

QUEST Economic Update | November 2022

Peaking inflation, slowing labor markets and higher interest rates continue for the US economy

Inflation may have peaked and labor markets may be beginning to loosen. At the same time the Federal Reserve is expected to further increase interest rates as it continues to work to bring inflation back to its 2% target. The risk of recession is increasing as the higher interest rates begin to take hold. An increasing number of forecasts see negative growth for at least part of next year with the potential for a recession.

The October CPI was 7.7%, continuing its gradual decline from the four-decade high of 9.1% reached in June. The October core CPI, which excludes the more volatile energy and food categories, increased by 6.3% over the past twelve months, down from the 6.6% increase in September. The Producer Price Index and personal consumption expenditure price index are also both off their highs from earlier this year.

The labor market shows some signs of cooling. The October unemployment rate rose to 3.7% from 3.5% in September and October job gains are below the levels in the prior several months. Although September job openings rose, they are below their highs earlier this year. The interest rate sensitive housing sector has slowed significantly with the rapid rise in interest rates. Many forecasts project the unemployment rate to rise to over 5% by the end of 2023 and remain above 5% for most of 2024.

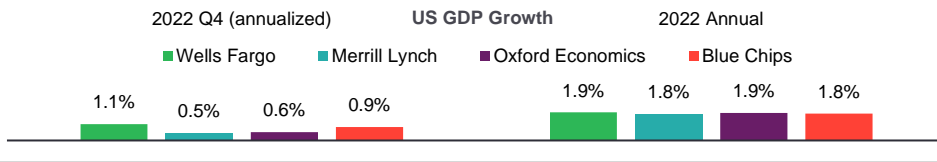
Market expectations are for the Federal Reserve to continue increasing the federal funds target rate through the Spring or Summer 2022 to near 5% and then possibly pause. At the same time, the Federal Reserve continues to reduce its balance sheet by roughly \$95 billion per month.



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 grew by a seasonally adjusted annual rate of 2.6% during the third quarter after contracting during the first half of the year. Forecasts expect the economic growth to slow as the effects of the higher interest rates spread throughout the economy and increase the risk of recession.

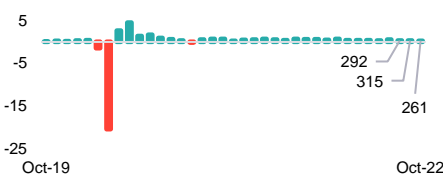


Labor markets

The labor market has softened but remains historically tight. The US economy added fewer jobs in October than in prior months and the unemployment rate increased to 3.7%. Job openings rose in September after falling in August. Weekly UI claims remain below pre-pandemic levels.

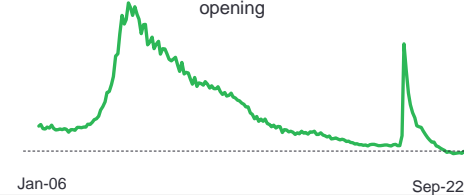
Nonfarm payroll employment

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



Unemployed workers per job opening

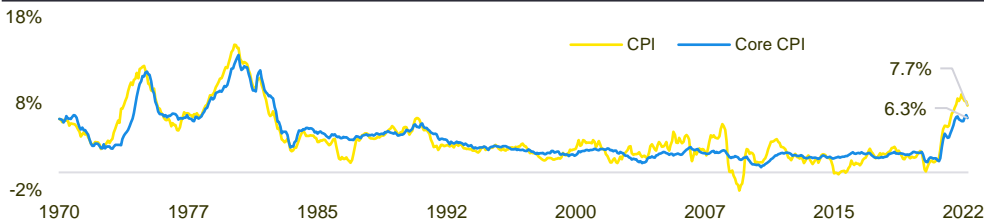
0.54 unemployed workers per job opening



Inflation

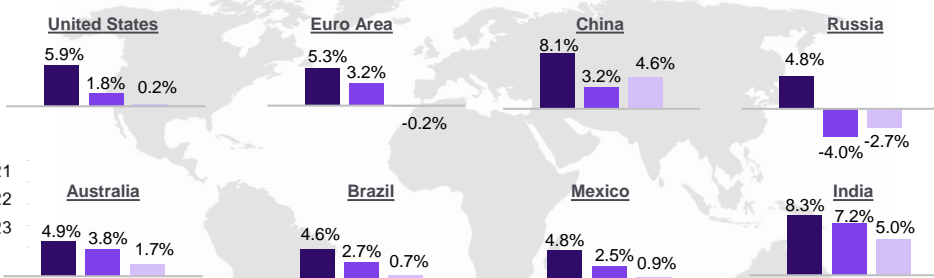
The October CPI rose by 7.7% from a year ago, continuing the decline from the four-decade high of 9.1% reached in June. The core CPI, which excludes the more volatile food and energy categories, rose by 6.3% in October as compared to 6.6% in September, indicating that inflation may be subsiding.

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 3.5% in 2022, following estimated growth of 5.9% to 6.1% growth in 2021.



Source: Blue Chip Economic Indicators (Vol. 47, No. 11, November 11, 2022).

Current as of 11/19/2022

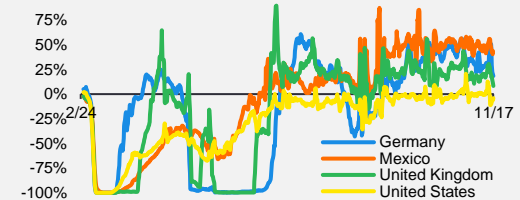
Real-time indicators

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 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 inflation, the Federal Reserve's interest rate increases, the Ukraine war, supply-chain disruptions and hiring difficulties. Energy prices rose markedly with the Ukraine war, 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 the economy has not slowed yet.

Global OpenTable reservations

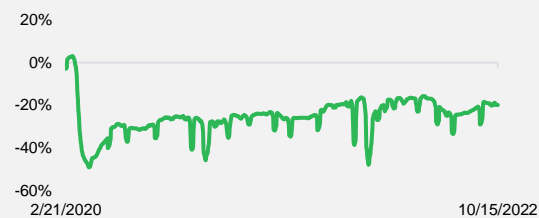
All dates compared to same weekday in 2019; % change



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

US workplace visits

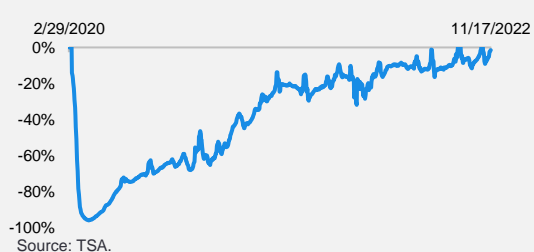
% Change from baseline (January 2020)



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.

Overall US economy

The US economy continues to face significant headwinds. Inflation remains high but may be slowing and the labor market remains tight but may be softening. The Federal Reserve's tight monetary policy continues to dampen economic growth and may be bringing inflation down. Forecasters have been pulling back their forecasts for growth in the United States and economic forecasts are starting to project recession in 2023.

Real US GDP grew by a seasonally adjusted annual rate of 2.6% in the third quarter of 2022. This makes the declines in real GDP during the first half of 2022 appear less worrisome than initially expected. 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.

Labor market

The US labor market remains tight. In September, job openings rose after a sharp decline in August, but remain below their high from earlier this year. The US economy added 261,000 jobs in October, down from 315,000 in September. 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 2.8 million below trend.

Other signs of a still tight but softening labor market include the low unemployment rate and weekly UI claims. The October unemployment rate was 3.7%, an increase from the five-decade low in September but 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 November 12 fell by 4,000 to 222,000 and are still well below the pre-

Inflation

The rise in consumer prices seems to have peaked and is starting to fall from levels not seen in decades. Consumer prices increased by 0.4% in October and by 7.7% over the past 12 months. While similar to the monthly increases in September, the core inflation rate, which excludes the more volatile food and energy categories, increased by 0.3% in October as compared to 0.6% in September and by 6.3% over the past 12 months as compared to the 6.6% in September.

Most of the other measures of inflation have peaked as well. The Producer Price Index, reflecting prices paid to producers, rose by 8.5% in September from 12 months ago, down from its peak of 11.7% in March. Moreover, the GDP price deflator, the personal consumption expenditure (PCE) price index, and the employment cost index all remain elevated but are lower than their peak readings from earlier this year. The sources of

Global growth

The global economy is expected to grow by 2.2% to 3.5% in 2022, following estimates of 6.0% to 6.2% 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. Reported growth in China was 3.9% in the third quarter and higher than the 0.4% growth it experienced in the second quarter. Forecasts in other countries depend on each country's policy response to inflation, risks of COVID variants,

Most forecasters expect above 1% annual GDP growth for 2022. The Federal Reserve Bank of Atlanta's GDPNow Tracker sees fourth quarter GDP growth surging to 4.0% (as of November 9). While consensus forecasts estimate slow but positive growth in the fourth quarter, this masks considerable variability. Most forecasts expect strong fourth quarter growth, but a significant number expect contraction. This reverses in 2023 as more forecasts project economic contraction.

Consumer confidence fell in October to 102.5 from 107.8 in September. The ISM Manufacturing PMI fell to 50.2 in October, but it marks the 29th 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 and housing starts continue to fall.

pandemic average of 245,000.

The Federal Reserve is forecasting the unemployment rate to be 3.8% in 2022, 4.4% in 2023 and 4.4% in 2024. Some economic forecasters see the unemployment rate rising to 5.6% by the second quarter of 2024 and remaining above 5% for all of 2024. The underemployment rate rose to 6.8% in October from 6.7% in September. The underemployment rate averaged 8.7% from 2015 through 2019. The October labor force participation rate was 1.2 percentage points below its February 2020 level. Average hourly earnings were up in October by 4.7% from a year ago, a pace well below the rise in consumer prices.

the surge in inflation have been 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 continued its more aggressive monetary tightening policy stance with another 75 basis-point increase at its November 1-2 meeting. Futures markets assign an 85% chance that the Federal Reserve will only hike rates by 50 basis points at its December 13-14 meeting. By March, the futures markets are pricing in a target rate of 5.00% to 5.25% suggesting only 125 basis points worth of hikes over the next three meetings.

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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