevated increases but rates are slowly declining.



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