# QUEST Economic Update | July 2022

**High inflation, interest rate hikes, and recession risks dominate the US economic landscape**

The US economy is forecast to expand in 2022, but forecasts have fallen from roughly 3.5% annual growth at the start of the year to roughly 1.5% to 2% growth in July. Some forecasts see growth in the second quarter between 0.3% to 1.1% (real annualized). The surge in inflation and the Federal Reserve's resulting tightening of monetary policy is increasing the likelihood of recession either this year or next. Some forecasts see the US economy entering a recession late this year, suggesting that the Federal Reserve may not be able to engineer a soft landing.

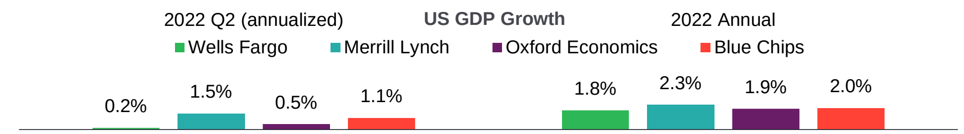
The consumer price index (CPI) rose by 9.1% in June, above the 8.6% increase in May, the largest increase in four decades and ninth consecutive month with inflation above 6%. The Federal Reserve's target rate is 2%. The Federal Reserve is expected to act more aggressively to combat inflation. A 75 to 100 basis point increase is anticipated at its next meeting on July 26-27. The Federal Reserve began to reduce its balance sheet in June. Many forecasters see a gradual loosening of the labor markets as the Federal Reserve tightens monetary policy. However, the labor market remains tight with a 3.6% unemployment rate. Job openings exceed the number of unemployed. In May, there were 11.3 million job openings, which translates into 2.1 job openings per unemployed worker. The Federal Reserve's June forecast predicts unemployment will edge up to 3.7% for 2022, 3.9% in 2023 and 4.1% in 2024. Some economic forecasters see the unemployment rate rising to 5% by the end of 2023.

Building a better working world

Ernst & Young LLP's Quantitative Economics and Statistics (QUEST) group's Economic Update summarizes the latest US economic trends and significant global developments.

## Overall US economy

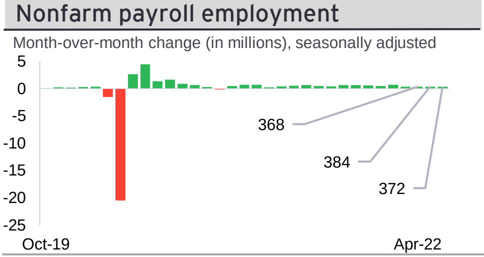
The US economy contracted during the first quarter and is expected to expand by roughly 0.3% to 1.1% during the second quarter, down significantly from earlier forecasts. Inflation, interest rate hikes, supply-chain disruptions, and the Ukraine war, all pose headwinds. The risk of recession is increasing.



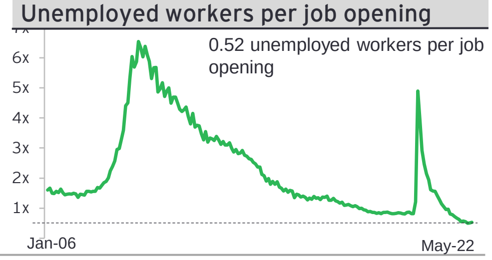

## Labor markets

Labor markets are tight, with the June unemployment rate remaining at 3.6% and April job openings exceeding the number of unemployed by 5.3 million. The US economy continues to add jobs at a rate well above the pre-pandemic level. The underemployment rate fell from 7.1% in May to 6.7% in June, below the 8.7% average from 2015-2019.

### Nonfarm payroll employment



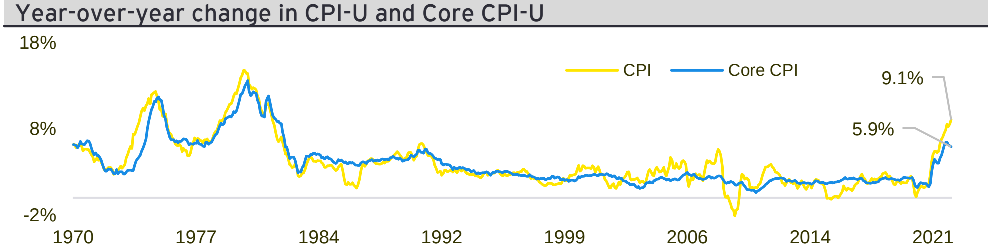

### Unemployed workers per job opening




## Inflation

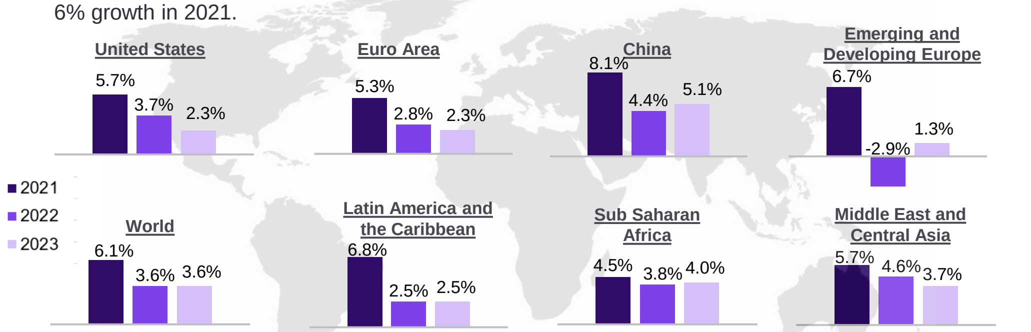
The June CPI report had consumer prices rising by 9.1% from a year ago, the largest increase in four decades. Supply-chain disruptions, rising energy and food prices, and Ukraine war are all contributing factors. The surge in inflation is causing the Federal Reserve to tighten monetary policy and increase interest rates more aggressively.

### Year-over-year change in CPI-U and Core CPI-U




## Global growth

Forecasts for economic growth in the United States, Eurozone, and China have tempered. The global economy is expected to grow by roughly 2.5% to 3.0% in 2022, following estimated growth of 5.5% to 6% growth in 2021.



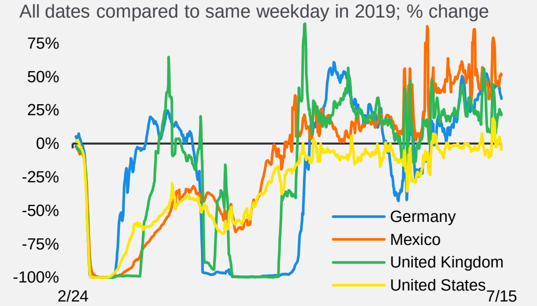

Source: IMF World Economic Outlook, April 2022.

## Real-time indicators

Due to rapidly changing economic conditions over the past two years, traditional economic data have not fully captured the dramatic turn from growth to recession to expansion. Analysts have relied more heavily on real-time data (e.g., Google trends) to take the economy's pulse and predict economic conditions going forward. Recent data on consumer confidence suggest some flatness, likely due to the Ukraine war, supply-chain disruptions, and hiring difficulties. Energy prices rose markedly with Russia's invasion of Ukraine, but have more recently pulled back, possibly due to the COVID-related lockdowns in China. The increase in in-person dining, workplace visits and air travel suggests continued recovery.

### Global OpenTable reservations

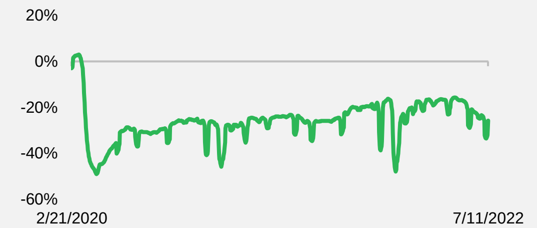
All dates compared to same weekday in 2019; % change




Note: Seven day moving average.
Source: OpenTable reservations.

### US workplace visits

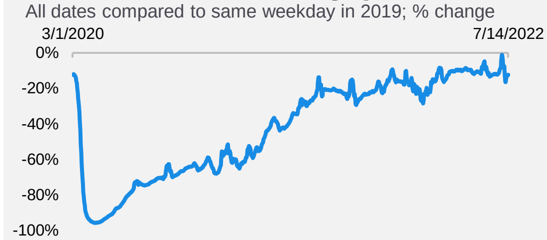
% Change from baseline (January 2020)




Note: Represents seven-day moving average.
Source: Google Mobility Reports.

### US TSA traveler throughput

All dates compared to same weekday in 2019; % change




Source: TSA.

Current as of 07/15/2022

## Overall US economy

The US economy is facing significant headwinds. Inflation is taking a toll, interest rates are rising, supply-chain disruptions continue, and commodity prices have begun to fall. In addition, consumer confidence has been faltering and forecasters have been pulling back their forecasts for growth in the United States and abroad for the past several months. All of these factors are increasing the likelihood of recession this year or next.

While the first-quarter 1.6% decrease in real US GDP was largely due to sharp reductions in business inventory investment and exports, consumer spending also weakened to 1.8% growth (real annualized) from 2.5% growth (real annualized) in the fourth quarter of 2021. Some forecasters see the economy further weakening in the second quarter perhaps to 0.3% to 1.1% growth (real annualized). However, the Federal Reserve Bank of Atlanta's GDPNow Tracker estimates (as of July 8) second quarter growth of -1.2% (real annualized). Two consecutive quarters of negative GDP growth is the rule of thumb used by many economists to define a recession. Many economic forecasts see growth of roughly 1.5% to 2% for 2022 overall, as compared to 3.5% growth forecast at the start of the year.

The Conference Board's consumer confidence index fell to 98.7 in June from 103.2 in May, and now stands at its lowest level since February 2021. The ISM Manufacturing PMI fell to 53.0 percent in June from 56.1 in May (values below 50 indicate contraction). While the index saw its 25th month of expansion, it is at its lowest level since June 2020.

The Federal Reserve is expected to increase interest rates more aggressively. This increases the concern of either an overcorrection by the Federal Reserve or of a contraction with significantly lower demand and higher unemployment to bring inflation back to the Federal Reserve's 2% target.

## Labor market

The US labor market remains tight. In May, job openings exceeded unemployment by 5.3 million. The US economy added 372,000 jobs in June, down from 384,000 in May. Overall, by June 2022, the US economy had recouped 96% of the 22.4 million jobs lost in March and April 2020.

Other signs of a tight labor market include the low unemployment rate. The June unemployment rate remained at 3.6%, near the 3.5% unemployment rate just before the start of the pandemic. The unemployment rate averaged 4.4% from 2015 through 2019. Many economists view the unemployment rate at which the economy's resources are fully employed to be about 4.4% to 4.5%. Hence, at least some economists view the low unemployment rate as contributing to the overheating of the economy.

The Federal Reserve increased its forecast for the 2022 unemployment rate to 3.7% in June from 3.5% in March. The Federal Reserve is forecasting the unemployment rate to be 3.9% in 2023 and 4.1% in 2024 as it tightens monetary policy to combat the surge in inflation. Some economic forecasters see the unemployment rising to 5% by the end of 2023.

The June labor force participation rate was 1.2 percentage points below its February 2020 level. Despite some improvement since the pandemic, the labor force had 3.1 million fewer workers in June 2022 than it would have had it continued to grow at trend. Average hourly earnings are up 5.1% from a year ago, but at a pace well below the rise in consumer prices.

## Inflation

By nearly any measure, the rise in consumer prices is broad-based and rising at levels not seen in decades. Consumer prices increased by 1.3% in June and by 9.1% over the past 12 months, above the 8.6% increase in May. Energy and food prices are a major factor, but the core inflation rate, which excluded food and energy prices, is also elevated, rising by 0.7% in June and 5.9% over the past 12 months. The producer price index, the GDP price deflator, the personal consumption expenditure (PCE) price index, and the employment cost index are also all elevated.

The sources are varied–surging demand for goods as the economy recovered from the pandemic, excess fiscal and monetary stimulus, and collateral effects of the Ukraine war. Supply-chain disruptions and labor shortages are derivative of these factors but have had important feedback effects. The potential unwinding of the roughly $2.5 trillion in pandemic-related savings may further support economic growth.

The Federal Reserve has shifted to a more aggressive monetary tightening policy stance with a 75-basis-point increase in the federal funds target rate at its June 14-15 meeting. Another 75 to 100 basis-point increase is expected at its July 26-27 meeting. The Federal Reserve will begin to reduce its balance sheet, which had been doubled in response to the pandemic. The Federal Reserve forecasts inflation to be brought back to just above its 2% target in 2024.

A significant question is whether the Federal Reserve will be able to engineer a soft landing, will overcorrect, or will more aggressively stem economic growth to quell inflation. A June Wall Street Journal poll estimated the likelihood of recession at 44%, as compared to 28% in April and 18% in January.

## Global growth

The global economy is expected to grow by 2.5% to 3.0% in 2022, following estimates of 5.5% to 6% growth in 2021. The global economy contracted by 4% in 2020. Recent forecasts for growth in the United States and the Eurozone have been reduced. Growth in China was 0.4% in the second quarter as compared to one year ago. Forecasts in other countries depend very much on each country's policy response to inflation, risks of COVID variants, and the exposure to the Ukraine war.

Risks to the global recovery include the impact of surging inflation in many countries, the Ukraine war, vaccine administration, COVID variants, trade tensions, potential geopolitical alignments and significant shifts in the policy agendas in the United States and elsewhere.



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