NRF National Retail Federation

MONTHLY Economic Review

June 2023

Jack Kleinhenz, Ph.D., CBE
Chief Economist
National Retail Federation

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 | **Measuring the economy yields a collision of data**

British economist George Shackle once described the economy as a kaleidoscope – "a collision of colors subject to ongoing, rapid and radical change." Today's economy is a lot like looking into a kaleidoscope, with the view changing and the data providing a different reflection of what's happening every time you look.

The revised estimate of first-quarter gross domestic product released by the Commerce Department late last month is a good example of the kaleidoscope economy. The revised data showed that GDP expanded at a 1.3% annualized pace, higher than the original estimate of 1.1 % released in late April. The modest upward adjustment didn't change the overall message. Economic growth in the first quarter was broad-based, powerfully led by consumer spending and supported by exports, government spending and nonresidential business investment. Large inventories that reduced the need for production were a major drag, with imports and residential investment also weighing on growth.

While the GDP news looks good, data on gross domestic income is more troubling and signals are seriously mixed. In contrast to the growth in GDP, GDI shrank 2.3% in the first quarter on the heels of a 3.3% decline in the fourth quarter. While GDP conceptually measures the value of everything produced, GDI measures the value of everything earned during production, including wages, rent, interest and corporate profits. In theory, growth in GDI should be identical to growth in GDP because one person's spending is another's income. Nonetheless, there is always a discrepancy between the two and GDI tends to signal eventual revisions to GDP. The average of real GDP and real GDI – a supplemental measure of U.S. economic activity that equally weights the two – decreased 0.5% in the first quarter following a decrease of 0.4 % in the fourth quarter.

This suggests that GDP likely overstates U.S. economic growth, and that higher interest rates, tighter credit and persistent inflation are having more of a concerted effect on the direction of the economy than suggested by GDP alone. Given that, we continue to look for a soft landing this year. Real GDP is likely to remain challenged throughout the rest of 2023 and should rise just 1% based on the current NRF retail sales forecast.

The kaleidoscope effect is also seen in other data. Historically, every aggressive Federal Reserve tightening cycle since 1970 has ended up in a recession. Nonetheless, there have been periods when the Fed increased rates and the result was a soft landing where the economy slowed down to avoid both a recession and a resurgence in inflation. These soft landings occurred in 1994-1995 and 2015-2018. According to research by the Federal Reserve Bank of St. Louis, “state coincident indexes” of state-level economic data produced by the Federal Reserve Bank of Philadelphia’s can be used to assess whether recession-like conditions have developed. In general, about half the states need to have negative growth in this index to have reasonable confidence that the national economy has entered into a recession. So where are we now? The May report showed that the coincident indexes had increased – not decreased – in every state but Alaska over the past three months, suggesting that we are not in a recession.

Despite longstanding predictions of a recession, the economy is holding up better than many have argued. Personal income and spending data released in late May showed renewed strength driven by solid gains and pay increases. Personal consumption rose 0.8% month over month in April and 6.7% year over year. Disposable personal income (income after taxes) increased 0.4% monthly and 7.9% from a year ago.

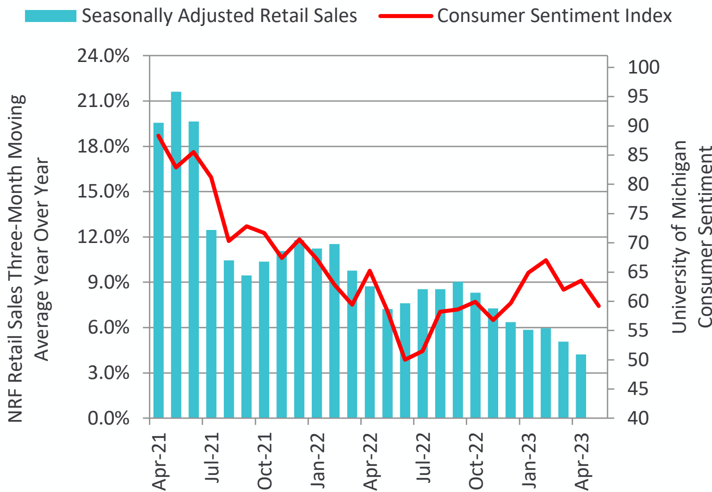
Unfortunately, stronger consumer spending in April brought a sharp rise in the Personal Consumption Expenditures Price Index measure of inflation, which was up 4.4% versus a year ago. Fed officials particularly watch “core” PCE, which excludes food and energy and was up 4.7%.

The University of Michigan Consumer Sentiment Index, which measures personal finances, business conditions and buying conditions, remains weak and stuck in deeply recessionary territory. The May final report came in at 59.2, down 4.3 points from April. While up from last June’s record low of 50, the index remains below January’s 64.9. Inflation is a key reason households have a murky outlook for the economy even though April’s unemployment rate was at 3.4%, the lowest since May 1969, and May’s was at a still-low 3.7%.

So, depending on which data you view in the economic kaleidoscope, you get two different angles on the state of the consumer. While survey data shows consumers do not have much confidence in the economy, actual spending data shows they were upbeat as the second quarter kicked off. Consumer spending has been bolstered by a strong job market and rising wages, which have helped counter rising prices and higher borrowing costs. While it’s difficult to reconcile these views, what we’ve learned over the last several years is don't count the American consumer out, at least not yet.

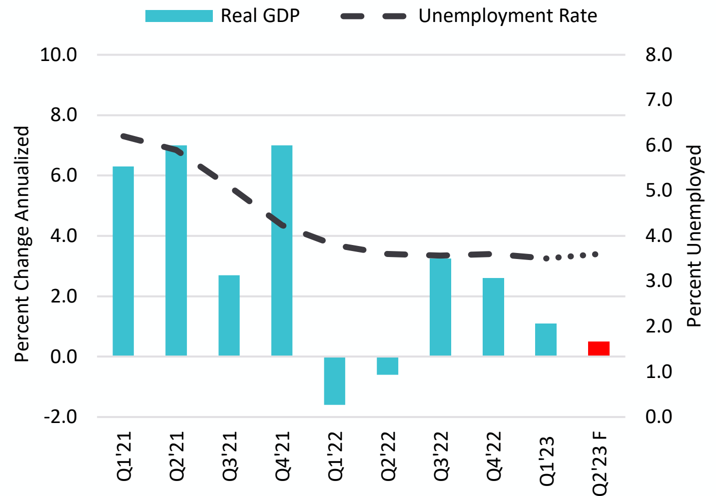
SALES AND SENTIMENT

While retail spending growth was solid in April, the year-over-year pace remained slow. The Consumer Sentiment Index remains in recessionary territory, only a little above its record low in June 2022.



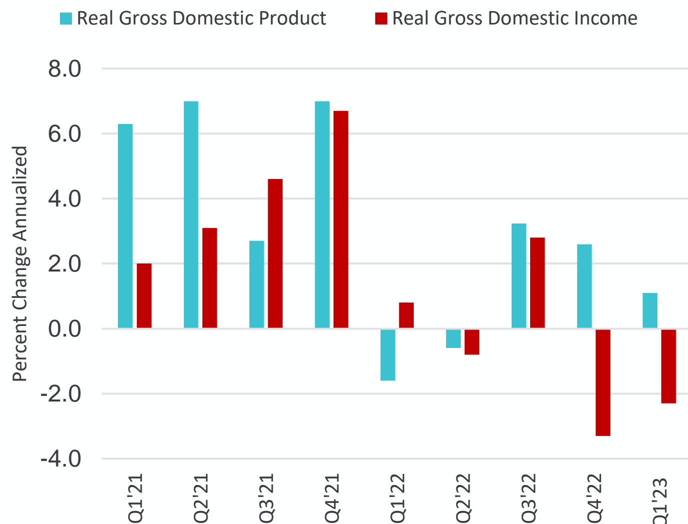
REAL GDP & UNEMPLOYMENT

Revised GDP rose a weak 1.3% in the first quarter. The story has changed little, with consumer spending remaining a source of growth. GDP is expected to rise around 1% in 2023.



GDP vs. GDI

Two measures of economic activity diverged in the first quarter. First-quarter GDP was revised higher to a 1.3% annualized rate, but GDI contracted for the second straight quarter.



EMPLOYMENT

Seasonally adjusted retail employment rose in April by 7,700 jobs to 15.5 million. The seasonally adjusted retail unemployment rate dropped to 3.7% in April from 4.5% in March.

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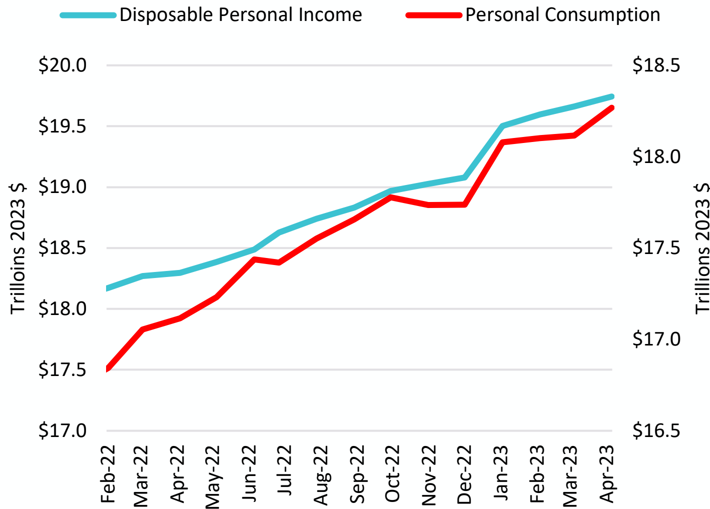
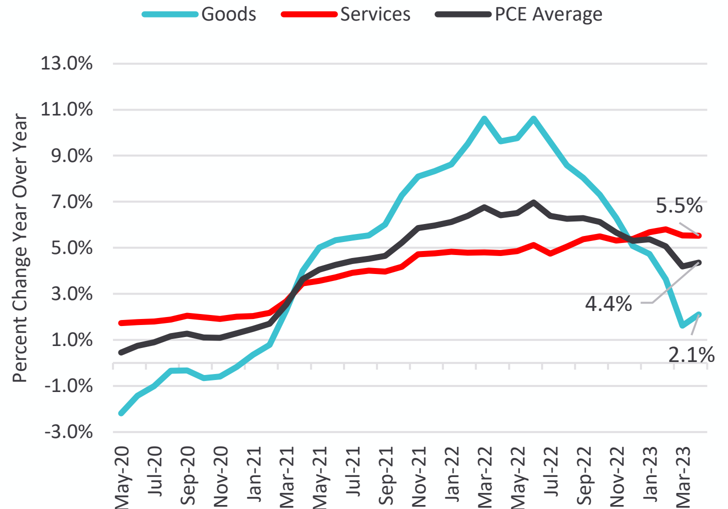
INCOME & CONSUMPTION

Income and spending rose in April as consumers continued to navigate elevated inflation. Spending was led by purchases on services, but goods also rose after monthly declines in the two prior months.



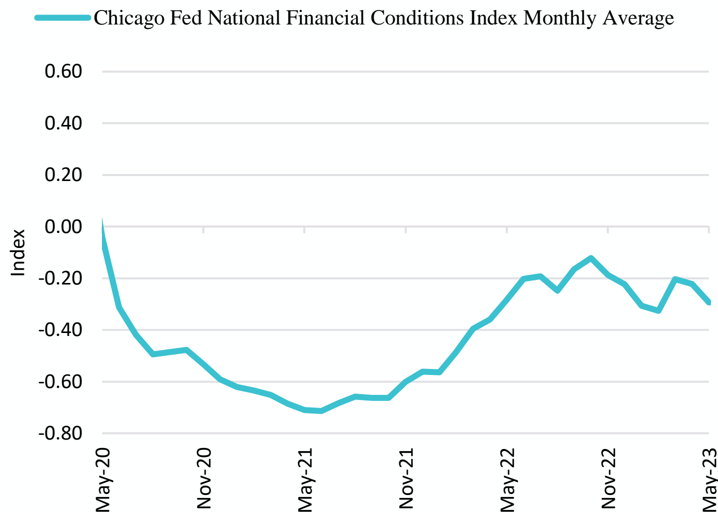
INFLATION

The PCE Price Index rose in April, up 4.4% year over year compared with 4.2% in March. Inflation appears to be too sticky for the Fed to hold off on further rate increases.



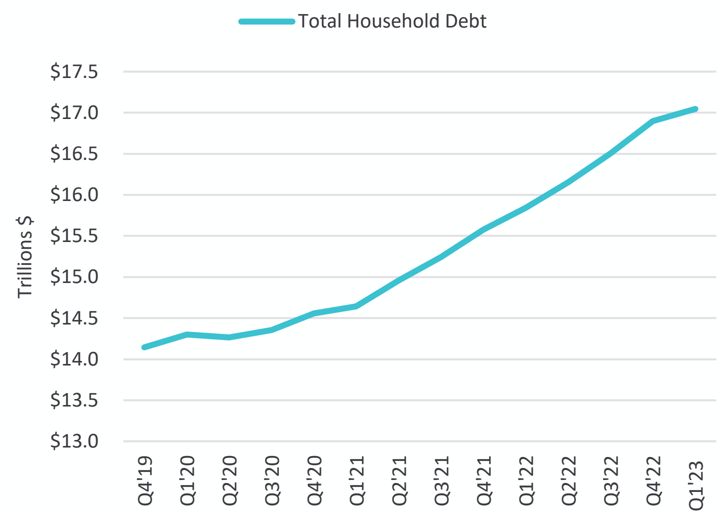
FINANCIAL CONDITIONS INDEX

Negative values for the latest Chicago Fed National Financial Conditions Index, which measures risk and the availability of funding, suggest financial conditions are less tight than average.



HOUSEHOLD DEBT

Total household debt reached $17.05 trillion in the first quarter. The upswing in the debt burden could become a problem if rising interest rates, elevated inflation and a slower economy cause an increase in defaults.



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