

# QUEST Economic Update | January 2023

The inflation rate is falling, but labor markets remain tight and recessions risks continue

The December Consumer Price Index (CPI) report had inflation falling for its sixth consecutive month suggesting that inflation likely peaked in June. Labor markets, however, continue to remain tight and resilient in the face of the fastest pace of interest rate hikes by the Federal Reserve since the early 1980s.

Overall, prices fell by 0.1 percent in December, although the core CPI, which excludes the more volatile food and energy categories, rose by 0.3. The December CPI was up 6.5% from a year ago, below its likely peak of 9.1% in June. While the decline in the inflation rate is expected to continue, most forecasters do not see it reaching the Federal Reserve's 2% target until sometime in 2024.

Labor markets, however, remain tight with the December unemployment rate falling back to 3.5%, its 50-year low reached earlier in 2022 and just before the pandemic. Weekly UI claims also remain near record lows. Signs of potential loosening can be seen in job openings that are well below their early 2022 highs and December job gains were below those of the prior several months.

Nevertheless, the Federal Reserve is likely getting close to the end of its interest rate hikes. Market expectations, based on the Chicago Mercantile Exchange's FedWatch Tool, are for 25 basis point increases in the federal funds target rate at each of the next two Federal Open Market Committee (FOMC) meetings.

The trajectory of the US economy over the next year remains uncertain. Recession risk appears to remain high and possibly increasing, with many forecasters expecting a mild recession sometime in 2023.



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

Current as of 1/13/2023

## OVERALL US ECONOMY

Economic growth is expected to slow in 2023 with mixed forecasts for the first quarter and for the year as the Federal Reserve's seven interest rate hikes in 2022 begin to take hold. The risk of a recession is increasing.

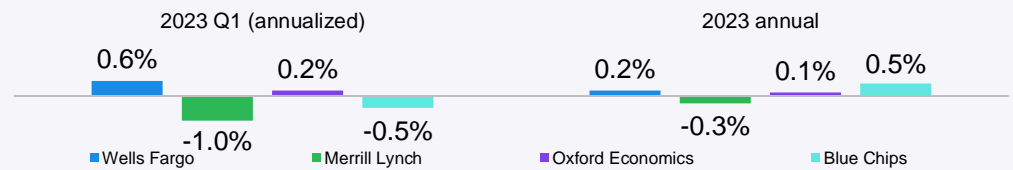
**-1.0% to 0.6% growth**

expected for 2023 Q1 (annualized)

**-0.3% to 0.5% growth**

expected for 2023

### US GDP growth forecast



## LABOR MARKETS

Labor markets remain tight with the December unemployment rate falling back to 3.5%. However, job gains have been slowing. Average hourly earnings, which rose by 4.6% in December, may portend some future stickiness in price, especially in services where wages are a significant component of costs.

**562k job gain**

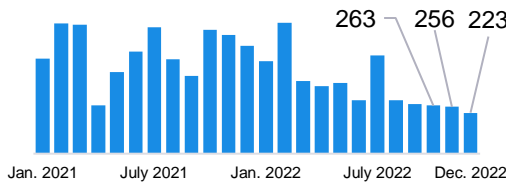
on average in 2021

**375k job gain**

on average in 2022

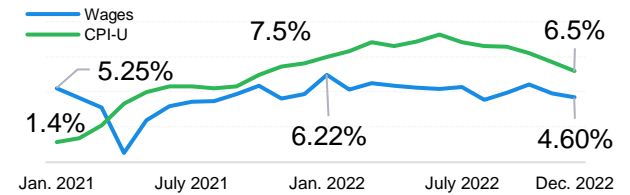
### Nonfarm payroll employment

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



### Hourly wages and CPI-U

Change from a year earlier, not seasonally adjusted

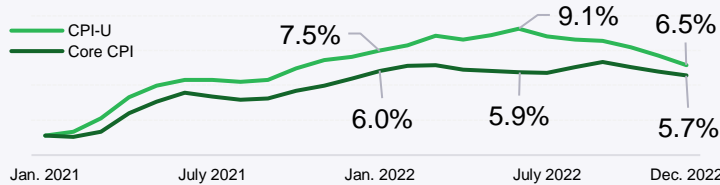


## INFLATION

Inflation appears to have peaked earlier this year. The December CPI rose by 6.5% from a year ago, continuing its decline from the four-decade high of 9.1% reached in June. The November Producer Price Index (PPI) rose by 7.4%, down from 11.7% in March. The inflation rate is not expected to reach the Federal Reserve's 2% target until 2024.

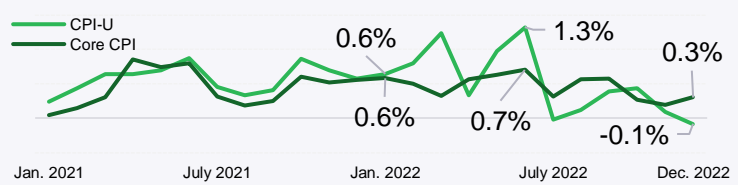
### CPI-U and core CPI

Change from a year earlier, not seasonally adjusted



### CPI-U and core CPI

Month-over-month change, seasonally adjusted



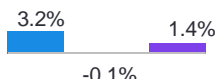
## GLOBAL GROWTH

Forecasts suggest slowing global economic growth in 2023, especially in the United States and the Eurozone. The lifting of COVID restrictions and path of the pandemic in China are weighing heavily on China's economic growth prospects in 2023.

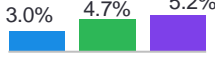
### United States



### Euro Area



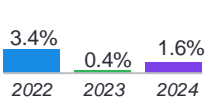
### China



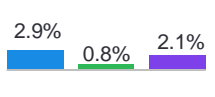
### Russia



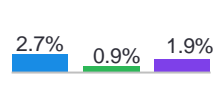
### Canada



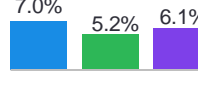
### Brazil



### Mexico



### India



### Upcoming economic data releases

- ▶ Producer Price Index for December, January 18
- ▶ Housing starts for November, January 19
- ▶ GDP 2022 Q4 (advance estimate), January 26
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, January 31-February 1
- ▶ Job openings for December, February 1
- ▶ Employment situation for January, February 3
- ▶ Consumer Price Index for January, February 14

## Overall US economy

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The US economy continues to face significant headwinds. Inflation remains elevated but has fallen for the past six consecutive months and likely peaked in the second quarter of 2022. The overall CPI fell slightly for the month December, although 6.5% higher than a year ago. The Federal Reserve is likely getting close to the end of its monetary tightening cycle and interest rate hikes with current market expectations for two additional 25 basis point increases in the target rate at the next two FOMC meetings.

Labor markets remain tight, which likely increases the uncertainty of the future path of inflation and Federal Reserve policy. The December unemployment rate fell to 3.5%, back to its 50-year low reached earlier in 2022 and just before the pandemic. Weekly UI claims are also near record lows. There are some signs of loosening. Although job openings increased in November, they are well below their levels from early 2022.

## Labor market

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US labor markets remain tight. The December unemployment rate fell to 3.5%, back to the 50-year low reached earlier in 2022 and just prior to the pandemic. Weekly UI claims remain near record lows. The unemployment rate is also well below the 4.4% average for the US 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.

There are some signs of loosening. Job openings, although increasing in November, are significantly lower than the highs reached earlier in 2022. The US economy added 223,000 jobs in December, below the job gains from prior months. November employment was 1 million above the pre-pandemic level.

## Inflation

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The rise in consumer prices appears to have peaked and the inflation rate, as measured by the CPI, has fallen for six consecutive months. Consumer prices fell by 0.1% in December and by 6.5% over the past 12 months. The core inflation rate, however, increased by 0.3% in December and by 5.7% over the past 12 months. Most of the other measures of inflation have peaked as well. The PPI, reflecting prices paid to producers, rose by 7.4% in November from 12 months ago, down from its peak of 11.7% in March.

The decline in gasoline prices was the largest contributor to the decrease in the December CPI. Shelter and food prices, however, increased. Prices for services (less food and energy) rose 0.5% while prices for commodities (less food and energy) fell 0.3% in December. The 4.6% December increase in average hourly earnings has drawn some attention

## Global growth

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The global economy is expected to slow in 2023 with growth in the 1.0% to 2.5% range. Economic growth is expected to slow, perhaps significantly, in the United States, the United Kingdom, and the Eurozone. Recession risk is higher in the United Kingdom and Eurozone due primarily to the instability in the energy markets caused by the invasion of Ukraine. That said, the mild winter, at least thus far, appears to have taken some pressure off European energy supplies.

Also, monthly job gains have generally been lower each month for the past several months suggesting that the higher interest rates may be taking hold.

A number of indicators suggest that the economy may be slowing. The December ISM manufacturing index fell to 48.4 from 49.0 in November (values below 50 indicate contraction). There has been a steady decline in housing starts since February 2022. A sign of resilience for the US economy, however, is seen in the increase in the Conference Board's Consumer Confidence Index to 108.3 in December from 101.4 in November.

The Federal Reserve is forecasting the unemployment rate to rise to 4.6% in 2023, remain at this level for 2024, and fall to 4.5% in 2025. Some economic forecasters see the unemployment rate rising to above 5.5% by the second quarter of 2024 and remaining above 5% for all of 2024. The December underemployment rate was 6.5%, below the average rate of 8.7% from 2015 through 2019. The December labor force participation rate was 1.0 percentage point below its February 2020 level. Average hourly earnings were up in December by 4.6% from a year ago, a pace well below the rise in consumer prices.

as a potential sign that inflation may have some stickiness going forward because wages are a very significant component of service productions costs.

It is anticipated that the Federal Reserve is getting close to the end of its cycle of interest rate hikes. Two additional 25 basis point increases are expected at the next two FOMC meetings on January 31-February 1 and March 22-23. Additional interest rate hikes are likely to depend on how much and how quickly inflation subsides.

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1909-3266768  
ED None

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