

QUEST Economic Update | September 2022

High inflation, increasing interest rates, and recession risks continue to dominate the US economic landscape

High inflation, interest rate hikes, and recession risks continue to dominate the US economic outlook. The US economy contracted during the first half of the year, is expected to recover during the third quarter, and then weaken in the fourth quarter. The consensus of forecasts for next year is continued growth, albeit growth that is weak. An increasing number of forecasts see negative growth for at least part of next year.

The more pessimistic economic outlook is largely due to inflation remaining higher for longer than anticipated and an inflation outlook that is less certain. The August inflation report was by most measures disappointing. While gasoline prices have come down, increases in shelter, food, and medical care prices all contributed to the broad-based increase in consumer prices. While the 8.3% August increase in prices from a year ago was below the 8.5% increase in July, it was higher than expected. On a monthly basis, the core CPI, which excludes the more volatile energy and food categories, increased by 0.6%, a larger increase than in July.

At the same time, despite some evidence of softening labor markets over the summer months, weekly unemployment insurance (UI) claims have fallen for five consecutive weeks and job openings in July rose after three consecutive months of decline. Additionally, the US economy continues to add jobs and the August 3.7% unemployment rate remains close to its five-decade low.

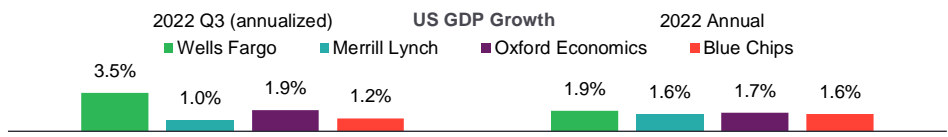
High inflation and tight labor markets have likely set the stage for a more aggressive regimen of interest rate hikes by the Federal Reserve, which may make it more difficult for the Federal Reserve to engineer a soft landing.



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 half of the year, is expected to expand during the third quarter, and then weaken during the fourth quarter and into 2023 as the Federal Reserve's interest rate hikes dampen economic growth. The risk of recession is increasing.

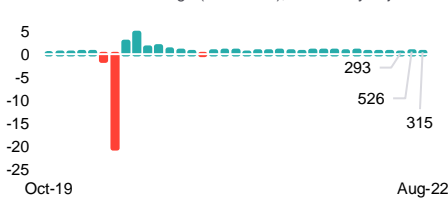


Labor markets

Despite some signs of softening, labor markets remain tight. Weekly UI claims have fallen for five consecutive weeks and July job openings increased after falling for three consecutive months. The US economy added 315,000 jobs in August and the 3.7% unemployment rate in August is close to its five-decade low.

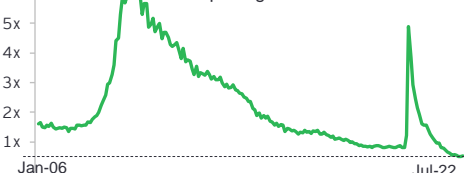
Nonfarm payroll employment

Month-over-month change (in millions), seasonally adjusted



Unemployed workers per job opening

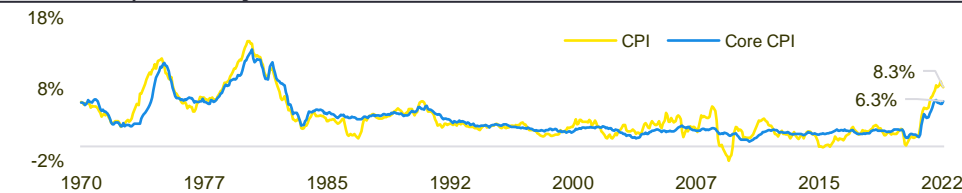
0.50 unemployed workers per job opening



Inflation

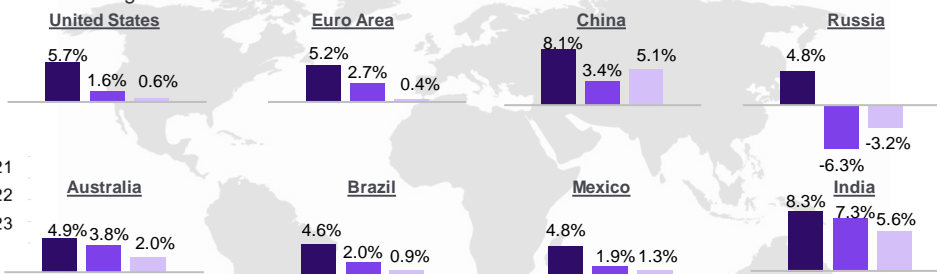
The August CPI report had consumer prices rising by 8.3% from a year ago, near a four-decade high. The core CPI, which excludes the more volatile food and energy categories, rose by 0.6% in August, higher than in July, and is raising concerns that inflation may not yet be abating. The continued surge in inflation is likely to cause 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, the Eurozone, and China have tempered. The global economy is expected to grow by roughly 2.0% to 3.0% in 2022, following estimated growth of 5.5% to 6% growth in 2021.



Source: Blue Chip Economic Indicators (Vol. 47, No. 9, September 12, 2022).

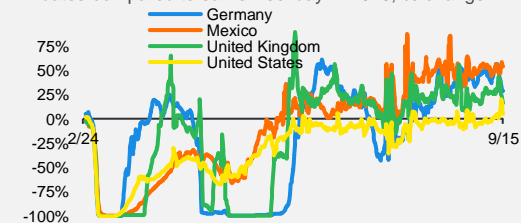
Real-time indicators

Due to rapidly changing economic conditions over the past two plus years, traditional economic data have not fully captured the dramatic turn from growth to recession to expansion. Analysts have relied more heavily on realtime 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 inflation, the Federal Reserve's interest rate increases, 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 suggest 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

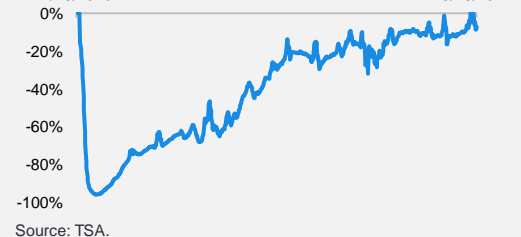
% Change from baseline (January 2020)



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

US TSA traveler throughput

All dates compared to same weekday in 2019; % change
2/29/2020 9/15/2022



Source: TSA.

Overall US economy

The US economy continues to face significant headwinds. Inflation remains high and the labor market remains tight. The Federal Reserve continues to tighten monetary policy to dampen economic growth and bring inflation down. Forecasters have been pulling back their forecasts for growth in the United States, especially for late this year and 2023 in anticipation of the impacts of the higher interest rates.

While the decline in real GDP during the first half of 2022 may be worrisome, the data appear inconclusive. Real GDP, which measures the real value of aggregate spending across the economy, declined by 1.6% during the first quarter and 0.6% during the second quarter. But gross domestic income (GDI), another measure of economic activity that aggregates income from production, rose by 1.8% during the first quarter and 1.4% during the second quarter. The increase in GDI is consistent with the increase in consumer spending and tight labor market during the first half of the year.

Labor market

The US labor market remains tight. In July, job openings increased after falling for three consecutive months and exceeded unemployment by 5.6 million. The US economy added 318,000 jobs in August, down from 526,000 in July. Overall, by August 2022, the US economy had recouped more than the 22.4 million jobs lost in March and April 2020, but employment was roughly 2.5 million below trend.

Other signs of a tight labor market include the low unemployment rate and weekly UI claims. The August unemployment rate was 3.7, near its five-decade low and below the 4.4% average for the economy 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. Weekly UI claims for the week ending September 10 fell to 213,000, the fifth consecutive week of decline and below the average 245,000 initial claims for the 2015 through 2019 period.

Inflation

By nearly any measure, the rise in consumer prices is broad-based and prices are rising at levels not seen in decades. Consumer prices increased by 0.1% in August and by 8.3% over the past 12 months. Gasoline prices have come down, but food, housing, health care, and many other categories continue to rise. The core inflation rate, which excludes the more volatile food and energy categories, is also elevated, rising by 0.6% in August and 6.3% over the past 12 months.

The producer price index, reflecting prices paid to producers, rose by 8.7% in August from 12 months ago, following its 9.8% increase in July. The decline in the rate of increase in producer prices may suggest the beginning of a turning point for inflation. Nevertheless, the GDP price deflator, the personal consumption expenditure (PCE) price index, and the employment cost index all remain elevated.

Global growth

The global economy is expected to grow by 2.0% 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.

Most forecasters see above 1% GDP growth (real annualized) in the third quarter. However, the Federal Reserve Bank of Atlanta's GDPNow Tracker sees third quarter GDP growth of 0.5% (as of September 15). The consensus is for low, but positive economic growth in the fourth quarter and through next year, but some forecasters see a contraction beginning in late 2022 or early 2023.

Consumer confidence increased in August to 103.2 from 95.2 in July. The ISM Manufacturing PMI stayed at 52.8 in August, the 27th consecutive month of expansion (values above 50 indicate expansion). The housing market continues to slow as seen in the steady decline in the NAHB/Wells Fargo Housing Market Index every month since December 2021.

The Federal Reserve is forecasting the unemployment rate to be 3.7% in 2022, 3.9% in 2023 and 4.1% in 2024. Some economic forecasters see the unemployment rate rising to 5.1% by the first quarter of 2024.

The underemployment rate rose to 7.0% in August from 6.7% in July. The underemployment rate averaged 8.7% from 2015 through 2019. The August labor force participation rate was 1.0 percentage point below its February 2020 level. Average hourly earnings are up 5.2% from a year ago, but at a pace well below the rise in consumer prices.

The sources of the surge in inflation 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 Federal Reserve has shifted to a more aggressive monetary tightening policy stance. Another 75 to 100 basis-point increase is expected at its September 20-21 meeting. The Federal Reserve is reducing its balance sheet, which had been doubled in response to the pandemic, by \$95 billion per month. Most forecasts do not expect inflation to be brought back to near the Federal Reserve's 2% target until 2024.

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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