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 remained resilient in first half of 2023 but pace is lessening

The economy was clearly more resilient in the first half of this year than many expected, and the consumer environment has been positive as inflation has slowed. Nonetheless, there are ongoing economic challenges and questions, and the pace of consumer spending growth is becoming incrementally slower. And inflation remains a critical problem for the Federal Reserve as it calibrates monetary policy.

U.S. gross domestic product grew at a 2.4% annual rate adjusted for inflation in the second quarter, following 2% growth in the first quarter. That's in line with the 2.1% seen for the full year in 2022 and significantly slower than 6% in 2021.

Consumer spending, which makes up approximately 70% of the U.S. economy, has played a major role in keeping the economic expansion on a good path. However, year-over-year spending growth decelerated to 1.6% in the second quarter from 4.2% in the first quarter. And while spending was in positive territory across both goods and services, services were the largest driver. Accordingly, slower growth was seen in retail sales. NRF's calculation – which excludes automobile dealers, gasoline stations and restaurants – showed retail sales were up 3.1% unadjusted year over year in the second quarter. That kept up with inflation but was below the 4% growth for the first six months of the year.

Consumers are still spending but are under financial pressure and have been adjusting how much they buy while also shifting from goods to services. While job and wage gains have counterbalanced inflation, the stockpile of savings accumulated during the pandemic is dwindling and is no longer providing as much spending power as previously available.

While we are seeing progress on inflation, higher prices remain. The Personal Consumption Expenditures Price Index – the Fed's preferred measure of inflation – was at 3.7% year over year in the second quarter. That was down from 4.9% in the first quarter but still far above the Fed's target of 2%. Core PCE, which excludes volatile food and energy prices, eased from 4.7% in the first quarter to 4.4% in the second.

Amid these numbers, it remains difficult to accurately judge how the economy has reacted to the Fed's moves to tighten financial conditions. Lending standards are tighter, the cost of borrowing has increased and effects are being seen in interest-sensitive sectors like housing and investment. But even though the Fed has "covered a lot of ground," the full effects "have yet to be felt … especially on inflation," Chairman Jerome Powell said last month.

The Federal Reserve continues to face a tricky job in addressing inflation without causing a recession. The long lag in the impact of rate hikes makes it impossible to know whether monetary tightening will lead to a soft landing or a recession, but the current framework clearly increases the chance of a slower economy. The Fed last month pushed its key policy rate up another quarter point to a range between 5.25% and 5.5%, the 11th increase since March 2022 and the highest rate since January 2001.

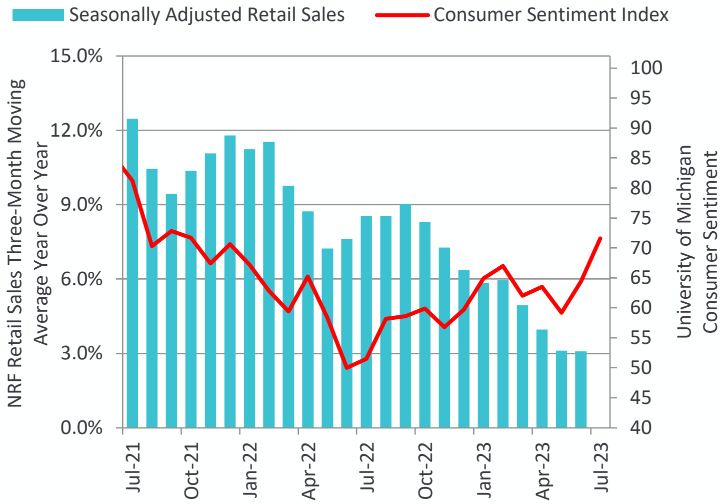
While the full impact is unpredictable, higher interest rates have cooled consumer borrowing, with growth in consumer credit slowing considerably during the past year. While the stock of outstanding consumer credit increased by $17.8 billion in June, revolving credit (credit cards) contracted by nearly $1 billion. This segment has slowed considerably, and it is worth monitoring as revolving credit appears to be a key means to expand spending to buffer the impact of higher prices.

The Fed's Senior Loan Officer Opinion Survey continued to report widespread tightening in lending across all consumer credit types except credit cards, which were unchanged. The demand for many types of borrowing remained depressed. The segment most likely to feel tighter lending standards will be revolving credit, with consumers less likely to use credit cards to fund purchases.

Recent labor market data provides another indication that the economy is in a lower gear. The revised 185,000 jobs added in June was the lowest number since mid-pandemic in December 2020 and the 187,000 in July was only slightly better. Demand for labor continues to gradually ease, with job openings for June declining slightly to 9.58 million from 9.62 million in May, according to the Bureau of Labor Statistics' latest Job Openings and Labor Turnover Survey. Hiring fell from 6.23 million in May to 5.9 million in June. Despite a desire to reduce costs, many companies are nonetheless holding off on downsizing since it could be difficult to replace workers should demand pick up again. The number of people quitting their jobs has also fallen, suggesting that workers are somewhat less confident to switch jobs or seek higher-paying positions.

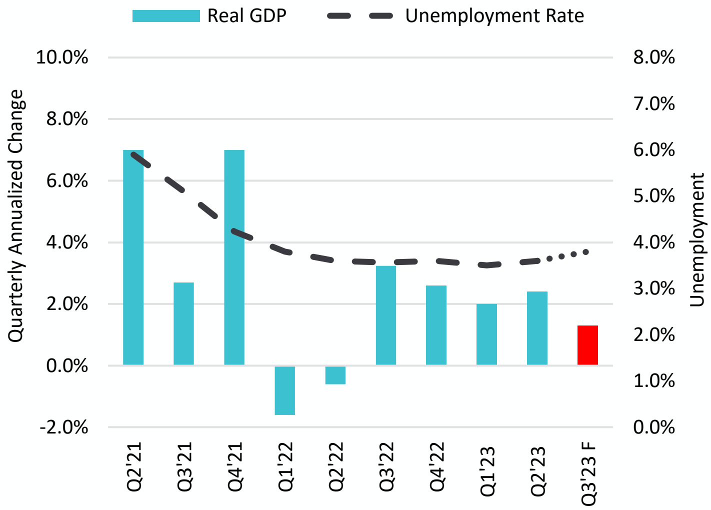
SALES AND SENTIMENT

Consumer spending softened during the second quarter. Meanwhile, confidence rose in July to its best reading since October 2021, according to the University of Michigan Consumer Sentiment Index.



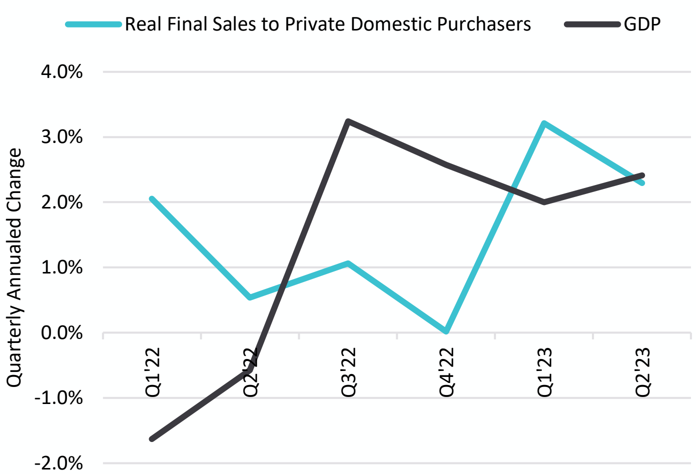
REAL GDP & UNEMPLOYMENT

Real GDP grew at an annual rate of 2.4% in the second quarter, following 2% in the first quarter. Unemployment remained low at 3.6%.



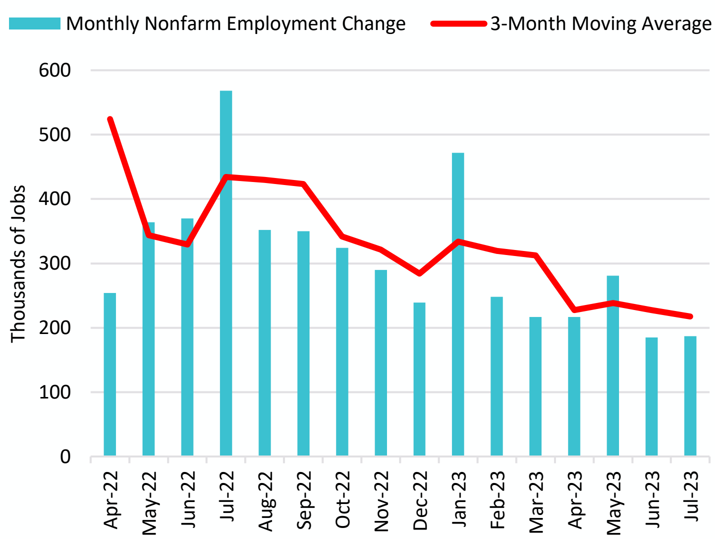
REAL FINAL SALES & GDP

Second-quarter final sales to domestic purchasers, which exclude inventories and net exports, rose at a 2.3% annualized rate adjusted for inflation and signaled an ample pace of growth for the U.S. economy throughout the first half of the year.



EMPLOYMENT

The labor market continues to cool. Nonfarm payroll employment for July rose by 187,000 jobs, below the three-month average of 218,000. June's job growth was the slowest since December 2020.



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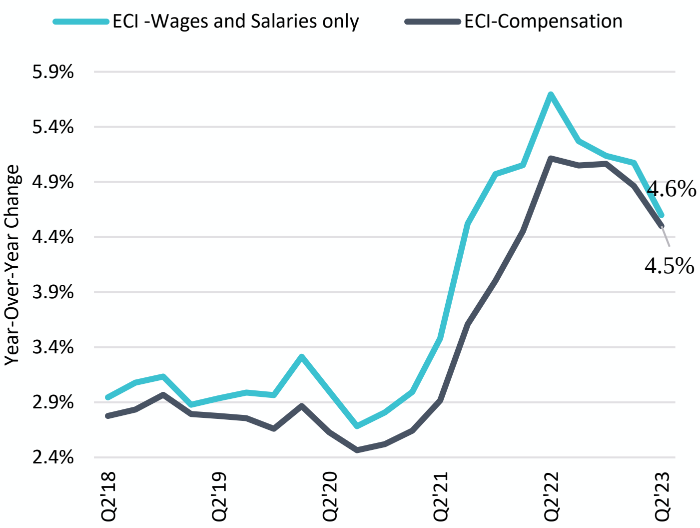
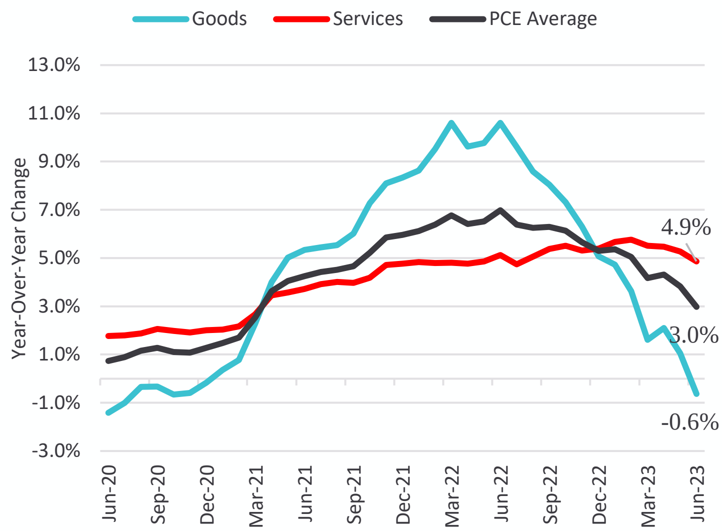
EMPLOYMENT COST INDEX

On a year-over-year basis, the Employment Cost Index in the second quarter was up 4.5%, compared with 4.8% in the first quarter. It remains high and will continue to fuel inflation concerns for the Fed.



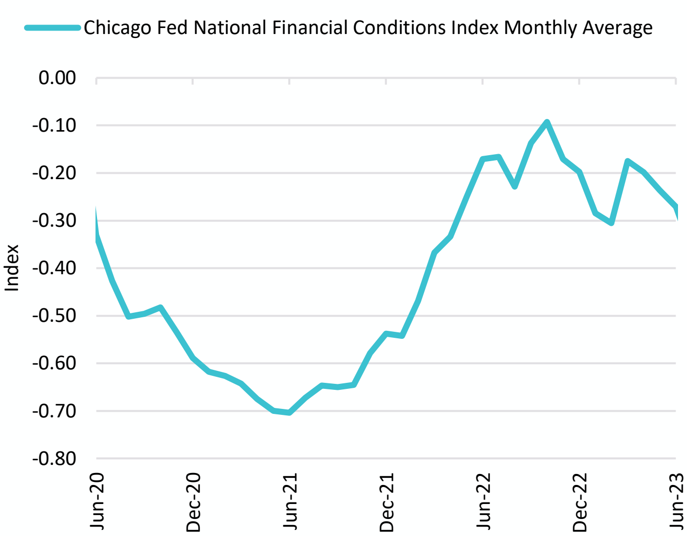
PERSONAL CONSUMPTION

The overall Personal Consumption Expenditures Index was at 3% in June. Inflation for services remains high while prices for goods have gone down for the first time since December 2020.



FINANCIAL CONDITIONS

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



HOUSEHOLD DEBT

Consumer spending is shifting from goods to services. Retail sales make up 40% of goods spending.

NRF National Retail Federation